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- The Reserve Bank of India set a three-year sunset window on Sahara India Financial Corp., India's largest residuary non-banking company allowing it to accept fresh deposits maturing until 30 June 2011. The central bank is in favor of the winding down of Sahara India's close to Rs200 bn public deposit base in seven years. It has directed Sahara India to repay the deposits as and when they mature and bring down the aggregate liability to depositors to zero on or before 30 June 2015. Sahara India has also been instructed to appoint statutory auditors from the panel of auditors suggested by RBI by 31 August and continue to appoint statutory auditors each year from a panel suggested by the regulator till all depositors are repaid in full. *(Mint)*
- Financial services group Religare Enterprises Ltd intends to enter the banking business, taking advantage of the Rs100 bn that its owners will receive when they complete the sale of their stake in Ranbaxy Laboratories Ltd, India's biggest drug maker, to a Japanese acquirer. *(Mint)*
- Reliance Natural Resources, a Reliance Anil Dhirubhai Ambani group company, has moved an application in the Bombay High Court alleging that RIL has signed MoUs with fertilizer and power firms to sell gas from the Krishna Godavari basin. The company claims this is against the order of the Bombay HC, which restrained RIL from entering into any contracts to sell gas to third parties or create any third party interest with respect to the 80 mmscmd of gas likely to come from KG basin in the later part of 2008. *(ET)*

Economic and political

- India may resume exports of non-basmati rice from November, which were suspended in the wake of rising domestic prices. India's export contribution of up to four million tons to the international rice market of 28 mn tons may help lower global rice futures, and cheer farmers who stand to gain from higher export prices. *(ET)*
- The government has made it clear that unlisted Indian companies should not be allowed to list abroad and that neither American depository receipt (ADR) nor global depository receipt (GDR) rules would be altered to enable them to raise capital on overseas bourses. *(FE)*

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

EQUITY MARKETS

India	Change, %			
	17-Jun	1-day	1-mo	3-mo
Sensex	15,697	2.0	(10.0)	5.8
Nifty	4,653	1.8	(9.8)	2.6
Global/Regional indices				
Dow Jones	12,160	(0.9)	(6.4)	(1.9)
Nasdaq Composite	2,458	(0.7)	(2.8)	8.4
FTSE	5,862	1.2	(7.0)	4.6
Nikkie	14,406	0.4	1.3	20.4
Hang Seng	22,994	(0.3)	(10.2)	7.5
KOSPI	1,760	0.5	(6.8)	10.8
Value traded - India				
		Moving avg, Rs bn		
	17-Jun	1-mo	3-mo	
Cash (NSE+BSE)	162.2	192.2	195.3	
Derivatives (NSE)	401.7	378.8	402	
Deri. open interest	836.1	788	679	

Forex/money market

	Change, basis points			
	17-Jun	1-day	1-mo	3-mo
Rs/US\$	42.9	0	31	235
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.4	(1)	34	73

Net investment (US\$m)

	16-Jun	MTD	CYTD
FIs	(132)	(1,382)	(5,255)
MFs	66	135	1,660

Top movers -3mo basis

Best performers	Change, %			
	17-Jun	1-day	1-mo	3-mo
Chambal Fert	91	0.8	15.5	91.9
i-Flex	1,368	4.4	(2.5)	46.1
Infosys	1,912	0.2	2.1	45.4
Wipro	494	1.4	(2.3)	37.6
Shipping Corp	255	1.8	(9.6)	35.0
Worst performers				
BPCL	280	1.2	(21.9)	(30.6)
HPCL	194	2.0	(21.8)	(25.9)
Siemens India	494	1.5	(15.2)	(24.6)
Thermax	425	(0.2)	(7.1)	(23.0)
Grasim	2,171	0.1	(5.2)	(17.4)

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Energy**BPCL.BO, Rs280**

Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	350
52W High -Low (Rs)	560 - 260
Market Cap (Rs bn)	91.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,105	1,546	1,556
Net Profit (Rs bn)	14.7	13.9	14.2
EPS (Rs)	40.7	38.4	39.1
EPS gth	(22.2)	(5.6)	1.8
P/E (x)	6.9	7.3	7.2
EV/EBITDA (x)	2.9	3.5	2.5
Div yield (%)	1.6	1.4	1.4

Shareholding, March 2008

	% of Pattern Portfolio	Over/(under) weight
Promoters	64.3	-
FIs	10.1	(0.2)
MFs	4.4	0.1
UTI	-	(0.4)
LIC	10.0	0.5

BPCL : Weak 4QFY08 results; uncertainty of earnings remains pending lack of clarity on subsidy-sharing scheme

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- **Lower-than-expected inventory gains and higher-than-expected employee costs dampen 4QFY08 results**
- **Further government action may be required in FY2009E to protect earnings**
- **Fine-tuned estimates; maintain REDUCE and 12-month TP of Rs350**

BPCL reported 4QFY08 adjusted net income at Rs548 mn versus our expected net income of Rs10 bn; the variance was due to (1) inventory gain of Rs3.5 bn versus Rs4.5 bn assumed by us, (2) higher other expenditure at Rs14 bn, (3) higher employee costs at Rs4.6 bn versus Rs2.9 bn assumed by us. BPCL's FY2008 reported net income is Rs15.8 bn (Rs43.7 EPS; adjusted EPS is Rs40.9). We have made modest earnings revisions for FY2009E-2011E EPS based on FY2008 results. Our revised FY2009E, FY2010E and FY2011E EPS estimates Rs38.4, Rs39.1 and Rs42.3, respectively, versus Rs39.7, Rs39.7 and Rs41.8, respectively, previously. However, estimating earnings for downstream companies remains an academic exercise given lack of clarity on the subsidy-sharing scheme. We retain our REDUCE rating with 12-month fair valuation of Rs350 based on 8X FY2010E EPS plus value of treasury shares. Key downside risk stems from higher-than-expected subsidy losses.

4QFY08 results dampened by higher employee costs and lower inventory gains.

Exhibit 1 gives details of BPCL's 4QFY08 results. BPCL reported net income of Rs548 mn compared to Rs1.6 bn in 3QFY08 and Rs6.7 bn in 4QFY07. BPCL's FY2008 reported net income is Rs15 bn versus Rs18.1 bn in FY2007. Employee costs were higher at Rs4.6 bn (+62.6% qoq and +57.7% yoy) due to provision of Rs1.7 bn on account of pending revision in salary for management staff with effect from January 1, 2007. BPCL reported inventory gains at Rs3.5 bn for 4QFY08, which was moderately lower versus our estimate of Rs4.5 bn and in line with the sharp rise in crude prices in the period. This is in contrast to moderate inventory gains of Rs1.9 bn reported by IOCL and inventory loss of Rs940 mn reported by HPCL.

BPCL received oil bonds of Rs86 bn for FY2008 resulting in a share of 24.3% of total oil bonds of Rs353 bn issued by the government. Other expenditure increased sharply to Rs13.8 bn versus Rs7.2 bn in 3QFY08. Other income was lower at Rs1.3 bn versus Rs2.2 bn estimated by us.

More required from government to protect FY2009E earnings. We believe the recent increase in retail prices and cut in duties announced by the government on June 4, 2008 only partly alleviates the problem given the high level of under-recoveries; in spite of the measures announced by the government, there is still a gap of Rs419 bn, which needs to be covered. In our view, the government may need to (1) lower crude prices (likely, in our view), which will result in lower under-recoveries, (2) issue of more oil bonds (possible but depends on the government's fiscal position (already under severe stress) and (3) higher retail price through another round of price increase (highly unlikely, in our view). We believe the underlying philosophy will be that the government will ensure profits of the downstream oil companies at a certain 'minimum' level over the next few years (until the situation improves); there is no other basis to forecast earnings of the downstream oil companies in the current environment.

Other financial and operating details of 4QFY08 and FY2008 results

- 1. Good refining margins.** BPCL's overall 4QFY08 refining margin was US\$6.8/bbl versus US\$5.4/bbl in 3QFY08 and US\$5.6/bbl in 4QFY07. BPCL's FY2008 refining margin was US\$5.6/bbl versus US\$3.6/bbl in FY2007. However, we expect refining margins to decline in FY2009E due to a decline in global benchmark margins led by (1) demand weakness and (2) significant refining capacity addition from 2HCY08. We model refining margin for BPCL at US\$4.2/bbl in FY2009E and US\$3.4/bbl in FY2010E against US\$5.6/bbl in FY2008.
- 2. Compensation (oil bonds) from the government.** BPCL received Rs86 bn of oil bonds for FY2008 resulting in a share of 24.3% of oil bonds of Rs353 bn issued by the government. Based on the same share of oil bonds for BPCL in the future also, we model BPCL will receive Rs271 bn and Rs227 bn of oil bonds in FY2009E and FY2010E, respectively, based on total issue of Rs1.1 tn and Rs935 bn of bonds to the industry in FY2009E and FY2010E, respectively.
- 3. Higher refining throughput in FY2008.** BPCL's two refineries processed 21 mn tons of crude in FY2008 compared to 19.8 mn tons in FY2007. BPCL's Mumbai refinery processed 12.75 mn tons of crude in FY2008 and its Kochi refinery processed 8.2 mn tons of crude. BPCL will expand its refining capacity (Kochi refinery) by 2 mtpa in FY2011E, which will boost its throughput significantly. We model crude throughput at 21 mn tons in FY2009E, 21.5 mn tons in FY2010E and 23 mn tons in FY2011E.

Interim results of Bharat Petroleum, March fiscal year-ends (Rs mn)

	2009E	qoq			yoy			yoy		
		4Q 2008	3Q 2008	% chg	4Q 2008	4Q 2007	% chg	2008	2007	% chg
Net sales	1,545,557	325,786	289,284	12.6	325,786	241,265	35.0	1,105,468	975,602	13.3
Increase/(decrease) in stock		(2,841)	(11,096)		(2,841)	(343)		(3,925)	2,054	
Raw material	(684,792)	(128,568)	(125,911)	2.1	(128,568)	(97,597)	31.7	(489,219)	(422,033)	15.9
Trading purchase	(800,719)	(167,363)	(137,893)	21.4	(167,363)	(113,433)	47.5	(526,646)	(463,904)	13.5
Staff cost	(12,864)	(4,550)	(2,798)	62.6	(4,550)	(2,885)	57.7	(12,972)	(10,037)	29.2
Other expenses	(15,860)	(13,864)	(7,215)	92.2	(13,864)	(14,269)	(2.8)	(42,980)	(47,522)	(9.6)
Total expenditure	(1,514,235)	(317,186)	(284,913)	11.3	(317,186)	(228,527)	38.8	(1,075,742)	(941,442)	14.3
EBITDA	31,322	8,600	4,371	96.8	8,600	12,738	(32.5)	29,726	34,160	(13.0)
Other income	9,046	1,343	1,904	(29.5)	1,343	2,547	(47.3)	12,394	7,332	69.0
Interest	(9,660)	(2,156)	(1,620)	33.1	(2,156)	(1,648)	30.8	(6,725)	(4,774)	40.9
Depreciation	(9,649)	(3,319)	(3,065)	8.3	(3,319)	(2,778)	19.5	(10,982)	(9,041)	21.5
Pretax profits	21,059	4,468	1,590	181.0	4,468	10,859	(58.9)	24,413	27,677	(11.8)
Extraordinary item	—	—	1,279		—	(68)		1,560	(68)	
Tax	(5,880)	(3,486)	(57)		(3,486)	(3,951)		(9,059)	(9,286)	
Deferred tax	(1,277)	(398)	101		(398)	(140)		(1,108)	(268)	
Net income	13,901	584	2,913	(80.0)	584	6,700	(91.3)	15,806	18,055	(12.5)
Adjusted net income	13,901	584	1,614	(63.8)	584	6,742	(91.3)	14,857	18,099	(17.9)
Tax rate (%)	34.0	86.9	(1.5)		86.9	37.9		39.1	34.6	
Volume data										
Crude throughput (mn tons)		5.0	5.2	(4.0)	5.0	5.3	(4.9)	21.0	19.8	5.9
Domestic sales volume (mn tons)		7.0	6.7	3.9	7.0	6.3	10.5	25.8	23.5	10.0
Refining margin (US\$/bbl)		6.8	5.4		6.8	5.6		5.6	3.6	
Inventory gain/(loss)		3,500	4,000		3,500	2,000		10,000	1,000	
Receipt from upstream companies		23,692	16,229		23,692	11,845		59,751	44,622	
Receipt from refining companies		—	—		—	—		—	—	
Receipt of oil bonds from government		39,715	20,789		39,715	9,009		85,895	52,479	
Subsidy gain/(loss)		(69,500)	(50,500)		(69,500)	(9,170)		(179,000)	(107,501)	

Source: Company, Kotak Institutional Equities estimates.

Earnings sensitivity of BPCL to refining margins, import duties and marketing margins, March fiscal year-ends (Rs mn)

	2009E			2010E			2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Refining margins									
Refining margins (US\$/bbl)	3.2	4.2	5.2	2.4	3.4	4.4	3.0	4.0	5.0
Net profits (Rs mn)	9,609	13,901	18,192	9,911	14,152	18,392	10,885	15,310	19,735
EPS (Rs)	26.6	38.4	50.3	27.4	39.1	50.9	30.1	42.3	54.6
% upside/(downside)	(30.9)		30.9	(30.0)		30.0	(28.9)		28.9
Import tariffs									
Tariff protection	1.9	2.4	2.9	2.1	2.6	3.1	2.1	2.6	3.1
Net profits (Rs mn)	12,451	13,901	15,351	12,697	14,152	15,606	13,763	15,310	16,857
EPS (Rs)	34.4	38.4	42.5	35.1	39.1	43.2	38.1	42.3	46.6
% upside/(downside)	(10.4)		10.4	(10.3)		10.3	(10.1)		10.1
Marketing margins									
Auto fuels marketing margin (Rs/ton)	(19,206)	(19,056)	(18,906)	(14,219)	(14,069)	(13,919)	(5,441)	(5,291)	(5,141)
Net profits (Rs mn)	12,901	13,901	14,901	13,100	14,152	15,204	14,203	15,310	16,417
EPS (Rs)	35.7	38.4	41.2	36.2	39.1	42.1	39.3	42.3	45.4
% upside/(downside)	(7.2)		7.2	(7.4)		7.4	(7.2)		7.2

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of BPCL, March fiscal year-ends, 2004-2011E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)								
Net sales	479,840	578,774	755,333	965,569	1,105,468	1,545,557	1,555,889	1,595,894
EBITDA	38,686	26,231	9,407	35,362	29,726	31,322	35,896	45,786
Other income	4,348	4,015	4,653	7,332	12,394	9,046	19,271	24,087
Interest	(1,447)	(1,748)	(2,474)	(4,774)	(6,725)	(9,660)	(23,115)	(35,106)
Depreciation	(6,754)	(7,130)	(7,680)	(9,041)	(10,982)	(9,649)	(10,614)	(11,573)
Pretax profits	34,833	21,368	3,906	28,879	24,413	21,059	21,439	23,194
Extraordinary items	(420)	810	176	(68)	1,560	—	—	—
Tax	(12,026)	(7,250)	(140)	(9,286)	(9,059)	(5,880)	(4,613)	(6,503)
Deferred taxation	(805)	(1,230)	(1,025)	(268)	(1,108)	(1,277)	(2,674)	(1,380)
Net profits	21,582	13,698	2,916	18,055	15,806	13,901	14,152	15,310
Net profits after minority interests	19,086	11,334	2,916	18,055	15,806	13,901	14,152	15,310
Earnings per share (Rs)	64.6	37.2	7.6	50.1	40.9	38.4	39.1	42.3
Balance sheet (Rs mn)								
Total equity	69,960	82,887	91,394	102,735	116,849	129,262	141,899	155,570
Deferred taxation liability	11,304	12,533	13,558	13,826	14,934	16,211	18,885	20,266
Total borrowings	32,701	46,589	83,736	108,292	85,166	152,666	440,166	459,666
Current liabilities	95,495	104,462	94,070	112,767	97,971	119,666	121,167	126,191
Total liabilities and equity	209,459	246,472	282,758	337,620	314,921	417,806	722,117	761,693
Cash	9,319	6,644	4,921	8,640	8,071	5,067	4,293	6,176
Current assets	97,729	130,393	128,208	127,698	114,517	153,246	153,624	157,396
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	88,484	98,542	110,855	118,334	131,730	143,891	158,599	157,519
Investments	13,927	10,893	38,774	82,949	60,602	115,602	405,602	440,602
Total assets	209,459	246,472	282,758	337,621	314,921	417,806	722,117	761,693
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	30,727	21,118	9,275	29,920	13,952	15,782	8,168	4,177
Working capital	1,025	(18,393)	1,577	11,451	1,133	(18,739)	2,314	2,559
Capital expenditure	(17,001)	(17,120)	(19,945)	(17,908)	(22,828)	(21,810)	(25,322)	(10,494)
Investments	1,278	2,992	(28,146)	(45,481)	22,347	(55,000)	(290,000)	(35,000)
Other income	1,985	2,445	1,785	4,337	9,645	10,750	18,081	22,779
Free cash flow	18,015	(8,957)	(35,455)	(17,682)	24,250	(69,016)	(286,759)	(15,978)
Ratios (%)								
Debt/equity	40.2	48.8	91.6	105.4	72.9	118.1	310.2	295.5
Net debt/equity	28.8	41.9	86.2	97.0	66.0	114.2	307.2	291.5
RoAE	28.8	14.4	3.3	16.3	12.7	10.0	9.2	9.1
RoACE	21.2	12.0	4.1	11.0	9.2	8.6	7.8	6.8
Key assumptions (standalone until FY2005)								
Crude throughput (mn tons)	8.8	9.1	17.2	19.8	21.0	21.0	21.5	23.0
Effective tariff protection (%)	7.2	4.8	2.9	1.6	1.4	2.4	2.6	2.6
Net refining margin (US\$/bbl)	4.2	3.8	2.1	3.2	5.6	4.2	3.4	4.0
Sales volume (mn tons)	20.9	21.5	23.3	24.2	26.4	27.4	28.5	29.6
Marketing margin (Rs/ton)	1,893	1,732	(671)	(1,140)	(2,983)	(13,536)	(10,127)	(3,691)
Subsidy under-recoveries (Rs mn)	(13,518)	(25,821)	(31,847)	(20,159)	(25,551)	(28,043)	(14,324)	(8,276)

Source: Kotak Institutional Equities estimates.

Banking**SREI.BO, Rs125**

Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	200
52W High -Low (Rs)	292 - 80
Market Cap (Rs bn)	16.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	2.4	4.1	6.2
Net Profit (Rs bn)	1.0	1.0	1.9
EPS (Rs)	9.6	7.6	13.8
EPS <i>gth</i>	32.4	(20.6)	80.7
P/E (x)	13.0	16.4	9.1
P/B (x)	3.0	1.4	1.3
Div yield (%)	1.3	1.8	2.2

Shareholding, March 2008

	% of	Over/(under)
	Pattern Portfolio	weight
Promoters	25.1	-
FIs	45.6	0.1
MFs	9.9	0.1
UTI	-	-
LIC	-	-

Srei Infrastructure Finance : PAT above estimates, one-time items and technical differences distort earnings

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- **PAT (after minority interest) up 61% yoy to Rs507 mn vs our estimate of Rs209 mn**
- **Key highlights—strong asset growth in JV, one-time items in the parent company, consolidation of the entire earnings of the JV v/s 50% economic stake considered in our estimates**
- **PBT from construction equipment finance business (JV) in line, tax liability higher than estimates**

Srei reported 61% growth in 4QFY08 PAT (post minority interest) of Rs507 mn comprising net earnings from JV - Rs268 mn and parent company - Rs267 mn. While the construction equipment finance business reported strong net operational income on the back of healthy asset growth (46%), operating expenses and tax liability were higher than estimates. Srei (parent) booked large income on deferred tax liability (DTL) writeback which supported its reported earnings. The company made investments of Rs8 bn (including warehousing investments of Rs6.5 bn) which will likely realize income in the subsequent quarters. Given the lack of information, we find it difficult to analyze the results; we will revisit our estimates and recommendation post discussion with the management.

Key highlights

JV: Consolidation of 100% stake in 4QFY08. In January 2008, Srei transferred its construction equipment finance business to a separate company—the proposed 50:50 JV with BNP. While BNP had proposed to join the JV in 4QFY08, the actual agreement was executed in April 2008. As such, Srei had a 100% share in the JV as of March 2008 as compared to 50% consolidation factored in our estimates (based on management guidance). Note that the consideration paid by BNP will not be change despite a delay in infusing capital.

Warehousing assets for Quipo. Srei (parent) made investments of Rs8 bn during the quarter comprising the following:

- Purchase of Spice Telecom's towers— Rs6.5 bn on behalf of Quipo telcom. Srei's management has highlighted that investment is for a temporary period and the company will eventually transfer the towers to Quipo Telecom. Srei will earn fees/ interest from Quipo for the warehousing facility but has not booked any income during 4Q08 resulting in subdued operating income from the parent company.
- Equity investments in various road projects—Rs1.5 bn. Note that Srei, in partnership with construction companies, has development rights for seven road projects.

Accounting income from DTL writeback supports earnings, entry confusing.

Srei (parent) has written back deferred tax liabilities (DTL) of Rs640 mn during the quarter largely supporting its reported profits. According to the management, the DTL was created due to difference in depreciation rates on its assets which were transferred to the JV. We are surprised with the entry given that the benefit of DTL should also have been transferred to the JV. At the same time, the JV has not created a corresponding liability in its books and will likely have to make higher provisions in the future.

Forex losses of Rs120 mn surprising. Srei has booked M2M losses of Rs120mn (US\$3 mn) during the quarter. We are surprised with the quantum of loss considering the fact that the company had a small unhedged exposure of US\$13 mn as of December 2007. It did not have any open position on Yen as on December 2007. We are awaiting clarification on this item from the management.

Srei Infrastructure Finance—quarterly results

4Q07-4Q08 (Rs mn)

	4Q07	1Q08	2Q08	3Q08	4Q08	YoY (%)
Interest income	1,234	1,214	1,493	1,735	2,859	132
Depreciation on leased assets	115	110	112	116	124	8
Interest income (net of lease depreciation)	1,120	1,104	1,381	1,619	2,735	144
Interest expenses	610	675	866	992	2,059	238
Net interest income	510	428	515	627	675	32
Provisions and write/off	103	28	39	105	106	3
Net interest income (after prov.)	407	400	476	522	569	40
Other income	13	3	15	20	670	5,175
Total income pre loan loss provision	522	431	529	647	1,345	158
Operating expenses	202	153	162	238	594	194
Employee expenses	72	58	61	117	215	197
Admin and other expenses	122	88	94	114	373	205
Depreciation	7	7	7	8	6	(18)
Pretax income	218	251	328	304	645	196
Tax provisions	(97)	18	32	20	111	(214)
Net Profit	315	233	296	284	535	70
Net profit after minority interest	315				507	61
PBT before extraordinary items	218				125	(42)
Tax rate(%)	(44.7)	7.1	9.8	6.6	17.1	

Source: Company.

Srei 4Q08 results (Rs mn)

	Reported financials			KS estimates		
	Parent	JV	Consolidated	JV	Actual vs KS (%)	Consolidated
Operational income	150	2,585	2,735	1,700	52	
Interest expenses	370	1,569	2,059	1,024	53	
Provision for forex	120					
Net operational income	(340)	1,015	675	677	50	
Provision expenses		106	106	40	166	
Provisions for forex		—				
Operating expenses	50	544	594	255	113	
Other income	640	30	670	—		
Profit before tax	250	395	645	382	3	
Tax	(17)	127	111	32	300	
Profit after tax	267	268	535	350	(23)	384
Profit after tax (after minority interest)			507	175		209
Profit before tax (excluding extraordinary)	(270)					
Tax rate (%)	(7)	32	17	8		

Source: Company, Kotak Institutional Equities estimates.

Media**ZEE.BO, Rs234**

Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	260
52W High -Low (Rs)	410 - 169
Market Cap (Rs bn)	101.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	18.3	20.8	24.2
Net Profit (Rs bn)	3.5	4.6	6.0
EPS (Rs)	8.2	10.6	13.7
EPS <i>gth</i>	49.4	29.7	29.8
P/E (x)	28.7	22	17.1
EV/EBITDA (x)	18.8	14.7	11.1
Div yield (%)	0.9	1.1	1.4

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters		41.5	-
FIs		27.4	0.4
MFs		13.6	1.0
UTI		-	(0.3)
LIC		7.5	0.5

Zee Entertainment Enterprises : Announces aggressive push into the film production business in India

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- **Aims to execute over 180 film projects in six languages over the next three years**
- **Zee Next to be demerged from the ZEEL given massive investment in marketing and distribution over the next few years; details still unclear**
- **Retain ADD rating with a 12-month DCF-based target price of Rs260 pending further clarity on announced plans**

The management of ZEEL in an analysts meeting outlined its plans for an aggressive foray into the film production business in India. The company is looking to execute over 180 film projects in six Indian languages over the next three years; ZEEL has already established six internal teams to lead in-house film production as well as signed output deals with about 8-10 directors. The company is targeting revenues of Rs14 bn and EBITDA margin of 34% from the business in FY2011E. ZEEL has also decided to demerge Zee Next, the youth-focused flanking Hindi general entertainment (GE) channel, into a separate entity. The details of the demerger process are not yet clear but the management has guided a loss of Rs500 mn due to Zee Next in the FY2009E ZEEL financials. We retain our ADD rating and 12-month DCF-based target price of Rs260 for ZEEL stock pending clarifications on the demerger process and film production business. We believe the flanking strategy of a second Hindi GEC to support the flagship channel has not worked and thus, the Zee Next demerger may be positive for ZEEL.

Aggressive push into film production business. The ZEEL management announced an aggressive push into the film production business in India with the formation of Zee Entertainment Studios (ZES); the company is looking to execute over 180 film projects in six Indian languages (Hindi, Tamil, Telugu, Marathi, Bengali and Gujarati) over the next three years. The management noted the experience of the group and synergies with other group companies (exhibition, broadcasting and distribution) for this business. ZEEL plans to establish two production studios—(1) Zee Motion Pictures for mainstream films and (2) Zee Limelight for niche films—to kick-start its in-house production. However, the company also plans to aggressively delve into co-productions, output deals and complete film acquisitions to achieve its targets; ZES has already signed 8-10 output deals with experienced directors.

The financing for the venture will be done using a mix of internal accruals and equity dilution in ZES. ZEEL plans to shift its entire library of over 3,300 movie titles to ZES in addition to the initial financing of Rs1 bn. Thereafter, the company will dilute a minority stake in ZES, the details of which are being worked out currently, to raise financing for the next 2-3 years of operations. ZES will utilize the services of group companies in the exhibition (E-city), broadcasting (ZEEL, Zee News) and distribution (WWIL, Dish TV) segments to monetize the developed film content. The international distribution of film content will be handled through the overseas television distribution arm of ZEEL. The IPR rights of all film content produced and acquired will be globally managed and monetized by ZES, though some rights will be sold to third parties initially given the large scale of operations.

Demerger of Zee Next. ZEEL also announced the demerger of Zee Next, the youth-focused flanking Hindi GE channel, into a separate entity. The management did not disclose the exact structure of the demerger process since the details are still being worked out; however, the company did note that the impact of losses in Zee Next channel will be capped at Rs500 mn in FY2009E ZEEL financials. The company plans to raise fresh capital in the demerged entity to continue investments in programming, distribution and marketing of the channel over the next 2-3 years. As we have previously highlighted, the flanking strategy of a second Hindi GE channel to support the flagship channel has not worked well in the past for either STAR or Sony, the other leading broadcasters in India, and we are not sure if the strategy will work for ZEEL. We note that the channel has had a disappointing run since December, 2007 and the demerger may be viewed in a positive light by the street depending upon the details of the demerger process.

Other developments

1. **Modest changes to FY2008 financials.** The audited FY2008 financial results of ZEEL were released (see Exhibit 1) and there are modest changes from the financial results released previously. The key change is reduction in FY2008 consolidated tax to Rs1.6 bn from Rs1.7 bn previously; the management attributed this to taxation benefit from accumulated losses of Rs360 mn in the education business (ZILS) which were included in FY2008 ZEEL financials.
2. **Clarification on extraordinary items.** The management reiterated that the loss in its open forex derivative position, which the company entered into three years ago, is capped at Rs470 mn (US\$10.9 mn) for FY2009E at current cross currency rates. The management also noted the tax credit of Rs574 mn from the Income Tax department which was paid by the company under protest and for which the company has recently won the appeal process. Thus, the company will likely report an extraordinary income of Rs104 mn in FY2009E.
3. **Financial guidance for FY2009E—aggressive in our view.** ZEEL reiterated its guidance of 25% revenue growth and 37% EBITDA growth, including the loss of Rs500 mn in Zee Next but excluding gains from the film production business, for FY2009E. We find the guidance given by the company to be aggressive given (1) entry of new Hindi GE channels will further fragment the ad revenue market and (2) increased competition will also result in greater spending on content and marketing. We model FY2009E ad and subscription (domestic and overseas) revenue growth of 15.3% and 15.8%, respectively, for ZEEL.
4. **Ratings set to improve going forward.** The TRP ratings of Zee TV (see Exhibit 2) have seen a marked improvement in the past few weeks with the close of IPL and new programming during weekends; we note that ZTV continues to have a strong lineup of weekday programs in the list of top Hindi GEC programs (see Exhibit 3) and it is now scaling up its weekend slots with the launch of new action and reality content, most notably the return of its prime property 'SaReGaMaPa Challenge' in July, 2008. We believe ZTV will likely maintain its strong number two position in the Hindi GEC genre and improve its TRP ratings going forward driven by continued investment in content, distribution and marketing.

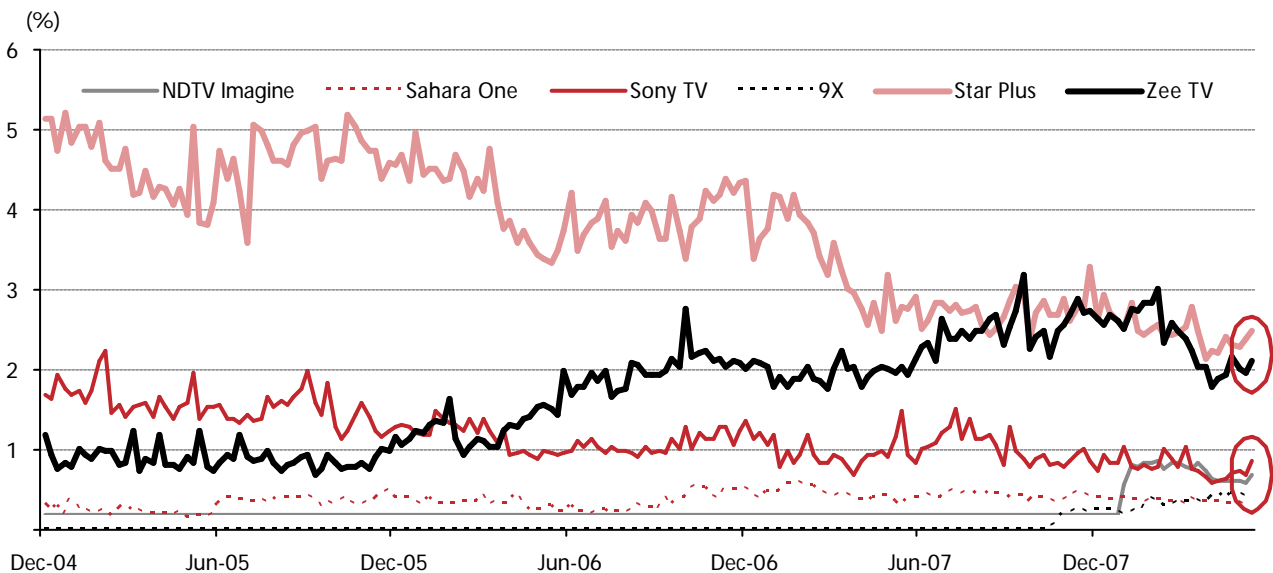
Zee Entertainment (ZEEL) consolidated interim results, March fiscal year-ends (Rs mn)

	2009E	qoq			yoy			yoy		
		4QFY08	3QFY08	% chg.	4QFY08	4Q 2007	% chg.	2008	2007	% chg.
Net sales	20,845	5,260	5,182	1.5	5,260	3,844	36.8	18,354	14,412	27.4
Advertisement revenues	10,770	2,466	2,638	(6.5)	2,466	1,849	33.3	9,307	7,064	31.8
Subscription revenues	8,483	2,071	1,950	6.2	2,071	1,849	12.0	7,436	6,606	12.6
Domestic pay-TV	4,425	987	878	12.4	987	854	15.5	3,394	3,064	10.8
International	4,058	1,084	1,072	1.1	1,084	995	8.9	3,933	3,542	11.0
Other sales	1,592	723	594	21.8	723	146	394.1	1,611	742	117.0
Total expenditure	(14,093)	(3,957)	(3,613)	9.5	(3,957)	(2,893)	36.8	(13,031)	(11,224)	16.1
Transmission and programming cost	(8,880)	(2,192)	(2,549)	(14.0)	(2,192)	(1,632)	34.3	(7,918)	(7,353)	7.7
Staff cost	(1,558)	(406)	(312)	30.3	(406)	(292)	39.1	(1,438)	(1,008)	42.7
Administrative & other costs	(3,654)	(1,359)	(753)	80.5	(1,359)	(969)	40.2	(3,675)	(2,863)	28.4
EBITDA	6,753	1,303	1,569	(17.0)	1,303	951	36.9	5,323	3,188	67.0
EBITDA margin (%)	32.4	24.8	30.3		24.8	24.8		29.0	22.1	
Other income	945	435	238	83.3	435	177	146.5	1,138	630	80.7
Interest	(507)	(184)	(167)	10.4	(184)	(8)	2,094.0	(516)	(220)	135.0
Depreciation	(271)	(54)	(47)	14.3	(54)	(56)	(4.1)	(232)	(228)	2.1
Pretax profits	6,920	1,500	1,592	(5.8)	1,500	1,064	41.0	5,713	3,370	69.5
Extraordinaries	—	(26)	—		(26)	—		(26)	—	
Tax	(2,135)	(430)	(458)	(6.0)	(430)	(365)	18.0	(1,627)	(964)	68.8
Net income	4,785	1,044	1,135	(8.0)	1,044	699	49.3	4,061	2,407	68.7
Minority interest	(187)	(120)	(38)		(120)	(95)		(333)	(212)	
Net income after minority interest	4,598	924	1,097	(15.7)	924	604	53.1	3,728	2,195	69.8
Tax rate (%)	30.9	29.2	28.7		29.2	34.3		28.6	28.6	

Source: Kotak Institutional Equities estimates.

Zee TV and Star Plus have created a strong positioning for themselves even as other Hindi GE channels faltered

Prime time (7:30-11:30 PM) ratings for Hindi general entertainment channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Share of top programs amongst Hindi general entertainment channels (#)

Week beginning:	Historical data						Recent weeks' data								
	27-Mar-05	25-Sep-05	26-Mar-06	24-Sep-06	25-Mar-07	23-Sep-07	23-Mar-08	13-Apr	20-Apr	27-Apr	4-May	11-May	18-May	25-May	1-Jun
Share of top 25 programs amongst Zee, Star, Sony and Imagine															
Zee TV	—	—	—	2	4	9	16	13	9	13	10	12	13	12	14
Star Plus	25	25	25	23	21	15	9	12	16	12	15	13	12	13	11
Star One	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Sony	—	—	—	—	—	1	—	—	—	—	—	—	—	—	—
Imagine	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Share of top 50 programs amongst Zee, Star, Sony and Imagine															
Zee TV	—	—	1	10	19	21	22	22	21	22	21	23	22	22	22
Star Plus	42	46	46	39	31	27	27	28	29	28	29	27	28	28	27
Star One	—	—	1	1	—	—	—	—	—	—	—	—	—	—	—
Sony	8	3	1	—	—	2	1	—	—	—	—	—	—	—	1
Imagine	—	—	1	—	—	—	—	—	—	—	—	—	—	—	—
Share of top 100 programs amongst Zee, Star, Sony and Imagine															
Zee TV	8	—	11	23	29	38	37	34	35	35	33	35	32	31	31
Star Plus	68	74	75	73	64	54	55	61	60	60	64	62	65	67	60
Star One	—	—	1	2	2	—	2	—	—	—	—	—	—	—	1
Sony	24	21	7	2	3	6	2	1	1	1	1	1	1	1	4
Imagine	—	4	6	—	—	—	4	4	4	3	2	2	2	1	4

Source: TAM Media Research, Compiled by Kotak Institutional Equities.

Consolidated profit and loss statement for Zee Telefilms, March fiscal year-ends, 2004-2006, ZEEL, 2007-2012E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Revenues									
National Hindi (Zee TV)	2,539	1,826	2,119	3,303	5,099	5,826	6,597	7,542	8,526
National Hindi (Zee Cinema)	756	914	996	1,574	1,830	2,063	2,378	2,719	3,073
Niche channels (English, Music, Zee Next)	965	956	1,081	400	504	716	954	1,161	1,366
Regional channels	1,365	1,324	1,486	—	—	—	—	—	—
Zee Sports + Taj TV	—	—	72	1,279	1,436	1,680	1,898	2,140	2,403
Cable TV (Siti)	220	266	261	—	—	—	—	—	—
Overseas - ZMWL	460	505	557	526	472	485	483	487	498
Others	50	(92)	(6)	(47)	—	—	—	—	—
Advertisement	6,355	5,698	6,566	7,035	9,342	10,770	12,309	14,049	15,867
Domestic pay-TV	2,173	2,696	2,801	3,113	3,393	4,425	5,928	7,358	8,839
Overseas	2,569	2,909	3,030	3,933	3,933	4,058	4,244	4,378	4,567
Domestic subscription	1,168	1,002	978	—	—	—	—	—	—
Others	115	(74)	364	(399)	—	—	—	—	—
Subscription revenues	6,026	6,533	7,174	6,648	7,326	8,483	10,172	11,736	13,406
Education	131	106	162	205	392	432	475	523	575
Others	1,190	742	2,641	1,271	1,283	1,160	1,217	1,277	1,340
Total revenues	13,702	13,079	16,544	15,159	18,343	20,845	24,173	27,585	31,188
Programming/Content	(2,520)	(2,611)	(4,247)	(4,783)	(5,067)	(5,646)	(6,594)	(7,476)	(8,293)
Broadcasting	(618)	(675)	(515)	(564)	(516)	(506)	(503)	(506)	(516)
Distribution	(1,837)	(1,534)	(2,565)	(1,967)	(1,538)	(1,736)	(1,793)	(1,841)	(1,915)
Other direct operating	—	—	(262)	(766)	(864)	(992)	(1,044)	—	—
Employees	(727)	(858)	(1,089)	(1,017)	(1,431)	(1,558)	(1,682)	(1,822)	(1,983)
SG&A	(3,691)	(3,051)	(3,431)	(2,858)	(3,539)	(3,654)	(3,904)	(3,991)	(4,396)
Total expenses	(9,393)	(8,728)	(13,848)	(11,955)	(12,955)	(14,093)	(15,519)	(16,735)	(18,260)
EBITDA	4,309	4,351	2,695	3,204	5,388	6,753	8,654	10,850	12,928
Other income	776	521	639	747	911	945	1,019	1,225	1,503
Interest expense	(583)	(207)	(188)	(334)	(554)	(507)	(2)	—	—
Depreciation	(320)	(329)	(360)	(185)	(222)	(271)	(283)	(290)	(300)
Amortization	—	—	—	—	—	—	—	—	—
Pretax profits	4,183	4,336	2,787	3,432	5,524	6,920	9,388	11,785	14,132
Extraordinary items	26	(140)	19	—	174	—	—	—	—
Tax	(1,103)	(1,123)	(528)	(926)	(1,732)	(2,141)	(3,230)	(4,105)	(4,946)
Deferred tax	54	99	(9)	(76)	(3)	6	12	16	19
Minority interest	(192)	(50)	(117)	(58)	(245)	(187)	(205)	(271)	(303)
Net income	2,969	3,123	2,153	2,373	3,718	4,598	5,966	7,424	8,901
Recurring net income	2,942	3,263	2,134	2,373	3,544	4,598	5,966	7,424	8,901
Fully diluted EPS	7.1	7.5	4.9	5.5	8.2	10.6	13.7	17.1	20.5
Key ratios									
EBITDA growth (%)	14.7	1.0	(38.1)	18.9	68.2	25.3	28.2	25.4	19.2
EPS growth (%)	18.2	5.2	(34.6)	11.2	49.4	29.7	29.8	24.8	19.9
EBITDA margin (%)	31.5	33.3	16.3	21.1	29.4	32.4	35.8	39.3	41.5
Tax rate (%)	24.9	24.4	19.1	29.2	30.5	30.9	34.3	34.7	34.9
Shares o/s year end (mn)	412	412	413	434	434	434	434	434	434
Shares o/s fully diluted (mn)	412	435	435	435	435	435	435	434	434

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of Zee Telefilms 2006 and of ZEEL 2007-2012E, March fiscal year-ends (Rs mn)

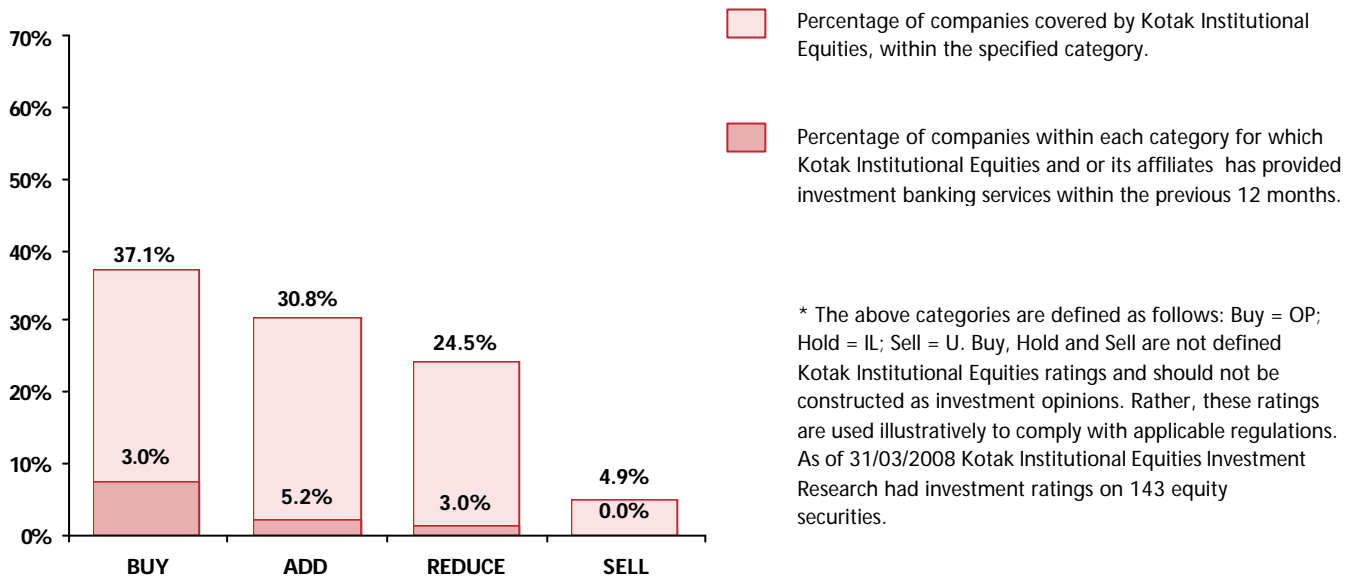
	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)							
Total revenues	16,544	15,159	18,343	20,845	24,173	27,585	31,188
EBITDA	2,695	3,204	5,388	6,753	8,654	10,850	12,928
Other income	639	747	911	945	1,019	1,225	1,503
Interest	(188)	(334)	(554)	(507)	(2)	—	—
Depreciation	(360)	(185)	(222)	(271)	(283)	(290)	(300)
Amortization	—	—	—	—	—	—	—
Pretax profits	2,787	3,432	5,524	6,920	9,388	11,785	14,132
Extraordinary items	19	—	174	—	—	—	—
Tax	(528)	(926)	(1,732)	(2,141)	(3,230)	(4,105)	(4,946)
Deferred tax	(9)	(76)	(3)	6	12	16	19
Minority interest	(117)	(58)	(245)	(187)	(205)	(271)	(303)
Net income	2,153	2,373	3,718	4,598	5,966	7,424	8,901
Recurring net income	2,134	2,373	3,544	4,598	5,966	7,424	8,901
Earnings per share (Rs)	4.9	5.5	8.2	10.6	13.7	17.1	20.5
Balance sheet (Rs mn)							
Total equity	21,286	26,181	28,885	32,167	36,425	41,724	48,077
Deferred tax balance	(148)	(75)	(72)	(78)	(91)	(106)	(125)
Minority interest	458	819	1,063	1,250	1,454	1,726	2,029
Total borrowings	4,901	3,226	2,646	274	—	—	—
Current liabilities	4,346	5,106	3,374	3,669	4,021	4,359	4,694
Total capital	30,844	35,256	35,896	37,281	41,810	47,702	54,675
Cash	1,286	955	2,984	2,695	5,436	9,549	14,726
Current assets	13,574	17,133	15,765	17,510	19,381	21,249	23,145
Net fixed assets	12,948	14,841	14,819	14,749	14,665	14,576	14,476
Investments	3,024	2,326	2,326	2,326	2,326	2,326	2,326
Deferred expenditure	12	2	2	2	2	2	2
Total assets	30,844	35,256	35,896	37,281	41,810	47,702	54,675
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	1,931	1,812	3,277	4,104	5,423	6,745	7,981
Working capital	(3,950)	(486)	(364)	(1,450)	(1,518)	(1,531)	(1,560)
Capital expenditure	(383)	(460)	(200)	(200)	(200)	(200)	(200)
Investments	418	(4,289)	—	—	—	—	—
Other income	488	469	911	945	1,019	1,225	1,503
Free cash flow	(1,496)	(2,954)	3,624	3,399	4,723	6,238	7,724
Revenue model (Rs mn)							
Advertising revenues	6,566	7,035	9,342	10,770	12,309	14,049	15,867
Subscription-domestic	2,801	3,113	3,393	4,425	5,928	7,358	8,839
Subscription-overseas	3,030	3,933	3,933	4,058	4,244	4,378	4,567
Subscription-cable	978	—	—	—	—	—	—
Others	3,168	1,078	1,675	1,592	1,692	1,800	1,915
Total revenues	16,544	15,159	18,343	20,845	24,173	27,585	31,188

Source: Kotak Institutional Equities estimates.

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

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities.

As of March 31, 2008

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

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

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

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

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

Old rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.

IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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

Other definitions

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

Other ratings/identifiers

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

CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.

NC = Not Covered. Kotak Securities does not cover this company.

RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.

NA = Not Available or Not Applicable. The information is not available for display or is not applicable.

NM = Not Meaningful. The information is not meaningful and is therefore excluded.

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