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Updates

Strategy: Hang in there; second half will likely be better

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News Round-up

- ▶ SEBI asks FII's to monitor PN beneficiaries, asks foreign institutions to make sure beneficial owners comply with PN reporting norms. (ECNT)
- ▶ SAIL (SAIL IN) calls off roadshows for USD 1.44bn FPO, govt. likely to miss divestment target for FY11. (ECNT)
- ▶ Tax authorities have asked Infosys Tech. (INFO IN) to fork out over USD 88.89mn, refusing to acknowledge onshore services - derogatorily called "body shopping" - as software exports. (ECNT)
- ▶ LIC will not be able to issue tax-saving infrastructure bonds aggregating USD 1.11bn to retail investors this fiscal due to regulatory glitch. Life insurer's can't raise money for any other activity but core business. (ECNT)
- ▶ Lodha Developers has awarded the civil construction contract of its proposed world's tallest residential building World One, to a JV of west Asia - based Arabian Construction Co. & Simplex Infrastructures (SINF IN). The contract is worth USD 100mn & is scheduled to be completed in 38 months. (ECNT)
- ▶ Sujana Towers (SUTL IN) revives stake sale plan, co. looks to raise USD 111.11mn, may also evaluate merger proposals. (ECNT)
- ▶ JSW Steel (JSTL IN) will infuse USD 844.44mn in Ispat Ind. (NDEN IN) over the next 2-3 years. (ECNT)
- ▶ Camlin (CAMLN IN) promoters looks to sell 15% stake to PE major India Value Fund, may raise USD 22.22mn. (ECNT)
- ▶ VA Tech Wabag Ltd (VATW IN) has signed a joint venture agreement with Zawawi Trading Company LLC (ZTC), Sultanate of Oman to float a new company to tap the market in West Asia. (BSTD)
- ▶ Ruchi Soya Industries (RSI IN) said it will invest USD 133 mn to expand refinery capacity by 1.1 million tones by the next financial year. (BSTD)

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

EQUITY MARKETS

India	Change %			
	17-Jan	1-day	1-mo	3-mo
Sensex	18,882	0.1	(4.9)	(6.2)
Nifty	5,655	0.0	(4.9)	(6.7)
Global/Regional indices				
Dow Jones	11,787	0.5	2.6	6.6
Nasdaq Composite	2,755	0.7	4.3	11.6
FTSE	5,986	(0.3)	1.9	5.0
Nikkei	10,513	0.1	2.0	10.7
Hang Seng	24,157	(0.5)	6.3	2.9
KOSPI	2,107	0.4	4.0	12.4
Value traded – India				
Cash (NSE+BSE)	143		81	28
Derivatives (NSE)	1,264		1,291	1,379
Deri. open interest	1,545		1,499	1,819

Forex/money market

	Change, basis points			
	17-Jan	1-day	1-mo	3-mo
Rs/US\$	45.4	(9)	(1)	98
10yr govt bond, %	8.2	2	26	16

Net investment (US\$mn)

	14-Jan	MTD	CYTD
FIs	(153)	(545)	(545)
MFs	(20)	116	(282)

Top movers -3mo basis

Best performers	Change, %			
	17-Jan	1-day	1-mo	3-mo
TCS IN Equity	1137.4	1.5	(0.3)	15.9
NEST IN Equity	3684.7	(1.1)	3.3	14.9
SUNP IN Equity	465.4	(2.0)	3.4	13.6
GNP IN Equity	325.0	(6.7)	(8.2)	10.2
GRASIM IN Equity	2445.0	(0.5)	8.6	8.0
Worst performers				
IBREL IN Equity	118.4	(2.6)	(12.7)	(42.6)
HDIL IN Equity	157.3	(3.3)	(17.6)	(42.0)
UT IN Equity	56.9	(1.0)	(9.2)	(39.9)
FTECH IN Equity	766.9	(2.4)	(12.9)	(34.7)
DLFU IN Equity	250.4	(3.5)	(11.2)	(33.7)

JANUARY 17, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): **1,137**

Target price (Rs): **1,350**

BSE-30: **18,882**

Delivers—10/10. TCS reported another strong quarter cementing its status as the industry bellwether further. Even as qoq US\$ revenue growth of 7% was a tad lower than our estimate, margin beat (30.2%, 90 bps higher than estimate) and higher-than-expected other income drove a 5.6% beat on net income (Rs23.3 bn versus expected Rs22.1 bn). Demand indicators continue to support our bullish stance. We increase our FY2012/13E EPS estimates to Rs54/62.7 and raise TP to Rs1,350. BUY.

Company data and valuation summary

TCS				Forecasts/Valuations			
Stock data				2011	2012E	2013E	
52-week range (Rs) (high,low)	1,187-676		EPS (Rs)	44.4	54.0	62.7	
Market Cap. (Rs bn)	2,226.1		EPS growth (%)	26.4	21.6	16.1	
Shareholding pattern (%)			P/E (X)	25.6	21.1	18.1	
Promoters	74.0		Sales (Rs bn)	374.8	478.9	565.9	
FIs	12.4		Net profits (Rs bn)	86.9	105.7	122.7	
MFs	2.4		EBITDA (Rs bn)	111.8	141.0	165.0	
Price performance (%)			EV/EBITDA (X)	19.0	14.8	12.4	
Absolute	1M	3M	12M	ROE (%)	37.4	37.2	35.6
Rel. to BSE-30	(0.3)	19.7	45.6	Div. Yield (%)	1.6	1.9	2.2
	4.9	27.6	35.3				

Premium to Infosys could sustain; reversal of margin convergence trend poses risk

TCS continues to expand its revenue, operating profit and net income leadership over Infosys. 3QFY11 marked the seventh consecutive quarter when TCS has outperformed Infosys on yoy EBITDA and net income growth—quarter net income gap between the two companies is now 31% in favor of TCS versus 18% in favor of Infosys only seven quarters back (March 2009). Even as Infosys has kept pace on revenue growth, TCS has managed to narrow the EBITDA margin gap versus Infosys to ~300 bps from a peak of 830 bps two years back.

More importantly, immediate reversal of this trend on revenues/EBITDA may not happen—we remain positive on strong revenue growth outlook for both the companies and pyramid expansion should serve as a strong margin lever for both in FY2012E. TCS does face an ETR increase headwind in FY2012E but the same is factored into Street estimates. We also note that Infosys has seen a sharp increase in non-manpower expenses post the downturn, which TCS hasn't yet.

3QFY11—another strong quarter

TCS delivered a robust Dec 2010 quarter on most parameters—strong qoq revenue growth (+7%, 0.5% lower than estimate), backed by strong volume growth (+5.7%) and marginal pricing uptick, OPM expansion of 20 bps qoq (90 bps higher than estimate) despite pressure from Re appreciation and rent cost normalization, and net income growth of 11% qoq and 30% yoy to Rs23.3 bn, 5.6% above our estimate. More importantly, 3Q results and management commentary provided solid demand indicators—broad-based growth (except Telecom vertical), strong client metrics, robust hiring (20,000+ gross hires for the quarter, strong campus hiring numbers), discretionary spend pick-up trends, deal closures and positive commentary on deal pipeline and pricing outlook.

Raise estimates and target price; reiterate BUY

We raise our EPS estimates for FY2011/12/13E by 2.3/1.5/1.1% to Rs44.4/54/62.7, respectively. We note that our FY2012E and FY2013E estimates are up despite an increase in ETR assumptions. Estimate increase is driven by modest upward revisions in revenue as well as margin assumptions. We raise our target price on the stock to Rs1,350 (Rs1,250 earlier). Our implied target multiple on TCS is now at a 5% premium to Infosys (10% adjusted for differences in depreciation policy).

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A closer look at the source of surprise—margins

Even as TCS' reported revenues for the quarter were a tad lower than our estimate, the company surprised on net income. The surprise was driven equally by higher-than-expected margins as well as other income. TCS' EBITDA margin for 3QFY11 at 30.2% came in 90 bps ahead of our estimated 29.3%, despite the expected normalization of rent expenses. Surprise came in at both the cost of revenues as well as SG&A level. We take a look at both

- ▶ COR—at the COR level, the sources of surprise were lower-than-expected employee costs and equipment sales. We note that we had expected strong growth in lower-margin domestic SI revenues, which was not the case, aiding margin surprise. Employee costs line item movement is a tad surprising—up just 2.5% qoq against a revenue growth of 4.1% in Re terms. We also note that overall employee base growth of 7.2% qoq was higher than volume growth (essentially utilization, including trainees, was down) and employee pyramid was flat. We believe hiring/attrition skew worked in favor of the company.
- ▶ SG&A—at the SG&A level, bulk of the positive variance came in from the bad debt provision line item. TCS reported a reversal of Rs331 mn (positive impact of 30 bps on margins) versus our expectation of a charge of Rs400 mn (40 bps)—a swing of 70 bps. Exhibit 3 depicts quarterly bad debt provision for TCS for the past several quarters.

Other key highlights from the earnings report and management commentary

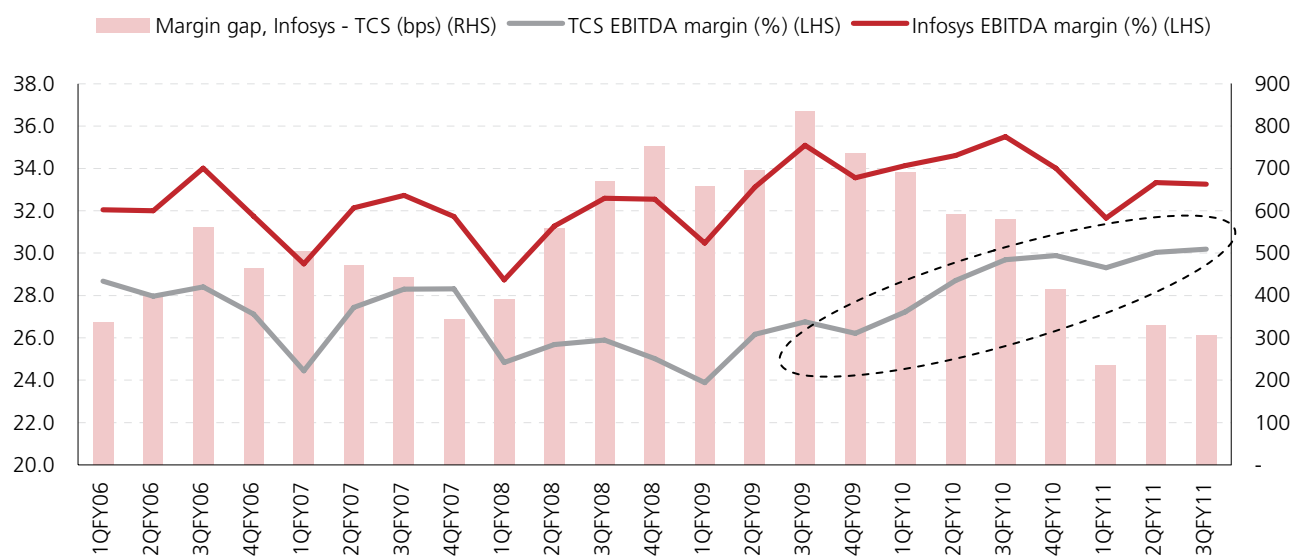
- ▶ Revenue growth was broad-based except the Telecom vertical (expected to remain weak for another quarter or two) and India/ LatAm geographies. Growth was particularly strong in the Hi-Tech (+16% qoq), Media (+23% qoq), Transportation (+14% qoq), BFSI (+8.4% qoq) and Retail (+7% qoq) verticals. Among geographies, even as US was robust (+6.6% qoq), non-US geographies fared much better with Europe and EMEA/Asia-Pac (ex-India) growing double-digit+ sequentially. Consulting (+17% qoq), Infra (+20% qoq), Products (+26% qoq) and BPO (+12% qoq) led among the service lines, even as ADM segment reported a modest 3% qoq growth.
- ▶ Management indicated timely closure of clients' IT budgets—flat to up with a shift towards discretionary spends and off-shoring.
- ▶ Company indicated a campus hiring target of 37,000 for the ongoing campus placement season; the company has made 23,700 offers so far and expects its campus hiring to be complete by mid-Feb 2011.
- ▶ Employee pyramid remains a key margin lever moving into FY2012E; employees with <3 years of experience now form 39% of the total base versus a historical peak of 52%.
- ▶ Attrition trended down sequentially to 17.1% (from 20.3% in 2QFY11) on a quarterly annualized basis.
- ▶ # of US\$100 mn clients increase by 1 (to 9 from 8) and # of US\$20 mn clients increase by 10 (to 76 from 66) on an LTM basis.
- ▶ The company indicated a positive pricing outlook and is seeing upticks in select renegotiations of existing contracts and most new deal signings.

Exhibit 1: TCS: key changes to FY2011-13E estimates

Rs mn	New			Old			Change (%)		
	FY2011E	FY2012E	FY2013E	FY2011E	FY2012E	FY2013E	FY2011E	FY2012E	FY2013E
Revenues	374,797	478,862	565,950	373,986	474,885	555,589	0.2	0.8	1.9
EBIT	104,030	131,442	153,378	102,596	128,520	147,589	1.4	2.3	3.9
Net Profit	86,904	105,697	122,698	84,965	104,095	121,361	2.3	1.5	1.1
EPS (Rs/ share)	44.4	54.0	62.7	43.4	53.2	62.0	2.3	1.5	1.1
Revenues (US\$ mn)	8,208	10,524	12,849	8,200	10,445	12,624	0.1	0.8	1.8
Revenue growth (%)	29.5	28.2	22.1	29.3	27.4	20.9			
Re/\$ rate	45.7	45.5	44.0	45.6	45.5	44.0	0.1	0.1	0.1
EBIT margin	27.8	27.4	27.1	27.4	27.1	26.6			

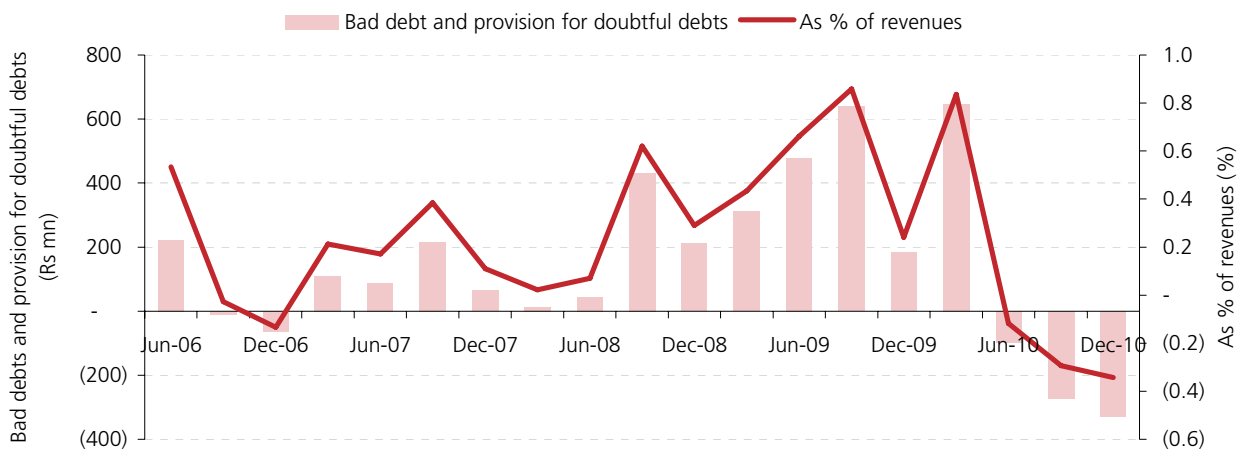
Source: Kotak Institutional Equities estimates

Exhibit 2: TCS has improved its EBITDA margin by 600+ bps since 1QFY2009



Source: Companies, Kotak Institutional Equities

Exhibit 3: Reversals in bad debt and provisions has helped the margins positively



Source: Company, Kotak Institutional Equities

Exhibit 4: Break-up of costs for TCS and Infosys

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Absolute costs (Rs mn)											
Infosys											
Cost of revenues	27,540	28,910	30,750	30,450	29,150	29,630	30,090	31,840	34,410	37,540	38,470
Manpower	23,500	24,550	26,710	26,330	25,460	26,250	26,470	27,920	29,590	32,010	33,480
Non man-power	4,040	4,360	4,040	4,120	3,690	3,380	3,620	3,920	4,820	5,530	4,990
SG&A expenses	6,210	7,330	6,800	6,990	6,890	6,890	6,940	7,380	7,950	8,780	8,960
Manpower	2,830	3,140	3,330	3,660	3,320	3,530	3,820	4,080	4,230	4,810	4,920
Non man-power	3,380	4,190	3,470	3,330	3,570	3,360	3,120	3,300	3,720	3,970	4,040
TCS											
Cost of revenues	37,147	37,752	40,304	39,217	39,238	40,311	40,959	41,160	45,155	50,731	52,544
Manpower	29,351	30,231	33,049	31,861	31,462	33,462	33,705	33,984	37,625	42,182	43,225
Non man-power excl depr	4,319	4,224	4,366	4,437	4,137	3,861	4,314	4,157	4,436	3,883	4,983
Depreciation and cost of equipment sales	3,477	3,297	2,889	2,919	3,639	2,988	2,940	3,019	3,094	4,666	4,336
SG&A expenses	12,366	14,458	13,948	14,802	14,243	13,794	13,945	14,309	14,107	15,522	16,275
Manpower	7,588	9,092	8,967	8,947	9,075	8,801	8,976	8,422	9,127	10,216	10,561
Non man-power excl depr	4,778	5,366	4,981	5,855	5,168	4,993	4,969	5,887	4,980	5,306	5,714
As % of revenues											
Infosys											
Cost of revenues	56.7	53.4	53.1	54.0	53.3	53.1	52.4	53.6	55.5	54.0	54.1
Manpower	48.4	45.3	46.2	46.7	46.5	47.0	46.1	47.0	47.7	46.1	47.1
Non man-power	8.3	8.0	7.0	7.3	6.7	6.1	6.3	6.6	7.8	8.0	7.0
SG&A expenses	12.8	13.5	11.8	12.4	12.6	12.3	12.1	12.4	12.8	12.6	12.6
Manpower	5.8	5.8	5.8	6.5	6.1	6.3	6.7	6.9	6.8	6.9	6.9
Non man-power	7.0	7.7	6.0	5.9	6.5	6.0	5.4	5.6	6.0	5.7	5.7
TCS											
Cost of revenues	57.9	54.3	55.4	54.7	54.4	54.2	53.5	53.2	55.0	54.6	54.4
Manpower	45.8	43.5	45.4	44.4	43.7	45.0	44.1	43.9	45.8	45.4	44.7
Non man-power excl depr	6.7	6.1	6.0	6.2	5.7	5.2	5.6	5.4	5.4	4.2	5.2
Depreciation and cost of equipment sales	5.4	4.7	4.0	4.1	5.0	4.0	3.8	3.9	3.8	5.0	4.5
SG&A expenses	19.3	20.8	19.2	20.6	19.8	18.6	18.2	18.5	17.2	16.7	16.8
Manpower	11.8	13.1	12.3	12.5	12.6	11.8	11.7	10.9	11.1	11.0	10.9
Non man-power excl depr	7.5	7.7	6.8	8.2	7.2	6.7	6.5	7.6	6.1	5.7	5.9

Source: Companies, Kotak Institutional Equities

Exhibit 5: TCS Interim Results 3QFY11 (consolidated, US GAAP)

Rs mn	3QFY10	2QFY11	3QFY11	% chg.		3QFY11E	% dev.	Comments
				qoq	yoy			
Revenues (US\$ mn)	1,635	2,004	2,144	7.0	31.1	2,155	(0.5)	Revenue growth of 7%, slightly below our estimates
Revenues	76,503	92,864	96,634	4.1	26.3	97,147	(0.5)	
Cost of revenues	(40,959)	(50,731)	(52,544)	3.6	28.3	(53,254)	(1.3)	
Gross profit	35,544	42,133	44,090	4.6	24.0	43,894	0.4	
SG&A expenses	(14,656)	(16,125)	(16,958)	5.2	15.7	(17,444)	(2.8)	
EBIT	20,888	26,008	27,132	4.3	29.9	26,450	2.6	EBITDA margin expanded by 20 bps versus our expectation of a 70 bps decline, partly by bad debt reversals
Other Income	569	337	1,817	439.2	219	1,125	61.5	
Profit Before Tax	21,457	26,345	28,949	9.9	34.9	27,575	5.0	
Provision for Tax	(3,241)	(4,992)	(5,385)	7.9	66.2	(5,191)	3.7	
Net income before minority in	18,216	21,353	23,564	10.4	29.4	22,384	5.3	
Minority Interest	(241)	(288)	(262)	(9.0)	8.7	(319)	(18.0)	
Net income	17,975	21,065	23,302	10.6	29.6	22,064	5.6	
Extraordinary items	-	-	-	-	-	-	-	
Net income	17,975	21,065	23,302	10.6	29.6	22,064	5.6	
EPS (Rs/ share)	9.2	10.8	11.9	10.6	29.6	11.3	5.6	
No of shares outstanding (mn)	1,957.2	1,957.2	1,957.2			1,957.2	-	
As % of revenues								
Gross Profit Margin (%)	46.5	45.4	45.6			45.2		
Operating Margin (EBIT)	27.3	28.0	28.1			27.2		
EBITDA (%)	29.7	30.0	30.2			29.3		
SG&A Expenses (%)	19.2	17.4	17.5			18.0		
Tax Rate	15.1	18.9	18.6			18.8		
Revenue Mix (%)								
Onsite	42.5	43.9	43.7					
Offshore	57.5	56.1	56.3					
Revenues (Rs mn)								
Onsite	29,761	36,721	38,340	4.4	28.8			
Offshore	40,264	46,927	49,395	5.3	22.7			
International Revenues	70,025	83,648	87,735	4.9	25.3			
Domestic Revenues	6,478	9,216	8,899	(3.4)	37.4			

Source: Company, Kotak Institutional Equities estimates

Exhibit 6: Broad-based growth across geographies, verticals and service lines

	Revenues (US\$ mn)	Growth (qoq)	Growth (yoy)
Total revenues	2,144	7.0	31.1
Revenue by geography (%)			
North America	1,147	6.6	33.6
Latin America	66	(15.0)	(17.0)
UK	343	11.9	31.1
Continental Europe	199	9.3	17.3
India	197	(0.6)	41.9
Asia Pacific	148	19.1	61.6
MEA	43	12.6	24.9
Revenue by verticals (%)			
BFSI	956	8.4	30.0
Telecom	255	(0.5)	29.0
Retail & Distribution	234	7.0	19.1
Manufacturing	154	4.1	13.8
Hi-Tech	107	16.3	31.1
Life sciences & healthcare	111	9.1	15.6
Transportation	73	13.7	31.1
Energy & Utilities	94	9.5	69.7
Media & Entertainment	49	23.0	43.6
Others	109	(4.3)	138.8
Revenue by service offerings (%)			
IT solutions and services			
- ADM	965	2.9	20.2
- Business intelligence	114	1.3	21.9
- Enterprise solutions	206	(0.3)	19.9
- Assurance business	152	15.1	82.6
Engineering & Industrial services	103	4.8	28.5
Infrastructure services	225	19.5	74.3
Global consulting	49	17.2	43.6
Asset leverage solutions	86	25.9	63.9
BPO	244	11.9	30.0

Source: Company, Kotak Institutional Equities

Exhibit 7: Key assumptions driving TCS earnings model, 2010-2013E, March fiscal year-ends

	2010	2011E	2012E	2013E
Key assumptions				
Revenue growth (US\$ terms) (%)	5.4	29.5	28.2	22.1
Volume growth yoy (%)	22.1	31.4	27.3	21.3
Pricing change yoy (%)				
Onsite	(7.8)	(0.4)	1.5	1.0
Offshore	(7.6)	(3.4)	2.2	1.0
Blended	(14.4)	(2.4)	1.3	1.3
Total employees (#) - excl subsidiaries	156,329	192,397	239,422	292,095
Employee additions	16,318	36,068	47,025	52,673
Utilization rate (%)	74.2	76.9	78.6	78.1
SG&A expense as % of revenues	18.7	17.1	17.4	17.5
Re/US\$ rate	47.4	45.7	45.5	44.0

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: Profit model, balance sheet, cash model of TCS, 2009-2013E, March fiscal year-ends (Rs mn)

	2009	2010	2011E	2012E	2013E
Profit model					
Revenues	278,129	300,289	374,797	478,862	565,950
Cost of sales	(154,420)	(161,668)	(204,166)	(260,981)	(309,653)
SG&A expenses	(57,694)	(59,030)	(66,601)	(86,439)	(102,918)
EBIT	66,015	79,591	104,030	131,442	153,378
Other income	(4,673)	2,255	4,360	6,256	8,857
Pre-tax profits	61,342	81,846	108,390	137,698	162,235
Provision for tax	(9,012)	(12,089)	(20,370)	(30,939)	(38,401)
Recurring net income	52,330	69,757	88,020	106,759	123,834
Minority Interest	(569)	(1,018)	(1,113)	(1,062)	(1,137)
Reported net income	51,761	68,739	86,907	105,697	122,697
EPS (Rs)	26.4	35.1	44.4	54.0	62.7
Balance Sheet					
Shareholders funds	156,545	209,404	255,639	311,872	377,149
Borrowings	2,762	111	—	—	—
Minority interest	3,098	3,768	4,882	5,944	7,081
Other non-current liabilities	2,744	6,732	8,402	10,735	12,688
Total liabilities	165,149	220,015	268,923	328,551	396,918
Net fixed assets	37,494	41,706	62,649	81,373	100,771
Goodwill	25,913	25,333	25,333	25,333	25,333
Intangibles	8,232	7,082	7,082	7,082	7,082
Investments	17,271	37,822	37,822	37,822	37,822
Other non-current assets	17,370	26,120	26,117	26,117	26,118
Cash and bank balances	24,742	46,773	68,626	104,366	149,695
Net current assets excluding cash	34,127	35,178	41,294	46,457	50,096
Total assets	165,149	220,015	268,923	328,551	396,918
Cash flow					
Operating cash flow, excl. working capital	62,769	74,709	91,473	110,104	126,603
Working capital changes	(3,986)	(3,154)	(4,818)	(2,830)	(1,687)
Capital expenditure	(13,046)	(14,990)	(25,186)	(28,326)	(31,024)
Acquisitions	(21,083)	—	—	—	—
Free cash flow	24,655	56,565	61,468	78,948	93,892

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: TCS: Quarterly operating metrics

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Revenues (US\$ mn)	1,483	1,433	1,481	1,538	1,635	1,686	1,794	2,004	2,144
Revenues (Rs mn)	72,770	71,718	72,070	74,351	76,503	77,365	82,173	92,864	96,634
Exchange rate (Re/US\$)	49.1	50.0	48.7	48.3	46.8	45.9	45.8	46.3	45.1
Revenue by geography (%)									
North America	52.2	52.4	52.3	52.5	52.5	54.0	55.0	53.7	53.5
Latin America	5.1	4.8	4.6	5.0	4.9	4.4	4.3	3.9	3.1
UK	18.5	17.9	16.9	16.5	16.0	15.2	15.1	15.3	16.0
Continental Europe	10.7	10.8	11.0	10.6	10.4	10.0	8.9	9.1	9.3
India	6.8	8.2	9.1	8.1	8.5	8.9	8.8	9.9	9.2
Asia Pacific	5.0	3.9	4.3	5.4	5.6	5.6	5.9	6.2	6.9
MEA	1.7	2.0	1.8	1.9	2.1	1.9	2.0	1.9	2.0
Vertical split of revenues (%)									
BFSI	41.9	42.8	43.9	45.0	45.0	44.4	44.7	44.0	44.6
Telecom	13.8	13.1	12.6	12.0	12.1	12.1	12.7	12.8	11.9
Retail & Distribution	11.2	12.0	12.2	12.0	12.0	12.3	11.0	10.9	10.9
Manufacturing	10.6	9.8	9.2	8.7	8.3	8.3	7.4	7.4	7.2
Hi-Tech	6.7	5.5	4.9	4.8	5.0	5.1	4.6	4.6	5.0
Life sciences & healthcare	5.2	5.7	5.7	6.0	5.9	6.1	5.2	5.1	5.2
Transportation	3.7	3.8	3.7	3.5	3.4	3.5	3.1	3.2	3.4
Energy & Utilities	2.6	2.7	2.7	2.8	3.4	3.3	3.3	4.3	4.4
Media & Entertainment	2.0	2.1	2.2	2.2	2.1	2.1	1.9	2.0	2.3
Others	2.3	2.5	2.9	3.0	2.8	2.8	6.1	5.7	5.1
Revenues by project type (%)									
Time and material basis	54.5	52.9	52.6	52.8	52.0	51.3	50.9	51.0	50.3
Fixed price, fixed time basis	45.5	47.1	47.4	47.2	48.0	48.7	49.1	49.0	49.7
Client concentration (%)									
Top client	5.1	4.7	5.7	6.8	8.1	8.2	8.1	8.0	7.7
Top 5 clients	17.3	18.6	19.4	20.5	21.5	21.8	22.0	22.1	21.9
Top 10 clients	26.3	26.9	28.0	28.9	29.9	30.2	30.5	30.1	30.1
US\$1 mn clients	395	405	423	409	419	409	409	420	434
US\$5 mn clients	166	172	178	171	178	183	191	192	200
US\$10 mn clients	112	111	113	111	112	118	122	131	139
US\$20 mn clients	59	62	59	62	61	63	65	66	76
US\$50 mn clients	23	24	23	23	23	23	24	25	25
US\$100 mn clients	-	7	6	6	6	7	7	8	9
Number of active clients	965	985	933	896	917	917	930	936	959
New clients added in the period	41	36	26	30	32	39	36	30	35
Revenue from repeat business (%)	96.3	95.6	99.7	98.2	96.5	95.7	98.4	98.3	97.6
Onsite-offshore split (%)									
Onsite	51.0	48.2	44.4	42.7	42.5	43.6	43.6	43.9	43.7
Offshore	43.6	47.7	50.4	51.1	51.3	51.0	51.2	51.1	51.4
GDC / RDC	5.4	4.1	5.2	6.2	6.2	5.4	5.2	5.0	4.9
Revenue by service offerings (%)									
IT solutions and services									
- ADM	49.0	48.6	48.7	49.6	49.1	47.6	47.9	46.8	45.0
- Business intelligence	8.1	6.8	6.1	5.7	5.7	5.4	5.4	5.6	5.3
- Enterprise solutions	12.6	11.8	10.9	10.3	10.5	10.1	9.8	10.3	9.6
- Assurance business	4.2	3.8	4.4	4.8	5.1	5.8	6.4	6.6	7.1
Engineering & Industrial services									
Infrastructure services	6.3	5.8	5.2	5.0	4.9	4.8	4.8	4.9	4.8
Global consulting	8.3	8.3	9.3	8.0	7.9	8.3	8.7	9.4	10.5
Asset leverage solutions	2.5	1.7	1.4	1.6	2.1	2.5	2.1	2.1	2.3
BPO	3.2	2.1	2.6	3.2	3.2	4.0	3.7	3.4	4.0
Utilization rates (%)									
- Including trainees	5.8	11.1	11.4	11.8	11.5	11.5	11.2	10.9	11.4
- Excluding trainees	71.8	69.4	71.3	73.6	77.2	74.3	74.8	77.7	77.1
Employee metrics									
Total employees - incl Indian subsidiaries	79.9	79.7	79.2	79.5	81.1	81.8	82.6	83.8	83.8
Total employees - TCS limited	130,343	143,761	141,642	141,962	149,654	160,429	163,700	174,417	186,914
Gross addition	126,613	126,613	123,404	123,092	130,509	140,619	142,939	153,168	163,995
Net addition	11,773	17,489	2,828	5,530	12,854	16,851	10,849	19,293	20,219
Attrition rate (%)	8,733	13,418	(2,119)	320	7,692	10,775	3,271	10,717	12,497
Attrition rate - qtrly annualized, incl Indian subsidiaries (%)	11.9	11.4	10.7	10.8	11.5	11.8	13.1	14.1	14.4
Attrition rate - qtrly annualized, incl Indian subsidiaries (%)			13.9	14.7	14.2	15.7	18.7	20.3	17.1

Source: Company, Kotak Institutional Equities

JANUARY 18, 2011

RESULT

Coverage view: **Cautious**

Price (Rs): **1,680**

Target price (Rs): **2,050**

BSE-30: **18,882**

Strong execution, would watch for margin recovery and order inflow pick-up.

Strong 3QFY11 revenue growth of 40.5% is likely led by power and infrastructure segments. We believe margins may recover partially as the 160 bps decline may have been led by the execution of several projects which had not yet reached threshold level. Full-year inflow guidance of 25% maintained though with caveats of slippage in FY2012E. We retain ADD for now and would watch for margin recovery and order inflow traction picking up.

Company data and valuation summary

Larsen & Toubro

Stock data

52-week range (Rs) (high,low) 2,213-1,371

Market Cap. (Rs bn) 1,016.6

Shareholding pattern (%)

Promoters 0.0

FIs 20.2

MFs 4.5

Price performance (%)

Absolute 1M 3M 12M

(15.3) (15.5) 1.7

Rel. to BSE-30 (10.9) (10.0) (5.4)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	57.9	74.9	86.0
EPS growth (%)	15.6	29.2	14.9
P/E (X)	29.0	22.4	19.5
Sales (Rs bn)	439.7	542.0	658.1
Net profits (Rs bn)	34.9	45.3	52.0
EBITDA (Rs bn)	63.7	89.7	110.8
EV/EBITDA (X)	18.5	13.7	11.4
ROE (%)	18.6	18.4	17.7
Div. Yield (%)	0.7	0.7	0.8

Strong revenue growth on execution pick-up likely led by power and infrastructure

L&T reported very strong revenue growth of 40.5% yoy to Rs114 bn in 3QFY11, about 12% higher than our estimate of Rs101.7 bn led by a pick-up in execution of the strong backlog. The strong revenue growth is likely to be led by the power and infrastructure segments. Lower-than-expected margin (10.8% versus estimate of 12.3%) led to in line PAT of Rs8.05 bn, up 15.6% yoy.

Margin decline attributed to several projects not yet reaching threshold and higher material costs

The 160 bps yoy EBITDA margin decline was primarily attributed to (1) some orders for which execution has started recently but have not entered the margin recognition phase and (2) increase in raw material costs (about 1/3rd backlog comprises of fixed price orders). We believe the power segment is likely to have contributed to more than 30% of 3QFY11 revenues. Assuming about 30% of this revenue line is from orders that have not achieved the margin recognition threshold that would contribute a difference of 200-250 bps at the contribution-margin level. Note that contribution margins have declined by 340 bps on a yoy basis.

Deferrals lead to sedate inflows in 3Q; maintains FY2011E guidance, with several caveats though

L&T management cited changes in ordering patterns for several projects leading to the lower-than-expected inflows in 3QFY11 (reported inflows of Rs113 bn – down 25% yoy). L&T management has maintained its full-year order inflow guidance growth of 25% yoy for FY2011E, however, with several caveats as orders may slip into FY2012E. The management has cited a majority of the expected orders are likely to be booked in the month of March 2012. We estimate order inflows of about Rs790 bn (up 14% yoy) for the full-year FY2011E.

Marginal changes and retain ADD as we watch for margins and order inflow traction recovery

We retain our ADD rating with a revised TP of Rs2,050 (from Rs2,125) based on (1) recent sharp correction, (2) incrementally positive on strong execution, (3) legible explanation on lower margins in 3QFY11, (4) lower-than-expected order inflows likely to be already factored in and (5) relatively reasonable valuations of 16-17X FY2012E standalone earnings. We marginally revise our consolidated estimates to Rs74.9 and Rs86 for FY2011E and FY2012E, respectively, from Rs76.3 and Rs87.6.

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Strong revenue growth likely led by power and infrastructure segments

L&T reported very strong revenue growth of 40.5% yoy to Rs114 bn in 3QFY11, about 12% higher than our estimate of Rs101.7 bn. This is likely a reflection of a pick-up in execution of the strong order backlog of the company. The company cited that several projects which were won in the second half of FY2010 moved from the initial engineering phase to the procurement and construction phase leading to the strong revenue growth for the quarter.

Margin declines on increase in material costs and several orders not reaching margin recognition threshold levels

The strong revenue growth was, however, partially offset by lower-than-expected EBITDA margin. L&T reported EBITDA margin of 10.8% in 3QFY11, about 160 bps down on a yoy basis led by lower contribution margins. We had expected margins to remain broadly flat on a yoy basis. Operating leverage has partially cushioned the margin decline, as contribution margins have declined sharply on a yoy basis by 340 bps. The lower-than-expected EBITDA margin led to a reported EBITDA of Rs12.4 bn - inline with our estimates.

The yoy margin decline was primarily attributed to (1) increase in raw material costs – about 1/3rd of L&T's order backlog comprises of fixed priced orders and (2) some orders for which execution has started recently but have not entered the margin recognition phase. We believe that power itself may have contributed more than 30% to the revenues in this quarter. If 30% of this revenue line is from orders that have not achieved the margin recognition threshold, then that would contribute a difference of 200-250 bps at contribution level.

L&T reported a PAT (before extraordinary items) of Rs8.05 bn, in line with our estimates and up 15.6% yoy from Rs6.96 bn. For the nine months ending December 31, 2010, the company has reported revenues of Rs286 bn, up 22% yoy. EBITDA margin of 11.4% was flat on a yoy basis leading to a net PAT growth of 18.5% to Rs21.7 bn in 9MFY11 versus Rs18.3 bn in 9MFY10.

Strong revenue growth; margin disappointment leads to in-line PAT

Larsen & Toubro (standalone) - 3QFY11 results - key numbers (Rs mn)

	3QFY11	3QFY11E	3QFY10	2QFY11	% change			9MFY11	9MFY10	% chg.
					vs est.	yoy	qoq			
Net sales	114,131	101,707	81,222	93,308	12.2	40.5	22.3	286,292	234,493	22.1
CoGS	(89,375)	(77,043)	(60,804)	(71,079)	16.0	47.0	25.7	(219,001)	(180,998)	21.0
Total RM consumption	(33,885)		(19,562)	(24,956)		73.2	35.8	(77,140)	(62,086)	24.2
Subcontracting charges	(28,058)		(20,190)	(18,632)		39.0	50.6	(63,371)	(58,822)	7.7
Construction materials	(20,660)		(15,608)	(19,203)		32.4	7.6	(57,798)	(42,446)	36.2
Other mfg. expenses	(6,772)		(5,443)	(8,288)		24.4	(18.3)	(20,692)	(17,644)	17.3
Employee	(7,010)	(6,700)	(6,144)	(7,067)	4.6	14.1	(0.8)	(20,602)	(15,666)	31.5
Other S,G&A	(5,367)	(5,500)	(4,206)	(5,105)	(2.4)	27.6	5.1	(14,183)	(11,069)	28.1
EBITDA	12,379	12,464	10,069	10,057	(0.7)	22.9	23.1	32,506	26,760	21.5
Other income	2,472	2,872	2,336	3,822	(13.9)	5.8	(35.3)	8,561	6,739	27.0
Interest	(1,757)	(1,932)	(1,339)	(1,932)	(9.0)	31.2	(9.0)	(5,112)	(3,745)	36.5
Depreciation	(1,281)	(1,243)	(1,045)	(1,212)	3.0	22.6	5.7	(3,635)	(2,984)	21.8
PBT	11,813	12,161	10,020	10,735	(2.9)	17.9	10.0	32,321	26,771	20.7
Tax	(3,760)	(4,038)	(3,058)	(3,794)	(6.9)	23.0	(0.9)	(10,666)	(8,495)	25.6
Net profit	8,052	8,124	6,963	6,941	(0.9)	15.6	16.0	21,655	18,276	18.5
Extraordinary items	353	-	626	708	NA	NA	NA	1,061	11,098	NA
RPAT	8,405	8,124	7,588	7,650	3.5	10.8	9.9	22,717	29,374	(22.7)
Order details										
Order booking	133,660		178,364	204,640		(25.1)	(34.7)	494,560	457,290	8.2
Order backlog	1,148,820		911,040	1,153,930		26.1	(0.4)	1,148,820	911,040	26.1
Key ratios (%)										
CoGS/Sales	78.3	75.8	74.9	76.2				76.5	77.2	
Raw materials/sales	47.8		43.3	47.3				47.1	44.6	
Subcontracting charges/sales	24.6		24.9	20.0				22.1	25.1	
Other manufacturing exp./sales	5.9		6.7	8.9				7.2	7.5	
Contribution margins	21.7	24.3	25.1	23.8				23.5	22.8	
Employee expenses/sales	6.1	6.6	7.6	7.6				7.2	6.7	
S G and A expenses/sales	4.7	5.4	5.2	5.5				5.0	4.7	
EBITDA margin	10.8	12.3	12.4	10.8				11.4	11.4	
PBT Margin	10.4	12.0	12.3	11.5				11.3	11.4	
PAT margin	7.1	8.0	8.6	7.4				7.6	6.6	
Tax rate	31.8	33.2	30.5	35.3				33.0	31.7	

Source: Company, Kotak Institutional Equities estimates

Strong revenue growth led by core E&C segment; product segments report relatively sedate quarter

Revenue growth in 3QFY11 was primarily led by the core E&C segment which recorded 42% yoy revenue growth. The product segments of L&T reported relatively weak results likely reflecting relatively slow pick-up in domestic capex activity. Machinery and Industrial products segment has reported a sedate growth of 15% for the quarter while Electrical and Electronics segment reported only a 10% growth on a yoy basis.

L&T - segmental numbers, 3QFY11 (Rs mn)

	3QFY11	3QFY10	2QFY11	% change		9MFY11	9MFY10	% change
				yoy	qoq			
Engineering and Construction								
Revenues	100,041	70,250	80,150	42.4	24.8	246,517	204,370	20.6
EBIT	10,647	8,554	9,002	24.5	18.3	27,816	22,485	
EBIT margin (%)	10.6	12.2	11.2			11.3	11.0	
Electrical and Electronics								
Revenues	7,950	7,182	6,724	10.7	18.2	22,125	19,982	10.7
EBIT	868	873	868	(0.6)	(0.1)	2,474	2,613	(5.3)
EBIT margin (%)	10.9	12.2	12.9			11.2	13.1	
Machinery & Industrial Products								
Revenues	6,807	5,910	6,981	15.2	(2.5)	19,271	15,376	25.3
EBIT	1,286	1,206	1,156	6.6	11.2	3,572	3,088	15.7
EBIT margin (%)	18.9	20.4	16.6			18.5	20.1	

Source: Company, Kotak Institutional Equities

Implied 4Q on revised estimates – 21% revenue and 19% PBT growth

Larsen & Toubro (standalone) - 4QFY11 implied results - key numbers (Rs mn)

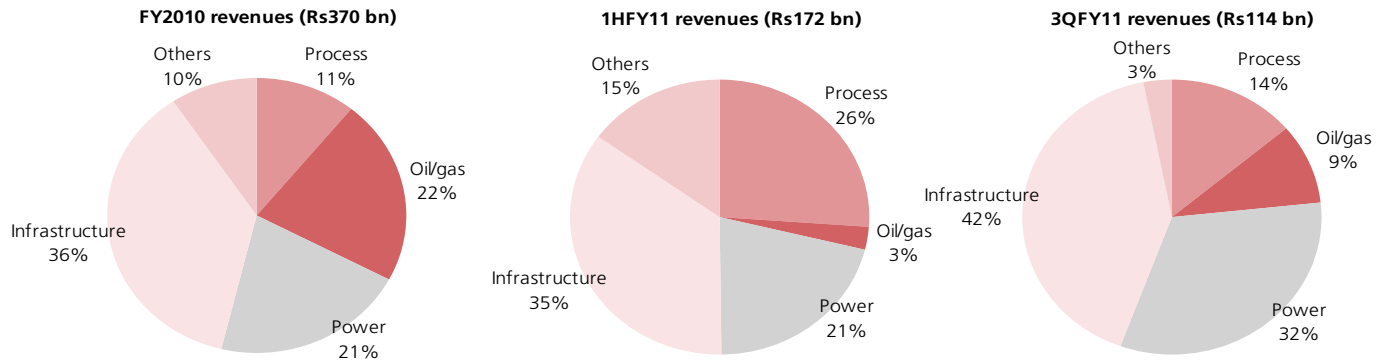
	9MFY11	9MFY10	% chg.	4QFY11E-imp	4QFY10A	% chg.	FY2011E	FY2010	% chg.
Net sales	286,292	234,493	22.1	164,183	135,851	20.9	450,475	370,348	21.6
Expenses	(253,785)	(207,733)	22.2	(139,733)	(115,343)	21.1	(393,518)	(322,193)	22.1
EBITDA	32,506	26,760	21.5	24,450	20,508	19.2	56,956	48,156	18.3
Other income	8,561	6,739	27.0	3,115	3,298	(5.5)	11,677	9,103	28.3
Interest	(5,112)	(3,745)	36.5	(934)	(1,356)	(31.1)	(6,046)	(5,053)	19.6
Depreciation	(3,635)	(2,984)	21.8	(1,338)	(1,162)	15.1	(4,972)	(4,146)	19.9
PBT	32,321	26,771	20.7	25,294	21,288	18.8	57,615	48,059	19.9
Tax	(10,666)	(8,495)	25.6	(8,463)	(7,914)	6.9	(19,128)	(16,409)	16.6
Net profit	21,655	18,276	18.5	16,831	13,374	25.9	38,487	31,650	21.6
Extraordinary items	1,061	11,098	NA	(1,061)	1,007	NA	-	12,105	NA
RPAT	22,717	29,374	(22.7)	15,770	14,381	9.7	38,487	43,755	(12.0)
Order details									
Order booking	494,560	457,290	8.2	296,600	238,430	24.4	791,160	695,720	13.7
Key ratios (%)									
EBITDA margin	11.4	11.4		14.9	15.1		12.6	13.0	
PBT Margin	11.3	11.4		15.4	15.7		12.8	13.0	
PAT margin	7.6	7.8		10.3	9.8		8.5	8.5	
Tax rate	33.0	31.7		33.5	37.2		33.2	34.1	

Source: Kotak Institutional Equities

Revenue pick-up likely to be led by power and infrastructure

L&T's strong revenue growth in 3QFY11 (up 40.5%) yoy is likely to be led by (1) power segment – start of execution of several BTG orders and (2) infrastructure segment – pick-up in execution of infrastructure orders under construction. Power segment is likely to have contributed to about 32% of the total sales of L&T in 3QFY11 – this is versus about 21% of total sales in FY2010 and 1HFY11.

Rough segmental break-up of L&T's revenues, FY2010, 1HFY11 and 3QFY11



Source: Company, Kotak Institutional Equities estimates

Maintains guidance of 25% inflow growth – we build inflow growth of 14%

L&T management has maintained its full-year order inflow guidance growth of 25% yoy for FY2011E. This implies an order inflow requirement of about Rs375 bn in 4QFY11E (reported order inflows of about Rs495 bn in 9MFY11). The management has cited that a majority of the expected orders are likely to be booked in the month of March 2012. We believe that several of these orders may slip into FY2012E. We estimate order inflows of about Rs790 bn (about 14% yoy growth) for the full-year FY2011E implying an order inflow requirement of Rs297 bn in 4QFY11E.

Requires Rs297 bn of order inflows in 4QFY11E to meet our full-year estimates

Rough break up of sector-wise order inflows of L&T, March fiscal year-ends, 2008-13E

Segment	FY08	FY09	FY10	9MFY11		4Q-imp.	FY11E orders		FY12E orders		FY13E orders	
				Ann.	Rep.	(Rs bn)	(Rs bn)	(%)	(Rs bn)	(%)	(Rs bn)	(%)
Process	95	125	94	44	40	33	72	9.1	94	10.0	108	10.1
Refineries	38	37	21	12	—	—	20	—	—	—	—	—
Petrochemicals	3	8	30	—	—	—	10	—	—	—	—	—
Minerals & metals	54	80	43	27	—	—	45	—	—	—	—	—
Bulk material handling	—	—	—	—	—	—	—	—	—	—	—	—
Oil & gas	42	15	74	4	30	47	77	9.7	107	11.4	118	11.0
Platforms	42	—	74	4	—	—	70	—	—	—	—	—
Pipelines	—	15	—	—	—	—	—	—	—	—	—	—
Power	35	80	217	188	213	97	310	39.2	356	37.9	410	38.3
BOP	5	7	45	46	—	—	75	—	—	—	—	—
EPC	—	—	103	82	—	—	125	—	—	—	—	—
Equipment	—	16	24	28	—	—	70	—	—	—	—	—
Electrification/ T&D	30	45	45	32	—	—	50	—	—	—	—	—
Infrastructure	100	185	135	144	168	95	263	33.2	302	32.2	348	32.5
Roads and bridges	3	43	15	27	—	—	50	—	—	—	—	—
Ports and airports	55	—	—	22	—	—	15	—	—	—	—	—
Railways	3	28	8	11	—	—	100	—	—	—	—	—
Industrial/commercial bldg	33	92	92	63	—	—	85	—	—	—	—	—
Water	6	23	21	22	—	—	25	—	—	—	—	—
Others	54	53	10	1	45	25	69	8.8	80	8.5	88	8.2
Total	326	458	530	380	495	297	791	100	940	100	1,071	100
Reported inflows	420	516	696									

Relatively sedate process and O&G segment order inflows in FY2011E so far

EPC order for L&T's in-house Rajpura power project

Primarily led by Hyd. Metro project (Rs121 bn)

Additional Rs297 bn of orders required to meet full-year estimates

Source: Company, Kotak Institutional Equities estimates

Deferment of order inflows leads to lower-than-expected inflows

L&T management cited changes in ordering patterns for several projects leading to the lower-than-expected inflows in 3QFY11 (reported inflows of Rs113 bn – down 25% yoy) such as (1) organization inertia, (2) delays in gas/coal allocations, land acquisition, environmental clearances etc., (3) splitting up of large EPC projects in smaller components, (4) scam and corruption related issues, (5) political issues etc. We believe some of these reasons may also impact future execution of the company.

Underlying reasons for sedate inflows may slow execution as well

Potential reasons for slower-than-expected order inflow activity

S No.	Reason	Details
1	Organizational inertia	Delays in ordering activity from several companies such as NTPC bulk tender
2	Delays in allocation of coal blocks	Has led to delays in award of EPC/equipment orders for several power projects
3	Delays in gas allocation from K.G.Basin	Adversely impacted orders from fertilizer, pipeline and power segments
4	Land acquisition issues	Land acquisition issues in several projects led to delays in award activity
5	Sequential versus parallel processing	Land acquisition, environmental clearance etc. is now sequentially processed versus parallelly earlier
6	Split-up of large EPC projects	GSPC (which had placed a large Rs5 bn order in 2Q) is now splitting up its orders into several parts such as process platform etc.
7	Scam and corruption issues	Has significantly impacted the roads segment; ordering activity considerably slow in recent months versus strong traction in 2HFY10 and 1QFY11
8	Political reasons	Several issues such as political unrest in AP, elections in Tamil Nadu till April-10, assembly elections in West Bengal led to delays in several orders
9	Fragmentation of vendors by PGCIL	From the next round of bidding; PGCIL has possibly not decided on closed tenders for the past nine months

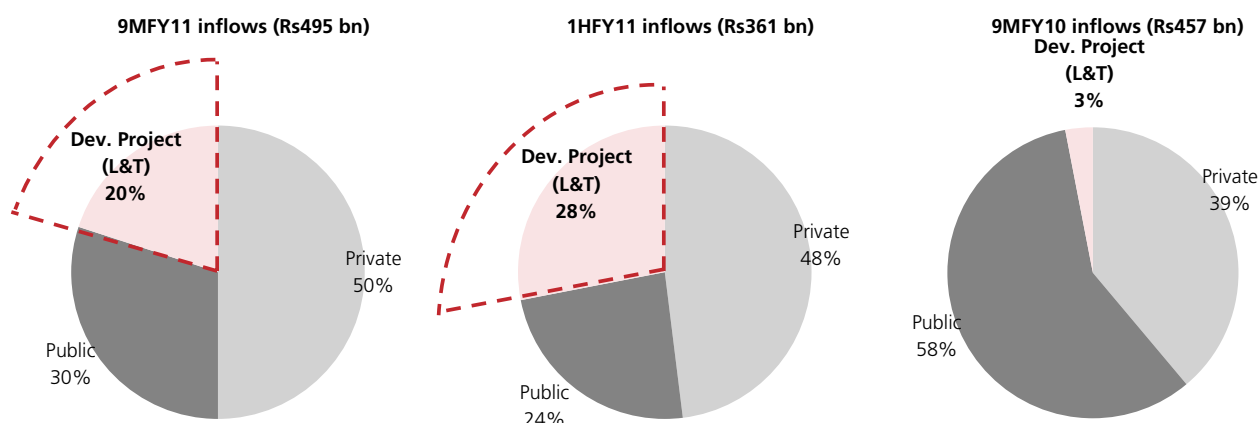
Source: Company, Kotak Institutional Equities

No contribution of in-house projects to Rs133 bn of inflows in 3QFY11 may be positive

In-house development projects did not contribute to the total Rs133 bn of order inflows in 3QFY11 versus a contribution of about 28% in 1HFY11.

No contribution of in-house projects to Rs133 bn of inflows in 3QFY11

Sectoral break-up of L&T's order inflows and backlog



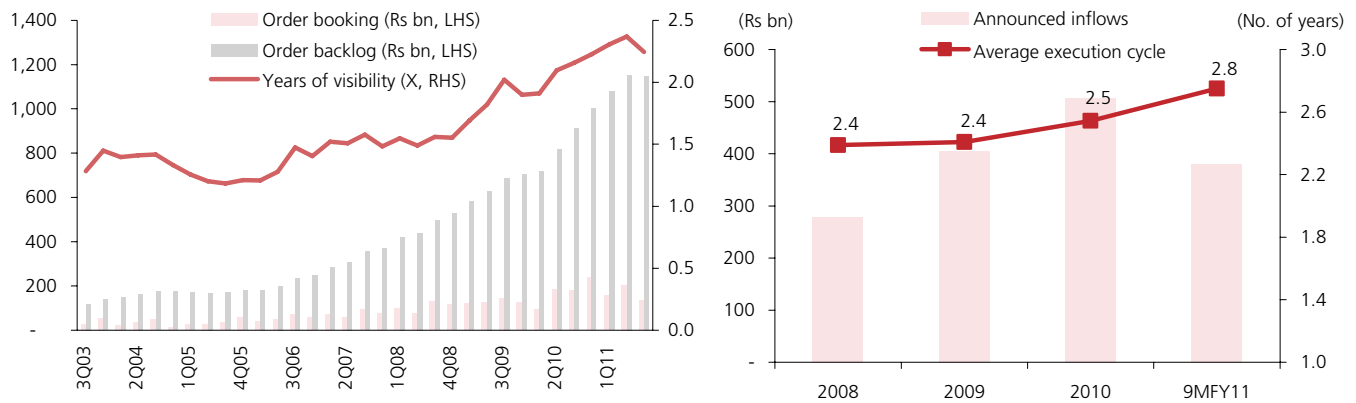
Source: Company, Kotak Institutional Equities

Rise in average execution cycle matched by increasing visibility

Our tracking suggests that average execution time of inflows has gone up to 2.8 years in 9MFY11 from 2.4 in FY2008. However, this is more than matched up by increasing visibility. The order backlog visibility has increased from an average of about 1.5 years (on forward four quarter revenues) in FY2008 to about 2.3 years at end-9MFY11.

Note that our study is based on estimated execution periods for order announcements of L&T over FY2008-9MFY11.

Order backlog provides a revenue visibility of about 2.3 years
 Visibility and average execution cycle trend for L&T (Rs mn)



Source: Company, Kotak Institutional Equities estimates

Steep competition witnessed in Hydrocarbons segment

Order inflows hydrocarbon segment remained weak in this quarter (contributed to 6% of inflows in 9MFY11 versus 17% in 9MFY10). Management cited very steep competition in this segment leading to loss of several orders (witnessed price difference of an average of 25% between L&T’s bid and the winning bid).

Balance sheet remains strong with no deterioration in working capital

L&T reported a strong balance sheet at end-9MFY11 with no deterioration in working capital levels (remained at about 7.5% of sales versus end-FY2010 levels) and gross debt to equity of 0.37X. L&T increased its investments in its subsidiaries and associates (in the form of equity investments, ICDs, loans & advances) by Rs24 bn to Rs100.9 bn at end-9MFY11 from FY2010-end level of Rs77 bn. This was primarily led by (1) buy-out of PE stake in L&T IDPL for Rs7.1 bn (increased stake to 97.5%), (2) increase in investment in L&T Finance and L&T Infra. Finance by Rs4.7 bn and (3) increase in investment in L&T Power Development to the tune of about Rs4.6 bn.

L&T - balance sheet highlights, as on December 31, 2010 (Rs mn)

	Dec-10	Sep-10	Mar-10	Mar-09	Mar-08
Net worth	210,060	199,410	183,120	124,590	95,520
Loan funds	78,550	77,236	68,010	65,560	35,840
Deferred tax liabilities	990	845	770	490	610
Total sources of funds	289,600	277,492	251,900	190,640	131,970
Net fixed assets	72,020	69,791	63,660	51,950	36,450
Current investments	69,510	66,410	79,650	48,800	42,830
Invt./ ICDs/ L&A to subsidiaries & associates	100,880	88,780	76,790	53,900	26,800
Other investments	3,040	3,021	5,490	3,520	3,190
Net current assets	44,150	49,490	26,310	32,470	2,270
Total application of funds	289,600	277,492	251,900	190,640	111,540

Source: Company

L&T IDPL buyback of 13.2% stake for Rs7.1 bn implies value of Rs54 bn; but does not include all projects

L&T recently completed a buyback of about 13.2% stake in L&T IDPL from private equity investors for a value of Rs7.1 bn. This implies a value of Rs54 bn for 100% of L&T IDPL. This value for IDPL is likely to not include several development projects (such as Hyderabad metro project, Gujarat road projects etc.) which are presently not within L&T IDPL. We currently value all the infrastructure SPVs of L&T (IDPL + other development projects) at Rs85 bn.

Retain ADD as we watch for margins and order inflow traction recovery

We retain our ADD rating with a revised target price of Rs2,050 based on (1) recent sharp correction provides about 18% upside to our target price (stock has corrected by about 15% on an absolute basis and 10% relative to SENSEX in the past month), (2) incrementally positive on strong execution, (3) legible explanation on lower margins in 3QFY11, (4) lower-than-expected order inflows likely to be already factored into the price and (5) relatively reasonable valuations of 16-17X FY2012E standalone earnings.

We have marginally revised our standalone earnings estimates to Rs63.6 and Rs73.7 from Rs65.1 and Rs75.3 for FY2011E and FY2012E, respectively. Our earnings revisions are based on marginally lower order inflow and EBITDA margin assumptions for FY2011E and FY2012E. We have correspondingly revised our estimates for the consolidated entity to Rs74.9 and Rs86 from Rs76.3 and Rs87.6 for FY2011E and FY2012E, respectively.

Change in earnings estimates of L&T, March fiscal year-ends, 2011E and 2012E (Rs mn)

	New estimates		Old estimates		% revision	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Consolidated						
Revenues	542,018	658,085	538,317	661,019	0.7	(0.4)
Operating profit	89,729	110,819	91,279	112,742	(1.7)	(1.7)
Operating profit margin (%)	16.6	16.8	17.0	17.1		
Profit after tax	45,302	52,040	46,206	53,011	(2.0)	(1.8)
EPS (Rs)	74.9	86.0	76.3	87.6	(2.0)	(1.8)
Standalone						
Revenues	450,475	546,305	447,064	549,010	0.8	(0.5)
Operating profit	56,956	69,108	58,550	70,996	(2.7)	(2.7)
Operating profit margin (%)	12.6	12.7	13.1	12.9		
Profit after tax	38,487	44,613	39,425	45,557	(2.4)	(2.1)
EPS (Rs)	63.6	73.7	65.1	75.3		
Order booking	791,160	939,819	802,598	951,233	(1.4)	(1.2)
Order booking growth (%)	13.7	18.8	15.4	18.5		
Order backlog	1,337,484	1,724,136	1,354,132	1,751,463	(1.2)	(1.6)

Source: Company, Kotak Institutional Equities estimates

We revise our SOTP-based target price to Rs2,050/share (from Rs2,125/share earlier) comprised of (1) Rs1,647/share from the core construction business based on 21X FY2012E expected earnings, (2) Rs238/share from L&T's service subsidiaries, (3) Rs76/share from the manufacturing subsidiaries, (4) Rs119/share from the infrastructure SPVs and (5) Rs94/share from other subsidiaries and investments. The target price revision is primarily due to increased value from the finance subsidiaries (L&T Finance, L&T Infra Finance) as additional capital would aid growth and reduce pressure on the parent's balance sheet.

We arrive at a SOTP-based target price of Rs2,050/share for L&T
FY2012E-based Sum of The Parts (SOTP) valuation of Larsen and Toubro

	Earnings/Book (Rs mn)	FY12E multiple (X)	Value (Rs bn)	Valuation basis	Stake (%)	Value for L&T's stake (Rs bn)	Per share (Rs)
Core company valuation	44,613	21.0	873	P/E	100	937	1,556
Key subsidiaries-services	22,467		80			144	238
L&T Finance	18,377	2.5	27.6	P/B	100	46	76
L&T Infra. Finance	14,519	2.5	52.8	P/B	100	36	60
L&T Infotech	4,089	15.0	82.4	P/E	100	61	102
Key subsidiaries - mfg	2,892					46	76
Tractor Engineers	87	15.0	35.1	P/E	100	1	2
Associate companies*	2,805	15.0	46.3	P/E	50	21	35
Power equipment JV	NA		77.5	DCF	51	24	39
Infrastructure SPVs	34,093	2.5	52	P/B	84.3	72	119
Other subsidiaries	37,626	1.5	292	P/B	100	56	94
Total subsidiaries						318	528
Grand total						1,255	2,083

Source: Company, Kotak Institutional Equities estimates

Details of Infra and other investments

We project Rs38 bn being invested in infrastructure assets at the end of FY2011E, going upto Rs86 bn at FY2013E end

Projects	Equity %	Project cost	Equity req.	Equity invested			Additional equity requirement			
				2010			2011E	2012E	2013E	Total
				IDPL	Standalone	Other				
Roads										
Completed										
L&T Panipat Elevated Corridor	30	4,220		843						843
Narmada Infra Construction Enterprise Ltd	30	1,420		121	127	226				474
L&T Krishnagiri Thopur Toll Road	30	5,250		788						788
L&T Western Andhra Tollways	30	3,730		565						565
L&T Transportation Infra Ltd	30	1,040		531	109					640
L&T Interstate Road Corridor Ltd	30	5,370		572						572
L&T Vadodara Bharuch Tollway Ltd	30	14,610		2,175						2,175
Under implementation										
Ahmedabad-Maliya Tollway	30	14,970	4,491		630		2,021	1,840		4,491
L&T Halol-Shamlaji Tollway Pvt Ltd	30	13,050	3,915		653		1,762	1,501		3,915
Rajkot Vadinar Tollway Pvt Ltd	30	10,960	3,288		550		1,480	1,258		3,288
Chennai-Tada Tollway Ltd	30	8,480	2,544			420	1,145	979		2,544
Pimplegaon-Nasik (60 km)	30	6,000	1,800		846		630	325	-	1,800
Krishnagiri-Walajahpet	30	14,500	4,350				870	1,740	1,740	4,350
Samaikhiali-Gandhidham (56 km)	30	5,600	1,680				252	672	756	1,680
Devihalli-Hassan (73 km)	30	7,300	2,190				329	876	986	2,190
Ports										
Dhamra port (50:50 JV)	30	24,600	3,690	2,465	-		1,225	-	-	3,690
Katupalli port	30	28,370	8,511				1,277	1,702	2,979	8,511
Metro										
Hyderabad Metro project	30	150,000	40,626					6,094	8,125	40,626
L&T Urban Infra (portfolio investment)				750						
Total				8,809	2,914	646	10,989	16,986	14,586	83,141
L&T Power Development Ltd										
Rajpura 700X 3 MW project				1,810	-	7,390	5,000	5,000	5,000	
Other projects								2,500	5,000	

Source: Kotak Institutional Equities, Company

Other investments amounted to Rs37 bn at the end of FY2010

	2009		2010			yoy change	
	Equity	L&A	Equity	L&A	Total	Equity	L&A
Subsidiary companies							
Bhilla Power supply co	0.5	71.9	0.5	71.9	72.4	—	—
L&T General Insurance Co.	—	—	290	—	290	290	—
L&T Realty	472	—	472	4,620	5,092	—	4,620
L&T Seawoods	0.1	5,899	0.1	8,583	8,583	—	2,683
L&T Shipbuilding	1	—	1	6,231	6,231	—	6,231
L&T Special Steels & Heavy Forgings	—	—	1,110	—	1,110	1,110	—
L&T Western India Tollbridge	140	—	140	—	140	—	—
L&T Sargent Lundy	15	—	15	—	15	—	—
L&T International FZE	10,498	—	11,474	—	11,474	976	—
Spectrum Infotech	68	—	68	—	68	—	—
Others	41	—	31	—	31	(11)	—
Subsidiaries total	11,211	5,971	13,600	19,505	33,105	2,389	13,534
Associate companies							
Gujarat Leather Industries	6	—	6	—	6	—	—
Intl Seaport Dredging	402	110	399	118	518	(3)	9
Associates total	402	110	—	118	118	(402)	9
Other investments							
City Union Bank Ltd	253	—	—	—	—	(253)	—
Satyam Computer Services	1,764	—	4,363	—	4,363	2,599	—
Ultratech Cement	143	—	—	—	—	(143)	—
Investments in Integrated JVs	1,278	—	1,088	—	1,088	(190)	—
Other investments total	2,241	—	4,403	—	4,403	2,162	—
Grand total	13,854	6,081	18,003	19,624	37,626	4,149	13,543

Source: Kotak Institutional Equities, Company

Standalone balance sheet and income statement of L&T, March fiscal year-ends, 2007-12E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Income statement						
Net operating revenues	176,142	248,779	339,385	370,348	450,475	546,305
Cost of goods sold	(158,247)	(220,515)	(300,164)	(322,592)	(393,518)	(477,197)
Construction materials	(36,510)	(56,103)	(75,100)	(74,781)	(90,125)	(109,350)
Sub contracts	(33,920)	(44,904)	(70,533)	(86,618)	(105,358)	(127,771)
Stores, spares and tools	(4,694)	(6,995)	(9,008)	(10,523)	(11,262)	(13,658)
Other mfg exp	(13,635)	(16,772)	(22,455)	(24,826)	(30,182)	(35,510)
S, G & A	(10,280)	(13,856)	(17,703)	(14,627)	(17,569)	(19,667)
Salaries & wages	(12,592)	(15,354)	(19,745)	(23,791)	(28,657)	(36,031)
EBIDTA	17,895	28,264	39,222	47,756	56,956	69,108
<i>EBIDTA margin (%)</i>	<i>10.2</i>	<i>11.4</i>	<i>11.56</i>	<i>12.9</i>	<i>12.6</i>	<i>12.7</i>
Other income	4,927	6,520	7,398	9,502	11,677	10,313
Interest	(930)	(1,227)	(4,156)	(5,053)	(6,046)	(6,821)
Depreciation	(1,715)	(2,022)	(3,073)	(4,159)	(4,972)	(5,815)
PBT	20,191	31,534	39,404	48,059	57,615	66,786
Tax	(6,019)	(9,821)	(12,312)	(16,409)	(19,128)	(22,173)
PAT	14,172	21,714	27,092	31,650	38,487	44,613
Extraordinaries	—	(8)	7,725	12,105	—	—
Reported PAT	14,172	21,706	34,817	43,755	38,487	44,613
EPS (Rs)	50.0	37.1	46.3	52.6	63.6	73.7
Balance sheet						
Equity capital	567	585	1,171	1,204	1,210	1,210
Reserves & surplus	56,839	94,707	123,180	181,679	215,269	249,969
Shareholders funds	57,405	95,292	124,351	182,884	216,480	251,180
Reval reserves	279	259	246	233	233	233
Secured loans	2,454	3,085	11,024	9,557	9,557	9,557
Unsecured loans	18,324	32,755	54,537	58,451	78,451	78,451
Total debt	20,778	35,840	65,560	68,008	88,008	88,008
Total sources of funds	78,462	131,391	190,157	251,125	304,721	339,421
Net Block	17,083	28,544	40,128	53,654	65,682	73,867
Capital WIP	4,357	6,990	10,410	8,577	5,000	5,000
Total fixed assets	21,440	35,534	50,538	62,231	70,682	78,867
Intangible assets	807	920	1,408	1,427	1,427	1,427
Investments	31,044	69,223	82,637	137,053	148,042	157,529
Net working capital (excl. cash)	14,530	16,652	48,303	36,869	72,829	90,756
Cash and bank balances	10,944	9,645	7,753	14,319	12,515	11,616
Total application of funds	78,462	131,391	190,157	251,124	304,721	339,421

Source: Company, Kotak Institutional Equities estimates

JANUARY 17, 2011
RESULT, CHANGE IN RECO.

 Coverage view: **Attractive**

 Price (Rs): **1,229**

 Target price (Rs): **1,600**

 BSE-30: **18,882**

Delivers a perfect quarter; upgrade to BUY. Amidst a lot of perceived concerns on margins and asset quality, Axis Bank has delivered a perfect quarter—margins are up by 13 bps qoq and net NPLs are down 5 bps qoq. The management reiterated their positive outlook on asset quality, but expect margins to decline from 3Q levels. Valuations have corrected sharply recently and the stock now trades at 2.3X PBR and 12X PER on FY2012E earnings. We upgrade our rating to BUY (from ADD) post this price correction with a TP of ₹1,600.

Company data and valuation summary

Axis Bank

Stock data

52-week range (Rs) (high,low) 1,609-965

Market Cap. (Rs bn) 498.0

Shareholding pattern (%)

Promoters 37.5

FIs 45.9

MFs 4.0

Price performance (%)

	1M	3M	12M
Absolute	(6.1)	(18.2)	14.0
Rel. to BSE-30	(1.3)	(12.8)	6.0

Forecasts/Valuations

	2011	2012E	2013E
EPS (Rs)	81.7	99.9	122.8
EPS growth (%)	31.6	22.3	22.9
P/E (X)	15.0	12.3	10.0
NII (Rs bn)	66.2	78.9	96.4
Net profits (Rs bn)	33.1	40.5	49.8
BVPS	459.3	536.6	631.8
P/B (X)	2.7	2.3	1.9
ROE (%)	19.1	20.1	21.0
Div. Yield (%)	1.3	1.6	1.9

Concern exaggerated; recent price correction offers a strong upside; upgrade to BUY

Axis Bank's results have allayed a lot of concerns prevailing about margin trends and asset quality. Margins have increased by 13 bps during the quarter, benefiting from higher CASA ratio and a reasonable pricing power. Asset quality has improved with quarterly run rate on slippages declining by 25% qoq. While we build margin compression in 4QFY11E and FY2012E due to rising deposit costs, we reiterate our view that banks with high CASA will be able to manage margins much better than other financial entities. Outlook on asset quality is positive and we expect similar trend in future quarters as well. We maintain our positive view on the stock, on the backdrop of a strong economic growth. Post the recent correction of 18% over past 3 months, valuations have become very attractive. We upgrade our rating to BUY with a target price of ₹1,600 (30% upside).

We increase our earnings estimates marginally by 4% in FY2011E and largely maintain it for FY2012E and FY2013E. We build in a margin compression of 10 bps in FY2012E over FY2011E. We also reduce our loan growth marginally to 22%, on a somewhat higher loan growth in FY2011E.

Loan growth ahead of industry; focus remains on large corporate segment

Sequential loan book growth was at 12% to ₹1,235 bn (46% yoy) but YTD loan growth is higher than industry at 18.4%. Focus continues to remain on the large corporate segment which grew by 70% yoy to ₹637 bn. Infrastructure and finance sectors saw healthy growth while disbursements for working capital has increased in the current quarter. Retail loans (20% of loans) grew by 33% yoy driven mainly by housing (26% yoy growth) and personal loans (short-term application money of ₹25 bn for housing). SME loans were flat during the quarter but agriculture loans grew 19% qoq (seasonal trend). We see limited concern on the ability of the bank to grow loans at 1.3X system growth and we build a 25% CAGR for FY2010-13E. Deposits increased by 37% yoy (flat qoq) to ₹1,558 bn. CASA deposit growth remained strong (savings deposit grew 32% yoy). CASA proportion to total deposits improved by 80 bps qoq to 42.3%.

QUICK NUMBERS

- NII growth at 29% yoy while loan growth at 46% yoy
- NIMs expand 13 bps qoq to 3.8%
- Asset quality stable with lower slippages
- Upgrade to BUY with TP of ₹1,600

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NIMs improve 13 bps qoq, above expectations

Axis Bank's net interest margin (NIM) was 3.8% in 3QFY11—13 bps improvement qoq and better than our expectations as cost of funds and asset yields were nearly flat for the quarter and CD ratio (average) for the quarter improved by about 100 bps (closing CD ratio expanded to 79% as compared to 71% in the previous quarter). Funding costs were flat qoq at 4.8%. NII grew 29% yoy, 5% ahead of our expectations to ₹16.2 bn. We are building NIMs to decline in 4QFY11E by about 20 bps and FY2012E by 10 bps as expansion in CD ratio from current levels is unlikely and funding costs have increased sharply in recent times. However, we highlight that the previous rate hike of 50 bps in December is yet to reflect fully in margins. Further the bank has taken a further rate hike of 25 bps in January 2011. Overall, we maintain our view that a tight liquidity environment would benefit banks given their pricing power and Axis Bank can leverage it better through its higher share of CASA deposits.

Reported asset quality trending better; slippages decline to 1.2% for the quarter

Axis Bank reported slippages at 1.2% (annualized), lower than 1.6% reported in 1HFY11. Upgradations and recoveries remained flat qoq and the bank reported lower write-offs during the quarter (₹870 mn compared to ₹2.9 bn in 2QFY11). The management mentioned that exposure to microfinance is less than 1% of overall loans. Gross NPLs were at ₹14.8 bn (1.1% of loans) while net NPLs were at ₹3.9 bn (0.3% of loans) compared to ₹13.6 bn and ₹4.1 bn in the previous quarter. Loan loss provisions for the quarter were at 0.8% (annualized) compared to 1.2% in 1HFY11. We are building loan loss provisions at 1.0% for FY2011E and 0.9% for FY2012E.

Other highlights

- ▶ Growth in fee income was slower than overall loan growth at 21% yoy and was driven mainly by the large corporate segment (36% yoy) and retail banking (21% yoy). Fee income from business banking, capital markets and agri/SME banking continues to remain under pressure. Treasury profits were at ₹1.3 bn compared to ₹1.1 bn in 2QFY11 and mainly from fixed income portfolio.
- ▶ There was a net write-back of ₹146 mn, largely from the overseas investment book, even as the bank made provisions for domestic G-Sec book.
- ▶ Capital adequacy ratio stands comfortable at 12.5% with tier-1 ratio at 10.2%.
- ▶ Cost-income ratio declined by 145 bps qoq to 42% mainly due to lower employee costs. The bank opened another 17 branches and 457 ATMs, taking the total branch network to 1,120 and ATMs to 5,303. Management highlighted that they are likely to open over 200 branches during the current fiscal. We have maintained our cost-income ratio at about 42% levels.

Axis Bank quarterly results-- key parameters
March fiscal year-ends, 3QFY10-3QFY11

	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	yoy growth (%)	3QFY11E	Actual Vs KS
Interest income	28,837	29,885	33,256	36,243	38,383	33.1	38,096	1
Advances	19,879	20,750	23,109	24,290	26,006	30.8	25,218	3
Investments	8,454	8,560	9,353	11,235	11,668	38.0	12,068	(3)
Balance with RBI	274	272	325	384	482	76.2	460	5
Interest expenses	15,345	15,284	18,118	20,092	21,052	37.2	21,591	(2)
Net interest income	13,491	14,601	15,138	16,151	17,331	28.5	16,505	5
Non-interest income	9,881	9,335	10,008	10,332	11,477	16.2	11,100	3
Treasury income	1,700	1,030	1,960	1,080	1,350	(20.6)	1,000	35
Income excl treasury	8,181	8,305	8,048	9,252	10,127	23.8	10,100	0
Total income	23,372	23,936	25,146	26,483	28,808	23.3	27,605	4
Operating expenses	9,626	10,098	10,645	11,620	12,224	27.0	12,165	0
Employee cost	3,085	3,338	4,164	4,053	3,962	28.4	4,165	(5)
Other operating cost	6,540	6,761	6,481	7,567	8,262	26.3	8,000	3
Pre-prov profit	13,746	13,838	14,501	14,864	16,585	20.6	15,439	7
Provisions	3,731	2,019	3,330	3,787	3,139	(15.9)	3,349	(6)
Loan loss	3,580	1,797	3,050	3,210	2,330	(34.9)	3,050	(24)
Investment depreciation	110	206	280	577	(101)	-	300	-
Profit before tax	10,015	11,819	11,171	11,077	13,446	34.3	12,090	11
Tax	3,455	4,171	3,752	3,725	4,532	31.2	3,990	14
Profit after tax	6,560	7,649	7,419	7,352	8,914	35.9	8,100	10
Tax rate (%)	34.5	35.3	33.6	33.6	33.7			
PBT- treasury gains	8,315	10,789	9,211	9,996	12,096	45.5	11,090	9
PBT- treasury gains+provisions	12,046	12,808	12,541	13,784	15,235	26.5	14,439	6
Key balance sheet items (Rs bn)								
Deposits	1,139	1,413	1,475	1,569	1,558	36.9		
Demand deposits	519	660	592	652	659	27.0		
Savings	296	339	347	378	391	32.1		
Current	223	322	245	274	268	20.3		
Term deposits	619	753	882	917	899	45.1		
CASA ratio (%)	45.6	46.7	40.2	41.5	42.3			
Customer assets	934	1,164	1,181	1,204	1,329			
Loans	848	1,043	1,086	1,106	1,235	45.7		
Retail loans	189	208	211	210	252	33.4		
Non-retail loans	659	835	875	896	983	49.3		
SME loans	156	195	168	168	171			
Agricultural loans	87	115	106	91	108			
Retail excluding CVs	187	208	211	210	252			
Housing	134	147	150	153	169			
Auto	26	27	27	27	28			
CV	2	1	-	-	-			
Others	8	9	8	8	10			
Investments	493	560	560	619	596	21.0		
Total assets	1,505	1,806	1,895	1,998	2,067	37.4		
Asset quality								
Gross NPA	11.7	13.2	13.4	13.6	14.8			
Net NPA	4.3	4.2	4.1	4.1	3.9			
Gross NPA (%)	1.23	1.13	1.13	1.12	1.09			
Net NPA (%)	0.46	0.36	0.35	0.34	0.29			
Provision coverage (calc, %)	63.4	68.2	69.2	70.0	74.0			

Source: Kotak Institutional Equities

Balance sheet snapshot

March fiscal year-ends, 2QFY10-3QFY11 (%)

	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
Balance sheet						
Capital	4	4	4	4	4	4
Reserves	147	154	156	165	173	182
Deposits	1,156.0	1,138.5	1,413.0	1,474.8	1,568.9	1,558.1
Borrowings	84	88	172	196	190	256
Other Liab & prov	126	120	61	55	62	67
Total liabilities	1,517	1,505	1,806	1,895	1,998	2,067
Cash	130	114	152	171	208	168
Investments	521	493	560	575	619	596
Loans	810	848	1,043	1,086	1,106	1,235
Fixed Assets	12	12	12	17	19	20
Other Assets	44	38	39	45	46	48
Total assets	1,517	1,505	1,806	1,895	1,998	2,067

Source: Company, Kotak Institutional Equities

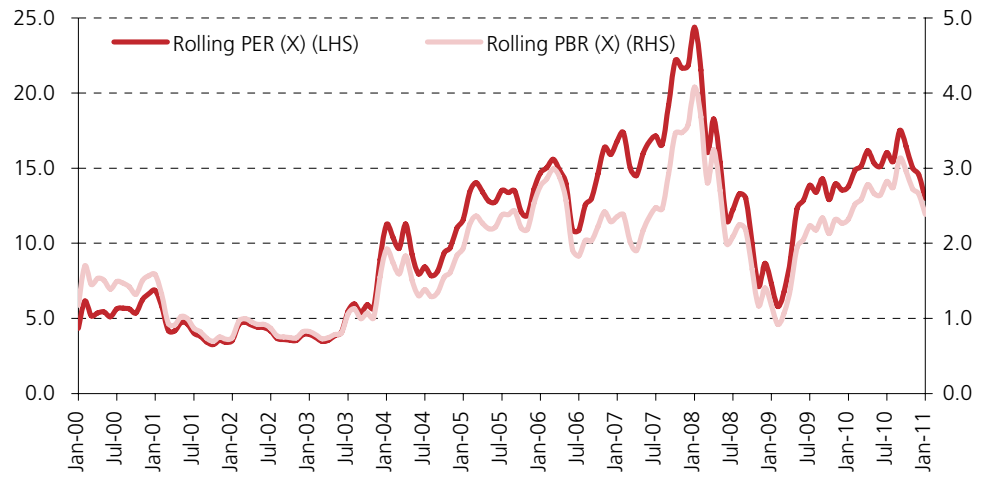
Axis Bank-- estimate changes

March fiscal year-ends, 2011-2013E, (₹ mn)

	Old estimates			New estimates			% change		
	FY2011E	FY2012E	FY2013E	FY2011E	FY2012E	FY2013E	FY2011E	FY2012E	FY2013E
Net interest income	65,501	79,991	96,710	66,166	78,950	96,449	1.0	(1.3)	(0.3)
NIM (%)	3.4	3.3	3.3	3.4	3.3	3.4	1.9	0.2	1.3
Customer assets	#####	#####	#####	#####	#####	#####	2.6	0.0	(0.8)
Loan loss provisions	13,445	14,599	16,310	11,878	13,309	16,231	(11.7)	(8.8)	(0.5)
Other income	44,629	52,753	62,352	44,629	52,753	62,352	-	-	-
Fee income	32,065	38,478	46,174	32,065	38,478	46,174	-	-	-
Treasury income	5,000	5,500	6,000	5,000	5,500	6,000	-	-	-
Operating expenses	46,628	55,441	65,505	47,343	56,303	66,526	1.5	1.6	1.6
Employee expenses	16,528	19,055	22,584	16,528	19,055	22,584	-	-	-
PBT	48,757	62,004	76,547	49,775	60,890	74,845	2.1	(1.8)	(2.2)
Tax	16,927	21,526	26,574	16,675	20,398	25,073	(1.5)	(5.2)	(5.6)
Net profit	31,830	40,478	49,972	33,100	40,492	49,772	4.0	0.0	(0.4)

Source: Company, Kotak Institutional Equities

Rolling PER and PBR for Axis Bank
 March fiscal year-ends, January 2000-January 2011 (X)



Source: Company, Kotak Institutional Equities

Axis Bank, growth rates, key ratios and Du Pont analysis
March fiscal year-ends, 2008-2013E (%)

	2008	2009	2010	2011E	2012E	2013E
Growth rates (%)						
Net loan	61.8	36.7	27.9	27.7	22.0	21.9
Total Asset	49.6	34.8	22.3	20.4	22.4	20.7
Deposits	49.1	33.9	20.4	21.7	24.3	21.9
Current	77.3	23.8	29.6	17.6	13.0	21.9
Savings	64.8	29.2	31.1	31.1	23.5	20.7
Fixed	34.6	40.2	12.8	19.2	29.5	22.5
Net interest income	65.0	42.6	35.8	32.2	19.3	22.2
Loan loss provisions	151.4	81.6	56.4	(15.9)	12.0	22.0
Total other income	78.7	60.0	36.2	13.1	18.2	18.2
Net fee income	69.5	64.6	18.0	25.0	20.0	20.0
Net capital gains	261.8	31.0	147.6	(30.0)	10.0	9.1
Net exchange gains	66.2	73.3	30.2	15.0	16.0	16.0
Operating expenses	77.4	32.6	29.8	27.6	18.9	18.2
Employee expenses	75.8	48.8	25.9	31.6	15.3	18.5
Key ratios (%)						
Yield on average earning assets	8.0	8.7	7.3	7.7	8.1	8.2
Yield on average loans	9.8	10.6	8.6	8.7	9.1	9.3
Yield on average investments	7.1	7.7	6.8	7.4	7.7	7.8
Average cost of funds	5.3	6.1	4.5	4.7	5.1	5.3
Interest on deposits	5.1	6.1	4.4	4.5	5.0	5.1
Difference	2.7	2.6	2.9	3.1	3.0	3.0
Net interest income/earning assets	2.9	3.0	3.1	3.4	3.3	3.4
New provisions/average net loans	1.0	1.3	1.5	1.0	0.9	0.9
Interest income/total income	58.8	56.0	55.9	59.7	59.9	60.7
Fee income/total income	30.0	33.0	28.7	28.9	29.2	29.1
Operating expenses/total income	49.0	43.4	41.4	42.7	42.8	41.9
Tax rate	35.0	34.8	34.7	33.5	33.5	33.5
Dividend payout ratio	19.0	19.8	19.3	19.3	19.3	19.3
Share of deposits						
Current	22.9	21.1	22.8	22.0	20.0	20.0
Fixed	54.3	56.9	53.3	52.2	54.4	54.6
Savings	22.8	22.0	24.0	25.8	25.6	25.4
Loans-to-deposit ratio	68.1	69.5	73.8	77.5	76.0	76.0
Equity/assets (EoY)	8.0	6.9	8.9	8.6	8.2	8.0
Dupont analysis (%)						
Net interest income	2.8	2.9	3.0	3.3	3.3	3.3
Loan loss provisions	0.5	0.7	0.9	0.6	0.6	0.6
Net other income	2.0	2.3	2.4	2.2	2.2	2.1
Operating expenses	2.4	2.2	2.3	2.4	2.4	2.3
Invt. depreciation	—	—	(—)	—	—	—
(1- tax rate)	65.0	65.2	65.3	66.5	66.5	66.5
ROA	1.2	1.4	1.5	1.7	1.7	1.7
Average assets/average equity	15.0	13.6	12.5	11.5	12.0	12.4
ROE	17.6	19.1	19.2	19.1	20.1	21.0

Source: Company, Kotak Institutional Equities estimates

Axis Bank, income statement and balance sheet
March fiscal year-ends 2008-2013E, (₹ mn)

	2008	2009	2010	2011E	2012E	2013E
Income statement (Rs mn)						
Total interest income	70,053	108,355	116,380	149,563	189,934	236,869
Loans	47,457	74,659	79,866	103,313	133,884	166,988
Investments	21,023	30,515	34,283	43,332	53,284	66,726
Total interest expense	44,200	71,493	66,335	83,396	110,984	140,420
Deposits from customers	37,425	62,089	57,145	71,038	95,630	122,016
Net interest income	25,853	36,862	50,045	66,166	78,950	96,449
Loan loss provisions	4,975	9,032	14,126	11,878	13,309	16,231
Net interest income (after prov.)	20,879	27,830	35,919	54,288	65,641	80,218
Other income	18,107	28,969	39,458	44,629	52,753	62,352
Net fee income	13,207	21,733	25,652	32,065	38,478	46,174
Net capital gains	2,203	2,884	7,140	5,000	5,500	6,000
Net exchange gains	2,075	3,595	4,681	5,383	6,244	7,243
Operating expenses	21,549	28,582	37,097	47,343	56,303	66,526
Employee expenses	6,702	9,977	12,558	16,528	19,055	22,584
Depreciation on investments	65	1,078	(222)	500—	500—	500—
Other provisions	754	(716)	(15)	1,300	700	700
Pretax income	16,465	27,855	38,517	49,775	60,890	74,845
Tax provisions	5,755	9,701	13,372	16,675	20,398	25,073
Net Profit	10,710	18,154	25,145	33,100	40,492	49,772
% growth	62.5	69.5	38.5	31.6	22.3	22.9
PBT+provisions-treasury	20,208	34,364	45,265	58,453	69,899	86,276
% growth	52.4	75.1	25.7	42.7	23.7	24.3
Balance sheet (Rs mn)						
Cash and bank balance	125,042	150,169	152,064	172,150	196,627	224,071
Cash	15,203	15,415	19,007	20,908	22,998	25,298
Balance with RBI	57,853	78,777	75,732	93,916	116,302	141,447
Balance with banks	11,181	5,406	7,916	7,916	7,916	7,916
Net value of investments	337,051	463,304	559,748	615,053	780,871	945,617
Govt. and other securities	201,788	284,182	341,959	395,568	559,266	721,362
Shares	5,856	4,201	5,296	5,296	5,296	5,296
Debentures and bonds	108,212	133,797	138,233	138,233	138,233	138,233
Net loans and advances	596,611	815,568	1,043,431	1,332,215	1,625,356	1,981,518
Fixed assets	9,229	10,729	12,224	14,966	17,488	18,422
Net owned assets	8,864	10,729	12,224	14,966	17,488	18,422
Other assets	27,845	37,451	39,011	40,634	42,325	44,086
Total assets	1,095,778	1,477,220	1,806,478	2,175,017	2,662,666	3,213,714
Deposits	876,262	1,173,741	1,413,002	1,719,767	2,138,151	2,606,681
Borrowings and bills payable	111,556	174,566	200,800	236,943	274,854	318,831
Other liabilities	20,253	26,765	32,230	32,230	32,230	32,230
Total liabilities	1,008,072	1,375,072	1,646,032	1,988,941	2,445,235	2,957,743
Paid-up capital	3,577	3,590	4,052	4,052	4,052	4,052
Reserves & surplus	84,130	98,558	156,394	182,025	213,379	251,919
Total shareholders' equity	87,707	102,148	160,446	186,077	217,431	255,971

Source: Company, Kotak Institutional Equities estimates

JANUARY 17, 2011
RESULT

 Coverage view: **Attractive**

 Price (Rs): **273**

 Target price (Rs): **300**

 BSE-30: **18,882**

Strong growth; headwinds for NIM. PFC reported 3QFY11 PAT of Rs6.58 bn, up 17% yoy and 4% below estimates. Strong loan growth (27%) and stable NIM underpinned core growth. We expect loan growth to remain strong as power generation capex typically picks up by the end of the (5-year) Plan. Higher borrowing rates will likely put pressure on spreads. We find downside risks on our margins estimate in the current environment, and would await better price points despite the recent correction. Retain REDUCE with price target of Rs300 (Rs325 earlier).

Company data and valuation summary

PFC

Stock data

52-week range (Rs) (high,low) 385-228

Market Cap. (Rs bn) 313.1

Shareholding pattern (%)

Promoters 89.8

FII's 3.8

MFs 2.1

Price performance (%)

	1M	3M	12M
Absolute	(14.9)	(25.1)	(3.0)
Rel. to BSE-30	(10.5)	(20.2)	(9.8)

Forecasts/Valuations

	2011	2012E	2013E
EPS (Rs)	24.1	28.2	33.0
EPS growth (%)	17.5	17.0	16.8
P/E (X)	11.3	9.7	8.3
NII (Rs bn)	37.8	45.2	53.0
Net profits (Rs bn)	27.7	32.4	37.9
BVPS	132.5	148.5	172.9
P/B (X)	2.1	1.8	1.6
ROE (%)	19.3	19.5	19.6
Div. Yield (%)	1.8	2.1	2.4

Loan growth strong at 27%

PFC reported 27% loan growth on the back of 20% growth in disbursements during 3QFY11. We are modeling 27% loan growth for PFC in FY2011E and FY2012E; we expect loan growth to moderate to about 22% in FY2013E and are revising our estimates accordingly.

We would like to highlight that PFC's loan growth picked up in the recent past (29% in 1QFY11, 28% in 2QFY11) as compared to 22% CAGR between FY2007 and FY2010.

High capex in generation segment. Capex in the generation segment typically picks up towards the end of the 5-year Plan thereby driving higher growth for PFC. Notably, generation has been a major growth driver, responsible for 65% of the disbursements and 89% of the loan growth between April and December 2010.

Visibility on loan pipeline remains strong. PFC has outstanding (undisbursed) approvals of Rs1.7 tn from which it has already executed documents for proposals of Rs1 tn (i.e. 1.1X current loan book).

Private sector playing bigger role. The share of private sector will clearly increase over time—about 23% of its outstanding approvals are driven by private players as compared to 7% share in the current loan book and 14% of disbursements over the past nine months.

Margins stable qoq; may face headwinds

PFC reported NIM of 4.1% on the back of 2.7% spreads—stable for the past three quarters. Borrowing cost declined by 10 bps qoq due to higher share of forex and short-term loans.

- ▶ PFC raised forex loans equivalent to Rs10 bn in September 2010; the full impact of these loans was visible during 3QFY11.
- ▶ Short-term borrowings accounted for about 25% of increase in borrowings during the quarter.
- ▶ PFC raised lending rates in September 2010 in order to pass on higher borrowings costs, despite which asset yields declined by 8 bps qoq.

QUICK NUMBERS

- **PAT up 17% yoy and 4% below estimates**
- **Loan growth strong at 27%**

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- ▶ We expect margins to remain under pressure over the next few quarters and are tweaking down our margin estimates. In 4QFY11E, about Rs47 bn of assets and Rs200 bn of liabilities will be re-priced at a higher rate (in the current interest rate regime). Since the liabilities due for re-pricing are significantly higher than assets due for re-pricing, margins will likely be under pressure unless PFC increases its benchmark rates sharply.
- ▶ In FY2012E, about Rs280 bn of assets will be due for re-pricing. Management has highlighted that the outstanding yield on these loans is almost equal to the current market rates. Hence, we are not sure if the large base of assets due for re-pricing in FY2012E will provide a buffer to margins.

Significant impact of standard asset provisioning norms, if applicable to PFC

RBI has prescribed provisioning requirements of 0.25% on all standard assets of NBFCs. It is not clear if this will be applicable to PFC (and REC) as the current NBFC guidelines are not applicable to Government-owned NBFCs. PFC has been growing at a fast pace but has made negligible provisions in the past. As such, nominal standard asset provisions may be prudent. If the guideline is applicable, PFC will likely need to make provisions of Rs2.5 bn, which is equivalent to 33% of 4QFY11E PBT.

Power Finance Corporation - Quarterly data (Rs mn)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	YoY(%)	3Q11E	Actual vs KS (%)
Profit and Loss statement										
Net interest income	7,000	7,200	7,484	7,570	8,580	8,960	9,260	24	9,205	1
Loan loss provisions	1	1	10	—	1—	2	60	-	-	-
Net interest income (after provisions)	7,000	7,199	7,474	7,570	8,579	8,958	9,200	23	9,205	(0)
Other operating income- incl. fees	60	810	130	(110)	650	548	380	192	500	(24)
Net operating income	7,060	8,009	7,604	7,460	9,229	9,506	9,580	26	9,705	(1)
Other income	631	(130)	295	290	(620)	510	(280)	(195)	(70)	300
Forex gains	631	(130)	295	290	(620)	510	(280)	(195)	(70)	300
Total income	7,691	7,879	7,899	7,750	8,609	10,016	9,300	18	9,635	(3)
Total income (after provisioning)	7,690	7,878	7,889	7,750	8,609	10,016	9,300	18	9,635	(3)
Operating expenses	180	240	252	397	15	370	290	15	360	(19)
Staff expenses	121	147	134	289	119	207	170	27	200	(15)
Other expenses	50	83	107	98	(112)	148	108	1	150	(28)
Depreciation	9	10	10	11	9	16	12	21	10	24
PBT	7,502	7,628	7,627	7,341	8,585	9,631	8,998	18	9,265	(3)
Tax	1,956	1,266	1,991	1,363	2,069	2,623	2,426	22	2,316	5
PAT (reported)	5,546	6,362	5,636	5,978	6,516	7,008	6,571	17	6,949	(5)
PAT (included deferred tax)	5,524	6,367	5,636	5,978	6,516	7,008	6,571	17	6,949	(5)
PBT - forex gains and extraordinaries	6,870	7,758	7,332	7,482	8,676	8,592	8,749	19	8,806	(1)
Other details										
Approvals (Rs bn)	188	162	42	282	144	291	178	319		
Disbursements (Rs bn)	43	45	65	104	81	63	78	20		
Loan assets (Rs bn)	662	687	724	798	856	879	921	27	912	1
Yield on Assets (%)	11.30	11.29	11.08	10.81	11.03	11.16	11.08			
Cost of funds (%)	8.64	8.83	8.57	8.32	8.28	8.45	8.35			
Spreads (%)	2.66	2.46	2.51	2.49	2.75	2.70	2.73			
Net interest margins - reported (%)	4.26	4.20	4.17	3.93	4.09	4.08	4.09			
Net interest margins- KS calc (%)	4.29	4.27	4.24	3.98	4.15	4.13	4.12	(3.0)	4.1	0.1
Gross NPLs(%)	0.02	0.02	0.03	0.02	0.02	0.02	0.01			
Capital adequacy ratio (%)	17.51	17.76	17.70	19.25	17.38	17.43	17.31			
Balance Sheet (Rs mn)										
Fixed Assets (Net)	740	740	740	740	770	781	780	5		
Loan Assets	662,050	686,610	724,410	798,560	855,970	879,064	921,180	27		
Investments	330	310	300	310	300	306	410	37		
Current Assets, Loans & Advances	38,590	55,410	43,830	47,850	52,270	54,373	52,430	20		
Total Assets	701,710	743,070	769,280	847,460	909,310	934,525	974,800	27		
Loans and borrowings	528,470	565,380	585,140	671,080	716,300	735,628	764,470	31		
Total Current Liabilities	43,030	38,300	43,280	34,660	45,670	46,329	51,080	18		
Deferred tax liability	530	540	510	480	440	427	810	59		
Interest Subsidy Fund from GOI	8,590	8,130	7,710	6,640	6,290	5,994	5,710	(26)		
Total liabilities	581,080	616,050	636,640	712,860	770,180	788,378	822,070	29		
Total equity	120,630	127,010	132,640	134,600	139,130	146,147	152,740	15		

Source: Company, Kotak Institutional Equities estimates

Power Finance Corporation – Other quarterly data (Rs mn)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	YoY(%)
Additional data								
Disbursements								
Generation	34,370	34,820	48,110	79,520	46,980	41,480	55,730	16
Transmission	3,340	1,420	2,020	3,780	4,300	611	9,250	358
Distribution	2,230	740	720	2,620	3,090	3,500	3,910	443
R APDRP (A)	-	3,740	3,700	3,810	170	-	280	(92)
R APDRP (B)	-	-	-	1,960	1,950	6,250	1,330	-
Others	3,520	4,450	10,380	12,840	24,780	6,060	7,510	(28)
Total	43,450	45,170	64,930	104,530	81,280	63,400	78,020	20
State	29,150	24,470	37,280	68,630	43,310	48,870	54,310	46
Central	6,610	14,040	18,650	24,210	17,020	4,510	12,650	(32)
Joint	5,930	4,310	6,150	8,100	3,850	3,180	3,830	(38)
Private	1,760	2,350	2,850	3,590	17,110	6,840	7,220	153
Loan assets								
Generation	542,170	567,200	604,880	670,130	705,560	732,940	778,330	29
Transmission	65,780	65,270	61,540	62,840	64,700	63,930	71,390	16
Distribution	35,120	34,900	32,390	34,020	35,830	38,200	40,720	26
Others	18,070	18,290	24,510	31,630	49,850	43,990	29,960	22
Total	661,140	685,670	723,320	798,620	855,940	879,060	920,410	27
State	475,160	482,630	495,610	541,420	564,870	580,320	601,070	21
Central	98,010	110,510	127,610	150,150	165,520	168,380	179,390	41
Joint	49,190	52,450	58,230	65,250	68,660	70,730	74,120	27
Private	3,878	40,090	41,870	41,790	56,900	59,630	65,820	57
Borrowings profile								
Total	528,460	565,380	443,030	671,080	716,300	735,630	764,460	73
Bonds	377,510	416,700	427,240	466,220	530,790	542,370	562,690	32
Domestic	364,080	407,970	418,760	458,010	522,310	534,210	554,540	32
Foreign	13,430	8,730	8,480	8,200	8,480	8,160	8,150	(4)
Term loans	139,660	138,680	14,773	181,610	182,040	190,890	192,060	1,200
Short term loans	11,290	10,000	1,017	23,250	3,470	2,370	9,710	855
Total	528,470	565,380	585,140	671,080	716,300	735,630	764,460	31
of which Rupee loans	503,990	549,990	570,610	643,500	688,260	697,360	726,330	27
of which forex loans	24,480	15,390	14,530	27,590	28,040	38,270	38,130	162

Source: Company, Kotak Institutional Equities estimates

PFC, old and new estimates

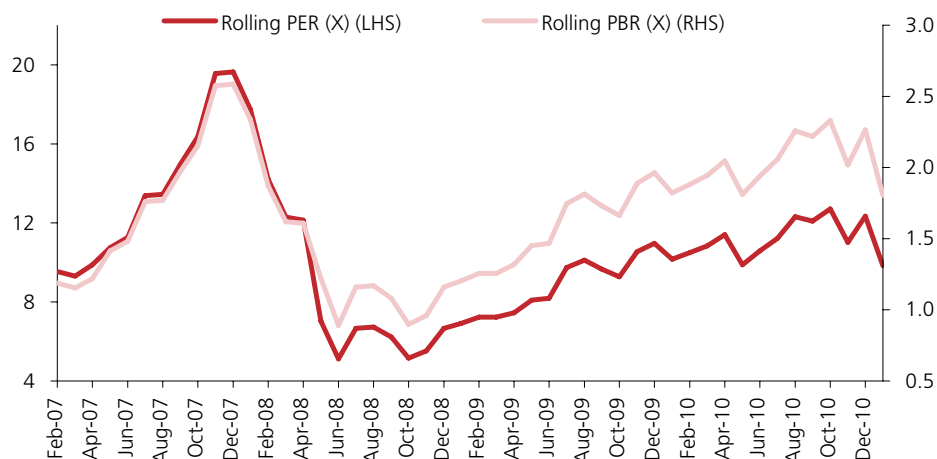
March fiscal year-ends, 2011-2013E (Rs mn)

	Old estimates			New estimates			Old vs New (%)		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
Net interest income	37,785	46,026	55,607	37,785	45,231	53,043	—	(2)	(5)
Loan growth (%)	28	27	27	28	27	23	—	—	—
NIM (%)	4.1	3.9	3.7	4.1	3.9	3.6	—	—	—
NPL provisions	182	1,158	1,471	182	1,158	1,444	—	—	(2)
Other operational income (incl forex gains/losses)	1,000	1,200	1,400	1,000	1,200	1,400	—	—	—
Operating expenses	1,149	1,452	1,840	1,149	1,452	1,806	—	—	(2)
Employee	744	856	984	744	856	984	—	—	—
PBT	37,421	44,583	53,662	37,421	43,787	51,159	—	(2)	(5)
Tax	9,729	11,591	13,952	9,729	11,385	13,301	—	(2)	(5)
PAT	27,691	32,991	39,710	27,691	32,403	37,858	—	(2)	(5)

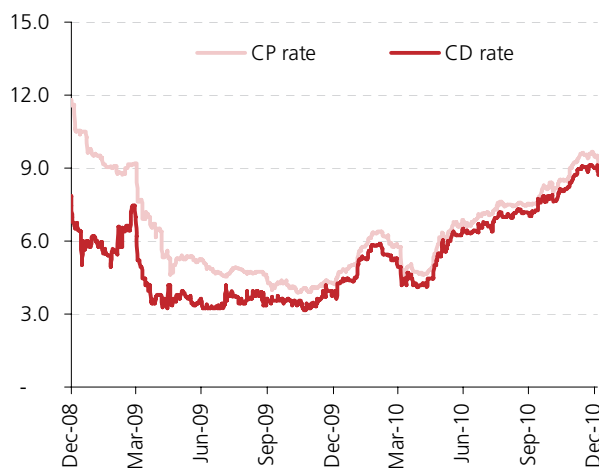
Source: Kotak Institutional Equities estimates

PFC- Rolling PER and PBR

February 2007-November 2010 (X)



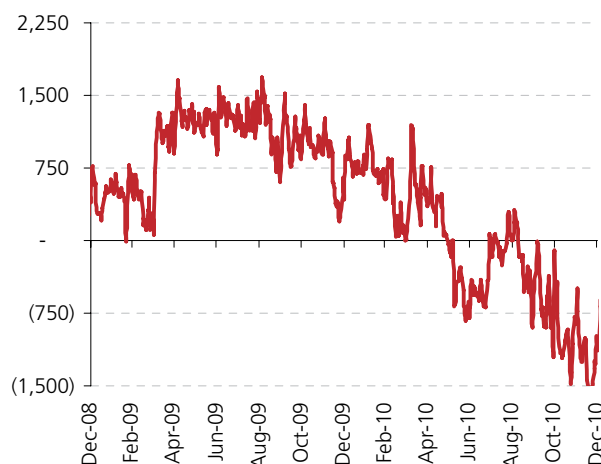
Source: Company, Bloomberg, Kotak Institutional Equities estimates

Short-term rates have seen a rise in the past few months
CP and CD rates, December 2008- December 2010 (%)

Source: Bloomberg, Kotak Institutional Equities

And liquidity remains in negative zone; puts pressure on
borrowings cost and NIM

Net Reverse Repo outstanding, 2008-2010 (Rs bn)



Source: Bloomberg, Kotak Institutional Equities

PFC: Key ratios, March fiscal year-ends, 2007-2013E

	2007	2008	2009	2010	2011E	2012E	2013E
Growth rates (%)							
Net interest income	25.8	25.6	32.5	26.2	26.4	19.7	17.3
Loan loss provisions	59.7	113.3	(135.0)	(115.6)	(3,289.6)	536.9	24.7
Other income	(59.0)	128.3	(71.2)	(21.5)	635.3	20.0	16.7
Operating expense	0.9	64.6	66.0	(21.3)	8.7	26.4	24.3
PBT	19.5	18.3	11.3	51.4	24.2	17.0	16.8
PAT	1.6	22.3	63.3	19.7	17.5	17.0	16.8
PBT- forex gains	21	27	26	29	29	17	17
Net loans	23	17	25	24	28	27	23
Disbursements	20	15	30	24	38	37	19
Unsecured loans (liabilities)	25	21	28	29	29	29	24
Net worth	24	9	23	15	16	16	16
Yield measures (%)							
Yield on earnings assets	8.9	9.6	10.4	10.3	10.8	10.9	11.0
Yield on loans	9.3	10.1	11.0	10.9	11.3	11.4	11.5
Cost of funds	7.6	8.3	8.8	8.3	8.6	8.9	9.1
Spread	1.7	1.8	2.2	2.6	2.7	2.5	2.4
Net interest margin	3.5	3.7	4.0	4.1	4.1	3.9	3.6
Total provisions/net loans (EoY)	(0.01)	(0.02)	0.01	—	0.02	0.09	0.09
Tax rate	35	32	1	22	26	26	26
Dividend payout ratio	26	33	23	22	20	20	20
Profitability measures (%)							
Interest income/total income	91.2	96.2	111.0	95.8	97.4	97.4	97.4
Other operating income/total income	1.7	3.2	0.8	0.4	2.6	2.6	2.6
Other income / total income	7.1	0.6	(11.8)	3.8	—	—	—
Operating expenses/total income	3.2	4.4	6.3	3.4	3.0	3.1	3.3
Payout ratio	26.3	33.3	23.3	21.9	20.0	20.0	20.0
LT Debt- Equity Ratio (X)	3.9	4.4	4.5	5.1	5.6	6.3	6.7
CAR (%)	22.63	23.6	17.9	16.6	15.1	13.8	13.0
Loan loss provisions/ ave loan assets	(0.01)	(0.02)	0.01	—	0.02	0.10	0.10
ROA decomposition - % of avg. assets							
Net interest income	3.4	3.5	3.9	3.9	3.9	3.7	3.5
Interest restructuring premium	—	—	—	—	—	—	—
Loan loss provisions	(0.0)	(0.0)	—	—	—	0.1	0.1
Adj. Net interest income	3.4	3.5	3.8	3.9	3.9	3.6	3.4
Net other operating income	0.1	0.1	—	0.0	0.1	0.1	0.1
Other income	0.3	—	(0.4)	0.2	—	—	—
Operating expenses	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Other expenses & extraordinary	—	(0.0)	—	—	—	—	—
(1- tax rate)	65.2	67.5	99.0	78.2	74.0	74.0	74.0
ROA	2.4	2.4	3.2	3.1	2.9	2.7	2.5
Average assets/average equity	5.4	5.7	5.9	6.2	6.7	7.3	7.8
ROE	12.7	13.5	18.9	19.0	19.3	19.5	19.6
RoE (incl def tax)	13.1	12.8	13.8	19.0	19.3	19.4	19.6

Source: Company, Kotak Institutional Equities estimates

PFC: Income statement and balance sheet, March fiscal year-ends, 2007-2013E (Rs mn)

	2007	2008	2009	2010	2011E	2012E	2013E
Income statement (Rsmn)							
Total interest income	37,171	48,833	64,534	79,214	104,007	133,191	167,254
Adj. interest (after rebate for timely)	37,035	48,452	63,965	78,634	103,007	131,941	165,754
Other interest income	136	381	569	580—	1,000	1,250	1,500
Total interest expense	22,948	30,968	40,859	49,324	66,221	87,960	114,211
Net interest income	14,223	17,865	23,675	29,890	37,785	45,231	53,043
Loan loss provisions	(49)	(105)	37	(6)	182	1,158	1,444
Other operating income	264	602	173	136	1,000	1,200	1,400
Other income	1,110	108	(2,525)	1,184	—	—	—
Net total income	15,597	18,574	21,323	31,209	38,785	46,431	54,443
Operating expenses	492	810	1344	1058	1149	1452	1806
Depreciation	38	45	38	34	34	34	34
PBT	15,116	17,876	19,905	30,134	37,421	43,787	51,159
Tax	5,253	5,809	205	6,562	9,729	11,385	13,301
PAT	9,863	12,067	19,699	23,573	27,691	32,403	37,858
PAT (incl def tax/normalised)	11,547	13,043	15,310	23,573	27,691	32,403	37,858
PBT + provisions-interest on restruction premium	15,067	17,771	19,941	29,983	37,602	44,945	52,603
EPS (Rs)	8.6	10.5	17.2	20.5	24.1	28.2	33.0
% growth	(8.8)	22.3	63.3	19.7	17.5	17.0	16.8
DPS(Rs)	2.3	3.5	4.0	4.5	4.8	5.6	6.6
BPS (Rs)	74.9	81.3	100.3	115.5	134.0	155.6	180.9
EPS (incl def tax Rs)	11	11	13	21	24	28	33
BPS (incl def tax Rs)	85	92	101	116	134	156	181
ABVPS (Rs)	73	77	96	110	132	148	172
ABVPS (incl def tax Rs)	83	88	96	110	132	149	173
Balance sheet (Rs mn)							
Assets							
Fixed Assets (Net)	817	770	752	745	699	676	654
Total Loan Assets	439,028	515,683	644,290	798,558	1,019,527	1,296,199	1,591,904
Total Current Assets, Loans & Advances	26,203	29,896	36,686	48,155	47,224	55,997	64,075
Total Assets	466,637	547,005	682,086	847,771	1,067,450	1,352,872	1,656,633
Unsecured Loans	335,842	406,478	521,602	671,084	864,741	1,119,732	1,387,689
Total current liabilities	11,882	12,125	18,606	21,245	22,103	23,005	23,951
Deferred tax liability	11,426	12,403	555	469	469	469	469
Interest Subsidy Fund from GOI	12,316	10,668	9,089	6,635	6,635	6,635	6,635
Total liabilities	380,706	453,706	567,007	715,164	913,628	1,174,226	1,448,984
Paid up capital	11,478	11,478	11,478	11,478	11,478	11,478	11,478
Reserves & surplus	74,453	81,821	103,601	121,130	142,345	167,168	196,171
Total equity	85,931	93,298	115,078	132,608	153,822	178,646	207,649

Source: Company, Kotak Institutional Equities estimates

JANUARY 17, 2011

UPDATE

BSE-30: 18,882

Hang in there; second half will likely be better. We have made a few minor changes to our Model Portfolio to take advantage of severe volatility in stock prices and large correction in certain high quality stocks. We continue to be overweight banking, metals and technology sectors—(1) banking in light of inexpensive valuations and NIMs likely surprising on the upside compared to Street expectations and (2) metals and technology given their exposure to global economic recovery. We continue to avoid infrastructure owners, high-debt companies and domestic consumption companies with low pricing power. Our BSE-30 Index fair valuation based on FY2012E and FY2013E estimates remains 21,000 (6-9 months target) and 24,000 (15-18 months target).

Tweaking the portfolio a bit

We have increased the weight on private banks (HDFC Bank and ICICI Bank) to take advantage of the recent correction in their stock prices and reduced weight on HDFC and some infrastructure and utilities stocks (already quite underweight) and Grasim (strong outperformance over the past few months). We continue to be overweight on PSU banks. We believe that banks have strong pricing power in the current tight-liquidity environment and banks with high CASA will be able to defend their NIMs; we also note that CASA as a proportion of total incremental deposits has gone up significantly in the past six quarters for the banking system. Among other major changes, we have included Wipro in place of GAIL and ICICI Bank instead of Jaiprakash Industries (admittedly a big disappointment) in the Top-10 List.

2HCY11E—earnings, government action, crude oil prices key triggers for the Indian market

We currently model 21% earnings growth for FY2012E for the BSE-30 but see downside risks to earnings of several sectors, particularly sectors with (1) high exposure to global commodities as inputs such as automobiles, consumers and energy and (2) high debt such as infrastructure (owners), real estate, telecom and utilities. We are underweight all these sectors. We rule out meaningful government action without lower inflation, which in turn would depend on softer commodity (particularly crude oil) prices. We see inflation turning more benign over the next few months (more due to base effects than price declines) and crude prices declining from current high levels; large QE2-led speculation has pushed up commodity prices well above fundamental levels, in our view.

1HCY11E—budget may be key but unlikely to be a big event

Current high inflation, an inflamed political environment and the government's weak fiscal position may preclude any radical policy changes in the FY2012 Union Budget. The government's resolve, if any, to tackle burgeoning fertilizer, food and fuel subsidies may be a good indicator of its attitude towards fiscal consolidation; the latter will be construed positively by the market. Reduction of taxes on crude (import duty) and diesel and gasoline (excise duty) may reduce the under-recoveries on selling fuels at a discount to global prices but also lead to lower tax revenues.

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Revised portfolio slightly but basic theme remains the same

Exhibit 1 gives our revised Model Portfolio. Our last changes were on November 16, 2010 when we had over-weighted metals and cut positions in infrastructure and utilities sectors. We have been overweight on the banking and technology sectors for the past 15 months. Our basic thesis is unchanged but we have made a few changes to our Model Portfolio to take advantage of the recent correction in stock prices of certain high quality stocks and divergent movement in some others.

We recommend large overweight positions in banking, metals and technology sectors
Kotak Institutional Equities Model Portfolio

Company	17-Jan		Weightage (%)		Diff. (bps)	Company	17-Jan		Weightage (%)		Diff. (bps)
	Price (Rs)	Rating	BSE-30	KS reco.			Price (Rs)	Rating	BSE-30	KS reco.	
Bajaj Auto	1,268	REDUCE	1.2	1.2	—	Larsen & Toubro	1,680	ADD	6.1	6.1	—
Hero Honda	1,788	REDUCE	1.2	—	(119)	Industrials/Construction			8.6	6.1	(250)
Mahindra & Mahindra	738	BUY	2.2	3.2	100	Hindalco Industries	225	ADD	2.0	3.0	100
Maruti Suzuki	1,270	BUY	1.2	1.2	—	Jindal Steel and Power	670	REDUCE	1.9	—	(187)
Tata Motors	1,179	ADD	3.4	1.4	(200)	Sterlite Industries	170	BUY	1.9	3.4	150
Automobiles			9.2	7.0	(219)	Tata Steel	626	NR	2.8	4.3	150
Bank of Baroda	829	BUY	—	1.5	150	Metals			8.6	10.7	213
Indian Bank	206	ADD	—	1.5	150	Cipla	347	REDUCE	1.2	—	(121)
Punjab National Bank	1,134	BUY	—	1.0	100	Pharmaceuticals			1.2	—	(121)
State Bank of India	2,516	BUY	4.8	6.3	150	DLF	250	ADD	0.7	0.7	—
Union Bank	314	BUY	—	1.5	150	Real estate			0.7	0.7	—
PSU Banking			4.8	11.8	700	Infosys Technologies	3,269	BUY	10.6	12.1	150
HDFC	664	REDUCE	5.7	3.7	(200)	TCS	1,137	BUY	4.5	6.0	150
HDFC Bank	2,068	ADD	5.1	6.6	150	Wipro	467	ADD	1.9	3.4	150
ICICI Bank	1,001	ADD	7.7	9.2	150	Technology			17.0	21.5	450
Pvt. Banking/Financing			18.5	19.5	100	Bharti Airtel	349	REDUCE	3.1	—	(309)
Jaiprakash Associates	88	BUY	0.7	0.7	—	Reliance Communications	132	SELL	0.7	—	(66)
Cement			0.7	0.7	—	Telecom			3.7	—	(374)
Hindustan Unilever	302	SELL	2.2	—	(219)	Lanco Infratech	55	BUY	—	1.0	100
ITC	172	ADD	6.1	7.1	100	NTPC	187	ADD	2.1	—	(206)
Consumers			8.3	7.1	(119)	Reliance Infrastructure	735	BUY	0.8	—	(79)
Bharat Petroleum	586	BUY	—	1.0	100	Tata Power	1,342	ADD	1.5	1.5	—
Oil & Natural Gas Corporation	1,170	BUY	3.3	4.8	150	Utilities			4.4	2.5	(184)
Reliance Industries	998	REDUCE	10.9	6.4	(445)	BSE-30			18,882	100.0	100.0
Energy			14.2	12.3	(195)						
Bharat Heavy Electricals	2,186	ADD	2.5	—	(250)						

Notes:

(a) Weights are with respect to January 17, 2011 prices.

Source: Company, Kotak Institutional Equities estimates

- ▶ We avoid stocks that have downside risks to earnings from high input costs (automobiles), high interest rates (infrastructure owners, real estate and utilities), limited pricing power accompanied by expensive valuations (certain consumer stocks) and companies with poor corporate governance (the lesser said, the better); this approach precludes a large section of the investible universe currently.
- ▶ We focus on stocks that will benefit from ongoing global economic recovery (metals, technology) or have pricing power (banks and few select stocks).
- ▶ Among the key changes to our Model Portfolio, we have increased weight on private banks such as HDFC Bank and ICICI Bank at the expense of certain stocks in the banking sector (HDFC), cement (Grasim), infrastructure and utilities sectors. We were already quite underweight the latter two sectors in our portfolio. Among other changes, we have replaced (1) GAIL with Wipro on increasing concerns about lower-than-expected gas transmission volumes from lower-than-expected gas production from RIL's KG D-6 block and (2) Jaiprakash Associates with ICICI Bank. Exhibit 2 is our revised Top-10 List.

We include ICICI Bank and Wipro in Top-10
Kotak Institutional Equities Top-10 List

Companies	Sector	Rating	Mkt cap. (US\$ mn)	CMP (Rs)	Target (Rs)	EPS (Rs)			P/E (X)			EV/EBDITA (X)		
						2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E
Infosys Technologies	Technology	BUY	41,183	3,269	3,700	108.3	120.0	155.2	30.2	27.2	21.1	22.3	19.0	14.6
ICICI Bank	Banking	ADD	25,290	1,001	1,230	36.1	45.0	58.0	27.7	22.3	17.3	—	—	—
State Bank of India	Banking	BUY	35,063	2,516	3,500	144.4	176.6	224.1	17.4	14.2	11.2	—	—	—
Oil & Natural Gas Corporation	Energy	BUY	54,932	1,170	1,500	90.3	115.0	137.9	13.0	10.2	8.5	4.5	3.9	3.3
TCS	Technology	BUY	48,861	1,137	1,250	35.1	43.4	53.2	32.4	26.2	21.4	24.8	19.2	15.1
Mahindra & Mahindra	Automobiles	BUY	9,677	738	875	33.9	45.9	51.8	21.8	16.1	14.2	14.3	11.4	10.0
Wipro	Technology	ADD	25,065	467	525	18.9	21.6	25.7	24.8	21.6	18.2	18.8	15.7	12.6
Hindalco Industries	Metals & Mining	ADD	9,446	225	255	20.0	15.0	16.9	11.3	15.0	13.3	6.4	8.4	8.6
Sterilite Industries	Metals & Mining	BUY	12,525	170	200	12.0	13.7	18.3	14.1	12.4	9.3	9.0	7.4	4.6
PSU bank basket														
Bank of Baroda	Banking	BUY	6,655	829	1,250	83.7	103.0	121.2	9.9	8.1	6.8	—	—	—
Indian Bank	Banking	ADD	1,942	206	350	35.1	35.7	44.9	5.9	5.8	4.6	—	—	—
Punjab National Bank	Banking	BUY	7,848	1,134	1,500	123.9	139.8	165.9	9.2	8.1	6.8	—	—	—
Union Bank	Banking	BUY	3,486	314	450	41.1	42.4	56.1	7.7	7.4	5.6	—	—	—
BSE-30				18,882										

Source: Company, Kotak Institutional Equities estimates

Earnings—risks have increased from continued high inflation, interest rates

Our portfolio reflects our concerns about earnings for several sectors. We currently model 22.7% and 20.9% net profit growth for the BSE-30 Index for FY2011E and FY2012E (translating into unadjusted 'EPS' of ₹1,100 and ₹1,331 and adjusted (free-float basis) 'EPS' of ₹1,041 and ₹1,258). Exhibit 3 gives the earnings growth broken down by sectors for the BSE-30 Index and their corresponding valuation parameters.

BSE-30 Index is trading at 17.2X FY2011E and 14.2X FY2012E basis

Valuation summary of BSE-30 sectors, March fiscal year-ends, 2010-2012E

	Mkt cap. (US\$ mn)	Adj. mkt cap. (US\$ mn)	EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Div. yield (%)			RoE (%)		
			2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E
Automobiles	50,815	30,406	424.5	94.3	10.3	24.3	12.5	11.3	11.8	8.1	7.2	6.6	4.1	3.2	1.2	1.0	27.2	33.1	27.8	
Banking	102,043	76,511	9.0	25.3	25.7	24.5	19.6	15.6	—	—	—	3.0	2.7	2.4	1.0	1.2	12.3	13.8	15.4	
Consumers	43,319	27,434	14.7	17.4	17.7	32.3	27.5	23.3	20.4	16.9	14.2	11.3	9.5	8.1	2.8	2.0	35.1	34.7	34.7	
Diversified	4,292	2,360	(8.0)	153.2	41.1	50.5	19.9	14.1	17.3	12.9	9.9	2.3	2.0	1.8	—	—	4.5	10.1	12.8	
Energy	120,115	46,837	2.2	22.6	21.9	15.4	12.6	10.3	6.8	5.5	4.5	2.0	1.8	1.6	1.7	3.3	12.7	14.4	15.6	
Industrials	45,800	28,302	28.6	31.8	17.6	26.8	20.3	17.3	15.1	11.4	9.6	5.5	4.4	3.7	0.8	0.9	20.4	21.7	21.1	
Metals	48,801	28,231	(38.7)	62.5	20.4	20.0	12.3	10.2	8.9	7.1	5.9	2.4	2.0	1.7	0.6	0.7	12.0	15.8	16.2	
Pharmaceuticals	6,112	3,973	40.4	3.5	19.2	25.7	24.8	20.8	18.2	16.7	14.2	4.7	4.1	3.5	0.6	0.7	18.3	16.5	16.9	
Property	9,420	2,355	(60.1)	27.8	55.2	23.8	18.6	12.0	16.2	11.7	8.6	1.4	1.3	1.2	0.8	1.2	5.9	7.2	10.3	
Technology	115,110	55,930	19.3	16.9	23.8	29.7	25.4	20.5	20.9	17.1	13.3	8.2	7.0	5.7	1.2	1.5	27.8	27.5	27.9	
Telecom	35,211	12,324	(6.3)	(40.8)	20.2	11.6	19.6	16.3	7.8	9.1	7.3	1.9	1.7	1.6	0.1	—	16.1	8.7	9.5	
Utilities	45,439	14,450	9.6	0.1	17.7	17.8	17.8	15.1	11.2	11.6	10.5	2.1	1.9	1.8	1.7	1.7	12.0	11.0	11.9	
BSE-30	626,477	329,114	4.7	22.7	20.9	21.1	17.2	14.2	10.8	9.1	7.6	3.1	2.8	2.4	1.3	1.6	14.9	16.0	16.9	
BSE-30 ex-Energy	506,361	282,276	5.6	22.8	20.6	23.1	18.8	15.6	13.0	10.9	9.1	3.7	3.1	2.7	1.2	1.2	15.9	16.7	17.5	
BSE-30 ex-Energy, Com.	457,560	254,045	16.1	17.8	20.7	23.5	19.9	16.5	14.1	11.9	9.9	3.9	3.4	2.9	1.2	1.2	16.6	16.9	17.7	

Source: BSE, Kotak Institutional Equities estimates

We discuss earnings drivers and risks for a few sectors (1) where our views on earnings may differ from consensus such as banking (positive versus Street view) and consumer (negative versus Street view) and (2) whose earnings are relevant for the market (energy and metals) but can be quite volatile depending on global and domestic issues. Exhibit 4 gives the breakdown of net profits and incremental net profits by sectors for the BSE-30 Index.

Scope for upside surprises may be limited in FY2012E given our 21% earnings growth forecast
Break-up of earnings of BSE-30 Index across sectors, March fiscal year-ends, 2008-12E

	Net profit (Rs bn)					Contribution (%)					Incremental profits			
											2011E		2012E	
	2008	2009	2010	2011E	2012E	2008	2009	2010	2011E	2012E	(Rs bn)	(%)	(Rs bn)	(%)
Automobiles	63	18	95	185	204	5	1	7	11	10	90	29	19	5
Banking	149	174	190	238	299	12	13	14	14	15	48	16	61	18
Consumers	49	53	61	72	85	4	4	5	4	4	11	3	13	4
Diversified	6	4	4	10	14	0	0	0	1	1	6	2	4	1
Energy	346	348	356	436	531	28	27	26	26	26	80	26	95	27
Reliance Industries	147	153	162	190	236	12	12	12	11	12	28	9	46	13
Industrials	51	61	78	103	121	4	5	6	6	6	25	8	18	5
Metals	134	181	111	181	217	11	14	8	11	11	69	23	37	11
Pharmaceuticals	7	8	11	11	13	1	1	1	1	1	0	0	2	1
Property	79	45	18	23	36	6	3	1	1	2	5	2	13	4
Technology	128	148	177	207	256	10	11	13	12	13	30	10	49	14
Telecom	124	147	138	82	98	10	11	10	5	5	(56)	(18)	16	5
Utilities	93	106	117	117	137	8	8	9	7	7	0	0	21	6
BSE-30	1,229	1,294	1,355	1,663	2,011	100	100	100	100	100	308	100	348	100
BSE-30 change (%)		5.3	4.7	22.7	20.9									
BSE-30 ex-energy change (%)		7.2	5.6	22.8	20.6									

Source: BSE, Kotak Institutional Equities estimates

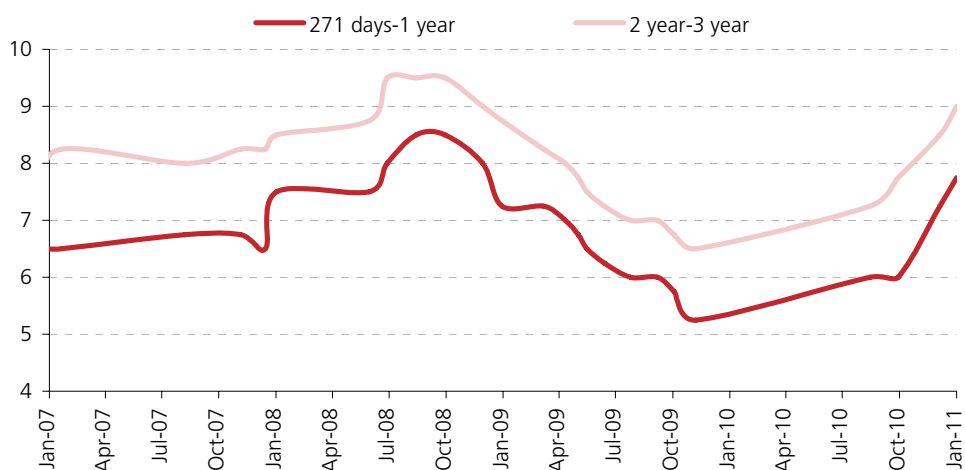
- ▶ **Banking.** We expect banks' NIMs to hold up quite well given their strong pricing power in a tight-liquidity environment and their high CASA deposits. (1) We note that banks have raised lending rates (see Exhibit 5) to match the increase in deposit rates (see Exhibit 6) over the past few months. We would clarify that revised deposit rates apply to new deposits only while revised lending rates apply to the entire lending book. Thus, there need not be a one-to-one correspondence in changes in deposit and lending rates. (2) Banks' CASA deposits have increased significantly over the past six quarters; rates on CASA (SA rate is unchanged at 3.5% for the past several years; CA is anyway at 0%) will not move up to the same extent as fixed deposits' rates. Exhibit 7 shows that CASA deposits have contributed to 57% of the increase in total deposits of the banks under our coverage over the past six quarters. Thus, we are not overly perturbed by the increase in interest rates even though we expect credit growth to slow down from the scorching 24% currently and current tight liquidity conditions to ease once government expenditure increases over the next few weeks.

Banks have been proactively increasing lending rates PLR and base rate by banks

	2QFY11	Initial PLR	3QFY11	Effective PLR	Initial base rate	3QFY11	Revised base rate
Andhra Bank		12.50	5-Oct-10	12.75	8.25	6-Oct-10	8.50
			13-Dec-10	13.00		13-Dec-10	9.00
			23-Dec-10	13.25			
Bank of Baroda	6-Aug-10	12.50	13-Dec-10	13.25	8.00	5-Oct-10	8.50
						13-Dec-10	9.00
Bank of India	14-Aug-10	12.50	15-Dec-10	13.25	8.00	6-Oct-10	8.50
						15-Dec-10	9.00
Canara Bank		12.00	12-Aug-10	12.50	8.00	1-Oct-10	8.50
						13-Dec-10	9.00
Indian Bank	2-Jul-09	12.50	1-Oct-10	12.75	8.00	1-Oct-10	8.50
			1-Dec-10	13.00	8.00	1-Oct-10	8.50
			13-Dec-10	13.25		13-Dec-10	9.00
OBC	6-Aug-10	12.50	15-Dec-10	13.25	8.00	1-Oct-10	8.50
						15-Dec-10	9.00
PNB	1-Aug-10	11.75	8-Dec-10	12.50	8.00	1-Oct-10	8.50
						13-Dec-10	9.00
SBI	16-Aug-10	12.25	21-Oct-10	12.50	7.50	21-Oct-10	7.60
						3-Jan-11	8.00
Union Bank	4-Aug-10	12.25	18-Dec-10	13.25	8.00	15-Oct-10	8.50
						27-Dec-10	9.00

Source: Company, Kotak Institutional Equities

Banks have raised lending rates to match the increase in deposit rates Deposit rate movement, March fiscal year-ends, 2007-11



Source: Company, Kotak Institutional Equities

CASA deposits have grown strongly in recent quarters

Deposits and CASA of major banks, 1QFY10-2QFY11 (Rs bn)

	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	Total
Incremental deposits	480	764	411	2,294	599	1,724	6,272
Incremental CASA deposits	19	807	455	1,252	171	858	3,562
CASA proportion to total deposits	4.0	105.6	110.7	54.6	28.5	49.8	56.8

Source: Company, Kotak Institutional Equities

- ▶ **Consumers.** We see earnings pressures from (1) high raw material costs and pressure on profitability given limited pricing power in some cases (HUL, Jyothy, Marico and Tata Global Beverages), (2) higher spending on food given high food inflation for the urban poor that may lead to some amount of down-trading in consumer products; the urban poor segments accounts for about 25% of the total consumption of consumer staples and (3) increased competition from MNC players in the more profitable segments (personal products) and diversification of Indian players into new segments. Also, we do not see the sector offering its historical defensive characteristics at 24.8X FY2012E earnings (average for KIE coverage universe) and in light of potential downside risks to earnings.
- ▶ **Energy.** We see downside risks to earnings of RIL from lower-than-expected gas production. Our FY2012E EPS will decline by 7.6% to ₹67 if gas production from KG D-6 block is 52 mcm/d versus 70 mcm/d assumed by us currently. Also, in case income tax exemption is not available on gas production, our FY2012E EPS will decline by 8.8% to ₹66. We see limited scope for positive earnings surprises for the chemical and refining segments since we model very strong chemical margins and US\$9.3/bbl refining margin for FY2012E (compared to US\$7.7/bbl in 1HFY11) and US\$8.2/bbl in FY2011E.

In the case of ONGC, we see downside risks from higher-than-expected subsidy burden. Our base-case earnings scenario assumes US\$85/bbl (Dated Brent) crude price for FY2012E and diesel deregulation from October 1, 2012, which results in a net realized price of US\$62.3/bbl for crude oil for FY2012E versus US\$55.7/bbl in 1HFY11. We note that oil companies would need to increase diesel prices by ₹3.8/liter (quite manageable given the current average selling price is ₹40/liter in the four major metros) to earn reasonable marketing margins at US\$85/bbl crude oil price. ONGC's FY2012E EPS could decline to ₹119, if we assume US\$56/bbl net crude oil price realization. We note that ONGC had reported an EPS of ₹93 in FY2009 when gross under-recoveries had gone up to ₹1.06 tn compared to our estimated ₹656 bn for FY2012E. The government has deregulated APM gas price since then, which has added about ₹20 to ONGC's earnings on a full-year basis.

We would clarify that ONGC also benefits from higher crude oil prices although its net realization will be stable at US\$54-57/bbl range if the government does not change domestic selling prices of diesel, kerosene and LPG in FY2012E and crude prices stay in the range of US\$90-100/bbl. This scenario, of course, assumes that the upstream companies will bear one-third of gross under-recoveries.

- ▶ **Metals.** This is one of the few sectors where we see upside risks to our earnings estimates currently. Exhibit 8 shows that our FY2012E price and margin assumptions for most metals are quite conservative compared to current spot prices. We expect the metals sector to contribute to 11% of FY2012E net profits of the BSE-30 Index and 10% of incremental profits for FY2012E.

We are comfortable with our earnings estimates of metal companies given sufficient buffers
Price assumptions for metal companies, March fiscal year-ends, 2011-12E (US\$/ton)

	Price assumptions		Historical prices	
	2011E	2012E	Spot	5-year avg.
Non-Ferrous				
Hindalco Industries				
Aluminium	2,050	2,150	2,453	2,285
Copper	7,500	7,600	9,662	6,120
Hindustan Zinc				
Zinc	2,000	2,150	2,445	2,337
Lead	2,000	2,150	2,711	1,797
Nalco				
Aluminium	2,050	2,150	2,453	2,283
Sterlite Industries				
Zinc	2,000	2,150	2,445	2,337
Lead	2,000	2,150	2,711	1,797
Copper	7,500	7,600	9,662	6,211
Aluminium	2,050	2,150	2,453	2,289
Ferrous				
Jindal Steel and Power				
HRC price	728	730	725	646
JSW Steel				
HRC price	728	730	725	646
Sesa Goa				
Benchmark Iron ore price	126	126	155	80

Source: Bloomberg, Company, Kotak Institutional Equities estimates

High interest rates, fuel prices pose additional risks to earnings

We also highlight risks to earnings for the market from high interest rates. High debt companies in the infrastructure, real estate, telecom and utilities sectors may face additional earnings risks other than those from weaker-than-expected operating conditions. Interest rates have gone up significantly over the past 3-4 months and can surprise negatively, if inflation turns out to be stickier versus our expectations.

Exhibit 9 shows the risks to interest expenses for companies under our coverage. We assume 200 bps higher interest rates for FY2012E versus in FY2011E for this exercise. We note that this is a hypothetical exercise and several companies have overseas borrowings, where rates may not go up significantly. Nonetheless, many of these companies face related risks of depreciation in the value of the Indian Rupee versus the currency of the foreign loans, which would impact earnings negatively (through increase in their foreign currency loans) even if their LIBOR-linked borrowing costs do not change meaningfully.

Risks to earnings for the market from high interest rates
Risks to interest expenses for companies under our coverage

Company	Avg o/s net debt	Interest paid (Rs)		EPS (Rs)		Remarks
	2012E	Base-case	New	Base-case	New	
Bajaj Auto	(69,575)	(4,992)	(6,166)	98	101	Interest free loan of Rs 10.7 bn
Bharat Forge	8,336	1,034	1,201	20	19	
Hero Honda	(65,548)	(4,904)	(5,804)	111	115	
Mahindra & Mahindra	3,601	366	438	52	52	
Maruti Suzuki	(73,884)	(4,757)	(5,682)	95	98	Export credit of Rs 3.75 bn, rest is term loan from bank
Tata Motors	210,311	15,331	19,559	144	139	
Ashok Leyland	28,781	(2,167)	(2,743)	4.7	4.4	
ACC	(29,587)	(296)	(789)	64	65	
Ambuja Cements	(18,600)	(489)	(793)	9.0	9.0	
Grasim Industries	7,554	1,612	1,925	239	237	Interest free sales tax deferral loan of Rs4.2 bn
India Cements	15,477	970	1,165	7.9	7.5	Includes zero coupon bonds of Rs3.5 bn
Shree Cement	(3,413)	65	(317)	239	249	Interest free sales tax deferral loan results in net interest income upon 200 bps increase
UltraTech Cement	9,229	1,418	1,748	93	88	Interest free sales tax deferral loan of Rs4.2 bn
IVRCL	21,995	2,345	2,785	10	9.2	
Nagarjuna Construction Co.	19,526	1,531	1,922	11	10	
Punj Lloyd	34,398	4,093	4,781	12	11	
Sadbhav Engineering	5,278	655	760	8.7	8.2	
Asian Paints	(3,005)	(225)	(286)	102	103	
Colgate-Palmolive (India)	(5,498)	(236)	(346)	37	38	
Dabur India	(6,879)	(440)	(577)	3.8	3.9	
GlaxoSmithkline Consumer (a)	(8,321)	(216)	(383)	84	88	
Godrej Consumer Products	10,519	679	894	17	17	
Hindustan Unilever	(20,504)	(1,422)	(1,824)	12	12	
ITC	(63,772)	(4,469)	5,739	7.6	7.8	
Jubilant Foodworks	(787)	(39)	(54)	13	13	
Jyothy Laboratories	(3,288)	(272)	(339)	15	16	
Nestle India (a)	(2,022)	(99)	(140)	108	110	
Tata Global Beverages	(6,534)	(405)	(536)	6.6	6.8	
Marico	(364)	(17)	(24)	5.4	5.4	
Titan Industries	(1,008)	(52)	(73)	111	111	
United Spirits	50,485	5,402	6,412	47	41	
Bharat Petroleum	119,874	6,036	8,434	60	55	
Cairn india	15,239	1,744	2,049	44	44	
Castrol India	(4,583)	(350)	(442)	22	22	
GAIL (India)	47,326	4,560	5,506	36	35	
GSPL	12,137	1,316	1,559	7.3	7.0	
Hindustan Petroleum	139,017	7,547	10,328	49	43	
Indian Oil Corporation (standalone)	295,474	13,994	19,903	39	38	
Oil India	(96,214)	(6,837)	(8,761)	159	164	
ONGC (standalone)	(271,157)	(16,317)	(21,740)	134	136	
Petronet LNG	31,416	3,212	3,840	8.3	7.7	
Reliance Industries	100,180	3,306	5,309	72	72	
Aban Offshore	113,730	7,438	9,713	124	71	
ABB	(8,774)	(667)	(842)	31	32	
BGR Energy Systems	6,666	838	971	53	52	
Bharat Electronics	(39,829)	(2,693)	(3,490)	118	125	
Bharat Heavy Electricals	(104,470)	(6,779)	(8,868)	139	141	
Crompton Greaves	(9,493)	(578)	(768)	17	17	
Larsen & Toubro	76,217	5,346	6,871	75	74	
Maharashtra Seamless	(8,539)	(558)	(726)	42	45	
Siemens	(29,422)	(1,327)	(1,915)	34	35	
Suzlon Energy	83,178	8,209	9,872	3.3	2.6	
Thermax	(5,074)	(384)	(485)	42	43	
Voltas	(9,230)	(130)	(315)	13	14	
Container Corporation	(24,834)	(1,695)	(2,192)	78	81	
GVK Power & Infrastructure	52,842	2,673	3,729	1.5	1.0	
IRB Infrastructure	42,519	3,699	4,550	12	11	
GMR Infrastructure	149,172	12,302	15,286	0.1	(0.5)	
Mundra Port and SEZ	11,277	587	812	6.1	6.0	
DB Corp	(580)	(5)	(20)	14	14	
Dish TV	6,250	700	825	0.2	0.1	Low rate foreign currency cash and high cost domestic debt
HT Media	(4,410)	(365)	(455)	8.3	8.5	Low cost foreign currency debt leads to financial leverage
Hindustan Media Ventures	(1,800)	(115)	(150)	11	11	
Jagran Prakashan	(2,050)	(170)	(210)	7.6	7.7	Low cost foreign currency debt leads to financial leverage
Sun TV Network	(7,080)	(500)	(650)	23	23	
Zee Entertainment Enterprises	(10,870)	(825)	(1,050)	7.1	7.3	
Hindalco Industries	258,733	10,627	15,589	17	15	
National Aluminium Co.	(51,539)	(3,691)	(4,673)	19	20	
Jindal Steel and Power	32,442	888	331	55	55	

Source: Company, Kotak Institutional Equities estimates

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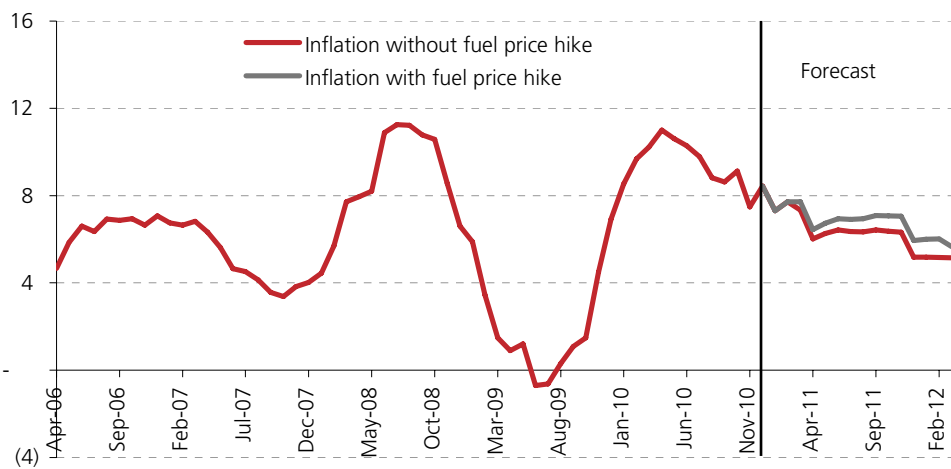
Risks to earnings for the market from high interest rates
Risks to interest expenses for companies under our coverage

Company	Avg o/s net debt	Interest paid (Rs)		EPS (Rs)		Remarks
	2012E	Base-case	New	Base-case	New	
JSW Steel	130,890	8,443	9,982	108	104	
Hindustan Zinc	(172,984)	(10,490)	(13,942)	116	122	
Sesa Goa	(25,957)	2,648	2,799	54	54	
Sterlite Industries	(161,391)	(14,257)	(17,323)	18	19	
Coal India	(527,612)	(31,199)	(40,734)	21	22	
Havells India	8,138	556	716	29	28	90% of the debt consists of dollar loans raised for acquisition of sylvania
Jaiprakash Associates	430,673	37,421	43,959	6.2	5.2	~Rs36 bn of secured NCDs not impacted by changed interest rate. Interest paid does not include interest capitalized
Sintex	17,573	518	861	14	13	Debt contains \$225 mn of FCCB where interest is not paid
Jet Airways	109,694	6,882	9,105	94	68	Most of the debt Rs95 bn is denominated in US \$; The interest rate on Rs debt is taken at 12%
SpiceJet	(2,409)	85	116	8.9	8.9	Debt has been taken from Canadian Exim bank at fixed rate of interest (5.5%) for 12 years
Dishman Pharma & chemicals	6,470	410	550	21	19	
GlaxoSmithKline Pharmaceuticals (a)	(24,330)	1,140	1,600	80	83	
Jubilant Life Sciences	25,221	1,400	1,900	25	23	
Lupin	5,790	300	440	24	24	
Cadila Healthcare	2,972	600	770	39	38	
Apollo Hospitals	5,310	580	700	21	20	
DLF	181,875	21,345	25,073	21	20	Impact on EPS is low due to interest capitalization
Housing Development & Infrastructure	24,324	4,329	4,897	29	29	Impact on EPS is low due to interest capitalization
Indiabulls Real Estate	12,788	2,011	2,272	8.5	8.1	Impact on EPS is low due to interest capitalization
Mahindra Life Space Developer	(3,596)	(144)	(216)	31	32	
Phoenix Mills	1,042	127	163	7.7	7.6	Impact on EPS is low due to interest capitalization
Puravankara Projects	9,422	1,114	1,308	8.8	8.6	Impact on EPS is low due to interest capitalization
Unitech	48,133	6,547	7,520	5.1	5.0	Impact on EPS is low due to interest capitalization
Sobha Developers	10,074	1,244	1,447	23	22	Impact on EPS is low due to interest capitalization
Oberoi Realty	(17,918)	(717)	(1,075)	30	31	
Bajaj Hindustan	26,441	1,067	1,586	12	9.5	Debt consists of an FCCB of Rs5 bn and ECB of Rs 4 bn. The company gets loans at subsidised rates from the government (~7%). Also, it has large loans and advances on which it gets interest income
Balrampur Chini Mills	2,019	129	169	11	10	The company has ECBs. Also, it get loans from government at subsidised rate of interest
Shree Renuka Sugars	35,514	2,830	3,551	7.3	6.2	The debt includes Brazilian business where debt is a mixture of real and US \$
Mahindra Satyam	(21,669)	(1,462)	(1,895)	4.1	4.4	
HCL Technologies	(7,253)	(242)	(387)	29	29	
Hexaware Technologies	(4,770)	(357)	(452)	10	11	
Infosys Technologies	(205,772)	(13,985)	(18,100)	155	161	
Mphasis BFL	(19,312)	(764)	(1,150)	49	50	
Mindtree	(1,716)	(120)	(154)	41	41	
Patni Computer Systems	(11,480)	(909)	(1,138)	37	38	
Polaris Software Lab	(6,090)	(294)	(415)	21	22	
TCS	(86,382)	(5,687)	(7,414)	53	54	
Tech Mahindra	8,609	735	907	69	68	
Wipro	(80,098)	(6,216)	(7,818)	26	26	
Bharti Airtel	616,513	31,364	43,694	20	18	
IDEA	144,375	11,477	14,364	0.9	0.2	
Reliance Communications	335,736	18,299	25,013	9.2	6.6	
Adani Power	205,407	22,466	26,188	19	18	
CESC	35,592	3,115	3,658	43	42	No earnings impact of higher interest cost as it is a pass through
Lanco Infratech	163,807	21,270	24,282	5	5	Limited EPS impact as ~65% of power will be sold with interest pass through
NTPC	477,927	27,529	34,728	12	12	No earnings impact of higher interest cost as it is a pass through. Interest income earned from Rs98 bn of 8.5% tax-free bond not impacted
Reliance Infrastructure	57,116	2,576	3,668	70	65	Earnings impact from business which do not have interest pass through (Roads, Metro)
Reliance Power	470,651	36,066	43,177	5	5	
Tata Power	253,646	18,525	22,643	88	88	Most of interest expense pass through. ~Rs20 bn of secured NCDs not impacted by changed interest rate
NHPC	105,476	3,017	5,037	1.6	1.7	No earnings impact of higher interest cost as it is a pass through. Interest income earned from Rs10 bn of 8.5% tax-free bond not impacted

Source: Company, Kotak Institutional Equities estimates

Exhibit 10 gives our inflation trajectory as measured by WPI. We expect inflation to average 6.5% in FY2012E assuming crude oil prices revert to more reasonable levels of US\$85/bbl (Dated Brent) and the government does not have to increase domestic fuel prices to levels corresponding to current crude price levels (US\$98/bbl). We take comfort from the fact the crude oil fundamentals look reasonable with a significant amount of 'OPEC' spare capacity in CY2011E (see Exhibit 11). It would seem that high speculation (see Exhibit 12) has pushed up crude prices well above fundamental levels. However, it is hard to predict commodity prices given so many divergent factors. If crude prices stay above US\$95/bbl, India will have no option but to increase diesel prices during the course of the year. This will result in higher freight costs and impact earnings negatively for companies in the cement sector. We do not rule out negative impact on automobile volumes also given high cost of ownership of cars in a high-interest rate environment.

Inflation might surprise on the higher side with diesel and gasoline price hikes
 WPI inflation (yoy change), 2006-12E (%)



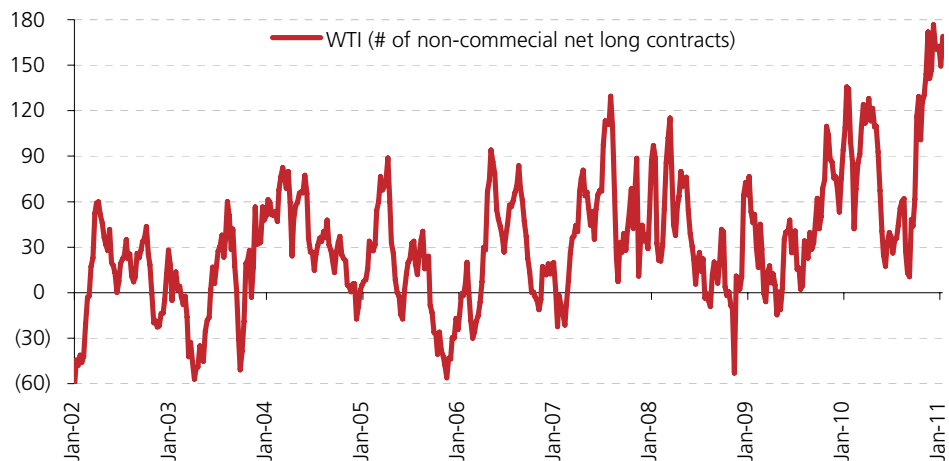
Source: Government of India, Kotak Institutional Equities estimates

We expect high OPEC spare capacity in CY2011E

Estimated global crude demand, supply and prices, calendar year-ends, 2005-15E

	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Demand (mn b/d)											
Total demand	84.1	85.2	86.7	86.1	85.0	87.4	88.8	90.0	91.2	92.3	93.4
Yoy growth	1.6	1.1	1.5	(0.5)	(1.2)	2.5	1.3	1.3	1.2	1.1	1.1
Supply (mn b/d)											
Non-OPEC	49.8	50.4	50.9	50.8	51.7	52.8	53.4	53.8	53.5	53.6	54.0
Yoy growth	1.0	0.6	0.5	(0.1)	0.9	1.1	0.6	0.4	(0.2)	0.1	0.4
OPEC											
Crude	30.4	30.5	30.3	31.2	28.7	29.4	29.5	30.0	31.0	31.8	32.3
NGLs	4.3	4.4	4.3	4.4	4.8	5.3	5.8	6.3	6.6	6.9	7.1
Total OPEC	34.7	34.9	34.6	35.6	33.5	34.7	35.4	36.2	37.6	38.7	39.4
Total supply	84.5	85.3	85.5	86.4	85.2	87.4	88.8	90.0	91.2	92.3	93.4
Total stock change	0.7	0.2	(1.2)	0.3	0.2						
OPEC crude capacity			34.4	34.2	34.9	35.5	35.2	35.3	35.7	36.7	36.9
Implied OPEC spare capacity			2.9	3.2	6.3	6.1	5.7	5.3	4.6	4.9	4.6
Demand growth (yoy, %)											
	1.9	1.3	1.7	(0.6)	(1.3)	2.9	1.5	1.4	1.3	1.2	1.2
Supply growth (yoy, %)											
Non-OPEC	2.0	1.2	1.0	(0.2)	1.7	2.1	1.2	0.7	(0.5)	0.1	0.7
OPEC	3.0	0.6	(0.9)	3.0	(6.0)	3.4	2.0	2.5	3.9	2.8	1.9
Total	1.3	0.9	0.2	1.1	(1.4)	2.6	1.5	1.4	1.3	1.2	1.2
Dated Brent (US\$/bbl)											
	54.4	65.8	72.7	102.0	62.1	79.7	85.0	85.0	85.0	85.0	85.0

Source: IEA, Kotak Institutional Equities estimates

Speculative net long positions remain high
WTI non-commercial futures contracts (#)

Source: Bloomberg, Kotak Institutional Equities

JANUARY 17, 2011

UPDATE

BSE-30: 18,882

NBFCs: RBI prescribes standard asset provisions to create long-term buffer. The RBI has prescribed standard asset provisions of 0.25% for NBFCs. Notably, most NBFCs have been growing at a brisk pace over the past few quarters, reporting low slippages and making negligible provisions. As such, the standard asset provisions would augur well over the long term even as earnings decline. We find a near-term impact on PFC and REC's earnings though it is not clear if the guidelines are applicable to Government-owned NBFCs.

RBI notification on standard assets

RBI has prescribed provisions of 0.25% for standard assets of deposit accepting and non-deposit accepting NBFCs. The guidelines will be applicable with immediate effect and hence we expect a significant one-time impact on 4QFY11 earnings. As in the case of banks, these provisions cannot be clubbed with specific provisions that provide a buffer to gross NPLs.

More relaxed than norms for banks

The NPL recognition and provisioning norms for NBFCs are relaxed as compared to the banking sector likely due to a focus on the niche segments of NBFCs wherein delinquencies tend to be high (though eventual losses may be lower). Banks currently need to make provisions of 0.4% of standard assets (for most assets classes); thus the new standard asset provision norm is also more relaxed for NBFCs.

Standard asset provisions will create a buffer

The NBFC sector, has been growing at a rapid pace (20-25%+) across asset classes (auto, infrastructure, gold loans, microfinance). Strong economic conditions have supported good asset quality performance. Most companies follow the regulatory guidelines (which are somewhat relaxed) and have not created significant provisioning buffers. As such, the standard asset provisioning requirement will help normalize earnings to some extent.

IDFC well placed

IDFC and Mahindra Finance follow more stringent guidelines amongst NBFCs under coverage. While the NPL recognition criteria for Mahindra Finance are more stringent, IDFC makes standard asset provisions at 0.7% of gross disbursements and currently has a buffer of about Rs6 bn as compared the requirement of about Rs1.2 bn.

It is not clear if the guidelines will be applicable to PFC (and REC) as the current NBFC guidelines are not applicable to Government-owned NBFCs. However, PFC and REC have also been categorized as 'infrastructure NBFCs' and need to follow other guidelines (like minimum capital adequacy etc) applicable to 'infrastructure NBFC'.

PFC and REC has been growing at 22-28% CAGR over the past 3-4 years but have made negligible provisions as they have maintained good collection efficiency despite poor financial health of state utilities. Standard asset provisions will clearly be prudential in the backdrop of the poor financial health of these utilities. PFC will likely need to make provisions of Rs2.5 bn i.e. 33% of 4QFY11E PBT while REC will need to make provisions of Rs2.2 bn i.e. 23% of 4QFY11E PBT.

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IDFC well placed, PFC and REC will have the highest impact

Standard asset provisions required by key NBFCs and likely impact on near-term earnings

	Standard assets	Required provisions@	Current provisions	Provisions required to be made		Comments
	(Rs bn)	0.25% (Rs mn)	(Rs mn)	(Rs mn)	% of 20011E PBT	
IDFC	467	1,168	6,000	NIL		IDFC makes standard asset provisions at 0.7% of disbursements, no impact
PFC	1,010	2,525	—	2,525	7	PFC makes negligible provisions, impact will be significant if the norm is applicable
REC	886	2,215	—	2,215	7	REC makes negligible provisions, impact will be significant if the norm is applicable
Shriram Transport Finance	260	650	—	650	3	Moderate one-time impact
Mahindra Finance	120	300	—	300	4	MMFSL's NPL norms are more stringent than RBI regulations, hence impact may be negligible

Source: Company, Kotak Institutional Equities estimates

December 2010: Results calendar

Mon	Tue	Wed	Thu	Fri	Sat
	18-Jan	19-Jan	20-Jan	21-Jan	22-Jan
	Bajaj Finserv	Bajaj Auto	Biocon	Bank of India	Ashok Leyland
	Cadila Healthcare	Bajaj Holdings	JSW Energy	BHEL	Bharat Forge
	Container Corp	HCL Technologies	Kotak Mahindra Bank	Corporation Bank	Godrej Consumer Products
	Development Credit Bank	Hindustan Zinc	TVS Motor	Dish TV India	State Bank of India
	Exide industries	LIC Housing Finance	Yes Bank	Hindustan Construction Co.	
	Gail India	Orchid Chemicals		IFCI	
	HT Media			Indiabulls Financial Services	
	Indiabulls Real Estate			ITC	
	ING Vysya Bank			Punjab National Bank	
	Mastek			Reliance Industries	
	Mindtree			Tech Mahindra	
	Opto Circuits			Wipro	
	Petronet LNG				
24-Jan	25-Jan	26-Jan	27-Jan	28-Jan	29-Jan
Asian Paints	Alstom Projects		Financial Technolgoy	Alok Industries	Maruti Suzuki
Century Textiles	Dr Reddys Laboratories		HDFC Bank	Bank of Baroda	
EIH	Grasim Industries		HPCL	Bharat Electronics	
Godrej Industries	Hindustan Unilever		IRB Infrastructure	Havells India	
ICICI Bank	IDBI Bank		JSW Steel	Jaiprakash Associates	
Idea Cellular	IOCL		Lupin	Procter & Gamble	
Indian Bank	Sterlite Industries		Marico	Siemens	
Jaypee Infratech	Ultratech Cement		National Fertilisers	Sun TV Netwrok	
Jindal Steel & Power	United Phosphorus		Neyveli Lignite	Tata Global Beverages	
Mahindra & Mahindra Financial Services			NHPC	Titan Industries	
Sesa Goa			Tata Chemicals	Uco Bank	
Sobha Developers			Thermax		
Union Bank of India					
Vijaya Bank					
Welspun Corp					
31-Jan	1-Feb	2-Feb	3-Feb	4-Feb	5-Feb
BPCL	Syndicate Bank	Bharti Airtel	Ambuja Cements		
Central Bank of India		Glaxosmithkline Consumer			
Colgate Palmolive		Jai Corp			
Dabur India		SJVN			
GVK Power					
IDFC					
Shree Cement					

Source: BSE, Kotak Institutional Equities

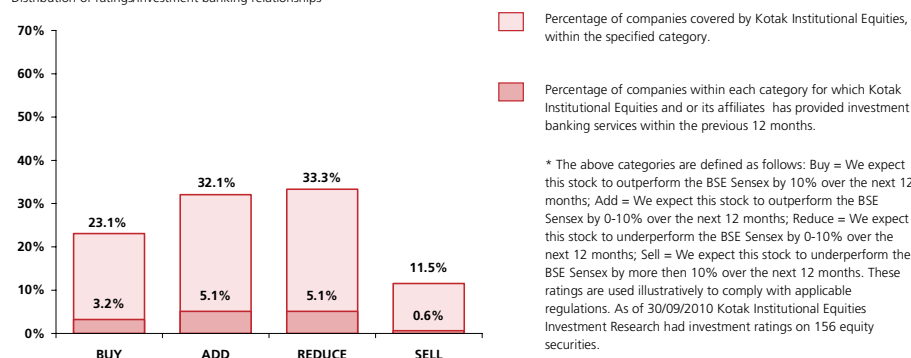
Kotak Institutional Equities: Valuation summary of key Indian companies

Company	17-Jan-11		Mkt cap.		O/S	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target	Upside	ADVT-3mo
	Price (Rs)	Rating	(Rs mn)	(US\$ mn)	shares (mn)	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	(Rs)	(%)	(US\$ mn)
Automobiles																													
Ashok Leyland	59	SELL	78,487	1,730	1,330	2.8	3.9	4.7	84.5	37.1	20.4	20.9	15.2	12.7	12.4	9.9	8.6	1.9	1.8	1.6	2.5	1.7	1.7	10.9	12.2	13.5	60	1.7	7.8
Bajaj Auto	1,268	REDUCE	367,075	8,092	289	58.8	87.4	97.5	160.2	48.5	11.5	21.6	14.5	13.0	14.0	10.3	9.2	12.5	8.0	5.6	1.6	2.0	2.0	70.9	67.1	50.4	1,462	15.3	21.2
Bharat Forge	351	ADD	83,874	1,849	239	0.1	12.1	19.6	(98.7)	11,693	61.5	3,409.3	28.9	17.9	25.8	12.3	8.4	5.4	4.0	3.3	—	—	—	5.2	8.0	16.2	400	14.0	3.6
Hero Honda	1,788	REDUCE	357,014	7,871	200	111.8	103.3	110.6	73.9	(7.6)	7.2	16.0	17.3	16.2	10.0	11.0	9.7	9.9	7.2	5.5	1.7	1.7	1.7	59.0	48.0	38.6	1,494	(16.4)	32.8
Mahindra & Mahindra	738	BUY	440,901	9,720	598	33.9	45.9	51.8	125.8	35.4	12.9	21.8	16.1	14.2	14.3	11.4	10.0	5.5	4.0	3.3	1.2	1.3	1.4	30.0	28.8	25.4	875	18.6	35.1
Maruti Suzuki	1,270	BUY	366,800	8,086	289	86.4	80.5	95.0	105.0	(6.8)	18.0	14.7	15.8	13.4	7.7	8.0	6.6	3.1	2.6	2.2	0.5	0.4	0.5	23.3	17.8	17.7	1,701	34.0	11.7
Tata Motors	1,179	ADD	783,358	17,270	665	18.5	133.2	143.8	(141.1)	621.6	7.9	63.8	8.8	8.2	12.8	6.4	5.8	9.3	3.7	2.6	1.1	0.5	0.5	15.3	60.7	37.4	1,235	4.8	108.1
Automobiles																													
		Cautious	2,477,509	54,619					351.4	95.0	11.4	25.0	12.8	11.5	12.1	8.3	7.3	6.1	4.0	3.1	1.2	1.0	1.1	24.4	30.9	26.6			
Banks/Financial Institutions																													
Andhra Bank	127	BUY	61,741	1,361	485	21.6	24.0	26.7	60.1	11.5	11.1	5.9	5.3	4.8	—	—	—	1.4	1.2	1.0	3.9	4.4	4.9	26.0	24.1	22.6	210	65.0	5.6
Axis Bank	1,229	BUY	497,959	10,978	405	62.1	81.7	99.9	22.7	31.6	22.3	19.8	15.0	12.3	—	—	—	3.1	2.7	2.3	1.0	1.3	1.6	19.2	19.1	20.1	1,600	30.2	51.6
Bank of Baroda	829	BUY	303,187	6,684	366	83.7	103.0	121.2	37.3	23.1	17.7	9.9	8.1	6.8	—	—	—	2.2	1.8	1.5	1.8	2.2	2.6	24.4	24.7	24.0	1,250	50.7	9.8
Bank of India	437	ADD	229,982	5,070	526	33.1	56.3	63.2	(42.1)	70.2	12.2	13.2	7.8	6.9	—	—	—	1.8	1.5	1.3	1.6	2.7	3.1	14.2	21.3	20.4	580	32.6	17.5
Canara Bank	528	ADD	216,562	4,774	410	73.7	90.7	102.8	45.8	23.1	13.4	7.2	5.8	5.1	—	—	—	1.7	1.4	1.1	1.9	1.9	2.3	22.5	22.8	21.4	740	40.1	23.4
Corporation Bank	558	ADD	80,445	1,765	143	82.0	86.7	100.7	31.8	5.7	16.2	6.8	6.4	5.5	—	—	—	1.4	1.2	1.0	3.0	3.1	3.6	22.0	19.9	19.9	800	43.4	1.5
Federal Bank	367	ADD	62,701	1,382	171	27.2	34.7	47.2	(7.1)	27.7	35.9	13.5	10.6	7.8	—	—	—	1.3	1.2	1.1	1.4	1.7	2.4	10.3	12.0	14.7	530	44.6	7.0
HDFC	664	REDUCE	952,703	21,003	1,436	19.7	24.3	27.4	22.7	23.4	12.7	33.7	27.3	24.2	—	—	—	6.3	5.5	4.9	1.1	1.3	1.4	20.0	21.5	21.3	690	4.0	47.1
HDFC Bank	2,068	ADD	946,659	20,870	458	64.4	84.9	109.9	22.1	31.8	29.5	32.1	24.4	18.8	—	—	—	4.4	3.9	3.3	0.6	0.8	1.0	16.1	16.9	19.0	2,500	20.9	43.1
ICICI Bank	1,001	ADD	1,152,213	25,402	1,151	36.1	45.0	58.0	6.9	24.6	29.0	27.7	22.3	17.3	—	—	—	2.2	2.1	1.9	1.2	1.3	1.7	8.0	9.7	11.6	1,230	22.9	118.2
IDFC	155	ADD	226,263	4,988	1,458	8.4	9.6	11.5	44.9	14.1	20.4	18.5	16.2	13.5	—	—	—	3.2	2.1	1.7	0.9	1.1	1.5	16.6	15.7	14.6	220	41.8	25.4
India Infoline	75	BUY	23,401	516	312	8.1	7.5	8.8	59.2	(8.0)	17.1	9.2	10.0	8.6	—	—	—	1.5	1.2	1.0	4.2	2.1	2.7	14.7	13.3	14.3	130	73.2	4.5
Indian Bank	206	ADD	88,490	1,951	430	35.1	35.7	44.9	25.5	1.6	25.9	5.9	5.8	4.6	—	—	—	1.3	1.1	0.9	3.2	3.1	3.9	24.1	20.5	21.8	350	70.0	3.6
Indian Overseas Bank	124	BUY	67,773	1,494	545	13.0	16.8	24.1	(46.7)	29.8	43.2	9.6	7.4	5.2	—	—	—	1.1	0.9	0.8	2.8	3.1	3.4	9.6	11.6	15.0	200	60.8	4.2
J&K Bank	702	ADD	34,029	750	48	105.7	123.0	143.9	25.0	16.4	17.0	6.6	5.7	4.9	—	—	—	1.1	1.0	0.9	3.1	3.6	4.3	18.2	18.4	18.7	1,000	42.5	1.6
LIC Housing Finance	151	ADD	71,860	1,584	475	13.9	21.4	21.1	11.5	53.7	(1.4)	10.9	7.1	7.2	—	—	—	2.2	1.8	1.5	2.0	3.0	3.0	23.6	27.0	22.2	206	36.2	63.8
Oriental Bank of Commerce	350	ADD	87,589	1,931	251	45.3	59.0	65.8	25.3	30.2	11.6	7.7	5.9	5.3	—	—	—	1.2	1.0	0.9	2.6	3.4	3.8	14.5	16.8	16.6	580	65.9	9.1
PFC	273	REDUCE	313,112	6,903	1,148	20.5	24.1	28.2	54.0	17.5	17.0	13.3	11.3	9.7	—	—	—	2.5	2.1	1.8	1.6	1.8	2.1	19.0	19.3	19.5	300	10.0	3.8
Punjab National Bank	1,134	BUY	357,553	7,883	315	123.9	139.8	165.9	26.4	12.9	18.6	9.2	8.1	6.8	—	—	—	2.2	1.8	1.5	1.9	2.5	3.0	26.2	24.2	23.9	1,500	32.3	10.5
Reliance Capital	574	REDUCE	141,308	3,115	246	13.7	13.0	14.5	(65.2)	(4.7)	11.5	42.0	44.1	39.5	—	—	—	2.1	2.0	2.0	1.1	0.9	1.0	5.2	4.6	5.0	800	39.4	23.1
Rural Electrification Corp.	261	REDUCE	257,610	5,679	987	20.3	25.7	30.0	23.2	26.7	16.9	12.9	10.2	8.7	—	—	—	2.3	2.0	1.8	2.5	3.0	3.5	22.0	21.3	21.7	300	15.0	18.0
Shriram Transport	747	ADD	166,652	3,674	223	39.2	55.4	68.1	30.1	41.4	23.0	19.1	13.5	11.0	—	—	—	4.5	3.8	3.1	1.6	2.2	2.7	28.4	29.1	29.6	850	13.8	8.2
SKS Microfinance	654	BUY	48,167	1,062	74	26.9	35.5	55.9	61.1	31.9	57.4	24.3	18.4	11.7	—	—	—	5.1	2.5	2.0	—	—	—	21.7	18.0	19.3	950	45.3	19.6
SREI	100	NR	11,588	255	116	8.3	7.9	9.9	17.8	(4.8)	25.8	12.0	12.6	10.0	—	—	—	1.0	0.9	0.8	1.2	1.2	1.2	11.1	10.5	12.3	—	—	5.7
State Bank of India	2,516	BUY	1,597,492	35,218	635	144.4	176.6	224.1	0.5	22.3	26.9	17.4	14.2	11.2	—	—	—	2.4	2.1	1.8	1.2	1.3	1.4	14.8	15.9	17.6	3,500	39.1	198.4
Union Bank	314	BUY	158,809	3,501	505	41.1	42.4	56.1	20.2	3.1	32.6	7.7	7.4	5.6	—	—	—	1.8	1.5	1.2	1.7	1.8	2.4	26.2	22.1	24.1	450	43.1	7.5
Yes Bank	255	BUY	86,564	1,908	340	15.0	21.0	26.6	46.7	40.2	26.6	17.0	12.1	9.6	—	—	—	2.8	2.3	1.9	0.6	0.8	1.0	20.3	21.0	22.0	400	57.0	20.0
Banks/Financial Institutions																													
		Attractive	8,302,040	183,026					15.0	24.1	21.6	16.4	13.2	10.9	—	—	—	2.5	2.2	1.9	1.3	1.6	1.9	15.5	16.6	17.5			
Cement																													
ACC	1,009	REDUCE	189,599	4,180	188	83.2	56.4	63.6	47.9	(32.3)	12.9	12.1	17.9	15.9	6.5	8.4	6.8	3.0	2.7	2.4	2.7	2.3	2.3	29.3	17.5	17.6	940	(6.9)	11.3
Ambuja Cements	126	SELL	191,591	4,224	1,522	8.0	8.1	9.0	11.4	1.4	10.6	15.7	15.5	14.0	8.7	8.5	7.1	2.8	2.4	2.2	1.5	1.6	1.7	19.3	17.1	16.8	108	(14.2)	6.5
Grasim Industries	2,445	ADD	224,182	4,942	92	301.0	194.9	238.6	26.1	(35.2)	22.4	8.1	12.5	10.2	4.8	5.9	4.4	1.8	1.6	1.4	1.4	1.4	1.4	22.9	13.5	14.7	2,500	2.2	3.8
India Cements	98	SELL	30,072	663	307	10.0	5.3	7.9	(43.5)	(47.6)	49.8	9.8	18.6	12.4	5.6														

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2010

Ratings and other definitions/identifiers

Definitions of ratings

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

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

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

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

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

Other definitions

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

Other ratings/identifiers

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

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