kotak® Institutional Equities

INDIA DAILY

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Contents

News Round-up

- SAIL's (SAIL IN) 20% share sale plan, which aims to generate up to USD 3.40 bn, may not happen this year due to certain regulatory hurdles. (BSTD)
- MTNL (MTNL IN) expects revenues of about USD 60 mn from roaming agreement with other telecom operators for 3G services. MTNL has invited bids from operators who could not get 3G spectrum in Delhi and Mumbai, to provide roaming facilities to their 3G subscribers through the PSU's network. (BSTD-Sat)
- Tata Motors (TTMT IN) will consider a USD 550mn sponsored overseas issue for its shares with differential voting rights (DVR) after some investors expressed discomfort with the steep discount they fetch in relation to the firm's ordinary shares. (ECNT-Sat)
- SBI (SBIN IN) has raised USD 1bn through the issue of 5 year bonds in the international markets, at 290 basis points over five year US treasury bills. (ECNT-Sat)

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

EQUITY MARKETS

		Change %		
India	**23-Jul**	**1-day**	**1-mo**	**3-mo**
Sensex	18,131	0.1	3.2	2.2
Nifty	5,449	0.1	3.4	2.4
Global/Regional indices				
Dow Jones	10,425	1.0	2.8	(7.0)
Nasdaq Composite	2,269	1.1	2.1	(10.0)
FTSE	5,313	(0.0)	5.3	(7.7)
Nikkie	9,546	1.2	(2.0)	(14.5)
Hang Seng	20,940	0.6	1.2	(3.0)
KOSPI	1,764	0.3	2.0	0.7
Value traded – India				
Cash (NSE+BSE)	189		165	169
Derivatives (NSE)	1,047		1,103	1,025
Deri. open interest	1,715		1,625	1,377

Forex/money market				
		Change, basis points		
	23-Jul	**1-day**	**1-mo**	**3-mo**
Rs/US$	47.0	2	79	254
10yr govt bond, %	7.7	-	10	(37)
Net investment (US$mn)				
	22-Jul		**MTD**	**CYTD**
FIIs	40		2,123	8,823
MFs	(63)		(425)	(282)

Top movers -3mo basis				
		Change, %		
Best performers	**23-Jul**	**1-day**	**1-mo**	**3-mo**
HPCL IN Equity	436.5	(0.9)	8.5	45.0
IOCL IN Equity	373.3	(0.4)	(1.2)	33.0
BJFIN IN Equity	426.5	(1.6)	1.0	30.4
AL IN Equity	73.3	0.7	17.2	29.6
BPCL IN Equity	632.1	(1.4)	1.8	25.9
Worst performers				
ABAN IN Equity	840.8	0.1	11.6	(31.2)
RNR IN Equity	44.1	(0.6)	(33.2)	(30.1)
ICEM IN Equity	106.9	(1.0)	(1.3)	(19.7)
JPA IN Equity	128.7	(1.6)	(0.4)	(19.1)
PUNJ IN Equity	134.7	(1.2)	4.5	(18.9)

Kotak Institutional Equities Research
kotak.research@kotak.com . Mumbai: +94-22-6634-1100

Economy

Monetary policy

Does RBI still have the tools to anchor inflation? The genie is almost out of the bottle with a likely sticky inflation path for FY2011E. Yet, with monetary conditions having already tightened, RBI's choice of tools appears limited to further policy rate hikes. The risk of hard-landing has increased, but we suggest unanticipated monetary policy by (1) compressing interest rate corridor to 100 bps by raising repo 25 bps and reverse repo rate 75 bps, (2) status quo on CRR and SLR.

Instrument options are currently constrained to policy rates

In our view, liquidity conditions are tight enough and a change in CRR or SLR is not a policy option at the present juncture. We expect RBI to raise repo and reverse repo rates by 25 bps each for the fourth time since mid-March at its July 27 policy. We note that this would de facto imply a 250 bps policy rate hardening in about four months.

Compressing interest rate corridor would improve transmission, reduce interest rate volatility

Given that private consumption demand stays weak and growth may again soften, but high inflation may persist, it is important to introduce monetary policy surprise, while avoiding hard landing. We suggest a compression of interest rate corridor to 100 bps by an asymmetric 25 bps hike in repo and 75 bps hike in reverse repo rate. This would reduce interest rate uncertainty, keep interest rates firm and help in speedier and adequate monetary transmission. It would also help banks price their products better and set the base rate appropriately, while reducing the volatility in short-term interest rates.

Inflation likely to remain sticky, but shrunk corridor can anchor expected inflation

In our assessment, inflation in FY2011E may turn out to be sticky averaging about 9% and ending in 7.5-8% band versus RBI's projection of 5.5% and GOI's still lower expectation. We note that current high inflation is the result of a combination of demand and supply side factors. YTD in FY2011, core inflation (ex-food and energy) is running at an annualized rate of 13.8% and accounts for 2/3rd of the price rise YTD.

Active liquidity management aimed at moderately tight liquidity likely

In our view, RBI is likely to change its monetary policy stance from ensuring adequate liquidity for meeting credit demand to active liquidity management aimed at a moderately tight liquidity. In our view, it may aim at net repos of about Rs200-400 bn ahead to clear the money markets. We also expect RBI to revise its end-FY2011E inflation projection to 6.5% from 5.5% made in April 2010, while retaining all other macro-projections.

Mridul Saggar
mridul.saggar@kotak.com
Mumbai: +91-22-6634-1245

Suvodeep Rakshit
suvodeep.rakshit@kotak.com
Mumbai: +91-22-6634-1409

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

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Bharat Heavy Electricals (BHEL)

Industrials

REDUCE

JULY 26, 2010

RESULT

Coverage view: Attractive

Price (Rs): 2,460

Target price (Rs): 2,600

BSE-30: 18,131

Revenue growth guidance in line with MOU--Management highlights high base.

Results broadly in line with estimates as slightly lower-than-expected revenue growth was balanced by better margins; inflow of Rs108 bn led by state JV. The management maintains inflow guidance of Rs600 bn for FY2011E; but suggested that the base effect of growing revenues is catching up and 16-18% growth (in line with MoU target) is reasonable in the medium term. We tweak estimates and retain REDUCE (TP:Rs2,600).

Company data and valuation summary

Bharat Heavy Electricals

Stock data			
52-week range (Rs) (high,low)			2,585-2,103
Market Cap. (Rs bn)			1,204.3
Shareholding pattern (%)			
Promoters			67.7
FIIs			15.2
MFs			6.5
Price performance (%)	1M	3M	12M
Absolute	1.1	(0.8)	13.5
Rel. to BSE-30	(1.0)	(3.2)	(4.7)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	88.1	116.3	135.4
EPS growth (%)	37.9	32.1	16.4
P/E (X)	27.9	21.2	18.2
Sales (Rs bn)	328.8	398.4	478.7
Net profits (Rs bn)	43.1	56.9	66.3
EBITDA (Rs bn)	55.7	76.2	89.5
EV/EBITDA (X)	19.9	14.2	11.9
ROE (%)	29.9	31.5	29.2
Div. Yield (%)	0.8	1.0	1.2

Results broadly in line with expectations; order inflow of Rs108 bn led by state JV

BHEL reported 1QFY11 net revenues of Rs64.8 bn (up 16% yoy) slightly below estimates. EBITDA margin showed a strong 380 bps yoy expansion to 13% led by decrease in material costs. PAT was Rs6.7 bn, up 42% yoy, marginally below estimates. Power segment led revenue growth as well as margin expansion. BHEL reported strong inflows of Rs108 bn (power inflows of Rs92 bn) led by a Rs63 bn Raichur order. Order book at end-1QFY11 was Rs1,480 bn vs. Rs1,427 bn at end-FY2010.

Management keeps inflow guidance; cautious on future revenue growth on base effect

The management sounded slightly cautious in the concall and suggested that base effect of growing revenues is catching up and thus 16-18% growth (consistent with FY2011E MOU) is a reasonable medium-term expectation. BHEL expects (1) ~Rs600 bn inflows (based on two more JV orders and bulk tender) and (2) 50-100 bps yoy reduction in raw material to sales in FY2011E. The company noted progress in new businesses—renewables, transportation and T&D equipment.

Sedate inflow may impact medium term growth; credible competition; bulk tender/JVs not positive

BHEL may face headwind in inflows as (1) about half of XIIth plan ordering may be complete, (2) new competition appears credible, and (3) other segments unlikely to scale up to counter sedate power inflows. Lower inflows would reduce visibility and revenue growth post FY2012-13E despite assuming stronger execution. Chinese competition has reduced but is not over as seen in some recent orders. We are not positive on (1) bulk tender (brings competition into fray dominated by BHEL), and (2) state JVs (capital commitment to win business has limited potential).

Marginally revise estimates and TP to Rs2,600/share; retain REDUCE

We revise estimates to Rs116 and Rs135 (from Rs113 and Rs138) for FY2011E and FY2012E, respectively, based on (1) slightly lower execution assumption, and (2) about 50 bps higher margin for FY2011E versus earlier on lower material costs. Revise TP to Rs2,600 implying about (19.5X FY2012E from Rs2,500 on 20X Sep-11E). We are positive on near-term earnings potential but expect sedate order inflow to keep the stock under pressure, slowing revenue growth post FY2012-13E. Retain REDUCE on limited upside to our FY2012-based TP.

Lokesh Garg
lokesh.garg@kotak.com
Mumbai: +91-22-6634-1496

Supriya Subramanian
supriya.subramanian@kotak.com
Mumbai: +91-22-6634-1383

Nitij Mangal
nitij.mangal@kotak.com
Mumbai: +91-22-6634-1453

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Results broadly in line with expectations; strong order inflow of Rs108 bn

Slightly lower-than-expected revenue growth balanced by better margins

BHEL reported 1QFY11 net revenues of Rs64.8 bn (up 16% yoy) slightly below our expectation of Rs69.8 bn. EBITDA margin showed a strong 380 bps yoy expansion to 13% in 1QFY11 versus our expectation of 300 bps yoy increase to 12.2%. Margin expansion was led by 460 bps yoy decrease in raw material costs as a percentage of sales to 58.8% in 1QFY11. Staff cost was reported at Rs13.4 bn versus our expectation of Rs12.4 bn; however, other expenses at Rs4.9 bn was significantly lower than our estimates of Rs6.6 bn. The company reported EBITDA of Rs8.4 bn, in line with our estimate. PAT was Rs6.7 bn, up 42% yoy, slightly below our estimate of Rs6.8 bn.

Strong inflows of Rs108 bn in 1QFY11, led by Rs63 bn state JV order

BHEL reported robust order inflows of Rs108 bn contributed by power segment inflows of Rs92 bn (2,800 MW) and industry inflows of Rs3.9 bn (including 244 MW of captive orders). Order book at end-1QFY11 was Rs1,480 bn vs. Rs1,427 bn at end-FY2010. The company secured two major orders in the power segment – (1) Rs63 bn BTG order for 2x800 MW Raichur plant (a JV project with Karnataka state where BHEL has 26% stake), and (2) Rs27 bn main plant package order for 2x600 MW Dainik Bhaskar Power Ltd. The company also secured orders in the industrial segment from Maruti Suzuki and GSPC.

BHEL 1QFY11 result - key numbers (Rs mn)

					% change					
	1QFY11	**1QFY11E**	**1QFY10**	**4QFY10**	**1QFY11E**	**1QFY10**	**4QFY10**	**FY2011E**	**FY2010**	***% change***
Net revenues	**64,797**	**69,779**	**55,957**	**135,591**	***(7.1)***	***15.8***	***(52.2)***	**398,381**	**328,803**	***21.2***
(Inc)/Dec in WIP	1,253		301	248		*316.8*	*406.1*	-	7,867	*(100.0)*
Raw material cost	(39,346)	(42,216)	(35,753)	(80,520)	*(6.8)*	*10.1*	*(51.1)*	(231,563)	(200,941)	*15.2*
Staff cost	(13,378)	(12,408)	(11,137)	(17,434)	*7.8*	*20.1*	*(23.3)*	(58,228)	(51,529)	*13.0*
Other items	(4,889)	(6,629)	(4,206)	(13,012)	*(26.2)*	*16.3*	*(62.4)*	(32,353)	(28,542)	*13.4*
Total Expenditure	**(56,360)**	**(61,266)**	**(50,795)**	**(110,718)**	***(8.0)***	***11.0***	***(49.1)***	**(322,144)**	**(273,145)**	***17.9***
EBITDA	**8,437**	**8,513**	**5,162**	**24,873**	***(0.9)***	***63.4***	***(66.1)***	**76,236**	**55,658**	***37.0***
Other income	2,848	3,110	3,029	5,935	*(8.4)*	*(6.0)*	*(52.0)*	14,436	15,164	*(4.8)*
PBDIT	**11,285**	**11,623**	**8,190**	**30,808**	***(2.9)***	***37.8***	***(63.4)***	**90,672**	**70,822**	***28.0***
Interest	(38)	(38)	(43)	(178)	*0.8*	*(10.5)*	*(78.5)*	(153)	(335)	*(54.2)*
Depreciation	(1,269)	(1,321)	(961)	(1,647)	*(3.9)*	*32.0*	*(23.0)*	(5,284)	(4,580)	*15.4*
PBT	**9,978**	**10,263**	**7,187**	**28,983**	***(2.8)***	***38.8***	***(65.6)***	**85,235**	**65,907**	***29.3***
Tax	(3,301)	(3,490)	(2,481)	(9,887)	*(5.4)*	*33.1*	*(66.6)*	(28,298)	(22,800)	*24.1*
PAT	**6,677**	**6,774**	**4,706**	**19,096**	***(1.4)***	***41.9***	***(65.0)***	**56,937**	**43,106**	***32.1***
Key ratios (%)										
Raw material/sales	58.8	60.5	63.4	59.2	*(1.7)*	*(4.6)*	*(0.4)*	58.1	58.7	
Staff cost/sales	20.6	17.8	19.9	12.9	*2.9*	*0.7*	*7.8*	14.6	15.7	
Other exp./sales	7.5	9.5	7.5	9.6	*(2.0)*	*0.0*	*(2.1)*	8.1	8.7	
EBITDA margin	**13.0**	**12.2**	**9.2**	**18.3**	*0.8*	*3.8*	*(5.3)*	**19.1**	**16.9**	
PBDIT margin	17.4	16.7	14.6	22.7				22.8	21.5	
Effective tax rate	33.1	34.0	34.5	34.1				33.2	34.6	
PAT margin	10.3	9.7	8.4	14.1				14.3	13.1	
Order details (Rs bn)										
Order backlog	1,480	1,442	1,240	1,427	*2.6*	*19.4*	*3.7*	1,612	1,427	*13.0*
Order inflow	108	100	91	226	*8.2*	*19.0*	*(52.1)*	626	590	*6.1*

Source: Company, Kotak Institutional Equities estimates

Power segment led revenue growth as well as margin expansion

Power segment led revenue growth with 18% yoy increase in top line to Rs53 bn; while industrial segment lagged at 11% yoy revenue growth n 1QFY11. Power segment also led margin expansion with 170 bps yoy increase in margins to 19.8% in 1QFY11 versus 18.1% in 1QFY10. Industry segment margins, however, contracted by 60 bps yoy to 11.5% from 12.2% in 1QFY10.

BHEL 1QFY11 segmental result - key numbers (Rs mn)

				% chg.	
	1QFY11	1QFY10	4QFY10	1QFY10	4QFY10
Segment revenues					
Power	53,999	45,688	111,549	*18.2*	*(51.6)*
Industry	14,763	13,325	31,491	*10.8*	*(53.1)*
Segment EBIT					
Power	10,701	8,281	30,584	*29.2*	*(65.0)*
Industry	1,704	1,620	8,049	*5.2*	*(78.8)*
Revenue mix (%)					
Power	78.5	77.4	78.0		
Industry	21.5	22.6	22.0		
EBIT margin (%)					
Power	19.8	18.1	27.4	*1.7*	*(7.6)*
Industry	11.5	12.2	25.6	*(0.6)*	*(14.0)*

Source: Company, Kotak Institutional Equities

Management keeps inflow guidance; cautious on future revenue growth given high base

Meet/exceed MoU target; growth in medium term may slow down on base effect

The management highlighted that the company is on track to meet or even potentially exceed the MoU growth target of 16%. Furthermore, the management emphasized on base effect and appeared cautious on likely revenue growth going forward; suggested 16-18% growth is potentially a reasonable medium term expectation.

Maintains inflow guidance of Rs600 bn (16 GW) led by bulk tender and state JV

The company maintained its order inflow guidance of about Rs600 bn (about 16,000 MW) for FY2011E. The inflow guidance likely includes assumptions of finalization of (1) at least two more state JVs, and (2) NTPC 660 MW bulk tender. The management cited progress on state JVs – Tamil Nadu JV is in the process of obtaining clearances while the other two (MP and Maharashtra) are in the proves of land acquisition. BHEL is also in talks with West Bengal and Andhra Pradesh state to form similar power JVs. The management believes that XIIth Plan capacity addition target of 100 GW could have potential upside. XIth Plan addition, according to the company, is expected to be about 70 GW including about 7-8 GW on best effort basis.

Low RM cost on indigenization and optimization; expect 50-100 bps yoy reduction

The management mentioned that the 460 bps yoy reduction in raw material cost (as percentage of sales) in 1QFY11 was partially led by rapid pace of indigenization of technology and design optimizations (in areas such as transmission and industrial products), besides the benefit provided by raw material prices remaining low. The company expected that FY2011E full year raw material cost as percentage of sales would be about 50-100 bps below FY2010 level of 58.7%.Moreover, the company mentioned that adoption of super-critical technology would not have a material impact on margins as it would achieve a high level of indigenization by the time the technology contributes a large proportion of the company’s revenues. Delivery timelines in super-critical orders are currently 46-52 months in 660 MW and 48-54 months in 800 MW

Cites continued traction in new businesses, but overall opportunity may be limited

The company also cites progress in building new business areas such as renewables (wind and solar PV), transportation (locomotives and other traction systems) and transmission equipment (Toshiba JV). However, the total opportunity in new business may be limited and no significant capital commitment has been made as yet in these businesses. The overall opportunity may be small compared to the size of the power business.

Other takeaways

- Rs144 bn of industry order inflows in FY2010 consisted of – (1) Rs80 bn from captive plants, (2) Rs13 bn from transportation, and (3) Rs20 bn from T&D
- Capex in 1QFY11 of Rs4 bn. Expansion from 15GW to 20 GW to cost about Rs16 bn total.
- Wind turbine JV is in final stages and is expected to finalize in the next 3-4 weeks

Sedate order inflow traction likely to squeeze revenue growth in medium term

We believe that order inflows for BHEL would grow at a modest CAGR of about 6% over FY2011E-13E which would materially squeeze revenue growth prospects of the company in the medium term. Our expectation of sedate inflow traction is based on (1) about 50% of XIIth Plan equipment ordering may already be complete, (2) upcoming competition appears credible on the back of JVs with global equipment players, and (3) industry, spares/R&M, and exports inflows are unlikely to pick the full tab of shortfall in power sector inflows. We estimate that revenue growth could contract to about 10-14% yoy by FY2014-15E despite assuming (1) reasonably optimistic success rate for BHEL in winning utility orders in remaining XIIth Plan activity and (2) improvement in execution days as order book matures.

Sedate order inflow traction likely to squeeze revenue growth in medium term

Segment-wise inflow and execution for BHEL, March fiscal year-ends, 2008-2015E (Rs bn)

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Power								
Utility order inflow (GW)	**14.6**	**17.0**	**16.5**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**
Realization (Rs mn / MW)	26.6	26.1	23.6	26.0	26.0	27.0	27.0	28.0
Utility order inflow	**387**	**444**	**389**	**390**	**390**	**405**	**405**	**420**
Spare orders	24	28	31	36	42	48	55	63
International orders	23	33	36	39	43	48	52	58
Orders received during the year	**434**	**504**	**456**	**466**	**475**	**501**	**513**	**541**
% growth	46.4	16.3	(9.7)	2.2	2.0	12.0	10.0	10.0
Revenues	**159**	**213**	**269**	**331**	**382**	**459**	**515**	**554**
% growth	14.9	34.1	25.8	23.1	15.6	20.0	12.4	7.5
Order backlog - year end	743	1,034	1,221	1,356	1,448	1,490	1,488	1,475
% growth	58.6	39.2	18.1	11.1	6.8	2.9	(0.2)	(0.9)
Order execution days	**1,074**	**1,270**	**1,405**	**1,347**	**1,294**	**1,153**	**1,056**	**981**
Industry								
Orders received during the year	**79**	**103**	**144**	**161**	**180**	**202**	**226**	**253**
% growth	19.9	30.5	40.1	12.0	12.0	12.0	12.0	12.0
Revenues	**60**	**72**	**79**	**95**	**132**	**162**	**194**	**214**
% growth	11.8	20.6	8.7	20.6	38.8	23.2	19.7	9.9
Order backlog - year end	96	126	191	257	305	345	376	416
% growth	23.8	31.3	51.4	34.5	18.8	12.9	9.2	10.5
Order execution days	**471**	**484**	**584**	**734**	**711**	**686**	**647**	**643**
Total								
Orders received during the year	**512**	**607**	**599**	**626**	**655**	**703**	**739**	**794**
% growth	41.6	18.4	(1.3)	4.6	4.6	7.3	5.1	7.5
Revenues	**219**	**286**	**347**	**426**	**514**	**621**	**710**	**767**
% growth	**14.0**	**30.4**	**21.5**	**22.5**	**20.8**	**20.8**	**14.3**	**8.1**
Order backlog - year end	839	1,160	1,412	1,612	1,753	1,835	1,864	1,890
% growth	53.7	38.3	21.7	14.2	8.7	4.7	1.6	1.4
Order execution days	**909**	**1,071**	**1,219**	**1,210**	**1,145**	**1,030**	**944**	**886**

15 GW inflow in FY11E-13E from XIIth Plan orders based on sector-wise break up of likely remaining orders and assuming a reasonably optimistic success rate for BHEL

Realizations inline with historicals

15% CAGR in spares and 10% CAGR in export inflows over FY11E-13E. Exports to small countries with potentially limited scale-up opportunity

Assume improvement in execution days as the order backlog matures over time

Expect 12% CAGR in industry orders, moderate upside post strong growth in FY2009-10.

Order inflow growth expected to significanly lag revenue growth impacting visbility

Lack of substantial upside to order inflow would meaningfully squeeze growth prospects in the medium-term

Source: Company, Kotak Institutional Equities estimates

Build 15 GW utility inflow; optimistic vs. bottom up estimate of 10-12 GW in thermal

An optimistic case scenario of total capacity addition of about 120 GW in the XIIth plan period would imply additional equipment ordering of about 60 GW. We estimate that of the 120 GW about 100 GW would be based on thermal plants out of which orders for about 58 GW have already been placed. Based on a detailed sector-wise analysis of likely remaining orders and assuming a reasonably optimistic success rate for BHEL, we believe that BHEL may get additional thermal orders of about 30 GW over FY2011E-13E. We believe most of the XIIth Plan orders would be placed by end-FY2013E as order placed in FY2014E and beyond are less likely to be commissioned in the XIIth Plan period.

This would imply average thermal inflows of about 10-12 GW (about Rs260-320 bn based on average realization of about Rs26 mn/ MW) per year over FY2011E-13E compared to 16.5 GW (Rs420 bn) in FY2010 and 17 GW (Rs470 bn) in FY2009. Our estimate of 30 GW already includes (1) 7.5 GW (about 60%) from 660 MW and 800 MW bulk tendering and (2) 6.2 GW of orders from JVs with state utilities. We have assumed a much high percentage of private and UMPP orders for BHEL compared to the success in the segments so far. We have mainly focused on the thermal orders as realizations in hydro and nuclear are much lower.

Estimate BHEL to secure additional thermal orders of about 10-12 GW p.a. over FY2011E-13E for XIIth plan projects

Projects expected to be commissioned in the XIIth Plan period (MW)

Total projects in the XIIth Plan - Likely to be taken up for commissioning (MW)	Thermal							
	Coal			Gas	Total	Hydro	Nuclear	Total
	Supercritical	Subcritical	Total					
Centre	**16,160**	**7,500**	**23,660**	**3,460**	**27,110**	**9,480**	**6,400**	**42,990**
NTPC	14,840	5,140	19,980	2,730	22,710	2,270	—	24,980
NHPC	—	—	—	—	—	4,760	—	4,760
DVC	1,320	500	1,820	—	1,820	—	—	1,820
Others	—	1,860	1,860	730	2,580	2,440	6,400	11,430
State	13,280	9,330	22,610	520	23,130	2,500	—	25,640
Private	12,090	19,490	31,580	2,930	34,520	2,510	—	37,030
UMPP	16,000	—	16,000	—	16,000	—	—	16,000
Total	**57,530**	**36,320**	**93,850**	**6,910**	**100,760**	**14,490**	**6,400**	**121,650**

Awarded so far (MW)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**3,300**	**6,390**	**9,690**	**726**	**10,416**
NTPC	3,300	4,640	7,940	—	**7,940**
NHPC	—	—	—	—	**—**
DVC	—	500	500	—	**500**
Others	—	1,250	1,250	726	**1,976**
State	6,780	8,000	14,780	—	**14,780**
Private	8,580	18,520	27,100	—	**27,100**
UMPP	5,700	—	5,700	—	**5,700**
Total	**24,360**	**32,910**	**57,270**	**726**	**57,996**

Potential remaining ordering activity (MW)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**12,860**	**1,110**	**13,970**	**2,730**	**16,700**
NTPC	11,540	500	12,040	2,730	**14,770**
NHPC	—	—	—	—	**—**
DVC	1,320	—	1,320	—	**1,320**
Others	—	610	610	—	**610**
State	6,500	1,330	7,830	520	**8,350**
Private	3,510	970	4,480	2,930	**7,420**
UMPP	10,300	—	10,300	—	**10,300**
Total	**33,170**	**3,410**	**36,580**	**6,180**	**42,760**

BHEL share in projects awarded so far (%)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**40**	**100**	**80**	**100**	**81**
NTPC	40	100	75	—	**75**
NHPC	—	—	—	—	**—**
DVC	—	100	100	—	**100**
Others	—	100	100	100	**100**
State	71	85	78	—	**78**
Private	23	69	55	—	**55**
UMPP	—	—	—	—	**—**
Total	**33**	**79**	**60**	**100**	**60**

Awarded to BHEL so far (MW)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**1,320**	**6,390**	**7,710**	**726**	**8,436**
NTPC	1,320	4,640	5,960	—	**5,960**
NHPC	—	—	—	—	**—**
DVC	—	500	500	—	**500**
Others	—	1,250	1,250	726	**1,976**
State	4,800	6,800	11,600	—	**11,600**
Private	1,980	12,830	14,810	—	**14,810**
UMPP	—	—	—	—	**—**
Total	**8,100**	**26,020**	**34,120**	**726**	**34,846**

Expected BHEL share in remaining projects (%)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**58**	**83**	**60**	**100**	**66**
NTPC	53	100	55	100	**63**
NHPC	—	—	—	—	**—**
DVC	100	—	100	—	**100**
Others	—	69	69	—	**69**
State	95	50	87	65	**86**
Private	99	84	95	50	**77**
UMPP	47	—	47	—	**47**
Total	**66**	**70**	**66**	**73**	**67**

Estimates of incremental order inflow for BHEL (MW)	Thermal				
	Coal			Gas	Total
	Supercritical	Subcritical	Total		
Centre	**7,420**	**920**	**8,340**	**2,730**	**11,070**
NTPC	6,100	500	6,600	2,730	**9,330**
NHPC	—	—	—	—	**—**
DVC	1,320	—	1,320	—	**1,320**
Others	—	420	420	—	**420**
State	6,150	660	6,820	340	**7,160**
Private	3,460	820	4,280	1,470	**5,740**
UMPP	4,800	—	4,800	—	**4,800**
Total	**21,830**	**2,400**	**24,240**	**4,530**	**28,770**

Source: CEA, Kotak Institutional Equities estimates

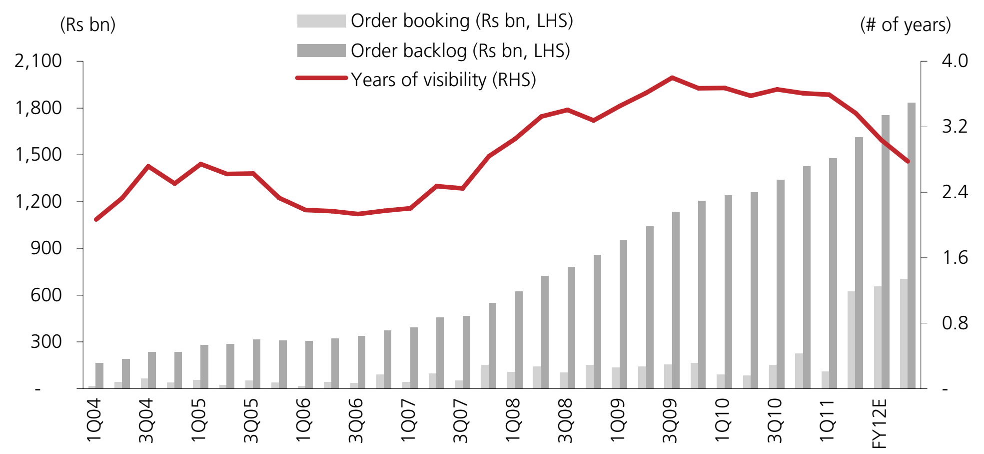
Industry, spares/R&M, exports inflow to grow but unlikely to pick the full tab

BHEL reported strong order inflow of Rs144 bn in industry segment in FY2010, up 40% yoy, led by captive power plant orders. We believe in limited upside to this strong ordering in the industry segment in the near-term on account of (1) limited overall market size for captive plants and (2) increasing competition with players such as Thermax. We estimate industry segment inflows to grow at about 10% CAGR over FY2011E-13E. We estimate that the company order inflow for spare and R&M could grow at about 15% over FY2011E-13E based on (1) average spares/R&M spending of about Rs0.2 mn per installed MW capacity per year (in line with historical trend), and (2) planned capacity addition in the country as per CEA schedule. However, the total size of the opportunity is expected to be limited, about Rs125bn, over the next three years. R&M and LE (Life Extension) execution has significantly lagged planned activities primarily due to reluctance to take unit shutdown and delayed supplies of material. Most of the export orders for BHEL are from small countries, such as Bhutan, Syria and Oman; and hence the segment is unlikely to see a significant scale-up. Order inflows from international business have remained in the range of Rs20-30 bn over FY2006-10. We estimate export order inflows to grow at 10% CAGR over FY2011E-13E.

Visibility may reduce as inflow growth likely to lag revenue growth over FY11E-13E

Order book visibility of the company may reduce to about 3.0X by FY2012E and about 2.8X by 2013E (from about 3.5 years at end-FY2010) as the order inflow growth is likely to lag revenue growth over FY2011E-13E. We estimate order inflow growth to grow at about 6% CAGR over FY2011E-13E while revenue to grow at about 21% CAGR over the same period.

Expect visibility to decrease as order inflow growth is likely to lag revenue growth over FY2011E-13E
Order booking, Order backlog & visibility trend for BHEL



Source: Company, Kotak Institutional Equities estimates

Global partners make newcomers credible; bulk tender, state JVs not positive

Commitment of leading global players makes upcoming competition credible

Upcoming private competition is primarily via joint ventures with established global power equipment manufacturers, such as Alstom and Toshiba, which makes the commitment more credible. For example, Alstom, Bharat Forge's JV partner, is the global leader in the sector contributing 25% of the total global installed capacity of about 4,600 GW. Toshiba, JSW JV partner, is a leading provider of steam turbines and generators, with over 1,800 units (150 GW) installed. Based on capacity addition plans by various players, manufacturing capacity is expected to significantly exceed the likely demand in the next few years.

The total utility market of about 20-23 GW p.a. could potentially be split as about (1) 15 GW for BHEL, (2) 3 GW for L&T, (3) 2 GW for Thermax (boilers only), (4) 2-3 GW each for JSW and Bharat Forge (turbine only), and (5) 2-3 GW for Chinese players. An assumption of 15 GW p.a. for BHEL also appears in line with expected capacity of 20 GW as the company is also likely to execute about 3-4 GW of captive/export orders. We also believe that the changing dynamics of the industry – (1) adoption of super-critical technology and (2) increasing share of private players in capacity addition – reduces incumbent's advantage and facilitates entry of new players.

Prima-facie, equipment manufacturing capacity may exceed likely demand of about 20-23 GW p.a.
Details of capacity addition by various players over the next few years

						Estimated utility orders	
	Structure	Capital investment	Boiler capacity (MW/ annum)	Turbine capacity (MW/ annum)	Likely start of manufacturing	Boiler (MW/ annum)	Turbine (MW/ annum)
L&T - Mitsubishi	51:49	30,000	4,000	4,000	Jun-10	3,000	3,000
BGR Energy - Hitachi	51:49	32,000	4,000	4,000	Jul-13	—	—
JSW - Toshiba	25:75	11,800	—	3,000	Jun-11	—	2,000
Bharat Forge - Alstom	49:51	24,000	—	5,000	Jun-11	—	3,000
Thermax - B&W PCG	51:49	7,000	3,000	—	NA	2,000	—
GB Engineering - Ansaldo(Gammon)	15:85		2,000	—		—	—
Total for new players			**13,000**	**16,000**		**5,000**	**8,000**
BHEL current capacity			15,000	15,000			
BHEL - incremental capacity			5,000	5,000			
Total for BHEL			**20,000**	**20,000**		**15,000**	**15,000**
Total supply			**33,000**	**36,000**		**20,000**	**23,000**

Source: Company, News flows, Kotak Institutional Equities

Chinese competition reduced but not disappeared; forex could tilt the balance

Chinese manufacturers have run out of favor to some extent due to (1) unfavorable currency movement, and (2) government preference for domestic manufacturing such as awarding super critical contracts in a majority of public sector orders to companies with domestic manufacturing. However, we continue to see some large orders placed to Chinese firms such as 1,980 MW order for Talwandi Sabo in Nov-2009. The exchange rate continues to favor domestic manufacturer despite slight correction in the rates recently. Further correction in the exchange rate could increase the attractiveness of Chinese equipment and potentially results in higher level of orders to the Chinese manufacturers.

NTPC bulk tendering opens up BHEL stronghold for private participation

In our view, NTPC bulk tendering is far from being a positive for BHEL as it would increase private participation in central utilities orders which is traditionally a stronghold for BHEL. BHEL secured all of the sub-critical and more than 80% of the total orders placed by NTPC for the XIth Plan. However, share of NTPC orders secured by BHEL may go down to 50-60% for the XIIth Plan as NTPC is likely to spread out orders across bidding participants, in line with the government policy to encourage setting up of domestic manufacturing facilities.

JVs ramp-up super-critical market share; but capital commitment may not be positive

We expect BHEL to receive additional orders of about 6 GW from JVs with state utilities for super-critical plants. Excluding the 1600 MW order for JV with Karnataka Power, BHEL had a low share of about 30% in about 21 GW of super-critical order placed for XIIth Plan. The formation of JVs could have been partially led by the motivation to secure a larger share of super-critical orders by using the balance sheet of the company and to that extent capital commitment by the company may not be considered positive.

Expect additional inflows of 6.1 GW from JVs with state utilities
JVs/MoU with state utilities announced by BHEL for super-critical plants

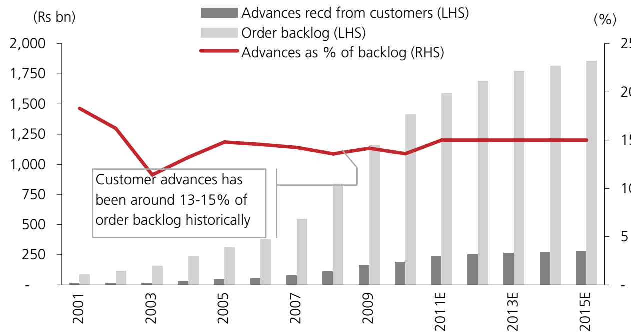
Parnter	Capacity (MW)	Cfg	Status
Karnataka Power Co. Ltd (KPCL)	1,600	2 X 800	2x800 MW order placed with BHEL in Apr-2010
Tamil Nadu Electricity Board (TNEB)	1,600	2 X 800	JV formed
Madhya Pradesh Power Generation Co. Ltd (MPPGCL)	1,600	2 X 800	JV formed
Maharashtra State Power Generation Co. Ltd (Mahgenco)	1,320	2 X 600	MoU signed
Gujarat State Electricity Corporation Ltd. (GSECL)	1,600	2 X 800	MoU signed
Total	**7,720**		

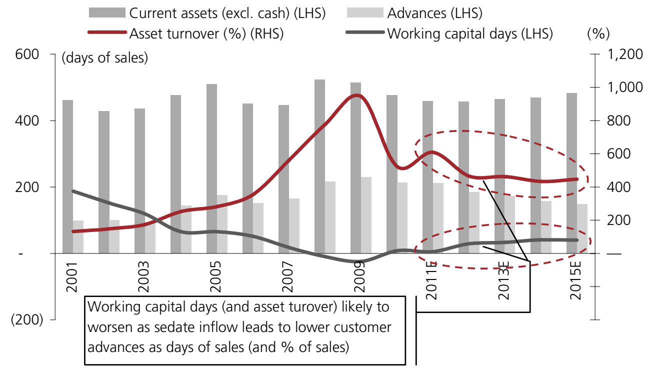
Source: Company, Kotak Institutional Equities

Working capital might worsen as backlog drives liabilities side through advances

The working capital requirement of the company is directly linked to the order backlog as the customer advances are the main driver for current liabilities of the company (customers advances have been about 13.5-15% of order backlog over FY2005-10). We estimate that the working capital as days of sales could increase going forward from about 8 days in FY2010 to about 30 days in FY2012E-13E and about 40 days by FY2015E. The increase would be led by lower customer advances as the company order backlog would significantly lag revenue growth due to sedate order inflow traction.

Working capital may increase going forward as customer advances, which are driven by order backlog, may reduce as days of sales
Customer advances, order backlog and working capital trends for BHEL, March fiscal year-ends, 2001-2015E





Source: Company, Kotak Institutional Equities estimates

Marginally revise estimates and TP of Rs2,600/share; retain REDUCE

We marginally revise earnings estimates to Rs116 and Rs135 (from Rs113 and Rs138) for FY2011E and FY2012E, respectively. Revision to estimates is based on (1) slightly lower assumption for execution in line with management guidance of revenue growth, and (2) about 50 bps higher margin assumption for FY2011E versus earlier as we build lower raw material costs. We have changed our target price to Rs2,600 based on 19.5X FY2012E EPS (earlier Rs2,500 based on 20X Sep-11E earnings estimate). Although we are positive on near-term earning potential of the company led by (1) margin expansion on account of operating leverage, and (2) execution of large order backlog; we believe there may be contraction in valuation multiples accorded to the stock as order inflow pressure becomes apparent in addition to (1) incremental earnings squeeze originating from margins and (2) potentially higher working capital (order backlog is proportional to advances, as order backlog declines as percentage of sales working capital metrics may suffer).

Revised estimates for BHEL, March fiscal year-ends, 2011E-12E (Rs mn)

	New estimates		Old estimates		% change	
Target price (Rs)	**2,600**		**2,500**		4.0	
Rating	**REDUCE**		**REDUCE**			
	FY2011E	**FY2012E**	**FY2011E**	**FY2012E**	**FY2011E**	**FY2012E**
Revenues	398	479	410	504	(2.9)	(5.0)
EBITDA	76	89	77	94	(0.6)	(5.2)
EBITDA margin (%)	19.1	18.7	18.7	18.7		
PBT	85	99	86	105	(0.9)	(5.2)
PAT	57	66	55	67	2.8	(1.6)
EPS (Rs)	**116.3**	**135.4**	**113.2**	**137.6**	**2.8**	**(1.6)**
yoy growth (%)						
Revenues	21.2	20.2	24.8	22.8		
EBITDA	37.0	17.4	37.8	23.1		
EPS	32.1	16.4	28.5	21.6		

Source: Kotak Institutional Equities estimates

We retain REDUCE based on limited upside to our FY2012 based target price. We believe that BHEL could face potential headwind in order inflows which would lead to contraction in revenue growth to about 10-14% yoy by FY2014-15E in spite of assuming (1) reasonably optimistic success rate for BHEL in winning utility orders in remaining XIIth Plan activity and (2) improvement in execution days as order book matures. Furthermore, we perceive bulk tendering event of NTPC as a negative for BHEL as it opens virtually captive customer's (NTPC) business to new competition and helps them take a foothold in the sector.

Key financials of BHEL, March fiscal year-ends, 2007-15E (Rs bn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Income Statement									
Total net revenues	**172.4**	**193.0**	**262.1**	**328.8**	**398.4**	**478.7**	**578.2**	**660.8**	**714.5**
Cost of goods sold	(140.2)	(159.9)	(225.1)	(273.1)	(322.1)	(389.2)	(471.2)	(537.9)	(583.5)
EBIDTA	**32.2**	**33.2**	**37.0**	**55.7**	**76.2**	**89.5**	**107.0**	**122.9**	**131.0**
Other income	8.2	14.4	15.0	15.2	14.4	16.2	18.2	20.8	24.4
Interest	(0.4)	(0.4)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Depreciation	(2.7)	(3.0)	(3.3)	(4.6)	(5.3)	(6.3)	(7.1)	(7.9)	(8.7)
Pre-tax Profit	37.3	44.3	48.4	65.9	85.2	99.2	117.8	135.7	146.6
Tax	(13.2)	(15.7)	(17.1)	(22.8)	(28.3)	(32.9)	(39.1)	(45.0)	(48.7)
PAT	**24.1**	**28.6**	**31.3**	**43.1**	**56.9**	**66.3**	**78.7**	**90.6**	**97.9**
Balance sheet									
Shareholders' equity	87.9	107.7	129.4	159.2	201.9	251.6	310.6	378.6	452.0
Loan funds	0.9	1.0	1.5	1.3	1.3	1.3	1.3	1.3	1.3
Total source of funds	**88.8**	**108.7**	**130.9**	**160.5**	**203.2**	**252.9**	**311.9**	**379.9**	**453.3**
Net block	9.9	9.8	14.7	28.1	38.9	47.1	50.0	54.1	57.4
WIP	3.0	6.6	11.6	11.6	6.5	5.0	5.0	5.0	5.0
Investments	0.1	0.1	0.5	0.8	0.8	0.8	0.8	0.8	0.8
Net current assets (excl cash)	8.3	(5.0)	(17.5)	7.0	15.7	44.5	68.5	97.6	105.7
Cash and bank balance	58.1	83.9	103.1	97.7	126.0	140.2	172.4	207.1	269.1
Deferred Tax Assets	9.4	13.4	18.4	15.3	15.3	15.3	15.3	15.3	15.3
Total applications	**88.8**	**108.7**	**130.9**	**160.5**	**203.2**	**252.9**	**311.9**	**379.9**	**453.3**
Cash flow statement									
Net profit before tax and extraordinary items	**37.3**	**44.3**	**48.4**	**65.9**	**85.2**	**99.2**	**117.8**	**135.7**	**146.6**
Add: Depreciation / amortisation / non-cash prov	2.7	3.0	3.3	4.6	5.3	6.3	7.1	7.9	8.7
Tax paid	(15.8)	(19.7)	(22.1)	(19.7)	(28.3)	(32.9)	(39.1)	(45.0)	(48.7)
Operating profit before working capital changes	24.2	27.5	29.6	50.8	62.2	72.6	85.9	98.5	106.6
Change in working capital / other adjustments	10.4	13.4	12.4	(24.5)	(8.7)	(28.8)	(24.0)	(29.1)	(8.1)
Net cashflow from operating activites	**34.6**	**40.9**	**42.0**	**26.3**	**53.5**	**43.8**	**61.9**	**69.4**	**98.5**
Fixed Assets	(4.3)	(6.6)	(12.8)	(18.0)	(11.0)	(13.0)	(10.0)	(12.0)	(12.0)
Investments	—	0.0	(0.4)	(0.3)	—	—	—	—	—
Net cashflow from investing activites	**(4.3)**	**(6.6)**	**(13.2)**	**(18.3)**	**(11.0)**	**(13.0)**	**(10.0)**	**(12.0)**	**(12.0)**
Free cash flow	**30.3**	**34.3**	**28.8**	**8.0**	**42.5**	**30.8**	**51.9**	**57.4**	**86.5**
Issue of share capital	—	0.0	(0.0)	(2.5)	—	—	—	—	—
Borrowings	(4.7)	0.1	0.5	(0.2)	—	—	—	—	—
Dividend paid	(6.9)	(8.7)	(9.7)	(10.8)	(14.2)	(16.6)	(19.7)	(22.7)	(24.5)
Net cashflow from financing activites	**(11.6)**	**(8.7)**	**(9.2)**	**(13.5)**	**(14.2)**	**(16.6)**	**(19.7)**	**(22.7)**	**(24.5)**
Cash generated /utilised	18.7	25.6	19.7	(5.5)	28.3	14.2	32.2	34.7	62.0
Net cash at end of year	**58.1**	**83.9**	**103.1**	**97.7**	**126.0**	**140.2**	**172.4**	**207.1**	**269.1**
Ratios (%)									
EBITDA margin	**18.7**	**17.2**	**14.1**	**16.9**	**19.1**	**18.7**	**18.5**	**18.6**	**18.3**
PAT margin	14.0	14.8	11.9	13.1	14.3	13.8	13.6	13.7	13.7
RoE	29.9	29.2	26.4	29.9	31.5	29.2	28.0	26.3	23.6
RoCE	29.1	29.2	26.3	29.7	31.4	29.1	27.9	26.2	23.5
Net current assets (excl cash) as days of sales	17.7	(9.5)	(24.3)	7.8	14.4	33.9	43.2	53.9	54.0
EPS (Rs)	**49.2**	**58.4**	**63.9**	**88.1**	**116.3**	**135.4**	**160.8**	**185.1**	**200.0**

Source: Company, Kotak Institutional Equities estimates

Major orders announced by BHEL, March fiscal year-ends, 2009-11E

	Project	Agency	Capacity (MW)	Configuration	Value (Rs mn)
Power	Dainik Bhaskar Power Limited	Private	1,200	2X 600	26,650
	Raichur Power Co. Ltd, JV of Karnataka Power Co. Ltd and BHEL	State	1,600	2X 800	63,000
	Orders announced in FY2011 so far		**2,800**		**89,650**
Power	Bara project, Prayagraj, UP, Jaiprakash Associates Limited (JAL)	Private	1,980	3X 660	56,000
	Raigarh Extn, Jindal Power Limited, Chattisgarh TPP	Private	2,400	4X 600	50,400
	India Bulls Amravati	Private	1,350	5X 270	28,890
	India Bulls Nasik	Private	1,350	5X 270	28,890
	Angul TPP in Orissa, Monnet Power Company Limited (MPCL)	Private	1,050	2X 525	26,300
	Angul TPP in Orissa, Jindal India Thermal Power Limited (JITPL)	Private	1,200	2X 600	26,000
	Pipavav, Gujarat (Videocon Power Ltd)	Private	1,200	2X 600	24,860
	BECL, Bhavnagar	State	500	2X 250	18,650
	Avantha Bhandar TPP, Chattisgarh, Korba West Power Company Limited	Private	600	1X 600	14,750
	Vallur TPP, NTPC-Tamil Nadu Energy Company Limited (NTECL)	Centre	500	1X 500	13,000
	Jhabua Power Ltd, Seoni, MP TPP Unit I (Avantha Group)	Private	600	1X 600	12,870
	Abhijeet, Matrishri Usha Jayaswal MPP Ph II (Corporate Power Ltd), Latehar, Jhark	Private	540	2X 270	12,630
	DPL, Durgapur Unit 8, WBPDCL	State	250	1X 250	12,430
	Surana Power Ltd, Raichur TPS	Private	420	2X 210	11,400
	KBUNL (NTPC), Muzaffarpur TPP Stage II	Centre	390	2X 195	10,770
	Bela TPP, Ideal Energy Projects Limited, Butibori, Maharashtra	Private	270	1X 270	7,030
	Nuclear Power Corporation of India limited (NPCIL)	Centre	700	1X 700	7,000
	TPP in Jharkhand, Adhunik Power, Saraikela, Padampur, Unit II	Private	270	1X 270	6,400
	TPP in Jharkhand, Adhunik Power, Saraikela, Padampur, Unit I	Private	270	1X 270	6,400
	Krishanganga hydro-electric plant in Jammu & Kashmir, HCC	Private	330	3X 110	4,950
	Ramgarh	State	160	1X 160	4,000
Captive	HNPCL, Vizag	Private	1,040	2X 520	41,800
	Captive plant at Paradip refinery of IOCL, Orissa	Private	376	NA	33,480
	Sambalpur TPP in Orissa, HINDALCO	Private	900	6X 150	20,075
	OPG Power Gujarat Power Ltd	Private	300	2X 150	7,000
	Sterlite, Tutitcorn	Private	160	2X 80	4,000
	Oil India Limited (OIL)	Private	20	1X 20	1,900
	Chennai Petroleum Corporation Limited (CPCL)	Private	20	1X 20	1,700
	Barauni refinery of Indian Oil Corporation (IOC)	Private	20	1X 20	1,050
Industry	Indian Railways	Centre	NA	NA	9,900
	Power Grid Corporation of India Ltd (PGCIL)	Centre	NA	NA	2,000
Export	Punatsangchhu-I hydro-electric project in Bhutan	Export	1,200	6X 200	10,000
	Petroleum Development Oman (PDO)	Export	252	2X 126	4,100
	Sultanate of Oman	Export	252	2X 126	3,750
	Grodnoenergo, Republic of Belarus	Export	126	1X 126	2,700
	Orders announced in FY2010		**21,041**		**528,675**
Power	Pragati Power Corporation Limited	State	1,371	NA	35,880
	Korba West TPP, Chhattisgarh State Electricity Board	State	1,500	3X 500	33,680
	Malwa TPP, Madhya Pradesh Power Generating Company Ltd	State	1,200	2X 600	31,500
	Krishnapatnam, Andhra Pradesh Power Dev Co Ltd (APPDCL)	State	1,600	2X 800	25,000
	Pallatana CPP, ONGC Tripura Power Company Limited (OTPCL)	Private	726	2X 363	22,000
	Chandrapur TPP, Mahgenco	State	1,000	2X 500	22,000
	Marwa TPP, Chattisgarh State Electricity Board	State	1,000	2X 500	22,000
	Tamil Nadu Electricity Board TNEB, North Chennai Thermal Power Station	State	600	1X 600	21,750
	Rihand TPP, NTPC	Centre	1,000	2X 500	21,538
	Tuticorn TPP, JV of NLC and TNEB	State	1,000	2X 500	21,538
	Vindhyachal TPP, NTPC	Centre	1,000	2X 500	21,538
	Mauda TPP, NTPC Ltd	Centre	1,000	2X 500	21,000
	Bokaro TPP, Damodar Valley Corporation	Centre	500	1X 500	18,400
	Barh II, NTPC Ltd	Centre	1,320	2X 660	14,740
	Kakatiya TPP, APGENCO	State	600	1X 600	13,250
	Bina Power Supply Company Ltd, Jai Prakash Group	Private	500	2X 250	11,750
	Goindwal TPP, GVK Power Ltd	Private	540	2X 270	11,550
	Chabra TPP Units 3&4, Rajasthan Rajya Vidyut Utpadan Nigam Limited	State	500	2X250	9,900
	Satluj Jal Vidyut Nigam Limited (SJVNL)	Centre	412	6x 69	6,410
	Parli 3 TPP of Mahagenco	State	250	1X 250	5,385
	Nuclear Power Corporation of India limited (NPCIL)	Centre	1,400	2X 700	3,450
Captive	Mahan CPP, Hindalco	Private	900	6X 150	20,000
	Guru Gobind Singh refinery, Bhatinda, JV of HPCL and Mittal Energy	Private	153	1X 153	11,500
	CPP for MRPL	Private	68	NA	3,400
Industry	Oil and Natural Gas Corporation Limited ONGC	Private	NA	NA	5,060
	SAIL	Private	NA	NA	3,380
	Mundra UMPP, Coastal Gujarat Power Limited (CGPL), Tata Power	Private	4,000	5X 800	2,400
	Tirora TPP, Powergen Infrastructure	Private	NA	NA	810
Export	Ministry of Electricity, Syria	Export	400	2X 200	20,800
	Ministry of Infrastructure, Government of the Republic of Rwanda	Export	28	2X 14	4,000
	Nam Chien Hydropower Joint Stock Company, Vietnam	Export	200	2X 100	2,000
	Petroleum Development Oman (PDO)	Export	126	1X 126	1,890
	International Energy Resources, UAE	Export	84	2X 42	1,600
	International Energy Resources (IER), UAE	Export	84	2X 42	1,400
	Orders announced in FY2009		**25,162**		**472,825**

Source: Company, Kotak Institutional Equities

kotak Institutional Equities

Wipro (WPRO)

Technology

ADD

JULY 23, 2010

RESULT

Coverage view: Attractive

Price (Rs): 412

Target price (Rs): 465

BSE-30: 18,113

Good but can get better. Wipro's 1QFY11 revenue was lower than our estimate. However, operating margin increase and strong revenue growth guidance for 2QFY11E made up for the revenue miss. A modest start to the year will lead to revenue growth underperformance in FY2011E compared to TCS and Infosys, though it will perform in line with peers starting FY2012E. We increase our earnings estimate marginally for FY2011E and FY2012E. Maintain our target price of Rs465. Reiterate ADD rating.

Company data and valuation summary

Wipro

Stock data			
52-week range (Rs) (high,low)			454-268
Market Cap. (Rs bn)			1,009.1
Shareholding pattern (%)			
Promoters			79.5
FIIs			8.9
MFs			0.6
Price performance (%)	1M	3M	12M
Absolute	1.9	(0.6)	50.6
Rel. to BSE-30	(0.2)	(3.0)	26.5

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	18.9	22.3	25.7
EPS growth (%)	22.1	18.1	15.6
P/E (X)	21.9	18.5	16.0
Sales (Rs bn)	271.2	314.4	371.7
Net profits (Rs bn)	45.9	54.5	63.0
EBITDA (Rs bn)	59.1	71.0	83.1
EV/EBITDA (X)	16.5	13.3	11.0
ROE (%)	26.5	25.0	23.7
Div. Yield (%)	0.9	1.1	1.3

Revenue growth miss compensated by robust guidance

Wipro's reported overall revenues of Rs72.4 bn were 1.8% ahead of our estimates. However, IT Services revenues of US$1,204 mn (3.2% qoq) missed our estimate by about a percent, though revenues were within the company guided range. Revenues on constant currency basis were a shade higher than the upper end of the guidance. Miss of revenues was made up by a strong guidance of 4.1-6.1% growth for the Sep-10 quarter. This reflects the strong demand environment for offshore services consistent with the 5% revenue growth guidance given by Infosys.

Margin performance creditable and drives strong net income outperformance

We believe that Wipro has not been given due credit for impressive execution that has driven significant productivity and margin improvement. Margin performance is amply demonstrated in 30 bps qoq and 310 bps yoy improvement, whereas other companies have struggled with execution challenges and margin headwinds. While Wipro's margin may decline in 2QFY11E on losses from old hedges and revision in compensation, it will increase on a yoy comparison in FY2011E. Strong margin performance in 1QFY11 drove strong net income outperformance. Net income grew 9.1% qoq and 34.6% yoy to Rs13.2 bn; performance was also aided by lower-than-expected tax payout for the quarter (ETR of 15.2% for 1QFY11).

Marginally raise estimates on change in Re/US$ assumption, reiterate ADD rating

We marginally raise our EPS estimates for FY2011E by 1.6% to Rs22.3 and for FY2012E by 2.8% to Rs25.7. Change in estimates is led by (1) revision in Re/US$ rate assumption to 45.6 and 46 for FY2011E and FY2012E from 44.2 and 44.7 earlier; and (2) marginal increase in EBIT margins for the IT services business. We maintain our fair value of Rs465 based on end-FY2012E financials; implied target multiple of 18X is at 10% discount to TCS and 15% discount to Infosys. We believe this discount is justified noting lower ROE/ ROCE of the business and mixed track record of acquisitions. Note that Wipro may trail peers on US$ revenue growth rate in FY2011E on transient factors of client portfolio mix and relatively weaker account management model, we expect Wipro's growth to be in line with peers starting FY2012E.

Kawaljeet Saluja
kawaljeet.saluja@kotak.com
Mumbai: +91-22-6634-1243

Rohit Chordia
rohit.chordia@kotak.com
Mumbai: +91-22-6634-1397

Vineet Thodge
vineet.thodge@kotak.com
Mumbai: +91-22-6634-1225

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Outstanding operating margin performance

Wipro reported 30 bps qoq margin increase as compared to our expectation of 50 bps decline. We find Wipro's margin performance impressive against the backdrop of (1) adverse cross currency impact, and (2) full quarter impact of wage hikes of 8-10% offshore and 2% onsite and (3) qoq realization decline of 4.9% onsite and 1.4% offshore. Note that Wipro attributes onsite realization decline to increase in new projects that are in the transition phase, for which they do not fully bill the client.

We attribute strong margin performance to (1) increase in Re/US$ realization, that aided margin by 60 bps. Note that Wipro's realized Re/US$ rate was closer to the spot in the last few quarters. The quantum of old hedges (taken at Re/U$ rate of 40-41) has reduced significantly since; and (2) improved profitability of acquisitions, especially Infocrossing.

Note that Wipro's margin may decline by 50-100 bps in Sep '10 quarter on account of maturity of old loss-making hedges (taken at Re/US$ rate of 40-41) and impact of promotions and RSU grant to employees.

Account mining an area of concern and opportunity as well

Although Wipro lags as compared to its peers on the account mining aspect, revenues from top 10 clients grew by the most in the past 2 years. Despite this, significant amount of attention needs to be given to the client mining aspect. The difference in aggregate top-10 client revenues accounts for nearly all the gap in Wipro's revenues versus Infosys (Exhibit 1). Wipro has been unable to scale up its top-10 clients, which is evident from the fact that Wipro's top-10 accounts have an average size of US$95 mn/annum versus US$183 mn for TCS and US$142 mn for Infosys. The gap in US$50 mn+ relationships between Infosys and Wipro has also widened over the past few quarters.

Exhibit 1: Relative underperformance in top-10 accounts may lead to underperformance
Size of top 10 clients account for a bulk of difference in revenues between Wipro and Infosys

(US$ mn)	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Wipro									
Revenues	**1,068**	**1,110**	**1,100**	**1,046**	**1,033**	**1,065**	**1,127**	**1,166**	**1,204**
Of which									
Top client	29	30	28	25	27	29	29	29	35
Top 5 clients	122	128	124	113	118	120	122	122	131
Top 10 clients	**223**	**226**	**222**	**206**	**213**	**210**	**220**	**225**	**238**
ex-top 10 clients	844	883	878	840	820	855	907	941	965
Infosys									
Revenues	**1,156**	**1,218**	**1,171**	**1,122**	**1,122**	**1,154**	**1,232**	**1,296**	**1,358**
Of which									
Top client	91	93	73	64	50	53	58	60	67
Top 5 clients	230	226	203	193	183	190	217	205	209
Top 10 clients	**348**	**341**	**318**	**301**	**289**	**302**	**339**	**334**	**354**
ex-top 10 clients	808	877	852	821	833	852	893	962	1,004
Difference: Wipro - Infosys									
Revenues	**(88)**	**(108)**	**(71)**	**(76)**	**(89)**	**(89)**	**(105)**	**(130)**	**(154)**
Of which									
Top client	(62)	(63)	(45)	(39)	(24)	(24)	(29)	(30)	(32)
Top 5 clients	(108)	(99)	(78)	(80)	(65)	(70)	(95)	(82)	(78)
Top 10 clients	**(125)**	**(114)**	**(96)**	**(95)**	**(77)**	**(93)**	**(119)**	**(109)**	**(116)**
ex-top 10 clients	37	7	26	19	(13)	4	14	(21)	(38)

Source: Companies, Kotak Institutional Equities

Exhibit 2: Client metrics for Wipro, TCS and Infosys

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Average size of top 10 accounts (US$mn) (a)									
Wipro	89	91	89	82	85	84	88	90	95
Infosys	139	136	127	120	116	121	136	134	142
TCS	150	147	145	147	152	155	164	172	183
# accounts > US$50 mn accounts									
Wipro	14	16	16	17	17	16	16	16	17
Infosys	18	20	20	20	19	21	22	26	26

Note:
(a) Average annualized revenues of top 10 accounts

Source: Companies

Other metrics—aggressive net hiring continues though employee attrition a concern

Wipro's net employee addition was 4,854; robust in our view on the back of 5,325 employee additions in 4QFY10 and 4,855 in 3QFY10. Strong hiring indicates a good demand visibility. Wipro, however, needs to watch out for increasing employee attrition. Quarterly annualized attrition for Wipro has jumped to 24.4% for 1QFY11 from 19.2% last quarter.

While Wipro has maintained solid project execution over the last few quarters, we still believe that its strategy of viewing bench from an absolute standpoint and keeping high utilization rate is risky noting (1) demand pick-up has led to tight supply, especially in the 3-5 year experience band, and (2) Wipro's compensation revision is below peers and may expose it to risk of higher-than-peer attrition.

Exhibit 3: Comments on Wipro 1QFY11 Results (IFRS)

Rs mn	1QFY10	4QFY10	1QFY2011	% chg. qoq	% chg. yoy	Kotak estimates	% deviation	Comments
- IT Services	48,205	52,596	55,002	4.6	14.1	54,636	0.7	Global IT revenues of US$1,204 mn, lower than our estimate of US$1,214 mn and in the company guided range of US$1,190-1,215 mn; constant currency revenues of US$1,218 mn ahead of the upper end of the guidance.
- IT Products	6,900	8,900	8,320	(6.5)	20.6	8,804	(5.5)	IT products revenues tend to be lumpy
- Consumer Care and Lighting	5,199	6,084	6,414	5.4	23.4	6,238	2.8	
- Others	2,884	2,249	2,628	16.9	(8.9)	1,412	86.1	
Total revenues	**63,188**	**69,829**	**72,364**	3.6	14.5	**71,090**	**1.8**	
Operating Income	**10,903**	**13,364**	**14,493**	8.4	32.9	**14,118**	**2.7**	
- IT Services	10,334	12,718	13,502	6.2	30.7	12,964	4.2	Global IT EBIT margin improved by 30 bps ; we had build in a decline of 50 bps due to full quarter impact of wage hikes effected from Feb 1, 2010.
- IT Products	295	262	337	28.6	14.2	285	18.3	
- Consumer Care and Lighting	720	807	879	8.9	22.1	799	10.0	
- Others	(446)	(423)	(225)	(46.8)	(49.6)	71	(418.7)	
Other income/ (expense)	455	1,612	948			1,112	(14.8)	
Pre-tax profits (pre-extraordinary)	**11,358**	**14,976**	**15,441**	3.1	35.9	**15,230**	1.4	
Pre-tax profit (after non-recurring)	11,358	14,976	15,441	3.1	35.9	15,230	1.4	
Income taxes	(1,627)	(3,015)	(2,345)	(22.2)	44.1	(2,819)	(16.8)	ETR at 15.2% lower than expectations
Net income	**9,731**	**11,961**	**13,096**	9.5	34.6	**12,411**	**5.5**	Net Income ahead of our expectations, partially due to lower tax provisions
Equity in earnings of affiliates	114	176	157	(10.8)	37.7	176	(10.8)	
Minority interest	(49)	(46)	(67)			(51)		
Income from continuing operations	**9,796**	**12,091**	**13,186**	9.1	34.6	**12,536**	**5.2**	
EPS- Continuing Operations	4.0	5.0	5.4	9.1	34.6	5.1	5.2	
MARGINS								
Operating margin								
IT Services	**21.4**	**24.2**	**24.5**			**23.7**		
IT Products	**4.3**	**2.9**	**4.1**			**3.2**		
- Consumer care & Lighting	13.8	13.3	13.7			12.8		
- Others	(15.5)	(18.8)	(8.6)			5.0		
Net Income Margin	15.5	17.3	18.2			17.6		
Billing Rates (US$/manmonth)								
Onsite	11,787	12,254	11,654	(4.9)	(1.1)			
Offshore	4,302	4,352	4,291	(1.4)	(0.3)			
Revenue Mix (%)								
Onsite	49.6	49.4	52.2					
Offshore	50.4	50.6	47.8					

Wipro has guided for US$1,253 - 1,277 mn of IT services revenues for 2QFY11, up 4.1%-6.1% qoq.

Source: Company, Kotak Institutional Equities estimates

Exhibit 4: Wipro: Key changes in FY2011E-12E estimates

	Revised		Earlier		Change (%)	
Rs mn	**FY2011**	**FY2012**	**FY2011**	**FY2012**	**FY2011**	**FY2012**
IT Services revenues (US$ mn)	**5,243**	**6,264**	**5,297**	**6,313**	**(1.0)**	**(0.8)**
- Wipro Technologies	4,705	5,567	4,713	5,576	(0.2)	(0.2)
- Wipro BPO	538	697	584	737	(7.8)	(5.4)
Revenue growth (%)	**19.4**	**19.5**	**20.7**	**19.2**		
Rupee/ US$ rate	45.6	46.0	44.2	44.7	*3.0*	*2.8*
EBITDA margin (%)	26.8	25.8	26.4	25.7		
EBIT margin (%) (ex forex gains)	**23.7**	**22.9**	**23.2**	**22.7**		
Total EBITDA (Rs mn)	71,017	83,103	69,513	81,297	*2.2*	*2.2*
Total EBITDA margin (%)	22.6	22.4	22.4	22.2		
EPS (Rs/share)	**22.3**	**25.7**	**21.9**	**25.0**	**1.6**	**2.8**
EPS/share (ex intangible amortization)	**22.3**	**25.7**	**21.9**	**25.0**	**1.6**	**2.8**

Source: Kotak Institutional Equities estimates

Exhibit 5: Vertical-wise revenue split (Wipro Global IT), 1QFY08-4QFY11

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Revenues (US$ mn)									
Technology	127	124	120	104	97	93	95	100	102
Telecom	110	105	106	92	87	86	89	96	97
Communications, Media, and Service Providers	**94**	**94**	**91**	**86**	**92**	**102**	**110**	**103**	**110**
Total TMT	331	324	317	281	276	281	294	298	309
Financial Services	**271**	**292**	**286**	**272**	**272**	**274**	**291**	**304**	**324**
Manufacturing and Healthcare	236	251	249	248	243	252	268	280	284
Retail and Transportation	137	151	160	163	157	162	167	171	179
Energy and Utilities	93	92	89	82	86	96	107	112	107
Total IT Services	**1,068**	**1,110**	**1,100**	**1,046**	**1,033**	**1,065**	**1,127**	**1,166**	**1,204**
Revenue contribution									
Technology	11.9	11.2	10.9	9.9	9.4	8.7	8.4	8.6	8.5
Telecom	10.3	9.5	9.6	8.8	8.4	8.1	7.9	8.2	8.1
Communications, Media, and Service Providers	**8.8**	**8.5**	**8.3**	**8.2**	**8.9**	**9.6**	**9.8**	**8.8**	**9.1**
Total TMT	31.0	29.2	28.8	26.9	26.7	26.4	26.1	25.6	25.7
Financial Services	**25.4**	**26.3**	**26.0**	**26.0**	**26.3**	**25.7**	**25.8**	**26.1**	**26.9**
Manufacturing and Healthcare	22.1	22.6	22.6	23.7	23.5	23.7	23.8	24.0	23.6
Retail and Transportation	12.8	13.6	14.5	15.6	15.2	15.2	14.8	14.7	14.9
Energy and Utilities	8.7	8.3	8.1	7.8	8.3	9.0	9.5	9.6	8.9
Total IT Services	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth qoq (%)									
Technology	0.1	(2.1)	(3.5)	(13.6)	(6.3)	(4.5)	2.1	5.9	2.0
Telecom	4.5	(4.1)	0.2	(12.8)	(5.8)	(0.5)	3.2	7.4	2.0
Communications, Media, and Service Providers	**1.2**	**0.4**	**(3.2)**	**(6.1)**	**7.1**	**11.3**	**8.0**	**(7.1)**	**6.8**
Total TMT	1.8	(2.1)	(2.2)	(11.2)	(2.0)	2.0	4.6	1.5	3.6
Financial Services	**5.6**	**7.7**	**(2.0)**	**(4.9)**	**(0.1)**	**0.8**	**6.2**	**4.7**	**6.4**
Manufacturing and Healthcare	16.7	6.3	(0.9)	(0.3)	(2.1)	4.0	6.2	4.3	1.5
Retail and Transportation	(12.3)	10.5	5.7	2.3	(3.8)	3.2	3.0	2.8	4.6
Energy and Utilities	1.2	(0.8)	(3.3)	(8.4)	5.0	11.9	11.7	4.6	(4.3)
Total IT Services	**3.5**	**4.0**	**(0.9)**	**(4.9)**	**(1.3)**	**3.2**	**5.8**	**3.5**	**3.2**

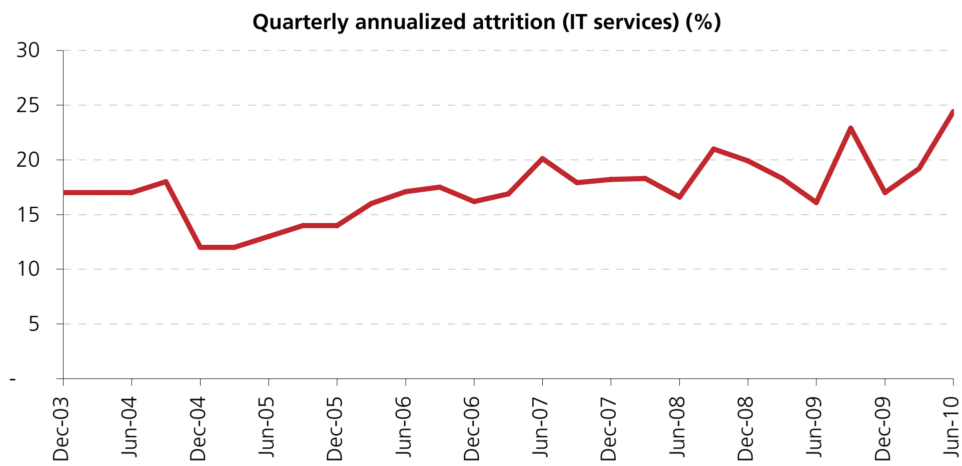
Source: Company

Exhibit 6: Service-wise revenue split (Wipro Global IT), 1QFY09-1QFY11

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Revenues (US$ mn)									
Technology Infra services (IMS)	199	216	213	219	216	219	240	252	254
Testing	115	123	127	124	125	128	130	136	137
Package implementation	**117**	**124**	**129**	**134**	**138**	**142**	**144**	**148**	**162**
BPO	100	103	100	100	104	112	119	127	122
Product Engineering	**61**	**67**	**64**	**54**	**47**	**42**	**46**	**48**	**57**
ADM	475	476	468	414	402	423	447	455	472
Total IT Services	**1,068**	**1,110**	**1,100**	**1,046**	**1,033**	**1,065**	**1,127**	**1,166**	**1,204**
Revenue contribution									
Technology Infra services (IMS)	18.6	19.5	19.4	20.9	20.9	20.6	21.3	21.6	21.1
Testing	10.8	11.1	11.5	11.9	12.1	12.0	11.5	11.7	11.4
Package implementation	**11.0**	**11.2**	**11.7**	**12.8**	**13.4**	**13.3**	**12.8**	**12.7**	**13.5**
BPO	9.4	9.3	9.1	9.6	10.1	10.5	10.6	10.9	10.1
Product Engineering	**5.7**	**6.0**	**5.8**	**5.2**	**4.6**	**3.9**	**4.1**	**4.1**	**4.7**
ADM	44.5	42.9	42.5	39.6	38.9	39.7	39.7	39.0	39.2
Total IT Services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Growth qoq (%)									
Technology Infra services (IMS)	(2.3)	9.0	(1.4)	2.4	(1.3)	1.7	9.4	4.9	0.9
Testing	6.4	6.9	2.7	(1.6)	0.4	2.3	1.4	5.3	0.6
Package implementation	**4.4**	**5.9**	**3.5**	**4.0**	**3.3**	**2.4**	**1.8**	**2.7**	**9.7**
BPO	13.1	2.9	(3.0)	0.3	3.9	7.2	6.8	6.4	(4.3)
Product Engineering	**5.3**	**9.4**	**(4.2)**	**(14.8)**	**(12.7)**	**(12.5)**	**11.2**	**3.5**	**18.4**
ADM	3.0	0.2	(1.8)	(11.4)	(3.0)	5.3	5.8	1.6	3.8
Total IT Services	**3.5**	**4.0**	**(0.9)**	**(4.9)**	**(1.3)**	**3.2**	**5.8**	**3.5**	**3.2**

Source: Company

Exhibit 7: Quarterly annualized attrition at a multi-year high



Source: Company, Kotak Institutional Equities

Exhibit 8: Profit model, balance sheet, cash model of Wipro Limited, 2009-2012E, March fiscal year-ends (Rs mn)

	2009	2010	2011E	2012E
Profit model				
Revenues	**254,564**	**271,242**	**314,363**	**371,723**
Cost of revenues (incl. deprn)	(178,368)	(186,299)	(212,962)	(253,554)
Revenues	**76,196**	**84,943**	**101,401**	**118,169**
SG&A expenses (incl. deprn)	(32,458)	(33,430)	(40,034)	(46,143)
EBITA	**43,738**	**51,513**	**61,368**	**72,027**
Amortization of intangibles	(1,488)	—	—	—
EBIT	**42,250**	**51,513**	**61,368**	**72,027**
Other income	369	3,369	5,171	7,549
Pre-tax profits	**42,619**	**54,882**	**66,539**	**79,575**
Provision for tax	(5,247)	(9,293)	(12,406)	(16,778)
PAT	**37,372**	**45,589**	**54,133**	**62,797**
Equity in earnings of affiliates	362	530	628	628
Reported PAT	**37,734**	**46,119**	**54,761**	**63,425**
EPS (Rs)	**15.4**	**18.9**	**22.3**	**25.7**
Balance Sheet				
Shareholders funds	150,182	196,112	240,351	290,580
Deferred tax liability/(assets)	—	—	—	—
Borrowings	27,563	26,009	9,158	10,829
Minority interest	235	437	748	1,203
Total liabilities	**177,980**	**222,558**	**250,258**	**302,613**
Net fixed assets	49,862	53,458	60,933	68,168
Cash and bank balances	65,297	95,298	63,579	97,604
Net current assets excluding cash	(13,143)	2,846	52,713	61,253
Other assets	75,964	70,956	73,033	75,588
Total assets	**177,980**	**222,558**	**250,258**	**302,613**
Cashflow statement				
Operating profit before working capital changes	52,193	59,056	71,017	83,103
Tax paid	(5,247)	(9,293)	(12,406)	(16,778)
Change in working capital/other adjustments	(11,753)	(9,709)	(5,656)	(8,796)
Capital expenditure	(16,234)	(12,979)	(17,124)	(18,311)
Investments/ acquisitions	(6,764)	(5,713)	—	—
Free cash flow	**12,194**	**21,362**	**35,832**	**39,217**

Note:
(1) US GAAP financials till FY2009; IFRS starting FY2010.

Source: Company, Kotak Institutional Equities estimates

Exhibit 9: Operating Metrics Pertaining to IT Services Segments

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
IT services revenues (US$ mn)	1,068	1,110	1,100	1,046	1,033	1,065	1,127	1,166	1,204
Service line split of revenues (%)									
Technology Infrastructure practices	18.6	19.5	19.4	20.9	20.9	20.6	21.3	21.6	21.1
Testing services	10.8	11.1	11.5	11.9	12.1	12.0	11.5	11.7	11.4
Package Implementation	11.0	11.2	11.7	12.8	13.4	13.3	12.8	12.7	13.5
BPO	8.6	8.5	8.5	9.1	10.1	10.5	10.6	10.9	10.1
Product engineering	5.7	6.0	5.8	5.2	4.6	3.9	4.1	4.1	4.7
ADM	45.3	43.7	43.1	40.1	38.9	39.7	39.7	39.0	39.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Consulting	2.6	2.5	2.3	2.1	2.0	2.3	2.3	2.7	2.6
Vertical split of revenues (%)									
Technology, media and telecom	31.0	29.2	28.8	26.9	26.7	26.4	26.1	25.6	25.7
- Technology	11.9	11.2	10.9	9.9	9.4	8.7	8.4	8.6	8.5
- Telecom	10.3	9.5	9.6	8.8	8.4	8.1	7.9	8.2	8.1
- Communications & media service provider	8.8	8.5	8.3	8.2	8.9	9.6	9.8	8.8	9.1
Financial services	25.4	26.3	26.0	26.0	26.3	25.7	25.8	26.1	26.9
Manufacturing	14.3	14.7	15.3	16.3	15.5	15.6	15.1	14.8	15.1
Healthcare and services	7.8	7.9	7.3	7.4	8.0	8.1	8.7	9.2	8.5
Retail & trasnportation	12.8	13.6	14.5	15.6	15.2	15.2	14.8	14.7	14.9
Energy & Utilities	8.7	8.3	8.1	7.8	8.3	9.0	9.5	9.6	8.9
Geographical split of revenues (%)									
US	59.8	59.4	60.0	60.5	59.7	58.4	57.1	56.7	57.3
Europe	26.9	26.9	26.1	25.5	25.5	26.5	26.3	26.3	25.4
Japan	2.7	2.5	2.4	2.3	1.8	1.6	1.6	1.5	1.5
India and Middle east business	7.1	7.8	7.5	7.7	7.9	8.1	8.9	8.8	9.0
Other emerging markets	3.5	3.4	4.0	4.0	5.1	5.4	6.1	6.7	6.8
Client metrics									
Customer size distribution (TTM)									
Million dollar clients of which	404	426	436	427	413	403	398	406	434
> US$50 mn	14	16	16	17	17	16	16	16	17
US$20 mn - US$50 mn	33	34	36	36	36	35	37	40	41
US$10 mn - US$20 mn	33	35	37	40	44	48	42	40	42
US$5 mn - US$10 mn	58	59	62	60	59	53	61	70	65
US$3 mn - US$5 mn	71	77	80	67	63	64	77	60	73
US$1 mn - US$3 mn	195	205	205	207	194	187	165	180	196
Repeat business (%)	99.2	98.4	96.7	96.8	99.5	98.1	97.8	96.5	99.6
New client additions	31	28	31	20	26	37	31	27	22
Total active customers	928	906	882	863	830	840	822	845	858
Customer concentration (%)									
Top customer	2.7	2.7	2.5	2.4	2.6	2.7	2.6	2.5	2.9
Top 5 customers	11.4	11.5	11.3	10.8	11.4	11.3	10.8	10.5	10.9
Top 10 customers	20.9	20.4	20.2	19.7	20.6	19.7	19.5	19.3	19.8
Employees (IT services)	95,675	97,552	96,965	97,810	98,251	97,891	102,746	108,701	112,925
Utilization (%)									
Global IT Services excl IFOX-Gross (a) (b)	67.9	70.3	69.8	68.4	70.0	70.8	73.2	72.1	71.3
Global IT Services excl IFOX-Net	74.4	77.0	76.6	75.4	77.1	78.2	80.7	79.3	78.4
Global IT Services excl IFOX -Net Excluding Trainees	78.3	79.3	79.4	76.8	78.2	80.5	84.5	83.0	81.6
Attrition (%)									
Global IT Services - Voluntary	14.7	11.0	11.9	7.9	8.4	10.5	13.4	17.1	23.0
Global IT Services - Involuntary Quarterly	2.0	10.0	8.0	10.4	7.7	12.4	3.6	2.1	1.4
BPO %- Quarterly	18.0	19.0	18.0	13.0	14.0	17.0	15.0	17.0	16.0
Sales & Support Staff - IT Services (avg)	7,458	7,343	7,518	7,765	7,670	7,752	7,971	8,309	8,783
Global IT Services (Excluding Infocrossing & BPO). CITOS is included from Q1 FY 09-10									
Revenues by project type (%)									
Fixed price	30.6	31.6	36.0	38.1	38.4	40.3	42.5	44.3	44.6
Time and material	69.4	68.4	64.0	61.9	61.6	59.7	57.5	55.7	55.4
Onsite-offshore revenue split (%)									
Onsite	53.9	54.1	53.2	51.2	49.6	49.9	50.3	49.4	52.2
Offshore	46.1	45.9	46.8	48.8	50.4	50.1	49.7	50.6	47.8
Price realization									
- Onsite	11,780	11,999	11,534	11,632	11,787	12,340	12,299	12,254	11,654
- Offshore	4,402	4,482	4,409	4,405	4,302	4,450	4,345	4,352	4,291
Person manmonths available									
Onsite	39,825	40,473	40,960	36,102	34,607	34,070	35,505	36,206	42,117
Offshore	127,403	122,935	127,004	123,833	126,628	122,581	123,428	132,063	135,970
Support	15,967	15,768	16,279	16,467	16,390	16,216	16,309	16,863	17,729
Total	183,195	179,176	184,243	176,402	177,625	172,867	175,242	185,132	195,816
Person manmonths billed									
Onsite	37,833	38,449	38,912	34,296	32,876	32,367	33,730	34,396	40,011
Offshore	86,548	87,423	89,706	86,277	91,454	90,093	94,487	99,067	99,698
Total	**124,381**	**125,872**	**128,618**	**120,573**	**124,330**	**122,460**	**128,217**	**133,463**	**139,709**

Note:
(a) Global IT Services consists of Services provided world-wide except India & Middle East Business
(b) CITOS is included for Utilization computation for Global IT Services from Q1 FY10

Source: Company

kotak Institutional Equities

Indian Oil Corporation (IOCL)

Energy

ADD

JULY 26, 2010

RESULT

Coverage view: Cautious

Price (Rs): 373

Target price (Rs): 415

BSE-30: 18,131

Deregulation and subsidy-sharing more pertinent than quarterly results. IOCL reported lower-than-expected 1QFY11 EBITDA at –₹26.7 bn versus our estimate of ₹18 bn as the company provided for the direct budgetary support on LPG and kerosene only. IOCL reported 1QFY11 refining margins at US$3/bbl versus US$3.4/bbl in 4QFY10 and US$7.4/bbl in 1QFY10. We note that (1) implementation of deregulation of auto fuels and (2) finalization of subsidy-sharing mechanism will be key for FY2011E earnings.

Company data and valuation summary

Indian Oil Corporation

Stock data			
52-week range (Rs) (high,low)			418-257
Market Cap. (Rs bn)			906.2
Shareholding pattern (%)			
Promoters			78.9
FIIs			0.7
MFs			1.7
Price performance (%)	**1M**	**3M**	**12M**
Absolute	7.2	32.8	40.9
Rel. to BSE-30	4.9	29.6	18.4

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	49.9	38.8	41.1
EPS growth (%)	406.8	(22.3)	5.9
P/E (X)	7.5	9.6	9.1
Sales (Rs bn)	2,691.4	3,357.4	3,553.5
Net profits (Rs bn)	121.1	94.1	99.7
EBITDA (Rs bn)	216.7	214.3	222.0
EV/EBITDA (X)	5.1	5.1	4.6
ROE (%)	22.7	15.6	15.1
Div. Yield (%)	3.5	3.2	3.3

No support from government in 1QFY11; will likely be given in subsequent quarters

IOCL reported 1QFY11 EBITDA at –₹26.7 bn versus ₹86.5 bn in 4QFY10 and ₹50 bn in 1QFY10; our estimate was at ₹17.7 bn. The weaker-than-expected performance was primarily due to nil compensation from the government for under-recoveries versus ₹74 bn assumed by us. We note that the company provided for ₹4 bn as direct budgetary support for subsidy on LPG and kerosene. We would not be unduly perturbed by the lack of compensation from the government as it will likely follow in subsequent quarters after the finalization of the subsidy-sharing scheme. IOCL's 1QFY11 refining margin was US$3/bbl versus US$3.4/bbl in 4QFY10 and US$7.4/bbl in 1QFY10. 1QFY11 sales volumes increased 4.1% yoy to 17.3 mn tons reflecting strong demand in auto fuels.

Stock performance and earnings will depend on subsidy-sharing scheme and deregulation

We note that the earnings and stock performance of downstream companies will depend on (1) deregulation of auto fuels and (2) subsidy-sharing scheme. We expect gasoline prices to be deregulated by August 1, 2010 and diesel to be deregulated by January 2011 with the easing of inflationary concerns. We would take comfort in a recent statement of India's petroleum ministry secretary on the government providing compensation for at least 50% of the under-recoveries after reviewing the performance of the downstream companies.

Reasonable upside to current target price; large upside in our blue-sky scenario

We find IOCL's valuation reasonable with the stock offering 11% potential upside to our target price of ₹415 based on 8X FY2012E adjusted EPS plus value of investments. We see large upside to IOCL's net profits assuming (1) deregulation of auto fuel prices and (2) full compensation for subsidy loss on cooking fuels (see Exhibit 1).

Revised earnings; increased marketing margins on deregulated products

We have raised our FY2011-13E EPS to ₹38.8 (+14%), ₹41.1 (+9.7%) and ₹43.8 (+14.3%) to reflect (1) 1QFY11 results, (2) weaker rupee and (3) other minor changes. Our earnings estimates are based on the philosophy that the government will provide adequate compensation to ensure a certain level of profits for the downstream companies and restrict the net under-recoveries of the downstream oil companies to around ₹55 bn.

QUICK NUMBERS

- 1QFY11 EBITDA at –₹26.7 bn versus ₹86.5 bn in 4QFY10
- Change of US$1/bbl in refining margin impacts EPS by 13%
- 20% potential upside to earnings assuming nil subsidy burden in FY2012E

Gundeep Singh
gundeep.singh@kotak.com
Mumbai: +91-22-6634-1286

Sanjeev Prasad
sanjeev.prasad@kotak.com
Mumbai: +91-22-6634-1229

Tarun Lakhotia
tarun.lakhotia@kotak.com
Mumbai: +91-22-6634-1188

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

IOCL's earnings can jump significantly in a blue sky scenario
EPS estimates, March fiscal year-ends, 2012-13E (₹)

	2012E	2013E
Base case	41	44
Blue sky scenario (a)	49	52
Potential upside (%)	**20**	**18**

Note:
(a) Assuming deregulation of auto fuels and full compensation of cooking fuels subsidy loss.

Source: Kotak Institutional Equities estimates

Key financial and operating details of 1QFY11 results

Exhibit 2 gives key highlights of IOCL's 1QFY11 results and compares the same on yoy and qoq basis. We do not see merit in a comparison of quarterly results given high volatility in the timing and quantum of compensation from government and upstream companies. To help understand the results better, we annualize the reported 1QFY11 EBITDA of IOCL after adjusting it for various items—we add back the under-recoveries and remove adventitious gains and forex losses to arrive at the 'normalized' EBITDA. We adjust the latter 'normalized' EBITDA for various amounts of net under-recoveries to be borne by downstream companies (0%, 10% and 17%) and compare the same with our base-case FY2011E EBITDA (see Exhibit 3).

Interim results of Indian Oil Corp., March fiscal year-ends (₹ mn)

					(% chg.)			
	1QFY11	**1QFY11E**	**1QFY10**	**4QFY10**	***1QFY11E***	***1QFY10***	***4QFY10***	**2011E**
Net sales (a)	719,245	890,622	591,796	785,770	*(19.2)*	*21.5*	*(8.5)*	3,357,352
Total expenditure	(745,901)	(872,874)	(541,806)	(699,312)	*(14.5)*	*37.7*	*6.7*	(3,185,442)
Increase/(Decrease) in stocks	1,660		5,099	17,334				
Purchase of products/crude for resale	(361,367)	(447,199)	(259,313)	(338,765)	*(19.2)*	*39.4*	*6.7*	(1,645,509)
Consumption of raw materials	(347,950)	(397,980)	(246,385)	(331,437)	*(12.6)*	*41.2*	*5.0*	(1,440,716)
Staff cost	(9,832)	(13,128)	(9,915)	(19,498)	*(25.1)*	*(0.8)*	*(49.6)*	(45,379)
Other expenditure (a)	(28,412)	(14,567)	(31,291)	(26,946)	*95.0*	*(9.2)*	*5.4*	(53,837)
EBITDA	**(26,657)**	**17,748**	**49,990**	**86,457**	***(250.2)***	***(153.3)***	***(130.8)***	**171,910**
Other income	8,830	7,702	15,044	5,232	*14.6*	*(41.3)*	*68.8*	32,036
Interest	(5,712)	(1,950)	(3,340)	(4,357)	*192.9*	*71.0*	*31.1*	(21,216)
Depreciation	(10,346)	(11,026)	(7,598)	(8,872)	*(6.2)*	*36.2*	*16.6*	(44,023)
Pretax profits	**(33,884)**	**12,474**	**54,096**	**78,460**	***(371.6)***	***(162.6)***	***(143.2)***	**138,707**
Previous years arrears/extraordinary income	—		—	—				—
Tax	—	(2,486)	(15,298)	(32,037)				(36,265)
Deferred tax	—	(2,476)	(1,969)	9,144				(9,810)
Net income	**(33,884)**	**7,512**	**36,828**	**55,568**	***(551.0)***	***(192.0)***	***(161.0)***	**92,632**
Tax rate (%)	0.0	39.8	31.9	29.2				33.2
Volume data								
Crude throughput (mn tons)	13.3	13.3	12.5	13.3		*6.5*	*(0.0)*	53.1
Domestic sales (mn tons)	17.3	17.0	16.6	16.6		*4.1*	*3.7*	67.3
Export sales (mn tons)	1.1		1.1	1.1		*(1.8)*	*(3.6)*	
Pipelines throughput (mn tons)	16.5		16.1	16.9		*2.4*	*(2.7)*	
Refining margin (US$/bbl)	3.0	2.7	7.4	3.4		*(59.2)*	*(12.5)*	4.7
Inventory gain/(loss)-products (Rs mn)	5,171	(3,680)	17,330	(180)				7,500
Direct budgetary support	3,976	3,837	3,860	4,243				16,030
Subsidy gain/(loss) (Rs mn)	(110,139)	(117,511)	(31,902)	(91,575)				(283,009)
Receipt from upstream companies (Rs mn)	36,713	35,253	2,291	32,454				94,336
Oil bonds/cash from government (Rs mn)	—	74,032	—	106,894				158,485
Net under-recovery	(73,426)	(8,226)	(29,611)	47,772				(30,188)
Exchange gain/(loss) (Rs mn)	(4,675)	—	6,528	6,940				(4,915)

(a) Reported sales and other expenditure include freight costs and local taxes. Our estimates are without the same.

Source: Company, Kotak Institutional Equities estimates

Annualized EBITDA, March fiscal year-end, 2011E (₹ bn)

1QFY11 EBITDA	**(26.7)**
Add: gross under-recovery	110.1
Less: receipt from upstream companies	(36.7)
Less: reported inventory gain	(5.2)
Add: reported exchange loss	4.7
Annualized EBITDA assuming nil subsidy burden	**185.1**
Annualized EBITDA assuming 10% subsidy burden	156.8
Annualized EBITDA assuming 17% subsidy burden	137.0
KIE estimate of FY2011E EBITDA (adjusted for adventitious gains and forex loss)	**159.5**

Source: Company, Kotak Institutional Equities estimates

- **Refining margins declined qoq in 1QFY11.** IOCL's 1QFY11 refining margin declined moderately to US$3/bbl versus US$3.4/bbl in 4QFY10 and US$7.4/bbl in 1QFY10. This is in line with the qoq decline in global benchmark margins.

- **Compensation (cash) from the government and discounts from the upstream oil companies.** IOCL did not receive any compensation from the government in 1QFY11 (barring ₹4 bn of direct payment from the budget on kerosene and LPG) which was the case in 1QFY10 as well. IOCL received ₹36.7 bn of discounts from the upstream companies in 1QFY11 compared to ₹2.3 bn in 1QFY10 and ₹32.5 bn in 4QFY10. Its net under-recovery was ₹73.4 bn compared to under-recovery of ₹29.6 bn in 1QFY10.

- **Refining throughput and sales volumes.** IOCL's refineries processed 13.3 mn tons of crude in 1QFY11 compared to 13.3 mn tons in 4QFY10 and 12.5 mn tons in 1QFY10. IOCL's sales volume (domestic sales) was 17.3 mn tons (+3.7% qoq, +4.1% yoy).

- **Other highlights.** IOCL's reported EBITDA includes adventitious gains of ₹5.2 bn and foreign exchange loss of ₹4.7 bn. The latter is included in other expenditure.

- **Taxation.** IOCL has not provided for current and deferred tax in 1QFY11 due to uncertainty in estimation of profits pending finalization of subsidy-sharing scheme.

Earnings revisions and key assumptions behind earnings model

We have fine-tuned FY2011E, FY2012E and FY2013E EPS estimates to ₹38.8, ₹41.1 and ₹43.8 from ₹34, ₹37.4 and ₹38.3. The revision in earnings reflects (1) 1QFY11 results, (2) weaker rupee and (3) other minor changes. We discuss key assumptions behind our earnings model below.

- **Refining margins.** We model refining margin (standalone) for IOCL at US$4.7/bbl in FY2011E, US$5.3/bbl in FY2012E and US$5.9/bbl in FY2013E compared to US$4.5/bbl in FY2010. We expect refining margins to remain weak in CY2010-11E due to (1) global demand weakness and (2) significant refining capacity additions in CY2010-11E (2.3 mn b/d plus 1.2 mn b/d of additional OPEC NGL supply). We assume adventitious gains at ₹7.5 bn in FY2011E and nil gains or losses for the future years.

- **Crude throughput.** We model crude throughput at 53.1 mn tons, 53.1 mn tons and 53.1 mn tons in FY2011E, FY2012E and FY2013E versus 50.7 mn tons in FY2010. The yoy jump in crude throughput in FY2011E reflects full year of operation of Panipat's expanded capacity (15 mtpa).

- **Marketing margins.** We model marketing margin on diesel and gasoline at –₹593/ton and –₹1,890/ton in FY2011E and ₹1,700/ton and ₹1,900/ton in FY2012E compared to ₹1,113/ton and –₹3,929/ton in FY2010. We assume losses on LPG and kerosene throughout our forecast period.

- **Compensation from government and discount from upstream companies.** For FY2011-13E, we assume the government will restrict the amount of net under-recoveries at around ₹55 bn for the downstream oil companies and will give sufficient compensation to maintain the profitability of downstream companies at a certain level. We model IOCL to receive compensation of ₹158 bn, ₹105 bn and ₹127 bn from the government in FY2011E, FY2012E and FY2013E. We assume IOCL to receive discount of ₹94 bn for FY2011E, ₹67 bn for FY2012E and ₹78 bn for FY2013E from the upstream companies. We assume net under-recoveries at ₹30 bn, ₹30 bn and ₹28 bn for FY2011E, FY2012E and FY2013E.

- **Exchange rate.** We now assume ₹/US$ exchange rate for FY2011E, FY2012E and FY2013E at ₹46/US$, ₹46/US$ and ₹46/US$ versus ₹45/US$, ₹45.3/US$ and ₹45.3/US$ previously.

Stock offers 11% upside to our fair valuation of IOCL
Fair valuation of IOCL (₹)

Valuation based on P/E multiple	
Profit after tax for FY2012E (Rs mn)	97,538
Less: income from investment valued separately (Rs mn)	9,204
Adjusted profit after tax for FY2012E (Rs mn)	88,334
Adjusted EPS for FY2012E	36
P/E multiple (X)	8
Fair value on P/E (without value of investments) (A)	**291**
Add: Value of investments (Rs mn)	301,968
Chennai Petroleum Corp.	*20,012*
Oil and Natural Gas Corp.	*238,497*
Gas Authority of India	*15,162*
Petronet LNG Ltd.	*7,688*
IOC treasury shares (IBP Co.)	*12,831*
Other equity	*7,778*
Value of investments (Rs) (B)	**124**
Total equity value (A) + (B)	**415**
Current stock price	373
Potential upside (%)	11

Source: Kotak Institutional Equities estimates

IOCL earnings model assumptions, March fiscal year-ends, 2006-2014E

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Rs/US$	44.3	45.3	40.3	45.8	47.4	46.0	46.0	46.0	46.0
Weighted average duty on products (%)	8.2	6.7	6.5	3.7	2.6	5.9	5.9	5.9	5.9
Import duty on crude (%)	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2
Effective 'import duty' on domestic crude (%)	2.6	2.6	2.6	0.5	0.2	2.6	2.6	2.6	2.6
Effective duty protection (%)	**3.1**	**1.6**	**1.3**	**2.8**	**2.2**	**0.8**	**0.8**	**0.8**	**0.8**
Refinery yield (US$/bbl)	62.9	71.1	91.0	94.8	73.7	80.8	81.4	87.2	87.2
Cost of crude (US$/bbl)									
Domestic - Northeast	52.9	61.8	74.8	87.3	67.6	71.6	71.6	76.6	76.6
- Gujarat	50.9	58.4	73.8	84.1	64.4	68.4	68.4	73.4	73.4
- Rest of India	58.5	67.2	82.2	92.9	69.2	73.2	73.2	78.2	78.2
Imported	56.7	65.2	80.3	91.3	69.7	73.7	73.7	78.7	78.7
Landed cost of crude (US$/bbl)	58.0	66.9	82.8	91.1	69.2	76.1	76.1	81.3	81.3
Net refining margin (US$/bbl)	**4.8**	**4.2**	**8.2**	**3.6**	**4.5**	**4.7**	**5.3**	**5.9**	**5.9**
Crude throughput (mn tons)	**38.5**	**44.0**	**47.4**	**51.3**	**50.7**	**53.1**	**53.1**	**53.1**	**53.1**
Domestic - Northeast	1.5	1.5	1.5	2.1	2.1	2.1	2.1	2.1	2.1
- Gujarat	5.9	5.9	5.9	6.0	5.8	5.8	5.8	5.8	5.8
- Rest of India	2.7	2.7	2.7	4.9	4.8	4.9	4.9	4.9	4.9
Imported	28.4	33.9	37.3	38.3	38.0	40.3	40.3	40.3	40.3
Other products	0.8	1.1	1.1	1.4	1.4	1.4	1.4	1.4	1.4
Fuel and loss	3.1	3.9	4.2	4.5	4.5	4.7	4.7	4.7	4.7
Production of main products	34.6	38.9	42.1	45.4	44.8	47.0	47.0	47.0	47.0
Fuel and loss (%)	8.1	8.9	8.8	8.8	8.8	8.8	8.8	8.8	8.8
Sales volume (mn tons)	**50.4**	**53.4**	**57.4**	**61.0**	**64.0**	**67.3**	**71.0**	**74.5**	**78.3**
Marketing margin (Rs/ton)	**26**	**(633)**	**(2,203)**	**(5,253)**	**874**	**409**	**1,791**	**1,775**	**1,773**

Source: Company, Kotak Institutional Equities estimates

Earnings sensitivity of IOC (standalone) to refining margins and marketing margins (₹ mn)

	Fiscal 2011E			Fiscal 2012E			Fiscal 2013E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Refining margins									
Refining margins (US$/bbl)	3.7	4.7	5.7	4.3	5.3	6.3	4.9	5.9	6.9
Net profits (Rs mn)	80,219	92,632	105,045	85,125	97,538	109,951	90,989	103,402	115,815
EPS (Rs)	33.0	38.2	43.3	35.1	40.2	45.3	37.5	42.6	47.7
% upside/(downside)	**(13.4)**		**13.4**	**(12.7)**		**12.7**	**(12.0)**		**12.0**
Marketing margins									
Transportation fuels margins (Rs/ton)	(955)	(805)	(655)	1583	1733	1883	1583	1733	1883
Net profits (Rs mn)	92,213	92,632	93,051	93,281	97,538	101,795	98,840	103,402	107,964
EPS (Rs)	38.0	38.2	38.3	38.4	40.2	41.9	40.7	42.6	44.5
% upside/(downside)	**(0.5)**		**0.5**	**(4.4)**		**4.4**	**(4.4)**		**4.4**

Source: Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of IOCL, March fiscal year-ends, 2006-2014E (₹ mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Profit model (Rs mn)									
Net sales	1,729,474	2,149,428	2,444,378	3,041,265	2,691,360	3,357,352	3,553,508	3,969,795	4,167,576
EBITDA	**82,044**	**110,451**	**120,872**	**61,445**	**178,821**	**181,296**	**187,783**	**198,596**	**202,167**
Other income	21,310	27,451	43,748	45,155	37,890	33,036	34,179	35,546	34,593
Interest	(12,101)	(17,058)	(17,556)	(41,758)	(16,638)	(23,392)	(20,716)	(18,646)	(14,648)
Depreciation	(24,711)	(28,686)	(29,918)	(31,389)	(34,943)	(47,849)	(48,921)	(52,094)	(52,927)
Pretax profits	66,542	92,157	117,145	33,453	165,131	143,091	152,325	163,402	169,185
Extraordinary items	5,590	24,757	5,374	—	(17,232)	—	—	—	—
Tax	(19,975)	(25,834)	(38,293)	(13,316)	(46,713)	(37,346)	(44,519)	(51,446)	(55,549)
Deferred taxation	(1,282)	(8,040)	(473)	1,435	5,556	(10,185)	(6,079)	(2,832)	(650)
Net profits	51,125	82,729	83,430	25,523	108,238	95,559	101,726	109,124	112,986
Net profits after minority interests	**45,331**	**62,702**	**74,517**	**27,437**	**117,767**	**94,149**	**99,708**	**106,366**	**110,056**
Earnings per share (Rs)	**19.4**	**26.3**	**31.2**	**11.5**	**48.6**	**38.8**	**41.1**	**43.8**	**45.3**
					48.6	34.0	37.4	38.3	39.4
Balance sheet (Rs mn)									
Total equity	317,977	378,117	450,449	470,654	547,803	596,245	661,399	731,309	803,695
Deferred tax liability	50,602	59,859	60,331	58,876	54,072	63,505	69,585	72,416	73,066
Total borrowings	292,395	290,215	382,818	465,250	497,523	491,133	406,087	336,441	244,547
Currrent liabilities	286,716	330,791	386,724	376,107	472,991	514,696	527,896	556,167	565,999
Total liabilities and equity	**947,691**	**1,058,981**	**1,280,322**	**1,370,888**	**1,572,389**	**1,665,580**	**1,664,967**	**1,696,333**	**1,687,307**
Cash	8,080	9,385	8,413	8,076	12,156	12,043	11,072	12,334	12,167
Current assets	413,904	437,178	599,256	473,965	648,895	755,333	776,233	835,511	855,740
Total fixed assets	383,717	415,014	460,307	565,545	691,510	694,293	698,753	669,579	640,490
Investments	141,990	197,403	212,345	323,301	219,828	203,910	178,910	178,910	178,910
Total assets	**947,691**	**1,058,981**	**1,280,322**	**1,370,888**	**1,572,389**	**1,665,580**	**1,664,967**	**1,696,333**	**1,687,307**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	(10,334)	(44,660)	(107,263)	(345,677)	95,357	118,509	119,837	132,185	114,942
Working capital changes	(8,136)	2,237	(1,414)	76,881	(36,589)	(77,933)	(3,602)	(44,501)	10,870
Capital expenditure	(49,042)	(50,969)	(79,586)	(135,923)	(127,749)	(53,936)	(51,407)	(22,897)	(25,313)
Investments	(17,778)	99,768	92,665	299,410	98,991	14,188	25,015	14	849
Other Income	10,317	13,582	18,253	16,413	7,950	38,359	33,149	34,371	33,375
Free cash flow	**(74,973)**	**19,958**	**(77,346)**	**(88,896)**	**37,959**	**39,187**	**122,992**	**99,172**	**134,724**
Ratios (%)									
Debt/equity	79.3	66.3	74.9	87.9	82.7	74.4	55.6	41.9	27.9
Net debt/equity	77.1	64.1	73.3	86.3	80.6	72.6	54.0	40.3	26.5
RoAE	13.7	16.1	16.3	5.5	21.5	15.4	14.7	14.2	13.4
RoACE	**9.4**	**11.2**	**11.4**	**5.1**	**12.5**	**9.9**	**10.1**	**10.7**	**10.9**
Key assumptions (IOC standalone)									
Crude throughput (mn tons)	38.5	44.0	47.4	51.3	50.7	53.1	53.1	53.1	53.1
Effective tariff protection (%)	3.1	1.6	1.3	2.8	2.2	0.8	0.8	0.8	0.8
Net refining margin (US$/bbl)	4.8	4.2	8.2	3.6	4.5	4.7	5.3	5.9	5.9
Sales volume (mn tons)	50.4	53.4	57.4	61.0	64.0	67.3	71.0	74.5	78.3
Marketing margin (Rs/ton)	26	(633)	(2,203)	(5,253)	874	409	1,791	1,775	1,773
Subsidy under-recoveries (Rs mn)	(47,740)	(21,900)	(97,738)	—	(31,588)	(30,188)	(29,527)	(28,378)	(27,677)

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Hindustan Zinc (HZ)

Metals

BUY

JULY 26, 2010

RESULT

Coverage view: Cautious

Price (Rs): 993

Target price (Rs): 1,240

BSE-30: 18,131

Lower grade of ore impacts production and 1QFY11 performance. Hindustan Zinc's (HZ) 1QFY11 net income of Rs8.9 bn was 14.9% lower than our estimate. Lower production from the Rampura Agucha mine and maintenance of one of the mills led to lower-than-expected production in 1QFY11. We maintain our BUY rating on HZ on inexpensive valuations; trading at 5.1X FY2011E and 3.5X FY2012E EBITDA. Aggressive volume growth and increase in silver production provides strong support to valuations.

Company data and valuation summary

Hindustan Zinc

Stock data			
52-week range (Rs) (high,low)			1,384-644
Market Cap. (Rs bn)			419.7
Shareholding pattern (%)			
Promoters			64.9
FIIs			2.2
MFs			1.1
Price performance (%)	**1M**	**3M**	**12M**
Absolute	(0.2)	(18.3)	45.1
Rel. to BSE-30	(2.3)	(20.3)	21.9

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	95.6	102.5	116.0
EPS growth (%)	48.2	7.2	13.1
P/E (X)	10.4	9.7	8.6
Sales (Rs bn)	80.2	91.1	109.3
Net profits (Rs bn)	40.4	43.3	49.0
EBITDA (Rs bn)	46.7	51.8	62.8
EV/EBITDA (X)	6.5	5.1	3.5
ROE (%)	24.1	20.8	19.4
Div. Yield (%)	0.6	0.6	0.6

1QFY11 performance impacted by lower-than-expected production

HZ reported net income of Rs8.9 bn (+23.9% yoy, -28.1% qoq), lower than our estimate of Rs10.5 bn. Overall performance was impacted by lower grades from Rampura Agucha mine and repair and maintenance of one of the mills. As a result, mined metal production (zinc and lead) declined to 182K from 193K in 4QFY10. Refined silver production was 43.3 tons versus 51.4 tons in 4QFY10 and 41.5 tons in 1QFY10. EBITDA of Rs10.2 bn was 20.6% lower than our estimate. Lower grade of ore lead to higher stripping cost at mines and consequently, an increase in raw material and other costs. Average LME zinc price for 1QFY11 was US$2,018/ ton and lead price was US$1,944/ ton. Average realizations of US$2,144/ ton for zinc and US$2,252/ ton for lead were in line with our expectations. HZ sold 35.8 tons of silver during the quarter.

Aggressive expansion plans and increase in silver production provides support to valuations

Hindustan Zinc recently commissioned 210 ktpa hydro zinc smelter at Dariba and 1 mtpa zinc concentrator at Rampura Agucha. As a result, its total zinc-lead capacity increased to 964 ktpa. This expansion contributed 33K tons of production in 1QFY10. Work on the 100 ktpa lead smelter and 160MW CPP at Dariba is progressing well for its scheduled completion in 2QFY11.

HZ is also setting up a new silver refinery at Dariba. This, along with expansion of Sindesar Khurd mine capacity (which has high silver particles in the ore), will lead to an increase in silver production capacity to 500 tons from 180 tons in FY2010. HZ indicates that silver refining costs are negligible; implying that significant portion of realization will flow through to the earnings. We forecast silver production of 179, 308 and 373 tons in FY2011E, FY2012E and FY2013E.

Maintain BUY on attractive valuations

We maintain our BUY rating and with a 12-month target price of Rs1,240/share. We maintain our EPS estimate of Rs102.5, Rs116 and RS129.3 for FY2011E, FY2012E and FY2013E, respectively. Our EPS estimates are based on zinc price of US$1,900, US$2,000 and US$2,100/ ton for FY2011E, FY2012E and FY2013E, respectively. We maintain our BUY rating with a target price of Rs1,240/share. Note that our estimates do not include the recently announced acquisition of zinc assets of Anglo American

Kawaljeet Saluja
kawaljeet.saluja@kotak.com
Mumbai: +91-22-6634-1243

Karan Durante
karan.durante@kotak.com
Mumbai: +91-22-6634-1527

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Interim results of Hindustan Zinc , March fiscal year-ends (Rs mn)

	1QFY11	1QFY11E	1QFY10	4QFY10	(% chg.) 1QFY11E	1QFY10	4QFY10
Net sales	**19,734**	**22,529**	**15,266**	**25,449**	**(12.4)**	**29.3**	**(22.5)**
Total expenditure	(9,516)	(9,663)	(7,443)	(9,967)	(1.5)	27.8	(4.5)
Inc/(Dec) in stock	700	-	(569)	(530)	—	(223.0)	(232.1)
Raw materials	(6,402)	(5,441)	(4,431)	(5,133)	17.7	44.5	24.7
Staff cost	(1,551)	(1,703)	(920)	(1,906)	(8.9)	68.7	(18.6)
Other expenditure	(2,332)	(2,803)	(1,637)	(2,953)	(16.8)	42.5	(21.0)
EBITDA	**10,218**	**12,867**	**7,823**	**15,482**	**(20.6)**	**30.6**	**(34.0)**
OPM (%)	**51.8**	**57.1**	**51.2**	**60.8**			
Other income	1,584	1,432	1,802	1,345	10.6	(12.1)	17.8
Interest	(66)	-	(32)	(277)	—	104.7	(76.3)
Depreciation	(1,123)	(1,208)	(748)	(1,006)	(7.0)	50.1	11.6
Pretax profits	**10,614**	**13,091**	**8,845**	**15,543**	**(18.9)**	**20.0**	**(31.7)**
Extraordinaries	—	—	—	—	—	—	—
Tax	(1,705)	(2,618)	(1,657)	(3,153)	(34.9)	2.9	(45.9)
Deferred taxation	—	—	(1,202)	—	—	—	—
Net income	**8,909**	**10,473**	**7,188**	**12,390**	**(14.9)**	**23.9**	**(28.1)**
Adjusted profits	**8,909**	**10,473**	**7,188**	**12,390**	**(14.9)**	**23.9**	**(28.1)**
Ratios							
EBITDA margin (%)	51.8	57.1	51.2	60.8			
ETR (%)	16.1	20.0	18.7	20.3			
EPS (Rs)	21.1	24.8	17.0	29.3			
Other details							
Sales volumes							
Zinc (tons)	164,445	160,833	138,015	151,294	2.2	19.2	8.7
Lead (tons)	14,075	19,695	15,073	18,450	(28.5)	(6.6)	(23.7)
Silver (kgs)	35,830	44,399	29,838	42,399	(19.3)	20.1	(15.5)
Average realizations (Rs/ton)							
Zinc	97,850	98,743	77,686	113,040	(0.9)	26.0	(13.4)
Lead	102,764	95,777	85,322	113,534	7.3	20.4	(9.5)
Silver	28,155	26,500	21,573	25,970	6.2	30.5	8.4

Source: Company, Kotak Institutional Equities estimates

Hindustan Zinc, valuation details, September 2011 basis

	EBITDA (Rs bn)	Multiple (X)	Enterprise Value (Rs bn)	Enterprise Value (Rs/ share)
Average of FY2011E and FY2012E EBITDA	57	6	344	814
Less: Net debt			(180)	(427)
Arrived market capitalization			**163**	**1,241**
Target price (Rs/share)				**1,240**

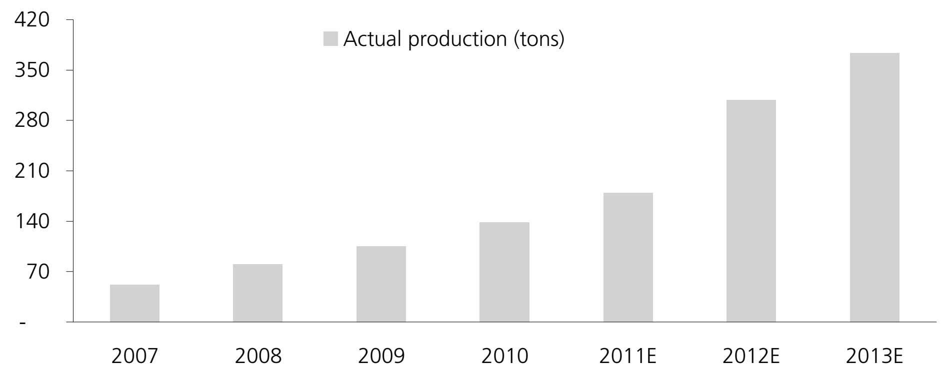
Source: Kotak Institutional Equities estimates

Hindustan Zinc, Key Assumptions, March fiscal-year ends, 2008-2013E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E
Volumes (tons)						
Zinc	425,532	552,330	577,685	703,200	791,100	835,050
Lead	58,298	60,564	64,391	101,750	148,000	155,400
Silver	82	103	139	179	308	373
Average realizations (Rs/ton)						
Zinc	125,946	70,353	99,421	95,147	99,911	102,572
Lead	122,771	86,385	105,922	94,617	98,858	101,541
Silver (Rs mn/ton)	19	20	25	27	28	28
LME-assumptions (US$/ton)						
Zinc	2,992	1,563	1,936	1,900	2,000	2,100
Lead	2,875	1,655	1,990	1,900	2,000	2,100
Cost per ton (US$/ton)	1,181	1,039	1,090	1,063	1,076	1,138

Source: Company, Kotak Institutional Equities estimates

Expect aggressive ramp up of silver production
Silver production details, March fiscal year ends, FY2007-13E



Source: Company, Kotak Institutional Equities estimates

Sensitivity of 2011 EPS to varying zinc price levels and Re/US$ rates

		Zinc (US$/ton)				
		2,200	2,050	1,900	1,750	1,600
Re/US$ Rate	44	116.9	106.7	96.6	86.5	76.3
	45	120.3	109.9	99.6	89.2	78.8
	46	123.7	113.1	102.5	91.9	81.3
	47	127.2	116.3	105.5	94.7	83.8
	48	130.6	119.5	108.5	97.4	86.3

Source: Kotak Institutional Equities estimates

Sensitivity of 2011 EPS to varying zinc price levels and lead price levels

		Zinc (US$/ton)				
		2,200	2,050	1,900	1,750	1,600
Lead (US$/ton)	2,200	123.7	114.5	105.3	96.0	86.8
	2,050	122.4	113.1	103.9	94.7	85.4
	1,900	121.0	111.8	102.5	93.3	84.1
	1,750	119.6	110.4	101.2	91.9	82.7
	1,600	118.3	109.0	99.8	90.6	81.3

Source: Kotak Institutional Equities estimates

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

	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	78,778	56,803	80,170	91,118	109,305	118,955
EBITDA	**53,784**	**27,342**	**46,701**	**51,759**	**62,822**	**68,246**
Other income	8,516	9,312	7,222	9,738	12,215	15,179
Interest	(242)	(219)	(439)	(307)	(338)	(372)
Depreciaiton	(2,205)	(2,853)	(3,343)	(4,187)	(4,687)	(5,013)
Profit before tax	**59,853**	**33,582**	**50,141**	**57,003**	**70,011**	**78,040**
Current tax	(14,673)	(5,209)	(8,309)	(11,980)	(18,962)	(20,962)
Deferred tax	(1,220)	(1,097)	(1,418)	(1,701)	(2,041)	(2,450)
Net profit	**43,961**	**27,276**	**40,414**	**43,322**	**49,008**	**54,628**
Earnings per share (Rs)	**104.0**	**64.6**	**95.6**	**102.5**	**116.0**	**129.3**
Balance sheet (Rs mn)						
Equity	118,482	143,576	181,240	221,596	267,638	319,299
Deferred tax liability	4,597	5,589	7,112	8,814	10,855	13,305
Total Borrowings	4	87	605	4	4	4
Current liabilities	8,984	10,010	13,258	13,474	11,177	11,415
Total liabilities	**132,067**	**159,261**	**202,215**	**243,888**	**289,673**	**344,023**
Net fixed assets	41,626	52,133	72,771	75,784	76,096	76,084
Investments	63,325	69,289	109,492	134,492	164,492	194,492
Cash	13,628	27,192	9,275	22,160	36,831	60,968
Other current assets	13,489	10,648	10,677	11,452	12,254	12,479
Miscellaneous expenditure	—	—	—	—	—	—
Total assets	**132,067**	**159,261**	**202,215**	**243,888**	**289,673**	**344,023**
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	39,120	23,460	45,555	49,211	55,737	62,090
Working capital changes	1,496	3,667	767	(559)	(3,100)	12
Capital expenditure	(13,667)	(13,743)	(22,492)	(7,200)	(5,000)	(5,000)
Free cash flow	**26,949**	**13,383**	**23,831**	**41,452**	**47,637**	**57,103**
Ratios						
Debt/equity (X)	0.0	0.0	0.0	0.0	0.0	0.0
Net debt/equity (X)	(0.6)	(0.6)	(0.6)	(0.7)	(0.7)	(0.8)
RoAE (%)	43.4	20.0	23.9	20.7	19.3	17.9
RoACE (%)	**43.6**	**20.2**	**24.1**	**20.8**	**19.4**	**18.0**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Maruti Suzuki (MSIL)

Automobiles

REDUCE

JULY 26, 2010

RESULT

Coverage view: Cautious

Price (Rs): 1,358

Target price (Rs): 1,200

BSE-30: 18,131

Hostage to technology. Suzuki raised the royalty it charges Maruti effective mid-December as royalty payments were freed under FEMA. Higher royalty expense and lower-than-expected financial other income resulted in a disappointing 1QFY11. We lowered our FY2011E & FY2012E EPS estimates to Rs78 and Rs88 from Rs94 and Rs104. We are downgrading the stock to REDUCE from ADD on reduced earnings and lack of earnings growth. We wouldn't look to enter into the stock above Rs1,100 levels.

Company data and valuation summary

Maruti Suzuki

Stock data			
52-week range (Rs) (high,low)			1,740-1,170
Market Cap. (Rs bn)			392.5
Shareholding pattern (%)			
Promoters			54.2
FIIs			21.1
MFs			2.7
Price performance (%)	**1M**	**3M**	**12M**
Absolute	(2.8)	1.8	(1.5)
Rel. to BSE-30	(5.7)	(0.3)	(16.4)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	86.4	77.6	88.3
EPS growth (%)	104.9	(10.2)	13.9
P/E (X)	15.7	17.5	15.4
Sales (Rs bn)	291.0	342.1	384.5
Net profits (Rs bn)	25.0	22.4	25.5
EBITDA (Rs bn)	34.6	33.2	36.9
EV/EBITDA (X)	9.7	10.0	8.8
ROE (%)	23.3	17.3	16.7
Div. Yield (%)	0.4	0.4	0.5

Maruti 1QFY11 misses on higher royalty payments and lower financial other income

Maruti reported 1QFY11 PAT of Rs4.65 bn, missing our estimate of Rs6.6 bn by a wide margin. The Rs2 bn miss was largely driven by Rs1.89 bn in higher royalty expenses and Rs1.25 bn in lower than expected financial other income. EBITDA for the quarter came in at Rs7.9 bn for a margin of 9.6% compared to our estimate of Rs9.4 bn and 11.3% EBITDA margin. Pursuant to amendments made to Maruti's royalty agreement with Suzuki, the company would be paying close to 5.1% of sales in royalty compared to 3.5% prior. The increase in royalty was triggered by the freeing up of foreign exchange payments towards royalty by the Government of India. Maruti's total royalty payment amounted to around Rs4.8 bn for the quarter or 5.9% of sales compared to 3.3% in 4QFY10 and 3.6% in 1QFY10. Additional royalty for the quarter compared to prior quarters amounted to Rs1.89 bn, Rs651 mn of which was towards prior quarters (16th December 2009 – 31st March 2010). Royalty payment would amount to 5.1% of sales starting 1QFY11.

Reducing FY2011E and FY2012E EPS estimates to Rs78 and Rs88 from Rs94 and Rs104

We are reducing our FY2011E EPS estimate to Rs78 from Rs94 prior. The Rs16 EPS reduction is driven by higher royalty payments (Rs12 per share) and lower financial other income (Rs4 per share). Our EBITDA margin for the year goes down to 10.7% from 12% prior. We have now modeled royalty expense of 5% of sales for FY2011E and FY2012E. Our FY2011E EPS estimate is based on 17% volume growth and flat realizations. Our estimate for flat realizations could be aggressive if we see renewed weakness in the Euro.

Reducing target to Rs1,200; downgrading to REDUCE

We are reducing our target for Maruti to Rs1,200 from Rs1,400 to reflect lower earnings power. We believe there could also be some de-rating of the stock, given the lack of income growth and abruptness of the change. Our Rs1,200 target is based on 13X FY2012E consolidated EPS estimate of Rs93 (Rs88 standalone EPS + Rs5 for share of profit from associates and subsidiaries). We expect the stock to be down in the 10-15% range today, but would not recommend buying into the stock above Rs1,100 levels. We expect headwinds and uncertainties in the form of competition, currency and mix to continue to pressure margins and limit upside on the stock.

Jairam Nathan CFA
jairam.nathan@kotak.com
Mumbai: +91-22-6634-1327

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Maruti misses 1QFY11 on higher royalty payments and lower financial income

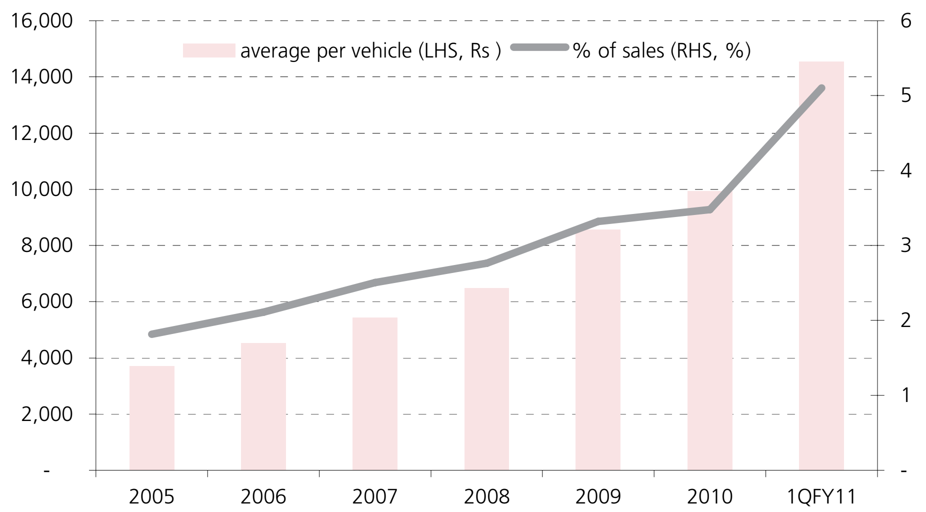
Maruti reported 1QFY11 PAT of Rs4.65 bn, missing our estimate of Rs6.6 bn by a wide margin. The Rs2 bn miss was largely driven by Rs1.89 bn in higher royalty expenses and Rs1.25 bn in lower than expected financial other income. EBITDA for the quarter came in at Rs7.9 bn for a margin of 9.6% compared to our estimate of Rs9.4 bn and 11.3% EBITDA margin. The Rs1.5 bn EBITDA miss was primarily related to the higher royalty expense offset by slightly higher than expected realizations.

Royalty would now amount to 5.1% of sales from 3.5% prior as foreign exchange requirement limits are removed

The Government of India through its Press Note, dated 16th December 2009, freed the withdrawal of foreign exchange for payment of royalty. Prior to the amendment, prior approval of the Ministry of Commerce and Industry was required to make royalty payments in foreign exchange exceeding 5% of local sales and 8% of exports. RBI notification for the same came on May 13, 2010 and allowed the change to be made with a retrospective effect. This change in rules seems to have triggered an amendment to Maruti's royalty agreement with Suzuki.

Pursuant to these amendments, Maruti's total royalty payment amounted to around Rs4.8 bn for the quarter or 5.9% of sales compared to 3.3% in 4QFY10 and 3.6% in 1QFY10. Additional royalty for the quarter compared to prior quarters amounted to Rs1.89 bn, Rs651 mn of which was towards prior quarters (December 16, 2009 –March 31, 2010). Going forward, royalty payment would amount to 5.1% of sales.

Exhibit 1: Past increases have largely been driven by mix changes
Royalty payments per vehicle and as a percentage of sales, March fiscal year ends, (2005-2010, 1QFY11)



Source: Company, Kotak Institutional Equities estimates

Maruti's royalty payments to Suzuki have increased over a period of time. But this has been largely driven by mix changes as royalty free vehicles such as 800, Omni and Gypsy became less important. However, the current change implies a step change to the amount of royalty Maruti will be paying on an individual vehicles basis. If we look at royalty as a proxy for R&D expense, the 5% of sales number does not seem excessive. Global automakers generally spend 5% of revenues towards R&D expenditure. The increase in the royalty rate seems to be driven by the significant investment by Suzuki into the K-series engine. The K-series engine offers good advancement in terms of weight, fuel efficiency and power. Going forward, with Maruti's own R&D facility coming up, new products designed locally would not be liable for royalty payments.

Other financial income totaled Rs1 bn compared to our Rs2.25 bn estimate and Rs2.2 bn last year

Maruti reported significantly lower-than-expected financial other income, which the company attributed to lower capital gains on sale of investments. This is a bit surprising, especially given the increase in investments that should have happened on the back of strong free cash flows during FY2010.

Exhibit 1: Interim results of Maruti Suzuki , March fiscal year-ends (Rs mn)

					(% chg.)					
	1QFY11	1QFY11E	1QFY10	4QFY10	1QFY11E	1QFY10	4QFY10	2011E	2010	(%chg)
Net sales	**80,904**	**81,444**	**63,647**	**82,808**	**(0.7)**	**27.1**	**(2.3)**	**342,082**	**290,989**	**17.6**
Other operating income	1,411	1,450	1,283	1,437	(2.7)	10.0	(1.8)	5,839	5,242	
Total expenditure	**(74,390)**	**(73,491)**	**(56,998)**	**(73,135)**	**1.2**	**30.5**	**1.7**	**(310,558)**	**(256,687)**	**21.0**
Inc/(Dec) in stock	(549)	600	596	(129)	(191.6)	(192.2)	327.5	2,004	(1,933)	(203.6)
Raw materials	(63,553)	(64,941)	(50,147)	(63,999)	(2.1)	26.7	(0.7)	(270,355)	(226,067)	19.6
Staff cost	(1,610)	(1,550)	(1,336)	(1,534)	3.8	20.5	5.0	(6,587)	(5,456)	20.7
Other expenditure	(8,678)	(7,600)	(6,112)	(7,474)	14.2	42.0	16.1	(35,619)	(27,097)	31.5
EBITDA	**7,925**	**9,403**	**7,932**	**11,111**	**(15.7)**	**(0.1)**	**(28.7)**	**37,364**	**39,543**	**(5.5)**
OPM (%)	**9.6**	**11.3**	**12.2**	**13.2**				**10.7**	**13.3**	
Other income	1,002	2,250	2,165	790	(55.5)	(53.7)	26.9	4,130	4,968	(16.9)
Interest	80	85	63	129	(6.1)	26.5	(37.9)	(239)	335	(171.4)
Depreciation	2,417	2,250	1,961	2,230	7.4	23.3	8.4	9,678	8,250	17.3
Pretax profits	**6,430**	**9,318**	**8,073**	**9,542**	**(31.0)**	**(20.3)**	**(32.6)**	**31,577**	**35,925**	**(12.1)**
Extraordinaries	—	—	—	—				—	—	
Tax	1,777	2,702	2,238	2,976	(34.3)	(20.6)	(40.3)	9,157	10,949	(16.4)
Net income	**4,654**	**6,616**	**5,835**	**6,566**	**(29.7)**	**(20.3)**	**(29.1)**	**22,420**	**24,976**	**(10.2)**
Adjusted profits	**4,654**	**6,616**	**5,835**	**6,566**	**(29.7)**	**(20.3)**	**(29.1)**	**22,420**	**24,976**	**(10.2)**
Income tax rate (%)	27.6	29.0	27.7	31.2				29.0	30.5	
EPS (Rs)	**16.1**	**22.9**	**20.2**	**22.7**				**77.6**	**86.4**	**(10.2)**
Ratios										
RM to sales (%)	79.2	79.0	77.9	77.4				78.4	77.0	
EBITDA margin (%)	9.8	11.5	12.5	13.4				10.7	13.3	
Net profit margin (%)	5.8	8.1	9.2	7.9				6.4	8.4	
ETR (%)	27.6	29.0	27.7	31.2				29.0	30.5	
Other details										
Sales volumes (# vehicles)	283,324	283,324	226,729	287,422	-	25.0	(1.4)	283,324	1,018,365	(72.2)
Net sales realisation (Rs/vehicle)	**285,553**	**287,459**	**280,719**	**288,107**	**(0.7)**	**1.7**	**(0.9)**	**287,459**	**285,741**	**0.6**

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Volume assumptions for Maruti Suzuki, March fiscal year-ends, 2007-12E (# vehicles)

Segment-wise sales (units)	2007	2008	2009	2010	2011E	2012E
Entry (A) segment	79,245	69,553	49,383	33,028	30,000	30,000
Van-Segment	83,091	89,729	77,948	101,325	152,003	170,493
Compact (B) segment	440,375	499,280	511,396	633,190	737,797	819,659
Mid-size (C) segment	29,697	49,335	75,928	99,315	114,212	128,398
D segment	-	-	-	-	500	2,000
MUV	3,221	3,921	7,489	3,932	4,508	4,959
Domestic	**635,629**	**711,818**	**722,144**	**870,790**	**1,039,021**	**1,155,510**
Exports	39,295	53,024	70,023	147,575	150,000	165,000
Total	**674,924**	**764,842**	**792,167**	**1,018,365**	**1,189,021**	**1,320,510**
Segment-wise sales growth(%)						
Entry (A) segment	(11.0)	(12.2)	(29.0)	(33.1)	(9.2)	-
Van-Segment	24.0	8.0	(13.1)	30.0	50.0	12.2
Compact (B) segment	31.5	13.4	2.4	23.8	16.5	11.1
Mid-size (C) segment	(7.3)	66.1	53.9	30.8	15.0	12.4
MUV	(19.5)	21.7	91.0	(47.5)	14.7	10.0
Domestic	**20.6**	**12.0**	**1.5**	**20.6**	**19.3**	**11.2**
Exports	13.0	34.9	32.1	110.8	1.6	10.0
Total	**20.1**	**13.3**	**3.6**	**28.6**	**16.8**	**11.1**

Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Maruti Suzuki, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Profit model (Rs mn)						
Net sales	146,539	179,362	204,553	290,989	342,082	384,473
EBITDA	**22,862**	**26,524**	**18,321**	**39,543**	**37,364**	**42,143**
Other income	3,026	4,784	6,013	4,968	4,130	5,246
Interest	(376)	(596)	(510)	(335)	(239)	(259)
Depreciaiton	(2,714)	(5,682)	(7,065)	(8,250)	(9,678)	(11,179)
Profit before tax	**22,798**	**25,030**	**16,758**	**35,925**	**31,577**	**35,951**
Current tax	6,281	7,696	4,689	9,700	8,526	9,707
Deferred tax	897	26	(118)	1,257	632	719
Net profit	**15,620**	**17,308**	**12,187**	**24,976**	**22,420**	**25,526**
Earnings per share (Rs)	**54.0**	**59.9**	**42.2**	**86.4**	**77.6**	**88.3**
Balance sheet (Rs mn)						
Equity	68,539	84,154	93,449	116,397	136,995	160,447
Deferred tax liability	1,675	1,701	1,551	2,808	3,440	4,159
Total Borrowings	6,308	9,002	6,989	3,989	3,989	3,989
Current liabilities	25,015	28,257	33,976	46,155	53,245	58,906
Total liabilities	**101,537**	**123,114**	**135,965**	**169,348**	**197,669**	**227,501**
Net fixed assets	29,104	40,328	49,321	54,071	68,393	81,214
Investments	34,092	51,807	31,733	33,733	35,733	37,733
Cash	14,228	3,305	19,390	30,591	32,593	39,602
Other current assets	24,113	27,674	35,521	50,953	60,950	68,952
Miscellaneous expenditure	—	—	—	—	—	—
Total assets	**101,537**	**123,114**	**135,965**	**169,348**	**197,669**	**227,501**
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	15,988	18,387	12,933	29,843	28,838	32,436
Working capital changes	4,410	(83)	(1,000)	(3,246)	(2,906)	(2,341)
Capital expenditure	(13,950)	(16,930)	(16,136)	(13,000)	(24,000)	(24,000)
Free cash flow	**6,448**	**1,374**	**(4,203)**	**13,597**	**1,932**	**6,096**
Ratios						
EBITDA margin (%)	15.3	14.5	8.8	13.3	10.7	10.8
PAT margin (%)	10.7	9.6	6.0	8.6	6.6	6.6
Debt/equity (X)	0.1	0.1	0.1	0.0	0.0	0.0
Net debt/equity (X)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.4)
Book value (Rs/share)	243.0	297.1	328.7	412.5	485.9	569.6
RoAE (%)	24.9	22.2	13.5	23.3	17.3	16.7
RoACE (%)	**35.4**	**33.7**	**14.4**	**27.2**	**19.8**	**18.4**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Jaiprakash Associates (JPA)

Others

BUY

JULY 26, 2010

RESULT

Coverage view:

Price (Rs): 129

Target price (Rs): 170

BSE-30: 18,131

Cement segment continues to grow. Jaiprakash (JAL) reported another quarter of strong cement volumes (+64% yoy), which helped compensate for the miss in construction earnings. JAL continues to restructure its business segments and towards this end, has concluded the listing of Jaypee Infratech (JIL), which houses a bulk of the company's real estate assets. We reiterate our BUY rating with a revised target price of Rs170/share.

Company data and valuation summary

Jaiprakash Associates

Stock data			
52-week range (Rs) (high,low)			180-108
Market Cap. (Rs bn)			274.0
Shareholding pattern (%)			
Promoters			46.0
FIIs			26.0
MFs			4.8
Price performance (%)	**1M**	**3M**	**12M**
Absolute	(0.4)	(19.1)	(20.1)
Rel. to BSE-30	(3.4)	(20.8)	(32.2)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	1.5	5.5	7.4
EPS growth (%)	(27.2)	279.8	34.1
P/E (X)	88.4	23.3	17.3
Sales (Rs bn)	65.3	96.3	123.7
Net profits (Rs bn)	3.1	11.8	15.8
EBITDA (Rs bn)	25.1	38.5	57.2
EV/EBITDA (X)	22.0	16.2	11.5
ROE (%)	4.1	12.8	14.9
Div. Yield (%)	0.0	0.0	0.0

Cement holds guard even as construction disappoints

JAL reported revenues of Rs31.7 bn, operating profits of Rs6.4 bn and net income of Rs1.1 bn for 1QFY11 against our estimate of Rs29.9 bn, Rs7.2 bn and Rs2.5 bn, respectively. Higher-than-estimated revenues were on account of robust cement volumes (64% yoy) and revenue recognition from Noida real estate project, which compensated for the miss on construction revenues. However, a sharp drop in construction margins, at 7% in 1QFY11 compared to our estimate of 19% resulted in operating profits missing our estimates by 11%. Reported profit of Rs5.1 bn includes profit of Rs4.1 bn from sale of shares in Jaypee Infratech for a consideration of Rs6 bn.

Jaypee Infratech IPO – restructuring of business units continues

JAL continues the process of restructuring its diverse businesses with the listing of its real estate arm – Jaypee Infratech (JIL) reducing its holding in JIL to 83.2%. We believe that Noida land parcel is valuable on account of its accessibility to Delhi which will allow JIL to command premium pricing for the Noida projects. However, we do not currently ascribe value to the other four land parcels. With ~25 mn sq. ft of real estate construction potential, we believe that traction on development of these four land parcel could be a key upside to our target price.

Maintain BUY rating with revised target price of Rs170/share

We maintain our BUY rating with a revised target price of Rs170/share (Rs183/share previously) as we adjust for (1) increased cost of Yamuna Expressway construction and (2) adjust for stake dilution in Jaypee Infratech and also revise our construction and cement valuation multiple to 6X FY2012E EBITDA (7X previously). Our SOTP-based target price includes Rs51/share for the standalone business which includes (1) cement business at Rs66/share valued at 6X EV/EBITDA, (2) construction business at Rs45/share valued at 6X EV/EBITDA, (3) Real estate business at Rs10/share which includes Jaypee Green, Greater Noida and Jaypee Sports City. We note that the standalone entity has a net debt of Rs73/share.

Murtuza Arsiwalla
murtuza.arsiwalla@kotak.com
Mumbai: +91-22-6634-1125

Shubham Satyarth
shubham.satyarth@kotak.com
Mumbai: +91-22-6634-1320

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

We ascribe Rs39/share for 83% stake in JIL and Rs82/share for power business after a 20% holding company discount. We have revised our EPS estimate to Rs5.5/share (Rs5.9 previously) in FY2011E and Rs7.4/share (Rs7.9 previously) in FY2012E.

Exhibit 1: Lower other income and higher tax rate resulted in a sharp drop in net income for the quarter
Interim results of Jaiprakash Associates Ltd (standalone), March fiscal year-ends (Rs mn)

					(% chg.)					
	1QFY11	1QFY11E	1QFY10	4QFY10	1QFY11E	1QFY10	4QFY10	FY2010	FY2011E	(% chg.)
Net sales	**31,742**	**29,976**	**20,671**	**33,452**	**6**	**54**	**(5)**	**100,889**	**124,670**	**24**
Total expenditure	(25,321)	(22,798)	(15,254)	(24,915)				(74,640)	(93,126)	
EBITDA	**6,421**	**7,178**	**5,417**	**8,537**	**(11)**	**19**	**(25)**	**26,249**	**31,544**	**20**
EBITDA (%)	20	24	26	26				26	25	
Other income	436	679	498	132				2,665	3,134	
EBITDA	**6,857**	**7,857**	**5,915**	**8,668**				**28,914**	**34,678**	**20**
Interest	(3,279)	(3,004)	(2,219)	(2,989)				(10,558)	(13,264)	
Depreciation	(1,503)	(1,350)	(1,017)	(1,334)				(4,561)	(6,009)	
Pre-tax profits	2,074	3,502	2,679	4,346				13,796	15,406	
Tax	(405)	(1,051)	(619)	(767)				(2,520)	(3,122)	
FBT	—	—	(20)	-				—	—	
Deferred tax	(611)	-	141	(1,123)				(2,336)	(1,887)	
Net income	**1,058**	**2,452**	**2,181**	**2,456**	**(57)**	**(51)**	**(57)**	**8,940**	**10,397**	**16**
Extraordinary income	4,102	—	2,731	—				8,160		
Reported net income	5,160	2,452	4,912	2,456	110	5	110	17,099	14,499	(15)
Segment revenues										
Cement	14,415	13,300	9,482	12,334		52	17	40,909	52,755	29
Construction	14,373	16,423	10,552	19,741		36	(27)	55,891	71,159	27
Real estate	3,661	812	952	1,244		285	194	6,536	4,908	(25)
Others	(271)	120	183	265		(248)	(202)	219	(1,018)	(565)
Total	**32,178**	**30,655**	**21,169**	**33,584**		**52**	**(4)**	**103,554**	**127,804**	**23**
Segment EBIT										
Cement	2,863	3,116	3,016	2,997		(5)	(4)	14,631	12,942	(12)
Construction	1,048	3,120	1,819	3,952		(42)	(73)	12,634	12,712	1
Real estate	1,558	234	447	388		249	301	1,844	2,086	13
Others	97	36	93	123		4	(21)	3,404	5,032	48
Total	**5,566**	**6,507**	**5,375**	**7,461**		**4**	**(25)**	**32,513**	**32,772**	**1**
EBIT margin (%)										
Cement	20	23	32	24				36	25	
Construction	7	19	17	20				23	18	
Real estate	43	29	47	31				28	43	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Our SOTP-based target price of JAL is Rs169/share
JAL SOTP

Business	Methodology	Comments	Value (Rs bn)	Value (Rs/share)
Cement	EV/EBITDA (X)	6X FY2012E EBITDA	126	66
Construction	EV/EBITDA (X)	6X FY2012E EBITDA	86	45
Hotels	EV/EBITDA (X)	6X FY2012E EBITDA	7	3
Real estate	NAV	Value for 8 mn sq. ft development at Jaypee Greens and option value for proposed development at Jaypee Sports City	19	10
Net debt			139	73
Parent entity			**98**	**51**
Real estate	NAV	Base case assumption of flat prices till FY2010 and 5% growth in realisation beyond that for 1,250 acre township at Noida	75	39
Power	DCF-to-equity	3,377 MW of attributable power portfolio, of which 511 MW is already under operation	153	80
Total			**325**	**170**

Source: Kotak Institutional Equities estimates

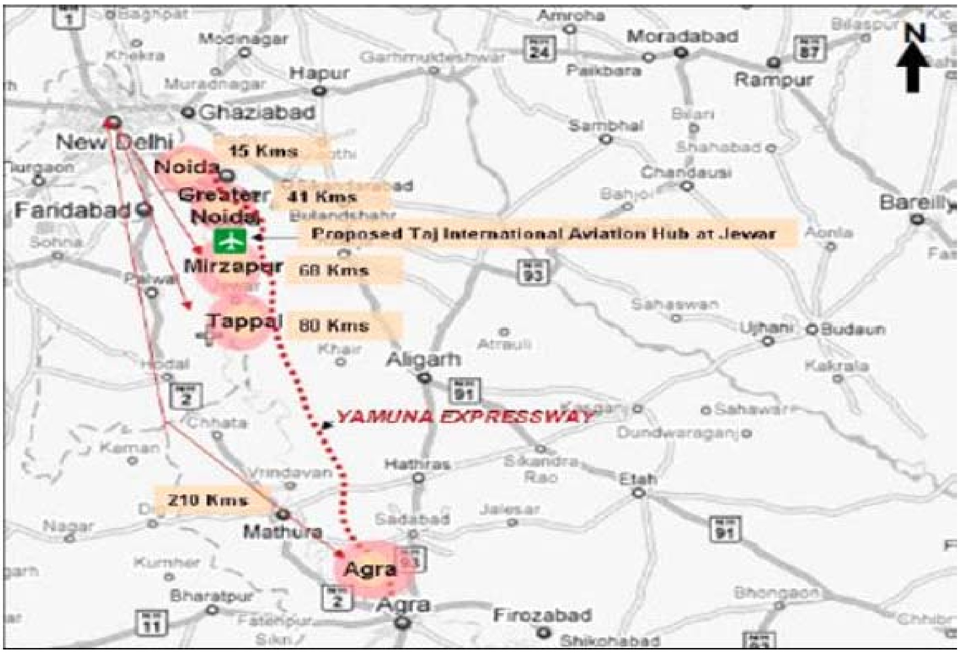
Real estate – Jaypee Infratech IPO

JAL continues the process of restructuring its diverse businesses with the listing of its real estate arm – Jaypee Infratech (JIL). JIL houses most of the real estate portfolio of JAL apart from Jaypee Greens, Greater Noida and proposed development at Jaypee Sport City which continue to be under the parent company JAL. We note that post the issue, JAL's holding in JIL has come down from 99.1% to 83.2%.

JIL is developing the 165-km access-controlled six-lane Yamuna Expressway under a concession from Yamuna Expressway Authority (YEA). The concession follows a build-operate-transfer model pursuant to which JIL has the right to earn toll revenue for a period of 36 years following the award of a certificate of completion of the expressway. Under the concession agreement, JIL has also been provided the right to develop 6,175 acres of land to be acquired by the YEA and leased to JIL for a 90-year term, which is will consist of 1,235 acre parcels at each of five different locations along the Yamuna Expressway. Exhibit 2 highlights the locations of these land parcels. The expressway construction is underway and management is guiding for a completion in FY2011, ahead of the scheduled deadline of April 2013.

We believe that Noida land parcel is valuable on account of its accessibility to Delhi with successful initial launches. We believe JIL will be able to command a premium pricing for this projects in this land parcel but remain skeptical about the prospects of the other four land parcels with their development with their development contingent upon the economic growth in the respective regions. We have accordingly valued only the Noida land parcel and foresee the NAV accretion from other four land parcels as a key upside to our target price. We value JAL stake in Jaypee Infratech at Rs76 bn. We value JIL at RsRs113.8 bn (March 2012-based NAV) which includes the negative value of Rs12.8 bn for the expressway project.

Exhibit 2: Yamuna expressway connects Noida to Agra
Location map for Yamuna expressway



Source: Company, Kotak Institutional Equities

Exhibit 3: Expressway construction under full swing
Construction progress of Yamuna expressway as of March 2010

Activity	Total quantity (lac cum)	Quantity completed (lac cum)	Percentage completed (%)
Clearing & Grubbing (acres)	1,735	1,735	100.0
Earthwork in embankment (thousand cubic meters)	40,173	34,837	86.7
Structural concrete			
Culverts (thousand cubic meters)	78	71	91.0
Vehicular Underpasses/CartTrack Underpasses (thousand cubic meters)	254	158	62.2
Minor Bridges (thousand cubic meters)	173	135	78.0
Interchanges (thousand cubic meters)	395	183	46.3
Pavement	2,477	521	21.0

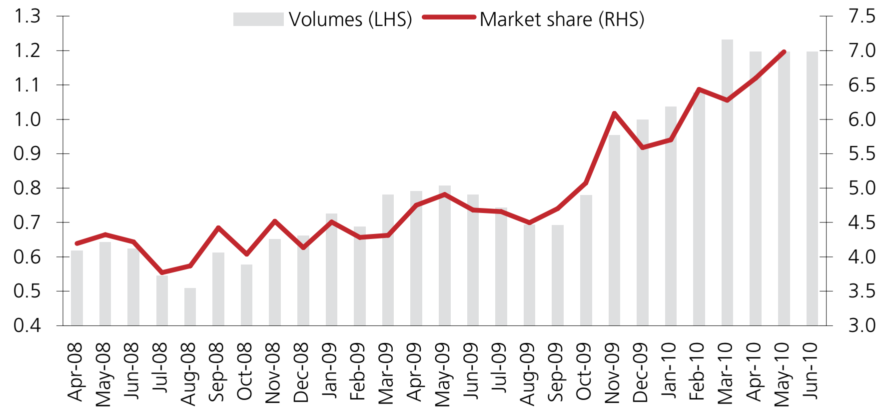
Source: Company, Kotak Institutional Equities

Cement – dramatic volume growth combats cost pressures

Cement business continues to surprise on the upside as JAL reported cement revenues of Rs14.4 bn (+17% yoy, +52% qoq) in 1QFY11, above our estimate of Rs13.3 bn. EBIT margins contracted to 20% and can be partially attributed to (1) higher depreciation expense from recently commissioned capacities and (2) increase in input costs as witnessed across cement companies. Strong volume growth (12.2% qoq, 64% yoy) helped combat the declining margins with marginally lower-than-expected cement EBIT of Rs2.9 bn (against our estimate of Rs3.1 bn).

Aggressive commissioning of capacities continues to realize higher market shares which have now moved up to 7% from 4.7% in June 2009. With aggressive capacity expansion plans of JAL, higher-than-estimated cement volumes remains an upside risk to our estimate.

Exhibit 4: JAL's All-India market improved to 7.0%.
Cement volumes and market share of Jaiprakash Associates Ltd, 1QFY09-1QFY11

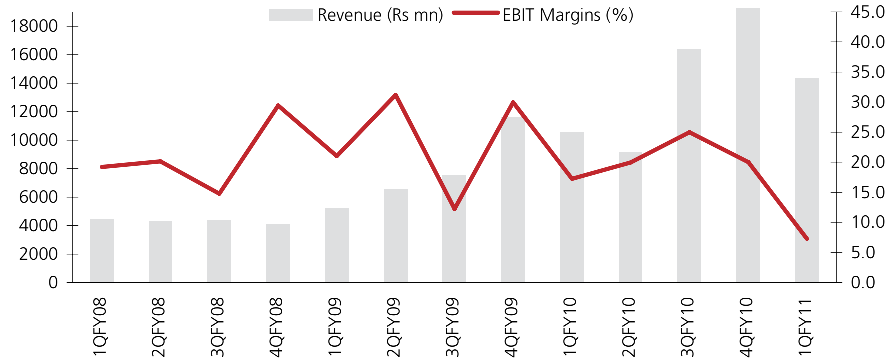


Source: Company, Kotak Institutional Equities

Construction—volatility in margins difficult to capture in estimates

JAL reported construction revenue of Rs14.3 bn in 1QFY10 (+36% yoy and -17% qoq) compared to our estimate of Rs16.4 bn while construction EBIT at Rs1.1 bn were significantly lower than our estimate of Rs3.1 bn. Construction margins continue to be volatile with a sharp sequential drop from 20% in 4QFY10 to 7% in 1QFY11. Management has indicated that the drop in margins is attributable to (1) increased contribution of internal projects in the overall revenue mix and (2) revenues not being recognised for two of the projects (Srisailam and Baglihar) despite accrual of establishment expenses. We highlight that volatility of construction revenues and margins over the past few quarters make estimation of quarterly earning very difficult.

Exhibit 5: Construction margins have been volatile over the last few quarters
Construction revenues and margins of Jaiprakash Associates Ltd, 1QFY08-1QFY11 (Rs mn, %)



Source: Company, Kotak Institutional Equities

Power – capacity additions to drive future growth

JPVL reported net revenues of Rs1.9 bn for 1QFY11 and net income of Rs485 mn contributed by 700 MW of operation power capacity – 300 MW at Baspa and 400 MW at Vishnuprayag.

JPVL will likely need equity support of ~Rs40 bn over the next three years, in order to fructify 9,465 MW of power capacity addition across the various projects being undertaken by the company. Merger of the various power entities under JPVL will help ease the equity support required to fund the current portfolio of projects, as the cash flows from extant projects can be productively deployed for funding future growth.

Exhibit 7: Profit model, balance sheet, cash model of Jaiprakash Associates Ltd, March fiscal year ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
Profit model						
Net revenues	39,328	41,872	47,063	65,256	96,272	123,720
EBITDA	**14,592**	**16,819**	**17,243**	**25,053**	**38,541**	**57,162**
Other income	987	2,195	2,612	2,632	3,336	2,687
Interest (expense)/income	(4,587)	(5,579)	(7,062)	(12,864)	(15,243)	(18,781)
Depreciation	(2,596)	(3,188)	(3,326)	(4,722)	(5,917)	(9,258)
Pretax profits	**8,395**	**10,247**	**9,467**	**10,099**	**20,717**	**31,811**
Tax	(2,408)	(2,200)	(3,432)	(5,914)	(5,293)	(11,504)
Deferred taxation	(65)	(762)	(899)	(458)	(2,402)	(552)
Minority interest	(882)	(1,202)	(923)	(627)	(1,246)	(3,962)
Net income	**5,040**	**6,084**	**4,213**	**3,100**	**11,776**	**15,793**
Extraordinary items	492	684	(10)	8,100	4,102	—
Reported profit	5,532	6,768	4,203	11,201	15,878	15,793
Earnings per share (Rs)	**3.1**	**3.3**	**2.0**	**1.5**	**5.5**	**7.4**
Balance sheet						
Paid-up common stock	2,192	2,343	2,804	4,249	4,249	4,249
Total shareholders' equity	29,286	49,772	65,963	85,403	99,277	113,068
Deferred taxation liability	5,824	7,101	8,787	11,979	14,381	14,933
Minority interest	4,591	7,025	7,153	10,064	14,693	21,754
Total borrowings	81,062	114,872	193,202	352,711	347,904	414,400
Total liabilities and equity	**120,762**	**178,770**	**275,105**	**460,156**	**476,255**	**564,155**
Net fixed assets	61,172	69,388	99,951	121,827	150,945	188,475
Capital work-in progress	27,390	62,250	96,347	182,223	253,786	256,612
Investments	77	1,203	10,964	10,566	10,566	10,566
Cash	18,230	24,622	39,214	84,852	13,920	53,480
Net current assets (excl. cash)	13,514	20,788	28,198	59,926	46,276	54,259
Net current assets (incl. cash)	32,122	45,929	67,843	145,540	60,958	108,501
Total assets	**120,762**	**178,770**	**275,105**	**460,156**	**476,255**	**564,155**
Free cash flow						
Operating cash flow, excl. working capital	5,334	9,905	6,739	14,375	22,107	26,877
Working capital changes	688	(7,274)	(7,410)	(31,729)	13,650	(7,984)
Capital expenditure	(24,654)	(45,993)	(68,390)	(112,474)	(106,598)	(49,614)
Free cash flow	**(18,633)**	**(43,362)**	**(69,060)**	**(129,827)**	**(70,841)**	**(30,720)**
Ratios						
Net debt/equity (%)	181	161	210	282	300	287
Return on equity (%)	15	13	7	4	11	13
Book value per share (Rs)	21	32	35	45	52	59
ROCE (%)	**9**	**8**	**4**	**2**	**5**	**6**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

IDEA (IDEA)

Telecom

REDUCE

JULY 25, 2010

RESULT

Coverage view: Cautious

Price (Rs): 69

Target price (Rs): 50

BSE-30: 18,131

Valuations demanding, operating environment uncertain; reiterate REDUCE. We make a few changes to our earnings model for Idea – (1) raise our base 2G estimates, driven by higher-than-expected minutes growth and strong execution, and (2) build in 3G payout, incremental revenues, and capex into our estimates. Despite fairly benign assumptions on the core 2G and incremental 3G business, we do not find the current valuations justified. We reiterate REDUCE with a target price of Rs55/share (from Rs50).

Company data and valuation summary

IDEA

Stock data			
52-week range (Rs) (high,low)			85-47
Market Cap. (Rs bn)			226.5
Shareholding pattern (%)			
Promoters			47.0
FIIs			7.4
MFs			0.9
Price performance (%)	1M	3M	12M
Absolute	24.4	4.7	(12.0)
Rel. to BSE-30	21.8	2.2	(26.1)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	2.7	2.2	1.5
EPS growth (%)	(5.8)	(19.7)	(30.8)
P/E (X)	25.1	31.3	45.2
Sales (Rs bn)	124.5	153.6	187.4
Net profits (Rs bn)	9.0	7.3	5.2
EBITDA (Rs bn)	34.1	38.7	47.2
EV/EBITDA (X)	8.6	9.4	8.0
ROE (%)	7.2	6.2	4.2
Div. Yield (%)	0.0	0.0	0.0

Revise revenue/EBITDA estimates upwards

Exhibit 1 depicts the key changes to our earnings estimates for Idea. We increase our revenue and EBITDA estimates for FY2011-13E by 7-9% and 11-19%, respectively, driven by (1) increase in core 2G estimates on the back of higher-than-expected minutes elasticity in the market, and strong execution shown by Idea in recent quarters; sharp increase in volume estimates is mitigated in part by a modest cut in our RPM estimates, (2) inclusion of 3G into our model; Exhibit 2 looks at the incremental revenues from 3G rollout modeled into our estimates; we factor in 3G rollout starting Jan 2011.

Revision in EPS estimates is varied across years, depending on the interplay between (1) increase on account of higher core 2G estimates and 3G EBITDA, and (2) decline on account of higher depreciation, 3G amortization charges, and interest payout on 3G-related debt. Net impact is an increase in FY2011E EPS estimate to Rs2.19 from Rs1.32, a decline in FY2012E EPS estimate to Rs1.52 from Rs2.27, and a modest change in FY2013E EPS estimate to Rs2.82 from Rs2.77 earlier.

Further thoughts on Idea's 1QFY11 performance

- Sequential volume growth was clearly a surprise with Idea reporting 13.2% like-on-like minutes growth for the quarter versus our expectation of ~8%. In addition to the possible reversal of minutes to incumbents from new entrants, we see two fundamental factors driving strong minutes growth – (1) usage elasticity, and (2) income/vintage effect in the rural subs base.
- Tariff pressure in the market is a reality, despite the lack of headline tariff cuts, as evidenced in the sharp 5.7% qoq RPM decline for Idea. As we have highlighted in some of our recent notes, we see ample evidence of subtle circle-specific tariff interventions continuing.
- Capex slowdown in the industry over the past two quarters has clearly been driven in part by the restrictions on equipment import. Idea management's earnings call commentary validated the same; this was also evident from Nokia management alluding to a EUR200 mn revenue loss for Nokia-Siemens networks in the quarter from India on account of these issues.

Rohit Chordia
rohit.chordia@kotak.com
Mumbai: +91-22-6634-1397

Kawaljeet Saluja
kawaljeet.saluja@kotak.com
Mumbai: +91-22-6634-1243

Vineet Thodge
vineet.thodge@kotak.com
Mumbai: +91-22-6634-1225

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Expensive despite upgrade; reiterate REDUCE

Idea trades at an expensive 9.4X FY2011E and 7.8X FY2012E EV/EBITDA, a 15% premium to Bharti (adjusted for Indus, including the impact of 3G/BWA/Zain), and substantial premium to other developing market wireless operators. We continue to believe that the Idea stock has an in-built M&A premium, which could sustain the stock at levels higher than our fair value estimates. We expect another round of tariff wars to disturb the temporary competitive equilibrium in the market (which has benefitted the strong incumbents) and put pressure on Idea's performance over the coming quarters. We raise our end-March 2012 target price on Idea to Rs55/share (Rs50 earlier) – our fair value estimate implies an EV/EBITDA of 6.75X FY2012E, fair in our view.

Other earnings call highlights

- Idea has increased its FY2011E capex guidance to Rs40-44 bn from Rs30 bn earlier. We note that this guidance excludes 3G spectrum payout and is ex-Indus (proportionate share). Even as a part of the capex guidance increase is 3G rollout driven, it also indicates the capex implications of a minutes-led revenue/EBITDA growth, a factor critical to the valuation of the business.

- Idea indicated that Rs19 bn of the total Rs58 bn debt raised for 3G spectrum payout is short-term in nature and the company could refinance the same through long-term debt or may go in for a short-term rollover of this debt.

- Idea expects 3G spectrum release by Sep 2010 and plans the initial 3G commercial launch by Jan/Feb 2011.

Exhibit 1: Idea Cellular--summary of key changes to the earnings model, March fiscal year-ends, 2011E-2017E

	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues (Rs mn)								
Revised	124,471	153,633	187,407	213,564	233,054	245,475	254,320	260,769
Old	124,471	141,221	174,541	197,190	214,784	227,278	236,564	243,679
Change (%)	**-**	**8.8**	**7.4**	**8.3**	**8.5**	**8.0**	**7.5**	**7.0**
EBITDA (Rs mn)								
Revised	34,072	38,665	47,229	57,154	63,999	68,975	72,285	74,830
Old	34,072	34,906	42,661	47,965	54,486	59,651	63,682	67,152
Change (%)	**-**	**10.8**	**10.7**	**19.2**	**17.5**	**15.6**	**13.5**	**11.4**
EBITDA margin (%)								
Revised	27.4	25.2	25.2	26.8	27.5	28.1	28.4	28.7
Old	27.4	24.7	24.4	24.3	25.4	26.2	26.9	27.6
Change (bps)	**(0.0)**	**45**	**76**	**244**	**209**	**185**	**150**	**114**
EBIT Margin (%)								
Revised	11.2	9.2	9.3	11.1	12.2	12.9	13.0	13.0
Old	11.2	6.9	8.7	9.3	10.6	11.5	11.9	12.2
Change (bps)	**(0.0)**	**236**	**57**	**180**	**158**	**140**	**110**	**72**
EPS (Rs)								
Revised	2.73	2.19	1.52	2.82	4.01	4.99	5.72	6.33
Old	2.73	1.32	2.27	2.77	3.87	4.82	5.58	6.36
Change (%)	**(0.0)**	**66.2**	**(33.2)**	**1.8**	**3.5**	**3.4**	**2.5**	**(0.5)**
Subscribers (mn)								
Revised	63.8	89.0	106.5	118.7	127.1	133.2	137.7	141.1
Old	63.8	89.0	106.5	118.7	127.1	133.2	137.7	141.1
Change (%)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
MOU (min/month)								
Revised	383	418	405	401	398	394	391	388
Old	383	375	367	367	366	366	366	365
Change (%)	**-**	**11.2**	**10.3**	**9.4**	**8.5**	**7.7**	**6.9**	**6.1**
ARPU (Rs/month)								
Revised	207	176	162	161	161	160	159	158
Old	207	163	153	150	150	150	150	150
Change (%)	**-**	**8.0**	**5.9**	**6.8**	**7.0**	**6.5**	**6.0**	**5.5**
RPM (Rs/min)								
Revised	0.54	0.422	0.400	0.400	0.404	0.405	0.407	0.408
Old	0.54	0.435	0.416	0.410	0.410	0.410	0.410	0.410
Change (%)	**-**	**(3.0)**	**(4.0)**	**(2.4)**	**(1.4)**	**(1.1)**	**(0.8)**	**(0.5)**
EPM (Rs/min)								
Revised	0.12	0.068	0.063	0.070	0.074	0.077	0.079	0.081
Old	0.12	0.064	0.058	0.055	0.059	0.063	0.066	0.069
Change (%)	**-**	**6.9**	**10.3**	**26.5**	**24.3**	**22.2**	**19.9**	**17.8**
Capex (Rs mn)								
Revised	33,024	106,924	44,442	36,612	34,506	33,882	34,878	35,772
Old	33,024	31,895	31,633	33,275	33,256	32,200	32,733	34,263
Change (%)	**-**	**235.2**	**40.5**	**10.0**	**3.8**	**5.2**	**6.6**	**4.4**
Capex/sales (%)								
Revised	26.5	69.6	23.7	17.1	14.8	13.8	13.7	13.7
Old	26.5	22.6	18.1	16.9	15.5	14.2	13.8	14.1
Change (bps)	**-**	**4,701**	**559**	**27**	**(68)**	**(37)**	**(12)**	**(34)**

Source: Kotak Institutional Equities estimates

Exhibit 2: Impact of 3G on Idea's revenues

Rs mn	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Change in revenue estimate	12,412	12,867	16,373	18,269	18,197	17,756	17,090
3G revenues built in	93	3,860	8,187	10,962	12,738	14,205	15,381
Incremental ARPU (Rs/sub/month) (a)	**150**	**180**	**153**	**130**	**111**	**99**	**95**
Subs converted (mn)	0.4	3.2	5.8	8.3	10.9	12.9	14.2
Total subs (mn)	**89**	**106**	**119**	**127**	**133**	**138**	**141**
% conversion	**0.5**	**3.0**	**4.9**	**6.5**	**8.2**	**9.4**	**10.1**

Note:
(a) Additional ARPU from 3G subs over the base case.

Source: Kotak Institutional Equities estimates

Exhibit 3: Discounted cash flow valuation for Idea Cellular
Our end-March 2012 target price is Rs55/share

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	28,353	34,072	38,665	47,229	57,154	63,999	68,975	72,285	74,830
Tax	(135)	(403)	(700)	(4,381)	(5,378)	(6,138)	(6,657)	(6,892)	(7,019)
Change in working capital	3,673	(21,908)	2,496	(4,701)	(6,683)	(3,191)	(1,540)	(284)	(49)
Post-tax operating cash flow	**31,892**	**11,760**	**40,461**	**38,147**	**45,093**	**54,670**	**60,778**	**65,110**	**67,763**
Capex	(61,402)	(33,024)	(106,924)	(44,442)	(36,612)	(34,506)	(33,882)	(34,878)	(35,772)
Free cash flow	**(29,511)**	**(21,264)**	**(66,464)**	**(6,296)**	**8,481**	**20,164**	**26,895**	**30,231**	**31,991**

		WACC and growth in perpetuity assumptions	
PV of cash flows	106,386	**Terminal growth - g (%)**	**5.0**
PV of terminal value	212,593	**WACC (%)**	**12.5**
EV	318,979		
Net debt	136,464		
Equity value (Rs mn)	**182,515**		
Equity value (US$ mn)	**3,925**		
Shares outstanding (mn)	3,300		
Equity value (Rs/Idea share)	**55**		
Exit FCF multiple (X)	13.2		
Exit EBITDA multiple (X)	**5.9**		

Key assumptions (%)	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**
Revenue growth	51.0	22.7	23.4	22.0	14.0	9.1	5.3	3.6	2.5
EBITDA growth	25.9	20.2	13.5	22.1	21.0	12.0	7.8	4.8	3.5
EBITDA margin	**27.9**	**27.4**	**25.2**	**25.2**	**26.8**	**27.5**	**28.1**	**28.4**	**28.7**
Capex/sales	60.5	26.5	69.6	23.7	17.1	14.8	13.8	13.7	13.7
Cash tax rate	0.9	2.8	4.6	23.2	21.6	20.7	20.3	20.1	20.0
Effective tax rate	3.9	11.9	12.1	12.8	15.2	18.1	19.7	20.0	20.2
ROCE	**10.4**	**7.6**	**6.2**	**4.9**	**6.5**	**7.8**	**8.7**	**9.2**	**9.7**

Source: Kotak Institutional Equities estimates

Exhibit 4: Idea 1QFY11E quarterly performance (Rs mn)

	1QFY10	4QFY10	1QFY11E	qoq (%)	yoy (%)	Jun-10E	Deviation (%)
Idea Cellular (standalone)							
Revenues	28,883	33,011	36,987				
EBITDA	**7,700**	**8,328**	**7,937**				
EBIT	3,636	3,400	2,777				
PAT	**3,074**	**2,764**	**1,965**				
EBITDA margin (%)	26.7	25.2	21.5				
EBIT margin (%)	12.6	10.3	7.5				
Wireless ARPU (Rs/sub/month)	232	185	182	(1.6)	(21.6)	179	1.8
Wireless MOU (min/sub/month)	399	398	415	4.3	4.0	393	5.7
Wireless RPM (Rs/min)	0.58	0.46	0.44	(5.7)	(24.6)	0.46	(3.7)
Wireless EPM (Rs/min)	0.16	0.12					
Total minutes of usage (mn min)	48,729	68,275	82,274	20.5	68.8	77,834	5.7
Idea Cellular (consolidated, with Spice and Indus)							
Revenues	**29,759**	**33,477**	**36,537**	**9.1**	**22.8**	**34,990**	**4.4**
Standalone	28,883	33,011	36,897	11.8	27.7	35,455	4.1
Spice	1,359	989	-			-	
Indus	1,990	2,335	2,554	9.4	28.3	2,475	3.2
Eliminations	(2,472)	(2,858)	(2,914)	2.0	17.9	(2,940)	(0.9)
Costs							
Interconnection costs	(4,221)	(5,064)	(5,761)			(5,354)	7.6
License fee and spectrum charges	(3,369)	(3,328)	(4,242)			(3,779)	12.3
Network operating costs	(7,506)	(8,214)	(10,159)			(8,993)	13.0
Employee costs	(1,446)	(1,558)	(1,715)			(1,680)	2.1
SG&A expenses	(4,619)	(6,079)	(5,776)			(6,403)	(9.8)
Total	**(21,160)**	**(24,243)**	**(27,653)**			(26,208)	5.5
EBITDA	**8,600**	**9,234**	**8,884**	**(3.8)**	**3.3**	**8,783**	1.2
EBITDA margin (%)	**28.9**	**27.6**	**24.3**			**25.1**	
EBIT	4,044	4,087	3,228	(21.0)	(20.2)	2,988	8.0
PAT	**2,971**	**2,665**	**2,014**	**(24.4)**	**(32.2)**	**1,698**	**18.6**

Source: Company, Kotak Institutional Equities estimates

Exhibit 5: Idea Cellular's condensed financial statements, March year ends, 2008-2012E

	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)					
Revenue	101,484	124,471	153,633	187,407	213,564
EBITDA	28,353	34,072	38,665	47,229	57,154
EBIT	14,314	13,922	14,189	17,451	23,747
Net interest income / (expense)	(4,943)	(3,689)	(5,857)	(11,442)	(12,376)
Tax	(362)	(1,214)	(1,005)	(769)	(1,730)
Recurring Net profit	9,009	9,019	7,240	5,007	9,314
Extraordinaries	-	520	-	-	-
Adjusted net profit	9,009	9,539	7,240	5,007	9,314
Fully diluted EPS	**2.90**	**2.73**	**2.19**	**1.52**	**2.82**
Balance sheet (Rs mn)					
Cash	51,316	14,204	17,129	22,304	21,257
Other current assets	21,540	25,080	30,946	38,729	45,579
Fixed assets	149,516	171,382	187,083	205,317	213,132
Other long term assets	44,722	15,823	82,571	79,001	74,390
Short tem debt	8,846	8,846	8,846	8,846	8,846
Other current liabilities	39,009	32,032	40,972	44,054	44,222
Long term debt	80,319	69,747	144,747	164,747	164,747
Other long term liabilities	714	2,142	2,114	1,414	614
Shareholders funds (incl. minorities)	138,206	113,722	120,962	125,969	135,283
Net (debt)/ cash	(37,849)	(64,389)	(136,464)	(151,288)	(152,335)
Free cash flow (Rs mn)					
EBITDA	**28,353**	**34,072**	**38,665**	**47,229**	**57,154**
Change in working capital	(21,908)	2,496	(4,701)	(6,683)	(3,191)
Cash tax (paid)	(162)	(364)	(455)	(1,469)	(2,530)
Cash interest (paid)	(4,943)	(4,005)	(7,001)	(12,868)	(13,532)
Capex on PP&E and intangibles	(76,741)	(33,024)	(106,924)	(44,442)	(36,612)
Miscallenous	19,227	(24,404)	7,197	1,982	(3,492)
Free cash flow	**(56,174)**	**(25,230)**	**(73,219)**	**(16,251)**	**(2,203)**
Ratios (%)					
Sales growth	51.0	22.7	23.4	22.0	14.0
EBITDA growth	25.9	20.2	13.5	22.1	21.0
EPS growth	(26.5)	(5.8)	(19.7)	(30.8)	86.0
FCF growth	NM	NM	NM	NM	(86.4)
EBITDA margin	**27.9**	**27.4**	**25.2**	**25.2**	**26.8**
Net margin	8.9	7.2	4.7	2.7	4.4
FCF margin	(55.4)	(20.3)	(47.7)	(8.7)	(1.0)
RoAE	10.4	7.6	6.2	4.1	7.1
ROAE (excl. cash and int. income)	**15.2**	**9.2**	**5.9**	**3.6**	**7.6**
RoACE	8.6	6.5	6.2	5.0	6.4
ROACE (excl. cash and int. income)	**10.4**	**7.6**	**6.2**	**4.9**	**6.5**
Net debt/EBITDA (X)	1.3	1.9	3.5	3.2	2.7
Net debt/equity (X)	0.3	0.6	1.1	1.2	1.1
Total debt/capital (X)	0.6	0.7	1.3	1.4	1.3

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Hindustan Petroleum (HPCL)

Energy

ADD

JUL 26, 2010

RESULT

Coverage view: Cautious

Price (Rs): 437

Target price (Rs): 535

BSE-30: 18,131

Results have limited significance in the larger picture. HPCL reported lower-than-expected 1QFY11 net income at –₹18.8 bn versus our estimate of ₹2.4 bn as the company provided for the direct budgetary support on LPG and kerosene only. We expect the compensation for under-recoveries for 1QFY11 to follow in the subsequent quarters. We retain our ADD rating on the stock with a revised target price of ₹535 based on 8X FY2012E adjusted EPS plus value of investments. We find HPCL's valuations attractive on our FY2012E EPS but this is subject to proper deregulation of auto fuel prices.

Company data and valuation summary

Hindustan Petroleum

Stock data			
52-week range (Rs) (high,low)			496-292
Market Cap. (Rs bn)			148.0
Shareholding pattern (%)			
Promoters			25.1
FIIs			45.2
MFs			9.6
Price performance (%)	**1M**	**3M**	**12M**
Absolute	21.6	43.8	34.9
Rel. to BSE-30	19.1	40.3	13.3

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	52.6	53.5	58.6
EPS growth (%)	210.1	1.8	9.5
P/E (X)	8.3	8.2	7.4
Sales (Rs bn)	1,085.0	1,232.7	1,290.4
Net profits (Rs bn)	18.2	18.2	19.9
EBITDA (Rs bn)	41.6	41.4	46.3
EV/EBITDA (X)	6.8	7.1	6.4
ROE (%)	13.3	12.2	12.1
Div. Yield (%)	2.7	3.8	4.2

Lack of government support results in losses in 1QFY11; compensation later likely

HPCL reported 1QFY11 EBITDA at –₹15.4 bn versus ₹15.5 bn in 4QFY10 and ₹13.3 bn in 1QFY10; our estimate was at ₹7.1 bn. The weaker-than-expected performance was due to nil compensation from the government for under-recoveries versus ₹30.5 bn assumed by us. We note that the company provided for ₹1.5 bn as direct budgetary support for subsidy on LPG and kerosene. We note that HPCL's annualized EBITDA would be ₹27.6 bn after adding back 83% of gross under-recoveries of ₹44.1 bn for 1QFY11; this scenario assumes the downstream companies bear 17% of under-recoveries in FY2011E (see Exhibit 2).

Not a bad quarter for refining margins; sales volumes increased 3.7% yoy

HPCL's 1QFY11 refining margin was US$3.7/bbl versus US$3.2/bbl in 4QFY10 and US$5.7/bbl in 1QFY10. Global benchmark refining margins were lower qoq but HPCL likely benefited from higher diesel spreads. 1QFY11 sales volumes increased 3.7% yoy to 6.5 mn tons reflecting strong demand in auto fuels.

Valuations look inexpensive but earnings subject to deregulation of auto fuel prices

We find HPCL's valuation attractive and the stock offers 22% potential upside to our target price of ₹535 based on 8X FY2012E adjusted EPS plus value of investments. We adjust the EPS for dividends from its subsidiaries, which we value separately. We compute HPCL's FY2012E EPS at ₹83 assuming (1) full deregulation of auto fuels prices and (2) full compensation for subsidy loss on cooking fuels. This is an unlikely scenario but gives an indication of the potential upside.

Revised earnings significantly for FY2011E to reflect higher refining margins, weaker rupee

We have revised our FY2011-13E EPS to ₹53.5 (+19.1%), ₹58.6 (-5.5%) and ₹63.6 (-3.8%) to reflect (1) 1QFY11 results, (2) weaker rupee and (3) other minor changes. We assume that the government will provide adequate compensation to the downstream companies and restrict their net under-recoveries to around ₹55 bn versus ₹56 bn in FY2010.

QUICK NUMBERS

- 1QFY11 refining margin at US$3.7/bbl versus US$3.2/bbl in 4QFY10
- Annualized FY2011E EBITDA at ₹47.4 bn
- 41% potential upside to earnings assuming nil subsidy burden in FY2012E

Gundeep Singh
gundeep.singh@kotak.com
Mumbai: +91-22-6634-1286

Sanjeev Prasad
sanjeev.prasad@kotak.com
Mumbai: +91-22-6634-1229

Tarun Lakhotia
tarun.lakhotia@kotak.com
Mumbai: +91-22-6634-1188

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Key financial and operating details of 1QFY11 results

Exhibit 1 gives key highlights of HPCL's 1QFY11 results and compares the same on yoy and qoq basis. We do not see significant merit in comparison of quarterly results given high volatility in the timing and quantum of compensation from the government of India and contribution from upstream companies.

Interim results of Hindustan Petroleum, March fiscal year-ends (₹ mn)

					(% chg.)			
	1QFY11	1QFY11E	1QFY10	4QFY10	*1QFY11E*	*1QFY10*	*4QFY10*	2011E
Net sales	293,015	308,951	244,362	315,584	*(5.2)*	*19.9*	*(7.2)*	1,232,740
Increase/(decrease) in stock	(13,999)		10,694	11,120				
Raw materials	(83,952)	(107,573)	(86,540)	(97,732)	*(22.0)*	*(3.0)*	*(14.1)*	(455,721)
Staff cost	(3,662)	(4,326)	(6,057)	(5,342)	*(15.4)*	*(39.5)*	*(31.5)*	(16,250)
Product purchase	(197,416)	(184,621)	(139,252)	(183,130)	*6.9*	*41.8*	*7.8*	(697,126)
Others	(9,325)	(5,282)	(9,946)	(24,991)	*76.5*	*(6.2)*	*(62.7)*	(22,219)
Total expenditure	(308,354)	(301,803)	(231,100)	(300,074)	*2.2*	*33.4*	*2.8*	(1,191,316)
EBITDA	**(15,339)**	**7,147**	**13,262**	**15,510**	***(314.6)***	***(215.7)***	***(198.9)***	**41,424**
Other income	1,653	1,725	2,018	2,079	*(4.2)*	*(18.1)*	*(20.5)*	7,930
Interest	(1,968)	(2,278)	(2,702)	(1,640)	*(13.6)*	*(27.2)*	*20.0*	(9,477)
Depreciation	(3,174)	(2,648)	(2,629)	(3,175)	*19.9*	*20.8*	*(0.0)*	(12,696)
Pretax profits	**(18,829)**	**3,946**	**9,948**	**12,774**	***(577.2)***	***(289.3)***	***(247.4)***	**27,181**
Extraordinaries	(14)		—	37				—
Tax	—	(786)	(1,925)	(4,204)				(5,417)
Deferred tax	—	(767)	(1,532)	(1,031)				(3,612)
Net income	**(18,843)**	**2,392**	**6,491**	**7,576**	***(887.6)***	***(390.3)***	***(348.7)***	**18,152**
Adjusted net income	**(18,829)**	**2,392**	**6,491**	**7,539**	***(887.1)***	***(390.1)***	***(349.8)***	**18,152**
Tax rate (%)	0.0	39.4	34.8	40.9				33.2
Volume data								
Crude throughput (mn tons)	3.3	3.8	4.1	3.9		*(19.8)*	*(15.9)*	16.5
Domestic sales volume (mn tons)	6.5	6.9	6.3	6.3		*3.7*	*4.0*	29.2
Pipeline throughput (mn tons)	3.4		2.9	3.1		*16.6*	*10.8*	
Refining margin (US$/bbl)	3.7	3.0	5.7	3.2				3.8
Inventory gain/(loss)	3,220	(1,000)	10,800	70				3,500
Direct budgetary support	1,511	1,692	1,413	1,612				7,267
Subsidy gain/(loss)	(44,090)	(48,485)	(11,640)	(37,170)				(116,501)
Receipt from upstream companies	14,699	14,546	1,737	13,486				38,834
Receipt of oil bonds/cash from governmen	—	30,546	—	36,663				65,241
Net under-recovery	(29,391)	(3,394)	(9,903)	12,979				(12,427)

Source: Company, Kotak Institutional Equities estimates

- **Compensation (cash) from the government and discounts from the upstream oil companies.** HPCL did not receive any compensation from the government in 1QFY11 which was the case in 1QFY10 as well. HPCL received ₹14.7 bn of discounts from the upstream companies in 1QFY11 compared to ₹13.5 bn in 4QFY10. Its net under-recovery was ₹29.4 bn compared to under-recovery of ₹9.9 bn in 1QFY10. Exhibit 2 gives a computation of HPCL's annualized EBITDA based on 1QFY10 reported EBITDA of –₹15.3 bn and different scenarios of net under-recoveries (0%, 10% and 17%).

Annualized EBITDA, March fiscal year-end, 2011E (₹ bn)

1QFY11 EBITDA	**(15.3)**
Add: gross under-recovery	44.1
Less: receipt from upstream companies	(14.7)
Less: reported inventory gain	(3.2)
Add: adjustment for lower crude throughput	1.0
Annualized EBITDA assuming nil subsidy burden	**47.4**
Annualized EBITDA assuming 10% subsidy burden	35.8
Annualized EBITDA assuming 17% subsidy burden	27.6
KIE estimate of FY2011E EBITDA (adjusted for adventitious gains)	**37.9**

Source: Company, Kotak Institutional Equities estimates

- **Refining margins improved moderately qoq.** HPCL's 1QFY11 refining margin was US$3.7/bbl versus US$3.2/bbl in 4QFY10 and US$5.7/bbl in 1QFY10. The qoq increase in margins despite a decline in global refining margins reflects expansion in diesel cracks. We note that diesel constitutes ~40% of the product slate for HPCL.

- **Refining throughput declined; sales volumes increased.** HPCL's two refineries processed 3.3 mn tons of crude in 1QFY11 compared to 3.9 mn tons in 4QFY10 and 4.1 mn tons in 1QFY10. The crude throughput was lower due to (1) shutdown of FRE unit in Mumbai refinery since April 16, 2010 and (2) shutdown of CDU unit-II in Vizag refinery for 32 days. HPCL's sales volume was 6.5 mn tons for 1QFY11 (+3.7% yoy and +4% qoq).

Key risks: Upside—refining margins, deregulation; downside—crude prices

- **Refining margins.** We note that HPCL's earnings have very high sensitivity to changes in refining margins. A US$1/bbl change in refining margins impacts FY2012E EPS by 21%. We model a moderate improvement in refining margins from trough levels in FY2010 and estimate FY2011E and FY2012E refining margins at US$3.8/bbl and US$4.3/bbl versus FY2010's US$2.7/bbl.

- **Lower-than-expected subsidy burden.** We assume that downstream oil companies will bear around ₹55 bn of subsidy burden versus ₹56 bn in FY2010. We assume full deregulation of auto fuel prices in FY2012E and beyond resulting in under-recoveries pertaining to cooking fuels only. We have not assumed any change in retail prices of cooking fuels in our forecast period; thus, any increase in domestic retail prices will likely result in lower gross under-recoveries and lower net under-recoveries for the downstream oil companies including HPCL.

- **Higher-than-expected crude prices.** We see downside risk to earnings from higher-than-expected crude prices, which will likely result in higher-than-expected under-recoveries especially if the government does not deregulate prices of auto fuels. We currently believe that US$70-80/bbl is a comfortable range for crude prices (see our note *'In a comfortable zone'* released on July 21, 2010). However, we do not rule our uncertainty to earnings resulting from reluctance to adhere to the scheme of deregulation if crude prices rise significantly beyond our estimated range.

Earnings revision and key assumptions behind earnings model

We have revised our FY2011E, FY2012E and FY2013E EPS estimates to ₹54, ₹59 and ₹64 from ₹45, ₹62 and ₹66. We discuss key assumptions behind our earnings model below.

- **Compensation from government and discount from upstream companies.** For FY2011-13E, we assume the government will restrict the amount of net under-recoveries at around ₹55 bn for the downstream oil companies and will give sufficient compensation to maintain the profitability of downstream companies at a certain level. We model HPCL to receive compensation of ₹65 bn, ₹43 bn and ₹54 bn from the government in FY2011E, FY2012E and FY2013E. We assume HPCL to receive discount of ₹39 bn for FY2011E, ₹28 bn for FY2012E and ₹33 bn for FY2013E from the upstream companies. Exhibit 3 gives our assumed under-recoveries up to FY2012E and the breakdown of under-recoveries between the government, upstream companies and downstream companies.

Downstream oil companies may bear low subsidy burden in FY2011-12E
Share of various participants of under-recoveries, March fiscal year-ends, 2007-2012E (₹ bn)

	2007	2008	2009	2010	2011E	2012E
Dated Brent crude oil price (US$/bbl)	65	79	89	67	75	75
Gross under-recoveries	**521**	**798**	**1,061**	**490**	**550**	**396**
Direct budgetary support	**27**	**27**	**29**	**30**	**32**	**30**
Payment by government (oil bonds/cash)	**241**	**353**	**713**	**260**	**290**	**190**
Share of BPCL	53	86	162	53	69	46
Share of HPCL	49	77	147	56	63	41
Share of IOCL	138	190	404	152	158	103
Net under-recovery of oil companies	**253**	**418**	**319**	**200**	**228**	**176**
Share of refining companies	—	—	—	—	—	—
Share of upstream companies	**205**	**257**	**329**	**144**	**173**	**122**
Share of ONGC	170	220	282	116	142	101
Share of GAIL	15	14	18	13	11	8
Share of Oil India	20	23	29	15	19	13
Net under-recovery of R&M companies (BPCL, HPCL, IOCL)	**48**	**161**	**(10)**	**56**	**55**	**54**

Source: Company, Kotak Institutional Equities estimates

- **Refining margins.** We model refining margin for HPCL at US$3.8/bbl in FY2011E, US$4.3/bbl in FY2012E and US$4.9/bbl in FY2013E compared to US$2.7/bbl in FY2010. A large portion of our earnings revision for FY2011E stems from higher refining margins, +US$0.3/bbl versus our previous US$3.5/bbl. We expect refining margins to remain weak in CY2010-11E due to (1) global demand weakness and (2) significant refining capacity additions in CY2010-11E (2.3 mn b/d plus 1.2 mn b/d of additional OPEC NGL supply). We assume adventitious gains at ₹3.5 bn in FY2011E in line with 1QFY11's ₹3.2 bn and nil gains or losses for the future years.

- **Crude throughput.** We model crude throughput at 16.5 mn tons in FY2011E and 17.9 mn tons in FY2012E versus 15.8 mn tons in FY2010.

- **Marketing margins.** We model marketing margin on diesel and gasoline at –₹593/ton and –₹1,890/ton in FY2011E and ₹1,700/ton and ₹1,900/ton in FY2012E compared to ₹1,113/ton and –₹3,929/ton in FY2010. We expect gasoline prices to be deregulated by August 1, 2010 and diesel to be deregulated by January 2011 with the easing of inflationary concerns. We assume losses on LPG and kerosene throughout our forecast period.

- **Exchange rate.** We now assume ₹/US$ exchange rate for FY2011E, FY2012E and FY2013E at ₹46/US$, ₹46/US$ and ₹46/US$ versus ₹45/US$, ₹45.3/US$ and ₹45.3/US$ previously. A weaker rupee is moderately positive for earnings of HPCL for the refining segment although it is negative for marketing margins of controlled products if it is unable to pass on the increase in crude oil costs (higher on import parity basis) to customers.

HPCL's earnings can jump significantly in a blue sky scenario
EPS estimates, March fiscal year-ends, 2012-13E (₹)

	2012E	2013E
Base case	59	64
Blue sky scenario (a)	83	87
Potential upside (%)	**41**	**37**

Note:
(a) Assuming deregulation of auto fuels and full compensation of cooking fuels subsidy loss.

Source: Kotak Institutional Equities estimates

Stock offers 22% upside to our fair valuation of HPCL
Fair valuation of HPCL (₹)

Valuation based on P/E multiple	
Profit after tax for FY2012E (Rs mn)	19,880
Less: income from investment valued separately (Rs mn)	368
Adjusted profit after tax for FY2012E (Rs mn)	19,512
Adjusted EPS for FY2012E	58
P/E multiple (X)	8
Fair value on P/E (without value of investments) (A)	**460**
Add: Value of investments (Rs mn)	25,122
MRPL (Rs50/share) (Rs mn)	*14,858*
HPCL-Mittal Energy (Book value) (Rs mn)	*7,610*
Other unquoted investments (Rs mn)	*2,655*
Value of investments (B)	**74**
Total equity value (A) + (B)	**535**
Current stock price	437
Potential upside (%)	22

Source: Kotak Institutional Equities estimates

HPCL earnings model assumptions, March fiscal year-ends, 2006-2014E

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Rs/US$	44.3	45.3	40.3	45.8	47.4	46.0	46.0	46.0	46.0
Weighted average duty on products (%)	8.2	6.6	6.5	3.3	2.7	6.1	6.0	6.0	6.0
Import duty on crude	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2
Import 'tariff' on domestic crude (%)	2.6	2.6	2.6	0.5	0.2	2.6	2.6	2.6	2.6
Effective duty protection (%)	**3.1**	**1.4**	**1.3**	**2.4**	**2.3**	**0.9**	**0.9**	**0.9**	**0.9**
Refinery yield (US$/bbl)	63.3	73.1	89.8	96.0	73.4	85.6	86.2	92.0	92.0
Cost of crude (US$/bbl)									
-Imported	56.7	64.8	78.1	89.9	70.1	78.1	78.1	83.1	83.1
-Domestic	57.5	69.3	84.5	95.2	71.0	79.0	79.0	84.0	84.0
Landed cost of crude	59.4	68.8	83.2	92.0	70.6	81.8	81.8	87.1	87.1
Net refining margin (US$/bbl)	**3.9**	**4.3**	**6.6**	**4.0**	**2.7**	**3.8**	**4.3**	**4.9**	**4.9**
Crude throughput (mn tons)	**14.0**	**16.7**	**16.8**	**15.8**	**15.8**	**16.5**	**17.9**	**19.3**	**19.3**
-Imported	10.6	12.9	12.6	11.7	11.3	11.9	13.2	14.7	14.7
-Domestic	3.4	3.8	4.2	4.2	4.5	4.7	4.7	4.7	4.7
Production of main products	12.7	15.2	15.2	14.4	14.4	15.1	16.3	17.7	17.7
Production of other products	0.4	0.4	0.6	0.4	0.4	0.4	0.4	0.4	0.4
Fuel and loss	0.9	1.0	1.0	1.0	1.0	1.0	1.1	1.2	1.2
Fuel and loss (%)	6.3	6.0	6.0	6.1	6.1	6.1	6.1	6.1	6.1
Sales volume (mn tons)	**20.1**	**23.4**	**26.2**	**27.0**	**28.3**	**29.2**	**30.7**	**32.2**	**33.8**
Marketing margin (Rs/ton)	**(463)**	**(710)**	**(2,345)**	**(5,021)**	**697**	**189**	**1,629**	**1,599**	**1,596**

Source: Company, Kotak Institutional Equities estimates

HPCL's earnings have high leverage to refining margins
Earnings sensitivity of HPCL to refining margins and marketing margins (₹ mn)

	Fiscal 2011E			Fiscal 2012E			Fiscal 2013E		
	Downside	**Base Case**	**Upside**	**Downside**	**Base Case**	**Upside**	**Downside**	**Base Case**	**Upside**
Refining margins									
Refining margins (US$/bbl)	2.8	3.8	4.8	3.3	4.3	5.3	3.9	4.9	5.9
Net profits (Rs mn)	14,304	18,152	22,000	15,713	19,880	24,047	17,037	21,546	26,055
EPS (Rs)	42.2	53.5	64.9	46.4	58.6	70.9	50.3	63.6	76.9
% upside/(downside)	**(21.2)**		**21.2**	**(21.0)**		**21.0**	**(20.9)**		**20.9**
Marketing margins									
Auto fuels margins (Rs/ton)	(1,031)	(881)	(731)	1,595	1,745	1,895	1,595	1,745	1,895
Net profits (Rs mn)	17,979	18,152	18,325	18,117	19,880	21,643	19,656	21,546	23,437
EPS (Rs)	53.0	53.5	54.1	53.4	58.6	63.8	58.0	63.6	69.1
% upside/(downside)	**(1.0)**		**1.0**	**(8.9)**		**8.9**	**(8.8)**		**8.8**

Source: Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of HPCL, March fiscal year-ends, 2006-2014E (₹ mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Profit model (Rs mn)									
Net sales	708,609	889,959	1,043,130	1,249,348	1,084,977	1,232,740	1,290,414	1,430,020	1,489,967
EBITDA	**8,056**	**24,036**	**15,757**	**28,707**	**41,603**	**41,424**	**46,334**	**52,196**	**54,326**
Other income	3,285	6,845	11,980	9,057	7,859	7,930	7,876	6,825	5,781
Interest	(1,587)	(4,230)	(7,925)	(20,828)	(9,038)	(9,477)	(11,263)	(11,717)	(12,625)
Depreciation	(6,902)	(7,040)	(8,508)	(9,813)	(11,644)	(12,696)	(13,178)	(15,041)	(16,924)
Pretax profits	2,851	19,611	11,303	7,122	28,780	27,181	29,769	32,263	30,559
Extraordinary items	2,201	3,030	—	—	(7,530)	—	—	—	—
Tax	(898)	(6,625)	(1,799)	(2,416)	(5,615)	(5,417)	(7,798)	(6,430)	(7,272)
Deferred taxation	(97)	(365)	(2,025)	(343)	(2,046)	(3,612)	(2,090)	(4,287)	(2,879)
Prior period adjustment	—	61	3,870	1,387	(575)	—	—	—	—
Adjusted net profits	**2,289**	**13,617**	**11,349**	**5,750**	**17,829**	**18,152**	**19,880**	**21,546**	**20,408**
Earnings per share (Rs)	**6.8**	**40.2**	**33.5**	**17.0**	**52.6**	**53.5**	**58.6**	**63.6**	**60.2**
Balance sheet (Rs mn)									
Total equity	87,357	95,987	105,633	107,306	115,560	127,096	139,729	153,421	166,390
Deferred tax liability	13,844	14,209	15,960	16,034	18,080	21,691	23,781	28,068	30,947
Total borrowings	66,638	105,175	167,867	227,552	225,552	224,173	211,673	212,423	180,423
Currrent liabilities	79,549	101,195	124,337	117,558	101,360	117,079	123,722	135,030	137,200
Total liabilities and equity	**247,389**	**316,566**	**413,797**	**468,450**	**460,552**	**490,040**	**498,906**	**528,943**	**514,960**
Cash	426	868	2,940	6,083	2,608	2,559	2,472	2,537	2,676
Current assets	109,674	113,779	190,034	153,844	158,002	179,162	186,873	204,120	209,010
Total fixed assets	97,013	130,644	152,452	166,558	194,961	218,337	234,581	262,305	258,294
Investments	40,276	71,275	68,371	141,965	104,981	89,981	74,981	59,981	44,981
Total assets	**247,389**	**316,566**	**413,796**	**468,450**	**460,552**	**490,040**	**498,906**	**528,943**	**514,960**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	10,126	23,966	(18,679)	(12,139)	14,932	21,918	24,425	30,972	33,296
Working capital changes	(5,351)	8,936	(6,504)	48,461	(16,830)	(6,402)	(1,067)	(5,939)	(2,720)
Capital expenditure	(25,298)	(38,510)	(31,638)	(19,275)	(36,135)	(31,460)	(26,574)	(39,689)	(11,779)
Investments	(22,884)	(31,704)	(1,851)	(70,386)	36,984	15,000	15,000	15,000	15,000
Other income	941	2,067	4,692	3,187	4,332	8,892	7,876	6,825	5,781
Free cash flow	**(42,466)**	**(35,246)**	**(53,980)**	**(50,151)**	**3,284**	**7,947**	**19,659**	**7,169**	**39,578**
Ratios (%)									
Debt/equity	65.8	95.4	138.1	184.5	168.8	150.7	129.5	117.0	91.4
Net debt/equity	65.4	94.7	135.6	179.6	166.8	148.9	127.9	115.6	90.1
RoAE	4.1	14.9	9.8	4.7	10.1	12.9	12.7	12.5	10.8
RoACE	**2.5**	**8.6**	**5.0**	**5.3**	**6.8**	**6.7**	**7.3**	**7.6**	**7.5**
Key assumptions									
Crude throughput (mn tons)	14.0	16.7	16.8	15.8	15.8	16.5	17.9	19.3	19.3
Effective tariff protection (%)	3.1	1.4	1.3	2.4	2.3	0.9	0.9	0.9	0.9
Net refining margin (US$/bbl)	3.9	4.3	6.6	4.0	2.7	3.8	4.3	4.9	4.9
Sales volume (mn tons)	20.1	23.4	26.2	27.0	28.3	29.2	30.7	32.2	33.8
Marketing margin (Rs/ton)	(463)	(710)	(2,345)	(5,021)	697	189	1,629	1,599	1,596
Subsidy under-recoveries (Rs mn)	(23,372)	(7,685)	(31,191)	5,587	(12,297)	(12,427)	(12,201)	(12,024)	(11,879)

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Godrej Consumer Products (GCPL)

Consumer products

ADD

JULY 24, 2010

RESULT

Coverage view: Attractive

Price (Rs): 359

Target price (Rs): 400

BSE-30: 18,131

Execution is the key. 1QFY11 standalone sales disappoint—soaps declined ~8% in volumes and value each (inventory correction and intense competition, in our view) and hair color grew 5%. We reiterate that potential for geographical distribution benefits exist—GHPL is strong in South India (Good Knight) whereas GCPL is in North India. Key risk is unhedged a USD loan (1% change in LIBOR = 2% of FY2011E EPS). Our rating on the stock is ADD with a new SOTP-derived target of Rs400.

Company data and valuation summary

Godrej Consumer Products

Stock data			
52-week range (Rs) (high,low)			383-202
Market Cap. (Rs bn)			110.6
Shareholding pattern (%)			
Promoters			71.8
FIIs			18.5
MFs			0.8
Price performance (%)	1M	3M	12M
Absolute	5.0	21.8	74.3
Rel. to BSE-30	1.8	19.2	47.9

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	11.3	13.0	17.3
EPS growth (%)	69.5	14.4	33.1
P/E (X)	31.7	27.7	20.8
Sales (Rs bn)	20.4	34.7	44.1
Net profits (Rs bn)	3.4	4.2	5.6
EBITDA (Rs bn)	4.3	6.5	8.3
EV/EBITDA (X)	25.4	18.9	14.2
ROE (%)	44.6	31.0	30.4
Div. Yield (%)	1.1	0.9	0.9

QUICK NUMBERS

- 1QFY11 results disappoint – soap sales down 8% in volume and value
- We value GCPL on SOTP basis with an ADD rating
- Key risk is unhedged USD loan (1% change in LIBOR = 2% of FY2011E EPS)

1QFY11 standalone results disappoint; consolidated not comparable yoy

GCPL reported standalone net sales of Rs3.2 bn, (-7%, KIE estimate Rs3.4 bn), EBITDA of Rs621 mn (-9%, KIE estimate Rs660 mn) and adjusted PAT of Rs548 mn (-9%, KIE estimate Rs591 mn).

Soaps portfolio—which forms about two-third of standalone sales—declined 8% in volumes and value each—due to (1) lower category growth due to impact of food inflation and (2) channel inventory correction undertaken by the company as well as by the trade. Hair color portfolio has grown 5% during the quarter. Gross margins declined 490 bps yoy—as expected—as the palm oil prices are ~20% higher and GCPL had benefited in FY2010 due to input cost correction (FY2010 margins were peak margins, in our view). However, a better comparator in staff cost (variable component in base quarter) limited the EBITDA decline to just 40 bps yoy.

Consolidated sales grew +47% to Rs6.4 bn, EBITDA +38% to Rs1.2 bn and PAT +21% to Rs841 mn. Consolidated financials are not comparable due to acquisitions in 1QFY11. The company received Rs403 mn (pre tax) from P&G on account of sale of Ambi Pur. According to the company, it has the technology to develop a similar product in India. Ambi Pur, Kiwi, Brylcreem, together account for ~10% of GHPL sales.

String of acquisitions

In YTD CY2010, GCPL has grown its portfolio through acquisitions across Latin America, Africa and Asia. Exhibit 4 summarizes the recent acquisitions by GCPL. We briefly discuss each of the businesses below:

- **Godrej Household Products**: GCPL acquired 49% stake in GHPL in September 2009 and the balance 51% in May2010. ~80% of GHPL's portfolio consists of household insecticides which includes the brands GoodKnight, Hit. We are bullish on this business due to (1) low penetration, (2) higher urban salience in sales (providing opportunity for rural distribution-led growth) and (3) GHPL's strong market share position. We model sales growth of 18% and 20% in FY2011E and FY2012E (GHPL—earlier called as Godrej Sara Lee—has grown sales at a CAGR of ~24% in FY2007-10 and ~17% between FY2000-10.

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

- **Megasari, Indonesia** - Acquisition of Megasari group in Indonesia places GCPL at the #2 position in Asia (ex Japan) in the household insecticides sector. We model sales CAGR of 17.5% in FY2010-12E.

- **Tura, Nigeria** – a relatively smaller acquisition of GCPL—purchased for gaining access to the Nigerian market—it is primarily present in medicated soaps segment. It operates under the brand Tura and had sales of ~Rs450mn in FY2010. We estimate sales growth of 8% and 12% in FY2011E and FY2012E.

- **Argencos, Latin America** – a hair care company with presence across hair color, hair styling, shampoo and conditioner. Key brands include Roby and 919. We estimate ~9% sales CAGR in FY2010-12E.

- **Issue Group** – Latin America based Issue Group, is present in hair color, bleaching powder, shampoo and conditioner. We estimate sales CAGR of 12% in FY2010-12E.

Exhibit1: Interim standalone results of Godrej Consumer Products, March fiscal year ends (Rs mn)

					(% chg)		
	1QFY11	1QFY11E	1QFY10	4QFY10	1QFY11E	1QFY10	4QFY10
Net sales	**3,174**	**3,387**	**3,398**	**2,824**	**(6)**	**(7)**	**12**
Total expenditure	(2,553)	(2,727)	(2,717)	(2,124)		(6)	20
Material cost	(1,582)	(1,669)	(1,527)	(1,146)		4	38
Staff cost	(152)	(182)	(305)	(103)		(50)	47
Advertising & promotion	(272)	(299)	(287)	(282)		(5)	(4)
Other expenditure	(548)	(577)	(598)	(593)		(8)	(8)
EBITDA	**621**	**660**	**681**	**700**	**(6)**	**(9)**	**(11)**
OPM (%)	**19.6**	**19.5**	**20.0**	**24.8**			
Other income #	1,271	124	105	98		1,110	1,192
Interest	(13)	(15)	(17)	(6)		(27)	105
Depreciation	(36)	(35)	(39)	(27)		(9)	34
Pretax profits	**1,844**	**734**	**730**	**766**	**151**	**153**	**141**
Tax	(136)	(143)	(127)	(135)		7	1
Reported PAT	**1,708**	**591**	**603**	**631**	**189**	**183**	**171**
Adj. PAT	**548**	**591**	**603**	**631**	**(7)**	**(9)**	**(13)**
Income tax rate (%) @	7.4	19.5	17.4	17.6			
Costs as a % of net sales							
Material cost	49.8	49.3	44.9	40.6			
Staff cost	4.8	5.4	9.0	3.7			
Advertising & promotion	8.6	8.8	8.5	10.0			
Other expenditure	17.3	17.0	17.6	21.0			

Note:
Other income includes Rs1.16 bn of dividend from subsidiary which is netted off in consolidation
@ Adjusted income tax rate for 1QFY11 is 20%

Source: Company, Kotak Institutional Equities

Exhibit2: Interim consolidated results of Godrej Consumer Products , March fiscal year ends (Rs mn)

				(%) chg	
	1QFY11	1QFY10	4QFY10	1QFY10	4QFY10
Net sales	**6,431**	**4,389**	**5,092**	**47**	**26**
Total expenditure	(5,240)	(3,524)	(4,017)	49	30
Material cost	(3,168)	(2,022)	(2,268)	57	40
Staff cost	(439)	(373)	(327)	18	34
Advertising & promotion	(651)	(433)	(345)	50	88
Other expenditure	(982)	(696)	(1,077)	41	(9)
EBITDA	**1,191**	**864**	**1,075**	**38**	**11**
OPM (%)	**18.5**	**19.7**	**21.1**		
Other income	106	101	122	4	(13)
Interest	(105)	(38)	(27)	178	288
Depreciation	(84)	(52)	(61)	62	39
Pretax profits	**1,108**	**876**	**1,110**	**27**	**(0)**
Tax	(267)	(179)	(192)	49	39
Adjusted PAT	**841**	**697**	**918**	**21**	**(8)**
Exceptional item	322	-	-		
Reported PAT	**1,164**	**697**	**918**		
Income tax rate (%)	24.1	20.5	17.3		
Costs as a % of net sales					
Material cost	49.3	46.1	44.5		
Staff cost	6.8	8.5	6.4		
Advertising & promotion	10.1	9.9	6.8		
Other expenditure	15.3	15.9	21.2		
Segment revenue of Godrej Consumer Products					
Personal wash	2,122				
Home care	1,865				
Hair care	1,158				
Others	965				
Exports	322				

Source: Company, Kotak Institutional Equities

Exhibit3: 1QFY11 performance of GCPL's international subsidiaries

Region	**Business segment**	**Sales (Rs mn**	**EBITDA (Rs mn)**	**Margin (%**	**Remarks**
Indonesia	Megasari	830	140	17	of 21% before payment of technical fee to GCPL
Africa	Tura, Rapidol, Kinky	340	60	18	Acquisition wef June16, 2010
Latin America	Issue Group	120	NA	NA	Acquisition wef June2, 2010
United Kingdom	Keyline	530	70	13	

Source: Company, Kotak Institutional Equities

Exhibit 4: Snapshot of GCPL's business segments

Business segment	Country	Category	Brands	Sales (Rs mn) FY2010	FY2011E	FY2012E	EBITDA (Rs mn) FY2010	FY2011E	FY2012E	Remarks
Domestic	India	Soaps, Hair color	Godrej No.1, Cinthol, Godrej Expert hair dye	12,679	13,549	14,821	2,659	2,447	2,553	
International	South Africa, UK	Hair color etc.	Kinky, Rapidol ,Keyline (UK)	3,644	3,379	3,676	658	544	603	
Tura	Nigeria	Soaps	Tura	450	365	544	68	55	87	FY2010 - Tura had sales of US$11 mn and assuming exchange rate of 1US$ = Rs45. FY2011E - Financials for 9 months has been incorporated
Megasari	Indonesia	Household insecticide	Hit, Stella etc.	5,400	5,547	7,875	1,080	1,132	1,536	FY2011E - Megasari financials is for 10 months
Godrej Household	India	Household insecticide	Good Knight, Hit etc.	4,089	10,045	14,452	756	1,908	2,961	FY2010 - Financials are for 10 months for 49% stake that GCPL had in GHPL. FY2011E - Financials are for 49% stake for 2 months and 100% stake for 10 months
Argencos	Argentina	Hair color		720	583	855	101	87	128	FY2011E - Argencos financials is for 9 months
Issue	Argentina	Hair color		1,485	1,247	1,863	208	175	261	FY2011E - Issue financials is for 9 months
Total					**34,715**	**44,086**		**6,348**	**8,129**	

Note:
FY2010 sales and EBITDA includes domestic, international and Godrej Household Products

Source: Kotak Institutional Equities estimates

Key variables to watch

Soaps facing significant headwinds - Focus on regional brands and micro-marketing initiatives by HUL and aggressive trade-spend driven growth strategy of ITC seems to be hurting GCPL’s soaps business, in the near-term, in our view. Given the competitive intensity in the category, GCPL’s target of gaining 1% incremental market share every year in soaps category looks difficult in FY2010-12E.

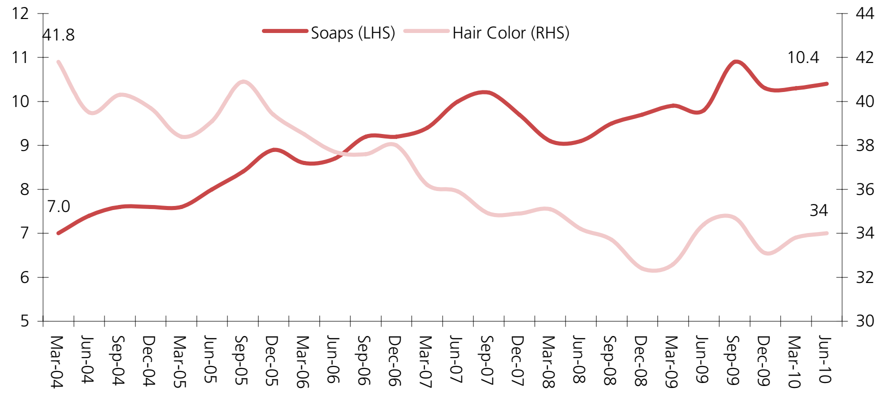
Palm oil prices – GCPL has seen gross margin decline during the quarter on account of higher raw material cost (and also an unfavorable mix—summer season is seasonally strong for soaps. The management says that GCPL has hedges in palm oil for ~6 months (likely till December 2010). This is critical as GCPL has traditionally been a price taker and lower input costs provides a fillip to players like GCPL that operate in the value-for-money segment (and hence the requirement for trade spends are relatively higher).

Distribution synergies – We reiterate our view highlighted in note dated October 30, 2009 that potential for geographical distribution benefits exist—GHPL is strong in South India (Good Knight) whereas GCPL is in North India. We expect GCPL’s domestic business to benefit from distribution synergies such that its soap portfolio may be actively marketed in south and household insecticides portfolio may be marketed in north. Moreover, there is scope to increase the active distribution coverage in existing markets due to integration of current distribution set-up (even with out rationalizing on the number of distributors).

New technology – GCPL has the opportunity to leverage Argencos’s technology to introduce crème hair color in sachets in India.

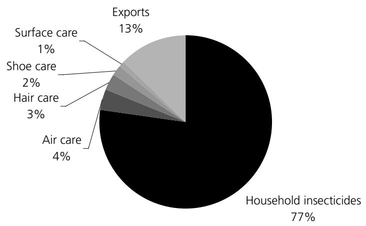
Cross pollinating products across geographies – GCPL could explore synergistic opportunities between its various business segments and evaluate options of cross pollinating products across geographies (for example hair color in Nigeria from the portfolio of Rapidol in South Africa)

Exhibit5: Marginal improvement in soap and hair color market share
Value market shares in soaps and hair color, %



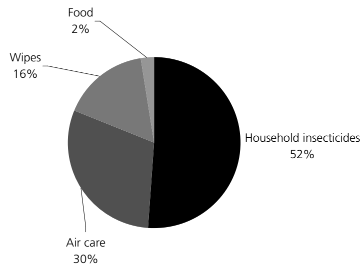
Source: Company, Kotak Institutional Equities

Exhibit6: Dominant share of household insecticides
Sales mix of GHPL, March fiscal year-end 2010 (%)



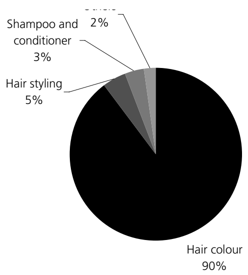
Source: Company, Kotak Institutional Equities

Exhibit7: Leading household insecticides player in Indonesia
Sales mix of Megasari, March fiscal year-end 2010 (%)



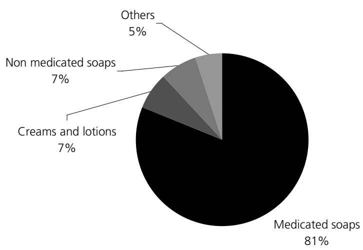
Source: Company, Kotak Institutional Equities

Exhibit8: Leading hair colour player in Argentina
Sales mix of Argencos, March fiscal year-end 2010 (%)



Source: Company, Kotak Institutional Equities

Exhibit9: Beauty care range dominated by soaps
Sales mix of Tura, March fiscal year-end 2010 (%)



Source: Company, Kotak Institutional Equities

ADD with SOTP-derived target price of Rs400

We assign an ADD rating to the stock with a target price of Rs400. We value GCPL on SOTP as the company operates in multiple categories (personal wash, hair color and household insecticides) with varying growth characteristics and multiple geographies (India, Indonesia, Africa, UK and Latin America). Moreover, considering the business transformation of GCPL (risk profile as well), we note that comparing the historical trading multiples is not meaningful. Please see Exhibit 10 for our detailed assumptions. We forecast earnings growth of 14.4% in FY2011E and 33.1% in FY2012E. The full year consolidation of the acquisitions and the resultant synergies will be seen in FY2012E.

Key risk is unhedged USD loan raised for overseas acquisitions (1% change in LIBOR = 2% of FY2011E EPS)—we model a 5% interest cost for FY2011E and FY2012E, respectively. Other risks are (1) inflation in input costs not neutralized by price increases, (2) underperformance of overseas subsidiaries and (3) inability to outperform market growth rate in hair color.

Exhibit 10: Key assumptions, March fiscal year-ends 2011, 2012

Sales (Rs mn)	2009	2010	2011E	2012E	Comments
Domestic	10,843	12,679	13,549	14,821	
- Soaps	7,125	8,241	8,488	9,083	
- Hair colour	2,305	2,789	3,012	3,314	
Godrej Household		4,089	10,045	14,452	FY2010 - Financials are for 10 months for 49% stake that GCPL had in GHPL. FY2011E - Financials are for 49% stake for 2 months and 100% stake for 10 months
Kinky	558	762	804	901	
Keyline	1,999	2,146	1,814	1,923	
Rapidol	530	736	761	852	
Megasari			5,547	7,875	FY2011E - Megasari financials is for 10 months
Tura			365	544	FY2011E - Financials for 9 months has been incorporated
Argencos			583	855	FY2011E - Argencos financials is for 9 months
Issue Group			1,247	1,863	FY2011E - Issue financials is for 9 months

Sales growth (%)	2009	2010	2011E	2012E	Comments
Domestic					
- Soaps	26	16	3	7	Assuming low single-digit sales growth, given the rising competition in this segment
- Hair colour	13	21	8	10	
Godrej Household			18	20	Bullish on sales growth in insecticides. Will likely benefit from synergies in distribution gro
Kinky		40	12	12	
Keyline	11	21	(8)	6	
Rapidol	21	41	10	12	
Megasari			17	18	
Tura			8	12	
Argencos			8	10	
Issue Group			12	12	

EBITDA margin (%)	2009	2010	2011E	2012E	Comments
Domestic	15	21	18	17	
Godrej Household		19	19	20	~60% of non coil business helps clock higher margins
Kinky	18	18	17	18	
Keyline	14	15	14	14	
Rapidol	18	25	21	21	
Megasari			20	20	
Tura			15	16	
Argencos			15	15	
Issue Group			14	14	

Company (Rs mn)	2009	2010	2011E	2012E	Comments
Sales	13,930	20,412	34,715	44,086	
EBITDA	2,037	4,073	6,348	8,129	
EBIT	1,845	3,837	6,019	7,676	
Interest	172	159	(757)	(583)	US$ 350mn net debt as on March 31, 2010. Assuming 5% interest rate on offshore debt
Other income	75	203	187	204	
PBT	2,092	4,199	5,448	7,298	
Tax	(366)	(803)	(1,251)	(1,710)	
PAT	1,726	3,396	4,197	5,588	
Effective tax rate (%)	17	19	23	23	

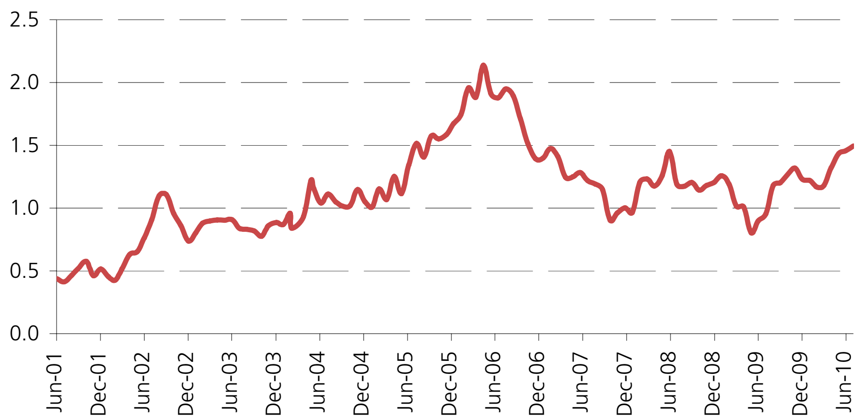
Source: Kotak Institutional Equities estimates

Exhibit11: SOTP valuation of GCPL

		EBITDA (Rs mn)		EBITDA multiple (x	EV	
Business segment	Country	FY2011E	FY2012E	FY2012E		Remarks
Domestic	India	2,447	2,553	14.8	37,783	(a) 15X FY2012E, 20% discount to Dabu
International	South Africa, UK	544	603	13.3	8,029	10% discount to (a)
Tura	Nigeria	55	87	13.3	1,160	10% discount to (a)
Megasari	Indonesia	1,132	1,536	14.8	22,726	At par with (a)
Godrej Household	India	1,908	2,961	20.4	60,262	10% premium to (a)
Argencos	Argentina	87	128	13.3	1,709	10% discount to (a)
Issue	Argentina	175	261	13.3	3,474	10% discount to (a)
EV #		**6,348**	**8,129**		**135,144**	
Less: Net debt					**(7,540)**	
Equity value					**127,604**	
Price per share (Rs)					**399**	
Implied PE on FY2012E (x)					**22.2**	

Source: Kotak Institutional Equities estimates

Exhibit12: Relative P/E of GCPL versus Sensex (X)



Source: Bloomberg, Kotak Institutional Equities

Exhibit13: GCPL: Profit model, balance sheet, 2007-2012E, March fiscal year-ends (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Profit model (Rs mn)						
Net sales	9,515	11,026	13,930	20,412	34,715	44,086
EBITDA	**1,797**	**2,148**	**2,037**	**4,073**	**6,348**	**8,129**
Other income	26	37	75	203	187	204
Interest	(96)	(126)	172	159	(757)	(583)
Depreciation	(142)	(182)	(192)	(236)	(329)	(452)
Pretax profits	1,585	1,878	2,092	4,199	5,448	7,298
Tax	(243)	(283)	(366)	(803)	(1,251)	(1,710)
Net profits	**1,342**	**1,595**	**1,726**	**3,396**	**4,197**	**5,588**
Earnings per share (Rs)	**5.9**	**7.1**	**6.7**	**11.3**	**13.0**	**17.3**
Balance sheet (Rs mn)						
Total equity	1,220	1,687	5,668	9,547	17,510	19,218
Total borrowings	1,736	1,871	2,776	369	15,776	9,576
Currrent liabilities	2,617	3,227	3,299	5,528	4,479	4,931
Deferred tax liability	80	89	42	66	63	63
Total liabilities and equit	**5,653**	**6,874**	**11,785**	**15,510**	**37,828**	**33,789**
Cash	475	426	3,783	3,052	2,623	2,037
Current assets	2,300	3,093	3,544	6,044	4,173	4,678
Total fixed assets	1,992	2,399	2,297	2,626	3,618	3,661
Investments	0	0	75	670	670	670
Other non current assets	886	956	2,086	3,119	26,744	22,744
Total assets	**5,653**	**6,874**	**11,785**	**15,510**	**37,828**	**33,789**
Key assumptions						
Revenue Growth (%)	36.0	15.9	26.3	46.5	70.1	27.0
EBITDA Margin(%)	18.9	19.5	14.6	20.0	18.3	18.4
EPS Growth (%)	12.5	18.9	(5.3)	69.5	14.4	33.1

Source: Kotak Institutional Equities estimates

kotak Institutional Equities

Indian Bank (INBK)

Banks/Financial Institutions

ADD

JULY 26, 2010

RESULT

Coverage view: Attractive

Price (Rs): 251

Target price (Rs): 280

BSE-30: 18,131

Quarter belies expectations. NPLs rise sharply; Downgrade to ADD. Indian Bank reported below par results, as asset quality deteriorated sharply with a 5.3% (annualized) slippage for the quarter – much higher than expected. While a large part of the slippage is technical, one-off in nature, the quantum is still high and is worrying. We expect the stock to trade sharply lower on account of this and likely to underperform over the medium term. However, valuations at 1.1X FY2012E PBR for 20% ROE are still reasonable. Downgrade to ADD.

Company data and valuation summary

Indian Bank

Stock data			
52-week range (Rs) (high,low)			260-125
Market Cap. (Rs bn)			108.0
Shareholding pattern (%)			
Promoters			80.0
FIIs			12.8
MFs			2.2
Price performance (%)	**1M**	**3M**	**12M**
Absolute	10.8	30.3	72.0
Rel. to BSE-30	8.5	27.2	44.5

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	35.1	35.5	43.8
EPS growth (%)	25.5	1.1	23.6
P/E (X)	7.2	7.1	5.7
NII (Rs bn)	33.0	37.7	44.4
Net profits (Rs bn)	15.5	15.6	19.2
BVPS	155.5	183.8	218.8
P/B (X)	1.6	1.4	1.1
ROE (%)	24.0	20.3	21.2
Div. Yield (%)	2.4	2.4	3.0

QUICK NUMBERS

- Fresh slippages of 5% for the quarter
- NII growth at 26% yoy; NIM maintained at 3.7%
- Maintaining TP; reducing to ADD

Seeking clarity on asset quality; downgrade to ADD

We are downgrading Indian Bank from BUY to ADD. We have revised our estimates for FY2010 but find valuations reasonable for the bank at 1.1X FY2012 PBR delivering RoEs in the range of 20% levels. However, we expect the bank to underperform till better clarity emerges on the bank's outlook on asset quality; a key overhang. Fresh slippage from hitherto unknown segments of loan book marks a sharp deviation from our discussion with the management in the recent past. We are yet to derive comfort from the fact that some of the slippages could be technical in nature recoveries could therefore be higher in the next few quarters.

Slippages at 5% for the quarter; gross NPA nearly doubles qoq

Indian Bank reported Rs 8.2 bn (5% slippages annualized) for the quarter, disappointing considering the reduction in restructured loans and low NPLs reported in March 2010. Gross NPA nearly doubled qoq at Rs9.9 bn (1.5% of loans) while net NPA increased to Rs 5.1 bn (0.8% of loans compared to 0.2% in March 2010). Slippages from the (1) restructured book (Rs 3.6 bn) (2) agriculture NPL (Rs2.2 bn) 3) change in recognition of NPLs giving fewer discretionary power to reclassify an asset as standard were the primary causes for the increase. Delay in payment (Rs 2.1 bn) in government sponsored schemes (largely restructured loans) led to higher slippages. Provision coverage declined to 48% from 72% in the previous quarter (including written-offs: 83% as compared to 94% in March 2010). Loan loss provisions were higher at Rs4 bn (2.6%).

Recoveries expected; but asset quality overhang will prevail

The management highlighted that the agri NPLs of Rs2.2 bn was one-off pertaining to the debt-waiver scheme. Further, about Rs2 bn was due to the bank moving towards system-driven recognition, rather than manual recognition, which the bank was following earlier – again a one-off. Slippage from the restructured book (Rs3.6 bn) was expected. The management expects strong recoveries over the rest of the year and new delinquencies are likely to remain low hereon, however, the overhang would remain. We currently model a delinquency ratio of 3% in FY2011E (about 1% in FY2010) and 1.3% in FY2012E to factor the credit risk.

Manish Karwa
manish.karwa@kotak.com
Mumbai: +91-22-6634-1350

M B Mahesh
mb.mahesh@kotak.com
Mumbai: +91-22-6634-1231

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Restructured loans decline to 2% of loans from the peak 10% in 2QFY10

In our interaction with the management, they highlighted that out of the total restructured book, about Rs20 bn has witnessed proper servicing during the quarter (for the past 12 months) and are now considered as standard loans. Thus, from a peak restructured book of Rs57 bn, about Rs 33 bn of loans have been upgraded / slipped as of June 2010, resulting in a restructured book of Rs14 bn as of June 2010 (2% of loans). Indian Bank also saw Rs. 3.6 bn (nearly 7% of restructured loans) slipping during the quarter.

Core operating performance stable; margins decline by 20 bps qoq at 3.7%

Indian Bank reported a net interest income (NII) of Rs9.3 bn (up 26% yoy). NIMs declined by 20 bps at 3.7% qoq for 1QFY11 but was supported by an increase in credit deposit ratio. Costs of deposits showed an increase reflecting the revised savings interest rates while lending yields was stable for the quarter. CASA ratio increased by 90 bps qoq to 32.7% as of June 2010 while credit-deposit ratio increased by 380 bps qoq to 75%. We are building NIMs to decline by ~20 bps by FY2012 from the levels of 3.6% (KS calc) reported in FY2010.

Asset growth remains strong

Indian Bank's loan growth has improved to 31% yoy as of June 2010, which was well ahead of the industry. The company's has increased thrust on higher yielding assets in recent quarters mainly in SME loans (up 32% yoy) while lending to large corporates were up by 39% yoy. Deposit growth was relatively slower at 19% yoy while CASA deposits grew impressively by 31% yoy.

Other operational highlights for the quarter

- Non-interest revenues for 1QFY11 were Rs3.5 bn (flat yoy). The sharp decline in treasury profits (45% yoy) was the prime reason for this muted growth in these revenues. Income from recovery of written-off accounts declined by 20% to Rs640 mn. Core fee income saw a strong growth of 40% yoy to Rs2.3 bn.

- Cost-income ratio was at 35% for the quarter. The bank has charged Rs 82 mn for the revised gratuity benefit with the balance taken across a period of five years.

We reduce our estimates for FY2011E by 9% to factor the results
Old and new estimates, March fiscal year-ends, 2011-12E (Rs mn)

	Old estimates		New estimates		% change	
	2011E	2012E	2011E	2012E	2011E	2012E
Net interest income	37,665	44,355	39,680	45,164	5.3	1.8
Loan growth	23.7	23.3	21.3	21.2		
Spread	2.9	2.9	3.2	3.0		
NIM	3.49	3.47	3.69	3.53		
Loan loss provisions	5,606	6,056	9,627	7,503	71.7	23.9
Other income	10,854	12,093	11,134	12,454	2.6	3.0
Fee income	3,635	4,233	2,682	3,192	(26.2)	(24.6)
Treasury income	1,000	1,200	1,000	1,200	-	-
Operating expenses	19,606	21,954	19,579	21,318	(0.1)	(2.9)
Employee expenses	14,010	15,175	12,973	14,057	(7.4)	(7.4)
PBT	22,307	27,437	20,413	27,603	(8.5)	0.6
Tax	6,692	8,231	6,124	8,281	(8.5)	0.6
Net profit	15,615	19,206	14,289	19,322	(8.5)	0.6
PBT before treasury and invest. depn	21,807	26,737	19,913	26,903	(8.7)	0.6
PBT - treasury + invest. deprn + LLP	27,413	32,794	29,540	34,406	7.8	4.9

Source: Company, Kotak Institutional Equities estimates

Indian Bank quarterly results
March fiscal year-ends, 1QFY10-1QFY11 (Rs mn)

	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	% change	1QFY11E	Actual Vs KS
Interest Earned	18,802	19,372	20,148	20,249	21,218	13	21,067	1
Interest/Discount on Advances/Bills	14,193	14,123	14,656	15,026	15,846	12	15,941	(1)
Interest on Investment	4,450	5,039	5,369	5,116	5,262	18	5,019	5
Interest on bal. with RBI & other inter bank funds	159	210	123	107	110	(31)	107	2
Interest expense	11,426	11,780	11,418	10,908	11,951	5	11,638	3
Net interest income	**7,377**	**7,591**	**8,730**	**9,341**	**9,266**	**26**	**9,429**	**(2)**
Other Income	3,502	2,372	2,935	2,929	3,555	2	3,067	16
Other Income exld treasury	2,472	2,073	2,162	2,854	2,985	21	2,769	8
Treasury	1,029	299	773	75	570	(45)	298	91
Recovery	802	286	432	901	640	(20)	617	4
Total Income	**10,878**	**9,963**	**11,665**	**12,270**	**12,821**	**18**	**12,497**	**3**
Operating Expenses	**4,573**	**4,425**	**4,758**	**3,546**	**4,443**	**(3)**	**4,452**	**(0)**
Payments to / Provisions for employees	3,452	3,114	3,408	2,150	3,215	(7)	3,107	3
Other operating expenses	1,121	1,312	1,350	1,396	1,228	10	1,345	(9)
Operating Profit Before Prov. & Cont.	6,305	5,538	6,907	8,723	8,378	33	8,044	4
Provisions & Contingencies	1,209	293	320	2,136	3,439	185	1,992	73
Loan loss provisions	1,400	350	320	3,110	4,100	193	1,728	137
Investment depreciation	-	(250)	-	(715)	-	-	125	-
Profit before tax	**5,096**	**5,245**	**6,586**	**6,588**	**4,939**	**(3)**	**6,052**	**(18)**
Provision for Taxes	1,780	1,526	2,172	2,488	1,258	(29)	2,050	(39)
Net Profit	**3,317**	**3,719**	**4,414**	**4,100**	**3,681**	**11**	**4,002**	**(8)**
Tax rate	35	29	33	38	25			
Key balance sheet items (Rs bn)								
Deposits	767	801	847	882	910	19		
CASA	227	248	264	281	298			
CASA (%)	29.6	31.0	31.1	31.8	32.7			
Advances	520	539	575	627	680	31		
Priority sector	189	196	210	217	237			
Agriculture	80	82	88	91	104			
Investments	230	269	286	274	291			
Yield management measures (%)								
Yield on advances	11.0	10.8	10.9	10.2	10.1			
Cost of deposits	6.1	5.9	5.6	5.1	5.3			
NIM	3.6	3.5	3.8	3.9	3.7			
Asset quality measures								
Gross NPL (Rs bn)	4.7	4.8	5.1	5.1	9.9			
Gross NPL (%)	0.9	0.9	0.9	0.8	1.5			
Net NPL (Rs bn)	2.1	1.0	0.9	1.4	5.1			
Net NPL (%)	0.4	0.2	0.2	0.2	0.8			
Provision coverage ratio (%)	56.6	79.7	82.6	71.6	48.3			
Provision coverage ratio (w/o) (%)				93.7	83.1			
Slippages (Rs bn)	0.5	0.8	0.6	3.9	8.2			
Slippages ratio (%)	0.4	0.6	0.4	2.7	5.3			
Restructured loans (Rs bn)	41.0	52.0	51.0	34.0	14.5			
Restructured loans (%)	7.9	9.6	8.9	5.4	2.1			
Capital adequacy details								
CAR (%)	14.2	13.9	13.2	12.7	12.5			
Tier I (%)	12.0	12.1	11.6	11.1	10.5			
Tier II (%)	2.2	1.8	1.6	1.6	2.0			

Source: Company, Kotak Institutional Equities estimates

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

	2008	2009	2010	2011E	2012E	2013E
Growth rates (%)						
Net loan	37.1	29.2	20.8	21.3	21.2	20.9
Total Asset	25.6	19.3	20.5	18.0	18.0	17.9
Deposits	29.6	18.9	21.6	19.4	19.1	18.8
Current	30.4	11.8	25.2	19.4	19.1	18.8
Savings	15.1	17.7	23.3	19.4	19.1	18.8
Fixed	35.8	20.2	20.5	19.4	19.1	18.8
Net interest income	10.5	26.1	26.7	20.1	13.8	12.7
Loan loss provisions	171.0	(81.7)	478.7	103.9	(22.1)	(19.3)
Total other income	29.7	(3.1)	13.4	(5.1)	11.9	10.1
Net fee income	21.0	29.5	(3.8)	20.0	19.0	18.0
Net capital gains	389.3	(19.3)	11.7	(54.1)	20.0	-
Net exchange gains	20.0	20.0	20.0	15.0	15.0	15.0
Operating expenses	12.3	13.4	8.9	13.2	8.9	13.5
Employee expenses	10.1	19.2	5.2	7.0	8.4	11.4
Key ratios (%)						
Yield on average earning assets	8.5	9.2	8.8	8.7	8.9	9.0
Yield on average loans	10.2	11.1	10.2	10.2	10.4	10.5
Yield on average investments	8.0	7.7	8.0	7.5	7.5	7.5
Average cost of funds	5.6	6.2	5.6	5.5	5.8	6.2
Interest on deposits	5.5	6.1	5.6	5.5	5.8	6.2
Difference	**2.9**	**3.0**	**3.2**	**3.2**	**3.0**	**2.9**
Net interest income/earning assets	3.2	3.5	3.7	3.7	3.5	3.4
New provisions/average net loans	1.3	0.2	0.8	1.4	0.9	0.6
Interest income/total income	65.9	71.6	73.8	78.1	78.4	78.8
Fee income to total income	5.7	6.4	5.0	5.3	5.5	5.8
Operating expenses/total income	44.6	43.6	38.6	38.5	37.0	37.4
Tax rate	18.3	30.3	33.9	30.0	30.0	30.0
Dividend payout ratio	12.8	17.3	18.0	18.0	18.0	18.0
Share of deposits						
Current	24.6	24.3	24.7	24.7	24.7	24.7
Fixed	67.7	68.4	67.8	67.8	67.8	67.8
Savings	24.6	24.3	24.7	24.7	24.7	24.7
Loans-to-deposit ratio	65.3	70.9	70.4	71.5	72.8	74.1
Equity/assets (EoY)	6.8	8.0	7.8	7.5	7.4	7.3
Dupont analysis (%)						
Net interest income	3.3	3.4	3.6	3.6	3.5	3.3
Loan loss provisions	0.7	0.1	0.5	0.9	0.6	0.4
Net other income	1.7	1.3	1.3	1.0	1.0	0.9
Operating expenses	2.0	2.0	1.9	1.8	1.7	1.6
Invt. depreciation	0.2	—	(—)	—	—	—
(1- tax rate)	81.7	69.7	66.1	70.0	70.0	70.0
ROA	**1.6**	**1.6**	**1.7**	**1.3**	**1.5**	**1.5**
Average assets/average equity	14.7	14.2	14.4	14.6	14.7	14.6
ROE (incl. preference capital)	**23.4**	**22.9**	**24.1**	**18.8**	**21.7**	**22.0**
ROE (ex- preference capital)	**24.8**	**23.9**	**24.9**	**19.3**	**22.3**	**22.5**

Source: Company, Kotak Institutional Equities estimates

Indian Bank P&L and balance sheet
March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Income statement						
Total interest income	52,278	68,303	78,571	93,515	113,280	136,348
Loans	35,027	50,867	57,998	70,210	86,409	106,123
Investments	16,799	16,873	19,974	22,884	26,398	29,674
Cash and deposits	453	563	599	422	473	550
Total interest expense	31,591	42,218	45,532	53,836	68,116	85,465
Deposits from customers	29,795	40,614	44,742	52,993	67,104	84,453
Net interest income	**20,688**	**26,085**	**33,039**	**39,680**	**45,164**	**50,883**
Loan loss provisions	4,452	816	4,722	9,627	7,503	6,054
Net interest income (after prov.)	16,236	25,269	28,317	30,053	37,661	44,829
Other income	10,684	10,354	11,737	11,134	12,454	13,711
Net fee income	1,793	2,322	2,235	2,682	3,192	3,766
Net capital gains	2,412	1,948	2,176	1,000	1,200	1,200
Net exchange gains	1,000	1,052	1,148	1,321	1,519	1,747
Operating expenses	14,003	15,881	17,302	19,579	21,318	24,189
Employee expenses	9,674	11,528	12,124	12,973	14,057	15,657
Depreciation on investments	1,916	2,027	(960)	500—	500—	500—
Other Provisions	(1,353)	(145)	195	694	694	694
Pretax income	12,355	17,853	23,516	20,413	27,603	33,157
Tax provisions	2,262	5,408	7,966	6,124	8,281	9,947
Net Profit	**10,093**	**12,453**	**15,550**	**14,289**	**19,322**	**23,210**
% growth	32.8	23.4	24.9	(8.1)	35.2	20.1
PBT - Treasury + Provisions	14,957	18,603	25,297	30,234	35,100	39,205
% growth	8.3	31.2	35.9	19.5	16.1	11.7
Preference Dividend	350	375	400	320	320	320
Balance sheet						
Cash and bank balance	67,728	66,838	81,132	87,477	101,717	118,379
Cash	1,895	2,480	3,038	3,190	3,349	3,517
Balance with RBI	62,435	59,635	67,569	73,762	87,842	104,337
Balance with banks	696	1,590	593	593	593	593
Net value of investments	219,151	228,006	282,682	335,793	377,659	424,353
Govt. and other securities	174,681	188,226	230,861	287,255	330,191	377,848
Shares	4,190	3,069	5,203	5,203	5,203	5,203
Debentures and bonds	15,868	18,295	11,890	10,701	9,631	8,668
Net loans and advances	398,387	514,653	621,461	753,785	913,558	1,104,303
Fixed assets	5,393	15,942	15,796	6,232	6,220	5,551
Net leased assets	—	—	—	—	—	—
Net Owned assets	5,393	15,942	15,796	6,232	6,220	5,551
Other assets	14,418	15,779	12,811	12,811	12,811	12,811
Total assets	**705,077**	**841,217**	**1,013,882**	**1,196,097**	**1,411,965**	**1,665,397**
Deposits	610,459	725,818	882,277	1,053,748	1,254,891	1,490,523
Borrowings and bills payable	18,405	9,960	16,861	16,861	16,861	16,861
Other liabilities	24,105	34,080	32,023	32,023	32,023	32,023
Total liabilities	**652,969**	**769,858**	**931,161**	**1,102,632**	**1,303,775**	**1,539,407**
Preference capital	**4,000**	**4,000**	**4,000**	**4,000**	**4,000**	**4,000**
Paid-up capital	4,298	4,298	4,298	4,298	4,298	4,298
Reserves & surplus	43,810	63,061	74,423	85,168	99,892	117,692
Total shareholders' equity	**48,108**	**67,359**	**78,721**	**89,465**	**104,189**	**121,989**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Biocon (BIOS)

Pharmaceuticals

BUY

JULY 23, 2010

UPDATE

Coverage view: Attractive

Price (Rs): 321

Target price (Rs): 400

BSE-30: 18,131

Sales growth intact in all segments except research services. PAT was 4% lower than our estimate due to poor operating margin which remained flat qoq. Sales growth excluding licensing income/Axicorp was strong at 24%, despite a lack of sequential pick-up in contract research revenues. Sales outlook remains solid with (1) new product launches in India, (2) immunosuppresants and (3) tender contracts for Axicorp in 2HFY11E. Maintain BUY and our target price at Rs400.

Company data and valuation summary

Biocon

Stock data			
52-week range (Rs) (high,low)			336-200
Market Cap. (Rs bn)			64.2
Shareholding pattern (%)			
Promoters			60.9
FIIs			3.9
MFs			9.4
Price performance (%)	**1M**	**3M**	**12M**
Absolute	(0.0)	8.5	43.9
Rel. to BSE-30	(3.1)	6.2	22.1

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	14.8	17.8	22.0
EPS growth (%)	216.4	19.8	23.7
P/E (X)	21.6	18.1	14.6
Sales (Rs bn)	23.7	28.2	31.4
Net profits (Rs bn)	2.9	3.6	4.4
EBITDA (Rs bn)	4.7	5.5	6.4
EV/EBITDA (X)	13.5	11.4	9.3
ROE (%)	17.9	18.8	20.0
Div. Yield (%)	0.0	0.0	0.1

Sales beat forecast by 4%, contract research sales disappoint

Sales beat forecasts by 4% due to (1) Axicorp which grew 37% yoy to Euro 45 mn— our estimate: Euro 35 mn and (2) licensing income at Rs206 mn was 13% higher than estimated. However, there were disappointments on (1) biopharma sales excluding Axicorp at US$67 mn, higher than US$49 mn in 4QFY10 and flat qoq—our estimate: US$73 mn and (2) research services at Rs720 mn, flat qoq—our estimate: Rs820 mn. EBITDA margin adding back forex, R&D spend, licensing income at 21% was 130 bps lower than estimated.

Margins were flat qoq and declined

Margins stayed flat qoq and declined yoy despite a 34% increase in revenues due to higher material costs on account of currency appreciation yoy and poor operating performance in research. We believe Biocon's strategy to move towards higher-value added business in research services underpinned the flat qoq margin and its efforts will begin to show results in 2HFY11E.

PAT was Rs768 mn, 4% lower than our estimate of Rs797 mn

PAT was lower by 4% due to (1) poor operating margin (2) higher interest cost and (3) higher tax rate. Interest cost was higher despite lower debt qoq due to hedging cost of Rs30 mn incurred this quarter. As of June 2010, BIOS was net cash positive with Rs4.4 bn of loans and cash and investments of Rs5.1 bn. Since BBPL is now a 100% subsidiary of the company, Biocon has paid off Rs650 mn of loans borrowed by BBPL in June 2010.

We estimate 22% earnings CAGR in FY2011-12E; Maintain BUY with SOTP-based TP at Rs400

We estimate 22% earnings CAGR in FY2011-12E on the back of (1) 20% sales growth in revenues excluding Axicorp/licensing income in FY2011E and 17% in FY2012E (2) BIOS maintained EBITDA margin excluding Axicorp at 30% and including Axicorp at 20.5% in 1QFY11, same as in FY2010. We build in a minimal 50 bps margin expansion over FY2011-12E due to higher R&D spend. Near-term stock triggers include (1) oral Insulin phase III data in India, (2) tender contracts for Axicorp in 2HFY11 and (3) additional long-term contracts for Syngene. BIOS is trading at 14X FY2012E earnings, lower than its 5-year average of 18X.

QUICK NUMBERS

- Yoy sales growth excluding licensing income, Axicorp strong at 24% despite disappointment on contract research revenues
- PAT was Rs768 mn, 4% lower than our estimate of Rs797 mn

Prashant Vaishampayan
prashant.vaishampayan@kotak.com
Mumbai: +91-22-6634-1127

Priti Arora
priti.arora@kotak.com
Mumbai: +91-22-6634-1551

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Sales beat forecast by 4%, contract research sales disappoint

Axicorp grew 37% yoy to Euro 45 mn, higher than our estimate of Euro 35 mn on the back of (1) new product launches (2) two small tender contracts

- Licensing income at Rs206 mn was 13% higher than our estimate. The licensing income was largely on account of milestone based income from Mylan towards MABs product development. BIOS expects similar milestone income on a quarterly basis for the next three quarters.

- Biopharma sales excluding Axicorp at US$67 mn, was higher than US$49 mn in 4QFY10 and flat qoq, however lower than our estimate of US$73 m. Yoy growth in rupee terms was 27% despite adverse currency movement. This strong yoy growth was due to strong growth in the following:

  - Statins aided by early entry in Atorvastatin API market in Spain.

  - Immunosuppresants businesses. Biocon is supplying Tacrolimus API to 2 partners currently marketing the product. Biocon maintains 6-7 partners are still awaiting approvals. We do not think the Watson approval for 5 mg tablets would have added to Biocon's revenues meaningfully as this dosage accounts for a small share of the market. Biocon expects significant contribution from this segment in 2HFY11E.

  - India branded finished dosage continues to maintain its high growth rate of 28% yoy this quarter, after reporting growth of 36% in FY2010. In Insulin, Biocon now commands 12% market share in the Indian market.

  - Insulin export sales driven by finished dosage supplies to emerging markets. As of March 2010, BIOS had vial and cartridge registrations in around 40 countries

- However, research services at Rs720 mn, disappointed with no increase qoq and lower than our estimate of Rs820 mn. This was primarily due to poor growth in Clinigene and strategy of staying away from commoditized research business, thereby getting into higher-value added research services business. Sygnene is now operating at capacity utilization of 80% h scientists working on BMS contract near 400.

Adjusted EBITDA margin at 21%, 130 bps lower than our estimate

EBITDA margin adjusted for forex, R&D spend, licensing income at 21% was 130 bps lower than our estimate. Margin was flat qoq and declined yoy despite 34% increase in revenues due to higher material costs on account of currency appreciation and poor operating performance in contract research revenues.

- Materials cost as a percentage of sales was at 63%% this quarter versus our estimate of 61% and 58% in 1QFY10. This was due to currency appreciation and product mix.

- Other expenses including R&D at 12% were lower than our estimate of 15%.

- Staff costs at 11% were higher than our estimate of 10%

PAT was Rs768 mn, 4% lower than our estimate of Rs797 mn

PAT was lower by 4% despite higher sales due to (1) poor operating performance with margin 130 bps lower than our estimate (2) higher interest cost. Interest cost was higher despite lower debt qoq due to hedging cost of Rs30 mn incurred this quarter. As of June 2010, BIOS was net cash positive with Rs4.4 bn of loans and cash and investments of Rs5.1 bn. Since BBPL is now a 100% subsidiary of the company, Biocon has paid off Rs650 mn of loans borrowed by BBPL in June 2010and (3) higher tax rate. Tax rate at 17% was higher than our estimate of 13% and previous two quarter's 12-14%.

R&D spend set to increase in FY2011E due to four clinical development programs

- Oral Insulin is entering Phase III in India and BIOS expects to report phase III data in early next year. It has initiated phase I trials for the US. BIOS expects to commence licensing discussions for oral insulin next year.

- BIOS'S second novel molecule for Psoriasis has started phase III trials in India.

- Biocon's biosimilar version of insulin has received approval for Phase III trials in Europe and Biocon expects to start recruiting patients in 2QFY11E. Biocon expects the trial duration to be around 12 months from start, post which regulatory approvals etc. will take another year.

- With increased R&D spend, BIOS expects net R&D spend to ramp up to Rs1.5 bn in FY2011E.

We estimate 22% earnings CAGR in FY2011-12E

We use US$/Rs rate of Rs46 for FY2011-12E. We estimate 22% earnings CAGR in FY2011-12E on the back of (1) 20% sales growth in revenues excluding licensing income/Axicorp in FY2011E and 17% in FY2012E (2) BIOS maintained EBITDA margin excluding Axicorp at 30% and including Axicorp at 20.5% in 1QFY11, same as FY2010. We expect minimal margin expansion in business including Axicorp due to higher R&D spend and hence build in 50 bps margin expansion over FY2011-12E.

There are no material changes to our estimates. Over FY2011-12E, we expect BIOS's key businesses to report strong growth driven by

- Contract research revenues of US$75 mn and US$93 mn in FY2011-12E vs US$60 mn in FY2010. This increase is primarily coming from new contract with BMS which started in April 2009 and is expected to peak to 400 scientists in 3QFY11 and new customer wins.

- Biocon is confident of maintaining above 30% growth in domestic branded finished dosage in FY2011E. It will launch two new divisions in 2QFY11 for hospitals and critical care products. Biocon has also started focusing on rural areas and Tier I-II cities inline with the trend seen in the industry.

- Axicorp sales expected to grow toEuro190 mn in FY2011E and Euro 217 mn in FY2012E from Euro 136 mn in FY2010 driven by products introductions (100 planned in 2010) and tender contracts for other products in addition to Metformin which it won in 2009. Axicorp expects to win two big tenders in 2HFY11E. In 2009, Axicorp achieved total revenue of Euro133 mn, up from Euro 91 mn in 2008 driven by a basket of 430 products and on the back of winning tender for Metformin which helped it achieved market share of 25% for the product.

- BIOS statin revenues will continue to see yoy revenue growth in addition to the 26% growth seen in FY2010 led by (1) sales of two new products of Atorvastatin and Rovustatin and (2) stable prices for existing products of Simvastatin.

- On top of the 28% growth see in Immunosuppresants in FY2010, Biocon expects significant growth in this segment driven by tacrolimus API sales in developed markets upon 6-7 partners securing ANDA approvals. In addition, Biocon also expects to commercialize additional products in this segment in 2HFY11

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

	1QFY11	1QFY11E	1QFY10	4QFY10	% change 1QFY11E	1QFY10	4QFY10
Sales	5,696	5,362	4,320	5,622	6	32	1
Contract research fees	720	821	639	740	(12)	13	(3)
Technology Licensing Fees	206	182	24	206	13	758	0
Expenses							
Materials	4,033	3,586	2,737	3,976	12	47	1
Power	0	185	155	0	NM	NM	NM
Staff costs	695	650	526	604	7	32	15
Other expenses	561	700	557	642	(20)	1	(13)
FX Losses(gains)	20	—	(28)	42	NM	NM	(52)
EBITDA	**1,313**	**1,244**	**1,037**	**1,304**	**6**	**27**	**1**
R&D expenses	212	320	200	192	(34)	6	10
EBITDA pre R&D	**1,339**	**1,381**	**1,185**	**1,332**	**(3)**	**13**	**1**
Interest	70	30	56	33	133	25	112
Depreciation	375	375	324	367	0	16	2
Other income	95	100	70	88	(5)	36	8
PBT	**963**	**939**	**727**	**992**	**3**	**32**	**(3)**
Current tax	164	122	96	144	34	71	14
PAT	**799**	**817**	**590**	**848**	**(2)**	**35**	**(6)**
Minority interest	31	20	14	42	55	121	(26)
Profits for shareholders	**768**	**797**	**576**	**806**	**(4)**	**33**	**(5)**
Exceptional item	—	—	—	—	NM	NM	NM
Profits for shareholders	**768**	**797**	**576**	**806**	**(4)**	**33**	**(5)**
Biopharmaceuticals	5,696	5,362	4,320	5,622	6	32	1
Axicorp	2,630	2,033	1,915	2,483	29	37	6
Contract research	720	821	639	740	(12)	13	(3)
Technology licensing fees	206	182	—	206	13	NM	0
Total	**6,622**	**6,365**	**4,959**	**6,568**	**4**	**34**	**1**
Total excl l.income/Axicorp	**3,786**	**4,150**	**3,044**	**3,879**	**(9)**	**24**	**(2)**

Source: Kotak Institutional Equities estimates, Company

Profit and loss statement, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Net sales	**9,857**	**10,538**	**16,086**	**23,678**	**28,177**	**31,368**
Total expenditure	(7,022)	(7,552)	(12,853)	(18,963)	(22,639)	(24,948)
EBITDA	**2,834**	**2,986**	**3,233**	**4,715**	**5,538**	**6,420**
Depreciation and amortisation	(665)	(939)	(1,103)	(1,401)	(1,580)	(1,750)
EBIT	**2,169**	**2,047**	**2,131**	**3,314**	**3,958**	**4,670**
Net finance cost	(98)	(102)	(177)	(169)	(160)	0
Other income	38	364	646	370	500	500
Loss/(gain) on forward covers	—	—	(1,472)	—	—	—
Pretax profits before extra-ordinaries	**2,109**	**2,309**	**1,128**	**3,515**	**4,298**	**5,170**
Current tax	(18)	(97)	(98)	(445)	(663)	(672)
Deferred tax	(151)	(17)	(1)	(42)	—	—
Fringe benefit tax	—	(15)	(19)	—	—	—
Reported net profit	**1,940**	**2,180**	**1,009**	**3,028**	**3,635**	**4,498**
Profit /(loss)in minority interest	(62)	(65)	79	96	80	99
Reported net profit after minority interests	**2,002**	**2,245**	**930**	**2,932**	**3,555**	**4,399**
Exceptional items	—	2,394	—	—	—	—
Reported net profit after minority interests a	**2,002**	**4,639**	**930**	**2,932**	**3,555**	**4,399**

Source: Kotak Institutional Equities estimates, Company

Balance sheet, cash model, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Balance sheet						
Total equity	10,686	14,841	15,107	17,578	20,224	23,713
Total debt	1,868	2,551	5,239	5,136	—	—
Current liabilities	2,749	3,005	4,375	5,799	7,232	8,204
Minority interests	(8)	(73)	248	338	418	517
Deferred tax liabilities	448	465	466	508	508	508
Total equity and liabilities	**15,744**	**20,789**	**25,436**	**29,359**	**28,381**	**32,942**
Cash and cash equivalents	87	96	118	1,399	150	150
Current assets	5,209	5,250	7,806	9,520	12,208	13,914
Net assets incl intangibles	9,657	10,695	13,836	14,134	15,054	14,804
Investments	790	4,748	3,676	4,306	969	4,074
Total uses of funds	**15,744**	**20,789**	**25,436**	**29,359**	**28,381**	**32,942**
Free cash flow						
Operating cash flow, excl. working ca	2,660	2,872	3,009	4,256	4,927	5,813
Working capital	(1,557)	(20)	(1,302)	(363)	(1,391)	(734)
Capital expenditure	(2,040)	(1,836)	(4,243)	(1,547)	(2,500)	(1,500)
Investments	(212)	3,957	(1,071)	630	(3,337)	3,105
Free cash flow	**(1,148)**	**4,974**	**(3,607)**	**2,976**	**(2,300)**	**6,684**

Source: Kotak Institutional Equities estimates, Company

kotak Institutional Equities

CESC (CESC)

Utilities

ADD

JULY 26, 2010

RESULT

Coverage view: Attractive

Price (Rs): 398

Target price (Rs): 466

BSE-30: 18,131

Stable earnings on extant business, traction on new projects. CESC reported another quarter of stable earnings from its extant power business, as the benefit of incremental demand in the Kolkatta distribution circle does not contribute to incremental earnings in a cost-plus environment. CESC has achieved financial closure of the 600 MW Haldia project, though hindrances on land acquisition persist. We maintain our ADD rating with a revised target price of Rs466/share.

Company data and valuation summary

CESC

Stock data			
52-week range (Rs) (high,low)			452-291
Market Cap. (Rs bn)			49.7
Shareholding pattern (%)			
Promoters			52.5
FIIs			18.6
MFs			15.3
Price performance (%)	1M	3M	12M
Absolute	6.4	(3.4)	36.4
Rel. to BSE-30	3.1	(5.5)	15.7

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	35.2	37.3	44.3
EPS growth (%)	9.3	5.7	18.9
P/E (X)	11.3	10.7	9.0
Sales (Rs bn)	32.9	38.9	41.5
Net profits (Rs bn)	4.4	4.7	5.5
EBITDA (Rs bn)	8.2	11.4	12.8
EV/EBITDA (X)	7.1	6.0	6.4
ROE (%)	11.1	10.4	11.3
Div. Yield (%)	1.1	1.2	1.4

QUICK NUMBERS

- Cover highlight
- Cover highlight
- Cover highlight

Higher sales in distribution circle met through purchased power

CESC reported revenues of Rs10.8 bn, operating profits of Rs2.4 bn and net income of Rs1.1 bn against our estimate of Rs9.6 bn, Rs2.4 bn and Rs1.2 bn, respectively. Higher-than-estimated revenues were on account of higher sales of 2,321 MU in 1QFY2011 (against our estimate of 2,133 MU). Correspondingly, dependence on purchased power increased sharply—447 MU in 1QFY101 against 169 MU in 4QFY10, although purchases in 1QFY11 were made at Rs4.1/kwh compared to Rs5.21/kwh in 4QFY10. Dependence on purchased power, led to contraction of operating margins as incremental sales did not contribute to operating profits for the company.

Limited downside to near-term earnings, expansion to drive growth

We continue to remain optimistic on CESC's core power business and estimate a steady growth in regulated equity-- Rs183/share in FY2011E and highlight that value for the core power business accounts for 76% of our fair value estimate for CESC. The growth in the extant power business will likely be driven by incremental capex incurred in the distribution segment. Moreover, commissioning of Budge Budge III (250 MW) will also allow CESC to benefit from sale of power at short-term rates during off-peak hours.

Earnings growth will be driven by CESC's plans to add another 4,520 MW of capacity in the next 4-5 years which would take its total installed capacity to 5,745 MW. Most of these capacities are planned to sell power outside the license area apart from Haldia Phase I which will cater to the Kolkatta distribution business along with part merchant sale.

Maintain ADD rating with a revised target price of Rs466/share

We maintain our ADD rating with a revised target price of Rs466/share based on March 2102 earnings. Our target price comprises (1) Rs333 for Kolkata business (inclusive of 250 MW expansion at Budge Budge), (2) Rs81/share for 100% ownership in DIPL for capacity of 600 MW, and (3) Rs21/share for real estate business based on March 2012 based NAV. We estimate an outflow of Rs4.3 bn to fund the losses in retail business.

Murtuza Arsiwalla
murtuza.arsiwalla@kotak.com
Mumbai: +91-22-6634-1125

Shubham Satyarth
shubham.satyarth@kotak.com
Mumbai: +91-22-6634-1320

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Exhibit 1: Margins contracted on account of higher fuel costs
Quarterly results for CESC, March year-ends (Rs mn)

	1QFY11	1QFY11E	1QFY10	4QFY10	(% chg.) 1QFY11E	1QFY10	4QFY10	FY2011E	FY2012E	(% chg.)
Net sales	**10,820**	**9,637**	**8,090**	**7,540**	**12**	**34**	**44**	**38,930**	**41,491**	**7**
Operating costs										
Cost of electrical energy purchased	(1,840)	(1,096)	(1,820)	(880)				(2,440)	(4,402)	
Cost of fuel	(3,760)	(3,435)	(2,520)	(2,650)				(15,001)	(15,001)	
Personnel costs	(970)	(1,200)	(890)	(870)				(4,042)	(4,521)	
Other expenses and provisions	(1,830)	(1,500)	(960)	(1,300)				(7,228)	(6,191)	
Total operating expense	**(8,400)**	**(7,231)**	**(6,190)**	**(5,700)**				**(28,711)**	**(30,115)**	
EBITDA	**2,420**	**2,406**	**1,900**	**1,840**	**1**	***27***	***32***	**10,220**	**11,375**	**11**
EBITDA margin (%)	22.4	25.0	23.5	24.4				26.3	27.4	
Depreciation	(670)	(605)	(480)	(520)				(2,776)	(2,859)	
EBIT	**1,750**	**1,801**	**1,420**	**1,320**	**(3)**	***23***	***33***	**7,444**	**8,517**	14
Other income	290	300	280	360				1,242	1,350	
Interest	(670)	(550)	(430)	(470)				(2,736)	(2,809)	
PBT	**1,370**	**1,551**	**1,270**	**1,210**	**(12)**	***8***	***13***	**5,950**	**7,058**	**19**
Tax	(270)	(310)	(220)	(210)				(1,293)	(1,519)	
Net profit	**1,100**	**1,241**	**1,050**	**1,000**	**(11)**	***5***	***10***	**4,657**	**5,539**	**19**
Extraordinary income/ (expenses)	—	—	—	—				—	—	
Key operating parameters										
Units sold (MU)	2,321	2,133	2,092	1,668	*9*	*11*	*39*	8,452	8,853	5
Units generated - gross (MU)	2,443	2,500	1,979	1,949	*(2)*	*23*	*25*	10,133	10,133	-
Units purchased (MU)	447	219	628	169	104	*(29)*	*164*	581	1,048	80
Fuel cost per unit generated (Rs/unit)	1.54	1.50	1.27	1.36	2.6	21	13	1.62	1.62	-
Cost of power purchased (Rs/unit)	4.12	5.00	2.90	5.21	(17.7)	42	(21)	4.20	4.20	-

Source: Company, Kotak Institutional Equities estimates

Haldia I achieves financial closure

We note that Haldia I (600 MW) has achieved financial closure. The estimated cost of project is Rs33 bn including the cost of evacuation and would entail 73% (Rs24 bn) debt financing by IDBI and ICICI bank. However, we note that land acquisition remains a concern for this project. The company has acquired ~80% of land (287 acres) and balance is still under progress.

CESC plans to add another 4,520 MW of capacity in the next 4-5 years which would take its total installed capacity to 5,745 MW. Most of these capacities are planned to sell power outside the license area apart from Haldia phase I which will cater to the Kolkatta distribution business along with part merchant sale. We highlight below the status update of these projects:

- We note visible and satisfactory progress in the Chandrapur project (600 MW, owned by DIPL) which has achieved financial closure and BoP and BTG orders have been placed.
- Land acquisition for its 1,000 MW coal-based Dhenkanal plant is almost complete
- Mahuagarhi Coal Company (a joint venture for a non-coking coal block exploration in Jharkhand) has been facing problem in land acquisition even though it had obtained prospecting license.
- Also, management has indicated CESC's foray into solar power with acquisition of 200 acres near Bikaner, Rajasthan, for setting up a solar farm.

Exhibit 2: 4,520 MW of capacity to drive future earnings of CESC
Status of pipeline projects of CESC

Project	Capacity (MW)	Cost (Rs bn)	Fuel	Land	Environmental clearance	Fuel arrangement	Financial closure	Expected CoD
Haldia I	600	30	Thermal	WIP	✓	✓	✓	FY2013
Chandrapur	600	29	Thermal	✓	✓	✓	✓	FY2013
Dumka	1,000	50	Thermal	WIP	✕	✓	✕	FY2014
Dhenkanal	1,320	62	Thermal	✓	✕	✕	✕	FY2014
Pirpainty	1,000	47	Thermal	✕	✕	✕	✕	FY2015
Total	**4,520**	**218**						

Source: Company, Kotak Institutional Equities

No respite from mounting retail losses

Retail losses continue to mount as was evident from FY2010 earnings with an operating loss of Rs3.5 bn. Although management has highlighted improvement in operations including (1) savings of ~Rs1,000 mn mainly on advertisement & corporate operating expenditure in FY2010 and (2) improvement in sales from 660/sqft in FY2009 to ~906/sqft in 1QFY11, we remain cautious and build in a funding loss of Rs4.3 bn in the retail business. In our view, any positive development in the retail business such as (1) sustainable reduction in losses, or (2) sale of stake in the retail business, or (3) infusion of equity through relaxation of FDI norms, will likely trigger the stock performance for CESC.

Exhibit 3: CESC Sum-of-the-parts valuation

	Methodology	Key assumptions	FY2011E Book value per share (Rs)	Per share value (Rs)
Kolkata generation, transmission & distribution	**DCF to equity** Disc. rate: 12% Terminal year growth: 2%	The business enjoys very high predictability of cash flows, regular reinvestments and high profitability (>20% RoE) from operational efficiencies and incentives.	183	333
Real-estate	**DCF** Disc. rate: 15% Terminal year growth: 5%	**Mall** Area for lease (sq. ft) 400,000 Rental (Rs/sq. ft) 120 Inflation in rental (%) 5 CESC's share (%) (A) 100 CESC's retainable share of A (%) 67 **35 acre land at Mulajore** Area for sale (sq. ft) 2,500,000 Rate (Rs/sq. ft) 600 CESC's share (%) (A 100 CESC's retainable sh 67		21
Cash and investible surplus on books	**Market value**	Marketable securities & cash on books (Rs bn): 12.2 Regulatory liability/unallocable debt (Rs bn) (2.6) Cash paid for controlling stake in DIPL (Rs bn) (3.0) Cash infusion required in retail (Rs bn) (4.3) 2.4		19
DIPL 600 MW	DCF to equity Disc. rate: 12.5%	50% of the capacity available for merchant sale at a sustainable tariff of Rs3/kwh		93
SOTP value			**263**	**466**

Source: Kotak Institutional Equities estimates

Exhibit 4: Higher volumes led to higher dependence on purchased power
Operational highlights of CESC, 1QFYFY09-1QFY11

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Units sold	**1,993**	**2,041**	**1,806**	**1,668**	**2,092**	**2,062**	**1,768**	**1,668**	**2,321**
Net revenue	7,830	7,550	7,520	7,410	8,090	9,490	7,790	7,540	10,820
(Rs/kwh)	**3.93**	**3.70**	**4.16**	**4.44**	**3.87**	**4.60**	**4.41**	**4.52**	**4.66**
Units generated (MU)	2,057	2,049	1,912	1,883	1,979	2,036	1,872	1,949	2,443
Fuel cost (Rs mn)	2,440	2,480	2,280	2,240	2,520	2,830	2,710	2,650	3,760
Fue cost (Rs/kwh)	**1.19**	**1.21**	**1.19**	**1.19**	**1.27**	**1.39**	**1.45**	**1.36**	**1.54**
Units purchased (MU)	445	506	293	160	628	577	401	169	447
Purchase (Rs mn)	1,250	1,540	710	620	1,820	2,350	1,320	880	1,840
Purchase (Rs/kwh)	**2.8**	**3.0**	**2.4**	**3.9**	**2.9**	**4.1**	**3.3**	**5.2**	**4.1**
O&M	2,920	1,660	3,020	3,030	1,850	2,210	2,060	2,170	2,800
(Rs/kwh)	1.42	0.81	1.58	1.61	0.93	1.09	1.10	1.11	1.15
PAT	825	1,240	980	940	1,050	1,260	1,020	1,000	1,100
Regulated equity	15,836	15,836	15,836	15,836	19,003	19,003	19,003	19,003	22,172
RoE (%)	21	31	25	24	22	27	21	21	20
Resonable return	574	574	574	574	689	689	689	689	689

Source: Kotak Institutional Equities, Company

Exhibit 5: Profit model, balance sheet, cash model of CESC, March fiscal year-ends, 2008-13E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	27,750	30,313	32,930	38,930	41,491	46,549
EBITDA	**6,045**	**6,885**	**7,501**	**10,754**	**12,037**	**13,395**
Other income	1,285	1,568	1,560	1,242	1,350	2,183
Interest	(1,885)	(2,170)	(1,780)	(3,270)	(3,471)	(3,430)
Depreciation	(1,685)	(1,700)	(2,060)	(2,776)	(2,859)	(3,165)
Pretax profits	3,760	4,583	5,220	5,950	7,058	8,983
Tax	(476)	(552)	(816)	(1,293)	(1,519)	(1,605)
Net profits	**3,285**	**4,031**	**4,404**	**4,657**	**5,539**	**7,378**
Extraordinary items	269	115	—	—	—	—
Earnings per share (Rs)	**27.8**	**32.3**	**35.2**	**37.3**	**44.3**	**59.1**
Balance sheet (Rs mn)						
Total equity	31,701	37,292	42,139	47,099	51,332	60,021
Total borrowings	16,288	23,981	27,719	38,018	51,421	57,318
Currrent liabilities	19,559	24,152	25,126	27,155	28,042	29,907
Total liabilities and equity	**67,548**	**85,425**	**94,984**	**112,272**	**130,795**	**147,246**
Cash	9,864	18,216	16,571	17,070	16,910	20,810
Current assets	9,752	9,868	10,293	11,266	11,692	12,626
Total fixed assets	42,148	54,159	63,853	79,677	97,940	109,565
Investments	5,697	3,104	3,104	3,104	3,104	3,104
Deferred Expenditure	86	79	72	65	57	50
Total assets	**67,548**	**85,425**	**93,894**	**111,182**	**129,704**	**146,155**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	6,375	7,176	7,234	9,562	10,651	12,500
Working capital	1,567	4,478	548	1,056	461	931
Capital expenditure	(8,353)	(14,932)	(11,755)	(18,599)	(21,122)	(14,573)
Investments	(408)	(82)	—	—	—	—
Free cash flow	**(819)**	**(3,360)**	**(3,973)**	**(7,981)**	**(10,010)**	**(1,142)**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Mahindra & Mahindra Financial (MMFS)

Banks/Financial Institutions

BUY

JULY 26, 2010

RESULT

Coverage view: Attractive

Price (Rs): 525

Target price (Rs): 590

BSE-30: 18,131

Accelerating growth. Mahindra Finance reported PAT of Rs742 mn, up 86% yoy and 7% above estimates. Business traction was at its peak with loan growth accelerating to 31% - the highest since March 2007. Earnings traction was somewhat tempered by higher operating expenses. Recoveries remained strong as provision cost was down 30% yoy. We revise estimates to factor stronger loan traction, lower credit cost and higher operating expenses. Rollover to FY2012E with price target of Rs590. Retain BUY.

Company data and valuation summary

Mahindra & Mahindra Financial

Stock data			
52-week range (Rs) (high,low)			517-210
Market Cap. (Rs bn)			48.8
Shareholding pattern (%)			
Promoters			61.1
FIIs			26.8
MFs			7.9
Price performance (%)	1M	3M	12M
Absolute	12.0	19.1	95.5
Rel. to BSE-30	9.8	16.4	64.4

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	35.7	42.6	49.8
EPS growth (%)	59.3	19.3	16.8
P/E (X)	14.2	11.9	10.2
NII (Rs bn)	9.1	10.5	12.3
Net profits (Rs bn)	3.4	4.1	4.8
BVPS	175.2	206.7	243.5
P/B (X)	2.9	2.5	2.1
ROE (%)	21.4	21.7	21.6
Div. Yield (%)	1.5	1.8	2.1

Business traction accelerates

Mahindra Finance (MMFSL) reported core PBT of Rs1 bn, up 111% yoy and 12% above estimates. Loan growth was strong at 31% yoy on the back of 77% growth in disbursements. The business mix of disbursements was almost unchanged, indicating growth across products. Management highlighted that - with an upturn in the CV cycle, financing of CVs and UVs has picked up. The company now finances about 7,000-8,000 Maruti cars per month as compared to 4,500 a year ago.

Strong pre-monsoon growth is an encouraging trend. The sharp traction in business volumes before the monsoon sets in (i.e. before getting clear signs of a normal monsoon) indicates the underlying income buoyancy in rural India and clearly inspires confidence in business prospects for the company during FY2011E. We are raising our loan growth estimates to 31% and 22% for FY2011E and FY2012E from 23% and 19% in FY2011E and FY2012E, respectively. We do not expect significant risk to our estimates unless the shortfall in monsoon is drastic.

Higher non-farm income is structurally positive. A sharp increase in construction activities and the NREGS scheme have increased the non-farm income in rural India. The impact is more pronounced in high density states like MP and UP which have initiated several new projects over the last few quarters. We believe that the shift towards higher non-farm income is structurally positive shift for the income profile in rural India and will augur well for MMFSL over the long term.

Margins on track. MMFSL report NIM (as per KS calculations) of 11.4% as compared to 10.8% in 1QFY10 and 11.2% estimated by us for the quarter. We are modeling NIM of 11.3% for FY2011 and FY2012E. Typically, asset yields follow a seasonal trend and rise towards the end of the year. We are not factoring any increase in NIM to factor the impact of likely rise in borrowings cost. High growth traction, strong ALM position and low (8-9%) proportion of floating rate borrowings will cushion margins for MMFSL.

QUICK NUMBERS

- PAT up 86% and 7% above estimates
- Loan growth at 31% - highest since March 2007
- Core PBT up 111% yoy and 12% above estimates

Nischint Chawathe
nischint.chawathe@kotak.com
Mumbai: +91-22-6634-1545

Manish Karwa
manish.karwa@kotak.com
Mumbai: +91-22-6634-1350

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Focus on growth, costs move up

MMFSL's operating expenses ratio increased to 39% during 1QFY11 from 34% in 1QFY10 and 29% in 4QFY10. In order to support its growth, MMFSL has recruited about 1,000 employees in its subsidiary company which will outsource its services to the parent. The cost typically tends to frontloaded and the operating expenses ratio typically declines over the next nine months. We are modeling operating expenses ratio of 32% for FY2011E from 30% in FY2010.

Asset quality performance – in sweet spot

MMFSL's credit cost was down 30% yoy clearly indicating strong underlying buoyancy in the rural economy. Gross NPL ratio declined to 6.9% from 9.8% in 1QFY10 but was up qoq (seasonal trend) from 6.4% in 4QFY10. We are accordingly reducing our provision cost estimates by 15-25%. We expect provision costs to be at about 2% of average assets – somewhat lower than the average ratio of 2.5% between FY2001 and FY2010. Notably, MMFSL's provision cost ratio had increased to 3.7-3.9% in FY2008 and FY2009; the average ratio was 2.2% if we exclude these two years.

Revising in estimates, retain positive stance

We are raising our earnings estimates by 9% and 13% for FY2011E and FY2012E to factor higher loan growth, operating expenses and lower credit cost. PBT before provisions will be higher by 3% and 10% for FY2011E and FY2012E, respectively. We now expect MMFSL to report 23-24% ROE and 25% PAT CAGR over FY2010 and FY2013E. We are raising our price target to Rs590 (from Rs500); at our price target, the stock will trade at 10.5X PER and 2.3X PBR FY2012E.

Mahindra Finance, Quarterly results (Rs mn)

	1Q10	2Q10	3Q10	4Q10	1Q11	YoY(%)	1Q11E	Actual vs KS (%)
Total interest income	3,075	3,364	3,591	4,177	3,817	-	-	-
Total interest expense	1,210	1,205	1,362	1,240	1,315	-	-	-
Net interest income	**1,865**	**2,159**	**2,229**	**2,937**	**2,502**	**34**	**2,369**	**6**
Provisions and write/off	**778**	**596**	**503**	**339**	**543**	**(30)**	**700**	**(22)**
Net interest income (after prov.)	1,088	1,564	1,726	2,598	1,959	80	1,669	17
Other income	218	261	429	573	197	(9)	275	(28)
Income from securitization	127	166	349	459	107	(16)	175	(39)
Others	91	95	81	114	90	(0)	100	(10)
Total income pre provisions	2,083	2,420	2,659	3,510	2,699	30	2,644	2
Operating expenses	**703**	**790**	**754**	**993**	**1,046**	**49**	**875**	**20**
Employee expenses	354	312	239	376	365	3	450	(19)
Depreciation	23	21	26	28	28	21	25	13
Other expenses	325	457	489	589	652	100	400	63
Pretax income	**602**	**1,034**	**1,402**	**2,178**	**1,111**	**85**	**1,069**	**4**
Tax provisions	202	342	469	765	366	81	374	(2)
Net Profit	**400**	**692**	**933**	**1,412**	**744**	**86**	**695**	**7**
Tax rate (%)	34	33	33	35	33	(2)	35	-
PBT bef. secu.,provisions and other i	**1,253**	**1,464**	**1,556**	**2,058**	**1,547**	**23**	**1,594**	**(3)**
PBT bef sec income post prov	**475**	**868**	**1,054**	**1,719**	**1,004**	**111**	**894**	**12**

Source: Company, Kotak Institutional Equities estimates

Mahindra Finance , Quarterly operational details

	1Q10	2Q10	3Q10	4Q10	1Q11	YoY(%)	1Q11E	Actual vs KS (%)
Other operational details								
Value of asset financed (Rs bn)	16	22	24	27	29	77	-	-
Outstanding assets (Rs bn)	75	83	86	91	97	29	-	-
Outstanding loans (Rs bn)	70	77	79	84	91	31	86	7
Receivables securitised during the period	1,480	1,650	3,250	4,066	1,580	-	1,580	-
Income on securitisation/ loans securitised during the period(%)	9	10	11	11	7	-	11	-
NIMs - KS calculations (%)	10.8	11.8	11.4	14.4	11.4	5.5	11.2	2
Cost to income (%)	33.8	32.7	28.3	28.3	38.7	-	-	-
Exp/ ave assets (%)	3.7	3.6	3.8	3.9	4.3	-	-	-
Total income/ average assets (%)	16.9	-	17.9	19.0	16.6	-	-	-
Interest / average assets (%)	6.3	-	6.2	6.0	5.5	-	-	-
Difference (%)	10.6	-	11.7	13.0	11.1	-	-	-
Gross NPLs (Rs mn)	7,934	7,933	7,988	6,112	7,105	-	-	-
Gross NPL ratio (%)	9.8	9.0	8.7	6.4	6.9	-	-	-
NPAs (Rs mn)	2,343	2,285	2,001	829	1,247	-	-	-
Net NPL ratio (%)	3.1	2.8	2.3	0.9	1.3	-	-	-
CAR (%)	18.8	17.7	-	18.5	17.4	-	-	-
Tier I (%)	17.2	16.2	-	16.1	15.4	-	-	-
Segmentwise mix								
Disbursements								
Auto/ utility vehicles	39	35	36	35	34	0	0	0
Tractors	22	19	20	21	22	0	0	0
Cars	25	29	29	29	29	0	0	0
Commercial vehcles	6	9	8	7	7	0	0	0
Refinance and others	8	8	7	8	8	0	0	0
AUMs								
0								
Auto/ utility vehicles	39	35	35	33	33	0	0	0
Tractors	22	23	23	23	23	0	0	0
Cars	26	28	28	30	30	0	0	0
Commercial vehcles	6	9	9	8	8	0	0	0
Refinance and others	8	5	5	6	6	0	0	0
Funding Mix (excludes assignments)								
(Rs mn)	66,270	72,430	76,740	64,570	69,130	-	-	-
Banks	40,230	44,510	48,860	39,520	36,990	-	-	-
Insurance	6,980	6,980	6,730	6,730	6,730	-	-	-
Mutual funds	15,580	17,580	15,530	10,680	14,970	-	-	-
Others	3,480	3,360	5,620	7,640	10,440	-	-	-
%age of total								
Banks	61	61	64	61	54	0	0	0
Insurance	11	10	9	10	10	0	0	0
Mutual funds	24	24	20	17	22	0	0	0
Others	5	5	7	12	15	0	0	0

Source: Company

Mahindra Finance
Quarterly balance sheet (Rs mn)

	1Q10	2Q10	3Q10	4Q10	1Q11	YoY(%)
Balance sheet (Rs mn)						
Sharecapital	958	958	958	960	960	0
Reserves	14,124	14,816	15,749	16,314	17,060	21
ESOP	13	14	15	12	11	(15)
Total Borrowings	51,502	58,173	61,292	64,577	69,131	34
Current Liabilities	8,869	8,729	7,614	9,087	10,240	15
Total liabilities and shareholders funds	**75,466**	**82,690**	**85,628**	**90,950**	**97,402**	**29**
Loans & Avd	69,630	77,206	78,855	83,788	91,488	31
Investments	1,248	261	1,809	2,159	831	(33)
Deferred tax	1,916	2,028	2,121	2,069	2,130	11
Current Assets	2,321	2,789	2,434	2,458	2,449	6
Fixed assets	351	406	409	476	504	44
Total assets	**75,466**	**82,690**	**85,628**	**90,950**	**97,402**	**29**

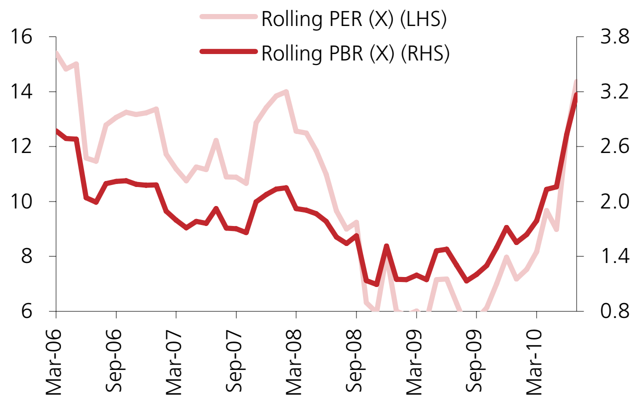
Source: Company

Mahindra Finance
Old and new estimates, March fiscal-years 2011-2012E (Rs mn)

	Old estimates		New estimates		% change	
	2011E	2012E	2011E	2012E	2011E	2012E
Net interest income	10,488	12,307	10,936	13,560	4.3	10.2
Loan book (Rs bn)	100.0	119.0	109.6	133.5	9.7	12.1
Loan growth (%)	19	19	31	22	0	0
NIM (%)	10.6	10.5	10.6	10.5	0	0
NPL provisions	2,618	3,120	1,932	2,613	(26)	(16)
Other income	1,900	2,200	1,510	1,727	(21)	(22)
Securitization	1,500	1,750	1,110	1,277	(26)	(27)
Operating expenses	3,652	4,236	3,903	4,661	7	10
Employee	1,464	1,694	1,535	1,776	5	5
Others	2,188	2,542	2,367	2,885	8	13
PBT	**6,118**	**7,150**	**6,612**	**8,012**	**8**	**12**
Tax	2,029	2,372	2,156	2,613	6	10
PAT	**4,089**	**4,779**	**4,456**	**5,399**	**9**	**13**
PBT-securitisation income	4,618	5,400	5,502	6,736	19	25
PBT-secu income+ provisions	7,236	8,521	7,433	9,349	3	10
EPS(Rs)	**43**	**50**	**46**	**56**	**9**	**13**

Source: Kotak Institutional Equities estimates

Mahindra Finance
Rolling 1-year forward PER and PBR (X)



Source: Kotak Institutional Equities estimates

Mahindra Finance, Key assumptions and ratios, March fiscal year-ends, 2008-2013E

	2008	2009	2010E	2011E	2012E	2013E
Growth in key parameters (%)						
Total interest income	42	15	13	26	27	23
Total interest expense	41	12	(2)	42	32	23
Net interest income	44	17	22	17	24	23
Loan loss provisions	101	15	(22)	(13)	35	28
Total income	48	13	22	17	23	22
Operating expenses	29	6	22	20	19	19
Employee expenses	49	22	9	20	16	16
Net loans	13	3	22	31	22	23
Total assets	12	6	22	29	21	22
Total Borrowings	3	3	24	35	23	25
Shareholders fund	69	12	18	19	20	20
Asset management measures (%)						
Yield on average earning assets	17.8	19.0	18.9	18.7	18.9	18.9
Average cost of funds	9.1	9.9	8.6	9.4	9.6	9.5
Difference	**8.7**	**9.1**	**10.3**	**9.3**	**9.3**	**9.4**
Net interest income/earning assets	**9.9**	**10.6**	**11.4**	**10.6**	**10.5**	**10.6**
Spreads on lending business	**8.7**	**9.1**	**10.3**	**9.3**	**9.3**	**9.4**
Net interest income/EA (after prov)	7	7	9	9	9	9
Tax rate	35	34	34	33	33	33
Dividend payout ratio	25	25	21	21	21	21
Profitability measures (%)						
Interest income/total income	85	87	88	88	89	89
Other income / total income	15	13	12	12	11	11
Operating expenses/total income	33	30	30	31	30	30
Payout ratio	25	25	21	21	21	21
Equity/assets (EoY)	19	20	19	18	17	17
ROA decomposition - % of avg. assets						
Net interest income	9.9	10.6	11.3	10.5	10.5	10.6
Loan loss provisions	3.7	3.9	2.7	1.9	2.0	2.1
Net other income	1.7	1.5	1.6	1.5	1.3	1.3
Gains on securitization	1.6	1.4	1.3	1.1	1.0	0.9
Operating expenses	3.8	3.7	3.9	3.8	3.6	3.5
(1- tax rate)	65.1	65.9	66.1	67.4	67.4	67.4
ROA	**2.7**	**3.0**	**4.2**	**4.3**	**4.2**	**4.2**
Average assets/average equity	6.4	5.2	5.2	5.5	5.7	5.8
ROE	**16.9**	**15.4**	**21.5**	**23.5**	**23.8**	**24.0**

Source: Company, Kotak Institutional Equities estimates

Mahindra Finance, Income statement & balance sheet, March fiscal year-ends, 2008-2013E
Rs mn

	2008	2009	2010E	2011E	2012E	2013E
Income statement						
Total interest income	11,120	12,748	14,366	18,045	22,923	28,142
Total interest expense	4,560	5,099	5,017	7,109	9,363	11,517
Net interest income	**6,560**	**7,649**	**9,349**	**10,936**	**13,560**	**16,625**
Provisions and write/off	2,463	2,824	2,215	1,932	2,613	3,351
Other income	**1,148**	**1,098**	**1,321**	**1,510**	**1,727**	**1,968**
Gains on securitisation of loans	1,074	977	1,110	1,110	1,277	1,468
Operating expenses	**2,525**	**2,667**	**3,250**	**3,903**	**4,661**	**5,553**
Pretax income	**2,720**	**3,256**	**5,205**	**6,612**	**8,012**	**9,688**
Tax provisions	950	1,111	1,762	2,156	2,613	3,161
Net Profit	**1,770**	**2,145**	**3,443**	**4,456**	**5,399**	**6,528**
PBT - securitization income + provisioning exp	4,109	5,103	6,310	7,433	9,349	11,572
EPS (Rs)	21	22	36	46	56	68
BPS (Rs)	138	154	180	215	257	308
ABVPS (Rs)	131	147	177	211	250	296
Balance sheet						
Net loans	**66,090**	**68,233**	**83,510**	**109,648**	**133,456**	**164,453**
Total Investments	**31**	**1,097**	**2,159**	**2,267**	**2,380**	**2,499**
Cash & deposits	2,153	2,763	2,420	2,686	2,982	3,310
Loans and advances and other assets	383	186	335	38	38	38
Deferred tax assets	1,254	1,787	2,069	2,069	2,172	2,281
Net fixed assets	305	371	408	360	323	302
Capital work in progress	**3**	3—	**68**	**70**	**72**	**74**
Total assets	**70,218**	**74,440**	**90,969**	**117,139**	**141,423**	**172,957**
Liabilities						
Total loans and bonds	50,682	51,406	59,784	84,541	106,206	134,272
Preference shares	—	—	—	—	—	—
Total Borrowings	**50,682**	**52,130**	**64,577**	**87,417**	**107,644**	**134,272**
Current liabilities	6,394	7,617	9,087	9,087	9,087	9,087
Total liabilities	**57,075**	**59,747**	**73,664**	**96,504**	**116,731**	**143,359**
Share capital	953	957	960	960	960	960
Reserves	12,190	13,735	16,326	19,675	23,732	28,639
Shareholders fund	**13,143**	**14,692**	**17,286**	**20,635**	**24,692**	**29,599**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Balrampur Chini Mills (BRCM)

Sugar

ADD

JULY 24, 2010

RESULT

Coverage view: Cautious

Price (Rs): 80

Target price (Rs): 93

BSE-30: 18,131

3QFY10 reflects full impact of higher sugarcane prices paid earlier. As expected, BRCM reported a subdued 3QFY10 with revenues flat yoy but EBITDA down 51% yoy. We expect relatively stable sugar prices now based on still low inventory levels and supportive government policy. We retain our ADD recommendation with a target price of Rs93 at 6X FY2011E EBITDA. At our target price, BRCM would trade at 7.3X FY2011E EPS, 5.8XFY2011E EBITDA and 1.3X BV.

Company data and valuation summary

Balrampur Chini Mills

Stock data			
52-week range (Rs) (high,low)			165-67
Market Cap. (Rs bn)			20.5
Shareholding pattern (%)			
Promoters			36.4
FIIs			17.8
MFs			13.8
Price performance (%)	**1M**	**3M**	**12M**
Absolute	0.1	(9.7)	(25.1)
Rel. to BSE-30	(2.0)	(11.9)	(37.1)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	4.3	10.4	7.0
EPS growth (%)	(43.2)	140.4	(32.7)
P/E (X)	18.4	7.7	11.4
Sales (Rs bn)	19.9	22.7	25.7
Net profits (Rs bn)	1.1	2.7	1.8
EBITDA (Rs bn)	3.2	5.0	4.0
EV/EBITDA (X)	8.8	5.3	5.8
ROE (%)	8.2	17.9	10.9
Div. Yield (%)	0.6	0.6	0.6

QUICK NUMBERS

- EBITDA down 21% qoq
- PAT down 60% qoq
- Distillery realizations down 15.5% to Rs 21.9

3QFY10 – higher-than-expected costs overshadow better volumes and realizations

BRCM's 3QFY10 PAT of Rs111 mn was below our estimated Rs360 mn due to (1) higher costs in the sugar segment even as the realizations at Rs28 were better than our estimates and (2) lower realizations in the distillery segment at Rs21/L versus Rs25.6/L in 2QFY2010. We await clarity on whether it has reversed the levy sugar provision made in 2QFY10 in the earnings call. Revenues at Rs5.4 bn (14.8% qoq and flat yoy) were higher than our estimates on account of higher sales in the sugar segment at 170,000 tons and higher realizations (Rs28/kg versus Rs26.5/kg). EBITDA margin at 11.9 % (down 540 bps qoq and 1,230 bps yoy) was lower than our estimated 23.6%.

We expect relative price stability now

We expect sugar prices to remain stable around current levels based on (1) Indian government policy to move towards stabilizing prices, and (2) Indian stock-to-consumption ratio remains low at two-three months of inventory. We have already seen signs of a reversal in government stance with (1) levy price increased to Rs18/kg from Rs13.8/kg and (2) moving from weekly sale quota to monthly quotas and (3) increased stock limit for bulk users to 15 days from 10 days earlier. While the industry expects (1) re-imposition of import duty and (2) move to towards at least partial decontrol of the sector, we have not factored the same in our outlook.

Maintain ADD with target price of Rs93 @ 6X FY2011E EV/EBITDA

We retain our ADD rating with a target price of Rs93 based on 6X FY2011E EBITDA which is in line with Brazilian peers and our target multiple for SHRS. The stock is currently trading at an FY2011E EV/EBITDA, P/E and P/BV of 5.8x, 7.3x, 1.3X respectively. We retain our CAUTIOUS stance on the sector given that we will get clarity on FY2011E sugar supply by September-end. Taking into consideration the better realizations for 3QFY2010 and the prevailing prices for sugar in the domestic market, we are increasing our average price realizations for FY2010E to Rs29.3/Kg but keep our realizations for FY2011E at Rs26.1/Kg. This is increasing our FY2010E revenue and EBITDA estimate by 1.2% and 6.8% respectively. We make no change to our FY2011E and FY2012E assumptions and estimates.

Jasdeep Walia
jasdeep.w@kotak.com
Mumbai: +91-22-6634-1328

Ajay Mathrani
ajay.mathrani@kotak.com
Mumbai: +91-22-6634-1376

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Higher costs impact sugar profits in 3QFY10

BRCM, interim results (standalone), September fiscal-year ends (Rs mn)

					(% change)			9 months		
	3QFY10	3QFY10E	3QFY09	2QFY10	KIE est.	yoy	qoq	FY2010	FY2009	Chng. (%)
Net revenues	**5,403**	**4,029**	**5,381**	**4,705**	**34.1**	**0.4**	**14.8**	**14,739**	**13,246**	**11.3**
Total expenditure	**(4,762)**	**(3,079)**	**(4,081)**	**(3,891)**	**54.7**	**16.7**	**22.4**	**(11,994)**	**(9,477)**	**26.6**
(Decrease)/ Increase in stock	(3,212)		(3,634)	5,907		(11.6)	NM	4,632	(89)	NM
Material consumed	(1,071)		(118)	(8,984)		808.3	NM	(14,673)	(7,620)	92.6
Employee expenses	(210)		(228)	(291)		(7.6)	(27.7)	(768)	(671)	14.5
Other expenses	(269)		(101)	(524)		164.8	(48.7)	(1,186)	(1,098)	8.0
EBITDA	**641**	**950**	**1,300**	**814**	**(32.5)**	**(50.7)**	**(21.3)**	**2,744**	**3,769**	**(27.2)**
Margins (%)	11.9	23.6	24.2	17.3				18.6	28.5	
Other income	2	10	2	7	(76.0)	4.3	(66.2)	29	9	214.0
Depreciation	(280)	(270)	(267)	(265)	3.8	5.0	5.7	(837)	(809)	3.5
EBIT	**363**	**690**	**1,035**	**556**	**(47.3)**	**(64.9)**	**NM**	**1,936**	**2,969**	**(34.8)**
Margins (%)	6.7	17	19.2	11.8				13.1	22.4	
Net Interest	(248)	(210)	(236)	(219)	18.0	5.0	13.4	(675)	(785)	(14.0)
PBT	**116**	**480**	**799**	**338**	**(75.9)**	**(85.5)**	**(65.8)**	**1,261**	**2,184**	**(42.3)**
Tax	(4)	(120)	(136)	(62)	(96.4)	(96.8)	(93.1)	(195)	(346)	(43.6)
Adjusted PAT	**111**	**360**	**664**	**276**	**(69.1)**	**(83.2)**	**(59.6)**	**1,066**	**1,838**	**(42.0)**
Prior period item	—	—	—	—				—	—	
Reported PAT	**111**	**360**	**664**	**276**	**(69.1)**	**(83.2)**	**(59.6)**	**1,066**	**1,838**	**(42.0)**

Source: Company, Kotak Institutional Equities

Other Highlights

- Current imports of raw sugar stand at 82,000 tons
  - Of the total imported raw sugar, 61000 tons have already been processed up to June,2010, the balance is under process.
  - Additional 30,000 tons of raw sugar that has been contracted earlier will arrive in August and will be refined in the next few months
- Modification of boilers at Haidergarh and Mankapur cogen plants (20 MW each) concluded during the quarter at a capex of Rs150 mn. This will enable use of the above facilities during off season when bagasse is not available using coal as an alternate fuel.
- 500 MT refinery has been commissioned at Haidergarh at a capex of Rs 60 mn.
- Average realization of power generated through coal stood at Rs5.26 per units. Total 22.18 mn units of electricity was generated from coal-based supply.

Operating Highlights

BRCM, operating highlights, September fiscal year ends (Rs mn)

					(% change)		
	3QFY10	3QFY10E	3QFY09	2QFY10	KIE est.	yoy	qoq
Sugar sales ('000 tons)	165.3	120	203.0	112.3	37.8	(18.6)	47.2
Average realisation (Rs/kg)	28.0	26.5	23.1	32.3	5.7	21.5	(13.1)
Distillery sales (KL)	13,364	13,000	12,067	13,823	2.8	10.7	(3.3)
Average realisation (Rs/ltr)	22.0	26.0	26.0	26.0	(15.4)	(15.3)	(15.3)
Power sales (mn units)	109	100	98	152	9.1	11.4	(28.4)
Average realisatin (Rs/unit)	4.0	4.0	4.0	1,523.6	0.5	0.5	(99.7)

Source: Company, Kotak Institutional Equities

Factor in higher-than-expected sugar realizations in 3QFY10

We make only one change to our assumptions and are now modeling sugar price of Rs 29.2/kg based on current price and 3QFY10 realization of Rs28/kg in 3QFY10 versus KIE expectation of Rs26.5/kg. This is increasing our FY2010E revenue and EBITDA estimate by 1.2% and 6.8%, respectively. We make no change to our FY2011E and FY2012E assumptions and estimates.

Factor in better-than-expected sugar realization in 3QFY10
BRCM, change in estimates, September fiscal year-ends (Rs mn)

	2010E			2011E		
	New	Old	Change(%)	New	Old	Change(%)
Sugar price (Rs / kg)	29.2	28.8	1.4	26.1	26.1	-
Sugar cane cost (Rs/ton)	2,400	2,400	-	1,900	1,900	-
Sugar sales ('000 tons)	580	580	-	720	720	-
Revenues (Rs mn)	19,923	19,681	1.2	22,742	22,742	-
EBITDA (Rs mn)	3,190	2,986	6.8	4,956	4,956	-
PAT (Rs mn)	1,113	943	18.0	2,676	2,676	-
EPS (Rs)	4.3	3.7	18.0	10.4	10.4	-

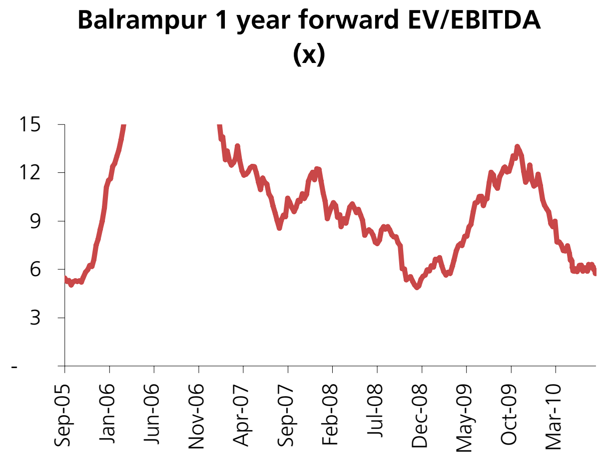
Source: Kotak Institutional Equities estimates

Retain ADD rating with target price of Rs92 at 6X FY2011E EV/EBITDA

We retain our ADD rating with a target price of Rs93 based on 6X FY2011E EBITDA which is in-line with Brazilian peers and our target multiple for SHRS. The stock is currently trading at an FY2011E EV/EBITDA, P/E and P/BV of 5.8X, 7.3X, 1.3X, respectively. At our target price, BRCM would trade at a P/E of 8.8X FY2011E earnings and a 1.5X P/BV multiple.

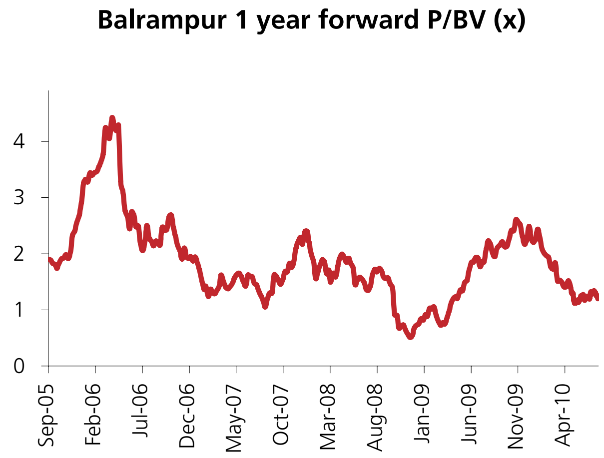
We continue to favor EBITDA multiples as our valuation methodology considering (1) strong cyclicality in earnings and (2) large disparity in capital structures of companies. We do not favor P/BV or EV/ton due to (1) different levels of capacity utilization due to availability or non-availability of cane making a capacity based evaluation less relevant and (2) high differences and yoy volatility in return ratios. We do not prefer an EPS multiple due to (1) its high sensitivity to various factors like sugar and cane prices, (2) impact of high leverage for some of the companies and (3) tax benefits from brought forward losses which will get exhausted over the next couple of years.

Trading range for BRCM has been very volatile
One-year forward rolling EV/EBITDA trend for BRCM



Source: Bloomberg, Kotak Institutional Equities

Trading range for BRCM has been very volatile
One-year forward rolling P/BV trend for BRCM



Source: Bloomberg, Kotak Institutional Equities

Brazilian sugar companies trade in a band of 5-6.5 X Sept 2011E earnings
Relative valuations, global sugar companies

	23-Jul-10			Mkt Cap.	EV/EBITDA (X)			PER (X)		EV/Sales (X)		
Company	**Price (local)**	**Currency**	**Year-end**	**(US$ mn)**	**LFY**	**FY1**	**FY2**	**FY1**	**FY2**	**LFY**	**FY1**	**FY2**
Brazil												
Acucar Guarani	4.2	BRL	Mar	672	6.1	4.8	4.7	10.3	14.6	1.4	1.3	1.2
Cosan	23.7	BRL	Mar	5,432	8.4	6.5	6.8	12.0	15.5	0.9	0.8	0.7
Sao Martinho	15.3	BRL	Mar	977	6.7	5.8	5.8	20.1	22.8	2.1	2.0	1.9
Average Brazil					**7.0**	**5.7**	**5.8**	**14.1**	**17.6**	**1.5**	**1.4**	**1.3**
Europe												
Agrana	72.6	EUR	Feb	799	8.8	7.1	6.9	15.3	13.2	0.8	0.7	0.7
Suedzucker	15.1	EUR	Feb	2,218	7.2	5.8	6.0	13.0	12.1	0.8	0.7	0.7
Tate & Lyle	4.7	GBP	Mar	1,401	20.6	6.5	7.0	1,107.3	1,018.4	0.8	0.9	0.9
Average Europe					**12.2**	**6.5**	**6.6**	**378.5**	**347.9**	**0.8**	**0.7**	**0.8**
Africa												
Illovo	28.1	ZAR	Mar	1,739	7.9	6.9	6.0	14.8	12.8	1.5	1.5	1.4
Tongaat Hulett	107.5	ZAR	Dec	1,499	7.4	7.2	6.1	14.8	13.0	1.6	1.5	1.3
Average Africa					**7.6**	**7.0**	**6.1**	**14.8**	**12.9**	**1.5**	**1.5**	**1.3**
Others												
CSR	1.7	AUD	Mar	2,909	7.8	5.3	6.5	12.2	11.5	0.9	0.8	1.1
Khon Kaen Sugar	11.2	THB	Oct	539	15.6	12.2	9.6	21.3	16.1	2.1	2.1	1.7
Average Others					**11.7**	**8.7**	**8.1**	**16.7**	**13.8**	**1.5**	**1.5**	**1.4**
Global average					**9.8**	**6.9**	**6.3**	**92.5**	**85.1**	**1.5**	**1.2**	**1.1**

Source: Bloomberg

Operating assumptions
BRCM, Operating assumptions, September fiscal year-ends, 2008-12E

	2008	2,009	2010E	2011E	2012E
Sugar segment					
Sugarcane crushed (mn tons)	8.1	4.8	5.2	6.8	7.5
Average recovery ratio (%)	10.2	9.1	9.4	10.0	10.1
Sugar produced ('000 tons)	819	442	487	679	753
Sugar sold (mn tons)	0.7	0.7	0.6	0.7	0.8
Average realisation (Rs/kg)	15.9	22.7	29.2	26.1	26.3
Sugarcane cost (Rs/ton)	1,209	1,209	2,400	1,900	2,100
Raw sugar imports (mn tons)	—	—	0.1	0.1	-
Distillery segment					
Alchohol produced (mn ltrs)	91	48	62	73	82
Alchohol sold (mn ltrs)	86	50	52	70	90
Average realisation (Rs/ltr)	22	26	27	28	28
Co-generation segment					
External sales (mn units)	574	358	382	493	541
Average realisation (Rs/unit)	3.0	3.4	3.9	3.9	3.9

Source: Company, Kotak Institutional Equities

Summary Financials
BRCM, Profit model, balance sheet, cash model (consolidated), September fiscal year-ends, 2007-2011E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
Profit model						
Total income	13,948	14,909	17,471	19,923	22,742	25,694
EBITDA	**791**	**3,141**	**4,472**	**3,190**	**4,956**	**3,980**
Interest (expense)/income	(600)	(1,001)	(1,068)	(789)	(663)	(536)
Depreciation	(877)	(1,253)	(1,160)	(1,139)	(1,154)	(1,129)
Other income	115	152	82	70	83	96
Pretax profits	**(571)**	**1,039**	**2,326**	**1,332**	**3,222**	**2,411**
Tax	(65)	(256)	(370)	(219)	(545)	(610)
Profit after tax	**(635)**	**783**	**1,956**	**1,113**	**2,676**	**1,801**
Diluted earnings per share (Rs)	**(2.6)**	**3.1**	**7.6**	**4.3**	**10.4**	**7.0**
Balance sheet						
Total equity	8,559	9,989	11,333	11,851	13,926	15,127
Deferred taxation liability	1,232	1,426	2,039	2,039	2,039	2,039
Total borrowings	12,891	13,804	9,906	8,699	7,437	6,279
Current liabilities	4,008	2,626	2,679	3,829	3,759	4,053
Total liabilities and equity	**26,690**	**27,845**	**25,957**	**26,417**	**27,161**	**27,498**
Cash	181	378	342	1,019	1,468	3,652
Other current assets	6,624	8,004	6,082	6,704	7,853	6,935
Tangible fixed assets	19,879	19,447	18,311	17,472	16,617	15,689
Investments	6	16	1,222	1,222	1,222	1,222
Total assets	**26,690**	**27,845**	**25,957**	**26,417**	**27,161**	**27,498**
Free cash flow						
Operating cash flow, excl. working capital	337	2,202	3,217	2,188	3,748	2,834
Working capital changes	(419)	(2,829)	2,326	828	(1,219)	1,213
Capital expenditure	(6,890)	(828)	(89)	(300)	(300)	(200)
Investment changes	—	(7)	(261)	—	—	—
Other income	1	20	10	70	83	96
Free cash flow	**(6,972)**	**(1,443)**	**5,204**	**2,786**	**2,311**	**3,943**
Ratios (%)						
EBITDA margin	5.7	21.1	25.6	16.0	21.8	15.5
Net debt/equity	129.8	117.6	71.5	55.3	37.4	15.3
Net debt/EBITDA	16.1	4.3	2.1	2.4	1.2	0.7
RoAE	(6.4)	7.4	15.8	8.2	17.9	10.9
RoACE	0.1	6.4	11.8	7.7	14.0	9.4
CRoCI	2.9	8.9	13.9	10.1	14.5	11.4

Source: Company, Kotak Institutional Equities

kotak Institutional Equities

Larsen & Toubro (LT)

Industrials

BUY

JULY 26, 2010

UPDATE

Coverage view: Attractive

Price (Rs): 1,916

Target price (Rs): 2,100

BSE-30: 17,977

FY2010 Annual report highlights: Reported return dilution exaggerated. Key highlights: (1) Adj. net working capital only at 12 days of sales, (2) Adj. RoCE remains high at 30% while reported declines to 15.6% from 20% in FY2008, (3) total subsidiaries investment of Rs72 bn (Rs120/share valued at Rs400 by us), (4) buys back 4.6% in IDPL implying value of Rs53 bn (v/s estimate of Rs82 bn) and (5) Seawoods stuck with about Rs20 bn capital, while Tamco, FZE and associates do well. Retain BUY.

Company data and valuation summary

Larsen & Toubro

Stock data			
52-week range (Rs) (high,low)			1,920-1,371
Market Cap. (Rs bn)			1,151.2
Shareholding pattern (%)			
Promoters			0.0
FIIs			17.1
MFs			5.4
Price performance (%)	1M	3M	12M
Absolute	5.0	21.8	32.2
Rel. to BSE-30	3.6	19.1	9.2

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	58.1	71.4	90.7
EPS growth (%)	16.0	22.8	27.1
P/E (X)	33.0	26.8	21.1
Sales (Rs bn)	437.9	547.2	681.0
Net profits (Rs bn)	34.9	43.1	54.8
EBITDA (Rs bn)	66.8	80.4	99.4
EV/EBITDA (X)	20.1	17.3	14.3
ROE (%)	18.6	17.6	18.8
Div. Yield (%)	0.6	0.6	0.7

Net adj. working capital surprisingly low at 12 days on better credit and advances; strong op. cash

L&T reported surprisingly low working capital of just twelve days of sales (adjusted for loans & advances to subsidiaries) from 29 days in FY2009. The reduction in working capital, led by better credit terms and customer advances, led to strong operating cash generation of Rs41 bn. The operating cash along with funds from QIP/FCCB (Rs29 bn) and divestiture (Rs12 bn) was applied towards capex of Rs14 bn, increase in investments in subsidiaries of Rs28 bn and increase in current investments of Rs31 bn. We note that L&T has levels of loans to subsidiaries (Rs9 bn) and advances for investments (Rs16 bn – Rs6 bn shipbuilding and Rs8.6 bn in Seawoods) being captured in loans and advances on the standalone balance sheet that needs to be adjusted.

Adj. RoCE remain high at 30%; investments in new businesses lead to reported returns dilution

Reported RoCE and RoE has diluted to 16% (from 21.5%) and 20.6 (from 28.4%) over the two years i.e. FY2008-10. However, L&T's RoCE adj. for investment in subsidiaries and non-business related loans and advances to subsidiaries has remained very high at about 30% for the past three years (NJCC/IVRCL have about 14% adj RoCE on similar comparison). Reported return ratios have got diluted on the back of large investments into new businesses such as power equipment and development, shipbuilding, infrastructure SPVs and current investments (Rs80 bn at FY2010-end). Projects such as metro would exacerbate the problem.

Buys 4.6% in IDPL implying Rs53 bn value; Seawoods stuck others (Tamco, FZE, Associates) do well

L&T has bought back 4.6% in IDPL from IDF for Rs2.45 bn implying valuation of Rs53 bn, (our estimate of Rs82 bn). External investors were inducted to bring arms length relationship between development and construction however intention to pursue growth across verticals, large projects (Hyd. metro) and asymmetric benefits for partners must have led to buy back. Seawoods remains stuck (Rs8.5 bn equity and likely Rs11 bn debt); however, other subs do well (Tamco - Rs0.75 bn PAT, Associate PAT of Rs1.9 bn versus Rs1.4 bn, FZE PAT positive versus Rs3 bn loss).

Retain earnings estimates and target price of Rs2,100/share; reiterate BUY

We retain estimates and target price of Rs2,100. Reiterate BUY on (1) likely strong execution about 25%+ over FY2011-12E, (2) likely revival of capex activity, (3) scale-up of power business, (4) value creation in subsidiaries and (5) capability and capacity enhancement.

Lokesh Garg
lokesh.garg@kotak.com
Mumbai: +91-22-6634-1496

Supriya Subramanian
supriya.subramanian@kotak.com
Mumbai: +91-22-6634-1383

Nitij Mangal
nitij.mangal@kotak.com
Mumbai: +91-22-6634-1453

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

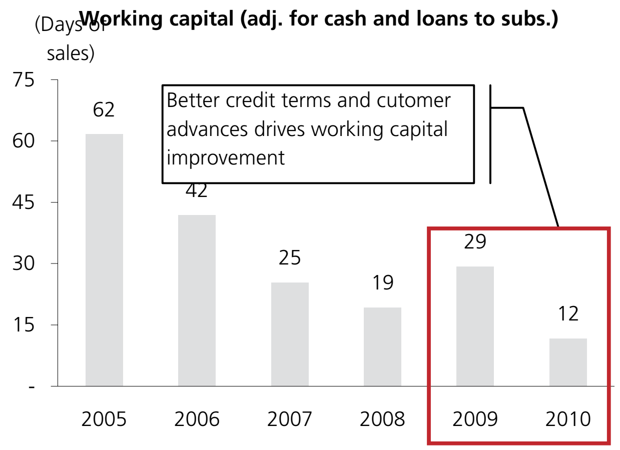
Better working capital management leads to positive operating cash flows

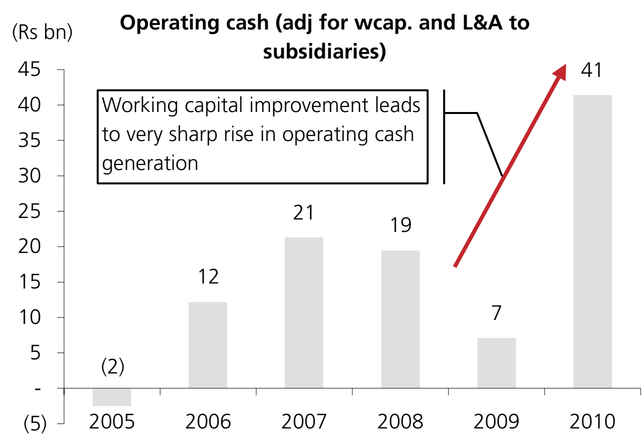
The company has been able to improve working capital efficiencies in FY2010. Net working capital (adjusted for cash and loans & advances to subsidiaries) for L&T standalone improved to 12 days of sales, versus 29 days of sale in FY2009. Improvement in working capital efficiencies was primarily led by stronger customer advances and improved credit terms from suppliers. Sundry creditors increased to 94 days of sales from 74 in FY2008 and advances from customers increased to 93 days of sales from 84.

Wcap. improves on better credit terms and customer advances; leads to positive operating cash

L&T standalone working capital levels, March fiscal year-ends, 2005-10 (days of sales)

Operating cash generated by L&T standalone, March fiscal year-ends, 200





Source: Company, Kotak Institutional Equities

The company incurred a capital expenditure of Rs14 bn during the year and increased investments by about Rs54 bn. These expenditures were funded by (1) operating cash generated of Rs42 bn, (2) Rs18.7 bn raised through a Qualified Institutional Placement (QIP), (3) issuance of Foreign Currency Convertible Bonds (FCCBs) to the tune of Rs9.3 bn, (4) new foreign currency debt of about Rs9 bn (US$20 mn) and (5) Rs15.7 bn from divestment proceeds. The capital raised through the FCCB and QIP was primarily used for financing capital expenditure and investments in the overseas subsidiaries. L&T ended the year with total cash balance of Rs14.3 bn, versus Rs7.7 bn at end-FY2009.

Details of capital raised by L&T, March fiscal year-ends, 2009-10

		Amount raised	
Mode	**Date**	**US$ mn**	**Rs mn**
FY2010 capital raised			
Equity capital			
Qualified Institutional Placement	Oct-09	400	18,730
Debt capital			
Foreign Currency Convertible Bonds	Oct-09	200	9,290
Total funds raised in FY2010		**600**	**28,020**

Source: Company, News flows, Kotak Institutional Equities

L&T Power, Capital Holdings and IDPL account for a majority of investments

L&T reported an increase in investments of about Rs54 bn led by increase in investment in subsidiaries of Rs21.6 bn (to Rs51.3 in FY2010) and increase in current investment of Rs30.8 bn. The increase in investment in subsidiaries was primarily led by (1) Rs8.3 bn towards L&T Power Development Ltd, (2) Rs5.5 bn towards L&T Capital Holdings Ltd (the company that holds L&T Finance and L&T Infrastructure Finance) and (3) Rs2.5 bn toward L&T IDPL for the various infrastructure projects.

Subsidiary investments are driven by power and finance businesses

Details of outstanding subsidiary investments made by L&T for the last two fiscal years (Rs mn)

Name	FY2010	FY2009	Change in investment
L&T Capital Holdings Ltd	**16,286**	**10,786**	**5,500**
L&T International FZE	11,474	10,498	976
L&T Power Development Limited	**9,200**	**860**	**8,340**
L&T Infrastructure Development Projects	**6,284**	**3,834**	**2,450**
L&T Power Limited	1,535	513	1,022
L&T Infotech Limited	1,343	150	1,193
L&T Special Steels and Heavy Forgings Pvt. Ltd	1,110	—	1,110
L&T Halol Shamlaji Tollway Pvt. Ltd	653	10	643
L&T Ahmedabad-Maliya Tollway Pvt. Ltd	630	—	630
L&T Rajkot Vadinar Tollway Pvt. Ltd	550	10	540
L&T Realty Private Limited	418	472	(54)
L&T General Insurance Company Ltd	290	—	290
L&T-Valdel Engineering Limited	239	252	(13)
L&T Capital Company Ltd	220	220	—
PNG Tollway Pvt. Ltd	220	—	220
International Seaport Dredging	—	308	(308)
Others	683	1,615	(932)
Total subsidiary investments (a)	**51,134**	**29,528**	**21,606**
Other equity investments (b)	5,187	3,030	2,157
Integrated JVs (c)	1,088	1,278	(190)
Current investments	**79,645**	**48,802**	**30,843**
Total reported investments (a+b +c)	**137,053**	**82,637**	**54,416**
Equity advances captured in loans and advances			
L&T Seawoods Pvt. Ltd	8,583	8,399	183
L&T Shipbuilding Ltd	6,231	2,485	3,746
Total equity advances captured in L&A (d)	**14,813**	**10,884**	**3,929**
Total business related investments (a+b+c+d)	**72,222**	**44,720**	**27,502**
Per share value (Rs)	**120**	**49**	**36**

Note:

(1) L&T Power Development Ltd includes application money of Rs7.4 bn in FY2010

(2) L&T Capital includes application money of Rs2.75 bn in FY2010 and Rs10.8 bn in FY2009

Source: Company, Kotak Institutional Equities

4.6% in IDPL bought from IDF (equity valuation of Rs53 bn); transaction logical but reverses three year old decision and rationale

L&T has bought 11.25 mn shares (4.64%) stake in L&T IDPL from IDF (India Development Fund - a fund managed by IDFC Private Equity) for a consideration of Rs2.45 bn implying a equity valuation of Rs53 bn for the subsidiary. Our valuation for subsidiary is Rs82 bn. Private equity investors seem to have made good return as they entered the company at a post money valuation of Rs25.5 bn. Private equity investors are exiting, while only three years ago they were inducted and L&T made a case that such investors would help in reducing conflict of interest between holding returns and construction business growth.

Growth mandate, conflicts of interest and capital commitments likely led to exit

We believe that L&T is buying back stakes from private equity investors inducted about three years ago because (a) L&T wants to create separate verticals such as power, real estate, infrastructure (potentially further subdivide into ports, roads etc) and pursue growth across all of these, which may not be amenable to private equity investors who may agree with certain investments and may not agree with others, (b) large projects such as Hyderabad Metro, would raise a question of where they need to be housed as equity capital commitments for even a 20% stake of private equity investors would be fairly large, IDPL, (c) private equity investors get only the holding return while L&T gets construction upside as well, creating conflicts of interest in large projects.

Gujarat road projects being pursued separately by L&T parent, P/E investors participating only in portion of total infrastructure development value

Gujarat road projects as well as Punjab power projects are being pursued separately by L&T standalone, implying that P/E investors are not participating in the entire infrastructure development value. This corroborates the firm intention to buy back their stake. This can potentially explain the differencet between our valuation of Rs82 bn for entire infrastructure development buisness versus Rs53 bn at which the buy back transaction has valued L&T IDPL.

Seawoods, shipbuilding and power equipment subsidiaries account for majority of loans to subsidiaries

Loans to subsidiaries from L&T stood at Rs32.7 bn at end-FY2010 versus about Rs23.6 bn at end of FY2009. The key subsidiaries accounting for these were L&T Seawoods Pvt. Ltd (to the tune of Rs8.6 bn), L&T Shipbuilding Ltd (Rs6.2 bn - strong increase versus end-FY2009 loans of Rs2.5 bn), L&T power equipment subsidiaries (boiler and turbine subsidiaries together at Rs6.1 bn - nil in the previous year) and L&T Realty Pvt. Ltd (Rs2.9 bn).

Loans and advances to subsidiaries from L&T standalone, March fiscal year-ends, 2009-10 (Rs mn)

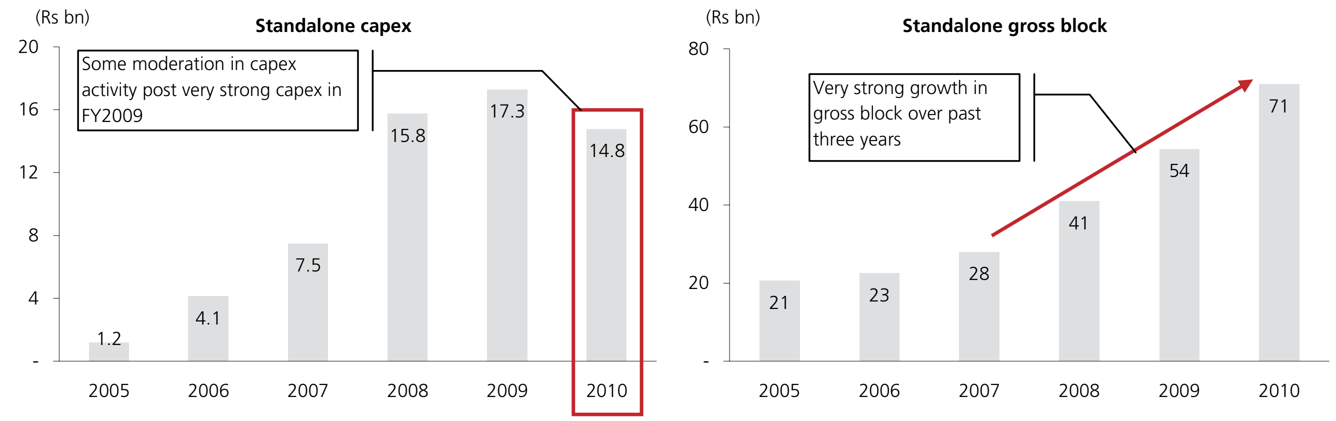
	2010	2009	change
Loans and advances to subsidiaries			
L&T Realty Pvt. Ltd	2,920	—	2,920
L&T Infrastructure Finance Co. Ltd	1,526	—	1,526
L&T Arun Excello IT SEZ Pvt. Ltd	1,701	—	1,701
India Infrastructure Developers Ltd	1,250	—	1,250
L&T Capital Company Ltd	1,242	7,708	(6,466)
Others	3,151	4,989	(1,837)
Total loans and advances to subsidiaries	**11,791**	**12,697**	**(906)**
Advances against equity commitment			
L&T Seawoods Pvt. Ltd	8,583	8,399	183
L&T Shipbuilding Ltd	6,231	2,485	3,746
Advances as normal course of business			
L&T-MHI Turbine Generators Pvt. Ltd	3,293	—	3,293
L&T-MHI Boilers Pvt. Ltd	2,822	—	2,822
Total	**32,719**	**23,581**	**9,137**

Source: Company

Moderately lower capex vs FY2009; but contributes to strong gross block growth

L&T slightly moderated its capital expenditure spends in FY2010 to Rs14.8 bn at the standalone level and Rs41.4 bn at the consolidated level. This is versus capex of Rs17.3 bn at the standalone and Rs77 bn at the consolidated levels in FY2009. The standalone gross block of the company grew by about 30% yoy. This is over very strong capex incurred in the past two years. The total gross block of L&T has grown to over 2.5X in the past three years to Rs70.9 bn from its FY2007-end gross block of Rs28 bn. The capex during the year was primarily towards creating additional fabrication facilities, adding construction equipment and expanding the existing production facilities at Coimbatore, Ahmednagar and Talegaon. We highlight that such investments are over a net-block (including capital work-in-progress) base of about Rs50 bn at end-FY2009 and post a capex of Rs17.3 bn in FY2009. These indicate the large size of expansion activity underway.

L&T standalone and consolidated capital expenditure, March fiscal year-ends, 2005-10 (Rs bn)



Source: Company, Kotak Institutional Equities

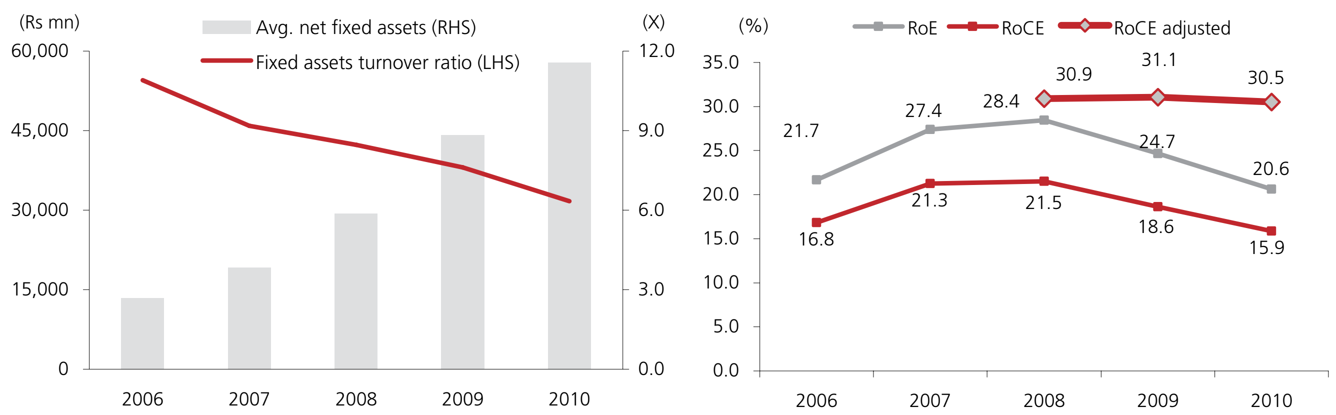
Large increase in capital base leads to reduction in returns

L&T's asset base recorded a very strong growth in FY2010 - 47% yoy increase in net worth, 23% yoy increase in net fixed assets and 32% increase in capital employed. This is versus a revenue growth of about 9% and net profit growth of 13.5% for the same period. The relatively sedate business/ execution in FY2010 versus a very strong capital growth led to the reduction in returns.

Investments towards emerging businesses are yet to start generating returns

We highlight that L&T has, over the last year, made several large investments into new business areas such as power equipment and development and several infrastructure SPVs. This has primarily led to the increase in the capital employed of the company. These new business areas are yet to start contributing to the profitability of the company. The returns on these investments are likely to come in only over a longer period of time and may lead to a reduction in the returns of L&T for the near term. Similarly the recent Hyderabad metro project won by L&T (likely equity requirement of Rs30-35 bn) may further dilute the returns of the company in the near term.

Increase in size of capital base leads to reduction in return ratios
Fixed asset turnover and return ratios of L&T standalone, March fiscal year-ends, 2006-10



Source: Company, Kotak Institutional Equities

Some reversal in profitability seen in associates versus sharp dip in 2009

Revenues of key associates of L&T declined by 9 % yoy to Rs24.6 bn in FY2010 from Rs27.1 bn in FY2010 (adjusted for stake in Voith Paper which was sold in FY2010). The decline in revenues was seen in Audco India, L&T-Komatsu and EWAC Alloys. Profitability of the associates saw a revival in FY2010 versus the sharp dip in FY2009. L&T associates reported a total net profit of Rs1.9 bn, up 31% yoy versus a 47% decline in FY2009. The PAT margin increased to 7.6% of revenues from 5.3% in FY2009; however this is still below FY2008 PAT margin levels of about 8.9%. The revival in PAT margins was primarily led by L&T Komatsu which had recorded a sharp dip in profitability in FY2009 - led by the slowdown of the hydraulic equipment industry. L&T Komatsu reported a net PAT of Rs660 mn, versus Rs190 mn in FY2009. We believe this could be a sign of pick up in construction activity.

Other associates which recorded a pick up in profitability include L&T Ramboll Consulting, Ewac Alloys, L&T Case Equipment and L&T Demag Plastic Machinery (reported a PAT of Rs60 mn versus losses in the last two years).

Associates PAT profitability improves versus sharp dip in FY2009

Snapshot financials of L&T's associate companies, March fiscal year-ends, 2006-12E (Rs mn)

Consolidated	2006	2007	2008	2009	2010	2011E	2012E
Revenues	15,549	21,934	30,411	27,189	24,610	29,532	33,962
PAT	1,129	1,748	**2,700**	**1,428**	**1,870**	2,291	2,692
Revenue growth (%)	34.1	41.1	38.7	(10.6)	(9.5)	20.0	15.0
PAT growth (%)	74.7	54.8	**54.5**	**(47.1)**	**30.9**	22.5	17.5

	2006	2007	2008	2009	2010
L&T Chiyoda - Petrochemical engg & design					
Stake (%)	50	50	50	50	50
Revenue	342	530	682	790	830
PAT	39	78	75	100	90
Voith Paper Technology - Technology solutions for					
Stake (%)	50	50	50	50	
Revenue	150	308	274	106	
PAT	32	89	63	86	
L&T Ramboll Consulting - Civil infrastructure design					
Stake (%)	50	50	50	50	50
Revenue	151	164	243	303	340
PAT	10	29	35	56	100
Ewac Alloys - JV with Messer Eutectic and Castolin - Welding solutions					
Stake (%)	50	50	50	50	50
Revenue	742	1,090	1,510	1,570	1,430
PAT	145	226	244	200	240

	2006	2007	2008	2009	2010
Audco India - JV with flowserve - industrial valves					
Stake (%)	50	50	50	50	50
Revenue	5,769	6,891	8,631	7,377	4,010
PAT	433	523	694	593	320
L&T Komatsu- Hydraulic excavators					
Stake (%)	50	50	50	50	50
Revenue	5,346	8,061	12,980	12,110	11,100
PAT	401	584	1,330	190	660
L&T Case Equipment - CNH America LLC - Construction machinery like backhoe loaders and vibratory compactors					
Stake (%)	50	50	50	50	50
Revenue	1,770	3,238	4,626	3,365	4,970
PAT	9	145	361	112	290
L&T Demag Plastic Machinery - Demag Ergotech, GmbH - plastics industry such as injection moulding					
Stake (%)	50	50	50	100	100
Revenue	1,124	1,402	1,041	843	1,330
PAT	29	32	(170)	(65)	60

Source: Company, Kotak Institutional Equities estimates

Revenues of recent road projects may have been insufficient to service interest

We estimate that a road project would require first year annualized toll collection of about 10% of the total project cost to be able to meet its interest servicing requirement. The estimate is based on (1) 70:30 debt:equity, (2) 80% EBITDA margin in the first year, and (3) 11% as the cost of debt. Toll collection on several of the recently commissioned projects may have been insufficient to meet interest service requirement for the year. For example, L&T reported toll collection of Rs256 mn on Panipat elevated project in FY2009 which implies annualized revenue of Rs363 mn i.e. less than 5% of the project cost. Annualized collection of Rs644 mn on Krishnagiri-Thopur project in FY2009 was about 7.4% of the total project cost.

Road projects may have found tough to even service interest service cost in the first year
Toll collection revenues of recently commissioned projects by L&T

	COD	FY	Revenues Reported	Revenues Annualized	PAT (Rs mn)	Project cost (Rs mn)	Annualized revenue/ project cost (%)
L&T Panipat Elevated Corridor	17-Jul-08	2010	360	360	(450)	7,746	4.6
L&T Krishnagiri Thopur Toll Road	6-Feb-09	2010	670	670	(300)	8,719	7.7
L&T Western Andhra Tollways	14-Mar-09	2010	320	320	(210)	3,728	8.6
L&T Interstate Road corridor		2010	890	890	80	5,370	16.6
L&T Vadodara Baruch Tollway	3-Jun-09	2010	1,350	1,637	(730)	14,610	11.2
Total			**3,590**	**3,877**	**(1,610)**	**40,173**	**9.7**

Source: Company, Kotak Institutional Equities estimates

Recent Hyderabad metro order provides confidence to inflow guidance; but may dilute returns

L&T has recently been declared as the lowest bidder for the Hyderabad metro rail project worth Rs121 bn. This large order certainly makes it easier for L&T to meet its order inflow guidance of about Rs870 bn in FY2011E. The management has guided for strong order inflow growth of 25% in FY2011E over and above the 35% growth recorded in FY2010. This implies order inflows to the tune of about Rs870 bn in FY2011E. L&T expects to have an order backlog of Rs1,300-1,400 bn by end-FY2011E. Apart from this large order, we believe that the inflow growth for L&T is likely to be supported strong order inflows from the power, hydrocarbon, roads and building segments. We have built in order inflows of Rs815 bn - 17% yoy growth versus management guidance of 25-30% growth.

Hyderabad metro would help meet Rs870 bn target including shortfall of Rs55 bn in any of the segments versus our estimates
Rough break up of sector-wise order inflows of L&T, March fiscal year-ends, FY2008-11E

Segment	FY2008 (Rs bn)	FY2009 (Rs bn)	Announced in FY2010 (Rs bn)	FY2010A (Rs bn)	Announced in 1QFY11 (Rs bn)	FY2011E w/o Metro (Rs bn)
Process	**95**	**125**	**94**	**90**	**10**	**109**
Refineries	38	37	21		—	20
Petrochemicals	3	8	30		5	40
Minerals & metals	54	80	43		2	50
Oil & gas	**42**	**15**	**74**	**139**	**—**	**97**
Platforms	42	—	74		—	90
Pipelines	—	15	—		—	—
Power	**35**	**80**	**217**	**230**	**21**	**321**
BOP	5	7	45		11	65
EPC	—	—	103		—	125
Equipment	—	16	24		—	70
Electrification/ T&D	30	45	45		10	60
Infrastructure	**100**	**185**	**135**	**188**	**161**	**225**
Roads and bridges	3	43	15		15	85
Ports and airports	55	—	—		—	—
Railways	3	28	8		121	15
Industrial & commercial bldg.	33	92	92		14	100
Water	6	23	21		11	25
Others	**54**	**53**	**10**	**49**	**—**	**62**
Total	**326**	**458**	**530**	**696**	**192**	**815**

Could be driven by further orders for e.g. IOC for the Paradip refinery

Potential order for platforms from ONGC - several opportunities but competition persist

BoP for 3,500 MW of power plants - Koradi itself could be 1,980 MW

EPC order for about 3 GW of power plants

NTPC bulk tender and other power equipmentopportunities

Historical business - assuming normal growth

This may be Rs135 bn including Rs121 bn Hyderabad metro order and may easily help absorb shortfall elsewhere versus guidance and our estimates

Expect NHAI road orders of about 700-750 km
- equivalent to 4-5 road projects;
3 orders likely to be announced soon (pending financial closure):
- Samaikhiali-Gandhidham - 56 km,
- Devihalli-Hassan - 73 km and
- Krishnagiri-walajhapet 148 km

Rs 63 bn order for process platform and 4 well platforms for ONGC's MHN project

Rs16 bn full-BoP order for 2X600 MW Malwa TPP and several other BoP package orders

Primarily led by commercial (~Rs33 bn) and residential (~28 bn) real estate orders

(1) Rs69 bn 3X 660 MW super-critical BTG units for Koradi TPP (MAHAGENCO)
(2) Rs20 bn for 2X 384 MW Vemagiri gas based power plant (GMR Infra)
(3) Rs14 bn Steam TG sets and Auxillary Package for 1,320 MW Rajpura TPP

Source: Company, Kotak Institutional Equities estimates

Metro project may dilute returns in the near term

We acknowledge that while Hyderabad Metro is one of the largest orders ever won by L&T, it comes at a cost of significant capital commitment - likely equity requirement of at least Rs30-35 bn. This is a significant amount of capital as it is equivalent to about 15% of total net worth of the parent company at FY2010-end. Returns on this capital would come only over a period of time, diluting the return ratios in the near term, making the company dependant on external capital or periodic dilution.

Maintain estimates and target price of Rs2,100/share; reiterate BUY

We retained our standalone earnings estimates of Rs64.2 and Rs80.9 and consolidated earnings estimates of Rs71.7 and Rs91.3 for FY2011E and FY2012E respectively. Our target price of Rs2,100/share is comprised of (1) Rs1,707/share from the core construction business based on 21X FY2012E expected earnings, (2) Rs132/share from L&T's service subsidiaries, (3) Rs75/share from the manufacturing subsidiaries, (4) Rs108/share from the infrastructure SPVs and (5) Rs86/share from other subsidiaries and investments.

We arrive at a SOTP-based target price of Rs2,100/share for L&T
FY2012E-based Sum of The Parts (SOTP) valuation of Larsen and Toubro

	Earnings/Book	FY2012E multiple	Valuation basis	Stake	Value	Per share
	(Rs mn)	(X)		(%)	(Rs bn)	(Rs)
Core company valuation	**48,945**	**21.0**	**P/E**	**100**	**1,028**	**1,707**
Key subsidiaries - services	**17,510**				**80**	**132**
L&T Finance	13,820	1.8	P/B	100	24	40
L&T Infotech	3,689	15.0	P/E	100	55	92
Key subsidiaries - manufacturing	**2,778**				**45**	**75**
Tractor Engineers	87	15.0	P/E	100	1	2
Associate companies*	2,692	15.0	P/E	50	20	34
Power equipment JVwth MHI	N.A.		DCF	51	24	39
Infrastructure SPVs	**32,800**	**2.5**	**P/B**	**79**	**65**	**108**
Other subsidiaries	**17,347**	**3.0**	**P/B**	**100**	**52**	**86**
Total subsidiaries					**241**	**401**
Grand total					**1,269**	**2,108**

Source: Company, Kotak Institutional Equities estimates

We retain our BUY rating on the stock based on (1) strong execution in FY2011-12E (potential for 25%+ growth) with modest margin decline, (2) scale-up of power equipment and EPC that is both less cyclical and competitive (versus other segments), (3) revival in capex activity, (4) strong investments in capacity and capability enhancement that would open new growth areas such as power equipment, nuclear energy and defense, (5) value creation in subsidiaries and (6) strong balance sheet and cash flows that enable L&T to capture opportunities in various areas including infrastructure development and (6) upside of only about 12.5% to our FY2012E-based target price of Rs2,100/share.

Key risks originate from (1) continued order booking pressures led by the slowdown in capex in important segments such as Middle East, metals, real estate, petrochemicals etc leading to lower-than-expected earnings momentum going forward, and (2) likely pressure on working capital and margins with likely dominance of infrastructure orders.

DCF for target price implies reasonably strong assumptions

DCF implies reasonably strong assumptions for the target price. Key implied assumptions are: (1) long-term revenue CAGR of 13% during FY2010-31E (16.5% CAGR for next 10 years i.e. FY2010-21E and 10% CAGR for another ten years i.e. FY2021-31E), (2) EBIT margins of 11%, (3) long-term net working capital of about 60 days of sales and (4) capital expenditure of 9% of incremental revenues each year.

DCF implies 13% revenue CAGR for next twenty years at 11% EBIT margins and 60 days of working capital
DCF valuation for L&T Standalone, March fiscal year-ends, 2010E-20E (Rs mn)

	2010	20011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2021E	2031E	CAGR (%)
Revenues	**367**	**466**	**584**	**671**	**772**	**888**	**1,021**	**1,174**	**1,350**	**1,552**	**1,964**	**5,094**	**13.3**
Growth (%)	9.0	27.0	25.3	15.0	15.0	15.0	15.0	15.0	15.0	15.0	10.0	10.0	
EBIT (excl finl income)	44	53	68	74	85	98	112	129	148	171	216	560	
Growth (%)	20.6	22.1	27.0	9.2	15.0	15.0	15.0	15.0	15.0	15.0	10.0	10.0	
EBIT Margins	11.9	11.4	11.6	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	
EBIT*(1-tax rate)	**29**	**36**	**45**	**49**	**57**	**65**	**75**	**86**	**99**	**114**	**144**	**374**	**13.0**
Growth (%)	15.5	23.8	27.0	9.2	15.0	15.0	15.0	15.0	15.0	15.0	10.0	10.0	
Depreciation / Amortisation	4	5	6	6	6	6	7	7	8	8	10	20	
Change in Working Capital	11	(31)	(20)	(13)	(15)	(17)	(20)	(23)	(26)	(30)	(27)	(69)	
Capital Expenditure	(15)	(8)	(13)	(8)	(9)	(10)	(12)	(14)	(16)	(18)	(16)	(42)	
Free Cash Flows	**30**	**2**	**18**	**34**	**38**	**44**	**50**	**56**	**64**	**74**	**111**	**283**	**11.4**
Growth (%)	(240.4)	(93.9)	902.0	90.4	13.0	13.3	13.6	13.9	14.1	14.3	32.2	9.9	
Discounted cash flow	**30**	**2**	**17**	**29**	**29**	**29**	**29**	**30**	**30**	**30**	**36**	**28**	

WACC used	**12.5%**

Terminal value calculation	
Cash flow in terminal year	283
Long-term growth (%)	5.0%
Capitalisation rate	7.5%
Terminal value	3,960
Discount period (years)	19.5
Discount factor	10.1%
Discounted value	398

NPV calculation	
Free cash	638
Terminal value	398
Enterprise value	1,037
Net debt	9
Core company valn	1,028
Shares o/s (mn)	602
NPV/share (Rs)	**1,707**

Source: Company, Kotak Institutional Equities estimates

Standalone balance sheet and income statement of L&T, March fiscal year-ends, 2007-12E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Income statement						
Net operating revenues	**176,142**	**248,779**	**339,385**	**370,348**	**465,882**	**583,615**
Cost of goods sold	**(158,247)**	**(220,515)**	**(300,164)**	**(322,592)**	**(407,734)**	**(510,328)**
Construction materials	(36,510)	(56,103)	(75,100)	(74,781)	(94,071)	(117,844)
Sub contracts	(33,920)	(44,904)	(70,533)	(86,618)	(108,961)	(136,497)
Stores, spares and tools	(4,694)	(6,995)	(9,008)	(10,523)	(11,647)	(14,590)
Other mfg exp	(13,635)	(16,772)	(22,455)	(24,826)	(30,282)	(37,935)
S, G & A	(10,280)	(13,856)	(17,703)	(14,627)	(17,238)	(21,010)
Salaries & wages	(12,592)	(15,354)	(19,745)	(23,791)	(29,996)	(37,715)
EBIDTA	**17,895**	**28,264**	**39,222**	**47,756**	**58,148**	**73,287**
EBIDTA margin (%)	*10.2*	*11.4*	*11.56*	*12.9*	*12.5*	*12.6*
Other income	4,927	6,520	7,398	9,502	9,161	9,372
Interest	(930)	(1,227)	(4,156)	(5,053)	(4,236)	(3,711)
Depreciation	(1,715)	(2,022)	(3,073)	(4,159)	(4,932)	(5,678)
PBT	**20,191**	**31,534**	**39,404**	**48,059**	**58,141**	**73,271**
Tax	(6,019)	(9,821)	(12,312)	(16,409)	(19,303)	(24,326)
PAT	**14,172**	**21,714**	**27,092**	**31,650**	**38,838**	**48,945**
Extraordinaries	—	(8)	7,725	12,105	—	—
Reported PAT	14,172	21,706	34,817	43,755	38,838	48,945
EPS (Rs)	**50.0**	**37.1**	**46.3**	**52.6**	**64.2**	**80.9**
Balance sheet						
Equity capital	567	585	1,171	1,204	1,210	1,210
Reserves & surplus	56,839	94,707	123,180	181,679	215,620	254,653
Shareholders funds	**57,405**	**95,292**	**124,351**	**182,884**	**216,831**	**255,863**
Reval reserves	279	259	246	233	233	233
Secured loans	2,454	3,085	11,024	9,557	9,557	9,557
Unsecured loans	18,324	32,755	54,537	58,451	43,451	43,451
Total debt	**20,778**	**35,840**	**65,560**	**68,008**	**53,008**	**53,008**
Total sources of funds	**78,462**	**131,391**	**190,157**	**251,125**	**270,072**	**309,105**
Net Block	17,083	28,544	40,128	53,654	64,722	71,544
Capital WIP	4,357	6,990	10,410	8,577	600	600
Total fixed assets	**21,440**	**35,534**	**50,538**	**62,231**	**65,322**	**72,144**
Intangible assets	807	920	1,408	1,427	1,427	1,427
Investments	31,044	69,223	82,637	137,053	134,413	136,913
Net working capital (excl. cash)	**14,530**	**16,652**	**48,303**	**36,869**	**67,540**	**87,984**
Cash and bank balances	10,944	9,645	7,753	14,319	2,145	11,411
Total application of funds	**78,462**	**131,391**	**190,157**	**251,124**	**270,072**	**309,105**

Source: Kotak Institutional Equities

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Economy

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PM's EAC Report: Growth buoyant but inflation risks up. Projecting an 8.5% growth for FY2011E and 9% for FY2012E, the PM's EAC has raised end-FY2011E inflation estimate to 6.5% versus RBI's April 2010 forecast of 5.5%. We see this as a hint that we may see policy rates being raised, perhaps by a surprise larger than 25 bps hike. We also see EAC recommending against dollar-buying FX interventions should capital flows rise.

Downside risk to growth acceleration forecast

PM's Economic Advisory Council (EAC) has projected real GDP growth to accelerate to 8.5% in FY2011E and further to 9% in FY2012E from 7.4% last year. We see downside risks to these projections, more so for FY2012E (see Exhibit 1). In our view, with inflation currently in double digits would require further monetary tightening. This runs the risk of hard-landing. As a base case, with some compression in demand, we see FY2012E growth at around 7.5-8%, i.e. around the potential growth rate.

Large risks that inflation trajectory would be higher than projected 6.5% for end-FY2011E

The PM's EAC sees end-3QFY11E inflation at 7-8%, dropping further to 6.5% by end-FY2011E. That is higher than the RBI's projection of 5.5% made in April 2010. In our assessment, inflation path for FY2011E is likely to be far stickier than indicated by the PM's EAC. We see FY2011E inflation averaging >9% and ending at ≅8%. EAC sees the current high inflation partly as a result of strong domestic demand and return of some pricing power, but more importantly due to rising money wages through NREGA and Bharat Nirman that has contributed to food inflation.

Capital flows not a worry, no sterilization pressures likely

PM's EAC sees current account deficit (CAD) persisting at current high levels. CAD may shrink to 2.7% in FY2011E from 2.9% in FY2010, but may widen back to 2.9% in FY2012E (see Exhibit 2). As a base case, we see a wider CAD than projected by EAC unless growth falls to below potential. We see CAD in 3-3.5% range in FY2011E as a result of high imports and new structural weakness in current account reflected in US$14 bn (1.1% of GDP) of net imports of non-software imports. We see the difference in ours and EAC perceptions arising from EAC's belief that FY2010 CAD/GDP ratio may, with data revisions, get lowered to 2.5% from 2.9%. The EAC has cited NASSCOM view of 12% ITES growth for FY2011E and 20% for FY2012E as a reason. This accounts for less than US$1 bn and we have no clues on what other data revisions might be. EAC projects total capital account flows of US$73 bn in FY2011E and US$91 bn in FY2012E. These estimates are significantly higher than our expectations of US$50-60 bn that factored in a sudden stop in capital flows at some point on account of contagion from Euro area crisis. EAC has expressed comfort with a wider CAD and larger capital flows and expects growth to absorb latter, indicating no sterilization pressures.

EAC hints at more tightening ahead

Our reading of the report suggests that the EAC is in favor of further tightening to curb aggregate demand through monetary and fiscal policy. It suggests completing the process of monetary policy exit with a bias towards tightening as necessary since liquidity conditions are tight enough for effective monetary policy transmission. It also favors exit from expansionary fiscal policy that it sees not only as feasible but also necessary. It sees consolidated GFD/GDP ratio in FY2011E lower from budgeted 8.4%. Amongst other policy initiatives, it has underscored the need for accelerating the pace of capacity creation in the power sector and reforming distribution through greater private investment. It has also suggested reducing coal dependence for power sector.

QUICK NUMBERS

PM's EAC projects:

- Growth at 8.5% in FY2011E and 9% in FY2012E
- Inflation at 6.5% at end-FY2011E
- CAD/GDP of 2.7% in FY2011E, 2.9% in FY2012E
- Reserve accretion of US$31 bn in FY2011E, US$40 bn in FY2012E
- Saving rate of 34% in FY2011E and 36% in FY2012E

Mridul Saggar
mridul.saggar@kotak.com
Mumbai: +91-22-6634-1245

Suvodeep Rakshit
suvodeep.rakshit@kotak.com
Mumbai: +91-22-6634-1409

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

Exhibit 1: Indian Economy likely to grow 8.5% in FY2011E and 9% in FY2012E, according to EAC
Growth in real (new base FY2005) GDP at factor cost and components, March fiscal year-ends, 2008-2012E (%)

Sector	2008	2009	2010	2011KIE	2011EAC	2012KIE	2012EAC
Agriculture and allied activities	**4.7**	**1.6**	**0.2**	**3.1**	**4.5**	**3.0**	**4.0**
Industry	**9.3**	**3.1**	**10.4**	**9.5**	**9.5**	**7.9**	**10.1**
Mining and quarrying	3.9	1.6	10.6	7.8	8.0	6.9	8.0
Manufacturing	10.3	3.2	10.8	10.0	10.0	8.2	10.5
Electricity, gas and water supply	8.5	3.9	6.5	7.3	7.5	6.5	9.0
Services	**10.4**	**9.3**	**8.3**	**8.6**	**9.1**	**8.5**	**9.8**
Construction	10.0	5.9	6.5	9.6	10.0	10.1	11.0
Trade, hotels, transport, storage and communication	10.7	7.6	9.3	10.0	10.0	9.8	10.0
Financing, insurance, real estate and business services	13.2	10.1	9.7	9.4	9.5	8.0	10.5
Community, social and personal services	6.7	13.9	5.6	4.0	6.0	6.0	7.5
Real GDP at factor cost	**9.2**	**6.7**	**7.4**	**8.0**	**8.5**	**7.6**	**9.0**
non-agricultural GDP	10.2	7.7	8.8	8.8	9.2	8.4	9.8

Note: FY2011KIE are KIE estimates over FY2010; FY2011EAC are EAC estimates over FY2010
Source: CSO, Prime Minister's Economic Advisory Council, Kotak Institutional Equities estimates

Exhibit 2: CAD/GDP ratio to be at 2.7% in FY2011E; rise to 2.9% in FY2012E, according to EAC
India's quarterly balance of payments, March fiscal year-ends, 2008-2012E,(US$ bn)

	2008	2009	2010	2011E	2011E(EAC)	2012E(EAC)
Current account	**(15.7)**	**(28.7)**	**(38.3)**	**(51.5)**	**(41.8)**	**(50.7)**
% of GDP	(1.3)	(2.4)	(2.9)	(3.4)	(2.7)	(2.9)
Trade balance	(91.5)	(118.7)	(117.2)	(140.8)	(137.8)	(160.3)
% of GDP	(7.4)	(9.8)	(8.8)	(9.2)	(9.0)	(9.3)
- Exports	166.2	189.0	182.2	208.2	216.1	254.0
- Imports	257.6	307.7	299.4	349.0	353.9	414.3
Invisibles (net)	75.7	89.9	78.9	89.3	96.0	109.7
Capital account	**106.6**	**7.2**	**53.7**	**54.4**	**72.8**	**90.5**
Foreign investment	43.3	3.5	52.1	36.4	55.0	65.0
- FDI	15.9	17.5	19.7	17.0	30.0	30.0
Banking capital	11.8	(3.2)	2.1	4.0	0.0	0.0
Other capital account items	10.8	(1.6)	(12.7)	(7.0)	0.0	0.0

Source: Reserve Bank of India, Prime Minister's Economic Advisory Council, Kotak Institutional Equities estimates

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Initiative for private firms in rail freight positive, but may take time to pan out.

SFTO and PFT policies appear to be a step forward to encourage private participation in freight train operation and third party logistics, respectively. SFTO allows for new wagon designs, business control (unlike WIS scheme) and wagon leasing; PFT provides rail access to operators to handle third party cargo. However, policies may take long to be operational as (1) leadership at ministry may lack the commitment, and (2) approval processes and land acquisition (in PFT) could face further roadblocks.

SFTO encourages new designs and private players; approvals and competition may limit positives

Special Freight Train Operator (SFTO) encourage private participation in freight transport with an aim to increase railways freight traffic through increasing share in the transportation of non-conventional commodities and introduction of high capacity and special purpose wagons. Key highlights of the policy include:

- Encourages new wagon design which would likely attract wagon manufacturers
- Allows wagon leasing; could reduce operators' upfront capex and make business model flexible
- Investors to be responsible for building the business in terms of traffic, unlike earlier WIS scheme
- Allows a very wide field of players linked to wagons/logistics who may apply for a license.

However, the positives could be potentially limited as:

- Approval processes for initial concessions and further growth could be cumbersome
- Potentially aggressive bidding could materially limit returns for private players

PFT policy: Third party logistics; revenue share, investments and land acquisition may be roadblocks

Private Freight Terminal (PFT) aims to speed up the development of freight terminals through participation of private logistics service providers. The policy allows a Terminal Management Company (TMC) to obtain rail access to handle third party cargo and earn revenues from provision of services such as warehousing, loading/unloading. Haulage charges, however, would belong to Railways in addition to revenue share. Key roadblocks to successful implementation could be:

- May not encourage conversion of container terminals due to revenue share
- Land acquisition could be costly and tough; only private (non-railways) land allowed
- Approval processes from Railways and zonal offices could be cumbersome with PFT as well

Policies still in early stage, may take long to implement; ministry may lack the commitment to push

In our view, there are two broad issues with such initiatives – (1) policies are only in draft stage and going by container transportation policy experience, these may take long before coming into operation and (2) leadership at ministry may lack the commitment to push these with gusto.

Lokesh Garg
lokesh.garg@kotak.com
Mumbai: +91-22-6634-1496

Supriya Subramanian
supriya.subramanian@kotak.com
Mumbai: +91-22-6634-1383

Nitij Mangal
nitij.mangal@kotak.com
Mumbai: +91-22-6634-1453

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

SFTO policy encourages new designs, leasing, business build by private sector

Ministry of Railways has put forth a draft policy for Special Freight Train Operator (SFTO) to encourage private participation with an aim to increase the freight traffic carried over Railways through increasing share in the transportation of non-conventional commodities and introduction of high capacity and special purpose wagons.

Encourages new wagon design which would likely attract wagon manufacturers

The policy encourages induction of new wagon design in the railways system to help achieve higher per train throughput. New designs such as aluminum wagons which are lighter and for same axle load, can carry higher amount of traffic. In our view, wagons manufacturers could be one of the categories of players who would be encouraged to apply for licenses under the policy. We note that Titagarh Wagons had mentioned contours of such a policy during its IPO time two/three years ago, based on their discussions with the Ministry.

Introduces concept of wagon leasing – could provide flexibility in business model

The policy also introduces wagon leasing as an option which has not been the case with any of the earlier railways policies. As per our understanding, container train operators are not allowed to lease wagons so far; the operators may ask for such relaxation in the SFTO policy which can reduce pressure of capex in near term and make the business model more flexible.

Responsibility to build business rests with private sector; several steps ahead of WIS

Investors would remain responsible for building the business in terms of traffic and thus SFTO policy would be very different from the earlier Wagon Investment Scheme (WIS) which merged private wagons with Indian railways pool. WIS allowed freight discount in return for wagons being bought by private sector and also guaranteed transit frequency or provision of empty rakes to investors for their material. WIS policy made sense for people whose business is primarily limited by transit such as mining. However, wagons were merged with Indian railway pool and investor was only entitled to discount and specific frequency of empty rakes to carry his stuff. WIS achieved limited success as only few players in mining space such a Roongta Mines etc. bought WIS wagons.

Broad terms for eligibility for application under five commodity groups

The policy is not limited to container operators but a very wide field of players linked to wagons/logistics may apply for a license. The policy allows for five commodity groups – (1) automobiles and RO-RO traffic, (2) bulk fertilizers, bulk cement and fly ash, (3) bulk chemicals, petrochemicals, and bulk alumina, (4) steel products, and (5) molasses, edible oil and caustic soda.

…however, approvals, leadership and irrational bidding may limit positives

Approval processes for initial concessions and further growth could be cumbersome

Under the policy, setting up of the concession agreements and initiatives for further growth would need to go through potentially complex approval processes. For instance, each rake induction would need approval from railways including potentially some approvals at the zonal level. Rake can be run only between designated origin/destination terminals and any changes to that would need approvals as well. Similarly, if a new wagon design is proposed, then it needs approval of Railway Design and Standards Organization which can be a very long process. In our view, these could be long-drawn bureaucratic process unless the mandate is strong from the top leadership.

Potentially aggressive bidding could materially limit returns for private players

The licenses would be handed out to a limited number of players (maximum up to five) in each commodity group based on a bidding process. The bidding process would require all the players to pay the same license fees as the top bidder. With evidence of potentially aggressive bidding in the highways and telecom space, competition may materially limit the returns of the private players early on itself.

PFT policy encourages setting up third party logistics facilities

The ministry has also put together a draft policy for Private Freight Terminal (PFT) with the aim to speed up the development of freight terminals through participation of private logistics service providers.

Existing logistics firms can offer rail-based services with pricing freedom

PFT policy allows a Terminal Management Company (TMC) to obtain rail access to handle third party cargo and thereby provides it a business opportunity to augment its presence in logistics chain. Revenue line of the TMC would come from provision of services such as warehousing, loading, unloading, palletization, with the freedom to price these services. Haulage charges, however, would belong to Railways in addition to revenue share. Revenue share after first few years would be about Rs20/ton increasing roughly at the rate of inflation.

PFT is a further extension of private siding policy for non-captive use

PFT policy is a development of private siding policy with the only difference being that PFT is aimed at independent third party business development while private siding policy was primarily captive usage. Even private sidings on private land can be converted to PFT but would face the balance between investments, revenue share and business volume.

Revenue share, investments and land acquisition may be roadblocks to PFT

May not encourage conversion of container terminals due to revenue share

The policy may not be a win-win for an existing container terminal (called Brownfield PFT) as the operator would have to provide revenue share potentially on the entire business. An existing container terminal operator would not find the conversion to PFT beneficial unless revenue share and cost of additional infrastructure can be balanced by increased traffic of other type.

Land acquisition could be costly and tough; only private (non-railways) land allowed

PFT can only be created on private (non-railways) land and thus land acquisition can be a hindrance as land areas which can be connected to railway lines in an efficient manner as well as near to catchment regions would be costly and tough to obtain.

Approval processes could be cumbersome with PFT as well

As with SFTO, we view that the opportunity could be marred by cumbersome bureaucratic approval process, which could lead to substantial delays unless led by a strong leadership. For instance, business plans under PFT would require approvals from Zonal railways which in itself may be a tall order.

June 2010: Earnings announcement calendar

Mon	Tue	Wed	Thu	Fri	Sat
26-Jul	**27-Jul**	**28-Jul**	**29-Jul**	**30-Jul**	**31-Jul**
Bharat Forge	Ashok Leyland	Bajaj Electric	Aban Offshore	ABB	EIH
Century Textiles	Asian Paints	Chennai Petroleum	Alok Industries	Aditya Birla Nuvo	Bank of India
Dabur India	Binani Cement	Corporation Bank	Bank of Baroda	Bharat Electronics	City Union Bank
Dena Bank	Blue Dart	DLF	Central Bank of India	BPCL	Grasim Industries
Essar Oil	Cadila Healthacare	Essel Propack	Federal Bank	Hindustan Construction	GVK Power & Infra
Glaxosmithkline Pharma	Cairn India	GTL Infra	GE Shipping	Indian Hotels	ICICI Bank
Maharashtra Seamless	Everest Kanto	Gujarat Mineral Development Corp.	GHCL	Indian Infoline	Indian Overseas Bank
Mahindra Holidays	Glenmark Pharmaceuticals	Havells India	GSPL	Karnataka Bank	JK Cement
NTPC	Godrej Industries	Jindal Steel & Power	HCL Technologies	Max India	Syndicate Bank
Sterlite Industries	GTL	JM financial	HDIL	NMDC	
Tech Mahindra	Hindustan Unilever	Lupin	Hero Honda	PSL	
Union Bank	IRB Infrastructure	Mahindra & Mahindra	ONGC	REI Agro	
United Phosporus	JSW Steel	Marico	Oriental Bank of Commerce	Reliance Infra	
	Jubilant Organosys	MMTC	Petronet LNG	Reliance Natural Resources	
	L&T	Neyveli Lignite	SAIL	Reliance Power	
	Manglore Refinery and Petrochemicals	Phoenix Mills	Siemens	Religare Enterprises	
	Reliance Industries	Samruddhi Cement	Tata Tea	Shipping Corp	
	Titan Industries	Sobha Develpoers	Tata Teleservices	Tata Chemicals	
		Sun Pharmaceuticals	Ultratech Cement	Torrent Power	
		SunTV Network			
		Tata Communications			
		Voltas			
		Welspun Corp			
2-Aug	**3-Aug**	**4-Aug**	**5-Aug**	**6-Aug**	**7-Aug**
GAIL	**Hindalco Industries**	IDFC		Rashtriya Chemicals & Fertilisers	GMR Infra
Glaxosmithkline Consumer		Mundra Port & SEZ		Power Grid Corp	
India Cements		Adani Power			
Madras Cement					
Nestle India					
NMDC					
9-Aug	**10-Aug**	**11-Aug**	**12-Aug**	**13-Aug**	**14-Aug**
	Nagarjuna Constructions		Ranbaxy Laboratories		Lanco Infratech

Source: BSE, Kotak Institutional Equities

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	23-Jul-10 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2010E	EPS (Rs) 2011E	EPS (Rs) 2012E	EPS growth (%) 2010E	EPS growth (%) 2011E	EPS growth (%) 2012E	PER (X) 2010E	PER (X) 2011E	PER (X) 2012E	EV/EBITDA (X) 2010E	EV/EBITDA (X) 2011E	EV/EBITDA (X) 2012E	Price/BV (X) 2010E	Price/BV (X) 2011E	Price/BV (X) 2012E	Dividend yield (%) 2010E	Dividend yield (%) 2011E	Dividend yield (%) 2012E	RoE (%) 2010E	RoE (%) 2011E	RoE (%) 2012E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Automobiles																													
Ashok Leyland	73	ADD	97,444	2,074	1,330	2.8	4.1	5.5	84.5	46.1	34.3	26.0	17.8	13.2	15.0	10.8	9.0	2.5	2.3	2.0	2.0	1.4	1.4	11.1	13.4	16.2	65	(11.3)	10.7
Bajaj Auto	2,470	ADD	357,438	7,608	145	117.7	169.0	189.5	160.1	43.6	12.2	21.0	14.6	13.0	13.6	10.4	9.0	12.2	7.1	4.8	0.8	0.8	0.8	70.9	61.4	44.0	2,650	7.3	12.4
Bharat Forge	332	ADD	79,797	1,699	240	0.7	11.4	18.7	(92.0)	1,553.7	64.6	482.6	29.2	17.7	23.9	11.3	7.9	2.2	2.0	1.8	—	—	—	0.9	13.9	18.2	335	0.9	4.4
Hero Honda	1,951	SELL	389,545	8,292	200	111.8	121.5	135.7	74.1	8.7	11.7	17.5	16.1	14.4	11.2	10.6	9.0	10.8	7.4	5.5	1.5	1.7	1.9	59.1	56.6	43.8	1,800	(7.7)	16.5
Mahindra & Mahindra	628	BUY	363,177	7,730	578	34.9	40.7	48.7	132.5	16.6	19.8	18.0	15.4	12.9	11.9	10.1	8.4	4.5	3.6	2.9	1.5	1.5	1.6	30.0	25.9	24.7	680	8.3	26.4
Maruti Suzuki	1,358	ADD	392,520	8,355	289	86.4	94.1	104.2	104.9	8.9	10.8	15.7	14.4	13.0	8.5	7.9	6.8	3.3	2.7	2.3	0.4	0.5	0.5	23.3	20.6	18.9	1,400	3.1	19.2
Tata Motors	838	ADD	525,004	11,175	626	23.8	27.1	32.8	137.8	13.5	21.4	35.2	31.0	25.5	16.2	14.9	12.9	2.9	2.5	2.2	1.6	0.7	0.7	8.6	8.6	9.1	900	7.3	85.2
Automobiles		**Cautious**	**2,204,924**	**46,933**					**109.9**	**22.2**	**16.6**	**21.6**	**17.7**	**15.2**	**12.7**	**10.9**	**9.3**	**4.2**	**3.4**	**2.8**	**1.2**	**1.0**	**1.0**	**19.5**	**19.4**	**18.6**			
Banks/Financial Institutions																													
Andhra Bank	146	BUY	70,737	1,506	485	21.0	21.1	25.4	56.1	0.6	20.0	6.9	6.9	5.7	—	—	—	1.5	1.3	1.1	2.9	2.9	3.5	24.4	20.2	20.7	160	9.7	5.0
Axis Bank	1,390	ADD	563,172	11,987	405	62.1	78.1	98.3	22.7	25.9	25.9	22.4	17.8	14.1	—	—	—	3.5	3.0	2.6	0.9	1.1	1.4	19.2	18.3	19.9	1,500	7.9	48.8
Bank of Baroda	725	BUY	265,081	5,642	366	83.7	93.2	114.7	37.3	11.4	23.0	8.7	7.8	6.3	—	—	—	1.9	1.6	1.3	2.1	2.3	2.8	24.4	22.6	23.2	825	13.8	9.9
Bank of India	403	REDUCE	211,917	4,511	526	33.1	42.7	56.7	(42.1)	28.9	32.8	12.2	9.4	7.1	—	—	—	1.7	1.5	1.3	1.7	2.2	3.0	14.2	16.4	19.1	360	(10.7)	7.0
Canara Bank	481	ADD	197,354	4,201	410	73.7	82.2	98.3	45.8	11.6	19.5	6.5	5.9	4.9	—	—	—	1.6	1.3	1.0	1.7	2.1	2.5	22.4	20.8	20.8	580	20.5	7.4
Corporation Bank	572	BUY	82,089	1,747	143	82.0	86.1	104.7	31.8	4.9	21.6	7.0	6.7	5.5	—	—	—	1.4	1.2	1.0	2.9	3.0	3.7	22.0	19.8	20.6	650	13.6	1.3
Federal Bank	355	BUY	60,725	1,293	171	27.2	38.7	48.0	(7.2)	42.3	24.2	13.1	9.2	7.4	—	—	—	1.3	1.2	1.0	1.4	2.0	2.5	10.3	13.4	14.8	360	1.4	6.2
HDFC	2,993	ADD	859,449	18,294	287	98.4	116.1	138.9	22.7	17.9	19.6	30.4	25.8	21.6	—	—	—	5.7	5.0	4.4	1.2	1.4	1.6	20.0	20.6	21.7	3,450	15.3	38.1
HDFC Bank	2,039	BUY	933,155	19,863	458	64.4	87.2	113.8	22.1	35.4	30.5	31.6	23.4	17.9	—	—	—	4.3	3.8	3.2	0.6	0.8	1.0	16.1	17.3	19.5	2,400	17.7	30.9
ICICI Bank	913	REDUCE	1,017,727	21,663	1,115	36.1	47.5	58.4	6.9	31.7	22.9	25.3	19.2	15.6	—	—	—	2.0	1.9	1.7	1.3	1.7	2.1	8.0	10.0	11.5	980	7.4	83.1
IDFC	192	ADD	280,445	5,969	1,459	8.2	9.2	11.3	41.1	13.3	22.8	23.6	20.8	16.9	—	—	—	4.0	2.6	2.2	0.7	0.9	1.1	16.1	15.2	14.5	205	6.6	23.7
India Infoline	99	BUY	30,759	655	312	8.1	8.9	10.0	59.2	9.8	12.5	12.1	11.1	9.8	—	—	—	1.9	1.6	1.3	3.2	1.9	2.4	16.4	15.9	16.1	140	41.9	4.0
Indian Bank	251	BUY	108,023	2,299	430	35.1	35.5	43.8	25.5	1.1	23.6	7.2	7.1	5.7	—	—	—	1.6	1.4	1.1	2.4	2.4	3.0	24.0	20.3	21.2	280	11.4	4.4
Indian Overseas Bank	116	BUY	62,952	1,340	545	13.0	15.4	26.4	(46.7)	18.9	71.3	8.9	7.5	4.4	—	—	—	1.0	0.9	0.7	3.5	3.9	4.3	9.6	10.6	16.3	120	3.9	4.1
J&K Bank	796	BUY	38,574	821	48	105.7	112.3	140.6	25.1	6.3	25.2	7.5	7.1	5.7	—	—	—	1.4	1.2	1.0	2.8	2.9	3.7	17.3	16.9	18.5	850	6.9	0.6
LIC Housing Finance	1,036	ADD	98,438	2,095	95	69.7	100.7	109.9	11.5	44.5	9.1	14.9	10.3	9.4	—	—	—	3.0	2.5	2.1	1.4	2.1	2.3	23.6	25.5	23.2	1,250	20.6	20.0
Mahindra & Mahindra Financial	525	BUY	50,376	1,072	96	35.7	42.6	49.8	59.3	19.3	16.8	14.7	12.3	10.5	—	—	—	3.0	2.5	2.2	1.4	1.7	2.0	21.4	21.7	21.6	500	(4.7)	1.3
Oriental Bank of Commerce	364	ADD	91,109	1,939	251	45.3	52.8	58.6	25.3	16.5	11.0	8.0	6.9	6.2	—	—	—	1.3	1.1	1.0	2.5	2.9	3.3	14.1	15.4	15.3	400	10.0	4.4
PFC	317	SELL	364,360	7,756	1,148	20.5	22.9	27.6	53.5	11.9	20.3	15.5	13.9	11.5	—	—	—	2.8	2.5	2.2	1.6	1.8	2.2	18.8	18.3	19.2	275	(13.4)	3.7
Punjab National Bank	1,051	BUY	331,288	7,052	315	123.9	133.4	163.3	26.4	7.7	22.4	8.5	7.9	6.4	—	—	—	2.0	1.7	1.4	2.1	2.6	3.2	26.2	23.2	23.7	1,300	23.7	8.8
Reliance Capital	795	ADD	195,771	4,167	246	13.8	16.1	14.1	(64.9)	17.0	(12.4)	57.6	49.2	56.2	—	—	—	2.8	2.8	2.7	0.8	0.8	0.7	5.0	5.7	4.8	875	10.0	40.5
Rural Electrification Corp.	304	ADD	300,167	6,389	987	20.3	25.3	31.2	23.2	24.5	23.4	15.0	12.0	9.8	—	—	—	2.7	2.4	2.0	2.1	2.5	3.1	22.0	21.0	22.5	325	6.9	14.1
Shriram Transport	633	ADD	141,214	3,006	223	39.2	53.4	64.8	30.1	36.4	21.3	16.2	11.9	9.8	—	—	—	3.8	3.2	2.7	1.9	2.5	3.1	28.4	28.2	28.4	700	10.6	4.5
SREI	88	NR	10,251	218	116	8.3	7.9	9.9	17.8	(4.8)	25.8	10.6	11.2	8.9	—	—	—	0.9	0.8	0.8	1.4	1.4	1.4	11.1	10.5	12.3	—	—	3.9
State Bank of India	2,497	BUY	1,585,175	33,741	635	144.4	170.9	210.6	0.5	18.3	23.2	17.3	14.6	11.9	—	—	—	2.4	2.1	1.9	1.2	1.3	1.4	14.8	15.5	16.7	2,900	16.1	92.4
Union Bank	326	BUY	164,668	3,505	505	41.1	45.8	57.3	20.2	11.5	25.0	7.9	7.1	5.7	—	—	—	1.9	1.5	1.3	1.7	2.1	2.6	26.2	23.7	24.3	380	16.6	4.0
Yes Bank	302	BUY	102,529	2,182	340	15.0	17.7	22.5	46.7	18.2	26.6	20.1	17.0	13.4	—	—	—	3.3	2.8	2.4	0.5	0.6	0.7	20.3	18.0	19.3	350	16.0	20.8
Banks/Financial Institutions		**Attractive**	**8,217,504**	**174,915**					**14.7**	**18.9**	**23.6**	**16.3**	**13.7**	**11.1**	**—**	**—**	**—**	**2.5**	**2.2**	**1.9**	**1.4**	**1.6**	**1.9**	**15.5**	**16.0**	**17.2**			
Cement																													
ACC	820	ADD	154,052	3,279	188	83.2	66.0	72.4	47.9	(20.7)	9.8	9.9	12.4	11.3	5.2	5.8	4.6	2.4	2.1	1.9	3.3	2.9	2.9	29.3	20.0	19.2	920	12.2	8.1
Ambuja Cements	115	SELL	175,073	3,727	1,522	8.0	8.4	8.9	11.4	5.3	5.1	14.4	13.6	13.0	7.9	7.5	6.4	2.5	2.2	2.0	1.6	1.8	1.9	19.3	17.8	16.5	108	(6.1)	5.5
Grasim Industries	1,828	ADD	167,563	3,567	92	301.0	240.1	282.0	26.1	(20.2)	17.5	6.1	7.6	6.5	3.9	3.9	3.0	1.3	1.2	1.0	1.8	1.9	1.9	22.9	16.4	16.7	2,150	17.6	8.1
India Cements	107	SELL	32,820	699	307	10.0	11.8	12.9	(43.5)	17.7	9.0	10.6	9.0	8.3	5.4	5.0	4.7	0.8	0.7	0.7	2.0	3.0	3.0	8.2	8.7	9.0	110	2.9	2.4
Shree Cement	1,831	BUY	63,789	1,358	35	208.0	221.1	242.5	19.0	6.3	9.7	8.8	8.3	7.6	4.3	4.1	3.2	3.5	2.5	1.9	0.6	0.6	0.6	48.0	35.0	28.1	2,550	39.3	1.0
UltraTech Cement	829	SELL	103,246	2,198	124	88.2	67.1	77.2	12.0	(23.9)	15.0	9.4	12.4	10.7	4.9	5.5	4.5	1.9	1.7	1.5	1.0	1.0	1.0	26.6	16.8	16.7	940	13.3	2.9
Cement		**Neutral**	**696,544**	**14,826**					**19.3**	**(12.8)**	**12.0**	**9.1**	**10.4**	**9.3**	**4.9**	**5.0**	**4.1**	**1.9**	**1.6**	**1.4**	**1.9**	**1.9**	**1.9**	**20.5**	**15.6**	**15.2**			

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

	23-Jul-10		Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price	Upside	ADVT-3mo
Company	Price (Rs)	Rating	(Rs mn)	(US$ mn)	(mn)	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	(Rs)	(%)	(US$ mn)
Consumer products																													
Asian Paints	2,521	BUY	241,771	5,146	96	71.5	81.5	101.1	85.3	13.9	24.2	35.2	30.9	24.9	21.7	19.2	15.3	15.1	12.0	9.6	1.1	1.4	1.7	51.8	44.4	44.0	2,500	(0.8)	4.2
Colgate-Palmolive (India)	846	REDUCE	115,091	2,450	136	31.1	34.5	39.6	44.2	10.9	14.6	27.2	24.5	21.4	22.3	18.2	15.5	35.3	30.1	25.7	2.4	3.1	3.5	156.1	132.3	129.4	830	(1.9)	2.3
Dabur India	212	BUY	183,221	3,900	866	5.8	6.8	8.2	28.1	17.6	20.8	36.5	31.0	25.7	27.1	21.8	18.1	17.4	14.3	11.8	1.5	1.7	2.0	54.3	51.1	50.7	200	(5.4)	3.1
GlaxoSmithkline Consumer (a)	1,782	ADD	74,962	1,596	42	55.4	70.0	82.9	23.6	26.5	18.4	32.2	25.5	21.5	17.8	15.0	12.3	8.4	6.9	5.8	1.0	1.3	1.5	27.9	29.6	29.2	1,800	1.0	0.6
Godrej Consumer Products	359	NR	110,563	2,353	308	8.7	9.8	11.6	29.7	13.2	18.2	41.4	36.5	30.9	29.3	26.2	22.0	9.4	8.3	8.2	1.1	1.1	1.1	30.7	24.1	27.8	—	—	3.0
Hindustan Unilever	262	REDUCE	570,910	12,152	2,179	9.7	10.4	11.8	1.7	7.3	14.0	27.1	25.2	22.1	18.2	17.2	14.4	22.4	19.3	16.7	2.9	3.2	3.7	91.6	82.2	80.8	230	(12.2)	11.5
ITC	302	BUY	1,153,893	24,561	3,825	10.6	12.5	14.5	22.6	17.5	16.0	28.4	24.2	20.8	17.2	15.1	12.8	7.8	6.7	5.8	3.3	1.8	2.0	29.2	31.4	31.1	330	9.4	23.4
Jubilant Foodworks	344	REDUCE	22,311	475	65	5.5	7.7	9.7	340.6	39.3	25.3	62.1	44.6	35.6	33.6	23.5	16.7	19.0	13.3	9.7	—	—	—	46.6	35.1	31.5	290	(15.7)	5.6
Jyothy Laboratories	274	NR	19,887	423	73	11.0	12.9	15.3	99.6	17.0	18.3	24.8	21.2	18.0	19.2	14.6	11.9	4.9	4.2	3.6	1.7	1.3	1.7	18.6	20.2	20.5	—	—	1.3
Nestle India (a)	2,953	REDUCE	284,692	6,060	96	74.4	87.0	105.5	27.0	17.0	21.3	39.7	33.9	28.0	26.2	23.2	20.0	49.0	38.9	30.7	1.6	2.1	2.5	136.0	127.8	122.7	3,000	1.6	2.2
Tata Global Beverages	121	BUY	74,610	1,588	618	6.6	7.4	8.4	23.4	11.1	13.8	18.2	16.4	14.4	11.6	9.5	8.5	1.5	1.4	1.3	1.8	2.0	2.3	10.9	11.4	12.0	125	3.6	3.8
Consumer products		**Attractive**	**2,851,911**	**60,705**					**23.7**	**14.6**	**16.8**	**30.0**	**26.1**	**22.4**	**19.2**	**16.9**	**14.2**	**10.0**	**8.7**	**7.5**	**2.5**	**2.1**	**2.4**	**33.4**	**33.1**	**33.5**			
Constructions																													
IVRCL	184	BUY	49,237	1,048	267	7.8	10.3	12.4	(7.7)	32.4	19.7	23.6	17.8	14.9	12.4	10.1	8.6	2.4	2.2	1.9	0.2	0.2	0.2	10.9	12.8	13.5	215	16.6	7.0
Nagarjuna Construction Co.	183	BUY	46,968	1,000	257	7.1	11.5	14.3	6.1	61.1	24.1	25.7	15.9	12.8	12.4	9.4	7.7	2.1	1.9	1.7	0.9	1.1	1.1	9.3	12.5	13.9	210	14.7	3.6
Punj Lloyd	135	REDUCE	45,631	971	339	(12.9)	9.8	12.0	79.2	(175.4)	22.4	(10.4)	13.8	11.3	37.2	7.3	6.7	1.5	1.4	1.2	(0.1)	0.3	0.8	(15.8)	10.3	11.4	140	4.0	11.8
Sadbhav Engineering	1,305	BUY	19,580	417	15	43.1	62.0	84.0	(15.8)	43.9	35.5	30.3	21.1	15.5	16.9	10.9	8.9	4.7	3.2	2.7	0.3	0.5	0.5	13.3	14.1	17.4	1,450	11.1	0.3
Construction		**Attractive**	**161,415**	**3,436**					**(96.9)**	**14,481**	**24.4**	**2,384.0**	**16.4**	**13.1**	**16.9**	**8.8**	**7.6**	**2.1**	**1.8**	**1.6**	**0.3**	**0.5**	**0.7**	**0.1**	**11.3**	**12.5**			
Energy																													
Aban Offshore	841	ADD	36,574	779	43	106.6	172.3	103.6	10.0	61.6	(39.8)	7.9	4.9	8.1	8.4	6.2	6.7	1.6	0.9	0.9	0.4	0.4	0.5	24.3	20.8	11.1	900	7.0	49.4
Bharat Petroleum	632	ADD	228,529	4,864	362	62.1	54.3	67.6	201	(12)	24.5	10	12	9.3	5.6	5.8	4.9	1.6	1.4	1.3	2.2	2.8	3.5	15.6	12.3	13.9	660	4.4	25.8
Cairn india	326	SELL	619,265	13,181	1,897	5.5	28.5	40.0	29.0	413.9	40.5	58.9	11.5	8.2	46.4	7.8	5.5	1.8	1.6	1.4	—	—	4.6	3.1	14.6	18.1	250	(23.4)	17.4
Castrol India (a)	468	REDUCE	115,628	2,461	247	15.4	20.7	21.2	45	34	2.4	30	23	22.1	18.1	14.0	13.5	25.1	23.6	22.3	2.7	3.5	3.6	83.8	107.4	103.7	380	(18.7)	1.1
GAIL (India)	465	ADD	589,653	12,551	1,268	24.8	26.2	38.8	11.7	5.8	48.0	18.8	17.7	12.0	10.5	10.9	8.6	3.2	2.9	2.5	1.6	1.8	2.7	17.4	16.3	21.1	495	6.5	16.2
GSPL	104	REDUCE	58,298	1,241	562	7.4	8.9	9.1	235	22	1.3	14	12	11.4	7.2	6.0	5.4	3.4	2.7	2.4	1.0	2.2	3.5	27.3	26.3	22.5	80	(22.8)	4.2
Hindustan Petroleum	437	ADD	147,978	3,150	339	52.6	45.0	62.0	210.1	(14.5)	38.0	8.3	9.7	7.0	3.0	3.5	2.7	1.1	1.0	0.9	2.7	3.2	4.4	13.3	10.3	13.0	500	14.5	31.8
Indian Oil Corporation	373	ADD	906,232	19,290	2,428	49.9	34.0	37.4	407	(32)	10.0	7	11	10.0	5.1	6.0	5.0	1.7	1.5	1.4	3.5	2.8	3.0	22.7	13.8	14.0	410	9.8	17.3
Oil India	1,352	BUY	325,142	6,921	240	115.1	130.7	152.0	13.8	13.5	16.3	11.7	10.3	8.9	5.0	4.0	3.2	2.2	1.9	1.7	2.5	3.3	3.7	16.7	17.8	18.2	1,440	6.5	7.5
Oil & Natural Gas Corporation	1,260	BUY	2,694,891	57,363	2,139	91.4	124.9	141.1	1	37	12.9	14	10	8.9	5.0	4.2	3.4	2.0	1.8	1.6	2.6	3.3	3.8	14.6	17.9	18.0	1,450	15.1	37.1
Petronet LNG	85	REDUCE	63,413	1,350	750	5.4	5.5	8.2	(22.0)	2.6	47.8	15.7	15.3	10.3	9.4	8.8	7.0	2.5	2.2	1.9	2.1	2.4	3.3	15.9	14.3	18.6	82	(3.0)	3.5
Reliance Industries	1,060	SELL	3,155,899	67,175	2,976	49.6	62.9	80.2	(2)	27	27.5	21	17	13.2	10.8	8.1	6.8	2.1	1.9	1.7	1.4	1.8	2.2	11.4	13.2	15.3	985	(7.1)	112.5
Energy		**Cautious**	**8,941,503**	**190,326**					**38.0**	**21.0**	**20.8**	**14.8**	**12.2**	**10.1**	**7.2**	**6.1**	**5.0**	**2.0**	**1.8**	**1.6**	**2.0**	**2.3**	**3.1**	**13.8**	**15.0**	**16.3**			
Industrials																													
ABB	839	REDUCE	177,728	3,783	212	16.7	23.3	37.2	(35.2)	39.2	59.8	50.1	36.0	22.5	28.7	21.2	13.1	7.3	6.3	5.0	0.2	0.4	0.4	15.6	18.8	24.7	840	0.2	6.9
BGR Energy Systems	741	BUY	53,352	1,136	72	16.0	28.0	39.7	32.2	74.6	41.9	46.2	26.5	18.7	26.0	15.1	10.9	9.5	7.6	5.8	0.4	0.9	1.1	22.3	31.8	35.1	800	8.0	3.2
Bharat Electronics	1,847	REDUCE	147,748	3,145	80	93.9	111.8	127.4	(9.6)	19.1	13.9	19.7	16.5	14.5	9.6	7.7	6.5	3.3	2.9	2.5	1.4	1.4	1.4	17.9	18.7	18.5	1,790	(3.1)	2.1
Bharat Heavy Electricals	2,460	REDUCE	1,204,317	25,635	490	88.1	113.1	137.5	37.9	28.4	21.6	27.9	21.8	17.9	15.6	11.8	9.6	7.6	6.0	4.8	0.8	1.0	1.2	29.9	30.8	29.8	2,500	1.6	28.4
Crompton Greaves	289	BUY	185,073	3,939	642	12.8	14.0	16.3	46.5	9.0	16.6	22.5	20.6	17.7	13.0	11.5	9.7	7.4	5.7	4.5	0.4	0.6	0.7	37.9	31.1	28.2	320	10.9	8.6
Larsen & Toubro	1,938	BUY	1,164,622	24,790	601	58.1	71.4	90.7	16.0	22.8	27.1	33.3	27.1	21.4	17.5	14.8	12.2	5.2	4.4	3.7	0.6	0.6	0.7	18.6	17.6	18.8	2,100	8.4	54.3
Maharashtra Seamless	395	BUY	27,828	592	71	40.2	43.6	49.8	12.1	8.5	14.2	9.8	9.0	7.9	5.2	4.5	3.6	1.7	1.5	1.3	1.5	2.0	2.5	19.3	17.9	17.7	450	14.1	0.4
Siemens	728	REDUCE	245,419	5,224	337	25.0	29.6	34.3	55.2	18.6	16.0	29.2	24.6	21.2	17.2	14.1	11.9	7.2	5.9	4.8	0.7	0.8	0.9	27.3	26.3	25.1	635	(12.8)	6.9
Suzlon Energy	59	REDUCE	94,756	2,017	1,594	(5.9)	0.3	5.3	(182.3)	(104.4)	1,931.8	(10.0)	229.2	11.3	17.1	8.8	5.7	0.9	0.9	0.8	—	—	0.3	(8.8)	0.4	7.5	70	17.7	25.9
Thermax	776	ADD	92,490	1,969	119	21.7	29.5	39.7	(10.4)	35.9	34.4	35.7	26.3	19.6	18.4	14.4	10.7	8.6	7.1	5.7	0.6	1.1	1.5	25.0	29.5	32.2	865	11.4	1.1
Voltas	207	REDUCE	68,462	1,457	331	10.9	11.3	12.6	57.4	3.8	12.1	19.0	18.3	16.4	11.3	10.0	8.6	6.4	5.2	4.3	1.5	1.6	1.8	38.3	31.3	28.8	200	(3.4)	4.5
Industrials		**Attractive**	**3,461,794**	**73,687**					**1.8**	**35.3**	**29.0**	**32.5**	**24.0**	**18.6**	**16.2**	**12.6**	**10.1**	**5.2**	**4.4**	**3.7**	**0.7**	**0.8**	**1.0**	**16.0**	**18.4**	**19.9**			

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	23-Jul-10 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2010E	EPS (Rs) 2011E	EPS (Rs) 2012E	EPS growth (%) 2010E	EPS growth (%) 2011E	EPS growth (%) 2012E	PER (X) 2010E	PER (X) 2011E	PER (X) 2012E	EV/EBITDA (X) 2010E	EV/EBITDA (X) 2011E	EV/EBITDA (X) 2012E	Price/BV (X) 2010E	Price/BV (X) 2011E	Price/BV (X) 2012E	Dividend yield (%) 2010E	Dividend yield (%) 2011E	Dividend yield (%) 2012E	RoE (%) 2010E	RoE (%) 2011E	RoE (%) 2012E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Infrastructure																													
Container Corporation	1,378	REDUCE	179,132	3,813	130	61.1	74.3	85.9	0.3	21.7	15.6	22.6	18.5	16.0	16.0	13.0	10.9	4.1	3.5	3.1	1.0	1.2	1.4	19.6	20.6	20.5	1,250	(9.3)	2.0
GMR Infrastructure	60	ADD	218,553	4,652	3,667	0.4	0.2	0.1	(43.8)	(48.9)	(40.0)	138.3	270.7	450.8	24.1	15.5	14.5	2.1	1.8	1.8	—	—	—	2.4	1.2	0.7	65	9.1	6.0
GVK Power & Infrastructure	45	BUY	71,064	1,513	1,579	0.8	1.1	1.4	6.7	33.5	32.4	55.3	41.4	31.3	18.7	17.1	17.5	2.2	2.2	2.0	—	0.7	0.7	4.7	5.3	6.7	54	20.0	5.4
IRB Infrastructure	261	RS	86,614	1,844	332	9.7	12.6	12.1	83.8	29.2	(3.7)	26.8	20.7	21.5	12.8	11.4	10.7	3.7	2.9	2.3	—	—	—	15.6	15.7	11.9	—	—	5.5
Mundra Port and SEZ	726	REDUCE	292,893	6,234	403	15.1	24.1	35.7	40.8	59.5	48.4	48.1	30.2	20.3	30.9	19.9	14.2	8.0	6.2	4.6	—	—	—	18.5	23.2	26.1	725	(0.1)	6.0
Infrastructure		**Attractive**	**848,257**	**18,056**					**12.7**	**29.5**	**24.1**	**42.1**	**32.5**	**26.2**	**21.1**	**15.6**	**13.4**	**3.5**	**3.0**	**2.7**	**—**	**—**	**0.4**	**8.4**	**9.2**	**10.2**			
Media																													
DB Corp	238	ADD	43,260	921	182	10.6	12.6	15.5	286.5	18.4	23.2	22.4	18.9	15.4	12.5	10.5	8.5	6.7	5.4	4.7	0.8	1.3	1.7	40.3	31.6	32.9	275	15.5	0.2
DishTV	45	ADD	47,959	1,021	1,063	(2.5)	(1.8)	0.1	(62.0)	(28.8)	(107.4)	(18.1)	(25.4)	344.8	59.8	24.2	12.8	11.7	21.6	20.3	—	—	—	249.3	(59.7)	6.1	47	4.2	3.5
HT Media	160	NR	37,530	799	235	6.1	7.8	9.4	623.3	27.0	20.9	26.2	20.6	17.0	13.1	10.9	8.9	3.9	3.4	3.1	0.6	1.3	2.5	15.6	17.6	19.2	—	—	0.4
Jagran Prakashan	123	ADD	36,893	785	301	5.8	6.4	7.5	91.9	9.5	16.7	21.0	19.2	16.4	12.6	11.1	9.5	6.0	5.4	4.8	2.9	2.9	3.3	30.0	29.8	31.0	130	6.1	0.6
Sun TV Network	435	REDUCE	171,385	3,648	394	13.1	17.9	22.8	44.8	36.0	27.5	33.1	24.3	19.1	18.8	14.0	11.1	8.8	7.5	6.2	1.7	1.7	2.1	28.4	33.5	35.5	420	(3.4)	1.8
Zee Entertainment Enterprises	298	REDUCE	129,649	2,760	435	10.6	11.8	14.4	25.0	12.0	21.5	28.3	25.2	20.8	21.0	16.7	13.3	3.5	3.3	3.2	0.8	1.0	1.2	13.1	13.8	16.0	270	(9.5)	8.9
Media		**Neutral**	**466,677**	**9,934**					**185.4**	**34.5**	**38.6**	**38.4**	**28.6**	**20.6**	**18.5**	**14.3**	**11.1**	**5.6**	**5.2**	**4.7**	**1.2**	**1.3**	**1.7**	**14.7**	**18.2**	**22.7**			
Metals																													
Hindalco Industries	158	ADD	302,595	6,441	1,914	5.7	12.6	15.1	(64.5)	122.5	19.4	27.9	12.5	10.5	8.1	8.5	8.7	1.4	1.2	1.1	0.9	0.9	0.9	10.3	10.4	11.2	185	17.0	41.9
Hindustan Zinc	993	BUY	419,743	8,935	423	95.6	102.5	116.0	48.2	7.2	13.1	10.4	9.7	8.6	6.5	5.1	3.5	2.2	1.8	1.5	0.6	0.6	0.6	24.1	20.8	19.4	1,240	24.8	4.3
Jindal Steel and Power	640	SELL	593,774	12,639	928	38.5	48.7	50.8	17.2	26.5	4.3	16.6	13.1	12.6	10.4	8.4	7.9	5.2	3.7	2.9	0.2	0.2	0.2	37.3	33.0	25.7	575	(10.1)	29.5
JSW Steel	1,198	REDUCE	237,979	5,066	199	80.4	106.4	136.9	447.0	32.3	28.7	14.9	11.3	8.7	9.0	7.5	6.0	2.0	1.7	1.4	0.7	0.4	0.4	15.4	16.4	17.3	1,150	(4.0)	56.0
National Aluminium Co.	435	SELL	280,565	5,972	644	10.1	28.0	27.7	(49.0)	178.6	(1.2)	43.3	15.5	15.7	19.2	7.6	7.0	2.6	2.2	2.0	0.5	0.5	0.5	6.1	15.4	13.3	320	(26.5)	1.0
Sesa Goa	365	REDUCE	324,652	6,910	890	29.6	58.6	46.3	23.5	98.4	(21.0)	12.3	6.2	7.9	10.2	4.4	4.3	4.0	2.5	1.9	1.0	1.0	1.0	35.8	41.5	23.7	340	(6.8)	78.4
Sterlite Industries	174	ADD	584,928	12,451	3,362	12.0	14.2	19.2	2.8	18.3	35.1	14.5	12.2	9.1	12.2	10.6	6.9	1.6	1.4	1.2	0.5	0.5	0.5	12.9	12.2	14.5	210	20.7	49.2
Tata Steel	536	BUY	475,336	10,118	887	3.2	78.7	93.5	(97.1)	2,331.6	18.7	165.4	6.8	5.7	17.9	6.0	5.1	1.9	1.5	1.2	1.5	1.5	1.5	1.1	24.7	23.8	700	30.7	110.4
Metals		**Cautious**	**3,219,572**	**68,531**					**(28.9)**	**79.7**	**11.5**	**18.0**	**10.0**	**9.0**	**11.0**	**7.2**	**6.1**	**2.2**	**1.8**	**1.5**	**0.7**	**0.7**	**0.7**	**12.3**	**18.3**	**17.1**			
Pharmaceutical																													
Biocon	321	BUY	64,190	1,366	200	14.8	18.1	22.1	216.4	22.0	22.3	21.6	17.7	14.5	12.5	10.5	8.5	3.6	3.1	2.6	—	—	0.1	17.9	19.1	20.1	400	24.6	4.0
Cipla	326	REDUCE	261,391	5,564	803	13.5	12.8	15.6	35.9	(4.9)	21.9	24.1	25.4	20.8	17.9	16.8	14.1	4.4	3.9	3.4	0.8	0.8	0.8	19.9	16.3	17.4	280	(14.0)	9.3
Cadila Healthcare	629	REDUCE	128,807	2,742	205	24.7	29.6	34.9	66.9	20.0	17.6	25.5	21.2	18.0	16.4	13.8	12.0	8.0	6.2	4.9	0.8	0.9	1.1	36.1	32.8	30.3	535	(15.0)	1.6
Dishman Pharma & chemicals	219	BUY	17,816	379	81	14.4	17.2	28.8	(19.7)	19.4	67.0	15.2	12.7	7.6	10.9	9.0	6.4	2.2	1.9	1.6	—	—	—	15.5	16.3	22.7	300	37.0	0.5
Divi's Laboratories	770	ADD	101,730	2,165	132	25.8	34.3	43.9	(18.3)	33.3	27.9	29.9	22.4	17.5	22.3	16.5	12.6	6.8	5.6	4.5	—	—	—	24.8	27.2	28.4	800	3.9	3.1
Dr Reddy's Laboratories	1,365	REDUCE	231,276	4,923	169	48.1	66.7	70.8	48.3	38.8	6.1	28.4	20.5	19.3	15.7	11.9	11.0	6.1	4.9	4.0	0.5	0.6	0.7	22.2	26.3	22.6	1,150	(15.8)	17.3
GlaxoSmithkline Pharmaceuticals (a)	2,077	REDUCE	175,907	3,744	85	59.1	69.1	79.2	8.1	17.0	14.5	35.1	30.0	26.2	20.2	17.3	14.8	9.8	8.4	7.2	—	—	—	29.8	30.2	29.5	1,800	(13.3)	1.5
Glenmark Pharmaceuticals	281	NR	77,001	1,639	274	12.7	19.2	20.3	14.7	50.6	5.6	22.1	14.6	13.9	14.1	9.2	8.8	3.3	2.7	2.3	—	—	—	16.7	19.9	17.6	—	—	4.8
Jubilant Organosys	361	BUY	57,350	1,221	159	26.5	34.2	39.3	49.0	29.1	14.9	13.6	10.5	9.2	9.8	8.6	7.2	2.6	2.1	1.7	0.5	0.7	0.8	26.3	22.3	21.0	400	10.8	2.3
Lupin	1,897	ADD	168,060	3,577	89	76.9	104.1	122.5	27.8	35.3	17.6	24.7	18.2	15.5	21.1	15.3	12.0	7.2	5.4	4.2	0.7	0.8	0.8	36.6	34.4	30.7	1,920	1.2	6.9
Piramal Healthcare	494	REDUCE	103,319	2,199	209	23.4	13.4	11.0	35.5	(42.9)	(17.6)	21.1	37.0	44.9	15.6	6.0	4.2	6.1	1.1	1.0	1.1	1.2	0.7	32.1	141.2	16.6	490	(0.9)	31.0
Ranbaxy Laboratories	448	SELL	191,795	4,082	428	7.1	28.0	11.7	(128.4)	297.1	(58.3)	63.5	16.0	38.3	15.6	9.3	18.6	4.9	3.9	3.6	—	0.9	0.9	6.9	24.6	9.1	220	(50.9)	10.2
Sun Pharmaceuticals	1,741	REDUCE	360,492	7,673	207	65.2	67.7	77.6	(25.7)	3.8	14.6	26.7	25.7	22.4	20.2	18.2	15.3	4.3	3.8	3.4	0.8	0.8	0.8	17.8	16.2	16.2	1,560	(10.4)	8.6
Pharmaceuticals		**Attractive**	**1,939,134**	**41,276**					**44.7**	**27.3**	**5.7**	**27.0**	**21.2**	**20.0**	**16.8**	**13.0**	**12.1**	**5.1**	**3.7**	**3.1**	**0.5**	**0.6**	**0.6**	**18.9**	**17.3**	**15.6**			
Property																													
DLF	323	ADD	550,890	11,726	1,708	9.6	16.3	25.1	(64.0)	69.4	53.8	33.5	19.8	12.9	21.0	13.3	10.0	2.1	1.9	1.7	0.9	0.9	1.5	6.4	9.9	13.8	340	5.4	47.5
Indiabulls Real Estate	164	RS	65,802	1,401	401	1.6	4.0	8.0	109.7	151.7	101.7	103.4	41.1	20.4	(71)	35.7	9.2	0.7	0.7	0.7	—	—	—	0.8	1.8	3.5	285	73.8	19.3
Mahindra Life Space Developer	495	ADD	20,836	444	42	18.9	20.3	27.5	82.4	7.3	35.8	26.2	24.5	18.0	22.3	18.6	10.3	2.2	2.1	1.9	0.8	0.8	0.8	8.4	8.5	10.7	540	9.0	0.6
Phoenix Mills	230	BUY	33,285	709	145	5.1	7.7	8.7	2.5	51.0	13.5	45.1	29.9	26.3	34.8	22.3	18.7	2.1	2.0	1.9	0.4	0.7	0.9	4.8	7.0	7.5	260	13.1	0.8
Puravankara Projects	115	REDUCE	24,597	524	213	6.4	8.2	8.1	(5.2)	28.4	(2.0)	18.0	14.0	14.3	22.2	15.0	14.6	1.7	1.6	1.5	1.7	1.7	1.7	10.0	11.9	10.7	110	(4.6)	0.4
Sobha	346	ADD	33,950	723	98	14.4	17.5	24.7	(4.8)	21.1	41.6	24.0	19.8	14.0	17.3	13.9	8.6	1.9	1.8	1.6	0.6	1.2	1.2	9.8	9.4	12.2	325	(6.1)	1.9
Unitech	84	SELL	220,282	4,689	2,616	3.4	4.3	5.6	(54.2)	26.3	30.2	25.0	19.8	15.2	21.9	15.1	9.6	2.1	1.8	1.6	—	—	1.8	9.7	9.4	11.1	72	(14.5)	51.0
Property		**Cautious**	**949,641**	**20,214**					**(52.9)**	**57.8**	**46.6**	**32.9**	**20.9**	**14.2**	**21.9**	**14.2**	**10.1**	**1.8**	**1.7**	**1.5**	**0.6**	**0.7**	**1.4**	**5.5**	**8.0**	**10.8**			

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	23-Jul-10 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2010E	EPS (Rs) 2011E	EPS (Rs) 2012E	EPS growth (%) 2010E	EPS growth (%) 2011E	EPS growth (%) 2012E	PER (X) 2010E	PER (X) 2011E	PER (X) 2012E
Retail														
Titan Industries	2,773	ADD	123,078	2,620	44	62.7	76.1	96.2	41.5	21.3	26.5	44.2	36.5	28.8
Retail		**Neutral**	**123,078**	**2,620**					**41.5**	**21.3**	**26.5**	**44.2**	**36.5**	**28.8**
Sugar														
Bajaj Hindustan	116	SELL	22,121	471	191	9.7	9.9	8.9	201.1	2.2	(10.4)	11.9	11.6	13.0
Balrampur Chini Mills	80	ADD	20,489	436	257	3.7	10.4	7.0	(51.9)	183.7	(32.7)	21.7	7.7	11.4
Shree Renuka Sugars	66	BUY	44,140	940	670	9.9	7.6	7.8	196.4	(23.2)	3.1	6.7	8.7	8.4
Sugar		**Cautious**	**86,750**	**1,847**					**96.1**	**2.5**	**(9.4)**	**9.2**	**9.0**	**9.9**
Technology														
HCL Technologies	373	REDUCE	257,232	5,475	690	17.8	25.1	28.5	2.0	40.6	13.6	20.9	14.9	13.1
Hexaware Technologies	81	REDUCE	11,657	248	144	9.3	5.1	9.4	127.7	(45.4)	84.0	8.7	15.9	8.6
Infosys Technologies	2,786	BUY	1,599,422	34,045	574	108.3	124.1	150.0	5.7	14.5	20.9	25.7	22.5	18.6
Mphasis BFL	613	REDUCE	127,888	2,722	208	43.6	49.0	45.6	207.5	12.5	(7.0)	14.1	12.5	13.5
Mindtree	539	REDUCE	22,183	472	41	52.2	32.6	51.6	294.3	(37.5)	58.1	10.3	16.5	10.5
Patni Computer Systems	518	REDUCE	69,005	1,469	133	36.6	42.3	38.6	36.4	15.6	(8.7)	14.2	12.3	13.4
Polaris Software Lab	182	SELL	18,111	385	100	15.4	19.1	18.8	16.9	24.3	(1.7)	11.8	9.5	9.7
TCS	839	BUY	1,642,678	34,965	1,957	35.1	42.1	48.2	32.8	19.8	14.5	23.9	20.0	17.4
Wipro	412	ADD	1,009,128	21,480	2,447	18.9	22.3	25.7	22.1	18.1	15.6	21.9	18.5	16.0
Technology		**Attractive**	**4,757,303**	**101,262**					**22.9**	**17.6**	**15.4**	**22.8**	**19.4**	**16.8**
Telecom														
Bharti Airtel	314	REDUCE	1,191,687	25,366	3,798	24.0	21.4	24.2	7.5	(10.8)	13.2	13.1	14.7	12.9
IDEA	69	REDUCE	226,531	4,822	3,300	2.7	2.2	1.5	(5.8)	(19.7)	(30.8)	25.1	31.3	45.2
MTNL	67	SELL	42,336	901	630	(15.6)	(10.4)	(9.1)	(750.8)	(33.7)	(11.9)	(4.3)	(6.5)	(7.3)
Reliance Communications	189	SELL	402,513	8,568	2,133	22.1	14.1	18.2	(30.2)	(36.2)	29.1	8.6	13.4	10.4
Tata Communications	285	REDUCE	81,325	1,731	285	14.0	15.2	15.7	3.2	8.2	3.5	20.4	18.8	18.2
Telecom		**Cautious**	**1,944,392**	**41,388**					**(15.1)**	**(17.8)**	**15.7**	**13.6**	**16.5**	**14.3**
Utilities														
Adani Power	128	ADD	278,495	5,928	2,180	0.8	4.9	16.4	—	524.1	235.3	163.0	26.1	7.8
CESC	398	ADD	49,706	1,058	125	35.2	42.2	45.7	9.3	19.6	8.4	11.3	9.4	8.7
Lanco Infratech	67	BUY	161,015	3,427	2,405	2.0	3.7	5.0	35.1	87.6	34.9	34.1	18.2	13.5
NHPC	31	REDUCE	383,783	8,169	12,301	1.9	1.3	1.6	74.9	(27.2)	20.1	16.8	23.1	19.3
NTPC	202	REDUCE	1,665,584	35,453	8,245	10.8	12.5	14.7	9.6	16.2	17.4	18.8	16.2	13.8
Reliance Infrastructure	1,137	ADD	279,870	5,957	246	61.8	62.7	80.3	(1.5)	1.6	28.0	18.4	18.1	14.2
Reliance Power	173	SELL	415,237	8,839	2,397	2.9	3.1	5.4	179.7	7.4	76.4	60.7	56.5	32.0
Tata Power	1,324	ADD	326,759	6,955	247	60.2	69.2	88.5	20.1	15.0	27.8	22.0	19.1	15.0
Utilities		**REDUCE**	**3,560,449**	**75,786**					**23.5**	**16.3**	**35.0**	**22.6**	**19.4**	**14.4**
Others														
Havells India	679	SELL	40,869	870	60	5.3	31.6	45.0	3.7	497.9	42.6	128.6	21.5	15.1
Jaiprakash Associates	129	BUY	273,980	5,832	2,129	1.5	5.9	7.9	(27.2)	305.4	34.4	88.4	21.8	16.2
Jindal Saw	203	ADD	59,564	1,268	294	25.0	18.6	17.9	110.8	(25.4)	(4.0)	8.1	10.9	11.3
PSL	136	BUY	7,249	154	53	22.9	25.4	28.2	3.3	10.6	11.0	5.9	5.3	4.8
Sintex	366	BUY	49,889	1,062	136	24.1	28.3	33.3	0.5	17.4	17.5	15.2	12.9	11.0
Tata Chemicals	327	ADD	79,651	1,695	243	26.4	32.4	37.3	(27.1)	22.6	15.1	12.4	10.1	8.8
Welspun Corp	248	REDUCE	51,008	1,086	205	25.1	23.0	24.4	44.9	(8.1)	5.8	9.9	10.8	10.2
United Phosphorus	181	BUY	83,538	1,778	463	11.9	15.6	19.0	18.8	30.2	22.1	15.1	11.6	9.5
Others			**645,749**	**13,745**					**11.6**	**39.7**	**19.5**	**20.0**	**14.3**	**12.0**
KS universe (b)			**45,076,596**	**959,485**					**14.3**	**22.7**	**20.4**	**19.1**	**15.6**	**13.0**
KS universe (b) ex-Energy			**36,135,093**	**769,159**					**7.9**	**23.4**	**20.3**	**20.7**	**16.7**	**13.9**
KS universe (d) ex-Energy & ex-Commodities			**32,218,977**	**685,802**					**14.4**	**18.5**	**22.2**	**21.6**	**18.2**	**14.9**

Company	EV/EBITDA (X) 2010E	EV/EBITDA (X) 2011E	EV/EBITDA (X) 2012E	Price/BV (X) 2010E	Price/BV (X) 2011E	Price/BV (X) 2012E	Dividend yield (%) 2010E	Dividend yield (%) 2011E	Dividend yield (%) 2012E	RoE (%) 2010E	RoE (%) 2011E	RoE (%) 2012E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Retail															
Titan Industries	31.3	24.6	19.3	15.6	11.7	8.8	0.4	0.4	0.5	40.7	36.6	34.8	2,400	(13.4)	4.7
Retail	**31.3**	**24.6**	**19.3**	**15.6**	**11.7**	**8.8**	**0.4**	**0.4**	**0.5**	**35.2**	**32.0**	**30.5**			
Sugar															
Bajaj Hindustan	7.0	5.8	5.4	0.9	0.8	0.8	0.6	0.6	0.6	8.1	7.5	6.3	99	(14.4)	6.3
Balrampur Chini Mills	9.3	5.3	5.7	1.5	1.3	1.2	0.6	0.6	0.6	7.0	18.1	11.0	92	15.3	5.9
Shree Renuka Sugars	4.6	5.2	4.4	1.7	1.4	1.2	0.6	0.5	0.5	32.0	18.1	15.7	76	15.3	14.8
Sugar	**6.1**	**5.4**	**5.0**	**1.4**	**1.2**	**1.1**	**0.6**	**0.6**	**0.6**	**14.9**	**13.3**	**10.8**			
Technology															
HCL Technologies	10.6	9.1	7.5	4.0	3.4	2.8	1.1	1.1	1.6	20.8	24.9	23.3	370	(0.8)	11.9
Hexaware Technologies	4.4	9.0	4.9	1.4	1.3	1.1	1.2	1.2	1.2	17.8	8.4	14.0	72	(11.3)	2.8
Infosys Technologies	18.8	15.4	12.4	6.9	5.7	4.8	0.9	1.2	1.5	30.1	28.0	28.0	3,100	11.3	59.1
Mphasis BFL	11.2	10.0	9.1	5.5	3.9	3.1	0.6	0.7	0.7	48.1	36.4	25.8	550	(10.3)	8.0
Mindtree	8.9	9.4	6.2	3.3	2.8	2.2	0.4	0.6	1.0	35.2	19.2	23.7	550	2.0	2.2
Patni Computer Systems	7.4	6.5	5.7	1.9	1.8	1.6	1.4	1.6	1.5	18.2	15.8	12.8	450	(13.1)	6.6
Polaris Software Lab	5.9	7.6	6.5	2.1	1.8	1.6	1.9	2.0	2.1	18.6	20.1	17.2	180	(0.9)	4.5
TCS	18.0	14.5	12.0	7.8	6.5	5.4	2.4	2.0	2.3	37.6	35.6	33.9	965	15.0	28.3
Wipro	16.5	13.3	11.0	5.1	4.2	3.5	0.9	1.1	1.3	26.5	25.0	23.7	465	12.7	15.6
Technology	**16.4**	**13.6**	**11.2**	**6.1**	**5.0**	**4.2**	**1.4**	**1.5**	**1.7**	**26.7**	**26.0**	**24.9**			
Telecom															
Bharti Airtel	7.4	7.0	6.0	2.7	2.3	2.0	1.0	1.3	1.6	24.1	17.0	16.5	290	(7.6)	51.1
IDEA	8.6	9.4	8.0	2.0	1.9	1.8	—	—	—	7.2	6.2	4.2	55	(19.9)	11.7
MTNL	(0.6)	(0.8)	(1.0)	0.4	0.4	0.4	—	—	—	(8.5)	(6.1)	(5.7)	50	(25.6)	2.8
Reliance Communications	7.6	8.5	6.4	1.0	1.0	0.9	0.4	—	—	11.7	7.4	8.9	175	(7.3)	42.4
Tata Communications	8.3	7.7	7.3	1.1	1.1	1.1	2.3	2.6	3.0	5.2	5.5	5.5	225	(21.1)	1.7
Telecom	**7.9**	**8.0**	**6.6**	**1.7**	**1.6**	**1.4**	**0.8**	**0.9**	**1.1**	**12.7**	**9.5**	**10.0**			
Utilities															
Adani Power	126.3	17.3	6.2	5.1	4.2	2.7	—	—	—	4.4	17.7	42.8	130	1.8	3.0
CESC	7.1	6.5	7.3	1.2	1.0	1.0	1.1	1.3	1.4	11.1	11.7	11.4	439	10.3	2.0
Lanco Infratech	20.2	8.6	8.1	4.7	3.7	3.0	—	—	—	15.8	21.2	22.7	77	15.0	8.6
NHPC	10.8	11.0	9.0	1.5	1.5	1.4	1.8	1.1	1.4	9.7	6.5	7.4	28	(10.3)	20.8
NTPC	14.3	12.5	10.5	2.6	2.4	2.2	2.0	2.3	2.7	14.5	15.4	16.6	200	(1.0)	10.4
Reliance Infrastructure	19.7	18.9	12.9	1.5	1.4	1.3	0.7	0.8	0.9	6.3	7.3	10.1	1,100	(3.3)	48.3
Reliance Power		98.4	33.8	2.9	2.7	2.5	—	—	—	4.8	5.0	8.2	135	(22.1)	22.9
Tata Power	13.8	12.5	10.7	2.5	2.3	2.0	0.9	1.1	1.1	12.9	12.5	14.3	1,420	7.3	10.5
Utilities	**17.7**	**14.3**	**10.8**	**2.4**	**2.2**	**2.0**	**1.3**	**1.4**	**1.6**	**10.6**	**11.4**	**13.8**			
Others															
Havells India	17.6	10.8	8.9	11.2	7.4	5.0	—	—	—	6.6	41.6	39.7	480	(29.3)	6.8
Jaiprakash Associates	22.0	14.0	10.3	3.2	2.9	2.5	—	—	—	4.1	13.9	16.3	183	42.2	32.4
Jindal Saw	5.3	6.0	5.8	1.6	1.3	1.2	—	—	—	20.5	12.9	11.1	256	26.4	4.0
PSL	3.3	2.8	2.9	0.8	0.7	0.6	4.8	4.8	5.2	12.6	11.7	12.0	175	29.1	0.6
Sintex	12.5	8.4	7.2	2.4	2.0	1.7	—	—	—	15.5	15.3	15.2	380	4.0	4.4
Tata Chemicals	6.7	5.6	4.8	1.7	1.5	1.3	2.7	2.7	2.7	16.0	18.4	18.3	360	10.0	3.1
Welspun Corp	5.4	5.6	5.0	1.7	1.5	1.3	0.8	0.8	0.9	20.6	14.8	13.5	245	(1.3)	5.8
United Phosphorus	8.7	7.3	5.9	2.4	2.1	1.7	0.8	1.1	1.1	17.7	19.0	19.5	250	38.5	9.8
Others	**11.4**	**9.1**	**7.6**	**2.4**	**2.1**	**1.8**	**0.6**	**0.7**	**0.7**	**12.0**	**14.5**	**14.9**			
KS universe (b)	**11.6**	**9.6**	**8.0**	**2.8**	**2.5**	**2.2**	**1.3**	**1.5**	**1.8**	**14.7**	**15.8**	**16.6**			
KS universe (b) ex-Energy	**14.2**	**11.5**	**9.5**	**3.1**	**2.7**	**2.3**	**1.2**	**1.2**	**1.4**	**15.1**	**16.1**	**16.8**			
KS universe (d) ex-Energy & ex-Commodities	**15.8**	**13.1**	**10.7**	**3.3**	**2.9**	**2.5**	**1.2**	**1.3**	**1.5**	**15.3**	**15.8**	**16.8**			

Note:

(1) For banks we have used adjusted book values.

(2) 2010 means calendar year 2009, similarly for 2011 and 2012 for these particular companies.

(3) EV/Sales & EV/EBITDA for KS universe excludes Banking Sector.

(4) Rupee-US Dollar exchange rate (Rs/US$)= 46.98

Source: Company, Bloomberg, Kotak Institutional Equities estimates

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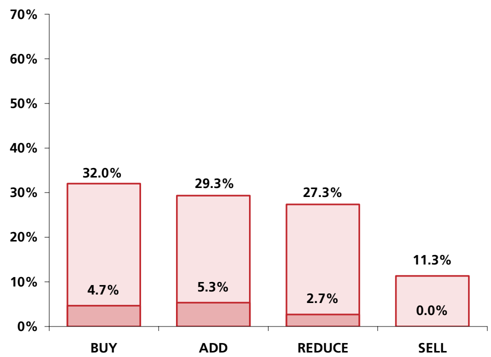

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Source: Kotak Institutional Equities | As of June 30, 2010

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Corporate Office

Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices

Kotak Mahindra (UK) Ltd
6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc
50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel:+1-914-997-6120

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