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### New Release

**Economy:** Indian State finances shapes up to slimming program but retention is unlikely

### Updates

**Reliance Petroleum:** Refinery commissioned in the midst of weakening refining cycle

## News Roundup

### Corporate

- In a sign that influential board members of Satyam Computer Services Ltd have decided to step in and take charge, independent director Vinod Dham said a board meeting next month would discuss a change in management, including the possible exit of chairman B. Ramalinga Raju, and induction of a professional chief executive or even a sale to another entity.
- Taking advantage of an extended annual plant maintenance shut down, General Motors India is cutting down production by up to 10% from its two plants—at Halol in Gujarat and at Talegaon in Maharashtra—as the auto mart reels under a demand slump. (FE)
- Jet Airways and Kingfisher have announced a reduction in fares following a steep fall in aviation turbine fuel prices. (The Telegraph)
- Tata Metaliks Ltd will raise Rs100 bn through non-convertible debentures from financial institutions. (The Telegraph)

### Economic and political

- The Reserve Bank of India may further trim key rates and reserve ratios in the coming weeks as it looks to make cheap credit available to borrowers and prevent the economic slowdown from gaining momentum, government officials said. (ET)
- The October 2008 landslide in stock prices, which caused a nearly 90% drop in India's equity derivatives business, has dealt a severe blow to Asia's oldest bourse, the Bombay Stock Exchange. In the past three months, 23 stock brokers have opted for voluntary closure of their derivatives business on the exchange and the daily turnover on the exchange is now as low as Rs8.5 mn, compared to Rs15 bn to Rs20 bn, when the market peaked in January this year. (BS)
- Prices of many food commodities in India are unlikely to come down in the current financial year, as record-high government procurement prices announced this year would keep these essential commodities dearer. (BS)

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

## EQUITY MARKETS

| India  | Change, % |       |      |        |
|--------|-----------|-------|------|--------|
|        | 26-Dec    | 1-day | 1-mo | 3-mo   |
| Sensex | 9,329     | (2.5) | 2.6  | (25.9) |
| Nifty  | 2,857     | (2.0) | 3.7  | (25.8) |

### Global/Regional indices

|           |        |       |       |        |
|-----------|--------|-------|-------|--------|
| Dow Jones | 8,516  | 0.6   | (3.6) | (17.8) |
| FTSE      | 4,217  | (0.9) | 1.1   | (18.9) |
| Nikkie    | 8,710  | (0.3) | 2.3   | (25.8) |
| Hang Seng | 14,184 | (0.3) | 10.1  | (25.1) |
| KOSPI     | 1,095  | (2.0) | 1.8   | (24.8) |

### Value traded - India

|                     | Moving avg, Rs bn |       |       |
|---------------------|-------------------|-------|-------|
|                     | 26-Dec            | 1-mo  | 3-mo  |
| Cash (NSE+BSE)      | 103.8             | 139.2 | 144.4 |
| Derivatives (NSE)   | 241.5             | 488.9 | 443   |
| Deri. open interest | 365.5             | 592   | 588   |

### Forex/money market

|                   | Change, basis points |       |       |       |
|-------------------|----------------------|-------|-------|-------|
|                   | 26-Dec               | 1-day | 1-mo  | 3-mo  |
| Rs/US\$           | 48.4                 | 0     | (192) | 146   |
| 6mo fwd prem, %   | #N/A                 | Sec   | ##### | ##### |
| 10yr govt bond, % | 5.1                  | (6)   | (188) | (331) |

### Commodity market

|                  | Change, % |       |        |        |
|------------------|-----------|-------|--------|--------|
|                  | 26-Dec    | 1-day | 1-mo   | 3-mo   |
| Gold (US\$/OZ)   | 889.8     | 2.4   | 8.8    | (2.2)  |
| Silver (US\$/OZ) | 11.0      | 2.6   | 6.6    | (16.4) |
| Crude (US\$/BBL) | 37.5      | 10.1  | (27.5) | (58.9) |

### Net investment (US\$m)

|     | 24-Dec | MTD  | CYTD     |
|-----|--------|------|----------|
| FIs | (29)   | 462  | (13,201) |
| MFs | 70     | (52) | 3,429    |

### Top movers -3mo basis

| Best performers      | Change, % |       |       |      |
|----------------------|-----------|-------|-------|------|
|                      | 26-Dec    | 1-day | 1-mo  | 3-mo |
| Bharat Petroleum C   | 374       | (2.8) | 5.4   | 9.8  |
| Punjab National Bar  | 499       | (1.6) | 11.9  | 8.4  |
| Indian Oil Corporati | 418       | 1.3   | 1.7   | 8.0  |
| Mmtc Limited         | 20,823    | (3.8) | 108.1 | 6.4  |
| Ntpc Limited         | 177       | (0.6) | 10.9  | 6.3  |

### Worst performers

|                     |     |       |       |        |
|---------------------|-----|-------|-------|--------|
| Housing Developme   | 127 | (2.4) | 65.7  | (23.4) |
| Unitech Limited     | 36  | (2.8) | 55.9  | (66.7) |
| Aban Offshore Limi  | 671 | (4.8) | (2.4) | (66.3) |
| Bajaj Finserv Ltd   | 134 | 5.0   | 39.9  | (64.5) |
| Suzlon Energy Limit | 57  | (2.5) | 36.5  | (63.0) |

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## Economy

Sector coverage view

N/A

**Indian State finances shapes up to slimming program but retention is unlikely**

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- **GFD/GDP ratio for states widens to 2.3% in FY2008 from a 30-year low of 1.9% in FY2007**
- **Ratio likely to slip ahead to 2.5% from budgeted 2.1% in FY2009 and to 3.3% in FY2010**
- **We expect State government borrowing at Rs820 bn in FY2009 against BE of Rs638 bn**
- **Our estimate: total fiscal gap in FY2009 likely to cross 9% of GDP (Centre's on-budget at 5% and off-budget at 1.6%; State's at 2.5%)**

The annual RBI study on State finances released over the weekend throws some interesting data points—(1) State GFD/GDP ratio shrank to a 30-year low of 1.9% in FY2007 as per accounts (final) data released, (2) GFD/GDP ratio has widened to 2.3% in FY2008 as per revised estimate (RE), but it still lower when compared to 2.7% for RE of FY2007 and (3) GFD/GDP ratio in FY2008 was still less than half of 4.6% in FY2000 confirming that the State finances have shaped up to the slimming program or the fiscal reforms. However, like in any slimming program, the retention of inch loss is the most difficult part and we see reasons to expect sharp deterioration in State finances over the next 2-3 years, so that GFD/GDP ratio could widen to 3.3% by FY2010. We also expect State governments to borrow over Rs400 bn in 4QFY09, which along with unplanned market borrowing of Rs300 bn by Centre can moderate the falling G-sec yields.

India has a federal structure with fiscal powers constitutionally shared between the Union government and the sub-national governments which include 28 States and 7 Union Territories (UT). State finances, therefore, have important implications for (1) understanding the fiscal position of the country and (2) likely impact on interest rates and financial markets as a result of State government borrowings crowding out private investment.

**Deficits of the State governments have slimmed up**

Various deficit indicators of the State governments have widened a bit in FY2008, but the data still suggests that State finances remain in good shape. Consider the following:

- 1) As per accounts data released for FY2007, GFD/GDP ratio had shrunk to a 30-year low of 1.9%. The ratio was 1.7% in FY1977 but had risen to 4.6% by FY2000 threatening Indian fiscal sustainability before a concentrated program of reforms of State finances was put in place (see Exhibit 1).
- 2) GFD/GDP ratio in FY2008 as per revised estimates (RE) was at 2.3%, same as the budget estimate. This suggests good fiscal marksmanship. Though the number reflects widening of fiscal gap when compared to accounts data for FY2007, the deficit is still lower when compared with 2.7% RE for 2007.
- 3) State governments have posted a revenue surplus for the second consecutive year. Revenue surplus at 0.5% in FY2008RE is broadly comparable with 0.6% in FY2007. States ran a revenue deficit from FY1988-FY2006 (see Exhibit 2).
- 4) After running a primary surplus of 0.4% of GDP for the first time, the 2008RE shows a slippage to marginal deficit of 0.1%. However, the data suggests that the revenue account for the States continue to be roughly in balance (see Exhibit 3).

### Retention of lower deficits difficult in our view

As is typical in any weight loss program, retention of weight or the inch loss is the most difficult part, we see fiscal gaps for the States widening over at least the next two years—FY2009 and FY2010. FY2007 and FY2008 have turned out to be exceptionally good years for State finances. However, deterioration is likely over the 2-3 years due to following factors:

1) **Hike in wages and salaries of State government employees:** State government's administrative expenditures on wages and salaries of its employees are budgeted to rise to Rs1.64 tn in FY2009 from Rs1.39 tn in FY2008RE. We project it to rise to over Rs2 tn in FY2010 and to over Rs2.4 tn in FY2011, putting severe strain on State finances (see Exhibit 4). Soaring wage bills for State governments look inevitable as they emulate the Sixth Central Pay Commission recommendations.

Some States have already announced implementation of the Sixth Central Pay Commission recommendations for its employees. These include the Uttar Pradesh, Madhya Pradesh, Chhattisgarh and Gujarat. However, the brunt of the implementation burden is more likely to take place in FY2010, where many States may also disburse arrears if they decide to implement the recommendations from April 2006 as has been the case with the Union government. Other States, like Orissa, have constituted committees to study implementation of the Central Pay Commission from the angle of fitment of pay scales or are setting up their own commissions on wage hikes. So while bulk of the burden would be in FY2010, some of it is also likely to spill over to FY2011.

2) **Lower devolution of taxes from the centre to States:** Centre's transfers to States have increased to Rs2.7 tn in FY2008RE from an average of Rs1.1 tn average in FY2001-05. As a percentage of GDP, they have gone up to 5.8% from 4.2% over the same periods. However, as Centre's tax collections decelerate over a 2-year cyclical slowdown, the transfers to States, especially in the form of sharable taxes would also decelerate. On this account, we expect a loss of over Rs100 bn to States in FY2009 and nearly Rs300 bn in FY2010

3) **Electoral cycle expenditure increase:** With seven States going to polls in FY2009 and general elections round the corner, we expect State expenditures to increase in FY2009 over the budget provision of Rs6.9 tn for FY2009. There are several plan expenditures which are borne in burden sharing form between Centre and States. As these are being pushed for quick implementation for the ensuing polls, there is likely to be an overshooting of over Rs100 bn in these

### States likely to overshoot market borrowing target and raise Rs400 bn in 4QFY09

In our assessment, state governments are likely to overshoot market borrowing in view of poor National Small Saving Fund (NSSF) collections for the second successive year. Against a BE for market borrowing of Rs638 bn, total market borrowing is likely to be around Rs800 bn.

If the entire amount of budgeted NSSF resources to finance States' GFD of Rs220 bn is to be met by additional market borrowing, the total market borrowings of State governments would add up to Rs859 bn. However, their total market borrowing is more likely to be around Rs800 bn as they are likely to make good a part of the NSSF shortfall through increased recourse to reserve funds and other means.

States, however, have borrowed only Rs414 bn from the market till December 23, 2008 at an weighted average yield of 8.1%. Considering that States may end up borrowing Rs820 bn in FY2009, we expect a large borrowing of about Rs406 bn in 4QFY09 by States. If they are able to borrow this at a lower average yield of 5.9%, the weighted average cost for State borrowing in FY2009 could drop to about 7% (see Exhibit 5).

States are also likely to be forced to draw from their cash balances and investment accounts with RBI to meet most of their overshooting of the GFD itself to about Rs1,350 bn against a BE of Rs1,127 bn (see Exhibit 6). State governments have cash balances of Rs749 bn as of December 19, 2008 invested in 14-day intermediate and auction T-bills of 91-day, 182-day and 364-day maturities.

### **Fiscal responsibility legislations and increased devolution has turned around State finance**

State finances have improved in the current decade so far, due mainly to the slimming program or the fiscal reforms which include: (1) fiscal responsibility legislations (FRL), (2) revenue enhancing user price reforms and fiscal consolidation measures and (3) increased devolution based on Finance Commission awards.

- 1) 26 out of 28 States have enacted FRLs with Sikkim and West Bengal being the two exceptions.
- 2) 19 out of 28 States have adopted new pension scheme (NPS) with the nine States which have not adopted so far being Arunachal Pradesh, J&K, Kerala, Meghalaya, Mizoram, Nagaland, Punjab, Tripura and West Bengal.
- 3) 17 out of 28 States have imposed ceilings on guarantees, with 11 States which are yet to do so include Arunachal Pradesh, Bihar, HP, J&K, Jharkhand, Maharashtra, Meghalaya, Mizoram, Tripura, Uttarakhand and Uttar Pradesh.
- 4) 20 out of 28 States have set up Consolidated Sinking Funds (CSF), with 8 States which are yet to do so include Bihar, HP, J&K, Jharkhand, Karnataka, MP, Rajasthan and Uttar Pradesh.
- 5) 11 out of 28 States have set up Guarantee Redemption Fund (GRF), with 17 States which are yet to do so include Arunachal Pradesh, Assam, Bihar, Chattisgarh, HP, Jharkhand, Karnataka, Kerala, Maharashtra, Meghalaya, Mizoram, Punjab, Rajasthan, Tamil Nadu, Tripura, Uttar Pradesh and West Bengal.

### **Difficulties ahead in keeping with fiscal responsibility obligations**

Though the FRL targets for FY2008 in respect of revenue deficit (elimination by FY2009) as well as GFD (reduction to 3% of GSDP by FY2010) have been met, the State governments are likely to face difficulties in meeting the FRL obligations ahead. The 13<sup>th</sup> Finance Commission would need to work out more reforms for State finances. These could include:

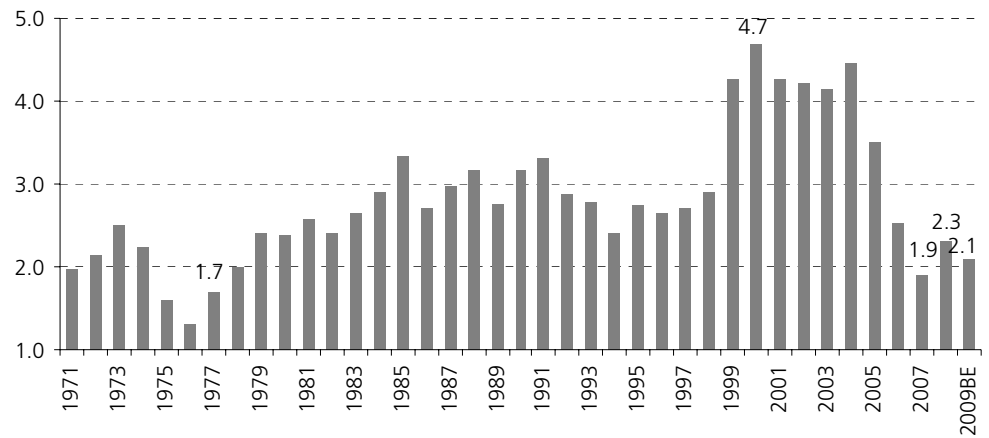
- Incentive compatible schemes to encourage States to enhance revenues as well as contain expenditures, rather than mainly revenue enhancing approach adopted so far.
- Further user price reforms to not only recover costs but generate reasonable returns
- Restructuring public administration to save on wage bill is necessary
- Scheme to use State government cash balances or improve returns thereon through auction of such balances if necessary. Currently State governments are bearing a negative carry as they raise market borrowings at higher yield than they earn T-bills, but are still reluctant to reduce market borrowing. The Centre also benefits from this inefficient scheme as they get to use State cash balances. Alternatively, incentives could be provided for use of cash balances to retire debt through buybacks as has been done in the case of Orissa and Tamil Nadu.

### **Combined fiscal gap may exceed 9% of GDP in FY2009**

With the above assessment of State finances, it is now clear that the combined fiscal gap of the Centre and States is likely to add up to over 9% of GDP in FY2009. On current reckoning, the on-budget GFD of the Centre and States are likely to be about 5% and 2.5% of GDP, respectively, which could be a deterioration of nearly 1.3 ppt from the preceding year. We had earlier seen similar 9% plus combined deficits from FY1999-FY2003 as well as in three earlier years.

**Exhibit 1: GFD/GDP ratio shrinks to 30-year low of 1.9% in FY2007**

Gross fiscal deficit/GDP, March fiscal year-ends, 1971-2009BE (%)

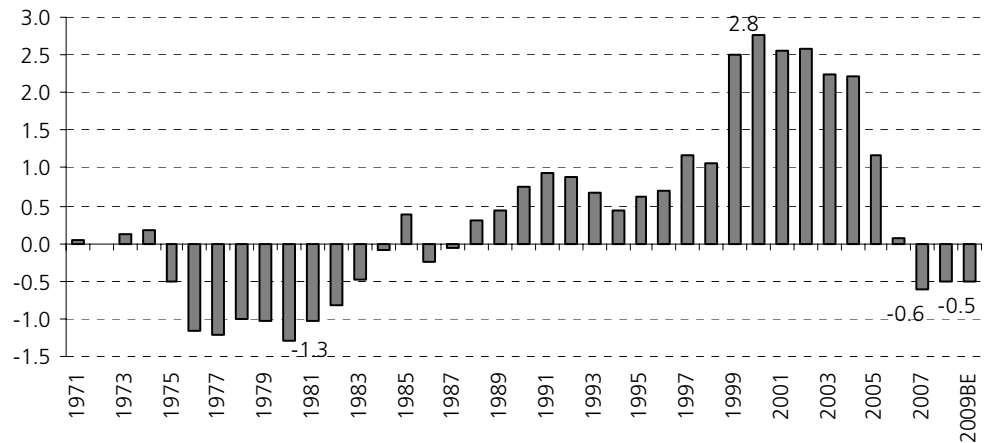


Note: Gross fiscal deficit (GFD) is aggregate disbursement (revenue expenditure+capital disbursements, excluding repayment of WMA and overdraft from RBI) less revenue receipts, non-debt capital receipts and recovery of loans and advances

Source: Reserve Bank of India

**Exhibit 2: Return to revenue surpluses for second successive year in FY2008**

revenue deficit/GDP, March fiscal year-ends, 1971-2009BE (%)

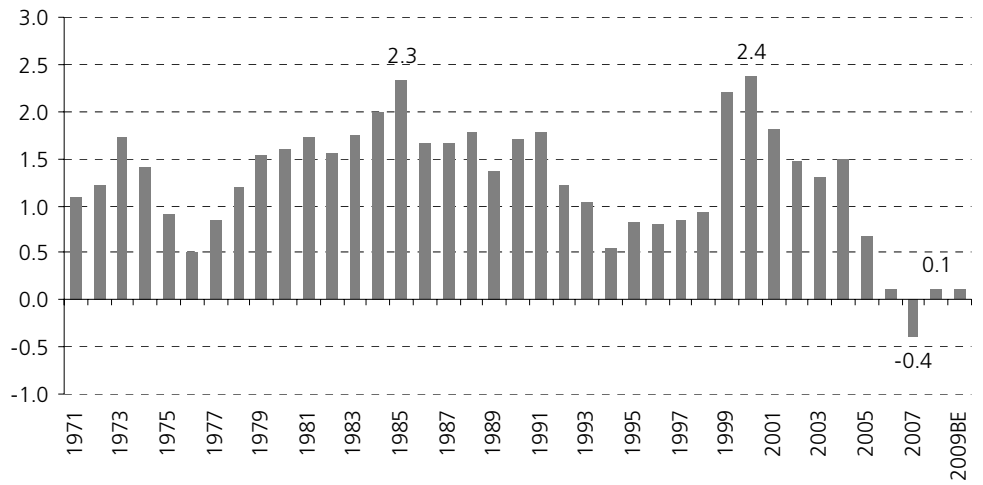


Note: revenue deficit is revenue expenditure minus revenue receipts

Source: Reserve Bank of India

**Exhibit 3: Primary deficit nearly in balance for third successive year in FY2008**

Primary deficit/GDP, March fiscal year-ends, 1971-2009BE (%)

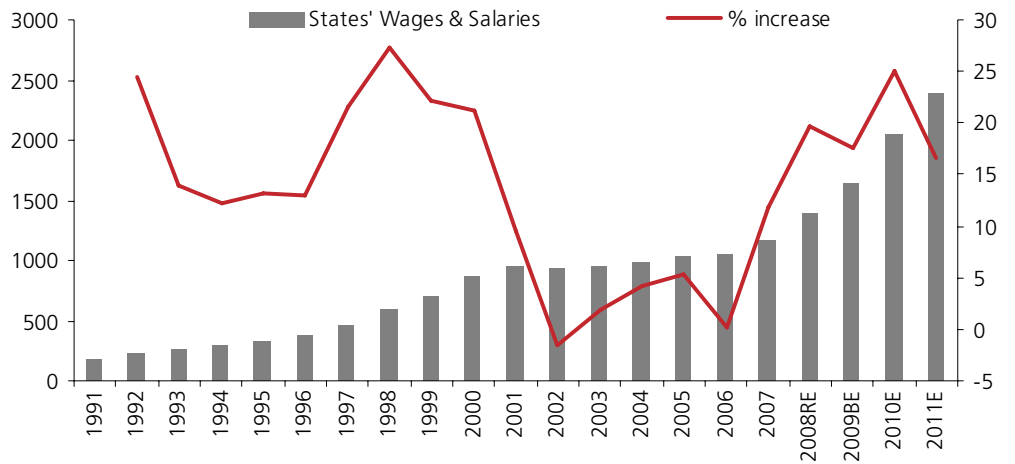


Note: Primary deficit is GFD less interest payments

Source: Reserve Bank of India

**Exhibit 4: Wage bill increase likely to put strain on State finances**

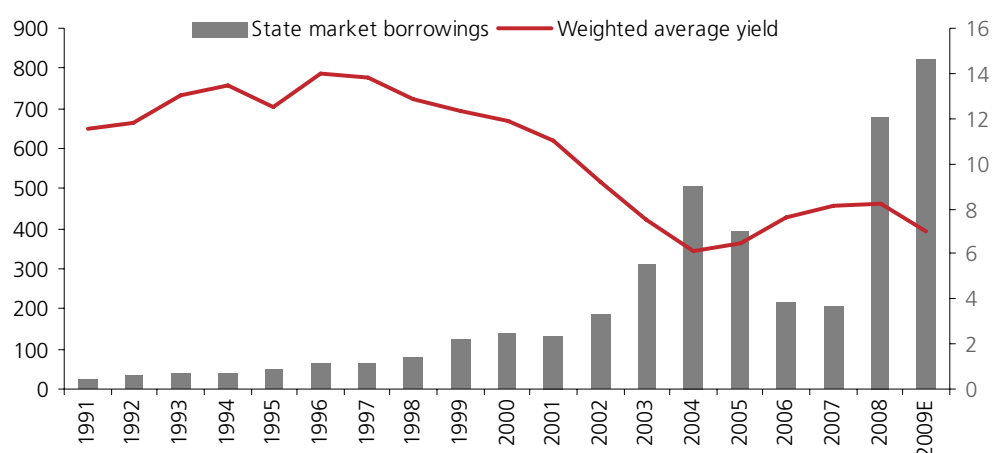
State government's expenses on wages and salaries (Rs bn) on LHS; increase (%) on RHS



Source: Reserve Bank of India; Kotak Institutional Equities estimates

**Exhibit 5: States borrowing more at lesser costs**

State government's market borrowing (Rs bn) on LHS; weighted average yield (%) on RHS



Source: Reserve Bank of India; Kotak Institutional Equities estimates

**Exhibit 6: State's increased GFD likely to be financed by additional market borrowing and decrease in cash balances**

Financing of State's gross fiscal deficit (Rs bn)

| year    | Market borrowing | Loans from centre | Special securities issued to NSSF | Loans from banks & FIs | Small savings, PFs | Reserve funds | Others | Decrease in cash balance/ investment account | Increase in WMA/ OD | Gross fiscal deficit (GFD) |
|---------|------------------|-------------------|-----------------------------------|------------------------|--------------------|---------------|--------|--|---------------------|----------------------------|
| 1991    | 26               | 100               | -                                 | 2                      | 31                 | 11            | 19     | -2   | 1                   | 188                        |
| 1992    | 33               | 94                | -                                 | 0                      | 29                 | 13            | 18     | -1   | 2                   | 189                        |
| 1993    | 35               | 89                | -                                 | 0                      | 36                 | 15            | 52     | -16  | -2                  | 209                        |
| 1994    | 36               | 94                | -                                 | 1                      | 43                 | 15            | 9      | 4  | 0                   | 204                        |
| 1995    | 41               | 143               | -                                 | 21                     | 48                 | 17            | 49     | -25  | -20                 | 273                        |
| 1996    | 59               | 141               | -                                 | 6                      | 49                 | 21            | 61     | -41  | 12                  | 309                        |
| 1997    | 65               | 167               | -                                 | 7                      | 54                 | 24            | -22    | 64   | 7                   | 366                        |
| 1998    | 73               | 226               | -                                 | 15                     | 62                 | 29            | 50     | -2   | -19                 | 435                        |
| 1999    | 105              | 304               | -                                 | 24                     | 120                | 36            | 110    | -7   | 42                  | 733                        |
| 2000    | 127              | 122               | 264                               | 34                     | 179                | 26            | 119    | 6  | 25                  | 901                        |
| 2001    | 125              | 83                | 326                               | 46                     | 131                | 31            | 161    | -16  | -8                  | 879                        |
| 2002    | 172              | 109               | 356                               | 63                     | 102                | 45            | 61     | 6  | 29                  | 943                        |
| 2003    | 285              | -4                | 490                               | 49                     | 99                 | 48            | 77     | 23   | -69                 | 997                        |
| 2004    | 473              | 139               | 180                               | 41                     | 93                 | 64            | 221    | -1   | -5                  | 1206                       |
| 2005    | 346              | -98               | 642                               | 0                      | 89                 | 71            | 132    | -87  | -18                 | 1078                       |
| 2006    | 153              | 0                 | 738                               | 41                     | 105                | 52            | 152    | -329   | -10                 | 901                        |
| 2007    | 131              | -89               | 560                               | 39                     | 104                | 76            | 117    | -165   | 2                   | 775                        |
| 2008RE  | 636              | 34                | 95                                | 74                     | 121                | -96           | -26    | 240  | 1                   | 1080                       |
| 2009BE  | 638              | 69                | 220                               | 74                     | 130                | 12            | 6      | -24  | 1                   | 1127                       |
| 2009KIE | 820              | 60                | 10                                | 80                     | 118                | 50            | 115    | 97   | 1                   | 1350                       |

Source: Reserve Bank of India; Kotak Institutional Equities estimates

**Energy****RPET.BO, Rs85**

|                      |          |
|----------------------|----------|
| Rating               | REDUCE   |
| Sector coverage view | Neutral  |
| Target Price (Rs)    | 80       |
| 52W High -Low (Rs)   | 260 - 68 |
| Market Cap (Rs bn)   | 381.4    |

**Financials**

| March y/e          | 2008  | 2009E | 2010E |
|--------------------|-------|-------|-------|
| Sales (Rs bn)      | 0.0   | 0.0   | 833.6 |
| Net Profit (Rs bn) | (4.7) | (0.1) | 44.6  |
| EPS (Rs)           | (1.1) | (0.0) | 9.9   |
| EPS gth            | -     | -     | -     |
| P/E (x)            | -     | -     | 8.5   |
| EV/EBITDA (x)      | -     | -     | 7.6   |
| Div yield (%)      | -     | -     | 2.4   |

**Pricing performance**

| Perf-1m | Perf-3m | Perf-6m | Perf-1y |
|---------|---------|---------|---------|
| 15.7    | (40.8)  | (51.2)  | (62.0)  |

**Shareholding, September 2008**

|           | % of<br>Pattern Portfolio | Over/(under)<br>weight |
|-----------|---------------------------|------------------------|
| Promoters | 75.4                      | -                      |
| FIs       | 1.4                       | 0.2 (1.8)              |
| MFs       | 0.8                       | 0.4 (1.5)              |
| UTI       | -                         | - (2.0)                |
| LIC       | 1.9                       | 0.9 (1.1)              |

**Reliance Petroleum: Refinery commissioned in the midst of weakening refining cycle**

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- **Refinery commissioned; 'commercial production' will likely begin from April 1, 2009**
- **Weak refining cycle led by large capacity additions plus demand weakness**
- **No change in valuations (12-month DCF-based target price of Rs80) or view (REDUCE rating) based on announcement**

We see the December 25 announcements regarding commissioning of RPET's refinery at Jamnagar on expected lines. We highlight that the refinery has been commissioned and we expect the 'commercial production' to commence from April 1, 2009, to take advantage of full year of 100% tax exemption. We are bemused by the spurt in stock price by 6.3% on the day of commissioning, given that the announcement was largely expected by the street. Although, we are impressed by the management's execution capability for completion of the project of such scale and complexity within a period of 36 months, we believe that stock performance will likely be determined by the likely strength/weakness of refining cycle. We expect supply-demand imbalance to persist for the next 2-3 years given large capacity additions and likely weak demand until FY2010E. We retain our REDUCE rating and 12-month DCF-based target price of Rs80. Key upside risk to our negative view stems from a sharp recovery in global GDP leading to higher-than-expected refining margins.

**Announcement of commissioning on expected lines; downside risk to earnings from weaker-than-expected refining cycle.** We view the announcement of commissioning of RPET's 580,000 b/d refinery at Jamnagar on expected lines. We note that refinery is yet to commence 'commercial production' from the refinery. We expect RPET to start commercial production from 1QFY10E to take advantage of a full year of 100% income tax exemption rather than for a few months in FY2009E at a time of very weak refining margins. We clarify that even one day of operations is counted as a full year for taxation purposes under the SEZ Act.

We would rather focus on deteriorating demand-supply balance which poses downside risks to our earnings estimates RPET as the earnings have high leverage to refining margins and weaker-than-expected margins could significantly impact their earnings negatively. Exhibit 2 shows the sensitivity of RPET's EPS to changes in refining margins, respectively. A US\$1/bbl lower refining margin versus our expectation will impact RPET's FY2010E EPS by 23%. We currently model refining margins for RPET's refinery at US\$8.6/bbl for FY2010E and FY2011E.

**Slowdown in demand turning out to be far worse than earlier anticipated.** Exhibit 3 gives our supply-demand estimates for oil but we do not rule out downside risks to global demand. The IEA currently projects CY2009E global oil demand growth at 0.5 mn b/d with degrowth of -0.6 mn b/d in OECD countries chipping off the non-OECD demand growth of 1.1 mn b/d. We see greater downside to non-OECD demand growth as the recession in the US and Euro-zone would likely impact exports from emerging Asian countries resulting in lower GDP growth in those countries, particularly China and East Asia.

The IEA now expects degrowth for CY2008E at -0.2 mn b/d (down from demand growth of 2 mn b/d in January 2008) reflecting demand compression in the OECD countries primarily. In particular, US demand continues to be weak with December demand declining by 5% yoy led by economic slowdown and ongoing financial crisis; demand contracted 8% yoy in November 2008 and October 2008 (Exhibit 4).



**Significant capacity addition due in CY2009-10E.** We expect significant addition to refining capacity from 4QCY08, which includes capacity addition of 0.95 mb/d in China and RPET's 580,000 b/d refinery (see Exhibit 5). We expect refining capacity addition of 0.6 mb/d, 2.4 mb/d and 1.7 mb/d in CY2008E, CY2009E and CY2010E (see Exhibit 6). In addition, we expect natural gas liquids (NGLs) supply to increase by 0.2 mb/d, 0.6 mb/d and 0.6 mb/d in CY2008E, CY2009E and CY2010E led by start of several gas-processing plants associated with gas developments in Iran (Phase 6-10 of South Pars development), Qatar (four new LNG trains of Qatargas 2 and RasGas), Saudi Arabia and Nigeria.

**Refining margins turn positive but remain weak.** Exhibit 7 shows that refining margins have bounced back in December 2008 from negative levels seen in November 2008. We had highlighted that the margins would likely bounce back from negative territory but expected them to remain weak. We would focus less on short-term volatility in refining margins and more on the deterioration in supply-demand balance of refined products which has started emerging from 2HCY08.

#### Our DCF-based fair value for RPL is Rs80

DCF valuation for Reliance Petroleum (Rs mn)

|                                      | 2009E           | 2010E         | 2011E         | 2012E         | 2013E         | 2014E         | 2015E         | 2016E         | 2017E         | 2018E         | 2019E         | 2020E         | 2021E         | 2022E         |
|--------------------------------------|-----------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>EBITDA</b>                        | —               | <b>71,330</b> | <b>69,257</b> | <b>74,963</b> | <b>79,747</b> | <b>79,469</b> | <b>79,163</b> | <b>78,828</b> | <b>78,464</b> | <b>78,071</b> | <b>77,648</b> | <b>77,648</b> | <b>77,648</b> | <b>77,648</b> |
| Tax expense                          | —               | (77)          | (67)          | (73)          | (73)          | (73)          | (8,804)       | (10,856)      | (11,539)      | (12,098)      | (12,561)      | (23,284)      |               |               |
| Working capital changes              | (1,883)         | (65,940)      | 1,312         | 707           | 745           | 109           | (11)          | (9)           | (7)           | (10)          | (14)          | (9)           |               |               |
| <b>Cash flow from operations</b>     | <b>(1,883)</b>  | <b>5,312</b>  | <b>70,502</b> | <b>75,597</b> | <b>80,418</b> | <b>79,505</b> | <b>70,348</b> | <b>67,962</b> | <b>66,918</b> | <b>65,963</b> | <b>65,073</b> | <b>54,355</b> |               |               |
| Capital expenditure                  | (39,097)        | —             | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       | (2,000)       |               |               |
| <b>Free cash flow to the firm</b>    | <b>(40,980)</b> | <b>5,312</b>  | <b>68,502</b> | <b>73,597</b> | <b>78,418</b> | <b>77,505</b> | <b>68,348</b> | <b>65,962</b> | <b>64,918</b> | <b>63,963</b> | <b>63,073</b> | <b>52,355</b> | <b>52,355</b> | <b>52,355</b> |
| <b>Discount factor at WACC</b>       | <b>0.96</b>     | <b>0.86</b>   | <b>0.76</b>   | <b>0.68</b>   | <b>0.60</b>   | <b>0.53</b>   | <b>0.48</b>   | <b>0.42</b>   | <b>0.38</b>   | <b>0.33</b>   | <b>0.30</b>   | <b>0.26</b>   | —             | —             |
| Discounted cash flow                 | (39,513)        | 4,553         | 52,187        | 49,823        | 47,188        | 41,456        | 32,496        | 27,868        | 24,380        | 21,352        | 18,715        |               |               |               |
| Discounted cash flow- 1 year forward |                 | 5,122         | 58,710        | 56,069        | 53,086        | 46,639        | 36,558        | 31,362        | 27,427        | 24,021        | 21,055        | 15,535        |               |               |
| Discounted cash flow-2 year forward  |                 |               | 66,049        | 63,077        | 59,741        | 52,468        | 41,128        | 35,282        | 30,866        | 27,024        | 23,687        | 17,477        | 15,535        |               |

|                                       | Now            | + 1-year       | + 2-years      |
|---------------------------------------|----------------|----------------|----------------|
| <b>Total PV of free cash flow (a)</b> | <b>280,506</b> | <b>389,389</b> | <b>446,139</b> |
| FCF one-year forward                  | 52,355         | 52,355         | 52,355         |
| Terminal value                        | 418,842        | 418,842        | 418,842        |
| <b>PV of terminal value (b)</b>       | <b>139,817</b> | <b>139,817</b> | <b>139,817</b> |
| <b>Total PV (a) + (b)</b>             | <b>420,324</b> | <b>529,207</b> | <b>585,957</b> |
| Net debt                              | 128,253        | 169,184        | 187,029        |
| Equity value                          | 292,071        | 360,022        | 398,927        |
| <b>Equity value (US\$ mn)</b>         | <b>6,490</b>   | <b>7,500</b>   | <b>8,488</b>   |
| Shares outstanding (mn)               | 4,500          | 4,500          | 4,500          |
| <b>Equity value/per share (Rs)</b>    | <b>65</b>      | <b>80</b>      | <b>89</b>      |

|                 |     | Sensitivity 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 (%) | -   | 95  | 89   | 85   | 80   | 76   | 72   | 68   |
|                 | 1.0 | 100   | 94   | 89   | 84   | 79   | 75   | 71   |
|                 | 2.0 | 106   | 100  | 94   | 88   | 83   | 78   | 74   |
|                 | 3.0 | 114   | 107  | 100  | 93   | 88   | 82   | 78   |
|                 | 4.0 | 125   | 115  | 107  | 100  | 93   | 87   | 82   |
|                 | 5.0 | 138   | 127  | 117  | 108  | 100  | 93   | 87   |
|                 | 6.0 | 157   | 142  | 130  | 119  | 109  | 101  | 94   |
|                 | 7.0 | 186   | 165  | 147  | 133  | 121  | 111  | 102  |

|   |             |
|---|-------------|
| <b>Discount rate (%)</b>                  | <b>12.5</b> |
| <b>Growth from 2020 to perpetuity (%)</b> | —           |
| Exit free cash multiple (X)               | 8.0         |
| Exit EBITDA multiple (X)                  | 5.4         |

**Reliance Petroleum's earnings have high leverage to refining margins**

Sensitivity of RPL's earnings to key variables

|                                    | Fiscal 2010E  |           |             | Fiscal 2011E  |           |             | Fiscal 2012E  |           |             |
|------------------------------------|---------------|-----------|-------------|---------------|-----------|-------------|---------------|-----------|-------------|
|                                    | Downside      | Base case | Upside      | Downside      | Base case | Upside      | Downside      | Base case | Upside      |
| <b>Rupee-dollar exchange rate</b>  |               |           |             |               |           |             |               |           |             |
| Rupee-dollar exchange rate         | 47.0          | 48.0      | 49.0        | 46.0          | 47.0      | 48.0        | 45.0          | 46.0      | 47.0        |
| Net profits (Rs mn)                | 42,676        | 44,620    | 46,565      | 40,895        | 42,840    | 44,786      | 48,763        | 50,880    | 52,997      |
| EPS (Rs)                           | 9.5           | 9.9       | 10.3        | 9.1           | 9.5       | 10.0        | 10.8          | 11.3      | 11.8        |
| <b>% upside/(downside)</b>         | <b>(4.4)</b>  |           | <b>4.4</b>  | <b>(4.5)</b>  |           | <b>4.5</b>  | <b>(4.2)</b>  |           | <b>4.2</b>  |
| <b>Refining margins (US\$/bbl)</b> |               |           |             |               |           |             |               |           |             |
| Margins (US\$/bbl)                 | 7.6           | 8.6       | 9.6         | 7.6           | 8.6       | 9.6         | 8.4           | 9.4       | 10.4        |
| Net profits (Rs mn)                | 34,472        | 44,620    | 54,768      | 32,903        | 42,840    | 52,778      | 41,154        | 50,880    | 60,606      |
| EPS (Rs)                           | 7.7           | 9.9       | 12.2        | 7.3           | 9.5       | 11.7        | 9.1           | 11.3      | 13.5        |
| <b>% upside/(downside)</b>         | <b>(22.7)</b> |           | <b>22.7</b> | <b>(23.2)</b> |           | <b>23.2</b> | <b>(19.1)</b> |           | <b>19.1</b> |

Source: Kotak Institutional Equities estimates

**We expect sharp deterioration in global-supply demand balance over the next few years**

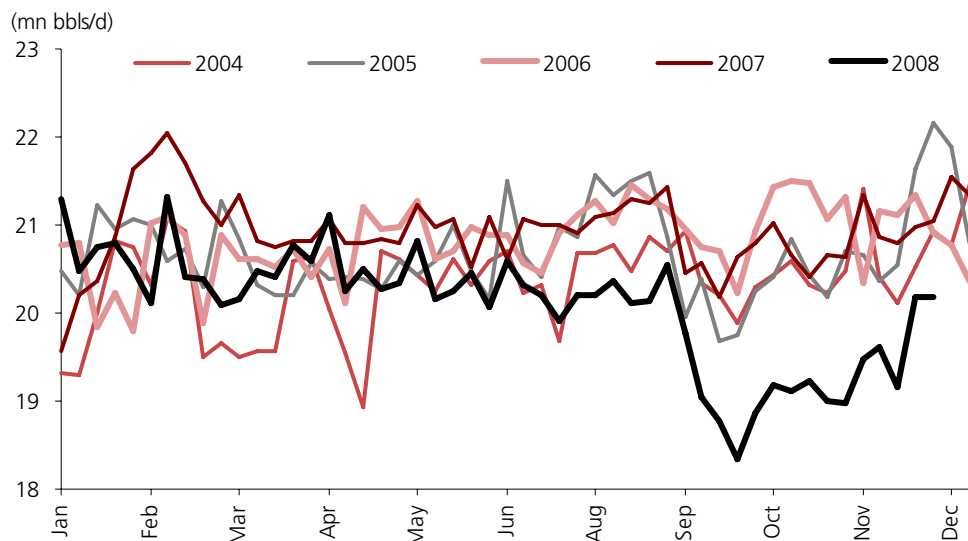
Estimated global crude demand, supply and prices, Calendar year-ends

|                                    | 2004        | 2005         | 2006        | 2007        | 2008E        | 2009E       | 2010E       | 2011E       | 2012E       | 2013E       |
|------------------------------------|-------------|--------------|-------------|-------------|--------------|-------------|-------------|-------------|-------------|-------------|
| <b>Demand (mb/d)</b>               |             |              |             |             |              |             |             |             |             |             |
| Total demand                       | 82.5        | 84.0         | 85.1        | 86.0        | 85.8         | 86.3        | 87.4        | 88.5        | 89.6        | 91.2        |
| Yoy growth                         | 3.3         | 1.5          | 1.1         | 0.9         | (0.2)        | 0.5         | 1.1         | 1.1         | 1.1         | 1.6         |
| <b>Supply (mb/d)</b>               |             |              |             |             |              |             |             |             |             |             |
| Non-OPEC                           | 48.8        | 48.7         | 49.2        | 49.7        | 49.6         | 50.1        | 50.1        | 50.3        | 50.5        | 50.8        |
| Yoy growth                         | 0.6         | (0.1)        | 0.5         | 0.5         | (0.1)        | 0.5         | 0.0         | 0.2         | 0.2         | 0.3         |
| OPEC                               |             |              |             |             |              |             |             |             |             |             |
| Crude                              | 29.5        | 30.8         | 31.3        | 31.6        | 31.2         | 30.6        | 31.1        | 31.7        | 32.3        | 33.4        |
| NGLs                               | 4.2         | 4.5          | 4.6         | 4.8         | 5.0          | 5.6         | 6.2         | 6.5         | 6.8         | 7.0         |
| <b>Total OPEC</b>                  | <b>33.7</b> | <b>35.3</b>  | <b>35.9</b> | <b>36.4</b> | <b>36.2</b>  | <b>36.2</b> | <b>37.3</b> | <b>38.2</b> | <b>39.1</b> | <b>40.4</b> |
| <b>Total supply</b>                | <b>83.4</b> | <b>84.7</b>  | <b>85.5</b> | <b>86.1</b> | <b>85.8</b>  | <b>86.3</b> | <b>87.4</b> | <b>88.5</b> | <b>89.6</b> | <b>91.2</b> |
| Total stock change                 | 1.0         | 0.7          | 0.8         |             |              |             |             |             |             |             |
| <b>OPEC crude capacity</b>         |             |              |             | <b>34.4</b> | <b>35.3</b>  | <b>36.4</b> | <b>37.4</b> | <b>37.3</b> | <b>37.6</b> | <b>37.9</b> |
| <b>Implied OPEC spare capacity</b> |             |              |             | <b>2.8</b>  | <b>4.1</b>   | <b>5.8</b>  | <b>6.3</b>  | <b>5.6</b>  | <b>5.3</b>  | <b>4.5</b>  |
| <b>Demand growth (yoy, %)</b>      |             |              |             |             |              |             |             |             |             |             |
|                                    | <b>4.2</b>  | <b>1.8</b>   | <b>1.3</b>  | <b>1.1</b>  | <b>(0.2)</b> | <b>0.6</b>  | <b>1.3</b>  | <b>1.3</b>  | <b>1.2</b>  | <b>1.8</b>  |
| <b>Supply growth (yoy, %)</b>      |             |              |             |             |              |             |             |             |             |             |
| Non-OPEC                           | <b>1.2</b>  | <b>(0.2)</b> | <b>1.0</b>  | <b>1.0</b>  | <b>(0.2)</b> | <b>1.0</b>  | <b>0.0</b>  | <b>0.4</b>  | <b>0.4</b>  | <b>0.6</b>  |
| OPEC                               | <b>8.4</b>  | <b>4.6</b>   | <b>1.9</b>  | <b>1.2</b>  | <b>(0.5)</b> | <b>0.0</b>  | <b>3.0</b>  | <b>2.4</b>  | <b>2.4</b>  | <b>3.3</b>  |
| <b>Total</b>                       | <b>4.4</b>  | <b>1.6</b>   | <b>0.9</b>  | <b>0.7</b>  | <b>(0.3)</b> | <b>0.6</b>  | <b>1.3</b>  | <b>1.3</b>  | <b>1.2</b>  | <b>1.8</b>  |
| <b>Dated Brent (US\$/bbl)</b>      |             |              |             |             |              |             |             |             |             |             |
|                                    | <b>38.3</b> | <b>54.4</b>  | <b>65.8</b> | <b>72.7</b> | <b>102.0</b> | <b>73.0</b> | <b>75.0</b> | <b>75.0</b> | <b>75.0</b> | <b>75.0</b> |

Source: IEA, BP Statistical Review of World Energy, and various government and industry sources

**US demand continues to be weak**

Demand in US (mn bbls/d)



Source: EIA, Kotak Institutional Equities

**Significant refining capacity to come onstream in China and India from 2HCY08**

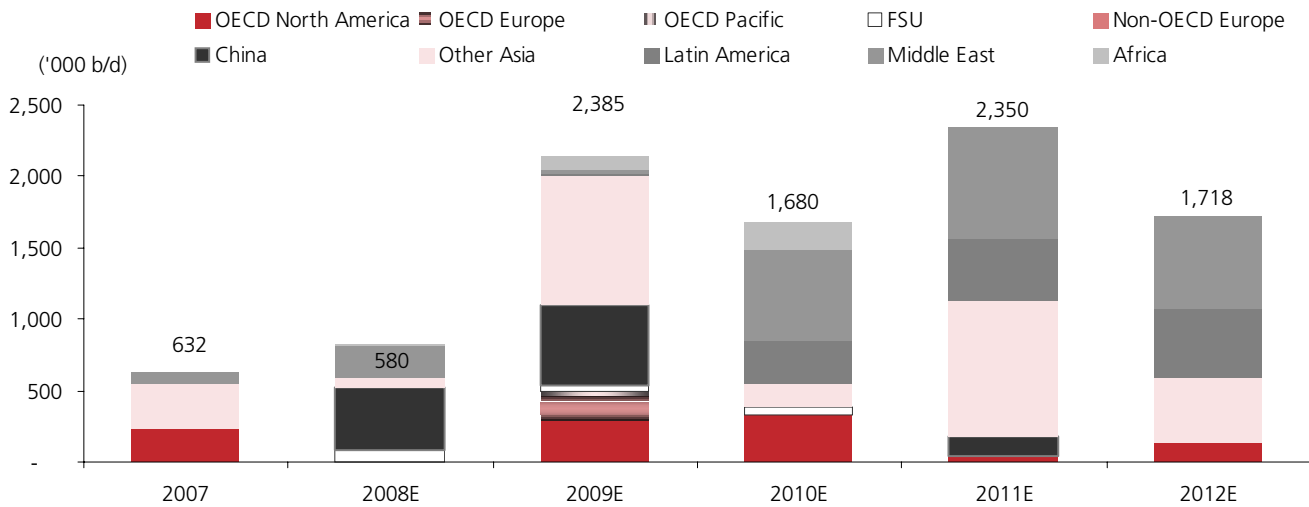
Upcoming refining capacity addition (b/d)

| Company                        | Location                            | Capacity addition<br>(b/d) | Expected<br>completion | Comments  |
|--------------------------------|-------------------------------------|----------------------------|------------------------|---|
| Sinopec                        | Qingdao, China                      | 200,000                    | 4QCY08                 | Commissioned  |
| Fujian Petrochemical           | Quangang, Quanzhou City, China      | 160,000                    | 1QCY09                 |   |
| CNOOC                          | Daya Bay, Huizhou, Guangdong, China | 240,000                    | 1QCY09                 | Delay of seven months from original schedule        |
| Sinopec                        | Tianjin, China                      | 150,000                    | 1QCY09                 | Start-up delayed to March 2009                      |
| Petrochina                     | Dagang, Quinzhou, China             | 200,000                    | 1QCY09                 | Expected to be commissioned on time                 |
| Petrovietnam                   | Dung Quat, Vietnam                  | 121,000                    | 1QCY09                 | Expected to be commissioned on Feb 25, 2009         |
| Reliance Petroleum             | Jamnagar, India                     | 580,000                    | 2QCY09                 | Commissioned but commercial production yet to start |
| <b>Total capacity addition</b> |                                     | <b>1,651,000</b>           |                        |   |

Source: Oil &amp; Gas journal, Kotak Institutional Equities estimates

**Significant supply additions to global refining capacity**

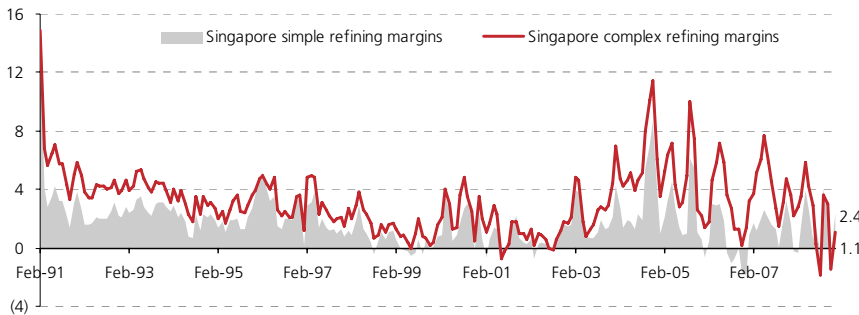
Global refinery capacity addition, calendar year ends, 2007-2012E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates.

**Refining margins continue to remain weak**

Singapore refining margins (US\$/bb)



| Simple refining margins, March fiscal year-ends (US\$/bb) |             |             |             |             |             |             |             |             |             |             |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|   | 2000        | 2001        | 2002        | 2003        | 2004        | 2005        | 2006        | 2007        | 2008        | 2009 YTD    |
| 1Q  | (0.32)      | 1.29        | 0.51        | 0.30        | 1.05        | 1.69        | 3.02        | 2.52        | 2.25        | 2.40        |
| 2Q  | (0.08)      | 2.47        | 0.45        | 0.07        | 1.20        | 3.13        | 2.78        | (0.70)      | 0.99        | 1.71        |
| 3Q  | 0.14        | 1.74        | 1.06        | 1.44        | 1.57        | 6.46        | 2.22        | (1.25)      | 2.32        | 1.31        |
| 4Q  | 1.86        | 0.21        | (0.03)      | 2.98        | 2.88        | 2.08        | 1.09        | 1.25        | 0.25        |             |
| <b>Average</b>  | <b>0.40</b> | <b>1.43</b> | <b>0.50</b> | <b>1.20</b> | <b>1.67</b> | <b>3.34</b> | <b>2.28</b> | <b>0.45</b> | <b>1.45</b> | <b>1.81</b> |

| Complex refining margins, March fiscal year-ends (US\$/bb) |             |             |             |             |             |             |             |             |             |             |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|  | 2000        | 2001        | 2002        | 2003        | 2004        | 2005        | 2006        | 2007        | 2008        | 2009 YTD    |
| 1Q   | 0.43        | 1.86        | 1.34        | 0.79        | 1.24        | 4.57        | 4.93        | 6.24        | 6.58        | 4.31        |
| 2Q   | 1.19        | 3.96        | 0.58        | 0.14        | 2.35        | 5.80        | 6.11        | 2.46        | 2.91        | 0.66        |
| 3Q   | 0.41        | 2.25        | 1.22        | 1.56        | 3.23        | 9.04        | 3.94        | 0.98        | 3.91        | 1.04        |
| 4Q   | 2.64        | 1.60        | 0.65        | 3.70        | 5.44        | 5.02        | 2.77        | 4.11        | 2.78        |             |
| <b>Average</b>   | <b>1.17</b> | <b>2.42</b> | <b>0.95</b> | <b>1.55</b> | <b>3.06</b> | <b>6.10</b> | <b>4.44</b> | <b>3.45</b> | <b>4.05</b> | <b>1.97</b> |

| Weekly margins |       |       |       |        |
|----------------|-------|-------|-------|--------|
| Current        | -1 Wk | -2 Wk | -3 Wk | -4 Wk  |
| 4.31           | 2.58  | 1.93  | 0.80  | (1.17) |

| Weekly margins |       |       |        |        |
|----------------|-------|-------|--------|--------|
| Current        | -1 Wk | -2 Wk | -3 Wk  | -4 Wk  |
| 3.48           | 1.52  | 0.24  | (1.01) | (2.53) |

| Singapore refining margins, March fiscal year-ends (US\$/bb) |      |      |      |      |      |      |      |      |      |          |
|--|------|------|------|------|------|------|------|------|------|----------|
|  | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 YTD |
| Simple   | 0.40 | 1.43 | 0.50 | 1.20 | 1.67 | 3.34 | 2.28 | 0.45 | 1.45 | 1.81     |
| Complex  | 0.43 | 1.86 | 1.34 | 0.79 | 1.24 | 4.57 | 4.93 | 3.45 | 4.05 | 1.97     |

Source: Bloomberg

**Profit model, balance sheet, cash model of Reliance Petroleum, March fiscal year-ends, 2010-15E (Rs mn)**

|  | 2010E          | 2011E          | 2012E          | 2013E          | 2014E          | 2015E          |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Profit model</b>                        |                |                |                |                |                |                |
| Net revenues                               | 833,643        | 816,346        | 806,849        | 796,460        | 796,460        | 796,460        |
| <b>EBITDA</b>                              | <b>71,330</b>  | <b>69,257</b>  | <b>74,963</b>  | <b>79,747</b>  | <b>79,469</b>  | <b>79,163</b>  |
| Other income                               | 85             | 72             | 66             | 67             | 96             | 125            |
| Interest (expense)/income                  | (12,730)       | (11,645)       | (9,188)        | (8,360)        | (3,012)        | (3,012)        |
| Depreciation                               | (14,005)       | (14,791)       | (14,899)       | (15,007)       | (15,116)       | (15,224)       |
| <b>Pretax profits</b>                      | <b>44,680</b>  | <b>42,893</b>  | <b>50,942</b>  | <b>56,446</b>  | <b>61,438</b>  | <b>61,052</b>  |
| Extraordinary items                        | —              | —              | —              | —              | —              | —              |
| Tax  | (60)           | (53)           | (62)           | (64)           | (69)           | (8,390)        |
| Deferred taxation                          | —              | —              | —              | —              | —              | 918            |
| <b>Net income</b>                          | <b>44,620</b>  | <b>42,840</b>  | <b>50,880</b>  | <b>56,383</b>  | <b>61,368</b>  | <b>53,581</b>  |
| <b>Earnings per share (Rs)</b>             | <b>9.9</b>     | <b>9.5</b>     | <b>11.3</b>    | <b>12.5</b>    | <b>13.6</b>    | <b>11.9</b>    |
| <b>Balance sheet</b>                       |                |                |                |                |                |                |
| Total equity                               | 168,518        | 200,829        | 209,591        | 200,009        | 189,579        | 180,473        |
| Deferred taxation liability                | —              | —              | —              | —              | —              | (918)          |
| Total borrowings                           | 188,275        | 141,775        | 119,275        | 115,275        | 113,275        | 110,275        |
| Current liabilities                        | 61,941         | 60,686         | 59,431         | 58,175         | 58,175         | 58,175         |
| <b>Total liabilities and equity</b>        | <b>418,735</b> | <b>403,290</b> | <b>388,297</b> | <b>373,459</b> | <b>361,030</b> | <b>348,005</b> |
| Cash                                       | 1,246          | 1,160          | 1,028          | 1,197          | 1,992          | 2,181          |
| Other current assets                       | 135,381        | 132,814        | 130,851        | 128,851        | 128,743        | 128,753        |
| Net fixed assets                           | 257,724        | 244,934        | 232,035        | 219,027        | 205,912        | 192,688        |
| Capital work-in-progress                   | —              | —              | —              | —              | —              | —              |
| Investments                                | 24,383         | 24,383         | 24,383         | 24,383         | 24,383         | 24,383         |
| Deferred expenditure                       | —              | —              | —              | —              | —              | —              |
| <b>Total assets</b>                        | <b>418,735</b> | <b>403,290</b> | <b>388,297</b> | <b>373,459</b> | <b>361,030</b> | <b>348,005</b> |
| <b>Free cash flow</b>                      |                |                |                |                |                |                |
| Operating cash flow, excl. working capital | 58,540         | 57,559         | 65,713         | 71,323         | 76,388         | 67,761         |
| Working capital changes                    | (65,940)       | 1,312          | 707            | 745            | 109            | (11)           |
| Capital expenditure                        | —              | (2,000)        | (2,000)        | (2,000)        | (2,000)        | (2,000)        |
| Investments                                | —              | —              | —              | —              | —              | —              |
| Other income                               | 85             | 72             | 66             | 67             | 96             | 125            |
| <b>Free cash flow</b>                      | <b>(7,315)</b> | <b>56,943</b>  | <b>64,486</b>  | <b>70,135</b>  | <b>74,593</b>  | <b>65,875</b>  |
| <b>Ratios (%)</b>                          |                |                |                |                |                |                |
| Debt/equity                                | 111.7          | 70.6           | 56.9           | 57.6           | 59.8           | 61.1           |
| Net debt/equity                            | 111.0          | 70.0           | 56.4           | 57.0           | 58.7           | 59.9           |
| ROAE (%)                                   | 29.5           | 23.2           | 24.8           | 27.5           | 31.5           | 29.0           |
| <b>ROACE (%)</b>                           | <b>17.3</b>    | <b>15.6</b>    | <b>17.9</b>    | <b>20.1</b>    | <b>20.8</b>    | <b>19.0</b>    |

Source: Kotak Institutional Equities estimates





**Kotak Institutional Equities: Valuation Summary of Key Indian Companies**

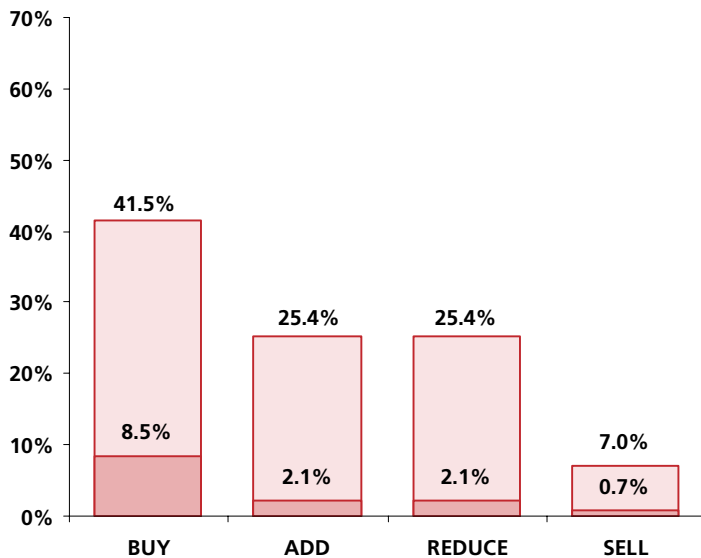
| Company                  | 26-Dec-08 Price (Rs) | Rating | Mkt cap. (Rs mn) | O/S shares (mn) | EPS (Rs) |       | EPS growth (%) |             | PER (X)     |             | EV/EBITDA (X) |             | Dividend yield (%) |             | Price/BV (X) |             | RoE (%)    |            | Target Upside (%) | ADVT-3mo (US\$ mn) |            |            |             |             |             |             |             |        |      |      |     |
|--------------------------|----------------------|--------|------------------|-----------------|----------|-------|----------------|-------------|-------------|-------------|---------------|-------------|--------------------|-------------|--------------|-------------|------------|------------|-------------------|--------------------|------------|------------|-------------|-------------|-------------|-------------|-------------|--------|------|------|-----|
|                          |                      |        |                  |                 | 2008     | 2009E | 2010E          | 2008        | 2009E       | 2010E       | 2008          | 2009E       | 2010E              | 2008        | 2009E        | 2010E       | 2008       | 2009E      |                   |                    | 2010E      | 2008       | 2009E       | 2010E       |             |             |             |        |      |      |     |
| Property                 | Cautious             |        | 685,566          | 13,122          |          |       |                | 199.3       | (8.1)       | 4.8         | 5.2           | 5.7         | 5.4                | 5.8         | 5.8          | 4.8         | 1.7        | 1.3        | 1.1               | 2.0                | 2.8        | 3.4        | 32.1        | 23.3        | 20.5        |             |             |        |      |      |     |
| <b>Retail</b>            |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| Pantaloon Retail         | 205                  | BUY    | 35,207           | 727             | 172      | 8.0   | 12.1           | 18.4        | 93.1        | 50.4        | 52.2          | 25.5        | 16.9               | 11.1        | 10.1         | 6.9         | 5.6        | 2.1        | 1.3               | 1.2                | 0.3        | 0.4        | 0.5         | 8.5         | 9.1         | 10.8        | 37.0        | 80.7   | 1.3  |      |     |
| Titan Industries         | 901                  | BUY    | 39,977           | 825             | 44       | 35.1  | 48.5           | 54.7        | 55.2        | 38.4        | 12.8          | 25.7        | 18.6               | 16.5        | 17.4         | 11.8        | 10.0       | 8.5        | 6.2               | 4.8                | 0.9        | 1.1        | 1.2         | 37.7        | 38.5        | 32.6        | 1,280       | 42.1   | 3.3  |      |     |
| Vishal Retail            | 92                   | ADD    | 2,064            | 43              | 22       | 18.1  | 14.9           | 20.6        | 37.2        | (17.6)      | 38.4          | 5.1         | 6.2                | 4.5         | 5.5          | 4.7         | 3.5        | 0.8        | 0.7               | 0.6                | —          | —          | —           | 20.2        | 11.5        | 14.0        | 125         | 35.6   | 0.1  |      |     |
| <b>Retail</b>            |                      |        | <b>77,248</b>    | <b>1,595</b>    |          |       |                | <b>31.8</b> | <b>41.8</b> | <b>32.6</b> | <b>24.0</b>   | <b>16.9</b> | <b>12.8</b>        | <b>11.5</b> | <b>8.0</b>   | <b>6.5</b>  | <b>3.2</b> | <b>2.1</b> | <b>1.9</b>        | <b>0.6</b>         | <b>0.7</b> | <b>0.9</b> | <b>13.2</b> | <b>12.6</b> | <b>14.6</b> |             |             |        |      |      |     |
| <b>Technology</b>        |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| HCL Technologies         | 113                  | REDUCE | 78,500           | 1,621           | 695      | 15.3  | 19.4           | 18.8        | (19.0)      | 27.0        | (3.1)         | 7.4         | 5.8                | 6.0         | 3.5          | 4.0         | 3.8        | 1.6        | 1.2               | 1.2                | 1.2        | 1.0        | 1.6         | 10.6        | 10.6        | 21.4        | 22.7        | 20.4   | 160  | 41.7 | 4.5 |
| Hexaware Technologies    | 20                   | SELL   | 2,807            | 58              | 142      | 7.7   | 2.9            | 3.8         | (13.7)      | (62.4)      | 32.1          | 2.6         | 6.9                | 5.2         | (0.3)        | 0.8         | 0.5        | 0.4        | 0.4               | 0.4                | 0.4        | 0.4        | 0.4         | 1.1         | 1.5         | 1.8         | 7.4         | 25     | 26.6 | 0.1  |     |
| Infosys Technologies     | 1,109                | BUY    | 636,710          | 13,146          | 574      | 79.1  | 100.8          | 108.6       | 18.0        | 27.5        | 7.8           | 14.0        | 11.0               | 10.2        | 10.6         | 7.9         | 6.7        | 4.6        | 3.5               | 2.8                | 3.0        | 2.2        | 2.4         | 36.1        | 36.4        | 30.9        | 1,500       | 35.2   | 62.8 |      |     |
| Mphasis BFL              | 151                  | REDUCE | 31,378           | 648             | 208      | 12.2  | 22.3           | 23.4        | 67.6        | 17.7        | 5.0           | 12.3        | 6.8                | 6.4         | 7.3          | 4.3         | 3.4        | 2.7        | 0.3               | 1.7                | 2.3        | 2.7        | 3.0         | 23.6        | 34.6        | 28.4        | 190         | 26.2   | 0.7  |      |     |
| Mindtree                 | 234                  | BUY    | 9,261            | 191             | 40       | 26.7  | 30.7           | 39.6        | 12.3        | 14.7        | 29.0          | 8.8         | 7.8                | 5.9         | 7.7          | 4.0         | 3.6        | 1.7        | 1.4               | 1.1                | 1.1        | —          | —           | 21.3        | 17.2        | 17.8        | 450         | 91.9   | 0.2  |      |     |
| PalmSecure Systems       | 128                  | SELL   | 16,411           | 339             | 129      | 33.2  | 26.3           | 30.8        | 29.2        | (20.8)      | 16.9          | 3.8         | 4.9                | 4.1         | 0.6          | 0.7         | (0.2)      | 0.6        | 0.5               | 0.5                | 1.7        | 2.1        | 2.4         | 19.2        | 14.1        | 12.0        | 160         | 25.4   | 0.5  |      |     |
| Polaris Software Lab     | 37                   | SELL   | 3,632            | 75              | 98       | 7.4   | 12.8           | 11.6        | (27.6)      | 71.6        | (9.6)         | 5.0         | 2.9                | 3.2         | 1.5          | 0.8         | 0.5        | 0.6        | 0.5               | 0.4                | 4.7        | 4.7        | 4.7         | 11.7        | 17.8        | 14.1        | 70          | 89.4   | 0.6  |      |     |
| Satyam Computer Services | 136                  | SELL   | 92,516           | 1,910           | 682      | 25.2  | 33.0           | 28.3        | 17.7        | 30.9        | (14.4)        | 5.4         | 4.1                | 4.8         | 2.7          | 1.6         | 1.3        | 1.3        | 1.0               | 0.9                | 7.2        | 8.2        | 10.3        | 26.0        | 27.7        | 19.9        | 150         | —      | 50.0 |      |     |
| TCS                      | 472                  | REDUCE | 461,561          | 9,530           | 979      | 51.3  | 56.4           | 63.0        | 21.5        | 10.0        | 11.6          | 9.2         | 8.4                | 7.5         | 7.3          | 5.9         | 5.3        | 3.7        | 2.9               | 2.4                | 3.0        | 4.2        | 5.3         | 47.0        | 39.3        | 35.6        | 650         | 37.8   | 26.9 |      |     |
| Tech Mahindra            | 236                  | BUY    | 29,424           | 607             | 125      | 59.1  | 73.5           | 70.6        | 25.7        | 24.5        | (4.0)         | 4.0         | 3.2                | 3.3         | 3.5          | 2.0         | 1.5        | 2.3        | 1.4               | 1.0                | 2.3        | 2.5        | 2.6         | 70.7        | 56.5        | 35.7        | 450         | 90.6   | 2.1  |      |     |
| Wipro                    | 227                  | ADD    | 331,362          | 6,841           | 1,462    | 22.2  | 25.1           | 26.8        | 12.6        | 13.0        | 6.7           | 10.2        | 9.0                | 8.5         | 8.1          | 6.1         | 5.3        | 2.6        | 2.1               | 1.8                | 2.8        | 3.3        | 3.6         | 27.9        | 23.7        | 23.1        | 280         | 23.5   | 12.0 |      |     |
| <b>Technology</b>        |                      |        | <b>1,693,561</b> | <b>34,966</b>   |          |       |                | <b>16.1</b> | <b>19.8</b> | <b>5.1</b>  | <b>9.8</b>    | <b>8.2</b>  | <b>7.8</b>         | <b>7.1</b>  | <b>5.5</b>   | <b>4.9</b>  | <b>2.9</b> | <b>2.3</b> | <b>1.9</b>        | <b>3.3</b>         | <b>3.7</b> | <b>4.3</b> | <b>29.4</b> | <b>28.0</b> | <b>24.7</b> |             |             |        |      |      |     |
| <b>Telecom</b>           |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| Bharti Airtel Ltd        | 686                  | BUY    | 1,302,719        | 26,896          | 1,898    | 35.3  | 45.3           | 55.1        | 65.0        | 28.3        | 21.7          | 19.4        | 15.2               | 12.4        | 11.8         | 8.9         | 6.9        | 5.8        | 4.2               | 3.1                | —          | 0.6        | 0.9         | 39.1        | 31.9        | 28.5        | 800         | 16.6   | 87.1 |      |     |
| IDEA                     | 48                   | REDUCE | 156,154          | 3,224           | 3,236    | 3.9   | 3.3            | 3.4         | 78.5        | (17.6)      | 5.7           | 12.2        | 14.8               | 14.0        | 9.4          | 5.9         | 5.2        | 4.4        | 1.1               | 1.0                | —          | —          | —           | 36.4        | 12.0        | 8.0         | 70          | 45.1   | 7.8  |      |     |
| MTNL                     | 79                   | REDUCE | 50,022           | 1,033           | 630      | 7.1   | 5.1            | 5.5         | (11.0)      | (28.4)      | 7.6           | 11.1        | 15.5               | 14.4        | 2.2          | 3.3         | 2.9        | 0.4        | 0.4               | 0.4                | 5.0        | 7.6        | 7.6         | 3.5         | 2.2         | 2.4         | 80          | 0.8    | 1.7  |      |     |
| Reliance Communications  | 205                  | SELL   | 422,711          | 8,727           | 2,064    | 26.1  | 26.3           | 33.1        | 84.3        | 0.5         | 25.8          | 7.8         | 7.8                | 6.2         | 6.9          | 6.8         | 5.5        | 1.5        | 1.2               | 1.0                | 0.4        | —          | —           | 16.8        | 18.3        | 18.7        | 265         | 29.4   | 63.7 |      |     |
| Tata Communications      | 500                  | REDUCE | 142,457          | 2,941           | 285      | 10.9  | 13.6           | 14.0        | (56.3)      | 24.0        | 3.2           | 45.7        | 36.8               | 35.7        | 19.0         | 15.7        | 14.2       | 2.1        | 2.1               | 2.0                | 0.9        | 1.0        | 1.3         | 4.4         | 5.4         | 5.2         | 400         | (20.0) | 5.1  |      |     |
| <b>Telecom</b>           |                      |        | <b>2,074,063</b> | <b>42,822</b>   |          |       |                | <b>65.3</b> | <b>16.3</b> | <b>21.0</b> | <b>14.4</b>   | <b>12.3</b> | <b>10.2</b>        | <b>9.8</b>  | <b>8.0</b>   | <b>6.4</b>  | <b>2.8</b> | <b>2.1</b> | <b>1.8</b>        | <b>0.4</b>         | <b>0.7</b> | <b>0.8</b> | <b>1.6</b>  | <b>1.7</b>  | <b>10.3</b> | <b>10.9</b> | <b>11.5</b> |        |      |      |     |
| <b>Transportation</b>    |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| Container Corporation    | 610                  | REDUCE | 79,288           | 1,637           | 130      | 57.7  | 69.4           | 74.2        | 7.8         | 20.3        | 6.8           | 10.6        | 8.8                | 8.2         | 6.7          | 5.3         | 4.7        | 2.5        | 2.0               | 1.7                | 2.0        | 2.4        | 2.6         | 25.8        | 25.6        | 22.8        | 800         | 31.1   | 1.1  |      |     |
| <b>Transportation</b>    |                      |        | <b>79,288</b>    | <b>1,637</b>    |          |       |                | <b>7.8</b>  | <b>20.3</b> | <b>6.8</b>  | <b>10.6</b>   | <b>8.8</b>  | <b>8.2</b>         | <b>6.7</b>  | <b>5.3</b>   | <b>4.7</b>  | <b>2.5</b> | <b>2.0</b> | <b>1.7</b>        | <b>2.0</b>         | <b>2.4</b> | <b>2.6</b> | <b>23.5</b> | <b>23.3</b> | <b>21.0</b> |             |             |        |      |      |     |
| <b>Utilities</b>         |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| CESC                     | 235                  | BUY    | 29,410           | 607             | 125      | 27.8  | 31.9           | 36.9        | (23.3)      | 14.9        | 15.8          | 8.5         | 7.4                | 6.4         | 4.4          | 4.1         | 5.2        | 0.9        | 0.8               | 0.7                | 1.7        | 2.0        | 2.3         | 12.5        | 11.7        | 11.9        | 450         | 91.2   | 1.1  |      |     |
| Lanco InfraTech          | 136                  | BUY    | 30,133           | 622             | 222      | 14.8  | 17.5           | 26.0        | 75.2        | 18.2        | 48.3          | 9.1         | 7.7                | 5.2         | 8.6          | 12.0        | 10.2       | 1.6        | 1.4               | 1.1                | —          | —          | —           | 19.7        | 19.2        | 23.0        | 370         | 173.0  | 9.2  |      |     |
| NTPC                     | 177                  | REDUCE | 1,457,798        | 30,098          | 8,245    | 9.3   | 9.0            | 9.7         | 7.9         | (3.2)       | 7.9           | 19.0        | 19.6               | 18.2        | 13.2         | 14.1        | 13.4       | 2.7        | 2.5               | 2.3                | 2.0        | 2.0        | 2.1         | 14.9        | 13.2        | 13.1        | 160         | (9.5)  | 34.4 |      |     |
| Reliance Infrastructure  | 543                  | BUY    | 125,396          | 2,589           | 231      | 37.6  | 53.6           | 56.8        | 13.9        | 42.6        | 6.0           | 14.4        | 10.1               | 9.6         | 21.1         | 16.9        | 16.7       | 0.8        | 0.7               | 0.7                | 1.2        | 1.3        | 1.5         | 4.3         | 6.2         | 6.6         | 1,250       | 130.2  | 79.3 |      |     |
| Reliance Power           | 115                  | REDUCE | 274,428          | 5,666           | 2,397    | 0.4   | 2.1            | 2.6         | —           | 443.9       | 25.2          | 30.1        | 55.4               | 44.2        | —            | —           | —          | —          | —                 | —                  | —          | —          | —           | 1.3         | 3.6         | 4.3         | 180         | 57.2   | 17.0 |      |     |
| Tata Power               | 730                  | BUY    | 162,584          | 3,357           | 223      | 31.8  | 69.9           | 103.4       | 19.5        | 19.6        | 47.9          | 22.9        | 10.4               | 7.1         | 11.3         | 8.0         | 7.3        | 1.9        | 1.6               | 1.3                | 1.5        | 1.5        | 1.6         | 9.6         | 16.3        | 20.1        | 1,230       | 68.4   | 14.9 |      |     |
| <b>Utilities</b>         |                      |        | <b>2,079,749</b> | <b>42,939</b>   |          |       |                | <b>12.2</b> | <b>14.9</b> | <b>15.4</b> | <b>20.7</b>   | <b>18.1</b> | <b>15.6</b>        | <b>14.4</b> | <b>14.3</b>  | <b>14.4</b> | <b>2.1</b> | <b>2.0</b> | <b>1.8</b>        | <b>1.6</b>         | <b>1.6</b> | <b>1.7</b> | <b>1.7</b>  | <b>10.3</b> | <b>10.9</b> | <b>11.5</b> |             |        |      |      |     |
| <b>Others</b>            |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |
| Aban Offshore            | 671                  | BUY    | 25,423           | 525             | 38       | 72.3  | 147.5          | 410.7       | (1,066)     | 104.0       | 178.5         | 9.3         | 4.6                | 1.6         | 11.8         | 7.3         | 4.1        | 2.9        | 1.6               | 0.8                | 0.5        | 0.7        | 1.2         | 51.7        | 47.1        | 57.4        | 1,100       | 63.9   | 15.6 |      |     |
| Educomp Solutions        | 2,408                | BUY    | 45,802           | 946             | 19       | 35.2  | 63.9           | 108.1       | 114         | 81.7        | 69.2          | 68.5        | 37.7               | 22.3        | 36.3         | 15.6        | 9.7        | 14.9       | 6.3               | 5.0                | 0.1        | 0.2        | 0.4         | 33.5        | 23.3        | 24.3        | 2,550       | 5.9    | 57.0 |      |     |
| Havells India            | 122                  | BUY    | 7,359            | 152             | 61       | 26.6  | 19.7           | 34.5        | 40          | (25.9)      | 75.1          | 4.6         | 6.2                | 3.5         | 5.2          | 5.1         | 3.5        | 1.1        | 0.9               | 0.7                | 2.0        | 2.6        | 3.4         | 33.7        | 16.5        | 22.2        | 365         | 200.2  | 0.4  |      |     |
| Jaiprakash Associates    | 74                   | BUY    | 103,365          | 2,134           | 1,403    | 4.9   | 5.4            | 7.1         | 7           | 10.8        | 30.8          | 15.0        | 13.6               | 10.4        | 11.9         | 9.8         | 8.9        | 2.1        | 1.8               | 1.6                | 0.0        | 0.0        | 0.0         | 15.4        | 14.2        | 16.2        | 105         | 42.6   | 4.2  |      |     |
| Jindal                   |                      |        |                  |                 |          |       |                |             |             |             |               |             |                    |             |              |             |            |            |                   |                    |            |            |             |             |             |             |             |        |      |      |     |



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Source: Kotak Institutional Equities

As of September 30, 2008

**Ratings and other definitions/identifiers**

**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 Sensex by more than 10% over the next 12 months.

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

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