kotak® Institutional Equities

INDIA DAILY

June 26, 2008

EQUITY MARKETS

			Change, %	
India	**25-Jun**	**1-day**	**1-mo**	**3-mo**
Sensex	14,220	0.8	(13.0)	(11.6)
Nifty	4,253	1.5	(12.8)	(11.9)
Global/Regional indices				
Dow Jones	11,812	0.0	(5.4)	(4.9)
Nasdaq Composite	2,401	1.4	(1.8)	3.3
FTSE	5,666	0.6	(6.9)	0.1
Nikkie	13,889	0.4	1.5	9.3
Hang Seng	22,797	0.7	(5.5)	0.8
KOSPI	1,732	0.8	(3.8)	3.1

Value traded - India

			Moving avg, Rs bn	
	25-Jun		**1-mo**	**3-mo**
Cash (NSE+BSE)	174.9		192.2	195.3
Derivatives (NSE)	810.0		413.2	666
Deri. open interest	873.2		833	671

Contents

Results

Oil & Natural Gas Corporation: 4QFY08 results: The award for the most conservative accounting practice goes to ONGC

Sadbhav Engineering: 4QFY08 PAT and margins lower than estimate; reduce target price to Rs1,100

Updates

Idea Cellular: An expensive acquisition funded through placement at expensive price—net result marginally positive

Siemens: Sharp correction prompts rating upgrade to ADD; reverse DCF valuation implies conservative growth estimates in our view

Banks/Financial Institutions: Revising earnings estimate and target price to reflect higher rates scenario

Forex/money market

			Change, basis points	
	25-Jun	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.7	0	1	259
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.7	11	58	96

Net investment (US$mn)

	24-Jun		**MTD**	**CYTD**
FIIs	68		(1,382)	(5,255)
MFs	49		134	1,660

Top movers -3mo basis

			Change, %	
Best performers	**25-Jun**	**1-day**	**1-mo**	**3-mo**
Chambal Fert	76	1.8	6.5	57.0
i-Flex	1,366	9.4	1.3	38.4
Ranbaxy	545	3.8	11.2	21.4
Ingersoll Rand	307	2.1	8.5	18.0
Infosys	1,747	(2.7)	(7.3)	16.5
Worst performers				
Siemens India	431	3.9	(25.7)	(36.7)
BPCL	270	2.3	(22.4)	(34.2)
SBI	1,194	(1.0)	(22.4)	(30.3)
Tata Motors	474	(1.9)	(23.6)	(30.1)
BoB	211	0.5	(23.3)	(27.8)

News Roundup

Corporate

- Hyderabad-based GMR Infrastructure Ltd has acquired 50% stake in Intergen, a power company based at Burlington in the US, for US$ 1.1 bn. The company acquired the stake from AIG Highstar Capital II fund. The acquisition is subject to clearances under the US antitrust laws. (BL)
- The operator of the newly-opened Bengaluru International Airport is seeking a valuation of up to $2.5 bn to raise about $200 mn in equity to fund the second phase of the airport's development. (ET)
- ITC Infotech, the $100 mn, wholly-owned subsidiary of ITC Ltd, is set to pull out of its BPO equal joint venture with US-based Sitel Corporation. (BS)
- Tech Mahindra has announced a multi-million dollar deal with Telecom Fiji to provide global ICT services to enterprise customers in Oceania market. (ET)

Economic and political

- The federal government is exploring the possibility of trebling the credit exposure limit on banks lending to non-banking financial companies for infrastructure projects, from 15% now. (FE)
- Three years after the tendering process for the country's longest sea bridge project began, the Maharashtra government, on Wednesday, finally decided to go ahead and build it through a special purpose vehicle comprising of its own agencies. The Rs60 bn, 22-km-long Mumbai Trans Harbour Link project, would become the fourth longest sea-bridge in the world. (Mint)

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

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

Energy

ONGC.BO, Rs865	
Rating	BUY
Sector coverage view	Cautious
Target Price (Rs)	1,200
52W High -Low (Rs)	1387 - 768
Market Cap (Rs bn)	1,851

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,114	1,299	1,285
Net Profit (Rs bn)	199.2	285.7	327.5
EPS (Rs)	93.1	133.6	153.1
EPS gth	*10*	*43.4*	*14.7*
P/E (x)	9.3	6.5	5.7
EV/EBITDA (x)	3.5	2.7	2.2
Div yield (%)	3.7	4.6	4.9

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	7.6	2.1	(3.4)
MFs	1.6	2.4	(3.1)
UTI	-	-	(5.5)
LIC	2.4	3.1	(2.4)

Oil & Natural Gas Corporation: 4QFY08 results—The award for the most conservative accounting practice goes to ONGC

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

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

- **4QFY08 results dampened by higher-than-expected DD&A and one-off expenditure**
- **Consistent approach to depressing profits as much as possible**
- **Fine-tuned estimates; retain BUY and 12-month target price of Rs1,200**

ONGC reported disappointing 4QFY08 net income (standalone) at Rs26.3 bn (-39.8% qoq, -2% yoy) well below our estimate of Rs42.5 bn. The variance was on account of (1) higher-than-expected other expenditure at Rs38 bn (+107% qoq and +72% yoy) and (2) higher DD&A expenses at Rs38.5 bn (+74% qoq and +34% yoy). Adjusted for these changes, ONGC's 4QFY08 net income would have been well ahead of our estimates. We have fine-tuned consolidated FY2009E and FY2010E EPS estimates to Rs134 (Rs140 previously) and to Rs153 (Rs150 previously). We reiterate our BUY rating and 12-month target price of Rs1,200 based on 9X normalized FCF based on a low normalized crude price of US$50/bbl. Key downside risks to our target price stem from higher-than-expected subsidy losses.

Consistent pattern about conservatism in accounting policies. Over the past several years, we have seen ONGC adopting extremely conservative accounting policies. We suspect this stems from its desire to show as low profits as possible in order to avoid a high subsidy burden. We give instances from the past three years.

1. **Change in depreciation rate on trunk pipelines and onshore flow lines to 100% from the previous 27.82% in FY2006.** This had resulted in profits being significantly lower versus otherwise in FY2006 and FY2007. ONGC has applied the same rate to OVL's pipeline assets in FY2008, which has resulted in additional depreciation of Rs5.4 bn in FY2008. We doubt the life of any pipeline is one year.

2. **Additional costs for dismantling and abandonment of wells provided for in FY2006.** ONGC had provided for Rs41.3 bn as abandonment costs in FY2006 and increased the gross producing properties by the same amount in FY2006. This has resulted in FY2006's net income being lower by Rs4.5 bn than otherwise. In FY2008, ONGC has revised down the eventual liability relating to dismantling, abandoning and restoring offshore well sites and allied facilities by Rs33.2 bn. This has resulted in additional pre-tax profits of Rs3.8 bn in FY2008. This figure is similar to the write-down in FY2007. However, the market had punished the stock heavily at the time of 4QFY06 results based on the higher-than-expected DD&A and well abandonment costs.

3. **Write-off of Rs6.1 bn of a discovered field in FY2008.** ONGC has written off the cost of acquisition of 90% stake (Rs3.7 bn) and cost of drilling of three wells (Rs2.4 bn) in KG-DWN-98/2 block. ONGC follows the more conservative practice of successful efforts method under which costs relating to successful discoveries are capitalized (as they should be) and costs relating to survey expenses and dry wells written off in the year they are incurred. We are very surprised to see ONGC writing down Rs6.1 bn of expenses relating to a field where it has made discoveries and is in the process of finalizing the development concept.

   ONGC management has clarified that it will not be able to develop the field over the next two years due to unavailability of rigs and hence, has opted to write down all associated costs in line with standard accounting policy. However, the same will be written back when the company eventually commences development work on the project.

Key highlights of 4QFY08 and FY2008 results

1. **Steep increase in other expenditure.** ONGC's 4QFY08 other expenditure jumped by Rs20 bn qoq and Rs16 bn yoy to Rs38.5 bn. The steep increase reflects provision of Rs10.5 bn for pay revision of employees effective January 1, 2007 and provision of Rs8.85 bn of gratuities. However, we see this as a one-off expense.

2. **Sharp increase in DD&A.** ONGC's 4QFY08 DD&A expenses increased by Rs16 bn qoq and Rs10 bn yoy to Rs38.5 bn. ONGC has provided for Rs6.1 bn pertaining to write-off of drilling and acquisition cost of KG-DWN-98/2 block, discussed above. In addition, expenditure on dry wells written off increased to Rs13.8 bn from Rs4.9 bn in 3QFY08 and Rs8.5 bn in 4QFY07. Expenditure on dry wells for FY2008 was Rs22.1 bn compared to Rs21.9 bn in FY2007.

3. **Steep increase in other income.** Other income jumped up to Rs20.4 bn (+136% qoq) on account of ONGC charging 6% interest rate on loans to 100% subsidiary, OVL, versus negligible rate previously and receipt of Rs1.97 bn of oil bonds pertaining to FY997-2002. The change in interest rate on loan to OVL is applicable for the full year and the amount is Rs7.3 bn. However, we note this has no impact on consolidated earnings.

4. **Net realization on crude oil.** ONGC's 4QFY08 net realized crude price was US$49.7/bbl versus US$54.5/bbl in 3QFY08. ONGC's subsidy burden per barrel of crude was US$50.7/bbl.

5. **Crude and natural gas volumes.** 4QFY08 crude sales increased 1.2% qoq but declined by 0.8% yoy to 6.06 mn tons. Crude oil production in FY2008 declined by 1.4% to 24.1 mn tons compared to 24.4 mn tons in FY2007. Gas sales decreased 8.1% qoq and 5.4% yoy to 4.9 bcm in 4QFY08 due to shutdown of operation at Mumbai High in February 2008.

6. **Reserve accretion.** We are encouraged by the addition of 64 mn tons or 466 mboe of proved reserves in ONGC alone (without overseas and domestic joint ventures), which result in reserves replacement ratio of 1.32X. ONGC made 28 discoveries in FY2008 out of which 15 (three deep-water, five shallow-water and seven onshore) are new prospects and 13 are new pools of hydrocarbons within extant discovered areas. Out of the 182 mtoe of in-place reserves added in FY2008, 101 mtoe is from new finds and the balance 69 mtoe from extant areas.

Key changes to and major assumptions behind earnings model

We discuss our key assumptions and the major changes to our earnings model below. Exhibit 6 gives the major assumptions behind our earnings model and Exhibit 7 gives sensitivity of ONGC's EPS to key variables (rupee-dollar rate, crude oil price, natural gas price).

1. **Subsidy amount.** We model subsidy amount at Rs500 bn, Rs350 bn and Rs290 bn for FY2009E, FY2010E and FY2011E, respectively. ONGC's FY2008 subsidy amount was Rs220 bn versus Rs170 bn in FY2007. We currently assume that the share of gross under-recoveries for upstream companies will be 33.33%. Although the government has announced that it will freeze the subsidy burden for upstream companies at Rs450 bn (about Rs380 bn for ONGC), we are building a more conservative case for subsidy losses by assuming Rs500 bn of subsidy loss to be borne by ONGC in FY2009E.

2. **Crude oil price assumptions.** We retain our crude oil price (Dated Brent) forecasts for FY2009E, FY2010E and FY2011E at US$110/bbl, US$95/bbl and US$90/bbl.

3. **Exploratory drilling and survey expenses.** We have increased exploratory and survey expenses to Rs62 bn (Rs46 bn previously) in FY2009E in line with the planned expenditure announced by the company.

4. Royalty and cess. We model ONGC to bear the entire burden of royalty (Rs481/ton) and its share (30%) of cess (Rs2,575/ton) for RJ-ON-90/1 block for which Cairn India is the operator. However, ONGC's FY2011E and FY2012E earnings would be higher if the government decides that the joint venture partners will bear cess on crude oil in proportion to their ownership.

5. Exchange rate. We have revised our rupee-dollar exchange rates for FY2010E and FY2011E to Rs41.5/US Dollar and Rs41/US Dollar versus Rs41/US Dollar and Rs40/US Dollar, respectively, previously. We retain our rupee-dollar exchange rates for FY2009E at Rs42/US Dollar.

MRPL 4QFY08 results dampened by lower refining margins

MRPL, ONGC's 71.6% refining subsidiary, reported 4QFY08 net income at Rs2.3 bn compared to 3QFY08's Rs3.5 bn and 4QFY07's Rs1.8 bn. 4QFY08 refining margin was US$6.7/bbl (computed) compared to US$8.7/bbl in 3QFY08 and US$8.6/bbl in 4QFY07. We model FY2009E and FY2010E EPS at Rs8.1 (Rs14 bn net income) and Rs4.2 (Rs7.4bn). The decline in net income in the next two years reflects lower refining margins, stronger rupee and increase in taxation. We model FY2009E and FY2010E refining margin at US$6.2/bbl and US$5.2/bbl versus US$7.4/bbl in FY2008.

ONGC standalone interim results, March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2009E	**4Q 2008**	**3Q 2008**	***% chg***	**4Q 2008**	**4Q 2007**	***% chg***	**2008**	**2007**	***% chg***
Net sales	620,688	156,261	151,208	*3.3*	156,261	123,970	*26.0*	598,485	566,328	*5.7*
Total expenditure	(291,222)	(98,494)	(70,891)	*38.9*	(98,494)	(79,825)	*23.4*	(297,025)	(281,598)	*5.5*
Change in stock in trade	—	(382)	293		(382)	(209)		1,141	(197)	
Raw materials (a)	(3,551)	(2,468)	(2,156)	*14.4*	(2,468)	(894)	*176.1*	(6,817)	(3,928)	*73.6*
Trading purchase	(68,907)	(21,870)	(14,539)	*50.4*	(21,870)	(12,543)	*74.4*	(65,115)	(59,401)	*9.6*
Staff expenditure	(13,172)	(1,630)	(3,612)	*(54.9)*	(1,630)	(15,549)	*(89.5)*	(11,454)	(29,818)	*(61.6)*
Statutory levies	(135,145)	(33,802)	(32,314)	*4.6*	(33,802)	(28,392)	*19.1*	(127,080)	(119,930)	*6.0*
Other expenditure	(70,447)	(38,342)	(18,562)	*106.6*	(38,342)	(22,239)	*72.4*	(87,700)	(68,324)	*28.4*
EBITDA	**329,466**	**57,767**	**80,318**	***(28.1)***	**57,767**	**44,145**	***30.9***	**301,460**	**284,731**	***5.9***
Other income	50,018	20,337	8,630	*135.7*	20,337	21,790	*(6.7)*	49,455	42,431	*16.6*
Interest	(895)	(123)	(114)	*8.2*	(123)	(65)	*91.3*	(590)	(215)	*174.3*
DD&A	(96,565)	(38,445)	(22,118)	*73.8*	(38,445)	(28,637)	*34.2*	(97,979)	(94,994)	*3.1*
Depletion		(6,020)	(11,770)	*(48.9)*	(6,020)	(8,110)	*(25.8)*	(36,780)	(33,869)	*8.6*
Depreciation		(3,970)	(3,530)	*12.5*	(3,970)	(3,100)	*28.1*	(14,000)	(16,094)	*(13.0)*
Dry wells written off		(14,920)	(2,260)	*560.2*	(14,920)	(7,200)	*107.2*	(22,110)	(21,927)	*0.8*
Survey expenses		(13,790)	(4,920)	*180.3*	(13,790)	(8,450)	*63.2*	(25,770)	(21,119)	*22.0*
Impairment loss and other adjustments		250	350	*(28.6)*	250	(1,780)	*(114.0)*	660	(1,658)	*(139.8)*
Pretax profits	**282,023**	**39,536**	**66,716**	***(40.7)***	**39,536**	**37,232**	***6.2***	**252,346**	**231,952**	***8.8***
Extraordinary/Prior period adjustment	0	5	3,058		5	4,751		3,871	4,751	
Tax	(98,279)	(13,045)	(22,210)	*(41.3)*	(13,045)	(8,183)	*59.4*	(80,720)	(78,403)	*3.0*
Deferred tax	16,799	(225)	(3,899)	*(94.2)*	(225)	(6,983)	*(96.8)*	(8,480)	(1,870)	*353.6*
Net income	**200,543**	**26,271**	**43,665**	***(39.8)***	**26,271**	**26,816**	***(2.0)***	**167,017**	**156,430**	***6.8***
Tax rate (%)	28.9	33.6	37.4		33.6	36.1		34.8	33.9	
Volume data										
Subsidy loss		84,720	60,800	*39.3*	84,720	46,680	*81.5*	220,010	170,240	*29.2*
Crude sales ('000 tons)		6,060	5,990	*1.2*	6,060	6,110	*(0.8)*	24,080	24,410	*(1.4)*
Gas sales (mcm)		4,890	5,320	*(8.1)*	4,890	5,170	*(5.4)*	20,430	20,300	*0.6*
LPG (000 tons)		265	275	*(3.6)*	265	263	*0.8*	1,037	1,033	*0.4*
Naphtha/NGL		372	376	*(1.1)*	372	396	*(6.1)*	1,442	1,442	*0.0*
C2/C3		135	142	*(4.9)*	135	141	*(4.3)*	520	548	*(5.1)*
SKO		36	46	*(21.7)*	36	42	*(14.3)*	168	156	*7.7*

Note:
(a) represents consumption of stores & spares.

Source: Company data, Kotak Institutional Equities estimates.

We value ONGC stock at Rs1,200 on US$50/bbl normalized crude price

Estimation of fair value of ONGC stock based on normalized free cash flow (Rs mn)

	2009E	2010E	2011E
A. Core business valuation			
Normalized crude price assumption (US$/bbl)	50.0	50.0	50.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	(73,628)	64,002	118,886
Add: OCF after normalizing natural gas price	34,979	27,041	23,754
Add: OCF after removing subsidies	359,796	252,228	211,230
Recurring OCF	321,147	343,272	353,869
Recurring capex			
Production per annum (mn bbls)	397	390	392
Replacement or F&D costs (US$/bbl)	9.0	9.0	9.0
Recurring capex	150,081	145,624	144,749
Free cash flow	**171,065**	**197,648**	**209,120**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,539,589	1,778,833	1,882,080
(Net debt)/cash	390,802	552,597	730,282
Investments	90,514	95,457	100,398
Equity value	2,020,905	2,426,887	2,712,760
Equity value of core business (Rs/share)	**945**	**1,135**	**1,268**
B. New discoveries valuation			
KG-DWN-98/2 block (Rs/share)	49	55	62
MN-DWN-98/3 block (Rs/share)	15	16	18
Equity value of new discoveries (Rs/share)	**64**	**71**	**80**
Total equity value per share (Rs/share)	**1,008**	**1,206**	**1,348**

Source: Kotak Institutional Equities estimates.

ONGC's valuation is highly leveraged to normalised crude prices

Valuation sensitivity of ONGC to normalised crude price (Rs/share)

	Equity value (Rs/share)	Change from base case (%)
Normalized crude prices		
US$90/bbl	2,343	94
US$80/bbl	2,064	71
US$70/bbl	1,784	48
US$60/bbl	1,515	26
US$50/bbl	**1,206**	
US$45/bbl	1,096	(9)
US$40/bbl	897	(26)

Source: Kotak Institutional Equities estimates.

Reserve replacement ratio of 1.32X for FY2008 very encouraging

ONGC's reserve accretion, production and reserve replacemnt ratio, March fiscal year-ends, 2006-2008

	2006	2007	2008
Ultimate reserve accretion (mn tons)	51.5	65.6	63.8
Production (mn tons)	47.0	48.5	48.3
Reserve replacement ratio (X)	**1.1**	**1.4**	**1.3**

Source: Company.

ONGC's earnings are highly leveraged to crude prices

Earnings sensitivity of ONGC to key variables

	2009E			2010E			2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rs/US$	41.0	42.0	43.0	40.5	41.5	42.5	40.0	41.0	42.0
Net profits (Rs mn)	268,699	285,657	302,600	311,946	327,550	343,145	342,184	357,846	373,501
Earnings per share (Rs)	125.6	133.6	141.5	145.8	153.1	160.4	160.0	167.3	174.6
% upside/(downside)	**(5.9)**		**5.9**	**(4.8)**		**4.8**	**(4.4)**		**4.4**
Average crude prices									
Crude price (US$/bbl)	108.0	110.0	112.0	93.0	95.0	97.0	88.0	90.0	92.0
Net profits (Rs mn)	273,093	285,657	298,209	314,367	327,550	340,725	344,043	357,846	371,641
Earnings per share (Rs)	127.7	133.6	139.4	147.0	153.1	159.3	160.9	167.3	173.8
% upside/(downside)	**(4.4)**		**4.4**	**(4.0)**		**4.0**	**(3.9)**		**3.9**
Cess									
Cess on domestic crude (Rs/ton)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	277,234	285,657	294,080	318,972	327,550	336,128	349,156	357,846	366,536
Earnings per share (Rs)	129.6	133.6	137.5	149.1	153.1	157.2	163.2	167.3	171.4
% upside/(downside)	**(2.9)**		**2.9**	**(2.6)**		**2.6**	**(2.4)**		**2.4**
Natural gas prices									
Natural gas price ceiling (Rs/'000 cum)	3,750	4,250	4,750	4,250	4,750	5,250	4,500	5,000	5,500
Net profits (Rs mn)	280,030	285,657	291,278	322,228	327,550	332,867	352,628	357,846	363,059
Earnings per share (Rs)	130.9	133.6	136.2	150.7	153.1	155.6	164.9	167.3	169.7
% upside/(downside)	**(2.0)**		**2.0**	**(1.6)**		**1.6**	**(1.5)**		**1.5**

Source: Kotak Institutional Equities estimates.

Natural gas price increase and moderate volume growth are key earnings drivers

Key assumptions, March fiscal year-ends, 2005-2012E

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Rs/US$ rate	45.0	44.3	45.3	40.3	42.0	41.5	41.0	40.0
Subsidy share scheme loss (Rs bn)	41.0	119.6	170.2	220.0	500.0	350.0	290.0	290.0
Import tariff on crude oil (%)	9.7	5.1	5.1	5.2	0.9	—	—	—
Crude/natural gas prices								
Crude price								
Crude price, WTI (US$/bbl)				78.9	112.0	97.0	92.0	92.0
Crude price, Dated Brent (US$/bbl)	40.6	57.2	64.8	78.9	110.0	95.0	90.0	90.0
Natural gas price								
Ceiling natural gas price, India (Rs/cu m)	2.85	3.52	4.21	4.25	4.25	4.75	5.00	5.25
Ceiling natural gas price, India (US$/mn BTU)	1.69	2.12	2.49	2.82	2.70	3.06	3.26	3.51
Net natural gas price, ONGC-India (Rs/cu m)	2.18	3.11	3.76	3.79	3.79	4.24	4.47	4.69
Net natural gas price, ONGC-India (US$/mn BTU)	1.29	1.88	2.22	2.52	2.41	2.73	2.91	3.13
International operations								
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.2	3.1	3.2	2.8	3.0	2.9	2.9	2.8
Net crude price, OVL-Sudan (Rs/ton)	5,893	8,118	9,384	10,142	14,710	12,567	11,767	11,480
Net crude price, OVL-Russia (Rs/ton)	—	8,320	9,633	10,434	15,177	12,951	12,122	11,826
Sales volumes—Domestic fields (a)								
Crude oil (mn tons)	24.1	22.5	24.4	24.1	25.0	25.0	24.9	24.8
Natural gas (bcm)	20.6	20.5	20.3	20.4	20.6	19.6	19.2	17.9
Sales volumes—Overseas fields								
Crude oil (mn tons)	3.7	4.6	5.8	7.8	8.8	8.6	8.6	8.6
Natural gas (bcm)	1.3	1.8	2.1	2.1	2.4	2.6	2.8	2.8
Total sales								
Crude oil (mn tons)	27.8	27.0	30.2	31.9	33.8	33.6	33.5	33.4
Natural gas (bcm)	22.0	22.3	22.5	22.6	23.0	22.2	22.0	20.7
Total sales (mn toe)	**47.4**	**46.9**	**50.3**	**52.0**	**54.4**	**53.4**	**53.2**	**51.9**
Total sales (mn boe)	**346**	**342**	**367**	**380**	**397**	**390**	**388**	**379**
Crude oil (%)	59	58	60	61	62	63	63	64
Natural gas (%)	41	42	40	39	38	37	37	36

(a) Includes ONGC's share of production from joint venture fields.

Source: Company data, Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of ONGC, March fiscal year-ends, 2004-2012E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)									
Net sales	467,124	707,083	807,603	968,227	1,114,284	1,299,050	1,284,718	1,335,750	1,331,785
EBITDA	**196,494**	**281,195**	**310,054**	**358,001**	**397,472**	**484,205**	**506,541**	**536,944**	**508,057**
Other income	23,752	17,595	27,350	45,377	55,402	52,143	60,318	58,487	58,356
Interest	(5,028)	(2,512)	(537)	394	(8,789)	(7,280)	(5,322)	(6,426)	(8,145)
Depreciation and depletion	(65,525)	(73,465)	(97,726)	(119,550)	(131,142)	(126,482)	(104,087)	(96,683)	(94,423)
Pretax profits	149,693	222,813	239,141	284,222	312,943	402,586	457,449	492,321	463,845
Tax	(46,101)	(74,690)	(71,196)	(88,987)	(103,319)	(130,329)	(137,907)	(137,020)	(129,933)
Deferred tax	(7,779)	(4,744)	(13,612)	(9,264)	(7,799)	17,441	10,120	3,295	4,679
Net profits	95,523	143,175	154,596	178,412	204,507	289,698	329,662	358,596	338,592
Net profits after minority interests	**94,219**	**140,670**	**153,542**	**176,921**	**200,921**	**285,657**	**327,550**	**357,846**	**338,854**
Earnings per share (Rs)	**44.1**	**65.8**	**71.8**	**82.7**	**93.9**	**133.6**	**153.1**	**167.3**	**158.4**
Balance sheet (Rs mn)									
Total equity	415,582	488,912	578,830	670,137	791,636	977,348	1,197,413	1,433,678	1,649,882
Deferred tax liability	54,250	57,911	71,557	80,976	88,775	71,333	61,214	57,919	53,239
Liability for abandonment cost	80,292	80,941	128,675	151,857	151,857	151,857	151,857	151,857	151,857
Total borrowings	60,961	39,028	28,767	21,826	41,123	51,545	83,673	120,073	114,473
Currrent liabilities	85,376	128,346	142,435	187,051	110,050	115,109	115,073	117,230	120,767
Total liabilities and equity	**696,461**	**795,138**	**950,264**	**1,111,847**	**1,183,440**	**1,367,193**	**1,609,230**	**1,880,756**	**2,090,217**
Cash	95,721	101,843	90,743	206,262	292,633	442,347	636,270	850,354	1,081,951
Current assets	133,039	178,421	240,210	192,652	197,401	206,506	204,708	232,187	234,542
Total fixed assets	419,213	471,543	565,722	643,219	623,691	648,625	693,598	718,620	694,130
Goodwill	11,661	10,753	14,172	27,686	27,686	27,686	27,686	27,686	27,686
Investments	30,811	26,961	35,753	36,888	36,888	36,888	41,828	46,769	46,770
Deferred expenditure	6,017	5,617	3,663	5,141	5,141	5,141	5,141	5,141	5,141
Total assets	**696,461**	**795,138**	**950,264**	**1,111,848**	**1,183,440**	**1,367,193**	**1,609,230**	**1,880,757**	**2,090,220**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	133,261	187,001	216,736	252,772	232,168	277,666	315,904	355,796	335,645
Working capital changes	25,630	18,787	46,461	(4,990)	(76,750)	(67,292)	32,731	(4,304)	1,182
Capital expenditure	(56,301)	(103,418)	(113,738)	(135,049)	(57,273)	(84,700)	(104,098)	(87,288)	(38,938)
Investments	(10,608)	(9,887)	(28,912)	53,822	—	—	(4,940)	—	—
Other income	9,767	13,049	14,537	20,422	56,057	52,518	60,318	58,487	58,356
Free cash flow	**101,749**	**105,532**	**135,083**	**186,976**	**154,202**	**178,192**	**299,914**	**322,691**	**356,245**
Ratios (%)									
Debt/equity	14.7	8.0	5.0	3.3	5.2	5.3	7.0	8.4	6.9
Net debt/equity	(8.4)	(12.8)	(10.7)	(27.5)	(31.8)	(40.0)	(46.1)	(50.9)	(58.6)
RoAE	21.6	28.0	25.9	25.5	24.9	30.0	28.8	26.3	21.4
RoACE	**20.6**	**24.6**	**22.0**	**22.1**	**21.4**	**26.4**	**25.5**	**23.8**	**19.7**
Key assumptions									
Rs/dollar rate	46.0	45.0	44.3	45.3	40.3	42.0	41.5	41.0	40.0
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	78.9	110.0	95.0	90.0	90.0
Ceiling/actual natural gas price (Rs/'000 cm)	2,850	2,850	3,515	4,211	4,250	4,250	4,750	5,000	5,250
Subsidy loss (Rs bn)	26.9	41.0	119.6	170.2	220.0	500.0	350.0	290.0	290.0

Source: Kotak Institutional Equities estimates.

Construction

SADE.BO, Rs751	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,100
52W High -Low (Rs)	1600 - 568
Market Cap (Rs bn)	9.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	8.7	13.1	16.0
Net Profit (Rs bn)	0.5	0.8	1.0
EPS (Rs)	40.5	62.6	78.1
EPS gth	*68.2*	*54.4*	*24.8*
P/E (x)	18.5	12.0	9.6
EV/EBITDA (x)	11.0	6.8	5.1
Div yield (%)	0.5	0.7	0.8

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	47.6	-	-
FIIs	27.2	0.1	0.1
MFs	10.6	0.1	0.1
UTI	-	-	-
LIC	-	-	-

Sadbhav Engineering: 4QFY08 PAT and margins lower than estimate; reduce target price to Rs1,100

Nitin Bhasin : nitin.bhasin@kotak.com, +91-22-6634-1395

Augustya Somani : augustya.somani@kotak.com, +91-22-6634-1328

- **4QFY08 results—revenues above estimate; PAT lower than estimate due to margin pressures**
- **Revise estimates for lower EBITDA margins on account of higher material prices**
- **Reduce target price to Rs1,100 (from Rs1,385); maintain BUY as valuations look attractive**
- **Acquired 74% stake in company owning mining rights in Mozambique—we currently do not assign any value to the same**

Sadbhav reported 4QFY08 results below estimates—adjusted PAT of Rs185 mn versus estimated Rs228 mn mainly on account of lower margins—9.7% versus estimated 12.1%. Higher input cost pressures resulted in lower-than-expected margins. Revenues for the quarter increased to Rs3.6 bn, up 83% yoy from Rs1.9 bn in 4QFY07 and adjusted net income increased by 51% yoy to Rs185 mn from Rs122 mn in 4QFY07. For the full year, revenues were Rs8.7 bn (up 78% yoy) and adjusted net income was Rs489 mn (up 84% yoy). We marginally revise our revenue estimates for FY2009E lower by 2.5% and for FY2010E upwards by 4.4%. We reduce our EBITDA margin estimates for FY2009E and FY2010E to 11.2% and 11.1%, respectively, from 12.3% previously for both years on account of rising material cost prices and limited potential to pass on the escalation. We reduce our net income estimates for FY2009E and FY2010E lower by 15% and 5.2%, respectively, on account of lower margins and marginally higher tax rates. We reduce target EV/EBITDA multiple for the construction business in line with current valuation of larger construction companies. We increase our interest cost and WACC assumptions for the BOT projects to account for higher interest rates and cost of equity. We revise our SOTP-based target price to Rs1,100 from Rs1,385 earlier and maintain BUY as valuations look attractive.

4QFY08 results—PAT and EBITDA margin below estimates; higher material costs pull down margins

Sadbhav's 4QFY08 results were lower than estimates with adjusted PAT of Rs185 mn (up 35% yoy) versus our estimate of Rs228 mn. Revenues for the quarter were slightly above estimates at Rs3.6 bn (up 83% yoy) versus our estimate of Rs3.4 bn. Net income for the quarter was lower than estimate due to lower margins at 9.7% versus 10.4% in 4QFY07 on account of higher material costs. Cement, steel, bitumen and diesel contribute close to 95% of the materials used in construction activity. Sharp increase in steel and bitumen costs has primarily impacted margins as there is limited escalation window available in the existing contracts. Tax provision during the quarter was also higher as two projects in which the company was enjoying tax benefits under section 80-IA were completed in the previous quarter hence the effective tax rate during the quarter was higher. For the full year, revenues were Rs8.7 bn (up 78% yoy) and adjusted net income was Rs489 mn (up 84% yoy). However, margins in FY08 were lower at 11% compared to 12% in FY07 (see Exhibit 1).

Revise estimates—reduce EBITDA margin on account of increasing material costs

We reduce our EBITDA margin estimates for FY2009E and FY2010E to 11.2% and 11.1%, respectively, from 12.3% for both years previously on account of rising material cost prices and limited potential to pass on the escalation. We marginally revise our revenue estimates for FY2009E lower by 2.5% and for FY2010E upwards by 4.4%. We reduce our net income estimates for FY2009E and FY2010E lower by 15% and 5.2%, respectively on account of lower margins and marginally higher tax rates. We believe, Sadbhav will maintain current margins as the company is bidding for new orders taking into account higher raw material costs and selective escalation clauses wherever possible (see Exhibit 2).

Valuation—Reduce target price to Rs1,100 from Rs1,385 earlier; maintain BUY

We reduce our SOTP-based target price to Rs1,100 from Rs1,385 to account for lower EV/EBITDA multiple for the construction business and higher cost of equity for the BOT business. We value the construction business at Rs770 per share and the BOT projects at Rs325 per share (see Exhibit 3). We reduce our target EV/EBITDA multiple for the external construction business to 7.5X from 9X earlier and for the in-house BOT projects to 6X from 6.5X earlier (see Exhibit 4). Our target multiple of 7.5X implies a 20% discount to the 9.3X EV/EBITDA multiple of larger construction companies (see Exhibit 5). We also increase our WACC and interest rate assumptions for the BOT projects due to the rising interest costs in line with the overall macro environment (see Exhibit 6). We maintain our BUY rating on the stock as we find current valuations very attractive supported by strong order book which provides better revenue visibility.

Strong order book provides greater support to earnings estimates

Sadbhav's outstanding order book of Rs27.3 bn provides improved earnings visibility and greater support to our FY2009E and FY2010E revenue estimates. Current order book provides earnings visibility of 1.9 years to our current revenue estimates (see Exhibit 7). The current order book is to be executed over a period of 30 months and is distributed across various segments thus cushioning against dependence on any particular segment (see Exhibit 8). It also has tendered for orders worth Rs26 bn, tenders for which are yet to be opened and has pre-qualified in orders worth Rs98 bn for which bid documents are under preparatory stage. We believe strong order flow and continuing traction in all its business segments provides support to our revenue growth estimates.

Venturing into mining—acquisition of prospecting license in Mozambique

Sadbhav recently acquired a 74% stake in Hong-Kong-based Ocean Bright Corporation Ltd (through its wholly-owned subsidiary Sadbhav Natural Resources Ltd) which owns 100% rights in four mining blocks in Mozambique. Company has paid initial commitment fees of US$2.75 mn to the Hong Kong company and also invested in certain mining equipments to be used there. The final cost of the investment will be determined only after initial prospecting is completed; however it will be capped to a maximum of US$25 mn. The company has four blocks in the region with reserves (estimated as per World Bank) of 350 mn tons of limestone, 400 mn tons of iron ore (including traces of copper), approximately 0.8-1 bn tons of coal and potential for further coal and uranium resources. The prospecting for these mines is under progress and final reserves will be determined once the same is completed. We currently do not assign any value to the mining business awaiting greater clarity on the reserve estimates and award of mining licenses.

BOT projects—looking to partial stake selloff

Sadbhav is looking to partially liquidate its stake in the BOT business to fund future projects in this segment. It has formed a 100% subsidiary company—Sadbhav Infrastructure Projects Ltd (SIPL) to which its ownership in the various BOT SPVs will be transferred. It is currently looking out for a strategic partner to partially selloff its stake in SIPL. As per management advanced talks are under progress and final negotiations are expected to be completed by mid-August 2008. Exhibit 9 illustrates the proposed organization structure for Sadbhav.

Exhibit 1: Sadbhav, interim results (standalone), March fiscal year-ends, (Rs mn)

		qoq		yoy			yoy	
	4QFY08	3QFY08	(% chg)	3QFY07	(% chg)	FY08	FY07	(% chg)
Net sales	**3,607**	**2,301**	***56.8***	**1,967**	***83.3***	**8,721**	**4,901**	***77.9***
Total expenditure	**(3,257)**	**(2,028)**	***60.6***	**(1,763)**	***84.8***	**(7,757)**	**(4,310)**	***80.0***
Inc/(Dec) in stock	119	15	*705.2*	(79)	*(250.5)*	227	(33)	*(782.9)*
Raw materials	(1,242)	(407)	*205.0*	(518)	*139.9*	(2,339)	(1,369)	*70.8*
Construction expense	(1,979)	(1,544)	*28.2*	(1,032)	*91.8*	(5,235)	(2,601)	*101.3*
Staff cost	(67)	(24)	*182.7*	(48)	*39.6*	(145)	(103)	*40.3*
Other expenditure	(88)	(68)	*30.0*	(85)	*3.8*	(265)	(203)	*30.3*
EBITDA	**349**	**273**	***28.0***	**205**	***70.7***	**964**	**591**	***63.2***
OPM (%)	**9.7**	**11.9**		**10.4**		**11.0**	**12.0**	
Other income	27	4	*637.7*	1	*2,238.0*	39	14	*174.0*
Interest	(45)	(51)	*(12.1)*	(19)	*129.6*	(157)	(69)	*126.4*
Depreciation	(38)	(34)	*12.9*	(36)	*6.6*	(139)	(149)	*(6.8)*
Pretax profits	**293**	**192**	***52.8***	**151**	***94.7***	**706**	**386**	***82.9***
Tax	(108)	(55)	*96.7*	(28)	*281.2*	(218)	(120)	*80.9*
Adjusted profits	**185**	**137**	***35.1***	**122**	***51.4***	**489**	**266**	***83.8***
Extra-ordinary (1)	35	—		(2)		35	(2)	
Reported net incom	**220**	**137**	***60.7***	**120**	***83.4***	**524**	**264**	***98.5***
Income tax rate (%)	*36.9*	*28.7*		*18.8*		*30.8*	*31.1*	

Note: (1) Extra-ordinary items adjusted for tax.

Source: Company data, Kotak Institutional Equities.

Exhibit 2: Sadbhav Engineering, change in estimates, March fiscal year-ends, (Rs mn)

	Revised estimates		Old estimates		Change (%)	
	2009E	2010E	2009E	2010E	2009E	2010E
Revenue	13,114	16,039	13,449	15,367	(2.5)	4.4
EBITDA	1,473	1,773	1,651	1,888	(10.8)	(6.1)
EBITDA margin (%)	11.2	11.1	12.3	12.3	—	—
Adjusted net profit	791	1,023	930	1,079	(14.9)	(5.2)
Diluted EPS (Rs)	60.4	78.1	71.0	82.4	(14.9)	(5.2)

Source: Kotak Institutional Equities estimates.

Exhibit 3: Our SOTP-based valuation for Sadbhav is Rs1,100

Business	Valuation method	Equity value (Rs mn) Total	SEL share	Per share (Rs)	Comments
Construction business (a)	EV/EBITDA	10,075	10,075	769	Based on 2009E EBITDA - 6X for BOT-construction and 7.5X for non-BOT construction business
BOT projects (b)	DCF	7,742	4,227	323	Based on DCF valuation of projects
Ahmedabad Ring Road		3,649	2,919	223	SEL has 80% stake
Mumbai Nasik		2,516	503	38	SEL has 20% stake
Aurangabad-Jalna		1,015	518	40	SEL has 51% stake
Nagpur-Seoni		562	287	22	SEL has 51% stake
Total (a) + (b)			**14,302**	**1,092**	
Target price				**1,100**	

Source: Kotak Institutional Equities estimates.

Exhibit 4: We value the construction business at Rs770 per share

Valuation of construction business, (Rs mn)

	Non-BOT	BOT	Total
EBITDA-FY2009E (Rs mn)	899	574	1,473
EV/EBITDA (X)	7.5	6.0	—
Enterprise value (Rs mn)	6,742	3,445	10,187
Net debt-FY2009E (Rs mn)	—	—	112
Equity value (Rs mn)			**10,075**
Equity value per share (Rs)			**769**

Source: Kotak Institutional Equities estimates.

Exhibit 5: Construction stocks currently trade at an average P/E of about 14X and EV/EBITDA of 9.3X based on FY2009E earnings

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

	Revenues			EBITDA			EPS (Rs)			P/E (X)			EV/EBITDA (X)		
Company	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E
Nagarjuna Construction Company	35	48	61	4	5	6	7.0	10.0	13.6	12.3	8.6	6.3	8.6	6.2	4.8
Punj Lloyd Ltd.	78	106	137	6	9	13	10.1	14.9	21.6	23.5	15.9	11.0	13.4	9.6	7.0
IVRCL Infrastructure	37	50	69	4	5	7	15.6	16.3	23.7	13.9	13.3	9.1	9.8	7.8	6.4
Larsen & Toubro standalone	249	336	451	28	40	54	71.5	94.9	123.1	22.5	16.9	13.0	17.9	12.8	9.6
Consolidated Construciton Company	15	22	29	1	2	3	28.9	38.9	52.6	20.7	15.4	11.4	15.2	10.3	7.6
Average										**18.6**	**14.0**	**10.2**	**13.0**	**9.3**	**7.1**
Sadbhav Engineering	9	13	16	1	1	2	40.5	62.6	78.1	10.5	6.8	5.4	6.2	4.4	3.2

Note:

(1) For Nagarjuna - we have adjusted value of land bank (about Rs39/share), other BOT projects (Rs6.5/share) and investments (Rs19/share) for a total of Rs65/share

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

(3) For IVRCL we have adjusted value of IVR Prime (Rs60/share corresponding to IVR Prime price of Rs200/share) and other BOT projects for a total adjustment of Rs115/share

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

(5) For Sadbhav Engineering we have deducted Rs325 per share (the value of BOT projects)

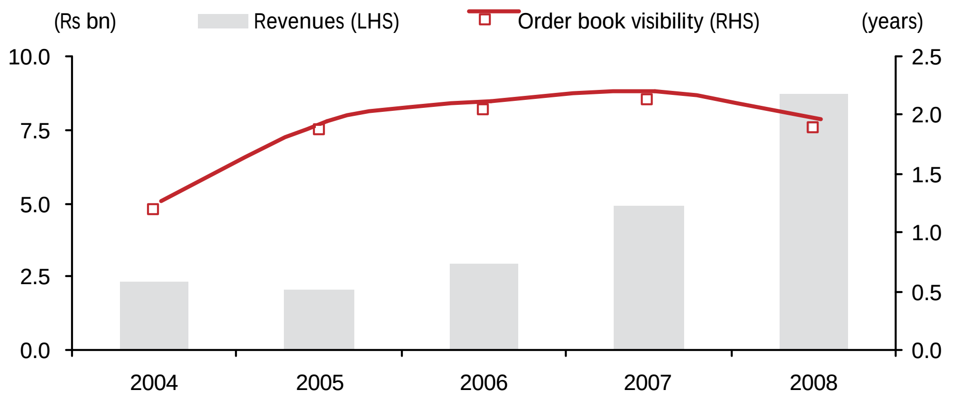
Source: Bloomberg, Kotak Institutional Equities estimates.

Exhibit 12: We value BOT projects at Rs325/share
Financial summary of BOT projects

	Project	Length	PV of equity (Rs mn)		WACC (%)		Cost of debt (%)		Equity IRR	Equity value per share (Rs)	
Project	cost (Rs mn)	(km)	Total	SEL share	Current	Previous	Current	Previous	(%)	Current	Previous
Sardar Patel Ring Road	5,150	76	3,649	2,919	12.5	10.5	11.0	9.5	27.3	223	271
Vadape-Gonde	7,530	100	2,516	503	12.5	10.5	11.0	9.5	23.8	38	60
Aurangabad-Jalna	2,770	69	1,015	518	12.8	12.1	11.3	11.3	15.8	40	32
Lakhanadon-Seoni	4,890	57	562	287	10.2	9.9	8.8	8.8	5.2	22	23
Total	**20,340**		**7,742**	**4,227**						**323**	**386**

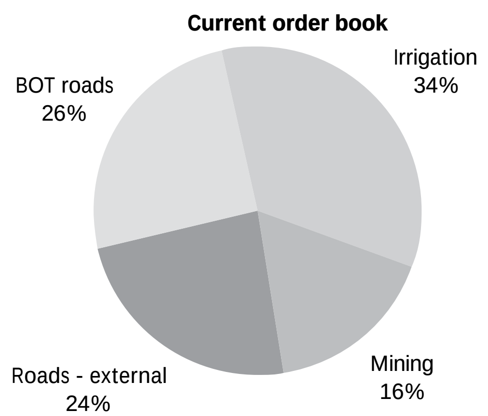
Source: Company data, Kotak Instituitonal Equities estimates.

Exhibit 7: Sadbhav continues to have strong order book visibility
Revenues and order book visibility for Sadbhav, March fiscal year-ends



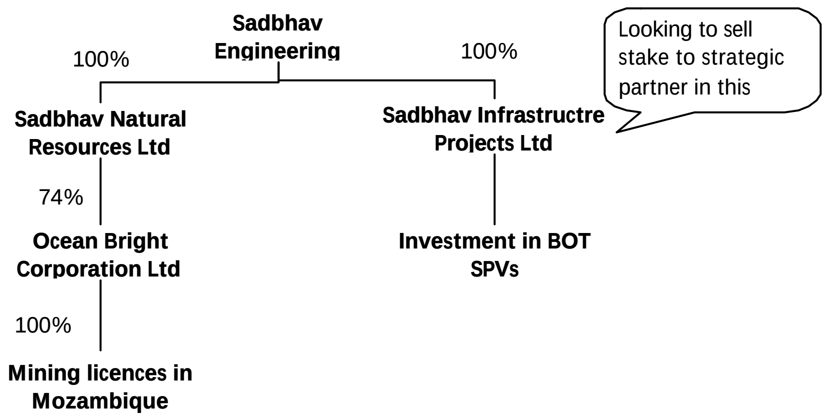
Source: Company, Kotak Institutional Equities estimates.

Exhibit 8: Sadbhav's current order book is distributed across segments
Segmental split of total order book of Rs27.3 bn



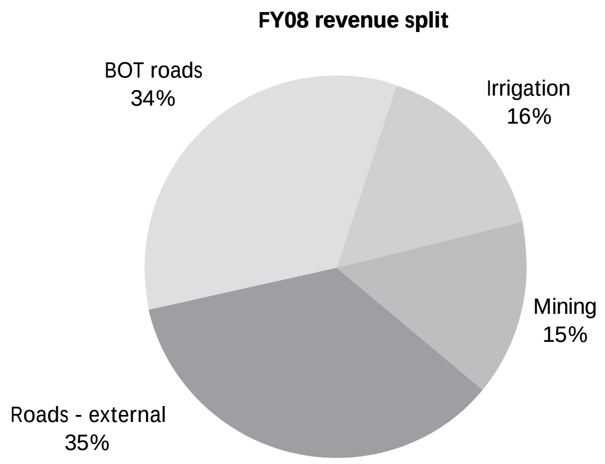
Source: Company.

Exhibit 9: Organisation structure for Sadbhav



Source: Company, Kotak Institutional Equities.

Exhibit 10: Roads contributed to 69% of FY2008 revenues



Source: Company.

Exhibit 11: Profit model, balance sheet, cash model for Sadbhav Engineering (standalone), 2006-2010E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model					
Total income	2,906	4,886	8,721	13,114	16,039
EBITDA	**353**	**579**	**972**	**1,473**	**1,773**
Interest (expense)/income	(84)	(54)	(157)	(145)	(57)
Depreciation	(139)	(149)	(139)	(164)	(189)
Other income	(2)	6	30	4	6
Pretax profits	**129**	**381**	**706**	**1,168**	**1,533**
Tax	(11)	(129)	(221)	(353)	(494)
Deferred taxation	(1)	8	(15)	(23)	(15)
Adjusted net income	**117**	**263**	**489**	**791**	**1,023**
Diluted earnings per share (Rs)	**14.1**	**24.1**	**37.3**	**60.4**	**78.1**
Balance sheet					
Total equity	1,254	1,466	2,896	3,911	4,842
Deferred taxation liability	108	93	108	132	147
Total borrowings	522	730	1,500	750	400
Current liabilities	1,751	2,551	3,485	5,210	6,376
Total liabilities and equity	**3,634**	**4,841**	**7,990**	**10,002**	**11,765**
Cash	432	251	648	638	1,168
Other current assets	2,025	2,984	4,779	6,192	7,222
Total fixed assets	1,038	1,119	1,391	1,626	1,837
Miscl. exp. not written off	34	26	17	9	—
Investments	104	461	1,155	1,537	1,537
Total assets	**3,634**	**4,841**	**7,989**	**10,002**	**11,765**
Free cash flow					
Operating cash flow, excl. working capital	215	467	647	962	1,198
Working capital changes	581	165	(868)	293	121
Capital expenditure	(398)	(232)	(410)	(400)	(400)
Investments	(440)	(782)	(694)	(383)	—
Other income	10	17	39	25	38
Free cash flow	**399**	**401**	**(630)**	**856**	**918**
Ratios (%)					
Debt/equity	38.3	46.8	49.9	18.6	8.0
Net debt/equity	6.6	30.7	28.4	2.8	(15.4)
RoAE	8.6	16.8	16.3	19.6	20.5
RoACE	**2.5**	**10.8**	**11.2**	**14.9**	**19.3**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 12: We value BOT projects at Rs325/share

Financial summary of BOT projects

	Project	Length	PV of equity (Rs mn)		WACC (%)		Cost of debt (%)		Equity IRR	Equity value per share (Rs)	
Project	cost (Rs mn)	(km)	Total	SEL share	Current	Previous	Current	Previous	(%)	Current	Previous
Sardar Patel Ring Road	5,150	76	3,649	2,919	12.5	10.5	11.0	9.5	27.3	223	271
Vadape-Gonde	7,530	100	2,516	503	12.5	10.5	11.0	9.5	23.8	38	60
Aurangabad-Jalna	2,770	69	1,015	518	12.8	12.1	11.3	11.3	15.8	40	32
Lakhanadon-Seoni	4,890	57	562	287	10.2	9.9	8.8	8.8	5.2	22	23
Total	**20,340**		**7,742**	**4,227**						**323**	**386**

Source: Company data, Kotak Instituitonal Equities estimates.

Telecom

IDEA.BO, Rs102	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	110
52W High -Low (Rs)	161 - 88
Market Cap (Rs bn)	268.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	67.2	97.3	128.2
Net Profit (Rs bn)	10.4	12.6	15.4
EPS (Rs)	4.0	4.8	5.8
EPS gth	*78.9*	*21.1*	*21.5*
P/E (x)	25.7	21	17.5
EV/EBITDA (x)	14.5	10.8	8.9
Div yield (%)	-	-	-

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.7	-	-
FIIs	7.7	0.3	0.3
MFs	0.4	0.1	0.1
UTI	-	-	-
LIC	-	-	-

Idea Cellular: An expensive acquisition funded through placement at expensive price—net result marginally positive

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

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

- **Expensive acquisition funded through placement of own equity at 56% premium to the current market price**
- **Overall acquisition EPS accretive in FY2010E assuming substantial synergy benefits**
- **Placement of stake to TM eases balance sheet pressure; business case for greenfield expansion in new circles still remains weak**
- **Recommend investors to use any increase in stock price to exit the stock. Maintain REDUCE**

We find Idea's acquisition of Spice, at an EV of US$1.5 bn (20.3X consensus CY2008E EBITDA) and at 80-100% premium to the current EV/EBITDA multiples of larger wireless players, extremely expensive. Idea is funding the acquisition through placement of its equity to Telekom Malaysia at Rs157, a 56% premium to Wednesday’s closing stock price. The dilution highlights the funding requirement of Idea to expand into new circles. The acquisition will give Idea a presence in two new circles—Punjab and Karnataka. The entire transaction would be 0.9% FY2010E and 1.6% FY2011E earnings accretive and provides partial funding for network rollout in the remaining circles; however, FY2009E EPS would get diluted by 7.3% (based on year-end shares outstanding). The acquisition, however, does not address the key issues, which include (1) business case for rollout of operations in the balance 10 circles—Idea may struggle to be NPV positive, in our view; and (2) high risk to operating metrics from emerging price competition. We believe ongoing deterioration in pricing is the real issue and note that Idea is the most vulnerable listed player in the emerging environment. We recommend investors to use Wednesday's increase in stock price as an opportunity to sell. Maintain REDUCE rating with 12-month DCF based target price of Rs110/ share.

Expensive acquisition funded through placement of own equity at 56% premium to the current market price. Idea would pay Rs38 bn in cash (including non-compete fee and assuming 100% subscription to open offer), assume approximately Rs10 bn of net debt, issue shares of 18.5% (post-money) to Telekom Malaysia to acquire Spice Communications. The deal values Spice at CY2008 EV/ EBITDA of 20.3X, a 100% premium to Bharti and 85% to Idea’s current valuations. Idea is funding this acquisition through 15% post-money equity dilution raising Rs73 bn through preferential placement to Telekom Malaysia at a valuation of 15.2X FY2009 and 12.3X FY2010 EV/EBITDA. Exhibit 1 details the mechanics of the deal.

Overall transaction EPS accretive, if compared to an earlier assumption of Greenfield rollout in the Punjab and Karnataka circle. Exhibit 2 details our assumptions on the earnings impact from this transaction. We believe this transaction is 0.9% FY2010E and 1.6% FY2011E earnings accretive assuming synergy benefits resulting in higher EBITDA margins by 100bps in FY2010 and 200bps in FY2011. We had assumed losses of Rs500 mn in FY2010 and Rs1 bn in FY2011 for the Punjab and Karnataka circle rollout for Idea earlier, which in our view would not accrue after the acquisition. We, however, note that Idea’ s FY2009 earnings may decline 7.3% after a significant equity dilution.

Spice has operations in two circles, Punjab and Karnataka, with total subs base of 4.4 mn and market share of 1.7% at end-April 2008. Spice is the second largest player in the Punjab circle with 2.65 mn subs (24% share) as at end-April 2008. However, Spice is a small player in Karnataka with a mere 10.2% market share of subs. Spice has not been able to extend coverage in Karnataka (a large circle) due to lack of funds and has thus trailed other operators despite an early start. Spice's operations are in 900 MHZ band. Idea management indicated that it may have to incur a one time capex to upgrade Spice's existing network infrastructure in addition to additional spending on rebranding in the two circles.

Placement of stake to TM eases balance sheet pressure; business case for greenfield expansion in new circles still remains weak. Idea has raised US$2.3 bn in the past two months, through partial monetization of holdings in Indus Towers and through preferential placement to Telekom Malaysia. Net cash infusion into Idea after paying for Spice acquisition and adjusting for Spice's net debt of US$230 mn is US$1.2 bn. We believe dilution was imminent given stretched balance sheet (end-FY2008 net debt/ EBITDA of 2.5X), aggressive capex plan of US$1.5 bn for existing circles and potential rollouts in new circles.

We maintain that any new entrant (a new player or an existing player entering a new circle) will likely face significant challenges in the form of (1) reduced addressable market, (2) deteriorating quality of incremental subscribers, with urban markets already highly penetrated; and (3) higher capex as the spectrum allocation would be in the 1,800 Mhz band. Our analysis of Idea's entry in the Mumbai circles suggests that Idea will likely need to garner 17% net subscriber market share over the next 10 years to generate an IRR of 12.5%, its cost of capital (see Exhibit 3). This is extremely unlikely, in our view even in a six-player market let alone a potentially 10-player market. Idea faces similar challenges as it branches out into newer circles

Pricing pressure is the key issue, Idea the most vulnerable. A 5% change in pricing versus our base case impacts Idea's valuations by 8%, the highest in our coverage universe. We expect the recent significant changes to pricing to have a significant negative impact on wireless ARPU, RPM (revenue per minute) and EPM (EBITDA per minute). In particular, we highlight the recent reduction in long distance (STD) and roaming rates. More important, we do not rule out further price declines because we expect competition to increase over the next few months led by aggressive expansion by existing players and entry of new players

Rationale for TM investment in Idea at a 56% premium to the current market price. TM was stuck with its investments in Spice, in our view. Spice was constrained for funding and did not have LOI's for pan-India GSM expansion (received only 4 LoIs in the LoI grants in Jan 2008). Further, newspaper reports indicate that TM's relationships with the Spice management were far from cordial. We believe TM was forced to pay (invest in Idea) an exorbitant amount to part its relationship with Spice and get opportunities in a high growth company i.e. Idea. We believe TM may become a regular source of equity funding for Idea in future.

Acquisition may create inefficiencies. In our view inefficiencies are created from

1. Idea recently paid Rs3.6 bn for Punjab and Karnataka circle licenses which would not be refunded by the DoT after the acquisition. This in our view should be added to the overall acquisition costs. We also presume that the performance bank guarantee would be confiscated.

2. Spice had already sold off its towers to Quipo for ~US$200 mn in Dec 2007 and committed future site expansion through Quipo. This creates a conflict as Idea is committed for passive infrastructure roll out in Punjab and Karnataka through Indus Towers. Idea management did not dwell into details about this potential conflict.

3. Spice recently paid Rs4.8 bn for acquiring license in four circles viz: Delhi, Andhra Pradesh, Maharashtra and Haryana, which cannot be merged (for three years from the date of license grant) as per the recent DoT guidelines on merger of telecom licenses (each circle has its own telecom license).

Transaction details. Idea has entered into an agreement to acquire Spice Communications through (1) Buying out promoters 40.8% stake through a cash payment at Rs77.3/ share resulting in total payout of Rs21.7 bn (2) Payment of non-compete fees of Rs5.44 bn to Spice amounting to 25% of the total consideration paid to the promoters; we note the current regulations allow up to 25% of the consideration to be paid as non-compete without that being added to the open offer price; (3) mandatory open offer to acquire additional 20% stake in Spice Communications entailing an outflow of Rs10.7 bn; and (4) stock swap with Idea offering 49 shares for every 100 shares held by TM in Spice—this would result in Idea's equity dilution of 3.5%. Separately, Idea has placed 465 mn shares to TM at Rs157, raising Rs73 bn in cash. TM would hold 18.5% in Idea after this transaction.

Idea—Spice acquisition transaction dynamics

Pre-deal			
Spice		**Transaction prices**	
# of shares	690	Spice (Rs/share)	77.3
% holding		Idea (Rs/share)	156.96
BK Modi group	40.8		
Telekom Malaysia ™	39.2	**EV/EBITDA at transaction price (X)**	
Others	20.0	Spice	20.3
Transaction dynamics			
Idea pays Spice group for 40.8% in Spice (Rs mn)	21,759		
Idea pays Spice Group for non- compete agreement	5,440		
Idea shares issued to TM for 39.2% stake in Spice (mn)	132.5	Swap ratio of 49:100	
Post-share swap equity share of Telekom Malaysia (in Idea)	4.8		
Further equity issuance to TM	464.7		
TM pays to Idea	72,944		
Post-equity issuance TM holding in Idea	18.5		
Open offer (assuming fully subscribed (residual 20%) at transaction price of Rs77.3)			
Idea shells out for open offer (Rs mn)	10,666		
Total amount that Idea pays in cash (Rs mn)	37,865		
Idea gets from TM (Rs mn)	72,944		
Debt assumed (Rs mn)	9,890		
Net cash inflow to Idea	25,189		
New equity issued	597.3		
As % of Post-deal equity	18.5		

Source: Company, Kotak Institutional Equities estimates

We expect the Spice acquisition to be EPS accretive for Idea in FY2010E

EPS impact				
	FY2008E	**FY2009E**	**FY2010E**	**FY2011E**
Idea - current estimates				
Revenues	67,200	97,334	128,218	154,530
EBITDA	22,538	32,613	44,369	54,906
EBIT	13,771	19,745	25,908	33,666
PBT	11,169	13,357	16,526	23,325
PAT	10,444	12,648	15,366	19,123
# of shares (mn)	2,635	2,635	2,635	2,635
EPS (Rs/share)	4.0	4.8	5.8	7.3
Add: Spice				
Revenues	10,415	14,632	17,998	19,926
EBITDA	2,556	3,512	4,499	5,181
EBITDA margin (%)	**24.5**	**24.0**	**25.0**	**26.0**
Depreciation (as % of sales)	**21.0**	**15.0**	**15.0**	**15.0**
EBIT	367	1,317	1,800	2,192
Interest paid	(1,769)	(563)	-	-
Interest income	762	400	400	400
PBT	(640)	1,154	2,200	2,592
Tax		(131)	(249)	(294)
PAT	(722)	1,024	1,951	2,298
EPS impact on Idea				
PAT pre-acquisition		12,648	15,366	19,123
Add: Spice PAT		1,024	1,951	2,298
Losses assumed for Punjab and Karnataka circle			500	1,000
Add: Interest income on excess cash		703	1,205	1,406
PAT post-acq		14,374	19,022	23,827
Expanded equity base		3,233	3,233	3,233
EPS (on expanded equity base at year-end)		4.45	5.88	7.37
EPS (dilution)/accretion		**(7.3)**	**0.9**	**1.6**

Idea would need to take 17% of net additions to achieve IRR of 12.5%; we model its share of net additions at 10%
Hypothetical model of Idea's operations in Mumbai circle and share of net additions to earn WACC, March fiscal year-ends, 2007-2023E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues	**399**	**1,267**	**2,067**	**2,636**	**3,111**	**3,569**	**3,994**	**4,399**	**4,787**	**5,027**	**5,278**	**5,542**	**5,819**	**6,110**	**6,416**
Subscribers (mn)	0.2	0.5	0.7	0.9	1.0	1.1	1.2	1.3	1.3						
Idea market share (%)	1.6	3.2	4.1	4.7	5.1	5.5	5.8	6.1	6.3						
Idea share of net adds (%)	**9.2**	**16.6**	**16.6**	**16.6**	**16.6**	**16.6**	**16.6**	**16.6**	**16.6**						
Blended ARPU (Rs)	290	284	281	281	284	290	296	302	308						
Growth yoy (%)		(2.0)	(1.0)	—	1.0	2.0	2.0	2.0	2.0						
EBITDA margin (%)	(40)	(10)	15	20	25	30	35	37	39						
EBITDA	**(159)**	**(127)**	**310**	**527**	**778**	**1,071**	**1,398**	**1,628**	**1,867**	**1,960**	**2,058**	**2,161**	**2,269**	**2,383**	**2,502**
Depreciation	(270)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)	(518)
Pre-tax profits	(429)	(644)	(208)	10	260	553	880	1,110	1,349	1,443	1,541	1,644	1,752	1,865	1,984
Effective tax rate (%)	—	—	—	—	—	—	—	—	—	24	24	24	24	24	34
Tax (Rs mn)	—	—	—	—	—	—	—	—	—	(343)	(367)	(391)	(417)	(444)	(675)
Operating cash flow	**(159)**	**(127)**	**310**	**527**	**778**	**1,071**	**1,398**	**1,628**	**1,867**	**1,617**	**1,692**	**1,770**	**1,853**	**1,939**	**1,828**
Entry fees	(2,030)														
Capex	(6,740)	—	—	—	—	—	—	—	—	(129)	(194)	(259)	(324)	(388)	(611)
Cash outflow	(8,770)	—	—	—	—	—	—	—	—	(129)	(194)	(259)	(324)	(388)	(611)
Free cash flow	**(8,929)**	**(127)**	**310**	**527**	**778**	**1,071**	**1,398**	**1,628**	**1,867**	**1,488**	**1,498**	**1,511**	**1,529**	**1,551**	**1,217**
FCF for IRR	**(8,929)**	**(127)**	**310**	**527**	**778**	**1,071**	**1,398**	**1,628**	**1,867**	**1,488**	**1,498**	**1,511**	**1,529**	**1,551**	**16,221**
IRR (%)	**12.5**														

Key assumptions:	
Terminal year growth rate (%)	5.0
WACC	12.5
Maintenance capex as % of revenues	10.0

Note:
(a) We assume Idea will claim Section 80 IA taxation benefits from the sixth year of its operations.

Source: Kotak Institutional Equities estimates.

Industrials

SIEM.BO, Rs431	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	520
52W High -Low (Rs)	1143 - 398
Market Cap (Rs bn)	145.2

Financials

September y/e	2007	2007	2009E
Sales (Rs bn)	94.2	102.8	124.3
Net Profit (Rs bn)	6.1	5.9	8.7
EPS (Rs)	18.2	17.4	25.8
EPS gth	*60.4*	*(4.2)*	*47.9*
P/E (x)	23.6	24.7	16.7
EV/EBITDA (x)	13.7	14.0	9.2
Div yield (%)	0.6	0.6	0.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	55.2	-	-
FIIs	5.9	0.2	(0.4)
MFs	6.1	0.9	0.3
UTI	-	-	(0.5)
LIC	8.9	1.2	0.6

Siemens: Sharp correction prompts rating upgrade to ADD; reverse DCF valuation implies conservative growth estimates in our view

Lokesh Garg : lokesh.garg@kotak.com, +91-22-6634-1496

Sandip Bansal : sandip.bansal@kotak.com, +91-22-6749-3327

- **Highlight sharp correction in the stock post our previous update**
- **Reverse DCF valuation implies revenue growth of 10-12% over FY2013E-2019E and terminal growth rate of 4%**
- **Cut target price to Rs520 (from Rs600 earlier); upgrade to ADD based on significant correction in valuation and sectoral prospects**

We highlight steep correction in Siemens stock price—9.4% relative to the market since our previous update with REDUCE rating on April 29, 2008 and—26.3%, 20.8% and 52% relative to the market over the last 3-month, 6-month and 1-year period, respectively. Our reverse SOTP and DCF valuation (using a WACC of 13.5%) on Siemens implies conservative assumptions for the standalone entity—(1) average sales growth of 10-12% over 2013E to 2019E, (2) terminal growth rate of 4% and (3) EBITDA margins of 9.25% from 2013E onwards. We maintain our EPS estimates of Rs17.4 and Rs25.8 for September year-ended 2008E and 2009E, respectively. We cut our SOTP-based target price to Rs520 (from Rs600 earlier) led by higher WACC assumption of 13.5% (12.5% earlier) for the standalone entity. We upgrade our rating to ADD from REDUCE earlier.

Highlight sharp correction in the stock post our previous update

We highlight steep correction in Siemen's stock price—26.3%, 20.8% and 52% relative to the market over the last 3-month, 6-month and 1-year period, respectively. Siemen's has also corrected 9.4% relative to the market post our previous update on April 29, 2008. Siemens is currently trading at a P/E of 24X FY2009E and 16X FY2010E our EPS estimates respectively, significantly lower than 33X FY2009E and 22X FY2010E EPS prevailing at the time of the previous update.

Reverse DCF valuation implies revenue growth of 10% over FY2013E-2019E and terminal growth rate of 4%

Our reverse SOTP and DCF valuation (using a WACC of 13.5%) on Siemens implies the following for the standalone entity—(1) average sales growth of 10-12% over 2013E to 2019E, (2) terminal growth rate of 4% and (3) EBITDA margins of 9.25% from 2013E onwards. Four our reverse SOTP calculations we have used P/E multiples of 13X, 12X and 12X September 2009E earnings for the IT, industrial and building businesses, respectively. The reverse DCF valuation of Siemens standalone (Rs354/ share) implies a P/E of 17X September 2009E earnings (Exhibits 1-2).

We assume 20% growth as well as return to normal profitability in 2HFY08E and FY2009E

We maintain our EPS estimates of Rs17.4 and Rs25.8 for September year-ended 2008E and 2009E, respectively. For the standalone entity we assume a growth of 20% in 2HFY08E over 2HFY07 and operating margins of 10.3% versus 9.4% (adjusted for one off provisions) achieved in 2HFY07. For September year-ended FY2009E we assume 21% revenue growth yoy for the standalone entity and operating margin of 10.4% (see Exhibit 3).

Cut target price to Rs520 (from Rs600 earlier); upgrade to ADD based on significant correction in valuation, sectoral prospects and likely strong execution

We cut our SOTP-based target price to Rs520 (from Rs600 earlier), comprising of (1) Rs435 for the standalone entity based on FY2009E-based DCF (implying a P/E multiple of 21X based on FY2009E EPS estimates), (2) Rs77 for SISL (P/E Multiple of 12X September 2009E earnings) and (3) Rs7 for the industrial and building subsidiaries (P/E multiple of 15X respective September 2009E earnings). The change in our target price is led by (1) increase in WACC assumptions to 13.5% (from 12.5% earlier) for the DCF valuation of the stand alone entity and (2) marginal reduction in growth and margin estimates post FY2013E (see Exhibits 4 and 5).

We upgrade our rating to ADD from REDUCE earlier based on (1) significant correction in valuations and (2) about 24% upside to our target price. We highlight that valuation gap of Siemens over the Sensex has reduced considerably over the past few months (it had been increasing since October 2004, see Exhibit 6). Key risks arise from (1) margin pressures due to commodity price increase, (2) continuation of problems witnessed in the last quarter, (3) dependence on large orders that potentially yield lower margins and (4) lower order book visibility.

Exhibit 1. Reverse valuation of Siemens adjusted for its IT business is close to 16X September 2009E earnings

Sum of the Parts (SOTP) valuation of Siemens based on y/e Sep 2009E (Rs mn)

	Earnings est. 2009E	Valuation (Rs mn)	Per share (Rs)	Methoodolgy
Consolidated PAT of Siemens	7,063			
Consolidated PAT of Siemens excluding SISL + SIPSL dividend	6,848	119,461	354	DCF - Implies P/E of 17X Sep 2009E earnings
SISL + SIPSL PAT	2,152	25,822	77	P/E Multiple of 12X September 2009E earnings
Siemesn Industrial Turbomachinery	56	671	2	P/E multiple of 12X September 2009E earnigns
Siemens Building Technologies	98	1,175	3	P/E multiple of 12X September 2009E earnigns
Total valuation	**139,753**	**147,129**	**436**	

Source: Kotak Institutional Equities estimates.

Exhibit 2. Reverse DCF for Siemens (standalone) to get Rs 420/ share

Siemens (standalone) - DCF model, September fiscal year-ends, 2008E-19E (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	88,745	107,488	128,150	150,438	172,935	193,687	216,930	242,961	272,116	304,770	335,248	368,772
Growth (%)	14.3	21.1	19.2	17.4	15.0	12.0	12.0	12.0	12.0	12.0	10.0	10.0
EBIT (excl finl income)	6,120	10,272	12,817	15,393	17,680	17,916	20,066	22,474	25,171	28,191	31,010	34,111
Growth (%)	(11.6)	67.8	24.8	20.1	14.9	1.3	12.0	12.0	12.0	12.0	10.0	10.0
EBIT Margins	6.9	9.6	10.0	10.2	10.2	9.3	9.3	9.3	9.3	9.3	9.3	9.3
Effective tax rate	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9
EBIT*(1-tax rate)	**3,984**	**6,687**	**8,344**	**10,021**	**11,509**	**11,663**	**13,063**	**14,631**	**16,386**	**18,353**	**20,188**	**22,207**
Growth (%)	(11.6)	67.8	24.8	20.1	14.9	1.3	12.0	12.0	12.0	12.0	10.0	10.0
Depreciation / Amortisation	733	865	948	1,036	1,129	1,591	1,674	1,679	1,713	1,893	2,099	2,219
Change in Working Capital	(4,100)	(1,673)	(1,575)	(1,692)	(1,679)	(2,075)	(2,324)	(2,603)	(2,916)	(3,265)	(3,048)	(3,352)
Capital Expenditure	(2,000)	(1,500)	(1,500)	(1,750)	(1,750)	(2,075)	(2,324)	(2,603)	(2,916)	(3,265)	(2,895)	(3,185)
Free Cash Flows	**(1,383)**	**4,379**	**6,216**	**7,614**	**9,209**	**9,104**	**10,088**	**11,103**	**12,268**	**13,715**	**16,344**	**17,888**
Growth (%)	(73.8)	(416.6)	41.9	22.5	20.9	(1.1)	10.8	10.1	10.5	11.8	19.2	9.4
Years discounted	-	-	1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0	9.0	10.0
Discount factor	1.0	1.0	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3
Discounted cash flow	**(1,383)**	**4,379**	**5,477**	**5,911**	**6,298**	**5,486**	**5,356**	**5,194**	**5,056**	**4,980**	**5,229**	**5,042**

Used WACC	**13.50%**

NPV Calc

	NPV	% of val	Terminal value Calc	NPV
Sum of free cash flow	57,024	47.7	Cash flow in terminal year	17,888
Terminal value	55,196	46.2	g	4%
Enterprise value	112,220	93.9	Capitalisation rate	10%
Add Investments	4,676	3.9	Terminal value	195,824
Net debt	(2,566)	2.1	Discount period (years)	10
Net present value-equity	119,461		Discount factor	0.28
Shares o/s	337		Discounted value	55,196
NPV /share(Rs)	**354**			

Source: Kotak Institutional Equities estimates.

Exhibit 3: Our segmental assumption reflect 20% growth as well as normal profitability going forward

Segmental revenues and margins of Siemens (Consolidated), September year-ends, FY2006-10E (Rs mn)

	2006	2007	2008E	2009E	2010E
Reveneus					
Information technology services	9,604	11,246	13,495	16,134	19,221
Automation & Drives	12,210	16,555	21,936	27,420	32,904
Industrial Solution and Services	5,463	10,038	12,522	15,561	18,606
Power	19,782	43,008	46,234	55,481	66,577
Transport	2,483	3,467	7,455	8,946	10,288
Healthcare & other services	4,138	5,247	5,562	6,396	7,355
Building Technologies	756	1,020	1,275	1,530	1,836
Real Estate	421	496	619	712	784
EBIT Margins					
Information technology services	20.5	17.3	17.8	17.6	17.4
Automation & Drives	8.6	6.9	8.0	9.0	9.0
Industrial Solution and Services	10.9	10.2	11.1	11.6	11.6
Power	6.2	6.0	5.0	8.0	8.5
Transport	8.3	6.5	0.0	7.0	8.5
Healthcare & other services	2.4	2.2	3.0	4.0	5.0
Building Technologies	5.4	9.1	10.0	10.0	10.5
Real Estate	58.8	65.6	60.0	60.0	60.0
Segmental EBIT					
Information technology services	1,967	1,950	2,402	2,839	3,349
Automation & Drives	1,052	1,147	1,755	2,468	2,961
Industrial Solution and Services	598	1,026	1,387	1,800	2,154
Power	1,228	2,599	2,312	4,438	5,659
Transport	206	226	0	626	874
Healthcare & other services	100	113	167	256	368
Building Technologies	41	93	128	153	193
Real Estate	248	325	372	427	470

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 4. Our DCF value for Siemens (standalone) is Rs435/share

Siemens (standalone) - DCF model, September fiscal year-ends, 2008E-19E (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	88,745	107,488	128,150	150,438	172,935	198,875	228,706	263,012	294,574	329,923	362,915	399,207
Growth (%)	14.3	21.1	19.2	17.4	15.0	15.0	15.0	15.0	12.0	12.0	10.0	10.0
EBIT (excl finl income)	6,120	10,272	12,817	15,393	17,680	20,285	23,328	26,827	30,047	33,652	37,017	40,719
Growth (%)	(11.6)	67.8	24.8	20.1	14.9	14.7	15.0	15.0	12.0	12.0	10.0	10.0
EBIT Margins	6.9	9.6	10.0	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Effective tax rate	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9
EBIT*(1-tax rate)	**3,984**	**6,687**	**8,344**	**10,021**	**11,509**	**13,206**	**15,187**	**17,465**	**19,560**	**21,908**	**24,098**	**26,508**
Growth (%)	(11.6)	67.8	24.8	20.1	14.9	14.7	15.0	15.0	12.0	12.0	10.0	10.0
Depreciation / Amortisation	733	865	948	1,036	1,129	1,591	1,762	1,854	1,974	2,152	2,359	2,475
Change in Working Capital	(4,100)	(1,673)	(1,575)	(1,692)	(1,679)	(2,594)	(2,983)	(3,431)	(3,156)	(3,535)	(3,299)	(3,629)
Capital Expenditure	(2,000)	(1,500)	(1,500)	(1,750)	(1,750)	(2,594)	(2,983)	(3,431)	(3,156)	(3,535)	(3,134)	(3,448)
Free Cash Flows	**(1,383)**	**4,379**	**6,216**	**7,614**	**9,209**	**9,609**	**10,982**	**12,457**	**15,222**	**16,989**	**20,024**	**21,907**
Growth (%)	(73.8)	(416.6)	41.9	22.5	20.9	4.3	14.3	13.4	22.2	11.6	17.9	9.4
Years discounted	-	-	1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0	9.0	10.0
Discount factor	1.0	1.0	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3
Discounted cash flow	**(1,383)**	**4,379**	**5,477**	**5,911**	**6,298**	**5,790**	**5,830**	**5,827**	**6,273**	**6,169**	**6,406**	**6,175**

Used WACC	**13.50%**

NPV Calc

	NPV	% of val	Terminal value Calc	NPV
Sum of free cash flow	63,152	43.1	Cash flow in terminal year	21,907
Terminal value	76,276	52.0	g	5%
Enterprise value	139,428	95.1	Capitalisation rate	9%
Add Investments	4,676	3.2	Terminal value	270,611
Net debt	(2,566)	1.7	Discount period (years)	10
Net present value-equity	146,670		Discount factor	0.28
Shares o/s	337		Discounted value	76,276
NPV /share(Rs)	**435**			

Source: Kotak Institutional Equities estimates.

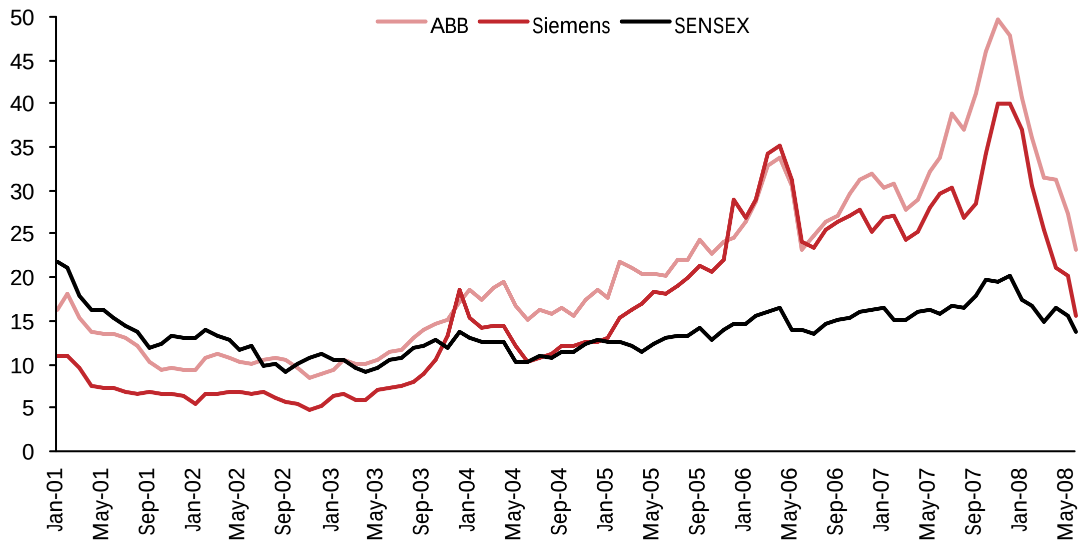
Exhibit 5. We have a sum of the parts target price of Rs520

Sum of the Parts (SOTP) valuation of Siemens based on y/e Sep 2009E (Rs mn)

	Earnings est. 2009E	Valuation (Rs mn)	Per share (Rs)	Methoodolgy
Consolidated PAT of Siemens	7,063			
Consolidated PAT of Siemens excluding SISL + SIPSL dividend	6,848	146,670	435	DCF - Implies P/E of 20.4X Sep 2009E earnings
SISL + SIPSL PAT	2,152	25,822	77	P/E Multiple of 14X September 2009E earnings
Siemesn Industrial Turbomachinery	56	839	2	P/E multiple of 15X September 2009E earnigns
Siemens Building Technologies	98	1,469	4	P/E multiple of 15X September 2009E earnigns
Total valuation	**139,753**	**174,799**	**518**	
Target price			**520**	

Source: Kotak Institutional Equities estimates.

Exhibit 6. Valuation gap of Siemens over the Sensex has narrowed significantly over the last few months
Valuation of Sensex, Siemens and ABB based on 12-month rolling forward P/E multiples



Source: Kotak Institutional Equities estimates.

Banking

Sector coverage view	Neutral

Company	Rating	Price, Rs 25-Jun	Target
SBI	ADD	1,194	1,700
HDFC	ADD	2,169	2,650
HDFC Bank	BUY	1,074	1,400
ICICI Bank	ADD	698	870
Corp Bk	ADD	248	355
BoB	ADD	211	310
PNB	BUY	423	625
OBC	ADD	136	200
Canara Bk	SELL	177	190
LIC Housing	REDUCE	296	305
Axis Bank	REDUCE	685	830
IOB	ADD	94	130
Shriram Transp	REDUCE	301	320
SREI	BUY	93	175
MMFSL	REDUCE	263	225
Andhra	REDUCE	58	75
IDFC	ADD	121	165
PFC	REDUCE	110	140
Centurion Bank	REDUCE	41	45
Federal Bank	BUY	180	275
J&K Bank	ADD	550	750
India Infoline	ADD	582	1,225
Indian Bank	ADD	101	140
Union Bank	BUY	114	200
Central Bank o	SELL	67	70

Revising earnings estimate and target price to reflect higher rates scenario

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

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

- **Expect banks to raise their lending rates post the monetary action of RBI to stem their margin pressure**
- **Downward earnings revision across banks to factor in higher MTM losses and credit provisions**
- **We believe that current prices factor in the negatives and do not warrant a downside**
- **HDFC Bank and ICICI Bank are preferred picks amongst private banks; PNB, Union Bank and BoB amongst public banks**

Post June 24, 2008 repo rate and CRR hike of 50 bps each, our economist Dr Mridul Saggar, has revised down his GDP growth estimate to 7.9% from 8.2% for FY2009, while revising up the CRR to 9.25% v/s 8.75% earlier. We expect banks to hike lending rates and deposit rates by 50bps and 25bps, respectively, within the next couple of days (deposit rates had already increased in the recent past, and therefore lower increase expectation). In line with this view, we are revising down our earnings estimates and target prices to reflect: (1) margin pressure, (2) higher MTM hit and (3) higher provisions for NPLs. We believe most of these negative developments are already reflected in the stock prices and fundamentals (stocks trading at 0.8X to 1.1X APBR FY2009) and do not warrant further downside from the current price levels. However, we expect the volatility in prices to continue and a sustainable reversal to occur only once concerns on inflation, oil prices and rising rates recede. In this challenging environment, banks with strong liability profile and/or banks with significant freedom to price their credit products will likely fare better and are therefore our preferred picks i.e. HDFC Bank and ICICI Bank. Within public banks we prefer PNB, Union Bank and BoB.

Earnings reduced: We have reduced our earnings estimates for most banks by 5% to 20% for FY2009. We now factor in: (1) CRR at 9.25% by March 2009, (2) lending rate and deposit rate increase of around 75 bps over a two-year period and (3) MTM hit on investment portfolio (not reflected in earnings estimates earlier), assuming 10-year Gsec yield of 8.5%. Note that we are of the view that yields will rise to around 9% by October 2008, but settle down to around 8.5% by end of the year as inflation comes off and the demand for SLR securities likely exceeds supply. A large part of the reduction in the case of PSU banks is due to the MTM hits. We are changing our rating on IOB to ADD from Reduce given the the significant 40% decline in price post our rating downgrade a month back. The stock now trades at 5.1X PER and 1.0X APBR FY2009.

Exhibit 1: Revise target prices by downwards by 5-10% to factor inlikely higher MTM losses and credit costs due to hardening rates

		EPS (Rs)						Target price (Rs)		
		Previous		Revised		% chg				
	Reco.	2009E	2010E	2009E	2010E	2009E	2010E	Previous	Revised	% chg
Public banks										
Andhra Bank	REDUCE	11.8	12.4	11.0	12.3	(6.1)	(1.4)	81	75	(7)
BoB	ADD	35.8	42.7	29.8	40.5	(16.8)	(5.2)	335	310	(8)
Canara Bank	SELL	27.5	37.5	23.1	35.5	(16.2)	(5.5)	200	188	(6)
Central Bank	SELL	10.8	15.5	6.0	15.6	(44.5)	0.2	85	70	(18)
Corporation Bank	ADD	44.6	55.6	41.2	52.9	(7.7)	(4.9)	375	355	(5)
Indian Bank	ADD	21.8	23.4	19.1	25.9	(12.0)	10.8	150	140	(7)
IOB	REDUCE	20.9	25.2	18.9	23.6	(9.7)	(6.3)	150	130	(13)
OBC	ADD	28.4	32.5	22.6	33.2	(20.5)	2.4	210	200	(5)
PNB	BUY	67.4	78.1	63.0	77.5	(6.5)	(0.8)	650	625	(4)
SBI	ADD	100.1	120.3	87.2	117.2	(12.9)	(2.6)	1,800	1,700	(6)
SBI incl. banking subsidiaries	ADD	134.3	160.8	134.3	160.8	0.0	0.0	1,558	1,458	(6)
SBI standalone	ADD	96.6	116.5	83.7	113.4	(13.4)	(2.7)	1,291	1,215	(6)
Union Bank	BUY	25.3	31.1	20.9	29.3	(17.3)	(6.0)	210	200	(5)
Old private banks										
Federal Bank	BUY	27.8	32.0	22.4	31.3	(19.5)	(2.1)	310	275	(11)
J&K Bank	ADD	74.7	76.3	69.0	75.1	(7.7)	(1.6)	785	750	(4)
New private banks										
Axis Bank	REDUCE	40.8	55.8	38.9	54.1	(4.6)	(3.0)	850	830	(2)
HDFC Bank	BUY	54.3	74.8	52.3	74.2	(3.6)	(0.7)	1,500	1,400	(7)
ICICI Bank	ADD	35.4	46.2	30.5	39.7	(13.8)	(14.1)	933	870	(7)
ICICI standalone	ADD	29.5	39.7	24.6	33.2	(16.6)	(16.4)	528	471	(11)
Non-banks										
HDFC	ADD	89.6	103.5	86.5	103.3	(3.5)	(0.1)	2,700	2,650	(2)
HDFC standalone	ADD	75.6	90.2	72.5	90.0	(4.1)	(0.2)	1,640	1,600	(2)
IDFC	ADD	8.2	11.3	7.9	10.7	(3.9)	(5.4)	170	165	(3)
LIC Hsg Fin	REDUCE	47.5	54.0	44.0	50.2	(7.3)	(7.0)	330	305	(8)
Mahindra Finance	REDUCE	25.1	28.9	24.6	28.7	(1.9)	(0.8)	235	225	(4)
Power Finance Corporation	REDUCE	14.0	16.6	13.2	15.2	(5.7)	(8.8)	155	140	(10)
Shriram Transport	REDUCE	27.6	33.3	26.3	31.1	(4.9)	(6.5)	330	320	(3)
Srei Infrastructure finance	BUY	4.9	9.7	4.9	9.7	0.0	0.0	175	175	0

Source: Companies, Kotak Institutional Equities estimates.

Exhibit 2: Valuations of key financial companies, March fiscal year-ends

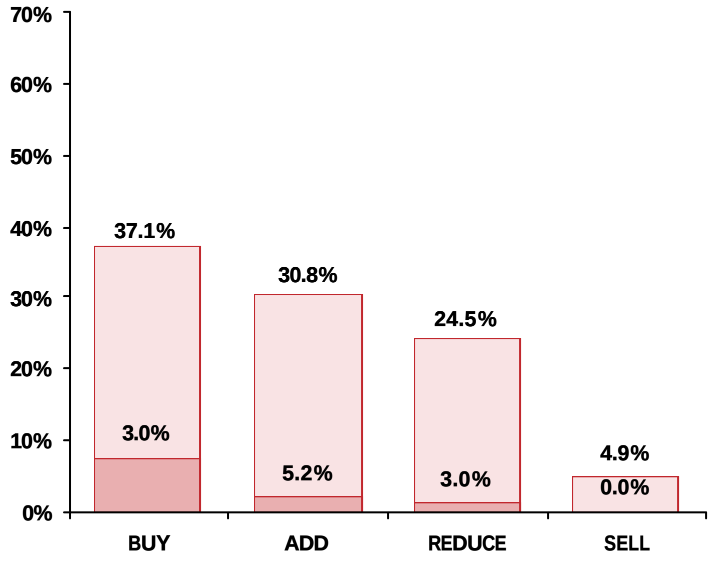
		Traget price	Price	Market cap.	EPS (Rs)			PER (X)			ABVPS (Rs)			APBR (X)			RoE (%)			Dividend Yield (%)	
	Reco.	(Rs)	(Rs)	US	2008E	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E
Public banks																					
Andhra Bank	REDUCE	75	59	0.7	11.9	11.0	12.3	4.9	5.3	4.8	63	71	78	0.9	0.8	0.7	18.0	15.6	15.7	4.8	5.1
BoB	ADD	310	210	1.8	39.3	29.8	40.5	5.4	7.1	5.2	245	274	303	0.9	0.8	0.7	14.4	9.4	11.9	3.1	2.4
Canara Bank	SELL	188	183	1.8	38.2	23.1	35.5	4.8	7.9	5.2	175	203	227	1.0	0.9	0.8	15.0	8.8	12.6	2.7	3.0
Central Bank	SELL	70	67	0.6	13.6	6.0	15.6	4.9	11.2	4.3	51	59	74	1.3	1.1	0.9	18.2	5.9	17.9	0.0	0.0
Corporation Bank	ADD	355	256	0.9	51.2	41.2	52.9	5.0	6.2	4.8	278	311	349	0.9	0.8	0.7	18.4	13.3	15.3	2.3	2.5
Indian Bank	ADD	140	102	1.0	22.5	19.1	25.9	4.5	5.3	3.9	101	119	140	1.0	0.9	0.7	24.8	16.6	19.3	0.0	0.0
IOB	REDUCE	130	96	1.2	22.1	18.9	23.6	4.3	5.1	4.0	76	93	111	1.3	1.0	0.9	27.2	19.6	21.0	2.5	2.5
OBC	ADD	200	145	0.8	23.9	22.6	33.2	6.1	6.4	4.3	198	237	261	0.7	0.6	0.6	6.2	9.4	12.8	3.5	2.1
PNB	BUY	625	421	3.1	65.0	63.0	77.5	6.5	6.7	5.4	297	360	418	1.4	1.2	1.0	19.3	17.2	18.4	1.0	1.5
SBI	ADD	1,700	1,207	17.9	106.6	87.2	117.2	11.3	13.8	10.3	671	793	889	1.8	1.5	1.4	16.8	10.8	13.3	0.9	1.0
SBI incl. banking subsidiaries	ADD	1,458	965	14.3	157.4	134.3	160.8	6.1	7.2	6.0	812	979	1,118	1.2	1.0	0.9	16.6	13.4	13.4		
SBI standalone	ADD	1,215	697	10.3	122.1	83.7	113.4	5.7	8.3	6.1	602	724	820	1.2	1.0	0.9	19.5	11.3	13.9		
Union Bank	BUY	250	116	1.4	27.5	20.9	29.3	4.2	5.6	4.0	106	124	147	1.1	0.9	0.8	26.8	17.5	20.8	3.0	3.0
Old private banks																					
Federal Bank	BUY	275	181	0.7	34.4	22.4	31.3	5.3	8.1	5.8	225	241	265	0.8	0.8	0.7	13.6	9.4	12.1	0.0	0.0
J&K Bank	ADD	750	553	0.6	74.2	69.0	75.1	7.4	8.0	7.4	434	495	556	1.3	1.1	1.0	16.8	13.8	13.6	0.0	0.0
New private banks																					
Axis Bank	REDUCE	830	679	5.7	32.2	38.9	54.1	21.1	17.4	12.5	229	275	317	3.0	2.5	2.1	17.6	15.0	18.2		
HDFC Bank	BUY	1,400	1,060	8.8	53.6	52.3	74.2	19.8	20.3	14.3	324	372	518	3.3	2.8	2.0	20.7	16.3	16.7	0.3	0.4
ICICI Bank	ADD	870	703	18.0	39.9	30.5	39.7	17.6	23.1	17.7	428	449	477	1.6	1.6	1.5	11.6	7.0	8.6	1.1	1.2
ICICI standalone	ADD	471	306	7.8	34.2	24.6	33.2	8.9	12.4	9.2	355	361	389	0.9	0.8	0.8	11.8	6.9	8.9	0.0	0.0
Non-banks																					
HDFC	ADD	2,650	2,264	15.0	85.8	86.5	103.3	26.4	26.2	21.9	421	477	544	5.4	4.7	4.2	27.8	20.2	20.2		
HDFC standalone	ADD	1,600	1,231	8.2	52.3	72.5	90.0	23.5	17.0	13.7	285	318	258	4.3	3.9	4.8	33.7	25.3	24.1		
IDFC	ADD	165	117	3.5	5.7	7.9	10.7	20.4	14.8	10.9	43	49	57	2.7	2.4	2.1	17.7	17.4	20.6		
LIC Hsg Fin	REDUCE	305	283	0.6	45.6	44.0	50.2	6.2	6.4	5.6	177	208	245	1.6	1.4	1.2	22.9	19.0	18.8		
Mahindra Finance	REDUCE	225	266	0.5	20.8	24.6	28.7	12.8	10.8	9.3	131	149	170	2.0	1.8	1.6	16.9	16.8	17.4		
Power Finance Corporation	REDUCE	140	111	3.0	11.4	13.2	15.2	9.8	8.4	7.3	89	100	112	1.2	1.1	1.0	12.8	13.4	13.7		
Shriram Transport	REDUCE	320	299	1.2	19.2	26.3	31.1	15.6	11.4	9.6	86	102	117	3.5	2.9	2.6	26.9	26.6	27.3		
Srei Infrastructure finance	BUY	175	95	0.2	11.4	4.9	9.7	8.3	19.3	9.8	56	89	95	1.7	1.1	1.0	23.1	10.9	14.0		

Source: Bloomberg, Companies, Kotak Institutional Equities estimates.

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

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 31/03/2008 Kotak Institutional Equities Investment Research had investment ratings on 143 equity securities.

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

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
SELL: We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

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

Other definitions

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

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.
NC = Not Covered. Kotak Securities does not cover this company.
RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA = Not Available or Not Applicable. The information is not available for display or is not applicable.
NM = Not Meaningful. The information is not meaningful and is therefore excluded.