MORNING INSIGHT

Kotak Securities

PRIVATE CLIENT RESEARCH

OCTOBER 13, 2008

Economy News

- Faced with a liquidity crunch, the public sector oil retailing-cum-marketing companies have asked domestic airlines to clear their dues for aviation turbine fuel (ATF) already purchased, failing which supplies will be suspended. (BL)
- The finance ministry has asked the department of telecom (DoT) to speed up 3G spectrum auction process, so that operators can roll out services as early as possible, and avoid introducing new clauses in the guidelines, which can cause further delays. (ET)
- The finance ministry has decided that financial firms in the US and the UK which have recently seen changes in ownership thanks to the bailout package from their respective governments will not be required to take fresh approvals from the Foreign Investment Promotion Board (FIPB) for their existing Indian joint ventures or other investments. (ET)
- The RBI should explore the option of having a say on the suitability of "major shareholders" in a non-banking financial company (NBFC). This is likely to be suggested by an advisory panel on financial regulation and supervision. (BL)
- Fertilizer subsidy, estimated at Rs.1200 bn in the current fiscal, is likely to come down below Rs.1000 bn owing to fall in prices of major nutrients like nitrogen and phosphate in the global market. (ET)
- The RBI has warned that the global financial crisis can spread to India through equity and forex markets, while money, debt and credit markets could be impacted indirectly due to the continuing onslaught. (BL)

Corporate News

- **Infosys Technologies** posted a 30.2% jump in quarterly profit, helped by a weaker rupee, beating market forecasts. (FE)
- Three public sector oil marketing companies viz. **IOC, HPCL** and **BPCL** have asked domestic airlines to clear their dues for aviation turbine fuel (ATF) already purchased, failing which supplies will be suspended. (BL)
- **Apollo Hospitals** aims to pump in Rs 2,000 crore over the next four to five years for setting up hospitals across the country. This would include setting up of Reach and High-end hospitals as well as knowledge centres. (BS)
- Country's largest private sector lender **ICICI Bank** filed a complaint against some brokers and websites that were creating panic among depositors and shareholders by spreading rumours about the financial health of the bank. (FE)
- **Zee Entertainment Enterprises Ltd** has expanded its TV channel Network by launching its new regional channel in Tamil – Zee Tamizh. (BL)
- **Piramal Healthcare** plans to set up a new research and development facility in Ahmedabad. The company is expected to invest close to Rs. 100 crore for the greefield project. (BS)
- **Proctor & Gamble Hygiene and Health Care Ltd** plans to launch personal health care and feminine care products developed by its parent company, Proctor & Gamble Co. (ET)
- Hyderabad-based **SMS Pharmaceuticals** is looking at the oncology segment as a major contributor to its revenue on the back of its newly-launched dedicated oncology manufacturing facility in Visakhapatnam. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange

Equity

	10 Oct 08	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
BSE Sensex	10,528	(7.1)	(24.8)	(21.8)
Nifty	3,280	(6.7)	(22.4)	(19.0)
BSE Banking	5,320	(7.8)	(24.3)	(12.0)
BSE IT	2,584	(4.3)	(32.1)	(33.9)
BSE Capital Goods	7,983	(9.2)	(32.6)	(25.9)
BSE Oil & Gas	7,272	(6.7)	(20.2)	(18.2)
NSE Midcap	3,908	(7.0)	(29.6)	(25.4)
BSE Small-cap	4,355	(7.3)	(35.1)	(35.1)
World Indices				
Dow Jones	8,451	(1.5)	(26.0)	(23.9)
Nasdaq	1,650	0.3	(27.1)	(26.3)
FTSE	3,932	(8.8)	(27.4)	(25.3)
Nikkei	9,157	(0.5)	(32.2)	(36.5)
Hangseng	14,797	(7.2)	(23.2)	(33.0)

Value traded (Rs cr)

	10 Oct 08	% Chg - Day
Cash BSE	5,021	(0.5)
Cash NSE	14,744	15.0
Derivatives	48,279	(16.3)

Net inflows (Rs cr)

	8 Oct 08	% Chg	MTD	YTD
FII	(848)	55	(284)	(41,353)
Mutual Fund	(119)	(61)	(620)	11,859

FII open interest (Rs cr)

	8 Oct 08	% Chg
FII Index Futures	9,599	(3.9)
FII Index Options	18,387	(4.5)
FII Stock Futures	12,913	(5.6)
FII Stock Options	781	(7.6)

Advances / Declines (BSE)

10 Oct 08	A	B	S	Total	% total
Advances	17	246	82	345	15
Declines	188	1400	368	1,956	84
Unchanged	-	34	4	38	2

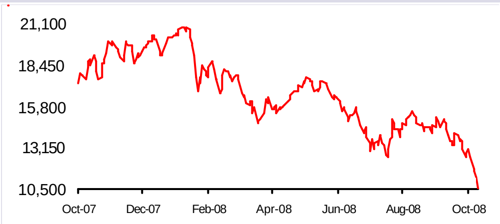
Commodity

		10 Oct 08	% Chg 1 Day	1 Mth	3 Mths
Crude (NYMEX)	(US$/BBL)	80.5	3.7	(20.4)	(44.5)
Gold (US$/OZ)		849.9	(6.9)	13.5	(9.9)
Silver (US$/OZ)		10.1	(16.8)	(5.0)	(45.0)

Debt / forex market

	10 Oct 08	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.97	8.21	8.34	9.42
Re/US$	48.48	48.00	45.30	42.97

Sensex



ECONOMY UPDATE

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RBI ACTS AGAIN: CUTS CRR BY ANOTHER 100 BPS

RBI has cut the CRR by another 100 bps of net demand and time liabilities (NDTL) with effect from the fortnight beginning October 11, 2008.

Thus the extent of cut comes up to 150 bps from 9.0% to 7.5%, including the 50 bps announced on October 06, 2008. As a result, Rs.600 bn would be released into the banking system.

We expect this move to help alleviate some liquidity pressure in the money markets rather than banks going for reducing their lending rates.

RBI has acted again by cutting Cash Reserve Ratio (CRR) by another 100 bps, amounting to total reduction of 150 bps to 7.5% of net demand and time liabilities (NDTL) from 9.0% of NDTL with effect from the fortnight beginning October 11, 2008. This move is likely to release Rs.600 bn into the banking system.

We prefer Axis bank, BOB, Indian bank and Union bank over others though the stocks may remain range bound in the short term & move in the line with the global developments

The reduction in CRR is follow-up to a series of measures (including 1% indirect cut in SLR below the mandatory 25%) announced by RBI on September 16, 2008 to ease the tight liquidity conditions due to the turmoil in the global financial markets.

This move has come as a response to tight liquidity conditions aggravated by foreign funds pullout, RBI's defence of rupee in the forex market, delays in releasing first tranch of sixth pay revision and advance tax payments.

According to RBI data, forex reserve for the week ended October 3, 2008 came down to $284 bn, a decline of around $7.9 bn for the week. This is tantamount to absorption of Rs.370 bn (INR/$: 47) of domestic currency by RBI from the banking system. Apart from this RBI also absorbed Rs.170 bn last week through auction.

Tight liquidity conditions in the market forced Indian banks to use the LAF (liquidity adjustment facility) window to borrow on average around Rs.900 bn from RBI every day for last many days. In the call money market, some banks have raised funds by paying as much as 15-17%.

The global risk aversion precludes resumption of capital inflows leading to continued pressure on rupee. RBI, in order to cushion domestic economy from global financial turmoil, is likely to continue with its intervention policy in the forex market. To stem rupee from depreciating, RBI would sell USD and buy INR (domestic currency) resulting into tighter liquidity conditions. To undo the tighter liquidity scenario, central bank is injecting liquidity in the system by cutting the CRR.

The policy statement further emphasized that RBI is monitoring developments closely and continuously and would respond swiftly and even preemptively to any adverse external developments impinging on domestic financial stability, price stability and inflation expectations.

RBI further assured to the market participants that it would respond swiftly to meet any liquidity requirements that may arise in the context of the highly volatile external situation.

Our Take

- This move is likely to release Rs.600 bn into the banking system, negating the RBI intervention worth Rs.371 bn in the forex market and Rs.170 bn through auction of government bonds.
- This move is likely to ease short term tighter liquidity for which there is demand.
- This move is likely to improve the NIM of banks by 15-18 bps. Banks do not get any interest on CRR deposits, whereas incremental yield of advances lies in the range of 11-12%. So, this release of money could push up NIM of the banks.

- It is likely to positively impact the bond yields. The 10-year government securities closed slightly lower at 8.65% (FIMMDA) at the end of Q2FY09 as compared to 8.69% at the end of Q1FY09. The cut in CRR would further depress the bond yields, leading to write-back of MTM provisions in H2FY09.
- We believe RBI has cut the CRR to provide liquidity in the system rather than giving any indication for softening in interest rate regime. With headline inflation still remains elevated and is expected to remain in double-digits till January 2009, we do not think RBI would cut the repo rate in near term. However, if tight liquidity situation prevails in the future, RBI would further cut CRR to manage liquidity in the banking system.
- However, we continue to believe that interest rates have peaked and our central bank would start cutting rates (read repo rate, which gives direct signal to bankers to cut their lending rates) by end of FY09. We maintain our long-term positive stance on banking sector. We prefer Axis bank, BOB, Indian bank and Union bank over others though the stocks may remain range bound in the short term & move in the line with the global developments.

ECONOMY UPDATE

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AUGUST IIP – SIGNIFICANTLY BELOW EXPECTATIONS

The Central Statistical Organization (CSO) has released a quick estimate of the index of industrial production (IIP) for August 2008. The IIP rose 1.3%, as compared to 10.9% in August 2007. This was due to slower growth of 1.1% in the manufacturing sector and 0.8% in electricity vs. 10.7% and 9.2%, respectively in August 2007.

The cumulative growth for April-August 2008-09 stands at 4.9% over the corresponding period of the previous year. However, IIP growth for July 2008 has been revised upwards to 7.4% from 7.1%.

The lower IIP number for August 2008 was expected on the back of high base last year (IIP grew 10.9% in August 2007). However, the extent of slowdown is a shocker. The extent of the fall does leave some chance of it being a one time blip. However, this has made us cautious of the full year GDP growth. In case the slowdown continues in IIP, it will definitely impact the full year GDP growth estimate of even 7.5%.

Key highlights

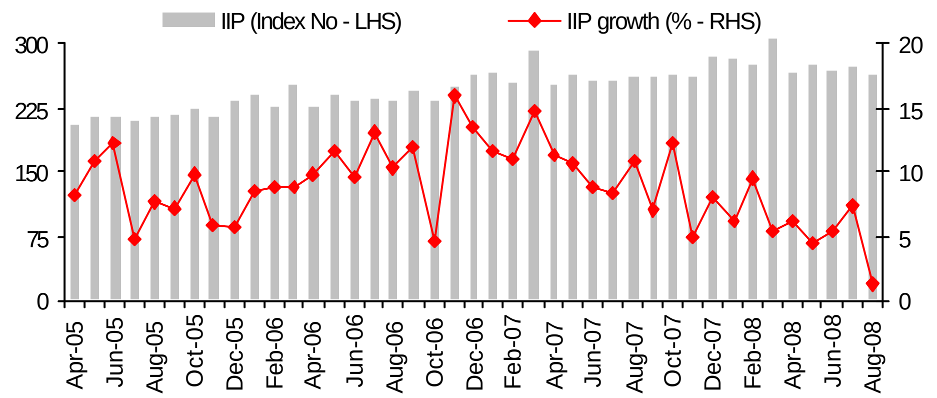
- The manufacturing sector recorded 1.1% growth during August 2008. This has led to a cumulative growth during April-August, 2008-09 of 5.2% over the corresponding period of last year.
- The mining sector grew 4.0% YoY. The cumulative growth during April-August, 2008-09 stands at 4.1% over the corresponding period of last year.
- The electricity sector grew 0.8% (YoY) and the cumulative growth during April-August, 2008-09 stands at 2.3% over the corresponding period of last year.
- In terms of industries, 7 out of 17 industry groups in the manufacturing sector have recorded positive growth during this month as compared to the corresponding month of the last year.
- The industry groups that have shown the highest growth in this month are…
  - Transport Equipment and Parts: 11.2%
  - Food Products: 8.9%
  - Basic Metal and Alloy Industries: 8.0 %
- The sectoral growth (use-based classification) has been as under:
  - Basic goods: 3.9%
  - Capital goods: 2.3%
  - Intermediate goods: -6.2%
  - Consumer goods: 5.1%
- In August, consumer durables recorded a growth of 5.1% while consumer non-durables grew 5.0% with the overall growth in consumer goods being 5.1%.
- Apart from this, the IIP for July 2008 has been revised upwards to 7.4% from the previously reported 7.1%.

Index of industrial production

	Mining index 10.47%	Growth YoY (%)	Maftg index 79.36%	Growth YoY (%)	Electricity index 10.17%	Growth YoY (%)	Total IIP 100.00%	Growth YoY (%)
Apr-07	161.2	2.6	267.1	12.4	215.2	8.7	250.7	11.3
May-07	168.1	3.8	280.5	11.3	225.6	9.4	263.1	10.6
Jun-07	158.6	1.5	273.6	9.7	211.7	6.8	255.3	8.9
Jul-07	157.0	3.2	272.9	8.8	216.2	7.5	255.0	8.3
Aug-07	156.0	14.7	279.2	10.7	219.9	9.2	260.3	10.9
Sep-07	154.0	4.9	281.0	7.4	210.1	4.5	260.5	7.0
Oct-07	169.6	5.1	280.2	13.8	221.4	4.2	262.6	12.2
Nov-07	174.2	6.3	278.9	4.7	210.9	5.8	261.0	4.9
Dec-07	184.1	5.0	306.3	8.6	219.6	3.8	284.7	8.0
Jan-08	186.7	2.9	301.9	6.7	223.8	3.7	281.9	6.2
Feb-08	183.6	7.9	296.8	9.6	211.3	9.8	276.2	9.5
Mar-08	205.8	4.9	327.9	5.7	227.1	3.7	304.9	5.5
Apr-08	171.1	6.1	285.0	6.7	218.2	1.4	266.3	6.2
May-08	177.4	5.5	293.1	4.5	230.1	2.0	274.6	4.4
Jun-08	160.9	1.5	290.2	6.1	217.1	2.6	269.2	5.4
Jul-08	161.7	3.0	294.7	8.0	225.9	4.5	273.8	7.4
Aug-08	162.2	4.0	282.4	1.1	221.6	0.8	263.6	1.3

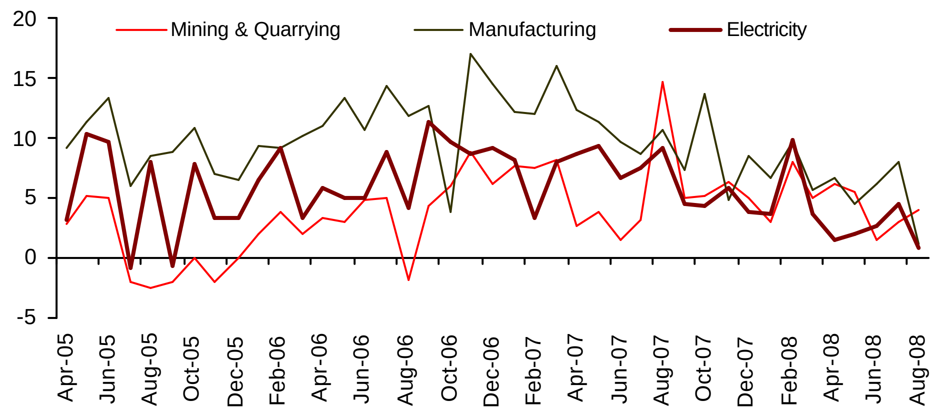
Source: Ministry of Statistics and Programme Implementation

Index of Industrial Production (IIP)



Source: Ministry of Statistics and Programme Implementation

Sectoral Breakup of IIP



Source: Ministry of Statistics and Programme Implementation

Decline in Intermediate goods was the main culprit

Intermediate goods (weight: 26.5% in IIP) declined by 6.2% for the month of August 2008 as against the 13.8% growth during the same period last year. As a result of this the cumulative growth for the period April-August, 2008-09 came down to 0.7% as against 9.9% during the same period last year.

Growth in Consumer goods provided some respite

The consumer goods sector has shown decent growth of 5.1% in August 2008. Both, consumer durable and non-durable have shown healthy growth at 5.1% and 5.0%, respectively. As a result of this the cumulative growth for the period April-August, 2008-09 stood at 7.8% as against 6.7% during the same period last year. The decent growth in this segment can be attributed to the initiatives taken by the Government in recent budget in the form of excise cut as well as reduction in tax burden on consumers.

Growth in Consumer goods

	Consumer durables 5.37%	Consumer non-durables 23.30%	Consumer Goods (both) 28.67%
Apr-07	2.4	18.7	14.7
May-07	-0.7	12.1	8.7
Jun-07	-3.6	6.3	3.6
Jul-07	-2.7	10.5	7.1
Aug-07	-6.2	2.4	0.0
Sep-07	-7.3	2.6	-0.2
Oct-07	9.0	15.8	13.7
Nov-07	-5.5	-2.0	-2.9
Dec-07	2.8	10.3	8.7
Jan-08	-0.5	11.1	8.4
Feb-08	3.1	14.3	11.7
Mar-08	-2.0	1.9	0.9
Apr-08	3.2	10.0	8.5
May-08	2.8	9.0	7.4
Jun-08	3.7	11.7	9.7
Jul-08	13.3	6.9	8.5
Aug-08	5.1	5.0	5.1

Source: Ministry of Statistics and Programme Implementation

Lower growth for Capital goods

Capital goods grew only 2.3% in the month of August 08 as compared to 30.8% in August 2007 and 20.4% in July 2008. On a cumulative basis, growth for the period April-August, 2008-09 came down to 9.2% as against 20.1% during the same period last year.

The CG index is an important component signifying the investment mood in the economy. The slower growth can be partly attributed to the high base. However, the fall in the absolute index month-on-month is a worrying statistic.

Should this kind of economic growth continue in the next month, it will be an indication of a significant reduction in the investments in the economy. We note that the financial crunch & negative global sentiments has impacted the investments in September & October.

Extent of moderation in IIP is a shocker

The lower IIP number for August 2008 was expected on the back of high base last year (IIP grew 10.9% in August 2007). However, the extent of slowdown is a real shocker.

We have been expecting moderation in IIP growth as we believe that the investment growth in FY09 would be lower than the last year. The deceleration in IIP is expected on the back of tightening measures initiated by the RBI in recent past. The tight financing environment along with the rise in input cost is affecting the investment climate of Indian economy.

India, largely being a domestic oriented economy with domestic savings playing a key role in financing its growth story, is less dependent on external world environment. However, the negative impact of financial turmoil in US and Europe can not be ignored as this is impacting the capital inflows which are used the bridge the gap between domestic investment and domestic savings.

We also believe that fiscal stimulus provided by government in the form of reduction in the excise duties as well as reduction in tax burden on consumers along with higher disposable income on account of sixth pay revision is likely to increase consumption demand and hence mitigate the ill effect of moderating investment climate to a certain extent.

However, we are now cautious on the GDP growth rate expectations of 7.5% in FY09.

RESULT UPDATE

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INFOSYS TECHNOLOGIES LTD

PRICE: RS.1260 **RECOMMENDATION: BUY**
TARGET PRICE: RS.1645 **FY09E P/E: 12.7X**

Better-than-expected operational numbers, marginally weaker guidance. Retain cautious stance on the sector in the immediate term. Retain Infosys as preferred pick.

- Operational results better than expected. 7.1% volume growth in constant currency terms. No pricing pressure seen, as yet. EBIDTA margins up by 264bps QoQ.
- > 10,000 gross adds in 2QFY09; guidance of 25,000 gross adds in FY09 maintained - encouraging, in our view.
- Investments in employees, SG&A to continue - enough levers available to sustain margins in narrow band - reinforces our base optimism of having a robust business model
- Refrains from a higher bid for Axon - positive in our view, looking at the macro scenario
- USD GAAP guidance lowered - partly because of cross currency fluctuations. Volume growth guidance lower by 300bps, more due to caution rather than client experiences. Indian GAAP guidance revised upwards, marginally.
- We revise exchange rate assumptions to Rs.45 per USD by FY09 end (Rs.40 earlier). We tweak our FY09 EPS estimates up at Rs.99 (Rs.97 earlier).
- Revise target price to Rs.1644 (Rs.2027 earlier) based on DCF analysis to accommodate the expected slower growth in future quarters.
- We note that, at our target price, our FY09E earnings will be discounted 16.5x. The stock is currently quoting at the lower end of the long term PE band.
- Continue to repose faith in management team and the strong business model. Rate Infosys the Top Pick in the sector and maintain BUY with a revised PT of Rs.1644, based on FY09E earnings.
- We also reiterate that, the stock may remain range bound in the near term due to the macro headwinds.
- A sharp appreciation in the rupee against various currencies beyond our assumptions and a prolonged recession in major user economies remain the key risks to our call.

Summary table

(Rs mn)	FY07	FY08	FY09E
Sales	36,227	166,920	214,965
Growth (%)	39.1	20.2	28.8
EBITDA	12,721	52,380	68,334
EBITDA margin (%)	35.1	31.4	31.8
Net profit	9,818	45,380	56,613
Net cash (debt)	15,651	85,100	91,567
EPS (Rs)	37.1	79.3	99.0
Growth (%)	21.4	21.5	24.8
CEPS	176.7	89.8	111.7
DPS (Rs)	10.0	33.3	15.0
ROE (%)	39.7	36.2	35.1
ROCE (%)	47.9	42.7	40.9
EV/Sales (x)	51.1	13.4	10.3
EV/EBITDA (x)	51.1	13.4	10.3
P/E (x)	66.2	15.5	12.4
P/Cash Earnings	55.5	13.7	11.0
P/BV (x)	22.7	5.1	3.8

Source: Company, Kotak Securities - Private Client Research

2QFY09 results - volume growth higher-than-expected

- As expected, 2QFY09 results of Infosys were not impacted by the macro headwinds and any client specific issues. In fact, the 7.1% volume growth (constant currency basis) was better than our expectations.
- Infosys added 40 clients during the quarter. Revenues from the BFSI vertical grew by 8% (INR terms) QoQ and those from the North American geography grew by about 10% over the period, indicating that, the slowdown was yet to impact the company.
- Revenues from the Top client grew by about 7% during the quarter. In 1QFY09, the Top client had seen revenues de-growing significantly.
- Assuming that the Top client over the quarters was the same, stability has come in that account, in line with the company's assertions last quarter.

Quarterly performance

(Rs mn)	1QFY09	2QFY09	% Chg	2QFY08	% Chg
Turnover	**48,540**	**54,180**	**11.6**	**41,060**	**32.0**
Expenditure	33,750	36,240		28,220	
EBIDTA	**14,790**	**17,940**	**21.3**	**12,840**	**39.7**
Depreciation	1,690	1,770		1,440	
EBIT	**13,100**	**16,170**	**23.4**	**11,400**	**41.8**
Interest	-	-		-	
Other Income	1,170	660		1,540	
PBT	**14,270**	**16,830**	**17.9**	**12,940**	**30.1**
Tax	1,560	2,510		1,940	
Minority interest	-	-		0	
PAT	**12,710**	**14,320**	**12.7**	**11,000**	**30.2**
E. O items	310	0		0	
PAT after EO items	12,400	14,320		11,000	
EPS (Rs)	**22.2**	**25.0**		**19.3**	
EBIDTA (%)	30.5	33.1		31.3	
EBIT (%)	27.0	29.8		27.8	
Net Profit (%)	26.2	26.4		26.8	

Source : Company

Revenue growth- vertical wise

(Rs mn)	2QFY09	2QFY08	YoY (%)	1QFY09	QoQ (%)
Manufacturing	10,890	5,707	90.8	8,931	21.9
As a % of revenues	20.1	13.9		18.4	
BFSI	18,096	14,987	20.7	16,746	8.1
As a % of revenues	33.40	36.50		34.50	
Telecom	10,294	8,458	21.7	9,562	7.7
As a % of revenues	19.00	20.60		19.70	
Retail	6,556	5,133	27.7	5,922	10.7
As a % of revenues	12.10	12.50		12.20	
Energy & Utlities	2,980	2,176	36.9	2,621	13.7
As a % of revenues	5.50	5.30		5.40	
Transportation & Logistics	1,246	944	32.0	1,165	7.0
As a % of revenues	2.30	2.30		2.40	
Services	2,763	3,162	-12.6	2,670	3.5
As a % of revenues	5.10	7.70		5.50	
Others	1,354	493	174.9	922	46.9
As a % of revenues	2.50	1.20		1.90	
Total revenues	**54,180**	**41,060**	**32.0**	**48,540**	**11.6**

Source : Company

Revenues by geography

	Q1FY08	Q2FY08	Q3FY08	Q4FY08	1QFY09	2QFY09
North America	23,619	25,704	26,608	27,570	30,386	33,321
As a % of revenues	62.6	62.6	62.3	60.7	62.6	61.5
Europe	10,111	11,251	12,215	13,308	13,251	15,225
As a % of revenues	26.8	27.4	28.6	29.3	27.3	28.1
India	679	411	513	590	631	704
As a % of revenues	1.8	1.0	1.2	1.3	1.3	1.3
Rest of World	3,320	3,695	3,374	3,952	4,272	4,930
As a % of revenues	8.8	9.0	7.9	8.7	8.8	9.1
Cons Revenues (Rs mn)	37,729	41,060	42,710	45,420	48,540	54,180

Source: Company

Revenue by Project Type

	2QFY09	1QFY09	4QFY08	3QFY08	2QFY08	1QFY08	4QFY07
Fixed price	18,475	15,921	15,079	14,009	11,783	10,044	10,448
As a % of revenues	34.1	32.8	33.2	32.8	25.9	27.5	25.9
Time & Material	35,705	32,619	30,341	28,701	27,758	26,478	27,272
As a % of revenues	65.9	67.2	66.8	67.2	74.1	72.5	74.1

Source: Company

Macro scenario more challenging

- The management clearly articulated that, the scenario has changed significantly over the past month and things have become more uncertain.
- The vertical heads, in their interaction, clearly indicated that, there are delays in decision making by clients because of either the overall slowdown or M&A activity or change in leadership / ownership patterns.
- The lengthening of the sales cycle is already having some impact on deal closures.
- However, there have been no project cancellations faced by the company till date.
- In fact, despite the lengthening sales cycles, the company has signed 10 significant deals during the quarter.
- It signed five transformational deals including consulting services, during the quarter, each one being in excess of $30mn spread over atleast three years.
- The company also signed 5 total outsourcing deals each more than $50mn spread over atleast three years. The management indicated that, it is currently pursuing 12 large deals.
- We understand that, Infosys and its comparable peers are better placed to weather the slowdown as against the mid tier vendors.
- We opine that, further deterioration in the overall economic scenario will start directly impacting the non-BFSI verticals more severely in the future quarters.
- This may impact the demand for Indian vendors in terms of overall slowdown and also in terms of direct client impact.
- We opine that, in case the weak global scenario persists, it may have an impact on the volume growth rather than pricing, as was the case in 2001 - 2003.

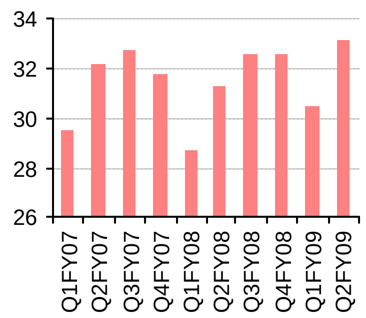
No pricing pressures yet

- The average on-site (0.6% higher QoQ) and off-shore rates (0.1% higher QoQ) were marginally higher during the quarter.
- The company has not yet encountered any significant number of price re-negotiation requests.
- We believe that, despite the potential slowdown, there may not be significant pressure on pricing as was witnessed in the slowdown on 2001 - 2003.
- This is because of the fact that, pricing is much more reasonable as compared to the previous period. Also, Indian vendors are providing much better value to customers and have become strategic outsourcing partners for the clients.

Employee additions on track

- Infosys added more than 10,000 employees on a gross basis in 2QFY09. This is in line with the guidance issued by the company.
- The management has also re-iterated that, it will add a gross 25,000 employees during the fiscal with 4,500 of these in 3QFY09.
- The company had made 18000 offers on campus of which about 11300 have already come on board. The company will be honoring the balance commitments in 3QFY09.
- The management has maintained its employee addition target while scaling down its USD based revenue target.
- Thus, it may end up with a larger bench over the near future.
- However, we believe that, this may not lead to a material fall in margins as the company has enough levers to restrict the impact.
- On the other hand, this will allow the company to take advantage of any uptrend which will emerge from this slowdown.
- The company has also made larger investments in its future growth by increasing spends on sales and marketing initiatives during the quarter.
- We believe that, Infosys is better placed than peers to handle the impact on margins and we maintain our base optimism on the robust business model of the company.

Infosys margins have been relatively resilient

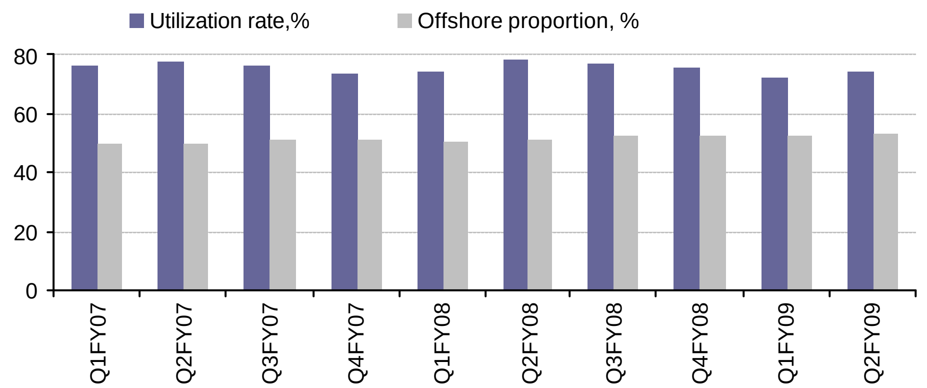


Source: Company

Margins improve

- EBIDTA margins improved by about 264bps QoQ. This was on the back of rupee depreciation (250bps) and lower visa charges (0.8%) and leverage on salary increases (260bps).
- This was partly compensated by increased investments in SG&A expenses.
- We have always opined that Infosys will re-invest into the business, any significant benefits from the rupee. On the other had, these investments form part of the several levers which the company has for margin protection.

Margin levers like utilization and higher offshore volumes have helped



Source: Company

Forex loss

- The company incurred a forex loss of Rs.1.26bn v/s Rs.800mn in the previous quarter.
- Infosys has increased its hedges from the previous quarter levels of about $811mn to about $926mn.
- However, these are still short term hedges maturing over the next two quarters and form about 20% of FY09E revenues.

USD based guidance revised downwards

- Infosys has revised its FY09 USD based revenue and EPS guidance downwards.
- It now expects revenues to grow by 13% - 15% as against 19% - 21% earlier. 3QFY09 revenues are expected to flat-to-3% lower on a sequential basis.
- The fall in guidance is partly because of the cross currency fluctuations.
- The quarter-end depreciation of the Australian dollar (14%), GBP (10%) and Euro (10%) v/s the USD has led the company to revise its USD guidance by 300bps.
- The balance reduction in guidance is due to the evolving macro economic scenario.
- The management has maintained that it has taken a cautious view of the demand scenario though it has not faced any client issues till date.
- To that extent, we believe that, Infosys may be able to meet its revised guidance unless there is a significant further deterioration in the macro outlook or that of its clients.
- The rupee based guidance has been largely maintained.

Future prospects

- We have made marginal changes to our FY09E estimates. We will introduce FY10E estimates once the macro scene stabilizes and we get we get more visibility on the numbers.
- We have changed our INR - USD exchange rate assumption. We now assume the rupee to average Rs.45 per USD in 2HFY09.
- We expect the company to achieve a volume growth of 18% in FY09. Pricing is expected to be marginally lower in 2HFY09 v/s 1HFY09.
- Margins are expected to be lower in 2HFY09 due to the expected appreciation in the rupee and the seasonality involved with the December quarter.
- We expect the EPS to work out to Rs.99 v/s our earlier estimate of Rs.96.6.

Valuations and recommendation

- The stock is currently quoting at about 12.5x FY09 earnings.
- We have done a rolling 12 - month PE band analysis and find the current valuations at the lower end of the 7-year PE band.
- We have done the DCF analysis for Infosys. We have assumed significantly low growth in the immediate term while assigning a 3% growth in perpetuity with a WACC of 14.5%.

We recommend BUY on Infosys with a price target of Rs.1644

- This analysis has led up to a fair price of Rs.1644 at which levels out FY09E earnings will be discounted about 16.5x.
- We continue to rate Infosys as our top pick in the sector with a price target of Rs.1644.

RESULTS PREVIEW

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QUARTERLY RESULTS PREVIEW: CEMENT SECTOR

Cement sector has been an under performer since last 2-3 quarters with companies reeling under high power and freight cost pressures. Cost pressures coupled with the upcoming oversupply scenario have resulted in de-rating of the entire sector. Capacity utilizations of cement companies have already started coming down due to lower demand as a result of slowdown witnessed in the real estate sector. With commissioning of new capacities, capacity utilizations along with cement prices would further start coming under pressure. Marginal price increases incorporated by companies are also not sufficient to set off high coal prices as well as freight expenses.

We continue to maintain our negative bias for the cement sector due to lower than expected growth in demand, upcoming oversupply, increased expenses as well as de-growth witnessed in the profitability for the companies.

Volume growth to be impacted by annual maintenance shutdown

Volume growth of the cement companies is expected to be impacted by the annual maintenance shutdowns carried out by companies during the second quarter of the year. Capacity utilizations of the companies have also witnessed a decline due to lower demand on account of slow offtake witnessed in the real estate sector. For Shree Cements and Ultratech Cement, increase in volume is expected to come from commissioning of new capacities.

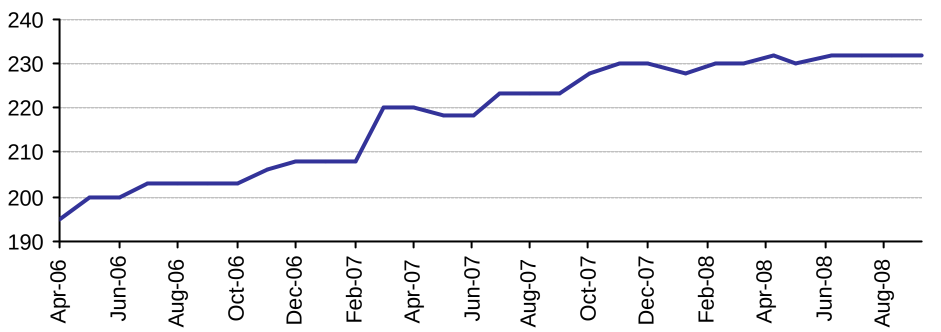
Margins continue to remain subdued

Marginal price increases incorporated by a few companies are not sufficient to set off the increase in the power and freight costs. Reduction in linkage from Coal India is expected to increase the power cost for the companies. Companies importing coal are also impacted negatively due to high coal prices on year on year basis. Though imported coal prices have started cooling down but corresponding depreciation of Indian currency has set off the gains expected from the cooling off of the prices. Full impact of the petrol and diesel price hikes is also expected in the current quarter, leading to higher freight costs. Thus operating margins are expected to remain under pressure for the cement companies.

Cement pricing trend

North (Rs/bg)

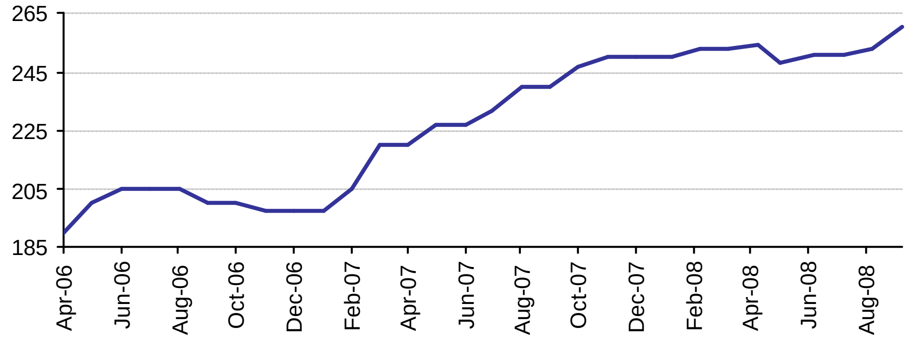
North - Cement prices remained almost constant in the northern region during Q2FY09. Lower than expected demand as well as monsoon season has resulted in constant prices in the northern region during Q2FY09.



Source: CMA

South - Cement prices have witnessed an increase in southern region in Q2FY09 due to strong demand.

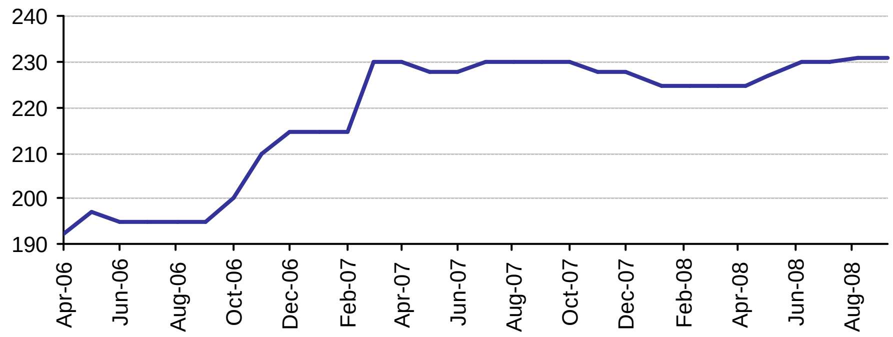
South (Rs/bg)



Source: CMA

East - Healthy demand kept the cement prices firm in the eastern region during Q2FY09.

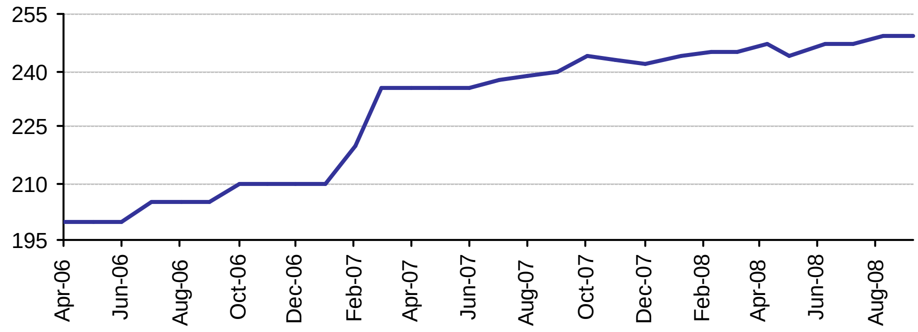
East (Rs/bg)



Source: CMA

West - Few pockets have witnessed price increases to the tune of Rs 2-3 per bag to set off the cost price increases. Prices are expected to pick up marginally post the Diwali season with onset of construction activity.

West (Rs/bg)



Source: CMA

Companies

- **ACC** - Dispatches for ACC for Q3CY08 stood at 4.8MT as against 5.32MT in Q2CY08 and 4.68MT in Q3CY07. We expect prices to be similar to Q2CY08. However, operating margins are expected to be impacted by higher power and freight expenses. We expect operating margins to be around 23.2%, resulting in EBITDA/tonne of Rs 780 for Q3CY08 as compared to Rs 958 for Q3CY07.

- **Ultratech Cements** - Dispatches for Ultratech Cements for Q2FY09 are expected to be 3.9 MT as against 3.61MT in Q2FY08. We expect pricing to be marginally better than Q1FY09 due to price increases in southern region witnessed in the corresponding period. Operating margins are expected to be in the range of 26.1%, resulting in EBITDA/tonne of Rs 929 as compared to Rs 913 for Q2FY08.

- **India Cements -** We expect dispatches for India Cements for Q2FY09 to be around 2.5MT. Cement pricing is expected to be better than Q1FY09 due to price hikes incorporated by company in last quarter. Though imported coal prices have started correcting down but corresponding rupee depreciation sets off the benefit of decline in coal prices. We thus expect power and fuel cost for the company to remain high. Higher fuel prices are expected to have an impact on freight costs for the company. We thus expect operating margins to be around 35%, resulting in EBITDA/tonne of Rs 1260 as compared to Rs 1331 for Q2FY08. Net profits for Q2FY09 are not comparable with Q2FY08 due to lower tax rates in Q2FY08.

- **Shree Cements** - Dispatches for the company for current quarter are expected to be around 1.6MT. Realizations are expected to be similar to Q1FY09. However rising costs are expected to impact the operating margins negatively. We expect operating margins to be around 32.4%, resulting in EBITDA/tonne of Rs 1102 as compared to Rs 1350 for Q2FY08. Sales tax, wage and interest subsidy benefits have also been withdrawn by the Rajasthan government so we expect the write offs related to removal of these subsidies to happen sometime in FY09.

Results preview

(Rs mn)	Revenues			Operating profits			Net profits		
Company	**Q2FY09E**	**Q2FY08**	**YoY (%)**	**Q2FY09E**	**Q2FY08**	**YoY (%)**	**Q2FY09E**	**Q2FY08**	**YoY (%)**
ACC*	16,128	16,369	-1	3,744	4,486	-17	2,279	2,924	-22
Ultratech Cements	13,884	11,734	18	3,623	3,296	10	1,925	1,859	4
India Cements	9,000	7,612	18	3,150	3,074	2	1,548	2,227	-30
Shree Cements	5,508	4,664	18	1,785	2,011	-11	884	1,062	-17

*Source: Kotak Securities - Private Client Research; * For ACC, financials are for Q3CY08E and Q3CY07*

RESULTS PREVIEW

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QUARTERLY RESULTS PREVIEW: PHARMACEUTICALS

Key expectations for Q2FY09

- During the quarter ended on September 30, 2008, we expect pharmaceutical/ healthcare companies in our coverage to report an overall revenue growth of 18.3% y-o-y to Rs.82.5bn. EBIDTA growth is likely to remain strong and is expected to grow 30.9% y-o-y to Rs.17.1bn. However, net profit growth during the same period is likely to be lower. We expect companies in our coverage to report 3.9% y-o-y growth in net profit to Rs.9.6bn. The expected lower growth in net profit is mainly due to likely provision for marked-to-market translation losses on outstanding liabilities denominated in foreign currencies.
- During the quarter, the aggregate EBITDA and net profit margins of companies in our coverage are expected to be around 20.7% and 11.7%, respectively.

Preferred picks: Cipla, Glenmark Pharma, Lupin, Piramal Healthcare and Jubilant Organosys.

- We believe that generic players with high export concentration, e.g. Ranbaxy, Dr. Reddy's, Sun Pharma, Jubilant, Glenmark etc will be benefited due to rupee depreciation vis-à-vis dollar. For Dr Reddy's, Betapharm has been a concern and its revenue growth and margins will be key variables for overall performance. Ranbaxy is likely to witness moderate revenue growth overall (strong growth in non-regulated markets) and higher growth in EBITDA due to lower R&D expenses and effective cost control. Cipla likely to report strong revenue and net profit growth led by strong growth in international formulation.
- In our earning estimates we have also considered translation losses due to marked-to-market of foreign currency debt (FCCB/ECB) due to depreciation of rupee against dollar. During the quarter rupee has depreciated around 8% vis-à-vis US dollar. We believe Ranbaxy, Cipla, Jubilant, Lupin, Panacea Biotec, and Strides Arcolab may report some forex MTM losses.
- We maintain our positive outlook on domestic pharmaceutical industry and expect most of the companies to report moderate to strong growth in quarter ending on September 30, 2008. We expect companies to report around 10-12% growth in domestic formulations business, which is slightly lower than what they have witnessed in last many quarters.
- The sector has out-performed the broader markets in the last 2-3 quarters mainly due to its defensive characteristic. We believe sector is showing strong fundamental strength buoyed by new products launches in the domestic and global markets, strong growth in CRAMS segment and improvement in margins led by better cost control and improving efficiencies.

Earning Estimates for Q2FY09 (July - Sep 2008)

Company	Revenue			EBIDTA			Net Profit			Q1FY09		
(Rs mn)	Q2FY09	Q2FY08	YoY (%)	Q2FY09	Q2FY08	YoY (%)	Q2FY09	Q2FY08	YoY (%)	Ebidta (%)	NPM (%)	EPS (Rs)
Alembic	2,458	3,071	(20.0)	412	612	(32.7)	315	456	(30.9)	16.8	12.8	2.3
Aventis Pharma *^	2,605	2,334	11.6	586	516	13.6	433	368	17.6	22.5	16.6	18.8
Cipla	11,993	10,984	9.2	2,755	2,240	23.0	1,662	1,906	(12.8)	23.0	13.9	2.1
Glenmark Pharma	4,245	3,749	13.2	1,273	1,184	7.6	894	751	19.0	30.0	21.1	3.6
IPCA Labs	3,279	3,001	9.3	689	726	(5.1)	483	454	6.4	21.0	14.7	19.3
Jubilant Organosys	9,584	6,183	55.0	1,917	1,133	69.2	1,467	811	80.8	20.0	15.3	9.9
Lupin	8,839	6,590	34.1	1,635	1,126	45.3	1,166	756	54.4	18.5	13.2	14.2
Opto Circuits	1,881	1,238	52.0	602	365	65.0	482	341	41.4	32.0	25.6	5.1
Panacea Biotec	2,286	1,751	30.5	823	497	65.5	381	321	18.8	36.0	16.7	5.7
Piramal Healthcare	8,630	7,646	12.9	1,640	1,329	23.4	1,116	848	31.5	19.0	12.9	5.3
Ranbaxy Labs*	19,861	17,730	12.0	3,452	2,831	21.9	702	2,074	(66.2)	17.4	3.5	1.9
Strides Arcolab*	2,860	2,043	40.0	572	61	831.6	(48)	(90)	(46.6)	20.0	(1.7)	-1.2
Torrent Pharma	4,025	3,471	16.0	767	459	67.1	565	262	115.5	19.1	14.0	6.7
Total	**82,545**	**69,790**	**18.3**	**17,123**	**13,079**	**30.9**	**9,617**	**9,257**	**3.9**	**20.7**	**11.7**	

*Source - Kotak Securities Private Client Research; *Calender year end; ^ Coverage discontinued*

Bulk Deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
10-Oct	Allied Digit	Kotak Mahindra UK Ltd Ac Sandstone Capital India Master Fund Ltd	B	101,704	492.00
10-Oct	Allied Digit	Morgan Stanley Mauritius Company Ltd	S	101,704	492.00
10-Oct	Apollo Tyre.	Kotak Mahindra UK Ltd Ac Sandstone Capital India Master Fund Ltd	B	8,405,530	33.25
10-Oct	Apollo Tyre.	Morgan Stanley Mauritius Company Ltd	S	8,405,530	33.25
10-Oct	Arshiya Intl	Credit Suisse Singapore Limited	B	423,458	113.50
10-Oct	Arshiya Intl	Morgan Stanley Mauritius Company Ltd	S	423,458	113.50
10-Oct	Aurionpro So	HSBC Bank Mauritius Limited	B	424,527	160.00
10-Oct	Aurionpro So	Morgan Stanley Mauritius Company Ltd	S	425,037	160.00
10-Oct	Bl Kashyap	ABN Amro Bank N V London	B	400,000	453.00
10-Oct	Bl Kashyap	Citigroup Global Mkts Mauritius P Ltd	S	400,000	453.00
10-Oct	Camson Bio	Batlivala and Karani Financial Cons	B	50,000	36.30
10-Oct	Cmc Ltd	Copthall Mauritius Investment Lted	B	213,160	362.00
10-Oct	Cmc Ltd	Merrill Lynch Capital Mkt Espana Sa Svb	S	213,100	362.00
10-Oct	Gennex Lab	Govindji Gupta	B	63,897	41.65
10-Oct	Geod Ltd	Deutsche Securities Mauritius Limited	B	689,928	131.65
10-Oct	Geod Ltd	Goldman Sachs Investments Mauritius	S	5,394,529	122.50
10-Oct	Geod Ltd	Morgan Stanley Mauritius Company Ltd	S	658,928	132.00
10-Oct	Hanung Toys	Kotak Mahindra UK Ltd Ac Sandstone Capital India Master Fund Ltd	B	879,180	100.00
10-Oct	Hanung Toys	Morgan Stanley Mauritius Company Ltd	S	879,180	100.00
10-Oct	Havellsindia	ABN Amro Bank N.V. London	B	900,000	217.50
10-Oct	Heg Limited	Deutsche Bank Ag London Gdr Ac	S	584,615	140.00
10-Oct	Igarashi Mot	Goldman Sachs Investments Mauritius	S	886,180	31.25
10-Oct	Inan Marb In	Chetan Dogra	B	16,449	61.74
10-Oct	Ing Vysya Bk	Copthall Mauritius Investment Limited	B	1,048,960	173.00
10-Oct	Ing Vysya Bk	Merrill Lynch Capital Mkt Espana Sa Svb	S	1,048,960	173.00
10-Oct	Karuturi Glo	Kotak Mahindra Uk Ltd Ac Sandstone Capital India Master Fund Ltd	B	7,236,699	9.15
10-Oct	Karuturi Glo	Morgan Stanley Investments Mauritius Ltd	S	7,236,699	9.15
10-Oct	Kec Intern	Reliance Capital Trustee Co.Ltd. Ac Reliance Diversified Pow	B	1,000,000	232.20
10-Oct	Kec Intern	Fidelity Fid Funds Mau Ltd	S	1,000,000	232.20
10-Oct	Madhucon Pro	Kotak Mahindra UK Ltd Ac Sandstone Capital India Master Fund Ltd	B	229,302	105.00
10-Oct	Madhucon Pro	Morgan Stanley Mauritius Company Ltd	S	229,302	105.00
10-Oct	Monne Ispat	Credit Suisse Singapore Limited	B	919,034	215.00
10-Oct	Monne Ispat	Morgan Stanley Mauritius Company Lted	S	919,034	215.00
10-Oct	Nucleu Sof E	Copthall Mauritius Investment Limited	B	1,031,219	82.25
10-Oct	Nucleu Sof E	Merrill Lynch Capital Mkt Espana Sa Svb	S	1,031,219	82.25
10-Oct	Om Met Infra	Copthall Mauritius Investment Limited	B	567,685	13.20
10-Oct	Om Met Infra	Morgan Stanley Mauritius Company Ltd	S	567,685	13.20
10-Oct	Om Met Infra	Morgan Stanley Investmnts Mauritius Ltd	S	1,996,000	13.20
10-Oct	Prithvi Info	Majestic Sales Promotion P Ltd	B	102,046	45.17
10-Oct	S. Kumars Nat	Morgan Stanley Mauritius Co Ltd	S	1,072,336	21.65
10-Oct	Shyam Soft I	Rajesh K Goda	S	35,000	4.84
10-Oct	Soma Tex Ind	Basmati Scurities Pvt. Ltd.	B	305,600	28.24
10-Oct	Soma Tex Ind	Kii Ltd	S	295,000	28.25
10-Oct	Tanla	Copthall Mauritius Investment Limited	B	990,000	119.00

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
10-Oct	Tanla	Citigroup Global Mkts Mauritius P Ltd	S	990,000	119.00
10-Oct	Vimta Labs L	Kotak Mahindra UK Ltd Ac Sandstone Capital India Master Fund Ltd	B	385,013	27.50
10-Oct	Vimta Labs L	Morgan Stanley Mauritius Co Limited	S	385,013	27.50
10-Oct	Zandu Phar W	Vrushal Trading Pvt Limited	B	10,170	15,041.27
10-Oct	Zandu Phar W	Tejal Merchantiles Pvt Limited	B	10,000	15,099.84
10-Oct	Zandu Phar W	M B Trade Link Pvt Limited	B	5,845	15,034.99
10-Oct	Zandu Phar W	Nova Tradex Private Limited	B	8,780	15,058.02
10-Oct	Zandu Phar W	Bhaskar Gopaldas Parikh	B	5,566	15,059.78
10-Oct	Zandu Phar W	Anuja Ajay Parikh	B	4,450	15,099.98
10-Oct	Zandu Phar W	Bharti Girish Parikh	B	9,722	15,085.00
10-Oct	Zandu Phar W	Ulka Business Links Pvt Limited	S	8,752	15,035.00
10-Oct	Zandu Phar W	Jimmy Bhaskar Parikh	S	5,280	15,063.98
10-Oct	Zandu Phar W	Neeta Bhaskar Parikh	S	5,066	15,049.00
10-Oct	Zandu Phar W	Pratibha Harendra Parikh	S	5,845	15,035.00
10-Oct	Zandu Phar W	Minoti Ajay Parikh	S	14,372	15,099.89
10-Oct	Zandu Phar W	Girish Gopaldas Parikh	S	9,722	15,085.00

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	% change	Index points	Volume (mn)
Gainers				
SBI	1,353	2.6	3.5	4.0
Ranbaxy Lab	293	5.1	0.9	5.8
BPCL	339	(0.8)	(0.2)	0.7
Losers				
Reliance Ind	1,528	(7.3)	(28.6)	8.4
Reliance Com	239	(20.3)	(20.5)	9.7
ONGC	916	(4.9)	(16.4)	3.3

Source: Bloomberg

Forthcoming events

Company/Market

Date	Event
13-Oct	Axis Bank, BASF India, Educomp Solutions earnings expected
14-Oct	NDTV, Jubilant Organosys earning expected
15-Oct	L&T, CMC Ltd, HCL Tech, Concor earnings expected
16-Oct	HDFC Bank, Mphasis, GTL, NIIT Technologies earnings expected
17-Oct	HDFC, Satyam, India Infoline earnings expected
18-Oct	Chambal Fertilizer, Ultratech Cement, Indian Bank, Federal Bank, Allahabad Bank earnings expected

Source: Bloomberg

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