kotak® Institutional Equities

INDIA DAILY

August 27, 2007

EQUITY MARKETS

India	24-Aug	Change, % 1-day	1-mo	3-mo
Sensex	14,425	1.8	(5.3)	0.6
Nifty	4,190	1.8	(5.7)	(1.4)
Global/Regional indices				
Dow Jones	13,379	1.1	0.9	(1.0)
Nasdaq Composite	2,577	1.4	0.6	0.8
FTSE	6,220	0.4	0.1	(5.3)
Nikkie	16,422	1.1	(5.0)	(6.1)
Hang Seng	23,334	1.8	3.4	13.7
KOSPI	1,817	1.4	(3.5)	10.5

Value traded - India

	24-Aug	Moving avg, Rs bn 1-mo	3-mo
Cash (NSE+BSE)	116.3	157.4	154.5
Derivatives (NSE)	433.4	642.8	347.6
Deri. open interest	838.5	943.1	640.4

Forex/money market

	24-Aug	Change, basis points 1-day	1-mo	3-mo
Rs/US$	41.1	(1)	49	59
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	(2)	9	(23)

Net investment (US$mn)

	23-Aug	MTD	CYTD
FIIs	82	(2,307)	7,928
MFs	75	601	347

Top movers -3mo basis

Best performers	24-Aug	Change, % 1-day	1-mo	3-mo
Chambal Fert	47	4.6	33.2	38.1
Thermax	600	1.5	(5.7)	36.2
Reliance Energy	736	4.2	(3.7)	32.4
BHEL	1,750	5.3	5.4	29.6
Rashtriya Chem	47	0.5	0.9	23.7
Worst performers				
Escorts	77	5.1	(26.3)	(39.5)
Polaris	108	2.5	(11.7)	(36.5)
Balrampur Chini	52	1.7	(24.4)	(30.7)
Punjab Tractors	223	(0.6)	(16.8)	(27.1)
Essel Propack	56	(0.3)	(9.5)	(23.2)

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Updates

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News Roundup

Corporate

- The government plans to sell 4.75% of its stake in National Thermal Power Corporation. (FE)
- Hong Kong-based US$400 mn Multex Holdings is all set to acquire 10% equity stake in Mumbai firm Effort BPO Ltd. (FE)
- Western Australia-based Howling Wolves Wine Group (HWWG) is entering into a 50:50 joint venture agreement with Indian distiller and distributior Brihans to manufacture wine in India. (FE)
- Indian Oil Corporation (IOC) is likely to rope in Petronet LNG as partner for its proposed liquefied natural gas (LNG) import and regasification terminal at Ennore, Tamil nadu. (BL)

Economic and political

- In a dramatic turnaround, the BJP (on Sunday) distanced itself from the Left over the Indo-US nuclear deal with Leader of Opposition LK Advani saying that his party has no objection to the 123 Agreement if the government amends the Indian Atomic Energy Act to ensure strategic independence and non-hindrance in reactor fuel supplies. (Indian Express)
- The petroleum ministry has said the government's right in pricing gas is limited to examining whether a proposal conforms to an arm's length pricing basis or not between buyer and seller. "The government cannot impose differential pricing if the market can bear a higher price," the ministry said. (BS)
- The government is likely to do away with a mandatory norm that requires Indian airline companies to operate in the domestic market for at least five years before they fly abroad. (ET)
- The government's aggressive policy of encouraging setting up of special economic zones (SEZs) has come under sharp attack from the parliamentary standing committee on commerce. Besides calling for a review of the SEZ Act and SEZ rules, the committee has suggested a reassessment of the fiscal concessions offered to SEZs. (ET)
- Robust growth in China and India is set to make Asia-Pacific the world's largest regional market for automobiles by 2009 (according to auto research firm JD Power and Associates). (FE)
- The Centre is considering a finance ministry proposal for a separate cap of US$10 bn a year as external commercial borrowings (ECB) from the Gulf. (FE)
- A preferential tariff scheme for corporates which produce power from renewable energy sources is likely to be in place soon. (BL)

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

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Banking

SBI.BO, Rs1466	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,450
52W High -Low (Rs)	1745 - 845
Market Cap (Rs bn)	771.7

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	234.9	259.3	289.1
Net Profit (Rs bn)	45.4	53.3	56.7
EPS (Rs)	86.3	101.3	107.7
EPS gth	*3.1*	*17.4*	*6.4*
P/E (x)	17.0	14.5	13.6
P/B (x)	2.9	2.6	2.2
Div yield (%)	1.0	1.1	1.2

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	59.7	-	-
FIIs	19.8	2.3	(0.2)
MFs	6.1	4.2	1.6
UTI	-	-	(2.5)
LIC	3.7	2.3	(0.2)

State Bank of India: Merger of subsidiary not significant in size, but in direction; could lead to positive sentiment on the stock

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- **State Bank of Saurashtra (SBS), the smallest amongst SBI's subsidiaries, will be merged with State Bank of India**
- **This move will likely increase expectations of mergers of all SBI's banking subsidiaries, which will likely be taken positively by the market**
- **Valuation of SBI relative to other banks remains stretched and we retain our IL rating on the stock**

State Bank of Saurashtra (SBS), the smallest amongst SBI's subsidiaries, will be merged with the State Bank of India, its parent company. This 100% subsidiary will add just around 3.6% to SBI's deposit base, and is amongst the least profitable of all its subsidiary banks. SBS' size is not significant, but the move has significant implications as it suggests SBI could be inclined to consolidate the operations of its subsidiaries. In all, SBI has seven subsidiary banks, which add a meaningful 45% to its deposit base and an estimated 21% value to the company. This move will likely increase expectation of merger of all its banking subsidiaries and will be taken positively by the market. However, the process of merging all the associate banks and subsidiaries could be long drawn out and challenging on several fronts, in our view, given that it would call for (1) rationalization of branch network—sometimes a politically sensitive issue, (2) rationalization of workforce as there are no forced exit options and (3) managing HR and cultural issues (as the subsidiaries have significant regional character). We expect the stock to open strong on the back of this development, however, SBI's valuations relative to other banks remain stretched and we retain our IL rating on the stock. The stock trades at 1.5X APBR FY2009 (standalone) and is trading close to our target price of Rs1,450. Note that we have already considered valuation of SBS in our SOTP calculation and therefore are not changing our target price.

About SBS. SBS has 425 branches, a deposit base of Rs158 bn and asset base of Rs189 bn or 3.6% and 3.3% of SBI's deposits and assets, respectively. It is the smallest of SBI's subsidiaries and is primarily focused on state of Gujarat. SBS reported net profit of Rs874 mn in FY2007 (1.9% of SBI standalone), down from its peak in FY2003 of Rs1.67 bn. It delivered average RoE of 7% over the past three years and 13% in the past five years. In our SOTP calculation for SBI, we have assumed a APBR multiple of 0.8X FY2009 for SBS, given its low RoE.

SBS is the smallest of SBI banking subsidiaries

Key data of SBI banking subsidiaries as % of corresponding SBI data, 2007, March fiscal year-ends.

	State Bank of Hyderabad	State Bank of Bikaner and Jaipur	State Bank of Patiala	State Bank of Mysore	State Bank of Travancore	State Bank of Indore	State Bank of Saurashtra
SBI's stake in the company (%)	100.0	75.0	100.0	92.3	75.0	98.1	100.0
Deposits	9.5	6.5	9.0	5.1	7.1	4.6	3.6
Advances	8.3	6.1	8.5	4.9	7.3	4.3	3.3
Assets	8.7	6.1	8.4	4.7	6.7	4.3	3.3
Net profit	11.1	6.7	8.1	5.5	7.2	4.2	1.9
Branches*	10.2	8.9	8.2	6.9	7.6	4.8	4.6

Note: * indicates data as on March 31, 2006.

Source: Companies, RBI, Kotak Institutional equities estimates.

Comparison of subsidiary banks and SBI (standalone) across key parameters

Stock data as of March 2007 and flow data for 2007, March fiscal year-ends.

	State Bank of Hyderabad	State Bank of Bikaner and Jaipur	State Bank of Patiala	State Bank of Mysore	State Bank of Travancore	State Bank of Indore	State Bank of Saurashtra	State Bank of India
SBI's stake in the company (%)	100.0	75.0	100.0	92.3	75.0	98.1	100.0	
Key data								
Deposits (Rs bn)	415.0	284.8	391.8	220.2	309.8	199.9	158.0	4,355.2
Advances (Rs bn)	281.1	205.3	287.7	164.7	247.9	146.1	110.8	3,373.4
Assets (Rs bn)	490.5	345.1	474.6	268.4	379.9	242.0	188.5	5,665.7
Net profit (Rs bn)	5.1	3.1	3.7	2.5	3.3	1.9	0.9	45.4
Branches*	930	816	753	634	694	436	425	9,143
Operational ratios								
NIM (%)	3.2	3.6	2.7	3.2	3.3	2.8	2.7	3.2
Other Income to total income (%)	30.1	31.6	28.5	32.9	24.3	27.0	19.8	31.7
Expense ratio (%)	41.7	48.2	42.4	52.9	43.1	51.3	56.7	50.3
Retaurn ratios								
ROA (%)	1.1	1.0	0.8	1.1	0.9	0.8	0.5	0.9
ROE (%)	21.7	20.0	15.5	24.0	22.3	17.3	8.7	15.4
Capital adequacy								
CAR (%)	12.5	12.9	12.4	11.5	11.7	11.8	12.8	12.3
Tier I (%)	8.3	7.8	8.4	6.6	7.6	6.7	6.9**	8.0
Asset quality								
Gross NPAs (%)	1.2	2.2	1.8	2.3	2.2	2.0	1.2	2.9
Net NPAs (%)	0.2	1.1	0.8	0.5	1.1	1.1	0.7	1.6

Note: * indicates data as on March 31, 2006

** Tier I ratio of SBS has been calculated based on Tier I ratio as on March 2006 and PAT of 2007. Tier I ratio as on March 2006 was 9.06%

Source: Companies, RBI, Kotak Institutional Equities estimates.

Key financial data for SBI and SBS

In Rs mn, March fiscal year-ends, 2007

	SBS	SBI	Consolidated
P&L statement			
Net interest income	4,610	160,542	165,152
Loan loss provision	239	20,175	20,414
Other income	1,138	74,468	75,440
Fees	NA	48,045	
Treasury	NA	5,678	
Miscellaneous	NA	20,745	
Operating expenses	3,260	118,235	121,496
Employees	NA	79,326	
Others	NA	38,909	
Other provisions (incl. tax)	1,375	51,187	52,561
PAT	**874**	**45,413**	**46,121**
Balance sheet			
Cash and bank balance	18,370	519,687	538,057
Investments	50,110	1,491,489	1,538,459
Loans	110,811	3,373,365	3,484,176
Other assets	9,177	281,112	290,288
Total assets	**188,468**	**5,665,652**	**5,850,981**
Deposits	158,049	4,355,211	4,513,260
Other borrowings	11,258	558,728	569,986
Other liabilities	8,737	438,728	447,465
Total liabilities	**178,043**	**5,352,667**	**5,530,710**
Paid up capital	3,140	5,263	5,263
Reserves and surplus	7,281	307,723	315,004
Total shareholder equity	**10,421**	**312,986**	**320,267**

Source: Companies, Kotak Institutional equities estimates.

SOTP valuation of SBI

Subsidiaries	SBI holding	NW FY2009E	Multiple assumed	Value per share FY2009	Methodology adopted
	(%)	(Rs mn)	(X)	(Rs)	
SBI				1,008	Based on residual growth model
SBI MF	63			12.4	Rs150bn of AUM and 5%
SBI Life	74			125	
SBI Associate banks					
State Bank of Bikaner and Jaipur	75	16,506	1.50		Based on ABVPS
State Bank of Hyderabad	100	35,615	1.50		
State Bank of Mysore	92	14,200	1.50		
State Bank of Patiala	100	28,545	1.25		
State Bank of Saurashtra	100	10,620	0.80		
State Bank of Travancore	75	16,032	1.50		
State Bank of Indore	98	13,932	1.30		
Banking subsidiaries and associates		135,450		**353**	
After subsidiary discount of 10%		121,905		318	
Value of all subsidiaries				**455**	
Total value of the stock				**1,463**	

Source: Company, Kotak Institutional Equities estimates.

Energy

CAIR.BO, Rs144	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	140
52W High -Low (Rs)	165 - 111
Market Cap (Rs bn)	254.7

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	18.3	19.8	23.0
Net Profit (Rs bn)	1.1	2.3	1.7
EPS (Rs)	0.6	0.4	1.0
EPS gth	*(68.0)*	*(30.0)*	*130.2*
P/E (x)	235.3	332.3	146.7
EV/EBITDA (x)	42.6	30.2	29.4
Div yield (%)	-	-	-

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	69.0	-	-
FIIs	11.1	0.4	0.4
MFs	0.6	0.1	0.1
UTI	-	-	-
LIC	2.2	0.4	0.4

Cairn India: Pipeline approval from government, finally. Already factored in our model

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- **Our model assumes full recovery of pipeline cost and no cess or royalty on Cairn's portion of crude oil**
- **Key to stock performance would be higher reserves, higher crude price in perpetuity**
- **Maintain 12-month DCF-based fair valuation of Rs140**

According to press reports, the Indian government (ministry of petroleum and natural gas) has approved Cairn India's plan to construct a crude oil pipeline to evacuate crude oil from its Rajasthan block RJ-ON-90/1. The in-principle approval means that Cairn and ONGC can treat pipeline capex as part of upstream development cost. Cairn is yet to confirm this development. However, our model assumes that the cost of the pipeline (US$500 mn net to Cairn) is treated as part of the upstream capex and Cairn will recover both capex and opex related to the pipeline as part of the overall production sharing contract for the block. We also do not assume any cess or royalty on Cairn's portion of crude oil. As such, we retain our estimates and 12-month DCF-based target price of Rs140. Key upside risk stems from higher-than-assumed normalized crude oil price in perpetuity.

What could make us more positive on Cairn stock? Higher reserves and normalized crude price

Higher recoverable reserves possible. We note that our 12-month valuation of Cairn factors in US$780 mn of additional value (20% of base valuation of Cairn's 70% stake in the block for potential upward revision to reserves). Cairn will likely provide updates on its crude reserves/production profile by end-2007 in terms of (1) outcome of further EOR studies including ASP simulation and pilot project for Mangala and (2) conversion of current contingent resources to reserves including 'tight' oil in Mangala Barmer Hill, Vijaya/Vandana/NR and other smaller satellite fields (Guda, Shakti).

Our model assumes about 800 mn bbls of crude oil production (gross basis) from RJ-ON-90/1 out of original oil in place reserves of 3.6 bn bbls. The key challenge for Cairn is to (1) increase recovery factor through EOR or (2) convert 1.4 bn bbls of contingent resources (especially in Barmer Hill formation) to reserves.

Higher crude price in perpetuity. We model US$50/bbl Dated Brent crude price from 2013E in perpetuity; for 2010E-2012E, we model US$70/bbl crude price. At US$60/bbl crude price in perpetuity from 2013E, our DCF-based 12-month fair valuation for Cairn stock would come to Rs154. At US$70/bbl in perpetuity, the same would increase to Rs166. Assuming Cairn is unable to discover more crude oil and gas and its recoverable reserves in Rajasthan block do not increase, our reverse valuation exercise suggests that Cairn's current stock price is discounting US$52.5/bbl crude oil Dated Brent price in perpetuity at Rs41/US Dollar. This seems realistic, in our view.

Profit model, balance sheet, cash model of Cairn 2006-2013E, calendar year-ends (Rs mn)

	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Profit model (Rs mn)								
Net sales	18,306	19,794	22,997	46,077	112,031	113,498	109,989	74,569
EBITDA	**5,288**	**6,929**	**9,155**	**31,664**	**84,011**	**65,549**	**45,919**	**28,715**
Other income	524	1,538	132	220	403	983	1,753	2,286
Interest	(404)	(62)	(69)	(500)	(406)	—	—	—
Depreciation	(3,925)	(5,530)	(6,309)	(7,743)	(8,179)	(7,748)	(7,877)	(7,840)
Pretax profits	1,484	2,875	2,909	23,640	75,828	58,784	39,795	23,161
Extraordinary items	—	(1,544)	—	—	—	—	—	—
Tax	(376)	(487)	(1,072)	(4,011)	(9,365)	(7,442)	(5,371)	(3,270)
Deferred taxation	(25)	(77)	(100)	(1,001)	(1,074)	(524)	(92)	161
Net profits	**1,082**	**767**	**1,736**	**18,628**	**65,389**	**50,818**	**34,332**	**20,052**
Earnings per share (Rs)	**0.6**	**0.4**	**1.0**	**10.6**	**37.0**	**28.8**	**19.4**	**11.4**
Balance sheet (Rs mn)								
Total equity	283,533	284,300	286,036	304,664	328,745	346,517	358,523	365,536
Deferred tax liability	3,205	3,283	3,383	4,384	5,458	5,982	6,074	5,913
Total borrowings	21,245	3,745	23,745	16,245	—	—	—	—
Currrent liabilities	1,742	1,738	1,896	1,988	4,040	7,053	9,490	6,753
Total liabilities and equity	**309,726**	**293,066**	**315,059**	**327,281**	**338,243**	**359,552**	**374,088**	**378,202**
Cash	28,362	2,480	5,082	7,498	15,587	40,724	59,695	71,267
Current assets	1,755	1,898	2,205	4,418	10,743	10,883	10,547	7,150
Total fixed assets	25,301	36,136	58,755	30,122	23,072	20,634	18,092	15,641
Net producing properties	7,708	5,952	2,419	38,643	42,242	40,711	39,154	37,544
Investments	4	4	4	4	4	4	4	4
Goodwill	246,595	246,595	246,595	246,595	246,595	246,595	246,595	246,595
Deferred expenditure	—	—	—	—	—	—	—	—
Total assets	**309,726**	**293,066**	**315,059**	**327,281**	**338,243**	**359,552**	**374,087**	**378,202**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	3,105	2,223	5,145	24,503	72,089	56,657	39,098	23,995
Working capital changes	998	(147)	(150)	(2,121)	(4,272)	2,873	2,773	660
Capital expenditure	(14,946)	(11,998)	(22,525)	(12,685)	(2,579)	(2,329)	(2,329)	(2,329)
Investments/Goodwill	(249,804)	—	—	—	—	—	—	—
Other income	524	1,538	132	220	403	983	1,753	2,286
Free cash flow	**(260,124)**	**(8,382)**	**(17,398)**	**9,917**	**65,641**	**58,184**	**41,296**	**24,612**
Key assumptions								
Gross production ('000 boe/d)	91.0	92.1	91.8	120.8	206.8	203.8	194.4	186.1
Net production ('000 boe/d)	25.1	26.3	29.3	53.7	117.5	118.3	114.1	110.9
Dated Brent (US$/bbl)	65.3	69.0	68.0	66.0	70.0	70.0	70.0	50.0
Discount of Rajasthan crude to Dated Brent (US$/bbl)	2.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0

Source: Kotak Institutional Equities estimates.

We value Cain India stock at Rs140

EV and equity value of Cairn (US$ mn)

	Now	+ 1-year	+ 2-years
RJ-ON-90/1	3,899	4,661	5,634
CB-OS-2	169	127	86
Ravva	368	345	306
Upside potential (KG-DWN-98/2, RJ-ON-90/1)	880	985	1,104
Total	**5,316**	**6,118**	**7,129**
Net debt	(157)	30	455
Equity value	**5,473**	**6,088**	**6,674**
Equity shares (mn)	1,765	1,765	1,765
Equity value per share (Rs/share)	**129**	**141**	**155**

Source: Kotak Institutional Equities estimates.

Cairn's Rajasthan field's enterprise value is highly leveraged to crude prices, regulations

Enterprise value sensitivity of Cairn's RJ-ON-90/1 block to key variables (US$ bn)

	Sensitvity of current valuation		Sensitvity of +1-year valuation	
	Enterprise value (US$ bn)	Change from base case (%)	Enterprise value (US$ bn)	Change from base case (%)
Average crude prices (2013E and beyond)				
Dated Brent price (US70$/bbl)	4.7	19	5.5	18
Dated Brent price (US60$/bbl)	4.3	10	5.1	9
Dated Brent price (US55$/bbl)	4.1	5	4.9	5
Dated Brent price (US50$/bbl)	**3.9**		**4.7**	
Dated Brent price (US40$/bbl)	3.5	(10)	4.2	(9)
Dated Brent price (US30$/bbl)	3.1	(21)	3.8	(19)
Cess, royalty				
Royalty (Rs0/tonne), Cess (Rs0/tonne)	**3.9**		**4.7**	
Royalty (Rs0/tonne), Cess (Rs927/tonne)	3.6	(7)	4.3	(7)
Royalty (Rs0/tonne), Cess (Rs2,575/tonne)	3.3	(15)	4.0	(14)
Royalty (Rs481/tonne), Cess (Rs927/tonne)	2.6	(33)	3.2	(31)
Royalty (Rs481/tonne), Cess (Rs2,575/tonne)	2.1	(46)	2.7	(43)

Source: Kotak Institutional Equities estimates.

Media

ZEE.BO, Rs283	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	230
52W High -Low (Rs)	361 - 167
Market Cap (Rs bn)	123.1

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	14.4	17.3	19.7
Net Profit (Rs bn)	2.2	3.8	5.0
EPS (Rs)	5.0	8.7	11.5
EPS gth	*2.9*	*72.6*	*32.4*
P/E (x)	56.0	32.5	24.5
EV/EBITDA (x)	39.4	21.7	16.1
Div yield (%)	0.4	0.7	0.9

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.2	-	-
FIIs	30.3	0.6	0.2
MFs	10.8	1.2	0.8
UTI	-	-	(0.4)
LIC	4.8	0.5	0.1

Zee Entertainment Enterprises: Ad rates hiked; already factored in our strong projected growth in ad revenues for FY2008E

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- **Zee TV increases ad rates—already in our 37% projected growth in Zee TV's ad revenues for FY2008E**
- **Continue to find valuations expensive despite strong projected growth in earnings**
- **Retain 12-month DCF-based target price of Rs230**

ZEEL has reportedly increased its prime-time ad rates for its flagship Zee TV channel by 15-20% and non-prime time rates by 40% following the 15%-25% increase in March 2007. The increase in ad rates for Zee TV will likely help ZEEL achieve our projected 24% growth in ad revenues for FY2008E and partially support ZEEL's current rich valuations. We model a 37% increase in ad revenues for FY2008E for Zee TV on the back of a 45% increase in ad revenues in FY2007E. The key to sustenance of ZEEL's multiples would be (1) continued high ratings for Zee TV particularly after start of new competing channels and (2) continued improvement in domestic pay-TV subscription revenues.

Strong ratings of Zee TV versus new competition. The key to continued strong growth in ZEEL's ad revenues would be (1) sustenance of Zee TV's ratings at current high levels, (2) retention of current market share even after start of several new Hindi general entertainment channels over the next few months and (3) robust growth of 13-14% CAGR for overall market ad revenues for the next several years. The strong increase in ad rates for ZEEL's key channels over the past nine months is primarily due to improved ratings of ZEEL network across most time bands led by its flagship channel (see Exhibits 2 and 3).

We are reluctant to ascribe high multiples to an earnings stream which is volatile and entirely dependent on a channel's market share, especially at a time when (1) the channel is doing very well and (2) several new channels will enter the market and likely impact the ratings and market shares of incumbent channels. Zee TV's recent success (we are not taking any credit from the channel's superb performance) highlights the ephemeral nature of the business and possible changes in fortunes in a short period of time. Accordingly, we balk at assigning very high multiples to ZEEL's earnings; this would imply a very high market share for Zee TV in perpetuity. ZEEL stock trades at 32.5X FY2008E EPS of Rs8.7 and 24.5X FY2009E EPS of Rs11.5.

Domestic pay-TV revenues—slow and steady. We expect (1) the gradual increase in the number of DTH subscribers (total subscriber base of Dish and Tata-Sky has reached 3.2 mn by end-July 2007 versus 2.6 mn at end-FY2007) and (2) gradual resolution of initial teething problems in the CAS-notified areas of Delhi, Kolkata and Muimbai to lead to higher domestic pay-TV revenues in the forthcoming quarters. We model ZEEL's domestic pay-TV revenues to increase to Rs3.7 bn in FY2008E, Rs4.7 bn in FY2009E and Rs6 bn in FY2010E against Rs3.06 bn in FY2007 and Rs754 mn in 1QFY08.

Consolidated profit and loss statement for Zee Telefilms, March fiscal year-ends, 2004-2006, ZEEL, 2007-2013E (Rs mn)

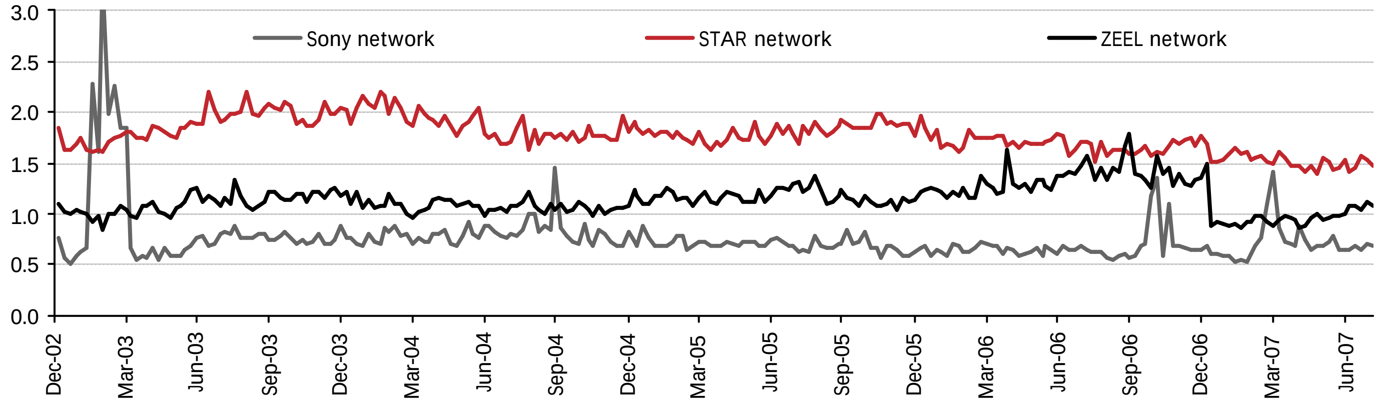
	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E
Revenues										
National Hindi (Zee TV)	2,539	1,826	2,119	**3,088**	**4,240**	**4,781**	**5,509**	**6,299**	**7,120**	**8,002**
National Hindi (Zee Cinema)	756	914	996	1,271	1,710	1,928	2,222	2,541	2,872	3,228
Niche channels	965	956	1,081	417	535	636	752	884	991	1,107
Regional channels (incl. ETC Punjabi)	1,365	1,324	1,486	—	—	—	—	—	—	—
Zee Sports + Taj TV	—	—	72	1,619	1,636	1,942	2,193	2,471	2,775	3,111
Cable TV (Siti)	220	266	261	—	—	—	—	—	—	—
Overseas - ZMWL	482	530	590	667	633	652	672	688	704	721
Others	28	(117)	(40)	—	—	—	—	—	—	—
Advertisement	**6,355**	**5,698**	**6,566**	**7,062**	**8,754**	**9,940**	**11,348**	**12,882**	**14,462**	**16,168**
Domestic pay-TV	2,173	2,696	2,742	**3,064**	**3,682**	**4,677**	**5,980**	**7,052**	**7,878**	**8,640**
Overseas	2,620	2,964	3,097	3,543	4,037	4,294	4,522	4,727	4,937	5,157
Domestic subscription	1,168	1,002	978	—	—	—	—	—	—	—
Others	64	(129)	356	—	—	—	—	—	—	—
Subscription	**6,026**	**6,533**	**7,174**	**6,607**	**7,718**	**8,971**	**10,501**	**11,780**	**12,815**	**13,797**
Education	131	106	162	302	318	334	351	368	387	406
Others	1,190	742	2,641	440	460	483	506	531	557	584
Total revenues	**13,702**	**13,079**	**16,544**	**14,412**	**17,251**	**19,727**	**22,706**	**25,560**	**28,221**	**30,956**
Costs										
Programming/Content	(2,520)	(2,611)	(4,247)	(5,051)	(5,426)	(5,663)	(6,264)	(6,868)	(7,530)	(8,257)
Broadcasting	(618)	(675)	(515)	(508)	(468)	(477)	(485)	(494)	(503)	(512)
Distribution	(1,837)	(1,534)	(2,565)	(1,473)	(1,426)	(1,519)	(1,597)	(1,657)	(1,719)	(1,784)
Other direct operating	—	—	(262)	(322)	(338)	(355)	(373)	(391)	(411)	(431)
Employees	(727)	(858)	(1,089)	(1,008)	(1,228)	(1,328)	(1,424)	(1,529)	(1,643)	(1,770)
SG&A	(3,691)	(3,051)	(3,431)	(2,863)	(2,717)	(2,988)	(3,190)	(3,488)	(3,779)	(4,082)
Total expenses	**(9,393)**	**(8,728)**	**(13,848)**	**(11,224)**	**(11,604)**	**(12,331)**	**(13,332)**	**(14,427)**	**(15,586)**	**(16,837)**
EBITDA	**4,309**	**4,351**	**2,695**	**3,188**	**5,647**	**7,396**	**9,374**	**11,134**	**12,635**	**14,118**
Other income	776	521	639	630	743	820	954	1,241	1,590	1,998
Interest expense	(583)	(207)	(188)	(219)	(371)	(131)	(2)	—	—	—
Depreciation	(320)	(329)	(360)	(228)	(274)	(287)	(299)	(305)	(315)	(323)
Amortization	—	—	—	—	—	—	—	—	—	—
Pretax profits	**4,183**	**4,336**	**2,787**	**3,371**	**5,744**	**7,799**	**10,027**	**12,069**	**13,910**	**15,793**
Extraordinary items	26	(140)	19	—	—	—	—	—	—	—
Tax	(1,103)	(1,123)	(528)	(984)	(1,896)	(2,602)	(3,474)	(4,204)	(4,842)	(5,493)
Deferred tax	54	99	(9)	20	19	19	19	18	18	18
Minority interest	(192)	(50)	(117)	(212)	(79)	(198)	(238)	(274)	(307)	(340)
Net income	**2,969**	**3,123**	**2,153**	**2,195**	**3,789**	**5,018**	**6,335**	**7,609**	**8,779**	**9,977**
Recurring net income	**2,942**	**3,263**	**2,134**	**2,195**	**3,789**	**5,018**	**6,335**	**7,609**	**8,779**	**9,977**
Fully diluted EPS	**7.1**	**7.5**	**4.9**	**5.0**	**8.7**	**11.5**	**14.6**	**17.5**	**20.2**	**22.9**
Key ratios										
EBITDA growth (%)	**14.7**	**1.0**	**(38.1)**	**18.3**	**77.1**	**31.0**	**26.7**	**18.8**	**13.5**	**11.7**
EPS growth (%)	**18.2**	**5.2**	**(34.6)**	**2.9**	**72.6**	**32.4**	**26.3**	**20.1**	**15.4**	**13.7**
EBITDA margin (%)	31.5	33.3	16.3	22.1	32.7	37.5	41.3	43.6	44.8	45.6
Tax rate (%)	24.9	24.4	19.1	28.6	32.7	33.1	34.4	34.7	34.7	34.7
Shares o/s year end (mn)	412	412	413	435	435	435	435	435	435	435
Shares o/s fully diluted (mn)	412	435	435	435	435	435	435	435	435	435

Source: Kotak Institutional Equities estimates.

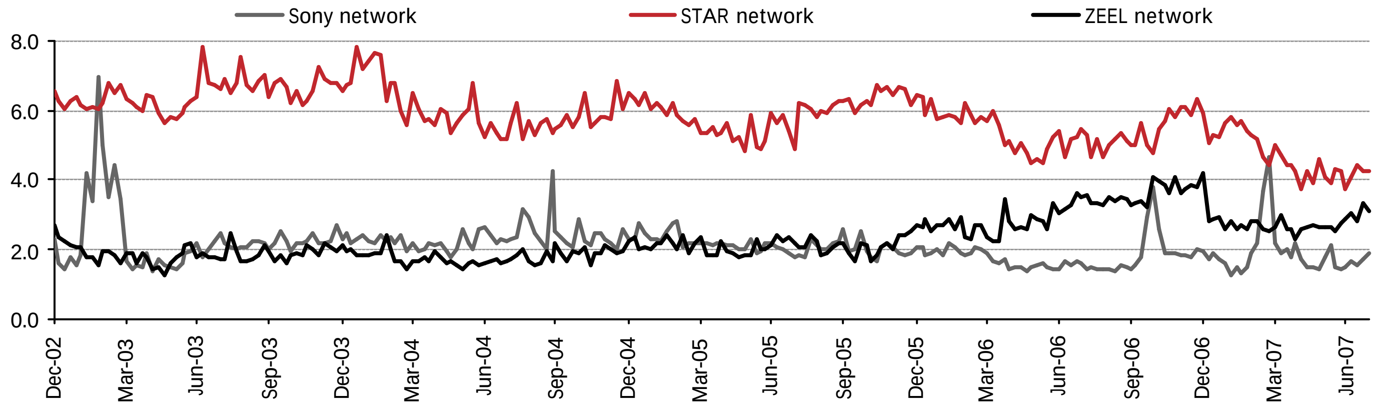
ZEEL network's ratings have improved of late pushed by Zee TV's improved ratings

Ratings of major television networks

24 hours, TRPs



Primetime TRPs (7:30 PM - 11:30 PM)



Note:

(1) TRP (television rating point) measures the percentage of target audience which has viewed the channel for the entire time band.

(2) Target group: All Cable and Satellite Households, All India.

(3) Sony Network includes Sony Entertainemtn Channel, SET MAX and AXN.

(4) STAR Network includes Star Plus, Star News, Star Gold, Star World, Star Movies, Channel V and Vijay TV (incl from Oct 01).

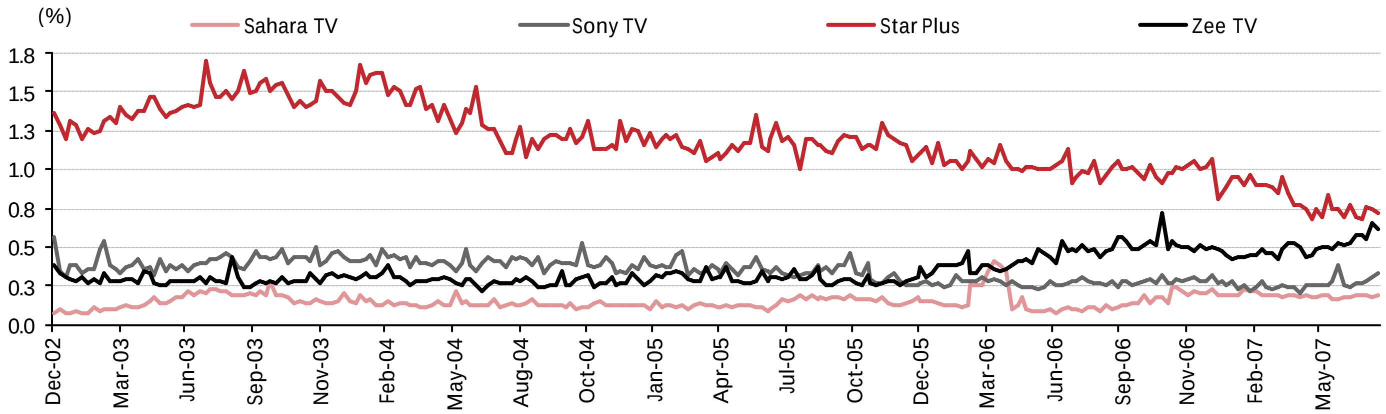
(5) Zee Network includes Zee TV, Zee Cinema, Zee Sports, Zee Music, Zee Smile, Zee Jagran, Zee Premiere, Zee Classic, Zee Action, Zee Studio, Zee Cafe and Zee Trendz (since January 2007).

Source: TAM Media Research, compiled by Kotak Institutional Equities research.

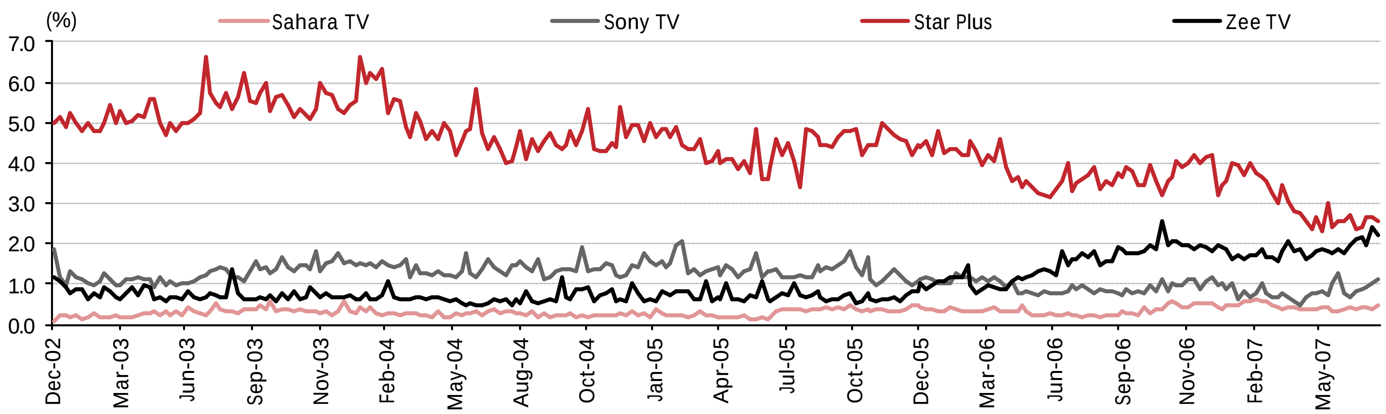
Zee TV's ratings have improved strongly over the past nine months

Ratings of major Hindi general entertainment television channels

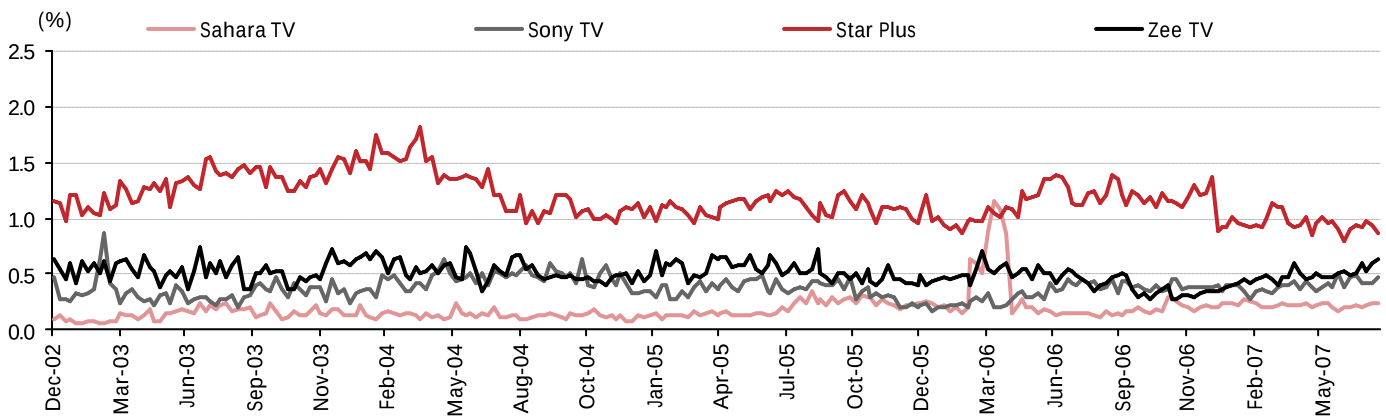
24 hours, TRPs



Primetime: 7:30 PM - 11:30 PM, TRPs



Afternoon: 2:00 PM - 5:30 PM, TRPs



Note:
(a) TRP (television rating point) measures the percentage of target audience which has viewed the channel for the entire time band. Target audience is All Cable and Satellite Households, All India.

Source: TAM Media Research, compiled by Kotak Institutional Equities research.

Technology

Sector coverage view			Attractive

		Price, Rs	
Company	Rating	24-Aug	Target
TCS	IL	1,016	1,300
Wipro	OP	456	560
Infosys	OP	1,823	2,250
Satyam Comp	OP	437	570
HCL Tech	IL	277	360
i-flex solutions	U	1,872	1,675
Patni	OP	447	530
Hexaware	IL	112	165
Polaris Softwa	U	108	130
Tech Mahindra	IL	1,196	1,500
Mphasis BFL	IL	277	300
iGate Global	U	214	310
MindTree	U	541	650

EPS of frontline tech names in the event of a recession in US economy

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- **Assuming a recession in the US economy, our EPS for FY2009 would be lower by 10-15%**
- **Our FY2008 EPS may not be impacted though guidance for March 2008 quarter would be tracked closely**
- **Distressed valuations are 8-12% lower than the current market price**

The recent trouble in the US sub-prime mortgage industry has led to concerns about demand in BFSI vertical and, more important, the US economy. We analyze the impact on EPS assuming a recession in the US economy which could materialize in severe cuts in IT budgets (5-10%). Recession will likely lead to pricing decline and some moderation in wage increase for offshore names. Our EPS estimates would be 10-15% lower for the Top 4 companies in such a scenario. The distressed valuations in such a case can be 8-12% lower than the current market price. Note that this is just a scenario analysis; our base case valuations imply 20-25% upside from the current levels.

The worst case scenario—10% cut in consensus EPS estimates: A recession in the US economy can result in 11% decline in our FY2009 EPS estimates for Infosys to Rs89.3, 13% decline to Rs25.5 for Wipro, 16% decline in Satyam to Rs26.5 and 12.5% decline in EPS for TCS to Rs54. In a recession scenario, we build in the following:

1. **Pricing; 5% cut likely.** We believe a recession in the US economy could result in a 5% decline in pricing. This is lower than the 5-10% correction witnessed during the previous slowdown. We believe that this is fair given the previous slowdown was against the backdrop of excessive technology spends while during the current phase the IT spends have been far more rational and have not gone over the top. Further, in the previous slowdown, the pricing impact was felt in two tranches; (1) direct re-negotiation of the then existing rate cards and change in business mix and (2) contracts with steep volume discount commitments, which impacted financials with a lag. We do not expect vendors to lock in steep volume discount commitment, if a slowdown were to occur today given that (1) companies have an experience of dealing with a slowdown, which was not the case in 2002 (2) better portfolio of service offerings and a supply constrained market will ensure that vendors are not irrational. Further, a reduction in dependence of vendors on US geography would come in handy
2. **Volumes growth of 28-30% may continue.** We believe the top tier companies would be able to deliver 28-30% volumes growth in FY2009 even in a recession. However, the volumes flow may witness an aberration. We believe that first indicator of a slowdown would be deceleration in volume growth and/or guidance for the subsequent quarter (ideally, hiring but it is difficult to take a call on hiring numbers for a single quarter). We further believe that a slowdown may lead to moderation in volumes for two-three quarters (inaction by clients followed by rationalization of vendors and spends followed by aggressive offshorization).
3. **Moderation of wage inflation.** We assume wage inflation to moderate out to a high single digit for offshore and low single digit for onsite from the current scenario of 13-15% for offshore and 3-5% for onsite wage inflation. We note that companies such as Infosys and TCS have variable compensation as high as 30% of the offshore salaries, which can come in handy in the environment of a slowdown

Exhibit 1 depicts the worst case EPS scenarios for Infosys, Wipro, Satyam, and TCS.

Distressed case EPS and DCF valuations of Infosys, Wipro, TCS and Satyam

	EPS			DCF value	Implied P/E (X)			CMP	Downside/ upside
Base case	**2008E**	**2009E**	**2010E**	**(Rs)**	**2008**	**2009**	**2010**	**(Rs)**	**(%)**
Re/ US$ rate	40.5	40.0	40.0						
Infosys	80.7	99.9	109.8	2,250	27.9	22.5	20.5	1,823	23.4
Wipro	23.1	29.2	32.2	560	24.2	19.2	17.4	456	22.9
Satyam	25.3	31.5	33.4	570	22.5	18.1	17.1	437	30.5
TCS	51.8	61.9	70.4	1,300	25.1	21.0	18.5	1,016	27.9

	EPS			DCF value	Implied P/E (X)			CMP	Downside/ upside
Worst case	**2008E**	**2009E**	**2010E**	**(Rs)**	**2008**	**2009**	**2010**	**(Rs)**	**(%)**
Re/ US$ rate	40.5	40.0	40.0						
Infosys	80.7	89.3	97.4	1,600	19.8	17.9	16.4	1,823	(12.2)
Wipro	23.1	25.5	27.8	425	18.4	16.7	15.3	456	(6.7)
Satyam	25.3	26.5	29.5	400	15.8	15.1	13.6	437	(8.4)
TCS	51.8	54.2	60.9	930	18.0	17.2	15.3	1,016	(8.5)

Source: Kotak Institutional Equities estimates

Valuation—distressed case scenario. Based on the above assumptions, our earnings growth slows down to 5-10% for various companies. In addition OPM will likely decline by 2-2.5%. Valuing companies in such a scenario may be challenging noting that a possible low growth in FY2009 would be followed by impact on earnings from increase in taxation in FY2010. We believe that DCF valuation methodology is ideal in such a scenario. Our distressed-case DCF based valuation for Infosys stands at Rs1600/ share. This implies a P/E multiple of 17x FY009 earnings, fair noting that global companies such as Accenture are trading at similar valuations.

Other considerations

Earnings for FY2008 may not be impacted. Our interactions with companies indicate that it is too early to assess the impact of the recent developments on the business. However, most of these companies indicate that their direct exposure to the mortgage segment is limited. We believe that the impact on the business, if any, would be felt only early next year (when IT budgets get frozen). We do not see a risk to our FY2008 estimates.

If the existing challenges are restricted to the banking and finance segment. Banking and finance account for 29% of Infosys revenues (26% ex-products), approx 32-33% of TCS's revenues and around 16-18% of Satyam's revenues. This segment has been growing at a rate faster than the industry for the last four years. A cut in IT spends in banking and finance may normalize growth to company average levels resulting in 3-4% reduction in overall growth rates

Infosys guidance for FY2009 would hold the key. Infosys may be conservative in its guidance in the event of a recession. The company may guide 5% lower than the actual potential, which, based on a worst-scenario EPS of Rs89 (11% growth) would imply EPS guidance of Rs84-85.

Company level discussion

Infosys Technologies (Rs1,823, OP). Our base case FY2009E EPS of Rs99.9 is based on a Re/US$ rate of Rs40, onsite billing rate increase of 1%, offshore billing rate increase of 2% and offshore wage increase of 12%. **Exhibit 2** details our OPM and EPS at different pricing assumptions. We assume that a recession or a significant slowdown would also moderate out wage inflation. Hence for every 1% decline in pricing, we assume 1.5% of decline in wage inflation. Our worst-case EPS scenario for FY2009 is Rs89.3

Infosys--FY2009 EPS and OPM at various level of changes in pricing

EPS (Rs)

		Onsite pricing change (%)				
		(5)	**(4)**	**(3)**	**(2)**	**(1)**
Offshore pricing change (%)	**(5)**	89.3	89.8	90.3	90.8	91.3
	(4)	90.1	90.6	91.1	91.6	92.1
	(3)	90.8	91.4	91.9	92.4	92.9
	(2)	91.7	92.2	92.7	93.2	93.7
	(1)	92.5	93.0	93.5	94.0	94.6

OPM (%)

		Onsite pricing change (%)				
		(5)	**(4)**	**(3)**	**(2)**	**(1)**
Offshore pricing change (%)	**(5)**	28.0	28.2	28.3	28.5	28.6
	(4)	28.2	28.4	28.5	28.7	28.8
	(3)	28.5	28.7	28.8	28.9	29.0
	(2)	28.6	28.8	28.9	29.1	29.2
	(1)	28.8	29.0	29.1	29.3	29.4

	FY2008E	FY2009E	FY2010E
Current estimates			
Base case EPS	80.7	99.9	109.8
Base case OPM (%)	30.1	29.8	29.0
Volume growth - onsite (%)	29.6	25.0	19.9
Volume growth - offshore (%)	30.7	31.8	22.0
Worst case scenario			
EPS		89.3	97.4
EPS - Change from base case (%)		(10.6)	(11.3)
OPM		28.0	27.7
OPM decline yoy worst case (bps)		(210)	(30)

Source: Kotak Institutional Equities estimates

Satyam Computer Services (Rs437, OP). Our base case EPS of Rs31.5 is based on Re/ Us$ rate of 40, onsite and offshore pricing improvement of 1.5%. **Exhibit 3** details our OPM and EPS at different pricing assumptions. Our worst case EPS scenario for FY2009 is Rs26.5

Satyam--FY2009 EPS and OPM at various level of changes in pricing

EPS (Rs)

		Onsite pricing change (%)				
		(5)	(4)	(3)	(2)	(1)
Offshore pricing change (%)	(5)	26.5	26.9	27.2	27.6	28.0
	(4)	26.8	27.2	27.5	27.9	28.3
	(3)	27.1	27.5	27.8	28.2	28.6
	(2)	27.4	27.8	28.2	28.5	28.9
	(1)	27.7	28.1	28.5	28.8	29.2

OPM (%)

		Onsite pricing change (%)				
		(5)	(4)	(3)	(2)	(1)
Offshore pricing change (%)	(5)	19.7	19.9	20.1	20.3	20.5
	(4)	19.9	20.1	20.3	20.4	20.6
	(3)	20.0	20.2	20.4	20.6	20.8
	(2)	20.1	20.3	20.5	20.7	20.9
	(1)	20.2	20.4	20.6	20.8	21.0

	FY2008E	FY2009E	FY2010E
Current estimates			
EPS	25.3	31.5	33.4
OPM	22.4	22.1	21.4
Volume growth - onsite (%)	29.1	28.8	21.6
Volume growth - offshore (%)	44.9	26.0	21.5
Worst case scenario			
EPS		26.5	29.5
EPS - Change from base case (%)		(15.9)	(11.7)
OPM		19.7	19.5
OPM decline yoy worst case (bps)		(270)	(20)

Source: Kotak Institutional Equities estimates

Wipro (Rs456, OP). Our base case EPS of Rs29.2 is based on Re/US$ rate of 40, onsite and offshore pricing improvement of 0.9% and 0.8%. **Exhibit 4** details our OPM and EPS at different pricing assumptions. Our worst-case EPS scenario for FY2009 is Rs25.5

Wipro--FY2009 EPS and OPM at various level of changes in pricing

EPS (Rs)

		Onsite pricing change (%)				
		(5)	**(4)**	**(3)**	**(2)**	**(1)**
Offshore pricing change (%)	**(5)**	25.5	25.9	26.2	26.5	26.8
	(4)	25.8	26.1	26.5	26.8	27.1
	(3)	26.1	26.4	26.8	27.1	27.4
	(2)	26.4	26.7	27.0	27.4	27.7
	(1)	26.7	27.0	27.3	27.6	28.0

OPM (%)

		Onsite pricing change (%)				
		(5)	**(4)**	**(3)**	**(2)**	**(1)**
Offshore pricing change (%)	**(5)**	19.9	20.1	20.3	20.5	20.6
	(4)	20.1	20.2	20.4	20.6	20.8
	(3)	20.2	20.4	20.5	20.7	20.9
	(2)	20.3	20.5	20.6	20.8	21.0
	(1)	20.4	20.6	20.8	20.9	21.1

	FY2008E	FY2009E	FY2010E
Current estimates			
EPS	23.1	29.2	32.2
OPM	21.1	21.7	21.4
Volume growth - onsite (%)	28.5	27.8	18.8
Volume growth - offshore (%)	35.5	31.3	23.2
Worst case scenario			
EPS		25.5	27.8
EPS - Change from base case (%)		(12.8)	(13.7)
OPM		19.9	19.7
OPM decline yoy worst case (bps)		(118)	(20)

Source: Kotak Institutional Equities estimates

TCS (Rs1,017, IL). Our base case EPS of Rs61.9 is based on Re/US$ rate of 40, onsite and offshore pricing improvement of 1.5%. **Exhibit 5** details our OPM and EPS at different pricing assumptions. Our worst-case EPS scenario for FY2009 is Rs54.2

TCS--FY2009 EPS and OPM at various level of changes in pricing

EPS (Rs)

		Onsite pricing change (%)				
		(5)	(4)	(3)	(2)	(1)
Offshore pricing change (%)	(5)	54.2	54.8	55.3	55.9	56.4
	(4)	54.8	55.3	55.9	56.4	57.0
	(3)	55.4	55.9	56.4	57.0	57.5
	(2)	55.9	56.5	57.0	57.6	58.1
	(1)	56.5	57.0	57.6	58.1	58.7

OPM (%)

		Onsite pricing change (%)				
		(5)	(4)	(3)	(2)	(1)
Offshore pricing change (%)	(5)	23.5	23.7	23.9	24.0	24.2
	(4)	23.7	23.8	24.0	24.1	24.3
	(3)	23.8	23.9	24.1	24.2	24.4
	(2)	23.9	24.0	24.2	24.3	24.5
	(1)	24.0	24.1	24.3	24.4	24.6

	FY2008E	FY2009E	FY2010E
Current estimates			
EPS	51.8	61.9	70.4
OPM	26.5	25.5	24.6
Volume growth - onsite (%)	30.9	28.1	18.2
Volume growth - offshore (%)	33.9	30.2	19.8
Worst case scenario			
EPS		54.2	60.9
EPS - Change from base case (%)		(12.5)	(13.5)
OPM		23.5	22.9
OPM decline yoy worst case (bps)		(296)	(60)

Source: Kotak Institutional Equities estimates

Lower exposure to US geography than during the previous period of US slowdown ('01-'03)

US revenue concentration (%)	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
Infosys	82.0	78.0	73.5	71.2	73.0	71.2	65.2	64.8	63.3
TCS				61.1	59.3	62.2	59.5	59.1	56.2
Wipro	74.0	70.0	63.6	57.0	64.0	69.0	65.3	62.7	64.2
Satyam	71.0	76.6	81.0	76.6	76.9	73.3	68.8	65.6	64.5

Source: Companies

BFSI revenues and revenue contribution for tier-I Indian IT companies

	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07
BFSI revenues (US$ mn)									
TCS	233.4	251.0	276.8	304.0	327.1	371.0	424.1	430.3	492.7
Infosys	172.7	187.2	201.2	213.6	240.4	278.8	316.8	319.0	335.0
Wipro	77.7	88.7	98.0	110.7	120.8	133.1	145.4	158.2	172.8
Satyam	64.1	73.2	75.5	81.7	89.7	95.0	91.7	96.4	102.4
BFSI revenues (% of total revenues)									
TCS	40.8	41.3	41.8	41.8	41.2	42.7	43.5	41.3	43.1
Infosys	36.3	35.7	36.0	36.0	36.4	37.4	38.6	37.0	36.1
Wipro	19.5	20.6	20.7	21.6	22.4	22.6	22.7	22.9	23.8
Satyam	27.0	28.7	28.0	28.8	29.7	28.6	25.6	24.7	23.8
BFSI revenues (qoq growth)									
TCS	15.1	7.6	10.3	9.8	7.6	13.4	14.3	1.5	14.5
Infosys	12.1	8.4	7.5	6.2	12.5	16.0	13.6	0.7	5.0
Wipro	23.2	14.2	10.4	12.9	9.2	10.2	9.2	8.8	9.3
Satyam	2.3	14.2	3.1	8.3	9.7	5.9	(3.5)	5.1	6.3

Source: Companies, Kotak Institutional Equities

Infosys' per capita realization onsite and offshore, FY1999-2007 (US$/ manmonth)

	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
Realization (US$/manmonth)									
Onsite	7,932	8,510	10,967	11,450	11,142	10,869	11,282	10,892	11,369
Offshore	3,713	4,359	5,333	4,925	4,698	4,446	4,659	4,574	4,698
Blended	4,822	5,708	7,250	6,933	6,877	6,474	6,356	6,464	6,763
Change yoy (%)									
Onsite	11.9	7.3	28.9	**4.4**	**(2.7)**	**(2.4)**	3.8	(3.5)	4.4
Offshore	7.4	17.4	22.4	**(7.7)**	**(4.6)**	**(5.4)**	4.8	(1.8)	2.7
Blended	9.8	18.4	27.0	**(4.4)**	**(0.8)**	**(5.9)**	(1.8)	1.7	4.6

Source: Company

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Kotak Institutional Equities Research coverage universe

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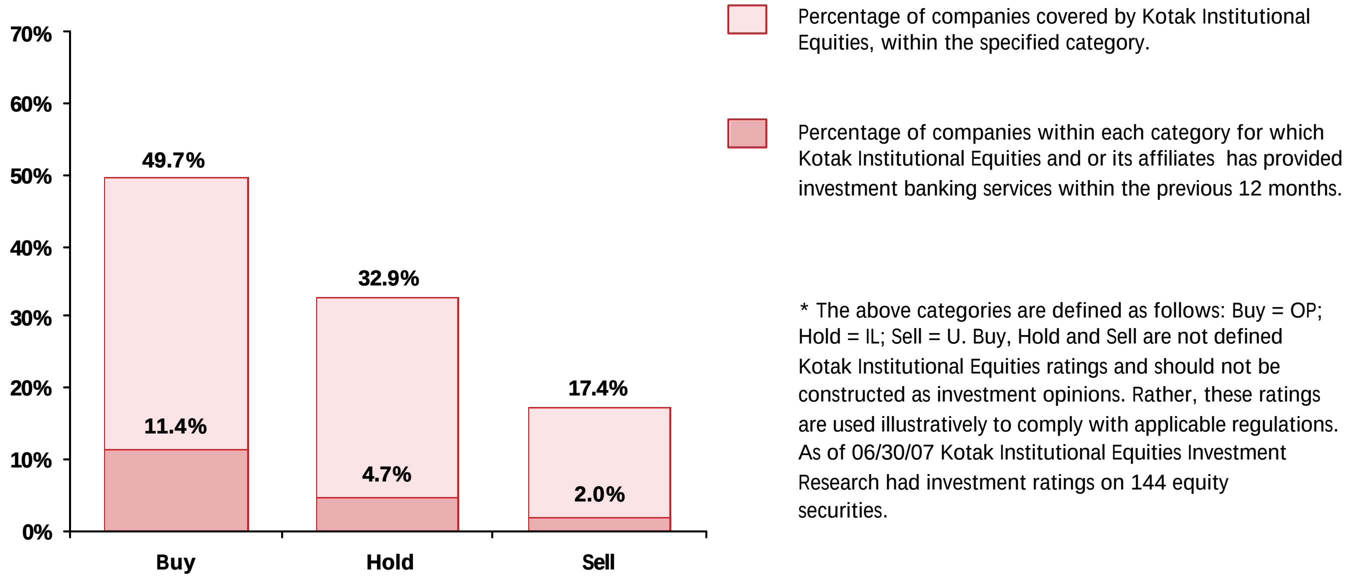

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Source: Kotak Institutional Equities. As of June 30, 2007

Ratings and other definitions/identifiers

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