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News Round-up

- ▶ Direct tax collections in Sept. rose 26.12% to USD 18.14bn against USD 14.39bn in the corresponding month of last year. *(BSTD)*
- ▶ Sesa Goa (SESA IN), part of Vedanta Resources, is talking to the Orissa based Ahluwalia family to renew a mining agreement that will enable Sesa to expand its capacity to five million tonne. *(ECNT)*
- ▶ Indian Oil (IOCL IN), Bharat Petroleum Corporation (BPCL IN) and Hindustan petroleum Corporation (HPCL IN) will get USD 2.22 bn as an ad hoc package from the centre to partially compensate fuel losses in the first half of this fiscal. *(THBL)*
- ▶ M&M (MM IN) is in the last leg to complete its acquisition of South Korean SUV maker Ssangyong Motors. The co. plans to sign the final agreement by second week of November. *(ECNT)*
- ▶ L&T (LT IN) has won an order worth USD 322mn from Bhaskar group's DB Power to supply & erect balance of plant package for a 1200mw power plant in Chattisgarh. *(ECNT)*
- ▶ BPCL (BPCL IN) has made a second natural gas discovery in a block off Mozambique. *(BSTD)*
- ▶ LN Mittal backed Indiabulls group has put its retail expansion plans on the backburner, focusing instead on its core business of financial services & real estate. *(BSTD)*
- ▶ Sponge iron prices are likely to rise 10% in November, due to demand for long steel from infrastructure cos. *(BSTD)*
- ▶ The BPO arm of Essar group, Aegis, has acquired Argentina's Actionline for an undisclosed price, propelling it to the league of top 10 outsourcing service providers globally. *(TTOI)*

Source: ECNT= Economic Times, BSTD = Business Standard, FNLE = Financial Express, THBL = Business Line.

EQUITY MARKETS

India	Change %			
	19-Oct	1-day	1-mo	3-mo
Sensex	19,983	(0.9)	0.4	11.8
Nifty	6,027	(0.8)	0.8	12.3
Global/Regional indices				
Dow Jones	10,979	(1.5)	2.1	7.3
Nasdaq Composite	2,437	(1.8)	3.4	9.7
FTSE	5,704	(0.7)	1.8	11.0
Nikkei	9,345	(2.0)	(2.9)	0.5
Hang Seng	23,764	1.3	8.1	17.3
KOSPI	1,858	0.0	1.4	7.0
Value traded – India				
Cash (NSE+BSE)	205		222	201
Derivatives (NSE)	1,488		1,165	787
Deri. open interest	1,844		2,079	1,579

Forex/money market

	Change, basis points			
	19-Oct	1-day	1-mo	3-mo
Rs/US\$	44.4	(1)	(135)	(301)
10yr govt bond, %	8.1	-	11	48
Net investment (US\$m)				
	18-Oct		MTD	CYTD
FIs	184		4,078	23,332
MFs	(236)		(1,054)	(282)

Top movers -3mo basis

Best performers	Change, %			
	19-Oct	1-day	1-mo	3-mo
TTMT IN Equity	1174.2	0.4	11.0	44.4
HNDL IN Equity	206.4	(2.4)	6.4	35.0
BOB IN Equity	969.6	(1.8)	10.1	32.3
IDBI IN Equity	159.5	0.8	10.9	31.0
BOI IN Equity	519.3	(2.4)	4.6	30.3
Worst performers				
IVRC IN Equity	155.6	2.2	(2.6)	(17.1)
FTECH IN Equity	1156.0	(1.5)	(17.6)	(13.5)
GMRI IN Equity	54.5	(0.8)	(7.5)	(11.2)
RNR IN Equity	39.4	(1.5)	(2.8)	(11.1)
Z IN Equity	278.3	1.5	(4.2)	(10.0)

In line; growth momentum remains strong. HDFC Bank 2Q earnings remained on track, with key highlights being: (1) Strong loan growth of 38% yoy (YTD growth of 26%), (2) margins decline by 10 bps qoq to 4.2%, (3) gross NPLs ratio flat qoq; provisioning coverage healthy at 78%, (4) CASA ratio at 51%, and (5) provisions higher due to creation of floating provisions. Growth and earnings outlook remains strong for HDFC Bank, but expensive valuations at 3.8X FY2012E PBR leave little room for upside. Maintain REDUCE with TP of ₹2,500.

Company data and valuation summary

HDFC Bank

Stock data

52-week range (Rs) (high,low)	2,540-1,549
Market Cap. (Rs bn)	1,084.3

Shareholding pattern (%)

Promoters	23.6
FIIs	45.2
MFs	4.0

Price performance (%)

	1M	3M	12M
Absolute	(1.3)	15.7	39.1
Rel. to BSE-30	(3.2)	3.8	20.6

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	64.4	84.9	111.2
EPS growth (%)	22.1	31.8	31.0
P/E (X)	36.8	27.9	21.3
NII (Rs bn)	83.9	103.1	126.0
Net profits (Rs bn)	29.5	38.9	50.9
BVPS	470.2	536.6	623.5
P/B (X)	5.0	4.4	3.8
ROE (%)	16.1	16.9	19.2
Div. Yield (%)	0.5	0.7	0.9

In-line performance for the quarter; outlook strong but valuations pricing current performance

HDFC Bank continues to show strong performance on all counts. Loans grew by 38% yoy (26% YTD). Retail is witnessing a steady turnaround, with all segments driving growth, including the unsecured loans as well. Margins declined 10 bps qoq, but remain healthy at 4.2%. We expect a marginal decline going forward as the proportion of mortgages/corporate assets increases. Declining pace of new NPL formation will result in lower loan loss provisions cushioning any pressure on margins or fee income. Fee income growth will remain weak as pricing of wealth management products remains under pressure.

We believe that HDFC Bank has enough cushions on costs and provisions to maintain its impeccable earnings momentum. We have maintained our earnings and TP at ₹2,500. We find valuations expensive at 3.8X FY2012 PBR leaving very little upside (6%) from current levels. Maintain REDUCE.

Sequential growth in loan book impressive at 8%; retail grows 31% yoy and 8% qoq

HDFC Bank's loan book grew 38% yoy (8% qoq) to ₹1.59 tn as of September 2010 mainly due to higher growth in corporate loans. Over the past 6 months, loan growth for HDFC Bank has been at 26%, one of the highest in the industry. We are revising our loan growth assumptions to 28% CAGR for FY2010-12E given the strong 1HFY11 performance.

Corporate loans grew by 46% yoy (9% qoq) while retail loans grew by 31% yoy (8% qoq) and now is about 52% of loan book. Corporate loans saw one large short-term lending during the quarter. Retail loans were largely driven by auto loans (up 36% yoy at Rs232 bn), and commercial vehicles (up 42% yoy at Rs112 bn). HDFC Bank has not bought any loans (housing loans declined 4% qoq) from HDFC Ltd in the current quarter. Unsecured loans (personal loans and credit cards) to total loans were flat qoq at 17% in the current quarter but growth is visible with the run-off from CBoP largely completed.

REDUCE

OCTOBER 19, 2010

RESULT

Coverage view: **Attractive**

Price (Rs): **2,369**

Target price (Rs): **2,500**

BSE-30: **19,983**

QUICK NUMBERS

- YTD growth in loans at 26%. NII growth at 29%; net profits growth at 33%
- Fee income growth at 16% yoy
- Maintain TP at ₹2,500

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CASA ratio improves 140 bps qoq to 50.6%; savings growth at 38% yoy

CASA ratio, which declined by 280 bps qoq in the previous quarter (seasonal trend), improved 140 bps qoq in the current quarter. CASA % at the end of 2QFY11 stood at 50.6% compared to 49.2% in June 2010 and 51.7% in March 2010. Savings deposits grew impressively by 38% yoy (11% qoq) while current account grew by 22% yoy (9% qoq). Deposits growth remained well ahead of industry at 30% yoy and 7% qoq. CASA ratio continues to grow impressively giving HDFC Bank a structural advantage compared to peers in a rising rate environment.

Margins decline 10 bps qoq but CD ratio cushions decline

NIMs for the quarter was at 4.2% (sequential decline of 10 bps) as lending yields have remained flat (KS calc.) while cost of funds (KS calc.) have increased by 20 bps. CD ratio expanded marginally to 80.4% from 79.9% in June 2010. On a calculated basis, investment yields have seen a sequential increase (investment yields on SLR has improved in the past few quarters, especially for shorter maturity). NII grew by 29% yoy in 2QFY11 to ₹25.3 bn, in line with our estimates.

We expect margins to moderate further as the bank would need to raise deposit rates sooner as the outlook on credit remains strong and the bank has little cushion on its investment book. The bank strives to maintain margins at 4-4.2%.

Asset quality trend healthy; coverage ratio healthy at 77%

Gross NPLs which have been declining continuously over the past four quarters reversed in 2QFY11; increasing by ₹0.5 bn to ₹18.4 bn. However, we believe that the increase is not material in nature as new NPL formation continues to remain low over the past few quarters. Despite lower NPL formation, loan loss provisioning for the quarter continued to remain high at 120 bps for the quarter. Nearly a third of these provisions were floating provisions. These provisions are not adjusted towards net NPA but are computed for tier-2 capital. We are building in provisions of 120 bps for HDFC Bank in FY2011-12E.

The bank continues to make higher provisions and write-offs (compared to regulatory norms) resulting in much lower net NPLs at 0.3%. Provision coverage ratio improved marginally by about 100 bps qoq to 78%, well ahead of 70% as mandated by RBI. The total restructured continued to be low at 0.3% of loans.

Fee income growth slower at 16% yoy; exchange income flat yoy

Non-interest income declined 9% yoy to Rs9.6 bn, as HDFC Bank reported a treasury loss of ₹0.5 bn, against a gain of ₹1.6 bn in 2QFY10. Core fees growth was slower at 16% yoy in 2QFY11 at ₹8.6 bn as pricing pressure remains on retail fees, especially third party products and selectively on corporate products (LC/BG etc). The bank has revised its fee income for the previous year adjusting ATM expenses in non-staff expenses as against netting off from other income. Exchange income was flat yoy at ₹1.5 bn. We are factoring 17% CAGR for FY2010-12E.

Others key highlights

- ▶ Operating costs have increased by 19% yoy mainly due to sharp increase in staff expenses (28% yoy). Cost-income ratio for the quarter was flat qoq at 48%.
- ▶ The bank has opened 40 branches and 328 ATMs in the current quarter taking the total branch network to 1,765 branches and 4,721 ATMs, respectively.
- ▶ Tier-1 capital has improved qoq to 12.7% (total CAR is 17%) from 12.4% (total CAR is 16.3%) in 1QFY11 as 2QFY11 have been audited. Improvement in tier-2 capital is mainly due to floating provisions created during the quarter.

HDFC Bank, quarterly performance

March fiscal year-ends, 2QFY10-2QFY11 (Rs mn)

	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	% chg	2QFY11E	Actual Vs KS
Interest income	39,919	40,348	40,531	44,202	48,089	20.5	47,136	2.0
Interest on advances	30,102	30,389	30,314	33,105	36,732	22.0	36,142	1.6
Interest on investments	9,596	9,802	10,081	10,532	11,003	14.7	10,542	4.4
Other interest	221	157	136	564	355	60.5	451	(21.4)
Interest expense	20,361	18,109	17,018	20,190	22,837	12.2	22,357	2.1
Net interest income	19,558	22,239	23,514	24,011	25,252	29.1	24,779	1.9
Non-int.income	10,535	8,530	9,036	9,399	9,607	(8.8)	9,914	(3.1)
- fee income	7,386	7,237	7,653	7,457	8,570	16.0	7,963	7.6
- exchange income	1,510	1,540	1,801	1,718	1,523	0.9	1,737	(12.3)
- sale of invts.	1,629	(265)	(473)	215	(521)	(132.0)	215	(342.3)
Non treasury income	8,906	8,795	9,509	9,184	10,128	13.7	9,699	4.4
Total income	30,093	30,769	32,549	33,410	34,859	15.8	34,693	0.5
Op. expenses	14,163	14,532	15,605	15,923	16,799	18.6	16,363	2.7
Employee cost	5,541	5,786	5,972	6,671	7,106	28.2	6,815	4.3
Other cost	8,622	8,746	9,634	9,252	9,693	12.4	9,548	1.5
Operating profit	15,930	16,237	16,944	17,487	18,060	13.4	18,329	(1.5)
Provisions and cont.	5,941	4,477	4,399	5,550	4,545	(23.5)	4,856	(6.4)
NPLs	5,941	4,379	2,750	3,650	4,450	(25.1)	3,395	31.1
PBT	9,989	11,760	12,545	11,937	13,515	35.3	13,473	0.3
Tax	3,114	3,575	4,178	3,820	4,405	41.5	4,352	1.2
Net profit	6,875	8,185	8,366	8,117	9,110	32.5	9,121	(0.1)
Tax rate (%)	31.2	30.4	33.3	32.0	32.6	-	32.3	-
Op.profit excl treasury gains	14,301	16,502	17,417	17,272	18,581	29.9	18,114	2.6
Key balance sheet items (Rs bn)								
Total deposits	1498	1548	1674	1830	1953	30.4		
Savings deposits	432	467	499	539	595	37.6		
Current deposits	322	333	372	362	394	22.4		
Term deposits	744	748	803	930	964	29.6		
CASA ratio (%)	50.3	51.7	52.0	49.2	50.6			
Loans	1151	1196	1258	1462	1585	37.7		
Retail credit	627	660	723	761	820	30.8		
Housing loans	64	77	87	95	91	42.2		
Car loans	171	180	197	214	232	35.7		
Loan against sec	8	8	9	10	11	40.0		
Personal loans	84	85	88	90	95	12.5		
Two wheeler	18	17	18	19	20	14.3		
Credit cards	38	38	38	39	42	10.7		
Commercial vehicles	79	84	94	100	112	41.8		
Business Banking	123	127	139	144	158	28.6		

Source: Company, Kotak Institutional Equities estimates

HDFC Bank-- key parameters and balance sheet
March fiscal year-ends, 2QFY10-2QFY11

	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11
Yield management measures (%)					
NIM	4.2	4.3	4.4	4.3	4.2
Asset quality details					
Gross NPL(Rs mn)	20,269	19,741	18,168	17,912	18,412
Gross NPL (%)	1.8	1.6	1.4	1.2	1.2
Net NPLs (Rs mn)	6,024	5,440	3,921	4,125	4,085
Net NPL (%)	0.5	0.4	0.3	0.3	0.3
Capital adequacy ratios (%)					
CAR	15.7	18.3	17.4	16.3	17.0
Tier I	10.9	13.8	13.3	12.4	12.7
Tier II	4.8	4.5	4.1	3.9	4.3
Other key details					
Branches	1,506	1,725	1,725	1,725	1,765
ATM network	3,573	3,898	4,232	4,393	4,721
Cities covered	635	771	779	780	819
Balance sheet snapshot (Rs bn)					
CAPITAL AND LIABILITIES					
Capital	4	5	5	5	5
Reserves and surplus	161	206	211	221	233
Deposits	1,498	1,548	1,674	1,830	1,953
Borrowings	51	76	66	52	133
Subordinated debt	64	64	64	63	-
Other liabilities and provisions	162	147	206	162	175
Total	1,940	2,046	2,225	2,333	2,500
ASSETS					
Cash and balances with RBI	137	112	155	149	166
Balances with banks, money at call and short	14	17	145	33	43
Investments	572	641	586	608	637
Advances	1,137	1,196	1,258	1,462	1,571
Fixed assets	20	21	21	22	21
Other assets	61	59	60	58	62
Total	1,939	2,046	2,225	2,333	2,500

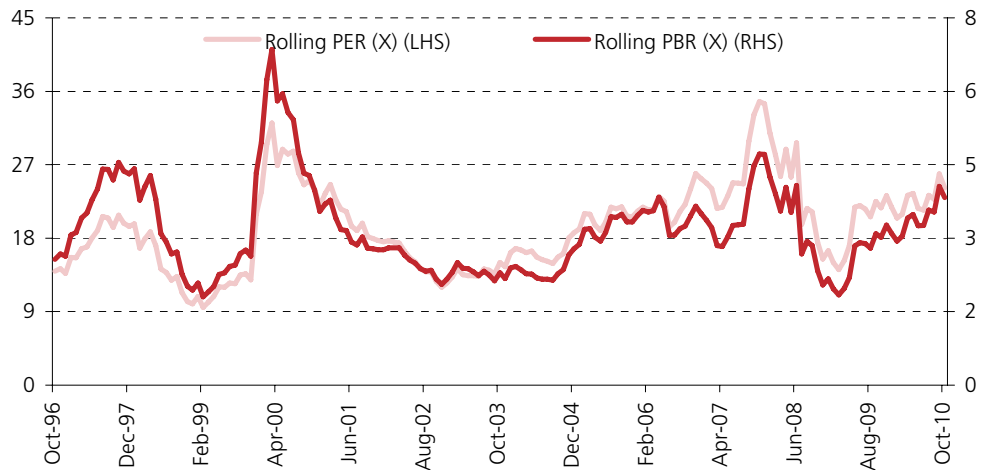
Source: Company

HDFC Bank—estimate changes

March fiscal year-ends, 2011-2013E, Rs bn

	Old estimates			New estimates			% change		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
Net loan growth (%)	27.2	25.1	25.0	30.4	25.1	25.0			
Retail loan to total loans (%)	47.0	40.9	27.1	45.8	39.9	26.4			
Total assets	2,708	3,329	4,086	2,781	3,421	4,197	2.7	2.8	2.7
Total income	143.2	171.9	215.9	144.2	175.1	216.3	0.7	1.9	0.2
Net interest income	100.6	121.4	155.8	103.1	126.0	157.4	2.4	3.8	1.0
NIM (%)	4.2	4.1	4.3	4.3	4.2	4.2			
Other income	42.5	50.4	60.1	41.1	49.1	58.8	-3.3	-2.7	-2.1
Fee income	33.7	40.0	47.4	33.7	39.4	46.9	0.0	-1.5	-1.1
Expenses	66.2	78.7	94.2	68.3	81.0	93.8	3.1	2.9	-0.4
Employee cost	26.9	33.0	40.5	28.5	34.2	39.0	6.2	3.6	-3.8
Other cost	39.4	45.7	53.7	39.8	46.8	54.8	1.0	2.5	2.2
Loan loss provisions	16.4	19.8	22.5	17.4	20.3	23.1	5.8	2.6	2.6
PBT	55.5	72.1	99.2	55.5	72.7	98.2	0.0	0.8	-1.0
PAT	38.8	50.5	69.4	38.9	50.9	68.7	0.0	0.8	-1.0
PBT-treasury+provisions	75.4	91.5	119.7	75.8	93.0	121.2	0.5	1.6	1.2
EPS (Rs)	84.9	110.3	151.7	84.9	111.2	150.1	0.0	0.8	-1.0
BVPS (Rs)	536.6	622.8	747.3	536.6	623.5	740.9	0.0	0.1	-0.9

Source: Company, Kotak Institutional Equities estimates

Rolling PER and PBR for HDFC Bank
October 1996-October 2010, (X)

Source: Kotak Institutional Equities

HDFC Bank growth rates and key ratios
 March fiscal year-ends, 2008-2013E (%)

	2008	2009	2010	2011E	2012E	2013E
Growth rates (%)						
Net loan	35.1	55.9	27.3	30.4	25.1	25.0
Customer assets growth	26.5	40.4	26.8	30.1	24.8	24.8
Retail loans to Customer assets	61.7	61.8	57.6	45.8	39.9	26.4
Net fixed assets	21.6	44.6	24.5	(3.5)	0.3	(2.1)
Cash and bank balance	61.4	18.5	71.0	(5.0)	11.2	12.1
Total Asset	46.0	37.6	21.4	25.0	23.0	22.7
Deposits	47.5	41.7	17.2	28.3	26.2	25.0
Current	45.2	(1.1)	30.9	15.4	19.9	25.0
Savings	33.5	73.3	1.1	33.7	28.7	25.0
Fixed	58.7	33.5	42.9	29.1	26.2	25.0
Net interest income	48.7	34.5	13.0	22.9	22.3	24.9
Loan loss provisions	41.2	42.0	12.3	(10.3)	16.8	13.7
Total other income	50.4	44.2	15.7	8.0	19.2	19.9
Net fee income	32.7	43.3	15.2	18.9	17.1	19.0
Net capital gains	(453.4)	58.2	(9.8)	(97.1)	900.0	30.0
Net exchange gains	48.7	111.4	2.0	16.0	18.0	20.0
Operating expenses	54.7	47.7	4.2	18.5	18.7	15.7
Employee expenses	67.5	72.0	2.3	24.7	19.8	14.0
Key ratios (%)						
Yield on average earning assets	9.7	10.8	8.3	8.2	8.7	9.0
Yield on average loans	12.6	15.0	10.8	10.3	10.7	11.0
Yield on average investments	7.9	7.4	6.8	7.0	7.2	7.3
Average cost of funds	5.2	6.7	4.6	4.5	5.1	5.3
Interest on deposits	5.2	6.6	4.5	4.4	5.0	5.1
Difference	4.6	4.1	3.7	3.7	3.6	3.6
Net interest income/earning assets	5.1	4.9	4.3	4.3	4.2	4.2
Spreads on lending business	7.5	8.3	6.2	5.8	5.6	5.6
Spreads on lending business (incl. Fees)	10.6	11.3	8.7	8.1	7.7	7.7
New provisions/average net loans	2.2	2.1	1.7	1.2	1.1	1.0
Total provisions/gross loans	1.0	1.0	1.1	1.9	2.5	2.8
Interest income/total income	70.7	69.3	68.8	71.5	72.0	72.8
Other income / total income	29.3	30.7	31.2	28.5	28.0	27.2
Fee income to total income	22.0	22.9	23.2	23.3	22.5	21.7
Fee income to advances	3.1	3.0	2.5	2.3	2.1	2.0
Fees income to PBT	75.2	74.5	66.0	60.6	54.2	47.8
Net trading income to PBT	(2.0)	11.6	8.0	(3.4)	—	0.1
Exchange inc./PBT	12.4	18.1	14.2	12.8	11.5	10.2
Operating expenses/total income	48.0	51.7	47.3	47.4	46.3	43.4
Operating expenses/assets	3.3	3.5	2.8	2.7	2.6	2.5
Operating profit /AWF	1.9	1.9	2.0	2.3	2.4	2.6
Tax rate	30.3	32.0	31.3	30.0	30.0	30.0
Dividend payout ratio	18.9	18.9	18.6	18.6	18.6	18.6
Share of deposits						
Current	28.5	19.9	22.2	20.0	19.0	19.0
Fixed	45.5	55.6	48.0	50.0	51.0	51.0
Savings	26.0	24.4	29.8	30.0	30.0	30.0
Loans-to-deposit ratio	62.9	69.2	75.2	76.4	75.8	75.8
Equity/assets (EoY)	8.6	8.2	9.7	8.8	8.3	8.1
Dupont analysis (%)						
Net interest income	4.7	4.7	4.1	4.1	4.1	4.1
Loan loss provisions	1.1	1.1	1.0	0.7	0.7	0.6
Net other income	2.0	2.1	1.9	1.6	1.6	1.5
Operating expenses	3.6	3.6	2.9	2.8	2.6	2.5
Inv. depreciation	—	—	—	0.1	0.0	0.0
(1- tax rate)	69.7	68.0	68.7	70.0	70.0	70.0
ROA	1.4	1.4	1.5	1.6	1.6	1.8
Average assets/average equity	12.5	11.9	11.1	10.9	11.7	12.2
ROE	17.7	16.9	16.1	16.9	19.2	22.0

Source: Company, Kotak Institutional Equities estimates

HDFC Bank P&L and balance sheet

March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Income statement						
Total interest income	104,034	163,323	161,729	198,886	262,998	333,766
Loans	69,667	121,368	120,983	149,129	198,487	253,420
Investments	31,604	40,080	39,813	47,713	62,408	79,005
Cash and deposits	2,762	1,876	933	2,044	2,103	1,342
Total interest expense	48,871	89,111	77,863	95,827	136,982	176,331
Deposits from customers	43,827	80,155	69,977	83,805	121,549	156,403
Net interest income	55,163	74,212	83,866	103,058	126,017	157,435
Loan loss provisions	12,160	17,263	19,391	17,397	20,316	23,089
Net interest income (after prov.)	43,002	56,949	64,475	85,661	105,701	134,346
Other income	22,825	32,906	38,077	41,137	49,053	58,817
Net fee income	17,145	24,573	28,306	33,658	39,399	46,893
Net capital gains	2,418	3,826	3,451	100	1,000	1,300
Net exchange gains	2,831	5,986	6,103	7,079	8,354	10,025
Operating expenses	37,456	55,328	57,645	68,294	81,043	93,800
Employee expenses	13,014	22,382	22,892	28,539	34,194	38,989
Depreciation on investments	2,884	—	—	2,000	1,000	1,200
Other Provisions	2,683	1,528	2,010	1,000	—	—
Pretax income	22,811	32,999	42,898	55,504	72,711	98,164
Tax provisions	6,909	10,549	13,410	16,651	21,813	29,449
Net Profit	15,902	22,449	29,488	38,853	50,898	68,715
% growth	39.3	41.2	31.4	31.8	31.0	35.0
Operating profit	35,229	47,964	60,847	75,802	93,027	121,153
% growth	33.8	36.1	26.9	24.6	22.7	30.2
Balance sheet						
Cash and bank balance	147,783	175,066	299,424	284,515	316,404	354,547
Cash	9,401	15,862	24,353	26,788	29,467	32,413
Balance with RBI	116,131	119,410	130,480	113,136	142,346	177,542
Balance with banks	9,949	9,051	7,092	7,092	7,092	7,092
Net value of investments	493,933	588,252	586,154	773,686	969,574	1,193,197
Govt. and other securities	316,656	521,566	510,499	698,503	894,391	1,118,014
Shares	345	397	1,035	1,035	1,035	1,035
Debentures and bonds	62,517	19,428	11,393	11,393	11,393	11,393
Net loans and advances	634,269	988,830	1,258,306	1,641,269	2,052,461	2,565,329
Fixed assets	11,751	16,989	21,150	20,410	20,472	20,040
Net leased assets	—	—	—	—	—	—
Net Owned assets	11,751	16,989	21,150	20,410	20,472	20,040
Other assets	44,027	63,568	59,551	60,983	62,558	64,291
Total assets	1,331,764	1,832,706	2,224,586	2,780,863	3,421,470	4,197,403
Deposits	1,007,686	1,428,116	1,674,044	2,147,144	2,708,837	3,385,720
Borrowings and bills payable	108,852	120,860	188,414	226,163	248,688	275,719
Other liabilities	100,254	133,257	146,902	161,945	178,527	196,808
Total liabilities	1,216,792	1,682,233	2,009,361	2,535,252	3,136,053	3,858,246
Paid-up capital	3,544	4,254	4,577	4,577	4,577	4,577
Reserves & surplus	111,428	146,219	210,648	241,033	280,839	334,580
Total shareholders' equity	114,972	150,473	215,225	245,611	285,417	339,157

Source: Company, Kotak Institutional Equities estimates

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RESULT

Coverage view: **Cautious**

Price (Rs): **1,514**

Target price (Rs): **1,450**

BSE-30: **19,983**

Higher revenues and in-line margins deliver marginal upside. Bajaj Auto's 2QFY11 PAT came in 6% above estimates, driven by sequential improvement in realizations, higher financial income and lower depreciation. However, a seasonal increase in working capital saw in a smaller proportion of earnings reach the bank. We tweak our EPS estimates upwards but maintain our REDUCE rating as the stock is discounting the continuation of the strong demand, pricing environment and a strong product cycle.

Company data and valuation summary

Bajaj Auto

Stock data

52-week range (Rs) (high,low)	1,615-683
Market Cap. (Rs bn)	438.2

Shareholding pattern (%)

Promoters	49.7
FIs	18.7
MFs	3.0

Price performance (%)

	1M	3M	12M
Absolute	3.8	26.3	101.7
Rel. to BSE-30	3.4	13.0	73.9

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	58.8	91.0	103.6
EPS growth (%)	160.2	54.6	13.9
P/E (X)	25.7	16.6	14.6
Sales (Rs bn)	115.1	162.6	186.9
Net profits (Rs bn)	17.0	26.3	30.0
EBITDA (Rs bn)	26.2	34.5	39.3
EV/EBITDA (X)	17.2	13.0	11.1
ROE (%)	70.9	67.4	49.6
Div. Yield (%)	0.7	1.3	1.3

Bajaj Auto reported slightly better than expected PAT on higher realizations; margins were in line

Bajaj Auto reported PAT for 2QFY11 of Rs6.8 bn, up 69% yoy and 16% qoq. The reported PAT came in 6% better than our expectations of Rs6.4 bn with the upside being driven by higher-than-expected revenues. Revenues for the quarter came in at Rs43.4 bn compared to our estimate of Rs41.5 bn. Realizations for the quarter were up 4% qoq and came in better than expectations. The sequential increase in realizations was driven by price increases taken during the quarter and a richer mix consisting of a higher proportion of 3-wheelers and Pulsars.

Margins were in line with estimates; up 70bps qoq but down 130 bps yoy

EBITDA margins for the quarter came in at 20.7% compared to 20% reported in 1QFY11 and 22% in 2QFY10. The 70 bps of sequential margin improvement was driven by lower raw material costs and higher realizations. Raw material costs as a percentage of sales declined to 73.5% from 74.1% as the company's raw material contracts reflected the pullback we saw in commodity prices during the May-June period. The sequential decline was offset by increases in tire prices and certain components.

Tweaking up FY2011E and FY2012E EPS estimates by 3%, largely reflecting 2QFY11 beat

We are raising our FY2011E and FY2012E EPS estimate to Rs91 and Rs104 from Rs88 and Rs101 prior. The increase primarily reflects higher financial income and lower depreciation expense. We expect depreciation expense to be flat or even trend down from 2QFY11 levels as the company's Chakan plant assets gets fully depreciated. Our FY2011E and FY2012E earnings estimates reflect volume growth of 38% and 15%, respectively, and margins in the 20% range.

Tweaking target upward to Rs1,450, maintain REDUCE

We raised our target by Rs30 to Rs1,450 to reflect the higher earnings estimates. We maintain our REDUCE rating as the stock largely reflects the strong demand fundamentals, product cycle and pricing power being enjoyed currently. Our earnings estimates assume a continuation of these favorable factors into FY2012E and could prove aggressive in the event of a mean reversion in growth to the 10-12% range, given increasing competitive intensity in the motorcycle segment.

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Balance sheet and cash flows

The company ended September 30, 2010 with cash of Rs1.9 bn. Total net cash and investments totaled Rs47.8 bn an increase of Rs4.8 bn from FY2010 levels compared to the Rs12 b in net income generated in 1HFY11. We notice an Rs8 bn increase in receivables and loans and advances as of the end of September from end FY2010 levels. The company attributed the higher receivables to the increased inventory at the dealer level ahead of the festival season.

Interim results of Bajaj Auto, March fiscal year-ends (Rs mn)

	2QFY11	2QFY11E	2QFY10	1QFY11	(% chg.)			2010	2011E	(% chg)
					2QFY11E	2QFY10	1QFY11			
Net sales	43,418	41,480	28,875	38,901	4.7	50.4	11.6	119,210	169,044	41.8
Total expenditure	(34,447)	(32,818)	(22,510)	(31,131)	5.0	53.0	10.6	(93,284)	(134,545)	44.2
Inc/(Dec) in stock	320	400	365	(869)	(20.0)	(12.4)	(136.8)	476	1,289	170.8
Raw materials	(31,032)	(29,603)	(19,489)	(26,813)	4.8	59.2	15.7	(81,180)	(121,166)	49.3
Staff cost	(1,142)	(1,300)	(1,074)	(1,264)	(12.2)	6.3	(9.7)	(3,995)	(4,791)	19.9
Other expenditure	(2,618)	(2,350)	(2,346)	(2,195)	11.4	11.6	19.3	(8,742)	(10,002)	14.4
Expenses capitalized	25	35	34	9	—	(26.9)	174.4	157	125	—
EBITDA	8,972	8,662	6,365	7,769	3.6	41.0	15.5	25,926	34,499	33.1
OPM (%)	20.7	20.9	22.0	20.0				21.7	20.4	
Other income	837	600	217	817	39.5	285.2	2.5	1,225	3,288	168.4
Interest	(7)	-	-	(6)	—	—	—	(60)	-	(100.0)
Depreciation	(300)	(335)	(336)	(318)	(10.6)	(10.8)	(5.9)	(1,365)	(1,231)	(9.8)
Pretax profits	9,503	8,927	6,247	8,262	6.4	52.1	15.0	25,726	36,556	42.1
Extraordinaries	-	-	458	-	—	—	—	1,650	-	
Tax	2,682	2,500	1,760	2,360	7.3	52.4	13.6	7,075	10,236	44.7
Net income	6,821	6,427	4,028	5,902	6.1	69.3	15.6	17,001	26,320	54.8
Income tax rate (%)	28.2	28.0	30.4	28.6				29.4	28.0	
Ratios										
RM to sales (%)	73.5	72.5	68.5	74.1				70.1	73.7	
EBITDA margin (%)	20.7	20.9	22.0	20.0				21.7	20.4	
Net profit margin (%)	15.7	15.5	14.0	15.2				14.3	15.6	
ETR (%)	28.2	28.0	30.4	28.6				29.4	28.0	
EPS (Rs)	23.6	22.2	13.9	20.4				58.8	91.0	
Other details										
Sales volumes (# vehicles)	1,000,570	1,000,548	686,727	928,336	0.0	45.7	7.8	2,852,580	3,921,453	37.5
Net sales realisation (Rs/vehicle)	41,785	40,258	40,674	40,258	3.8	2.7	3.8	41,790	43,107	3.2

Source: Company, Kotak Institutional Equities

Bajaj Auto, Volume assumptions, March fiscal year ends, 2007-2012E

	2008	2009	2010E	2011E	2012E	2013E
Volumes (# vehicles)						
Motorcycles	2,139,633	1,907,810	2,506,845	3,479,156	4,001,029	4,601,183
Domestic	1,658,084	1,276,427	1,781,748	2,448,003	2,815,204	3,237,484
Exports	481,549	631,383	725,097	1,031,152	1,185,825	1,363,699
Scooters	21,294	11,772	4,851	—	—	—
Total 2-wheelers	2,160,927	1,919,582	2,511,696	3,479,156	4,001,029	4,601,183
Domestic 3-Wheelers						
Passenger 3-wheelers	127,379	125,273	164,493	189,167	212,813	244,735
Goods 3-wheelers	26,607	10,197	11,534	5,767	5,767	5,767
Exports	136,315	139,056	164,909	247,364	284,468	327,138
Total 3-wheelers	290,301	274,526	340,936	442,297	503,048	577,640
Total vehicles	2,451,228	2,194,108	2,852,632	3,921,453	4,504,077	5,178,823
Growth rates (yoy %)						
Motorcycles	(10.0)	(10.8)	31.4	38.8	15.0	15.0
Domestic	(20.2)	(23.0)	39.6	37.4	15.0	15.0
Exports	61.8	31.1	14.8	42.2	15.0	15.0
Scooters	4.0	(44.7)	(58.8)			
Total 2-wheelers	(9.8)	(11.2)	30.8	38.5	15.0	15.0
Domestic 3-Wheelers	(15.0)	(12.0)	29.9	10.7	12.1	14.6
Passenger 3-wheelers	(8.2)	(1.7)	31.3	15.0	12.5	15.0
Goods 3-wheelers	(37.2)	(61.7)	13.1	(50.0)	—	—
Exports	(3.1)	2.0	18.6	50.0	15.0	15.0
Total 3-wheelers	(9.8)	(5.4)	24.2	29.7	13.7	14.8
TOTAL Vehicles	(9.8)	(10.5)	30.0	37.5	14.9	15.0

Source: Company, Kotak Institutional Equities estimates

Bajaj Auto, Profit model and Balance Sheet, March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	86,633	84,369	115,085	162,636	186,928	217,993
Operating profit	12,900	12,097	26,175	34,499	39,300	42,374
Other income	1,262	1,043	976	3,288	3,655	4,629
Interest	(52)	(210)	(60)	—	—	—
Depreciation	(1,740)	(1,298)	(1,365)	(1,231)	(1,318)	(1,397)
Profit before tax	12,371	11,632	25,726	36,556	41,636	45,606
Extra-ordinary items	(1,025)	(2,071)	(1,624)	—	—	—
Taxes	(3,788)	(3,016)	(7,075)	(10,236)	(11,658)	(12,770)
Net profit	7,558	6,545	17,027	26,320	29,978	32,836
Earnings per share (Rs)	54.2	22.6	58.8	91.0	103.6	113.5
Balance sheet (Rs mn)						
Equity	15,876	18,697	29,283	48,833	72,040	98,105
Deferred tax liability	110	42	17	17	17	17
Total borrowings	13,343	15,700	13,386	12,060	10,867	9,793
Current liabilities	18,773	24,376	42,750	50,409	53,878	57,896
Total liabilities	48,102	58,814	85,436	111,319	136,802	165,811
Net fixed assets	12,928	15,481	15,211	16,730	17,662	18,515
Investments	18,571	18,085	40,215	57,215	72,215	87,215
Cash	561	1,369	1,014	3,444	11,013	21,756
Other current assets	15,936	21,884	28,995	33,921	35,903	38,316
Miscellaneous expenditure	105	1,996	—	—	—	—
Deferred tax assets	—	—	—	9	9	9
Total assets	48,102	58,814	85,436	111,319	136,802	165,812
Ratios						
Operating margin (%)	14.3	13.7	21.9	20.4	20.2	19.3
PAT margin (%)	8.4	7.4	14.3	15.6	15.4	14.9
Debt/equity (X)	0.8	0.8	0.5	0.2	0.2	0.1
Net debt/equity (X)	0.0	0.2	(0.7)	(0.8)	(0.9)	(0.9)
Book Value (Rs/share)	114.6	129.5	202.5	168.8	249.0	339.1
RoAE (%)	21.0	37.7	70.9	67.4	49.6	38.6
RoACE (%)	72.5	44.1	174.0	777.0	379.7	187.9

Source: Company, Kotak Institutional Equities estimates

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RESULT

Coverage view: **Attractive**

Price (Rs): **1,287**

Target price (Rs): **1,300**

BSE-30: **19,983**

Broadly in-line results. Concor reported revenues of Rs9.4 bn, down 1.6% yoy and 3.8% below estimate. Low rail freight expenses led the 130 bps yoy margin expansion; in line with estimates. Exim segment led the revenue disappointment (5.7% below estimates) likely led by lower-than-expected volume growth and shorted lead distances. Domestic segment reported a revenue growth of 13% yoy while the exim segment led the margin expansion. PAT at Rs2.06 bn was marginally below estimates of Rs2.1 bn.

Company data and valuation summary

Container Corporation

Stock data

52-week range (Rs) (high,low)	1,500-1,045
Market Cap. (Rs bn)	168.3

Shareholding pattern (%)

Promoters	63.1
FIs	24.3
MFs	3.3

Price performance (%)

	1M	3M	12M
Absolute	(1.6)	(8.7)	14.7
Rel. to BSE-30	(4.4)	(18.8)	(1.5)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	60.5	73.1	84.6
EPS growth (%)	(0.7)	20.9	15.7
P/E (X)	21.4	17.7	15.3
Sales (Rs bn)	37.0	40.8	46.9
Net profits (Rs bn)	7.9	9.5	11.0
EBITDA (Rs bn)	10.1	12.0	13.8
EV/EBITDA (X)	14.9	12.4	10.3
ROE (%)	19.4	20.3	20.3
Div. Yield (%)	1.1	1.3	1.5

Results broadly in line with estimates; revenues decline on a yoy basis

- ▶ **Revenue records de-growth:** Concor reported 2QFY11 revenues of Rs9.4 bn, down 1.6% on a yoy basis and marginally below our estimate (by 3.8%) of Rs9.8 bn (see Exhibit 1). We had expected the company to report a marginal revenue growth of about 2-3%. The slight revenue disappointment is likely to have been led by a slower-than-expected pick-up in exim volumes.
- ▶ **EBITDA margin expansion—in line with estimates:** Concor reported a 130 bps yoy expansion in EBITDA margin to 27.7%, in line with estimates. The margin expansion was led by lower rail freight expenses as a percentage of sales (down 150 bps yoy to 56.7%). The revenue miss led to a net PAT of Rs2.06 bn in 2QFY11, marginally (2%) below our estimate of Rs2.1 bn.
- ▶ **Half-year performance:** For the half year ending September 30, 2010, Concor reported flat revenues on a yoy basis of Rs18.6 bn. EBITDA margin expanded by about 50 bps yoy to 27.4% in 1HFY11 from 26.8% in 1HFY10, while net PAT remained relatively flat at Rs4 bn.

Domestic segment leads revenue growth while exim segment leads margin expansion

Exim revenues of Rs7.3 bn were about 5.7% below our estimate while domestic revenues of Rs2.1 bn (up 13% yoy) was 3.5% above our estimate (see Exhibit 2). Our estimates were based on 7-9% yoy growth in volumes and flat realizations on a sequential basis. Apart from lower-than-expected volumes the exim revenues could also have been impacted by lower average lead distances in 2QFY11 versus 2QFY10. Note that this trend was seen in 1QFY11 as well. The margin expansion was, however, led by the exim segment which recorded a 150 bps expansion in EBIT margins, while the domestic segment recorded a 290 bps yoy decline in EBIT margins.

Reiterate REDUCE with a TP of Rs1,300; will revisit estimates post today's conference call

We retain our estimates of Rs73.1 and Rs84.6 for FY2011E and FY2012E, respectively (see Exhibit 4). We reiterate our REDUCE rating with a target price of Rs1,300/share based on relatively expensive valuations and increasing competition likely to partake market share.

We will revisit our estimates post today's conference call at 11:00 am.

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Exhibit 1: Results broadly in line with estimates

Container Corporation - 2QFY11 results - key numbers (Rs mn)

	2QFY11	2QFY11E	2QFY10	1QFY11	% change			1HFY11	1HFY10	%change
					vs est.	yoy	qoq			
Net Sales	9,442	9,813	9,599	9,159	(3.8)	(1.6)	3.1	18,601	18,673	(0.4)
Staff cost	(194)	(216)	(209)	(202)	(10.3)	(7.5)	(4.3)	(396)	(407)	(2.6)
Rail freight exp	(5,353)	(5,594)	(5,588)	(5,274)	(4.3)	(4.2)	1.5	(10,627)	(10,857)	(2.1)
Others	(1,276)	(1,295)	(1,267)	(1,213)	(1.5)	0.7	5.2	(2,489)	(2,397)	(1.1)
Total exp	(6,823)	(7,105)	(7,065)	(6,689)	(4.0)	(3.4)	2.0	(13,512)	(13,661)	(1.2)
EBITDA margin	2,619	2,709	2,534	2,470	(3.3)	3.3	6.0	5,089	5,012	1.5
Other Income	381	377	439	359	0.9	(13.4)	6.1	739	852	(13.2)
PBDIT	2,999	3,086	2,973	2,829	(2.8)	0.9	6.0	5,828	5,864	(0.6)
Depreciation	(365)	(380)	(328)	(352)	(4.0)	11.3	3.5	(717)	(643)	11.4
PBT	2,635	2,706	2,646	2,476	(2.6)	(0.4)	6.4	5,111	5,221	(2.1)
Tax	(567)	(595)	(602)	(541)	(4.7)	(5.8)	4.8	(1,109)	(1,168)	(5.1)
PAT	2,068	2,111	2,043	1,935	(2.0)	1.2	6.8	4,003	4,052	(1.2)
Key ratios (%)										
Rail freight exps/Sales	56.7	57.0	58.2	57.6		(1.5)		57.1	58.1	
Other exp/Sales	13.5	13.2	13.2	13.2				13.4	12.8	
Employee exp/Sales	2.1	2.2	2.2	2.2				2.1	2.2	
EBITDA margin	27.7	27.6	26.4	27.0				27.4	26.8	
PBT margin	27.9	27.6	27.6	27.0				27.5	28.0	
Effective tax rate	21.5	22.0	22.8	21.9				21.7	22.4	
PAT margin	21.9	21.5	21.3	21.1				21.5	21.7	

Source: Company, Kotak Institutional Equities estimates

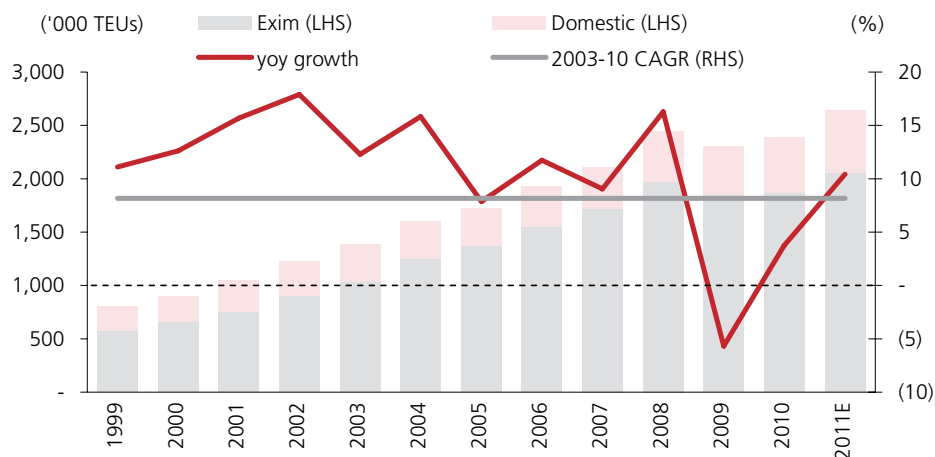
Exhibit 2: Domestic segment leads revenue growth while exim segment leads margin expansion

Container Corporation - 2QFY11 results - segmental key numbers (Rs mn)

Segmental	2QFY11	2QFY11E	2QFY10	1QFY11	% change			1HFY11	1HFY10	%change
					vs est.	yoy	qoq			
Sales (Rs mn)										
Exim	7,333	7,775	7,735	7,202	(5.7)	(5.2)	1.8	14,535	14,979	(3.0)
(% of total)	77.7	79.2	80.6	78.6				78.1	80.2	
Domestic	2,109	2,038	1,864	1,957	3.5	13.1	7.8	4,065	3,694	10.0
(% of total)	22.3	20.8	19.4	21.4				21.9	19.8	
EBIT (Rs mn)										
Exim	2,089		2,086	1,986		0.2	5.2	4,075	4,046	0.7
Margin (%)	28.5		27.0	27.6				28.0	27.0	
Domestic	210		239	266		(12.4)	(21.1)	475	546	(13.0)
Margin (%)	9.9		12.8	13.6				11.7	14.8	

Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Historical volumes handled by Concor, March fiscal year-ends, 1999-11E (TEUs)



Source: Company, Kotak Institutional Equities estimates

Exhibit 4: Key financials of Container Corporation, March fiscal year-ends, 2007-12E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
Income statement						
Net revenues	30,573	33,473	34,172	36,842	42,489	48,810
Total operating cost	(21,661)	(24,569)	(24,861)	(27,102)	(30,683)	(35,217)
EBIDTA	8,912	8,904	9,311	9,740	11,805	13,592
Other income	846	1,645	2,111	1,686	1,869	2,255
PBDIT	9,758	10,548	11,422	11,427	13,674	15,848
Depreciation	(936)	(1,063)	(1,159)	(1,450)	(1,682)	(1,888)
Pre tax profits	8,823	9,485	10,262	9,977	11,992	13,960
Tax	(1,862)	(1,980)	(2,347)	(2,038)	(2,332)	(2,791)
PAT	6,961	7,505	7,915	7,939	9,660	11,168
EPS (Rs)	54	58	61	61	74	86
One time items	77.4	16.9	(3.1)	—	—	—
PAT (reported)	7,038	7,522	7,912	7,939	9,660	11,168
Volume handled ('000 TEUs)						
Exim	1,716	1,977	1,855	1,874	2,061	2,267
Domestic	58	71	453	521	584	642
Balance sheet						
Networth	26,298	31,839	37,622	43,425	50,485	58,648
Share capital	650	650	1,300	1,300	1,300	1,300
Reserves & surplus	25,648	31,189	36,322	42,125	49,185	57,348
Total sources of funds	26,298	31,839	37,622	43,425	50,485	58,648
Net block	15,515	16,652	19,490	25,214	28,673	30,271
CWIP	2,028	1,721	2,457	818	818	818
Investments	1,317	1,554	2,031	3,031	4,031	5,031
Net current assets	9,051	13,650	15,582	16,300	18,901	24,466
Net deferred tax asset	(1,613)	(1,737)	(1,938)	(1,938)	(1,938)	(1,938)
Total application of funds	26,298	31,839	37,622	43,425	50,485	58,648

Source: Company, Kotak Institutional Equities estimates

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UPDATE

Coverage view: **Attractive**

Price (Rs): **682**

Target price (Rs): **600**

BSE-30: **19,983**

In-line results, on track to achieve FY2011E US\$1 bn sales target. PAT was 2% higher than our estimate due to better-than-expected operating margin at 21% despite higher R&D and staff cost versus our estimate. Sales were in line with our estimate, marked by recovery in Latin America and strong growth continuing in domestic business (up 19% yoy). We leave our estimates largely unchanged. At current price, Cadila is trading at 18X FY2012E earnings. We maintain REDUCE rating due to rich valuations, PT at Rs600.

Company data and valuation summary

Cadila Healthcare

Stock data

52-week range (Rs) (high,low)	728-355
Market Cap. (Rs bn)	139.7

Shareholding pattern (%)

Promoters	74.8
FIs	4.4
MFs	7.0

Price performance (%)

	1M	3M	12M
Absolute	6.7	7.8	85.9
Rel. to BSE-30	4.7	(3.3)	61.1

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	24.7	33.9	39.3
EPS growth (%)	66.9	37.2	16.1
P/E (X)	27.6	20.1	17.3
Sales (Rs bn)	35.7	43.8	51.5
Net profits (Rs bn)	5.1	6.9	8.1
EBITDA (Rs bn)	7.0	8.9	10.7
EV/EBITDA (X)	21.2	16.1	13.1
ROE (%)	36.0	36.4	32.3
Div. Yield (%)	0.7	1.0	1.2

QUICK NUMBERS

- Sales at Rs11 bn was in line with estimates
- PAT was Rs1.7 bn, was 2% higher than our estimate
- Cadila on track to FY2011E sales guidance of US\$1 bn
- We maintain REDUCE rating due to rich valuations

Sales at Rs11 bn were in line with estimates marked by outperformance in India and US

Sales were in line with our estimate marked by (1) 19% yoy in India branded business, higher than 17% seen in 1QFY11. India growth rate has picked up YTD due to marketing push and benefits from added field force (400 MRs added in FY2010) in cardiovascular, respiratory (30% of sales), (2) US sales of US\$48 mn, flat qoq and likely to ramp up in 2HFY11E on account of new product launches, (3) 26% yoy sales growth in Latin America post weak IQFY11 and (4) 50% yoy increase in Hospira JV sales on account of Docetaxel supplies.

PAT was Rs1.7 bn, 2% higher than our estimate

PAT was 2% higher than our estimate due to higher EBITDA margin at 21%, 40 bps higher than our estimate despite higher R&D expenses and staff costs this quarter. Materials cost at 32% was 100 bps lower than our estimate due to strong growth in the high-margin segment of domestic formulations while other expenses at 28% was 200 bps lower than our estimate.

Cadila on track to FY2011E sales guidance of US\$1 bn

We forecast net sales growth of 22% in FY2011E with margin expanding 200 bps. We believe Cadila is very close to attaining its sales guidance for FY2011E with sales of Rs44 bn in FY2011E. We leave our estimates largely unchanged.

We maintain REDUCE due to rich valuations with PT at Rs600 (was Rs580)

At current price, Cadila is trading at 18X FY2012E earnings. We maintain REDUCE rating due to rich valuations, PT at Rs600 (15.5X FY2012E est.).

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Key takeaways from conference call

- ▶ Cadila is confident of maintaining India sales growth at 15% in FY2011E, YTD growth in branded segment is 17-19%. India growth rate has picked up YTD due to marketing push and benefits from added field force in key segments of cardiovascular, respiratory. Cadila is growing at 30-40% yoy in these two segments (30% of sales) outpacing market growth of 25%. Cadila added field of around 400 in these two segments in FY2010 and has expanded doctor coverage.
- ▶ Sales from Hospira JV will ramp up in 2HFY11E on account of Docetaxel supplies which commenced this quarter.
- ▶ Sales from Abbott deal will start in 12-18 months from now. Additional licensing income is also expected from Abbott based upon reaching pre-defined milestone; however, company did not indicate timing or amount.
- ▶ API plant at Navi Mumbai for Nycomed will get inspected by US FDA in Jan-March quarter. Sale of API supplies in Nycomed JV (8 APIs) will commence in FY2012E.

Interim results- Cadila, March fiscal year-ends (Rs mn)

	2QFY11	2QFY11E	2QFY10	1QFY10	% change		
					2QFY11E	2QFY10	1QFY10
Net sales	11,063	10,976	9,127	10,551	1	21	5
(Increase)/decrease in stock	(196)	0	(165)	(169)	NM	NM	NM
Material consumed	3,737	3,622	3,186	3,429	3	17	9
R&D	691	549	474	585	26	46	18
Personnel costs	1,365	1,175	1,112	1,277	16	23	7
Other expenditure	3,121	3,348	2,795	3,243	(7)	12	(4)
Total expenditure	8,718	8,694	7,401	8,364	0	18	4
EBITDA	2,344	2,283	1,726	2,187	3	36	7
Interest expenses	160	180	231	316	(11)	(31)	(49)
Other Income	142	300	373	816	(53)	(62)	(83)
Depreciation & Amortisation	304	370	311	314	(18)	(2)	(3)
PBT	2,022	2,033	1,557	2,373	(1)	30	(15)
Tax	254	295	179	338	(14)	42	(25)
Net Profit before MI	1,768	1,738	1,378	2,036	2	28	(13)
Extra ordinary expense	—	0	23	0	NM	NM	NM
Adjustments on consolidation	(60)	(60)	(35)	(43)	NM	NM	NM
Profit for shareholders	1,708	1,678	1,320	1,992	2	29	(14)
India	5,934	5,827	5,012	5,675	2	18	5
Finished dosage - Branded	4,399	4,249	3,695	4,142	4	19	6
Finished dosage - Generic	269	269	240	219	0	12	23
API	64	90	87	92	(29)	(26)	(30)
Consumer	799	844	649	873	(5)	23	(8)
Animal Health and others	403	375	341	349	7	18	15
International	5,279	5,266	4,239	5,007	0	25	5
Finished dosage - Emerging m:	474	398	332	476	19	43	(1)
Finished dosage - Europe	588	840	528	632	(30)	11	(7)
Finished dosage - Latin Americ	584	566	461	387	3	27	51
Finished dosage - USA	2,258	2,091	1,604	2,227	8	41	1
Finished dosage - Hospira JV	312	240	203	139	30	54	124
Finished dosage - Japan	98	100	72	89	(2)	36	10
API - Others	801	790	831	902	1	(4)	(11)
API - Nycomed JV	164	240	208	153	(32)	(21)	7
Total gross sales	11,213	11,093	9,251	10,682	1	21	5

Source: Kotak Institutional Equities estimates, Company

Cadila—abridged profit model, balance sheet, cash model, March fiscal year-ends, 2008-2012E
(Rs mn)

	2008	2009	2010	2011E	2012E
Profit model					
Net revenues	22,660	28,624	35,748	43,761	51,482
EBITDA	4,013	5,407	6,966	8,939	10,681
EBITDA margin (%)	17.7	18.9	19.5	20.4	20.7
Other income	609	778	1,286	1,558	1,200
Depreciation	969	1,118	1,339	1,408	1,650
Net finance cost	350	1,128	821	763	300
PBT	3,303	3,939	6,092	8,326	9,931
Tax	613	666	741	1,144	1,589
Minority interest	37	83	247	243	290
Extra ordinary expense (income)	69	241	46	—	—
Pre acquisition profits/(loss)	8	(82)	—	—	—
Reported net profit	2,576	3,031	5,058	6,939	8,052
Balance sheet					
Total equity	10,622	11,914	16,183	21,889	27,995
Total debt	8,377	12,674	10,905	5,487	1,665
Minority interest	194	228	392	635	925
Deferred tax liabilities	1,234	1,316	1,141	1,241	1,341
Total liabilities and equity	20,427	26,132	28,621	29,252	31,926
Net fixed assets incl CWIP	14,001	17,187	19,326	19,986	21,336
Investments	254	249	207	187	187
Net current assets	5,246	6,179	6,581	8,129	9,454
Cash	926	2,517	2,507	950	950
Total assets	20,427	26,132	28,621	29,252	31,926
Ratios					
Diluted EPS (Rs)	13.7	14.8	24.7	33.9	39.3
ROE (%)	26.7	26.9	36.0	36.4	32.3
Debt/equity (X)	79	106	67	25	6

Source: Kotak Institutional Equities estimates, Company

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RESULT

Coverage view: **Attractive**

Price (Rs): **535**

Target price (Rs): **450**

BSE-30: **19,983**

Reiterate REDUCE, this time on core business concerns. Even as course correction on the (costly) mis-step to invest in handset products business is welcome, we note reasons for concern on the core business and would be wary of any re-rating in a hurry. In its acquisitive and bold pursuits (into unrelated areas), MT appears to have taken its eye off the ball on core business – underperformance on revenue growth as well as margins, the unpleasant outcomes. We cut our TP 18% to Rs450; reiterate REDUCE.

Company data and valuation summary

Mindtree

Stock data

52-week range (Rs) (high,low)	747-462
Market Cap. (Rs bn)	22.0

Shareholding pattern (%)

Promoters	32.4
FIs	15.6
MFs	8.2

Price performance (%)

	1M	3M	12M
Absolute	5.2	(6.1)	(5.9)
Rel. to BSE-30	3.1	(15.8)	(18.4)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	52.2	27.4	39.3
EPS growth (%)	294.3	(47.5)	43.3
P/E (X)	10.2	19.5	13.6
Sales (Rs bn)	13.0	15.5	18.6
Net profits (Rs bn)	2.1	1.1	1.6
EBITDA (Rs bn)	2.5	2.0	2.8
EV/EBITDA (X)	8.8	10.7	7.3
ROE (%)	35.2	16.1	20.2
Div. Yield (%)	0.4	0.2	0.7

Products (3G Android handset) investments – a costly mis-step...

What started as an unnecessary diversification into an unrelated area (in our view) is ending as a costly (~US\$20 mn) mis-step. MindTree has decided not to pursue its 'white-labeled handsets' (products) ambitions any further. The company has already invested close to US\$5 mn on this foray and indicates that closing this business would entail a further US\$12-14 mn charge over the next 2-3 quarters. This charge would be on account of (1) some fixed-asset write-off, (2) non-cancellable purchase orders for handset/prototype components, (3) severance pay for a few employees who will be let off, and (4) penalty on cancelling sub-contracting commitments.

...adds to the previous disappointments

The product investments mis-step adds to the list of disappointments from MindTree as a public listed company, which includes among others – (1) entering into exotic forex derivative contracts – this continues to lend volatility to the company's reported quarterly financials, (2) weakly timed acquisitions, and (3) poor guidance management – the company had to do away with giving annual revenue/EBITDA/PAT in beginning-FY2011E.

Moving on – core business margin concerns drive EPS and target price cuts; REDUCE

MT's revenue performance for the Sep 2010 quarter was marginally better than expectations, however, and more importantly, core business margin performance disappointed. The 120 bps qoq improvement in core (ex-product investments) margins was aided to the tune of 330 bps on account of provision reversals, indicating a 210 bps underlying decline in margins. In a quarter with strong tailwinds in the form of strong volume growth and currency benefits, such margin performance is disappointing and reflects the pricing/wage pressure facing the company.

Even as we remain positive on revenue growth for MT (in line with our sector view), our margin outlook for the company has weakened further. We take our FY2012E margin estimates down 220 bps (in effect a 450 bps downgrade, as we remove the earlier assumed product investments). We cut our (pre-exceptional) FY2011E and FY2012E EPS estimate to Rs27.4 and Rs39.3, respectively. Reiterate REDUCE with a revised target price of Rs450/share (Rs550 earlier).

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Sep 2010 quarter – beats expectations; on one-off provision reversals, though

MT's reported headline numbers beat our expectations at the revenue, EBITDA, as well as PAT level. Revenues at US\$82.4 mn came in 0.7% ahead of estimates, EBITDA of Rs447 mn 12% above estimate, and PAT of Rs232 mn beat our expectation by 8.8%. However, the underlying driver of the positive variance on EBITDA takes the sheen away from the headline beat – at a consolidated level, better-than-expected EBITDA was aided by lower-than-expected products investments. More importantly though, the 120 bps qoq improvement in ex-products OPM was aided to the tune of 330 bps by provision reversals (bad debt and foreseeable loss on contracts).

Revenue growth was once again led by IT services, which grew 12.8% qoq; product engineering services were up by a modest 0.3%. The company reported strong growth in Europe (+14% qoq), among geographies. Net headcount addition was 572. LTM attrition increased 410 bps qoq to 21.9%.

Margins - several headwinds ahead

High offshore leverage (69.4% of revenues offshore) makes MT's margins more sensitive to the Rupee as compared to most other companies in the sector. Rupee appreciation risk aside, we see a few fundamental headwinds to MT's margin outlook over the coming quarters, the key ones being – (1) high attrition – reported LTM attrition masks the worryingly high 35% quarterly annualized attrition for MT (see Exhibit 3); the company has effected wage hikes for its employees in the Jun and Sep 2010 quarters, but we do not rule out the possibility of another out-of-turn wage revision for select skill-sets, (2) sub-contracting costs could hurt further – high-attrition, especially if its is in the high-demand skill sets, could keep subcontracting costs high in the coming quarters, and (2) sustained pressure on offshore billing rates; see Exhibit 4.

Sustaining valuation premium requires consistent strategic decisions and execution

Disappointments on issues like forex contracts, guidance, and product investments as well as sustained operational underperformance is likely to (and should) dent MT's hitherto premium positioning with the mid-sized IT universe, in our view. More disappointing to us has been the inconsistency in decision making and lack of a common long-term underlying thread behind the company's acquisition and investment decisions in the past three years. Some of these may have been excellent tactical moves in their own right, but do little to signal the company's long-term ambitions, in our view.

We expect earnings downgrades as well as multiple contractions ahead, and reiterate our negative stance on the stock with a reduced target price of Rs450/share (Rs550 earlier).

Exhibit 1: Mindtree Consulting: Indian GAAP consolidated quarterly earnings statement

Rs mn	Sep-09	Jun-10	Sep-10	qoq (%)	yoy (%)	Kotak E	Deviation
Revenues (US\$ mn)	65.3	77.0	82.4	7.0	26.2	81.8	0.7
Revenues	3,150	3,487	3,844	10.2	22.0	3,756	2.3
Software development expenses	(1,869)	(2,310)	(2,559)	10.8	36.9	(2,514)	1.8
Gross profit	1,281	1,177	1,285	9.2	0.3	1,242	3.4
SG&A expenses	(622)	(736)	(837)	13.7	34.7	(843)	(0.7)
EBITDA	659	441	447	1.5	(32.1)	399	12.0
Depreciation	(159)	(145)	(177)	22.2	11.2	(157)	13.1
EBIT	500	296	270	(8.6)	(45.9)	243	11.3
Interest	(1)	(0)	(0)	50.0	(66.7)	-	-
Other income	38	3	43	1,234.4	11.2	23	87.1
Profit before tax	537	299	313	4.7	(41.8)	266	17.7
Tax	(39)	(140)	(80)	(43)	107.8	(52)	-
Net profit	499	159	232	46.5	(53.4)	214	8.8
Minority interest	—	—	—	—	—	—	—
Share of profit/(loss) in associates	—	—	—	—	—	—	—
Net income	499	159	232	46.5	(53.4)	214	8.8
Extraordinaries	—	—	—	—	—	—	—
Net profit- reported	499	159	232	46.5	(53.4)	214	8.8
EBITDA margin	20.9	12.6	11.6			10.6	
EPS (Rs/ share)	12.7	4.0	5.9	46.5	(53.4)	5.4	8.8
Shares outstanding (mn)	39.2	39.2	39.2			39.2	

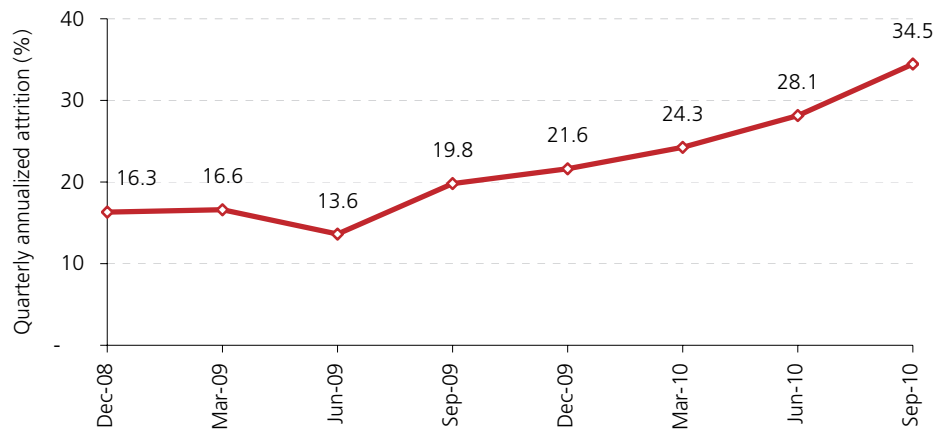
Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Key changes to estimates, fiscal year-ends March, 2011E-2012E

	New		Old		Change (%)	
	2011E	2012E	2011E	2012E	2011E	2012E
Consolidated						
Revenues (Rs mn)	15,456	18,562	15,553	18,973	(0.6)	(2.2)
Revenues (US\$ mn)	339	417	338	413	0.4	1.0
EBITDA (Rs mn)	2,028	2,846	2,279	3,316	(11.0)	(14.2)
Net Profit (Rs mn)	1,128	1,617	1,342	2,122	(15.9)	(23.8)
Fully diluted EPS (Rs/share)	27.4	39.3	32.6	51.6	(15.9)	(23.8)
Re/ \$ rate	45.5	44.5	46.0	46.0	(1.0)	(3.2)
EBITDA margin (%)	13.1	15.3	14.7	17.5		

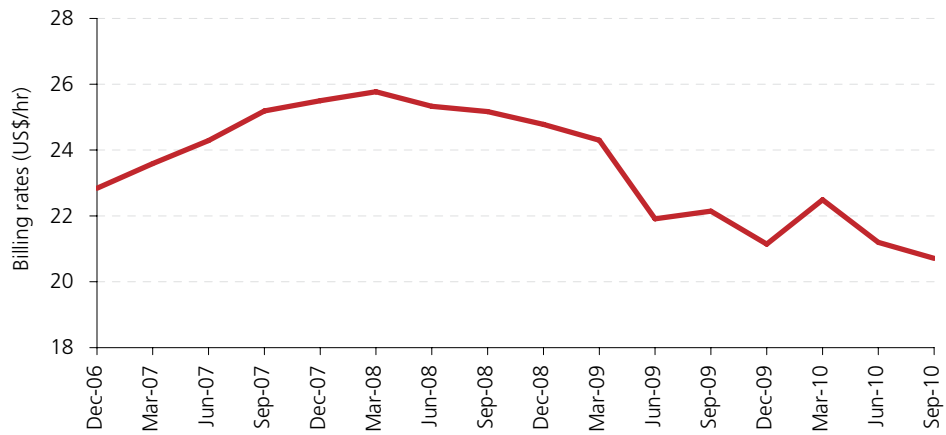
Source: Kotak Institutional Equities estimates

Exhibit 3: Quarterly annualized attrition at worryingly high levels of 35%



Source: Company, Kotak Institutional Equities

Exhibit 4: Offshore billing rates continue to decline



Source: Company, Kotak Institutional Equities

Exhibit 5: Condensed consolidated financials for MindTree Limited, 2008-2012E, March fiscal year-ends (Rs mn)

	2008	2009	2010	2011E	2012E
Profit model					
Revenues	7,398	12,375	12,960	15,456	18,562
EBITDA	1,254	3,309	2,456	2,028	2,846
Interest (expense)/income	(59)	(162)	(27)	(1)	—
Depreciation	(356)	(570)	(652)	(653)	(752)
Other income	279	(1,974)	770	143	120
Pretax profits	1,118	604	2,547	1,518	2,214
Tax	(85)	(67)	(398)	(390)	(597)
Profit after tax	1,033	537	2,148	1,128	1,617
Diluted earnings per share (Rs)	26.1	13.2	52.2	27.4	39.3
Balance sheet					
Total equity	5,331	5,513	6,706	7,309	8,737
Deferred taxation liability	(90)	(190)	(214)	(214)	(214)
Total borrowings	919	1,394	31	—	—
Minority interest	—	328	—	—	—
Current liabilities	1,392	3,082	2,604	3,039	3,641
Total liabilities and equity	7,553	10,126	9,127	10,134	12,165
Cash	553	488	403	294	1,184
Other current assets	2,765	4,203	4,438	5,354	6,504
Goodwill	214	1,460	154	154	154
Tangible fixed assets	2,625	2,962	2,859	3,359	3,349
Investments	1,395	1,013	1,272	972	972
Total assets	7,553	10,126	9,127	10,134	12,165
Free cash flow					
Operating cash flow, excl. working capital	1,398	1,889	2,637	2,040	2,846
Tax paid	(188)	(287)	(685)	(390)	(597)
Working capital changes	(408)	251	(713)	(481)	(548)
Capital expenditure	(2,176)	(369)	(473)	(1,165)	(743)
Investment changes/acquisition	491	(2,538)	(552)	300	—
Free cash flow	(883)	(1,053)	215	304	959
Ratios (%)					
EBITDA margin	16.9	26.7	18.9	13.1	15.3
EBIT margin	12.1	22.1	13.9	8.9	11.3
Debt/equity	0.2	—	—	—	—
Net debt/equity	(0.2)	(0.0)	(0.2)	(0.2)	(0.2)
RoAE	21.3	5.5	35.2	16.1	20.2
RoACE	16.5	32.2	25.8	19.6	26.1

Source: Company, Kotak Institutional Equities estimates

Exhibit 6: Mindtree: Key operational metrics

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
Revenues (US\$ mn)	54.6	59.6	56.8	51.6	62.1	65.3	70.4	74.5	77.0	82.4
Revenue by geographical segment (%)										
USA	60.4	58.9	59.3	61.5	66.8	66.2	64.4	62.8	64.6	63.1
Europe	24.1	23.7	24.6	20.0	21.0	21.0	18.4	18.7	16.9	18.0
India	5.2	4.9	6.6	8.5	5.8	5.3	6.4	6.3	8.0	8.5
Rest of the world	10.3	12.5	9.5	10.0	6.4	7.5	10.8	12.2	10.5	10.4
Revenue by business (%)										
ITS	78.6	79.2	78.7	76.7	56.6	54.7	51.1	53.3	54.1	57.0
Product engineering services (a)	21.4	20.8	21.3	23.3	43.4	45.3	48.9	46.7	45.9	43.0
Revenue by service offering (%)										
Development	50.3	50.1	50.7	47.9	46.9	48.6	51.8	52.7	51.2	50.3
Maintenance	28.7	28.8	29.5	31.5	23.6	22.0	20.8	18.9	19.6	20.3
Consulting & IP licensing	4.8	4.5	4.4	4.9	2.9	2.9	2.5	2.5	3.1	3.1
Package implementation	5.2	5.6	4.7	4.6	4.1	4.3	4.2	4.8	4.1	2.8
Independent testing	6.3	5.5	6.2	6.9	18.1	18.2	17.0	17.0	17.0	17.6
Infrastructure management & Tech su	4.5	4.4	4.5	4.2	4.4	4.0	3.7	4.1	5.0	5.9
Revenue by industry (%)										
Manufacturing	23.5	27.0	26.6	23.1	12.9	13.3	12.1	12.5	13.6	14.0
BFSI	27.2	26.4	26.7	29.1	17.8	17.4	16.0	17.5	17.3	18.1
T&T	19.7	20.4	20.1	19.2	15.1	13.8	12.6	14.3	13.3	12.6
Hitech	10.6	9.4	10.0	9.8	-	-	-	-	-	-
R&D Services	-	-	-	-	14.1	14.9	14.4	14.4	13.3	11.8
Software product engineering	-	-	-	-	29.3	30.3	27.8	26.1	27.0	26.1
Mindtree Wireless products	-	-	-	-	-	-	6.7	6.2	5.6	5.1
Others	19.0	16.8	16.6	18.8	10.8	10.3	10.4	9.0	9.9	12.3
Revenue by project type (%)										
Fixed price	17.3	18.4	17.1	16.8	21.6	23.8	24.7	31.2	33.7	33.9
Time & materials	82.7	81.6	82.9	83.2	78.4	76.2	75.3	68.8	66.3	66.1
Effort mix (%)										
Onsite	13.1	12.6	12.2	12.0	12.5	12.3	10.8	11.4	11.3	11.3
Offshore	86.9	87.4	87.8	88.0	87.5	87.7	89.2	88.6	88.7	88.7
Revenue mix (%)										
Onsite (%)	27.9	28.5	27.1	27.0	29.2	28.9	27.5	28.1	29.8	30.6
Offshore (%)	72.1	71.5	72.9	73.0	70.8	71.1	72.5	71.9	70.2	69.4
Effort and Utilization										
Onsite - Billed hours	233,551	244,291	231,429	210,782	285,668	295,083	293,906	305,207	326,103	352,197
Offshore - Billed hours	1,554,090	1,692,855	1,671,528	1,551,437	2,005,960	2,095,674	2,415,428	2,380,025	2,549,975	2,761,225
Total	1,787,641	1,937,146	1,902,957	1,762,219	2,291,628	2,390,757	2,709,334	2,685,232	2,876,078	3,113,422
Fee revenues (US\$ mn)										
Onsite	14.6	16.4	14.7	13.3	17.8	18.3	19.0	20.5	22.4	24.7
Offshore	38.1	41.1	39.8	36.1	43.1	45.2	49.9	52.3	52.8	56.0
Utilization (%)										
Including trainees	65.6	70.2	69.7	64.3	61.1	64.7	71.4	71.4	70.5	70.0
Excluding trainees	65.6	70.5	71.1	66.6	63.7	65.6	72.9	72.6	71.9	73.0
Client metrics										
Number of active clients	196	206	201	209	239	243	253	258	261	261
New clients added	26	22	19	18	18	24	35	27	31	21
US\$1 mn clients	48	51	48	52	60	59	58	60	62	64
US\$5 mn clients	8	10	10	10	12	11	13	13	13	14
US\$10 mn clients	2	3	2	2	3	4	5	5	5	5
Client contribution to revenue (%)										
Top customer	7.9	9.2	9.0	7.3	7.0	7.8	7.2	7.2	7.0	6.8
Top 5 customers	27.9	29.0	27.2	25.8	26.4	26.9	28.4	27.9	26.9	26.2
Top 10 customers	42.9	43.9	40.5	39.5	29.4	39.7	40.5	40.0	40.2	39.9
Fortune 500 accounts	37	38	38	34	32	37	40	40	39	45
Revenue from repeat business	98.3	99.0	99.7	99.0	99.1	98.8	98.2	99.1	98.9	99.4
DSO	86	85	81	71	86	70	65	68	68	76
Employee metrics										
Software professionals	5,308	5,325	5,406	5,670	7,073	6,832	7,460	7,651	8,353	8,893
Sales and support	408	421	420	421	620	618	667	646	659	691
Total	5,716	5,746	5,826	6,091	7,693	7,450	8,127	8,297	9,012	9,584
Gross addition	377	321	299	506	92	132	462	668	1,324	1,373
Net addition	76	30	48	217	(173)	(243)	41	170	715	572
Attrition (LTM)	16.3	15.0	13.8	11.8	11.4	9.7	10.7	14.1	17.8	21.9

Note:

(a) R&D, Software product engineering and Mindtree wireless form part of PES

(b) Metrics from Dec-2009 are for Mindtree + Mindtree wireless

(c) Metrics from Jun-2009 include Aztecsoft

Source: Company

OCTOBER 19, 2010

RESULT

Coverage view: **Attractive**

Price (Rs): **173**

Target price (Rs): **180**

BSE-30: **19,983**

Margin improvement impressive but sustainability a concern. Polaris reported revenues of US\$83.6 mn (+6% qoq), in line with our estimates, but surprised positively on margins. EBITDA margins improved 220 bps sequentially versus our expectation of flat margins. We retain our negative stance on the stock given our concerns on weak positioning and margin sustenance due to (1) rupee appreciation headwinds, (2) increasing supply side cost pressures. Maintain SELL and target price of Rs180/share.

Company data and valuation summary

Polaris Software Lab

Stock data

52-week range (Rs) (high,low)	215-142
Market Cap. (Rs bn)	17.2

Shareholding pattern (%)

Promoters	29.1
FIs	13.4
MFs	17.4

Price performance (%)

	1M	3M	12M
Absolute	(0.4)	(9.7)	16.7
Rel. to BSE-30	(2.3)	(19.0)	1.2

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	15.4	19.4	19.8
EPS growth (%)	16.9	26.2	2.2
P/E (X)	11.2	8.9	8.7
Sales (Rs bn)	13.5	15.6	18.4
Net profits (Rs bn)	1.5	1.9	2.0
EBITDA (Rs bn)	2.2	2.2	2.5
EV/EBITDA (X)	5.5	6.9	5.9
ROE (%)	18.6	20.4	18.0
Div. Yield (%)	2.0	2.1	2.3

Modest revenue growth – given the demand unconstrained environment

Polaris reported revenues of US\$83.6 mn (+6% qoq, +19.5% yoy), in line with our expectations. A 6% US\$ revenue growth when the industry is operating in a demand unconstrained environment is just about par for the course, in our view. We expect the Tier-II pack including Polaris to lag the Tier-I companies on revenue growth in the current growth phase for the Indian IT industry. Cut back in investments and running on a very thin bench during the downturn may have robbed companies like Polaris to participate in the strong growth phase. Under-investments during the downturn and not being ready for the growth phase is evident from the management commentary that they were unable to fulfill demand for the past two quarters.

Strong margin performance – but sustainability is the question

A sharp 220 bps improvement in margins versus our expectation of flat margins drove outperformance at EBITDA and net income level. Company reported an EBITDA of Rs606 mn (+26% qoq) and net income of Rs484 mn (+3.5% qoq). Although a 220 bps improvement in margins is commendable, sustainability of the same is a question. The industry is operating in a supply constrained environment and cost pressures on the employee front are bound to have an impact on margins. The company recruited more than 900 people in 2QFY11, mostly during the end of the quarter which would keep the margins under pressure in the next quarter. Appreciating Re is another major concern – rupee has appreciated 4.6% in 3QFY11 till date vs 2QFY11. Mid-sized companies including Polaris have a greater sensitivity to the movement of Re/US\$.

Weak positioning and margin sustainability concerns drive our negative view

We increase our EPS estimates for FY2011E/FY2012E to Rs19.4 and Rs19.8 from Rs19.1 and Rs18.8 earlier. Increase in estimates is driven by increase in OPM assumptions for FY2011E/FY2012E by 60 and 20 bps given the better-than-expected performance. Despite building in 20% revenue growth in FY2012E, the EPS broadly remains same due to (1) increase in tax rates, (2) pressure on margins due to rupee and (3) supply side constraints. Weak positioning in multi-vendor situations and questions on margin sustainability drives our negative view on Polaris. Retain SELL rating with a target price of Rs180/share.

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Exhibit 1: Polaris Software Interim Results 2QFY11 (Rs mn)

	2QFY10	1QFY11	2QFY11	qoq % chg.	yoy % chg.	Kotak estimates	% Deviation
Revenues (US\$ mn)	69.9	78.9	83.6	5.9	19.5	82.8	0.9
Total Revenues	3,383	3,606	3,883	7.7	14.8	3,812	1.9
Cost of Revenues	(2,207)	(2,430)	(2,551)	5.0	15.6	(2,556)	(0.2)
Gross Profit	1,177	1,176	1,332	13.3	13.3	1,256	6.1
SG&A Expenses	(638)	(694)	(726)	4.6	13.9	(746)	(2.6)
EBITDA	539	482	606	25.8	12.5	510	18.8
Other income	(45)	142	50	(65.0)	(210.0)	129	(61.4)
Interest expense	(2)	(2)	(3)			-	
EBDT	492	622	654	5.1	32.9	639	2.2
Depreciation	(87)	(78)	(84)	7.9	(3.6)	(86)	(2.5)
Minority interest			2				
Pretax profits	404	544	571	5.1	41.3	553	3.4
Provision for Tax	(48)	(79)	(90)	14.5	86.5	(92)	(2.1)
Net Profit	356	465	482	3.5	35.2	461	4.4
Extraordinaries	(4)	1	2			—	
Net Profit reported	352	466	484	3.8	37.4	461	4.9
EPS - recurring (Rs)	3.6	4.7	4.8	3.5	35.2	4.6	
Margins (%)							
Gross margin	34.8	32.6	34.3	1.69		33.0	
SG&A expenses	18.9	19.3	18.7	0.55		19.6	
EBITDA margin	15.9	13.4	15.6	2.24		13.4	
EBIT margin	13.3	11.2	13.4			11.1	
Net profit margin	10.5	12.9	12.5			12.1	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Key changes to estimates, FY2011E-FY2012E

	Revised		Earlier		Change (%)	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Revenues (US\$ mn)	343	413	335	384	2.5	7.4
Revenues (Rs mn)	15,621	18,365	15,409	17,673	1.4	3.9
Revenue growth, US\$ (%)	20.3	20.2	17.3	14.7		
EBITDA (Rs mn)	2,218	2,468	2,100	2,330	5.6	5.9
EBIT (Rs mn)	1,862	2,060	1,744	1,930	6.8	6.8
Net profit (Rs mn)	1,934	1,977	1,905	1,873	1.5	5.5
EPS (Rs)	19.4	19.8	19.1	18.8	1.5	5.5
EBITDA margin (%)	14.2	13.4	13.6	13.2		
EBIT margin (%)	11.9	11.2	11.3	10.9		
Re/US\$ rate	45.5	44.5	46.0	46.0	(1.1)	(3.3)

Source: Kotak Institutional Equities estimates

Exhibit 3: Condensed consolidated financials for Polaris, 2009-2012E, March fiscal year-ends (Rs mn)

	FY2009	FY2010	FY2011E	FY2012E
Profit & Loss Model				
Revenues	13,779	13,538	15,621	18,365
EBITDA	2,335	2,220	2,218	2,468
Depreciation	(505)	(350)	(356)	(408)
EBIT	1,830	1,870	1,862	2,060
Other Income	(316)	(73)	453	504
PBT	1,507	1,788	2,310	2,565
Tax	(209)	(255)	(376)	(588)
Net Profit	1,298	1,533	1,934	1,977
Balance Sheet (Rs mn)				
Total Equity	7,727	8,725	10,227	11,749
Borrowings	4	25	—	—
Total capital	7,730	8,749	10,227	11,749
Net fixed Assets	2,157	2,271	2,667	3,062
Investments	2,442	3,897	3,897	3,897
Goodwill	199	506	506	506
Working Capital	2,901	2,041	3,123	4,250
- Cash	1,054	1,237	1,813	2,629
- Current Assets	4,356	3,830	4,708	5,585
- Current Liabilities	2,509	3,026	3,398	3,964
Deferred Expenditure	30	34	34	34
Total assets	7,730	8,749	10,227	11,749
Free Cash Flow (Rs mn)				
Cash generated from operations	2,364	2,163	2,335	2,335
Working Capital Changes	884	871	(506)	(311)
Capital expenditure	(578)	(429)	(751)	(803)
Tax	(209)	(290)	(376)	(588)
Free Cash Flow	2,462	2,315	702	634

Source: Company, Kotak Institutional Equities estimates

OCTOBER 18, 2010
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Coverage view: **Neutral**

Price (Rs): **54**

Target price (Rs): **55**

BSE-30: **19,983**

Towards blue-sky valuation; REDUCE. Dish TV's near-term operating performance remains robust—(1) strong volume growth, (2) price increases in Sep 2010 (effective 3QFY11E), (3) operating leverage given large fixed costs and (4) potential regulatory drivers. However, the stock is nearing its blue-sky valuation scenario and factoring in (1) simultaneous strong growth in volume and pricing (unlikely, in our view) and (2) expectations of regulatory upsides (running ahead of reality). Downgrade to REDUCE with 12-month DCF-based target price of Rs55 (Rs47 previously).

Company data and valuation summary

DishTV

Stock data

52-week range (Rs) (high,low)	60-32
Market Cap. (Rs bn)	57.8

Shareholding pattern (%)

Promoters	64.8
FIs	16.7
MFs	5.7

Price performance (%)

	1M	3M	12M
Absolute	(2.7)	17.6	20.5
Rel. to BSE-30	(4.6)	5.5	4.4

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	(2.5)	(2.0)	0.1
EPS growth (%)	(61.9)	(19.2)	(104.3)
P/E (X)	(21.7)	(26.9)	626.0
Sales (Rs bn)	10.8	14.2	18.8
Net profits (Rs bn)	(2.7)	(2.2)	0.1
EBITDA (Rs bn)	0.9	2.2	5.0
EV/EBITDA (X)	72.1	29.6	13.7
ROE (%)	249.0	(71.2)	4.6
Div. Yield (%)	0.0	0.0	0.0

Strong operating performance continues; FY2011E may not be right benchmark, however

Dish TV's (and DTH's) strong operating performance continues with (1) strong volume growth YTD-FY2011E (0.46 mn additions in July-August 2010 to cross 8 mn gross subscriber landmark, one month ahead of our expectation), (2) price increases of Rs10-15 in September 2010 (effective 3QFY11E; in line with average 3-5% price growth expected in FY2011E) and (3) positive operating leverage as volume and pricing growth likely outpaces large semi-fixed (content) and fixed (marketing, distribution) cost base (see Exhibit 1).

However, we highlight that FY2011E may not be the right benchmark given (1) strong sports calendar in FY2011E (see Exhibit 2), which has been leveraged well by organized DTH operators, (2) likely continued shift of rural subscribers from FTA DD Direct platform to commercial pay-TV DTH operators (see Exhibit 3; limited potential given peak claimed subscriber base of ~6-7 mn) as well as (3) one-off technical issues with Sun Direct, which have been resolved with Reliance Big TV sharing some of its transponders with Sun Direct.

Trade-off between volume and pricing, rising competitive intensity are the key risks

The competitive intensity in the DTH segment has returned as seen by the aggressive pricing of the new schemes launched. (1) Tata Sky started off by reducing the price of its basic DTH service to Rs990 and (2) Dish TV followed by launching a similar offer; (3) Sun Direct and Videocon countered by reducing the price of their basic DTH service to Rs890 and (4) Dish TV has reacted by offering Rs990 worth of free content with the basic DTH service. We believe there may be both structural (equity infusion in Tata Sky and Sun Direct by strategic investors) and cyclical (festival season in Oct-Nov 2010) elements to the new schemes.

However, we are more concerned about the sub-Rs100 basic package re-introduced by Sun Direct. We note that price increases by Dish TV recently (Rs10-15 on its Rs125-210 packages) had raised expectations of pricing power returning to the DTH industry. However, the price-volume trade-off highlighted in our note "*Weak Dish TV 3QFY10 reveals certain ARPU myths*" dated January 25, 2010 remains in place. Dish TV may be able to meet its ARPU guidance for FY2011E but its ability to take further price hikes remains uncertain.

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Regulatory upsides exist: Content cost and license fee regulations

Reduction in license fee to the government currently at 10% of gross revenues (GR)

In response to a petition filed by Sun Direct and Bharti Telemedia (Airtel Digital TV) on May 28, 2010, the broadcasting appellate authority TDSAT has come out with a ruling that mandates the government to charge license fees at 10% of adjusted gross revenues (AGR; gross revenues excluding items of a pass-through nature such as content costs, sale of hardware and taxes paid). This would result in effective license fee reducing to ~4-5% of GR versus 10% currently. However, we note that the government has the option of legally challenging the ruling in a higher court of law.

We note that TRAI/MIB have considered reduction in license fee to 6% of GR in the past; we believe the worsening fiscal position of the government in FY2010-11E precluded any definitive action on its part (potentially in FY2012E as well). Thus, we have already factored in the license fee paid to the government at 6% of GR starting FY2013E (versus 13% of GR currently) into our estimates/valuation. The acceptance of the TDSAT scheme by the government will result in ~100-200 bps increase in long-term margins and ~Rs2-5 increase in our valuation of the stock (see Exhibit 5 for sensitivity).

TRAI mandates channel rates on DTH at 35% of analog cable rates (50% currently)

The broadcasting regulator TRAI, in its Telecommunication (broadcasting and cable) services (forth) tariff order on July 21, 2010, has mandated pay channel rates for addressable systems at 35% of channel rates on non-addressable analog cable systems (versus 50% currently). This helps reduce the content cost burden of DTH operators and promotes a level-playing field between the various C&S platforms (effective declaration rate of subscribers is only 12-15% on analog cable systems). However, Dish TV had signed fixed fee deals with broadcasters in FY2009 and we estimate its pay channel rates to be ~35-40% of analog cable rates, with limited benefit of the new regulation. Moreover, the regulation has been legally challenged by broadcasters and its implementation is uncertain.

Towards blue-sky valuation: Leaves limited room for upside currently

Dish TV stock has outperformed the benchmark BSE-30 Index by over 32% in the past 6 months on the back of continued positive operating drivers: (1) Strong volume growth, (2) price hikes in Sep 2010, (3) positive operating leverage given large fixed costs and (4) potential for regulatory upsides. We expect (1) strong volume growth (notwithstanding FY2011E being a unique year) and (2) operating leverage to continue but (3) price hikes and (4) regulatory drivers are beyond the control of the company. Our blue-sky valuation scenario for Dish TV stock is Rs61—(1) 10% higher-than-base volumes, (2) another 1% reduction in license fees and (3) no change to ARPUs—but still leaves limited upside from current market price of Rs54. Downgrade to REDUCE.

We have adjusted our estimates and valuation (Rs55 versus Rs47 previously) of Dish TV to factor in (1) strong volume growth (has certainly surprised on the upside) and (2) resultant positive operating leverage with (3) modest reduction in our ARPU estimates. We model FY2011E and FY2012E gross Dish TV subscriber additions at 2.8 mn (2.2 mn previously) and 2.4 mn (2.0 mn). We have reduced FY2011E and FY2012E content cost for Dish TV to Rs5.25 bn (Rs5.35 bn previously) and Rs6.2 bn (Rs6.3 bn). We model FY2011E and FY2012E net Dish TV ARPU at Rs144 (Rs146 previously) and Rs154 (Rs157). Our 12-month DCF-based target price is revised to Rs55 (Rs47 previously). Our FY2011E EBITDA estimate remains unchanged at Rs2.3 bn as higher volumes are negated by higher subscriber addition costs. Our FY2012E EBITDA increases to Rs5.2 bn (Rs4.4 bn).

Key operating metrics of Dish TV, March fiscal year-ends, 2008-13E

	2008	2009	2010E	2011E	2012E	2013E
Gross subscriber addition (mn)	1.0	2.1	1.8	2.8	2.4	2.2
Net subscriber addition (mn)	0.9	1.8	1.4	2.2	1.5	1.2
Gross subscriber base (mn)	3.0	5.1	6.9	9.7	12.1	14.3
Net paying subs base (mn)	2.5	4.3	5.7	7.8	9.3	10.5
growth (%)		71	33	38	19	12
Net paying ARPU (Rs)	130	143	140	144	154	167
growth (%)		10	(2)	3	7	8
Revenues (Rs bn)	4.1	7.4	10.8	14.2	18.8	22.0
Content costs (Rs bn)	2.5	3.8	4.5	5.3	6.2	7.3
Gross margin (%)	39	49	58	63	67	67
EBITDA (Rs bn)	(2.2)	(1.4)	0.9	2.3	5.2	6.8
EBITDA margin (%)	(52)	(18)	8	16	28	31

Source: Company data, Kotak Institutional Equities

Details of the sports calendar, March fiscal year-end, 2011

Tournament	Type	Time period
IPL T20 Season 3	Cricket	Mar-Apr 2010
ICC T20 World Cup 2010	Cricket	May 2010
India's tour of Zimbabwe	Cricket	May-Jun 2010
Asia Cup 2010	Cricket	Jun 2010
FIFA World Cup	Soccer	Jun-Jul 2010
India's tour of Sri Lanka	Cricket	Jul-Aug 2010
Commonwealth Games 2010	Various	Oct 2010
Australia's tour of India	Cricket	Oct 2010
New Zealand's tour of India	Cricket	Nov-Dec 2010
India's tour of South Africa	Cricket	Dec-Jan 2011
ICC ODI World Cup 2011	Cricket	Feb-Mar 2011
IPL T20 Season 4	Cricket	Apr-May 2011

Source: Industry data, Kotak Institutional Equities estimates

Subscriber base of FTA DD Direct, calendar year-ends, 2009-10

	2008	2009
Urban		
DD Direct (%)	21	14
DD Direct (mn)	0.8	0.8
Rural		
DD Direct (%)	51	36
DD Direct (mn)	5.6	4.9
Total	6.4	5.7

Source: TAM Media Research, Kotak Institutional Equities estimates

Various DTH offers in the upcoming festival season

	Tata Sky	Dish TV	Sun Direct	Videocon D2H	Bharti	Dish TV (new)
Cost to consumer						
Cost of offer	999	990	—	888	999	990
Installation cost	—	200	890	300	—	200
Cost to consumer	999	1,190	890	1,188	999	1,190
Free content	no	no	no	yes	yes	yes
Value of content	—	—	—	265	200	990 (a)

Note:

(a) Assuming ~80% fixed content cost for Dish TV, cost of free content to company would be ~Rs200.

Source: Company data, Kotak Institutional Equities estimates

Sensitivity of Dish TV's valuation to various parameters

	DCF value (Rs/share)	Change from base case (%)
Change in # of paying subscribers (%)		
10%	59	7
Base case	55	
-10%	52	(7)
Change in license fees (%)		
-1%	58	4
Base case	55	
1%	53	(4)
Change in monthly subscription fees (%)		
5%	64	16
Base case	55	
-5%	47	(15)
Change in average content costs (%)		
-5%	59	6
Base case	55	
5%	52	(6)
Change in churn rate (%)		
-1%	59	7
Base case	55	
1%	52	(7)

Source: Kotak Institutional Equities estimates

Comparative valuation of Dish TV, March fiscal year-ends, 2011E

Company	18-Oct-10		Wireless	
	Mcap (US\$ bn)	EV (US\$ bn)	Mcap (US\$ bn)	EV (US\$ bn)
Bharti Airtel	28.0	29.2	19.6	20.4
Reliance Comm	8.3	15.8	6.2	11.9
Idea Cellular	4.6	5.4	3.7	4.3

Company	2010				
	Subscribers (mn)	ARPU (Rs/month)	EBITDA margin (%)	EBITDA (Rs/sub)	EV/sub (US\$)
Bharti Airtel	128	243	39	1,126	160
Reliance Comm	102	161	33	644	116
Idea Cellular	64	207	27	679	68

Dish TV comparative valuation	Comments
Dish TV paying subs base (mn, end-FY2015E)	11.9
Dish TV ARPU (Rs/sub/month, FY2015E)	195 ARPUs lower but with rising trend
Dish TV EBITDA margin (% , FY2015E)	36 EBITDA margin in line with sector
EV/subscriber (US\$, end-FY2015E)	160 In line with leader Bharti Airtel
Enterprise Value (US\$ bn, end-FY2015E)	1.91
Enterprise Value (US\$ bn, end-FY2011E)	1.19
Enterprise Value (Rs bn, end-FY2011E)	53.6
Net debt/(cash) (Rs bn, end-FY2011E)	1.2 Dish TV rights issue/GDR in FY2010
Equity value (Rs bn, end-FY2011E)	52.3
Shares outstanding (mn, end-FY2011E)	1,063
Equity value (Rs/share, end-FY2011E)	49

Source: Bloomberg data, Kotak Institutional Equities estimates

Financial summary of Dish TV, March fiscal year-ends, 2007-13E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E	2013E
Profit model							
Net revenues	1,909	4,127	7,377	10,848	14,197	18,771	21,982
EBITDA	(1,852)	(2,152)	(1,350)	853	2,276	5,181	6,824
Other income	34	30	13	709	742	688	688
Interest (expense)/income	(118)	(513)	(1,019)	(1,184)	(1,079)	(1,345)	(1,439)
Depreciation	(565)	(1,480)	(2,144)	(3,043)	(4,050)	(4,366)	(4,895)
Amortization	(10)	(10)	(10)	—	—	—	—
Pretax profits	(2,511)	(4,126)	(4,511)	(2,664)	(2,112)	158	1,177
Extraordinary items	(5)	—	(244)	—	—	—	—
Tax	(3)	(6)	(7)	—	—	(31)	(235)
Deferred taxation	—	—	—	—	—	106	201
Net income	(2,519)	(4,132)	(4,763)	(2,664)	(2,112)	233	1,144
Earnings per share (Rs)	(5.9)	(9.6)	(6.9)	(2.5)	(2.0)	0.2	1.1
Balance sheet							
Total equity	(395)	(4,527)	(6,241)	4,101	1,990	2,222	3,366
Deferred taxation liability	—	—	—	—	—	(106)	(308)
Total borrowings	1,751	5,266	11,311	7,015	10,015	12,515	12,515
Current liabilities	8,596	11,376	15,899	14,196	14,896	13,718	13,079
Total liabilities and equity	9,952	12,116	20,969	25,313	26,901	28,350	28,652
Cash	113	199	540	2,434	1,018	912	1,004
Other current assets	2,271	3,276	8,297	8,701	8,986	9,375	9,652
Total fixed assets	6,107	7,190	11,187	13,233	15,953	17,117	17,052
Intangible assets	516	506	—	—	—	—	—
Investments	945	945	945	945	945	945	945
Total assets	9,952	12,116	20,969	25,313	26,901	28,350	28,652
Free cash flow							
Operating cash flow, excl. working capital	(1,814)	(2,552)	(2,675)	(331)	1,197	3,804	5,150
Working capital changes	3,507	2,129	(883)	(2,106)	415	(1,567)	(917)
Capital expenditure	(2,921)	(2,579)	(5,102)	(5,089)	(6,770)	(5,531)	(4,830)
Investments	(451)	(293)	14	—	—	—	—
Other income	5	9	11	709	742	688	688
Free cash flow	(1,674)	(3,287)	(8,635)	(6,816)	(4,416)	(2,605)	92
Ratios (%)							
Debt/equity	(443.6)	(116.3)	(181.3)	171.0	503.4	563.2	371.8
Net debt/equity	(414.9)	(111.9)	(172.6)	111.7	452.2	522.1	342.0
ROAE (%)	(331.3)	167.9	88.5	249.0	(69.3)	11.3	44.2
ROACE (%)	(283.2)	(345.3)	(120.4)	(18.3)	(8.9)	16.6	16.8

Source: Company data, Kotak Institutional Equities estimates

OCTOBER 19, 2010
UPDATE

Coverage view: **Cautious**

Price (Rs): **359**

Target price (Rs): **320**

BSE-30: **19,983**

Expansion plans hit an air pocket. Sesa lowered FY2011E volume growth guidance to 10% from 20%. In addition, the path to expansion of iron mining capacity to 50 mn tons is also unclear on account of regulatory hurdles. We incorporate Cairn India financials in our model, lower iron ore volumes by 13% to 21.7 mn tons and TP by 6% to Rs320. REDUCE on (1) delay in capacity expansion plans; (2) regulatory hurdles; (3) expensive valuations and (4) value destruction from acquisition of stake in Cairn India.

Company data and valuation summary

Sesa Goa

Stock data

52-week range (Rs) (high,low)	495-266
Market Cap. (Rs bn)	319.7

Shareholding pattern (%)

Promoters	55.7
FIs	27.2
MFs	0.5

Price performance (%)

	1M	3M	12M
Absolute	10.5	3.1	0.3
Rel. to BSE-30	8.4	(7.5)	(13.0)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	29.6	52.5	54.0
EPS growth (%)	23.5	77.6	2.8
P/E (X)	12.2	6.8	6.7
Sales (Rs bn)	58.6	88.1	98.2
Net profits (Rs bn)	26.3	46.7	48.0
EBITDA (Rs bn)	31.4	53.1	55.9
EV/EBITDA (X)	10.0	4.6	6.3
ROE (%)	35.8	34.9	31.5
Div. Yield (%)	1.0	1.0	1.0

Lowers volumes growth guidance; capacity expansion may be at risk

Sesa lowered FY2011E iron ore volume growth guidance to 10% from 20% earlier citing (1) impact on ban of iron ore exports by the Karnataka Government; and (2) continued logistics constraints for iron ore shipments in Orissa and Goa. We believe that even the revised volume growth guidance is dependent on the lifting of ban on iron ore exports imposed by the Karnataka Government by November '10. Note that Karnataka contributed to ~20% of iron ore shipments in FY2010.

Further, Sesa's plans to expand iron ore production capacity to 50 mn tons by end-FY2013E may be at risk on account of delays in getting environment clearance from MOEF. Sesa currently has EC approval to mine up to 25 mn tons per annum. Sesa indicates that the Goa Government is not taking up any mine expansion request pending further announcements on revised MMDR draft. Expansion of Orissa mine has also hit an air pocket. We lower our iron ore sales estimates to 21.7 mn, 24.1 mn and 29.7 mn tons for FY2011E, FY2012E and FY2013E from 25 mn, 30.5 mn and 29.7 mn earlier.

Cairn transaction may be EPS accretive but value destructive

We assume that Sesa's open offer to acquire 20% in Cairn India at Rs355/share is fully subscribed and consolidate earnings starting FY2012E. Note, in case of a shortfall in open offer, it will acquire the balance shares from Vedanta at Rs405/share. Our FY2012E and FY2013E EPS estimates increase by 11.1% and 20.2% for this consolidation. Our energy team values CAIR at Rs280/share as compared to Rs355 paid by Sesa for the stake; this leads to value destruction of 21%.

Maintain REDUCE rating; multiple headwinds ahead

Delays in iron ore capacity expansion by the non-Big 3 miners underpin our outlook for iron ore prices—we now model iron ore prices of US\$120, US\$115 and US\$105/ton for FY2011E, FY2012E and FY2013E, respectively; this partially offsets the decline in our volume assumptions. Our core EBITDA estimates reduce by 17.2%, 2.2% and -0.6% to 53.1 bn, 55.9 bn and 60.8 bn for the next three years. EPS estimates increase to Rs52.5, Rs54 and Rs61.5 per share on proportionate earnings consolidation of Cairn India. We value Sesa's core business at Rs197/share and stake in Cairn India at Rs119/share. We lower our fair value to Rs320, from Rs340 earlier.

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Core business valuations based on generous assumptions

We find Sesa Goa's valuations expensive even after building in (1) aggressive long-term iron ore price of US\$90/dmt (long-term benchmark price, fob basis) and (2) further reserve accretion of about 90 mn.

Sesa faces multiple headwinds in the form of (1) imposition of ban on iron ore exports by the Karnataka Government. Near-term volumes may be hit by this ban, while medium-term expansion plans may be impacted by lack of environment clearances (Sesa has EC approval for iron ore mining up to 25 mn tons); (2) potential changes in MMDR Act that may call for sharing of 26% of profit generated with the population displaced from the mine and (3) unrelated and value destructive move to acquire 20% in Cairn India. Not only Sesa is overpaying for the asset, the move appears to be driven to fund group aspirations.

Key highlights from 2QFY11 earnings call

- ▶ Cost of iron ore production (including royalties) was US\$90-95/ton for the Orissa mine and US\$40/ton for the Karnataka mine.
- ▶ The company reassessed profits for FY2011E after ban on iron ore exports from Karnataka and reversed provision for taxation created in 1QFY11 during the quarter. This led to ETR of nominal 4.6% in 2QFY11. The company has also lowered FY2011E ETR guidance to 15-16% from 18% earlier. Note that Sesa's ETR will move to 33.5% after EOU tax benefits expire in FY2011E.
- ▶ Total iron ore inventory stands at 5.3 mn tons—2.5 mn tons in Goa mines, 2.3 mn tons in Karnataka and 0.5 mn in Orissa. Volume impact from Karnataka iron ore export ban was 1 mn ton.
- ▶ Environment clearance for mining is 25 mn tons, broken up in to 17 mn tons for Goa, 6 mn tons for Karnataka mine and 2 mn tons for Orissa mines.
- ▶ Capex guidance for FY2011E is Rs14 bn broken up into Rs2 bn for sustenance capex and Rs12 bn for pig iron and mine capacity expansion.
- ▶ No clarity on expansion of borrowings limits to Rs150 bn over and above the aggregate of the paid-up share capital and free reserves of the company. Sesa had indicated that it would fund acquisition of stake in Cairn India through internal accruals; the company has cash and cash equivalent of Rs75.7 bn on end-September '10.

Sesa Goa, changes in estimates, March fiscal year ends, 2011E-13E (Rs mn)

	Revised estimates			Old estimates			Change (%)		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
Blended iron ore realizations (Rs/ton)	3,626	3,462	3,221	3,705	3,019	2,775	(2.1)	14.7	16.1
Iron ore volumes ('000 tons)	21,706	24,069	29,692	24,967	30,486	37,613	(13.1)	(21.0)	(21.1)
Net revenues	88,054	98,172	110,940	101,810	101,761	114,052	(13.5)	(3.5)	(2.7)
EBITDA	53,063	55,932	60,850	64,091	57,215	60,485	(17.2)	(2.2)	0.6
PAT	46,695	48,012	54,689	52,151	41,198	44,735	(10.5)	16.5	22.3
EPS (Rs)	52.5	54.0	61.5	58.6	46.3	50.3	(10.5)	16.5	22.3
USD INR	45.5	44.5	44.1	46.0	46.0	45.5	(1.1)	(3.3)	(3.3)

Source: Kotak Institutional Equities estimates

DCF-based valuation for Sesa Goa

DCF valuation of Sesa, March fiscal year-ends, 2011E-19E

	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
EBITDA	53,063	55,932	60,850	54,793	65,601	62,146	59,791	57,385	54,920
Tax expense	(10,418)	(18,157)	(19,673)	(17,520)	(21,067)	(19,833)	(18,975)	(18,100)	(17,205)
Changes in working capital	(2,565)	(307)	(387)	(208)	(771)	73	41	41	40
Cash flow from operations	40,080	37,468	40,790	37,064	43,763	42,385	40,857	39,326	37,756
Capital expenditure	(14,630)	(6,080)	(6,080)	(4,290)	(3,080)	(3,080)	(3,080)	(3,080)	(3,080)
Free cash flow to the firm	25,451	31,388	34,710	32,774	40,683	39,305	37,777	36,246	34,676
Discounted cash flow-now	24,668	26,805	26,116	21,726	23,761	20,226	17,128	14,479	12,204
Discounted cash flow-1 year forward	—	30,423	29,642	24,659	26,969	22,956	19,440	16,433	13,852
Discounted cash flow-2 year forward	—	—	33,643	27,988	30,610	26,056	22,064	18,652	15,722
Discount rate	13.5%								

	Mar-12
Total PV of free cash flow (a)	196,011
PV of terminal value (b)	—
EV (a) + (b)	196,011
EV (US\$ mn)	4,405
Net debt	20,640
Equity value	175,372
No. of shares	889.7
Implied share price (Rs)	197

Source: Kotak Institutional Equities estimates

Sesa Goa, valuation (Rs mn)

	Value	
	(Rs mn)	(Rs/share)
DCF valuation of core business	175,372	197
Add: Value of investments in Cairn India	106,231	119
Arrived market capitalization	281,602	317
Target price (Rs)		320

Source: Kotak Institutional Equities estimates

Income accretion derived on consolidation of Cairn financials, March fiscal year-ends 2012E-13E (Rs mn)

	2012E	2013E
Consideration paid for Cairn acquisition	134,685	134,685
	6.0	6.0
Normalised after-tax earnings	8,081	8,081
Share of profits/(losses) of Cairn	13,869	16,824
Income accretion (Rs mn)	5,788	8,743
EPS accretion (Rs/share)	6.5	9.8
EPS accretion (%)	11.1%	20.2%

Source: Kotak Institutional Equities estimates

Sesa Goa, Key assumptions, March fiscal year-ends, 2008-13E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Tonnages ('000 ton)						
Iron ore production	7,754	10,689	12,845	12,203	14,033	17,120
Iron ore purchases	5,165	4,485	5,740	5,166	5,941	7,248
Iron ore sales	12,391	15,103	16,875	17,369	19,974	24,368
Metallurgical coke sales	260	217	263	250	392	420
Tonnages consolidated ('000 tons)						
Iron ore production	7,754	10,689	12,845	13,414	15,365	18,852
Iron ore purchases	5,165	4,485	5,740	7,678	8,704	10,839
Iron ore sales	12,391	15,103	20,521	21,706	24,069	29,692
Metallurgical coke sales	260	217	263	250	392	420
Realizations						
Weighted average ore realization (Rs/ton)	2,617	3,036	2,512	3,626	3,462	3,221
Average ore realization (US\$/ton)	61	62	53	80	78	73
Iron ore EBITDA/ton (US\$)	38	31	27	46	43	38
Metallurgical coke prices	11,901	21,415	13,545	20,566	20,585	20,354
Costs (Rs/ton)						
Iron ore purchase cost	459	589	539	647	680	713
Coking coal purchased	5,876	7,861	9,190	11,028	10,477	9,953
Raw material cost per ton of iron ore produced	434	436	444	600	669	632
Employee cost per ton of iron ore produced	43	56	64	78	78	74

Source: Company, Kotak Institutional Equities estimates

Sesa Goa (consolidated), Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	38,227	49,591	58,583	88,054	98,172	110,940
EBITDA	23,032	25,388	31,448	53,063	55,932	60,850
Other income	744	2,240	4,260	4,580	4,289	3,942
Interest	(28)	(10)	(517)	(963)	(7,138)	(5,755)
Depreciation	(500)	(517)	(745)	(975)	(1,893)	(2,299)
Profit before tax	23,249	27,102	34,446	55,705	51,190	56,738
Taxes	(7,760)	(7,153)	(8,056)	(8,913)	(16,893)	(18,724)
Net profit	15,489	19,949	26,390	46,792	34,297	38,014
Minority interest	(74)	(68)	(99)	(98)	(154)	(149)
Income from associates	—	—	—	—	13,869	16,824
PAT	15,415.8	19,881.3	26,291.3	46,694.6	48,012.4	54,689.4
Earnings per share (Rs)	17.3	23.9	29.6	52.5	54.0	61.5
Balance sheet (Rs mn)						
Equity	29,435	47,157	79,177	122,725	167,592	239,288
Deferred tax liability	664	664	750	750	750	750
Total Borrowings	—	19	19,606	19,606	89,606	64,162
Minority interest	266	334	433	531	685	834
Current liabilities	3,763	5,840	12,400	11,351	12,183	13,233
Total liabilities	34,128	54,015	112,366	154,963	270,815	318,267
Net fixed assets	4,975	5,930	22,557	36,212	40,399	44,179
Investments	20,510	31,252	45,649	—	148,554	165,378
Cash	210	177	23,918	96,993	58,966	84,376
Other current assets	8,433	16,656	20,242	21,758	22,897	24,333
Miscellaneous expenditure	0	0	(0)	—	—	—
Total assets	34,128	54,015	112,366	154,963	270,815	318,267
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	15,561	18,221	23,922	43,283	31,901	36,372
Working capital changes	(1,699)	3,199	1,791	(2,565)	(307)	(387)
Capital expenditure	(575)	(1,363)	(1,316)	(14,550)	(6,000)	(6,000)
Free cash flow	13,286	20,058	24,397	26,168	25,595	29,985
Ratios						
Debt/equity (%)	—	0.0	0.2	0.2	0.5	0.3
Net debt/equity (%)	(0.7)	(0.7)	(0.8)	(0.7)	0.1	(0.1)
RoAE (%)	67.8	52.4	35.8	34.9	31.5	25.5
RoACE (%)	67.8	52.4	31.4	29.3	24.3	18.9

Source: Company, Kotak Institutional Equities estimates

OCTOBER 20, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **708**

Target price (Rs): **855**

BSE-30: **19,983**

Gas provides buffer. An Anadarko-led consortium with BPCL as a 10% partner has made another discovery in Area 1 in the Rovuma basin in Mozambique. This is the consortium's fourth successful discovery in the same block. Reserves and PSC data are not yet available but a consortium partner (Cove Energy) has put the resource potential of the block as exceeding 10 tcf. We do not ascribe any value currently to BPCL's E&P assets in our 12-month fair valuation of ₹855.

Company data and valuation summary

Bharat Petroleum

Stock data

52-week range (Rs) (high,low)	840-482
Market Cap. (Rs bn)	255.9

Shareholding pattern (%)

Promoters	54.9
FIs	7.4
MFs	7.4

Price performance (%)

	1M	3M	12M
Absolute	(7.6)	8.0	34.0
Rel. to BSE-30	(9.4)	(3.1)	16.1

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	58.6	57.0	65.4
EPS growth (%)	230.2	(2.8)	14.8
P/E (X)	12.1	12.4	10.8
Sales (Rs bn)	1,202.2	1,347.6	1,404.6
Net profits (Rs bn)	21.2	20.6	23.7
EBITDA (Rs bn)	32.6	43.2	47.4
EV/EBITDA (X)	11.4	8.7	7.7
ROE (%)	14.9	13.3	13.8
Div. Yield (%)	2.0	2.7	3.0

E&P portfolio could be meaningful

Exhibit 1 gives details of discoveries in BPCL's E&P assets. The available data is quite sketchy currently for us to ascribe value to BPCL's E&P assets. However, the value of the E&P portfolio could be meaningful in the context of BPCL's current market capitalization of US\$5.8 bn. Preliminary estimates put gross resource potential of over 300 mn bbls oil in BM-C-30 block in the Campos basin in Brazil (BPCL's stake: 12.5%) and over 10 tcf of gas in Area 1 in the Rovuma basin in Mozambique (BPCL's stake: 10%).

Downside risks to earnings exist for FY2011E but too early to take a call

We do not rule out earnings risks to our FY2011E earnings given (1) continued delay in deregulation of diesel prices; we currently model deregulation from January 1, 2011 and (2) higher-than-expected FYTD crude oil prices. We would note that FY2011E earnings would depend on the amount of compensation from the government and net under-recoveries to be borne by the downstream oil companies. We assume that the government-owned downstream oil companies will bear net under-recoveries of ₹54 bn in FY2011E.

We base our BUY rating on FY2012E earnings anyway

We assume full deregulation of auto fuel prices in FY2012E and assume that the downstream oil companies would bear ₹53 bn of net under-recoveries in FY2012E; the latter compares with ₹56 bn in FY2010. We currently assume US\$75/bbl crude price and ₹46/US\$ exchange rate for FY2012E. The recent spike in crude oil prices poses risks to earnings of the downstream oil companies; however, the recent increase in crude oil price seems to be largely driven by increased speculation in crude oil futures (see Exhibit 2).

Value exists but realization will likely test patience

Exhibit 3 gives our computation for the fair valuation of BPCL and other downstream oil stocks while Exhibit 4 shows our fair valuation under a blue-sky scenario of full deregulation. We use 10X FY2012E EPS (less dividends from associates and subsidiaries valued separately) plus fair value of investments to arrive at our 12-month fair valuation of ₹855 for BPCL.

QUICK NUMBERS

- **BPCL has reported six oil and gas discoveries in two years**
- **19-27% potential upside to our 12-month fair valuations of OMCs**
- **39-70% upside to fair valuation of OMCs from current levels in a blue-sky scenario**

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BPCL has reported six discoveries in the past two years

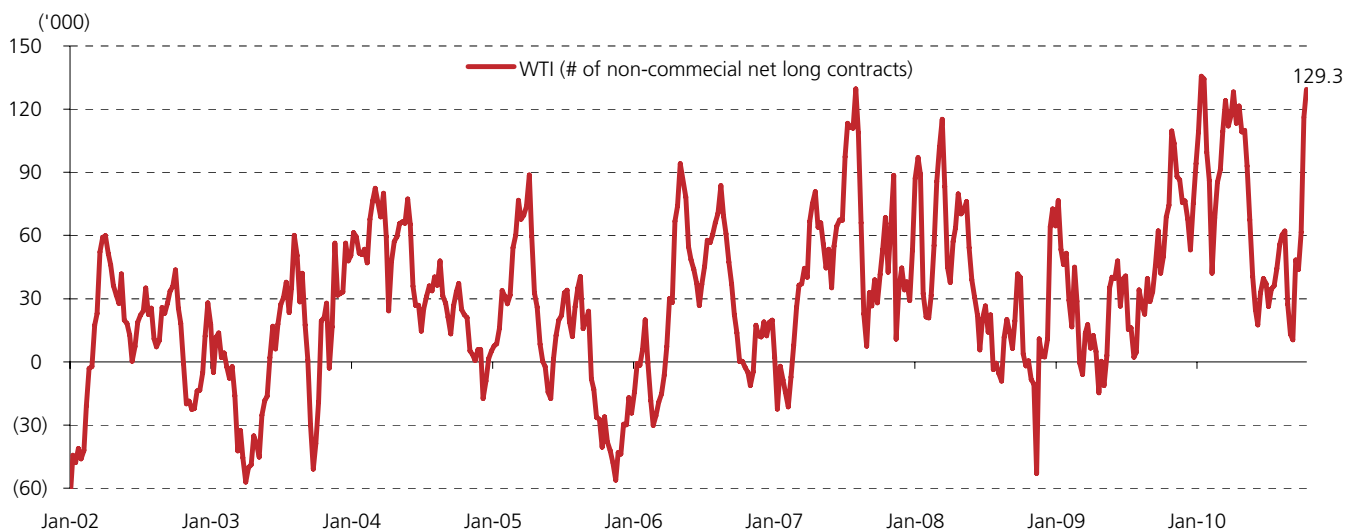
Details of BPCL's discoveries

Block	BPCL's stake (%)	Discovery	Discovery details	Resource	Consortium
BM-C-30, Campos basin, Brazil	12.5	Oil (Oct-2008)	>195 ft of net oil pay	Estimated gross resource potential >300 mn bbls	Anadarko (30%), Devon Energy (25%), SK Energy (20%), Videocon (12.5%)
		Oil (Nov-2009)	>90 ft of net oil pay		
Area 1, Rovuma basin, Mozambique	10	Gas (Feb-2010)	>480 ft of net gas pay	Estimated gross resource potential >10 tcf	Anadarko (36.5%), Cove Energy (8.5%), Mitsui (20%), Videocon (10%), ENH (15%)
		Gas (Mar-2010)	>76 ft of net gas pay		
		Oil (Aug-2010)	>125 ft of net oil pay and gas-saturated sands		
		Gas (Oct-2010)	>416 ft of net gas pay		

Source: Company, Kotak Institutional Equities

Speculative net long positions have jumped sharply in the recent weeks

WTI non-commercial futures contracts (#)



Source: Bloomberg, Kotak Institutional Equities

Fair valuation of OMCs (Rs)

BPCL		HPCL		IOCL	
Profit after tax for FY2012E (Rs mn)	23,663	Profit after tax for FY2012E (Rs mn)	19,846	Profit after tax for FY2012E (Rs mn)	98,901
Less: income from investments valued separately (Rs mn)	1,319	Less: income from investment valued separately (Rs mn)	368	Less: income from investment valued separately (Rs mn)	9,749
Adjusted profit after tax for FY2012E (Rs mn)	22,344	Adjusted profit after tax for FY2012E (Rs mn)	19,477	Adjusted profit after tax for FY2012E (Rs mn)	89,152
Adjusted EPS for FY2012E	62	Adjusted EPS for FY2012E	57	Adjusted EPS for FY2012E	37
P/E multiple (X)	10	P/E multiple (X)	9	P/E multiple (X)	10
Fair value on P/E (without value of investments) (A)	618	Fair value on P/E (without value of investments) (A)	517	Fair value on P/E (without value of investments) (A)	367
Add: Value of investments (Rs mn)	85,666	Add: Value of investments (Rs mn)	36,795	Add: Value of investments (Rs mn)	271,618
<i>KRL treasury shares</i>	28,838	<i>MRPL (Rs50/share) (Rs mn)</i>	14,858	<i>Oil and Natural Gas Corp.</i>	197,377
<i>Numaligarh</i>	13,606	<i>HPCL-Mittal Energy (Book value) (Rs mn)</i>	12,265	<i>Chennai Petroleum Corp.</i>	19,239
<i>Indraprastha Gas</i>	8,316	<i>Oil India (Rs mn)</i>	6,634	<i>Gas Authority of India</i>	13,477
<i>Oil India Ltd</i>	6,634	<i>Other unquoted investments (Rs mn)</i>	3,039	<i>Oil India Ltd.</i>	13,268
<i>Petronet LNG</i>	6,600	Value of investments (B)	109	<i>IOC treasury shares (IBP Co.)</i>	14,841
<i>Other equity</i>	21,672	Total equity value (A) + (B)	626	<i>Petronet LNG Ltd.</i>	6,600
Value of investments (Rs) (B)	237			<i>Other equity</i>	6,815
Total equity value (A) + (B)	855			Value of investments (Rs) (B)	112
				Total equity value (A) + (B)	479
Current stock price	708	Current stock price	494	Current stock price	403
Potential upside (%)	21	Potential upside (%)	27	Potential upside (%)	19
KIE rating	BUY	KIE rating	BUY	KIE rating	ADD

Source: Company, Kotak Institutional Equities estimates

Earnings and valuations of downstream companies would jump significantly in a blue-sky scenario
EPS estimates and fair valuation, March fiscal year-end, 2012E (Rs)

	EPS (Rs)	P/E (X)	Value of investments (Rs)	Fair value (Rs)	Current stock price (Rs)	Upside (%)
BPCL	83	10	237	1,071	708	51
HPCL	81	9	109	840	494	70
IOCL	45	10	112	560	403	39

Note:

(a) EPS adjusted for other income from investments valued separately.

Source: Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of BPCL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	965,569	1,102,081	1,340,734	1,202,170	1,347,607	1,404,572	1,546,005	1,604,712
EBITDA	35,362	28,472	27,507	32,635	43,152	47,424	51,116	52,289
Other income	7,332	13,954	15,087	22,402	14,648	12,914	11,205	9,445
Interest	(4,774)	(6,725)	(22,699)	(10,110)	(12,959)	(11,400)	(8,997)	(6,415)
Depreciation	(9,041)	(10,982)	(10,755)	(12,423)	(13,981)	(13,506)	(13,902)	(14,212)
Pretax profits	28,879	24,719	9,141	32,505	30,861	35,433	39,422	41,107
Extraordinary items	(68)	—	—	(8,290)	—	—	—	—
Tax	(9,286)	(9,059)	(5,103)	(11,317)	(7,882)	(11,029)	(12,188)	(13,072)
Deferred taxation	(268)	(1,108)	2,421	3,033	(2,369)	(741)	(908)	(583)
Adjusted net profits	18,100	15,806	6,324	20,830	20,610	23,663	26,327	27,452
Earnings per share (Rs)	50.1	43.7	17.5	57.6	57.0	65.4	72.8	75.9
Balance sheet (Rs mn)								
Total equity	102,735	116,768	121,281	130,867	143,566	158,145	174,367	191,281
Deferred taxation liability	13,826	14,814	12,392	8,593	10,962	11,703	12,610	13,194
Total borrowings	108,292	150,224	211,714	221,952	199,450	163,950	125,736	83,736
Current liabilities	112,767	145,803	128,313	171,312	162,579	165,977	175,006	178,915
Total liabilities and equity	337,620	427,608	473,701	532,724	516,556	499,775	487,719	467,126
Cash	8,640	9,616	4,416	3,424	3,561	4,041	4,130	3,762
Current assets	127,698	187,457	148,469	232,416	230,039	234,338	247,786	252,476
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	118,334	127,354	140,033	161,871	174,180	177,619	177,025	177,112
Investments	82,949	103,182	180,784	135,013	108,777	83,777	58,777	33,777
Total assets	337,621	427,608	473,701	532,724	516,556	499,775	487,719	467,126
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	29,920	22,988	19,717	22,972	22,311	24,995	29,931	32,802
Working capital	11,451	(25,161)	20,585	(48,542)	(7,799)	(901)	(4,420)	(779)
Capital expenditure	(17,908)	(20,665)	(23,323)	(33,698)	(26,289)	(16,944)	(13,308)	(14,298)
Investments	(45,481)	(21,684)	(82,456)	35,270	26,237	25,000	25,000	25,000
Other income	4,337	6,434	6,655	13,694	16,091	12,914	11,205	9,445
Free cash flow	(17,682)	(38,088)	(58,822)	(10,304)	30,551	45,063	48,408	52,170
Ratios (%)								
Debt/equity	105.4	128.7	174.6	169.6	138.9	103.7	72.1	43.8
Net debt/equity	97.0	120.4	170.9	167.0	136.4	101.1	69.7	41.8
RoAE	16.3	12.7	4.8	11.3	14.0	14.6	14.8	14.0
RoACE	10.9	7.3	7.2	7.9	8.2	9.1	10.0	10.6
Key assumptions (standalone until FY2005)								
Crude throughput (mn tons)	19.8	20.9	20.0	20.4	22.3	22.3	22.3	22.3
Effective tariff protection (%)	1.6	1.4	2.4	2.2	0.7	0.7	0.7	0.7
Net refining margin (US\$/bbl)	3.2	5.6	5.2	2.9	3.6	4.2	4.7	4.7
Sales volume (mn tons)	24.5	26.7	27.8	29.3	31.3	32.7	34.2	35.9
Marketing margin (Rs/ton)	(1,140)	(3,010)	(5,944)	511	(62)	1,664	1,644	1,643
Subsidy under-recoveries (Rs mn)	(10,400)	(33,354)	2,728	(12,375)	(12,479)	(11,679)	(11,822)	(11,732)

Source: Company, Kotak Institutional Equities estimates

September 2010: Results calendar

Mon	Tue	Wed	Thu	Fri	Sat
18-Oct	19-Oct	20-Oct	21-Oct	22-Oct	23-Oct
		Ashok Leyland	ACC	Bank of India	Bharat Forge
		Canara Bank	Allahabad Bank	Biocon	Dr Reddys Laboratories
		Gujarat State Fertilisers	Alstom Projects	D B Corp	
		HCL Technologies	Ambuja Cements	Indian Bank	
		Hindustan Zinc	Corporation Bank	Kirloskar Industries	
		Indiabulls Power	Indiabulls Financial Services	Pramal Healthcare	
		Indiabulls Real Estate	Novartis India	Sobha Developers	
		Kotak Mahindra Bank	SKF India	Vijaya Bank	
		Mahindra Life Space Developers	South Indian Bank	Wipro	
		Power Grid Corp	TCS		
		Tanla Solutions	TVS Motor		
		Yes Bank			
25-Oct	26-Oct	27-Oct	28-Oct	29-Oct	30-Oct
Adani Power	Bosch	Asian Paints	Adani Enterprises	ABB	Aditya Birla Nuvo
Crompton Greaves	Central Bank of India	Cummins India	Andhra Bank	Bharat Electronics	Areva T&D
Hindustan Oil Exploration	DishTV India	Dabur India	Bank of Baroda	BHEL	GVK Power
Hindustan Uniliver	JB Chemicals	Glenmark Pharma	BGR Energy	BPCL	Maruti Suzuki
Idea Cellular	Jindal Steel & Power	Godrej Industries	Cairn India	Federal Bank	National Aluminium Co.
Mundra Port & SEZ	JSW Steel	Gujarat State Petronet	Colgate Palmolive	GE Shipping	Sun Pharma
Petronet LNG	Mangalore Refinery & Petrochemicals	Hindustan Copper	EIH	Hindustan Construction Co	Suzlon Energy
Procter & Gamble	Marico	HPCL	Glaxosmithkline Pharma	ICICI Bank	
Rural Electrification Corp	NTPC	IFCI	Grasim Industries	Indian Oil Corp	
Titan Industries	Sterlite Industries	Indian Hotels	IDBI Bank	Indian Overseas Bank	
	Tech Mahindra	Patni Computer	IRB Infrastructure	ITC	
	Ultratech Cement	Shriram Transport	Monsanto India	Jet Airways	
	United Phosphorus	Thermax	NHPC	Mahindra & Mahindra	
	Voltas	Torrent Power	NMDC	Motherson Sumi	
		Union Bank	ONGC	National Fertilizers	
		United Spirits	Phoenix Mills	Nestle India	
			SAIL	Shipping Corp	
			Tata Communications	Syndicate Bank	
			Tata Global Beverages	Tata Chemicals	
			Zee Entertainment Enterprises	UCO Bank	
1-Nov	2-Nov	3-Nov	4-Nov	5-Nov	6-Nov
Century Textiles	Jai Corp	Oriental Bank			
JSW Energy	Neyveli Lignite				
8-Nov	9-Nov	10-Nov	11-Nov	12-Nov	13-Nov
IDFC	Hindalco Industries		Apollo Tyres	Tata Power	
			Ranbaxy Laboratories		
			Shree Cement		

Source: BSE, Kotak Institutional Equities

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	19-Oct-10		Mkt cap.		O/S shares (mn)	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price (Rs)	Upside (%)	ADVT-3mo (US\$ mn)
	Price (Rs)	Rating	(Rs mn)	(US\$ mn)		2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Automobiles																													
Ashok Leyland	75	ADD	99,240	2,237	1,330	2.8	4.3	5.9	84.5	52.3	37.5	26.4	17.4	12.6	15.2	11.4	9.0	2.5	2.2	2.0	2.0	1.3	1.3	10.9	13.5	16.7	78	4.6	8.3
Bajaj Auto	1,514	REDUCE	438,232	9,880	289	58.8	91.0	103.6	160.2	54.6	13.9	25.7	16.6	14.6	16.6	11.8	10.2	15.0	9.0	6.1	0.7	1.3	1.3	70.9	67.4	49.6	1,450	(4.3)	22.8
Bharat Forge	370	REDUCE	88,572	1,997	239	0.7	12.4	19.7	(92.0)	1,705.4	59.1	538.9	29.9	18.8	27.2	12.8	9.0	2.3	2.3	2.0	—	—	—	0.9	0.4	0.1	360	(2.8)	4.8
Hero Honda	1,837	REDUCE	366,799	8,270	200	111.8	114.9	129.8	74.1	2.8	12.9	16.4	16.0	14.2	10.3	10.2	8.7	10.1	7.1	5.3	1.6	1.7	1.9	59.0	52.1	42.7	1,800	(2.0)	23.9
Mahindra & Mahindra	702	BUY	417,723	9,418	595	33.9	44.1	51.7	125.8	30.1	17.3	20.7	15.9	13.6	13.6	11.4	9.6	5.2	4.1	3.3	1.3	1.3	1.4	30.0	29.0	27.3	760	8.3	26.1
Maruti Suzuki	1,495	REDUCE	431,877	9,737	289	86.4	80.6	93.4	105.0	(6.7)	15.8	17.3	18.5	16.0	9.4	9.5	7.9	3.6	3.0	2.6	0.4	0.4	0.4	23.3	17.8	17.5	1,330	(11.0)	23.2
Tata Motors	1,174	ADD	735,265	16,577	626	27.4	94.8	109.2	(182.5)	246.1	15.2	42.9	12.4	10.8	14.6	7.6	6.7	4.7	3.3	2.5	1.2	0.5	0.5	8.7	11.9	11.1	1,150	(2.1)	97.7
Automobiles																													
Cautious																													
			2,577,707	58,115					276.0	59.8	16.6	24.7	15.4	13.2	13.4	9.4	8.0	5.2	4.0	3.1	1.0	0.9	1.0	20.9	25.8	23.8			
Banks/Financial Institutions																													
Andhra Bank	168	BUY	81,480	1,837	485	21.6	22.9	26.7	60.1	6.4	16.4	7.8	7.3	6.3	—	—	—	1.8	1.6	1.3	3.0	3.2	3.7	26.0	23.1	22.7	190	13.1	7.2
Axis Bank	1,469	ADD	594,998	13,414	405	62.1	78.6	99.9	22.7	26.6	27.2	23.7	18.7	14.7	—	—	—	3.7	3.2	2.7	0.8	1.0	1.3	19.2	18.4	20.2	1,700	15.8	46.4
Bank of Baroda	970	BUY	354,397	7,990	366	83.7	95.1	115.7	37.3	13.7	21.7	11.6	10.2	8.4	—	—	—	2.6	2.1	1.8	1.5	1.8	2.1	24.4	23.0	23.3	1,000	3.1	8.4
Bank of India	519	ADD	273,081	6,157	526	33.1	54.5	62.0	(42.1)	64.7	13.6	15.7	9.5	8.4	—	—	—	2.1	1.8	1.6	1.3	2.2	2.5	14.2	20.7	20.1	560	7.8	14.3
Canara Bank	634	ADD	260,043	5,863	410	73.7	82.2	98.3	45.8	11.6	19.5	8.6	7.7	6.5	—	—	—	2.1	1.7	1.4	1.3	1.6	1.9	22.4	20.8	20.8	580	(8.6)	9.6
Corporation Bank	720	ADD	103,340	2,330	143	82.0	101.5	118.1	31.8	23.8	16.3	8.8	7.1	6.1	—	—	—	1.8	1.5	1.3	2.3	2.8	3.3	22.0	23.0	22.5	750	4.1	2.0
Federal Bank	458	ADD	78,299	1,765	171	27.2	36.4	49.0	(7.2)	34.1	34.4	16.9	12.6	9.4	—	—	—	1.7	1.5	1.3	1.1	1.5	2.0	10.3	12.6	15.2	430	(6.1)	7.5
HDFC	721	REDUCE	1,034,529	23,324	1,436	19.7	24.0	28.1	22.7	21.8	17.2	36.6	30.0	25.6	—	—	—	6.8	6.0	5.3	1.0	1.2	1.4	20.0	21.2	21.9	720	(0.1)	52.2
HDFC Bank	2,369	REDUCE	1,084,325	24,447	458	64.4	84.9	111.2	22.1	31.8	31.0	36.8	27.9	21.3	—	—	—	5.0	4.4	3.8	0.5	0.7	0.9	16.1	16.9	19.2	2,500	5.5	43.5
ICICI Bank	1,120	REDUCE	1,248,174	28,141	1,115	36.1	45.2	57.3	6.9	25.3	26.6	31.0	24.8	19.6	—	—	—	2.4	2.3	2.1	1.1	1.3	1.7	8.0	9.5	11.3	1,000	(10.7)	91.2
IDFC	202	ADD	294,223	6,633	1,458	8.4	9.4	11.2	44.9	12.4	18.7	24.1	21.4	18.0	—	—	—	4.2	2.7	2.3	0.7	0.9	1.1	16.6	15.5	14.3	205	1.6	25.6
India Infoline	114	BUY	35,670	804	312	8.1	7.2	8.7	59.2	(11.9)	21.6	14.1	16.0	13.1	—	—	—	2.2	1.9	1.6	2.8	1.3	1.8	16.4	12.9	14.4	130	13.6	6.2
Indian Bank	295	ADD	126,696	2,856	430	35.1	32.4	44.1	25.5	(7.7)	36.2	8.4	9.1	6.7	—	—	—	1.9	1.6	1.4	2.2	2.0	2.7	24.1	18.8	21.7	280	(5.0)	5.9
Indian Overseas Bank	157	BUY	85,479	1,927	545	13.0	16.7	24.8	(46.7)	29.0	48.4	12.1	9.4	6.3	—	—	—	1.3	1.2	1.0	2.2	2.5	2.7	9.6	11.6	15.4	160	2.0	5.5
J&K Bank	793	ADD	38,457	867	48	105.7	119.3	139.6	25.0	12.9	17.1	7.5	6.6	5.7	—	—	—	1.3	1.2	1.0	2.8	3.1	3.7	18.2	17.9	18.3	850	7.2	3.4
LIC Housing Finance	1,313	REDUCE	124,717	2,812	95	69.7	109.0	119.0	11.5	56.3	9.2	18.8	12.1	11.0	—	—	—	3.9	3.2	2.6	1.1	1.8	1.9	23.6	27.4	24.6	1,325	0.9	34.9
Mahindra & Mahindra Financial	693	REDUCE	66,538	1,500	96	35.9	46.4	56.2	60.0	29.4	21.2	19.3	14.9	12.3	—	—	—	3.9	3.3	2.8	1.1	1.4	1.7	21.5	23.5	23.8	635	(8.4)	4.5
Oriental Bank of Commerce	480	ADD	120,234	2,711	251	45.3	57.8	66.8	25.3	27.6	15.5	10.6	8.3	7.2	—	—	—	1.6	1.4	1.2	1.9	2.4	2.8	14.5	16.5	16.9	450	(6.2)	9.1
PFC	360	SELL	412,910	9,309	1,148	20.5	22.9	27.6	53.5	11.9	20.3	17.6	15.7	13.1	—	—	—	3.2	2.8	2.5	1.4	1.6	1.9	18.8	18.3	19.2	275	(23.6)	4.6
Punjab National Bank	1,300	BUY	409,925	9,242	315	123.9	133.4	163.3	26.4	7.7	22.4	10.5	9.7	8.0	—	—	—	2.5	2.1	1.7	1.7	2.1	2.6	26.2	23.2	23.7	1,450	11.5	9.4
Reliance Capital	828	NR	203,784	4,594	246	12.9	13.7	9.8	(67.3)	6.5	(28.6)	64.4	60.5	84.7	—	—	—	3.0	2.9	2.8	0.7	0.7	0.5	4.7	4.8	3.4	—	—	32.2
Rural Electrification Corp.	367	REDUCE	362,273	8,168	987	20.3	25.3	31.2	23.2	24.5	23.4	18.1	14.5	11.8	—	—	—	3.3	2.9	2.5	1.8	2.1	2.5	22.0	21.0	22.5	325	(11.4)	10.7
Shriram Transport	761	ADD	169,709	3,826	223	39.2	53.3	65.1	30.1	36.2	22.0	19.4	14.3	11.7	—	—	—	4.6	3.9	3.2	1.5	2.1	2.6	28.4	28.2	28.6	800	5.2	8.7
SKS Microfinance	1,140	ADD	83,962	1,893	74	26.9	48.9	77.5	61.1	81.3	58.6	42.3	23.3	14.7	—	—	—	8.8	4.1	3.1	-	-	-	21.7	23.9	24.7	1,400	22.9	-
SREI	113	NR	13,164	297	116	8.3	7.9	9.9	17.8	(4.8)	25.8	13.7	14.3	11.4	—	—	—	1.1	1.0	1.0	1.1	1.1	1.1	11.1	10.5	12.3	-	-	5.2
State Bank of India	3,117	BUY	1,978,675	44,610	635	144.4	176.8	209.3	0.5	22.4	18.4	21.6	17.6	14.9	—	—	—	3.0	2.6	2.3	1.0	1.0	1.1	14.8	15.9	16.6	3,400	9.1	129.0
Union Bank	404	BUY	203,992	4,599	505	41.1	48.8	60.2	20.2	18.8	23.5	9.8	8.3	6.7	—	—	—	2.3	1.9	1.5	1.4	1.6	2.0	26.2	25.1	25.1	450	11.4	5.9
Yes Bank	347	BUY	117,831	2,657	340	15.0	18.7	25.8	46.7	24.5	38.3	23.1	18.6	13.4	—	—	—	3.8	3.2	2.7	0.4	0.5	0.7	20.3	18.8	21.7	375	8.1	15.7
Banks/Financial Institutions																													
			9,960,904	224,572					15.0	21.9	22.2	19.7	16.2	13.2	—	—	—	3.1	2.7	2.3	1.1	1.3	1.6	15.5	16.4	17.4			
Cement																													
ACC	976	REDUCE	183,427	4,135	188	83.2	66.0	72.9	47.9	(20.7)	10.4	11.7	14.8	13.4	6.3	7.0	5.7	2.9	2.5	2.2	2.8	2.4	2.4	29.3	20.0	19.3	980	0.4	10.5
Ambuja Cements	139	SELL	212,143	4,783	1,522	8.0	8.4	8.9	11.4	5.3	5.1	17.4	16.5	15.7	9.7	9.1	7.9	3.0	2.7	2.4	1.3	1.5	1.5	19.3	17.8	16.5	108	(22.5)	7.1
Grasim Industries	2,273	ADD	208,453	4,700	92	301.0	242.3	292.5	26.1	(19.5)	20.7	7.6	9.4	7.8	4.5	4.8	3.6	1.7	1.4	1.2	1.5	1.5	1.5	22.9					

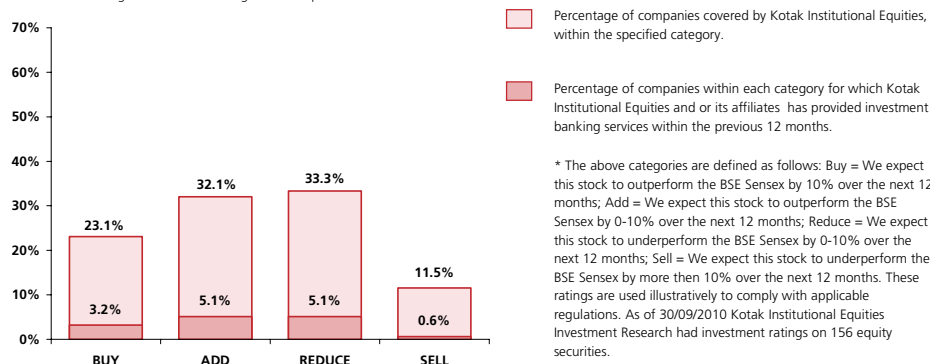
Kotak Institutional Equities: Valuation summary of key Indian companies

Company	19-Oct-10		Mkt cap.		O/S	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price	Upside	ADVT-3mo
	Price (Rs)	Rating	(Rs mn)	(US\$ mn)	(mn)	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	(Rs)	(%)	(US\$ mn)
Consumer products																													
Asian Paints	2,636	ADD	252,816	5,700	96	71.5	89.0	104.3	85.3	24.4	17.3	36.8	29.6	25.3	22.7	18.5	15.5	15.8	12.3	9.9	1.0	1.4	1.7	51.8	47.9	44.4	3,000	13.8	8.9
Colgate-Palmolive (India)	854	SELL	116,097	2,617	136	31.1	34.5	39.6	44.2	10.9	14.6	27.4	24.7	21.6	22.5	18.3	15.7	35.6	30.3	25.9	2.3	3.0	3.5	156.1	132.3	129.4	830	(2.8)	3.1
Dabur India	103	ADD	177,881	4,010	1,731	2.9	3.4	4.2	28.2	16.8	23.3	35.4	30.3	24.6	26.3	21.1	17.2	16.9	13.0	10.8	1.5	1.7	2.1	54.3	49.0	48.4	115	11.9	5.4
GlaxoSmithKline Consumer (a)	2,079	ADD	87,444	1,971	42	55.4	68.8	83.9	23.6	24.3	22.0	37.6	30.2	24.8	21.1	18.2	14.5	9.8	8.1	6.8	0.9	1.1	1.3	27.9	29.1	29.6	2,200	5.8	1.0
Godrej Consumer Products	388	ADD	125,391	2,827	324	11.3	13.5	18.0	69.5	18.9	33.4	34.2	28.8	21.6	27.1	20.5	15.4	13.0	7.0	6.4	1.0	0.8	0.8	44.6	31.9	31.1	450	16.1	2.5
Hindustan Unilever	297	SELL	647,961	14,609	2,182	9.4	10.2	12.0	(0.9)	8.4	17.5	31.5	29.1	24.7	21.7	20.8	17.0	25.1	21.7	18.7	2.6	2.8	3.3	71.1	80.2	81.3	250	(15.8)	15.1
ITC	171	ADD	1,304,418	29,409	7,651	5.3	6.4	7.5	22.6	20.5	17.8	32.1	26.7	22.6	19.5	16.8	14.0	8.8	7.4	6.3	2.9	1.6	1.8	29.2	31.6	31.3	175	2.6	27.7
Jubilant Foodworks	505	SELL	32,257	727	64	5.5	10.0	13.1	340.6	79.9	31.4	91.2	50.7	38.6	48.5	28.9	19.4	27.4	17.8	12.2	—	—	—	46.6	42.6	37.5	400	(20.8)	25.9
Jyothy Laboratories	314	ADD	24,079	543	77	11.0	14.3	17.0	99.6	30.1	18.2	28.5	21.9	18.5	23.2	14.9	11.9	5.8	3.9	3.4	1.4	1.2	1.6	16.0	18.4	19.6	320	1.8	0.8
Marico	129	ADD	79,166	1,785	612	4.4	5.3	6.4	32.9	20.2	20.4	29.1	24.2	20.1	19.9	16.2	13.5	11.9	8.6	6.4	0.5	0.7	0.9	48.9	41.6	36.7	140	8.1	1.9
Nestle India (a)	3,315	REDUCE	319,575	7,205	96	74.4	90.7	109.8	27.0	22.0	21.0	44.6	36.5	30.2	29.5	24.4	20.7	55.0	41.6	31.9	1.5	1.8	2.2	136.0	129.7	119.5	3,100	(6.5)	4.0
Tata Global Beverages	130	ADD	80,237	1,809	618	6.1	7.3	8.7	14.5	20.7	19.0	21.4	17.8	14.9	10.3	7.8	6.6	1.7	1.5	1.4	1.5	1.9	2.2	10.2	11.7	12.9	130	0.2	4.7
Consumer products		Cautious	3,247,322	73,212					23.8	18.4	19.0	33.2	28.0	23.6	21.3	18.2	15.0	11.2	9.3	7.9	2.2	1.8	2.1	33.8	33.1	33.7			
Constructions																													
IVRCL	156	BUY	41,533	936	267	7.9	9.1	11.6	(6.7)	15.0	27.9	19.7	17.1	13.4	10.1	9.6	7.6	2.1	1.8	1.6	0.3	0.3	0.3	11.0	11.3	12.9	205	31.8	7.8
Nagarjuna Construction Co.	156	BUY	40,078	904	257	7.1	8.9	11.6	6.1	24.3	31.1	21.9	17.6	13.4	11.0	9.6	8.0	1.8	1.7	1.5	0.9	1.3	1.3	9.3	9.8	11.8	205	31.2	4.4
Punj Lloyd	128	REDUCE	43,241	975	339	(12.9)	9.8	12.0	79.2	(175.4)	22.4	(9.9)	13.1	10.7	36.1	7.1	6.5	1.4	1.3	1.2	(0.1)	0.3	0.8	(15.8)	10.3	11.4	140	9.7	13.8
Sadbhav Engineering	1,483	BUY	22,246	502	15	42.8	61.8	87.2	(16.3)	44.3	41.0	34.6	24.0	17.0	19.0	12.7	9.8	5.5	3.6	3.0	0.2	0.4	0.4	15.8	15.1	17.8	1,750	18.0	0.4
Construction		Attractive	147,099	3,316					(91.1)	4,479	28.0	753.7	16.5	12.9	15.5	8.8	7.4	1.9	1.7	1.5	0.3	0.6	0.7	0.3	10.3	11.8			
Energy																													
Aban Offshore	830	ADD	36,109	814	44	94.5	151.1	129.7	(2.5)	59.9	(14.2)	8.8	5.5	6.4	8.4	7.0	6.6	1.6	1.5	1.3	0.4	0.4	0.5	21.7	32.9	21.9	915	10.3	36.4
Bharat Petroleum	708	BUY	255,880	5,769	362	58.6	57.0	65.4	230	(3)	14.8	12	12	10.8	6.8	6.5	6.1	1.8	1.7	1.5	2.0	2.7	3.0	14.9	13.3	13.8	855	20.8	28.0
Cairn india	337	RS	639,849	14,426	1,897	5.5	20.5	36.6	29.0	270.1	78.3	60.9	16.4	9.2	47.9	9.8	6.0	1.9	1.7	1.5	—	—	4.4	3.1	10.7	17.2	—	—	31.8
Castrol India (a)	470	SELL	116,321	2,622	247	15.4	21.0	21.7	45	36	3.5	31	22	21.7	18.2	13.9	13.3	25.3	24.0	22.8	2.7	3.6	3.7	83.8	109.9	107.9	390	(17.1)	2.4
GAIL (India)	510	BUY	646,291	14,571	1,268	24.8	26.8	40.3	11.7	8.2	50.4	20.6	19.0	12.6	11.6	11.4	8.9	3.6	3.2	2.7	1.5	1.7	2.5	17.4	16.6	21.7	550	7.9	18.2
GSPL	121	SELL	68,000	1,533	562	7.3	7.1	8.0	233	(3)	12.6	17	17	15.2	8.3	8.2	6.8	4.0	3.3	3.0	0.8	1.5	2.6	27.1	21.2	20.6	83	(31.3)	6.2
Hindustan Petroleum	494	BUY	167,420	3,775	339	51.6	52.1	58.5	204.2	1.0	12.4	9.6	9.5	8.4	3.4	3.2	2.9	1.3	1.1	1.0	2.4	3.3	3.7	13.1	11.9	12.1	625	26.6	29.0
Indian Oil Corporation	403	ADD	979,314	22,079	2,428	49.1	37.9	41.9	399	(23)	10.7	8	11	9.6	6.0	6.1	5.3	1.8	1.6	1.5	3.2	2.8	3.1	22.4	15.3	15.4	480	19.0	13.5
Oil India	1,464	REDUCE	352,013	7,936	240	115.2	131.9	149.0	13.9	14.6	12.9	12.7	11.1	9.8	5.9	4.4	3.8	2.4	2.1	1.9	2.3	3.0	3.5	16.8	17.9	17.9	1,550	5.9	3.7
Oil & Natural Gas Corporation	1,351	BUY	2,888,781	65,129	2,139	90.3	116.4	136.7	(1)	29	17.5	15	12	9.9	5.2	4.6	4.0	2.2	2.0	1.8	2.4	3.1	3.6	14.4	16.8	17.7	1,500	11.1	33.0
Petronet LNG	120	SELL	89,625	2,021	750	5.4	6.5	7.9	(22.0)	20.5	21.8	22.2	18.4	15.1	12.5	10.6	9.2	3.5	3.0	2.6	1.5	1.7	2.3	15.9	16.7	17.6	88	(26.4)	9.8
Reliance Industries	1,044	REDUCE	3,108,134	70,074	2,976	49.6	57.7	74.4	(2)	16	28.9	21	18	14.0	10.6	8.5	7.0	2.1	1.9	1.7	0.7	0.8	1.0	11.4	12.1	13.9	1,015	(2.8)	131.7
Energy		Cautious	9,347,736	210,748					36.6	15.9	23.9	15.6	13.5	10.9	7.6	6.5	5.4	2.1	1.9	1.7	1.7	1.9	2.6	13.7	14.3	15.8			
Industrials																													
ABB	904	REDUCE	191,586	4,319	212	16.7	18.3	33.1	(35.2)	9.3	80.7	54.0	49.4	27.4	31.0	28.5	15.9	7.9	7.0	5.7	0.2	0.3	0.4	15.6	15.0	23.0	725	(19.8)	5.6
BGR Energy Systems	724	BUY	52,117	1,175	72	16.0	28.0	41.1	32.2	74.4	46.9	45.2	25.9	17.6	25.4	14.9	10.6	9.3	7.4	5.6	0.4	1.0	1.1	22.3	31.7	36.1	950	31.2	4.3
Bharat Electronics	1,775	REDUCE	142,028	3,202	80	96.1	105.9	120.3	(7.4)	10.2	13.6	18.5	16.8	14.8	8.7	7.6	6.4	3.2	2.8	2.4	1.1	1.4	1.4	17.5	17.7	17.6	1,800	1.4	3.5
Bharat Heavy Electricals	2,503	REDUCE	1,225,244	27,624	490	87.9	114.3	135.5	37.7	30.0	18.5	28.5	21.9	18.5	15.9	12.3	10.3	7.7	6.1	4.9	0.8	1.0	1.2	29.8	31.1	29.3	2,600	3.9	31.8
Crompton Greaves	306	REDUCE	196,491	4,430	642	12.8	14.0	16.3	46.5	9.0	16.6	23.8	21.9	18.8	13.8	12.3	10.3	7.8	6.0	4.7	0.4	0.6	0.7	37.9	31.1	28.2	320	4.5	9.3
Larsen & Toubro	1,996	ADD	1,201,871	27,097	602	57.9	76.7	90.5	15.6	32.3	18.1	34.4	26.0	22.0	19.1	13.8	11.7	5.4	4.4	3.7	0.6	0.6	0.7	18.6	18.8	18.5	2,200	10.2	54.5
Maharashtra Seamless	438	BUY	30,910	697	71	40.2	43.6	49.8	12.1	8.5	14.2	10.9	10.0	8.8	6.0	5.2	4.2	1.9	1.7	1.5	1.4	1.8	2.3	19.3	17.9	17.7	450	2.7	0.6
Siemens	803	REDUCE	270,672	6,102	337	25.2	27.0	31.9	56.4	7.3	18.0	31.9	29.7	25.2	19.6	17.8	14.8	7.9	6.6	5.5	0.6	0.7	0.8	27.6	24				

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As of September 30, 2010

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