investor's eye

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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
F-M Goetze	18-Jan-07	385	**335**	559
HCL Tech	30-Dec-03	206	**674**	720
HLL	24-Nov-05	172	**206**	280
India Cements	28-Sep-06	220	**205**	315
SKF	23-Dec-04	141	**286**	406

Sharekhan Budget Special

Run-up to Budget 2007-08

It's that time of the year again when wish lists are drawn by all and sundry and expectations are high that at least some of the wishes will be granted in the Union Budget. Yes, in about two weeks from now, the incumbent United Progressive Alliance (UPA) government will present its last but one budget before it goes to general parliamentary elections in CY2009. Needless to say investors will be hanging on every word of P Chidambaram when he presents the budget for FY2008 on February 28, 2007. That's because they will be eager to see if the finance minister uses the opportunity to push forward fiscal reforms and announce well-directed spending on infrastructure, education and the farm sector. With the budget around the corner, we take this opportunity to present our pre-budget report.

The nation's coffers are overflowing, thanks to the government's improving fiscal health, and we expect the government to use the additional funds to tackle problems such as tax reforms, inflation and inadequate infrastructure.

We expect the budget to have the following key themes:

- measures to boost supply, especially in agriculture and infrastructure;
- some moderation in tax rates including a possible removal/reduction in corporate tax surcharge, this would be coupled with removal of certain tax exemptions;
- increase in the number of services that are taxed under the service tax and a possible increase in the service tax rate from 12% to 14%;
- further reduce the import duty from 12.5% to 10%;
- steps to phase out the central sales tax (CST) and compensate states for the loss in the CST by allowing them to tax cigarettes, some other services and levy the value added tax (VAT) on imports.
- measures like further excise and customs duty cuts to tackle inflation could also be on the cards.

Budget is expected to be positive for sectors

- **Engineering and capital goods**
- **FMCG (excluding ITC)**
- **Automobile**
- **Telecom**

Will the market go up post-budget?

Historical evidence suggests that the market normally rallies before the budget (as has happened four times in the past seven years) and falls after the budget (in five of the last seven years it has fallen). The market had recorded a gain in the aftermath of the budget in 2006. So will that positive trend continue this year too? We think the following factors would determine the market's direction post-budget.

1. The government's fiscal performance so far has been better than expected. If the government unveils its budgetary plans that reinforce its will and vision to further improve its performance, the same would be cheered by the market. A credible fiscal deficit target for the next year would be a huge positive for the market and ease the concerns pertaining to rising interest rates and government borrowing.
2. The upcoming state elections in Uttar Pradesh could have some influence on the overall reforms and disinvestment plans of the government. However any unexpected positive development on this front could actually be a positive for the market.
3. There are concerns about a hike in the short-term capital gains tax—a sharp hike would be negative in the short-term.
4. Any steps to align the caps on foreign institutional investment and foreign direct investment would raise the foreign institutional investment ceiling and increase India's weightage in key global benchmark indices such as Morgan Stanley Capital International (MSCI) Index.
5. Credible steps to reduce inflation would allay the current concerns related to inflation and interest rate hikes.

Fiscal deficit likely to be lower than target

The government's improved performance in this fiscal speaks for itself. The data for the April-December 2006 period indicates that the government has performed extremely well on both revenue generation and expenditure control fronts. The improved fiscal performance coupled with the revised gross domestic product (GDP) forecast of 9.2% has tilted the odds in favour of the fiscal deficit falling to 3.6% of the GDP, lower than the budgeted target of 3.8% for FY2007. We expect the fiscal deficit for FY2007 to come down to Rs146,300 crore, below the budgeted estimate of Rs148,686 crore, due to improved revenue collections and controlled expenditure. We further estimate that in FY2008 the fiscal deficit would come down to 3.3% of the GDP (nominal GDP growth for FY2008 estimated at 13%). For FY2008, we estimate the primary deficit to be insignificant and revenue deficit to be 1.5% of the GDP.

Recently rating agency Standard & Poor's has upgraded our sovereign rating from *Speculative* to *Investment* grade and if the government can keep up the good work done so far, we could expect more such positives going forward.

Rural economy and high employment generating sectors to be in focus

In the forthcoming budget, apart from the thrust on the rural economy in the form of continued reforms for the agriculture sector, industries such as leather, footwear, textiles & clothing and sports goods are likely to get special attention as these industries have a great potential to generate employment. The government is likely to reduce the customs duty on machinery imports for these industries.

In addition, the finance ministry is considering allowing tax exemptions on reinvested profits. Giving a boost to high employment-generating sectors and the small-scale industry is high on the UPA government's agenda and also features in the National Common Minimum Programme.

Infrastructure focus of the government to continue

Apart from allocating higher resources for its programmes in the areas of employment guarantee, education, health and agriculture, we feel the government would continue to focus on infrastructure development. Some other sectors like oil & gas may also come in its focus along with roads, power, ports and irrigation projects.

The oil & gas sector may hear some important announcements in this year's budget. The oil ministry is seeking a series of tax and duty changes to reduce prices of retail petroleum products and attract greater investment for the sector. It is also expected that infrastructure status would be granted to gas pipelines, and exploration and production (E&P) activities in order to facilitate growth through higher investments.

Infrastructure funding is another key issue that could be dealt in this year's budget, with the long-term funding needs of the infrastructure sector projected to reach $320 billion (about Rs1,450,000 crore) in the Eleventh Five-Year Plan (2007-2012). A couple of years back, the Planning Commission had proposed that India's booming foreign exchange reserves be used to finance development of ports, railways, highways, aviation and electricity sectors. However, after opposition from the Reserve Bank of India (RBI), the government put the proposal on the backburner.

Central government finances for FY2007

Rs '00 crore	FY04	FY05A	FY06RE	FY07BE	FY07E*
Gross tax revenues	2,544.0	2,248.0	3,701.4	4,421.5	4,626.8
% yoy change		*-11.6*	*64.7*	*19.5*	*25.0*
Net tax revenues	1,870.0	2,248.0	2,741.4	3,272.1	3,426.7
% yoy change		*20.2*	*21.9*	*19.4*	*25.0*
Non-tax revenues	769.0	743.4	743.4	762.6	758.2
Total expenditure	4,714.0	4,976.8	5,087.1	5,639.9	5,727.9
% yoy change		5.6	2.2	10.9	12.6
Plan expenditure	1,222.0	1,322.8	1,437.9	1,727.3	1,727.3
% yoy change		8.2	8.7	20.1	20.1
Non-plan expenditure	3,492.0	3,654.1	3,649.2	3,912.7	4,000.6
Fiscal deficit	1,232.0	1,365.1	1,461.8	1,486.9	1,463.0
As % of GDP	*4.5*	*4.4*	*4.1*	*3.6*	*3.6*
Revenue deficit	983.0	852.2	918.3	847.3	790.4
As % of GDP	*3.6*	*2.7*	*2.6*	*2.1*	*1.9*
Primary deficit	-14.0	64.8	161.5	88.7	65.0
As % of GDP	*-0.1*	*0.2*	*0.5*	*0.2*	*0.2*

* Sharekhan estimates

However, recently, Mr Chidambaram has revisited the issue and the government has also set up a committee headed by HDFC chairman Deepak Parekh to find ways of raising funds for the sector. Easing of existing securitisation guidelines, tax exemptions on infrastructure bonds and efficient utilisation of our burgeoning foreign exchange reserves could be some of the financing options that could be unveiled in the upcoming budget.

Key budget expectations: taxation

- Peak customs duty is expected to be reduced to 10% from 12.5%
- Service tax is likely to increase to 14% from 12% and more services are expected to be brought under the tax net.
- The CST could be reduced to 2% from 4%. The government will also need to announce the method for compensating states for the loss of the CST by allowing them to (a) tax cigarettes, (b) tax some services, and (c) levy VAT on imports.
- The government is likely to eliminate/reduce the 10% surcharge on the corporate tax, however it might marginally raise the education cess from the existing 2%.
- A reduction in the corporate tax rate could benefit those companies that are currently paying a higher effective tax rate. The table on right gives a list of the companies with a higher effective tax rate for their latest financial year.

Large-cap companies with high effective tax rate

Company	Effective tax rate (%)
State Bank of India	36.2
BHEL	34.5
Hindustan Zinc	34.0
ONGC	33.9
Tata Steel	33.1
Maruti Udyog	32.1
Hero Honda Motors	31.2
ITC	30.7
HDFC Bank	30.5
Bajaj Auto	30.3

Other policy initiatives

- The government may grant infrastructure status to certain sectors: oil & gas pipelines, liquefied natural gas terminals.
- Income tax holiday for export-oriented units is set to expire in 2009 and the same is unlikely to be extended in the upcoming budget.
- The Planning Commission has advised the government to revamp the Centrally Sponsored Scheme by scrapping 120 of them; 52 schemes with an outlay of Rs300 crore each to be retained and 25 schemes with an outlay of Rs100-300 crore to be transferred to states. We may see some restructuring on this front.

Fiscal performance YTD (Rs) '000 crore

		Apr - Dec 06	yoy (%) growth	yoy (%) budgeted growth	FY07B	Ytd of 07B (%)
a.	Revenue receipts	280.9	29.6	15.8	403.5	69.6
	Net tax revenues	232.2	37.6	19.4	327.2	71.0
	Non-tax	48.7	1.5	2.6	76.3	63.9
b.	Non-debt receipts	8.0	7.2	-15.8	11.8	67.2
c.	Total receipts (a + b)	288.9	28.9	14.6	415.3	69.6
d.	Revenue expenditure	347.7	17.3	10.9	488.2	71.2
e.	Capital expenditure	36.0	-0.1	10.9	75.8	47.5
f.	Total expenditure (d + e)	383.7	15.4	10.9	564.0	68.0
g.	Fiscal deficit (f - c)	94.9	-12.4	1.7	148.7	63.8
h.	Revenue deficit (d - a)	66.8	-16.2	-7.7	84.7	78.8

Source: Controller General of Accounts: Budget Documents

Likely inflation measures in the budget

The current inflation rate at 6.73% for the week ended February 3, 2007 looks high and definitely beyond the RBI's comfort zone of 5-5.5%.

Latest inflation number forces a cut in fuel prices

The government slashed the price of per litre of petrol and diesel by Rs2 and Re1 respectively on February 15, 2007 after the inflation rate rose higher to 6.73%. The move comes as an urgent response to the rising inflation. The last cut in fuel prices carried out in end November 2006 had helped the fuel index to cool off by 1.8% over its previous week's figure. The effect of the latest cut would be visible in the next week's inflation data. The fuel segment has a 14.2% weightage in the overall index and the fuel index has stayed constant over the recent period. The present price cut would help the fuel index to drop further. This would ease the inflationary pressures going forward.

So what is causing this rise? Inflation has risen mainly due to (a) the higher prices of food products, like pulses and cereals, and manufactured products; and (b) the lower base effect of last year.

With the general elections in politically important states like Uttar Pradesh due in April this year, the government needs to seriously tackle the rising inflation. The government has already taken some major steps in this regard to bring down the prices of food products.

- It has imported food grains on a large scale and released higher quantities of wheat from buffer stocks; it has also banned the exports of certain products.
- It has cut the customs duty on palm oil.
- It has also reduced the customs duty on the key metals and cement (the key contributor to the price rise in the non-metallic segment).

Although the customs duty on the key metals has been reduced to lower manufacturing prices, yet we feel the government could undertake another round of duty cuts in metals and other sectors, which are also contributing to the rise in inflation.

There are talks that the prime minister is seriously considering reducing the peak tariffs to the Asean levels in this budget itself. The average Asean tariff for manufactured items is in the range of 5% and 6%. The industry demand for a reduction in the peak customs duty from 12.5% to 10%, and lower in some special cases, may be met in the upcoming budget.

We feel the government can also consider lowering the excise duty from 16% to 14% and raising the service tax rate from 12% to 14% simultaneously. This would be in line with the recommendations made by the Kelkar Task Force. The panel had suggested that the long-standing distortion in terms of a differential treatment of manufacturing and service sectors can be eliminated by imposing a common goods and service tax.

Possible measures to bring down inflation

Sectors	Wt (%)	(%) yoy	Likely measures in the budget
Fuel, power & light	14.23	2.33	The government has already reduced the price of per litre of petrol and diesel by Rs2 and Re1 respectively on February 15, 2007 after the inflation rate rose further to 6.73%. The effect of this cut would be visible in the next week's inflation data. The cut will help the fuel index to decline and ease inflationary pressures to an extent going forward.
Basic metals	8.34	16.31	This segment has significantly contributed to the rise in the price of manufactured products. The government has already reduced the customs duty on key metals, however there is scope for further reduction in the budget if the inflation numbers don't moderate to some extent before the budget is presented.
Paper & paper products	2.04	7.58	The excise and the customs duty stand at 16% and 12.5% respectively for most categories of products in this segment. This leaves some room for rationalisation in this segment, as paper and paper products are widely used in our daily lives.
Basic chemicals	11.93	2.75	The government could review the excise and the customs duty on caustic soda and soda ash; the same stand at 16% and 10% respectively.
Rubber & plastic products	2.39	7.29	The inverted duty structure with 20% import duty on rubber and 15% import duty on tyres may be rationalised.
Machinery & machine tools	8.36	7.84	We can expect the government to further rationalise the duty structure in this segment as was done in the previous budgets.

Sector-specific impact

Automobiles

Issue	Current status	Proposal/Likely changes	Impact
Excise duty on cars	16% on small cars; 24% on all other cars.	Uniform excise rate of 16% sought for all passenger vehicles. We believe the same is unlikely to happen this year.	**Neutral** for the sector.
Customs duty on alloy steel and other ferrous metals	7.5%.	5.0%.	**Positive** for the sector.
R&D expenditure	150% weighted deduction (available up to March 31, 2007).	To be extended for another ten years.	**Positive** for the sector.
Peak customs duty	12.50%.	May be reduced to 10%.	**Positive** for OEMs. **Negative** for auto component makers.

Banking/Insurance

Issue	Current status	Proposal/Likely changes	Impact
Tax saving deposit under section 80C	Five-year lock-in and restrictive in nature.	The lock-in-period for the term deposit may be reduced from five years to three years to bring it at par with other tax saving instruments such as ELSS and mutual funds.	**Positive** for the sector as it will help banks tide over the problem of deposit mobilisation to a great extent.
Tax paid on interest income from saving deposits, benefits availed under section 80L and TDS ceiling	Interest income on saving deposits taxed; benefit that allowed tax deduction of Rs12,000 under section 80L withdrawn and current TDS ceiling at Rs5,000.	Tax exemption of interest income from saving deposits, restoration of tax exemption on interest income under section 80L and increase in TDS ceiling to Rs10,000.	**Positive:** The sector will benefit if all or any of the measures are implemented, as the same would make bank deposits look attractive.
Permission to issue tax saving long-term bonds	Many banks are eligible to issue bonds, but unable to price it attractively.	If tax exemptions are given to these bonds, banks will be in a position to attract investor interest.	**Positive** for the sector as it will help banks to resolve their asset liability mismatch issues, given the fact that they mobilise short-term resources and lend for long-term projects.

Cement

Issue	Current status	Proposal/Likely changes	Impact
Excise duty	Rs408 per tonne.	Reduce excise duty to Rs350 per tonne. We believe the same is unlikely to happen.	**Neutral** for the sector.
Customs duty on coal/petcoke	5%.	0%.	**Positive** for Gujarat Ambuja, UltraTech Cement, Madras Cement and India Cements.
Increase in infrastructure spending		Continue to increase infrastructure spending.	**Positive** for the sector as the same will continue to fuel the demand for cement.

FMCG

Issue	Current status	Proposal/Likely changes	Impact
Alcoholic beverages			
Customs duty	150-312% (including CVD).	No change sought.	**Neutral** for the sector.
Cigarettes			
VAT	Tobacco products exempt 10% AED on tobacco products.	VAT to be introduced. 10% AED to be scrapped.	**Negative** for ITC.
CST	4% currently.	To be reduced.	With the imposition of VAT expected, no benefits.
Personal & Home care products			
Custom duty on soda ash and caustic soda	10% currently.	Likely to be reduced.	**Positive** for HLL and P&G.
Excise duty on ready-to-eat foods	Duty on some of the processed food products reduced to either 8% or nil.	Excise duty of 16% on a number of processed food products is expected to be reduced to 8% or nil.	**Positive** for ITC Foods and Kohinoor Foods.
Customs duty on palm oil and other edible oils	Refined bleached and deoderised palm oil, palmolein and other refined palm oils—67.5% Crude palm oil and palmolein—60% Crude sunflower oil—65% Refined sunflower oil—75%.	Headroom left for further reduction. 4% SAD expected to be scrapped. Duty on refined sunflower oil expected to get reduced to 65%.	**Positive** for HLL and Godrej Consumer. **Positive** for AgroTech Foods, Ruchi Soya.

Engineering and capital goods

Issue	Current status	Proposal/Likely changes	Impact
Customs duty on capital goods and project imports	Already reduced from 12.5% to 7.5%.	-	Marginally **negative** for the domestic companies.
Customs duty on primary and semi-finished form of copper, aluminium, zinc, tin and other metals	Already reduced from 7.5% to 5%.	-	**Positive** as this neutralises the impact of the rise in the raw material prices witnessed in 2006.
Customs duty on tubes, pipes and fittings of copper, aluminium or zinc.	Already cut from 12.5% to 7.5%.	-	**Positive** as this neutralises the impact of the rise in the raw material prices witnessed in 2006.
Infrastructure spending		Continue to increase infrastructure spending.	**Positive:** The existing order backlog and the potential backlog with increased infrastructure spending will ensure greater visibility.

IT services

Issue	Current status	Proposal/Likely changes	Impact
Tax exemptions	Tax exemptions under section 10A for STP registered units to expire by 2009.	Extension of direct tax exemptions under section 10A on STP registered units for another ten years beyond 2009, in line with the tax exemption proposed for SEZs.	**Positive** for IT service companies. Especially the mid-cap companies, as the cost of setting up centres in SEZs is estimated to be relatively higher. Also, SEZs are generally located outside city limits (which is inconvenient for employees). In case the tax exemption on STP units is not extended, the effective tax rate is estimated to increase to the 18-24% range (up from 11-17% currently) depending on the offshore/onsite mix, proportion of revenues from SEZ units and the contribution from the domestic business. This, in turn, would lower the net margin by 150-300 basis points. The impact would be more pronounced in case of mid-cap companies and ITES/BPO units.

Media and Entertainment

Issue	Current status	Proposal/Likely changes	Impact
Increase in import duty on STBs in line with the duty on inputs for manufacturing STBs	Nil.	A higher import duty of 5% has been sought. We believe the same is unlikely to happen considering the thrust on the implementation of CAS and the need to keep the price of STBs under control. STBs are already subsidised by MSOs and DTH operators.	A higher import duty would correct the inverted and anomalous duty structure; but it will also raise the cost of imported STBs. **Negative** for WWIL, Hinduja TMT, Dish TV, Tata Sky.
Reduction of import duty on capital goods	Up to 36%.	Reduced in line with the reduction in peak customs duty.	Will reduce set-up costs. **Positive** for the entire media industry.

Metals

Issue	Current status	Proposal/Likely changes	Impact
Customs duty	Duty on non-ferrous metals, eg copper, aluminum, zinc and tin, cut from 7.5% to 5%. Duty on ferro-alloy stainless steel and other alloy steel cut from 7.5% to 5%.	No change.	**Negative**—as the landed cost of imports would be lower. Consequently, domestic prices will be capped.
Customs duty	Duty on calcined alumina cut from 7.5% to 5%.	No change.	**Positive** for non-integrated aluminum companies as calcined alumina is an important raw material.
Customs duty	Duty on refractories cut from 7.5% to 5%. Duty on specified raw materials of refractories cut from 10.75% to 5%.	No change.	**Positive** for the steel industry as the refractories are a key input. **Neutral** for refractory manufacturers like Vesuvius as the duty on both the final product and the raw materials has been cut.
Customs duty	Duty on copper concentrate currently at 2%.	Likely to be reduced.	In January the duty on copper concentrate was maintained at 2%. The differential between the duties on copper and copper concentrate was 5.5% earlier; the same is only 3% now. The government could cut duty on concentrate to increase the differential. **Positive** for the copper industry.
Excise duty	16%.	Likely to be reduced.	Since the government wants to rein in inflation, a duty cut is a distinct possibility. **Positive** for the sector.

Oil and gas

Issue	Current status	Proposal/Likely changes	Impact
Income tax	E&P projects: Seven years of tax holiday.	Extend tax holiday to ten years or make the provision for a block of seven years from the first fifteen years.	**Positive** for companies like ONGC, RIL and Cairn India.
Income tax	Projects in pipeline don't have infrastructure status.	Infrastructure status sought which would lead to tax exemptions	**Positive** for RIL and ONGC.
Customs duty	Different rates for crude oil (5%) and petroleum products (7.5%).	Uniform rate sought.	**Positive** for marketing companies like HPCL, BPCL and IOC. **Negative** for oil refiners like Bongaigaon Refinery, Kochi Refineries and Chennai Petroleum.
Excise duty	Petrol—8.16% + Rs13.26 Diesel—8.16% + Rs3.32.	Reduce only specific duties or both *ad valorem* and specific duties.	**Positive** for marketing companies like HPCL, BPCL and IOC.

Paints

Issue	Current status	Proposal/Likely changes	Impact
Duty on import of raw material	12.8% currently	To be reduced to 10%.	**Positive** for paint companies like ICI India and Asian Paints.

Pharmaceuticals

Issue	Current status	Proposal/Likely changes	Impact
R&D	Weighted deduction of 150% on R&D expenditure incurred up to March 31, 2007 is available for in-house R&D facility.	Extension of the benefit for a few more years beyond March 31, 2007 and an increase in the weighted deduction from 150% to 200%.	**Positive** for Ranbaxy, Dr Reddy's and Cadila. In the mid-cap space, Alembic, Torrent and Dishman will be benefited.
	ANDA filling expenses and R&D activities conducted outside the approved facilities like clinical trials carried out in approved hospitals and institutions are not eligible for weighted deduction.	ANDA filling expenses and activities like clinical trials carried outside the approved R&D facilities may become eligible for weighted deduction.	**Positive** for Ranbaxy, Lupin, Sun Pharma, Nicholas Piramal and Aurobindo Pharma.
Excise duty	MRP-based 16% excise structure and 42.5% abatement.	Reduction of excise duty to 8% and/or an increase in the abatement to 52%.	The proposal is less likely, as the government has recently increased the abatement from 40% to 42.5% and a large number of players have set up facilities in excise-exempt areas.
Custom duty	5-12.5% is levied on cancer, life saving and anti-AIDS drugs.	Life saving drugs may be exempted from customs duty. Further, reduction of peak custom duty from 12.5% to 10% is on cards.	**Positive** for Aventis, Novartis and GSK Pharma
Service tax	Indian companies conducting clinical trials and other scientific services are subject to service tax, even if exported.	Clinical trials and other scientific services for foreign clients may be exempted from service tax.	**Positive** for Nicholas Piramal, Vimta and Biocon.

Telecom

Issue	Current status	Proposal/Likely changes	Impact
Licence fee as revenue share	Revenue share is based on category of circle: 10% for metros, 8% for category A circles and 6% for category B circles.	Reduce to a uniform rate of 6% across circles.	**Positive** for all private sector telecom operators like Bharti Airtel, Reliance Communications and Tata Teleservices. It is a long-awaited demand from the industry and is not expected to materialise in the Budget.
Customs duty	Additional duty of 4% levied on mobile handsets.	Remove additional duty of 4% on handsets.	Lowering the cost of handsets will boost subscriber base. **Positive** for all telecom operators and handset importers like HCL Infosystems.
Corporate tax	Benefits under section 80IA applicable for five years. However, the telecom operators have to pay MAT, which mitigates the impact of the benefits under section 80IA.	Extend the benefits under section 80IA and make an amendment to section 115JB related to MAT.	**Positive**—It would reduce the tax burden on the private telecom operators.
Service tax	Service tax of 12% applicable.	Increase service tax rate.	Marginally **Negative** for the telecom operators, as it would increase the monthly billing for subscribers and possibly affect the growth in the subscriber base and volumes.

IT/Telecom Hardware

Issue	Current status	Proposal/Likely changes	Impact
Customs duty	8% CVD applicable on software imported for installation in telecom equipment.	Exempt telecom software from 8% CVD.	**Positive** for all private sector telecom operators like Bharti Airtel, Reliance Communications and Tata Teleservices as it would bring down the capex cost.
Excise duty on access equipment for telecom networks	Currently at 16%.	To be brought down to 12% or 8%.	**Positive** for all private sector telecom operators like Bharti Airtel, Reliance Communications and Tata Teleservices as it would bring down the capex cost.
Custom duty on hardware imports by PC manufacturers	CVD of 4%.	Reduce CVD to 2%.	**Positive** for the domestic manufacturers that import various components and parts.
Service tax	Currently, the service tax is levied on maintenance or repair of software.	Exempt from service tax.	**Positive** for IT hardware vendors.

Tourism

Issue	Current status	Proposal/Likely changes	Impact
Tax holiday	Nil.	Ten-year tax holiday sought for all tourism projects.	**Positive** for Indian Hotels, Hotel Leela, EIH and Taj GVK.

Tyres

Issue	Current status	Proposal/Likely changes	Impact
Peak custom duty	12.50%.	May be reduced to 10%.	**Positive** for the sector as it would reduce the cost of SBR, PBR and NTC.
Inverted duty structure	A 20% import duty on rubber A 15% import duty on tyres.	Reduce import duty on rubber. We feel the same is unlikely to happen.	Impact on either case would be **Neutral** as majority of tyre makers source rubber from the domestic market (since it is cheaper); even if they are required to import the same, they enjoy zero duty against exports.

Abbreviations used in the report

AED: additional excise duty
ANDA: abbreviated new drug application
BPCL: Bharat Petroleum Corporation Ltd
BPO: business process outsourcing
CAS: conditional access system
CST: central sales tax
CVD: countervailing duty
DTH: direct-to-home
ELSS: equity linked savings scheme
HLL: Hindustan Lever Ltd
HPCL: Hindustan Petroleum Corporation Ltd
IOC: Indian Oil Corporation
IT: information technology
ITES: IT enabled services
MAT: minimum alternate tax
MRP: maximum retail price
MSO: multi-system operator
NTC: nylon tyre cord
OEM: original equipment manufacturer
ONGC: Oil and Natural Gas Corporation
P&G: Procter and Gamble
PBR: poly butadiene rubber
R&D: research and development
RIL: Reliance Industries Ltd
SAD: special additional duty
SBR: Styrene butadiene rubber
SEZ: special economic zone
STB: set-top box
STP: software technology park
TDS: tax deduction at source
VAT: value-added tax
WWIL: Wire and Wireliess Ltd

Tata Motors

Apple Green

Stock Update

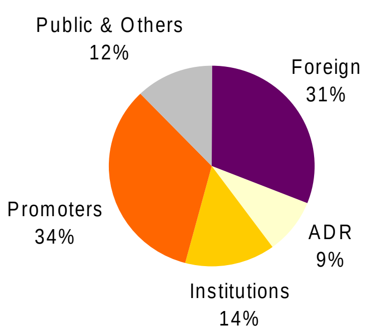
Deepening relationship with Fiat

Buy; CMP: Rs869

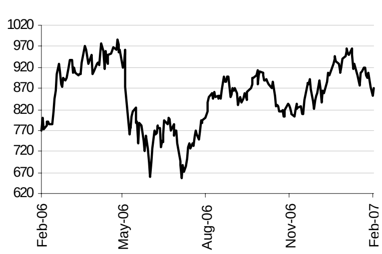
Company details

Price target:	Rs1,075
Market cap:	Rs33,471 cr
52 week high/low:	Rs997/650
NSE volume: (No of shares)	13.5 lakh
BSE code:	500570
NSE code:	TATAMOTORS
Sharekhan code:	TELCO
Free float: (No of shares)	22.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.6	2.6	6.2	12.8
Relative to Sensex	-9.3	-1.8	-14.5	-19.9

Key points

- Tata Motors (TAMO) has entered into an agreement with Italy's Fiat to provide the design and technology for manufacture of pick-ups in Argentina. Fiat will manufacture and market it under the *Fiat* brand name. TAMO would get a licence fee through this venture, both as a one-time fee and as sales dependent fee.
- TAMO has also signed a memorandum of understanding (MoU) with Iveco to analyse the feasibility of their co-operation, across markets, in the area of commercial vehicles.
- The joint venture agreement with Fiat for manufacture of cars, engines and transmission components has commenced trial production. The first batch of cars will roll out in early 2007. This would require an aggregate investment of Rs4,000 crore over a period of time.
- TAMO has bid for a 43.5% stake in Punjab Tractors together with the Fiat group's CNH (New Holland Tractors India). This would mark TAMO's entry into the tractor business and would catapult the TAMO-CNH combine to the third spot in India's tractor market with CNH's market share of 5.23%.
- We believe all these developments would have positive implications for TAMO in the long term. At the current market price of Rs869, the stock trades at 12.3x its consolidated earnings and at an enterprise value/earnings before interest, depreciation, tax and amortisation of 6.4x. We maintain our Buy recommendation on the stock with a price target of Rs1,075.

Entering Argentinean market by launching a pick-up vehicle

TAMO has entered into an agreement with Italy's Fiat to manufacture pick-up trucks in Cordoba, Argentina. TAMO will be providing the engine technology and design for the pick-up vehicle and Fiat will manufacture and market it under the *Fiat* brand

Earnings table

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Stand alone					
Net profit (Rs cr)	853.6	1,228.7	1,371.0	1,828.9	2,191.7
% y-o-y change		*44.0*	*11.6*	*33.4*	*19.8*
Shares in issue (cr)	35.3	36.2	38.3	38.5	38.5
EPS (Rs)	24.2	34.0	35.8	47.5	56.9
PER (x)	35.8	25.5	24.2	18.2	15.2
EV/EBIDTA (x)	16.5	14.3	13.8	10.1	8.2
RoCE (%)	34.5	32.5	29.0	30.8	30.4
RoNW (%)	23.8	29.9	24.8	26.9	26.0
Consolidated					
Net profit (Rs cr)	918.6	1,334.8	1,563.5	2,177.2	2,685.8
% y-o-y change		*45.3*	*17.1*	*39.3*	*23.4*
Shares in issue (cr)	35.3	36.2	38.3	38.5	38.5
EPS (Rs)	25.9	37.5	44.6	56.9	70.1
PER (x)	33.4	23.1	19.4	15.2	12.3
EV/EBIDTA (x)	16.6	12.8	11.9	8.3	6.4
ROCE (%)	35.4	33.2	31.5	32.6	34.7
RONW (%)	25.0	30.9	27.9	28.1	27.2

name. The venture is expected to commence production during 2008 with an annual capacity of 20,000 units. The total planned investment in the project is around US$80 million, which would be borne by Fiat.

TAMO would provide its pick-up vehicle technology while Fiat could make modifications if needed. The vehicle would be available in the following versions: 4x4, 4x2, double and single cab. It will be powered by a JTD diesel 2.3 litre, 134 PS Euro IV engine, manufactured in Fiat Power Train Technology's facility in Sete Lagoas, Brazil. The vehicles would be sold in South America and Central America, and select European markets through Fiat's distribution channel.

TAMO would get a licence fee through this venture, both as a one-time fee and as sales dependent fee. We view the development as a positive since Latin America is an important destination and the company is also devising various strategies to further increase its presence in the region, through an agreement with Fiat and Iveco.

Signs MoU with IVECO

TAMO has also signed a MoU with Iveco to analyse the feasibility of their co-operation, across markets, in the area of commercial vehicles. Both the companies would be setting up a joint steering committee, which would determine the feasibility of co-operation, both in the short and the long run. When found feasible, the two companies will enter into a definitive agreement in the course of the coming months.

All these agreements are in line with TAMO's decision to extend its relationship with Fiat. TAMO first established its relationship with Fiat in March 2006 for distribution of Fiat cars in India. A major step was taken in July 2005 when TAMO signed an MoU with Fiat for manufacture of cars, engines and transmission systems for the Indian and overseas markets. The agreement to this effect was signed in December 2006. The joint venture would manufacture cars in excess of one lakh units and two lakh units of engine and transmission components for the domestic and overseas markets at Fiat's Ranjangaon facility. Both Fiat and Tata vehicles will be manufactured at the same facility, which will be managed equally by the two shareholder partners. Fiat will introduce its premium cars for the B and C segments, namely the *Fiat Grande* Punto and the *Fiat Linea*. A first assembly line for Fiat cars at Ranjangaon plant has already been commissioned for *Fiat Palio* and *Fiat Adventure* models and trial runs have already commenced. The first batch of cars will roll out in early 2007. The Tata-Fiat dealer network will be increased to 100 outlets from the existing 42. The engine division will manufacture the highly acclaimed Fiat 1.3 litre multi-jet diesel engine, the 1.4 litre and a new 1.2 litre gasoline engine. The aggregate investments in this industrial joint venture will be made in a phased manner and may exceed Rs4,000 crore. The joint venture will start production of engines and new cars progressively from the beginning of 2008.

Bidding for Punjab Tractors

TAMO has bid for a 43.5% stake in Punjab Tractors together with the Fiat group's CNH (New Holland Tractors India). Punjab Tractors is India's fifth largest tractor company with a market share of 10%. This would mark TAMO's entry into the tractor business. The acquisition of Punjab Tractors would catapult the TAMO-CNH combine to the third spot in India's tractor market, along with CNH's market share of 5.23%.

Valuations

At the current market price of Rs869, the stock trades at 12.3x its consolidated earnings and at an enterprise value/ earnings before interest, depreciation, tax and amortisation of 6.4x. We maintain our Buy recommendation on the stock with a price target of Rs1,075.

The author doesn't hold any investment in any of the companies mentioned in the article.

Cement

Sector Update

Dispatch growth slows down

Key points

- The industry dispatches for January 2007 have grown by 7% year on year (yoy) to 14 million tonne. The growth is much slower as compared with that in January 2006 when dispatches had grown by 16%. The growth has been slower because very few players have added capacity in the last one year and therefore been operating at full capacity.
- Amongst the regions, the north witnessed the highest dispatch growth of 14% yoy followed by the east, which grew by 9% yoy, and the western region, which grew by 8.6% yoy.
- Industry utilisation level continues to rise, breaching the 100% mark and settling at 102%, driven by the northern region where utilisation level stands at 110%.
- With all the three demand drivers, ie the housing, industry and infrastructure sectors, showing strong signs of growth, the consumption of cement is expected to grow at a compounded annual growth rate of 10-10.5% for the next three years.
- From January 1, 2007 Tamil Nadu implemented value-added tax (VAT), reducing the sales tax rate in the state from 14.5% to 12.5%. We maintain our earlier view that the savings that the companies will enjoy on account of the reduction in the tax on the selling price will be offset by the tax that will now be payable on the freight component.
- The prices have started rising in the south post-monsoons. Andhra Pradesh and Tamil Nadu witnessed a Rs10-per-bag increase in January. In the north, Delhi and Jaipur have witnessed a Rs5-per-bag hike in the same month. Dealers expect cement prices to rise across the country in the next couple of months as the construction activity reaches its peak.
- We believe that the import duty cut on cement from 12.5% to nil will not have any impact on the cement prices, as the landed cost of bulk cement translates into a 25% premium to the current national average of Rs205 per bag.
- The government has hinted that in the upcoming budget it might take measures to reduce the input costs for cement to contain the prices. On the other hand, it has ruled out any excise duty cut on cement.
- Taking cognisance of the third quarter performance of cement companies, we have upgraded our FY2007 and FY2008 estimates for UltraTech Cement, JK Cements, and Orient Paper and Industries. We have upgraded only the FY2008 estimates for Madras Cement. We also strongly believe that the south-based cement companies, after a lacklustre third quarter performance, would bounce back with better results in the fourth quarter.
- We maintain our positive view on the sector and believe that the companies that have taken a lead in announcing capacity expansions, such as Grasim Industries, Shree Cement, Jaiprakash Associates, UltraTech Cement and Madras Cement, will benefit the most in a scenario of rising prices. We rate Grasim Industries, UltraTech Cement and India Cements as our top large-cap picks in the sector. Among the mid-caps, we like Shree Cement and Madras Cement. We also like Orient Paper and Industries, and JK Cement on account of their compelling valuations, which are much less than the sector average.

Companies	Price Target	PER		EV/EBITDA		EV/Tonne	
		FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
ACC	1250.0	18.1	14.5	11.7	8.5	205.1	183.6
Grasim	3350.0	13.2	11.2	6.8	5.3		
UTCL	1365.0	15.7	10.6	8.7	6.0	170.5	162.8
JP Associates	850.0	25.4	17.6	12.8	9.9	-	-
Shree Cement	1700.0	14.1	10.6	9.5	6.6	253.2	187.9
Madras Cement	4000.0	11.5	10.1	7.5	6.0	151.0	137.0
JK Cement	295.0	7.8	6.0	5.8	4.3	84.3	72.5
Orient Paper	800.0	7.9	5.3	4.8	2.9	76.0	50.0
India Cements	315.0	9.9	6.9	7.1	4.9	121.0	94.0

Dispatch growth slows down

The industry dispatches for January have grown by 7% yoy to 14 million tonne. The growth is much slower as compared to that in January 2006 when the dispatches had grown by 16%. The growth has been slower because very few players have added capacity in the last one year and therefore been operating at full capacity. The cement majors (refer our report dated February 12, 2007) cumulatively reported a meager growth of 2.8% yoy at 59.4 lakh tonne. Amongst our cement mid-caps, Shree Cement and JK Cement could continue to achieve higher growth at 32% yoy and 46% yoy respectively, fuelled by fresh capacities whereas Madras Cement could post a growth of 18%, thanks to higher blending.

Company	Jan'07	Jan'06	YoY (%)	Capacity utilisation (%)
ACC	1.64	1.65	-0.5	105.0
AV Birla	2.81	2.73	2.9	94.0
Gujarat Ambuja	1.49	1.4	6.4	108.0
Shree Cement	0.41	0.31	32.0	109.0
JK Cement	0.32	0.22	46.0	96.6
Madras Cement	0.50	0.42	18.0	99.6
India Cements	0.69	0.77	-10.0	108.0
Orient Paper	0.19	0.20	-5.0	96.0
Jaiprakash	0.62	0.33	89.0	
Industry	14.08	13.08	8.0	102.0

Source: ShareKhan,CMA

North leads the dispatch growth

Amongst the regions, the north witnessed the highest dispatch growth of 14% yoy followed by the east, which grew by 9% yoy, and the western region, which grew by 8.6% yoy.

Utilisation level breaches the 100% mark

Industry utilisation level followed its upward trend and breached the 100% mark, settling at 102%. The rise was driven by the west where the utilisation level jumped from 96% in the last month to 110% in the current month. With the demand picking up in the south post-monsoons, the utilisation level reached 100%. We believe the utilisation level will increase further in the next couple of months as the demand increases further.

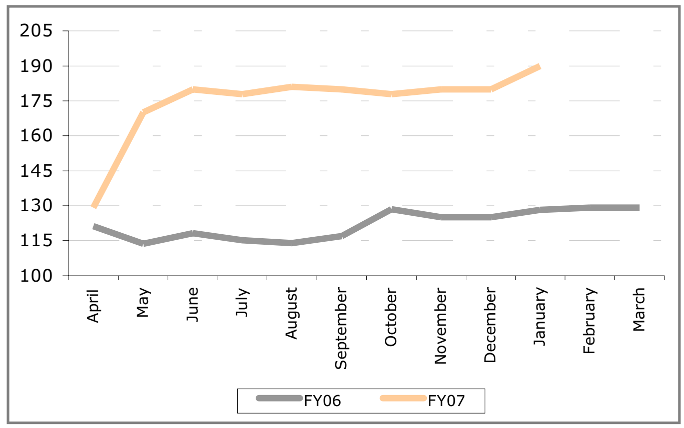
Company	Jan'07	Jan'06	YoY (%)	Capacity utilisation (%)
North	2.90	2.54	14.0	105
West	2.72	2.50	8.6	110
Central	2.16	2.16	0.3	100
East	1.98	1.80	9.9	94
South	4.33	4.07	6.2	100
Total	14.08	13.08	7.7	102

Demand-Supply gap further drives prices

Prices in AP rise by Rs5 per bag in first week of February

With the construction activity picking up post-monsoon, cement prices have started moving skywards. Tamil Nadu and Andhra Pradesh have witnessed a Rs10-per-bag rise in January. In February, Andhra Pradesh has already witnessed a Rs5-per-bag increase and the dealers expect the price to further rise by at least Rs10 per bag in the current month. Dealers in Tamil Nadu are further expecting a Rs3-5-per-bag increase in the month of February.

Hyderabad average price rises by 48% yoy

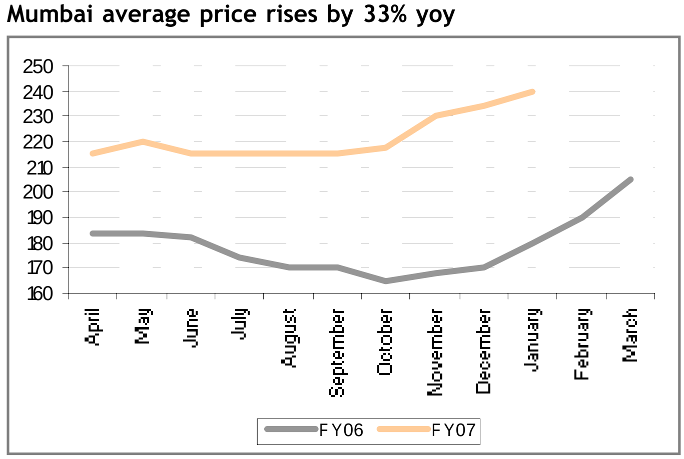


Source: CMA, Sharekhan Research

Prices stable in the west

In Ahmedabad, retail cement prices stand at Rs205-210 per bag, the same have increased by Rs3-4 per bag in the first week of February. In Mumbai, retail prices have risen by Rs5 per bag to Rs240 per bag in January. On account of the demand-supply gap, dealers expect the prices to reach Rs250 per bag by the end of March.

Mumbai average price rises by 33% yoy

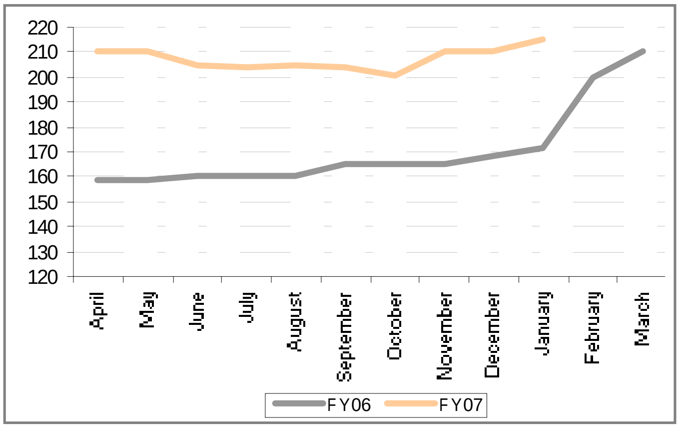


Source: CMA, Sharekhan Research

Prices increase by Rs5 per bag in Delhi

At the end of January, the prices in Delhi stood at Rs215 per kilogram after witnessing a hike of Rs5 per bag. Jaipur also witnessed a Rs5-per-bag increase to Rs190. In February, Jaipur has already witnessed a Rs5-per-bag hike on account of a tight demand-supply situation. Dealers expect this scenario to continue for the next couple of months and thus expect further hike in prices.

Delhi average price rises by 25% yoy



Source: CMA, Sharekhan Research

Pricing trends in major cities

City	Jan	YoY (%)	YTD	YoY (%)
Mumbai	240	33	222	27
Delhi	215	25	207	27
Hyderabad	190	48	175	45
Chennai	200	22	196	14

Source: Dealers, Sharekhan

Implementation of VAT in Tamil Nadu from January '07

From January 1, 2007 Tamil Nadu implemented VAT, reducing the sales tax rate in the state from 14.5% to 12.5%. We reiterate our earlier view that the savings that the companies will enjoy on account of a reduction in the tax on selling price will be offset by the tax that will now be payable on the freight component. Thus we believe that it will have a neutral impact on our south-based companies, namely India Cements and Madras Cement.

Customs duty slashed to nil, no impact in the near future

As the inflation rate crossed 6% in the last month, the government slashed the customs duty on cement from 12.5% to nil. As mentioned in our earlier report, we believe that this will not have any impact on the prices as the landed cost of bulk cement translates into a 25% premium to the current national average of Rs205 per bag. Except for certain coastal-based projects, the use of imported cement will be unviable due to the high freight costs attached to transport of cement over a long distance. But we do believe that the price hikes by the cement manufacturers would slow down as the import price, which acts as a reference for the domestic players, would come down.

What's in there for the industry in the Budget?

There have been talks in the industry that the excise duty on cement would be reduced from the current rate of Rs408 per tonne. But the government, at the CII meet at Davos in January, categorically denied any duty cut on cement as it fears that the cement manufacturers would not pass on the benefit to the consumers.

But the government has hinted that it might take steps to make inputs cheaper for cement manufacturers so as to contain the prices. So we can expect some positive surprises in the form of a reduction on duty on pet coke or a reduction of excise duty on slag, a key input for Portland cement.

Maintain positive view on sector

In the third quarter, the cement companies have posted a superlative earnings growth, those in Sharekhan universe have posted a mammoth growth of 215% yoy. With the cement prices on an uptrend in the fourth quarter as well, we believe that the cement pack would be able to put up a superlative earnings performance in the fourth quarter as well.

The scenario for FY2009 looks bright enough for the cement prices to remain firm till then, thanks to the delay in cement capacity addition and the continued strong growth in cement consumption. We maintain our positive view on the sector and believe that the companies that have taken a lead in announcing capacity expansions, such as Grasim Industries, Shree Cement, Jaiprakash Associates, UltraTech Cement and Madras Cement, will benefit the most in a scenario of rising prices. We rate Grasim Industries, UltraTech Cement and India Cements as our top large-cap picks in the sector. Among the mid-caps, we like Shree Cement and Madras Cement. We also like Orient Paper and Industries, and JK Cement on account of their compelling valuations, which are much less than the sector average.

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India Cements	315.0	9.9	6.9	7.1	4.9	121.0	94.0

Industry Update

Mutual Fund

Equity AUMs rise in line with market movement

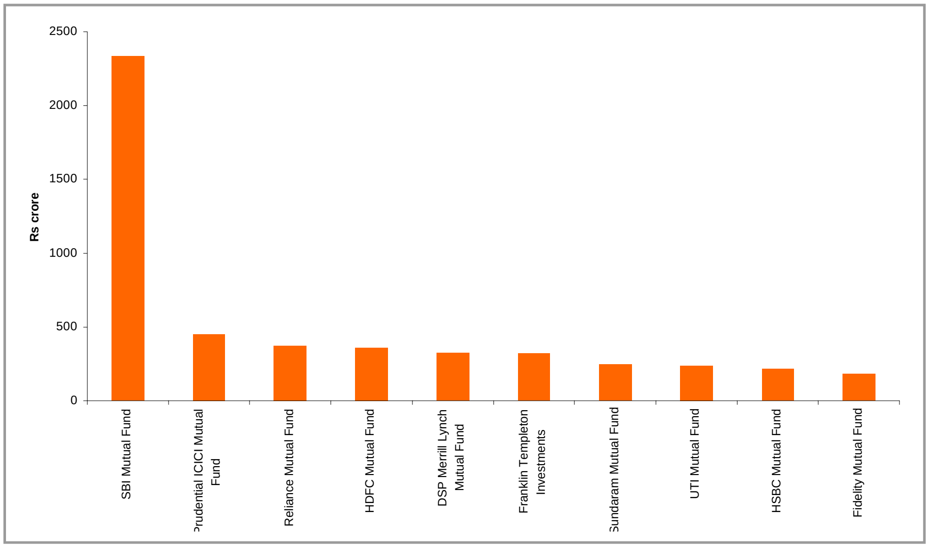
Industry news

- **Reliance MF takes over UTI MF as top MF:** A moderate mobilisation of resources through fixed maturity plans (FMPs), has helped the private sector player Reliance Mutual Fund (RMF) emerge as India's largest mutual fund (MF), in terms of assets under management (AUM), for the first time. RMF has pushed UTI MF, the public sector behemoth, to the second position. RMF's AUM went up by 5.6%, or Rs2,092 crore, to Rs39,019.94 crore whereas that of UTI MF dipped 1.5%, or Rs73.43 crore, to Rs37,535.08 crore.
- **MFs add 18.5 lakh investors in Q3FY2007:** The total MF investor base crossed 2.67 crore in Q3 of this financial year!! As many as 17.2 lakh folios were added in equity schemes of which 2.8 lakh were added in equity tax saving schemes (ELSS). About 9.47 lakh folios were added in the equity-based close-ended schemes which was higher than the 7.73 lakh folios added in the equity-based open-ended schemes. About 1.19 lakh investors were added in debt schemes.
- **Tata MF files for gold fund:** Tata MF has filed its offer document for Tata Gold Fund with the Securities and Exchange Board of India (Sebi). The open-ended exchange traded fund will track the domestic price of gold through investments in physical gold and will be listed on the stock exchanges. Units with face value of Rs10 will be issued along with an applicable load during the new fund offer.
- **Benchmark, UTI MF get Sebi nod for GETFs:** UTI MF and Benchmark Asset Management Company have received the approval from Sebi to launch their gold exchange-traded funds (GETFs). The schemes would be open-ended and be listed on the National Stock Exchange. GETFs are products through which investors can trade in the yellow metal via the stock exchange without physically owning it.
- **MFs too face PANdemic:** The government is examining a proposal to make it mandatory to quote the permanent account number (PAN) for MF investments. Proposed on the lines of the practice for demat accounts where the investor has to quote his/her PAN to invest in shares, the finance ministry is now planning to introduce the eligibility condition for MFs as well. Quoting the PAN would enable revenue officials track down investment details of individuals in MFs and the earnings in cases of tax evasion.

Highlights

- The AUM for equity funds increased by 2.2% to Rs146,749 crore in January 2007. The rise in the equity AUM was in line with the 2.2% upward movement in the market.
- Fund managers made purchases worth Rs11,644 crore and turned net sellers to the tune of Rs1,342 crore during the month. The sell-off was largely to pay dividends at the end of the year.
- Equity MFs registered a net inflow of Rs1,361 crore. The relatively lower new fund offering (NFO) collections coupled with the higher redemption volumes lowered the funds flow in January 2007.
- MFs are sitting on Rs12,067 crore of cash, waiting to be deployed in the market. Of this, Rs9,957 crore of cash lies with the existing MFs, while the remaining Rs2,110 crore has been mobilised through NFOs.
- Amongst all sector funds, technology funds have generated the highest returns in January 2007. Banking and technology funds have outperformed the Sensex, whereas the funds in the auto, pharma and fast moving consumer goods (FMCG) sectors have underperfomed the Sensex.
- MFs have slashed their exposure to computer, auto and diversified companies, and have bought stocks in the entertainment, telecom and oil & gas sectors.

- **Major movers for January 2007**



The AUM of equity MFs increased by 2.2% from Rs143,619 crore in December 2006 to Rs146,749 crore in January 2007. The rise in the equity AUM was in line with the market movement of 2.2%. The AUM for the equity-diversified funds surged by 3.5%, whereas that of the tax planning and sector funds rose by 10.5% and 4.6% respectively. The index funds saw a massive decline of 10.5% in their AUM.

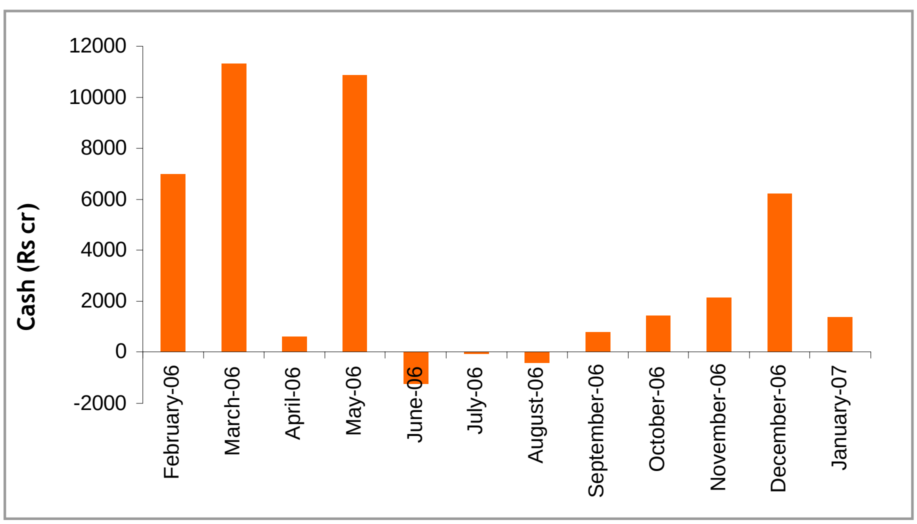
SBI MF clocked the highest increase of 23.3%, amounting to Rs2,333 crore, in its AUM, largely fuelled by the robust collections of the newly launched SBI One India Fund. Prudential ICICI MF and RMF followed SBI MF and recorded increases of Rs453 crore and Rs372 crore respectively in their equity AUM. The top loser was Benchmark MF, which saw its equity AUM declining by Rs1,858 crore, followed by Standard Chartered MF and ABN Amro MF.

- **Stock market activities for mutual funds**

Mutual funds turned net sellers of equities in January 2007.

Month	Purchase (Rs cr)	Sales (Rs cr)	Net (Rs cr)
Jan-07	11643.6	12985.8	-1342.2

Equity fund flow



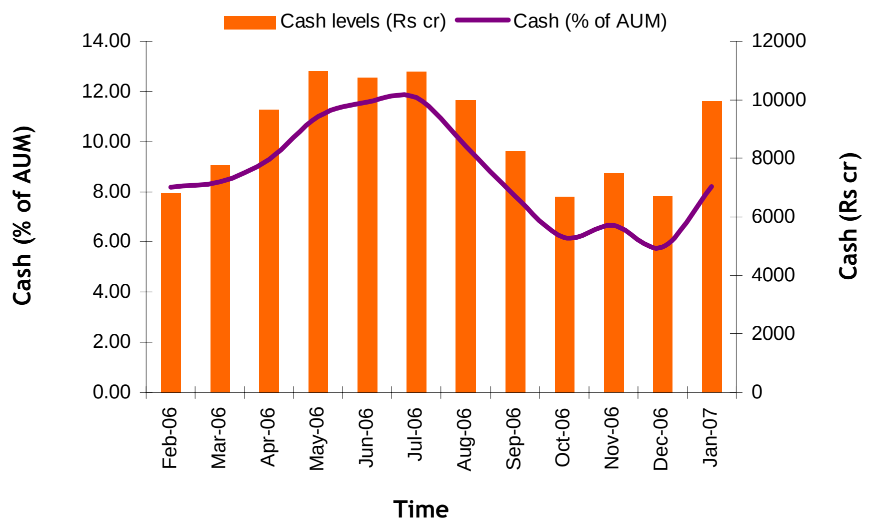
Fund flows into the equity MFs reversed their advancing trend in January 2007, with the equity MFs registering a net inflow of Rs1,361 crore in January 2007 as compared with Rs6,229 crore in December 2006. The decline in the fund flows in January 2007 as compared with December 2006 is mainly attributed to the lower amounts mobilised by the NFOs (Rs2,110 crore in January 2007 compared with Rs5,720 crore in December 2006) and the relatively higher volume of redemptions. The NFO collections include the amounts raised by SBI One India Fund, DSP Merrill Lynch Taxsaver Fund and HSBC Tax Saver Equity Fund. The same however do not include the collections made by Can Multicap Fund, Sundaram Equity Multipler Fund and Sundaram Select Small Cap Fund. These funds were launched in January 2007 but did not close in the month, as the allotment of the units for these funds is not yet complete. The collections made by these funds (approximately Rs600 crore) will be reflected in the next month's fund flow figures.

Cash levels

Liquidity

The absolute cash levels for all equity funds launched before January 2007 increased from Rs6,710 crore in December 2006 to Rs9,957 crore in January 2007. The cash as a percentage of the total corpus also followed a similar trend, increasing from 5.8% of the total corpus in December 2006 to 8.2% in January 2007. The increase in the cash levels has been largely due to profit booking in a rallying market.

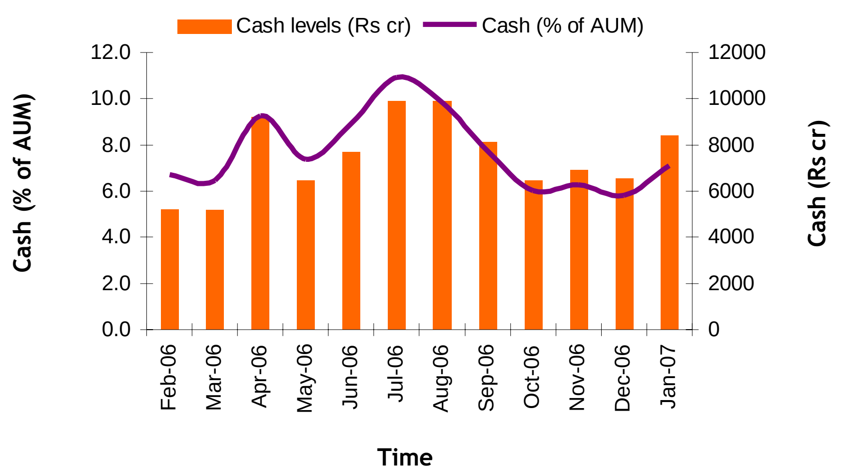
The total cash sitting with MFs, including the cash mobilised through the recently launched NFOs, however, stands at a healthy Rs12,067 crore. Flush with cash, MFs are well placed to maintain the buying interest and propel the market forward.



Note: Includes all equity funds in the industry launched before January 2007

Sentiments

MFs have stepped back a bit from the strong investment mode seen in December 2006 with cash levels rising from 5.8% of the total corpus in December 2006 to 7.1% of the total corpus in January 2007. However, with the prospects for the Indian market yet remaining strong, sentiments continue to be bullish and funds may be holding more amounts of cash to counter the redemption requests or to invest at lower valuations.



Note: Includes all equity funds in the industry with a NAV track record of three months+.

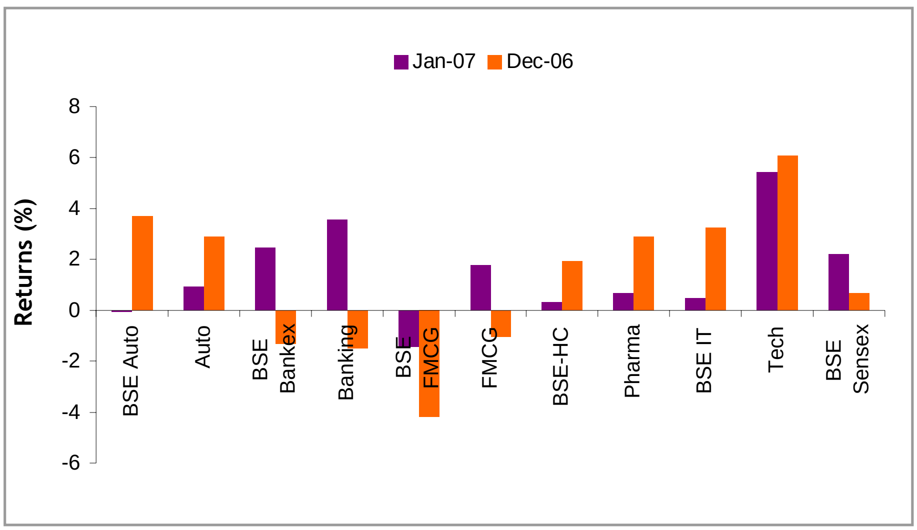
Sector allocation

Major shifts in the sector allocation for the equity-diversified category are as under:

Sector name	January 2007		December 2006	
	Amount (Rs cr)	% of net assets	Amount (Rs cr)	% of net assets
Increase in exposure				
Miscellaneous	4093.02	4.35	3263.39	3.57
Entertainment	2510.04	2.67	2026.94	2.21
Telecom	5031.81	5.34	4509.23	4.93
Oil & Gas, Petroleum & Refinery	3883.02	4.12	3492.65	3.82
Electricals & Electrical Equipments	3341.18	3.55	3073.29	3.36
Chemicals	1437.13	1.53	1228.08	1.34
Decrease in exposure				
Computers--software & education	10105.49	10.73	10433.91	11.40
Auto & Auto ancillaries	6785.71	7.21	7159.96	7.82
Diversified	12402.43	13.17	12459.76	13.61
Cement	2483.88	2.64	2763.11	3.02
Tobacco & Pan Masala	1619.93	1.72	1835.36	2.01
Housing & Construction	5301.05	5.63	5357.49	5.85

Performance of sector funds

Despite the Sensex advancing by 2.2% in January, most fund categories except banking and FMCG have generated lower returns in January 2007 as compared with the significantly higher returns clocked in December 2006. Banking and technology funds have outperformed the Sensex, whereas the funds in the auto, FMCG and pharmaceutical sectors have underperfomed the Sensex by 0.5-1%. Additionally, all the sector funds (auto, banking, FMCG, pharma and technology) have outperformed their respective benchmark indices (the BSE Auto Index, the BSE Bankex, the BSE FMCG Index, the BSE Healthcare Index and the BSE IT Index) in January 2007. The technology funds gave the highest returns in January 2007, followed by the banking and FMCG funds.



Disclaimer: mutual fund investments are subject to market risk. Please read the offer document carefully before investing. Past performance may or may not be sustained in the future.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Balrampur Chini Mills
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Overseas Electronics
HCL Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
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Vulture's Pick

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