MORNING INSIGHT

PRIVATE CLIENT RESEARCH

OCTOBER 16, 2008

Economy News

- Reserve Bank of India has reduced the CRR by 100bps to 6.5% retrospectively with effect from October 11. The FII investment limit in corporate debt has been doubled to $6bn. The Government will provide capital to PSU banks whose CAR is below 12%. The Finance Minister said the government will provide farm loan waiver of Rs250 bn to banks immediately. (ET)
- SEBI has tightened margin norms in derivatives segment to ward off potential defaults and curb volatility. In a move that could halt short-selling through participatory notes, it has asked FIIs and their sub-accounts to provide details of such lending and borrowing in overseas markets. FIIs have been asked to submit data on such transactions twice a week (BS)
- The government would consider imposing 5% import duty on cheaper shipments and scrapping exports levy of up to 15% for steel as demanded by industry majors like Tata Steel and SAIL. (BL)
- The fertiliser ministry has requested the finance ministry to provide it about Rs 650.0bn in supplementary grants for disbursal of subsidies to the manufacturing companies. (BL)
- Tea exports shot up by 4% in volume in August due to a shortfall in output in Kenya-- a major producer - that continues to benefit the country, while shipments in the first eight months rose by 20%. Exports surged to 18.47 mn kg in August against 17.78 mn kg in the year-ago period, while shipments in the first eight months of this year shot up to 124.04 mn kg, compared with 106.64 mn kg in the corresponding period last year. (ET)
- Government is unlikely to reduce the capacity of ultra mega power projects (UMPPs), from the present 4,000 MW, on Asian Development Bank's suggestion which had said that by doing so they would be able to lend financial support to such projects. (BL)
- The government may provide Air India up to Rs 25bn, in the absence of funds from the market route, to help it stay in the skies right through the global financial crisis. (FE)

Corporate News

- **Bharti Airtel,** has entered into an innovation and technology partnership with Infosys Technologies Ltd to deliver superior experience to the customers of Airtel digital TV, its Direc t-to-Home TV service. (BL)
- The Gujarat government today decided to allot land at Rs 400 per sq meter to **Tata Motors** for setting up Nano plant in Sanand in Gujarat. The company will acquire 1,100 acres of land for the proposed project for Rs 4bn. (BS)
- **Tata Steel** has state that the pension funds for its Corus unit had a surplus of 500 mn pounds ($1 bn) for the three months period ended June 30, 2008 and it is estimated to be higher in September quarter. The UK Pension Funds of Corus are significantly de-risked with around 70% of the portfolio in debt related instruments. (BS)
- **Jet Airways's** 1,900 staff of the 13,000 staff was being given notices of separation. Jet has already given pink slip to 850 cabin crew . Jet and Kingfisher, along with their acquired airlines, have a combined strength of 19,000 employees, a fleet of 189 aircraft serving 1,009 daily flights, of which 82 are on international routes. (ET)
- **Reliance Power** has signed a supplementary power purchase agreement (PPA) with fourteen buyers from seven states for its upcoming 4,000-MW ultra mega power project (UMPP) in Sasan. (BS)
- **Financial Technologies** has said that the Group had acquired 90% stake in UK-based ACE Group for a consideration of $22.5 million, subject to fulfillment of certain representations and warranties by the sellers. (BS)

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

Equity

	15 Oct 08	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
BSE Sensex	10,809	(5.9)	(20.0)	(14.0)
Nifty	3,338	(5.1)	(18.1)	(12.5)
BSE Banking	5,842	(3.3)	(14.8)	8.2
BSE IT	2,780	(5.4)	(21.6)	(22.1)
BSE Capital Goods	8,088	(8.9)	(28.3)	(20.4)
BSE Oil & Gas	7,231	(5.1)	(19.0)	(15.8)
NSE Midcap	4,003	(4.6)	(24.0)	(19.2)
BSE Small-cap	4,393	(4.8)	(30.1)	(30.5)
World Indices				
Dow Jones	8,578	(7.9)	(22.4)	(23.7)
Nasdaq	1,628	(8.5)	(26.3)	(28.7)
FTSE	4,080	(7.2)	(18.8)	(20.8)
Nikkei	9,547	1.1	(25.6)	(32.3)
Hangseng	15,998	(5.0)	(18.9)	(30.1)

Value traded (Rs cr)

	15 Oct 08	% Chg - Day
Cash BSE	3,502	(16.0)
Cash NSE	9,748	(17.7)
Derivatives	43,996	(6.9)

Net inflows (Rs cr)

	14 Oct 08	% Chg	MTD	YTD
FII	(189)	(78)	(7,202)	(44,708)
Mutual Fund	(261)	(150)	(45)	12,434

FII open interest (Rs cr)

	14 Oct 08	% Chg
FII Index Futures	11,704	(3.5)
FII Index Options	18,550	(8.4)
FII Stock Futures	14,852	(1.7)
FII Stock Options	789	(5.4)

Advances / Declines (BSE)

14 Oct 08	A	B	S	Total	% total
Advances	26	308	85	419	18
Declines	178	1364	354	1,896	81
Unchanged	-	23	7	30	1

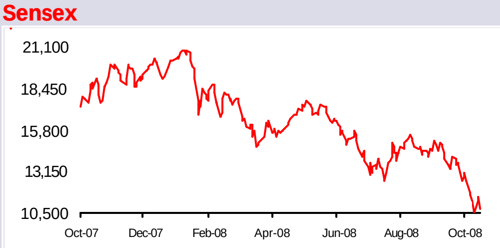
Commodity

		15 Oct 08	% Chg 1 Day	1 Mth	3 Mths
Crude (NYMEX)	(US$/BBL)	73.4	(1.6)	(19.5)	(45.5)
Gold	(US$/OZ)	846.9	1.2	8.0	(12.2)
Silver	(US$/OZ)	10.3	(6.1)	(2.6)	(45.6)

Debt / forex market

	15 Oct 08	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.20	8.01	8.14	9.54
Re/US$	48.53	48.08	45.93	43.10

Sensex



ECONOMY UPDATE

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RBI ACTS AGAIN: CUTS CRR BY ANOTHER 100 BPS

TRINITY- RBI, SEBI & Govt. are at work

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

This is follow-up to 150 bps cut in CRR announced earlier. Thus the extent of total cut comes up to 250 bps from 9.0% to 6.5%, including the 150 bps announced earlier (50 bps on October 6, 2008 & 100 bps on October 10, 2008).

Incrementally, Rs.400 bn would be released into the banking system on back of the current reduction in CRR by 100 bps. Rs.250bn would further come into the system on back of advance spending by Centre in the form of debt waivers to farmers.

The hike in interest ceiling on FCNR & NRE deposits and hike in borrowing limits by banks from their overseas branches would help RBI in protecting rupee from further depreciation

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

RBI has acted again by cutting Cash Reserve Ratio (CRR) by another 100 bps to 6.5% of net demand and time liabilities (NDTL) of NDTL with effect from the current reporting fortnight that began on October 11, 2008.

This is follow-up to 150 bps cut in CRR announced earlier. Thus the extent of total cut comes up to 250 bps from 9.0% to 6.5%, including the 150 bps announced earlier (50 bps on October 6, 2008 & 100 bps on October 10, 2008).

Incrementally, Rs.400 bn would be released into the banking system on back of the current reduction in CRR by 100 bps. So, total release of liquidity into the banking system stands at Rs.1000 bn on back of total cut of 250 bps in CRR.

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

On October 14, 2008, the RBI also decided to conduct a special 14 -day Repo auction at 9% for a notified amount of Rs.200 bn with a view to enabling banks to meet the liquidity requirements of mutual funds. Further, the RBI also clarified that this 14 day repo facility will now be conducted every day until further notice upto a cumulative amount of Rs.200 bn for the same purpose.

Banks can also avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of mutual funds to the extent of up to 0.5% of their NDTL. This additional liquidity support will terminate 14 days from the closure of this special term repo facility announced on October 14, 2008. This accommodation will be in addition to the temporary measure announced on September 16, 2008 permitting banks to avail of additional liquidity support to the extent of up to 1% of their NDTL.

In another move by the government which is likely to help liquidity flow in, the Centre has now advanced its spending by releasing Rs.250 bn to banks in the form of debt waivers to farmers.

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

Tight liquidity conditions in the market forced Indian banks to use the LAF (liquidity adjustment facility) window to borrow on average around Rs.900 bn from RBI every day till couple of days back. The borrowing through LAF window has come down from Rs.900 bn levels to Rs.550 bn (October 15, 2008) but still indicates liquidity crunch in the system. The call money rate was prevailing around 10%, showing the same liquidity tightness in the money market.

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

Interest ceiling on FCNR and NRE deposits have been raised to attract more NRI money. The interest rate ceiling on FCNR (B) deposits has been increased by 50 bps, i.e., to Libor/Swap rates plus 25 bps. Similarly, the interest rate ceiling on NR(E)RA deposits has been increased by 50 bps, i.e., to Libor/Swap rates plus 100 bps.

Banks are now allowed to borrow funds from their overseas branches and correspondent banks up to a limit of 50% of their unimpaired Tier-I capital as at the end of the previous quarter or $10 mn, whichever is higher, as against the existing limit of 25%.

The FII investment limit in corporate debt has been doubled to $6 bn from $ 3 bn earlier. This will help in blue-chip corporate raising capital at a slightly cheaper rate along with helping INR from depreciating further due to excess demand for USD in the forex market.

In yet another move, the government has decided to provide the banks access to finance in order to raise the capital adequacy ratio (CAR) of banks that are now between 10-12% to reach the level of 12% by a suitable date. This would improve the resilience of the Indian banking system in the environment when global financial systems are facing turbulence. However, we are waiting for more clarity on how banks would be recapitalized.

Our Take

These moves are likely to release Rs.650 bn into the banking system (Rs.400 bn due to CRR cut by 100 bps and Rs.250 bn through advanced spending by Centre to banks in the form of debt waivers to farmers.

These moves are likely to ease short term tighter liquidity environment for which there is demand.

This move is likely to improve the NIM of banks by 10-12 bps. Banks do not get any interest on CRR deposits, whereas incremental yield of advances lies in the range of 11-12%. So, this release of money could push up NIM of the banks.

It is likely to positively impact the bond yields. The 10-year government securities closed slightly lower at 8.65% (FIMMDA) at the end of Q2FY09 as compared to 8.69% at the end of Q1FY09. The cut in CRR would further depress the bond yields, leading to write-back of MTM provisions in H2FY09.

The hike in interest ceiling on FCNR and NRE deposits would help in attracting more NRI money. Similarly, banks can now borrow funds from their overseas branches up to a limit of 50% of their unimpaired Tier-I capital. These steps would help RBI in protecting rupee from further depreciating.

The government's decision to provide the banks access to finance in order to raise their capital adequacy ratio (CAR) to reach the level of 12% by a suitable date would improve the resilience of the Indian banking system.

We believe RBI has cut the CRR to provide liquidity in the system rather than giving any indication for softening in interest rate regime.

We continue to believe the interest rate cycle has peaked

However, we continue to believe that interest rates have peaked and our central bank may start cutting rates (read repo rate, which gives direct signal to bankers to cut their lending rates) in case there is significant demand slow down. We prefer Axis bank, BOB, Indian bank and Union bank over others though the stocks may remain range bound in the short term & move in the line with the global developments.

RESULT UPDATE

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HCL TECHNOLOGIES LTD (HCLT)

PRICE: RS.160 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.221 **FY09E P/E: 7X**

1QFY09 results below expectations. Maintain cautious stance on sector. Potential slowdown in future earnings incorporated in DCF analysis. Expect stock performance to be subdued due to the above and uncertainty regarding impact of Axon acquisition (if successful). Downgrade to Accumulate despite decent upside and undemanding valuations.

- HCLT's operational 1QFY09 results were below our expectations, both on topline and bottom-line. Forex loss impacted the net profits significantly.
- Revenues were flat in USD terms, about 2.4% in constant currency terms. Organic revenue growth lower
- Scale down in one BFSI client impacted revenues by $10.5mn. Client to stabilize in 2QFY09. One BPO clients also scales down.
- Management indicates little pricing pressure. Company adopting output based pricing and fixed priced pricing to reduce cost to customers
- Overall, these indicate pressure on business. Next couple of quarters to be watched closely.
- Company's focus on the change-the-business budgets and Collaborative Transformation seeing increased traction. Signed 8 deals worth $270mn in 1Q
- Expect EPS of Rs.23 in FY09. We incorporate a challenging demand scenario for the foreseeable future in our DCF analysis. The fair value works out to Rs.221 (v/s TP of Rs.347 earlier). At our price target our FY09E earnings will be discounted by 9.5x, a discount to peers.
- Challenging demand scenario and client specific issues to keep sentiment subdued on the sector and the stock. Thus, recommend ACCUMULATE despite decent upside. Continue to prefer Infosys and Satyam over HCLT.
- A prolonged recession in major user economies and a sharper-than-expected appreciation in rupee v/s our revised assumption of Rs.44 by FY09 end (June 09) are key downside risks to our call.

Summary table

(Rs mn)	FY07	FY08	FY09E
Revenues	60338	76394	96322
Growth (%)	37.3	26.6	26.1
EBITDA	13371	16960	21907
EBITDA margin (%)	22.2	22.2	22.7
Net profit	13045	10372	16100
Net cash (debt)	25297	24722	32711
EPS (Rs)	19.7	15.3	23.3
Growth (%)	65.8	-22.1	52.2
CEPS	23.5	19.8	28.9
DPS (Rs)	8.0	8.0	8.0
ROE (%)	28.8	20.3	27.5
ROCE (%)	33.2	24.5	32.6
M Cap/Sales (x)	1.8	1.4	1.1
EV/EBITDA (x)	7.9	6.4	5.0
P/E (x)	8.1	10.4	6.9
P/Cash Earnings	6.8	8.1	5.5
P/BV (x)	2.1	2.1	1.7

Source: Company, Kotak Securities - Private Client Research

1QFY09 results

(Rs mn)	1QFY09	4QFY08	QoQ %	1QFY08	YoY %
Turnover	**23693**	**21688**	**9.2**	**17091**	**38.6**
Expenditure	18382	16604		13451	
Operating Profit	**5311**	**5084**	**4.5**	**3640**	**45.9**
Depreciation	908	850		686	
Gross Profit	**4403**	**4234**	**4.0**	**2954**	**49.0**
Other Income	-416	-2644		504	
PBT	**3987**	**1590**	**150.8**	**3458**	**15.3**
Tax	439	203		346	
PAT	**3548**	**1387**	**155.9**	**3112**	**14.0**
Share of income	0	5		-28	
ESOP charge	187	231		227	
Minority interest	-14	-23		0	
Adj. PAT	3375	1184	185.1	2857	18.1
Shares (mns)	677	677		677	
EPS (Rs) *	**5.1**	**1.8**		**4.2**	
OPM (%)	22.4	23.4		21.3	
GPM (%)	18.6	19.5		17.3	
NPM (%)	15.0	6.4		18.2	

*Source : Company * - on diluted equity*

Revenues

- Revenues were 9% higher QoQ in INR terms. However, in USD terms, revenues were flat QoQ. In constant currency terms, the growth was about 2.4%, lower than estimates.
- Revenue growth was impacted by a scale down in one large BFSI account in IT services ($10.5mn impact) and in one BPO client ($4.2mn impact).
- IMS revenues continued to grow at about 3.7% in USD terms, probably higher in constant currency terms
- The company has won 8 accounts during the quarter with a consolidated booking of $270mn, most of which are integrated deals.
- HCLT has been focusing on the Tier II accounts and also first time outsourcers and thus may face some client specific issues in the back drop of the current turmoil in developed markets.
- The management has indicated that, there are no further scale downs expected. However, we believe that, there could be client specific scale downs, which can impact growth going forward. We have accounted for the same in our DCF analysis.

Client concentration (% of revenues)

	1QFY09	4QFY08	Growth QoQ (%)
Top 5	26.10	26.70	6.79
Top 10	36.60	37.30	7.20
Top 20	48.80	49.60	7.48

Source : company

- Revenues from the Top 20 accounts witnessed subdued growth in USD terms (7% rise in INR terms) because of the currency fluctuations and the scale down in a large account QoQ.

Geographical breakup of revenues

(Rs mn)	1QFY09	4QFY08	Growth QoQ (%)
USA	13,576	12,449	9.06
Europe	6,800	6,311	7.74
Asia Pacific	3,293	2,928	12.48

Source : company

Employee additions below estimates

- Employee additions in the core IT services business were lower than expected. However, combined with IMS, they matched up to our numbers.
- The additions in core IT services business are reflective of the scale down in one client and probably also of the challenging scene in the BFSI segment.
- The BPO business also saw employee count go down despite the consolidation of Liberata and Control Point. We note that, Liberata had 800 employees and Control Point had about 200. The BPO business saw off-shore employees reducing by about 1200 QoQ. This is of concern to us.

Margins lower

- EBIDTA margins were impacted by about 102bps largely because of the consolidation of the acquisitions in the BPO business and salary increases to part employees.
- Salary increases impacted margins by 145bps, acquisitions by 55bps and lower utilization by 27bps. Absence of grants had an impact of 36bps while currency impacted margins positively by 176bps.
- The acquisitions are for only one month and hence, will impact margins further in the next quarter.
- With more salary hikes (for senior management) due in 2QFY09, margins are expected to remain under pressure.

Forex loss

- The company reported a significant forex loss of about Rs.900mn during the quarter. This was the main reason for the variance between our profit estimates and the actual profits.
- The company continued to incur forex loss on its hedges. As at the quarter end, the company had total hedges of $1.9bn, covering the next seven quarters.
- Of these, about $343mn ($579mn in 1QFY09) were ineffective hedges which led to a MTM loss of $20.8mn during the quarter.
- About $42mn of losses were carried to the balance sheet taking the total loss under the head "other comprehensive income" to $156mn.
- The extensive hedges taken by the company has not allowed and will not allow the company to benefit from any kind of rupee depreciation over the next seven quarters.

Axon acquisition - Macro scenario has changed, of late

- HCLT expects the acquisition of Axon to be completed by March 2009 in case the scheme of arrangement is successful. It has purchased about 10.43% stake in Axon already from the market for about GBP 42mn.
- We opine that, the macro scenario has changed dramatically over the past month. SAP itself has warned of lower growth going ahead.
- In these circumstances, we are skeptical about the actual impact of this proposed acquisition on HCLT's financials.
- The BFS space in USA and Europe has significantly weakened and it is expected to impact other parts of those economies as well. This can impact growth rates of Axon going forward.

Valuations may be impacted

- We note that, HCLT's offer is at 20x historical earnings as compared to HCLT's own valuations of about 10x FY08 earnings.
- We also note that, the company will have to take on significant debt of about GBP 400mn which is more than the $570mn cash lying in the balance sheet.
- Moreover, the margins of HCLT (14% net margins in FY08) will be impacted as Axon has relatively lower margins (net margins of 8.7% in 1HCY08). Axon's revenues are about 20% of HCLT's revenues.
- These factors will possibly continue to weigh on the stock and may impact future valuations, making us cautious on the stock.

Future prospects

- We have suitably modified our FY09 earnings estimates to accommodate the 1QFY09 numbers and our changed currency assumptions. We have also brought in more caution on the demand side.
- We have not considered Axon in our estimates. We now expect the rupee to end the fiscal at Rs.44 per USD.
- While IT services revenues are expected to grow by 23% YoY, BPO and IMS revenues are expected to report growth of 31% and 35%, respectively. BPO revenues will be aided by acquisitions.
- Margins are expected to be largely maintained as the acquisition and rupee appreciation impact will be largely nullified by cost control and better utilization of resources.
- Consequently, we expect the EPS to be Rs.23.3 in FY09E. This is after assuming a further equity dilution in FY09 due to ESOPs.

Valuations

We recommend ACCUMULATE on HCL Technologies with a price target of Rs.221

- We have arrived at a fair value for the stock by adopting the DCF methodology.
- In our DCF model, we have exercised greater caution in forecasting the growth in foreseeable future. We also note that, FY11 growth rate swill be lower because of the higher tax incidence.
- We arrive at a fair value of Rs.212 for the stock, which is significantly lower than our earlier target of Rs.347. The reduction reflects the caution which we have exercised for the foreseeable future.
- We rate the stock an ACCUMULATE. We prefer Infosys and Satyam.

Concerns

- A prolonged recession in major user economies may impact our projections.
- A sharp acceleration in the rupee from our assumed levels may impact our earnings estimates for the company.

RESULT UPDATE

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JUBILANT ORGANOSYS LTD

PRICE: RS.181 **RECOMMENDATION: BUY**
TARGET PRICE: RS.412 **FY10E P/E: 6.6X**

Strong revenue growth; unrealized forex losses hit the bottom-line. Maintain BUY but expect the stock to remain range bound till there is significant appreciation in the rupee.

- Net sales grew 52.1% to Rs.9.41bn on the back of strong growth in outsourcing related segments comprising CRAMS and DDDS. CRAMS operation witnessed a strong growth of 61% to Rs.5bn against Rs.3.1bn;
- International revenues grew 65% to Rs.5.37bn led by good performance in CRAMS and the integration of the results of the Draxis for full quarter;
- The industrial & performance products business delivered strong growth of 41.8% to Rs.3.55bn, ahead of our expectation;
- EBIDTA grew sharply 54.9% to Rs.1.77bn against Rs.1.14bn given the strong growth in overall realizations and strong growth across all businesses and particularly in CRAMS. EBIDTA margin during the quarter improved by 30bps to 18.8%;
- During the quarter, the company has reported loss of Rs.696mn at net level as compared to Rs.1.09bn profit in Q2FY08;
- Jubilant has provided Rs.1.74bn towards unrealized exchange loss on restatement of foreign currency borrowing including FCCB. Hence, the adjusted net profit grew 28% to Rs.1.05bn as compared to Rs.818mn;
- The company has reported adjusted EPS Rs.7.1 in Q2FY09 and Rs.15.2 in H1FY09. We expect fully diluted adjusted EPS Rs.29.2 and Rs.27.4 in FY09 and FY10, respectively;
- We reduce our target price to Rs.412 (earlier Rs.460) valuing stock on 15x FY10E price to earning multiple. We maintain BUY. The stock may remain range bound in near term till there is significant appreciation in the rupee which can reverse the forex losses.

Summary table

(Rs mn)	FY08	FY09E	FY10E
Revenues	24,889	35,072	40,667
Growth (%)	37.5	40.9	16.0
EBITDA	4,507	6,839	8,133
Growth (%)	77.7	51.7	18.9
EBITDA Margin (%)	18.1	19.5	20.0
Adj. Net Profit	2,949	4,587	4,925
Growth (%)	86.4	55.6	7.4
Adj. FDEPS (Rs)	20.1	29.2	27.4
Growth (%)	82.3	45.6	(6.1)
DPS (Rs)	1.5	1.5	1.5
RoE (%)	27.3	31.0	20.6
RoCE (%)	15.7	7.1	13.4
EV/Sales (x)	2.7	1.4	1.0
EV/EBITDA (x)	14.8	7.0	4.9
P/E (x)	9.0	6.2	6.6
P/BV (x)	4.1	1.7	1.1

Source: Company, Kotak Securities - Private Client Research

Financial Performance (Consolidated)

(Rs mn)	Q2FY09	Q2FY08	YoY (%)	Q1FY09	QoQ (%)	FY08	FY07	YoY (%)
Net Sales	**9,405**	**6,183**	**52.1**	**8,266**	**13.8**	**24,889**	**18,097**	**37.5**
Expenditures	7,632	5,039		6,608		20,252	15,528	
EBIDTA	**1,773**	**1,144**	**54.9**	**1,658**	**6.9**	**4,637**	**2,569**	**80.5**
Depreciation	411	237		337		1,039	623	
EBIT	**1,362**	**908**	**50.1**	**1,322**	**3.0**	**3,598**	**1,946**	**84.9**
Interest	221	109		138		337	195	
Other Income	71	95		74		261	544	
PBT	**1,212**	**894**	**35.6**	**1,258**	**(3.6)**	**3,522**	**2,295**	**53.4**
Extra-Ordinary Items	(1,742)	278		(1,076)		1,040	658	
Tax	166	76		61		573	712	
Profit After Tax	**(696)**	**1,096**	**(163.5)**	**121**	**(675.4)**	**3,989**	**2,241**	**78.0**
Extra-Ordinary Adjustment	(1,742)	278		(1,076)		1,040	658	
Adjusted PAT	1,046	818	28.0	1,197	(12.6)	2,949	1,583	86.3
Equity Shares (Mn)	148	144		146		146	143	
EPS (Rs)	**7.1**	**5.7**	**24.5**	**8.2**	**(13.4)**	**20.2**	**11.0**	**82.7**
EBIDTA Margin (%)	18.8	18.5		20.1		18.6	14.2	
Adj. PAT Margin (%)	11.1	13.2		14.5		11.8	8.7	

Source: Company

Revenue on organic basis grew 38% during the quarter

Net sales for the quarter grew 52.1% to Rs.9.41bn as compared to Rs6.18bn on the back of strong growth in outsourcing related segments comprising CRAMS and DDDS. CRAMS operation witnessed a strong growth of 61% to Rs.5bn against Rs.3.1bn. International revenues grew 65% to Rs.5.37bn led by good performance in CRAMS and the integration of the results of the Draxis for full quarter. Revenues from North American markets increased 95.8% to Rs.2.98bn due to integration of Draxis Health. On a like-to-like basis organic revenue grew strongly by 38% during the quarter.

The industrial & performance products business delivered strong growth of 41.8% to Rs.3.55bn, which is ahead of our expectation, and contributed 37.7% to revenue. The company has seen a good increase in realizations of its products despite higher raw material prices. The demand in IPP remained intact and the company's key product lines demonstrated improved client traction.

EBIDTA grew sharply 54.9% to Rs.1.77bn against Rs.1.14bn given the strong growth in overall realizations and strong growth across all businesses and particularly in CRAMS. EBIDTA margin during the quarter has increased by 30bps to 18.8%. During the quarter, the company has reported loss of Rs.696mn at net level as compared to Rs.1.09bn profit in Q2FY08. The company has provided Rs.1.74bn towards unrealized exchange loss on restatement of foreign currency borrowing including FCCB. Hence, the adjusted net profit grew 28% to Rs.1.05bn as compared to Rs.818mn.

Pharma & life science products business remains lead growth driver

The pharma and life science products business is continued to show strong performance largely driven by spectacular growth in CRAMS business on the back of improved capacities, acquisitions, new launches and long-term contracts. The custom research and manufacturing services (CRAMS) remains the lead value creator for the company. The pharma and life science products business grew 59.1% to Rs.5.86bn and contributed 62.3% to net sales during the quarter.

Business wise Revenue Break-up

	Q2FY09	Q2FY08	FY08	FY07
Pharma & Life Science	5,858	3,681	15,301	8,950
% Sales	62.3	59.5	61.5	49.5
% Growth Y-o-Y	59.1	53.9	71.0	32.1
Industrial & Performance Products	3,547	2,502	9,587	9,147
% Sales	37.7	40.5	38.5	50.5
% Growth Y-o-Y	41.8	10.4	4.8	11.3
Net Sales	**9,405**	**6,183**	**24,889**	**18,097**

Source: Company

International business witnessing strong growth

International operations continue to deliver robust results. International sales during the quarter grew 64.8% to Rs.5.37bn on the back of full integration of Draxis health and strong growth in other markets. Regulated markets (US & EU) have registered a growth of 80% to Rs.3.74bn and contributed 70% of international sales. The company has seen a significant growth in other markets due to exports of proprietary intermediates.

Geographical Revenue Break-up

	Q2FY09	Q2FY08	FY08	FY07
Domestic Sales (Net)	4,033	2,924	10,950	9,779
% Sales	42.9	47.3	44.0	54.0
% Growth Y-o-Y	37.9	24.1	12.0	7.4
Exports Sales	5,372	3,260	13,940	8,318
- Regulated Markets	3,742	2,097	9,354	5,450
- Other Markets	1,630	1,163	4,586	2,868
% Sales	57.1	52.7	56.0	46.0
% Growth Y-o-Y	64.8	41.6	67.6	41.3
Net Sales	**9,405**	**6,184**	**24,890**	**18,097**

Source: Company

DRAXIS Health provides entry into Radio-pharmaceutical business

Jubilant had acquired Canada based Draxis health Inc. in April 2008 for US$253m. Draxis Health sells sterile products including liquid and freeze-dried injectables and sterile ointments and creams; non-sterile products like solid oral and semi-solid dosage forms; and radio-pharmaceuticals. With this acquisition Jubilant became one of the leading providers of contract manufacturing of small volume parenterals to large pharma and biotech companies in North America. Draxis has an excellent regulatory track record with expertise in radio-pharmaceuticals and contract manufacturing.

We expect significant improvement in Draxis financials from 2009 onwards. Among the key growth drivers in 2009 are commencement of commercial supplies to Johnson & Johnson consumer and full year sales of Sestamibi in US (to be launched through GE Healthcare). The J&J consumer contract is expected to earn over US$120mn in sales from 2009-13 and has potential to repeat business. In 2010 the company is expected to launch the complete suite of radio-pharmaceuticals products in EU and Canada.

Drug discovery services to gain further traction

Jubilant forayed in the drug discovery services business in 2002 by setting up Jubilant Biosys to provide bio/chemo informatics databases to drug discovery companies for their early-stage lead generation programs. Jubilant Chemistry provides medicinal chemistry services for lead optimization in new chemical entities development. In the current environment, most of the drug discovery work is concentrated in the US. With an emphasis on accelerating the drug development process, the drug discovery companies are collaborating with CROs to outsource part of the drug development work.

Healthcare business reached break-even at EBIDTA level

Jubilant plans to spend around Rs.1.8bn capital expenditure over the next two years, to reach a capacity of around 1000 beds with hub and spoke model. Unlike other established healthcare chains, the company has a different business model with focus on good-quality healthcare at low prices. The target segment is the low and middle income groups of the society. The company has started with 200 bed hospital in Kolkata with some group of professional doctors/physician who will hold around 5-10% of equity in the venture.

For the quarter, healthcare segment has registered revenue of Rs.14mn as compared to Rs.4.2mn in Q2FY08. The progress of the development of healthcare operations is satisfactorily. The land acquisition / construction process for the network of hub and spokes is presently underway. In Q1 FY09 this business reached break-even at the EBIDTA level. Under the development plan, a new 110 bed hospital is slated to open at Barasat by December 2008 taking the total number of beds to 200. The company is targeting RoCE of ~20% and EBITDA of ~25%.

We expect 41% revenue growth in FY09 led by higher CRAMS contribution

We expect sales growth of 40.9% in FY09 and 16% in FY10. The higher growth in FY09 sales is due to the significant traction in CRAMS business and full integration of Draxis Health. In the past, the revenue was driven by the industrial and performance chemicals business, but going forward we expect the product mix to shift towards CRAMS and drug discovery and, to a lesser extent, APIs. This is consistent with management's strategy to reduce cyclicality in its chemicals business and move up the value chain.

We believe, focus will continue on CRAMS operation where higher volumes and margin expansion are expected due to the following factors:

- Exclusive synthesis business is expected to show increased revenue on account of the increase in the (customer) order book and strong pipeline with few products in Phase III of the customer's drug development program;
- In contract manufacturing business at Hollister Stier, expanded capacities of sterile injectable from 48mn to 120mn vials per annum is up and running, which will add higher revenues from existing and new customers at better margins;
- The proprietary product business has seen the signing of long term contracts with many customers with higher volumes and at better margins;
- Drug delivery and development services are showing improved results and given the pipeline of orders from existing and new customers, this is likely to result in higher revenues and operating profits.

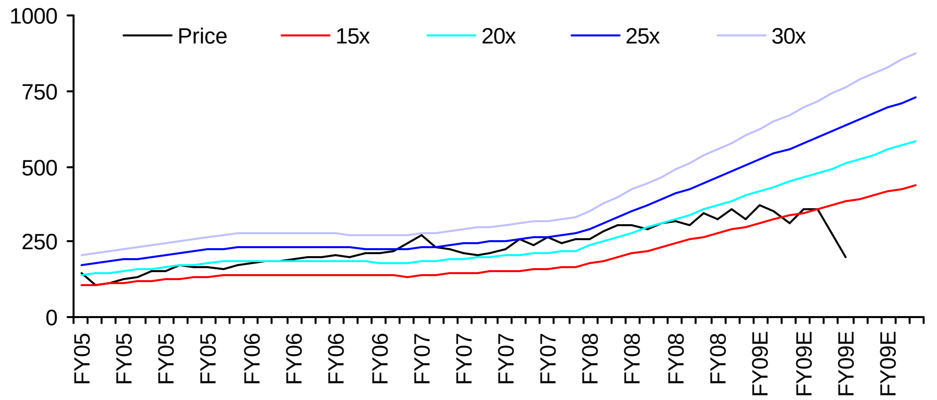
Valuations and Recommendation

- We expect revenue growth of 40.9%, 140bps margin expansion on products mix and acquisition synergies (19.5% EBITDA) and 55.6% growth in net profit in FY09. In FY10, we expect revenue growth of 16% and net profit growth of 7.4%
- The company has reported adjusted EPS Rs.7.1 in Q2FY09 and Rs.15.2 in H1FY09. We expect fully diluted adjusted EPS Rs.29.2 and Rs.27.4 in FY09 and FY10, respectively

We maintain our BUY recommendation on Jubilant with a revised price target of Rs.412

- We reduce our target price to Rs.412 (earlier DCF-based target price Rs.460) valuing stock on 15x FY10E price to earning multiple
- At current market price Rs.181, the stock is trading at 6.2x FY09E and 6.6x FY10E price to earnings multiple on fully diluted EPS estimates
- Jubilant remains our preferred pick in CRAMS segment. We maintain **BUY**.

PE Band



Source: Capitaline, Kotak Securities - Private client research

RESULT UPDATE

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LARSEN & TOUBRO

PRICE: RS.893 **RECOMMENDATION: BUY**
TARGET PRICE: RS.1209 **FY09E P/E: 18.4X**

- Results below expectations as EBITDA margins disappoint
- Order inflows at Rs 124 bn up 74% yoy and 1.8% qoq.
- Management maintained guidance on 30% growth in revenue and order inflow growth in FY09. Maintains positive outlook for FY10 as well.
- Maintain BUY with a revised target price of Rs 1209.

Summary table

(Rs mn)	FY08	FY09E	FY10E
Sales	293,504	378,341	466,504
Growth (%)	43.1	28.9	23.3
EBITDA	35,916	46,158	57,380
EBITDA margin (%)	12.2	12.2	12.3
Net profit	23,254	28,342	33,937
EPS (Rs)	39.2	48.5	58.1
Growth (%)	20.6	23.7	19.7
DPS (Rs)	12.6	12.6	12.6
ROE (%)	26.6	24.2	24.3
ROCE (%)	16.5	15.7	17.0
EV/Sales (x)	1.9	1.6	1.3
EV/EBITDA (x)	15.8	12.7	10.4
P/E (x)	22.8	18.4	15.4
P/BV (x)	4.9	4.1	3.4

Source: Company, Kotak Securities - Private Client Research

Quarterly performance

(Rs mn)	Q2 FY09	Q2 FY08	YoY (%)
Net sales	**76,822**	**55,012**	**40**
Other op income	42	9	341
Other income	1,559	1,124	39
Total op expenses	**70,095**	**50,049**	**40**
Raw material	17,317	14,181	22
Sun-contracting charges	13,875	8,760	58
Construction materials	18,371	10,848	69
purchase of trading goods	4,815	3,730	29
Other operating expenses	5,758	3,896	48
sales and admin exp	3,897	4,185	-7
Personnel	6,063	4,449	36
Operating Profit	**6,768**	**4,972**	**36**
Interest	690	132	421
Gross Profit	**7,637**	**5,964**	**28**
Depreciation	731	483	51
PBT	**6,907**	**5,481**	**26**
current Tax	2,304	2,001	15
Adjusted PAT	4,603	3,480	32
OPM (%)	8.8	9.0	

Source: Company

- Net sales for the quarter recorded strong growth of 40% yoy to Rs 76.8 bn. The Engineering and Construction (E&C) business, which contributes 76% of revenues grew 41% yoy and was the prime growth driver. Revenue growth in this division has been clearly well ahead of expectations over the last few quarters, thus highlighting L&T's superior execution skills.

- The electrical business which has been growing at a fast pace has clearly slowed down since the last three quarters. Revenues grew 13% yoy in the second quarter. Moderation in industrial production is reflecting in the lower offtake of electrical products (low voltage switchgear, metering and medical equipment) and petrol dispensing machines. This business segment has slowed down due to curtailment in capex plans of petrol marketing companies impacting petrol dispensing machines business. The LV electrical business has been hit by the slowdown in real estate. The outlook for this segment remains moderately positive.

- The machinery and industrial products division includes mining equipments (L&T Komatsu, L&T Case Equipments and TENGL), Rubber Processing Machinery, Voith paper Technology, plastics machinery, Valves (Audco India), welding products and EWAC Alloys. Revenue growth of 16% yoy has been driven by healthy demand for construction equipment and rubber making machinery. Depreciation in Rupee has been one of the enabling factors driving growth.

- Others segment include Technology Services division, e-Engineering solutions and embedded systems and RMC business. Favourable movement in Rupee contributed towards increased export realizations of Tech services.

Segment table

(Rs mn)	Q1 FY09	Q1 FY08	% change
Engg and Construction	59896	42599	41
Electronics	7604.8	6717	13
Mach and ind products	6846	5917	16
Others	4021	2329	73
Segment profits			
Engg and Construction	6484	4539	42.9
Electronics	847	1100	-23.0
Mach and Industrial products	1369.7	870.9	57.3
Others	218	165	32.5
Segment Margins (%)			
Engg and Construction	10.8	10.7	
Electronics	11.1	16.4	
Mach and ind products	20.0	14.7	
Others	5.4	7.1	

Source: Company

Contraction in operating margins:

- During the quarter the company has regrouped the forex numbers for the corresponding quarter of the previous year. The company was earlier following the practice of showing net forex gain in other income and net forex loss in other expenditure. The company has changed this practice and has now shown forex loss in other expenditure and forex gain in other income. As a result of this reclassification, the EBITDA margin for Q1 FY08 now stands reduced to 9.0%.
- Following this reclassification, the decline in EBITDA margins is of 20 bps to 8.8% in Q2 FY09.
- The major increase in operating costs has been due to construction materials and subcontracting expenses.
- Management indicated that staff costs have increased as the employee headcount has increased by 20% on a yoy basis. Sequential increase in employee costs from Rs 4.1 bn to Rs 6.1 bn partly due to payout of increments and incentives during the quarter.
- The management indicated the company has incurred costs of Rs 300 mn towards various new initiatives in building its railways and power generation equipment business. The company has already taken 200 executives for driving its initiative in railways vertical.
- L&T has close to 70% of its projects protected by price variation clause. Hence to that extent, the company may not completely benefit from the decline in commodity prices. However, the company indicated that generally, the profitability should improve if metal prices contract further.
- Quarterly comparison of segment margins in the Engg &Construction segment may not be appropriate given the long execution cycle of the projects. This segment managed to maintain its margins on a yoy basis.
- The electrical and electronics segment witnessed margin erosion due to general inflationary conditions coupled with lower capacity utilization.

- Machinery and industrial products group posted margin expansion on a yoy basis mainly aided by depreciation in rupee.

Other income driven by treasury income and greater dividend payout by JVs and Associates: The company booked treasury gains on liquid investments and dividend payouts has increased from JV and associate companies, which has driven the increase in other income.

Sharp increase in interest costs

Interest expenses rose 421% yoy to Rs 690 mn. The increase has been on the back of firming up of interest rates in recent times as also due to the overall increase in borrowings which has gone up to Rs 48 bn from Rs 35.8 bn at the end of FY08.

Order booking continued to be strong

Order backlog for L&T is up 47.8% yoy to Rs 609.3 bn, equivalent to revenue visibility of 25 months based on trailing four quarters revenues. Order inflows in the second quarter grew 74% yoy to Rs 124 bn. The order backlog does not include Rs 18 bn order for developiong the integrated commercial complex at Seawoods railway station.

Outlook

- Management expects to maintain the growth momentum of 30% in revenues and order inflows in FY09.
- Divestment of the RMC business will be reflected in the December ending results.
- Margins are expected to be maintained. As much as 70% of the order backlog is neutral to commodity price increase. In addition to this, the company maintains that it has several levers to maintain margins even in the fixed price orders.
- Revenue outlook for FY10 also appears to be healthy as present order backlog and order pipeline should support growth.
- Management indicated that the execution period of the order backlog has declined in the quarter from 27 months in Q2 FY08 to 25 months in Q2 FY09. Long gestation period orders including the Delhi Airport project has been completed to a significant extent.
- The company has not seen any major slowdown in middle east market so far and expects the region to sustain its investment momentum.

Reduced earnings estimates

We have made a few changes to our earnings estimates. We have made marginal changes to revenue and EBITDA margin forecast. However, we have taken higher interest expenses in view of recent firming of interest rates. We have increased borrowings as a result of company's capex and likely increase in working capital in a challenging business environment.

Earnings

	Earlier		Revised	
	FY09	FY10	FY09	FY10
Revenues (Rs mn)	378341	467238	378341.4	466504.3
EBITDA (%)	12.50	12.50	12.2	12.3
EPS (Rs)	53.45	67.1	48.5	58.1
			-9.2%	-13.4%

Source: Kotak Securities - Private Client Research

Valuation:

L&T is currently trading at 18.4x and 15.4x FY09 and FY10 consolidated earnings respectively.

We recommend BUY on L&T with a price target of Rs.1209

We revise our target price to Rs 1209 (Rs 1677 earlier) based on SOTP. We maintain a **BUY**.

Valuation

	Parameter	Fair Value	Per share
L&T Infotech	10x 09 earnings	25,699	44
L&T Finance	10x FY09	24,000	41
Infrastructure/overseas	12x FY09 PAT	8,185	14
subs/property subsidiaries			
L&T IDPL	2x P/BV	14,065	24
Associates	15x 08 earnings	18,450	32
Ultratech	market value	7,722	13
L&T Standalone	DCF		1041
Total			1,209

Source: Company

Bulk Deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
15-Oct	Bafna Pharma	R K Patwari Huf	S	92,159	16.9
15-Oct	Db(Intr) Stbr	Sulabh Plantations And Finance	S	17,000	22.7
15-Oct	Diamon Cable	Amansa Capital Pte Ltd	B	248,138	128.0
15-Oct	Diamon Cable	Credit Suisse Singapore Limited	S	248,138	128.0
15-Oct	Dynamatic Te	Amansa Capital Pte Ltd	B	42,466	860.0
15-Oct	Dynamatic Te	Credit Suisse Singapore Limited	S	42,466	860.0
15-Oct	Eicher Motors	Amansa Capital Pte Ltd	B	156,727	201.0
15-Oct	Eicher Motors	Credit Suisse Singapore Limited	S	156,727	201.0
15-Oct	Elpro Intern	Rekha Mukesh Gupta	B	56,500	282.0
15-Oct	Elpro Intern	India Max Investment Fund Ltd.	S	56,500	282.0
15-Oct	G.S. Auto	Spjstock	B	26,604	62.5
15-Oct	Koff Br Pict	Pravin D Gala	B	62,808	28.6
15-Oct	Mount Eve Mi	Tree Line Asia Master Fund Singa Pte Ltd	B	2,541,300	84.8
15-Oct	Mount Eve Mi	Goldman Sachs Investmts Mauritius I Ltd	S	2,541,300	84.8
15-Oct	Nucleu Sof E	Amansa Capital Pte Ltd	B	167,165	87.0
15-Oct	Nucleu Sof E	Credit Suisse Singapore Limited	S	167,165	87.0
15-Oct	Prranet Indu	Champalal Chouhan	B	1,200,000	1.6
15-Oct	Spanc Telesy	Kapilpuri	B	300,000	45.0
15-Oct	Suashis Diam	Somerset Emerging Opportunitie	B	243,000	419.1
15-Oct	United Phosp	Tree Line Advisors Hong Kong Ltd. Ac	B	1,957,847	228.0
15-Oct	United Phosp	Goldman Sachs Investmts Mauritius I Ltd	S	1,957,847	228.0
15-Oct	Zandu Phar W	Emami Limited	B	33,314	14,356.6

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	% change	Index points	Volume (mn)
Gainers				
Sun Pharma	1,399	1.1	0.5	0.5
BPCL	352	1.0	0.2	0.5
Hero Honda Motors	826	0.1	0.0	0.5
Losers				
Reliance Ind	1,520	(6.2)	(23.9)	5.2
Bharti Airtel	715	(6.8)	(16.0)	5.8
ONGC	839	(4.9)	(14.9)	2.5

Source: Bloomberg

Forthcoming events

Company/Market

Date	Event
16-Oct	HDFC Bank, Mphasis, GTL, Biocon, NIIT Technologies, Madras Aluminium, Indusind Bank, Finolex Cables earnings expected
17-Oct	HDFC, Satyam, India Infoline earnings expected
18-Oct	Chambal Fertilizer, Ultratech Cement, Indian Bank, Federal Bank, Allahabad Bank earnings expected
20-Oct	Titan, Canara Bank, Shree Cements, Petronet LNG, Idea Cellular, Jet Airways, Akruti City, United Phosp, Rolta India earnings expected
21-Oct	LIC Housing Finance, BRPL, PFC, Chennai Pet, Wockhardt, Ashok Leyland, Marico, Tech Mahindra, Indian Hotels Co, Hero Honda Motors, Jaiprakash Associates, Zee Entertainment, Opto Circuit, Hindustan Zinc, RNRL, Indiabulls Securities, Indiabulls Financials, Pantaloon Retail earning expected

Source: Bloomberg

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