kotak® Institutional Equities

INDIA DAILY

May 13, 2008

EQUITY MARKETS

		Change, %		
India	**12-May**	**1-day**	**1-mo**	**3-mo**
Sensex	16,861	0.7	6.7	(0.5)
Nifty	5,013	0.6	4.9	1.7
Global/Regional indices				
Dow Jones	12,876	1.0	4.5	2.6
Nasdaq Composite	2,488	1.8	8.7	4.8
FTSE	6,221	0.3	5.5	5.8
Nikkie	13,832	0.6	3.8	5.8
Hang Seng	25,121	0.2	1.8	9.6
KOSPI	1,824	0.0	2.5	11.0

Value traded - India

			Moving avg, Rs bn	
	12-May		**1-mo**	**3-mo**
Cash (NSE+BSE)	189.8		199.8	193.6
Derivatives (NSE)	349.5		311.1	394
Deri. open interest	709.4		576	703

Forex/money market

		Change, basis points		
	12-May	**1-day**	**1-mo**	**3-mo**
Rs/US$	41.9	0	189	214
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	1	(9)	45

Net investment (US$mn)

	8-May		**MTD**	**CYTD**
FIIs	(100)		(78)	(2,792)
MFs	(80)		9	1,611

Top movers -3mo basis

		Change, %		
Best performers	**12-May**	**1-day**	**1-mo**	**3-mo**
Thomas Cook	100	(0.2)	2.8	59.2
Nestle India	1,847	1.9	22.0	42.0
Polaris	107	4.6	23.9	35.7
Chambal Fert	70	7.6	39.6	32.7
Ranbaxy	495	5.3	11.2	33.8
Worst performers				
Siemens India	569	(2.4)	(8.2)	(22.6)
Reliance Cap	1,304	1.3	1.7	(28.3)
Thermax	460	(3.6)	(9.9)	(27.1)
Essel Propack	36	0.6	(10.4)	(19.9)
BoB	291	(0.8)	(1.5)	(23.6)

Contents

Updates

News Roundup

Corporate

- The Dubai Silicon Oasis Authority (DSO) has invited companies from Saurashtra and Rajkot operating in the field of diesel engines, watches, engineering goods , and auto parts to invest in the authority. *(FE)*
- Ranbaxy Laboratories has signed a collaboration agreement with US-based Merck's Co for drug discovery and clinical development of new products in anti-infective field. *(FE)*
- Bajaj Auto has announced its joint venture with European car maker Renault and Japanese giant Nissan to manufacture a small car in India with a wholesale price tag of US$2,500 (Rs1.03 lakh). *(BS)*
- The UK-based Kansagra family and promoter of Delhi-based low-cost carrier Spicejet is willing to divest the family stake in the airline if the valuations are right. The family owns 12.91% in the airline, which has a 10% share of the Indian market. *(BS)*

Economic and political

- The inflation rate is expected to come down to 5.5% afte four months due to an anticipated good monsoon and measures taken by the government and the RBI, the Prime Minister's Economic Advisory Council Chairman C. Rangarajan said on Monday, May 12. *(BS)*
- Punjab has received six fresh investment proposals of Rs1,300 crore from companies, including Green Plywood, Century Plywood for setting up of agro based industries, which would generate 3,500 jobs in the state. *(FE)*

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

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Economy

Sector coverage view	N/A

March IIP growth disappoints; signals below 8% growth for FY2009E

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- **IIP growth in March 2008 falls to 3.0%; lowest in 72 months**
- **Consumer non-durables output stagnates in March**
- **We expect IIP growth in FY2009E to average below 8.0%**
- **RBI unlikely to further tighten monetary policy in near term**

The worst for the industry may not be over yet. IIP growth in March 2008 at 3.0% was distinctly below market expectations of a 6-7% growth. It was the lowest since February 2002. This reconfirmed that industrial growth has slowed down. Lackluster industrial activity may continue for some more time with deteriorating maroeconomic climate and rising input costs. We see growth improving moderately from June 2008, but IIP growth in FY2009E could still be lower, in the range of 7.5-8.0%.

Disappointing March reconfirms that industrial growth has slowed down

On a 4mMA basis, IIP growth has decelerated in each of the months of FY2008 (Exhibits 1). 4mMA growth has fallen to 6.4% in March 2008 from 12.2% a year ago. March 2008 only reconfirmed this deceleration. It was disappointing because (1) it was below street expectations of a 6-7% growth and (2) it reconfirmed that industrial growth has slowed down in FY2008.

Typically, industrial output in March (last month of the fiscal) bulges. This time around too, it bulged with March IIP turning out to be 8.7% higher than in February. This was not unusual, but base effects arising from a whopping 14.8% growth in March FY2007 ensured that growth in March 2008 nose dived to a 6-year low of 3.0%.

Consumer non-durables production stagnate in March 2008

Rising input costs, especially those for agro-based products are likely to have impacted production of consumer non-durables and exacerbated the fall of growth in March. Edible oil production was particularly hit, with output in March much lower than in the preceding month. Coconut oil production fell 43%, soyabean oil 27%, sunflower oil 26%, mustard oil 12%.Sugar output was also lower by 10%. As a result, consumer non-durables output stagnated with just 0.6% growth in March after registering a double digit growth in each of the preceding three months.

Growth in March was also disappointing across other sectors due to strong base effects. For example, in spite of 7.5% higher production mom, electricity output expanded by just 3.7% yoy in March.

IIP growth in FY2008 confirms deceleration across all sectors

IIP growth in FY2008 was lower than in FY2007 in case of all sectors (Exhibit 2). It was also lower in the case of all use-based sector classifications (Exhibit 3). Only growth in capital goods at 16.5% was still impressive, though lower than 18.2% in FY2007. However, even in case of capital goods, growth fell to 9.7% during last four months of FY2008 from 20.9% in the first eight months. Therefore, all sectors are now growing at single digits, though growth in FY2008 has stayed above the average of 6.9% for the post reform period since FY1993.

The slowdown in industrial growth has been perceptible since November 2007. This has been spot on on our contrarian call taken in our Economy Report of November 5, 2007 (page 6), *"India story to continue"*, where we had said, *"IIP growth to decelerate to 8.1% in FY2008E"*, when the consensus estimate was still about 10%.

We expect further deceleration with growth in FY2009E in 7.5-8.0% range

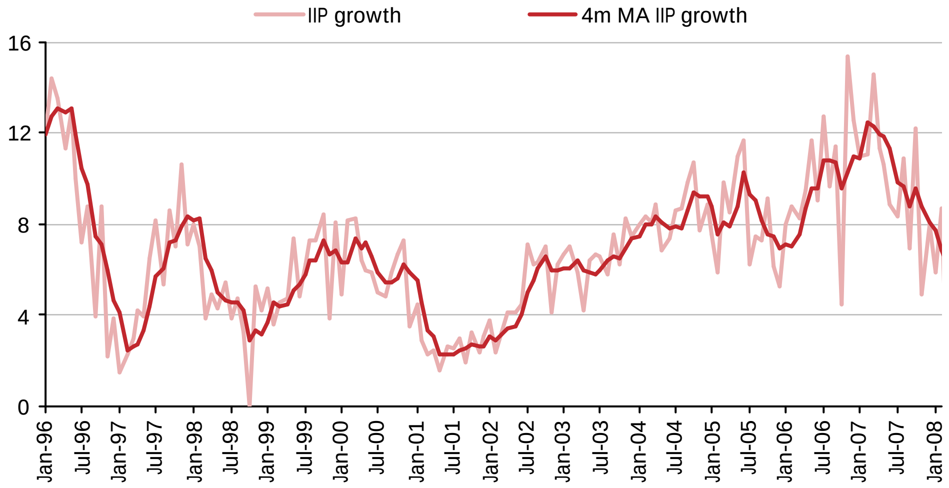
We expect weak industrial growth to persist during FY2009E with growth for the year slowing down further to below 8%, but staying above 7.5%. In our view, the earliest we could see IIP growth returning to double digits would be June, when base effects would work favourably with less than 10% growth in June 2007.

RBI unlikely to further tighten monetary policy in near term

With clear evidence that IIP growth is slowing down, we believe that RBI would take no further monetary tightening measures in the near future and instead try defending rupee against current depreciation onslaught. In our view, RBI has been hesitant in its defence of the Indian rupee for fear of excessively sucking out liquidity from the system. RBI has already raised CRR 75 bps and it may be waiting for the first round impact to be over before resorting to dollar sales.

Exhibit 1: IIP growth decelerates in FY2008

yoy growth in IIP and its 4-month moving average (%), April 1995-March2008



Source: CSO, Government of India.

Exhibit 2: Industry slows down since November 2007 as per our projections

Sectoral classification for IIP, March fiscal year-ends, 2007-2008 (%)

	Mining (%)		Manufacturing (%)		Electricity (%)		General (%)	
	2007	2008	2007	2008	2007	2008	2007	2008
Weights (%)	**10.47**		**79.36**		**10.17**		**100.0**	
April	3.4	2.6	11.0	12.4	5.9	8.7	9.9	11.3
May	2.9	3.8	13.3	11.3	5.0	9.4	11.7	10.6
June	4.7	1.5	10.8	9.7	4.9	6.8	9.7	8.9
July	5.1	3.2	14.3	8.8	8.9	7.5	13.2	8.3
August	(1.7)	14.7	11.9	10.7	4.1	9.2	10.3	10.9
September	4.3	4.9	12.7	7.4	11.3	4.5	12.0	7.0
October	5.9	5.1	3.8	13.8	9.7	4.2	4.5	12.2
November	8.8	6.3	17.2	4.7	8.7	5.8	15.8	4.9
December	6.1	5.0	14.5	8.6	9.1	3.8	13.4	8.0
January	7.7	2.4	12.3	6.3	8.3	3.7	11.6	5.8
February	7.5	7.6	12.0	8.6	3.3	9.8	11.0	8.6
March	8.0	3.8	16.0	2.9	7.9	3.7	14.8	3.0
April-March	**5.4**	**5.0**	**12.5**	**8.6**	**7.2**	**6.4**	**11.6**	**8.1**

Source: CSO, Government of India.

Exhibit 3: Capital goods also decelerate from high growth till November 2007

Use-based classification for IIP, March fiscal year-ends, 2007-2008 (%)

	Basic goods		Capital goods		Intermediate goods		Consumer goods		Consumer durables		Consumer non-durables	
	2007	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**
Weights (%)	**35.57**		**9.26**		**26.51**		**28.66**		**5.37**		**23.30**	
April	9.3	8.6	19.6	10.9	8.5	10.6	8.9	14.7	7.4	2.4	9.4	18.7
May	9.2	10.3	21.5	22.4	12.5	8.8	10.5	8.7	17.5	(0.7)	8.2	12.1
June	8.5	9.2	21.7	23.1	11.3	8.6	6.1	3.6	19.9	(3.6)	1.8	6.3
July	10.0	8.7	18.3	12.3	10.7	7.7	16.8	7.1	16.2	(2.7)	17.1	10.5
August	4.8	12.7	16.6	30.8	8.7	13.8	15.0	(0.0)	19.0	(6.2)	13.6	2.4
September	11.5	6.5	9.5	20.9	13.8	10.1	12.1	(0.2)	11.8	(7.3)	12.2	2.6
October	10.5	6.5	6.5	20.9	5.9	13.9	(2.8)	13.7	0.2	9.0	(4.1)	15.8
November	12.1	5.2	29.4	24.2	17.9	5.5	13.5	(2.9)	10.1	(5.5)	14.8	(2.0)
December	12.4	3.4	26.2	17.6	12.7	7.6	10.7	8.7	1.8	2.8	13.5	10.3
January	12.0	3.5	16.3	2.3	13.7	7.3	8.2	7.8	5.3	(0.3)	9.1	10.3
February	10.7	7.3	18.0	10.4	13.3	7.9	7.4	9.6	1.8	3.0	9.3	11.8
March	11.9	3.1	18.1	8.6	15.3	3.5	15.8	(0.1)	3.8	(2.1)	20.2	0.6
April-March	**10.3**	**6.9**	**18.2**	**16.5**	**12.0**	**8.7**	**10.1**	**5.7**	**9.2**	**(1.0)**	**10.4**	**8.0**

Source: CSO, Government of India.

Cement

Sector coverage view	Cautious

		Price, Rs	
Company	**Rating**	**12-May**	**Target**
Gujarat Ambuj	REDUCE	112	117
ACC	REDUCE	703	800
Grasim	ADD	2,257	2,750
India Cements	REDUCE	158	270
UltraTech Cem	REDUCE	664	850
Shree Cement	ADD	918	1,300

ACC freezes cement prices in response to government concerns on rising inflation

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- **ACC rules out price hikes—others will likely comply**
- **Marginal relief from excise and import duty a possibility**
- **Reiterate 'Cautious' view on the sector**

ACC has ruled out increase in cement prices for the next 2-3 months in response to government's increasing concern on rising cement prices and their impact on inflation. In the event of India's leading cement manufacturer holding cement prices, we believe other cement manufacturers will also not be able to take any price increases, especially since some large new capacities have started production. Our earnings estimates build in a stable pricing environment during FY2009 followed by a 5% decline in cement prices in FY2010 due to the large build-up of fresh cement capacities. We have been highlighting two major concerns for the cement sector—(1) the change in supply-demand balance, with large capacity addition during CY2008-09 and (2) frequent government and regulatory intervention, which has eroded the pricing power of the cement manufacturers. We reiterate our 'Cautious' view on the sector as we believe that rising costs (fuel and freight), coupled with the erosion of pricing power, will result in a decline in profitability of cement companies. While cement stocks have corrected ahead of an anticipated decline in profitability during the last few months and smaller cement companies are currently trading below their replacement cost, we await positive news flow before changing our view on the sector.

ACC rules out price hikes—others will likely comply. We infer from ACC's assurance that it will freeze price hikes that cement manufacturers will not be able to take any price increases in the near future. A commitment by the largest cement manufacturer puts pressure on other cement manufacturers to hold prices as well—cement manufacturers will not want to be on the wrong side of government's efforts to control inflation. Commissioning of fresh cement capacities and therefore lower capacity utilizations will ensure that the price increases cannot happen without the participation of one of the largest cement manufacturers. We note that last month, the government had banned export of cement and clinker that is weighing on realizations in the West. In our view, freezing cement prices at a time of ever-increasing cost side pressures will weigh on the profitability in the sector.

Marginal relief from excise and import duty—a possibility. In view of the increasing cost-side pressures and possible stagnant (or reducing) cement prices, the government could provide marginal relief in the form of (1) lower incidence of excise duty (by way of abatement) and (2) lower import duty on coal. We note that the cement sector has been facing increasing input costs from (1) higher raw material costs, (2) increasing power and fuel costs as imported coal does not show signs of weakening and (3) higher freight costs on account of higher prices of fuel.

Reiterate 'Cautious' view on the sector. We reiterate our 'Cautious' view on the sector as increasing costs and a loss of pricing power continue to weigh on profitability. The assurance by ACC that it will freeze price hikes in response to government concerns on increasing cement prices reaffirms the risk the industry faces due to fiscal and regulatory intervention from the government. In our view, key risks to earnings stem from (1) lower realizations in FY2009 as 30 mtpa of cement capacities will get commissioned, thereby reversing the current demand supply mismatch (2) higher fuel and freight costs and (3) probable import of cement from neighboring countries that will further enhance the supply of cement.

Cement comparative valuation

Company	Market cap. (US$ mn)	CMP (Rs) 12-May	Target price (Rs)	Rating	EPS (Rs) 2006	2007	2008E	2009E	P/E (X) 2006	2007	2008E	2009E
ACC	3,154	703	800	REDUCE	29.3	56.7	65.1	68.8	24.0	12.4	10.8	10.2
Ambuja Cement	4,030	112	117	REDUCE	4.9	8.5	8.7	8.8	22.6	13.1	12.8	12.7
Grasim Industries	4,926	2,257	2,750	ADD	107.9	214.6	284.6	267.4	20.9	10.5	7.9	8.4
India Cements	977	158	270	REDUCE	1.5	26.1	25.4	27.9	104.7	6.0	6.2	5.7
Shree Cement	759	915	1,300	ADD	48.0	45.2	85.9	108.6	19.0	20.2	10.7	8.4
UltraTech Cement	1,967	664	850	REDUCE	17.8	63.1	81.1	86.1	37.2	10.5	8.2	7.7

Company	EV/EBITDA (X) 2006	2007	2008E	2009E	EV / ton production (US $) 2008E	2009E	EV/ton - capacity (US $) 2008E	2009E
ACC	14.3	7.3	5.9	5.6	143.6	133.6	124.1	110.6
Ambuja Cement	14.7	9.5	7.2	7.0	222.7	189.9	208.5	179.9
Grasim Industries	10.2	5.6	4.3	4.3	NA	NA	NA	NA
India Cements	21.1	7.9	4.4	3.6	130.9	102.8	111.9	81.8
Shree Cement	14.7	6.1	3.8	3.4	134.4	94.1	93.6	86.2
UltraTech Cement	15.7	6.6	5.2	4.8	132.0	125.3	101.3	100.9

Note: Ambuja Cement - assumed exercise of put option for stake in ACIL.
ACC - 2006 numbers for 12 months ending March 2006 (adjusted) and 2007 numbers for 12 months ending Dec 2006.
Ambuja Cement- 2006 numbers for 12 months ending June 2006 and 2007 numbers for 12 months ending Dec 2006 (adjusted).

Source: Company data, Kotak Institutional Equities estimates.

Intermittent interference from the government poses a constant risk to profitability of cement manufacturers

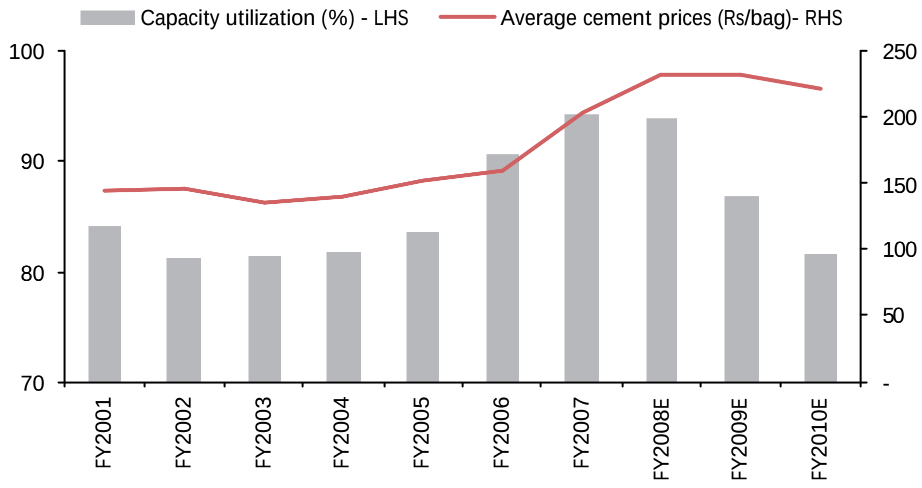
Chronology of intervention by the government

Date	Government action
May-08	ACC agrees to stabilise cement prices for 2-3 months in response to governments' concern on increasing cement prices and their impact on inflation
Apr-08	Government bans export of cement and clinker with immediate effect in order to increase domestic supply of cement
Mar-08	Withdrawal of duty entitlement passbook scheme to dis-incentivise export of cement and clinker
Jan-08	Tamil Nadu government forces cement manufacturers to sell 1.2 mn tpa of cement at a subsidized rate of Rs200/bag to economically backward sections of society
Jul-07	India's trade practices regulator MRTPC orders a probe into the business practices of 14 leading cement manufacturers to investigate the possibility of manipulative practices and price collusion
Apr-07	Removal of import and countervailing duty on imported cement facilitating import of cement form neighbouring countries at competitive prices
Feb-07	Dual structure of excise duty introduced, implying higher incidence of excise duty at then prevalent market prices

Source: Media reports, Government release, Company data, Kotak Institutional Equities.

Cement prices may get impacted as capacity utilization come down

Capacity utilization (%) and Average cement prices (Rs/bag of 50 kg)



Source: CMA, Kotak Institutional Equities estimates.

Metals

Sector coverage view	Attractive

Company	Rating	Price, Rs 12-May	Target
Hindalco	ADD	175	215
NALCO	REDUCE	451	400
Tata Steel	ADD	843	800
Hindustan Zinc	ADD	628	850
JSPL	ADD	2,129	2,900
Sterlite	ADD	847	1,000
Sesa	ADD	3,932	4,400
JSW	ADD	928	1,040

Export-duty notification published—that's a googly

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- **Ministry of Finance (MoF) publishes the notification levying export-duty on several iron and steel articles, including semi-finished steel, rolled products as well as pipes**
- **We expect MoF to annul the impact of the current notification—in response to suo-motu price reduction by major steel makers.**
- **We do not alter estimates just yet, expecting a reversal of levies; JSW Steel (JSW) most hit if notification not reversed**

Following the President's assent to the Finance Bill on May 10, 2008, the MoF published the notification levying export duty on iron & steel products (including pipes). We expect MoF to publish a subsequent notification annulling the current one, as we believe key steel makers had agreed to cut (and hold for three months) the price of key steel products despite domestic costs being lower than landed cost. If not annulled, JSW Steel and Welspun Gujarat in our coverage will be most impacted.

With the President's assent to the Finance Bill on Saturday, the May 10, 2008, the Ministry of Finance (MoF) published the notification in the Official Gazette levying export duty on several iron & steel articles at 5%-15%. Details of articles charged under the section are given in Exhibit 1.

We believe companies operating in Galvanized Products (GP) exports (JSW Steel, Tata Steel), plate exports (JSPL, Welspun Gujarat) and pipe exports (Jindal Saw, Welspun Gujarat and PSL—refer separate report of even date from our pipes analyst, Nitin Bhasin for scenario analysis on pipes segment) will be impacted if the notification is not annulled.

We would be surprised if the notification is not reversed, after Indian steel-makers decided, suo-motu, to cut product prices by US$100/ton to arrest inflation. According to media reports, the steel makers had agreed to cut product-prices to help the Government curb inflation despite domestic prices being much lower than landed cost (even prior to the cut) in consideration of a promise by the MoF to desist from levying export duty on steel.

We believe that publication of the notification is technical ground rather than indicative of MoF's willingness to tax exports. With the Presidential accord to the Finance Bill, all notifications have to be published in the Official Gazette, which led to the publication. We expect the MoF to move another notification to annul the impact of the current one.

We do not alter estimates just yet, expecting a reversal of levies; JSW Steel is the most hit (in our Metals coverage) and Welspun Gujarat (in our coverage of pipes) if notification not reversed.

As we had observed in our note on April 10, 2008, JSW Steel will be most impacted in our Metals coverage universe following (a) a higher proportion of GP exports and (b) increase in slab exports to US facility after likely commissioning of new capacity in Sept-08. In KIE's pipe coverage universe (see today's report by our pipes analyst, Nitin Bhasin), Welspun Gujarat is likely to be doubly hit since it has begun plates exports in addition to its pipes export business (the latter being common to all SAW pipes companies).

The recent notification impacts a lot of companies under our coverage universe
Details of the notification issued

Description of goods	Companies under KIE coverage impacted	Duty levied
Pig iron, Sponge iron, Ingots and other primary items (slabs etc), Hot-rolled Coils and Plates	JSW Steel, Tata Steel, JSPL, Monnet Ispat, Welspun Gujarat	15%
Cold-rolled Coils, Bars and rods, angles and wires, tubes and pipes	JSW Steel, Tata Steel, JSPL, Jindal Saw, Welspun Gujarat, Maharashtra Seamless, PSL	10%
Flat-rolled products coated with Zinc (GP/GC)	JSW Steel, Tata Steel	5%

Source: Notification No. 66/2008-Customs, compiled by Kotak Institutional Equities

Export cess equates domestic prices with export realizations
Analysis of export premiums versus domestic realizations

Scenarios	**1**	**2**	**3**
Export tax	0%	0%	5%
DEPB (note 1)	6%	0%	0%
Implications			
Export Galvanized coils (US$/ton)	1,250	1,250	1,250
Less: Export tax (US$/ton)	—	—	(63)
Add: DEPB (US$/ton)	49	—	—
Export realization (US$/ton)	**1,299**	**1,250**	**1,188**
INR:USD conversion rate	40.5	40.5	40.5
Export realization (Rs/ton)	**52,599**	**50,625**	**48,094**
Domestic realization (Rs/ton)	**48,000**	**48,000**	**48,000**
Export realization premium (%)	10	5	0

Notes:
(a) DEPB is generally credited as % of FOB value, but is capped at certain value (6% of Rs32,500 per ton of GP)

Source: Industry data, Kotak Institutional Equities estimates

Hit on JSW earnings is 2% based on announced actions
Calculation of hit on JSW Steel, March fiscal year-ends (Rs mn)

Galvanised steel production (mn tons)	0.7
Of which, exported	0.4
Reduction in realization (US$/ton)	60.0
Reduction in EBITDA (US$ mn)	**26.4**
Savings in costs	**10.3**
Zinc usage (tons)	33,000
Zinc prices (US$/ton)	2,200
Reduction in landed costs (US$/ton)	110
Saving in costs (US$ mn)	3.6
Coke usage (tons)	268,000
Coke prices (US$/ton)	500
Reduction in landed costs (US$/ton)	25
Saving in costs (US$ mn)	6.7
Loss of EBITDA (US$ mn)	**16.1**
Loss of EBITDA (Rs mn)	651
Reduction in pre-tax profits (Rs mn)	456
Reduction in EPS (Rs/share)	2.4
% reduction in EPS (%) FY2009E	**2.4**

Source: Kotak Institutional Equities estimates

Construction

Sector coverage view	Attractive

Company	Rating	Price, Rs 12-May	Target
Punj	BUY	332	420
NCCL	BUY	208	310
IVRCL	BUY	416	570
Sadbhav Engin	BUY	1,078	1,385
Consolidated C	ADD	629	800

Better protected against commodity price increases with escalation clauses, reiterate BUY on coverage stocks given attractive valuations

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- **Better protected against commodity price increases, most contracts offer escalations clauses**
- **Recent correction has made valuations of construction sector stocks attractive**
- **Revise our execution and earnings estimates downwards, maintain BUY with a revised target price of Rs310 versus Rs360 earlier**
- **Punj Lloyd—may see pressure from commodity price increases; maintain BUY rating with a revised target price of Rs420 versus Rs450 earlier**

Construction companies are better protected against commodity price increase related risks versus their industrial counterparts. Our discussions suggest that upto 90% of their order books may have escalation clauses related to specific commodities such as cement, steel, bitumen etc. Valuations of construction stocks in our coverage universe have become attractive after the recent market correction. Punj, Nagarjuna and IVRCL are currently trading at an average P/E of about 15X based on FY2009E earnings. We revise our EPS estimate for Nagarjuna Construction for FY2009E and FY2010E based on revision in execution estimates to Rs11.3 and Rs14.8 from Rs12.7 and Rs17.2 earlier. We revise our target price for Nagarjuna Construction to Rs310 from Rs360 earlier but maintain BUY. We revise our EPS estimate for IVRCL for FY2009E and FY2010E to Rs20.6 and Rs27.4 from Rs20.4 and Rs31.4 earlier and maintain BUY with a target price of Rs570. We have revised our EPS estimate for Punj Lloyd for FY2009E and FY2010E to Rs16.9 and Rs24.7 from Rs19.6 and Rs29.4 earlier based on (a) upwards revision in execution estimates lead by strong order booking and (b) lower margin expectation for Punj Lloyd (excluding Sembawang) versus earlier. We maintain our BUY rating on Punj Lloyd with a revised DCF-based target price to Rs420 from Rs450 earlier.

Better protected against commodity price increases, most contracts offer escalation clauses

We highlight that construction companies are better protected against commodity price-escalation-related risks versus their industrial counterparts. Our discussions suggest that upto 90% of the order book of construction companies may have escalation clauses related to specific commodities such as cement, steel, bitumen etc. We believe that construction companies are also less exposed (versus their industrial counterparts) to ferrous and non-ferrous metals where price increases in the past few months have been very sharp. Margins of IVRCL and Nagarjuna have expanded during FY2004-07, surprisingly aided by lower raw material and subcontracting expenses (when prices of most input materials have gone up), perhaps led by better pricing (indicating that these companies likely do not have to bear the burden of input price increases). In the case of Punj though, standalone margins have declined due to increased raw material and subcontracting expenses. Hence, Punj may have to bear some portion of the increase in input prices (Exhibit 1).

Recent correction has made valuations of construction sector stocks attractive

Valuations of construction stocks under our coverage universe have become attractive after the recent market correction. Punj, Nagarjuna and IVRCL are currently trading at an average P/E of about 15X based on FY2009E (Exhibit 2). The valuations seem attractive given the high growth prospects for these companies – average EPS CAGR of over 40% over FY2008-10E (Exhibit 2).

Nagarjuna—expect execution to pick up in 4QFY08, revise estimates and target price, maintain BUY

We expect execution to pick up in 4QFY08 as we believe that there has been positive movement towards resolution of problems on four road projects under execution in the state of UP (that partly contributed to lower-than-expected execution in 9mFY08). We expect Nagarjuna to have revenues of Rs12 bn (yoy growth of 38%), EBITDA of Rs1.3 bn (yoy growth of 29% and operating margins of 10.8%) and PAT of Rs634 mn.

Revise execution and earnings estimates - We have revised our execution estimates for FY2009E and FY2010E to Rs47.1 bn and Rs61.8 bn from Rs49 bn and Rs66 bn earlier, based on lower-than-expected execution in 9MFY08. We have revised our EPS estimate for FY2009E and FY2010E to Rs11.3 and Rs14.8 from Rs12.7 and Rs17.2 earlier. We expect flat margins in FY2009E and FY2010E of 11.3%. We have revised our target price to Rs310 from Rs360 earlier based on (1) lower value of core construction business from Rs298 to Rs245 per share and (2) lower valuation of land bank etc from Rs84 to Rs65 per share (Exhibit 3). Our valuation of core construction business implies 16.5X FY2010E earnings (Exhibit 4). We highlight that Nagarjuna had a visibility of 2.3 years at the end of 9MFY08 based on forward four quarter revenues (Exhibits 3, 4 and 5).

IVRCL Infrastructure—expect moderation in execution in 4QFY08 after >70% growth in 9mFY08, marginally revise estimates, maintain BUY

We expect IVRCL to report revenues of Rs13.6, a yoy growth of 37% versus 9MFY08 growth of over 78%. We believe that yoy growth in 4QFY08 is likely to be lower led by (1) more even spread of revenues and (2) base effects with very strong yoy growth in 4QFY07 also.

We have revised our execution estimates for FY2009E and FY2010E to Rs50.4 bn and Rs69.5 bn from Rs49 bn and Rs70.7 bn earlier, based on more even distribution of execution growth. We have revised our EPS estimate for FY2009E and FY2010E to Rs20.6 and Rs27.4 from Rs20.4 and Rs31.4 earlier. We expect flat margins in FY2009E and FY2010E of 10.3%. We maintain our target price of Rs570 comprised of (1) Rs413 for the core construction business, (2) Rs112 for IVR Prime, (3) Rs15 for Hindustan Dorr Oliver and (4) Rs39 for BOTs and infrastructure holdings (Exhibit 6). Our valuation of core construction business implies 14X FY2010E earnings (Exhibit 7). We highlight that IVRCL had a visibility of 2.6 years at the end of 9mFY08 based on forward four quarter revenues (Exhibits 6, 7 and 8).

Punj Lloyd—may see pressure from commodity price increases, revise estimates based on lower margin expectations

We believe that Punj Lloyd is likely to witness pressure from commodity price increases despite (a) back-to-back contracts with commodities and components suppliers, (b) escalation clauses, (c) contingencies built-in the bids. We expect about 80% of order backlog of Punj Lloyd excluding Sembawang to be fixed-price denominated. We believe that Sembawang as a project management company may not be significantly exposed to raw material price increases. Thus we have revised our margin expectation for Punj Lloyd group excluding Sembawang to 11% from 12% to build in the pressure the commodity price increases. We have revised our execution estimates upwards for FY2009E and FY2010E to Rs114 bn and Rs153 bn from Rs111 bn and Rs141.5 bn respectively, based on strong order booking in the last three months. We have revised our EPS estimate for FY2008E and FY2009E to Rs16.9 and Rs24.7 from Rs19.6 and Rs29.4 earlier. We maintain BUY with a revised DCF-based target price to Rs420 from Rs450 earlier (Exhibits 9 and 10).

Exhibit 1. IVRCL and Nagarjuna have expanded margins, while Punj's margins have declined

Expense and margin ratios for construction coverage stocks, March fiscal year-ends, 2004-2007 (%)

IVRCL	FY04	FY05	FY06	FY07
Raw material and subcontracting expenses	82.9	85.1	84.3	81.3
Other manufacturing expenses	4.5	2.5	2.3	3.2
Employee and SG&A	5.1	4.1	4.3	5.5
EBITDA margin	**7.6**	**8.2**	**9.0**	**10.0**

Nagarjuna	FY04	FY05	FY06	FY07
Raw material and subcontracting expenses	67.7	70.1	68.2	65.8
Other manufacturing expenses	19.5	17.5	17.7	19.9
Employee and SG&A	5.1	4.8	5.2	5.0
EBITDA margin	**7.8**	**7.6**	**8.9**	**9.4**

Punj (standalone)	FY04	FY05	FY06	FY07
Raw material and subcontracting expenses	46.8	47.8	53.4	54.0
Other manufacturing expenses	18.3	18.4	13.9	15.9
Employee and SG&A	16.5	22.1	21.7	19.0
EBITDA margin	**18.4**	**11.7**	**11.3**	**11.1**

Source: Company data, Kotak Institutional Equities.

Exhibit 2: Construction stocks currently trade at an average P/E of about 16X and EV/EBITDA of 10X based on FY2009E earnings

Comparison of valuation of various construction companies in India, March fiscal year-ends 2008E-10E (Rs bn)

	Revenues			EBITDA			EPS (Rs)			P/E (X)			EV/EBITDA (X)			EV/SALES (X)		
Company	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Nagarjuna Construction Company	34.8	47.1	61.8	3.9	5.3	6.9	8.3	11.3	14.8	17.2	12.6	9.7	11.0	8.7	6.7	1.2	1.0	0.7
Punj Lloyd Ltd.	81.4	114.2	152.9	6.3	10.2	14.4	10.4	16.9	24.7	32.0	19.6	13.4	18.2	11.8	8.3	1.4	1.0	0.8
IVRCL Infrastructure	35.4	50.4	69.5	3.6	5.2	7.1	13.8	20.6	27.4	20.7	13.9	10.4	8.6	6.1	5.0	0.9	0.6	0.5
Larsen & Toubro standalone	242.0	321.4	419.9	28.6	39.2	52.7	71.9	94.8	124.1	29.8	22.6	17.3	22.4	16.6	12.5	2.7	2.0	1.6
Sadbhav Engineering	8.5	13.4	15.4	1.0	1.7	1.9	44.7	73.5	82.4	15.8	9.6	8.6	9.4	6.1	5.0	1.1	0.7	0.6
Consolidated Construciton Company	14.6	22.1	28.8	1.4	2.1	2.8	28.9	38.9	52.6	21.9	16.2	12.0	16.1	11.0	8.1	1.5	1.0	0.8
Average										**22.9**	**15.8**	**11.9**	**14.3**	**10.0**	**7.6**	**1.5**	**1.1**	**0.8**

Note:

(1) For Nagarjuna - we have adjusted value of land bank (about Rs28/share), other BOT projects (Rs18/share) and investments (Rs19/share) for a total of Rs65/share

(2) For Punj Lloyd & CCCL estimates are based on consolidated estimates as they do not have any BOT projects

(3) For IVRCL we have adjusted value of IVR Prime (Rs70/share corresponding to IVR Prime price of Rs250/share) and other BOT projects for a total adjustment of Rs130/share

(4) For L&T we have deducted Rs700 per share as the value of subsdiaries/associates/JVs

(5) For Sadbhav Engineering we have deducted Rs385 per share (the value of BOT projects)

Source: Bloomberg, Kotak Institutional Equities estimates.

Exhibit 3. Derivation of SOTP based target price for NCCL

	Equity commitment (Rs mn)	Incremental P/B multiple (X)	Valuation (Rs mn)	Per share Rs
BOT Projects	**3,148**	**0.4**	**1,554.6**	**6.5**
Roads				
Brindavan Infrastructure Co. Ltd.	150	0.4	59.9	0.2
Bangalore elevated Corridor Project	637	1.0	636.9	2.6
Western UP Tollway Ltd.	239	1.0	238.5	1.0
Orai - Bhognipur	832	0.4	332.8	1.4
Pondicherry Tindivanam Tollway Limited	375	0.5	187.5	0.8
Power				
Gautami Power	420	-	-	-
Hydropower project in Himachal Pradesh	495	0.2	99.0	0.4
ICICI Ventures/Tishman/ Nagarjuna project			2,666.3	11
Book value of investments	4,642			19
Value of core construction business			58,995.4	245
Value of land bank			6,734.0	28
Total				**310**

Source: Kotak Institutional Equities

Exhibit 4. Nagarjuna Construction - DCF model, March fiscal year-ends, 2009E-2018E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**47,079**	**61,833**	**77,737**	**96,738**	**120,912**	**149,982**	**182,573**	**219,088**	**258,524**	**297,303**	**327,033**
Revenue growth rate (%)	35	31	26	24	25	24	22	20	18	15	10
EBITDA	**5,328**	**6,908**	**8,685**	**10,808**	**12,904**	**16,006**	**19,484**	**24,976**	**29,472**	**33,893**	**37,282**
EBITDA margin (%)	11.3	11.2	11.2	11.2	11.4	11.4	11.4	11.4	11.4	11.4	11.4
Depreciation	(585)	(727)	(870)	(1,020)	(1,197)	(1,415)	(1,652)	(1,758)	(2,242)	(2,790)	(3,655)
EBIT	**4,754**	**6,192**	**7,826**	**9,799**	**11,718**	**14,603**	**17,844**	**23,229**	**27,242**	**31,114**	**33,638**
Tax	(1,510)	(1,955)	(2,447)	(3,041)	(3,636)	(4,509)	(5,503)	(7,164)	(8,401)	(9,595)	(10,374)
Change in net working capital	(3,461)	(3,737)	(4,371)	(4,972)	(6,414)	(7,817)	(8,926)	(7,503)	(7,563)	(7,437)	(5,702)
Capex	(1,800)	(1,800)	(1,800)	(2,000)	(2,500)	(3,000)	(3,000)	(5,477)	(6,463)	(7,433)	(8,176)
Free cash flow	**(1,443)**	**(583)**	**67**	**795**	**353**	**680**	**2,055**	**4,832**	**7,044**	**9,428**	**13,030**
PV of each cash flow	(1,283)	(461)	47	496	196	336	901	1,883	2,440	2,903	3,567

PV of cash flows	11,026
PV of terminal value	49,935
EV	60,961
Debt	1,966
Equity value	58,995
Fully diluted shares outstanding (mn)	241
Equity value (Rs/share)	**245.2**

FCF in terminal year (Rs mn)	13,030
Exit FCF multiple: (1+g)/(WACC-g)	14.0
Terminal value of FCF (Rs mn)	182,425
Exit EBITDA multiple	4.9

Exit FCF multiple (X)	14.0
Exit EBITDA multiple (X)	4.9

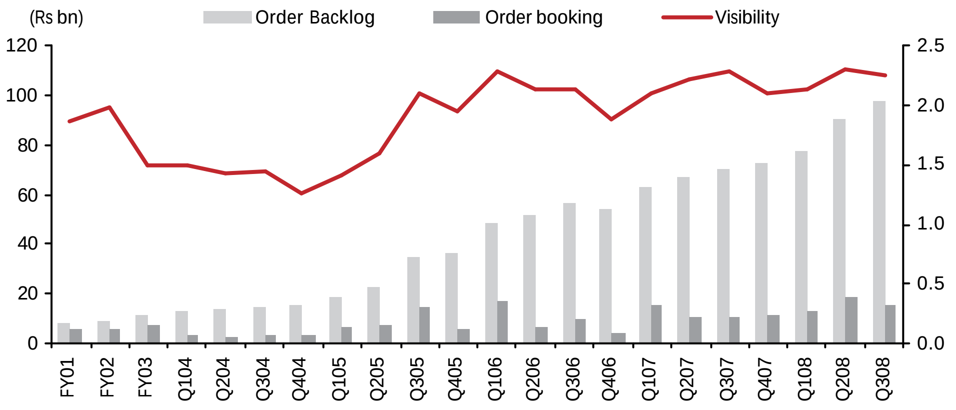
Terminal growth - g (%)	5.0
Risk free rate-Rf (%)	8.0
Market risk premium—(Rm-Rf) (%)	5.5
Beta (x)	1.1
Cost of equity-Ke (%)	14.1
Cost of debt-Kd (%)	12.0
Tax rate (%)	33.6
Debt/Capital (%)	42.7
Equity/Capital (%)	57.3
WACC (%)	11.5
Used WACC (%)	12.5

Sensitivity of DCF value to WACC, Terminal Growth rate

		WACC (%)				
		11.5	**12.0**	**12.5**	**13.0**	**14.0**
Terminal Growth rate (%)	**4.0**	269	242	219	199	165
	5.0	306	273	**245**	221	181
	6.0	357	315	279	249	202
	7.0	431	373	326	287	228
	9.0	755	605	499	420	311

Source: Kotak Institutional Equities estimates.

Exhibit 5. Nagarjuna Construction has visibility of 2.3 years based on forward four quarter revenues
Order backlog, order booking and visibility (X) of Nagarjuna Construction



Source: Company data, Kotak Institutional Equities.

Exhibit 6. Derivation of SOTP based target price for IVRCL

	Equity commitment (Rs mn)	P/B Multiple (X)	Per share (Rs)
Value of core construction business			378
Roads			
Jallandhar- Amristar Tollways	400	1.0	3
Salem - Kumarapalayam	760	1.0	6
Sumarapalayam Chenagmpalli	1,290	1.0	10
Water			
Chennai Water	713	1.0	5
Infrastructure holdings		Book value	16
Value of Hindustan Dorr Oliver		Market Price	15
Value of IVRCL Prime Developers limited		Discount to NAV	140
Total			**571**

Source: Kotak Institutional Equities estimates.

Exhibit 7. IVRCL - DCF model, March fiscal year-ends, 2009E-2018E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**50,434**	**69,455**	**90,996**	**117,549**	**137,213**	**159,330**	**181,654**	**203,452**	**227,866**	**255,210**	**280,731**
Revenue growth (%)	*42.6*	*37.7*	*31.0*	*29.2*	*16.7*	*16.1*	*14.0*	*12.0*	*12.0*	*12.0*	*10.0*
EBITDA	**5,245**	**7,119**	**9,327**	**12,049**	**14,064**	**16,331**	**18,620**	**20,956**	**23,470**	**26,287**	**28,915**
EBITDA margin (%)	*10.4*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*	*10.3*
Depreciation	(436)	(593)	(773)	(976)	(1,201)	(1,448)	(1,718)	(1,623)	(1,941)	(2,281)	(2,648)
EBIT	**4,820**	**6,536**	**8,564**	**11,083**	**12,874**	**14,893**	**16,911**	**19,343**	**21,540**	**24,016**	**26,278**
Tax	(1,533)	(2,074)	(2,717)	(3,519)	(4,090)	(4,739)	(5,387)	(6,162)	(6,862)	(7,651)	(8,371)
Change in net working capital	(1,428)	(5,472)	(5,698)	(7,493)	(5,549)	(6,241)	(6,300)	(4,479)	(5,017)	(5,619)	(5,244)
Capex	(1,500)	(2,000)	(2,000)	(2,500)	(2,500)	(3,000)	(3,000)	(4,069)	(4,557)	(5,104)	(5,615)
Free cash flow	**784**	**(2,427)**	**(1,088)**	**(1,464)**	**1,925**	**2,351**	**3,933**	**6,245**	**7,035**	**7,913**	**9,686**
PV of each cash flow	784	(2,158)	(859)	(1,028)	1,202	1,305	1,940	2,738	2,742	2,741	2,983

PV of cash flows	12,390	23%
PV of terminal value	41,757	77%
EV	54,147	100%
Debt	3,270	
Equity value	50,876	
Equity value (Rs/share)	**378**	

FCF in terminal year (Rs mn)	9,686
Exit FCF multiple: (1+g)/(WACC-g)	14.0
Terminal value of FCF (Rs mn)	135,598
Exit EBITDA multiple	4.7

Weighted average cost of capital-WACC	
Terminal growth - g (%)	5.0
Risk free rate-Rf (%)	8.0
Market risk premium—(Rm-Rf) (%)	5.5
Beta (x)	1.1
Cost of equity-Ke (%)	14.1
Cost of debt-Kd (%)	12.0
Tax rate (%)	33.6
Debt/Capital (%)	38.2
Equity/Capital (%)	61.8
WACC (%)	11.7
Used WACC (%)	12.5

Sensitivity of DCF value to WACC, Terminal Growth rate

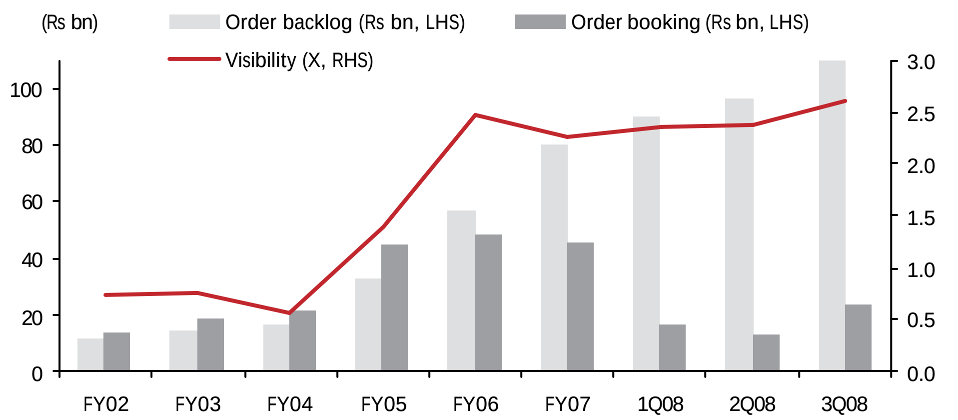
	WACC				
Terminal Growth rate (%)	11.5	12.0	12.5	13.0	13.5
4.0	411	372	339	309	282
5.0	466	419	378	342	311
6.0	542	480	429	385	347
7.0	651	567	498	442	394
8.0	822	696	599	522	459

Base case

Source: Kotak Institutional Equities estimates

Exhibit 8. Order book provides visibility of 2.6 years based on forward 4 quarters revenues

Order backlog, order booking and visibility for IVRCL (Rs bn)



Source: Company data, Kotak Institutional Equities.

Exhibit 9. Punj Lloyd Consolidated- DCF model, March fiscal year-ends, 2009E-18E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**114,205**	**152,888**	**197,957**	**243,199**	**296,975**	**359,237**	**427,298**	**491,393**	**565,102**	**621,612**	**683,773**
Revenue growth (%)	40.3	33.9	29.5	22.9	22.1	21.0	18.9	15.0	15.0	10.0	10.0
EBITDA	**10,169**	**14,442**	**18,777**	**23,017**	**28,110**	**34,005**	**40,449**	**46,682**	**53,685**	**59,053**	**64,958**
EBITDA (%)	8.9	9.4	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
Depreciation	(1,596)	(1,832)	(2,094)	(2,392)	(2,707)	(3,022)	(3,337)	(3,504)	(3,679)	(3,863)	(4,056)
EBIT	8,574	12,611	16,683	20,625	25,403	30,983	37,112	43,179	50,006	55,190	60,902
Tax	(2,412)	(3,546)	(4,703)	(5,803)	(7,149)	(8,722)	(10,449)	(14,249)	(16,502)	(18,213)	(20,098)
Change in net working capital	**(9,420)**	**(9,558)**	**(8,524)**	**(8,837)**	**(11,941)**	**(13,940)**	**(15,738)**	**(13,170)**	**(15,146)**	**(11,612)**	**(12,773)**
Capex	(3,250)	(3,500)	(4,000)	(4,500)	(4,500)	(4,500)	(4,500)	(4,914)	(5,651)	(6,216)	(6,838)
Free cash flow	**(4,914)**	**(2,162)**	**1,551**	**3,877**	**4,520**	**6,844**	**9,762**	**14,349**	**16,386**	**23,013**	**25,250**
PV of each cash flow	(4,914)	(1,922)	1,225	2,723	2,822	3,798	4,816	6,292	6,386	7,972	7,776
Capex (% of sales)	2.8	2.3	2.0	1.9	1.5	1.3	1.1	1.0	1.0	1.0	1.0

PV of cash flows	22,106	17%
PV of terminal value	108,859	83%
EV	130,965	100%
Debt	5,267	
Equity value	125,698	
Shares outstanding (mn)	300.6	
Equity value (Rs/share)	**418**	
Equity value (US$ mn)	**2,736**	
Exit FCF multiple (X)	**14.0**	
Exit EBITDA multiple (X)	**5.4**	

FCF in terminal year (Rs mn)	25,250
Exit FCF multiple: (1+g)/(WACC-g)	14.0
Terminal value of FCF (Rs mn)	353,501
Exit EBITDA multiple	5.4

Weighted average cost of capital-WACC	
Terminal growth - g (%)	5.0
Risk free rate-Rf (%)	7.5
Market risk premium—(Rm-Rf) (%)	5.5
Beta (x)	1.1
Cost of equity-Ke (%)	13.6
Cost of debt-Kd (%)	12.0
Tax rate (%)	33.9
Debt/Capital (%)	41.9
Equity/Capital (%)	58.1
WACC (%)	11.2
Used WACC (%)	12.5

Sensitivity of DCF value to WACC, Terminal Growth rate

		WACC (%)				
		11.5	**12.0**	**12.5**	**13.0**	**13.5**
Terminal growth rate (%)	**3.0**	406	369	336	307	282
	4.0	455	411	**373**	339	309
	5.0	520	465	418	377	342
	6.0	608	537	478	427	384
	7.0	736	638	559	494	439

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 10: Punj Lloyd has had strong order inflows in the last three months

Key orders won by Punj Lloyd since FY2007 so far (Rs mn)

Date	Segment	Area	Client	'Value (Rs mn)	Group entity	Description
30-Apr-08	Power	Pipeline	PT Makmur Sejahtera Wisesa, Indonesia	3,300	Punj Lloyd	EPC project for 2x30 MW Coal Power Plant in Kalimantan Island
11-Apr-08				18,640	Punj Lloyd	
11-Apr-08				970	Sembawang Engineers and Constructors	
31-Mar-08	Process	Process	Tecnimont S.p.A (Italy)	2,720	Sembawang Engineers and Constructors	Construction works for Abu Dhabi Polymers Company, UAE
7-Mar-08	Oil and Gas	Pipeline	Petronas, Malaysia	20,150	Punj Lloyd	EPC of a 512 km, 36" diameter onshore natural gas pipeline in Malaysia with support from local partners
14-Feb-08	Civil, Infrastructure and Power	Buildings	Marina Bay Sands Pte Ltd, Singapore	11,192	Sembawang Engineers and Constructors	Construction of the North Podium in the integrated resort comprising casino, theatres and retail arcade
12-Dec-07	Process	Process	Indian Oil Corporation	5,900	Punj Lloyd	Construction of coker unit & block for the Vadodara refinery in Gujarat
30-Nov-07	Civil, Infrastructure and Power	Infrastructure	Land Transport Authority, Singapore	12,720	Sembawang Engineers and Constructors	Construction of the MRT station in Marina Bay in Singapore
5-Nov-07	Process	Process	Jurong Aromatics Corporation Pte Ltd, Singapore	17,700	Sembawang Engineers and Constructors	EPC work for a new mega aromatics plant at Jurong island
12-Oct-07	Oil and Gas	Pipeline	Qatar Petroleum	3,890	Punj Lloyd	EPC on LSTK basis of 46 km of 18" multi-product pipeline
6-Aug-07	Process	Process	Bharat Oman Refineries Limited	5,900	Punj Lloyd	Lump-sum turnkey contract for building a sulphur block at Bina Refinery
2-Aug-07	Civil, Infrastructure and Power	Buildings	Sentosa Pte Ltd, subsidiary of Genting Group	6,660	Sembawang Engineers and Constructors	Sub-structural works at Sentosa Integrated Resort Development
27-Jul-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	3,180	Punj Lloyd	Laying of pipeline & associated facilities for East-West Pipeline project
23-Jul-07	Oil and Gas	Tankage	Saudi Kayan Petrochemical Company (SABIC)	1587(a)	Dayim Punj Lloyd Construction Contracting Company Ltd	EPC of tanks at Jubail Industrial city, Saudi Arabia
20-Jul-07	Process	Process	Gulf Fluor	500(b)	Simon Carves Ltd.	Fluorides plant incorporating a new Sulphuric Acid plant
14-May-07	Oil and Gas	Pipeline	GAIL (India) Ltd	1,227	Punj Lloyd	Phase II of Panvel — Dabhol Pipeline
16-Apr-07	Oil and Gas	Pipeline	Oman Gas Company	5,300	Punj Lloyd	24", 40 Km pipeline
19-Apr-07	Oil and Gas	Pipeline	Ras Laffan Olefins Company Ltd, USA	1,935	Punj Lloyd	Ethylene pipeline
23-Apr-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	1,802	Punj Lloyd	48", 122 Km pipeline
Total				**125,272**		

(a) Estimated share of Punj Llyod

(b) Estimated order value

Source: Company data, Kotak Institutional Equities estimates.

Pipes

Sector coverage view	Attractive

Company	Rating	Price, Rs 12-May	Target
Jindal Saw	BUY	584	1,080
PSL	BUY	337	500
WGSR	REDUCE	381	375

Export-duty notified on pipes—expect roll-back/exemptions; stalemate to impact Welspun the most

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- **Government notifies levy of 10% export duty on steel tubes and pipes; we expect roll-back/exemptions post recent price reduction by major domestic steel players**
- **If export duty were to continue as notified, Welspun and Jindal Saw to be severely impacted as export orders account for more than 90% of current linepipe order books**
- **Awaiting more clarity, we do not revise estimates but present three scenarios which highlight possible impact on earnings—Welspun most impacted, PSL least impacted**
- **Maintain BUY on PSL and JSAW and REDUCE on Welspun**

The government recently notified a levy of 10% export duty on the export of steel tubes and pipes following the President's assent to the Finance Bill on May 10, 2008. However, our metals analyst, Jigar Mistry, expects that this export duty on iron & steel products (including pipes) will be rolled back as the industry has already conceded to the government's call for a reduction in steel prices. However, if not annulled, Welspun and Jindal Saw will be severely impacted as exports account for more than 90% of their current linepipe order books. Welspun will be further impacted by 15% export duty on steel plates as we expect steel plates to contribute about 17% of revenues in FY2009E and FY2010E. We are awaiting more clarity we do not revise estimates but present three scenarios (see Exhibit 2) which highlight possible impact on net earnings—Welspun most impacted and PSL least impacted.

Export duty notified on steel pipes and plates, expect roll back

10% export duty on steel pipes will impact Welspun and JSAW the most because of export orders contributing to more than 90% of their linepipe order books. PSL will be the least impacted as its export orders account for not more than 6% of the unexecuted order book. However, our metals analyst, Jigar Mistry expects that this export duty on iron & steel products (including pipes) will be rolled back as the industry has already conceded to the Government's call for reduction in steel prices.

If export duty not annulled—Welspun to be most impacted

If export duty continues, we expect impact to be highest in the current fiscal for Welspun and JSAW as they will not be able to negotiate pricing for the existing orders. Moreover, if this notification continues, it is highly unlikely that the linepipe companies will be able to maintain margins due to their inability to pass on such export duty to international customers. Also, in the case of Welspun, export duty on plates will further impact earnings as plates will attract 15% export duty.

Provide scenarios for possible impact on pipe companies

Awaiting more clarity we do not revise estimates but present three scenarios (see Exhibit 2) which highlight possible impact on net earnings. Scenario I illustrates continuation of export duty at 10% and 15% for pipes and plates, respectively; scenario II illustrates exemption of export duty on exports made from imported raw material and scenario III illustrates possible pass-on of 50% of export duty to customers on incremental orders.

Exhibit 1: Overview of various possible scenarios for the application of export duties on pipes and tubes

	Scenario		
	I	II	III
Export duty levied on steel pipes and tubes	10%	10%	10%
Exemption for exports made against imported raw materials	No	Yes	No
Share of export duty passed on to customers in incremental orders	No	No	50%
Impact on profitability	Highest	Lowest	Medium

Source: Kotak Institutional Equities estimates.

Exhibit 2: Export duty to have significant impact on net earnings

Impact of export duty on net income under various scenarios, March fiscal year-ends (Rs mn)

	2009E				2010E			
	Current	Scenario I	Scenario II	Scenario III	Current	Scenario I	Scenario II	Scenario III
JSAW (1)	3,918	2,093	3,371	2,093	6,568	3,001	5,498	4,485
% impact		(46.6)	(14.0)	(46.6)		(54.3)	(16.3)	(31.7)
Welspun	5,733	2,206	4,936	2,603	9,320	3,751	8,054	6,356
% impact		(61.5)	(13.9)	(54.6)		(59.7)	(13.6)	(31.8)
PSL	1,680	1,585	1,642	1,537	2,314	2,016	2,195	2,089
% impact		(5.7)	(2.3)	(8.5)		(12.9)	(5.2)	(9.8)

Notes:

(1) Calender year-ends, 2009E numbers represent CY2008E and 2010E represents CY2009E.

(2) JSAW 2009E scenario III impact is similar to that in scenario I as current order book covers CY2008E revenues.

Source: Kotak Institutional Equities estimates.

Exhibit 3: PSL Ltd, scenario analysis of the impact of export duty applicable on steel products, March fiscal year-ends (Rs mn)

	Current estimates		Scenario - I		Scenario - II		Scenario - III	
	2009E	2010E	2009E	2010E	2009E	2010E	2009E	2010E
Net revenues	30,651	38,267	30,651	38,267	30,651	38,267	30,651	38,267
EBITDA	3,405	4,278	3,261	3,826	3,348	4,097	3,117	3,600
EBITDA margin (%)	11.1	11.2	10.6	10.0	10.9	10.7	10.2	9.4
PBT	2,424	3,279	2,280	2,827	2,366	3,098	2,280	3,053
PAT	1,680	2,314	1,585	2,016	1,642	2,195	1,537	2,089
PAT impact (%)			(5.7)	(12.9)	(2.3)	(5.2)	(8.5)	(9.8)

Source: Kotak Institutional Equities estimates.

Exhibit 4: PSL Ltd, calculation of impact of export duty (Rs mn)

Revenues	2009E	2010E	Comments
India	25,712	30,134	
UAE	1,750	2,090	
USA	3,189	6,043	
Total revenues	**30,651**	**38,267**	
Unexecuted order book			
Export from India	1,440	-	
Domestic	22,560	-	
Total	**24,000**	**-**	
Export revenues	1,440	4,520	assuming 15% of India revenues is from exports
Impact of export duty			
Scenario - I	144	452	10% on export revenues
Scenario - II	58	181	assuming 60% of export revenue is from imported materials
Scenario - III	144	226	assuming 50% of export duty on future orders will be passed on to customers

Source: Kotak Institutional Equities estimates.

Exhibit 5: Welspun Gujarat, scenario analysis of the impact of export duty applicable on steel products, March fiscal year-ends (Rs mn)

	Current estimates		Scenario - I		Scenario - II		Scenario - III	
	2009E	2010E	2009E	2010E	2009E	2010E	2009E	2010E
Net revenues	65,560	95,076	65,560	95,076	65,560	95,076	65,560	95,076
EBITDA	12,079	17,580	6,735	9,391	10,872	15,718	7,337	13,222
EBITDA margin (%)	18.4	18.5	10.3	9.9	16.6	16.5	11.2	13.9
PBT	8,708	13,735	3,365	5,546	7,501	11,873	3,966	9,376
PAT	5,733	9,320	2,206	3,751	4,936	8,054	2,603	6,356
PAT impact (%)			(61.5)	(59.7)	(13.9)	(13.6)	(54.6)	(31.8)

Source: Kotak Institutional Equities estimates.

Exhibit 6: Welspun , calculation of impact of export duty (Rs mn)

Revenue split	2009E	2010E	Comments
HSAW	23,145	28,560	
LSAW	20,409	31,977	
ERW	3,269	4,935	
US HSAW	5,035	9,291	
Job charges	94	131	
Export benefits	2,622	3,666	
Plate revenues	10,987	16,517	
Total revenues	**65,560**	**95,076**	
Order book (Rs mn)			
HSAW	28,000		
LSAW	15,000		
ERW	3,700		
Total	**46,700**		
Export revenues			
HSAW	20,155	27,132	95% exports
LSAW	18,750	31,977	100% exports
ERW	1,348	2,961	60% exports
Plate revenues	8,790	13,213	80% exports
Total revenues	**49,043**	**75,283**	
Impact of export duty			
Scenario - I	5,344	8,189	10% on pipe exports and 15% on plate exports
Scenario - II	1,208	1,862	assuming 100% of plate revenue and 70% of pipe revenue is from imported materials
Scenario - III	4,743	4,359	assuming 50% of export duty on future orders will be passed on to customers

Source: Kotak Institutional Equities estimates.

Exhibit 7: JSAW, scenario analysis of the impact of export duty applicable on steel products,December year-ends (Rs mn)

	Current estimates		Scenario - I		Scenario - II		Scenario - III	
	2008E	2009E	2008E	2009E	2008E	2009E	2008E	2009E
Net revenues	47,124	79,457	47,124	79,457	47,124	79,457	47,124	79,457
EBITDA	7,153	11,647	4,582	6,401	6,382	10,073	4,582	8,583
EBITDA margin (%)	15.2	14.7	9.7	8.1	13.5	12.7	9.7	10.8
PBT	5,544	9,688	2,973	4,443	4,773	8,115	2,973	6,624
PAT	3,918	6,568	2,093	3,001	3,371	5,498	2,093	4,485
PAT impact (%)			(46.6)	(54.3)	(14.0)	(16.3)	(46.6)	(31.7)

Source: Kotak Institutional Equities estimates.

Exhibit 8: JSAW, calculation of impact of export duty (Rs mn)

Revenues	CY2008E	CY2009E	Comments
HSAW	5,231	14,724	
LSAW	23,896	38,391	
Seamless	5,992	12,450	
DI	8,751	10,707	
Pig Iron	1,037	751	
Others	5,709	7,872	
Gross sales	**50,616**	**84,895**	
less: excise duty	3,492	5,438	
Net sales	**47,124**	**79,457**	
Order book ($ mn)			
SAW pipes	860		
DI	165		
Seamless	65		
Revenues chargeable to export duty (from current order book)			
SAW pipes	23,367	11,033	
Seamless	2,344	-	
DI + Pig	-	-	
Others	-	-	
Total	**25,711**	**11,033**	
Revenues chargeable to export duty (from new orders)			
SAW pipes	-	42,082	
Seamless	-	12,450	
DI + Pig	-	-	
Others	-	-	
Total	**-**	**54,532**	
Export revenues			
SAW pipes	23,367	53,115	assuming 100% export in CY2008E and 80% in CY2009E
Seamless	2,344	12,450	assuming 80% exports
Total	**25,711**	**65,566**	
Impact of export duty			
Scenario - I	2,571	5,245	10% on export revenues
Scenario - II	771	1,574	assuming 70% of export revenue is from imported materials
Scenario - III	2,571	3,064	assuming 50% of export duty on future orders will be passed on to customers

Source: Kotak Institutional Equities estimates.

Exhibit 9: Comparative valuation summary, March fiscal year-ends,

	2008E	2009E	2010E
EV/EBITDA (X)			
PSL	8.8	6.1	4.4
JSAW	4.8	3.0	2.3
Welspun	13.1	7.6	5.0
P/E (X)			
PSL	13.1	8.4	6.1
JSAW	8.5	5.0	4.5
Welspun	20.2	12.5	7.7
EV/EBIT (X)			
PSL	9.5	6.8	4.9
JSAW	5.5	3.3	2.5
Welspun	14.0	8.5	5.6

Note:
December fiscal year-ends for JSAW (September fiscal year-end for 2006); 2007 is for 15 months

March fiscal-year ending for PSL,Welspun.

Source: Kotak Instituional Equities estimates.

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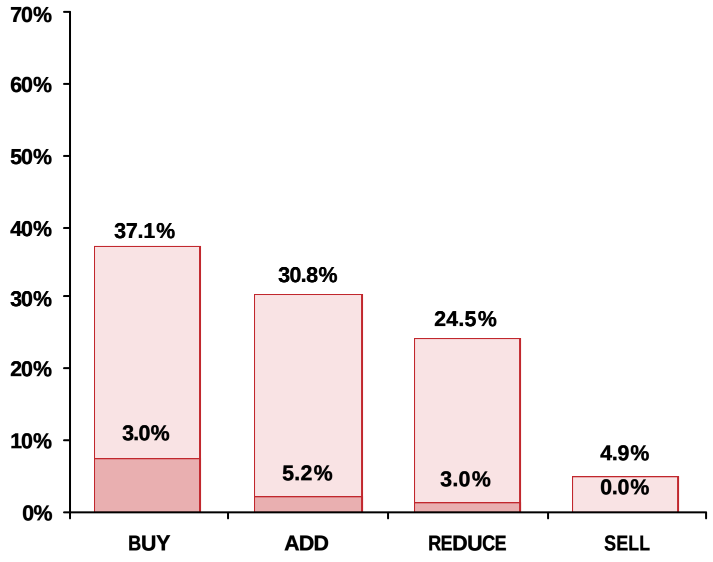

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