kotak® Institutional Equities

INDIA DAILY

May 08, 2008

EQUITY MARKETS

India	7-May	1-day	1-mo	3-mo
		Change, %		
Sensex	17,339	(0.2)	10.0	(1.1)
Nifty	5,136	(0.2)	7.9	0.0
Global/Regional indices				
Dow Jones	13,021	0.4	3.2	6.3
Nasdaq Composite	2,483	0.8	5.0	8.3
FTSE	6,272	0.9	4.3	9.6
Nikkie	14,102	0.4	6.1	2.6
Hang Seng	25,610	(2.5)	4.2	9.1
KOSPI	1,854	(0.3)	4.5	9.3

Value traded - India

	7-May		1-mo	3-mo
			Moving avg, Rs bn	
Cash (NSE+BSE)	209.1		187.3	191.4
Derivatives (NSE)	328.6		337.2	422
Deri. open interest	695.2		539	706

Forex/money market

	7-May	1-day	1-mo	3-mo
		Change, basis points		
Rs/US$	41.4	47	149	189
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	(1)	(12)	37

Net investment (US$mn)

	6-May		MTD	CYTD
FIIs	(181)		-	(2,725)
MFs	(6)		9	1,611

Top movers -3mo basis

Best performers	7-May	1-day	1-mo	3-mo
		Change, %		
Thomas Cook	101	0.1	4.4	34.1
i-Flex	1,347	(0.3)	39.4	32.3
Sun Pharma	1,442	0.3	12.9	32.3
Polaris	108	(1.2)	33.1	27.7
Nestle India	1,714	(0.4)	11.4	26.5
Worst performers				
Siemens India	584	0.1	(0.4)	(26.3)
Essel Propack	36	(1.0)	(0.5)	(25.9)
Reliance Cap	1,453	1.6	19.3	(22.4)
Thermax	495	(0.7)	1.1	(21.0)
Engineers India	663	(1.6)	3.0	(20.3)

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News Roundup

Corporate

- The JWS Group and Toshiba Corporation of Japan have agreed to establish a JV to manufacture and market super-critical steam turbines and generators for thermal power plants in India. *(BL)*
- Bharti Airtel has joined 15 global telecommunications majors including South Africa's MTN, British Telecom, US-based AT&T and Verizon to construct a new high-bandwidth, sub-sea cable system linking the United Kingdom and India. *(ET)*
- The government is planning to divest its residue 26.12% equity in the Tata-owned VSNL, now called Tata Communication. *(BS)*
- After the UK-based Hinduja group, ONGC's proposed Rs26,500 crore refinery at Kakinada in Andhra Pradesh has found new suitors in Reliance Industries and Essar Oil. *(BS)*

Economic and political

- 625 companies have borrowed nearly US$1 bn through external commercial borrowings during 2007-08. *(BL)*
- State governments are likely to slap a common 12.5% tax on aviation turbine fuel drawn by airlines. *(FE)*

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

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

Banking

UNBK.BO, Rs173	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	250
52W High -Low (Rs)	250 - 105
Market Cap (Rs bn)	87.6

Financials

May y/e	2008	2009E	2010E
Sales (Rs bn)	43.2	46.3	55.4
Net Profit (Rs bn)	13.9	12.8	15.7
EPS (Rs)	27.5	25.3	31.1
EPS gth	*2.0*	*(7.9)*	*23.2*
P/E (x)	6	6.9	5.6
P/B (x)	1.2	1.1	0.9
Div yield (%)	2.3	2.2	2.7

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	55.4	-	-
FIIs	19.6	0.2	(0.0)
MFs	9.3	0.5	0.3
UTI	-	-	(0.2)
LIC	1.9	0.1	(0.1)

Union Bank of India: Profit much higher than estimates on provision reversal; retain BUY

Tabassum Inamdar : tabassum.inamdar@kotak.com, +91-22-6634-1252

Ramnath Venkateswaran : ramnath.venkateswaran@kotak.com, +91-22-6634-1240

- **Union Bank reported net profit of Rs5.2 bn in 4QFY08 (124% yoy), double our estimate of 2.5 bn**
- **Healthy non-interest income growth, reversal of employee provisions and lower effective tax rate were the drivers of earnings**
- **Retain BUY rating with a price target of Rs250 given reasonable valuations**

Union Bank reported net profit of Rs5.2 bn in 4QFY08—growth of 124% yoy and double our estimate of Rs2.5 bn. A large part of this growth was driven by reversal of employee expenses on account of transitional pension liability and lower tax rate. NII remained flat on a yoy basis as margin remained under pressure, while non-interest income grew by a healthy 26%. The bank's asset quality remained good, with net NPLs at 0.17%. Going forward management expects margin to remain stable, and business to grow by over 22% as the bank expands its network more aggressively than in the past. We are revising our earnings estimates for Union Bank upwards by 7% and 5% for FY2009 and FY2010 on account of lower employee cost as the bank has already made the adjustment of transitional liabilities under AS-15 guidelines through its reserves. We are disappointed with the flat NII growth but remain positive on Union Bank, retaining our BUY rating and target price at Rs250 per share. We believe there is potential for further upside, given high RoE and earnings growth post FY2009 and likely upside risk to our earnings estimates. The stock is amongst our preferred picks in the banking sector, trading at 6.9X PER and 1.4X PBR FY2009 as against expected RoE of 20%.

NII flat, 8% lower than our estimate

- Union Bank 4QFY08 NII was flat yoy at Rs8.3 bn, 8% lower than our estimate.
- The bank moderated both advances and deposits growth compared to previous quarters to 19.2% and 21.9%. Within deposits, the focus was on CASA deposits and core retail deposits both of which increased 23.2% and 28.6%, respectively.
- Despite this, the bank reported a fall in NIM to 2.8% for the full year, down from 3.05% last year, likely due to the recent reduction in PLR of 50 bps.
- Management indicated that margin will likely remain stable as the bank is focusing on core deposits, repricing nearly Rs100 bn of bulk deposits at rates 100 bps lower than last year and reducing its rate on the recently-introduced special deposit scheme. Accordingly, we are assuming flat margin for FY2009 and FY2010 at around 2.82%.

Treasury and other core fees both showed good growth

Union Bank's non-interest income grew by 42% yoy to Rs3.5 bn in 4QFY08. Within this, treasury income doubled to Rs400 mn, while core income grew 25% to Rs3.1 bn.

Writeback of provisions reduced qoq expenses sharply, boosting profit

- Operating expenses declined by 22% yoy to Rs2.5 bn in 4QFY08 largely driven by the lower employee costs of Rs571 mn (compared to Rs2.8 bn in 3QFY08 and Rs1.5 bn in 4QFY07).
- The company has written down its transitional liabilities of employee benefits under the revised AS-15 guidelines against its net worth instead of amortizing it over a five year period.

- Union Bank thus showed a write-back of Rs1.28bn in the 4Q (Rs900 mn for AS15 and balance for gratuity) in the employee expense.
- The full provision through the reserves has impacted its Tier I ratio which has come down to 7.5% and total CAR at 12.5%. As per Basel II norms, the bank CAR is even lower at 11.7%. Management indicated that the bank is considering a rights issue and will be approaching the government (as was the case with SBI), to raise capital. The government holds 55.4% stake in the bank leaving little scope for Union Bank to raise capital by fresh equity issuance.
- The bank also made lower tax provision of 1% in the 4Q. Management indicated this was due to higher tax liability provision made in the previous quarters. The tax rate for the full year was 25%.

Asset quality: still going strong

- Union Bank, gross and net NPL ratio remained low at 2.2% and 0.17% respectively. Gross NPLs have however, increased qoq by 6%.
- The bank reported incremental slippage ratio of 1.23% down from 1.96% in March 2006 and is targeting a ratio of 1.1% for FY2009. This despite and increasing share of SME and wholesale trade advances. SME advances increased 39% yoy and wholesale advances by 20%. SME now accounts for 16% of total advances and wholesale trade 10%. We believe NPLs in this segment may increase and are therefore assuming higher provisioning going forward at 1% of loan book.
- The bank has claimed around Rs13.9 bn or 12% of agriculture portfolio under the loan waiver scheme announced by Government of India. Management indicated the NPL level was low at Rs.3.5 bn, but the overdue loans were high.

Union Bank of India Quarterly results, Rs mn

	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	% chg	4QFY08KS	Actual Vs
Interest income	20,949	21,112	22,548	24,586	26,024	24.2	27,537	(5.5)
Loans	14,305	15,352	16,261	17,562	18,135	26.8	20,183	(10.1)
Investments	5,386	5,555	5,852	6,718	6,832	26.9	6,968	(2.0)
Balances with RBI	668	192	172	140	104	(84.4)	386	(73.0)
Others	591	13	263	166	953	61.4		
Interest expense	12,586	13,399	15,820	16,705	17,685	40.5	18,474	(4.3)
Net interest income	**8,364**	**7,713**	**6,728**	**7,881**	**8,339**	**(0.3)**	**9,064**	**(8.0)**
NII adj. for invst depreciation	**7,984**	**7,343**	**6,358**	**7,521**	**7,979**	**(0.1)**	**8,684**	**(8.1)**
Non-int.income	2,800	2,153	3,078	3,835	3,467	23.8	2,441	42.0
core fees	860	820	890	990	940	9.3	912	3.0
exchange income	670	550	610	690	760	13.4	729	4.3
sale of invts.	130	330	810	1,560	400	207.7		
Non-int income excl treasury	2,670	1,823	2,268	2,275	3,067	14.9	2,441	25.6
Total income	11,164	9,866	9,806	11,715	11,806	5.8	11,505	2.6
Op. expenses	3,259	4,241	4,153	4,997	2,539	(22.1)	4,854	(47.7)
Employee cost	1,488	2,543	2,546	2,794	571	(61.6)	2,727	(79.1)
Other cost	1,771	1,699	1,607	2,203	1,968	11.2	2,127	(7.5)
Operating profit	7,905	5,625	5,653	6,719	9,267	17.2	6,651	39.3
Provisions and cont.	3,540	1,924	1,346	1,468	4,012	13.3	2,766	45.0
Investment amortization	380	370	370	360	360	(5.3)	380	(5.3)
Investment Depreciation	780	270	40	(640)	1,100	41.0		
NPLs	2,500	1,280	1,290	1,520	2,560	2.4	1,880	36.1
Other provisions	(120)	4	(354)	239	(140)	16.7	495	(128.3)
PBT	4,365	3,701	4,308	5,250	5,255	20.4	3,885	35.3
Tax	2,144	1,450	1,550	1,600	44	(98.0)	1,400	(96.9)
Net profit	**2,221**	**2,251**	**2,758**	**3,650**	**5,211**	**134.7**	**2,485**	**109.8**
Tax rate (%)	49.1	39.2	36.0	30.5	0.8		36.0	
PBT-invt gains+ NPL Prov+extra. Item	**7,515**	**4,921**	**4,828**	**4,570**	**8,515**	**(143.9)**	**5,765**	**71.4**
Key balance sheet items (Rs bn)								
Total Deposit	852	870	948	992	1,039	21.9		
Savings deposits	208	NA	217	227	244	17.4		
Current deposits	86	NA	91	101	118	37.3		
Term deposits	558	581	640	664	677	21.3		
CASA (%)	34.5	33.3	32.5	33.1	34.9			
Gross advances	637	637	686	743	759	19.2		
Investments	282	298	316	331	341	20.9		
AFS	65	82	106	98	96	47.9		
Duration (years)	2.1	2.8	4.3	2.4	3.0			
HTM	217	217	209	233	241	11.1		
Duration (years)	4.2	4.2	4.1	4.6	3.8			
Yield management measures (%)								
Cost of funds	5.03	5.41	6.02	5.99	5.76			
Cost of deposits	NA	5.72	6.41	6.32	NA			
Yield on advances	8.98	10.03	10.26	10.33	10.12			
Yield on investments	7.67	7.57	7.28	7.91	7.67			
Yield of funds	8.08	8.52	8.58	9.82	8.56			
NIM	3.52	3.11	2.56	2.83	2.80			
Capital adequacy details (%)								
CAR	12.8	12.7	11.6	13.0	12.5			
Tier I	7.8	8.0	7.4	7.8	7.5			
Tier II	5.0	4.7	4.2	5.3	5.1			
Asset quality details								
Gross NPLs (Rs bn)	18.7	17.7	16.6	15.6	16.6	(11.6)		
Gross NPLs (%)	2.9	2.8	2.4	2.1	2.2			
Net NPLs (Rs bn)	6.0	4.9	4.4	2.6	1.3	(79.0)		
Net NPLs (%)	1.0	0.8	0.7	0.4	0.2			

Source: Company.

Union Bank (Old and new estimates)

March fiscal year-ends, 2008-2010E, Rs mn

	Old estimates			New estimates			% change		
	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Net interest income	31,385	36,685	44,401	30,864	37,157	44,325	(1.7)	1.3	(0.2)
NIM (%)	2.87	2.80	2.87	2.82	2.82	2.85			
Loan growth (%)	25.18	19.11	19.10	21.63	20.91	19.67			
Loan loss provisions	5,970	5,989	9,171	6,650	8,381	10,077	11.4	39.9	9.9
Other income	11,507	9,869	11,920	12,330	9,186	11,025	7.1	(6.9)	(7.5)
Fee income	3,612	4,154	4,777	3,010	3,371	3,776	(16.7)	(18.8)	(21.0)
Treasury income									
Operating expenses	18,245	20,751	23,028	15,930	18,839	22,229	(12.7)	(9.2)	(3.5)
Employee expenses	10,609	12,208	13,432	8,453	10,132	12,126	(20.3)	(17.0)	(9.7)
Investment dep/amortization	1,150	1,036	725	2,240	1,022	715	94.8	(1.4)	(1.4)
PBT	17,144	18,394	23,012	18,514	18,241	22,469	8.0	(0.8)	(2.4)
Net profit	**11,144**	**11,956**	**14,958**	**13,871**	**12,769**	**15,728**	**24.5**	**6.8**	**5.2**
Profit bef. treasury and investment dep.	16,814	18,394	23,012	19,294	18,241	22,469	14.8	(0.8)	(2.4)
+ NPL provisions	22,784	24,383	32,184	25,944	26,623	32,546	13.9	9.2	1.1

Source: Company, Kotak Institutional Equities estimates.

Banking

IOBK.BO, Rs149	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	160
52W High -Low (Rs)	229 - 99
Market Cap (Rs bn)	81

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	37.5	39.8	47.4
Net Profit (Rs bn)	12.0	11.4	13.7
EPS (Rs)	22.1	20.9	25.2
EPS gth	*19.8*	*(5.6)*	*21.3*
P/E (x)	6.7	7	5.9
P/B (x)	1.7	1.4	1.2
Div yield (%)	2.5	3.3	3.7

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.2	-	-
FIIs	18.7	0.2	(0.0)
MFs	3.2	0.2	(0.0)
UTI	-	-	(0.2)
LIC	2.4	0.1	(0.1)

Indian Overseas Bank: Profit ahead of our estimate due to higher non-interest income and writeback of employee expenses

Tabassum Inamdar : tabassum.inamdar@kotak.com, +91-22-6634-1252

Ramnath Venkateswaran : ramnath.venkateswaran@kotak.com, +91-22-6634-1240

- **Indian Overseas Bank (IOB) reported PAT of Rs3 bn in 4QFY08, 9% ahead of our estimates**
- **Higher non-interest income and writeback of employee expenses**
- **Retain ADD rating with a price target of Rs160**

Indian Overseas Bank (IOB) reported a PAT of Rs3 bn in 4QFY08—a growth of 5.6% yoy and 9% ahead of our estimates. The bank's 4QFY08 earnings was driven by (1) higher non-interest income growth of 61% yoy, (2) decline in credit provisions by 68% and (3) employee expenses reduction of 8%, while NII declined 11% given margin pressure. The company reported total income (excl. treasury) in line with our estimates. We have updated our earnings model for the annual accounts published by the company—increased our earnings by 2% and 5% for FY2009 and FY2010, respectively. We retain our ADD rating on the company and have marginally revised our target price to Rs160 per share from Rs150 per share.

NIM remained under pressure in 4QFY08

- IOB reported an 11% decline in NII to Rs6.8 bn in 4QFY08, 15% lower than our estimates as margins declined yoy.
- IOB's net interest margin (NIM) declined by close to 74 bps (as per our calculations) to 3.0% in FY2008 compared to 3.74% in FY2007. The company believes that this pressure on margins was largely driven by the bulk deposits of Rs160 bn (23% of deposits as of March 2007) that it had contracted in February-April 2007 at 11.25-11.5%. Nearly Rs60 bn of these will be repriced at 100-150 bps lower rates in 1QFY09.
- The company has been amongst the few public banks that did not reduce its prime lending rate (PLR) in the last quarter, which could help the bank mitigate the margin pressure in the current environment. The management has also indicated that it has been reducing its discount rate on its sub-PLR lending to maintain its NIM.
- For the purpose of our projections, we have assumed a further 18 bps decline in margin yoy to 2.83%.

Non-interest income contribution remained healthy in 4QFY08

- IOB had a non-interest income of Rs4.1 bn in 4QFY08 aided by (1) treasury income of Rs1.3 bn (Rs600 mn from equity trading), (2) forex income of Rs1.3 bn and (3) fee income of Rs1.4 bn. Income excluding treasury grew by 57% yoy.
- The company benefited from an income of Rs1.5 bn from recoveries of written-off accounts in FY2008. Management has indicated that it has close to Rs4 bn of written-off accounts, which it can potentially recover.

Employee expenses were muted due to adjusted of short-term transitional liabilities against reserves

- IOB employee expense was down 8% yoy to Rs2.2 bn in 4QFY08. The company has revised its accounting policy and adjusted its short-term transitional employee liabilities (e.g. sick leave, medical leave, etc.) under the revised AS-15 norms against its networth. Consequently, it reversed an entry of Rs250 mn in 4QFY08 form this expense account. The adjustment against reserves (net of deferred tax) was Rs1.3 bn.
- The company continues to have a transitional liability for other employee benefits of Rs3.6 bn, which would be amortized over a four year period.

Sharp increase in provision burden due to higher MTM hit on equity book

- IOB made provision (incl. investment amortization) of Rs3 bn in 4QFY08. The sharp drop in equity market led to losses on equity investment of Rs1.4 bn in 4QFY08.
- The company reported credit provisions (incl. NPL + standard provisions) of Rs330 mn in 4QFY08. The lower NPL provisions resulted in a sharp increase in net NPLs qoq to Rs3.6 bn as of March 2008 compared to Rs1.9 bn as of December 2007.
- Despite this asset quality remains good, with gross NPLs at 1.63% and net NPLs at 0.6%. We believe the bank will likely make higher provisions in FY2009 if MTM losses reduce.

Indian Overseas Bank, Quarterly results (Rs mn)

	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	% chg	4QFY08KS	Actual Vs Kotak
Interest income	17,454	18,462	19,303	20,759	21,159	21.2	21,535	(1.7)
Interest on advances	11,358	12,890	13,059	14,279	14,992	32.0	15,539	(3.5)
Income from invts	4,846	4,944	5,675	5,938	5,800	19.7	5,457	6.3
Bal with RBI	1,250	628	570	542	367	(70.7)	539	(32.0)
Interest expenses	9,771	11,372	12,982	14,199	14,335	46.7	13,538	5.9
Net interest income	**7,682**	**7,090**	**6,321**	**6,560**	**6,823**	**(11.2)**	**7,997**	**(14.7)**
Non-interest income	2,555	1,616	2,405	2,795	4,121	61.3	1,857	121.9
Treasury income	790	130	1,205	1,420	1,340	69.6	45	2,871.2
Other income (excluding treasury)	1,765	1,486	1,200	1,375	2,781	57.6	1,812	53.4
Total income	10,237	8,706	8,726	9,355	10,944	6.9	9,854	11.1
Operating expenses	3,970	3,614	3,486	3,824	3,929	(1.0)	4,197	(6.4)
Employee	2,423	2,431	2,239	2,598	2,229	(8.0)	2,601	(14.3)
Others	1,547	1,183	1,247	1,226	1,701	9.9	1,596	6.5
Operating profit	6,267	5,092	5,240	5,531	7,015	11.9	5,657	24.0
Provisions	2,470	1,620	743	967	2,998	21.4	1,622	84.8
Loan loss	1,025	776	208	590	330	(67.8)	1,056	(68.7)
Invt. Depreciation	1,050	-70	17	-300	2,240	113.3	3	
PBT	3,798	3,472	4,497	4,564	4,017	5.8	4,034	(0.4)
Taxation	900	787	1,300	1,482	957	6.4	1,236	(22.5)
Net profit	**2,898**	**2,685**	**3,197**	**3,082**	**3,060**	**5.6**	**2,799**	**9.3**
Tax rate	24	23	29	32	24		31	
Key balance sheet items (Rs bn)								
Deposits	687	702	783	788	843	22.7		
CASA ratio	34.9	32.8	31.8	30.9	33.5			
Advances	479	486	513	546	611	27.4		
Asset quality details								
Gross NPA (Rs bn)	11.2	11.4	10.8	10.2	10.0	(11.0)		
Gross NPLs (%)	2.3	2.3	2.1	1.9	1.6			
Net NPA (Rs bn)	2.6	2.4	1.8	1.9	3.6	41.9		
Net NPLs (%)	0.6	0.5	0.4	0.4	0.6			
Yield management measures (%)								
Yield on advances	9.58	10.49	10.50	10.83	10.61			
Yield on investments	8.13	8.00	7.95	NA	8.10			
Yield on funds	NA	9.66	NA	9.86	NA			
NIM	4.16	3.71	3.39	3.30	3.26			
Cost of deposits	5.24	5.93	6.43	6.68	NA			
Cost of funds	NA	6.11	6.47	6.75	6.66			
Capital adequacy details (%)								
CAR (%)	13.21	13.31	13.31	12.95	11.96			
Tier I	8.20	NA	NA	8.49	7.86			

Source: Company, Kotak Institutional Equities estimates.

Indian Overseas Bank earnings estimates (Rs mn)
March fiscal year-ends, 2008E-2010E

	Old Estimates			New Estimates			% chg		
	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Net interest income	27,968	32,169	37,057	26,795	31,357	36,846	(4.2)	(2.5)	(0.6)
Advances	581,195	685,810	788,681	604,238	729,549	861,332	4.0	6.4	9.2
Spread (%)	2.69	2.66	2.81	2.59	2.47	2.43			
Loan loss provisions	3,818	5,212	7,581	1,910	4,668	7,159	(50.0)	(10.4)	(5.6)
Other income	8,673	7,589	9,548	10,739	8,452	10,602	23.8	11.4	11.0
Fee income	4,270	4,698	5,167	4,687	5,250	5,880	9.8	11.8	13.8
Treasury income	2,800	-	1,200	2,296	-	1,200			
Operating expenses	15,121	16,938	19,211	14,853	17,209	19,735	(1.8)	1.6	2.7
Employee expenses	9,869	10,921	12,560	9,497	10,921	12,560	(3.8)	0.0	-
Investment amortization	2,450	1,960	1,372	2,678	2,143	1,500	9.3	9.3	9.3
PBT	16,567	15,648	18,440	16,547	15,789	19,054	(0.1)	0.9	3.3
Net profit	**11,763**	**11,110**	**13,092**	**12,023**	**11,368**	**13,719**	**2.2**	**2.3**	**4.8**
Profit bef. treasury and investment	13,399	15,648	17,240	15,752	15,789	17,854	17.6	0.9	3.6
+ NPL provisions	17,218	20,859	24,821	17,662	20,458	25,013	2.6	(1.9)	0.8

Source: Kotak Institutional Equities estimates.

Cement

SHCM.BO, Rs955	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	1,300
52W High -Low (Rs)	1700 - 900
Market Cap (Rs bn)	33

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	21	26	27
Net Profit (Rs bn)	3.0	3.8	3.1
EPS (Rs)	85.9	108.6	89.5
EPS gth	*92.7*	*27.2*	*(18.0)*
P/E (x)	11.1	9	10.7
EV/EBITDA (x)	4.3	3.8	3.5
Div yield (%)	0.7	0.8	0.8

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	63.7	-	-
FIIs	7.3	0.0	(0.1)
MFs	5.8	0.2	0.1
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Shree Cement : 4QFY08 - Operational performance in line with expectations

Aman Batra : aman.batra@kotak.com, +91-22-6634-1231

Murtuza Arsiwalla : murtuza.arsiwalla@kotak.com, +91-22-66341-125

- **Revenue growth aided by expanded capacities**
- **Commissioned 1 mtpa clinker capacity during the quarter**
- **Retain ADD rating with a target price of Rs1,300/share**
- **Await clarity on growth prospects and utilization of cash**

Shree Cement reported 72% increase in sales at Rs6.5 bn (our est. Rs6.4 bn), 48% increase in EBITDA at Rs2.5 bn (our est. Rs2.5 bn) and a 70% increase in net income at Rs0.4 bn (our est. Rs0.8 bn). Decline in net income was due to a higher depreciation expense of Rs1.7 bn against our estimate of Rs1.2 bn. Top-line was aided by strong volume growth of 58% yoy on expanded capacities. We have revised our earnings estimates to factor in (1) pressure on realizations as production from new capacities may create a supply surplus in the region and (2) higher fuel (pet-coke) and freight costs. We have revised our EPS estimates to Rs108.6/share (Rs132/share previously) for FY2009 and Rs89.5/share (Rs113/share previously) for FY2010. Our target price of Rs1,300/share (Rs1,600/share previously) implies EV/EBITDA of 4.8X, P/E of 12.4X on FY2009E and EV/ton of US$125 on 9 mn ton capacity. Though the valuation looks attractive, we retain our ADD rating on the stock. We await clarity on further growth prospects of the company and/or utilization of large surplus cash generation over the next few years. We project a declining EBITDA/ton over the next two years, a larger-than-anticipated price decline could pose a risk to our estimates.

Revenue growth aided by expanded capacities. Shree Cement sold 1.9 mn tons of cement during 4QFY08, an increase of 58% yoy. Freight expenses increased 52% yoy due to higher freight charges and additional costs incurred on inter-unit clinker transfer. We have revised our estimates to factor in higher freight costs on expanded capacities. We expect the profitability of Shree Cement to come under pressure due to (1) large capacity additions in its key market of North India and (2) higher fuel and freight costs due to significant increase in crude oil prices—impacting pet coke prices as well as freight rates.

Commissioned 1 mtpa clinker capacity during the quarter. We expect Shree Cement to benefit from increased cement consumption in its northern markets due to construction activity in the build up to the Commonwealth Games in FY2010. During the quarter, Shree Cement commissioned a clinker unit of 1 mn tpa capacity and a 25 MW captive power plant. Shree Cement has now completed its entire capacity addition program adding 3 mn tpa during FY2008.

Retain ADD rating with target price of Rs1,300/share. We retain our ADD rating with a target price of Rs1,300/share (Rs1,600/share previously) with an earnings estimate of Rs108.6/share (Rs132/share previously) for FY2009 and Rs89.5/share (Rs113/share previously) for FY2010. We expect realizations for Shree Cements to decline in FY2009 as new capacities get commissioned in North India and the company expands its geographical reach to sell higher output from expanded capacities. We note that our earning estimates could be at risk in the event of a larger-than-anticipated decline in cement prices. Shree Cement has largely completed its expansion plans and we await clarity from management on utilization of the likely large surplus cash.

Interim results of Shree Cement, March fiscal year-ends (Rs mn)

	yoy			yoy			qoq		Our est.	
	2008	2007	(% chg)	Mar-08	Mar-07	(% chg)	Dec-07	(% chg)	Dec-07	(% chg)
Net sales	**20,659**	**13,655**	***51***	**6,501**	**3,783**	***72***	**5,236**	***24***	**6,436**	***70***
Raw materials	(2,200)	(1,642)		(855)	(417)		(490)		(664)	
Power & fuel	(3,672)	(2,345)		(1,073)	(722)		(893)		(1,187)	
Freight	(3,514)	(1,867)		(1,286)	(535)		(903)		(1,183)	
Personnel	(736)	(583)		(219)	(210)		(202)		(231)	
Others	(1,912)	(1,296)		(536)	(185)		(494)		(623)	
Total expenditure	(12,035)	(7,733)		(3,969)	(2,069)		(2,982)		(3,887)	
EBITDA	**8,624**	**5,922**	***46***	**2,531**	**1,714**	***48***	**2,253**	***12***	**2,549**	***49***
EBITDA (%)	*42*	*43*		*39*	*45*		*43*		*40*	
Other income	733	212		146	91		170		85	
EBITDA	9,357	6,134		2,677	1,806		2,423		2,634	
Interest	(497)	(63)		(246)	(16)		(127)		(162)	
Depreciation	(4,788)	(4,331)		(1,867)	(1,547)		(1,875)		(1,227)	
Pre-tax profits	**4,072**	**1,740**	***134***	**564**	**242**	***133***	**421**	***34***	**1,245**	***414***
Tax	(1,227)	(852)		(339)	(3)		(57)		(399)	
Deferred tax	147	727		181	—		(13)		—	
Net income	**2,993**	**1,616**	***85***	**406**	**239**	***70***	**351**	***16***	**847**	***254***
Extraordinary	(389)	195		—	—		—		—	
Reported income	**2,604**	**1,811**	***44***	**406**	**239**	***70***	**351**	***16***	**847**	***254***
Sales ('000 tons)	**6,339**	**4,804**	***32***	**1,992**	**1,261**	***58***	**1,510**	***32***	**1,873**	***49***
Realization (Rs/ton)	**3,259**	**2,842**	***15***	**3,263**	**3,000**	***9***	**3,467**	***(6)***	**3,435**	***15***
Cost (Rs/ton)	1,898	1,609	*18*	1,992	1,640	*21*	1,975	*1*		
Raw materials	347	342	*2*	429	331	*30*	325	*32*		
Power & fuel	579	488	*19*	539	572	*(6)*	591	*(9)*		
Freight	554	389	*43*	645	424	*52*	598	*8*		
Personnel	116	121	*(4)*	110	167	*(34)*	134	*(18)*		
Others	302	270	*12*	269	147	*84*	327	*(18)*		
Operating profit (Rs/ton)	**1,360**	**1,233**	***10***	**1,271**	**1,359**	***(7)***	**1,492**	***(15)***	**1,361**	***0***
Tax rate (%)	30.1	48.9		60.2	1.3		16.7		32.0	

Source: Company data, Kotak Institutional Equities.

Change in estimates for Shree Cement, March fiscal year-ends, 2009-10E (Rs mn)

	Revenues			EBITDA			Net profit		
	Old	New	(% chg)	Old	New	(% chg)	Old	New	(% chg)
2009E	26,732	26,297	*(1.6)*	11,083	9,828	*(11.3)*	4,610	3,782	*(18.0)*
2010E	27,694	27,348	*(1.3)*	10,151	8,897	*(12.4)*	3,947	3,119	*(21.0)*

Source: Kotak Institutional Equities estimates.

Lower realizations coupled with cost-side pressures will reduce profitability

Key assumptions for Shree Cement

	2008	2009E	2010E
Sales (mn tons)	6.3	8.3	9.0
Realizations (Rs/ton)	3,259	3,158	3,050
Net revenues (Rs mn)	20,659	26,297	27,348
EBITDA (Rs mn)	8,624	8,952	8,160
EBITDA (Rs/ton)	1,360	1,075	910

Source: Company data, Kotak Instituional Equities estimates.

Shree Cement Limited, Profit model, March fiscal year-ends, 2006-2010E

(Rs mn)

	2006	2007	2008	2009E	2010E
Net sales	**6,677**	**13,655**	**20,659**	**26,297**	**27,348**
Raw materials	(896)	(1,642)	(2,110)	(2,986)	(3,344)
Power costs	(1,373)	(2,345)	(3,672)	(5,390)	(6,130)
Freight cost	(1,005)	(1,556)	(3,125)	(4,933)	(5,315)
Employee costs	(330)	(583)	(736)	(1,035)	(1,139)
Other expenses	(702)	(1,589)	(2,391)	(3,001)	(3,261)
Operating profits	**2,371**	**5,939**	**8,624**	**8,952**	**8,160**
Operating margin %	35.5	43.5	41.7	34.0	29.8
Other income	35	212	733	875	737
EBITDA	2,406	6,151	9,357	9,828	8,897
Interest	(141)	(121)	(497)	(568)	(566)
Depreciation	(503)	(4,331)	(4,788)	(4,015)	(4,116)
Pretax profits	**1,761**	**1,700**	**4,072**	**5,244**	**4,214**
Tax	(29)	(852)	(1,227)	(1,719)	(1,415)
Deferred tax	(59)	727	147	256	320
Net profits	**1,674**	**1,575**	**2,993**	**3,782**	**3,119**
Extraordinaries	(1,483)	195	(389)	—	—
Reported net profits	**190**	**1,770**	**2,604**	**3,782**	**3,119**
Diluted EPS (Rs)	**48.0**	**45.2**	**85.9**	**108.6**	**89.5**
Reported EPS (Rs)	**5.5**	**50.8**	**74.7**	**108.6**	**89.5**
Diluted avg. shares (mn)	34.8	34.8	34.8	34.8	34.8
Growth (%)					
Sales	14.7	104.5	51.3	27.3	4.0
EBITDA	32.8	155.7	52.1	5.0	(9.5)
Net income	61.4	(5.9)	90.0	26.4	(17.5)
EPS	61.4	(5.9)	90.0	26.4	(17.5)
Tax rate (%)	1.6	50.1	30.1	32.8	33.6
Total tax rate	5.0	7.3	26.5	27.9	26.0

Source: Company data, Kotak Institutional Equities estimates.

Energy

RELI.BO, Rs2689	
Rating	RS
Sector coverage view	Cautious
Target Price (Rs)	-
52W High -Low (Rs)	3298 - 1531
Market Cap (Rs bn)	3,534

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,334	1,493	2,112
Net Profit (Rs bn)	147.3	158.5	271.5
EPS (Rs)	105.0	104.7	172.5
EPS gth	*25.5*	*(0.3)*	*64.7*
P/E (x)	25.6	25.7	15.6
EV/EBITDA (x)	15.2	13.2	7.6
Div yield (%)	0.5	0.6	0.9

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.8	-	-
FIIs	22.5	8.7	0.5
MFs	2.6	5.9	(2.3)
UTI	-	-	(8.2)
LIC	4.6	9.6	1.4

Reliance Industries: Stay order on sale of KG D-6 gas to third parties continues; final resolution of RIL-RNRL dispute doesn't look imminent

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

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

- **Stay order on sale of D6 gas to third parties continues; RIL cannot sign sale contracts with third parties**
- **Court adjourns RIL-RNRL case to July 22nd; delay in resolution may jeopardize RIL's production schedule**
- **Final resolution will take time; could be negative for RIL's valuation if it has to supply gas at a lower-than-market price**

The Bombay High Court has ordered status quo to be maintained on its earlier order restraining RIL from selling gas from its KG D-6 block to third parties; the court has adjourned the case until 22nd July. We believe that the final resolution of this dispute will take some time and this might delay RIL's plans to start the production of gas from KG D-6 from 2HCY08. Also, the final resolution may take time since both the parties have the option of approaching the Supreme Court even if the matter is settled by the Bombay High Court expeditiously. More important, the development could be negative for RIL if it has to supply the contracted volumes of gas to RNRL at less-than-market price (US$4.2/mn BTU). Key upside risk stems from higher-than-expected margins and new discoveries.

Stay order on sale of KG-D6 gas to third parties continues; could jeopardize scheduled start of production unless RIL and RNRL can arrive at an out-of-court settlement. The Bombay High Court has ordered status quo on its stay order restraining RIL from entering into contracts for gas sales to third parties for KG D-6 gas. This could jeopardize RIL's planned schedule of production of gas from KG D-6 by 2HCY08 unless RIL and RNRL can arrive at an out-of-court settlement in the interim. RIL's counsel has stated that the gas production from KG D-6 block will start from August 2008. However, this looks unlikely in the current scenario given that (1) both the parties have the option (and will likely exercise the same) of approaching the Supreme Court to appeal against the decision of the Bombay High Court and (2) it will take time to firm up gas sales agreement with potential customers even if the court lifts the stay on the sale of gas to third parties in July.

Final outcome may take time; may be neutral-to-negative for RIL whenever it comes. The Bombay High Court has adjourned the case until July 22. We believe that the issue will likely take time to resolve unless the parties reach an out-of-court settlement before the final decision by the court. Even if the Bombay High Court decides on the case before the scheduled start of production, either party can appeal against the decision in the higher court; final resolution of the dispute doesn't look imminent in that case. We do not rule out an out-of-court settlement between the two parties, but we think the impact on Reliance can be neutral-to-negative under various outcomes, irrespective of whether the settlement is reached through an out-of-court settlement or through a judicial order.

1. **Scenario 1—Reliance sells contracted amount of gas to RNRL at government-approved price; neutral impact.** This would be neutral versus street expectation since it would not matter who Reliance sells gas to as long as it receives the government approved price. We believe the street is factoring a selling price of about US$4.2/mn BTU for the price of gas. We model US$4.2/mn BTU for FY2009E and FY2010E and bring it down moderately after that assuming Reliance will sell gas to NTPC at a lower price of US$2.34/mn BTU.

2. **Scenario 2—Reliance sells contracted amount of gas to RNRL at a price lower than the government approved price; negative impact**. It might be possible that under a renegotiated GSMA RIL supplies gas to RNRL at a price lower than the government-approved price of US$4.2/ mn BTU. This would be lower than the street's and our expectations and would result in a drop in the profits of Reliance and valuation of KG D-6 block. Even in the current GSMA, which is under dispute, Reliance will supply gas to RNRL at a price and commercial terms, which are "no worse than the agreement with NTPC." This presumably means that Reliance will sell 28-40 mcm/d of gas to RNRL at a price of US$2.34/mn BTU, which would be significantly lower than street and our expectations. We currently value the KG D-6 block at US$10.3 bn; however, if Reliance were to sell 28 mcm/d of gas to RNRL for the contracted period of 17 years, then the value of the block would decline to US$8.3 bn and would reduce our FY2010E EPS to Rs160/share from Rs173/share currently.

Gas supply to power plants of NTPC and Reliance Power may leave little gas for outside sales

Supply and potential sales of gas from KG D-6 block (mcm/d)

		Comments
Reliance gas peak production	**80**	**This could increase to 120 mcm/d**
Consumption in RIL and RPET refineries and RIL's chemical plants	15	
NTPC gas supply	10	Construction of 2 X 1,300 MW power plants not commenced
RNRL/Reliance Power gas supply for Dadri power plant	29	Construction of 7,480 MW power plant not commenced
RNRL/Reliance Power gas supply for Shahapur power plant	11	Construction of 2,800 MW power plant not commenced
Total gas volumes for RIL, NTPC, Reliance Power	65	
Gas available for sale to 'third' parties	**15**	
Shortfall in KG area for power generation + new capacity	5	State government may demand that AP's gas requirement be met first
Gas required for conversion of naphtha/FO-based fertilizer units to gas	10	Government is likel y to accord high priority to the fertilizer sector
City gas distribution	5	City gas distribution will also get high priority from the government
Total demand from 'third' parties	**20**	

Source: Kotak Institutional Equities estimates.

Power, fertilizer and internal consumption to account for the bulk of KG D-6 gas sales

Supply and potential sales of gas from RIL's KG D-6 block (mcm/d)

		Comments
Reliance KG D-6 gas peak production	**80**	**This could increase to 120 mcm/d**
1. Firm demand		
Consumption in RIL and RPET refineries and RIL's chemical plants	15	
Shortfall of power generation capacity in KG-basin area	5	Shortage of about 5 mcm/d
Conversion of FO/naphtha urea units to gas	10	Most units can switch to gas quickly as pipeline infrastructure exists
Sub-total	**30**	
2. Firm demand in short/medium term		
Replacement of FO/LSHS from industrial units	20	This will likely take time given wide disperson of consumption
Consumption in BPCL and HPCL Mumbai refineries	4	
New power generation capacity in KG-basin area	13	3,433 MW of new capacity
Sub-total	**38**	
3. Likely demand in medium term		
NTPC gas supply	10	Construction of 2 X 1,300 MW power plants not commenced
RNRL/REL gas supply	40	Construction of 10,280 MW power plant not commenced
New power generation plants in KG-basin area	8	2,100 MW plant of AP GENCO
City gas distribution	5	Submitted plans to various state governments; will take time
Sub-total	**64**	
Total	**131**	

Source: Kotak Institutional Equities estimates.

RIL consolidated with RPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2003-2012E (Rs mn)

	2003	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)										
Net sales	451,133	510,715	656,223	809,113	1,114,927	1,334,430	1,492,916	2,112,049	2,068,392	2,102,509
EBITDA	**75,808**	**91,148**	**123,820**	**139,991**	**198,462**	**233,060**	**254,167**	**424,985**	**395,376**	**419,315**
Other income	10,012	11,381	14,498	6,829	4,783	8,950	10,125	15,116	25,264	42,225
Interest	(15,552)	(14,347)	(14,687)	(8,770)	(11,889)	(10,770)	(11,696)	(11,513)	(3,661)	241
Depreciation & depletion	(28,371)	(32,470)	(37,235)	(34,009)	(48,152)	(48,470)	(61,523)	(84,837)	(90,764)	(97,898)
Pretax profits	41,897	55,711	86,397	104,041	143,205	182,770	191,073	343,751	326,215	363,883
Extraordinary items	7,845	7,300	4,290	3,000	2,000	47,330	—	—	—	—
Tax	(2,459)	(3,510)	(7,050)	(9,307)	(16,574)	(26,510)	(27,859)	(46,536)	(45,897)	(61,249)
Deferred taxation	(6,240)	(7,900)	(7,920)	(7,040)	(9,196)	(9,000)	1,822	1,737	6,194	10,013
Minority interest	—	—	—	—	—	—	(6,521)	(27,491)	(25,231)	(26,549)
Net profits	41,043	51,601	75,717	90,693	119,434	194,590	158,515	271,460	261,282	286,099
Adjusted net profits	**34,570**	**45,623**	**72,135**	**88,152**	**117,789**	**152,620**	**158,515**	**271,460**	**261,282**	**286,099**
Earnings per share (Rs)	**24.8**	**32.7**	**51.7**	**63.3**	**81.0**	**105.0**	**104.7**	**172.5**	**166.1**	**181.8**
Balance sheet (Rs mn)										
Total equity	303,744	344,525	404,033	430,543	673,037	862,347	1,147,524	1,378,561	1,599,066	1,820,902
Deferred taxation liability	26,848	34,748	42,668	49,708	69,820	78,820	76,998	75,261	69,067	59,054
Minority interest	—	—	—	—	33,622	33,622	39,126	59,697	78,360	90,238
Total borrowings	197,583	209,447	187,846	218,656	332,927	494,470	232,151	116,642	30,435	29,107
Currrent liabilities	109,666	122,855	171,315	164,545	192,305	225,120	254,537	283,407	278,773	277,936
Total liabilities and equity	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,694,380**	**1,750,336**	**1,913,568**	**2,055,700**	**2,277,237**
Cash	1,472	2,242	36,087	21,461	18,449	119,532	56,810	127,183	273,366	490,178
Current assets	227,809	218,159	248,438	224,283	286,566	357,215	384,002	465,930	460,187	462,154
Total fixed assets	340,863	351,460	350,823	626,745	899,403	1,075,338	1,134,729	1,128,161	1,109,853	1,097,611
Investments	67,227	139,714	170,515	(9,038)	97,294	142,294	174,794	192,294	212,294	227,294
Deferred expenditure	472	—	—	—	—	—	—	—	—	—
Total assets	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,694,379**	**1,750,336**	**1,913,568**	**2,055,700**	**2,277,237**
Free cash flow (Rs mn)										
Operating cash flow, excl. working cap	67,072	83,301	107,002	119,520	164,285	234,260	209,014	365,584	343,688	355,467
Working capital	(17,614)	20,265	46,875	(32,188)	(13,075)	(37,834)	2,630	(53,058)	1,109	(2,804)
Capital expenditure	(37,043)	(43,191)	(52,440)	(94,273)	(247,274)	(229,997)	(116,479)	(76,918)	(70,325)	(82,816)
Investments	(34,204)	(68,430)	(48,192)	(32,364)	(105,760)	(45,000)	(32,500)	(17,500)	(20,000)	(15,000)
Other income	5,219	5,902	3,032	5,159	4,143	8,950	10,125	15,116	25,264	42,225
Free cash flow	**(16,569)**	**(2,153)**	**56,276**	**(34,146)**	**(197,681)**	**(69,622)**	**72,790**	**233,226**	**279,735**	**297,072**
Ratios (%)										
Debt/equity	59.8	55.2	42.1	45.5	44.8	52.5	19.0	8.0	1.8	1.5
Net debt/equity	59.3	54.6	34.0	41.1	42.3	39.8	14.3	(0.7)	(14.6)	(24.5)
RoAE	10.7	12.7	17.6	19.9	20.3	18.8	15.0	20.6	16.9	16.2
RoACE	**8.8**	**9.7**	**13.0**	**13.8**	**13.9**	**12.6**	**11.7**	**19.7**	**17.1**	**16.8**

Source: Kotak Institutional Equities estimates.

Strategy

Sector coverage view	N/A

Closing trade—simple trades, high return

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229
Puneet Jain : puneet.j@kotak.com, +91-22-6634 1255
Bhavesh Shah : bhavesh.shah@kotak.com, +91-22-6634-1498

- **Closing long L&T and short BHEL - gross return +9.2%**
- **Trade 1: Long Tata Power, short NTPC**
- **Trade 2: Long DLF, short Unitech**
- **Trade 3: Long ITC, short HUL**

Closing long L&T, short BHEL

We had initiated long L&T, short BHEL trade on April 16, 2008 to capture the valuation differential arising from structural nature of BHEL's execution issues versus L&T, which is better placed because of the diversified nature of its order book. Further, L&T is also better positioned to benefit from value accretive opportunities from a wider set of areas. Since the initiation of the trade, L&T stock has appreciated by 6.6% and BHEL stock has corrected by 2.6% giving gross positive return of 9.2%.

Open trades

We continue to recommend long ITC, short HUL (+6.5%), long Tata Power, short NTPC (+5%) and long DLF, short Unitech (-8.3%). Please refer to our previous report *'Initiating new trades—a brave new world'* dated April 16, 2008.

Alpha-Bet trades
Statistics of trades, current price, initiation price, gross return

	Stock	Current price (Rs)	Initiation price (Rs)	Return (%)
Closed trade (15 April-7 May 2008)				
Long	L&T	2,993	2,807	6.6
Short	BHEL	1,785	1,833	(2.6)
Return (%)				**9.2**
Trade 1				
Long	ITC	227	208	9.0
Short	HUL	252	246	2.4
Return (%)				**6.5**
Trade 3				
Long	Tata Power	1,364	1,274	7.1
Short	NTPC	195	191	2.0
Return (%)				**5.0**
Trade 3				
Long	DLF	651	617	5.5
Short	Unitech	305	268	13.8
Return (%)				**(8.3)**

Source: Bloomberg, Kotak Institutional Equities estimates.

Technology

Company	Rating	Price, Rs 7-May	Target
TCS	REDUCE	967	950
Wipro	ADD	498	490
Infosys	BUY	1,844	1,800
Satyam Comp	BUY	489	500
HCL Tech	REDUCE	294	260
i-flex solutions	SELL	1,347	1,100
Patni	SELL	276	270
Hexaware	SELL	71	70
Polaris Softwa	SELL	108	85
Tech Mahindra	BUY	953	850
Mphasis BFL	SELL	230	200
MindTree	BUY	482	480

Modest 2QCY08 guidance from CTSH reflects the near-term growth challenges for the industry

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

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

- **Cautionary stance on BFSI vertical reflects in a modest 2QCY08 revenue guidance**
- **Back-ended revenue growth implied in the guidance of CTSH (and Infosys) perplexing**
- **Pricing remains the key indicator to watch**

We believe that CTSH's modest 2QCY08 guidance and more conservative stance on CY2008 (though guidance is maintained at same levels) reflects the near-term revenue growth challenges for the Indian IT services players. CTSH's stance is in line with the earnings commentary of other tier-I peer. We find the strong back-ended revenue growth implied in CTSH's (and Infosys') full year guidance slightly perplexing; however, this could be driven by project ramp-downs and delays in decision making from select clients, in our view. We remain cautious about further deterioration in the external environment, especially in the BFSI space. On the positive side, we have not seen the challenges spreading to other verticals; we continue to monitor the external environment closely. Maintain our neutral coverage view on the sector with a bias towards companies with superior execution (Infosys) and/or low exposure to BFSI vertical (Satyam, Tech Mahindra). We do not see risks to our earnings estimates for the tier-I names, especially Infosys and Satyam. However, the recent run-up in stock prices limits upside, in our view.

Back-ended revenue growth implied in the guidance of CTSH perplexing. We find the strong back-ended revenue gro wth assumptions implied in the CY2008/ FY2009 guidance of CTSH perplexing as well as aggressive. CTSH's CY2008 (and 2QCY08) revenue growth guidance implies revenue CQGR of 13% over 3Q-4QCY2008 versus a qoq revenue growth of 7% in 1QCY08 and 5.7% guidance for 2QCY08. We believe that the confidence on strong growth towards the second half of the respective fiscals is likely reflective of (1) expectations that the ramp-downs these companies are likely seeing from select clients get over by the end of first half; these ramp-downs stop impacting sequential growth rates from that point, (2) strong spend/volume commitments from the key client base with some delays in decision-making/budget allocation impacting near-term growth and (3) strong ramp-up from some of the recently won large deals in the second half of the calendar/fiscal.

Modest 2QCY08 guidance from CTSH once again reflects the near-term growth challenges for the industry. CTSH has guided for a 5.7% revenue growth for 2QCY08, its weakest 2Q guidance in the past four years (since CTSH started providing guidance). In addition, this also marks the first time that CTSH has not raised its beginning-of-the-year full year revenue growth guidance at the end of 1Q (see Exhibit 2). We believe that CTSH's modest June quarter (its strongest quarter historically) guidance once again reflects the challenging external environment, as also indicated in the June quarter revenue guidance and earnings commentary of other tier-I peers. We remain cautious about the challenges in the BFSI client base; our channel checks indicate select cases of pricing pressure. On the positive side, our channel checks do not indicate any deterioration in the non-BFSI verticals.

Cautionary stance on BFSI vertical factored in June quarter guidance and changed stance on CY2008 guidance. CTSH management cited a cautionary stance on tech spending by its BFSI clients as the key reason for relatively modest 2QCY08 revenue growth guidance. In addition, we attribute the change in CY2008 revenue guidance from 'at least US$2.95 bn' to 'approximately US$2.95 bn' to the decline in confidence levels on tech spends of BFSI clients. BFSI vertical grew a modest 3% qoq in the March 2008 quarter, a sharp slowdown from the 9% qoq growth reported in the December 2007 quarter. Management indicated that it is factoring in a low single digit qoq growth from the BFSI clients for the June quarter. More importantly, the management indicated that several of its clients in the BFSI vertical have re-assessed their IT budgets since the beginning of March as the external environment deteriorated further. We note that CTSH had mentioned IT budget finalization from 80% of its top 100 clients in its 4QCY07 earnings commentary.

Pricing remains the key indicator to watch, in our view. We believe that a breakdown of pricing discipline in the industry could be a key indicator of demand slowdown for the industry. Pricing commentary from some tier-I companies indicates pressure within the BFSI client base. The 'free transitions' mentioned by TCS in its 4QFY08 earnings call also calls for a close monitoring of the situation.

Cognizant interim results (US$ mn)

	1QCY07	4QCY08	1QCY08	% qoq	% yoy
Revenues	**460.3**	**600.0**	**643.1**	**7.2**	**39.7**
Cost of revenues	(254.9)	(341.5)	(366.3)	7.2	43.7
SG&A expenses	(109.5)	(137.6)	(148.9)	8.2	35.9
EBITDA	**95.9**	**120.9**	**128.0**	**5.9**	**33.5**
Depreciation and amortization	(12.3)	(14.7)	(16.3)	10.6	32.9
EBIT	**83.6**	**106.1**	**111.7**	**5.2**	**33.6**
Other income	6.7	8.6	10.2	17.8	52.9
PBT	**90.3**	**114.8**	**121.9**	**6.2**	**35.0**
Provision for taxes	(14.8)	(18.5)	(20.0)	8.1	35.0
PAT	**75.4**	**96.3**	**101.9**	**5.8**	**35.0**
Margins (%)					
EBITDA	20.8	20.1	19.9		
EBIT	18.2	17.7	17.4		
Net income	16.4	16.0	15.8		
Tax rate (%)	16.4	16.1	16.4		

Source: Company.

Cognizant's 2QCY08 guidance weakest in four years (since it started providing guidance) (US$ mn)

	2005	2006	2007	2008
1Q revenue guidance	180.0	275.0	448.0	640.0
1Q revenue growth guidance (%)	4.2	7.0	5.6	6.7
1Q revenues actual	181.7	285.5	460.3	643.1
1Q actual revenue growth (%)	5.1	11.1	8.5	7.2
1Q outperformance/(underperformance) (% pts)	**1.0**	**4.1**	**2.9**	**0.5**
2Q revenue guidance	206.0	317.0	500.0	680.0
2Q revenue growth guidance (%)	**13.4**	**11.0**	**8.6**	**5.7**
2Q revenues actual	211.7	336.8	516.5	
2Q actual revneue growth (%)	**16.5**	**18.0**	**12.2**	
2Q outperformance/(underperformance) (% pts)	3.1	6.9	3.6	
Full year guidance beginning of the year	845.0	1,260.0	2,040.0	2,950.0
Full year revenue growth guidance beginning of year (%)	44.0	42.2	43.2	38.1
Full year guidance at end of 1Q	870.0	1,300.0	2,070.0	2,950.0
Full year growth guidance at end of 1Q (%)	48.3	46.8	45.3	38.1
Full year guidance raise (% pts)	**4.3**	**4.5**	**2.1**	**-**

Source: Company.

Metals

Sector coverage view	Attractive

Company	Rating	Price, Rs 7-May	Target
Hindalco	ADD	179	215
NALCO	REDUCE	444	400
Tata Steel	ADD	823	800
Hindustan Zinc	ADD	660	850
JSPL	ADD	2,276	2,900
Sterlite	ADD	864	1,000
Sesa	ADD	3,993	4,400
JSW	ADD	876	1,040

Steel: New variable in Indian steel-prices forecast model—Inflation!

Jigar Mistry : jigar.mistry@kotak.com, +91-22-6749-3571

Amit Agarwal : agarwal.amit@kotak.com, +91-22-6749-3390

- **Indian steel companies reportedly decide to cut prices by Rs4,000/ton (US$100), despite domestic prices trading at a discount to landed prices**
- **We continue to believe that reduction in excise duty of steel and funding it with export tax on iron ore is a revenue-neutral solution**
- **We would be surprised if the government does not reciprocate steelmakers' efforts with counter offers**
- **Earnings projections for steel companies extremely difficult under such volatile non-predictable actions**
- **Unless some of the sops extended, JSW Steel most impacted followed by Tata Steel and JSPL in our coverage. We have ADD rating of all the companies**

Motivated by the Government and nationalism, steel companies decided to do their bit to control inflation by reportedly reducing prices by Rs4,000/ton despite domestic prices trading at discount to landed prices. We continue to believe that a reduction in excise duty on steel and funding the exchequer loss with increasing export tax on iron is a revenue-neutral solution, but if that does not come to pass, we would be extremely surprised if the Government does not reciprocate with counter offers. While projections of earnings have been extremely difficult in the current scheme of volatile, non-predictable actions, we believe JSW Steel will likely be hit the most, followed by Tata Steel and JSP in that order.

Indian steel companies reportedly decide to cut prices on HR Coils by Rs4,000/ton (US$100) and long product prices by Rs2,000 (US$50) following consultations with the Government and compelled by the need to curb inflation. We note that prior to the stated cut, domestic HR Coil prices in India were trading at a discount of 5% (and therefore, theoretically steel prices in India had room to increase 5% (or US$50/ton). After the cuts, the discount widened to 17% or US$177/ton.

We continue to believe that reduction in excise-duty of steel and funding it with export tax on iron ore is a revenue-neutral as well as a moral solution. We argue that a reduction in excise duty on steel to 5% (from 14% currently) and an increase in export taxes on export of iron ore by 20% is a revenue neutral solution.

We also believe that the imposition of export tax on ore is justified as (a) India exports iron ore and imports steel—ironical considering that conversion costs in India are among lowest globally, (b) Central or State Governments do not materially gain from exports of iron ore as royalty rates (at US$0.7 per ton) and export tax (US$7.5 for higher grades, US$1.5 for lower grades) are do not materially contribute to exchequer and (c) domestic ore costs for steel companies will get reduced, which is a logical conclusion if export duty on steel is considered appropriate (see Exhibit 3).

We will be surprised if government does not reciprocate this action of steelmakers with some sops. The Government is likely to respond to this offer from steel-makers with various sops, among which we could see (a) a reduction of excise duty on steel, allowing steel companies to pocket the reduction in costs, (b) withdrawal of export duty on all steel products and (c) faster allocation and clearance of iron ore and coking coal mines.

Earnings projections for steel companies extremely difficult in the wake of such unpredictable actions. Our earnings estimates incorporate an average price increase of US$150/ton versus US$125/ton that now stands after the proposed reduction. Under such circumstances and unless the Government decides to pass on some sops for immediate relief, we estimate that JSW Steel will be most impacted, followed by Tata Steel and JSPL, in that order.

Rather than cut excise duty, steel companies are requested to reduce prices

Analysis of domestic versus landed steel prices in different scenarios

	What should have been done			What is done
Scenarios	**1**	**2**	**3**	
	Earlier	**Custom duty cut**	**Excise duty cut**	
Import duty on steel (%)	5%	0%	0%	0%
CVD on steel imports (%)	14%	14%	0%	14%
Excise duty on steel (%)	14%	14%	0%	14%
Implications				
International landed price (US$/ton)				
Steel prices in China (FOB)	1,000	1,000	1,000	1,000
Add: Freight	40	40	40	40
Add: Other costs	10	10	10	10
Steel prices (CIF)	**1,050**	**1,050**	**1,050**	**1,050**
Add: Customs duty (US$/ton)	53	-	-	
Add: CVD (US$/ton)	154	147	-	147
Landed prices (US$/ton)	**1,257**	**1,197**	**1,050**	**1,197**
INR:USD conversion rate	40.5	40.5	40.5	40.5
Landed prices (Rs/ton)	**50,902**	**48,479**	**42,525**	**48,479**
Domestic price arrived (Rs/ton)				
Base ex-factory price	38,000	38,000	38,000	34,000
Add: excise duty	5,320	5,320	-	4,760
Add: CST	1,733	1,733	1,520	1,550
Add: Local transportation	1,000	1,000	1,000	1,000
Domestic prices (Rs/ton) fully loaded	**46,053**	**46,053**	**40,520**	**41,310**
Difference between landed and domestic (%)	11	5	5	17
Difference (US$/ton)	**120**	**60**	**50**	**177**

Reduction of custom duty does not reduce domestic prices; just lowers the cap

Instead, companies reduce steel prices by Rs4,000/ton.

Discount widens even more-now at 17%

Source: Industry data, Kotak Institutional Equities estimates

Reduction of excise duty on steel and imposition of export tax makes economic sense

Net changes in exchequer, March fiscal year-ends (Rs mn)

	2008	2009E
Loss to exchequer		
Steel production (mn tons)	46	50
Avg. ex-factory price (Rs/ton)	28,000	34,000
Excise duty (%)	14.0	5.0
Excise duty per ton (Rs/ton)	3,920	1,700
Total excise collection (Rs bn)	180	85
Loss in excise collection (Rs bn)		95
Loss in excise collection (US$ bn)		**2.4**
Gain to exchequer		
Iron ore production (mn tons)	160	170
Iron ore exports (mn tons)	83	87
Export tax on iron ore (US$/ton)	7.5	37.5
Export tax on ore (US$ mn)	624	3,244
Gain to exchequer (US$ bn)		**2.6**

Reduce excise duty; impose export tax. But ecomomic and political sense do not always gel

Source: Kotak Insitutional Equities estimates

JSW Steel most impact under current scheme of things

Impact of current move vs. our estimates, March fiscal year-ends

	Tata Steel	JSW Steel	JSPL
FY2009E domestic volumes (mn tons)	5.6	3.9	2.1
FY2009E EBITDA (Rs bn)			
Pre-cuts	106	38	29
Post-cuts	99	34	27
Domestic steel business valuation			
Pre-cuts (Rs/share)	800	853	1,081
Post-cuts (Rs/share)	742	694	925
SOTP-based valuation (Rs/share)			
Pre-cuts (Rs/share)	800	1,040	2,900
Post-cuts (Rs/share)	742	876	2,744
Reduction in value (%)			
In extant steel business	(7.3)	(18.6)	(14.4)
In SOTP-based valuation	**(7.3)**	**(15.8)**	**(5.4)**

Source: Kotak Institutional Equities estimates

Insurance

March 2008: Overall slow growth, some players do well

Tabassum Inamdar : tabassum.inamdar@kotak.com, +91-22-6634-1252

As widely expected, premium income (individual business APE) growth for March 2008 came down sharply to 8%, within which the private sector showed a growth of 45% while LIC's premium collection declined 17%.

Other than BSL, HDFC SL and Max, all other players under our coverage showed deceleration. Amongst the slowest performers, Bajaj Allianz showed flat growth yoy in March, while ICICI Prudential Life reported a 20% increase yoy.

We believe most players will deliver moderate-to-high growth in premium collection through aggressive branch and agency expansion. However, we are more concerned about the likely reduction in margin due to the competitive pressures and are factoring the same in our fair value estimate. We have lowered our estimates for Reliance Life by 20%, Bajaj Allianz by 12%, ICICI Prudential Life by 6% and SBI Life by 10%. Post results, we had revised our estimates for BSL upwards by 4%. Also, we are increasing our estimates for Max and HDFC SL by 8% on higher volumes.

Life insurance premium income collections adjusted for single premium (Rs mn)

	Mar-08						FY2008					
	Individual	yoy growth (%)	Group	yoy growth (%)	Total	yoy growth (%)	Individual	yoy growth (%)	Group	yoy growth (%)	Total	yoy growth (%)
Bajaj Allianz	10,744	3	135	289	10,879	4	56,422	79	188	198	56,610	80
Bharti Axa	251	—	1	—	253	—	1,062	—	4	—	1,066	1,272
Birla Sunlife	3,984	137	123	129	4,107	137	17,117	143	224	60	17,341	142
HDFC Standard Life	3,707	61	196	144	3,904	64	22,159	80	337	22	22,497	78
ICICI Prudential	10,086	20	480	86	10,566	22	66,839	68	1,262	45	68,102	68
ING Vysya	1,408	41	3	(80)	1,411	39	6,620	57	10	(61)	6,629	57
Max NY	2,747	116	3	85	2,750	116	13,079	70	42	605	13,121	70
Reliance Life	3,283	60	160	60	3,443	60	18,729	168	412	214	19,141	169
SBI Life	6,248	66	466	47	6,714	65	26,529	111	1,050	31	27,579	106
Tata AIG	1,501	89	21	64	1,523	89	7,933	52	131	27	8,064	52
Private sector	**51,049**	**45**	**1,697**	**84**	**52,745**	**46**	**265,717**	**86**	**3,887**	**53**	**269,604**	**85**
LIC	43,392	(17)	3,275	(10)	46,667	(16)	260,887	0	10,549	—	271,436	0
Total	**94,440**	**8**	**4,972**	**9**	**99,412**	**8**	**526,604**	**31**	**14,436**	**4**	**541,040**	**30**

* Nos are not adjusted for single premium

Source: IRDA.

Premium collection compared to our estimate has been low for most players

Premium assumption and actuals for key players, March 2008 year-end

	Our estimates (Rs bn)			Actuals (Rs bn)			Actual v/s Estimates (%)		
	Annualized individual premium	Annualized group premium	Total annualized premium	Annualized individual premium	Annualized group premium	Total annualized premium	Annualized individual premium	Annualized group premium	Total annualized premium
Bajaj Allianz	63,975	85	64,060	56,422	188	56,610	(11.8)	122.1	(11.6)
Birla Sunlife	17,533	186	17,719	17,117	224	17,341	(2.4)	20.4	(2.1)
HDFC Standard Life	21,592	325	21,917	22,159	337	22,497	2.6	3.7	2.6
ICICI Prudential	69,950	1,264	71,214	66,839	1,262	68,102	(4.4)	(0.1)	(4.4)
Max NY	12,262	45	12,307	13,079	42	13,121	6.7	(7.1)	6.6
SBI Life	30,040	930	30,970	26,529	1,050	27,579	(11.7)	12.9	(11.0)

Source: IRDA and Kotak Institutional Equities

Premium growth will likely remain high for most

Premium growth assumption for key players, March yearend

	Actuals/New estimates of premium income (Rs bn)			YoY growth (%)	
	2007A (Rs bn)	2008A (Rs bn)	2009E (Rs bn)	2008	2009E
Bajaj Allianz	31.5	56.6	79.0	79.6	39.6
Birla Sunlife	7.3	17.3	31.2	138.7	79.7
HDFC Standard Life	12.6	22.5	33.7	78.6	50.0
ICICI Prudential	40.6	68.1	95.5	67.8	40.2
Max NY	7.7	13.1	19.0	70.5	45.0
SBI Life	7.1	19.1	38.3	106.8	50.0

Source: IRDA and Kotak Institutional Equities

Insurance business adds significant value to parent companies

Value addition to parent's SOTP from insurance business (Rs/share of holding co.)

Insurance company	Parent/Holding company	Economic value assumed (%)	Addition to SOTP of parent (Rs/share)	% of parent company current market price (%)
Bajaj Allianz	Bajaj Auto Ltd	38	531	-
Birla Sun Life	Aditya Birla Nuvo	74	496	33.1
HDFC Standard Life	HDFC Ltd	74	252	9.3
ICICI Bank	ICICI Bank	74	173	18.6
Max India	Max India	50	120	77.3
Reliance Life	Reliance Capital group companies	100	433	30.3
SBI Life	SBI Ltd	74	142	8.1

Source: Kotak Institutional Equities estimates.

Revising our contribution to parent's SOTP for most

Contribution per share to parent's SOTP (Rs)

	Old estimate (Rs/share)	Revised estimate (Rs/share)	change (%)
Bajaj Allianz	603	531	(12)
Birla Sunlife *	477	496	NA
HDFC Standard Life	231	252	9
ICICI Prudential	184	173	(6)
Max NY	111	120	8
Reliance Life	540	433	(20)

* Post adjustment for equity issuance at parent ABNL

Source: Kotak Institutional Equities

"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: Tabassum Inamdar, Aman Batra, Sanjeev Prasad, Kawaljeet Saluja, Jigar Mistry."

Kotak Institutional Equities Research coverage universe

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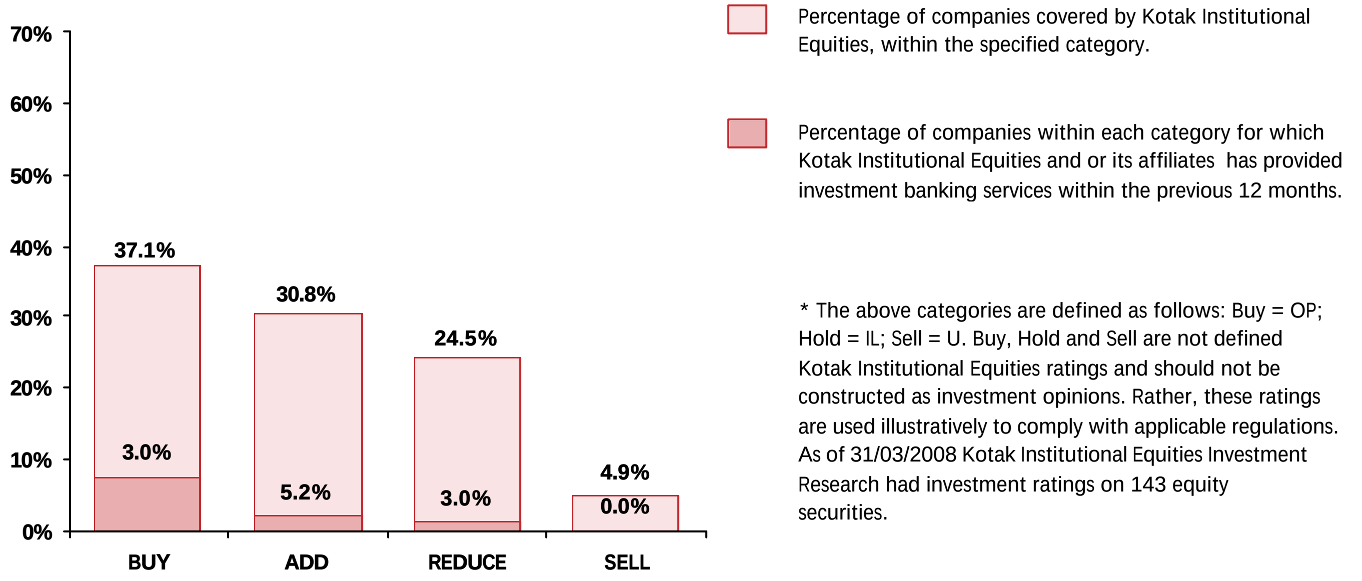

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Source: Kotak Institutional Equities. As of March 31, 2008

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 Sensexby 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).

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

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

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

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