kotak Institutional Equities

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News Roundup

Corporate

- Hardening interest rates and higher car prices have slowed passenger car sales growth to 2.89 per cent in March 2007 over the year-ago period - the lowest in 13 months. (BS)
- World's largest financial services firm Citigroup Inc said it will eliminate 17,000 jobs or nearly five per cent of its global workforce, even as it plans to move 9,500 positions to India and other low-cost locations. (FE)
- Indian state-run exploration firm Oil and Natural Gas Corp will invest over Rs 67 billion ($1.56 billion) to raise oil and gas output, and set up its first large power plant. (FE)

Economic and political

- Tension gripped the three panchayats near Paradip in Orissa today as the state government sought to quell the villagers agitating against acquisition of land for South Korean steel maker Posco's mega steel plant. (BS)
- Bank credit growth decreased to 27 per cent in 2006-07 from 29.6 per cent a year earlier, as a result of stiffer monetary tightening since December, 2006. The year-on-year growth in bank credit till December 29, 2006, was 30.1 per cent. (BS)

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

EQUITY MARKETS

		Change, %		
India	11-Apr	1-day	1-mo	3-mo
Sensex	13,183	(0.0)	2.2	(6.2)
Nifty	3,863	0.4	3.4	(4.7)
Global/Regional indices				
Dow Jones	12,485	(0.7)	1.3	(0.6)
Nasdaq Composite	2,459	(0.7)	2.4	(1.7)
FTSE	6,413	(0.1)	2.9	2.8
Nikkei	17,477	(1.1)	1.1	2.5
Hang Seng	20,356	(0.5)	4.7	3.8
KOSPI	1,514	0.0	5.1	9.1

Value traded - India

			Moving avg, Rs bn	
	11-Apr		1-mo	3-mo
Cash (NSE+BSE)	117.9		107.6	125.2
Derivatives (NSE)	228.8		349.4	354.5
Deri. open interest	487.0		543.1	560.0

Forex/money market

		Change, basis points		
	11-Apr	1-day	1-mo	3-mo
Rs/US$	42.8	-	(138)	(159)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	1	2	55

Net investment (US$mn)

	10-Apr		MTD	CYTD
FIIs	92		203	40
MFs	(101)		(107)	(303)

Top movers -3mo basis

		Change, %		
Best performers	11-Apr	1-day	1-mo	3-mo
SAIL	123	4.3	17.2	35.4
BEL	1,659	(1.1)	8.3	26.0
Punjab Tractors	303	0.2	(1.6)	24.6
NALCO	247	6.4	7.8	16.7
Bharti Tele	774	1.2	0.5	16.4
Worst performers				
Ingersoll Rand	270	(0.1)	(9.6)	(31.9)
Acc	732	(2.0)	(2.1)	(31.6)
Tvs Motor	57	(0.6)	(2.7)	(30.9)
Century Tex	528	(1.6)	(4.7)	(30.1)
Gujarat Ambuja	108	(1.3)	2.5	(23.5)

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

Technology

IGAT.BO, Rs385	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	325
52W High -Low (Rs)	432 - 145
Market Cap (Rs bn)	12.1

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	8.1	9.9	12.2
Net Profit (Rs bn)	0.5	0.7	1.0
EPS (Rs)	15.7	22.5	30.0
EPS gth	*101.5*	*43.5*	*33.2*
P/E (x)	24.6	17.1	12.9
EV/EBITDA (x)	13.0	8.8	6.4
Div yield (%)	0.6	0.7	0.7

iGate Global Solutions: Slowdown in sub-prime mortgage segment impacts growth. Maintain Underperform

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243

Rohit Chordia : rohit.chordia@kotak.com, +91-22-6634-1397

- **Revenue growth below expectations**
- **Margins target for 4QFY07 met; margins will likely be under pressure in 1QFY08**
- **Revenue growth likely to be sluggish in 1QFY07**
- **Revising FY2008 and FY2009 EPS estimates downwards by 6.4% and 12.3% to Rs22.5 and Rs30 respectively. Maintain Underperform with a target price of Rs325/ share**

iGate's reported net income of Rs226 mn for 4QFY07 was 12.3% ahead of our estimates, led by a) aggressive rationalization of costs leading to absolute decline in both direct and SG&A expenses b) lower than expected depreciation costs and c) lower than expected tax rates. Operating margins expanded 260bps to 15.3% to surpass management's target of 15% for the quarter. While the operating margin performance is impressive, the critical factor for P/E re-rating and sustained stock performance, in our view, is acceleration in revenue growth rates to tier-I levels, which will likely be a challenge for iGate in the near to medium term. Revenue growth in the Mar '07 quarter was a disappointing 2% qoq in US$ terms, impacted by specific challenges in the iTOPS business. In addition, new customer addition continues to be below our and management expectations. We are revising our EPS estimates for FY2008 and FY2009 downwards by 6.4% and 12.3% to Rs22.5 and Rs30 respectively. Maintain Underperform rating with a target price of Rs325/ share.

Client acquisition pace critical for acceleration in revenue growth: We believe that the most critical factor for sustained stock performance of iGate is acceleration in revenue growth rates, which is contingent on two factors—a) new client acquisition, which has been slower than the management's stated target of 8-10 new customers each quarters—it added 6 new clients in Mar '07 quarter and 25 in FY2007 b) ramp up from existing clients—conversion of new account wins to sustained revenue billing is again below expectations. We expect iGate to once again trail industry revenue growth for FY2008.

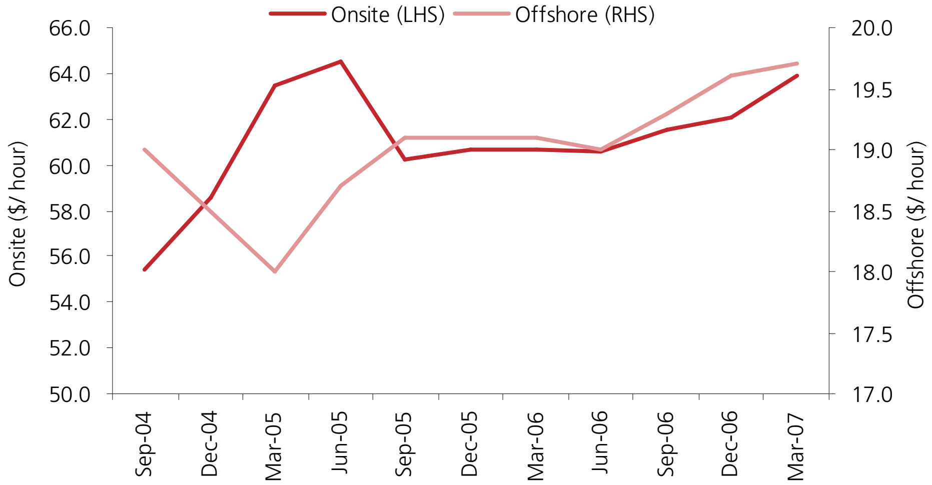
4QFY07 revenue growth disappoints; will likely remain sluggish in Jun '07 quarter. iGate reported modest revenue growth of 2% qoq (US$ terms). Revenue growth was primarily impacted by slowdown in revenues from clients in the sub-prime mortgage segment (9% of iGate's 4QFY07 revenues) in the US. We note that 2 out of iGate's top 20 clients are from this segment. Companies in the sub-prime mortgage segment in the US are grappling with pressures from rising default rates and borrowing costs. iGate's business with these clients is largely transaction-based and thus, any slowdown in loan origination and servicing transactions from these clients has an immediate negative impact on revenues. Management indicates that revenues from this segment will further decline in the Jun '07 quarter and expects revenue growth to remain sluggish in the quarter.

Offshore shift in revenues and billing rate improvement helps margin expansion: iGate reported an operating margin expansion of 260bps qoq to 15.3% from 12.7% in the Dec '06 quarter. Margin expansion was primarily driven by a) offshore shift in revenues (1.2%) b) billing rate improvement of 2.9% onsite and 0.5% offshore and c) aggressive SG&A rationalization—SG&A as a % of revenues was down 130bps to 17.2% from 18.5% in Dec '06 quarter. Net income for the quarter expanded to Rs226 mn, up 41.7% qoq (12.3% higher than our expectation of Rs201 mn) on the back of expansion in EBITDA margins and lower than expected tax rates.

1QFY08 margins will likely be under pressure: While iGate may have achieved its stated margin target of 15%+ in 4QFY07, we would be wary of projecting a similar number for FY2008. We expect a 300bps decline in OPM in 1QFY07 as a result of a) wage increases during the quarter b) limited levers on SG&A rationalization c) sluggish revenue growth. We are factoring in an 180bps OPM improvement in FY2008 to 13.2% from 11.4% in FY2007.

Improvement in billing rate reflects the increasing contribution of revenues from new clients

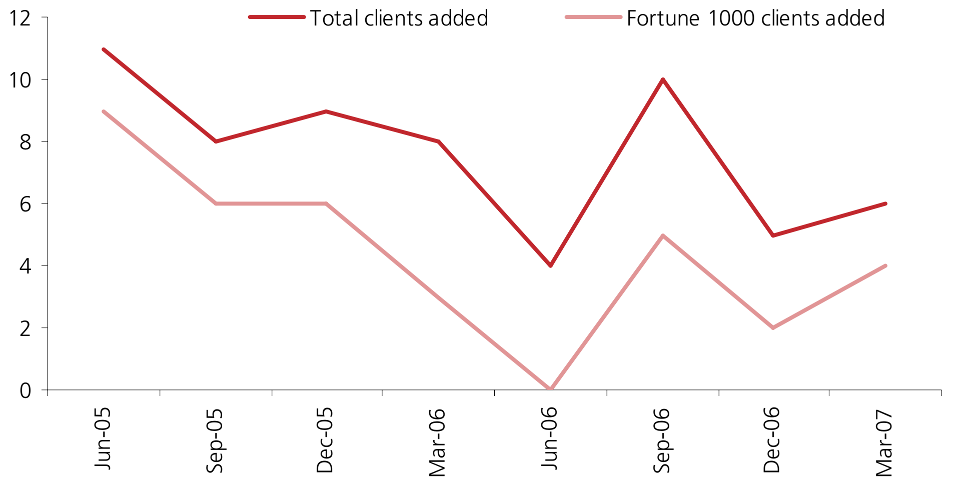
iGate's onsite and offshore billing rates over the past ten quarters



Source: Company reports

iGate's client acquisition pace has been below management's stated targets over the past 3-4 quarters

Total and Fortune 1000 client additions for iGate



Note: Sharp decline in Jun'06 and Sep'06 is largely on account of deferred tax assets created because of provisiong for leave encashment and gratuity

Source: Company reports

Exhibit: Key changes in FY2008 and FY2009 estimates

	New		Old		Change (%)	
Rs mn	**FY2008**	**FY2009**	**FY2008**	**FY2009**	**FY2008**	**FY2009**
Revenues	**9,883**	**12,208**	**10,368**	**12,663**	**(4.7)**	**(3.6)**
EBITDA	1,300	1,661	1,371	1,818	(5.2)	(8.7)
Depreciation	(491)	(542)	(503)	(579)	(2.4)	(6.5)
EBIT	827	1,153	886	1,273	(6.7)	(9.4)
Net Profit	**713**	**959**	**752**	**1,069**	**(5.2)**	**(10.3)**
EPS (Rs/ share)	**22.5**	**30.0**	**24.0**	**34.2**	**(6.4)**	**(12.3)**
Margins (%)						
EBITDA	13.2	13.6	13.2	14.4		
EBIT	8.4	9.4	8.5	10.1		
Revenue (US$ mn)	**227**	**281**	**233**	**282**	**(2.5)**	**(0.4)**
Re/US$ rate	**43.5**	**43.5**	**44.5**	**44.5**	**(2.2)**	**(2.2)**
Revenue Mix - IT Services (US$ mn)						
Onsite	105	128	106	127	(0.8)	0.4
Offshore	98	122	100	120	(1.3)	1.9

Source: Kotak Institutional Equities Esimates

iGate Global Solutions - Comments on interim results

Rs mn	4QFY06	3QFY07	4QFY07	QoQ % chg.	YoY % chg.	Kotak Estimates	Deviation %	Comments on QoQ performance
Revenues	**1,674**	**2,107**	**2,101**	**(0.3)**	**25.5**	**2,256**	(6.9)	Revenue growth of 2% qoq in US$ terms lower than our expectation of 7.5% qoq growth. Revenue growth was impacted by a) slowdown in sub-prime mortgage segment and b) offshore shift
Direct costs	(1,172)	(1,449)	(1,417)	(2.2)	20.9	(1,534)	(7.6)	
Gross profit	**502**	**658**	**684**	**4.0**	**36.3**	**723**	(5.3)	Gross profit margin expansion of 140bps qoq driven primarily by a) 1.2% shift of revenues offshore and b) billing rate improvement of 2.9% onsite and 0.5% offshore
Other expenses	(341)	(391)	(362)	(7.5)	6.3	(403)	(10.1)	
Operating profit	**161**	**267**	**322**	**20.7**	**99.6**	**320**	0.7	The company surpassed its stated OPM target of 15%. OPM 110bps ahead of our expectations. Driven by aggressive SG&A rationalization and significant offshore shift of revenues (1.2%)
Other income	(3)	(1)	11			15	(27.8)	Includes forex gains on hedges of Rs4 mn
EBITDA	158	265	333	25.5	110.2	335	(0.6)	
Depreciation	(95)	(102)	(99)	(3.1)	4.5	(127)	(21.9)	
EBIT	**64**	**163**	**234**	**43.5**	**267.3**	**208**	12.4	
Interest	(8)	(7)	(7)		(12.5)	2	(388.3)	
PBT-before extra-ord items	56	156	227	45.6	307.5	211	7.8	
Extra-ord items	-	-	4			0		Prior period tax adjustment
PBT-after extra-ord items	56	156	231	48.2	314.7	211	9.6	
Tax	(9)	(10)	(13)	31.3	51.2	(19)	(31.1)	Effective tax rate at 5.6% lower than our expectations; Full year tax charge of Rs41.3 mn lower than Rs61.9 mn in FY2006 on account of receipt of favorable orders from income-tax authorities
PAT-Reported	**47**	**146**	**218**	**49.3**	**362.8**	**192**	13.6	
Minority Interest	-	14	8	**(40.7)**	**nmf**	9		
Net Income	**47**	**160**	**226**	41.7	379.8	201	12.3	
Adjusted Net Income	**47**	**160**	**222**	39.2	371.3	201		
EPS - reported (Rs)	**1.5**	**4.7**	**7.2**	54.6	375.7	**6.1**	17.6	
Margins								
Gross profit margin (%)	30.0	31.2	32.6			32.0		
Operating profit margin (%)	9.6	12.7	15.3			14.2		
Net profit margin - reported (%)	2.8	7.6	10.8			8.9		
Revenues from GE (Rs mn)	626.5	557.3	544.8	(2.2)	(13.0)	-		GE revenues continue to show weak trend. Down 13% yoy and 2.2% qoq
Onsite: Offshore mix (Rs mn))								
Onsite	839	1,012	993	(1.9)	18.3	-		
Offshore	705	874	898	2.7	27.5	-		Overall revenue growth driven primarily by strong growth in offshore revenues. Onsite revenues declined to 52.5%

Source: Kotak Institutional Equities

Industrials

SUZL.BO, Rs1059	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	1,390
52W High -Low (Rs)	1510 - 760
Market Cap (Rs bn)	304.5

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	83.0	130.0	158.9
Net Profit (Rs bn)	11.1	16.9	18.7
EPS (Rs)	38.8	58.7	65.2
EPS gth	*47.4*	*51.4*	*11.0*
P/E (x)	27.3	18.0	16.3
EV/EBITDA (x)	20.7	13.8	10.8
Div yield (%)	0.7	0.8	0.8

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	69.7	-	-
FIIs	21.4	1.3	(0.0)
MFs	1.0	0.4	(0.9)
UTI	-	-	(1.3)
LIC	-	-	(1.3)

Suzlon Energy: The Repower bid may not destroy as much value as feared

Shilpa Krishnan : shilpa.krishnan@kotak.com, +91-22-6634-1239

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

- **Value destruction in the most pessimistic scenario: Rs170/share**
- **Acquisition expensive; access to technology and markets and ability to enhance Repower's delivery capability may however make it less steep**
- **We believe the stock may offer entry opportunity as uncertainties prevail over the acquisition over the next month or so**

We believe Suzlon's potential acquisition of Repower may not destroy as much value as feared, going by a discounted cashflow analysis of the acquisition under various scenarios. In a pessimistic scenario of Suzlon's bid getting accepted at Euro 170 (further 15% up from current offer) and inability to derive any synergy gains, the value destruction is Rs42.5 bn (Rs170/share). In the most optimistic situation of Suzlon's bid going through at the current offer of Euro 150, and the company deriving moderate synergy gains as well, the damage whittles down to Rs70/share. The acquisiton is thus expensive, but the management of Suzlon possibly sees benefits and synergy gains beyond the obvious. In terms of near-term earnings impact, the sensitivity of EPS to 15% increase in bid price is just around 2%, indicating that the stock may not fall as steeply if there is a further bidding war. Notwithstanding yesterday's rally in the stock, we believe the sharp correction over the past few months offers an entry opportunity.

Discounted cashflow approach to valuing the potential acquisition of Repower

Based on the consensus estimates for Repower, we work out the DCF of the acquisition under 4 scenarios. 1) If the bid goes through at current prices (less likely, in our view), the acquisition could destroy value of Rs33 bn (Rs116/share). 2) If the bid goes through at 15% above current prices (more likely), the acquisition could destroy Rs42.5 bn value (Rs148/share). 3) In the most optimistic scenario of the bid going through at current prices and synergy gains coming in from the acquisition, we believe the acquisition would destroy only Rs68/share value. 4) In the most likely scenario of acquisition at Euro 170 and moderate synergy gains, the damage is only Rs100/share. We use WACC of 12% for our analysis.

Limitations of our approach: short horizon, unavailability of management guidance on synergies

For our cash flow estimates, we use a brief horizon of CY2009, beyond which consensus numbers of Repower are not available. While estimating the synergy gains, we use the following assumptions: 1) Suzlon would be able to debottleneck Repower to the extent of 100MW and 300MW for CY2008 and 2009 respectively. The average selling price of a turbine would be Rs45mn/MW and the EBIT margin would be 12%. Hansen would supply gearboxes to Suzlon. The loss on transfer pricing would equal an EBIT margin of 14% on gearbox, which accounts for 15% of the value of a turbine as per our estimates.

We strongly believe the acquisition offers synergy benefits and would improve Suzlon's stature

Gearboxes is a known area of constraint for Repower, which Suzlon could resolve through its earlier acquisition of Hansen. The capacity of a manufacturing system = capacity of the bottleneck resource. Repower has been facing component supply bottlenecks and has highlighted risks to its revenue estimates because of delay in supply of 2 key components—gearboxes and bearings. Suzlon with its vertically integrated supply chain model may have seen the ability to increase Repower's deliverable capacity beyond the current level of ~500MW and the projected level of ~1000MW.

We see 4 additional benefits for Suzlon from the potential acquisition:

1) Access to Repower's delivery capability of ~500MW, moving up to ~1000MW by December 2008

2) Access to new markets: Repower is strong in Germany and France, and is also present in UK, USA, Japan, China, Australia and Canada. Europe accounts for about half of the worldwide wind energy equipment market. Suzlon, with a miniscule presence in Europe, could strengthen its position with Repower

3) Advanced technology, particularly offshore: Repower has products in 1.5MW, 2MW and 5MW (offshore), while its 3.3MW machine is under development. Repower is known to be a technology leader, famed for 'German engineering' of its turbines. It has proven technology for 5MW class of offshore wind turbines. The 5MW turbine was successfully installed in the demonstration wind farm project and the company expects that this turbine would enter serial production in CY2008.

4) Staving of potential competition: Areva is a focused player in CO2-free power generation technologies and is keen to get a foothold in the global wind equipment market. Moreover, Repower has licensed its 1.5MW technology to its Indian JV with Essar. If Suzlon completes this acquisition, it could keep strong new potential entrants at bay, both in its home turf and in global markets.

Expensive bid, EPS dilutive

The revised offer price, if evaluated based on near-term earnings impact, is certainly EPS dilutive. The dilutive effect on Suzlon's EPS is 13.6% for FY2008E and 7.9% for FY2009E, should this acquisition go through at the current offer price (Exhibit 1). We have assumed

a) Successful open offer for 75% of Repower's shares (excluding Martifer's stake of 25%),

b) Repower's revenue increases from Euro 400 mn in CY2006 to Euro 900mn in CY2008,

c) Improvement in Repower's EBIDTA margin from 3% to 10% over 4 years and

d) No tax benefit on debt raised to fund Repower's acquisition as the debt is being raised by the SPV, which would not have any business activity to avail of tax benefit on interest payments.

Event: Suzlon raises offer price for Repower, further bidding war may be possible

Suzlon has increased its offer price for Repower to Euro 150. This compares with its earlier bid of Euro 126 and Areva's competing bid at Euro 140. Suzlon has also purchased 7.7% stake in the company from the market, highlighting its seriousness in pursuing the acquisition. Repower's share price has gained further to close at Euro157, indicating that investors expect further bidding war and eventual offer price to be higher than Suzlon's current Euro150/share offer.

We believe the stock factors in the worst case and offers an entry point

In terms of near-term earnings impact, the sensitivity of EPS to 15% increase in bid price is just around 2%, indicating that the stock may not fall as steeply if there is a further bidding war. Considering a worst case scenario of further bidding war and no synergy gains, Suzlon's fair value could decline to Rs1,220. This implies an upside from current levels nothwithstanding the sharp rally in the stock yesterday. Potential uncertainties until the acquisition is consummated (around mid-May) may offer entry points.

The Repower acquisition may not destroy as much value as feared

Per share value destruction under various scenarios (Rs)

	Bid price (Euros)	
	150	**170**
Synergy gains		
None	(116)	(168)
Moderate	(70)	(100)

Source: Kotak Institutional Equities estimates

DCF analysis of potential acquisition at current bid price of Euro 150 and moderate synergies

(Rs mn)

	CY2007E	CY2008E	CY2009E
EBIT(1-tax rate)+depreciation	1,351	2,096	2,866
Add: synergy gains	0	446	1,347
Operating cashflows	**1,351**	**2,542**	**4,213**
Capex	70,692	0	0
Free cashflows	**(69,341)**	**2,542**	**4,213**
Discount rate (%)	12.0	12.0	12.0
No of years (#)	-	1.0	2.0
Discount factor (X)	1.0	0.9	0.8
Discounted cashflows	**(69,341)**	**2,269**	**3,358**

Growth to perpetuity (%)	3
Terminal value	38,434
Discounted cash flows	(63,713)
Net debt	5,742
Total value added	**(19,538)**
Per share	**(68)**

Source: Kotak Institutional Equities estimates

Calculation of synergy benefits for Suzlon energy from Repower's acquisition (Rs mn)

	CY2007E	CY2008E	CY2009E
Improvement in delivery capability			
Improvement in delivery capacity (MW)	-	100.0	300.0
Revenue/MW	45.0	45.0	45.0
EBIT margin (%)	12.0	12.0	12.0
Gross EBIT	-	540.0	1,620.0
Less: loss of value due to transfer pricing			
Gearbox as % of turbine	15.0	15.0	15.0
EBIT margin on gearbox	14.0	14.0	14.0
Lower EBIT for Hansen (gearbox supplier)	-	94.5	283.5
Net EBIT contribution		**445.5**	**1,336.5**
Shift of production to low-cost centers			
Incremental EBIT margin (%)	-	-	1.0
Incremental EBIT	**-**	**-**	**10.1**
Total EBIT contribution from synergy	**-**	**445.5**	**1,346.6**

Source: Kotak Institutional Equities estimates

Acquisition is likely to be EPS dilutive in the medium term

EPS contribution from the acquisition of Repower Systems AG (Euro mn)

	CY2006	CY2007E	CY2008E	CY2009E
Repower Systems AG				
Revenues	466	627	854	1,009
EBITDA	17	35	59	76
Depreciation	4	4	2	11
EBIT	12	31	57	65
PBT	11	30	55	62
PAT	7	19	33	37
PAT after minority interest		14	25	28
EBITDA margin (%)	3.5	5.6	7.0	7.5
EBIT margin (%)	2.7	5.0	6.7	6.4
Tax rate (%)	35.6	37.3	39.6	39.9
Bid @ 150Euro				
Debt raised by Suzlon		926.9	926.9	1,235.9
Interest Cost		55.6	55.6	74.2
Post tax interest cost		55.6	55.6	74.2
Consolidated PAT contribution		(41.7)	(30.7)	(46.3)
Consolidated EPS contribution (Rs)		(8.3)	(6.1)	(9.2)
Estimated fiscal year EPS (Rs)		58.8	64.2	80.4
Estimated fiscal year EPS dilution (%)		**14.1**	**9.5**	**11.5**
Assumptions				
Interest rate (%)		6	6	6
Tax benefit for Bidco.		0	0	0
Implied multiples (without synergy)				
EV/Sales		2.0	1.4	1.2
EV/EBIDTA		35.0	20.8	16.3
Pre-acquisition P/E		65.4	36.6	32.8

Source: Kotak Institutional Equities estimates

Suzlon's profitability is superior to that of Repower

	Suzlon			Repower		
	FY2005	FY2006	FY2007E	CY2004	CY2005	CY2006
Ratio (% of sales)						
Materials & manufacturing	65.9	67.5		77.5	81.1	83.0
Employee cost	3.2	3.2		8.9	7.8	6.1
Other SG&A	6.7	6.0		12.4	10.4	7.4
EBITDA margin	**24.2**	**23.4**	**19.1**	**1.2**	**0.7**	**3.6**
PBT margin	21.9	21.3	15.2	-2.3	-2.5	2.4
PAT margin	19.9	19.8	13.5	-3.1	-1.9	1.5
Dupont analysis						
PAT to sales	0.20	0.20	0.13	(0.03)	(0.02)	0.02
Sales to assets	1.49	1.20	1.10	1.91	2.20	2.25
Assets to equity	1.64	1.17	2.10	1.63	1.59	1.10
RoE (%)	**48.5**	**27.9**	**31.0**	**(9.7)**	**(6.8)**	**3.8**
Employees (#)	2,071	5,300	5,301	587	631	831
Sales/ Employee (thousands euros)	174	134	290	527	553	561
Employee cost / employee (thousands euros)	5.5	4.2	12.6	46.9	43.3	34.3

Source: Company Data, Kotak Institutional Equities estimates

Summary financials of Repower Systems AG, calendar year 2004-2006 (Euro mn)

	2004	2005	2006
Income statement			
Income from operations	**309.2**	**348.9**	**465.9**
EBITDA	**3.7**	**2.3**	**16.5**
Other income	0.2	0.0	0.2
PBDIT	**3.8**	**2.3**	**16.8**
Interest & finance charges	(3)	(4)	(1)
Depreciation	(7)	(7)	(4)
PBT	**(7)**	**(9)**	**11.2**
Tax	(3)	1.8	(4)
PAT	**(10)**	**(6.8)**	**7.2**
Key ratios			
EBITDA margin (%)	1.2	0.7	3.6
Tax rate (%)	(35.7)	21.2	35.6
PAT margin (%)	(3.1)	(1.9)	1.5
Balance Sheet			
Share holder's Funds	**99.0**	**99.9**	**187.8**
Capital	5.4	5.9	8.1
Reserves and Surplus	93.6	94.0	179.7
Loan Funds	**62.5**	**58.7**	**19.7**
Secured Loans	48.2	16.9	19.7
Unsecured Loans	14.4	41.8	0.0
Total	**161.5**	**158.6**	**207.5**
Net Block	66.2	36.3	53.4
Cash & Bank Balances	26.8	67.4	120.1
Investments	0.6	0.7	3.6
Net Current Assets	67.9	54.2	30.4
Total	**161.5**	**158.6**	**207.5**
D/E	0.6	0.6	0.1
FATR	4.7	9.6	8.7
Return on equity (%)		(6.8)	5.1
Return on capital employed (%)		(2.6)	4.5

Source: Kotak Institutional Equities estimates

Transportation

JET.BO, Rs609	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	400
52W High -Low (Rs)	1059 - 475
Market Cap (Rs bn)	52.6

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	72.3	105.5	138.0
Net Profit (Rs bn)	(0.5)	(3.1)	1.6
EPS (Rs)	(6.2)	(35.5)	18.7
EPS gth	*(115.2)*	-	-
P/E (x)	(98.1)	(17.2)	32.5
EV/EBITDA (x)	35.0	11.0	5.1
Div yield (%)	(0.2)	(1.2)	0.6

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	8.6	0.1	(0.1)
MFs	1.7	0.1	(0.1)
UTI	-	-	(0.2)
LIC	2.8	0.1	(0.1)

Jet Airways: Jet to takeover Air Sahara at lower valuation

Shilpa Krishnan : shilpa.krishnan@kotak.com, +91-22-6634-1239
Lokesh Garg : lokesh.garg@kotak.com, +91-22-6634-1496

Jet Airways will takeover Air Sahara at an EV of Rs19.5 bn, after a series of arbitration proceedings lasting over a year, as per news reports. The ET reports that the amount includes Rs1.8 bn that Jet had already invested in Sahara's operations, Rs5 bn paid as a loan, Rs2 bn liabilities taken over and Rs1.25 bn assets pushed out, leaving Rs9.5 bn to be paid for the deal. Of this Rs4 bn would be paid upfront and the rest would be paid in 4 equal installments. Jet Airways has not made an official release confirming these numbers. We maintain Underperform on Jet Airways, with a target price of Rs400. Our negative outlook stems from concerns on continued losses on international operations in the medium term

Jet had earlier backed out due to unexpected hitches

Jet had earlier offered Rs23 bn (US$500 mn) for Air Sahara last February. It subsequently backtracked from the deal, possibly due to a) the fact that a number of favourable lease deals were expiring very shortly, b) major attrition amongst Sahara's pilots, one of the key attractions at the time of the deal and c) the possibility that Sahara's prime slots at key airports would not automatically pass to Jet.

Three factors may have prompted Jet to agree for the takeover

1) Possible write-off of a major part of Rs6.8 bn that Jet had committed to the deal, resulting in a lower implied EV for the deal

2) At an adjusted EV of Rs19.5 bn, the adjusted EV/EBIDTAR, assuming the most optimal fleet utilization and yield management, would work out to 5x, which is far lower than what most airlines are quoting at. However, the path to the turnaround story may be protracted

3) Considering the combine would have a combined market share of 32% (Jet's share is 25%), we believe the deal may accelerate the return of rational pricing in domestic markets

Best case numbers for Air Sahara

Current seat capacity (# of seats)	3,675
Optimal ASKM with this seat capacity (multiple of 1.8x)	6,615
Optimal seat factor (%)	75.0
Best case RPK (mn)	4,961
Optimal yield (Rs/RPK)	5.0
Best case revenues (Rs mn)	24,806
Best case EBIDTAR margin (%)	15.0
Best case EBIDTAR (Rs mn)	3,721
Adjusted EV of the deal	19,500
EV/EBIDTAR under ideal circumstances	5.2

Source: Kotak Institutional Equities

Automobiles

Sector coverage view	Attractive

Company	Rating	Price, Rs 11-Apr	Target
Hero Honda	U	641	625
Bajaj Auto	OP	2,280	2,860
Tata Motors	OP	721	925
Maruti	OP	782	950
Mah & Mah	OP	726	1,000
Ashok Leyland	IL	37	40
Punjab Tractor	IL	303	215
TVS Motor	U	57	55
Bharat Forge	OP	312	390

Automobiles: Feedback from auto finance companies - Car and CV sales soften in April

Abhijeet Naik : abhijeet.naik@kotak.com, +91-22-6634-1220

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

- **Feedback from auto finance companies - Car and CV sales soften in April**

Our discussions with auto finance companies indicates a perceptible softening of demand for both cars and CVs post the sharp rise interest rates. However, Maruti seems to be doing better than peers due to the success of its recent launches. In the case of CVs, a worrisome feedback we received was that finance companies have started noticing some strain in instalment payments from large truck operators. We maintain out 8-10% growth etimate for cars and 6% growth estimate for CVs for FY08.

Cars: Softening demand after interest rate hikes

There has been a definite softening of demand in cars since the second half of March post the sharp rise in auto finance rates, which have now risen to about 13-14% from 9% a year back. The top three car companies –Maruti, Hyundai and Tata Motors were struggling to meet sales targets towards the end of March. Stocks have now started building up at car dealerships, more so in the small car segments. The finance companies expect a sharp drop in car industry growth rates in FY08 after the 20% growth of FY07. Another fall-out of the rise in interest rates is that more people are now opting to buy a car by paying the full amount upfront and not availing of loan facilities. The finance penetration in cars has slipped to 75-77% from 80% plus previously. We understand that Hyundai is now giving subventions (subsidies) to finace companies as it is seeing a severe pressure on its 'Santro' sales. However, Maruti seems to be doing relatively better than Tata Motors and Hyundai on the back of the success of its recent launches of the diesel 'Swift' and the 'Zen Estilo'.

We currently estimate 8-10% growth for cars in FY08. We expect Maruti to outperform with 11% growth and expect Tata Motors to grow a slower 8% for the year.

CVs: Soft demand plus some strain in instalment payments by large truck operators

Finance companies are also seeing signs of slowdown in CVs from mid-March. The sharp rise in interest rates have resulted in a deferment of purchase for many large buyers. CV companies have indicated 10-15% growth in FY08 but the finance companies are of the opinion that growth could come lower than the same. They are however seeing better growth for tractor-trailers and heavy tonnage CVs compared to MCVs. They are also optimistic on strong sales growth continuing for the 'Ace' in FY08.

A worrisome feedback we received from the CV finance companies is that they have started noticing some strain in instalment payments from large truck operators. The finance companies had to 'chase the large operators' till the last day of March to receive their payments, something that they never needed to do before. They are however not seeing any rise in overdue payments cases or NPA cases, which are classic red flags pointing towards an acute downcycle for the CV industry. This gives us confidence that FY08 CV industry growth will remain positive. However, the fact that large truck operators need to be chased for instalment payments indicates that things are not hunky-dory either.

We currently estimate 6% growth for CVs for FY08 (3% for M&HCVs and 10% for LCVs). We will be keeping in touch with CV industry participants on a periodic basis to assess ground-level developments in the industry.

Telecom

Sector coverage view	Neutral

		Price, Rs	
Company	**Rating**	**11-Apr**	**Target**
Bharti	U	774	525
Rcom	IL	413	400
MTNL	U	153	135
VSNL	OP	421	560
IDEA	IL	96	90

March GSM net adds; No meaningful impact of subs re-verification

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243

- **GSM operators added a record 6.1 mn subs in March 2007 led by BSNL**
- **Negligible impact of subscriber re-verification on GSM operators**
- **In contrast, RCL has de-activated 5 mn unverified subscribers**

GSM operators added 6.1 mn subs in March 2007, an increase from 4.9 mn in February 2007 and appear to be unaffected by subscriber re-verifications. This is in sharp contrast to RCL, which knocked off 5 mn subscribers in the re-verification exercise. BSNL led the industry adding a record 2 mn subs (32.4% of the net additions) as compared to 1 mn in February 07 and 0.0.86 mn average in FY2007. We attribute this to year-end push but expect a repeat of March performance over the next few months to put solid pressure on other operators. We maintain our FY2008, FY2009 and long-term (FY2016) subscribers forecast of 239 mn, 312 mn and 551 mn, respectively. However, we would adjust our market share assumptions, increase for Bharti, BSNL and Hutch and cut for RCL. We maintain our DCF-based 12-month target prices of Rs525 for Bharti and Rs90 for Idea. We are reviewing our assumptions for RCL (Rs400). Key risk is level of profitability.

GSM operators sailed through re-verification test unlike RCL. The subscriber re-verification exercise did not have any impact on GSM operators excluding Idea. Bharti stated that the impact was marginal and subscriber addition without forced disconnections would have been marginally higher. This compares with a 5 mn reduction in the subscriber base of RCL, which raises issues about historical subscriber numbers and execution. However, RCL can bounce back if the de-activations merely reflect a delay in re-verification. Also, RCL management has claimed negligible impact on revenues and profitability since de-activated subscribers were very low revenue subscribers.

BSNL—not sure whether it can sustain near-term but large capacity addition looms. We believe a part of BNL's March additions may reflect push to meet its year-end target; sister concern MTNL also reported a similar jump in March. Nonetheless, BSNL's 2 mn addition is very impressive given constraints on its capacity. We believe that the street is ignoring the potential threat on subs addition and pricing once BSNL starts additional capacity (63.5 mn). We expect market subscriber additions to remain robust over the next few quarters but are chary about pricing given (a) expansion of operators into new circles (Idea and Maxis) (b) aggressive market share plans of Vodafone and (c) start of additional capacity of BSNL.

Bharti—steady progress. Bharti added 1.7 mn subs, largely similar to additions in the previous 3-4 months. Bharti's end-FY2007 subscriber base stood at 37.1 mn. It is possible Bharti's monthly additions may have been depressed in the previous 3-4 months due to phased de-activation of unverified subscribers. If this were the case, we expect Bharti's subscriber addition to increase from April but this would also depend on market growth and competition.

Idea Cellular—performance impacted by subscriber re-verification. IDEA added 371,000 subs (6% of GSM market net adds), down from 568,000 subs in February 2007. We attribute the decline to possible de-activation of unverified subscribers. Idea ended FY2007 at 14 mn subscribers versus our 14.4 mn estimate. Idea had a decline in subscriber base in Gujarat and UP (W) circles. In addition, subscriber addition in 'old' circles such as Mahrashtra and Haryana was muted. Ideas's share of net additions has declined for the last four months and thus, it needs to tighten execution, in our view. The loss in market shares may also reflect forced de-activation of unverified subscribers.

Subscriber details of leading GSM cellular operators ('000)

	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07
Subs ('000)													
Bharti	19,579	20,684	21,860	23,073	24,338	25,649	27,061	28,612	30,262	31,974	33,732	35,440	37,141
Hutchison	15,361	16,062	16,768	17,544	18,399	19,380	20,357	21,267	22,275	23,306	24,414	25,343	26,442
IDEA-Escotel	7,366	7,641	8,063	8,537	9,122	9,735	10,364	10,980	11,841	12,442	13,072	13,640	14,011
BPL	1,338	1,308	1,293	1,297	1,285	1,043	1,045	1,049	1,053	1,056	1,062	1,066	1,071
Modi group	1,933	1,985	2,028	2,055	2,095	2,148	2,197	2,266	2,357	2,450	2,520	2,579	2,729
Reliance	1,904	2,010	2,156	2,317	2,517	2,737	2,958	3,184	3,410	3,641	3,876	4,111	4,348
MTNL	1,941	2,018	2,097	2,170	2,238	2,264	2,290	2,326	2,375	2,425	2,498	2,579	2,747
BSNL	17,157	17,584	18,001	18,294	19,031	20,063	20,936	22,054	22,975	23,619	24,442	25,444	27,429
Others	2,612	2,831	3,025	3,199	3,391	3,601	3,804	4,005	4,238	4,513	4,802	5,095	5,514
Total market	**69,192**	**72,122**	**75,290**	**78,485**	**82,415**	**86,620**	**91,014**	**95,742**	**100,786**	**105,425**	**110,420**	**115,297**	**121,431**
Market share of subs (%)													
Bharti	28.3	28.7	29.0	29.4	29.5	29.6	29.7	29.9	30.0	30.3	30.5	30.7	30.6
Hutchison	22.2	22.3	22.3	22.4	22.3	22.4	22.4	22.2	22.1	22.1	22.1	22.0	21.8
IDEA-Escotel	10.6	10.6	10.7	10.9	11.1	11.2	11.4	11.5	11.7	11.8	11.8	11.8	11.5
BPL	1.9	1.8	1.7	1.7	1.6	1.2	1.1	1.1	1.0	1.0	1.0	0.9	0.9
Modi group	2.8	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.2	2.2
Reliance	2.8	2.8	2.9	3.0	3.1	3.2	3.3	3.3	3.4	3.5	3.5	3.6	3.6
MTNL	2.8	2.8	2.8	2.8	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.2	2.3
BSNL	24.8	24.4	23.9	23.3	23.1	23.2	23.0	23.0	22.8	22.4	22.1	22.1	22.6
Others	3.8	3.9	4.0	4.1	4.1	4.2	4.2	4.2	4.2	4.3	4.3	4.4	4.5
Growth (%)													
Bharti	6.1	5.6	5.7	5.5	5.5	5.4	5.5	5.7	5.8	5.7	5.5	5.1	4.8
Hutchison	5.7	4.6	4.4	4.6	4.9	5.3	5.0	4.5	4.7	4.6	4.8	3.8	4.3
IDEA-Escotel	5.2	3.7	5.5	5.9	6.8	6.7	6.5	5.9	7.8	5.1	5.1	4.3	2.7
BPL	0.0	(2.2)	(1.2)	0.4	(1.0)	(18.8)	0.2	0.4	0.3	0.3	0.6	0.3	0.5
Modi group	6.2	2.6	2.2	1.3	2.0	2.5	2.3	3.1	4.0	3.9	2.9	2.3	5.8
Reliance	5.8	5.6	7.3	7.5	8.6	8.7	8.1	7.6	7.1	6.8	6.5	6.0	5.8
MTNL	12.9	3.9	4.0	3.4	3.1	1.2	1.2	1.5	2.1	2.1	3.0	3.2	6.5
BSNL	6.8	2.5	2.4	1.6	4.0	5.4	4.4	5.3	4.2	2.8	3.5	4.1	7.8
Others	6.0	8.4	6.9	5.8	6.0	6.2	5.6	5.3	5.8	6.5	6.4	6.1	8.2
Total market	**6.1**	**4.2**	**4.4**	**4.2**	**5.0**	**5.1**	**5.1**	**5.2**	**5.3**	**4.6**	**4.7**	**4.4**	**5.3**
Net monthly adds ('000)													
Bharti	1,129	1,105	1,176	1,212	1,265	1,311	1,413	1,551	1,650	1,712	1,758	1,708	1,701
Hutchison	830	701	705	777	855	981	977	910	1,008	1,032	1,108	929	1,099
IDEA-Escotel	362	274	422	474	584	613	629	616	862	601	629	568	371
BPL	0	(30)	(15)	5	(13)	(242)	3	4	4	4	6	4	5
Modi group	113	51	43	27	40	53	49	69	91	92	70	59	150
Reliance	104	106	146	161	200	220	222	225	226	231	235	235	237
MTNL	221	76	80	72	68	26	26	35	49	50	74	81	168
BSNL	1,098	427	417	293	737	1,032	873	1,118	921	643	824	1,002	1,985
Others	148	219	194	174	193	210	203	201	233	275	290	292	420
Total market	**4,005**	**2,930**	**3,168**	**3,195**	**3,930**	**4,205**	**4,394**	**4,728**	**5,044**	**4,639**	**4,994**	**4,877**	**6,135**
Market share of net adds (%)													
Bharti	28.2	37.7	37.1	37.9	32.2	31.2	32.1	32.8	32.7	36.9	35.2	35.0	27.7
Hutchison	20.7	23.9	22.3	24.3	21.8	23.3	22.2	19.2	20.0	22.2	22.2	19.0	17.9
IDEA-Escotel	9.0	9.4	13.3	14.8	14.9	14.6	14.3	13.0	17.1	13.0	12.6	11.6	6.0
BPL	0.0	(1.0)	(0.5)	0.1	(0.3)	(5.8)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Modi group	2.8	1.7	1.4	0.8	1.0	1.3	1.1	1.5	1.8	2.0	1.4	1.2	2.5
Reliance	2.6	3.6	4.6	5.0	5.1	5.2	5.0	4.8	4.5	5.0	4.7	4.8	3.9
MTNL	5.5	2.6	2.5	2.3	1.7	0.6	0.6	0.7	1.0	1.1	1.5	1.7	2.7
BSNL	27.4	14.6	13.1	9.2	18.8	24.6	19.9	23.6	18.3	13.9	16.5	20.5	32.4
Others	3.7	7.5	6.1	5.4	4.9	5.0	4.6	4.2	4.6	5.9	5.8	6.0	6.8
Circlewise subs ('000)													
Metros	15,860	16,217	16,654	17,104	17,577	17,924	18,525	18,977	19,472	20,072	20,634	21,322	21,959
Circle A	24,333	25,442	26,646	27,813	29,359	30,825	32,443	34,191	36,059	37,443	39,237	40,717	42,680
Circle B	22,724	23,734	24,788	25,951	27,512	29,462	31,101	33,073	35,097	37,130	39,137	41,072	43,543
Circle C	6,275	6,728	7,201	7,616	7,966	8,409	8,945	9,501	10,159	10,779	11,412	12,185	13,250
Total	**69,192**	**72,122**	**75,290**	**78,485**	**82,415**	**86,620**	**91,014**	**95,742**	**100,786**	**105,425**	**110,420**	**115,297**	**121,431**
Circlewise net adds ('000)													
Metros	806	357	438	450	473	347	600	452	495	601	561	688	637
Circle A	1,355	1,110	1,204	1,167	1,546	1,465	1,618	1,749	1,867	1,385	1,794	1,480	1,963
Circle B	1,235	1,010	1,054	1,163	1,561	1,949	1,639	1,972	2,024	2,033	2,007	1,935	2,470
Circle C	622	453	473	415	350	443	536	555	659	620	632	774	1,064
Total	**4,005**	**2,930**	**3,168**	**3,195**	**3,930**	**4,205**	**4,394**	**4,728**	**5,044**	**4,639**	**4,994**	**4,877**	**6,135**
Circlewise subs (%)													
Metros	23	22	22	22	21	21	20	20	19	19	19	18	18
Circle A	35	35	35	35	36	36	36	36	36	36	36	35	35
Circle B	33	33	33	33	33	34	34	35	35	35	35	36	36
Circle C	9	9	10	10	10	10	10	10	10	10	10	11	11
Circlewise net adds (%)													
Metros	20	12	14	14	12	8	14	10	10	13	11	14	10
Circle A	34	38	38	37	39	35	37	37	37	30	36	30	32
Circle B	31	34	33	36	40	46	37	42	40	44	40	40	40
Circle C	16	15	15	13	9	11	12	12	13	13	13	16	17

Source: Cellular Operator's Association of India, Compiled by Kotak Institutional Equities/Goldman Sachs Research.

Economy

Sector coverage view	N/A

India's interest rate outlook: Namaste, SLR deficit

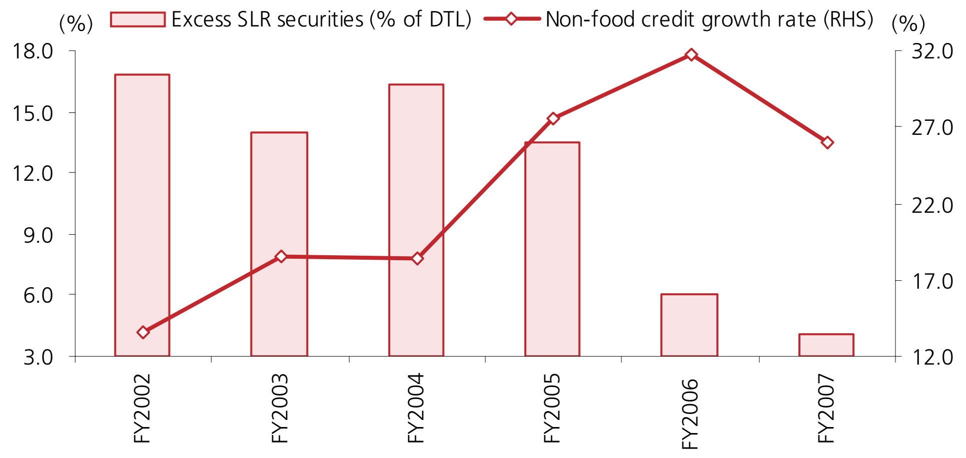
Indranil Sen Gupta : indranil.sengupta@kotak.com, +91-22-6634-1216

- **Banks face FY2008E 0.6% SLR deficit; end March 2007 with 29.1% SLR**
- **Expect the RBI to cut SLR by 1% of demand and time liabilities in late FY08E**
- **50bp PLR hike, if inflation peak-off allows RBI top off; real lending rates neutral**
- **10-year yield 8.1% near-term, FY2008E 7.5%, assuming a normal monsoon**

We estimate that Indian commercial banks face an effective statutory liquidity ratio (SLR) deficit of 0.6% of demand and time liabilities in FY2008E. This, in turn, implies that they need to buy Rs186 bn/US$4.2 bn of gilts during the year (Exhibits 1-2). We continue to expect the RBI to cut the SLR by 1% in 2HFY2008E and 3% in FY2009E to balance the government securities market and prevent a lending rate spike that would otherwise destroy the India story (Exhibit 3). Even assuming a 1% SLR cut, a persistent credit gap will likely push up lending rates by 50bps (Exhibit 4). This will likely revert interest rates to neutral, closing the gap between the real lending rate—currently 7.25% - and the 7.8% potential real GDP growth rate. Notwithstanding banks' SLR demand, monetary policy risk premium will likely hold 10-year yields around 8%. A normal monsoon which sustains a 1QFY08E inflation peak off could spur gilts (and by extension, PSU bank stocks), especially if the good Governor Reddy is able to sort out what he now dubs 'confusing realities' in the meanwhile.

Exhibit 1: Strong credit offtake eroded banks' SLR to 29.1% from 41.3% in March 2004

Excess SLR securities (% of demand and time liabilities), non-food credit growth rate



Source: RBI.

Exhibit 2: Banks' effective SLR now works out to 22.4%

SLR securities with commercial banks (Rsbn)

		25% SLR	24% SLR FY08	Assumptions
1	Opening balance as on March 31, 2006	1,560	1,560	
2	Add: Net contribution to government borrowing	645	645	
3	Recapitalization bonds	80	80	
4	Other approved securities	44	44	
5	Market Stabilization Scheme (MSS)	339	339	
6	Banks' vault cash	22	22	
7	Minus: Additional SLR requirements	1,376	1,376	
8	Net repos under the LAF	360	360	
9	Closing balance as on March 31, 2007 (1+2+3+4+5+6-7-8)	954	954	
10	Add: Recapitalization bonds	148	148	As per Union Budget 2006.
11	Banks' vault cash	25	25	
12	Net reverse repos under the LAF	287	287	
13	Minus: Additional SLR requirements	1,140	813	16.0% deposit growth (see Ex 4)
14	Maturity of MSS paper	460	460	Excludes 2009 issuances
15	Closing balance as on March 31, 2008 (9+10+11+12-13-14)	(186)	141	
	(SLR as % of banks FY2008E DTL)	24.4	24.4	
16	Net contribution to government borrowing {=(-15)}	186	(141)	

Source: RBI, Kotak Institutional Equities estimates.

Exhibit 3: 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

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)
FY2006	7.4	1,187	500	417	270	25.0	—	270	223
FY2007E	7.0	1,308	575	492	241	25.0	—	241	447
FY2008E	6.5	1,317	657	542	118	25.0	186	(68)	—
FY2008E	**6.5**	**1,317**	**657**	**542**	**118**	**24.0**	**(141)**	**259**	**—**
FY2009E	6.1	1,359	807	599	(47)	25.0	1,326	(1,373)	—
FY2009E	**6.1**	**1,359**	**807**	**599**	**(47)**	**21.0**	**128**	**(175)**	**—**

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

Exhibit 4: 1% SLR cut will likely limit additional PLR hike to 50bps

Sources and uses of bank funds (in Rsbn)

Key sources/uses	25% SLR FY2008E	24% SLR FY2008E	Assumptions
1. Deposits	4,151	4,151	8.3% real GDP growth, 5% inflation, base effects.
2. Non-deposit sources	50	50	
3. Primary issuances	150	150	
4. Bank reserves	437	437	6.5% CRR
5. Investment in government securities	186	(141)	See Ex 2.
6. Net foreign assets	(100)	(100)	
7. Resources available for interest rate-neutral credit offtake (1+2+3-4-5-6)	3,828	4,155	
8. Credit offtake/demand	4,246	4,246	21% credit offtake, based on growth/inflation projections
9. Credit gap (8-7)	418	91	
Memo item			
1. Capital account	200	200	
2. Other liabilities	250	250	

Source: RBI, Kotak Institutional Equities estimates.

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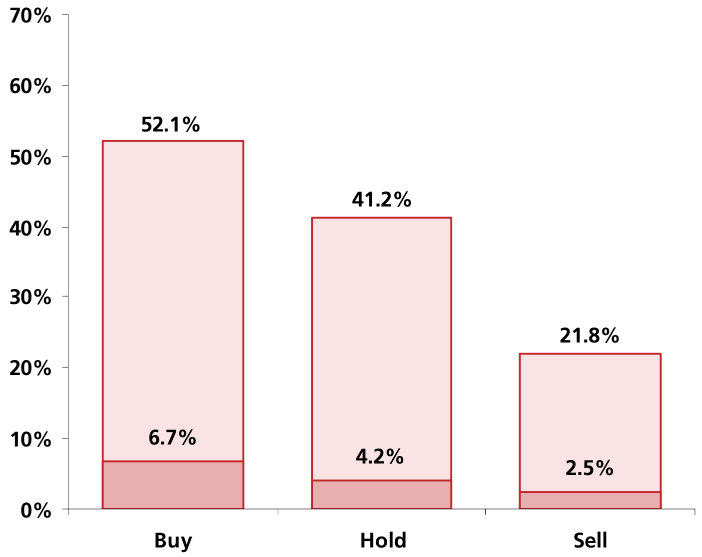

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Source: Kotak Institutional Equities. As of March 31, 2007

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

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

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

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