INDIA DAILY

March 03, 2008

EQUITY MARKETS

	Change, %			
India	29-Feb	1-day	1-mo	3-mo
Sensex	17,579	(1.4)	(3.6)	(10.3)
Nifty	5,224	(1.2)	(1.8)	(10.9)
Global/Regional indices				
Dow Jones	12,266	(2.5)	(3.7)	(7.9)
Nasdaq Composite	2,271	(2.6)	(5.9)	(13.9)
FTSE	5,884	(1.4)	(2.4)	(7.9)
Nikkie	13,057	(4.0)	(3.3)	(16.5)
Hang Seng	23,666	(2.7)	(1.9)	(17.4)
KOSPI	1,664	(2.8)	1.8	(12.6)

Value traded - India

	Moving avg, Rs bn			
	29-Feb		1-mo	3-mo
Cash (NSE+BSE)	224.0		188.6	162.5
Derivatives (NSE)	610.7		560.2	982
Deri. open interest	899.7		912	1,164

Forex/money market

	Change, basis points			
	29-Feb	1-day	1-mo	3-mo
Rs/US$	40.0	0	58	53
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.6	(6)	8	(36)

Net investment (US$mn)

	28-Feb		MTD	CYTD
FIIs	(131)		317	(4,271)
MFs	150		(413)	1,407

Top movers -3mo basis

	Change, %			
Best performers	29-Feb	1-day	1-mo	3-mo
Punjab Tractors	283	0.1	8.5	37.3
NALCO	463	(3.0)	10.5	25.3
Glaxosmithkline	1,109	4.5	29.2	15.7
BPCL	460	(1.2)	19.6	14.1
Ranbaxy	446	0.3	23.9	13.6
Worst performers				
Balaji Telefilms	212	(1.9)	(8.2)	(38.2)
Neyveli Lignite	152	(1.0)	8.0	(37.3)
MRF	4,577	(1.3)	(4.9)	(37.2)
Moser Baer	177	(0.7)	(12.8)	(36.6)
Arvind Mills	49	(3.4)	3.3	(36.5)

Contents

Updates

News Roundup

Corporate

- Delays in deliveries of Boeing 787 Dreamliners to Air India have led the finance ministry to cut the outlay for public sector airlines by nearly 40%. (BS)
- Tata Teleservices will offer Virgin Mobile services through a brand frachisee agreement with the Virgin group. (FE)
- Nilgiris Dairy Farm, controlled by Actis Private Equity, is set to take control over Bangalore-based Valdel Retail over a period of time (the Valdel Group has significant interests in engineering and construction). (BS)
- Phenix Varco Pruden (PVP) a JV between Ahmedabad-based Manibhai & Brothers Group of Companies (MB Group) and US-based Varco Pruden Buildings, plans to invest Rs200 crore over the next one year for setting up two greenfield projects to produce complete pre-engineered buildings (PEB).
- Luxury hotel chain Orient Express, in which the Tatas have become the second-largest shareholder, has said talks about its possible acquisition could affect its share price although its anti-takeover measures are firmly in place. (FE)
- The Manipal group is likely to pick up around 40% stake in Kochi-based Lakeshore Hospital—a super specialty medical centre and pioneers in medical tourism initiatives—for about Rs100 crore, thus putting up a tough fight against Thailand's tourism major Bumrungrad and at least two private players. (ET)

Economic and political

- The government is likely to give about Rs12,000 crore in cash as support to public sector banks to help waive farm loans. Top government sources said compensating the banks using the bond option was difficult as the stock markets might react adversely to such a move. (FE)
- The government is planning to adopt the public private partnership (PPP) for government housing that is proposed for the capital city. (BS)

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

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Energy

RELI.BO, Rs2458	
Rating	RS
Sector coverage view	Neutral
Target Price (Rs)	-
52W High -Low (Rs)	3252 - 1250
Market Cap (Rs bn)	3,084

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,115	1,164	1,382
Net Profit (Rs bn)	121.2	134.7	164.6
EPS (Rs)	83.4	97.9	108.8
EPS gth	*32.0*	*17.5*	*11.1*
P/E (x)	29.5	25.1	22.6
EV/EBITDA (x)	15.7	14.4	11.4
Div yield (%)	0.5	0.6	0.7

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.5	-	-
FIIs	24.1	8.9	0.9
MFs	2.3	5.3	(2.7)
UTI	-	-	(8.0)
LIC	4.1	8.6	0.6

Reliance Industries: Moderate negative impact from budget; fine-tuned estimates

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- **Higher import duty for naphtha used by petrochemical industry for polymer production—negative for RIL**
- **No change in import tariffs for products is moderately positive versus expectations**
- **Reduced estimates to factor budget-related and other minor changes**

We have revised our earnings model for Reliance Industries to factor in budget-related and other minor changes. The key budget-related changes include (1) higher import tariff on naphtha (5.2% from 0% previously) used by the petrochemical sector (negative for RIL) and (2) no change in import tariffs on other products (moderately positive in terms of continued tariff protection and versus expectations). We have also made changes to factor (1) lower benchmark refining margins and (2) lower displacement of liquid fuels used for internal heating requirements than assumed previously. Our revised consolidated EPS estimates for FY2008E, FY2009E and FY2010E are Rs98, Rs109, respectively, and Rs174 versus Rs101, Rs113 and Rs179 previously. Key downside risks stem from the weaker-than-expected refining and chemical cycle.

Higher import tariff on naphtha for petrochemical industry's polymer production. The government has increased the import tariff on naphtha used for polymers to 5% from 0%. This is negative for polymer producers such as RIL and Haldia Petrochemicals. RIL imports naphtha partly for cracking to make olefins and polymers and exports some amount of naphtha. It largely uses internally-produced naphtha at its Jamnagar refinery for the production of aromatics (PX). We compute the impact of higher import duty on naphtha on the chemical segments EBIT at Rs4.5 bn.

Earnings revision. We have revised our consolidated EPS estimates for FY2008E, FY2009E and FY2010E to Rs98, Rs109 and Rs174 from Rs101, Rs113 and Rs179, respectively, previously (Exhibit 1) to factor the following additional changes:

Lower refining margins. We have made moderate downward revisions to refining margins to factor (1) lower benchmark refining margins and (2) lower displacement of liquid fuels than assumed previously. We assume refining margins of US$14.2/bbl, US$13.1/bbl and US$14.1/bbl for FY2008E, FY2009E and FY2010E, respectively, versus US$14.7/bbl, US$13.3/bbl and US$15.1/bbl previously. We observe that benchmark refining margins have fallen sharply in the recent quarter led by flat fuel oil prices compared to the rise in crude prices (Exhibit 2). Reliance's earnings have high sensitivity to refining margins. Exhibit 3 gives the sensitivity of RIL's standalone earnings to key variables (refining margin, chemical prices and rupee-dollar rate).

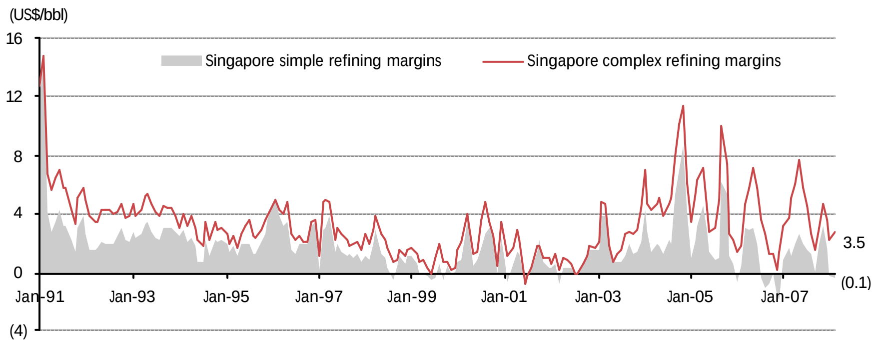
No change in tariff protection for refining; minor reduction in chemicals tariff protection. The government has left import tariffs on all oil and gas products and crude oil unchanged. We compute the tariff differential between products (6.05% weighted average) and crude oil (5.15%) at 0.9%, marginally lower than 1.1% in FY2007 (see Exhibit 4). The government has also left the tariffs of chemical products unchanged although naphtha duty for polymer production has been revised up, leading to a modest decline in tariff protection. However, we had assumed a small decline in import tariffs of polymers and certain other chemicals; so the unchanged tariffs versus expectations is a modest positive.

Revision in earnings estimates for RIL, March fiscal year-ends, 2008-2010E

	2008E	2009E	2010E
EBITDA (Rs mn)			
New	217,203	257,689	425,828
Old	222,382	266,817	441,484
Change(%)	**(2.3)**	**(3.4)**	**(3.5)**
EPS (Rs/share)			
New	97.9	108.8	174.0
Old	100.8	112.9	179.2
Change(%)	**(2.9)**	**(3.6)**	**(2.9)**

Source: Kotak Institutional Equities estimates.

Refining margins have declined in the recent quarter led by high crude prices
Singapore refining margins (US$/bbl)



Simple refining margins, March fiscal year-ends (US$/bbl)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	1.69	(0.32)	1.29	0.51	0.30	1.05	1.69	3.02	2.52	2.25
2Q	0.14	(0.08)	2.47	0.45	0.07	1.20	3.13	2.78	(0.70)	0.99
3Q	0.94	0.14	1.74	1.06	1.44	1.57	6.46	2.22	(1.25)	2.32
4Q	0.62	1.86	0.21	(0.03)	2.98	2.88	2.08	1.09	1.25	(0.29)
Average	**0.85**	**0.40**	**1.43**	**0.50**	**1.20**	**1.67**	**3.34**	**2.28**	**0.45**	**1.45**

Complex refining margins, March fiscal year-ends (US$/bbl)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	2.89	0.43	1.86	1.34	0.79	1.24	4.57	4.93	6.24	6.58
2Q	1.14	1.19	3.96	0.58	0.14	2.35	5.80	6.11	2.46	2.91
3Q	1.42	0.41	2.25	1.22	1.56	3.23	9.04	3.94	0.98	3.91
4Q	1.28	2.64	1.60	0.65	3.70	5.44	5.02	2.77	4.11	2.44
Average	**1.68**	**1.17**	**2.42**	**0.95**	**1.55**	**3.06**	**6.10**	**4.44**	**3.45**	**4.09**

Weekly margins (Simple)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(0.09)	0.51	(0.85)	(1.01)	(0.99)

Weekly margins (Complex)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
3.48	3.60	1.93	2.05	1.75

Singapore refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
Simple	0.40	1.43	0.50	1.20	1.67	3.34	2.28	0.45	1.45
Complex	0.43	1.86	1.34	0.79	1.24	4.57	4.93	3.45	4.09

Source: Bloomberg, Kotak Institutional Equities.

Reliance has high leverage to refining margins

Sensitivity of RIL's standalone (without RPL) earnings to key variables

	Fiscal 2008E			Fiscal 2009E			Fiscal 2010E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	39.1	40.1	41.1	37.5	38.5	39.5	36.5	37.5	38.5
Net profits (Rs mn)	136,316	142,304	148,283	144,394	150,440	156,485	204,841	212,063	219,286
EPS (Rs)	93.8	97.9	102.0	95.4	99.4	103.4	130.2	134.8	139.4
% upside/(downside)	**(4.2)**		**4.2**	**(4.0)**		**4.0**	**(3.4)**		**3.4**
Chemical prices									
Change in prices (%)	(5.0)		5.0	(5.0)		5.0	(5.0)		5.0
Net profits (Rs mn)	136,638	142,304	147,946	145,761	150,440	155,118	207,707	212,063	216,420
EPS (Rs)	94.0	97.9	101.8	96.3	99.4	102.5	132.0	134.8	137.6
% upside/(downside)	**(4.0)**		**4.0**	**(3.1)**		**3.1**	**(2.1)**		**2.1**
Refining margins (US$/bbl)									
Margins (US$/bbl)	13.2	14.2	15.2	12.1	13.1	14.1	13.1	14.1	15.1
Net profits (Rs mn)	134,116	142,304	150,495	142,530	150,440	158,349	206,093	212,063	218,033
EPS (Rs)	92.3	97.9	103.6	94.2	99.4	104.6	131.0	134.8	138.6
% upside/(downside)	**(5.8)**		**5.8**	**(5.3)**		**5.3**	**(2.8)**		**2.8**

Source: Kotak Institutional Equities estimates.

No change in import tariffs on crude and products in Union Budget 2009

Import tariffs on oil products, March fiscal year-ends, 2005-2009E (%)

	2005	2006	Mar-07	2007	2008	2009E
LPG	6.6	—	—	—	—	—
Gasoline	16.7	10.2	7.7	8.1	7.7	7.7
Naphtha	7.6	4.7	—	—	—	—
Kerosene	6.6	—	—	—	—	—
ATF	19.4	10.2	10.3	10.2	10.3	10.3
Diesel	16.7	10.2	7.7	8.1	7.7	7.7
FO	19.4	10.2	10.3	10.2	10.3	10.3
Bitumen	19.4	10.2	10.3	10.2	10.3	10.3
Weighted average import duty	**14.5**	**7.9**	**6.1**	**6.2**	**6.1**	**6.1**
Duty on crude	10.2	5.1	5.2	5.1	5.2	5.2
Tariff differential	**4.4**	**2.8**	**0.9**	**1.1**	**0.9**	**0.9**

Note:

(a) Import duty on naphtha utilised by petrochemical industry has been increased to 5.15%

Source: Kotak Institutional Equities estimates.

Valuation of Reliance Industries stock (Rs)

	FY2010E EPS (Rs)	P/E (X)	Valuation (Rs/share)	Comments
Chemicals, refining, E&P (a) (b)	199	10	1,992	Consolidated FY2010E EPS including Reliance Petroleum
Valuation based on FY2010E EPS			**1,753**	**12.5% discount rate; discounted to March, 2008**
E&P (higher reserves in KG-DWN-98/3, other blocks)			—	We model 0.93 tcf of gas per annum production in perpetuity
E&P (NEC-25, CBM)			100	Based on KG D-6 reserves and valuation
Investments			184	
Other investments			7	
Retailing			159	US$5.5 bn valuation; ~US$1.5 bn equity invested in Reliance Retail as of end-1HFY08
SEZ development			18	SEZs will require investment for the first few years
12-month fair valuation			**2,037**	

Notes:

(a) FY2010E EPS is Rs174 on 1.573 bn shares after considering conversion of 120 mn warrants issued to the major shareholder.

(b) FY2010E EPS is adjusted for treasury shares or computed using 1.372 bn shares.

Source: Kotak Institutional Equities estimates.

SOTP valuation of Reliance is Rs1,750 per share on FY2009 estimates

Sum-of-the-parts valuation of Reliance Industries, FY2008 basis (Rs)

	Valuation base (Rs bn)		Multiple (X)		EV	Value share
	Other	EBITDA	Muliple	EV/EBITDA	(Rs bn)	(Rs)
Chemicals		90		6.0	543	395
Refining & Marketing		78		6.0	470	342
Oil and gas—producing		22		5.0	112	82
Gas—developing (DCF-based) (a)	527	—	100%	—	527	383
Oil—KG-DWN-98/3 (b)	79	—	100%	—	79	58
Investments						
RPL (3.167 bn shares at Rs175)	554	—	100%	—	554	403
Others	10	—	100%	—	10	7
Retailing	219	—	100%	—	219	159
SEZ development	22	—	100%	—	22	16
Total					**2,457**	**1,846**
PV of refining division's future sales tax incentives					2	2
Total value					**2,459**	**1,847**
Net debt (adjusted for capex of RPL and investment by Reliance in RPL) (d)					136	99
Implied equity value					**2,323**	**1,749**

Note:

(a) We value the KG D-6 gas find on DCF and offshore Orissa (NEC-25) and CBM discoveries based on KG D-6's valuation.

(b) 180 mn bbls of recoverable reserves based on gross OOIP of 0.5 bn bbls.

(c) Net debt reflects a standalone (without RPL) scenario; however, we consolidate for RPL otherwise as it a 75% subsidiary.

(d) We use 1.374 bn shares (excluding treasury shares) for our per share computation.

Source: Kotak Institutional Equities estimates.

Upstream segment EBITDA growth to power overall EBITDA growth

Segment breakdown of Reliance's standalone financials, March fiscal year-ends, 2003-2010E (Rs mn)

	2002	2003	2004	2005	2006	2007	2008E	2009E	2010E
Revenues									
Chemicals	159,124	199,564	213,347	261,572	295,579	480,207	463,625	497,918	473,771
Refining & marketing	293,461	313,685	383,051	477,051	661,079	834,161	798,249	765,780	769,945
Others (incl. Upstream)	13,030	13,133	25,179	26,153	17,707	24,681			
Upstream							33,808	85,315	190,665
Inter-divisional sales	(52,106)	(75,249)	(110,861)	(103,579)	(148,544)	(203,348)	(131,285)	(134,613)	(129,497)
Total	**413,509**	**451,133**	**510,715**	**661,197**	**825,822**	**1,135,701**	**1,164,396**	**1,214,400**	**1,304,883**
EBITDA									
Chemicals	39,585	44,203	47,658	51,107	58,748	93,703	95,737	90,429	80,009
Refining & marketing	23,631	24,142	40,260	60,952	70,186	95,065	99,014	78,368	98,344
Others (incl. Upstream)	8,599	7,056	6,914	14,207	13,340	17,204			
Upstream							22,453	59,766	134,519
Unallocated	(444)	408	(3,683)	(2,446)	(2,282)	(184)	—	—	—
Total	**71,370**	**75,808**	**91,148**	**123,819**	**139,991**	**205,789**	**217,203**	**228,563**	**312,873**
EBIT									
Chemicals	23,314	27,370	31,229	31,911	44,267	67,423	75,240	69,407	57,803
Refining & marketing	12,382	13,677	25,242	45,203	52,879	76,643	81,581	59,666	79,237
Sales tax incentives	7,380	7,845	7,300	4,290	3,418	2,000	—	—	—
Others (incl. Upstream)	7,966	5,983	5,890	11,918	11,118	13,002			
Upstream							14,632	43,274	105,809
Unallocated	(444)	408	(3,683)	(2,446)	(2,700)	(274)	—	—	—
Total	**50,598**	**55,282**	**65,978**	**90,875**	**108,982**	**158,794**	**171,453**	**172,346**	**242,849**
Pretax profits									
Chemicals	14,150	18,130	21,821	23,105	42,922	63,509	68,487	64,805	55,535
Refining & marketing	3,295	7,270	20,057	39,433	45,677	67,898	77,928	58,681	79,872
Sales tax incentives	11,497	7,845	7,300	4,290	3,418	2,000	—	—	—
Others (incl. Upstream)	7,966	5,983	5,890	11,918	11,118	13,002			
Upstream							14,632	43,274	105,809
Other income	7,823	10,012	11,381	14,498	6,829	4,783	8,500	10,000	15,000
Unallocated	(444)	408	(3,683)	(2,446)	(2,700)	(274)	—	—	—
Total	**44,287**	**49,648**	**62,765**	**90,798**	**107,265**	**150,918**	**169,547**	**176,760**	**256,216**

Source: Kotak Institutional Equities estimates.

RIL consolidated with RPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2003-2010E (Rs mn)

	2003	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)								
Net sales	451,133	510,715	656,223	809,113	1,114,927	1,164,396	1,382,155	1,939,588
EBITDA	**75,808**	**91,148**	**123,820**	**139,991**	**198,462**	**217,203**	**257,689**	**425,828**
Other income	10,012	11,381	14,498	6,829	4,783	8,500	10,128	15,124
Interest	(15,552)	(14,347)	(14,687)	(8,770)	(11,889)	(10,406)	(9,198)	(10,220)
Depreciation & depletion	(28,371)	(32,470)	(37,235)	(34,009)	(48,152)	(45,750)	(61,203)	(84,814)
Pretax profits	41,897	55,711	86,397	104,041	143,205	169,547	197,416	345,918
Extraordinary items	7,845	7,300	4,290	3,000	2,000	47,330	—	—
Tax	(2,459)	(3,510)	(7,050)	(9,307)	(16,574)	(26,073)	(28,254)	(47,238)
Deferred taxation	(6,240)	(7,900)	(7,920)	(7,040)	(9,196)	(8,775)	1,453	1,026
Minority interest	—	—	—	—	—	—	(5,976)	(25,960)
Net profits	41,043	51,601	75,717	90,693	119,434	182,029	164,639	273,746
Adjusted net profits	**34,570**	**45,623**	**72,135**	**88,152**	**117,789**	**142,304**	**164,639**	**273,746**
Earnings per share (Rs)	**24.8**	**32.7**	**51.7**	**63.3**	**81.0**	**97.9**	**108.8**	**174.0**
Balance sheet (Rs mn)								
Total equity	303,744	344,525	404,033	430,543	673,037	834,662	1,125,880	1,358,963
Deferred taxation liability	26,848	34,748	42,668	49,708	69,820	78,595	77,142	76,116
Minority interest	—	—	—	—	33,622	33,622	38,666	57,944
Total borrowings	197,583	209,447	187,846	218,656	332,927	430,261	236,433	117,642
Currrent liabilities	109,666	122,855	171,315	164,545	192,305	223,614	233,266	258,549
Total liabilities and equity	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,600,754**	**1,711,387**	**1,869,214**
Cash	1,472	2,242	36,087	21,461	18,449	53,773	46,470	137,253
Current assets	227,809	218,159	248,438	224,283	286,566	331,694	362,243	435,038
Total fixed assets	340,863	351,460	350,823	626,745	899,403	1,072,993	1,127,880	1,104,629
Investments	67,227	139,714	170,515	(9,038)	97,294	142,294	174,794	192,294
Deferred expenditure	472	—	—	—	—	—	—	—
Total assets	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,600,754**	**1,711,386**	**1,869,214**
Free cash flow (Rs mn)								
Operating cash flow, excl. working cap	67,072	83,301	107,002	119,520	164,285	220,897	213,753	365,235
Working capital	(17,614)	20,265	46,875	(32,188)	(13,075)	(13,820)	(20,896)	(47,513)
Capital expenditure	(37,043)	(43,191)	(52,440)	(94,273)	(247,274)	(229,538)	(110,256)	(58,429)
Investments	(34,204)	(68,430)	(48,192)	(32,364)	(105,760)	(45,000)	(32,500)	(17,500)
Other income	5,219	5,902	3,032	5,159	4,143	8,500	10,128	15,124
Free cash flow	**(16,569)**	**(2,153)**	**56,276**	**(34,146)**	**(197,681)**	**(58,961)**	**60,228**	**256,918**
Ratios (%)								
Debt/equity	59.8	55.2	42.1	45.5	44.8	47.1	19.7	8.2
Net debt/equity	59.3	54.6	34.0	41.1	42.3	41.2	15.8	(1.4)
RoAE	10.7	12.7	17.6	19.9	20.3	18.0	16.2	21.4
RoACE	**8.8**	**9.7**	**13.0**	**13.8**	**13.9**	**12.1**	**12.5**	**20.1**

Source: Kotak Institutional Equities estimates.

Consumer Products

ITC.BO, Rs202	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	250
52W High -Low (Rs)	239 - 140
Market Cap (Rs bn)	756

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	123.7	142.1	161.2
Net Profit (Rs bn)	27.0	31.2	36.3
EPS (Rs)	7.2	8.3	9.7
EPS gth	*20.4*	*15.4*	*16.6*
P/E (x)	28.0	24.3	20.8
EV/EBITDA (x)	17.8	15.4	12.7
Div yield (%)	1.5	1.6	1.8

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	14.3	1.2	(0.6)
MFs	3.0	1.5	(0.3)
UTI	11.9	49.0	47.2
LIC	13.4	6.2	4.5

ITC: Large excise increase on non-filter cigarettes has modest impact on ITC

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- **Non-filter category bears the brunt of ~15% excise increase**
- **Volume loss likely to bidis**
- **ITC to benefit from lower proportion of non-filter cigarettes in sales**
- **Reiterate BUY with a one-year target price of Rs250/share**

The proposal on excise increase on cigarettes in the Union Budget surprised everyone with a rather heavy increase for non-filter cigarettes while keeping the excise on filter cigarettes unchanged. The excise on non-filter cigarettes has been increased 2.4X-4.9X, resulting in about 15% weighted average excise increase on cigarettes. ITC, with its strong presence in filter cigarettes (80% of volumes), has the ability to absorb the excise increase with a 5-7% price increase spread across segments, but, in our view, is unlikely to cross-subsidize to absorb the differential excise increase. Moreover, other cigarette companies have a portfolio of largely non-filter cigarettes (contributing~60% to their volumes) and will have to pass the excise hike to the respective segments. The lopsided increase in excise, if passed on as price increases in the respective segments, will likely result in non-filter cigarettes losing volumes to filter cigarettes at the upper end and bidis at the lower end. We believe cigarette companies will likely approach the government for modification in the proposed excise increases in order to prevent losses of volumes in bidis. We will keenly watch for any proposed changes in the excise rates as well as price increases taken by cigarette manufacturers. We retain our BUY rating on ITC with a DCF-based target price of Rs250/share.

- **Non-filter category bears the brunt.** The Union Budget has proposed an increase in excise on non-filter cigarettes of 2.4X-4.9X, resulting in a 15% weighted average excise increase (assuming volumes in each segment do not change). The proposed changes will likely result in elimination of the non-filter cigarettes altogether if commensurate price increases are taken to pass the higher tax incidence. At the lowest end (non-filter of <60 mm length), the price of a Rs0.5/stick cigarette will have to at least double to pass the excise increase to Rs0.819/stick from Rs0.168/ stick previously. This segment will likely see large volumes losses for bidis. The taxation on non-filter cigarettes of 60-70 mm length has been increased to Rs1.323/ stick compared to Rs0.819/stick for filter cigarettes of the same length. Thus pricing at par (if not more) with filter cigarettes will result in the loss of volumes for non-filter cigarettes at the higher end.

- **Volumes take a knock when price increases are stiff.** A large price increase in non-filter cigarettes to pass on the increase in excise can potentially eliminate the segment altogether with an overall decline in cigarette volumes as well. We believe a 5-7% increase in cigarette prices across segments can absorb a 15% increase in excise without any impact on volumes. However, most cigarette manufacturers (except ITC) are excessively dependent on non-filter cigarettes and cannot implement this strategy. A study of the historical data suggests that cigarette volumes have declined (or growth rate slowed down) whenever sharp price increases were taken (which is intuitively correct as well). ITC had taken a price increase of 20% following the introduction of 12.5% VAT last year, which is likely to result in a 2-3% decline in cigarette volumes in FY2008.

- **ITC to benefit due to a lower proportion of non-filter cigarettes in sales.** We estimate the excise increase to be lower for ITC, with non-filter cigarettes accounting for only 20% of its sales volumes. Contribution to cigarette revenues and EBITDA is likely even lower at about 10% and 6%, respectively, in our view. The rest of the industry is far more (60% by volumes) dependent on non-filter cigarettes. ITC can potentially absorb the excise hike by taking 5-7% price increase across segments, but we believe the rest of the industry does not have the same flexibility. We also expect ITC (with about 80% market share in filter cigarettes) to capture a large volumes shift from other company's non-filter cigarettes. We note that ITC's volumes growth had lagged peers during the past few months (after VAT introduction) as competitors like VST and GTC saw better growth in non-filter category (with a better presence in the low and middle end of the category with brands like Berkeley, Four Square etc.). We had attributed the segment's PBIT margin expansion—by 190 bps yoy during 3QFY08—to significant product mix improvements for ITC.
- **We believe the healthy pace of growth in rural and urban income augurs well for the core business of the company.** A study conducted by NCAER suggests that the impact of growth in income on demand of cigarettes is more than three times that of a basket of 20 FMCG products (including cigarettes). We expect the sales of FMCG products to benefit from higher disposable income with consumers. The Union Budget has several proposals which will likely add to the disposable income—(1) increased spending on rural-oriented projects (including employment generation schemes), (2) waiver of agricultural loans and (3) raising of the slabs for personal income tax.
- **Reiterate BUY with a one-year target price of Rs250/share.** We expect ITC to post 15% earnings growth during FY2008-10. In the last three years, the stock has traded at an average P/E of 23X and has remained in the 20X-30X band. Our DCF-based target price of Rs250 implies P/E of 25.8X FY2009E. We expect ITC to maintain its cigarette EBITDA growth despite volumes decline (due to lopsided excise increase) by increasing the prices of filter cigarettes and improving blended margins. We reiterate our BUY rating on the stock.

Excise increase only for non-filter cigarettes may threaten the existence of categorie

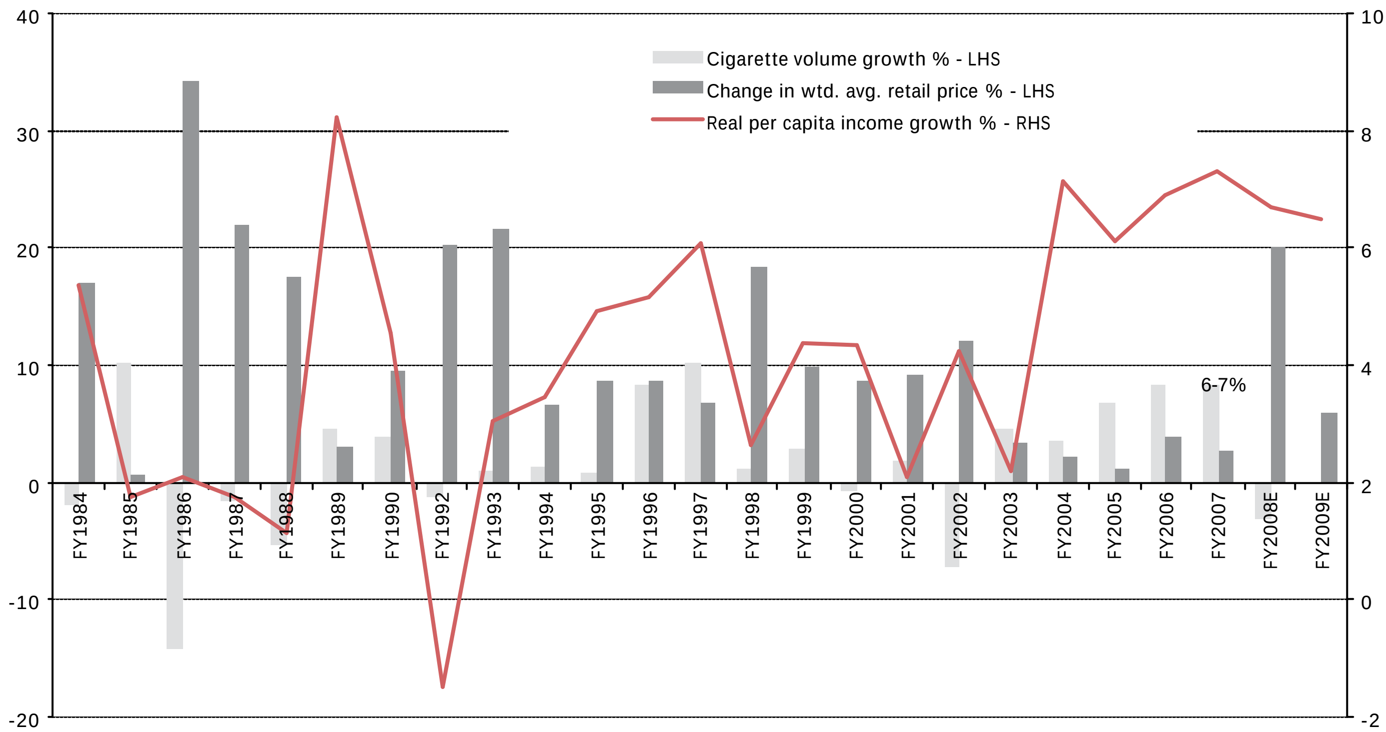
Excise increase in 2008-09 budget

	Present	Proposed	Excise increase
	(Rs per 1,000 cigarettes)		(%)
Non-filter < 60 mm	168	819	388
Non-filter 60-70 mm	546	1,323	142
Filter< 70 mm	819	819	-
Filter between 70-75 mm	1,323	1,323	-
Filter between 75-85 mm	1,759	1,759	-
Filter > 85 mm	2,163	2,163	-

Source: Budget document 2008-2009, Kotak Institutional Equities.

Robust macro environment provides reason to believe moderate excise-linked price hikes can be absorbed without impacting volumes

Cigarette volumes growth, average retail price increase and real per capita income growth (%)



Source: Company data, Kotak Institutional Equities estimates.

Scenario analysis-passing the increase in excise as price hikes in the respective segments

Brand	Segment	Old price (Rs/stick)	Increase in excise (Rs/stick)	Est. new price (Rs/stick)	Comments
Scissors Standard	non-filter, < 60 mm	0.50	0.65	1.15	Likely to lose large volumes to bidis; likely to get some sales from downtrading from higher segments
Scissors	non-filter, 60-70 mm	1.50	0.78	2.28	Likely to lose volumes to filter cigarettes
Gold Flake Plain	non-filter, 60-70 mm	1.75	0.78	2.53	Likely to lose volumes to filter cigarettes
Bristol Filter	filter, < 70 mm	1.90	—	1.90	
Gold Flake Filter	filter, < 70 mm	2.40	—	2.40	

Source: Industry sources, Kotak Institutional Equities estimates.

ITC has a much lower proportion of non-filter cigarettes compared to other players

Split of cigarette sales volumes (%)

	Industry	ITC	Others
Filter	70	80	40
Non-filter	**30**	**20**	**60**
Total	100	100	100

Source: Industry sources, Kotak Institutional Equities estimates.

Consumer Products

HLL.BO, Rs227	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	230
52W High -Low (Rs)	244 - 166
Market Cap (Rs bn)	501.7

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	121.0	135.6	151.9
Net Profit (Rs bn)	15.5	17.7	20.5
EPS (Rs)	7.0	8.0	9.3
EPS gth	*18.3*	*14.0*	*15.6*
P/E (x)	32.3	28.3	24.5
EV/EBITDA (x)	25.5	22.3	19.1
Div yield (%)	3.0	4.6	3.9

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.4	-	-
FIIs	13.2	0.7	(0.5)
MFs	3.9	1.4	0.1
UTI	-	-	(1.2)
LIC	7.4	2.4	1.1

Hindustan Unilever: New CEO for HUL, parent Unilever merges HPC and Foods categories

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- **HUL appoints Nitin Paranjpe as MD & CEO, market to likely react positively**
- **Current CEO Doug Baillie joins Unilever Executive as Head for Western Europe**
- **Unilever merges Home and Personal care, Foods categories, reorganization in HUL likely**
- **We forecast 15% earnings CAGR for HUL in 2007-09E, retain ADD rating and target price of Rs230**

HUL has elevated the current Executive Director for the Home & Personal Care business Nitin Paranjpe to the position of MD & CEO. In line with its parent's 'One Unilever' strategy, HUL will likely merge the two business divisions, HPC and Foods. We believe the efficacy of the new structure will likely be dependent upon the degree of business and financial autonomy provided to the business segment heads (soaps, detergents, beverages etc.). While the integration at middle and top-level management will result in a leaner organization, HUL will likely continue with the current sales organization (matrix) focused on channels as well as categories. Favorable tailwinds of beneficial base effect and extended winter will likely aid near-term performance favorably. We believe HUL will at best grow in line with industry and deliver a 15% earnings CAGR over 2007-09E. At the current market price of Rs220, the stock trades at 25XCY08 and 21XCY09. We believe that the stock is trading closer to fair value, retain ADD rating and target price of Rs230/share.

New CEO for HUL, 'One Unilever' takes a step forward

HUL has elevated the current Executive Director for the Home & Personal Care business Nitin Paranjpe as MD & CEO. The current CEO Doug Baillie joins the Unilever Executive as Head for Western Europe. In line with taking the 'One Unilever' strategy (announced in 2005) a step forward; Unilever announced the merger of the two business divisions HPC and Foods. The company had already integrated the support functions like Finance, HR and IT. We believe the integration of both business units is likely at HUL as well. We believe the efficacy of the new structure will likely depend on the degree of business and financial autonomy provided to the business segment heads (soaps, detergents, beverages etc.). The integration of middle and top-level management will result in a leaner organization, while we expect HUL will likely continue with the current sales organization (matrix) focused on channels as well as categories. We note that Unilever's global competitors Nestle and P&G have similar organization structures and hence it seemed imperative for Unilever to follow suit. However, the key difference is that P&G has a HPC-dominated portfolio while Nestle has Foods.

Favorable tailwinds aid near-term performance, stock trading closer to fair value

We believe several factors will likely aid near-term performance favorably—(1) beneficial base effect (personal products business grew at 6% for the first three quarters of CY2007, (2) strong underlying growth in detergents, (3) extended and harsh winter in north and east India favoring the personal products sales in 1QCY08, and (4) incremental fiscal benefit from new manufacturing facility for Lakme in Haridwar. We believe the stock will likely trade at our DCF-based target price of Rs230 in the near term and has positive news flow as a tailwind. Dividend yield (3.5%) and cheap valuations (21X CY2009, lowest in over five years) limits downside as well. We believe HUL will at best grow in line with industry and deliver a 15% earnings CAGR over 2007-2009E. At the current market price of Rs220, the stock trades at 25XCY08 and 21XCY09. We believe the stock is trading closer to fair value, retain ADD rating and target price of Rs230/share.

Energy

Sector coverage view			Neutral

		Price, Rs	
Company	**Rating**	**29-Feb**	**Target**
Reliance Inds	RS	2,458	-
ONGC	ADD	1,012	1,325
IOC	ADD	561	625
HPCL	BUY	299	425
GAIL	REDUCE	423	400
Castrol	REDUCE	276	290
Petronet LNG	SELL	74	65
Cairn	SELL	228	160
RPL	ADD	175	175
GSPL	SELL	71	65

Modest changes in FY2009 budget, but larger issues not touched

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- **Change in excise tariff structure for auto fuels, no impact on earnings of R&M companies**
- **Removal of tax holiday for refineries; negative for proposed refinery projects**
- **No attempt to tackle subsidy issue; companies will continue to depend on oil bonds**

We see the Indian Budget FY2009 having little impact on the Indian oil and gas sector. The key changes are—(1) change in excise tariff structure for diesel and gasoline to a specific duty from a combination of specific and ad valorem duty and (2) removal of seven-year income tax exemption available under Section 80 IB for refineries starting operations on or after April 1, 2009, which would impact the financial feasibility of several proposed refining projects. The direct subsidy provided by the government on LPG and kerosene remains the same, which implies continued dependence on oil bonds for R&M companies. However, the recent increase in oil bonds highlights the government's keenness to protect the profits of the downstream oil companies at a certain level. We retain our 12-month target price of Rs425 for HPCL and Rs625 for IOCL; our 12-month target prices are based on 20-25% discount to 5X normalized EBITDA plus the value of investments. Key downside risks are higher-than-expected subsidies and irrational government pricing policy.

Change in excise duty structure for auto fuels; no impact on earnings though. The government has decided to change the excise duty structure for unbranded diesel and petrol to a specific duty from a combination of specific and ad valorem duty earlier (see Exhibit 1). The revised excise tariff for unbranded petrol is Rs 14.77/l specific excise duty versus the earlier tariff of 6.2% ad valorem excise duty plus specific duty of Rs 13.4/l. The revised excise tariff for unbranded diesel is Rs 4.74/l specific excise duty versus the earlier tariff of 6.2% ad valorem excise duty plus specific duty of Rs 3.35/l. However, there will be no impact on the earnings of R&M companies as the specific duty fixed rates fixed is at par with current levies. Exhibit 2 gives the build-up of retail prices for diesel and gasoline under the current and previous excise structures.

Removal of tax holiday for refineries u/s 80 IB; negative for new refineries, no impact on RPET. The government has decided to discontinue the tax holiday granted to refineries u/s 80 IB for all new refineries commencing operation on or after April 1, 2009. This will be negative for new refineries as it will impact the economic feasibility of the refinery projects which are scheduled to commence operation after April 1, 2009. However, this will not impact RPET's proposed refinery at Jamnagar as it is a SEZ refinery and gets tax exemption under u/s 10 AA enjoying a tax exemption for 15 years from the start of commercial operations of the refinery. For the first five years, 100% of its profit will be exempt from taxation, for the next five years, 50% of its profits will be exempt from taxation and for the final five years, 50% of the profits, if invested in the business, will be exempt. It will anyway start before April 1, 2009.

Direct subsidy from budget remains unchanged; dependence on oil bonds will persist. The government has provided for a direct subsidy of Rs27 bn for FY2009E from the budget on kerosene and LPG, unchanged from revised estimates for FY2008 and moderately higher than FY2008 budget estimate of Rs26.5 bn. This would suggest that the unit subsidy payment remains unchanged at Rs0.81/liter on kerosene and Rs22.6/ cylinder on LPG. It is unfortunate that the government refuses to provide subsidy directly from the budget, which would provide more certainty to oil companies' earnings; they would continue to have to depend on ad hoc oil bonds.

However, the recent increase in quantum of oil bonds for FY2008E highlights government's keenness to protect the profits of downstream oil companies at a certain level. We would note that the government has agreed to take a larger share of the gross under-recoveries in FY2008E by issuing oil bonds amounting to 57% of the total under-recoveries (Rs718 bn as per the government's estimate) versus the original 42.7%.

Import tariffs left unchanged—moderate positive in terms of higher tariff protection. The government has left import tariffs on all oil and gas products and crude oil unchanged. We compute tariff differential between products (6.05% weighted average) and crude oil (5.15%) at 0.9% marginally lower versus 1.1% in FY2007 (see Exhibit 3).

Introduction of Goods and Services Tax (GST) by April 1, 2010, if implemented, would be a large positive for BPCL and HPCL. The finance minister's budget speech highlighted the government's commitment for a GST by April 2010; we note that the reduction of CST to 2% from 3% is a step in that direction. We assume introduction of GST would entail removal of several state and city-level taxes including octroi duty or availability of offset on such irrecoverable taxes. However, it is possible that crude oil and refined products may be kept out of the GST; oil is outside the VAT regime currently.

Based on the current 3% octroi duty on crude oil in Mumbai and US$70/bbl crude price, we compute a pre-tax impact of Rs7.2 bn (12 mtpa crude throughput) for BPCL and Rs4.5 bn for HPCL (7.4 mtpa crude throughput). The EPS impact works out to Rs13.2 and Rs8.7 for BPCL and HPCL, respectively.

Impact of changes proposed in Union Budget 2009 on energy sector

	Prevalent Tariffs (%)		Proposed Tariffs (%)		
	Excise	Imports	Excise	Imports	Comments
Diesel	6.18% + Rs3.35/l	7.7%	Rs4.74/l	7.7%	• Change in excise tariff structure to specific rate; no impact on earnings of R&M companies
Gasoline	6.18% + Rs13.39/l	7.7%	Rs14.77/l	7.7%	• Change in excise tariff structure to specific rate; no impact on earnings of R&M companies

Proposals	Implications
• Removal of income tax exemption u/s 80 IB for refineries commencing operation after April 1, 2009	• Will impact economic feasibility of planned refining projects scheduled to commence operations after April1, 2009
	• No impact on RPET's refinery as it gets tax exemption under SEZ Act
• Budget subsidy amount for LPG and kerosene at Rs28.84 bn, similar to FY2008 figure	• Oil companies will have to depend on government for oil bonds to make up deficit
• No specific proposal to address subsidy problem	• Likely issue of commensurate oil bonds by the government should address concerns regarding earnings of R&M companies in FY2009E

Source: Union Budget 2009, Kotak Institutional Equities.

No impact on earnings of R&M companies from proposed change in excise duty structure

Marketing margins on petrol and diesel (Rs/l)

	Existing	Proposed
Petrol		
Retail price	45.52	45.52
Dealer margin	1.02	1.02
Sales tax rate (%)	20.0	20.0
Sales tax	7.4	7.4
Ex-storage point price (incl. excise)	**37.1**	**37.1**
Excise duty-ad valorem (%)	6.2	—
Excise duty-fixed	13.4	14.8
Excise duty	14.8	14.8
Ex-storage point price (excl. excise) (A)	22.3	22.3
Transport (B)	1.3	1.3
Ex-refinery price (C)	**26.9**	**26.9**
Marketing margin (C-A-B)	**(5.9)**	**(5.9)**
Diesel		
Retail price	31.76	31.76
Dealer margin	0.60	0.60
Sales tax rate (%)	12.0	12.0
Sales tax	3.3	3.3
Ex-storage point price (incl. excise)	**27.8**	**27.8**
Excise duty-ad valorem (%)	6.2	—
Excise duty-fixed	3.3	4.7
Excise duty	4.8	4.7
Ex-storage point price (excl. excise) (A)	23.0	23.1
Transport (B)	1.2	1.2
Ex-refinery price (C)	**26.7**	**26.7**
Marketing margin (C-A-B)	**(4.8)**	**(4.8)**

Note:
(a) Retail prices for diesel and petrol are for Delhi.

Source: Cmpany, Kotak Institutional Equities estimates.

No change in import tariffs on crude and products in Union Budget 2009

Import tariffs on oil products, March fiscal year-ends, 2005-2009E (%)

	2005	2006	Mar-07	2007	2008	2009E
LPG	6.6	—	—	—	—	—
Gasoline	16.7	10.2	7.7	8.1	7.7	7.7
Naphtha	7.6	4.7	—	—	—	—
Kerosene	6.6	—	—	—	—	—
ATF	19.4	10.2	10.3	10.2	10.3	10.3
Diesel	16.7	10.2	7.7	8.1	7.7	7.7
FO	19.4	10.2	10.3	10.2	10.3	10.3
Bitumen	19.4	10.2	10.3	10.2	10.3	10.3
Weighted average import duty	**14.5**	**7.9**	**6.1**	**6.2**	**6.1**	**6.1**
Duty on crude	10.2	5.1	5.2	5.1	5.2	5.2
Tariff differential	**4.4**	**2.8**	**0.9**	**1.1**	**0.9**	**0.9**

Note:
(a) Import duty on naphtha utilised by petrochemical industry has been increased to 5.15%

Source: Kotak Institutional Equities estimates.

Banking

Sector coverage view	Attractive

		Price, Rs	
Company	Rating	29-Feb	Target
HDFC	REDUCE	2,803	2,450
HDFC Bank	ADD	1,453	1,500
ICICI Bank	ADD	1,091	1,200
Corp Bk	BUY	326	470
BoB	ADD	366	400
PNB	BUY	604	650
OBC	SELL	251	240
Canara Bk	REDUCE	278	250
LIC Housing	BUY	308	350
Axis Bank	REDUCE	1,019	850
IOB	ADD	165	150
Shriram Transj	REDUCE	391	335
SREI	BUY	191	240
MMFSL	REDUCE	317	290
Andhra	BUY	91	115
IDFC	SELL	195	150
PFC	SELL	187	150
Centurion Banl	REDUCE	49	45
Federal Bank	BUY	297	340
J&K Bank	ADD	714	850
India Infoline	ADD	1,117	1,400
Indian Bank	SELL	204	170
Union Bank	BUY	186	250

Budget: Waiver of agri loans a short-term positive, long-term negative

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The Finance Minister's proposed a waiver of Rs600 bn on agricultural loans. The government will likely compensate the banking sector against this waiver/rebate over a three-year period. In the near-term, bank NPLs will likely reduce and earnings increase, but we believe this move is directionally negative as it may turn regular 'paying' borrowers into defaulters as well, increasing the risk of NPLs on agri-sector lending. For now, we are not changing our earnings estimate to factor in either higher NPLs or the above recoveries. Additionally, our view on interest rates remains unchanged. Our economist Dr Mridul Saggar expects the government borrowing programme to exceed the budget estimate marginally. We expect Gsec yields to remain firm in the short term (7.8% by March 2008), but soften in FY2009 to 7.5%. We therefore expect banks to remain on track for reducing deposit rates in April/May 2009 to protect their spreads. However, we expect the government's influence on banks to persist till the elections, a potential risk, which could pressure the performance of bank stocks. Our preferred stocks are: ICICI Bank, HDFC Bank, PNB and Union Bank.

PSU and private bank exposure likely limited compared to co-operative banks. The total banking sector exposure to agriculture sector (including co-operatives, regional rural banks) in March 2007 was an estimated Rs5 tn. The loan waiver will be to the extent of Rs600 bn, which is 12% of the agriculture loans and 3% of overall bank credit. Of this, the NPL exposure of private and public banks is around Rs75-85 bn, and that of co-operative banks and regional rural banks in excess of Rs500 bn. We understand that the loan waiver will apply to all banks i.e. PSUs, private, regional rural banks and co-operative banks (Exhibit 1).

Payment mode not yet clear

- It is not clear how the government will compensate banks for these loans. Most bankers we spoke to indicated that this would be in form of cash. The finance minister has indicated that the amount will be paid over a three-year period, however, he has not divulged information regarding the mode of payment - i.e. cash or bonds.
- In the case of bonds—(1) Bonds held against such loans may not be considered as agri loans for meeting priority sector requirements, increasing the burden on banks to meet their priority sector targets. (2) The risk weight on these bonds will likely be half that on the loan, releasing capital. (3) The rate of interest on these bonds will likely be low (oil bonds currently carry interest rate of 8% and a tenure of 13-14 years), though this is better than receiving zero interest on NPLs.
- We further understand that banks will be compensated on gross NPLs not net NPLs. Banks typically hold provisions of 17-25% on these loans. A write-back of this amount will lead to increasing the profits of banks by around 3-4% in the immediate short term.

Moral hazard—regular payers may start defaulting: We believe the move will likely have the following adverse implications:

1. Borrowers who have been so far regular may start defaulting in the expectation of similar waivers in the future
2. Banks will likely become more cautious in their agri lending business
3. Companies like MMFSLs, which are focused largely on the rural area with 22% exposure in form of tractor loans, may find lending more difficult. Farmers will now prefer borrowing from banks with the expectation of similar waiver schemes in the future

- This also raises another crucial question, what about farmers who have borrowed from moneylenders?
- To quote from micro-finance company Basix's annual report of FY2006, "One persistent malaise in the rural credit sector in India was low repayments, whether in agricultural loans through cooperatives, or asset acquisition loans given under schemes like the IRDP in the 1980s. The Agricultural and Rural Debt Relief scheme of 1989, or more popularly known as the loan waiver by the then Deputy Prime Minister, Mr. Devi Lal, and several waivers of cooperative bank loans announced by state governments from time to time, had destroyed the repayment norm among rural borrowers. This led to bankers being extremely reluctant to lend to the rural borrowers." Thus, when BASIX was established, one of its main institutional development tasks was to re-establish the repayment norm among rural poor borrowers. BASIX established new lending methods which used a high degree of peer assessment for loan approval and used mutual or joint liability for ensuring repayment.

  (The Agriculture and Rural Debt Relief (ARDR) Scheme, 1989, waived loans up to Rs10,000 issued to farmers, landless cultivators, artisans and weavers by state-run banks. Till 1992, more than 44 mn farmers benefited from this scheme to the tune of Rs60 bn).

Proposed scheme

- All agricultural loans disbursed by scheduled commercial banks, regional rural banks and cooperative credit institutions up to March 31, 2007 and overdue as on December 31, 2007 will be covered under the scheme.
- For marginal farmers (i.e., holding upto 1 hectare) and small farmers (1-2 hectares), there will be a complete waiver of all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008.
- In respect of other farmers, there will be a one-time settlement (OTS) scheme for all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008. Under the OTS, a rebate of 25 per cent will be given against payment of the balance of 75 per cent.
- Agricultural loans were restructured and rescheduled by banks in 2004 and 2006 through special packages. These rescheduled loans as well as other loans rescheduled in the normal course (in accordance with RBI guidelines) will also be eligible either for a waiver or an OTS on the same pattern.
- The implementation of the debt waiver and debt relief scheme will be completed by June 30, 2008. Upon being granted a debt waiver or signing an agreement for debt relief under the OTS, the farmer would be entitled to fresh agricultural loans from the banks in accordance with normal rules.
- An estimated 30 mn small and marginal farmers and about 10 mn other farmers will benefit from the scheme. The total value of overdue loans being waived is estimated at Rs500 bn and the OTS relief on overdue loans is estimated at Rs100 bn.

Exhibit 1: Impact of the write-off of agricultural loans on banks is likely to be marginally positive in the near-term

March fiscal year-ends, 2007 & 2009E

	2007				2009		
	Agri loans (Rs mn)	Agri loan as % of total loans (%)	Gross NPL in agri (Rs mn)	NPLs in agri loans (%)	NPL write-back (Rs mn)	As % of PAT (%)	Revised PAT (Rs mn)
Andhra Bank	51,490	18.5	187	0.4	22	0.4	6,074
BoB	103,650	12.4	4,039	3.9	473	3.4	14,461
Canara Bank	155,210	15.8	2,284	1.5	267	2.3	12,052
Central Bank of India	92,519	17.9	4,507	4.9	527	8.7	6,595
Corporation Bank	26,217	8.8	649	2.5	76	1.1	6,916
Indian Bank	56,561	19.5	627	1.1	73	0.7	10,847
IOB	78,902	16.8	853	1.1	100	0.8	12,120
OBC	57,323	13.0	1,291	2.3	151	2.6	5,901
PNB	185,710	19.2	6,474	3.5	757	4.0	19,698
Union Bank	106,748	17.1	3,303	3.1	386	3.1	13,013
Old private banks							
Federal Bank	22,314	15.0	204	0.9	24	0.4	5,514
J&K Bank	6,951	4.1	285	4.1	33	0.9	3,652
New private Banks							
Axis Bank	50,948	13.8	830	1.6	97	0.6	15,060
CBOP	22,034	19.6	317	1.4	37	1.3	2,953
HDFC Bank	84,619	18.0	329	0.4	38	0.2	23,840
ICICI Bank	189,269	9.7	4,038	2.1	472	0.9	50,980

Note:
(1) Calculations have been performed assuming that banks receive the government compensation in FY2009.

Source: RBI, Companies, Kotak Institutional Equities estimates.

Exhibit 2: Details on the agricultural NPLs of various entities

Amount in Rs bn

	Outstanding loans	Gross NPLs
Public sector banks	2,051	65
Private sector banks	521	9
Rural Co-operative banks	2,011	479
Regional rural banks	473	16

Note:
(1) Data of public and private banks are as of March 2007.
(2) Data of regional co-operative banks is as of March 2006.
(3) Data of regional rural banks is provisional and is as of March 2007.

Source: RBI.

Automobiles

Sector coverage view	Attractive

		Price, Rs	
Company	Rating	29-Feb	Target
Bajaj Auto	BUY	2,280	2,865
Tata Motors	BUY	700	940
Maruti Suzuki	BUY	867	1,240
Mah & Mah	BUY	693	915

Cut in excise duty to fuel demand for small cars, revive 2-wheeler industry volumes

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- **Excise duty on small cars, 2-wheelers and buses cut to 12% (16% previously)**
- **We expect strong demand growth for small cars led by price cuts across models; 2-wheeler industry to receive a boost**
- **We believe Maruti and Bajaj Auto will be the biggest beneficiaries;**
- **We revise our volume estimates and upgrade earnings for Maruti, Tata Motors, Bajaj Auto and M&M**
- **We maintain BUY rating on Maruti, Tata Motors, Bajaj Auto and M&M with revised target price of Rs1,240 (Rs1,200 previously), Rs940 (Rs915 previously), Rs2,865 (Rs2,815 previously) and Rs915 respectively.**
- **Continue to be positive on the sector—Maruti and Bajaj Auto are our top picks**

We believe the cut in excise duty on small cars, 2-3-wheelers and buses will provide an impetus to the automobile industry. Most of the manufacturers have already announced that they will pass on this benefit to customers resulting in lower prices across models. We believe this will likely result in strong demand growth for small cars and will help revive the sagging 2-wheeler industry. We believe Maruti will be biggest gainer as 80% of its total volume s come from cars on which excise duty has been reduced. We revise our FY2009E and FY2010E earnings estimates for Maruti to Rs93 and Rs100.7 (Rs88.4 and Rs95.6 previously), for Tata Motors to Rs55.6 and Rs56 (Rs54 and Rs51.6 previously), for Bajaj Auto to Rs135.9 and Rs154.4 (Rs131.5 and Rs148.6 previously) and M&M to Rs45 and Rs48.3 (Rs44.5 and Rs48 previously), respectively. We maintain our positive view on the auto sector and our BUY rating on Maruti (TP: Rs1,240), BUY on Tata Motors (TP: Rs940), BUY rating on Bajaj Auto (TP: Rs2,865) and BUY on M&M (TP: Rs915).

Excise duty cut, greater disposable income to likely result in strong demand growth for small cars; 2-wheeler industry to receive a boost

We believe the reduction in excise on small cars and 2-wheelers to 12% (16% previously) will likely boost the demand for small cars. Besides, it will likely revive the sagging 2-wheeler volumes. Auto manufacturers will likely pass on the benefit of lower excise to the customers leading to price cuts—most manufacturers have already announced price cuts across models. We believe that the higher disposable income in the hands of the people on account of reduction in taxes along with the price cuts will result in a strong demand growth for small cars. Maruti will likely be the biggest beneficiary of this as approximately 80% of its volumes come from cars on which excise has been lowered. We expect 2-wheeler industry to receive a boost as prices of motorcycles across the various segments will come down. However, the availability of finance remains an area of concern.

Maruti to be the biggest beneficiary as lower prices, higher disposable income and Sixth Pay Commission to boost small car volumes

We believe Maruti will be the biggest beneficiary of the budget proposals. The reduction in excise will likely lead to lower prices for its various models (models on which excise duty has been cut forms approximately 80% of its total volumes). The rise in disposable income on account of lower taxes and the impending Sixth Pay Commission will likely result in a strong demand growth for the small car segment.

Maruti—Revise our volume estimates, raises earnings estimates and raise target price to Rs1,240/share (Rs1,200 previously)—Maintain BUY rating

Maruti will likely be the biggest beneficiary of the growth in small car segment volumes. We now factor higher volumes for its compact cars and also factor in volumes from "D'zire"—Maruti will likely launch the sedan version of Swift (named "D'zire") by end-March'08 as a replacement for its Esteem. We have raised our FY2009E and FY2010E volumes estimates for Maruti by 2.4% and 3.8%, respectively. We have also raised our FY2009E and FY2010E earnings estimates for Maruti to Rs93 and Rs100.7 (Rs88.4 and Rs95.6 previously). We continue to believe that Maruti offers strong volume visibility and are positive on the stock. We maintain our BUY rating on the stock and raise our target price to Rs1,240/share (Rs1,200 previously) based on 8X FY2009E EV/EBITDA.

Tata Motors—Lower excise to boost bus, small car volumes; raise our FY2009E and FY2010E earnings by 3% and 8.5%, respectively; raise target price to Rs940/share (Rs915 previously)—maintain BUY rating

We believe that the reduction in excise on buses will likely lead to increase in demand from private transport operators as well as state transport corporations. Besides, lower duties on small cars will likely result in increased sales of Indica—Tata Motors will launch a new version of Indica and a new compact car in FY2009. Lower excise on "Nano" will enable Tata Motors to improve its margins on Nano as it will likely not pass the entire benefit of the reduction of excise duty to Nano's customers. We raise our volume estimates for Tata Motors marginally to factor in increased bus sales. We raise our earnings estimates for Tata Motors to Rs55.6 and Rs56 (Rs54 and Rs51.6 previously). We maintain our BUY rating on Tata Motors with a revised SOTP-based target price of Rs940/share (Rs915 previously). We value Tata Motors' standalone auto business at Rs828 based on 9X FY2009E EV/EBITDA, adjusted for net debt of Rs125/share, and value the stake in its subsidiaries and investments at Rs237/share.

Bajaj Auto—Lower prices to likely revive motorcycle sales; availability of finance remains a key concern—raise target price to Rs2,865 (Rs2,815 previously), maintain BUY rating

The reduction in excise on 2-wheelers will likely provide an impetus to sagging motorcycle sales. We believe that the rise in disposable income along with lower prices of entry-level and executive-segment bikes will revive demand for motorcycles. However, we continue to be concerned over the stance adopted by 2-wheeler financers. Besides, aggressive price cuts by Hero Honda as well as Bajaj would continue to put pressure on margins. We raise our volume growth assumptions for Bajaj Auto for FY2009E and FY2010E by 3.5% and 5.1%, respectively. We also raise our earnings estimates for standalone auto business to Rs135.9 and Rs154.4 (Rs131.5 and Rs148.6 previously). We revise our SOTP-based target price to factor higher earnings from standalone auto business. We value Bajaj's standalone auto business Rs1,088/share based on 7X FY2009E EV/EBITDA (Rs1,046 previously). Our revised target price of Rs2,865/share represents a potential upside of 26% from current levels—maintain our BUY rating on the stock.

M&M—Not likely to benefit too much from budget proposals; marginally revise our earnings estimates—maintain BUY rating and target price of Rs915/share

We believe M&M will not benefit too much from the budget proposals. Hence, we do not make any change in our volume assumptions for M&M. We marginally tweak our model, raise our FY2009E and FY2010E earnings estimates to Rs45 and Rs48.3 (Rs44.5 and Rs48 previously) respectively. We value standalone auto business of M&M at Rs466/share (Rs463/share previously) based on 7X FY2009E EV/EBITDA. We value M&M's stake in its various subsidiaries and investments at Rs413/share. We maintain our SOTP based target price of Rs915/share and our BUY rating on the stock.

We continue to be positive on the auto sector—Maruti and Bajaj Auto are our top picks

We believe the reduction in excise duty and increase in disposable income will likely benefit Maruti and Bajaj Auto the most in its passenger car and 2-wheeler segments, respectively. Maruti and Bajaj Auto are our top picks in the auto sector. Our target price of Rs1,240 for Maruti and Rs2,865 for Bajaj Auto offers a potential upside of 43% and 26%, respectively. We continue to be positive on the auto sector.

We continue to be positive on the auto sector - Maruti and Bajaj are our top picks

Recommendation summary for Maruti, Tata Motors, M&M and Bajaj Auto

Company	Stock Reco.	Revised target price (Rs)	Old target price (Rs)	Change (%)	Current Price (Rs)	Potential upside (%)	Valuation basis
Maruti	BUY	1,240	1,200	3.3	867	43.0	Valued at 8X FY2009E EV/EBITDA
Tata Motors	BUY	940	915	2.7	700	34.3	Core auto business valued at 9X FY2009E EV/EBITDA; subsdiaries and investments valued at Rs237/share
M&M	BUY	915	915	-	693	32.0	Core auto business valued at 7X FY2009E EV/EBITDA; subsdiaries and investments valued at Rs413/share
Bajaj Auto	BUY	2,865	2,815	1.8	2,280	25.7	Core auto business valued at 7X FY2009E EV/EBITDA; life insurance subsidiary valued at Rs920/share; other subsdiaries and investments valued at Rs506/share

Source: Kotak Institutional Equities estimates.

Valuation summary for Maruti, Tata Motors, M&M, Bajaj Auto

	EV/EBITDA (X)			PER (X)			P/BV (X)		
Company	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Maruti Suzuki	7.7	5.5	4.5	12.8	9.3	8.6	2.8	2.1	1.7
Tata Motors	8.9	7.8	7.9	13.8	11.8	11.7	3.1	2.5	2.2
M&M	9.7	9.5	8.5	15.7	15.4	14.4	3.4	2.9	2.5
Bajaj Auto	14.7	12.4	10.4	19.8	16.8	14.8	3.7	3.2	2.8

Notes:

(1) Bajaj Auto,Tata Motors, M&M valuation is on consolidated basis and not for standalone auto business.

Source: Bloomberg, Kotak Institutional Equities estimates.

Summary financials for Maruti, Tata Motors and M&M.

	EBITDA (Rs mn)			EBITDA margin (%)			PAT (Rs mn)			EPS (Rs)		
	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2010E
Maruti	29,156	43,317	49,083	16.0	18.5	17.7	19,608	26,869	29,094	67.8	93.0	100.7
Tata Motors	32,171	39,376	41,602	11.3	11.9	10.6	20,393	23,798	23,966	47.7	55.6	56.0
M&M	15,563	17,194	19,899	14.1	13.9	14.5	11,410	11,600	12,457	44.2	45.0	48.3
Bajaj Auto	13,624	15,720	18,158	14.4	14.5	14.5	11,642	13,747	15,619	115.1	135.9	154.4

Note:

(1) The financials for Bajaj Auto,Tata Motors and M&M are for standalone auto business.

Source: Kotak Institutional Equities estimates.

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

	Revised estimates			Old estimates			% change		
	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Bajaj Auto									
Net sales	92,059	106,236	122,943	92,368	102,733	118,121	(0.3)	3.4	4.1
EBITDA	19,223	22,045	25,007	19,521	21,428	24,195	(1.5)	2.9	3.4
PAT	11,642	13,747	x	11,851	13,302	15,034	(1.8)	3.3	3.9
EPS (Rs/share)	115.1	135.9	154.4	117.1	131.5	148.6	(1.8)	3.3	3.9
Sales volume (vehicles sold)	2,586,417	2,864,167	3,216,194	2,586,417	2,766,769	3,060,276	-	3.5	5.1
Maruti Suzuki									
Net sales	182,148	233,571	276,864	182,032	225,681	263,132	0.1	3.5	5.2
EBITDA	29,156	43,317	49,083	29,044	41,367	47,064	0.4	4.7	4.3
PAT	19,608	26,869	29,094	19,531	25,542	27,642	0.4	5.2	5.3
EPS (Rs/share)	67.8	93.0	100.7	67.6	88.4	95.6	0.4	5.2	5.3
Sales volume (vehicles sold)	802,000	990,000	1,152,000	802,000	967,000	1,110,000	-	2.4	3.8
Tata Motors									
Net sales	285,585	330,501	390,783	285,585	328,778	387,436	-	0.5	0.9
EBITDA	32,171	39,376	41,602	32,171	38,451	39,173	-	2.4	6.2
PAT	20,393	23,798	23,966	20,393	23,096	22,092	-	3.0	8.5
EPS (Rs/share)	47.7	55.6	56.0	47.7	54.0	51.6	-	3.0	8.5
Sales volume (vehicles sold)	583,150	687,126	898,233	583,150	684,582	895,475	-	0.4	0.3
Mahindra & Mahindra									
Net sales	110,388	123,489	137,683	110,388	123,327	137,565	-	0.1	0.1
EBITDA	15,563	17,194	19,899	15,563	17,049	19,800	-	0.9	0.5
PAT	11,410	11,600	12,457	11,410	11,489	12,375	-	1.0	0.7
EPS (Rs/share)	44.2	45.0	48.3	44.2	44.5	48.0	-	1.0	0.7
Sales volume (vehicles sold)	289,847	313,194	339,123	289,847	313,194	339,123	-	-	-

Source: Kotak Institutional Equities estimates.

Maruti, Valuation details (FY2009E basis)

	EBITDA (Rs mn)	EV/EBITDA (X)	EV (Rs mn)	Value (Rs/share)	Comments
FY2009E	43,317	8.0	346,535	1,199	Based on Maruti's historical average EBITDA multiple and FY2009E EBITDA
Less: net debt			(10,918)	(38)	FY2009E net debt
Market capitalisation			**357,453**	**1,237**	
Target price				**1,240**	

Source: Company data, Kotak Institutional Equities estimates.

Volume assumptions for Maruti Suzuki, March fiscal year-ends

	2007	2008E	2009E	2010E
Segment-wise sales (no of vehicles)				
Entry (A) segment	79,245	80,000	80,000	60,000
Van-Segment	83,091	80,500	90,000	95,000
Compact (B) segment	440,375	528,500	651,000	768,000
Mid-size (C) segment	29,697	55,000	80,000	100,000
MUV	3,221	3,000	4,000	4,000
Domestic	**635,629**	**747,000**	**905,000**	**1,027,000**
Exports	39,295	55,000	85,000	125,000
Total	**674,924**	**802,000**	**990,000**	**1,152,000**
Segment-wise sales growth(yoy %)				
Entry (A) segment	(11.0)	1.0	-	(25.0)
Van-Segment	24.0	(3.1)	11.8	5.6
Compact (B) segment	31.5	20.0	23.2	18.0
Mid-size (C) segment	(7.3)	85.2	45.5	25.0
MUV	(19.5)	(6.9)	33.3	-
Domestic	**20.6**	**17.5**	**21.2**	**13.5**
Exports	13.0	40.0	54.5	47.1
Total	**20.1**	**18.8**	**23.4**	**16.4**

Source: SIAM, Kotak Institutional Equities estimates.

Tata Motors, SOTP-based valuation, FY2009E basis (Rs mn)

	EBITDA	Multiple	Value	Value per share	Comments
	Rs mn	(X)	Rs mn	Rs	
Tata Motors standalone	39,376	9.0	354,382	828	Based on 9X FY2009E EBITDA
Less: Net debt			53,525	125	
Total				**703**	
Value of subsidiaries				199	
Embedded value of investments				39	Value of investments in Tata Steel at CMP
SOTP-based value				**937**	
Target price				**940**	

Notes:
(1) We have valued the subsidiaries and the investments in Tata Steel after considering 20% holding company discount.

Source: Company data, Kotak Institutional Equities estimates.

Tata Motors, volume assumptions, March fiscal year ends

Volumes (no of vehicles)	2006	2007	2008E	2009E	2010E
M&HCVs	**136,871**	**184,997**	**175,937**	**193,354**	**207,960**
M&HCVs-domestic	128,610	172,842	160,743	173,603	182,283
M&HCVs-exports	8,261	12,155	15,194	19,752	25,677
LCVs	**108,151**	**149,241**	**168,484**	**190,220**	**214,774**
LCVs-domestic	86,226	125,744	141,462	159,145	179,038
LCVs-exports	21,925	23,497	27,022	31,075	35,736
UVs	**39,791**	**49,306**	**52,408**	**55,558**	**57,705**
UVs-domestic	37,910	47,892	50,287	52,801	54,121
UVs-exports	1,881	1,414	2,121	2,757	3,584
Passenger vehicles	**169,280**	**196,736**	**186,323**	**247,994**	**417,794**
Passenger vehicles-domestic	151,160	180,328	174,017	184,458	202,903
Passenger vehicles-exports	18,120	16,408	12,306	13,537	14,890
Small car	-	-	-	50,000	200,000
Total domestic sales	403,906	526,806	526,508	620,006	818,345
Total export sales	50,187	53,474	56,642	67,121	79,888
Total vehicle sales	**454,093**	**580,280**	**583,150**	**687,126**	**898,233**
Volume growth (yoy %)					
M&HCVs	**1.2**	**35.2**	**(4.9)**	**9.9**	**7.6**
M&HCVs-domestic	(0.5)	34.4	(7.0)	8.0	5.0
M&HCVs-exports	39.3	47.1	25.0	30.0	30.0
LCVs	**45.7**	**38.0**	**12.9**	**12.9**	**12.9**
LCVs-domestic	41.9	45.8	12.5	12.5	12.5
LCVs-exports	62.7	7.2	15.0	15.0	15.0
UVs	**7.5**	**23.9**	**6.3**	**6.0**	**3.9**
UVs-domestic	10.7	26.3	5.0	5.0	2.5
UVs-exports	(32.4)	(24.8)	50.0	30.0	30.0
Passenger vehicles	**10.9**	**16.2**	**(5.3)**	**33.1**	**68.5**
Passenger vehicles-domestic	4.4	19.3	(3.5)	6.0	10.0
Passenger vehicles-exports	132.0	(9.4)	(25.0)	10.0	10.0
Small car	-	-	-	-	300
Total domestic sales	9.4	30.4	(0.1)	17.8	32.0
Total export sales	67.3	6.5	5.9	18.5	19.0
Total vehicle sales	**13.8**	**27.8**	**0.5**	**17.8**	**30.7**

Source: Company data, Kotak Institutional Equities estimates.

Bajaj Auto, SOTP valuation (FY2009E basis)

	EBITDA (Rs mn)	Multiple (X)	Value (Rs mn)	Value per share (Rs)	Comment
Bajaj Auto- core auto business	15,720	7.0	110,040	1,088	Based on historical average multiple
Less: Net debt			(35,518)	(351)	FY2009E net debt
Total			**145,558**	**1,439**	
Bajaj Allianz Life Insurance				920	17X NBAP margin at 38% stake of Bajaj Auto and 15% holding company discount
Bajaj Allianz General Insurance				80	At 6X FY2007 BVPS and 15% holding company discount
Bajaj Auto Finance				45	Based on current market price and 20% holding company discount
Cash and other investments					
Stake in ICICI Bank Ltd			43,588	349	Based on 20% holding discount to KIE target price of Rs1,200
Other investments				32	At 20% holding company discount
SOTP-based value				**2,865**	
Target price				**2,865**	

Source: Company data, Kotak Institutional Equities estimates.

Bajaj Auto, Volume assumptions, March fiscal year ends

Volumes (No. of vehicles)	2006	2007	2008E	2009E	2010E
Motorcycles	**1,912,577**	**2,376,519**	**2,257,931**	**2,514,341**	**2,841,253**
Domestic	1,747,289	2,078,860	1,870,974	2,011,297	2,162,144
Exports	165,288	297,659	386,957	503,044	679,109
Scooters	**115,472**	**20,480**	**19,794**	**21,773**	**23,950**
Geared	62,860	5,254	-	-	-
Ungeared	52,612	15,226	19,794	21,773	23,950
Step thrus	870	-	-	-	-
Total 2-wheelers	**2,028,919**	**2,396,999**	**2,277,725**	**2,536,114**	**2,865,204**
Domestic 3-Wheelers	**176,745**	**181,133**	**153,963**	**150,114**	**146,361**
Passenger 3-wheelers	141,351	138,759	117,945	114,997	112,122
Goods 3-wheelers	35,394	42,374	36,018	35,117	34,240
Exports	75,261	140,663	154,729	177,939	204,629
Total 3-wheelers	**252,006**	**321,796**	**308,692**	**328,053**	**350,991**
Total vehicles	**2,280,925**	**2,718,795**	**2,586,417**	**2,864,167**	**3,216,194**

Source: SIAM, Kotak Institutional Equities estimates.

M&M, SOTP-based valuation, March fiscal year-ends

	EBITDA (Rs mn)	Multiple (X)	Value (Rs mn)	Value per share (Rs)	Comment
M&M standalone business	17,194	7.0	120,361	466	Based on 7X EV/EBITDA FY2009E earnings
Less: Net debt			(9,381)	(36)	
Total				**503**	
Subsidiaries				**301**	
Tech Mahindra				167	Based on KIE target price of Rs1,000/per share
Mahindra Lifespace Developers Ltd				42	Based on KIE target price of Rs 890/share
Punjab Tractors				44	Valued at open-offer price of Rs360/share of Punjab Tractors
Mahindra & Mahindra Financial Services Ltd				48	Based on KIE target price of Rs 265/share
Other investments				112	
SOTP-based value				**915**	
Target price				**915**	

Note
(1) The subsidiaries have been valued at a holding company discount of 20%.

Source: Company data, Kotak Institutional Equities estimates

Automobiles

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**29-Feb**	**Target**
Bajaj Auto	BUY	2,280	2,865
Tata Motors	BUY	700	940
Maruti Suzuki	BUY	867	1,240
Mah & Mah	BUY	693	915

Feb 08 sales: 2-wheeler industry volumes continue to decline; Maruti records marginal growth

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- **Bajaj Auto: 2-wheeler volumes decline 8.4% yoy**
- **Hero Honda: Volumes decline 5.4% yoy as industry reels under a slowdown**
- **Maruti: Domestic volumes flat as people postpone purchases on budget expectations**
- **Reduction in excise duties to likely result in strong growth in Mar'08**

Passenger car volumes remained flat for Maruti as people deferred their purchases on budget expectations of changes in excise duty. Besides, traditionally February has been a lean month for car sales. Maruti's domestic volumes have remained flat on a yoy basis even as GM has recorded a sharp increase in its volumes for Feb'08. Two-wheeler sales continue to be disappointing as volumes have failed to pick up. Financers have continued their strict stance towards 2-wheeler lending, resulting in declining volumes. We expect the reduction in excise duties to pep up volumes in the car segment as well as the 2-wheeler segment. We believe this will likely result in strong volume growth in Mar'08.

Bajaj Auto: 2-wheeler volumes decline 8.4% yoy

Bajaj Auto reported a 8.4% yoy decline and a 4.8% mom decline in motorcycle sales in Feb’08. Three-wheeler sales also continued their downward trend, declining 13% yoy in Feb’08. Total exports grew a sharp 65% yoy for the month. Two-wheeler industry growth continues to be negative as financers have continued to adopt strict financing norms. The industry trend continues to be similar to the previous months wherein the 100 cc segment growth continues to be negative while the >125 cc segment continues to do well. We believe that the reduction in excise duties will likely be a positive for the industry and boost volume growth. We expect this to be a big positive for Bajaj Auto.

Hero Honda: Volumes decline 5.4% yoy as industry reels under a slowdown

Hero Honda’s 2-wheeler volumes declined 5.4% yoy and 11% mom in Feb’08 as the industry continues to reel under a slowdown and lack of credit on account of stricter financing norms adopted by the financers. We believe motorcycle sales should pick up in Mar’08 led by a reduction in excise duty on motorcycles.

Maruti: Domestic volumes flat as people postpone purchases on budget expectations

Maruti’s domestic sales remained flat on a yoy basis in Feb’08 while exports grew 15.5% yoy. Overall volumes grew a marginal 1.3% yoy. Domestic sales were lower as people postponed their purchases in the light on expectations of an excise duty reduction in the annual Budget. Entry-segment sales declined 3.5% while compact car sales grew marginally at 2.7% yoy. The mid-size car segment volumes grew 9% on a yoy basis as the demand for SX4 continues to be quite strong—SX4 still has a waiting period of 2-4 weeks. Meanwhile, the reduction of excise on small cars is likely to be a huge positive for Maruti as about 80% of its volumes come from cars on which excise duty has been reduced. We believe Mar’08 will see a surge in volumes as people who postponed their buying decisions will now purchase cars. Moreover, volumes would increase as customers would buy cars in Mar’08 to avail of the depreciation benefit. We continue to be positive on Maruti.

4-wheelers Feb 2008 sales performance

	Feb-08	Feb-07	yoy %	Jan-08	mom %	YTD, FY2008	YTD, FY2007	yoy %
Maruti Udyog								
Entry (A) segment	5,745	5,955	-3.5%	5,470	5.0%	63,200	73,104	-13.5%
Van-segment	7,268	8,069	-9.9%	8,861	-18.0%	81,688	74,430	9.8%
Compact (B) segment	44,059	42,913	2.7%	45,957	-4.1%	457,411	393,307	16.3%
Mid-size (C) segment	1,958	1,798	8.9%	2,939	-33.4%	41,799	27,283	53.2%
MUV	281	360	-21.9%	232	21.1%	3,305	2,949	12.1%
Domestic	**59,311**	**59,095**	**0.4%**	**63,459**	**-6.5%**	**647,403**	**571,073**	**13.4%**
Exports	4,511	3,904	15.5%	4,648	-2.9%	47,149	32,079	47.0%
Total	**63,822**	**62,999**	**1.3%**	**68,107**	**-6.3%**	**694,552**	**603,152**	**15.2%**

Source: Company, Kotak Institutional Equities.

Reported monthly sales of top two-wheeler companies - Feb 2008

	Feb-08	Feb-07	yoy %	Jan-08	mom %	YTD, FY2008	YTD, FY2007	yoy %
Bajaj Auto								
Geared Scooters	-	-		-		-	5,254	-100.0%
Ungeared Scooters	846	2,440	-65.3%	1,100	-23.1%	20,254	11,764	72.2%
Step thrus	-	-		-		-	-	
Motorcycles	158,662	171,780	-7.6%	166,492	-4.7%	1,984,859	2,210,995	-10.2%
Total 2-Wheelers	**159,508**	**174,220**	**-8.4%**	**167,592**	**-4.8%**	**2,005,113**	**2,228,013**	**-10.0%**
3 Wheelers	24,299	27,992	-13.2%	24,601	-1.2%	269,536	297,220	-9.3%
Hero Honda								
Total 2-Wheelers	265,431	280,515	-5.4%	298,050	-10.9%	3,016,548	3,058,841	-1.4%

Source: Company, Kotak Institutional Equities.

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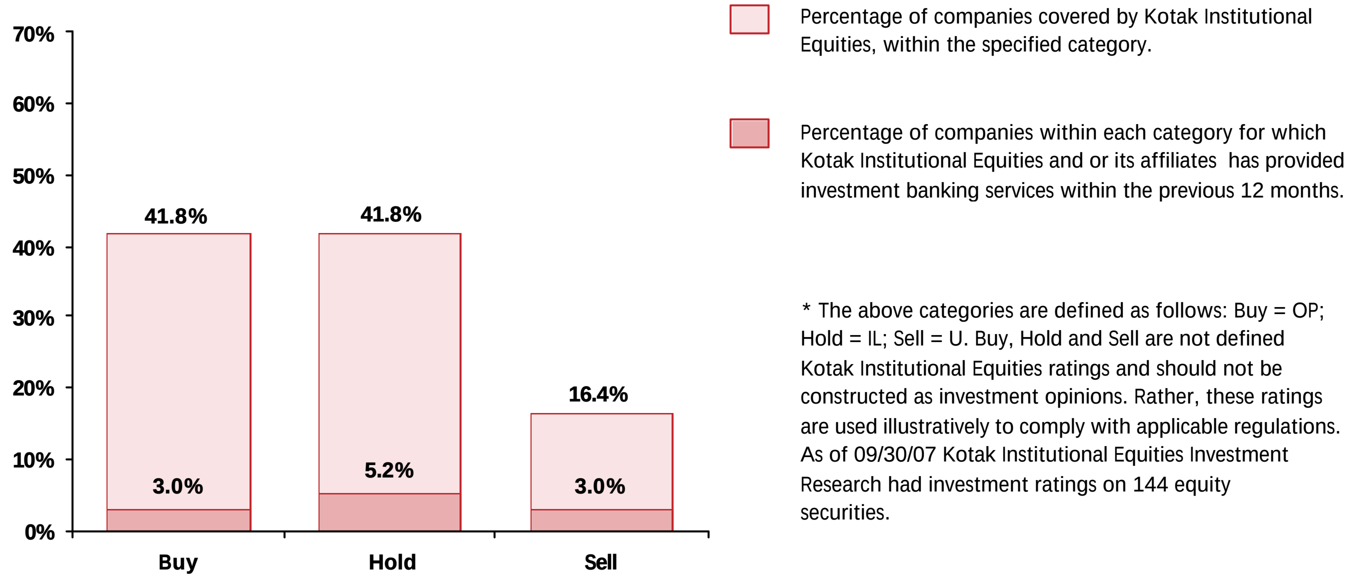

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Source: Kotak Institutional Equities. As of September 30, 2007

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