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Sterlite Industries: Cut earnings estimates but retain ADD rating on attractive valuations

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News Round-up

- ▶ State run IOC (IOCL IN) & Bharat Petroleum (BPCL IN) plan to bid for Shell India's retail outlets. Shell India has offered for sale 20 of its 80 operational retail outlets & around 20 sites acquired earlier for setting up these outlets. *(BSTD)*
- ▶ Tata Motors (TTMT IN) has initiated a move to jointly develop engines & vehicles with its UK subsidiary, Jaguar Land Rover, over two years after its USD 2.3bn acquisition of the British cos. *(BSTD)*
- ▶ The govt. is considering selling part of its stake in some public sector firms to large institutional investors through auctions instead of public offers, after a couple of mega follow-on public offers that hit the market last fiscal failed to enthruse retail investors. *(ECNT)*
- ▶ Diesel price decontrol may only be partial, unlike in the case of free pricing of petrol, as the govt. may continue to provide a fixed subsidy of INR 1.49 per litre irrespective of the rise or fall in its market linked retail price. *(ECNT)*
- ▶ IT services firm HCL technologies has signed a "mega" outsourcing agreement with Saudi Arabia's AL Majdouie Group to provide end-to-end services for seven years. *(THBL)*
- ▶ Singapore Telecommunications has increased its stake marginally in Bharti Airtel (BHARTI IN) to 32.04% from 32% by purchasing around 1.5mn shares in an open market transaction deal for about USD 12.45mn. *(BSTD-Sat)*
- ▶ Everonn Education (ESIL IN) plans to open 300 schools over the next five years at a total investment of USD 766 mn. *(THBL)*
- ▶ TajGVK (TAJG IN) is going slow on its earlier plan to put up a luxury hotel in Bangalore. The construction has been deferred by four years. *(BSTD)*
- ▶ Piramal Healthcare (PIHC IN) expects to get USD 2.12bn in 4-6 weeks following completion of the sale of its branded generics business to Abbott Labs. *(BSTD-Sat)*
- ▶ ICICI Bank (ICICIB IN) has raised USD 106.38mn by selling bonds maturing in 5.5 years to global investors. *(BSTD-Sat)*
- ▶ JK Cement (JKCE IN) has initiated talks with a few banks to raise debt of over USD 170.21mn to part finance setting up its first overseas plant in the Middle East. *(ECNT)*
- ▶ Reliance Ind. (RIL IN) may run for Bombay Dyeing (BD IN) business, likely to compete with Indo Rama & JBF Ind. to buy loss making polyester plant. *(ECNT-Sat)*

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

EQUITY MARKETS

India	Change %			
	9-Jul	1-day	1-mo	3-mo
Sensex	17,834	1.0	7.1	(0.6)
Nifty	5,352	1.0	7.0	(0.2)
Global/Regional indices				
Dow Jones	10,139	1.2	2.4	(7.8)
Nasdaq Composite	2,175	0.7	0.8	(11.4)
FTSE	5,110	0.1	0.5	(11.4)
Nikkie	9,585	0.5	1.5	(14.5)
Hang Seng	20,379	1.6	3.9	(8.2)
KOSPI	1,723	1.4	4.6	(0.1)
Value traded – India				
Cash (NSE+BSE)	150		168	171
Derivatives (NSE)	716		865	755
Deri. open interest	1,343		1,278	1,140

Forex/money market

	Change, basis points			
	9-Jul	1-day	1-mo	3-mo
Rs/US\$	46.7	(14)	(30)	245
10yr govt bond, %	7.6	(1)	13	(26)
Net investment (US\$m)				
	7-Jul		MTD	CYTD
FIs	7		107	6,807
MFs	10		(28)	(282)

Top movers -3mo basis

Best performers	Change, %			
	9-Jul	1-day	1-mo	3-mo
HPCL IN Equity	488.7	2.4	37.9	58.3
BPCL IN Equity	710.8	1.8	28.6	40.5
IOCL IN Equity	400.7	1.0	15.8	38.3
IBULL IN Equity	161.8	7.0	21.7	27.5
AL IN Equity	69.6	0.7	12.8	24.1
Worst performers				
RNR IN Equity	44.9	0.2	(13.0)	(30.8)
ABAN IN Equity	868.2	0.7	34.0	(30.7)
EDSL IN Equity	543.7	2.2	0.1	(26.9)
TATA IN Equity	496.0	2.3	7.1	(26.7)
SESA IN Equity	352.3	0.5	1.0	(24.8)

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UPDATE

Coverage view: **Cautious**

Price (Rs): 168

Target price (Rs): 210

BSE-30: 17,834

Lower earnings estimates but retain ADD rating on attractive valuations. We lower our estimates and target price of Sterlite on lower metals prices and a delay in the commissioning of its power project. However, we believe that the stock price has upside even after building distressed metal prices. Sterlite's earnings have low sensitivity to changes in metal prices on account of high cash reserves, presence in copper smelting business, increasing contribution from power and expansion of silver business.

Company data and valuation summary

Sterlite Industries

Stock data

52-week range (Rs) (high,low) 232-133

Market Cap. (Rs bn) 563.7

Shareholding pattern (%)

Promoters 52.1

FIs 29.1

MFs 3.8

Price performance (%)

Absolute 1M 3M 12M

6.6 (24.2) 20.4

Rel. to BSE-30 (0.5) (23.8) (7.1)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	12.0	14.2	19.2
EPS growth (%)	2.8	18.3	35.1
P/E (X)	14.0	11.8	8.7
Sales (Rs bn)	244.1	276.0	360.7
Net profits (Rs bn)	40.4	47.8	64.5
EBITDA (Rs bn)	60.7	76.9	120.8
EV/EBITDA (X)	11.9	10.3	6.8
ROE (%)	12.9	12.2	14.5
Div. Yield (%)	0.6	0.6	0.6

Cut FY2011-12E earnings estimates by 16/7.8%, target price to Rs210

We cut our FY2011E and FY2012E earnings estimates by 15.9% and 7.8% led by (1) reduction in zinc price estimate to US\$1900 and US\$2,000 from US\$2,100 and US\$2300/ ton earlier; (2) reduction in lead price estimate to US\$1,900 and US\$2,000 from US\$2,050 and US\$2,150 earlier; and (3) delay in commissioning in power of Jharsugada power plant; we model commercial generation from October 2010 as compared to April 2010 earlier. We forecast EPS of Rs14.2 for FY2011E and Rs19.2 for FY2012E. We lower our target price to Rs210/ share but retain our ADD rating. Clearance for mining Niyamgiri bauxite deposit can be a significant stock price catalyst.

Stock discounting material correction in commodity prices even from the current levels

We find Sterlite's valuations inexpensive even in a scenario of a further decline in commodity prices. Sterlite will trade at an EV/ EBITDA multiple of 8.1X FY2011E and 4.5X FY2012E financials even if zinc and aluminium prices decline by further 10% from spot (which in itself has corrected by 20% in the past month). We forecast EPS of Rs11.4 and Rs16.3 for FY2011E and FY2012 in a distressed-case scenario. We note that Sterlite has relatively lower sensitivity to commodity prices on account (1) high cash on books accounting for ~30% of the current market capitalization; (2) likely accrual of close to 24% of FY2011E EBITDA from the power business; and (3) increasing silver recovery leading to reduction in cost of production of zinc (or higher EBITDA contribution).

Volume expansion to offset some of the pricing risks

Sterlite is undertaking significant capacity expansion in the zinc, aluminium and power businesses, which partially offsets the risks from decline in prices. Of course, we assume that the demand does not collapse similar to 2009, in which case volume expansion may become a liability, especially in the aluminium business. Capacity expansion includes—zinc- lead to 1.06 mn tpa, silver refinery expansion to 500 ktpa from 180 ktpa (as a result of additional production at the Sindershah Khurd mine) and expansion of aluminium smelter capacity to 600 ktpa from 250 ktpa at Korba in Balco.

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Sterlite Industries (consolidated), change in estimates, March fiscal year-ends, 2011E-13E (Rs mn)

	Revised estimates			Old estimates			% change		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
Net sales	275,996	360,746	488,214	302,752	369,026	517,809	(8.8)	(2.2)	(5.7)
EBITDA	76,868	120,784	138,307	97,361	132,848	144,507	(21.0)	(9.1)	(4.3)
PAT	47,788	64,543	74,926	56,812	69,998	77,651	(15.9)	(7.8)	(3.5)
EPS (Rs)	14.2	19.2	22.3	16.9	20.8	23.1	(15.9)	(7.8)	(3.5)
Prices (US\$/ton)									
Aluminium	1,950	2,050	2,200	2,200	2,300	2,350	(11.4)	(10.9)	(6.4)
Zinc	1,900	2,000	2,100	2,100	2,300	2,300	(9.5)	(13.0)	(8.7)
Copper	6,700	7,100	7,242	6,700	7,100	7,242	-	-	-
Lead	1,900	2,000	2,100	2,050	2,150	2,250	(7.3)	(7.0)	(6.7)
Re/ US\$ rate	46.0	46.0	46.0	45.0	45.0	45.0	2.2	2.2	2.2

Source: Kotak Institutional Equities estimates

Reduce 12-month target price to Rs210; upsides from favorable decision in Balco and HZ arbitration and access to Niyamgiri bauxite mines

We reduce our target price to Rs210 from Rs220 earlier. We value the zinc business at Rs101/share based on 6X September 2011E EBITDA. We value Balco's operations at 7X September 2011E EBITDA; higher assigned multiple captures the entire value from commissioning of power plant and 325ktpa aluminium smelter in FY2012E. We value other businesses at Rs51 (including 29.5% stake in Vedanta Aluminium and stake in the Tasmanian copper mines). Exhibit 2 details our SOTP valuation for Sterlite. Key upsides for Sterlite could result from (1) exercise of call options for the acquisition of balance stake in HZ and BALCO, (2) earlier-than-expected execution of capacity expansion plans and (3) access to Niyamgiri bauxite mine.

SOTP-based target price of Sterlite Industries is Rs210/share

SOTP-based target price of Sterlite, March fiscal year-ends, average of 2011-2012E basis (Rs mn)

	EBITDA (Rs bn)	Multiple (X)	EV (Rs bn)	Net debt (Rs bn)	Implied M Cap (Rs bn)	Sterlite's stake (%)	Attributable M Cap (Rs bn)	Contribution Rs/ share
BALCO	18	7.0	125	35.1	90.2	51.0	46	14
Copper business								
Copper smelting business	7	6.0	40	(104)	143.4	100.0	143	43
Copper mining								2
Zinc business								
Hindustan Zinc	57	6.0	344	(180)	524	64.9	340	101
Other businesses								51
Target price (Rs/ share)								210

Source: Kotak Institutional Equities estimates

Stock has upside even if metal prices correct further

Exhibit 1 provides our base case assumption for FY2011E and FY2012E. Assuming a further correction in commodity prices to US\$1,600/ ton for zinc and US\$1,650 / ton for aluminium (at which 45% of the smelters will not make money), EPS reduces to Rs12 and Rs16.1 for FY2011E and FY2012E, respectively. Our fair value in such a scenario works out to Rs200.

We note that Sterlite earnings are relatively less sensitive to change in commodity prices on account of (1) huge net cash reserves of Rs180 bn at end-FY2010. This accounts for 30% of the current market capitalization; (2) high-EBITDA accrual from non-commodity businesses and (3) new income streams such as silver refinery expansion (courtesy expansion in SIndeshwar Khurd mines) that may eventually contribute to US\$250-300 mn to total EBITDA

Sensitivity of 2011 EPS to varying aluminium and zinc price levels

EPS		Aluminium (US\$/ton)				
		2,050	1,950	1,850	1,750	1,650
Zinc (US\$/ton)	2,200	16.1	15.9	15.8	15.6	15.5
	2,000	14.9	14.8	14.6	14.5	14.3
	1,800	13.8	13.6	13.5	13.3	13.2
	1,600	12.6	12.5	12.3	12.2	12.0
	1,400	11.5	11.4	11.2	11.0	10.9

Source: Kotak Institutional Equities estimates

Sensitivity of 2012 EPS to varying aluminium and zinc price levels

EPS		Aluminium (US\$/ton)				
		2,050	1,950	1,850	1,750	1,650
Zinc (US\$/ton)	2,200	20.4	20.2	20.0	19.8	19.6
	2,000	19.2	19.0	18.8	18.6	18.4
	1,800	18.0	17.8	17.6	17.5	17.3
	1,600	16.8	16.7	16.5	16.3	16.1
	1,400	15.7	15.5	15.3	15.1	14.9

Source: Kotak Institutional Equities estimates

Distressed analysis of Sterlite's earnings

	FY2011E				FY2012E			
	Base case	Spot	Spot (-)10%	Spot (-)20%	Base case	Spot	Spot (-)10%	Spot (-)20%
Zinc prices (US\$/ ton)	1,900	1,875	1,688	1,500	2,000	1,875	1,688	1,500
Aluminium prices (US\$/ ton)	1,950	1,983	1,785	1,586	2,050	1,983	1,785	1,586
Consolidated EBITDA (Rs mn)- proportion.	76,868	76,323	66,356	56,336	120,784	114,205	107,129	98,902
EV/EBITDA (X)- proportionate	7.0	7.1	8.1	9.4	4.0	4.2	4.5	4.9
EPS (Rs/ share)	14.2	14.1	12.8	11.4	19.2	18.3	17.4	16.3
P/E (X)	11.8	11.9	13.2	14.7	8.7	9.1	9.7	10.3

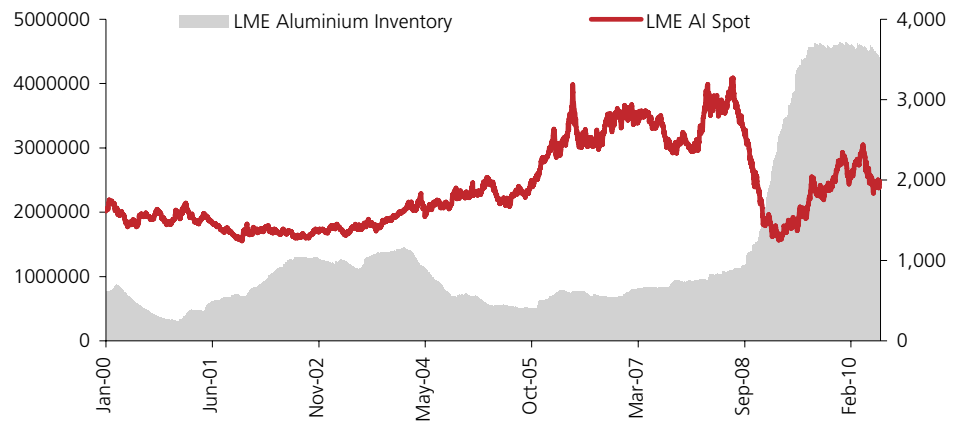
Source: Kotak Institutional Equities estimates

Aluminium prices likely to remain range bound

We expect aluminium prices to remain range bound over the next few months. On the one hand, current aluminium prices are significantly lower than Chinese marginal cost of production of RmB15,000 -15,500/ ton (US\$2,196-2,270/ ton), as per CRU. The cost of production of Chinese smelters increased further after the recent revision in power prices. This combined with fall in aluminium prices has already triggered supply side reaction; we understand that close of 700K of capacity in the Henan province is curtailed due to high power tariffs and decline in SHFE prices. On the other hand, an all-time high inventory (locked in financing deals, which will eventually unwind) will keep the aluminium prices under check. LME and total inventory stands at 9 weeks and 6 weeks of total consumption.

High inventory levels could pressure aluminium prices in the near term

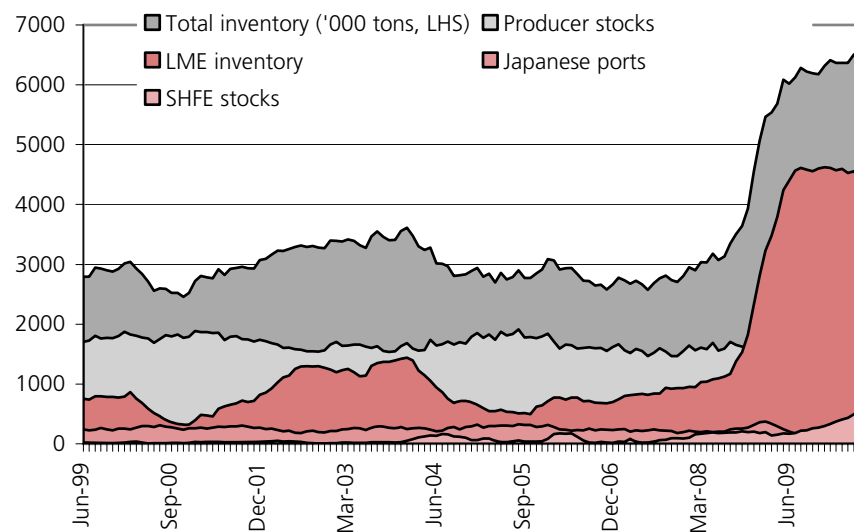
Daily global LME primary aluminium inventory and price



Source: Bloomberg, Kotak Institutional Equities estimates

Aluminum inventory close to an all-time high of 6.5 mn tons

Monthly aluminium inventory, December year ends, 1999-2010 ('000tons)



Source: CRU, Kotak Institutional Equities estimates

We expect strong support for metal prices at around US\$1,850-1,900 / ton, the 75th percentile cash cost for smelter globally (note that the current industry capacity utilization stands at 81%). We do not expect prices to increase beyond US\$2,100, a level at which close to 90% of the smelter will recover cash cost of production.

We would closely monitor the indicated cash cost of production for new smelter additions in India and Middle East. We suspect the cash cost curve may shift downwards since some of the new capacities have extremely low cash cost of production.

Zinc prices likely to be weak near term; may improve over the medium term

Zinc prices have corrected by more than 21% in the past three months and 30% from the 2010 peak of US\$2686/ ton. The correction has been severe than other metals viz copper and aluminium. Premature capacity restarts supported by high zinc prices, have led a significant increase in inventory despite solid demand recovery. Zinc inventory on LME has increased to a cycle high of 620475 tons on May 26, 2010. This is 79% of the cycle high inventory in 2004. Note that zinc underperformed in a similar situation of high inventory during 2001-2004, after which prices started moving up. We believe that zinc prices may decline moderately and remain in the US\$1,700-2,000 range on account of the above-mentioned factors. We expect zinc market surplus to increase further in 2010E, which will keep any meaningful upward price movement in check (refer to Exhibit below).

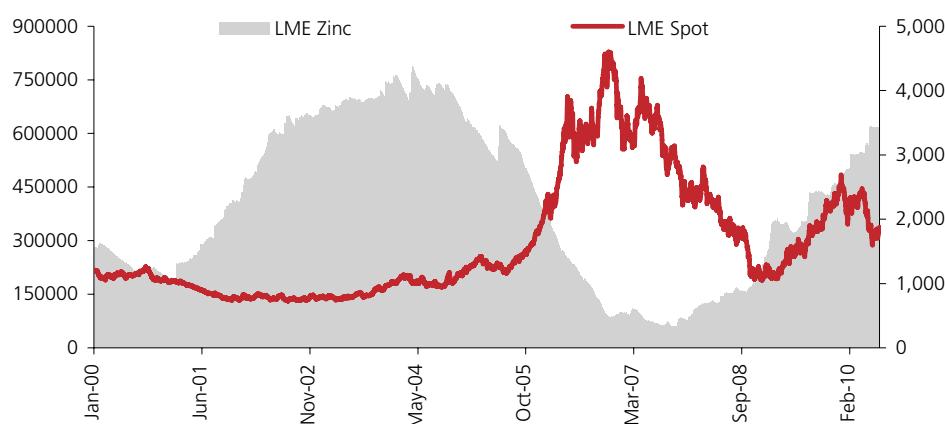
Zinc, quarterly world balance position ('000 tons)

	1QCY08	2QCY08	3QCY08	4QCY08	1QCY09	2QCY09	3QCY09	4QCY09	1QCY10	2QCY10	3QCY10	4QCY10
World												
World production	2,872	3,014	2,899	2,871	2,558	2,756	2,898	3,149	3,021	3,230	3,045	3,179
World consumption	2,882	2,921	2,786	2,536	2,395	2,475	2,645	2,715	2,775	2,850	2,835	2,965
World balance	(10)	93	113	335	163	281	253	434	246	380	210	214
North America												
Production	349	347	342	327	300	293	308	335	336	331	313	325
Consumption	362	368	337	282	245	258	282	309	325	335	323	342
NAFTA balance	(13)	(21)	5	45	55	35	26	26	11	(4)	(10)	(17)
US premia delivered (cents/lb)	4	3	3	3	3	3	3					
US premia delivered (US\$/ton)	79	75	72	61	61	55	55					
Asia												
Production	670	669	618	671	648	651	613	670	655	662	668	700
Consumption	682	677	662	602	538	562	602	618	630	641	652	667
Exports	(3)	(20)	(47)	(11)	(183)	(239)	(106)	(36)	(19)	75	125	149
Asia balance	(15)	(28)	(91)	58	(73)	(150)	(95)	16	6	96	141	182
Far East premia- Chinese (US\$/ton)	105	102	95	90	82	80	76					
Far East premia- western (US\$/ton)	120	117	103	95	87	85	83					
Western Europe												
Production	479	489	470	451	368	383	405	437	466	457	445	458
Consumption	558	559	527	462	413	414	438	456	465	475	455	495
Exports	117	128	107	145	131	86	79	77	100	38	45	77
Western Europe balance	38	58	50	134	86	55	46	58	101	20	35	40
Western Europe premia- FSU (US\$/ton)	63	53	38	30	28	32	35					
Western Europe premia- western (US\$/to)	167	145	107	80	80	87	89					
Other Western World												
Production	198	200	195	179	166	171	170	183	178	180	194	207
Consumption	168	160	169	165	154	131	143	147	150	154	155	161
Other Western World balance	30	40	26	14	12	40	27	36	28	26	39	46

Source: CRU, Kotak Institutional Equities estimates

High inventory levels could pressure zinc prices in the near term

Total zinc inventory (tons), LME zinc prices (US\$/ton), December year ends, 2000-2010



Source: Bloomberg, Kotak Institutional Equities estimates

Sterlite Industries (consolidated), Key assumptions, March fiscal year ends 2008-13E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E
Volumes (tons)						
Zinc	425,532	552,330	577,685	703,200	791,100	835,050
Lead	58,298	60,564	64,391	101,750	148,000	155,400
Copper	337,073	312,572	333,244	335,044	337,081	564,467
Aluminium metal	358,328	356,513	267,802	266,135	326,525	541,420
Silver	82	103	139	179	308	373
Power (mn units)	—	—	—	4,327	17,597	18,374
Average realization (Rs/ton)						
Zinc	125,946	70,353	99,421	95,147	99,911	102,572
Lead	122,771	86,385	105,922	94,617	98,858	101,541
Copper cathode	330,044	272,349	303,652	326,496	345,844	348,308
Aluminium ingots	119,772	113,566	96,607	101,634	106,592	110,406
Silver (Rs mn/ton)	19	20	25	27	28	28
Power (Rs/unit)				2.6	2.5	2.4
LME assumptions (US\$/ton)						
Zinc	2,992	1,563	1,936	1,900	2,000	2,100
Lead	2,875	1,655	1,990	1,900	2,000	2,100
Copper	7,588	5,885	6,375	6,700	7,100	7,242
Aluminium	2,624	2,227	1,900	1,950	2,050	2,200
Divisional EBITDA mix (US\$ mn)						
Hindustan Zinc	1,336	597	988	1,125	1,366	1,484
Sterlite (standalone)	213	184	108	138	150	284
BALCO	330	167	182	229	549	625
Power	—	(2)	(2)	136	501	547
Others	73	81	9	43	60	67
Total	1,952	1,027	1,285	1,671	2,626	3,007
USD:INR	40.3	45.8	47.3	46.0	46.0	46.0

Source: Company, Kotak Institutional Equities estimates

Sterlite Industries, Key valuation ratios, March fiscal year-ends, 2008-13E

	2008	2009	2010E	2011E	2012E	2013E
Valuation Matrix						
P/E (X)	10.7	13.7	14.0	11.8	8.8	7.5
EV/EBITDA (X)	4.6	7.5	7.3	6.1	3.6	2.8
EV/ EBITDA (X)- proportionate	7.2	11.1	9.6	7.0	4.0	3.0
Price to Book (X)	2.1	1.9	1.5	1.4	1.2	1.0
Ratios						
EBITDA margin (%)	31.8	22.2	24.9	27.9	33.5	28.3
EBIT margin (%)	29.4	18.9	21.8	23.7	29.7	24.8
PAT margin (%)	25.8	23.5	22.2	23.6	24.4	20.6
Return ratios						
ROE (year-end) (%)	20.0	13.6	10.9	11.5	13.6	13.7
ROE (average) (%)	27.6	14.5	12.9	12.2	14.5	14.7
ROCE (year-end) (%)	17.8	9.7	7.8	7.9	10.7	11.2
ROCE (average) (%)	21.7	10.3	9.7	8.5	11.3	11.6
Leverage ratios						
Debt/ Equity (X)	0.2	0.3	0.3	0.4	0.4	0.3
Net debt/ Equity (X)	(0.5)	(0.5)	(0.3)	(0.2)	(0.3)	(0.3)
Debt/ Capitalization (X)	(0.2)	(0.3)	(0.2)	(0.2)	(0.2)	(0.3)
Net debt/ EBITDA (X)	(1.5)	(2.6)	(2.0)	(1.2)	(1.0)	(1.3)

Source: Kotak Institutional Equities estimates

Sterlite Industries, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	247,054	211,442	244,103	275,996	360,746	488,214
EBITDA	78,584	47,041	60,718	76,868	120,784	138,307
Other income	15,623	21,543	19,594	24,887	27,512	30,677
Interest	(3,051)	(3,973)	(3,424)	(6,332)	(11,408)	(12,436)
Depreciation	(5,949)	(7,007)	(7,498)	(11,538)	(13,751)	(17,129)
Profit before tax	85,207	57,604	69,390	83,884	123,136	139,419
Extraordinaries	(665)	2,258	(2,970)	-	-	-
Current tax	(18,555)	(8,795)	(11,038)	(16,773)	(29,632)	(33,532)
Deferred tax	(2,336)	(1,461)	(1,291)	(2,105)	(5,329)	(5,441)
Net income before minorities	63,652	49,607	54,091	65,006	88,175	100,445
Minority interest	(19,616)	(12,671)	(17,241)	(17,824)	(24,450)	(26,622)
Share of profit/loss from associates	(42)	(1,536)	588	605	817	1,103
Net income	43,994	35,400	37,437	47,788	64,543	74,926
Adjusted net income	44,522	34,847	40,407	47,788	64,543	74,926
EPS (Rs)	15.7	12.3	12.0	14.2	19.2	22.3
Balance sheet (Rs mn)						
Equity	223,026	256,132	370,120	414,221	475,076	546,315
Deferred tax liability	13,537	14,076	15,524	17,629	22,958	28,399
Total Borrowings	50,745	70,135	92,600	150,956	170,078	153,991
Minority Interest	56,233	68,132	84,096	101,920	126,369	152,991
Current liabilities	31,943	42,051	49,319	50,481	50,304	59,299
Total liabilities	375,484	450,526	611,659	735,206	844,786	940,995
Net fixed assets	99,754	102,319	122,656	212,830	266,307	317,517
Capital work-in-progress	24,613	69,786	110,844	113,150	108,581	92,515
Investments	162,941	162,062	203,045	226,045	253,545	273,545
Cash	24,536	55,048	33,378	43,011	66,033	87,593
Other current assets	63,640	61,312	141,737	139,564	148,898	167,300
Miscellaneous expenditure	0	-	0	-	-	-
Total assets	375,484	450,526	611,659	734,601	843,363	938,469
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	2,032	13,636	(8,487)	3,334	(9,510)	(9,407)
Working capital changes	(18,516)	(8,522)	(11,549)	(16,773)	(29,632)	(33,532)
Capital expenditure	-	-	-	-	-	-
Free cash flow	(16,485)	5,114	(20,036)	(13,439)	(39,143)	(42,940)
Ratios						
Debt/equity (X)	0.2	0.3	0.3	0.4	0.4	0.3
Net debt/equity (X)	(0.5)	(0.5)	(0.3)	(0.2)	(0.3)	(0.3)
RoE (%)	27.6	14.5	12.9	12.2	14.5	14.7
RoACE (%)	21.7	10.3	9.7	8.5	11.3	11.6

Source: Company, Kotak Institutional Equities estimates

JULY 12, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **962**

Target price (Rs): **1,240**

BSE-30: **17,834**

Inexpensive despite cut in estimates. We maintain our BUY rating on Hindustan Zinc despite our downward revision in our zinc price estimates. A combination of aggressive volume growth and increase in silver production will likely mitigate damage from the recent weakness in prices on earnings/valuations. We lower our target price to Rs1,240 from Rs1,400 earlier. A US\$100/ ton change in zinc price changes our EPS by 6%, while a change of Re1 against the US\$ impacts earnings by 2.9%.

Company data and valuation summary

Hindustan Zinc

Stock data

52-week range (Rs) (high,low) 1,384-538

Market Cap. (Rs bn) 406.6

Shareholding pattern (%)

Promoters 64.9

FIs 2.2

MFs 1.1

Price performance (%)

	1M	3M	12M
Absolute	2.0	(22.7)	66.1
Rel. to BSE-30	(4.7)	(22.3)	28.1

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	95.6	102.5	116.0
EPS growth (%)	48.2	7.2	13.1
P/E (X)	10.1	9.4	8.3
Sales (Rs bn)	80.2	91.1	109.3
Net profits (Rs bn)	40.4	43.3	49.0
EBITDA (Rs bn)	46.7	51.8	62.8
EV/EBITDA (X)	6.2	4.8	3.3
ROE (%)	24.1	20.8	19.4
Div. Yield (%)	0.6	0.6	0.6

Lowering zinc price assumption

We lower our zinc price assumption by 13.6% and 13% for FY2011E and FY2012E to US\$1900 and US\$2000/ ton, respectively. A combination of excess premature production restarts has compounded the challenges of already high inventory levels. As a result, zinc prices may be cyclically weak in the near term. Nevertheless, we find support for zinc prices in the medium term from a likely decline in production and exhaustion of key mines (Antamania and Brunswick)

Cut estimates and target price but maintain our BUY rating

We cut FY2011E and FY2012E EPS estimate by 12.7% and 12.9% to Rs102.5 and Rs116 on the back of (1) 13.6% and 13% cut in zinc prices to US\$1900 and US\$2000 and (2) 9.5% and 13% reduction in lead prices to US\$1,900 and US\$2,000, respectively. The impact of the above two factors is somewhat reduced by a change in our Re/US\$ rate for FY2011E and FY2012E to 46 from 45 earlier. Despite the reduction in our estimates, we find the valuations of 4.8X FY2011E and 3.3X FY2012E EBITDA attractive. We maintain our BUY with a revised target price of Rs1,240; at our target price the stock will trade at 6.6X FY2011E and 5.5X FY2012E EBITDA. Note that our estimates do not include the recently-announced acquisition of the zinc assets of Anglo American.

Aggressive expansion plans and increase in silver production to reduce impact of lower prices

Hindustan Zinc recently commissioned 210 hydro zinc smelter at Dariba and 1 mtpa zinc concentrator at Rampura Agucha ahead of schedule. As a result, its total zinc-lead capacity increased to 964 ktpa. Work on the 100 ktpa lead smelter and 160MW CPP at Dariba is progressing well for its scheduled completion in 2QFY11. Post completion of the expansion, HZ will become the world's largest integrated lead-zinc producer with a total capacity of 1,064 ktpa.

HZ is also setting up new silver refinery at Dariba. This, along with expansion of Sindesar Khurd mine capacity (which has high silver particles in the ore), will lead to an increase in silver production capacity to 500 tons from 180 tons in FY2010. HZ indicates that silver refining costs are negligible; implying that significant portion of realization will flow through to the earnings. We forecast silver production of 179, 308 and 373 tons in FY2011E, FY2012E and FY2013E, respectively.

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Key changes to our assumptions, March fiscal year ends, FY2011-13E

	Revised estimate			Previous estimate			Change (%)		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
Price (US\$/ton)									
Zinc	1,900	2,000	2,100	2,200	2,300	2,350	(13.6)	(13.0)	(10.6)
Lead	1,900	2,000	2,100	2,100	2,300	2,300	(9.5)	(13.0)	(8.7)
Volumes (tons)									
Zinc ingots	703,200	791,100	835,050	703,200	773,520	808,680	—	2.3	3.3
Lead ingots	101,750	148,000	155,400	96,500	154,400	162,120	5.4	(4.1)	(4.1)
Earnings estimates (Rs mn)									
Revenues	91,118	109,305	118,955	100,410	119,450	125,985	(9.3)	(8.5)	(5.6)
EBITDA	51,759	62,822	68,246	60,335	73,049	76,049	(14.2)	(14.0)	(10.3)
PAT	43,322	49,008	54,628	49,644	56,298	60,681	(12.7)	(12.9)	(10.0)

Source: Kotak Institutional Equities estimates

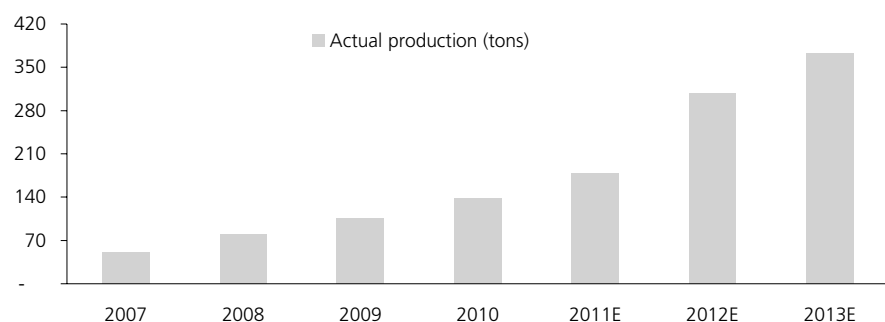
Hindustan Zinc, valuation details, September 2011 basis

	EBITDA (Rs bn)	Multiple (X)	Enterprise Value		
			(Rs bn)	(US\$ mn)	(Rs/ share)
Average of FY2011E and FY2012E EBITDA	57	6	344	7,473	814
Less: Net debt			(180)	(3,923)	(427)
Arrived market capitalization			163	3,549	1,241
Target price (Rs/share)					1,240

Source: Kotak Institutional Equities

Expect aggressive ramp of silver production

Silver production details, March fiscal year ends, FY2007-13E



Source: Company, Kotak Institutional Equities estimates

Sensitivity of target price to varying zinc price levels and EBITDA multiples

		Zinc (US\$/ton)				
		2,200	2,050	1,900	1,750	1,600
EV/EBITDA (X)	5.0	1,196	1,150	1,105	1,060	1,015
	5.5	1,270	1,222	1,173	1,124	1,075
	6.0	1,345	1,293	1,241	1,188	1,136
	6.5	1,420	1,364	1,308	1,253	1,197
	7.0	1,495	1,435	1,376	1,317	1,258

Source: Kotak Institutional Equities estimates

Sensitivity of target price to varying zinc price levels and Re/US\$ rate

		Zinc (US\$/ton)				
		2,200	2,050	1,900	1,750	1,600
Re/US\$ Rate	44	1,311	1,261	1,211	1,162	1,112
	45	1,328	1,277	1,226	1,175	1,124
	46	1,345	1,293	1,241	1,188	1,136
	47	1,362	1,309	1,255	1,202	1,149
	48	1,379	1,324	1,270	1,215	1,161

Source: Kotak Institutional Equities estimates

Sensitivity of target price to varying zinc and lead price levels

		Zinc (US\$/ton)				
		2,200	2,050	1,900	1,750	1,600
Lead (US\$/ton)	2,200	1,345	1,300	1,254	1,209	1,163
	2,050	1,338	1,293	1,247	1,202	1,156
	1,900	1,332	1,286	1,241	1,195	1,150
	1,750	1,325	1,279	1,234	1,188	1,143
	1,600	1,318	1,273	1,227	1,182	1,136

Source: Kotak Institutional Equities estimates

Sensitivity of target price to varying zinc and lead price levels

		Zinc (US\$/ton)				
		2,200	2,050	1,900	1,750	1,600
Lead (US\$/ton)	2,200	123.7	114.5	105.3	96.0	86.8
	2,050	122.4	113.1	103.9	94.7	85.4
	1,900	121.0	111.8	102.5	93.3	84.1
	1,750	119.6	110.4	101.2	91.9	82.7
	1,600	118.3	109.0	99.8	90.6	81.3

Source: Kotak Institutional Equities estimates

Zinc prices likely to be weak near term; may improve in the medium term

Zinc prices have corrected by more than 21% in the past three months and 30% from the 2010 peak of US\$2686/ ton. The correction has been more severe than other metals viz copper and aluminium. Premature capacity restarts supported by high zinc prices, has led to significant increase in inventory despite a solid demand recovery. Zinc inventory on LME has increased to a cycle high of 620K tons on May 26, 2010. This is 79% of cycle high inventory in 2004. Note that zinc underperformed other commodities when in a similar situation of high inventory during 2001-2004, after which prices started moving up. We believe that zinc prices may decline moderately and remain in the US\$1,700-2,000 range on account of the above-mentioned factors. We expect zinc market surplus to increase further in 2010E which will keep any meaningful upward price movement in check (refer to Exhibit below)

Zinc, quarter-wise world balance position ('000 tons)

	1QCY08	2QCY08	3QCY08	4QCY08	1QCY09	2QCY09	3QCY09	4QCY09	1QCY10	2QCY10	3QCY10	4QCY10
World												
World production	2,872	3,014	2,899	2,871	2,558	2,756	2,898	3,149	3,021	3,230	3,045	3,179
World consumption	2,882	2,921	2,786	2,536	2,395	2,475	2,645	2,715	2,775	2,850	2,835	2,965
World balance	(10)	93	113	335	163	281	253	434	246	380	210	214
North America												
Production	349	347	342	327	300	293	308	335	336	331	313	325
Consumption	362	368	337	282	245	258	282	309	325	335	323	342
NAFTA balance	(13)	(21)	5	45	55	35	26	26	11	(4)	(10)	(17)
US premia delivered (cents/lb)	4	3	3	3	3	3	3					
US premia delivered (US\$/ton)	79	75	72	61	61	55	55					
Asia												
Production	670	669	618	671	648	651	613	670	655	662	668	700
Consumption	682	677	662	602	538	562	602	618	630	641	652	667
Exports	(3)	(20)	(47)	(11)	(183)	(239)	(106)	(36)	(19)	75	125	149
Asia balance	(15)	(28)	(91)	58	(73)	(150)	(95)	16	6	96	141	182
Far East premia- Chinese (US\$/ton)	105	102	95	90	82	80	76					
Far East premia- western (US\$/ton)	120	117	103	95	87	85	83					
Western Europe												
Production	479	489	470	451	368	383	405	437	466	457	445	458
Consumption	558	559	527	462	413	414	438	456	465	475	455	495
Exports	117	128	107	145	131	86	79	77	100	38	45	77
Western Europe balance	38	58	50	134	86	55	46	58	101	20	35	40
Western Europe premia- FSU (US\$/ton)	63	53	38	30	28	32	35					
Western Europe premia- western (US\$/ton)	167	145	107	80	80	87	89					
Other Western World												
Production	198	200	195	179	166	171	170	183	178	180	194	207
Consumption	168	160	169	165	154	131	143	147	150	154	155	161
Other Western World balance	30	40	26	14	12	40	27	36	28	26	39	46

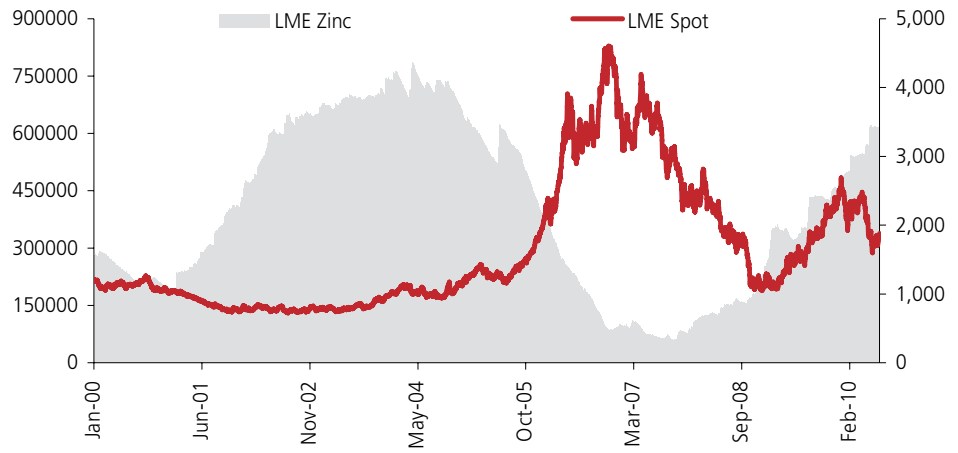
Source: CRU, Kotak Institutional Equities estimates

We believe the resulting surplus may offset the potential demand growth of 12% in 2010. Any material slowdown in demand may lead to a slide in prices. Note that zinc prices are far more geared to growth; cost curve support in case of material slowdown is only at US\$1,400-1,500/ ton.

However, in the medium term, there is reasonable probability that the zinc market may slip towards a deficit. The impact of several mines reaching the end of their useful lives or reduction in quality of ore grades may result in a slowdown of production growth in 2011 and 2012E. Some of the large mines that may have a reduction in output are Brunswick (Canada) and Anatamina (Peru). Canada and Peru itself can potentially take out 500,000 tons of production over the next few years.

High inventory levels could pressure zinc prices in the near term

Total zinc inventory (tons), LME zinc prices (US\$/ton), December year ends, 2000-2010



Source: Bloomberg, Kotak Institutional Equities estimates

Hindustan Zinc, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	78,778	56,803	80,170	91,118	109,305	118,955
EBITDA	53,784	27,342	46,701	51,759	62,822	68,246
Other income	8,516	9,312	7,222	9,738	12,215	15,179
Interest	(242)	(219)	(439)	(307)	(338)	(372)
Depreciation	(2,205)	(2,853)	(3,343)	(4,187)	(4,687)	(5,013)
Profit before tax	59,853	33,582	50,141	57,003	70,011	78,040
Current tax	(14,673)	(5,209)	(8,309)	(11,980)	(18,962)	(20,962)
Deferred tax	(1,220)	(1,097)	(1,418)	(1,701)	(2,041)	(2,450)
Net profit	43,961	27,276	40,414	43,322	49,008	54,628
Earnings per share (Rs)	104.0	64.6	95.6	102.5	116.0	129.3
Balance sheet (Rs mn)						
Equity	118,482	143,576	181,240	221,596	267,638	319,299
Deferred tax liability	4,597	5,589	7,112	8,814	10,855	13,305
Total Borrowings	4	87	605	4	4	4
Current liabilities	8,984	10,010	13,258	13,474	11,177	11,415
Total liabilities	132,067	159,261	202,215	243,888	289,673	344,023
Net fixed assets	41,626	52,133	72,771	75,784	76,096	76,084
Investments	63,325	69,289	109,492	134,492	164,492	194,492
Cash	13,628	27,192	9,275	22,160	36,831	60,968
Other current assets	13,489	10,648	10,677	11,452	12,254	12,479
Miscellaneous expenditure	—	—	—	—	—	—
Total assets	132,067	159,261	202,215	243,888	289,673	344,023
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	39,120	23,460	45,555	49,211	55,737	62,090
Working capital changes	1,496	3,667	767	(559)	(3,100)	12
Capital expenditure	(13,667)	(13,743)	(22,492)	(7,200)	(5,000)	(5,000)
Free cash flow	26,949	13,383	23,831	41,452	47,637	57,103
Ratios						
Debt/equity (X)	0.0	0.0	0.0	0.0	0.0	0.0
Net debt/equity (X)	(0.6)	(0.6)	(0.6)	(0.7)	(0.7)	(0.8)
RoAE (%)	43.4	20.0	23.9	20.7	19.3	17.9
RoACE (%)	43.6	20.2	24.1	20.8	19.4	18.0

Source: Company, Kotak Institutional Equities estimates

JULY 12, 2010
UPDATE
Coverage view: Attractive
Price (Rs): 185
Target price (Rs): 205
BSE-30: 17,834

Capitalizing on strong business opportunities, retain ADD. In a recent meeting with our banking team, IDFC's management gave us insights in its changing business mix. The change is on account of strong growth opportunities in lending business (supported by recent capital infusion) and business opportunities in asset management. We revise our model to factor higher growth and capital infusion. Retain ADD with price target of Rs205.

Company data and valuation summary

IDFC				Forecasts/Valuations		
Stock data				2010	2011E	2012E
52-week range (Rs) (high,low)	186-115			8.2	9.2	11.3
Market Cap. (Rs bn)	269.9			41.1	13.3	22.8
Shareholding pattern (%)				22.7	20.0	16.3
Promoters	0.0			11.2	15.1	19.9
FIs	44.4			10.6	13.5	17.1
MFs	5.5			46.5	71.2	85.7
Price performance (%)	1M	3M	12M	4.0	2.6	2.2
Absolute	12.4	6.3	46.1	16.1	15.2	14.5
Rel. to BSE-30	4.9	6.9	12.7	0.7	0.9	1.1

IDFC has raised Rs35 bn

IDFC has concluded capital issuance of Rs35 bn in two tranches (1) QIP of 158 mn equity shares issued at Rs168/ share i.e. 19X PER and 2X PBR FY2011E and 15X PER and 2X PBR FY2012E and (2) 48 mn preference shares compulsory convertible after 18 months at Rs176/ share. The equity issuance will increase dilution by 16%. IDFC proposes to grow its loan book by 3X over next 3-4 years, i.e. at 32-44% CAGR. In order to maintain its capital adequacy at about 15%, the company will need a capital base of about Rs130-150 bn by FY2013E-FY2014E as against its net worth of about Rs70 bn as on March 2010. A larger capital base will also enable IDFC to have higher single-party limits with select companies. A larger role in lending will also improve prospects for non-fund businesses of IDFC.

Revising estimates, retain ADD rating

We are revising up our PAT estimates to factor the capital issuance and higher loan growth estimates. According to the management, its key accounts have lined up large capex plans and are likely to be the key drivers of its growth; thus, the company will not have to compromise on the quality of its client base. Thus, the management is bullish on growth but it will continue to remain selective and focus on asset quality as well. We are raising our loan growth estimates to 40% CAGR for next two years from 33% earlier. We raise our PAT estimates by 13% and 17% for FY2011E and FY2012E respectively, while our EPS estimates increases by 1% in FY2012E. We are retaining our ADD rating on the stock with an SOTP-based price target of Rs205 (Rs195 earlier). At our price target, IDFC will trade at 2.1X core PBR FY2011E and 1.9X core PBR FY2012E for core RoEs of 16-17% over the medium term.

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Operating income skew towards lending business, asset management

A larger pie in the lending business will likely drive non-fund based income avenues as well, albeit a lower pace. Consequently, the share of interest income in operational will likely increase- 60-65% of operational income from 55% in 2010.

IDFC proposes to sell about 25% stake in its asset management business (IDFC AMC) to a strategic investor. The partner will likely help the company mobilize overseas funds for its private equity and listed equity funds. IDFC's private equity and project equity funds are currently committed to the extent of about 40-50%. The company will explore opportunities to raise new funds by end of FY2011E when current funds get committed to the extent of 70-80%. IDFC will consider raising new funds (listed equities, PMS etc). In the past, IDFC has invested seed capital of 7% of the fund; incremental, seed capital may likely increase to 10-12% as well. Thus, the share of venture capital investments in IDFC's equity investment book will rise over the medium term. The share of non-interest income in IDFC's operational income may thus have an upside to our estimates.

Infrastructure bonds to augur well for IDFC's ALM

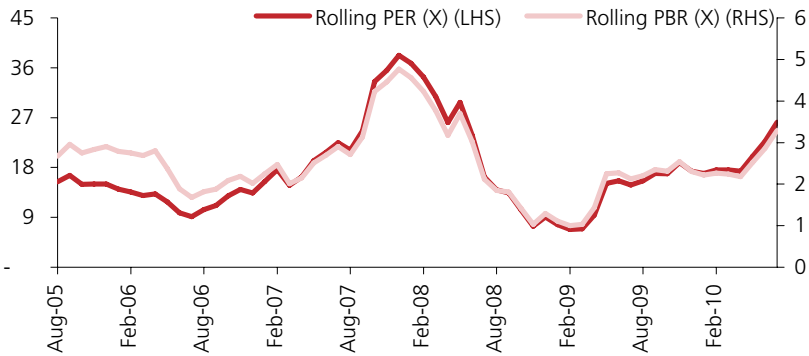
IDFC, along with LIC and IFCI, can be allowed to raise infrastructure bonds under section 80 CCF as announced in the Union Budget. The bonds have tenure of about 10 years and will have EEE status. The Union Budget prescribes a limit on tax exemption of Rs20,000 per individual (this is in addition to the limit of Rs1,00,000 u/s 80C). We believe tax benefits will help issuers place the bonds at about 3% below other market borrowings. Based on a rough calculation, we estimate the total market for these bonds at about Rs80-100 bn- about 5 mn tax assesses have taxable income of over Rs2,00,000/ year. While the amount mobilized may not be as large, these bonds will provide access to long-term funding avenues.

IDFC : Sum-of-the-parts-based valuation

	Valuation (Rs mn)	Value per share (Rs)	Comments
IDFC (core)	170,557	132	Based on residual growth model- implies 2.1X core PBR for medium term RoE of about 17%
IDFC (India Development fund)	2,250	1.5	25% of AUMs - US\$200 mn
IDFC (Private equity)	10,878	7.2	15% of FY2012E AUM - US\$2 bn
IDFC (Project equity)	8,400	5.6	10% of FY2012E AUM - US\$1.4 bn
IDFC investment advisors (PMS)	646	0.4	10% of FY2012E AUMs - US\$100 mn
IDFC MF	19,500	11.6	4% of FY2012E AUMs
IDFC SSKI	16,440	10.9	18X FY2012E PAT
IDFC's investment in NSE	17,595	11.7	18X FY2012E PER
Value of market investments	27,026	21	2X book value (including unrealised value)
Total	246,265	202	

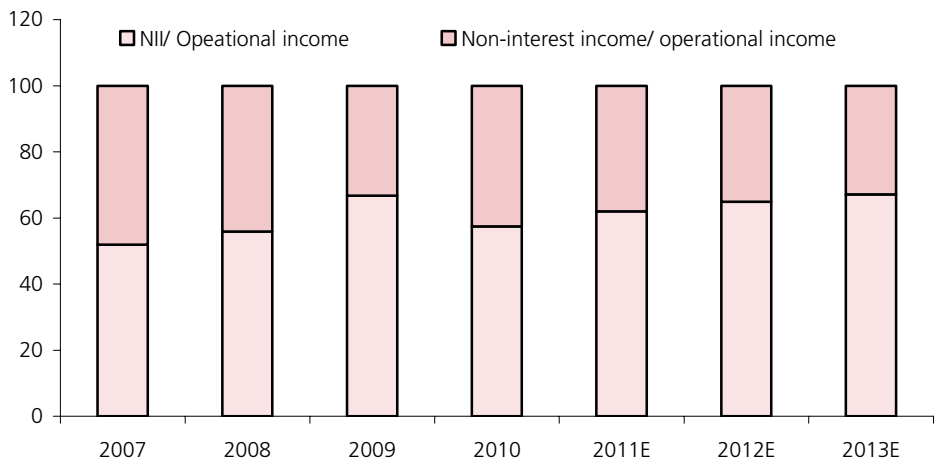
Source: Kotak Institutional Equities estimates

IDFC- Rolling PER and PBR
 Monthly data, August 2005-July 2010 (X)



Source: Company, Bloomberg, Kotak Institutional Equities estimates

Share of net-interest income in operating income will rise over time
 Ratio of NII and non-interest income in operating income, March fiscal year-ends, 2005-2012E (%)



Source: Company, Kotak Institutional Equities estimates

IDFC- old and new estimates

March fiscal year-ends, 2011-2012E (Rs mn)

	Old estimates		New estimates		Old vs New (%)	
	2011E	2012E	2011E	2012E	2011E	2012E
Net interest income	13,157	16,641	15,137	19,884	15	19
NIM (%)	3.4	3.3	3.8	3.7	-	-
Treasury and bank bal.	75,338	83,621	75,338	83,621	-	-
Cash and bank	19,721	22,251	19,721	22,251	-	-
Treasury book	55,617	61,371	55,617	61,371	-	-
Infrastructure loans	334,596	440,375	354,000	497,696	6	13
Loan loss provisions	1,024	1,550	1,058	1,703	3	10
Other income	10,288	12,221	10,346	12,452	1	2
Fee income	7,789	9,416	7,847	9,646	1	2
Capital gains	2,498	2,806	2,498	2,806	-	-
Operating expenses	6,589	7,943	6,589	7,943	-	-
Employee expenses	3,715	4,545	3,715	4,545	-	-
PBT	16,360	19,898	18,364	23,217	12	17
Tax	4,375	5,289	4,876	6,119	11	16
Net profit	11,985	14,608	13,487	17,098	13	17
Net profit (after minority interest)	11,985	14,608	13,487	17,098	13	17
PBT-treasury+provisions	14,357	18,114	16,395	21,586	14	19
EPS (Rs)	9	11	9	11	0	1

Source: Kotak Institutional Equities

IDFC (consolidated) key ratios, March fiscal year-ends, 2007-2013E (%)

	2007	2008	2009	2010	2011E	2012E	2013E
Income Statement							
Operating income	64	70	38	2	29	37	37
Net fund based income	51	63	35	21	35	31	38
Fee income	160	64	8	48	25	23	26
On AUM	84	5	287	40	24	19	23
Other operating income	7	29	(15)	81	(25)	12	32
Operating expenses	43	228	55	42	22	21	19
Net profit	60	21	1	41	27	27	38
Core operating profit (PBT-treasury+provisions)	84	42	16	25	35	32	39
Balance Sheet							
Assets							
Investments	52	174	40	(7)	14	11	11
Infrastructure loans	37	43	3	22	41	41	40
Total assets	44	61	7	12	34	34	35
Liabilities							
Loan funds	57	57	7	13	31	39	41
Total liabilities	52	55	6	12	30	38	40
Shareholders equity	14	90	10	14	53	20	14
Key ratios (%)							
Yield on							
Earning assets exld treasury assets	9.1	10.2	11.3	10.4	10.6	10.7	10.9
Earning assets incl treasury income and assets	9.7	10.5	11.0	10.8	10.7	10.7	10.9
Infrastructure loans	9.3	10.2	11.8	11.3	11.4	11.4	11.4
Interest on bank deposits	8.4	16.0	9.9	15.7	15.4	13.1	13.6
Average cost of funds	7.2	8.1	9.1	7.8	8.0	8.3	8.2
Capital gains to eqty investments	21.3	20.6	10.1	15.6	11.2	10.6	12.3
NIM (excl capital gains)	2.8	3.0	3.2	3.5	3.8	3.7	3.8
Employee .exp to income	0.5	1.1	1.3	1.7	1.6	14.1	12.8
Operating expnses/ income	9.0	18.9	24.8	25.9	25.9	24.6	21.9
Du Pont (%age of average assets)							
Net interest income	2.8	3.0	3.1	3.4	3.7	3.7	3.8
Loan loss provisions	0.1	0.3	0.5	0.4	0.3	0.3	0.3
Other operating income	2.7	2.7	2.1	3.0	2.7	2.4	2.2
Operating expenses	0.5	1.1	1.3	1.7	1.6	1.5	1.3
Invnt. depreciation	—	—	—	—	—	—	—
ROA	4.1	3.2	2.5	3.3	3.3	3.2	3.2
Average assets/average equity	5.5	5.5	5.0	4.9	4.6	4.6	5.3
ROE	22.6	17.6	12.9	16.1	15.2	14.5	17.1

Source: Company, Kotak Institutional Equities estimates

IDFC (consolidated) : Income statement and balance sheet, March fiscal year-ends, 2007-2013E

	2007	2008	2009	2010	2011E	2012E	2013E
(Rsmn)							
Total income	16,917	27,928	36,339	40,513	50,522	67,264	90,967
Operating income	12,778	21,700	30,032	30,755	39,649	54,284	74,629
Dividend	91	62	542	141	137	161	185
Interest on deposits	100	—	—	—	—	—	—
Other charges	136	101	-	15	15	15	15
Net fund based income	4,223	6,866	9,237	11,220	15,137	19,884	27,425
Less: provisions for NPLs	174	688	1,495	1,304	1,058	1,703	2,391
Net fund based income post provisions	4,049	6,178	7,742	9,916	14,079	18,180	25,034
Fee income	2,406	3,944	4,253	6,293	7,847	9,646	12,111
SSKI	—	1,873	1,071	1,832	2,278	2,619	3,012
Fees - upfront fees, prepayments	—	—	—	—	—	—	—
On guarantees/commissions- standalone	656	1,515	1,032	1,440	1,813	2,555	3,587
Fees on AMC	528	556	2,150	3,021	3,757	4,471	5,512
Net operating income	8,137	12,288	13,835	19,539	24,425	30,632	40,844
Operating expenses	745	2,447	3,795	5,390	6,589	7,943	9,480
Profit before tax	7,444	9,959	10,254	14,286	18,364	23,217	31,891
Tax	1,235	2,463	2,697	3,666	4,876	6,119	8,304
Net profit	6,209	7,496	7,558	10,619	13,487	17,098	23,587
% growth	60	21	1	41	27	27	38
Minority interest	—	143	62	-	-	-	-
Net profit post minority interest	6,209	7,353	7,495	10,619	13,487	17,098	23,587
PBT - treasury	5,710	7,675	8,201	10,820	15,337	19,883	27,665
% chg	112	34	7	32	42	30	39
PBT - treasury + provisions	5,884	8,363	9,695	12,123	16,395	21,586	30,057
No. of shares	1,126	1,294	1,295	1,301	1,459	1,506	1,506
Balance Sheet							
Assets							
Mutual Funds	3,477	7,148	-	-	-	-	-
Equity Shares	6,147	12,606	19,652	15,614	18,737	21,548	24,780
Venture Capital Units	954	1,273	2,983	4,386	5,935	6,523	7,062
Infrastructure loans	139,155	199,024	205,918	250,310	354,000	497,696	698,004
Current assets	18,287	28,674	18,987	18,223	22,996	25,526	28,648
Fixed assets	486	3,812	4,449	4,330	4,766	4,963	5,231
Other assets	854	953	1,393	1,463	1,536	1,613	1,693
Total assets	178,506	286,600	306,530	344,755	463,588	619,238	833,173
Liabilities							
Subordinated debt (unsecured)	6,500	6,500	6,500	6,500	6,500	6,500	6,500
Loan funds	137,136	214,784	229,259	258,940	340,109	473,343	668,128
Current liabilities and provisions	5,561	9,484	9,101	9,215	9,764	10,353	10,986
Total liabilities	149,197	230,767	244,860	274,655	356,373	490,196	685,614
Paid-up capital	11,259	12,943	12,953	13,010	14,588	15,065	15,065
Reserves and surplus	18,049	42,889	48,717	57,090	92,628	113,977	132,494
Shareholders equity	29,308	55,832	61,670	70,100	107,216	129,042	147,559

Source: Company, Kotak Institutional Equities estimates

JULY 12, 2010

UPDATE

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Likely strong revenues; but inflows would be the test of capex momentum.

Expect robust revenue growth in 1QFY11E led by a pick up in execution of the existing order book and yoy base effect. Margins to remain relatively flat - rise in commodity prices versus FY2010 levels to be partially offset by operating leverage and recent pull back in prices. Order inflows remain the key indicator of capex momentum - announcements of inflows have remained relatively sedate in 1QFY11E. Top picks: L&T,

Expect strong revenue growth; order inflow would be key indicator of capex momentum

We expect industrial companies to report moderate to strong revenue growth in 1QFY11, primarily led by existing order backlogs (BHEL, L&T), partial revival in the demand scenario in the products segment (ABB, Siemens, Crompton) and low base effects of 1QFY10 (Thermax, Construction companies). We believe order inflows and product revenues would be key factors to watch as we believe they could be a harbinger of a pick-up in industrial capex activity – the quantum of order announcements has been relatively sedate in 1QFY11 versus strong inflows in 2HFY10.

Potential headwinds of RM prices on margins; but operating leverage, recent pull back may help

We expect the margin expansion trend in 1QFY11 to reverse led by a partial revival in commodity prices. Most commodity prices picked up in 4QFY10 versus average levels of FY2010, hence we believe the companies are likely to face margin pressure. However, as revenue growth picks up in FY2011E, operating leverage could help support margins. Also, commodity prices have again corrected slightly (post rise in 4QFY10) which would also help support margin levels. We have built in relatively flat-to-slight margin contraction for most industrial and construction companies (except for BHEL – margins expansion on low yoy base and operating leverage) in 1QFY11E.

Potential for negative surprise in Thermax, ABB, Siemens; positive in Crompton versus estimates

We see potential for negative surprises in the results versus our estimates of (1) Thermax – 47% revenue growth may not pan out and (2) ABB/ Siemens - volatile quarterly performance and project specific one-offs could continue to impact numbers. We see potential for moderate positive surprises in Crompton led by higher-than-expected revenues and margins. For BHEL and L&T, while revenue growth may disappoint (higher-than-guidance and MOU for L&T and BHEL, respectively) however, moderate positive surprise may come from margins.

Top picks - Industrials: L&T, Crompton, BGR Energy; Construction: Nagarjuna, IVRCL, Sadbhav

- ▶ **Industrials. We have a positive view - L&T:** (1) Capex revival, (2) scale-up of power equipment and EPC, (3) investments for capacity & capability expansion, (4) value creation in subsidiaries, (5) execution pick-up in FY11-12E; **Crompton:** (1) Traction in domestic business, (2) contained risk from overseas subs, (3) consistent execution, (4) likely upside from higher participation in substation execution; **BGR Energy:** (1) Strong execution earns credibility in a large opportunity sector, (2) potential upside to estimates on incremental orders, (3) upside from equipment JV with Hitachi.
Negative view: ABB/Siemens: Pricing pressures, company specific issues, volatility in operating performance; **BHEL:** Expect potentially sedate traction in order inflows which may lead to sedate revenue growth post FY2012E; **Voltas:** (1) continued slowdown in target MEP markets, (2) potential margins pressure, (3) slow execution of new projects.
- ▶ **Construction:** Positive view on NJCC, IVRCL, Sadbhav led by strong backlog, attractive valuation.

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Industrials

Company wise 1QFY11E results estimates for the industrials segment – key numbers (Rs mn)

	Jun-10E	Jun-09	Mar-10	% change		Comments
				yoy	qoq	
Larsen & Toubro						
Net sales	93,176	74,083	135,851	25.8	(31.4)	Expect strong revenue growth of 26% versus moderate performance in FY2010 (especially 9MFY10) led by large backlog and execution pick up
EBITDA	9,784	8,319	20,508	17.6	(52.3)	
EBITDA margin (%)	10.5	11.2	15.1			
PBT	9,990	8,514	21,288	17.3	(53.1)	Potential for strong revenue growth of 25%+ in FY2011E and FY2012E; expect relatively flat margins on a yoy basis
PAT	6,673	5,783	13,374	15.4	(50.1)	
Extraordinaries	—	10,199	1,007	NA	(100.0)	
PAT-reported	6,673	15,982	14,381	(58.2)	(53.6)	
Bharat Heavy Electricals						
Net sales	69,779	55,957	135,591	24.7	(48.5)	Order backlog-led strong revenue growth to continue; estimate revenue growth of about 25% yoy in 1QFY11E
EBITDA	8,513	5,162	24,873	64.9	(65.8)	
EBITDA margin (%)	12.2	9.2	18.3			
PBT	10,846	7,187	28,983	50.9	(62.6)	However we expect inflows traction to squeeze growth post FY2012E
PAT	7,159	4,706	19,096	52.1	(62.5)	
ABB						
Net sales	18,476	15,148	14,559	22.0	26.9	Expect pick up in revenue growth to about 22% in 2QCY10; incremental losses from withdrawal from RGGVY project may be limited as remaining order book is insignificant
EBITDA	1,663	1,379	29	20.6	5,633.6	
EBITDA margin (%)	9.0	9.1	0.2			
PBT	1,747	1,284	84	36.0	1,991.3	Pick up in capex activity may drive revenue growth; margins expected to remain relatively flat at 9% on a yoy basis
PAT	1,170	836	67	40.0	1,659.2	
Siemens						
Net sales	23,776	19,177	22,261	24.0	6.8	Expect strong revenue growth of 24% yoy led by pick up in power as well as industrials segment
EBITDA	2,853	2,571	2,861	11.0	(0.3)	
EBITDA margin (%)	12.0	13.4	12.9			
PBT	2,816	2,568	2,741	9.6	2.7	One-offs and project specific issues led to volatile margins in the past; have built in expected long-term margin of 12%
PAT	1,858	1,944	1,811	(4.4)	2.6	
Crompton Greaves						
Net sales	23,099	21,975	25,079	5.1	(7.9)	Expect moderate revenue growth of 5% led by domestic power business; expect slowdown to continue in the international markets especially in the distribution segment
EBITDA	2,772	2,476	4,027	11.9	(31.2)	
EBITDA margin (%)	12.0	11.3	16.1			
PBT	2,576	2,299	3,840	12.1	(32.9)	Expect slight margin to expansion to 12% from 11.3%
PAT	1,752	1,605	2,702	9.2	(35.2)	
BGR Energy Systems						
Net sales	7,942	3,111	16,598	155.3	(52.2)	Expect strong revenue growth on the back of strong progress in execution of large EPC (Mettur and Kalisindh) and BoP (Chandrapur and Marwa) contracts
EBITDA	854	422	1,752	102.1	(51.3)	
EBITDA margin (%)	10.8	13.6	10.6			
PBT	709	307	1,642	131.4	(56.8)	Expect decline in operating margins to 11% with increasing proportion of revenue from EPC orders
PAT	472	202	1,083	133.1	(56.4)	
Thermax						
Net sales	7,909	5,376	12,193	47.1	(35.1)	Expect very strong revenue growth of about 47% yoy led by execution pick up especially in the domestic market
EBITDA	929	689	1,466	34.8	(36.6)	
EBITDA margin (%)	11.8	12.8	12.0			
PBT	928	692	1,541	34.1	(39.8)	Expect some decline in margins to 12% led by higher revenue contribution from large EPC orders and higher raw material costs
PAT	622	465	992	33.7	(37.3)	
Voltas						
Net sales	13,634	12,510	14,802	9.0	(7.9)	Expect moderate revenue growth of about 9% yoy
EBITDA	1,261	1,117	1,495	12.9	(15.6)	
EBITDA margin (%)	9.3	8.9	10.1			
PBT	1,381	1,177	1,598	17.4	(13.6)	Expect operating margin to remain relatively flat on a yoy basis at 8.5%; Order inflows would be key factor to look out for
PAT	923	790	1,240	16.8	(25.6)	
Suzlon Energy						
Net sales	18,000	11,650	41,500	54.5	(56.6)	Expect low execution of about 300 MW leading to low operating margin of 7.5%
EBITDA	1,350	(1,730)	3,510	(178.0)	(61.5)	
EBITDA margin (%)	7.5	(14.8)	8.5			
PBT	(1,911)	(4,550)	410	(58.0)	(566.0)	High interest costs likely to lead to a net loss of about Rs1.9 bn for the quarter
PAT	(1,911)	(4,440)	(2,440)	(57.0)	(21.7)	
Bharat Electronics						
Net sales	10,446	9,106	18,137	14.7	(42.4)	Expect moderate revenue growth of 15% led by large order backlog
EBITDA	1,293	916	1,729	41.0	(25.2)	
EBITDA margin (%)	12.4	10.1	9.5			
PBT	1,589	1,073	2,861	48.1	(44.5)	
PAT	1,081	727	1,997	48.6	(45.9)	

Source: Company, Kotak Institutional Equities estimates

- ▶ **Larsen & Toubro:** We expect the strong pick up in execution seen in 4QFY10 to continue in this quarter as well (versus sedate 9MFY10 revenues). We expect revenue growth of 25.6% yoy in 1QFY11E to Rs93.2 bn, in line with our full-year revenue growth expectation. Margins are expected to contract slightly (~70 bps) as the commodity advantage reverses. We expect the company to report a net profit of about Rs6.7 bn, up 15% yoy.
- ▶ **BHEL:** We expect a strong revenue growth of 25% to Rs70 bn in 1QFY11E. The revenue growth would be driven by the strong order backlog of Rs1,427 bn at the end of FY2010. We expect margins to expand to 12.2% in 1QFY11E led by lower raw material and employee costs as a percentage of sales. Highlight that 1QFY09 raw materials were higher due to subcontracting of gas turbines. Expect net profit of Rs7.2 bn, up 52% yoy.
- ▶ **ABB:** We expect ABB to report a strong revenue growth of 22% in 2QCY10E to Rs18.5 bn led by likely pick up in project business. We believe that incremental losses from withdrawal from RGGVY project may be limited as remaining order book is insignificant. We estimate the margins to remain relatively flat on a yoy basis at 9% and expect the company to report a net profit of Rs1.2 bn in 2QCY10E, up 40% yoy.
- ▶ **Siemens:** Likely pick-up in industrial capex activity and robust inflows are expected to lead to strong revenue growth of 24% yoy in 3QFY10E led by both the products and projects segments. Yoy growth would also be partially aided by low base effects. One-offs and project specific issues have led to volatile margins in the past; hence we build in expected long-term margins of 12%.
- ▶ **Crompton:** We expect Crompton to report a moderate revenue growth of about 5% yoy led by full-year assumption of about 15-17% yoy growth in the domestic business and about 0-5% de-growth in the international subsidiary business. We expect moderate PAT growth of 9% to Rs1.7 bn (versus 46% growth in FY2009) as margin expansion-led earnings growth is unlikely to sustain and PAT growth would have to align with revenue growth.
- ▶ **BGR Energy:** Strong pick-up in execution of the two large EPC projects (also seen in previous quarter) is likely to lead to very strong revenues of Rs7.9 bn in 1QFY11E, more than double the revenues of 1QFY10. Margins are expected to remain relatively flat on a sequential basis.
- ▶ **Thermax:** We expect Thermax to report very strong revenue growth of 47% yoy to Rs7.9 bn led by execution of large EPC order and pick-up in execution of Essar and SAIL orders - had slowed down in 1HFY10. However margins may contract by ~100 bps led by (1) likely lower margins of EPC, large-sized projects and (2) a majority of backlog is at fixed prices.
- ▶ **Voltas:** We expect Voltas to report moderate revenue growth of about 9% to Rs13.6 bn in 1QFY11E. The revenue growth is likely to be led by completion of certain large orders and pick up in the agency business. Margins are expected to remain relatively flat leading to a net PAT growth of 17% yoy to Rs923 mn in 1QFY11E. However, we believe that order inflows would be key factor to look out for.
- ▶ **Suzlon:** We expect the company to report sales of about 300 MW in 1QFY11E; versus our full-year execution assumption of 1,838 MW. The low sales volumes are likely to lead to lower operating margins of 7.5% in 1QFY11E. High interest cost of Rs2.5 bn is likely to lead to a net loss of Rs1.9 bn in 1QFY11E.
- ▶ **Bharat Electronics:** We expect BEL to execute orders to the tune of about Rs10.4 bn in 1QFY11E, up 15% yoy and about 18% of our full-year estimates. The revenue growth would be driven by the strong order backlog of about Rs114 bn at the end of FY2010.

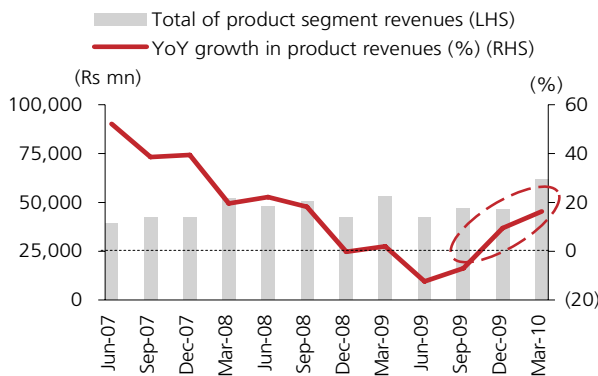
Robust revenue growth; order inflows would be key factor to watch for

We expect industrial company revenues to report moderate to strong revenue growth in 1QFY11 led by existing order backlogs, partial revival in the demand scenario in the products segment and . The yoy growth would also be partially aided by low base effects of 1QFY10. We expect strong revenue growth of about 25%-26% for BHEL and L&T in line with our full-year estimates. We believe that order inflow momentum and products segment execution which started to pick up in the previous few quarters would strengthen further in 1QFY11.

Likely strong pick-up in project segment on back of robust inflows in 2HFY10; expect lag effect to products

We expect a pick-up in project segments in 1QFY11E on the back of strong growth in order inflows seen in 2HFY10. We believe that the growth in projects business generally lags products business due to a longer execution cycle. Project businesses also did not exhibit the same order of slowdown as projects businesses in 1HFY10. Strong inflows across the broad set of industrial companies are likely to be a harbinger of strong execution and revenue growth in the near term. This would be positive for companies such as ABB and Siemens having 30-40% of their revenues from projects business. We build in some recovery in execution for these companies and expect them to report a revenue growth of about 22-24%.

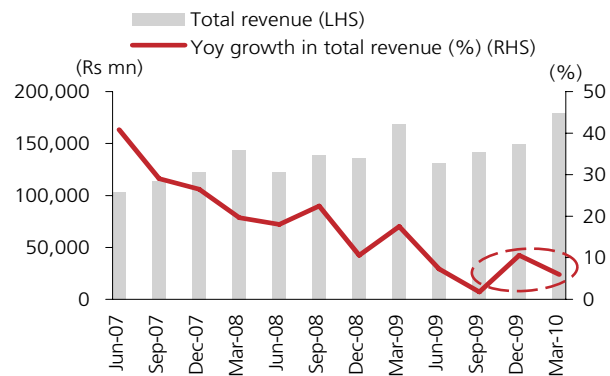
Sum of product segment revenues and growth, 1QFY07-4QFY10



Note: (1) Excludes BHEL, includes Machinery & Indl. segment of L&T.

Source: Company, Kotak Institutional Equities

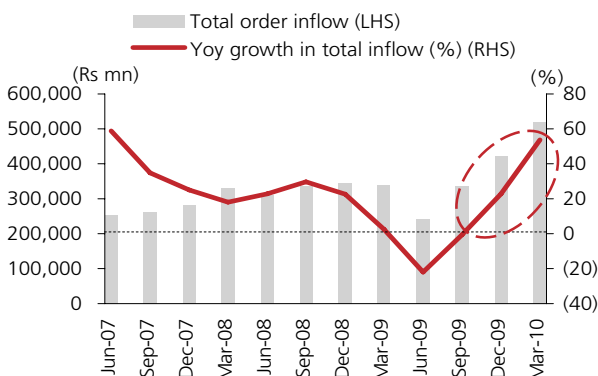
Sum of total company revenues and growth, 1QFY07-4QFY10



Note: (1) Excludes BHEL and L&T.

Source: Company, Kotak Institutional Equities

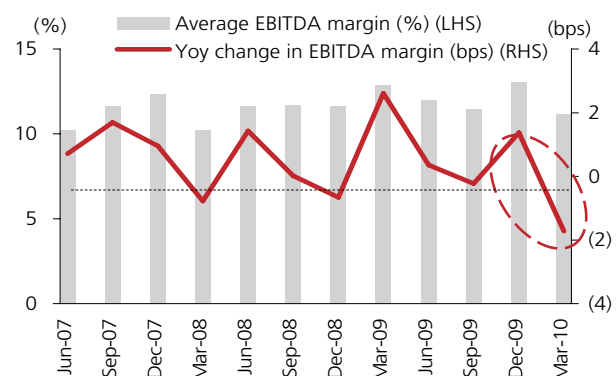
Sum of order inflow and yoy growth, 1QFY07-4QFY10



Note: (1) Includes BHEL and L&T.

Source: Company, Kotak Institutional Equities

Sum of PAT and yoy growth, 1QFY07-4QFY10



Note: (1) Excludes BHEL and L&T.

Source: Company, Kotak Institutional Equities

Order inflows would be key factor - indicator of potential capex momentum

Order inflows trend remained strong across companies increasing visibility for a pick-up in execution in the near term. In 2HFY10, we noticed a sharp yoy growth in inflows across the broad set of industrial companies. We believe that order inflows during the quarter would be a key factor to look out for as we believe it could be a harbinger pick up in industrial capex activity and potentially lead to strong execution and robust revenue growth in the near term. Highlight that order inflow announcements have remained relatively muted in 1QFY11; L&T has announced orders to the tune of about Rs66 bn in 1QFY11 versus average quarterly announcements of about Rs132 bn in FY2010 and full-year order inflow guidance of above Rs850 bn. BHEL has not announced any orders in 1QFY10.

Order inflow has shown strong recovery in 2HFY10

Quarterly order inflows for various industrial companies, quarter-ends June 30, 2009 - Mar 31, 2010 (Rs mn)

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	yoy change			
									Jun-09	Sep-09	Dec-09	Mar-10
BHEL	134,297	143,426	155,223	164,054	90,921	84,252	153,003	226,000	(32.3)	(41.3)	(1.4)	37.8
L&T	122,000	124,530	146,200	125,170	95,700	183,650	178,364	238,430	(21.6)	47.5	22.0	90.5
Crompton	13,789	13,586	10,574	14,542	14,695	13,061	10,848	20,572	6.6	(3.9)	2.6	41.5
Siemens (Sept year-ends)	20,780	23,851	19,797	18,594	23,400	26,169	51,680	22,380	12.6	9.7	161.0	20.4
Areva T&D (Dec year-ends)	14,866	9,019	7,834	9,988	7,807	10,288	14,180	10,156	(47.5)	14.1	81.0	1.7
ABB (Dec year-ends)	22,086	18,891	12,610	23,033	21,116	18,933	23,767	16,887	(4.4)	0.2	88.5	(26.7)
Voltas	14,843	6,316	3,598	4,091	6,481	4,622	7,041	12,810	(56.3)	(26.8)	95.7	213.1
Thermax	9,140	20,560	7,310	5,810	10,030	20,500	13,790	13,620	9.7	(0.3)	88.6	134.4
Elecon Engineering	2,550	6,490	3,010	1,290	1,470	1,920	1,930	2,134	(42.4)	(70.4)	(35.9)	65.5
Total order inflow	354,351	366,669	366,156	366,572	271,619	363,395	454,603	562,989	(23.3)	(0.9)	24.2	53.6
Yoy growth (%)		28.3	15.9	(0.3)	(23.3)	(0.9)	24.2	53.6				
Total order inflow (excl. BHEL, L&T)	98,054	98,712	64,733	77,348	84,999	95,493	123,236	98,559	(13.3)	(3.3)	90.4	27.4
Yoy growth (excl. BHEL, L&T) (%)		43.3	(21.0)	(23.5)	(13.3)	(3.3)	90.4	27.4				

Source: Company, Kotak Institutional Equities estimates

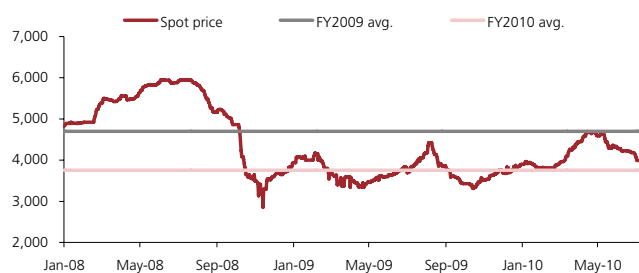
Potential headwinds of material prices on margins; but operating leverage and price fall back to help

Most companies reported margin expansion in 4QFY09-3QFY10 on the back of low commodity prices although some portion of the contribution margin was dissipated in the negative operating leverage led by slow execution. We see a possible reversal of trend in 1QFY11 led partial revival in commodity prices versus lows of 2HFY09. Part of the margin contraction was witnessed in 4QFY10 itself - more than 150 bps contraction in margins, on both yoy as well as qoq basis, as measured across the sector.

Most commodities prices picked-up in 4QFY10 versus average levels of FY2010 and thereby we believe that the companies are likely to face potential headwinds of margin pressure. However, we expect that as the revenue growth picks up in FY2011E, operating leverage would also help support margins irrespective of a potential increase in commodity prices. Furthermore the commodity prices have, in the recent past, again corrected slightly (post rise in 4QFY10) which would also partially help support margin levels.

Trend of daily price of key metal commodities since Jan-2008

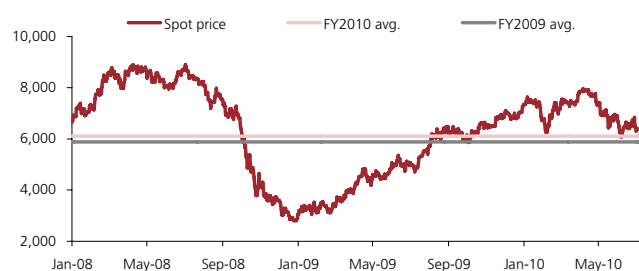
Spot prices of Hot-rolled Steel on CHIS (CNY/ton)



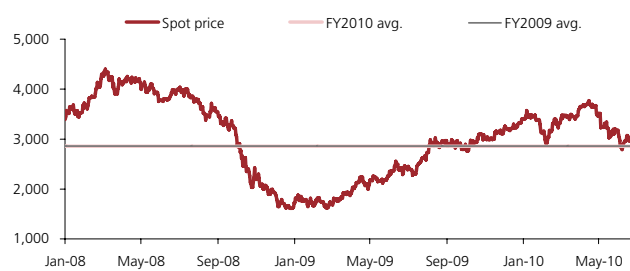
Spot prices of Aluminium on LME (USD/ton)



Spot prices of Copper on LME (USD/ton)



LME Metals commodities Index (X)



Source: Bloomberg, Kotak Institutional Equities

Potential for negative surprise in Thermax, ABB, Siemens

We believe that there is a potential for negative surprises in the results versus our estimates of (1) **Thermax** - have built in strong execution from large EPC projects and other large projects (SAIL/ Essar) which may not pan out and (3) **ABB/ Siemens** - volatile quarterly performance and project specific one-offs could adversely impact numbers.

Potential for positive surprise in Crompton versus estimates

Also highlight a potential for positive surprises for Crompton versus our estimates led by higher-than-expected execution and margins. We estimate 5% revenue growth and 9% growth in profits. We have built in 70 bps margin expansion on a yoy basis as 1QFY2010 margins were significantly lower than the full-year average.

BHEL revenue estimates may have downside risk led by lower-than-expected revenues - we have built in a revenue growth of 25% yoy to Rs70 bn in 1QFY11E based on our full-year revenue growth estimate of 25%; this is versus the company's MOU target for "excellent" rating of 16%. However, margins may have moderate upside.

L&T, while revenue growth may disappoint (higher-than-guidance of 20% revenue growth) however moderate positive surprise may come from margins (70 bps margin decline may not pan out).

Construction

Expect strong growth versus relatively subdued FY2010 (especially first 9MFY10)

We believe that construction companies would report strong results in 1QFY11E versus relatively moderate growth in FY2010. The sedate growth in FY2010 was primarily seen in the first nine months of the fiscal while most companies reported a strong pick up in execution in 4QFY10. We expect the execution pick up seen in the previous quarter to continue in 1QFY11E as well. Furthermore, 9MFY10 results were also partially affected by eventualities and one-offs. Margins are expected to remain relatively flat on a yoy basis as benefit from operating leverage (due to high execution levels) would be partially offset by rise in commodity prices.

We are positive on the construction sector based on potential earnings upgrades with new order inflows, decline in borrowing cost and upside potential in valuation of infrastructure and real estate assets in the portfolio. Our top picks in the construction space would include IVRCL and Nagarjuna.

Company wise 1QFY11E results estimates for the construction segment – key numbers (Rs mn)

	Jun-10E	Jun-09	Mar-10	% change		#	Comments
				yoy	qoq		
IVRCL							
Net sales	13,090	10,860	18,904	20.5	(30.8)		Expect strong revenue growth of 23% yoy led by pick up of execution of large backlog; margins to remain relatively flat
EBITDA	1,211	996	1,984	21.6	(39.0)		
EBITDA margin (%)	9.3	9.2	10.5				
PBT	645	516	1,338	24.9	(51.8)		Risk related to slowdown in Andhra Pradesh state order abates as it constitutes only about 17-18% of backlog
PAT	432	351	852	23.0	(49.3)		
Nagarjuna							
Net sales	12,323	10,010	15,227	23.1	(19.1)		Expect strong revenue growth of 23% yoy led by pick up of execution of large order backlog
EBITDA	1,232	1,038	1,527	18.7	(19.3)		
EBITDA margin (%)	10.0	10.4	10.0				
PBT	767	578	1,055	32.6	(27.3)		Margins expected to remain relatively flat on a yoy basis
PAT	512	382	618	34.1	(17.1)		
Extraordinaries	-	-	408	NA	(100.0)		
PAT-reported	512	382	1,026	34.1	(50.1)		
Sadbhav Engg							
Net sales	3,996	2,994	4,573	33.5	(12.6)		Strong topline growth led by large order backlog boosted by recent wins in road segment and start of toll collections in Aurangabad-Jalna BOT project
EBITDA	460	340	544	35.2	(15.6)		
EBITDA margin (%)	11.5	11.4	11.9				
PBT	294	244	428	20.5	(31.3)		
PAT	197	179	181	9.7	8.4		
Punj Lloyd							
Net sales	26,145	29,728	17,765	(12.1)	47.2		Expect yoy decline in revenues as execution seems to lag aspirations; Libya projects remain delayed
EBITDA	2,418	3,094	(5,147)	(21.8)	NA		
EBITDA margin (%)	9.3	10.4	(29.0)				
PBT	913	1,872	(6,569)	(51.2)	NA		Subsidiary-related one off losses continue to adversely impact margins
PAT	639	1,250	(6,247)	(48.9)	NA		
Extraordinaries	-	-	3,238	NA	(100.0)		
PAT-reported	639	1,250	(3,009)	(48.9)	NA		

Source: Company, Kotak Institutional Equities estimates

Company-wise key highlights

- ▶ **IVRCL:** We expect IVRCL to report strong revenue growth of 20% yoy in 1QFY11E to Rs13.1 bn from Rs10.9 bn in 1QFY10. The strong growth is likely to be led by pick up in the execution of the large order backlog of Rs212 bn at end-FY2010. We believe that risk related to slowdown of Andhra Pradesh state orders has lowered as it constitutes only ~18% of the existing backlog. IVRCL reported very strong inflows in 4QFY10 which further diversified away from AP orders. Furthermore the segment mix incrementally is tilting towards roads versus water supply and buildings earlier. Margins are likely to remain flat on a yoy basis. We expect a net profit of Rs432 mn in 1QFY11E, up 23% yoy.
- ▶ **Nagarjuna:** We expect large backlog-led strong revenue growth of 23% yoy in 1QFY11E for Nagarjuna. The company has guided for strong FY2011E revenues of Rs73 bn at the consolidated level with about Rs58 bn of revenues from the standalone entity and Rs11bn from international construction subsidiaries. We expect margins of the company to remain relatively flat leading to a PAT growth of 34% yoy to Rs512 mn.
- ▶ **Sadbhav Engg:** Execution of recent road sector project wins is expected to lead to a strong revenue growth of 33% in 1QFY11E to Rs4 bn. Sadbhav achieved financial closure for Hyderabad-Yadgiri and Maharashtra check post projects in 4QFY10 which allows the company to start execution of these orders. Sadbhav reported a FY2010-end order backlog of Rs68 bn. We expect only a moderate PAT growth of 9.7% yoy to Rs197 mn led by higher interest cost and tax expenses.
- ▶ **Punj Lloyd:** We expect Punj Lloyd to report a 12% yoy decline in revenues to Rs26 bn in 1QFY11E versus Rs29.7 bn in 1QFY10. The execution expertise of Punj Lloyd seems to lag its aspirations and large projects in Libya continue to face slow execution. Furthermore, one-offs in subsidiaries and project-specific cases (ONGC, Petronas - delays, cost overruns, continued exposure to Ensus) remain a risk to the performance of the company. High interest costs led by higher debt levels are expected to further mar the results leading to a net profit decline of about 49% yoy to Rs639 mn.

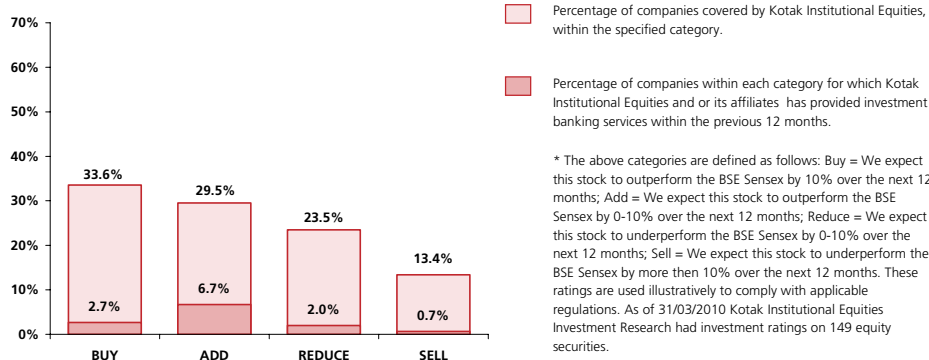
Kotak Institutional Equities: Valuation summary of key Indian companies

Company	9-Jul-10 Price (Rs)	Rating	Mkt cap.		O/S shares (mn)	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price Upside ADVT-3mo (Rs) (%) (US\$ mn)		
			(Rs mn)	(US\$ mn)		2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Retail																													
Titan Industries	2,505	ADD	111,206	2,380	44	62.7	76.1	96.2	41.5	21.3	26.5	40.0	32.9	26.0	28.3	22.2	17.4	14.1	10.5	7.9	0.4	0.5	0.5	40.7	36.6	34.8	2,400	(4.2)	4.2
Retail		Neutral	111,206	2,380					41.5	21.3	26.5	40.0	32.9	26.0	28.3	22.2	17.4	14.1	10.5	7.9	0.4	0.5	0.5	35.2	32.0	30.5			
Sugar																													
Bajaj Hindustan	121	SELL	23,202	497	191	9.7	9.9	8.9	201.1	2.2	(10.4)	12.5	12.2	13.6	7.1	5.9	5.6	1.0	0.9	0.8	0.6	0.6	0.6	8.1	7.5	6.3	99	(18.4)	6.5
Balrampur Chini Mills	87	ADD	22,440	480	257	3.7	10.4	7.0	(51.9)	183.7	(32.7)	23.8	8.4	12.5	9.9	5.7	6.2	1.6	1.4	1.3	0.5	0.5	0.5	7.0	18.1	11.0	92	5.3	6.5
Shree Renuka Sugars	71	BUY	47,723	1,021	670	9.9	7.6	7.8	196.4	(23.2)	3.1	7.2	9.4	9.1	4.9	5.6	4.8	1.9	1.6	1.3	0.6	0.5	0.5	32.0	18.1	15.7	76	6.7	15.2
Sugar		Cautious	93,366	1,998					96.1	2.5	(9.4)	9.9	9.7	10.7	6.4	5.7	5.4	1.5	1.3	1.1	0.6	0.5	0.5	14.9	13.3	10.8			
Technology																													
HCL Technologies	361	REDUCE	249,297	5,335	690	17.8	25.1	28.5	2.0	40.6	13.6	20.3	14.4	12.7	10.3	8.8	7.3	3.9	3.3	2.7	1.1	1.1	1.7	20.8	24.9	23.3	370	2.4	13.2
Hexaware Technologies	85	REDUCE	12,174	261	144	9.3	5.1	9.4	127.7	(45.4)	84.0	9.1	16.6	9.0	4.6	9.5	5.2	1.4	1.3	1.2	1.2	1.2	1.2	17.8	8.4	14.0	72	(15.0)	2.9
Infosys Technologies	2,874	BUY	1,649,561	35,300	574	108.3	125.2	150.5	5.7	15.6	20.2	26.5	23.0	19.1	19.4	15.9	12.9	7.2	5.9	4.9	0.9	1.2	1.5	30.1	28.2	28.0	3,100	7.9	65.8
Mphasis BFL	623	REDUCE	129,921	2,780	208	43.6	49.0	45.6	207.5	12.5	(7.0)	14.3	12.7	13.7	11.4	10.1	9.2	5.5	4.0	3.2	0.6	0.6	0.7	48.1	36.4	25.8	550	(11.7)	9.5
Mindtree	578	REDUCE	23,786	509	41	52.2	38.9	51.6	294.3	(25.5)	32.6	11.1	14.9	11.2	9.5	9.2	6.5	3.5	2.9	2.3	0.4	0.7	0.9	35.2	21.4	23.1	550	(4.8)	2.3
Patni Computer Systems	505	REDUCE	67,280	1,440	133	36.6	42.3	38.6	36.4	15.6	(8.7)	13.8	12.0	13.1	7.2	6.2	5.5	1.9	1.8	1.6	1.4	1.7	1.5	18.2	15.8	12.8	450	(10.9)	6.2
Polaris Software Lab	196	SELL	19,491	417	100	15.4	19.1	18.6	16.9	24.3	(2.7)	12.7	10.2	10.5	6.5	8.2	7.1	2.2	1.9	1.7	1.8	1.9	2.0	18.6	20.1	17.0	180	(7.9)	3.5
TCS	774	BUY	1,515,754	32,436	1,957	35.1	41.1	46.3	32.8	16.9	12.8	22.1	18.9	16.7	16.9	13.7	11.4	7.2	6.0	5.0	2.6	2.1	2.4	37.6	34.8	32.8	900	16.2	30.4
Wipro	401	ADD	981,603	21,006	2,447	18.9	21.9	25.0	22.1	16.2	14.4	21.3	18.3	16.0	16.1	13.2	10.9	5.0	4.1	3.4	0.9	1.1	1.3	26.5	24.6	23.2	465	15.9	15.6
Technology		Attractive	4,648,866	99,484					22.9	16.7	14.2	22.2	19.1	16.7	16.2	13.5	11.1	5.9	4.9	4.1	1.4	1.5	1.7	26.7	25.8	24.6			
Telecom																													
Bharti Airtel	309	REDUCE	1,172,129	25,083	3,798	24.0	21.4	24.2	7.5	(10.8)	13.2	12.9	14.4	12.7	7.2	6.9	5.9	2.7	2.3	2.0	1.0	1.3	1.6	24.1	17.0	16.5	290	(6.0)	44.2
IDEA	67	REDUCE	220,097	4,710	3,300	2.7	1.3	2.3	(5.8)	(51.7)	71.9	24.4	50.5	29.4	8.4	8.4	6.8	1.9	1.9	1.8	—	—	—	7.2	3.8	6.3	50	(25.0)	8.8
MTNL	67	SELL	42,242	904	630	(15.6)	(10.4)	(9.1)	(750.8)	(33.7)	(11.9)	(4.3)	(6.5)	(7.3)	(0.6)	(0.8)	(1.0)	0.4	0.4	0.4	—	—	—	(8.5)	(6.1)	(5.7)	50	(25.4)	2.6
Reliance Communications	193	SELL	412,429	8,826	2,133	22.1	14.1	18.2	(30.2)	(36.2)	29.1	8.8	13.8	10.6	7.7	8.6	6.5	1.1	1.0	0.9	0.4	—	—	11.7	7.4	8.9	175	(9.5)	39.8
Tata Communications	276	REDUCE	78,703	1,684	285	14.0	15.2	15.7	3.2	8.2	3.5	19.7	18.2	17.6	8.1	7.4	7.1	1.1	1.1	1.0	2.4	2.7	3.1	5.2	5.5	5.5	225	(18.5)	1.3
Telecom		Cautious	1,925,600	41,207					(15.1)	(19.8)	20.7	13.5	16.8	13.9	7.8	7.7	6.3	1.7	1.6	1.4	0.8	0.9	1.1	12.7	9.3	10.2			
Utilities																													
Adani Power	128	ADD	278,495	5,960	2,180	0.8	4.9	16.4	-	524.1	235.3	163.0	26.1	7.8	126.4	17.3	6.2	5.1	4.3	2.8	—	—	—	4.4	17.8	43.0	130	1.8	3.1
CESC	404	ADD	50,468	1,080	125	35.2	42.2	45.7	9.3	19.6	8.4	11.5	9.6	8.8	7.2	6.6	7.3	1.2	1.1	1.0	1.1	1.3	1.4	11.1	11.7	11.4	439	8.7	2.0
Lanco Infratech	67	BUY	162,217	3,471	2,405	2.0	3.6	4.5	35.1	82.2	26.4	34.3	18.8	14.9	20.3	8.7	8.4	4.7	3.8	3.1	—	—	—	15.8	20.6	21.0	70	3.8	9.5
NTPC	198	REDUCE	1,634,251	34,972	8,245	10.6	12.4	14.7	7.8	16.8	18.9	18.7	16.0	13.5	14.6	12.3	10.3	2.6	2.3	2.1	2.0	2.3	2.8	14.2	15.3	16.6	200	0.9	10.5
Reliance Infrastructure	1,173	ADD	288,518	6,174	246	61.8	62.7	80.3	(1.5)	1.6	28.0	19.0	18.7	14.6	20.2	19.4	13.3	1.5	1.4	1.3	0.7	0.8	0.9	6.3	7.3	10.1	1,100	(6.2)	47.7
Reliance Power	175	SELL	420,031	8,988	2,397	2.9	3.1	5.4	179.7	7.4	76.4	61.4	57.2	32.4	99.0	34.0	2.9	2.8	2.5	—	—	—	4.8	5.0	8.2	135	(23.0)	22.5	
Tata Power	1,316	ADD	324,809	6,951	247	60.2	69.2	88.5	20.1	15.0	27.8	21.9	19.0	14.9	13.8	12.4	10.7	2.5	2.3	2.0	0.9	1.1	1.1	12.9	12.5	14.3	1,420	7.9	10.4
Utilities		Attractive	3,158,790	67,597					16.1	23.0	37.2	23.5	19.1	13.9	19.5	14.8	11.0	2.6	2.3	2.1	1.2	1.4	1.7	10.9	12.2	15.0			
Others																													
Havells India	631	SELL	37,963	812	60	5.3	31.6	45.0	3.7	497.9	42.6	119.4	20.0	14.0	16.6	10.2	8.3	10.4	6.9	4.7	—	—	—	6.6	41.6	39.7	480	(23.9)	8.0
Jaiprakash Associates	125	BUY	266,742	5,708	2,129	1.5	5.9	7.9	(27.2)	305.4	34.4	86.0	21.2	15.8	21.7	13.8	10.1	3.1	2.8	2.4	—	—	—	4.1	13.9	16.3	183	46.0	34.1
Jindal Saw	207	ADD	60,888	1,303	294	27.5	19.3	17.9	121.9	(29.8)	(7.2)	7.5	10.7	11.6	5.4	6.2	5.9	1.6	1.3	1.2	—	—	—	20.5	12.9	11.1	243	17.4	5.1
PSL	131	BUY	7,001	150	53	22.9	25.4	28.2	3.3	10.6	11.0	5.7	5.2	4.6	3.2	2.7	2.9	0.8	0.7	0.6	5.0	5.0	5.3	12.6	11.7	12.0	175	33.6	0.6
Sintex	325	BUY	44,354	949	136	24.1	29.8	34.3	0.5	23.5	15.1	13.5	10.9	9.5	9.8	7.5	6.2	2.0	1.7	1.4	—	—	—	15.1	15.6	15.2	380	16.9	3.3
Tata Chemicals	327	ADD	79,578	1,703	243	26.4	32.4	37.3	(27.1)	22.6	15.1	12.4	10.1	8.8	6.7	5.6	4.8	1.7	1.5	1.3	2.7	2.8	2.8	16.0	18.4	18.3	360	10.1	3.1
Welspun Gujarat Stahl Rohren	241	REDUCE	49,601	1,061	205	25.1	23.0	24.4	44.9	(8.1)	5.8	9.6	10.5	9.9	5.3	5.5	4.8	1.7	1.5	1.3	0.8	0.9	0.9	20.6	14.8	13.5	245	1.5	7.8
United Phosphorus	175	BUY	81,132	1,736	463	11.9	15.6	19.0	18.8	30.2	22.1	14.7	11.3	9.2	8.5	7.1	5.7	2.4	2.0	1.7	0.9	1.1	1.1	17.7	19.0	19.5	250	42.6	9.4
Others			627,258	13,423					11.6	40.3	19.3	12.9	19.5	13.9	11.6	11.1	9.0	7.4	2.3	2.0	1.7								

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 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.

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