kotak® Institutional Equities

INDIA DAILY

May 26, 2008

Contents

Results

BHEL: Final results worse-off versus estimates from provisional; several challenges on execution, margins, competitive positioning; reiterate REDUCE

ITC: Cigarettes do well, scale up investments on other FMCG products

Federal Bank: PAT below estimate on higher expenses, await clarification

Updates

Jaiprakash Associates: Acquires Bina Power —1,000 MW thermal power project

Bajaj Auto: Demerged auto company to list on Monday; we estimate fair value at Rs750/share

Economy: Inflation stays flat but elevated

Banks/Financial Institutions: 4QFY2008 results weak, increase in macro risk, leading us to downgrade target price for banks

News Roundup

Corporate

- Within a day of Bharti Airtel pulling out of negotiations to acquire an estimated $50 billion MTN, Anil Ambani group company Reliance Communications is understood to have started discussions for a possible tie up with the South African telecom entity. (BS)
- AV Birla group is in talks with Accor of France to bring its budget hotel brand Formule-1 to India, to be opened besides its More retail chain. (ET)
- Reliance Communications is close to acquiring the ailing London based global virtual network operator VANCO. Reliance has competition from around eleven other leading telcos and PE firms which includes British Telecom and Cable & Wireless. (BS)

Economic and political

- Despite a significant slowdown in capital inflows and the rupee weakening 8% since January, the government is unlikely to relax restrictions on domestic companies borrowing overseas in the near term, according to senior central bankers. (BS)
- India may lift the ban on rice exports to select African nations. A proposal with an empowered panel of ministers seeks to allow private players to sell 13 lakh tons to Senegal, Ghana and Liberia. (ET)

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

EQUITY MARKETS

		Change, %		
India	**23-May**	**1-day**	**1-mo**	**3-mo**
Sensex	16,650	(1.5)	(2.8)	(6.5)
Nifty	4,947	(1.6)	(3.2)	(6.1)
Global/Regional indices				
Dow Jones	12,480	(1.2)	(3.2)	(1.6)
Nasdaq Composite	2,445	(0.8)	0.9	4.3
FTSE	6,087	(1.5)	(0.1)	(0.0)
Nikkie	13,700	(2.2)	(1.2)	(0.9)
Hang Seng	24,148	(2.3)	(5.4)	1.8
KOSPI	1,797	(1.7)	(1.5)	5.2

Value traded - India

			Moving avg, Rs bn	
	23-May		**1-mo**	**3-mo**
Cash (NSE+BSE)	178.8		205.5	193.9
Derivatives (NSE)	450.8		516.4	364
Deri. open interest	822.6		726	777

Forex/money market

		Change, basis points		
	23-May	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.8	0	254	285
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	(2)	(11)	49

Net investment (US$mn)

	22-May		**MTD**	**CYTD**
FIIs	(137)		6	(2,709)
MFs	(22)		(197)	1,394

Top movers -3mo basis

		Change, %		
Best performers	**23-May**	**1-day**	**1-mo**	**3-mo**
i-Flex	1,440	(4.4)	8.2	29.8
Shipping Corp	292	0.4	27.9	32.6
Thomas Cook	103	-	2.6	35.3
Nestle India	1,772	1.4	10.9	30.4
NALCO	534	0.3	19.5	15.0
Worst performers				
Reliance Cap	1,322	(5.0)	(9.7)	(32.5)
Thermax	455	(0.4)	(10.3)	(33.7)
SAIL	173	(1.8)	(2.6)	(30.0)
Essel Propack	34	(1.9)	(15.5)	(26.2)
Raymond	243	(2.6)	(11.6)	(29.1)

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Industrials

BHEL.BO, Rs1745	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	2,100
52W High -Low (Rs)	2930 - 1301
Market Cap (Rs bn)	854.3

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	193.7	247.4	318.2
Net Profit (Rs bn)	28.6	34.8	43.6
EPS (Rs)	58.4	71.2	89.1
EPS gth	*23.0*	*21.8*	*25.2*
P/E (x)	30	24.5	19.6
EV/EBITDA (x)	16.0	13.1	10.3
Div yield (%)	0.7	0.9	1.1

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	67.7	-	-
FIIs	19.5	2.3	(0.2)
MFs	4.9	3.4	0.9
UTI	-	-	(2.5)
LIC	1.8	1.1	(1.4)

BHEL: Final results worse-off versus estimates from provisional; several challenges on execution, margins, competitive positioning; reiterate REDUCE

Lokesh Garg : lokesh.garg@kotak.com, +91-22-6634-1496

Sandip Bansal : sandip.bansal@kotak.com, +91-22-6749-3327

- **Final results highlights: revenues and margins lower than our estimates from provisional results**
- **Provisioning for higher employee costs affect margins by 200 bps, similar provisioning would be required in FY2009E as well**
- **Increase in commodity prices to impact margins; likely to be offset by operating leverage gains**
- **Revise estimates and reduce target price to Rs1,875 (Rs2,100 earlier), reiterate REDUCE rating**

BHEL reported FY2008 revenues of Rs194 bn (up 12% yoy), EBITDA of Rs34 bn (up 2% yoy and PAT of Rs29 bn (up 18% yoy) versus our expectation of Rs198bn, Rs37 bn and Rs28 bn, respectively, estimated from the provisional results. Increase in employee cost ratio by 200 bps—provisioning for the impact of Sixth Pay Commission recommendations—contributed to the decline in margin. Key highlights from management conference call are (1) 40-45% of BHEL's order book comprises of fixed price contracts and hence it is likely to be impacted by commodity price pressures (2) BHEL-NTPC JV would initially focus on execution and production of power equipment particularly the BTG component is likely to start in about four years with initial capacity of about 5,000 MW, (3) order backlog as on date is Rs914 bn, implying that strong order inflows for BHEL continue (4) BHEL's capacity expansion plans are on track and currently 11 GW of capacity is already on stream and (5) company expects strong growth in the industrial segment led by expansion of businesses in areas like (a) defence, (b) railways, (c) oil rigs and (d) exports. We revise our FY2009E EPS estimate to Rs71.2 from Rs71.3 earlier and and for FY2010E to Rs89.1 Rs92.8 earlier primarily driven by lower margins versus earlier expectation. We lower our FY2009E DCF-based target price to Rs1,875 (Rs2,100 earlier) and reiterate our REDUCE rating while highlighting a 10% underperformance of the stock since our downgrade to REDUCE on April 15, 2008. Key risks include (1) commodity price pressures, (2) possible deterioration in competitive position, (3) competing domestic manufacturing, (4) potential slips ups in the XIth and XIIth Plan execution and (5) larger role of private sector in power generation capacity addition. Key catalysts include (1) negotiated orders for 800MW supercritical units from, (2) award of Krishnapatnam project, (3) visibility on execution of projects in JVs like that with TNEB and (4) strong execution resulting in robust near-term earnings growth.

Final results highlights: revenues and margins lower than estimates from provisional results led by higher-than-expected other income (interest on tax refunds)

BHEL reported FY2008 revenues of Rs194 bn (up 12% yoy), EBITDA of Rs34 bn (up 2% yoy and PAT of Rs29 bn (up 18% yoy) versus our expectation of Rs198bn, Rs37 bn and Rs28 bn respectively estimated from the provisional results (Exhibit 1). BHEL has thus reported 12.3% growth in revenues and 2.3% growth in EBITDA for FY2008 versus FY2007. EBITDA margin of 17.4% in FY2008 is lower than our estimate of 18.7% from the provisional results (Exhibit 2). This is mostly contributed by accounting of one-time interest income of Rs2.5 bn on income tax refunds reported in 2QFY08. Other components of other income were (a) enhanced income of Rs6.21 bn from higher cash balances and (2) sale of scrap of Rs1.4 bn.

Provisioning for higher employee affect margins by 200 bps, similar provisioning would be required in FY2009E as well

Increase in employee cost ratio by 200 bps—provisioning for the impact of Sixth Pay Commission recommendations—contributed to the margin decline. Actual salary cost for FY2008 was Rs26 bn, while provisions were made to the tune of Rs6.2 bn comprising of (1) Rs820 mn per quarter for three quarters during 9MFY08, estimating an increase of 25% in wage costs, (2) Rs2.92 bn in 4QFY08, with new estimates of 45% increase in salaries (thus 45% of wage cost in 4QFY08 and shortfall of 20% in provisions during 9MFY08), (3) Rs2 bn for increase in leave encashment provisions due to the estimated wage hike and (4) a deduction of Rs1.16 bn already made as ad-hoc payments (total ad-hoc payment of Rs1.98 bn out of which we presume Rs0.82 bn pertained to 4QFY07). We expect provisioning of Rs7 bn in FY2009E led by (a) Provisioning at a rate of Rs1.35 bn for four quarters (calculated as total provisioning of Rs2.46 bn in 9MFY08 + provisioning of Rs2.9 bn in 4QFY08 to be spread equally over four quarters of FY2009E) and (b) provisioning for leave encashment of Rs0.4 bn per quarter (calculated based on provisioning of Rs2 bn done in 4QFY08, probably for five quarters starting from 4QFY07).

Increase in commodity prices to impact margins; likely to be offset by operating leverage gains

40-45% of BHEL's order book is comprised of fixed price contracts, margins on which we believe is likely to be impacted by input price pressures (especially given that BHEL is a heavy user of steel which has witnessed a very sharp increase in prices in recent times). Management has, however, highlighted in the earnings call that critical raw material inputs are purchased as soon as BHEL is awarded the project or declared as the lowest bidder. Hence, BHEL is protected to some extent from the impact of commodity price increases. Management expects margins to be maintained as high operating leverage, comprising of lower employee and other expense cost ratios, are likely to counterbalance the increased raw material cost ratio (as BHEL is likely to show strong revenue growth on the back of its large order backlog).

No difficulties expected in implementation of supercritical projects; margins to improve with higher indigenization

Management does not expect difficulties in meeting its supercritical commitments. Management believes BHEL has the capabilities to cater to supercritical requirements as differences from the sub-critical segment are more on the materials front than on technology (which in the sub-critical segment BHEL already has established expertise). However, it highlighted that some clients insist on particular components being imported and this may likely act as a constraint due to capacity limitations at the end of foreign suppliers led by global uptake in demand. Such imports comprise about 30-35% of the order value. With gradual increase in indigenization, such teething problem would be resolved, leading to increased margins. Margins in the supercritical segment are expected to be similar to those in the sub-critical segment with complete indigenization.

Order-backlog provides visibility of 3.5 years; order inflows continue to remain strong

BHEL has reported order inflows of Rs503 bn for FY2008 comprising 80% from the power segment, 14% from the industrial segment and 6% from international orders. Order backlog at the end of FY2008 is Rs854 bn (Rs726 bn and Rs780 bn at the end of 2QFY08 and 3QFY08 respectively), providing 3.5 years of revenue visibility based on estimated following four quarters revenues (Exhibit 3). The order book comprises Rs710 bn from the power segment, Rs88 bn from the industrial segment and Rs57 bn from international orders. Order backlog as on date is Rs914 bn, implying that strong order inflows for BHEL continue. We expect growth in BHEL's order book to continue as (1) most orders for the XIth Plan are likely to be placed by 1HFY09 (though orders for some gas-based power plants may be placed in 2HFY09) and (2) ordering activity for the XIIth Plan, to the tune of 85-90 GW, is likely to start thereafter.

BHEL expects 85-90 GW of capacity addition in XIIth Plan implying low growth over XIth Plan (78 GW) and challenges from shift in composition to more private sector

BHEL expects that 85-90 GW of capacity addition in XIIth Plan versus estimated capacity addition of 78 GW in the XIth Plan. We highlight two challenges from such an assertion:

1 Low growth over XIth Plan base—capacity addition of 90 GW in XIIth Plan implies a low growth of 15% only over the base of XIth Plan.

2 Shift in composition of ordering activity—Further, if larger proportion of capacity addition happens through (a) ultra-mega power projects, (b) tariff-based competitive bidding for state level projects, (c) gas-based projects in the private sector with increasing gas availability, then BHEL's overall market share of the overall capacity addition may also be under pressure. This would be particularly relevant in light of competing domestic manufacturing capability that is also coming up to cater to XIIth Plan requirements.

3 Only mitigation to this is perhaps that the demand is grossly underestimated at this point of time and actual capacity addition required in the XIIth Plan is of the order of 125-130 GW or so.

Expansion in several areas, particularly in the industrial segment is envisaged to boost growth over next few years

Industrial segment growth is likely to be strong as BHEL expands its businesses in areas like (1) defence, (2) railways, (3) oil rigs and (4) exports. BHEL also proposes to foray into the renewable energy business by venturing in to solar photovoltaic and wind energy segments through appropriate tie-ups. This will enable BHEL to be present across the power spectrum and leverage its existing expertise in these emerging high-growth segments. BHEL is also scouting for foreign technology collaboration for local manufacturing of LP and generator forgings. These are currently imported and BHEL expects to operationalize the JV in the next 18-24 months. Management has also not ruled out possibilities of growth through the inorganic route.

BHEL-NTPC JV would initially focus on EPC execution, over the long term, however, it may challenge BHEL's virtual control over equipment supply for public sector

BHEL also expects negotiated orders from NTPC and orders from NTPC for next couple of years are likely to continue to be on BHEL. BHEL-NTPC JV is expected to be formed only by FY2009-end and in the beginning it is likely to only undertake EPC projects. Production of power equipment particularly the BTG component is likely to start in about four years with initial capacity of about 5,000 MW.

Capacity expansion plans on track; 11 GW of capacity already on-stream

BHEL's capacity expansion plans are on track and currently 11 GW of capacity is already on stream with three shifts in operation. Further capacity will come online from April 2009, though the entire additional capacity of 4GW is likely to be complete only by CY2009-end. Capex of Rs50-60 bn will likely be incurred on the entire capacity expansion program from 7 GW to 15 GW. Acquisition of BHPV is also likely to contribute incremental capacity of about 5% in FY2009E. BHPV is likely to be a source for boilers and pressure parts. Higher output will also be facilitated by potentially increased outsourcing that BHEL may undertake.

Revise estimates based on lower margin expectations versus earlier

We revise our FY2009E EPS estimate to Rs71.2 from Rs71.3 earlier and FY2010E estimate to Rs89.1 from Rs92.8 earlier. Estimate changes are based on (1) lower margins of 17.9% (versus 19% earlier) for FY2009E and 18.1% for FY2010E (versus 18.4% earlier) led by higher raw material and employee expense ratios and (3) higher other income in FY2009E (primarily based on higher cash balances) and (c higher execution estimate of Rs318 bn for FY2010E versus Rs305 bn earlier based on continued strength of order booking (Exhibits 4-6).

Reduce target price to Rs1,875 (Rs2,100 earlier), reiterate REDUCE rating

We reiterate our REDUCE rating with a revised FY2009E DCF-based target price to Rs1,875 (from Rs2,100 earlier) (Exhibit 7). We highlight that BHEL has underperformed the Sensex by about 10% since we downgraded our rating to REDUCE from ADD on April 15, 2008. Key risks include (1) commodity price pressures leading to lower margins, (2) possible deterioration in competitive position with foreign vendors winning significant orders in India particularly from the private sector, (3) competing domestic manufacturer grabbing market share, (4) potential slips ups in the XIth and XIIth Plan execution that would reduce market opportunity and (5) larger role that private sector is likely to have in power generation capacity addition in future as compared to the past.

Key catalysts for the stock include (1) negotiated orders for 800MW supercritical units from NTPC (including units for XIIth Plan requirements such as Lara and Darlipali), (2) award of 800X2 MW supercritical units from Krishnapatnam project, (3) visibility on execution of projects in JVs like that with TNEB for supercritical projects (including projects like Koradi, Maharashtra and OBRA, UP) and (4) strong execution resulting in robust near-term earnings growth.

Exhibit 1. BHEL - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			yoy		
	4QFY08	4QFY07	*% change*	4QFY08	3QFY08	*% change*	FY2008	FY2007	*% change*
Net revenues	**72,020**	**69,197**	***4.1***	**72,020**	**49,641**	***45.1***	**193,655**	**172,375**	***12.3***
(Inc)/Dec in WIP	3,931	(2,385)	*(264.8)*	3,931	687	*472.1*	8,273	1,812	*356.6*
Raw material consumption	(41,943)	(35,911)	*16.8*	(41,943)	(28,510)	*47.1*	(114,895)	(98,740)	*16.4*
Staff cost	(11,661)	(9,037)	*29.0*	(11,661)	(7,464)	*56.2*	(31,459)	(24,511)	*28.3*
Other items	(8,714)	(5,992)	*45.4*	(8,714)	(4,380)	*99.0*	(21,905)	(18,028)	*21.5*
Total Expenditure	(58,387)	(53,325)	*9.5*	(58,387)	(39,666)	*47.2*	(159,987)	(139,466)	*14.7*
EBIDTA	**13,634**	**15,872**	***(14.1)***	**13,634**	**9,976**	***36.7***	**33,668**	**32,909**	***2.3***
Other income	4,242	2,860	*48.3*	4,242	2,649	*60.1*	13,962	7,615	*83.4*
EBIDT	17,875	18,732	*(4.6)*	17,875	12,624	*41.6*	47,630	40,524	*17.5*
Interest	(42)	(47)	*(9.6)*	(42)	(98)	*(56.7)*	(354)	(433)	*(18.3)*
Depreciation	(827)	(762)	*8.5*	(827)	(762)	*8.6*	(2,972)	(2,730)	*8.9*
PBT	**17,006**	**17,923**	***(5.1)***	**17,006**	**11,765**	***44.5***	**44,304**	**37,361**	***18.6***
Tax	(5,897)	(6,419)	*(8.1)*	(5,897)	(4,046)	*45.7*	(15,711)	(13,214)	*18.9*
PAT	**11,109**	**11,504**	***(3.4)***	**11,109**	**7,719**	***43.9***	**28,593**	**24,147**	***18.4***
EPS	22.7	23.5	*(3.4)*	22.7	15.8	*43.9*	58.4	49.3	*18.4*
Key ratios (%)									
Raw Material to Sales	52.8	55.3		52.8	56.0		55.1	56.2	
Staff Cost to sales	16.2	13.1		16.2	15.0		16.2	14.2	
Other exp to sales	12.1	8.7		12.1	8.8		11.3	10.5	
OPM	18.9	22.9		18.9	20.1		17.4	19.1	
EBIDTA margin	24.8	27.1		24.8	25.4		24.6	23.5	
Effective tax rate	34.7	35.8		34.7	34.4		35.5	35.4	
Order Backlog	859	550		859	780		859	550	
Order Inflow	151	152	*(0.8)*	151	104	*45.7*	503	347	*44.7*
Segmental revenues									
Power	56,740	54,220		56,740	42,046		159,188	138,576	
Industry	24,133	22,917		24,133	14,354		60,106	53,763	
Revenue mix (%)									
Power	70.2	70.3		70.2	74.5		72.6	72.0	
Industry	29.8	29.7		29.8	25.5		27.4	28.0	
EBIT margin (%)									
Power	31.3	32.2		31.3	20.5		24.7	25.8	
Industry	26.1	24.3		26.1	17.2		18.1	16.3	

Source: Company data, Kotak Institutional Equities estimates.

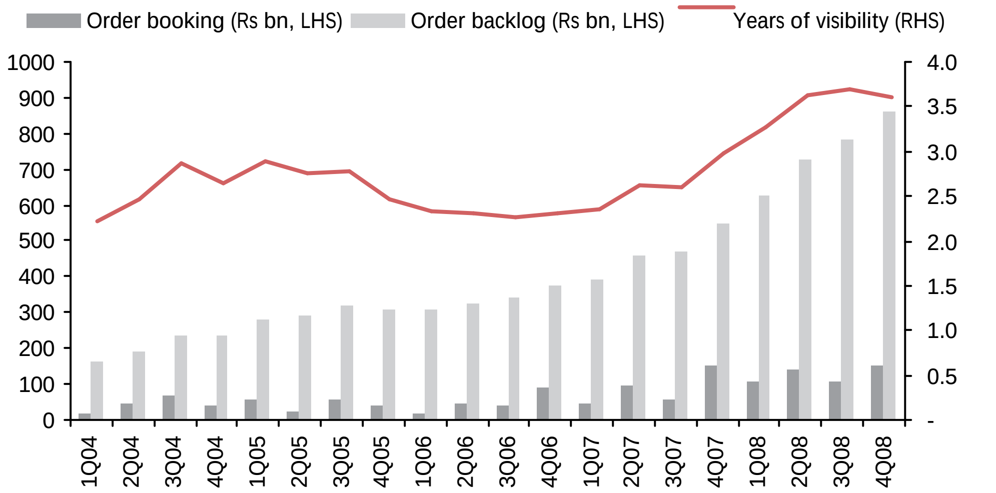
Exhibit 2. BHEL - 4QFY08 - Comparison of actual numbers versus provisional numbers including our assumptions

	yoy			yoy		
	4QFY08-Actual	4QFY08-Provisional	*% change*	FY2008-Actual	FY2008-Provisional	% change
Net revenues	**72,020**	**76,619**	**(6)**	**193,655**	**198,253**	**(2)**
EBIDTA	**13,634**	**16,961**	**(20)**	**33,668**	**36,995**	**(9)**
Other income	4,242	3,102	37	13,962	10,148	38
EBIDT	17,875	20,063	(11)	47,630	47,143	1
Interest	(42)	(98)	(57)	(354)	(235)	51
Depreciation	(827)	(813)	2	(2,972)	(2,958)	0
PBT	**17,006**	**19,153**	**(11)**	**44,304**	**43,950**	**1**
Tax	(5,897)	(7,211)	(18)	(15,711)	(15,800)	(1)
PAT	**11,109**	**11,942**	**(7)**	**28,593**	**28,150**	**2**
Key ratios (%)						
EBITDA margin	18.9	22.1		17.4	18.7	
Effective tax rate	34.7	37.6		35.5	35.9	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 3. Order backlog provides visibility of 3.3 years based on forward four quarter revenues

Order booking, Order backlog & visibility trend for BHEL



Source: Company data, Kotak Institutional Equities.

Exhibit 4: Profit Model of BHEL, March year-ends, 2005-2010E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E
Net revenues	**95,644**	**132,275**	**172,375**	**193,655**	**247,373**	**318,230**
Total RM & erection exps	(51,256)	(75,267)	(96,512)	(108,075)	(142,763)	(189,225)
Employee expenses	(16,504)	(18,785)	(24,510)	(25,250)	(29,038)	(41,443)
Other expenses	(12,712)	(15,037)	(19,955)	(20,546)	(24,347)	(29,822)
Total expenditure	(80,472)	(109,089)	(140,977)	(159,987)	(203,148)	(260,490)
EBDITA	**15,171**	**23,186**	**31,399**	**33,668**	**44,225**	**57,740**
Other income	3,848	5,469	8,236	13,962	13,436	14,419
EBIDT	19,019	28,655	39,634	47,630	57,662	72,159
Interest	(814)	(587)	(433)	(354)	(107)	(107)
PBDT	18,205	28,068	39,201	47,276	57,554	72,052
Depreciation	(2,189)	(2,459)	(2,730)	(2,958)	(3,546)	(4,430)
PRETAX PROFITS	**15,837**	**25,609**	**36,471**	**44,304**	**54,008**	**67,622**
Tax (incl deferred tax provision)	(6,282)	(8,852)	(13,214)	(15,710)	(19,173)	(24,006)
PAT (R)	**9,534**	**16,792**	**23,258**	**28,594**	**34,835**	**43,616**
Dividend (Incl tax)	2,224	4,047	6,925	7,148	8,709	10,904
Retained earnings	7,310	12,745	16,333	21,445	26,126	32,712
Per share (Rs)						
EPS	**19.5**	**34.2**	**47.5**	**58.4**	**71.2**	**89.1**
DPS	8.0	14.5	24.5	12.5	15.2	19.0
% of sales						
Raw material & erection expenses	53.6	56.9	56.0	55.8	57.7	59.5
Employee expenses	17.3	14.2	14.2	16.2	14.6	13.0
Other expenses	13.3	11.4	11.6	10.6	9.8	9.4
EBIDTA	15.9	17.5	18.2	17.4	17.9	18.1
EBIDT	19.9	21.7	23.0	24.6	23.3	22.7
PBT	16.6	19.4	21.2	22.9	21.8	21.2
Growth (%)						
Net revenues	19.6	38.3	30.3	12.3	27.7	28.6
EPS	40.8	75.4	38.8	22.9	21.8	25.2

Source: Company data, Kotak Institutional Equities Estimates

Exhibit 5: Balance sheet model of BHEL, March year-ends, 2005-2010E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E
Share capital	2,448	2,448	2,448	4,895	4,895	4,895
Reserves & surplus	57,821	70,566	85,435	104,433	130,559	163,271
Total shareholders funds	**60,269**	**73,014**	**87,883**	**109,328**	**135,454**	**168,166**
Total debt	5,370	5,582	893	893	893	893
Total liabilities	**65,639**	**78,596**	**88,776**	**110,221**	**136,348**	**169,060**
Gross block	36,289	38,221	41,351	45,651	58,651	71,651
Less: accum. depreciation	25,847	28,398	31,463	34,421	37,967	42,398
Net block	**10,442**	**9,823**	**9,887**	**11,229**	**20,683**	**29,253**
Capital work in progress	953	1,846	3,025	3,025	3,025	3,025
Investments	90	83	83	83	83	83
Current assets	133,430	163,308	210,630	250,189	300,905	364,184
of which, cash	31,779	41,340	58,089	93,663	101,641	113,077
Less: Current liabilities	84,459	103,200	144,201	163,657	197,701	236,837
Net current assets	**48,971**	**60,108**	**66,429**	**86,532**	**103,205**	**127,347**
Total assets	**65,639**	**78,596**	**88,776**	**110,221**	**136,348**	**169,060**
Ratios						
BVPS	246.2	298.3	359.1	223.3	276.7	343.5
RoE	16.9	25.1	28.9	29.0	28.5	28.7
RoCE	16.2	23.8	28.1	29.0	28.3	28.6

Source: Company data, Kotak Institutional Equities Estimates

Exhibit 6: Cashflow model of BHEL, March year-ends, 2005-2010E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E
Operating						
Net profit before tax and extraordinary items	15,837	25,609	36,471	44,304	54,008	67,622
Add: Depreciation / amortisation / non-cash prov	2,369	2,459	2,730	2,958	3,546	4,430
Tax paid (incl dividend tax)	(6,480)	(10,406)	(15,828)	(15,710)	(19,173)	(24,006)
Operating profit before working capital changes	11,725	17,661	23,373	31,552	38,381	48,046
Change in working capital / other adj	(2,910)	(1,576)	10,428	15,470	(8,694)	(12,707)
Net cashflow from operating activites	**8,815**	**16,086**	**33,801**	**47,022**	**29,687**	**35,340**
Investing						
Fixed assets	(1,561)	(2,824)	(4,310)	(4,300)	(13,000)	(13,000)
Investments	200	7	-	-	-	-
Cash (used) / realised in investing activities	**(1,361)**	**(2,817)**	**(4,310)**	**(4,300)**	**(13,000)**	**(13,000)**
FREE CASH FLOW	7,454	13,269	29,492	42,722	16,687	22,340
Financing						
Issue of share capital	-	-	-	-	-	-
Borrowings	(30)	213	(4,689)	-	-	-
Dividend paid	(2,224)	(4,047)	(6,925)	(7,148)	(8,709)	(10,904)
Cash (used) / realised in financing activities	**(2,255)**	**(3,834)**	**(11,614)**	**(7,148)**	**(8,709)**	**(10,904)**
Cash generated /utilised	5,179	9,470	17,878	35,574	7,979	11,436
Net cash at beginning of year	26,596	31,779	41,340	58,089	93,663	101,641
Net cash at end of year	**31,779**	**41,340**	**58,089**	**93,663**	**101,641**	**113,077**

Source: Company data, Kotak Institutional Equities Estimates

Exhibit 7: Our DCF based valuation results in a target price of Rs1,900/share

DCF valuation for BHEL, March fiscal year ends, 2009E-2018E (Rs mn)

	Existing orders ensure visibility				XII plan execution of 60,000 MW; 16% CAGR growth in industry sector revenues					Terminal year	
Year to March	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**
Revenue	**247,373**	**318,230**	**365,145**	**417,012**	**410,019**	**489,341**	**591,453**	**712,600**	**787,300**	**866,031**	**952,634**
Growth (%)	*27.7*	*28.6*	*14.7*	*14.2*	*(1.7)*	*19.3*	*20.9*	*20.5*	*10.5*	*10.0*	*10.0*
EBIT margin	*19.7*	*16.8*	*20.0*	*20.0*	*18.5*	*18.5*	*18.5*	*18.5*	*18.0*	*18.0*	*18.0*
EBIT*(1-tax rate)	**32,141**	**35,245**	**48,147**	**54,995**	**50,063**	**59,749**	**72,216**	**87,009**	**93,531**	**102,884**	**113,173**
Depreciation	3,546	4,430	5,213	5,792	5,038	4,645	4,534	4,814	5,424	5,493	5,594
Change in working capital	(8,694)	(12,707)	(14,381)	(5,824)	839	(9,519)	(12,253)	(14,538)	(8,964)	(9,448)	(10,392)
Capital expenditure	(13,000)	(13,000)	(7,000)	(7,000)	(4,626)	(6,346)	(8,169)	(9,692)	(5,976)	(6,298)	(6,928)
Free Cash Flows	**13,993**	**13,969**	**31,979**	**47,964**	**51,315**	**48,529**	**56,328**	**67,593**	**84,015**	**92,631**	**101,446**
Growth (%)	*(65.3)*	*(0.2)*	*128.9*	*50.0*	*7.0*	*(5.4)*	*16.1*	*20.0*	*24.3*	*10.3*	*9.5*
Years discounted	-	1	2	3	4	5	6	7	8	9	10
Discount factor	1.00	0.89	0.79	0.70	0.62	0.55	0.49	0.44	0.39	0.35	0.31
Discounted cash flow	**13,993**	**12,417**	**25,267**	**33,686**	**32,036**	**26,930**	**27,785**	**29,637**	**32,744**	**32,091**	**31,240**

Target price calculation	**Rs mn**
Sum of free cash flow	297,827
Discounted terminal value	509,450
Enterprise value	807,277
Add Investments	83
Net debt	(108,627)
Net present value-equity	915,987
Shares o/s	490
Target price /share(Rs)	**1,871**

Terminal multiples	
EV/EBIDTA	10.3
P/FCF	16.3

Terminal value calculation	
Cash flow in terminal year	101,446
Growth to perpetuity (g)	***6.0%***
Capitalisation rate (WACC-g)	*6.5%*
Terminal value	1,654,347
Discount period (years)	10.0
Discount factor	0.31
Discounted terminal value	**509,450**

WACC calculation	
Risk-free rate (Rf)	*7.5%*
Beta (B)	1.00
Equity risk premium	*5.0%*
Expected market Return (Rm)	*12.5%*
Cost of Equity (Ke)	*12.5%*
Cost of Debt (Kd) (Post-tax)	*8.0%*
WACC	***12.5%***

Note: We have used cash EBIT margins for DCF, effecting the margins in FY2010E, when we expect the employee cost related provisions to be realised as cash expense

Source: Kotak Institutional Equities estimates.

Consumer products

ITC.BO, Rs214	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	250
52W High -Low (Rs)	239 - 145
Market Cap (Rs bn)	799.2

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	140.1	160.5	187.2
Net Profit (Rs bn)	31.3	35.4	41.0
EPS (Rs)	8.4	9.5	11.0
EPS gth	*15.9*	*13.1*	*15.9*
P/E (x)	25.5	23	19.5
EV/EBITDA (x)	16.9	14.8	12.5
Div yield (%)	1.6	1.8	1.9

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	14.7	1.1	(0.5)
MFs	2.8	1.2	(0.3)
UTI	11.9	42.4	40.8
LIC	13.5	5.4	3.8

ITC: Cigarettes do well, scale up investments on other FMCG products

Aman Batra : aman.batra@kotak.com, +91-22-6634-1231
Manoj Menon : manoj.menon@kotak.com, +91-22-6749-3391

- **We estimate cigarette volume growth of 2.2%**
- **Spate of launches in FMCG continue; Hotels, Paper and packaging grow well**
- **Reiterate BUY with a one-year DCF-based target price of Rs250**
- **Key triggers—uptrading of plains consumer to filters, likely price increases in cigarettes and news flow on market share gains in personal care**

ITC reported 13.5% net sales growth, 12.3% EBITDA growth and 13.1% PAT growth during 4QFY08 against our expectation of 11.6%, 16.7% and 15.8%, respectively. Cigarette sales revenues increased 9% yoy due to significant product-mix improvement and estimated volume growth at 2.2%. New launches in personal care and faster growth in foods portfolio helped ITC register 48% growth in FMCG segment—we estimate 'Aashirward' and 'Sunfeast' brands together to be a Rs15 bn business—a significant achievement in about five years of ramp up. EBIT margins yoy improved across segments except FMCG—cigarettes +180 bps, hotels +360 bps, agri business +250bps and paper and packaging +160bps. The higher EBIT losses in FMCG for the quarter at Rs1,179 mn (higher by Rs696 mn) surprised the street. As the company expands its reach in personal care and with new category entries in the anvil, we believe significant market development expenses will be incurred—we forecast EBIT loss of Rs2,500 mn in FMCG business for FY09E. We expect ITC to post 15% earnings growth during FY2008-10, our EPS estimates for FY2009E and FY2010E at Rs9.5 and Rs11 remain largely unchanged. In the past three years, the stock has traded at an average PE of 23X and has remained in the 20X-30X band. The stock has delivered a relative return of 10%, 25% and 11% over the past three, six and 12 months respectively. Reiterate BUY rating on the stock with a target price of Rs250. Key triggers to watch out are uptrading of 'Plains' consumer to 'Filters', likely price increases in cigarettes and news flow on market share gains in personal care.

Cigarette volume growth of 2.2% is a positive. Cigarette sales revenues increased 9% yoy broadly in line with our expectations. Segment PBIT margin expanded by 180 bps yoy due to product mix improvement with cigarette volume growth for the quarter estimated at over 2%. For FY08, cigarette volumes likely declined by 1%—we like the resilience displayed by the category after the 20% price increase effected in March/ April 2007. We believe the company's pricing decision for filter segment will hinge upon the quantum of uptrading from 'Plains' segment to 'Filters'. 'Plains' segment likely accounted for about 13% of ITC's cigarette volumes in FY08. South India is the key market for 'Plains' segment where the relative consumption of other forms of tobacco (chewing tobacco, pan, gutkha etc is low. Therefore, the 'Plains' smoker is left with no choice but to upgrade to filters or continue with 'Plains' which currently retails at a higher price point (ITC has stopped production of 'Plains' and 'Micros' after the budget and is likely to re-enter the 'Plains' segment in select geographies—for example, 'Scissor' brand plain cigarettes in Kerala). However, given the significant price hike in plains, we believe the volumes under this segment would drop.

We believe the current concerns on cigarette volumes is overplayed and continue to believe ITC has adequate pricing power to see through the current phase of difficult times in non-filter cigarette taxation. We estimate a 5% decline in volumes for ITC for FY09E and believe the company can possibly take a 5-6% price increase in filter cigarettes and can retain its EBITDA growth. Sustained higher growth in per capita income (over 6% for the past five years) would aid ITC in effecting such a price increase in filter cigarettes comfortably without impacting volumes. We believe the company will likely increase the prices in the premium segment (Rs3.5 +/stick price-point) as the impact of price increases on volumes in FY08 was the maximum in the RSFT segment (Rs3 – 3.50/stick price-point). We reiterate that in the scenario of non-filter cigarette category effectively becoming extinct; ITC with its dominant market shares in filter cigarettes is better equipped to see through this phase.

Agri-business—growth story in the wake of high soft-commodity prices. Revenues from agri-business recorded 16% yoy growth during the quarter. Higher volumes in soybean trading and leaf tobacco exports were the highlights of the current quarter. The company has started utilizing the e-choupal network to procure potatoes for their 'Bingo' potato chips business. Our estimates suggest that the company has about 2% sourcing cost advantage for products which have backward linkages with e-choupal. After the success of 'Aashirwad' and 'Sunfeast' brands, sourcing of potatoes through the rural network augurs well for the 'Bingo' line of business. The segment profitability improved by 150 bps to 3.4% aided by higher leaf tobacco exports and possibly inventory gains.

Spate of launches in FMCG continues. Other FMCG business recorded 48% yoy increase in sales. All round growth across business segments augurs well—biscuits at 53%, Aashirwad atta at 43%, confectionery at 40%, stationery business at 72% and domestic lifestyle retailing at 26%. We estimate 'Aashirward' and 'Sunfeast' brands together to be a Rs15 bn business—a significant achievement in about five years of ramp up. We continue to have a positive view on the strategic intent displayed by the company in building a portfolio of FMCG products. Sources indicate that 'Superia' soaps and shampoo is currently available in 5 states, 'Vivel' range of soaps and 'Fiama Di Wills' soaps and shampoo range in the top-30 cities. The company is rightly adopting a differentiated launch strategy for each of its FMCG launches—while the focus is on distribution width in the low-end soaps category with below-the-line advertising focus, the strategy in middle-segment of soaps and shampoo seems to be urban focused and supported by heavy media investments. While we believe the company has taken the right path to build a sustainable personal care business, we note that market share gains in soaps category will fructify over a period of time (only) as the typical inventory carried by a household is about 2-3 months. We also note that ITC's task of gaining meaningful market shares in shampoo category will be a more difficult task as the company is up against well entrenched competitive positions—HUL (47% market share), P&G (25% market share) and Cavinkare (11% market share).

Hotels, Paper and packaging grow well. Revenues from hotels business increased 12% and EBIT margins expanded 360 bps yoy to 42.1%. The hotels business growth was driven by sustenance of higher REVPARs (revenue per available room). The tie-up with 'Starwoods' has repositioned seven of the company's hotel properties as 'premium luxury' from May 2007, which helped realize better room rates and margins. Company indicated the construction of the super deluxe luxury hotels at Bangalore and Chennai is progressing as per schedule. The decision to move away from the dual pricing methodology to Rupee billing from September 2007 also helped insulate the company from the impact of appreciating rupee during the quarter.

Paper and packaging business recorded 16% sales growth and yoy margin expansion of 160 bps. The capacity expansion of the cartons line at Uttarakhand in 3QFY08 aided the strong performance during the quarter. The growth in modern retail increases demand for cartoned products as compared to wrappers / polypacks. This augurs well for ITC's paperboard business. The commissioning of new pulp mill at Bhadrachalam in April 2008 will help improve margins by reducing dependence on expensive purchased pulp.

Reiterate BUY with a one-year target price of Rs250. We expect ITC to post 15% earnings growth during FY2008-10. Post 4QFY08 results, our EPS estimates for 2009 and 2010 at Rs9.5 and Rs11 remain largely unchanged. At the current market price of Rs214, the stock is trading at 22.6X FY09E and 19.5X FY10E. In the last three years, the stock has traded at an average PE of 23X and has remained in the 20X-30X band. At our DCF-based target price of Rs250, the implied PE is 26.4X FY09E. The stock has delivered a relative return (vis-à-vis Sensex) of 10%, 25% and 11% over the past three, six and 12 months, respectively, and has been one of the best-performing stocks in our consumer coverage universe. Reiterate BUY rating on the stock with a one-year DCF-based target price of Rs250 for a potential 17% upside. The uptrading of 'Plains' consumer to 'Filters', the quantum of likely price increases in 'Filters' and news flow on market share gains in personal care category are the key triggers to watch out for in the next few months.

ITC Limited, quarterly summary, March year-ends (Rs mn)

			yoy
	4QFY08	4QFY07	% change
Net sales	**39,344**	**34,663**	**13.5**
EBITDA	**10,447**	**9,303**	**12.3**
Depreciation	1,215	922	
EBIT	**9,232**	**8,381**	
Other income	1,637	1,023	
Net interest	27	(1)	
Pre-tax profit	**10,842**	**9,404**	**15.3**
Tax	3,485	2,897	
Net profit	**7,356**	**6,507**	**13.1**
Extraordinary item	-	-	
Reported Net Profit	**7,356**	**6,507**	
Ratios (%)			
EBITDA margin	26.6	26.8	
PAT margin	18.7	18.8	
Tax rate	32.1	30.8	
Costs as % of net sales			
Material costs	46.9	45.5	
Staff costs	4.9	4.7	
Other expenditure	21.7	23.0	
Segment revenue			
Cigarette	35,830	32,940	8.8
Other FMCG	7,384	4,985	48.1
Hotels	3,393	3,044	11.5
Agri Business	10,781	9,287	16.1
Paper & Packaging	6,197	5,334	16.2
TOTAL	**63,585**	**55,589**	
Less: Inter segment revenue	5,124	2,876	
Gross sales	58,461	52,714	
Segment EBIT			
Cigarette	8,701	7,417	
Other FMCG	(1,179)	(483)	
Hotels	1,428	1,171	
Agri Business	370	87	
Paper & Packaging	1,227	972	
TOTAL	**10,547**	**9,162**	
EBIT contribution of other businesses	**17.5**	**19.1**	
EBIT Margin			
Cigarette	24.3	22.5	
Other FMch	(16.0)	(9.7)	
Hotels	42.1	38.5	
Agri Business	3.4	0.9	
Paper & Packaging	19.8	18.2	

Source: Company data, Kotak Institutional Equities.

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

	FY2009E			FY2010E		
	New	Old	Change (%)	New	Old	Change (%)
Sales	160456	156320	2.6	187229	179327	4.4
Operating profit	49765	54118	(8.0)	57946	61871	(6.3)
PBT	51246	53344	(3.9)	59492	61169	(2.7)
Net profit	35413	36124	(2.0)	41027	41466	(1.1)
EPS (Rs)	9.5	9.7	(2.0)	11.0	11.1	(1.1)
Sales growth (%)	14.5	13.8		16.7	13.5	
Operating profit growth (%)	12.7	21.5		16.4	18.8	
PAT growth (%)	13.1	15.1		15.9	16.6	
EPS growth (%)	13.1	15.1		15.9	16.6	

Source: Kotak Institutional Equities estimates.

ITC: Profit model, balance sheet, cash flow model 2006-2010E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009E	2010E
Profit model (Rs mn)					
Net sales	97,905	123,693	140,111	160,456	187,229
EBITDA	**33,274**	**39,700**	**44,170**	**49,765**	**57,946**
Other income	2,899	3,365	6,223	6,634	7,372
Interest	(158)	(169)	(146)	(137)	(137)
Depreciation	(3,323)	(3,629)	(4,487)	(5,016)	(5,689)
Extraordinary items	(63)	#REF!	0	0	0
Pretax profits	32,629	#REF!	45,760	51,246	59,492
Tax	(10,276)	(12,267)	(14,457)	(15,833)	(18,465)
Net profits	**22,353**	**#REF!**	**31,303**	**35,413**	**41,027**
Earnings per share (Rs)	**6.0**	**7.2**	**8.4**	**9.5**	**11.0**
Balance sheet (Rs mn)					
Total equity	90,615	104,371	120,352	139,350	162,868
Deferred taxation liability	3,248	4,729	4,729	4,729	4,729
Total borrowings	1,197	2,009	2,009	2,009	2,009
Currrent liabilities	35,781	38,576	40,286	42,306	46,513
Total liabilities and equity	**130,840**	**149,684**	**167,376**	**188,393**	**216,118**
Cash	8,558	9,002	16,585	26,148	39,824
Current assets	43,061	53,896	58,356	65,439	74,220
Total fixed assets	44,051	56,109	61,757	66,129	71,397
Investments	35,170	30,678	30,678	30,678	30,678
Total assets	**130,840**	**149,684**	**167,376**	**188,393**	**216,118**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	25,638	31,040	36,158	40,666	47,156
Working capital	(5,469)	(8,667)	(732)	(3,056)	(3,281)
Capital expenditure	(6,013)	(15,702)	(10,150)	(9,403)	(10,972)
Investments	3,577	4,492	0	0	0
Free cash flow	**17,734**	**11,164**	**25,276**	**28,207**	**32,903**
Ratios (%)					
Net debt/equity	(33.8)	(24.2)	(27.3)	(30.4)	(34.4)
Return on equity	26.4	27.7	27.9	27.3	27.2
RoCE	76.7	56.8	43.6	43.5	44.7
Key assumptions					
Sales growth (%)	28.2	26.3	13.3	14.5	16.7
EBITDA margins (%)	34.0	32.1	31.5	31.0	30.9

Source: Kotak Institutional Equities estimates.

Banking

FED.BO, Rs236	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	310
52W High -Low (Rs)	407 - 188
Market Cap (Rs bn)	40

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	13	15	18
Net Profit (Rs bn)	4.0	5.5	6.2
EPS (Rs)	37.8	32.0	36.3
EPS gth	*10.5*	*(15.2)*	*13.4*
P/E (x)	6.2	7	6.5
P/B (x)	1.0	0.9	0.8
Div yield (%)	2.0	2.7	3.1

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	53.4	0.1	0.1
MFs	11.0	0.2	0.1
UTI	-	-	(0.1)
LIC	2.1	0.0	(0.0)

Federal Bank: PAT below estimate on higher expenses, await clarification

Tabassum Inamdar : tabassum.inamdar@kotak.com, +91-22-6634-1252

Ramnath Venkateswaran : ramnath.venkateswaran@kotak.com, +91-22-6634-1240

- **Federal Bank reported a PAT of Rs1 bn flat on a yoy basis and 21% lower-than-expected**
- **NII growth was impressive, however, higher operating expenses and provisions impact PAT**
- **Would be revisiting estimates post discussion with the management**

Federal Bank reported PAT of Rs1 bn in 4QFY08'a marginal growth of 4% yoy and 21% lower than our estimates. While the NII growth and non-NII (ex-treasury) remained healthy at 22% yoy and 77% yoy, respectively. Higher-than-expected increases in operating expenses and provisions pulled down the overall PAT growth. The company has attributed this increase in operating to the significant branch expansion in the current quarter. We would be revising our estimates on the company post discussion with the management on some of the key entries in 4QFY08.

NII growth was impressive at 22% yoy

- Federal Bank NII (adj. for investment amortization) grew 22% yoy in 4QFY08 to Rs2.8 bn, which was marginally lower than our estimates by 5%.
- The company's NII was aided by the rights offering of Rs21.4 bn made in January 2008, which likely enabled the company to improve its NIM to 3.76% in 4QFY08 compared to 3.17% reported in 3QFY08. It is to be noted that the company reports its NIM based on period end numbers rather than on average earnings assets.
- Deposit growth of the company continued to remain moderate at 20% yoy, while advances growth was 26% yoy. CASA ratio of the company remained steady at 25% in line with the historical trend.
- The significant equity raising by the company in January has helped boost Tier I capital ratio to 19.1% providing it with sufficient cushion to grow its asset book.

Non-interest income was boosted by recoveries

- Non-interest income of Federal Bank in 4QFY08 was Rs1.3 bn—an increase of 19% yoy. While the growth in non-interest income (ex-treasury) was a hefty 76% yoy. A large part of the growth in non-interest income can be attributed to the significant contribution of income from recovery of written-off assets.
- The company booked income from recovery of Rs280 mn in the current quarter. We do not have comparable figures for 4QFY07.

Significant branch expansion and IT investments increase operational costs

- Federal Bank had a significant increase in other operational expenses to Rs630 mn (62% yoy). The press release of the company has attributed this to the branch expansion and significant IT investments being made to enhance the productivity.
- The branch network of the company has increased to 603 branches as of March 2008 from 560 branches as of December—a growth of 8% sequentially.

Provision burden has increased sharply in the current quarter

- Federal Bank has reported provisions (incl. investment amortization) of Rs1.4 bn a growth of 64% yoy and much ahead of our estimates.
- The company has likely made ad-hoc provisions for the expected wage hike given the undergoing wage negotiations between the employee unions and IBA.
- NPL provisions for the company and investment amortization expenses remained moderate at Rs470 mn and Rs40 mn respectively.
- Further, the asset quality was healthy with a gross NPL ratio of 2.4% and a provision coverage ratio of 91% as of March 2008.
- It is also likely that company booked investment depreciation expenses both on its bond and equity portfolio. Proportion of investments in available for sale category was 40% (of overall portfolio) as of March 2008 with a duration of 4 years.

Federal Bank, quarterly results

In Rs mn

	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	% chg	4QFY08KS	Actual Vs Kotak
Interest earned	5,313	5,592	5,982	6,527	7,212	35.7	7,566	(4.7)
Interest/discount on advances/bills	3,818	4,046	4,275	4,759	5,194	36.0	5,648	(8.0)
Income on Investments	1,290	1,374	1,524	1,637	1,841	42.6	1,772	3.9
Interest on balances with RBI and other inter bank funds	134	118	93	130	33	(75.4)	146	(77.4)
Others	70	54	90	0	144	106.9	-	-
Interest expended	3,033	3,665	3,918	4,450	4,442	46.4	4,635	(4.2)
Net interest income	**2,280**	**1,928**	**2,063**	**2,077**	**2,770**	**21.5**	**2,931**	**(5.5)**
Other Income	1,054	1,045	809	850	1,249	18.5	1,017	22.7
Sale of investments	460	220	130	180	200	(56.5)	20	900.0
Recovery of written off assets	NA	470	120	140	280			
Other income excl treasury	594	825	679	670	1,049	76.7	1,087	(3.6)
Total income	3,333	2,972	2,872	2,927	4,019	20.6	3,948	1.8
Operating Expenses	1,086	1,048	1,066	1,210	1,365	25.6	1,252	9.0
Payments to and provisions for employees	697	631	629	716	737	5.6	775	(5.0)
Other operating expenses	389	417	437	494	628	61.6	477	31.7
Operating profit	**2,247**	**1,924**	**1,806**	**1,716**	**2,654**	**18.1**	**2,696**	**(1.6)**
Other Provisions and Contingencies	867	710	588	385	1,417	63.5	768	84.5
NPL	75	400	670	441	490	557.7	530	(7.5)
PBT	**1,381**	**1,214**	**1,218**	**1,331**	**1,238**	**(10.4)**	**1,928**	**(35.8)**
Provision for Taxes	388	545	265	302	209	(46.1)	623	(66.4)
Net Profit	**992**	**669**	**953**	**1,029**	**1,028**	**3.6**	**1,306**	**(21.2)**
Tax rate (%)	28	45	22	23	17		32	
PBT before provisions	**2,247**	**1,924**	**1,806**	**1,716**	**2,654**	**18.1**	**2,696**	**(1.6)**
Key balance sheet items (Rs bn)								
Deposits	216	209	241	233	259	20.1		
CASA ratio (%)	25.6	25.0	25.0	25.8	25.0			
Advances	149	147	162	175	189	26.9		
Retail	43.4	NA	48.6	51.7	56.1	29.3		
Retail advances to total advances (%)	29.1	NA	30.0	29.6	29.7			
Asset management details								
Gross Non-performing assets (Rs mn)	4,508	4,408	4,729	4,948	4,686	3.9		
Gross NPL ratio (%)	3.0	2.9	2.9	2.8	2.4			
Net Non-performing assets (Rs mn)	651	542	698	514	432	(33.6)		
Net NPL ratio (%)	0.4	0.4	0.4	0.3	0.2			
Yield management measures (%)								
Yield on advances	10.18	11.36	11.47	11.52	11.46			
Cost of deposits	5.55	6.51	6.63	6.75	6.42			
NIM	3.06	3.21	3.15	3.17	3.76			
Capital Adequacy details (%)								
Capital Adequacy ratio	13.4	13.3	13.1	13.1	22.5			
Tier I	9.0	9.3	9.2	9.4	19.1			

Source: Company.

Diversified

JAIA.BO, Rs237	
Rating	BUY
Sector coverage view	-
Target Price (Rs)	310
52W High -Low (Rs)	510 - 128
Market Cap (Rs bn)	294.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	42	73	96
Net Profit (Rs bn)	6.1	11.0	17.2
EPS (Rs)	4.9	8.8	13.9
EPS gth	*6.7*	*80.3*	*56.7*
P/E (x)	48.4	26.8	17.1
EV/EBITDA (x)	22.1	14.1	12.2
Div yield (%)	0.0	0.0	0.0

Jaiprakash Associates: Acquires Bina Power—1,000 MW thermal power project

Aman Batra : aman.batra@kotak.com, +91-22-6634-1231

Murtuza Arsiwalla : murtuza.arsiwalla@kotak.com, +91-22-66341-125

- **Bina Power—developing 1,000 MW project in Madhya Pradesh**
- **No value assigned for Bina Power—await fuel allocation**
- **Power business of JAL valued at Rs114 bn (Rs92/share)**
- **Retain BUY rating with target price of Rs310/share**

According to media reports, JAL has acquired a 100% stake in Bina Power from the AV Birla Group through its subsidiary Jaiprakash Power Ventures for Rs1.5-1.75 bn. Bina Power was formed in the early-1990s for developing a 1,000 MW thermal power project in Madhya Pradesh. Bina Power had received several clearances including fuel linkage for 500 MW which was subsequently cancelled due to lack of progress. While JAL will need to renew all the clearances and coal linkage for the project, the acquisition brings a critical input—1,600 acres of land—needed for the project. We believe the project will take at least five years for completion and await establishment of fuel linkage before assigning any value to the project. We maintain our consolidated EPS estimates at Rs8.8 for FY2009 and Rs13.9 for FY2010. We believe JAL has a robust 'developer-builder' model in place to derive value from the growing infrastructure spend in the country. We retain our BUY rating with an SOTP-based target price of Rs310/share.

Bina Power—developing 1,000 MW project in Madhya Pradesh. JPVL (81% subsidiary of JAL) has reportedly acquired Bina Power Supply Co. from the AV Birla Group for Rs1.5-1.75 bn. We note that Bina Power already has in its possession 1,600 acres of land required for the development of the power project. This is JAL group's second commercial venture in thermal power; JPVL is also developing the 1,320 MW coal-based Jaypee Nigries project in Madhya Pradesh. Bina Power was allocated a 500-MW coal linkage that was subsequently cancelled due to a lack of progress on the project. We believe JPVL will be able to put in place approvals and linkages ahead of time in comparison to timelines for obtaining regulatory clearances for new power projects. However, we await finalization of fuel linkage for the project before assigning any value.

Power business valued at Rs114 bn. We ascribe Rs114 bn (Rs92/share) for 4,770 MW of JAL's attributable generation capacity of operational and future project portfolio. We use DCF-equity to arrive at the valuation of each power project. We use 11% cost of equity for operating power projects and higher cost of equity (12.5%/ 14%) for projects under construction or development. The sum of the DCF-equity of projects yields a value of Rs182 bn (2.4X P/B), which is adjusted for a net equity-funding requirement of Rs68 bn to arrive at a net value of Rs114 bn.

Retain BUY rating with target price of Rs310/share. We retain our BUY rating with a target price of Rs310/share. We value cement business at 7X EV/EBITDA on FY2010E— Rs103 bn and construction business at 10X EV/EBITDA on FY2010E—Rs51 bn. Real estate (Rs159 bn) and power (Rs114 bn) valuations are based on one-year forward NAVs. Upside risks to our target price emanate from (1) higher realizations and early development of land parcels located near proposed airport at Jewar, (2) higher utilization from expanded cement capacities and (3) possible upsides from the Ganga Expressway and Formula 1 racetrack projects.

Valuation of power project portfolio of Jaiprakash Associates Ltd

			Cost		Equity Investment			JAL's share	
Project	Type	Capacity (MW)	(Rs bn)	(Rs mn / MW)	(%)	(Rs bn)	P/B (X)	(%)	Value (Rs bn)
Vishnuprayag	Hydro	400	17	42	30	5.0	3.4	81	13.8
Karcham Wangtoo	Hydro	1,000	56	56	30	16.8	1.8	91	28.4
Jaypee Powergrid	Transmission	NA	10	NA	30	3.0	1.1	63	2.1
Jaypee Nigrie	Thermal	1,320	53	40	30	15.8	4.1	81	51.7
Lower Siang	Hydro	2,025	110	54	30	33.0	2.3	72	53.6
Hirong	Hydro	500	30	60	30	9.0	1.7	72	11.2
Kynshi II	Hydro	450	27	60	30	8.1	1.7	60	8.4
Umngot	Hydro	270	16	60	30	4.9	1.7	60	5.0
Baspa II	Hydro	300	15	50	30	4.5	2.9	63	8.1
Total		**6,265**	**334**	**52**			**2.4**		**182.2**
Less : Equity to be invested									(68)
Net Value									**114.4**

Source: Kotak Institutional Equities estimates.

Income statement for the power business of Jaiprakash Associates, March fiscal year-ends, 2007-12E (Rs mn)

	2007	2008	2009E	2010E	2011E	2012E
Net revenues	**5,497**	**7,470**	**7,052**	**6,905**	**6,911**	**20,244**
O & M	(124)	(341)	(360)	(379)	(397)	(1,200)
EBITDA	**5,373**	**7,129**	**6,692**	**6,526**	**6,514**	**19,044**
Depreciation & amortization	(819)	(915)	(915)	(915)	(916)	(2,734)
EBIT	**4,554**	**6,214**	**5,777**	**5,611**	**5,598**	**16,310**
Interest (expense)	(2,006)	(2,248)	(2,106)	(1,964)	(1,767)	(6,437)
Interest/treasury income	293	300	271	388	527	807
Other income/(expense)	6	196	596	596	596	596
Pre-tax profit	**2,846**	**4,462**	**4,538**	**4,631**	**4,954**	**11,275**
Income tax	(343)	(396)	(399)	(403)	(431)	(1,000)
Minority interest / share of profits of associates	(878)	(1,249)	(1,041)	(1,059)	(1,130)	(3,858)
Net profit	**1,625**	**2,817**	**3,098**	**3,169**	**3,393**	**6,417**

Source: Company data, Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Jaiprakash Associates Ltd, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E	2012E
Profit model							
Net revenues	32,711	39,328	42,010	73,001	95,966	127,985	167,377
EBITDA	**8,585**	**14,592**	**16,990**	**28,183**	**37,211**	**48,022**	**72,858**
Other income	944	987	2,060	1,607	1,759	1,475	1,218
Interest (expense)/income	(3,424)	(4,587)	(5,580)	(7,190)	(8,168)	(8,643)	(15,434)
Depreciation	(2,149)	(2,596)	(3,220)	(3,243)	(3,448)	(3,561)	(5,570)
Pretax profits	**3,955**	**8,395**	**10,250**	**19,358**	**27,353**	**37,293**	**53,071**
Tax	(1,449)	(2,408)	(2,200)	(7,316)	(8,335)	(10,954)	(14,059)
Deferred taxation	(53)	(65)	(760)	(22)	(750)	(525)	(61)
Minority interest	(607)	(882)	(1,200)	(1,041)	(1,059)	(1,130)	(3,858)
Net income	**1,847**	**5,040**	**6,090**	**10,979**	**17,208**	**24,684**	**35,093**
Extraordinary items	4,500	492	680	—	—	—	—
Reported profit	6,347	5,532	6,770	10,979	17,208	24,684	35,093
Earnings per share (Rs)	**1.7**	**4.6**	**4.9**	**8.8**	**13.9**	**19.9**	**28.3**
Balance sheet							
Paid-up common stock	2,151	2,192	2,342	2,342	2,342	2,342	2,342
Total shareholders' equity	26,058	29,286	43,107	52,501	67,860	90,432	123,148
Deferred taxation liability	4,827	5,445	6,205	6,227	6,977	7,502	7,564
Minority interest	3,771	4,591	6,013	7,497	10,982	15,411	22,368
Total borrowings	63,777	81,062	106,621	143,112	194,508	250,690	320,867
Total liabilities and equity	**98,432**	**120,383**	**161,945**	**209,337**	**280,328**	**364,035**	**473,946**
Net fixed assets	42,601	61,172	74,818	88,834	108,095	190,769	245,766
Capital work-in progress	23,114	27,390	40,307	53,620	101,060	112,401	141,768
Investments	46	77	77	77	77	77	77
Cash	18,470	18,230	31,308	47,304	46,433	29,114	44,933
Net current assets (excl. cash)	14,201	13,514	15,435	19,502	24,662	31,674	41,402
Net current assets (incl. cash)	32,672	31,743	46,742	66,806	71,095	60,787	86,335
Total assets	**98,432**	**120,383**	**161,945**	**209,337**	**280,328**	**364,035**	**473,946**
Free cash flow							
Operating cash flow, excl. working capital		5,698	9,890	13,678	20,707	28,425	43,365
Working capital changes		688	(1,921)	(4,068)	(5,160)	(7,012)	(9,728)
Capital expenditure		(24,654)	(29,783)	(30,572)	(70,150)	(97,575)	(89,934)
Free cash flow		**(18,268)**	**(21,814)**	**(20,961)**	**(54,602)**	**(76,162)**	**(56,297)**
Ratios							
Net debt/equity (%)	174	215	175	182	218	245	224
Return on equity (%)	7	17	14	21	25	27	28
Book value per share (Rs)	24	27	37	45	58	77	105
ROCE (%)	**8**	**11**	**10**	**13**	**13**	**13**	**15**

Source: Company data, Kotak Institutional Equities estimates.

Division-wise breakup of Jaiprakash's (consolidated) key financials, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E	2012E
Sales							
Cement	12,206	18,314	20,690	29,185	40,020	45,207	53,467
Construction	16,754	14,329	17,550	22,080	27,219	43,371	40,518
Real estate	—	—	2,560	15,244	22,482	33,182	53,883
Power	2,732	5,497	7,470	7,052	6,905	6,911	20,244
Hotel	1,109	1,367	1,640	1,640	1,640	1,640	1,640
Total	32,801	39,507	49,910	75,201	98,266	130,310	169,752
less inter-div transfer	(91)	(180)	(7,900)	(2,200)	(2,300)	(2,325)	(2,375)
Reported total	**32,711**	**39,328**	**42,010**	**73,001**	**95,966**	**127,985**	**167,377**
EBITDA							
Cement	2,751	6,625	7,727	10,273	14,712	15,695	19,456
Construction	5,379	4,166	4,268	4,571	5,090	8,110	7,577
Real estate	—	—	810	8,201	12,451	19,286	28,454
Power	2,700	5,373	7,129	6,692	6,526	6,514	19,044
Hotel	513	592	796	796	796	796	796
Total	11,343	16,756	20,729	30,533	39,576	50,402	75,328
Others	(2,758)	(2,164)	(3,739)	(2,350)	(2,365)	(2,380)	(2,470)
Reported total	**8,585**	**14,592**	**16,990**	**28,183**	**37,211**	**48,022**	**72,858**

Source: Company data, Kotak Instittuional Equities estimates.

SOTP-based valuation of Jaiprakash Associates Ltd

			Value	
Business	**Methodology**	**Comments**	**(Rs bn)**	**(Rs/share)**
Cement	EV/EBITDA (X)	7X FY2010E EBITDA; JAL proposes to increase capacity to 23 mn tpa by FY2010 from the current 7 mn tpa	103	83
Construction	EV/EBITDA (X)	10X FY2010E EBITDA on an order book of US$2.8 bn	51	41
Real estate	NAV	Base case assumption of flat prices till FY2010 and 5% growth in realisation beyond that for 25 mn sq. ft of ribbon development along Taj Expressway and 8 mn sq. ft at Jaypee Greens	159	128
Power	DCF-to-equity	4,721 MW of attributable power portfolio, of which 501 MW is already under operation	114	92
Hotels	Market value	20% holding company discount on JAL's 72% stake in Jaypee Hotels	5	4
Net debt	Book value	Net debt for cement, construction and real estate business	(47)	(38)
Total			**386**	**310**

Source: Kotak Institutional Equities estimates.

Bajaj Auto: Demerged auto company to list on Monday; we estimate fair value at Rs750/share

Amit Agarwal : agarwal.amit@kotak.com, +91-22-6749-3390

- **We value the demerged auto business at Rs750/share based on 7X FY2009E EV/ EBITDA**
- **Demerged auto entity—Bajaj Auto to list on Monday**
- **Management guides a flat volume growth for FY2009E—we estimate 2.5% growth in motorcycle volumes for FY2009E; expect strong export growth at 30% for FY2009E**
- **Bajaj Auto to continue to focus on higher-end bikes—to launch four models in the >125 cc segment, KTM and Kawasaki bikes during FY2009**

Bajaj Auto—the demerged entity containing the auto business of Bajaj Auto (old)—will be listed on Monday, 26 May 2008. We peg the fair value of Bajaj Auto at Rs750/ share. We value the standalone auto business of the company at 7X FY2009E EV/ EBITDA based on historical trading band. We value the auto business at Rs655/share and the net cash of the company at Rs97/share. We estimate FY2009E domestic motorcycle growth at 2.5% given the management guidance of flat volumes for the year while we expect exports to grow strongly at 30% for FY2009E. We believe the reluctance of financiers to extend credit for 2-wheelers will continue to hit industry growth. Bajaj has clearly indicated its continued focus on higher-end bikes by announcing four new launches in the >125 cc category in FY2009E.

Our fair value for Bajaj Auto is Rs750/share

We peg the fair value of Bajaj Auto at Rs750/share. We value the auto business of Bajaj Auto at Rs655/share based on 7X FY2009E EV/EBITDA. The company has net cash of Rs97/share, comprising liquid investments. We estimate that the net earnings of the company at Rs55.8 and Rs63.7 for FY2009E and FY2010E, respectively—earning to grow at a CAGR of 10% over the next two years. Based on our fair value estimate, Bajaj Auto would be trading at a P/E of 13.4X FY2009E earnings and 11.8X FY2010E earnings, respectively.

Management guides flat domestic volume growth—we estimate 2.5% growth in domestic motorcycle volumes; strong export growth

The management of Bajaj Auto has guided for a flat volume growth in the domestic motorcycle segment citing tight financing conditions as the major hurdle. We estimate Bajaj's domestic motorcycle volumes to grow at 2.5% and 5% in FY2009E and FY2010E, respectively. We expect exports should grow strongly with pick up in exports to Egypt and other newer markets. We model exports to grow 30% in FY2009E. Meanwhile 3-wheelers continue to perform badly on account of strong competition from the LCV segment—we expect domestic 3-wheeler volumes to decline 2.5% in FY2009E.

Bajaj to increase focus on high-end bikes—host of new launches in FY2009E

Bajaj has reiterated its continued focus on higher-end bikes and a gradual shift towards the more profitable upper segment motorcycles. Bajaj has announced that it would be launching four new bikes in the >125 cc segment motorcycle category. These launches would happen between Aug-Dec '08. Moreover, the company aims to launch higher-end KTM bikes and Kawasaki bikes through exclusive pro-biking showroom to be set up by Bajaj (Bajaj had recently acquired a 24% stake in KTM). These bikes would be launched in the next four-six months. Besides, the company also plans to launch two new 3-wheeles—one passenger and one goods 3-wheeler in order to boost 3-wheeler volumes.

Financing of 2-wheelers continues to be a concern

Financing of 2-wheelers continues to be a major concern for the industry as financiers are reluctant to extend credit for 2-wheeler financing. We note that around 75-80% of 2-wheelers are financed—any pull back by financiers will likely hurt the industry's growth prospects. Our channel checks indicate that rising delinquencies have resulted in financiers going slow on 2-wheeler financing thereby lowering demand for motorcycles. We expect such a situation to continue for most part of FY2009 as a result 2-wheeler industry growth would not be very exciting in FY2009E.

Bajaj Auto Ltd, interim results (Rs mn)

	9m FY2008	4Q FY08	FY2008
Net sales & other operating income	**69,717**	**20,744**	**90,462**
Material cost	50,963	15,240	66,204
Employee cost	2,553	863	3,416
Other expenses	6,050	2,088	8,137
Expenses capitalized	(168)	(63)	(230)
Operating profit	**10,319**	**2,616**	**12,935**
Other income	1,022	205	1,227
EBITDA	**11,341**	**2,820**	**14,162**
Interest	34	18	52
Depreciation	1,326	414	1,740
Profit before exceptional items	**9,981**	**2,388**	**12,371**
Exceptional items -VRS	512	512	1,024
Prior period adjustments	(3)	1	(2)
Profit before taxes	**9,466**	**1,878**	**11,346**
Provision for taxes	3,118	670	3,788
Profit after taxes	**6,348**	**1,208**	**7,558**
No of shares	145	145	145
EPS (Rs)	43.9	8.3	52.2
Key ratios			
Operating margin (%)	14.8	12.6	14.3
Raw materials/sales (%)	73.1	73.5	73.2
Net profit margin (%)	9.1	5.8	8.4
Volumes	**1,902,167**	**549,240**	**2,451,407**
Domestic	**1,441,576**	**391,490**	**1,833,066**
2-wheelers	1,320,047	359,022	1,679,069
3-wheelers	121,529	32,468	153,997
Exports	**460,591**	**157,750**	**618,341**
2-wheelers	358,444	123,582	482,026
3-wheelers	102,147	34,168	136,315

Source: Company, Kotak Institutional Equities.

Bajaj Auto, valuation details, FY2009E basis (Rs mn)

	EBITDA	Multiple	Value	No of shares	Value per share	
	Rs mn	(X)	Rs mn	mn	Rs	Comments
FY2009E EBITDA	13,538	7.0	94,764	145	655	Based on FY2009E EBITDA
Less : Net debt			(14,046)	145	(97)	FY2009E net debt adjusted for cash and investments
Fair value			**108,811**	**145**	**752**	
Target price					**750**	

Source: Kotak Institutional Equities estimates.

Bajaj Auto, Profit model and balance sheet, March fiscal year-ends, 2008E-2010E (Rs mn)

	2008E	2009E	2010E
Profit model (Rs mn)			
Net sales	90,462	101,235	113,796
Operating profit	**12,937**	**13,538**	**15,063**
Other income	1,227	1,410	1,620
Interest	(52)	(54)	(57)
Depreciaiton	(1,740)	(1,995)	(2,055)
Profit before tax	**12,373**	**12,899**	**14,572**
Extra-ordinary itemss	(1,025)	(1,025)	(1,025)
Taxes	(3,790)	(3,800)	(4,335)
Net profit	**7,558**	**8,074**	**9,212**
Earnings per share (Rs)	**52.2**	**55.8**	**63.7**
Balance sheet (Rs mn)			
Equity	18,236	22,925	28,751
Deferred tax liability	673	436	165
Total Borrowings	14,514	15,240	16,002
Current liabilities	39,815	41,216	42,797
Total liabilities	**73,238**	**79,816**	**87,714**
Net fixed assets	12,224	11,230	10,175
Investments	20,589	27,589	34,589
Cash	2,258	1,697	2,349
Other current assets	38,074	39,207	40,508
Miscellaneous expenditure	93	93	93
Total assets	**73,238**	**79,816**	**87,714**
Ratios			
Operating margin (%)	14.3	13.4	13.2
PAT margin (%)	8.4	8.0	8.1
Debt/equity (X)	0.8	0.7	0.6
Net debt/equity (X)	(0.4)	(0.6)	(0.7)
Book Value (Rs/share)	130.7	161.5	199.9
RoAE (%)	20.2	38.2	35.2
RoACE (%)	**17.5**	**17.8**	**17.8**

Source: Company, Kotak Institutional Equities estimates.

Economy

Sector coverage view N/A

Inflation stays flat but elevated

Mridul Saggar : mridul.saggar@kotak.com, +91-22-6634-1245

- **Headline inflation for the week-ended May 10, 2008 stays flat (7.82% versus 7.83% in the previous week)**
- **Steel price roll back yet to reflect in WPI**
- **Inflation for the week-ended March 15 revised to 8.02% from 6.68% provisional**
- **We retain our forecast of average inflation of 8.0% in FY2009E**

Inflation for the week-ended May 10, 2008 stayed flat after rising for four successive weeks to 7.83% from 7.14% (Exhibit 1). Inflation remained flat in spite of steel price roll back yet to reflect in WPI. Inflation did not rise in spite of 'all commodities WPI index' rising to 229 from 228.6 (a 0.17% increase over the previous week). This was mainly due to favorable base effects. Considering the significant upward revisions effected in the past data, the inflationary concerns are far from over. We retain our forecast of an average WPI inflation of 8% for FY2009E.

Fibres, jute textiles and pesticide prices rise over the week

Food prices increased only marginally, while energy prices were constant in the week-ended May 10. Price increase was significant only in case of jute textiles (6.1%), tea (4.0%), pesticides (3.8%) and fibres (1.6%). Prices of vegetables (-3.2%) and pulses (-1.7%) declined.

Favorable base effects soften food price inflation

Food price inflation dropped to 4.56% from 5.23% in the previous week, mainly due to favorable base effects. Reports of bumper procurement of wheat crop augur well for a further softening of food inflation but the trend would be set by progress of monsoon in the coming months. Management of food stocks by public procurement agencies would also determine the impact on prices.

Steel price roll back may soften inflation next week

There was no change in the wholesale prices of iron and steel for the week-ended May 10. This was surprising given that steel producers had assured the Prime Minister on May 7 that they would roll back prices of flat products by about 8% and structural by about 5%. The roll back of prices was with immediate effect, but the WPI for 'iron & steel', however, remained unchanged at 354.6 for the week-ended May 10. If the roll back was not immediate, we could possibly see inflation rate dropping by about 0.45% next week on this account. Otherwise, we expect inflation rate to rise further next week close to 8.0%.

Upward revisions in past data significant

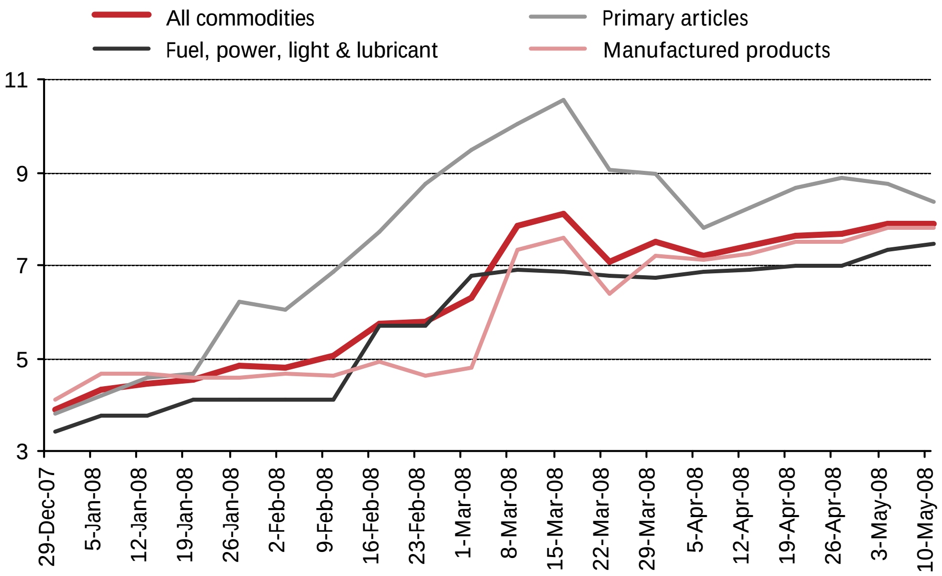
We find large upward revisions in past data as significant to the inflation outcome. The upward revision for the week-ended March 15 for which the final data was released increased inflation rate by over 1.3 ppt. The upward revision was significant in primary commodities and several manufactured products, including basic metals and alloys.

Inflationary pressures unlikely to ease in near term

We do not expect inflationary pressures to ease in near term and retain our average inflation forecast of 8.0% for FY2009E. Risks to inflation arise from rising global crude prices which can either give an inflationary shock or an interest rate shock with likelihood that both shocks may occur. The sharp 5.7% depreciation of rupee in May so far (till May 22) is also likely to add 0.5 ppt to the headline inflation rate. We see headline inflation averaging 8% or more in the first three quarters in FY2009E, but dropping to about the RBI's target of 5.5% by the end of FY2009.

Inflation plateuing at 8.0%, expect it to stay elevated with further upside risks

WPI inflation rate for major groups (yoy %)



Note: Data til March 15, 2008 is final, while that thereafter is provisional

Source: Office of the Economic Advisor, Ministry of Commerce & Industry, Government of India

Banking

Sector coverage view	Attractive

Company	Rating	Price, Rs 23-May	Target
SBI	ADD	1,573	1,800
HDFC	REDUCE	2,675	2,700
HDFC Bank	BUY	1,382	1,500
ICICI Bank	ADD	862	933
Corp Bk	ADD	344	375
BoB	ADD	285	335
PNB	BUY	514	650
OBC	ADD	202	210
Canara Bk	SELL	225	200
LIC Housing	REDUCE	334	350
Axis Bank	REDUCE	799	850
IOB	REDUCE	137	145
Shriram Trans|	REDUCE	338	335
SREI	BUY	151	240
MMFSL	REDUCE	281	290
Andhra	REDUCE	80	81
IDFC	REDUCE	156	170

4QFY2008 results weak, increase in macro risk, leading us to downgrade target price for banks

Tabassum Inamdar : tabassum.inamdar@kotak.com, +91-22-6634-1252

Ramnath Venkateswaran : ramnath.venkateswaran@kotak.com, +91-22-6634-1240

- **Core performance was weak for most public banks, while private banks performed better in 4QFY08**
- **Reviewing our recommendations on the stocks and target prices based on these results and the near-term macro environment**
- **PNB and Union Bank remain our top picks among public banks, while Federal Bank and HDFC Bank remain our preferred picks amongst private banks**

The financial results of banks in 4QFY08 highlighted the following: (1) margin stable qoq but significantly down from yoy for most PSU banks; (2) other income remains buoyant driven by fees and recoveries; (3) asset quality remains reasonably healthy across banks, (4) most public banks adjusted their transitional liability under the revised AS-15 guidelines against their networth thereby aiding PAT. We expect the macro-environment for banks to remain challenging over the next 12-18 months given: (1) moderation in GDP growth, which could impact credit offtake, (2) inflationary pressures, leading to higher interest rates, (3) likely slippage in asset quality and (4) risk to treasury income from rising rates. All of which could lead to decline in earnings for PSU banks and their underperformance. Given the significant risk to earnings from macro environment we are increasing our cost of equity assumption for key banking stocks to 13.5-14% from 13-13.5% earlier. Within PSU space, PNB and Union Bank remain our top picks, while Federal Bank and HDFC Bank remain our preferred picks amongst private banks.

Macro-environment to remain challenging for banks. We believe the banking sector operating and bottom-line growth is unlikely to improve over the next one year. We believe the risk to earnings could arise from : (1) lower credit growth, thereby enhancing margin pressure; (2) higher credit provisioning costs as the risk of NPLs are enhanced, (3) lower treasury income and MTM hit due to higher interest rates. We believe interest rates will likely inch up due to inflationary pressures (oil, commodity price increases) and or higher government borrowings (incl. off balance sheet items).

Revise our recommendations and target prices for companies: We find PSU banks have underperformed the market over the plast three years on the back of lower earnings, and higher interest rates. As against this, the private banks have outperformed both the index and the PSU banks (see Exhibits 2-5). We see no change in this scenario and believe PSU banks performance will remain under pressure despite attractive valuations. We have tried factoring in the increasing risk to earnings and macro environment by increasing our cost of equity estimate for banks to 13.5-14% from 13-13.5%. We have downgraded our price target across major banks and have changed recommendation on Andhra Bank from Buy to REDUCE, Corporation Bank from BUY to ADD, IOB from ADD to REDUCE and on Canara Bank from REDUCE to SELL. The details on the adjustment to cost of equity and price targets for banks can be found in Exhibit 6.

NII growth continues to be under pressure for public banks. The NII growth for public banks remained under pressure in 4QFY08 (Exhibit 7). Union Bank and PNB among the public banks reported NII growth (excl. extraordinary entries) of around 8% and 12% in the current quarter. On the other hand, NII growth of private banks was healthy at 20-78%, partly aided by the equity capital raising done by them in FY2008. The encouraging feature in the current quarter was that the excess liquidity (or investment in SLR bonds) has come off significantly in 4QFY08 for most banks. This could be positive for bank margins if they maintain lower SLR proportion (Exhibits 11-13).

Non-interest income continues to remain healthy. The contribution of non-interest income continued to be healthy for most banks, which reported a growth of 10-30% in their non-interest income (excl. treasury) aided by recoveries from written-off assets and healthy fee income growth (Exhibit 14). The treasury income had come off for most banks in 4QFY08, which were impacted by the volatile capital markets. ICICI Bank reported a MTM hit of US$100 mn in 4QFY08 in its parent book due to the widening of spreads on the credit derivatives portfolio. While BOB and SBI reported MTM losses on their international credit derivatives portfolio of around US$10 mn. We expect this income to be subdued going forward as: (1) rising rates and volatile equity markets may make it difficult to book treasury income, (2) banks may see MTM hits on their portfolio and (3) recoveries may reduce given rising rates and a moderation in economic growth and profitability of corporate India.

Most public banks adjusted their transitional liability against their networth. The public banks have adjusted their transitional liability of employee benefits under the revised AS-15 guidelines against their networth. The exceptions to this trend were BOB, Indian Bank and IOB. These companies have decided to amortize this expense over a five-year period. PNB on the other hand has adjusted a large part of its transitional liability (net of deferred tax) against its reserves. This accounting adjustment helped these banks to reduce their employee expenses in the current quarter and boost their PAT. Some public banks like PNB and BOB made ad-hoc provisions of Rs1 bn each for meeting their expected employee liabilities on account of the wage hike negotiations that are currently on between IBA and employee unions. SBI made an ad-hoc provision of Rs2 bn for the same reason.

Asset quality remains healthy. The asset quality of companies across the sector continued to be healthy and most banks reported a decline in absolute levels for their NPLs (Exhibit 15). SBI and ICICI Bank were the exceptions to this trend and reported large increase in their gross NPLs. SBI attributed the increase in NPLs to the agriculture segment and 'technical' issues for some of the SME NPLs. ICICI Bank continued to report slippages in its unsecured personal loan portfolio—a segment that it has reduced focus over the past few quarters. As mentioned in the previous para, we expect NPL levels to rise given increasing interest rates and a moderation in economic growth and profitability of corporate India. The recently announced loan waiver scheme of Government of India for the agriculture sector could increase the risk of NPLs in the agriculture segment or lead to the banks reducing their exposure to this segment—both of which highlighted was by us previously in our note of February 29, 2008. Further, the Government has over the weekend announced finalized the debt waiver scheme, which has led to an increase in the amount of loans written-off to Rs712 bn from Rs600 bn estimated earlier for the banking industry including the regional rural banks and co-operative sector companies.

Exhibit 1: Overall credit has slowed down, while industrial credit growth remains healthy

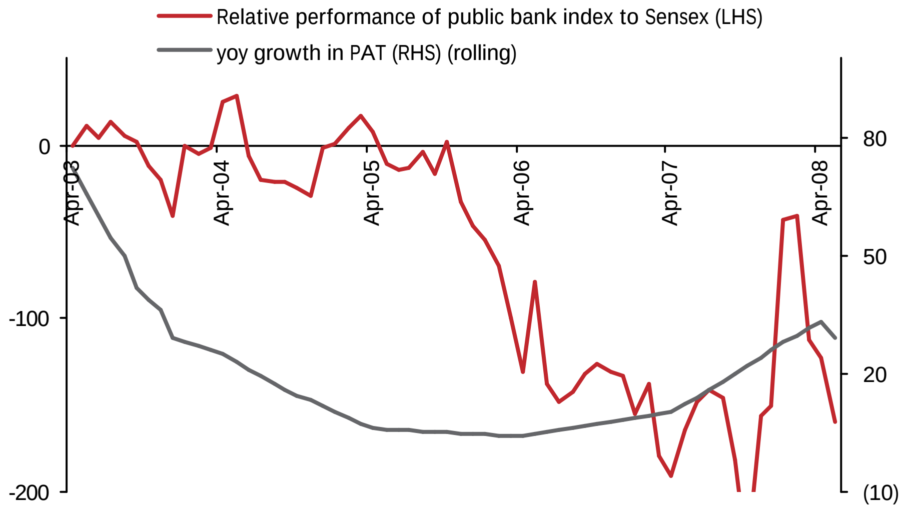
yoy growth in credit (%)

	22-Dec-06	30-Mar-07	25-May-07	17-Aug-07	23-Nov-07	15-Feb-08
Agriculture	31.2	33.6	32.2	24.4	21.4	16.4
Non-food bank credit	31.1	24.5	22.6	20.2	22.4	22.0
Industry	**27.8**	**25.9**	**26.4**	**24.6**	**25.3**	**25.9**
Real estate	**66.7**	**69.9**	**69.7**	**52.9**	**33.0**	**26.7**
Retail	**34.9**	**28.8**	**23.9**	**19.8**	**20.0**	**13.2**
Housing	30.3	23.7	21.6	16.6	15.1	12.0
Consumer durables	23.3	4.2	23.2	4.1	(4.4)	5.9
Credit cards	43.2	45.1	45.0	45.9	43.7	50.6
Education loans	49.2	49.3	46.5	43.7	44.6	40.9

Source: RBI.

Exhibit 2: Public banks under performed the index over the past two years

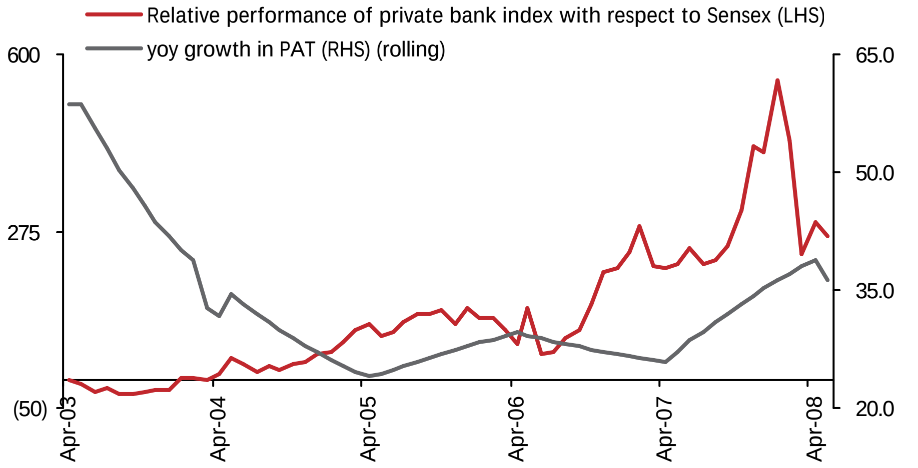
Relative performance of PSU bank index with respect to Sensex (April 2003 as base) and yoy growth in PAT (%)



Source: Companies,Bloomberg, Kotak Institutional Equities estimates.

Exhibit 3: Private banks have been consistently outperforming the index over the past four years likely due to their earnings growth trajectory

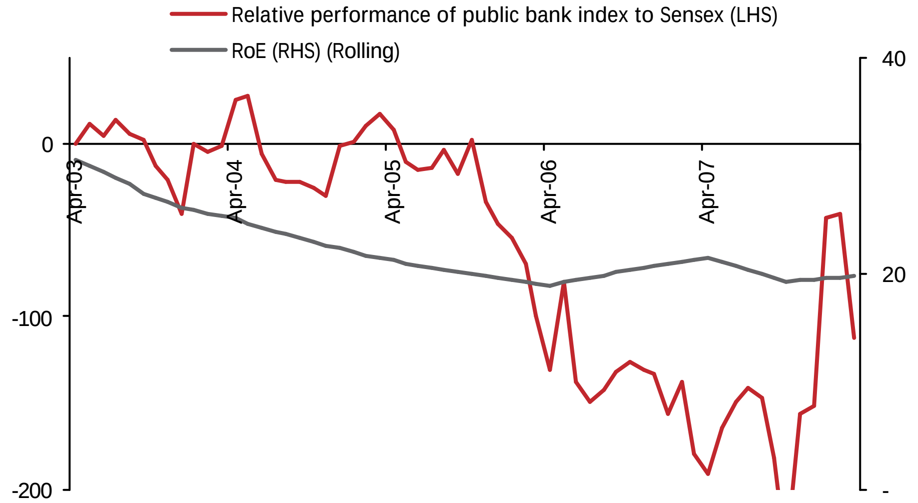
Relative performance of private bank index with respect to Sensex (April 2003 as base) and yoy growth in PAT (%)



Source: Companies,Bloomberg, Kotak Institutional Equities estimates.

Exhibit 4: Public banks RoE will likely be impacted by rising interest rates as in the past and impact stock price performance

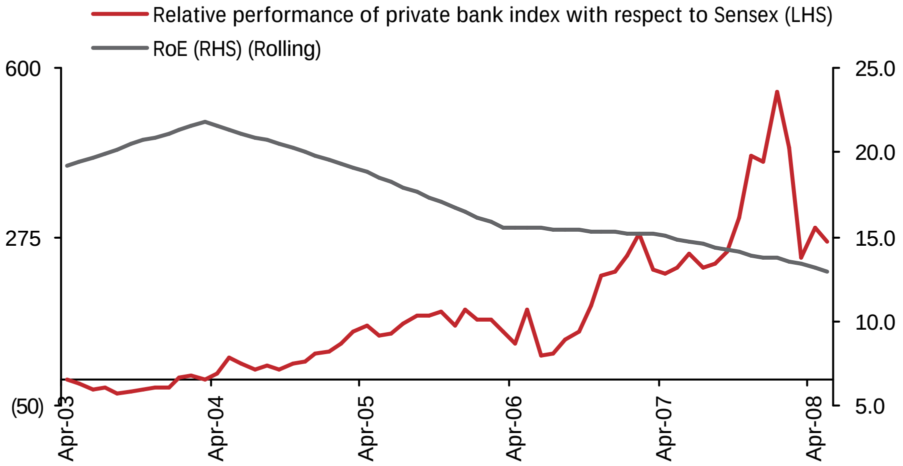
Relative performance of PSU bank index with respect to Sensex (April 2003 as base) and RoE (%)



Source: Companies,Bloomberg, Kotak Institutional Equities estimates.

Exhibit 5: Private bank outperformance likely driven by earnings growth and increasing valuation of subsidiaries, despite lower RoE

Relative performance of private bank index with respect to Sensex (April 2003 as base) and RoE (%)



Source: Companies,Bloomberg, Kotak Institutional Equities estimates.

Exhibit 6: Reducing target prices for most public banks to factor in higher cost of equity

Summary of the change in target prices and recommendations

	Previous recommendation	New recommendation	Previous cost of equity (%)	New cost of equity (%)	Previous target Price (Rs)	New target price (Rs)	Reduction in target price (%)
Public banks							
Andhra Bank	BUY	REDUCE	14.0	12.8	105	81	(22.9)
BoB	ADD	ADD	13.5	13.0	400	335	(16.3)
Canara Bank	REDUCE	SELL	13.8	13.3	250	200	(20.0)
Central Bank	SELL	SELL			85	85	-
Corporation Bank	BUY	ADD	14.0	13.0	470	375	(20.2)
Indian Bank	ADD	ADD	14.0	13.5	170	150	(11.8)
IOB	ADD	REDUCE	14.0	13.5	160	145	(9.4)
OBC	ADD	ADD	13.5	13.0	260	210	(19.2)
PNB	BUY	BUY	13.3	12.8	650	650	-
SBI	ADD	ADD	13.0	12.5	2,000	1,800	(10.0)
SBI standalone			13.0	12.5	1,473	1,263	(14.2)
Union Bank	BUY	BUY	13.5	13.0	250	210	(16.0)
Old private banks							
Federal Bank	BUY	BUY	13.5	13.0	340	310	(8.8)
J&K Bank	ADD	ADD	13.5	13.0	850	785	(7.6)
New private banks							
Axis Bank	REDUCE	REDUCE	12.5	12.5	850	850	-
HDFC Bank	ADD	ADD	12.3	12.3	1,500	1,500	-
ICICI Bank	ADD	ADD	13.5	13.0	1,000	933	(6.7)
ICICI standalone	ADD	ADD	13.5	13.0	587	528	(10.0)

Source: Kotak Institutional Equities estimates.

Exhibit 7: Margins continue to be under pressure for most public banks

NIM and yoy growth in NII (%)

	NIM (%)								NII yoy growth (%)							
	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Public banks																
Andhra Bank	3.8	3.8	3.6	3.5	3.5	3.0	3.2	2.9	22.2	14.7	22.8	25.1	8.0	4.2	1.8	(11.6)
Bank of Baroda	3.2	3.1	3.2	3.4	3.2	3.1	3.0	2.9	16.3	22.9	17.8	27.1	19.6	9.4	11.6	(2.0)
Canara Bank	3.2	3.2	3.1	3.2	2.5	2.4	2.4	2.4	13.8	21.6	8.4	7.7	(5.7)	(19.8)	(10.0)	(13.0)
Corporation Bank	3.4	3.2	3.2	3.2	3.0	3.0	2.9	NA	15.6	3.3	1.5	31.0	14.6	18.2	6.1	3.7
Indian Bank	3.3	3.6	NA	3.8	3.4	3.4	3.7	3.3	20.2	20.0	18.1	30.0	19.8	7.9	28.8	(10.4)
IOB	4.0	4.0	3.7	4.2	3.7	3.4	3.3	3.3	19.1	18.3	15.1	42.0	23.2	3.3	8.4	(11.2)
OBC	2.6	2.5	2.8	2.7	2.7	2.4	2.4	2.3	2.0	2.1	6.6	10.8	7.8	(3.2)	(4.5)	(2.1)
PNB	4.1	4.2	4.2	4.1	3.8	3.9	3.9	3.9	18.8	14.4	19.7	20.6	6.6	0.3	(1.5)	11.9
State Bank of India	3.4	3.3	3.3	3.4	3.3	3.0	3.0	3.1	0.1	13.5	35.8	68.4	13.6	6.3	23.5	6.3
Union Bank	2.9	2.8	3.0	3.5	3.1	2.6	2.8	2.8	18.7	4.2	7.3	39.9	21.6	7.2	14.9	(0.3)
Old private banks																
Federal Bank	3.2	NA	3.3	3.1	3.2	3.2	3.2	3.8	10.0	25.0	19.3	32.4	21.5	23.2	16.5	21.5
New private banks																
Axis Bank	2.7	2.9	3.0	3.1	2.7	3.3	3.9	3.9	44.7	43.0	44.7	48.4	38.8	61.2	79.7	78.5
HDFC Bank	4.1	4.0	4.0	4.5	4.2	4.2	4.3	4.4	56.1	38.1	38.5	51.2	27.5	44.5	62.6	56.0
ICICI Bank	2.5	2.5	2.6	2.7	2.3	2.5	2.3	2.4	52.2	47.4	31.9	36.4	16.2	26.6	27.1	23.7

Source: Companies, Kotak Institutional Equities.

Exhibit 8: Cost of deposits remained high, benefit of rate reduction on bulk will likely get reflected in 1Q
In %

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Andhra Bank	5.0	5.1	5.1	5.9	6.2	6.6	6.5	7.1
Bank of Baroda	4.4	4.4	4.6	4.8	5.4	5.5	5.6	5.7
Canara Bank	4.7	4.8	4.9	5.1	6.1	6.3	6.1	6.2
Corporation Bank	4.7	5.0	5.2	5.3	6.6	6.4	6.4	6.5
Indian Bank	4.9	5.0	NA	5.2	5.6	5.8	5.9	5.8
IOB	4.8	5.0	5.3	5.2	5.9	6.4	6.7	NA
OBC	5.3	5.6	5.7	6.1	6.6	6.9	7.0	7.1
PNB	4.4	4.4	4.4	4.5	5.5	5.6	5.6	5.6
State Bank of India	4.5	4.5	4.6	4.8	5.4	5.5	5.6	5.6
Union Bank	4.8	5.0	5.1	5.2	5.4	6.0	6.0	5.8

Source:Companies, Kotak Institutional Equities.

Exhibit 9: Mixed trend in loan growth across banks
yoy growth in loans (%)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Public banks								
Andhra Bank	20.4	23.6	23.5	25.6	27.1	29.2	22.4	22.4
Bank of Baroda	37.5	45.0	46.8	39.6	27.5	27.1	23.0	27.6
Canara Bank	34.2	26.8	28.6	24.0	18.0	15.5	9.2	8.6
Corporation Bank	37.4	38.5	30.7	25.0	17.5	16.6	19.4	30.8
Indian Bank	23.1	29.0	26.2	28.4	22.0	20.6	33.6	36.4
IOB	38.9	40.3	38.9	38.9	28.3	24.8	23.9	27.4
OBC	32.5	28.7	25.0	35.2	23.8	21.3	23.5	21.9
PNB	37.4	28.9	30.4	29.4	23.3	23.2	15.8	23.7
State Bank of India	23.1	18.8	28.0	28.9	29.4	26.7	26.1	23.6
Union Bank	34.1	29.4	15.0	16.5	14.2	11.6	27.4	19.2
Old private banks								
Federal Bank	NA	NA	29.5	26.9	22.9	23.5	28.2	26.9
New private banks								
Axis Bank	64.9	58.2	65.6	65.3	59.8	53.5	50.4	61.8
HDFC Bank	47.7	34.9	32.8	33.9	32.7	45.6	48.7	35.1
ICICI Bank	50.3	45.1	40.9	34.0	34.7	33.3	24.7	15.2

Source: Companies.

Exhibit 10: CASA ratio has stabilized and even improved for some banks in the 4QFY08
yoy deposit growth and CASA ratio of banks (%)

	Deposit growth								CASA ratio							
	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Public banks																
Andhra Bank	28.8	8.7	15.4	22.2	23.3	36.7	21.6	19.3	37.7	39.8	37.0	34.5	33.4	32.0	34.1	33.6
Bank of Baroda	23.1	25.0	31.0	33.4	22.7	22.0	21.9	21.7	41.2	41.7	40.4	38.7	38.8	37.5	37.3	36.0
Canara Bank	25.4	18.9	26.0	21.9	16.4	18.9	9.0	8.2	36.5	34.5	32.0	32.0	31.0	31.0	32.0	32.1
Corporation Bank	26.8	27.7	33.5	28.8	27.4	20.3	24.0	30.9	32.5	29.8	31.0	34.1	28.7	28.7	30.0	35.0
Indian Bank	14.0	16.4	NA	15.4	19.6	21.8	18.1	19.1	36.1	35.1	35.7	35.4	35.4	34.3	36.2	33.2
IOB	18.8	20.3	19.8	36.1	31.9	37.3	33.1	22.7	38.2	37.7	36.0	34.9	32.8	31.8	30.9	33.5
OBC	21.7	21.1	22.8	27.5	18.4	15.7	22.2	21.7	30.6	30.4	30.1	30.1	28.0	27.0	26.3	27.7
PNB	15.7	17.4	23.1	16.9	21.7	16.8	17.2	19.0	48.6	48.7	47.0	46.2	44.0	43.0	43.0	43.0
State Bank of India	0.4	3.3	11.2	14.6	19.0	23.3	26.2	23.4	42.7	42.6	43.3	43.6	41.1	39.5	41.1	43.0
Union Bank	21.2	14.4	9.7	15.0	13.7	20.7	28.4	29.4	33.6	33.5	34.9	34.5	33.3	32.5	33.1	34.9
Old private banks																
Federal Bank	NA	NA	12.9	20.7	13.2	31.9	25.7	20.1	25.0	NA	28.4	25.6	25.0	25.0	25.8	25.0
New private banks																
Axis Bank	35.7	43.8	49.7	46.5	45.1	30.9	34.6	49.1	35.5	40.0	37.1	39.9	37.8	45.4	45.3	45.7
HDFC Bank	58.1	39.6	30.4	22.4	34.6	43.5	48.9	47.5	52.6	52.2	54.9	57.7	51.5	52.5	50.9	54.5
ICICI Bank	60.8	57.3	47.1	39.6	26.1	20.5	16.7	6.0	21.9	22.5	23.9	21.6	22.6	25.4	27.2	26.0

Source: Companies, Kotak Institutional Equities.

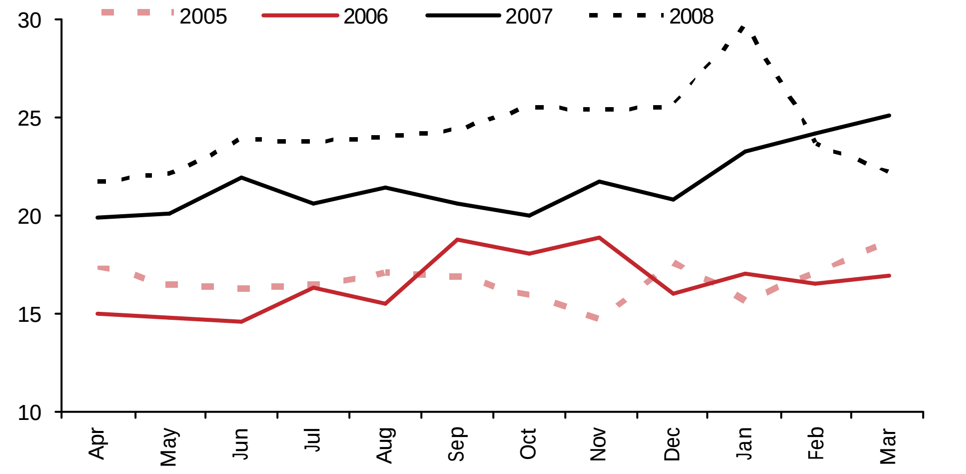
Exhibit 11: Seasonal factors driving higher deposit mobilization and advances growth in 4QFY08 compated to 3QFY08. On the positive note all banks had reduced excess SLR investments
Incremental deposits, deposits and SLR (Rs bn)

	Incremental deposits					Incremental loans					Incremental SLR and CRR requirements					Excess investments in SLR over and above loan growth				
	2007	1QFY08	3QFY08	4QFY08	2008	2007	1QFY08	3QFY08	4QFY08	2008	2007	1QFY08	3QFY08	4QFY08	2008	2007	1QFY08	3QFY08	4QFY08	2008
Public banks																				
Andhra Bank	75	(7)	(5)	55	80	57	(5)	8	32	63	27	(0)	1	18	32	(9)	(2)	(14)	5	(16)
Bank of Baroda	313	(25)	55	151	271	237	(54)	53	112	231	78	(1)	25	49	107	(3)	31	(22)	(10)	(66)
Canara Bank	256	7	(15)	103	116	191	(38)	37	79	85	64	9	2	34	59	1	36	(54)	(10)	(28)
Corporation Bank	95	9	34	62	131	60	4	18	47	92	24	5	13	20	49	11	(0)	3	(5)	(11)
Indian Bank	63	27	(4)	77	140	65	6	45	35	107	16	11	1	25	52	(12)	11	(51)	17	(20)
IOB	182	15	5	55	156	134	7	33	64	131	46	8	6	18	61	2	(0)	(33)	(27)	(36)
OBC	138	5	50	37	139	118	(3)	44	41	99	34	5	20	12	55	(15)	3	(13)	(16)	(15)
PNB	202	27	26	138	266	220	(10)	1	180	229	50	16	16	45	107	(68)	21	9	(86)	(70)
State Bank of India	555	141	260	273	1,019	757	25	315	265	795	139	66	109	89	396	(341)	51	(164)	(81)	(172)
Union Bank	111	18	44	46	187	90	1	57	16	122	28	10	19	15	73	(7)	8	(31)	15	(9)
Old private banks																				
Federal Bank	36	(7)	(8)	26	43	32	(2)	13	14	40	9	(1)	(0)	(13)	(4)	12	(4)	(20)		(17)
New private banks																				
Axis Bank	187	23	44	191	288	146	44	39	110	228	47	7	13	32	63	(6)	(28)	(8)	48	(3)
HDFC Bank	125	133	83	14	325	119	69	91	(80)	165	31	45	33	14	126	(25)	19	(41)	79	34
ICICI Bank	654	3	15	146	138	497	24	84	101	298	164	1	4	36	35	(6)	(22)	(73)	8	(194)

Source: Companies, Kotak Institutional Equities estimates.

Exhibit 12: Reduction in excess SLR investments likely aided by lower deposit growth…

yoy growth in deposits (%)



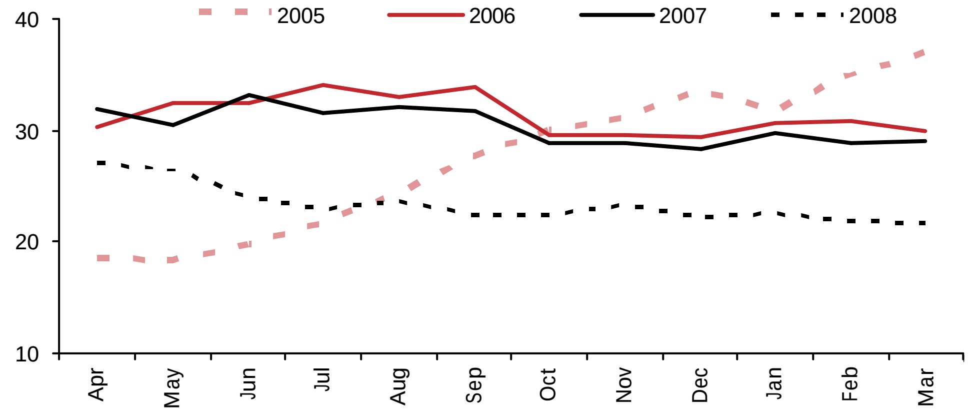
Note:

Deposit growth in January 2008 impact by IPO flows.

Source: RBI.

Exhibit 13: … while loan growth was sustained in 4QFY08

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



Note: Credit data in 2005 impacted due to IDBI-IDBI Bank merger.

Source: RBI.

Exhibit 14: Fees and recoveres both driving non interest income (ex-treasury)
yoy growth in non -interest income (ex-treasury) (%)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Public banks								
Andhra Bank	27.3	19.5	18.2	64.3	15.4	15.7	(4.9)	17.7
Bank of Baroda	47.5	28.9	29.0	28.8	8.7	30.5	40.2	12.3
Canara Bank	19.0	(12.9)	(2.1)	41.2	32.4	23.2	77.3	7.2
Corporation Bank	19.2	11.4	27.2	14.8	10.0	8.5	3.3	15.4
Indian Bank	19.7	35.6	75.2	98.9	51.4	3.0	48.3	(20.3)
IOB	18.3	35.4	(24.3)	(17.2)	27.4	(15.5)	46.5	57.6
OBC	38.3	27.3	27.5	(21.4)	12.0	0.9	4.7	(3.6)
State Bank of India	7.2	36.1	(12.3)	37.3	1.6	12.7	36.9	6.4
Union Bank	23.0	43.3	48.5	34.1	33.4	47.1	29.8	14.9
Old private banks								
Federal Bank	NA	(15.9)	(22.6)	(14.9)	NA	42.6	78.7	76.7
New private banks								
Axis Bank	60.6	65.7	58.9	58.9	47.1	54.5	78.0	77.8
HDFC Bank	47.0	51.9	32.9	17.7	47.3	15.7	38.8	16.9
ICICI Bank	41.1	52.6	72.2	30.7	47.5	42.6	28.4	32.8

Source: Companies, Kotak Institutional Equities.

Exhibit 15: Asset quality of banks continues to remain healthy. SBI and ICICI Bank reported a deterioration in asset quality, while PNB had a sharp decline in reported gross NPLs
Gross NPL, Net NPL of banks

	Gross NPLs (Rs bn)			Gross NPLs (%)		Net NPLs (Rs bn)			Net NPLs (Rs %)		
	4QFY07	3QFY08	4QFY08	4QFY07	4QFY08	4QFY07	3QFY08	4QFY08	4QFY07	3QFY08	4QFY08
Public banks											
Andhra Bank	4.0	4.2	3.7	1.4	1.1	0.5	0.5	0.5	0.2	0.2	0.2
Bank of Baroda	20.9	20.4	19.8	2.5	1.8	5.0	5.2	5.0	0.6	0.5	0.5
Canara Bank	14.9	15.2	14.2	1.5	1.3	9.3	8.8	9.0	0.9	0.9	0.8
Corporation Bank	6.2	6.0	5.8	2.1	1.5	1.4	1.1	1.3	0.5	0.3	0.3
Indian Bank	5.5	5.1	4.9	1.9	1.2	1.0	0.8	1.0	0.4	0.2	0.2
IOB	11.2	10.2	10.0	2.3	1.6	2.6	2.0	3.7	0.6	0.4	0.6
OBC	14.5	14.0	12.8	3.2	2.3	2.2	3.4	5.5	0.5	0.7	1.0
PNB	33.9	42.5	33.2	3.5	2.7	7.3	12.3	7.6	0.8	1.2	0.6
State Bank of India	100.0	106.4	128.4	2.9	3.0	52.6	56.2	74.2	1.6	1.4	1.8
Union Bank	18.7	15.6	16.6	2.9	2.2	6.1	2.6	1.3	1.0	0.4	0.2
Old private banks											
Federal Bank	4.5	4.9	4.7	3.0	2.4	0.7	0.5	0.4	0.4	0.3	0.2
New private banks											
Axis Bank	4.2	4.5	4.9	1.0	0.7	2.2	2.0	2.1	0.6	0.4	0.4
HDFC Bank	6.6	8.7	9.1	1.3	1.3	1.9	2.9	3.2	0.4	0.4	0.5
ICICI Bank	48.5	72.5	83.5	2.5	3.7	20.2	33.0	35.6	1.0	1.5	1.6

Source: Companies.

Exhibit 16: Despite margin pressure, PAT growth was strong for most banks

yoy growth in PAT (%)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
Public banks								
Andhra Bank	36.7	10.2	5.8	0.1	21.2	3.2	16.7	(10.5)
Canara Bank	2.2	18.1	1.9	2.3	26.0	11.0	26.4	(8.3)
Corporation Bank	16.8	20.3	27.2	18.1	22.8	27.1	30.4	73.7
Indian Bank	187.5	71.9	117.8	127.0	17.4	109.7	129.6	19.1
IOB	21.2	25.9	25.1	41.7	20.9	28.0	24.9	5.6
OBC	48.2	37.2	19.0	(56.2)	29.1	(24.0)	(18.0)	
PNB	2.6	19.7	16.0	(17.7)	15.7	6.6	26.0	128.8
State Bank of India	(34.7)	(2.5)	(4.5)	75.0	78.5	36.0	69.8	26.1
Union Bank	(30.6)	218.1	11.7	53.6	34.9	42.0	42.7	134.7
Old private banks								
Federal Bank	(17.5)	28.2	17.0	95.6	66.6	37.2	22.8	3.6
New private banks								
Axis Bank	30.2	30.2	40.2	39.6	45.2	60.5	66.2	70.6
HDFC Bank	30.4	31.7	31.7	30.5	34.2	40.1	45.2	37.1
ICICI Bank	17.0	30.2	42.2	4.5	25.0	32.8	35.2	39.4

Source: Companies, Kotak Institutional Equities.

Exhibit 17: Valuations of key banks, March fiscal year-ends

		Traget price	Price (Rs)	Market cap.	EPS (Rs)				PER (X)				ABVPS (Rs)				APBR (X)				RoE (%)				Dividend yield (		
	Reco.	(Rs)	(Rs)	US $bn	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E
Public banks																											
Andhra Bank	REDUCE	81	80	0.9	10.0	12.0	11.8	12.4	7.2	6.7	6.8	6.4	62	64	71	79	1.3	1.2	1.1	1.0	17.8	18.1	16.5	15.8	4.8	5.0	4.4
BoB	ADD	335	285	2.4	22.6	39.3	35.8	42.9	10.2	7.3	8.0	6.7	213	245	279	317	1.3	1.2	1.0	0.9	12.4	14.4	11.2	12.2	2.4	2.8	2.6
Canara Bank	SELL	200	225	2.2	32.8	38.2	27.5	37.5	6.5	5.9	8.2	6.0	173	177	217	251	1.3	1.3	1.0	0.9	16.3	15.0	10.4	13.0	3.1	3.6	3.1
Central Bank	SELL	85	88	0.8	2.3	13.6	10.8	15.5	5.7	6.5	8.2	5.7	52	51	62	79	1.7	1.7	1.4	1.1	18.3	18.2	12.6	16.8	3.5	2.3	0.0
Corporation Bank	ADD	375	344	1.2	31.0	51.2	44.6	55.6	9.2	6.7	7.7	6.2	244	278	313	354	1.4	1.2	1.1	1.0	15.0	18.4	14.3	15.9	2.6	3.1	2.7
Indian Bank	ADD	150	132	1.3	6.8	22.5	21.8	23.4	7.9	5.9	6.1	5.7	70	101	121	140	1.9	1.3	1.1	0.9	26.4	24.8	18.7	17.3	2.3	2.3	2.1
IOB	REDUCE	150	137	1.7	14.4	22.1	20.9	25.2	7.4	6.2	6.6	5.4	63	76	95	114	2.2	1.8	1.4	1.2	28.1	27.2	21.5	21.9	2.6	2.8	3.1
OBC	ADD	210	202	1.2	32.0	23.9	28.8	34.7	6.1	8.5	7.0	5.8	188	198	242	267	1.1	1.0	0.8	0.8	10.9	6.2	11.9	13.1	2.3	2.3	2.9
PNB	BUY	650	514	3.8	45.6	65.0	67.4	78.1	10.5	7.9	7.6	6.6	289	297	363	421	1.8	1.7	1.4	1.2	15.5	19.3	18.3	18.4	2.5	2.5	2.6
SBI	ADD	1,800	1,573	23.3	83.7	106.5	108.0	131.3	18.2	14.8	14.6	12.0	503	673	810	925	3.1	2.3	1.9	1.7	15.4	16.8	13.2	14.4	0.9	1.6	1.4
SBI incl. banking subsidiarie	ADD	1,540	1,313	19.4	105.8	157.4	134.3	160.8	11.4	8.3	9.8	8.2	664	812	979	1,118	2.0	1.6	1.3	1.2	15.5	16.6	13.4	13.4			
SBI standalone	ADD	1,273	1,046	15.5	77.7	122.1	104.6	127.6	14.0	8.6	10.0	8.2	454	632	769	884	2.3	1.7	1.4	1.2	14.6	19.1	13.5	14.6			
Union Bank	BUY	250	147	1.7	14.6	27.5	25.3	31.1	8.8	5.3	5.8	4.7	82	106	127	152	1.8	1.4	1.2	1.0	19.2	26.8	20.8	21.5	2.4	2.7	2.6
Old private banks																											
Federal Bank	BUY	310	236	0.9	24.4	34.4	31.3	35.4	6.9	6.9	7.5	6.7	161	225	248	274	1.5	1.1	1.0	0.9	21.2	13.6	13.0	13.3	1.7	1.7	2.7
J&K Bank	ADD	785	695	0.8	36.5	72.6	72.5	86.0	12.3	9.6	9.6	8.1	371	431	494	564	1.9	1.6	1.4	1.2	14.4	16.4	14.5	15.4	1.7	2.1	2.1
New private banks																											
Axis Bank	ADD	850	799	6.7	17.4	32.2	41.2	57.3	34.2	24.8	19.4	13.9	106	238	277	322	7.5	3.4	2.9	2.5	21.0	17.6	15.8	19.2	0.7	0.8	1.0
HDFC Bank	BUY	1,500	1,382	11.5	27.8	46.0	53.4	76.0	38.7	30.0	25.8	18.2	201	324	436	499	6.9	4.3	3.2	2.8	19.5	17.7	15.4	16.3	0.5	0.6	0.8
ICICI Bank	ADD	933	862	22.1	32.8	39.9	35.4	46.2	24.9	21.6	24.4	18.7	270	428	453	485	3.2	2.0	1.9	1.8	13.4	11.6	8.0	9.8	1.2	1.4	1.0
ICICI standalone	ADD	528	456	11.7	18.7	34.2	29.5	39.7	15.4	13.3	15.4	11.5	225	355	364	397	2.0	1.3	1.3	1.1	13.4	11.8	8.2	10.4			

Source: Bloomberg, Companies, Kotak Institutional Equities estimates.

Exhibit 18: Stock price performance—absolute and relative (%)

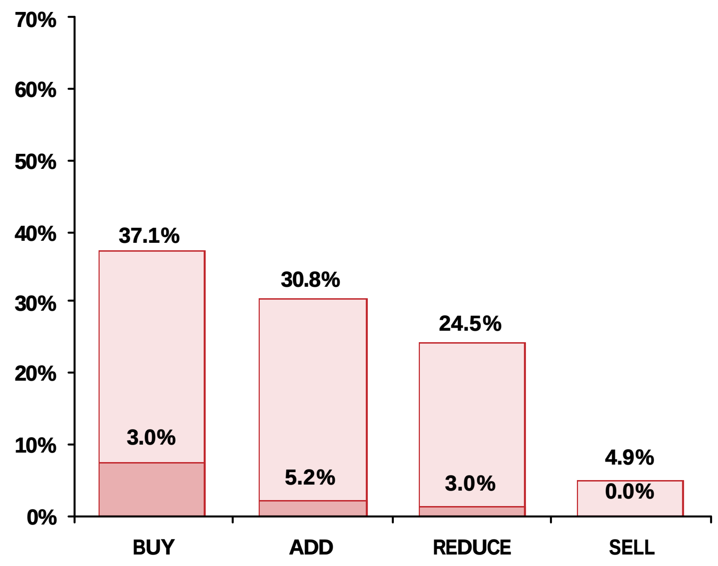
	Price		Change in price (%)					Relative performance to sensex (%)					52 week	52 week	% change
	23-May-08	Rating	1 month	3 month	6 month	12 month	Ytd	1 month	3 month	6 month	12 month	Ytd	high	low	from high
Public banks															
Andhra Bank	80	REDUCE	(2.3)	(10.4)	(19.6)	(7.3)	(24.7)	(2.0)	(6.2)	(7.1)	(20.0)	(5.8)	130	67	(38.5)
Bank of Baroda	285	ADD	(7.1)	(24.4)	(19.3)	4.6	(37.9)	(6.8)	(19.6)	(6.8)	(9.8)	(17.0)	501	227	(43.1)
Canara Bank	225	SELL	(1.9)	(18.3)	(13.5)	(14.5)	(32.1)	(1.6)	(13.8)	(1.6)	(26.2)	(12.0)	421	198	(46.6)
Corporation Bank	344	ADD	5.3	1.6	(17.5)	0.8	(20.0)	5.5	5.4	(5.2)	(13.0)	(1.8)	490	230	(29.7)
Indian Bank	132	ADD	(8.6)	(35.4)	(20.7)	2.7	(31.9)	(8.3)	(30.2)	(8.1)	NA	(11.8)	256	114	(48.3)
IOB	137	REDUCE	(4.9)	(18.4)	(3.8)	16.7	(23.5)	(4.6)	(13.8)	7.1	0.7	(4.7)	229	99	(40.3)
OBC	202	ADD	4.0	(19.2)	(19.8)	(14.6)	(27.8)	4.3	(14.5)	(7.2)	(26.3)	(8.4)	321	158	(37.1)
PNB	514	BUY	(5.3)	(11.2)	(11.6)	(8.2)	(22.6)	(5.0)	(6.9)	0.1	(20.8)	(4.0)	721	420	(28.7)
SBI	1,573	ADD	(7.2)	(25.6)	(25.9)	27.4	(29.7)	(6.9)	(20.7)	(12.7)	9.9	(10.0)	2,429	1,170	(35.2)
Union Bank	147	BUY	(9.2)	(21.9)	(12.9)	18.9	(28.7)	(8.9)	(17.2)	(1.1)	2.6	(9.1)	250	112	(41.3)
Old private banks															
Federal Bank	236	BUY	(4.7)	(19.8)	(30.0)	12.1	(29.7)	(4.4)	(15.1)	(16.4)	(3.3)	(9.9)	407	188	(42.0)
J&K Bank	695	ADD	5.8	(3.4)	(4.6)	1.9	(18.9)	6.1	0.6	6.3	(12.1)	(0.8)	1,005	570	(30.9)
New private banks															
Axis Bank	799	REDUCE	(10.9)	(17.7)	(13.7)	37.5	(17.6)	(10.6)	(13.1)	(1.8)	18.6	0.3	1,292	523	(38.1)
HDFC Bank	1,382	BUY	(4.4)	(6.3)	(11.6)	23.9	(20.1)	(4.1)	(2.2)	0.1	6.9	(1.8)	1,825	1,050	(24.3)
ICICI Bank	862	ADD	(0.3)	(21.6)	(24.3)	(6.1)	(30.4)	(0.0)	(16.9)	(11.3)	(19.0)	(10.6)	1,465	720	(41.2)

Source: Bloomberg, 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: Lokesh Garg, Aman Batra, Tabassum Inamdar, Amit Agarwal, Mridul Saggar."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



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

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

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 31/03/2008 Kotak Institutional Equities Investment Research had investment ratings on 143 equity securities.

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

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
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.

Other definitions

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

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.
NC = Not Covered. Kotak Securities does not cover this company.
RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA = Not Available or Not Applicable. The information is not available for display or is not applicable.
NM = Not Meaningful. The information is not meaningful and is therefore excluded.

Corporate Office
Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices
Kotak Mahindra (UK) Ltd.
6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc.
50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

Kotak Securities Limited and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We along with our affiliates are leading underwriter of securities and participants in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationships with a significant percentage of the companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. Investors should assume that Kotak Securities Limited and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may participate in the solicitation of such business. Our research professionals are paid in part based on the profitability of Kotak Securities Limited, which include earnings from investment banking and other business. Kotak Securities Limited generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, Kotak Securities Limited generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Kotak Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. Kotak Securities Limited does not provide tax advise to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment.

Certain transactions -including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. For the purpose of calculating whether Kotak Securities Limited and its affiliates holds beneficially owns or controls, including the right to vote for directors, 1% of more of the equity shares of the subject issuer of a research report, the holdings does not include accounts managed by Kotak Mahindra Mutual Fund.Kotak Securities Limited and its non US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition , investors in securities such as ADRs, the value of which are influenced by foreign currencies affectively assume currency risk. In addition options involve risks and are not suitable for all investors. Please ensure that you have read and understood the current derivatives risk disclosure document before entering into any derivative transactions.

This report has not been prepared by Kotak Mahindra Inc. (KMInc). However KMInc has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed. Any reference to Kotak Securities Limited shall also be deemed to mean and include Kotak Mahindra Inc.