kotak® Institutional Equities

INDIA DAILY

October 19, 2007

EQUITY MARKETS

		Change, %		
India	**18-Oct**	**1-day**	**1-mo**	**3-mo**
Sensex	17,998	(3.8)	10.3	15.7
Nifty	5,351	(3.7)	13.1	17.3
Global/Regional indices				
Dow Jones	13,889	(0.0)	0.5	(0.8)
Nasdaq Composite	2,799	0.2	5.0	2.9
FTSE	6,609	(1.0)	2.3	(0.5)
Nikkie	16,834	(1.6)	2.8	(7.1)
Hang Seng	29,465	0.6	15.3	28.0
KOSPI	1,990	(0.8)	4.6	2.7

Value traded - India

			Moving avg, Rs bn	
	18-Oct		**1-mo**	**3-mo**
Cash (NSE+BSE)	373.6		267.7	195.5
Derivatives (NSE)	1,105.6		450.7	450.5
Deri. open interest	982.4		888.8	865.1

Contents

Results

Reliance Industries: 2QFY08 results interesting

ACC: 3QCY07: Higher power cost dents profitability; retain Underperform rating

Hero Honda: Operating performance beats street-expectations

Petronet LNG: Strong 2QFY08 results on expected lines; longer-term issues exist

Hexaware Technologies: Inexpensive but no catalysts for stock performance. Maintain Inline rating

GMR Infrastructure: Results first take: earnings decline led by interest and depreciation charge on non-operational Vemagiri power plant

Updates

Tata Consultancy Services: Nielsen US$1.2 bn 10-year deal lends confidence to the sustainability of revenue growth trajectory

News Roundup

Corporate

- TCS has won a $1.2 bn 10 year outsourcing deal from Dutch firm The Nielson Company. This is the largest outsourcing order won by an Indian company so far. (ET)
- Rashtriya Chemical Fertilizers (RCF) is said to invest Rs24 bn along with GAIL into a new urea-ammonia fertilizer plant to be set up in Orissa (ET)
- Ranbaxy to spin off its research arm into a separately listed company to accelerate drug discovery (BS)
- HPCL has tied up with L.N. Mittal group to explore the possibility of setting up a refinery-cum-petrochemicals project in Vishakhapatnam in Andhra Pradesh. Total (France), Oil India Ltd., and GAIL have also joined HPCL for the project. The equity structure and financing would be decided only after the feasibility report is received. (BL)

Economic and political

- The Centre's direct tax revenues continue to remain buoyant, with collections up to October 15 this fiscal recording over 40 per cent growth to US$30.5 bn (Rs121,950 crore) from US$21.7 bn (Rs86,751 crore). (BL)
- The Reserve Bank of India (RBI) has recommended to the finance ministry a series of measures to curb investment flows from venture funds and into real estate. These measures are expected to help check part of the huge inflows of foreign capital, particularly since the last week of July, and plug loopholes in foreign investment norms (BS)
- The Foreign Investment Promotion Board (FIPB) has cleared 14 FDI proposals involving FDI worth US$315 mn (Rs1,257 crore), including those of Mauritius-based Essar Telecom Holdings and US-based Goldman Sachs Asset Management (GSAM). (ET)

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

Forex/money market

		Change, basis points		
	18-Oct	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.8	-	(37)	(61)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	(1)	4	11

Net investment (US$mn)

	17-Oct		**MTD**	**CYTD**
FIIs	(440)		4,450	17,468
MFs	6		(760)	(105)

Top movers -3mo basis

		Change, %		
Best performers	**18-Oct**	**1-day**	**1-mo**	**3-mo**
Reliance Energy	1,591	(9.7)	68.2	132.0
Tata Power	1,079	(8.3)	41.8	61.6
Neyveli Lignite	118	(6.5)	20.6	50.5
SAIL	231	(6.5)	25.9	48.9
Thermax	802	3.0	12.7	41.7
Worst performers				
i-Flex	1,677	(5.2)	(11.3)	(29.1)
Punjab Tractors	221	1.0	(7.1)	(22.4)
Britannia	1,358	(2.2)	(10.4)	(21.1)
Container Corp	1,875	(0.6)	(16.2)	(16.9)
Moser Baer	269	(5.3)	(12.7)	(16.4)

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Energy

RELI.BO, Rs2576	
Rating	—
Sector coverage view	Neutral
Target Price (Rs)	—
52W High -Low (Rs)	2805 - 1170
Market Cap (Rs bn)	3,744

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,115	1,058	1,267
Net Profit (Rs bn)	120.4	137.4	193.7
EPS (Rs)	82.8	94.5	128.0
EPS gth	*31.2*	*14.1*	*35.4*
P/E (x)	31.1	27.2	20.1
EV/EBITDA (x)	19.0	17.3	12.0
Div yield (%)	0.4	0.5	0.6

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.5	-	-
FIIs	23.6	8.1	0.6
MFs	2.4	4.8	(2.7)
UTI	-	-	(7.5)
LIC	4.3	7.9	0.4

Reliance Industries: 2QFY08 results interesting

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- **Better-than-expected results due to better margins in both segments**
- **Refining margin decline qoq lower than decline in benchmark margins**
- **Removed coverage view and target price**

Reliance Industries reported 2QFY08 net income at Rs38.4 bn (+5.7% qoq and +27.9% yoy) well ahead of our Rs29.2 bn estimate and consensus estimate of Rs33 bn. Higher-than-expected refining margins of US$13.6/bbl and forex gain of Rs2.7 bn may have contributed to the positive variance and strong yoy growth. 2QFY08 EBITDA improved +1.9% qoq and 14.2% yoy to Rs57.8 bn. We have raised FY2008E, FY2009E and FY2010E consolidated EPS to Rs94, Rs128 and Rs197 from Rs88, Rs124 and Rs184. We have removed coverage view (previously Underperform) and target price (previously Rs1,800 based on FY2010E EPS plus value of investments discounted back) on the stock.

Chemical segment analysis

1. **2QFY08 chemical segment EBIT increased 9.8% qoq but volumes likely declined sharply.** RIL's chemical segment EBIT increased 9.8% qoq to Rs20.3 bn led by improved chemical margins. RIL did not provide a breakup of contribution by price and volume this time. However, we believe sales volumes likely declined qoq in 2QFY08 noting (1) lower qoq sales (-1.9%) and higher prices and (2) 8.6% qoq decline in GAIL's sales volumes. GAIL's 2QFY08 EBIT had declined 6.8% qoq. However, we believe RIL may have benefited from higher margins for chemicals made from naphtha; we note that naphtha prices were flat qoq but product prices had gone up modestly qoq. GAIL uses natural gas as feedstock as do two of RIL's four crackers.

2. **3.7% yoy decline in EBIT somewhat surprising in context of decline in margins and appreciation in rupee (see Exhibit 2).** We are positively surprised by the small (3.7%) yoy decline in chemical segment EBIT to Rs20.3 bn (-Rs770 mn) given (1) a sharp decline in yoy chemical margins in US Dollar terms and (2) appreciation in the rupee (12.6% to Rs40.5). Exhibit 3 gives details of margins and exchange rate over the past few quarters. We can attribute moderately higher volumes and lower employee and depreciation costs as partly offsetting the impact of weaker margins and stronger rupee. RIL's yoy revenues are virtually flat and production volumes have grown moderately with polymers flat and polyester and polyester intermediates up by 9%.

Refining segment analysis

1. **Smaller-than-expected decline in refining margins in contrast with bigger declines in benchmark margins.** 2QFY08 refining margin stood at US$13.6/bbl or –US$1.8/bbl qoq but +US$4.5/bbl yoy. Exhibit 4 compares RIL's reported refining margins with benchmark refining margins as taken from RIL's press release and computed by Reuters. We observe that benchmark refining margins have fallen between US$3.1/bbl to US$10.2/bbl qoq. Also, we observe that benchmark refining margins have changed between –US1.7/bbl to +US$1.7/bbl yoy compared to the US$4.5/bbl yoy improvement in RIL's refining margins.

RIL's refining segment EBIT declined 9.2% qoq or Rs2.4 bn to Rs23.2 bn. A US$1.8/bbl decline would result in lower contribution margin of around Rs4.3 bn. We assume RIL has been able to save on other costs (volumes were marginally higher at 8.1 mn tons versus 8 mn tons in 1QFY08), which may explain the lower decline in EBIT versus that computed using refining margins alone.

2. **Change in product mix likely contributed to better-than-expected performance.** The management attributed the relatively lower decline in RIL's margins versus global benchmark margins to more production of middle distillates, whose crack spreads declined less qoq than gasoline's. Exhibit 5 shows crack spreads of various products for March 2007-September 2007. RIL's very high margins in 1QFY08 probably reflected very high gasoline prices in the US. However, it has produced less of gasoline and more of diesel in 2QFY08. We are impressed (as we have been for some time) by RIL's uncanny ability to spot and forecast market developments and benefit accordingly; we cite RIL's hedging of crude in 2QFY07 when crude prices had collapsed as another example, which led to RIL not suffering inventory losses unlike the large losses suffered by un-hedged refiners.
3. **Comparison with hypothetical margins of RPL shows interesting results.** Exhibit 6 compares RIL's reported margins with our hypothetical margins of RPL. We assume the same product and crude slate for RPL as in our earnings model and use the quarterly product and crude prices to compute RPL's hypothetical margins assuming it had operated in those quarters. We get a very low figure of US$7.3/bbl for RPL's hypothetical refining margin in 2QFY08, which probably reflects the depressed price/margin for gasoline in 2QFY08. We note that RPL's product slate is heavily skewed towards gasoline unlike RIL's. Exhibit 7 compares the product slates of RIL and RPL.

Earnings revisions

FY2008—raised earnings on lower interest and taxation. We have raised our FY2008E EPS to Rs94 from Rs88 to reflect lower interest and taxation. We have reduced interest expense to reflect (1) lower borrowings, which in turn reflects lower cash taxation and (2) higher capitalized interest (Rs3.55 bn in 1HFY08). RIL management attributed the lower taxation rate in 2QFY08 at 15.9% versus 19.1% in 1QFY08 (pre-merger with IPCL) to merger with IPCL and carry-forward unabsorbed depreciation of IPCL.

Our EBITDA estimate is moderately higher at Rs218 bn versus Rs216 bn previously; 1HFY08 EBITDA was Rs114.5 bn. We have raised chemical and refining margins moderately and also raised crude price estimate to US$75/bbl versus US$70/bbl. We model refining margins at US$14.3/bbl versus US$11.7/bbl in FY2007 and US$13.6/bbl assumed previously. RIL's 1HFY08 refining margin stood at US$14.5/bbl but we expect current weaker margins in 2HFY08E to pull down RIL's margins for FY2008E. We note that RIL had forex gains of Rs4.4 bn in 1HFY08 (Rs2.7 bn in 2QFY08), which is equivalent to about US$0.9/bbl savings on crude purchase or higher refining margins, in other words. We do not expect forex gain of a similar magnitude in 2HFY08 due to a steadier rupee.

We model exchange rate at Rs40/US$ versus Rs41/US$ previously, which partially offsets some of the positive impact of the aforementioned changes to margins and prices. Exhibit 8 gives a sensitivity of its earnings to key variables (refining margin, chemical prices and rupee-dollar rate) and Exhibit 9 gives RIL's key financials.

FY2009—fine-tuned estimates. We model FY2009E consolidated EPS (consolidated for RPL) at Rs128 (Rs124 previously); the upward revision reflects primarily reflects lower taxation. We model effective taxation rate at 16.2% versus 21.8% previously. We have reduced EBITDA estimate marginally to Rs297 bn from Rs308 bn to reflect a stronger rupee (Rs39/US$ versus Rs40/US$ assumed previously).

We expect chemical margins to further decline in FY2009E versus FY2008E led by new plant capacities globally. However, we expect refining margins to remain firm and model refining margins (standalone) at US$14.4/bbl, similar to FY2008E levels.

FY2010—the year that matters given full year contribution of D-6 gas and RPL. We have raised FY2010E consolidated EPS to Rs197 from Rs184 to reflect lower taxation, higher gas production in KG D-6 block (70 mcm/d versus 60 mcm/d assumed previously) and higher crude oil prices (US$70/bbl from US$68/bbl) but weaker rupee (Rs38/US$ versus Rs39/US$). We model RIL's standalone refining margin at US$16.1/bbl for RIL's refinery and US$17.3/bbl for RPL's refinery. The sharp jump in refining margins versus FY2009E reflects use of gas for internal processes, which would lead to significant savings in power and fuel and thus, higher refining margins.

Updates on new businesses

E&P—update on KG D-6 block. RIL is on schedule to start gas production in 2HFY09. It has completed 95% of well drilling, 50% of offshore development and 55% of onshore development. We model gas production at 20 mcm/d for FY2009E, 70 mcm/d for FY2010E (raised from 60 mcm/d previously) and 80 mcm/d for FY2011E and the next few years. We continue to model gas price at US$4.2/mn BTU for FY2009E and FY2010E but reduce it to US$3.9/mn BTU after that based on weighted average price of US$2.34/mn BTU for 12 mcm/d of gas to be supplied to NTPC and 68 mcm/d of gas at US$4.2/mn BTU up to FY2013E and US$4.5/mn BTU beyond that. We assume that RIL will supply gas to RNRL, if any, at US$4.2/mn BTU.

In case of the MA (oil) development, RIL is in process of finalizing the design of the development. We model 15,000 b/d of oil production in FY2009E and 40,000 b/d in FY2010E lower than our previous estimate of 30,000 b/d and 50,000 b/d; RIL's share is 90%. RIL has submited a development plan to the DGH for approval in 2QFY08.

On NEC-25 block, the company expects to start production in FY2012 and expects peak production of 6.5 mcm/d. However, it has not disclosed the capex and other details as it has submitted a development plan to the DGH and is awaiting the latter's approval. On CBM, the management expects production from FY2010; we have not factored in CBM in our model as yet. RIL has submitted a development plan for Sohagpur East and West blocks to the DGH for its approval. RIL expects peak production of 5 mcm/d from its Sohagpur CBM blocks.

RPL—to start ahead of schedule. RIL management expects to start the RPL refinery ahead of the scheduled completion date of December 2008 but has not specified a revised schedule. As per the management, the project is over 70% complete. Basic engineering is 100% complete, detailed engineering 97%, civil construction almost 100% and deliveries and installation of critical long-lead items started.

We model RPL's refining margins at U$17.3/bbl, US$16.2/bbl and US$15.1/bbl for FY2010E, FY2011E and FY2012E. Our FY2010E-FY2012E EPS estimates are Rs21.9, Rs21.3 and Rs20.4, respectively versus Rs22.7, Rs21.2 and Rs20.4, respectively, previously. The modestly lower earnings estimate reflects a stronger Indian rupee (raised by Rs1/US$ for all the years). Our 12-month target price is Rs170, based on 9X FY2010E EPS of Rs21.9 discounted back to October 2008.

Reliance Retail—steady progress despite some hiccups. RIL added 128 *Reliance Fresh* stores (small-format F&B stores) in 2QFY08 and had 329 stores in around 30 cities at end-2QFY08. It has started its first hypermarket under the *RelianceMart* brand in August 2007 and operates a single *Reliance Digital* store. We value the retailing business at US$4.3 bn (Rs123/share); RIL has invested Rs60 bn as equity in Reliance Retail as of September, 2007 up from Rs40 bn as of March, 2007. We model RIL to invest Rs40 bn and Rs20 bn of in the equity of Reliance Retail in FY2009E and FY2010E, respectively.

Interim results of Reliance Industries , March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2008E	2Q 2008	1Q 2008	(% chg)	2Q 2008	2Q 2007	(% chg)	1H 2007	1H 2007	(% chg)
Net sales	**1,058,303**	**320,430**	**295,240**	***8.5***	**320,430**	**300,560**	***6.6***	**615,670**	**560,500**	***9.8***
Total expenditure	(840,195)	(262,620)	(238,510)	*10.1*	(262,620)	(249,920)	*5.1*	(501,130)	(463,530)	*8.1*
Inc/(Dec) in stock	—	9,200	(8,780)	*(204.8)*	9,200	9,950	*(7.5)*	420	14,290	*(97.1)*
Raw materials	(742,248)	(242,740)	(200,100)	*21.3*	(242,740)	(226,280)	*7.3*	(442,840)	(408,720)	*8.3*
Staff cost	(20,941)	(4,710)	(4,960)	*(5.0)*	(4,710)	(4,960)	*(5.0)*	(9,670)	(10,490)	*(7.8)*
Other expenditure	(77,007)	(24,370)	(24,670)	*(1.2)*	(24,370)	(28,630)	*(14.9)*	(49,040)	(58,610)	*(16.3)*
EBITDA	**218,108**	**57,810**	**56,730**	***1.9***	**57,810**	**50,640**	***14.2***	**114,540**	**96,970**	***18.1***
OPM (%)	**20.6**	**18.0**	**19.2**		**18.0**	**16.8**		**18.6**	**17.3**	
Other income	7,750	1,680	1,970	*(14.7)*	1,680	1,250	*34.4*	3,650	2,330	*56.7*
Interest	(11,065)	(2,570)	(2,950)	*(12.9)*	(2,570)	(2,970)	*(13.5)*	(5,520)	(5,950)	*(7.2)*
Depreciation	(45,046)	(11,290)	(11,250)	*0.4*	(11,290)	(12,130)	*(6.9)*	(22,540)	(23,140)	*(2.6)*
Pretax profits	**169,747**	**45,630**	**44,500**	***2.5***	**45,630**	**36,790**	***24.0***	**90,130**	**70,210**	***28.4***
Extraordinaries/sales tax benefit	—	—	—		—	—		—	—	
Tax	(21,215)	(5,270)	(5,170)	*1.9*	(5,270)	(4,190)	*25.8*	(10,440)	(7,980)	*30.8*
Deferred taxation	(11,033)	(1,990)	(3,030)	*(34.3)*	(1,990)	(2,600)	*(23.5)*	(5,020)	(5,170)	*(2.9)*
Net income	**137,499**	**38,370**	**36,300**	***5.7***	**38,370**	**30,000**	***27.9***	**74,670**	**57,060**	***30.9***
Adjusted profits	**137,499**	**38,370**	**36,300**	***5.7***	**38,370**	**30,000**	***27.9***	**74,670**	**57,060**	***30.9***
Income tax rate (%)	19.0	15.9	18.4		15.9	18.5		17.2	18.7	
Chemicals production										
Polymer volumes ('000 tons)		829	833	*(0)*	829	831	*(0)*	1,662	1,561	*6*
Polyester volumes ('000 tons)		387	389	*(1)*	387	355	*9*	776	725	*7*
Fiber intermediates ('000 tons)		1,214	1,152	*5*	1,214	1,112	*9*	2,366	2,075	*14*
Refining										
Crude throughput (mn tons)		8.1	8.0	*1.0*	8.1	8.2	*(1.2)*	16.1	15.7	*2.5*
Refining margin (US$/bbl) incl. sales tax incentives		**13.6**	**15.4**	*(11.7)*	13.6	9.1	*49.5*	14.5	10.7	*35.8*
Average exchange rate		40.5	41.3	*(1.8)*	40.5	46.4	*(12.7)*	40.9	45.9	*(11.0)*
E&P										
Crude oil production (000 tons)		156	149	*5.2*	156	127	*23.4*	305	241	*26.4*
Gas production (bcf)		13	11	*13.9*	13	8	*54.4*	24	17	*37.1*

Segment results of Reliance Industries

	qoq			yoy			yoy		
	2Q 2008	1Q 2008	(% chg)	2Q 2008	2Q 2007	(% chg)	1H 2007	1H 2007	(% chg)
Revenues									
Petrochemicals	129,610	132,130	*(1.9)*	129,610	128,880	*0.6*	261,740	246,540	*6.2*
Refining	235,750	223,280	*5.6*	235,750	231,900	*1.7*	459,030	440,370	*4.2*
Others	8,010	5,900	*35.8*	8,010	5,550	*44.3*	13,910	10,850	*28.2*
Gross turnover	373,370	361,310	*3.3*	373,370	366,330	*1.9*	734,680	697,760	*5.3*
Inter segment	39,350	48,410	*(18.7)*	39,350	52,110	*(24.5)*	87,760	104,510	*(16.0)*
Excise duty	13,590	17,660	*(23.0)*	13,590	13,660	*(0.5)*	31,250	32,750	*(4.6)*
Net sales	**320,430**	**295,240**	***8.5***	**320,430**	**300,560**	***6.6***	**615,670**	**560,500**	***9.8***
EBIT									
Petrochemicals	20,250	18,450	*9.8*	20,250	21,020	*(3.7)*	38,700	34,080	*13.6*
Refining	23,210	25,570	*(9.2)*	23,210	14,890	*55.9*	48,780	35,240	*38.4*
Others	3,900	3,010	*29.6*	3,900	3,650	*6.8*	6,910	6,490	*6.5*
Total	**47,360**	**47,030**	***0.7***	**47,360**	**39,560**	***19.7***	**94,390**	**75,810**	***24.5***
Interest expense	(2,570)	(2,950)	*(12.9)*	(2,570)	(2,970)	*(13.5)*	(5,520)	(5,950)	*(7.2)*
Interest income	1,380	1,350	*2.2*	1,380	820	*68.3*	2,730	1,500	*82.0*
Other unallocable (net)	(540)	(930)	*(41.9)*	(540)	(620)	*(12.9)*	(1,470)	(1,150)	*27.8*
PBT	**45,630**	**44,500**	***2.5***	**45,630**	**36,790**	***24.0***	**90,130**	**70,210**	***28.4***
Current tax	(5,270)	(5,170)	*1.9*	(5,270)	(4,190)	*25.8*	(10,440)	(7,980)	*30.8*
Deferred tax	(1,990)	(3,030)	*(34.3)*	(1,990)	(2,600)	*(23.5)*	(5,020)	(5,170)	*(2.9)*
PAT	**38,370**	**36,300**	***5.7***	**38,370**	**30,000**	***27.9***	**74,670**	**57,060**	***30.9***
Capital employed									
Petrochemicals	305,850	263,340	*16.1*	305,850	343,880	*(11.1)*	305,850	343,880	*(11.1)*
Refining	381,400	392,720	*(2.9)*	381,400	420,660	*(9.3)*	381,400	420,660	*(9.3)*
Others	249,530	187,430	*33.1*	249,530	76,990	*224.1*	249,530	76,990	*224.1*
Unallocated corporate	146,140	96,700	*51.1*	146,140	81,230	*79.9*	146,140	81,230	*79.9*
Total	**1,082,920**	**940,190**	***15.2***	**1,082,920**	**922,760**	***17.4***	**1,082,920**	**922,760**	***17.4***

Source: Company data, Kotak Institutional Equities.

Small yoy decline in chemical segment EBIT a positive surprise

Segment-wise perfomance (Rs mn)

	2Q 2008	1Q 2008	2Q 2007	Change qoq	Change yoy
Revenues					
Petrochemicals	129,610	132,130	128,880	(1.9)	0.6
Refining	235,750	223,280	231,900	5.6	1.7
Operating costs					
Petrochemicals	109,360	113,680	107,860	(3.8)	1.4
Refining	212,540	197,710	217,010	7.5	(2.1)
EBIT					
Petrochemicals	20,250	18,450	21,020	9.8	(3.7)
Refining	23,210	25,570	14,890	(9.2)	55.9

Source: Company, Kotak Institutional Equities.

2QFY08 chemical margins are significantly lower yoy

Asian chemical margins and prices, March fiscal year-ends (US$/ton)

	2Q 2007	3Q 2007	4Q 2007	1Q 2008	2Q 2008	2Q08 vs. 2Q07 (%)
Margins						
HDPE – naphtha	729	736	662	580	665	(8.8)
LLDPE – naphtha	727	734	703	606	662	(8.9)
PP – naphtha	726	722	667	593	671	(7.5)
PVC – naphtha	294	295	272	241	321	9.2
PSF – naphtha	771	812	797	748	762	(1.2)
PFY – naphtha	933	985	1,013	941	1,002	7.4
PX – naphtha	782	572	541	528	399	(49.0)
Prices						
HDPE	1,345	1,282	1,247	1,270	1,355	0.8
LLDPE	1,343	1,281	1,288	1,296	1,353	0.7
PP	1,341	1,268	1,252	1,283	1,362	1.5
PVC	910	841	857	931	1,011	11.2
PSF	1,387	1,358	1,382	1,438	1,452	4.7
PFY	1,548	1,532	1,598	1,632	1,692	9.3
PX	1,398	1,119	1,126	1,218	1,089	(22.1)
Naphtha	**616**	**546**	**585**	**690**	**690**	**12.1**
Rupee-dollar exchange rate	**46**	**45**	**44**	**41**	**41**	**(12.6)**

Source: Platt's, Bloomberg.

RIL's 2QFY08 refining margin shows a smaller decline versus benchmark margins

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

	2Q 2007	3Q 2007	4Q 2007	1Q 2008	2Q 2008
Singapore (Dubai)	4.7	3.9	6.8	9.5	6.4
US Gulf Coast (Dated Brent)	7.8	4.2	7.5	13.1	6.9
US Gulf Coast (WTI)	8.0			18.8	8.6
Rotterdam (Dated Brent)	5.2	2.8	4.1	6.6	3.5
Mediterranean (Urals)	5.4	4.0	5.7	7.2	3.8
RIL's reported margins	**9.1**	**11.7**	**13.0**	**15.4**	**13.6**
Premium over reported Singapore margins	**4.4**	**7.8**	**6.2**	**5.9**	**7.2**

Source: Company, Reuters.

Gasoline and naphtha cracks declined steeply qoq
Calculation of product cracks (US$/bbl)

	Gasoline	Naphtha	Kerosene	Gasoil	Jet fuel	Fuel oil
Apr-07	18.9	9.9	16.7	16.3	14.0	(9.8)
May-07	23.3	11.9	17.4	17.0	12.5	(10.1)
Jun-07	18.4	8.4	17.9	16.3	13.7	(9.8)
Jul-07	15.4	6.2	17.6	16.2	14.6	(9.1)
Aug-07	8.8	4.5	17.0	15.7	13.5	(8.1)
Sep-07	8.2	2.9	17.0	17.4	14.0	(11.4)
1QFY08	**20.2**	**10.1**	**17.3**	**16.5**	**13.4**	**(9.9)**
2QFY08	**10.8**	**4.5**	**17.2**	**16.4**	**14.0**	**(9.5)**

Note:
(a) Crack spread computed using Singapore fob prices and Dubai crude.

Source: Bloomberg, Kotak Institutional Equities.

RPL's hypothetical margins are significantly lower than RIL's reported margins in certain quarters
Refining margins for RIL and RPL, March fiscal year-ends (US$/bbl)

	2QFY08	1QFY08	4QFY07	3QFY07	2QFY07	1QFY07	4QFY06	3QFY06
RIL's reported margins	13.6	15.4	13.0	11.7	9.1	12.4	10.4	9.1
Singapore margins as computed by IEA (a)	2.5	4.7	3.1	1.0	1.5	4.9	1.2	2.9
Premium over reported Singapore margins	**11.1**	**10.7**	**9.9**	**10.7**	**7.6**	**7.5**	**9.2**	**6.2**
Hypothetical margins for RPL (b)	7.3	13.1	11.1	8.5	11.4	13.8	5.8	9.1
Premium of RPL's computed margins over RIL's reported margins	**(6.3)**	**(2.3)**	**(1.9)**	**(3.2)**	**2.3**	**1.4**	**(4.6)**	**(0.0)**

Note:
(a) Singapore hydrocracking margins over Dubai.
(b) Margins computed without considering use of gas for heating.

Source: Bloomberg, company, Kotak Institutional Equities estimates.

RPL refinery has a superior product slate as compared to RIL refinery
Comparison of product slate of RIL with RPL

	RIL refinery		RPL refinery	
	(mtpa)	(%)	(mtpa)	(%)
LPG	2.4	7.6		
Naphtha	6.0	18.9		
Gasoline	3.7	11.7	8-10	31.0
Alkylates (gasoline blend)			2-3	8.6
Jet/Kerosene	2.9	9.1	1-2	4.3
Diesel	11.7	37.1	12-13	43.1
LAB	1.1	3.4		
Petcoke	2.4	7.7	2-3	8.6
Sulphur	0.6	2.1	0.5-0.6	1.9
Propylene	0.8	2.4	0.5-0.9	2.4
Total	**31.5**	**100.0**	**29.0**	**100.0**

Source: Company, Kotak Institutional Equities.

Reliance has high leverage to refining margins

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

	Fiscal 2008E			Fiscal 2009E			Fiscal 2010E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	39.0	40.0	41.0	38.0	39.0	40.0	37.0	38.0	39.0
Net profits (Rs mn)	131,283	137,499	143,715	172,554	179,395	186,235	225,237	233,113	240,990
EPS (Rs)	90.3	94.6	98.9	114.0	118.5	123.1	143.2	148.2	153.2
% upside/(downside)	**(4.5)**		**4.5**	**(3.8)**		**3.8**	**(3.4)**		**3.4**
Chemical prices									
Change in prices (%)	(5.0)		5.0	(5.0)		5.0	(5.0)		5.0
Net profits (Rs mn)	131,842	137,499	143,155	173,846	179,395	184,943	228,111	233,113	238,115
EPS (Rs)	90.7	94.6	98.5	114.9	118.5	122.2	145.0	148.2	151.3
% upside/(downside)	**(4.1)**		**4.1**	**(3.1)**		**3.1**	**(2.1)**		**2.1**
Refining margins (US$/bbl)									
Margins (US$/bbl)	13.3	14.3	15.3	13.4	14.4	15.4	15.0	16.0	17.0
Net profits (Rs mn)	129,209	137,499	145,788	171,384	179,395	187,405	227,076	233,113	239,150
EPS (Rs)	88.9	94.6	100.3	113.2	118.5	123.8	144.3	148.2	152.0
% upside/(downside)	**(6.0)**		**6.0**	**(4.5)**		**4.5**	**(2.6)**		**2.6**

Source: Kotak Institutional Equities estimates.

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

	2003	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)								
Net sales	451,133	510,715	656,223	809,113	1,114,927	1,058,303	1,266,600	1,843,105
EBITDA	**75,808**	**91,148**	**123,820**	**139,991**	**198,462**	**218,108**	**296,924**	**476,258**
Other income	10,012	11,381	14,498	6,829	4,783	7,750	10,222	15,463
Interest	(15,552)	(14,347)	(14,687)	(8,770)	(11,889)	(11,065)	(9,994)	(10,819)
Depreciation & depletion	(28,371)	(32,470)	(37,235)	(34,009)	(48,179)	(45,157)	(60,357)	(83,768)
Pretax profits	41,897	55,711	86,397	104,041	143,177	169,636	236,795	397,133
Extraordinary items	7,845	7,300	4,290	3,000	2,000	—	—	—
Tax	(2,459)	(3,510)	(7,050)	(9,307)	(16,574)	(21,215)	(40,076)	(63,308)
Deferred taxation	(6,240)	(7,900)	(7,920)	(7,040)	(9,196)	(11,033)	1,704	1,252
Minority interest	—	—	—	—	—	—	(4,757)	(25,491)
Net profits	41,043	51,601	75,717	90,693	119,406	137,388	193,666	309,586
Adjusted net profits	**34,570**	**45,623**	**72,135**	**88,152**	**117,761**	**137,388**	**193,666**	**309,586**
Earnings per share (Rs)	**24.8**	**32.7**	**51.7**	**63.3**	**81.0**	**94.5**	**128.0**	**196.8**
Balance sheet (Rs mn)								
Total equity	303,744	344,525	404,033	430,543	673,037	790,050	1,109,361	1,374,235
Deferred taxation liability	26,848	34,748	42,668	49,708	69,820	80,853	79,149	77,897
Minority interest	—	—	—	—	33,622	33,595	38,352	61,210
Total borrowings	197,583	209,447	187,846	218,656	332,927	409,377	237,259	112,642
Currrent liabilities	109,666	122,855	171,315	164,545	192,305	199,874	206,423	232,709
Total liabilities and equity	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,513,748**	**1,670,543**	**1,858,693**
Cash	1,472	2,242	36,087	21,461	18,449	17,754	69,850	184,401
Current assets	227,809	218,159	248,438	224,283	286,566	310,216	334,962	410,190
Total fixed assets	340,863	351,460	350,823	626,745	899,403	1,043,484	1,090,937	1,071,809
Investments	67,227	139,714	170,515	(9,038)	97,294	142,294	174,794	192,294
Deferred expenditure	472	—	—	—	—	—	—	—
Total assets	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,513,748**	**1,670,543**	**1,858,693**
Free cash flow (Rs mn)								
Operating cash flow, excl. working cap	67,072	83,301	107,002	119,520	164,285	179,875	241,674	399,806
Working capital	(17,614)	20,265	46,875	(32,188)	(13,075)	(16,081)	(18,197)	(48,941)
Capital expenditure	(37,043)	(43,191)	(52,440)	(94,273)	(247,274)	(197,524)	(103,037)	(62,316)
Investments	(34,204)	(68,430)	(48,192)	(32,364)	(105,760)	(45,000)	(32,500)	17,500—
Other income	5,219	5,902	3,032	5,159	4,143	7,750	10,222	15,463
Free cash flow	**(16,569)**	**(2,153)**	**56,276**	**(34,146)**	**(197,681)**	**(70,980)**	**98,161**	**286,511**
Ratios (%)								
Debt/equity	59.8	55.2	42.1	45.5	44.8	47.0	20.0	7.8
Net debt/equity	59.3	54.6	34.0	41.1	42.3	45.0	14.1	(4.9)
RoAE	10.7	12.7	17.6	19.9	20.3	17.9	19.6	24.2
RoACE	**8.8**	**9.7**	**13.0**	**13.8**	**13.9**	**12.0**	**14.9**	**22.5**

Source: Kotak Institutional Equities estimates.

Valuation of Reliance Industries stock (Rs)

	FY2010E EPS (Rs)	P/E (X)	Valuation (Rs/share)	Comments
Chemicals, refining, E&P (a) (b)	225	9	2,028	Consolidated FY2010E EPS including Reliance Petroleum
Valuation based on FY2010E EPS			**1,716**	**12.5% discount rate; discounted to October, 2008**
E&P (higher reserves in KG-DWN-98/3, other blocks)			—	We model 0.93 tcf of gas per annum production in perpetuity
E&P (NEC-25, CBM)			59	Based on KG D-6 reserves and valuation
Investments			130	
Other investments			7	
Retailing			123	US$4.25 bn valuation; ~US$1.5 bn equity invested in Reliance Retail as of end-1HFY08
SEZ development			—	SEZs will require investment for the first few years
12-month fair valuation			**1,906**	

Notes:
(a) FY2010E EPS is Rs197 on 1.573 bn shares after considering conversion of 120 mn warrants issued to the major shareholder.
(b) FY2010E EPS is adjusted for treasury shares or computed using 1.372 bn shares.

Source: Kotak Institutional Equities estimates.

Estimation of implied valuation of new businesses of Reliance Industries (US$ bn)

		Comments
1. Valuation of extant businesses		**Chemicals, RIL refinery, extant oil and gas**
FY2008E EPS of Reliance (Rs)	94.5	Significantly higher than FY2007 EPS of Rs81
FY2008E EPS adjusted for treasury shares (Rs)	109.5	Adjusted for 199 mn treasury shares
Effective tax rate in FY2008E (%)	19.0	
FY2008E EPS adjusted for tax rate	89.3	Normalized for 34% tax rate for extant earnings
Appropriate P/E multiple (X)	9.0	Generous given above mid-cycle margins, earnings and cost of equity of 12.5%
Valuation of extant businesses (Rs)	**803**	
Valuation of extant businesses	**25**	**Reasonable in the context of replacement value, returns**
2. Valuation of investments		**RPL, others (without Reliance Retail)**
Reliance Petroleum	476	3.375 bn shares at current market price of Rs177
Others	8	
Total value of investments	**484**	
Valuation of RIL ex-new E&P, retailing, SEZs	**1,288**	
Current stock price	2,576	
3. Valuation of new businesses		**Emerging E&P business, retailing, SEZs**
Market-ascribed value of new businesses	**1,288**	
Market-ascribed value of new businesses (US$ bn)	**41**	
Estimated valuation of retailing (US$ bn)	4.3	Reliance has invested about US$1 bn in Reliance Retail as at end-FY2007
Estimated valuation of SEZs (US$ bn)	—	Value will take time to emerge
Market-ascribed value of emerging E&P business	**37**	**Seems very high to us based on official reserves, announced discoveries**
Estimated value of Reliance's stake in KG D-6 (gas)	6.1	Based on gas production of 17 tcf, US$8.8 bn capex, US$4.5/mn BTU net price
Estimated value of Reliance's stake in KG D-6 (oil)	1.8	0.5 bn bbls of OOIP assumed versus current announced reserves of 180 mn bbls
Estimated value of Reliance's stakes in NEC-25, CBM	2.2	
Implied value of new discoveries	**26**	**Higher reserves in KG D-6, NEC-25, Cauvery-III-D5, GS-01, MN-D4 blocks?**

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Reliance Petroleum 2009-2014E, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E
Profit model						
Net revenues	135,515	631,583	622,338	613,094	613,094	613,094
EBITDA	**28,307**	**123,578**	**114,442**	**105,273**	**105,039**	**104,775**
Other income	222	463	1,292	3,806	5,627	5,481
Interest (expense)/income	(3,637)	(8,362)	(2,793)	—	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**19,905**	**100,889**	**98,041**	**94,072**	**95,550**	**95,032**
Extraordinary items	—	—	—	—	—	—
Tax	(424)	(2,362)	(2,239)	(2,049)	(2,081)	(15,561)
Deferred taxation	—	—	—	—	—	1,624
Net income	**19,481**	**98,527**	**95,802**	**92,022**	**93,469**	**81,095**
Earnings per share (Rs)	**4.3**	**21.9**	**21.3**	**20.4**	**20.8**	**18.0**
Balance sheet						
Total equity	153,860	241,857	327,129	377,034	361,149	347,367
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	135,170	79,670	—	—	—	—
Current liabilities	9,487	40,061	40,040	40,019	40,019	40,019
Total liabilities and equity	**298,516**	**361,587**	**367,169**	**417,053**	**401,168**	**385,762**
Cash	4,542	8,904	28,291	92,026	89,247	87,055
Other current assets	25,174	96,673	95,767	94,924	94,933	94,943
Net fixed assets	266,520	253,729	240,830	227,823	214,707	201,483
Capital work-in-progress	—	—	—	—	—	—
Investments	2,280	2,280	2,280	2,280	2,280	2,280
Deferred expenditure	—	—	—	—	—	—
Total assets	**298,516**	**361,587**	**367,169**	**417,053**	**401,168**	**385,762**
Free cash flow						
Operating cash flow, excl. working capital	24,246	112,854	109,409	103,224	102,957	89,214
Working capital changes	(11,132)	(40,926)	885	823	(9)	(10)
Capital expenditure	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	222	463	1,292	3,806	5,627	5,481
Free cash flow	**(3,264)**	**70,392**	**109,586**	**105,853**	**106,575**	**92,685**
Ratios (%)						
Debt/equity	87.9	32.9	0.0	—	—	—
Net debt/equity	84.9	29.3	(8.6)	(24.4)	(24.7)	(25.1)
ROAE (%)	13.5	49.8	33.7	26.1	25.3	22.9
ROACE (%)	**8.3**	**34.9**	**30.4**	**26.1**	**25.3**	**22.9**

Source: Kotak Institutional Equities estimates.

Reliance Petroleum has high leverage to refining margins

Sensitivity of RPL's earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	38.0	39.0	40.0	37.0	38.0	39.0	37.0	38.0	39.0
Net profits (Rs mn)	18,650	19,481	20,313	94,787	98,527	102,266	92,291	95,802	99,313
EPS (Rs)	4.1	4.3	4.5	21.1	21.9	22.7	20.5	21.3	22.1
% upside/(downside)	**(4.3)**		**4.3**	**(3.8)**		**3.8**	**(3.7)**		**3.7**
Refining margins (US$/bbl)									
Margins (US$/bbl)	16.2	17.2	18.2	16.3	17.3	18.3	15.2	16.2	17.2
Net profits (Rs mn)	17,807	19,481	21,156	90,645	98,527	106,408	87,920	95,802	103,684
EPS (Rs)	4.0	4.3	4.7	20.1	21.9	23.6	19.5	21.3	23.0
% upside/(downside)	**(8.6)**		**8.6**	**(8.0)**		**8.0**	**(8.2)**		**8.2**

Source: Kotak Institutional Equities estimates.

Cement

ACC.BO, Rs1036	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	900
52W High -Low (Rs)	1315 - 680
Market Cap (Rs bn)	195.4

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	57.5	70.3	77.3
Net Profit (Rs bn)	10.7	13.7	14.5
EPS (Rs)	56.7	72.7	77.1
EPS gth	*93.7*	*28.2*	*6.0*
P/E (x)	18.3	14.2	13.4
EV/EBITDA (x)	10.9	8.6	7.7
Div yield (%)	1.6	1.7	1.7

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.0	-	-
FIIs	16.1	0.4	(0.1)
MFs	2.0	0.3	(0.3)
UTI	-	-	(0.6)
LIC	14.1	1.9	1.3

ACC: 3QCY07: Higher power cost dents profitability; retain Underperform rating

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- **Volume growth and realization gains partially offset by higher power cost**
- **RMC business continues to make losses.**
- **Unexciting growth prospects in the absence of pricing power.**

ACC reported 22% yoy increase in net revenues at Rs16.7 bn (our estimate of Rs17.3 bn), 23% increase in EBITDA at Rs4.4 bn (our estimate of Rs5.2 bn) and 28% increase in net profits at Rs2.8 bn (our estimate of Rs3.4 bn) for 3QCY07. Sales volumes increased by 9.6% yoy as increased capacities at Lakheri and Kymore began commercial production during the year. Improvement in realizations (12% yoy) was offset by higher power costs and other expenses. We have revised our EPS estimates to Rs72.7 (Rs71.7 previously) for CY2007 and Rs77.1 (Rs77.6 previously) for CY2008 respectively. We retain our Under-perform rating on the stock with target price of Rs900/share. The stock is trading at EV/tonne of US$202/tonne—much above the replacement cost of $85-100/tonne.

Volume growth and realization gains partially offset by higher power cost. Higher cement volumes (9.6% yoy) and a 12% improvement in realizations resulted in ACC reporting a strong revenue growth of 22%. The increase in revenues was partially offset by a higher power cost of Rs698/ton (Rs522/ton in 2QCY2006). The average cost of power for the half year ended June 2007 was Rs540/ton and our estimates factor in Rs580/ton for CY2007. We await clarity from the management on this sudden jump in power cost. We note that imported coal prices have gone up, but ACC largely uses domestic coal in its kilns and power plants. During the current quarter ACC commissioned a 9 MW wind power plant in Tamil Nadu and a 25 MW captive thermal power plant at Kymore.

RMC business continues to make losses. The RMC business of the company posted an EBIT loss of Rs197 mn in 3QCY2007 and has reported a cumulative loss of Rs335 mn for the nine months ended September 2007. We note that the board has approved the de-merger of the RMC business into a separate subsidiary, and the same awaits shareholder approval.

Targeting installed capacity of 27.5 mn tpa by end-CY2009. ACC is working on several projects spread across its manufacturing facilities to increase the production capacity to 27.5 mn tpa by end-CY2009 from the current 21 mn tpa. ACC is augmenting grinding capacities at Tikaria, Wadi and Sindri in 2007 to increase the total cement capacity to 23.1 mn tpa. Capacity expansion at Bargarh Cement in Orissa (by 1.2 mn tpa) will likely get completed in 2008. ACC also plans to increase the capacity at Wadi in Karnataka by 3 mn tpa by end-2009. We note that capacity addition across various projects is progressing as per schedule.

Unexciting growth prospects in the absence of pricing power. We expect the earnings growth during CY2008 to be muted in the absence of significant price increases and moderate volumes growth (8-9%). We expect capacity addition during FY2009 to be ahead of incremental cement demand. After the sharp price increases during the last 18 months, which have buoyed the sales of cement manufacturers, we expect prices to stabilize in CY2008 as new capacities come on stream.

Retain Underperform rating with target price of Rs900/share. We have fine-tuned our earnings estimates to factor in the firm price trend so far witnessed in CY2007. However, we expect new capacities commissioning in FY2008 to change the current favorable demand-supply balance and retain our Underperform rating on the stock. ACC is trading at 8.6X EV/EBITDA on CY2008E. On an asset valuation basis, ACC is trading at EV/tonne of US$202/tonne—much above the replacement cost of $85-100/tonne.

Quarterly results for ACC Limited, December yearends (Rs mn)

	yoy			Our Estimates	
	Sept 2007	**Sept 2006**	***% chg***	**Sept 2007**	***% chg***
Sales	**16,788**	**13,735**	***22***	**17,312**	***26***
Operating costs					
Raw materials	(2,021)	(1,933)	*5*	(2,391)	*24*
Employee costs	(977)	(702)	*39*	(861)	*23*
Freight costs	(2,164)	(2,003)	*8*	(2,582)	*29*
Power costs	(3,265)	(2,231)	*46*	(2,774)	*24*
Purchased cement	(228)	(139)	*64*	(96)	*(31)*
Other expenditure	(3,647)	(3,067)	*19*	(3,348)	*9*
Total operating costs	(12,302)	(10,075)	*22*	(12,052)	*20*
EBITDA	**4,486**	**3,660**	***23***	**5,261**	***44***
EBITDA margin (%)	26.7	26.6		30.4	
Other income	284	217	*31*	250	*15*
Interest	9	(144)	*(106)*	(50)	*(65)*
Depreciation	(707)	(593)	*19*	(700)	*18*
PBT	**4,072**	**3,140**	***30***	**4,761**	***52***
Current tax (expense)/income	(1,186)	(894)		(1,285)	
Deferred tax (liability)/asset	-	-		-	
Net income	**2,885**	**2,246**	***28***	**3,475**	***55***
Extraordinaries	**39**	**1**		**-**	
Reported net income	**2,924**	**2,247**		**3,475**	
Sales, mn tonnes	**4.7**	**4.3**	***9.6***	**4.8**	***12.0***
Realization (Rs/tonne)	**3,587**	**3,217**	***12***	**3,620**	***13***
Operating costs (Rs/tonne)					
Raw materials	432	453	*(5)*		
Employee costs	209	164	*27*		
Freight costs	462	469	*(1)*		
Power & fuel costs	698	522	*34*		
Purchased cement	49	33	*50*		
Other expenditure	779	718	*8*		
Profitability (Rs/tonne)	**958**	**857**	***12***	**1,100**	***28***

Source: Company data, Kotak Institutional Equities estimates

Calculation of target prices using our multi-stage valuation process

	ACC
Dec 2007 CROGCI/WACC (X)	1.95
Assigned premium of EV/GCI to CROGCI/WACC (%)	14.5
Assigned EV/GCI (X)	2.23
GCI (Rs bn)	67.3
EV (Rs bn)	150.3
Net debt (Rs bn)	(13.4)
Market cap (Rs bn)	164
No. of shares (fully diluted)	189
Implied price (Rs)	868
Target price (Rs)	**900**

Source: Kotak Institutional Equities estimates.

Automobiles

HROH.BO, Rs725

Hero Honda: Operating performance beats street-expectations

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- **2Q net profit at Rs2 bn lower by 5.4% yoy but increased 7.6% qoq**
- **2Q operating performance better-than-expected as margins remain flat amidst lower bike sales**
- **Competition heats up ahead of the festival season**

Hero Honda (HH) reported 2QFY2008 net profit at Rs2 bn--a 5.4% yoy decline. 2Q EBITDA at Rs2.9 bn increased 3%yoy. 2Q EBITDA margin at 12.4% declined 30 bps yoy but was up 160 bps qoq. Net sales increased 6% yoy mainly on account of improved realizations as sales of higher-end bikes grew during the quarter.

2Q operating performance better-than-expected

2QFY2008 margins at 12.4% declined 30 bps yoy despite a 4.8% increase in average realizations. Raw material cost increased 130 bps yoy but declined 60 bps qoq on account of higher metal prices on a yoy basis. Hero Honda sold 756,633 bikes in 2Q—marginally higher than 1QFY2007. EBITDA grew 3% yoy and 11% qoq mainly on account of improved sales of higher-end bikes. Net profit at Rs2 bn declined 5.4% yoy but grew 7.6% qoq despite lower volumes and slowdown in the industry.

Competition heats up ahead of the festival season

Hero Honda cut its entry-level bike (CD-Deluxe) prices by Rs2,000 in a bid to improve sales in the coming months even as Bajaj reduced its entry-level "Platina" prices by Rs4,000. Hero Honda announced the launch of its new bike—150 cc 'Hunk in the premium segment. Priced at Rs55,000-57,000 (ex-showroom, Delhi), it is target to compete with Bajaj's Pulsar and TVS' Apache. The oncoming festival season holds the key to future performance as the company expects demand to pick up in 3QFY2008. We believe that the cut in the prices of entry-level bike will put margins under pressure and future profitability would depend on strong volume-growth.

Hero Honda: 2QFY2008 results

(in Rs mn)	2QFY07	1QFY08	2QFY08	% chg. qoq	% chg. yoy	FY07
Net sales	**22,300**	**24,480**	**23,521**	**(3.9)**	**5.5**	**99,000**
Operating costs	**(19,465)**	**(21,845)**	**(20,606)**	**(5.7)**	**5.9**	**(87,269)**
Increase/(decrease) in stock	818	125	973	681.8	18.9	(22)
Raw materials	(16,657)	(17,972)	(17,986)	0.1	8.0	(71,765)
Staff cost	(848)	(966)	(870)	(9.9)	2.6	(3,538)
Other expenditure	(2,778)	(3,032)	(2,724)	(10.2)	(2.0)	(11,944)
EBITDA	**2,835**	**2,635**	**2,915**	**10.6**	**2.8**	**11,730**
Other income	595	389	393	0.9	(34.0)	1,899
Interest costs	65	90	101	12.6	55.6	230
Depreciation	(344)	(376)	(384)	2.2	11.7	(1,398)
Extraordinairies						
PBT	**3,151**	**2,737**	**3,024**	**10.5**	**(4.0)**	**12,461**
Taxes	(991)	(839)	(980)	16.8	(1.0)	(3,882)
PAT	**2,160**	**1,898**	**2,043**	**7.6**	**(5.4)**	**8,579**
Key ratios						
Volumes	751,968	802,853	756,633	(5.8)	0.6	3,336,760
Net realizations (Rs/vehicle)	29,655	30,491	31,086	2.0	4.8	29,669
RM/net sales (%)	71.0	72.9	72.3	(0.6)	1.3	72.5
RM/VOP (%)	72.1	73.0	73.4	0.4	1.4	72.5
EBITDA per vehicle (Rs)	3,770	3,282	3,852	17.4	2.2	3,516
EBITDA margin (%)	12.7	10.8	12.4	1.6	(0.3)	11.8
PAT margin (%)	9.7	7.8	8.7	0.9	(1.0)	8.7
Effective tax rate (%)	31.4	30.6	32.4	1.8	1.0	31.2

Source: Company data, Kotak Institutional Equities

Energy

PLNG.BO, Rs74	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	57
52W High -Low (Rs)	92 - 41
Market Cap (Rs bn)	55.2

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	55.1	65.5	67.2
Net Profit (Rs bn)	3.1	4.3	3.8
EPS (Rs)	4.2	5.7	5.0
EPS gth	*62.5*	*38.3*	*(12.7)*
P/E (x)	17.6	12.9	14.7
EV/EBITDA (x)	9.7	7.9	10
Div yield (%)	1.7	2.0	1.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	50.0	-	-
FIIs	11.2	0.1	(0.1)
MFs	0.9	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Petronet LNG: Strong 2QFY08 results on expected lines; longer-term issues exist

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- **Strong 2QFY08 results boosted by increase in volumes (additional spot LNG cargoes)**
- **Ability to sell high-priced LNG in gas-surplus market longer term remains the key issue**
- **Fine-tuned estimates and 12-month DCF-based target price to Rs57 (Rs53 previously)**

PLNG reported 2QFY07 net income at Rs1.15 bn, marginally ahead of our Rs1.06 bn estimate. Sales volume increased sharply to 83.2 tn BTU compared to 78.6 tn BTU in 1QFY08 and 71 tn BTU in 2QFY07 led by higher spot LNG volumes. We note that at 6.5 mtpa equivalent in 2QFY08, PLNG's terminal has operated at 130% of its rated capacity and at its theoretical maximum. Notwithstanding the strong quarterly results, we have issues about (1) PLNG's ability to sell high-priced LNG in a likely gas surplus market and (2) its high re-gasification tariff. We have fine-tuned our FY2008E-FY2010 EPS to Rs5.7, Rs5 and Rs4, respectively, from Rs5.7, Rs5.2 and Rs3.6, respectively, previously. Our revised 12-month DCF-based target price is Rs57 versus Rs53 previously and primarily reflects roll-forward and fine-tuning of costs. Key upside risks to our cautious stock view are higher-than-expected re-gasification tariffs and delay (regulatory or otherwise) in supply of domestic gas.

Details of 2QFY08 results. PLNG sold 83.2 tn BTU of LNG in 2QFY08 (+6% qoq and +17% yoy) primarily due to the start of supplies (150 mcm in 2QFY08) for Ratnagiri Gas & Power plant from September. We expect sales volumes to increase 14% in FY2008 (we model 328 tn BTU of LNG or 6.4 mn tonnes) due to higher imports to feed Ratnagiri Gas and Power's power plant. Staff expenses declined to Rs42 mn as against Rs57 in 1QFY08 due to payment of bonus in the previous quarter. In other developments—(1) PLNG's board has accorded approval for a 1,200 MW power plant to be commissioned at Dahej by 2011at an estimated capex of Rs30 bn and (2) PLNG has commissioned its truck loading facility to facilitate transportation of LNG in cryogenic vehicles.

Future of LNG imports remains uncertain beyond 2010. We expect an imminent steep increase in domestic gas supply from FY2009E led by Reliance, ONGC and GSPC (see Exhibit 2); our supply model does not factor gas to be produced by ONGC and GSPC from their recent discoveries in KG and Mahanadi basin blocks or CBM. The start of new LNG capacity of PLNG at Dahej and Kochi will coincide with steep increase in supply of domestic gas. We expect the price of domestic gas to be significantly lower versus that of imported LNG. This creates issues about acceptance of high-priced LNG in the domestic market.

We note that Petronet LNG is yet to finalize the price of the additional 10 mtpa of LNG required by it for its Dahej (5 mtpa) and Kochi terminals (5 mtpa). The company is in talks with ExxonMobil to source gas from the Gorgon Project (2.5 mtpa) as well as Sonatrach of Algeria for a 25-year contract to import 1.25 mtpa of LNG. However, neither of these LNG projects is expected to start before 2011. Irrespective of timely availability of gas from these sources, we doubt LNG can be competitive with domestic gas given additional (liquefaction, re-gasification, shipping) costs involved.

PLNG's decision to construct a power plant may be a tacit acceptance of this issue; however, the moot point still remains availability of competitively-priced LNG to produce competitively-priced electricity.

High re-gasification tariff, understated capacity. PLNG's sales volume of 1.63 mn tons in 2QFY08 highlights our historical concern about its high re-gasification tariff, which is presumably based on its nameplate capacity of 5 mtpa. We see no reason for PLNG to make additional profits from volumes above its nameplate capacity; in our view, PLNG's tariff should reflect its actual capacity. We highlight the high CROCI (21.3%) for FY2007 to show PLNG's super-normal profitability. PLNG's re-gasification tariff has increased to Rs29.4/mn BTU for 1HFY08 against Rs26.6/mn BTU in FY2007, Rs22/mn BTU in FY2006 and Rs19.9/mn BTU in FY2005. It seems PLNG has got stiffer increases in FY2007 and FY2008 versus the agreed 5% unless we are computing PLNG's tariffs incorrectly (sales less raw materials divided by sales volumes).

We model a 5% increase in re-gasification tariff for FY2008E in line with PLNG's 'agreement' with gas purchasers. However, we believe a high re-gasification tariff would be difficult to sustain once supply of cheaper domestic gas increases meaningfully. We assume PLNG's re-gasification tariff to increase 3.75% in FY2009E, 2.5% per annum for FY2011E and FY2012E and model flat tariffs beyond that until FY2017E, the terminal year of our DCF model (Exhibit 4). We reduce tariffs in FY2010 to Rs23.7/mn BTU, the initial tariff based on our understanding of possible renegotiation of tariff as per the agreement between PLNG and gas purchasers.

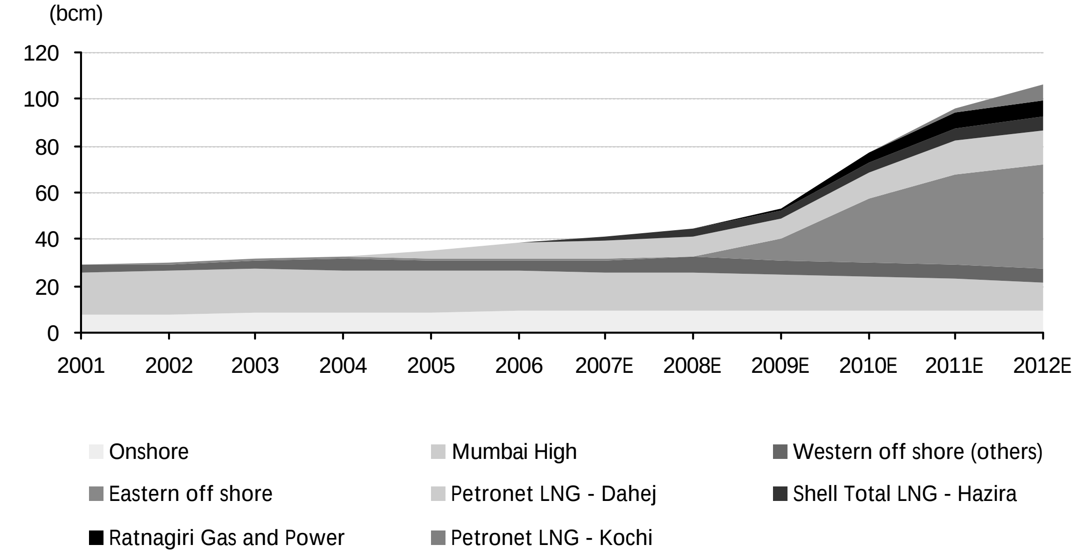
Interim results of Petronet LNG, March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2008E	2Q 2008	1Q 2008	*Chg. (%)*	2Q 2008	2Q 2007	*Chg. (%)*	1H2008	1H2007	*Chg. (%)*
Net sales	**65,529**	**16,705**	**15,510**	***8***	**16,705**	**13,751**	***21***	**32,215**	**23,942**	***35***
Total expenditure	(56,332)	(14,562)	(13,461)	*8*	(14,562)	(12,304)	*18*	(28,023)	(21,186)	*32*
Raw material	(693)	(14,299)	(13,154)	*9*	(14,299)	(12,051)	*19*	(27,453)	(20,590)	*33*
Staff cost	(486)	(42)	(57)	*(26)*	(42)	(28)	*51*	(99)	(65)	*53*
Other expenditure	(57,511)	(221)	(250)	*(12)*	(221)	(225)	*(2)*	(471)	(531)	*(11)*
EBITDA	**8,018**	**2,143**	**2,049**	***5***	**2,143**	**1,447**	***48***	**4,193**	**2,756**	***52***
Other income	494	121	116	*5*	121	77	*58*	237	130	*83*
Depreciation	(1,016)	(258)	(254)	*1*	(258)	(257)	*0*	(512)	(511)	*0*
Interest	(1,062)	(261)	(257)	*2*	(261)	(269)	*(3)*	(517)	(535)	*(3)*
Profit before tax	**6,433**	**1,747**	**1,654**	***6***	**1,747**	**998**	***75***	**3,401**	**1,839**	***85***
Extraordinary/prior period items	—	—	—		—	—		—	—	—
Current tax	(804)	(580)	(413)		(580)	—		(993)	—	—
Deferred tax liabilities/assets	(1,331)	(2)	(160)	*(99)*	(2)	(336)	*(100)*	(162)	(615)	—
Fringe benefit tax	—	(10)	(2)		(10)	(2)		(12)	(3)	—
Profit after tax	**4,298**	**1,155**	**1,080**	***7***	**1,155**	**660**	***75***	**2,235**	**1,221**	***83***
Adj Profit after tax	**4,298**	**1,155**	**1,080**	***7***	**1,155**	**660**	***75***	**2,235**	**1,221**	***83***
Tax rate	33.2	33.9	34.7		33.9	33.8		33.9	33.4	
Sales quantity (tn BTU)		83	79	*6*	83	71	*17*	162	137	*18*
Re-gasification tariff (Rs/mn BTU)		29	30	*(3)*	29	24	*21*	29	24	*21*

Source: Company, Kotak Institutional Equities estimates.

We project a steep increase in domestic supply from FY2009

Supply of natural gas in India, March fiscal year-ends, 2001-2012E (bcm)

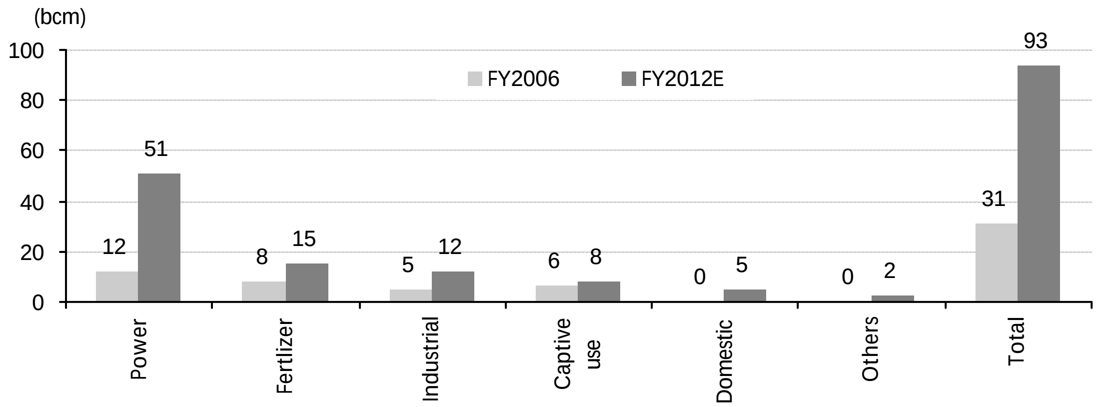


Note: Eastern offshore includes potential gas from Reliance's field in KG basin.

Source: Kotak Institutional Equities estimates.

Current supply-constrained demand set to increase sharply

Segment wise demand for natural gas, current versus potential (bcm)



Source: Ministry of petroleum and natural gas, Kotak Institutional Equities estimates.

We model Petronet's volumes scaling up to 9 mtpa by FY2010

Key volume/price assumptions for Petronet LNG

	2005	2006	2007	2008E	2009E	2010E	2011E
Volume assumptions							
Sales volume (mn tons)	2.5	4.8	5.6	6.4	6.6	8.8	11.8
Price assumptions							
LNG purchase price (FOB) (US$/mn BTU)	2.5	2.5	3.3	3.8	3.8	4.4	4.6
Landed cost (incl. import tariff) (US$/mn BTU)	2.9	2.9	3.8	4.3	4.4	5.0	5.14
Re-gasification charges (US$/mn BTU)	0.53	0.57	0.58	0.69	0.72	0.62	0.64
Escalation in re-gasification charges (%)	**5.0**	**5.0**	**5.0**	**5.0**	**3.75**	**(13.2)**	**2.5**
Sales price (US$/mn BTU)	3.5	3.5	4.4	5.0	5.1	5.6	5.8
Other assumptions							
Rupee/US dollar exchange rate	45.0	44.3	45.3	40.0	39.0	38.0	38.0

Source: Kotak Institutional Equities estimates.

Our DCF-based target price for PLL is Rs57

Calculation of equity value of PLL using discounted cash flow analysis (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	8,018	7,583	8,076	11,193	16,004	15,791	15,615	15,518	15,414	15,303
Adjusted tax expense	(931)	(1,464)	—	(1,036)	(1,599)	(2,892)	(3,472)	(3,933)	(4,293)	(4,453)
Change in working capital	2,398	9	(381)	724	1,447	(68)	(118)	(196)	(239)	(292)
Operating cash flow	**9,484**	**6,128**	**7,695**	**10,881**	**15,853**	**12,830**	**12,024**	**11,389**	**10,882**	**10,558**
Capital expenditure	(8,000)	(15,000)	(9,000)	(8,166)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(2,500)
Free cash flow	**1,484**	**(8,872)**	**(1,305)**	**2,715**	**14,853**	**11,830**	**11,024**	**10,389**	**9,882**	**8,058**
Discounted cash flow-now	1,408	(7,480)	(978)	1,808	8,792	6,225	5,156	4,319	3,651	2,646
Discounted cash flow-1 year forward		(8,415)	(1,100)	2,034	9,894	7,003	5,801	4,859	4,108	2,977
Discounted cash flow-2 year forward			(1,237)	2,289	11,131	7,880	6,526	5,466	4,622	3,350

	Now	+ 1-year	+ 2-years
Discount rate (%)	12.5%	12.5%	12.5%
Total PV of free cash flow	25,547	29,807	45,649
Terminal value assumption			
Growth in perpetuity	0.0%	0.0%	0.0%
FCF in 2018E	8,058	8,058	8,058
Exit FCF multiple (X)	8.0	8.0	8.0
Exit EV/EBITDA multiple (X)	4.2	4.2	4.2
Terminal value	64,465	64,465	64,465
PV of terminal value	21,168	21,168	21,168
Total company value	**46,716**	**50,976**	**66,818**
Net debt	7,647	8,099	18,865
Equity value	39,068	42,876	47,953
Shares outstanding (mn)	750	750	750
Estimated share price using DCF	**52.1**	**57.2**	**63.9**

Sensitivity of 12-month DCF to WACC and perpetual growth

		Perpetual growth (%)				
		-1.0%	**-0.5%**	**0.0%**	**0.5%**	**1.0%**
WACC (%)	**11.5%**	61.3	63.0	64.9	66.9	69.2
	12.0%	57.6	59.2	60.9	62.7	64.7
	12.5%	54.3	55.7	**57.2**	58.8	60.6
	13.0%	51.1	52.4	53.8	55.2	56.8
	13.5%	48.2	49.4	50.6	51.9	53.3

Fiscal Year end (March 31, XXXX)	March-08	March-09	March-10	March-11	March-12	March-13	March-14	March-15	March-16	March-17
Today	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07	19-Oct-07
Days left	164	529	894	1,259	1,625	1,990	2,355	2,720	3,086	3,451
Years left	0.45	1.45	2.45	3.45	4.45	5.45	6.45	7.45	8.45	9.45
Discount factor at WACC	**0.95**	**0.84**	**0.75**	**0.67**	**0.59**	**0.53**	**0.47**	**0.42**	**0.37**	**0.33**

Source: Kotak Institutional Equities estimates.

Petronet LNG: Profit model, balance sheet, cash model March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)							
Net sales	19,453	38,197	55,090	65,529	67,210	95,503	132,041
EBITDA	**1,505**	**4,707**	**6,481**	**8,018**	**7,583**	**8,076**	**11,193**
Other income	133	194	366	494	472	461	460
Interest	(1,094)	(1,116)	(1,070)	(1,016)	(967)	(1,815)	(1,974)
Depreciation	(968)	(1,010)	(1,020)	(1,062)	(1,383)	(2,019)	(2,506)
Extraordinary items	—	175	—	—	—	—	—
Pretax profits	(424)	2,950	4,756	6,433	5,705	4,702	7,173
Tax	—	(256)	(6)	(804)	(1,252)	—	(813)
Deferred taxation	140	(745)	(1,617)	(1,331)	(687)	(1,683)	(1,625)
Net profits	**(284)**	**1,949**	**3,133**	**4,298**	**3,766**	**3,019**	**4,735**
Earnings per share (Rs)	**(0.4)**	**2.4**	**4.2**	**5.7**	**5.0**	**4.0**	**6.3**
Balance sheet (Rs mn)							
Total equity	8,770	10,719	12,755	15,737	18,625	20,767	24,185
Deferred taxation liability	(140)	605	2,472	3,803	4,490	6,173	7,799
Total borrowings	12,599	12,599	13,832	14,432	24,432	28,932	28,932
Currrent liabilities	3,585	1,725	5,877	6,504	6,620	8,581	11,114
Total liabilities and equity	**24,814**	**25,648**	**34,936**	**40,476**	**54,168**	**64,453**	**72,030**
Cash	2,980	2,506	3,405	3,553	2,787	3,231	2,782
Current assets	2,753	2,946	7,478	5,707	5,815	8,157	9,965
Total fixed assets	18,903	18,627	21,273	28,436	42,786	50,286	56,503
Investments	179	1,569	2,780	2,780	2,780	2,780	2,780
Total assets	**24,814**	**25,648**	**34,936**	**40,476**	**54,168**	**64,453**	**72,030**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	437	3,524	4,927	5,973	4,631	5,741	7,849
Working capital	628	(2,057)	(710)	2,398	9	(381)	724
Capital expenditure	(18,969)	(335)	(36)	(8,000)	(15,000)	(9,000)	(8,166)
Investments	(179)	(1,390)	(1,211)	—	—	—	—
Free cash flow	**(18,083)**	**(258)**	**2,970**	**371**	**(10,360)**	**(3,639)**	**407**
Other income	128	184	326	494	472	461	460
Ratios (%)							
Debt/equity	146	111	91	74	106	107	90
Net debt/equity	111	89	68	56	94	95	82
RoAE	(3.2)	19.5	23.6	24.7	17.7	12.1	16.1
RoACE	**2.1**	**11.9**	**14.5**	**15.8**	**10.8**	**8.1**	**10.3**
Adjusted CROCI	**8.9**	**21.3**	**25.1**	**34.2**	**16.7**	**20.7**	**15.6**
Key assumptions							
Sales volume (mn tons)	2.5	4.8	5.6	6.4	6.6	8.8	11.8
LNG purchase price (FOB) (US$/mn BTU)	2.5	2.5	3.3	3.8	3.8	4.4	4.6
Re-gasification charges (US$/mn BTU)	0.53	0.57	0.58	0.69	0.72	0.62	0.64
Sales price (US$/mn BTU)	3.5	3.5	4.4	5.0	5.1	5.6	5.8
Rupee/US dollar exchange rate	45.0	44.3	45.3	40.0	39.0	38.0	38.0

Source: Kotak Institutional Equities estimates.

Technology

HEXT.BO, Rs113	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	130
52W High -Low (Rs)	205 - 108
Market Cap (Rs bn)	16.0

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	8.5	10.4	12.4
Net Profit (Rs bn)	1.3	1.2	1.5
EPS (Rs)	8.9	8.1	10.4
EPS gth	*16.1*	*(9.3)*	*29.7*
P/E (x)	12.7	14.0	10.8
EV/EBITDA (x)	9.5	8.7	6.1
Div yield (%)	1.4	1.4	1.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	25.5	-	-
FIIs	52.7	0.2	0.1
MFs	2.2	0.0	(0.0)
UTI	-	-	(0.1)
LIC	3.9	0.1	(0.0)

Hexaware Technologies: Inexpensive but no catalysts for stock performance. Maintain Inline rating

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- **Revenue decline, operating margin slippage and net profit miss**
- **Sustainable value can be created only through significant improvement in sales execution**
- **Share buyback, ESOPs and conversion of preference shares by General Atlantic Partners**
- **Valuations—downside limited though waiting for catalysts for rating change**

Hexaware's 3QCY07 results were significantly below our expectations. Revenues declined 1.5% qoq to US$63.1 mn, EBITDA declined 5.2% and net income was up a modest 3%. The company attributed the revenue decline to loss of its only mortgage client and proactive rationalization of low margin business. CY2007 would be another year of disappointment with organic revenue growth in low teens. The company has initiated a number of measures to stem the rot including (1) Increasing the North America sales headcount, fine tuning the profile of people and separating the hunting and farming team; (2) Increasing the breadth of technology capabilities and (3) greater emphasis on large deals. We would however like to see the progress on these initiatives, especially on sales execution where the company has faltered, before taking a positive stance on the company. Hexaware has announced a buy-back of shares, though it has not quantified the quantum or the maximum price at which it would consider the buyback. We reduce our CY2007 EPS estimate by 19% to Rs8.1, CY2008 EPS estimate by 18% to Rs10.4 and CY2009 EPS estimate by 16% to Rs11.9. We reduce our end-CY2008 DCF based target price to Rs130 (Rs140 earlier).

Revenue decline, operating margin slippage and net profit miss: Hexaware reported revenues of US$63.1 mn for the Sep' 07 quarter, a qoq decline of 1.5%. The company attributes the decline to proactive rationalization of low margin clients and ramp down by its only mortgage client. As a result, EBITDA margin declined 40bps qoq and 310bps yoy to 11.9%. Net income grew 3% qoq (25% lower than our expectations) led primarily by forex gains and higher other income. Key business metrics have deteriorated including (1) the number of US$ 10 mn accounts have slipped; (2) growth is anemic from top 5 clients; (3) attrition increased to 18% and (4) receivables days increased to 82 from 75 in the previous quarter.

... however all is not lost: While the performance for September quarter and flat revenue guidance for December quarter is disappointing, there are some positives to look forward to including (1) the company won a large US$50 mn, three deal from an existing client of which US$30 mn in incremental; (2) the company recruited 1041 employees, highest ever in a quarter. We concede that 50% of the recruits may be freshers, of which a large part may be campus commitments given in the prior year; (3) strong US$100 mn order book; and (4) robust pipeline of deals—the company indicates that it is pursuing 15 deals with a total value of around US$150 mn. The company has won a further US$28 mn worth of contracts in the first three weeks of October. All these point to an improving outlook.

… though sustainable value can be created only through significant improvement in sales execution; we would wait and watch before taking a positive stance: Hexaware has suffered on growth in the last two years on account of significant slippages on sales execution. The company has attempted to address this issue through change in profile of people at the front end, instituting new structures as CBU's and increase in sales count. However the success has been limited resulting in wastage of significant opportunity of mining the high quality accounts (55 F-500/G-500 clients) for sustainable competitive advantage. This reflects in organic revenue growth of 27% in CY2007, 21% in CY2006 and likely 21% in CY2008. The company is now in the midst of several changes including (1) increasing the North America sales team count (2) separation of hunting team and farming team. Hexaware plans to increase the strength of its hunting team to 19 from 4 currently and (3) further fine tuning of the profile of sales people without causing disruptions. We believe that the new head of North America sales may come on board in January 2008. In addition the company may also add more people to the Europe sales team. All these are good steps in our view, though we would wait for success on some of these efforts. Some of the metrics, which we closely track including sales productivity, change in growth pattern from large clients and pricing.

Share buyback, ESOPs and conversion of preference shares by General Atlantic Partners: Hexaware has announced its intention of share buyback. The board would meet in November to discuss aspects such as quantum of buyback, pricing and period. Hexaware has US$80 mn of cash (Rs22.5/ share) as at end- September 2007. The company has also announced grant of 4.5 mn shares at Rs109 to certain key employees of the company. The options granted would vest over a period of four years with a strike price of Rs109. General Atlantic Partners has converted its preference shares into 10.6 mn of equity shares (7.4% of fully diluted equity) at a price of Rs142, a 26% premium over today's closing price of Rs113.

Valuations—downside limited though waiting for catalysts for rating change: Hexaware is trading at 10.9x our revised CY2008 and 9.5x CY2009 earnings. We have made certain changes to our assumptions (1) **Revenue growth:** We build in revenues of US$318 mn for CY2008 and US$398mn for CY2009 from US$335 mn and US$426 mn respectively earlier (2) **OPM**: We reduce our OPM forecast for CY2008 by 110bps to 14.2% and CY2009 forecast by 50 bps to 14.4% and (3) **EPS**: We revise our CY2008 EPS estimate by 18% to Rs10.4 and CY2009 EPS forecast by 16% to Rs11.9. We base our forecasts on a revised Re/US$ rate of 39 for CY2008 and 38 for CY2009. On the back of these revisions, we reduce our end 2008 DCF based target price to Rs130.

Key changes in CY2007, CY2008, and CY2009 estimates

	New			Old			Change (%)		
US$ mn	**CY2007**	**CY2008**	**CY2009**	**CY2007**	**CY2008**	**CY2009**	**CY2007**	**CY2008**	**CY2009**
Revenues (US$ mn)	**251**	**318**	**398**	**264**	**335**	**426**	**(4.8)**	**(5.1)**	**(6.7)**
EBITDA Margin (%)	12.9	14.2	14.4	14.8	15.3	14.9	(1.9)	(1.1)	(0.4)
EPS (Rs/ share)	**8.1**	**10.4**	**11.9**	**10.0**	**12.7**	**14.1**	**(19.2)**	**(17.7)**	**(15.8)**
Re/ US$ rate	**41.2**	**39.0**	**38.0**	**41.4**	**40.0**	**40.0**	**(0.4)**	**(2.5)**	**(5.1)**

Source: Kotak Institutional Equities Estimates

Comments: Hexaware Interim Results (consolidated) 3QCY07

					% chg.		Kotak		
Rs mn	**2QCY06**	**1QCY07**	**2QCY07**	**3QCY07**	**qoq**	**yoy**	**estimates**	**% deviation**	**Comments**
Revenues	**2,069**	**2,644**	**2,616**	**2,546**	**(2.7)**	**13.2**	**2,751**	**(7.5)**	Revenues declined 1.5% qoq to US$63.1 mn. Driven by a volume decline of 2%. Revenue decline was due to the loss of a sub-prime mortgage client of FocusFrame. Inc.
Software Development Costs	(1,324)	(1,603)	(1,663)	(1,640)	(1.4)	16.1	(1,721)	(4.7)	
Gross profit	**745**	**1,040**	**953**	**906**	**(5.0)**	**8.2**	**1,030**	**(12.0)**	
Total SG&A Expenses	(434)	(645)	(633)	(602)	(4.8)	26.3	(609)	(1.1)	
EBITDA	**311**	**395**	**321**	**304**	**(5.2)**	**(15.8)**	**421**	**(27.8)**	EBITDA margin decline of 40bps disappointing.
Depreciation	(46)	(56)	(58)	(57)	(0.9)	3.1	(58)	(1.6)	
EBIT	265	339	263	247	(6.2)	(19.2)	363	(32.0)	
Other Income	46	68	50	75	48.6	(6.6)	61	22.6	
Profit Before Tax	311	407	313	322	2.6	(16.6)	424	(24.1)	
Provision for Tax	(13)	(55)	(52)	(52)	0.6	35.7	(57)	(8.1)	
Net Profit	**298**	**352**	**261**	**269**	**3.0**	**(22.4)**	**367**	**(26.6)**	Net income came 27% lower than expectations.
EPS (Rs/ share)	2.1	2.5	1.8	1.9	3.0	(22.4)	2.58	(26.6)	
No of shares outstanding (mn)	142.1	142.1	142.1	142.1	-	-	142.1		
As % of revenues									
Gross Profit Margin (%)	36.0	39.4	36.4	35.6			37.4		
Operating Margin	15.0	15.0	12.3	11.9			15.3		
SG&A Expenses (%)	21.0	24.4	24.2	23.7			22.1		
Billing Rates (US$/manhour)									
Onsite	65.8	66.5	66.9	67.2	0.4	1.8	67.6	(0.6)	
Offshore	22.9	23.3	23.4	23.4	-	2.0	23.6	(1.0)	
Revenue Mix (%)									
Onsite	60.4	62.1	64.7	64.7			64.0		Both onsite and offshore revenues down on a qoq basis
Offshore	39.6	37.9	35.3	35.3			36.0		

Hexaware Technologies: Consolidated Profit & Loss Statement Statement, December Year End (Rs mn)

	2005	2006	2007E	2008E	2009E
Income From Software Development					
Overseas	6,787	8,482	10,357	12,409	15,112
Revenues	**6,787**	**8,482**	**10,357**	**12,409**	**15,112**
Software Development Costs	(4,173)	(5,318)	(6,547)	(7,925)	(9,715)
Gross profit	**2,613**	**3,164**	**3,809**	**4,484**	**5,397**
Selling and marketing exp	(641)	(771)	(984)	(1,136)	(1,350)
Administration exp	(885)	(1,071)	(1,489)	(1,588)	(1,870)
Total SG&A Expenses	(1,526)	(1,842)	(2,473)	(2,724)	(3,220)
EBITDA	**1,087**	**1,322**	**1,336**	**1,760**	**2,177**
Depreciation	(223)	(200)	(230)	(250)	(286)
EBIT	**865**	**1,122**	**1,106**	**1,510**	**1,891**
Interest	-	-	-	-	-
Other Income	146	241	265	294	278
Profit Before Tax	**1,010**	**1,363**	**1,371**	**1,804**	**2,169**
Provision for Tax	(97)	(101)	(214)	(293)	(442)
Net Profit	**913**	**1,262**	**1,157**	**1,511**	**1,727**
Extraordinaries	-	-	-	-	-
Net Profit- Reported	**913**	**1,262**	**1,157**	**1,511**	**1,727**
		-	-	-	-
EPS (Rs/ share)	**7.6**	**8.9**	**8.1**	**10.4**	**11.9**
No of shares outstanding (mn)	119.4	142.1	143.6	144.6	145.6
Margins (%)					
Gross Profit margin	38.5	37.3	36.8	36.1	35.7
EBITDA Margin	16.0	15.6	12.9	14.2	14.4
EBIT Margin	12.7	13.2	10.7	12.2	12.5
NPM	13.5	14.9	11.2	12.2	11.4
Growth Rates (%)					
Revenues	24.3	25.0	22.1	19.8	21.8
Gross Profit	26.4	21.1	20.4	17.7	20.4
EBITDA	38.1	21.6	1.1	31.7	23.7
EBIT	38.9	29.8	-1.4	36.5	25.3
Net Profit	44.1	38.2	-8.3	30.6	14.3
As percentage of Sales					
Revenues	100.0	100.0	100.0	100.0	100.0
Software Development Expenses	61.5	62.7	63.2	63.9	64.3
Gross Profit	38.5	37.3	36.8	36.1	35.7
Selling Expenses	9.4	9.1	9.5	9.2	8.9
Administrative Expenses	13.0	12.6	14.4	12.8	12.4
S G & A Expenses	22.5	21.7	23.9	22.0	21.3
EBITDA	16.0	15.6	12.9	14.2	14.4
Depreciation	3.3	2.4	2.2	2.0	1.9
EBIT	12.7	13.2	10.7	12.2	12.5
Net Profit	13.5	14.9	11.2	12.2	11.4
Tax Rate	9.6	7.4	15.6	16.3	20.4

Source: Company data, Kotak Institutional Equities estimates.

Infrastructure

GMRI.BO, Rs160	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	135
52W High -Low (Rs)	201 - 56
Market Cap (Rs bn)	264.4

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	17.0	17.5	30.1
Net Profit (Rs bn)	1.7	2.9	3.4
EPS (Rs)	1.1	1.8	2.1
EPS gth	*97.5*	*66.6*	*17.6*
P/E (x)	151.6	91.0	77.4
EV/EBITDA (x)	52.7	59.2	29.0
Div yield (%)	-	-	-

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.6	-	-
FIIs	9.0	0.3	0.3
MFs	0.3	0.1	0.1
UTI	-	-	-
LIC	-	-	-

GMR Infrastructure: Results first take: earnings decline led by interest and depreciation charge on non-operational Vemagiri power plant

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- **Operating results below expectations led by the power segment**
- **EBIT margin in the airports segment lower than our expectations probably led by differences in depreciation methodology**
- **Highlight cash balance and suboptimal leverage at the end of FY2007 with respect to potentially large equity issuance worth about Rs50 bn**
- **Maintain target price of Rs135, reiterate Underperform rating**

GMR Infrastructure has reported operating performance below our expectations with 2QFY08 revenues of Rs3,953 mn (up 26.5% yoy) versus our estimate of Rs4,377 mn. Reported PAT in 2QFY08 is Rs496 mn (Exhibits 1 & 2) versus over expectation of Rs726 mn. Delhi airport revenues are up 49% yoy, while power segment revenues are up 10.4% and roads segment revenues have remained flat on a sequential basis. Management is organizing a conference call today, where we expect to receive further details on sale of development rights in Delhi and equity issuance. We maintain our target price of Rs135 and reiterate our Underperform rating.

Operating results below expectations led by the power segment

GMR Infrastructure has reported operating performance below our expectations with 2QFY08 revenues of Rs3,953 mn (up 26.5% yoy) versus our estimate of Rs4,377 mn. Reported PAT in 2QFY08 is Rs496 mn (Exhibits 1 & 2) versus over expectation of Rs726 mn.

Airports segment – EBIT margin lower than our expectations probably led by differences in depreciation methodology

GMR has reported revenues of Rs2,282 mn in the airports segment, up 23% qoq and 49.3% yoy while EBIT contribution has increased 123% yoy and 56% qoq to Rs304 mn from Rs136 and Rs195 respectively. We highlight that EBIT margin in the airport segment in 1HFY08 at 22.4% has been lower than our expectation of 34%. Key difference in EBIT margin could originate from difference in our depreciation assumption for Delhi Airport capital expenditure – we have assumed no depreciation for Delhi International Airport till FY2010 i.e. project completion. Sequential improvement in EBIT margin to 24.7% in 2QFY08 from 19.5% in 1QFY08 highlight that full year EBIT margin would inch up in the 2HFY08.

Power segments EBIT contribution declines led by non operational Vemagiri plant on a yoy basis

GMR has reported revenues of Rs2,145 mn in the power segment – up 10.4% yoy, but down 35.3% qoq. Power segment revenues are lower qoq probably because of lower PLFs in 2Q versus 1Q, as the monsoon season during 2Q reduces the demand for power.

22% yoy decline in EBIT contribution in the power segment is probably led by the fact that non operational Vemagiri power plant has reported a loss of Rs342 mn in 2QFY08. Vemagiri plant is non-operational but has to charge depreciation and interest in the post commercial operation date (September 2006).

Potential large equity issuance worth about Rs50 bn, highlight cash balance and suboptimal leverage at the end of FY2007

GMR has announced board approval for raising upto Rs50 bn through further equity issuance. We highlight that GMR has cash balance of Rs 13 bn and net debt to equity ratio of only 0.95X on a consolidated basis at the end of FY2007. Equity issuance of Rs50 bn could potentially fund equity component of projects worth more than Rs200 bn (at a debt-equity mix of 3:1). We do not have visibility of GMR building such a large project portfolio over the next one to two years.

Highlight recent under performance of the stock, maintain target price of Rs675, reiterate under perform rating

We maintain our target price of Rs135 and reiterate our Underperform rating. We highlight that the stock has under performed the market by 10.2% and 21.8% over the last one month and three month period respectively.

Management is organizing a conference call today, where we expect to receive updates on several aspects like – status of sale of development rights for first tranche of 45 acres of Delhi airport real estate, recent SEZ project and equity issuance.

Exhibit 1. GMR Infrastructure - 2QFY08 - key numbers (Rs mn)

			yoy			qoq			yoy		
	FY07	FY08E	2QFY08	2QFY07	% change	2QFY08	1QFY08	% change	1HFY08	1HFY07	% change
Income from operations	**16,967**	**17,506**	**3,953**	**3,125**	**26.5**	**3,953**	**4,766**	**(17.1)**	**8,719**	**7,218**	**20.8**
Total Expenditure	(11,531)	(11,909)	(2,396)	(1,875)	27.8	(2,396)	(3,380)	(29.1)	(5,776)	(4,687)	23.2
Generation and operating expenses	(8,844)	(10,801)	(1,442)	(1,216)	18.5	(1,442)	(2,613)	(44.8)	(4,054)	(3,493)	16.1
Admin and other expenses	(1,382)	(1,926)	(503)	(377)	33.5	(503)	(382)	31.7	(885)	(623)	42.1
Employees	(1,305)	(2,241)	(451)	(282)	60.3	(451)	(386)	17.0	(837)	(571)	46.6
Operating profit	**5,437**	**5,598**	**1,557**	**1,250**	**24.6**	**1,557**	**1,386**	**12.4**	**2,943**	**2,531**	**16.3**
Other income	183	2,739	117	46	152.2	117	191		308	63	388.9
EBIDTA	5,620	8,336	1,674	1,296	29.1	1,674	1,577	6.1	3,250	2,594	25.3
Interest	(1,441)	(2,030)	(359)	(236)	52.4	(359)	(375)	(4.3)	(735)	(530)	38.6
Depreciation	(1,346)	(1,978)	(439)	(268)	63.8	(439)	(406)	8.3	(845)	(528)	59.9
Profit before tax	2,833	4,329	875	792	10.4	875	796	10.0	1,671	1,535	8.8
Tax	(415)	(704)	(157)	(86)	81.3	(157)	(101)	55.1	(257)	(182)	41.1
Net profit	**2,418**	**3,624**	**719**	**706**	**1.8**	**719**	**695**	**3.4**	**1,413**	**1,353**	**4.5**
Minority interest	(673)	(718)	(223)	(170)	31.2	(223)	(231)	(3.6)	(454)	(351)	29.3
Reported profit	**1,744**	**2,906**	**496**	**536**	**(7.5)**	**496**	**464**	**6.9**	**960**	**1,002**	**(4.2)**
Key ratios											
OPM	**32.0**	**32.0**	**39.4**	**40.0**		**39.4**	**29.1**		**33.8**	**35.1**	
EBIDTA margin	33.1	47.6	42.3	41.5		42.3	33.1		37.3	35.9	
Pre-tax margin	16.7	24.7	22.1	25.4		22.1	16.7		19.2	21.3	
PAT margin	14.2	20.7	18.2	22.6		18.2	14.6		16.2	18.7	
Tax rate	14.7	16.3	17.9	10.9		17.9	12.7		15.4	11.9	

Source: Company data, Kotak institutional equities estimates.

Exhibit 2. GMR Infrastructure - 2QFY08 - segmental numbers (Rs mn)

			yoy			qoq			yoy		
	FY2007	FY2008E	2QFY08	2QFY07	% change	2QFY08	1QFY08	% change	1HFY08	1HFY07	% change
Airports											
Gross revenues	5,880	7,528	2,282	1,529	49.3	2,282	1,858	22.8	4,140	2,494	66.0
Less: AAI rev share	(2,720)	(3,462)	(1,051)	(706)	49.0	(1,051)	(858)	22.5	(1,909)	(1,154)	65.5
Net revenue	3,160	4,066	1,230	823	49.5	1,230	1,000	23.0	2,231	1,340	66.5
EBIT	618	1,381	304	136	123.8	304	195	56.1	499	186	167.8
Power											
Gross revenues	11,949	12,013	2,145	1,943	10.4	2,145	3,314	(35.3)	5,459	5,141	6.2
EBIT	2,594	2,291	541	699	(22.6)	541	704	(23.1)	1,245	1,452	(14.2)
Roads											
Gross revenues	1,432	1,427	349	360	(3.0)	349	347	0.5	696	732	(4.9)
EBIT	714	697	160	179.0	(10.8)	160	181	(11.7)	340	375	(9.3)
Key ratios											
EBIT Margins											
Airports	19.6	34.0	24.7	16.5		24.7	19.5		22.4	13.9	
Power	21.7	19.1	25.2	36.0		25.2	21.2		22.8	28.2	
Roads	49.9	48.9	45.7	49.8		45.7	52.0		48.9	51.3	

Source: Company data, Kotak Institutional Equities estimates.

Technology

TCS.BO, Rs1119	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	1,225
52W High -Low (Rs)	1399 - 978
Market Cap (Rs bn)	1,095

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	186.3	228.5	287.7
Net Profit (Rs bn)	41.3	50.7	60.0
EPS (Rs)	42.2	51.8	61.3
EPS gth	*43.3*	*22.6*	*18.5*
P/E (x)	26.5	21.6	18.2
EV/EBITDA (x)	21.2	17.5	14.0
Div yield (%)	1.0	1.9	2.2

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.1	-	-
FIIs	7.7	1.3	(2.3)
MFs	2.0	1.9	(1.7)
UTI	-	-	(3.6)
LIC	2.2	1.9	(1.6)

Tata Consultancy Services: Nielsen US$1.2 bn 10-year deal lends confidence to the sustainability of revenue growth trajectory

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- **Announces US$1.2 bn 10-year contract with Nielsen**
- **Contract covers the entire gamut of TCS' service offerings**
- **Contract will not be dilutive to corporate margins**

We believe that TCS' contract win (US$ 1.2bn, 10-year, full service) with Nielsen, a global information and media major operating in over 100 countries, reflects the growing maturity of the frontline Indian IT companies in the large multi-service, multi-location, multi-year contracts—note that this is now the largest deal announced by an Indian IT company, surpassing Tech Mahindra's US$1 bn deal with BT Global. It also showcases the capability of the frontline Indian IT companies (and specially TCS as compared to other large peers) to structure and take up large integrated contracts; this has hitherto been the strong area of large global players like IBM, Accenture, EDS. etc. This deal lends further confidence to our estimates and reflects growing acceptability and success in newer service offerings viz: BPO, KPO and infrastructure management. The deal implies an annual contribution of 1.6% to TCS' revenues for FY2009E. Given TCS' size, we believe that TCS will likely have to win more such deals to meet our revenue growth estimates (38% for FY2008 and 29% for FY2009). Maintain our In-Line rating on TCS with an end-march 2009 DCF based target price of Rs1,225.

Take-or-pay contract, no margin dilution: We believe that the key highlight of the deal is the increasing ability of TCS to leverage full range of service offerings and structure large contracts. This may help ease some of the street's concern on ability of the frontline companies to manage growth on an increasing revenue base. We discuss some of the other key aspects of the deal below:

- **Multi-service, multi-location deal:** The deal was won leveraging TCS' complete bundle of service offerings. It covers services such as application management, infrastructure management, BPO (F&A, and HR), enterprise applications (SAP), and KPO. TCS would be taking over 350 people from Nielsen's KPO operation in Baroda.
- **Take-or-pay contract:** We highlight that this deal is one of the few deals signed by the Indian IT players with total revenue commitment which removes any volume risk to the deal.
- **No margin dilution:** TCS indicates that the contract is profitable from the inception, would not be dilutive to corporate margins and meets the company's profitability expectations. We believe that this should allay concerns over large deal being necessarily negative for margins.
- **Highlights the potential of some of the less-penetrated verticals:** Most of the large deals signed by the frontline IT players in the past have been in verticals like BFSI, Telecom, and Manufacturing. TCS' contract win with a media major underlines the revenue potential of some of the less-penetrated verticals for the Indian IT industry.
- **No asset takeover:** TCS indicates that the deal does not involve any asset takeover or people takeover (onsite). This reflects the growing ability of the frontline Indian IT companies to structure large deals without taking over any assets on their books (a key ingredient of most mega deals signed by the likes of IBM, EDS, etc.).
- **Contract would reach steady state by end-FY2009.** TCS indicates that transition of work would take 12-18 months. The revenue flow would be even over the life of the contract starting FY2010.

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Sanjeev Prasad, Aman Batra, Amit Agarwal, Kawaljeet Saluja, Lokesh Garg."

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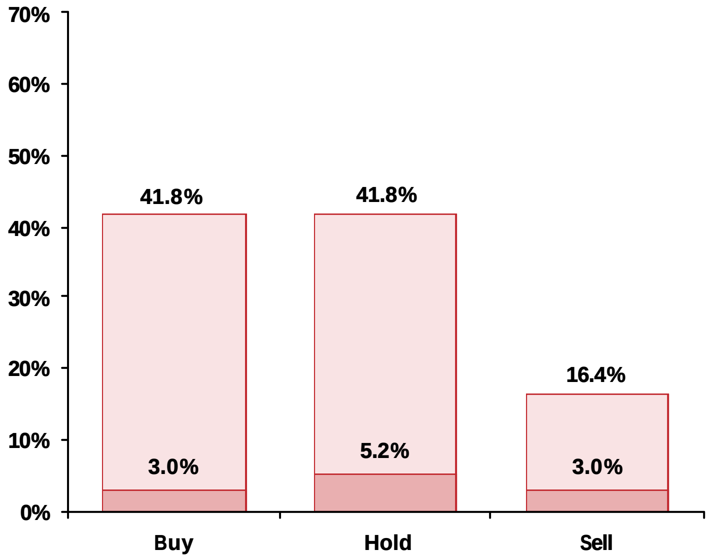

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Source: Kotak Institutional Equities. As of September 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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