kotak® Institutional Equities

INDIA DAILY

October 03, 2007

EQUITY MARKETS

		Change, %		
India	**1-Oct**	**1-day**	**1-mo**	**3-mo**
Sensex	17,329	0.2	13.1	18.2
Nifty	5,069	0.9	13.6	17.5
Global/Regional indices				
Dow Jones	14,047	(0.3)	5.2	3.5
Nasdaq Composite	2,747	0.2	5.8	3.9
FTSE	6,500	(0.1)	2.9	(2.1)
Nikkie	17,055	0.1	3.2	(6.0)
Hang Seng	28,174	(0.1)	17.9	27.2
KOSPI	2,014	2.6	7.0	11.6

Value traded - India

			Moving avg, Rs bn	
	1-Oct		**1-mo**	**3-mo**
Cash (NSE+BSE)	242.8		156.5	161.9
Derivatives (NSE)	614.5		450.1	354.6
Deri. open interest	785.6		646.6	612.4

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Forex/money market

		Change, basis points		
	1-Oct	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.9	-	(95)	(64)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	3	2	(18)

Net investment (US$mn)

	28-Sep		**MTD**	**CYTD**
FIIs	856		-	9,663
MFs	23		-	747

Top movers -3mo basis

		Change, %		
Best performers	**1-Oct**	**1-day**	**1-mo**	**3-mo**
Reliance Energy	1,349	11.9	73.7	119.7
Neyveli Lignite	108	2.5	29.0	71.3
Reliance Cap	1,809	14.1	47.0	60.5
Chambal Fert	58	-	16.2	60.0
SAIL	206	(0.6)	23.8	58.2
Worst performers				
i-Flex	1,884	(0.3)	(6.8)	(27.2)
Polaris	121	(1.5)	1.4	(20.9)
Punjab Tractors	245	(0.4)	3.6	(14.5)
Pfizer	710	(0.8)	3.2	(14.0)
HCL Tech	295	(1.7)	(5.0)	(12.0)

News Roundup

Corporate

- The world’s largest coffee chain, Starbucks, and PepsiCo have signed a deal to sell Starbucks ready-to-drink beverages in international markets, including those countries that do not have Starbucks outlets such as India. (ET)
- The UK-based Cobra Beer is all set to make operational two of its greefield units in India by the end of 2QFY08. (BL)
- ICICI Bank Ltd, India’s biggest private lender, plans to raise US$11 bn overseas in the next 12 months to fund its expansion abroad and credit growth in the country. (FE)
- India's leading corporate house, the Tata group, is looking to expand its presence in the UK through the inorganic growth route, including in new areas such as leather footwear, after its successful takeover of the steel giant Corus earlier in 2007. (FE)
- A number of foreign investors are in talks for picking up a sgifnicant stake in Tata group's tea plantation business in India spanning across 24 tea gardens in Assam and West Bengal. (FE)

Economic and political

- The government-owned GAIL India, the country’s largest transporter and marketer of gas, plans to set up a mega US$2.3 bn petrochemical plant in Iran.(BS)
- The shipping ministry plans to set up five deep-sea ports in the country during the 11th Five year Plan, at an expected investment of Rs1 tn. (BS)
- Singapore has agreed to allow the State Bank of India nad ICICI Bank to launch full banking operations in the South-East Asian coutnry, under the Comprehensive Economic Cooperation Agreement (CECA) with India. (BS)

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

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Technology

Sector coverage view			Neutral

		Price, Rs	
Company	**Rating**	**1-Oct**	**Target**
TCS	L	1,039	1,300
Wipro	OP	454	560
Infosys	OP	1,893	2,250
Satyam Comp	OP	443	570
HCL Tech	L	295	360
i-flex solutions	U	1,884	1,675
Patni	L	460	450
Hexaware	L	123	140
Polaris Softwa	U	121	110
Tech Mahindra	L	1,305	1,500
Mphasis BFL	L	280	300
iGate Global	U	223	260
MindTree	U	506	550

Risk:Reward still favors tier-I players

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- **Valuations-risk-return in favor of tier-1 names**
- **Sep '07 quarter-strong fundamentals should ensure a solid quarter**
- **However, the focus would be on Dec '07/ FY2008 guidance and demand outlook**
- **Rupee appreciation the key risk-hedging critical to near-term earnings growth**

We expect another quarter of robust performance from the tier-1 names in the Sep '07 quarter. However, we focus on Dec '07 quarter guidance and demand outlook amidst concerns regarding a potential economic recession in the US. We believe the risk:reward ratio remains favorable for Tier 1 IT names in various rupee/US$ and US recession scenarios. Satyam, Infosys and Wipro remain our top picks in the sector. However, we remain concerned about mid-cap names and recommend staying away from them despite significant correction in these stocks in the past six months.

Valuations-risk-return in favor of tier-1 names

Not discounting the twin challenges of a potential US slowdown (and its impact on Indian IT industry) and sustained rupee appreciation, we remain positive on the sector noting that the core business metrics (ex-currency) remain buoyant. However, we favor tier-1 companies over the mid-size companies as they are better placed to weather the challenges and maintain a robust earnings growth profile, in our view.

Sep '07 quarter-strong fundamentals should ensure a solid quarter

We expect another quarter of robust revenue growth for the frontline companies led by volume growth (7-8%) as well as pricing improvements. Infosys and Satyam will likely lead the sector in revenue growth (8-9% US$ terms qoq). We expect OPM to improve for companies that effected wage increases in the June quarter (TCS, Infosys), while expect a decline for companies that effect hikes in the Sep quarter (Satyam, HCLT).

However, the focus would be on Dec '07/ FY2008 guidance and demand outlook

We expect a strong (in-line or better-than historical average) revenue growth guidance from Infosys, Satyam, as well as Wipro. We also expect to see Satyam and Infosys increase their FY2008 revenue growth guidance by 1-3%. However, the key focus would likely be the commentary on demand outlook for FY2009, though we maintain that it might be too early to take a call on CY2008 IT budgets.

Rupee appreciation the key risk-hedging critical to near-term earnings growth

Sustained rupee appreciation remains the key risk to the earnings growth of Indian IT companies, in our view. We believe that the extent of hedging will be critical to earnings growth over the next two years. We find TCS and HCLT well-placed with hedges covering four and eight quarters of net receivables, respectively.

Property

DLF.BO, Rs767	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	750
52W High -Low (Rs)	788 - 506
Market Cap (Rs bn)	1,307

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	39.2	128.4	167.2
Net Profit (Rs bn)	19.4	62.0	87.0
EPS (Rs)	12.7	36.3	51.0
EPS gth	*25.1*	*186.2*	*40.4*
P/E (x)	60.4	21.1	15.0
EV/EBITDA (x)	50.0	16.8	12.1
Div yield (%)	-	0.7	0.9

DLF Limited: Wins large township near Bangalore

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- **DLF gets permission to develop 9,178-acre township at Bidadi, a suburb of Bangalore**
- **We estimate NAV accretion of Rs20/share**

As per press reports, the Karnataka government has granted DLF permission to develop a 9,178 acre integrated township at Bidadi, a suburb of Bangalore. DLF intends to develop this township in a 50:50 JV with Nakheel. We estimate NAV accretion of Rs20/share from this project based on our assumptions for development. Currently, we do not factor the township into our estimates and will do the same after getting more clarity on development schedule and plans. DLF by winning this township has shown that it can continuously bolster its NAV and we retain our Outperform rating.

Bidadi township is amongst largest planned townships in India

Bidadi township will be spread over 9,178 acres and is planned to come up as a knowledge city. The project has been awarded to DLF, following a global tender issued by the Bangalore Metropolitan Regional Development Authority (BMRDA). This township when fully occupied is expected to have a population of more than 0.7 mn. Key details of the project are as below:

Location: The township is going to be located at a distance of 35 km from Bangalore along the Bangalore-Mysore highway.

Development plan: Developable area for this mixed-use township is going to be approximately 6,000 acres with balance being open areas and green spaces. Land use plan for the township is residential (25%), retail (5%), industrial (20%), utilities (10%), parks (15%) and transport facilities (25%).

Connectivity: Nearest railway station is going to be Bidadi. BMRDA is also considering a dedicated metro rail project to connect the township with Bangalore.

Land acquisition: The government is going to aid DLF in acquiring land from private parties. A certain portion of the land has been acquired that will be transferred to the JV. The JV is required to deposit Rs5.8 mn/acre as development charges with Bangalore Development Authority.

We estimate NAV accretion for DLF at Rs20/share

We assume an FSI of 1.5 for residential and 1 for industrial/retail development. This results in developable area of 98 mn sq. ft for residential and 65 mn sq. ft for industrial/retail development. Since this is a large project, we estimate a development timeframe of 10 years for this project. Our NAV for DLF's share of this project comes out to be Rs36 bn or Rs20/share. (Exhibit 1). However, we are not incorporating the project into our estimates and will do the same after getting more clarity on development schedule and plans.

Bidadi township win highlights DLF's ability to execute large-scale townships

DLF has formed a large number of JVs for forward as well as backward integration that will assist in development of townships. In order to have better control on execution, DLF has formed JVs with Laing O'Rourke (construction), Feedback Ventures (project management) and WSP Group plc (for architectural and engineering designs). DLF has formed JVs with Fortis (Healthcare) and Hilton (Hotels) and is in the process of tying up with educational institutions. We note that DLF's JV with Nakheel group has also started land acquisition for large 20,000-acre townships at Gurgaon and Goa.

We retain outperform rating on the company

Having clinched the Bidadi township order, DLF has shown that it can continuously bolster its NAV and sustain its Outperform rating. Our DLF NAV estimate is Rs646/share and our target price of Rs750 is based on a 15% premium to NAV. We assign a 15% premium on NAV on account of several factors (i) NAV accretion possible on account of large ticket projects, (ii) yield compression on its commercial assets, (iii) value accretion from joint ventures.

We estimate Bidadi's township to result in NAV accretion of Rs36 bn for DLF

		Total development	
	FSI	Acres	mn sq. ft
Residential	1.5	1,500	98
Industrial, Retail	1	1,500	65

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Residential										
Volume (mn sq. ft)	3.0	4.0	5.0	7.0	9.0	11.0	13.0	15.0	15.0	15.0
Selling price/sq. ft	2,700	2,835	2,977	3,126	3,282	3,446	3,618	3,799	3,989	4,189
Construction cost/sq. ft	1,200	1,260	1,323	1,389	1,459	1,532	1,608	1,689	1,773	1,862
Sales (Rs bn)	8	11	15	22	30	38	47	57	60	63
Cost (Rs bn)	4	5	7	10	13	17	21	25	27	28
Taxes (Rs bn)	1.1	1.6	2.1	3.0	4.1	5.3	6.5	7.9	8.3	8.7
Industrial/Retail										
Volume (mn sq. ft)	1.5	2.0	2.5	3.3	4.3	5.6	7.2	9.4	12.2	15.9
Selling price/sq. ft	4,200	4,410	4,631	4,862	5,105	5,360	5,628	5,910	6,205	6,516
Construction cost/sq. ft	2,000	2,100	2,205	2,315	2,431	2,553	2,680	2,814	2,955	3,103
Sales (Rs bn)	6	9	12	16	22	30	41	56	76	104
Cost (Rs bn)	3	4	6	8	10	14	19	26	36	49
Taxes (Rs bn)	0.8	1.1	1.5	2.1	2.9	3.9	5.3	7.3	9.9	13.6

NAV (Rs bn)	122
Land Payments (Rs bn)	50
NAV (Rs bn)	72
DLF's share (Rs bn)	36

Source: Kotak Institutional Eqities estimates.

	March '09 based NAV			
	Growth rate in selling prices			
	0%	3%	5%	10%
Valuation of land reserves	**767**	**946**	**1,084**	**1,505**
Residential projects	268	357	427	652
Commercial projects	266	306	335	416
Retail projects	233	284	322	437
Add: 22 Hotel sites	25	25	25	25
Add: Construction JV	20	20	20	20
Add: Other properties (plots in Gurgaon - 7.2 mn sq. ft, hotel site in Gurgaon)	22	22	22	22
Add: Investments as on March 31, 2008	20	20	20	20
Less: Net debt as on March 31, 2008	(28)	(28)	(28)	(28)
Less: Land cost to be paid as on March 31, 2008	(30)	(30)	(30)	(30)
NAV	**795**	**975**	**1,112**	**1,533**
Total no. of shares including ESOPs of 17 mn shares (mn)				1,722
NAV/share (Rs)				**646**

Media

SUTV.BO, Rs336	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	310
52W High -Low (Rs)	462 - 264
Market Cap (Rs bn)	132.4

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	6.8	9.5	12.2
Net Profit (Rs bn)	2.5	3.9	5.3
EPS (Rs)	6.3	10.0	13.4
EPS gth	*20.8*	*57.4*	*34.6*
P/E (x)	53.0	33.7	25.0
EV/EBITDA (x)	29.6	18.6	13.7
Div yield (%)	0.5	0.7	1.1

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	93.0	-	-
FIIs	4.4	0.0	(0.1)
MFs	0.9	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Sun TV Network: Competition makes strong entry in Tamil broadcasting market

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- **Kalaignar TV garners impressive TRP ratings in the first full week of operation**
- **Recent developments in key markets not good for Sun TV**
- **We retain our U rating and 12-month DCF-based target price of Rs310**

As per TAM TRP ratings data for the most recent week, Kalaignar TV channel has made an impressive entry into the Tamil broadcasting market, a stronghold of Sun TV Network for many years. Additionally, recent developments in the Tamil broadcasting and TV distribution market further highlight the risks to Sun's high market share and resultant profitability. We see increasing risks to our assumptions of Sun's revenues and profitability from (1) strong competition across South-Indian regional language markets, (2) proposed cable TV network by Tamil Nadu government, (3) opposition to Sun TV by other cable networks and last-mile operators and (4) increasing cost of programming and film telecast rights. We retain our U rating on Sun TV Network stock and 12-month target price of Rs310. Key upside risks stem from higher-than-expect ad and subscription revenues.

Kalaignar TV—strong opening. Kalaignar TV reported solid ratings in its first week of operation. It was in the second position in the afternoon band, behind Sun TV but ahead of Sun's movie channel KTV and in the third position in the primetime band (see Exhibits 1 & 2) behind Sun's Sun TV and KTV. The impressive performance of the channel reflects the telecast of hit Tamil movies in the first few days of operations. Sun TV held its top position in the Tamil market but saw moderate erosion in its primetime ratings for the week. We would like to see Kalaignar TV's performance in subsequent weeks but find it hard to believe that Sun's ratings would not be impacted given Kalaignar's impressive credentials. According to media reports, Kalaignar TV channel has over 300 movies in its portfolio (including three biggest Tamil hits) and has roped in experienced production houses for programming content.

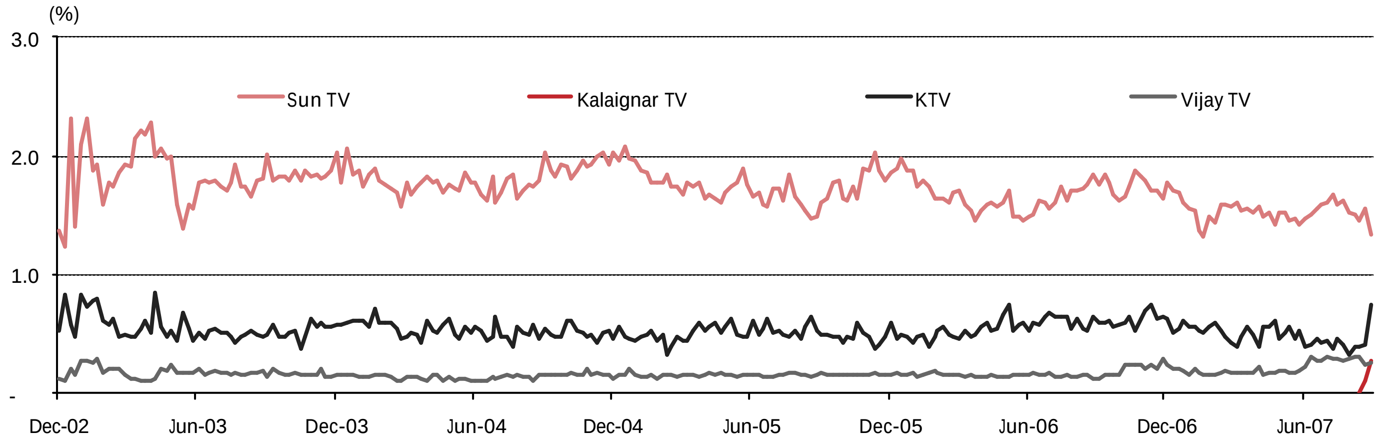
Developments in Tamil broadcasting and distribution markets may have potentially negative ramifications for Sun TV Network. We see potential risks to Sun TV Network's high market share and resultant high profitability from the entry of new channels, even as extant channels have renewed their investment in programming and distribution. Exhibit 3 lists the extant and new regional language channels that will start operations over the next few months. The Tamil Nadu government plans to start a cable distribution in the state, which should also benefit other broadcasters. We note that Sumangli Cable Vision, the leading multi-system operator in the state of Tamil Nadu, is an affiliate of Sun TV Network.

The launch of Sun Direct (the DTH arm of Sun TV group), which would have had a positive impact on Sun TV Network's subscription revenues, has also been mired in controversy. The local cable network operators in Tamil Nadu are not happy with its proposed pricing strategy and believe it is a move to undercut them. They have threatened to boycott Sun TV Network's channels and stop payment of pay-TV revenues to Sun TV. A local cable operator has also filed a PIL against the license granted to Sun TV group promoter to provide DTH services arguing that extant regulations prevent a broadcasting company from holding more that 20% stake in a cable services provider and vice versa.

However, this may not be legally tenable as Sun TV Network does not own any stake in Sun Direct. Nonetheless, it would be interesting to see how the courts and the government respond to this since the ultimate ownership of both cable and DTH distribution platforms and of broadcasting reside in a group of persons/companies in Sun's case; this is true for the Zee group too.

Sun TV leads in primetime TRP ratings by a wide margin; Kaliagnar TV enters at third position

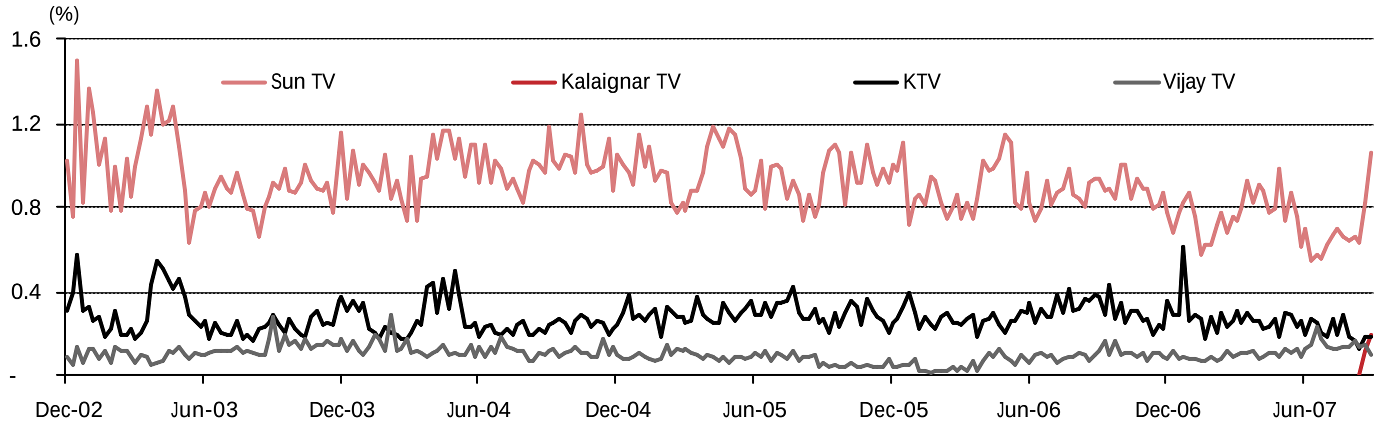
Prime-time (7:30-11:30 PM) ratings of major Tamil channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Kalaignar TV ahead of Sun's KTV in afternoon TRP ratings due to its solid movie portfolio

Afternoon (2:00-5:30 PM) ratings of major Tamil channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

32 new regional language channels will start operations over the next few months

List of extant and proposed regional language channels

	Tamil	Telugu	Marathi	Kannada	Malayalam	Punjabi	Bengali	Gujarati
Existing								
	Aasirvatham	DD8 Saptagiri	DD10 Sahyadri	DD9 Chandana	Amrita TV	Balle Balle	24 Ghanta TV	DD11 Gujarati
	Brindavan TV	Eenadu TV	ETV Marathi	ETV Kannada	Asianet	DD Punjabi	Aakaash Bangla	ETV Gujarati
	Chutti TV	ETV2 News	Star Majha	Kasturi TV	Asianet News	ETC Punjabi	Atn Bangla	Gurjari
	DD5 Podhigai	Gemini Music	Mi Marathi	Suvarna	Asianet Plus	Lashkara TV	Bangla Akhon	Zee Gujarati
	Imayam	Gemini News	Star Majaa	TV9 Karnataka	Asianet Interactiv	NRI TV	BTV World	
	Jaya TV	Gemini TV	Zee 24 Taas	U2	DD4 Malayalam	PBC TV	DD7 Bangla	
	Kalaignar TV	Maa Telugu	Zee Marathi	Udaya Movies	Indiavision	PTC News	ETV Bangla	
	KTV	Manna Telugu	Zee Talkies	Udaya TV	Jeevan TV	Punjab News	Kolkata TV	
	Makkal TV	Sanskriti		Udaya Varthegalu	Kairali	Punjab Today	NTV	
	Raj Digital Plus	Siti Telugu		Ushe TV	Kiran TV	Punjab TV	Sangeet Bangla	
	Raj Musix	Teja TV			Manorama News	Zee Punjabi	Star Ananda	
	Raj TV	TV9 News			People TV		Tara Muzik	
	Sun Music	Vissa			Surya TV		Tara Newz	
	Sun News	Zee Telugu					Zee Bangla	
	Sun TV							
	Vijay TV							
	Win TV							
Total existing channels	**17**	**14**	**8**	**11**	**13**	**11**	**14**	**4**
Proposed								
	Asianet	Asianet	Asianet	Sun Kids	Jaihind TV	Gurbani	INX Group	INX Group
	Kalaignar TV (3)	Bhakti	IBN Lokmat	TV9 Kannada	Sun Kids	INX Group		Triveni news
	Jaya Plus	Maa TV (3)		TV9 Sanskruti				TV9 Gujrati
	Maga TV	N TV						
	Raj News	STAR-Balaji						
	Raj Youth	Sun Kids						
	Vasanth TV	TV1						
	Zee News Tamil	Subhavaartha						
Total proposed channels	**10**	**10**	**2**	**3**	**2**	**2**	**1**	**3**
Total existing and proposed	**27**	**24**	**10**	**14**	**15**	**13**	**15**	**7**

Source: Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of Sun TV for 2006 and Sun TV Network for 2007-2012E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	3,219	6,780	9,465	12,234	14,525	16,847	19,188
EBITDA	**2,035**	**3,874**	**5,977**	**8,073**	**9,951**	**11,795**	**13,617**
Other income	172	411	789	910	1,196	1,550	1,974
Interest (expense)/income	(65)	(64)	(18)	—	—	—	—
Depreciation	(147)	(294)	(525)	(630)	(515)	(436)	(381)
Amortization	—	(56)	(235)	(235)	(235)	(235)	(195)
Pretax profits	**1,995**	**3,871**	**5,989**	**8,118**	**10,398**	**12,675**	**15,015**
Tax-cash	(709)	(1,509)	(2,059)	(2,852)	(3,614)	(4,377)	(5,163)
Tax-deferred	16	108	(18)	51	38	27	17
Minority interest	—	(9)	21	(25)	(50)	(72)	(96)
Net profits after minority interests	**1,302**	**2,461**	**3,932**	**5,292**	**6,771**	**8,253**	**9,773**
Earnings per share (Rs)	**5.3**	**6.3**	**10.0**	**13.4**	**17.2**	**20.9**	**24.8**
Balance sheet (Rs mn)							
Total equity	3,071	11,932	14,714	18,277	22,628	27,930	34,210
Deferred Tax	32	(56)	(38)	(88)	(127)	(153)	(170)
Total borrowings	2,333	867	—	—	—	—	—
Currrent liabilities	741	1,693	1,633	1,766	1,845	1,930	2,023
Total capital	**6,209**	**14,478**	**16,329**	**19,999**	**24,441**	**29,874**	**36,325**
Cash	732	6,494	6,348	9,522	13,507	18,355	24,121
Current assets	2,440	3,221	5,143	6,338	7,356	8,397	9,458
Total fixed assets	2,830	3,543	2,910	2,405	2,040	1,779	1,599
Intangible assets	206	1,220	1,927	1,732	1,537	1,342	1,146
Total assets	**6,209**	**14,478**	**16,329**	**19,999**	**24,441**	**29,874**	**36,325**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	1,722	3,239	4,721	6,350	7,579	8,784	9,956
Working capital	(251)	(1,992)	(1,982)	(1,063)	(938)	(956)	(968)
Capital expenditure	(2,091)	(433)	(793)	(125)	(150)	(175)	(200)
Investments	(326)	(849)	(821)	(1,129)	(1,242)	(1,366)	(1,503)
Other income	80	402	789	910	1,196	1,550	1,974
Free cash flow	**(619)**	**814**	**1,946**	**5,161**	**6,490**	**7,654**	**8,788**
Ratios (%)							
Debt/equity	76.0	7.3	—	—	—	—	—
Net debt/equity	52.1	(47.2)	(43.1)	(52.1)	(59.7)	(65.7)	(70.5)
RoAE	36.1	32.9	29.6	32.2	33.3	32.8	31.6
RoACE	**26.6**	**26.8**	**29.9**	**33.0**	**34.1**	**33.6**	**32.3**

Source: Kotak Institutional Equities estimates.

Banking

Sector coverage view			Attractive

		Price, Rs	
Company	Rating	1-Oct	Target
SBI	L	1,894	1,450
HDFC	L	2,508	1,700
HDFC Bank	L	1,404	1,250
ICICI Bank	OP	1,058	1,000
Corp Bk	L	390	360
BoB	OP	332	330
PNB	OP	539	610
OBC	L	244	240
Canara Bk	L	283	250
LIC Housing	OP	239	240
Axis Bank	U	751	570
IOB	OP	147	150
Shriram Trans|	OP	190	200
SREI	L	115	110
MMFSL	L	240	265
Andhra	OP	104	120
IDFC	L	145	120
PFC	U	207	125
Centurion Banl	U	45	35
Federal Bank	OP	379	340
J&K Bank	OP	775	875
India Infoline	U	866	670
Indian Bank	L	160	135

Higher liquidity increases the possibility of a deposit rate cut

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- **Expect a marginal improvement in margin of banks in 2QFY08 on a sequential basis**
- **Our sensitivity analysis shows that a simultaneous cut in the lending and deposit rates may not hurt margins and profits significantly (in FY2009) given the ALM profile of banks**
- **Our top picks are PNB (OP), IOB (OP), Andhra Bank (OP), BoB (OP) and ICICI Bank (OP)**

On a sequential basis, the banking sector will likely report flat to marginally higher NIM in 2QFY08. Improvement in credit demand compared to 1QFY08, lower bulk deposit costs and removal of cap on reverse repo funds with RBI are likely reasons. We expect banks to cut deposit rates in 2H, while going slow on lending rate cuts, leading to margin improvement. Our sensitivity analysis shows that a simultaneous cut in the lending rate and the deposit rate may not hurt margins and profits significantly (in FY2009) given the ALM profile of banks. Banks with lower CASA ratio and bulk deposits will likely benefit the most. We continue to maintain a positive stance on banks given the likely improvement in the banking sector earnings, and low valuations. Our top picks are PNB (OP), IOB (OP), Andhra Bank (OP), BoB (OP) and ICICI Bank (OP).

Margins pressure likely to reduce

- In 2QFY08, the banking sector will likely report flat to marginally higher NIM qoq, though it may be lower yoy.
- We believe the following factors will positively influence margin (1) improvement in loan growth (see Exhibit 1), (2) decline in bulk deposit rates and (3) removal of cap of Rs30 bn on reverse repo funds with RBI.
- However, the net impact on margin of banks will likely be offset to some extent by (1) lower yields on Gsec portfolio (as banks are still deploying excess liquidity in Gsec), (2) increase in CRR for banking sector by 50 bps in the current quarter and (3) non-payment of interest on CRR balances by RBI. We have already seen the adverse impact of the lower yields on Gsec and non-payment of interest on CRR balances by the RBI in the 1QFY08 financial results of banks.

Deposit and lending rates at peak, enough justification to reduce deposit rate

- The pressure on RBI to increase rates has likely reduced on the back of (1) slow down in credit demand, (2) lower inflation and (3) cut in Fed Funds rate by the Federal Reserve. We, however, believe that the RBI may not rush to cut policy rates as yet, unless industrial growth deceleration continues.
- Nevertheless we expect banks to cut deposit rates in 2H of the year, in particular if credit demand remains at current levels, while the huge inflow of foreign funds continue to drive deposit growth. A cut in SLR by the RBI will likely provide greater comfort to banks to cut their deposit rates. An excessive increase in CRR may however, delay this process.
- Simultaneously, the excess liquidity will also likely put downward pressure on short-term instruments such as CP, CD, etc. We are, however, of the opinion that banks will likely retain PLR at the current level in the immediate term, unless liquidity remains high and competition for credit intensifies.
- We have provided a sensitivity analysis on NII and profits of banks under different scenarios. Our analysis shows:

1. A cut in deposit rates with stable lending rates will likely be positive for banking sector margins.

2. Most banks have a fairly balanced book and a reduction in lending rates is unlikely to adversely impact profits in a meaningful manner in FY2009. However, in FY2008 most banks may show lower NII and profit compared to our current estimates due to the lag affect in deposit repricing.

3. Banks with lower CASA ratios, e.g ICICI Bank, OBC, BoB and Federal Bank, will likely benefit due to higher bulk/term deposit component getting re-priced at lower levels.

4. Meanwhile, banks with higher CASA may show lower profits i.e HDFC Bank, SBI and PNB, as the interest reduction will likely be on a lower base.

Credit growth moderates while deposit growth remains strong

- Banking sector credit grew by a healthy 24% yoy as on August 31, 2007, but was subdued compared to the FY2006 and FY2007 growth of over 30%. We believe the deceleration in growth rate reflects the slowdown in retail credit, while corporate and agriculture demand remained strong.
- The growth in deposits has been fairly strong at 24% yoy, compared to 21% in the previous year, likely aided by huge foreign fund inflows and attractive deposit rates offered by banks.
- The incremental deposit accretion to the banking sector since 30 March 2007 has been Rs1,847 bn, while the incremental credit outflow from the sector has been Rs549 bn as on September 14, 2007.
- The excess deposits mobilized have thus been parked in government securities. Investments by banking sector in the SLR securities (including MSS securities) as proportion of deposits has increased to 30% as of September 14, 2007 up from the 28.5% witnessed in March 2007. This is against the current mandatory requirement of 25% of net demand and time liabilities.

CRR hike possible, but unlikely to impact lending or deposit rates

- RBI will likely continue to sterilize excess liquidity through MSS and even hike CRR if projected liquidity (M3 growth) moves significantly above 17-17.5% in FY2008.
- A hike in CRR by RBI, however, is unlikely to lead to either a deposit rate hike or lending rate hike as banks are carrying excess liquidity. Besides the RBI sterilization will target the excess amount over and above what is required to meet the credit demand comfortably.

Demand-supply mismatch for Government securities favors a SLR cut

We expect a mismatch between supply (lower) and demand (higher) for government securities going forward and believe this likely favors a reduction in the statutory liquidity requirement (SLR) for banks. A cut in SLR along with the increase in MSS bonds (instrument used by RBI to sterilize liquidity) will likely keep Gsec yields at the current levels. Key reasons for a possible SLR cut are:

- Improvement in the fiscal position of the government, which is targeted to come down to 6.1% of GDP by FY2009 from 7.0% of GDP as of FY2007.
- Increased savings mobilization by the insurance, provident and pension funds.
- Both of the above are leading to reduced reliance of the government on the banking sector for meeting its funding requirements.
- In our estimate, the RBI may need to cut SLR by 1% in FY2008 and 3% in FY2009. We believe the RBI may take this step only closer to end of this fiscal year.

Incremental credit and deposits of the banking system

In Rs bn

	Since March 2007		Since June 2007
	29-Jun-07	14-Sep-07	14-Sep-07
Incremental deposits	1,086	1,847	761
Incremental credit	(145)	549	694
Net excess liquidity	**1,231**	**1,298**	**67**

Source: RBI.

Impact on NII likely to be limited given improved ALM position

Comparison of NII under various scenarios with our current assumptions, March fiscal year-ends, 2008-2009E (%).

	2008			2009		
	Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
Interest rate assumption						
Deposits	50 bps fall	50 bps fall	75 bps fall	50 bps fall	50 bps fall	75 bps fall
Advances	Status quo	50 bps fall	50 bps fall	Status quo	50 bps fall	50 bps fall
Public banks						
Andhra Bank	1.4	(3.7)	(3.0)	7.7	(0.1)	3.7
BoB	1.8	(3.6)	(2.7)	9.7	1.4	6.3
Canara Bank	1.9	(4.5)	(3.5)	9.4	(0.2)	4.5
Corporation Bank	1.5	(3.9)	(3.2)	7.8	(0.5)	3.4
Indian Bank	1.1	(2.6)	(2.1)	6.4	0.2	3.4
IOB	0.9	(3.4)	(2.9)	5.7	(1.2)	1.6
OBC	2.1	(4.4)	(3.3)	10.5	0.3	5.5
PNB	0.9	(3.5)	(3.0)	4.8	(2.0)	0.4
SBI	1.0	(4.3)	(3.8)	5.7	(2.7)	0.1
Old private banks						
Federal Bank	1.7	(3.2)	(2.3)	9.2	1.7	6.2
J&K Bank	1.4	(4.2)	(3.5)	7.3	(1.1)	2.5
New private banks						
Axis Bank	1.2	(3.6)	(3.0)	6.1	(1.1)	2.0
HDFC Bank	0.6	(2.4)	(2.1)	2.9	(2.0)	(0.5)
ICICI Bank	2.3	(3.6)	(2.4)	10.2	1.9	7.0

Note:

(a) 50% of average advances will reprice in FY2008, impact assumed for half year.

(b) 75% of average advances will reprice in FY2009.

(c) Maturity profile published in annual reports of banks is used to calculate deposit repricing. Term deposits mobilized from FY2008 onwards are assumed to reprice in the ratio of 20:60:20 over the next three years.

(d) In case of ICICI Bank, we have assumed borrowing repricing. As borrowings constitute close to 20% of interest bearing liabilities of ICICI Bank.

Source: Companies, Kotak Institutional Equities estimates.

Impact on PAT likely to be limited given improved ALM position

Comparision of PAT under various scenarios with our current assumptions, March fiscal year-ends, 2008-2009E (%).

	2008			2009		
	Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
Interest rate assumption						
Deposits	50 bps fall	50 bps fall	75 bps fall	50 bps fall	50 bps fall	75 bps fall
Advances	Status quo	50 bps fall	50 bps fall	Status quo	50 bps fall	50 bps fall
Public banks						
Andhra Bank	2.3	(6.1)	(5.0)	14.4	(0.3)	7.0
BoB	3.9	(7.9)	(6.0)	23.4	3.5	15.2
Canara Bank	4.2	(9.7)	(7.6)	19.3	(0.4)	9.2
Corporation Bank	2.6	(6.7)	(5.4)	14.4	(0.8)	6.3
Indian Bank	2.0	(4.7)	(3.7)	13.1	0.5	5.2
IOB	1.6	(5.6)	(4.8)	10.0	(2.1)	3.8
OBC	4.5	(9.2)	(7.0)	23.6	0.6	12.4
PNB	2.1	(7.8)	(6.7)	10.7	(4.4)	0.9
SBI	2.2	(9.3)	(8.2)	13.2	(6.3)	0.3
Old private banks						
Federal Bank	2.6	(4.7)	(3.4)	15.2	2.7	10.3
J&K Bank	2.5	(7.4)	(6.2)	13.4	(2.0)	4.6
New private banks						
Axis Bank	2.0	(5.7)	(4.7)	10.0	(1.8)	3.3
HDFC Bank	1.2	(4.6)	(4.0)	5.7	(3.8)	(1.0)
ICICI Bank	3.8	(5.9)	(4.0)	16.6	3.1	11.3

Note:

(a) 50% of average advances will reprice in FY2008, impact assumed for half year.

(b) 75% of average advances will reprice in FY2009.

(c) Maturity profile published in annual reports of banks is used to calculate deposit repricing. Term deposits mobilized from FY2008 onwards are assumed to reprice in the ratio of 20:60:20 over the next three years.

(d) In case of ICICI Bank, we have assumed borrowing repricing. As borrowings constitute close to 20% of interest bearing liabilities of ICICI Bank.

Source: Companies, Kotak Institutional Equities estimates.

PAT growth in 2009 will likely to improve for most banks

yoy growth in PAT, March fiscal year-ends, 2008-2009E (%).

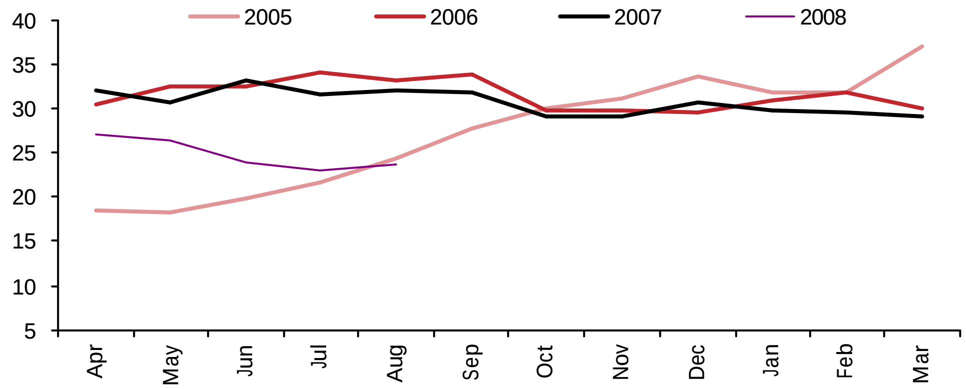
	Current estimates		Scenario 1		Scenario 2		Scenario 3	
	2008	2009	2008	2009	2008	2009	2008	2009
Interest rate assumption								
Deposits			50 bps fall	50 bps fall	50 bps fall	50 bps fall	75 bps fall	75 bps fall
Advances			Status quo	Status quo	50 bps fall	50 bps fall	50 bps fall	50 bps fall
Public banks								
Andhra Bank	11.5	5.1	14.0	17.6	4.6	11.7	5.9	18.3
BoB	24.7	6.7	29.6	26.7	14.8	19.9	17.3	30.7
Canara Bank	(11.9)	22.6	(8.2)	40.3	(20.4)	35.2	(18.6)	44.9
Corporation Bank	8.3	9.2	11.1	21.8	1.1	16.0	2.5	22.7
Indian Bank	40.0	(4.5)	42.7	6.0	33.4	0.7	34.8	4.3
IOB	16.1	5.3	17.9	14.0	9.6	9.2	10.5	14.9
OBC	(0.1)	7.6	4.3	27.3	(9.3)	19.3	(7.1)	30.1
PNB	13.1	14.7	15.4	24.3	4.3	18.8	5.5	24.0
SBI	17.4	6.4	20.0	17.8	6.4	10.0	7.7	16.3
Old private banks								
Federal Bank	27.0	6.8	30.3	19.9	21.0	15.1	22.7	22.0
J&K Bank	15.6	19.5	18.5	32.1	7.0	26.5	8.5	33.3
New private banks								
Axis Bank	51.3	37.4	54.2	48.3	42.6	43.2	44.1	48.9
HDFC Bank	43.4	32.9	45.1	38.9	36.8	34.0	37.6	37.1
ICICI Bank	24.6	46.5	29.3	64.5	17.2	60.5	19.5	70.0

Note:
(a) PAT growth for FY2008 measured against the reported FY2007 PAT.
(b) PAT for FY2009 under each of the scenarios is compared with the corresponding scenario in FY2008.

Source: Companies, Kotak Institutional Equities estimates.

Loan growth has come off for the banking system in the current fiscal

yoy growth in advances (%)

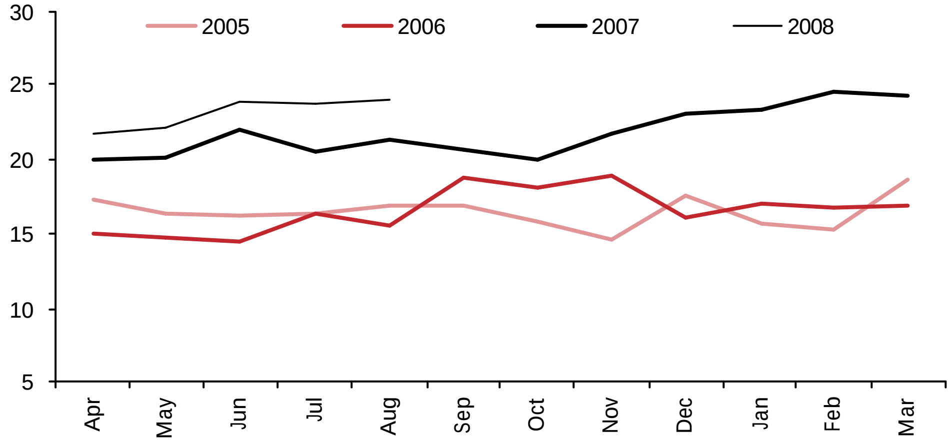


Note: Credit data in FY2005 impacted due to IDBI-IDBI Bank merger.

Source: RBI.

While deposit mobilization by the banking system has improved

yoy growth in deposits (%)



Source: RBI.

Extant 25% SLR will unduly pull down yields at the cost of a lending rate spike

Gross fiscal deficit, potential investments by provident and pension funds and insurance companies

March fiscal year-ends, 2006-2009E.

Year	GFD (as proportion of GDP) (%)	Net market borrowings (Rs bn)	Insurance funding (Rs bn)	Provident, PFs, gilt funds, States (Rs bn)	Balance to be funded by banks (Rs bn)	SLR (% of DTL)	SLR requirements by banks (Rs bn)	Banks' excess demand (Rs bn)	Actual funding by banks (Rs bn)
2006	7.4	1,187	530	417	270	25.0	—	270	179
2007E	7.0	1,308	670	492	146	25.0	—	146	596
2008E	6.5	1,317	700	542	75	25.0	331	(255)	—
2008E	**6.5**	**1,317**	**700**	**542**	**75**	**24.0**	**—**	**75**	**—**
2009E	6.1	1,359	800	599	(40)	25.0	1,286	(1,333)	—
2009E	**6.1**	**1,359**	**800**	**599**	**(40)**	**21.0**	**86**	**(126)**	**—**

Source: CSO, GoI, RBI, Kotak Institutional Equities estimates.

Automobiles

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**1-Oct**	**Target**
Bajaj Auto	OP	2,484	2,750

Sep 07 auto sales: Mixed bag

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- **Bajaj Auto: Bang on target with XCD**
- **Hero Honda: Benign volume growth ahead of the festival season**
- **TVS Motors: Disappointment continues**
- **Maruti: Volume growth continues albeit at a slower pace**
- **Tata Motors: M&HCV volumes continue to decline**
- **M&M: UVs continue to grow while Logan falters**

The 2-wheeler industry volumes continue to decline in September. Bajaj, with the launch of its much-awaited new 125 cc bike—XCD, is set for a revival in volume growth as initial response for the new bike is positive. Hero Honda reported a benign volume-growth in September. We believe the coming festival season will revive demand for motorcycles. The passenger car segment also seems to have slowed down with Maruti recording a slower volume growth while Tata Motors passenger car- volumes, like M&M's Logan volumes, have declined on a yoy basis.

Bajaj Auto: Bang on target with XCD

Bajaj Auto reported a 25% yoy decline and 22% mom growth in motorcycle sales in Sep'07. Three-wheeler sales for Bajaj were down 6% yoy in Sep. Total exports at 48,048 vehicles grew 30% yoy. Overall volumes for Bajaj dropped 24%. Bajaj launched its new bike XCD in September and sold 18,131 units for the month—bang on target for the first month. The company in its press release has stated that it has already received advance bookings for 50,000 units covering its production target for October. The new bike has received a positive response from the customers. We believe that XCD would achieve its target volumes and this would bring back the desired volume-growth for Bajaj. We continue to be positive on Bajaj.

Hero Honda: Benign volume growth ahead of the festival season

Hero Honda's Sep'07 2-wheeler sales grew 4% yoy and 31% mom. The launch of new models - Splendor NXG, Pleasure and Passion Plus have contributed to the volume growth. The company management suggests that Sep'07 number represent a good beginning to the forthcoming festival season and expects to record strong growth going forward. We believe that Hero Honda would face tough competition from Bajaj's XCD and that growth in volumes are highly dependent on a strong revival in motorcycle demand.

TVS Motors: The disappointment continues

TVS Motors reported a 50% yoy decline in motorcycle sales for Sep'07 while its overall 2-wheeler volumes fell 29% yoy. Lack of a product profile, strong competition with stronger peers and slowing industry has hit TVS the most. We believe that in the battle between the two bigger competitor—Bajaj and Hero Honda, TVS would continue to bleed despite having a couple of new launches in the pipeline.

Maruti: Volume growth continues albeit at a slower pace

Maruti's domestic sales grew at 11% yoy while exports, at 4,362 vehicles, grew 55% yoy in Sep. This was led mainly by a strong volume growth in the compact car segment as sales of Alto, Zen-Estilo and Swift grew 22% yoy. The mid-car segment grew 43% yoy led by a robust demand for SX4. The entry-level Maruti-800 saw its volumes decline 32% yoy for the month. The sales of Maruti were affected by the inauspicious period of 'Shraadh' wherein traditionally sales see a dip. However, we believe that the festival season ahead the volume-growth would be far stronger in the coming months. We are positive on Maruti as its successful new models will power its future growth.

Tata Motors: M&HCV volumes continue to decline

Tata Motors recorded a 7% yoy decline in domestic M&HCV volumes. However, domestic CV sales grew 1.5% yoy as the LCV segment continues to ride the success of ‘Ace’—growing at 13% yoy. The domestic M&HCV industry continues to be sluggish due to the high interest rates. Our talks with financiers have indicated that the interest rates are expected to come down in the coming months. We believe this to be positive for the M&HCV industry. UV segment volumes declined 17.5% yoy while passenger cars declined 3% yoy mainly due to the lack of new products across the segments. Tata Motors is planning to offer discounts on its products in a bid to revive sales.

M&M: UVs continue to grow while Logan falters

The UV segment continues to do well for M&M recording a 12% yoy growth in September as Scorpio volumes grow 6% yoy. Logan sales have declined by 3% on a mom basis. We note that the volumes for Logan have been declining since the past threemonths. Even as Maruti’s passenger car volumes have been growing especially in the mid-car segment, Logan’s volumes have been declining. M&M’s tractor volumes have recorded an 11% yoy decline for the month. We believe that UV volumes for M&M should continue to do well while tractor volumes would pick up in the coming months buoyed by the end of monsoons and the oncoming festival season.

4-wheelers Sep 2007 sales performance

	Sep-07	Sep-06	yoy %	Aug-07	mom %	YTD, FY2008	YTD, FY2007	yoy %
Tata Motors								
M&HCV	14,129	15,193	-7.0%	11,625	21.5%	68,776	76,902	-10.6%
LCV	12,907	11,434	12.9%	11,806	9.3%	64,095	56,978	12.5%
Domestic CV sales	27,036	26,627	1.5%	23,431	15.4%	132,871	133,880	-0.8%
CV Exports	3,015	2,819	7.0%	3,316	-9.1%	18,816	16,502	14.0%
Total CV	**30,051**	**29,446**	**2.1%**	**26,747**	**12.4%**	**151,687**	**150,382**	**0.9%**
UV	3,614	4,379	-17.5%	3,480	3.9%	21,440	20,849	2.8%
Passenger Cars	14,682	15,138	-3.0%	14,917	-1.6%	89,823	93,775	-4.2%
Total	**48,347**	**48,963**	**-1.3%**	**45,144**	**7.1%**	**262,950**	**265,006**	**-0.8%**
Mahindra & Mahindra								
UVs	12,246	10,961	11.7%	11,494	6.5%	66,478	54,665	21.6%
LCVs	930	742	25.3%	832	11.8%	5,473	3,921	39.6%
Logan	2,185	-		2,252	-3.0%	12,502	-	
Tractors	8,668	9,729	-10.9%	6,572	31.9%	49,518	50,930	-2.8%
3 Wheelers	3,208	3,162	1.5%	2,860	12.2%	16,453	15,469	6.4%
Total	**27,237**	**24,594**	**10.7%**	**24,010**	**13.4%**	**150,424**	**124,985**	**20.4%**
						-	-	
Maruti Udyog								
Entry (A) segment	5,221	7,680	-32.0%	5,480	-4.7%	34,665	40,445	-14.3%
Van-segment	6,350	7,289	-12.9%	7,889	-19.5%	42,084	37,332	12.7%
Compact (B) segment	46,216	37,955	21.8%	41,736	10.7%	233,102	191,197	21.9%
Mid-size (C) segment	4,885	3,410	43.3%	4,839	1.0%	25,174	15,960	57.7%
MUV	414	272	52.2%	285	45.3%	1,733	1,688	2.7%
Domestic	**63,086**	**56,606**	**11.4%**	**60,229**	**4.7%**	**336,758**	**286,622**	**17.5%**
Exports	4,362	2,814	55.0%	5,739	-24.0%	24,236	16,009	51.4%
Total	**67,448**	**59,420**	**13.5%**	**65,968**	**2.2%**	**360,994**	**302,631**	**19.3%**

Source: Company, Kotak Institutional Equities.

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

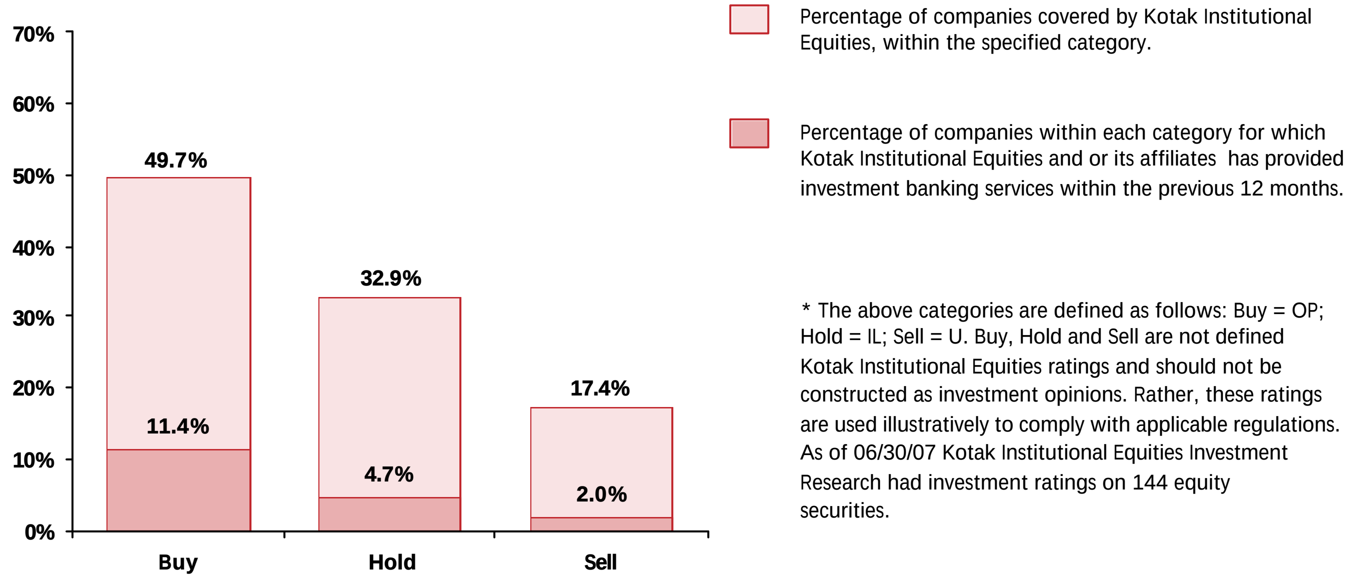
	Sep-07	Sep-06	yoy %	Aug-07	mom %	YTD, FY2008	YTD, FY2007	yoy %
Bajaj Auto								
Geared Scooters		1	-100.0%	-		-	5,254	-100.0%
Ungeared Scooters	2,056	893	130.2%	2,720	-24.4%	13,908	7,158	94.3%
Step thrus		-		-	0.0%	-	-	
Motorcycles	204,152	271,377	-24.8%	167,483	21.9%	1,025,081	1,191,249	-13.9%
Total 2-Wheelers	**206,208**	**272,271**	**-24.3%**	**170,203**	**21.2%**	**1,038,989**	**1,203,661**	**-13.7%**
3 Wheelers	26,288	27,870	-5.7%	25,504	3.1%	146,217	151,558	-3.5%
TVS Motor								
Motorcycles	53,991	106,972	-49.5%	46,235	16.8%	295,148	492,137	-40.0%
Scooty	27,199	24,890	9.3%	24,645	10.4%	121,884	136,956	-11.0%
Moped	33,901	30,338	11.7%	31,854	6.4%	165,346	165,876	-0.3%
Total 2-Wheelers	**115,091**	**162,200**	**-29.0%**	**102,734**	**12.0%**	**643,352**	**794,969**	**-19.1%**
Hero Honda								
Total 2-Wheelers	314,567	301,577	4.3%	240,875	30.6%	1,559,486	1,584,659	-1.6%

Source: Company, Kotak Institutional Equities.

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Kawaljeet Saluja, Puneet Jain, Sanjeev Prasad, Tabassum Inamdar, Amit Agarwal."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 06/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities. As of June 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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

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

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

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