kotak Institutional Equities

INDIA DAILY

September 8, 2010

Contents

News Round-up

- Maruti (MSIL IN) to invest USD 409 mn on third Manesar plant. Proposed plant is expected to boost capacity by more than 17%. *(BSTD)*
- Tata Steel (TATA IN), seeking a greater role the government in promoting Indian industry, has called for an ultra mega steel plant policy, on the lines of similarly named policy to promote the power sector. *(BSTD)*
- DLF (DLFU IN) said it plans to raise up to USD 638 mn in the next 12-18 months through sale of non-core assets for reducing its net debt. *(THBL)*
- BHEL (BHEL IN) plans to leverage its balance sheet and reserves to expand its role beyond equipment supplies to enter the financial services sector. *(THBL)*
- Cairn Plc needs at least 10 separate clearances from the petroleum ministry before Vedanta Resources planned purchase of a controlling stake in oil & gas explorer Cairn India (CAIR IN) sail through, potentially delaying the deal closure beyond October. *(ECNT)*
- Bharat heavy Electricals (BHEL IN) plans NBFC for power projects, move to aid companies short of cash, help PSU turn total solutions provider. *(FNLE)*
- Tata Steel (TATA IN) is looking for a buyer for its South African unit after agreeing to sell its Teesside operations in the UK. *(BSTD)*
- Ashok Leyland (AL IN) said it planned to raise up to USD 127 mn in long-term debt this financial year to fund its capital expenditure plans till 2011-12. *(BSTD)*
- SCI (SCI IN) plans to purchase a stake in a shipyard to diversify its business after profit and sales slumped last year. *(BSTD)*
- IOC (IOCL IN) said it would rope in a strategic investor for its proposed USD 2.14 bn project at Ennore, Tamil Nadu. *(BSTD)*
- HDFC (HDFC IN) relaunches teaser home loan scheme, SBI may extend its own. *(BSTD)*
- Bank of India (BOI IN) can raise USD 1.50 bn debt. *(BSTD)*
- SBI (SBIN IN) to raise USD 106 mn via retail bonds. *(THBL)*
- Tata Power (TPWR IN) plans USD 53 mn bonds issue. *(THBL)*

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

EQUITY MARKETS

		Change %		
India	**7-Sep**	**1-day**	**1-mo**	**3-mo**
Sensex	18,645	0.5	2.8	12.2
Nifty	5,604	0.5	3.0	12.4
Global/Regional indices				
Dow Jones	10,341	(1.0)	(2.9)	4.0
Nasdaq Composite	2,209	(1.1)	(3.5)	1.8
FTSE	5,408	(0.6)	1.4	7.6
Nikkie	9,040	(2.0)	(6.2)	(5.2)
Hang Seng	21,213	(0.9)	(2.1)	8.9
KOSPI	1,777	(0.6)	(0.4)	7.6
Value traded – India				
Cash (NSE+BSE)	205		193	178
Derivatives (NSE)	977		605	806
Deri. open interest	1,820		1,470	1,242

Forex/money market

		Change, basis points		
	7-Sep	**1-day**	**1-mo**	**3-mo**
Rs/US$	46.8	30	71	(25)
10yr govt bond, %	7.9	(5)	12	45
Net investment (US$mn)				
	6-Sep		**MTD**	**CYTD**
FIIs	224		472	13,353
MFs	76		129	(282)

Top movers -3mo basis

		Change, %		
Best performers	**7-Sep**	**1-day**	**1-mo**	**3-mo**
HPCL IN Equity	515.3	(0.7)	16.0	47.8
BHFC IN Equity	363.3	(1.5)	8.1	42.9
BOI IN Equity	460.3	(0.9)	5.9	41.7
TCOM IN Equity	338.5	(0.8)	22.8	41.5
TTMT IN Equity	1039.2	0.4	16.3	41.2
Worst performers				
RNR IN Equity	39.2	(0.8)	(0.5)	(23.3)
HH IN Equity	1708.9	0.3	(6.8)	(11.5)
ABB IN Equity	784.5	0.2	(2.1)	(8.0)
IVRC IN Equity	160.7	0.5	(7.5)	(6.2)
SESA IN Equity	319.6	(0.3)	(12.3)	(5.9)

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kotak Institutional Equities

Asian Paints (APNT)

Consumer products

ADD

SEPTEMBER 07, 2010

CHANGE IN RECO.

Coverage view: Attractive

Price (Rs): 2,854

Target price (Rs): 3,000

BSE-30: 18,645

Earnings upgrade cycle likely coming to an end, for now. Higher number of rainy days this year versus poor monsoon last year means lower painting days in 2QFY11E. Contours of paint industry are slowly changing—(1) higher activation spends, (2) spate of new launches and (3) aggressive dealer acquisition activities by competition. While medium-term positive outlook on the industry is intact, the earnings upgrade cycle of APNT is likely coming to an end, for now. Recommend 'ADD' on dips ('BUY' previously).

Company data and valuation summary

Asian Paints

Stock data			
52-week range (Rs) (high,low)			2,892-1,343
Market Cap. (Rs bn)			273.8
Shareholding pattern (%)			
Promoters			50.6
FIIs			15.5
MFs			2.4
Price performance (%)	1M	3M	12M
Absolute	9.5	30.6	106.8
Rel. to BSE-30	6.5	17.5	77.6

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	71.5	89.0	107.1
EPS growth (%)	85.3	24.4	20.4
P/E (X)	39.9	32.1	26.6
Sales (Rs bn)	51.3	64.2	78.6
Net profits (Rs bn)	6.9	8.5	10.3
EBITDA (Rs bn)	10.9	13.3	16.1
EV/EBITDA (X)	24.7	20.0	16.4
ROE (%)	51.8	47.9	45.4
Div. Yield (%)	0.9	1.3	1.6

Rating cut to ADD (BUY previously). Why ADD, why not REDUCE?

We cut our stock rating on APNT to ADD from BUY, as we see limited potential upside from the current levels. We continue to maintain the highest-on-the-Street target price of Rs3,000.

Why ADD, why not REDUCE? We note that underlying demand conditions for paints continues to be good and competition is still rational (as evidenced by price increase to defend gross margins). Our analysis suggests that mix improvement has contributed to a 5% benefit in sales for APNT in FY2010 (Exhibit 4 provides the detailed analysis). The paint industry has been witnessing a mix improvement towards emulsions over several years, a trend that has accelerated in the past two years, in our view. A confluence of positive factors is driving this, in our view—(1) benefits of aspirational positioning, (2) continuing stronger demand in Tier II, III towns, (3) disproportionate market development activities and activation programs in emulsions segment and (4) innovative products in exterior emulsions (Exhibit 7).

We maintain our standalone EPS estimates of Rs89 and Rs107 for FY2011E and FY2012E, respectively, which are the highest on the Street. At our target price of Rs3,000, the stock would trade at 25XFY2012E EPS (at the past three years average PE). Our target price includes Rs200/share for international operations at a reasonable 7XFY2012E EBITDA.

We recently met a paints industry expert; key takeaways

- **Monsoon impact.** The paint industry witnessed flat growth on yoy basis in the July-August 2010 primarily due to weather conditions. The industry is more impacted by number of overcast/rainy days than the total rainfall quantity. Exterior paint cycle (~33% of the industry) in states like Kerala, Karnataka, Goa and Maharashtra typically falls by 50% during the monsoon. By September, paint usage picks up by ~30% and there is a further pick-up by October/November (Diwali).

However, higher number of rainy days this year versus poor monsoon last year means lower painting days in 2QFY11E.

QUICK NUMBERS

- Flat yoy growth for paint industry in July-August 2010
- Less than 10% of the households in India engage in painting / repainting
- Maintain our highest-on–the-Street TP of Rs3,000
- Downgrade to ADD on limited potential upside from current levels

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- **Competitive landscape is changing, albeit at a slow pace.** We see instances of (1) higher activation spends, (2) spate of new launches and (3) aggressive dealer acquisition activities by competition (incentives offered to exclusive APNT dealers to stock competition products as well). We see increasing activity levels from MNCs such as Nippon, Jotun, Sherwin Williams etc.

- **Consumer mindset is changing for good.** Painting is gradually shifting from being a discretionary spend to a necessity. This is being triggered by, (1) increase in home ownership, (2) increase in salary levels and disposable income and (3) penetration-led opportunity—of the 210 mn households in India, industry experts estimate that <20 mn engage in painting/repainting activity.

- **Increasing brand relevance.** With increasing competitive intensity, brand equity is becoming increasingly important. Consumer involvement in decision-making is increasing—ratio of consumers and painters in decision making is 50:50 now (estimated at 70:30 ten years ago).

- Margins are likely to be under pressure as competitive intensity warranting higher adpro spends.

- GST impact—(1) cash flow cycle will improve on account of lower inventory levels, (2) go-to-market capabilities could improve and (3) modest improvement in EBITDA margins.

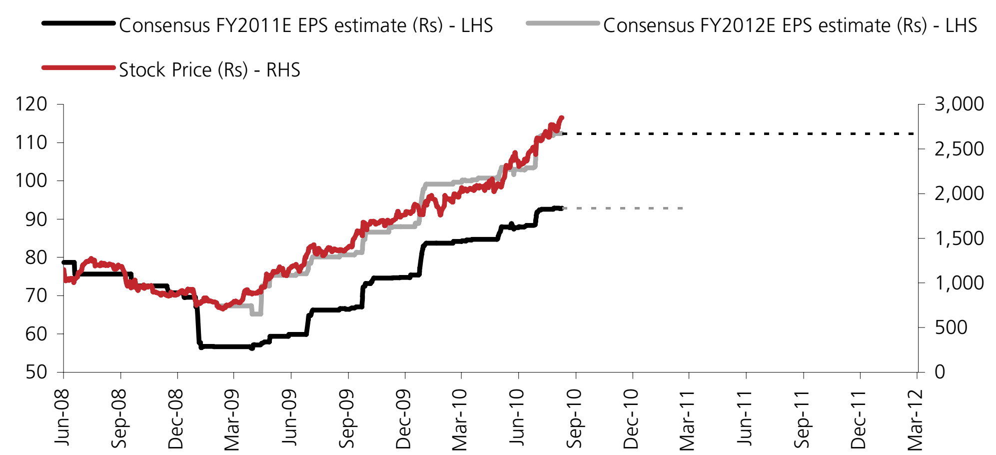
- Paint industry players are focusing on quality of distributors rather than just numeric distribution.

- Industry focus has shifted to launch of innovative products to drive differentiation and build on brand equity. Higher adpro spends are evident (example is the recent signing of Shahrukh Khan, a Bollywood celebrity, by Kansai Nerolac to endorse their products).

- Pricing power is clearly with the market leader APNT. Competition typically follows the benchmark set by the leader as pricing is not a major decision-making factor for the consumer (and hence the ability to gain by resorting to undercutting is limited).

Key risks include higher-than-expected impact of raw material costs due to higher crude prices, significant slowdown in construction and housing demand and inability of the company to effect adequate price increases.

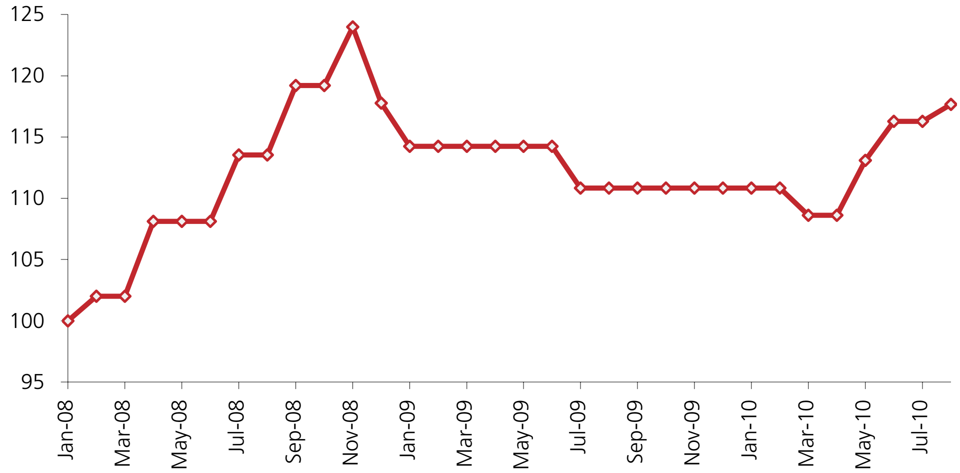
Exhibit 1: **Consensus earnings upgrade has lagged stock price**
APNT consensus FY2011E, FY2012E EPS estimate, stock price (Rs)



Note:
(a) We do not expect major earnings upgrades in near-term

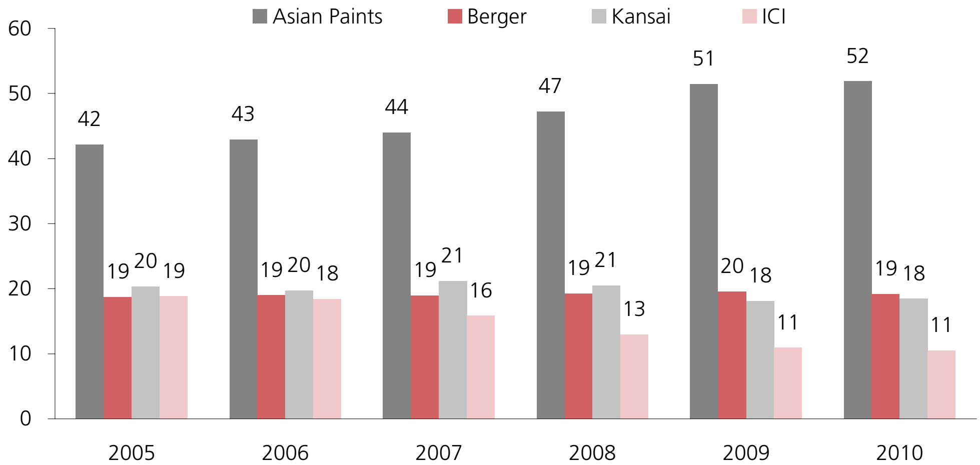
Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 2: **Price increase season is back**
Price index of APNT's products (x)



Source: Company, Kotak Institutional Equities estimates

Exhibit 3: APNT has strengthened its leadership position
Market share of top 4 paint players, March fiscal year-ends, 2005-2010 (%)



Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 4: Sales mix shifting towards emulsions
Indexed volume, price per unit and value, March fiscal year-ends 2009, 2010

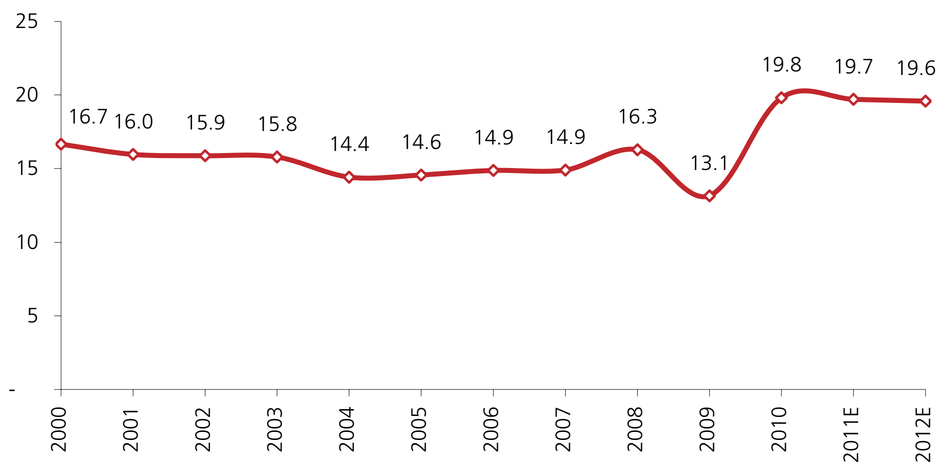
	2009			2010			
Segments	Volume mix	Price per unit	Value	Volume mix	Price per unit	Value	Volume growth (% yoy)
Emulsions	35	100	3,500	43	97	4,157	22
Distemper	25	70	1,750	29	68	1,959	15
Enamel	25	50	1,250	27	49	1,314	8
Primer/putty	15	30	450	18	29	517	18
Total	**100**		**6,950**	**116**		**7,947**	

Volume growth	16%
Derived sales growth	14%
Reported sales growth	19%

Mix improvement of 5% in FY2010

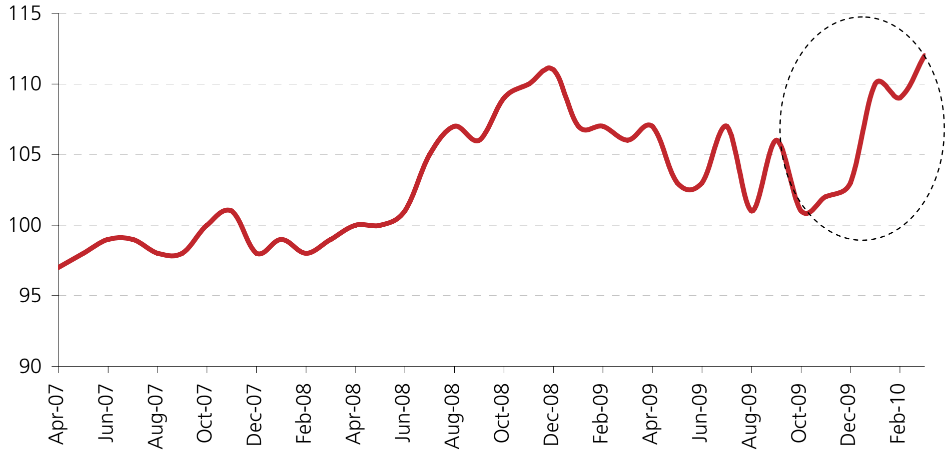
Source: Kotak Institutional Equities estimates

Exhibit 5: We expect marginal decline in EBITDA margins on account of higher adpro spends
APNT EBITDA margins, March fiscal year-ends, 2000-2012E (%)



Source: Company, Kotak Institutional Equities estimates

Exhibit 6: Titanium dioxide prices are inflationary
Titanium dioxide price in USA (US$ per pound)



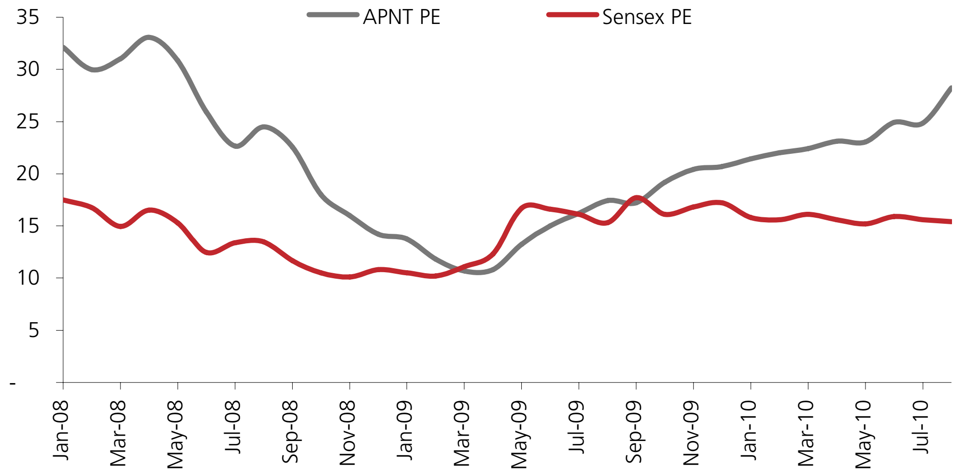
Source: Bloomberg, Kotak Institutional Equities

Exhibit 7: Innovative products launched by competition

Reduces room temperature by upto 5 degrees celsius	Washable, stain resistant and odourless paint	Suits extreme tropical conditions of high rainfall, humidity and heat and helps prevent fungal growth	Silicon-enhanced exterior paint with strong water-resistant property to provide long-lasting protection

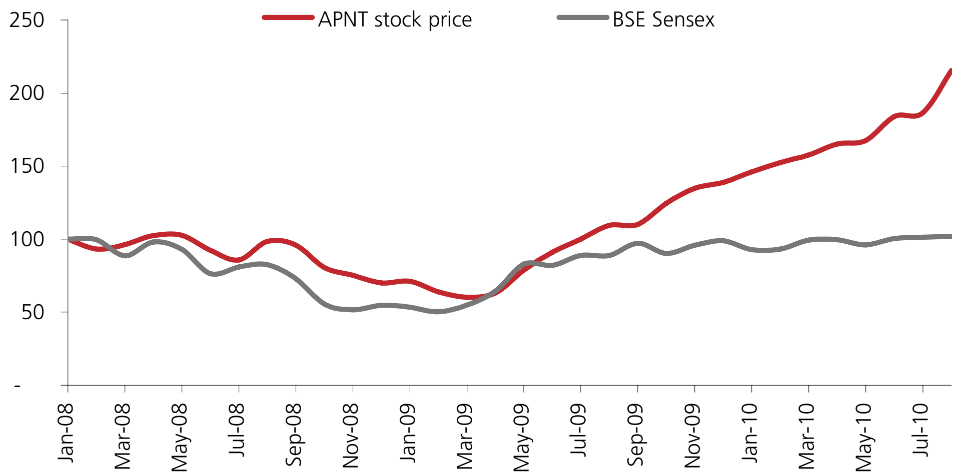
Source: Company, Kotak Institutional Equities

Exhibit 8: APNT has outperformed Sensex
APNT and Sensex PE (x)



Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 9: APNT has outperformed Sensex
APNT and BSE Sensex (Index to base = 100)



Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 10: Relative P/E of APNT versus Sensex (X)

Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 12: Companies with good franchise value has outperformed

Performance of consumer companies under KIE universe

	Price	6-Sep-10		Change (%)				Relative change (%)			
Company	**Rs**	**Mkt cap (Rs mn)**	**Rating**	**1-mo**	**3-mo**	**6-mo**	**1-Year**	**1-mo**	**3-mo**	**6-mo**	**1-Year**
Titan	3,030	134,508	ADD	8	35	66	135	6	22	52	103
Jyothy Laboratories	289	20,940	NR	4	29	57	121	2	16	44	91
Asian Paints	2,850	273,343	BUY	9	30	45	106	7	18	33	78
Glaxosmithkline Consumer	1,793	75,412	ADD	(3)	7	20	64	(5)	(3)	10	41
Godrej Consumer Products	399	129,258	ADD	10	14	55	63	8	3	42	40
Dabur India	212	183,221	REDUCE	4	9	24	55	2	(1)	14	34
Nestle India	3,208	309,263	REDUCE	16	15	19	50	13	4	9	29
ITC	166	1,268,460	BUY	4	18	38	47	2	6	27	27
Marico	125	76,065	ADD	4	18	22	39	1	6	12	20
Colgate-Palmolive (India)	824	112,092	REDUCE	(2)	0	17	32	(4)	(9)	7	14
Tata Global Beverages	123	76,156	ADD	10	15	27	30	7	4	16	13
Hindustan Unilever	272	592,655	REDUCE	7	8	12	(1)	4	(2)	2	(14)
Jubilant Foodworks	517	33,007	REDUCE	26	82			23	65		
Consumer Products		**3,149,871**	**Attractive**	**6**	**15**	**28**	**38**	**4**	**4**	**18**	**19**
KS universe		**46,924,625**		**5**	**14**	**14**	**25**	**2**	**3**	**4**	**8**
Sensex	**18,560**			**2**	**11**	**9**	**16**				

Source: Bloomberg estimates, Kotak Institutional Equities estimates

Exhibit 13: Asian Paints: Profit model, balance sheet, cash model 2007-2012E, March fiscal year-ends (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Profit model (Rs mn)						
Net sales	**28,196**	**34,191**	**42,701**	**51,251**	**64,209**	**78,567**
EBITDA	**4,200**	**5,564**	**5,613**	**10,153**	**12,651**	**15,376**
Other income	405	602	601	808	999	1,164
Interest	(69)	(83)	(104)	(191)	(120)	(125)
Depreciation	(454)	(438)	(572)	(607)	(859)	(1,111)
Pretax profits	4,082	5,645	5,538	10,163	12,672	15,304
Tax	(1,400)	(1,880)	(1,836)	(3,302)	(4,139)	(5,027)
Net profits	**2,682**	**3,766**	**3,702**	**6,861**	**8,533**	**10,277**
Earnings per share (Rs)	**28.0**	**39.3**	**38.6**	**71.5**	**89.0**	**107.1**
Balance sheet (Rs mn)						
Total equity	7,441	9,285	10,945	15,572	20,034	25,212
Total borrowings	1,257	947	745	686	686	686
Currrent liabilities	6,482	9,516	9,577	14,604	18,512	22,630
Deferred tax liability	221	315	479	479	551	563
Total liabilities and equity	**15,401**	**20,063**	**21,747**	**31,342**	**39,783**	**49,090**
Cash	425	414	1,283	286	2,793	5,236
Current assets	8,167	10,029	10,999	13,137	16,430	20,122
Total fixed assets	3,465	5,392	7,118	10,882	13,523	16,695
Investments	3,344	4,229	2,348	7,037	7,037	7,037
Total assets	**15,401**	**20,063**	**21,747**	**31,342**	**39,783**	**49,090**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	2,802	4,240	4,082	8,102	8,928	10,740
Working capital	282	27	(965)	2,054	(170)	(161)
Capital expenditure	(673)	(2,365)	(2,297)	(4,372)	(3,500)	(4,283)
Free cash flow	**2,412**	**1,903**	**820**	**5,785**	**5,258**	**6,295**
Key assumptions (%)						
Revenue growth	22.0	21.3	24.9	20.0	25.3	22.4
EBITDA margin	14.9	16.3	13.1	19.8	19.7	19.6
EPS growth	21.2	40.4	(1.7)	85.3	24.4	20.4

Source: Kotak Institutional Equities estimates

Oil & Natural Gas Corporation (ONGC)

Energy

BUY

SEPTEMBER 08, 2010

UPDATE

Coverage view: Cautious

Price (Rs): 1,354

Target price (Rs): 1,500

BSE-30: 18,645

Still looking good. We have fine-tuned our earnings model for ONGC's FY2010 annual report but retain our BUY rating with a revised 12-month target price of ₹1,500. The two key takeaways from additional disclosures in the annual report are (1) ONGC's RRR exceeded 1X in terms of proved reserves in FY2010 and (2) ONGC continues to follow very conservative accounting policies. The company had shared most of its balance sheet items at the time of 4QFY10 results and annual analyst meeting.

Company data and valuation summary

Oil & Natural Gas Corporation

Stock data			
52-week range (Rs) (high,low)			1,378-934
Market Cap. (Rs bn)			2,895.3
Shareholding pattern (%)			
Promoters			74.1
FIIs			4.2
MFs			2.3
Price performance (%)	1M	3M	12M
Absolute	10.0	14.8	13.9
Rel. to BSE-30	7.0	3.3	(2.2)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	90.3	116.4	136.7
EPS growth (%)	(0.8)	28.9	17.5
P/E (X)	15.0	11.6	9.9
Sales (Rs bn)	1,069.7	1,224.7	1,357.5
Net profits (Rs bn)	193.2	249.0	292.5
EBITDA (Rs bn)	499.5	561.1	635.8
EV/EBITDA (X)	5.3	4.6	4.0
ROE (%)	14.4	16.8	17.7
Div. Yield (%)	2.4	3.1	3.5

Maintain BUY rating despite strong outperformance of late

We maintain our BUY rating on ONGC stock despite its 15% performance over the past three months (+3.3% relative to the BSE-30 Index) led by (1) 'deregulation' of natural gas prices, (2) announcement of deregulation of auto fuel prices and (3) strong operating performance in terms of addition to reserves.

Several potential catalysts exist; will boost earnings and sentiment as they unfold

We see several potential catalysts for ONGC in the near and medium term—(1) implementation of deregulation of auto fuel prices; current under-recoveries on auto fuels are quite small anyway, (2) lower taxation under the new Direct Tax Code (DTC), (3) announcement/upgrade of reserves in several discoveries, (4) potential upside from announcement of new discoveries given the heavy exploration plan and (5) potential favorable resolution of disproportionate royalty payment in Cairn's RJ-ON-90/1 block as a result of a likely change in ownership of Cairn India; we assign low probability to it though.

Valuations remain reasonable; 11% potential upside to our revised target price of ₹1,500

We find ONGC's valuation reasonable even without factoring in some of the aforementioned catalysts. ONGC stock is trading at 11.6X FY2011E EPS and at 9.9X FY2012E EPS. We model ONGC and other upstream companies bearing one-third of total under-recoveries in FY2011E and FY2012E and assume full deregulation of auto fuel prices from January 1, 2011.

Earnings revision

We maintain our BUY rating on ONGC with a revised target price of ₹1,500 (₹1,480 previously). We have revised our FY2011-13E EPS to ₹116 (no change), ₹137 (+0.5%) and ₹154 (-3.1%). The revision to earnings reflects (1) information in FY2010 annual report, (2) modest increase in production volumes from joint ventures and overseas assets, (3) higher capex and (4) other housekeeping changes.

QUICK NUMBERS

- RRR in terms of proved reserves was 1.19X in FY2010
- Stock trading at 11.6X FY2011E EPS without factoring in several potential catalysts; 3.1% dividend yield
- 11% potential upside to 12-month fair valuation of ₹1,500

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New information in the FY2010 annual report

We have updated our earnings model for ONGC's FY2010 annual report and made a few minor changes accordingly. Our revised earnings are ₹116, ₹137 and ₹154 for FY2011E, FY2012E and FY2013E. We give our key assumptions in Exhibit 1. We highlight two key takeaways from the annual report although ONGC had shared most of the financial and operating data for FY2010 in various earnings releases and during its annual meeting with analysts.

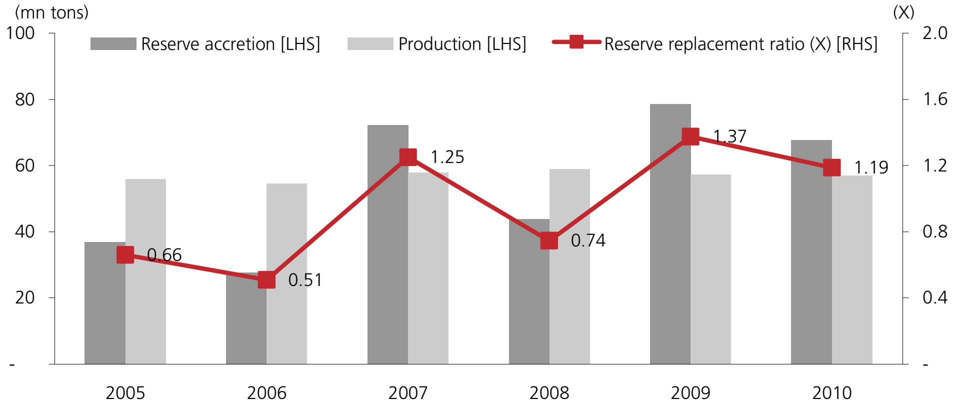
Strong growth in net crude price realization over the next few years
Key assumptions, March fiscal year-ends, 2006-2014E

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Macro assumptions									
Rs/US$ rate	44.3	45.3	40.3	45.8	47.4	46.0	46.0	46.0	46.0
Subsidy share scheme loss (Rs bn)	119.6	170.2	220.0	282.3	115.5	151.1	109.9	126.3	129.6
Import tariff on crude oil (%)	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2
Pricing and volumes assumptions									
Crude price									
Crude price, Bonny Light (US$/bbl)	57.2	64.8	78.9	83.0	67.1	75.0	75.0	80.0	80.0
Net crude price, ONGC-India (US$/bbl)	43.8	46.1	54.2	51.2	55.9	54.4	60.1	63.1	63.0
Natural gas price									
Ceiling natural gas price, India (Rs/cu m)	3.52	3.20	3.20	3.20	3.20	6.78	7.50	7.50	7.50
Ceiling natural gas price, India (US$/mn BTU)	2.12	1.89	2.12	1.87	1.80	3.94	4.36	4.36	4.36
International operations									
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.1	3.2	2.8	3.2	3.3	3.2	3.2	3.2	3.2
Net crude price, OVL-Sudan (Rs/ton)	8,118	9,384	10,142	12,136	10,173	11,021	11,021	11,748	11,748
Net crude price, OVL-Russia (Rs/ton)	8,320	9,633	10,434	12,493	10,448	11,333	11,333	12,089	12,089
Sales volumes—Domestic fields									
Crude oil - own fields (mn tons)	20.7	22.6	22.3	21.2	20.5	20.1	20.2	20.6	21.0
Crude oil - JV (mn tons)	1.7	1.8	1.8	1.7	1.8	3.1	4.3	5.1	5.1
Natural gas - own fields (bcm)	18.2	17.9	17.8	17.7	18.1	17.5	17.0	17.5	17.8
Natural gas - JV (bcm)	2.3	2.4	2.7	2.8	2.5	2.7	2.9	2.9	2.9
Sales volumes—Overseas fields									
Crude oil (mn tons)	4.6	5.8	6.8	5.8	5.1	5.6	5.9	6.0	6.3
Natural gas (bcm)	1.8	2.1	2.0	2.2	2.4	2.9	3.0	3.0	3.0
Total sales									
Crude oil (mn tons)	25.3	28.4	29.1	27.0	25.6	25.6	26.1	26.6	27.3
Natural gas (bcm)	20.0	20.1	19.7	19.9	20.5	20.4	20.0	20.5	20.8
Total sales (mn toe)	**43.1**	**46.3**	**46.7**	**44.8**	**43.9**	**43.8**	**44.0**	**44.9**	**45.9**
Total sales (mn boe)	**315**	**338**	**341**	**327**	**320**	**320**	**321**	**328**	**335**
Crude oil (%)	59	61	62	60	58	58	59	59	60
Natural gas (%)	41	39	38	40	42	42	41	41	40

Source: Company, Kotak Institutional Equities estimates

- **Reserve-replacement ratio (RRR) exceeded 1X in FY2010 also.** We compute ONGC's RRR at 1.19X, which is very encouraging following on the 1.37X in FY2009 (see Exhibit 2). We are encouraged by a modest increase in domestic proved reserves in FY2010, which would suggest that the company added reserves marginally ahead of its production in FY2010. Exhibit 3 shows the history of ONGC's proved reserves broken down between domestic and international assets and further between oil and gas. We would highlight that ONGC's domestic proved reserves have been largely flat between FY2004 and FY2010, which is quite encouraging given that ONGC's major fields have been in operation for the past 35 years.

ONGC's proved reserve replacement ratio has been encouraging in FY2007-10
Proved reserve accretion and production data, March fiscal year-ends, 2005-10 (mn tons)



Source: Company, Kotak Institutional Equities

Domestic oil and gas reserves have remained flat for ONGC despite matured fields
Proved oil and gas reserves of ONGC (including share of PSCs), March fiscal year-ends, 2004-10

	2004	2005	2006	2007	2008	2009	2010
Domestic							
Oil (mn ton)	424	422	403	408	417	414	414
Gas (bcm)	347	332	314	336	347	345	363
International							
Oil (mn ton)	82	82	92	95	75	100	96
Gas (bcm)	116	115	113	99	83	85	83
Total reserves (mn TOE)	**919**	**904**	**877**	**891**	**876**	**898**	**908**
Total reserves (mn BOE)	**6,710**	**6,597**	**6,401**	**6,507**	**6,397**	**6,554**	**6,632**

Source: Company, Kotak Institutional Equities

- **Accounting policies continue to be very conservative.** ONGC made one-off provisions of ₹4 bn in FY2010 in line with its conservative accounting policies. Exhibit 4 gives details of one-off provisions made by ONGC over the past few years.

ONGC's PBT could have been higher but for the provisions made for contingent liabilities
Provision for contingent liabilities and PBT, March fiscal year-ends, 2007-10 (₹ mn)

	2007	2008	2009	2010
Provision for dispute in Ravva JV	—	—	8,601	65
Provision for expenditure on KG-DWN-98/2	—	6,105	2,360	918
Provision for cost of unfinished Minimum Work Programme (MWP)	3,845	(98)	1,440	3,149
Provision for Liquidated Damages for delay in MWP	683	499	563	(78)
Reported profit before taxes	**239,803**	**252,347**	**238,954**	**250,021**

Source: Company, Kotak Institutional Equities

Several potential catalysts exist; hence, retain BUY despite moderate upside to 12-month target price

- **Proper deregulation of auto fuel prices.** We believe that changes to auto fuel prices — particularly diesel —could be the next potential trigger for all the government-owned stocks including ONGC. We assume that diesel prices will be deregulated from January 1, 2011. We expect the street to accord a higher multiple to ONGC's earnings in the case of proper deregulation of auto fuel prices. The recent decline in crude prices presents a good window of opportunity for a full-fledged deregulation. We note that the under-recovery on diesel is a mere ₹0.3/liter at crude price (Dated Brent) of US$75/bbl. Exhibit 5 shows the marketing margins/losses on the four 'controlled' products over the past few months.

Subsidy loss on auto fuels remain low over the past few months
Marketing margins/subsidy of key products

	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10
LPG (Rs/cylinder)	**(221)**	**(251)**	**(302)**	**(316)**	**(328)**	**(267)**	**(272)**	**(296)**	**(297)**	**(227)**	**(185)**	**(221)**
Gasoline (Rs/liter)	**(2.0)**	**(2.6)**	**(3.8)**	**(3.1)**	**(5.0)**	**(4.0)**	**(4.8)**	**(6.7)**	**(4.0)**	**(1.4)**	**(0.9)**	**(1.0)**
Kerosene (Rs/liter)	**(15.5)**	**(17.0)**	**(18.6)**	**(17.6)**	**(18.3)**	**(17.1)**	**(18.2)**	**(21.1)**	**(18.9)**	**(16.3)**	**(15.9)**	**(16.1)**
Diesel (Rs/liter)	**1.4**	**0.2**	**(1.2)**	**(0.0)**	**(1.0)**	**0.1**	**(1.0)**	**(3.9)**	**(2.0)**	**(0.4)**	**0.0**	**(0.6)**

Source: Kotak Institutional Equities

We note that the petroleum ministry has proposed a divestment of 10% stake in Indian Oil Corp. and 5% in ONGC as part of the government's ongoing divestment program. The government has targeted ₹400 bn of divestment proceeds but has raised ₹20 bn so far in FYTD2011 (see Exhibit 6). The proposed divestment in IOC and ONGC would help the government meet its target. However, in our view, the government may have to lay out the counters of deregulation properly if it plans to raise around ₹250 bn through the proposed divestments in IOC and ONGC.

Government divestment proceeds reach ₹255 bn
Divestment proceeds to the government of India, March fiscal year-end, 2010-11 (₹ bn)

Name	Shares (mn)	Issue price (Rs)	Divestment (Rs bn)	Current price (Rs)	Return (%)	Month of divestment
Divesment proceeds						
NHPC	559	36	20.1	31	(13)	Aug-09
Oil India	21	1,050	22.5	1,471	40	Sep-09
NTPC	412	202	83.3	197	(3)	Feb-10
Rural Electrification Corp.	43	206	8.8	340	66	Feb-10
NMDC	332	300	99.7	254	(15)	Mar-10
SJVN Ltd	415	26	10.8	24	(9)	Apr-10
Engineers India	34	290	9.8	343	18	Jul-10
Total divestment			**255**			

Source: Company, Kotak Institutional Equities

- **Lower taxation under the proposed Direct Taxes Code (DTC), 2010.** We expect ONGC to benefit from the new DTC, if it is implemented in its current form, which provides for a flat tax rate of 30% for companies (no surcharge and education cess) versus the current corporate tax rate of 33.2% (including 7.5% surcharge and 3% education cess). We see an upside of 4% to ONGC's EPS from the lower corporate taxation rate. However, the DTC will be applicable from FY2013E and will not impact FY2011-12E earnings of companies.

- **Removal of royalty paid by ONGC on the behalf of Cairn India.** We do not rule out a favorable outcome for ONGC in the ongoing Cairn-Vedanta transaction through removal of royalty paid by ONGC for Cairn India's share. We ascribe a low probability to it though as the production sharing contract states that ONGC will bear royalty on behalf of Cairn. We compute a potential upside of ₹4.8 and ₹7.6 to ONGC's FY2011E and FY2012E EPS if ONGC does not have to pay royalty for Cairn's share of production also.

- **Full 'deregulation' of all product prices.** This is a blue-sky scenario and is unlikely in the medium term. However, we discuss this to highlight the potential large upside to earnings of ONGC (and other government-owned companies) in the case of full deregulation of all fuel prices (including kerosene and LPG) and/or direct payment to downstream companies as compensation for under-recoveries on kerosene and LPG for selling these products below market rates. Exhibit 7 gives our blue-sky earnings for ONGC for FY2012E and FY2013E and compares the same with our base-case assumptions.

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

	2012E	2013E
Base case	137	154
Blue-sky scenario (a)	168	190
Potential upside (%)	**23**	**23**

Note:
(a) Assuming full deregulation of auto fuel and cooking fuels prices.

Source: Kotak Institutional Equities estimates

ONGC's earnings are highly sensitive to crude price and exchange rate assumptions
Earnings sensitivity of ONGC to key variables

	2011E			2012E			2013E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rs/US$	45.0	46.0	47.0	45.0	46.0	47.0	45.0	46.0	47.0
Net profits (Rs mn)	238,081	248,968	259,854	281,005	292,488	303,971	317,242	329,896	342,550
Earnings per share (Rs)	111.3	116.4	121.5	131.4	136.7	142.1	148.3	154.2	160.2
% upside/(downside)	**(4.4)**		**4.4**	**(3.9)**		**3.9**	**(3.8)**		**3.8**
Average crude prices									
Crude price (US$/bbl)	73.0	75.0	77.0	73.0	75.0	77.0	78.0	80.0	82.0
Net profits (Rs mn)	236,083	248,968	261,853	278,875	292,488	306,102	315,768	329,896	344,025
Earnings per share (Rs)	110.4	116.4	122.4	130.4	136.7	143.1	147.6	154.2	160.8
% upside/(downside)	**(5.2)**		**5.2**	**(4.7)**		**4.7**	**(4.3)**		**4.3**
Cess									
Cess on domestic crude (Rs/ton)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	241,913	248,968	256,023	285,267	292,488	299,708	322,458	329,896	337,333
Earnings per share (Rs)	113.1	116.4	119.7	133.4	136.7	140.1	150.8	154.2	157.7
% upside/(downside)	**(2.8)**		**2.8**	**(2.5)**		**2.5**	**(2.3)**		**2.3**

Source: Kotak Institutional Equities estimates

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

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)									
Net sales	807,603	966,542	1,091,644	1,200,176	1,069,703	1,224,741	1,357,489	1,513,615	1,564,792
EBITDA	**312,185**	**357,906**	**408,423**	**419,955**	**449,078**	**521,537**	**589,274**	**639,632**	**647,841**
Other income	27,350	45,378	53,565	50,721	50,409	39,540	46,548	55,341	66,387
Interest	(537)	394	(12,027)	(5,966)	(5,669)	(535)	(526)	(2,062)	(5,260)
Depreciation and depletion	(97,726)	(119,550)	(138,624)	(153,985)	(190,429)	(190,484)	(205,307)	(213,625)	(212,021)
Pretax profits	241,272	284,127	311,338	310,725	303,389	370,058	429,988	479,286	496,948
Tax	(71,196)	(88,986)	(102,908)	(111,333)	(94,961)	(114,109)	(127,550)	(134,409)	(140,308)
Deferred tax	(13,612)	(9,264)	(6,471)	(3,495)	(12,076)	(5,246)	(7,215)	(12,426)	(12,732)
Net profits	156,727	178,318	203,710	201,719	196,360	250,703	295,223	332,451	343,908
Net profits after minority interests	**155,672**	**176,827**	**200,099**	**198,335**	**193,203**	**248,968**	**292,488**	**329,896**	**342,207**
Earnings per share (Rs)	**72.8**	**82.7**	**93.6**	**92.7**	**90.3**	**116.4**	**136.7**	**154.2**	**160.0**
Balance sheet (Rs mn)									
Total equity	578,830	670,137	786,657	929,353	1,040,801	1,185,403	1,358,736	1,554,473	1,757,389
Deferred tax liability	71,557	80,976	87,227	92,076	104,153	109,399	116,614	129,040	141,772
Liability for abandonment cost	128,675	151,857	129,325	171,451	175,368	175,368	175,368	175,368	175,368
Total borrowings	28,767	21,826	22,039	73,633	18,070	31,420	74,820	97,220	82,620
Currrent liabilities	142,435	187,051	251,797	293,499	305,680	304,961	323,522	348,757	362,263
Total liabilities and equity	**950,264**	**1,111,847**	**1,277,045**	**1,560,013**	**1,644,072**	**1,806,550**	**2,049,061**	**2,304,858**	**2,519,412**
Cash	90,743	206,262	249,807	224,671	231,289	274,450	369,090	562,999	784,305
Current assets	240,210	192,652	257,384	309,514	286,032	306,912	324,492	348,441	360,266
Total fixed assets	565,722	643,219	695,227	871,287	953,678	1,047,176	1,177,467	1,215,407	1,196,829
Goodwill	14,172	27,686	22,847	111,108	111,108	111,108	111,108	111,108	111,108
Investments	35,753	36,888	45,041	36,926	53,551	58,491	58,491	58,491	58,491
Deferred expenditure	3,663	5,141	6,739	6,506	8,413	8,413	8,413	8,413	8,413
Total assets	**950,264**	**1,111,848**	**1,277,045**	**1,560,013**	**1,644,072**	**1,806,551**	**2,049,061**	**2,304,859**	**2,519,412**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	216,736	252,772	284,517	274,321	282,776	318,514	367,648	408,668	410,768
Working capital changes	46,461	(4,990)	(24,929)	(109,306)	17,211	28,401	60,982	34,351	1,681
Capital expenditure	(113,738)	(135,049)	(166,427)	(208,137)	(159,396)	(195,602)	(242,050)	(157,072)	(101,938)
Investments	(28,912)	53,822	(7,348)	(92,159)	(17,288)	—	—	—	—
Other income	14,537	20,422	22,822	31,612	23,582	39,540	46,548	55,341	66,387
Free cash flow	**135,083**	**186,976**	**108,636**	**(103,668)**	**146,885**	**190,853**	**233,128**	**341,288**	**376,898**
Ratios (%)									
Debt/equity	5.0	3.3	2.8	7.9	1.7	2.7	5.5	6.3	4.7
Net debt/equity	(10.7)	(27.5)	(29.0)	(16.3)	(20.5)	(20.5)	(21.7)	(30.0)	(39.9)
RoAE	26.3	25.5	24.9	21.2	18.1	20.7	21.4	21.2	19.3
RoACE	**22.3**	**22.1**	**22.0**	**18.2**	**15.9**	**18.0**	**18.9**	**19.0**	**17.7**
Key assumptions									
Rs/dollar rate	44.3	45.3	40.3	45.8	47.4	46.0	46.0	46.0	46.0
Crude fob price (US$/bbl)	57.2	64.8	78.9	83.0	67.1	75.0	75.0	80.0	80.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,200	6,783	7,500	7,500	7,500
Subsidy loss (Rs bn)	119.6	170.2	220.0	282.3	115.5	151.1	109.9	126.3	129.6

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Bharti Airtel (BHARTI)

Telecom

REDUCE

SEPTEMBER 07, 2010

UPDATE

Coverage view: Cautious

Price (Rs): 344

Target price (Rs): 305

BSE-30: 18,645

Upside from these levels challenging. We find the odds stacked against reasonable returns from these levels for Bharti. A reasonable 15% annualized return through March 2012 demands (1) sustenance of premium valuation multiples and (2) robust EBITDA growth over the next few years. We see risks on both these counts – telcos get de-rated as their operating markets mature, and we see challenges to healthy EBITDA growth, in both India as well as Africa. Reiterate REDUCE.

Company data and valuation summary

Bharti Airtel

Stock data			
52-week range (Rs) (high,low)			485-230
Market Cap. (Rs bn)			1,304.7
Shareholding pattern (%)			
Promoters			67.9
FIIs			16.7
MFs			3.5
Price performance (%)	**1M**	**3M**	**12M**
Absolute	6.2	28.0	(18.3)
Rel. to BSE-30	3.4	15.2	(29.8)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	23.6	20.0	20.7
EPS growth (%)	5.8	(15.6)	3.9
P/E (X)	14.5	17.2	16.6
Sales (Rs bn)	418.5	619.7	720.9
Net profits (Rs bn)	89.8	75.8	78.7
EBITDA (Rs bn)	167.6	218.9	261.6
EV/EBITDA (X)	8.2	8.9	7.3
ROE (%)	24.4	16.5	14.7
Div. Yield (%)	0.0	0.0	0.0

Returns from these levels demand a lot

We take a look at the required FY2013E EBITDA/EPS to deliver specific levels of returns for Bharti under various scenarios of EV/EBITDA or P/E multiples. Exhibits 1-2 give the required FY2013E EBITDA and FY2011-13E EBITDA CAGR under different 1-year forward EV/EBITDA multiple scenarios while Exhibits 3-4 give the required FY2013E EPS and FY2011-13E EPS CAGR under various P/E multiple scenarios. A few thoughts

- A 15% annualized return (for the next 19 months through March 2012) from these levels at our current FY2013E EBITDA estimate (of Rs298 bn) would require Bharti to trade at ~7.5X 1-year forward EV/EBITDA. At 6-6.5X multiple (and even this is at the premium end of global telco valuation spectrum), the company would need to deliver an FY2013E EBITDA of Rs342-371 bn, or an FY2011-13E EBITDA CAGR of 23-28%, challenging in our view.

- Looking at the equation from a PE perspective, a 15% return would require Bharti to trade at ~17.5X 1-year forward PE on our current FY2013E estimate of Rs24.2. A more reasonable 12-14X multiple would demand Bharti to deliver an EPS of Rs31-36 in FY2013E, a CAGR of 24-33% over FY2011-13E.

Possible? – yes, probable? – no

We see challenges to both the assumptions in requisite 'optimistic' scenarios panning out – (1) telcos de-rate as their operating markets mature and we do not see why the Indian telcos will remain an exception. We note that Bharti's emerging market peers are trading at 5-8X 1-year forward EV/EBITDA multiples (average 5.4X); telcos in the developed markets trade at 4-9X (average 5.3X). Even on a fundamental basis, assuming a 45% FCF/EBITDA conversion, a 7-8X multiple on FY2013E EBITDA would imply an FCF-growth-in-perpetuity assumption of 6.2-7.0% (at a WACC of 13%, see Exhibit 5 for workings), unreasonable for a telco, in our view, (2) a lower and more reasonable EV/EBITDA multiple assumption (6-6.5X, as discussed above), would need Bharti to deliver an EBITDA of Rs342-371 bn in FY2013E, challenging in our view. We discuss our thoughts on this aspect in detail on the next page.

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Multiples will contract; India and Africa wireless markets will both mature over the coming years and then there are other factors as well

As mentioned earlier in the note, global wireless companies are trading at 4-9X 1-year forward EV/EBITDA multiple (average 5.2X), reflecting steady-state multiples for telcos operating in low-growth, mature markets. We do not intend to get into a detailed analysis of the growth potential of Indian and African markets here. We also note that we are talking about revenue/EBITDA growth here, and not subscriber (or reported SIM-cards-in-use) growth.

The limited point that we wish to make is that Indian wireless could be closer to reaching maturity than is commonly perceived. We see a sharp and sustained slowdown in growth in the Indian wireless market beyond FY2013E (by when we estimate a subs base of 1,029 mn, implying an 84% penetration). Increased data uptake will provide upside to revenue growth, but is unlikely to push it beyond high single digits, in the best case.

Africa could turn out to be a surprise, but we see a few risks – (1) reported penetration in Bharti's key African markets (Nigeria, Kenya, Zambia…) is already reasonable at 40-50%, (2) demographics and income levels place a cap on the penetration potential, and (3) price wars in Africa have just started – this may keep revenue and EBITDA growth in check, if elasticity turns out to be lower than expected.

Required EBITDA/EPS growth is possible, but a lot of things have to go right

As discussed earlier, a 6-6.5X 1-year forward EV/EBITDA multiple at end-March 2012 would require Bharti to deliver Rs342-371 bn of EBITDA in FY2013E to meet 15% return expectations from current levels. This is Rs44-73 bn (or 15-24%) higher than our current EBITDA estimate for the year. We now examine what this incremental EBITDA requirement means in operating terms. Exhibit 6 gives the break-up of our FY2011E, 12E, and 13E, revenue and EBITDA estimates across business segments. We note that we have adjusted Zain EBITDA for FY2011E to reflect full-year consolidation.

- Assuming that 10% of the incremental EBITDA requirement (over our base estimate) comes from better-than-expected performance in the non-wireless (India and Africa) segments, Bharti would need to deliver Rs40-66 bn of incremental EBITDA from its India and Africa wireless businesses.

- **Scenario 1 – India (plus South Asia) wireless business delivers 100% of this incremental EBITDA** of Rs40-66 bn over our base case EBITDA estimate of Rs165 bn for this segment. Assuming a part of it comes from better EBITDA margin performance than expected, say margins are 200 bps higher than our estimated 35.4%, this would require additional (over our estimated Rs464 bn) revenues of Rs82-152 bn from the India wireless business. In ARPU terms, this translates into Rs35-64 incremental ARPU over our current estimate of Rs187 for FY2013E.

- **Scenario 2 – Africa delivers 100% of this incremental EBITDA**. This would essentially require Bharti to deliver 56-92% higher EBITDA in Africa than in FY2013E than our current estimate of Rs72 bn (US$1.6 bn).

- **Scenario 3 – India and Africa wireless both contribute to the incremental EBITDA, say India 75% and Africa 25%**. Under the same assumptions as discussed in scenario 1, this would require Rs55-107 bn of incremental revenues from the India wireless business, or an incremental ARPU of Rs23-45. On the Africa business, this would translate into a 14-23% higher EBITDA requirement. We note that a 23% higher EBITDA in Africa than our base case would be ~US$2 bn, Bharti's stated target.

Relative operational gains need not translate into absolute stock gains; reiterate REDUCE

Even as we view Bharti as the best-positioned to emerge 'relative' winner post the hyper-competitive phase in the Indian wireless market, our negative view on the stock is combination of stretched 'absolute' expectations and premium 'absolute' valuations.
We find the stock expensive at the current levels and reiterate our REDUCE recommendation with an end-March 2012E target price of Rs305/share.

Exhibit 1: FY2013E EBITDA required for return scenarios from current levels, Rs mn

		12-month forward EV/EBITDA multiple (end-FY2012E)						
		5.0	5.5	6.0	6.5	7.0	7.5	8.0
Expected return (%)	(10.0)	341	**310**	**284**	263	244	228	213
	(5.0)	361	328	**301**	**278**	258	241	226
	-	381	346	318	**293**	272	254	238
	5.0	402	365	335	**309**	**287**	268	251
	10.0	423	384	352	325	**302**	**282**	264
	15.0	445	404	371	342	318	**296**	278
	20.0	467	425	389	359	334	**311**	**292**

Source: Kotak Institutional Equities estimates

Exhibit 2: FY2011-13E EBITDA CAGR required for return scenarios from current levels (%)

		12-month forward EV/EBITDA multiple (end-FY2012E)						
		5.0	5.5	6.0	6.5	7.0	7.5	8.0
Expected return (%)	(10.0)	22	**17**	**12**	7	3	(0)	(3)
	(5.0)	26	20	**15**	**10**	6	3	(1)
	-	29	23	18	**13**	9	6	2
	5.0	33	27	21	**16**	**12**	8	5
	10.0	36	30	24	19	**15**	**11**	8
	15.0	40	33	28	23	18	**14**	10
	20.0	43	37	31	26	21	**17**	**13**

Source: Kotak Institutional Equities estimates

Exhibit 3: FY2013E EPS required for return scenarios from current levels, Rs/share

		12-month forward PE multiple (end-FY2012E)						
		10.0	11.0	12.0	13.0	14.0	15.0	16.0
Expected return (%)	(10.0)	29.1	26.5	**24.3**	**22.4**	20.8	19.4	18.2
	(5.0)	31.7	28.8	26.4	**24.4**	**22.6**	21.1	19.8
	-	34.4	31.2	28.6	26.4	**24.5**	**22.9**	21.5
	5.0	37.1	33.7	30.9	28.5	26.5	**24.7**	**23.2**
	10.0	39.9	36.3	33.2	30.7	28.5	26.6	24.9
	15.0	42.8	38.9	35.6	32.9	30.5	28.5	26.7
	20.0	45.7	41.5	38.1	35.1	32.6	30.5	28.6

Source: Kotak Institutional Equities estimates

Exhibit 4: FY2011-13E EPS CAGR required for return scenarios from current levels (%)

		12-month forward PE multiple (end-FY2012E)						
		10.0	11.0	12.0	13.0	14.0	15.0	16.0
Expected return (%)	(10.0)	20.7	15.1	**10.2**	**5.9**	2.0	(1.5)	(4.6)
	(5.0)	25.9	20.0	14.9	**10.4**	**6.4**	2.8	(0.5)
	-	31.1	25.0	19.6	14.9	**10.8**	**7.0**	3.6
	5.0	36.2	29.8	24.3	19.4	15.1	**11.2**	**7.6**
	10.0	41.2	34.6	28.9	23.8	19.3	15.3	11.6
	15.0	46.2	39.4	33.5	28.2	23.6	19.4	15.6
	20.0	51.2	44.1	38.0	32.6	27.7	23.4	19.5

Source: Kotak Institutional Equities estimates

Exhibit 5: EV/EBITDA multiple of 8X implies a 7% FCF growth in perpetuity

EV/EBITDA multiple (X)	**8.0**
WACC (%)	13.0
EBITDA to FCF conversion (%)	45.0
EBITDA	100
EV/EBITDA multiple (X)	8.0
Enterprise value	800
EBITDA to FCF conversion (%)	45.0
FCF	45
Implied FCF multiple (X)	17.8
Required FCF growth rate till perpetuity	**7.0**

FCF to EBITDA conversion	
Sales	100.0
EBITDA margin (%)	37.5
EBITDA	37.5
Capex as % of sales	12.0
Capex	15.0
Taxes as % sales	2.9
Working capital as days of sales	10
Working capital	2.8
FCF	16.9
FCF/EBITDA	**45.0**

Source: Kotak Institutional Equities estimates

Exhibit 6: Bharti: Segmental break-up of EBITDA

Rs mn	2010	2011E	2012E	2013E
EBITDA				
Wireless - India and South Asia	128,053	133,294	144,587	164,541
Telemedia services	14,729	16,433	17,699	18,810
Enterprise	12,578	10,976	11,975	13,064
Passive Infra	24,523	31,874	40,479	45,928
Others	(9,754)	(9,926)	(11,646)	(12,917)
Wireless - Africa		47,985	61,819	72,032
Intersegment eliminations	(2,496)	(2,809)	(3,268)	(3,612)
Total EBITDA	**167,633**	**227,826**	**261,644**	**297,845**
EBITDA margin (%)				
Wireless - India and South Asia	38.7	35.3	34.5	35.4
Telemedia services	43.1	44.0	44.0	44.0
Enterprise	28.1	24.5	24.3	24.1
Passive Infra	34.6	35.5	39.8	40.4
Others	(167.5)	(120.0)	(110.0)	(100.0)
Wireless - Africa		34.6	32.6	34.6
Overall	**40.1**	**36.8**	**36.3**	**37.4**

Source: Kotak Institutional Equities estimates

Exhibit 7: Bharti - condensed financials, IFRS, March fiscal year-ends (Rs mn)

	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E
Profit and loss statement									
Revenues	418,472	619,723	720,856	796,816	867,521	928,422	984,188	1,034,097	1,081,806
EBITDA	167,633	218,886	261,644	297,845	328,994	357,483	385,082	406,378	426,439
EBIT	104,798	117,501	130,877	150,072	166,008	180,372	194,445	202,493	209,546
PBT	105,136	93,629	100,555	120,870	139,982	159,052	180,789	197,274	213,394
Recurring PAT	89,765	75,796	78,717	91,948	104,177	115,996	129,370	139,427	150,112
Recurring EPS (Rs/share)	**23.6**	**20.0**	**20.7**	**24.2**	**27.4**	**30.5**	**34.1**	**36.7**	**39.5**
Balance sheet									
Total Equity	447,225	524,001	605,451	702,147	812,733	936,793	1,076,000	1,225,928	1,385,974
Borrowings	101,898	667,784	667,784	587,784	487,784	415,886	365,886	315,886	265,886
Other liabilities	161,817	305,782	326,794	333,498	334,353	341,176	344,823	345,303	343,831
Total equity and liabilitie	**710,940**	**1,497,567**	**1,600,029**	**1,623,429**	**1,634,870**	**1,693,855**	**1,786,709**	**1,887,118**	**1,995,691**
Net fixed assets	482,629	663,132	731,254	768,547	783,974	783,811	772,615	753,174	724,460
Net intangibles	59,890	628,475	613,447	598,420	583,392	568,365	553,337	538,310	523,282
Cash and equivalents	25,323	32,548	66,870	56,705	57,228	122,343	233,125	360,578	505,795
Other assets	143,098	173,411	188,457	199,757	210,276	219,336	227,632	235,057	242,154
Total assets	**710,940**	**1,497,567**	**1,600,029**	**1,623,429**	**1,634,870**	**1,693,855**	**1,786,709**	**1,887,118**	**1,995,691**
Cash flow statement									
Operating cash flow after WC changes	283,323	248,505	269,074	289,935	320,254	338,851	352,088	364,520	
Capex	(151,053)	(183,861)	(170,038)	(163,385)	(161,920)	(164,413)	(169,416)	(173,151)	
Free cash flow	132,270	64,644	99,036	126,550	158,333	174,438	182,672	191,369	
Acquisitions	(699,420)	—	—	—	—	—	—	—	
Borrowings	565,886	—	(80,000)	(100,000)	(71,898)	(50,000)	(50,000)	(50,000)	
Others	8,490	(30,322)	(29,202)	(26,026)	(21,321)	(13,656)	(5,220)	3,849	
Total change in cash balances	**7,225**	**34,322**	**(10,165)**	**523**	**65,115**	**110,782**	**127,453**	**145,218**	

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: Valuation of global wireless companies

Companies	Currency	Price (LC) 06-Sep-2010	Market cap. (US$ mn)	Enterprise Value (US$ mn)	P/E (X) +1-year	P/E (X) +2-year	EV/EBITDA (X) +1-year	EV/EBITDA (X) +2-year
EMEA								
MTN Group Ltd.	ZAR	124.5	31,738	32,878	13	11	4.7	4.0
Partner Communications Co. Ltd.	ILS	64.6	2,654	3,546	8.3	8.7	5.7	5.8
Turkcell Iletisim Hizmetleri A.S.	TRY	9.9	14,423	13,496	12.1	11.3	6.5	5.8
Safaricom Ltd.	KES	4.7	2,321	2,397	10.9	9.2	4.8	4.1
Total / Average			**51,136**	**52,317**	**12.2**	**10.6**	**5.1**	**4.4**
Developed Europe								
Bouygues S.A.	EUR	32.7	14,976	21,519	9.8	9.2	4.2	3.9
Mobistar S.A.	EUR	44.9	3,472	3,867	11.1	11.6	5.6	5.7
Tele2 AB	SEK	135.7	7,892	8,850	12.0	11.5	6.2	5.7
Vodafone Group PLC	GBP	1.6	129,911	183,872	10.1	10.0	8.1	8.0
BT Group PLC	GBP	1.4	16,814	32,214	8.3	7.8	3.6	3.5
Telenor ASA	NOK	94.0	25,472	31,107	12.9	11.8	6.3	5.7
Total / Average			**198,538**	**281,431**	**10.1**	**10.0**	**6.5**	**6.3**
Americas								
Sprint Nextel Corp.	USD	4.3	12,801	28,992			4.9	4.6
AT&T Inc.	USD	27.4	162,143	231,969	11.8	11.0	5.3	5.0
Verizon Communications Inc.		30.2	85,368	182,837	13.6	13.1	3.9	3.5
Total / Average			**260,312**	**443,799**	16.9	13.4	**4.7**	**4.3**
Developed Asia/ Japan								
Far EasTone Telecommunications Co. Ltd.	TWD	41.4	4,232	3,792	14.8	14.4	5.5	5.3
mobilezone holding AG	CHF	9.9	350	329	15.5	14.4	8.9	8.4
SmarTone Telecommunications Holdings L	HKD	8.2	552	564	14.8	12.6	5.0	4.3
StarHub Ltd.	SGD	2.5	3,175	3,610	17.1	14.7	8.5	7.8
Taiwan Mobile Co. Ltd.	TWD	63.4	7,559	6,049	13.4	12.6	9.0	8.4
NTT DoCoMo Inc.	JPY	143,300	74,500	70,064	12	12	3.9	3.7
Singapore Telecommunications Ltd.	SGD	3.1	36,837	40,379	12	12	9.1	8.5
Total / Average			**127,204**	**124,788**	**12.9**	**12.4**	**5.1**	**4.9**
Emerging Asia								
Advanced Info Service PCL	THB	95.5	9,101	9,477	15.3	14.8	6.1	5.9
China Mobile Ltd.	HKD	81.3	210,054	171,011	12.1	11.8	5.0	4.6
China Unicom (Hong Kong) Ltd.	HKD	11.7	35,439	45,482	42.2	28.5	5.3	4.9
DiGi.com Bhd	MYR	24.7	6,155	6,257	17.4	16.3	8.5	8.0
Indosat	IDR	5,150.0	3,109	5,487	20.7	16.2	5.4	4.8
Hutchison Telecommunications Hong Kon	HKD	2.1	1,327	1,783	15	14	6.3	5.9
Total / Average			**265,185**	**239,499**	**13.6**	**12.9**	**5.2**	**4.7**
Total / Average - ex China Mobile			**55,131**	**68,487**	**27.0**	**21.7**	**5.6**	**5.2**
India - Factset estimates								
Bharti Airtel Ltd.	INR	343.6	28,043	30,378	17.1	15.2	8.8	7.1
Reliance Communications Ltd.	INR	162.9	7,226	15,094	15.0	13.1	8.3	6.8
Idea Cellular Ltd.	INR	71.8	5,090	6,788	36.0	28.3	9.5	7.9
			40,358	**52,260**	**18.1**	**15.9**	**8.7**	**7.1**
World total/average - ex India			**902,374**	**1,141,833**	**13.1**	**12.0**	**5.2**	**4.9**
Emerging markets			**316,321**	**291,815**	**13.3**	**12.5**	**5.2**	**4.7**
Emerging markets ex China Mobile			**106,267**	**120,804**	**17.1**	**14.4**	**5.4**	**4.8**
Developed markets			**586,053**	**850,018**	**13.0**	**11.8**	**5.3**	**5.0**
Premium / (discount) for Indian players					**37.9**	**32.2**	**67.1**	**45.9**

Source: Factset, Kotak Institutional Equities

kotak Institutional Equities

Bharat Electronics (BHE)

Industrials

REDUCE

SEPTEMBER 08, 2010

UPDATE

Coverage view: Attractive

Price (Rs): 1,727

Target price (Rs): 1,800

BSE-30: 18,645

Sedate annual report takeaways apart from strong cash balance. Key highlights include (1) FY11E MoU target for "Excellent" rating of Rs56.2 bn—below our revenue estimate of Rs57 bn, (2) sedate backlog growth (up 9.3%); no mention of potential large system opportunities, (3) strong cash balance of Rs450/share (we believe that this is built from accumulated retained earnings and not from creditors/customer advances) and (4) other income boosted by forex gains, withdrawal of provisions. Retain REDUCE.

Company data and valuation summary

Bharat Electronics

Stock data			
52-week range (Rs) (high,low)			2,252-1,362
Market Cap. (Rs bn)			138.1
Shareholding pattern (%)			
Promoters			75.9
FIIs			4.7
MFs			6.8
Price performance (%)	1M	3M	12M
Absolute	(1.3)	1.6	22.2
Rel. to BSE-30	(4.0)	(8.6)	5.0

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	96.1	105.9	120.3
EPS growth (%)	(7.4)	10.2	13.6
P/E (X)	18.0	16.3	14.3
Sales (Rs bn)	53.6	59.1	66.1
Net profits (Rs bn)	7.4	8.5	9.6
EBITDA (Rs bn)	10.6	11.4	12.9
EV/EBITDA (X)	9.7	8.8	7.4
ROE (%)	17.5	17.7	17.6
Div. Yield (%)	1.1	1.4	1.4

Sedate MoU target and order backlog growth; no mention of large system opportunities

The MoU revenue target for "Excellent" rating of Rs56.2 bn implies sedate yoy revenue growth of only 7.6% for FY2011E, marginally below our standalone revenue estimate of Rs57 bn. BEL just about met its FY2010 MoU target for "Excellent" rating of Rs52 bn—standalone revenues of Rs51.8 bn in FY2010. Furthermore, BEL reported a sedate backlog growth, up only about 9.3% to Rs113.5 bn at the end of FY2010 from Rs104 bn at the end of FY2009. The annual report also made no mention of potential strong system integration opportunities. BEL had won an order for two squadrons of Akash Missile for Air Force. We expected the company to win another order for six squadrons (worth Rs43 bn—not mentioned in annual report). We believe that the company may also win a large tactical communication systems order (potentially to be as big as Rs100 bn).

Strong cash of Rs450/share which we reckon has not come from creditors and customer advances

BEL reported FY2010-end strong cash balance of Rs35.8 bn, which implies a per share value of Rs450. The accumulated retained earnings of the company over the last five years suggest that BEL has invested cash in working capital. Hence the strong cash balance has not originated from creditors and/or customer advances. BEL generated strong operating cash flow of Rs10.6 bn in FY2010 primarily led by working capital improvement—improved to 5 days of sales versus 39 days at end-FY09 led by better collection from debtors due to more even spread of sales over the year.

Forex gains and provision withdrawals boost other income in FY2010

The strong increase in other income, up 64% yoy, to Rs3.7 bn in FY2010 from Rs2.3 bn was led by (1) Rs694 mn exchange gains in FY2010 which was not present in FY2009, (2) Rs835 mn of withdrawal of provisions (Rs359 mn in FY2009).

Revise estimates and target price to Rs1,800/share; reiterate REDUCE

We revise our estimates to Rs105.9 and Rs120.3 from Rs107.2 and Rs122.3 for FY2011E and FY2012E. Reiterate REDUCE with a revised TP of Rs1,800 (from Rs1,835) based on (1) potential long-term increase in competition, (2) lack of publicly available data points, (3) potential margin dilution based on shift to system integration orders and (4) infrequent investor communication.

QUICK NUMBERS

- Sedate MoU revenue target for "Excellent" rating of Rs56.2 bn for FY2011E—below our estimates
- Strong operating cash generation of Rs10.6 bn on back of working capital improvement
- Forex gains of Rs694 mn and provision withdrawals of Rs835 mn boost other income

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MoU target for "Excellent" rating below our estimates; highlight downside risk

The Memorandum of Understanding signed by BEL with the ministry of defense sets a FY2011E sales target of Rs53.5 bn for "Very Good" performance rating and Rs56.2 bn for "Excellent" performance rating. The target for "Excellent" rating is marginally below our standalone revenue estimate of Rs57 bn. Hence we believe that there could be a downside risk to our revenue estimates of FY2011E in case the company only manages to meet its "Excellent" rating level. We highlight that BEL only just about met its FY2010 MoU target of Rs52 bn for "Excellent" rating—reported standalone revenues of Rs51.8 bn in FY2010. The MoU target revenue for "Excellent" rating of Rs56.2 bn implies a sedate yoy revenue growth of only 7.6% for FY2011E at the standalone level.

Company target of Rs57 bn revenues in FY2011E

The BEL management had earlier guided for a revenue target of Rs57 bn in FY2011E which implies a growth of about 10% over FY2010 revenues. This would imply a revenue growth of about 11.8% on the remaining nine months in of FY2011E in order to meet the management guidance. We have built in standalone revenues of about Rs57 bn in FY2011E with an EBITDA margin of 17.7%. The company had an order backlog of Rs113.5 bn at the end of FY2010 which provides a revenue visibility of about two years based on FY2011E estimated revenues. Our full-year estimates imply a revenue growth of 11.9% in remaining 9MFY11E and EBITDA margin expansion of 230 bps to 19.3%—based on 1QFY11 performance.

BEL - remaining 9MFY11E implied key numbers (Rs mn)

	1QFY11	1QFY10	% change	Rem. 9MFY11E	Rem 9MFY10	% change	FY2011E	FY2010	% change
Net Sales	**9,242**	**9,106**	**1.5**	**47,800**	**42,699**	**11.9**	**57,042**	**51,804**	**10.1**
Total Expenditure	(8,325)	(8,189)	1.7	(38,596)	(35,451)	8.9	(46,921)	(43,640)	7.5
EBITDA	**917**	**916**	**0.1**	**9,204**	**7,248**	**27.0**	**10,121**	**8,164**	**24.0**
Other Income	514	437	17.5	2,789	3,327	(16.2)	3,303	3,764	(12.3)
Interest	—	(1)		(5)	(5)	18.8	(5)	(5)	—
Depreciation	(298)	(280)	6.4	(937)	(879)	6.6	(1,235)	(1,159)	6.5
PBT	**1,134**	**1,073**	**5.7**	**11,049**	**9,691**	**14.0**	**12,183**	**10,764**	**13.2**
Tax	(320)	(346)	(7.4)	(3,579)	(2,897)	23.5	(3,899)	(3,243)	20.2
PAT	**814**	**727**	**12.0**	**7,471**	**6,794**	**10.0**	**8,285**	**7,521**	**10.1**
Key ratios									
EBITDA margin	**9.9**	**10.1**		**19.3**	**17.0**		**17.7**	**15.8**	
Effective Tax Rate	28.2	32.2		32.4	30.9		32.0	31.0	
EPS	10.2	9.1		93.4	81.0		103.6	90.1	
PAT Margin	8.8	8.0		15.6	15.2		14.5	13.9	

Source: Company, Kotak Institutional Equities estimates

Sedate order backlog growth; no mention of expected large system orders

BEL reported a sedate order backlog growth of about 9.3% to Rs113.5 bn at the end of FY2010 from Rs104 bn at the end of FY2009. This was broadly in line with our estimates. The annual report highlights that out of the total backlog, orders worth about Rs44.8 bn are executable in FY2011E. The remaining backlog would get executed from FY2012E onwards. The management had earlier communicated its target of winning domestic orders to the tune of about Rs74-75 bn and about US$100 mn of international orders. This is likely to lead to a year-end order backlog of about Rs130 bn at end-FY2011E.

No mention of large systems integration opportunity; expect several large orders but may adversely impact margins and execution cycle

The annual report also made no mention of potential strong system integration orders. We believe that the company could win several large system integration orders in the near future which would help boost the backlog but orders would potentially be at lower margins. We believe that the nature of the business of BEL, based on incremental orders, is shifting to system integration opportunities versus manufacturing and supply business that BEL predominantly focuses upon. In such system integration orders, margins are likely to be significantly lower versus product manufacturing business. Timelines for execution are also expected to be longer (may be of the order of four to five years). Hence the company may have higher revenue growth incrementally but with potentially significantly lower margins. Some instances of the large system integration orders in the offing for BEL include:

- **Expect large tactical communication systems order—potentially could be as big as Rs100 bn:** The management has cited that BEL could win an order for tactical communication systems (TCS) from the Indian Army with a potential size of over Rs100 bn. The company has been developing this system for over a decade now which is a huge complex system involving very heavy investments already done by BEL and large number of research and development engineers working on it.

- **Incremental order for Akash Missile Induction:** BEL was already working on an order for two squadrons of Akash Missile for Air Force. The company has also likely won another order of Rs43 bn for six squadrons of Akash Missile for Air Force apart (not mentioned in the annual report). Usually when a system like Akash missile is inducted in the defense, it is inducted by all arms of Defense such as Navy, Army etc. In such a case it is possible that Bharat Electronics receives incremental orders for Akash Missile induction from Navy, Army etc. also.

Exchange gain and withdrawal of provisions boosts other income

BEL reported very strong other income of Rs3.7 bn in FY2010, up 64% yoy from Rs2.3 bn in FY2009. The strong other income in FY2010 was primarily boosted by (1) foreign exchange gain of Rs694 mn in FY2010 which was absent in FY2009, (2) Rs336 mn of withdrawal of provisions related to contingencies towards long-term contracts (was absent in FY2009) and (3) Rs447 mn of withdrawal of provisions related to doubtful debts etc. (versus Rs299 mn in FY2009).

Details of other income of BEL, March fiscal year-ends, 2009-10 (Rs mn)

	2010	2009
Sale of scrap & surplus stores	66	63
Export benefits	17	17
Interest income	1,773	1,700
Transport, rent & canteen receipts	85	33
Provisions withdrawn	**835**	**359**
Foreign exchange gain	**694**	**—**
Miscallaneous	228	136
Total other income	**3,699**	**2,308**

Source: Company

Value of production relatively flat despite 13% revenue growth

BEL reported a revenue growth of about 13% yoy in FY2010 to Rs51.8 bn from Rs45.8 bn in FY2009. However, we highlight that the value of production for BEL remained relatively flat (marginal decline) to Rs52.4 bn in FY2010. The strong value of production in FY2009 had led to a strong increase in work in progress (WIP) by about Rs6.5 bn versus relatively flat WIP in FY2010—recorded a marginal increase of about Rs281 mn. Part of this strong WIP at end-FY2009 would have helped drive the revenues of FY2010. Work-in-progress inventory at end-FY2010 has remained relatively flat at Rs9.8 bn versus end-FY2009 levels.

Standalone and consolidated income statement of Bharat Electronics, March fiscal year-ends, 2008-12E (Rs mn)

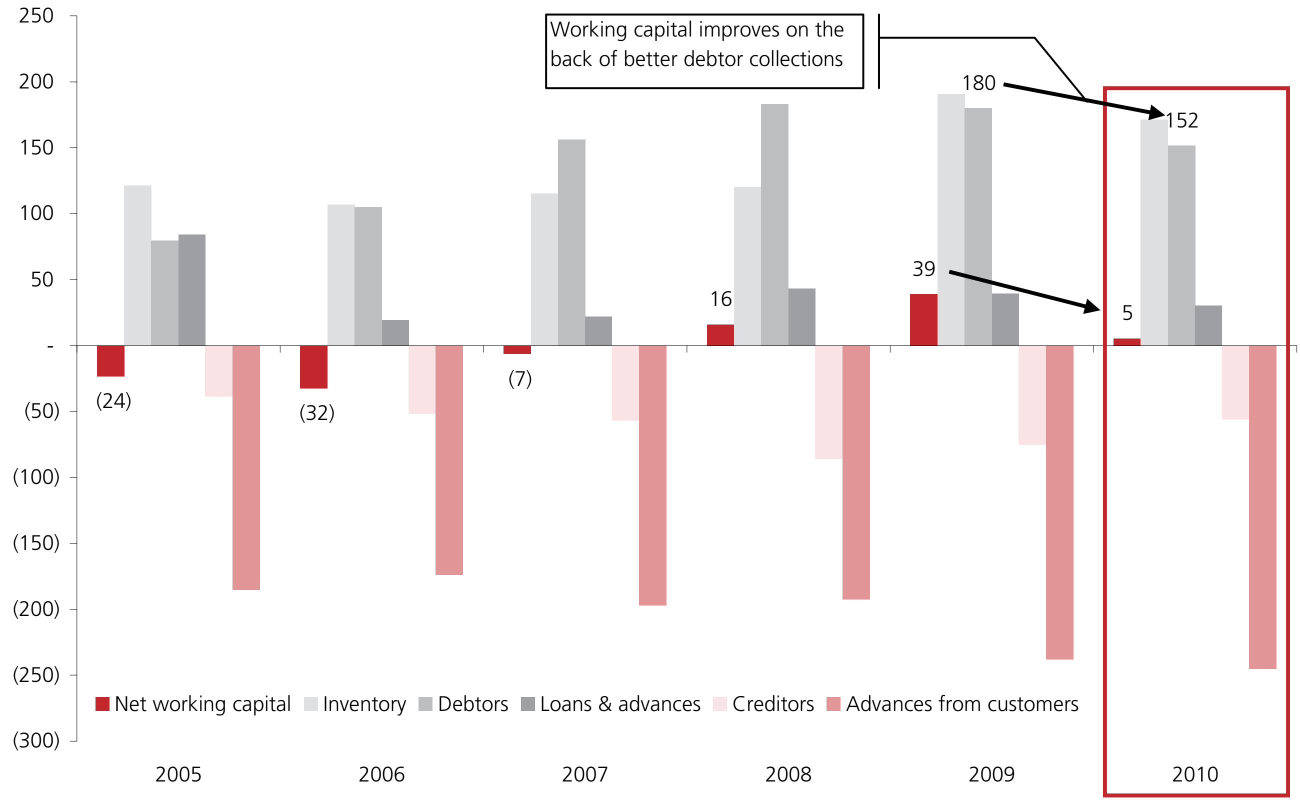
	Standalone					Consolidated				
				Yoy growth (%)					Yoy growth (%)	
	2008	2009	2010	2009	2010	2008	2009	2010	2009	2010
Value of production	**41,114**	**52,733**	**52,479**	**28.3**	**(0.5)**					
Net sales	**40,603**	**45,836**	**51,804**	**12.9**	**13.0**	**42,067**	**47,469**	**53,645**	**12.8**	**13.0**
Raw material consumed	(20,638)	(30,405)	(30,245)	47.3	(0.5)	(21,686)	(31,625)	(31,652)	45.8	0.1
Stock adjustment	88	**6,496**	**281**	7,259.1	(95.7)	21	6,505	296	30,652.3	(95.5)
Employee expenses	(6,592)	(7,558)	(10,096)	14.7	33.6	(6,658)	(7,632)	(10,176)	14.6	33.3
Other expenses	(3,414)	(3,757)	(3,578)	10.0	(4.8)	(3,529)	(3,955)	(3,692)	12.1	(6.7)
Total expenditure	**(30,556)**	**(35,224)**	**(43,638)**	**15.3**	**23.9**	**(31,852)**	**(36,708)**	**(45,224)**	**15.2**	**23.2**
EBITDA	**10,047**	**10,611**	**8,167**	**5.6**	**(23.0)**	**10,215**	**10,762**	**8,422**	**5.3**	**(21.7)**
Other income	2,389	2,296	3,764	(3.9)	64.0	2,456	2,348	3,831	(4.4)	63.1
Interest	(2)	(108)	(5)	4,295.3	(95.0)	(3)	(108)	(6)	3,493.6	(94.6)
Depreciation	(926)	(1,056)	(1,159)	14.0	9.8	(1,007)	(1,128)	(1,223)	12.0	8.4
PBT	**11,506**	**11,743**	**10,766**	**2.1**	**(8.3)**	**11,661**	**11,873**	**11,023**	**1.8**	**(7.2)**
Tax	(3,446)	(3,511)	(3,242)	1.9	(7.7)	(3,503)	(3,568)	(3,333)	1.8	(6.6)
PAT	**8,061**	**8,233**	**7,524**	**2.1**	**(8.6)**	**8,157**	**8,305**	**7,691**	**1.8**	**(7.4)**
Extraordinaries	207	(775)	(316)	(475.1)	(59.3)	216	(775)	(315)	(458.3)	(59.3)
Reported PAT	**8,267**	**7,458**	**7,209**	**(9.8)**	**(3.3)**	**8,373**	**7,530**	**7,376**	**(10.1)**	**(2.1)**

Source: Company, Kotak Institutional Equities

Strong operating cash generation on back of working capital reduction

Bharat Electronics reported very strong operating cash generation of Rs10.6 bn in FY2010 (versus Rs4 bn in FY2009) primarily led by working capital improvement. Working capital (excluding sales) has improved to five days of sales at the end of FY2010 versus 39 days at the end of FY2009. The improvement in working capital levels was primarily led by better collection from debtors—debtor days have declined to 152 days of sales versus FY2009-end level of 180 days. The company has attributed the better collection of debtors (both opening as well as FY2010 debtors) to more even flow of sales throughout the year. The company had focused on a more even distribution of sales over the four quarters in FY2010—the fourth quarter revenues contributed to about 35% of the full-year sales versus almost 60% of FY2009 sales recorded in the fourth quarter. Inventory levels have declined to 171 days of sales in FY2010 versus 191 days in FY2009. However, as days of value of production the inventory level has in fact increased marginally to 172 days from 169 days at end-FY2009.

Working capital improvement led by lower debtor levels
Standalone working capital (excl. cash) of BEL, March fiscal year-ends, 2005-10 (days of sales)



Source: Company, Kotak Institutional Equities

Even stronger cash position of Rs36 bn at end of FY2010—about Rs450/share

BEL reported a strong cash position of Rs35.8 bn at the end of FY2010 which implies a per share value of about Rs450 for BEL (BEL has negligible debt on its balance sheet). Cash levels of BEL increased by about Rs9.4 bn from Rs26.4 bn at the end of FY2009.

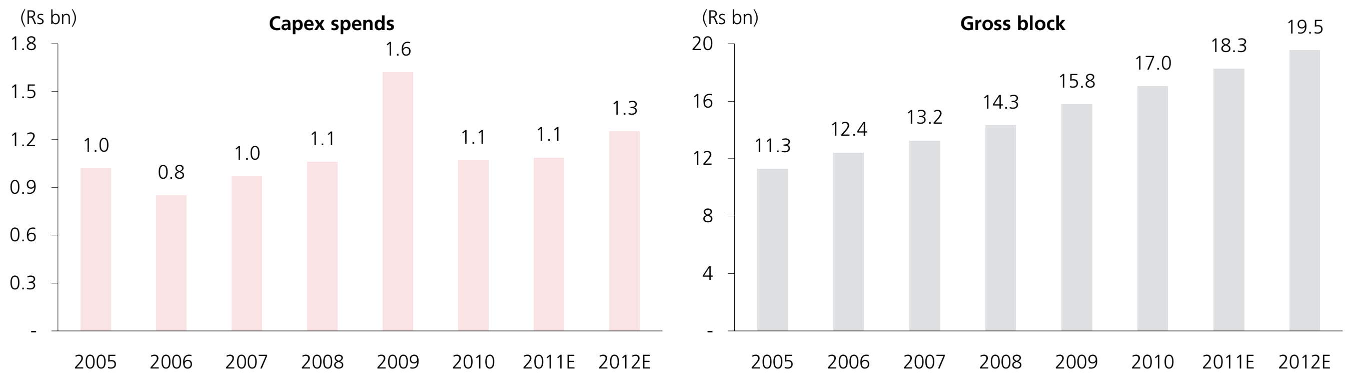
Standalone and consolidated balance sheet of Bharat Electronics, March fiscal year-ends, 2008-12E (Rs mn)

	Standalone					Consolidated				
	2008	2009	2010	2011E	2012E	2008	2009	2010	2011E	2012E
Share capital	800	800	800	800	800	800	800	800	800	800
Reserves & surplus	31,531	37,271	42,657	48,133	54,738	32,644	38,446	43,992	50,216	57,594
Total shareholders funds	**32,331**	**38,071**	**43,457**	**48,933**	**55,538**	**33,444**	**39,246**	**44,792**	**51,016**	**58,394**
Total debt	**14**	**12**	**7**	**—**	**—**	**21**	**18**	**13**	**—**	**—**
Total sources of funds	**32,345**	**38,083**	**43,464**	**48,933**	**55,538**	**33,465**	**39,265**	**44,805**	**51,016**	**58,394**
Gross block	14,308	15,799	17,022	18,272	19,522	15,173	16,710	17,988	19,238	20,488
Less: accum. depreciation	(10,173)	(11,124)	(12,122)	(13,357)	(14,680)	(10,803)	(11,824)	(12,881)	(14,203)	(15,613)
Net block	**4,135**	**4,675**	**4,900**	**4,914**	**4,842**	**4,370**	**4,886**	**5,107**	**5,035**	**4,875**
Capital work in progress	337	467	314	150	150	354	499	327	327	327
Investments	120	120	120	120	120	—	—	—	—	—
Cash and bank balances	24,535	**26,419**	**35,784**	38,503	44,246	24,616	26,577	35,867	37,374	42,742
Net current assets (excl. cash)	**1,794**	**4,936**	**779**	**3,678**	**4,613**	**2,700**	**5,822**	**1,920**	**6,696**	**8,866**
Deferred tax assets	1,424	1,466	1,567	1,567	1,567	1,425	1,480	1,583	1,583	1,583
Total application of funds	**32,345**	**38,083**	**43,464**	**48,933**	**55,538**	**33,465**	**39,265**	**44,805**	**51,016**	**58,394**

Source: Company, Kotak Institutional Equities estimates

The increase in cash flows was primarily led by strong operating cash flows of Rs10.6 bn in FY2010. The company utilized Rs1.2 bn in capital expenditure towards purchase of fixed assets, plus another Rs1.7 bn in dividend payments. We expect the company to maintain similar levels of capital expenditure going forward as well—expect capex of about Rs1.1-1.3 bn in each year over FY2011-12E.

Capex spends of BEL (standalone), March fiscal year-ends, 2005-12E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Legitimate cash generation; does not belong to creditors and/or customers

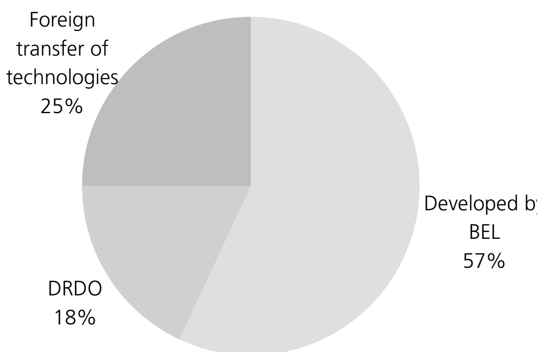
The accumulated retained earnings of the company over the last five years suggest that BEL has invested cash in working capital. Hence the strong cash balance has not originated from creditors and/or customer advances.

Other takeaways: majority revenues from in-house technology, several JVs in the offing

Majority of BEL's revenues originate from in-house technology

Majority of BEL's revenues (about 57%) originated from products developed by BEL itself. The company is likely to enhance emphasis on in-house technology development to lower dependence on foreign technologies due to likely incremental difficulty in acquiring the same. The turnover comprised of 57% from products developed by BEL, 18% from products developed by DRDO and the remaining 25% from foreign transfer of technologies.

Composition of BEL's turnover, March fiscal year-ends, 2010 (%)

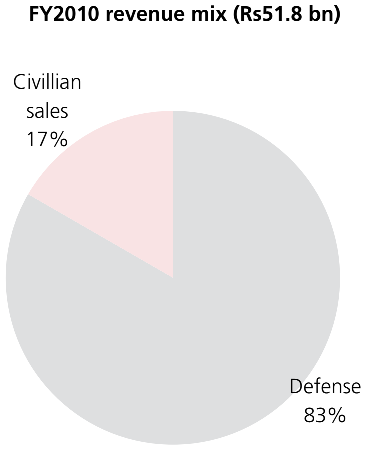


Source: Company

83% revenues from defense segment—expected to remain at similar levels

Supplies to the defense sector contributed to about 83.4% of the company's revenues, remaining from supplies to the civilian sector. Although the company would try to improve the share of the civilian/offset business in the total revenues of BEL, the management expects the defense: civilian mix of revenues to remain broadly at 80:20.

Revenue mix of BEL, March fiscal year-ends, 2010 (%)



Source: Company

Several JVs in the offing to explore new business opportunities

The company plans to diversify into newer businesses and technologies in order to counter the loss of market share to private players in its core defense segment. Several new initiatives taken during the year in this regards include (1) MoU with BHEL to form a JV for solar photovoltaic business, (2) MoU with Indus Teqsite, Chennai for setting up a JV for development of digital subsystems and test systems for radars, avionics, electronic warfare, etc. and (3) MoU with Thales International, France for setting up a JV for civilian and select defense radars.

Revise earnings estimates and target price to Rs1,800; reiterate REDUCE

We have marginally revised our estimates to Rs105.4 and Rs120 from Rs107.2 and Rs122.3 for FY2011E and FY2012E, respectively, and have correspondingly revised our 15X March-12E earnings based target price to Rs1,800/share from Rs1,835/share.

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

	New estimates		Old estimates		% revision	
Target price	**1,800**		**1,835**		**(1.9)**	
	FY2011E	**FY2012E**	**FY2011E**	**FY2012E**	**FY2011E**	**FY2012E**
Revenues	59,051	66,139	59,988	67,184	(1.6)	(1.6)
EBITDA	10,435	11,899	10,873	12,388	(4.0)	(3.9)
EBITDA margin (%)	17.7	18.0	18.1	18.4		
PAT	8,472	9,626	8,580	9,786	(1.3)	(1.6)
EPS (Rs)	**105.9**	**120.3**	**107.2**	**122.3**	**(1.3)**	**(1.6)**
Yoy growth (%)						
Revenues	10.1	12.0	11.6	12.0		
EBITDA	23.9	14.0	29.1	13.9		
PAT	14.9	13.6	14.3	14.1		
EPS (Rs)	14.9	13.6	14.3	14.1		

Source: Kotak Institutional Equities estimates

We reiterate our REDUCE rating on the stock based on (1) potential long-term increase in competition given that several firms may be awarded the Raksha Udyog Ratna status, (2) likelihood that BEL would miss large part of offset related upside as that may be dominated by private sector manufacturing and design companies such as L&T etc., (3) lack of publicly available data points/news flows to justify more optimism, (4) potential margin dilution led by higher proportion of order inflows/revenues from system integration orders and (5) infrequent investor communication and disclosures.

We maintain our view that as the economic outlook improves the stock is likely to underperform as its business is independent of business cycles and is more attractive when outlook on broad economy is weaker.

Key upside risks arise from (1) new initiatives in naval and nuclear areas, (2) non-defense/offset-related orders, (3) strong execution over the next few quarters and (4) better-than-expected margins.

Consolidated financials of Bharat Electronics, March fiscal year-ends, 2005-12E (Rs mn)

	2005	2006	2007	2008	2009	2010	2011E	2012E
Income statement								
Net Sales	**33,401**	**36,550**	**40,485**	**42,067**	**47,469**	**53,645**	**59,051**	**66,139**
Total Expenditure	(26,450)	(27,786)	(30,791)	(31,852)	(36,708)	(45,224)	(48,616)	(54,240)
Total RM consumption	(18,535)	(20,485)	(21,777)	(21,665)	(25,121)	(31,356)	(33,828)	(37,883)
Employee Expenses	(4,467)	(4,315)	(5,223)	(6,658)	(7,632)	(10,176)	(9,928)	(10,916)
Other Expenses	(3,448)	(2,986)	(3,791)	(3,529)	(3,955)	(3,692)	(4,861)	(5,440)
EBDITA	**6,950**	**8,764**	**9,694**	**10,215**	**10,762**	**8,422**	**10,435**	**11,899**
Other Income	1,206	1,178	1,978	2,456	2,348	3,831	3,369	3,691
Interest	(105)	(270)	(8)	(3)	(108)	(6)	(5)	(5)
Depreciation	(784)	(895)	(933)	(1,007)	(1,128)	(1,223)	(1,322)	(1,410)
Pretax profits	**7,267**	**8,777**	**10,731**	**11,661**	**11,873**	**11,023**	**12,476**	**14,175**
Tax	(2,410)	(2,759)	(3,398)	(3,503)	(3,568)	(3,333)	(4,002)	(4,547)
PAT	**4,857**	**6,017**	**7,333**	**8,157**	**8,305**	**7,691**	**8,474**	**9,628**
One-time items	(312)	(28)	(9)	216	(775)	(315)	—	—
Reported PAT	4,545	5,989	7,325	8,373	7,530	7,376	8,474	9,628
EPS	**60.7**	**75.2**	**91.7**	**104.7**	**94.1**	**92.2**	**105.9**	**120.3**
Balance sheet								
Total Shareholders Funds	**16,672**	**21,302**	**26,927**	**33,444**	**39,246**	**44,792**	**51,016**	**58,394**
Share Capital	800	800	800	800	800	800	800	800
Reserves & Surplus	15,872	20,502	26,127	32,644	38,446	43,992	50,216	57,594
Total Debt	**158**	**93**	**23**	**21**	**18**	**13**	**—**	**—**
Secured Loans	8	18	13	19	16	11	—	—
Unsecured Loans	149	75	11	2	2	2	—	—
Total Liabilities	**16,830**	**21,395**	**26,951**	**33,465**	**39,265**	**44,805**	**51,016**	**58,394**
Net Block	**3,576**	**4,038**	**4,139**	**4,370**	**4,886**	**5,107**	**5,035**	**4,875**
Capital Work in Progress	487	218	352	354	499	327	327	327
Cash and bank balance	13,487	18,577	20,931	24,616	26,577	35,867	37,374	42,742
Net Current Assets	**(1,927)**	**(2,706)**	**19**	**2,700**	**5,822**	**1,920**	**6,696**	**8,866**
Deferred Tax Assets	1,170	1,246	1,501	1,425	1,480	1,583	1,583	1,583
Total Assets	**16,830**	**21,395**	**26,951**	**33,465**	**39,265**	**44,805**	**51,016**	**58,394**

Source: Company, Kotak Institutional Equities estimates

kotak Institutional Equities

Tata Chemicals (TTCH)

Others

REDUCE

SEPTEMBER 07, 2010

UPDATE

Coverage view:

Price (Rs): 413

Target price (Rs): 370

BSE-30: 18,645

Annual Report highlights. Annual report analysis confirms 3 trends—(1) TCL's consumer/fertilizer business continues to be the key sales driver in FY2010 in volume terms with volumes up 6-15%, (2) soda ash price realizations down yoy in FY2010 across its three subsidiaries, price decline in India arrested due to re-imposition of duty till April 2011E, price in Europe to show yoy decline as seen in 1QFY11, and (3) EBITDA margin up 440 bps in FY2010 due to lower RM costs with all other costs remaining flat yoy due to cost control measures. However, increase in RM cost seen in 1QFY11 may limit margin upside in FY2011E. We revise FY2012E earnings/PT upwards by 3%. Retain REDUCE with PT at Rs370.

Company data and valuation summary

Tata Chemicals

Stock data			
52-week range (Rs) (high,low)			425-248
Market Cap. (Rs bn)			100.5
Shareholding pattern (%)			
Promoters			28.1
FIIs			12.8
MFs			8.9
Price performance (%)	**1M**	**3M**	**12M**
Absolute	16.1	31.4	62.6
Rel. to BSE-30	13.0	18.3	39.7

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	26.4	35.1	39.2
EPS growth (%)	(27.1)	32.9	11.7
P/E (X)	15.6	11.8	10.5
Sales (Rs bn)	94.5	108.1	116.0
Net profits (Rs bn)	6.4	8.5	9.5
EBITDA (Rs bn)	18.1	21.4	23.5
EV/EBITDA (X)	7.7	6.1	5.2
ROE (%)	16.0	19.6	18.9
Div. Yield (%)	2.2	2.3	2.3

Sales down 25% yoy in FY2010 due to dip in realizations of phosphatics and trading volumes

Overall sales at Rs95 bn was down 25% due to (1) 38% decline in fertilizer sales with sales of phosphatics, IMACID, trading sales declining due to a decline in price realization. However, except for decline in trading volumes, volumes of urea and phosphatics were up yoy, (2) global chemical sales down 8% yoy despite shutdown of Defzil plant, offset by 24% increase in sales of salt.

Analysis of vol./price trends reveals all businesses doing well; however, problems continue at BMGL

Analysis of volume/price trends confirms all businesses of TCL across fertilizers, chemicals, salt performed well in FY2010. However, problems at BMGL (20% of sales) continue led by (1) Magadi which registered 28% dip in sales in FY2010 on the back of flat sales volume and 27% decline in price realization due to oversupply of Chinese soda ash in Asian markets and (2) BMGL, UK which registered only a 6% dip in sales led by 13% price increase yoy. We expect price in Europe to show yoy decline as seen in 1QFY11 due to increased supply of natural soda ash into Europe. We do not think TCL can counter the price decline in Europe through lower-cost natural soda ash from Magadi due to trade barriers in place in Europe and higher freight cost.

EBITDA margin up 440 bps in FY10; RM cost rise seen in 1QFY11 may limit margin upside in FY11E

EBITDA margin at 18.4% was up 440 bps due to (1) lower RM (down 43% yoy) and power costs (down 24% yoy) due to lower production volumes in Europe and increase in usage of natural gas for urea. However, all other costs were largely constant due to strict cost control programs.
We think with RM costs increasing yoy in FY2011E as seen in 1QFY11 to 42%, margin upside in FY2011E may be limited, especially with trading volumes expected to increase yoy in FY2011E.

We revise FY2012E earnings/PT upwards by 3%. Retain REDUCE with PT at Rs370

We believe, at current levels, earnings upside is captured and reiterate REDUCE.

QUICK NUMBERS

- Analysis of vol./price trends reveals all businesses doing well; however, problems continue at BMGL
- We revise FY2012E earnings/PT upwards by 3%. Retain REDUCE with PT at Rs370

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FY2010— year of restructuring with Defzil plant shutdown and entry into pesticides with Rallis

FY2010 was a year of restructuring at TCL marked by two events

- Defzil plant shutdown—TCL shutdown its soda ash and sodium bicarbonate facility and incurred total restructuring cost of Rs900 mn and impairment cost of Rs349 mn towards the same in FY2010. TCL's BMGL UK capacity now stands at 1 mtpa, down 0.3 mtpa due to this closure. BMGL recorded 18% reduction in staff costs in FY2010 partly on account of this closure.

- Entry into pesticides with Rallis—Rallis became a subsidiary from Nov-2009 post acquisition of 5.3 mn shares at a cost of Rs4.6 bn in FY2010.

Total sales down 25% yoy in FY2010 due to dip in realizations of phosphatics and trading volumes

Overall sales at Rs95 bn was down 25% due to 38% decline in fertilizer sales with sales of phosphatics, IMACID, trading sales declining due to a fall in price realization. However, except for decline in trading volumes, volumes of urea and phosphatics were up yoy.

- Trading volumes/sales of imported DAP/MOP dipped significantly as there was a delay in fixing the price/subsidy and as the company adopted a cautious approach towards imports during FY2010.

- Despite a shutdown of Haldia plant for 34 days over Feb-March 2010, TCL delivered an increase in phosphatics sales volume at 0.6 mtpa in FY2010, up 6% yoy.

- Customized fertilizer sales at Rs1.25 bn, was up 56% yoy.

Vol./price/sales inc/(Dec), FY2010, %

	% of sales	Volume	Price realisation	Sales	Comments
Fertiliser (incl IMACID)	**45**			**(38)**	
Urea	12	15	(16)	(3)	Realisations down due to cost savings being passed on
Phosphatics	15	6	(55)	(51)	Decline in price realisation
Chemical (Global)	**55**			**(8)**	
BMGL (UK)	14	(17)	13	(6)	Volume decline on account of closure of Defzil and 9% lower production in UK; price increase in FY2010 being reversed now
BMGL (Africa)	5	(2)	(27)	(28)	Price realisation decline due to chinese oversupply in Asia
GCIP (USA)	18	(2)	(3)	(2)	Export volumes recovered in 2HFY10
India soda ash	10	1	(12)	(11)	Chinese imports affected price realisations in 1HFY10, price stabilised in 2HFY10 due to effect of duty
Salt	7	13	12	24	Increase in market share
Total				**(25)**	

Source: Kotak Institutional Equities estimates, Company

Global chemical sales down 8% yoy despite shutdown of Defzil plant and problems at Magadi continue

Global chemical sales were driven by a decline in soda ash sales in all geographies, offset by 24% increase in sales of branded salt to Rs6.6 bn.

- Soda ash sales in GCIP were down 2% yoy despite steep decline in export volumes in 1HFY10. Sales volume and price realization declined 2% yoy as recovery in key export market of Latin America took place in 2HFY10, making up for the poor volumes in 1HFY10.

- Soda ash sales in BMGL declined 12% yoy due to (1) 28% decline in Magadi sales on account of drop in price realizations even though sales volumes remained flat yoy, (2) 17% dip in sales volumes at BMGL UK on account of closure of Defzil plant and 9% lower production at UK plant.

- Soda ash sales in India declined 11% yoy despite flat volumes due to 12% drop in sales realizations on account of (1) cheaper Chinese soda ash imports in 1HFY10 which was arrested due to imposition of safeguard duty in April 2009, (2) higher-than-proportionate reduction in output prices as compared to decline in raw material. TCL expects this trend to continue in the near term. However, with the re-imposition of safeguard duty we expect any further sales decline to be minimal.

- Sales of branded salt increased 24% due to (1) 13% increase in sales volumes to 0.75 mtpa from 0.6 mtpa and (2) 12% increase in price realization.

EBITDA margin up 440 bps primarily due to lower RM costs with all other costs remaining same yoy

EBITDA margin at 18.4% was up 440 bps due to lower RM (down 43% yoy) and power costs (down 24% yoy).

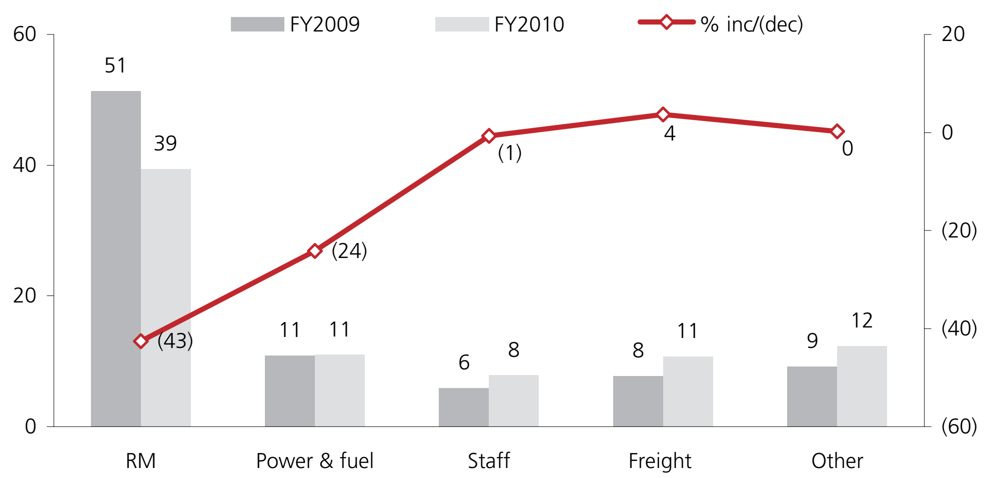
- Power and fuel costs declined by 24% yoy due to lower production volumes in Europe and increase in usage of natural gas compared to naphtha for urea operations. Babrala plant reduced its energy consumption to 5.17gcal/mt against 5.33 in FY2009.

However, all other costs were largely constant due to strict cost control programs put in place during the year.

- Personnel cost excluding the actuarial losses of Rs1.15 bn on account of pension liabilities in FY2009 were constant yoy. In FY2010, these costs have been accounted in reserves. Had the practice of recognizing the actuarial losses of pension plans of the overseas subsidiaries in the P&L been followed, consolidated PBT in FY2010 would have been lower by Rs2.5 bn. Personnel costs declined in BMGL and GCIP while they increased in Indian operations on account of wage increases.

- Freight and forwarding charges were up 4% yoy due to an increase in freight rates while other costs remained constant.

Break-up of costs, FY2009-10, %



Source: Kotak Institutional Equities estimates, Company

However, increase in RM cost as seen in 1QFY11 may limit margin upside in FY2011E

We think with RM costs increasing yoy in FY2011E as seen in 1QFY11 to 42%, margin upside in FY2011E may be limited. We estimate margin at 19.7% in FY2011E, up 130 bps yoy and think any further increase in RM cost may pose a risk to our margin assumptions.

Break-up of costs, FY2009-1QFY11, % of sales

	FY2009	FY2010	% inc/(dec)	1QFY11
RM	51	39	(43)	42
Power & fuel	11	11	(24)	10
Staff	6	8	(1)	8
Freight	8	11	4	10
Other	9	12	0	9

Source: Kotak Institutional Equities estimates

Total debt declines by Rs13 bn to net D/E of 0.8X due to scheduled repayments of Rs18 bn with additional rupee debt of Rs5 bn raised during FY2010

- Total outstanding FCCB debt of US$43 mn was either converted (US$42.7 converted resulting in increase in shares issued of 8 mn) and balance US$1 mn was redeemed on February 1, 2010.
- TCL repaid long-term debt outstanding to the tune of US$50 mn on books of BMGL.
- During FY2010, TCL raised additional rupee debt of Rs4 bn—(1)10.4% NCD of Rs2.5 bn to be repaid after 10 years and (2) 7.4% NCD of Rs1.5 bn to be repaid on November 23, 2011.
- TCL raised foreign currency debt of Rs1.12 bn to be repaid at end of two years.
- Fertilizer bonds of Rs5 bn were sold during FY2010 realizing a gain of Rs63 mn.

Total debt details, FY2009-10, Rs mn

	FY2009	FY2010
Term loans	20,853	15,989
FCCB	2,227	
Buyer's credit	7,496	
ECB	23,555	21,099
Others	6,308	5,328
Total debt repaid	**60,438**	**42,415**
Debentures	2,400	6,400
FCNR		1,123
Total debt raised	**2,400**	**7,523**
Total debt	**62,838**	**49,937**
Cash	9,899	11,589
Fertiliser bonds	4,469	
Investments in MF	365	1,982
Net debt	**48,106**	**36,366**

Source: Kotak Institutional Equities estimates, Company

TCL—abridged profit model, balance sheet, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Profit model						
Net revenues	**57,538**	**59,757**	**126,520**	**94,485**	**108,120**	**116,000**
EBITDA	**9,438**	**9,277**	**18,811**	**17,421**	**21,311**	**22,480**
EBITDA margin (%)	16.4	15.5	14.9	18.4	19.7	19.4
Other income	1,726	6,909	883	681	91	1,000
Depreciation	2,739	3,138	4,226	4,468	4,600	4,800
Net finance cost	944	1,289	3,953	3,932	3,339	2,900
PBT	**7,481**	**11,759**	**11,515**	**9,703**	**13,463**	**15,780**
Tax	2,401	2,115	1,575	2,093	3,515	4,734
(Profit)/loss in minority interest	—	—	(1,117)	(1,177)	(1,400)	(1,500)
Restructuring costs			(2,342)	(374)		
Reported net profit	**5,080**	**9,644**	**6,481**	**6,059**	**8,547**	**9,546**
Balance sheet						
Total equity	25,718	37,185	47,698	47,164	54,407	62,749
Total debt	18,642	48,505	62,838	49,937	40,398	29,483
Minority interests	—	—	1,522	3,501	4,901	6,401
Net Deferred tax liabilities	2,511	2,837	216	182	182	182
Total liabiilities and equity	**46,871**	**88,526**	**112,273**	**100,784**	**99,887**	**98,814**
Net fixed assets incl CWIP	30,561	33,712	39,959	38,389	36,789	34,989
Goodwill on consolidation	7,632	46,492	56,213	53,247	53,247	53,247
Investments	7,753	4,174	4,229	5,577	5,577	5,577
Net current assets	(619)	(2,620)	1,975	(8,017)	(7,314)	(6,587)
Cash	1,545	6,767	9,899	11,589	11,589	11,589
Total assets	**46,871**	**88,526**	**112,273**	**100,784**	**99,887**	**98,814**
Ratios						
Diluted EPS (Rs)	20.9	39.6	36.3	26.4	35.1	39.2
ROE (%)	21.2	30.7	23.4	16.0	19.6	18.9
Debt/equity (%)	72.5	130.4	131.7	105.9	74.3	47.0

Source: Kotak Institutional Equities estimates, Company

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The past is certain, the future less so but does anybody care anymore? We do not rule out a 30-40% correction in the stock prices of Indian gas transmission and distribution (T&D) companies. The stocks are trading well above our 12-month target prices on expectations of continued regulatory lacunae and oversight. As history has shown, wild expectations often get belied although it may take months (or even years) for Street expectations to align to levels dictated by fundamentals.

Street expectations on Indian gas T&D companies largely based on hope, in our view

We find Street expectations about Indian gas T&D companies fairly exaggerated. The same holds for Street expectations about large LNG imports at high re-gasification tariffs in the future that support PLNG's current rich valuations. The regulator's lackadaisical approach to implementing its own regulations has perhaps led to Street expectations that the regulator will continue to allow Indian gas T&D companies to earn returns well above regulated levels.

Why have regulations when nobody cares about them?

Almost all Indian T&D companies earn returns that are well above the stipulated returns fixed by the regulator. A few investors have argued that the regulator may allow companies to earn super-normal returns (as is the case currently) so as to develop infrastructure in India. We find these arguments and investor concerns about infrastructure development in India rather self-serving.

History shows that nobody knows until it's all over

We have no idea about if and when the regulator will follow its regulations and decide on tariffs that are in consonance with regulations. Similarly, we do not know if there will be further gas discoveries in India. We make the limited point that investors should not base investment decisions on unknown factors. We highlight unrealistic expectations surrounding RIL stock price in late 2007 to stress the point that Street expectations can get very wild at times. Also, many of the same stocks had gone through a phase of 'irrational expectations' in late 2007, early 2008 before collapsing to 50% of their then peak levels.

Margin for safety is quite low in any case, so why take so much risk?

We note that GSPL and PLNG among our covered stocks are trading at EV/GCI of 1.8X and 2.9X based on FY2011E data. We find these quite absurd in the context of regulated and/or tolling nature of the businesses. The stocks are factoring in (1) strong volume growth over the next few years and (2) 'high' tariffs. We see downside risks to both these assumptions. We do not cover Gujarat Gas (GGAS) and Indraprastha Gas (IGL) but note that these companies enjoy returns that can only arise from exploitation of their monopoly positions in their key markets. We retain SELL rating on GSPL and change rating on PLNG to SELL from REDUCE.

Gas companies are quite expensive even on inflated earnings

Price/earnings and EV/EBITDA, March fiscal year-ends, 2010-13E (X)

	P/E (X)				EV/EBITDA (X)			
	2010	2011E	2012E	2013E	2010E	2011E	2012E	2013E
GAIL	18.8	17.1	11.6	10.3	11.8	11.7	9.2	7.7
Gujarat Gas	22.0	19.3	18.2	NA	13.4	11.7	10.6	NA
Gujarat State Petronet	16.5	16.9	15.1	13.5	8.4	8.3	7.0	6.3
Indraprastha Gas Ltd	22.7	19.3	16.5	14.7	12.3	9.7	8.2	7.2
Petronet LNG	21.1	17.5	14.4	13.3	12.7	10.7	9.4	8.5

Source: Bloomberg consensus for GGAS and IGL, Kotak Institutional Equities estimates

QUICK NUMBERS

- EV/GCI of 1.8X and 2.9X (FY2011E basis) for GSPL and PLNG quite absurd
- GSPL: Best-case fair valuation, ₹123, worst-case, ₹60
- PLNG: FY2011E CROCI of 20% already quite high; no rationale for further increases

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Super-normal returns for the major Indian gas T&D companies

Exhibit 1 shows that almost all the Indian gas T&D companies (we include PLNG also in this for the sake of completeness) earned very high financial returns in FY2010, whether measured by ROACE, ROAE or CROCI. In our view, CROCI is the purest measure of financial returns of a company and we focus largely on it; ROACE and ROAE also depend on accounting policies. Current regulations allow Indian transmission companies to earn 12% post-tax project IRR and Indian distribution companies to earn 14% post-tax project IRR. The financial returns of the Indian companies as measured by CROCI suggest that they are earning returns that are well above stipulated levels.

Financial returns earned by gas companies exceed the regulated return
Trends of returns in natural gas sector companies, March fiscal year-ends, 2006-10 (%)

	2006	2007	2008	2009	2010
ROACE					
GAIL	20	16	18	17	17
GAIL gas transmission segment	44	34	23	18	19
Gujarat Gas	25	20	29	23	22
Gujarat State Petronet	10	10	8	9	19
Indraprastha Gas	27	30	32	26	28
Petronet LNG	12	14	17	15	11
ROAE					
GAIL	22	21	19	18	18
Gujarat Gas	26	21	29	23	22
Gujarat State Petronet	7	9	9	10	27
Indraprastha Gas	28	30	32	26	28
Petronet LNG	20	24	28	25	17
CROCI					
GAIL	20	15	17	16	20
Gujarat Gas	24	20	32	27	30
Gujarat State Petronet	16	11	17	14	23
Indraprastha Gas	31	35	37	30	28
Petronet LNG	17	22	32	29	18

Note:
(a) Data for Gujarat Gas is calendar year-ending.

Source: Company, Kotak Institutional Equities estimates

The regulator has been quite lackadaisical in deciding on transmission tariffs for the companies. The regulations are effective November 20, 2008. As of now, it has fixed the tariffs of two pipelines of GAIL and a cross-country pipeline of Reliance Gas Transportation Infrastructure Ltd. Furthermore, in our view, it has miscalculated the tariffs for GAIL's extant HVJ system with the result that GAIL's pre-tax IRR as per our computation exceeds 50% compared to the then stipulated 18.2% (now 18%). Exhibit 2 shows our computations for GAIL's HVJ pipeline based on the data shared by the regulator in its tariff order. We would suggest a review of the workings of the regulator.

IRR calculation for extant HVJ-DVPL pipeline (Rs mn)

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Capex	(36,030)													
Volumes (mcm/d)	57	57	57	57	57	57	57	57	57	57	57	57	57	57
Revenues	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781	18,781
Opex (15% of capex)	(5,405)	(5,648)	(5,902)	(6,167)	(6,445)	(6,735)	(7,038)	(7,355)	(7,686)	(8,032)	(8,393)	(8,771)	(9,165)	(9,578)
EBITDA	**13,376**	**13,133**	**12,879**	**12,613**	**12,336**	**12,046**	**11,743**	**11,426**	**11,095**	**10,749**	**10,388**	**10,010**	**9,615**	**9,203**
FCF	**(22,654)**	**13,133**	**12,879**	**12,613**	**12,336**	**12,046**	**11,743**	**11,426**	**11,095**	**10,749**	**10,388**	**10,010**	**9,615**	**9,203**
DCF	(19,203)	9,437	7,845	6,513	5,399	4,469	3,693	3,046	2,507	2,059	1,687	1,378	1,122	910
NPV	30,862													
Inflation (%)	4.5													
Target pre-tax IRR (%)	17.97													
Target tariff (Rs/cu m)	0.92													
Computed IRR (%)	**55.67**													

Source: Company, Kotak Institutional Equities estimates

It seems to us that the Indian consumer is paying a high price for regulatory oversight and the lack of a proper market-based pricing system in India. None of the T&D companies face any real risk in their businesses given (1) natural monopoly of pipelines, (2) assured market and (3) regulated returns. It is indeed a travesty that the producer of gas in India, who bears the maximum risk in the value chain, receives lower-than-market prices (until recently not even earned a positive return on investment) while other players in the value chain are earning super-normal returns in businesses that entail low investment risk.

Regulator's benign approach may have led to heighted expectations for GSPL; RIL's production problems for PLNG

We believe that GSPL and PLNG stocks are factoring in current favorable conditions continuing in perpetuity or unrealistic expectations about volumes and/or pricing. We discuss the two stocks in more detail below.

- **GSPL.** Exhibit 3 shows our price (transmission tariff) and volume assumptions for GSPL over the next 10 years. As can be seen, we model a strong growth in transmission volumes over the next few years despite recent Street concerns about availability of domestic gas in India; it is another matter that a section of the Street is even willing to give value for pipelines that are yet to be bid by GSPL. We model a moderate decline in tariffs to align long-term returns with regulated levels. Our 12-month fair valuation for GSPL stock is Rs83 under our base-case assumptions.

CROCI and Pre-tax ROCE, March fiscal year-ends, 2011-21E (%)

	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Transmission tariffs (Rs/cu m)	0.75	0.71	0.65	0.60	0.57	0.57	0.57	0.57	0.57	0.57	0.57
Gas volumes (mcm/d)	38.8	47.1	53.6	57.6	59.6	62.6	62.6	62.6	62.6	62.6	62.6
CROCI	18.2	18.0	18.1	17.6	17.0	17.4	17.0	16.7	16.3	16.0	14.6
Pre-tax ROCE	22.2	23.0	25.8	28.4	30.8	35.3	37.0	38.9	41.1	43.7	54.6

Source: Kotak Institutional Equities estimates

We estimate GSPL's 12-month fair valuation at ₹123 if we assume GSPL's current tariffs remain in perpetuity as shown in Exhibit 4. However, this results in average CROCI of 21.7% over the next 10 years, well ahead of regulated returns. Our 12-month DCF-valuation drops to ₹60 if we assume a transmission tariff of ₹0.5/cu m in perpetuity although average CROCI for the forecast period is 14%, a respectable figure in the context of the stipulated regulated returns.

GSPL's valuation is highly sensitive to tariff assumptions
DCF valuation, CROCI and ROCE at various levels of average tariff, 2011-21E

Average tariff (Rs/cu m)	Valuation (Rs/share)	CROCI (%)	ROCE (%)	Comments
0.77	**123**	**21.7**	**48.7**	**1QFY11 tariffs in perpetuity**
0.70	106	19.7	42.7	
0.61	**83**	**17.0**	**33.0**	**Base case**
0.55	73	15.6	29.9	
0.50	**60**	**14.0**	**25.0**	**Likely regulated CROCI**
Assuming flat volumes from FY2011E onwards				
0.61	41	11.9	15.7	
0.72	**58**	**14.0**	**23.1**	**Likely regulated CROCI**

Source: Kotak Institutional Equities estimates

- **PLNG.** An increase in market capitalization of ₹23.7 bn (+38.4%) over the past 50 days (since RIL's 2QFY10 results and confirmation of likely delay in ramp-up in gas production in its key KG D-6 block) would suggest that the Street now expects that (1) India will not see major gas discoveries in the future and/or (2) PLNG would be in a position to increase its tariffs in perpetuity.

  On the assumptions of large LNG imports in India, we question the use of imported LNG as a substitute for domestic gas for power generation even assuming that there are no significant gas discoveries in the future. Imported coal (even if domestic coal is not sufficient) is a far better option versus imported LNG (see Exhibit 5) and we doubt that any power generator would set up a power plant on imported LNG without some form of subsidy from the state or central government.

Gas above US$7/mn BTU (delivered) may not be competitive for the power sector
Comparative cost of power generation using various fuels

	Naphtha (a)	Gas (b)	Coal (d)	Gas (c)	Coal (e)	Coal (f)
Unit	Kg	m3	Kg	m3	Kg	Kg
Fuel price (Rs/unit)	**28.4**	**6.0**	**1.0**	**12.0**	**1.8**	**4.6**
Calorific value (Kcal/unit)	10,500	9,000	3,500	9,000	3,500	6,500
Thermal efficiency (%)	54	54	37	54	37	37
Thermal requirement (kcal/kwh)	1,593	1,593	2,324	1,593	2,324	2,324
Cost of generation (Rs/Kwh)	**4.31**	**1.07**	**0.63**	**2.13**	**1.20**	**1.64**
Other operating costs (Rs/Kwh)	**0.16**	**0.16**	**0.20**	**0.16**	**0.20**	**0.20**
Plant load factor (%)	85	85	85	85	85	85
Fixed capital investment (Rs mn/MW)	30	30	45	30	45	45
Depreciation charge (%)	5.5	5.5	4.8	5.5	4.8	4.8
Depreciation charge (Rs/Kwh)	0.22	0.22	0.29	0.22	0.29	0.29
Fixed capital charge (%)	15.5	15.5	15.5	15.5	15.5	15.5
Fixed capital charge (Rs/Kwh)	0.62	0.62	0.94	0.62	0.94	0.94
Total cost (Rs/Kwh)	**5.31**	**2.07**	**2.06**	**3.14**	**2.62**	**3.07**

Note:
(a) Naphtha price for the period Apr'09-Mar'10.
(b) Gas price at US$3.5/mn BTU (delivered).
(c) Gas price at US$7/mn BTU (delivered).
(d) Domestic coal at pithead.
(e) Domestic coal 1,000 kms from pithead.
(f) Current price for imported coal at coastal plant.

Source: Kotak Institutional Equities estimates

PLNG has a rather peculiar arrangement with its marketing companies regarding re-gasification tariffs. It has increased re-gasification tariffs by 5% per annum since inception. We compute that PLNG's CROCI was 23.5% in FY2006-10 and 17.7% in FY2010 (see Exhibit 6); we note that the CROCI for FY2010 was pulled down by capex incurred for the expansion of Dahej terminal without the corresponding benefit of full capacity utilization.

PLNG earns very high CROCI; FY2010's CROCI was pulled down because of Dahej expansion
Trends of returns for Petronet LNG, March fiscal year-ends, 2006-10 (%)

	2006	2007	2008	2009	2010
CROCI	17.3	21.9	32.0	28.5	17.7
ROAE	19.5	23.6	27.8	25.0	16.8
ROACE	11.9	14.5	17.0	14.7	11.0

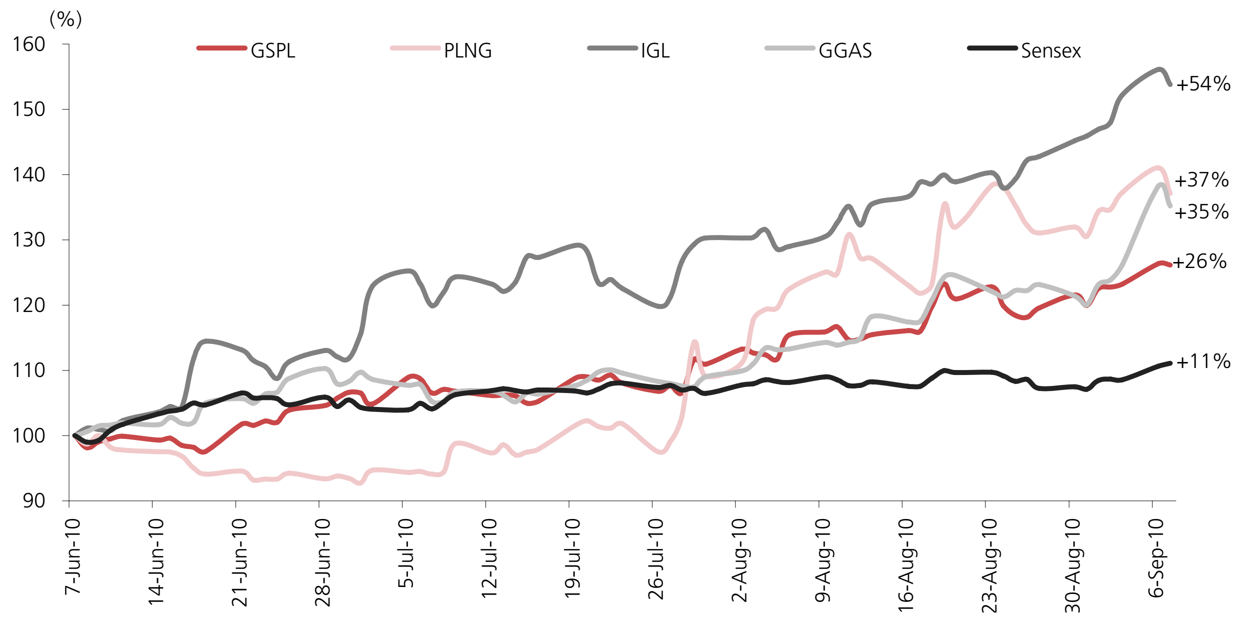
Source: Kotak Institutional Equities estimates

We are not sure about the basis of the annual increase in re-gasification tariff allowed by the marketing companies (incidentally PLNG's major shareholders) since PLNG anyway seems to be earning returns that would not be possible in a proper market.

Historical experience suggests stocks can get quite grossly over-valued or under-valued at times

We focus on overvaluation in the stocks at the current juncture given the sharp run-up in the stock prices over the past few months (see Exhibit 7). Exhibit 8 shows the EV/GCI of GSPL and PLNG and other valuation parameters. In our view, P/E and EV/EBITDA are meaningless without sustainable earnings for an extended period of time. We would draw investors' attention to EV/GCI, which is the best measure for regulated businesses or low-risk, asset-heavy commodity businesses, essentially cost-of-capital businesses. Such businesses should trade close to their book value or GCI if the regulated return is not very different from the prevailing cost of capital.

Smaller gas transmission and distribution companies have been re-rated in past three months
Stock performance (%)



Source: Bloomberg, Kotak Institutional Equities

Gas stocks are quite richly valued on EV/GCI
EV/GCI, Price/earnings and EV/EBITDA, March fiscal year-ends, 2010-12E (X)

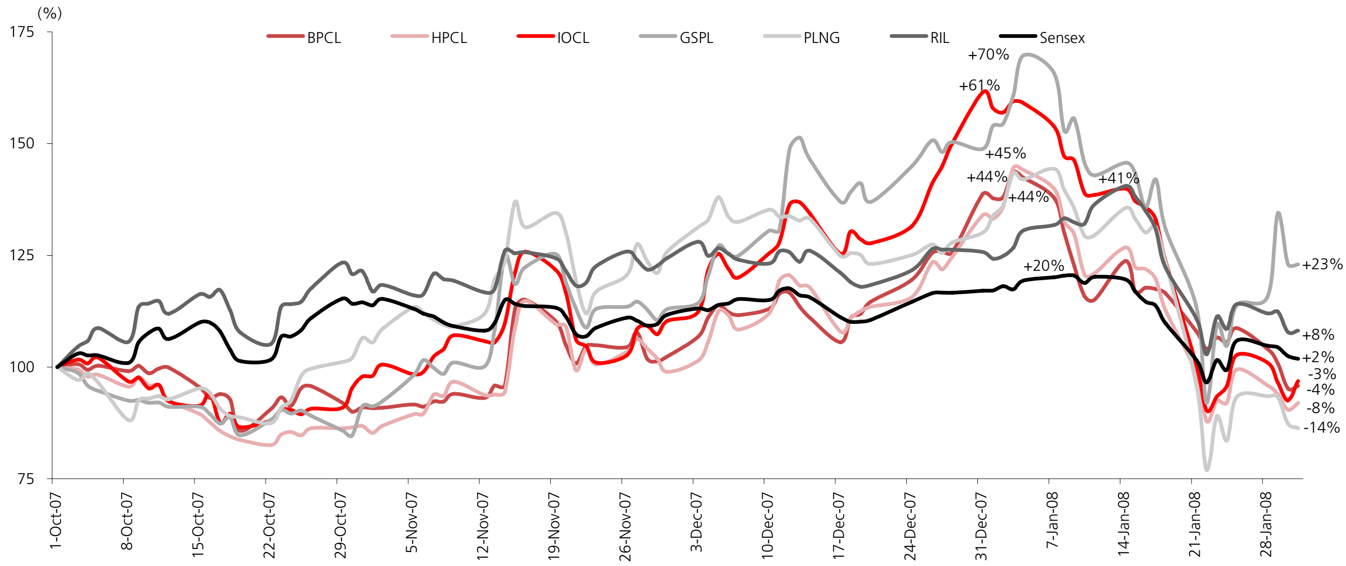
	EV/GCI (X)			P/E (X)			EV/EBITDA (X)		
	2010E	2011E	2012E	2010	2011E	2012E	2010E	2011E	2012E
Gujarat State Petronet	2.6	1.8	1.6	16.5	16.9	15.1	8.4	8.3	7.0
Petronet LNG	3.0	2.9	2.8	21.1	17.5	14.4	12.7	10.7	9.4

Source: Kotak Institutional Equities estimates

GSPL and PLNG are trading at 1.8X and 2.9X FY2011E GCI. We find this completely absurd for (1) GSPL, a pipeline company that is supposed to earn 12% post-tax return on capital and for (2) PLNG, an LNG importer, which essentially earns tolling charges on imported LNG and does not bear any risk regarding the price of the product it is selling.

As history has shown, investment sentiment can get wild at times to the extent that investors start ignoring the basic tenets of investment—(1) don't value things that don't exist and (2) don't value earnings that are not sustainable. It doesn't look like investors have learnt much from the bitter experience of 2HCY07 and early CY2008. Exhibit 9 shows the sharp jump in the prices of energy stocks during this period without any real change in their fundamentals and their subsequent collapse after that when the unrealistic expectations in the stocks were belied later. We do not rule out a similar experience—it is a matter of time.

Energy stocks corrected sharply after the run-up in end-CY2008
Stock performance, Oct-2007 to Jan-2008 (%)



Source: Bloomberg, Kotak Institutional Equities

GSPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2007-14E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	3,176	4,179	4,875	10,009	10,666	12,155	12,623	12,578
EBITDA	**2,677**	**3,645**	**4,249**	**9,414**	**9,861**	**11,259**	**11,650**	**11,549**
Other income	175	294	243	159	284	263	263	262
Interest	(457)	(815)	(870)	(938)	(1,148)	(1,227)	(814)	(349)
Depreciation	(1,026)	(1,632)	(1,705)	(2,365)	(2,961)	(3,531)	(3,519)	(3,511)
Pretax profits	1,369	1,491	1,918	6,269	6,036	6,764	7,580	7,952
Contribution towards GSEDS	—	—	—	—	—	—	—	—
Tax	(70)	(389)	(536)	(1,870)	(1,342)	(2,236)	(2,672)	(2,936)
Deferred taxation	(409)	(82)	(145)	(261)	(663)	(11)	154	294
Net profits	**894**	**999**	**1,234**	**4,138**	**4,031**	**4,517**	**5,062**	**5,310**
Earnings per share (Rs)	**1.6**	**1.8**	**2.2**	**7.4**	**7.2**	**8.0**	**9.0**	**9.4**
Balance sheet (Rs mn)								
Total equity	9,659	11,410	12,152	15,637	18,489	20,899	23,010	24,605
Deferred tax liability	917	999	1,144	1,405	2,068	2,079	1,925	1,631
Total borrowings	8,638	9,660	11,509	12,595	14,665	11,165	5,965	1,365
Currrent liabilities	1,845	5,106	5,331	8,334	3,165	1,041	1,041	1,042
Total liabilities and equity	**21,059**	**27,175**	**30,137**	**37,972**	**38,387**	**35,184**	**31,941**	**28,642**
Cash	1,811	2,569	975	1,740	1,057	1,052	1,051	1,016
Current assets	2,126	2,928	4,641	5,808	5,647	5,730	5,756	5,754
Total fixed assets	17,029	21,259	24,132	29,755	31,014	27,733	24,465	21,204
Investments	—	356	356	666	666	666	666	666
Deferred expenditure	93	63	33	3	3	3	3	3
Total assets	**21,059**	**27,175**	**30,137**	**37,972**	**38,387**	**35,184**	**31,941**	**28,642**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	2,212	2,743	2,918	6,435	7,227	7,796	8,163	8,265
Working capital changes	(1,058)	2,460	(1,752)	1,836	(5,009)	(2,207)	(25)	3
Capital expenditure	(4,404)	(5,863)	(4,579)	(7,787)	(4,076)	(250)	(250)	(250)
Investments	—	(356)	—	(310)	—	—	—	—
Other income	146	—	297	159	284	263	263	262
Free cash flow	**(3,103)**	**(659)**	**(3,116)**	**642**	**(1,574)**	**5,602**	**8,151**	**8,280**
Ratios (%)								
Debt/equity	81.7	77.9	86.6	73.9	71.3	48.6	23.9	5.2
Net debt/equity	45.0	43.8	46.4	42.5	41.6	32.7	19.3	4.9
RoAE	8.8	8.8	9.6	27.3	21.4	20.8	21.1	20.8
RoACE	**10.0**	**8.2**	**8.6**	**18.6**	**17.2**	**15.4**	**16.7**	**17.9**
CROCI	**13.5**	**16.9**	**14.8**	**23.6**	**18.2**	**18.0**	**18.1**	**17.6**
Key assumptions								
Volumes-old pipelines (mcm/d)	12.6	12.7	11.1	13.8	14.0	15.0	17.0	20.0
Volumes-new pipelines (mcm/d)	1.7	4.1	3.8	18.2	24.8	32.1	36.6	37.6
Volumes (mcm/d)	**14.3**	**16.8**	**14.9**	**32.0**	**38.8**	**47.1**	**53.6**	**57.6**
Average tariff (Rs/cu m)	**0.61**	**0.67**	**0.83**	**0.86**	**0.75**	**0.71**	**0.65**	**0.60**

Source: Company, Kotak Institutional Equities estimates

Petronet LNG: Profit model, balance sheet, cash model March fiscal year-ends, 2007-2014E (Rs mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	55,090	65,553	84,287	106,491	122,381	154,171	189,218	228,570
EBITDA	**6,481**	**8,661**	**9,013**	**8,465**	**10,634**	**12,858**	**15,415**	**19,198**
Other income	366	536	765	978	532	511	481	463
Interest	(1,070)	(1,024)	(1,012)	(1,839)	(2,011)	(2,541)	(3,754)	(4,525)
Depreciation	(1,020)	(1,022)	(1,025)	(1,609)	(1,855)	(1,933)	(2,510)	(4,575)
Extraordinary items	—	—	—	—	—	—	—	—
Pretax profits	4,756	7,152	7,740	5,995	7,301	8,895	9,633	10,561
Tax	(6)	(2,185)	(2,526)	(1,410)	(1,455)	(2,227)	(1,920)	(2,105)
Deferred taxation	(1,617)	(220)	(30)	(540)	(970)	(728)	(1,280)	(1,403)
Net profits	**3,133**	**4,747**	**5,184**	**4,045**	**4,876**	**5,940**	**6,433**	**7,053**
Earnings per share (Rs)	**4.2**	**6.3**	**6.9**	**5.4**	**6.5**	**7.9**	**8.6**	**9.4**
Balance sheet (Rs mn)								
Total equity	12,755	16,185	19,834	22,349	25,476	29,011	32,820	37,250
Deferred taxation liability	2,472	2,692	2,722	3,262	4,232	4,960	6,240	7,643
Total borrowings	13,832	15,776	22,817	24,998	31,998	37,498	48,498	41,998
Currrent liabilities	5,877	8,588	8,922	9,006	9,607	11,381	13,318	15,447
Total liabilities and equity	**34,936**	**43,242**	**54,295**	**59,614**	**71,312**	**82,850**	**100,876**	**102,337**
Cash	3,405	3,586	6,578	3,405	3,228	2,808	2,376	2,294
Current assets	7,478	7,890	11,519	8,811	12,076	15,033	18,639	23,757
Total fixed assets	21,273	26,293	33,156	42,012	50,622	59,623	74,475	70,900
Investments	2,780	5,473	3,043	5,386	5,386	5,386	5,386	5,386
Total assets	**34,936**	**43,242**	**54,295**	**59,614**	**71,312**	**82,850**	**100,876**	**102,337**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	4,927	6,982	5,378	5,513	6,704	7,156	9,195	12,568
Working capital	(710)	1,589	(3,384)	3,026	(2,664)	(1,182)	(1,669)	(2,989)
Capital expenditure	(36)	(263)	(27)	(15,757)	(10,000)	(10,000)	(16,816)	(1,000)
Investments	(1,211)	(2,780)	2,462	(2,339)	—	—	—	—
Free cash flow	**2,970**	**5,528**	**4,429**	**(9,556)**	**(5,960)**	**(4,026)**	**(9,290)**	**8,579**
Other income	326	(414)	695	452	532	511	481	463
Ratios (%)								
Debt/equity	91	84	101	98	108	110	124	94
Net debt/equity	68	65	72	84	97	102	118	88
RoAE	23.6	27.8	25.0	16.8	17.6	18.7	17.6	16.8
RoACE	**14.5**	**17.0**	**14.7**	**11.0**	**11.1**	**11.5**	**11.2**	**11.6**
Adjusted CROCI	**29.6**	**33.2**	**28.7**	**19.2**	**22.0**	**23.4**	**13.4**	**16.3**
Key assumptions								
Contract LNG volume (mn tons)	5.1	4.8	4.8	7.1	7.5	7.5	8.0	10.5
LNG purchase price (FOB) (US$/mn BTU)	3.3	3.7	4.2	4.7	4.9	5.5	5.9	5.7
Base re-gasification charges (US$/mn BTU)	0.58	0.69	0.64	0.65	0.70	0.73	0.77	0.77
Sales price (US$/mn BTU)	4.4	4.9	5.4	5.9	6.3	6.9	7.4	7.3
Rupee/US dollar exchange rate	45.3	40.1	45.8	47.4	46.0	46.0	46.0	46.0

Source: Company, Kotak Institutional Equities estimates

Cement

India

NEUTRAL

SEPTEMBER 08, 2010

UPDATE

BSE-30: 18,645

Sharp spike in South. Cement prices in South India have increased by Rs20-40/bag, following an equivalent price correction seen in recent months. The quantum, timing, and region of the price increase are a bit surprising. Importantly though, the action reflects the resilience of the industry. We re-iterate our positive stance on Ultratech, Grasim and Shree Cement while maintaining our cautious stance on India Cement and Ambuja Cement, and downgrade ACC to REDUCE on the back of recent performance.

Cement prices rise by Rs20-40/bag in South, offsetting the decline in the previous months

Our channels check suggest that cement prices have been hiked by Rs20-40/bag across South India, offsetting a similar price decline seen over the past few months. We note that the pricing action is not broad-based as no price hike has been indicated in rest of India with West actually showing some weakness (prices in Ahmadabad down by ~Rs10/bag). India Cements, followed by Ultratech amongst our coverage universe have the maximum exposure to South markets, though the recent price hike has led to a limited revision in estimates as (1) some revival of pricing in South had already been factored in our estimates, and (2) the price increase came on the back of declines in the previous months.

Price increase highlights resilience of industry, despite monsoon overhang

The price increase in South India is surprising due to (1) large capacity overhang and sluggish demand in monsoon, and (2) South being amongst the most fragmented industry where the top-5 players command only 50% market share compared to 70-80% market share in the other regions. In our view, the price increase, besides being reflective of the strong industry resilience, also signals bottoming of prices in South which saw prices come off by near Rs20-40/bag over the past few months, leading to operating losses for some of the marginal players in the region.

Recently commissioned capacities gradually getting absorbed

Greenfield capacities commissioned in FY2010 are operating at a utilization of 51% in 1QFY11 indicating steady absorption of recently commissioned capacities. We note that of the 41 mn tpa of capacities commissioned in FY2010, 20 mn tpa (65% commissioned in 4QFY10) were greenfield capacities. We highlight that four out of five greenfield capacities commissioned by Jaiprakash in FY2010 are operating at utilization levels above 80%.

Spike in prices re-affirms our long-term view on the sector

We are surprised by the magnitude, timing and region of price increase, it is reflective of the industry resilience and re-affirms our positive stance on the sector. In our view, the decelerating pace of capacity addition, conservatism in earning estimates and reasonable valuation multiples continue to offer an opportune entry level in select cement stocks. Our preferred picks remain Ultratech, Grasim and Shree Cement while we continue to maintain our SELL rating on India Cement and Ambuja Cement due to rich valuations in comparison to peers. We recommend that investors book profits in ACC on the back of the recent outperformance and mid-cycle trading multiples.

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Exhibit 1: ICEM has the largest exposure in South India
FY2010 Sales exposure of cement companies (%)

	ACC	Ambuja	Ultratech	Grasim	Shree	India Cements	JPA
North	22.6	32.6	0.0	32.4	66.2	0.0	6.9
Central	27.8	8.9	5.8	25.0	31.4	0.0	71.3
East	17.7	12.9	16.5	8.0	0.8	0.3	17.2
West	13.5	38.8	42.5	17.5	1.1	9.0	0.3
South	18.2	2.1	31.9	17.1	0.0	90.6	0.0
Exports	0.1	4.8	3.2	0.0	0.5	0.0	4.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Kotak Institutional Equities

Exhibit 2: South remains the least consolidated market with Top-5 accounting for only 50% market share
Analysis of market share and industry structure based on installed capacity as on March 31st, 2010 (mn tpa)

	All-India			North			South		
	Company	**Capacity (mn tpa)**	**Market Share (%)**	**Company**	**Capacity (mn tpa)**	**Market Share (%)**	**Company**	**Capacity (mn tpa)**	**Market Share (%)**
	1 Grasim	26	10	Grasim	11	18	India Cements	13	13
	2 ACC	25	10	Shree Cement	9	15	Madras Cements	10	10
	3 Ultratech	23	9	Ambuja	9	15	Dalmia Cements	9	9
	4 Ambuja	21	8	Binani	6	10	ACC	9	9
	5 Jaiprakash	17	7	ACC	6	10	Chettinad Cement	8	8
Top-5		**112**	**43**		**41**	**68**		**49**	**50**
Others		150	57		19	32		48	50
Total		**262**	**100**		**60**	**100**		**97**	**100**

	West			Central			East		
	Company	**Capacity (mn tpa)**	**Market Share (%)**	**Company**	**Capacity (mn tpa)**	**Market Share (%)**	**Company**	**Capacity (mn tpa)**	**Market Share (%)**
	1 Ultratech	11	29	Jaiprakash	11	33	Lafarge	7	19
	2 Ambuja	8	21	Grasim	6	17	OCL India	5	15
	3 Jaiprakash	3	7	ACC	5	14	ACC	5	14
	4 Mehta	3	7	Century	4	12	Ultratech	4	12
	5 Sanghi Industries	3	7	Prism	2	6	Ambuja	3	9
Top-5		**27**	**72**		**26**	**82**		**24**	**68**
Others		11	28		6	18		11	32
Total		**38**	**100**		**32**	**100**		**35**	**100**

Source: Kotak Institutional Equities

Exhibit 3: Recent price hike to have limited impact on earnings for affected players
Earnings impact post price hike in South India

	FY2011E EPS			FY2012E EPS			Target Price		
	Old	**Revised**	**(%)**	**Old**	**Revised**	**(%)**	**Old**	**Revised**	**(%)**
ACC	66.0	66.0	0.1	72.4	72.9	0.6	920	960	4.3
Grasim	240.1	244.4	1.8	282.0	289.9	2.8	2,200	2,500	13.6
Ultratech	65.0	66.2	1.8	97.5	99.5	2.1	985	1,100	11.7
India Cements	8.7	7.4	(15.4)	10.6	9.4	(11.0)	95	100	5.3

Source: Company, Kotak Institutional Equities estimates

Exhibit 4: Cement capacities installed since April 2009 have ramped up at a reasonably brisk pace
Details of capacity additions since April 2009 and utilization in 1QFY11

Company	Plant	Region	State	Capacity (mn tpa)	Commissioning	Type	Year	Utililzation (% YTD)
India Cements	Parli	West	Maharashtra	1.1	Apr-09	Greenfield	2010	68
Dalmia Cements	Ariyalur	South	Tamil Nadu	2.5	Jun-09	Greenfield	2010	18
Madras Cements	Uthirmerir	South	Tamil Nadu	0.6	Jul-09	Greenfield	2010	45
Madras Cements	Valapadi	South	Tamil Nadu	0.6	Sep-09	Greenfield	2010	53
Jaiprakash	Kutch	West	Gujarat	1.2	Sep-09	Greenfield	2010	82
Jaiprakash	Sidhi	Central	Madhya Pradesh	1.0	Sep-09	Greenfield	2010	119
Jaiprakash	Roorkee	Central	Uttar Pradesh	1.2	Jan-10	Greenfield	2010	87
Jaiprakash	Wanakbori	West	Gujarat	1.5	Jan-10	Greenfield	2010	37
Madras Cements	Kolaghat	East	West Bengal	1.0	Feb-10	Greenfield	2010	14
Jaiprakash	Bagheri	North	Himachal Pradesh	1.8	Mar-10	Greenfield	2010	87
Grasim	Kotputli	North	Rajasthan	3.1	Mar-10	Greenfield	2010	36
Grasim	Aligarh	Central	Uttar Pradesh	1.3	Mar-10	Greenfield	2010	41
JK Cement	Mudhol (JK Muddapur)	South	Karnataka	3.0	Mar-10	Greenfield	2010	43
Greenfield (ex-Holcim)				**20**				**51**
ACC	Thondebhavi	South	Karnataka	1.6	Dec-09	Greenfield	2010	
ACC	Kudithini	South	Karnataka	1.2	Jan-10	Greenfield	2010	
Ambuja	Dadri	Central	Uttar Pradesh	1.5	Mar-10	Greenfield	2010	
Holcim				**4.3**				
Greenfield				**24**				
Shriram Cement	Kota	North	Rajasthan	0.2	Apr-09	Brownfield	2010	63
OCL India	Rajgangpur	East	Orissa	2.2	Apr-09	Brownfield	2010	59
OCL India	Kapilas	East	Orissa	0.5	Apr-09	Brownfield	2010	72
India Cements	Chilamkur	South	Andhra Pradesh	0.0	Apr-09	Brownfield	2010	85
India Cements	Yerraguntala	South	Andhra Pradesh	0.2	Apr-09	Brownfield	2010	78
India Cements	Raasi	South	Andhra Pradesh	0.2	Apr-09	Brownfield	2010	100
India Cements	Visaka	South	Andhra Pradesh	1.3	Apr-09	Brownfield	2010	66
Chettinad	Karur	South	Tamil Nadu	0.4	Apr-09	Brownfield	2010	62
Chettinad	Karikalli	South	Tamil Nadu	0.6	Apr-09	Brownfield	2010	80
India Cements	Sankarnagar	South	Tamil Nadu	0.3	Apr-09	Brownfield	2010	78
India Cements	Sankaridurg	South	Tamil Nadu	0.3	Apr-09	Brownfield	2010	70
JK Lakshmi	Sirohi	North	Rajasthan	0.8	Aug-09	Brownfield	2010	92
Jaiprakash	Chunar	Central	Uttar Pradesh	0.5	Dec-09	Brownfield	2010	107
Jaiprakash	Dalla	Central	Uttar Pradesh	0.1	Dec-09	Brownfield	2010	75
Kesoram	Sedam (Vasavadatta)	South	Karnataka	1.7	Jan-10	Brownfield	2010	90
Chettinad Cement	Karur	South	Tamil Nadu	0.6	Jan-10	Brownfield	2010	62
Chettinad Cement	Karikalli	South	Tamil Nadu	0.2	Jan-10	Brownfield	2010	80
Chettinad Cement	Ariyalur	South	Tamil Nadu	2.6	Jan-10	Brownfield	2010	36
Orient	Devapur	South	Andhra Pradesh	0.6	Mar-10	Brownfield	2010	95
Orient	Jalgaon	West	Maharashtra	1.0	Mar-10	Brownfield	2010	77
Ultratech	Tadipatri	South	Andhra Pradesh	1.2	Mar-10	Brownfield	2010	69
Brownfield (ex-Holcim)				**15**				**69**
Ambuja	Nalagarh	North	Himachal Pradesh	1.5	Mar-10	Brownfield	2010	
Holcim				**1.5**				
Brownfield				**17**				
Total (ex-Holcim)				**35**				**59**
Total				**41**				

Source: CMA, Kotak Institutional Equities

Ultratech (ADD, TP Rs1,100/share) – merger with Samurddhi leads to earnings revision

We re-iterate our ADD rating on Ultratech with a revised target price of Rs1,100/share (Rs985 previously). We have increased our EPS estimate by 1.8% to Rs66/share in FY2011E and by 2.1% to Rs99.5/share in FY2012E as (1) we increase our realization assumptions and (2) adjust for post-merger earnings of Ultratech. Our revised target price implies an EV/EBITDA multiple of 5.5X on consolidated EBITDA of FY2012E. We highlight our investment thesis for UTCEM:

- The merger allows UTCEM to geographically diversify its presence, thus reducing the risk of sharp pressure on earnings in case of regional price weaknesses.
- The merger with Samruddhi is earnings accretive for UTCEM increasing the EPS by 4% in FY2011E and 31% in FY2012E.
- UTCEM has traditionally traded at a discount to its peers (Historical Average: 9X EV/EBITDA for ACC) though creation of a large pure-play cement entity will likely reduce this discount, in our view.

Exhibit 5: Merger will diversify the geographic exposure of UTCEM
Region wise sale mix of UTCEM (%)

	Ultratech		Samruddhi		Ultratech+Samruddhi	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
North	0.0	0.0	37.6	39.2	19.5	20.6
Central	6.9	6.9	24.6	25.7	16.1	16.8
East	15.1	15.1	7.4	7.1	11.1	10.9
West	42.7	42.5	15.3	14.0	28.5	27.5
South	32.5	33.0	15.1	13.9	23.5	23.0
Exports	2.8	2.5	0.0	0.0	1.3	1.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Kotak Institutional Equities estimates

Grasim Industries (ADD, TP 2,500/share) – reasonable valuations, upside from 60% stake in UTCEM

We increase our target price to Rs2,500/share as we ascribe a 5.5X EV/EBITDA multiple to the cement business (previously 5X) to account for consolidation within UTCEM. Our investment argument for Grasim Industries:

- CMP of Grasim implies a high holding company discount of 27% on our fair value estimate of Rs1,100 for UTCEM (see Exhibit 6).
- Reasonable valuations of 3.5X EV/EBITDA on FY2012E and cushion from VSF earnings further strengthen our case for incremental investment in Grasim.

We maintain our ADD rating with revised target price of Rs2,500/share. We value the cement business at 5.5X EV/EBITDA on FY2012E and factor an additional 'holding-company' discount for the restructuring of the cement business. We value the steady cash streams from VSF and allied chemicals business using DCF model. On comparative valuations on FY2011E, our assigned valuation implies 5.1X EV/EBITDA for chemicals business and 4X EV/EBITDA for the VSF business.

Exhibit 6: Grasim's CMP implies a holding company discount of 27% on our TP of UTCEM
Implied discount (%) for Grasim's ownership in cement business based on Ultratech's target price

	Valuation	
	(Rs mn)	(Rs/share)
Current market capitalization of Grasim (a)	**201,264**	**2,195**
Value of non-cement business		
VSF	55,979	611
Others (Chemicals)	6,491	71
Value of investments	17,245	188
Net debt of non-cement business	(10,221)	(111)
Value of non-cement business (b)	**69,494**	**758**
Implied value of ownership in cement business (c=a-b)	**131,770**	**1,437**
Value of stake in Ultratech +Samruddhi		
KIE fair value of UTCEM	1,100	
Outstanding shares in Ultratech+Samruddhi (post-merger)	274	
Ultratech+Samruddhi (post-merger value)	301,070	
Value of Grasim's 60% ownership (d)	**181,636**	**1,981**
Implied discount for ownership in cement business (1-c/d)	**27**	

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: Our valuation for the cement business factors 20% 'holding-company' discount
SOTP-based valuation of Grasim (Rs mn)

Cement	125,540	5X EV/EBITDA and 20% 'holding-company' discount
VSF	55,979	DCF value implying an EV/EBITDA of 4X on FY2012E
Others (Chemicals)	6,491	DCF value implying an EV/EBITDA of 4X on FY2012E
Value of key investments	17,245	20% discount to current market price
Enterprise value (Rs mn)	**205,254**	
Gross debt	36,131	
- Cash	(60,139)	
Net debt	(24,008)	Attributable net debt for ownerhsip in Ultratech and Samruddhi
Equity value (Rs mn)	**229,263**	
Number of shares o/s (mn)	91.7	
Implied share price (Rs)	**2,500**	
Target price (Rs)	**2,500**	

Source: Company, Kotak Institutional Equities estimates

ACC (REDUCE, Rs980/share) – recommend booking profits on recent outperformance

We revise our target price on ACC to Rs980/share (previously Rs920/share) as we marginally revise our earnings assumptions to reflect weak volumes, albeit on marginally improved realizations. However, we note that the recent price hike in South India will have a limited upward impact on ACC's earnings owing to its limited exposure in South (18%). We recommend investors book profits at current prices as (1) ACC's trading multiples have expanded to 5.6X EV/EBITDA and US$136/ton on CY2011E production post the recent 16.7% out performance over the past month and (2) ACC continues to report de-growth in despatch numbers (-3.5% YTD), which is a risk to earnings.

India Cements (SELL, Rs100/share) – price spike only offsets the recent correction

We note that the price revision in South India will have limited impact on ICEM's earnings estimates even though ICEM has almost 90% sales exposure in South on account of (1) our FY2011E earnings had already factored in a moderate increase in realizations in 2HFY11 and (2) recent price hike comes on the back of continued weakness in South India and therefore the effective increase in realization is marginal.

We revise our EPS estimate from Rs8.7/share to Rs7.4/share in FY2011E and from Rs10.6/share to Rs9.4/share in FY2012E.

We maintain our SELL rating on ICEM with a revised target price of Rs105/share. Our target price implies a P/E of 10.6X and EV/EBITDA of 5.6X on FY2012E earnings. We factor volume of 12.3 mn tons in FY2011E and 12 mn tons in FY2012E. We continue to maintain our SELL rating on the stock as we believe that exposure to South, which is the market most vulnerable to continued pricing pressures and balance sheet concerns on account of US$75 mn FCCB which is due to repayment in early FY2012, will likely continue to be a drag on stock performance.

Exhibit 8: Comparative valuation summary

	Market cap.	CMP (Rs)	Target		EPS (Rs)				P/E (X)			
Company	(US$ mn)	7-Sep	price (Rs)	Rating	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
ACC	3,895	962	920	ADD	56	83	66	73	17.1	11.6	14.6	13.2
Ambuja Cements	4,462	136	108	SELL	7.2	8.0	8.4	8.9	18.9	17.0	16.1	15.4
Grasim Industries	4,337	2,195	2,200	ADD	239	301	244	290	9.2	7.3	9.0	7.6
India Cements	770	116	95	SELL	18	10	7	9	6.5	11.6	15.8	12.4
Jaiprakash Associates	5,446	119	170	BUY	2.0	1.5	8.0	10.8	59.4	81.5	14.9	11.0
Shree Cement	1,522	2,027	2,550	BUY	175	208	221	242	11.6	9.7	9.2	8.4
UltraTech Cement	2,667	994	985	ADD	79	88	66	100	12.6	11.3	15.0	10.0

	EV/EBITDA (X)				EV/ton of production (US$)				EV/ton of capacity (US$)			
Company	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
ACC	8.7	6.2	6.9	5.6	173	166	158	136	169	156	125	110
Ambuja Cements	10.2	9.1	8.7	7.5	244	222	204	175	221	207	189	160
Grasim Industries	5.7	4.6	4.8	3.7	NA	NA	NA	NA	NA	NA	NA	NA
India Cements	5.0	6.6	8.7	6.2	123	111	96	78	112	93	90	69
Jaiprakash Associates	20.7	19.2	12.4	9.0	NA	NA	NA	NA	NA	NA	NA	NA
Shree Cement	7.0	4.5	4.1	3.3	186	149	122	101	171	153	113	98
UltraTech Cement	7.4	5.9	8.3	5.2	159	130	139	116	151	113	125	112

Source: Company, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	7-Sep-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	74	ADD	98,841	2,110	1,330	2.8	4.3	5.9	84.5	52.3	37.5	26.3	17.3	12.6	15.1	11.3	8.9	2.4	2.2	2.0	2.0	1.3	1.3	10.9	13.5	16.7	78	5.0	7.0
Bajaj Auto	2,997	ADD	433,724	9,260	145	117.7	169.0	189.5	160.1	43.6	12.2	25.5	17.7	15.8	16.4	12.5	10.9	14.8	8.6	5.8	0.7	0.7	0.7	70.9	61.4	44.0	2,650	(11.6)	17.8
Bharat Forge	363	ADD	86,850	1,854	239	0.7	12.4	19.7	(92.0)	1,705.4	59.1	528.4	29.3	18.4	26.8	12.6	8.8	2.3	2.2	2.0	—	—	—	0.9	0.4	0.1	360	(0.9)	5.0
Hero Honda	1,709	SELL	341,257	7,286	200	111.8	115.3	130.1	74.1	3.1	12.8	15.3	14.8	13.1	9.7	9.6	8.1	9.5	6.6	4.9	1.8	1.8	2.0	59.1	52.5	42.8	1,800	5.3	20.9
Mahindra & Mahindra	629	BUY	374,700	8,000	595	33.9	44.1	51.7	125.8	30.1	17.3	18.6	14.3	12.2	12.2	10.3	8.6	4.6	3.7	3.0	1.5	1.5	1.5	30.0	29.0	27.3	760	20.8	23.8
Maruti Suzuki	1,315	REDUCE	380,151	8,116	289	86.4	77.6	88.3	104.9	(10.2)	13.9	15.2	17.0	14.9	8.2	8.6	7.4	3.2	2.7	2.3	0.5	0.4	0.5	23.3	17.3	16.7	1,200	(8.8)	20.5
Tata Motors	1,039	ADD	650,726	13,893	626	27.4	94.8	109.2	(182.5)	246.1	15.2	37.9	11.0	9.5	13.4	7.0	6.1	4.2	2.9	2.2	1.3	0.5	0.5	8.7	11.9	11.1	1,150	10.7	86.5
Automobiles		**Cautious**	**2,366,249**	**50,518**					**276.0**	**57.2**	**16.1**	**22.7**	**14.4**	**12.4**	**12.4**	**8.9**	**7.6**	**4.7**	**3.7**	**2.9**	**1.1**	**0.9**	**0.9**	**20.9**	**25.3**	**23.3**			
Banks/Financial Institutions																													
Andhra Bank	155	BUY	75,054	1,602	485	21.6	22.9	26.7	60.1	6.4	16.4	7.2	6.7	5.8	—	—	—	1.7	1.4	1.2	3.2	3.4	4.0	26.0	23.1	22.7	180	16.3	5.1
Axis Bank	1,398	ADD	566,231	12,089	405	62.1	78.1	98.3	22.7	25.9	25.9	22.5	17.9	14.2	—	—	—	3.5	3.1	2.6	0.9	1.1	1.4	19.2	18.3	19.9	1,500	7.3	38.8
Bank of Baroda	830	BUY	303,260	6,474	366	83.7	95.1	115.7	37.3	13.7	21.7	9.9	8.7	7.2	—	—	—	2.2	1.8	1.5	1.8	2.1	2.5	24.4	23.0	23.3	950	14.5	8.1
Bank of India	460	REDUCE	242,078	5,168	526	33.1	49.9	58.1	(42.1)	50.9	16.4	13.9	9.2	7.9	—	—	—	1.9	1.6	1.4	1.5	2.3	2.7	14.2	19.0	19.2	460	(0.1)	9.0
Canara Bank	539	ADD	220,867	4,715	410	73.7	82.2	98.3	45.8	11.6	19.5	7.3	6.6	5.5	—	—	—	1.7	1.4	1.2	1.5	1.9	2.2	22.4	20.8	20.8	580	7.7	7.0
Corporation Bank	605	BUY	86,844	1,854	143	82.0	88.0	102.6	31.8	7.3	16.6	7.4	6.9	5.9	—	—	—	1.5	1.3	1.1	2.7	2.9	3.4	22.0	20.2	20.2	700	15.6	1.3
Federal Bank	358	ADD	61,290	1,308	171	27.2	36.4	49.0	(7.2)	34.1	34.4	13.2	9.8	7.3	—	—	—	1.3	1.2	1.0	1.4	1.9	2.5	10.3	12.6	15.2	360	0.5	5.5
HDFC	633	ADD	908,703	19,400	1,436	19.7	23.2	27.8	22.7	17.9	19.6	32.1	27.3	22.8	—	—	—	6.0	5.3	4.7	1.1	1.3	1.5	20.0	20.6	21.7	690	9.0	40.1
HDFC Bank	2,199	BUY	1,006,623	21,491	458	64.4	84.9	111.1	22.1	31.7	30.9	34.1	25.9	19.8	—	—	—	4.7	4.1	3.5	0.5	0.7	0.9	16.1	16.9	19.2	2,400	9.1	32.3
ICICI Bank	1,039	REDUCE	1,157,924	24,721	1,115	36.1	45.2	57.3	6.9	25.3	26.6	28.8	23.0	18.1	—	—	—	2.2	2.1	2.0	1.2	1.4	1.8	8.0	9.5	11.3	1,000	(3.7)	79.2
IDFC	184	ADD	268,556	5,733	1,458	8.4	9.4	11.2	44.9	12.4	18.7	22.0	19.5	16.5	—	—	—	3.8	2.5	2.1	0.7	0.9	1.2	16.6	15.5	14.3	205	11.3	23.4
India Infoline	99	BUY	30,931	660	312	8.1	7.2	8.7	59.2	(11.9)	21.6	12.2	13.9	11.4	—	—	—	1.9	1.6	1.4	3.2	1.5	2.0	16.4	12.9	14.4	120	21.0	4.6
Indian Bank	255	ADD	109,785	2,344	430	35.1	32.4	44.1	25.5	(7.7)	36.2	7.3	7.9	5.8	—	—	—	1.7	1.4	1.2	2.5	2.3	3.1	24.1	18.8	21.7	280	9.6	4.4
Indian Overseas Bank	136	BUY	74,011	1,580	545	13.0	16.7	24.8	(46.7)	29.0	48.4	10.5	8.1	5.5	—	—	—	1.2	1.0	0.9	2.6	2.8	3.1	9.6	11.6	15.4	160	17.8	4.8
J&K Bank	770	ADD	37,349	797	48	105.7	119.3	139.6	25.0	12.9	17.1	7.3	6.5	5.5	—	—	—	1.3	1.1	1.0	2.9	3.2	3.8	18.2	17.9	18.3	850	10.4	2.0
LIC Housing Finance	1,193	REDUCE	113,280	2,418	95	69.7	100.7	109.9	11.5	44.5	9.1	17.1	11.8	10.9	—	—	—	3.5	2.9	2.4	1.3	1.8	2.0	23.6	25.5	23.2	1,250	4.8	23.4
Mahindra & Mahindra Financial	623	BUY	59,770	1,276	96	35.9	46.4	56.2	60.0	29.4	21.2	17.4	13.4	11.1	—	—	—	3.5	3.0	2.5	1.2	1.6	1.9	21.5	23.5	23.8	590	(5.2)	2.2
Oriental Bank of Commerce	436	ADD	109,160	2,330	251	45.3	57.8	66.8	25.3	27.6	15.5	9.6	7.5	6.5	—	—	—	1.5	1.3	1.1	2.1	2.7	3.1	14.5	16.5	16.9	430	(1.3)	6.4
PFC	346	SELL	397,358	8,483	1,148	20.5	22.9	27.6	53.5	11.9	20.3	16.9	15.1	12.6	—	—	—	3.1	2.7	2.4	1.5	1.7	2.0	18.8	18.3	19.2	275	(20.6)	4.3
Punjab National Bank	1,219	BUY	384,212	8,203	315	123.9	133.4	163.3	26.4	7.7	22.4	9.8	9.1	7.5	—	—	—	2.3	1.9	1.6	1.8	2.2	2.7	26.2	23.2	23.7	1,300	6.7	8.7
Reliance Capital	795	NR	195,673	4,177	246	12.9	13.7	9.8	(67.3)	6.5	(28.6)	61.8	58.1	81.3	—	—	—	2.8	2.8	2.7	0.8	0.7	0.5	4.7	4.8	3.4	—	—	39.2
Rural Electrification Corp.	343	ADD	339,119	7,240	987	20.3	25.3	31.2	23.2	24.5	23.4	16.9	13.6	11.0	—	—	—	3.1	2.7	2.3	1.9	2.2	2.7	22.0	21.0	22.5	325	(5.4)	9.9
Shriram Transport	745	ADD	166,273	3,550	223	39.2	53.4	64.8	30.1	36.4	21.3	19.0	14.0	11.5	—	—	—	4.5	3.8	3.1	1.6	2.1	2.6	28.4	28.2	28.4	700	(6.1)	5.4
SREI	95	NR	11,036	236	116	8.3	7.9	9.9	17.8	(4.8)	25.8	11.5	12.0	9.6	—	—	—	0.9	0.9	0.8	1.3	1.3	1.3	11.1	10.5	12.3	—	—	4.3
State Bank of India	2,837	BUY	1,801,194	38,454	635	144.4	177.7	211.2	0.5	23.1	18.8	19.7	16.0	13.4	—	—	—	2.7	2.4	2.1	1.1	1.1	1.2	14.8	16.0	16.7	3,100	9.3	97.3
Union Bank	342	BUY	172,902	3,691	505	41.1	45.7	56.9	20.2	11.3	24.5	8.3	7.5	6.0	—	—	—	2.0	1.6	1.3	1.6	1.8	2.2	26.2	23.7	24.1	400	16.9	4.8
Yes Bank	318	BUY	107,878	2,303	340	15.0	17.7	22.5	46.7	18.2	26.6	21.2	17.9	14.1	—	—	—	3.5	3.0	2.5	0.4	0.6	0.7	20.3	18.0	19.3	350	10.2	19.4
Banks/Financial Institutions		**Attractive**	**9,007,359**	**192,301**					**14.8**	**20.1**	**22.2**	**17.9**	**14.9**	**12.2**	**—**	**—**	**—**	**2.8**	**2.4**	**2.1**	**1.2**	**1.4**	**1.7**	**15.5**	**16.2**	**17.2**			
Cement																													
ACC	962	REDUCE	180,731	3,858	188	83.2	66.0	72.9	47.9	(20.7)	10.4	11.6	14.6	13.2	6.2	6.9	5.6	2.8	2.5	2.2	2.8	2.4	2.4	29.3	20.0	19.3	960	(0.2)	7.9
Ambuja Cements	136	SELL	207,043	4,420	1,522	8.0	8.4	8.9	11.4	5.3	5.1	17.0	16.1	15.4	9.4	8.9	7.7	3.0	2.6	2.3	1.4	1.5	1.6	19.3	17.8	16.5	108	(20.6)	5.2
Grasim Industries	2,195	ADD	201,264	4,297	92	301.0	229.0	273.3	26.1	(23.9)	19.4	7.3	9.6	8.0	4.4	4.8	3.8	1.6	1.4	1.2	1.5	1.6	1.6	22.9	15.7	16.3	2,200	0.2	6.5
India Cements	116	SELL	35,740	763	307	10.0	7.4	9.4	(43.5)	(26.5)	27.5	11.6	15.8	12.4	6.2	8.2	5.8	0.8	0.8	0.8	1.8	2.7	2.7	8.2	5.7	7.0	100	(14.1)	3.0
Shree Cement	2,027	BUY	70,605	1,507	35	208.0	221.1	242.5	19.0	6.3	9.7	9.7	9.2	8.4	4.8	4.6	3.7	3.9	2.7	2.1	0.5	0.5	0.5	48.0	35.0	28.1	2,550	25.8	1.3
UltraTech Cement	994	ADD	272,434	5,816	274	88.2	66.2	99.5	12.0	(25.0)	50.4	11.3	15.0	10.0	13.1	8.3	5.2	5.0	2.1	1.8	0.3	0.4	0.4	25.9	18.0	22.3	1,100	10.6	3.4
Cement		**Neutral**	**967,816**	**20,662**					**19.3**	**(3.1)**	**22.2**	**12.6**	**13.0**	**10.7**	**6.7**	**6.6**	**5.0**	**2.6**	**2.0**	**1.7**	**1.3**	**1.3**	**1.4**	**20.6**	**15.1**	**15.9**			

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

	7-Sep-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	2,854	ADD	273,750	5,844	96	71.5	89.0	107.1	85.3	24.4	20.4	39.9	32.1	26.6	24.7	20.0	16.4	17.1	13.3	10.6	0.9	1.3	1.6	51.8	47.9	45.4	3,000	5.1	7.3
Colgate-Palmolive (India)	824	REDUCE	112,038	2,392	136	31.1	34.5	39.6	44.2	10.9	14.6	26.5	23.9	20.8	21.7	17.7	15.1	34.4	29.3	25.0	2.4	3.1	3.6	156.1	132.3	129.4	830	0.7	2.1
Dabur India	216	REDUCE	187,032	3,993	866	5.8	6.8	8.2	28.1	17.6	20.8	37.2	31.7	26.2	27.7	22.2	18.4	17.8	14.6	12.0	1.4	1.7	2.0	54.3	51.1	50.7	210	(2.7)	5.0
GlaxoSmithkline Consumer (a)	1,819	ADD	76,518	1,634	42	55.4	68.6	81.3	23.6	23.9	18.6	32.9	26.5	22.4	18.2	15.7	12.9	8.6	7.1	5.9	1.0	1.2	1.5	27.9	29.0	28.7	2,000	9.9	0.5
Godrej Consumer Products	398	ADD	128,773	2,749	324	11.3	13.5	18.0	69.5	18.9	33.4	35.1	29.5	22.1	27.9	21.0	15.8	13.4	7.2	6.5	1.0	0.8	0.8	44.6	31.9	31.1	420	5.5	1.6
Hindustan Unilever	271	REDUCE	590,474	12,606	2,182	9.4	10.2	12.0	(0.9)	8.4	17.5	28.7	26.5	22.5	19.6	18.8	15.4	22.9	19.8	17.1	2.8	3.1	3.6	71.1	80.2	81.3	250	(7.6)	10.8
ITC	166	BUY	1,271,520	27,146	7,651	5.3	6.3	7.3	22.6	18.2	15.8	31.3	26.5	22.9	19.0	16.7	14.1	8.6	7.2	6.2	3.0	1.7	1.8	29.2	31.1	30.5	165	(0.7)	22.1
Jubilant Foodworks	518	REDUCE	33,077	706	64	5.5	9.7	12.1	340.6	75.7	24.6	93.5	53.2	42.7	49.7	30.2	21.1	28.1	18.4	12.9	—	—	—	46.6	41.8	35.4	370	(28.6)	14.9
Jyothy Laboratories	290	NR	21,020	449	73	11.0	12.9	15.3	99.6	17.0	18.3	26.3	22.4	19.0	20.4	15.5	12.7	5.2	4.4	3.8	1.6	1.2	1.6	18.6	20.2	20.5	—	—	1.1
Marico	125	ADD	76,095	1,625	609	4.5	5.4	6.4	33.8	19.6	20.4	27.9	23.3	19.4	18.3	15.5	12.8	12.3	8.8	6.6	0.8	0.9	1.1	50.8	43.9	38.8	140	12.0	2.6
Nestle India (a)	3,204	REDUCE	308,945	6,596	96	74.4	86.6	104.8	27.0	16.4	20.9	43.1	37.0	30.6	28.5	24.7	21.0	53.2	42.4	33.8	1.5	1.9	2.3	136.0	127.5	122.9	3,000	(6.4)	2.8
Tata Global Beverages	128	ADD	78,970	1,686	618	6.6	7.4	8.4	23.4	11.1	13.8	19.3	17.4	15.3	12.2	10.0	9.0	1.6	1.5	1.4	1.7	1.9	2.1	10.9	11.4	12.0	125	(2.1)	4.1
Consumer products		**Attractive**	**3,158,211**	**67,426**					**24.2**	**16.6**	**17.9**	**32.2**	**27.6**	**23.4**	**20.8**	**18.0**	**15.0**	**10.9**	**9.1**	**7.8**	**2.3**	**1.9**	**2.2**	**33.9**	**32.9**	**33.4**			
Constructions																													
IVRCL	161	BUY	42,908	916	267	7.9	9.1	11.6	(6.7)	15.0	27.9	20.3	17.7	13.8	10.4	9.8	7.7	2.1	1.9	1.7	0.2	0.2	0.2	11.0	11.3	12.9	205	27.6	6.6
Nagarjuna Construction Co.	160	BUY	40,964	875	257	7.1	9.2	11.8	6.1	29.6	27.8	22.4	17.3	13.5	11.2	9.7	8.1	1.8	1.7	1.5	0.8	1.3	1.3	9.3	10.2	11.9	210	31.5	3.4
Punj Lloyd	112	REDUCE	38,057	812	339	(12.9)	9.8	12.0	79.2	(175.4)	22.4	(8.7)	11.5	9.4	33.7	6.6	6.0	1.2	1.1	1.0	(0.1)	0.4	0.9	(15.8)	10.3	11.4	140	24.7	10.4
Sadbhav Engineering	1,514	BUY	22,706	485	15	42.8	61.8	87.2	(16.3)	44.3	41.0	35.3	24.5	17.4	19.3	12.9	9.9	5.6	3.7	3.1	0.2	0.4	0.4	15.8	15.1	17.8	1,750	15.6	0.4
Construction		**Attractive**	**144,634**	**3,088**					**(91.1)**	**4,528**	**27.2**	**741.1**	**16.0**	**12.6**	**15.3**	**8.6**	**7.3**	**1.9**	**1.7**	**1.5**	**0.3**	**0.6**	**0.7**	**0.3**	**10.4**	**11.9**			
Energy																													
Aban Offshore	818	ADD	35,580	760	43	94.5	154.1	139.3	(2.5)	63.0	(9.6)	8.7	5.3	5.9	8.3	6.7	6.5	1.6	1.5	1.3	0.4	0.4	0.5	21.7	33.1	22.9	935	14.3	43.9
Bharat Petroleum	758	ADD	274,138	5,853	362	62.1	57.4	65.7	201	(8)	14.5	12	13	11.5	6.4	6.3	5.7	1.9	1.7	1.6	1.8	2.5	2.8	15.6	13.0	13.5	690	(9.0)	35.2
Cairn india	334	RS	633,115	13,517	1,897	5.5	20.5	36.6	29.0	270.1	78.3	60.2	16.3	9.1	47.4	9.7	5.9	1.8	1.6	1.5	—	—	4.5	3.1	10.7	17.2	—	—	27.6
Castrol India (a)	521	REDUCE	128,709	2,748	247	15.4	20.7	21.2	45	34	2.4	34	25	24.6	20.2	15.6	15.1	28.0	26.2	24.9	2.4	3.2	3.3	83.8	107.4	103.7	380	(27.0)	1.9
GAIL (India)	466	BUY	590,604	12,609	1,268	24.8	27.2	40.2	11.7	10.1	47.4	18.8	17.1	11.6	10.5	10.6	8.5	3.2	2.9	2.4	1.6	1.8	2.7	17.4	17.0	21.6	550	18.1	16.0
GSPL	121	SELL	68,141	1,455	562	7.4	7.2	8.0	235	(3)	12.1	16	17	15.1	8.3	8.1	6.8	4.0	3.3	3.0	0.8	1.5	2.7	27.3	21.4	20.8	83	(31.5)	4.6
Hindustan Petroleum	515	ADD	174,692	3,730	339	52.6	53.5	58.6	210.1	1.8	9.5	9.8	9.6	8.8	3.5	3.5	3.2	1.3	1.2	1.1	2.3	3.2	3.6	13.3	12.2	12.1	535	3.8	42.2
Indian Oil Corporation	426	ADD	1,035,035	22,097	2,428	49.9	38.8	41.1	407	(22)	5.9	9	11	10.4	5.7	5.7	5.1	1.9	1.7	1.6	3.0	2.8	2.9	22.7	15.6	15.1	415	(2.7)	19.2
Oil India	1,491	BUY	358,421	7,652	240	115.1	133.6	153.4	13.8	16.1	14.8	13.0	11.2	9.7	5.7	4.4	3.7	2.4	2.1	1.9	2.3	3.0	3.4	16.7	18.1	18.3	1,550	4.0	7.1
Oil & Natural Gas Corporation	1,354	BUY	2,895,304	61,813	2,139	90.3	116.4	136.7	(1)	29	17.5	15	12	9.9	5.3	4.6	4.0	2.2	2.0	1.8	2.4	3.1	3.5	14.4	16.8	17.7	1,500	10.8	33.8
Petronet LNG	114	SELL	85,538	1,826	750	5.4	6.5	7.9	(22.0)	20.5	21.8	21.1	17.5	14.4	12.0	10.2	8.9	3.3	2.9	2.5	1.5	1.8	2.4	15.9	16.7	17.6	88	(22.8)	7.5
Reliance Industries	962	REDUCE	2,863,805	61,140	2,976	49.6	57.7	74.4	(2)	16	28.9	19	17	12.9	9.9	7.8	6.4	1.9	1.7	1.6	0.7	0.8	1.0	11.4	12.1	13.9	1,015	5.5	110.6
Energy		**Cautious**	**9,143,082**	**195,198**					**37.1**	**15.9**	**23.1**	**15.2**	**13.1**	**10.7**	**7.3**	**6.2**	**5.3**	**2.1**	**1.9**	**1.7**	**1.7**	**2.0**	**2.6**	**13.8**	**14.4**	**15.8**			
Industrials																													
ABB	784	REDUCE	166,232	3,549	212	16.7	18.3	33.1	(35.2)	9.3	80.7	46.9	42.9	23.7	26.8	24.6	13.7	6.9	6.1	5.0	0.3	0.4	0.4	15.6	15.0	23.0	725	(7.6)	4.6
BGR Energy Systems	852	BUY	61,351	1,310	72	16.0	28.0	39.7	32.2	74.6	41.9	53.2	30.4	21.5	29.8	17.3	12.4	10.9	8.7	6.6	0.4	0.8	0.9	22.3	31.8	35.1	950	11.5	4.2
Bharat Electronics	1,727	REDUCE	138,128	2,949	80	96.1	105.9	120.3	(7.4)	10.2	13.6	18.0	16.3	14.3	8.3	7.3	6.1	3.1	2.7	2.4	1.1	1.4	1.4	17.5	17.7	17.6	1,800	4.3	2.3
Bharat Heavy Electricals	2,434	REDUCE	1,191,516	25,438	490	87.9	114.3	135.5	37.7	30.0	18.5	27.7	21.3	18.0	15.5	12.0	9.9	7.5	5.9	4.7	0.8	1.0	1.2	29.8	31.1	29.3	2,600	6.8	24.5
Crompton Greaves	314	BUY	201,303	4,298	642	12.8	14.0	16.3	46.5	9.0	16.6	24.4	22.4	19.2	14.2	12.6	10.6	8.0	6.2	4.8	0.4	0.6	0.7	37.9	31.1	28.2	320	2.0	7.5
Larsen & Toubro	1,876	ADD	1,129,878	24,122	602	57.9	71.7	89.0	15.6	23.8	24.1	32.4	26.2	21.1	18.1	14.2	11.9	5.1	4.2	3.6	0.7	0.6	0.7	18.6	17.7	18.5	2,075	10.6	48.7
Maharashtra Seamless	383	BUY	27,031	577	71	40.2	43.6	49.8	12.1	8.5	14.2	9.5	8.8	7.7	5.0	4.4	3.4	1.7	1.5	1.3	1.6	2.0	2.6	19.3	17.9	17.7	450	17.4	0.4
Siemens	713	REDUCE	240,294	5,130	337	25.2	27.0	31.9	56.4	7.3	18.0	28.3	26.4	22.4	17.2	15.6	12.9	7.1	5.9	4.9	0.7	0.7	0.9	27.6	24.2	23.8	635	(10.9)	5.9
Suzlon Energy	52	REDUCE	82,395	1,759	1,594	(6.2)	(0.8)	3.3	(185.4)	(86.8)	(504.1)	(8.4)	(63.7)	15.8	14.1	11.7	7.8	1.2	1.1	1.1	—	—	0.4	(11.4)	(1.8)	6.9	55	6.4	21.1
Thermax	792	ADD	94,420	2,016	119	21.7	29.5	39.7	(10.4)	35.9	34.4	36.5	26.8	20.0	18.9	14.7	10.9	8.8	7.2	5.8	0.6	1.1	1.5	25.0	29.5	32.2	865	9.2	1.3
Voltas	218	REDUCE	72,001	1,537	331	10.9	11.8	13.4	57.4	8.2	14.3	20.0	18.5	16.2	11.9	10.4	8.7	6.7	5.4	4.4	1.4	1.6	1.8	38.3	32.5	30.2	225	3.4	4.7

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	7-Sep-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	1,323	REDUCE	172,016	3,672	130	61.1	74.3	85.9	0.3	21.7	15.6	21.7	17.8	15.4	15.3	12.4	10.4	4.0	3.4	2.9	1.1	1.3	1.5	19.6	20.6	20.5	1,250	(5.5)	1.7
GMR Infrastructure	58	ADD	214,336	4,576	3,667	0.4	0.2	0.1	(43.8)	(48.9)	(40.0)	135.6	265.5	442.1	23.7	15.3	14.4	2.0	1.7	1.7	—	—	—	2.4	1.2	0.7	65	11.2	6.5
GVK Power & Infrastructure	49	BUY	76,750	1,639	1,579	0.8	1.1	1.4	6.7	33.5	32.4	59.7	44.7	33.8	19.7	17.9	18.3	2.4	2.3	2.2	—	0.6	0.6	4.7	5.3	6.7	54	11.1	5.9
IRB Infrastructure	282	RS	93,560	1,997	332	9.7	12.6	12.1	83.8	29.2	(3.7)	28.9	22.4	23.3	13.6	12.0	11.2	4.0	3.1	2.5	—	—	—	15.6	15.7	11.9	—	—	11.9
Mundra Port and SEZ	777	REDUCE	313,592	6,695	403	16.7	21.9	34.1	55.7	31.0	56.1	46.6	35.5	22.8	34.8	22.7	16.4	8.8	7.5	5.9	(0.5)	—	—	20.8	22.9	28.9	750	(3.5)	5.6
Infrastructure		**Attractive**	**870,254**	**18,579**					**16.3**	**21.2**	**26.0**	**41.9**	**34.6**	**27.4**	**21.9**	**16.2**	**14.0**	**3.6**	**3.1**	**2.8**	**—**	**—**	**0.3**	**8.7**	**9.1**	**10.3**			
Media																													
DB Corp	258	BUY	46,867	1,001	182	10.6	13.0	15.7	286.5	22.4	21.0	24.3	19.8	16.4	13.5	11.2	9.2	7.2	5.8	5.1	0.8	1.2	1.6	40.3	32.6	33.2	290	12.4	0.3
DishTV	56	ADD	59,763	1,276	1,063	(2.5)	(1.8)	0.1	(62.0)	(28.8)	(107.4)	(22.5)	(31.6)	429.6	73.5	29.4	15.5	14.5	26.9	25.3	—	—	—	249.3	(59.7)	6.1	47	(16.4)	4.0
HT Media	175	NR	41,019	876	235	6.1	7.7	9.2	623.3	25.9	19.8	28.6	22.7	18.9	14.3	12.0	10.0	4.2	3.8	3.4	0.6	1.1	2.3	15.6	17.5	18.9	—	—	0.4
Jagran Prakashan	135	BUY	40,640	868	301	5.8	6.6	7.7	92.0	13.4	17.0	23.1	20.4	17.4	13.9	11.8	10.1	6.6	6.1	5.6	2.6	3.0	3.7	30.0	31.1	33.3	145	7.4	1.6
Sun TV Network	507	REDUCE	199,877	4,267	394	13.1	18.0	22.5	44.8	36.9	25.2	38.6	28.2	22.5	21.9	16.3	13.1	10.3	8.7	7.2	1.5	1.5	1.8	28.4	33.7	35.1	420	(17.2)	2.8
Zee Entertainment Enterprises	293	REDUCE	127,345	2,719	435	10.6	11.8	14.4	25.0	12.0	21.5	27.7	24.8	20.4	20.6	16.4	13.1	3.4	3.3	3.1	0.8	1.0	1.2	13.1	13.8	16.0	270	(7.8)	8.2
Media		**Neutral**	**515,512**	**11,006**					**185.4**	**36.0**	**37.0**	**42.5**	**31.2**	**22.8**	**20.4**	**15.7**	**12.3**	**6.2**	**5.7**	**5.2**	**1.1**	**1.3**	**1.6**	**14.7**	**18.4**	**22.8**			
Metals																													
Hindalco Industries	181	ADD	345,850	7,384	1,914	5.7	13.6	15.5	(64.5)	139.5	14.2	31.8	13.3	11.6	8.0	8.0	8.3	1.6	1.4	1.3	0.7	0.7	0.7	10.3	11.1	11.5	200	10.7	35.6
Hindustan Zinc	1,108	BUY	468,123	9,994	423	95.6	102.5	116.0	48.2	7.2	13.1	11.6	10.8	9.6	7.5	6.0	4.2	2.5	2.0	1.7	0.5	0.5	0.5	24.1	20.8	19.4	1,240	11.9	3.9
Jindal Steel and Power	708	REDUCE	659,267	14,075	931	38.4	50.9	56.0	17.3	32.7	9.9	18.5	13.9	12.6	12.7	9.2	7.7	5.9	4.1	3.1	0.2	0.3	0.3	37.8	34.9	28.0	625	(11.7)	22.6
JSW Steel	1,219	REDUCE	307,571	6,566	252	80.4	68.5	108.5	481.1	(14.8)	58.5	15.2	17.8	11.2	11.2	9.5	6.3	2.8	1.7	1.3	0.6	0.7	0.8	16.0	12.0	13.3	1,075	(11.8)	39.9
National Aluminium Co.	407	SELL	262,137	5,596	644	12.6	14.3	17.3	(34.9)	13.3	20.5	32.2	28.4	23.6	15.4	12.7	10.4	2.5	2.4	2.2	0.6	1.2	1.2	8.1	8.6	9.8	260	(36.1)	1.5
Sesa Goa	320	REDUCE	284,304	6,070	890	29.6	58.6	46.3	23.5	98.4	(21.0)	10.8	5.5	6.9	8.9	3.7	3.6	3.5	2.2	1.7	1.1	1.1	1.1	35.8	41.5	23.7	340	6.4	54.9
Sterlite Industries	164	ADD	552,824	11,802	3,362	12.0	14.2	19.3	2.8	18.4	35.5	13.7	11.6	8.5	8.8	7.7	4.8	1.5	1.3	1.2	0.6	0.6	0.6	12.9	12.2	14.6	200	21.6	36.9
Tata Steel	576	REDUCE	527,066	11,252	914	(3.6)	63.4	65.5	(103.6)	(1,880.2)	3.4	(161.9)	9.1	8.8	10.8	6.0	5.7	2.3	1.8	1.5	1.3	1.4	—	(1.5)	22.0	18.7	550	(4.6)	90.0
Metals		**Cautious**	**3,407,144**	**72,740**					**(30.6)**	**72.5**	**11.3**	**19.5**	**11.3**	**10.2**	**10.0**	**7.1**	**6.0**	**2.4**	**1.9**	**1.6**	**0.7**	**0.8**	**0.6**	**12.3**	**17.1**	**15.9**			
Pharmaceutical																													
Biocon	348	BUY	69,610	1,486	200	14.8	17.8	22.0	216.4	19.8	23.7	23.5	19.6	15.8	13.6	11.3	9.4	3.9	3.4	2.9	—	—	—	17.9	18.8	20.0	400	14.9	5.1
Cipla	313	REDUCE	251,274	5,365	803	13.7	14.0	16.6	38.1	1.9	19.2	22.8	22.4	18.8	16.4	15.0	12.8	4.3	3.7	3.2	0.6	0.8	0.8	21.1	17.6	18.2	295	(5.7)	8.7
Cadila Healthcare	631	REDUCE	129,186	2,758	205	24.7	33.2	37.7	66.9	34.2	13.7	25.5	19.0	16.7	16.6	12.8	11.3	7.9	5.9	4.7	0.8	1.1	1.2	36.0	35.8	31.3	580	(8.1)	1.5
Dishman Pharma & chemicals	197	ADD	15,998	342	81	14.4	17.8	22.8	(19.7)	23.7	28.0	13.6	11.0	8.6	10.1	8.2	6.4	2.0	1.7	1.5	—	—	—	15.5	16.8	18.3	230	16.9	0.6
Divi's Laboratories	762	REDUCE	99,553	2,125	131	26.1	34.0	44.9	(18.2)	30.4	32.1	29.3	22.4	17.0	21.7	16.6	11.9	6.6	5.4	4.4	—	—	—	24.7	26.4	28.5	800	5.0	2.6
Dr Reddy's Laboratories	1,432	REDUCE	242,533	5,178	169	48.1	66.7	70.8	48.3	38.8	6.1	29.8	21.5	20.2	16.5	12.4	11.5	6.4	5.1	4.2	0.5	0.6	0.6	22.2	26.3	22.6	1,150	(19.7)	16.4
GlaxoSmithkline Pharmaceuticals (a)	1,917	REDUCE	162,359	3,466	85	59.1	69.7	79.2	8.1	18.0	13.5	32.4	27.5	24.2	18.5	15.6	13.4	9.1	7.7	6.6	—	—	—	29.8	30.4	29.4	1,880	(1.9)	1.5
Glenmark Pharmaceuticals	280	NR	76,823	1,640	274	12.7	19.2	20.3	14.7	50.6	5.6	22.0	14.6	13.8	14.1	9.2	8.8	3.3	2.7	2.3	—	—	—	16.7	19.9	17.6	—	—	4.4
Jubilant Organosys	344	BUY	54,650	1,167	159	26.5	31.8	38.9	49.0	19.8	22.4	13.0	10.8	8.8	9.5	8.5	6.9	2.5	2.0	1.7	0.6	0.7	0.9	26.3	21.7	21.1	400	16.2	2.5
Lupin	368	ADD	162,915	3,478	442	15.4	19.8	25.5	27.9	28.7	28.7	23.9	18.6	14.4	20.5	14.8	11.7	7.0	6.6	5.8	3.5	3.9	4.2	36.6	37.2	43.6	400	8.6	7.1
Piramal Healthcare	510	REDUCE	106,680	2,278	209	22.4	13.3	9.5	29.7	(40.4)	(28.9)	22.8	38.2	53.8	16.5	7.2	5.5	6.3	1.2	1.0	1.1	1.2	0.7	30.7	140.7	16.5	490	(4.0)	24.7
Ranbaxy Laboratories	509	SELL	217,906	4,652	428	7.1	27.0	11.6	(128.4)	282.7	(57.0)	72.0	18.8	43.7	17.5	10.7	20.6	5.6	4.0	3.7	—	0.8	0.8	6.9	22.6	8.3	255	(49.9)	9.8
Sun Pharmaceuticals	1,723	REDUCE	356,816	7,618	207	65.2	90.4	87.4	(25.7)	38.6	(3.3)	26.4	19.1	19.7	19.9	13.8	13.4	4.3	3.6	3.1	0.8	0.8	0.8	17.8	21.0	17.3	1,835	6.5	6.0
Pharmaceuticals		**Attractive**	**1,946,303**	**41,552**					**45.5**	**33.7**	**3.2**	**26.9**	**20.1**	**19.5**	**16.8**	**12.5**	**11.9**	**5.1**	**3.7**	**3.1**	**0.7**	**0.9**	**0.9**	**19.0**	**18.2**	**16.1**			
Property																													
DLF	316	ADD	539,786	11,524	1,708	10.7	16.3	25.1	(60.0)	53.1	53.8	29.7	19.4	12.6	20.6	13.1	9.9	2.0	1.9	1.7	0.9	0.9	1.6	7.1	9.9	13.8	340	7.6	42.0
Housing Development & Infrastructure	275	ADD	105,774	2,258	385	12.4	14.2	16.7	(41.2)	14.2	17.9	22.2	19.4	16.5	11.0	12.4	8.2	1.5	1.3	1.2	1.0	1.8	1.8	10.0	9.3	9.9	318	15.7	32.6
Indiabulls Real Estate	177	RS	70,857	1,513	401	0.3	2.5	7.4	(62.7)	777.3	195.3	620.2	70.7	23.9	(26.4)	(283.8)	12.1	0.8	0.8	0.8	—	—	—	0.1	1.1	3.2	285	61.4	17.6
Mahindra Life Space Developer	469	ADD	19,803	423	42	20.1	23.6	35.8	77.8	17.6	51.5	23.3	19.9	13.1	20.6	14.8	7.3	2.1	1.9	1.7	0.8	0.8	0.8	8.9	9.7	13.4	540	15.3	0.7
Phoenix Mills	247	BUY	35,842	765	145	4.1	6.6	7.6	(16.7)	59.0	15.6	59.8	37.6	32.5	47.9	26.4	22.1	2.3	2.2	2.1	0.4	0.6	0.8	3.9	6.0	6.7	260	5.1	0.8
Puravankara Projects	114	REDUCE	24,330	519	213	6.8	8.2	8.0	0.6	20.1	(1.9)	16.7	13.9	14.2	19.1	14.5	14.2	1.7	1.6	1.4	1.8	1.8	1.8	10.5	11.6	10.5	110	(3.5)	0.5
Sobha	372	ADD	36,431	778	98	14.1	17.0	26.2	(7.1)	20.8	54.0	26.4	21.9	14.2	19.1	14.9	9.9	2.1	1.9	1.7	0.3	0.3	0.4	9.7	9.2	12.8	372	0.1	2.2
Unitech	82	SELL	217,837	4,651	2,666	3.0	3.8	5.1	(58.8)	25.0	34.0	26.9	21.5	16.1	26.6	19.2	12.5	2.1	1.8	1.6	—	—	1.8	9.0	8.7	10.6	74	(9.4)	47.0

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	7-Sep-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)
Retail																													
Titan Industries	3,004	ADD	133,341	2,847	44	57.3	83.4	110.2	29.3	45.6	32.2	52.5	36.0	27.3	33.4	24.3	18.5	18.1	12.9	9.2	0.5	0.4	0.4	38.7	41.8	39.4	3,000	(0.1)	8.0
Retail		**Neutral**	**133,341**	**2,847**					**29.3**	**45.6**	**32.2**	**52.5**	**36.0**	**27.3**	**33.4**	**24.3**	**18.5**	**18.1**	**12.9**	**9.2**	**0.5**	**0.4**	**0.4**	**34.5**	**35.8**	**33.8**			
Sugar																													
Bajaj Hindustan	122	SELL	23,365	499	191	4.9	9.9	8.9	52.3	101.0	(9.9)	24.8	12.4	13.7	8.4	6.1	5.8	1.0	0.9	0.9	0.6	0.6	0.6	4.2	7.9	6.5	99	(18.9)	4.6
Balrampur Chini Mills	91	ADD	23,262	497	257	4.3	10.4	7.0	(43.2)	140.4	(32.7)	20.9	8.7	12.9	9.5	5.8	6.4	1.7	1.5	1.4	0.5	0.5	0.5	8.2	17.9	10.9	93	2.6	4.2
Shree Renuka Sugars	72	BUY	48,494	1,035	670	9.9	7.7	8.1	195.3	(21.9)	4.7	7.3	9.4	9.0	4.6	5.3	4.5	1.7	1.4	1.2	0.6	0.5	0.5	22.4	17.0	14.8	76	5.0	10.8
Sugar		**Cautious**	**95,120**	**2,031**					**80.0**	**12.4**	**(8.4)**	**11.0**	**9.8**	**10.7**	**6.5**	**5.7**	**5.3**	**1.4**	**1.3**	**1.1**	**0.5**	**0.5**	**0.5**	**13.1**	**12.8**	**10.5**			
Technology																													
HCL Technologies	402	REDUCE	277,277	5,920	690	17.5	24.5	30.1	0.2	39.7	23.0	22.9	16.4	13.3	11.2	9.8	8.0	3.9	3.3	2.9	1.0	1.0	1.5	19.3	22.0	21.2	390	(2.9)	12.6
Hexaware Technologies	74	REDUCE	10,652	227	144	9.3	5.0	9.4	127.7	(46.3)	87.7	7.9	14.8	7.9	3.9	9.1	4.5	1.3	1.2	1.0	1.3	1.3	1.3	17.8	8.2	14.0	72	(2.9)	1.8
Infosys Technologies	2,865	BUY	1,644,481	35,108	574	108.3	124.1	150.0	5.7	14.5	20.9	26.4	23.1	19.1	19.3	15.8	12.8	7.1	5.9	4.9	0.9	1.2	1.5	30.1	28.0	28.0	3,100	8.2	53.9
Mphasis BFL	653	REDUCE	137,507	2,936	211	43.6	50.3	45.6	207.5	15.5	(9.3)	15.0	13.0	14.3	12.0	10.4	9.8	5.9	4.2	3.3	0.5	0.6	0.7	48.1	37.5	25.8	550	(15.7)	7.3
Mindtree	519	REDUCE	21,339	456	41	52.2	32.6	51.6	294.3	(37.5)	58.1	9.9	15.9	10.1	8.5	9.0	5.9	3.2	2.7	2.2	0.4	0.6	1.0	35.2	19.2	23.7	550	6.1	0.9
Patni Computer Systems	454	REDUCE	60,500	1,292	133	36.6	41.3	37.5	36.4	12.8	(9.1)	12.4	11.0	12.1	6.1	5.2	4.3	1.7	1.6	1.4	1.6	1.8	1.7	18.2	15.1	12.4	450	(0.9)	13.6
Polaris Software Lab	177	SELL	17,622	376	100	15.4	19.1	18.8	16.9	24.3	(1.7)	11.5	9.3	9.4	5.7	7.4	6.3	2.0	1.7	1.5	2.0	2.1	2.2	18.6	20.1	17.2	180	1.8	4.3
TCS	871	BUY	1,705,406	36,409	1,957	35.1	42.1	48.2	32.8	19.8	14.5	24.8	20.7	18.1	18.8	15.1	12.5	8.1	6.7	5.6	2.3	1.9	2.2	37.6	35.6	33.9	965	10.7	29.4
Wipro	408	ADD	998,852	21,325	2,447	18.9	22.3	25.7	22.1	18.1	15.6	21.7	18.3	15.9	16.4	13.2	10.8	5.1	4.2	3.4	0.9	1.1	1.3	26.5	25.0	23.7	465	13.9	12.3
Technology		**Attractive**	**4,961,282**	**105,920**					**20.4**	**16.7**	**15.4**	**23.0**	**19.7**	**17.1**	**16.5**	**13.8**	**11.4**	**6.1**	**5.0**	**4.2**	**1.4**	**1.4**	**1.7**	**26.4**	**25.5**	**24.6**			
Telecom																													
Bharti Airtel	344	REDUCE	1,304,665	27,854	3,798	23.6	20.0	20.7	5.8	(15.6)	3.9	14.5	17.2	16.6	8.2	8.9	7.3	3.1	2.6	2.3	—	—	—	24.4	16.5	14.7	305	(11.2)	46.4
IDEA	74	REDUCE	244,350	5,217	3,300	2.7	2.2	1.5	(5.8)	(19.7)	(30.8)	27.1	33.8	48.8	9.1	9.9	8.4	2.1	2.0	1.9	—	—	—	7.2	6.2	4.2	55	(25.7)	10.5
MTNL	64	SELL	40,163	857	630	(15.6)	(10.4)	(9.1)	(750.8)	(33.7)	(11.9)	(4.1)	(6.1)	(7.0)	(0.4)	(0.5)	(0.6)	0.4	0.4	0.4	—	—	—	(8.5)	(6.1)	(5.7)	50	(21.6)	2.9
Reliance Communications	163	SELL	347,921	7,428	2,133	22.1	6.0	9.4	(30.2)	(72.8)	56.1	7.4	27.2	17.4	6.9	9.5	7.9	0.9	0.9	0.8	0.5	—	—	11.7	3.2	4.9	125	(23.4)	36.9
Tata Communications	339	REDUCE	96,473	2,060	285	14.0	15.2	15.7	3.2	8.2	3.5	24.2	22.3	21.6	9.8	9.0	8.6	1.4	1.3	1.3	1.9	2.2	2.5	5.2	5.5	5.5	225	(33.5)	3.1
Telecom		**Cautious**	**2,033,571**	**43,415**					**(15.9)**	**(33.1)**	**9.5**	**14.3**	**21.4**	**19.6**	**8.3**	**9.3**	**7.7**	**1.8**	**1.7**	**1.6**	**0.2**	**0.1**	**0.1**	**12.8**	**7.9**	**8.0**			
Utilities																													
Adani Power	137	ADD	299,641	6,397	2,180	0.8	4.8	19.1	NM	510.9	298.8	175.4	28.7	7.2	142.7	23.9	6.6	5.2	4.4	2.7	—	—	—	4.2	16.6	46.7	143	4.0	3.9
CESC	400	ADD	49,918	1,066	125	35.2	37.3	44.3	9.3	5.7	18.9	11.3	10.7	9.0	7.2	6.0	6.4	1.2	1.1	1.0	1.1	1.2	1.4	11.1	10.4	11.3	466	16.6	1.9
Lanco Infratech	70	BUY	167,749	3,581	2,405	2.0	3.7	5.0	35.1	87.6	34.9	35.5	18.9	14.0	20.7	8.7	8.3	4.9	3.9	3.1	—	—	—	15.8	21.2	22.7	77	10.4	6.5
NHPC	31	REDUCE	382,553	8,167	12,301	1.9	1.3	1.6	74.9	(27.5)	20.6	16.8	23.2	19.2	10.8	11.6	8.9	1.5	1.5	1.4	1.8	1.1	1.4	9.7	6.4	7.4	28	(10.0)	5.7
NTPC	200	REDUCE	1,646,207	35,145	8,245	10.8	12.5	14.7	9.6	16.2	17.4	18.5	16.0	13.6	14.2	12.4	10.4	2.6	2.4	2.2	2.0	2.3	2.8	14.5	15.4	16.6	210	5.2	7.4
Reliance Infrastructure	1,042	ADD	256,446	5,475	246	61.8	65.0	84.5	(1.5)	5.3	30.0	16.9	16.0	12.3	18.2	16.0	11.2	1.3	1.2	1.1	0.8	0.9	1.0	6.3	7.3	10.1	1,160	11.3	40.1
Reliance Power	158	SELL	377,968	8,069	2,397	2.9	3.1	5.3	179.7	9.8	70.0	55.3	50.3	29.6	(516.9)	228.1	35.6	2.6	2.5	2.3	—	—	—	4.8	5.1	8.1	135	(14.4)	18.8
Tata Power	1,270	ADD	313,504	6,693	247	60.2	69.2	88.5	20.1	15.0	27.8	21.1	18.3	14.4	13.5	12.2	10.5	2.4	2.2	1.9	0.9	1.1	1.2	12.9	12.5	14.3	1,420	11.8	9.6
Utilities		**REDUCE**	**3,493,986**	**74,594**					**23.5**	**16.2**	**38.7**	**22.1**	**19.0**	**13.7**	**17.5**	**14.6**	**10.6**	**2.3**	**2.2**	**1.9**	**1.3**	**1.4**	**1.6**	**10.6**	**11.3**	**14.1**			
Others																													
Havells India	801	SELL	48,165	1,028	60	5.3	31.6	45.0	3.7	497.9	42.6	151.5	25.3	17.8	20.0	12.4	10.2	13.3	8.7	5.9	0.3	0.3	0.3	6.6	41.6	39.7	497	(37.9)	9.3
Jaiprakash Associates	119	BUY	252,692	5,395	2,129	1.5	5.5	7.4	(27.2)	279.8	34.1	81.5	21.5	16.0	21.2	15.6	11.1	3.0	2.5	2.2	—	—	—	4.1	12.8	14.9	170	43.2	23.4
Jindal Saw	215	ADD	63,373	1,353	294	25.0	18.6	17.9	110.8	(25.4)	(4.0)	8.6	11.6	12.0	5.6	6.4	6.2	1.7	1.4	1.2	0.4	0.4	0.4	20.5	12.9	11.1	256	18.8	3.3
PSL	126	BUY	6,755	144	53	22.9	25.4	28.2	3.3	10.6	11.0	5.5	5.0	4.5	3.2	2.6	2.8	0.7	0.7	0.6	5.1	5.1	5.5	12.6	11.7	12.0	182	44.0	0.8
Sintex	376	BUY	51,261	1,094	136	24.1	28.3	33.3	0.5	17.4	17.5	15.6	13.3	11.3	12.7	8.6	7.4	2.4	2.0	1.7	0.3	0.3	0.4	15.5	15.3	15.2	380	1.2	4.7
Tata Chemicals	413	REDUCE	100,477	2,145	243	26.4	35.1	39.2	(27.1)	32.9	11.7	15.6	11.8	10.5	7.7	6.1	5.2	2.1	1.8	1.6	2.2	2.3	2.3	16.0	19.6	18.9	370	(10.4)	4.8
Welspun Corp	254	ADD	52,107	1,112	205	32.0	27.0	25.6	85.2	(15.7)	(5.4)	7.9	9.4	9.9	4.5	5.0	4.7	1.6	1.4	1.2	0.9	0.9	0.9	24.8	15.6	12.8	286	12.8	4.2
United Phosphorus	184	BUY	85,158	1,818	463	11.9	13.8	17.4	18.8	15.8	25.9	15.4	13.3	10.6	8.9	8.1	6.5	2.5	2.2	1.8	0.8	1.1	1.1	17.7	17.2	18.3	225	22.2	7.6
Others			**659,987**	**14,090**					**16.3**	**33.7**	**17.3**	**19.7**	**14.7**	**12.5**	**11.3**	**9.9**	**8.2**	**2.4**	**2.1**	**1.8**	**0.7**	**0.7**	**0.7**	**12.4**	**14.1**	**14.4**			
KS universe (b)			**47,253,288**	**1,008,823**					**15.1**	**21.9**	**20.8**	**20.0**	**16.4**	**13.6**	**11.8**	**9.8**	**8.2**	**3.0**	**2.6**	**2.2**	**1.2**	**1.3**	**1.6**	**14.9**	**15.7**	**16.5**			
KS universe (b) ex-Energy			**38,110,205**	**813,625**					**9.1**	**24.0**	**20.0**	**21.7**	**17.5**	**14.6**	**14.2**	**11.6**	**9.6**	**3.3**	**2.8**	**2.4**	**1.1**	**1.2**	**1.3**	**15.3**	**16.2**	**16.8**			
KS universe (d) ex-Energy & ex-Commodities			**33,735,245**	**720,223**					**16.3**	**19.7**	**21.4**	**22.4**	**18.7**	**15.4**	**15.9**	**13.2**	**10.8**	**3.5**	**3.0**	**2.6**	**1.1**	**1.2**	**1.4**	**15.5**	**16.1**	**17.0**			

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.

Source: Company, Bloomberg, Kotak Institutional Equities estimates

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Kotak Institutional Equities Research coverage universe

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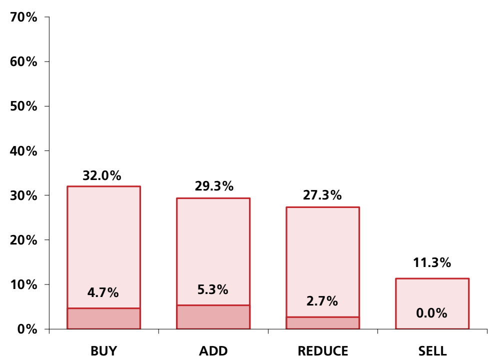

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Source: Kotak Institutional Equities

As of June 30, 2010

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE. We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL. We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

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