kotak® Institutional Equities

# INDIA DAILY

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### Updates

**HT Media:** HT Media (HTML) reported weaker-than-expected 3QFY08 results; retain ADD

## News Roundup

### Corporate

- DLF's Ltd, the country's largest real estate developer has signed an agreement with infrastructure firm Gayatri Projects Ltd (GPL) to develop roads, highways and bridges across the country. (BS)
- Broiler chicken and egg prices have crashed 25-30% in various parts of the country following confirmed reports of bird flu in West Bengal. (BS)
- Paris-based foods major Danone is understood to be keen on buying a najority stake in a new milk-processing project being set up in Rajasthan by Keventer, the Kolkatta-based group promoted by MK Jalan. (ET)
- Essar Shipping (ESL) may merge a group company specialising in oilfield services with itself, hoping to increase its stock market value through the addition of this high-potential and fast growing business. (ET)

### Economic and political

- Even as the government dithers over the fuel price hike, the spurt in global crude oil prices has taken the oil import bill close to US$73 bn, almost 6% of GDP, putting a strain on the economy. (ET)
- Market regulator SEBI has proposed a 25% price band on the issue price on the listing day of an IPO up to Rs250 crore in size. This would not apply in case of recommencement of trading in equity shares of a company on the stock exchange. (FE)

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

## EQUITY MARKETS

| | | Change, % | | |
|---|---|---|---|---|
| **India** | **17-Jan** | **1-day** | **1-mo** | **3-mo** |
| Sensex | 19,701 | (0.8) | 3.3 | 9.5 |
| Nifty | 5,913 | (0.4) | 3.0 | 10.5 |
| **Global/Regional indices** | | | | |
| Dow Jones | 12,159 | (2.5) | (8.1) | (12.5) |
| Nasdaq Composite | 2,347 | (2.0) | (9.6) | (16.2) |
| FTSE | #N/A | #N/A | #N/A | #N/A |
| Nikkie | 13,396 | (2.8) | (11.9) | (21.7) |
| Hang Seng | 24,537 | (2.3) | (8.2) | (16.7) |
| KOSPI | 1,692 | (1.8) | (9.1) | (15.6) |

**Value traded - India**

| | | Moving avg, Rs bn | | |
|---|---|---|---|---|
| | **17-Jan** | | **1-mo** | **3-mo** |
| Cash (NSE+BSE) | #N/A | | 186.4 | #N/A |
| Derivatives (NSE) | 678.7 | | 733.7 | 984.0 |
| Deri. open interest | 1,344.1 | | 1,126 | ##### |

**Forex/money market**

| | | Change, basis points | | |
|---|---|---|---|---|
| | **17-Jan** | **1-day** | **1-mo** | **3-mo** |
| Rs/US$ | 39.3 | 0 | (25) | (45) |
| 6mo fwd prem, % | 0.7 | (25) | 71 | 24 |
| 10yr govt bond, % | 7.6 | (1) | (39) | (36) |

**Net investment (US$mn)**

| | **16-Jan** | | **MTD** | **CYTD** |
|---|---|---|---|---|
| FIIs | (565) | | 14 | (4) |
| MFs | (132) | | (340) | 32 |

**Top movers -3mo basis**

| | | Change, % | | |
|---|---|---|---|---|
| **Best performers** | **17-Jan** | **1-day** | **1-mo** | **3-mo** |
| Rashtriya Chem | 130 | 5.0 | 46.5 | 147.3 |
| Neyveli Lignite | 237 | 1.3 | (3.9) | 100.5 |
| Engineers India | 1,020 | 0.2 | 15.4 | 90.3 |
| Chambal Fert | 78 | (0.5) | (5.3) | 71.4 |
| BoB | 464 | (0.2) | 10.5 | 64.8 |
| **Worst performers** | | | | |
| Acc | 860 | 0.5 | (19.4) | (16.9) |
| Bharti Tele | 872 | 0.8 | (4.3) | (14.5) |
| Infosys | 1,491 | (0.2) | (8.0) | (21.1) |
| i-Flex | 1,433 | (0.7) | (0.6) | (14.5) |
| Satyam Computer | 372 | (1.9) | (8.0) | (19.5) |

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**Banking**

| CBI.BO, Rs136 | |
|---|---|
| Rating | ADD |
| Sector coverage view | Attractive |
| Target Price (Rs) | 150 |
| 52W High -Low (Rs) | 155 - 102 |
| Market Cap (Rs bn) | 55.0 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 30.4 | 31.7 | 35.3 |
| Net Profit (Rs bn) | 5.0 | 5.3 | 5.9 |
| EPS (Rs) | 15.4 | 13.2 | 14.7 |
| *EPS gth* | *570.9* | *(14.4)* | *11.4* |
| P/E (x) | 8.9 | 10.4 | 9.3 |
| P/B (x) | 3.3 | 1.8 | 1.6 |
| Div yield (%) | 1.8 | 1.9 | 2.1 |

# Central Bank of India: Better operations, higher leverage to buoy profitability

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- **High CASA support margin, leverage inflates RoE**
- **Expect the stock to trade at premium to fair value given technical factors**
- **Initiating coverage with ADD rating, target price Rs150**

Better operations, higher leverage to buoy profitability. We expect Central Bank of India to report improved operational performance on the back of higher margins as compared to 1HFY08 levels, 20% loan growth over FY2007-10E and high-but-declining operating expenses. Higher leverage despite capital restructuring and equity infusion will support ROE, as RoA remains relatively low.

## We initiate coverage with an ADD rating and target price of Rs150

- We believe that Central Bank of India will likely deliver moderate operating performance with12% PAT CAGR between FY2007 and FY2010E and long-term RoE of 13-14%. The stock is currently trading at 9.3X PER and 1.6X PBR FY2009E.

  Public banks, with long-term RoE in the range of 12-18%, currently trade at 1.3-2.0X PBR FY2009E.We believe that the stock will marginally outperform the index given technical factors and hence initiate coverage with an ADD rating and target price of Rs150. We assign a 15% premium to our fair value estimate to factor in favorable technical factors.

## Medium-size bank with large branch network

- Central Bank of India has a market share of 3.2% and 2.7% in deposits and advances, respectively, as of March 2007. A network of 3,194 branches across India provides the bank with a wide geographical reach. The bank proposes to leverage this distribution network and provide a gamut of financial services to its customers.

## High CASA support margin, leverage inflates RoE

- Central Bank of India is likely to maintain NIMs at about 2.5-3% over the next three years, in our view.
- We believe its high CASA ratio of 40% (key strength of the bank) will help contain the bank's funding cost. However, relatively lower yields on loans, lower non-interest income and operating expenses constrain RoA at about 0.6-0.7% for FY2007-2010E—lower than other public banks (sustainable RoA of about 1%).
- However, the RoE will be inflated in the medium term, mainly due to higher leverage (asset-to-equity ratio) of 27X as compared to 15-17X for other banks.

## Key business risks: Lower CAR, economic slowdown

- Company could face several challenges: (1) growth may be constrained by lower CAR (Tier I of 8.3% as of September 2007), (2) NPLs could increase in an economic slowdown, (3) young talent may not be easy to attract, and (4) competition from other banks.

**Key risks to our stock price call**

- Central Bank of India's stock may trade at a premium to our fair value for the following technical factors: (1) high level of investor interest in the Indian banking industry and (2) current free float of Central Bank of India is at 19.8% and would allow foreign investors to invest in the stock without breaching the 20% limit of foreign investment in public banks.
- Further, in the near-term, Central Bank of India's income could be boosted by recoveries of written-off assets (Rs35 bn). The market may ascribe a multiple for such earnings, which could be inappropriate in our view, given the lack of sustainability of such earnings.

**Construction**

| CCCL.BO, Rs1177 | |
|---|---|
| Rating | REDUCE |
| Sector coverage view | Attractive |
| Target Price (Rs) | 1,100 |
| 52W High -Low (Rs) | 155 - 102 |
| Market Cap (Rs bn) | 43.5 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 8.6 | 17.1 | 24.1 |
| Net Profit (Rs bn) | 0.5 | 1.2 | 1.8 |
| EPS (Rs) | 14.3 | 32.6 | 48.1 |
| *EPS gth* | *125.0* | *127.3* | *47.6* |
| P/E (x) | 82.0 | 36.1 | 24.4 |
| EV/EBITDA (x) | 59.8 | 24.3 | 16.7 |
| Div yield (%) | 0.1 | 0.3 | 0.5 |

# Consolidated Construction Consortium: Structured to ride growth opportunities

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- **CCCL: Play on rising commercial development activity**
- **Earnings to grow at a CAGR of 73% during 2007-2010E, led by commercial construction**
- **Initiate with REDUCE rating and DCF-based target price of Rs1,150 per share**
- **Key risks: Development slowdown, execution issues, acceptability of tax treatment**

We expect Consolidated Construction Consortium Limited (CCCL) to achieve strong growth driven by (1) rising commercial development activity, (2) its execution excellence, and (3) ramp-up of allied services like mechanical and electrical, glazing and interior fit-outs. In our view, CCCL's margins will expand, driven by strong demand and operating leverage.

### CCCL: Play on rising commercial development activity

CCCL offers integrated construction services. Apart from core construction, it offers mechanical and electrical (M&E) services, and glazing and interior fit-outs. We believe CCCL is well poised to leverage the likely strong growth in the construction industry with its execution excellence and professional management.

### Earnings to grow at a CAGR of 73% during 2007-2010E, led by commercial construction

We expect CCCL’s revenues and earnings to grow at a CAGR of 54% and 73%, respectively, during FY2007-10E. Commercial construction and a ramp-up of newer segments such as M&E, glazing and interior fit-outs will drive growth. We expect margins to expand, led by (1) addition of higher margin segments such as M&E, glazing and interior fit-outs, (2) operating leverage, and (3) the buoyant demand environment.

### Initiate with REDUCE rating and DCF-based target price of Rs1,150 per share

We value CCCL based on DCF (on a consolidated basis including its subsidiaries) at Rs1,150 per share. We note that CCCL has lower working capital requirements than its peers. We initiate coverage with a REDUCE rating as its current valuation multiples appear rich (P/E multiple of 28X and 20X (on a full-tax adjusted basis) and EV/EBITDA multiple of 17X and 12X on FY2009E and FY2010E, respectively).

### Key risks: Development slowdown, execution issues, acceptability of tax treatment

Concentrated revenue streams expose CCCL to risks as most revenues come from commercial construction for the IT/ITES sector within a limited geography (Karnataka and Tamil Nadu). Execution risks arise from (1) tight demand-supply for skilled labor and project management professionals, and (2) ramp-up of business segments such as glazing and interior fit-outs. The effective tax rate may be higher than our assumption (average of about 25% between FY2008E-10E) if CCCL’s accounting method (of not recognizing current tax on retention money) is held to be contrary to tax norms.

**Energy**

| RELI.BO, Rs2996 | |
|---|---|
| Rating | RS |
| Sector coverage view | Neutral |
| Target Price (Rs) | - |
| 52W High -Low (Rs) | 3252 - 1250 |
| Market Cap (Rs bn) | 3,758 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 1,115 | 1,144 | 1,360 |
| Net Profit (Rs bn) | 121.2 | 138.9 | 170.9 |
| EPS (Rs) | 83.4 | 100.8 | 112.9 |
| *EPS gth* | *32.0* | *20.9* | *12.0* |
| P/E (x) | 35.9 | 29.7 | 26.5 |
| EV/EBITDA (x) | 19.0 | 16.9 | 13.4 |
| Div yield (%) | 0.4 | 0.5 | 0.6 |

**Shareholding, September 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 43.5 | - | - |
| FIIs | 24.1 | 8.9 | 0.9 |
| MFs | 2.3 | 5.3 | (2.7) |
| UTI | - | - | (8.0) |
| LIC | 4.1 | 8.6 | 0.6 |

## Reliance Industries: 3QFY08 results in line with street estimates

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- **Better-than-expected results due to higher refining margins, forex gains**
- **A few unasked questions require clarification—flat chemical segment costs qoq and movement in refining margins**
- **We would like some more clarity on RIL's refining margins**

Reliance Industries reported adjusted 3QFY08 net income at Rs38.8 bn (+1.2% qoq and +26% yoy) ahead of our Rs28.7 bn estimate and in line with street estimates. Higher-than-expected refining margins of US$15.4/bbl versus our estimate of US$11.9/bbl primarily explain the difference; we deal with this 'recurring' issue in more detail below. 3QFY08 EBITDA was flat qoq (+0.9%) and up 12.6% yoy to Rs58.3 bn (see Exhibit 1). We have raised FY2008E EPS to Rs101 from Rs94 but have cut FY2009E and FY2010E consolidated EPS to Rs113 and Rs179 from Rs128 and Rs197 due to (1) lower refining and chemical margins, (2) lower forex gains and (3) a stronger rupee. Reported 3QFY08 net income was Rs80.8 bn including one-off gains of Rs42 bn from sale of 208 mn RPET shares.

**RPET share sale—more sold than told but value unlocked.** RIL management disclosed that RIL had sold 208 mn shares of RPET in 3QFY08 compared to the previously disclosed figure of 180.4 mn shares. Sales realization was Rs47.3 bn, which translates into an average selling price of Rs227.5. RIL has booked a gain of Rs41.97 bn on the sales and paid tax of Rs5.36 bn on the transaction. RIL now owns 70.4% of RPET versus 75% previously.

**Chemical segment analysis—flat costs qoq and decline yoy requires clarity in light of higher RM prices**

**3QFY08 chemical segment EBIT declined 12.2% qoq.** RIL's chemical segment EBIT declined 12.2% qoq to Rs17.8 bn led by a decline in chemical margins (steep increase in naphtha price of US$125/ton relative to product prices. Exhibit 3 shows quarterly margins for the past few quarters. Also, lower product prices qoq and flat gas prices (feedstock for two of RIL's four crackers) would have impacted profitability of gas-based products (PE primarily from erstwhile IPCL's plants).

RIL's 3QFY08 costs (revenues less EBIT) remained flat qoq at Rs109 bn despite a steep increase in naphtha costs (see Exhibit 2). We estimate the qoq increase in naphtha costs at Rs9 bn based on US$125/ton increase (based on Arab Gulf fob prices). Production volumes have gone up moderately qoq but presumably sales volumes declined qoq since revenues also declined 2% qoq and prices were generally flat. The yoy decline in costs (3.8% or Rs4.3 bn) requires clarification in light of a steep US$260/ton increase in naphtha prices, which alone would have resulted in costs rising by about Rs18-19 bn. Revenues declined 3.3% yoy. We can attribute a part of the yoy decline in chemical segment costs to lower depreciation due to the use of WDV methodology for certain assets.

**Refining segment analysis—we still have difficulty in understanding RIL's margins**

**We have been underestimating the refining margins of RIL for the past few quarters.** We use a certain product and crude slates rather than work off benchmark margins and movements thereof to estimate RIL's refining margins. We have been perhaps using the wrong product and crude slate and thus, getting large deviations versus the reported margins. We have been hoping for guidance from the management on this issue. We would suggest investors attempt to establish RIL's refining margins through an independent assessment based on its product and crude slate (in other words, work from the first principles) rather than merely go by analysts/street assumptions and forecasts.

1. **Margin improved qoq and yoy despite setbacks on refining cracks.** RIL's refining segment EBIT increased 12.6% qoq or Rs2.9 bn to Rs26.1 bn. Lower crude throughput at 7.6 mn tons versus 8.1 mn in 2QFY08 tons (sales of 8.5 mn tons versus 9 mn tons in 2QFY08) partly nullified the US$1.8/bbl qoq increase in refining margins. RIL's 3QFY08 refining margin stood at US$15.4/bbl or +US$1.8/bbl qoq and +US$3.7/bbl yoy and was much higher versus our computed US$11.9/bbl. Exhibit 4 compares RIL's reported refining margins with benchmark refining margins as taken from RIL's press release and computed by Reuters. It is interesting to note that RIL's premium over regional benchmark margins has expanded for all the regions in the past two quarters. We observe that US benchmark refining margins in 3QFY08 have fallen between US$3/bbl to US$5.2/bbl qoq led by lower increase in gasoline prices relative to crude prices. However, Europe and Singapore benchmark margins have improved by about US$1.3-1.8/bbl.

2. **Optimization in product mix likely contributed to better-than-expected performance.** RIL's press release attributes the improved qoq margins to focus on middle distillate products such as diesel, kerosene. RIL's refinery may have also benefited from the surge in prices of LPG and sulfur in 3QFY08 versus 2QFY08. Exhibit 5 shows crack spreads of various products for April 2007-December 2007. RIL's very high margins in 1QFY08 probably reflected very high gasoline prices in the US; gasoline spreads have come off significantly since then. However, it appears to have produced less of gasoline and more of diesel in 2QFY08 and 3QFY08.

3. **Comparison with hypothetical margins of RPET continues to show a surprisingly large gap in favor of RIL refinery.** Our hypothetical exercise (see Exhibit 6, where we compute RPET's margins assuming it had operated in 3QFY08 and the previous quarters and compare the same with RIL's reported margins) shows a wide gap (US$8.5/bbl) between RIL's reported margins and RPET's hypothetical reported margins. We get a very low figure of US$6.9/bbl for RPET's hypothetical refining margin in 3QFY08, which probably reflects the depressed price/spread for gasoline in 3QFY08. We do not have an explanation for this. We note that RPET's product slate is heavily skewed towards gasoline, unlike RIL's. Exhibit 7 compares the product slates of RIL and RPET.

**Earnings revisions—cut earnings for FY2009E and FY2010E on lower margins**

**FY2008—raised earnings on higher refining margins.** We have raised our FY2008E EPS to Rs101 from Rs94 to reflect (1) higher refining margins and (2) higher crude prices (US$79/bbl versus US$75/bbl previously). We have revised our refining margin estimates upward by building in a premium to product prices to reflect 9MFY08 refining margins; our model shows a significantly lower figure otherwise. We model FY2008E refining margin at US$14.7/bbl compared to reported US$14.9/bbl in 9MFY08. We expect lower margins in 4QFY08E; global margins have collapsed over the past two weeks.

We have revised our EBITDA estimate to Rs222 bn from Rs218 bn; 9MFY08 EBITDA was Rs173 bn. We model forex gains of Rs8.4 bn (Rs8.4 bn in 9MFY08 and Rs1.8 bn in 3QFY08), which is equivalent to about US$1.2/bbl savings on crude purchase (the same reflects in lower other expenditure in RIL's reporting statements). Exhibit 8 gives a sensitivity of its earnings to key variables (refining margin, chemical prices and rupee-dollar rate) and Exhibit 9 gives RIL's key financials.

**FY2009—cut estimates on slightly less positive view of margins.** We have reduced FY2009E consolidated EPS (consolidated for RPET) to Rs113 from Rs128 and EBITDA estimate to Rs267 bn from Rs297 bn. The downward revision reflects lower refining and chemical margins and a stronger rupee (Rs38.5/US$ versus Rs39/US$). We also assume negligible forex gain in FY2009E given likely modest appreciation in the rupee versus US Dollar versus Rs8.4 bn in FY2008E.

We expect chemical margins to further decline in FY2009E versus FY2008E led by new plant capacities globally (see Exhibit 10), which will result in a decline in operating rates (see Exhibit 11). We model refining margins (standalone) at US$13.3/bbl lower versus FY2008E's US$14.7/bbl and our previous US$14.4/bbl estimate.

**FY2010—the first full year of contribution from KG D-6 gas and RPET.** We have reduced FY2010E consolidated EPS to Rs179 from Rs197 to reflect lower chemical and refining margins and weaker rupee (Rs37.5/US$ versus Rs38/US$). The steep yoy increase full impact of contribution from (1) KG D-6 gas, (2) KG D-6 oil and (3) RPET refinery. We model KG D-6 gas production at 70 mcm/d and oil production at 40,000 b/d with RIL's share at 90%.

We model RIL's standalone refining margin at US$15.1/bbl for RIL's refinery and US$15.9/bbl for RPET's refinery. The sharp jump in refining margin versus FY2009E reflects use of gas for internal processes, which would lead to significant savings in power and fuel and thus, higher refining margins.

**Updates on new businesses**

**E&P—solid execution on large, complex development of KG D-6 block.** RIL is on schedule to start gas production in 2HFY09. It has completed 95% of well drilling (17 development wells drilled), 65% of offshore development and 70% of onshore development. We model gas production at 20 mcm/d for FY2009E, 70 mcm/d for FY2010E and 80 mcm/d for FY2011E and the next few years. We continue to model gas price at US$4.2/mn BTU for FY2009E and FY2010E but reduce it to US$3.9/mn BTU after that based on weighted average price of US$2.34/mn BTU for 12 mcm/d of gas to be supplied to NTPC and 68 mcm/d of gas at US$4.2/mn BTU up to FY2013E and US$4.5/mn BTU beyond that. We assume that RIL will supply gas to RNRL, if any, at US$4.2/mn BTU.

In case of the MA (oil) development, RIL has finalized the design of the development and will use a 60,000 b/d FPSO for production of oil at a plateau rate of 40,000 b/d based on four development wells. We model 15,000 b/d of oil production in FY2009E and 40,000 b/d in FY2010E; RIL's share is 90%. RIL submitted a development plan to the DGH in 2QFY08.

On NEC-25 block, the company expects to start production in FY2012E and expects peak production of 6.5 mcm/d. However, it has not disclosed the capex and other details as it has submitted a development plan to the DGH and is awaiting the latter's approval. On CBM, the management expects production from FY2011E. The DGH has approved the development plan for Sohagpur East and West blocks in 3QFY08. RIL expects peak production of 6 mcm/d from its Sohagpur CBM blocks.

Exhibit 12 gives details of discoveries made by Reliance in KG D-6 and other blocks since January 2007. RIL's exploration track-record has been very impressive with 34 discoveries in India and 4 in Yemen out of 61 wells. More important, it has planned impeccably and has ensured availability of sufficient number of drilling rigs in a tight global environment. We believe the planning reflects the management's confidence about potential new discoveries.

**RPET—refinery to start ahead of schedule.** RIL management expects to start the RPET refinery ahead of the scheduled completion date of December 2008 but has not specified a revised schedule. As mentioned in our note titled *Refinery on track for early completion; concerns emerge about strength of refining margins* dated January 16, 2008, we have reduced RPET's refining margins to U$15.9/bbl, US$15/bbl and US$14.9/bbl versus US$17.2/bbl, US$17.3/bl and US$16.2/bbl for FY2010E, FY2011E and FY2012E. Our FY2010E-FY2012E EPS estimates are Rs19.5, Rs18.2 and Rs18.8.

**Reliance Retail—steady progress.** RIL added 112 *Reliance Fresh* stores (small-format F&B stores) in 3QFY08 versus 128 in 2QFY08 and had 441 stores in 45 cities at end-3QFY08. It has rolled out six new formats in 3QFY08. We value the retailing business at US$5.5 bn (Rs159/share). Reliance Retail now has over 2 mn customers in its loyalty programme.

**Reliance Haryana SEZ—land acquisition in progress.** The management has stated that it has acquired 7,500 acres of land for its Haryana SEZ.

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

| | | qoq | | | yoy | | | yoy | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2008E | 3Q 2008 | 2Q 2008 | (% chg) | 3Q 2008 | 3Q 2007 | (% chg) | 9M 2008 | 9M 2007 | (% chg) |
| **Net sales** | **1,144,278** | **345,900** | **320,430** | ***7.9*** | **345,900** | **281,950** | ***22.7*** | **961,570** | **842,450** | ***14.1*** |
| Total expenditure | (921,897) | (287,570) | (262,620) | *9.5* | (287,570) | (230,150) | *24.9* | (788,700) | (693,680) | *13.7* |
| Inc/(Dec) in stock | — | (6,770) | 9,200 | *(173.6)* | (6,770) | (10,360) | *(34.7)* | (6,350) | 3,930 | *(261.6)* |
| Raw materials | (821,713) | (251,610) | (242,740) | *3.7* | (251,610) | (184,330) | *36.5* | (694,450) | (593,050) | *17.1* |
| Staff cost | (20,941) | (5,770) | (4,710) | *22.5* | (5,770) | (5,040) | *14.5* | (15,440) | (15,530) | *(0.6)* |
| Other expenditure | (79,243) | (23,420) | (24,370) | *(3.9)* | (23,420) | (30,420) | *(23.0)* | (72,460) | (89,030) | *(18.6)* |
| **EBITDA** | **222,382** | **58,330** | **57,810** | ***0.9*** | **58,330** | **51,800** | ***12.6*** | **172,870** | **148,770** | ***16.2*** |
| **OPM (%)** | **19.4** | **16.9** | **18.0** | | **16.9** | **18.4** | | **18.0** | **17.7** | |
| Other income | 8,500 | 2,410 | 1,680 | *43.5* | 2,410 | 1,200 | *100.8* | 6,060 | 3,530 | *71.7* |
| Interest | (10,406) | (2,530) | (2,570) | *(1.6)* | (2,530) | (3,060) | *(17.3)* | (8,050) | (9,010) | *(10.7)* |
| Depreciation | (45,750) | (12,130) | (11,290) | *7.4* | (12,130) | (12,740) | *(4.8)* | (34,670) | (35,880) | *(3.4)* |
| **Pretax profits** | **174,725** | **46,080** | **45,630** | ***1.0*** | **46,080** | **37,200** | ***23.9*** | **136,210** | **107,410** | ***26.8*** |
| Extraordinaries/sales tax benefit | 47,330 | 47,330 | — | | 47,330 | — | | 47,330 | — | |
| Tax | (27,077) | (10,630) | (5,270) | *101.7* | (10,630) | (4,370) | *143.2* | (21,070) | (12,350) | *70.6* |
| Deferred taxation | (8,775) | (1,990) | (1,990) | — | (1,990) | (2,020) | *(1.5)* | (7,010) | (7,190) | *(2.5)* |
| **Net income** | **186,203** | **80,790** | **38,370** | ***110.6*** | **80,790** | **30,810** | ***162.2*** | **155,460** | **87,870** | ***76.9*** |
| **Adjusted profits** | **146,515** | **38,820** | **38,370** | ***1.2*** | **38,820** | **30,810** | ***26.0*** | **108,130** | **87,870** | ***23.1*** |
| Income tax rate (%) | 16.1 | 16.5 | 15.9 | | 16.5 | 17.2 | | 15.3 | 18.2 | |
| | | | | | | | | | | |
| **Chemicals production** | | | | | | | | | | |
| Polymer volumes ('000 tons) | | 852 | 829 | *3* | 852 | 852 | — | 2,514 | 2,413 | *4* |
| Polyester volumes ('000 tons) | | 392 | 387 | *1* | 392 | 389 | *1* | 1,168 | 1,114 | *5* |
| Fiber intermediates ('000 tons) | | 1,114 | 1,214 | *(8)* | 1,114 | 1,076 | *4* | 3,480 | 3,151 | *10* |
| **Refining** | | | | | | | | | | |
| Crude throughput (mn tons) | | 7.6 | 8.1 | *(6.1)* | 7.6 | 7.9 | *(3.8)* | 23.7 | 23.6 | *0.4* |
| Refining margin (US$/bbl) incl. sales tax incentives | | **15.4** | **13.6** | *13.2* | 15.4 | 11.7 | *31.6* | 14.9 | 10.7 | *39.5* |
| Average exchange rate | | 39.5 | 40.5 | *(2.5)* | 39.5 | 45.0 | *(12.2)* | 40.4 | 45.6 | *(11.4)* |
| **E&P** | | | | | | | | | | |
| Crude oil production (000 tons) | | 170 | 156 | *8.5* | 170 | 158 | *7.6* | 475 | 399 | *18.9* |
| Gas production (bcf) | | 16 | 13 | *28.0* | 16 | 11 | *49.4* | 40 | 28 | *41.8* |

**Segment results of Reliance Industries**

| | qoq | | | yoy | | | yoy | | |
|---|---|---|---|---|---|---|---|---|---|
| | 3Q 2008 | 2Q 2008 | (% chg) | 3Q 2008 | 3Q 2007 | (% chg) | 9M 2008 | 9M 2007 | (% chg) |
| **Revenues** | | | | | | | | | |
| Petrochemicals | 127,060 | 129,610 | *(2.0)* | 127,060 | 131,450 | *(3.3)* | 388,800 | 377,990 | *2.9* |
| Refining | 261,540 | 235,750 | *10.9* | 261,540 | 208,700 | *25.3* | 720,570 | 649,070 | *11.0* |
| Others | 9,190 | 8,010 | *14.7* | 9,190 | 6,340 | *45.0* | 23,100 | 17,190 | *34.4* |
| Gross turnover | 397,790 | 373,370 | *6.5* | 397,790 | 346,490 | *14.8* | 1,132,470 | 1,044,250 | *8.4* |
| Inter segment | 38,990 | 39,350 | *(0.9)* | 38,990 | 48,960 | *(20.4)* | 126,750 | 153,470 | *(17.4)* |
| Excise duty | 12,900 | 13,590 | *(5.1)* | 12,900 | 15,580 | *(17.2)* | 44,150 | 48,330 | *(8.6)* |
| **Net sales** | **345,900** | **320,430** | ***7.9*** | **345,900** | **281,950** | ***22.7*** | **961,570** | **842,450** | ***14.1*** |
| **EBIT** | | | | | | | | | |
| Petrochemicals | 17,780 | 20,250 | *(12.2)* | 17,780 | 17,880 | *(0.6)* | 56,480 | 51,960 | *8.7* |
| Refining | 26,140 | 23,210 | *12.6* | 26,140 | 19,250 | *35.8* | 74,920 | 54,490 | *37.5* |
| Others | 3,960 | 3,900 | *1.5* | 3,960 | 3,640 | *8.8* | 10,870 | 10,130 | *7.3* |
| **Total** | **47,880** | **47,360** | ***1.1*** | **47,880** | **40,770** | ***17.4*** | **142,270** | **116,580** | ***22.0*** |
| Interest expense | (2,530) | (2,570) | *(1.6)* | (2,530) | (3,060) | *(17.3)* | (8,050) | (9,010) | *(10.7)* |
| Interest income | 1,410 | 1,380 | *2.2* | 1,410 | 720 | *95.8* | 4,140 | 2,220 | *86.5* |
| Other unallocable (net) | (680) | (540) | *25.9* | (680) | (1,230) | *(44.7)* | (2,150) | (2,380) | *(9.7)* |
| **PBT** | **46,080** | **45,630** | ***1.0*** | **46,080** | **37,200** | ***23.9*** | **136,210** | **107,410** | ***26.8*** |
| Current tax | (10,630) | (5,270) | *101.7* | (10,630) | (4,370) | *143.2* | (21,070) | (12,350) | *70.6* |
| Deferred tax | (1,990) | (1,990) | — | (1,990) | (2,020) | *(1.5)* | (7,010) | (7,190) | *(2.5)* |
| **PAT** | **80,790** | **38,370** | ***110.6*** | **80,790** | **30,810** | ***162.2*** | **155,460** | **87,870** | ***76.9*** |
| **Capital employed** | | | | | | | | | |
| Petrochemicals | 305,190 | 263,340 | *15.9* | 305,190 | 329,510 | *(7.4)* | 305,190 | 329,510 | *(7.4)* |
| Refining | 405,820 | 392,720 | *3.3* | 405,820 | 403,690 | *0.5* | 405,820 | 403,690 | *0.5* |
| Others | 289,880 | 187,430 | *54.7* | 289,880 | 89,510 | *223.9* | 289,880 | 89,510 | *223.9* |
| Unallocated corporate | 189,840 | 96,700 | *96.3* | 189,840 | 114,900 | *65.2* | 189,840 | 114,900 | *65.2* |
| **Total** | **1,190,730** | **940,190** | ***26.6*** | **1,190,730** | **937,610** | ***27.0*** | **1,190,730** | **937,610** | ***27.0*** |

Source: Company data, Kotak Institutional Equities.

**Flat costs qoq in chemical segment surprising given surge in naphtha costs**
Segment-wise perfomance (Rs mn)

| | 3Q 2008 | 2Q 2008 | 3Q 2007 | Change qoq | Change yoy |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Petrochemicals | 127,060 | 129,610 | 131,450 | (2.0) | (3.3) |
| Refining | 261,540 | 235,750 | 208,700 | 10.9 | 25.3 |
| **Operating costs** | | | | | |
| Petrochemicals | 109,280 | 109,360 | 113,570 | (0.1) | (3.8) |
| Refining | 235,400 | 212,540 | 189,450 | 10.8 | 24.3 |
| **EBIT** | | | | | |
| Petrochemicals | 17,780 | 20,250 | 17,880 | (12.2) | (0.6) |
| Refining | 26,140 | 23,210 | 19,250 | 12.6 | 35.8 |

Source: Company, Kotak Institutional Equities.

**3QFY08 chemical margins are significantly lower yoy**
Asian chemical margins and prices, March fiscal year-ends (US$/ton)

| | 3QFY07 | 4QFY07 | 1QFY08 | 2QFY08 | 3QFY08 | 3Q08 vs 3Q07 (%) |
|---|---|---|---|---|---|---|
| **Margins** | | | | | | |
| HDPE – naphtha | 736 | 662 | 580 | 665 | 609 | (17.2) |
| LLDPE – naphtha | 734 | 703 | 606 | 662 | 601 | (18.2) |
| PP – naphtha | 722 | 667 | 593 | 671 | 579 | (19.7) |
| PVC – naphtha | 295 | 272 | 241 | 321 | 163 | (44.8) |
| PSF – naphtha | 812 | 797 | 748 | 762 | 747 | (8.0) |
| PFY – naphtha | 985 | 1,013 | 941 | 1,002 | 978 | (0.7) |
| PX – naphtha | 572 | 541 | 528 | 399 | 271 | (52.6) |
| **Prices** | | | | | | |
| HDPE | 1,281 | 1,288 | 1,296 | 1,353 | 1,428 | 11.5 |
| LLDPE | 1,281 | 1,288 | 1,296 | 1,353 | 1,419 | 10.8 |
| PP | 1,268 | 1,252 | 1,283 | 1,362 | 1,398 | 10.2 |
| PVC | 841 | 857 | 931 | 1,011 | 981 | 16.6 |
| PSF | 1,532 | 1,598 | 1,632 | 1,692 | 1,565 | 2.2 |
| PFY | 1,532 | 1,598 | 1,632 | 1,678 | 1,797 | 17.3 |
| PX | 1,119 | 1,126 | 1,218 | 1,089 | 1,090 | (2.6) |
| **Naphtha** | **546** | **585** | **690** | **690** | **818** | **49.8** |
| **Rupee-dollar exchange rate** | **45.0** | **44.2** | **41.3** | **40.5** | **39.5** | **(12.2)** |

Source: Platt's, Bloomberg.

**RIL's 3QFY08 refining margins show stronger increase versus benchmark margins**
Global refining margins, March fiscal year-ends (US$/bbl)

| | 2Q 2007 | 3Q 2007 | 4Q 2007 | 1Q 2008 | 2Q 2008 | 3Q 2008 |
|---|---|---|---|---|---|---|
| Singapore (Dubai) | 4.7 | 3.9 | 6.8 | 9.5 | 6.4 | 7.7 |
| US Gulf Coast (Dated Brent) | 7.8 | 4.2 | 7.5 | 13.1 | 6.9 | 3.9 |
| US Gulf Coast (WTI) | 8.0 | | | 18.8 | 8.6 | 3.4 |
| Rotterdam (Dated Brent) | 5.2 | 2.8 | 4.1 | 6.6 | 3.5 | 5.3 |
| Mediterranean (Urals) | 5.4 | 4.0 | 5.7 | 7.2 | 3.8 | 4.6 |
| **RIL's reported margins** | **9.1** | **11.7** | **13.0** | **15.4** | **13.6** | **15.4** |
| **Premium over Singapore margins** | **4.4** | **7.8** | **6.2** | **5.9** | **7.2** | **7.7** |
| **Premium over US Gulf Coast (Dated Brent) margins** | **1.3** | **7.5** | **5.5** | **2.3** | **6.7** | **11.5** |
| **Premium over Rotterdam (Dated Brent)** | **3.9** | **8.9** | **8.9** | **8.8** | **10.1** | **10.1** |

Source: Company, Reuters.

**Gasoline cracks have come off significantly from 1QFY08 levels**
Calculation of product cracks (US$/bbl)

| | Gasoline | Naphtha | Kerosene | Gasoil | Jet fuel | Fuel oil |
|---|---|---|---|---|---|---|
| Apr-07 | 19.5 | 9.9 | 16.7 | 16.3 | 16.7 | (9.8) |
| May-07 | 24.2 | 11.9 | 17.4 | 17.0 | 17.4 | (10.1) |
| Jun-07 | 19.7 | 8.4 | 17.9 | 16.3 | 17.9 | (9.8) |
| Jul-07 | 16.3 | 6.2 | 17.6 | 16.2 | 17.6 | (9.1) |
| Aug-07 | 10.2 | 4.5 | 17.0 | 15.7 | 17.0 | (8.1) |
| Sep-07 | 9.3 | 2.9 | 17.0 | 17.4 | 17.0 | (11.4) |
| Oct-07 | 11.3 | 4.8 | 19.0 | 18.1 | 19.0 | (8.0) |
| Nov-07 | 13.4 | 5.0 | 25.7 | 19.9 | 25.7 | (7.5) |
| Dec-07 | 13.0 | 6.6 | 22.7 | 20.4 | 22.7 | (11.1) |
| **1QFY08** | **21.1** | **10.1** | **17.3** | **16.5** | **17.3** | **(9.9)** |
| **2QFY08** | **11.9** | **4.5** | **17.2** | **16.4** | **17.2** | **(9.5)** |
| **3QFY08** | **12.6** | **5.4** | **22.4** | **19.5** | **22.4** | **(8.9)** |

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

Source: Bloomberg, Kotak Institutional Equities.

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

| | 3QFY08 | 2QFY08 | 1QFY08 | 4QFY07 | 3QFY07 | 2QFY07 | 1QFY07 | 4QFY06 | 3QFY06 |
|---|---|---|---|---|---|---|---|---|---|
| RIL's reported margins | 15.4 | 13.6 | 15.4 | 13.0 | 11.7 | 9.1 | 12.4 | 10.4 | 9.1 |
| Singapore margins as computed by IEA (a) | 3.5 | 2.5 | 4.7 | 3.1 | 1.0 | 1.5 | 4.9 | 1.2 | 2.9 |
| **Premium over reported Singapore margins** | **11.9** | **11.1** | **10.7** | **9.9** | **10.7** | **7.6** | **7.5** | **9.2** | **6.2** |
| Hypothetical margins for RPL (b) | 6.9 | 7.3 | 13.1 | 11.1 | 8.5 | 11.4 | 13.8 | 5.8 | 9.1 |
| **Premium of RPL's computed margins over RIL's reported margins** | **(8.5)** | **(6.3)** | **(2.3)** | **(1.9)** | **(3.2)** | **2.3** | **1.4** | **(4.6)** | **(0.0)** |

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

Source: Bloomberg, company, Kotak Institutional Equities estimates.

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

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

Source: Company, Kotak Institutional Equities.

**Reliance has high leverage to refining margins**

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

| | Fiscal 2008E | | | Fiscal 2009E | | | Fiscal 2010E | | |
|---|---|---|---|---|---|---|---|---|---|
| | Downside | Base case | Upside | Downside | Base case | Upside | Downside | Base case | Upside |
| **Rupee-dollar exchange rate** | | | | | | | | | |
| Rupee-dollar exchange rate | 39.1 | 40.1 | 41.1 | 37.5 | 38.5 | 39.5 | 36.5 | 37.5 | 38.5 |
| Net profits (Rs mn) | 140,528 | 146,515 | 152,593 | 150,455 | 156,663 | 162,872 | 212,800 | 220,230 | 227,660 |
| EPS (Rs) | 96.7 | 100.8 | 105.0 | 99.4 | 103.5 | 107.6 | 135.3 | 140.0 | 144.7 |
| **% upside/(downside)** | **(4.1)** | | **4.1** | **(4.0)** | | **4.0** | **(3.4)** | | **3.4** |
| **Chemical prices** | | | | | | | | | |
| Change in prices (%) | (5.0) | | 5.0 | (5.0) | | 5.0 | (5.0) | | 5.0 |
| Net profits (Rs mn) | 140,838 | 146,515 | 152,170 | 151,719 | 156,663 | 161,607 | 215,643 | 220,230 | 224,817 |
| EPS (Rs) | 96.9 | 100.8 | 104.7 | 100.3 | 103.5 | 106.8 | 137.1 | 140.0 | 142.9 |
| **% upside/(downside)** | **(3.9)** | | **3.9** | **(3.2)** | | **3.2** | **(2.1)** | | **2.1** |
| **Refining margins (US$/bbl)** | | | | | | | | | |
| Margins (US$/bbl) | 13.7 | 14.7 | 15.7 | 12.3 | 13.3 | 14.3 | 14.1 | 15.1 | 16.1 |
| Net profits (Rs mn) | 138,316 | 146,515 | 154,717 | 148,771 | 156,663 | 164,555 | 214,273 | 220,230 | 226,187 |
| EPS (Rs) | 95.2 | 100.8 | 106.5 | 98.3 | 103.5 | 108.7 | 136.2 | 140.0 | 143.8 |
| **% upside/(downside)** | **(5.6)** | | **5.6** | **(5.0)** | | **5.0** | **(2.7)** | | **2.7** |

Source: Kotak Institutional Equities estimates.

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

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|---|---|
| **Profit model (Rs mn)** | | | | | | | | |
| Net sales | 451,133 | 510,715 | 656,223 | 809,113 | 1,114,927 | 1,144,278 | 1,360,194 | 1,923,568 |
| **EBITDA** | **75,808** | **91,148** | **123,820** | **139,991** | **198,462** | **222,382** | **266,817** | **441,484** |
| Other income | 10,012 | 11,381 | 14,498 | 6,829 | 4,783 | 8,500 | 10,128 | 15,124 |
| Interest | (15,552) | (14,347) | (14,687) | (8,770) | (11,889) | (10,406) | (9,198) | (10,220) |
| Depreciation & depletion | (28,371) | (32,470) | (37,235) | (34,009) | (48,152) | (45,750) | (61,203) | (84,814) |
| Pretax profits | 41,897 | 55,711 | 86,397 | 104,041 | 143,205 | 174,725 | 206,544 | 361,574 |
| Extraordinary items | 7,845 | 7,300 | 4,290 | 3,000 | 2,000 | 47,330 | — | — |
| Tax | (2,459) | (3,510) | (7,050) | (9,307) | (16,574) | (27,077) | (31,158) | (54,727) |
| Deferred taxation | (6,240) | (7,900) | (7,920) | (7,040) | (9,196) | (8,775) | 1,453 | 1,026 |
| Minority interest | — | — | — | — | — | — | (5,976) | (25,960) |
| Net profits | 41,043 | 51,601 | 75,717 | 90,693 | 119,434 | 186,203 | 170,863 | 281,913 |
| **Adjusted net profits** | **34,570** | **45,623** | **72,135** | **88,152** | **117,789** | **146,515** | **170,863** | **281,913** |
| **Earnings per share (Rs)** | **24.8** | **32.7** | **51.7** | **63.3** | **81.0** | **100.8** | **112.9** | **179.2** |
| | | | | | | | | |
| **Balance sheet (Rs mn)** | | | | | | | | |
| Total equity | 303,744 | 344,525 | 404,033 | 430,543 | 673,037 | 838,837 | 1,136,277 | 1,377,527 |
| Deferred taxation liability | 26,848 | 34,748 | 42,668 | 49,708 | 69,820 | 78,595 | 77,142 | 76,116 |
| Minority interest | — | — | — | — | 33,622 | 33,622 | 38,666 | 57,944 |
| Total borrowings | 197,583 | 209,447 | 187,846 | 218,656 | 332,927 | 430,261 | 236,433 | 117,642 |
| Currrent liabilities | 109,666 | 122,855 | 171,315 | 164,545 | 192,305 | 218,344 | 226,695 | 252,103 |
| **Total liabilities and equity** | **637,842** | **711,574** | **805,863** | **863,452** | **1,301,712** | **1,599,659** | **1,715,213** | **1,881,333** |
| Cash | 1,472 | 2,242 | 36,087 | 21,461 | 18,449 | 57,491 | 56,079 | 154,954 |
| Current assets | 227,809 | 218,159 | 248,438 | 224,283 | 286,566 | 326,881 | 356,461 | 429,456 |
| Total fixed assets | 340,863 | 351,460 | 350,823 | 626,745 | 899,403 | 1,072,993 | 1,127,880 | 1,104,629 |
| Investments | 67,227 | 139,714 | 170,515 | (9,038) | 97,294 | 142,294 | 174,794 | 192,294 |
| Deferred expenditure | 472 | — | — | — | — | — | — | — |
| **Total assets** | **637,842** | **711,574** | **805,863** | **863,452** | **1,301,712** | **1,599,659** | **1,715,213** | **1,881,332** |
| | | | | | | | | |
| **Free cash flow (Rs mn)** | | | | | | | | |
| Operating cash flow, excl. working cap | 67,072 | 83,301 | 107,002 | 119,520 | 164,285 | 225,071 | 219,976 | 373,402 |
| Working capital | (17,614) | 20,265 | 46,875 | (32,188) | (13,075) | (14,277) | (21,229) | (47,586) |
| Capital expenditure | (37,043) | (43,191) | (52,440) | (94,273) | (247,274) | (229,538) | (110,256) | (58,429) |
| Investments | (34,204) | (68,430) | (48,192) | (32,364) | (105,760) | (45,000) | (32,500) | 17,500— |
| Other income | 5,219 | 5,902 | 3,032 | 5,159 | 4,143 | 8,500 | 10,128 | 15,124 |
| **Free cash flow** | **(16,569)** | **(2,153)** | **56,276** | **(34,146)** | **(197,681)** | **(55,244)** | **66,119** | **265,011** |
| | | | | | | | | |
| **Ratios (%)** | | | | | | | | |
| Debt/equity | 59.8 | 55.2 | 42.1 | 45.5 | 44.8 | 46.9 | 19.5 | 8.1 |
| Net debt/equity | 59.3 | 54.6 | 34.0 | 41.1 | 42.3 | 40.6 | 14.9 | (2.6) |
| RoAE | 10.7 | 12.7 | 17.6 | 19.9 | 20.3 | 18.5 | 16.7 | 21.8 |
| **RoACE** | **8.8** | **9.7** | **13.0** | **13.8** | **13.9** | **12.4** | **12.9** | **20.5** |

Source: Kotak Institutional Equities estimates.

**Large new capacity additions in ethylene in CY2008-10E**

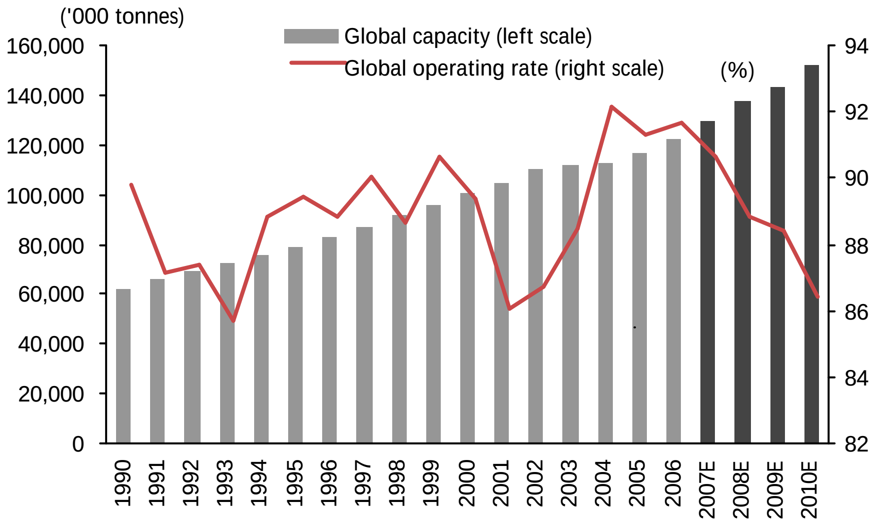
Major additions to ethylene capacity in Asia and Middle-East, calendar year-ends, 2008-2010E ('000 tons)

| | 2008 | 2009 | 2010 |
|---|---|---|---|
| **China** | | | |
| Fujian Petrochemical | | 800 | |
| PetroChina Dushanzi | | 1,000 | |
| PetroChina Fushun | | | 800 |
| Shanghai Secco Petrochemical | | | 500 |
| Sinopec Tianjin | | | 800 |
| Sinopec Zhenhai | | | 1,000 |
| **Total China** | — | **1,800** | **3,100** |
| **India** | | | |
| Haldia Petrochemicals | 180 | | |
| Indian Oil Corp. | | | 800 |
| **Total India** | **180** | — | **800** |
| **Iran** | | | |
| Arya Sasol | 1,000 | | |
| Jam Petrochemical | 1,320 | | |
| NPCL, Illam | | 318 | |
| **Total Iran** | **2,320** | **318** | — |
| **Korea** | | | |
| Lotte Daesan | 350 | | |
| Samsung Total | 200 | | |
| **Total Korea** | **550** | — | — |
| **Kuwait** | | | |
| Equate | 850 | | |
| **Total Kuwait** | **850** | — | — |
| **Qatar** | | | |
| QAPCO | 200 | | |
| Q-Chem/Atofina | | 1,300 | |
| **Total Qatar** | **200** | **1,300** | — |
| **Saudi Arabia** | | | |
| Petro-Rabigh | | 650 | 650 |
| Petrokemya | | | 800 |
| Saudi ChevronPhillips Petrochem | 300 | | |
| SEPC | 1,000 | | |
| SHARQ | 600 | 600 | |
| Yanbu Petrochemical Complex | 1,300 | | |
| **Total Saudi Arabia** | **3,200** | **1,250** | **1,450** |
| Singapore | | | |
| Shell Singapore | | | 800 |
| **Total Singapore** | — | — | **800** |
| **Total Asia** | **7,300** | **4,668** | **6,150** |
| **Total globe (including expansions)** | **8,300** | **5,628** | **8,610** |

Source: Kotak Institutional Equities estimates.

**Continued steep decline in operating rates through CY2010E**

Ethylene capacity and operating rates, 1991-2010E




Source: Kotak Institutional Equities estimates.

**Reliance has made new discoveries over the past few months but not yet disclosed reserves**

Oil and gas discoveries of Reliance since January 2007

| | Block | Area (sq. km) | Consortium | RIL's stake (%) | Comments |
|---|---|---|---|---|---|
| 1 | KG-DWN-98/3 | 7,645 | Reliance, Niko | 90 | Oil and gas discovery in MA-2 well in February 2007 |
| 2 | KG-DWN-98/3 | 7,645 | Reliance, Niko | 90 | KG-D6-AA1, KG-D6-Q1 wells in deeper areas of block in February 2007 |
| 3 | KG-DWN-98/3 | 7,645 | Reliance, Niko | 90 | R1 well in August 2007 encountered two significant gas-bearing zones |
| 4 | NEC-OSN-97/2 | 14,535 | Reliance, Niko | 90 | Dhirubhai-32 (7th) gas discovery |
| 5 | GS-OSN-2000/1 | 8,841 | Reliance, Hardy | 90 | Gas discovery in May 2007 |
| 6 | CY-DWN-2001/2 | 14,325 | Reliance | 100 | Oil and gas discovery in July 2007 |
| 7 | KG-DWN-98/1 | 8,100 | Reliance | 100 | Dhirubhai-36 oil discovery in September 2007; first oil discovery in the block |
| 8 | MN-DWN-2003/1 | 17,050 | Reliance, Niko | 85 | Date of drilling yet to be decided |
| 9 | KG-OSN-2001/2 | 210 | Reliance | 100 | Gas discovery notified to DGH; commerciality to be ascertained |
| 10 | KG-OSN-2001/1 | 1,100 | Reliance | 100 | Dhirubhai-38; gas discovery in January 2008 |
| 11 | KG-OSN-2001/2 | 1,100 | Reliance | 100 | Dhirubhai-37; gas discovery notified to DGH |
| 12 | SR-OS-94/1 | 6,860 | Reliance | 100 | Oil discovery notified to DGH |

Note:
(a) We have included the MN-DWN-2003/1 (MN D-4) block given high expectations from this block.

Source: Company, Rigzone, Kotak Institutional Equities estimates.

**RIL stock price is implying huge discoveries of hydrocarbons in the future**

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

| | | Comments |
|---|---|---|
| **1. Valuation of extant businesses** | | **Chemicals, RIL refinery, extant oil and gas** |
| FY2008E EPS of Reliance (Rs) | 100.8 | Significantly higher than FY2007 EPS of Rs81 |
| FY2008E EPS adjusted for treasury shares (Rs) | 116.8 | Adjusted for 199 mn treasury shares |
| Effective tax rate in FY2008E (%) | 16.1 | |
| FY2008E EPS adjusted for tax rate | 92.0 | Normalized for 34% tax rate for extant earnings |
| Appropriate P/E multiple (X) | 10.0 | Generous given above mid-cycle margins, earnings and cost of equity of 12.5% |
| **Valuation of extant businesses (Rs)** | **920** | |
| **Valuation of extant businesses** | **29** | **Reasonable in the context of replacement value, returns** |
| **2. Valuation of investments** | | **RPL, others (without Reliance Retail)** |
| Reliance Petroleum | 433 | 3.1955 bn shares at 12-month fair valuation of Rs170 |
| Others | 8 | |
| **Total value of investments** | **441** | |
| **Valuation of RIL ex-new E&P, retailing, SEZs** | **1,361** | |
| Current stock price | 2,996 | |
| **3. Valuation of new businesses** | | **Emerging E&P business, retailing, SEZs** |
| **Market-ascribed value of new businesses** | **1,636** | |
| **Market-ascribed value of new businesses (US$ bn)** | **52** | |
| Estimated valuation of retailing (US$ bn) | 5.5 | Reliance has invested ~US$1.5 bn equity in Reliance Retail as of end-1HFY08 |
| Estimated valuation of SEZs (US$ bn) | — | Value will take time to emerge |
| **Market-ascribed value of emerging E&P business** | **46** | **Seems very high to us based on official reserves, announced discoveries** |
| Estimated value of Reliance's stake in KG D-6 (gas) | 6.1 | Based on gas production of 17 tcf, US$8.8 bn capex, US$4.2/mn BTU net price |
| Estimated value of Reliance's stake in KG D-6 (oil) | 1.8 | 0.5 bn bbls of OOIP assumed versus current announced reserves of 180 mn bbls |
| Estimated value of Reliance's stakes in NEC-25, CBM | 2.2 | |
| **Implied value of new discoveries** | **36** | **Higher reserves in KG D-6, NEC-25, Cauvery-III-D5, GS-01, MN-D4 blocks?** |

Source: Kotak Institutional Equities estimates.

**Reliance's current stock price is implying additional recoverable reserves of 85~ tcf of gas today**

Valuation of Reliance's E&P segment and implied valuation for potential discoveries (US$ bn)

| | | Commnets |
|---|---|---|
| DCF valuation of KG D-6 block, gas for D1 & D3 fields | 6.1 | 15.4 tcf of net recoverable gas reserves |
| Valuation of KG D-6 block, oil for MA-1 field | 1.8 | 450 mn bbls of net proved reserves of oil at EV/bbl of US$10 |
| Valuation of Reliance's stakes in NEC-25, CBM | 2.2 | 5.7 tcf of net recoverable gas reserves |
| **Total valuation of extant announced reserves** | **10** | |
| **Total recoverable reserves (tcf)** | **24** | |
| Implied valuation of E&P segment | 46 | |
| Implied valuation of new E&P discoveries | 36 | |
| **Implied additional recoverable reserves in stock price (tcf)** | **85** | **This is what Reliance needs to announce today** |
| # of years from discovery to production | 6 | KG D-6 first gas discovered in Oct-02, production in 2HFY09 |
| Cost of capital (%) | 12.0 | |
| **Additional gas reserves required to be added in six years (tcf)** | **169** | **This is what Reliance needs to bring in production in six years** |

Note:
(a) The above exercise assumes for simplicity that all future gas and oil discovery would have similar PSC terms as the KG D-6 block.

Source: Kotak Institutional Equities estimates.

**Valuation of Reliance Industries stock (Rs)**

| | FY2010E EPS (Rs) | P/E (X) | Valuation (Rs/share) | Comments |
|---|---|---|---|---|
| Chemicals, refining, E&P (a) (b) | 205 | 10 | 2,052 | Consolidated FY2010E EPS including Reliance Petroleum |
| **Valuation based on FY2010E EPS** | | | **1,788** | **12.5% discount rate; discounted to February, 2008** |
| E&P (higher reserves in KG-DWN-98/3, other blocks) | | | — | We model 0.93 tcf of gas per annum production in perpetuity |
| E&P (NEC-25, CBM) | | | 56 | Based on KG D-6 reserves and valuation |
| Investments | | | 167 | |
| Other investments | | | 7 | |
| Retailing | | | 159 | US$5.5 bn valuation; ~US$1.5 bn equity invested in Reliance Retail as of end-1HFY08 |
| SEZ development | | | — | SEZs will require investment for the first few years |
| **12-month fair valuation** | | | **2,011** | |

Notes:
(a) FY2010E EPS is Rs179 on 1.573 bn shares after considering conversion of 120 mn warrants issued to the major shareholder.
(b) FY2010E EPS is adjusted for treasury shares or computed using 1.372 bn shares.

Source: Kotak Institutional Equities estimates.

**Technology**

| HCLT.BO, Rs268 | |
|---|---|
| Rating | REDUCE |
| Sector coverage view | Attractive |
| Target Price (Rs) | 320 |
| 52W High -Low (Rs) | 366 - 260 |
| Market Cap (Rs bn) | 186 |

**Financials**

| June y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 60.3 | 75.2 | 94.2 |
| Net Profit (Rs bn) | 12.9 | 13.0 | 15.4 |
| EPS (Rs) | 18.9 | 18.7 | 22.1 |
| *EPS gth* | *66* | *(1.0)* | *18.5* |
| P/E (x) | 14.2 | 14.3 | 12.1 |
| EV/EBITDA (x) | 12.7 | 10.6 | 8.6 |
| Div yield (%) | 3.0 | 3.0 | 3.0 |

**Shareholding, September 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 67.5 | - | - |
| FIIs | 14.5 | 0.3 | (0.2) |
| MFs | 4.2 | 0.6 | 0.1 |
| UTI | - | - | (0.5) |
| LIC | 2.4 | 0.3 | (0.2) |

## HCL Technologies: In-line quarter. Business model risks are higher than peers

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- **Revenue growth in line with expectations; IT services leads the way**
- **Adjusted OPM declines 80 bps qoq**
- **Maintain REDUCE rating**

HCL Technologies' (HCLT) Dec' 07 quarter results were in line with our expectations. Revenues grew 7.4% qoq to US$461 mn. EBITDA margin (ex-RSU charge) improved 10 bps qoq to 21.4% (down 80 bps qoq adjusted for cash flow hedging gains of US$7 mn in the revenue line versus US$1.5 mn in the previous quarter). Net income (excluding stock compensation charge) of US$79.8 mn was marginally below our expectations, primarily on account of higher SG&A expenses and lower forex gains than expected. We remain confident of the robust near-term EPS growth for HCLT on the back of recently won large contracts and aggressive hedging (US $2.5 bn, covering 10 quarters of net inflows) relative to size. However, we see significant risks in the business model (focusing on clients outside F-500/G-500) being pursued by the company in the medium-to-long term. Exposure to a large number of small and medium-sized clients adds scalability and growth challenges for the company, especially in case the US economy goes into a slowdown/ recession, in our view. We maintain our REDUCE rating with an unchanged Jun '09 DCF-based target price of Rs320/share. We have fine-tuned our EPS estimates for FY2008 to Rs18.7 (Rs18.6 earlier) and FY2009 to Rs22.1 (Rs21.9 earlier). The stock is trading at 14.4FY2008E and 12.1XFY2009E earnings.

**Revenue growth in line with expectations; IT services lead the way.** HCLT reported sequential revenue growth of 7.4% to US$461 mn. Growth was led by IT services (core software), up 8.3% qoq to US$335 mn. Revenue growth was characterized by 7.3% volumes growth and 0.9% pricing improvement. Hiring was modest at 1,327 employees in IT services. Infrastructure services grew 9.1% qoq to US$71 mn. BPO revenues were hardly changed at US$55.4 mn. Consistent with earlier trends, the company announced one more large deal (US$250 m). We believe that the large multi-service deal strategy for clients outside F-200 is paying dividends, though consistency in this area remains the key to revenue growth going forward. Overall recruitment for the quarter was 2,312, 5% of the Sep' 07 quarter base.

**Adjusted OPM declines 80 bps qoq.** HCLT's reported OPM (EBITDA) improved 10 bps qoq and declined 70 bps yoy to 21.4%. However, adjusted for cash flows, hedging gains of US$7 mn (US$1.5 mn in the previous quarter) in the revenue line and RSU expenses, OPM was down 80 bps qoq to 19.1%, lower than our expectations. Note that the company effected wage increases for senior management team in the current quarter. HCLT's cost line includes a one-time provision of US$1.5 mn to take into effect the change in the Payment of Bonus Act. Similar to peers, the decline in EBITDA margin was arrested by realization improvement of 1.6% on a blended basis (123 bps margin support), efficiency gains of 69 bps and depreciation leverage. Rupee appreciation impacted the margins by 107 bps while lower billing days in the quarter had a negative impact of 83 bps. Higher SG&A on account of the company's global sales meet during the quarter had a negative impact of 89 bps on margins.

**Valuations—marginally lower than historic trends.** We have tweaked our estimates to factor in marginally higher revenue growth for the company. We now model 38% and 27.7% revenue growth for HCLT in FY2008E and FY2009E versus 36.7% and 27% earlier. Consequently, we have revised upwards our EPS estimates for FY2008 and FY2009 to Rs18.7 and Rs22.1, an increase of 0.5% and 0.8%, respectively. The stock trades at 14.4XFY2008E and 12.1XFY2009E earnings, lower than the historical trend.

**Dec '07 revenue growth driven by IT and infrastructure services; BPO was weak on expected lines**

| Revenues - US$mn | Sep-05 | Dec-05 | Mar-06 | Jun-06 | Sep-06 | Dec-06 | Mar-07 | Jun-07 | Sep-07 | Dec-07 |
|---|---|---|---|---|---|---|---|---|---|---|
| IT services | 168.9 | 177.7 | 187.1 | 202.1 | 222.3 | 242.7 | 262.4 | 282.4 | 309.1 | 334.9 |
| Infrastructure services | 22.0 | 26.7 | 29.3 | 34.0 | 39.8 | 46.4 | 50.2 | 59.3 | 64.7 | 70.6 |
| BPO | 29.7 | 29.7 | 35.1 | 36.3 | 38.4 | 42.0 | 49.7 | 54.0 | 55.1 | 55.4 |
| **Total** | **220.6** | **234.2** | **251.5** | **272.4** | **300.5** | **331.1** | **362.3** | **395.7** | **428.9** | **460.9** |
| **Growth qoq (%)** | **Sep-05** | **Dec-05** | **Mar-06** | **Jun-06** | **Sep-06** | **Dec-06** | **Mar-07** | **Jun-07** | **Sep-07** | **Dec-07** |
| IT services | 3.9 | 5.2 | 5.3 | 8.0 | 10.0 | 9.2 | 8.1 | 7.6 | 9.5 | 8.3 |
| Infrastructure services | 0.8 | 21.3 | 9.7 | 16.0 | 17.0 | 16.6 | 8.2 | 18.1 | 9.1 | 9.1 |
| BPO | 0.1 | 0.1 | 18.0 | 3.5 | 5.8 | 9.4 | 18.3 | 8.7 | 2.0 | 0.5 |
| **Total** | **3.1** | **6.1** | **7.4** | **8.3** | **10.3** | **10.2** | **9.4** | **9.2** | **8.4** | **7.5** |

Source: Company

**HCLT's OPM, adjusted for cash flow hedging gains were down 80bps qoq**

| US$ mn | Dec-06 | Sep-07 | Dec-07 | qoq change | yoy change |
|---|---|---|---|---|---|
| Reported revenues | 331.1 | 429.0 | 461.0 | 7.5% | 39.2% |
| Reported EBITDA | 73.2 | 91.3 | 98.6 | 8.0% | 34.7% |
| **EBITDA margin (%)** | **22.1** | **21.3** | **21.4** | **11 bps** | **-72 bps** |
| RSU expenses | 4.0 | 4.7 | 4.7 | | |
| Cash flow hedging gains | - | 1.5 | 7.0 | | |
| Adjusted revenues (a) | 331.1 | 427.5 | 454.0 | 6.2% | 37.1% |
| Adjusted EBITDA (b) | 69.2 | 85.1 | 86.9 | 2.1% | 25.6% |
| **Adjusted EBITDA margin (%)** | **20.9** | **19.9** | **19.1** | **-77 bps** | **-176 bps** |

Note:
(a) Adjusted for cash flow hedging gains.
(b) Adjusted for cash flow hedging gains as well as RSU expenses.

Source: Company, Kotak Institutional Equities

**Key Changes to our FY2008 and FY2009 estimates**

| | Revised | | Old | | Change (%) | |
|---|---|---|---|---|---|---|
| **US$ mn** | **FY2008E** | **FY2009E** | **FY2008E** | **FY2009E** | **FY2008E** | **FY2009E** |
| **Revenues** | **1,918** | **2,450** | **1,884** | **2,393** | **1.8** | **2.4** |
| *- Software Services* | *1,391* | *1,785* | *1,366* | *1,745* | *1.8* | *2.3* |
| *- BPO* | *233* | *288* | *229* | *281* | *1.7* | *2.3* |
| *- Infrastructure Services* | *294* | *377* | *290* | *367* | *1.6* | *2.9* |
| | | | | | | |
| **Revenue growth yoy (%)** | **38.0** | **27.7** | **36.7** | **27.0** | | |
| | | | | | | |
| EBITDA | 391 | 483 | 381 | 471 | 2.5 | 2.5 |
| EBIT | 315 | 394 | 307 | 384 | 2.6 | 2.6 |
| **Net Income** | **331** | **400** | **330** | **397** | **0.5** | **0.8** |
| | | | | | | |
| EBITDA margin (%) | 20.4 | 19.7 | 20.2 | 19.7 | | |
| EBIT | 16.4 | 16.1 | 16.3 | 16.0 | | |
| Re/ US$ rate | 39.2 | 38.4 | 39.2 | 38.4 | **0.1** | **0.0** |
| | | | | | | |
| **EPS Rs/ share** | **18.7** | **22.1** | **18.6** | **21.9** | **0.5** | **0.8** |

Source: Kotak Institutional Equities estimates

HCL Technologies (year ending June) - Comments on 2QFY08 financial performance

| Rs mn | 2QFY07 | 1QFY08 | 2QFY08 | QoQ % chg. | YoY % chg. | Kotak Estimates | % Deviation | Comments on QoQ performance |
|---|---|---|---|---|---|---|---|---|
| **CONSOLIDATED** | | | | | | | | |
| **Revenues** | 14,651 | 17,092 | 18,166 | 6.3 | 24.0 | 17,983 | 1.0 | Overall revenue growth of 7.5% qoq (US$ terms), slightly ahead of our expectations of 6.7% growth. Led by strong performance in core software (8.3% qoq) and infrastructure services (9.1% qoq). BPO revenues grew 0.5% qoq, better than our expectations of a marginal decline. HCTL had US$7 mn of cash-flow hedge gains in the revenue line, against US$1.5 mn in the previous quarter. Adjusted revenue growth was 6.2% qoq, lower than our expectations |
| Cost of Revenues | (9,288) | (10,948) | (11,433) | 4.4 | 23.1 | (11,469) | (0.3) | |
| **Gross profit** | 5,363 | 6,144 | 6,733 | 9.6 | 25.5 | 6,513 | 3.4 | |
| SG&A expenses | (2,301) | (2,693) | (3,023) | 12.2 | 31.4 | (2,886) | 4.7 | |
| **EBITDA (including RSU expenses)** | 3,062 | 3,450 | 3,710 | 7.5 | 21.2 | 3,627 | 2.3 | |
| **EBIDTA adjusted for non cash RSU charges** | 3,239 | 3,638 | 3,885 | 6.8 | 19.9 | 3,812 | 1.9 | |
| Depreciation | (624) | (681) | (724) | 6.3 | 16.0 | (708) | 2.3 | |
| EBIT | 2,438 | 2,769 | 2,986 | 7.8 | 22.5 | 2,919 | 2.3 | Reported EBIT margins show an improvement of 12bps qoq. However, adjusted for RSU expenses and cash-flow hedging gains, margins were down 80bps qoq, much below our expectations of flat margins |
| Other Income | 478 | 502 | 542 | 8.0 | 13.4 | 680 | (20.2) | Other income includes forex gains of US$1.5 mn versus US$3.6 mn in the Sep '07 quarter. We had factored in forex gains of US$6 mn for the quarter |
| **Earnigs before tax** | 2,916 | 3,271 | 3,528 | 7.9 | 21.0 | 3,599 | (2.0) | |
| Provision for Tax | (208) | (347) | (355) | 2.4 | 70.7 | (432) | (17.8) | |
| **Earnings after & before share of earnings in affiliates** | 2,708 | 2,924 | 3,173 | 8.5 | 17.2 | 3,167 | 0.2 | |
| Share of income (loss) of equity investees | (9) | 0 | 0 | | | - | | |
| Minority Interest | (22) | (28) | (21) | | | - | | |
| **Net Income (before extraordinaries)** | 2,677 | 2,896 | 3,152 | 8.8 | 17.7 | 3,167 | (0.5) | Net income, adjusted for RSU expenses, marginally below expectations |
| **EPS** | 4.0 | 4.2 | 4.6 | 8.8 | 14.3 | 4.6 | (0.5) | |
| No of shares outstanding | 670.0 | 690.0 | 690.0 | | | 690.0 | | |
| | | | | | | | | |
| **Margins (%)** | | | | | | | | |
| Gross Profit margin | 36.6 | 35.9 | 37.1 | | | 36.2 | | |
| EBITDA Margin | 20.9 | 20.2 | 20.4 | | | 20.2 | | |
| EBIT Margin | 16.6 | 16.2 | 16.4 | | | 16.2 | | |
| NPM | 18.3 | 16.9 | 17.4 | | | 17.6 | | |
| | | | | | | | | |
| **Software Services Business** | | | | | | | | |
| **Revenues** | 10,739 | 12,315 | 13,199 | 7.2 | 22.9 | 13,077 | 0.9 | Revenue growth of 8.3% in US$ terms led by (a) 7.3% overall volume growth, 8.4% offshore and 4.2% onsite and (b) 0.9% improvement in blended realizations |
| Cost of Revenues | (6,545) | (7,598) | (8,029) | 5.7 | 22.7 | (8,041) | (0.2) | |
| Gross profit | 4,195 | 4,717 | 5,170 | 9.6 | 23.2 | 5,035 | 2.7 | |
| S G & A expenses | (1,739) | (2,084) | (2,320) | 11.3 | 33.4 | (2,252) | 3.0 | |
| **EBITDA** | 2,456 | 2,634 | 2,850 | 8.2 | 16.0 | 2,783 | 2.4 | |
| Depreciation | (358) | (418) | (455) | 8.8 | 26.9 | (426) | 6.7 | |
| EBIT | 2,097 | 2,215 | 2,395 | 8.1 | 14.2 | 2,357 | 1.6 | EBIT margins improved marginally versus our expectations of a moderate decline |
| | | | | | | | | |
| **Margins (%)** | | | | | | | | |
| Gross Profit margin | 39.1 | 38.3 | 39.2 | | | 38.5 | | |
| EBITDA Margin | 22.9 | 21.4 | 21.6 | | | 21.3 | | |
| EBIT Margin | 19.5 | 18.0 | 18.1 | | | 18.0 | | |
| | | | | | | | | |
| **BPO Services** | | | | | | | | |
| **Revenues** | 1,859 | 2,195 | 2,184 | (0.5) | 17.5 | 2,130 | 2.5 | Revenues grew 0.5% qoq, better than our expectations of a marginal decline |
| Cost of Revenues | (1,181) | (1,347) | (1,301) | (3.4) | 10.1 | (1,304) | (0.2) | |
| **Gross profit** | 677 | 849 | 883 | 4.1 | 30.4 | 827 | 6.8 | |
| S G & A expenses | (252) | (279) | (316) | 13.3 | 25.3 | (273) | 15.7 | |
| **EBITDA** | 425 | 570 | 567 | (0.5) | 33.5 | 553 | 2.5 | |
| Depreciation | (150) | (135) | (133) | (1.8) | (11.6) | (137) | (2.9) | |
| **EBIT** | 274 | 434 | 434 | (0.1) | 58.2 | 416 | 4.2 | Margin performance ahead of expectations, driven by higher than expected revenues |
| | | | | | | | | |
| **Margins (%)** | | | | | | | | |
| Gross Profit margin | 36.4 | 38.7 | 40.4 | | | 38.8 | | |
| EBITDA Margin | 22.9 | 26.0 | 26.0 | | | 26.0 | | |
| EBIT Margin | 14.8 | 19.8 | 19.9 | | | 19.5 | | |
| | | | | | | | | |
| **Infrastructure Services** | | | | | | | | |
| **Revenues** | 2,053 | 2,582 | 2,783 | 7.8 | 35.5 | 2,776 | 0.3 | Revenue growth (9.1% qoq and 52.2% yoy) impressive. |
| Direct Cost | (1,385) | (1,817) | (1,928) | 6.1 | 39.2 | (1,939.5) | (0.6) | |
| **Gross Profit** | 668 | 765 | 855 | 11.8 | 28.0 | 836.3 | 2.2 | |
| SG&A | (310) | (331) | (387) | 17.0 | 24.9 | (361.1) | 7.2 | |
| **EBITDA** | 358 | 434 | 468 | 7.8 | 30.6 | 475.3 | (1.5) | EBITDA margins below expectations |
| Depreciation & Amortization | (115) | (127) | (135) | 5.9 | 17.3 | (144.3) | (6.5) | |
| **EBIT** | 243 | 307 | 333 | 8.5 | 36.8 | 330.9 | 0.6 | EBIT inline with expectations |
| | | | | | | | | |
| **Margins (%)** | | | | | | | | |
| Gross Profit margin | 32.5 | 29.6 | 30.7 | | | 30.1 | | |
| EBITDA Margin | 17.5 | 16.8 | 16.8 | | | 17.1 | | |
| EBIT Margin | 11.9 | 11.9 | 12.0 | | | 11.9 | | |

**HCL Technologies- Profit and Loss Statement, June Year End**

| Rs mn | FY2006 | FY2007 | FY2008E | FY2009E | FY2010E |
|---|---|---|---|---|---|
| **Revenues** | **44,002** | **60,337** | **75,194** | **94,187** | **111,512** |
| RSU expenses | 279 | 612 | 738 | 723 | 700 |
| Direct Costs | 27,576 | 37,604 | 46,921 | 59,948 | 71,719 |
| **Gross Profit** | **16,147** | **22,122** | **27,536** | **33,516** | **39,093** |
| SG&A | 6,577 | 9,370 | 12,221 | 14,941 | 17,370 |
| **EBIDTA (excl other income)** | **9,570** | **12,752** | **15,315** | **18,574** | **21,722** |
| Depreciation | 2,032 | 2,534 | 2,957 | 3,445 | 3,876 |
| EBIT | 7,538 | 10,218 | 12,358 | 15,129 | 17,847 |
| Interest income/(Expenses) | 578 | 4,262 | 2,274 | 2,800 | 2,831 |
| Earnings Before Tax | 8,116 | 14,480 | 14,632 | 17,929 | 20,678 |
| Tax | 626 | 1,489 | 1,605 | 2,552 | 4,342 |
| **Income bef share of equity investees** | **7,490** | **12,990** | **13,027** | **15,377** | **16,335** |
| Share of income (loss) of equity investees | 0 | 0 | -9 | -4 | 0 |
| Minority Interest | 16 | 52 | 47 | 0 | 0 |
| **Net Income** | **7,473** | **12,938** | **12,971** | **15,373** | **16,335** |
| Less: Stock sales incentive | 0 | 0 | 0 | 0 | 0 |
| **Net Income after stock sales incentive** | **7,473** | **12,938** | **12,971** | **15,373** | **16,335** |
| Less: Extraordinary items | -1,290 | 0 | 0 | 0 | 0 |
| **Net Income** | **6,183** | **12,938** | **12,971** | **15,373** | **16,335** |
| | | | | | |
| **EPS (Rs.) fully diluted** | **11.4** | **18.9** | **18.7** | **22.1** | **23.5** |
| | | | | | |
| **Margins (%)** | | | | | |
| Gross Profit Margin | 36.7 | 36.7 | 36.6 | 35.6 | 35.1 |
| Operating margin | 21.7 | 21.1 | 20.4 | 19.7 | 19.5 |
| EBIT margin | 17.1 | 16.9 | 16.4 | 16.1 | 16.0 |
| Net Profit | 17.0 | 21.5 | 17.3 | 16.3 | 14.6 |
| Net Income margin | 17.0 | 21.4 | 17.2 | 16.3 | 14.6 |
| | | | | | |
| SG&A expenses | 14.9 | 15.5 | 16.3 | 15.9 | 15.6 |
| Tax Rate | 7.7 | 10.3 | 11.0 | 14.2 | 21.0 |
| **Growth (%)** | | | | | |
| Revenue Growth | 30.6 | 37.1 | 24.6 | 25.3 | 18.4 |
| Gross Profit | 28.8 | 37.0 | 24.5 | 21.7 | 16.6 |
| EBITDA | 23.9 | 33.3 | 20.1 | 21.3 | 16.9 |
| EBIT | 22.2 | 35.6 | 20.9 | 22.4 | 18.0 |
| Net Profit | 15.5 | 73.4 | 0.3 | 18.0 | 6.2 |
| Net Income | 24.2 | 73.1 | 0.2 | 18.5 | 6.3 |

Source: Kotak Institutional Equities estimates.

**Pharmaceuticals**

| RANB.BO, Rs368 | |
|---|---|
| Rating | BUY |
| Sector coverage view | Neutral |
| Target Price (Rs) | 485 |
| 52W High -Low (Rs) | 490 - 306 |
| Market Cap (Rs bn) | 137.1 |

**Financials**

| December y/e | 2006 | 2007E | 2008E |
|---|---|---|---|
| Sales (Rs bn) | 60.2 | 66.0 | 73.2 |
| Net Profit (Rs bn) | 5.1 | 7.4 | 7.4 |
| EPS (Rs) | 13.7 | 20.0 | 19.8 |
| *EPS gth* | *115.7* | *45.9* | *(0.7)* |
| P/E (x) | 26.9 | 18.4 | 18.6 |
| EV/EBITDA (x) | 18.5 | 13.0 | 13.2 |
| Div yield (%) | 2.3 | 2.6 | 2.9 |

**Shareholding, September 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 34.8 | - | - |
| FIIs | 18.0 | 0.3 | (0.1) |
| MFs | 4.5 | 0.5 | 0.1 |
| UTI | - | - | (0.4) |
| LIC | 14.6 | 1.5 | 1.1 |

## Ranbaxy Laboratories: Management gives strong growth guidance for 2008

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- **4Q2007 revenues increased 5% yoy to Rs18 bn—in line with expectations**
- **Adjusted EBITDA margins at 16.7%, 90 bps below expectations**
- **PAT at Rs 1.9 bn, beats estimates due to higher other income, lower depreciation and tax rate**
- **2008 management guidance: 18-20% dollar sales growth, EBITDA margin of 17-18%, PAT growth 20-25% yoy**
- **Market reaction driving share price down was puzzling. Maintain BUY rating with price target of Rs485**

Ranbaxy's 4QFY07 sales and EBITDA performance was in line with our expectations. However, PAT was higher due to significant other income, lower depreciation and tax rate. Ranbaxy reported 19% revenue growth in US$ terms yoy as per our expectations. Revenue growth was driven by emerging markets with Romania, Africa, and Latin America showing strong growth qoq. The stock trades at 17.8X FY2008E and 13.9X FY2009E earnings. Maintain BUY rating with a SOTP-based target price of Rs485.

**Revenues increase 5% yoy to Rs18 bn in line with expectations.** 4QFY07 revenues grew 5% yoy in rupee terms and 19% yoy in US$ terms to touch Rs 18 bn. Emerging markets of Asia, CIS, Africa and Latin America contributed 43% of sales for 4Q07 with strong growth of 7% qoq and 80% yoy. Ranbaxy reported strong growth in Europe with sales doubling in Romania qoq. North American sales were largely flat, as expected, at US$113 mn.

Adjusted EBITDA margin at 17.8%, 90 bps below expectations. EBITDA margin disappointed as cost of sales was higher than forecast. R&D expenses at 7.8% of sales, were as expected. The number of US filings generally picks up for Ranbaxy in 2H of the year leading to higher research spending.

**PAT at Rs 1.9 bn, beats estimates due to higher other income, lower depreciation and tax rate.** Ranbaxy reported other income and fx gain of Rs196 mn, higher than the our estimate of Rs50 mn. Tax rate at 20% was lower than our forecast of 22% forecast which was in line with the rate for previous 4 quarters.

**2008 management guidance: 18-20% sales growth, EBITDA margin of 17-18%, PAT growth 20-25% yoy.** The management has guided towards 18-20% growth over 2007 sales. The key geographies driving this growth will be North America, India and East European markets. For North America, Ranbaxy guided towards base business growth in double digits above the 6% growth shown in 2007. In India, the company guided towards 15-20% growth in 2008 compared to 11% growth seen in 2007. We have modeled a 10% growth for North America and 13% market growth rate for India.

Management guided towards EBITDA margin of 17-18% for 2008. We have modeled a 17.3% margin for 2008. PAT growth rate of 20-25% growth yoy guided by the management gives a PAT estimate of Rs9.5-9.9 bn for 2008. Our 2008 PAT estimate of Rs 7.4 bn is lower than the guidance due to exclusion of fx gain. (2007 reported PAT includes Rs 3.2 bn fx gain). In addition we believe, Ranbaxy maybe factoring in an asset disposal or monetization of surplus SEZ land in Mohali in their profit guidance.

Ranbaxy will announce a FTF (First to file) product settlement next week. It is to be launched in the US in 2H2008. Implications of this product are not included in management forecasts and in our forecasts.

**Market reaction driving share price down was puzzling. Maintain BUY rating with price target of Rs485.** We believe that share price decline today following the results announcement was unwarranted. While fine print of guidance may still be debated, it is clear that Ranbaxy is expecting robust operating performance starting 2008. In addition, exclusive opportunities will likely become a regular feature of earnings for the next four years. While they may be treated as a special dividend for valuation purpose, their impact on cash flows is undeniable. We remain buyers of the stock.

**Interim results, December fiscal year-ends (Rs mn)**

| | 4QFY06 | 3QFY07 | 4QFY07 | 4QFY07E | Growth (%, yoy) | Growth (%, qoq) | Chg (%) |
|---|---|---|---|---|---|---|---|
| Gross sales | 17,077 | 16,520 | 17,951 | 17,973 | 5 | 9 | — |
| Excise duty | 102 | 106 | 106 | 117 | 4 | — | 11 |
| **Net sales** | **16,975** | **16,414** | **17,845** | **17,856** | **5** | **9** | **0** |
| Income from operations | 794 | 1,316 | 1,178 | 855 | 48 | (10) | (27) |
| Cost of sales | 9,131 | 8,702 | 9,653 | 9,464 | 6 | 11 | (2) |
| SG&A | 4,749 | 5,091 | 5,008 | 5,050 | 5 | (2) | 1 |
| R&D expenses | 1,224 | 1,106 | 1,385 | 1,200 | 13 | 25 | (13) |
| Expenses | 15,104 | 14,899 | 16,046 | 15,714 | 6 | 8 | (2) |
| **EBITDA as defined by management** | **2,665** | **2,831** | **2,977** | **2,997** | **12** | **5** | **1** |
| **EBITDA - (adjusted)** | **3,095** | **2,621** | **3,184** | **3,342** | **3** | **21** | **5** |
| Depreciation/amortisation | 531 | 613 | 493 | 625 | (7) | (20) | 27 |
| Interest - exp/(inc) | 247 | 394 | 385 | 350 | 56 | (2) | (9) |
| Other income | 24 | 56 | 87 | 50 | 263 | 55 | (43) |
| Fx gain/(loss) | 460 | 487 | 109 | — | (76) | (78) | NM |
| **PBT** | **2,371** | **2,367** | **2,295** | **2,072** | **(3)** | **(3)** | **(10)** |
| Tax | 512 | 516 | 461 | 456 | (10) | (11) | (1) |
| **PAT** | **1,859** | **1,851** | **1,834** | **1,616** | **(1)** | **(1)** | **(12)** |
| Extra ordinary income post tax | — | 223 | 44 | — | NM | (80) | NM |
| Minority interests | 26 | — | — | 30 | NM | NM | NM |
| **Profit for shareholders** | **1,833** | **2,074** | **1,878** | **1,586** | **2** | **(9)** | **(16)** |

| | 4QFY06 | 3QFY07 | 4QFY07 | 4QFY07E | Growth (%, yoy) | Growth (%, qoq) | Chg (%) |
|---|---|---|---|---|---|---|---|
| Dosage - India | 2,973 | 3,289 | 3,025 | 2,932 | 2 | (8) | (3) |
| Dosage - Europe | 6,068 | 3,167 | 4,219 | 3,894 | (30) | 33 | (8) |
| Dosage - CIS | — | 934 | 1,234 | 1,791 | NM | 32 | 45 |
| Dosage - Africa | — | 1,380 | 1,473 | 1,393 | NM | 7 | (5) |
| Dosage - Asia/Middle East | 1,075 | 1,056 | 1,234 | 1,194 | 15 | 17 | (3) |
| Dosage- Latam | 695 | 731 | 796 | 677 | 15 | 9 | (15) |
| Dosage -North America | 5,101 | 4,425 | 4,498 | 4,578 | (12) | 2 | 2 |
| API | 1,167 | 1,056 | 1,075 | 1,115 | (8) | 2 | 4 |
| Global consumer Healthcare | — | 406 | 438 | 398 | NM | 8 | (9) |
| Other Adjustments | (2) | 77 | (40) | — | NM | NM | NM |
| **Total** | **17,077** | **16,520** | **17,951** | **17,973** | **5** | **9** | **0** |

**Forecasts and valuation, December fiscal year-ends, 2005-2009E**

| | Net sales | | Adjusted EBITDA | | Net Profit | | EPS | ROCE | ROE | P/E | EV/EBITDA |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | (Rs mn) | Growth(%) | (Rs mn) | Growth(%) | (Rs mn) | Growth(%) | (Rs) | (%) | (%) | (X) | (X) |
| 2005 | 50,949 | (2.9) | 6,265 | (45.4) | 2,618 | (62.5) | 6.3 | (0.5) | 9.5 | 58.0 | 140.2 |
| 2006 | 60,183 | 18.1 | 11,529 | 84.0 | 5,103 | 95.0 | 13.7 | 10.4 | 20.3 | 26.9 | 23.0 |
| 2007E | 66,010 | 9.7 | 10,950 | (5.0) | 7,666 | 50.2 | 20.0 | 6.6 | 26.9 | 18.4 | 25.3 |
| 2008E | 73,152 | 10.8 | 12,943 | 18.2 | 7,388 | (3.6) | 19.8 | 9.4 | 24.0 | 18.6 | 18.3 |
| 2009E | 84,648 | 15.7 | 16,340 | 26.2 | 9,496 | 28.5 | 25.5 | 12.3 | 27.6 | 14.4 | 14.1 |

**Consumer Products**

| GOCP.BO, Rs127 | |
|---|---|
| Rating | ADD |
| Sector coverage view | Neutral |
| Target Price (Rs) | 140 |
| 52W High -Low (Rs) | 178 - 117 |
| Market Cap (Rs bn) | 28.7 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 9.5 | 11.1 | 12.3 |
| Net Profit (Rs bn) | 1.3 | 1.7 | 1.9 |
| EPS (Rs) | 5.9 | 7.5 | 8.3 |
| *EPS gth* | *12.5* | *25.7* | *11.6* |
| P/E (x) | 21.4 | 17.1 | 15.3 |
| EV/EBITDA (x) | 16.3 | 13.0 | 11.5 |
| Div yield (%) | 2.9 | 3.1 | 3.1 |

## Godrej Consumer Products: 3QFY08—Modest quarter

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- **Price hikes drive sales growth**
- **Input cost scenario continues to be challenging**
- **Two scenarios in soaps and its impact on GCPL —pricing, downtrading**
- **Potential for geographic expansion led growth exists**
- **Underlying growth in international business modest**
- **Rights issue for soap capacity expansion, repayment of debt and supporting inorganic growth**
- **Retain ADD rating and target price of Rs140/share**

GCPL reported 15.9% growth in standalone sales as against our estimate of 14.4%. Soap sales grew 25.7% yoy ' aided by two rounds of price hikes (~17%) in the last 6 months. Hair color growth at 6% disappointed as it had the benefit of price increase taken during December 2006 on powder sachet hair dye. GCPL reported an EBITDA growth of 11.9% (we expected 17.4%) and 13.2% increase in net profit (we expected 28.5%) for 3QFY08. Lower sales growth in high margin toiletries and liquid detergents business, higher employee costs and advertisement costs resulted in EBITDA margins declining 80 bps yoy to 22.2%. We believe that the unbridled price hikes in soaps by market leaders HUL and GCPL could result in category downtrading. However, based on the current coverage, geographic expansion led growth exists for GCPL. The underlying sales growth in international operations is modest. The company has filed an offer document to raise Rs4 bn through a rights issue—for soap capacity expansion, repayment of debt and supporting inorganic growth. We have marginally reduced the earnings estimates to Rs7.3 (Rs 7.5 earlier) for FY2008E and Rs8.1 (Rs8.3 earlier) for FY2009E. We retain our ADD rating and target price of Rs140/share.

**Price hikes drive sales growth.** Significant price increase in both soaps (~17% in the past six months) and hair color business (~10% yoy) drive GCPL's topline growth of 15.9% in 3QFY2008E. GCPL recorded 25.7% yoy growth in soap sales, aided by two price hikes of about 8% each in June and October 2007. Market sources indicate soap industry value growth during the quarter at about 10% implying that adjusting for the price increases, the volume growth is marginally negative in this highly penetrated category. GCPL's gained soap market shares yoy to 9.7% in 3QFY2008 (9.3% in 3QFY07). However, the shares declined 50 bps on a qoq basis (first time in over three years). We note that GCPL's soap market share are flat (seasonal) in December quarter as sales of glycerin (Pears of HUL) and specialty soaps (Dove of HUL) witness an uptick.

Hair color sales grew by a disappointing 6.1% yoy. We note that hair color had the benefit of about 7% average price increase due to Re1 increase in price of its main SKU—powder sachet hair dye. Adjusting for the price hike, we estimate hair color volumes would have declined marginally. The market share in hair color continues at 34.9% (the lowest in over five years) due to better growth at the high-end fashion color segment.

While we believe in the company's ability to have a presence and garner higher incremental share in the top-end fashion hair color market, substantial back-end and front-end investments would be required to mark an entry. We note that planned relaunch of powder hair dye and communication regarding newer consumer benefits can positively impact sales in the next few months.

**Input cost scenario continues to be challenging.** EBITDA margins during 3QFY08 declined by 80 bps yoy to 22.2% because of higher employee costs and lower sales growth in high margin toiletries and liquid detergents business. However, the input cost scenario continues to be challenging with prices of palm oil and variants continue to rule firm. The management had earlier indicated that appropriate price increases will be considered to counter input cost inflation. We note that the higher depreciation expenditure is on account of the Katha (Himachal) and Sikkim factories, which were commissioned in December 2006 and March 2007, respectively.

**Two scenarios in soaps and its impact on GCPL.**

**Pricing**

Over the past year, measured price hikes by HUL and GCPL have helped mitigate the higher palm prices (up over 70%). However, ITC's entry could possibly cap further price increases and the requirement for higher ad spends could adversely impact the margin profile as well. We believe that incremental growth will come at significantly higher cost than before. In September / October 2007, ITC has launched 'Superia' brand of soaps at the lower end ('popular' segment) of the category in four variants. Market sources indicate that Superia soaps has had reasonable success in the test markets on the back of aggressive trade promotions. Management had indicated earlier that the impact of 'Superia' on 'Godrej No.1' will not be significant as Godrej No.1 is Grade 1 soap and the direct competition brands are having lower oil content (Please refer Exhibit). We believe that even though the TFM / oil content is important, attributes like product feel, perception, value proposition, wear rate (no. of baths/soap tablet) and most importantly the perfume quality influences a purchase decision in soaps.

**Downtrading**

GCPL has secured the near-term performance in soap margins with forward covers for inputs (mainly palm oil and variants) till March 2008. Management indicated that it would look at measured price increases to protect margins. Management views that the impact of price hikes on eventual sales will be minimal in this highly penetrated category even though there could be postponement of purchases. However, we estimate two possible scenarios in the event of unbridled price increases by the category leaders:

1. There is a substantial unorganized segment in personal wash category that stands to gain. There are strong regional players like Power soaps in Tamil Nadu, Lyka in Madhya Pradesh, Aura in Punjab/Haryana etc. Downtrading by consumers from brands of organized players to local brands is a strong possibility.
2. Companies opting for TFM (Total Fatty Matter) reduction by increasing the filler content in soaps. A recent example is the 6% TFM reduction in 'Breeze' brand by HUL to 60%.

Godrej has positioned the flagship brand 'Godrej No.1' soap as Grade I soap under the value-for-money plank with minimum 76% TFM content. Typically, the actual TFM content in soap will be 2-3% higher than the declared quantity in pack. The product positioning reduces the flexibility for GCPL to relook at formulation during periods of hyperinflation in key inputs.

**Potential for geographic expansion led growth exists.** Over the past three years, GCPL had derived significant growth through geographic expansion in sales territories (sales growth by moving into newer markets / geographies). Currently, the company has a total reach of about 3 mn and direct reach of about 0.6 mn retail outlets. The current coverage means that GCPL reaches all villages with population of about 10,000. However, we believe that further geographical expansion will entail significantly higher incremental cost and would require higher concern sales. (The total no. of retail outlets in India as per AC Nielsen is 2.5 mn in urban and 5.0 mn in rural).

**Underlying growth in international business modest.** Adjusted for currency translation losses, we estimate a 12% growth in Keyline (UK) sales and 6% growth in Rapidol (South Africa). Management had indicated in a recent meeting that both the acquisitions have surpassed the internal expectations/ benchmarks, which GCPL had at the time of the transaction. The company plans to bring some of the brands from the global product portfolio into India in a phased manner. We believe that there are further synergies to be gained from acquisition by providing GCPL's products access to the retail channel in UK and cater to the Indian diaspora, leverage GCPL's R&D strengths to expand the Keyline portfolio and to utilize low-cost operations in India to manufacture products for Keyline.

**Rights issue for soap capacity expansion, repayment of debt and supporting inorganic growth.** GCPL has filed the offer document for a rights issue for a maximum amount of Rs4.0 bn. The detailed structure and other terms of the rights issue is yet to be decided by the company. GCPL will utilize the money raised for the following:

- Soaps capacity expansion in Himachal: Rs1,135 mn. We estimate the company will add about 30,000 tons capacity in soaps including the back-end facilities like distilled fatty acid. The company would target commissioning this by March 2010 before the sunset clause for the location takes effect.
- Investment in JV, Godrej SCA Hygiene Ltd: Rs205 mn
- Repayment of debt (taken for Keyline, Rapidol acquisitions): Rs1,304 mn
- For M&A:Rs1,356 mn

**Retain ADD rating and target price of Rs140/share.** We model soap and hair color to grow at 12% and 10% respectively in FY2009E and FY2010E. Modest growth of 2.3% in soaps and higher penetration and upgradation driven growth rates of 24.5% is considered for the hair color business during FY2011-15E. We have marginally reduced the earnings estimates to Rs7.3 (Rs 7.5 earlier) for FY2008E and Rs8.1 (Rs8.3 earlier) for FY2009E. Our one-year forward DCF value works out to Rs164/share. We retain our target price at Rs140/share (15% discount to our DCF value) implying a P/E of 19.2X on FY2008E and 17.2X on FY2009E. Considering the expected heightened competitive activity in both the categories GCPL operates in—particularly soaps, we believe that the stock will trade at a discount to its DCF value. Key risks to our estimates include softening of palm prices, lesser than expected impact of ITC's soap launches, ITC gaining market share from Nirma and HUL brands, upsides due to GCPL pursuing inorganic route to growth.

**Godrej Consumer Products Limited -Quarterly summary, March yearend (Rs mn)**

| | yoy | | | Our est. | yoy | Consolidated yoy | | |
|---|---|---|---|---|---|---|---|---|
| | 3Q FY08 | 3Q FY07 | % chg | 3Q FY08 | % chg | 3Q FY08 | 3Q FY07 | % chg |
| **Sales** | **2,291** | **1,977** | **15.9** | **2,262** | **14.4** | **2,728** | **2,380** | **14.6** |
| Material costs | (1,059) | (941) | | | | (1,218) | (1,129) | |
| Employee costs | (137) | (108) | | | | (182) | (150) | |
| A&P expenditure | (148) | (121) | | | | (212) | (149) | |
| Other expenses | (438) | (352) | | | | (546) | (438) | |
| Total expenses | (1,782) | (1,522) | | | | (2,159) | (1,865) | |
| **EBITDA** | **509** | **455** | **11.9** | **534** | **17.4** | **568** | **515** | **10.3** |
| Depreciation | (39) | (32) | | 40 | | (48) | (36) | |
| **EBIT** | **470** | **422** | | **494** | | **520** | **479** | |
| Other income | 23 | 22 | | 33 | | 15 | 17 | |
| Interest | (20) | (24) | | 23 | | (29) | (33) | |
| **PBT** | **473** | **421** | **12.3** | **504** | **19.6** | **506** | **464** | **9.3** |
| Tax | (59) | (55) | | 59 | | (76) | (68) | |
| **Net profit** | **415** | **366** | **13.2** | **445** | **21.5** | **430** | **396** | **8.7** |
| Exceptional item | - | - | | - | | - | - | |
| | | | | | | | | |
| EBITDA margin (%) | 22.2 | 23.0 | | 23.6 | | 20.8 | 21.6 | |
| Tax rate (%) | 12.4 | 13.1 | | 11.7 | | 15.0 | 14.6 | |
| | | | | | | | | |
| **Sales break up** | | | | | | | | |
| Soaps | 1,341 | 1,066 | 25.7 | 1,247 | 16.9 | | | |
| Hair Colour | 501 | 472 | 6.1 | 521 | 10.5 | | | |
| Toiletries | 117 | 110 | 6.0 | 137 | 25.0 | | | |
| Liquid Detergents | 279 | 287 | (2.7) | 309 | 8.0 | | | |
| **Total Godrej Brands** | **2,237** | **1,935** | **15.6** | **2,215** | **14.5** | | | |
| Contract manufacturing | - | - | | - | | | | |
| Sale of by-products/others | 54 | 42 | 27.7 | 46 | 10.0 | | | |
| **TOTAL** | **2,291** | **1,977** | **15.9** | **2,262** | **14.4** | | | |

Source: Company data, Kotak Institutional Equities estimates

**Keyline Brands, Quarterly summary (Rs mn)**

| | 3QFY2006* | 4QFY2006 | 1Q FY2007 | 2Q FY2007 | 3Q FY2007 | 4Q FY2007 | 1Q FY2008 | 2Q FY2008 | 3Q FY2008 |
|---|---|---|---|---|---|---|---|---|---|
| Sales | 150 | 281 | 460 | 463 | 258 | 493 | 391 | 541 | 275 |
| EBIT | 11 | 20 | 67 | 74 | 25 | 77 | 36 | 53 | 31 |
| PBT | 6 | 10 | 52 | 64 | 15 | 68 | 27 | 41 | 20 |
| Tax | (1) | (6) | (15) | (20) | (5) | (19) | (8) | (14) | (8) |
| Net profit | 4 | 4 | 37 | 44 | 10 | 49 | 19 | 27 | 12 |
| | | | | | | | | | |
| **Sales growth (%)** | | | | | | **76** | **(15)** | **17** | **7** |
| **EBIT growth (%)** | | | | | | **285** | **(46)** | **(28)** | **24** |
| **EBIT margin (%)** | **7** | **7** | **15** | **16** | **10** | **16** | **9** | **10** | **11** |

* represents financial performance for 2 months

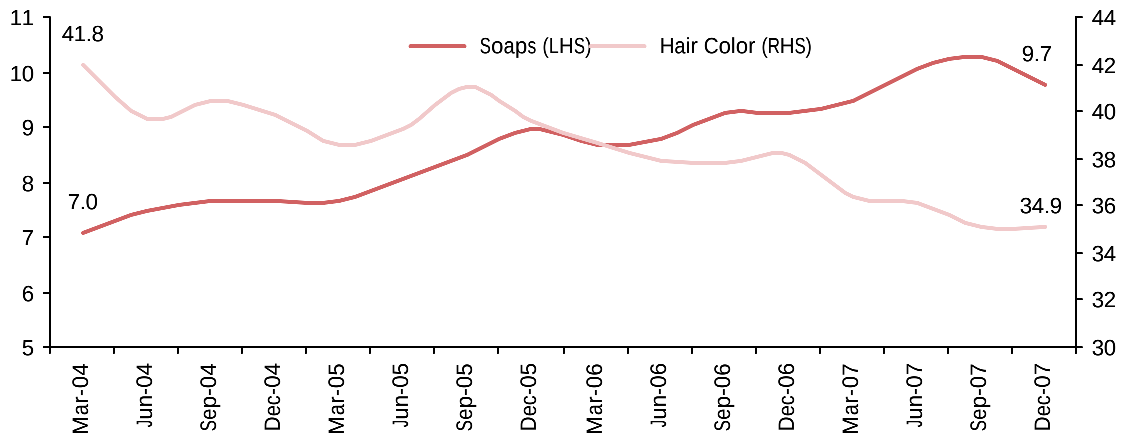
**Rapidol Pty Limited, Quarterly summary (Rs mn)**

| | 2Q FY2007 * | 3Q FY2007 | 4Q FY2007 | 1Q FY2008 | 2Q FY2008 | 3Q FY2008 |
|---|---|---|---|---|---|---|
| Sales | 30 | 145 | 101 | 119 | 117 | 146 |
| EBIT | 5 | 27 | 9 | 17 | 12 | 25 |
| PBT | 5 | 27 | 10 | 18 | 11 | 25 |
| Tax | (1) | (8) | (3) | (5) | (4) | (6) |
| Net profit | 4 | 19 | 7 | 13 | 7 | 19 |
| | | | | | | |
| **Sales growth (%)** | | | | | | **1** |
| **EBIT growth (%)** | | | | | | **(7)** |
| **EBIT margin (%)** | **17** | **19** | **9** | **14** | **10** | **17** |

* represents performance for 1 month w.e.f September 1, 2006

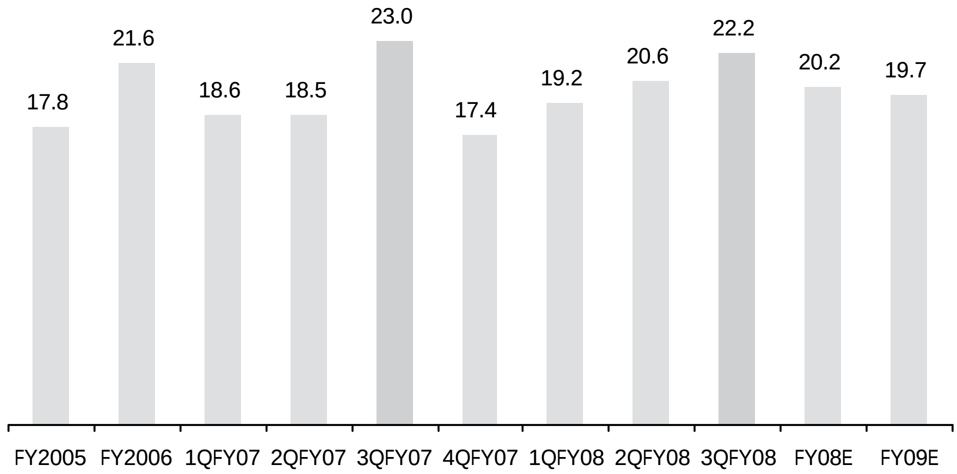
Source: Company data

**Exhibit 3: Share gains in soaps moderating, hair color shares maintained**
Value market shares (%) in soaps and hair color




Source: Company data

**Exhibit 4: Price increases offset margin decline on the back of hyperinflation in palm prices**
EBITDA margin (%) trend




Source: Company data, Kotak Institutional Equities

**Exhibit 5: Competitive positioning in soaps**
Soaps (Low-end/Popular segment) - Brands and price points

| Brand | Company | MRP for 75 gm Rs | TFM (c) % |
|---|---|---|---|
| Breeze (a) | HUL | 6 | 66 |
| Godrej No.1 | Godrej Consumer | 7 | 76 |
| Superia | ITC | 6.5 | 70 |

(a) Banded pack of 4 soaps of 75 gm for Rs 25
(b) Banded pack of 4 soaps of 75 gm for Rs 27
(c) Total Fatty Matter (TFM) content indicates the oil content in soap. Typical consumer perception is higher TFM = higher quality

Source: Company, Kotak Institutional Equities

**Exhibit 6: Godrej Consumer, change in estimates, March fiscal year-ends, (Rs mn)**

| | FY08 | | | FY09 | | | FY10 | | |
|---|---|---|---|---|---|---|---|---|---|
| Rs m | New | Old | Change (%) | New | Old | Change (%) | New | Old | Change (%) |
| Net Sales | 11,033 | 11,052 | (0.2) | 12,313 | 12,334 | (0.2) | 13,746 | 13,770 | (0.2) |
| EBIDTA | 2,122 | 2,163 | (1.9) | 2,316 | 2,363 | (0.0) | 2,577 | 2,630 | (2.0) |
| Net profit | 1,649 | 1,686 | (2.2) | 1,840 | 1,882 | (2.2) | 2,074 | 2,121 | (2.2) |
| EPS | 7.3 | 7.5 | (2.2) | 8.1 | 8.3 | (2.2) | 9.2 | 9.4 | (2.2) |
| Sales growth | 15.7 | 15.9 | | 11.6 | 11.6 | | 11.6 | 11.6 | |
| Own brand sales growth | 16.9 | 17.2 | | 11.6 | 11.5 | | 11.6 | 11.6 | |
| EPS growth | 22.9 | 25.7 | | 11.6 | 11.6 | | 12.7 | 12.7 | |

Source: Kotak Institutional Equities estimates

**Exhibit 7: Moderated growth in medium term (2009E & 2010E), we built-in higher growth rates for hair color in later years**

GCPL sales growth rate assumptions (%)

| | 2008E | 2009E | 2010E | 2011-15 |
|---|---|---|---|---|
| Soaps | 22.2 | 12.0 | 12.0 | 2.3 |
| Hair Color | 8.5 | 10.0 | 10.0 | 24.5 |
| Toiletries | 13.0 | 15.0 | 15.0 | 5.8 |
| Liquid Detergents | (3.0) | 8.0 | 8.0 | 7.1 |
| **Total Godrej Brands** | **16.9** | **11.6** | **11.6** | **8.9** |

Source: Kotak Institutional Equities estimates

**Exhibit 8: Company is raising Rs4 bn through a rights issue**

Objects of the issue

| Item | Deployment (Rs mn) |
|---|---|
| Soaps capacity expansion in Himachal | 1,135 |
| Investment in JV, Godrej SCA Hygiene Ltd | 205 |
| Repayment of debt | 1,304 |
| For M&A | 1,356 |
| Net proceeds of the Issue | 4,000 |

Source: SEBI, Kotak Institutional Equities estimates

**Media**

| HTML.BO, Rs234 | |
|---|---|
| Rating | ADD |
| Sector coverage view | Cautious |
| Target Price (Rs) | 260 |
| 52W High -Low (Rs) | 266 - 164 |
| Market Cap (Rs bn) | 54.9 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 10.4 | 12.2 | 14.5 |
| Net Profit (Rs bn) | 1.0 | 1.5 | 2.3 |
| EPS (Rs) | 4.1 | 6.2 | 9.8 |
| *EPS gth* | *53.6* | *50.9* | *57.8* |
| P/E (x) | 56.7 | 37.6 | 23.8 |
| EV/EBITDA (x) | 31.5 | 21.4 | 13.5 |
| Div yield (%) | 0.1 | 0.4 | 0.9 |

**Shareholding, September 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 68.7 | - | - |
| FIIs | 18.8 | 0.1 | 0.1 |
| MFs | 7.7 | 0.3 | 0.3 |
| UTI | - | - | - |
| LIC | - | - | - |

## HT Media: HT Media (HTML) reported weaker-than-expected 3QFY08 results; retain ADD

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- **Weaker-than-expected 3QFY08 results on higher RM costs, marketing expenses**
- **Ad revenue growth on expected lines; reality and autos continue to under-spend**
- **New initiatives continue to lose cash; prospects remain bright over long term**
- **Fine tuned estimates; retain ADD and revised 12-month DCF-based TP to Rs260**

HTML reported weaker-than-expected 3QFY08 results with EBITDA at Rs592 mn (+20.7% yoy and +22.1% qoq), below our Rs755 mn estimate; higher RM costs on increased circulation levels of HT Mumbai, HT Mint and Hindustan and greater marketing spend during the quarter resulted in higher-than-expected operating expenses. The company reported 3QFY08 revenues at Rs3.2 bn (+16.1% yoy and +13.7% qoq) driven by a robust 16.5% yoy growth in ad revenues. We have fine-tuned our model and our FY2008E, FY2009E and FY2010E earnings estimates are reduced to Rs6.2 (Rs6.8 previously), Rs9.8 (Rs10.7) and Rs13.2 (Rs14.3), respectively. We retain our ADD rating on the stock with a DCF-based 12-month target price of Rs260 (Rs250 previously); the higher DCF valuation reflects greater visibility in ad revenues from HT Mumbai edition, HT Mint and Hindustan print properties and roll-forward which are compensated by higher circulation levels, increased pagination levels and higher newsprint prices in perpetuity. Key downside risks stem from the pace of ad growth and competition. We continue to expect significant value creation in HTML's new initiatives in print and other media businesses, though they will continue to bleed cash for some more time.

### 3QFY08 results analysis

**Robust revenue growth led by ad revenues; circulation revenues impacted by higher discounts and agent commissions.** HTML's 3QFY08 revenues increased 16.1% yoy to Rs3.2 bn from Rs2.8 bn in 3QFY07.

1. Ad revenues increased to Rs2.8 bn in 3QFY08 from Rs2.4 bn in 3QFY07, a robust growth of 16.5%. Ad spending by real estate and automobiles sector remained soft in 3QFY08 resulting in weak growth in the English segment. HT Mint continued to scale up well and monthly run-rate in its ad revenues increased to Rs30 mn by end-3QFY08. Strong 30% yoy growth in the Hindi segment (Hindustan) was a result of expansion into new territories.

2. Circulation levels increased substantially during 3QFY08, led by increased penetration of HT Mumbai, HT Mint and Hindustan and seasonally higher HT Delhi circulation to support HT's newspaper in education initiative (Next). Thus, circulation revenues increased to Rs390 mn (+11.4% yoy and +8.3% qoq) despite readership discounts and increased agent commissions to help expand coverage and distribution.

**Weaker-than-expected 3QFY08 EBITDA due to higher raw material and marketing costs.** HT Media reported 2QFY08 EBITDA of Rs592 mn (+20.7% yoy and +22.1% qoq), below our Rs755 mn estimate. Robust growth in ad revenues was offset by higher-than-expected raw material and marketing costs, which grew 4.8% yoy and 77.7% yoy, respectively. Raw material costs grew moderately as higher circulation levels of HT Mumbai, HT Mint and Hindustan and seasonal increase in HT Delhi circulation in 3QFY08 negated the favorable effects of a stronger rupee and weak global newsprint prices. Higher-than-expected sales and marketing spend was necessary to support HT Mumbai's distribution, HT Mint's Bangalore launch and Hindustan's expansion. Higher marketing costs also reflect a number of events (HT Leadership Conference, A. R. Rehman concert) organized by the company during the quarter. HTML continued to incur large cash losses in its new media businesses (HT Mumbai edition, HT Mint and Radio); it has highlighted EBITDA loss of Rs106 mn in 3QFY08 related to Mint (Rs296 mn in 1HFY08). EBITDA margin increased to 18.5% in 3QFY08 from 17.3% in 2QFY08 and 17.8% in 3QFY07 despite relatively the large increase in operating expenses.

**Earnings revisions**

**Revised earnings estimates on greater visibility on HT Mumbai, HT Mint and Hindustan revenues offset by higher global newsprint prices and greater circulation.** We have fine-tuned our model and reduced our FY2008E, FY2009E and FY2010E EPS to Rs6.2, Rs9.8 and Rs13.2, respectively, from Rs6.8, Rs10.7 and Rs14.3, respectively, previously.

1. **Greater visibility on ad revenues.** The revenue visibility in the large number of new editions and print properties launched by HTML over the past few years is starting to emerge. HTML achieved a monthly run-rate of Rs100 mn and Rs30 mn in ad revenues from the Mumbai market and HT Mint, respectively, by end-3QFY08. We note that HTML's Hindi newspaper has being gaining traction over the past few years; we model ad revenue growth in Hindustan at 11.5% CAGR (10% previously) between FY2009E-2017E given greater management focus on the Hindi market. Overall, we increase HTML's FY2009E and FY2010E ad revenues to Rs12.1 bn (Rs11.9 bn previously) and Rs13.7 bn (Rs13.4 bn), respectively.

2. **Newsprint prices.** The decision by North American and European newsprint producers, most notably AbitibiBowater, to aggressively close capacities led to global newsprint prices increasing US$10/ton and US$15/ton, respectively, in November 2007 and December 2007. We have revised our landed newsprint price for FY2009E to US$620/ton from US$580/ton previously. Thereafter, we model a newsprint price of US$620/ton in perpetuity versus US$570/ton previously.

3. **Higher circulation and pagination.** HTML has been very aggressive lately in increasing the coverage and distribution of its various print brands. It plans to increase the circulation of its HT Mumbai edition, launch a number of HT Mint editions and expand Hindustan in UP. In addition, HTML plans to increase the pagination levels of its various newspaper properties to attract readers. Thus, we model HTML's raw material costs for FY2009E and FY2010E at Rs4.9 bn (Rs4.5 bn previously) and Rs5.2 bn (Rs4.6 bn), respectively.

4. **Higher sales and marketing costs.** Given the aggressive plans of HTML to increase the circulation of its various newspaper properties through higher discounts, agent commissions and other promotional activities, we have revised upwards our expected S&M spends for the company in the medium term. We model HTML's S&M expenditure for FY2008E, FY2009E and FY2010E at Rs915 mn, Rs980 mn and Rs1.1 bn, respectively, from Rs793 mn, Rs933 mn and Rs1.05 bn, respectively, previously.

**HT Media Ltd. standalone interim results, March fiscal year-ends (Rs mn)**

| | | | qoq | | | yoy | | | yoy | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2008E | 3Q 2008 | 2Q 2008 | *% chg* | 3Q 2008 | 3Q 2007 | *% chg* | 9M 2008 | 9M 2007 | *% chg* |
| **Revenues** | **12,200** | **3,194** | **2,810** | ***13.7*** | **3,194** | **2,752** | ***16.1*** | **8,737** | **7,643** | ***14*** |
| Advertisement revenues | 10,246 | 2,748 | 2,393 | *14.8* | 2,748 | 2,359 | *16.5* | 7,491 | 6,405 | *17* |
| Circulation revenues | 1,440 | 390 | 360 | *8.3* | 390 | 350 | *11.4* | 1,079 | 1,032 | *5* |
| Others | 216 | 56 | 57 | *(1.8)* | 56 | 43 | *30.8* | 167 | 206 | *(19)* |
| **Total expenditure** | **(9,757)** | **(2,602)** | **(2,325)** | ***11.9*** | **(2,602)** | **(2,261)** | ***15.1*** | **(7,105)** | **(6,156)** | ***15*** |
| Inc/(Dec) in inventories | — | 1 | (3) | | 1 | 2 | | (1) | 3 | |
| Raw material costs | (4,492) | (1,226) | (1,127) | *8.8* | (1,226) | (1,170) | *4.8* | (3,440) | (3,199) | *8* |
| Employee costs | (1,959) | (433) | (423) | *2.3* | (433) | (388) | *11.5* | (1,258) | (1,091) | *15* |
| Sales and marketing | (915) | (318) | (198) | *60.2* | (318) | (179) | *77.7* | (660) | (370) | *79* |
| Manufacturing and G&A costs | (2,391) | (626) | (574) | *9.0* | (626) | (526) | *19.0* | (1,745) | (1,499) | *16* |
| **EBITDA** | **2,443** | **592** | **485** | ***22.1*** | **592** | **491** | ***20.7*** | **1,632** | **1,486** | ***10*** |
| Other income | 355 | 87 | 85 | *3.3* | 87 | 149 | *(41.4)* | 275 | 312 | *(12)* |
| Interest & finance charges | (171) | (45) | (44) | *1.6* | (45) | (36) | *22.9* | (130) | (108) | *21* |
| Depreciation | (511) | (114) | (110) | *3.6* | (114) | (98) | *16.4* | (330) | (290) | *14* |
| **Pretax profits** | **2,117** | **521** | **416** | ***25.3*** | **521** | **506** | ***3.1*** | **1,448** | **1,401** | ***3*** |
| Extraordinary items | — | — | — | | — | — | | — | (3) | |
| Provision for tax | (664) | (145) | (89) | *62.9* | (145) | (161) | *(10.0)* | (395) | (463) | *(15)* |
| Deferred tax | 13 | — | — | | — | — | | — | — | |
| Fringe benefit tax | — | (8) | (8) | | (8) | (9) | | (23) | (24) | |
| **Net income** | **1,465** | **369** | **319** | ***15.5*** | **369** | **336** | ***9.8*** | **1,029** | **911** | ***13*** |
| Tax rate (%) | *31* | *29* | *23* | | *29* | *34* | | *29* | *33* | |
| | | | | | | | | | | |
| **EBITDA margin (%)** | **20.0** | **18.5** | **17.3** | | **18.5** | **17.8** | | **18.7** | **19.4** | |

Note:
(a) Annual figures represent consolidated numbers with radio business while quarterly figures represent standalone numbers.

Source: Company, Kotak Institutional Equities estimates.

**Our DCF-based target price for HTML is Rs260**
Discounted cash flow analysis of HT Media (Rs mn)

| | 2008E | 2009E | 2010E | 2011E | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EBITDA** | **2,443** | **3,733** | **4,784** | **5,840** | **6,748** | **7,502** | **8,317** | **9,223** | **10,216** | **11,250** | **11,278** | **11,955** | **12,673** |
| Tax expense | (731) | (1,259) | (1,663) | (2,067) | (2,392) | (2,666) | (2,959) | (3,284) | (3,637) | (4,002) | | | |
| Changes in working capital | (644) | (339) | (287) | (291) | (277) | (262) | (286) | (313) | (343) | (370) | | | |
| **Cash flow from operations** | **1,069** | **2,134** | **2,834** | **3,483** | **4,079** | **4,574** | **5,072** | **5,626** | **6,236** | **6,878** | | | |
| Capital expenditure | (360) | (20) | (320) | (20) | (320) | (20) | (320) | (20) | (320) | (320) | | | |
| Cash flows for minority interest | (5) | (24) | (34) | (45) | (62) | (67) | (73) | (80) | (86) | (88) | | | |
| **Free cash flow to the firm** | **704** | **2,090** | **2,480** | **3,418** | **3,697** | **4,486** | **4,678** | **5,526** | **5,830** | **6,470** | **6,212** | **6,585** | **6,980** |
| Dicounted cash flow-now | 687 | 1,813 | 1,912 | 2,342 | 2,252 | 2,429 | 2,251 | 2,364 | 2,216 | 2,186 | | | |
| Discounted cash flow-1 year forward | | 2,040 | 2,151 | 2,635 | 2,534 | 2,732 | 2,532 | 2,659 | 2,494 | 2,459 | 2,099 | | |
| Discounted cash flow-2 year forward | | | 2,420 | 2,964 | 2,851 | 3,075 | 2,849 | 2,991 | 2,805 | 2,767 | 2,361 | 2,225 | |
| | | | | | | | | | | | | | |
| Discount rate (%) | 12.5 | | | | | | | | | | | | |
| Growth from 2017 to perpetuity (%) | 6.0 | | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| **Fiscal year-end (March 31, XXXX)** | 31-Mar-08 | 31-Mar-09 | 31-Mar-10 | 31-Mar-11 | 31-Mar-12 | 31-Mar-13 | 31-Mar-14 | 31-Mar-15 | 31-Mar-16 | 31-Mar-17 | 31-Mar-18 | 31-Mar-19 | |
| **Today** | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | 15-Jan-08 | |
| **Years left** | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | |
| **Discount factor at WACC** | **1.0** | **0.9** | **0.8** | **0.7** | **0.6** | **0.5** | **0.5** | **0.4** | **0.4** | **0.3** | **0.3** | **0.3** | |

| | + 1-year | | + 2-years | |
|---|---|---|---|---|
| **Total PV of free cash flow (a)** | **24,334** | **42%** | **27,308** | **43%** |
| FCF in terminal year | 6,585 | | 6,980 | |
| Exit FCF multiple (X) | 15.4 | | 15.4 | |
| Terminal value | 101,303 | | 107,382 | |
| **PV of terminal value (b)** | **34,223** | **58%** | **36,277** | **57%** |
| **EV (a) + (b)** | **58,557** | | **63,584** | |
| **EV (US$ mn)** | **1,273** | | **1,382** | |
| Net debt | (2,672) | | (4,584) | |
| **Equity value** | **61,230** | | **68,168** | |
| **Implied share price (Rs)** | **261** | | **291** | |
| Exit EV/EBITDA multiple (X) | 9.0 | | 9.0 | |

**Sensitivty of share price to different levels of WACC and growth rate (Rs)**

| | | WACC (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | **11.0** | **11.5** | **12.0** | **12.5** | **13.0** | **13.5** | **14.0** |
| **Growth rate (%)** | **1.0** | 219 | 209 | 199 | 190 | 182 | 174 | 167 |
| | **1.0** | 219 | 209 | 199 | 190 | 182 | 174 | 167 |
| | **2.0** | 232 | 220 | 209 | 199 | 190 | 181 | 174 |
| | **3.0** | 249 | 234 | 221 | 209 | 199 | 190 | 181 |
| | **4.0** | 270 | 252 | 236 | 223 | 210 | 200 | 190 |
| | **5.0** | 298 | 275 | 256 | 239 | 225 | 212 | 201 |
| | **6.0** | 337 | 307 | 282 | **261** | 243 | 228 | 214 |
| | **7.0** | 396 | 353 | 319 | 291 | 268 | 248 | 231 |
| | **8.0** | 494 | 426 | 375 | 335 | 303 | 276 | 255 |

Source: Kotak Institutional Equities estimates.

**Derivation of revenues of HT, March fiscal year-ends, 2005-2012E (Rs mn)**

| | Revenues (Rs mn) | | | | | | | | Breakdown of revenues (%) | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E | 2011E | 2012E | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E | 2011E | 2012E |
| **Advertisement revenues** | | | | | | | | | | | | | | | | |
| HT Delhi | 3,709 | 4,612 | 6,102 | 6,645 | 7,505 | 8,353 | 9,297 | 10,250 | 60 | 56 | 59 | 54 | 52 | 51 | 50 | 50 |
| HT Mumbai | — | 449 | 711 | 989 | 1,367 | 1,623 | 1,824 | 2,011 | — | 5 | 7 | 8 | 9 | 10 | 10 | 10 |
| HT Others | 408 | 571 | 720 | 1,052 | 1,399 | 1,647 | 1,871 | 2,107 | 7 | 7 | 7 | 9 | 10 | 10 | 10 | 10 |
| HH | 774 | 926 | 1,215 | 1,560 | 1,834 | 2,075 | 2,315 | 2,583 | 12 | 11 | 12 | 13 | 13 | 13 | 13 | 13 |
| Others | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| **Advertisement revenues** | **4,891** | **6,558** | **8,748** | **10,246** | **12,106** | **13,699** | **15,307** | **16,952** | **79** | **80** | **84** | **84** | **83** | **83** | **83** | **83** |
| **Circulation revenues** | | | | | | | | | | | | | | | | |
| HT Delhi | 366 | 524 | 572 | 620 | 652 | 689 | 727 | 768 | 6 | 6 | 6 | 5 | 4 | 4 | 4 | 4 |
| HT Mumbai | — | (10) | (91) | (96) | (4) | 144 | 309 | 348 | — | (0) | (1) | (1) | (0) | 1 | 2 | 2 |
| HT Others | 177 | 181 | 186 | 208 | 252 | 296 | 345 | 363 | 3 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| HH | 713 | 650 | 695 | 709 | 829 | 858 | 888 | 922 | 11 | 8 | 7 | 6 | 6 | 5 | 5 | 5 |
| Others | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| **Circulation revenues** | **1,256** | **1,345** | **1,362** | **1,440** | **1,729** | **1,986** | **2,269** | **2,401** | **20** | **16** | **13** | **12** | **12** | **12** | **12** | **12** |
| **Others** | **60** | **295** | **233** | **216** | **219** | **246** | **273** | **275** | **1** | **4** | **2** | **2** | **2** | **1** | **1** | **1** |
| **Total revenues** | **6,208** | **8,198** | **10,377** | **12,200** | **14,518** | **16,496** | **18,507** | **20,431** | **100** | **100** | **100** | **100** | **100** | **100** | **100** | **100** |

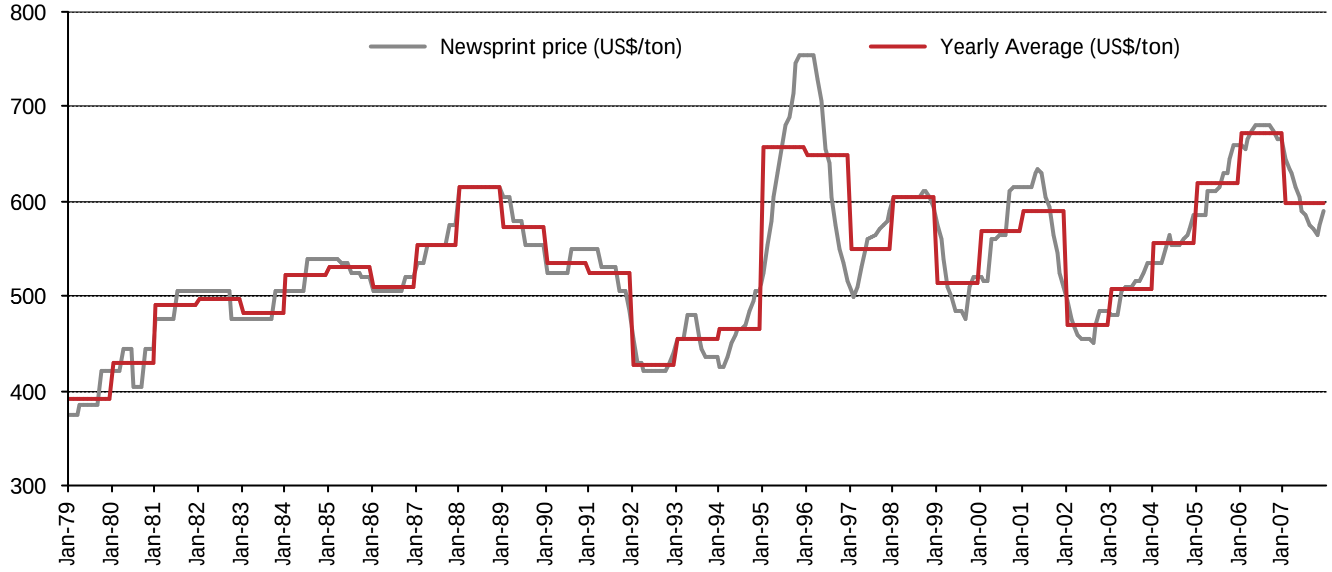
Source: Kotak Institutional Equities estimates.

**Profit model, balance sheet, cash model of HT Media 2005-2012E, March fiscal year-ends (Rs mn)**

| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|---|---|
| **Profit model** | | | | | | | | |
| Net sales | 6,247 | 8,210 | 10,397 | 12,200 | 14,518 | 16,496 | 18,507 | 20,431 |
| **EBITDA** | **753** | **1,184** | **1,680** | **2,443** | **3,733** | **4,784** | **5,840** | **6,748** |
| Other income | 91 | 177 | 367 | 355 | 394 | 480 | 570 | 587 |
| Interest | (72) | (135) | (143) | (171) | (70) | — | — | — |
| Depreciation | (227) | (385) | (436) | (511) | (529) | (539) | (360) | (371) |
| **Pretax profits** | **546** | **841** | **1,468** | **2,117** | **3,528** | **4,725** | **6,049** | **6,964** |
| Extraordinary items | (106) | (229) | 2 | — | — | — | — | — |
| Tax | (22) | (65) | (573) | (664) | (1,237) | (1,663) | (2,067) | (2,392) |
| Deferred taxation | (142) | (174) | 27 | 13 | 38 | 57 | 11 | 25 |
| **Net income** | **274** | **373** | **924** | **1,465** | **2,329** | **3,119** | **3,993** | **4,597** |
| Minority interest | — | — | (46) | 5 | 24 | 34 | 45 | 62 |
| **Adjusted net income** | **349** | **537** | **969** | **1,460** | **2,305** | **3,085** | **3,948** | **4,535** |
| **Earnings per share (Rs)** | **1.8** | **2.4** | **4.1** | **6.2** | **9.8** | **13.2** | **16.9** | **19.4** |
| | | | | | | | | |
| **Balance sheet** | | | | | | | | |
| Total equity | 4,114 | 6,932 | 7,642 | 8,828 | 10,585 | 12,574 | 12,827 | 13,117 |
| Minority interest | — | — | — | 5 | 29 | 63 | 108 | 170 |
| Deferred taxation liability | 132 | 296 | 273 | 260 | 222 | 165 | 155 | 130 |
| Total borrowings | 1,716 | 1,696 | 1,658 | 1,650 | — | — | — | — |
| Current liabilities | 1,406 | 1,809 | 2,113 | 2,063 | 2,197 | 2,302 | 2,425 | 2,542 |
| **Total liabilities and equity** | **7,367** | **10,733** | **11,685** | **12,806** | **13,033** | **15,104** | **15,514** | **15,958** |
| Cash | 489 | 2,678 | 1,104 | 1,812 | 2,074 | 3,972 | 4,309 | 4,410 |
| Other current assets | 1,889 | 3,276 | 2,863 | 3,457 | 3,931 | 4,323 | 4,736 | 5,131 |
| Total fixed assets | 3,823 | 3,736 | 4,109 | 4,033 | 3,600 | 3,456 | 3,191 | 3,215 |
| Intangible assets | 158 | 182 | 1,098 | 1,023 | 948 | 873 | 797 | 722 |
| Investments | 1,009 | 861 | 2,510 | 2,510 | 2,510 | 2,510 | 2,510 | 2,510 |
| **Total assets** | **7,367** | **10,733** | **11,685** | **12,836** | **13,063** | **15,134** | **15,544** | **15,988** |
| | | | | | | | | |
| **Free cash flow** | | | | | | | | |
| Operating cash flow, excl. working capital | 540 | 757 | 1,194 | 1,639 | 2,425 | 3,121 | 3,773 | 4,356 |
| Working capital changes | 78 | (232) | (226) | (644) | (339) | (287) | (291) | (277) |
| Capital expenditure | (1,085) | (327) | (867) | (360) | (20) | (320) | (20) | (320) |
| Investments | (566) | 388 | (319) | — | — | — | — | — |
| Other income | 27 | 130 | 197 | 355 | 394 | 480 | 570 | 587 |
| **Free cash flow** | **(1,006)** | **716** | **(21)** | **990** | **2,460** | **2,994** | **4,032** | **4,346** |
| | | | | | | | | |
| **Ratios (%)** | | | | | | | | |
| Debt/equity | 40.4 | 23.5 | 20.9 | 18.2 | — | — | — | — |
| Net debt/equity | 28.9 | (13.6) | 7.0 | (1.8) | (19.2) | (31.2) | (33.2) | (33.3) |
| ROAE (%) | 9.8 | 9.4 | 12.8 | 17.2 | 23.2 | 26.2 | 30.7 | 34.6 |
| **ROACE (%)** | **11.1** | **12.1** | **10.6** | **15.5** | **21.7** | **26.0** | **31.0** | **34.9** |

Source: Kotak Institutional Equities estimates.

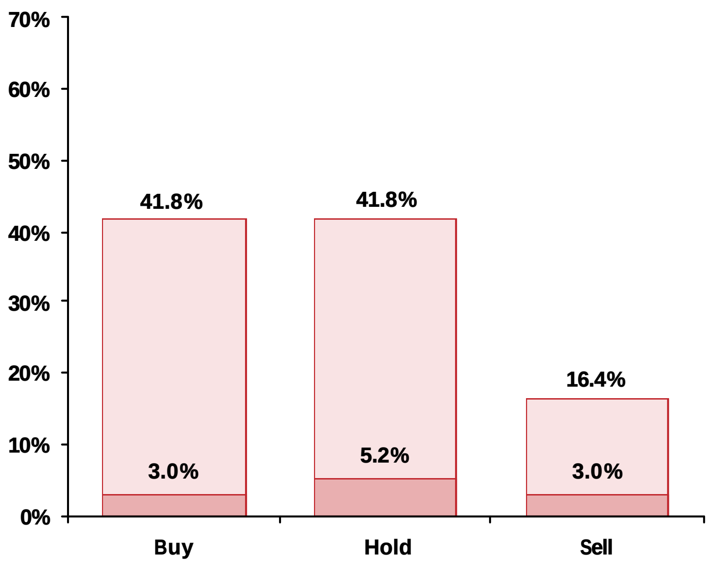
**Newsprint prices have started to increase as supply surplus in the North American market reduces**



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

**Kotak Institutional Equities Research coverage universe**

Distribution of ratings/investment banking relationships




Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 09/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

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

## Ratings and other definitions/identifiers

### New rating system

Definitions of ratings

**BUY.** We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
**REDUCE:** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
**SELL:** We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

### Old rating system

Definitions of ratings

**OP = Outperform**. We expect this stock to outperform the BSE Sensex over the next 12 months.
**IL = In-Line.** We expect this stock to perform in line with the BSE Sensex over the next 12 months.
**U = Underperform.** We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

### Other definitions

**Coverage view.** The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

### Other ratings/identifiers

**NR = Not Rated.** The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
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**NM = Not Meaningful.** The information is not meaningful and is therefore excluded.

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