

**December 5, 2007**
**FOR PRIVATE CIRCULATION**
**Equity**

	4 Dec 07	% Chg		
		1 Day	1 Mth	3 Mths
<b>Indian Indices</b>				
Sensex	19,530	(0.4)	(0.3)	26.4
Nifty	5,858	(0.1)	0.2	30.9
Banking	10,797	(0.6)	(1.9)	34.7
IT	3,732	0.0	(4.3)	2.7
Healthcare	3,858	0.1	(0.9)	4.3
FMCG	2,178	0.3	7.4	8.8
PSU	9,873	1.0	0.5	37.1
CNX Midcap	8,309	1.2	11.2	34.8
<b>World indices</b>				
Nasdaq	2,620	(0.7)	(6.3)	0.5
Nikkei	15,480	(1.0)	(5.1)	(4.4)
Hangseng	28,880	0.8	(0.5)	19.6

**Value traded (Rs cr)**

	4 Dec 07	% Chg - 1 Day
Cash BSE	8,877	(1.7)
Cash NSE	19,771	(2.8)
Derivatives	56,330	2.8

**Net inflows (Rs cr)**

	3 Dec 07	% Chg	MTD	YTD
FII	114	(92)	114	67,170
Mutual Fund	449	(32)	449	3,345

**FII open interest (Rs cr)**

	3 Dec 07	% chg
FII Index Futures	16,464	(1.1)
FII Index Options	6,416	12.9
FII Stock Futures	44,898	4.8
FII Stock Options	37	17.6

**Advances/Declines (BSE)**

	4 Dec 07	A	B1	B2	Total	% Total
Advances	125	517	640	1,282	67	
Declines	90	231	271	592	31	
Unchanged	1	10	21	32	2	

**Commodity**

	4 Dec 07	% Chg		
		1 Day	1 Mth	3 Mths
Crude (NYMEX) (US\$/BBL)	88.4	0.1	(6.0)	16.7
Gold (US\$/OZ)	801.7	0.9	(0.5)	17.7
Silver (US\$/OZ)	14.3	1.1	(2.6)	17.3

**Debt/forex market**

	4 Dec 07	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.90	7.90	7.85	7.94
Re/US\$	39.42	39.50	39.35	40.90

**Sensex**


Source: Bloomberg

**ECONOMY NEWS**

- The government may increase the tax exemption ceiling on rental income from existing 30% to 50%. (ET)
- TRAI is setting up a panel on number portability which will also discuss issues relating to time taken for porting a number and porting fees. (BL)
- The government has decided to limit trade margins on all medicines sold in the country. The move is likely to take away companies' freedom to decide trade margins for almost three-fourths of the market. (ET)
- The pension regulator is pitching for income-tax exemption for contributions to the New Pension Scheme (NPS), akin to the one available for investments in Public Provident Fund (PPF) and government provident fund (GPF). (ET)
- Mutual fund assets took a 3.3% dip in November, 2007 from Rs.5567.3 bn to Rs.5379.4. (BL)

**CORPORATE NEWS**

- Portuguese cement maker, CIMPOR, has agreed to buy **Grasim Industries'** 53.3% stake in Digvijay Cement for about Rs 3.22 bn. (ET)
- Holcim, the world's second largest cement maker, has increased its stake in one of its Indian affiliates, **Ambuja Cements (ACL)**, through an open offer to 46%. (BS)
- Soros Fund Management LLC has picked up 5.8% stake in Ahmedabad-based **Gujarat Ambuja Exports (GAEL)**. (BS)
- Promoters of **Bajaj Electricals (BEL)** have made an voluntary open offer to acquire 12.10 lakh shares of BEL Rs 389 per share, a discount to today's closing price of Rs 428, to consolidate their holdings. (BS)
- **Air India** is planning to divest 10-15 per cent equity in its IPO next year. (BS)
- **Hindustan Construction Company (HCC)** is planning to float a wholly-owned infrastructure subsidiary to bid for public-private partnership (PPP) projects including airports. (BS)
- GTL International, a wholly-owned subsidiary of **GTL**, has acquired 100% stake in Strategic Communication Services (SCS), a network deployment company in North America, for an undisclosed amount. (BS)
- **Reliance Industries** and **GAIL India** joined hands to set up a multi-billion dollar petrochemical plants in gas-rich Middle-East, Central Asia or Russia. It will be a mega petrochemical plant with a capacity of 1.9-2 million tons (FE)
- **DLF** is foraying into asset management through a joint venture with the US-based Prudential Financial Inc. DLF will hold a minority stake of 39%, and Prudential will hold the remaining 61%. The two companies will jointly invest \$50 million in the new company (BS)
- **ONGC Videsh (OVL)** and the Hinduja group are in talks to seal a partnership with Switzerland-registered NICO, a subsidiary of the National Iranian Oil Company (NIOC). The OVL-Hinduja group JV proposes to pick up 50% stake in one of the world's largest gas fields and onshore oil block — South Pars and Azadegan. (ET)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, Tol: Times of India, BSE = Bombay Stock Exchange

## FROM OUR RESEARCH TEAM

### INITIATING COVERAGE

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## POWER FINANCE CORPORATION (PFC)

PRICE : Rs.249

RECOMMENDATION : HOLD

TARGET PRICE : Rs.252

FY09E PE : 19.5x

With a well-structured lending portfolio post interest rate restructuring in December 2005, and discreet asset quality management system, PFC is all geared for strong business growth. Given the robust capex requirement in the power sector under the 11th Five year plan, the company's loan book is expected to grow at a CAGR of 24% over the next 5 years. Prudent asset liability management of the company would help the company in maintaining stable spreads at around 2%. Firm spreads along with strong business growth would boost company's core operating performance. While thrust on fee income from the consultation and advisory for setting up a power project and UMPP's would boost PFC's overall profitability.

Based on our calculations using the two methods - dividend discount model and two stage PBV, we have arrived at a fair value of Rs.238 and Rs.266 respectively. On assigning an equi-weight to the two methods, we arrive at a price target of Rs.252. PFC is currently trading at Rs 249, which is 19.5x its FY2009E EPS of Rs.12.8 and 2.8x its FY2009E Adjusted Book Value of Rs.88.8. The stock offers marginal upside from the current levels. We recommend a HOLD on the stock with a price target of Rs 252. In the event of a positive announcement from ICAI regarding deferred tax liability (DTL) issue, the stock may provide decent upside from the current levels (Please refer Page 11).

### Investment Arguments

- **Robust Business growth:** With the addition of 78602MW of power generation capacity in the Eleventh Five Year plan over FY2007-2012, key financiers for the power sector like Power Finance Corporation (PFC), have great opportunity lying ahead. Given the huge capex required of (\$260) bn in the power sector and PFC's market share of 20%, we expect PFC's Loan book to grow at CAGR of 24% over a period of next 5 years.
- **Prudent Asset Liability Management to support margins:** Superior credit rating has helped the company fetch funds at a relatively competitive rate. The company has a prudent mix of assets and liabilities with well balanced maturity have helped the company in improving its spread. The company has a reset clause in place for ~55% of its loans getting re-priced every 3yrs while around 39% is fixed, and the balance 6% are floating and short term loans. The interest due on outstanding loans is received as Equated Quarterly Interest. As against this, ~13% of the borrowings at floating rate.
- **Thrust on fee income:** Under its advisory and consultancy umbrella, PFC is planning to generate significant income from setting up of UMPP projects. During H1FY08, PFC has earned a fee income of around Rs.130 mn. However, going forward, the management has to charge a fee income of Rs.150 mn per project. Presently PFC has around 19 assignments for consultancy valued at Rs.492 mn, while another 14 project are in the pipeline.
- **Lean structure leads to higher operating efficiency:** The centralized and lean organizational structure leads to lower cost of operation. PFC's cost to income ratio and operating expenses to average assets ratio remained significantly lower at 4.5% and 0.2% respectively. Operating efficiency of the company would remain superior. PFC's cost to income ratio and operating expenses to average assets is likely to remain at 4.2% and 0.2%, respectively for FY2009E.

### Summary table (year end Mar)

Rs bn	FY06	FY07	FY08E	FY09E
Income from opn	29.3	37.4	49.1	61.4
Interest expenses	17.9	23.1	30.8	39.2
Net interest income	11.4	14.3	18.3	22.2
Other Income	0.6	0.4	0.5	0.7
Total Income	12.0	14.7	18.8	22.9
Operating Profit	11.5	14.1	18.0	22.0
PAT	9.7	9.9	12.0	14.7
Gross NPA (%)	0.3	0.1	0.1	0.2
Net NPA (%)	0.2	0.1	0.1	0.1
NIM (%)	3.5	3.6	3.7	3.6
RoA (%)	2.8	2.3	2.3	2.3
RoE (%)	15.5	13.1	13.4	15.1
Dividend Payout (%)	37.2	30.4	35.0	35.0
EPS (Rs)	9.4	8.6	10.5	12.8
BV (Rs)	63.1	74.9	81.2	88.8
Adj. Book Value (Rs)	62.3	74.5	80.5	87.9
P/E (x)	26.5	29.1	23.8	19.5
P/BV (x)	4.0	3.3	3.1	2.8

Source: Company & Kotak Securities - Private Client Research

- **Increasing leverage to boost:** The lever for the company remains as low as 5x its average networth. The maximum permissible leverage for NBFCs, according to RBI guidelines is 10x. Considering the strong growth in the company's loan book and the Government's ongoing power sector reforms and capacity expansion plans under the Eleventh Five Year Plan, leverage of the company is expected to go up significantly. We expect PFC leverage to increase to over 7x by FY2009E. Higher leverage would facilitate the company in boosting its return ratios, which will support re-rating for the stock.
- **Improvement in return ratios:** On the back of firm RoA at around 2.2% and lower leverage of 5x, PFC's RoE remained lower in the past at 13%. However, with the increasing leverage following robust business growth, return ratios of the company are expected to improve. We expect PFC's RoA to improve to 2.2% and RoE of 15% in FY2009E.
- **Reversal of Deferred Tax Liability:** Being a long term infrastructure financing company, PFC is eligible for tax benefit pertaining to creation of special reserve, to the extent of 20% of net profits under section 36 (1) (viii) of Income tax Act. Following a relative conservative accounting policy PFC has created a deferred tax liability in its books in context of such tax benefit available to the company. The Company as on 30th Sept 2008 had Rs 11940mn in its books as deferred tax liability. ICAI is considering the issue of allowing the company to avail this benefit with retrospect impact. In case this is allowed, this would boost company's RoE and profitability significantly with reduction in effective tax to 26% from the existing 33%. In this case our fair value for the stock will rise to Rs.291. (Please refer Page 11)

## Risks & Concerns

- **Bank's cap on lending to NBFCs can restrict fund borrowings:** A bank's lending to non-deposit taking NBFCs has been restricted to 15% of their networth. This can restrict the sources of funding for a non-deposit taking NBFC like PFC. However, with the superior credit ratings, the company can raise funds through bonds and debenture route, which is a relatively cheaper source of funds.
- **No access to low-cost funds, leads to strong competition with banks:** PFC does not have access to low-cost funds (current accounts and savings accounts). This leads to a higher differential in the cost of funds of a bank and NBFC. However, the significantly lower cost of operation and the benefits available to PFC in terms of provisioning norm relative to banks and other Financial Institutions would continue to facilitate PFC, in maintaining its lending rate at competitive levels
- **Larger focus on public sector lending:** As on 30th Sept. 2007, ~92% of PFC's lending portfolio consisted of loans to State and Central public utilities, while the remaining 8% comprised of lending to private sector. Considering the past track record of state power utilities, higher exposure to these entities can affect the company's asset quality in the event of poor performance of these entities. However, the company is looking forward to increasing its exposure to private players as well, to balance its lending portfolio. PFC is diversifying into other segments to de-risk its loan portfolio by extending exposure to not only power generation capacity but also to transmission and distribution, merchant power and private players.
- **Un-hedged forex loan:** Foreign currency loans pegged against a basket of currencies including Japanese yen, US dollar and Euro, comprising 7% of PFC's total borrowings. Of this, 54% is hedged while about 46% is un-hedged open position. This un-hedged open forex position could lead to MTM losses due to exchange rate fluctuations. However, we believe this would have only an insignificant impact on the companies earning as this portion comprises only 3.25% of the total borrowing and approximately 13.1% of the company's networth (excluding deferred tax liability)
- Negative trends in the Indian Power Sector or the Indian economy could negatively impact company's financial performance.

## Bulk deals

Trade details of bulk deals					
Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. Price (Rs)
4-Dec	Axon Infotec	Axon Infotec	S	5,417	131.28
4-Dec	Bella Ste Al	JMP Securities	B	1,746,262	6.39
4-Dec	Carnatio Ind	Rahul Priyadarshi Doctor	B	25,000	61.55
4-Dec	Carnatio Ind	Sun Investment and Trading	S	134,130	61.55
4-Dec	Carnatio Ind	Upturn Securities	S	31,268	61.55
4-Dec	Comp-U-Learn	Mukesh Kumar Agarwal	S	98,000	5.79
4-Dec	Empower Inds	Dewang D Master	S	27,161	17.69
4-Dec	Epic Energy	Hardik M Mithani	B	34,404	162.37
4-Dec	Gemstone Inv	Bharat S Thakker	B	50,000	26.71
4-Dec	Gemstone Inv	Alpesh Arvind Patel	B	20,000	26.73
4-Dec	Greycells En	Tanivin Trade Finance	B	37,000	401.03
4-Dec	HaryaCapfin	KS Account PMS	S	28,542	60.68
4-Dec	HB Lea Fin C	Vijay Kumar Agarwal	S	68,143	25.60
4-Dec	IFL Prmoter	Shark Communication	S	25,000	21.00
4-Dec	Jindal South	Rel Cap MF Account Tax Saver Elss	S	59,807	1,214.57
4-Dec	K Sera Sera	Oudh Finance Investment	S	110,025	35.06
4-Dec	Kashyap Tec	Mavi Investment Fund Ltd Ac GDR	S	900,000	3.58
4-Dec	Kashyap Tec	Lotus Global Investment Ltd Ac GDR	S	900,000	3.57
4-Dec	Khaitan Wvg	Harvard Trading	B	4,000	403.27
4-Dec	Khaitan Wvg	Kirtikumar N Mehta	S	9,000	402.95
4-Dec	Kirti Finves	ENCA Finlease	B	1,090,450	0.74
4-Dec	Kirti Finves	Highway Dealers Pvt Ltd.	S	454,492	0.74
4-Dec	Nouvea Multi	Tammansa D Katwa	B	35,000	31.53
4-Dec	Nouvea Multi	Ravish Tammansa Katwa	B	35,000	31.10
4-Dec	Nouvea Multi	Katwa Kanchanmala T	B	35,000	31.10
4-Dec	Nouvea Multi	Arunoday Holding	S	50,000	31.10
4-Dec	Oriental	Rajkumar Shyamsunder Bidwatka	B	155,000	26.66
4-Dec	Paras Petrof	Falgun Financial Services	B	2,500,000	1.94
4-Dec	Patel Airtem	Ratandevi Mehta	S	48,036	92.95
4-Dec	Pyramid Saim	UBS Securities Asia Ltd	S	227,846	340.24
4-Dec	RK Forgings	Prism Impex Pvt Ltd	B	204,903	180.05
4-Dec	RK Forgings	Indian Institutional Fund Ltd	S	210,000	180.05
4-Dec	Roselabs Fin	Aabtac Lifecare Pvt.Ltd.	B	370,000	10.70
4-Dec	Roselabs Fin	Shree Trilok Dye Synth Pvt Ltd.	S	370,000	10.70
4-Dec	Spectra Indu	Vishu Enterprise	S	50,000	21.85
4-Dec	Uniroyal In	Vishal Agarwal	S	69,030	6.10
4-Dec	Unity Infra	Intime Spectrum Securities	S	79,985	686.85
4-Dec	Unity Infra	Pegasus Stocks and Shares Pvt. Ltd.	S	80,000	685.20
4-Dec	Visesh Infot	Lokesh Kapoor	S	350,000	33.85
4-Dec	Yash Mana Sa	Nikunj Alloys and Steel Pvt Ltd.	B	105,000	15.01

Source: BSE

## Gainers & Losers

Nifty Gainers & Losers				
	Price (Rs)	% change	Index points	Volume (mn)
<b>Gainers</b>				
SAIL	285	8.5	16.3	20.4
Tata Steel	873	3.6	3.9	2.3
BHEL	2,818	1.5	3.6	0.8
<b>Losers</b>				
Reliance Ind	2,863	(2.5)	(18.6)	2.6
ONGC	1,158	(1.1)	(4.7)	1.0
ICICI Bank	1,140	(1.9)	(4.3)	2.6

Source: Bloomberg

## Forthcoming events

COMPANY/MARKET	
Date	Event
5-Dec	Apar Industries holds press meet for its strategic tie-up
6-Dec	Motor Industries - Boss group holds press meet on India plans; Raymond holds press meet to announce new business initiative
14-Dec	MRF to announce earnings and final dividend

Source: Bloomberg

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