MORNING INSIGHT

kotak Kotak Securities

PRIVATE CLIENT RESEARCH

JANUARY 2, 2009

Economy News

- India's exports declined by 9.9% in November 2008, Exports dropped to $11.5 bn in November this fiscal, from $12.7 bn a year ago while imports grew by 6.1% to $21.5 bn, leaving a monthly trade deficit of $10 bn, according to official figures released today. (BS)
- Declining food and fuel prices pushed inflation down for the eighth week in succession to 6.38% for the week ended December 20. The index of fuel items came down by 0.5% on account of decline in prices of jet fuel (ATF) by 13%, bitumen by 7%, light diesel oil by 6% and furnace oil by 3%. (BL)
- The Government is targeting an investment of Rs.1000bn in the infrastructure sector within the next two years. To bankroll the plan, the government may ask Infrastructure Investment Finance Company Ltd (IIFCL) to put together a corpus of over Rs.400bn (BS)
- In what could further delay the auction process, the Finance Ministry has asked the telecom department to double the floor price for 3G and wireless broadband spectrum, according to executives of two leading telecom companies. (ET)
- India attracted about $27 bn of foreign direct investment in the manufacturing sector in the last nine years despite liberalising rules, while China received $40 billion FDI inflows per year, a study has said. (BL)
- The Prime Minister's Office has informed the Defence Ministry that the armed forces personnel would henceforth have a separate pay commission, which is delinked from the civilian pay panel. (ET)
- India imported 3 tonnes of gold in December, down 81% from the same month a year earlier, India had imported 16 tonnes of gold in December 2007, data from the association showed. (ET)

Corporate News

- **The Leela Hotel Group** plans to launch three new hotels in 2009, its Chairman C P Krishnan Nair said, these includes The Leela, Hotel and Residences in Gurgaon (near Delhi) in January 2009 and The Leela Palace, Udaipur shortly thereafter. The Leela Palace, Chennai will open in late 2009 (BS)
- **GAIL** bought 50 million standard cubic metres of regassified-LNG from Shell to plug the gap in supplies resulting from the shutdown of Petronet LNG Ltd's Dahej terminal from January 6 to 12 at US$ 11.7 per mn British thermal unit. (FE)
- **Hindustan Construction Company** has started work on the second phase development of its hill-station destination Lavasa to triple the number of residential units, even as it plans to open ITC Fortune hotel within the project this month. (BL)
- **NMDC** has proposed setting up a 10-million-tonne integrated steel plant in Karnataka if the state government provides it adequate iron ore deposits and infrastructure support. (BL)
- **Bajaj Auto** reported 33% decline in two-wheeler sales during December 08 at 119,215 units against 177,249 units in the same month previous year. Hero Honda sold 215931 bikes in December 08 v/s 240532 units in the same month of previous year, a fall of 10% (ET)
- **Maruti Suzuki** reported 9.95% decline in sales during December 08 at 56,293 units against 62,515 units in the same month of 2007. (BL)
- **PTC India,** the country's largest electricity trading company, is diversifying into coal and looking for coal mines to buy abroad. It will set up a joint venture with Singapore-based firm Asian Infratech for identifying and acquiring companies overseas. (ET)
- Ravi Uppal, former head of global markets and member of the group executive committee of the ABB Group, has joined **Larsen & Toubro (L&T)** as the managing director and chief executive officer of L&T Power. (ET)
- Ecofin has acquired 10% stake in Hansen Transmission, which is a UK listed subsidiary of **Suzlon Energy Ltd** (CNBC TV18)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange

Equity

		% Chg		
	1 Jan 09	1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	9,903	2.7	13.3	(24.1)
NIFTY Index	3,033	2.5	14.1	(23.2)
BANKEX Index	5,585	2.4	25.9	(16.5)
BSET Index	2,313	3.8	(6.6)	(28.1)
BSETCG INDEX	7,238	4.7	20.2	(31.7)
BSEOIL INDEX	6,160	1.8	14.1	(31.1)
CNXMcap Index	3,815	2.1	18.1	(22.6)
BSESMCAP INDEX	3,810	3.5	17.2	(32.0)
World Indices				
Dow Jones	8,776	1.2	7.7	(19.0)
Nasdaq	1,577	1.7	12.8	(23.8)
FTSE	4,434	0.9	9.1	(10.6)
Nikkei	8,747	0.1	4.1	(21.3)
Hangseng	14,387	1.1	3.9	(18.7)

Value traded (Rs cr)

	1 Jan 09	% Chg - Day
Cash BSE	3,043	(17.8)
Cash NSE	7,016	(21.6)
Derivatives	22,397.0	(25.4)

Net inflows (Rs cr)

	31 Dec 08	% Chg	MTD	YTD
FII	(12)	(109)	1,319	(53,797)
Mutual Fund	257	59	(72)	13,702

FII open interest (Rs cr)

	31 Dec 08	% Chg
FII Index Futures	6,538	3.6
FII Index Options	7,536	6.1
FII Stock Futures	10,649	3.7
FII Stock Options	464	20.5

Advances / Declines (BSE)

1 Jan 09	A	B	S	Total	% total
Advances	186	1,352	339	1,877	79
Declines	14	341	80	435	18
Unchanged	-	46	10	56	2

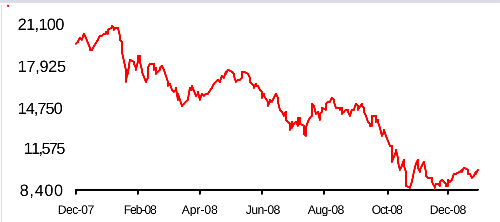
Commodity

		% Chg		
	1 Jan 09	1 Day	1 Mth	3 Mths
Crude (NYMEX) (US$/BBL)	42.6	(4.4)	(9.2)	(54.6)
Gold (US$/OZ)	879.4	0.7	11.7	4.5
Silver (US$/OZ)	11.4	3.9	16.4	2.8

Debt / forex market

	1 Jan 09	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	5.34	5.36	7.09	8.37
Re/US$	48.77	48.80	50.29	46.61

Sensex



ECONOMY UPDATE

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INFLATION: DROPPED FURTHER TO 6.38%

Lowest in last 42 weeks; Downward movement to continue

- **India's wholesale price index (WPI) dropped to 6.38% for the week ended December 20, 2008 from 6.61% for the week ended December 13, 2008, lowest in last 42 weeks.**
- **The index number of all the three categories namely - Primary articles, manufactured goods and fuel groups declined week-on-week for the week ended December 20, 2008.**
- **We expect headline Inflation (read WPI) to continue to fall at an accelerated pace before touching 2.5-3.5% levels by the end of FY09.**
- **We also expect continuation of monetary and fiscal policies. There is a likelihood of second fiscal stimulus package and further cuts in CRR, Repo as well as Reverse repo rates to provide booster to the economy.**

India's wholesale price index (WPI) dropped further to 6.38% for the week ended December 20, 2008 from 6.61% for the week ended December 13, 2008. The index number of all the three categories namely - Primary articles, manufactured goods and fuel groups declined week-on-week for the week ended December 20, 2008.

The absolute WPI declined by 5 ticks to 230.2 for the week ended December 20, 2008 as compared to 230.7 for the previous week. The reported WPI number for the week ended December 20, 2008 is lowest in last 42 weeks.

Composition of Inflation

	Weights	20/12/2008	13/12/2008	22/12/2007	YoY (%)	WoW (%)
Primary Articles	**22.0%**	**248.8**	**249.2**	**222.0**	**12.1**	**-0.16**
Food Articles	15.4%	242.6	242.9	219.5	10.5	-0.1
Food Grains (Cereals + Pulses)	5.0%	238.1	237.1	216.3	10.1	0.4
Fruits & Vegetables	2.9%	259.9	262.7	220.0	18.1	-1.1
Pulses	0.6%	264.9	266.1	233.9	13.3	-0.5
Minerals	0.5%	606.9	610.1	433.8	39.9	-0.5
Non Food Articles	6.1%	236.1	236.4	211.6	11.6	-0.1
Oil seeds	2.7%	251.5	251.9	215.8	16.5	-0.2
Fuel, Power, Light & Lubricants	**14.2%**	**330.5**	**332.1**	**332.7**	**-0.7**	**-0.48**
Mineral Oil	7.0%	392.0	395.3	400.0	-2.0	-0.8
Coal Mining	1.8%	254.4	254.4	251.9	1.0	0.0
Electricity	5.5%	276.5	276.5	272.7	1.4	0.0
Naphta	0.4%	385.0	386.3	772.2	-50.1	-0.3
ATF	0.2%	209.3	240.4	319.5	-34.5	-12.9
Manufactured Products	**63.8%**	**201.4**	**201.7**	**188.5**	**6.8**	**-0.15**
Food products	11.5%	199.6	199.3	192.1	3.9	0.2
Chemicals & chemical pdts	11.9%	220.0	220.1	206.9	6.3	0.0
Sugar, Khandsari & Gur	3.9%	169.0	168.9	151.3	11.7	0.1
Non-metallic mineral prod.	2.5%	215.6	215.9	210.3	2.5	-0.1
Basic metals, etc	8.3%	277.5	279.4	247.0	12.3	-0.7
Machinery & machine tools	8.4%	176.9	177.0	167.4	5.7	-0.1
Transport equipment, etc.	4.3%	176.5	176.5	170.6	3.5	0.0
All commodities	**100.0%**	**230.2**	**230.7**	**216.4**	**6.38**	**-0.22**

Source: MOSPI

The prices for primary articles increased 12.1% (YoY) for the week ended December 20, 2008 as compared to 12.2% in the previous week. On week-on-week basis, it declined by 0.16% to 248.8 for the week ended December 20, 2008 from 249.2 in the previous week.

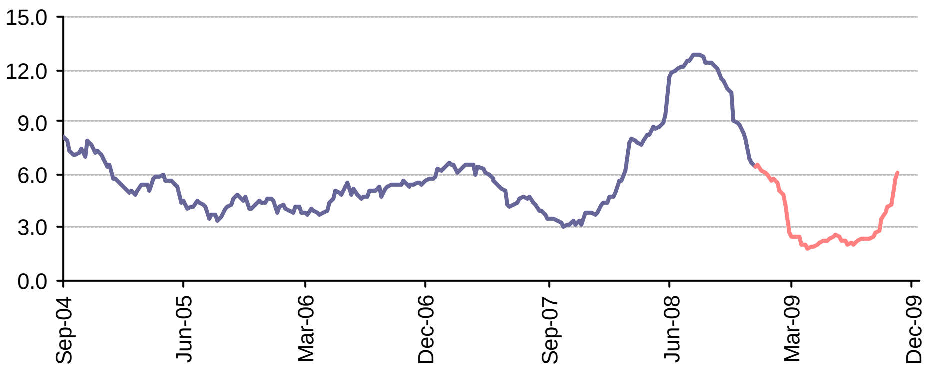
In primary articles category, food grains (0.4%) witnessed marginal increase in prices whereas fruits & vegetables (1.1%), pulses (0.5%), minerals (0.5%) and oil seeds (0.2%) etc contributed to decline in prices (W-o-W).

The index of "Fuel, Power, Light & Lubricant" category also declined (week-on-week) to 330.5 for the week ended December 20, 2008 from 332.1 in the previous week. This category has entered into a deflationary phase since last week, when its price fell 0.2% YoY (for the week ended December 13, 2008). The prices of fuel segment also declined 0.48% for the week ended December 20, 2008 on back of fall in non-administered fuel prices.

Manufacturing segment, which has a weight of 63.75% in WPI, also declined week-on-week to 201.4 for the week ended December 20, 2008 from 201.7 in the previous week. In this segment, Basic metals, Chemicals & chemical products, Textiles and Machinery & machine tools etc declined (W-o-W). Moreover, the inflation in this category was 6.8% YoY for the week ended December 20, 2008 as compared to 7.0% in the previous week.

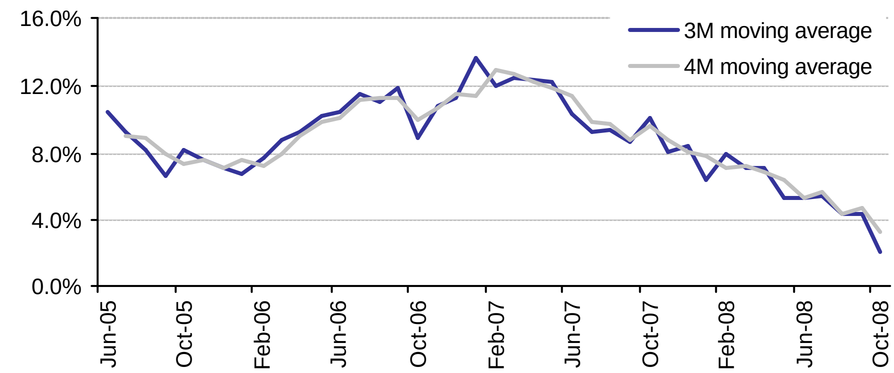
The prices in manufacturing products segment generally follow a trend over a period of time. This segment has continued to show downward movement during thirteen weeks in last fifteen weeks. Going forward, we believe inflation risk emanating from this segment would be more benign as firms are likely to cut their output prices on back of falling input costs (due to falling commodity prices) and falling demand for their products (due to economic slackening).

Trend in Inflation (%)



Source: MOSPI

3M & 4M IIP moving average



Source: MOSPI

Recent IIP (index of industrial production) numbers are already showing the aggravated slowdown in the economy. The 3-months & 4-months moving average of IIP numbers indicate the magnitude of economic slowdown. Apart from the RBI's tighter monetary policy in the past, knock down effect of global financial and credit crisis has also impacted the growth process.

We believe that we are on the downward trajectory of interest rate cycle. With the softening in international commodity prices, domestic headline inflation (read WPI) has already come down to 6.38%, lowest in the last 42 weeks. We expect WPI to continue to fall at an accelerated pace before touching 2.5-3.5% levels by the end of FY09.

Although inflation has been coming down, we are also witnessing deceleration in industrial activity particularly manufacturing and infrastructure sectors. The service sector, which was main engine of growth for last five years, is also witnessing slowdown. For the first time in seven years, exports have declined in absolute terms in the month of October and November 2008.

In response to the challenging global and domestic environment, the RBI has taken a slew of measures since mid-September 2008. Government has also announced fiscal stimulus package to revive the economic activities. There is a likelihood of second fiscal stimulus package and further cuts in CRR, Repo as well as Reverse repo rates to provide booster to the economy.

COMPANY UPDATE

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HDFC LTD

PRICE: RS.1505 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.1908 **FY09E P/E: 18.4X; P/ABV: 3.3X**

We recently interacted with the management of HDFC, following are the key takeaways

- **Mortgage finance leader with a time tested business model, however, unfavorable macroeconomic factors are likely to impact disbursement growth during the H2FY09 and FY10.**
- **Improving liquidity and macro-economic scenario is expected to be advantageous for HDFC. Moreover, measures by RBI and reduction in interest rate for customers remain positive for the company.**
- **We are tweaking our earnings estimates in the light of slower disbursement growth and downgrade the stock to ACCUMULATE (Buy earlier) with a revised price target to Rs.1908 (Rs 2061 earlier).**

Summary table

(Rs bn)	2008	2009E	2010E
Int. Income	77.8	95.2	113.9
Int. expenses	51.4	64.0	79.5
NII	26.4	31.2	34.5
Non-Int Income	10.5	4.5	7.3
Total Income	36.89	35.68	41.74
Optg Profit	34.1	32.5	38.3
PAT	24.4	23.5	27.7
GNPA - 6 mths(%)	0.7	1.0	1.0
NNPA (%)	0.4	0.4	0.4
NIMs (%)	3.7	3.4	3.0
RoA (%)	338.7	257.6	243.1
RoE (%)	2784	1861	1926
Divi. Payout (%)	28.0	35.5	30.2
EPS (Rs)	85.8	81.8	96.1
BV (Rs)	420.6	463.4	534.5
Adj. BV (Rs)	411.5	451.8	519.9
P/E (x)	17.5	18.4	15.7
P/ABV (x)	3.7	3.3	2.9

Source: Company, Kotak Securities - Private Client Research

Disbursements likely to be impacted primarily by unfavorable macroeconomic conditions

Of late retail demand for real estate has slowed down significantly, is largely on the back of a combined effect of high real estate prices and higher interest rate. This has impacted the real estate affordability for the retail consumers. Correction in property prices would be essential to boost real estate demand going forward. We opine that HDFC's business growth will be impacted more by the present unfavorable macro-economic conditions - then the competition with real estate

We also believe that HDFC's disbursement growth is likely to slow down during H2FY09 and FY10 moreover due to present unfavorable macro-economic conditions. We expect a loan book growth of 23% in FY09 to Rs 898bn and 20% in FY10 to Rs 1078bn.

RBI's refinance package for National Housing Bank (NHB)

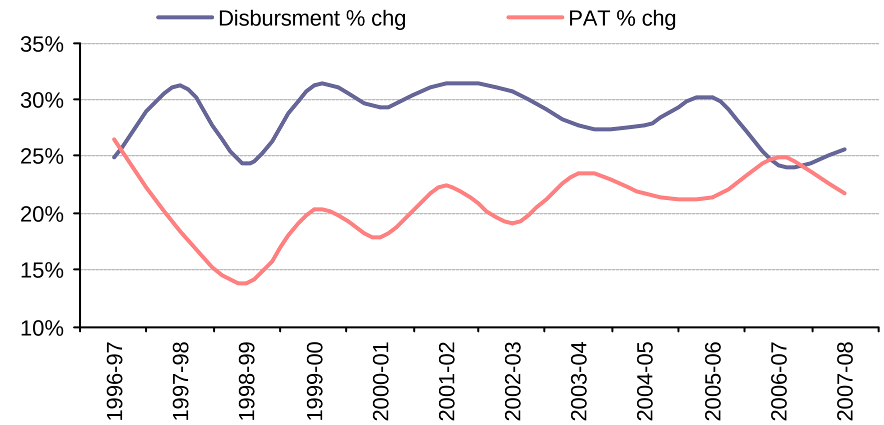
RBI has announced refinancing facility for NHB amounting Rs 40,000mn for housing finance companies. The proposal details are still awaited. However, we are of the view that HDFC, being a leading player in the housing finance segment would also benefit from refinancing package. The priority housing loan segment, ie upto Rs 20 lacs loans comprise of approximately 40% of HDFC's loan book. HDFC's average ticket size is Rs 15lacs, with an average tenure of 13 yrs.

Time-tested business model

HDFC is a well diversified financial service conglomerate, with its presence in mortgage finance, insurance, asset management. It is a leader in mortgaged finance segment and holds significant market share. Historically HDFC has maintained consistency in its earnings growth and has sailed through difficult operating conditions. Its sound and efficient management system has helped in mitigating risk, containing defaults and maintaining impeccable asset quality.

We believe that HDFC would be able to maintain its earnings and business growth consistency and would be on early beneficiary of easing liquidity conditions and improving macroeconomic environment.

Disbursement



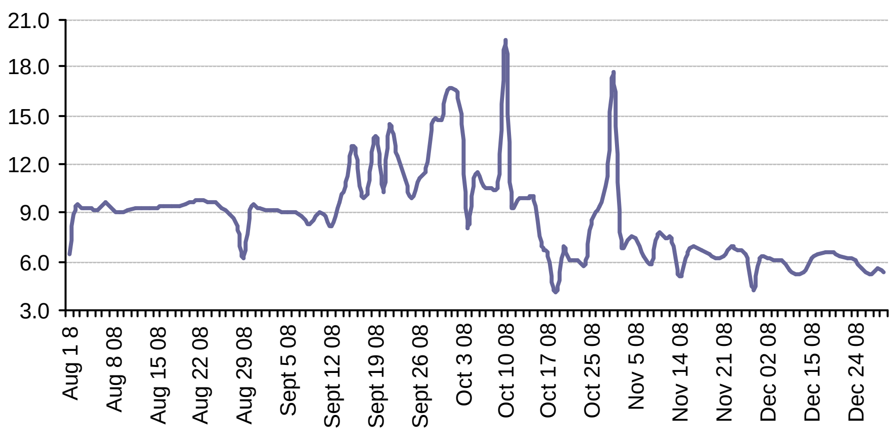
Source: Company

Better liquidity conditions has improved accessibility to funds

The short term call money rate has corrected significantly over the recent past, which is an indicative of easing liquidity in the system and easy access to money at relatively fair interest cost.

HDFC is raising NCD worth Rs 10,000mn at the rate of 9.9%, which is relatively at a lower rate as compared to Rs 8,000mn raised at 11.95%. This is an indicative of cost of funds easing out over the period. Further easing of liquidity would facilitate fund availability at competitive rate of interest. We expect HDFC to maintain spread at over 2%.

Call money rate (%)



Source: Company

Strong asset liability management system

Efficient Asset Liability management system has also helped HDFC in consistently maintaining its spreads. Effective risk management systems have helped to mitigate risks arising from fund management and asset quality deterioration.

NHB Revised guideline for Capital Adequacy Ratio (CAR) to improve CAR by 1%

National Housing Bank (NHB) has revised HFC's risk weightage, which will be based on their loan-to-value (LTV) ratio.

- Housing loans up to Rs 30 lakh with an LTV ratio of less than 75%, the risk weightage stands unchanged at 50%.
- For loans above Rs 30 lakh and with an LTV ratio of less than 75%, the risk weightage will be 75%.
- The risk weightage loan sanctioned with an LTV ratio of more than 75% has been increased from 50% to 100%.

The revised risk weight norm has raised the minimum limit from Rs 20 lakh to Rs.30 lakh, and has also reduced the max risk weight limit from 150% to 100%.

HDFC's average LTV is at 65% which is below the prescribed limit. Secondly, ~40% of the total outstanding loan portfolio is below Rs 20 lakh limit. Hence, in the backdrop of revised guideline, HDFC's capital adequacy would expand by 1% (15.2% in Q2FY09).

Interest rates reduced

HDFC has reduced its retail prime lending rate by 50 bps to 14.5 %. The same will be effective for all existing customers as 93% of the loan portfolio is on floating rate basis. Meanwhile the fixed housing loan rate remains at 14% only. HDFC also introduced interest rate discounts to new customer with loan requirement of below Rs 20 lacs at 10.25%. Meanwhile interest rate for customers with loan requirement more than Rs 20 lacs remains at 11.25%. The reduction in interest rate has comes on the back of re-pricing of debt. Meanwhile it has also reduced the retail deposit rates by 50 bps.

Reduction in interest rates (for both existing and news customers) would help HDFC compete with PSU Banks post announcement of special package for priority housing loans (Rs 5 lacs at 8.5% and Rs 20 lacs at 9.5%). Given the fact that the PSU Banks account for close to 20% of the total housing loan market share, which we believe is less likely to change the mortgage finance industry dynamics. Hence, we opine that HDFC would continue to remain the market leader in the housing finance segment.

Valuation and Recommendation

HDFC is diversified financial service company, holds investment in Insurance Asset Management, Bank etc, which add significant value to the company. We value HDFC on sum-of-the-part (SoTP) valuation method, while valuing the core business (on dividend discount model) at Rs 1265, which is 2.8x P/ABV of FY09. We ascribe a 25% holding company discount to HDFC's investment in its subsidiaries and associates.

We recommend ACCUMULATE on HDFC with a price target of Rs.1908

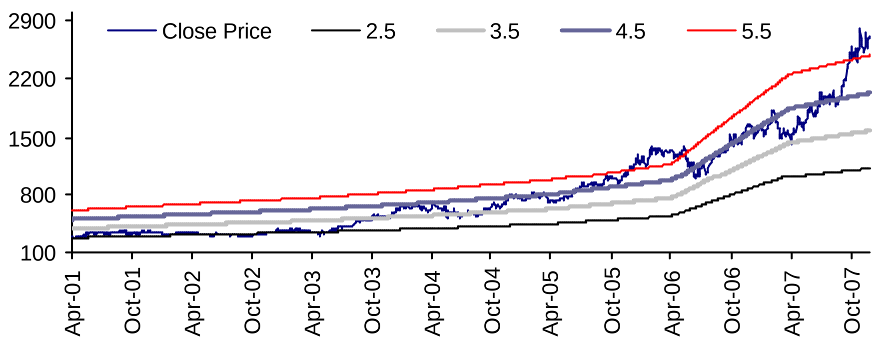
At the current price the stock trades at P/ABV of 3.3x and 2.9x for FY09 and FY10 respectively. In the backdrop of slower disbursement growth, we have tweaked our earnings estimate and lowered our price target. We are downgrding our stock recommendation from BUY to **ACCUMULATE**. recommendation for HDFC with a revised price target of Rs, 1908 (Rs. 2061 earlier).

Sum of the parts Valuation (SoTP)

	% Holding	Per share value	Valuation basis
HDFC Bank	23	391	Valued at 3.0x FY10E ABV
HDFC Standard Life Insurance	72	349	Valued at DCF
HDFC AMC	60	63	Value at 6% of AUM
HDFC Ergo General Insurance	74	33	Valued at the recent deal price
Gruh Finance	62	8	Value at CMP Rs 110
HDFC Real Venture Capital	100	13	Valued at DCF
Value of Subsidiaries		**857**	
Less: Holding company discount	**25**	**214**	
Net value of Subsidiaries		643	
HDFC Ltd		1265	
Total Value of HDFC Ltd		**1908**	
CMP (Rs)		1503	

Source: Kotak Securities - Private Client Research

PE Band



Source: Capitaline, Kotak Securities - Private Client Research

Bulk Deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
1-Jan	Aarey Drugs	Shah Jipal Pineshkumar	B	27,100	18.45
1-Jan	Allied Comp	Rajeev Mimani	B	100,000	0.56
1-Jan	Axon Infotec	BDS Share Brokers Ltd	B	4,001	10.64
1-Jan	Bang	Maruti Securities Ltd	B	96,486	154.49
1-Jan	Bang	Kundan Leasing and Finvest Private Ltd	S	83,500	154.70
1-Jan	Ceekay Diaki	Shilpa Ketan Shah	S	23,488	32.30
1-Jan	FGP Limited	Mega Resources Ltd	S	104,406	1.34
1-Jan	First Win	Vipul Pannalal Shah	S	107,850	21.05
1-Jan	Guj.Toolroom	Devang Jayantkumar Gadoya	B	20,000	11.85
1-Jan	Kohinorfoods	Temptation Foods Ltd	B	200,000	89.00
1-Jan	Pyramid Saim	Latin Manharlal Sec Pvt Ltd	B	211,323	41.69
1-Jan	Pyramid Saim	BP Fintrade Private Ltd	B	438,286	41.27
1-Jan	Pyramid Saim	BP Fintrade Private Ltd	S	422,892	41.22
1-Jan	Sanguine Md	Khaitan Weaving Mills Ltd	S	103,723	6.19
1-Jan	Tokyo Financ	Mayurkdesai	B	34,900	3.25

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
Reliance Com	246	8.2	6.2	11.7
ONGC	685	2.7	6.1	1.2
Reliance Ind	1,255	1.8	5.6	2.9
Losers				
BPCL	360	(4.3)	(0.9)	1.0
Sun Pharma	1,056	(0.8)	(0.3)	0.1
Ranbaxy Labs	250	(0.9)	(0.1)	1.3

Source: Bloomberg

Forthcoming events

Company/Market

Date	Event
8 Jan	Mastek earnings expected
10 Jan	Satyam Computer to consider buy-back of its shares
13 Jan	Infosys Earnings expected

Source: Bloomberg

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