kotak Institutional Equities

India Daily
March 21, 2007

Equity market

India	20-Mar	1-day	1-mo	3-mo
		Change, %		
Sensex	12,706	0.5	(10.4)	(5.1)
Nifty	3,698	0.5	(9.7)	(3.5)
Global/Regional indices				
Dow Jones	12,288	0.5	(3.5)	(1.1)
Nasdaq Composite	2,408	0.6	(4.4)	(0.3)
FTSE	6,220	0.5	(2.2)	0.6
Nikkie	17,163	0.9	(4.2)	0.7
Hang Seng	19,345	(0.1)	(6.3)	0.6
KOSPI	1,441	(0.2)	(0.7)	0.3

Value traded - India	20-Mar		1-mo	3-mo
		Moving avg, Rs bn		
Cash (NSE+BSE)	88.8		126.2	110.8
Derivatives (NSE)	91.6		74.7	78.7
Deri. open interest	121.3		101.1	85.2

Forex/money market

	20-Mar	1-day	1-mo	3-mo
		Change, basis points		
Rs/US$	43.8	6	(38)	(71)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	2	7	48

Net investment (US$mn)

	19-Mar		MTD	CYTD
FIIs	(56)		#N/A	40
MFs	8		#N/A	(303)

Top movers -3mo basis

Best performers	20-Mar	1-day	1-mo	3-mo
		Change, %		
Punjab Tractors	308	(0.6)	(3.8)	38.7
SAIL	103	-	(11.5)	25.9
Bharti Tele	739	0.7	(8.4)	21.4
BEL	1,512	3.5	(7.2)	20.5
Exide Indus	43	1.2	(9.1)	15.9
Worst performers				
Balrampur Chini	59	0.4	1.3	(28.9)
Acc	748	1.2	(25.8)	(27.3)
Tvs Motor	62	(1.4)	(12.9)	(26.6)
Corp Bank	247	12.1	(13.4)	(24.6)
Hindalco	133	3.3	(11.7)	(22.2)

From our research team

New releases

Wipro: Rebound: Well positioned for a strong FY2008'reiterate Outperform

Results

Nestle India: 4QCY06: Sales growth picks up, but pressure on margins persist; retain IL

Change in recommendations

Automobiles: Two-wheelers - the war intensifies

Update

Bharti Airtel, Reliance Communications: USO funding for rural telecom infrastructure: Bharti opts for reverse subsidy

ICICI Bank: Higher provisions on standard loans, and branch expansion costs may pull down 4Q and FY2008 profits

Media: Dish TV analyst meeting—as upbeat as it could get

Corporate news

- The Foreign Investment Promotion Board (FIPB) has deferred taking a decision on Vodafone's application to pick up a 51.96% stake in Hutchison Essar Ltd (now to be renamed Vodafone Essar Ltd). The aggregate foreign interest in the company will be 74% following the completion of the overseas transaction. *(BS)*
- Dutch bank ABN AMRO and British bank Barclays are in exclusive talks for a possible $160 bn merger that would be Europe's biggest financial services deal. *(FE)*
- Ranbaxy is understood to have pulled out of the race to acquire German pharmaceutical company Merck's generic business on concerns of over-valuation. *(FE)*

Economic and political news

- Money market rates touched nine-year highs as the liquidity squeeze in the banking system worsened. The overnight call money rate touched 60% intra-day and some banks, particularly foreign and private banks, used dollars to raise Rupee resources for a day at a record rate of 105%. *(BS)*
- Planning Commission Deputy Chairman Montek Singh Ahluwalia has said that there are signs of overheating in the economy and the 9% economic growth is putting pressure on inflation. *(BS)*

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

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Technology

WIPR.BO, Rs573	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	660
52W High -Low (Rs)	690 - 383
Market Cap (Rs bn)	821.5

Financials

March y/e	2006	2007E	2008E
Sales (Rs bn)	106.1	147.4	195.0
Net Profit (Rs bn)	20.3	28.3	37.6
EPS (Rs)	14.2	19.8	26.1
EPS gth	*26.4*	*38.9*	*32.2*
P/E (x)	40.3	29.0	22.0
EV/EBITDA (x)	30.8	22.5	16.3
Div yield (%)	0.6	0.8	1.1

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.6	-	-
FIIs	6.5	0.9	(2.1)
MFs	1.0	0.8	(2.2)
UTI	-	-	(3.0)
LIC	1.1	0.8	(2.2)

Wipro: Rebound – Well positioned for a strong FY2008'reiterate Outperform

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- **Key growth levers falling in place across verticals and horizontals**
- **Revamped account management model to improve large account mining**
- **BPO'turnaround complete, growth driven by innovative pricing models**
- **Stable margins with robust growth to drive outperformance**
- **Reiterate OP rating**

We expect Wipro to grow in line with the best in the industry given its improved positioning in key verticals, revamped account management, turnaround in BPO business and strong full service model. We reiterate our Outperform rating with a 12-month DCF-based target price of Rs660/ share.

Key growth levers falling in place across verticals and horizontals: We believe that Wipro is well positioned to grow in line with the best in the industry in FY2008 buoyed by recent large deals wins, strong traction in key large verticals and sustained momentum in new service offerings (testing and remote infrastructure management). The key growth verticals, in our view, would be BFSI, energy and utilities and TSPs.

Revamped account management model to improve large account mining: Wipro has made several changes to its account management model in the past few quarters, including identification of focus accounts, separation of the hunting and farming teams, verticalization of the sales team etc. These changes have enabled the company to grow its US$50 mn+ accounts to eight in the past four quarters (from zero earlier).

BPO-turnaround complete, growth driven by innovative pricing models: Wipro has transformed its BPO business model by (a) exiting outbound voice business, (b) rationalizing processes and (c) increasing its thrust on integrated services. We believe that these steps, coupled with Wipro's investments in developing platforms for various verticals (which enable it to offer transaction pricing model to its clients) would help Wipro's BPO business achieve a sustainable revenue growth rate of 35-40%.

Stable margins with robust growth to drive outperformance; retain OP: We expect Wipro's OPM to remain stable in FY2008. We believe that levers such as higher utilization rates, pricing improvement, increase in rookie ratio and improvement in profitability of acquisitions will offset the impact of wage inflation in FY2008. We reiterate our Outperform rating on Wipro with a 12-month DCF based target price of Rs660/ share.

Consumer Products

NEST.BO, Rs910	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	1,000
52W High -Low (Rs)	1387 - 800
Market Cap (Rs bn)	87.7

Financials

December y/e	2005	2006E	2007E
Sales (Rs bn)	24.8	28.2	31.8
Net Profit (Rs bn)	3.3	3.2	3.8
EPS (Rs)	34.1	32.8	39.1
EPS gth	*17.2*	*(3.8)*	*18.9*
P/E (x)	26.6	27.7	23.3
EV/EBITDA (x)	16.1	16.2	14.2
Div yield (%)	2.7	2.8	3.0

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.8	-	-
FIIs	9.1	0.2	(0.2)
MFs	3.8	0.4	0.0
UTI	-	-	(0.4)
LIC	3.7	0.4	(0.0)

Nestle India: 4QCY06: Sales growth picks up, but pressure on margins persist; retain IL

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- **Domestic sales growth indicates robust business environment.**
- **Cost increases put pressure on margins.**
- **Exports bounce back on low base.**
- **Retain In Line rating with target price of Rs1,000/share (Rs950 previously)**

Nestle India reported y-o-y sales growth of 18.2% (against our estimate of 14.7%) and EBITDA growth of 2.4% (our estimate of 7.4% growth) for 4QCY06. Domestic sales growth rate at 16.4% y-o-y was inline with our estimate of 16.0%. Exports grew strongly at 37% as against our estimate of 2.1%. Increase in prices of commodities (milk, wheat etc.) and higher operating costs resulted in EBITDA margins declining by 260 bp yoy to 16.3% during 4QCY06. Nestle ended CY2006 with a domestic sales growth of 14.4% over CY2005, with both price and volumes growth contributing to the gains. EBITDA margin during CY2006 was 235 bp lower as compared to CY2005. We have marginally changed our estimates to reflect higher export sales during CY2007 and CY2008. Our EPS estimate for CY2007 remains unchanged at Rs39.1, while EPS for CY2008 has increased by 2.4% to Rs42.6. We retain our In Line rating on the stock. We have revised our DCF based target price to Rs1,000/share (from 950/share previously).

Domestic sales growth indicates robust business environment. Domestic sales growth of 14.4% during CY2005 is the highest growth recorded by Nestle in the last five years and is an indicator of the robust macro environment. The domestic sales growth was aided by company's focus on 'Nutrition, Health and Wellness'. Nestle launched Kit Kat Lite, Everyday Slim, Maggi Rice Mania, Fresh 'n' Natural Slim Dahi on this platform during the year. While we are enthused by the pickup in sales growth rate for the company, we expect earnings growth to be constrained due to cost pressures.

Cost increases put pressure on margins. Steep increase in prices of agri-commodities (milk, wheat etc.) and higher operating costs associated with upgraded formulations and manufacturing processes of the infant nutrition products have put pressure on the operating margins of the company. Increase in selling prices and higher volumes growth has only been able to partially offset the cost increases.

Exports bounce back on low base. Exports surged by 37% yoy during 4QCY06 aided by a low base of last year (8% yoy decline in export sales during 4QCY05). Exports grew 7.9% yoy during CY2006 due to lower beverage exports to the key markets of Russia and Japan, which was partially offset by improved sales in other categories and geographies.

20-year explicit forecast based DCF model derived target price of Rs1,000/ share. The model builds in a WACC of 14% and a terminal year growth rate of 6%.

Nestle-Quarterly summary, December year-ends (Rs mn)

	yoy			yoy			Our est.	yoy
	2006	2005	% chg	4Q 2006	4Q 2005	% chg	4Q 2005	% chg
Net sales	**28,162**	**24,769**	**13.7**	**7,363**	**6,228**	**18.2**	**7,146**	**14.7**
Material cost	(12,934)	(10,876)		(3,339)	(2,679)		(3,364)	
Employee cost	(2,162)	(1,833)		(569)	(441)		(540)	
Other overheads	(7,791)	(6,840)		(2,252)	(1,933)		(2,000)	
Total expense	(22,886)	(19,549)		(6,160)	(5,053)		(5,904)	
EBITDA	**5,276**	**5,221**	**1.1**	**1,203**	**1,175**	**2.4**	**1,262**	**7.5**
Depreciation	(664)	(568)		(177)	(138)		(151)	
EBIT	4,612	4,652		1,026	1,037		1,112	
Other income	214	237		73	32		74	
Net interest	(4)	(2)		(1)	(0)		(7)	
PBT	**4,821**	**4,887**	**(1.4)**	**1,097**	**1,069**	**2.7**	**1,178**	**10.3**
Tax	(1,654)	(1,595)		(303)	(305)		(251)	
PAT	**3,167**	**3,293**	**(3.8)**	**794**	**763**	**4.0**	**927**	**21.4**
Extraordinary Income (loss)	(16)	(197)		(169)	(22)		-	
Net profit	**3,151**	**3,096**	**1.8**	**625**	**742**	**(15.8)**	**927**	**25.0**
EBITDA margin (%)	18.7	21.1		16.3	18.9		17.7	
Effective tax rate (%)	34.3	32.6		27.6	28.6		21.3	
Domestic sales (net of excise)	25,366	22,177	14.4	6,603	5,672	16.4	6,579	16.0
Exports	2,796	2,592	7.9	760	555	36.9	567	2.1

Source: Company data, Kotak Institutional Equities.

Automobiles

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**20-Mar**	**Target**
Hero Honda	U	635	625
Bajaj Auto	OP	2,500	2,860
Tata Motors	OP	770	1,055
Maruti	OP	789	1,010
Mah & Mah	OP	745	1,000
Ashok Leylanc	IL	40	47
Punjab Tracto	IL	308	215
TVS Motor	U	62	55
Bharat Forge	OP	311	390

Two-wheelers - the war intensifies

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- **Discounts and price cuts intensify in motorcycles; margins set to worsen further**

The war in the two-wheeler space has worsened substantially in the last two months with the price-line set to move down even further from already low levels in the entry 100CC bike segment. Moreover, fundamentals have weakened with slower-than-trend growth in motorcycles in the last three months. Two-wheeler finance companies, too, are now becoming a lot stricter while extending loans than before. We now factor in lower industry growth and margin assumptions for all three two-wheeler companies over FY08-09 resulting in a sharp cut in our EPS estimates over the period. We maintain OP on Bajaj Auto with an SOTP target price of Rs2,860 (Rs3,220 previously). In our view, while near-term news-flow for Bajaj will be negative in terms of quarterly results, we see both volumes and margins improving for the company post its new launches in 2QFY08. In the case of Hero Honda, we see continued pressure on margins, especially after Bajaj Auto's new launches and downgrade the stock to Underperform (In-Line previously) with a target price of Rs625 (Rs735 previously). We also maintain our Underperform rating on TVS Motor with a target price of Rs55 (Rs68 previously).

Discounts and price cuts intensify in motorcycles; margins set to worsen further

The last month has seen the level of discounts and price-cuts increasing further in the 2W industry. Hero Honda is currently offering a discount of Rs1000 on every bike sold. TVS has just launched the ‘Star Sport’ in the entry segment with alloy wheels at a very aggressive price of Rs33,390. Bajaj Auto is set to cut the price of its entry segment bike ‘Platina’ by upto Rs2000-3000 in April. Bajaj will likely be shifting most/all of Platina production to its plant in Uttarakhand in April where it will enjoy excise and income tax benefits. However, the likely price-cut will more than offset the tax benefits putting further pressure on margins, in our opinion.

Inventories rise across players

Industry motorcycle inventories have risen to 30-35 days in the last month. We understand that Hero Honda is now offering 45 days interest free credit to its dealers Vs 21 days previously. Inventory with Hero Honda’s dealers has now gone up to about 35-40 days. Bajaj, too, has seen a sharp increase in ‘Platina’ inventories to about 20 days. The aggressive pricing adopted by Hero Honda on its entry segment variant launches combined with an expectation of a price cut on the ‘Platina’ in April has likely led to the increase in ‘Platina’ inventories in the last two months.

Two-wheeler finance companies tighten their purses

Our talks with leading two-wheeler finance companies indicate a substantial tightening of credit for two-wheelers. A rise in delinquency rates in some states like Uttar Pradesh and Bihar has prompted the finance companies to slow down 2W loan approvals in those areas. We understand that the banks are now demanding subventions (effective subsidies) from the two-wheeler companies for extending credit in some areas. Two-wheeler loan approvals in other parts of India, too, have become stricter. A dealer we spoke to mentioned that previously the banks would disburse loans without proper paper work and due diligence while now they are following the rule-book while approving loans. As a result, the marginal customer is no longer getting access to credit easily. This, in our opinion, is one of the reasons why two-wheeler growth rates have come off in the last three months.

In our view, industry growth should improve somewhat after the steep price-cuts in April. Plus, we understand that April will witness a marriage season in northern India, which should boost volumes. Nevertheless, we now expect the motorcycle industry to grow a lower 10-12% in FY08 versus our expectation of 14-15% growth previously.

Bajaj Auto: New 125CC launches in 2QFY08 are the key

We lower our EPS estimates for Bajaj Auto 4% for FY07 to Rs118.2 (Rs123.0 previously), 13% for FY08 to Rs138.0 (Rs158.3 previously) and 16% for FY09 to Rs160.3 (Rs190.1 previously). We now factor in 15% growth in domestic motorcycles for Bajaj in FY08 and FY09 (20% previously). We now expect EBITDA margins for Bajaj (excl financial other income) to fall below 3QFY07 levels in 4Q and decline further in 1QFY08. However, we expect both volumes and margins for Bajaj to improve 2QFY08 onwards, post its new 125CC launches. In our opinion, after the expected price cut in the ‘Platina’ in April, Bajaj’s entry segment EBITDA margins will likely fall below 5%. Consequently, even if the new launches in 2QFY08 have low margins at 8-10%, overall margins for the company will likely see a sequential improvement in 2QFY08.

However, in the interim, news flow for Bajaj will be poor. We expect net profit for Bajaj Auto to decline 18% yoy in 4QFY07 and 1% yoy in 1QFY08 before returning to growth 2QFY08 onwards. We don’t expect the stock to weaken below current levels on account of the expected de-merger announcement of the company’s auto and finance businesses in May. However, the next trigger for stock performance (excl de-merger related run-up) will be the market response to the company’s new 125CC launches in 2QFY08. Bajaj Auto will be launching 125CC bikes in 2Q on a new low-cost platform at the price of a 100CC bike. Potential success of these bikes could act as a major positive trigger for the stock, in our opinion.

Consequently, we find risk/reward favorable for Bajaj Auto at current levels and maintain OP on the stock with our target price standing reduced at Rs2,860 (Rs3,220 previously). Our revised target price also takes into account lower value of the holding in ICICI Bank both due to fall in stock price as well as fall in level of holding.

Hero Honda: Outlook worsens further

We lower our EPS estimates for Hero Honda 2% for FY07 to Rs43.2 (Rs43.9 previously), 16% for FY08 to Rs43.3 (Rs51.3 previously) and 21% for FY09 to Rs46.6 (Rs59.3 previously). We now factor in 7.5% growth in domestic motorcycles for Hero Honda in FY08 and FY09 (12.5% previously). We factor in EBITDA margins to decline 100 bps in FY08 for Hero Honda. We now see a fairly real possibility of Hero Honda’s margins slipping below 10% in FY08 if it lowers prices of the ‘Splendor-Passion’ duo after Bajaj Auto’s new launches in 2QFY08.

We lower our rating on Hero Honda to Underperform (In-Line previously) with a target price of Rs625 (Rs735 previously).

TVS Motor: Will likely fight for survival

We lower our EPS estimates for TVS Motor 4% for FY07 to Rs2.9 (Rs3.0 previously), 19% for FY08 to Rs3.8 (Rs4.7 previously) and 28% for FY09 to Rs4.3 (Rs5.9 previously). We now factor in 7.5% growth in domestic motorcycles for TVS Motor in FY08 and FY09. We factor in EBITDA margins to increase 80 bps in FY08 for TVS Motor factoring in the upcoming launch of 3Ws (more profitable hopefully) during the year. We maintain our view that TVS Motor will likely get caught in the cross-fire between Bajaj Auto and Hero Honda as it has the least slack in terms of margins or products to indulge in price competition with the two leaders. We also note that the company’s three-wheeler launch has once again got postponed to 2QFY08 (1Q previously).

We maintain our Underperform rating on TVS Motor with a target price of Rs55 (Rs68 previously).

Target price computation for Bajaj Auto

	FY2008
Value of core business at 8.5X FY2008 EV/EBITDA	1,939
Value of Bajaj Allianz General Insurance	55
Value of Bajaj Allianz Life Insurance	584
Value of stake in ICICI Bank (at 20% discount to market value)	245
Value of other listed investments (at 20% discount to market value)	37
SOTP based target price	**2,860**

Source: Kotak Institutional Equities

Volume assumptions for Bajaj Auto

	2005	2006	2007E	2008E	2009E
Volumes (units)					
Motorcycles-domestic	1,325,727	1,747,289	2,096,747	2,411,259	2,772,948
Motorcycles-exports	123,950	165,288	297,518	371,898	464,873
Total motorcycles	**1,449,677**	**1,912,577**	**2,394,265**	**2,783,157**	**3,237,820**
Geared scooters	102,575	62,860	5,254	-	-
Ungeared scooters	30,931	52,612	15,784	59,978	65,975
Step-thrus	19,165	870	-	-	-
Total two-wheelers	**1,602,348**	**2,028,919**	**2,415,303**	**2,843,135**	**3,303,796**
Passenger three-wheelers-domestic	123,794	141,351	138,524	138,524	138,524
Goods three-wheelers-domestic	32,446	35,394	42,473	42,473	42,473
Three-wheeler exports	65,747	75,261	145,519	174,623	209,547
Total three-wheelers	**221,987**	**252,006**	**326,516**	**355,619**	**390,544**
Total vehicles	**1,824,335**	**2,280,925**	**2,741,818**	**3,198,754**	**3,694,339**
YoY growth (%)					
Motorcycles-domestic	40.9	31.8	20.0	15.0	15.0
Motorcycles-exports	49.6	33.4	80.0	25.0	25.0
Total motorcycles	**41.6**	**31.9**	**25.2**	**16.2**	**16.3**
Geared scooters	(42.4)	(38.7)	(91.6)	(100.0)	-
Ungeared scooters	(43.5)	70.1	(70.0)	280.0	10.0
Step-thrus	(41.0)	(95.5)	(100.0)	-	-
Total two-wheelers	**24.3**	**26.6**	**19.0**	**17.7**	**16.2**
Passenger three-wheelers-domestic	(10.7)	14.2	(2.0)	-	-
Goods three-wheelers-domestic	31.0	9.1	20.0	-	-
Three-wheeler exports	(0.1)	14.5	93.4	20.0	20.0
Total three-wheelers	**(3.1)**	**13.5**	**29.6**	**8.9**	**9.8**
Total vehicles	**20.2**	**25.0**	**20.2**	**16.7**	**15.5**

Source: SIAM, Kotak Institutional Equities estimates

Volume assumptions for Hero Honda

	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Volumes (units)					
Motorcycles-domestic	2,557,385	2,893,070	3,153,446	3,389,955	3,644,201
Motorcycles-exports	64,015	92,666	92,666	92,666	92,666
Total motorcycles	**2,621,400**	**2,985,736**	**3,246,112**	**3,482,621**	**3,736,867**
Scooters	-	15,015	96,000	105,600	116,160
Total two-wheelers	**2,621,400**	**3,000,751**	**3,342,112**	**3,588,221**	**3,853,027**
YoY growth (%)					
Motorcycles-domestic	25.8	13.1	9.0	7.5	7.5
Motorcycles-exports	63.1	44.8	-	-	-
Total motorcycles	**26.5**	**13.9**	**8.7**	**7.3**	**7.3**
Scooters			539.4	10.0	10.0
Total two-wheelers	**26.5**	**14.5**	**11.4**	**7.4**	**7.4**

Source: SIAM, Kotak Institutional Equities estimates

Volume assumptions for TVS Motor

	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Volumes (units)					
Motorcycles-domestic	640,707	752,576	842,885	906,102	974,059
Motorcycles-exports	38,392	53,164	82,404	94,765	108,980
Total motorcycles	**679,099**	**805,740**	**925,289**	**1,000,866**	**1,083,039**
Mopeds	263,390	290,085	339,399	364,854	392,218
Scooters	224,527	244,550	256,778	276,036	296,738
Total two-wheelers	**1,167,016**	**1,340,375**	**1,521,466**	**1,641,757**	**1,771,996**
Three-wheelers	-	-	-	24,000	26,400
Total vehicles	**1,167,016**	**1,340,375**	**1,521,466**	**1,665,757**	**1,798,396**
YoY growth (%)					
Motorcycles-domestic	(6.2)	17.5	12.0	7.5	7.5
Motorcycles-exports	60.9	38.5	55.0	15.0	15.0
Total motorcycles	**(3.9)**	**18.6**	**14.8**	**8.2**	**8.2**
Mopeds	4.9	10.1	17.0	7.5	7.5
Scooters	18.6	8.9	5.0	7.5	7.5
Total two-wheelers	**1.8**	**14.9**	**13.5**	**7.9**	**7.9**
Three-wheelers					10.0
Total vehicles	1.8	14.9	13.5	9.5	8.0

Source: SIAM, Kotak Institutional Equities estimates

Telecom

BRTI.BO, Rs739	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	525
52W High -Low (Rs)	850 - 310
Market Cap (Rs bn)	1,401

Financials

March y/e	2006	2007E	2008E
Sales (Rs bn)	116.6	192.1	273.1
Net Profit (Rs bn)	20.8	41.7	59.2
EPS (Rs)	10.7	21.5	30.5
EPS gth	*67.4*	*100.9*	*42.0*
P/E (x)	69.1	34.4	24.2
EV/EBITDA (x)	34.8	19.6	13.7
Div yield (%)	-	-	0.3

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.0	-	-
FIIs	25.6	4.8	0.7
MFs	2.3	2.7	(1.4)
UTI	-	-	(4.1)
LIC	1.6	1.7	(2.4)

Telecom

RLCM.BO, Rs400	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	400
52W High -Low (Rs)	518 - 186
Market Cap (Rs bn)	818

Financials

March y/e	2006	2007E	2008E
Sales (Rs bn)	106.3	148.0	208.0
Net Profit (Rs bn)	4.8	29.5	47.1
EPS (Rs)	2.2	13.9	22.5
EPS gth	*-*	*543.1*	*61.5*
P/E (x)	184.6	28.7	17.8
EV/EBITDA (x)	36.9	14.6	10.6
Div yield (%)	-	-	-

Bharti Airtel, Reliance Communications: USO funding for rural telecom infrastructure: Bharti opts for reverse subsidy

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- **BSNL the lowest bidder in 63 out of 81 clusters for passive infrastructure**
- **Bharti bids 'negative' subsidy to set up active infrastructure in 12 clusters; final decision awaited**
- **Aggressive bidding underlines the drive for market share among operators**

According to unconfirmed press reports, BSNL has emerged as the lowest bidder for providing passive infrastructure in 63 of the 81 rural clusters identified for USO funding in the second round of bidding. A final government decision on three service providers (for setting active infrastructure) per cluster is awaited. However, it appears that Bharti has put in negative bids in the 12 clusters that it could bid for (it was rejected in 33 clusters in the first round). We see the decision of certain operators to do without USO funding (and willing to pay the government) for active infrastructure as reflective of likely higher price competition in the future; operators appear willing to compromise on pricing/profitability to increase market share; as of now, there is sufficient scope for lower pricing given very high industry returns. We retain our 12-month DCF-based target prices of Rs525 and Rs400, respectively, for Bharti and RCL. Key upside risk stems from higher-than-expected profitability.

BSNL the most aggressive bidder. The details of the first round of bidding show that BSNL was the most aggressive bidder in the first round and was short-listed in 65 clusters for passive infrastructure and 77 clusters for active infrastructure for the second round of bidding out of 81 identified clusters. Bharti had put its bid for 45 clusters but was short-listed for the second round only in 4 and 12 clusters for passive and active infrastructure, respectively. We note that RCL has bid through its CDMA (74 clusters), GSM (40 clusters) and infrastructure (only passive in 81 clusters) companies.

USO funding for rural infrastructure for expansion of coverage. The objective of the USO funding-led rural infrastructure development is to bring 500 districts (clubbed into 81 clusters), 212,304 villages and 269 mn population under potential mobile coverage. This corresponds to 24% of India's total population and is important in the context of about 54% coverage of population of the leading operator, Bharti Airtel. The current wireless penetration in India is about 14% and extension of coverage to the remaining population may increase penetration; however, we note that rural incomes are very low and entry costs (handset + monthly payment or handset + one-time payment) may also act as barriers. The scheme addresses the supply side (improves economics for operators) but we are less sure about the demand-side.

Passive infrastructure—bids as low as 20% of benchmark subsidy. Newspaper articles (unconfirmed) suggest that BSNL has asked the government for just 20% of the benchmark subsidy for passive infrastructure in 63 clusters, where it is the lowest bidder. The government will select only one passive infrastructure provider per cluster. The benchmark subsidy in various clusters was in the range of Rs369,000 to Rs609,000 per annum for five years. We believe that the winning bids for the 18 clusters won by other players (RCL and GTL Infrastructure in most as per press reports) would not be meaningfully different. We find these bids aggressive noting that the cost of setting up one telecom tower is in the range of Rs2.6-3 mn. We also note that as many as 14 players had put in their bids for passive infrastructure in the first round. This would likely mean high level of competition for the tower companies being spun-off by RCL (which has received court clearance for de-merger of its tower business) and Bharti.

Active infrastructure—Bharti opts for reverse subsidy; no subsidy sought by other telecom service providers. Newspaper articles also report that Bharti has chosen to put in negative bids for the 12 clusters that it was eligible to bid for (which means it would pay the government to roll out its network in the cluster), while the other operators have chosen to put zero subsidy bids in the clusters they bid for. We see Bharti's 'negative' subsidy bid as a fall-out of not getting short-listed in 30 of the 42 clusters it had bid for in the first round. We note that the government benchmark subsidy was in the range of Rs104,000 to Rs326,000 per annum for different clusters. We believe that the aggressive bids underline the drive for market share among operators; this may lead to increased pressure on pricing in the future.

As many as 14 players bidding for passive infrastructure suggests possible high degree of competition in tower business

Details of first round bidding and shortlists for active and passive infrastructure under USO funding

Company	Passive Infrastructure		Active Infrastructure	
	Bids (#)	Shortlisted for second round (#)	Bids (#)	Shortlisted for second round (#)
ACME TelePower Limited	12	—	—	—
Aircel				
Aircel Digilink India Limited	9	8	9	9
Aircel Limited	4	4	4	4
Bharat Sanchar Nigam Limited	81	65	81	77
Bharti				
Bharti Airtel Limited	42	12	42	12
Bharti Hexacom Limited	3	—	3	-
Dishnet Wireless Limited	—	—	22	21
Essar				
Essar Spacetel Private Limited	13	—	—	—
ESSAR TELECOM Infrastructure Private Limited	43	4	—	—
GTL Infrastructure Limited	81	65	—	—
Hutchison-Essar				
Hutchison Essar Cellular Limited	14	14	14	14
Hutchison Essar South Limited	17	12	17	17
Fascel Limited	1	1	1	1
Idea Cellular				
Idea Cellular Limited	—	—	16	16
Idea Mobile Communications Limited	—	—	5	4
Idea Telecommunications Limited	—	—	3	2
BTA Cellcom Limited	—	—	15	15
ITI Ltd	23	—	—	—
National Information Technologies Limited	51	7	—	—
Quipo Telecom Infrastructure Limited	24	9	—	—
Reliance Communications				
Reliance Communications Infrastructure Limited	81	81	—	—
Reliance Communications Limited	74	64	74	74
Reliance Telecom Limited	40	38	40	40
Skippers Steel Limited	14	—	—	—
SPANCO Telesystems & Solutions System	8	—	—	—
Tata Teleservices (Maharashtra) Limited	—	—	3	—
Tata Teleservices Limited	—	—	42	5
Telecommunications Consultants India Limited	30	—	—	—

Source: Department of Telecommunications, Kotak Institutional Equities.

Banking

ICBK.BO, Rs824	
Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	950
52W High -Low (Rs)	1007 - 440
Market Cap (Rs bn)	733

Financials

March y/e	2006	2007E	2008E
Sales (Rs bn)	99.1	138.5	182.2
Net Profit (Rs bn)	25.4	30.5	37.1
EPS (Rs)	32.8	34.3	41.7
EPS gth	*20.4*	*4.6*	*21.7*
P/E (x)	25.1	24.0	19.7
P/B (x)	3.3	3.0	2.7
Div yield (%)	1.0	1.0	1.2

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	71.4	9.0	6.3
MFs	5.0	3.8	1.1
UTI	-	-	(2.7)
LIC	8.0	5.7	3.0

ICICI Bank: Higher provisions on standard loans, and branch expansion costs may pull down 4Q and FY2008 profits

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- **ICICI Bank PAT adjusted downwards by 5% for FY2007 and 7% for FY2008 to factor in new developments**
- **Retain OP rating with a target price of Rs950**

We are revising downwards our earnings estimate for ICICI Bank by 5% for FY2007 and 7% for FY2008 to reflect: (1) higher general provisions on personal loans and credit card loans as indicated in the recent RBI credit policy, (2) likely lower treasury income given volatile markets and (3) higher branch expansion costs. However, the positive impact of the branch expansion will likely be reflected over the next few years in the form of higher CASA ratio and lower bulk deposits. Both these developments on the liability side should enable ICICI Bank to expand its margins. For the purpose of our projections we are factoring in nominal expansion in NIM of around 20 bps between FY2007 and FY2010. We believe that there is a good probability of ICICI Bank expanding margins beyond our current estimates. Despite downward revision in our earnings estimates we are maintaining our target price of Rs950 and OP rating on the ICICI Bank stock. We believe that an improvement in margins and moderate growth in assets will likely lead to an improvement overtime in ICICI Bank core RoE to around 17% from around 15% in FY2008.

ICICI Bank (Old and new estimates Rsmn)

	Old estimates			New estimates			% change in estimates			YoY change (%)	
	FY2007E	FY2008E	FY2009E	FY2007E	FY2008E	FY2009E	FY2007E	FY2008E	FY2009E	FY2008E	FY2009E
Net interest income	66,962	91,214	119,711	66,501	93,545	127,938	(0.7)	2.6	6.9	40.7	36.8
Spread	1.48	1.64	1.77	2.04	2.15	2.36					
NIM (%)	2.11	2.15	2.20	2.36	2.41	2.59					
Customer assets (Rs bn)	2,222	2,983	3,832	2,222	2,940	3,651	-	(1.5)	(4.7)	32.3	24.2
Loan loss provisions	19,773	30,305	43,439	22,904	30,130	42,290	15.8	(0.6)	(2.6)	31.6	40.4
Other income	73,311	92,153	116,702	72,011	88,610	110,255	(1.8)	(3.8)	(5.5)	23.1	24.4
Fee income	51,039	71,455	96,464	51,039	71,812	96,242	-	0.5	(0.2)	40.7	34.0
Treasury income	8,746	4,000	2,000	9,846	4,000	2,000	12.6	-	-	(59.4)	(50.0)
Profit on sale of loans	800	1,800	2,450	400	900	1,225	(50.0)	(50.0)	(50.0)	125.0	36.1
Operating expenses	68,931	89,044	110,299	68,704	94,748	116,334	(0.3)	6.4	5.5	37.9	22.8
Employee expenses	17,022	23,234	31,190	17,022	24,107	31,746	-	3.8	1.8	41.6	31.7
Investment amortization	9,540	8,586	7,727	9,540	7,155	5,366	-	(16.7)	(30.6)	(25.0)	(25.0)
PBT	41,428	54,832	74,348	36,764	49,522	73,602	(11.3)	(9.7)	(1.0)	34.7	48.6
Tax	7,043	13,708	22,304	6,250	12,381	22,081	(11.3)	(9.7)	(1.0)	98.1	78.3
Net profit	**34,385**	**41,124**	**52,044**	**30,514**	**37,142**	**51,522**	**(11.3)**	**(9.7)**	**(1.0)**	**21.7**	**38.7**
PBT-treasury+provisions	**52,456**	**81,137**	**115,787**	**49,822**	**75,652**	**113,892**	**(5.0)**	**(6.8)**	**(1.6)**	**51.8**	**50.5**

Source: Kotak Institutional Equities estimates.

Media

Sector coverage view			Neutral

		Price, Rs	
Company	**Rating**	**20-Mar**	**Target**
Zee Entertainn	U	246	200
HTML	IL	192	170
SunTV	U	1,502	1,200

Dish TV analyst meeting—as upbeat as it could get

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- **Zee management may be going overboard with its guidance of the distant future**
- **Dish TV guidance—8 mn subs, 26% EBITDA margin in FY2011**
- **Cash break-even pushed back by one year to FY2009 versus previous guidance**

Dish TV management gave a bullish view of the prospects of the DTH business in India and of Dish TV with its expectation about strong growth in DTH subscribers and ARPU. The management expects 27.3 mn subs, US$10 ARPU and 25% EBITDA margin for the industry by FY2011, which is well ahead of our estimate of 20.5 mn subs, US$7 ARPU and 15% EBITDA margin for FY2011. Despite our relatively dim view of the DTH business, we value the DTH opportunity in India at US$5 bn (see our February 27 report titled A bird in the sky may be worth a billion). On more short-term guidance, Dish seems to have pushed back its cash break-even guidance by one year to FY2009 versus the previous guidance of FY2008 and capex over the next 2-3 years to Rs10 bn from the previous guidance of Rs5 bn over the next two years; subscriber target for FY2011 at 8 mn is unchanged versus the previous guidance.

Management guidance on financials of the distant future is not a good practice, in our view. We are surprised by the Zee management's willingness to provide precise guidance on revenues and profits for the distant future (3-5 years); we are not sure if this is such a good thing, especially since several of the entities have/are getting listed (akin to an IPO). Even if this meets regulations on future guidance, we are not sure about any company's ability to provide such precise guidance so far out in the future (that remains the preserve of research analysts, we assume). Over the past few quarters (since restructuring in March 2006), the Zee management has been providing a lot of future numbers about the new entities (ZEEL, Zee News, WWIL, Dish TV) with rather precise guidance on revenues and EBITDA for FY2011 and FY2012. We welcome the management's desire to share its vision of the future but such precise financial forecasts may become an issue if it fails to meet them. Very few Indian companies give guidance and that too for the distant future in such a precise fashion; Indian IT companies give guidance in a band for the next quarter or the year at best.

Dish TV—strong growth in subs, ARPU, margin as per the company. Dish TV expects 8 mn subs by FY2011 and 16 mn by FY2016. It has also guided to EBITDA margin of 26% in FY2011 and increase in ARPU to Rs450 over the next 4-5 years from Rs230 currently. The company plans to achieve cash break-even by FY2009 (looks like a year's delay compared to the previous guidance of FY2008). By FY2009E, Dish TV expects a subscriber base of 4.4 mn, which it believes is the critical mass required to achieve cash break-even. However, we note that it would need to add around in 1.4 mn subscribers in FY2009, which seems difficult considering that there will be five DTH players in the market by early FY2009. The management expects Dish TV to add 1.1 mn subs in FY2008, which would result in about 3 mn subs by end-FY2008.

Projected increase in ARPU seems highly improbable. Dish TV expects ARPU to improve to Rs450 over the next 4-5 years from its current stated figure of ARPU of Rs230 (we believe this would be significantly lower in reality due to several months of free subscription offered to new subscribers). Dish offers two packages of Rs210 and Rs240; so ARPU cannot be Rs230, in our view. The steep increase in ARPUs as per the management would be driven by (1) increase in the number of channels to around 400 (150 at present), (2) value-added services and (3) higher revenues from niche channels. We model an ARPU of Rs312 in our industry model for FY2011E from about Rs120 for FY2007E.

Current financials depressed by high start-up costs, subsidy on STBs. Dish TV had revenues of Rs1.3 bn and operating loss of Rs1.2 bn in 9MFY07 due to (1) start-up costs and (2) high subsidy on STBs. It gives a subsidy of Rs1,600 on CPE (consumer premise equipment) versus cost of Rs4,000. It gives the CPE on lease to a subscriber for five years and provides depreciation equivalent to the lease rentals.

Funding requirement. The company stated a funding requirement of around Rs10 bn over the next 2-3 years with debt constituting around 30%-40% of the total requirement.

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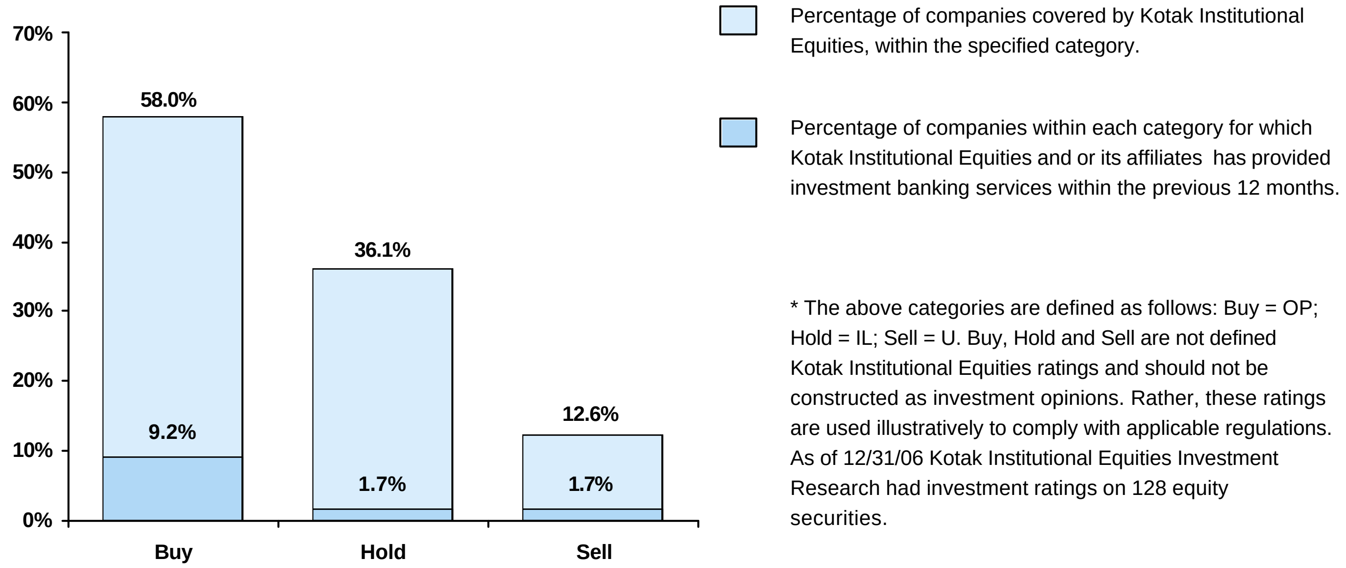

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Source: Kotak Institutional Equities. *As of December 31, 2006*

Ratings and other definitions/identifiers

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