

# India Daily Views

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#### India

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# MindTree Consulting Ltd.

Strong 4QFY07 and robust FY08 outlook

- **Mindtree reported strong 4Q FY07** with 9% Q/Q growth in US\$ revenues and 200bp+ Q/Q expansion in EBITDA margins driven by G&A leverage and better price realization. This led to a sharp 21% Q/Q growth in EBITDA and 30% Q/Q growth in net profit, significantly ahead of our expectations.
- **Robust FY08 guidance:** Good quarter was backed with a robust FY08 guidance of 36% Y/Y revenue growth and 26% Y/Y net profit growth. We note that guidance implies Y/Y operating margin expansion given higher expected taxes in FY08 and is broadly in line with our earlier estimates. We have slightly adjusted our estimates in line with guidance. We continue to expect 35% revenue and 32% EPS CAGR over FY07-09E.
- **Strong fundamentals evinced:** We believe that Mindtree's strong 4QFY07 is an indication of our thesis that muted 3QFY07 was not a trend and fundamental business traction remains solid. Further, we continue to believe that Mindtree is one of the top quality players in the mid-cap Indian IT space and will be among the leaders in growth profile over the next 2-3 years.
- **We maintain our price target of Rs725/share:** Despite strong fundamentals, we expect the share price to remain range-bound for the next 9-12 months as valuations remain expensive compared to peers and even to the large players. We would wait for earnings to catch with share price before turning more bullish on the stock. We advise investors to enter on declines below Rs650/share.

Reuters: MINT.BO; Bloomberg: MTCL IN  
Rs in millions, year-end March

	FY06A	FY07A	FY08E	FY09E	Rs m	FY06A	FY07A	FY08E	FY09E		
Sales	4,488	5,904	7,781	10,789	Y/E BPS (Rs)	43.9	115.3	138.0	171.1	52-Week range Rs	425.0-1,021.8
Operating Profit	544	852	1,098	1,693	ROE (%)	48.9	31.9	23.6	27.2	Shares Outstg	38Mn
EBITDA	754	1,096	1,523	2,356	ROIC (%)	37.3	41.2	30.3	31.6	Avg daily volume	2.1
Pre Tax Profit	558	896	1,296	1,869	Qtr EPS (Rs)	1Q	2Q	3Q	4Q	Avg daily value (US\$)	40 M
Net profit	542	901	1,143	1,654	Qtr EPS (Rs)	1Q	2Q	3Q	4Q	Index (Sensex)	13,934
EPS (Rs)	18.5	23.9	29.5	41.6	EPS (FY07)	5.7	6.7	5.0	6.5	Free float	15%
P/E (x)	42.2	32.7	26.4	18.7	EPS (FY08) E	6.2	7.0	8.1	8.8	Div Yld FY06 (%)	0.0%
P/Sales(x)	6.6	5.0	3.8	2.7	Local	1M	3M	12M		Exchange rate	Rs40.9/US\$1
P/BV (x)	17.8	6.8	5.7	4.6	Abs. Perf.(%)	-1.6	n.m.	n.m.		Market Cap (US\$)	719.8M
Cash	800	2,908	2,356	2,786	Rel. Perf.(%)	-8.7	n.m.	n.m.			

Source: JPMorgan estimates, Company data.

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Neutral

Rs780.00

04 May 2007  
Price Target: Rs725.00

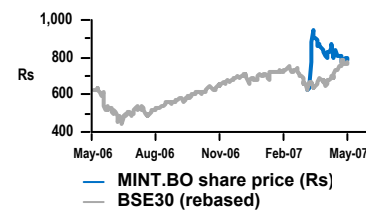
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Price Performance



	YTD	-1M	-3M	-12M
Absolute	26.3%	-1.6%	26.3%	26.3%
Relative	16.6%	-18.2%	21.3%	1.8%

Source: RIMES, Reuters.

## Strong 4Q FY07 results

Mindtree reported strong 4Q FY07 with 9% Q/Q growth in US\$ revenues. EBITDA margins improved by 200+ bp Q/Q due to scale leverage and better price realization.

Table 1: Estimate changes

Mindtree reported 4Q FY07 results ahead of expectations – revenues by 4%, EBITDA by 5% and EPS by 11%

	Actual	Expected	Change
Revenue	1,566	1,510	3.7
Gross Profit	568	565	0.5
EBIT	233	210	10.9
EBITDA	300	285	5.4
Net Other Income	14	10	39.2
Pre Tax Profit	247	220	12.2
<b>Net Profit</b>	<b>245</b>	<b>215</b>	<b>13.9</b>
EPS (Rs.)	6.5	5.8	11.4
<b>Margins (%)</b>			
Gross Margin	36.3	37.4	(1.2)
Operating Margin	14.9	13.9	1.0
EBITDA Margin	19.2	18.9	0.3
Net Margin	15.7	14.3	1.4

Source: JPMorgan estimates, Company data.

## FY08 outlook also strong, in line with our expectations

Management guided to revenues of US\$ 178-180 million, up 36% Y/Y and net profit of US\$25.1-25.2 million up 26% Y/Y. Based on an exchange rate of Rs42.25/US\$, management guided to EPS of Rs28.9-29.5. Revenue guidance is slightly ahead of our expectations; we are raising our revenue estimates to be in line with guidance. On profits, we expect that there is upside to our management guidance but have cut our estimates marginally to be inline with top end of guidance.

## Estimate changes

We are marginally increasing our FY08 revenue estimate by 2% inline with management guidance. We are leaving our EPS estimates largely unchanged. Overall, we expect 35% revenue CAGR, 36% net profit CAGR and 32% EPS CAGR over FY07-09E

Table 2: Estimate changes

	Current		Previous		Change	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Revenue	7,781	10,789	7,605	10,690	2.3	0.9
Gross Profit	2,709	3,657	2,720	3,720	-0.4	-1.7
EBIT	1,098	1,693	1,094	1,666	0.4	1.6
EBITDA	1,523	2,356	1,532	2,342	-0.6	0.6
Pre Tax Profit	1,296	1,869	1,282	1,842	1.1	1.5
<b>Net Profit</b>	<b>1,143</b>	<b>1,654</b>	<b>1,130</b>	<b>1,629</b>	<b>1.1</b>	<b>1.5</b>
EPS (Rs.)	29.5	41.6	29.8	41.9	-1.1	-0.6
<b>Margins (%)</b>						
Gross Margin	34.8	33.9	35.8	34.8	-2.7	-2.6
Operating Margin	14.1	15.7	14.4	15.6	-1.8	0.7
EBITDA Margin	19.6	21.8	20.1	21.9	-2.8	-0.3
Net Margin	14.7	15.3	14.9	15.2	-1.2	0.6

Source: JPMorgan estimates.

## Valuation – maintain price target of Rs 725/share

Our Dec-07 price target for MindTree is Rs725/share based on a combination of P/E multiples and DCF valuation.

### P/E multiples

We expect MindTree to trade at a premium to the mid-cap peer group and at multiples comparable to the Tier-2 players, such as Satyam, HCL Tech and Patni, given the strong EPS growth profile, strong metrics and high quality management. Our Mindtree target price assumes 18x one-year forward multiple on the Dec-08 EPS, in line with target price multiple assumptions for Satyam and HCL Tech. This yields a target price of Rs725/share.

### DCF valuation

Our DCF-based fair value for MindTree is Rs600/share based on a 10-year revenue CAGR of 21%, EBIT margins of 16%, ROIC of 25% and WACC of 12.3%. Our target price assumes a 20% premium to this fair value.

**Table 3: MindTree P&L**

Rs in millions, year-end March

	2007				2008E				2003	2004	2005	2006	2007	2008E	2009E
	1Q	2Q	3Q	4Q	1QE	2QE	3QE	4QE							
<b>Revenue</b>	<b>1,333</b>	<b>1,537</b>	<b>1,468</b>	<b>1,566</b>	<b>1,633</b>	<b>1,830</b>	<b>2,053</b>	<b>2,265</b>	824	1,304	2,465	4,488	5,904	7,781	10,789
<b>Gross Profit</b>	<b>524</b>	<b>541</b>	<b>517</b>	<b>568</b>	<b>569</b>	<b>636</b>	<b>716</b>	<b>788</b>	237	424	760	1,544	2,150	2,709	3,657
EBIT	227	210	182	233	213	246	300	339	(127)	(18)	143	544	852	1,098	1,693
EBITDA	273	274	249	300	289	342	416	476	(39)	50	248	754	1,096	1,523	2,356
Pre Tax Profit	236	224	188	247	267	299	347	384	(70)	22	173	558	896	1,296	1,869
<b>Net Profit</b>	<b>215</b>	<b>251</b>	<b>188</b>	<b>245</b>	<b>234</b>	<b>263</b>	<b>306</b>	<b>339</b>	(74)	26	169	542	901	1,143	1,654
EPS (Rs.)	5.7	6.7	5.0	6.5	6.2	7.0	8.1	8.8	(3.4)	1.2	7.7	18.5	23.9	29.5	41.6
<b>Margins (%)</b>															
Gross Margin	39.3	35.2	35.2	36.3	34.9	34.8	34.9	34.8	28.8	32.5	30.8	34.4	36.4	34.8	33.9
Operating Margin	17.0	13.7	12.4	14.9	13.1	13.5	14.6	15.0	-15.4	-1.4	5.8	12.1	14.4	14.1	15.7
EBITDA Margin	20.5	17.8	17.0	19.2	17.7	18.7	20.3	21.0	-4.7	3.9	10.0	16.8	18.6	19.6	21.8
Net Margin	16.2	16.3	12.8	15.7	14.4	14.4	14.9	15.0	-9.0	2.0	6.8	12.1	15.3	14.7	15.3
<b>Sequential Growth (%)</b>															
Revenue	5.1	15.3	(4.5)	6.6	4.3	12.1	12.2	10.3	14.1	58.4	89.0	82.1	31.5	31.8	38.7
Gross Profit	5.7	3.3	(4.5)	9.8	0.3	11.7	12.6	9.9	44.2	79.2	79.0	103.2	39.3	26.0	35.0
EBIT	(5.2)	(7.5)	(13.3)	28.2	(8.5)	15.4	21.7	13.2	(47.8)	(86.0)	(902.0)	281.1	56.5	28.9	54.1
EBITDA	(13.8)	0.2	(9.1)	20.6	(3.8)	18.5	21.6	14.5	(76.2)	(229.8)	392.5	204.4	45.4	38.9	54.7
EPS	(35.9)	16.6	(25.0)	30.3	(4.5)	12.1	16.5	7.9	n.m.	n.m.	553.3	138.8	29.2	23.6	41.1

Source: JPMorgan estimates, Company data.

## MindTree Consulting: Summary of financials

Rs in millions, year-end December

Income statement						Ratio Analysis					
	FY05A	FY06A	FY07A	FY08E	FY09E	%	FY05A	FY06A	FY07A	FY08E	FY09E
Revenues	2,465	4,488	5,904	7,781	10,789	Gross Margin	30.8	34.4	36.4	34.8	33.9
Cost of Goods Sold	1,705	2,944	3,753	5,071	7,131	EBITDA margin	10.0	16.8	18.6	19.6	21.8
Gross Profit	760	1,544	2,150	2,709	3,657	Operating Margin	5.8	12.1	14.4	14.1	15.7
						Net Margin	6.8	12.1	15.3	14.7	15.3
SG&A	617	999	1,298	1,611	1,965						
Operating Profit (EBIT)	143	544	852	1,098	1,693	SG&A/Sales	25.0	22.3	22.0	20.7	18.2
EBITDA	248	754	1,096	1,523	2,356						
Interest Income	50.7	65.7	73.6	250.5	229.1	Sales growth	89.0	82.1	31.5	31.8	38.7
Interest Expense	-20.9	-52.6	-30.0	-52.8	-52.8	Operating Profit Growth	-902.0	281.1	56.5	28.9	54.1
Investment Income (Exp.)	0.0	0.0	0.0	0.0	0.0	Net profit growth	558.4	221.2	66.1	26.9	44.8
Non-Operating Income (Exp.)	0.0	0.0	0.0	0.0	0.0	EPS (Reported) growth	553.3	138.8	29.2	23.6	41.1
Earnings before tax	173	558	896	1,296	1,869						
Tax	-4	-15	5	-154	-215	Interest coverage (x)	6.8	10.3	28.4	20.8	32.1
Net Income (Reported)	169	542	901	1,143	1,654	Net debt to total capital	n.m.	n.m.	n.m.	n.m.	n.m.
Net Income (Adjusted)	169	542	901	1,143	1,654	Net debt to equity	n.m.	n.m.	n.m.	n.m.	n.m.
INR											
EPS (Reported)	7.7	18.5	23.9	29.5	41.6	Asset Turnover	125.1	157.8	104.4	110.7	121.5
EPS (Adjusted)	7.7	18.5	23.9	29.5	41.6						
BPS	42.6	43.9	115.3	138.0	171.1	ROE	20.0	48.9	31.9	23.6	27.2
DPS	-	-	2.0	3.5	4.5	ROIC	17.1	37.3	41.2	30.3	31.6
Shares Outstanding (bn)	21.8	29.4	37.8	38.8	39.8	ROCE	12.0	29.9	25.3	19.2	23.6
Balance sheet						Cash flow statement					
	FY05A	FY06A	FY07A	FY08E	FY09E		FY05A	FY06A	FY07A	FY08E	FY09E
Cash and cash equivalents	608	800	2,908	2,356	2,786	Net Income	169	542	901	1,143	1,654
Accounts receivable	598	1,098	1,172	1,695	2,212	Depr. & Amortisation	105	209	244	425	664
Deferred tax	402	558	830	1,201	1,567	Change in working capital	-133	-417	-226	-515	-488
Others	0	0	0	0	0	Other	0	0	0	0	0
Current assets	1,608	2,456	4,910	5,252	6,565	Cash flow from operations	141	335	919	1,052	1,829
LT investments	0	0	0	0	0	Capex	-293	-262	-555	-1,500	-1,200
Net fixed assets	336	389	699	1,775	2,311	Disposal/ (purchase)	-27	27	-46	47	0
Others	27	0	46	0	0	Cash flow from investing	-320	-235	-602	-1,453	-1,200
Total assets	1,971	2,844	5,656	7,027	8,876	Free cash flow	-152	73	364	-448	629
Liabilities						Equity raised/ (repaid)	3	-184	2,245	2	2
Provisions	0	0	0	0	0	Debt raised/ (repaid)	258	242	-478	0	0
Payables	502	741	862	1,240	1,636	Other	26	34	103	0	0
Others	0	0	0	0	0	Dividends paid	0	0	-79	-153	-202
Total current liabilities	502	741	862	1,240	1,636	Cash flow from financing	287	91	1,791	-151	-200
Long term debt	500	742	264	264	264						
Other liabilities	39	73	176	176	176	Net change in cash	108	191	2,109	-552	430
Total liabilities	1,041	1,556	1,301	1,680	2,075	Beginning cash	501	608	800	2,908	2,356
Shareholders' equity	930	1,288	4,355	5,346	6,801	Ending cash	608	800	2,908	2,356	2,786

Source: Company data, JPMorgan estimates.

# Mphasis BFL

Decent 4Q FY07

- **Decent 4Q FY07:** Mphasis reported a decent 4Q FY07 with 10% Q/Q revenue growth. While IT services grew 5% Q/Q, BPO grew 24% Q/Q driven by the ramp-up for EDS internal work. Further, BPO margins saw strong improvement led by a higher proportion of non-voice work and a turnaround in domestic BPO. Overall, net profit grew 27% Q/Q, ahead of our expectations.
- **Combined entity performance disappoints:** Management indicated that EDS India had revenues of Rs5,700MM (up 76% Y/Y) and net profit of Rs590MM (up 40% Y/Y). EDS India net margins fell from ~13% in FY06 to 10% in FY07. Combined with Mphasis BFL, the consolidated entity grew revenues by 40% Y/Y in FY07 but net profit declined 7% Y/Y.
- **Revenue story on track, but margins might be lower than expected:** We continue to expect good revenue growth for the consolidated entity as EDS outsources significant work to India. This was evinced by management guidance of a 8,000-10,000 people addition in FY08 for the consolidated entity. However, we believe that EBIT margins will remain below market estimates as management invests in sales and recruitment engine, training facilities and building new capabilities.
- **Estimates unchanged; we remain negative:** We still expect 32% revenue CAGR and 39% net profit CAGR over FY07-09E for the combined entity. With the stock trading at FY08E P/E of 26x, ahead of even the top-tier Indian IT players, we believe that it is expensive, and we remain uncomfortable on valuations. We expect share price underperformance as margin expectations on Mphasis BFL get downgraded over the coming 9-12 months.

Reuters: [MBFL.BO](#), Bloomberg: [MPHL IN](#)

Rs in millions, year-end March

	FY06	FY07	FY08E	FY09E	Rsmn	FY06	FY07	FY08E	FY09E		
Sales	9,401	11,958	22,474	30,737	Y/E BPS (Rs)	41.0	45.9	61.6	73.1	52-Week range	Rs121.0-332.8
Operating Profit	1,442	1,403	2,989	4,025	ROE (%)	23.0	17.0	25.7	24.7	Shares Outstg	164mn
EBITDA	1,886	1,953	4,193	5,699	ROIC (%)	22.4	17.6	25.2	24.3	Avg daily volume	0.32 mn
Pre Tax Profit	1,536	1,335	3,053	4,097		1Q	2Q	3Q	4Q	Avg daily value (US\$ M)	2.12 mn
Net profit	1,499	1,199	2,610	3,462	EPS (FY07)	0.9	1.4	2.2	2.8	Index (Sensex)	13,934
EPS (Rs)	9.4	7.4	12.5	16.6	EPS (FY08) E	2.8	2.8	3.3	3.6	Free float	33%
P/E (x)	35.0	44.6	26.2	19.7	EPS (FY09) E	3.4	3.9	4.5	4.8	Dividend Yld (%)	0.9%
EV/EBITDA (x)	28.2	27.2	12.7	9.3	Sh. Perf	1M	3M	12M		Exchange rate	Rs40.9/US\$
P/BV (x)	8.0	7.2	5.3	4.5	Abs. Perf.(%)	21.1	8.5	61.8		Market Cap	US\$1.3B
Cash	989	1,228	702	1,227	Rel. Perf.(%)	12.4	9.9	38.4			

Source: Company data, Bloomberg, JPMorgan estimates.

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Underweight

Rs329.05

04 May 2007  
Price Target: Rs205.00

India

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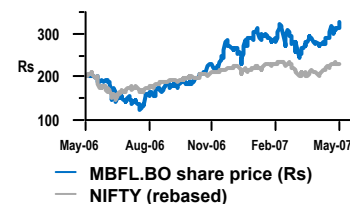
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Price Performance



	YTD	-1M	-3M	-12M
Absolute	8.2%	21.1%	8.5%	61.8%
Relative	3.5%	8.6%	9.3%	47.6%

Source: RIMES, Reuters.

## Decent 4Q FY07

Table 4: 4Q FY07 Actual and estimates

Rs in millions, year-end March

	Expected	Reported	Difference (%)
Revenue	3,355	3,373	0.5
Gross Profit	1,056	1,049	(0.7)
EBIT	415	483	16.6
EBITDA	562	629	11.8
Pre Tax Profit	428	478	11.7
Net Profit	376	456	21.1
EPS (Rs)	2.3	2.8	19.8
<b>Margins (%)</b>			
Gross margin	31.5	31.1	
EBIT margin	12.4	14.3	
EBITDA margin	16.8	18.6	

Source: Company data, JPMorgan estimates.

Revenues grew 10% Q/Q driven by strong traction in BPO

EBITDA margins were flat Q/Q and ahead of our expectations. BPO margins improved Q/Q due to increase in non voice revenues leading to the upside surprise

EPS came in 20% ahead of our expectations due to lower tax provisions

Table 5: Mphasis 4Q FY07 performance

Rs in millions, year-end March

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
<b>Total revenues</b>	<b>2,197</b>	<b>2,274</b>	<b>2,424</b>	<b>2,505</b>	<b>2,607</b>	<b>2,919</b>	<b>3,060</b>	<b>3,373</b>
IT Services	1,479	1,561	1,657	1,724	1,828	2,057	2,185	2,291
BPO	718	713	768	781	779	862	874	1,081
<b>Q/Q growth (%)</b>								
IT Services	13.1%	5.5%	6.1%	4.1%	6.0%	12.6%	6.2%	4.8%
BPO	-3.3%	-0.6%	7.6%	1.7%	-0.2%	10.6%	1.4%	23.7%
<b>Gross profit</b>	<b>628.7</b>	<b>730.7</b>	<b>777.6</b>	<b>765.0</b>	<b>620.2</b>	<b>848.9</b>	<b>936.1</b>	<b>1,048.6</b>
IT Services	463.6	551.1	593.4	597.5	489.3	652.7	721.3	748.2
BPO	165.1	179.6	184.2	167.5	130.9	196.2	214.8	300.4
<b>Gross margin (%)</b>								
IT Services	28.6	32.1	32.1	30.5	23.8	29.1	30.6	31.1
BPO	23.0	25.2	24.0	21.5	16.8	22.8	24.6	27.8
<b>EBIT</b>	<b>273.5</b>	<b>372.5</b>	<b>423.9</b>	<b>372.5</b>	<b>164.6</b>	<b>328.3</b>	<b>427.1</b>	<b>483.4</b>
EBIT margin (%)	12.4	16.4	17.5	14.9	6.3	11.2	14.0	14.3
Net profit	337.0	401.6	408.4	351.6	151.6	233.9	357.7	455.6
Net margin (%)	15.3	17.7	16.8	14.0	5.8	8.0	11.7	13.5

Source: Company data, JPMorgan.

Mphasis saw strong headcount addition in IT services of 805 people and 1003 people in BPO

Table 6: Headcount addition

IT Services	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
Manpower	2854	2971	3467	3533	3670	3966	4389	5194
Net addition	113	117	496	66	137	296	423	805
<b>BPO</b>								
Manpower	5319	6541	7404	7881	7,564	8,447	8482	9485
Net addition	-315	1222	863	477	-317	883	35	1003

Source: Company data.

## Outlook – revenue growth looks good, margins still suspect

EDS contributed US\$ 9 million of revenues in 4Q FY07, ~12% of revenues. Management expects strong ramp-up in this business going forward as EDS continues to outsource work to India. Further, EDS continues to outsource to its captive entity that had FY07 revenues of Rs5,700 million, up 76% Y/Y, and net profit of Rs 590 million, up 40% Y/Y. Management indicated an addition of 8,000-10,000 people during CY07 for the combined entity of Mphasis and EDS due to the incremental work from EDS from the current level of ~22,000 people.



However, margins still remain suspect. Mphasis BFL saw sharp erosion in margins in FY07 like EDS India Captive business (margins fell from ~13% in FY06 to ~10% in FY07). Further, management plans to invest in building its recruitment engine, training facilities, new capabilities, wider service portfolio, and higher strategic bench. However, management expects to still increase margins in FY08 due to higher price realization and operating efficiencies. We remain skeptical about the margin targets given the salary hikes and Rupee appreciation in addition to the investments being made by the company.

## Estimate changes

We are not making significant changes to our estimates and expect revenues of combined entity (Mphasis+ EDS India) to grow 27% Y/Y in FY08 with net profit up 46% Y/Y.

**We are leaving our FY08 and FY09 estimates largely unchanged**

**Table 7: Mphasis BFL estimate changes**

Rs in millions, year-end March

			New		Old		Change (%)		
	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09
Revenue	11,958	22,474	30,737	11,940	22,091	30,543	0.1	1.7	0.6
Gross Profit	3,454	6,952	9,284	3,461	6,725	9,086	(0.2)	3.4	2.2
EBIT	1,403	2,989	4,025	1,335	2,988	4,106	5.1	0.0	(2.0)
EBITDA	1,953	4,193	5,699	1,887	4,145	5,716	3.5	1.2	(0.3)
Pre Tax Profit	1,335	3,053	4,097	1,285	3,033	4,158	3.9	0.6	(1.4)
Net Profit	1,199	2,610	3,462	1,119	2,593	3,513	7.1	0.6	(1.4)
EPS (Rs)	7.4	12.5	16.6	6.9	12.6	17.0	6.7	(0.2)	(2.2)
<b>Margins (%)</b>									
Gross margin	28.9	30.9	30.2	29.0	30.4	29.7			
EBIT margin	11.7	13.3	13.1	11.2	13.5	13.4			
EBITDA margin	16.3	18.7	18.5	15.8	18.8	18.7			
Net margin	10.0	11.6	11.3	9.4	11.7	11.5			

Source: JPMorgan estimates, Company data.

**Our Dec-07 target price of Rs 205/share is in-line with EDS' open offer price**

## Valuation – our target price remains Rs 205/share

Our DCF-based Dec-07 price target remains Rs 205/share. Our long-term assumptions include 10-year revenue growth assumption of 23%, long-term EBIT margins of 13%, long-term ROIC of 21% and cost of capital of 12%.

**Risks to our target price:** Potential buyout of minority shareholders by EDS and higher-than-expected margins on EDS business remain the key risks to our target price.



**Table 8: Mphasis P&L**

Rs in millions, year-end December

	2007				2008E				2003	2004	2005	2006	2007	2008E	2009E
	1Q	2Q	3Q	4Q	1QE	2QE	3QE	4QE							
<b>Revenue</b>	<b>2,607</b>	<b>2,919</b>	<b>3,060</b>	<b>3,373</b>	<b>5,117</b>	<b>5,320</b>	<b>5,784</b>	<b>6,254</b>	<b>4,293</b>	<b>5,806</b>	<b>7,657</b>	<b>9,401</b>	<b>11,958</b>	<b>22,474</b>	<b>30,737</b>
<b>Gross Profit</b>	<b>620</b>	<b>849</b>	<b>936</b>	<b>1,049</b>	<b>1,574</b>	<b>1,613</b>	<b>1,813</b>	<b>1,953</b>	<b>1,585</b>	<b>1,759</b>	<b>2,366</b>	<b>2,902</b>	<b>3,454</b>	<b>6,952</b>	<b>9,284</b>
EBIT	165	328	427	483	670	677	793	849	753	869	1,016	1,442	1,403	2,989	4,025
EBITDA	293	463	568	629	933	963	1,107	1,190	898	1,115	1,353	1,886	1,953	4,193	5,699
Net Other Income	42	(56)	(50)	(6)	15	13	17	18	34	185	113	94	(69)	64	72
Pre Tax Profit	207	273	378	478	685	690	810	867	787	1,055	1,129	1,536	1,335	3,053	4,097
<b>Net Profit</b>	<b>152</b>	<b>234</b>	<b>358</b>	<b>456</b>	<b>586</b>	<b>590</b>	<b>693</b>	<b>742</b>	<b>669</b>	<b>986</b>	<b>1,246</b>	<b>1,499</b>	<b>1,199</b>	<b>2,610</b>	<b>3,462</b>
EPS (Rs)	0.9	1.4	2.2	2.8	2.8	2.8	3.3	3.6	4.9	7.0	8.2	9.4	7.4	12.5	16.6
<b>Margins (%)</b>															
Gross Margin	23.8	29.1	30.6	31.1	30.8	30.3	31.3	31.2	36.9	30.3	30.9	30.9	28.9	30.9	30.2
Operating Margin	6.3	11.2	14.0	14.3	13.1	12.7	13.7	13.6	17.5	15.0	13.3	15.3	11.7	13.3	13.1
EBITDA Margin	11.2	15.9	18.6	18.6	18.2	18.1	19.1	19.0	20.9	19.2	17.7	20.1	16.3	18.7	18.5
Net Margin	5.8	8.0	11.7	13.5	11.4	11.1	12.0	11.9	15.6	17.0	16.3	15.9	10.0	11.6	11.3
<b>Sequential Growth (%)</b>															
Revenue	4.1	12.0	4.8	10.2	51.7	4.0	8.7	8.1	37.0	35.2	31.9	22.8	27.2	87.9	36.8
EBIT	(55.8)	99.4	30.1	13.2	38.5	1.1	17.2	7.0	119.0	15.4	17.0	41.9	(2.7)	113.0	34.7
EBITDA	(40.5)	58.1	22.7	10.6	48.4	3.2	15.0	7.6	92.5	24.1	21.3	39.4	3.6	114.6	35.9
Net Profit	(56.9)	54.2	52.9	27.4	28.5	0.8	17.4	7.0	63.8	47.3	26.4	20.2	(20.0)	117.7	32.7
EPS	(57.0)	53.8	52.6	26.1	1.3	0.8	17.4	7.0	63.2	44.2	17.1	14.1	(21.5)	70.4	32.7

Source: Company data, JPMorgan estimates.

## Mphasis-BFL: Summary of financials

Rs in millions, year-end March

Income statement						Ratio Analysis					
	FY05A	FY06A	FY07A	FY08E	FY09E	%	FY05A	FY06A	FY07A	FY08E	FY09E
Revenues	7,657	9,401	11,958	22,474	30,737	Gross Margin	30.9	30.9	28.9	30.9	30.2
Cost of Goods Sold	5,290	6,499	8,504	15,522	21,453	EBITDA margin	22.1	24.8	20.9	24.0	24.0
Gross Profit	2,366	2,902	3,454	6,952	9,284	Operating Margin	17.7	20.1	16.3	18.7	18.5
SG&A Expenses	1,350	1,460	2,050	3,964	5,259	Net Margin	16.3	15.9	10.0	11.6	11.3
Operating Profit (EBIT)	1,353	1,886	1,953	4,193	5,699	SG&A/Sales	17.6	15.5	17.1	17.6	17.1
EBITDA	1689	2329	2503	5397	7373						
Interest Income	40.9	17.5	57.2	64.0	72.3	Sales growth	31.9	22.8	27.2	87.9	36.8
Investment Income (Exp.)	68.3	85.2	-125.0	0.0	0.0	Operating Profit Growth	17.0	41.9	-2.7	113.0	34.7
Non-Operating Income (Exp.)	3.6	-8.7	-1.0	0.0	0.0	Net profit growth	26.4	20.2	-20.0	117.7	32.7
Earnings before tax	1,129	1,536	1,335	3,053	4,097	EPS (Reported) growth	17.1	14.1	-21.5	70.4	32.7
Tax	117	-38	-136	-443	-635	Interest coverage (x)	n.m.	n.m.	n.m.	n.m.	n.m.
Net Income (Reported)	1246	1499	1199	2610	3462	Net debt to total capital	n.m.	n.m.	n.m.	n.m.	n.m.
Net Income (Adjusted)	1246	1499	1199	2610	3462	Net debt to equity	n.m.	n.m.	n.m.	n.m.	n.m.
INR											
EPS (Reported)	8.2	9.4	7.4	12.5	16.6	Asset Turnover	90.8	116.8	128.0	143.6	160.8
BPS	40.7	41.0	45.9	61.6	73.1	ROE	25.2	23.0	17.0	25.7	24.7
DPS	2.2	3.0	3.0	4.0	4.5	ROIC	24.9	22.4	17.6	25.2	24.3
Shares Outstanding (bn)	157	161	164	208	208	ROCE	22.7	22.0	17.5	25.2	24.3
Balance sheet						Cash flow statement					
	FY05A	FY06A	FY07A	FY08E	FY09E		FY05A	FY06A	FY07A	FY08E	FY09E
Cash and cash equivalents	955	989	1,228	702	1,227	Net Income	1,246	1,499	1,199	2,610	3,462
Accounts receivable	1,835	2,050	2,657	5,483	6,637	Depr. & Amortisation	336	443	550	1,204	1,674
Loans and advances	806	711	1,055	1,048	1,128	Change in working capital	797	-706	-577	-1,807	-163
Others	2	2	6	3	3	Other	0	0	0	0	0
Current assets	3,597	3,752	4,946	7,237	8,996	Cash flow from operations	2,379	1,236	1,172	2,007	4,974
LT investments	150	167	119	119	119	Capex	-487	-701	-659	-5,254	-
Net fixed assets	1,198	1,455	1,564	5,614	7,322	Disposal/ (purchase)	-3,554	799	13	35	0
Others	3,492	2,676	2,710	2,676	2,676	Cash flow from investing	-4,041	98	-646	-5,219	-
Total assets	8,437	8,050	9,339	15,646	19,113	Free cash flow	1,892	535	513	-3,247	1,592
Liabilities						Equity raised/ (repaid)	1,632	-804	214	3,518	-131
ST loans	-	-	-	-	-	Debt raised/ (repaid)	19	-9	-8	1	0
Payables	-	-	-	-	-	Other	0	0	0	0	0
Others	1,992	1,407	1,785	2,795	3,867	Dividends paid	-361	-487	-492	-832	-936
Total current liabilities	1,992	1,407	1,785	2,795	3,867	Cash flow from financing	1,291	-1,300	-287	2,687	-
Long term debt	46	37	28	29	29						1,067
Other liabilities	-	-	-	-	-	Net change in cash	-371	34	239	-525	524
Total liabilities	2,039	1,444	1,813	2,824	3,896	Beginning cash	1,326	955	989	1,228	702
Shareholders' equity	6,398	6,606	7,526	12,822	15,217	Ending cash	955	989	1,228	702	1,227

Source: Company data, JPMorgan estimates.

# Canara Bank

## 4Q07: Continued Margin Pressure - ALERT

- Canara Bank reported net profit of Rs 5,051 mn - implying a 2.3% yoy growth. For FY07, net profit growth was sluggish at 5.8% as against healthy increase of 22% and 24% yoy in deposits and advances respectively
- The stock reacted by closing 4% higher as 4Q profits were ahead of street expectations. However, it was due to significantly higher non-interest Income and lower than expected operating cost
- Canara bank is facing continued margin pressure which is clearly reflected in 7.7% yoy increase in NII during 4Q, despite 25% yoy growth in total assets. NIM declined by 21 bps to 3.15% for FY07
- Non-interest revenues jumped 58.2% yoy IN 4Q primarily because of a 3 fold increase in miscellaneous and other income. While there was Rs. 528 mn in 4Q07 write-back on account of inter-branch balance, there seems to be other one-offs too - details of which are awaited. CEB revenue was higher by 20% yoy in 4Q
- Operating cost in 4Q was stagnant (up 1% yoy) and Cost-Income ratio at 37.6% in 4Q (as against 47.9% in FY07), was below average levels leading to 34% yoy growth in core operating profits
- Provisions (excluding tax) too jumped substantially by 66.1% in 4Q. Reasons being low base effect (as there was a substantial write-back in 4Q06) and significant increase in provisions for standard assets (due to change in general provisioning guidelines of RBI). Effective tax rate for 4Q07 was only 9% (and for FY07 it is 15%)
- Loan loss provision charge was lower at 46 bps in 4Q. Net NPLs were higher in absolute terms by 5.4% and coverage ratio declined to 38% in FY07, compared to 51% last year
- The stock currently trades at 1.14x FY07 book, we maintain our neutral rating given continued margin pressure and low coverage ratio.

Neutral

**Rs222.65**

04 May 2007

### Banks

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Table 9: Canara Bank: 4Q FY07 Summary

INCOME STATEMENT (Rs. Mn)	Q4FY07	YoY (%)	QoQ (%)	FY07	YoY (%)
Interest/Discount on Advances/Bills	21,588	39.4%	13.3%	75,076	36.8%
Interest & Dividend on Investments	8,845	25.5%	3.6%	33,240	16.4%
Other Interest income	1,672	21.3%	-17.5%	5,330	44.9%
<b>Total Interest Income</b>	<b>32,105</b>	<b>34.3%</b>	<b>8.4%</b>	<b>113,646</b>	<b>30.5%</b>
Interest Expended	21,512	52.9%	11.9%	73,377	43.0%
<b>Net Interest Income (NII)</b>	<b>10,593</b>	<b>7.7%</b>	<b>2.0%</b>	<b>40,268</b>	<b>12.4%</b>
Comm./Exch./Brkrng.	1,314	19.9%	23.5%	4,749	10.2%
P/L on Sale of Invsts.	916	171.4%	202.0%	1,341	20.1%
P/L on Exchange Transactions	606	76.9%	28.5%	1,731	11.8%
Amortisation of Premium (HTM)	-148	-15.5%	-2.9%	-609	-1.8%
Recovery from W/O Assets	808	-45.8%	169.2%	2,008	-45.9%
Misc. & Other Income	2,767	218.5%	224.0%	5,290	71.0%
<b>Total Non-Interest revenue</b>	<b>6,262</b>	<b>58.2%</b>	<b>120.5%</b>	<b>14,510</b>	<b>10.3%</b>
<b>Total Income</b>	<b>16,855</b>	<b>22.2%</b>	<b>27.4%</b>	<b>54,778</b>	<b>11.9%</b>
<b>Core Operating Income</b>	<b>15,940</b>	<b>18.4%</b>	<b>23.3%</b>	<b>53,437</b>	<b>11.7%</b>
Employee Cost	3,731	-3.8%	-7.0%	16,093	6.2%
Other Operating Costs	2,603	8.8%	10.5%	9,560	14.9%
<b>Total Operating Costs</b>	<b>6,334</b>	<b>1.0%</b>	<b>-0.5%</b>	<b>25,653</b>	<b>9.3%</b>
<b>Pre-provisioning Profits</b>	<b>10,521</b>	<b>39.8%</b>	<b>53.4%</b>	<b>29,125</b>	<b>14.2%</b>
<b>Core Operating Profits</b>	<b>9,606</b>	<b>33.6%</b>	<b>46.6%</b>	<b>27,784</b>	<b>13.9%</b>
Prov. for NPAs	1,018	-66.8%	103.2%	4,580	-27.9%
Prov. for Standard Assets	1,480	886.7%	448.1%	2,000	35.1%
Prov. for Investments	2,401	79.3%	42.4%	5,745	86.2%
Other Provisions	72	-104.6%	259.5%	92	-110.8%
<b>Total Provisions</b>	<b>4,970</b>	<b>66.1%</b>	<b>100.6%</b>	<b>12,417</b>	<b>23.3%</b>
<b>Profit before Tax</b>	<b>5,551</b>	<b>22.4%</b>	<b>26.7%</b>	<b>16,708</b>	<b>8.3%</b>
Tax	500	-225.0%	-33.3%	2,500	25.0%
<b>Profit after Tax</b>	<b>5,051</b>	<b>2.3%</b>	<b>39.1%</b>	<b>14,208</b>	<b>5.8%</b>
<b>BALANCE SHEET (Rs. Bn)</b>					
Deposits	1,423.81	21.9%	8.0%		
Advances	985.06	24.0%	8.6%		
Investments	452.26	22.3%	2.4%		
Total Assets	1,659.61	25.0%	8.2%		
<b>RATIOS</b>					
CASA / Domestic Deposits	31.5%	-1.77%	-0.24%		
Loan / Deposit	69.2%	1.18%	0.34%		
NIM	na	na	na	3.15%	-0.21%
Non IR / Total Income	37.2%	8.45%	15.68%	26.5%	-0.38%
Cost / Income	37.6%	-7.86%	-10.57%	46.8%	-1.10%
ROAA (Annualised)	1.40%	-0.26%	0.45%	0.98%	-0.15%
<b>ASSETS QUALITY</b>					
Gross NPL (Rs. Mn)	14,934	-16.7%	-20.3%		
Net NPL (Rs. Mn)	9,270	5.4%	6.8%		
Gross NPL Ratio	1.51%	-0.74%	-0.55%		
Net NPL Ratio	0.94%	-0.18%	-0.02%		
Coverage ratio	37.93%	-13.03%	-15.76%		
LLP / Avg Loans (Annualised)	0.46%	-1.29%	0.21%	0.51%	-0.39%
<b>ADEQUACY</b>					
Tier I	7.17%	-0.64%	-0.53%		
Tier II	6.33%	2.92%	1.34%		
CAR	13.50%	2.28%	0.81%		
Effective Tax Rate (%)	9.01%	17.83%	-8.11%	15.0%	2.00%

Source: JPMorgan estimates, Company data

## Development Credit Bank

4Q07:One off Provisions depress bottomline - ALERT

- DCB reported 4Q07 net loss of Rs 4.1 mn - as against modest profit expectations. Additional charge of Rs 70 mn on account of higher standard asset provisioning impacted the bottomline.
- DCB Board approved equity issuance of Rs 2.75 bn to sustain strong balance sheet growth. The bank expects to complete this equity issue by July.
- Robust balance sheet growth (deposits up 20% qoq, loans up 24%qoq) coupled with stable sequential margins ensured that net interest income grew at a healthy 22% qoq, in line with our estimates. Operating profits at Rs 148 mn (up 10% qoq) also met our expectations.
- Provisions almost doubled sequentially to Rs 214 mn .About Rs 70 mn was due to one time catch up impact of RBI's requirement for additional standard provisioning on certain categories of loans.
- Gross NPL ratio declined 750 bps sequentially to 5.14 % on account of write offs against provisions.Net NPL ratio also reduced to 1.64% implying improvement in asset quality levels.
- There are several one – off items in the P&L for which we await management clarification.

**Overweight**

**Rs74.45**

04 May 2007

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Table 10: DCB: 4Q07 Summary

INCOME STATEMENT (Rs mn)	4Q07A	QoQ
<b>Net Interest Income</b>	<b>384</b>	<b>22%</b>
Other Income	269	-18%
<b>Total Income</b>	<b>653</b>	<b>2%</b>
Operating Expenses	506	-0.4%
<b>Operating Profits</b>	<b>148</b>	<b>10%</b>
Provisions	214	100%
<b>Pre Tax Profits</b>	<b>-67</b>	<b>NM</b>
Tax	63	NM
<b>Net Profit</b>	<b>-4</b>	<b>NM</b>
<b>BALANCE SHEET(Rs mn)</b>		
Deposits	44,150	20%
Loans	26,855	24%
Investments	18,466	37%
Total Assets	52,624	18%
<b>RATIOS</b>		
Non-Int Inc/Tot Inc	41.1%	-9.7%
Cost Income Ratio	77.4%	-1.6%
NIM (FY 07)	2.69%	
<b>Asset Quality</b>		
Gross NPLs (Rs mn)	1,462	-52%
Gross NPL Ratio	5.1%	-7.5%
Net NPLs (Rs mn)	436	-27%
Net NPL ratio	1.64%	-1.1%
Coverage Ratio	70.2%	-6.8%

Source: JPMorgan estimates, Company data

# Hindalco Industries

Fasten Your Seatbelts for a Challenging FY08 - ALERT

Neutral

**Rs148.15**

04 May 2007

India Metals & Mining

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- 4QFY07 results – ahead of expectations-** Hindalco's 4QFY07 earnings rose 26% yoy to Rs7.86bn - significantly ahead of our expectations and consensus. Surprise attributed to a 66% qoq increase in other income and a near 500bps reduction in effective tax rate. FY07 earnings rose 59% yoy to Rs26.28 - 7% ahead of our expectations.
- Robust performance in aluminum business –** With near record LME aluminum prices, company was able to offset the sharp raw material price hikes (CPC, coal tar pitch and bauxite) enabling it to expand EBIT margins in FY07 by 470bps to 39.9%. Aluminum business ROCE expanded to impressive 41.8% from 35.2% in FY06. Copper business also recovered sharply in FY07 after a poor performance in FY06 (which saw the combined impact of unanticipated shutdowns at a time of LME copper being in large backwardation). FY07 copper business EBIT margin was 4.7% and RoCE was 10.3%.
- FY08 will be a challenging year –** We expect FY08 to be a challenging year for Hindalco and yoy comparisons will not look good, particularly considering that FY07 was a year of record earnings. We see two key challenges confronting the company - Sharp appreciation of Indian rupee (since April exchange rate has averaged Rs42.1/US\$ versus average rate of Rs45.25 in FY07 - implying an appreciation of 7% till date) and a near 47% yoy reduction in copper TC/RC charges.
- We expect company to respond to the above mentioned headwinds with three key initiatives -** Increasing aluminum volume at Hirakud where captive cost of power is 33% lower than cost at its flagship Renukoot plant, higher copper production and a conscious attempt to reduce copper smelting costs (we estimate that these can be brought down by 20-25% in FY08).
- Novelis acquisition impact cost –** We expect Hindalco to take control of Novelis in May07. With no major yoy change in macro environment in downstream sector and continuance of fixed price contracts in can stock, the acquisition impact costs could make yoy EPS comparisons unfavorable in FY08. We reiterate Neutral.

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**Table 11: Hindalco Quarterly and Annual Financials**

Rs mn, %

	Q4 FY 06	Q4 FY 07	% change Y/Y	% change Q/Q	FY06	FY 07	% change Y/Y
<b>Net sales</b>	<b>36,574</b>	<b>47,489</b>	<b>30%</b>	<b>2%</b>	<b>113,965</b>	<b>183,130</b>	<b>61%</b>
(Inc) Dec in Stocks	-4,858	3,612	-174%	-54%	-10,338	-4,425	-57%
Raw Materials	23,590	23,386	-1%	18%	66,034	110,783	68%
Employee Costs	1,230	1,465	19%	15%	4,627	5,196	12%
Manufacturing Costs	6,217	4,297	-31%	-28%	23,223	23,134	0%
Other Expenditure	1,097	3,580	226%	182%	4,368	7,642	75%
Total Expenditure	27,276	36,340	33%	1%	87,914	142,330	62%
<b>EBITDA</b>	<b>9,298</b>	<b>11,149</b>	<b>20%</b>	<b>7%</b>	<b>26,051</b>	<b>40,800</b>	<b>57%</b>
Interest	624	577	-8%	-17%	2,252	2,424	8%
Depreciation	1,443	1,576	9%	14%	5,211	6,381	22%
Other Income	743	1,233	66%	111%	2,439	3,701	52%
Profit before tax	7,974	10,229	28%	14%	21,027	35,696	70%
Tax	1,711	2,366	91%	-22%	4,502	9,408	197%
<b>Profit after tax</b>	<b>6,263</b>	<b>7,863</b>	<b>26%</b>	<b>22%</b>	<b>16,525</b>	<b>26,288</b>	<b>59%</b>
Extraordinary items		-650			30	-650	
Reported Profit after tax	6,263	7,213	15%	12%	16,555	25,638	55%
EBITDA Margin	25%	23%			23%	22%	
EBIT Margin	21%	20%			18%	19%	

Source: Company reports and JPMorgan estimates.

## i-flex Solutions

Muted 4QFY07; Oracle consolidates financial services into a separate unit

- i-flex reported a muted 4QFY07 below our expectations.** Product business had a weak quarter with revenues up 1% Q/Q and EBITDA margins down 400 bps Q/Q as pressure on profitability continues in the business. Services business had a relatively strong quarter with 10% Q/Q revenue growth and margin expansion. Overall, net profit was flat Q/Q in a seasonally strong quarter disappointing compared to expectations.
- Relevance of i-flex performance reducing - new business unit at Oracle:** Oracle announced formation of a new Financial Services Global Business Unit (FSGBU) headquartered in New York. This unit will consolidate all financial services assets of Oracle and senior members of i-flex management will drive this unit. We believe that this is a move to gradually move business from i-flex to Oracle and clearly defines Oracle intention of not paying a higher offer price for remaining minority stake in i-flex.
- We have not changed our estimates our i-flex and expect 16% EPS CAGR over FY07-09E. While our Dec-07 DCF fair price is Rs 900/share, the stock will not trade on DCF fair values in our view. Our Dec-07 target price of Rs 2,100/share is based on the last open offer from Oracle and we believe that Oracle would not make any further offers at a higher price. We would not advise buying the stock at current levels.

Neutral

**Rs2,358.00**

04 May 2007  
Price Target: Rs2,100.00

India

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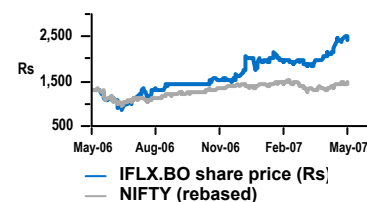
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Price Performance



	YTD	-1M	-3M	-12M
Absolute	23.4%	16.5%	21.9%	85.2%
Relative	18.7%	4.0%	22.7%	71.0%

Source: RIMES, Reuters.

Table 12: Reuters: IFLX.BO, Bloomberg: IFLEX IN

RsMillion (Year-end: Mar)	FY06	FY07	FY08E	FY09E	RsMillion	FY06	FY07	FY08E	FY09E		
Sales	14,835	20,381	23,969	27,313	Y/E BPS (Rs)	177.8	271.1	305.4	338.9	52-Week range	Rs840.0-2,545.0
Operating Profit	2,445	2,753	3,837	4,150	ROE (%)	17.6	12.3	14.6	13.6	Shares Outstg	81Mn
EBITDA	2,950	3,586	4,847	5,157	ROIC (%)	28.1	14.5	19.7	18.8	Avg daily volume	0.0Mn
Pre Tax Profit	2,726	3,111	4,421	4,908	<b>EPS (Rs)</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>	Avg daily value (US\$ M)	2.0
Net profit	2,190	2,768	3,714	3,828	<b>EPS (FY07) A</b>	5.4	9.9	9.5	9.3	Index (Sensex)	13,934
<b>EPS (Rs)</b>	28.9	34.4	44.6	46.0	<b>EPS (FY08) E</b>	10.3	10.0	11.3	13.0	Free float	57%
<b>P/E (x)</b>	81.6	68.5	52.9	51.3	<b>EPS (FY09) E</b>	12.6	10.0	13.0	10.4	Dividend Yld (%)	0.2%
Cash	6,841	7,181	10,982	13,233		<b>1M</b>	<b>3M</b>	<b>12M</b>		Exchange rate	Rs40.9/US\$1
Gross Debt	133	45	45	45	Abs. Perf.(%)	16.5	21.9	85.2		Market Cap	US\$4.6B
Equity	13,562	22,580	25,439	28,223	Rel. Perf.(%)	8.8	23.2	68.3			

Source: JPMorgan estimates, Company data.

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## 4QFY07 results above expectations

Revenues were below our expectations driven by weak products performance with sharp drop in license fees.

Net profit was 23% below expectations with lower license fees leading to lower than expected margins.

Table 13: 4QFY07: Actual vs. expected

	Actual	Expected	Difference (%)
<b>Revenue</b>	5,794	6,046	-4.2
<b>Gross Profit</b>	2,339	2,654	-11.9
EBIT	845	1,090	-22.4
EBITDA	1,093	1,327	-17.6
Pre Tax Profit	874	1,168	-25.2
Tax	97	187	
<b>Net Profit</b>	777	981	-20.9
EPS (Rs)	9.3	12.1	-23.1
<b>Margins (%)</b>			
Gross Margin	40.4	43.9	(352.1)
Operating Margin	14.6	18.0	(343.5)
EBITDA Margin	18.9	21.9	(308.4)
Net Margin	13.4	16.2	(282.8)
<b>Revenue Break up</b>			
Products	3,206	3,600	-10.9
Services	2,445	2,338	4.6
KPO	143	108	32.7

Source: Company reports and JPMorgan estimates.

Products revenues grew just 1% Q/Q despite seasonally strong quarter. Margins declined due to lower license fees contribution.

Services revenues grew 10% Q/Q with improvement in margins as company recognized certain milestone related revenues for which they had incurred cost in previous quarter.

Overall margins were largely stable Q/Q.

Table 14: Segmental results

Revenues	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
Products	1,143	1,721	2,088	2,619	2,000	2,589	3,172	3,206
Services	1,509	1,825	1,805	1,891	1,984	2,319	2,222	2,445
KPO	48	47	72	67	92	102	108	143
Total	2,701	3,593	3,965	4,577	4,075	5,009	5,502	5,794
<b>% mix</b>								
Products	42.3	47.9	52.7	57.2	49.1	51.7	57.7	55.3
Services	55.9	50.8	45.5	41.3	48.7	46.3	40.4	42.2
KPO	1.8	1.3	1.8	1.5	2.3	2.0	2.0	2.5
<b>Q/Q growth (%)</b>								
Products	(37.6)	50.6	21.3	25.4	(23.6)	29.5	22.5	1.1
Services	(5.9)	20.9	(1.1)	4.7	4.9	16.9	(4.2)	10.1
KPO	0.1	(1.8)	50.7	(5.9)	36.6	10.5	6.2	32.7
<b>EBITDA Margins (%)</b>								
Products	6.8	27.7	38.8	43.9	19.8	30.1	31.9	27.9
Services	21.0	18.9	19.7	17.3	14.7	19.9	15.4	23.8
KPO	(80.1)	(94.3)	(51.0)	(39.2)	(5.8)	(10.0)	(22.9)	(35.7)
Total	13.2	21.6	28.5	31.7	16.7	24.5	24.1	24.6

Source: Company reports.

## Estimate changes

Table 15: Estimate changes

**We are leaving our FY08 and FY09 revenue and EPS estimates largely unchanged.**

**Overall, we expect 16% revenue CAGR and 16% EPS CAGR over FY07-09E.**

Rs in millions	New			Old			Change (%)		
	FY07	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Revenue	20,381	23,969	27,313	20,633	23,847	27,204	(1.2)	0.5	0.4
Gross Profit	7,908	9,636	10,240	8,223	9,558	9,989	(3.8)	0.8	2.5
EBIT	2,753	3,837	4,150	2,997	3,836	4,154	(8.2)	0.0	(0.1)
EBITDA	3,586	4,847	5,157	3,820	4,751	5,115	(6.1)	2.0	0.8
Net Other Income	358	584	758	407	530	680	(12.2)	10.2	11.5
Pre Tax Profit	3,111	4,421	4,908	3,405	4,366	4,834	(8.6)	1.3	1.5
Net Profit	2,768	3,714	3,828	2,973	3,667	3,770	(6.9)	1.3	1.5
EPS (Rs)	34.4	44.6	46.0	37.2	45.3	46.6	(7.6)	(1.5)	(1.3)
<b>Company margins (%)</b>									
Gross margin	38.8	40.2	37.5	39.9	40.1	36.7	(1.1)	0.1	0.8
EBIT margin	13.5	16.0	15.2	14.5	16.1	15.3	(1.0)	(0.1)	(0.1)
EBITDA margin	17.6	20.2	18.9	18.5	19.9	18.8	(0.9)	0.3	0.1
Net margin	13.6	15.5	14.0	14.4	15.4	13.9	(0.8)	0.1	0.2
<b>Assumption Changes</b>									
	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>			
Product	<b>10,966</b>	<b>12,325</b>	<b>12,950</b>	<b>11,360</b>	<b>12,725</b>	<b>13,450</b>	(3.5)	(3.1)	(3.7)
Services	<b>8,970</b>	<b>11,071</b>	<b>13,790</b>	<b>8,863</b>	<b>10,691</b>	<b>13,322</b>	1.2	3.6	3.5
<b>Y/Y growth (%)</b>									
License fees	0.6	46.0	9.6	30.4	12.7	9.6			
Implementation fees	76.0	(6.3)	4.3	62.6	8.5	5.6			
Maintenance fees	51.3	24.5	0.0	56.6	20.3	-			
Total product revenues	44.8	12.4	5.1	50.1	12.0	5.7			
Services revenues	27.6	23.4	24.6	26.1	20.6	24.6			

Source: JPMorgan estimates, Company data.

## Valuation and recommendation

### Dec-07 price target of Rs 2,100

Our Dec-07 target price remains Rs 2,100/share. While our DCF fair value is significantly lower at Rs 900/share, we believe that i-flex will trade at significant premium given possibility of buyout by Oracle.

### Risks to our price target

On the upside, any further open offer from Oracle at a higher price could cause the stock to run-up. On the negative side, weak performance in the product business and departure of management team to Oracle could cause the stock to trade downwards.

### DCF valuation at Rs 900/share

Our Dec-07 DCF fair value estimate is Rs 900 based on 10-year revenue CAGR of 20%, long-term EBIT margins of 18%, weighted average cost of capital (WACC) assumption of 12.9% and long-term ROIC of 34%.

## Financials

Table 16: I-Flex P&L

(Rs in Million, year-end March)	2007				2008E				2003	2004	2005	2006	2007	2008E	2009E
	1Q	2Q	3Q	4Q	1QE	2QE	3QE	4QE							
<b>Revenue</b>	<b>4,075</b>	<b>5,009</b>	<b>5,502</b>	<b>5,794</b>	<b>5,589</b>	<b>5,737</b>	<b>5,885</b>	<b>6,758</b>	<b>6,357</b>	<b>8,053</b>	<b>11,404</b>	<b>14,835</b>	<b>20,381</b>	<b>23,969</b>	<b>27,313</b>
<b>Gross Profit</b>	<b>1,310</b>	<b>2,109</b>	<b>2,150</b>	<b>2,339</b>	<b>2,274</b>	<b>2,225</b>	<b>2,366</b>	<b>2,771</b>	<b>3,472</b>	<b>4,250</b>	<b>5,119</b>	<b>6,183</b>	<b>7,908</b>	<b>9,636</b>	<b>10,240</b>
EBIT	298	805	805	845	911	843	966	1,118	1,868	2,097	2,433	2,445	2,753	3,837	4,150
EBITDA	458	970	1,064	1,093	1,147	1,084	1,212	1,404	2,010	2,244	2,770	2,950	3,586	4,847	5,157
Pre Tax Profit	500	931	806	874	1,019	990	1,124	1,289	2,023	2,225	2,658	2,726	3,111	4,421	4,908
Tax	85	127	33	97	163	158	180	206	253	515	627	535	342	707	1,080
<b>Net Profit</b>	<b>415</b>	<b>804</b>	<b>773</b>	<b>777</b>	<b>856</b>	<b>832</b>	<b>944</b>	<b>1,083</b>	<b>1,771</b>	<b>1,710</b>	<b>2,031</b>	<b>2,190</b>	<b>2,768</b>	<b>3,714</b>	<b>3,828</b>
EPS (Rs)	5.4	9.9	9.5	9.3	10.3	10.0	11.3	13.0	23.7	22.9	27.2	28.9	34.4	44.6	46.0
<b>Margins (%)</b>															
Gross Margin	32.1	42.1	39.1	40.4	40.7	38.8	40.2	41.0	54.6	52.8	44.9	41.7	38.8	40.2	37.5
Operating Margin	7.3	16.1	14.6	14.6	16.3	14.7	16.4	16.5	29.4	26.0	21.3	16.5	13.5	16.0	15.2
EBITDA Margin	11.2	19.4	19.3	18.9	20.5	18.9	20.6	20.8	31.6	27.9	24.3	19.9	17.6	20.2	18.9
Net Margin	10.2	16.0	14.0	13.4	15.3	14.5	16.0	16.0	27.9	21.2	17.8	14.8	13.6	15.5	14.0
<b>Seq Growth (%)</b>															
Revenue	(11.0)	22.9	9.8	5.3	(3.5)	2.6	2.6	14.8	45.9	26.7	41.6	30.1	37.4	17.6	14.0
Gross Profit	(39.0)	61.0	2.0	8.8	(2.8)	(2.2)	6.3	17.1	50.5	22.4	20.4	20.8	27.9	21.8	6.3
EBIT	(74.3)	170.0	0.0	5.0	7.7	(7.4)	14.5	15.8	63.9	12.2	16.0	0.5	12.6	39.4	8.1
EBITDA	(65.1)	111.8	9.7	2.6	5.0	(5.5)	11.8	15.9	57.0	11.6	23.5	6.5	21.6	35.2	6.4
EPS	(64.5)	82.6	(3.8)	(2.3)	10.2	(2.8)	13.5	14.7	53.2	(3.5)	18.6	6.4	19.2	29.5	3.1

Source: JPMorgan estimates, Company data.

## I-Flex: Summary of Financials

Income statement						Ratio Analysis					
INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E	%, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E
Revenues	11,404	14,835	20,381	23,969	27,313	Gross Margin	44.9	41.7	38.8	40.2	37.5
Cost of Goods Sold	6,285	8,652	12,473	14,333	17,073	EBITDA margin	24.3	19.9	17.6	20.2	18.9
Gross Profit	5,119	6,183	7,908	9,636	10,240	Operating Margin	21.3	16.5	13.5	16.0	15.2
R&D Expenses	500	937	1,378	1,664	1,563	Net Margin	17.8	14.8	13.6	15.5	14.0
SG&A Expenses	1,529	2,038	2,701	2,886	3,241	R&D/sales	4.4	6.3	6.8	6.9	5.7
Operating Profit (EBIT)	2,433	2,445	2,753	3,837	4,150	SG&A/Sales	13.4	13.7	13.3	12.0	11.9
EBITDA	2770	2950	3586	4847	5157	Sales growth	41.6	30.1	37.4	17.6	14.0
Interest Income	226.6	273.3	348.6	583.9	758.4	Operating Profit Growth	16.0	0.5	12.6	39.4	8.1
Interest Expense	0	0	0	0	0	Net profit growth	18.8	7.8	26.4	34.2	3.1
Investment Income (Exp.)	-1.1	7.3	9.2	0.0	0.0	EPS (Reported) growth	18.6	6.4	19.2	29.5	3.1
Non-Operating Income (Exp.)	0.0	0.0	0.0	0.0	0.0	Interest coverage (x)	n.m.	n.m.	n.m.	n.m.	n.m.
Earnings before tax	2,658	2,726	3,111	4,421	4,908	Net debt to total capital	n.m.	n.m.	n.m.	n.m.	n.m.
Tax	-627	-535	-342	-707	-1,080	Net debt to equity	n.m.	n.m.	n.m.	n.m.	n.m.
Net Income (Reported)	2031	2190	2768	3714	3828	Asset Turnover	82.4	83.7	69.6	72.2	73.9
INR						ROE	19.6	17.6	12.3	14.6	13.6
EPS (Reported)	27.2	28.9	34.4	44.6	46.0	ROCE	18.1	16.0	11.2	13.1	11.8
BPS	150.8	177.8	271.1	305.4	338.9	ROIC	35.6	28.1	14.5	19.7	18.8
DPS	5.0	5.0	7.5	9.0	11.0						
Shares Outstanding	75	76	80	83	83						
Balance sheet						Cash flow statement					
INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E	INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E
Cash and cash equivalents	6,506	6,841	7,181	10,982	13,233	Net Income	2,031	2,190	2,768	3,714	3,828
Accounts receivable	3,822	5,279	8,644	10,081	11,381	Depr. & Amortisation	337	505	833	1,010	1,007
Inventories	0	0	0	0	0	Change in working capital	-237	-641	-2,509	-818	-740
Others	478	1,131	2,869	3,346	3,777	Other	0	0	0	0	0
Current assets	10,807	13,251	18,694	24,409	28,392	Cash flow from operations	2,131	2,054	1,092	3,906	4,096
LT investments	1,690	2,282	7,619	7,619	7,619	Capex	-497	-1,343	-1,604	780	-800
Net fixed assets	1,285	2,124	2,894	1,105	898	Disposal/ (purchase)	-564	-585	-5,336	0	0
Others	66	59	58	58	58	Cash flow from investing	-1,061	-1,928	-6,939	780	-800
Total assets	13,848	17,716	29,265	33,191	36,967	Free cash flow	1,634	711	-512	4,686	3,296
Liabilities						Equity raised/ (repaid)	215	514	6,250	0	0
Total current liabilities	2,533	4,001	6,595	7,692	8,683	Debt raised/ (repaid)	-22	131	-89	0	0
Long term debt	2	133	45	45	45	Other	8	-2	-4	0	0
Other liabilities	22	20	16	16	16	Dividends paid	-427	-433	0	-855	-1,044
Total liabilities	2557	4154	6656	7752	8744	Cash flow from financing	-227	209	6,157	-855	-1,044
Shareholders' equity	11291	13562	22580	25439	28223	Net change in cash	844	335	309	3,831	2,251
						Beginning cash	5,662	6,506	6,841	7,181	10,982
						Ending cash	6,506	6,841	7,151	11,012	13,233

Source: JPMorgan estimates, Company data.

# Indian Financial Services

On Bank Street -Vol 81

**\*\*\*FLASH\*\*\*** Inflation at 5.77% - little lower than expected – 32 bps lower than last week's release.

- **Stock Movement:** SOE and private bank index down 1.2% and 4.1% respectively - underperforming the Sensex. Star stock performer –DCB up 16%.
- ICICI Bank to raise US\$5bn – 1).To meet higher capital requirements under Basel II 2). To fund its subsidiaries 3).To fund corporate India’s capex plans
- HDFC's Q4 profit up 29 % yoy – The numbers came in higher than our expectations mainly from better fee growth and lower cost-income ratio. We maintain our Overweight rating and have increased our price target to Rs 1,824.
- UTI bank to retain Dr. Nayak

## Banks

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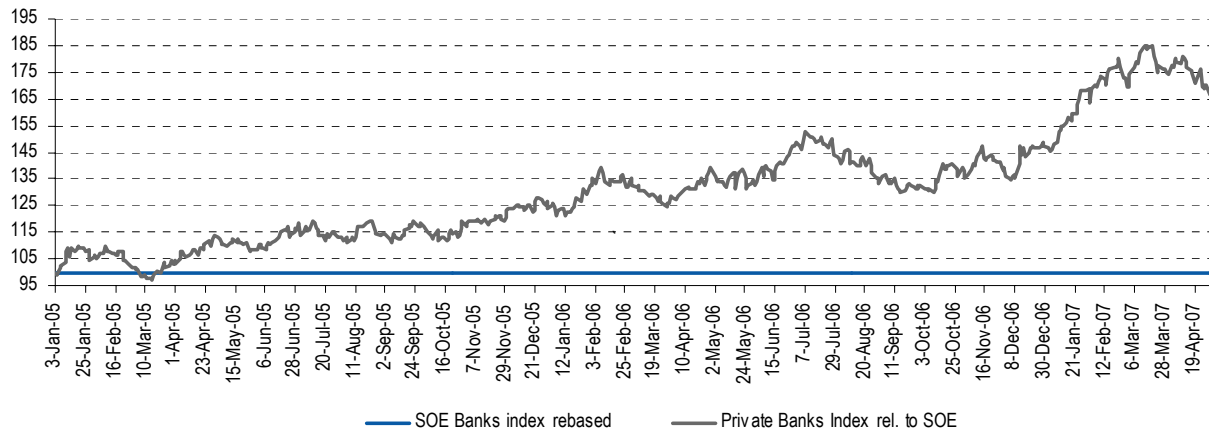
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Figure 1: Private Banks Index relative to SOE since January 2005



Source: Bloomberg, JPMorgan

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### Stock Price Performance

	03-May	Chg
BOB	245	-0.2%
CBK	226	1.0%
PNB	517	1.2%
SBI	1,122	-2.1%
UNBK	110	0.7%
ALBK	81	1.8%
BOI	199	-0.3%
IOB	118	-0.9%
SNDB	75	-3.0%
CBOP	40	3.4%
HDFC	1,679	-3.3%
HDFC Bank	1,006	-2.4%
ICICI Bank	872	-9.5%
IDFC	100	0.9%
YES	152	-2.4%
DEVB	79	15.6%
KBL	170	-2.3%
Sensex	14,078	-1.1%
SOE Bank Index		-1.2%
Pvt Bank Index		-4.1%

Source: Bloomberg, JPMorgan estimates;  
Change in prices is weekly.

### ADR/GDR (USD)

	03-May	Chg	Prem
HDFCB	74.43	-0.3%	1.5%
ICICIB	41.78	-10.1%	-1.4%
SBI	69.00	-2.4%	26.5%
UTI B	11.50	0.9%	-0.2%

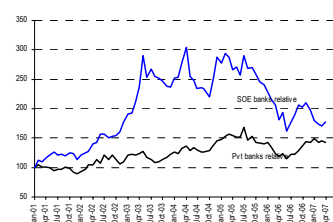
Source: Bloomberg, JPMorgan estimates;  
Change in prices is weekly.

### Others

	03-May	Chg
10 year yield	8.15	0.10
Rs/US\$	41.15	0.28
Brent (US\$/bbl)*	65.02	(2.30)
Inflation	5.77	(0.32)

Source: Bloomberg, JPMorgan estimates;  
Change in prices is weekly.

Figure 2: SOE bank and private bank index relative to Sensex



Source: Bloomberg, JPMorgan estimates

## On Bank Street

We are happy to present you with our banking news digest for the week ended 04 May 2007.

### Sector news

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- [Basel II to hit banks' capital](#)

### Private Banks

- [ICICI Bank 4Q07 net up 4% yoy](#)
- [ICICI Bank to raise USD 5bn](#)
- [HDFC's Q4 profit up 29 % yoy](#)
- [UTI bank to retain Dr. Nayak](#)
- [Indusind's first priority is wealth management](#)
- [ICICI bank launches Rs 1bn fund for SMEs](#)
- [ICICI holdings raising capital through private placement](#)
- [Chryscapital Ups stake in M&M Financial to 5%](#)
- [ING Vysya bank net at Rs 183 mn in 4Q07](#)

### SOE Banks

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- [Andhra Bank to hold 25 % in Malaysian Entity](#)
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### Insurance

- [Insurers solvency margin to stay 150 %](#)
- [Policyholders may loose benefits on transfer of Health Insurance](#)
- [Life's Bustling with 5 New Insurers](#)
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## Appendix 1

### [Valuation](#)

### [Macro data](#)

## Sector news

### ***RBI ups cap for priority sector lending (May 1-ET)***

[Top](#)

RBI increased the cap for home loans under priority sector to Rs 2 mn from 1.5 mn earlier. The central bank has also increased the lending cap for educational loans to Rs 1 mn for studies in India and Rs 2 mn for studies abroad. Earlier, the limits were Rs 0.75 mn and Rs 1.5 mn respectively. The revised RBI guidelines excluded loans to software industry from priority sector lending. The guidelines specified that NRI deposits such as FCNR (B) and NRNR deposits balances will no longer be deducted for computation of Adjusted Net Bank Credit (ANBC) for priority sector lending purpose.

### ***Basel II to hit banks' capital (May 1-ET)***

[Top](#)

The capital adequacy of banks will fall by 50 bps in FY08 and by as much as 75 bps each in the second and third year, after adopting the new capital adequacy norms. A major cause for the reduction in the capital adequacy would be the introduction of capital charges for operational risks. The impact would have been about three times higher, if the central bank had not deferred the introduction of risk weights on unrated corporates. Under the revised framework, the RBI has mandated higher capital requirements for unrated corporate borrowers in a phased manner. For FY 08, the incremental corporate exposures over Rs 500 mn would attract a higher risk weight of 150 %. From April 1, 2009, the applicable threshold would be Rs 100 mn.

## Private Banks

### ***ICICI Bank 4Q07 net up 4% yoy (Apr 30-ET)***

[Top](#)

ICICI Bank's 4Q07 net profit was up 4% yoy at Rs 8251 mn. This amount includes impact of about Rs 3.1 bn due to increase in provision requirements by RBI on certain categories of loans. Customer assets and deposits were up 35% and 40% yoy. Operating profit was up 44% yoy at Rs 17,877 mn.

#### **Comments:**

For further details please refer our report ICICI Bank: The 5 billion dollar question answered dated 30 April 07.

### ***ICICI Bank to raise USD 5bn (Apr 30-ET)***

[Top](#)

ICICI Bank Board approved a US\$5 bn equity issuance - partly due to final Basel-2 guidelines released by RBI over the weekend which would increase capital requirements, partly to fund subsidiaries but mainly upping the ante to fund corporate India's capex plans

### ***HDFC's Q4 profit up 29 % yoy (May 4-ET)***

[Top](#)

HDFC has reported a net profit of Rs 5.5 bn for the 4Q07, an increase of 29% yoy. This was led by better than expected fee income growth and lower cost-income ratio. The net interest spread remained firm at 2.18%. Sanctions and disbursements were up 36% and 27% yoy respectively.

#### **Comments:**

We maintain our Overweight rating and have raised our SOP based price target (May 08) to Rs1824. Key risks: further rate hikes, property prices continuing to rise, and significantly worsening asset quality. For further details please refer our report HDFC: Getting better all the time dated 04 May 07.

### ***UTI bank to retain Dr. Nayak (May 2-ET)***

[Top](#)

The UTI Bank board has found a way to retain Dr .P J Nayak at the helm by recommending his name as the executive chairman for two years from August 1, 2007. Nayak, who is the CMD of UTI Bank, had decided to quit after his term ends on July 31, 2007, as the RBI had declined a two-year extension to his tenure as chairman and managing director. However, Nayak's appointment from August 1 is subject to approval from the RBI, and shareholders. Meanwhile, the board has also mooted the name change to 'Axis bank'. It is also likely to enter into asset management, private equity and venture capital businesses.

### ***IndusInd's first priority is wealth management (Apr 30-ET)***

[Top](#)

IndusInd Bank intends to give first priority to its wealth management subsidiary which is expected to be launched soon and then move forward on its proposed asset reconstruction company. IndusInd plans to conduct its wealth management business through a subsidiary while its proposed ARC business will be driven through a joint venture. IndusInd is presently awaiting regulatory approvals to launch its subsidiary.

***ICICI bank launches Rs 1bn fund for SMEs (Apr 30-ET)***

[Top](#)

ICICI Bank has launched a Rs 1 bn fund to support innovation and development of green businesses in India. The fund would provide short to medium-term loans ranging between Rs 0.5 mn and Rs 4 mn SMEs.

***ICICI holdings raising capital through private placement (Apr 29-HBL)***

[Top](#)

ICICI Holdings, the new subsidiary being set up by ICICI Bank, will raise capital through private placement of equity before hitting the capital market with an initial public offering. The bank had decided to hive off its insurance and mutual fund businesses into a separate subsidiary. The bank plans to first receive approvals from the RBI and IRDA to set up the company and then raise capital from third-party investors in the form of placements before going for an IPO.

***Chryscapital Ups stake in M&M Financial to 5% (May 2-ET)***

[Top](#)

Copa Cabana, a wholly owned subsidiary of ChrysCapital, bought 1.18 mn shares of M&M Financial. Post-transaction, Copa Cabana holds 4.4 mn shares or 5.05 % stake in the company, which provides finance for utility vehicles, tractors and cars.

***ING Vysya bank net at Rs 183 mn in 4Q07 (Apr 30-BS)***

[Top](#)

ING Vyasa Bank reported a net profit of Rs 183.9 mn for 4Q07 as compared to a net loss of Rs 246.5 mn in the same period last fiscal.

## SOE Banks

### ***Canara bank 4Q07 net up 2.3% (Apr 30-BS)***

[Top](#)

Canara Bank reported a marginal rise of 2.34 % yoy in its net profit to Rs 5.05 bn crore for 4Q07. Return on assets declined to 0.98 % during the fiscal compared to 1.13 %. Operating profit for the quarter went up by 39.76 % to Rs 10.5 bn

### ***Andhra Bank to hold 25 % in Malaysian Entity (May 2-BS)***

[Top](#)

Andhra Bank will hold 25 % equity in a joint venture bank being promoted in Malaysia in association with Bank of Baroda and Punjab National Bank. Bank of Baroda, with 40 % stake in the joint venture initiative, had been taking the lead in setting up the Malaysian entity. Punjab National Bank will hold 35 % stake in the new bank

### ***State Bank of Hyderabad for 10-15 % equity dilution (May 2-ET)***

[Top](#)

State Bank of Hyderabad (SBH), a subsidiary of SBI, is keen to dilute 10 % to 15 % of its equity when it firms up plans for IPO. The IPO would depend on the passage of the SBI Subsidiary Banks Amendment Bill in Parliament, which would allow increasing the authorised capital base from Rs 500 mn to Rs 5000 mn.

### ***ICRA, Canara bank signs MOU (May 2-ET)***

[Top](#)

Credit rating agency ICRA and Canara Bank have signed a memorandum of understanding, under which the agency will assign ratings to small enterprises, small-scale industries and small and medium enterprises that comprise the public sector lender's borrowers.

## Insurance

### ***Insurers solvency margin to stay 150 % (Apr 30-ET)***

[Top](#)

IRDA has decided against lowering prudential requirements that mandate setting aside 150 % of their capital as solvency margin. Insurers hoped a reduction in the requirement could free up capital for expansion. With the FDI cap in insurance restricted to 26 %, insurance companies had been pressing for relaxation on this front as it is becoming increasingly difficult to pump in capital for expansion needs. Further, the IRDA has also decided against companies using hybrids to raise debt.

### ***Policyholders may lose benefits on transfer of Health Insurance (May 2-BL)***

[Top](#)

Health insurance policyholders may no longer be able to avail themselves of the existing benefits if they transfer their policy from one public sector insurance company to another. The 'portability' of health insurance policies has been dealt a blow as several public sector insurance companies have either introduced or are on the verge of launching new health insurance products with variable rate structures and clauses. The General Insurance Council, the self-regulatory body for non-life industry, has now constituted a task force to examine the issue of 'portability' and evolve guidelines.

### ***Life's Bustling with 5 New Insurers (May 2-ET)***

[Top](#)

The insurance space is hotting up with at least 5 new entrants in the private life insurance market. Some of the foreign companies may include, France's largest insurance company Scor group, QBE Insurance, a subsidiary of QBE Insurance Group, Australia's largest international general insurance and reinsurance group, Korea's oldest insurance company Samsung Life and Millea Holdings of Japan. There are already 16 life insurers operating in the space.

### ***SBI Life net up 88 % (May 1-BS)***

[Top](#)

SBI Life has registered an 88 % growth in net profit at Rs 38.3 mn for FY07 compared with Rs 20.2 mn in the previous year. It is so far the only private sector life insurance company, out of the 15, that has been able to break even so far. The company registered a new business premium of Rs 25.66 bn a 210 % growth over last year. Total premium increased to Rs 29.3 bn, up 172 % from Rs 10.75 bn in FY06.

### ***Non-Life Insurers Ditch Group Policies (May 2-ET)***

[Top](#)

Faced with thinning margins, non-life insurers have started canceling loss-making group health insurance policies midway. With post-detariffing competition whittling down margins, non-life insurance companies have started getting rid of their "burning portfolios" - accounts that generate volumes but little profits. Incidentally, this is a boon for individual policy buyers, who are paying a higher premium to compensate for the losses suffered in group schemes. Industry watchers say this is a good development for the health insurance business as risks will be priced on a more scientific basis.

## Appendix 1

### Valuations

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Table 17: Indian Financials – Valuation Summary

	Price (Rs)	Target Price (Rs)	Mcap \$ mil	Stock Rating	Earnings growth (%)			ROE (%)			P/E (x)		P/B (x)	
					2006	2007E	2008E	2006	2007E	2008E	2007E	2008E	2007E	2008E
<b>SOE Banks</b>														
Bank of Baroda	245	171	2,166	UW	-2	0	26	12.3	10.2	11.8	10.8	8.6	1.06	0.97
Canara Bank	226	214	2,254	N	21	6	16	20.3	18.6	18.8	6.5	5.6	1.14	0.99
Punjab National Bank	517	427	3,958	UW	2	4	36	16.4	14.9	17.6	10.9	8.0	1.53	1.31
State Bank of India	1,122	1010	14,353	OW	2	-23	15	17.0	11.8	12.2	17.3	15.1	1.95	1.76
State Bank of India (Consol)	1,122		14,353								13.3	11.6	1.44	1.31
Union Bank of India	110	100	1,352	UW	-15	39	12	16.5	19.0	18.5	5.9	5.3	1.06	0.91
Allahabad Bank	81	68	875	UW	10	15	11	19.9	19.9	19.1	4.6	4.3	0.86	0.75
Bank of India	199	110	2,362	UW	34	16	24	17.5	17.6	18.8	10.4	9.0	1.70	1.48
Indian Overseas Bank	118	162	1,560	OW	32	15	14	28.8	26.6	24.8	6.2	5.4	1.61	1.30
Syndicate Bank	75	64	954	UW	38	4	39	23.9	21.0	24.4	4.9	4.7	1.14	0.96
<b>Private Banks</b>														
Centurion Bank of Punjab	40	31	1,431	OW	NM	38	72	11.2	12.4	18.2	46.4	27.0	5.40	4.50
HDFC Bank	1,006	980	7,632	N	25	29	30	17.7	19.5	21.2	27.9	21.5	4.99	4.20
HDFC	1,679	1824	10,173	OW	21	23	21	30.1	31.3	30.9	27.1	22.4	7.65	6.34
ICICI Bank	872	1044	18,849	OW	5	21	20	14.6	13.4	12.7	25.2	21.0	3.22	2.01
IDFC	100	69	2,722	N	17	20	21	18.5	18.4	19.1	22.5	19.3	3.92	3.47
YES Bank	152	194	1,034	OW	NM	65	93	14.0	13.9	17.8	45.1	23.3	5.41	3.16
Development Credit Bank	79	80	284	OW	NM	NM	556%	NM	3.1	12.8	147.8	22.5	3.08	2.71
Karnataka Bank	170	156	501	OW	20	13	19	16.9	16.8	17.6	10.3	8.7	1.63	1.43

Source: Bloomberg, JPMorgan

Prices as of May 03, 2007; annual data represents financial year ending March;

### Macro Indicators

Table 18: Loan, Deposit growth

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#### As at 13-Apr-2007

Loan Growth (yoy)	27.7%
Deposit Growth (yoy)	23.1%
Incremental LDR	84.7%
LDR	73.3%

Source: RBI, JPMorgan

Note: YoY growth rates have been computed by taking 14 Apr 2006 as the base date

Table 19: Interest Rates

[Top](#)

Yields	03-May-07	1m Chg	3M Chg	12M chg
3m T Bill	7.32	-0.48	0.04	1.75
10 year g sec	8.15	-0.03	0.45	0.64
1 year AAA corp	10.23	-0.40	0.99	2.89

Source: Bloomberg

## Company Events

Table 20: 4Q07 Results & Misc.

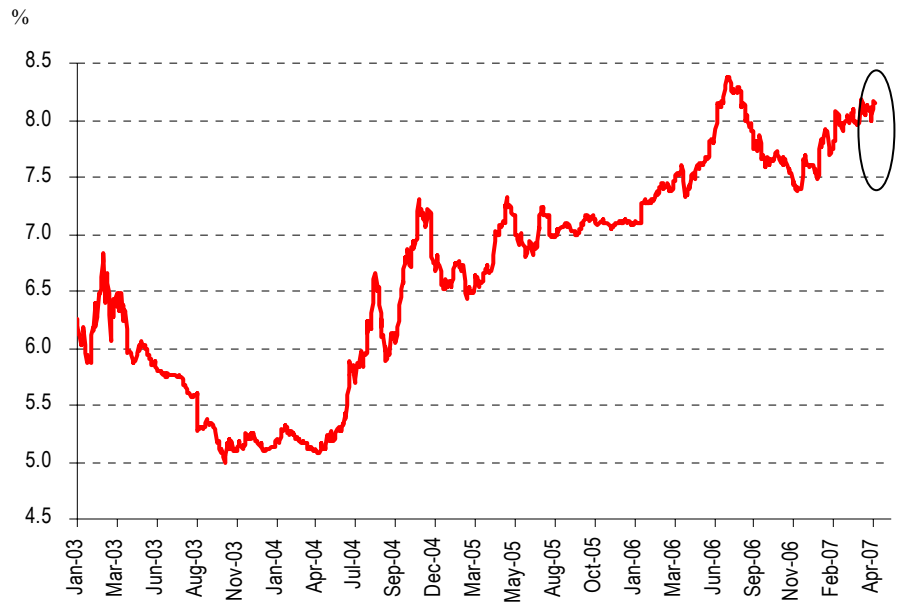
[Top](#)

Date	Events
7-May	Union Bank results
12-May	SBI results

Source: Companies.

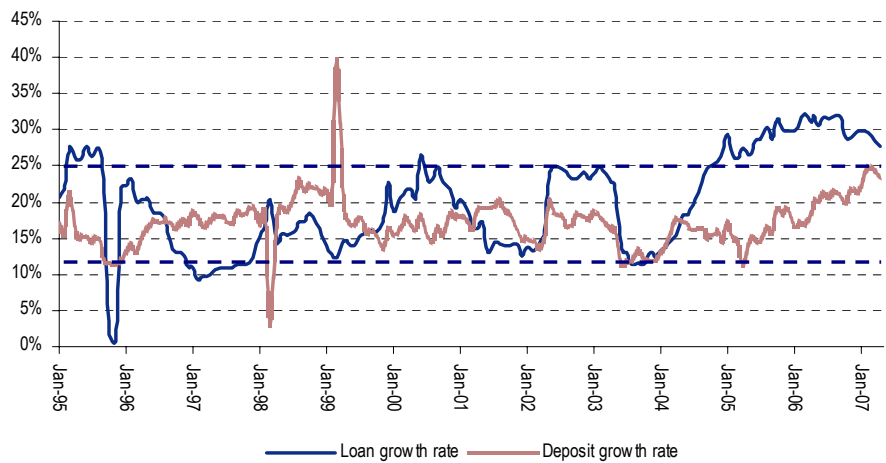


Figure 3: 10 yr bond yields:



Source: Bloomberg

Figure 4: System loan and deposit growth

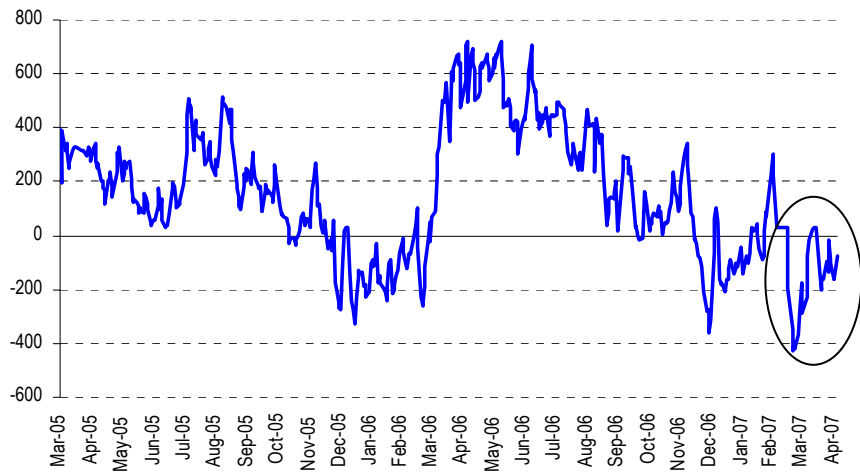


Source: Reserve Bank of India, JPMorgan

## Liquidity Metrics

Figure 5: Net Reverse Repo Amount Outstanding

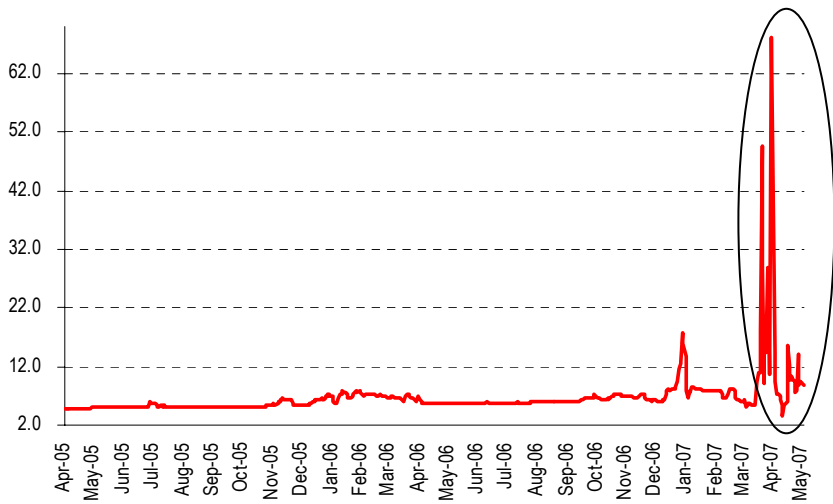
Rs bn:



Source: Bloomberg

Figure 6: Interbank Rate

%



Source: Bloomberg

## Glossary of terms

BS: Business Standard

DC: Deccan Chronicle

ET: Economic Times

FE: Financial Express

HBL: Hindu Business Line

DH: Deccan Herald

HT: Hindustan Times

TOI: Times of India

IE: Indian Express

RBI: Reserve Bank of India

FM: Finance Minister

MoF: Ministry of Finance

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IB clients*	49%	51%	38%
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IB clients*	68%	64%	53%

\*Percentage of investment banking clients in each rating category.

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