Strategy In-Depth

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India Mini Conference - London 2007

6-7 September 2007

Gateway of India, Mumbai

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See Appendix A-1 for Analyst Certification and important disclosures.

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We are very pleased to welcome you to the India Mini Conference 2007 in London. Over the past few years, this event has grown to become the most widely participated and attended Indian corporate event in London. Meetings are restricted to one-on-ones and small groups to ensure quality time with top managements of 13 companies participating in the conference.

We hope you will find this conference useful and rewarding. Please contact us with any feedback or questions you may have about the conference.

Yours sincerely,

Brian Brown
Head – Indian Equities

Ratnesh Kumar
Head of India Research

Figure 1. India — Macroeconomic and Financial Market Forecasts

Year -end 31 March	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08E
National income indicators											
Nominal GDP (Rs bn)	15,288	17,481	19,520	21,024	22,811	24,581	27,655	31,266	35,672	41,257	46,621
Nominal GDP (US$ bn)	411	414	450	460	475	509	603	695	805	919	1,117
Per Capita GDP (US$)	423	420	451	457	467	495	584	673	769	864	1,035
Real GDP growth (%YoY)	4.8	6.5	6.0	4.4	5.8	3.8	8.5	7.5	9.0	9.4	9.3
Agriculture growth	-2.4	6.2	0.5	-0.2	6.3	-7.2	10.0	0.0	6.0	2.7	3.0
Industry growth	4.3	3.7	4.1	6.3	2.7	7.1	7.4	9.8	9.6	10.9	10.0
Services growth	9.8	8.4	10.8	5.7	7.2	7.4	8.5	9.6	9.8	11.0	11.0
By Demand – Real (%YoY)											
Consumption	4.1	7.5	7.7	2.2	5.4	1.8	6.2	5.4	7.2	6.6	7.9
Pvt Consumption	3.0	6.5	6.5	2.6	6.0	2.2	6.9	5.4	6.7	6.2	8.2
Public Consumption	11.1	12.9	14.2	0.5	2.0	-0.4	2.5	5.4	9.8	9.0	6.0
Gross Fixed Capital Formn	2.1	8.7	11.4	0.3	4.5	8.7	13.1	11.8	15.3	14.6	15.0
Cons; Invst, Savings (%GDP)											
Total Consumption	74.0	75.9	77.2	76.4	76.5	74.7	73.0	70.6	69.2	66.6	65.4
Total Investments	25.2	23.1	25.9	24.0	22.9	25.2	28.0	31.5	33.8	34.5	35.5
Gross Domestic Savings	23.5	21.9	24.8	23.4	23.5	26.4	29.7	31.1	32.4	33.5	34.6
Real indicators (%YoY)											
Cement dispatches	10.6	6.4	14.1	0.1	8.6	11.1	6.5	9.3	10.3	10.0	10.0
Commercial vehicle sales	-33.2	-11.2	22.0	-11.9	-4.5	27.9	38.1	24.0	13.0	24.0	7.0
Car sales	1.1	-0.9	54.9	-6.9	4.5	7.6	32.8	18.7	7.0	15.0	12.0
Two-wheelers	-3.7	5.0	-5.4	-28.1	-3.1	-13.1	10.6	16.8	15.0	14.0	10.0
Diesel consumption	3.5	3.7	5.5	2.0	-3.5	3.0	4.5	5.5	3.0	5.0	5.0
Tele-density	1.9	2.2	2.8	3.5	4.3	5.2	7.4	9.4	12.7	16.2	17.2
Monetary indicators(%YoY)											
Money supply	18.0	19.4	15.0	16.4	14.1	14.7	16.7	12.3	21.2	18.0	18.0
Int rate PLR - year end	13.0	12.0	11.3	11.5	11.3	10.8	10.3	10.0	10.3	11.5	11.5
Inflation – WPI	4.4	5.9	3.3	7.2	3.5	3.4	5.4	6.5	4.5	5.3	4.5
CPI	6.8	13.1	3.4	3.8	4.3	4.0	4.0	4.5	4.0	6.0	6.0
Bank credit growth	16.4	13.8	18.2	17.3	15.3	23.7	15.3	30.9	37.0	27.6	20.0
Deposit growth	18.4	19.3	13.9	18.4	14.6	16.1	17.5	13.0	24.0	23.0	15.0
Fiscal Indicators(% GDP)											
Centre's fiscal deficit	4.8	5.1	5.4	5.6	6.2	5.9	4.5	4.0	4.1	3.7	3.5
State fiscal deficit	2.9	4.3	4.7	4.3	4.2	4.2	4.5	3.5	3.2	2.7	2.5
Combined deficit (Centre+State)	7.1	8.9	9.4	9.5	9.9	9.6	8.5	7.5	7.4	6.2	6.0
Combined domestic liabilities	61.8	62.7	66.6	71.0	76.4	80.7	81.5	82.4	78.7	75.3	72.9
Combined o/s guarantees	9.7	9.8	11.1	12.2	11.5	11.2	11.0	9.9			
External Sector											
Exports (US$bn)	35.7	34.3	37.5	45.5	44.7	53.8	66.3	85.2	105.2	127.1	146.2
% YoY	4.5	-3.9	9.5	21.1	-1.6	20.3	23.3	28.5	23.4	20.9	15.0
Imports (US$bn)	51.2	47.5	55.4	57.9	56.3	64.5	80.0	118.9	157.0	192.0	223.8
%YoY	4.6	-7.1	16.5	4.6	-2.8	14.5	24.1	48.6	32.0	22.3	16.5
Trade deficit (US$bn)	-15.5	-13.2	-17.8	-12.5	-11.6	-10.7	-13.7	-33.7	-51.8	-64.9	-77.6
Invisibles (US$bn)	10.0	9.2	13.7	9.8	15.0	17.0	27.8	31.2	42.7	55.3	61.9
Current Account Deficit (US$bn)	-5.5	-4.0	-4.1	-2.7	3.4	6.3	14.1	-2.5	-9.2	-9.6	-14. 7
% to GDP	-1.3	-1.0	-0.9	-0.6	0.7	1.2	2.3	-0.4	-1.1	-1.0	-1.3
Forex reserves (excl gold) (US$bn)	26.0	29.5	35.1	39.6	51.0	71.9	106.1	135.1	145.1	191.9	213.0
Months of imports	6.1	7.5	7.6	8.2	10.9	13.4	15.9	13.6	11.1	12.0	11.4
Exchange rate											
Rs/US$ - annual avg	37.2	42.2	43.4	45.7	48.0	48.3	45.9	45.0	44.3	44.9	41.8
% depreciation	4.8	13.4	2.8	5.3	5.0	0.6	-5.0	-2.0	-1.6	1.4	-7.0
Rs/US$ - year end	39.52	42.4	43.6	46.5	48.9	47.5	43.6	43.8	44.6	43.5	40.0
% depreciation	10.4	7.3	2.8	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.5	-8.0

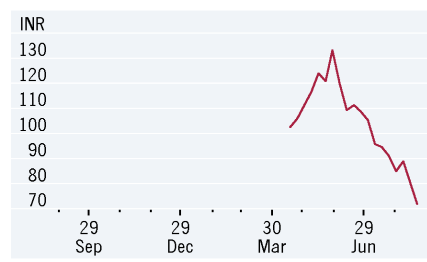
Source: Citigroup estimates

Dish TV (DSTV.BO)

Analyzed Non-Rated Snapshot

Price (30 Aug 07)	Rs75.40
Shares Outstanding	428M
Free Float (%)	42
Fiscal Year End	31 Mar
Market Cap	Rs32,288M US$788M

Price Performance (RIC: DSTV.BO, BB: DITV IN)



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- Company overview — Dish TV is India's largest direct-to-home (DTH) player with a subscriber base of 2.1m. The company is growing rapidly and is present in 4,300 towns across India, with more than 400 distributors and more than a 30,000-strong dealer network.
- Business strategy — Dish TV intends to sustain its leadership in the DTH market. It has so far focused on tier-II and tier-III cities, but has increased its focus on tier-I cities. The company expects 50% of its subscribers to come from tier-I cities. In addition to rapid subscriber addition, Dish is looking to increase contribution from value-added services like movies-on-demand and gaming. Management targets a subscriber base of 8m by 2011 and expects revenues to grow from Rs0.8bn in FY06 to Rs35.2bn by FY11, with an EBITDA margin of about 28%, as stated on its website.
- Industry overview — The pay-TV market in India is growing strongly, driven by increasing TV ownership. With more than 110m TV households, India is the third-largest TV market in the world and provides significant opportunities for pay-TV service providers.
- Competitive analysis — Competition for Dish TV is on the rise, with Star-Tata offering marketing and consumer subsidies. Entry of new players such as Sun TV, Reliance and Bharti may significantly increase the competitive intensity.
- Recent results — For the quarter ending June 2007, standalone revenues for Dish TV increased 35%qoq. Additional subscribers numbered 1.8m. The company continues to invest in infrastructure and services.
- Strengths — Being the first entrant, Dish already has a large subscriber base. Dish TV has strong operating infrastructure and content tie-up, an established brand and the backing of a strong group.
- Weaknesses — Competitive intensity is likely to increase in the next 3 years, with Tata Sky's aggressive expansion plans and the entry of new players. Increasing competition from existing and emerging new technologies like digital cable and IPTV could slow the growth of the industry.

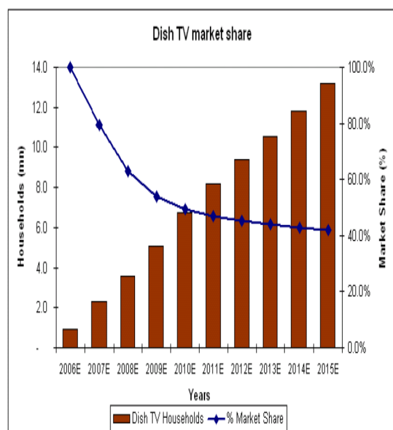
Fiscal year end 31-Mar	2004	2005	2006	2007
Valuation Ratios				
P/E adjusted (x)	na	-19.4	-6.2	nm
EV/EBITDA adjusted (x)	na	na	-15.3	-17.3
P/BV (x)	na	1.7	4.6	nm
Dividend yield (%)	na	0.0	0.0	0.0
Per Share Data (Rs)				
EPS adjusted	na	-3.89	-12.22	-3.52
EPS reported	na	-3.89	-12.22	-3.52
BVPS	na	45.46	16.42	-0.55
DPS	na	0.00	0.00	0.00
Profit & Loss (RsM)				
Net sales	na	94	319	1,916
Operating expenses	na	-371	-2,381	-4,349
EBIT	**na**	**-277**	**-2,062**	**-2,433**
Net interest expense	na	-31	-19	-175
Non-operating/exceptionals	na	29	3	91
Pretax profit	**na**	**-279**	**-2,078**	**-2,516**
Tax	na	0	0	-3
Extraord./Min.Int./Pref.div.	na	1	1,204	1
Reported net income	**na**	**-278**	**-875**	**-2,518**
Adjusted earnings	na	-278	-875	-2,518
Adjusted EBITDA	na	-270	-2,033	-1,857
Growth Rates (%)				
Sales	na	na	240.8	500.1
EBIT adjusted	na	na	-644.0	-18.0
EBITDA adjusted	na	na	-653.4	8.7
EPS adjusted	na	na	-214.2	71.2
Cash Flow (RsM)				
Operating cash flow	**na**	**na**	**2,125**	**3,371**
Depreciation/amortization	na	7	28	575
Net working capital	na	na	2,971	5,313
Investing cash flow	**na**	**na**	**-819**	**-5,385**
Capital expenditure	na	na	-1,001	-5,509
Acquisitions/disposals	na	na	182	124
Financing cash flow	**na**	**na**	**-1,865**	**972**
Borrowings	na	na	-66	1,667
Dividends paid	na	na	0	0
Change in cash	**na**	**na**	**-560**	**-1,042**
Balance Sheet (RsM)				
Total assets	**na**	**3,927**	**3,819**	**9,952**
Cash and cash equivalent	na	44	59	113
Accounts receivable	na	21	76	391
Net fixed assets	na	148	1,142	6,623
Total liabilities	**na**	**673**	**2,644**	**10,347**
Accounts payable	na	523	2,558	8,577
Total Debt	na	149	84	1,751
Shareholder funds	**na**	**3,254**	**1,175**	**-395**
Profitability/Solvency Ratios (%)				
EBITDA margin adjusted	na	nm	nm	-96.9
ROE adjusted	na	na	-39.5	nm
ROIC adjusted	na	na	-184.0	nm
Net debt / equity	na	3.2	2.1	na
Total debt / capital	na	4.4	6.7	129.1

Powered by: dataCentral

Company description

Dish TV is the first company to provide DTH satellite broadcast operations in India. The company has a strong backing of the Essel Group, the parent company of Zee Network. Launched in 2005, the company has more than 2.1m subscribers and has a deep distribution network of distributors and dealers. With the advent of digital technology, Dish has been able to offer superior services covering a good range of 148 TV and 22 audio channels.

Dish TV Market Share



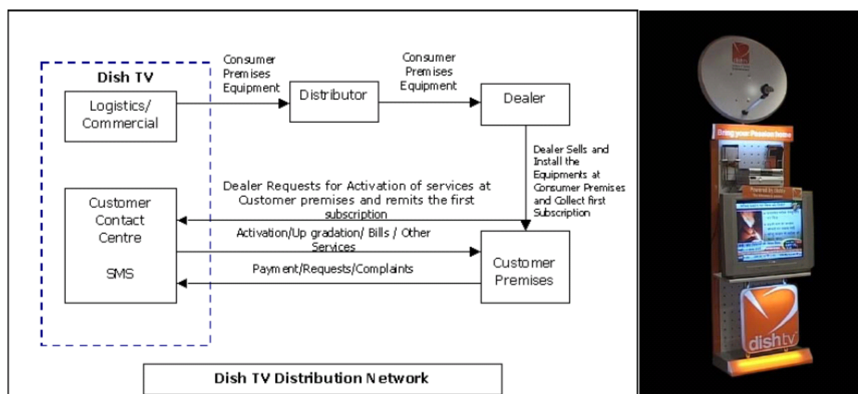
Source: Company Reports

Recent developments

Industry trends: The Indian pay-TV market looks set to grow rapidly, driven by increasing penetration of television and rising consumer preference for cable & satellite TV. Besides lower penetration, pay TV is cheaper in India than in other markets, thus there is scope for expansion of broadcast services and value-added services. In conjunction with the recent roll-out of Conditional Access System being mandated in key metro cities in India, it is likely to drive strong growth for DTH players.

News flow and developments: In 1Q FY08, Dish TV's top line increased 35.3%qoq. There were 1.8m new subscribers and 8 channels added during this quarter. Aggressive investments continue for customer acquisitions and service to maintain market share. According to management, going forward the company will concentrate on increasing ARPUs, value-added services, service capability ramp-up and commercial sales (i.e. hotels, restaurants, malls, etc).

Dish TV Distribution Network



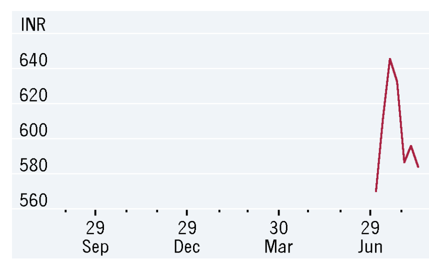
Source: Company

DLF (DLF.BO)

Big Player, Opportunity, Ambition

Buy/Medium Risk	1M
Price (30 Aug 07)	Rs587.40
Target price	Rs725.00
Expected share price return	23.4%
Expected dividend yield	0.0%
Expected total return	**23.4%**
Market Cap	Rs951,647M US$23,265M

Price Performance (RIC: DLF.BO, BB: DLFU IN)



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- **Tier-one developer** — DLF is India's largest developer with an emerging pan-India presence. The company has a large diversified landbank of ~ 615m sq ft spread across more than 10,255 acres and a development mix that is leveraged toward commercial and retail development.

- **What differentiates DLF?** — 1) Focus on scale with a portfolio mix of ~615m sq. ft spread across top-tier cities; 2) strong cash reserves in this liquidity-strained environment, 3) a de-risked business model, with JVs in construction and hotels aiding growth, and 4) a robust earnings CAGR of 81% for FY07-10E.

- **Relatively good proxy to play yield compression** — DLF's large pipeline of IT SEZ projects and strategy to sell assets to DLF Assets or others at lower cap rates of 9% vs.10% earlier should boost cash flows. However, this remains contingent on capital. We expect more such structures for its retail/hotel assets.

- **Development mix geared toward commercial and retail space** — DLF has 49m sq ft under construction, which is largely geared toward commercial and retail projects — less sensitive to interest rates. In residential, the focus is super luxury-premium projects, most of which are pre-sold. While residential remains a core area, growth will likely be more back-ended. We believe this to an extent insulates DLF from the current slowdown in the residential space.

- **Key risks** — 1) Concentration risk in NCR (40% of portfolio), 2) high exposure to DLF Assets and its ability to raise capital; 3) price, demand and execution risks.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,917	12.34	100.2	45.7	9.2	22.6	0.0
2007A	19,413	12.80	3.7	44.0	28.3	97.9	0.0
2008E	69,431	40.73	218.1	13.8	5.0	62.6	0.0
2009E	99,170	58.17	42.8	9.7	3.3	41.1	0.0
2010E	129,661	76.05	30.7	7.4	2.3	36.5	0.0

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	45.7	44.0	13.8	9.7	7.4
P/E reported (x)	45.7	44.0	13.8	9.7	7.4
P/BV (x)	9.2	28.3	5.0	3.3	2.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	12.34	12.80	40.73	58.17	76.05
EPS reported	12.34	12.80	40.73	58.17	76.05
BVPS	61.16	19.90	112.32	170.49	246.54
NAVps ordinary	na	na	na	na	na
DPS	0.10	0.01	0.00	0.00	0.00
Profit & Loss (RsM)					
Net operating income (NOI)	**5,154**	**15,875**	**98,304**	**139,217**	**178,221**
G&A expenses	-397	-922	-2,365	-2,838	-3,406
Other Operating items	-361	-584	-969	-1,774	-2,497
EBIT including associates	**4,396**	**14,369**	**94,969**	**134,604**	**172,318**
Non-oper./net int./except.	-801	11,113	-2,394	-2,377	563
Pre-tax profit	**3,595**	**25,482**	**92,575**	**132,227**	**172,881**
Tax	-1,668	-6,058	-23,144	-33,057	-43,220
Extraord./Min. Int./Pref. Div.	-10	-11	0	0	0
Reported net income	**1,917**	**19,413**	**69,431**	**99,170**	**129,661**
Adjusted earnings	1,917	19,413	69,431	99,170	129,661
Adjusted EBIT	4,396	14,382	94,969	134,604	172,318
Adjusted EBITDA	4,757	14,953	95,939	136,379	174,815
Growth Rates (%)					
NOI	142.1	208.0	519.2	41.6	28.0
EBIT adjusted	225.9	227.2	560.3	41.7	28.0
EPS adjusted	100.2	3.7	218.1	42.8	30.7
Cash Flow (RsM)					
Operating cash flow	**-15,375**	**-39,212**	**-68,153**	**33,286**	**39,987**
Depreciation/amortization	361	571	969	1,774	2,497
Net working capital	-8,589	-67,025	-138,553	-67,659	-92,171
Investing cash flow	**-15,075**	**-19,157**	**-29,152**	**-39,319**	**-37,418**
Capital expenditure	-7,175	-25,350	-28,942	-39,087	-37,163
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**31,976**	**60,574**	**101,775**	**10,888**	**54**
Borrowings	31,644	58,008	9,900	10,888	54
Dividends paid	-16	-18	0	0	0
Change in cash	**1,526**	**2,205**	**4,470**	**4,855**	**2,623**
Balance Sheet (RsM)					
Total assets	**69,436**	**181,708**	**353,645**	**476,020**	**611,281**
Cash & cash equivalent	1,950	4,155	8,625	13,480	16,103
Net fixed assets	17,043	41,872	69,844	107,157	141,823
Total liabilities	**59,881**	**141,944**	**152,574**	**175,779**	**181,380**
Total Debt	41,320	99,328	109,228	120,116	120,169
Shareholders' funds	**9,555**	**39,764**	**201,071**	**300,241**	**429,902**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	38.1	55.0	68.3	63.7	61.1
ROE adjusted (%)	22.6	97.9	62.6	41.1	36.5
ROA adjusted (%)	4.0	15.5	25.9	23.9	23.9
Net debt to equity (%)	412.0	239.3	50.0	35.5	24.2
Interest coverage (x)	2.8	4.9	17.6	22.7	29.1

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Company description

DLF is one of India's oldest real estate developers. Established in Delhi in 1946, it has continued to expand and diversify its real estate businesses, and is among the largest developers in India. It has historically built its businesses in Delhi and adjoining areas, known as the National Capital Region (NCR). While, Gurgaon in the NCR continues to be the hub of its business, DLF has meaningfully diversified into other geographic locations over the past few years. These expansions are spread across India, with a particular focus on the Northern India Belt, Calcutta, Mumbai, Chennai, and a number of other large and rapidly growing cities. DLF's initial real estate development was focused on residential colonies and townships, and remained so until a decade ago. It further diversified into the development of commercial office space in the early 1990s, and with significant success, has substantially scaled up these developments. DLF also entered retail mall developments in the early 2000s, and is pursuing this business aggressively. DLF also has a very strong brand, with a reputation as one of the foremost and most credible developers in the country. The company recently made a primary offering of 175m shares at Rs525 per share. DLF is a family owned and controlled business with promoters holding 90% stake (post the recent IPO).

Recent developments

Industry trends: The Indian real estate development opportunity is structural, large and will last for long, in our view. However, we believe the sector is in for some cyclical pain in the near-term — sustained high interest rates are damaging affordability; there is significant slowdown in volumes; property prices are cooling off, particularly in the residential segment; and supply risks exist. In this scenario, we see markets increasingly distinguishing between tier-one developers and the surfeit of small developers.

Results: DLF's standalone 1Q FY08 revenues were Rs11,219m. Standalone EBITDA increased 26% yoy to Rs8,8710m and net profit increased 42% to Rs5,793m. Standalone EBITDA margin increased from 61% in 1Q FY07 to 78% in 1Q FY08. 1Q FY08 consolidated revenues, EBITDA and net profit were Rs30,738m, Rs22,039m and Rs15,155m, respectively.

News flow & developments

- DLF purchased 38 acres of prime land in Delhi at a cost of Rs16bn, making it the largest private sector land deal in the country.
- Awarded an esteemed project worth Rs60bn to develop and operate an international convention centre at Dwarka in Delhi.
- Announced a 95-acre township at Durgapur in West Bengal.
- Signed an MOU with American realty firm Hines to develop a landmark commercial complex covering more than 2.5m sq ft in Gurgaon.

Investment thesis

We rate DLF Buy/Medium Risk (1M), with a target price of Rs725. DLF's focus on scale, integrated development with execution record, and a large land holding spread across top-tier growth cities differentiates it from its peers. Its diversified portfolio of ~615m sq.ft is relatively leveraged toward commercial/IT Parks/Retail mall (35% of total development) assets, which should provide a good hedge particularly in the near-term, when the residential segment is seeing some slowdown. Strong cash flows (Rs94.7bn) and a de-leveraged balance sheet give it a competitive advantage in the current liquidity-strained environment. We expect its new joint ventures in construction and hotels to complement the core business, aid growth and offer valuation upside.

Valuation

Our target price of Rs725 is based on a 25% premium to an estimated core NAV of Rs530, and Rs62 for other asset holdings and new JV businesses (Rs45/share for the existing 4.6m sq.ft leased assets and 7.2m sq.ft plot, and Rs17/share for DLF's share in construction and hotel JVs). We believe an NAV-based valuation methodology is most appropriate for developers, as it factors the varied development projects and spread out time frame. Our NAV estimate of Rs530 is based on the following assumptions: 1) current market prices will persist, without any price inflation; 2) development volume will be 606m sq.ft (as ~9m is already recognized as revenue in FY07); 3) a cap rate of 9% for commercial/IT Park, IT SEZs in Super Metros and Metros, and 10% for other locations; 4) all projects undertaken by DLF will be completed largely on schedule; though given the scale of the roll-out, we expect risk of delays; 5) an average cost of capital of 14%; and 6) a tax rate of 25%.

Risks

We rate DLF Medium Risk. This is different from the Speculative Risk rating assigned by our quantitative risk-rating system (which measures the stock's volatility over a 260-day period) to stocks that have less than one year's trading history. The key reasons for assigning a Medium Risk rating include: 1) the company's robust business model; 2) pan-India land bank with initiatives to de-risk the business model through new business JVs; and 3) relatively healthy cash flows, at a time when most developers are facing funding constraints. The main downside risks to our investment thesis and target price include: 1) Concentration in the NCR region, particularly Gurgaon (33% of development), where risk of excess supply over the next 2-3 years is high; 2) Related party transaction and conflict of interest risks with DLF Assets; 3) Delays in execution of projects and planned developments would impact the company's reputation and our NAV assumptions; and 4) A rapidly changing property market environment could lead to property price-demand risks, regulatory risks and potential supply risks.

Hindustan Unilever (HLL.BO)

Earnings Picking Up, Share Buyback Support

Buy/Low Risk	1L
Price (30 Aug 07)	Rs202.35
Target price	Rs254.00
Expected share price return	25.5%
Expected dividend yield	3.6%
Expected total return	**29.1%**
Market Cap	Rs438,550M
	US$10,721M

Price Performance (RIC: HLL.BO, BB: HUVR IN)

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- Growth turning around — Sales and earnings growth momentum is picking up. EBITDA profits in June quarter grew 23.5%, highest in the last six years. After significant investment into brands, HUL seems to be now in a position to scale back its ad spend (already coming off a high base), which should aid margins further.

- Strong improvement in operating performance — HUL reported 2Q net profit growth of 24.4%, aided by 30.6% yoy growth in other income. Adjusted for the water business losses, we estimate net profit to have grown by 30%. Net sales growth of 12.9% was driven by 11.1% growth in HPC and 25% growth in the foods business.

- Valuations look attractive — Valuations have abated and the stock trades near historical lows. Premium to Sensex has shrunk to only 25%, against the historical average of 80-100%.

- Stock buyback support — Historically, HUL's capital structuring has been shareholder friendly (high dividend payout, bonus debenture issue in 2003 etc.). A buyback of up to 27.4m at Rs230/share has been approved, which is marginally dilutive to EPS (1.3% for 2007E and 0.9% for 2008E). The buyback should provide downside support to the stock. We have a target price of Rs254.

Statistical Abstract

Year to 31 Dec	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	14,082	6.40	17.6	31.1	19.0	64.0	2.7
2006A	18,554	8.43	31.8	23.6	17.8	78.0	3.4
2007E	17,624	8.01	-5.0	24.8	17.3	70.8	3.4
2008E	20,709	9.41	17.5	21.1	16.8	80.7	4.0
2009E	23,949	10.88	15.6	18.3	16.2	90.1	4.7

Source: Powered by dataCentral

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	31.1	23.6	24.8	21.1	18.3
EV/EBITDA adjusted (x)	28.9	25.0	21.7	18.1	15.4
P/BV (x)	19.0	17.8	17.3	16.8	16.2
Dividend yield (%)	2.7	3.4	3.4	4.0	4.7
Per Share Data (Rs)					
EPS adjusted	6.40	8.43	8.01	9.41	10.88
EPS reported	6.40	8.43	8.01	9.41	10.88
BVPS	10.47	11.15	11.47	11.86	12.30
DPS	5.39	6.74	6.81	8.00	9.25
Profit & Loss (RsM)					
Net sales	110,605	121,034	135,406	150,816	166,166
Operating expenses	-97,416	-105,855	-117,872	-129,773	-141,439
EBIT	**13,189**	**15,179**	**17,534**	**21,043**	**24,727**
Net interest expense	-192	-107	-150	-150	-150
Non-operating/exceptionals	3,048	3,545	3,722	3,909	4,104
Pre-tax profit	**16,046**	**18,617**	**21,106**	**24,802**	**28,681**
Tax	-2,500	-3,220	-3,483	-4,092	-4,732
Extraord./Min.Int./Pref.div.	536	3,157	0	0	0
Reported net income	**14,082**	**18,554**	**17,624**	**20,709**	**23,949**
Adjusted earnings	14,082	18,554	17,624	20,709	23,949
Adjusted EBITDA	14,434	16,481	18,903	22,481	26,233
Growth Rates (%)					
Sales	11.4	9.4	11.9	11.4	10.2
EBIT adjusted	0.2	15.1	15.5	20.0	17.5
EBITDA adjusted	0.4	14.2	14.7	18.9	16.7
EPS adjusted	17.6	31.8	-5.0	17.5	15.6
Cash Flow (RsM)					
Operating cash flow	**24,786**	**17,756**	**19,750**	**24,463**	**27,908**
Depreciation/amortization	1,245	1,302	1,370	1,438	1,506
Net working capital	9,460	-2,099	757	2,316	2,454
Investing cash flow	**1,509**	**-714**	**-2,845**	**-4,598**	**-4,936**
Capital expenditure	-645	-1,000	-1,000	-1,000	-1,000
Acquisitions/disposals	2,154	286	-1,845	-3,598	-3,936
Financing cash flow	**-27,530**	**-16,720**	**-16,905**	**-19,865**	**-22,972**
Borrowings	-14,142	31	0	0	0
Dividends paid	-13,388	-16,750	-16,905	-19,865	-22,972
Change in cash	**-1,235**	**323**	**0**	**0**	**0**
Balance Sheet (RsM)					
Total assets	**64,809**	**70,265**	**74,993**	**81,442**	**88,177**
Cash & cash equivalent	3,550	6,000	6,000	6,001	6,001
Accounts receivable	10,623	13,027	14,498	16,079	17,673
Net fixed assets	14,835	14,534	14,164	13,726	13,221
Total liabilities	**41,752**	**45,728**	**49,738**	**55,343**	**61,101**
Accounts payable	29,594	31,383	34,734	38,332	41,956
Total Debt	569	600	600	600	600
Shareholders' funds	**23,056**	**24,537**	**25,255**	**26,100**	**27,076**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	13.0	13.6	14.0	14.9	15.8
ROE adjusted	64.0	78.0	70.8	80.7	90.1
ROIC adjusted	nm	na	na	na	na
Net debt to equity	-12.9	-22.0	-21.4	-20.7	-19.9
Total debt to capital	2.4	2.4	2.3	2.2	2.2

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Asia Pacific at CitiResearchDataServices@citigroup.com or +852-2501-2791

Company description

HUL is the largest consumer non-durables company in Asia. 51%-owned by the Unilever Group, HUL has one of the best-managed businesses in India, in our view, and a record of steady growth spanning decades. It has a diversified product portfolio, including fabric wash, personal care, tea, coffee and staple foods. Some of the strongest brands in India such as Lifebuoy, Lux, Surf, Wheel, Lakme, Ponds and Lipton are from the HUL stable.

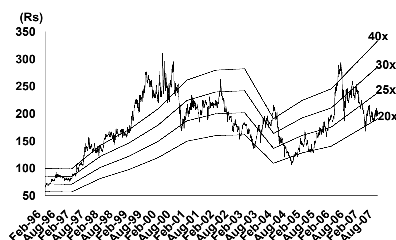
Recent developments

Industry trends: 1Q FY08 was a strong quarter for the Indian consumer sector. Competition has become more rational, allowing for pricing power; margins are improving despite cost pressures. Markets have continued to ignore the significant pick-up in the growth profile. The sector's absolute and relative valuations are near historical lows. The sector's de-rating was quick following irrational competition (P&G, HUL price war) and growth slowdown, but the market has been slow to reward a turn in fundamentals. Consumer company managements believe the growth outlook remains strong. More price hikes are not ruled out and earnings windfall is likely in the event of input commodity prices cooling off.

Results: In the April-June 2007 quarter, HUL's earnings growth was the fastest in the last 6 years. HUL's operating performance showed a dramatic improvement in 2Q despite losses associated with the new water business. Adjusting for the new water losses, we estimate that the EBITDA for the core business would have grown 30.5% yoy. Sales growth of 12.9% is in line with our expectation with HPC growing by 11.1%, led by soaps and detergents. Slow growth in personal care remains a concern. Growth in the foods segment remains strong at 32%.Net profit in 2Q grew 24.4%, aided by 30.6% yoy growth in other income. Adjusted for the water business losses, we estimate net profit to have grown by 30%. Advertising expenses were down 155bps as HUL has now scaled back its ad-spend after making significant investment in brands.

News flow & developments: In its board meeting, HUL has approved a buyback of up to 27.4m at Rs230/share. Historically, the company's capital structuring has been shareholder friendly (high dividend payout, bonus debenture issue in 2003 etc.). Our analysis shows that this would be marginally dilutive to EPS (1.3% for 2007E and 0.9% for 2008E). However, we believe that the significant improvement in operating profits overshadows the marginal dilution and we would advise investors not to tender at Rs230, which is below our target price of Rs254. We expect the proposed buyback to be value accretive to shareholders.

HUL: P/E Bands



Source: Bloomberg, Citigroup Investment Research

Investment thesis

We have a Buy/Low Risk (1L) rating on the stock. HUL's valuations look attractive after the recent sell-off. The stock is trading at the lower end of its historical trading range and offers downside protection, in our view. HUL's fundamentals are looking up, with a significant pick-up in growth on improving demand from the urban as well as rural segments, especially in the rural areas. Management has increased its focus on market-share gains and as a result investment in brands has picked up. The company has been aggressively launching new product variants and has also undertaken product re-launches, which we believe will continue. With the high-end personal-care segment growing faster, the product mix is also improving. We believe margins could also surprise on the upside, driven by price hikes and declines in commodity prices. Margins have been under pressure in the past few quarters, and we believe they have bottomed.

Valuation

HUL's fairly steady stream of earnings makes P/E a good tool to value the stock. Our target price of Rs254 is based on what we think is a conservative multiple of 27x 2008E P/E, at the mid-end of the stock's historical trading band of 20-35x, over the past 8 years. We choose mid-end as we expect a re-rating for the stock given that its operating parameters are improving. We do not use a top-end multiple, as competitive intensity has increased over the last few years and the environment in which HUL operates is not as conducive as before. At 27x P/E, HUL would trade at a 40% premium to the Sensex. The company has historically enjoyed more than a 100% premium to the Sensex owing to its high capital-efficiency ratios and consistent earnings growth. However, we do not expect the stock to re-trace to its historical high premium, given that the company now operates in a different competitive landscape, with higher competitive intensity and a lower margin profile. On EV/EBITDA, we believe the stock should trade at 24x 2008E EV/EBITDA, which gives a fair value of close to Rs250. The stock's trading band has been 20-30x over the past 3 years.

Risks

We rate HUL as Low Risk because the company operates in branded consumer products and has a diversified product portfolio. The Low Risk rating is consistent with our quantitative risk-rating system which tracks the 260-day share-price volatility of the shares. The most significant risk to our target price is the possibility of a prolonged battle for market share with other MNC peers as well as Indian companies. HUL is leveraged equally to the rural and the urban economies and, as such, any dislocation would affect the company's performance. Although the company's brands have strong pricing power, in a challenging external environment price increases are limited. PG is aggressively seeking to increase its market share in detergents, shampoos and some other categories. Other downside risks include higher-than-expected raw-material costs and the company's inability to deliver on top-line growth.

Infosys Technologies (INFY.BO)

Offshore Bellwether

Buy/Low Risk	1L
Price (30 Aug 07)	Rs1,858.40
Target price	Rs2,440.00
Expected share price return	31.3%
Expected dividend yield	0.9%
Expected total return	32.2%
Market Cap	Rs1,022,266M
	US$24,918M

Price Performance (RIC: INFY.BO, BB: INFO IN)

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- Impact of "subprime" issues — The impact of "sub-prime" issue remains the most important investor focus at this point in time. Infosys's exposure to the mortgage/subprime space and the likely impact on revenues/profits is a key focus area.
- Outlook on IT budgets for next year — IT budgets could suffer if the situation in the US mortgage market worsens and spreads to other financial services. What is Infosys's view based on its discussion with customers.
- Margin outlook and impact of INR — The INR has appreciated ~8% YTD against the US dollar. What is Infosys doing to mitigate this, and what are the other margin levers?
- Tax rates post 2009 — With the STPI benefits ending (as per current regulations) in FY09 and SEZ's still taking time to ramp up, the impact on tax rates post 2009 is another area worth focusing on.
- Pricing trends — Infosys has witnessed a strong improvement of ~5-6% in revenue per employee on a YoY basis in 1Q FY08. Going forward, the trends in pricing should be a key focus area as pricing remains one of the key margin levers for the sector.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	24,599	43.82	27.5	40.8	14.1	40.4	1.3
2007A	38,560	67.76	54.6	26.4	8.9	42.3	0.6
2008E	46,004	80.24	18.4	22.3	6.8	35.1	0.9
2009E	56,389	98.35	22.6	18.2	5.3	32.8	1.1
2010E	64,658	112.77	14.7	15.9	4.2	29.4	1.3

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	40.8	26.4	22.3	18.2	15.9
EV/EBITDA adjusted (x)	31.9	22.1	18.3	13.7	11.0
P/BV (x)	14.1	8.9	6.8	5.3	4.2
Dividend yield (%)	1.3	0.6	0.9	1.1	1.3
Per Share Data (Rs)					
EPS adjusted	43.82	67.76	80.24	98.35	112.77
EPS reported	43.82	67.76	80.24	98.35	112.77
BVPS	126.60	199.99	261.66	340.38	429.58
DPS	22.50	11.50	16.00	20.00	24.00
Profit & Loss (RsM)					
Net sales	95,216	138,930	171,181	217,434	265,154
Operating expenses	-68,669	-100,160	-125,407	-157,873	-193,063
EBIT	**26,547**	**38,770**	**45,773**	**59,562**	**72,091**
Net interest expense	1,396	3,720	6,535	5,986	8,348
Non-operating/exceptionals	-11	-20	0	0	0
Pre-tax profit	**27,932**	**42,470**	**52,309**	**65,547**	**80,439**
Tax	-3,132	-5,110	-6,305	-9,159	-15,781
Extraord./Min.Int./Pref.div.	-201	1,200	0	0	0
Reported net income	**24,599**	**38,560**	**46,004**	**56,389**	**64,658**
Adjusted earnings	24,599	38,560	46,004	56,389	64,658
Adjusted EBITDA	30,918	43,910	52,177	67,591	81,285
Growth Rates (%)					
Sales	33.5	45.9	23.2	27.0	21.9
EBIT adjusted	29.6	46.0	18.1	30.1	21.0
EBITDA adjusted	32.4	42.0	18.8	29.5	20.3
EPS adjusted	27.5	54.6	18.4	22.6	14.7
Cash Flow (RsM)					
Operating cash flow	**31,118**	**29,100**	**38,565**	**53,242**	**61,530**
Depreciation/amortization	4,371	5,140	6,404	8,029	9,194
Net working capital	3,549	-9,410	-7,238	-5,190	-3,973
Investing cash flow	**-10,890**	**-20,590**	**-18,868**	**-15,778**	**-18,517**
Capital expenditure	-10,890	-20,590	-18,868	-15,778	-18,517
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-7,447**	**5,000**	**-9,089**	**-11,424**	**-13,709**
Borrowings	0	0	0	0	0
Dividends paid	-12,360	-6,432	-9,139	-11,424	-13,709
Change in cash	**12,782**	**13,510**	**10,607**	**26,040**	**29,304**
Balance Sheet (RsM)					
Total assets	**93,800**	**134,090**	**174,272**	**226,257**	**286,023**
Cash & cash equivalent	34,290	58,710	76,102	108,127	145,780
Accounts receivable	16,080	24,360	29,163	37,043	45,173
Net fixed assets	22,260	37,710	50,174	57,924	67,246
Total liabilities	**23,460**	**21,500**	**24,768**	**31,788**	**40,605**
Accounts payable	9,340	14,690	17,046	21,497	25,860
Total Debt	0	0	0	0	0
Shareholders' funds	**70,340**	**112,590**	**149,504**	**194,469**	**245,418**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	32.5	31.6	30.5	31.1	30.7
ROE adjusted	40.4	42.3	35.1	32.8	29.4
ROIC adjusted	88.8	83.6	63.1	63.9	61.2
Net debt to equity	-48.7	-52.1	-50.9	-55.6	-59.4
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Company description

Infosys is the second-largest IT services company in India with more than 66,000 professionals. It also is among the fastest-growing IT services organization in the world, and is a leader in the offshore services space. Infosys provides business consulting, application development and maintenance and engineering services to more than 475 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing, and Utilities in the Americas, Europe and Asia Pacific. Infosys sells a core banking application, Finacle, which is used by leading banks in India, the Middle East, Africa and Europe. Its subsidiary, Infosys BPO (formerly Progeon), which employs more than 11,000 people, is a provider of BPO services. It launched a subsidiary in April 2004, Infosys Consulting, which provides high-end IT consulting services.

Recent developments

Industry trends: Indian IT companies have seen strong volume growth of 30-35% yoy over past few years. Last year saw improving trends in pricing, led by industry leaders Infosys and TCS. However, a sharp INR appreciation has led to a decline in operating margins, though partly recovered by forex gains at the net level. The subprime crisis in US has led to a few mortgage companies shutting down, leading to loss of business for some Indian IT companies – First Magnus for WNS, GreenPoint for Infosys BPO, etc. However, most offshore IT companies have said that their subprime exposure has been less than 1% of revenue.

Results: Revenue of US$928m (up 7.5% qoq) and EBITDA of Rs10.8bn (margins down ~300bp) were in line with expectations. Higher other income (driven by better forex gains and higher cash yields) and tax write-backs saw net profit at Rs10.8bn — better than expectations. Realization per employee was up 6.7% yoy onsite and 5.3% qoq offshore. In QoQ terms, it was 1%+. Management has reiterated their view of 3-4% pricing increase for renegotiations. The US$ revenue guidance was raised ~1% while INR EPS guidance was revised down 3% to factor in stronger revenue visibility and the appreciation in the INR. Upward revenue revision was below expectations, while INR EPS revision was broadly in-line.

News flow and development: Infosys has announced a seven-year BPO contract with Royal Philips Electronics where Infosys BPO would provide Finance & Accounting (F&A) and Procurement processing services. As part of this contract, it will acquire three centers with employees in Poland (755 employees), India (445), and Thailand (190) and would pay US$28m as consideration for this takeover. Green Point Mortgage, a client of Infosys BPO, has shut shop due to the subprime crisis in the US. Infosys received US$1.2m (~0.1% of its revenue) from this client in the recent quarter and had net receivables of ~US$0.4m.

Investment thesis

We rate Infosys as Buy/Low Risk (1L). We are positive on the stock from a fundamental 12-month view. Offshore IT outsourcing has now become a mainstream option, and we think scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore IT vendors. In this respect, Infosys appears well positioned and continues to gain ground given its strong branding and industry-leading sales force. Infosys should see above-industry average volume growth along with modest pricing improvement. We expect Infosys to deliver a revenue CAGR of 24.5% and EPS CAGR of 19.1% for FY07-10. Unlike many other high-growth firms in other industries, Infosys continues to generate solid FCF, and its RoE of 40%+ continues to be well above its cost of capital.

Valuation

Our target price of Rs2,440 is based on 25x FY09E EPS. This is close to the midpoint of the last one-year trading band of 20-28x 1-year forward earnings and factors in some deceleration in growth. We are now forecasting 19% earnings growth (on a high base of FY07) with some upside potential from pricing improvement and/or rupee depreciation. This is also supported by comparing it with global peers and the broader Indian market. The 25x multiple was also derived from a P/E band analysis of Infosys' trading pattern. During slowdowns in tech and offshore IT services, Infosys has traded at an average one-year rolling P/E of 25.1x with a low of 13x. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF, ROIC and growth rates for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitable record and high earnings visibility.

Risks

We rate Infosys shares as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. The key downside risks to the shares reaching our target price include: (1) any significant appreciation of the rupee against the US dollar/euro/pound; (2) pressure on billing rates (as Infosys continues to enjoy a 10-15% premium in its billing rates); (3) a sharp slowdown in the US economy; and (4) limited H1B visa quotas.

Larsen & Toubro (LART.BO)

Building India at a Rapid Pace

Buy/Low Risk	1L
Price (30 Aug 07)	Rs2,580.30
Target price	Rs2,765.00
Expected share price return	7.2%
Expected dividend yield	0.6%
Expected total return	**7.7%**
Market Cap	Rs658,954M
	US$16,062M

Price Performance (RIC: LART.BO, BB: LT IN)

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- **Infrastructure opportunity gets bigger** — According to the latest plan documents, India is targetting infrastructure investments of Rs14,717bn in the XIth Plan (FY07-12), 133% growth over the Xth Plan (FY02-07).

- **Top Indian E&C pick** — L&T, in our view, is still the safest play on India capex and is part of our "India Model Portfolio" given its unparalleled diversity in skill sets, strong corporate governance and risk-management procedures, and one of the best execution capabilities. Buoyed by strong infrastructure tailwinds, it is in an envious position of picking and choosing orders.

- **Strong PAT and order inflow growth in 1Q FY08** — L&T's 1Q FY08 PAT at Rs2.9bn (up 57% yoy) was driven by 30% sales growth and a 259bp margin expansion. Reported PAT was Rs3.8bn (up 140% yoy) on forex gains in 1Q FY08. L&T booked Rs99bn (up 32% yoy) of order in 1Q FY08, taking the order backlog at end-1Q FY08 to Rs416bn, up 45% yoy.

- **EPS CAGR of 35% over FY07-10E** — Stronger-than-expected order inflows in 1Q FY08E gives an early indication of the likely order inflows in the remaining 9 months of the year. We forecast that L&T will end 1Q FY08E with an order backlog of Rs400bn-plus. We expect L&T to grow its EPS at a CAGR of 35% over FY07-10E vis-à-vis 31% earlier with RoEs at the 29 -32% levels.

- **Manpower is the single biggest constraint** — Recovery in the Middle East capex typically leads to increased pressure on Indian E&C companies, as India is the preferred source of manpower for MNC contractors working in the Middle East.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	6,305	24.32	13.6	95.3	18.1	20.9	0.6
2006A	8,632	29.50	21.3	78.6	13.9	21.8	0.5
2007E	13,846	47.32	60.4	49.0	11.5	26.8	0.6
2008E	19,526	66.73	41.0	34.7	9.1	30.2	0.6
2009E	26,176	89.46	34.1	25.9	7.1	31.8	0.7

Source: Powered by dataCentral

Other Per Share Data

NAV	481.5
Discount to NAV	-382%

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	95.3	78.6	49.0	34.7	25.9
P/BV (x)	18.1	13.9	11.5	9.1	7.1
Dividend yield (%)	0.6	0.5	0.6	0.6	0.7
Payout Ratio (%)	56.7	37.3	27.5	22.5	19.0
Per Share Data (Rs)					
EPS adjusted	24.32	29.50	47.32	66.73	89.46
EPS reported	37.95	34.59	47.95	66.73	89.46
BVPS	128.21	167.00	202.23	254.06	327.09
DPS	13.78	11.00	13.00	15.00	17.00
Profit & Loss (RsM)					
Net sales	130,918	146,976	175,716	237,217	314,312
Operating expenses	-122,995	-136,231	-159,895	-214,167	-283,244
EBIT	**7,923**	**10,745**	**15,821**	**23,050**	**31,068**
Net interest expense	-536	-751	-339	-390	-462
Non-operating/exceptionals	1,941	2,354	4,337	5,639	7,330
Pre-tax profit	**9,328**	**12,348**	**19,819**	**28,299**	**37,937**
Tax	-3,023	-3,717	-5,973	-8,773	-11,760
Extraord./Min.Int./Pref.div.	3,533	1,490	184	0	0
Reported net income	**9,839**	**10,122**	**14,030**	**19,526**	**26,176**
Adjusted earnings	6,305	8,632	13,846	19,526	26,176
Adjusted EBIT	7,923	10,745	15,821	23,050	31,068
Growth Rates (%)					
Sales	36.9	12.3	19.6	35.0	32.5
EBIT adjusted	32.0	35.6	47.2	45.7	34.8
EPS adjusted	13.6	21.3	60.4	41.0	34.1
Cash Flow (RsM)					
Operating cash flow	**4,574**	**14,785**	**19,400**	**17,714**	**24,154**
Depreciation/amortization	942	1,145	1,700	1,977	2,577
Net working capital	-6,018	3,691	4,032	-3,794	-4,605
Investing cash flow	**-1,576**	**-15,962**	**-17,598**	**-13,000**	**-13,000**
Capital expenditure	-1,640	-6,377	-5,753	-10,000	-10,000
Acquisitions/disposals	50	-9,586	-11,845	-3,000	-3,000
Financing cash flow	**1,789**	**-1,530**	**3,445**	**-4,845**	**-5,491**
Borrowings	5,347	-4,055	6,077	0	0
Dividends paid	-4,066	-3,446	-4,199	-4,845	-5,491
Change in cash	**4,786**	**-2,707**	**5,247**	**-131**	**5,663**
Balance Sheet (RsM)					
Total assets	**108,772**	**130,313**	**160,572**	**199,791**	**250,837**
Cash & cash equivalent	8,539	5,832	11,079	10,948	16,611
Accounts receivable	39,636	48,142	54,818	73,264	96,105
Net fixed assets	10,290	15,472	19,285	27,374	34,864
Total liabilities	**75,530**	**84,425**	**103,286**	**127,823**	**158,184**
Accounts payable	33,520	40,626	51,418	68,985	91,344
Total Debt	18,591	14,536	20,613	20,613	20,613
Shareholders' funds	**33,242**	**45,888**	**57,286**	**71,967**	**92,653**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	6.1	7.3	9.0	9.7	9.9
ROE adjusted	20.9	21.8	26.8	30.2	31.8
ROA adjusted	6.4	7.2	9.5	10.8	11.6
Net debt to equity	30.2	19.0	16.6	13.4	4.3
Total debt to capital	35.9	24.1	26.5	22.3	18.2

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Asia Pacific at CitiResearchDataServices@citigroup.com or +852-2501-2791

Powered by: dataCentral

Company description

L&T is a diversified conglomerate with market leadership in the engineering and construction (E&C) and electrical-equipment businesses in India. L&T Information Technology is its 100% subsidiary engaged in software services. L&T has demerged its cement business into a separate company, and sold it to Grasim. L&T holds a residual stake of 11.5% in Ultratech Cemco.

Recent developments

Industry trends: According to the latest plan documents India is targetting infrastructure investment of Rs14,717bn in the XIth Plan (FY07-FY12), 133% growth over that seen in the Xth Plan (FY02-07).

India Infrastructure Investments

(Rsbn)	Construction Intensity	Infrastructure Investments					Construction Investments				
		IXth plan	Xth plan	Growth	XIth Plan	Growth	IX plan	X plan	Growth	XIth Plan	Growth
		FY98-FY02	FY03-FY07		FY08-FY12		FY98-FY02	FY03-FY07		FY08-FY12	
Airports	42%	66	99	50%	400	304%	28	42	50%	168	304%
Irrigation	60%	574	972	69%	1,258	29%	344	583	69%	755	29%
Ports	50%	50	47	-6%	500	964%	25	24	-6%	250	964%
Power	41%	866	1,581	83%	4,200	166%	352	642	49%	1,705	166%
Railways	42%	464	694	50%	3,220	364%	195	291	50%	1,352	364%
Roads	100%	546	1,329	143%	2,140	61%	546	1,329	143%	2,140	61%
Telecom	10%	801	579	-28%	870	50%	80	58	-28%	87	50%
Tourism	55%	6	25	317%	29	16%	3	14	317%	16	16%
Urban infrastructure	60%	586	991	69%	2,100	112%	352	595	69%	1,260	112%
Total	**53%**	**3,959**	**6,317**	**60%**	**14,717**	**133%**	**1,925**	**3,577**	**86%**	**7,733**	**116%**

Source: Plan Documents

Results: L&T's 1Q FY08 PAT at Rs2.9bn (up 57% yoy) was 18% ahead of the consensus estimate of Rs2.4bn, driven by 30% sales growth and a 259bp margin expansion. Reported PAT was Rs3.8bn, up 140% yoy due to forex gains in 1Q FY08 (forex losses in 1Q FY07) on foreign currency borrowings. Order inflow momentum continues to be robust, with L&T booking orders worth Rs99bn, up 32% yoy, which took the order backlog at end-1Q FY08 to Rs416bn, up 45% yoy. L&T Finance's PAT of Rs200m was up 136% yoy, helped by the equity infusion in the previous year, whereas L&T Infotech had a tepid PAT of Rs430m, up 16% yoy, impacted by the rupee's appreciation.

News flow & developments: L&T is seeking shareholder approval for raising fresh capital up to US$700m through domestic or foreign capital issue. The company is also seeking specific shareholder approval for converting its existing GDRs to ADRs for listing them on NASDAQ or NYSE. The company has sought permission for listing any new issues in quite a few global stock exchanges, such as London, Singapore and Hong Kong.

Investment thesis

We rate L&T Buy/Low Risk (1L) with a target price of Rs2,765. L&T's order backlog of Rs400bn plus and forecast stable margins provide good earnings visibility. That most process industries are operating at near peak capacity utilization, together with the thrust on hydrocarbon and infrastructure spending, should augur well for the order pipeline. We are positive on management's efforts at improving the company's product mix by increasing the share of high-technology products for process industries, defense, nuclear, and aerospace applications; and of engineering and embedded services. These segments have better growth potential and margins than the projects business, in our view. The initial response to the new initiative has been encouraging. Management also appears to be on course to decrease its vulnerability to the business from the local cycle by increasing international sales as a proportion of total revenues.

Valuation

Using a comps-based P/E of 26x FY09E, we get a core business value of Rs2,326 for L&T's core business. We also believe that the parent numbers do not capture the value inherent in the subsidiaries of L&T. We use a sum-of-the-parts (SOTP) methodology to value the L&T group, resulting in a target price of Rs2,765. We value L&T's subsidiaries at Rs439 with L&T Infotech at Rs222 (16x FY09E EPS, in-line with second-tier peers) and L&T IDPL at Rs79 (a 20% premium to private equity valuations, because a number of projects will be commissioned over the next couple of years).

Risks

We rate L&T Low Risk, as opposed to the High Risk suggested by our quantitative risk-rating system, because L&T's order backlog of c.Rs369bn represents two years' sales and provides earnings visibility. Downside risks to our target price include: 1) Attracting and retaining talent; 2) the E&C and electrical equipment businesses are sensitive to economic variables; 3) Competitive pressures, and 4) L&T needs to keep abreast of technology trends to sustain valuations and earnings.

Pantaloon (PART.BO)

First-Mover Advantage to the Fore

Buy/Medium Risk	1M
Price (30 Aug 07)	Rs504.30
Target price	Rs545.00
Expected share price return	8.1%
Expected dividend yield	0.1%
Expected total return	8.2%
Market Cap	Rs70,440M
	US$1,719M

Price Performance (RIC: PART.BO, BB: PF IN)

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- Strong growth for organized retail — Pantaloon is the largest organized retail player in India with more than 140 stores covering a total area of 4m sq. ft. Pantaloon is present in 3 major formats – Fashion and apparel through its 'Pantaloon' and 'Central Stores'; hypermarkets through its 'Big Bazaar' stores and foods through its 'food bazaar stores'.

- Competition rising, but Pantaloon has first-mover advantage — The entry of new players will increase competitive intensity, but Pantaloon enjoys first-mover advantages. Its rentals are locked in at significantly lower rates compared to prevailing market rates, and it has a formidable lead in setting up a supply chain.

- Strong expansion plans — Pantaloon has strong expansion plans. It is looking to increase its total retail area to 8m sq. ft. from 4m sq. ft by FY08. It has also aggressively expanded into new formats including electronics, home products, health and wellness and financial services retailing

- Unlocking value through subsidiaries — Pantaloon is looking to raise funds for its further expansion through listing some of its subsidiaries. The company has already raised private equity money in its Central format and is looking at unlocking value in some other subsidiaries as well

Statistical Abstract

Year to 30 Jun	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	386	3.51	69.4	136.8	23.8	24.4	0.1
2006A	642	4.86	38.5	98.7	12.0	17.1	0.1
2007E	1,049	7.24	48.9	66.3	7.7	14.6	0.1
2008E	1,890	13.03	80.1	36.8	8.6	22.0	0.1
2009E	2,394	16.51	26.7	29.1	6.7	26.0	0.2

Source: Powered by dataCentral

Fiscal year end 30-Jun	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	136.8	98.7	66.3	36.8	29.1
EV/EBITDA adjusted (x)	80.1	52.1	33.1	19.3	15.3
P/BV (x)	23.8	12.0	7.7	8.6	6.7
Dividend yield (%)	0.1	0.1	0.1	0.1	0.2
Per Share Data (Rs)					
EPS adjusted	3.51	4.86	7.24	13.03	16.51
EPS reported	3.51	4.86	7.24	13.03	16.51
BVPS	20.14	39.91	62.62	55.61	71.19
DPS	0.50	0.51	0.36	0.65	0.83
Profit & Loss (RsM)					
Net sales	10,528	18,678	31,079	56,094	76,930
Operating expenses	-9,753	-17,465	-29,108	-52,555	-72,099
EBIT	**775**	**1,212**	**1,971**	**3,539**	**4,831**
Net interest expense	-275	-335	-640	-860	-1,410
Non-operating/exceptionals	31	42	800	100	100
Pre-tax profit	**531**	**919**	**2,131**	**2,779**	**3,521**
Tax	-145	-277	-682	-889	-1,127
Extraord./Min.Int./Pref.div.	0	0	-400	0	0
Reported net income	**386**	**642**	**1,049**	**1,890**	**2,394**
Adjusted earnings	386	642	1,049	1,890	2,394
Adjusted EBITDA	909	1,420	2,270	4,070	5,574
Growth Rates (%)					
Sales	60.1	77.4	66.4	80.5	37.1
EBIT adjusted	68.0	56.3	62.6	79.5	36.5
EBITDA adjusted	65.3	56.3	59.8	79.3	36.9
EPS adjusted	69.4	38.5	48.9	80.1	26.7
Cash Flow (RsM)					
Operating cash flow	**-403**	**-2,626**	**-1,085**	**381**	**-2,023**
Depreciation/amortization	133	208	299	531	743
Net working capital	-1,020	-3,610	-2,575	-2,089	-5,160
Investing cash flow	**-1,145**	**-1,335**	**-1,935**	**-1,166**	**0**
Capital expenditure	-1,145	-1,335	-1,935	-1,166	0
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,133**	**5,565**	**4,723**	**3,642**	**6,739**
Borrowings	496	3,152	1,983	2,749	6,875
Dividends paid	-63	-77	-59	-107	-135
Change in cash	**-415**	**1,604**	**1,703**	**2,858**	**4,717**
Balance Sheet (RsM)					
Total assets	**6,651**	**14,174**	**21,153**	**26,388**	**38,862**
Cash & cash equivalent	215	218	300	5	5
Accounts receivable	123	170	255	307	422
Net fixed assets	2,295	3,955	5,169	8,509	11,294
Total liabilities	**4,441**	**8,916**	**12,073**	**18,324**	**28,539**
Accounts payable	1,271	2,298	3,189	5,955	8,583
Total Debt	2,862	6,014	7,997	10,746	17,620
Shareholders' funds	**2,215**	**5,269**	**9,080**	**8,064**	**10,323**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.6	7.6	7.3	7.3	7.2
ROE adjusted	24.4	17.1	14.6	22.0	26.0
ROIC adjusted	15.6	12.4	10.6	15.3	15.0
Net debt to equity	119.5	110.0	84.8	133.2	170.6
Total debt to capital	56.4	53.3	46.8	57.1	63.1

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Asia Pacific at CitiResearchDataServices@citigroup.com or +852-2501-2791

Company description

Pantaloon is the largest organized modern-format retailer in India, with a presence in apparel, general merchandise, home products and food retailing. It has retail space of about 3.5m sq. ft. with plans to expand to 30m sq. ft. by FY11. Pantaloon retails fashion apparel and accessories through its Pantaloon stores, and general merchandise and food through discount department stores Big Bazaar and Food Bazaar. It has presence in retail property management services through Central Malls, managing retail space for concessionaries fees and a share of sales. It has recently launched Home Town for home interiors, which it plans to expand aggressively. Its real estate investment subsidiary, Kshitij Retail Destinations plans to set up 51 malls across India spanning 14.5m sq. feet in the next three years. Pantaloon also has interests in media, logistics, brand management and e-tailing, through subsidiaries.

Recent developments

Industry trends: Organized retail, which is only 3.5% of India's total retail market of about US$200bn, is growing at over 30%. Favorable demographics, changing consumer habits and aggressive entry of new players are likely to sustain strong growth over the next 10-15 years. We believe that Pantaloon is well positioned along a peaking window of opportunity for the Indian retail sector. While Pantaloon has so far has been able to expand at a rapid pace, and has really not faced any material competitive challenges, the landscape is likely to change over the next 2-3 years. Large business houses like Reliance, Tatas, Bharati (through a JV with Wal-Mart), and the Birla group are planning aggressive entries into retail. It is in this environment we believe Pantaloon's business model will be tested the most. While we do expect sales growth and margins for incumbents like Pantaloon to be adversely impacted, we believe that the company has some strong first-mover advantages, which should continue to drive strong growth for the company. The key advantages include: 1) Strong brands and well established retail formats; 2) a judicious product mix; 3) below market lease rentals, which are locked in; and 4) long standing experience of understanding the complex heterogeneous Indian consumer.

News flow & developments: Over the last 2 years, we have been skeptical of Pantaloon's plans to expand at an aggressive pace and diversify into numerous new formats. Our skepticism was driven by Pantaloon's foray into numerous new segments and retail formats and concerns whether Pantaloon had the execution capabilities to deliver such rapid expansion. However, successful roll-out of the new formats over the last two years, albeit slightly delayed, has made us rethink. While we do not deny the execution risk entailed in the aggressive expansion plans going forward, we believe that Pantaloon now has the scale to be able to absorb losses arising from any failed formats. Pantaloon has forayed into businesses that are ancillary to its retail business but can potentially unlock significant value. These businesses are held in subsidiaries, which could see equity infusion over the next 3-4 quarters as these are scaled up.

There have been issues pertaining to seemingly high inventory at the store level. While over the years, per sq. ft. inventory has been coming down, there was a sharp increase in FY06. Store inventory per sq. ft. is a function of the store mix, typically the Pantaloon store has the highest inventory on a per sq. ft. basis, while Food Bazaar carries the lowest per sq. ft. inventories. Going forward, we expect overall inventory per sq. ft. to decline, partly driven by change in store mix, and partly through better inventory management systems due to recent implementation of SAP across the organization.

Investment thesis

We rate Pantaloon Buy/Medium Risk (1M) with a target price of Rs545. In the near term, stock upside triggers should come from stake sales in subsidiaries. We are including the Home Solutions and Future Capital subsidiaries into our valuations. We believe that the risk profile of the business has come down, and that Pantaloon is now better positioned to grow from its current base. While we are cognizant of the emerging competitive landscape, we believe that Pantaloon has sustainable competitive advantages: 1) strong brands and well-established retail formats; 2) judicious product mix; 3) below-market rentals locked in with long-term leases; and 4) longstanding experience in understanding Indian consumer behaviour.

Valuation

Our Rs545 target price is based on sum of the parts. We value parent Pantaloon Retail at Rs390 per share based on 30x FY08E P/E, similar to early-stage valuations for Chinese retailers. Our 30x multiple is also benchmarked against our regional retail universe. We expect a two-year EPS CAGR of 64% for Pantaloon, vs. 30% for our Asian retail universe. We benchmark valuations of Home Solutions against recent stake sales (mid-point of Rs7.5bn-10bn). We also use Market Cap/Sales valuation of 1.2x FY08E, on a par with Pantaloon's valuations. Our fair value per share for the Home Solutions subsidiary is Rs60 per share. We attribute per share value of Future Capital, Pantaloon's 74% subsidiary at Rs95, based on the NPV of cash flows to Pantaloon from the three 7-year close-ended funds (management fee + carry) and new funds that are being raised, which should increase the total assets under management to US$2bn by FY08E. We assumed a 15% increase in the fund NAV every year, and a 15% discount rate to calculate NPV of cash flows for the funds already deployed and a 12% NAV increase and 15% discount rate for new funds.

Risks

We assign a Medium Risk rating to Pantaloon Retail based on our quantitative risk-rating system. The main downside risks to our target price include: 1) Delay in store opening plans; 2) Legislative changes that allow FDI in retail; 3) Increase in competitive intensity, irrational competition; and 4) Continued pressure on rentals, which could result in lower-than-expected margins. The main upside risks to our target price and estimates include: 1) Better-than-expected sales growth; 2) Value unlocking in subsidiaries through listing / stake sales; and 3) Any significant acquisitions perceived to be creating value.

Punj Lloyd (PUJL.BO)

The Next Big Thing?

Buy/Low Risk	1L
Price (30 Aug 07)	Rs274.20
Target price	Rs305.00
Expected share price return	11.2%
Expected dividend yield	0.1%
Expected total return	**11.3%**
Market Cap	Rs63,617M
	US$1,551M

Price Performance (RIC: PUJL.BO, BB: PUNJ IN)

- **More than just numbers** — At end-FY07 Punj Lloyd had the third largest order backlog of Rs159bn in our rated Engineering & Construction universe, after BHEL (Rs550bn) and L&T (Rs369bn). The gap between Punj and the other mid-cap construction companies is not a mere numerical one but also one of skill sets which Punj can leverage further in coming years.
- **Starting to deliver on the early promise** — Punj Lloyd is perhaps the only mid-cap E&C company that could leapfrog into the next level, which is occupied by L&T with its diversified skill sets. The first sign that Punj Lloyd can actually deliver on its potential came when the company reported 4Q FY07 PAT of Rs889m, which was 59% ahead of CIR estimates.
- **Painting on a larger canvas** — In FY07 Punj Lloyd acquired Semb which scaled up its expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunneling. With these extended capabilities Punj is now pre-qualified for larger/more complex projects. Indications of this scale-up are already available (average order is up from US$30m to US$100m in FY07 and likely to go up to US$200m).
- **1Q FY08 PAT up 101%** — Punj Lloyd's 1Q FY08 PAT at Rs529m was up 101% yoy, driven by 73% growth in sales and a 239bp margin expansion. The company ended 1Q FY08 with an order backlog of Rs152bn, up 61% yoy, on the back of strong order inflows.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	272	2.23	na	109.0	5.8	na	0.1
2006A	545	1.93	-13.6	126.2	5.7	6.7	0.1
2007E	1,973	6.98	261.7	34.9	5.2	16.8	0.1
2008E	2,577	9.12	30.6	26.7	4.3	19.0	0.1
2009E	3,750	13.27	45.5	18.4	3.5	22.6	0.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	109.0	126.2	34.9	26.7	18.4
P/E reported (x)	29.4	125.7	34.9	26.7	18.4
P/BV (x)	5.8	5.7	5.2	4.3	3.5
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1
Per Share Data (Rs)					
EPS adjusted	2.23	1.93	6.98	9.12	13.27
EPS reported	8.27	1.94	6.97	9.12	13.27
BVPS	41.89	42.96	47.05	56.57	70.51
NAVps ordinary	na	na	na	na	na
DPS	0.15	0.20	0.25	0.30	0.35
Profit & Loss (RsM)					
Net operating income (NOI)	**na**	**na**	**na**	**na**	**na**
G&A expenses	na	na	na	na	na
Other Operating items	na	na	na	na	na
EBIT including associates	**1,265**	**1,306**	**2,691**	**4,290**	**5,955**
Non-oper./net int./except.	-160	-475	-35	-603	-603
Pre-tax profit	**1,105**	**831**	**2,656**	**3,687**	**5,352**
Tax	-102	-291	-690	-1,103	-1,603
Extraord./Min. Int./Pref. Div.	2	7	3	-7	0
Reported net income	**1,006**	**547**	**1,969**	**2,577**	**3,750**
Adjusted earnings	272	545	1,973	2,577	3,750
Adjusted EBIT	1,262	1,298	2,681	4,280	5,945
Adjusted EBITDA	2,102	1,902	3,743	5,625	7,574
Growth Rates (%)					
NOI	na	na	na	na	na
EBIT adjusted	na	2.8	106.5	59.6	38.9
EPS adjusted	na	-13.6	261.7	30.6	45.5
Cash Flow (RsM)					
Operating cash flow	**-1,748**	**-548**	**6,487**	**2,788**	**4,424**
Depreciation/amortization	839	604	1,062	1,345	1,629
Net working capital	-3,598	-1,680	3,447	-1,141	-954
Investing cash flow	**2,138**	**-2,705**	**-8,234**	**-5,250**	**-5,250**
Capital expenditure	-398	-2,548	-7,029	-4,500	-4,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-507**	**3,938**	**10,659**	**-91**	**-107**
Borrowings	-2,680	-1,637	11,550	0	0
Dividends paid	-21	-60	-89	-91	-107
Change in cash	**-118**	**685**	**8,912**	**-2,554**	**-933**
Balance Sheet (RsM)					
Total assets	**16,779**	**23,056**	**57,201**	**67,887**	**79,381**
Cash & cash equivalent	432	1,107	10,020	7,453	6,521
Net fixed assets	5,144	7,108	12,470	15,635	18,516
Total liabilities	**11,660**	**11,833**	**44,903**	**53,111**	**60,962**
Total Debt	7,187	5,551	17,102	17,103	17,104
Shareholders' funds	**5,119**	**11,225**	**12,300**	**14,779**	**18,423**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	7.1	7.7	5.2	6.4	7.3
ROE adjusted (%)	na	6.7	16.8	19.0	22.6
ROA adjusted (%)	na	2.7	4.9	4.1	5.1
Net debt to equity (%)	132.0	39.6	57.6	65.3	57.4
Interest coverage (x)	1.6	2.4	4.5	4.9	6.5

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Company description

Punj Lloyd is an Indian Engineering & Construction (E&C) major catering to the hydrocarbons and civil construction sectors across India, Asia and the Middle East. Its services include laying pipelines, building roads, and the construction of refineries and tankages, power plants, and other infrastructure facilities. In FY07 Punj Lloyd acquired Semb, which helped the company scale up its expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunneling amongst others, in the infrastructure domain. Enabled by the extended capabilities accruing from this acquisition, Punj Lloyd is now also pre-qualified for larger and more complex project bids. Punj Lloyd is perhaps the only Indian mid cap engineering & construction (E&C) company that has the necessary skill sets and desire to leapfrog into the next level, which is occupied by L&T with its immensely diversified skill sets. The first sign that Punj Lloyd can actually leverage on these skill sets and deliver on its potential came when the company reported 4Q FY07 PAT of Rs889m, 59% ahead of our estimate.

Recent developments

Industry trends: According to the latest plan documents India is targetting infrastructure investments of Rs14,717bn in the XIth Plan (FY07-FY12), 133% growth over the Xth Plan (FY02-07).

India Infrastructure Investments

(Rsbn)	Construction Intensity	Infrastructure Investments					Construction Investments				
		IXth plan	Xth plan	Growth	XIth Plan	Growth	IX plan	X plan	Growth	XIth Plan	Growth
		FY98-FY02	FY03-FY07		FY08-FY12		FY98-FY02	FY03-FY07		FY08-FY12	
Airports	42%	66	99	50%	400	304%	28	42	50%	168	304%
Irrigation	60%	574	972	69%	1,258	29%	344	583	69%	755	29%
Ports	50%	50	47	-6%	500	964%	25	24	-6%	250	964%
Power	41%	866	1,581	83%	4,200	166%	352	642	49%	1,705	166%
Railways	42%	464	694	50%	3,220	364%	195	291	50%	1,352	364%
Roads	100%	546	1,329	143%	2,140	61%	546	1,329	143%	2,140	61%
Telecom	10%	801	579	-28%	870	50%	80	58	-28%	87	50%
Tourism	55%	6	25	317%	29	16%	3	14	317%	16	16%
Urban infrastructure	60%	586	991	69%	2,100	112%	352	595	69%	1,260	112%
Total	**53%**	**3,959**	**6,317**	**60%**	**14,717**	**133%**	**1,925**	**3,577**	**86%**	**7,733**	**116%**

Source: Plan Documents

Results: Punj Lloyd's 1Q FY08 PAT at Rs529m was up 101% yoy, driven by 73% growth in sales and a 239bp margin expansion. The company ended 1Q FY08 with an order backlog of Rs152bn, up 61% yoy, on the back of strong order inflows.

News flow & developments: (1) Secured a Rs5.9bn contract for building a sulphur block at Bina Refinery of Bharat Oman Refineries Limited; (2) Secured a contract worth over S$250m for sub-structural works at the Sentosa Integrated Resort Development; (3) has signed an MoU to invest Rs4.0bn for acquiring a 25.1% stake in Pipavav Shipyard Limited; (4) has been awarded a contract by Reliance Gas Transportation & Infrastructure for its East-West Pipeline project for laying of pipeline and associated facilities for Rs4.9bn.

Investment thesis

We rate Punj Lloyd Buy/Low Risk (1L) as: 1) We always believed that Punj could be the only mid-cap Indian construction company to give L&T a run for its money. The first sign that Punj Lloyd could actually deliver on its potential came with a 4Q FY07 PAT of Rs889m, 59% ahead of our estimate. 2) Punj Lloyd has taken more risks in terms of bidding in more countries and domains to ramp up its skill sets. At the end of FY07 Punj Lloyd had the third-largest order backlog of Rs159bn, after BHEL and L&T. 3) In FY07 Punj Lloyd acquired Semb, which has helped it scale up its infrastructure expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunneling, amongst others. Also, Punj Lloyd is now pre-qualified for larger and more complex project bids. 4) Punj Lloyd's move up the value chain is reflected in the average size of the projects it has won increasing from US$30m to US$100m in FY07 (which could move up to US$200m).

Valuation

Our target price of Rs305 is based on a target P/E of 23x FY09E, which is well supported by an earnings CAGR of 38% over FY07-10E and RoEs expanding from 17% in FY08E to 25% in FY10E. Our target multiple is in line with that of L&T. Despite Punj Lloyd’s superior earnings CAGR of 38% over FY07-10E vis-à-vis that of 31% for L&T, we believe Punj Lloyd should not trade at a premium to L&T given L&T’s superior order backlog and execution capabilities.

Risks

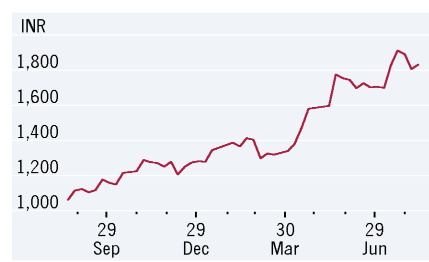
We rate Punj Lloyd Low Risk rather than Medium Risk (as suggested by our quantitative risk-rating system), in line with other construction companies given its order book. The key downside risks that could impede the stock from reaching our target price include: (1)Likely equity dilution in the future; (2) Integration risks relating to SembCorp E&C; (3) Revenue volatility due to project-driven nature of the business; (4) Exports – subject to geopolitical risks; (5) Project implementation risks, bad debts and receivables; (6) Sensitivity to raw-material costs and foreign currency fluctuations; (7) Employee retention could be a key challenge.

Reliance Industries (RELI.BO)

Valuing Sustained Exploration Success

Buy/Low Risk	1L
Price (30 Aug 07)	Rs1,907.40
Target price	Rs2,005.00
Expected share price return	5.1%
Expected dividend yield	0.7%
Expected total return	**5.8%**
Market Cap	Rs2,477,657M
	US$60,453M

Price Performance (RIC: RELI.BO, BB: RIL IN)



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- **Life beyond KG-D6** — Reliance has confirmed exploration success in CY-DWN-2001/2 (100% interest), first deepwater discovery in Cauvery basin. Presence of gas and oil in this 14,325 sq. km block has been termed as "good", though any comparison with the flagship KG-D6 block is very premature. This was one of the three blocks awarded to RIL in the Cauvery basin in NELP-III. Recent media reports also suggest that the company has struck oil in the D4 block in the KG Basin (100% interest).

- **Discoveries provide sustainability of cash flows** — Cauvery discovery and further potential in D9, D3 (with Hardy Oil), and D4 (with Niko), for which drilling is planned over 6-18 months, does two things: i) sustains oil/gas production when D6 goes into decline and, more importantly, ii) sustains RIL's share of cash flows especially when D6 investment multiple becomes >2.5x. Though rig shortage and pre-occupation with D6 will stagger exploratory drilling activity, the recently contracted drillship (Neptune Explorer) will come in handy.

- **Low global refining supply** — Growing risks to refinery expansions in the Middle East due to cost inflation should bode well for RIL's margins in FY08-10E. Besides, RIL's differentials over benchmarks have expanded to US$5-8/bbl over the last five quarters. RPL's green field capacity addition in FY09 would leverage it further.

- **Petrochemicals: Stable FY08E, but expect pressure in FY09E** — Tightness in naphtha supplies and commissioning of ME projects (ex. Iran) in 2H08-2009 imply increased possibility of cycle downturn beyond 2008. However, stable to improving trends in PX and PVC should partially offset the impact.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	75,717	54.34	43.0	32.7	6.2	20.3	0.4
2006A	90,693	65.10	19.8	27.3	8.7	26.4	0.6
2007E	109,184	78.37	20.4	22.7	6.6	32.9	0.6
2008E	118,564	85.11	8.6	20.9	5.2	27.8	0.7
2009E	129,139	92.70	8.9	19.2	4.3	24.4	0.8

Source: Powered by dataCentral

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	32.7	27.3	22.7	20.9	19.2
EV/EBITDA adjusted (x)	19.4	17.6	14.3	13.7	12.4
P/BV (x)	6.2	8.7	6.6	5.2	4.3
Dividend yield (%)	0.4	0.6	0.6	0.7	0.8
Per Share Data (Rs)					
EPS adjusted	54.34	65.10	78.37	85.11	92.70
EPS reported	54.34	65.10	78.37	85.11	92.70
BVPS	288.75	205.28	271.28	341.76	417.59
DPS	7.50	10.00	11.00	13.00	15.00
Profit & Loss (RsM)					
Net sales	660,513	812,113	1,063,657	1,041,568	1,016,083
Operating expenses	-571,173	-702,072	-921,523	-890,886	-861,934
EBIT	**89,340**	**110,041**	**142,134**	**150,682**	**154,148**
Net interest expense	-14,687	-8,770	-11,140	-12,320	-12,287
Non-operating/exceptionals	16,034	5,770	1,930	7,115	10,758
Pre-tax profit	**90,687**	**107,041**	**132,924**	**145,477**	**152,619**
Tax	-14,970	-16,347	-23,740	-26,913	-23,480
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**75,717**	**90,693**	**109,184**	**118,564**	**129,139**
Adjusted earnings	75,717	90,693	109,184	118,564	129,139
Adjusted EBITDA	126,575	144,050	182,224	185,877	201,293
Growth Rates (%)					
Sales	27.5	23.0	31.0	-2.1	-2.4
EBIT adjusted	41.0	23.2	29.2	6.0	2.3
EBITDA adjusted	32.1	13.8	26.5	2.0	8.3
EPS adjusted	43.0	19.8	20.4	8.6	8.9
Cash Flow (RsM)					
Operating cash flow	**144,871**	**117,189**	**183,831**	**168,816**	**188,653**
Depreciation/amortization	37,235	34,009	40,090	35,195	47,145
Net working capital	31,919	-7,514	34,557	15,057	12,369
Investing cash flow	**-42,746**	**2,515**	**-133,006**	**-115,000**	**-89,000**
Capital expenditure	-37,669	-126,361	-92,300	-115,000	-89,000
Acquisitions/disposals	-5,035	128,876	-40,706	0	0
Financing cash flow	**-37,120**	**-176,268**	**-27,141**	**20,616**	**-28,349**
Borrowings	6,620	41,174	-9,901	59,207	-764
Dividends paid	-11,917	-15,885	-17,240	-20,374	-23,509
Change in cash	**65,005**	**-56,565**	**23,684**	**74,431**	**71,305**
Balance Sheet (RsM)					
Total assets	**804,198**	**718,893**	**907,012**	**1,055,156**	**1,159,438**
Cash & cash equivalent	70,756	14,192	37,876	112,308	183,612
Accounts receivable	39,278	41,636	61,442	60,136	58,563
Net fixed assets	349,582	441,935	494,145	573,950	615,805
Total liabilities	**401,829**	**432,909**	**529,085**	**579,038**	**577,691**
Accounts payable	123,086	114,387	211,851	204,971	194,522
Total Debt	187,846	218,656	208,755	249,745	244,905
Shareholders' funds	**402,369**	**285,980**	**377,923**	**476,113**	**581,744**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.2	17.7	17.1	17.8	19.8
ROE adjusted	20.3	26.4	32.9	27.8	24.4
ROIC adjusted	19.3	21.2	23.3	22.0	20.9
Net debt to equity	29.1	71.5	45.2	28.9	10.5
Total debt to capital	31.8	43.3	35.6	34.4	29.6

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Company description

Reliance Industries is a conglomerate with interests in upstream oil & gas (E&P), refining, and petrochemicals. It is building a super-size refinery project through its 75% subsidiary (RPL) and is now undertaking development of a large gas find in KG basin. RIL is foraying into organized retailing and has plans to undertake SEZ projects over the medium to long term. In FY07, RIL derived 53% of its EBITDA from refining, 37% from petrochemicals, and the rest from its E&P business. The promoter group led by Mr. Mukesh Ambani holds a 51% stake in the company, FIIs hold 20%, while domestic FIs and public hold the remaining.

Recent developments

Industry trends: Delayed refining capacity expansions (esp. Middle Eastern and North African greenfield expansions), sustained strength in product spreads, and light-heavy crude spreads bode well for RIL's refining profitability over FY08-10E. In addition, RIL has continued to deliver strong differentials over regional margins in recent times, with differentials over Singapore GRMs in excess of US$6/bbl over the last 3 quarters. While petrochem should remain stable in FY08E, we anticipate a downcycle beyond 2008, especially given RIL's exposure to PE/PP spreads where we forecast declining spreads. On the E&P side, RIL continues to sustain its exploration success, with the Cauvery discovery and further potential in D9, D3, and D4, for which drilling is planned over the next 6-18 months.

Results: RIL's 1Q FY08 net profit of Rs32.6bn (up 28% yoy and 14% qoq) beat estimates driven by robust polyester margins, forex gains (Rs1.8bn on WC loans) and the absence of one-off payments incurred in 4Q FY07. Polyesters had a strong quarter (EBIT margins up 8-15% yoy) plus volume growth across the petchem chain negated the QoQ decline in PE/PP deltas. In addition, one-off PX royalty expense in 4Q FY07 drove a sharp 310bp qoq improvement in petchem EBIT.

Refining performance was par for the course as RIL's GRM rose in line with global trends. Refining margins at US$15.4/bbl implied differentials over Singapore benchmark (adjusted for marketing losses) remained steady on a qoq basis at ~US$6.5/bbl.

News flow & developments: RIL has submitted FDPs for NEC-25 (plateau 6.5mmscmd, first gas FY12) and CBM (5mmscmd, FY10), indicating progress on blocks other than D6.

Reliance has confirmed exploration success in CY-DWN-2001/2 (100% interest), the first deepwater discovery in Cauvery basin. RIL will undertake appraisal wells in this block over the next 8-12 months.

Management has also indicated 3 more deep water rigs to be mobilized in 2H FY08 (from existing 3) to drill exploratory wells in 11 out of the 26 blocks (incl. D9, D3, and D4).

In organized retail, RIL's total investment went up by Rs12bn in 1Q FY08 to Rs60bn, with a total of 201 stores.

Investment thesis

We rate RIL Buy/Low Risk with a target price of Rs2,005. We expect regional refining margins to remain robust due to project delays in the Middle East, with RIL enjoying an enhanced premium for its superior complexity. E&P business has delivered positive surprise and looks set to become more meaningful in the next 3-4 years as KG D6 field commences production and new discoveries are brought on stream. Upgrade of reserves in KG basin adds to the value, although the NAV of the gas find depends on development capex and the demand profile from anchor customers. Given the track record of exploratory success and the evolving portfolio (much beyond KG D6), RIL's E&P business needs to be valued as a going concern rather than a combination of assets. We have therefore valued E&P business (Rs631/share) on a more traditional EV/FCF multiple rather than the consensus NAV approach. While petrochemicals will likely face pressure in FY09E, this will be offset by diversity of products to some extent. Factors such as diversity of revenues, integration across product chains, and volume growth should help RIL tide over downturns in product cycles.

Valuation

Our target price of Rs2,005 is based on a sum-of-the-parts value: 1) RIL's core petrochem and downstream oil business is valued on an EV/EBITDA of 6.5x mid-FY09E, in line with the regional chemicals and refining peers; 2) Total E&P assets including oil & gas prospects and other blocks are valued at Rs631/share based on 10x steady state (FY11E) FCF; 3) Investment in IPCL and RPL valued at 8x profit contribution to consolidated profits; 4) Organized retail business is factored in at Rs125/share; and 5) Treasury stock is valued at RIL's target price.

Risks

We rate RIL Low Risk, as opposed to the Medium Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Diversified earnings and significant value contribution from the emerging E&P business and investment in listed subsidiaries have led to qualitative changes in the value constituents of the stock. Risks that could impede the stock from reaching our target price are: RIL's margins are exposed to the global petrochemical and refining cycles; the group could be asked to offer larger discounts on products sold to oil public sector units; delays in the key KG-D6 gas development and RPL refinery project; delays in the drilling programme for the new blocks (D9, D3, D4); and the organized retail business would call for significant investment in non-core areas.

Sterlite Industries (India) (STRL.BO)

In Sync With Zinc

Buy/Medium Risk	1M
Price (30 Aug 07)	Rs630.10
Target price	Rs910.00
Expected share price return	44.4%
Expected dividend yield	0.7%
Expected total return	**45.1%**
Market Cap	Rs424,684M
	US$10,363M

Price Performance (RIC: STRL.BO, BB: STLT IN)

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- A diversified conglomerate — Sterlite is a non-ferrous metals conglomerate producing zinc, aluminium and copper. The largest proportion (70%) of Sterlite's consolidated EBITDA comes from Hindustan Zinc in which it currently owns 64.9%, which it plans to soon hike to 94.4%.

- Robust zinc outlook — Hindustan Zinc is India's only integrated zinc producer with a 60% market share. Zinc is Sterlite's best-performing business. Prices have been relatively subdued so far this year, but we expect supply from China to moderate over the coming months, enabling prices to recover in 2H FY08 to above US$4,000/t. We expect zinc and lead prices to be buoyant in FY09E.

- Aluminium benefits from lower costs — Sterlite's aluminium revenues and profits come from its 51% ownership of Balco. Balco accounts for 14% of Sterlite's sales and 17% of EBITDA. Despite flat aluminium prices, we expect moderate earnings growth in Balco. We expect average costs at Balco to fall on a YoY basis in FY08 as their new plant stabilizes and increases output, and from lower alumina prices.

- Difficult times for copper — Sterlite operates a copper smelter which accounts for 48% of sales and only 8% of its EBITDA. The key profit driver for the smelter is TC/RC margins, which are expected to halve from FY07 levels to 14-15c/lb.

- Sterlite Energy — Sterlite intends to enter the commercial power sector through its 100% subsidiary, Sterlite Energy. It intends to build a pit-head thermal coal based 3,600MW capacity power plant in two phases of 2,400MW and 1,200MW.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	16,781	30.05	153.1	19.9	5.5	32.3	0.2
2007A	44,841	80.29	167.2	7.5	3.4	55.9	0.7
2008E	52,359	73.90	-8.0	8.1	1.9	32.3	0.7
2009E	64,488	91.02	23.2	6.6	1.5	25.2	0.7
2010E	44,142	62.30	-31.6	9.6	1.3	14.1	0.8

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	19.9	7.5	8.1	6.6	9.6
EV/EBITDA adjusted (x)	11.7	4.7	4.5	4.3	5.8
P/BV (x)	5.5	3.4	1.9	1.5	1.3
Dividend yield (%)	0.2	0.7	0.7	0.7	0.8
Per Share Data (Rs)					
EPS adjusted	30.05	80.29	73.90	91.02	62.30
EPS reported	30.05	80.29	73.90	91.02	62.30
BVPS	108.38	178.72	316.81	405.81	476.96
DPS	1.25	4.00	4.25	4.40	4.50
Profit & Loss (RsM)					
Net sales	131,272	243,868	269,452	289,169	244,139
Operating expenses	-96,300	-150,501	-176,564	-197,054	-181,106
EBIT	**34,972**	**93,367**	**92,888**	**92,115**	**63,033**
Net interest expense	-2,353	-3,791	-3,447	-4,624	-4,618
Non-operating/exceptionals	-101	-198	0	0	0
Pre-tax profit	**32,518**	**89,378**	**89,441**	**87,491**	**58,415**
Tax	-10,165	-24,118	-22,218	-20,720	-13,464
Extraord./Min.Int./Pref.div.	-5,572	-20,420	-14,864	-2,284	-810
Reported net income	**16,781**	**44,841**	**52,359**	**64,488**	**44,142**
Adjusted earnings	16,781	44,841	52,359	64,488	44,142
Adjusted EBITDA	40,241	101,406	101,381	101,027	71,935
Growth Rates (%)					
Sales	81.0	85.8	10.5	7.3	-15.6
EBIT adjusted	127.5	167.0	-0.5	-0.8	-31.6
EBITDA adjusted	119.3	152.0	0.0	-0.3	-28.8
EPS adjusted	153.1	167.2	-8.0	23.2	-31.6
Cash Flow (RsM)					
Operating cash flow	**22,086**	**56,490**	**71,061**	**72,504**	**54,827**
Depreciation/amortization	5,269	8,039	8,493	8,912	8,902
Net working capital	-8,339	-18,647	4,234	-2,799	4,274
Investing cash flow	**-16,172**	**-43,070**	**-118,433**	**-47,149**	**-17,341**
Capital expenditure	-13,506	-23,796	-24,570	-34,076	-25,489
Acquisitions/disposals	-6,009	-26,091	-99,836	-20,000	0
Financing cash flow	**-3,103**	**-13,438**	**90,181**	**22,169**	**-8,833**
Borrowings	-320	217	13,238	30,387	-500
Dividends paid	-732	-4,441	-132	-3,595	-3,716
Change in cash	**2,811**	**-19**	**42,810**	**47,524**	**28,653**
Balance Sheet (RsM)					
Total assets	**170,976**	**239,990**	**390,494**	**496,658**	**552,379**
Cash & cash equivalent	11,153	11,134	53,944	101,468	130,121
Accounts receivable	13,475	16,521	19,534	22,572	19,944
Net fixed assets	85,497	97,176	118,641	171,067	202,315
Total liabilities	**93,279**	**103,916**	**122,376**	**158,099**	**157,824**
Accounts payable	13,917	9,078	17,376	19,291	18,235
Total Debt	51,653	46,103	59,342	89,729	89,229
Shareholders' funds	**77,696**	**136,074**	**268,118**	**338,559**	**394,556**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	30.7	41.6	37.6	34.9	29.5
ROE adjusted	32.3	55.9	32.3	25.2	14.1
ROIC adjusted	23.9	51.1	35.0	25.8	15.6
Net debt to equity	52.1	25.7	2.0	-3.5	-10.4
Total debt to capital	39.9	25.3	18.1	21.0	18.4

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Powered by: dataCentral

Company description

Sterlite, a 60% subsidiary of Vedanta Resources Plc, is a diversified non-ferrous metals conglomerate. Sterlite has a custom copper smelter with a capacity of 400,000 tpa, which according to Brook Hunt, is in the lowest cost quartile in terms of production costs of all copper smelting operations worldwide. Bharat Aluminium (Balco) has an aluminium smelter capacity of 345,000 tpa and 810MW of power, which is the most important cost component in the aluminium manufacturing process. Hindustan Zinc is among the lowest-cost producers of zinc in the world largely due to the low cost of mining ore at the Rampura Agucha mine which meets about 90% of its requirement. In FY07, the copper business, Balco and Hindustan Zinc accounted for 48%, 17% and 35% of Sterlite's sales respectively and 14%, 17% and 60% of its EBITDA respectively.

Recent developments

Industry trends: While zinc prices had been in the range of US$3,600-4,000/t since April 2007, they have come off to around US$3,000-3,100/t. Our global analyst expects zinc prices to rebound to around US$4,400/t in 2H FY08. On the other hand, supply disruptions and falling Chinese exports, have led to lead prices rising substantially from US$2,000/t in April 2007 to ~ $3,300/t in August, surpassing prices of both aluminium and zinc. Aluminium is trading in the range of US$2,500/t, in line with our FY08 forecast. Copper TC/RCs have been under pressure with mid-year contracts settling at ~US12-13c/lb, down from 15c/lb earlier this year. Spot TC/RCs are currently at a 3-year low of ~US5c/lb.

Results: On a standalone basis, Sterlite reported a PAT of Rs2bn for 1Q FY08, down 10% yoy. Net sales grew 31% yoy to Rs31.2bn due to higher copper prices and volumes. However, EBITDA fell 16% yoy due to lower TC/RC margins. TC/RC margins during the quarter were around US21c/lb versus an average of 31c/lb during FY07. Sterlite expects TC/RC margins to fall to around 15c/lb in FY08E, in line with our forecasts. On a consolidated basis, attributable PAT for 1Q FY08 grew 30% yoy to Rs11.4bn. Consolidated net sales rose 33% yoy to Rs61.4bn. EBITDA for the quarter grew 17% yoy to Rs21.6bn. Sales and EBITDA growth were driven by higher volumes of all 3 major metals – particularly aluminium and zinc. There was some increase in international prices, but some of this was offset by the appreciation of the rupee versus the US$. EBITDA was adversely impacted due to lower copper TC/RCs and higher global alumina prices.

News flow and developments: ADS Offering: Sterlite has raised US$2bn through an ADS issue by issuing 150m underlying equity shares of Rs2 each to be used for acquiring the government's balance stake in HZL and its entry into commercial power generation business.

LME registration: HZL has received LME registration for lead products that will allow it to deliver the metal at exchange warehouses worldwide.

Vedanta: Sterlite's holding company, Vedanta, has received SEBI approval to make an open offer to acquire an additional 20% stake in Sesa Goa.

Investment thesis

We rate Sterlite shares Buy/Medium Risk (1M). Sterlite is a diversified non-ferrous metals conglomerate with exposure to aluminium, copper and zinc. Zinc (Hindustan Zinc) is the biggest contributor to Sterlite's EBITDA (70% of total) and should continue to benefit from robust pricing and strong volume growth. Sterlite is expected to soon raise its holding in HZL to 94.4% and hence can be considered as an alternative investment vehicle for investors looking to participate in the zinc story. Sterlite is also 4x more liquid than HZL. In the aluminium business (Balco), lower costs and some volume growth should help compensate for lower domestic prices in FY08. Sterlite's shareholding in Balco is also expected to soon reach 100%. Copper has a difficult outlook due to the fall in TC/RC margins expected in FY08-FY09. We expect Sterlite's attributable net income to rise around 17-23% yoy in FY08-09E due to higher profits in zinc and aluminium and the completion of the minority stake acquisition of Hindustan Zinc (29.5%) and Balco (49%) from the government during FY08.

Valuation

Since April 2006, the stock has been substantially re-rated to a P/E range of 6-8x due to the positive trends in all its three major businesses. We expect this re-rating process to continue based on our robust outlook for zinc and steady profits in aluminium, with triggers coming from progress in acquiring the balance minority stakes from HZL and Balco. Our target price of Rs910 is arrived at by applying a P/E of 10x to FY09E earnings. This appears justified as Sterlite's earnings are substantially driven by zinc's robust outlook, and the sector re-rating following recent M&A activity. The stock has also crossed its 4-year average EV/EBITDA of 3.7x in the last few months, largely driven by zinc and lead prices. Based on our zinc outlook, we expect the EV/EBITDA upside to continue. At our target price, the stock would trade at an EV/EBITDA of 6.5x.

We also examine the value for Sterlite using a sum-of-the-parts by applying a P/E of 6x to 10x for FY09E for its various businesses. We also add to this value the book value of investments in Sterlite Energy at the end of FY09E. This method gives a value of Rs873 per share.

Risks

We rate Sterlite shares as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Risk factors that could prevent the shares from reaching our target price include: (1) Any delays in completion of Hindustan Zinc minority stake acquisition; (2) Any delays in acquisition of Balco minority stake; (3) Weaker-than-expected commodity prices or TC/RC margins; (4) Delays in expansion plans for zinc and power; (5) Substantial dependence on the Rampura Agucha mines in case of zinc; and (6) Trends in exchange rates.

Suzlon Energy (SUZL.BO)

Play on Global Demand for Renewables

Buy/Medium Risk	1M
Price (30 Aug 07)	Rs1,248.70
Target price	Rs1,700.00
Expected share price return	36.1%
Expected dividend yield	0.4%
Expected total return	**36.6%**
Market Cap	Rs371,474M
	US$9,055M

Price Performance (RIC: SUZL.BO, BB: SUEL IN)

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- WTG suppliers in a sweet spot — According to our latest Citi Global Wind Power forecasts the average annual WTG market is set to jump to 26GW/year over the next 5 years vis-à-vis 10GW/year over the previous 5 years.
- Component shortages, a key constraint — Despite efforts on the part of (WTG) manufacturers to meet this demand through capacity expansion much demand might go unmet because of massive component shortages. The component bottlenecks are: gearboxes, large bearings, some of the large forged items in particular main shafts and carbon fibre for larger blades.
- Suzlon is vertically integrated — Suzlon is one of the most vertically integrated WTG suppliers in the world and is one of the best equipped to cash in on this huge WTG opportunity on the back of some prudent steps that its has taken, namely (1) acquisition of Hansen for gearbox capacity, (2) enhancing gearbox capacity, (3) internal sourcing of gearboxes from Hansen, (4) adding component and sub-component capacity in the India SEZ.
- Disappointing 1Q FY08 — 1Q FY08 PAT of Rs189m was down 80% yoy on the back of a severe margin contraction. Reasons cited by management were: (1) rupee appreciation, (2) recruitment of people in Hansen and Suzlon 6 months in advance, (3) 1Q being a weak quarter implies lower volumes, which lead to fixed costs not getting properly apportioned, (4) tower problems in the US, and (5) rain in India leading to delay in domestic deliveries.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	3,654	42.04	-12.8	30.7	14.2	63.9	0.3
2006A	7,562	26.30	-37.4	49.0	13.6	43.1	0.4
2007E	8,648	29.99	14.0	43.0	10.6	27.8	0.4
2008E	14,863	50.24	67.5	25.7	7.7	35.7	0.4
2009E	21,558	72.87	45.0	17.7	5.5	37.2	0.4

Source: Powered by dataCentral

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	30.7	49.0	43.0	25.7	17.7
EV/EBITDA adjusted (x)	80.0	41.8	30.4	18.3	13.5
P/BV (x)	14.2	13.6	10.6	7.7	5.5
Dividend yield (%)	0.3	0.4	0.4	0.4	0.4
Per Share Data (Rs)					
EPS adjusted	42.04	26.30	29.99	50.24	72.87
EPS reported	42.03	26.30	29.99	50.24	72.87
BVPS	90.77	94.56	122.02	167.26	235.77
DPS	4.00	5.01	5.00	5.50	5.50
Profit & Loss (RsM)					
Net sales	19,425	38,410	79,857	146,647	212,616
Operating expenses	-15,227	-30,146	-68,617	-125,996	-182,296
EBIT	**4,197**	**8,265**	**11,240**	**20,651**	**30,320**
Net interest expense	-458	-648	-2,523	-5,036	-7,482
Non-operating/exceptionals	234	556	965	1,175	1,392
Pre-tax profit	**3,973**	**8,173**	**9,683**	**16,790**	**24,229**
Tax	-322	-568	-1,035	-1,927	-2,671
Extraord./Min.Int./Pref.div.	2	-43	0	0	0
Reported net income	**3,653**	**7,562**	**8,648**	**14,863**	**21,558**
Adjusted earnings	3,654	7,562	8,648	14,863	21,558
Adjusted EBITDA	4,691	8,980	12,958	23,854	35,210
Growth Rates (%)					
Sales	126.5	97.7	107.9	83.6	45.0
EBIT adjusted	219.4	96.9	36.0	83.7	46.8
EBITDA adjusted	223.4	91.5	44.3	84.1	47.6
EPS adjusted	-12.8	-37.4	14.0	67.5	45.0
Cash Flow (RsM)					
Operating cash flow	**-583**	**-3,288**	**-331**	**-18,949**	**-15,435**
Depreciation/amortization	493	716	1,718	3,203	4,890
Net working capital	-4,662	-10,989	-11,691	-37,015	-41,883
Investing cash flow	**-1,855**	**-4,061**	**-18,457**	**-23,261**	**-15,800**
Capital expenditure	-1,920	-4,063	-18,377	-23,261	-15,800
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,301**	**11,320**	**46,303**	**38,971**	**21,171**
Borrowings	1,574	549	47,113	40,815	23,015
Dividends paid	-396	-1,647	-1,640	-1,844	-1,844
Change in cash	**864**	**3,970**	**27,515**	**-3,239**	**-10,064**
Balance Sheet (RsM)					
Total assets	**20,874**	**49,024**	**125,413**	**200,837**	**265,101**
Cash & cash equivalent	1,545	5,515	15,383	12,144	2,080
Accounts receivable	6,929	16,473	25,704	48,739	73,505
Net fixed assets	3,079	6,425	23,085	43,143	54,052
Total liabilities	**11,767**	**21,585**	**90,136**	**152,541**	**197,091**
Accounts payable	5,206	7,253	0	0	0
Total Debt	3,958	4,507	51,620	92,435	115,450
Shareholders' funds	**9,107**	**27,439**	**35,277**	**48,296**	**68,010**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.1	23.4	16.2	16.3	16.6
ROE adjusted	63.9	43.1	27.8	35.7	37.2
ROIC adjusted	40.5	36.1	19.2	17.7	17.1
Net debt to equity	26.5	-3.7	102.7	166.2	166.7
Total debt to capital	30.3	14.1	59.4	65.7	62.9

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Company description

Suzlon Energy Limited is the world's fifth-largest wind turbine generator (WTG) company, and the largest WTG manufacturer in India and Asia. Suzlon is a fully integrated wind power company that provides customers with consultancy, design, manufacturing, operations, and maintenance services. Suzlon has a subsidiary in Germany for technology development, an R&D facility in the Netherlands for rotor blade molding and tooling, and wind turbine and rotor blade manufacturing facilities in India. SUEL's product range includes turbines of 350kW, 600kW, 950kW, 1000kW, 1250kW, 1500kW, 2000kW, and 2100kW capacity.

Recent developments

Industry trends: According to our latest Citi Global Wind Power forecasts the average annual WTG market is set to jump to 26GW/year over the next 5 years vis-à-vis 10GW/year over the previous 5 years. Despite efforts on the part of wind turbine generator (WTG) manufacturers to meet this demand through capacity expansion, much demand might go unmet because of massive component shortages. The component bottlenecks are: gearboxes, large bearings, some of the large forged items in particular main shafts and carbon fibre for larger blades.

Results: Suzlon’s 1Q FY08 PAT of Rs189m was down 80% yoy on the back of a severe margin contraction. Reasons cited by the management were (1) rupee appreciation, (2) recruitment of people in Hansen and Suzlon 6 months in advance, (3) 1Q being a weak quarter imply lower volumes which led to fixed costs not getting properly apportioned, (4) tower problems in the US, and (5) rain in India leading to delays in domestic deliveries.

News flow & developments: At the close of the bidding war, Suzlon had a 33.85% direct stake, a 23.15% stake through Martifer and a 30.10% stake through Areva in REPower. If Areva exercises its put option after 1 year[1] Suzlon will have to fund the acquisition cost of €1.2bn over a three year period with out flows of €450m in CY07E/FY08E, €466m in CY08E/FY09E and €269m in CY09E/FY10E. This is to be funded with debt with an effective interest rate of 5.25%. By the end of CY09E Suzlon would have acquired an 87.10% stake in REPower on the payment of ~ €1.2bn which should be funded through debt at an interest cost of 5.25%. The fact that this would be staggered over a three-year period means that the acquisition would turn EPS positive from CY08E.

REPower Acquisition Transaction Structure

	Stake	Shares	Price	Euro Million	Remarks
Suzlon	7.84%	699,969	145.0	101	- Shares bought in the open market and rights issue subscribed
Suzlon	26.01%	2,322,219	150.0	348	- Shares tendered in the open offer
Areva	30.10%	2,687,381	173.4	466	- Areva has a put option to sell to Suzlon any time after 1 year. We estimate a price of Euro 173.4/share
Martifer	23.15%	2,066,873	130.0	269	- We expect Suzlon to acquire these shares after 2 years
	87.10%			1184	

Source: Citigroup Investment Research estimates

[1]We have assumed a value creation of €350mn for Areva, in line with their press release and arrived at a price of €173.4/share.

Investment thesis

We rate Suzlon shares Buy/Medium Risk (1M) in view of the following:

- Investors are largely ignoring the robust 45% CAGR in WTG volumes over FY07-10E on the back of 6.7% yoy FY07 WTG margins compression. It is pertinent to note that end FY07 EBITDA margin of 16.7% was somewhere close to the trough. We expect Suzlon + Hansen to grow FD EPS at a robust CAGR of 44% over FY07-10E which would broadly track sales CAGR of 45% over the same period.

- By the end of CY09E Suzlon would have acquired an 87.10% stake in REPower on the payment of ~ €1.2bn which should be funded through debt at an interest cost of 5.25%. The fact that this would be staggered over a three-year period means that the acquisition would turn EPS positive from CY08E.

- The REPower acquisition provides Suzlon (1) immediate access to the mature European markets, the largest WTG market in terms of absolute volumes over the next 5 years, (2) acceptance in the European markets as REPower's is viewed as a great technology company with widely accepted product portfolio, (3) Complementary product portfolio in terms high and medium capacity WTGs, (4) REPower margins are one of the lowest in the industry as it is basically an assembler. With Suzlon's vertical integration there is plenty of room to accelerate topline growth and improve margins, and (5) REPower also has a commercially proven 5MW turbine for offshore installations.

- According to our latest Citi Global Wind Power forecasts the average annual WTG market is set to jump to 26GW/year over the next 5 years vis-à-vis 10GW/year over the previous 5 years.

- Suzlon is one of the most vertically integrated WTG supplier in the world and is one of the best equipped to cash in on this huge WTG opportunity on the back of some prudent steps that it has taken.

Valuation

Our target price is Rs1,700, based on a target FY09E P/E of 23x, in line with that of global WTG majors like Vestas and Gamesa and at a 15% premium to BHEL (Given Suzlon's superior earnings growth and RoEs). It appears well supported by Suzlon + Hansen EPS CAGR of 44% and RoEs in the 30-40% range over FY07-10E.

Risks

We rate Suzlon shares Medium Risk based on a number of factors, namely: industry-specific risks, financial risk and management risks. The key downside risks which could prevent the shares from reaching our target price include higher oil prices, which would lower the attraction of renewable energy sources; withdrawal of policy support; foreign currency risk; employee retention; supply chain risks as the company expands internationally; technology obsolescence; interest rate risk; outstanding litigation, and competition.

Tata Motors (TAMO.BO)

India's Leading Auto Manufacturer

Buy/Low Risk	1L
Price (30 Aug 07)	Rs681.90
Target price	Rs1,029.00
Expected share price return	50.9%
Expected dividend yield	2.2%
Expected total return	**53.1%**
Market Cap	Rs259,141M
	US$6,335M

Price Performance (RIC: TAMO.BO, BB: TTMT IN)

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- **Dominant player in truck market** — With consolidated revenues of c.US$7bn, Tata Motors is India's leading auto manufacturer with a dominant presence in heavy and light trucks (market shares of around 63% and 65% respectively) and a healthy presence in cars and utility vehicles (an aggregate market share of 16.4%).

- **Robust new product pipeline** — TAMO has a slew of new product launches over the next 2 years – encompassing cars, UVs and trucks – to capitalize on the growth opportunities in domestic and international markets. Initiatives with Fiat and Iveco should drive long-term product development initiatives.

- **Growth-driven capex** — TAMO's overall medium-term capex plan is Rs120bn, primarily driven by new product development, and expansion in extant capacities. Cash flows over the next 2 years will remain pressured due to these initiatives. Balance sheet is forecast to remain relatively healthy.

- **Operating margins to remain constrained** — Due to escalating input cost pressures and muted heavy truck sales (which are relatively higher margin vs. cars and light trucks) operating margins will likely remain constrained. We expect heavy truck sales to pick up by end 3Q / early 4Q FY08, which will likely improve profitability into 2H FY08E.

- **Catalysts and risks** — Recovery in HCV sales and IPOs of key subsidiaries are near-term catalysts. Risk factors are margin pressures and large-scale acquisitions with attendant integration risks

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	12,474	34.48	45.9	19.6	6.0	32.4	1.8
2006A	14,023	34.60	0.3	19.5	4.7	29.1	1.9
2007E	18,412	45.43	31.3	14.9	3.9	30.0	2.2
2008E	22,523	55.57	22.3	12.2	3.1	30.0	2.4
2009E	25,411	62.69	12.8	10.8	2.6	27.7	2.5

Source: Powered by dataCentral

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	19.6	19.5	14.9	12.2	10.8
EV/EBITDA adjusted (x)	15.6	15.4	12.0	10.0	8.8
P/BV (x)	6.0	4.7	3.9	3.1	2.6
Dividend yield (%)	1.8	1.9	2.2	2.4	2.5
Per Share Data (Rs)					
EPS adjusted	34.48	34.60	45.43	55.57	62.69
EPS reported	34.19	37.72	45.43	55.57	62.69
BVPS	113.64	144.62	175.61	216.20	263.19
DPS	12.50	13.00	15.00	16.00	17.00
Profit & Loss (RsM)					
Net sales	172,597	201,695	248,581	282,985	331,010
Operating expenses	-157,591	-185,686	-227,011	-256,594	-300,074
EBIT	**15,006**	**16,009**	**21,570**	**26,390**	**30,936**
Net interest expense	-1,542	-2,264	-2,800	-2,750	-3,800
Non-operating/exceptionals	3,055	6,788	5,977	6,390	6,746
Pre-tax profit	**16,519**	**20,534**	**24,748**	**30,030**	**33,882**
Tax	-4,150	-5,245	-6,335	-7,508	-8,470
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**12,370**	**15,289**	**18,412**	**22,523**	**25,411**
Adjusted earnings	12,474	14,023	18,412	22,523	25,411
Adjusted EBITDA	15,006	16,009	21,570	26,390	30,936
Growth Rates (%)					
Sales	30.5	16.9	23.2	13.8	17.0
EBIT adjusted	3.7	6.7	34.7	22.3	17.2
EBITDA adjusted	3.7	6.7	34.7	22.3	17.2
EPS adjusted	45.9	0.3	31.3	22.3	12.8
Cash Flow (RsM)					
Operating cash flow	**2,715**	**-14,463**	**20,085**	**22,322**	**14,007**
Depreciation/amortization	0	0	0	0	0
Net working capital	-9,655	-29,752	1,673	-201	-11,404
Investing cash flow	**-7,627**	**10,470**	**9,282**	**-5,596**	**-12,582**
Capital expenditure	0	0	0	0	0
Acquisitions/disposals	1,447	8,969	1,756	0	0
Financing cash flow	**8,521**	**2,495**	**-13,077**	**-751**	**5,799**
Borrowings	12,357	4,414	-6,530	6,232	13,219
Dividends paid	-5,156	-5,678	-6,547	-6,984	-7,420
Change in cash	**3,609**	**-1,498**	**16,291**	**15,975**	**7,224**
Balance Sheet (RsM)					
Total assets	**137,729**	**162,118**	**180,475**	**210,965**	**253,263**
Cash & cash equivalent	20,050	11,194	2,800	2,925	2,916
Accounts receivable	8,113	7,158	9,354	10,626	12,414
Net fixed assets	36,965	45,212	63,368	85,449	105,901
Total liabilities	**96,615**	**106,747**	**113,239**	**128,190**	**152,497**
Accounts payable	22,697	28,385	33,876	38,243	44,607
Total Debt	24,954	29,368	22,839	29,071	42,290
Shareholders' funds	**41,114**	**55,371**	**67,236**	**82,775**	**100,767**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.7	7.9	8.7	9.3	9.3
ROE adjusted	32.4	29.1	30.0	30.0	27.7
ROIC adjusted	57.2	26.2	22.6	22.0	20.0
Net debt to equity	11.9	32.8	29.8	31.6	39.1
Total debt to capital	37.8	34.7	25.4	26.0	29.6

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Asia Pacific at CitiResearchDataServices@citigroup.com or +852-2501-2791

Company description

Tata Motors (TAMO) is one of the flagship companies of the Tata Group, India's largest business conglomerate. TAMO is the country's largest manufacturer of automobiles with a dominant position in the commercial-vehicle business. It also has a healthy presence in utility vehicles and passenger cars. The company has a broad ranging agreement with Fiat to include product design and development and also manufacturing and marketing initiatives for both cars and trucks. The promoter group holds around 33% stake in the company, FIIs hold 33% (including ADRs), whilst the remainder is held by domestic FIs and the public.

Recent developments

Industry trends: FY08 YTD commercial vehicle sales have been muted (+3% yoy), impacted by rising interest rates and the consequent lagged effect. The c10% yoy growth in LCV sales has mitigated the modest decline in MHCV sales (-3% yoy). Recent trends indicate that 12-16 ton vehicles are becoming increasingly economically unviable (as overloading is not permitted) and there is a pronounced shift toward higher tonnage (25 MT GVW) vehicles. The evolution of the hub and spoke model is also resulting in strong sales of the ACE (<1MT LCV).

Within the passenger-car segment, sub compacts continue to register healthy growth (+14% Y/Y), whilst sedans (C segment) have reported a near 20% decline in volumes due to higher interest rates, and a jaded product line-up from most manufacturers

Recent results: 1Q FY08 reported PAT at Rs4.7bn, up 22% yoy — substantially above our estimates, with F/X gains of Rs2.06bn being the key variance. Excluding these, operating result (EBITDA) was 17% lower than our expectation as the EBITDA margin compressed 290bps YoY on a weaker product mix (MHCV sales declined ~8%Y/Y) and continued input cost pressures (+220bps YoY).

News flow & developments: Tata Motors has evinced interest in purchasing the Land Rover and Jaguar brands from Ford. Media reports suggest that the deal is expected to be valued at US$1.5bn. Ford has stated that it is expected to finalize the deal by September end.

Tata Motors has also confirmed that its small car is on schedule and is expected to be launched by June 2008.

Investment thesis

We have a Buy/Low Risk rating on Tata Motors, with our positive view reflecting a) the impending spinning off of the auto-finance business (which will release substantial funds locked into the business and positively impact TTMT's return / asset turnover ratios) and b) stronger-than-expected growth in heavy trucks as the ban on overloading continues to be implemented (not as effectively as we would like, but far better than we had initially envisaged). Key reasons for a strong growth outlook in commercial vehicles include a sustained pick-up in economic activity, a focus on infrastructure spending (expected to continue with funding in place) and a strong replacement cycle (27% of the existing fleet in India is more than 15 years old and needs to be replaced both for commercial and environmental reasons). Tata Motors should also benefit from the launch of new products and international initiatives, given a competitive cost structure.

Valuation

Our 12-month target price of Rs1,029 is based on a sum-of-the-parts valuation methodology, which we believe captures the value embedded in subsidiaries and group holdings. Management has indicated its intent to unlock value (to the benefit of Tamo's existing shareholders), for either / both HV Transmissions Ltd. and HV Axles Ltd., through an IPO or strategic sale to outside parties.
We value Tata Motors' core business at Rs 827/share, which is based on 9.2x FY08E EBITDA, at the lower end of the recent trading band, and which should be comfortably supported by a 25% CAGR in EBITDA over FY06-08E. Over the past fiscal year, the EV/EBITDA multiple has ranged between 6.2-11.4x. We value the subsidiaries at Rs201/share.

Risks

We rate Tata Motors Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price are movements in economic variables — particularly GDP growth, interest rates and fuel prices, to which sales of commercial and passenger vehicles are very sensitive. Competition in the passenger-car business remains intense with the presence of most global majors in the Indian market. While the commercial vehicle business has been relatively less exposed to competition, the situation could change over the next three years with international companies eyeing the Indian market. Key upside risks to our target price include: a) Strategic sale/IPO of key subsidiaries; b) an indication that the Supreme Court ruling on overloading is being implemented over the longer term; and c) reduction in input costs (notably steel).

Buy/Low Risk	1L
Price (30 Aug 07)	Rs296.45
Target price	Rs354.00
Expected share price return	19.4%
Expected dividend yield	1.2%
Expected total return	20.6%
Market Cap	Rs121,442M
	US$2,969M

Price Performance (RIC: ZEE.BO, BB: Z IN)

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Zee Entertainment (ZEE.BO)

A New Growth Paradigm

- **Strong pay-TV growth and increase in broadcaster's share** — India's pay-TV industry is expected to grow at a 17.5% CAGR over the next 5 years to US$8.7bn, driven by rising penetration of C&S households and emergence of new distribution medium like DTH. This will arrest pay revenue leakages and increase broadcasters' share of pay revenues.

- **Ratings pick-up driving ad revenue growth** — Zee's viewer ratings continue to pick up, which is driving its advertising revenue growth (46.8% in 1Q FY08). Management has guided to over 30% ad revenue growth for FY08. According to management, all new advertising contracts are being renewed with at least 10% rate hikes.

- **Potential margin upside from new channels** — Zee is launching a new youth focused general entertainment channel, an Arabic dubbed Hindi movie channel for the Middle-East market and its sports channel in the US, while discontinuing loss making Zee Arabia channel. This could enhance margins, given that sports and movie channels will not require new investments and leverage off current content.

- **Subscription growth yet to kick in fully** — Subscription revenues grew 26.6% yoy this quarter but declined sequentially due to 1) non-payment from CAS areas and 2) lower revenues from Tata Sky (DTH player) as TRAI reduced the bouquet rate from Rs75 to Rs42 per subscriber. Subscription revenues have not yet fully kicked in and we expect significant pick-up in growth rates over the next 2-3 quarters

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	2,142	5.19	-32.5	53.9	11.0	17.9	0.3
2007A	2,411	5.55	6.8	50.5	7.2	17.6	0.2
2008E	3,987	9.17	65.4	30.5	6.4	22.2	1.3
2009E	5,130	11.80	28.7	23.7	5.8	25.6	2.1
2010E	6,232	14.34	21.5	19.5	5.1	27.8	2.6

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	53.9	50.5	30.5	23.7	19.5
EV/EBITDA adjusted (x)	49.4	37.8	21.7	16.7	13.7
P/BV (x)	11.0	7.2	6.4	5.8	5.1
Dividend yield (%)	0.3	0.2	1.3	2.1	2.6
Per Share Data (Rs)					
EPS adjusted	5.19	5.55	9.17	11.80	14.34
EPS reported	5.19	5.55	9.17	11.80	14.34
BVPS	25.48	38.87	43.62	48.51	54.49
DPS	0.74	0.54	3.65	5.93	7.24
Profit & Loss (RsM)					
Net sales	11,042	14,416	17,215	20,343	24,036
Operating expenses	-8,728	-11,451	-12,023	-13,610	-15,805
EBIT	**2,314**	**2,965**	**5,192**	**6,733**	**8,231**
Net interest expense	-131	-220	-154	-108	-75
Non-operating/exceptionals	562	630	500	500	500
Pre-tax profit	**2,745**	**3,375**	**5,538**	**7,125**	**8,656**
Tax	-603	-964	-1,551	-1,995	-2,424
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**2,142**	**2,411**	**3,987**	**5,130**	**6,232**
Adjusted earnings	2,142	2,411	3,987	5,130	6,232
Adjusted EBITDA	2,474	3,192	5,452	7,033	8,571
Growth Rates (%)					
Sales	-15.6	30.6	19.4	18.2	18.2
EBIT adjusted	-42.5	28.1	75.1	29.7	22.3
EBITDA adjusted	-43.1	29.0	70.8	29.0	21.9
EPS adjusted	-32.5	6.8	65.4	28.7	21.5
Cash Flow (RsM)					
Operating cash flow	**2,400**	**-265**	**3,710**	**3,940**	**4,009**
Depreciation/amortization	160	228	260	300	340
Net working capital	98	-2,904	-538	-1,491	-2,563
Investing cash flow	**3,237**	**-186**	**-400**	**-500**	**-500**
Capital expenditure	-400	-186	-400	-400	-400
Acquisitions/disposals	2,917	0	0	0	0
Financing cash flow	**-683**	**-4,830**	**-1,979**	**-2,756**	**-3,364**
Borrowings	-449	-4,622	-280	0	0
Dividends paid	-344	-249	-1,699	-2,756	-3,364
Change in cash	**4,954**	**-5,281**	**1,331**	**684**	**145**
Balance Sheet (RsM)					
Total assets	**20,215**	**23,054**	**27,709**	**32,270**	**36,936**
Cash & cash equivalent	1,286	255	1,412	1,905	1,779
Accounts receivable	4,855	5,848	7,250	8,824	10,695
Net fixed assets	2,171	2,129	2,269	2,369	2,429
Total liabilities	**9,247**	**5,674**	**8,215**	**10,592**	**12,661**
Accounts payable	3,108	4,130	4,909	5,780	6,806
Total Debt	4,901	280	0	0	0
Shareholders' funds	**10,967**	**17,380**	**19,494**	**21,678**	**24,275**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.4	22.1	31.7	34.6	35.7
ROE adjusted	17.9	17.6	22.2	25.6	27.8
ROIC adjusted	13.5	15.4	24.7	29.9	32.3
Net debt to equity	33.0	0.1	-7.2	-8.8	-7.3
Total debt to capital	30.9	1.6	0.0	0.0	0.0

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Company description

Zee Telefilms Limited (Zee) is India's largest vertically integrated media and entertainment company. It has an integrated range of businesses, encompassing the content-to-consumer value chain of media and entertainment business. The company owns a bouquet of channels across various genres including general entertainment, cinema, music, news and sports. Zee has been investing heavily in new businesses, including new channels and content.

Recent developments

Industry trends: We are positive on growth of Indian media sector, being driven by a strong economic growth environment, and view Zee as one of the best plays on the theme. CIR India model portfolio is 'overweight' on media owing to strong growth and operating leverage. We estimate the 2006 pay-TV market size in India was about US$2.1bn and estimate that it will grow to US$8.7n over the next 5 years, implying a CAGR of 17.5%. The key drivers for this growth are 1) Increasing number of TV households, 2) Increasing penetration of C&S TV households, 3) New distribution medium like DTH, 4) Rising ARPUs. As a leading broadcaster, Zee looks well positioned to benefit from the trend of rising pay revenue market share for broadcasters. Broadcasters share of pay TV should increase from the current 15% to 30% over next 5 years, driving a 27% CAGR in subscription revenues. CAS driven by legislation and rising penetration of DTH should curb pay revenue leakages for broadcasters. LCOs are likely to lose pay-TV market share to broadcasters, DTH operators and MSOs.

Results: Zee's 1Q FY08 net profits grew 50.8%, driven by solid top-line growth of 35.3% and EBITDA margin expansion of 750bps to 30.6%. Its advertising revenues grew strong 46.8% yoy in 1Q FY08, and even after stripping off the impact of Ten Sports acquisition and Zee Cine awards, we estimate that ad-revenues would have grown by 24%. Zee's viewer ratings continue to improve and its gap with the leader Star TV has narrowed considerably. Over the last 2 years, its number of programs in the top-100 has increased from just 2 to 26. While subscription revenue growth has picked up considerably over the last few quarters, the story is yet to unfold completely. In 1Q FY08, Zee's subscription revenues increased 26.6% yoy, though they declined sequentially. We estimate subscription revenues for broadcasters to increase from US$500m in 2006 to US$2.2bn by 2010, implying a CAGR of 27.3%. Even if Zee were to maintain its market share of pay revenues, its domestic pay revenues are likely to grow at similar rates over next 4 years. Broadcasting business inherently has strong operating leverage and we believe that Zee's margins will continue to expand, driven by strong top-line growth.

News flow & developments: Zee is looking to launch a new youth focused general entertainment channel. We believe that there is scope for Zee to successfully launch a second general entertainment channel, with differentiated programming. Currently, Zee's flagship channel Zee TV is focused on family oriented soaps during its prime time programming. A new general entertainment channel could be positioned with differentiated content like talk shows, soaps with more contemporary themes and reality TV, which can potentially attract new audience without compromising on the viewership of the flagship channel. According to Zee management, the new general entertainment channel is likely to be launched in January 2008 and launch-related expenses are unlikely to have a material impact on margins. Zee is also planning to launch a new movie channel for the Middle East market, which will showcase Hindi films dubbed into Arabic. It is also launching its sports channel in the US through the DISH

TV platform. Zee is also closing down its loss-making Zee Arabia channel, which should be positive for margins.

Investment thesis

We rate Zee as Buy/Low Risk (1L). We view the recent restructuring by Zee in which the company has split its business into four entities as positive because this has added focus to the business and allays our concerns related to Zee's investment in DTH, which we believe would have strained Zee's balance sheet and diverted the focus away from the core broadcasting business. Additionally, Zee looks well positioned to benefit from the rising share of broadcasters in the rapidly increasing pay revenue stream. Zee's viewer ratings are also rising, which is expected to drive advertising revenue growth of over 20%. Strong revenues and margin expansion are likely to drive 37% EPS CAGR over the next 3 years.

Valuation

We are valuing Zee on a P/E multiple. We believe that P/E is the appropriate valuation methodology, given Zee's stable earnings stream and low capital intensity of the business. We use a 30x P/E multiple which returns a value of Rs354 per share. Our 30x target multiple is at the higher end of the historical trading average, which we believe is warranted given that fundamentals are looking up as channel ratings are improving. Our target multiple of 30x factors in: a) an improving EPS growth profile due to a pickup in advertising and pay revenues; b) higher ROE and free cash flow profile of Zee on account of de-merger of distribution businesses; and c) maintaining a relative premium to the Sensex.

Risks

We believe that with the restructuring, the business will become more transparent and that the execution risk on DTH will be mitigated. As such, our Low Risk rating is consistent with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The following factors could negatively affect earnings and investor sentiment: an economic slowdown, which could result in a decline in advertising growth rates; the loss of channel ratings; change in regulatory environment curbing pay revenue growth; slower than expected growth of CAS and DTH; and an increase in competitive activity resulting in higher costs and margin contraction. Any of these risks could impede the stock from reaching our target price.

Appendix A-1

Analyst Certification

I, Ratnesh Kumar, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).
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