kotak® Institutional Equities

# INDIA DAILY

May 15, 2007

## EQUITY MARKETS

| India | 14-May | 1-day | 1-mo | 3-mo |
|---|---|---|---|---|
| | | Change, % | | |
| Sensex | 13,966 | 1.2 | 4.3 | (2.7) |
| Nifty | 4,134 | 1.4 | 5.5 | (0.3) |
| **Global/Regional indices** | | | | |
| Dow Jones | 13,347 | 0.2 | 5.8 | 4.6 |
| Nasdaq Composite | 2,546 | (0.6) | 2.2 | 2.0 |
| FTSE | 6,556 | (0.2) | 1.4 | 1.9 |
| Nikkie | 17,556 | (0.7) | 1.1 | (1.9) |
| Hang Seng | 20,971 | (0.0) | 3.1 | 2.1 |
| KOSPI | 1,605 | (0.0) | 5.5 | 11.2 |

**Value traded - India**

| | 14-May | | 1-mo | 3-mo |
|---|---|---|---|---|
| | | | Moving avg, Rs bn | |
| Cash (NSE+BSE) | 124.5 | | 132.1 | 124.2 |
| Derivatives (NSE) | 280.4 | | 332.2 | 420.2 |
| Deri. open interest | 549.8 | | 518.8 | 601.4 |

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**Forex/money market**

| | 14-May | 1-day | 1-mo | 3-mo |
|---|---|---|---|---|
| | | Change, basis points | | |
| Rs/US$ | 40.9 | - | (104) | (323) |
| 6mo fwd prem, % | 0.7 | (25) | 71 | 24 |
| 10yr govt bond, % | 8.2 | 3 | 6 | 10 |

**Net investment (US$mn)**

| | 11-May | | MTD | CYTD |
|---|---|---|---|---|
| FIIs | (80) | | 1,257 | 40 |
| MFs | 18 | | 237 | (303) |

**Top movers -3mo basis**

| Best performers | 14-May | 1-day | 1-mo | 3-mo |
|---|---|---|---|---|
| | | Change, % | | |
| Balaji Telefilms | 185 | 3.2 | 28.9 | 43.4 |
| Thomas Cook | 62 | 5.0 | 24.7 | 27.7 |
| Castrol India | 280 | 1.3 | 23.5 | 24.8 |
| GESCO | 260 | 0.1 | 15.7 | 21.3 |
| Wockhardt | 417 | 4.3 | (1.9) | 21.0 |
| **Worst performers** | | | | |
| Polaris | 167 | 1.2 | (11.9) | (25.0) |
| Arvind Mills | 45 | (1.5) | (4.7) | (22.0) |
| Wipro | 544 | (0.3) | (4.2) | (19.5) |
| M&M | 729 | 1.1 | (2.1) | (19.1) |
| Ashok Leyland | 38 | 0.8 | (0.5) | (18.2) |

## News Roundup

### Corporate

- Sterlite Industries (India), a unit of billionaire Anil Agarwal's Vedanta Resources, plans to raise as much as US$2 bn in its first share sale in the US to pay for a new power plant.(BS)
- The State Bank of India plans to issue shares with restricted or no voting rights for subscribers to its public issue, estimated to be Rs60 bn, that is slated to hit the market this financial year. (BS)
- India's Essar Global will invest US$3.4 bn in a proposed 300,000 barrels per day oil refinery in northern Egypt, an Egyptian government official said on Monday (FE)
- Power equipment maker Bharat Heavy Electricals Ltd said it will spend Rs32 bn in the 11th Five-Year Plan period to increase manufacturing capacity from the current 6,000 MW to 15,000 MW per annum. (FE)

### Economic and political

- As many as 45 banks have failed to meet the priority sector target set by the Reserve Bank of India. The target stipulates that 18 per cent of their net credit should flow to the agriculture sector. This has been due to low demand resulting from less capital formation in the sector and low penetration of banking services in rural areas (BS)
- With the Uttar Pradesh Assembly polls now over and the focus shifting on the impending presidential race, Left parties have convened a meeting of the Front partners on May 16 to devise a strategy for placing a UPA nominee in Rashtrapati Bhawan. (FE)

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

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**Property**

| SOBH.BO, Rs873 | |
|---|---|
| Rating | OP |
| Sector coverage view | Attractive |
| Target Price (Rs) | 940 |
| 52W High -Low (Rs) | 1179 - 620 |
| Market Cap (Rs bn) | 63.6 |

**Financials**

| April y/e | 2007E | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 13.1 | 22.7 | 38.4 |
| Net Profit (Rs bn) | 1.7 | 2.9 | 4.4 |
| EPS (Rs) | 22.9 | 40.1 | 60.4 |
| *EPS gth* | *1.0* | *75.4* | *50.5* |
| P/E (x) | 38.1 | 21.7 | 14.4 |
| EV/EBITDA (x) | 26.1 | 15.8 | 10.0 |
| Div yield (%) | 0.2 | 0.3 | 0.5 |

# Sobha Developers: FY2007 revenues below estimates; margins slightly higher than expectations

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- **FY2007 revenues below estimates; grow 91% on a y-o-y basis**
- **We increase project execution time from 12 months to 18 months for contractual business**
- **Retain outperform rating and target price**

Sobha Developers (Sobha) reported revenues of Rs11.9 bn (v/s our expectation of Rs13 bn) and PAT of Rs1.61 bn (v/s our expectation of Rs1.66 bn) for FY2007. Operating margin of 21.6% is 150 bp better than our expectations of 20.1%. Higher operating margins have resulted from better than expected margins in contractual business and higher revenue booking from higher margin residential projects. Revenue estimates have been below expectations due to company unable to book revenues in couple of residential projects as they still have to achieve 25% threshold and delayed booking in contractual revenues. Going forward, we increase total development time taken for a contractual project to 18 months from 12 months currently. As a result we revise our revenue estimates to Rs21.8 bn for FY2008 (Rs22.6 bn earlier) and Rs37.2 bn for FY2009 (Rs38.4 bn earlier). We revise out PAT estimates to Rs2.9 bn in FY2008 (Rs2.92 earlier) and Rs4.32 bn in FY2009 (Rs4.4 bn earlier). We retain outperform rating on the company.

### We lower our revenue estimates from contractual business due to larger project execution cycle

We observe Sobha Developers is able to execute contractual projects in a period of 18 months vis-à-vis our estimates of 12 months. We note that for recently launched projects significant amount of time is being spent on design of these projects thus leading to higher project execution cycle. Therefore, going ahead for new projects launches we assume slower construction and completion over 18-month period. As a result of higher project execution cycle, our revenue estimates stand revised to Rs6.6 bn in FY2008 (Rs7.3 bn earlier) and Rs8.3 bn in FY2009 (Rs9.3 bn earlier). However, margins in contractual business have been higher than our expectations and we raise our PAT estimates to 650 bp.

### Project launches in real estate business continue to be strong

Sobha is currently executing 28 projects in residential business equivalent to 10.2 mn sq. ft and four commercial projects totaling 314,000 sq. ft. Futhermore, over the next two quarters Sobha is planning to launch 23 projects totaling 10.7 mn sq. including 6.9 mn sq. ft residential projects. Sobha is also planning to launch construction of 2.2 mn sq. ft retail project in Bangalore.

### We retain our Mar’08 based target price of Rs940/share; retain outperform rating

We retain our target price of Rs940/ share wherein our value of contractual business stands revised to Rs76/share from Rs81/share earlier.

**Sobha Developers :4QFY2007 results**

| (in Rs mn) | 3QFY07 | 4QFY07 | % chg. qoq | FY06 | FY07E | % chg. |
|---|---|---|---|---|---|---|
| **Net sales** | **2,976** | **3,573** | **20.1** | **6,277** | **11,865** | **89.0** |
| | | | | | | |
| **Operating costs** | **(2,302)** | **(2,673)** | **16.1** | **(4,870)** | **(9,303)** | **91.0** |
| (Increase)/Decrease intock in inventories | 691 | 380 | (45.0) | | 1,017 | |
| Land cost expenses | (698) | (754) | 8.0 | | (1,832) | |
| Construction expenses | (1,433) | (1,433) | - | | (4,952) | |
| Raw material consumption | (197) | (178) | (9.6) | | (1,051) | |
| Production expenses | (52) | (52) | - | | (236) | |
| Staff cost | (163) | (261) | 60.1 | | (707) | |
| Other administrative expenses | (450) | (375) | (16.7) | | (1,542) | |
| | | | | | | |
| **EBITDA** | **674** | **900** | **33.5** | **1,407** | **2,562** | **82.1** |
| Other income | 9 | 16 | 77.8 | 8 | 29 | 262.5 |
| Interest costs | (123) | (87) | (29.3) | (219) | (481) | 119.6 |
| Depreciation | (68) | (67) | (1.5) | (112) | (244) | 117.9 |
| **PBT** | **492** | **762** | **54.9** | **1,084** | **1,866** | **72.1** |
| Taxes | (35) | (143) | 308.6 | (188) | (251) | 33.5 |
| **PAT** | **457** | **619** | **35.4** | **892** | **1,615** | **81.1** |
| | | | | | | |
| **Key ratios** | | | | | | |
| | | | | | | |
| EBITDA margin (%) | 22.6 | 25.2 | | 22.4 | 21.6 | |
| PAT margin (%) | 15.4 | 17.3 | | 14.2 | 13.6 | |
| Effective tax rate (%) | 7.1 | 18.8 | | 17.3 | 13.5 | |

Source: Company data, Kotak Institutional Equities

| | | Valuation (Rs bn) | Per share |
|---|---|---|---|
| Land Reserves (growth rate in selling price = 5%, discount rate = 14%) | 10% Discount to NAV | 79.1 | 1,085 |
| Less: Land cost to be paid | | (11.5) | (158) |
| Less: Net Debt | | (5.0) | (69) |
| Contractual business | | 5.6 | 76 |
| **Fair price** | | | **935** |
| **Total** | | | **935** |

**Profit model of Sobha Developers, March fiscal year-ends, 2005-2010E (Rs mn)**

| | 2005 | 2006P | 2007E | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| **Total revenues** | **4,629** | **6,277** | **11,865** | **21,787** | **37,222** | **55,544** |
| Land costs | (1,054) | (781) | (1,832) | (2,009) | (4,341) | (6,079) |
| Construction costs | (2,344) | (2,975) | (5,222) | (12,245) | (20,494) | (30,433) |
| Employee costs | (221) | (286) | (707) | (917) | (1,430) | (2,231) |
| SG&A costs | (376) | (829) | (1,542) | (2,070) | (3,536) | (5,277) |
| **EBITDA** | **634** | **1,407** | **2,563** | **4,546** | **7,421** | **11,525** |
| Other income | 23 | 8 | 29 | 16 | 24 | 36 |
| Interest | (109) | (219) | (481) | (821) | (1,265) | (1,595) |
| Depreciation | (74) | (112) | (244) | (417) | (579) | (800) |
| **Pretax profits** | **473** | **1,083** | **1,866** | **3,324** | **5,602** | **9,165** |
| Extraordinary items | - | - | - | — | — | — |
| Current tax | (123) | (188) | (251) | (419) | (1,295) | (2,732) |
| Deferred tax | (11) | (0) | | (7) | 16 | (63) |
| **Net income** | **339** | **892** | **1,615** | **2,898** | **4,322** | **6,369** |
| **Adjusted net income** | **339** | **892** | **1,615** | **2,898** | **4,322** | **6,369** |
| | | | | | | |
| **EPS (Rs)** | | | | | | |
| Primary | 5.3 | 14.0 | 24.5 | 39.7 | 59 | 87 |
| Fully diluted | 5.3 | 14.0 | 24.5 | 39.7 | 59 | 87 |
| | | | | | | |
| **Shares outstanding (mn)** | | | | | | |
| Year end | 63 | 63 | 73 | 73 | 73 | 73 |
| Primary | 63 | 63 | 66 | 73 | 73 | 73 |
| Fully diluted | 63 | 63 | 66 | 73 | 73 | 73 |
| | | | | | | |
| **Cash flow per share (Rs)** | | | | | | |
| Primary | 7 | 15 | 28 | 45 | 67 | 99 |
| Fully diluted | 7 | 15 | 28 | 45 | 67 | 99 |
| | | | | | | |
| **Growth (%)** | | | | | | |
| Net income (adjusted) | 281 | 163 | 78 | 82 | 49 | 47 |
| EPS (adjusted) | 281 | 161 | 73 | 65 | 49 | 47 |
| DCF/share | 277 | 114 | 91 | 61 | 47 | 48 |
| | | | | | | |
| Cash tax rate (%) | 26 | 17 | 11 | 13 | 23 | 30 |
| Effective tax rate (%) | 28 | 17 | 12 | 13 | 23 | 31 |

Source: Kotak Institutional Equities estimates.

**Banking**

| LICH.BO, Rs162 | |
|---|---|
| Rating | OP |
| Sector coverage view | Neutral |
| Target Price (Rs) | 160 |
| 52W High -Low (Rs) | 217 - 128 |
| Market Cap (Rs bn) | 13.7 |

**Financials**

| March y/e | 2007E | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 4.8 | 5.7 | 6.8 |
| Net Profit (Rs bn) | 2.8 | 2.8 | 3.2 |
| EPS (Rs) | 32.8 | 33.2 | 37.5 |
| *EPS gth* | *34.9* | *1.1* | *13.3* |
| P/E (x) | 4.9 | 4.9 | 4.3 |
| P/B (x) | 1.1 | 0.8 | 0.7 |
| Div yield (%) | 4.9 | 4.9 | 5.6 |

**Shareholding, March 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 40.5 | - | - |
| FIIs | 29.7 | 0.1 | 0.0 |
| MFs | 1.2 | 0.0 | (0.0) |
| UTI | - | - | (0.0) |
| LIC | 40.5 | 0.4 | 0.4 |

## LIC Housing Finance: Profits exceed estimates on lower provision, operating too above estimates, upgrade to OP.

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- **Net Profit up 116% yoy to Rs893 mn, 55% above estimates,**
- **Net operating income up 28% yoy (8% above estimates), low provisions (down 95% yoy);**
- **Revising estimates, rolling target price to FY2009 estimate to Rs220, upgrade to OP from Underperform.**

LICHF reported a net profit of Rs893 mn for 4QFY07 up 116% yoy. Net operating income has grown by 28% yoy to Rs1.51 bn on the back of growth in housing loans and stable spreads. The company has made lower provisions (Rs21 mn, down 95% yoy and 93% below estimates) on the back of lower NPLs. LICHF has managed to deliver a disbursement growth of 23% in 4QFY07 as against de-growth in the previous two quarters. We raise our earnings estimates by 21% for FY2008 and 35% for FY2009 to factor higher net interest income on the back of higher housing loan growth and stable spreads. We rollover our target price to Rs220 (based on FY2009E) from Rs160 (based on FY2008E) and upgrade to OP from U.

### Key highlights

**Revise estimates to factor higher loan growth:** We revise our earnings estimates by 21% and 35% for FY2008 and FY2009 respectively in order to factor : (a) higher growth in housing loans - 17% and 16% for FY2008 and FY2009 as against 11% and 12% expected earlier, (b) marginally higher spreads of about 2.1% as against 1.8% expected in the past, (c) lower growth in employee expenses. While we expect the loan loss provisions to be marginally lower in FY2008, the company will likely increase its provisioning level overtime.

**Lower competition from bank aid disbursements growth:** After reporting disappointing de-growth in disbursements over the previous two quarters, LICHF has delivered 23% disbursement growth to Rs17.6 bn in 4QFY07. We believe slowdown in disbursements by the largest player- ICICI Bank and PSU banks has likely enabled housing finance companies like LICHF to deliver growth. Given competition for funds and the relatively lower rates earned by bank on housing loans, we expect this scenario to continue for at least another year. This will likely lead LICHF to deliver about 15% disbursement growth over the next 12 to 15 months.

**Lower provisions during the quarter:** LICHF has made provisions of Rs20 mn in 4QFY07 as against Rs390 mn in 4QFY06. Gross NPL ratio for the company has reduced to 2.58% from 3.41% in March 2006. Also, LICHF has made lower additional provisions (over and above the stipulations of National Housing Bank) at 5% of sub-standard assets as against 10% in March 2006. If LICHF had made similar provisions in FY2007, provisioning expenditure for the quarter would have increased to Rs130 mn still 67% below 4QFY06.

**Deposit scheme to improve financial flexibility:** In order to tap retail deposits, LICHF has recently launched a fixed deposit (FDs) scheme. The company will offer 9% and 9.25% interest on FDs of 3 years and 5 years respectively. We believe that this will increase the financial flexibility of the company and provide a new avenue for raising funds specially when the debt market tightens.

**CAR will improve if risk weights on home loan reduce:** LICHF has Tier I CAR of 10.39% in March 2007 as against 15.12% in March 2006. RBI has recently reduced the risk weight for home loans below Rs2 mn to 50% and we expect NHB to follow the same. Such a move will increase capital adequacy ratio for the company.

**Stake in LIC Mutual Fund adds value:** LICHF holds 39.3% stake in LIC Mutual Fund. The fund has over Rs90 bn of assets under management as on March 2007. LICHF's stake in this fund adds Rs21 per share - if valued at 5% of AUMs. We have not factored the valuation of the fund and this will only provide an upside to our target price.

**LIC Housing Finance (Old and new estimates Rsmn)**

| | Old estimates | | | New estimates | | | % change | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY2007E | FY2008E | FY2009E | FY2007E | FY2008E | FY2009E | FY2007E | FY2008E | FY2009E |
| Net interest income | 3,862 | 4,373 | 4,777 | 3,977 | 4,893 | 5,946 | 3.0 | 11.9 | 24.5 |
| Other income | 843 | 764 | 779 | 841 | 848 | 865 | (0.2) | 11.0 | 11.0 |
| Fee income | 475 | 499 | 524 | 480 | 509 | 539 | 1.0 | 1.9 | 2.9 |
| Other income | 367 | 264 | 255 | 361 | 339 | 325 | (1.6) | 28.1 | 27.8 |
| Total income | 4,704 | 5,137 | 5,556 | 4,818 | 5,741 | 6,810 | 2.4 | 11.8 | 22.6 |
| Loan loss provisions | 515 | 575 | 729 | 236 | 564 | 879 | (54.1) | (1.8) | 20.5 |
| Operating expenses | 1,088 | 1,243 | 1,401 | 1,043 | 1,202 | 1,362 | (4.1) | (3.3) | (2.8) |
| Employee expenses | 293 | 337 | 388 | 268 | 300 | 336 | (8.6) | (11.0) | (13.3) |
| Other expenses | 794 | 906 | 1,013 | 775 | 902 | 1,025 | (2.5) | (0.4) | 1.2 |
| PBT | 3,102 | 3,319 | 3,425 | 3,539 | 3,974 | 4,570 | 14.1 | 19.7 | 33.4 |
| Tax | 624 | 989 | 1,055 | 746 | 1,153 | 1,384 | 19.6 | 16.6 | 31.1 |
| **PAT** | **2,478** | **2,330** | **2,370** | **2,793** | **2,821** | **3,186** | **12.7** | **21.1** | **34.4** |
| PBT+provisions | 3,617 | 3,893 | 4,155 | 3,775 | 4,538 | 5,449 | 4.4 | 16.6 | 31.1 |
| **Housing loan growth (%)** | **12.3** | **11.1** | **12.2** | **18.0** | **17.1** | **16.5** | | | |

**LIC Housing Finance Ltd (Rsmn)**

| Quarterly Results | 4Q06 | 1Q07 | 2Q07 | 3Q07 | 4Q07 | YoY(%) | 4Q07E | Actual vs KS (%) |
|---|---|---|---|---|---|---|---|---|
| Operating income | 3,544 | 3,401 | 3,843 | 4,051 | 4,537 | 28 | 4,402 | 3 |
| Interest on loans | 3,409 | 3,222 | 3,657 | 3,851 | 4,260 | 25 | 4,208 | 1 |
| Fees and other charges | 135 | 107 | 115 | 110 | 150 | 12 | 144 | 4 |
| Other income | | 73 | 71 | 90 | 127 | | 50 | 155 |
| Interest expenses | 2,362 | 2,565 | 2,607 | 2,816 | 3,026 | 28 | 3,009 | 1 |
| **Net operating income** | **1,182** | **836** | **1,236** | **1,236** | **1,511** | **28** | **1,392** | **8** |
| **Net operating income extraordinary item** | **1,182** | 836 | 1,236 | 1,236 | 1,511 | 28 | 1,392 | 8 |
| Total Fund based income | 3,409 | 3,295 | 3,728 | 3,941 | 4,387 | 29 | 4,258 | 3 |
| Net interest income | 1,047 | 656 | 1,050 | 1,036 | 1,233 | 18 | 1,432 | (14) |
| Other exp. | **663** | **405** | **282** | **261** | **292** | **(56)** | **622** | **(53)** |
| Establishment exp. | 223 | 142 | 194 | 193 | 207 | (7) | 234 | (12) |
| Staff expenses | 48 | 55 | 86 | 63 | 65 | 34 | 90 | (28) |
| Provisions | 390 | 208 | 2 | 5 | 21 | (95) | 298 | (93) |
| **PBDT** | **518** | **431** | **954** | **974** | **1,218** | **135** | **771** | **58** |
| Depreciation | 19 | 8 | 8 | 8 | 15 | (22) | 7 | 106 |
| PBT | 499 | 423 | 946 | 966 | 1,204 | 141 | 763 | 58 |
| Tax | 86 | 49 | 186 | 200 | 311 | 263 | 187 | 66 |
| **PAT** | **413** | **374** | **759** | **766** | **893** | **116** | **576** | **55** |
| Tax rate | 17 | 12 | 20 | 21 | 26 | | 25 | |
| **PBT excl. extraordinary item** | **499** | **423** | **946** | **966** | **1,204** | 141 | **763** | **58** |
| PBT excl. extraordinary item+provisions | 889 | 631 | 948 | 972 | 1,224 | 38 | 1,061 | 15 |

| **Other details** | **4Q06** | **1Q07** | **2Q07** | **3Q07** | **4Q07** | **YoY(%)** |
|---|---|---|---|---|---|---|
| Approval for the quarter (Rs bn) | 14.5 | 10.7 | 13.4 | 12.2 | 24.8 | 72 |
| Disbursements (Rs bn) | 14.3 | 10.9 | 11.7 | 11.0 | 17.55 | 23 |
| Individual (Rs bn) | | 10.6 | | 10.5 | | |
| Outstanding portfolio (Rs bn) | 148.7 | 153.9 | 159.6 | 164.5 | 175.6 | 18 |
| Individual (Rs bn) | | | 154 | 159.5 | 170.1 | |
| Floating rate basis (Rs bn) | 141.2 | | | 145.2 | 154.8 | 10 |
| **NPLs** | | | | | | |
| Gross NPLs (Rs mn) | 5,062 | 5,790 | 5,985 | 5,857 | 4,520 | (11) |
| Gross NPL ratio (%) | 3.4 | 3.8 | 3.8 | 3.6 | 2.6 | |
| Net NPLs (Rs mn) | 2,680 | | | | 2,210 | (18) |
| Net NPL ratio (%) | 1.8 | 2.0 | 2.1 | 1.97 | 1.3 | |
| CAR (%) | 15.12 | | | | 14.19 | |
| Tier I | 15.12 | | | | 10.4 | |
| Average spread (%) | 1.34 | 1.25 | 1.25 | 1.26 | 1.30 | |
| Average cost of funds (%) | | 7.55 | 7.70 | 7.91 | 8.3 | |
| Incremental cost of fund (%) | | 8.50 | | | 9.3 | |
| Average lending rate (%) | | | | | 9.6 | |
| Incremental lending rate (%) | 8.75 | 9.5 | 9.5 | 9.50 | 11.0 | |

Source: Company, Kotak Institutional Equities estimates

**Economy**

Sector coverage view N/A

## Rakesh Mohan savings group: Higher growth through fiscal discipline, FDI

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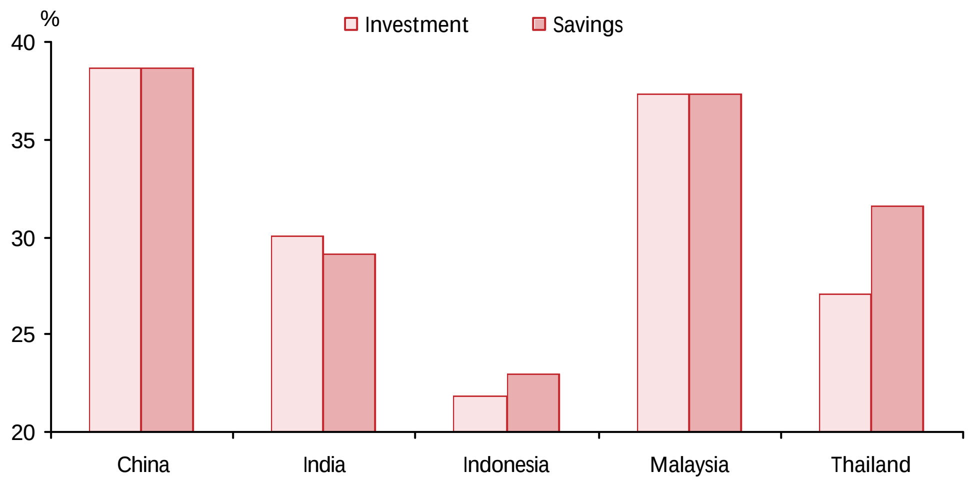
- **Higher savings key: 34% saving rate necessary to sustain 8% real GDP growth rate**
- **Domestic savings at peak; FDI, PSU efficiency key to higher savings**
- **Vanilla report: Skirts the key issue of emerging project finance gap**

The Rakesh Mohan working group report on savings for India's 11th Five Year Plan, released yesterday, naturally stresses the need to step up savings to fund the India story (Exhibit 1). We agree with the group that (1) domestic household savings has likely topped off; (2) higher growth will likely depend on fiscal discipline (especially, higher PSU efficiency); and India's ability to attract sufficient FDI to run a large current account deficit (Exhibits 2 and 4); and (3) household saving will switch to insurance and pensions, reflecting our demograhic dividend of a younger population (Exhibit 3). The group's emphasis on higher savings (and a higher current account deficit) is that much more because the implied incremental capital output ratio—a measure of economic efficiency—is pitched at 4.2-5. This is much higher than not only the current 3.5 levels but also our rather conservative 4-trend. We are disappointed that the group did not address the critical question of an emerging project finance gap. We continue to highlight that the Indian economy is running into a crisis of long tenor funds. This has been exacabareted by the conversion of dedicated developed financial institutions—ICICI for example—into banks (with shortern deposit liabilities. Resource mobilization by IPOs is still less than 1% of GDP.

**Exhibit 1: India has to save more, invest more to grow faster**

Investment, savings rate (% of GDP)




Source: RBI.

**Exhibit 2: Higher PSU efficiency, current account deficit key to higher growth**
% of GDP

| | Real GDP growth rate (%) | | | |
|---|---|---|---|---|
| **Item** | **7.0** | **8.0** | **8.5** | **9.0** |
| 1 Domestic private saving | 29.7 | 29.9 | 30 | 30.1 |
| 1 Household saving | 24.1 | 24.3 | 24.3 | 24.4 |
| 1.1 Physical saving | 12.9 | 12.9 | 12.9 | 13 |
| 1.1 Financial saving | 11.3 | 11.4 | 11.4 | 11.4 |
| 1 Corporate saving | 5.6 | 5.6 | 5.7 | 5.7 |
| 2 Public sector saving | 3.7 | 4.1 | 4.2 | 4.6 |
| 2 Fiscal deficit | 5.7 | 5.7 | 5.7 | 5.7 |
| 2 PSU savings | **3.4** | **3.8** | **3.9** | **4.3** |
| 3. Gross domestic saving (1+2) | 33.4 | 34 | 34.2 | 34.7 |
| 4. Current account deficit | **1.4** | **2.1** | **2.4** | **2.8** |
| 5 Gross domestic capital formation (3+4) | 34.8 | 36.1 | 36.6 | 37.5 |
| 6 ICOR | 5.0 | 4.5 | 4.3 | 4.2 |
| Memo | | | | |
| XIth FYP Approach Paper projection | 27.1 | 29.6 | 31 | 32.3 |
| ICOR | 4.1 | 4.0 | 3.9 | 3.9 |

Source: RBI.

**Exhibit 3: Domestic savings topping off; larger flow to life insurance, provident & pension funds**
% of GDP

| | Real GDP growth rate (%) | | | | Memo: |
|---|---|---|---|---|---|
| **Item** | **7.0** | **8.0** | **8.5** | **9.0** | **FY2006** |
| 1 Currency | 1.6 | 1.6 | 1.6 | 1.6 | 1.5 |
| 2 Bank deposits | 7 | 7.2 | 7.2 | 7.3 | 7.8 |
| 3 Non-bank deposits | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| 4 Life insurance funds | 3.3 | 3.3 | 3.4 | 3.4 | 2.4 |
| 5 Provident and pension funds | 2.3 | 2.3 | 2.3 | 2.3 | 1.7 |
| 6 Claims on government | 3 | 3 | 3 | 2.9 | 2.5 |
| 7 Shares and debentures | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 |
| 8 Units of UTI | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| 9 Trade debt | 0 | 0 | 0 | 0 | 0 |
| 10 Gross financial saving (1 to 9) | 17.8 | 18.1 | 18.2 | 18.2 | 16.6 |
| 11 Financial liabilities | 6.5 | 6.7 | 6.7 | 6.8 | 5.2 |
| 12 Household financial saving (net) (11-10) | 11.3 | 11.4 | 11.5 | 11.4 | 11.5 |
| 13 Household physcial saving | 12.9 | 12.9 | 12.9 | 13.0 | 11.7# |
| 14 Household saving (12+13) | 24.2 | 24.3 | 24.4 | 24.4 | 22# |

Note: # relates to FY2005.

Source: RBI.

**Exhibit 4: Higher growth turns on higher FDI, NRI deposit flows**

US$ bn

| | Item | Real GDP growth rate (%) | | | | Memo: |
|---|---|---|---|---|---|---|
| | | 7.0 | 8.0 | 8.5 | 9.0 | FY20087E |
| 1 | FDI, net | 9.8 | 10.7 | 12.6 | 14.1 | 10 |
| 2 | NRI deposits | 8.7 | 8.7 | 8.7 | 8.7 | 3.5 |
| 3 | External commercial borrowings | 10.5 | 10.5 | 10.5 | 10.5 | 12.5 |
| 4 | FIIs | 7.1 | 6.7 | 8.4 | 8.5 | 12 |
| 5 | External assistance, net | 1.6 | 1.6 | 1.6 | 1.6 | 1.7 |
| 6 | Non-NRI banking capital | 2.1 | 2.1 | 2.1 | 2.1 | 2.5 |
| 7 | Short-term credit | 2.8 | 2.8 | 2.8 | 2.8 | 3 |
| 8 | Net capital flows (1 to 7) | 42.6 | 43.1 | 46.7 | 48.3 | -0.2 |
| 9 | (% of GDP) | 3.1 | 3.2 | 3.4 | 3.5 | |

Source: RBI, 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: Puneet Jain, Tabassum Inamdar, Indranil Sen Gupta."

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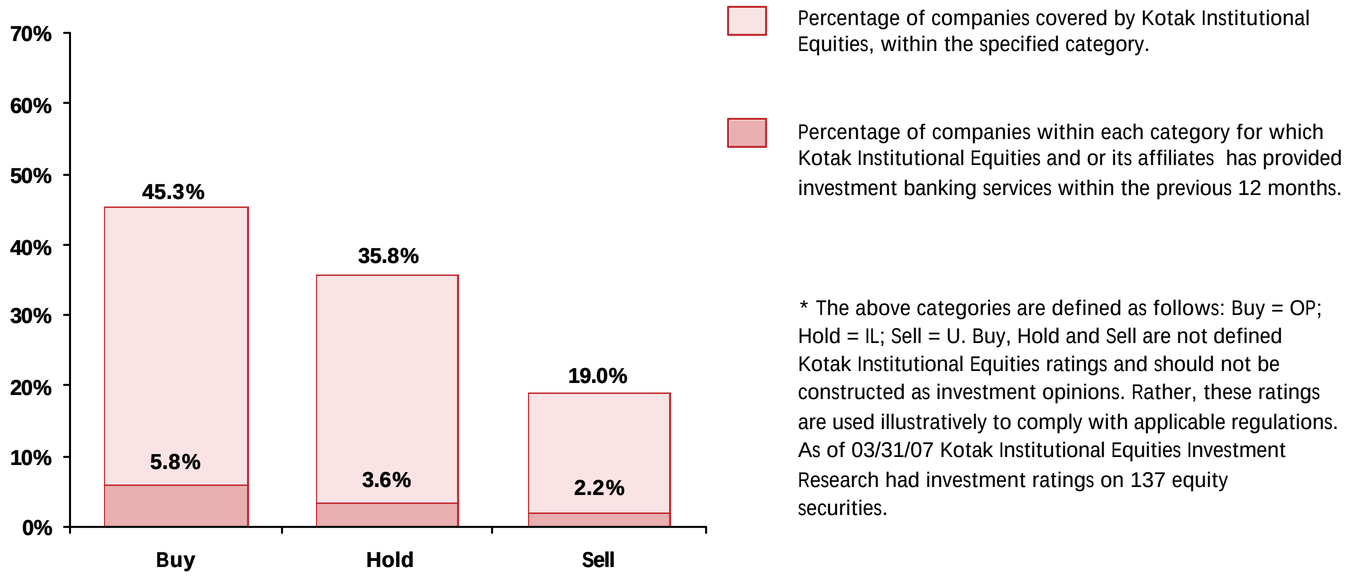


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Source: Kotak Institutional Equities. As of March 31, 2007

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