kotak® Institutional Equities

INDIA DAILY

January 15, 2008

EQUITY MARKETS

India	14-Jan	Change, % 1-day	1-mo	3-mo
Sensex	20,728	(0.5)	3.5	8.8
Nifty	6,207	0.1	2.6	9.5
Global/Regional indices				
Dow Jones	12,778	1.4	(4.2)	(8.6)
Nasdaq Composite	2,478	1.6	(6.0)	(10.9)
FTSE	6,216	0.2	(2.8)	(6.5)
Nikkie	14,179	0.5	(8.6)	(18.2)
Hang Seng	26,428	(0.2)	(4.1)	(10.5)
KOSPI	1,771	0.3	(6.6)	(13.0)

Value traded - India

	14-Jan		Moving avg, Rs bn 1-mo	3-mo
Cash (NSE+BSE)	246.3		146.3	50.4
Derivatives (NSE)	684.5		613.3	904.2
Deri. open interest	1,258.8		1,156	959.5

Forex/money market

	14-Jan	Change, basis points 1-day	1-mo	3-mo
Rs/US$	39.3	0	(26)	(2)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.6	2	(34)	(35)

Net investment (US$mn)

	11-Jan		MTD	CYTD
FIIs	28		14	462
MFs	(70)		(341)	304

Top movers -3mo basis

Best performers	14-Jan	Change, % 1-day	1-mo	3-mo
Neyveli Lignite	245	5.5	(1.4)	120.2
Rashtriya Chem	122	5.0	42.0	118.5
Engineers India	1,112	2.0	20.1	89.4
Thomas Cook	97	(0.7)	6.6	57.3
Balrampur Chini	112	3.6	1.1	56.6
Worst performers				
Acc	876	(2.5)	(20.6)	(31.9)
Infosys	1,530	(3.2)	(7.1)	(20.7)
Bharti Tele	907	(6.1)	(4.8)	(19.5)
i-Flex	1,484	(0.1)	(4.5)	(18.2)
Zee Tele	295	0.4	(5.0)	(14.6)

Contents

News Roundup

Corporate

- The US$37 bn Dutch retail giant SPAR International, which has tied up with the Landmark Group for its hypermarket foray in India, may bring in large format 'kirana stores' (mom & pop grocery stores) under its fold. (ET)
- In the largest commercial property deal in India, the Essar group has bought Peninsula Land's (PLL's) Kurla commercial prokect for about Rs1,200 crore. (ET)
- US patent officials have initially rejected claims for the basic patent on Pfizer's Lipitor, the world's biggest-sellng drug with US$12 bn sales. (ET)
- Sony Max, along with World Sport Group, has bagged the Board of Control for Cricket in India (BCCI)-backed Indian Premier League (IPL) media and production rights for the next 10 years in a deal worth US$1.026 bn. (FE)

Economic and political

- The Insurance Regulatory Authority of India (IRDA) is planning acredit rating for insurance companies. (BS)

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

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Banking

IDFC.BO, Rs223	
Rating	SELL
Sector coverage view	Attractive
Target Price (Rs)	145
52W High -Low (Rs)	235 - 74
Market Cap (Rs bn)	287.3

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	7.1	10.8	15.0
Net Profit (Rs bn)	4.9	6.9	9.5
EPS (Rs)	4.4	5.4	7.4
EPS gth	*25.8*	*23.2*	*37.6*
P/E (x)	51.0	41.4	30.1
P/B (x)	9.8	5.2	4.7
Div yield (%)	0.4	0.6	0.9

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	42.6	0.9	0.4
MFs	5.2	0.7	0.2
UTI	-	-	(0.5)
LIC	2.8	0.3	(0.1)

IDFC: Higher fees and capital gains drive profits

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- **IDFC's 3QFY08 PAT was up 73% yoy to Rs1.98 bn, 10% above estimates**
- **Strong disbursements, higher-than-expected fees and capital gains**
- **However, core income below estimates due to lower net income from infrastructure and provisions**
- **We will revisit our estimates after today's conference call with management, retain SELL**

IDFC's reported standalone net profit for 3QFY08 of Rs1.98 bn is up 73% yoy and 10% above estimates. IDFC net operating income was up 89% yoy mainly supported by higher fees, large capital gains. Loan growth remained robust on the back of 85% growth in disbursements. However, net income from infrastructure was below expectations, indicating lower-than-estimated spreads. We will revisit our earnings estimates after discussing the results with the management.

Key highlights

- **Strong growth in lending but lower core growth.** IDFC has delivered 44% loan growth on the back of 85% growth in disbursements during 3QFY08. The company has shared the break-up of its loan book—about 47% exposed to project finance, 40% to corporate loans and the balance 13% to loan-against-shares business.

  IDFC's spreads were lower-than-expected as indicated by lower income from infrastructure despite high growth in outstanding loans. The company made lower-than-expected provisions.

  Its core growth (PBT before treasury and provisions) was 7% below estimates.

- **Fees- lumpy income stream.** IDFC's standalone fee income (Rs436 mn) was 39% above our estimates, largely supporting core growth. We note that this stream has been lumpy in the past and is difficult to estimate.

- **Robust markets—driving capital gains and SSKI's business.** IDFC has booked capital gains of Rs730 mn (up 152% yoy and 62% qoq) in 3QFY08 on the back of robust equity markets. However, income from treasury business (debt market operations) was lower (down 44% qoq) during the quarter.

  Volumes on BSE and NSE have grown 50% qoq in 3QFY08. Consequently, SSKI's income (considered in consolidated accounts) has increased by 47% qoq.

IDFC - Quarterly results
Quarterly data, 3QFY07-3QFY08 (Rs mn)

	3Q07	4Q07	1Q08	2Q08	3Q08	YoY(%)	3Q08E	Actual vs KS (%)
Standalone financials								
Total Income	3,863	4,104	5,568	6,044	6,919	79	6,062	14
Operating Income	3,863	4,058	5,568	6,028	6,888	78	6,045	14
Other Income		45	0	17	31			
Interest and Other Charges	2,291	2,660	3,106	3,298	3,953	73	3,298	20
Net operating income	**1,572**	**1,443**	**2,462**	**2,747**	**2,967**	**89**	**2,748**	**8**
Net operating inc excl cap gains	**1,282**	**1,443**	**1,682**	**2,297**	**2,237**	**74**	**2,363**	**(5)**
Net interest income on infr	900	970	1,040	1,460	1,490	66	1,550	(4)
Treasury	120	30	300	500	280	133	500	(44)
Fees and advisory	140	420	400	280	436	211	313	39
Dividend	-			40				
Profit on sale of equity	**290**	**-**	**780**	**450**	**730**	**152**	**385**	**90**
Miscellaneous income								
Total Expenditure	**181**	**341**	**288**	**394**	**323**	**79**	**385**	**(16)**
Staff Expenses	90	117	151	154	153	70	160	(4)
Other Expenses	48	66	74	77	107	124	75	42
Provisions and Contingencies	43	158	63	163	63	46	150	(58)
PBDT	**1,391**	**1,102**	**2,174**	**2,352**	**2,643**	**90**	**2,363**	**12**
Depreciation	10	11	10	10	10	(4)	20	(50)
Profit before Tax	**1,381**	**1,091**	**2,164**	**2,342**	**2,633**	**91**	**2,343**	**12**
Provision for Tax	229	240	486	548	646	182	539	20
Profit after Tax	**1,152**	**851**	**1,678**	**1,794**	**1,987**	**73**	**1,804**	**10**
PBT treasury and provisions	1,134	1,249	1,447	2,056	1,967	73	2,108	(7)
PBT bef treasury provisions and misc income	1,134	1,249	1,447	2,056	1,967	73	2,108	(7)
Tax rate	16.6	22.0	22.5	23.4	24.5		23.0	

ROA analysis (%)	**3Q07**	**4Q07**	**1Q08**	**2Q08**	**3Q08**
Net interest income	2.9	2.8	2.7	3.0	2.9
Infrastructure	2.6	2.6	2.4	2.5	2.3
Treasury	0.2	0.2	0.4	0.5	0.5
Non Interest income	2.0	1.7	2.2	2.2	2.6
Fees, syndiaction and advisory	0.8	0.9	1.2	1.1	1.0
Capital gains & dividend	1.0	0.1	1.0	0.9	0.2
Mis. Fees	0.1	0.8	-	(0.0)	0.8
Operating income	4.9	4.5	5.0	5.1	5.5
Operating expenses	0.5	0.5	0.7	0.8	0.9
Pre- provisioning profits	4.4	4.1	4.3	4.3	4.6
Provisions and losses	0.1	0.1	0.1	0.2	0.2
PBT	4.3	4.0	4.1	4.1	4.3
Tax	0.8	0.8	0.9	1.0	1.1
Associate co profit	0.1	0.1	0.1	0.1	-
Net Income (PAT)	3.5	3.3	3.3	3.2	3.2

Other details	**3Q07**	**4Q07**	**1Q08**	**2Q08**	**3Q08**	**YoY(%)**
Gross approvals (Rs bn)	28	39	42	43	64	128
Gross disbursements (Rs bn)	19	19	24	25	35	84
Loan book (Rs bn)	134	142	148	168	192	44

Total exposure (Rs bn)	210	220	246	277	318
Energy	85	85	91	100	109
Transportation	58	38	70	77	87
Telecom	38	59	39	35	53
Commercial/Industrial	24	19	22	26	31
Tourism	12	12	15	17	17
Others	5	6	10	22	21
O/s disbursements					
Energy	65	66	68	73	79
Telcom	41	43	49	56	30
Transportation	22	19	22	23	61
Commercial/Industrial	15	23	15	20	24
Others	3	3	13	19	19

Consolidated numbers (Rs mn)	3Q07	4Q07	1Q08	2Q08	3Q08	YoY(%)
Total Income	4,023	4,277	6,097	6,567	7,667	91
Operating Income	4,023	4,232	6,096	6,551	7,634	90
Other Income	0	45	1	16	33	8,175
Interest and Other Charges	2,291	2,660	3,112	3,306	3,960	73
Net operating income	1,733	1,617	2,986	3,261	3,707	114
Net operating inc excl cap gains	1,443	1,617	2,206	2,811	2,977	106
Net interest income on infr	900	970	1,040	1,460	1,490	66
Treasury	120	30	300	500	280	133
Fees and advisory	270	520	870	790	1,167	332
Asset management	130	120	130	130	130	
IDFC SSKI	-		340	380	560	
Dividend				40		
Profit on sale of equity	290	-	780	450	730	152
Total Expenditure	225	443	549	650	702	212
Staff Expenses	112	176	348	344	451	304
Other Expenses	70	108	138	142	179	155
Provisions and Contingencies	43	159	63	164	73	69
PBDT	1,508	1,174	2,437	2,611	3,004	99
Depreciation	11	12	12	13	13	21
Profit before Tax	1,496	1,161	2,425	2,598	2,991	100
Provision for Tax	268	271	582	620	774	189
Current Tax	263	360	553	635		(100)
Deferred Tax	0	(92)	24	(18)		(100)
Fringe Benefit Tax	1	3	5	4		(100)
Profit after Tax	1,228	890	1,843	1,978	2,217	80
Share of profit in associates / minority interest	22	39	(33)	3	41	90
Profit after Tax (incl minorities share/ after minority share)	1,250	930	1,810	1,946	2,176	74
PBT treasury and provisions	1,250	1,321	1,708	2,313	2,334	87
PBT bef treasury provisions and misc income	1,250	1,321	1,708	2,313	2,334	87

Breakup of outstanding borrowings	3Q07	4Q07	1Q08	2Q08	3Q08	YoY(%)
Short term	19%		18%	17%		
LT Rupee loans	31%		26%	28%		
LT bonds	41%		41%	44%		
Foreign currency loans	6%		7%	7%		
Sub debt	5%		4%	4%		

Outstanding disbursements (Rs bn)	3Q07	(%of total)	4Q07	(% of total)	3Q08	(% of total)
Loans	**134.6**	**91**	**141.2**	**90**	**191.8**	**90**
Project loans	82.5	56	81.0	52	90.1	42
Corporate loans	43.8	30	52.9	34	77.1	36
Loans against shares	8.3	6	7.3	5	24.6	11
Mezzanine products	**0.4**	**0**	**0.6**	**0**	**6.5**	**3**
Sub-debt	0.2	0	0.3	0	0.6	0
Preference shares	0.3	0	0.3	0	5.9	3
Equity/ pref shares	**5.1**	**3**	**5.9**	**4**	**11.5**	**5**
Financial	2.3	2	2.2	1	3.1	1
Infrastructure	2.1	1	2.7	2	7.2	3
Venture Capital units	0.8	1	1.0	1	1.2	1
Non-funded	**8.2**	**6**	**8.7**	**6**	**4.2**	**2**
Total	**148.3**	**100**	**156.4**	**100**	**214.0**	**100**

Source:Company, Kotak Institutional Equities estimates.

Diversified

SNTX.BO, Rs555	
Rating	ADD
Sector coverage view	-
Target Price (Rs)	560
52W High -Low (Rs)	615 - 185
Market Cap (Rs bn)	74.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	11.2	22.0	35.6
Net Profit (Rs bn)	1.3	2.2	3.8
EPS (Rs)	10.8	15.3	20.8
EPS gth	*15.3*	*42.6*	*35.4*
P/E (x)	51.6	36.2	26.7
EV/EBITDA (x)	34.9	22.9	12.6
Div yield (%)	0.1	0.1	0.1

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	31.3	-	-
FIIs	19.1	0.1	0.1
MFs	10.7	0.3	0.3
UTI	-	-	-
LIC	-	-	-

Sintex Industries: Acquisitions have to deliver for returns hereon; maintain ADD; raise TP

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- **3QFY08 consolidated net earnings of Rs588 mn better than expected**
- **Operating margin for 3QFY08 contract, as newly acquired businesses now contribute a larger proportion of revenues**
- **Move valuation basis to consolidated accounts, as management communicates integrated acquisition strategy. Raise TP to Rs560**
- **Acquisitions have to deliver for significant returns hereon; maintain Add rating**

Sintex, in its 3QFY08 results, reported consolidated net earnings of Rs588 mn, higher than our expectations. Net earnings grew 125% as newly acquired businesses contributed to the numbers for the first time. Recent announcement from the management lead us to believe that they might be in fray for yet another large acquisition. We now move our valuation basis to consolidated accounts and consequently raise our target price to Rs560 from Rs330 earlier. We believe that execution risk for Sintex is significantly higher as it now plans to integrate various newly acquired businesses. Continue to rate the stock as ADD.

3QFY08 consolidated net earnings of Rs588 mn have bettered our expectations. 3QFY08 results include revenues and earnings from acquisitions of Nief Plastic SA, Wausaukee Composite Inc., and Bright Autoplast and hence numbers are not comparable to previous quarters (see Exhibit 1).

Revenues for the quarter, at Rs6.1 bn grew 115% yoy and 57% qoq following growth (organic and inorganic) in plastics business. Revenues from textiles grew ~11% on a qoq and yoy basis as rising contribution from collection segment (higher realization business) nullified the impact of stronger rupee. EBITDA, at Rs1 bn, grew 103% yoy and 30% qoq following stronger-than-expected growth in plastic business. Net earnings, at Rs588 mn grew 125% yoy.

Operating margins contracted for 3QFY08 as newly acquired business now account for a higher proportion of revenues. EBITDA margins for 3QFY08 fell to 16.6% versus 20.2% sequentially, as lower margin businesses of Nief Plastic got consolidated for the full quarter and businesses of Bright Autoplast and Nero Plastic for part of the quarter.

We suspect Sintex is getting ready for another large acquisition observing its requirements of capital versus what it plans to raise over the next issuances. Sintex has announced plans to raise US$300 mn through combination of convertible and QIP issuance. This is in addition to the US$150 mn preferential allotment to promoters at Rs454/ share. We note that announced business plans of Sintex do not call for such a huge cash injection and that the company appears to be readying for a large acquisition (or series of small acquisitions) (see Exhibit 2).

Move valuation basis to reflect consolidated earnings. Management has recently communicated its plans to integrate the businesses of recently acquired companies in France and the United States. We now build our model based on consolidated earnings and include estimated revenues and earnings from the newly acquired companies (see Exhibit 3). Consequently, we raise our target price to Rs560/ share (Rs330 earlier). We value pre-fabricated plastics business of the company at 14X FY2009E EV/EBITDA, in line with fast growing engineering companies in India, and custom moulding and composites business at 12X FY2009E EV/EBITDA, at slightly lower valuations than the pre-fab business. Exhibit 4 gives our SOTP-based valuation for Sintex.

Sintex has been successful, so far, in acquiring companies that make strategic sense to its business at reasonable valuations. Acquiring client face-front in western countries and intending to integrate those business in India with low-cost manufacturing will call for addressal of significant integration challenges on part of Sintex.

Besides, our estimates suggest that the company is getting ready for another round of acquisitions (or one large acquisition), which will increase the execution risk that Sintex now faces. The company has been successful in ensuring growth in niche areas in the past, but integrating acquisitions call for completely different skill sets. Our current numbers imply reasonable growth of revenues and growth in operating margins (as seen in Exhibit 3), and investor returns hereon will be governed from addressing this execution challenge, more than anything else. We retain our ADD rating on the stock and await more communication from the management.

Exhibit 1: Consolidated results of Sintex were better than our expectations

Sintex Industries, Consolidated interim results, March fiscal year-ends (Rs mn)

	3Q 2008	2Q 2008	3Q 2007	Growth (%)		2007	2008E	Yoy growth
				qoq	yoy			(%)
Consolidated interim results								
Net sales	**6,129**	**3,894**	**2,846**	**57.4**	**115.3**	**11,653**	**20,812**	**78.6**
Expenditure	(5,112)	(3,109)	(2,345)			(9,426)	(17,210)	
Stock adjustment	(28)	71	34			397	214	
Raw materials	(3,283)	(2,249)	(1,783)			(7,297)	(11,936)	
Employee expenditure	(743)	(242)	(102)			(497)	(2,059)	
Others	(1,059)	(689)	(494)			(2,029)	(3,429)	
EBITDA	**1,016**	**785**	**501**	**29.5**	**102.8**	**2,227**	**3,602**	**61.7**
Other income	81	83	67			269	369	
Depreciation	(211)	(132)	(105)			(420)	(686)	
EBIT	887	736	463			2,076	3,285	
Interest	(224)	(143)	(115)			(415)	(715)	
Pre-tax income	663	593	348			1,661	2,570	
Taxes	(74)	(143)	(87)			(327)	(402)	
Net income	**588**	**450**	**261**	**30.7**	**125.4**	**1,335**	**2,168**	**62.4**
Key ratios								
EBITDA margin	16.6	20.2	17.6			19.1	17.3	
Tax rate	11.2	24.1	25.0			19.7	15.6	
Segmental results								
Segmental revenue	**6,210**	**3,977**	**2,913**	**56.2**	**113.2**	**11,922**		
Textiles	930	838	836	**11.0**	**11.3**	3,180		
Plastics	5,224	3,070	2,020	**70.2**	**158.6**	8,545		
Unallocated	57	69	64			215		
Less: intersegment	-	-	(6)			(19)		
Segmental EBIT	**887**	**736**	**463**	**20.5**	**91.4**	**2,076**		
Textiles	203	142	167	**43.1**	**21.3**	654		
Plastics	656	548	287	**19.7**	**128.9**	1,262		
Unallocated	28	46	9			160		
EBIT margin (%)	**14.3**	**18.5**	**15.9**			**17.4**		
Textiles	21.8	16.9	20.0			20.6		
Plastics	12.6	17.9	14.2			14.8		

Source: Company data, Kotak Institutional Equities estimates

Exhibit 2: Sintex is getting ready for a large acquisition

Sintex Industries, Acquisition war-chest, March fiscal year-ends (Rs mn)

	2008E	2009E	2010E
Estimates before considering dilutions			
Equity (incl deferred tax liability)	11,135	21,177	26,888
Net debt	4,420	(2,069)	(5,128)
Net debt to Equity (%)	39.7	(9.8)	(19.1)
Announced dilutions			
FCCB (US$ mn)	150		
QIP (US$ mn)	150		
Net debt assuming dilutions	(7,580)	(14,069)	(17,128)

Note:

(a) 2009E equity includes promoter warrants of US$150 mn at Rs454/ share

Source: BSE website, Kotak Institutional Equities estimates

Exhibit 3: Already building a strong-case for recently acquired companies

Sintex Industries, Acquired company estimates, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Revenues					
Zepplin	-	530	1,500	2,800	3,500
Wausaukee	-	-	600	1,500	1,750
Nero	-	-	200	600	700
Bright brothers	-	-	400	1,500	2,000
Nief	-	-	2,000	5,000	8,000
EBITDA margin (%)					
Zepplin	15.0	20.0	18.0	18.5	18.5
Wausaukee	-	-	4.0	10.0	12.0
Nero	-	-	4.0	7.0	9.0
Bright brothers	-	-	4.0	16.0	18.0
Nief	-	-	4.0	8.0	9.0

Source: Kotak Institutional Equities estimates

Exhibit 4: Sintex industries, SOTP-based valuation, 2009E basis, March fiscal year-ends (Rs mn)

	EBITDA	Multiple (X)	EV		
			(Rs mn)	(US$ mn)	(Rs/share)
Pre-fab (incl. Monolithic)	2,949	14.0	41,279	1,032	306
Custom moulding and composites	1,683	12.0	20,196	505	150
Tanks	71	5.0	357	9	3
Textiles	978	12.0	11,731	293	87
Enterprise value	**5,681**		**73,563**	**1,839**	**546**
Less: Net debt			(2,069)	(52)	(15)
Market capitalizaton			**75,632**	**1,891**	**561**
Target price (Rs)					**560**

Sintex profit model, March fiscal year-ends, 2006-2010E, (Rs mn)

	2006	2007	2008E	2009E	2010E
Net revenues	8,534	11,178	22,042	35,610	48,493
Other operating income	-	-	-	-	-
Gross operating revenues	8,534	11,178	22,042	35,610	48,493
Operating expenses					
Cost of goods sold	(5,190)	(6,557)	(12,151)	(19,942)	(27,641)
Staff costs	(374)	(479)	(2,059)	(2,676)	(3,479)
SG&A expenses	(1,523)	(1,969)	(4,449)	(7,312)	(9,588)
Total expenditure	(7,087)	(9,005)	(18,659)	(29,930)	(40,709)
(% of revenues)	**83**	**83**	**83**	**83**	**81**
EBITDA	1,447	2,173	3,383	5,681	7,784
EBITDA Margin (%)	**17.0**	**19.4**	**15.3**	**16.0**	**16.1**
Net finance cost	(291)	(410)	(410)	(410)	(410)
Other income	298	267	267	267	267
PBDT	1,454	2,030	3,240	5,538	7,641
Depreciation and amortisation	(311)	(415)	(522)	(655)	(796)
Pretax profits before extra-ordinaries	1,143	1,616	2,718	4,882	6,845
Exceptional items	-	-	-	-	-
Prior period items	-	-	-	-	-
Profit before tax	1,143	1,616	2,718	4,882	6,845
Current tax	(173)	(200)	(408)	(732)	(1,027)
Deferred tax	**(49)**	**(110)**	**(136)**	**(342)**	**(479)**
Minority / Associate earnings	-	-	-	-	-
Reported PAT	920	1,306	2,174	3,808	5,339
Adjusted net profit	920	1,306	2,174	3,808	5,339
Primary EPS (using wtd avg shares)	10.0	12.4	18.6	29.7	39.6
Diluted EPS	7.6	10.8	16.1	28.3	39.6
Year end no of shares (mn)	98.7	111.9	121.5	134.7	134.7
Weighted average no of shares (mn)	92.5	105.3	116.7	128.1	134.7
Fully diluted no of shares (mn)	121.5	121.5	134.7	134.7	134.7
Margins (%)					
EBITDA margin	17.0	19.4	15.3	16.0	16.1
PBT margin	13.4	14.5	12.3	13.7	14.1
Net profit margin (w/o extraordinaries)	10.8	11.7	9.9	10.7	11.0
Effective tax rate (%)	19.5	19.1	20.0	22.0	22.0
Growth (% p.a)					
Revenues	-	31.0	97.2	61.6	36.2
EBITDA	-	50.2	55.7	67.9	37.0
PBT	-	41.3	68.2	79.6	40.2
Net profit (w/o extraordinaries)	-	41.9	66.4	75.1	40.2
Diluted EPS	-	41.9	50.1	75.1	40.2

Sintex balance sheet, March fiscal year-ends, 2006-2010E, (Rs mn)

	2006	2007	2008E	2009E	2010E
Equity					
Share capital	197	222	241	267	267
General reserves and surplus	4,351	6,287	10,035	19,709	24,941
Net worth	**4,549**	**6,509**	**10,275**	**19,976**	**25,208**
Deferred tax liability	619	724	860	1,201	1,680
Debt					
Secured	3,595	5,060	5,060	5,060	5,060
Unsecured	2,231	1,723	23	23	23
Total Debt	**5,827**	**6,783**	**5,083**	**5,083**	**5,083**
Current liability and provisions	1,797	2,921	4,919	7,707	10,354
Total capital	**12,792**	**16,936**	**21,136**	**33,967**	**42,325**
Assets					
Cash and cash equivalents	3,553	3,853	663	7,151	10,211
Inventory	863	1,455	2,870	4,636	6,314
Sundry Debtors	1,507	2,130	3,623	5,854	7,971
Loans and Advances	370	668	668	668	668
Gross block	6,772	8,819	10,819	13,819	16,119
Less: Accumulated depreciation	(2,065)	(2,464)	(2,987)	(3,642)	(4,438)
Net fixed assets	4,706	6,354	7,832	10,177	11,680
Capital -WIP	190	388	388	388	388
Net fixed assets (incl. C-WIP)	**4,897**	**6,742**	**8,220**	**10,564**	**12,068**
Investments	1,568	2,065	5,071	5,071	5,071
Miscallenous expenditure	34	21	21	21	21
Intangibles	—	—	—	—	—
Total Assets	**12,792**	**16,936**	**21,136**	**33,967**	**42,325**
Leverage and return raitos (%)					
Debt/Equity	113.5	94.1	45.7	24.0	18.9
Debt/Capitalisation	53.2	48.5	31.4	19.4	15.9
Net Debt/Equity	14.0	14.9	39.8	(9.8)	(19.1)
Net Debt/Capitalisation	12.3	13.0	28.5	(10.8)	(23.6)
Net Debt/EBITDA	49.8	49.5	130.6	(36.4)	(65.9)

Energy

RELI.BO, Rs3216	
Rating	RS
Sector coverage view	Neutral
Target Price (Rs)	-
52W High -Low (Rs)	3236 - 1250
Market Cap (Rs bn)	4,034

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,115	1,058	1,267
Net Profit (Rs bn)	120.4	137.4	193.6
EPS (Rs)	82.8	94.5	127.9
EPS gth	*31.2*	*14.1*	*35.3*
P/E (x)	38.8	34.0	25.1
EV/EBITDA (x)	20.4	18.6	13.0
Div yield (%)	0.4	0.4	0.5

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.5	-	-
FIIs	24.1	8.9	0.9
MFs	2.3	5.3	(2.7)
UTI	-	-	(8.0)
LIC	4.1	8.6	0.6

A different scenario versus street expectations

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- **Playing the devil's advocate and looking at a different (although improbable) scenario**
- **Assessing the downside in case optimistic street expectations are not met with**
- **Re-rating continues with or without news flow and/or change in fundamentals**

Given the current euphoria in the Indian stock market (in our view), we try and look at a different scenario for RIL versus street expectations. Our 'devil's advocate' scenario value for RIL stock comes to around Rs1,600 (see Exhibit 1) based on (1) no future discoveries of oil and gas, (2) use of appropriate multiples (5X EBITDA) for the current stage of the chemical and refining cycles and forecasted margins for FY2009E, (3) fair value of RPL stock of Rs125 (our DCF-based fair valuation versus our 12-month target price of Rs170 or much higher current stock price), (4) US$5.5 bn valuation for retailing and (5) nil valuation for RIL's two SEZs (acquisition price of land = valuation; no cash outflow assumed currently). Using 6X EBITDA multiple for the chemical and refining segment and Rs170 value for RPL stock would improve RIL's valuation to about Rs1,900/share (see Exhibit 2). We attribute the gap between the current stock price and the afore-mentioned scenarios to (1) likely higher E&P reserves, (2) expectations of strong margins and use of high multiples and (3) large value creation in new initiatives (proposed low-cost petrochem complex for example).

What if RIL does not find more gas or oil? Very high likelihood that RIL will though

In our view, a realistic valuation of RIL's announced discoveries (10 tcf of gas in KG D-6 block, oil in KG D-6 block, around 3 tcf net of NEC-25 block and 3 tcf of CBM, all data on net basis) would not exceed US$15 bn under a good set of assumptions (low WACC). Our valuation for the upcoming E&P segment comes to US$10 bn even after factoring in higher reserves versus official figures. However, we believe the street is according about US$40-50 bn valuation for RIL's E&P segment and a significant portion of this (about 60-70%) reflects the street's confidence about future discoveries. We have no doubt that RIL will discover more oil and gas (the more, the better for the country) bur we have nil experience/understanding of geology and geophysics (and are also weak in statistics) to extrapolate RIL's success in discovered blocks (9 with 8 in India) to its other blocks (34 NELP blocks, 5 CBM blocks and 2-4 overseas).

RIL management has stated its objective to eventually have 10 boe of hydrocarbon reserves. It seems to us that the stock price is already giving value for about ~100 tcf of gas or 15 boe of hydrocarbon reserves (see Exhibits 3 and 4). However, the amount of 'required' reserves may be lower (more oil than gas, for example) and would depend on (1) the nature of hydrocarbons (oil or gas), (2) the nature of production sharing contracts (PSCs) in discovered block; the KG D-6 block does not have a particularly favorable PSC but 'new discoveries' may be in blocks with better PSCs and (3) the timing of discovery and development (time value of money).

In this context, we find the use of EV/boe to value oil and gas reserves odd (reminds us of EV/eyeballs and other such esoteric valuation models) given that profitability/bbl of hydrocarbon is more critical and depends on several variables, the most obvious ones being (1) the nature of hydrocarbon (oil or gas) and (2) the nature of the PSC/fiscal regime for the block.

What if petchem and refining are (still) cyclical businesses? What if chemical and refining margins decline sharply led by new capacity additions? What if one uses the 'right' multiples for petchem and refining cycle at various stages of the cycle?

We do not have (unfortunately) the luxury of having looked at half a cycle only and thus, are reluctant to change our view that petchem and refining are and will likely remain cyclical businesses. As such, we believe that target multiples must reflect the stage of the cycle even if break-even margins may have moved up to reflect higher capex for a new asset. We believe around 10X normalized or mid-cycle FCF is the most appropriate multiple for cyclical commodity businesses (12% WACC, 2% growth in perpetuity) in the Indian context. This would translate into about 6X normalized or mid-cycle EBITDA (adjusted for tax and recurring capex). We attribute the street's propensity to use higher multiples at the current stage of the cycle as symptomatic of (1) belief that the current stage of the cycles are still well below peak levels and (2) very low cost of capital/equity driven by large global liquidity .

A de-rating of global multiples due to tightening global liquidity, onset of cyclical decline or re-assessment of multiples for cyclical commodity businesses would result in a collapse of valuation of RIL's chemical and refining segments. If we use 5X EBITDA multiple on our FY2009E EBITDA for the chemical and refining segments, the EV/share for these segments would amount to Rs800/share (based on 1.374 bn shares) as compared to Rs1,200-1,800 being accorded by the street currently. We note that we model Rs219 bn as the combined EBITDA for FY2009E for RIL's chemical and refining (without RPL). We are not even factoring in a possible collapse (we model a very modest decline in chemical margins and flat refining margins) in chemical and refining margins. After all, RIL's average EBITDA (without IPCL) in FY2002-FY2005 was Rs91 bn (without sales tax incentives but including contribution from PMT) and varied between Rs71.4 bn in FY2002 to Rs123.8 bn in FY2005. The EBITDA for FY2006, which was a very good year for both chemical and refining margins, was Rs160 bn (including IPCL). Alternatively, we could use 6X EBITDA multiple on Rs160 bn (assuming FY2006 margins reflected normalized margins), which would translate into a valuation of Rs700/share.

We believe that CY2008/FY2009 would mark the peak year of both chemical and refining margins given significant additions to capacity in case of both (see Exhibits 5 and 6). In fact, our projected rates for global ethylene resemble the plunge in operating rates in 1999-2001 as shown in Exhibit 7; chemical margins collapsed in this period. In case of refining, we would highlight significant increase in supply of NGLs in CY2008E (0.6 mn b/d) and CY2009E (0.9 mn b/d) in addition to the increase in refining capacity (see Exhibit 8).

What if RIL's premium to global refining margins goes down? There is no reason for this to happen though

We have had difficulty predicting RIL's refining margins (absolute and quarterly movement) for the past several quarters and have been generally under-estimating its margins. We suspect we are using the wrong product slate or crude slate and have been hoping for guidance from the RIL management on RIL refinery's product and crude slate. We had also tried to reconcile RIL's reported quarterly margins with RPL's hypothetical margins assuming it had operated in those quarters. We compute lower margins for RPL versus RIL's reported margins in certain quarters as can be seen in Exhibit 9.

This appears odd since RPL's refinery has assumed a superior product slate versus RIL's refinery. We can attribute this to (1) incorrect product slate for RIL but we do assume a better product slate for RPL versus RIL's refinery (see Exhibit 10) and (2) smart or fortuitous purchase of crude parcels, trading or hedging by RIL. We think investors may want to seek more clarity on this from the management since we do not have a good understanding of RIL's refining margins.

What if the market values RPL the 'correct' way? DCF instead of multiples

The street (including us) is valuing RPL stock using multiples (P/E or EV/EBITDA) although DCF is the more appropriate methodology given the nature of RPL's earnings and cash flows (higher in the initial years due to tax advantages). The use of multiples implies continuity of earnings and cash flows at least at FY2010E levels and implicitly assumes investment of cash flows generated in the initial years in additional refining capacity to sustain earnings and generate ROE higher than COE. Our DCF valuation for RPL comes to Rs125/share, which is meaningfully lower versus our multiple-based valuation of Rs170/share, the current market price and the recent peak price.

What if extraneous factors prevent RIL from executing well in retailing and SEZs?

Reliance Retail—slow progress due to opposition by various parties. Given the limited details available on RIL's retailing plans, we are not sure whether RIL is on track to meet its sales (Rs1 tn by FY2012E) and store targets. However, we assume that progress has been slower than the management's expectations given opposition by various parties (political, small retailers). We note that Reliance Retail added 128 Reliance Fresh stores (small-format F&B stores) in 2QFY08 and had 329 stores in around 30 cities at end-2QFY08. We value the retailing business at US$5.5 bn (Rs159/share); RIL has invested Rs60 bn as equity in Reliance Retail as of September, 2007 up from Rs40 bn as of March, 2007. We model RIL to invest Rs40 bn and Rs20 bn of in the equity of Reliance Retail in FY2009E and FY2010E, respectively.

SEZs—speed of execution will be critical given the large number of proposed SEZs and land acquisition issues. We do not think the street is according meaningful value to RIL's upcoming SEZs given the early stage of the projects and issues associated with SEZs in general regarding land acquisition. We note that the government has given approvals (formal and in-principle) to SEZs with a total area of 200,000 hectares. In theory, these SEZs can employ about 200 mn people (assuming 50% processing area, FSI ratio of 2X and 100 sq. ft/employee). This seems like a very large number and is unlikely to be achieved (we do hope that even a fraction of the afore-mentioned area comes up given the burgeoning number of jobs required in India—13 mn non-agricultural jobs every year).

We expect RIL's Haryana SEZ to be among the more successful ones although it will have to compete with several other proposed SEZs in that area. We note that the success of RIL's SEZ (like any other) would depend on its ability to attract units with a high degree of labor intensity and would be closely linked to India's ability to create and reinvigorate low-tech manufacturing. India is lacking in this area and the only large low-tech labor-intensive industry currently (textiles) is also under severe pricing/margin pressure.

'Devil's advocate' valuation of Reliance comes to Rs1,650 per share on FY2009E estimates

Sum-of-the-parts valuation of Reliance Industries, FY2009E basis (Rs)

	Valuation base (Rs bn)		Multiple (X)		EV	Value share
	Other	EBITDA	Muliple	EV/EBITDA	(Rs bn)	(Rs)
Chemicals		118		5.0	592	431
Refining & Marketing		100		5.0	502	365
Oil and gas—producing		18		5.0	92	67
Gas—developing (DCF-based) (a)	420	—	100%	—	420	305
Oil—KG-DWN-98/3 (b)	80	—	100%	—	80	58
Investments						
RPL (3.195 bn shares at DCF value of Rs125/share)	399	—	100%	—	399	291
Others	10	—	100%	—	10	7
Retailing	219	—	100%	—	219	159
SEZ development	—	—	100%	—	—	—
Total					**2,235**	**1,684**
PV of refining division's future sales tax incentives					2	2
Total value					**2,237**	**1,686**
Net debt (adjusted for capex of RPL and investment by Reliance in RPL) (d)					74	54
Implied equity value					**2,163**	**1,632**

Note:
(a) We value the KG D-6 gas find on DCF and offshore Orissa (NEC-25) and CBM discoveries based on KG D-6's valuation.
(b) 180 mn bbls of recoverable reserves based on gross OOIP of 0.5 bn bbls.
(c) Net debt reflects a standalone (without RPL) scenario; however, we consolidate for RPL otherwise as it a 71% subsidiary.
(d) We use 1.374 bn shares (excluding treasury shares) for our per share computation.

Source: Kotak Institutional Equities estimates.

'Devil's advocate' valuation of Reliance comes to Rs1,900 per share on FY2009E estimates but based on more generous assum

Sum-of-the-parts valuation of Reliance Industries, FY2009E basis (Rs)

	Valuation base (Rs bn)		Multiple (X)		EV	Value share
	Other	EBITDA	Muliple	EV/EBITDA	(Rs bn)	(Rs)
Chemicals		118		6.0	711	517
Refining & Marketing		100		6.0	602	438
Oil and gas—producing		18		5.0	92	67
Gas—developing (DCF-based) (a)	420	—	100%	—	420	305
Oil—KG-DWN-98/3 (b)	80	—	100%	—	80	58
Investments						
RPL (3.195 bn shares at Rs170/share)	543	—	100%	—	543	395
Others	10	—	100%	—	10	7
Retailing	219	—	100%	—	219	159
SEZ development	—	—	100%	—	—	—
Total					**2,597**	**1,948**
PV of refining division's future sales tax incentives					2	2
Total value					**2,599**	**1,950**
Net debt (adjusted for capex of RPL and investment by Reliance in RPL) (d)					74	54
Implied equity value					**2,525**	**1,896**

Note:
(a) We value the KG D-6 gas find on DCF and offshore Orissa (NEC-25) and CBM discoveries based on KG D-6's valuation.
(b) 180 mn bbls of recoverable reserves based on gross OOIP of 0.5 bn bbls.
(c) Net debt reflects a standalone (without RPL) scenario; however, we consolidate for RPL otherwise as it a 71% subsidiary.
(d) We use 1.374 bn shares (excluding treasury shares) for our per share computation.

Source: Kotak Institutional Equities estimates.

RIL's current stock price is implying huge discoveries of hydrocarbons

Estimation of implied valuation of new businesses of Reliance Industries (US$ bn)

		Comments
1. Valuation of extant businesses		**Chemicals, RIL refinery, extant oil and gas**
FY2008E EPS of Reliance (Rs)	94.6	Significantly higher than FY2007 EPS of Rs81
FY2008E EPS adjusted for treasury shares (Rs)	109.6	Adjusted for 199 mn treasury shares
Effective tax rate in FY2008E (%)	19.0	
FY2008E EPS adjusted for tax rate	89.3	Normalized for 34% tax rate for extant earnings
Appropriate P/E multiple (X)	9.0	Generous given above mid-cycle margins, earnings and cost of equity of 12.5%
Valuation of extant businesses (Rs)	**803**	
Valuation of extant businesses	**25**	**Reasonable in the context of replacement value, returns**
2. Valuation of investments		**RPL, others (without Reliance Retail)**
Reliance Petroleum	433	3.1955 bn shares at 12-month fair valuation of Rs170
Others	8	
Total value of investments	**441**	
Valuation of RIL ex-new E&P, retailing, SEZs	**1,244**	
Current stock price	3,128	
3. Valuation of new businesses		**Emerging E&P business, retailing, SEZs**
Market-ascribed value of new businesses	**1,884**	
Market-ascribed value of new businesses (US$ bn)	**60**	
Estimated valuation of retailing (US$ bn)	5.5	Reliance has invested ~US$1.5 bn equity in Reliance Retail as of end-1HFY08
Estimated valuation of SEZs (US$ bn)	—	Value will take time to emerge
Market-ascribed value of emerging E&P business	**54**	**Seems very high to us based on official reserves, announced discoveries**
Estimated value of Reliance's stake in KG D-6 (gas)	6.1	Based on gas production of 17 tcf, US$8.8 bn capex, US$4.2/mn BTU net price
Estimated value of Reliance's stake in KG D-6 (oil)	1.8	0.5 bn bbls of OOIP assumed versus current announced reserves of 180 mn bbls
Estimated value of Reliance's stakes in NEC-25, CBM	2.2	
Implied value of new discoveries	**44**	**Higher reserves in KG D-6, NEC-25, Cauvery-III-D5, GS-01, MN-D4 blocks?**

Source: Kotak Institutional Equities estimates.

Reliance's current stock price is implying additional recoverable reserves of 100~ tcf of gas today

Valuation of Reliance's E&P segment and implied valuation for potential discoveries (US$ bn)

		Commnets
DCF valuation of KG D-6 block, gas for D1 & D3 fields	6.1	15.4 tcf of net recoverable gas reserves
Valuation of KG D-6 block, oil for MA-1 field	1.8	450 mn bbls of net proved reserves of oil at EV/bbl of US$10
Valuation of Reliance's stakes in NEC-25, CBM	2.2	5.7 tcf of net recoverable gas reserves
Total valuation of extant announced reserves	**10**	
Total recoverable reserves (tcf)	**24**	
Implied valuation of E&P segment	54	
Implied valuation of new E&P discoveries	44	
Implied additional recoverable reserves in stock price (tcf)	**104**	**This is what Reliance needs to announce today**
# of years from discovery to production	6	KG D-6 first gas discovered in Oct-02, production in 2HFY09
Cost of capital (%)	12.0	
Additional gas reserves required to be added in six years (tcf)	**205**	**This is what Reliance needs to bring in production in six years**

Note:
(a) The above exercise assumes for simplicity that all future gas and oil discovery would have similar PSC terms as the KG D-6 block.

Source: Kotak Institutional Equities estimates.

Large new capacity additions in ethylene in CY2008-10E

Major additions to ethylene capacity in Asia and Middle-East, calendar year-ends, 2008-2010E ('000 tons)

	2008	2009	2010
China			
Fujian Petrochemical		800	
PetroChina Dushanzi		1,000	
PetroChina Fushun			800
Shanghai Secco Petrochemical			500
Sinopec Tianjin			800
Sinopec Zhenhai			1,000
Total China	—	**1,800**	**3,100**
India			
Haldia Petrochemicals	180		
Indian Oil Corp.			800
Total India	**180**	—	**800**
Iran			
Arya Sasol	1,000		
Jam Petrochemical	1,320		
NPCL, Illam		318	
Total Iran	**2,320**	**318**	—
Korea			
Lotte Daesan	350		
Samsung Total	200		
Total Korea	**550**	—	—
Kuwait			
Equate	850		
Total Kuwait	**850**	—	—
Qatar			
QAPCO	200		
Q-Chem/Atofina		1,300	
Total Qatar	**200**	**1,300**	—
Saudi Arabia			
Petro-Rabigh		650	650
Petrokemya			800
Saudi ChevronPhillips Petrochem	300		
SEPC	1,000		
SHARQ	600	600	
Yanbu Petrochemical Complex	1,300		
Total Saudi Arabia	**3,200**	**1,250**	**1,450**
Singapore			
Shell Singapore			800
Total Singapore	—	—	**800**
Total Asia	**7,300**	**4,668**	**6,150**
Total globe (including expansions)	**8,300**	**5,628**	**8,610**

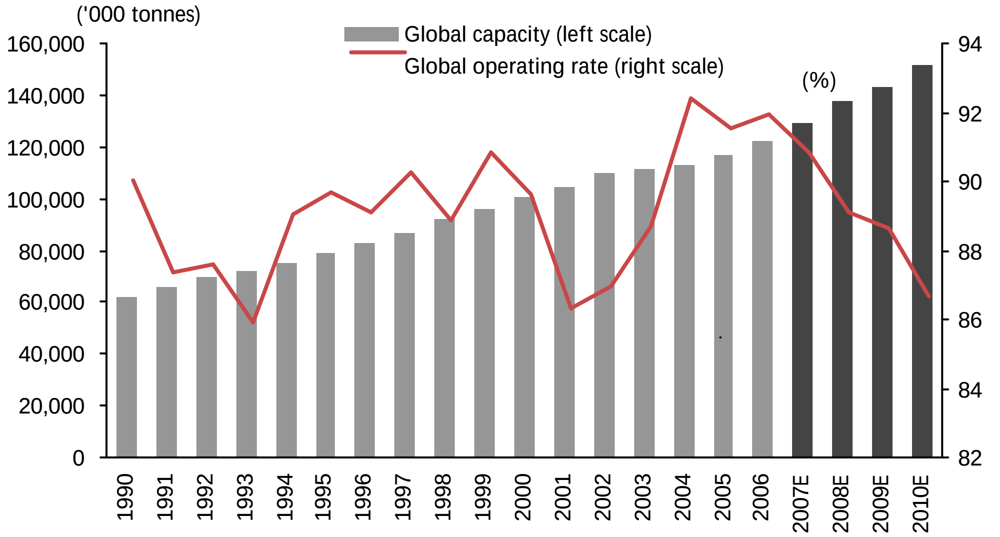
Source: Kotak Institutional Equities estimates.

Breakdown of new refining capacity by region ('000 b/d)
World refinery capacity additions ('000 b/d)

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Refinery capacity additions							
OECD North America	31	191	116	215	290	395	100
OECD Europe	—	(60)	—	20	306	(22)	—
OECD Pacific	—	135	—	34	115	—	—
FSU	—	—	3	—	140	—	140
Non-OECD Europe	—	—	—	—	—	30	—
China	542	170	706	536	150	340	400
Other Asia	474	302	258	910	154	—	—
Latin America	35	20	103	18	28	—	—
Middle East	161	15	256	—	351	120	1,781
Africa	3	13	50	100	150	—	—
Total World	**1,246**	**786**	**1,492**	**1,833**	**1,684**	**863**	**2,421**

Source: IEA, Kotak Institutional Equities estimates.

Continued steep decline in operating rates through CY2010E
Ethylene capacity and operating rates, 1991-2010E



Source: Kotak Institutional Equities estimates.

Expect high crude prices to sustain backed by strong demand growth

Estimated global crude demand, supply and prices, Calendar year-ends

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Demand (mb/d)									
Total demand	**82.5**	**83.9**	**84.7**	**85.7**	**87.8**	**89.5**	**91.4**	**93.3**	**95.3**
Yoy growth	3.3	1.4	0.8	1.0	2.1	1.7	1.9	1.9	2.0
Supply (mb/d)									
Non-OPEC	49.3	49.2	49.7	50.2	51.3	51.5	51.8	52.1	52.5
Yoy growth	1.1	(0.1)	0.5	0.5	1.1	0.2	0.3	0.3	0.4
OPEC									
Crude	29.0	30.2	30.4	30.6	31.1	31.7	32.9	34.3	35.7
NGLs	4.2	4.5	4.6	4.8	5.4	6.3	6.7	6.9	7.1
Total OPEC	**33.2**	**34.7**	**35.0**	**35.4**	**36.5**	**38.0**	**39.6**	**41.2**	**42.8**
Total supply	**83.4**	**84.6**	**85.4**	**85.6**	**87.8**	**89.5**	**91.4**	**93.3**	**95.3**
Total stock change	1.0	0.7	0.8						
OPEC crude capacity				**34.4**	**35.5**	**36.1**	**37.1**	**37.9**	**38.4**
Implied OPEC spare capacity				**3.8**	**4.4**	**4.4**	**4.2**	**3.6**	**2.6**
Demand growth (yoy, %)	**4.2**	**1.7**	**1.0**	**1.2**	**2.5**	**1.9**	**2.1**	**2.1**	**2.1**
Supply growth (yoy, %)									
Non-OPEC	**2.3**	**(0.2)**	**1.0**	**1.0**	**2.2**	**0.4**	**0.6**	**0.6**	**0.8**
OPEC	**6.8**	**4.5**	**1.0**	**1.2**	**3.0**	**4.1**	**4.2**	**4.0**	**3.9**
Total	**4.4**	**1.4**	**0.9**	**0.3**	**2.5**	**1.9**	**2.1**	**2.1**	**2.1**

Note:

(a) Angola has become an OPCE memberfrom 2005

(b) Including Angola from 2005

Source: IEA, BP Statistical Review of World Energy, and various government and industry sources.

RPL's hypothetical margins are significantly lower than RIL's reported margins in certain quarters

Refining margins for RIL and RPL, March fiscal year-ends (US$/bbl)

	2QFY08	1QFY08	4QFY07	3QFY07	2QFY07	1QFY07	4QFY06	3QFY06
RIL's reported margins	13.6	15.4	13.0	11.7	9.1	12.4	10.4	9.1
Singapore margins as computed by IEA (a)	2.5	4.7	3.1	1.0	1.5	4.9	1.2	2.9
Premium over reported Singapore margins	**11.1**	**10.7**	**9.9**	**10.7**	**7.6**	**7.5**	**9.2**	**6.2**
Hypothetical margins for RPL (b)	7.3	13.1	11.1	8.5	11.4	13.8	5.8	9.1
Premium of RPL's computed margins over RIL's reported margins	**(6.3)**	**(2.3)**	**(1.9)**	**(3.2)**	**2.3**	**1.4**	**(4.6)**	**(0.0)**

Note:

(a) Singapore hydrocracking margins over Dubai.

(b) Margins computed without considering use of gas for heating.

Source: Bloomberg, company, Kotak Institutional Equities estimates.

RPL refinery has a superior product slate as compared to RIL refinery
Comparison of product slate of RIL with RPL

	RIL refinery		RPL refinery	
	(mtpa)	**(%)**	**(mtpa)**	**(%)**
LPG	2.4	7.6		
Naphtha	6.0	18.9		
Gasoline	3.7	11.7	8-10	31.0
Alkylates (gasoline blend)			2-3	8.6
Jet/Kerosene	2.9	9.1	1-2	4.3
Diesel	11.7	37.1	12-13	43.1
LAB	1.1	3.4		
Petcoke	2.4	7.7	2-3	8.6
Sulphur	0.6	2.1	0.5-0.6	1.9
Propylene	0.8	2.4	0.5-0.9	2.4
Total	**31.5**	**100.0**	**29.0**	**100.0**

Source: Company, Kotak Institutional Equities.

RIL consolidated with RPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2003-2010E (Rs mn)

	2003	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)								
Net sales	451,133	510,715	656,223	809,113	1,114,927	1,058,303	1,266,594	1,837,091
EBITDA	**75,808**	**91,148**	**123,820**	**139,991**	**198,462**	**218,108**	**297,386**	**472,751**
Other income	10,012	11,381	14,498	6,829	4,783	7,750	10,222	15,463
Interest	(15,552)	(14,347)	(14,687)	(8,770)	(11,889)	(11,065)	(9,994)	(10,819)
Depreciation & depletion	(28,371)	(32,470)	(37,235)	(34,009)	(48,179)	(45,157)	(60,357)	(83,768)
Pretax profits	41,897	55,711	86,397	104,041	143,177	169,636	237,256	393,627
Extraordinary items	7,845	7,300	4,290	3,000	2,000	—	—	—
Tax	(2,459)	(3,510)	(7,050)	(9,307)	(16,574)	(21,160)	(39,141)	(62,673)
Deferred taxation	(6,240)	(7,900)	(7,920)	(7,040)	(9,196)	(11,033)	1,704	1,252
Minority interest	—	—	—	—	—	—	(4,870)	(24,632)
Net profits	41,043	51,601	75,717	90,693	119,406	137,443	194,950	307,574
Adjusted net profits	**34,570**	**45,623**	**72,135**	**88,152**	**117,761**	**137,443**	**194,950**	**307,574**
Earnings per share (Rs)	**24.8**	**32.7**	**51.7**	**63.3**	**81.0**	**94.6**	**128.8**	**195.5**
Balance sheet (Rs mn)								
Total equity	303,744	344,525	404,033	430,543	673,037	790,104	1,110,700	1,373,561
Deferred taxation liability	26,848	34,748	42,668	49,708	69,820	80,853	79,149	77,897
Minority interest	—	—	—	—	33,622	33,595	38,465	60,464
Total borrowings	197,583	209,447	187,846	218,656	332,927	409,377	237,259	112,642
Currrent liabilities	109,666	122,855	171,315	164,545	192,305	199,874	206,384	232,501
Total liabilities and equity	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,513,803**	**1,671,956**	**1,857,066**
Cash	1,472	2,242	36,087	21,461	18,449	17,809	71,307	183,522
Current assets	227,809	218,159	248,438	224,283	286,566	310,216	334,918	409,441
Total fixed assets	340,863	351,460	350,823	626,745	899,403	1,043,484	1,090,937	1,071,809
Investments	67,227	139,714	170,515	(9,038)	97,294	142,294	174,794	192,294
Deferred expenditure	472	—	—	—	—	—	—	—
Total assets	**637,842**	**711,574**	**805,863**	**863,452**	**1,301,712**	**1,513,802**	**1,671,956**	**1,857,066**
Free cash flow (Rs mn)								
Operating cash flow, excl. working cap	67,072	83,301	107,002	119,520	164,285	179,930	243,071	396,935
Working capital	(17,614)	20,265	46,875	(32,188)	(13,075)	(16,081)	(18,192)	(48,406)
Capital expenditure	(37,043)	(43,191)	(52,440)	(94,273)	(247,274)	(197,524)	(103,037)	(62,316)
Investments	(34,204)	(68,430)	(48,192)	(32,364)	(105,760)	(45,000)	(32,500)	17,500—
Other income	5,219	5,902	3,032	5,159	4,143	7,750	10,222	15,463
Free cash flow	**(16,569)**	**(2,153)**	**56,276**	**(34,146)**	**(197,681)**	**(70,925)**	**99,564**	**284,175**
Ratios (%)								
Debt/equity	59.8	55.2	42.1	45.5	44.8	47.0	19.9	7.8
Net debt/equity	59.3	54.6	34.0	41.1	42.3	45.0	13.9	(4.9)
RoAE	10.7	12.7	17.6	19.9	20.3	17.9	19.7	24.0
RoACE	**8.8**	**9.7**	**13.0**	**13.8**	**13.9**	**12.0**	**15.0**	**22.3**

Source: Kotak Institutional Equities estimates.

Property

DLF.BO, Rs1206	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	1,250
52W High -Low (Rs)	1225 - 506
Market Cap (Rs bn)	2,055

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	39.2	156.9	201.0
Net Profit (Rs bn)	19.4	96.8	123.7
EPS (Rs)	12.7	56.8	72.6
EPS gth	*1.0*	*347.1*	*27.8*
P/E (x)	94.9	21.2	16.6
EV/EBITDA (x)	76.7	17.3	13.5
Div yield (%)	-	0.4	0.6

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	88.2	-	-
FIIs	7.3	1.1	(2.2)
MFs	0.3	0.3	(2.9)
UTI	-	-	(3.3)
LIC	-	-	(3.3)

DLF Limited: Key takeaways from management meeting; target price revised to Rs1,250

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- **Listing of DLF Offices Trust is on track; process likely to be completed in next six weeks**
- **Revise our capitalization rate to 7% (9% earlier)**
- **Our NAV is revised to Rs823/share; target price of Rs1,250/share based on NAV and Rs423 of terminal value**

Our management meetings with DLF indicated continued momentum in retail and commercial business. DLF has also met with success in its first few mid-market residential projects at three locations—Kochi, Chennai and Kolkata. Management also indicated that the process of listing of DLF Offices Trust (DOT) is on track and the process could be completed within the next six weeks. As a result, we revise our cap rate to 7% from 9% earlier. We revise our PAT estimates to Rs97 bn in FY2008 (Rs79 bn earlier) and Rs124 bn in FY2009 (Rs103 bn earlier). We note that DLF is continuously able to invest to expand its core business as well as make strategic investments. We see a large investment pipeline ahead for DLF in terms of investments in new projects, hotels, SEZ and insurance wherein we expect DLF to earn IRRs of 20%+. Therefore, we assign a terminal value of Rs423/ share based on 1.5X FY2011E P/B discounted back to March 2009. As a result, our target price is revised to Rs1,250/share based on March 2009E NAV of Rs823/share (Rs717 earlier) and terminal value of Rs423/share.

Planned listing of real estate trust in Singapore makes significant progress

DLF is currently in the process of floating a business trust in Singapore, DLF Offices Trust (DOT). DOT will likely comprise 10 mn sq. ft of commercial property—5 mn sq. ft in Gurgaon and the balance in Hyderabad and Chennai. In terms of leasing status, approximately 4 mn sq. ft is occupied, 4 mn sq. ft is pre-leased and 2 mn sq. ft is yet to be leased. DOT will also have the Right of First Refusal for a further 10 mn sq. ft that is likely to come up in the next three years at similar locations. DLF will pay interest at the rate of 9% to investors on funds raised that will correspond to non-leased property.

We note that DLF has already done confidential filing of DOT and the prospectus is likely to become public in a week. We expect the IPO process of DOT to be completed in the next six weeks. DLF through its Singapore subsidiary will subscribe to approximately 25% of the offering with the balance 75% getting subscribed by external investors.

DLF has been booking revenues and profits at a capitalization rate of 9% for 1QFY08 and 2QFY08 and will likely book revenues at similar cap rate in 3QFY08. However, DLF management intends to pass on to DLF any benefit likely to accrue on compression of capitalization rate. This will likely result in DLF booking a large one-off gain in 4QFY08. Based on compression of cap rates, our PAT estimates are revised to Rs97 bn in FY2008 (Rs79 bn earlier) and Rs124 bn in FY2009 (Rs103 bn earlier). We currently built in the assumption of a cap rate of 7%. In case DOT is able to attract investments at a 6% cap rate, our NAV for March 2009E will increase by Rs54/share to Rs877/share.

Mid-income housing starts to make progress

Initial launches of DLF in mid-income housing have generated good responses. DLF has launched three projects in recent past—one each in Indore, Kolkata and Kochi. DLF has sold more than 75% of these three projects comprising 1,000 units. In the near future, DLF intends to launch projects in Chennai and Bangalore. DLF intends to launch projects in these cities at 10-20% discount compared to real estate prices quoted other large players in the same region. We expect such a strategy will likely help establish DLF as an important player in markets other than National Capital Region (NCR).

Large investment pipeline ahead to help reinvest large cashflows generated

We expect DLF to start generating large free cash flows from FY2009E. DLF has already lined up various ventures to invest into new projects that include townships, hotels and Special Economic Zones. We expect DLF to generate IRRs of 20%+ on its investments in new projects. We describe below various investments likely to be undertaken by DLF in the near future.

Hotels: The management has indicated that the company is in the process of acquiring 125 sites with a potential of 25,000 rooms. The potential capital outlay in this business is estimated to be US$5 bn. We highlight that this business vertical continues to make extremely strong progress. Hotel projects at New Delhi, Kolkata, Chennai, Bangalore, Mysore, Bhubaneshwar, Kochi and Hyderabad are at an advanced stage of design and development under a joint venture with Hilton International. DLF has also signed a Letter of Intent signed with "Four Seasons" for the first super luxury hotel in Gurgaon. Overall, 39 projects are under various stages of design, development and execution with recent site acquisitions in Cochin, Gangtok, Calicut, Trivandrum, Jaipur, Kasauli, Kovalam.

Special Economic Zones: Management has indicated that it continues to make progress on land acquisition for two 20,000 acre townships to be set up at Gurgaon and Southern Maharashtra. These large townships are going to be set up in partnership with Nakheel group. The JV for South Maharashtra is looking to set up a "resort city" to attract a large number of domestic as well as international tourists. Each of the SEZs will likely require investments greater than US$3 bn.

Bidadi township. DLF has received the LOI (Letter of Intent) to build an integrated township over 9,000 acres in Bidadi. This township is going to be developed in a 50:50 JV with Nakheel group and investment required over the next five years for purchase of land and basic development will likely be Rs70 bn.

Land bank for building future projects. DLF will likely require large investments to purchase land in prime locations as indicated by these deals, (1) 38 acre land from Shivaji Marg properties (SBM) for Rs16 bn, (2) 26 acre plot in Chennai for Rs6.6 bn, and (3) 25 acre plot in Raidurg for Rs4.5 bn. We expect opportunities to win more deals to increase in the near term as municipal corporations of various cities auction land in order to fund infrastructure projects. Also, the increase in land prices has resulted in corporates putting up surplus land in prime locations for sale.

Retail. DLF's strategy in retail segment is to acquire properties in key locations and in the recent past has acquired attractively located land parcels in Ludhiana, Dwarka, Banjara Hills and SBM-Delhi.

Other investments. DLF intends to invest in healthcare and financial services through its joint ventures.

Our target price is revised to Rs1,250/share; retain ADD rating

Our March '09 based NAV for DLF is revised to Rs823/share (Rs717 earlier) on account of these adjustments, (1) decrease of capitalization rate for commercial properties from 9% to 7%, (2) increase of NTC Mill, Mumbai area from 1.7 mn sq. ft to 2.6 mn sq. ft, (3) increase in valuation of hotel business from Rs25 bn to Rs50 bn as there has been a significant progress, and (4) increase in pricing for commercial properties in Gurgaon. Since DLF has shown a track record of investing in new projects at high IRRs we assign a terminal value of Rs423/share based on 1.5X FY2011E P/B and discount it back to March 2009. As a result our target price is revised to Rs1,250/share and we retain our ADD rating.

Our target price for DLF is revised to Rs1,250/share

NAV sensitivity for DLF for different growth rate in selling prices

		March '09 based NAV			
		Growth rate in selling prices			
	Valuation Methodology	0%	3%	5%	10%
Valuation of land reserves		**767**	**946**	**1,262**	**1,505**
Add: 22 Hotel sites	2X land acquisition cost	50	50	50	50
Add: Construction JV	15X FY2009E P/E	28	28	28	28
Add: Other properties (plots in Gurgaon - 7.2 mn sq. ft, hotel site in Gurgaon)	Current Market value	22	22	22	22
Add: Present value of project management fees		8	8	8	8
Add: Investments as on March 31, 2008		20	20	20	20
Add: Bidadi township		65	65	65	65
Less: Net debt as on March 31, 2008		(7)	(7)	(7)	(7)
Less: Land cost to be paid as on March 31, 2008		(30)	(30)	(30)	(30)
NAV (Rs bn)		**923**	**1,102**	**1,418**	**1,661**
NAV/share (Rs)		**536**	**640**	**823**	**964**
Terminal value (Rs bn)	1.5X FY2011E P/B discounted to March 2009	729	729	729	729
Total no. of shares including ESOPs of 17 mn shares (mn)					1,722
Valuation/share (Rs)					**1,246**

Source: Kotak Institutional Equities

Profit model of DLF, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Total revenues	**6,082**	**11,536**	**39,233**	**156,887**	**200,994**	**240,631**	**326,910**
Land costs	(2,517)	(4,416)	(6,319)	(7,078)	(13,862)	(16,478)	(17,678)
Construction costs	-	-	-	(23,791)	(30,856)	(39,676)	(57,567)
Employee costs	(446)	(397)	(922)	(2,009)	(2,873)	(3,929)	(5,187)
SG&A costs	(1,435)	(1,966)	(3,958)	(4,684)	(5,858)	(6,902)	(9,129)
EBITDA	**1,684**	**4,757**	**28,034**	**119,325**	**147,546**	**173,646**	**237,348**
Other income	178	883	1,108	1,407	2,826	3,757	6,886
Interest	(390)	(1,685)	(3,076)	(3,191)	(607)	(1,534)	(1,750)
Depreciation	(333)	(361)	(571)	(1,303)	(1,773)	(3,728)	(5,047)
Pretax profits	**1,138**	**3,594**	**25,494**	**116,238**	**147,992**	**172,141**	**237,438**
Profit/(loss) share of associates	-	-	-	-	-	-	-
Current tax	(490)	(2,537)	(6,058)	(19,482)	(24,398)	(29,168)	(40,740)
Deferred tax	231	870	-	36	146	11	(5,431)
Net income	**879**	**1,927**	**19,436**	**96,793**	**123,739**	**142,984**	**191,267**
Reported net income	**865**	**1,917**	**19,425**	**96,793**	**123,739**	**142,984**	**191,267**
EPS (Rs)							
Primary	6.3	12.7	13.0	58.3	73	84	112
Fully diluted	6.3	12.7	13.0	57.7	72	83	111
Shares outstanding (mn)							
Year end	140	1,511	1,530	1,705	1,705	1,705	1,705
Primary	140	152	1,496	1,661	1,705	1,705	1,705
Fully diluted	140	152	1,496	1,678	1,722	1,722	1,722
Cash flow per share (Rs)							
Primary	5	18	4	56	72	86	118
Fully diluted	5	18	4	55	71	85	117
Growth (%)							
Net income (adjusted)	61	122	913	398	28	16	34
EPS (adjusted)	59	103	2	344	25	16	34
DCF/share	39	273	(77)	1,218	30	19	38
Cash tax rate (%)	43	71	24	17	16	17	17
Effective tax rate (%)	23	46	24	17	16	17	19

Source: Kotak Institutional Equities estimates.

Balance sheet of DLF, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Equity							
Share capital	35	378	3,059	3,409	3,409	3,409	3,409
Reserves/surplus	7,437	9,122	36,613	215,213	325,348	448,896	616,840
Total equity	**7,472**	**9,500**	**39,672**	**218,622**	**328,757**	**452,305**	**620,256**
Deferred tax liability/(asset)	963	93	187	151	5	(6)	5,425
Liabilities							
Secured loans	7,951	39,560	92,053	39,328	9,328	9,328	9,328
Unsecured loans	1,724	1,760	7,275	—	—	—	—
Total borrowings	**9,675**	**41,320**	**99,328**	**39,328**	**9,328**	**9,328**	**9,328**
Currrent liabilities	9,342	18,469	42,429	63,032	79,844	95,587	127,384
Total capital	**27,494**	**69,435**	**181,708**	**321,225**	**418,025**	**557,306**	**762,393**
Assets							
Cash	424	1,950	4,155	32,392	65,718	179,216	371,418
Current assets	15,939	35,113	124,639	210,205	226,931	212,794	219,478
Gross block	8,253	11,237	17,787	32,581	44,335	93,194	126,168
Less: accumulated depreciation	1,549	1,891	2,412	3,917	5,691	9,418	14,465
Net fixed assets	6,704	9,346	15,375	28,664	38,644	83,776	111,703
Capital work-in-progress	3,506	6,239	26,497	20,828	47,594	32,383	10,741
Total fixed assets	**10,210**	**15,585**	**41,872**	**49,491**	**86,238**	**116,159**	**122,444**
Intangible assets	—	—	—	—	—	—	—
Investments	921	16,789	11,042	28,935	38,935	48,935	48,935
Misc. expenses	—	—	—	202	202	202	202
Total assets	**27,494**	**69,437**	**181,708**	**321,225**	**418,025**	**557,306**	**762,478**
Leverage ratios (%)							
Debt/equity	114.7	430.7	249.2	18.0	2.8	2.1	1.5
Debt/capitalization	53.4	81.2	71.4	15.2	2.8	2.0	1.5
Net debt/equity	109.7	410.4	238.8	3.2	(17.2)	(37.6)	(57.9)
Net debt/capitalization	52.3	80.4	70.5	3.1	(20.7)	(60.2)	(137.4)
RoAE	**10.7**	**21.3**	**78.6**	**74.8**	**45.2**	**36.6**	**35.5**
RoACE	**5.3**	**4.5**	**22.9**	**50.0**	**41.6**	**36.1**	**36.1**

Source: Kotak Institutional Equities estimates.

Cash flow statement of DLF, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E
Operating						
Pre-tax profits before extraordinary items	1,138	3,595	25,495	116,238	147,992	172,141
Depreciation	334	362	571	1,303	1,773	3,728
Taxes paid	(448)	(751)	(6,078)	(19,482)	(24,398)	(29,168)
Other income	(1)	98	(13,857)	—	—	—
Interest expenses	315	970	3,076	3,191	607	1,534
Interest paid	(645)	(1,483)	(2,898)	(8,947)	(3,036)	(1,534)
Working capital changes (a)	4,415	(15,225)	(66,758)	(59,207)	2,514	29,881
Total operating	**5,108**	**(12,436)**	**(60,449)**	**33,097**	**125,452**	**176,582**
Operating, excl. working capital (b)	**693**	**2,789**	**6,309**	**92,304**	**122,938**	**146,701**
Investing						
Fixed assets	(8,299)	(3,863)	(18,878)	(9,124)	(38,520)	(33,649)
Investments	618	(14,797)	14,044	(17,893)	(10,000)	(10,000)
Total investing (c)	**(7,681)**	**(18,660)**	**(4,834)**	**(27,017)**	**(48,520)**	**(43,649)**
Financing						
Issue of share capital	—	—	—	91,875	—	—
Borrowings	2,734	32,638	58,007	(60,000)	(30,000)	—
Dividend (d)	(16)	(16)	(18)	(9,718)	(13,605)	(19,436)
Total financing	**2,718**	**32,622**	**67,487**	**22,157**	**(43,605)**	**(19,436)**
Net increase in cash and cash equivalents	146	1,526	2,204	28,237	33,327	113,498
Beginning cash	279	424	1,951	4,155	32,392	65,718
Ending cash	**424**	**1,951**	**4,155**	**32,392**	**65,718**	**179,216**
Gross cash flow (b)	693	2,789	6,309	92,304	122,938	146,701
Free cash flow (b) + (a) + (c)	**(2,572)**	**(31,096)**	**(65,283)**	**6,080**	**76,931**	**132,934**
Excess cash flow (b) +(a) + (c) + (d)	(2,588)	(31,112)	(65,301)	(3,638)	63,327	113,498

Source: Kotak Institutional Equities estimates.

Consumer Products

ITC.BO, Rs225	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	250
52W High -Low (Rs)	239 - 140
Market Cap (Rs bn)	840.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	123.7	142.1	161.2
Net Profit (Rs bn)	27.0	31.2	36.3
EPS (Rs)	7.2	8.3	9.7
EPS gth	*20.4*	*15.4*	*16.6*
P/E (x)	31.1	27.0	23.1
EV/EBITDA (x)	19.9	17.1	14.2
Div yield (%)	1.4	1.4	1.6

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	14.3	1.2	(0.6)
MFs	3.0	1.5	(0.3)
UTI	11.9	49.0	47.2
LIC	13.4	6.2	4.5

ITC: Clement horizons. Reiterate BUY, target price increased to Rs250

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- **Cigarettes—profits expected to continue**
- **Consolidating the success of the e-Choupal network, second wave in the offing**
- **It's a mixed bag in 'Other FMCG'—business categories with backward integration have outperformed**
- **Paper and packaging capacities being augmented, hotel revenues growth to slow down post 2009**
- **Reiterate BUY, target price increased to Rs250**

We expect ITC to post 15% earnings growth during FY2008-10. We have marginally increased our EPS estimates for 2009 to Rs9.7 (Rs 9.6 earlier) to account for margin expansion in cigarettes due to the introduction of VAT in Uttar Pradesh from January 1, 2008. We came back impressed after visiting an echoupal and a choupal sagar. We believe that the second wave of growth in agri sourcing with flanking produce like cotton, sugarcane, fruits and vegetables are on the anvil. Our DCF-based target price stands increased to Rs250 from Rs225. At our target price, the stock trades at 25XFY2009E. In the past three years, the stock has traded at an average PE of 23X and has remained in the 20X-30X band. We expect multiples to be maintained on the back of cigarette volumes returning to growth and new launches in foods and personal care. We reiterate our BUY rating on the stock. Upside risks include better-than-expected cigarette volumes, conducive taxation regime, replicating the foods' success in personal care and stronger REVPARs in hotels business.

Cigarettes—Puffing profits expected to continue. We believe that the modest volume decline of 3% (our estimates) witnessed in CY2007 is over and the volume growth would revert to about 8% in 2009E. We note that cigarette volumes displayed significant resilience even after a steep 20% price hike effected in early 2007 to pass-on the increased tax burden. We expect strong rural incomes aided by high commodity prices to drive upgradation from beedis to cigarettes. We note the recent statements by Finance Minister regarding possible reductions in direct tax rates. On the back of an effectively punitive tax rate increase on cigarettes in 2007, the chances of a moderate adjustment in cigarette taxation is highly possible in 2008. Over the past 20 years, the tax increases in cigarettes has trended at the inflation rate vindicating our hypothesis. We model 8% volume growth for cigarettes segment in 2009.

Effective January 1, 2008, Uttar Pradesh has adopted VAT regime. Cigarettes which were taxed at 33.5% including the state trade tax would now fall under the 12.5% VAT regime. We estimate that Uttar Pradesh accounts for about 5% of ITC's cigarette volumes and build in the margin expansion (by about 0.6%) in our earnings model.

Government of India has notified the Cigarettes and Other Tobacco Products (Packaging and Labeling) Rules, 2007 (COPTA). These rules governing the packaging and labeling of tobacco products will result in the introduction of graphic health warnings "Smoking Kills'' (on smoking forms of tobacco products) as well as "Tobacco Kills" (on smokeless/ chewing and other forms of tobacco products). While the implementation of the notification is pending, we do not expect it to materially impact cigarette sales as (1) 65% of industry sales (a higher proportion in rural areas) is in the form of single stick sales and (2) Lack of conclusive evidence globally to suggest the contrary.

Consolidating the success of the e-Choupal network, second wave in the offing. We came back impressed after visiting an e-choupal (procurement and distribution channel), choupal sagar (rural retail) and a local mandi (trading market at the district level) at Talegaon in Wardha district, Maharashtra state (about 1,000 kilometers east of Mumbai). Key takeaways from the visit::

- The soyabean crop season was coming to end, which was evident in the relatively quiet activities at the centers
- We could observe the all the merits of the system in action (see Exhibit 1 and Exhibit 2)
- In the agri-sourcing business, we expect ITC to enter flanking products like cotton, sugarcane (requirement of 80,000 tons of sugar for the biscuits and confectionery business).
- However, the primary trading nature of the business, coupled with conservative policies regarding maintenance of open positions (for example, open positions in agri trade are capped at about one-fourth of annual turnover) limit the profitability of the division to 2-3%.
- This network provides ITC two key benefits (1) increase in own FMCG sales and revenues from distribution and marketing of other company's products, fee income by selling insurance products (primarily the highly competitive life insurance and the highly complex weather insurance) and (2) the strong relationship developed through this network is likely to come useful for sourcing of F&V for the Choupal Fresh as well.
- Sources indicate that the current throughput value of transactions through the rural distribution channel comprising agri-inputs, FMCG products, vehicles, consumer durables, insurance products and other marketing services is about Rs2.5 bn (up from about Rs0.5 bn in 2005). The key companies using this channel are Colgate, Eveready, Philips, TVS Motors, John Deere tractors, Fena detergents and few regional tea brands. We estimate that ITC earns a net commission of 2-3% on the throughput in this channel (about Rs100 mn).
- The choupal sagar outlet is typically located in the periphery of district headquarters / taluka town (about 10 kilometers). Hence it attracts footfalls from the farmer who visit the ITC complex for selling his produce as well as the urban population from the town. Sources indicated that currently the revenue contribution from the urban population is well over 50%. Given the aggressive expansion plans of other retails companies focusing on opportunities beyond the tier I cities, ITC may have to improve the stocking pattern (higher assortment in apparels, consumer durables) in the near term.

ITC intends to ramp up its network of e-choupals to 20,000 (currently about 6,500) and Choupal Sagars to 700 (currently 22, we estimate current annualized revenues of about Rs1 bn) by FY2015. We believe that the further expansions in echoupal network would be for sourcing of fruits & vegetables as the company has well penetrated the soya and wheat producing areas in key states of Madhya Pradesh, Maharashtra and Uttar Pradesh.

The pace of addition of choupal sagars has been slower than desired as the company sorts out issues on land acquisition and construction at dispersed locations. The echoupal unit to hub ratio is 1:40 i.e., there is a collection hub for every 40 echoupals. Given that there are about 6,500 echoupals currently, there is a latent opportunity to create 160 choupal sagar outlets.

It's a mixed bag in 'Other FMCG' business. Contrary to street belief, we believe that ITC's performance in the foods and personal care category is mixed. While the agri commodity sourcing capability provides significant tangible (cost leadership) and intangible (brand equity) benefits in food business, the company clearly needs to identify a differentiating proposition for each of its personal care forays.

- The company had fantastic success in staples, biscuits and snack foods - Aashirwad is estimated to be a Rs5 bn brand in just over 5 years and is the market leader, Sunfeast is estimated to have about 10% market share in the Rs50 bn biscuits industry in just over 3 years. In confectionery, ITC's Minto-Fresh recently attained market leadership with a 17% market share overtaking Perfetti's Chlormint. Bingo chips is estimated to have crossed Rs2bn annualized sales with a 10% market share.
- However, trade sources indicate that repeat purchases in the Sunfeast Pasta Treat (whole wheat based non-fried product as a healthy snacking option for children) is declining
- As per press reports, 2008 is expected to see launches of many new Foods brands, particularly in processed foods and beverages segment. Nestle is test marketing 'Cerevita' cereal brand, ITC is expected more products under 'Benne vita' brand and HUL is preparing to launch brain foods and health drink under the 'Amaze' brand
- The slew of launches in personal care products continue. ITC had launched Fiama Di Wills Shampoos, shower gel & soaps in the premium segment in the top 8 cities and Superia shampoo and soaps at the lower end in Andhra Pradesh and Orissa. Market sources indicate that the response to Fiama Di Wills shampoo is relatively muted and Superia soaps has had reasonable success on the back of aggressive trade promotions

We are impressed by the company's ability to build and scale up food brands in a short period. We believe that ITC is well-placed to make a dent into HUL's dominant shares, gain from CavinKare as well as garner a higher incremental share in this under penetrated and fast growing shampoo category if the company successfully identifies a differentiating proposition. We expect ITC's task in penetrating further into the soap category to be much more challenging than in shampoos. Consumer loyalty in soaps is significantly lower compared to personal care products. The exceptions are highly differentiated products like Dove, Pears etc. Soaps is a highly penetrated (>90%), mature category and value market growth rates are in high single digits.

Paper and packaging capacities being augmented, hotel revenues growth to slow down post 2009. We model the paper, packaging and hotels business to grow at 10% in 2009. Incremental capacity addition at Bhadrachalam, Chennai units and improved capacity utilization at Coimbatore plant is expected to drive growth in paperboard business. The commissioning of new pulp mill at Bhadrachalam is scheduled to be commissioned by end-FY2008 and will help improve margins by reducing dependence on purchased pulp which is currently imported at higher prices. The cartons line at Uttarakhand has been commissioned in 2HCY07. We note that the capacity expansion, particularly at Uttarakhand is happening at the appropriate time. The growth in modern retail increases demand for cartoned products as compared to wrappers / polypacks. This augurs well for ITC's paperboard business.

The hotels business is expected to grow by 10% in 2009 on account of modest growth in REVPAR (revenue per available room) and occupancy rates. The tie up with Starwoods has repositioned seven of the company's hotel properties as 'premium luxury' from May 2007, which will likely help realize better room rates and margins. Company indicated that the construction of the super deluxe luxury hotels at Bangalore and Chennai is progressing as per schedule. The decision to move away from the dual pricing methodology to Rupee billing from September will help insulate the company from the impact of appreciating rupee.

Valuation and recommendation. We expect ITC to post 15% earnings growth during FY2008-10. We have marginally increased our EPS estimates for 2009 to Rs9.7 (Rs 9.6 earlier) to account for margin expansion in cigarettes due to introduction of VAT in Uttar Pradesh from 1st January 2008. Our DCF-based target price stands increased to Rs250 from Rs225. The company is currently trading at 27XFY2008E and 23XFY2009E. In the last three years, the stock has traded at an average PE of 23X and has remained in the 20X-30X band. The implied PE at our target price is 25XFY2009E. We expect multiples to be maintained on the back of cigarette volumes returning to growth and new launches in foods and personal care. We reiterate our BUY rating on the stock. Upside risks include better than expected cigarette volumes, conducive taxation regime, replicating the foods' success in personal care and stronger REVPARs in hotels business.

Exhibit 1: ITC e-choupal vs traditional 'mandi' system

ITC had built a strong competitive advantage which help build cost leadership

	Traditional	e-Choupal Platform
Price Discovery	Mandi	Village
Quality Inspection	Visual	Scientific
Weighing	Manual (w/ material loss)	Automatic (no material loss)
Choice	Effectively none (only Mandi)	At least two (ITC hub & Mandi)
Prices	Unpredictable (Mandi is a spot market)	One channel (ITC hub) with fixed price
Sell-to-cash cycle	1-2 days	3-4 hours
Distance Travelled to sell	20-25 kms	20-25 kms
Labor and Handling	More	Less

Source: HBS, Kotak Institutional Equities

Exhibit 2: ITC e-choupal vs traditional 'mandi' system

The tangible benefits of disintermediation is sustainable

(Rs per metric ton)

Transaction	Mandi supply chain		E-choupal model	
	Farmer	ITC	Farmer	ITC
Freight	120	120	120	
Labor / Handling	50	40		40
Commission	150	100		50
Handling Loss	50			
Bagging		75		75
Cash Disbursement Costs				50
Total (for each Stage)	370	335	120	215
Total for the chain	**705**		**335**	

Source: HBS, Kotak Institutional Equities

Exhibit 3: Immense growth opportunities for ITC considering the high market shares of HUL and gap with the nearest competitor

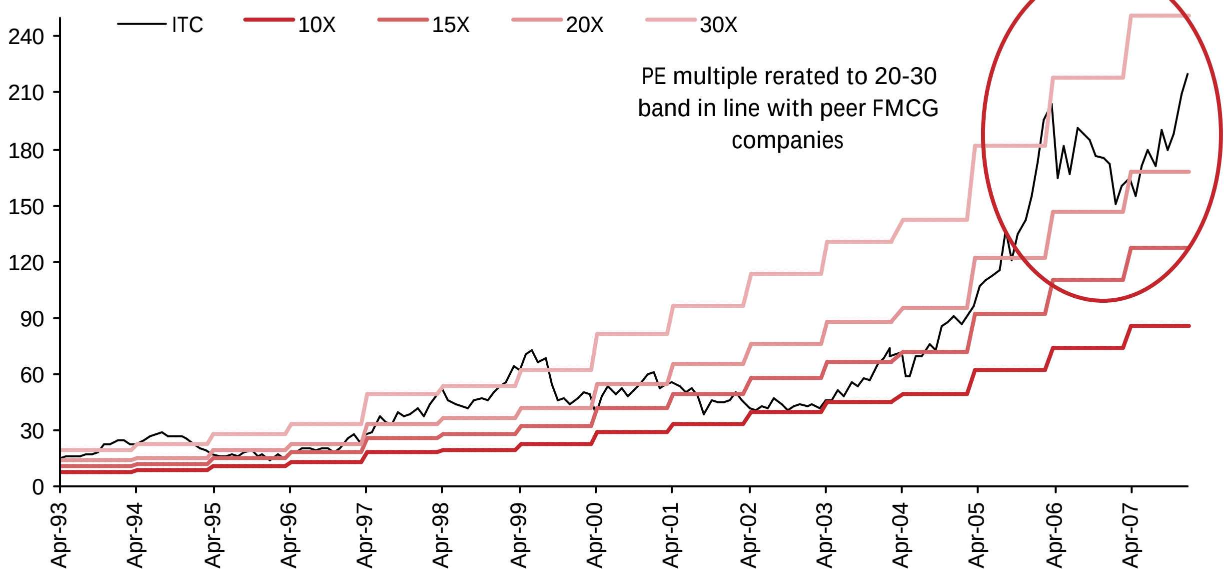
Category snapshot for personal products

	Market share %		Market growth %		Category penetration %		
	HUL	Nearest competitor	2006	YTD 2007	All India	Urban	Rural
Personal wash	54.0	10.0	8.2	7.9	92.0	92.0	92.0
Shampoo	47.5	24.8	13.1	13.3	38.0	52.1	31.9
Skincare	55.1	7.5	15.0	16.3	22.0	31.5	17.8

Source : HUL presentation

Exhibit 4: At 23XFY2009E, ITC is trading at its 3-year average PE

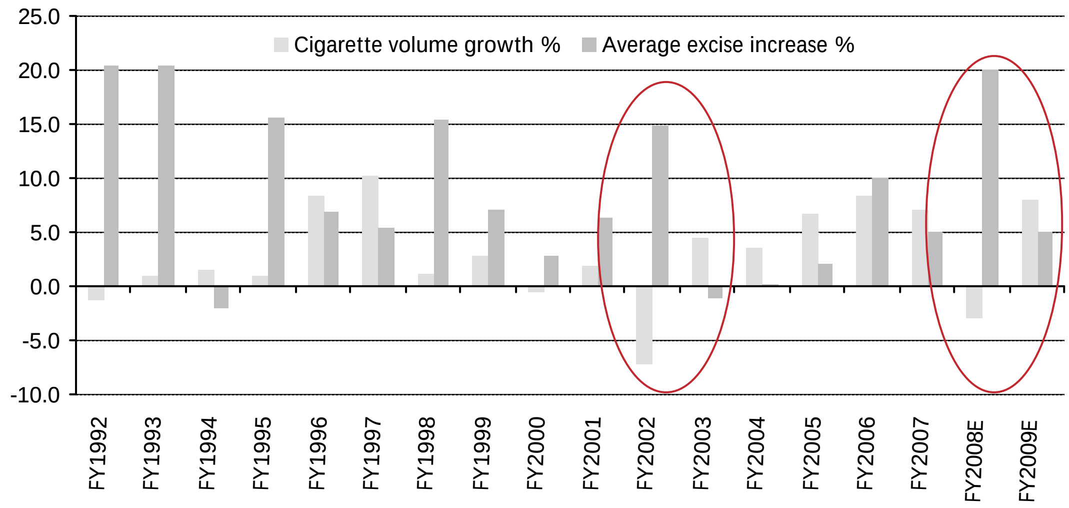
ITC - P/E bands



Source:Kotak Institutional Equities estimates

Exhibit 5: Cigarette volumes display reselience in FY2008 on the back of a steep price hike

Cigarette volume growth percentage and average excise increase percentage



Note: Average excise increase for FY2008E includes VAT of 12.5%

Source: CSO, Kotak Institutional Equities

ITC: Profit model, balance sheet, cash flow model 2005-2009E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	97,905	123,693	142,079	161,209	184,902
EBITDA	**33,274**	**39,700**	**45,837**	**54,457**	**62,598**
Other income	2,899	3,365	4,523	4,416	5,155
Interest	(158)	(169)	(146)	(173)	(173)
Depreciation	(3,323)	(3,629)	(4,487)	(5,016)	(5,684)
Extraordinary items	(63)	0	0	0	0
Pretax profits	32,629	39,267	45,728	53,683	61,896
Tax	(10,276)	(12,267)	(14,561)	(17,341)	(19,957)
Deferred taxation					
Net profits	**22,353**	**27,000**	**31,167**	**36,342**	**41,939**
Earnings per share (Rs)	**6.0**	**7.2**	**8.3**	**9.7**	**11.2**
Balance sheet (Rs mn)					
Total equity	90,615	104,371	121,530	142,113	166,542
Deferred taxation liability	3,248	4,729	4,729	4,729	4,729
Total borrowings	1,197	2,009	2,009	2,009	2,009
Currrent liabilities	35,781	38,576	39,509	40,739	44,253
Total liabilities and equity	**130,840**	**149,684**	**167,776**	**189,589**	**217,533**
Cash	8,558	9,002	16,767	29,217	44,707
Current assets	43,061	53,896	58,574	63,564	70,932
Total fixed assets	44,051	56,109	61,757	66,129	71,216
Investments	35,170	30,678	30,678	30,678	30,678
Total assets	**130,840**	**149,684**	**167,776**	**189,589**	**217,533**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	25,638	31,040	36,039	41,822	48,060
Working capital	(5,469)	(8,667)	(948)	(2,495)	(2,840)
Capital expenditure	(6,013)	(15,702)	(10,150)	(9,403)	(10,785)
Investments	3,577	4,492	0	0	0
Free cash flow	**17,734**	**11,164**	**24,941**	**29,924**	**34,435**
Other income					
Ratios (%)					
Net debt/equity	-34%	-24%	-27%	-32%	-37%
Return on equity	26%	28%	28%	28%	27%
RoCE	77%	57%	46%	48%	49%
Key assumptions					
Sales growth	28%	26%	15%	13%	15%
EBITDA margins	34%	32%	32%	34%	34%

Source: Kotak Institutional Equities estimates

Pharmaceuticals

GLEN.BO, Rs574	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	488
52W High -Low (Rs)	624 - 248
Market Cap (Rs bn)	152.5

Financials

March y/e	2006	2007E	2008E
Sales (Rs bn)	10.4	15.8	19.7
Net Profit (Rs bn)	3.1	5.9	6.9
EPS (Rs)	13.0	23.4	25.8
EPS gth	*258.0*	*79.7*	*10.4*
P/E (x)	44.0	24.5	22.2
EV/EBITDA (x)	36.3	19.3	16.6
Div yield (%)	0.1	0.1	0.1

Glenmark Pharmaceuticals: Diabetes molecule to be called Melogliptin

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- **We await clarity on the future on the molecule which has been out-licensed to Merck KGaA as the latter has decided to exit diabetes research. Merck is seeking a buyer or a licensor and hopes to conclude the deal in 2008**
- **Our forecast is based on the 2011 proposed launch in the US market and global peak sales of ~US$1 bn in 2017**
- **Our share price target includes Rs13 for royalty, Rs7 for milestone income and Rs125 for our estimated value of the research pipeline**
- **Share price rose 6.6% following the news. We think this is overreaction as there in no change in fundamentals**

Glenmark's lead candidate for Type II Diabetes GRC 8200 will now be called Melogliptin. It is in-licensed by Merck but it announced in 2007 that it will either sell or seek a partner for its existing R&D activities in diabetes which it no longer wants to compete in effectively. DPP segment is getting crowded with Takeda announcing filing NDA for its product on January 4th. We have arrived at our target price including the probability adjusted DCF value, assuming 2011 launch in US and peak sales of US$1 bn by 2017. We believe that there are limited chances of earnings surprise as the management has proferred detailed guidance for FY2008E and FY2009E in November. We forecast milestone income of US$67 mn in 2HFY08E and 3QFY08E to account for the chunk of this. Asthma molecule with Forest has seen limited progress in 2HFY08E and negative news could lead to a correction in the share price. We recommend taking profit at these levels. We reiterate our REDUCE rating with a price target Rs480.

Glenmark announces chemical name for its diabetes molecule

Glenmark announced that its lead candidate for Type II Diabetes GRC 8,200 has received the International Non-proprietary Name (INN) – Melogliptin - from the World Health Organization (WHO). This name was made by the International Panel for Pharmacopoeia and Pharmaceutical Preparations. GRC 8200, Glenmark's lead DPPIV inhibitor, is a novel, oral DPPIV inhibitor in development for type 2 diabetes. It is currently in Phase II clinical trials.

Current status of the deal with Merck KGaA

The molecule was in-licensed by Merck but it announced in 2007 that it will either sell or partner out its existing research and development (R&D) activities in diabetes (under which GRC8200 falls), which it no longer wants to compete in effectively, according to Outsourcing-Pharma.com. According to an English translation of an internal memo circulated to Merck's employees in France, Elmar Schnee, the board member with responsibility for the pharmaceuticals business sector, wrote that: "An in-depth analysis of various strategic options demonstrated that Merck Serono's limited number of Type II diabetes pipeline candidates does not allow us to maintain a competitive position in the market." Merck has stated that rather than a licensing partnership, it is first and foremost "seeking a buyer for its research in diabetes". Merck hopes to complete any sale or licensing out of its diabetes business by the end of 2008.

DPP segment is getting crowded

On January 4, Japanese company Takeda announced that it submitted a New Drug Application to the US Food and Drug Administration for alogliptin belonging to this class. In addition, there are other molecules in this class. Merck's Januvia is already in the market. Novartis' Galvus has received approvable status from US FDA in February 2007 but it has not been approved yet. Bristol Myers and AstraZeneca are working on saxagliptin which is in Phase III trials.

Our target price is based on 2011 launch in USA

Our forecasts are based on the following assumptions relating to this product. At this point, we assume that molecule will complete its development phase and be in the US market in 2011 and in the other parts of the world shortly thereafter. Global peak sales are expected to reach US$1 bn in 2017 with 15% royalty on sales to Glenmark. We think current probability of launch of the product is about 27%. This will increase as molecule progresses further in development stage driving DCF value of molecule. At 15% cost of capital, we estimate the current value of the molecule is Rs13 per share and milestone income is worth additional Rs7 per share. We have included this in calculating Rs125 per share, the probability adjusted DCF value of research pipeline of Glenmark.

Limited scope for earnings surprise

Glenmark gives detailed financial guidance for the current fiscal year and the next two years. This reduces the chances of a large earnings surprise. We do not see any patent-challenge-based upside for the next couple of years. The only big difference can come due to exchange rate changes. Glenmark has based its forecast for FY2009E-2010E on Rs40/US$, but we have based ours Rs38/US$ for FY2009E and Rs37.5 for FY2010E. We forecast milestone income of US$67mn in 2HFY08E and 3Q to see most of this income. Asthma molecule with Forest has seen limited progress in 2HFY08E and negative news could lead to a correction in share price.

Progress on R&D will bring volatility to share price

In the next 12 months, we expect Glenmark and its partners to share clinical data results. This will make share prices extremely volatile before and after the announcement. Outlicensing deals for more molecules will also create positive sentiment for the share price. As more and more molecules progress through the pipeline, we expect Glenmark's share price to respond more to research-related news flow and less to generic business developments.

Forecasts and valuation, March fiscal year-ends, F2006-F2010E

	Net sales		Adjusted EBITDA		Net Profit		EPS	ROCE	ROE	P/E
	(Rs mn)	Growth(%)	(Rs mn)	Growth(%)	(Rs mn)	Growth(%)	(Rs)	(%)	(%)	(X)
2006	6,428	42.5	1,370	37.3	864	(18.8)	3.6	9.2	25.8	158.7
2007	10,442	62.4	3,300	140.9	3,093	258.0	13.0	17.8	58.5	44.3
2008E	15,807	51.4	5,698	72.6	5,921	91.4	23.4	20.8	48.1	24.7
2009E	19,679	24.5	7,481	31.3	6,868	16.0	25.8	20.4	32.6	22.3
2010E	25,981	32.0	9,973	33.3	8,436	22.8	31.7	21.8	29.6	18.2

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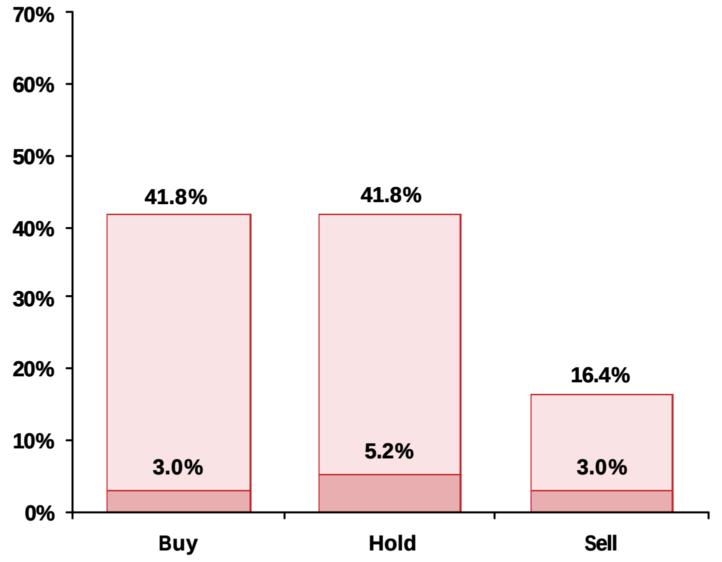

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Source: Kotak Institutional Equities. As of September 30, 2007

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

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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.

Old rating system

Definitions of ratings

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U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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

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