MARKET STRATEGY JANUARY 2008

Benchmarks recoup November's losses

Benchmark indices, Sensex and Nifty, recouped (till December 26) the losses suffered in November 2007 and gained about 5% during December 2007. The month witnessed significant volatility with a large part of gains coming towards the end of the period.

However, the month saw significant gains in the mid and small caps. In our opinion, relative undervaluation to large caps led to greater participation in these stocks.

We opine that, while valuations on FY08E earnings expectations do appear stretched, FY09E estimates also look priced in to a significant extent. The high crude prices (around $95 per barrel) remain a concern for the global economy. On the other hand, we believe that, the strong macro factors of India and continuing good corporate results (in line with expectations) may not allow the markets to fall significantly.

Thus, we expect the markets to trade in a narrow band till the time there is a significant trigger either internationally or domestically. In January 2008, the markets will react to the 3QFY08 numbers as also to the US Federal Reserve's decision on interest rates, towards the end of the month.

In such a scenario, we opine that, interest in some of the fundamentally sound mid and small cap stocks will sustain, leading to stock price out-performance.

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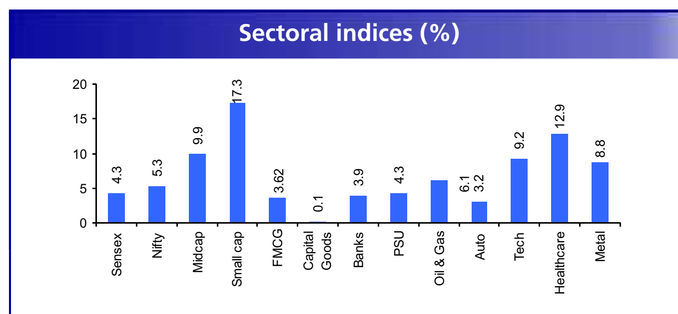
Thus, we maintain our recommendation of adopting a bottoms-up approach in our preferred sectors like power, capital goods, engineering, construction, logistics, banking, media, FMCG and food processing. We also maintain our contrarian positive bias for large-cap IT stocks, while noting that a fast appreciation in the rupee and a recession in the US economy may impact the earnings of these companies. We remain negative on the cement sector (unless there is a sustained and significant rise in cement prices, which we do not expect).

Mid-caps and small-caps deliver significant out-performance

While the benchmark indices gained by about 5% during the period, the mid-cap and small-cap indices were up by 10% and 17%, respectively and significantly out-performing the benchmarks.

We had mentioned in our previous monthly strategy report about the potential in quality mid-caps and small-caps versus large-caps. The markets reacted to relative undervaluation of these stocks and also to the largely in-line performance of most of these companies.

Sectoral indices (%)



Source: Bloomberg

IT and healthcare reversed the weak trend of past few months

Though all sectoral indices gained during the period, IT, Pharma and Metals indices out-performed the rest. In fact, IT and Pharma reversed the weak trend of the past few months by posting strong gains. Stocks in both the sectors were beaten down to attractive levels, which did attract some bargain-hunting, in our opinion. There can be further gains in case the US economy does not go into a recession and the rupee appreciates against the USD at a gradual pace. We had been recommending a contrarian buy on large cap IT and Pharma stocks.

On the other hand, the Capital Goods index and Banking index under-performed during the said period. Stocks in the capital goods sector encountered some profit booking due to high valuations as a result of the significant out-performance witnessed over the past few months.

Fed rate cut along expected lines

The Federal Reserve in USA cut the benchmark interest rates by 25bps to 4.25%. This was largely in line with expectations. The continuing sub-prime mortgage issues and the corresponding impact on the economy led the Fed to undertake further rate cuts. In our view, the move was intended to help spruce up consumption demand and demand for new houses. The Fed as well as the European Central Bank also injected billions of dollars to increase liquidity in their banking systems.

However, we believe that, in future, the Fed will have to walk a tight-rope while striking a balance between growth in economy and the rise in inflation.

This cut in interest rates by the Federal Reserve was largely expected and did not have any significant impact on the markets in India. We believe that, markets will now focus on the retail sales figures during Christmas and also on the December quarter GDP growth in USA for clues about the state of the economy.

FII continued to pull monies out of India

During this month, FIIs sold stocks worth about Rs.4bn (till 25 November, 2007) on a net basis. The revised norms issued by the SEBI regarding PNs could be partly responsible for slight reversal in FII flow. Also, some profit booking at the fag end of the year could have led to these net sales.

This selling comes on the heels of net sales of about Rs.46bn in November 2007. However, this trend may be short-term in nature as the Indian economy will continue to attract global fund flows.

Rupee remained range-bound

With FII fund flows moderating post the new PN rules, the rupee remained relatively steady during the month. The cut in interest rates in the US in September 2007 helped improve the risk appetite among investors resulting in a considerable flow of funds to emerging markets including India. We saw nearly $10 bn of FII inflows into the Indian markets during September-October 2007, which strengthened the rupee.

We will be closely watching the developments on the upcoming meet by the Federal Reserve towards the end of January 2008.

IIP growth rebounded in October 2007

Index of Industrial Production for the month of October 2007 grew at 11.8% as against 4.5% in the corresponding month a year ago. Growth in Mining and Electricity indices was at 3.7% and 4.2%, respectively. Growth in Manufacturing stood 13.3% for the month.

According to the data released by the CSO, cumulative growth for the period April-October 2007-08 declined to 9.7% as against 10.1% over the corresponding period of the pervious year. The cumulative growth rates for mining, manufacturing and electricity over the corresponding period of 2006-07 were 4.8%, 10.4% and 7.2% respectively.

As per use-based classification, the sectoral growth rates in October 2007 over October 2006 were 6.2% in basic goods, 20.5% in capital goods and 14.2% in intermediate goods. The consumer durables and consumer non-durables have recorded growth of 9.3% and 13.9% respectively, with the overall growth in consumer goods being 12.5%.

This re-bound in IIP came as a booster to the markets as it eased concerns about the fall in IIP in the month of September 2007.

Crude prices remain firm

One of the factors that has gone largely unnoticed in the recent stock market bull run is high crude prices. Crude prices firmed up to $96 per barrel after easing in the initial part of the month. We view this as a major concern for India as well as for the global economy. We note that while the rupee has appreciated about 9% in this calendar, this is not enough to set off the nearly 45% rise in crude prices.

Outlook

On a fundamental basis, we remain bullish on the longer-term growth prospects of the economy. With the economy expected to sustain a structurally high growth rate, corporate profit growth may remain high over the medium to long-term.

In our opinion, the economic growth is also expected to have a rub-off impact on the equity markets. We believe the markets do offer scope for decent returns to long-term players. However, at current levels, markets are discounting FY08E consensus Sensex estimates by about 24x and FY09E consensus Sensex estimates by about 20x, which is not undemanding, in our view.

The market has remained range-bound in the month and this is expected to be the case in the near term. High crude prices remain a concern from an inflation point of view. In our opinion, high crude prices and valuations could cap significant upside from current levels. The downside may be low as sustained economic growth and corporate profit growth are expected to attract strong global fund flows.

We continue to recommend a bottoms-up approach of buying/owning select value plays with good growth potential, on a staggered basis. We remain negative on the cement sector (unless there is sustained increase in cement prices).

We believe stocks in the capital goods, engineering, banking, power, construction, media, logistics, FMCG, and food processing may outperform the broader markets. We also prefer large caps in the IT sector. A sharp appreciation in the rupee from current levels and/or a recession in major user economies are key risks for IT stocks.

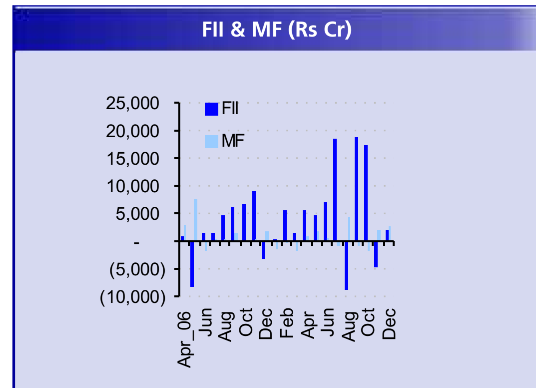
The following are our preferred picks from among the sectors we cover:

Preferred picks

Sector	Stocks
Banking	ICICI Bank, Axis Bank, PNB, IOB
Construction	Nagarjuna Constructions, Patel Engineering, IVRCL, Unity
Engineering	L&T, Suzlon, KOEL, Hindustan Dorr Oliver, Siemens
Food Processing	Riddhi Siddhi Gluco Biols
IT	Infosys, Satyam, TCS, Infotech, Megasoft
Logistics	Concor, Redington, Allcargo, Gateway Distriparks
Media	Deccan Chronicle ENIL, HT Media
Pharmaceuticals	Ranbaxy, Lupin, Glenmark, Alembic, Jubilant, Torrent
Other Midcaps	Nitin Fire, JBF, AIA, Sunil Hi Tech

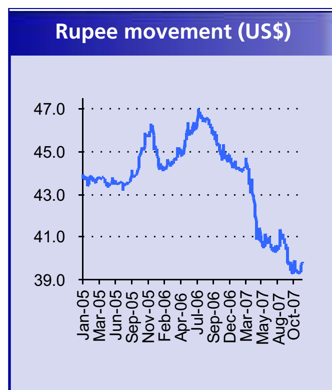
Source: Kotak Securities - Private Client Research

FII & MF (Rs Cr)



Source: Bloomberg

Rupee movement (US$)

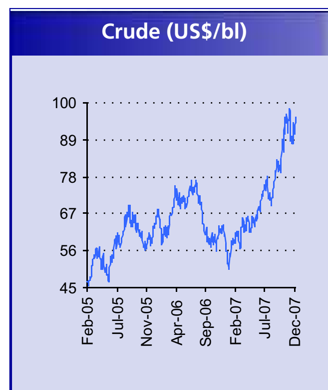


Source: Bloomberg

IIP growth (%)

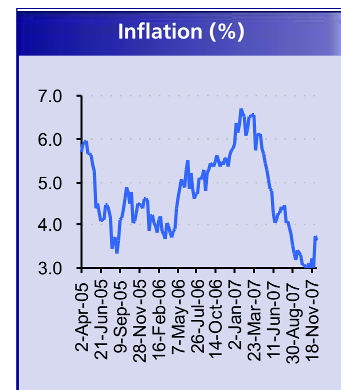
Source: Bloomberg

Crude (US$/bl)

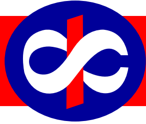


Source: Bloomberg

Inflation (%)



Source: Bloomberg



SUNIL HI TECH ENGINEERS LTD.

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 276** | **TARGET PRICE: Rs. 400**

28 November 2007

Apurva Doshi

Power packed innings: Poised for aggressive growth

Sunil Hi Tech Engineers Ltd (SHEL) is a niche player in the power sector that builds, maintains and refurbishes power plants. The company also sets up transmission and distribution (T&D) substations, control rooms and erects super structures for steel, cement, aluminum, refineries and gas-based plants.

India's current power generating capacity is 134717 MW. It is likely to add 80000 MW in the next five years. This translates into a huge opportunity for SHEL that has elevated itself from a labor contractor into a principal contractor for major players like NTPC and Reliance Energy.

SHEL enjoys a strong order book of Rs.7.2 bn with L1 (lowest bidder) for another Rs.1.5 bn, which is to be executed over the next 30 months. This is 4.8x its FY07 revenues of Rs. 1.5 bn.

We are positive on the growth prospects of SHEL. Therefore, we are initiating coverage on SHEL with a BUY recommendation. We are assigning a price target of Rs.400 (45% upside potential) over a 12-month horizon. This is based on DCF method of valuation with 13.3% WACC and 3% terminal growth rate.

Key investment rationale

- Growing power requirements in India to lead to massive capacity addition. Almost 60% of the current power capacity is to be added in next five years. The Government has also planned ultra mega power projects (UMPP) with a capacity of at lest 4000 MW each. This translates into a huge opportunity for players like SHEL.
- Significant experience in power sector. More than 90% of the revenues of SHEL are from the power sector while the balance comes from steel and other activities like manufacturing of pressure parts for boilers. The company has already worked on projects of 9850 MW and is currently working on projects worth 20000 MW.
- Eyeing larger share of balance of plants business. Typically, BOP work consists of 40% of the total cost per MW of the power plant. SHEL, which used to take small packets of this BOP, has now moved up the value chain. Today it is capable on its own of doing almost 80% of the BOP work.
- Foray into other BOP work. SHEL has been awarded three hydropower plants for an American company, that is, Dodson-Lindblom. Recently, the company has successfully forayed into setting up of EHV substation and control room for transmission and distribution in the power sector upto 400 KV. The company has won two orders for fabrication works in steel plants.
- Commenced manufacturing pressure parts for boilers under subsidiary for upto 500 MW thermal power plant. In FY07, SHEL formed a subsidiary to manufacture boiler pressure parts for power plants up to 500 MW. This business has the potential to scale up to Rs.1 bn in three years.
- Already pre-qualified, jointly bid for Mundra UMPP. The company has already made joint bid for the BOP work for the Mundra UMPP. Each UMPP of 4000 MW has potential BOP work of around Rs.6.4 bn, which is huge opportunity for players like SHEL.
- Robust growth in sales & profits. We expect revenues to grow at a CAGR of 78.0% to Rs.4.6 bn in FY09E and net profits to grow at a CAGR of 125.8% to Rs.386 mn in FY09E, from FY07 to FY09E.

Attractive valuations

- At the current price of Rs.276, the stock is trading at 11.7x FY09E earnings and 9.3x FY09E cash earnings. The stock is trading at 6.0x EV/EBIDTA multiple and 1.0x EV/sales multiple based on FY09E estimates. We expect the company to report RoE of 17.2% in FY09E.
- We feel the valuations are attractive due to the strong past track record, good future potential due to strong focus of SHEL on the growing power sector in India.
- Also the company has successfully diversified into other fabrication works like transmission, distribution, steel, cement, hydropower and manufacturing of pressure parts for boilers. This would help to reduce its dependents on power projects thereby derisking the business. This would lead to significant growth in revenues and profitability, going forward.
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Key risks

- Any economic slowdown would impact the demand for power. Thus, it would also impact the company's growth.
- SHEL faces competition from large domestic and international players. Any move to distort the market with irrational pricing would impact the profitability of the company.
- Any delay in getting right of way for work could lead to lower than expected growth for the company
- Slow execution of orders would have an impact on sales booking
- Non-availability of skilled manpower to execute the job in the allotted time could result in penalties, thereby affecting the profitability of the company.

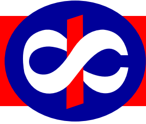
Stock details		
BSE code	:	532711
NSE code	:	SUNILHITEC
Market cap (Rs mn)	:	4506
Free float (%)	:	34.85
52-wk Hi/Lo (Rs)	:	323 / 67
Avg. daily volume BSE	:	101967
Avg. daily volume NSE	:	103572
Shares o/s diluted (m)	:	16.3

Sourse:Capitaline,BSE & NSE

Standalone Summary table (year end Mar)

Rs mn	FY07	FY08E	FY09E
Sales	1,448	2,860	4,588
Growth (%)	9.1	97.5	60.4
EBITDA	181	462	730
EBITDA margin (%)	12.5	16.2	15.9
Net profit	75.7	216.6	385.8
Net debt	291	(485)	(122)
EPS (Rs)	7.5	13.3	23.6
Growth (%)	35.4	186.3	78.1
DPS (Rs)	1.2	1.5	2.0
ROE (%)	13.3	16.4	17.2
ROCE (%)	14.8	22.3	24.5
EV/Sales (x)	3.3	1.4	1.0
EV/EBITDA (x)	26.5	8.7	6.0
P/E (x)	36.6	20.8	11.7
P/BV (x)	7.9	2.2	1.9

Source: Company & Kotak Securities - Private Client Research



HT MEDIA LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 212** | **TARGET PRICE: Rs. 261**

30 November 2007

Saurabh Gurnurkar

HT Media's net arm buys a domestic social networking site; initial foray into consumer internet. Company looks at growing internet presence - organically and inorganically to build on print franchise, targeting c10% of revenues from internet by 2010E.

Continuing investments in new initiatives- 'Mint' and new editions of 'Hindustan' to impact near term financials. Retain positive bias given evolving cross media presence & favorable risk-reward outlook. Maintain BUY with a price target of Rs.261.

- In an attempt to enter one of the fastest growing segments in the Indian Internet space, Firefly e-Ventures Ltd, the wholly owned Internet subsidiary of HT Media Ltd, has acquired social networking site Desimartini.com.
- The company has not disclosed the acquisition cost for this particular transaction. Financial details of the acquired company are also not available which precludes the analysis of the acquisition and impact on near term company financials.
- Desimartini.com; initially launched by the Pahwa group of companies has a membership base of close to 2, 50,000 and attracts around 2.5mn page views a month, according to news reports.
- Apart from global social networking sites such as Google Inc.'s Orkut and Facebook, Desimartini.com competes with homegrown players such as the Bangalore-based Minglebox.com which connects students across school and university campuses, Ibibo.com, Indyarocks.com, and Bigadda.com, a site launched by Reliance Entertainment. In terms of competitor subscriber base Ibibo launched seven months ago claims a user base of 2.98mn.
- HT Media also plans to launch online portals in the jobs, matrimonial, real estate and auto verticals-areas where the classifieds pages of newspapers currently dominate and where Hindustan Times has a strong presence in some markets.
- We see this as a natural extension for a legacy print company given its databases, client relationships and brand recall.
- HT's internet arm is also looking at the inorganic route to ramp up its net presence in the medium term. The management is targeting c10% of revenues from the internet business in the next three years.
- We opine ramp up and greater visibility of revenues from the net stream are required to factor impact of Internet revenues in our financials. Given this we keep our earnings estimates and positive bias unchanged at this point in time.

H1'08- challenging industry environment coupled with continuing investments impact; expect 2H to be better given seasonality and maturing investments

- Ad revenue growth in H1'08 has been modest at 15-16% for HT; we believe this is due to challenges the sector has been facing in certain client segments like autos and real estate. We expect ad revenue growth to pick up in 2H'08, the seasonally better half and expect ad revenue growth close to 20% in the period.
- Profit growth has been muted due to new investments- Mint and new editions of Hindustan. This has resulted in single digit EBITDA growth YoY for the last two quarters. We are cognizant of new investments HT is making and opine a pick up in EBITDA growth will be more a function of older editions driving operating leverage than new investments turning profitable soon.

'Hindustan'- shaping well, to be transferred as separate undertaking to a fully owned sub

- Hindustan, HT's Hindi paper has gained readership and maintains its dominant position in Jharkhand and Bihar. Hindustan's new launches in UP - Agra, Kanpur, Meerut & Varanasi have gained circulation; ad revenues are also picking up in tandem with edition popularity.
- HT is now looking to carry out sale/transfer of its 'Hindi business' as a separate undertaking to a fully owned subsidiary company. We opine this is being done to bring about more effective managerial focus on the Hindi business in addition to possibly take care of any funding requirement 'Hindustan' may have, given its plan to increase its footprint. The company expects to complete this by the end of CY07.
- In FY07, Hindustan contributed close to 50% of HTML's circulation revenues and Rs.1.1bn in ad revenues (c 15% of overall ad revenues). Also, in terms of growth, ad revenues registered a 20% growth over the previous year.

EBITDA growth slowing, as new investments take toll.

- For 2Q'08 HT Media reported EBITDA margins of 17.3% that were down by about 110bps YoY. These margins in Q2 include an EBITDA burn of Rs.96mn towards the business paper- Mint.
- Adjusted for the investments in 'Mint', EBITDA margins expanded by 200bps YoY for 2Q (21.2% vis-à-vis 19.2% in 2Q'07).
- EBITDA margins including 'Mint' stood at 17.3% for Q2FY08 vis-à-vis the 20.3% reported in Q1FY08.
- We opine that continuing investments in different editions, and increased ad & sales costs towards the business paper will possibly keep margins at current quarter's levels during FY08. We also feel that good execution of these initiatives will add longer term value as it could result in overall yields trending up on the back of increased addressable market.

Financials

- In financials, HT Media's print business is expected to deliver 18.6% and 43% CAGR in revenues and earnings respectively over FY07-09E. We expect EBITDA for the company to grow at a CAGR of 39% to Rs.3.6bn in FY09 from Rs.1.9bn reported in FY07 over the period FY07-09. Consequently, we expect EBITDA margins to improve to 25% in FY09 from the 18.2% reported in FY07.
- We expect HTML to report revenues of Rs.12.2bn in FY08 and a further Rs.14.6bn in FY09 and net profits of Rs.1.58bn in FY08 and Rs.2.35bn (Rs2.4bn earlier) in FY09. This would translate into an EPS of Rs.6.8for FY08 and Rs.10.1 in Fy09.

Valuation & Recommendation

- The HT stock has been languishing at these levels since the last quarter, after delivering more than 110% returns since initiation (Q2'07). We believe it has lagged the broader market on concerns of new investments paring profits, a slowdown in EBITDA growth YoY (last 2Q's) on account of new investments and also concerns about challenges being faced in key client segments like auto/real estate with regards to ad revenue momentum, in 1H'08.
- The current price levels in our opinion offer an attractive entry point given our expectations of margin expansion in the current business and the scale up in its new initiatives like 'Mint', 'Fever' in the medium term.
- These new initiatives in addition to the ramp up HT is planning in its internet offerings(verticals like real estate, matrimonial etc) are expected to provide longer term growth drivers for HT.
- We have valued HTML's print business using an average of DCF and EV/EBITDA methodologies. Our weighted average price target stands at Rs.247 for HT Media.
- To this we have added Rs.14, our estimate of fair value accretive to the HT shareholder from 'Fever 104'- HT's radio business to arrive at a price target of Rs.261 for the stock, maintain BUY.

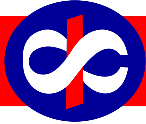
Key Concerns

- Higher than estimated newsprint costs: Any continued and sustained uptrend in the newsprint prices could lead to greater expenditure for print companies like HTML and impact their profitability negatively.
- High competition in the existing print markets and more so from ambitious new entrants could lead to price wars, slashing of ad rates and a general tepid outlook for growth and profitability for the players.
- Shift of advertising revenue momentum from the print medium to other mediums like radio, Internet or television could impact the growth and profitability of print media players like HTML.

Summary table - Standalone

(Rs mn)	FY07	FY08E	FY09E
Sales	10,391	12,193	14,625
Growth (%)	26.6	17.3	19.9
EBITDA	1,902	2,536	3,661
EBITDA margin (%)	18.3	20.8	25
Net profit	1,149	1,581	2,357
Net debt (cash)	(2,623)	(3,828)	(5,768)
EPS (Rs)	4.9	6.8	10.1
Growth (%)	208.2	37.7	49.0
CEPS	6.6	8.6	12.0
DPS (Rs)	0.4	0.4	0.5
ROE (%)	15.4	18.2	22.5
ROCE (%)	20.9	24.2	30.3
EV/Sales (x)	4.7	3.9	3.1
EV/EBITDA (x)	25.4	18.6	12.4
P/E (x)	43.8	31.9	21.4
P/Cash Earnings	32.6	25.0	17.9
P/BV (x)	6.3	5.4	4.3

Source: Company & Kotak Securities - Private Client Research



PATEL ENGINEERING

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 806** | **TARGET PRICE: Rs. 964**

6 December 2007

Teena Virmani

On the basis of company's detailed plan of real estate development, we are revising our land bank valuations for the company. We arrive at a target price of Rs 964 based on sum-of-the-parts methodology, taking into account the valuation of core business (Rs.429), subsidiary valuation (Rs.14) and land development valuation (Rs.521) and recommend BUY.

Q2FY08 Result highlights

- Patel Engineering reported excellent set of numbers for Q2FY08 with revenues for the current quarter registering a 19% YoY growth, slightly lower than our expectations. But higher than expected operating margins resulted in sharp improvement in net profits by 30% YoY.
- Higher operating margins of 17.8% are on account of higher margin hydro power projects executed in the current quarter. Company intends to increase the proportion of hydro power projects in future, which is expected to tilt the order book in favor of higher margin projects.
- However company has not made provisions for a higher tax rate as announced in Union Budget 2007-08. Thus, it has resulted in growing net profits by 30% YoY.
- Company has also enhanced the land bank to approximately 1000 acres as against 500 acres earlier and has announced detailed plans of development in Mumbai, Bangalore and Hyderabad for first phase. We have revised our land bank valuations based on the development details for first phase and incorporated the value of remaining land based on prevailing rates in the respective areas. We arrive at Rs.521 per share for entire 1000 acres.
- With a robust order book of Rs 54 bn, we expect company's revenues on a standalone basis to grow at a CAGR of 30% and profits to grow at a CAGR of 15% between FY07-FY09.

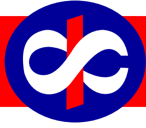
Standalone results

(Rs mn)	Q2FY08	Q2FY07	YoY (%)
Net Sales	2,358	1,979	19
Expenditure	1,938	1,672	
Operating Profit	420	307	37
Operating Profit Margin	17.8	15.5	
Depreciation	70	65.9	
EBIT	350	241	45
Interest	28	-13	
EBT (exc other income)	322	254	
Other Income	45	20	
EBT	367	274	34
Tax	43	24	
Tax Rate (%)	11.6	8.6	
PAT	324	250	30
NPM (%)	13.8	12.7	
Equity Capital	59.6	59.6	
EPS (Rs)	5.4	4.2	

Source: Company

Revenue growth slightly lower than expectations

- Company has registered a growth of 19% in revenues for Q2FY08 which is slightly lower than our estimates. This was on account of higher proportion of long gestation hydro power projects executed in the current quarter.
- With a robust order of approximately Rs 54 bn, we expect company's revenues to grow at a CAGR of 30% between FY07-FY09.



Higher than expected operating margins

Operating margins for Patel Engineering were better than our expectations. Company expects to increase the proportion of hydro power projects from current levels of 55% to 60% by next year. Hence we expect an improvement in the operating margins of the company going forward and have incorporated slight improvement in our estimates for Fy09.

Healthy net profit growth but tax rate is still low

- Net profits have grown by 30% for Q2FY08, ahead of our estimates. This is due to lower tax outgo and higher operating margins as against our estimates.
- Though company has not made provisions for a full tax rate, we have assumed tax rate at 30% in our estimates for the company and we expect net profits to be Rs1.09 bn and Rs 1.42 bn in FY08 and FY09 respectively.

Real estate development plans

Company has also enhanced the land bank to approximately 1000 acres as against 500 acres earlier and has announced detailed plans of development in Mumbai, Bangalore and Hyderabad for first phase. This land has been acquired at very low prices by the company and company has given its development rights to Patel Realty India Ltd (PRIL).

Following are the details for its first phase development -

- **Jogeshwari, Mumbai**
  - Corporate Park - Company plans to develop and lease 80,000 sq ft of area, half of which is already constructed and leased while remaining is expected to be completed by July, 2008. We expect lease rentals to be in the range of Rs.110-115 per sq ft per month, cost of construction of Rs 1800 per sq ft and a capitalisation yield of 10%.
  - Corporate office Tower - Company plans to develop 0.75 mn sq ft in two phases. First phase is expected to be completed by December, 2009 and second phase by June, 2011. We expect lease rentals to be in the range of Rs.115-120 per sq ft per month, cost of construction of Rs 2000 per sq ft and a capitalisation yield of 10%.
- **IT SEZ, Gachibowli, Hyderabad**

  Company intends to develop an IT SEZ in Gachibowli, Hyderabad with a built up area of 2.7 mn sq ft. Construction work is expected to commence in March 2008 and is expected to end by March, 2011. We expect lease rentals to be in the range of Rs.40 per sq ft per month, cost of construction of Rs 1500 per sq ft and a capitalisation yield of 10%.
- **Electronic City, Bangalore**

  Company intends to develop an integrated township in Bangalore with a built up area of 12 mn sq ft involving two SEZs, hotel or mall and residential complexes. This is also expected to commence in two phases, with first phase of construction expected to get over by September 2011 and second phase by September 2014. We have assumed a lease model for SEZs, hotel or mall but a sale model for residential complexes.
- **Other areas**

  Land bank at other areas has also been revised upwards, primarily in Hyderabad and Chennai. Company would decide on the development plans for the remaining land over a period of time.

  We have revised our land bank valuations based on the development details for first phase and incorporated the value of remaining land based on prevailing rates in respective areas. We arrive at Rs.521 per share for entire 1000 acres.

Valuation and recommendation

At current market price of Rs.806, the stock is trading at 33.8x on P/E multiples and 17.6x on EV/EBITDA multiples on FY09 estimates. Adjusted with the subsidiary and land bank valuations, it is trading at 14.8x and 11.4x on P/E multiples on FY08 and FY09 estimates. We recommend BUY with a price target of Rs.964 based on the sum of DCF value of the core business, subsidiary valuation and land development valuations arrived through NPV methodology on FY09 estimates.

Target price based on Fy09

	(Rs)	Methodology
Core business valuation	429	Valued at 18x FY09 earnings
Subsidiary valuation	14	Relative valuations
Land valuation	521	NPV
Total (Rs)	964	

Source: Kotak Securities - Private Client Research

Summary table - Standalone

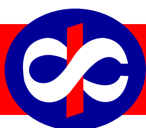
(Rs mn)	FY07	FY08E	FY09E
Revenues	11,036	14,951	18,597
% change YoY		35.5	24.4
EBITDA	1,512	2,026	2,585
% change YoY		34.0	27.6
Other Income	80.0	80.0	80.0
Depreciation	273	393	450
EBIT	1,319	1,713	2,216
% change YoY		29.9	29.3
Net interest	109	150	184
Profit before tax	1,210	1,563	2,032
% change YoY		29.2	30.0
Tax	129	469	610
as % of PBT	10.6	30.0	30.0
Profit after tax	1,081	1,094	1,422
Shares outstanding (m)	59.7	59.7	59.7
EPS (reported) (Rs)	18.1	18.3	23.8
P/E (x)	44.5	43.9	33.8
EV/EBITDA (x)	30.0	22.5	17.6

Source: Company & Kotak Securities - Private Client Research

Real estate development plan

City	Area (acres)
Hyderabad	640
Chennai	232
Mumbai	6
Bangalore	85
Mysore	21
Panvel	20

Source: Company



JUBILANT ORGANOSYS LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 302** | **TARGET PRICE: Rs. 360**

7 December 2007

Awadhesh Garg

Jubilant entered into Drug Discovery partnership with Forest Laboratories, USA

Jubilant Organosys Ltd (through its wholly owned subsidiary Jubilant Biosys Ltd) has entered into a collaborative agreement with Forest Laboratories, USA, to discover small molecule drug candidates for a novel metabolic disorders target. As per the terms of the agreement, Forest will give the target to Jubilant Biosys and then Jubilant will conduct the drug discovery work which will include development of hits-to-lead and optimization of leads. This discovery program will take around 26 months and will cover two aspects of metabolic disorder viz. obesity and diabetes.

Forest will have responsibility for the subsequent pre-clinical and clinical development and will own the drugs discovered under the collaboration with unencumbered worldwide commercialization rights. Forest will pay Jubilant certain milestone payments (not disclosed) towards research funding, development and commercialization milestones.

We believe with this agreement, Jubilant Biosys will be able to leverage its innovation capabilities in drug discovery and preclinical development while Forest will be able to get the access of India advantage viz. much lower cost of drug discovery and development and high chemistry skills.

We expect robust sales growth led by higher CRAMS contribution

We expect sales growth of 35% for FY08 and 20% for FY09. The higher growth in FY08 sales is due to the acquisition of Hollister-Stier Laboratories, USA. In the past, the revenue was driven by the specialty chemicals business, but from this year we expect the product mix to shift towards CRAMS and, to a lesser extent, API. This is consistent with management's strategy to reduce cyclicality in its chemicals business and move up the value chain. We expect the specialty chemicals business to grow at a slower pace from this year, as the company evolves as a dedicated CRAMS provider.

…CRAMS order book at US$ 60mn

The company has added custom research and manufacturing services (CRAMS) contract worth US$33mn to its 2007 order book, taking total order book size to US$60mn. Ninety percent of the contracts are from drug firms based in regulated markets of the US and Europe. With growing confidence of global life science companies in Jubilant's capability to partner and service them, the company is expected to sign more such contracts over the next few months as the talks are in advanced stage with several other global life sciences companies for CRAMS.

At present, Jubilant is catering to more than 130 global customers with more than 150 products used in 229 APIs and 17 agrochemicals. It has further strengthened the portfolio of intermediates used in NCEs undergoing Phase I, II and III clinical trials and has added new products to existing portfolio.

Outsourcing opportunity in India is expected to grow to 5 times to US$3.7bn by 2010 largely driven by huge growth in contract manufacturing and custom chemical synthesis. We believe that, being the second largest company in CRAMS space in India, Jubilant is all set to benefit significantly from this growing opportunity.

…Drug discovery services to gain further traction

Jubilant forayed in the drug discovery services business in 2002 by setting up Jubilant Biosys to provide bio/chemo informatics databases to drug discovery companies for their early-stage lead generation programs. Jubilant Chemistry provides medicinal chemistry services for lead optimization in new chemical entities development. In the current environment, most of the drug discovery work is concentrated in the US. With an emphasis on accelerating the drug development process, the drug discovery companies are collaborating with CROs to outsource part of the drug development work. We expect that Jubilant's drug discovery business to grow at 30% CAGR to Rs3.15bn in FY09 from Rs1.27bn in Fy07.

Non-Pharma business to witness moderate growth with sustained cash flow

While the P&LS business should be the key growth driver going forward, we expect non-pharma business (industrial and performance chemicals) would provide sustained cash flow required for the company's growth plans. Importantly these businesses do not involve much additional investment. Overall, we expect sales CAGR of 5% for the next two year.

We expect margins should improve going forward in Industrial chemicals business due to downward trend in molasses prices (main raw material) due to increase in sugarcane acreage, high level of integration with APIs/CRAMS business and improved margins from increased exports to South East Asia, Middle East and Europe.

Hollister acquisition to strengthen CRAMS business significantly

Jubilant had acquired Hollister-Stier Laboratories, a US-based contract manufacturing company for a sum of US$122.5mn. Hollister is a profitable company with high growth outlook. We believe that acquisition significantly strengthens Jubilant's global CRAMS business via entry into the high barrier Injectable segment. It will give Jubilant a ready entry into contract manufacturing of Injectables and presents a compelling business opportunity, especially in the US market. It also brings with it, a high quality, steady cash flow Allergy extracts and products business. We expect Hollister business to grow at 40% CAGR over the next two years.

Expanding customer base

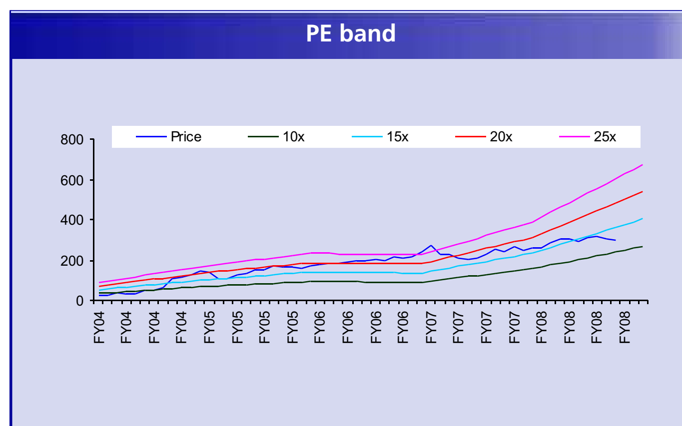
Jubilant has a strong customer base, serving 15 of the top 20 pharmaceutical companies and seven of the top agrochemical companies globally. It is also making progress in its drug discovery and development services businesses, having signed a five-year multi-target agreement with a major pharmaceutical company, which further demonstrates its research capabilities.

Valuations and Recommendation

For FY08, we have modeled revenue growth of 35%, 80bps margin expansion on products mix and acquisition synergies (18.5% EBITDA) and 88.1% growth in net profit. We estimate an EPS of Rs26.9 and Rs21.7 for FY08 and FY09, respectively. The EPS in FY09 likely to be lower due to equity dilution. At current market price Rs.302, the stock is trading at 11.2x FY08 and 13.9x FY09 expected earnings. We maintain BUY with the target price Rs360.

Key risks and concerns

- Failure of new molecule during clinical trials/studies
- Integration risk
- Rising competition in CRAMS space
- Pricing pressure in the generics APIs and/or formulation business
- Molasses (raw material) price fluctuation

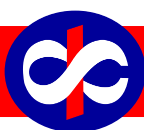


Source: Kotak Securities - Private Client Research

Summary table

(Rs mn)	FY07	FY08E	FY09E
Net Sales	18,097	24,335	29,211
Growth (%)	20.7	34.5	20.0
EBITDA	3,194	4,502	5,550
EBITDA margin (%)	17.7	18.5	19.0
Net profit	2,241	4,215	3,889
Net Margin (%)	12.4	17.3	13.3
EPS diluted (Rs)	15.6	26.9	21.7
Growth (%)	72.3	72.7	(19.3)
DPS (Rs)	1.3	1.3	1.3
RoE (%)	25.9	32.9	16.9
RoCE (%)	14.4	18.0	15.4
EV/Sales (x)	2.4	1.8	1.1
EV/EBITDA (x)	13.7	9.8	5.8
P/E (x)	19.4	11.2	13.9
P/BV (x)	4.0	2.9	1.8

Source: Company & Kotak Securities - Private Client Research



NICHOLAS PIRAMAL INDIA LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 316** | **TARGET PRICE: Rs. 385**

11 December 2007

Awadhesh Garg

Another milestone; NPIL gets product patent for CDK inhibitors compound

Nicholas Piramal has secured product patent from US Patent & Trademark office for its Cyclin-Dependent Kinase (CDK) inhibitors compound. The granted claims of the patent cover the novel compounds, including Nicholas' clinical candidate P-276-00 in multiple myeloma, and processes for their preparation. These compounds are in various stages of development as therapeutic agents useful in the treatment of cancer.

Earlier, the company has been granted a patent in South Africa for its CDK inhibitors. The company has related national phase applications in 14 other countries and has filed five other patent applications covering different aspects of its CDK inhibitors.

NCE Research pipeline seems robust

Nicholas has witnessed significant traction in its discovery research pipeline during the last few years. The company's NCE pipeline has expanded from five compounds in 2002 to 13 compounds in 2007, out of which four are in clinical trials. It has recently received approval from USFDA for its IND application for P276 (a lead cancer compound), which is currently undergoing Phase-I clinical trials in India and Canada. With this approval, the company will soon commence clinical trials for multiple myeloma - a devastating type of cancer - in collaboration with Harvard Medical School and Dana Faber Cancer Centre, US. The company expects to have eight compounds in clinical trials by the end of the current financial year.

Nicholas' focus areas are cancer (CDK-4 inhibitors), diabetes, inflammation (TNFa) and infectious diseases. It is also working on pro-drugs, mainly in the area of NSAIDs like aspirin and diclofenac. It has one NCE and two phyto-pharmaceutical products in the clinic currently. Overall, it seems the company is progressing very well in its NCE research endeavors.

NCE Research Pipeline

Compound	Target	Therapeutic	Stage	Mkt Size (US$ bn)
P-276	CDK-4	Oncology	Phase II	2.7
NPS31807	TNF-a	Inflammation	Phase II	0.3
NPH30907	Dermato-phytes	Anti-Infective	Phase II	0.1
NPB-001-05	Bcr-Abl	Oncology	Phase I/II	1.6
P-1446	CDK-4	Oncology	Pre Clinical	2.7
Pxxx	HIF-a	Oncology	Pre Clinical	1.0
Microbial Leads	General	Oncology	Pre Clinical	1.1
P-979	TNF-a	Inflammation	Pre Clinical	7.5
Back ups	TNF-a	Inflammation	Pre Clinical	7.5
P-1539	NSAID	Inflammation	Pre Clinical	0.8
In-licensed from Eli Lilly	NA	Diabetes	Pre Clinical	
P-1736	Non PPAR	Diabetes	Pre Clinical	4.5
PM-181104	MRSA/VRE	Anti-Infective	Pre Clinical	0.5

Source - Company

Struck in-licensing deal with Merck

Nicholas has recently signed an R&D collaboration agreement with MSD pharmaceuticals Pvt Ltd, the Indian subsidiary of Merck & Co., US for discovering and developing new drugs for two selected targets provided by the Merck. According to the agreement, Nicholas will be responsible for carrying out an integrated drug discovery program from hits to leads through pre-clinical candidate selection, followed by Investigational New Drug (IND)-enabling non-clinical studies and human clinical trials demonstrating proof-of-concept primarily for oncology. Merck will have an option to advance the most promising drug candidates into late stage clinical trials and to commercialize these drug candidates.

Nicholas will be eligible to receive milestone payments associated with progress in the development of drug candidates of up to US$175 mn per target, plus royalties on sales of any products resulting from the collaboration.

Demerging NCE research into separate entity

The company is demerging its NCE R&D unit into a separate company. We believe the company has taken a decision to separate its NCE research due to a variety of reasons, namely, huge capital investments, long gestation period, risk of failure and investors' impatience when this process is underway. In our view, the demerger will enable NPIL to pursue independent funding strategies, isolating it from any shocks, like failure of drug candidate.

The company can even consider inducting a strategic investor in the R&D entity, while the promoter retains control over the main company. NPIL will be able to devote resources to its mainstay businesses, namely, custom manufacturing and branded formulations. After the listing of the R&D entity, valuations will run independently; and investors with a greater risk appetite can choose to stay with the R&D business. Even if one new drug with a sizeable target market becomes a commercial success, these investors will be rewarding handsomely. Source : Company press release

NPIL profitability to improve after demerger

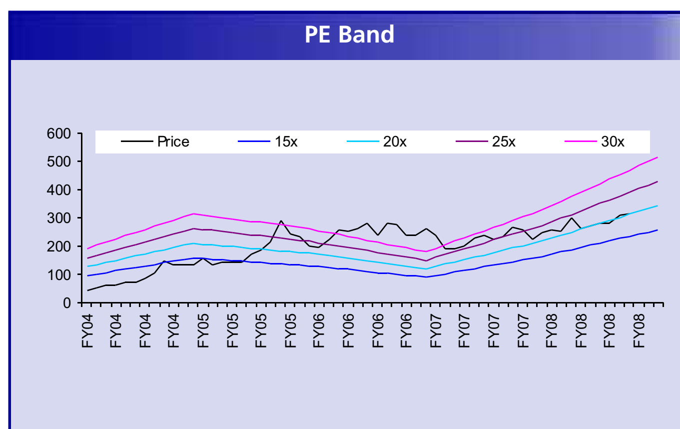
NPIL will recover revenue expenditure on NCE research of Rs.730 mn for FY08 from NPRC. This will improve the profitability of NPIL. We now expect operating profit margin of 17.5% in FY08 and 18% in FY09. EPS is likely to go up to Rs.17.2 and 21.4 from Rs.14.6 and 18.2 for FY08 and FY09, respectively. R&D operating expenditure is likely to come down to Rs.1.0 bn from Rs.1.7 bn in Fy08.

Valuations and recommendation

We expect the company to register a 19% and 40% consolidated revenues and earnings CAGR over FY07-09E, respectively. The company has posted an EPS of Rs.10.9 in FY07 and we expect EPS to grow by 57% and 25% to Rs.17.2 and Rs.21.4 in FY08 and FY09, respectively. In our estimates, we have not considered potential milestones payments associated with progress in the development of drug candidates (based on probability) from the Merck deal.

At the current market price of Rs.316, the stock is trading at 18.4x FY08 and 14.8x FY09 earning estimates and 10.3x FY09 EV/EBIDTA. Nicholas remains our top pick in the CRAMS space and we maintain BUY with target price of Rs.385. At our target price, the stock will be trading at 18x FY09 earning estimates.

PE Band

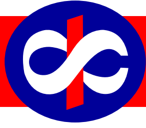


Source: Capitaline, Kotak Securities - Private Client Research

Summary table

(Rs mn)	FY07	FY08E	FY09E
Sales	24,386	29,666	34,426
Growth (%)	52.9	22.6	16.0
EBITDA	3,501	5,192	6,197
EBITDA margin (%)	14.4	17.5	18.0
Net profit	2,283	3,591	4,475
Net Margin (%)	9.4	12.1	13.0
EPS diluted (Rs)	10.9	17.2	21.4
Growth (%)	83.3	57.3	24.6
DPS (Rs)	3.5	3.5	3.5
RoE (%)	21.7	29.4	29.4
RoCE (%)	18.4	22.1	23.3
EV/Sales (x)	2.4	2.3	1.9
EV/EBITDA (x)	16.5	13.0	10.3
P/E (x)	28.9	18.4	14.8
P/BV (x)	5.0	5.0	3.9

Source: Company & Kotak Securities - Private Client Research



ALEMBIC LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 89** | **TARGET PRICE: Rs. 130**

11 December 2007

Awadhesh Garg

UCB announces positive Phase-III trial results for Keppra XR; positive for Alembic

UCB recently announced results of a Phase-III clinical trial demonstrating that its antiepileptic drug in development Keppra XR(TM) (levetiracetam) extended-release tablets significantly reduced partial onset seizure frequency when administered as adjunctive therapy for adults with refractory epilepsy. We believe this development is positive for Alembic since it has licensed its novel drug delivery system (NDDS) platform technology to UCB for developing the extended release version of its blockbuster anti-epileptic drug Keppra (twice-a-day dose).

This data, which was presented at a scientific exhibit at annual meeting of the American Epilepsy Society, Philadelphia, shows that the once daily, extended-release formulation of Keppra® reduced the frequency of partial onset seizures in patients with uncontrolled epilepsy and was generally well tolerated. The Phase-III, multi-center, randomized, double-blind, placebo-controlled study evaluated efficacy, safety, and tolerability of extended-release levetiracetam tablets (2x500 mg) once-daily as adjunctive therapy in 158 refractory epilepsy patients, 12 to 70 years of age, with partial onset seizures.

UCB is in the process of submitting a new drug application (NDA) for the use of Keppra XR(TM) in the adjunctive treatment of partial onset seizures in adults with epilepsy to the USFDA.

Alembic's epilepsy drug delivery deal with UCB first ever and lucrative

Alembic has licensed its novel drug delivery system (NDDS) platform technology to bio-pharma major UCB for developing the extended release version of its blockbuster anti-epileptic drug Keppra (twice-a-day dose). The extended release (XR) version of UCB's Keppra (levetiracetam) is currently in Phase-III trials, which has shown positive results recently. The drug promises to offer full 24 hours of protection to epileptics when it hits the market towards late 2008 or early 2009. According to the terms of the deal, Alembic will receive a milestone payment of US$11 mn and royalty on global sales of Keppra XR. Source : Company press release

We believe that with milestone payments of US$11 mn and low to mid single-digit royalty, the deal may seem a drop in the ocean to heavyweight UCB (whose 2006 revenue hit •2.5 bn) but is much more significant for the Alembic. Alembic is currently working on three to four such NDDS-based products.

Alembic has invested significantly in creating infrastructure

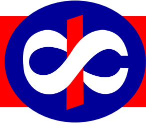
Alembic has invested heavily in setting up infrastructure for contract manufacturing and exports to regulated markets. It has initiated dialogue with global pharmaceutical companies and managed to bag a few contracts in the process. It is close to signing a manufacturing deal with an innovator company from Europe, where it will supply intermediates and the innovator will make the drug from these supplies.

The company has decided to work on three models. In the first model, it is getting manufacturing contracts for medicines or for complex compounds, or APIs required to make drugs. In the second model, it has become suppliers to these companies. In the third model, the company is collaborating with marketing companies abroad to sell its products on a profit sharing basis. We believe the company is passing through the consolidation phase where it has started capitalizing its expansion carried out in past four years.

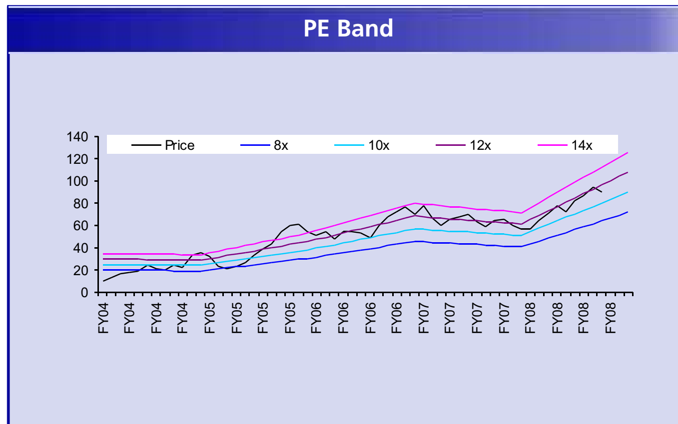
Valuations and recommendation

We expect 23% and 45% compounded growth in revenues and earning over the next two years. For FY08, we have modeled revenue growth of 37.1% and earning growth of 77.1%. We estimate an EPS of Rs.9 and Rs.10.7 for FY08 and FY09, respectively.

At the current markets price of Rs.89, the stock is trading at 9.8x FY08 and 8.3x FY09 earning estimates. We are maintaining our DCF-based one-year target price to Rs.130, which provides potential upside of 46% from current market price. At our target price, the stock will be valued at 8.5x FY09 EV/EBIDTA and 12x FY09 earnings multiple. We maintain BUY.



PE Band

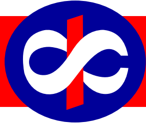


Source: Capitaline, Kotak Securities - Private Client Research

Summary table

(Rs mn)	FY07	FY08E	FY09E
Revenues	6,946	9,531	10,614
Growth (%)	9.0	37.4	11.1
EBITDA	1,158	1,878	2,162
EBITDA margin (%)	17.2	20.2	21.0
Net profit	707	1252	1485
Net Margin (%)	10.5	13.5	14.4
EPS (Rs)	5.1	9.0	10.7
Growth (%)	(10.0)	77.1	18.6
DPS (Rs)	1.0	1.0	1.0
RoE (%)	19.6	28.5	26.5
RoCE (%)	11.9	20.8	20.9
EV/Sales (x)	1.7	1.5	1.2
EV/EBITDA (x)	10.1	7.4	5.9
P/E (x)	17.4	9.8	8.3
P/BV (x)	2.6	2.5	2.0

Source: Company & Kotak Securities - Private Client Research



VISHAL RETAIL

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 740** | **TARGET PRICE: Rs. 861**

13 December 2007

Rohit Ledwani

Vishal Retail is one of the leading players in the value retail segment. It operates 50 stores in 18 states spread over 1.26 mn sq ft. The company recently went public and raised Rs.1.1 bn to fund its future expansion plans. It operates mainly in the hypermarket segment and most of it sales are of apparel.

The company's revenue has grown at a CAGR of 86% between FY03-FY07 and net profit at a CAGR of 160% over the same period. Going forward, we estimate the high growth to continue. We are positive on the prospects of the company given its strong foothold in Tier-II and Tier-III cities. The company's operating margins are higher at 11.1% mainly due to lower costs of rentals and share of private and quasi private labels. The company plans to aggressively expand in Tier-II and III cities. We estimate the company will operate 2.1 mn sq ft of space by FY08. We feel this expansion will further strengthen the presence of the company in smaller cities and will significantly add to its revenues and profits. It has a strong supply chain. With further expansion and economies of scale we do not see the margins coming under too much pressure, going forward. We estimate the revenues to grow at a CAGR of 72% between FY07 and FY09 and PAT to grow at a CAGR of 76% in the same period. At the current price of Rs.740, the stock discounts FY08 and FY09 earnings by 36x and 22x, respectively. We are positive on the company, and recommend investors BUY the stock with a price target of Rs.861.

First mover advantage in Tier-II and Tier-III cities

Vishal Retail's stores are located primarily in small towns and its concept is to provide quality at low costs. It has been able to develop a strong connect with the middle and lower income groups and has a strong foothold in small towns. As none of the big retailers have ventured into small cities as yet Vishal Retail has a first mover advantage and has built a strong reputation.

Low real estate costs

Since Vishal Retail's stores are located in Tier-II and Tier-III cities, it has lower real estate costs compared to other retailers who are primarily present in metro and Tier-I cities. The average rental per sq ft is only Rs.32 for Vishal Retail as compared to Rs.70 for Shoppers' Stop and Rs.50 for Pantaloons. This allows the company to achieve a higher level of profitability.

In-house brands / private labels expected to prevent margin erosion

The overall company's sales currently consist of only 10% of in-house brands and 20% of its apparel sales are of private labels. Going forward, the company wants to further increase its sales of private labels as these have higher margins. Its EBITDA margins in FY07 were 11.1% and net margins at 4.2%. With economies of scale kicking in further, we do not see these margins reducing significantly even though the company is on an expansion mode and this increase in sales of private labels will help protect its margins.

Procurement from low-cost production centers and efficient logistics

In order to keep margins stable Vishal Retail has a strong distribution network with warehouses spread across the country and has a fleet of its own trucks. The company also sources products from low cost centers such as China and has also set up an office there for sourcing.

Increasing sales of FMCG and other private labels

Sales of private labels accounted for only 10% of the total revenues in FY07, and more than 60% of revenues of the company come from apparels. However, with a view to reduce seasonality, Vishal is now focused on increasing the proportion of FMCG products sales. This is also expected to help in attracting more footfalls. As competition sets in, such measures to increase footfalls will be helpful in increasing its same store growth. In order to nullify the dip in margins due to sales of FMCG products, Vishal has its own private labels for products such as toothbrushes etc.

Valuation and recommendation

The current price discounts FY08 earnings by 36x and FY09 earnings by 22x. We estimate sales to grow at a CAGR of 72% between FY07 and FY09 and PAT to grow at a CAGR 76% in the same period. We value the stock on a P/E multiple of 25(x) based on FY09 earnings giving it a discount to Pantaloon, owing to the fact that it is the leader in the hyper market segment and Vishal being relatively smaller. We recommend investors BUY with a price target of Rs.861.

Risks and Concerns

- High inventory level: Last year the inventory days of Vishal Retail shot up to 151 days. Such high levels of inventory block up working capital and also will have to be sold at low prices or written off on a later date. We have assumed the inventory days to decline going forward as in FY07 the inventory was higher due to SAP implementation and piling of inventory for new stores.
- Competition: As other companies expand their presence in Tier-II and Tier-III cities Vishal may have to face competition, going forward.
- Staff costs: With growth in the sector, the company will now have to spend more on retaining its employees and high staff costs can impact margins, going forward.

Company Background and management

Promoted by Ram Chandra Agarwal.

Vishal Retail is one of the leading players in the value retail segment. It operates 50 stores in 18 states spread over 1.26 mn sq ft. The company started off as a retailer of readymade apparel in Kolkata in 2001. Vishal has a diversified portfolio of offerings ranging from readymade garments to FMCG products, household products, groceries, toys, footwear etc.

The company either manufactures products in-house or procures them directly from manufacturers to reduce costs and achieve economies of scale. Vishal Retail has got a manufacturing plant in Gurgaon and seven distribution centers across the country. The company has a fleet of owned trucks in order to maintain an efficient logistics system. Out of its 50 stores, 43 are located in Tier-II and Tier-III cities. The company operates its stores under the brand name 'Vishal Mega Mart'.

Vishal Retail plans to further expand its base of 50 stores covering 1.26 mn sq ft to 2.1 mn sq ft in FY08. A total of 22 new stores will be funded from the money raised in the IPO and the balance from internal accruals. Out of these 22 new stores, 18 will be opened in Tier-III cities, one in a Tier-II city and the remaining three in Tier-I cities. The company wants to strengthen sales from its private labels by expanding its manufacturing and importing products from low-cost locations like China, thereby achieving superior profitability, going forward.

Investment Argument : Tremendous growth opportunities in organized retail in small cities

With most retail companies focusing on metro and Tier-I cities, Vishal has decided to concentrate on smaller towns and cities. It is a strategy that has benefited the company immensely. With hardly any presence of organized retailers in these cities, we believe Vishal will stand to benefit immensely as the population of these cities are becoming more aspirational and are willing to spend in such stores. Vishal will have a first movers advantage in these cities and will help it get a strong foothold in these cities before any competition sets in and will become a dominant retailer in these cities

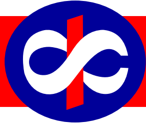
This strategy has also helped the company to have strong margins as the capex costs as well as lease costs are significantly lower as compared to metro and Tier I cities. With its first mover advantage Vishal has built a successful model and in just five years created a strong brand for itself.

Strong player in value retail segment

Vishal's retail business works on the 'value retailing' concept - providing quality products at low prices. Vishal has been able to develop a strong customer connect with its target segment of middle and lower middle class consumers.

In our opinion, the company has been able to provide these because of its relatively lower costs in the form of lower rents and also it's sourcing capabilities. The company has a strong back end supported by distribution centers and transport facilities spread across the country. It has close to 0.8 mn of warehousing space. The company's focus on private and quasi private labels has ensured higher margins for the company and low prices for the consumer.

Focus on all aspects such as manufacturing, private/quasi private labels, supply chain, low cost of rentals has ensured that Vishal Retail always provided consumers with quality at low costs and has built a strong reputation in this segment.



Procurement from low-cost production centers and efficient logistics

In order to obtain cost efficiencies, Vishal Retail already procures and intends to increasingly procure products from low-cost production centers across the globe. In India, for example, it sources shirts from locations such as Tirupur and uses its strong distribution network to obtain cost savings.

Rather than focusing on national private labels, Vishal stocks quasi private labels. This gives Vishal Retail more bargaining power as such brands are localized, are directly procured from the manufacturers, in turn have higher margins. In FY07, these labels contributed to 72% of sales.

It also sources a few products from low cost locations like China. It has set up a sourcing office in China, which is helping in overall sourcing for the company. Efficient sourcing, along with a strong distribution network is one of the key strengths of Vishal Retail.

Approximately 5% of the products of the company are imported. This figure however will increase as Vishal increases scale. Sales of products that are imported from destinations like China have higher margins. This will also prevent margins from coming under pressure as the company expands its presence.

The company also set up SAP for better inventory management. This will ensure working capital is not locked up in inventory as well as stocks are replenished just in time to ensure shelves are always stocked and costs are kept to the minimum.

Presence in Tier-II and Tier-III cities, low real estate costs

Vishal Retail operates and aims to expand, primarily in Tier II and Tier III cities where the penetration of organized retail is very low. This strategy reduces the cost of running a store as rentals in these towns are relatively low compared to a Tier I city.

Also, big retailers like Pantaloon and Shoppers' Stop do not have any significant presence in these Tier-II and Tier-III cities. Hence, this reduces the risk arising from competition. On an average, Vishal Retail has been paying a rental of Rs.32 per sq ft for all its stores. This compares favorably with competition, which pays average rentals of Rs.50-75 per sq feet.

Out of the 1.84 mn sq ft it plans to add by FY09, Vishal Retail has already tied up for 1 mn sq ft and the remaining is in the pipeline.

Aggressive store openings - strong execution skills

Over the past four years, Vishal has expanded its stores from seven (in 2003) to 49 (in 2007). With this, Vishal has shown strong execution skills which are very essential in the retail business.

As the stores need not be located in malls, Vishal Retail is not dependent on mall developers, who generally cause delay in handing over properties. Since its stores can be stand-alone stores and real estate costs are lower in cities that it aims to operate, we feel that Vishal will be able to get real estate without any delay.

It further plans to expand its space to 2.1 mn sq ft in FY08 and to 3.1 mn sq feet in FY09. The total number of stores is expected to go up to 124 by FY09, with average store sizes being 25,000 sq ft. With strong execution skills and low real estate costs, we expect the company to perform well over the next two years. It has shown over 100% CAGR in sales over past few years and this strong growth is expected to continue going forward.

New stores opened between FY03-FY07

Year end 31st-March	2007	2006	2005	2004	2003
No. of stores at the beginning of the year	26	16	14	9	7
Stores opened during the year	27	11	4	5	7
Total stores at the end of the year	49	26	16	14	7

We have assumed the space will expand to 2.1 mn sq ft in FY08 and to 3.1 mn sq ft in Fy09.

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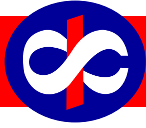


High margins

Because of low cost of sourcing and manufacturing, Vishal Retail's operating and net profit margins are higher than any of its peers. We do not see margins coming under too much pressure going forward.

Focusing on increasing sales of private labels & FMCG products

In order to increase footfalls and reduce the risk of seasonality of its products such as apparel, Vishal Retail is increasing the mix of FMCG products in its stores. This will ensure footfalls throughout the year. This, in turn, may lead to higher sales of its apparel.

However, other than private labels the company has been able to report high margins also due to the fact that most of its apparel other than the private labels are quasi brands, which have higher margins as compared to national brands. It aims to keep national brands in very low quantities going forward. The company wants to continue its focus on quasi brands to protect margins.

Vishal Retail also aims to manufacture at least 25% of its apparel requirements in-house. As of FY07, the contribution of private labels was 9.7% overall. The rise in sales of private labels could help in improving margins as well as reducing dependencies on few suppliers. This is expected to keep overall margins intact as the company is on an expansion mode

Financials

In FY07, Vishal Retail reported sales of Rs.6.03 bn, EBITDA of Rs.670 mn and PAT of Rs.249 mn. The company's revenues have grown at a CAGR of 90% between FY04 and FY07 and PAT has grown at a CAGR of 302% in the same period.

EBITDA margins have improved significantly from 3.3% in FY04 to 11.1% in FY07.

For the half year ended September 30 2007 Vishal Retail posted sales of Rs.3.85 bn and net profit of Rs.147.2 mn. EBITDA margins were at 11.5%, which are higher than the margins recorded for FY07 which stood at 11.1%. The sales/sq ft stood at Rs.2872 for the half year.

During the period under review Vishal Retail added 2509 employees, seven new warehouses spread over 0.4 mn sq ft, taking the warehouse space to 0.89 mn sq ft.

During the period under review, they also commenced operations of their garment manufacturing plant located in Dehradun, which has a capacity of 5000 units/day.

Imports as a percentage of sales also increased to 7% as compared to 5% for the full FY07.

The improvement in operating margins, we feel, is primarily due to savings accrued from low cost sourcing and improved margins on products. It is also because only one store was opened, hence there was no significant cost pressure. The share of non apparel sales increased to over 40% during this period.

Only one new store was opened during the first half of the year. However, Vishal Retail has signed MoUs for 45 new stores spanning an area of 0.99 mn sq ft.

Going forward we estimate the company's revenues will grow at a CAGR of 72% between FY07 and FY09 and net profit at CAGR of 76% during the same period. However, on the Operating margin front we estimate the margins to be 11.7% in FY08 and 10.7% in FY09, primarily because of increased competition in the retail space that it operates in, and cost pressures that could be faced during expansion going forward with increased competition.

Based on our estimates, we expect the company to report an EPS of Rs.34.3 in FY09 and we give Vishal Retail a 10% discount to Pantaloon, which is the leader in the hypermarket segment and also India' largest retailer. Based on this we value Vishal Retail at a P/E of 25(x) on FY09 earnings and recommend investors BUY with a target price of Rs.861.

Valuation & recommendation

Going forward, we estimate the company's revenue will grow at a CAGR of 72% over FY07-FY09. Net profit will grow at 76% over the same period. We value Vishal Retail on P/E of 25x, based on FY09 earnings, giving it a discount to Pantaloon. Pantaloon is the leader in the Indian retail industry and also in the hypermarket segment with its store Big Bazaar and other value retailing formats such as Brand Factory and Food Bazaar.

Vishal has grown at a scorching pace over the last few years. We feel this growth will continue, going forward. We recommend investors BUY Vishal Retail with a price target of Rs.861.

Concerns

- High level of inventory. Vishal Retails inventory days shot up from 99 to 151 days in FY07. This pile up of inventory locks up working capital and may result in the inventory having to be sold at low prices. The reason for the pile of inventory was due to implementation of SAP and for new stores.
- Staff costs. Owing to the competition in the retail sector the company will have to spend more to retain its employees and factors like attrition etc will have to be countered owing to the demand for professionals in the sector.
- Competition. Vishal had the first mover advantage in the Tier-II and III cities where it primarily operates. However, with these cities now coming under the radar of other players Vishal will have to face stiff competition

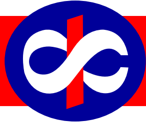
Stock details		
BSE code	:	532867
NSE code	:	VISHALRET
Market cap (Rsm)	:	16569
Free float (%)	:	36.07
52-wk Hi/Lo (Rs)	:	815/423
Avg. daily volume (m)	:	29802
Shares o/s (m)	:	22.39

Sourse:Capitaline,BSE & NSE

Summary table

(Rs mn)	FY07	FY08E	FY09E
Sales	6,027	10,589	17,853
Growth %	108.9	75.7	68.6
EBITDA	670	1,240	1,916
EBITDA margin %	11.1	11.7	10.7
PBT	393	693	1,147
Growth (%)	110.0	76.5	65.4
Net profit	250	465	768
Growth (%)	100.3	85.9	65.4
EPS (Rs)	11.2	20.7	34.3
Net cash (debt)	(2,281)	(2,954)	(4,347)
ROE %	25.0	23.1	25.0
ROCE %	21.6	19.8	21.8
Operating Cash Flow	(1,008)	140	736
Net W Capital (Days)	150.5	123.6	97.4
P/E (x)	66.3	35.7	21.6
P/BV (x)	13.1	6.0	4.9
DPS (Rs)	0.0	3.1	5.1
EV/Sales (x)	3.2	1.9	1.2
EV/EBITDA (x)	28.4	16.2	11.1

Source: Company, Kotak Securities - Private Client Research



SUZLON ENERGY

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 2010** | **TARGET PRICE: Rs. 2281**

13 December 2007

Sanjeev Zarbade

- **Hansen has completed its IPO on the LSE with an offer price of £1.75 per share, implying a market cap of £1.14 bn.**
- **The proceeds are to be used to fund ongoing capex on forgings, foundry and gear box facilities in India and China.**
- **We are raising our target price to Rs.2281 and maintain BUY.**

Hansen has a strong debut on LSE

As indicated by Suzlon in its Q2FY08 briefing, Hansen has completed the formalities for listing on the LSE. The final share price for the IPO has been fixed at £1.75 per share. Post listing, Hansen's share has been trading at GBP 2.4 per share, which reflects a total market capitalisation of GBP 1.6 billion, or Rs 129.9 bn.

Proceeds of •400 mn to be utilized to fund ongoing capex

Suzlon has current debt equity ratio of 1.6x and has a net debt of Rs.6.56 bn. Over the next 12-18 months, the company's fund requirements are likely to remain high on account of capex of Rs.26.9 bn towards capacity expansions as tabulated below. Additionally, over the next 18 months, Suzlon has to purchase stake of Areva and Martifer in REpower. The cost of purchase of Areva (likely in June-July 2008) and Martifer (likely in June/July 2009) works out to Rs.39 bn at the current price of Repower.

Fund requirement

Location	Capex (Rs mn)	Date of commissioning	Capacity
Foundry at Coimbatore	11000	Q1 FY09	120000 tons
Forging at Vadodara		Q2 FY09	70000 ton
Integrated turbine mfg plant at karnataka	15000	Q1-Q3 FY09	3000 MW
Total capex	26000		

Source: Company

Global demand environment remains strong for wind gearbox manufacturers

Hansen supplies gearboxes to Vestas, Gamesa and Siemens, some of the largest wind turbine manufacturers globally. The market for wind-mill gear boxes remains tight due to supply constraints at the component level.

Given the healthy pace of development of wind power, Suzlon plans to increase Hansen's current wind mill gearbox capacity of 3800 MW to 14300 MW over the next five years. It plans to build plants in India and China. Moreover, there exists strong potential for labor cost arbitrage as employee cost to sales at Lommel Belgium is more than 20%.

Further fund raising likely in near future

Suzlon has taken approval to raise Rs.50 bn through equity/quasi equity instruments. Out of this, it has already got Rs.20 bn through FCCB. The company may raise the balance amount in the coming months.

The proceeds of the issue are likely to be utilized for acquisition of stake in REpower. The company may acquire Areva's stake of 30.9% in the next year. While the purchase price of Areva's stake is firmed up, we estimate that at current price of REpower, the cost works out to Rs.22.8 bn.

We maintain a BUY with an enhanced price target of Rs.2281

Post the listing of Hansen, we have valued Suzlon on a sum-of-the-parts basis. Our target EV/EBITDA multiple for Suzlon's pure wind mill business is based on current FY09 EV/EBITDA for Bhel.

Sum of the parts

	(Rs mn)
Target EV/EBITDA (X) for pure wind mill business	19
EBITDA in FY09	30,763
EV	584,498
Net Debt	47,196
Implied fair value of pure wind mill business	537,302
Value of Suzlon's stake in Hansen at current market price of GBP 2.5	94,719
Value of Suzlon's stake in Repower at current market price	24,878
Total Fair Value	656,899
FV per share (Rs)	2,281

Source: Kotak Securities - Private Client Research

Global valuations

	2 Yr EPS CAGR (%)	PE (x) 2008	PE (x) 2009	EV/EBITDA (x) FY09
Gamesa	18.9	32	26.3	14.7
Vestas	52.7	54	29.7	15.7
Nordex	45.2	53.7	32	21.1
Suzlon	43.6	44.5	27.0	20.3

Source: Bloomberg

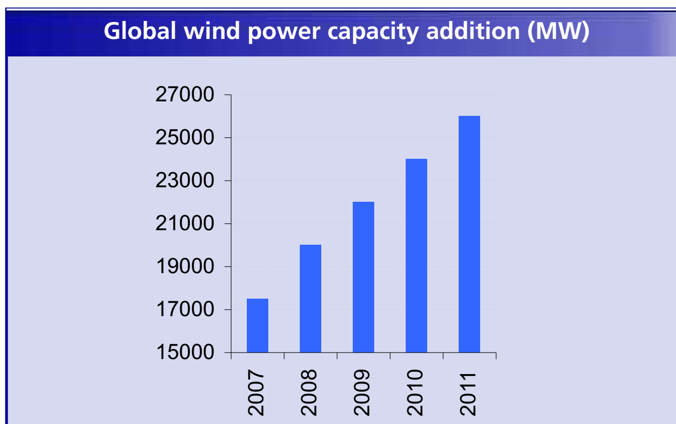
Risks

- Regulatory risk: The decrease in or elimination of government incentives to renewable energy sources, and in particular to wind energy, may have an adverse effect on the demand for wind power development.
- The PTC or production tax credit is expected to expire in the US at the end of CY08. The production tax credit (PTC) provides a 1.9-cent per kilowatt-hour (kWh) benefit for the first ten years of a renewable energy facility's operation. This PTC has been extended twice in the past. However, any adverse development on this front could be a setback for wind power in the US.

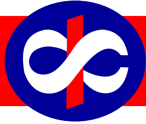
Summary table

(Rs mn)	FY07	FY08E	FY09E
Sales	79,857	131,550	193,192
Growth (%)	107.9	64.7	46.9
EBITDA	12,958	20,205	31,994
EBITDA margin (%)	16.2	15.4	16.6
Net profit (Adj)	10,001	12,636	19,111
EPS (Rs)	30.1	45.2	74.5
Growth (%)	13.7	50.2	64.9
CEPS	36	53.3	86.1
ROE (%)	28.9	33.8	39.7
ROCE %	19.3	18.4	22.5
EV/Sales (x)	7.7	4.8	3.4
EV/EBITDA (x)	47.3	31.4	20.3
P/E (x)	66.8	44.5	27.0
P/Cash Earnings	55.8	37.7	23.4
P/BV (x)	19.3	14.0	9.5

Source: Company & Kotak Securities - Private Client Research



Source: Company, Kotak Securities - Private Client Research



PVR LTD.

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 325** | **TARGET PRICE: Rs. 405**

17 December 2009

Saurabh Gurnurkar & Dipen Shah

We believe the multiplex industry is set to witness strong volume growth on the back of rising consumerism, entertainment tax exemptions, advent of organized retail and overall multiplex under-penetration in India. We opine that, PVR's dominant market share at the box-office, diversification into movie production and aggressive but selective geographical expansion plans bode well for the company's prospects. On a consolidated basis, we expect PVR to deliver 58% revenue CAGR through FY07-09E and its net profit to grow at a 99% CAGR to Rs.420.1mn by FY09E from Rs.105.6mn in FY07. This is expected to translate into a diluted EPS of Rs.8.9 in FY08E and a further Rs.17.4 in FY09E, an EPS CAGR of 94% over FY07-09E.

We have valued PVR using the two-stage DCF valuation methodology with a terminal growth rate of 4% and a WACC of 12.2%. This yields a fair value of Rs.405 for the stock on a rolling 12 month basis. We initiate coverage on PVR with a BUY.

Investment Argument

- **Conducive macro environment to spur growth of multiplexes:** We believe the multiplex industry is set to witness strong volume growth in the years to come. Rising income levels, increasing consumerism, advent of organized retail and overall multiplex under-penetration in India are expected to drive volumes for the industry. In addition to these, entertainment tax exemptions may attract more players to set up multiplexes. We believe though that industry profitability is contingent on variables like timely mall development, regulatory outlook (entertainment taxes, service tax), steady availability of quality content and the growing bargaining power of content providers (movie production houses). Given this, we opine that first movers, good executors, strong brands and evolving integrated players like PVR are likely to be better placed in a competitive marketplace

- **Dominant multiplex chain- First mover & an established brand:** PVR operates close to 95 screens in 24 locations across 14 cities. It dominates the screen count in India's multiplex industry along with Adlabs. PVR's screens pan 24 properties and have a cumulative capacity of more than 24,000 seats. PVR is also the only player to have crossed the mark of serving 14mn patrons in a year, a milestone it achieved in FY07 when it clocked 14.73mn patrons. PVR vitally, also has a dominant share at the box office with an 11-13% share of All India box office collections of leading releases.

- **Extensive expansion plans:** Through aggressive capacity expansion plans, PVR is looking at geographical diversification (beyond Delhi/NCR, its dominant pocket) and also target market broadening through its low - cost offering, PVR Talkies. PVR has aggressive expansion plans and intends to scale up its operations to 195 screens in FY09E and 248 screens by FY10E from the current 95 screens. Besides strengthening its dominance in North India, PVR has lined up aggressive expansion plans in the South and West of India as well.

- **Business diversification - PVR building presence across the value chain through production and distribution forays:** Over the recent quarters, PVR has been looking at de-risking its business model by backward integrating in the movie value chain through its fully owned sub 'PVR Pictures'. We see merit in PVR's entry into film distribution and production as integrated movie exhibition houses are better placed than standalone multiplexes in the longer term, in our opinion. It could also strengthen its bargaining power given our premise of content providers calling the shots across the value chain.

- **PVR Pictures' first film project:** 'Taare Zameen Par' - is one of the two projects being co-produced with Aamir Khan. It is slated for release in December 07. In addition to this, PVR Pictures is working on four other projects in addition to these two and is looking at releasing six-eight movies per year with a budget of Rs.100-300mn each. Given its aggressive plans to build scale in this segment over the succeeding quarters, it is likely to look at external funding options in the medium term, in our opinion.

- **Growth in estimated financials:** driven by capacity additions, tax sops and diversification: Growth in financials is expected to driven by the exhibition segment that is expected to grow at a 47% CAGR over FY07-09E to Rs.3.56bn in FY09 from the Rs.1.64bn in FY07. The nascent movie production business is expected to contribute meanfingfully to financials in FY09E, based on the current projects in hand which are to be executed in the succeeding quarters.

  Profitability is expected to be positively impacted by the higher margin production business; consolidated EBITDA margins are expected to rise to 22.1% in FY09E from the 20% expected in FY08E.

  In consolidated financials, we expect PVR to deliver 58% revenue CAGR through FY07-09E; as PVR attains scale and contribution from entertainment tax exempted properties move up, we expect PVR's EBITDA margins to improve from 15.4% in FY07 to 22.1% in FY09E. We forecast a 99% CAGR over FY07-09E in PVR's PAT to Rs.420.1mn by FY09E from Rs.105.6mn in FY07. This is expected to translate into a diluted EPS of Rs.8.9 in FY08E and a further Rs.17.4in FY09E, an EPS CAGR of 94% over FY07-09E.

Valuation & Recommendation

We have valued PVR using the two-stage DCF valuation methodology with a terminal growth rate of 4% and a WACC of 12.2%. This yields a fair value of Rs.405 for the stock on a rolling 12 month basis. We initiate coverage on PVR with a BUY; our target price provides an upside of 25% from the current levels.

At current price levels of Rs.325 the stock is currently trading at 18x FY09E earnings. On an EV/EBITDA basis the stock is currently trading at 10x FY09E EV/EBITDA. At our target price the stock will trade at 23x FY09E earnings and 12x FY09E EV/EBITDA, backed by an estimated 94% consolidated EPS CAGR over FY07-09E.

Our target valuations, thrown up by DCF methodology are in line with global peers and at a discount to the domestic multiplex basket despite a higher 2 year EPS CAGR, a diversifying business model and higher estimated profitability metrics & return ratios. BUY.

Key Concerns

- **Project execution delays:** A majority of Indian multiplex companies have been coping with unorganized retail property developers and bottlenecks on the regulatory front- multiple state and city level civic body clearances for properties. These factors have often led to significant project delays for the multiplex operators. While we are confident of PVR's ability to ramp up, project delays at the mall developers' end can definitely be not ruled out.

  In our projections we have factored in a four-five month delay in project handover to the exhibitor and our estimates for company screen count at end of FY08E & FY09E is c10% lower than management expectation.

  Delays in properties coming on stream, ahead of our factored in delay will impact exhibitor prospects and earnings estimates negatively.

- **Big studio bargaining power and content costs:** In the recent past, the movie production business has consolidated in the hands of a few big players namely Yash Raj Films, Dharma Productions, UTV, Adlabs, etc. Also these have been the players delivering the box-office success.

  In our opinion this trend entails higher bargaining power for the content provider and has led to a rise in the distributor's share of ticket collections (negative for exhibitors, c30-35% of ticket sales) - more so for the lucrative high-profile, big-budget releases. We believe this to be a significant risk for all the multiplex operators, PVR in our opinion though may possibly be better placed given its dominant presence and aggressive geographical expansion plans.

  Given this, we are positive about PVR's movie production diversification and opine efficient execution of this new initiative could ensure a decent content funnel for its core exhibition business.

- **Potential overcrowding in lucrative locations:** Pricing and occupancy- the key to exhibitor stock valuations may be impacted by possible overcrowding in certain lucrative areas. We note movie exhibition per se is a 'nil content innovation' business and most multiplexes provide a comparable service experience to consumers.

- **Lack of a steady and quality content pipeline:** Quality of movie releases directly impact occupancy and thus profitability; a poor content funnel will impact industry earnings negatively. We expect that PVR is likely to be better off given its attempts to ramp up its movie production business- routed through PVR Pictures.

- **Entertainment tax modifications:** Any move to tone down current entertainment tax benefits provided by states to exhibitors will impact player/industry profitability negatively.

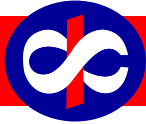
Stock details		
BSE code	:	532689
NSE code	:	PVR
Market cap (Rs mn)	:	7,869
Free float (%)	:	59.49
52-wk Hi/Lo (Rs)	:	268/148
Avg. Daily Volume BSE+NSE	:	104128
Shares o/s (mn)	:	24.21

Sourse:Capitaline,BSE & NSE

Summary table (Rs mn)

	FY07	FY08E	FY09E
Sales	1,641	2,473	4,127
Growth (%)	59.3	50.7	66.9
EBITDA	253	496	911
EBITDA margin %	15.4	20.0	22.1
Net profit	106	214	420
Growth (%)	93.1	103.1	95.9
Net cash (debt)	314	562	748
EPS (Rs)	4.6	8.9	17.4
Growth (%)	92.0	93.0	95.9
CEPS	10.0	15.4	26.0
DPS (Rs)	1.5	0.5	0.5
ROE (%)	5.4	9.6	15.8
ROCE (%)	7.7	12.5	19.4
EV/Sales (x)	5.1	3.7	2.2
EV/EBITDA (x)	32.9	18.3	10.0
P/E (x)	70.8	36.7	18.2
P/Cash Earnings	32.5	21.1	12.5
P/BV (x)	3.7	3.2	2.7

Source: Company & Kotak Securities - Private Client Research



NIIT TECHNOLOGIES LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 229** | **TARGET PRICE: Rs. 346**

18 December 2007

Dipen Shah

- Till date, no impact of the US sub-prime crisis is anticipated by NIITT's clients
- The company has not faced any scale-downs, cancellations of projects from any of the clients
- There is potential for good scale up in recent projects in the travel, transportation and logistics vertical. Pilots are under way.
- The scale-down of revenues from the insurance BPO client in Q2FY08 has not spilled over to Q3FY08
- The Adecco JV is expected to scale up fast post the likely receipt of a large order
- NIITT is hedging over a longer period with a view to restricting the impact of rupee appreciation
- We maintain our EPS estimates at Rs.24 for FY08 and Rs.28 for FY09. We maintain our price target at Rs.346. Target FY09 P/E of 12.4x.
- There has been a significant correction in the stock price post our downgrade (to HOLD) post Q2FY08 results.
- We recommend BUY in view of the recent price correction. Potential entry of a strategic partner through sale of NIIT Ltd's 25% stake in NIITT could be a positive for the stock.
- An accelerated slowdown/recession in major user economies and a sharper-than-expected appreciation in the rupee v/s major currencies are key risks.

We spoke to the management of the company recently to update ourselves on recent developments in the company. We also wanted to understand the impact, if any, of the potential US economic slowdown. The main takeaways are as under:

Revenues

- The prevailing economic conditions in the US economy have not had any impact on the company. The financial services vertical contributed about 42% to FY07 revenues.
- None of the clients of the company are directly involved in the sub-prime business in the US. They have also indicated that, as on date, they do not anticipate any impact on their operations.
- The recent wins in the travel, transport and logistics vertical have significant potential for scaling up. The company is conducting pilot projects for these clients and further projects can be expected going ahead.
- The company's JV with Adecco is in the process of negotiating a large order from one of Adecco's large clients, which is expected to significantly increase the visibility for the JV.
- Room Solution's H1FY08 revenue growth was impacted as it is in the process of transferring its solutions on a new platform. The whole process is expected to be completed by Q4FY08 post which new orders are expected to flow in.
- In BPO, one of the large clients in the insurance segment scaled down business with NIIT in Q2FY08.
- The stringency of compliance laws for financial advisors in the UK reduced significantly. This directly impacted NIIT, which was providing compliance services to that insurance company.
- The scale-down was completed in Q2FY08 and revenues have stabilized at those reduced levels. There are no other instances of scale-downs in projects due to regulatory changes.
- With a view to restrict the impact of the appreciating rupee, the company has increased its hedges and now covers the next 15 to 18 months of receivables as against 12 months earlier.

Margins

- EBIDTA margins during Q2FY08 were sustained at Q1FY08 levels. This was despite the increase in employees, some salary hikes and the rupee appreciation.
- The company reduced the proportion of employees employed on-site and also initiated other cost control initiatives, which allowed it to protect margins.
- We believe the company should be able to improve the margins in H2FY08 as the impact of salary increases wanes and the company adopts more cost control initiatives.

Future prospects

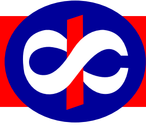
(Rs mn)	FY07*	FY08E	% chg	FY09E	% chg
Revenues	8,859	9,465	6.8	11,268	19.0
Expenditure	7,057	7,628		8,960	
EBDITA	1,802	1,837	1.9	2,308	25.6
Depreciation	434	445		620	
EBIT	1,368	1,392	1.8	1,688	21.3
Other Income	148	226		245	
PBT	1,516	1,618	6.7	1,933	19.5
Tax	185	208		290	
PAT	1,331	1,410	5.9	1,643	16.5
Minority interest	36	3		0	
PAT after M I	1,295	1,407		1,643	
Shares (mn)	39.1	58.7		58.7	
EPS (Rs)	33.1	24.0		28.0	
Margins (%)					
EBDIT	20.3	19.4		20.5	
EBIT	15.4	14.7		15.0	
Net Profit	15.0	14.9		14.6	

Source : Company, Kotak PCG   ** - consolidation of ROOM WEF 8/5/06*

- We maintain our earnings estimates. We have assumed the rupee will end FY08 at Rs.39 per US dollar and FY09 at Rs.38.50 per US dollar.
- We expect BPO revenues to grow to Rs.612 mn in FY09 v/s Rs.553 mn in FY07. IT services revenues are expected to cross the Rs.10-bn mark in FY09.
- EBIDTA margins are expected to improve from Q2FY08 levels due to improved utilization levels, improvement in BPO margins and improved performance of ROOM in addition to leverage on SG&A expenses.
- Net profits are expected to grow to Rs.1.41 bn in FY08 and Rs.1.64 bn in FY09, translating into earnings of Rs.24 and Rs.28, respectively.

Concerns

- Rupee appreciation beyond our assumed levels could provide a downward bias to our earnings estimates.
- A steep deceleration/recession in major global economies could impact revenue growth of NIITT.



LIC HOUSING FINANCE LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 335** | **TARGET PRICE: Rs. 450**

19 December 2007

Sarika Lohra

We expect the growth rates in LICHF's loan book to pick up (CAGR of 22% over FY07-09E) and the company's asset quality to improve going ahead. The company has completed its business restructuring, streamlined its credit appraisal methodology and geared up its recovery management systems. These, along with decent return ratios should lead to a re-rating of the stock, in our opinion. At the current market price of Rs.355, the stock trades at 8.6x its FY09E EPS of Rs.41.4, and 1.5x its FY09E adjusted book value of Rs.244. Our valuation methodology places equal weightage on DDM and PBV(x) leading to a fair price target of Rs.419. Adding Rs.31 per share for its 39.5% stake in LIC Mutual Fund, we arrive at a fair price of Rs.450 for LICHF. Thus, despite the recent run up in the stock we recommend a BUY on the stock with 12-month price target of Rs.450, an upside of 27% from current levels.

Investment Rationale

- Strong macro fundamentals to support business growth: Lower penetration of 6%, rising disposable income and increasing demand for housing remain the key driver for the growth of the mortgage finance industry. Moreover, moderating competition from banks is an added advantage for HFCs. In light of the positive macro fundamentals, we expect LICHF to witness a 22% CAGR growth in its loan book to Rs.250 bn over FY08-09E

- Banks reducing exposure to mortgage finance: Leading banks in India have switched to a passive approach towards the home loan segment. Since ICICI Bank and SBI which controled over 41% of the total market share in mortgage finance segment indicated signs of slow down in their dispursement growth in FY07. This is following the increase in delinquencies due to higher interest rates. The housing loan portfolio also have lost attractiveness for bank's since RBI increased the risk weightage on the housing loan segment.

- Improved recovery mechanism leading to enhancement of asset quality: The Company has streamlined its credit appraisal methodology to keep a check on defaults and strengthened its recovery management mechanism. The move is expected to improve the company's asset quality. We expect NNPA to come down to 0.7% in FY09E as against 1.3% in FY07.

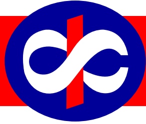
- Efforts to contain cost of funds facilitated improvement in NIMs: Effective measures to contain cost of funds by way of use of synthetic swaps and a balance of fixed and floating liability has helped the company improve its NIMs. LICHF has also initiated a fixed deposit (FD) scheme to check risking cost of funds. We expect NIMs to improve to 2.7% over FY08-09E as against 2.5% in FY07.

- Capital infusion to boost CRAR and reduce leverage: The Company is expected to infuse close to Rs.5 bn by way of preferential issuance of shares. This move has been considered in order to ramp up its capital risk adequacy ratio (CRAR), and to also check its increasing leverage. We expect this to lead to around a 13% equity dilution. We have factored in dilution at Rs.355 (based on Sebi formula). The CRAR of the company will increase to 21% post dilution.

- Decent return ratios to support valuations: The net profit of the Company is expected to grow in-line with the growth in advances. We expect the net profit of the company to growth at a CAGR of 21% over FY08-09E, which would support return ratios. We believe that post dilution, the company's return ratios are likely to remain firm with a RoA of 1.7% over FY08-09E, while RoE is likely to stabilize at around 17% over next two years. Decent return ratios normally yield attractive valuations for the stock.

Valuation

Given the improving fundamental, the business outlook for the company remains attractive. We expect business to demonstrate a CAGR of 22% over FY07-09, while the bottomline of the company is expected to grow by 20% and 22% over FY08 and FY09 to Rs3.35bn and Rs4.09bn respectively. Due to the equity dilution, EPS growth will remain moderate for the company at Rs 34 in FY08 before increasing to Rs 41 in FY09. We believe the strong return ratios and improving asset quality would lead to a re-rating of the stock. Our valuation methodology places equal weightage on DDM and PBV(x) leading to a fair price target of Rs.419. The value of 39.5% stake in LIC Mutual Fund, would add Rs.31 to our fair value estimate. Based on this, we have arrived at a fair price for LICHF at Rs.450. At the current market price of Rs.380, the stock trades at 8.6x its FY09E EPS of Rs.41.4, and 1.5x its FY09E adjusted book value of Rs.244. Hence, despite the recent run up in the stock we recommend a BUY on the stock with 12-month price target of Rs.450, with an upside of 27% from current price.



Risks and Concerns

- **Intense Competition with banks and HFC's:** LICHF currently has a 6% market share in the housing finance segment. The major market is controlled by banks and other HFCs. Aggressive moves by competitors to increased market share would lead to a loss of market share for LICHF and can also impact the Company's margins.
- **Delayed or sticky recoveries to impact asset quality:** Delay in recoveries from bad loans can affect the company's asset quality, which, in turn, can lead to higher than expected loan loss provision and might affect the company's valuations.
- **Down turn in housing industry:** Since LICHF is catering particularly to the housing industry, any downturn in the housing industry would lead to increase in slippages would impact its future business growth.

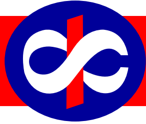
Stock details		
BSE code	:	500253
NSE code	:	LICHSGFIN
Market cap (Rs bn)	:	302
Free float (%)	:	59.5
52-wk Hi/Lo (Rs)	:	295/376
Avg. daily volume BSE	:	178748
Avg. daily volume NSE	:	421158
Shares o/s (mn)	:	85

Sourse:Capitaline,BSE & NSE

Summary table (year end Mar)

Rs bn	FY06	FY07	FY08E	FY09E
Interest Income	11.9	15.0	20.2	24.6
Interest expenses	8.5	11.0	15.0	18.2
NII	3.4	4.0	5.2	6.4
Non-Int Income	0.8	0.8	1.0	1.2
Total Income	4.1	4.8	6.2	7.6
Optg Profit	3.2	3.7	4.9	6.0
PAT	2.1	2.8	3.4	4.1
Gross NPA (%)	3.40	2.57	2.16	1.85
Net NPA (%)	1.80	1.32	0.96	0.67
NIMs (%)	2.5	2.5	2.7	2.7
RoA (%)	1.5	1.7	1.7	1.7
RoE (%)	16.4	19.3	17.5	16.8
Divi. Payout Ratio (%)	27.2	26.1	27.3	27.1
EPS (Rs)	24.5	32.9	33.9	41.4
BV (Rs)	158.3	181.6	231.6	261.8
Adj. BV (Rs)	126.8	154.5	210.7	244.3
P/E (x)	14.5	10.8	10.5	8.6
P/ABV (x)	2.8	2.3	1.7	1.5

Source: Company & Kotak Securities - Private Client Research



COLGATE-PALMOLIVE (INDIA) LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 390** | **TARGET PRICE: Rs. 474**

19 December 2007

Chetan Shet

Colgate Palmolive (India) Ltd (CPIL) is the largest and only focused player in the Indian oral care space. The company has an impressive product offering, operates across all the price points and enjoys a strong pan-India presence. Low penetration levels of oral care and growing awareness in the semi-urban and rural Indian markets offer a huge growth potential. CPIL has consciously undertaken rural initiatives and entered into strategic tie-ups to increase its reach in lowly penetrated areas.

We are projecting the net profits to grow to Rs.2.38 bn in FY08E and to Rs.2.83 bn in FY09E. This delivers an EPS of Rs.17.5 and Rs.20.8 in FY08E and FY09E respectively.

We have valued the stock on DCF Valuation methodology with a terminal growth rate of 4% and WACC of 12% yielding a price target of Rs.474 over the 12 month period. The stock should earn Rs.20.8 per share in FY09 and is attractively priced at 19x FY09E earnings.

Hence, we recommend a BUY on the stock with a price target of Rs.474 over a 12-month period.

Key investment rationale

- Low oral care penetration - opportunities galore. Low penetration level of toothpastes, toothbrush and dentifrices in semi-urban and rural India will keep the demand strong. Rising oral healthcare awareness and affluence levels will accelerate the growth.
- Strong distribution network. Colgate is the second largest distributed product in the country reaching out to over 3.5 million retail outlets. To strengthen its rural reach the company has entered into strategic tie-ups with ITC's e-Choupal and Disha, to distribute its products in the interiors of states like Uttar Pradesh and Madhya Pradesh.
- Product offerings - Diverse & Impressive. Colgate has a diverse oral care product portfolio. The company has presence across all the price points. The strategic acquisition of Cibaca has given CPIL a stronghold in the low price segment while its new urban centric launches like Max Fresh and its variants have cornered additional market share for the company.
- Baddi plant benefits to kick-in. The company is in the process of ramping up the production at its Baddi plant from 24000 TPA in FY08 to 40000 TPA. The excise and tax benefits accruing from this plant will boost the profitability of company on a gross revenue basis. The likely tax rate is expected to come down to 20% by FY10 from 23.5% in Fy07.

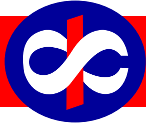
Valuations

At the current price, CPIL is trading at 22x and 19x FY08 and FY09 EPS estimates of Rs.17.5 and Rs.20.8, respectively. On an EV/EBIDTA basis, the stock is trading at 22x FY09 earnings. After the share capital reduction that took place recently, the company enjoys a leaner balance sheet and has a negligible debt position.

We initiate a BUY on the stock with a price target of Rs.474 over a 12-month period based on DCF analysis. At our exit price, the stock will trade at 23x FY09 earnings.

Key Concerns

- Need to Diversify. Colgate continues to remain a single category operator and the oral care segment contributes over 90% of its net revenues. With majority of revenues coming from a single segment the company growth potential is restricted to the growth of segment
- Price war. In the price sensitive market of consumer goods, a possible price war initiated by competitors to enter new segments (entry of other FMCG majors in the low price segments) can have significant impact on the company's profitability
- Raw material prices. Sorbitol, one of the key raw materials used in tooth pastes, is a derivative of maize. Though maize prices in India have shown a declining trend, any adverse movements in the maize prices will directly impact the company margins.



Stock details		
BSE code	:	500830
NSE code	:	Colgate
Market cap (Rs mn)	:	51952
Free float (%)	:	49
52-wk Hi/Lo (Rs)	:	434.25/291
Avg. daily volume	:	84866
Shares o/s (m)	:	136

Sourse:Capitaline,BSE & NSE

Summary table (Rs mn)

	FY07	FY08E	FY09E
Sales	12,956	14,700	16,648
Growth (%)	15.1	13.5	13.3
EBITDA	1,501	2,441	2,924
EBITDA margin (%)	11.6	16.6	17.6
Net profit	1,484	2,377	2,830
EPS (Rs)	10.9	17.5	20.8
Growth (%)	6.0	60.2	19.1
CEPS	12.4	19.0	22.4
DPS (Rs)	9.5	13.1	15.6
ROE (%)	53.1	101.4	134.1
ROCE (%)	73.5	137.6	179.4
EV/Sales (x)	4.1	3.6	3.2
EV/EBITDA (x)	35.4	21.7	18.2
P/E (x)	35.7	22.3	18.7
P/Cash Earnings	31.6	20.5	17.4
P/BV (x)	19.1	27.9	22.9

Source: Company & Kotak Securities - Private Client Research

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