kotak® Institutional Equities

INDIA DAILY

October 22, 2008

Contents

Results

Idea Cellular: Rapid expansion will keep performance in check. Maintain REDUCE

Hero Honda: Net profit in line with expectations, expect volumes to come off post festival season; cut TP to Rs770, retain REDUCE

Power Finance Corporation: Core performance strong, in line with estimates

Hindustan Zinc: Strong quarter in a bleak environment

Jaiprakash Associates: 2QFY09: Strong growth in construction revenues compensates misses in other business'

United Spirits: Quarter impacted by high input prices

Zee Entertainment Enterprises: Largely in-line 2QFY09 results on strong revenue growth; upgraded to BUY

Tech Mahindra: Margin expansion takes care of operating performance even as revenue performance slips

LIC Housing Finance: Sharp growth in home loans, core performance in line; retain ADD

Polaris Software Lab: A good quarter - surviving the BFSI turmoil for now. We see challenges ahead. Maintain SELL

Updates

Reliance Petroleum: Refinery on the verge of completion but global refining margins under pressure

IRB Infrastructure Developers: Will likely benefit from declining commodity and interest costs, however, valuations imply low traffic growth and high interest costs in perpetuity; reiterate BUY

Pharmaceuticals: Indian Pharma: Generics business may be hit by ongoing credit crisis

News Roundup

Corporate

- **Hindalco Industries**, the flagship company of the **Aditya Birla** group, may sell stakes in group companies to raise funds to repay a part of the $3-billion bridge loan it obtained to buy Novelis. (BS)
- Global pharma majors such as **Novartis**, **Roche** and **Pfizer** have secured 392 medicine patents in less than three years of India changing its patent laws to allow product patenting system for drugs in the country. While Swiss multinational Hoffmann La Roche leads the tally with 34 patent grants, Novartis AG and Pfizer Inc follow closely with 25 and 24 respectively. (BS)

Economic and political

- The government and the Reserve Bank of India (RBI) are looking at easing external commercial borrowings (ECB) guidelines and foreign direct investment (FDI) norms to enhance overseas fund flows.

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

EQUITY MARKETS

		Change, %		
India	**21-Oct**	**1-day**	**1-mo**	**3-mo**
Sensex	10,683	4.5	(23.9)	(22.9)
Nifty	3,235	3.6	(23.8)	(22.2)
Global/Regional indices				
Dow Jones	9,034	(2.5)	(20.7)	(21.2)
FTSE	4,230	(1.2)	(20.4)	(21.7)
Nikkie	9,034	(2.9)	(25.3)	(31.5)
Hang Seng	15,041	(1.8)	(23.4)	(33.2)
KOSPI	1,173	(1.9)	(19.7)	(24.8)

Value traded - India

			Moving avg, Rs bn	
	21-Oct		**1-mo**	**3-mo**
Cash (NSE+BSE)	149.0		169.9	172.7
Derivatives (NSE)	512.7		739.7	528
Deri. open interest	731.6		893	744

Forex/money market

		Change, basis points		
	21-Oct	**1-day**	**1-mo**	**3-mo**
Rs/US$	49.0	0	357	635
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.6	(12)	(81)	(149)

Commodity market

		Change, %		
	21-Oct	**1-day**	**1-mo**	**3-mo**
Gold (US$/OZ)	771.5	(0.0)	(14.0)	(18.5)
Silver (US$/OZ)	10.1	(0.5)	(25.2)	(44.0)
Crude (US$/BBL)	66.8	(0.3)	(35.9)	(48.3)

Net investment (US$mn)

	20-Oct		**MTD**	**CYTD**
FIIs	(208)		(2,683)	(11,908)
MFs	45		24	3,196

Top movers -3mo basis

		Change, %		
Best performers	**21-Oct**	**1-day**	**1-mo**	**3-mo**
Union Bank Of India	151	(3.3)	0.7	18.0
Maruti Suzuki India	677	3.2	(6.1)	15.3
Hero Honda Motors	825	2.3	0.9	13.6
Bajaj Auto Limited	561	3.6	(7.7)	13.3
Tata Communicatio	467	0.5	1.7	11.7
Worst performers				
Housing Developme	152	19.9	(31.7)	(57.7)
Bajaj Finserv Ltd	150	(3.0)	(61.4)	(64.2)
Jsw Steel Limited	268	3.0	(55.0)	(63.2)
Welspun-Gujarat St	131	5.2	(48.6)	(58.3)
Jindal Steel & Powe	793	1.7	(47.4)	(57.6)

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

Telecom

IDEA.BO, Rs54	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	70
52W High -Low (Rs)	155 - 52
Market Cap (Rs bn)	174.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	67.2	106.5	161.2
Net Profit (Rs bn)	10.4	10.7	11.8
EPS (Rs)	3.9	3.3	3.4
EPS gth	*78.5*	*(17.6)*	*5.7*
P/E (x)	13.7	16.6	15.7
EV/EBITDA (x)	10.2	6.5	5.6
Div yield (%)	-	-	-

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.7	-	-
FIIs	11.3	0.4	(0.3)
MFs	1.7	0.4	(0.4)
UTI	-	-	(0.7)
LIC	2.5	0.4	(0.3)

Idea Cellular: Rapid expansion will keep performance in check. Maintain REDUCE

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243
Rohit Chordia : rohit.chordia@kotak.com, +91-22-6634-1397

- **Valuations now partly reflect our concerns on pricing and profitability**
- **Pushback in EBITDA breakeven for new circles disappointing**
- **Maintain REDUCE rating with a revised DCF-based target price of Rs70/share**

We have taken stock of heightened competition in the sector and the weak rollout of operations in new circles. Accordingly, we have significantly altered our long-term profitability assumptions. We assume long-term EBITDA margins of 30% as compared to 37% earlier, fair given that a fourth or a fifth operator in any circle has significantly lower margins than the leader. Note that Idea's profitability in the Delhi circle (where it was the fourth operator) is still at least ~7-8%pts lower than the other 'established circles'. We have reduced our long-term ARPU, RPM assumptions and modeled network rollout in all circles by FY2010. We have reduced our FY2009E, FY2010E and FY2011E EPS to Rs3.3 (-29%), Rs3.4 (-38%) and Rs4.5 (-34%), respectively (the revised EPS also builds in increased shares outstanding post preferential allotment to Telekom Malaysia). We believe that Idea can create significant value after 2-3 years assuming flawless execution; however, we have little visibility on this and have to contend with a deteriorating competitive environment. We maintain our REDUCE rating with a revised 12-month DCF-based target price of Rs70 (Rs100 earlier). Our estimates (earnings and cash flows) are consolidated for a proportionate stake in Indus Towers; accordingly, we do not assign a separate option value for the business.

Valuations partly reflect the risks to profitability. We have long argued that (1) pricing assumptions matter more for valuations than volume assumptions and (2) our pricing and profitability assumptions may be at risk in a more competitive environment. We were, however, taken by surprise by the severity of the decline in profitability in established circles (Exhibit 1). We believe that a part of the reasons for the decline in margins appears to be Idea's higher carriage charges given the non-integrated nature of the business. We also believe that Idea's planned expansion in the remaining circles may not be value accretive. Exhibit 2 has the key changes to our earnings model, Exhibit 3 is our summary earnings model and Exhibit 4 is our DCF valuation model for Idea.

We have made the following adjustments to our earnings model:

1. **Spice acquisition and preferential allotment of shares to Telekom Malaysia.** We model Spice's financials for 2HFY09. After buying out Modi's 40.8% stake in Spice, the subsequent legs of the transaction i.e. open offer, infusion of funds from Telekom Malaysia are completed. Completion of merger formalities may take longer. The management has not specified whether it has got a 50% or higher stake in Spice; hence, we are not sure about the method of consolidation for the December quarter, though for FY2010 Spice would be merged and TM's holding in Spice would be swapped with Idea shares. Exhibit 5 explains the entire Spice transaction including its funding through a preferential allotment of shares to Telekom Malaysia. Note that Spice has a presence in two circles i.e. Punjab and Karnataka, with a subscriber base of 3.6 mn and spectrum in the 900 MHZ band. We also use the revised equity share of 3,266 mn in our model.

2. **Indus Towers and Providence PE deal.** We now incorporate proportionate consolidation of the Indus JV starting Nov' 08. Idea management indicated that the IRU for old tower usage (towers to be transferred by the JV partners) will become effective starting Nov 1, 2008. We note that model rental payment for towers constructed by Indus is already consolidated by Idea. We also incorporate the likely inflow of US$640 of cash, courtesy part monetization of Indus Towers stake. This deal was structured through the placement of a 20% stake in ABTL to Providence Equity Partners, for US$640 mn; ABTL holds a 16% stake in Indus and Bihar license.
3. **We model the start of operations in the Bihar and Orissa circles in 2HFY09, Tamil Naidu/ Chennai in 1QFY10 and the remaining circles in 2HFY10.** Management indicated that the EBITDA break-even target in new circles will continue to be 20-30 months. The company has achieved EBITDA break-even in the UP (E) circles while Rajasthan and Himachal Pradesh may take some more time to achieve EBITDA break-even.

Further thoughts on the operating margin performance. We expect Idea's EBITDA margins to remain below 30% for the next three years, as the company remains in an investment mode. Idea management stated at the earnings call that OPM was partly impacted by elevated spends on advertisement and that this would decline in absolute levels over the next two quarters. Further, the management stated that the impact on operating margin was exaggerated by a seasonally weak quarter for volumes (total minutes carried up only 9.8% qoq) whereas the growth in cell sites was a strong 15% qoq. This, coupled with an overheads build-up for the launch of operations in Mumbai and Bihar, and an increase in employee costs, contributed to the margin pressure (Exhibit 6). The company also had marginal impact on margins resulting from being a guest on 56% incremental towers set up in the past six months.

We were, however, taken by surprise by the steep decline in margin in the existing circles. The decline in EBITDA margins in existing circles highlights three issues. (1) The challenges of being a non-integrated player. Idea's interconnection costs have increased further to 18.6% of revenues versus 18.2% in 1Q and 16.3% in the same quarter of the previous year. Idea does not own an integrated national backbone leading to dependence on other players for carrying long distance traffic. Bharti had increased NLD carriage charges in mid-1Q. Idea expects to substantially increase its captive NLD minutes by end-FY2009 from 15% currently. (2) Higher sales and marketing costs—while Idea stepped in sales and marketing spend to 14.3%, this is still lower than Bharti (14.7% of revenues in 1QFY09). The competition has taken a slew of measures including increase ad spend and increase in distributor commissions to accelerate subs addition.(3) The pace of decline in tariff appears to be faster than the economies of scale.

We also struggle to make a positive NPV case for the rollout of operations in new circles. A number of factors work against the company including spectrum in the 1,800 MHz band, lower quality of incremental subscribers, lower tariffs, more competition etc. Further, financials are impacted as the company would be in an investment mode in atleast 10 of the 23 circles (not counting Punjab and Karnataka), not an exciting prospect. In any case, the company had delays in achieving EBITDA break-even in circles in three circles in which it launched operations 24-30 months ago. We believe that EBITDA break-even in new circles for Idea may take longer.

Robust balance sheet after TM investment and part monetization of stake in the subsidiary. Idea's balance sheet has strengthened significantly after (1) cash inflow from 15% preferential allotment to Telekom Malaysia as a part of the Spice acquisition transaction; (2) sale of 20% stake in ABTL (which holds Idea's 16% stake in Indus towers and license for the Bihar circle) to Providence Equity partners for US$640 mn. These two transactions have led to a net cash inflow of ~Rs60 bn into Idea after paying for the Spice acquisition (including the non-compete fees paid to the Modi group). As a result, we estimate Idea's net debt to equity at 0.34X at end-FY2009E versus 1.7X at end-FY2008. We expect net debt/ EBITDA of 1.6X in FY2009E and 2.1X in FY2010E. Idea's management indicated that it has sufficient funding for 2G capex for the next 12 months (3G investments would require incremental funding, though).

Capex guidance of US$1.7-1.8 bn for FY2009E. Idea has guided for a capex of Rs75-80 bn for FY2009E. The capex guidance includes capex for the existing circles including Mumbai and Bihar, new network rollouts in Chennai and TamilNadu, and capex on NLD backbone. The guidance does not factor in any 3G capex or incremental capex in Punjab and Karnataka (Spice's operating circles), or new circles (pending spectrum grant).

Significant margin pressure was evident in old circles as well
Idea's margin performance, 4QFY07-2QFY09

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Revenues (Rs mn)							
Old circles (a)	13,195	14,776	15,643	17,103	19,852	21,781	22,985
New circles (b)							52
Total	13,195	14,776	15,643	17,103	19,852	21,781	23,037
EBITDA (Rs mn)							
Old circles	4,473	5,136	5,128	5,694	6,734	7,203	6,405
New circles							(337)
Total	4,473	5,136	5,128	5,694	6,734	7,203	6,068
EBITDA margin (%)							
Old circles	33.9	34.8	32.8	33.3	33.9	33.1	27.9
New circles							(648)
Total	33.9	34.8	32.8	33.3	33.9	33.1	26.4

Note:
(a) A.P., Delhi, Gujarat, M.P., Maharashtra, Haryana, Kerala, U.P. (West), H.P., Rajasthan, U.P.(East)
(b) Mumbai

Source: Company data

Idea Cellular--summary of key changes to the earnings model, March fiscal year-ends, 2009E-2017E

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues (Rs mn)									
Revised	106,489	161,219	195,755	221,650	241,880	257,145	269,518	278,420	285,263
Old	97,334	125,914	150,744	168,185	184,244	197,251	208,276	216,370	222,778
Change (%)	**9.4**	**28.0**	**29.9**	**31.8**	**31.3**	**30.4**	**29.4**	**28.7**	**28.0**
EBITDA (Rs mn)									
Revised	29,408	40,404	49,692	60,205	67,074	72,624	77,648	81,637	84,930
Old	31,152	41,459	50,800	58,246	64,768	69,870	74,529	78,317	81,862
Change (%)	**(5.6)**	**(2.5)**	**(2.2)**	**3.4**	**3.6**	**3.9**	**4.2**	**4.2**	**3.7**
EBITDA margin (%)									
Revised	27.6	25.1	25.4	27.2	27.7	28.2	28.8	29.3	29.8
Old	32.0	32.9	33.7	34.6	35.2	35.4	35.8	36.2	36.7
Change (bps)	**(438.9)**	**(786.5)**	**(831.5)**	**(747.0)**	**(742.3)**	**(717.9)**	**(697.4)**	**(687.5)**	**(697.3)**
EPS (Rs)									
Revised	3.3	3.4	4.5	5.7	7.2	8.2	8.9	10.0	11.1
Old	4.6	5.5	6.8	7.9	9.4	10.6	11.4	12.6	13.3
Change (%)	**(28.8)**	**(37.7)**	**(34.3)**	**(27.5)**	**(23.6)**	**(23.3)**	**(22.1)**	**(20.7)**	**(16.2)**
Subscribers (mn)									
Revised	40.6	52.3	61.3	67.7	72.5	76.2	79.0	81.2	82.9
Old	35.9	45.8	53.3	59.2	63.9	67.7	70.7	73.1	75.1
Change (%)	**13.0**	**14.2**	**14.9**	**14.3**	**13.4**	**12.5**	**11.7**	**11.0**	**10.4**
MOU (min/month)									
Revised	449	459	464	468	472	476	479	480	480
Old	438	446	451	455	460	464	467	468	468
Change (%)	**2.6**	**2.8**	**2.7**	**2.7**	**2.6**	**2.6**	**2.5**	**2.5**	**2.5**
ARPU (Rs/month)									
Revised	260	254	250	249	249	249	250	250	249
Old	270	256	253	248	249	249	250	250	250
Change (%)	**(3.7)**	**(0.8)**	**(0.9)**	**0.1**	**0.0**	**(0.0)**	**(0.1)**	**(0.1)**	**(0.1)**
RPM (Rs/min)									
Revised	0.58	0.55	0.54	0.53	0.53	0.52	0.52	0.52	0.52
Old	0.62	0.57	0.56	0.55	0.54	0.54	0.54	0.53	0.53
Change (%)	**(6.1)**	**(3.5)**	**(3.5)**	**(2.5)**	**(2.5)**	**(2.6)**	**(2.6)**	**(2.6)**	**(2.6)**
EPM (Rs/min)									
Revised	0.17	0.16	0.16	0.17	0.17	0.17	0.17	0.18	0.18
Old	0.20	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.20
Change (%)	**(14.8)**	**(16.6)**	**(16.9)**	**(12.2)**	**(11.4)**	**(10.3)**	**(9.3)**	**(8.7)**	**(8.6)**
Capex (Rs mn)									
Revised	80,230	60,170	48,962	39,834	30,968	29,738	28,781	29,544	28,961
Old	64,817	63,175	37,017	32,216	31,573	31,699	30,563	28,339	27,843
Change (%)	**23.8**	**(4.8)**	**32.3**	**23.6**	**(1.9)**	**(6.2)**	**(5.8)**	**4.3**	**4.0**
Capex/sales (%)									
Revised	79.5	42.5	28.7	20.7	14.8	13.4	12.4	12.3	11.8
Old	66.8	50.3	24.6	19.2	17.2	16.1	14.7	13.1	12.5
Change (bps)	**1,270**	**(781)**	**407**	**149**	**(239)**	**(273)**	**(234)**	**(82)**	**(74)**

Source: Kotak Institutional Equities estimates

Consolidated profit and loss for Idea Cellular, March fiscal year-ends, 2007-2017E (Rs mn)

	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues											
Consolidated revenues	**43,664**	**67,200**	**106,489**	**161,219**	**195,755**	**221,650**	**241,880**	**257,145**	**269,518**	**278,420**	**285,263**
Interconnection costs	(7,321)	(11,334)	(18,662)	(25,750)	(30,713)	(34,258)	(37,054)	(39,093)	(40,703)	(41,749)	(42,481)
License fees and spectrum charges	(4,487)	(6,851)	(11,332)	(15,893)	(19,138)	(21,570)	(23,443)	(24,864)	(26,034)	(26,860)	(27,497)
Network operating costs	(5,336)	(10,470)	(22,179)	(42,794)	(52,635)	(57,352)	(62,140)	(65,555)	(68,095)	(69,846)	(71,075)
Sales and marketing expenses	(7,649)	(9,649)	(15,142)	(21,932)	(26,322)	(28,969)	(31,112)	(32,556)	(33,727)	(34,358)	(34,778)
Employee costs	(2,609)	(3,464)	(5,405)	(8,617)	(10,226)	(11,324)	(12,348)	(13,163)	(13,557)	(13,880)	(14,155)
G&A costs	(1,610)	(2,914)	(4,362)	(5,829)	(7,029)	(7,971)	(8,709)	(9,287)	(9,753)	(10,090)	(10,347)
Consolidated EBITDA	**14,653**	**22,518**	**29,408**	**40,404**	**49,692**	**60,205**	**67,074**	**72,624**	**77,648**	**81,637**	**84,930**
Other income incl. Interest income	209	175	591	651	431	395	445	617	431	1,027	2,854
Interest expense	(3,051)	(2,776)	(5,827)	(7,506)	(8,319)	(8,787)	(7,721)	(5,793)	(3,157)	(1,722)	(1,764)
Amortization of entry fee	(1,081)	(1,199)	(1,175)	(1,548)	(1,540)	(1,527)	(1,527)	(1,527)	(1,527)	(1,527)	(1,527)
Depreciation	(5,637)	(7,569)	(11,305)	(18,705)	(22,899)	(26,780)	(28,623)	(31,565)	(33,190)	(34,085)	(34,050)
Pretax profits	**5,093**	**11,148**	**11,692**	**13,296**	**17,365**	**23,507**	**29,648**	**34,357**	**40,206**	**45,331**	**50,443**
Extraordinary income/(charges)	—	—	—	—	—	—	—	—	—	—	—
Prior period adjustments	—	—	—	—	—	—	—	—	—	—	—
Current tax expense	(0)	(426)	(261)	(871)	(1,240)	(3,326)	(4,152)	(7,552)	(10,880)	(12,433)	(13,733)
Deferred tax (liability)/asset	—	(299)	(774)	(674)	(774)	(474)	(674)	926	926	926	926
Minority interest expense	—	—	(129)	(617)	(912)	(1,223)	(1,464)	(1,349)	(1,452)	(1,529)	(1,583)
Reported net profits	**5,092**	**10,423**	**10,528**	**11,133**	**14,439**	**18,484**	**23,358**	**26,382**	**28,800**	**32,295**	**36,053**
Adjusted net profits	**5,092**	**10,423**	**10,528**	**11,133**	**14,439**	**18,484**	**23,358**	**26,382**	**28,800**	**32,295**	**36,053**
Adjusted EPS (Rs)											
Year end	2.0	3.9	3.3	3.4	4.5	5.7	7.2	8.2	8.9	10.0	11.1
Primary	2.2	3.9	4.0	4.2	5.5	7.0	8.9	10.0	10.9	12.2	13.7
Fully diluted	2.2	3.9	3.3	3.4	4.5	5.7	7.2	8.2	8.9	10.0	11.1
Growth (%)											
Revenues	47	54	58	51	21	13	9	6	5	3	2
EBITDA	37	54	31	37	23	21	11	8	7	5	4
Net profits	154	105	1	6	30	28	26	13	9	12	12
EPS	150	79	(18)	6	30	28	26	13	9	12	12
Margin (%)											
EBITDA	33.6	33.5	27.6	25.1	25.4	27.2	27.7	28.2	28.8	29.3	29.8
EBIT	18	20	16	12	13	14	15	15	16	17	17
0	-	-	-	-	-	-	-	-	-	-	-
Current tax rate (%)	0.0	3.8	2.2	6.6	7.1	14.1	14.0	22.0	27.1	27.4	27.2
0	—	—	—	—	—	—	—	-	-	-	-
DPS (for a Rs10 share)	—	—	—	—	—	—	—	-	2.5	3	4

Source: Kotak Institutional Equities estimates

Discounted cash flow valuation of Idea Cellular (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	29,408	40,404	49,692	60,205	67,074	72,624	77,648	81,637	84,930
Tax	(391)	(1,363)	(1,834)	(4,569)	(5,234)	(8,825)	(11,734)	(12,905)	(14,213)
Change in working capital	5,172	(8,599)	884	(1,616)	(1,568)	2,728	3,488	4,875	4,687
Post-tax operating cash flow	**34,188**	**30,441**	**48,743**	**54,020**	**60,272**	**66,528**	**69,402**	**73,606**	**75,404**
Capex	(74,145)	(60,170)	(48,962)	(39,834)	(30,968)	(29,738)	(28,781)	(29,544)	(28,961)
Free cash flow	**(39,957)**	**(29,729)**	**(219)**	**14,186**	**29,304**	**36,789**	**40,621**	**44,062**	**46,443**

	+ 1-year	**WACC and growth in perpetuity assumptions**	
PV of cash flows	91,068	**Terminal growth - g (%)**	**4.0**
PV of terminal value	153,005	**WACC (%)**	**14.5**
EV	244,073		
Net debt	14,937		
Equity value (Rs mn)	**229,137**		
Equity value (US$ mn)	**5,728**		
Shares outstanding (mn)	3,236		
Equity value (Rs/Idea share)	**71**		
Exit FCF multiple (X)	9.5		
Exit EBITDA multiple (X)	**5.4**		

Key assumptions (%)	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**
Revenue growth	58.5	51.4	21.4	13.2	9.1	6.3	4.8	3.3	2.5
EBITDA growth	30.6	37.4	23.0	21.2	11.4	8.3	6.9	5.1	4.0
EBITDA margin	**27.6**	**25.1**	**25.4**	**27.2**	**27.7**	**28.2**	**28.8**	**29.3**	**29.8**
Capex/sales	69.6	37.3	25.0	18.0	12.8	11.6	10.7	10.6	10.2
Cash tax rate	2.2	6.6	7.1	14.1	14.0	22.0	27.1	27.4	27.2
Effective tax rate	8.9	11.6	11.6	16.2	16.3	19.3	24.8	25.4	25.4
Return on avg. capital employed	**18.6**	**11.5**	**8.8**	**9.4**	**10.2**	**11.6**	**11.4**	**12.0**	**13.4**

Source: Kotak Institutional Equities estimates

Idea—Spice acquisition transaction dynamics

Pre-deal			
Spice		**Transaction prices**	
# of shares	690	Spice (Rs/share)	77.3
% holding		Idea (Rs/share)	156.96
BK Modi group	40.8		
Telekom Malaysia (TM)	39.2	**EV/EBITDA at transaction price (X)**	
Others	20.0	Spice	20.3
Transaction dynamics			
Idea pays Spice group for 40.8% in Spice (Rs mn)	21,759		
Idea pays Spice Group for non- compete agreement	5,440		
Idea shares issued to TM for 49.2% stake in Spice (mn)	166.3	Swap ratio of 49:100	
Post-share swap equity share of Telekom Malaysia (in Idea)	5.9		
Further equity issuance to TM	464.7		
TM pays to Idea	72,944		
Post-equity issuance TM holding in Idea	19.3		
Open offer (residual 20% at open offer price of Rs77.3)			
Idea shells out for open offer (Rs mn)	5,333		
Total amount that Idea pays in cash (Rs mn)	32,532		
Idea gets from TM (Rs mn)	72,944		
Debt assumed (Rs mn)	9,890		
Net cash inflow to Idea	30,522		28800
New equity issued	631.1		
As % of Post-deal equity	19.3		

Source: Company, Kotak Institutional Equities estimates

Pressure on margins will likely continue as S&M costs also start moving up with new launches (Rs mn)
Break-up of cost elements, 1QFY08-2QFY09

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Revenues	30,395	17,081	19,724	21,735	44,727	22,992
Interconnection costs	(4,946)	(2,930)	(3,445)	(3,957)	(8,228)	(4,271)
License fee and spectrum charges	(3,150)	(1,736)	(1,965)	(2,446)	(5,017)	(2,571)
Network operating costs	(4,275)	(2,915)	(3,262)	(3,756)	(8,241)	(4,485)
Employee costs	(1,586)	(954)	(885)	(1,022)	(2,345)	(1,323)
Sales and marketing expenses	(4,797)	(2,185)	(2,648)	(2,465)	(5,744)	(3,279)
Other expenses	(1,407)	(688)	(897)	(931)	(1,972)	(1,041)
Total operating costs	(20,161)	(11,409)	(13,103)	(14,577)	(31,545)	(16,970)
EBITDA	10,234	5,672	6,621	7,158	13,182	6,022
As % of revenues						
Interconnection costs	**16.3**	**17.2**	**17.5**	**18.2**	**18.4**	**18.6**
License fee and spectrum charges	10.4	10.2	10.0	11.3	11.2	11.2
Network operating costs	**14.1**	**17.1**	**16.5**	**17.3**	**18.4**	**19.5**
Employee costs	5.2	5.6	4.5	4.7	5.2	5.8
Sales and marketing expenses	**15.8**	**12.8**	**13.4**	**11.3**	**12.8**	**14.3**
Other expenses	4.6	4.0	4.5	4.3	4.4	4.5
Total operating costs	66.3	66.8	66.4	67.1	70.5	73.8
EBITDA margin (%)	33.7	33.2	33.6	32.9	29.5	26.2

Source: Company, Kotak Institutional Equities

Consolidated interim results for Idea Cellular Limited (Rs mn)

		qoq			yoy			yoy	
	2Q 2009	1Q2009	% chg	2Q 2009	2Q 2008	% chg	1H 2009	1H 2008	% chg
Gross sales	**22,992**	**21,735**	***5.8***	**22,992**	**15,622**	***47.2***	**44,727**	**30,395**	***47.2***
Operating costs									
Interconnection costs	(4,271)	(3,957)	*7.9*	(4,271)	(2,550)	*67.5*	(8,228)	(4,946)	*66.3*
License fee and spectrum charges	(2,571)	(2,446)	*5.1*	(2,571)	(1,551)	*65.7*	(5,017)	(3,150)	*59.3*
Network operating costs	(4,485)	(3,756)	*19.4*	(4,485)	(2,380)	*88.4*	(8,241)	(4,275)	*92.7*
Employee costs	(1,323)	(1,022)	*29.4*	(1,323)	(878)	*50.6*	(2,345)	(1,586)	*47.8*
SG&A expenses	(3,279)	(2,465)	*33.0*	(3,279)	(2,514)	*30.4*	(5,744)	(4,797)	*19.7*
Other expenses	(1,041)	(931)	*11.8*	(1,041)	(643)	*61.9*	(1,972)	(1,407)	
Total operating costs	(16,968)	(14,577)	*16.4*	(16,968)	(10,516)	*61.4*	(31,545)	(20,161)	*56.5*
EBITDA	**6,024**	**7,158**	***(15.8)***	**6,024**	**5,106**	***18.0***	**13,182**	**10,234**	***28.8***
EBITDA margin (%)	26.2	33.0		26.2	32.7		**29.5**	**33.7**	
Net finance cost	(1,497)	(1,526)	*(1.9)*	(1,497)	(641)	*133.7*	(3,023)	(1,572)	*92.3*
Other income	45	46	*(3.3)*	45	21	*107.9*	91	813	*(88.9)*
Depreciation & Amortization	(3,032)	(2,749)	*10.3*	(3,032)	(2,007)	*51.1*	(5,781)	(3,894)	*48.5*
PBT	**1,540**	**2,929**	***(47.4)***	**1,540**	**2,480**	***(37.9)***	**4,469**	**5,581**	***(19.9)***
Current tax (expense)/income	(99)	(297)	*(66.7)*	(99)	(277)	*(64.3)*	(396)	(293)	*35.3*
Deferred tax (liability)/asset	—	—	—	—	—	—	—	—	—
Minority loss/(income)	—	—	—	—	—	—	—	—	—
Reported net income	**1,441**	**2,632**	***(45.3)***	**1,441**	**2,203**	***(34.6)***	**4,073**	**5,289**	***(23.0)***
Key operational metrics									
Cellular subscribers ('000)									
Prepaid	28,557	25,481	*12.1*	28,557	17,141	*66.6*	28,557	17,141	*66.6*
Postpaid	1,823	1,713	*6.4*	1,823	1,531	*19.1*	1,823	1,531	*19.1*
Total	30,380	27,194	*11.7*	30,380	18,672	*62.7*	30,380	18,672	*62.7*
ARPU (Rs/mth)									
Blended	261	278	*(6.1)*	261	288	*(9.4)*	272	297	*(8.4)*
MOU (min/mth)									
Blended	417	428	*(2.6)*	417	360	*15.8*	422	366	*15.2*
Churn (%)									
Prepaid	4.0	4.1	—	4.0	4.5	—	—	—	—
Postpaid	2.5	2.5	—	2.5	3.7	—	—	—	—
Revenue/min: RPM = ARPU/MOU									
Blended revenue/min (incl. in-roaming)	0.63	0.65	*(3.6)*	0.63	0.80	*(21.8)*	0.64	0.81	*(20.5)*
Estimated volume (mn mins)									
Total estimated volume (mn mins)	36,315	33,087	*9.8*	36,315	18,831	*92.8*	69,402	35,931	*93.2*
EBITDA per min - blended (Rs)	0.17	0.22	*(23.3)*	0.17	0.27	*(38.8)*	0.19	0.28	*(33.3)*
VAS as % of wireless ARPU revenues	9.8	8.9	—	9.8	8.3	—	9.4	8.3	—

Source: Company

Automobiles

HROH.BO, Rs825	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	770
52W High -Low (Rs)	898 - 550
Market Cap (Rs bn)	164.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	103.3	117.6	126.9
Net Profit (Rs bn)	9.7	11.3	12.6
EPS (Rs)	48.5	56.8	63.2
EPS gth	*12.8*	*17.2*	*11.3*
P/E (x)	17.0	14.5	13.0
EV/EBITDA (x)	10.7	9.6	9.0
Div yield (%)	2.3	2.4	2.4

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	55.0	-	-
FIIs	24.3	0.5	0.1
MFs	3.8	0.4	0.0
UTI	-	-	(0.4)
LIC	5.8	0.6	0.2

Hero Honda: Net profit in line with expectations, expect volumes to come off post festival season; cut TP to Rs770, retain REDUCE

Jairam Nathan : jairam.nathan@kotak.com, +91-22-6634-1327
Amit Agarwal : agarwal.amit@kotak.com, +91-22-6749-3390

- **2QFY09 net at Rs3.1 bn grows 50% yoy; EBITDA margin at 13.2% up 90 bps yoy**
- **Net sales grow 36% yoy led by (1) 28.5% increase in volumes and (2) 5.6% increase in average realization**
- **We expect sales to come off post festive season**
- **Lower EPS estimates for FY2009E and FY2010E; cut TP to Rs770, retain REDUCE**

Hero Honda reported 2QFY09 at Rs3.1 bn—up 50% yoy and lower than our estimate of Rs3.2 bn. Net sales at Rs31.9 bn was higher 35.6% yoy led by increase in volumes by 28.5% and better realizations on account of price hikes by the company. 2QFY09 EBITDA margin at 13.2% was up 90 bps yoy and marginally higher than our estimate of 13%. The company reported a higher tax rate of 32% as against our expectation of 23% as Hero Honda has guided for a lower production from its Haridwar plant. While results beat our expectations above the tax line, driven by superior margin performance and other income, we are cautious of the quarters ahead. We believe sales will likely come off post the festive season as demand will be weak on account of a slowing economy and strict financing norms with respect to 2-wheelers. We lower our volume assumptions to 7.6% and 5% for FY2009E and FY2010E, respectively. Besides, we now factor in lower raw material costs as steel and aluminum prices have declined sharply. We lower our EPS estimate to Rs56.8 and Rs63.2 for FY2009E and FY2010E, respectively. We revise our target price to Rs770/share (Rs790 previously) and retain REDUCE rating on the stock.

2Q net at Rs3.1 bn up 50% yoy led by increased sales, higher realizations

Hero Honda reported 2QFY09 net profit at Rs3.1 bn—up 50% yoy and lower than our estimate of Rs3.2 bn. Net sales grew 35.6% yoy led mainly by (1) 28.5% yoy increase in volumes and (b) 5.6% increase in average realizations on account of the price hikes by the company. EBITDA margin at 13.2% grew 90 bps yoy and 125 bps qoq.

Volumes to come off post festive season; we lower our volume growth assumptions

We expect volumes to decline post the festive season on account of sluggish industry conditions. Besides, tight financing conditions with respect to the 2-wheeler segment will continue to effect sales. We expect current high levels of inventory to result in lower production. We expect full-year retail sales to lag the 20% year-to-date increase in dealer deliveries. We have lowered our volume growth assumptions for Hero Honda. We now estimate a volume growth of 7.6% and 5% for FY2009E and FY2010E, respectively.

Tax rate increase signals impending production cuts

Hero Honda reported a higher tax rate of 32% for 2Q as against our expectation of 23%. The company has guided for a higher tax rate for FY2009E on account of lower production from its Haridwar plant—it is entitled to excise as well as income tax benefits. We believe reversal in effective tax rates seems to be driven by reduced production levels resulting in an inability to utilize/ramp up to the full capacity of the company's Haridwar plant. This lower utilization seems to be precluding the company from taking the full excise and income tax benefits in the current fiscal year. We now expect production to total 3.6million units in FY2009E increasing to 3.8 million units in FY2010E.

Factor lower raw material costs as steel and aluminum costs have come off significantly

We now factor lower raw material costs as steel and aluminum prices have come off significantly. We note steel prices have corrected sharply in the past few months—HRC prices have come off 50% while aluminum prices have corrected approximately 35% over the past six months. We believe this will benefit Hero Honda as bulk of its raw material purchases are on spot basis.

We lower our EPS estimates by 5% and 4% for FY2009E and FY2010E

While the recent reduction in commodity prices help reduce the negative impact of lower volumes and higher taxes, we see downside risks to our volume assumptions, given the non-availability of credit and slowdown in the economy. We now factor is higher margins while we have lowered our volume growth assumptions. We lower our EPS estimates 5% and 4% for FY2009E and FY2010E, respectively. We now estimate EPS at Rs56.8 and Rs63.2 for FY2009E and FY2010E, respectively.

Lower target price to Rs770/share (Rs790 previously), retain REDUCE rating

We have revised our target price to Rs770/share—we value Hero Honda at 7X FY2010E EV/EBITDA. At current market price, Hero Honda is trading at an EV/EBITDA of 7.6X FY2010E and at a P/E of 13.1X FY2010E earnings. We continue to maintain our REDUCE rating on the stock.

Hero Honda, quarterly results, March fiscal year-ends (Rs mn)

		qoq			yoy	
	2Q 2009	1Q 2009	Change (%)	2Q 2009	2Q 2008	Change (%)
Net Sales	**31,897**	**28,435**	**12.2**	**31,897**	**23,521**	**35.6**
Expenditure	(27,672)	(25,025)	10.6	(27,672)	(20,606)	34.3
(Increase)/decrease in stocks	832	163	412.1	832	973	(14.5)
Consumption of Raw materials	(24,015)	(20,616)	16.5	(24,015)	(17,986)	33.5
Staff cost	(1,103)	(1,039)	6.1	(1,103)	(870)	26.7
Other expenditure	(3,386)	(3,532)	(4.1)	(3,386)	(2,724)	24.3
EBITDA	**4,226**	**3,410**	**23.9**	**4,226**	**2,915**	**45.0**
Other income	662	467	41.7	662	393	68.6
Interest (net)	83	50	67.8	83	101	(17.3)
Depreciation	(466)	(422)	10.5	(466)	(384)	21.3
Profit before extra-ordinary items	**4,505**	**3,505**	**28.5**	**4,505**	**3,024**	**49.0**
Extra-ordinary items	-	-		-	-	
Profit before tax	**4,505**	**3,505**	**28.5**	**4,505**	**3,024**	**49.0**
Tax	(1,442)	(777)	85.6	(1,442)	(980)	47.1
Profit after tax	**3,063**	**2,729**	**12.3**	**3,063**	**2,043**	**49.9**
Adjusted PAT	**3,063**	**2,729**	**12.3**	**3,063**	**2,043**	**49.9**
Volumes	**972,095**	**894,244**	**8.7**	**972,095**	**756,633**	**28.5**
Average realisation	**32,813**	**31,798**	**3.2**	**32,813**	**31,086**	**5.6**
Margins (%)						
EBITDA margin	13.2	12.0	1.25	13.2	12.4	0.86
Net profit margin	9.6	9.6	0.01	9.6	8.7	0.92
Key ratios						
RM costs (% of net sales)	75.3	72.5	2.79	75.3	76.5	(1.18)
Staff costs (% of net sales)	3.5	3.7	(0.20)	3.5	3.7	(0.24)
Effective tax rate (%)	(32.0)	(22.2)	(9.85)	(32.0)	(32.4)	0.42
EPS (Rs/share)	15.3	13.7		15.3	10.2	

Source: Company data, Kotak Institutional Equities estimates.

Hero Honda, valuation details, March fiscal year-ends

	EBITDA (Rs mn)	EV/EBITDA (X)	EV (Rs mn)	Value (Rs/share)	Comments
FY2010E	16,411	7.0	114,878	575	Based on Hero Honda's historical average
Less: net debt			(39,426)	(197)	FY2010E net debt
Market capitalisation				**773**	
Target price				**770**	

Source: Company data, Kotak Institutional Equities estimates.

Hero Honda, volume details, March fiscal year-ends, 2002-2010E

Volumes	2006	2007	2008	2009E	2010E
Motorcycles	**2,985,736**	**3,243,832**	**3,232,320**	**3,479,437**	**3,654,628**
Domestic	2,893,070	3,147,219	3,144,101	3,395,629	3,575,010
< 125 cc	2,815,682	3,041,143	2,966,329	3,203,635	3,363,817
> 125 cc	77,388	106,076	177,772	191,994	211,193
Exports	92,666	96,613	88,219	83,808	79,618
< 125 cc	84,571	93,692	80,620	76,589	72,760
> 125 cc	8,095	2,921	7,599	7,219	6,858
Scooters	**15,015**	**92,921**	**104,822**	**112,742**	**118,444**
Domestic	15,014	91,889	102,470	110,155	115,663
Exports	1	1,032	2,352	2,587	2,781
Total 2-wheelers	**3,000,751**	**3,336,753**	**3,337,142**	**3,592,180**	**3,773,072**
Growth (yoy %)					
Motorcycles	**13.9**	**8.6**	**(0.4)**	**7.6**	**5.0**
Domestic	**13.1**	**8.8**	**(0.1)**	**8.0**	**5.3**
< 125 cc	15.5	8.0	(2.5)	8.0	5.0
> 125 cc	(35.7)	37.1	67.6	8.0	10.0
Exports	**44.8**	**4.3**	**(8.7)**	**(5.0)**	**(5.0)**
< 125 cc	45.7	10.8	(14.0)	(5.0)	(5.0)
> 125 cc	35.2	(63.9)	160.2	(5.0)	(5.0)
Scooters		**518.9**	**12.8**	**7.6**	**5.1**
Domestic		512.0	11.5	7.5	5.0
Exports		103,100.0	127.9	10.0	7.5
Total 2-wheelers	**14.5**	**11.2**	**0.0**	**7.6**	**5.0**

Source: Company data, Kotak Institutional Equities estimates.

Hero Honda, profit model, balance sheet and cash flow model, March fiscal year-ends, 2006-2010E (Rs mn)

	2006	2007	2008	2009E	2010E
Profit model (Rs mn)					
Net sales	87,140	99,000	103,318	117,620	126,893
EBITDA	**13,645**	**11,730**	**13,494**	**15,213**	**16,411**
Other income	1,563	1,899	1,854	1,885	1,950
Interest	61	230	358	377	397
Depreciaiton	(1,146)	(1,398)	(1,603)	(1,717)	(1,921)
Profit before tax	**14,122**	**12,461**	**14,103**	**15,758**	**16,837**
Current tax	(4,230)	(3,788)	(4,412)	(4,482)	(4,295)
Deferred tax	(179)	(94)	(12)	70	86
Net profit	**9,713**	**8,579**	**9,679**	**11,346**	**12,628**
Earnings per share (Rs)	**48.6**	**43.0**	**48.5**	**56.8**	**63.2**
Balance sheet (Rs mn)					
Equity	20,093	24,701	29,862	36,535	44,490
Deferred tax liability	1,188	1,282	1,254	1,184	1,098
Total Borrowings	1,858	1,652	1,320	785	285
Current liabilities	15,628	14,792	18,247	20,832	21,542
Total liabilities	**38,767**	**42,426**	**50,684**	**59,336**	**67,415**
Net fixed assets	9,936	13,555	15,487	16,270	16,849
Investments	20,619	19,739	25,668	32,168	39,168
Cash	1,587	358	1,311	979	543
Other current assets	6,625	8,775	8,057	9,758	10,695
Miscellaneous expenditure	-	-	161	161	161
Total assets	**38,767**	**42,426**	**50,684**	**59,336**	**67,415**
Free cash flow (Rs mn)					
Operating cash flow excl. working capital	9,723	8,474	9,506	10,731	12,116
Working capital changes	(362)	(2,224)	2,612	883	(227)
Capital expenditure	(3,937)	(5,152)	(3,739)	(2,500)	(2,500)
Free cash flow	**5,424**	**1,099**	**8,379**	**9,115**	**9,389**
Ratios					
Operating margin (%)	15.7	11.8	13.1	12.9	12.9
PAT margin (%)	11.1	8.7	9.4	9.6	10.0
Debt/equity (X)	0.1	0.1	0.0	0.0	0.0
Net debt/equity (X)	(1.0)	(0.7)	(0.8)	(0.9)	(0.9)
Book Value (Rs/share)	106.6	130.1	155.0	188.1	227.5
RoAE (%)	52.2	36.3	34.0	33.1	30.4
RoACE (%)	**47.1**	**33.2**	**31.5**	**31.4**	**29.3**

Source: Company, Kotak Institutional Equities estimates.

Banking

PWFC.BO, Rs113	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	130
52W High -Low (Rs)	297 - 97
Market Cap (Rs bn)	129.1

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	18.6	21.6	26.6
Net Profit (Rs bn)	13.1	14.9	18.1
EPS (Rs)	11.4	13.0	15.8
EPS gth	*2.6*	*14.3*	*21.1*
P/E (x)	9.9	8.6	7.1
P/B (x)	1.3	1.1	1.0
Div yield (%)	1.4	1.6	1.9

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	89.8	-	-
FIIs	4.1	0.1	(0.3)
MFs	1.6	0.2	(0.2)
UTI	-	-	(0.3)
LIC	-	-	(0.3)

Power Finance Corporation: Core performance strong, in line with estimates

Nischint Chawathe : nischint.chawathe@kotak.com, +91-22-6749-3588

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

- **PFC reported PAT for 2QFY09 of Rs3.3 bn, up 17% and 8% above estimates**
- **High loan growth, other operating income above estimates**
- **We will revise estimates after discussing the results with the management**

Power Finance Corporation (PFC) reported core earnings (PBT + forex losses) up 21% yoy, and in line with our estimates. Business growth was strong—loan growth was up 24% yoy on the back of 53% growth in disbursements. However, the company reported a 36% decline in approvals for 2QFY09 compared to 2QFY08. This may be an early sign of a slowdown in infrastructure projects—a trend which needs to be monitored. Other operating income (fees etc.) was considerably higher than estimates likely indicating that the company has made progress in boosting its non-asset based revenues, which is a positive in our view. However, forex losses (Rs800 mn) on an exposure equivalent to US$530 mn (45% of which is unhedged) pulled down earnings. The effective tax rate (including deferred tax) declined to 28%, which is lower than the 33% observed over the past few years—rationale for this is unclear to us. The company's operational environment is akin to that of a regulated entity, whose operations are unlikely to be impacted by developments in the international financial markets. The earnings are likely to have greater visibility and return on equity (RoE) for the company is likely to be steady at around 13-14%. The current valuations of 7.2X PER and 1X PBR FY2010E provides downside protection to investors. We will revisit our earnings estimates and recommendation after tomorrow's conference call with the management.

Power Finance Corporation—quarterly data (Rs mn)

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	YoY(%)	2Q09E	Actual vs KS (%)
Profit and Loss statement													
Interest on loans	8,219	8,660	9,280	11,010	11,170	11,950	12,640	13,130	14,050	15,430	29	15,177	2
Other interest income	55	33				-	-						
Total interest income	8,274	8,605	9,280	11,010	11,170	11,950	12,640	13,130	14,050	15,430	29	15,177	2
Total interest expenses	5,204	5,420	6,020	6,370	7,020	7,480	8,000	8,280	8,910	10,010	34	9,724	3
Net interest income	3,070	3,240	3,260	4,640	4,150	4,470	4,640	4,850	5,140	5,420	21	5,453	(1)
Loan loss provisions	65	(1)	(10)	(105)	41	0	(140)	0	60	50	124,900	50	-
Net interest income (after loan loss provisions)	3,005	3,241	3,270	4,745	4,109	4,470	4,780	4,850	5,080	5,370	20	5,403	(1)
Other operating income- incl. fees	60	70	60	180	130	120	120	320	80	240	100	80	200
Net operating income	3,130	3,310	3,320	4,820	4,280	4,590	4,760	5,170	5,220	5,660	23	5,533	2
Other income	(305)	170	180	1,050	409	(229)	30	(380)	(570)	(800)	250	(700)	14
Forex gains	(305)		180	1,050	409	(229)	8	(380)	(570)	(800)	250	(700)	14
Total income	2,825	3,480	3,500	5,870	4,689	4,361	4,790	4,790	4,650	4,860	11	4,833	1
Total income (after provisioning)	2,760	3,481	3,510	5,975	4,648	4,361	4,930	4,790	4,590	4,810	10	4,783	1
Operating expenses	112	130	98	180	105	147	209	345	164	221	50	219	1
Staff expenses	-	123	56	77	65	81	118	251	110	108	33	130	(17)
Other expenses	-	68	42	82	40	66	93	94	54	113	72	89	27
Depreciation		6	12	21	11	12	11	12	9	10	(9)	10	4
PBT	2,648	3,346	3,400	5,795	4,532	4,203	4,710	4,433	4,416	4,579	9	4,554	1
Tax	1,069	1,050	1,060	2,056	1,450	1,379	1,503	1,462	1,446	1,280	(7)	1,503	(15)
Current tax	790	630	660	1,450	1,134	1,177	1,221	1,286	1,338	1,170	(1)	1,391	(16)
Deferred tax	279	420	400	620	316	202	281	176	108	110	(45)	112	(2)
PAT (reported)	**1,579**	**2,296**	**2,340**	**3,738**	**3,082**	**2,824**	**3,207**	**2,971**	**2,970**	**3,299**	**17**	**3,051**	**8**
PAT (included deferred tax)	1,858	2,716	2,740	4,345	3,398	3,026	3,489	3,147	3,078	3,409	13	3,163	8
PBT - forex gains	**2,953**	**3,345**	**3,220**	**4,745**	**4,123**	**4,431**	**4,702**	**4,813**	**4,986**	**5,379**	**21**	**5,254**	**2**
Tax rate (overall)	40	31	31	36	32	33	32	33	33	28		33	
Other details													
Approvals (Rs bn)	**123.4**	**76.3**	**76.0**	**35.7**	**132.7**	**218.6**	**84.0**	**261.9**	**153.0**	**139.8**	**(36.1)**		
Disbursements (Rs bn)	**28.5**	**31.5**	**35.3**	**45.2**	**32.2**	**33.4**	**31.7**	**64.9**	**47.3**	**51.0**	**52.6**		
Loan assets (Rs bn)	367	386	405	439	452	466	471	516	547	579	24	582	(1)
Yield on Assets (%)	9.01	9.17	9.36	9.25	9.88	10.05	10.21	10.12	10.42	10.83			
Cost of funds (%)	7.30	7.34	7.74	7.32	7.95	8.01	8.19	8.03	8.24	8.74			
Spreads (%)	**1.7**	**1.8**	**1.6**	**1.9**	**1.9**	**2.0**	**2.0**	**2.1**	**2.2**	**2.1**			
Net interest margins (%)	3.31	3.43	3.29	3.52	3.67	3.76	3.74	3.75	3.81	3.80			
Operating cost to average assets(%)	0.03	0.13	0.10	0.04	0.02	0.13	0.17	0.07	0.03	0.04			
Gross NPLs (%)	0.25	0.23	0.21	0.04	0.06	0.06	0.03	0.03	0.02	0.02			
Capital adequacy ratio (%)	18.25	17.77	17.48	18.34	18.59	18.59	19.07	17.42	16.75	16.38			
Balance Sheet													
Fixed Assets (Net)			850	810	800	790	780	770	760	770	(3)		
Loan Assets			405,730	439,030	452,500	465,820	471,290	515,660	547,030	578,770	24		
Investments			280	590	610	650	600	660	650	640	(2)		
Current Assets, Loans & Advances			17,050	26,200	26,930	47,800	51,060	29,750	34,870	31,270	(35)		
Total Assets			**423,910**	**466,630**	**480,840**	**515,060**	**523,730**	**546,840**	**583,310**	**611,460**	**19**		
Loans and borrowings			309,570	335,840	345,240	375,240	380,970	406,480	435,270	458,660	22		
Total Current Liabilities			16,690	21,120	23,230	24,640	24,600	22,630	29,280	31,150	26		
Deferred tax liability			10,810	11,430	11,740	11,940	12,210	12,400	12,510	12,620	6		
Interest Subsidy Fund from GOI			11,380	12,320	11,620	11,400	10,890	10,670	9,980	9,470	(17)		
Total liabilities			**348,450**	**380,710**	**391,830**	**423,220**	**428,670**	**452,180**	**487,040**	**511,910**	**21**		
Total equity			**75,470**	**85,930**	**89,020**	**91,840**	**95,040**	**94,660**	**89,590**	**99,550**	**8**		

Source: Company, Kotak Institutional equities estimates.

Metals

HZNC.BO, Rs287	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	400
52W High -Low (Rs)	3357 - 689
Market Cap (Rs bn)	121.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	78.8	63.8	56.3
Net Profit (Rs bn)	44.0	32.6	23.6
EPS (Rs)	104.0	77.2	55.9
EPS gth	*(1.0)*	*(25.8)*	*(27.6)*
P/E (x)	2.8	3.7	5.1
EV/EBITDA (x)	2.0	2.4	3.5
Div yield (%)	1.7	2.6	3.5

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	64.9	-	-
FIIs	2.3	0.1	(0.6)
MFs	0.9	0.2	(0.5)
UTI	-	-	(0.7)
LIC	-	-	(0.7)

Hindustan Zinc: Strong quarter in a bleak environment

Rahul Jain : rahulk.jain@kotak.com, +91-22-6634-1318

Amit Agarwal : agarwal.amit@kotak.com, +91-22-6749-3390

- **Results ahead of expectations aided by higher concentrate sales, lower costs and low tax rates**
- **Zinc and lead prices have crashed from the 2Q FY2008 realizations by 32% and 24% to US$1,230 and to US$1,440, respectively**
- **Reinitiate coverage with ADD rating**

Hindustan Zinc (HZL) reported better-than expected 2QFY2009 results on the back of higher concentrate sales, lower costs and low tax rates. Net sales at Rs17.9 bn were down 11.4% as higher metal production was offset by a sharp decline in LME zinc and lead prices. Average zinc prices for 2QFY2009 have declined 44% on a yoy basis while average lead prices have declined 38% yoy. We expect zinc and lead prices to remain weak. We value HZL at Rs400/share based on 3X FY2010E EBITDA. HZL is well placed to expand its zinc smelting capacity to 1 mntpa and is well supported by its strong cash balance of Rs9.9bn. We reinitiate coverage on Hindustan Zinc with ADD rating and target price of Rs400/share.

EBITDA and PAT ahead of expectations

HZL's 2QFY2009 net income of Rs9.6bn (up 13.2% qoq, and down 17.9% yoy) was better than our expectations. EBITDA margins declined from 72% to 54.8% yoy and 59.5% qoq due to a sharp 44% yoy and 16% qoq decline in zinc prices. Volumes of zinc concentrate sales saw a surge from 10,507 tons in Q1FY2009 to 97,000 tons in Q2FY2009, boosting overall absolute profitability. Average cost of production is now at US$473 per ton without royalty and is at the lowest decile of the global cost curve. Other income continues to remain robust owing to high cash reserves which are in excess of Rs99 bn and is generating a yield of 8.5% post tax. Tax rates were significantly lower due to classification of one of the plants under the EOU category.

EBITDA margins to remain under pressure

HZL's earnings bear a direct correlation to the underlying zinc and lead prices both of which have been under significant pressure owing to over supply. Our assumptions forecast an average zinc price of US$1,800 for FY2009 and US$1,300 for FY2010. Zinc prices have declined by 32% to US$1,230 recently and the fundamentals are weak. We believe that lower zinc prices in the coming quarters will likely result in subdued earnings.

Capacity expansion on track

HZL is well on track to increase its zinc and lead smelting capacity by 60% to 1 mtpa at Rajpura Dariba with a 160 MW captive power plant along with Rampura Agucha mine expansion by FY2011 at a capital expenditure of US$900 mn. Also other mining expansions at Sindesur Khurd and Kayar are also on progress to commissioning by FY2012.

Zinc outlook

The International Lead Zinc Study Group expects the recent financial crisis to result in a lower usage and production. Global zinc demand is expected to grow by 3.8% in CY2008 and 3.3% to 12.2 mn tons in CY2009. As a whole the zinc market is expected to remain in a surplus by 150,000 tons in CY2008 and by 330,000 in CY2009. Chinese demand is expected to be sluggish owing to an 8.8% decline in galvanized sheet production in first seven months in 2008 following a significant cooling down of the housing market. Also, reported LME stocks at 170,000 tons are at a 2-year high indicating a widening of surpluses. Clearly, in the short-term zinc prices are headed to new lows.

Valuations

We re-initiate coverage on Hindustan Zinc with an ADD rating and a target of Rs400/ share. While current zinc market fundamentals do not indicate a recovery in the near-term, valuations of HZL are attractive. Stock performance in the short-term would be muted due to weak outlook for zinc pricing; we have valued HZL at 3X EBITDA of FY2010 expected earnings.

Hindustan Zinc, valuation details, March fiscal year-ends

	EBITDA	Multiple	Enterprise Value		
	(Rs bn)	(X)	(Rs bn)	(US$ mn)	(Rs/ share)
FY2010E EBITDA	24	3.0	73	1,765	173
Less: Net debt	.		(99)	(2,394)	(235)
Arrived market capitalization			**(26)**	**(629)**	**408**
Target price (Rs/share)					**400**

Source: Company data, Kotak Institutional Equities estimates.

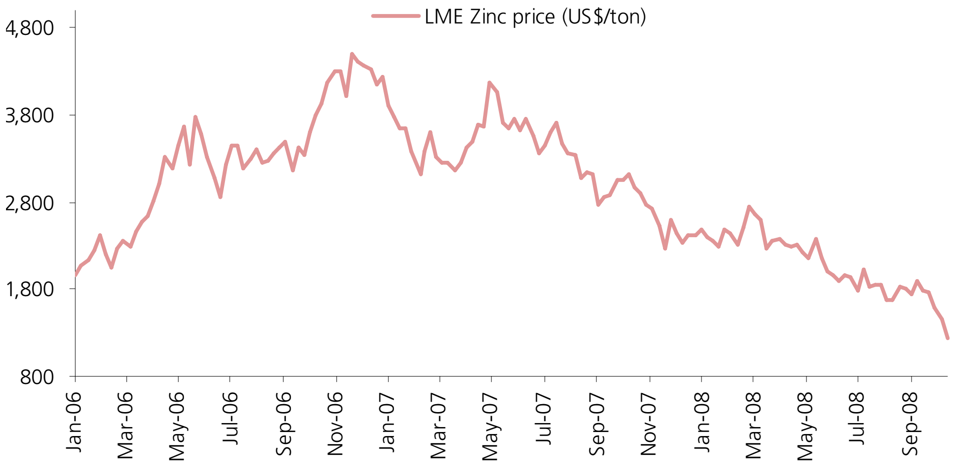
Hindustan Zinc, Interim results, March fiscal year-ends (Rs mn)

	2Q 2009	1Q 2009	2Q 2008	% change qoq	% change yoy	Comments on interim results
Quantitative details (tons)						
Mined metal production	166,998	157,862	143,000	5.8	16.8	Higher zinc production was offset by a sharp decline in LME prices.
Refined zinc production	121,556	127,889	94,000	(5.0)	29.3	Production was higher on account of increased capacity at Chanderiya
Zinc/Lead concentrate sales	97,000	10,507	85,000	823.2	14.1	
Earnings drivers						
Average LME Zinc (US/ton)	1,807	2,146	3,221	(15.8)	(43.9)	Zinc prices declined 44% yoy; 16 % on qoq basis resulting in lower margins
Average LME Lead (US/ton)	1,911	2,316	3,094	(17.5)	(38.2)	Lead price have declined sharply resulting in operating margin
Average INR:USD	43.76	41.65	40.53	5.1	8.0	
Interim results						
Net revenues	**17,905**	**16,437**	**20,201**	**8.9**	**(11.4)**	Net revenue was down as higher zinc production was offset by a sharp fall in LME zinc and lead prices
Expenditure	**(8,084)**	**(6,660)**	**(5,659)**			
Stock adjustment	(106)	317	(38)			
Raw materials	(5,162)	(5,368)	(2,849)			
Employee cost	(865)	(847)	(633)			
Other costs	(1,951)	(761)	(2,140)			
EBITDA	**9,821**	**9,777**	**14,542**	**0.4**	**(32.5)**	EBITDA margin was lower by 17% mainly on account of a sharp fall in zinc and lead prices
Other income	1,807	2,094	1,527			
Depreciation	(704)	(686)	(485)			
EBIT	10,924	11,185	15,584			
Interest	(71)	(69)	(57)			
Pre-tax profits - as reported	10,853	11,116	15,527			
Unusual or infrequent items	-	-	-			
Pre-tax profits - as adjusted	**10,853**	**11,116**	**15,527**	**(2.4)**	**(30.1)**	
Taxes	(1,257)	(2,638)	(3,842)			ETR at 11.6% was lower than expected as one of it plants was classified under the EOU category
Current taxes	(1,035)	(2,467)	(3,354)			
Deferred taxes	(223)	(171)	(488)			
Reported profits - as adjusted	**9,595**	**8,478**	**11,685**	**13.2**	**(17.9)**	
Extra-ordinary items	-	-	-			
Reported profits - as reported	**9,595**	**8,478**	**11,685**			
Ratios						
Costs as % of revenue (%)	45.2	40.5	28.0			
EBITDA margin (%)	54.8	59.5	72.0			
ETR (%)	11.6	23.7	24.7			
EPS (Rs/share)	22.7	20.1	27.7			

Source: Company data, Kotak Institutional Equities estimates.

Zinc prices have come off sharply since its highs

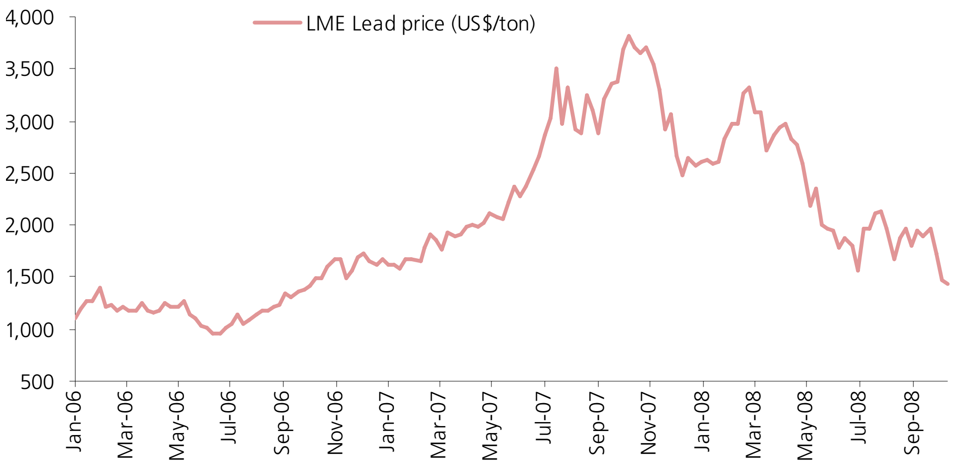
LME Zinc price chart (US$/ton)



Source: Bloomberg

Lead prices have dropped 62% from its highs in Oct-2007

LME Lead price chart (US$/ton)



Source: Bloomberg

Hindustan Zinc, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2005-2010E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)						
Net sales	38,770	85,602	78,778	63,818	56,295	65,413
EBITDA	**22,994**	**64,069**	**53,784**	**36,119**	**24,409**	**31,989**
Other income	1,158	2,313	8,516	9,057	9,851	9,667
Interest	(474)	(284)	(242)	(0)	(0)	(0)
Depreciaiton	(1,383)	(1,561)	(2,205)	(2,815)	(3,601)	(5,211)
Profit before tax	**22,296**	**64,537**	**59,853**	**42,360**	**30,659**	**36,445**
Current tax	(6,238)	(19,524)	(14,673)	(8,279)	(5,295)	(6,639)
Deferred tax	(1,333)	(595)	(1,220)	(1,464)	(1,757)	(2,108)
Net profit	**14,725**	**44,418**	**43,961**	**32,617**	**23,607**	**27,698**
Earnings per share (Rs)	**34.8**	**105.1**	**104.0**	**77.2**	**55.9**	**65.6**
Balance sheet (Rs mn)						
Equity	76,271	118,482	147,930	167,312	190,362	4,225
Deferred tax liability	2,414	3,006	4,597	6,061	7,818	9,926
Total Borrowings	5,580	4	4	4	4	4
Current liabilities	6,032	8,268	8,984	6,271	6,281	6,660
Total liabilities	**48,324**	**87,548**	**132,067**	**160,266**	**181,414**	**206,952**
Net fixed assets	19,181	28,706	41,626	47,786	66,635	68,624
Investments	16,049	44,033	63,325	63,325	63,325	63,325
Cash	740	1,197	13,628	34,794	36,017	57,692
Other current assets	12,354	13,613	13,489	14,361	15,438	17,312
Miscellaneous expenditure	-	-	-	-	-	-
Total assets	**48,324**	**87,548**	**132,067**	**160,266**	**181,415**	**206,953**
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	18,166	45,086	39,120	36,896	28,965	35,017
Working capital changes	(5,349)	960	2,960	(3,586)	(1,067)	(1,494)
Capital expenditure	(2,143)	(11,103)	(15,131)	(8,975)	(22,450)	(7,200)
Free cash flow	**10,674**	**34,943**	**26,949**	**24,335**	**5,448**	**26,323**
Ratios						
Debt/equity (%)	15.2	0.0	0.0	0.0	0.0	0.0
Net debt/equity (%)	13.2	(1.5)	(11.1)	(22.6)	(20.6)	(28.8)
RoAE (%)	50.3	76.6	43.4	23.5	14.3	14.8
RoACE (%)	**43.1**	**73.4**	**43.6**	**23.5**	**14.3**	**14.8**

Source: Company, Kotak Institutional Equities estimates.

Diversified

JAIA.BO, Rs79	
Rating	BUY
Sector coverage view	-
Target Price (Rs)	205
52W High -Low (Rs)	510 - 64
Market Cap (Rs bn)	93.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	41.9	72.1	94
Net Profit (Rs bn)	6.1	8.7	13.1
EPS (Rs)	4.9	7.3	11.0
EPS gth	*6.5*	*49.5*	*50.9*
P/E (x)	16.1	10.8	7.1
EV/EBITDA (x)	11.4	8.7	8.2
Div yield (%)	0.0	0.0	0.0

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.5	-	-
FIIs	24.4	0.6	0.1
MFs	8.5	1.2	0.7
UTI	-	-	(0.5)
LIC	2.5	0.3	(0.2)

Jaiprakash Associates: 2QFY09—Strong growth in construction revenues compensates misses in other businesses

Aman Batra : aman.batra@kotak.com, +91-22-6634-1231

Murtuza Arsiwalla : murtuza.arsiwalla@kotak.com, +91-22-66341-125

Puneet Jain : puneet.j@kotak.com, +91-22-6634 1255

- **Profitability boosted by construction revenue; compensates for slippages in real estate**
- **Equity infusion through rights issue (Rs 18 bn)**
- **We revise our EPS estimates to Rs7.3 (Rs7.6 previously) for FY2009E and Rs11.0 (Rs11.6 previously) for FY2010E**
- **Retain BUY rating with SOTP-based target price of Rs205/share (Rs255 previously)**

Jaiprakash Associates (JAL) reported 37% yoy increase in revenues to Rs11.8 bn (our est. Rs10.5 bn), 57% increase in EBITDA to Rs3.4 bn (our est. Rs2.8 bn) and 95% increase in net profit to Rs2 bn for 2QFY09. Higher-than-estimated revenues were on account of a 55% yoy increase in construction revenues and 10% expansion in EBIT margins of the construction business. An increase in cement volumes partially compensated for lower margins caused by increased coal costs and overheads. We have revised our estimates to factor in higher construction revenues, slower-than-expected execution in real estate and delays in ramping up of production at new cement manufacturing facilities. We have revised our EPS estimates to Rs7.3 (Rs7.6 previously) for FY2009E and Rs11.0 (Rs11.6 previously) for FY2010E. We retain our BUY rating with SOTP-based target price of Rs205/share (Rs255/previously). We assume the FCCB-III (convertible at Rs248/share) as debt in our analysis. In lieu of the 120 mn warrants that were to be allotted to the promoters on a preferential basis, JAL has now proposed a rights issue to raise Rs18 bn with the promoters giving a firm commitment to subscribe to any unsubscribed portion of the rights issue.

Profitability boosted by construction revenue; compensates for slippages in real estate

JAL reported 37% sales growth, 57% EBITDA growth and a 95% growth in net profit on a standalone basis during 2QFY09. Construction revenues for the quarter grew by 27% sequentially and 55% yoy. EBITDA growth was even higher on account of 10% (sequentially and yoy) expansion in EBIT margins for construction business. Real estate revenues were lower at Rs285 mn against our estimate of Rs912 mn. Contraction of EBIT margins in cement business (500 bps sequentially) was compensated by higher-than-estimated volumes growth. We note that JPVL has declared 8% dividend and accordingly an income of Rs407.2 mn has been recognized by JAL in 2QFY09. We note the near-term growth in revenues and profits for JAL on a consolidated basis are led by cement and real estate business, while the power division will start contributing significantly to growth from FY2012E.

Construction—execution on Yamuna Expressway gains traction

The construction division reported revenues of Rs2 bn (55% yoy growth) during the quarter. Strong revenue growth was accompanied by 10% expansion of EBIT margins resulting in 136% yoy growth in EBIT from the division. Strong revenue growth is attributed traction on construction activity on the Rs60 bn Yamuna Expressway project and progress on Karcham Wangtoo (1,000 MW). We expect the order book (~US$2.8 bn currently) of the construction business to swell further with the addition of more projects. JAL has won the contracts for implementation of (1) 1,047 km long 8 lane access controlled expressway between Greater Noida and Balia in Uttar Pradesh at a contract price of Rs300 bn and (2) 27.14 km Zirakpur–Parwanoo expressway from NHAI. We have revised our earnings estimates to factor in faster execution of projects and value the construction business at 6X FY2010E EBITDA (8X FY2010E EBITDA previously) in line with the current valuation of construction stocks under coverage.

Cement—lower margins compensated by higher-than-estimated volume growth

The cement division of JAL reported revenues growth of 14% yoy for 2QFY09. Contraction of EBIT margins by 5% was compensated by higher-than-estimated volume growth at 10% yoy. We have revised our estimates for the cement business to reflect lower volumes and higher input costs. We note JAL successfully commissioned Phase-I of Chunar and Dalla cement plants in Uttar Pradesh and grinding unit at Panipat in Haryana during March 2008. While the management has indicated that progress on commissioning of cement capacities remains on schedule, we anticipate some delays in production ramp-up. We note margins of cement companies have started declining and large cement stocks are trading just below replacement costs (~US$120/ton). We value JAL's cement business at 6X FY2010E EBITDA (7X FY2010E EBITDA previously) implying EV/ton of US$110.

Slower-than-expected execution results in lower real estate revenues

JAL reported standalone real estate (Jaypee Greens project) revenues of Rs285 mn in 2QFY09 (61% decline qoq) translating to Rs1 bn in 1HY2009 which is low when compared to the total sales volume of 2.9 mn sq. ft amounting to Rs18 bn in value as indicated by the management. We believe revenue booking has been much lower compared to sales due to slower-than-expected execution of projects. However, we would highlight that JAL's real estate business would continue to exhibit volatile quarterly performance as most of its projects are in the initial stage and have not reached the revenue booking stage. We expect the quarterly numbers to be more stable in another 2-3 quarters when larger number of the projects reach the revenue booking stage.

The management has indicated that JAL has— (1) sold 2.9 mn sq. ft in Jaypee Greens at an average price of Rs6,200/sq. ft and has customer advances of Rs8.5 bn; (2) sold 4 mn sq. ft in Wish Town at an average price of Rs5,800/sq. ft and has customer advances of Rs8 bn. We note that JAL has increased prices for Jaypee Greens by 5% in 2QFY09, which may result in volume risk going ahead. We, however, assume a decline of 10% in residential selling prices for FY2009E, flat residential prices for FY2010E and flat prices for commercial and retail rentals for FY2009E and FY2010E.

We build in delays in execution of projects and revise our revenue estimates for Jaypee Greens to Rs4.7 bn from Rs6.5 bn for FY2009E and Rs4.3 bn from Rs4.4 bn in FY2010E. We highlight that our revenue booking estimates are lower than management guidance of Rs6 bn. Our consolidated real estate revenues are revised to Rs8.5 bn from Rs12 bn in FY2009E and Rs16.5 bn from Rs17.2 bn in FY2010E. We are also delaying the non-Noida projects by two years and now assume a launch in FY2013 for these projects. The NAV for the non-Noida land bank reduces to Rs22 bn from Rs31 bn (post consideration of Rs20 bn of land cost to be paid).

We would closely monitor the pace of revenue booking in future to gain more confidence in pace of residential sales. Key downside risks to our NAV estimates include (1) lower selling prices, and (2) slower project execution. Upside risks to our NAV estimates would come from (1) lower-than-estimated construction costs and (2) faster launches.

Equity infusion through rights issue and conversion of warrants to promoters

The Board of Directors has approved a rights issue to raise a sum of Rs18 bn to meet the capex requirements of the company. The promoters have given a firm commitment to subscribe to any unsubscribed portion of the rights issue. The rights issue is in lieu of the 120 mn warrants that were to be allotted to the promoters on a preferential basis.

The fresh allotment will be in addition to 50 mn equity warrants allotted to the promoters earlier convertible at a price of Rs397/share. We note that the promoters have exercised their option to convert 10 mn equity warrants at the convertible price of Rs397/share and have infused an additional sum of Rs1.6 bn for the balance 40 mn warrants outstanding. Our estimates currently do not assume the conversion of the balance warrants. Equity infusion from the promoters will shore up the capital and reduce dependency on debt financing to fund the large capex of Rs320 bn. We believe this partly allays investors' concerns on the high leverage of the company and the company's ability to arrange for funds (both debt and equity) for its growth projects.

Retain BUY rating with target price of Rs205/share. We retain our BUY rating with a target price of Rs205/share (Rs255 previously). We value the cement business at 6X EV/EBITDA on FY2010E i.e.Rs67 bn, and construction business at 6X EV/EBITDA on FY2010E, i.e.Rs51 bn. Real estate and power valuations are based on one-year forward NAVs of Rs113 bn and Rs93 bn, respectively.

Interim results of Jaiprakash Associates Ltd (standalone), March fiscal year-ends (Rs mn)

	FY2009E	2QFY09	2QFY08	*(%chg)*	1QFY09	*(%chg)*
Net sales	**59,722**	**11,826**	**8,620**	***37***	**11,487**	***3***
Total expenditure	(42,339)	(8,348)	(6,410)		(8,365)	
EBITDA	**17,383**	**3,478**	**2,210**	***57***	**3,123**	***11***
EBITDA (%)	29	29	26		27	
Other income	3,164	1,040	600		394	
Interest	(5,587)	(1,008)	(840)		(984)	
Depreciation	(2,757)	(667)	(460)		(622)	
Pre-tax profits	12,203	2,844	1,510		1,911	
Tax	(3,780)	(812)	(320)		(639)	
FBT	—	—	(20)		—	
Deferred tax	(516)	—	(130)		—	
Net income	**7,907**	**2,031**	**1,040**	***95***	**1,273**	***60***
Segment revenues						
Cement	25,904	5,209	4,560	*14*	5,827	*(11)*
Construction	29,050	6,684	4,320	*55*	5,246	*27*
Real estate	4,404	285	—		748	*(62)*
Others	3,528	665	340	*95*	61	*995*
Total	**62,886**	**12,843**	**9,220**	***39***	**11,881**	***8***
Segment EBIT						
Cement	6,724	1,315	1,420	*(7)*	1,796	*(27)*
Construction	6,898	2,055	870	*136*	1,102	*86*
Real estate	1,314	100	—		273	*(63)*
Others	2,854	635	250	*154*	47	*1,265*
Total	**17,790**	**4,105**	**2,540**	***62***	**3,217**	***28***
EBIT margin (%)						
Cement	26	25	31		31	
Construction	24	31	20		21	
Real estate	30	35	NA		36	

Source: Company data, Kotak Institutional Equities estimates.

Change in estimates for Jaiprakash Associates (consolidated), March fiscal year-ends, 2008-12E (Rs mn)

	Revenues			EBITDA			Net profit		
	Old	**New**	**% Chg.**	**Old**	**New**	**% Chg.**	**Old**	**New**	**% Chg.**
2008	41,872	41,872	0.0	19,014	19,014	0.0	6,084	6,084	(0.0)
2009E	72,016	72,053	0.1	28,008	26,844	(4.2)	9,410	8,697	(7.6)
2010E	92,677	94,117	1.6	35,319	35,312	(0.0)	14,444	13,124	(9.1)
2011E	125,554	118,736	(5.4)	45,322	44,161	(2.6)	21,877	20,055	(8.3)
2012E	163,797	146,492	(10.6)	67,976	65,427	(3.7)	31,597	30,400	(3.8)

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Jaiprakash Associates Ltd, March fiscal year ends, 2007-2012E (Rs mn)

	2007	2008	2009E	2010E	2011E	2012E
Profit model						
Net revenues	39,328	41,872	72,053	94,117	118,736	146,492
EBITDA	**14,592**	**16,819**	**25,176**	**33,357**	**42,625**	**64,239**
Other income	987	2,195	1,668	1,954	1,536	1,188
Interest (expense)/income	(4,587)	(5,579)	(7,774)	(10,058)	(10,177)	(14,157)
Depreciation	(2,596)	(3,188)	(3,666)	(3,811)	(3,930)	(5,905)
Pretax profits	**8,395**	**10,247**	**15,404**	**21,443**	**30,054**	**45,366**
Tax	(2,408)	(2,200)	(5,126)	(6,129)	(7,824)	(10,413)
Deferred taxation	(65)	(762)	(516)	(1,091)	(1,006)	(678)
Minority interest	(882)	(1,202)	(1,065)	(1,100)	(1,169)	(3,876)
Net income	**5,040**	**6,084**	**8,697**	**13,124**	**20,055**	**30,400**
Extraordinary items	492	684	—	—	—	—
Reported profit	5,532	6,768	8,697	13,124	20,055	30,400
Earnings per share (Rs)	**4.6**	**4.9**	**7.3**	**11.0**	**16.9**	**25.6**
Balance sheet						
Paid-up common stock	2,192	2,343	2,363	2,363	2,363	2,363
Total shareholders' equity	29,286	49,772	58,470	69,727	87,650	115,651
Deferred taxation liability	5,824	7,101	7,617	8,707	9,713	10,390
Minority interest	4,591	7,025	8,534	12,060	16,527	23,502
Total borrowings	81,062	114,872	156,201	196,848	231,234	271,163
Total liabilities and equity	**120,762**	**178,770**	**230,821**	**287,342**	**345,125**	**420,707**
Net fixed assets	61,172	69,388	93,357	106,256	176,713	203,549
Capital work-in progress	27,390	62,250	73,572	119,981	127,725	153,150
Investments	77	1,203	1,203	1,203	1,203	1,203
Cash	18,230	24,622	38,465	29,175	2,152	17,091
Net current assets (excl. cash)	13,514	20,788	23,704	30,208	36,813	45,195
Net current assets (incl. cash)	32,122	45,929	62,688	59,903	39,484	62,805
Total assets	**120,762**	**178,770**	**230,821**	**287,342**	**345,125**	**420,707**
Free cash flow						
Operating cash flow, excl. working capital	5,532	9,905	12,275	17,171	24,624	39,669
Working capital changes	688	(7,274)	(2,916)	(6,504)	(6,605)	(8,382)
Capital expenditure	(24,654)	(45,993)	(38,958)	(63,118)	(82,131)	(58,165)
Free cash flow	**(18,435)**	**(43,362)**	**(29,598)**	**(52,451)**	**(64,112)**	**(26,878)**
Ratios						
Net debt/equity (%)	181	161	181	216	238	203
Return on equity (%)	15	13	14	18	23	27
Book value per share (Rs)	32	48	55	66	82	106
ROCE (%)	**9**	**8**	**7**	**8**	**9**	**12**

Source: Company data, Kotak Institutional Equities estimates.

Division-wise breakup of Jaiprakash's (consolidated) Key Financials, 2006-2012E

(Rs mn)

	2006	2007	2008	2009E	2010E	2011E	2012E
Sales							
Cement	12,206	18,314	19,504	25,904	35,005	44,437	53,773
Construction	16,754	14,329	11,486	29,050	34,192	44,452	43,259
Real estate	—	—	2,560	8,533	16,557	21,517	27,067
Power	2,732	5,497	6,845	7,174	7,072	7,062	21,174
Hotel	1,109	1,367	1,593	1,593	1,593	1,593	1,593
Total	32,801	39,507	41,988	72,253	94,417	119,061	146,867
less inter-div transfer	(91)	(180)	(116)	(200)	(300)	(325)	(375)
Reported total	**32,711**	**39,328**	**41,872**	**72,053**	**94,117**	**118,736**	**146,492**
EBITDA							
Cement	2,751	6,625	7,974	8,189	11,215	15,371	20,050
Construction	5,379	4,166	4,407	7,756	8,445	10,980	10,685
Real estate	—	—	810	4,075	8,678	11,298	15,308
Power	2,700	5,373	6,504	6,814	6,693	6,665	19,974
Hotel	513	592	691	691	691	691	691
Total	11,343	16,756	20,385	27,526	35,722	45,005	66,709
Others	(2,758)	(2,164)	(3,567)	(2,350)	(2,365)	(2,380)	(2,470)
Reported total	**8,585**	**14,592**	**16,819**	**25,176**	**33,357**	**42,625**	**64,239**

Source: Company data, Kotak Instittuional Equities estimates.

SOTP-based valuation of Jaiprakash Associates Ltd

			Value	
Business	**Methodology**	**Comments**	**(Rs bn)**	**(Rs/share)**
Cement	EV/EBITDA (X)	6X FY2010E EBITDA; JAL proposes to increase capacity to 23 mn tpa by FY2010 from the current 7 mn tpa	67	57
Construction	EV/EBITDA (X)	6X FY2010E EBITDA on an order book of US$2.8 bn	51	43
Real estate	NAV	Base case assumption of flat prices till FY2010 and 5% growth in realisation beyond that for 25 mn sq. ft of ribbon development along Taj Expressway and 8 mn sq. ft at Jaypee Greens	113	96
Power	DCF-to-equity	4,721 MW of attributable power portfolio, of which 501 MW is already under operation	93	78
Hotels	Market value	20% holding company discount on JAL's 72% stake in Jaypee Hotels	2	2
Net debt	Book value	Net debt for cement, construction and real estate business	(84)	(70)
Total			**243**	**204**

Source: Kotak Institutional Equities estimates.

Beverages

UNSP.BO, Rs739	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,050
52W High -Low (Rs)	2190 - 610
Market Cap (Rs bn)	69.2

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	46.3	57.4	66.0
Net Profit (Rs bn)	3.8	3.8	4.9
EPS (Rs)	40.0	40.1	52.4
EPS gth	*50.8*	*0.1*	*30.9*
P/E (x)	18.5	18.5	14.1
EV/EBITDA (x)	11.3	9.9	8.7
Div yield (%)	0.0	0.0	0.0

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	36.6	-	-
FIIs	33.9	0.6	0.3
MFs	2.0	0.2	(0.2)
UTI	-	-	(0.4)
LIC	-	-	(0.4)

United Spirits: Quarter impacted by high input prices

Ravi Agrawal : ravi.agrawal@kotak.com, +91-22-66341348

- **2QFY09 results in line with yoy gross sales growth of 26% and yoy EBITDA growth of 25%**
- **EBITDA margins increase 82 bps yoy to 21% versus KIE expectation of 19.8%; gross margins decline 3.6% qoq**
- **W&M registers strong sales growth of 33% yoy in 1HFY09, EBITDA grew 66% yoy to £6.7 mn but quarterly performance not representative**
- **Introduce FY2011E estimates; reduce target price to Rs1,050, retain BUY rating**

United Spirits (USL's) 2QFY09 results were broadly in line, with net sales at Rs9 bn (20% yoy growth, KIE Rs9.3 bn) and EBITDA and PAT of Rs 1.9 bn and Rs940 mn, respectively, (KIE Rs1.8 bn and Rs914 mn, respectively). Volume growth at 15% yoy was higher than our estimates of 13% growth. EBITDA margins increased marginally to 21% (versus KIE of 19.8%) despite higher COGS impact, offset by lower fixed costs. Standalone interest costs increased 20% yoy to Rs395 mn. W&M sales grew 83% in 1HFY09 while EBITDA grew 66% during the quarter to £6.7 mn. We believe recent communications by management should allay fears on W&M operations, especially with regards to its debt and interest outlook. We reduce our FY2009E and FY2010E earnings estimates 12% and 11%, respectively, to factor in higher interest outflow on domestic and W&M operations. We, however, reduce our SOTP-based target price to Rs1,050, (Rs 1,600 earlier) to factor in lower relative valuations of global majors. We retain our BUY rating.

EBITDA margins at 21% versus KIE expectation of 19.8%, despite higher input costs

While USL's EBITDA (including other operating income) at Rs1.89 bn was largely in line versus our expectation of Rs1.85 bn, COGS movement during the quarter was higher than expectation. While we were expecting COGS to increase to 51% of sales (200 bps higher than 1QFY09), actual COGS was 55% of sales, as the company bore the brunt of higher molasses prices and glass prices during the quarter. The management expects this ratio to decrease to around 50-52% over the next few quarters with the advent of the sugarcane crushing season beginning October-November. This would also be abetted by lower fuel costs and lower-than-anticipated increase in glass costs over the coming quarters.

We highlight that we expect COGS to trail at upper-end of the management guidance and expect COGS to remain at around 52% levels for the coming quarters. While we expect molasses prices to fall over the next 1-2 months with the advent of the crushing season, we have also repeatedly been highlighting that government data suggests at least a 20-30% lower sugarcane acreage this year, which would imply that year-on-year prices should continue to remain high.

Higher COGS was offset by lower fixed costs, especially on account of staff and selling costs during quarter, leading to better margins. Even after adjusting for the significant base effect on selling costs (where around Rs300 mn of IPL related expenses were expensed in 1QFY09) and in staff costs (2QFY08 numbers were considerably higher due to expensing of staff arrears), fixed costs under these heads are significantly lower than previous quarters. Management has, however, also indicated that marketing and staff costs over the year would normalize to their historical trends.

1QFY09 sales in line with expectation

Gross sales grew 27% yoy to Rs16.4 bn versus KIE of Rs16.2 bn. Volume growth was 15.2%, higher than our expectation of 13% in the quarter and against 19% in 1QFY09. Total cases sold during quarter were 21mn with the Maharashtra growing 17%, Karnataka growing 10%, Andhra Pradesh 11% and Tamil Nadu 10%.

Total volume growth in 1HFY09 is around 17% versus our full-year expectation of 14% volume growth. Traditionally 2H is a stronger period for sales, coinciding with the festive season. However, there is also a strong base effect and hence we would prefer to continue with our volume assumptions currently.

The company has also effected a price increase in Maharashtra during the quarter, one of its key states for volumes (around 11-12% of total sales), which is a positive and whose effect should be seen from 3QFY09 onwards. Moreover, the crucial state of Andhra Pradesh (around 18-20% of sales) has created a new excise slab at Rs400-450 per case levels, effectively allowing USL to increase its prices for products positioned marginally below Rs400. These changes will take effect from around middle of October and help in mitigating some of the input price increases.

W&M registers strong sales growth of 33% yoy for 1HFY09 and estimated EBITDA of £6.67 mn in 2QFY09 but quarterly performance not representative

W&M sales have grown 33% yoy in 1HFY09 to £65 mn against our FY2009E estimated growth of 8% yoy but we highlight that quarterly sales are not representative as almost 70% of sales tend to bunch around Oct-Dec quarter. Share of branded business to total sales mix continues to increase and contributed around 33% of sales from around 25% of sales in 1QFY09. Branded business has grown 11% in volume terms and around 14% in value terms. We estimate that EBITDA for the quarter has increased to £6.67 mn (66% yoy growth). We highlight that management expects total EBITDA in W&M in FY2009E of £60 mn (against £52 mn for 10.5 months in FY08) which is in line with our estimates of £59.9 mn for FY2009.

USL has repositioned Jura and Dalmore at the luxury segment and expects branded business to form an increasing part of sales. Moreover, it is planning to launch at least three more W&M brands in India. According to the company, scotch prices continue to remain strong and have increased around 30% post acquisition.

W&M debt and servicing under control

A considerable amount of management time went to assuaging investor concerns on consolidated debt and interest outlook, which is welcome given the recent headwinds in the credit market and the high leverage in the company. USL currently has around Rs14 bn of debt on its standalone books, with an additional US$620 mn on W&M books and around £325 mn in an SPV with recourse to USL. As shown in Exhibit 3, USL's first principal repayment of US$40 mn begins from June 2009 on the Citibank loan. The first principal payment on ICICI Bank loan of around £65 mn begins from June 2011. The management has clearly indicated it would use sale of its treasury stock to pay off loan proceeds, if the need arises. It also clearly reiterated that there are no adverse reset clauses in any of these loans.

On the interest outlook, Exhibit 4 shows that current six-month LIBOR (despite recent elevated levels) is actually trailing LIBOR around W&M acquisition in May 2007. This should benefit the company since most of the loans are on floating rates (except 50% of ICICI loan which has been covered at 5.4% + 260 bps).

We introduce FY2011 estimates and reduce our FY2009E and FY2010E consolidated earnings by 11-12% each to factor in higher interest costs

We reduce our FY2009E and FY2010E by 12% and 11% to factor in higher interest costs. We have increased our interest rate assumptions on standalone entity to 13% and 12.5% in FY2009E and FY2010E, respectively. Moreover, we also increase our average cost of debt assumptions in W&M to 8.5%, in line with management assumptions, from around 7.8% previously. We make only marginal changes at an operating level.

We also introduce FY2011E assumptions in our estimates. We factor a 10% volume growth in FY2011E in domestic business (from around 12% in FY2010E) with price/mix improvement of 8%. We also factor in a 10% increase in molasses prices. On W&M, we factor in revenue growth of 8% with absolute EBITDA estimated at £67 mn, representing 8% growth yoy.

We reduce our target price to Rs1,050 (Rs1,600 earlier) and retain BUY rating

We reduce our SOTP-based target price to Rs1,050 based on 12X FY2009E EV/EBITDA (16X earlier). At these valuations, we value the stock at the lower end of the 25-50% premium to leading global players (see Exhibit 10) which have seen significant de-rating over the recent past. We maintain our BUY rating. Key downside risks are higher molasses prices or worse-than-expected performance in W&M.

Interim results of United Spirits (standalone), March fiscal year-ends, (Rs mn)

	qoq			yoy		
	2Q2009	1Q2009	(% chg.)	2Q2009	2Q2008	(% chg.)
Gross Sales	16,456	18,497	(11.0)	16,456	12,985	26.7
Less: Excise Duty	(7,436)	(8,363)	(11.1)	(7,436)	(5,459)	36.2
Net sales	9,020	10,134	(11.0)	9,020	7,526	19.9
Expenditure						
COGS	(4,967)	(5,212)	(4.7)	(4,967)	(3,689)	34.6
Staff costs	(477)	(645)	(26.0)	(477)	(579)	(17.5)
Advertising & Sales Promotion	(490)	(1,089)	(55.0)	(490)	(668)	(26.6)
Other expenditure	(1,296)	(1,036)	25.1	(1,296)	(1,113)	16.5
Total	(7,230)	(7,982)	(9.4)	(7,230)	(6,047)	19.6
EBITDA	1,791	2,152	(16.8)	1,791	1,479	21.1
EBITDA Margin (% to sales)	19.9	21.2		19.9	19.6	
Interest (net)	(395)	(341)	15.6	(395)	(328)	20.4
Depreciation	(87)	(82)	6.7	(87)	(72)	21.2
Other income	106	72	48.2	106	42	152.7
Profit before tax	1,415	1,801	(21.4)	1,415	1,121	26.2
Total tax	(494)	(630)	(21.5)	(494)	(389)	27.0
PAT	921	1,171	(21.4)	921	732	25.8
Extraordinaries	18			18	70	
Net profit	939	1,171	(19.8)	939	802	17.1
% to net sales						
Excise (% to gross sales)	45.2	45.2		45.2	42.0	
COGS	55.1	51.4		55.1	49.0	
Staff costs	5.3	6.4		5.3	7.7	
SG&A	5.4	10.7		5.4	8.9	
Other expenditure	14.4	10.2		14.4	14.8	
EBITDA margins (including other income)	**21.0**	**21.9**		**21.0**	**20.2**	

Source: Company, Kotak Instituitonal Equities estimates

SOTP value of USL

Consolidated EBITDA (Rs mn)	12,980
Target EV/EBITDA multiple (x)	12
Target enterprise value (Rs mn)	155,757
Net debt (Rs mn)	59,596
Target equity value (Rs mn)	96,161
Fully diluted shares (mn) (1)	93.7
Price target (Rs)	**1,027**

Note:
(1) We use 93.7mn shares after FCCB dilution, adjusting for SWC merger and 13.7mn treasury shares.

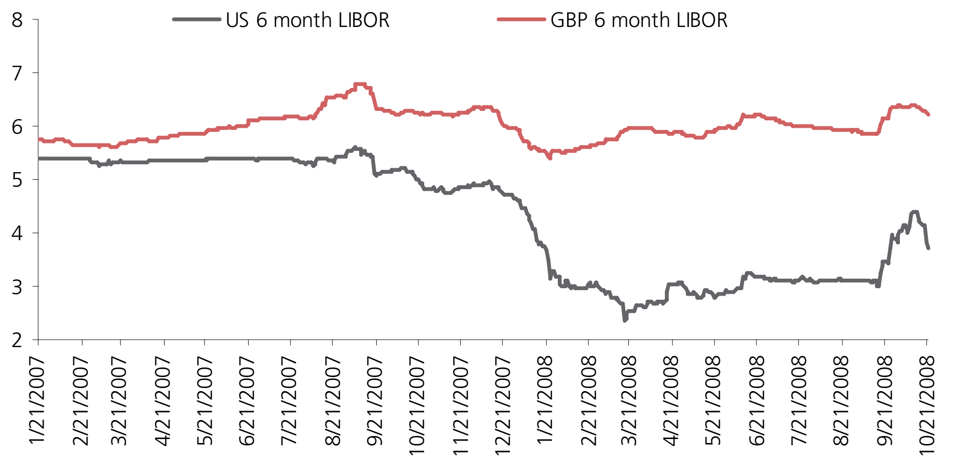
Source: Kotak Instituitonal Equities estimates

Summary of debt on account of W&M

Bank	Amount	Recourse company	Nature of interest rate	First principal payment
Citibank	US$ 619 mn	USL	Floating rate at 250 bps above 6 month US LIBOR	$90 mn in FY2010
ICICI	GBP 325 mn	W&M	50% floating at 260 bps above 6 month GBP LIBOR +50% hedged at 8%	Around GBP 65mn in FY2011

Source: Company

Reference LIBOR rates have reduced from the time of W&M acquisition in May 2007



Source: Bloomberg

Key changes in estimates for 2009/10E, March fiscal year-ends, (Rs mn)

	New		Old		Change (%)	
	2009E	2010E	2009E	2010E	2009E	2010E
Net Sales	57,404	65,962	57,363	65,913	0	0
COS	(29,789)	(34,486)	(29,776)	(34,471)	0	0
Gross Profit	27,615	31,476	27,587	31,443	0	0
EBITDA	**12,980**	**14,508**	**12,852**	**14,563**	**1**	**(0)**
EBITDA margin	22.6	22.0	22.4	22.1		
Interest and Fin Costs	(5,914)	(5,669)	(5,172)	(4,946)	14	15
Profit/Loss Before Tax	**5,650**	**7,355**	**6,264**	**8,132**	**(10)**	**(10)**
PAT	**3,779**	**4,943**	**4,287**	**5,565**	**(12)**	**(11)**

Source: Kotak Instituitonal Equities estimates

W&M: We adjust our W&M assumptions for higher interest costs

Key W&M estimates for 2009/11, March fiscal year-ends, (£ mn)

				yoy change (%)		
	2009E	2010E	2011E	2009E	2010E	2011E
Net Sales	193.5	209.0	225.7	23.2	8.0	8.0
COS	(89.0)	(96.1)	(101.6)	26.8	8.0	5.7
Gross Profit	104.5	112.9	124.2	20.3	8.0	10.0
EBITDA	**59.9**	**62.5**	**67.4**	15.1	4.3	7.8
Contribution	52.1	54.7	59.5	14.4	5.0	8.9
Restructuring costs	(0.3)	(0.3)	(0.3)	14.1	0.0	0.0
Amortisation of G/W	(2.9)	(2.9)	(2.9)	14.1	0.0	0.0
Interest and Fin costs	(52.1)	(50.0)	(45.2)	30.2	(4.0)	(9.7)
Profit/Loss Before Tax	**(3.2)**	**1.5**	**11.2**	(217.4)	(146.1)	661.0

Note:
(1) yoy comparisons for FY2009 are against a base of 10.5 months in FY2008.

Source: Kotak Instituitonal Equities estimates

Key estimates for USL (consolidated), March fiscal year-ends

	2006	2007	2008E	2009E	2010E	2011E
Total sales (Rs mn)	21,485	29,249	46,288	57,404	65,962	76,437
Gross margins (%)	47.3	45.1	50.7	48.1	47.7	47.8
EBITDA (Rs mn)	2,518	5,233	11,496	12,980	14,508	16,808
EBITDA margins (%)	11.5	17.4	24.5	22.4	21.8	21.8
Adjusted net profit (Rs mn)	2,067	2,411	3,773	3,779	4,943	6,984

Source: Company, Kotak Instituitonal Equities estimates

Key estimates for USL (ex-W&M), March fiscal year-ends

	2006	2007	2008	2009E	2010E	2011E
Total consolidated cases (mn cases)	59.4	66.4	73.7	82.3	92.2	101.5
Total sales (Rs mn)	21,485	29,249	33,248	40,954	48,196	57,250
Gross margins (%)	47.3	45.1	48.9	45.7	45.4	45.4
EBITDA (Rs mn)	2,518	5,233	7,180	7,885	9,194	11,080
EBITDA margins (%)	11.7	17.9	21.6	19.3	19.1	19.4
Adjusted net profit (Rs mn)	2,067	2,411	3,548	4,004	4,840	6,196

Source: Company, Kotak Instituitonal Equities estimates

Molasses prices expectation, March fiscal year-ends, (Rs/MT)

Source: Kotak Instituitonal Equities estimates

Valuations of some alcoholic beverages companies

	Ticker	Market cap (US$ mn)	EBITDA margin %	EV (US$ mn)	EV/EBITDA 2008E	EV/EBITDA 2009E	EV/EBITDA 2010E	P/E 2008E	P/E 2009E	P/E 2010E	EPS Growth (2007-10)
Campari	cpr im Equity	2,080	23.0	2,604	8.7	8.5	8.2	12.7	11.7	11.0	7
Constellation Brands Inc	stz US Equity	2,852	17.0	8,011	12.5	7.8	7.5	8.7	8.6	7.9	7
Diageo PLC	dge ln Equity	38,502	31.1	50,760	10.4	9.7	9.0	13.3	12.1	10.6	20
Fortune Brands Inc	FO US Equity	6,036	20.9	11,034	6.5	7.7	7.5	8.0	9.5	9.3	(3)
LVMH	mc fp Equity	37,399	24.9	45,424	8.1	7.7	7.3	13.1	12.4	11.7	7
Pernod-Ricard SA	RI FP Equity	14,432	25.5	23,422	8.3	7.6	7.0	10.4	8.8	7.8	18
Remy Cointreau SA	RCO FP Equity	1,906	21.2	2,503	11.0	10.0	9.1	15.3	14.1	12.4	(14)
Radico Khaitan	rdck in Equity	144	10.4	198	9.2	8.1	7.3	16.8	13.8	12.7	24
United Spirits	unsp in Equity	1,503	24.8	2,813	10.0	8.9	7.7	18.3	14.0	9.9	31

Note:
(1) 2008E represents FY2009E for all companies with March year-ends.

SourceL Bloomberg, Kotak Institutional estimates

USL: Profit model, balance sheet, cash model, March fiscal year-ends, 2005-11E, (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Profit Model (Rs mn)							
Total income (inc. other op. income)	**12,682**	**21,895**	**30,125**	**46,878**	**58,004**	**66,462**	**76,987**
EBITDA	**968**	**2,518**	**5,233**	**11,502**	**12,980**	**14,508**	**16,808**
EBITDA margin (%)	*7.6*	*11.5*	*17.4*	*24.5*	*22.4*	*21.8*	*21.8*
Depreciation	(164)	(426)	(338)	(892)	(1,145)	(1,214)	(1,279)
Amortization & restructuring expense	—	—	—	(232)	(271)	(271)	(271)
Other Income (inc. extraordinaries)	(303)	—	3,135	—	—	—	—
EBIT	**502**	**2,093**	**8,030**	**10,378**	**11,564**	**13,024**	**15,258**
Net finance cost	(356)	(1,524)	(873)	(4,699)	(5,914)	(5,669)	(5,259)
Profit before tax	**146**	**568**	**7,157**	**5,679**	**5,650**	**7,355**	**10,000**
Tax	**(83)**	**(123)**	**(1,049)**	**(1,906)**	**(1,871)**	**(2,412)**	**(3,015)**
Adjusted net profit	**396**	**1,254**	**2,848**	**3,773**	**3,779**	**4,943**	**6,984**
Diluted EPS (Rs)	**9.2**	**34.2**	**25.7**	**40.3**	**40.3**	**52.8**	**74.6**
Balance Sheet (Rs mn)							
Total Equity	2,811	14,164	19,828	23,665	27,252	31,955	38,627
Deferred tax liability	31	86	19	13	119	252	420
Total borrowings	9,732	10,970	10,378	64,948	64,948	60,808	55,283
Current liabilites & provisions	3,871	7,377	7,264	9,590	10,704	12,192	13,911
Total Liabilities and equity	**16,445**	**32,597**	**37,489**	**98,216**	**103,023**	**105,207**	**108,241**
Cash	5,088	3,611	5,778	4,582	5,352	3,785	2,275
Current assets excl. cash	6,944	10,802	13,152	42,770	46,996	51,004	55,871
Total net fixed assets	2,401	4,864	5,190	23,128	23,184	23,170	23,092
Investments	547	2,485	2,044	6,780	6,780	6,780	6,780
Goodwill on consolidation	1,465	10,835	11,324	20,955	20,711	20,468	20,224
Total assets	**16,445**	**32,597**	**37,489**	**98,216**	**103,023**	**105,207**	**108,241**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	142	800	6,379	4,868	5,248	6,501	8,632
Working capital	(68)	(1,171)	(2,610)	(27,292)	(3,122)	(2,562)	(3,210)
Capital expenditure	(541)	(2,717)	(872)	(18,830)	(1,200)	(1,200)	(1,200)
Free cash flow	**(467)**	**(3,088)**	**2,897**	**(41,254)**	**926**	**2,739**	**4,222**

Source: Company, Kotak Instituitonal Equities estimates

Media

ZEE.BO, Rs148	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	205
52W High -Low (Rs)	350 - 126
Market Cap (Rs bn)	64.0

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	18.4	22.6	25.5
Net Profit (Rs bn)	3.9	4.2	5.2
EPS (Rs)	8.9	9.7	12.0
EPS gth	*62.6*	*9.1*	*24.0*
P/E (x)	16.6	15.2	12.3
EV/EBITDA (x)	12.2	10.2	8.2
Div yield (%)	1.4	1.7	2.1

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	41.5	-	-
FIIs	26.0	0.3	0.1
MFs	12.6	0.9	0.6
UTI	-	-	(0.3)
LIC	8.2	0.5	0.2

Zee Entertainment Enterprises: Largely in-line 2QFY09 results on strong revenue growth; upgraded to BUY

Amit Kumar : amit.ckumar@kotak.com, +91-22-6749-3392

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

- **Strong growth in revenues driven by Ten Sports, higher pay-TV revenues**
- **Higher-than-expected operating costs due to sports rights, SG&A expenses**
- **Upgraded to BUY from ADD on inexpensive valuations**

ZEEL reported adjusted 2QFY09 net income of Rs991 mn (report net income at Rs1.8 bn) versus our expectation of Rs1.05 bn. However, specific line items such as ad revenues at Rs5.7 bn (+43% yoy) surprised positively (our estimate was Rs5.4 bn), largely due to incremental revenues from the sports business. Subscription revenue at Rs2.25 bn exhibited a strong 38% yoy growth due to rapid uptake of DTH (domestic pay-TV) and rupee depreciation (international pay-TV). However, 2QFY09 EBITDA at Rs1.5 bn was exactly in line with our estimates due to (1) cost of rights associated with the cricket series and (2) higher-than-expected SG&A expenses. We have fine-tuned our FY2009E, FY2010E and FY2011E EPS to Rs9.7 (Rs10.2 previously), Rs12 (Rs12.9) and Rs14.2 (Rs16) to factor in 2QFY09 results along with (1) lower ad revenue estimates for ZTV given loss of market share and (2) higher operating costs. Our revised 12-month DCF-based target price is Rs205 (Rs240 previously); key risks stem from lower-than-expected ad revenues and higher-than-expected increase in operating costs.

2QFY09 results analysis

Strong ad revenue growth likely unsustainable. ZEEL reported 2QFY09 ad revenues at Rs2.85 bn, an increase of 30% yoy and above our Rs2.7 bn estimate; the positive variance resulted from India-Sri Lanka cricket series on Ten Sports. The high growth also reflects (1) 15-20% ad rate increase by ZEEL at the start of the financial year (April 2008) and (2) good ratings of the ZEEL network in 2QFY09 (see Exhibit 2). However, we do not expect the strong growth to sustain given (1) seasonality associated with sports (largely cricket in India) and (2) significant drop in market share of ZEEL's flagship Hindi general entertainment (GE) channel, ZTV, with the entry of new competition (see Exhibit 4).

We do not expect all the Hindi GE channels (14 at last count, including flagship and flanking channels) to sustain operations over an extended period of time and believe consolidation in the industry is inevitable; nonetheless, consolidation will likely take time given new players are well funded (new players have raised money to fund operations for 2-3 years until break-even) and fragmentation will impact ad revenue growth in the interim. Moreover, the media buying agencies expect the ad revenue market to experience a slowdown in FY2010E with only 9-11% growth versus 15-20% growth in the past three years.

Robust pay-TV revenue growth—DTH and rupee depreciation. ZEEL's reported 2QYF09 subscription revenues at Rs2.25 bn, 38% yoy growth and in line with our estimates. Domestic pay-TV revenues increased 6% qoq and 44% yoy to Rs1.1 bn due to improved contribution from rapidly expanding DTH platforms and contribution from sports business. However, we note that 2QFY09 domestic pay-TV revenues did not include any contribution from new DTH platforms (Reliance Big TV, which launched in August 2008, and Airtel Digital TV) and revenues from new DTH operators will accrue 2-3 months after launch as per ZEEL management. We highlight that subscriber addition has improved significantly since the launch of new platforms.

International subscription revenues also improved 3% qoq and 33% yoy to Rs1.1 bn, in line with our estimates; rupee depreciation during the quarter (Rs43.75/US$ versus Rs40.5/US$ in 2QFY08) also contributed to yoy revenue growth. We note the sharp depreciation in the local currency in 3QFY09, which will likely lead to strong growth in 3QFY09 and FY2009 international subscription revenues. However, we expect international subscription revenues to grow slowly beyond FY2009E (5% CAGR in FY2009E-2011E) since the international markets (mainly USA, Canada and UK) have limited scope for volume or price increases.

Muted EBITDA growth on cricket series rights cost and SG&A expenses. ZEEL reported 2QFY09 EBITDA at Rs1.5 bn, a modest increase of 13% yoy despite strong growth in revenues. We highlight that sports business (India-Sri Lanka cricket series) was the key driver of revenue growth but its contribution to EBITDA declined with an operating loss of Rs85 mn versus Rs12 mn in 2QFY08 due to cost of sports rights. Employee expenses at Rs513 mn increased 52% yoy and were above our Rs450 mn estimate; the negative variance reflects continuous booking of employee incentives in the quarter versus as one-time expenses previously.

Also, we highlight the entry of competition has had a significant impact on ZEEL's cost structure (content and distribution). Higher SG&A expenses at Rs1.1 bn (+65% yoy, +20% qoq) versus our expected Rs1 bn also contributed to the disappointment on EBITDA margins. However, we see higher SG&A expenses as necessary to protect the franchise in an increasingly competitive broadcasting market and thus, view this development positively as a sign of renewed action by the company to improve visibility of its channels.

One-off tax write-back pulled up net income; improved subsidiary financials. ZEEL's reported net income increased 93% yoy against a 5% yoy increase in PBT due to extraordinary income of Rs792 mn arising from a tax refund for previous years. We note the impressive improvement in subsidiaries' financials of ZEEL (see Exhibit 1), which helped mitigate the qoq decline in EBITDA from standalone operations. We note that ZEEL's international subsidiaries were the key drivers of improved profitability in 2QFY09, which helped mitigate the impact of operating losses from the sports business.

Earnings revisions

We discuss below the changes behind our ZEEL earnings model, which reflect 2QFY09 results and our long-term assumptions on the broadcasting sector.

1. **Ad revenues.** We have revised our FY2009E, FY2010E and FY2011E ad revenues to Rs11.4 bn (Rs11.1 bn previously), Rs12.3 bn (Rs12.3 bn) and Rs13.4 bn (Rs13.8 bn) to reflect (1) ramp-up in sports business in FY2009E and (2) higher competitive intensity in broadcasting. We have revised our ad revenue growth estimate for ZTV to 6% CAGR for FY2008-FY2011E to reflect lower market share. However, our assumptions may prove conservative if the industry was to consolidate.

2. **Subscription revenues and exchange rate.** We have increased our international subscription revenues modestly to account for (1) a weaker rupee (Rs45/US$ in FY2009E and FY2010E versus Rs43.25/US$ and Rs42/US$ previously, Rs44/US$ in FY2011E versus Rs41/US$). We model international subscription revenues to increase 20% and 7% in FY2009E and FY2010E to Rs4.7 bn and Rs5.1 bn.

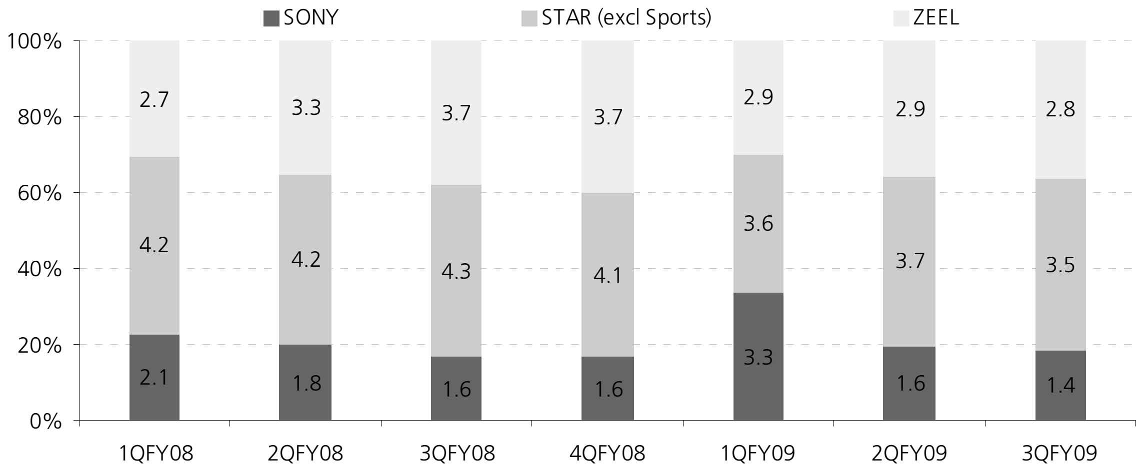
3. **Operating expenses.** We have increased FY2009E, FY2010E and FY2011E operating expenses to Rs16.3 bn, (Rs15 bn previously) Rs18 bn (Rs16.6 bn) and Rs19.4 bn (Rs18.1 bn) on account of (1) greater spend on content (more number of hours of programming) due to increased competitive intensity in the market, (2) higher rights costs associated with the sports business and (3) higher carriage fees.

Zee Entertainment (ZEEL) consolidated interim results, March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2009E	2Q 2009	1Q 2009	% chg.	2Q 2009	2Q 2008	% chg.	1H 2009	1H 2008	% chg.
Net sales	**22,552**	**5,717**	**5,420**	***5***	**5,717**	**3,986**	***43***	**11,136**	**7,902**	***41***
Advertisement revenues	11,427	2,851	2,798	*2*	2,851	2,195	*30*	5,650	4,239	*33*
Subscription revenues	9,248	2,244	2,150	*4*	2,244	1,625	*38*	4,394	3,306	*33*
Domestic pay-TV	4,499	1,113	1,053	*6*	1,113	775	*44*	2,166	1,529	*42*
International	4,749	1,131	1,097	*3*	1,131	850	*33*	2,228	1,777	*25*
Other sales	1,876	621	471	*32*	621	166	*273*	1,092	358	*205*
Total expenditure	**(16,296)**	**(4,229)**	**(3,978)**	***6***	**(4,229)**	**(2,665)**	***59***	**(8,207)**	**(5,384)**	***52***
Transmission and programming cost	(9,986)	(2,613)	(2,366)	*10*	(2,613)	(1,660)	*57*	(4,979)	(3,245)	*53*
Staff cost	(2,180)	(513)	(691)	*(26)*	(513)	(338)	*52*	(1,204)	(712)	*69*
Administrative & other costs	(4,130)	(1,102)	(921)	*20*	(1,102)	(668)	*65*	(2,024)	(1,427)	*42*
EBITDA	**6,256**	**1,488**	**1,442**	***3***	**1,488**	**1,321**	***13***	**2,930**	**2,518**	***16***
EBITDA margin (%)	**27.7**	**26.0**	**26.6**		**26.0**	**33.1**		**26.3**	**31.9**	
Other income	1,028	280	278	*1*	280	225	*24*	558	438	*27*
Interest	(753)	(223)	(214)	*4*	(223)	(85)	*162*	(437)	(203)	*115*
Depreciation	(265)	(65)	(55)	*18*	(65)	(55)	*18*	(121)	(122)	*(1)*
Pretax profits	**6,267**	**1,479**	**1,450**	***2***	**1,479**	**1,405**	***5***	**2,930**	**2,630**	***11***
Extraordinaries	—	792	574		792	—		1,366	—	
Tax	(1,997)	(489)	(417)	*17*	(489)	(435)	*13*	(906)	(847)	*7*
Net income	**5,636**	**1,782**	**1,607**	***11***	**1,782**	**971**	***84***	**3,389**	**1,783**	***90***
Minority interest	(62)	1	(6)		1	(46)		(5)	(88)	
Net income after minority interest	**5,574**	**1,783**	**1,601**	***11***	**1,783**	**925**	***93***	**3,384**	**1,696**	***100***
Tax rate (%)	31.9	33.1	28.8		33.1	30.9		30.9	32.2	

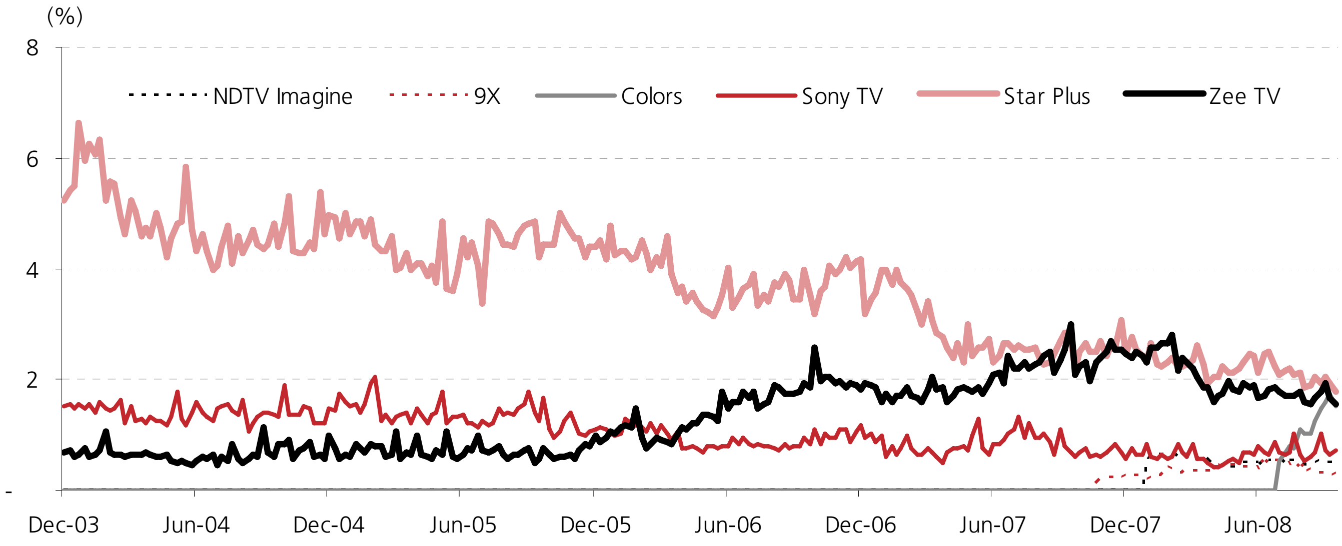
Source: Kotak Institutional Equities estimates

Primetime network rating share between SONY, STAR and ZEEL (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities

Primetime (7:30-11:30 PM) ratings for Hindi general entertainment channels and programs (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities

Key financials of ZEEL, consolidated and standalone (Rs mn)

	ZEEL consolidated			ZEEL standalone			ZEEL "rest"		
	2Q 2009	1Q 2009	1H 2009	2Q 2009	1Q 2009	1H 2009	2Q 2009	1Q 2009	1H 2009
Revenues	**5,717**	**5,420**	**11,136**	**3,030**	**3,333**	**6,363**	**2,687**	**2,086**	**4,773**
EBITDA	1,488	1,442	2,930	891	1,042	1,933	597	400	997
EBITDA margin (%)	**26.0**	**26.6**	**26.3**	**29.4**	**31.3**	**30.4**	**22.2**	**19.2**	**20.9**
Pre-tax profits	1,479	1,450	2,930	905	1,109	2,014	575	341	915
Tax	489	417	906	326	374	699	164	44	207
Adjusted net income	**990**	**1,033**	**2,023**	**579**	**736**	**1,315**	**411**	**297**	**708**
Tax rate (%)	**33.1**	**28.8**	**30.9**	**36.0**	**33.7**	**34.7**	**28.5**	**12.8**	**22.7**

Note:
(a) ZEEL "rest" primarily comprises of overseas operations.

Source: Company data, compiled by Kotak Institutional Equities

DCF analysis for ZEEL (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBITDA	**6,256**	**7,471**	**8,826**	**10,334**	**12,332**	**13,569**	**14,690**	**15,888**	**16,822**			
Tax expense	(2,195)	(2,825)	(3,287)	(3,897)	(4,686)	(5,232)	(5,752)	(6,237)	(6,711)			
Changes in working capital	(1,640)	(1,278)	(1,216)	(1,346)	(1,462)	(1,299)	(1,294)	(1,344)	(1,420)			
Cash flow from operations	**2,421**	**3,368**	**4,323**	**5,092**	**6,183**	**7,039**	**7,644**	**8,307**	**8,690**			
Capital expenditure	(200)	(200)	(225)	(225)	(250)	(250)	(275)	(275)	(300)			
Free cash flow	**2,180**	**3,104**	**4,013**	**4,762**	**5,810**	**6,652**	**7,217**	**7,903**	**8,225**	**8,718**	**9,241**	**9,796**
Discounted cash flow- now	2,069	2,619	3,009	3,173	3,441	3,502	3,378	3,286	3,040	2,865		
Discounted cash flow-1 year forward		2,946	3,385	3,571	3,871	3,940	3,800	3,698	3,420	3,223	3,037	
Discounted cash flow-2 year forward			3,809	4,018	4,357	4,433	4,275	4,161	3,849	3,626	3,416	3,219

	Now	+ 1-year	+ 2-years
Total PV of free cash flow (a)	30,383	34,893	39,161
PV of terminal value (b)	46,717	49,520	52,491
Total company value (a) + (b)	77,100	84,412	91,652
Net debt/(cash)	(2,839)	(4,948)	(7,151)
Value to equity holders	79,939	89,361	98,803
Value to equity holders (Rs/share)	**184**	**206**	**227**

Assumptions for WACC and growth in perpetuity	
Growth from 2017 to perpetuity (%)	6.0
FCF multiple (X)	**15.4**
Exit EV/EBITDA multiple (X)	**8.5**
WACC (%)	**12.5**

Source: Kotak Institutional Equities estimates

Consolidated profit and loss statement for Zee Telefilms, March fiscal year-ends, 2004-2006, ZEEL, 2007-2012E (Rs mn)

	2004	2005	2006	2007	2008	2009E	2010E	2011E	2012E
Revenues									
National Hindi (Zee TV)	2,539	1,826	2,119	3,303	5,081	5,793	5,793	6,102	6,867
National Hindi (Zee Cinema)	756	914	996	1,574	1,814	2,159	2,466	2,795	3,160
Niche channels (English, Music, Zee Next)	965	956	1,081	400	504	674	867	1,059	1,229
Regional channels	1,365	1,324	1,486	—	—	—	—	—	—
Zee Sports + Taj TV	—	—	72	1,279	1,033	1,808	2,102	2,370	2,663
Cable TV (Siti)	220	266	261	—	—	—	—	—	—
Overseas - ZMWL	460	505	557	526	468	548	569	572	572
Others	50	(92)	(6)	(47)	406	447	491	516	542
Advertisement	**6,355**	**5,698**	**6,566**	**7,035**	**9,307**	**11,427**	**12,289**	**13,414**	**15,032**
Domestic pay-TV	2,173	2,696	2,801	3,113	3,460	4,499	6,021	7,390	8,672
Overseas	2,569	2,909	3,030	3,933	3,949	4,749	5,090	5,256	5,394
Domestic subscription	1,168	1,002	978	—	—	—	—	—	—
Others	115	(74)	364	(399)	26	—	—	—	—
Subscription revenues	**6,026**	**6,533**	**7,174**	**6,648**	**7,436**	**9,248**	**11,112**	**12,646**	**14,066**
Education	131	106	162	205	235	386	418	460	506
Others	1,190	742	2,641	1,271	1,376	1,490	1,637	1,718	1,803
Total revenues	**13,702**	**13,079**	**16,544**	**15,159**	**18,354**	**22,552**	**25,456**	**28,238**	**31,408**
Programming/Content	(2,520)	(2,611)	(4,247)	(4,783)	(5,173)	(7,042)	(8,015)	(8,900)	(9,821)
Broadcasting	(618)	(675)	(515)	(564)	(605)	(651)	(685)	(673)	(669)
Distribution	(1,837)	(1,534)	(2,565)	(1,967)	(1,953)	(2,167)	(2,303)	(2,359)	(2,401)
Other direct operating	—	—	(262)	(766)	(88)	(126)	(142)	(156)	(172)
Employees	(727)	(858)	(1,089)	(1,017)	(1,438)	(2,180)	(2,479)	(2,796)	(3,169)
SG&A	(3,691)	(3,051)	(3,431)	(2,858)	(3,675)	(4,130)	(4,360)	(4,527)	(4,841)
Total expenses	**(9,393)**	**(8,728)**	**(13,848)**	**(11,955)**	**(12,931)**	**(16,296)**	**(17,984)**	**(19,412)**	**(21,073)**
EBITDA	**4,309**	**4,351**	**2,695**	**3,204**	**5,423**	**6,256**	**7,471**	**8,826**	**10,334**
Other income	776	521	639	747	1,138	1,028	1,055	1,148	1,299
Interest expense	(583)	(207)	(188)	(334)	(516)	(753)	(130)	—	—
Depreciation	(320)	(329)	(360)	(185)	(232)	(265)	(327)	(334)	(346)
Amortization	—	—	—	—	—	—	—	—	—
Pretax profits	**4,183**	**4,336**	**2,787**	**3,432**	**5,813**	**6,267**	**8,070**	**9,640**	**11,287**
Extraordinary items	26	(140)	19	—	(26)	1,366	—	—	—
Tax	(1,103)	(1,123)	(528)	(926)	(1,794)	(1,998)	(2,781)	(3,287)	(3,897)
Deferred tax	54	99	(9)	(76)	168	1	7	9	11
Minority interest	(192)	(50)	(117)	(58)	(328)	(62)	(77)	(195)	(223)
Net income	**2,969**	**3,123**	**2,153**	**2,373**	**3,833**	**5,574**	**5,219**	**6,166**	**7,178**
Recurring net income	**2,942**	**3,263**	**2,134**	**2,373**	**3,859**	**4,208**	**5,219**	**6,166**	**7,178**
Fully diluted EPS	**7.1**	**7.5**	**4.9**	**5.5**	**8.9**	**9.7**	**12.0**	**14.2**	**16.6**
Key ratios									
EBITDA growth (%)	**14.7**	**1.0**	**(38.1)**	**18.9**	**69.3**	**15.4**	**19.4**	**18.1**	**17.1**
EPS growth (%)	**18.2**	**5.2**	**(34.6)**	**11.2**	**62.6**	**9.1**	**24.0**	**18.5**	**16.4**
EBITDA margin (%)	31.5	33.3	16.3	21.1	29.5	27.7	29.4	31.3	32.9
Tax rate (%)	24.9	24.4	19.1	29.2	28.1	26.2	34.4	34.0	34.4
Shares o/s year end (mn)	412	412	413	434	434	434	434	434	434
Shares o/s fully diluted (mn)	412	435	435	435	435	435	435	434	434

Source: Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of ZEEL, 2006-2012E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009E	2010E	2011E	2012E
Profit model (Rs mn)							
Total revenues	**16,544**	**15,159**	**18,354**	**22,552**	**25,456**	**28,238**	**31,408**
EBITDA	**2,695**	**3,204**	**5,423**	**6,256**	**7,471**	**8,826**	**10,334**
Other income	639	747	1,138	1,028	1,055	1,148	1,299
Interest	(188)	(334)	(516)	(753)	(130)	—	—
Depreciation	(360)	(185)	(232)	(265)	(327)	(334)	(346)
Amortization	—	—	—	—	—	—	—
Pretax profits	**2,787**	**3,432**	**5,813**	**6,267**	**8,070**	**9,640**	**11,287**
Extraordinary items	19	—	(26)	1,366	—	—	—
Tax	(528)	(926)	(1,794)	(1,998)	(2,781)	(3,287)	(3,897)
Deferred tax	(9)	(76)	168	1	7	9	11
Minority interest	(117)	(58)	(328)	(62)	(77)	(195)	(223)
Net income	**2,153**	**2,373**	**3,833**	**5,574**	**5,219**	**6,166**	**7,178**
Recurring net income	**2,134**	**2,373**	**3,859**	**4,208**	**5,219**	**6,166**	**7,178**
Earnings per share (Rs)	**4.9**	**5.5**	**8.9**	**9.7**	**12.0**	**14.2**	**16.6**
Balance sheet (Rs mn)							
Total equity	21,286	26,181	28,611	32,663	35,853	38,975	42,096
Deferred tax balance	(148)	(75)	(243)	(244)	(251)	(260)	(271)
Minority interest	458	819	1,117	1,179	1,256	1,451	1,675
Total borrowings	4,901	3,226	3,866	3,111	—	—	—
Currrent liabilities	4,346	5,106	6,279	7,347	7,858	8,258	8,671
Total capital	**30,844**	**35,256**	**39,629**	**44,055**	**44,715**	**48,425**	**52,170**
Cash	1,286	955	1,652	3,434	2,433	4,636	6,743
Current assets	13,574	17,133	19,856	22,564	24,353	25,969	27,728
Net fixed assets	12,948	14,841	15,605	15,541	15,414	15,304	15,183
Investments	3,024	2,326	2,515	2,515	2,515	2,515	2,515
Deferred expenditure	12	2	—	—	—	—	—
Total assets	**30,844**	**35,256**	**39,629**	**44,055**	**44,715**	**48,425**	**52,170**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	1,931	1,812	3,898	4,871	4,561	5,539	6,438
Working capital	(3,950)	(486)	(1,622)	(1,640)	(1,278)	(1,216)	(1,346)
Capital expenditure	(383)	(460)	(1,019)	(200)	(200)	(225)	(225)
Investments	418	(4,289)	(1,511)	—	—	—	—
Other income	488	469	876	1,028	1,055	1,148	1,299
Free cash flow	**(1,496)**	**(2,954)**	**622**	**4,059**	**4,138**	**5,246**	**6,165**
Revenue model (Rs mn)							
Advertising revenues	6,566	7,035	9,307	11,427	12,289	13,414	15,032
Subscription-domestic	2,801	3,113	3,460	4,499	6,021	7,390	8,672
Subscription-overseas	3,030	3,933	3,949	4,749	5,090	5,256	5,394
Subscription-cable	978	—	—	—	—	—	—
Others	3,168	1,078	1,637	1,876	2,055	2,178	2,309
Total revenues	**16,544**	**15,159**	**18,354**	**22,552**	**25,456**	**28,238**	**31,408**

Source: Kotak Institutional Equities estimates

Technology

TEML.BO, Rs413	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	700
52W High -Low (Rs)	1310 - 333
Market Cap (Rs bn)	51.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	37.7	47.8	56.1
Net Profit (Rs bn)	7.8	10.0	11.1
EPS (Rs)	59.1	76.4	85.0
EPS gth	*25.7*	*29.4*	*11.2*
P/E (x)	7.0	5.4	4.9
EV/EBITDA (x)	6.2	3.5	2.6
Div yield (%)	1.3	1.5	1.5

Tech Mahindra: Margin expansion takes care of operating performance even as revenue performance slips

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243
Rohit Chordia : rohit.chordia@kotak.com, +91-22-6634-1397

- **2QFY09—margin expansion the key highlight even as revenues disappoint**
- **Quarterly volatility in margins is here to stay; we would focus on full-year OPM performance**
- **Hedged aggressively; more forex losses likely if Re continues at current levels**

Tech Mahindra reported significant OPM expansion though revenue growth was below our expectations. Revenues for the Sep '08 quarter at US$269.6 mn (-0.8% qoq, +22% yoy, qoq growth of 2.7% at constant currency) were lower than our expectation of US$276 mn. Strong core EBITDA growth of 14% qoq was driven margin expansion of 230 bps to 28%. Net income (at Rs2.35 mn, down 8.9% qoq) was impacted by forex losses of US$9 mn (versus gains of US$4 mn in the previous quarter). We believe that the quarterly performance of TM would be volatile given the concentrated nature of business. We, however, reduce our revenue growth expectations noting (1) decline in core BT IT spending; (2) appreciation of US$ against GBP and (3) push-back in the transition of the recently won US$700 mn, front-ended transformation program. We are not building any large deal wins in our model (except BT). Accordingly, we lower our revenue estimates for TM for FY2009-11E by 4-8%. TM continues to exceed our expectation on OPM performance led better-than-expected cost management and execution. We increase our EPS estimate for FY2009 by 4.2% to Rs76.4, 0.8% for FY2010 to Rs85 and 2.5% for FY2011 to Rs91.2. We maintain our BUY rating on the stock noting (1) higher visibility on revenues from key large clients; (2) company will continue to demonstrate better growth profile than peers and (3) lower risks to the pricing and operating margin. The company has a FCF yield of 18% on FY2009 forecasts.

2QFY09-margin expansion the key highlight even as revenues disappoint. TM's reported EBITDA of Rs3.26 bn for the Sep '08 quarter was 15% ahead of our estimates. Revenues of US$269.6 mn, however, came in 2.2% lower than our expectations. Revenue growth was driven primarily by non-BT accounts, which grew 7.2% qoq. A 11.3% qoq decline in BT core revenues led to a 5.6% decline in BT revenues qoq; BTGS revenues ramped up by US$7 mn in absolute terms to US$32 mn. Note that BT account was stable in GBP billing.

Adjusted EBITDA margins (adjusted for the Rs673 mn UK payee tax write-back in cost of revenues) grew 230 bps qoq and 600 bps yoy to 28%, despite a decline in utilization rates. Margin expansion was driven by (1) significant cost rationalization measures taken by the company; non-employee expenses, adjusted for the write-back, were down 230bps qoq, (2) sharp rupee depreciation during the quarter and (3) absorption of the wage hikes effected in the previous quarter.

Revenue growth strategy-convert core BT revenues to annuity business, aggressive expansion in non-BT. We believe that TM has a three-pronged growth strategy (1) strategic partnership in high growth areas with BT; BTGS relationship will pay rich dividends in our view. This is a high growth and under-penetrated area; (2) convert BT core revenues into large annuity contracts. This provides the company with revenue visibility and offers savings to clients through investments in automation and productivity tools. We believe that this strategy is appropriate especially noting that the certain large programs in BT may be nearing completion. The company had signed a US$350 mn deal in 1QCY08 as a part of this strategy and (3) aggressive push in the non-BT relationships. The company has recently won a large US$300 mn deal from a North American telco. Further, the company has four high potential clients, which if mined and executed well can provide the next fillip to growth. We highlight that the deceleration in growth in the company revenues partly contributed to an extremely weak performance from two TEM clients which are a part of the Top 5 accounts.

Quarterly volatility in margins is here to stay. Over the past few quarters, TM has increasingly sought to get into long-term contracts with its top few accounts. This has reflected in some of the recent contract signings like the US$1 bn BTGS deal signed in Dec '06, the US$350 mn deal with BT and US$300 mn deal with AT&T signed in the previous two quarters and the US$700 mn deal with BT signed in the Jun '08 quarter. We expect the quarterly margins to fluctuate depending on the quantum of transition costs in the given quarter on the above large deals. The impact of fluctuating transition work on a qoq basis is amply demonstrated in the volatility in TM's non-employee expenses over the past few quarters. We build in a 390 bps improvement in TM's OPM for FY2009E and a 190 bps decline in FY2010E.

We do not share the street's excessive caution on margins of BTGS and other large deals (with or without upfront payments). TM management has emphasized in the past that the profitability of the US$1-bn BTGS deal (after accounting for the upfront payment of US$118 mn) and the recent US$700 mn (incremental revenues, we discuss the deal details below) deal (TM will bear a portion of US$110 mn paid to BT last quarter) will be close to the corporate-average profitability (FY2008 EBIT margin was 20%) over the course of the deal. We highlight some of the likely factors driving management's confidence (1) TM would be able to capture productivity investments through the course of the contract (and not pass the same on to BT in the form of volume discounts or lower pricing, as is the case with typical contracts), and (2) the long-term nature of the deal provides substantial headroom for investing in tools/automation, to drive higher productivity and/or lower cost of service delivery.

Hedged aggressively; more forex losses likely if Re continues at current levels. TM had US$800 mn of USD-INR and US$300 mn of GBP-USD hedges outstanding as on Sep 30, 2008, equivalent to close to 5 quarters of gross receivables (7-8 quarters of net inflows). TM's hedging is higher than most of tier-I names. The company has indicated that it has US$26.5 mn of forex losses sitting in the OCI (down from US$58 mn in the previous quarter, thanks to gains on GBP/USD hedges) and the forex losses for the rest of FY2009E will likely be US$2-4 mn if the Re/US$ rate remains at the current levels. We model forex losses of Rs140 mn for the remaining two quarters of FY2009.

EPS estimates revised upwards; maintain BUY. We have increased our FY2009E and FY2010E EPS by 4.2% and 0.8% to Rs76.4 and Rs85 respectively despite lowering our revenue growth estimates (to 17.3% and 17.5% versus 22.4% and 22.6% for FY2009E and FY2010E respectively)-the key change being increase in OPM assumptions. Maintain our BUY rating on the stock noting inexpensive valuations (5.4X FY2009E and 4.9X FY2010E earnings) post the recent steep correction in the stock price. Our target price of Rs700/share implies an upside of 69% from current levels.

Key changes in FY2009-11 estimates, March fiscal year-ends

	New			Old			Change (%)		
	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E
Revenues (Rs mn)	**47,762**	**56,143**	**67,616**	**49,528**	**60,357**	**72,564**	**(3.6)**	**(7.0)**	**(6.8)**
Revenues (US$ mn)	**1,097**	**1,289**	**1,568**	**1,145**	**1,403**	**1,704**	**(4.2)**	**(8.1)**	**(8.0)**
Revenue growth (%)	**17.3**	**17.5**	**21.7**	**22.4**	**22.6**	**21.4**			
EBITDA (Rs mn)	12,301	13,440	15,460	11,341	13,193	14,977	8.5	1.9	3.2
Net Profit (Rs mn)	10,010	11,133	11,946	9,611	11,046	11,650	4.2	0.8	2.5
Fully diluted EPS (Rs/share)	**76.4**	**85.0**	**91.2**	**73.4**	**84.3**	**88.9**	**4.2**	**0.8**	**2.5**
Re/$ rate	43.5	43.5	43.1	43.3	43.0	42.6	0.7	1.3	1.3
EBITDA margin (%)	25.8	23.9	22.9	22.9	21.9	20.6			

Source: Kotak Institutional Equities estimates

Tech Mahindra interim results, March year end (Rs mn)

	2QFY08	1QFY09	2QFY09	% change qoq	% change yoy	Kotak Estimates	% Deviation	Comments on QoQ performance
Revenues	**8,976**	**11,164**	**11,648**	**4.3**	**29.8**	**12,099**	**(3.7)**	Revenues declined 0.8% qoq, versus our expectation of 1.2% growth. Impacted by adverse cross-currency movements and lower-than-expected volumes from the BT account
Cost of revenues	(5,658)	(6,825)	(6,867)	0.6	21.4	(7,554)	(9.1)	
Gross profit	**3,318**	**4,339**	**4,781**	**10.2**	**44.1**	**4,545**	**5.2**	Another quarter of impressive gross margin improvement despite a 500bps drop in utilization
SG&A expenses	(1,346)	(1,470)	(1,520)	3.4	12.9	(1,712)	(11.2)	
EBITDA	**1,972**	**2,869**	**3,261**	**13.7**	**65.4**	**2,833**	**15.1**	EBITDA margins 460 bps ahead of expectations (up 230 bps qoq and 600 bps yoy). Driven by lower-than-expected SG&A expenses and rupee depreciation
Depreciation	(193)	(258)	(267)	3.5	38.3	(265)	0.6	
EBIT	**1,779**	**2,611**	**2,994**	**14.7**	**68.3**	**2,567**	**16.6**	
Interest	(26)	-	-			-		
Other income	249	258	(320)	(224.0)	(228.5)	279		Includes US$xx mn of forex loss (US$4 mn gain in the previous quarter)
Profit before tax	**2,002**	**2,869**	**2,674**	**(6.8)**	**33.6**	**2,846**	**(6.0)**	
Tax	(187)	(283)	(320)	13.1	71.1	(373)		Tax rate lower than expectations
Net profit	**1,815**	**2,586**	**2,354**	**(9.0)**	**29.7**	**2,473**	**(4.8)**	
Minority interest	2	(2)	(1)			-		
Net income	**1,817**	**2,584**	**2,353**	**(8.9)**	**29.5**	**2,473**	**(4.8)**	**Adjusted net income 4.8% lower than our expectations primarily on account of Rs320 mn forex loss**
Extraordinaries	-	-	673			-		UK payee tax write-back of US$15.3 mn
Net profit- reported	**1,817**	**2,584**	**3,026**			**2,473**	**22.4**	
EPS -Diluted (Rs)	**13.9**	**19.7**	**18.0**	**(8.9)**	**29.5**	**18.9**		
Shares outstanding (mn)	131.0	131.0	131.0	-	-	131.0		
Margins (%)								
Gross profit margin	37.0	38.9	41.0			37.6		
EBITDA margin	22.0	25.7	28.0			23.4		
EBIT margin	19.8	23.4	25.7			21.2		
NPM	20.2	23.1	20.2			20.4		
Employee Metrics								
Software Professionals	18,883	19,386	20,273					
Sales & Support	1,026	1,101	1,128					
BPO professionals	3,191	3,882	3,734					
Total Employees	23,100	24,369	25,135					
Other Metrics								
BT revenues (% of total)	65.0	63.0	60.0					
Revenues (%)								
BT	5,834	7,033	6,989	(0.6)	19.8			
Non-BT	3,142	4,131	4,659	12.8	48.3			Strong growth in non-BT revenues (+7.2% qoq and +39.5% yoy in US$ terms)
Revenue Mix (%)								
Onsite	45.0	40.0	40.0					
Offshore	55.0	60.0	60.0					

Source: Kotak Instutional Equities estimates

Tech Mahindra- consolidated Indian GAAP profit & loss statement. March fiscal year ends (Rs mn)

	2007	2008	2009E	2010E	2011E
Revenues	**29,290**	**37,661**	**47,762**	**56,143**	**67,616**
Direct cost	(17,536)	(23,854)	(29,026)	(34,930)	(42,759)
Gross profit	**11,754**	**13,807**	**18,736**	**21,213**	**24,857**
SG&A expenses	(4,387)	(5,549)	(6,435)	(7,773)	(9,398)
EBITDA	**7,368**	**8,258**	**12,301**	**13,440**	**15,460**
Depreciation	(515)	(796)	(1,052)	(1,373)	(1,713)
EBIT	**6,852**	**7,462**	**11,249**	**12,067**	**13,747**
Other income	77	1,044	74	971	1,310
Interest	(61)	(62)	—	—	—
Profit before tax	**6,868**	**8,444**	**11,322**	**13,038**	**15,057**
Tax	(740)	(748)	(1,313)	(1,905)	(3,111)
Net profit	**6,128**	**7,696**	**10,010**	**11,133**	**11,946**
Minority interest	(1)				
Net income	**6,127**	**7,696**	**10,010**	**11,133**	**11,946**
Extraordinaries	(4,910)	(4,401)	—	—	—
Net profit- reported	**1,218**	**3,295**	**10,010**	**11,133**	**11,946**
Fully Diluted EPS (Rs/Share)	**47.0**	**59.0**	**76.4**	**85.0**	**91.5**
Margins (%)					
Gross profit margin	40.1	36.7	39.2	37.8	36.8
EBITDA margin	25.2	21.9	25.8	23.9	22.9
EBIT margin	23.4	19.8	23.6	21.5	20.3
NPM	20.9	20.4	21.0	19.8	17.7
Growth rates (%)					
Revenues	135.7	28.6	26.8	17.5	20.4
Gross profit	133.7	17.5	35.7	13.2	17.2
EBITDA	175.0	12.1	49.0	9.3	15.0
EBIT	200.3	8.9	50.7	7.3	13.9
Net profit	160.3	25.6	30.1	11.2	7.3

Source: Kotak Institutional Equities estimates.

Banking

LICH.BO, Rs243	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	325
52W High -Low (Rs)	403 - 192
Market Cap (Rs bn)	20.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	6.8	8.2	9.2
Net Profit (Rs bn)	3.9	4.6	4.8
EPS (Rs)	45.5	54.6	56.2
EPS gth	*39.8*	*20.4*	*3.0*
P/E (x)	5.3	4.5	4.3
P/B (x)	1.1	0.9	0.8
Div yield (%)	4.1	4.9	5.1

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	40.8	-	-
FIIs	31.7	0.1	0.0
MFs	2.5	0.0	(0.0)
UTI	-	-	(0.1)
LIC	40.8	0.6	0.6

LIC Housing Finance: Sharp growth in home loans, core performance in line; retain ADD

Nischint Chawathe : nischint.chawathe@kotak.com, +91-22-6749-3588

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

- **LICHF reported net profit of Rs1.35 bn, up 16% yoy and 9% above estimates**
- **Strong loan growth, stable spreads and provision write-back support earnings**
- **Reported NPLs reduced qoq though high disbursement growth raises concerns on future slippages**
- **We raise estimates; retain ADD with price target of Rs325**

LIC Housing Finance (LICHF) reported core profit (PBT+ provisions) of Rs1.78 bn, up 25% yoy and in line with estimates. Core performance for the quarter was strong—primarily driven by 26% growth in loans and stable spreads. Provisions write-back due to a reduction in NPLs supported PAT. While LICHF's performance during the quarter appears satisfactory, strong disbursements growth (35% yoy) will likely increase slippages over the medium term. We are raising our earnings estimates by 2%-5% for FY2009-2010E to factor marginally higher NIMs, loan growth and lower provisioning expenses in FY2009E. Despite a rollover to FY2010E, we are reducing our target price to Rs325 from Rs380 as we now factor a 15% discount to our fair value estimate. Retain ADD recommendation. The stock is currently trading at 4.3X PER and 0.9X APBR FY2010E.

Strong growth in business, maintaining asset quality remains the key. LICHF reported 26% yoy growth in overall (retail and builder) loans during 2QFY09 on the back of 41% yoy growth in retail disbursements. We believe lower competition from banks has aided housing finance companies like LICHF and HDFC though the overall retail market for housing finance may have stagnated.

Collection efficiency remained strong as gross NPLs reduced 11% qoq. Gross NPLs ratio stood at 1.85% as of 2QFY09 versus 2.22% as of June 2008 and 2.8% as of 2QFY08. We believe relatively high real estate prices at the current juncture are aiding the recovery efforts of the company. While current NPLs are low, rapid loan growth in the current phase of the real estate cycle will likely provide a risk to LICHF's asset quality in the medium term. We are reducing our provisioning estimates by 10% for FY2009E to factor the on-going traction in recoveries. However, we continue to factor in provisioning expenses at 0.3% of average assets in FY2010E versus 0.2% in FY2009E and 0.1% reported in FY2008. This is significantly below the peak level of NPL provisions-to-average assets ratio of 0.7%, which was booked in FY2005.

Spreads appear comfortable. LICHF reported spreads of 1.75% which were stable in comparison to those observed in 1QFY09 and 2QFY08. LICHF has raised its prime lending rate (PLR) by 50 bps in August 2008, which is over and above 25 bps hike effected in May 2008. The entire loan portfolio is likely to be repriced by November 2008. We factor stable NIMs in our estimates for 2HFY09E followed by a marginal decline in FY2010E. The management has highlighted that the company had surplus liquidity for most part of the quarter. The liquid balance sheet helped the company book higher income on funds parked with short-term mutual funds.

LIC Housing Finance—old and new estimates

March fiscal year-ends, 2009-2010E (Rs mn)

	Old estimates		New estimates		Old vs New (%)		YoY(%)	
	2009E	2010E	2009E	2010E	2009E	2010E	2009E	2010E
NIMs(%)	2.9	2.7	2.9	2.7				
Loan growth (%)	23.3	19.8	24.6	20.6				
Net interest income	6,824	7,917	6,902	8,039	1.1	1.5	22.8	16.5
Other income	1,250	1,254	1,393	1,254	11.4	0.0	8.8	(10.0)
Fee income	579	596	579	596	0.0	0.0	10.0	3.0
Other income	672	658	815	658	21.3	0.0	7.9	(19.3)
Total income	8,074	9,171	8,295	9,293	2.7	1.3	20.2	12.0
Loan loss provisions	490	892	443	904	(9.5)	1.4	82.6	103.9
Operating expenses	1,520	1,722	1,520	1,722	0.0	0.0	13.6	13.3
Employee expenses	397	456	397	456	(0.0)	(0.0)	15.0	15.0
Other expenses	1,123	1,265	1,123	1,265	0.0	0.0	13.2	12.7
PBT	6,064	6,558	6,332	6,667	4.4	1.7	19.0	5.3
Tax	1,639	1,862	1,694	1,893	3.4	1.6	16.8	11.7
PAT	**4,426**	**4,695**	**4,638**	**4,774**	**4.8**	**1.7**	**19.8**	**2.9**
PBT+provisions-extraordinary items	6,554	7,449	6,775	7,571	3.4	1.6	24.2	11.7
EPS (Rs per share)	52	55	55	56			19.8	2.9

Source: Company, Kotak Institutional Equities estimates.

LIC Housing Finance Ltd—quarterly results

(Rs mn)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	YoY(%)	2Q09E	Actual vs KS(%)
Operating income	4,635	5,265	5,515	6,293	6,220	7,077	34	7,022	1
Interest on loans	4,422	4,998	5,225	5,720	5,928	6,661	33	6,747	(1)
Fees and other charges	107	127	120	176	126	164	29	125	31
Other income	106	140	170	397	166	252	80	150	68
Interest expenses	3,378	3,498	3,815	4,053	4,431	4,950	42	4,967	(0)
Net operating income	**1,258**	**1,767**	**1,700**	**2,240**	**1,789**	**2,127**	**20**	**2,055**	**3**
Net operating income extraordinary item	1,258	1,767	1,700	2,240	1,789	2,127	20	2,055	3
Total Fund based income	4,529	5,138	5,395	6,117	6,094	6,913	35	6,897	0
Net interest income	1,045	1,500	1,410	1,667	1,497	1,711	14	1,780	(4)
Other exp.	**625**	**191**	**358**	**431**	**354**	**270**	**42**	**351**	**(23)**
Establishment exp.	168	265	242	327	173	251	(5)	210	20
Staff expenses	97	62	74	113	84	83	35	71	17
Provisions	360	(136)	42	(9)	97	(64)	(53)	70	(192)
PBDT	**632**	**1,576**	**1,342**	**1,809**	**1,435**	**1,857**	**18**	**1,704**	**9**
Depreciation	8	9	9	11	10	11	20	10	8
PBT	624	1,567	1,333	1,798	1,425	1,846	18	1,694	9
Tax	157	404	273	617	379	495	23	457	8
PAT	**467**	**1,163**	**1,060**	**1,181**	**1,046**	**1,351**	**16**	**1,237**	**9**
Tax rate (%)	25	26	20	34	27	27	4	27	
PBT +provisions	**984**	**1,431**	**1,375**	**1,682**	**1,522**	**1,782**	**25**	**1,764**	**1**
Other details									
Approval for the quarter (Rs bn)	11.6	22.7	22.8	29.1	17.9	29.5	30		
Disbursements (Rs bn)	12.2	16.0	16.5	26.0	15.2	21.6	35		
Individual (Rs bn)	11.1	13.4	14.3	20.3	14.2	18.8	41		
Outstanding portfolio (Rs bn)	182	191	202	219	228	241	26	239	1
Individual (Rs bn)	176	183	192	206	214	226	23		
Gross NPLs (Rs mn)	7,390	5,425	5,580	3,730	5,050	4,470	(18)		
Gross NPL ratio (%)	4.0	2.8	2.8	1.7	2.2	1.9	(35)		
Net NPLs (Rs mn)	4,000	3,145	3,243	1,410	2,610	2,090	(34)		
Net NPL ratio (%)	2.6	1.6	1.6	0.6	1.2	0.9	(47)		
CAR (%)	12.9	15.3	15.0	14.0	15.0	NA			
Tier I	9.9	12.0	12.0	10.5	10.0	NA			
Average spread (%)	1.4	1.8	1.7	1.6	1.7	1.8			
Average cost of funds (%)	8.6	8.6	8.6	8.9	8.9	9.5			
Average lending rate (%)	10.0	10.3	10.3	10.5	10.6	11.3			

Source: Company, Kotak Institutional Equities estimates

Technology

POLS.BO, Rs51	
Rating	SELL
Sector coverage view	Neutral
Target Price (Rs)	70
52W High -Low (Rs)	141 - 41
Market Cap (Rs bn)	5.0

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	11.0	14.1	15
Net Profit (Rs bn)	0.7	1.3	1.1
EPS (Rs)	7.4	12.8	11.6
EPS gth	*(27.6)*	*71.6*	*(9.6)*
P/E (x)	6.8	4.0	4.4
EV/EBITDA (x)	2.7	1.5	1.2
Div yield (%)	3.5	3.5	3.5

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	28.4	-	-
FIIs	2.6	0.0	0.0
MFs	1.3	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Polaris Software Lab: A good quarter—surviving the BFSI turmoil for now. We see challenges ahead. Maintain SELL

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243
Rohit Chordia : rohit.chordia@kotak.com, +91-22-6634-1397

- **2QFY09 performance ahead of expectations**
- **Quarterly performance likely to be volatile; we see significant challenges ahead**
- **Maintain SELL**

Polaris reported second robust operating quarter in a row (a positive surprise for a change). Reported net income of Rs338 mn for the quarter was 31% ahead of our expectations. Net income outperformance was driven by positive surprises on both revenues as well as operating margins. Revenues at US$80.2 mn grew 5.5% qoq (our expectation was a 1% growth) while operating margins at 16.4% were up 420 bps qoq, impressive (though unsustainable) in our view. We believe that it is too early to call this a decisive turnaround in the company's growth trajectory; we see significant challenges ahead for the company given the challenging macro environment, especially among the banking clients. The business model risks remain with a high dependence on a few clients, uncertainty around success of Intellect product suite and continuity of execution challenges (with a weak employee profile). We have revised our FY2009E and FY2010E EPS estimates upwards by 26.5% and 3.5% to Rs12.8 and Rs11.6 noting 1H outperformance. Maintain SELL. Stock may see an upside in the near term on the back of 1H performance.

2QFY09 performance ahead of expectations. Polaris reported 5.5% qoq and 19% yoy revenue growth in US$ terms to US$80.2 mn. Revenue growth was driven by strong growth in the company's top clients. Top-10 accounts grew 12.8% qoq led by a strong 10.6% qoq growth in Citigroup revenues. Dependence on Citigroup has once again increased and it now accounts for 42.7% of the company's revenues. OPM at 16.4% (up 420 bps qoq and 540 bps yoy) was substantially ahead of our expectations of 11.9%. OPM improvement was driven by rupee depreciation, SG&A efficiencies and a sharp 296 bps qoq improvement in utilization. Net income at Rs336mn was up 32.4% qoq and 86% yoy.

Quarterly performance likely to be volatile; we see significant challenges ahead. While we find Polaris' 1HFY09 performance impressive, we remain cautious on the company's business outlook in the near to medium term. Our caution emanates from (1) Polaris' dependence on a few large banking names; a good number of Polaris' clients have been directly impacted by the turmoil in the banking industry, (2) volatile nature of Polaris' quarterly numbers—Polaris' revenue as well as OPM performance has been extremely volatile in the past, and (3) slowing products business.

Business model risks remain higher than other players. While we like the product-led revenue growth strategy adopted by Polaris, we would like to highlight the potential risks of the approach in an IT spending slowdown environment. Polaris' small size and weaker positioning with the clients (relative to some of its larger peers) makes it more vulnerable than peers to (1) likely cuts in new spending in the BFSI vertical and (2) vendor rationalization by some of the large clients.

Revising estimates upwards; maintain SELL. We have revised our FY2009E and FY2010E EPS estimates upwards by 26.5% and 3.5% to Rs12.8 and Rs11.6 respectively. The revision is primarily on account of 1HFY09 outperformance against expectations. We maintain our SELL rating on the stock noting macro challenges and the company's history of volatile performance.

Key changes to estimates, FY2009E-FY2010E

	Revised		Earlier		Change (%)	
	FY2009E	FY2010E	FY2009E	FY2010E	FY2009E	FY2010E
Revenues (US$ mn)	313	341	310	349	0.9	(2.3)
Revenues (Rs mn)	14,071	15,337	13,631	14,994	3.2	2.3
Revenue growth	14.3	9.0	13.3	12.6		
EBITDA (Rs mn)	1,843	1,733	1,554	1,694	18.6	2.3
EBIT (Rs mn)	1,383	1,210	1,070	1,163	29.3	4.1
Net profit (Rs mn)	1,256	1,136	993	1,097	26.5	3.5
EPS (Rs)	12.8	11.6	10.1	11.2	26.5	3.5
EBITDA margin (%)	13.1	11.3	11.4	11.3		
EBIT margin (%)	9.8	7.9	7.9	7.8		
Re/US$ rate	45.0	45.0	44.0	43.0	2.3	4.7

Source: Kotak Institutional Equities estimates

Polaris Software Interim Results (Rs mn)

	2QFY08	1QFY09	2QFY09	QoQ % chg.	YoY % chg.	Kotak Estimates	% Deviation	Comments on QoQ performance
Revenues	**2,736**	**3,170**	**3,511**	**10.8**	**28.4**	**3,328**	**5.5**	Revenue growth of 5.5% in US$ terms substantially ahead of our expectations of 1% revenue growth.
Cost of revenues	(1,847)	(2,147)	(2,292)	6.8	24.1	(2,247)	2.0	
Gross profit	**889**	**1,023**	**1,220**	**19.2**	**37.3**	**1,082**	**12.8**	
Sales & marketing expenses	(315)	(318)	(344)	8.0	9.1	(349)	(1.7)	
General administration expenses	(272)	(317)	(301)	(5.0)	10.7	(336)	(10.4)	
SG&A expenses	(587)	(635)	(645)	1.5	9.8	(686)	(6.0)	
Operating Profits	**302**	**388**	**575**	**48.1**	**90.7**	**396**	**45.2**	Operating margin improvement of 420 bps qoq impressive. Led by rupee depreciation, SG&A efficiencies, and sharp jump in utilization
Non-operating Income	39	13	(67)	(628.2)	(272.7)	29	(333.6)	
EBIDTA	341	401	508	26.6	49.1	425	19.5	
Financial expenses	(2)	(2)	(2)	(20.3)	(12.5)	(2)	**(16.0)**	
EBDT	339	399	506	26.9	49.5	423	19.7	
Depreciation	(119)	(106)	(108)	1.5	(9.2)	(119)	(8.9)	
Pretax profits	**220**	**293**	**398**	36.1	81.2	304	30.8	
Tax	(37)	(37)	(60)	61.7	59.8	(46)	31.1	
Net profit	**182**	**256**	**338**	32.4	85.6	259	30.8	Net income 31% ahead of our estimates on account of revenue and margin outperformance
Extraordinaries	-	-	6			-		
PAT-Reported	**182**	**256**	**344**	34.7	88.9	**259**	33.1	
Period EPS								
EPS - recurring (Rs)	1.9	2.6	3.5	34.3	88.3	1.9		
EPS - reported (Rs)	1.9	2.6	3.5	33.9	87.7	1.9		
Margins								
Gross margin (%)	32.5	32.3	34.7			32.5		
SG&A expenses (%)	21.5	20.0	18.4			20.6		
Operating profit margin (%)	**11.0**	**12.2**	**16.4**			**11.9**		
Net profit margin (%)	6.7	8.1	9.6			7.8		
Revenues from Citigroup (%)	38.7	40.7	42.6			-		
Revenues from Citigroup (Rs mn)	1,058.6	1,288.8	1,496.9	16.1	41.4	-		

Source: Company, Kotak Institutional Equities estimates.

Energy

RPET.BO, Rs107	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	130
52W High -Low (Rs)	295 - 97
Market Cap (Rs bn)	479.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	0.0	187.9	######
Net Profit (Rs bn)	(4.7)	11.0	76.5
EPS (Rs)	(1.1)	2.4	17.0
EPS gth	-	-	*614.5*
P/E (x)	-	-	6.3
EV/EBITDA (x)	-	-	5.5
Div yield (%)	-	-	1.9

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	75.4	-	-
FIIs	1.5	0.2	(2.1)
MFs	1.2	0.7	(1.5)
UTI	-	-	(2.2)
LIC	1.7	0.9	(1.3)

Reliance Petroleum: Refinery on the verge of completion but global refining margins under pressure

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229
Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **Weak global GDP growth means lower demand for refined products**
- **Increase in supply (new refining capacity, NGLs) is a given**
- **Maintain REDUCE with revised 12-month target price of Rs130 (Rs150 previously)**

RPET's upcoming 580,000 b/d refinery remains on track for completion before the initial completion date of Dec '08. However, the rapid deterioration in global supply-demand balance over the past few months has increased our concerns about refining margins. We see further downside risk to our refining margins assumptions given increasing concerns about global GDP growth in CY2009E and CY2010E. We retain our REDUCE rating on RPET stock with revised 12-month target price of Rs130 (8X FY2010E EPS) versus Rs150 previously (9X FY2010E EPS previously). We assume a lower multiple to factor in increasing downside risks to global oil demand and hence, refining margins. Our 12-month DCF value for RPET comes to Rs97. We note that our valuation methodology implicitly assumes that FY2010E earnings will sustain in perpetuity. RPET's earnings will likely decline from FY2014E after its five-year 100% income tax exemption gets over.

Solid refinery but likely weak refining cycle. As per the management, the project is over 97% complete and is on track for completion before the initial completion date of Dec '08. We like Reliance Petroleum's fundamentals and its very competitive (perhaps the most competitive globally) position in refining. However, we see large downside risks to refining margins as a potential risk to the stock. We expect refining margins to remain weak for the next 18-24 months led by (1) likely weak demand and (2) large refining capacity additions from 2HCY08. Exhibit 1 shows that Singapore refining margins have declined after the spurt seen in September due to shutdown of significant refining capacity in the US due to hurricanes Gustav and Ike.

1. **Increasing evidence of demand implosion; risk is on the downside.** The IEA currently projects CY2009E global demand growth at 0.7 mn b/d but we see risks to the downside from weaker-than-expected global GDP growth. Exhibit 2 shows the IMF's latest GDP growth projections for major areas in CY2008E and CY2009E. The IMF currently projects GDP growth for US at 0.1%, Euro-zone at 0.2% and Japan at 0.5%. However, we see risks to the projections for emerging countries including China (9.3%) and Developing Asia (7.7%) in light of high linkages between emerging Asia and developed countries. As per the IEA, non-OECD demand growth of 1.3 mn b/d in CY2009E will make up for demand loss of 0.6 mn b/d in OECD countries and slower-than-expected GDP growth in non-OECD countries will impact global oil demand further, in our view.

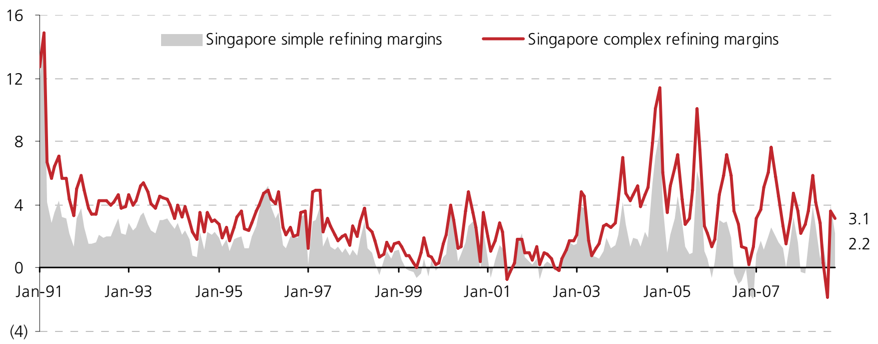
   The IEA recently cut its demand growth for CY2008E again to 0.4 mn b/d, which reflects demand compression in the OECD countries primarily. This figure is down from 2 mb/d at the beginning of the year. In particular, US demand continues to be weak with September demand declining by 7% yoy led by economic slowdown and ongoing financial crisis; demand contracted 4.5% yoy in Aug '08 and 4% yoy in Jul '08. Gasoline demand has shrunk sharply by 5.5% with plummeting sales of light trucks (-31% yoy) and passenger cars (-22%) in Sep '08. Exhibit 3 gives our supply-demand for oil.

2. **Significant capacity addition is a given.** We expect significant addition to refining capacity from 4QCY08, which includes capacity addition of 0.95 mb/d in China and RPET's 580,000 b/d refinery (see Exhibit 4). We expect refining capacity addition of 1.4 mb/d, 1.6 mb/d and 1.7 mb/d in CY2008E, CY2009E and CY2010E (see Exhibit 5). In addition, we expect natural gas liquids (NGLs) supply to increase by 0.3 mb/d, 0.8 mb/d and 0.5 mb/d in CY2008E, CY2009E and CY2010E led by start of several gas-processing plants associated with gas developments in Iran (Phase 6-10 of South Pars development), Qatar (four new LNG trains of Qatargas 2 and RasGas), Saudi Arabia and Nigeria.

Earnings revision. We have revised our FY2010E, FY2011E and FY2012E EPS estimates to Rs17, Rs14 and Rs14.5 from Rs16.9, Rs14.2 and Rs14.7 to reflect (1) weaker rupee and (2) lower refining margins than previously assumed. We model refining margins for RPET at US$12.6/bbl for FY2010E and US$11.3/bbl for FY2011E versus US$13.3/bbl and US11.9/bbl previously. We have revised our rupee-dollar exchange rate assumption to Rs45/US$ for FY2010E, Rs44/US$ for FY2011E and US$43/US$ for FY2012E from Rs42.5/US$, Rs42/US$ and Rs41/US$.

Singapore refining margins have declined after the spurt in September caused by hurricanes

Singapore refining margins (US$/bbl)



Simple refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
1Q	(0.32)	1.29	0.51	0.30	1.05	1.69	3.02	2.52	2.25	2.40
2Q	(0.08)	2.47	0.45	0.07	1.20	3.13	2.78	(0.70)	0.99	1.71
3Q	0.14	1.74	1.06	1.44	1.57	6.46	2.22	(1.25)	2.32	2.18
4Q	1.86	0.21	(0.03)	2.98	2.88	2.08	1.09	1.25	0.25	
Average	**0.40**	**1.43**	**0.50**	**1.20**	**1.67**	**3.34**	**2.28**	**0.45**	**1.45**	**2.07**

Weekly margins

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
2.12	2.41	2.02	6.03	5.40

Complex refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
1Q	0.43	1.86	1.34	0.79	1.24	4.57	4.93	6.24	6.58	4.31
2Q	1.19	3.96	0.58	0.14	2.35	5.80	6.11	2.46	2.91	0.66
3Q	0.41	2.25	1.22	1.56	3.23	9.04	3.94	0.98	3.91	3.12
4Q	2.64	1.60	0.65	3.70	5.44	5.02	2.77	4.11	2.78	
Average	**1.17**	**2.42**	**0.95**	**1.55**	**3.06**	**6.10**	**4.44**	**3.45**	**4.05**	**2.55**

Weekly margins

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
3.97	3.66	1.72	6.02	5.80

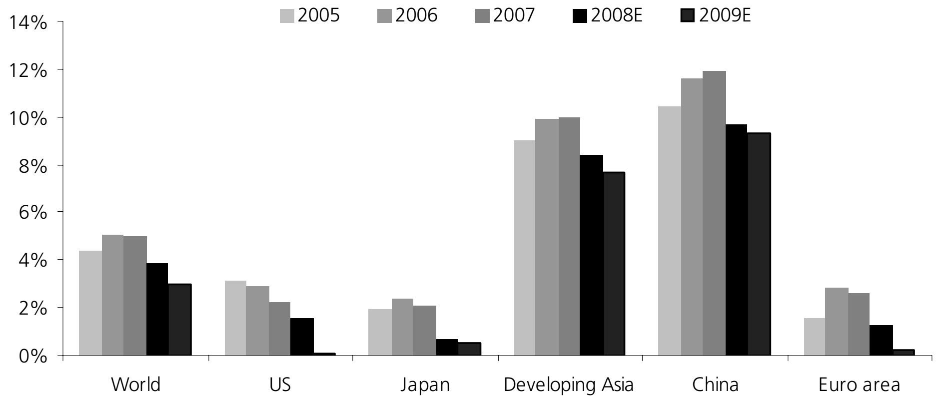
Singapore refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
Simple	0.40	1.43	0.50	1.20	1.67	3.34	2.28	0.45	1.45	2.07
Complex	0.43	1.86	1.34	0.79	1.24	4.57	4.93	3.45	4.05	2.55

Source: Bloomberg, Kotak Institutional Equities

Global GDP growth is set to slow down in CY2009E

Growth in real GDP (yoy) for world and key economies, 2004-2009E



Source: IMF

Expect moderate demand growth led by economic slowdown and ongoing financial crisis

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

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E
Demand (mb/d)										
Total demand	82.5	84.0	85.1	86.1	86.5	87.2	88.3	89.5	90.7	92.2
Yoy growth	3.3	1.5	1.1	1.0	0.4	0.7	1.1	1.2	1.2	1.5
Supply (mb/d)										
Non-OPEC	48.8	48.7	49.2	49.6	49.8	50.4	50.6	50.7	50.7	51.3
Yoy growth	0.6	(0.1)	0.5	0.4	0.2	0.6	0.2	0.1	0.0	0.6
OPEC										
Crude	29.5	30.8	31.3	31.7	31.6	30.9	31.3	32.3	33.2	34.0
NGLs	4.2	4.5	4.6	4.8	5.1	5.9	6.4	6.5	6.8	6.9
Total OPEC	**33.7**	**35.3**	**35.9**	**36.5**	**36.7**	**36.8**	**37.7**	**38.8**	**40.0**	**40.9**
Total supply	**83.4**	**84.7**	**85.5**	**86.1**	**86.5**	**87.2**	**88.3**	**89.5**	**90.7**	**92.2**
Total stock change	1.0	0.7	0.8							
OPEC crude capacity				**34.4**	**35.3**	**36.4**	**37.4**	**37.3**	**37.6**	**37.9**
Implied OPEC spare capacity				**2.7**	**3.7**	**5.5**	**6.1**	**5.0**	**4.4**	**3.9**
Demand growth (yoy, %)	**4.2**	**1.8**	**1.3**	**1.2**	**0.5**	**0.8**	**1.3**	**1.4**	**1.3**	**1.7**
Supply growth (yoy, %)										
Non-OPEC	**1.2**	**(0.2)**	**1.0**	**0.8**	**0.4**	**1.2**	**0.4**	**0.2**	**0.0**	**1.2**
OPEC	**8.4**	**4.6**	**1.9**	**1.5**	**0.6**	**0.3**	**2.4**	**2.9**	**3.1**	**2.3**
Total	**4.4**	**1.6**	**0.9**	**0.7**	**0.5**	**0.8**	**1.3**	**1.4**	**1.3**	**1.7**
Dated Brent (US$/bbl)	**38.3**	**54.4**	**65.8**	**72.7**	**105.0**	**90.0**	**95.0**	**95.0**	**95.0**	**75.0**

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

Significant refining capacity to come onstream in China and India from 2HCY08

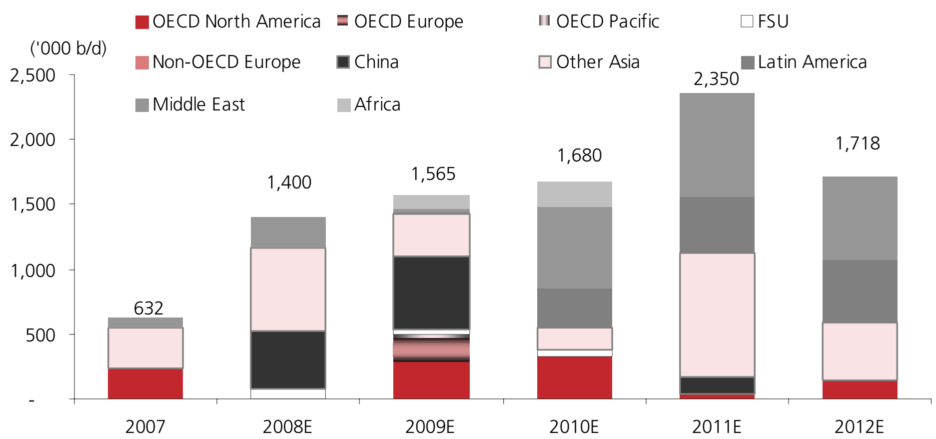
Upcoming refining capacity addition (b/d)

Company	Location	Capacity addition (b/d)	Expected completion
CNOOC	Daya Bay, Huizhou, Guangdong, China	240,000	3QCY08
Reliance Petroleum	Jamnagar, India	580,000	4QCY08
Sinopec	Qingdao, China	200,000	4QCY08
Fujian Petrochemical	Quangang, Quanzhou City, China	160,000	1QCY09
Sinopec	Tianjin, China	150,000	1QCY09
Petrochina	Dagang, Quinzhou, China	200,000	1QCY09
Petrovietnam	Dung Quat, Vietnam	121,000	1QCY09
Total capacity addition		**1,651,000**	

Source: Oil & Gas journal, Kotak Institutional Equities estimates

Significant supply additions to global refining capacity

Global refinery capacity addition, calendar year ends, 2007-2012E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates

DCF valuation for Reliance Petroleum (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
EBITDA	**26,777**	**110,577**	**92,592**	**88,808**	**81,059**	**79,870**	**79,564**	**79,229**	**78,865**	**78,472**	**78,049**	**78,049**	**78,049**	**78,049**
Tax expense	(55)	(113)	(72)	(68)	(57)	(8,114)	(10,326)	(11,107)	(11,752)	(12,278)	(23,231)	(23,453)		
Working capital changes	(16,451)	(68,335)	3,112	1,961	3,745	127	(7)	(5)	(4)	(4)	(3)	1		
Cash flow from operations	**10,272**	**42,130**	**95,632**	**90,701**	**84,747**	**71,883**	**69,232**	**68,117**	**67,109**	**66,190**	**54,815**	**54,597**		
Capital expenditure	(39,097)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)		
Free cash flow to the firm	**(28,825)**	**40,130**	**93,632**	**88,701**	**82,747**	**69,883**	**67,232**	**66,117**	**65,109**	**64,190**	**52,815**	**52,597**	**52,597**	**52,597**
Discount factor at WACC	**0.95**	**0.85**	**0.76**	**0.68**	**0.60**	**0.54**	**0.48**	**0.43**	**0.38**	**0.34**	**0.31**	**0.27**	**—**	**—**
Discounted cash flow	(27,428)	34,093	71,025	60,057	50,023	37,720	32,401	28,441	25,006	22,012	16,171			
Discounted cash flow-1 year forward		38,185	79,548	67,285	56,026	42,246	36,289	31,863	28,007	24,654	18,111	16,104		
Discounted cash flow-2 year forward			89,094	75,359	62,768	47,316	40,643	35,687	31,378	27,612	20,285	18,036	16,104	

	Now	+ 1-year	+ 2-years
Total PV of free cash flow (a)	**349,522**	**452,693**	**478,657**
FCF one-year forward	52,597	52,597	52,597
Terminal value	438,306	438,306	438,306
PV of terminal value (b)	**150,304**	**150,304**	**150,304**
Total PV (a) + (b)	**499,826**	**602,997**	**628,961**
Net debt	128,253	167,833	157,407
Equity value	371,573	435,164	471,555
Equity value (US$ mn)	**8,257**	**9,670**	**10,717**
Shares outstanding (mn)	4,500	4,500	4,500
Equity value/per share (Rs)	**83**	**97**	**105**

Sensitivity of share price to different levels of WACC and growth rate (Rs)

		WACC (%)						
		11.0	**11.5**	**12.0**	**12.5**	**13.0**	**13.5**	**14.0**
Growth rate (%)	**-**	**107**	**102**	**97**	92	88	84	80
	1.0	**112**	**106**	**101**	96	91	87	83
	2.0	**119**	**112**	**106**	**100**	95	90	86
	3.0	**127**	**119**	**112**	**105**	**99**	94	89
	4.0	**137**	**127**	**119**	**112**	**105**	**99**	94
	5.0	**150**	**139**	**129**	**120**	**112**	**105**	**99**
	6.0	**169**	**154**	**141**	**130**	**121**	**113**	**105**
	7.0	**197**	**176**	**159**	**145**	**133**	**123**	**114**

Discount rate (%)	**12.0**
Growth from 2020 to perpetuity (%)	—
Exit free cash multiple (X)	8.3
Exit EBITDA multiple (X)	5.6

Source: Kotak Institutional Equities estimates

Reliance Petroleum has high leverage to refining margins

Sensitivity of RPL's earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	44.0	45.0	46.0	44.0	45.0	46.0	43.0	44.0	45.0
Net profits (Rs mn)	10,293	10,982	11,671	73,555	76,500	79,445	60,245	62,854	65,463
EPS (Rs)	2.3	2.4	2.6	16.3	17.0	17.7	13.4	14.0	14.5
% upside/(downside)	**(6.3)**		**6.3**	**(3.9)**		**3.9**	**(4.2)**		**4.2**
Refining margins (US$/bbl)									
Margins (US$/bbl)	13.1	14.1	15.1	11.6	12.6	13.6	10.3	11.3	12.3
Net profits (Rs mn)	9,342	10,982	12,622	66,985	76,500	86,015	53,548	62,854	72,160
EPS (Rs)	2.1	2.4	2.8	14.9	17.0	19.1	11.9	14.0	16.0
% upside/(downside)	**(14.9)**		**14.9**	**(12.4)**		**12.4**	**(14.8)**		**14.8**

Source: Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of Reliance Petroleum 2009-2014E, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E
Profit model						
Net revenues	187,920	1,056,461	1,018,070	993,965	945,387	944,465
EBITDA	**26,777**	**110,577**	**92,592**	**88,808**	**81,059**	**79,870**
Other income	14	69	122	103	93	121
Interest (expense)/income	(10,796)	(19,266)	(14,903)	(8,666)	(5,853)	(3,161)
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**11,009**	**76,590**	**62,912**	**65,238**	**60,183**	**61,606**
Extraordinary items	—	—	—	—	—	—
Tax	(28)	(90)	(58)	(60)	(52)	(7,718)
Deferred taxation	—	—	—	—	—	1,624
Net income	**10,982**	**76,500**	**62,854**	**65,178**	**60,131**	**55,512**
Earnings per share (Rs)	**2.4**	**17.0**	**14.0**	**14.5**	**13.4**	**12.3**
Balance sheet						
Total equity	145,471	211,442	263,766	286,826	276,607	267,172
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	168,275	159,275	91,275	52,275	46,275	44,275
Current liabilities	14,735	77,307	75,626	73,945	70,584	70,584
Total liabilities and equity	**328,481**	**448,024**	**430,667**	**413,047**	**393,467**	**380,408**
Cash	443	1,869	2,204	1,232	1,873	2,165
Other current assets	36,802	167,708	162,916	159,275	152,169	152,042
Net fixed assets	266,854	254,063	241,164	228,157	215,041	201,817
Capital work-in-progress	—	—	—	—	—	—
Investments	24,383	24,383	24,383	24,383	24,383	24,383
Deferred expenditure	—	—	—	—	—	—
Total assets	**328,481**	**448,024**	**430,667**	**413,047**	**393,467**	**380,408**
Free cash flow						
Operating cash flow, excl. working capital	15,954	91,221	77,631	80,082	75,153	68,991
Working capital changes	(16,451)	(68,335)	3,112	1,961	3,745	127
Capital expenditure	(39,097)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	14	69	122	103	93	121
Free cash flow	**(39,580)**	**20,956**	**78,864**	**80,146**	**76,991**	**67,239**
Ratios (%)						
Debt/equity	115.7	75.3	34.6	18.2	16.7	16.6
Net debt/equity	115.4	74.4	33.8	17.8	16.1	15.8
ROAE (%)	7.8	42.9	26.5	23.7	21.3	20.5
ROACE (%)	**7.5**	**28.0**	**21.4**	**21.3**	**19.9**	**18.4**

Source: Kotak Institutional Equities estimates

Infrastructure

IRBI.BO, Rs96	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	155
52W High -Low (Rs)	222 - 84
Market Cap (Rs bn)	31.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	7.3	10.8	23.9
Net Profit (Rs bn)	1.1	2.0	4.4
EPS (Rs)	3.4	5.9	13.2
EPS gth	*150.9*	*73.0*	*122.3*
P/E (x)	28.0	16.2	7.3
EV/EBITDA (x)	10.9	10.8	5.2
Div yield (%)	-	-	-

Shareholding, June 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.4	-	-
FIIs	6.3	0.0	(0.1)
MFs	3.9	0.2	0.0
UTI	-	-	(0.2)
LIC	-	-	(0.2)

IRB Infrastructure Developers: Will likely benefit from declining commodity and interest costs, however, valuations imply low traffic growth and high interest costs in perpetuity; reiterate BUY

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

Supriya Subramanian : supriya.subramanian@kotak.com, +91-22-6634-3383

- **Valuations imply low toll traffic growth expectations as well as high interest rates till perpetuity, in addition to negating the value of the construction business**
- **Short-term interest rate for BOT projects may go up to 13-14%**
- **Near-term tight credit situation delayed financial closure of Surat-Dahisar project**
- **Decline in commodity prices would help margins in the construction business**
- **We reduce our TP to Rs155 (from Rs195) and reiterate our BUY rating**

We highlight that the current valuations of IRB imply low toll traffic growth expectations as well as high interest rates till perpetuity, negating the value of the construction business and cash on the books of the company. The current tight credit situation is likely to lead to higher interest costs of around 13-14% in the near future. However, we highlight that the recent infusion of liquidity in the market would help alleviate the credit crunch. The decline in commodity prices would also help IRB maintain its margins. We reduce our SOTP-based target price to Rs155/share (from Rs195). It comprises (1) Rs125 per share for the road BOT portfolio, based on free cash flow to equity method, (2) Rs21 per share for the construction business (FY2010E EV/ EBITDA multiple of 4X) and (3) value for net cash on books of Rs9 per share. We reiterate BUY as the stock stands to benefit from lower commodity and interest costs.

Valuations imply low toll traffic growth expectations as well as high interest rates till perpetuity negating the value of the construction business

We highlight that even if we assume (1) 200 bps higher interest rate for all the projects in perpetuity versus a base case of 11.5%, (2) required return on equity of 16% versus a base case of 14% and (3) 100 bps lower traffic growth versus base case throughout the life of the project (we assume staggered traffic growth rate: 8% in the first five years, 7% in the next five years and so on) we would still have a value of Rs90 for the BOT road assets portfolio versus a current stock price of Rs96 for IRB. Thus the current market price does not take into account Rs9/share value for net cash on books and Rs21 per share for the construction business (see Exhibit 2). Our base case builds in interest rates of 14% for the next two years (FY2009E and FY2010E) and then 11.5% over the rest of the life cycle of the project.

We believe IRB has the ability to leverage opportunities in the sector and create value based on its experience, however, again no value is placed on that currently.

Short-term interest rate for road BOT projects may go up to 13-14%; however we expect interest costs would decline over a period of time

IRB has highlighted that it is likely to tie up debt for the new projects i.e. Surat-Dahisar and Kolhapur urban road project at an interest rate in the range of 13% currently. This interest rate is likely to be one year reset and linked to bank PLRs and thus having an advantage of reduction in PLFs, if any. Even the spread over and above PLR could be reset every year, passing benefit of milestones such as completion of construction, establishment of base toll collection numbers etc. We highlight that the interest rate over life cycle of the project is likely to be lower as the economy-wide interest rate moderates. We have built in interest costs of 14% for the next two years (FY2009E and FY2010E) and then 11.5% over the rest of the life cycle of the project.

Near-term tight credit situation delayed financial closure of Surat-Dahisar project—would lead to lower construction revenues and delay in start of toll collection versus earlier plan

We highlight that financial closure for Surat-Dahisar has been delayed to November-end versus September-October planned earlier. It was envisaged that IRB would start toll collection as well as construction in November on the Surat-Dahisar stretch. The National Highways Authority of India (NHAI) has also not passed toll notification on the stretch of road which is a condition precedent before other deadlines such as for financial closure start ticking. We were not accounting any toll collection in FY2009E in this project; however, delay in financial closure would lead to postponement of construction business revenues as well. Thus we have reduced our construction revenue estimates for IRB by about Rs1.5-2 bn in FY2009E related to this development.

Easing of monetary policy would help alleviate the current credit crunch; would help speeding up of financial closure as well as lower interest costs

The current delays faced in achieving financial closure for new projects is likely to alleviate given the recent measures (150 bps CRR cut and 100 bps cut in repo rate) to improve the liquidity situation. Further, our economist Dr Mridul Saggar believes at least one more CRR cut and a further cut of 100 bps in the repo rate is possible by end of FY2009E. The 10-year benchmark Gsec yields have been declining over the past few months from 9.32% at end of July 2008 to 7.59% on October 20, 2008 (see Exhibit 3). Dr Saggar expects the 10-year benchmark Gsec yield to soften to 7.5% by end-2009E.

Decline in commodity prices would help maintain margins in the construction business; bitumen may be imported as it is cheaper

We highlight that decline in commodity prices would help maintain construction margins. IRB highlighted that since domestic oil companies have not reduced bitumen prices in line with fall in crude prices, they are importing bitumen from the Middle-East (landed cost of Rs30,000/ton versus domestic supply cost of Rs45,000/ton).

News reports have mistakenly reported lack of progress on Kolhapur Road project

IRB has highlighted that newspaper reports citing delays in Kolhapur urban road project are misinformed. IRB has signed the concession agreement recently in September and has four-five months to achieve financial closure. The project was won in end-March but signing the concession agreement took time as it required approval of MSRDC, Kolhapur municipality etc.

We reduce our target price to Rs155, from Rs195 earlier; reiterate BUY

We reduce our earning estimate to Rs5.9 (from Rs7.3) and Rs13.2 (from Rs15.7) for FY2009E and FY2010E respectively based on (1) higher interest cost assumptions of 14% in the next two years and 11.5% for the remaining years of the project lifecycle versus our earlier assumption of 11% throughout the life of the project and (2) lower construction revenue estimates of about Rs6.5 bn in FY2009E (versus Rs7.9 bn earlier). We have reduced our target price to Rs155 from Rs195 earlier. Our SOTP-based valuation of IRB at Rs155 per share comprises (a) Rs125 per share for the road BOT portfolio, based on free cash flow to equity method, (b) Rs21 per share for the construction business (FY2010E EV/EBITDA multiple of 4X) and (c) value for net cash on books of Rs9 per share (see Exhibit 1). We have not valued the township development initiative adjoining the Mumbai-Pune Expressway.

We highlight that risks for IRB originate from (1) rising prices of commodity prices especially those for bitumen and steel, however recent decline in steel and bitumen prices highlight relaxation of pressure on this count, (2) unexpected delay in execution of projects such as Surat-Dahisar and Bharuch-Surat delays the start of toll-collection as well, apart from accumulating costs and (3) delay in the process of awarding road projects for development by the government lowers visibility of growth opportunities for IRB.

Exhibit 1. We value IRB at Rs155 per share based on SOTP in the base case

IRB Infrastructure Developers - SOTP valuation

	Equity value of asset (Rs mn)	IRB's stake (%)	Value of IRB's stake (Rs mn)	Contribution to value of IRB (%)	Per share contribution to IRB (%)	Asset valuation methodology
Roads	**42,183**		**41,803**	**80.7**	**125.8**	**FCFE**
4 BOT projects	3,399	100.0	3,399	6.6	10.2	FCFE based on FY2010E
Kharpada Bridge	422	100.0	422	0.8	1.3	FCFE based on FY2010E
Nagar - Karmala - Tembhurni	730	100.0	730	1.4	2.2	FCFE based on FY2010E
Pune - Solapur	1,513	100.0	1,513	2.9	4.6	FCFE based on FY2010E
Pune - Nashik	1,839	100.0	1,839	3.5	5.5	FCFE based on FY2010E
Mumbai - Pune	16,071	100.0	16,071	31.0	48.4	FCFE based on FY2010E
Thane - Ghodbunder	3,327	100.0	3,327	6.4	10.0	FCFE based on FY2010E
Bharuch - Surat	11,239	100.0	11,239	21.7	33.8	FCFE based on FY2010E
Surat-Dahisar	1,900	80.0	1,520	2.9	4.6	FCFE based on FY2010E
Kolhapur urban road project	1,743	100.0	1,743	3.4	5.2	FCFE based on FY2010E
Construction	**7,075**	**100.0**	**7,075**	**13.7**	**21.3**	**EV/EBITDA multiple of 4X based on FY2010E**
Net cash/debt at parent level	**2,932**	**100.0**	**2,932**	**5.7**	**8.8**	**Estimated balance at end-FY2009E**
Grand Total	**52,190**		**51,810**	**100**	**155.9**	**SOTP**

Source: Kotak Institutional Equities estimates

Exhibit 2. Sensitivity of share price based on sensitivity of BOT assets valuation

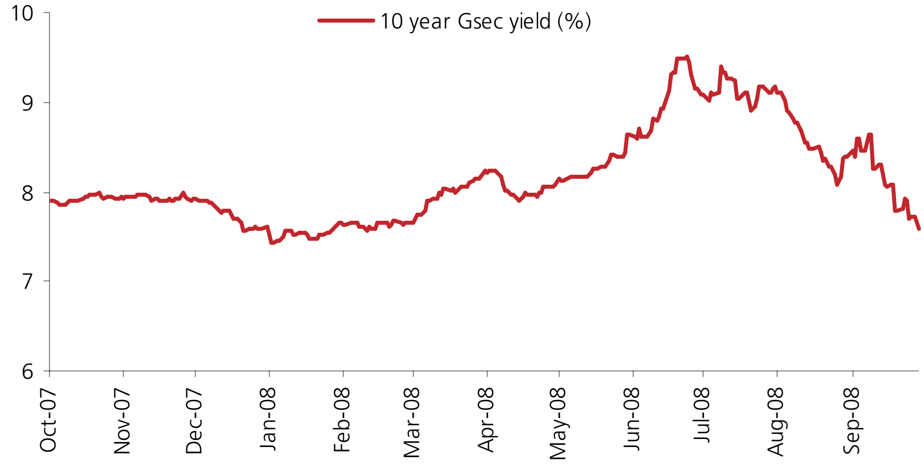
		Initial Traffic growth rate (%)				
		6.0	7.0	8.0	9.0	10.0
Interest rate (base case - 12%) / expected return on equity(base case 14.5%)	Assumed rate -2	118	134	152	170	190
	Assumed rate -1	106	122	138	155	174
	Assumed rate	96	110	**126**	142	159
	Assumed rate +1	86	100	114	130	146
	Assumed rate +2	76	90	104	118	133

Note: We have used staggered traffic growth rate - 7% in first five years, 6% in next five years and so on

Source: Kotak Institutional Equities

Exhibit 3. The 10-year Gsec yields have started to soften during the past few months

10-year benchmark Gsec yield, October 2007 - October 2008



Source: Bloomberg

Pharmaceuticals

Sector coverage view	Attractive

		Price, Rs	
Company	**Rating**	**21-Oct**	**Target**
Ranbaxy	REDUCE	262	420
Dr. Reddy's	BUY	510	790
Cipla	REDUCE	189	230
Sun Pharma	BUY	1,339	1,780
Biocon	BUY	124	260
Piramal Health	BUY	240	530
Divi's	BUY	1,106	2,330
Glenmark Pha	BUY	504	770
Dishman Pharr	BUY	226	515
Jubilant	BUY	166	475
Ipca	REDUCE	97	800
Lupin	BUY	694	950

Indian Pharma: Generics business may be hit by ongoing credit crisis

Prashant Vaishampayan : prashant.vaishampayan@kotak.com, +91-22-6634-1127
Priti Arora : priti.arora@kotak.com, +91-22-6749-3596

- **According to Bloomberg, credit-default swap rate indicates increasing credit risks in Emerging Europe, Latin America, Russia/CIS may hit Indian companies**
- **Glenmark has largest exposure among KIE generics coverage with 17% of FY2008 sales from Latin America/CIS**
- **Working capital cycle may increase due to delays in payments**
- **Demand for discretionary medicines may slow down**
- **We believe revenue generation for companies with exposure to these economies is not a problem, its conversion to cash is**
- **We expect more clarity at the earnings calls over the next two weeks**

Higher credit risks seen in Ukraine, Kazakhstan, Russia, Brazil and Latin America. Indian pharma companies have exposure to these countries either directly (through established subsidiaries) or indirectly (through sales via partners/distributors). Companies exposed to these countries are Glenmark, DRL and Ranbaxy. Glenmark has the maximum exposure with 17% of FY2008 sales. We think working capital cycle may increase due to delays in payments. While pharma industry is considered recession proof, we think there is a component of discretionary spending which may witness a slowdown. We believe revenue generation for companies with exposure to these economies is not a problem, its conversion to cash is. We are unsure of timing and size of impact on cash collection and hence we would make changes to earnings estimates only after the earnings calls.

Credit squeeze spreading in Latin America, Russia/CIS may hit Indian companies with exposure to these regions. According to press reports, companies in Brazil and Russia/CIS have started to feel the credit squeeze. Banks in Brazil have stopped renewing credit lines for trade finance. Brazil's central bank has stepped in to provide financing to exporters. Similar problems have been reported in countries such as Hungary, Russia, Ukraine and Kazakhstan.

Glenmark has the largest exposure among KIE generics coverage with 17% of FY2008 sales from Latin America/CIS. Indian companies which have exposure to the above mentioned countries in KIE generics coverage are Glenmark, DRL and Ranbaxy with Glenmark having the maximum exposure. For Cipla, Lupin and Sun Pharma, we did not get the sales exposure to these countries in their annual reports.

1) **Glenmark** with 17% of FY2008 sales from these countries is the one most at risk. In FY2008, it earned Rs857 mn from Russia/CIS and Rs2.2 bn from Latin America. Glenmark is focusing on building operations in three markets in CIS—Ukraine, Kazakhstan and Uzbekistan. There are currently six products that Glenmark promotes in Ukraine. In Kazakhstan, Glenmark has filed 21 products out of which four have been registered.

2) **DRL's** Russian revenue crossed Rs4 bn in FY2008 across OTC and prescription sales. In addition, DRL's sales from CIS were Rs1.4 bn largely contributed by Ukraine, Belarus, Uzbekistan. 11% of DRL's total sales were from Russia/CIS in FY2008 (7% in FY2007)

3) **Ranbaxy's** sales in 2007 were Rs3.7 bn across Russia and Ukraine. In Russia, it is present in both the ethical & OTC segments. Ranbaxy's sales from Brazil stood at Rs1.6 bn. It is currently ranked 5th in Brazilian generic market. Rest of Latin America (excluding Brazil) revenues were Rs1 bn led by growth in the company's operations in Ecuador and Peru.

Working capital cycle set to increase due to delays in payments. This will be a key thing to watch out for in the quarterly results. Companies which have reported results so far, such as Biocon, have reported stretching of working capital cycle with deteriorating debtors' position and increasing debtors' days. Kiran Mazumdar-Shaw, chairperson of Biocon, indicated that Biocon has not seen a slowdown in business despite the global financial turmoil. However, it would follow a policy of exercising caution in international business due to fear of inability to pay on part of their customers.

Demand for drugs in discretionary category may slow down. While pharma industry is seen to be recession proof, there is a certain portion of discretionary spending which we think may witness a slowdown. Vitamin supplements and cosmaceuticals are likely to be impacted by the global slowdown.

What are we doing to estimates or ratings? Sharp and sudden decline in credit ratings for countries and tightening of banking system in Emerging Europe, Russia/CIS, Latin America would have impact on revenue and profit estimates for FY2009E and FY2010E but we are unable to quantify them at the moment.

Local currency in Brazil dropped sharply against the US Dollar in the past six weeks. This would make imports expensive. We think impact of these changes will take time to fully play out.

It is worth nothing that demand for pharmaceuticals has been strong in most of these countries in the past 12 months. We continue to believe that revenue generation in these economies is not a problem, its conversion to cash is.

We are unsure of timing and size of impact on cash collection and hence we would make changes to earnings estimates only after the earnings calls.

Exposure to Russia/CIS and Latin America (Rs mn)

				(% of sales)	
	Total sales	**Russia/CIS**	**L. America**	**Russia/CIS**	**L. America**
Glenmark	17,689	857	2,211	5	13
DRL	49,700	5,525	NA	11	NA
Ranbaxy	67,887	3,720	2,687	5	4
Lupin	27,730	348	NA	1	NA
Cipla	41,010	25% of exports from North, Central and South America			

Source:Company.

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

	21-Oct-08		Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price	Upside	ADVT-3mo
Company	Price (Rs)	Rating	(Rs mn)	(US$ mn)	(mn)	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	(Rs)	(%)	(US$ mn)
Automobiles																													
Bajaj Auto	561	ADD	81,153	1,656	145	59.3	58.7	63.2	(53.4)	(1.1)	7.8	9.5	9.6	8.9	6.6	6.7	6.1	5.1	4.1	3.3	3.6	3.6	3.6	21.0	41.5	36.4	630	12.3	—
Hero Honda	825	REDUCE	164,663	3,359	200	48.5	56.8	63.2	12.8	17.2	11.3	17.0	14.5	13.0	10.7	9.6	9.0	5.3	4.4	3.6	2.3	2.4	2.4	34.0	33.1	30.4	770	(6.6)	8.7
Mahindra & Mahindra	409	ADD	105,641	2,155	258	38.1	36.9	37.2	(2.0)	(2.9)	0.6	10.8	11.1	11.0	8.1	8.2	7.5	2.4	1.9	1.6	2.7	2.3	2.4	27.8	22.0	17.8	640	56.4	5.6
Maruti Suzuki	677	ADD	195,783	3,994	289	59.9	60.0	65.1	10.8	0.2	8.4	11.3	11.3	10.4	6.4	6.1	5.6	2.3	1.9	1.6	0.7	0.7	0.7	22.1	18.3	16.8	790	16.6	16.6
Tata Motors	248	SELL	144,013	2,938	581	47.4	25.1	22.3	0.9	(47.1)	(10.9)	5.2	9.9	11.1	5.6	6.8	7.1	1.6	0.6	0.7	4.0	5.1	5.1	24.3	9.8	7.4	425	71.5	9.6
Automobiles		**Cautious**	**691,252**	**14,102**					**(0.8)**	**(6.2)**	**3.1**	**10.6**	**11.3**	**10.9**	7.0	7.2	6.9	**2.6**	**1.7**	**1.5**	**2.4**	**2.6**	**2.6**	**24.3**	**15.2**	**13.9**			
Banks/Financial Institutions																													
Andhra Bank	54	REDUCE	26,214	535	485	11.9	11.6	12.1	7.0	(2.4)	4.7	4.6	4.7	4.5	—	—	—	0.9	0.8	0.7	7.4	5.4	5.6	18.0	16.3	15.3	65	20.3	0.9
Axis Bank	657	REDUCE	234,836	4,791	358	32.2	39.7	51.8	37.7	23.2	30.5	20.4	16.5	12.7	—	—	—	2.9	2.5	2.2	0.9	1.2	1.5	17.6	15.2	17.5	750	14.2	70.1
Bank of Baroda	309	ADD	113,021	2,306	366	39.3	39.3	44.6	39.8	0.1	13.4	7.9	7.9	6.9	—	—	—	1.3	1.1	1.0	2.6	2.6	2.9	14.6	12.5	13.0	310	0.3	8.7
Bank of India	288	BUY	151,647	3,094	526	40.6	43.9	51.0	76.6	7.9	16.2	7.1	6.6	5.7	—	—	—	1.9	1.5	1.2	1.4	1.6	1.8	27.6	23.4	22.3	375	30.1	21.5
Canara Bank	183	REDUCE	74,907	1,528	410	38.2	31.9	41.0	10.1	(16.5)	28.7	4.8	5.7	4.5	—	—	—	1.0	0.9	0.8	4.4	3.8	4.1	15.0	11.9	13.9	210	14.9	3.9
Central Bank of India	42	SELL	16,853	344	404	11.6	9.4	17.1	(24.6)	(18.6)	81.0	3.6	4.4	2.4	—	—	—	0.8	0.5	0.4	4.8	—	—	15.3	11.6	16.7	55	31.9	0.5
Corporation Bank	237	ADD	33,966	693	143	51.3	48.7	55.5	37.2	(5.0)	13.9	4.6	4.9	4.3	—	—	—	0.8	0.7	0.6	4.4	4.2	4.8	18.4	15.5	15.7	355	49.9	0.5
Federal Bank	160	BUY	27,340	558	171	34.4	26.6	29.8	0.5	(22.7)	12.2	4.7	6.0	5.4	—	—	—	0.7	0.6	0.6	2.5	3.1	3.5	13.6	11.1	11.4	300	87.7	1.6
Future Capital Holdings	190	BUY	12,025	245	63	(4.5)	4.5	28.8	(689.8)	(198.6)	546.1	(42.1)	42.7	6.6	—	—	—	1.7	1.6	1.3	—	—	—	(6.7)	3.8	21.4	440	131.3	1.1
HDFC	1,975	ADD	566,927	11,565	287	85.8	78.0	97.1	38.2	(9.0)	24.5	23.0	25.3	20.3	—	—	—	4.7	4.1	3.6	1.3	1.2	1.5	27.8	17.4	18.9	2,200	11.4	73.7
HDFC Bank	1,090	BUY	461,193	9,408	423	46.0	55.6	68.9	28.7	20.9	23.9	23.7	19.6	15.8	—	—	—	4.0	3.1	2.2	0.7	0.9	1.1	17.7	17.9	17.1	1,350	23.9	52.6
ICICI Bank	431	ADD	479,620	9,784	1,113	39.9	32.9	40.2	15.4	(17.7)	22.2	10.8	13.1	10.7	—	—	—	1.0	1.0	0.9	2.6	1.9	2.3	11.7	7.7	8.8	650	50.8	169.1
IDFC	62	ADD	79,988	1,632	1,294	5.7	6.8	8.1	2.9	19.2	19.0	10.9	9.1	7.7	—	—	—	1.4	1.3	1.1	1.9	2.0	2.3	17.6	14.9	15.7	100	61.8	25.0
India Infoline	56	ADD	16,108	329	287	5.6	6.3	6.2	85.6	12.0	(1.2)	10.0	8.9	9.0	2.3	4.1	3.7	1.3	1.2	1.1	2.1	2.4	2.4	20.7	14.1	12.9	70	24.9	3.7
Indian Bank	135	ADD	58,126	1,186	430	22.5	22.8	23.2	33.9	1.2	1.8	6.0	5.9	5.8	—	—	—	1.3	1.1	1.0	2.2	2.2	2.2	23.4	18.8	16.6	140	3.5	2.9
Indian Overseas Bank	98	ADD	53,499	1,091	545	22.1	22.0	23.6	19.2	(0.1)	7.2	4.4	4.5	4.2	—	—	—	1.1	0.9	0.8	3.8	5.1	5.6	27.2	22.6	20.5	130	32.4	1.1
J&K Bank	436	ADD	21,145	431	48	74.2	76.1	78.4	31.2	2.5	3.1	5.9	5.7	5.6	—	—	—	1.0	0.9	0.8	3.6	3.6	3.8	16.8	15.2	14.1	750	72.0	0.4
LIC Housing Finance	243	ADD	20,680	422	85	45.5	54.6	56.2	38.7	19.8	2.9	5.3	4.5	4.3	—	—	—	1.1	0.9	0.8	4.1	4.9	5.1	—	—	—	325	33.6	4.1
Mahindra & Mahindra Financial	200	SELL	19,060	389	95	20.8	22.9	27.2	32.6	10.1	18.7	9.6	8.7	7.3	—	—	—	1.5	1.3	1.2	2.3	2.9	3.4	16.9	15.7	16.6	215	7.5	0.1
Oriental Bank of Commerce	161	ADD	40,425	825	251	23.9	32.0	32.6	(27.6)	34.0	2.1	6.8	5.0	4.9	—	—	—	0.8	0.7	0.6	2.9	4.0	4.0	6.2	13.2	12.2	200	24.0	2.0
PFC	113	REDUCE	129,124	2,634	1,148	11.4	13.0	15.8	2.6	14.3	21.1	9.9	8.6	7.1	—	—	—	1.3	1.1	1.0	1.4	1.6	1.9	13.4	13.6	14.6	130	15.6	3.0
Punjab National Bank	501	BUY	157,888	3,221	315	65.0	73.2	82.5	33.0	12.6	12.8	7.7	6.8	6.1	—	—	—	1.6	1.3	1.2	2.6	2.9	3.3	18.0	17.6	17.6	650	29.8	11.2
Shriram Transport	220	REDUCE	44,718	912	203	19.2	26.8	31.1	85.7	39.9	15.9	11.5	8.2	7.1	—	—	—	2.6	2.2	1.8	2.3	3.7	4.4	26.9	27.2	27.2	320	45.3	0.9
SREI	53	BUY	7,114	145	134	11.4	5.5	8.1	57.4	(51.8)	47.8	4.6	9.6	6.5	—	—	—	1.1	0.6	0.6	2.0	4.3	5.3	23.1	11.6	12.5	160	201.6	0.6
State Bank of India	1,488	ADD	939,375	19,163	631	106.6	113.4	124.6	23.5	6.4	9.9	14.0	13.1	11.9	—	—	—	2.2	1.9	1.7	1.4	1.4	1.5	16.8	13.8	13.6	1,700	14.3	94.8
Union Bank	151	BUY	76,096	1,552	505	27.5	26.3	30.8	64.1	(4.2)	17.0	5.5	5.7	4.9	—	—	—	1.0	0.9	0.8	2.7	2.6	3.1	26.8	21.5	21.1	200	32.8	4.4
Banks/Financial Institutions		**Attractive**	**3,861,896**	**78,783**					**36.9**	**6.5**	**17.6**	**11.8**	**11.0**	**9.4**	**—**	**—**	**—**	**1.8**	**1.6**	**1.4**	**1.8**	**1.8**	**2.0**	**15.4**	**14.2**	**14.5**			
Cement																													
ACC	484	REDUCE	91,368	1,864	189	64.1	61.2	47.7	13.0	(4.5)	(22.0)	7.6	7.9	10.2	3.8	3.8	5.2	2.0	1.8	1.6	4.8	4.8	4.8	33.3	25.3	17.5	610	25.9	5.8
Ambuja Cements	54	REDUCE	81,980	1,672	1,522	7.6	8.0	6.6	(11.2)	6.4	(17.5)	7.1	6.7	8.1	3.6	4.1	4.4	1.6	1.3	1.1	4.8	5.6	4.0	26.6	21.7	15.4	95	76.4	2.6
Grasim Industries	1,210	ADD	110,940	2,263	92	284.6	257.6	240.4	32.6	(9.5)	(6.7)	4.3	4.7	5.0	2.7	2.8	2.5	1.0	0.8	0.7	2.6	2.8	2.8	25.3	18.3	14.5	2,320	91.7	4.6
India Cements	92	ADD	25,904	528	282	24.5	19.1	19.9	n/a	(21.8)	4.1	3.8	4.8	4.6	3.0	3.3	2.7	0.8	0.7	0.6	2.0	2.3	2.3	25.9	15.8	14.4	160	74.1	2.1
Shree Cement	505	BUY	17,598	359	35	90.2	109.1	71.4	99.5	21.0	(34.6)	5.6	4.6	7.1	3.0	3.5	3.4	2.7	1.8	1.5	1.6	1.6	1.6	56.9	46.6	22.9	850	68.3	0.3
UltraTech Cement	374	BUY	46,828	955	125	81.4	71.0	54.7	28.5	(12.8)	(22.9)	4.6	5.3	6.8	3.5	3.8	4.2	1.4	1.2	1.0	2.0	2.2	2.2	45.2	28.8	18.2	550	47.1	1.0
Cement		**Cautious**	**374,618**	**7,642**					**19.3**	**(6.2)**	**(14.3)**	**5.4**	**5.7**	**6.7**	**3.2**	**3.4**	**3.5**	**1.3**	**1.1**	**1.0**	**3.5**	**3.7**	**3.4**	**24.5**	**18.9**	**14.3**			
Consumer (Discretionary)																													
Radico Khaitan	59	REDUCE	6,959	142	118	3.4	3.2	3.8	8.4	(7.0)	21.5	17.4	18.7	15.4	8.6	8.7	7.9	1.4	1.3	1.2	0.7	0.7	0.7	9.4	8.1	9.0	91	53.8	0.5
United Breweries	92	REDUCE	21,988	449	240	1.9	2.4	4.4	(11.6)	25.7	82.1	48.1	38.2	21.0	12.8	9.5	7.1	3.8	2.1	1.9	—	—	—	8.3	7.1	9.6	160	74.7	0.2
United Spirits	739	BUY	69,239	1,412	94	40.0	40.1	52.4	50.8	0.1	30.9	18.5	18.5	14.1	11.3	9.9	8.7	2.9	2.9	2.2	0.0	0.0	0.0	18.8	15.9	17.7	1,050	42.0	7.6
Consumer (Discretionary)		**Attractive**	**98,186**	**2,003**					**35.8**	**1.2**	**35.3**	**20.4**	**20.2**	**14.9**	**11.3**	**9.8**	**8.4**	**2.9**	**2.3**	**2.0**	**0.1**	**0.1**	**0.1**	**14.0**	**11.3**	**13.4**			
Consumer products																													
Asian Paints	1,034	ADD	99,143	2,023	96	38.3	44.3	52.4	36.1	15.8	18.2	27.0	23.3	19.7	16.2	13.6	11.3	10.2	8.2	6.7	1.5	1.7	1.9	43.5	40.2	38.3	1,240	20.0	0.8
Colgate-Palmolive (India)	391	REDUCE	53,221	1,086	136	17.3	19.2	22.4	18.4	10.6	17.0	22.6	20.4	17.4	17.8	15.1	12.7	28.4	24.2	20.7	3.3	3.7	4.3	100.8	128.5	128.3	420	7.3	0.9
GlaxoSmithkline Consumer (a)	605	BUY	25,444	519	42	38.5	45.5	53.8	27.4	18.4	18.3	15.7	13.3	11.2	8.2	6.7	5.4	3.8	3.3	2.8	2.1	2.5	2.9	27.3	27.3	27.3	800	32.2	0.1
Godrej Consumer Products	113	ADD	29,192	596	258	7.3	8.0	8.5	22.9	9.0	6.9	15.5	14.2	13.3	13.5	10.6	9.5	13.7	4.2	3.7	3.1	3.5	3.5	100.9	46.1	39.3	140	23.8	0.1
Hindustan Unilever	250	ADD	545,019	11,118	2,177	8.1	9.2	10.8	15.4	12.9	17.9	30.8	27.3	23.1	25.0	20.8	17.1	37.9	35.2	32.5	4.3	3.5	4.1	85.2	134.3	146.7	280	11.9	21.1
ITC	169	BUY	632,690	12,907	3,742	8.0	9.1	10.4	11.3	13.3	14.3	21.0	18.6	16.3	13.8	12.1	10.3	5.1	4.5	3.9	2.1	2.2	2.4	26.9	26.6	26.4	230	36.0	25.6
Jyothy Laboratories	275	ADD	3,993	81	15	31.0	42.1	68.3	(12.8)	35.8	62.3	8.9	6.5	4.0	5.8	3.9	2.0	1.1	0.9	0.7	3.4	3.8	4.3	11.5	13.1	17.9	740	169.0	
Nestle India (a)	1,530	ADD	147,487	3,009	96	44.5	58.6	70.2	31.3	31.7	19.7	34.4	26.1	21.8	20.7	16.1	13.3	28.6	21.7	16.8	1.8	2.3	2.8	94.8	94.5	86.9	1,900	24.2	1.4
Tata Tea	574	BUY	35,475	724	62	54.1	63.3	67.3	3.6	17.2	6.2	10.6	9.1	8.5	4.1	3.6	3.0	0.7	0.7	0.7	2.6	3.1	3.3	9.7	9.4	9.4	1,100	91.8	1.4
Consumer products		**Attractive**	**1,571,662**	**32,062**					**15.0**	**15.2**	**15.8**	**24.1**	**20.9**	**18.1**	**16.0**	**13.7**	**11.6**	**7.3**	**6.3**	**5.6**	**2.8**	**2.7**	**3.1**	**30.3**	**30.3**	**30.8**			
Constructions																													
Consolidated Construction Co.	375	BUY	13,856	283	37	24.0	34.2	44.9	67.6	42.4	31.1	15.6	10.9	8.4	10.2	6.5	4.9	3.1	2.5	2.0	0.7	1.3	1.7	27.7	25.0	26.4	700	86.7	0.0
IVRCL	131	BUY	17,718	361	135	16.0	17.1	22.8	29.2	6.5	33.2	8.2	7.7	5.7	7.5	5.7	4.6	1.1	1.0	0.8	1.1	0.6	0.6	14.8	13.5	15.6	415	217.0	5.8
Nagarjuna Construction Co.	53	BUY	12,165	248	229	7.2	8.1	10.6	14.5	13.4	30.2	7.4	6.5	5.0	6.6	5.8	5.2	0.8	1.4	0.6	2.1	2.5	3.0	12.6	11.3	13.3	195	267.2	4.9
Punj Lloyd	176	BUY	56,846	1,160	323	10.0	14.7	20.8	323.5	46.9	42.1	17.6	12.0	8.4	9.5	6.9	5.3	2.1	1.7	1.5	0.2	0.4	0.5	16.8	16.1	19.4	350	99.1	33.7
Sadbhav Engineering	523	BUY	6,844	140	13	40.5	62.6	78.1	68.2	54.4	24.8	12.9	8.4	6.7	7.9	4.7	3.4	2.3	1.6	1.4	0.7	1.0	1.1	16.3	19.6	20.5	1,100	110.5	0.1

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

Company	21-Oct-08 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2008	EPS (Rs) 2009E	EPS (Rs) 2010E	EPS growth (%) 2008	EPS growth (%) 2009E	EPS growth (%) 2010E	PER (X) 2008	PER (X) 2009E	PER (X) 2010E	EV/EBITDA (X) 2008	EV/EBITDA (X) 2009E	EV/EBITDA (X) 2010E	Price/BV (X) 2008	Price/BV (X) 2009E	Price/BV (X) 2010E	Dividend yield (%) 2008	Dividend yield (%) 2009E	Dividend yield (%) 2010E	RoE (%) 2008	RoE (%) 2009E	RoE (%) 2010E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Energy																													
Bharat Petroleum	353	REDUCE	115,557	2,357	328	39.8	40.7	38.3	(24.0)	2.1	(5.9)	8.8	8.7	9.2	3.5	3.9	2.8	0.9	0.9	0.7	1.3	1.2	1.1	11.4	10.4	8.9	360	2.1	6.8
Cairn india	171	ADD	319,977	6,528	1,868	(0.1)	3.9	20.3	(105)	(3,390)	418	(1,437)	44	8.4	40.1	17.7	5.8	1.1	1.0	0.9	—	—	—	(0.1)	2.3	10.9	245	43.0	22.1
Castrol India (a)	311	ADD	38,409	784	124	20.1	23.6	24.1	64.6	17.5	2.1	15.5	13.1	12.9	8.9	7.8	7.6	9.3	8.7	8.1	4.5	5.8	5.8	59.5	68.5	65.2	350	12.7	0.5
GAIL (India)	240	REDUCE	304,434	6,210	1,268	20.4	26.7	29.6	21.0	30.9	10.8	11.8	9.0	8.1	6.1	5.4	5.7	2.1	1.9	1.5	2.8	3.6	3.9	18.1	20.8	19.7	285	18.8	15.0
GSPL	38	BUY	21,133	431	563	1.8	3.0	4.2	10.1	66.1	39.9	20.8	12.5	9.0	7.2	6.3	4.5	1.7	1.5	1.3	1.3	2.2	3.1	8.8	12.9	16.1	65	73.1	2.2
Hindustan Petroleum	224	REDUCE	75,823	1,547	339	33.5	26.1	33.4	(16.4)	(21.9)	27.7	6.7	8.6	6.7	5.6	3.7	2.2	0.6	0.6	0.5	1.3	1.0	1.3	9.6	6.8	7.9	260	16.2	5.5
Indian Oil Corporation	400	REDUCE	471,787	9,624	1,179	60.5	40.9	61.8	29.2	(32.5)	51.2	6.6	9.8	6.5	4.4	8.0	7.5	1.0	1.0	0.8	1.4	1.3	1.8	17.2	10.1	13.5	500	25.0	3.8
Oil & Natural Gas Corporation	789	BUY	1,688,544	34,446	2,139	92.0	150.4	159.5	8.2	63.4	6.1	8.6	5.2	4.9	3.1	2.0	1.7	1.7	1.4	1.1	4.1	5.1	5.7	19.4	27.3	24.0	1,300	64.7	49.1
Petronet LNG	42	ADD	31,575	644	750	6.3	6.0	7.1	—	(5.7)	18.7	6.7	7.1	5.9	4.4	5.8	4.5	1.7	1.4	1.1	3.6	3.6	3.6	26.7	20.6	20.3	60	42.5	1.6
Reliance Industries	1,395	RS	1,833,508	37,404	1,314	101.7	105.8	158.3	23.0	4.0	49.5	13.7	13.2	8.8	8.5	6.6	4.0	2.1	1.8	1.4	0.9	1.0	1.5	18.5	15.5	19.8	—	—	233.1
Reliance Petroleum	107	REDUCE	479,475	9,781	4,500	(1.1)	2.4	17.0	n/a	n/a	596.6	n/a	43.7	6.3	n/a	23.3	5.5	3.6	3.3	2.3	—	—	1.9	(3.5)	7.8	42.9	130	22.0	55.2
Energy		**Cautious**	**5,380,223**	**109,757**					**10.7**	**32.3**	**38.5**	**11.6**	**8.7**	**6.3**	**5.8**	**4.8**	**3.7**	**1.7**	**1.4**	**1.2**	**2.0**	**2.4**	**3.0**	**14.5**	**15.9**	**18.9**			
Industrials																													
ABB	672	REDUCE	142,371	2,904	212	23.2	28.6	35.4	44.5	23.2	23.7	29.0	23.5	19.0	17.0	13.4	10.3	8.8	6.6	5.1	0.3	0.4	0.5	34.8	32.1	30.3	875	30.2	9.1
BGR Energy Systems	183	REDUCE	13,194	269	72	12.3	18.3	23.2	(67.1)	49.5	26.7	15.0	10.0	7.9	9.4	6.6	6.0	2.6	2.1	1.7	0.6	1.0	1.3	30.1	23.5	24.1	325	77.4	1.9
Bharat Electronics	690	ADD	55,200	1,126	80	102.1	104.4	111.1	11.3	2.3	6.4	6.8	6.6	6.2	2.1	1.8	1.5	1.7	1.4	1.2	3.6	3.6	3.6	27.9	23.1	20.9	1,200	73.9	1.4
Bharat Heavy Electricals	1,142	ADD	559,105	11,406	490	58.4	73.1	96.9	22.9	25.1	32.6	19.6	15.6	11.8	10.0	7.7	5.9	5.2	4.2	3.3	1.3	1.4	1.8	29.2	29.5	31.1	2,000	75.1	77.8
Larsen & Toubro	860	BUY	509,485	10,393	593	37.9	54.3	68.9	20.8	43.1	26.9	22.7	15.8	12.5	15.0	9.7	7.9	4.3	3.1	2.5	1.0	2.3	2.3	22.7	22.7	22.5	1,225	42.5	107.1
Maharashtra Seamless	209	BUY	14,765	301	71	29.4	38.5	43.0	(23.5)	31.2	11.8	7.1	5.4	4.9	4.4	3.5	3.1	1.3	1.1	0.9	2.4	2.8	3.1	19.7	21.7	20.2	350	67.2	0.7
Siemens	307	REDUCE	103,340	2,108	337	18.2	18.8	25.9	60.4	3.1	38.0	16.8	16.3	11.8	9.5	8.9	6.1	5.6	4.4	3.3	0.8	0.9	1.0	39.9	30.2	32.0	570	86.0	6.9
Suzlon Energy	92	BUY	144,003	2,938	1,567	6.6	10.9	16.1	9.5	65.9	47.8	14.0	8.4	5.7	7.7	8.0	6.0	1.6	1.3	1.1	1.0	1.1	1.1	16.3	17.0	20.5	225	144.8	36.6
Industrials		**Neutral**	**1,541,463**	**31,446**					**24.6**	**31.6**	**30.8**	**18.5**	**14.0**	**10.7**	**10.6**	**8.2**	**6.5**	**3.8**	**3.0**	**2.4**	**1.1**	**1.6**	**1.8**	**20.8**	**21.4**	**22.5**			
Infrastructure																													
IRB Infrastructure	96	BUY	31,890	651	332	3.4	5.9	13.2	150.9	73.0	122.3	28.0	16.2	7.3	10.9	10.8	5.2	1.9	1.7	1.3	—	—	—	10.7	11.1	20.4	155	61.5	0.5
Media																													
DishTV	18	BUY	11,465	234	644	(9.6)	(6.1)	(2.7)	n/a	(36.8)	(55.2)	(1.8)	(2.9)	(6.5)	(7.2)	(5.4)	(96.5)	(2.5)	3.9	31.6	—	—	—	167.9	497.0	####	32	79.8	4.1
HT Media	83	BUY	19,431	396	234	4.3	3.1	6.0	4.7	(28.8)	94.1	19.2	26.9	13.9	10.7	11.9	6.8	2.2	2.1	1.9	0.5	0.5	1.0	12.2	8.1	14.4	130	56.7	0.2
Jagran Prakashan	59	BUY	17,829	364	301	3.3	3.1	5.0	33.5	(6.3)	63.3	18.2	19.4	11.9	10.0	10.2	6.5	3.3	3.1	2.8	3.4	3.1	4.2	18.7	16.6	25.1	95	60.5	0.3
Sun TV Network	175	ADD	68,826	1,404	394	8.3	9.5	11.6	30.7	14.2	22.0	21.1	18.4	15.1	10.9	9.3	7.6	4.6	4.0	3.6	1.4	1.7	3.4	24.8	23.7	25.5	245	40.3	0.9
Zee Entertainment Enterprises	148	BUY	63,951	1,305	434	8.9	9.7	12.0	62.6	9.1	24.0	16.6	15.2	12.3	12.2	10.2	8.2	2.2	1.9	1.7	1.4	1.7	2.1	14.2	13.8	15.3	205	39.0	6.3
Media		**Attractive**	**181,503**	**3,703**					**24.0**	**13.4**	**78.4**	**36.4**	**32.1**	**18.0**	**14.5**	**11.9**	**8.2**	**3.4**	**2.6**	**2.5**	**1.4**	**1.6**	**2.6**	**9.2**	**8.2**	**13.8**			
Metals																													
Hindalco Industries	64	SELL	112,605	2,297	1,753	13.8	8.9	7.0	(10.0)	(35.7)	(21.2)	4.7	7.2	9.2	6.0	5.4	6.0	0.5	0.3	0.4	-	-	-	14.4	10.0	6.7	65	1.2	10.1
National Aluminium Co.	266	REDUCE	171,097	3,490	644	25.2	30.3	33.5	(31.8)	20.0	10.6	10.5	8.8	7.9	5.2	4.6	3.5	1.8	1.6	1.4	2.8	2.8	2.8	18.4	19.4	18.7	370	39.3	5.0
Jindal Steel and Power	793	BUY	122,107	2,491	154	91.1	126.1	125.9	101.5	38.4	(0.1)	8.7	6.3	6.3	6.8	4.9	4.8	2.9	2.0	1.5	1—	0.7	0.9	43.8	37.3	27.3	1,800	127.0	22.1
JSW Steel	268	ADD	49,807	1,016	186	92.0	103.1	146.8	35.7	12.0	42.4	2.9	2.6	1.8	3.3	3.8	2.7	0.5	0.4	0.3	6.9	6.9	6.9	21.2	18.1	21.0	1,040	287.9	12.8
Hindustan Zinc	287	ADD	121,393	2,476	423	104.0	77.2	55.9	(1.0)	(25.8)	(27.6)	2.8	3.7	5.1	2.0	2.4	3.5	1.0	0.8	0.7	1.7	2.6	3.5	43.6	23.5	14.3	400	39.2	2.4
Sesa Goa	85	BUY	67,073	1,368	787	18.8	22.6	23.2	144.6	19.7	2.7	4.5	3.8	3.7	2.9	2.1	1.7	2.4	1.6	1.2	4.1	4.7	5.9	68.6	50.8	36.9	195	128.9	33.7
Sterlite Industries	294	BUY	208,333	4,250	708	64.3	47.3	50.9	(22.6)	(26.5)	7.6	4.6	6.2	5.8	3.7	4.8	4.2	0.9	0.8	0.7	—	—	—	26.1	13.7	13.4	480	63.2	34.6
Tata Steel	278	REDUCE	228,554	4,663	822	75.7	89.7	74.6	43.8	18.5	(16.9)	3.7	3.1	3.7	4.1	4.2	4.5	0.6	0.5	0.5	5.2	4.6	4.7	46.3	29.9	22.6	285	2.5	58.5
Metals		**Cautious**	**1,080,969**	**22,052**					**13.2**	**(2.9)**	**(5.0)**	**4.5**	**4.7**	**4.9**	**4.1**	**4.3**	**4.2**	**0.9**	**0.7**	**0.7**	**2.4**	**2.4**	**2.6**	**19.9**	**16.1**	**13.5**			
Pharmaceutical																													
Biocon	124	BUY	24,790	506	200	23.3	9.5	16.4	126.0	(59.0)	71.7	5.3	13.0	7.6	6.7	6.2	4.9	1.7	1.6	1.4	0.1	0.1	0.1	17.6	15.7	19.6	260	109.8	0.7
Cipla	189	REDUCE	147,025	2,999	777	9.0	10.5	12.2	4.9	16.2	16.4	21.0	18.1	15.5	15.4	13.8	11.7	3.9	3.4	2.9	1.1	1.3	1.6	20.1	20.1	20.3	230	21.6	7.7
Dishman Pharma & chemicals	226	BUY	18,385	375	81	14.7	19.7	27.7	30.5	34.1	40.1	15.4	11.4	8.2	12.3	9.3	6.9	3.2	2.5	2.0	0.0	0.0	0.0	26.8	24.8	27.3	515	127.8	0.4
Divi's Laboratories	1,106	BUY	71,408	1,457	65	53.2	76.5	103.6	85.8	43.7	35.4	20.8	14.5	10.7	16.9	11.6	8.2	8.4	5.4	3.7	0.1	0.1	0.1	49.8	45.7	41.3	2,330	110.6	4.5
Dr Reddy's Laboratories	510	BUY	86,253	1,760	169	26.1	33.8	41.0	(57.2)	29.6	21.5	19.6	15.1	12.4	9.4	7.5	6.4	1.9	1.7	1.5	0.7	0.8	0.8	10.3	12.0	13.0	790	55.0	6.4
Glenmark Pharmaceuticals	504	BUY	134,030	2,734	266	25.8	31.8	41.8	98.4	23.2	31.3	19.5	15.8	12.1	16.8	12.8	9.5	8.8	5.0	3.6	0.0	0.0	0.0	57.4	39.6	35.1	770	52.7	6.6
Jubilant Organosys	166	BUY	30,125	615	181	22.1	11.0	29.6	69.9	(50.4)	170.2	7.5	15.2	5.6	7.7	12.0	5.9	2	1.7	1.6	0.7	1.0	1.3	37.0	14.9	32.2	475	185.7	0.4
Lupin	694	BUY	61,516	1,255	89	49.8	51.3	59.5	30.2	3.0	16.1	13.9	13.5	11.7	16.2	11.0	9.4	5	2.9	2.5	1.3	1.4	1.7	37.9	27.7	23.9	950	36.8	3.0
Piramal Healthcare	240	BUY	50,097	1,022	209	17.7	20.3	26.3	66.8	14.6	29.3	13.5	11.8	9.1	10.2	8.3	6.4	4.6	3.5	2.7	1.8	1.7	1.9	30.9	33.8	33.4	530	121.1	1.4
Ranbaxy Laboratories	262	REDUCE	109,943	2,243	419	23.3	9.8	15.5	70.4	(58.1)	58.7	11.2	26.9	16.9	9.9	11.3	5.4	3.7	1.7	1.0	2.9	4.0	5.1	29.8	9.1	9.2	420	60.1	38.4
Sun Pharmaceuticals	1,339	BUY	277,308	5,657	207	74.7	86.1	79.1	78.9	15.3	(8.0)	17.9	15.6	16.9	15.2	11.8	12.1	5.3	4.0	3.3	0.8	0.8	1.0	38.3	30.9	22.7	1,780	32.9	20.7
Pharmaceuticals		**Attractive**	**1,010,881**	**20,622**					**34.1**	**6.2**	**25.3**	**16.8**	**15.9**	**12.7**	**12.7**	**10.9**	**8.5**	**4.1**	**3.0**	**2.3**	**0.9**	**1.1**	**1.4**	**24.5**	**18.9**	**18.1**			
Property																													
Housing Development & Infrastruc	152	BUY	41,999	857	275	51.2	56.6	63.6	118.6	10.6	12.3	3.0	2.7	2.4	4.1	3.9	3.2	1.2	0.8	0.7	2.5	5.2	5.2	64.5	36.3	30.7	610	300.1	38.5
DLF	286	BUY	488,084	9,957	1,705	43.8	49.8	55.1	244.6	13.9	10.5	6.5	5.7	5.2	6.3	5.3	4.2	2.5	1.8	1.4	1.7	2.4	3.5	63.2	36.6	30.8	660	130.5	64.1
IVR Prime Urban Developers	54	BUY	3,467	71	64	27.0	15.5	17.1	552.0	(42.6)	10.8	2.0	3.5	3.2	0.9	3.6	4.4	0.3	0.3	0.3	7.4	9.3	13.0	31.9	9.6	10.0	360	566.0	0.1
Mahindra Life Space Developer	277	BUY	11,668	238	42	12.7	13.9	19.0	208.4	8.9	37.4	21.8	20.0	14.6	44.8	14.6	8.0	1.4	1.3	1.2	1.1	1.4	1.4	6.4	6.5	8.5	810	192.2	0.4
Phoenix Mills	84	BUY	12,176	248	145	2.6	4.4	11.6	(59.8)	68.1	162.1	31.9	19.0	7.2	25.9	12.8	4.2	0.8	0.8	0.7	—	—	—	5.0	4.4	10.6	350	316.2	0.9
Puravankara Projects	97	REDUCE	20,723	423	213	11.3	14.0	16.7	67.4	24.8	19.1	8.6	6.9	5.8	12.7	11.4	9.1	1.7	1.4	1.3	1.0	4.1	6.2	32.9	22.4	23.1	220	126.6	0.4
Sobha	125	REDUCE	9,138	186	73	31.7	30.2	33.2	42.9	(4.7)	9.8	3.9	4.1	3.8	7.2	6.3	6.0	0.9	0.8	0.6	5.2	3.2	3.2	25.3	20.0	18.6	250	99.4	1.1
Indiabulls Real Estate	138	BUY	37,487	765	273	16.4	6.8	7.5	2,383.9	(58.6)	10.4	8.4	20.2	18.3	(1,249.5)	28.0	10.4	0.7	0.5	0.5	0.2	0.0	0.0	10.6	2.9	2.8	275	100.0	32.1

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

Company	21-Oct-08 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2008	EPS (Rs) 2009E	EPS (Rs) 2010E	EPS growth (%) 2008	EPS growth (%) 2009E	EPS growth (%) 2010E	PER (X) 2008	PER (X) 2009E	PER (X) 2010E	EV/EBITDA (X) 2008	EV/EBITDA (X) 2009E	EV/EBITDA (X) 2010E	Price/BV (X) 2008	Price/BV (X) 2009E	Price/BV (X) 2010E	Dividend yield (%) 2008	Dividend yield (%) 2009E	Dividend yield (%) 2010E	RoE (%) 2008	RoE (%) 2009E	RoE (%) 2010E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Property		**Neutral**	**753,949**	**15,381**					**177.5**	**11.8**	**13.9**	**6.5**	**5.8**	**5.1**	**6.6**	**5.5**	**4.5**	**2.0**	**1.5**	**1.2**	**1.6**	**2.5**	**3.7**	**30.5**	**25.9**	**24.0**			
Retail																													
Pantaloon Retail	224	BUY	38,500	785	172	8.0	12.1	18.4	93.1	50.4	52.2	27.9	18.5	12.2	10.8	7.4	6.0	2.3	1.4	1.3	0.2	0.4	0.4	8.5	9.1	10.8	400	78.7	1.4
Titan Industries	1,001	BUY	44,418	906	44	35.1	49.8	56.6	55.2	42.1	13.6	28.5	20.1	17.7	19.3	12.6	10.6	9.4	6.8	5.2	0.8	0.9	1.1	37.7	39.3	33.2	1,280	27.9	2.4
Vishal Retail	125	ADD	2,792	57	22	18.1	21.6	35.6	37.2	19.2	65.2	6.9	5.8	3.5	6.1	4.7	3.9	1.0	0.9	0.7	—	—	—	20.2	16.2	22.1	485	289.1	0.2
Retail			**85,710**	**1,748**					**31.8**	**48.2**	**35.6**	**26.6**	**18.0**	**13.2**	**12.6**	**8.4**	**6.7**	**3.5**	**2.4**	**2.0**	**0.5**	**0.7**	**0.8**	**13.2**	**13.1**	**15.3**			
Technology																													
HCL Technologies	186	REDUCE	129,444	2,641	695	15.3	20.6	21.7	(19.0)	35.0	5.4	12.2	9.0	8.6	6.6	4.8	4.4	2.6	2.0	1.8	4.3	4.3	4.3	21.4	23.8	22.7	200	7.4	4.0
Hexaware Technologies	26	SELL	3,624	74	142	7.7	4.6	5.1	(13.7)	(39.8)	10.6	3.3	5.5	5.0	0.3	(0.1)	(0.5)	0.5	0.5	0.5	3.6	6.3	6.3	15.1	9.1	9.5	35	37.3	0.2
Infosys Technologies	1,348	BUY	773,522	15,780	574	79.1	100.8	108.8	18.0	27.5	7.9	17.0	13.4	12.4	13.2	9.9	8.8	5.6	4.3	3.4	2.5	1.8	1.9	36.1	36.4	30.9	1,600	18.7	69.0
Mphasis BFL	198	REDUCE	41,323	843	208	12.2	22.3	23.4	67.6	81.7	5.0	16.2	8.9	8.5	9.7	5.8	4.8	3.6	0.4	2.2	1.8	2.0	2.3	23.6	34.6	28.4	190	(4.1)	1.8
Mindtree	282	BUY	7,357	150	26	26.7	30.7	39.6	12.3	14.7	29.0	10.6	9.2	7.1	6.2	3.4	3.0	1.4	1.1	0.9	1.4	—	—	—	17.2	17.8	450	59.3	0.4
Patni Computer Systems	165	SELL	22,977	469	139	33.4	25.8	28.2	29.7	(22.6)	9.4	5.0	6.4	5.9	2.0	1.4	0.9	0.8	0.8	0.7	1.2	1.4	1.5	19.2	11.7	11.6	200	21.0	1.6
Polaris Software Lab	51	SELL	4,969	101	98	7.4	12.8	11.6	(27.6)	71.6	(9.6)	6.8	4.0	4.4	2.7	1.5	1.2	0.8	0.7	0.6	3.5	3.5	3.5	11.7	17.8	14.1	70	38.5	4.9
Satyam Computer Services	317	BUY	216,063	4,408	682	25.2	33.7	35.5	17.7	33.3	5.3	12.5	9.4	8.9	9.4	6.2	5.3	3.0	2.4	2.0	3.1	3.8	4.4	26.0	28.2	24.2	400	26.3	35.9
TCS	559	REDUCE	547,141	11,162	979	51.3	60.4	65.9	21.5	17.9	9.0	10.9	9.2	8.5	8.7	7.0	6.1	4.4	3.4	2.8	2.5	3.8	4.7	47.0	41.8	36.6	750	34.1	23.1
Tech Mahindra	413	BUY	51,496	1,051	125	59.1	76.4	85.0	25.7	29.4	11.2	7.0	5.4	4.9	6.2	3.5	2.6	4.1	2.3	1.6	1.3	1—	1.5	70.7	58.0	40.9	700	69.4	3.5
Wipro	297	ADD	430,433	8,781	1,450	22.2	26.9	30.5	12.6	20.9	13.5	13.4	11.0	9.7	10.6	7.6	6.4	3.3	2.7	2.3	2.1	2.7	3.1	27.9	27.1	25.4	380	28.0	11.4
Technology		**Neutral**	**2,228,348**	**45,458**					**16.1**	**24.7**	**8.9**	**12.9**	**10.3**	**9.5**	**9.7**	**7.2**	**6.2**	**3.8**	**3.0**	**2.5**	**2.5**	**2.8**	**3.2**	**29.5**	**29.0**	**26.1**			
Telecom																													
Bharti Airtel Ltd	724	BUY	1,374,744	28,045	1,898	35.3	47.0	57.0	65.0	33.2	21.1	20.5	15.4	12.7	12.5	9.1	7.0	6.1	4.3	3.2	—	0.5	0.8	39.1	32.9	29.1	840	16.0	85.2
IDEA	54	REDUCE	174,601	3,562	3,236	3.9	3.3	3.4	78.5	(17.6)	5.7	13.7	16.6	15.7	10.2	6.5	5.6	4.9	1.2	1.1	—	—	—	36.4	12.0	8.0	70	29.7	11.0
MTNL	67	REDUCE	42,431	866	630	6.0	6.5	7.0	(25.2)	7.7	8.2	11.2	10.4	9.6	(0.5)	(0.6)	(0.6)	0.4	0.4	0.4	8.9	8.9	8.9	2.7	2.9	3.2	100	48.5	3.1
Reliance Communications	258	SELL	532,409	10,861	2,064	25.0	28.6	34.8	76.4	14.1	21.9	10.3	9.0	7.4	7.7	6.7	5.3	1.9	1.6	1.3	0.3	—	—	16.1	19.9	19.8	390	51.2	72.1
Tata Communications	467	REDUCE	133,152	2,716	285	10.9	12.0	13.3	(36.3)	9.2	11.2	42.7	39.1	35.2	17.8	16.6	14.3	2.0	1.9	1.9	1.0	1.1	1.4	4.4	4.7	4.9	430	(8.0)	3.6
Telecom		**Cautious**	**2,257,336**	**46,050**					**61.9**	**22.9**	**20.0**	**16.0**	**13.0**	**10.8**	**10.3**	**8.0**	**6.3**	**3.1**	**2.3**	**1.9**	**0.5**	**0.7**	**0.8**	**19.4**	**17.6**	**17.6**			
Transportation																													
Container Corporation	727	REDUCE	94,463	1,927	130	57.7	69.4	74.2	7.8	20.3	6.8	12.6	10.5	9.8	8.3	6.7	5.9	3.0	2.4	2.1	1.7	2.0	2.2	25.8	25.6	22.8	800	10.1	1.5
Transportation		**Neutral**	**94,463**	**1,927**					**7.8**	**20.3**	**6.8**	**12.6**	**10.5**	**9.8**	**8.3**	**6.7**	**5.9**	**3.0**	**2.4**	**2.1**	**1.7**	**2.0**	**2.2**	**23.5**	**23.3**	**21.0**			
Utilities																													
CESC	190	BUY	23,725	484	125	27.8	28.2	31.1	(23.3)	1.4	10.4	6.8	6.7	6.1	3.6	4.3	5.5	0.7	0.7	0.6	2.1	2.1	2.6	12.5	10.6	10.5	500	163.3	1.5
Lanco Infratech	138	BUY	30,689	626	222	14.8	17.5	26.0	75.2	18.2	48.3	9.3	7.9	5.3	8.7	12.0	10.2	1.7	1.4	1.1	-	—	—	19.7	19.2	23.0	400	189.8	10.9
NTPC	152	REDUCE	1,257,021	25,643	8,245	8.9	9.5	10.3	3.5	6.7	8.0	17.0	16.0	14.8	12.4	13.7	13.9	2.4	2.2	2.1	2.3	2.5	3.4	14.4	14.2	14.3	179	17.4	32.8
Reliance Infrastructure	505	BUY	116,610	2,379	231	37.6	49.4	50.0	13.9	31.3	1.2	13.4	10.2	10.1	20.1	18.8	17.7	0.7	0.7	0.7	1.3	1.4	1.6	4—	5—	6—	1,250	147.5	84.5
Reliance Power	121	REDUCE	289,054	5,897	2,397	0.4	2.1	2.6	—	443.9	25.2	317.1	58.3	46.6	—	—	—	2.1	2.0	1.9	—	—	—	1.2	3.5	4.3	180	49.3	33.4
Tata Power	789	BUY	183,802	3,750	233	29.7	38.1	39.9	11.6	28.5	4.6	26.6	20.7	19.8	19.4	17.5	18.3	2.4	1.9	1.7	1.1	1.2	1.2	10.0	10.3	9.0	1,425	80.6	23.7
Utilities		**Attractive**	**1,900,901**	**38,778**					**8.5**	**14.8**	**9.3**	**19.6**	**17.1**	**15.6**	**14.0**	**16.0**	**17.0**	**2.0**	**1.8**	**1.7**	**1.7**	**1.9**	**2.5**	**10.1**	**10.7**	**10.9**			
Others																													
Aban Offshore	1,116	BUY	43,128	880	39	72.3	264.8	453.9	(1,066)	266.3	71.5	15.4	4.2	2.5	13.2	6.3	4.1	4.9	2.1	1.2	0.3	0.9	1.3	51.7	59.5	52.1	2,400	115.2	18.3
Aditya Birla Nuvo	665	ADD	62,028	1,265	93	22.9	26.6	29.2	(5.6)	16.0	9.8	29.0	25.0	22.8	14.5	13.1	12.1	1.8	1.7	1.6	0.9	1.0	1.0	6.4	7.1	7.4	2,000	200.9	2.5
Educomp Solutions	2,049	ADD	38,967	795	19	35.2	46.2	112.0	114	31.5	142.4	58.3	44.3	18.3	31.1	14.3	8.0	12.9	5.1	4.2	0.1	0.2	0.5	33.5	17.4	26.2	3,650	78.1	24.5
Havells India	234	BUY	14,134	288	61	26.6	36.9	46.5	40.0	38.7	26.0	8.8	6.3	5.0	7.1	5.4	3.9	2.1	1.5	1.1	1.0	1.4	1.8	33.7	28.4	25.5	430	84.1	0.4
Jaiprakash Associates	79	BUY	93,730	1,912	1,188	4.9	7.9	11.1	7	61.3	40.7	16.1	10.0	7.1	11.4	8.4	8.1	1.9	1.6	1.3	0.0	0.0	0.0	15.4	17.2	20.4	210	166.2	47.3
Jindal Saw	367	BUY	22,490	459	61	57.7	90.7	110.4	(50.2)	57.0	21.7	6.4	4.0	3.3	3.6	1.9	1.4	0.7	0.6	0.5	2.1	3.8	4.4	11.4	16.1	16.9	900	145.4	1.7
PSL	148	BUY	6,448	132	44	21.1	45.6	64.5	4	116.1	41.5	7.0	3.2	2.3	4.5	3.5	2.5	1.2	0.9	0.7	3.5	4.1	5.1	11.3	15.4	18.4	500	238.0	0.2
Sintex	197	BUY	31,948	652	163	19.5	23.4	31.2	58.2	19.6	33.5	10.1	8.4	6.3	9.3	6.6	4.6	1.9	1.2	1.1	0.4	0.7	0.9	14.0	14.8	15.9	460	134.0	1.8
Welspun Gujarat Stahl Rohren	131	REDUCE	24,777	505	189	20.6	29.2	47.4	94	41.9	62.7	6.4	4.5	2.8	7.2	3.9	2.3	1.4	1.0	0.7	1.8	3.7	4.3	27.1	26.0	31.3	360	174.3	4.9
Others			**337,650**	**6,888**					**22.2**	**92.3**	**49.8**	**15.7**	**8.2**	**5.5**	**10.5**	**6.6**	**5.2**	**2.0**	**1.5**	**1.2**	**0.6**	**1.0**	**1.3**	**12.5**	**18.5**	**21.8**			
KS universe (b)			**23,590,327**	**481,243**					**24.5**	**16.7**	**20.1**	**12.1**	**10.3**	**8.6**	**7.6**	**6.7**	**5.7**	**2.1**	**1.8**	**1.5**	**1.8**	**2.0**	**2.4**	**17.7**	**17.0**	**17.6**			
KS universe (b) ex-Energy			**18,210,105**	**371,486**					**29.5**	**11.8**	**13.3**	**12.2**	**10.9**	**9.7**	**8.6**	**7.7**	**7.0**	**2.3**	**1.9**	**1.6**	**1.7**	**1.9**	**2.2**	**19.1**	**17.5**	**17.0**			
KS universe (d) ex-Energy & ex-Commodities			**16,754,518**	**341,792**					**34.1**	**15.9**	**17.8**	**14.2**	**12.2**	**10.4**	**10.8**	**9.1**	**7.9**	**2.7**	**2.2**	**1.8**	**1.7**	**1.8**	**2.2**	**18.7**	**17.7**	**17.8**			

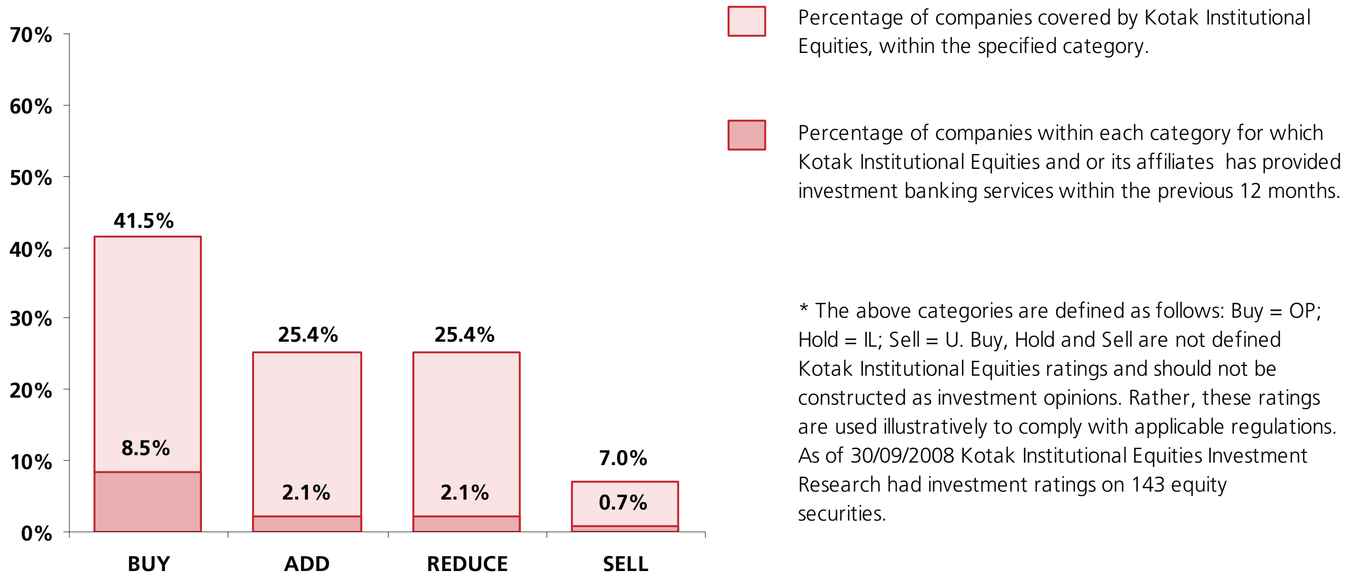
Note:
(a) 2007 means calendar year 2006, similarly for 2008 and 2009 for these particular companies.
(b) EV/Sales & EV/EBITDA for KS universe excludes Banking Sector.
(c) Rupee-US Dollar exchange rate (Rs/US$)= 49.02

Source: Company, Bloomberg, Kotak Institutional Equities estimates

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Kawaljeet Saluja, Amit Agarwal, Nischint Chawathe, Rahul Jain, Aman Batra, Ravi Agrawal, Sanjeev Prasad, Ramnath Venkateswaran, Lokesh Garg, Prashant Vaishampayan."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 30/09/2008 Kotak Institutional Equities Investment Research had investment ratings on 143 equity securities.

Source: Kotak Institutional Equities

As of September 30, 2008

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

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

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

Other definitions

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

Other ratings/identifiers

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

Corporate Office
Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices
Kotak Mahindra (UK) Ltd.
6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc.
50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

Kotak Securities Limited and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We along with our affiliates are leading underwriter of securities and participants in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationships with a significant percentage of the companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. Investors should assume that Kotak Securities Limited and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may participate in the solicitation of such business. Our research professionals are paid in part based on the profitability of Kotak Securities Limited, which include earnings from investment banking and other business. Kotak Securities Limited generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, Kotak Securities Limited generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Kotak Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. Kotak Securities Limited does not provide tax advise to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment.

Certain transactions -including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. For the purpose of calculating whether Kotak Securities Limited and its affiliates holds beneficially owns or controls, including the right to vote for directors, 1% of more of the equity shares of the subject issuer of a research report, the holdings does not include accounts managed by Kotak Mahindra Mutual Fund.Kotak Securities Limited and its non US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition , investors in securities such as ADRs, the value of which are influenced by foreign currencies affectively assume currency risk. In addition options involve risks and are not suitable for all investors. Please ensure that you have read and understood the current derivatives risk disclosure document before entering into any derivative transactions.

This report has not been prepared by Kotak Mahindra Inc. (KMInc). However KMInc has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed. Any reference to Kotak Securities Limited shall also be deemed to mean and include Kotak Mahindra Inc.