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Update

Oil & Natural Gas Corporation, Oil India: Gas price increase may be around the corner

ITC: Taxation fears create buying opportunity

LIC Housing Finance: Business environment remains strong; retain ADD

News Round-up

- ▶ Bharti Airtel (BHARTI IN) has lined up funds aggregating US\$9 bn from a string of foreign & local banks for its proposed acquisition of the African assets of Kuwait based Zain Telecom, as it settles to finance the entire deal through debt in the first phase, a move which may not place any undue strain on the Indian telecom balance sheet. (ET)
- ▶ Shree Renuka Sugars (SHRS IN) has signed an agreement with Brazilian conglomerate Grupo Equipav to buy a controlling 50.79% in Equipav A ACUCAR e ALCOOL (Equipav) for US\$329 mn. (BS)
- ▶ M&M (MM IN) is looking to expand its pre-owned vehicles business with plans to sell 100,000 units every year by 2015, for which it will ramp up its outlets by over four-fold. (BS)
- ▶ Ambuja Cements (ACEM IN) plans to spend around US\$760.87mn to expand its capacity to 24 mn tonnes from current 19mt by year end to meet strong demand from the infrastructure sector. (ET)
- ▶ Reliance (RIL IN) may increase bid for Lyondell. The new offer will include cash and stock options for shareholders and creditors. (BS)
- ▶ Supreme Court notice to Reliance Ind (RIL IN). Essar on petro board's powers of control fuel prices, asks board not to pass any final order on Reliance Ind appeal. (FE)
- ▶ The government is likely to sell its 330 mn shares in mining major NMDC next month through a price band of INR 415-430 a share and dump the auction route adopted in the case of two power PSUs, NTPC and REC. (BS)
- ▶ United Spirits (UNSP IN) enters non-alcoholic drinks category with Romanov. (BS)
- ▶ HDFC Bank (HDFCB IN) hikes fixed deposit rates by up to 150bps across maturities a move that follows the CRR hike of 0.75% by RBI last month. (ET)
- ▶ Coal India Ltd plans to file the draft red herring prospectus with SEBI for its initial public offer by June. The IPO is expected to hit the market in August. (BL)
- ▶ The Godrej group is ready to buy the 51% stake owned by Sara Lee Ltd. (BL)
- ▶ An expert environment committee has given its approval to JSW's (JSW IN) 1200-MW coal based thermal power project in the ecologically sensitive area of Jaigarh. (BL)

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

EQUITY MARKETS

India	Change %			
	19-Feb	1-day	1-mo	3-mo
Sensex	16,192	(0.8)	(4.0)	(4.9)
Nifty	4,845	(0.9)	(3.8)	(4.1)
Global/Regional indices				
Dow Jones	10,402	0.1	2.3	0.8
Nasdaq Composite	2,244	0.1	1.7	4.6
FTSE	5,358	0.6	1.0	2.0
Nikkie	10,434	3.1	(1.5)	9.9
Hang Seng	20,408	2.6	(1.5)	(9.1)
KOSPI	1,627	2.1	(3.4)	0.4
Value traded - India				
Cash (NSE+BSE)	155.9		191.7	108.6
Derivatives (NSE)	927.2		634.4	790
Deri. open interest	1,232.8		1,161	1,126

Forex/money market

	Change, basis points			
	19-Feb	1-day	1-mo	3-mo
Rs/US\$	46.0	(34)	(20)	(51)
10yr govt bond, %	7.9	-	24	64
Net investment (US\$m)				
	18-Feb		MTD	CYTD
FIs	(6)		(80)	(230)
MFs	(29)		(9)	(282)

Top movers -3mo basis

Best performers	Change, %			
	19-Feb	1-day	1-mo	3-mo
MSEZ IN Equity	655.3	(1.9)	6.5	22.4
ACEM IN Equity	105.5	(1.0)	(0.2)	21.2
BJAUT IN Equity	1806.6	(0.3)	1.1	20.4
ADE IN Equity	494.5	(1.9)	6.7	19.7
SIEM IN Equity	669.6	(1.1)	6.4	19.1
Worst performers				
IBREL IN Equity	155.1	(6.2)	(22.1)	(31.0)
IBULL IN Equity	100.0	(2.8)	(23.3)	(25.5)
GMRI IN Equity	54.9	(1.3)	(12.7)	(19.5)
PUNJ IN Equity	173.3	(4.3)	(6.9)	(19.4)
DLFU IN Equity	303.7	0.0	(13.9)	(19.0)

FEBRUARY 22, 2010

RESULT

Coverage view: **Attractive**

Price (Rs): **2,640**

Target price (Rs): **3,000**

BSE-30: **16,192**

Higher activity levels may expand noodles category. Nestle surprised the street with >15% volume growth in 4QCY09 (led by brand investments in Maggi, in our view). Increasing competition in noodles (GSK has launched 'Foodles' in South India and likely entry of HUL) may accelerate category growth rates (similar to experience in malted food drink category). Likely return of growth in exports and lower income tax rates are upside triggers. We model 20% EPS CAGR over CY2009-11E, BUY on dips.

Company data and valuation summary

Nestle India (a)

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	3,244-1,409	EPS (Rs)	76.7	92.2	110.2
Market Cap. (Rs bn)	254.5	EPS growth (%)	30.8	20.3	19.5
Shareholding pattern (%)		P/E (X)	34.4	28.6	24.0
Promoters	61.8	Sales (Rs bn)	51.5	62.0	73.4
FIs	10.0	Net profits (Rs bn)	7.4	8.9	10.6
MFs	3.6	EBITDA (Rs bn)	10.9	12.7	14.8
Price performance (%)		EV/EBITDA (X)	23.2	19.9	17.0
Absolute	1M 3.3 3M 0.0 12M 75.5	ROE (%)	139.6	136.3	132.7
Rel. to BSE-30	10.0 3.4 (2.0)	Div. Yield (%)	2.1	2.5	3.0

Sales volume surprise, we attribute it to the marketing campaign for Maggi

In 4QCY09, Nestle reported net sales of Rs13.6 bn, (+24%, KIE Rs12.8 bn), EBITDA of Rs2.4 bn (+12%, KIE Rs2.6 bn) and PAT of Rs1.7 bn (+25%, KIE Rs1.7 bn). Domestic sales grew 25% on the back of 19% sales growth in 9MICY09 and 25% growth in base. Growth drivers, in our view, are (1) successful "Taste bhi, health bhi" (flavor + health) campaign, distribution-led growth as well as launch of new variants in Maggi (Pazzta), (2) success of new SKUs in chocolate (Munch Guru pack) and (3) faster growth in coffee (likely aided by extended winter; Nestle coffee sales is skewed towards north India). Nestlé's strategy of focusing on PPP (popularly positioned products) along with LUP (low unit pricing) has likely helped the company sustain high growth rates.

Adjusted EBITDA margin declined 190 bps to 17.6% likely due to (1) higher adspends in Maggi and (2) likely higher promotional spends in view of GSK's entry into noodles category, likely entry of HUL in noodles (media reports suggest that HUL is planning to extend its soups and cooking aids brand 'Knorr' into noodles as well). Effective tax rate improved 1040 bps to 20.4%, aiding adjusted PAT growth of 25%. Reported PAT declined 7% due to actuarial losses under staff costs.

Higher activity levels may expand noodles category

Nestle holds a ~90% market share in noodles and increasing competitive activity can potentially accelerate category growth rates (effectively, market development expenses for Nestle get subsidized by competition, if Maggi is able to grow in line with category growth).

GSK Consumer has entered the instant noodles market under the brand Foodles. The multi grain variety is priced at Rs15 and the flour variety is priced at Rs10 (mostly in line with Nestle brand variants). The total instant noodle market is estimated to be about Rs10-Rs12bn and growing at about 30%. Foodles was launched in December 2009 and is presently being test marketed in South India. We keenly watch for increasing activity in one of the fastest growing culinary categories—noodles—dominated by Maggi (Nestle) and have players like Top Ramen Smoodles and Cup Noodles (Indo-Nissin), Chings Instant Noodles and Wai-Wai (Capital Foods). Media reports suggest that Hindustan Unilever is planning an entry in this segment under the Knorr brand.

QUICK NUMBERS

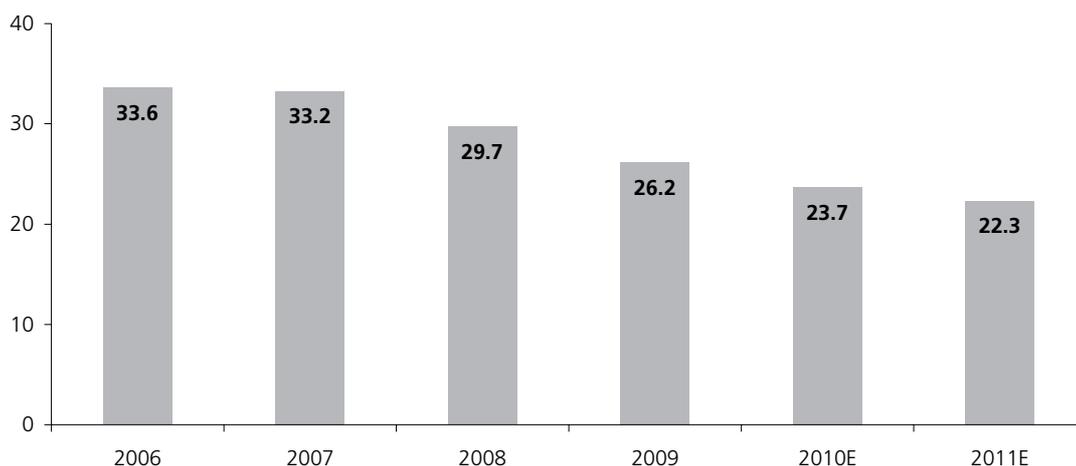
- Domestic sales growth of 25%
- Extended winter likely aided coffee growth
- Higher activity levels may expand noodles category
- Upside risk of lower effective tax rate - every one percentage point reduction in effective tax rate adds 1.3% to EPS

Every one percentage point reduction in effective tax rate adds 1.3% to EPS

Retain ADD, look for better entry points

We like the structural growth opportunity for most of Nestlé's categories, but look for better entry points into the stock. We maintain our EPS estimates of Rs92.2 and Rs110.8 for CY2010E and CY2011E, respectively. We model higher adspends in CY2010E and model an 80 bps decline in EBITDA margins. We retain our ADD rating and target price of Rs3,000. Given the strong underlying sales performance, we note that there is upside risk to our sales growth assumption of 19% CAGR over CY2009-11E. We also note that any likely increase in capacity utilization in Pantnagar facility can reduce effective tax rates (in our view, most of the incremental volumes in Maggi can be produced in Pantnagar which is a tax exempt location). We model 250 bps improvement in effective tax rate in CY2010E and 140 bps in CY2011E (on the back of 350 bps and 350 bps improvement in CY2008 and CY2009, respectively). We highlight that every one percentage point reduction in effective tax rate adds 1.3% to EPS. Key risks are (1) mix deterioration due to faster growth in low unit packs and (2) inability to pass on input cost inflation.

Likely brownfield expansion in Pantnagar and benefits of mix improvement lead to modest tax savings, in our view
Effective income tax rate of Nestle, December fiscal year -ends, 2006-2011E (%)



Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Foodles, the new instant noodle offering by GSK Consumer under the Horlicks umbrella



Source: Media reports, Kotak Institutional Equities

Interim results of Nestle, December fiscal year-ends (Rs mn)

	4QCY09	4QCY09E	4QCY08	3QCY09	(% chg)		
					4QCY09E	4QCY08	3QCY09
Net sales	13,518	12,797	10,901	13,022	6	24	4
Total expenditure	11,143	10,213	8,778	10,380	9	27	7
Material cost	6,522	6,054	5,145	6,223	8	27	5
Staff cost (adjusted)	983	990	836	974	(1)	18	1
Other expenditure (including adspends)	3,639	3,168	2,797	3,183	15	30	14
EBITDA	2,375	2,585	2,123	2,642	(8)	12	(10)
OPM (%)	17.6	20.2	19.5	20.3			
Other income	106	104	129	88	1	(18)	20
Interest	5	3	2	2		188	172
Depreciation	307	294	257	286	4	19	7
Pretax profits	2,169	2,391	1,994	2,443	(9)	9	(11)
Tax	442	673	614	659	(34)	(28)	(33)
Adjusted PAT	1,726	1,718	1,380	1,784	0	25	(3)
Extraordinaries (including actuarial loss)	(597)	-	(169)	44		253	(1,456)
Reported PAT	1,129	1,718	1,211	1,828	(34)	(7)	(38)
Income tax rate (%)	20.4	28.2	30.8	27.0			
Growth (%)							
Overall	24.0	17.4	21.7	17.6			
Domestic	25.3	18.8	25.4	18.0			
Exports	8.5	0.1	(10.1)	11.2			
Costs as a % of net sales							
Material cost	48.2	47.3	47.2	47.8			
Staff cost (adjusted)	7.3	7.7	7.7	7.5			
Other expenditure (including adspends)	26.9	24.8	25.7	24.4			

Source: Company, Kotak Institutional Equities estimates

Maggi drives growth

Performance of business divisions

Category	Sales volume (000 tons)			Sales (Rs bn)			Remarks
	9MCY08	9MCY09	Growth (%)	9MCY08	9MCY09	Growth (%)	
Milk Products & Nutrition	92	101	11	15	18	18	Sales growth primarily led by Everyday dairy whitener
Prepared Foods & Cooking Aic	94	113	20	8	10	25	Maggi noodles continues to drive growth
Beverages	18	16	(9)	5	5	-	Lower exports to Russia and South Asia
Chocolates & Confectionary	31	33	5	5	5	15	

Source: Company, Kotak Institutional Equities

Prepared dishes and cooking aids outperforms

Revenue break down (%)

	9MCY09	9MCY08
Chocolates	14	14
Prepared dishes & cooking aic	26	24
Beverages	14	16
Milk Products	46	46
Total	100	100

Source: Company, Kotak Institutional Equities

Nestle: Profit model, balance sheet, 2007-2011E, December fiscal year-ends (Rs mn)

	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)					
Net sales	35,044	43,242	51,497	61,960	73,358
EBITDA	6,963	8,637	10,753	12,477	14,618
Other income	246	322	371	421	509
Depreciation	(747)	(924)	(1,113)	(1,252)	(1,455)
Pretax profits	6,461	8,036	10,010	11,646	13,673
Tax	(2,148)	(2,387)	(2,619)	(2,755)	(3,053)
Net profits	4,313	5,649	7,390	8,891	10,620
Earnings per share (Rs)	44.7	58.6	76.7	92.2	110.2
Dividend per share (Rs)	33.0	42.5	55.6	66.9	79.9
Balance sheet (Rs mn)					
Total equity	4,184	4,733	5,852	7,197	8,804
Total borrowings	29	8	400	400	400
Current liabilities and provisions	9,865	12,208	14,015	15,964	18,354
Total liabilities and equity	14,078	16,950	20,266	23,561	27,558
Cash	1,322	2,286	4,007	4,776	5,825
Current assets	6,001	6,043	6,588	7,763	9,085
Total fixed assets	6,755	8,622	9,671	11,022	12,648
Total assets	14,078	16,950	20,266	23,561	27,558
Key assumptions					
Revenue Growth (%)	24.4	23.4	19.1	20.3	18.4
EBITDA Margin(%)	19.9	20.0	20.9	20.1	19.9
EPS Growth (%)	32.0	31.0	30.8	20.3	19.5

Source: Company, Kotak Institutional Equities estimates

FEBRUARY 19, 2010
UPDATE

Price ONGC/Oil India

(Rs): 1,110 / 1,148

Target price: ONGC/Oil India

(Rs): 1,200 / 1,150

Gas price increase may be around the corner. We see the recent government decision to increase urea prices as a step towards a long-pending increase in the price of APM natural gas. The petroleum ministry has proposed a 29% increase in the price of APM gas and will seek the cabinet's approval for the same over the next few weeks. We compute a modest positive impact on EPS of OIL (+4.8%) and ONGC (+4.6%) of the proposed price increase.

Company data and valuation summary

Oil & Natural Gas Corporation

Stock data

52-week range (Rs) (high,low) 1,278-637

Market Cap. (Rs bn) 2,373.7

Shareholding pattern (%)

Promoters 74.1

FIs 4.5

MFs 2.3

Price performance (%)

	1M	3M	12M
Absolute	(7.3)	(4.6)	63.2
Rel. to BSE-30	0.1	(1.1)	(8.8)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	90.1	107.8	133.0
EPS growth (%)	(0.8)	19.7	23.3
P/E (X)	12.3	10.3	8.3
Sales (Rs bn)	1,002.2	1,063.5	1,175.7
Net profits (Rs bn)	192.7	230.7	284.4
EBITDA (Rs bn)	465.8	515.0	580.6
EV/EBITDA (X)	4.4	3.7	3.1
ROE (%)	14.4	15.8	17.8
Div. Yield (%)	3.2	4.0	4.5

Company data and valuation summary

Oil India

Stock data

52-week range (Rs) (high,low) 0-0

Market Cap. (Rs bn) 260.8

Shareholding pattern (%)

Promoters 78.4

FIs 3.2

MFs 2.6

Price performance (%)

	1M	3M	12M
Absolute	(6.6)	(5.7)	0.0

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	110.5	111.7	116.3
EPS growth (%)	9.2	1.1	4.1
P/E (X)	10.4	10.3	9.9
Sales (Rs bn)	76.1	81.0	87.6
Net profits (Rs bn)	25.1	26.8	28.0
EBITDA (Rs bn)	44.7	51.2	56.2
EV/EBITDA (X)	3.7	3.1	2.6
ROE (%)	16.3	15.6	14.7

Price increase on urea may allow for a modest gas price increase

A 10% price increase in the selling price of urea from April 1, 2010 may allow the government more leeway to raise APM gas prices without impacting its overall subsidy burden. The petroleum ministry had recently circulated a note on increasing the APM gas price to various ministries. As per press reports, the fertilizer and power ministries have opposed an increase in natural gas prices on account of the consequent increase in subsidies on fertilizers and in the price of electricity.

Modest impact on government's subsidy burden or consumer even in the case of full deregulation

Exhibits 1 and 2 show that the impact of a full deregulation (natural gas price at Rs7.5/cu m versus Rs3.2/cu m currently) is about Rs39 bn in the case of the fertilizer sector and Rs54 bn in the case of the power sector. We see these amounts as very reasonable in the context of likely fertilizer subsidy of Rs600 bn in FY2011E and 820 bn units of power generation in FY2011E in India. The proposed price increase to Rs4.14/cu m from Rs3.2/cu m will hardly have an impact on the government's budget (Rs9 bn) or the Indian consumer, in our view.

Modest impact on EPS of OIL and ONGC of the proposed gas price increase

We compute a 4.8% and 4.6% impact on EPS of OIL and ONGC if the government raises APM natural gas price to Rs4.14/cu m from Rs3.2/cu m—as has been proposed by the petroleum ministry. However, we already model APM natural gas price at Rs4/cu m for FY2011E for both OIL and ONGC and see limited impact on our FY2011E earnings of the two companies if the government does increase natural gas prices to the proposed level of Rs4.14/cu m.

QUICK NUMBERS

- Rs9 bn impact on fertilizer subsidy of proposed gas price increase to Rs4.14/cu m
- 4.6-4.8% impact on EPS of OIL and ONGC in the case of first phase of APM natural gas price increase
- Rs20-21 impact on EPS of OIL and ONGC of full deregulation

Real impact only if and when government fully deregulates APM gas price

The petroleum ministry has proposed a roadmap for full deregulation by FY2013E through annual increases in APM natural gas price. It eventually proposes to raise the price of APM gas to US\$4.2/mn BTU, the government-approved price for gas produced from RIL's KG D-6 block. Exhibits 3 and 4 show that the EPS of both OIL and ONGC would increase by about Rs20 under a scenario of APM natural gas price of Rs7.5/cu m (US\$4.2/mn BTU).

We expect a small impact on the fertilizer sector even in case of full deregulation

Estimation of impact on fertilizer sector of a gas price increase (Rs bn)

Consumption of gas by fertilizer sector (bcm)	9
Current ceiling price of gas in India (Rs/cu m)	3.2
Likely market price after full deregulation (Rs/cu m)	7.5
Impact of gas price increase on fertilizer sector	39
Fertilizer subsidy in FY2010E	500
Impact of gas price increase/fertilizer subsidy (%)	8
Fiscal deficit in FY2010E (BE)	4,010
Impact of gas price increase/fiscal deficit (%)	1.0

Source: Kotak Institutional Equities estimates

OIL should be a big beneficiary of gas price increase in India

Impact of gas price increase on OIL's earnings (Rs)

Gas sales in FY2009 (bcm)	1.7
Average gas price in FY2009 (Rs/cu meter)	3.4
Average gas price in FY2009 (US\$/mn BTU)	2.0
Long-term delivered price of gas (US\$/mn BTU)	5.0
Pipeline tariff and royalty (US\$/mn BTU)	0.8
Average long-term wellhead price (US\$/mn BTU)	4.2
Increase in gas price (US\$/mn BTU)	2.2
Increase in pretax profits (Rs bn)	7
Pretax profits in FY2009 (Rs bn)	34
% increase in pretax profits (%)	19
Increase in post-tax profits (Rs bn)	4
Increase in EPS (Rs)	20

Source: Company, Kotak Institutional Equities estimates

We expect a small impact on the power sector even in case of full deregulation

Estimation of impact on power sector of a gas price increase (Rs bn)

Consumption of gas by power sector (bcm)	13
Current ceiling price of gas in India (Rs/cu m)	3.2
Likely market price after full deregulation (Rs/cu m)	7.5
Impact of gas price increase on power sector	54
Power generation by all power plants in FY2009 (bn units)	724
Increase in power price per unit (Rs/KWh)	0.1
Current average power selling price in India (Rs/KWh)	3.0
Increase in average consumer price (%)	2.5

Source: Kotak Institutional Equities estimates

ONGC should be a big beneficiary of gas price increase in India

Impact of gas price increase on ONGC's earnings (Rs)

Gas sales in FY2009 (bcm)	20.5
Average gas price in FY2009 (Rs/cu meter)	3.9
Average gas price in FY2009 (US\$/mn BTU)	2.3
Long-term delivered price of gas (US\$/mn BTU)	5.0
Pipeline tariff and royalty (US\$/mn BTU)	0.8
Average long-term wellhead price (US\$/mn BTU)	4.2
Increase in gas price (US\$/mn BTU)	1.9
Increase in pretax profits (Rs bn)	67
Pretax profits in FY2009 (Rs bn)	310
% increase in pretax profits (%)	22
Increase in post-tax profits (Rs bn)	44
Increase in EPS (Rs)	21

Source: Company, Kotak Institutional Equities estimates

Key assumptions for Oil India, March fiscal year-ends, 2006-2012E

	2006	2007	2008	2009	2010E	2011E	2012E
Rs/US\$ rate	44.3	45.3	40.3	45.8	47.3	46.0	46.0
Subsidy share scheme loss (Rs mn)	9,775	19,938	23,051	30,233	17,818	19,500	26,250
Import tariff on crude oil (%)	5.1	5.1	5.2	0.9	—	—	—
Crude/natural gas prices							
Crude price							
Crude price, Bonny Light (US\$/bbl)	57.2	64.8	78.9	83.0	67.5	70.0	75.0
Net crude price, OIL-India (US\$/bbl)	49.7	47.9	60.9	56.2	53.4	54.7	55.0
Natural gas price							
Ceiling natural gas price, India (Rs/cu m)	3.52	3.20	3.20	3.20	3.20	4.00	4.50
Ceiling natural gas price, India (US\$/mn BTU)	2.12	1.89	2.12	1.87	1.81	2.32	2.61
Net natural gas price, OIL-India (Rs/cu m)	3.16	2.88	2.88	2.88	2.88	3.60	4.05
Net natural gas price, OIL-India (US\$/mn BTU)	1.91	1.70	1.91	1.68	1.63	2.09	2.35
Sales volumes—Domestic fields							
Crude oil (mn tons)	3.1	3.0	3.0	3.4	3.7	3.8	3.9
Natural gas (bcm)	1.7	1.8	1.8	1.7	1.9	2.2	2.9
Total sales (mn toe)	4.7	4.6	4.7	4.9	5.4	5.8	6.5
Total sales (mn boe)	34	34	34	36	39	42	48
Crude oil (%)	67	66	65	68	68	66	60
Natural gas (%)	33	34	35	32	32	34	40

Source: Company, Kotak Institutional Equities estimates

Key assumptions for ONGC, March fiscal year-ends, 2006-2012E

	2006	2007	2008	2009	2010E	2011E	2012E
Macro assumptions							
Rs/US\$ rate	44.3	45.3	40.3	45.8	47.3	46.0	46.0
Subsidy share scheme loss (Rs bn)	119.6	170.2	220.0	282.3	129.2	138.7	178.7
Import tariff on crude oil (%)	5.1	5.1	5.2	0.9	—	—	—
Pricing and volumes assumptions							
Crude price							
Crude price, Bonny Light (US\$/bbl)	57.2	64.8	78.9	83.0	67.5	70.0	75.0
Net crude price, ONGC-India (US\$/bbl)	43.8	46.1	54.2	51.2	50.8	51.8	52.0
Natural gas price							
Ceiling natural gas price, India (Rs/cu m)	3.52	3.20	3.20	3.20	3.20	4.00	4.50
Ceiling natural gas price, India (US\$/mn BTU)	2.12	1.89	2.12	1.87	1.81	2.32	2.61
International operations							
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.1	3.2	2.8	3.2	3.3	3.2	3.2
Net crude price, OVL-Sudan (Rs/ton)	8,118	9,384	10,142	12,136	10,212	10,294	11,021
Net crude price, OVL-Russia (Rs/ton)	8,320	9,633	10,434	12,493	10,488	10,578	11,333
Sales volumes—Domestic fields (a)							
Crude oil (mn tons)	22.5	24.4	24.1	22.9	22.7	24.1	25.4
Natural gas (bcm)	20.5	20.3	20.4	20.5	20.7	20.4	19.9
Sales volumes—Overseas fields							
Crude oil (mn tons)	4.6	5.8	6.8	5.8	5.3	6.0	6.7
Natural gas (bcm)	1.8	2.1	2.0	2.2	2.7	2.9	2.9
Total sales							
Crude oil (mn tons)	27.0	30.2	30.9	28.7	28.1	30.1	32.1
Natural gas (bcm)	22.3	22.5	22.4	22.8	23.4	23.3	22.8
Total sales (mn toe)	46.9	50.3	50.9	49.0	48.9	50.9	52.4
Total sales (mn boe)	342	367	372	358	357	371	383
Crude oil (%)	58	60	61	59	57	59	61
Natural gas (%)	42	40	39	41	43	41	39

(a) Includes ONGC's share of production from joint venture fields.

Source: Company, Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of OIL, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	55,502	53,892	60,819	72,414	76,082	80,982	87,570
EBITDA	26,554	22,292	23,852	28,339	37,142	41,001	45,417
Other income	3,639	5,335	6,770	9,372	7,575	10,175	10,825
Interest	(152)	(151)	(383)	(26)	(38)	(24)	(9)
Depreciation and depletion	(3,314)	(2,595)	(3,093)	(3,768)	(6,654)	(10,480)	(13,877)
Pretax profits	26,728	24,881	27,145	33,916	38,024	40,673	42,357
Tax	(9,347)	(7,406)	(8,538)	(11,910)	(12,739)	(13,691)	(14,427)
Deferred tax	(498)	(1,020)	(707)	(343)	(185)	(134)	30
Net profits	16,883	16,454	17,901	21,663	25,100	26,848	27,960
Earnings per share (Rs)	78.9	76.9	83.6	101.2	110.5	111.7	116.3
Balance sheet (Rs mn)							
Total equity	58,483	68,491	79,330	93,310	136,336	152,653	169,644
Deferred tax liability	7,013	8,033	8,655	8,998	9,184	9,317	9,287
Liability for abandonment cost	10	11	11	15	15	15	15
Total borrowings	3,341	8,140	1,749	565	375	213	—
Current liabilities	11,668	10,320	17,541	30,914	30,171	30,625	31,100
Total liabilities and equity	80,515	94,995	107,286	133,801	176,080	192,823	210,046
Cash	31,015	32,757	42,808	60,700	90,632	98,458	108,352
Current assets	14,540	22,350	18,957	22,853	24,755	25,652	26,859
Total fixed assets	30,658	35,813	40,633	45,361	55,807	63,825	69,948
Investments	4,302	4,075	4,887	4,887	4,887	4,887	4,887
Deferred expenditure	—	—	—	—	—	—	—
Total assets	80,515	94,995	107,286	133,801	176,080	192,823	210,046
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	19,843	18,357	20,104	27,246	22,115	23,287	24,982
Working capital changes	5,884	(8,696)	7,435	2,368	(2,644)	(443)	(732)
Capital expenditure	(6,108)	(9,370)	(9,492)	(8,496)	(14,851)	(14,498)	(14,000)
Investments	(2,482)	226	(811)	—	—	—	—
Other income	1,670	2,892	4,214	5,470	7,575	10,175	10,825
Free cash flow	18,807	3,409	21,450	26,587	12,195	18,521	21,074
Ratios (%)							
Debt/equity	5.7	11.9	2.2	0.6	0.3	0.1	—
Net debt/equity	(33.1)	(32.8)	(31.9)	(31.9)	(44.3)	(44.4)	(45.5)
RoAE	28.1	23.2	21.8	22.8	20.3	17.5	16.4
RoACE	28.0	23.0	21.5	22.7	20.2	17.5	16.4
Key assumptions							
Rs/dollar rate	44.3	45.3	40.3	45.8	47.3	46.0	46.0
Crude fob price (US\$/bbl)	57.2	64.8	78.9	83.0	67.5	70.0	75.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,200	4,000	4,500
Subsidy loss (Rs bn)	9.8	19.9	23.1	30.2	17.8	19.5	26.3

Source: Company, Kotak Institutional Equities estimates

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

	2006	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	807,603	966,542	1,091,644	1,200,176	1,002,197	1,063,509	1,175,703
EBITDA	310,054	358,001	407,790	419,527	430,280	464,288	513,470
Other income	27,350	45,378	53,565	56,197	35,529	50,742	67,125
Interest	(537)	394	(12,027)	(11,442)	(3,531)	(352)	(2,346)
Depreciation and depletion	(97,726)	(119,550)	(138,624)	(153,985)	(168,665)	(171,214)	(160,478)
Pretax profits	239,141	284,222	310,705	310,298	293,613	343,463	417,771
Tax	(71,196)	(88,986)	(102,908)	(111,333)	(95,008)	(111,074)	(123,906)
Deferred tax	(13,612)	(9,264)	(6,471)	(3,495)	(3,275)	609	(6,581)
Net profits	154,596	178,414	203,076	201,292	195,330	232,998	287,285
Net profits after minority interests	153,542	176,922	199,466	197,908	192,728	230,654	284,448
Earnings per share (Rs)	71.8	82.7	93.3	92.5	90.1	107.8	133.0
Balance sheet (Rs mn)							
Total equity	578,830	670,137	786,657	929,353	1,030,385	1,148,001	1,302,854
Deferred tax liability	71,557	80,976	87,227	92,076	95,352	94,743	101,324
Liability for abandonment cost	128,675	151,857	129,325	171,451	171,451	171,451	171,451
Total borrowings	28,767	21,826	22,039	73,633	23,377	40,224	114,124
Current liabilities	142,435	187,051	251,797	293,480	279,985	294,567	310,923
Total liabilities and equity	950,264	1,111,847	1,277,045	1,559,994	1,600,551	1,748,986	2,000,676
Cash	90,743	206,262	249,807	224,671	312,178	482,057	663,061
Current assets	240,210	192,652	257,384	309,494	259,814	269,421	285,440
Total fixed assets	565,722	643,219	695,227	871,287	869,079	833,089	887,754
Goodwill	14,172	27,686	22,847	111,108	111,108	111,108	111,108
Investments	35,753	36,888	45,041	36,926	41,866	46,806	46,806
Deferred expenditure	3,663	5,141	6,739	6,506	6,506	6,506	6,506
Total assets	950,264	1,111,848	1,277,045	1,559,994	1,600,552	1,748,987	2,000,676
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	216,736	252,772	284,517	274,321	244,876	289,153	317,210
Working capital changes	46,461	(4,990)	(24,929)	(109,306)	27,106	158,040	336
Capital expenditure	(113,738)	(135,049)	(166,427)	(208,137)	(82,265)	(75,767)	(150,909)
Investments	(28,912)	53,822	(7,348)	(92,159)	(4,940)	—	—
Other income	14,537	20,422	22,822	31,612	35,529	50,742	67,125
Free cash flow	135,083	186,976	108,636	(103,668)	220,306	422,168	233,762
Ratios (%)							
Debt/equity	5.0	3.3	2.8	7.9	2.3	3.5	8.8
Net debt/equity	(10.7)	(27.5)	(29.0)	(16.3)	(28.0)	(38.5)	(42.1)
RoAE	25.9	25.5	24.8	21.2	18.2	19.8	21.8
RoACE	22.0	22.1	21.9	18.5	15.9	17.2	19.3
Key assumptions							
Rs/dollar rate	44.3	45.3	40.3	45.8	47.3	46.0	46.0
Crude fob price (US\$/bbl)	57.2	64.8	78.9	83.0	67.5	70.0	75.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,200	4,000	4,500
Subsidy loss (Rs bn)	119.6	170.2	220.0	282.3	129.2	138.7	178.7

Source: Company, Kotak Institutional Equities estimates

FEBRUARY 22, 2010
UPDATE

Coverage view: **Attractive**

Price (Rs): **249**

Target price (Rs): **300**

BSE-30: **16,192**

Taxation fears create buying opportunity. We highlight that the all non-cigarette businesses of ITC will likely contribute positively to incremental profit growth in FY2011E. In the past three years, the cigarette business, in our view, cross-subsidized the other businesses (and hence, higher price increases in cigarettes) to manage company-level profit growth. Taxation worries notwithstanding, we believe there is reasonable headroom for price hikes. The stock trades at 19X FY2011E EPS, BUY.

Company data and valuation summary

ITC					
Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	271-156	EPS (Rs)	10.7	13.0	14.7
Market Cap. (Rs bn)	936.5	EPS growth (%)	23.1	21.5	13.2
Shareholding pattern (%)		P/E (X)	23.3	19.2	17.0
Promoters	0.0	Sales (Rs bn)	172.1	198.0	228.4
FIs	13.1	Net profits (Rs bn)	40.2	48.8	55.2
MFs	3.6	EBITDA (Rs bn)	63.5	74.8	85.8
Price performance (%)		EV/EBITDA (X)	14.1	11.9	10.2
Absolute	1M 3M 12M	ROE (%)	27.2	28.7	28.1
	(0.6) (3.2) 37.3	Div. Yield (%)	1.8	2.2	2.4
Rel. to BSE-30	6.4 0.4 (23.3)				

We address four fears amongst investors regarding ITC. We find that ITC has reasonable pricing power to manage the worst-case (VAT of 20% *plus* excise increase of 10%). We highlight two likely positive triggers of (1) all non-cigarette businesses contributing to incremental profit growth in FY2011E and (2) potential for reintroduction of Re1 price point.

Fear #1: All States will increase VAT to 20%

Valid. We believe that the probability of all states increasing VAT on cigarettes to 20% during FY2011E is high. However, contrary to street perception, we believe the impact is likely to be about 3-4% during FY2011E for two reasons, (1) the effective VAT rate for ITC is ~14%, hence the increase, in the worst case, is 6%, (2) typically, VAT rates are increased in state budgets (hence, the effective increase during FY2011E is likely to be ~4%).

Fear #2: Excise rates will increase in Central budget

ITC would need to effect a price increase of 5% in the event of a 10% excise increase in the central budget. We expect an increase in applicable excise rates given the reprieve in the Union budget of July 2009. We continue to believe that coinage prices settling at a higher level provide additional pricing power to the cigarette industry (this was demonstrated by the company in the recent price increase in Gold Flake Kings—prices were increased to Rs47/pack of 10 from Rs44, retail prices remain the same at Rs5/stick) and about 30% of the portfolio have not seen price increases for over two years now, including key brands like Wills Navy cut, Scissors etc.

QUICK NUMBERS

- All non-cigarette businesses likely contribute to incremental profit growth in FY2011E
- Cumulative price increase of 9% (bear case) would be required in FY2011E, in our view
- Potential for reintroduction of Re1 price point

Fear #3: GST—impact of which is yet to be assessed

Our discussion with industry experts suggests that continuation of the current specified duty structure (under Cenvat) is likely under the GST regime when it is implemented. The White Paper on GST states that tobacco products would be subjected to GST with input tax credit. The Centre may be allowed to levy excise duties on tobacco products over and above GST without input tax credit. The White Paper proposes subsuming nine indirect taxes currently levied by the Centre and six indirect taxes currently levied by the State. The White Paper, however, remains silent on the proposed rates under the new regime. While the street waits for clarity on GST (as we do), we highlight that indirect tax as a proportion of retail price is already at 58% in India—one of the highest amongst developed and developing nations.

Fear #4: Cigarette business highly sensitivity to price hike

Valid. However, price increases of ~6% per annum are manageable without hurting volumes, in our view. Predictability is preferred by the industry so that price increases can be calibrated over a period of time without hurting consumption and hence volumes. The key challenge which the industry faces is a dip in volumes for a quarter or two when disproportionate price increases are undertaken (volumes typically come back after a quarter or two, given the nature of the product).

Therefore, cumulative price increase of 9% (bear case) would be required in FY2011E, in our view – (1) 4% price increase assuming all States increase VAT to 20% and (2) 5% price increase assuming an excise rate hike of 10%. We highlight that mix improvement likely provides 1-2% pricing benefit as well. Hence, net price increase of about 8%, which is manageable, in our view.

Positive trigger #1

All non-cigarette businesses contribute to incremental profit growth in FY2011E

We highlight that all the non-cigarette businesses contribute to incremental profit growth in FY2011E. In the past three years, cigarette business, in our view, cross subsidized the other businesses (and hence higher price increases in cigarettes) to manage the overall profit growth. FMCG losses are expected to be lower in FY2011E, the hotels business is seeing a rebound in demand, paper business will likely derive full benefits of backward integration and focus on value in agri business augurs well for profitability.

Positive trigger #2

Potential for a reintroduction of Re1 price point exists

According to ITC, the vacuum created by the exit of the popular low priced micros and plain non-filter cigarettes (in the wake of the heavy imposition of excise duties last year) has been occupied by duty-evaded illegal regular size filter cigarettes which are sold at Re1 per stick. According to ITC, these low priced tax-evaded illegal cigarettes account for about 12-13% of cigarette industry today (~5% in 1HCY08). The industry has asked the government to consider the introduction of a new tax slab that would enable them to offer the consumer tax-paid cigarettes at this price point (we recall that Cenvat to be paid to manufacture any cigarette in India is Rs0.84). This proposal, if accepted and implemented, augurs well for significant uptick in cigarette industry volume growth, in our view.

Stock trades at 19X FY2011E EPS, BUY. Any unexpected increase or change in taxation pose a risk to our BUY rating.

All non-cigarette businesses contribute to incremental profit growth in FY2011E

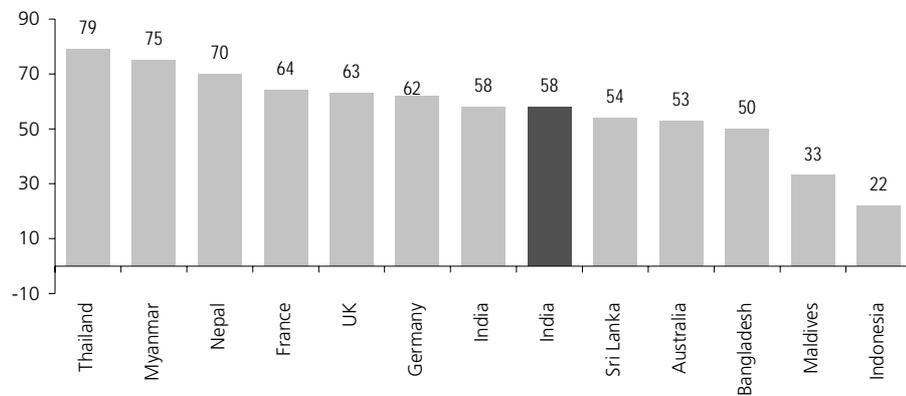
Contribution of various business divisions in absolute incremental profit growth, March fiscal year-ends (%)

	2005	2006	2007	2008	2009	2010E	2011E	2012E
Cigarettes	64	64	74	74	132	132	74	73
Other FMCG	(5)	(5)	(5)	(5)	(53)	(53)	8	4
Hotels	27	27	15	15	(23)	(23)	10	5
Agri Business	2	2	5	5	30	30	2	6
Paperboards, I	13	13	10	10	13	13	6	12

Source: Company, Kotak Institutional Equities estimates

India already have a penal taxation regime for cigarettes

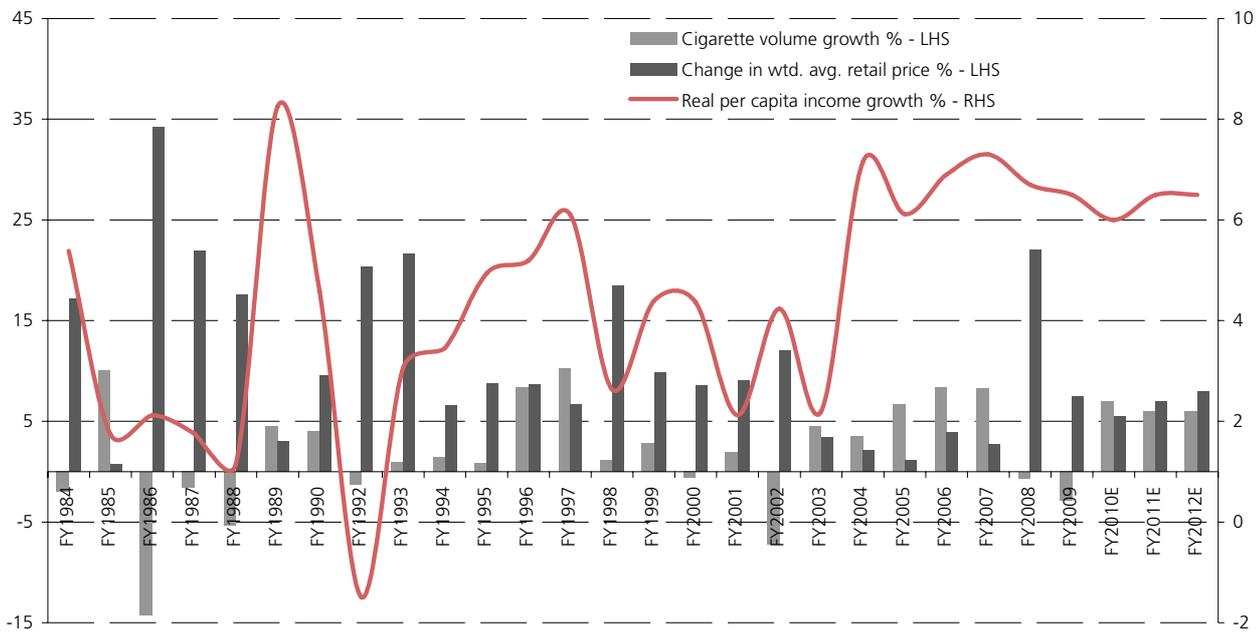
Indirect taxes as a % of cigarette prices across various countries



Source: Kotak Institutional Equities

Cigarette volumes likely to grow due to sustaining real per capita income growth

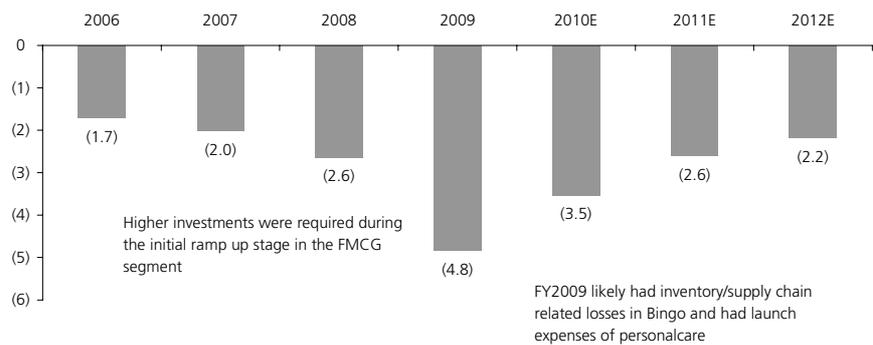
Cigarette volumes growth, average retail price increase and real per capita income growth (%)



Source: Company, Kotak Institutional Equities estimates

We expect improvement in FMCG losses

FMCG losses, March fiscal year-ends, 2006-2012E (Rs mn)



Source: Kotak Institutional Equities

ITC: Segment revenue and PBIT, 2006-2011E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Segment revenue, gross (Rs mn)							
Cigarettes	113,297	128,337	138,256	151,151	172,733	194,936	220,435
Other FMCG	10,135	17,044	25,231	30,140	34,382	40,144	46,628
Hotels	7,834	9,857	11,002	10,203	9,151	10,740	13,340
Agri Business	26,784	36,914	38,998	38,460	37,842	43,469	49,747
Paperboards, Paper & Packaging	18,957	21,001	23,643	28,220	32,702	37,529	44,326
TOTAL	177,007	213,152	237,131	258,173	286,811	326,818	374,477
Less: Inter segment revenue	14,763	18,101	23,137	26,738	30,764	36,449	42,333
Gross sales	162,244	195,051	213,994	231,435	256,047	290,369	332,144
Net sales	97,905	123,693	140,012	153,881	172,098	198,025	228,396
Segment revenue break up, (%)							
Cigarettes	69.8	65.8	64.6	65.3	67.5	67.1	66.4
Other FMCG	6.2	8.7	11.8	13.0	13.4	13.8	14.0
Hotels	4.8	5.1	5.1	4.4	3.6	3.7	4.0
Agri Business	16.5	18.9	18.2	16.6	14.8	15.0	15.0
Paperboards, Paper & Packaging	11.7	10.8	11.0	12.2	12.8	12.9	13.3
TOTAL	109.1	109.3	110.8	111.6	112.0	112.6	112.7
Less: Inter segment revenue	9.1	9.3	10.8	11.6	12.0	12.6	12.7
Gross sales	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Segment PBIT margins (Rs mn)							
Cigarettes	27,088	31,722	36,340	41,838	49,733	58,086	66,068
Other FMCG	(1,718)	(2,020)	(2,635)	(4,835)	(3,538)	(2,607)	(2,175)
Hotels	2,581	3,508	4,108	3,162	1,743	2,909	3,422
Agri Business	909	1,236	1,292	2,562	4,530	4,704	5,410
Paperboards, Paper & Packaging	3,514	4,168	4,531	5,086	7,085	7,804	9,117
TOTAL	32,373	38,613	43,636	47,813	59,553	70,896	81,843
Segment PBIT margins (%)							
Cigarettes	23.9	24.7	26.3	27.7	28.8	29.8	30.0
Other FMCG	(17.0)	(11.9)	(10.4)	(16.0)	(10.3)	(6.5)	(4.7)
Hotels	32.9	35.6	37.3	31.0	19.0	27.1	25.7
Agri Business	3.4	3.3	3.3	6.7	12.0	10.8	10.9
Paperboards, Paper & Packaging	18.5	19.8	19.2	18.0	21.7	20.8	20.6
TOTAL	18.3	18.1	18.4	18.5	20.8	21.7	21.9

Source: Company, Kotak Institutional Equities estimates

ITC: Segment revenue, 2006-2011E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Segment revenue, gross (Rs mn)							
Cigarettes	113,297	128,337	138,256	151,151	172,733	194,936	220,435
Other FMCG	10,135	17,044	25,231	30,140	34,382	40,144	46,628
Hotels	7,834	9,857	11,002	10,203	9,151	10,740	13,340
Agri Business	26,784	36,914	38,998	38,460	37,842	43,469	49,747
Paperboards, Paper & Packaging	18,957	21,001	23,643	28,220	32,702	37,529	44,326
TOTAL	177,007	213,152	237,131	258,173	286,811	326,818	374,477
Less: Inter segment revenue	14,763	18,101	23,137	26,738	30,764	36,449	42,333
Gross sales	162,244	195,051	213,994	231,435	256,047	290,369	332,144
Net sales	97,905	123,693	140,012	153,881	172,098	198,025	228,396
Segment revenue growth, (%)							
Cigarettes		13.3	7.7	9.3	14.3	12.9	13.1
Other FMCG		68.2	48.0	19.5	14.1	16.8	16.2
Hotels		25.8	11.6	(7.3)	(10.3)	17.4	24.2
Agri Business		37.8	5.6	(1.4)	(1.6)	14.9	14.4
Paperboards, Paper & Packaging		10.8	12.6	19.4	15.9	14.8	18.1
TOTAL		20.4	11.2	8.9	11.1	13.9	14.6
Gross sales		20.2	9.7	8.2	10.6	13.4	14.4
Net sales		26.3	13.2	9.9	11.8	15.1	15.3

Source: Company, Kotak Institutional Equities estimates

ITC: Profit model, balance sheet, cash flow model 2006-2012E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	97,905	123,693	140,012	153,881	172,098	198,025	228,396
EBITDA	33,274	39,700	44,703	48,686	60,192	71,362	82,128
Other income	2,899	3,365	6,109	5,349	6,211	7,819	8,118
Interest	(158)	(169)	(173)	(284)	(511)	(591)	(698)
Depreciation	(3,323)	(3,629)	(4,385)	(5,494)	(6,188)	(7,045)	(8,303)
Extraordinary items	(63)	0	0	0	0	0	0
Pretax profits	32,629	39,267	46,255	48,258	59,705	71,545	81,245
Tax	(10,276)	(12,267)	(14,517)	(15,622)	(19,533)	(22,730)	(26,007)
Net profits	22,353	27,000	31,738	32,636	40,172	48,815	55,238
Earnings per share (Rs)	6.0	7.2	8.4	8.7	10.7	13.0	14.7
Balance sheet (Rs mn)							
Total equity	90,615	104,371	120,577	137,351	157,698	182,284	211,089
Deferred taxation liability	3,248	4,729	5,451	8,672	8,672	8,672	8,672
Total borrowings	1,197	2,009	2,144	1,776	1,776	1,776	1,776
Current liabilities	35,781	38,576	44,323	47,050	47,816	50,830	54,698
Total liabilities and equity	130,840	149,684	172,495	194,848	215,962	243,561	276,234
Cash	8,558	9,002	5,703	10,324	28,666	34,624	45,981
Current assets	43,061	53,896	64,490	71,287	71,651	78,564	85,354
Total fixed assets	44,051	56,109	72,956	84,860	87,267	101,995	116,522
Investments	35,170	30,678	29,346	28,378	28,378	28,378	28,378
Total assets	130,840	149,684	172,495	194,848	215,962	243,561	276,234
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	25,638	31,040	37,112	41,493	46,963	56,355	64,048
Working capital	(5,469)	(8,667)	(6,634)	(4,977)	1,722	(2,784)	(1,058)
Capital expenditure	(6,013)	(15,702)	(21,239)	(17,407)	(8,605)	(21,783)	(22,840)
Investments	3,577	4,492	1,332	968	0	0	0
Free cash flow	17,734	11,164	10,570	20,077	40,081	31,788	40,151
Key ratios (%)							
Sales growth	28.2	26.3	13.2	9.9	11.8	15.1	15.3
EBITDA margin	34.0	32.1	31.9	31.6	35.0	36.0	36.0
EPS growth	28.3	20.1	17.1	2.8	23.1	21.5	13.2

Source: Company, Kotak Institutional Equities estimates

FEBRUARY 22, 2010

UPDATE

Coverage view: **Attractive**

Price (Rs): **743**

Target price (Rs): **925**

BSE-30: **16,192**

Business environment remains strong; retain ADD. We retain our positive stance on LIC Housing Finance in the backdrop of receding fears on competition and strong demand for mortgages. We believe LICHF is well placed to face the proposed regulatory developments—bank lending linked to base rate (versus PLR) and a common lending rate for existing and new customers of housing loans. We retain our ADD rating with a price target of Rs925 (24% upside).

Company data and valuation summary

LIC Housing Finance

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	915-178	EPS (Rs)	82.6	77.4	95.8
Market Cap. (Rs bn)	63.2	EPS growth (%)	39.8	(6.2)	23.7
Shareholding pattern (%)		P/E (X)	9.0	9.6	7.8
Promoters	36.5	NII (Rs bn)	9.1	11.3	14.4
FIs	32.7	Net profits (Rs bn)	7.4	7.4	9.1
MFs	12.6	BVPS	345.6	395.9	463.9
Price performance (%)		P/B (X)	2.2	1.9	1.6
Absolute	1M (6.8) 3M (13.6) 12M 263.9	ROE (%)	26.2	19.8	21.1
Rel. to BSE-30	(2.7) (8.3) 98.8	Div. Yield (%)	2.3	2.3	2.8

Competitive pressures easing

HDFC and Axis Bank have recently announced that a discontinuance of their discounted home loan schemes. A sharp rise in CRR (up 75 bps) in the recent credit policy indicating a tightening interest rate scenario is likely the key reason for these companies to end these schemes. As such, competitive pressures—the key risk housing finance, are now peaking out. Incrementally, banks will need to get much more rational in loan pricing as they shift to the base rate system (from PLR) which makes loan pricing much more transparent.

Interest rate risk in the horizon, LICHF better placed

We believe the borrowings cost for bulk borrowers like LICHF will move up as interest rates begin to rise; we are modeling a marginal yoy decline in LICHF's spread in FY2011E. The ability of LICHF to pass on the rise in interest rates to its customers and maintain healthy spreads will be crucial to maintain its earnings momentum. Two key arguments in favor of LICHF:

- ▶ LICHF's floating rate product (contributing to about 40-45% of its retail disbursements) offers a discount of 1% for 1-2 quarters. The company has reported high disbursements growth over the past few quarters—these loans are now getting re-priced at a higher rate, thereby supporting its margins as the disbursements growth moderates.
- ▶ LICHF has reported very strong business traction—retail disbursements up 78% and loan book up 33% in 9MFY10. We believe that its loan growth will likely remain strong at 34% in FY2010E and 30% in FY2011E due to the traction in retail business even as the managements proposes to moderate down its disbursements in favor of better margins.
- ▶ RBI's proposal to benchmark bank lending to base rate from PLR will likely increase LICHF's borrowings cost in the medium term (most high-rated bulk borrowers have been enjoying low interest rates for short-to-medium-term loans from banks due to excess liquidity in the system; the rate of interest will now move up as loan pricing becomes much more methodical for banks). However, home loan rates for banks will also likely move up—as discussed above.

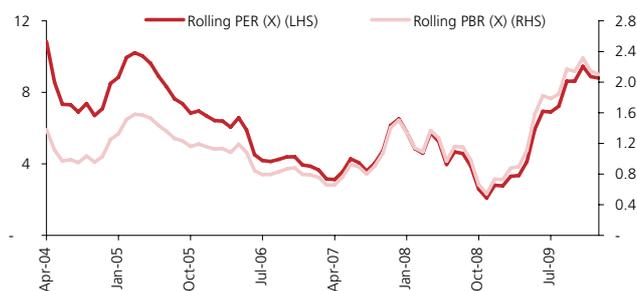
QUICK NUMBERS

- LICHF trades at 9.6X PER and 1.9X APBR for 23% core PBT CAGR in FY2010-FY2012E and RoE of 22%
- At our target price, LICHF will trade at 2.2X PBR FY2011E

- ▶ RBI has expressed concerns on differential rate of interest charged by banks / housing finance companies for new and existing customers. According to these lenders, the difference is an outcome of the variation in outstanding and incremental borrowings cost for these players. RBI has already proposed the base rate mechanism for banks in order to correct this; we believe that a similar guideline may follow for housing finance companies. Currently, the difference between the highest and lowest home loan customers of LICHF is 50 bps (excluding fixed rate loans), thus, the company is well placed in this regard.

Valuations are close to peak

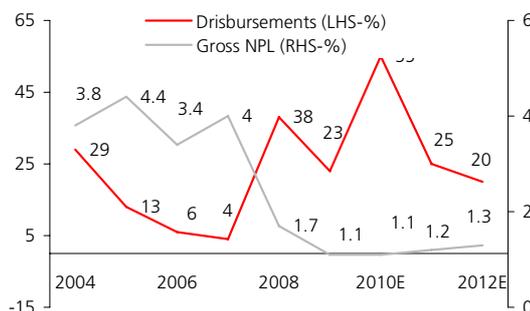
LICHF: Rolling PER and PBR, April 2004-February 2010 (X)



Source: Bloomberg, Company, Kotak Institutional Equities estimates

...so too operating performance

LICHF: Growth in disbursements (LHS) and gross NPL ratio (RHS), March fiscal year-ends, 2004-2011E (%)



Source: Company, Kotak Institutional Equities estimates

LICHF's loan growth remains high, SBI is also going strong

O/s mortgage loan book of key players, quarterly data (Rs bn)

	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
SBI (Rs bn)	506	521	541	575	624	673
QoQ growth (Rs bn)		15	20	35	49	49
YoY (%)	23	22	21	25	23	29
HDFC (Rs bn)	812	829	894	926	956	981
QoQ growth (Rs bn)		17	66	32	30	25
YoY (%)	31	24	23	20	18	18
ICICI Bank (Rs bn)	617	607	573	535	490	484
QoQ growth (Rs bn)		(10)	(33)	(39)	(45)	(6)
YoY (%)	(8)	(9)	(14)	(18)	(21)	(20)
LIC Housing Fin (Rs bn)	241	253	277	292	319	342
QoQ growth (Rs bn)		12	23	15	27	23
YoY (%)	26	26	26	28	32	35

Source: Company

Retail demand remains strong

We believe strong latent demand and improving economic outlook will likely support growth in mortgages over the medium term. Underlying momentum in the real estate sector remains strong. Prices have moved up from their bottom (in select pockets as prices are close to its peak) but the retail demand remains robust, thereby driving strong disbursements growth for the housing finance sector.

According to our real estate analysts, real estate companies under coverage have together sold 26+ mn sq. ft of residential projects in 9MFY10 compared to our estimates of 38.9 mn sq. ft in FY2010E and 14.9 mn sq. ft in FY2009. Our analysts forecast, 50% yoy growth in the revenue of real estate companies – an indication of the strong buoyancy.

Pricing movement to determine affordability—stable pricing for robust volumes

We believe that affordability will increasingly depend on price movements since the impact of a likely increase in interest rates will be offset by an increase in salaries. Affordability will likely decrease wherever prices are increased, which we believe would result in a decline in volumes. During Jan-May 2009, affordability improved 40%, leading to a sharp pick-up in demand helped by falling prices and interest rates.

Increase in affordability in FY2010E because of decline in interest rates and selling prices

Measurement of affordability of housing in India, March fiscal year-ends, 1999-2010E

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	May-09	Current
Housing loan interest rates (%)	14.5	13.9	12.8	12.1	10.4	8.9	8.0	8.5	9.5	10.5	10.5	8.50
EMI per Rs100,000 on 20 yr loan (Rs)	1,366	1,240	1,160	1,110	995	895	836	868	932	998	998	850
Avg annual household income (for households with annual income > Rs200,000)		577,201	606,061	636,364	668,182	701,591	736,671	788,238	843,414	902,453	947,576	947,576
Income growth (%)			5.0%	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	5.0%	0.0%
Taxes		115,440	121,212	127,273	133,636	140,318	147,334	157,648	168,683	180,491	142,136	142,136
Post tax income		461,761	484,849	509,091	534,546	561,273	589,337	630,590	674,731	721,963	805,439	805,439
Selling prices decline by 10% each in FY2009E and FY2010E												
Capital price in Koramangala, Bangalore		1,900	1,800	1,750	1,900	2,350	2,800	4,500	4,750	4,750	3,600	3,600
Price of 1,500 sq. ft house (Rs mn)		2.9	2.7	2.6	2.9	3.5	4.2	6.8	7.1	7.1	5.4	5.4
EMI payable assuming 70% LTV		24,738	21,924	20,396	19,850	22,084	24,578	41,013	46,484	49,775	37,724	32,130
Price/income ratio (X)		4.9	4.5	4.1	4.3	5.0	5.7	8.6	8.4	7.9	5.7	5.7
Affordability Index (assuming FY2000 as 100)		100	84	75	69	73	78	121	129	129	87	74
Capital price in Bandra, Mumbai		7,992	8,791	8,000	8,500	8,500	10,000	13,000	16,000	20,000	14,000	17,000
Affordability Index (assuming FY2000 as 100)		100	98	81	74	63	66	83	103	129	81	84

Source: RBI, Industry, Kotak Institutional Equities estimates

LICHF: Key ratios, March fiscal year-ends 2008-2012E

	2008	2009	2010E	2011E	2012E
Growth (%)					
Total assets	24	24	32	29	26
Housing loans	25	26	34	30	27
Total borrowings	24	26	32	32	28
Net income before provision	49	27	14	24	28
Fee income	9	55	50	12	12
Total expenses	19	16	14	20	20
PBT	50	37	37	(1)	25
PAT	39	37	40	(1)	24
Spread calculation (%)					
Average cost of funds	8.0	8.8	8.7	8.9	8.8
Average yield on assets	10.0	10.7	10.8	10.8	10.8
Spreads	1.9	2.0	2.1	2.0	2.0
Difference on housing loan	2.3	2.7	1.9	1.8	1.9
NIM	3.0	3.0	2.7	2.6	2.6
Other ratios (%)					
Tax rate	27	27	25	26	26
Debt/equity (X)	11	12	10	11	12
Total expenses/assets	0.6	0.5	0.5	0.4	0.4
Total expenses/total income	20	18	17	17	16
Divd payout ratio	22	22	22	22	22
Du Pont analysis (% of average assets)					
Net interest income	3.0	3.0	2.7	2.6	2.6
Loan loss provisions and Inv pro	0.1	—	(0.0)	0.1	0.2
Net other income	0.3	0.3	0.8	0.3	0.3
Gains on securitization	—	—	—	—	—
Operating expenses	0.6	0.6	0.5	0.5	0.5
(1- tax rate)	72.8	73.2	74.7	74.4	73.9
ROA	1.8	2.0	2.2	1.7	1.6
Average assets/average equity (X)	12.5	12.9	11.9	11.9	13.0
ROE (%)	22.9	26.2	26.2	19.8	21.1

Source: Company, Kotak Institutional Equities estimates

LICHF: Income statement and balance sheet, March fiscal year-ends 2008- 2012E

	2008	2009	2010E	2011E	2012E
Income statement					
Total income excluding fee income	20,365	27,476	34,452	45,617	58,569
Other operating income	127	634	612	357	357
Interest payable	14,744	20,155	25,963	34,703	44,507
Provision	243	53	-50	639	1,095
Fee income					
Net total income	6,554	8,716	10,371	11,999	14,856
Total expenses	1,338	1,552	1,771	2,119	2,536
Staff expenses	345	447	514	617	740
Establishment expenses	182	166	183	219	263
Other expenses	774	890	1,023	1,228	1,474
Depreciation	37	49	51	55	59
Other income	105	100	1,350	0	0
Profit before tax	5,321	7,264	9,951	9,881	12,320
Tax	1,450	1,948	2,520	2,525	3,219
Net profit	3,871	5,316	7,430	7,356	9,100
EPS (Rs)	46	63	83	77	96
BVPS (Rs)	215	262	362	419	491
ABVPS (Rs)	184	233	365	396	464
Balance sheet					
Disbursements	70,710	86,800	134,540	168,175	201,810
YoY growth (%)	38	23	55	25	72,400
Net loans	219,360	277,000	369,990	482,667	612,077
Total Investments	7,746	7,746	7,746	7,746	7,746
Cash & deposits	3,617	2,893	2,893	2,893	2,893
Loans and advances and other assets	1,597	1,597	1,597	1,597	1,597
Deferred tax assets	929	929	929	929	929
Fixed assets owned	300	324	350	378	408
Total assets	233,549	290,490	383,506	496,210	625,650
Total liabilities	215,232	268,224	349,122	456,364	579,046
Share capital	850	850	950	950	950
Reserves	17467	21415	33433	38896	45654
Shareholders fund	18,317	22,265	34,383	39,846	46,604

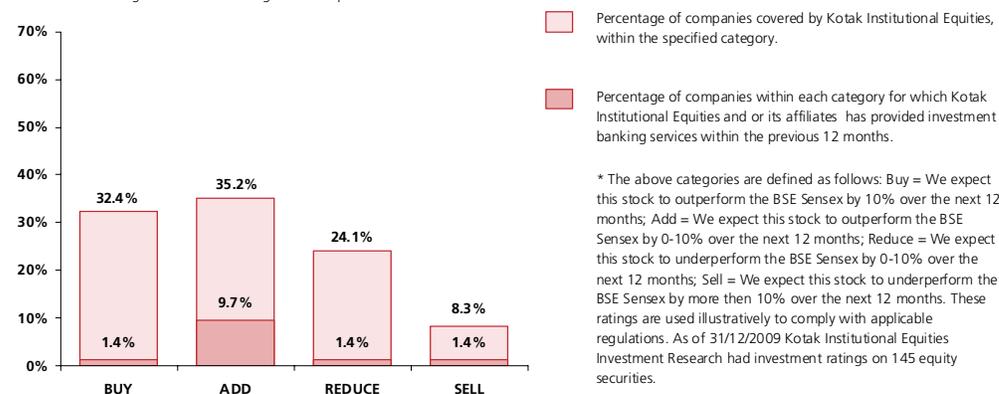
Source: Company, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of key Indian companies

Company	19-Feb-10		Mkt cap.		O/S shares (mn)	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price (Rs)	Upside (%)	ADVT-3mo (US\$ mn)	
	Price (Rs)	Rating	(Rs mn)	(US\$ mn)		2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	(Rs)	(%)	(US\$ mn)	
Energy																														
Bharat Petroleum	583	RS	191,152	4,158	328	20.6	58.1	61.7	(50.1)	181.9	6.2	28.3	10.0	9.4	5.7	4.9	4.3	1.4	1.3	1.2	1.3	4.4	4.7	5.3	14.1	13.7	—	—	10.0	
Cairn india	268	REDUCE	508,876	11,070	1,897	4.3	6.0	20.9	—	41	245.8	62	44	12.8	43.7	34.9	10.1	1.5	1.5	1.5	—	—	—	7.5	2.5	3.4	11.5	265	(1.2)	16.9
Castrol India (a)	660	REDUCE	81,590	1,775	124	21.3	30.8	39.8	20.8	44.7	29.2	31.0	21.4	16.6	17.9	13.1	10.1	18.2	17.7	15.9	2.3	3.8	4.5	61.2	83.8	101.1	640	(3.0)	2.3	
GAIL (India)	405	REDUCE	513,100	11,162	1,268	22.2	22.7	23.5	8.7	2.3	3.7	18.3	17.8	17.2	9.9	10.4	10.8	3.2	2.9	2.6	1.7	2.0	2.0	17.5	15.9	15.0	370	(8.5)	16.7	
GSPL	87	REDUCE	49,079	1,068	563	2.2	7.5	12.4	21.9	241.9	64.6	39.7	11.6	7.1	13.3	6.3	4.0	3.7	3.0	2.5	0.9	2.9	7.1	9.6	28.7	38.9	95	8.9	7.8	
Hindustan Petroleum	355	RS	120,450	2,620	339	17.0	46.3	49.7	(49.3)	173.1	7.2	20.9	7.7	7.2	3.2	2.6	2.4	1.0	0.9	0.9	1.5	7.3	7.8	4.4	11.2	11.4	—	—	10.0	
Indian Oil Corporation	322	RS	762,973	16,597	2,372	9.8	33.0	32.1	(67.9)	235.4	(2.7)	32.7	9.7	10.0	8.7	6.0	5.1	1.6	1.4	1.3	1.2	2.1	2.0	4.8	15.3	13.1	—	—	6.2	
Oil India	1,148	ADD	260,757	5,672	227	10.1	110.5	111.7	—	9.2	1.1	11.3	10.4	10.3	5.2	3.7	3.1	2.5	1.8	1.6	2.5	3.2	3.5	20.1	16.3	15.6	1,150	0.2	—	
Oil & Natural Gas Corporation	1,104	ADD	2,360,262	51,344	2,139	90.8	90.1	107.8	(2.1)	(0.8)	19.7	12.2	12.2	10.2	4.6	4.4	3.6	2.0	1.8	1.7	2.9	3.3	4.0	16.6	14.4	15.8	1,200	8.7	22.4	
Petronet LNG	72	ADD	54,188	1,179	750	6.9	5.3	8.1	—	(22.7)	51.2	10.5	13.5	8.9	7.5	8.2	5.8	2.4	2.1	1.7	2.4	2.1	2.8	23.9	15.8	20.5	90	24.6	4.6	
Reliance Industries	983	SELL	2,867,994	62,388	2,917	50.6	48.0	68.7	(3.7)	(5.2)	43.3	19.4	20.5	14.3	13.0	9.9	7.2	2.1	1.8	1.6	0.7	0.7	0.9	13.6	10.6	13.3	950	(3.4)	150.6	
Energy																														
Industrials																														
ABB	807	REDUCE	170,978	3,719	212	25.8	21.6	30.4	11.3	(16.6)	41.3	31.2	37.4	26.5	18.5	21.0	15.1	8.1	6.9	5.6	0.3	0.4	0.4	29.2	19.8	23.3	720	(10.8)	6.0	
BGR Energy Systems	496	ADD	35,680	776	72	16.0	21.0	29.7	32.2	31.2	41.0	30.9	23.6	16.7	17.5	13.0	10.0	6.3	5.2	4.2	0.6	0.7	1.0	22.3	24.3	27.7	500	0.9	2.5	
Bharat Electronics	2,054	REDUCE	164,312	3,574	80	103.8	117.7	126.2	1.8	13.4	7.2	19.8	17.4	16.3	10.5	8.7	7.8	4.2	3.5	3.0	0.9	1.2	1.2	20.7	22.0	20.1	1,870	(9.0)	3.7	
Bharat Heavy Electricals	2,351	ADD	1,150,935	25,037	490	63.9	92.0	115.8	9.4	44.1	25.8	36.8	25.6	20.3	20.2	14.2	11.1	8.9	7.1	5.6	0.7	0.8	1.1	26.4	30.0	30.7	2,500	6.3	39.5	
Crompton Greaves	403	BUY	147,868	3,217	367	15.3	20.7	23.7	37.3	35.2	14.1	26.3	19.4	17.1	14.0	10.7	9.2	8.0	5.9	4.6	0.5	0.7	0.8	35.6	35.1	30.4	450	11.6	6.5	
Larsen & Toubro	1,478	BUY	888,529	19,328	601	50.1	53.7	64.5	32.1	7.2	20.2	29.5	27.5	22.9	19.1	15.3	13.0	5.9	4.1	3.4	0.7	0.7	0.8	21.7	17.4	16.3	1,700	15.0	59.6	
Maharashtra Seamless	341	BUY	24,068	524	71	35.9	40.2	41.1	22.2	12.0	2.3	9.5	8.5	8.3	5.4	4.3	4.0	1.8	1.5	1.3	1.6	1.8	2.2	20.3	19.2	16.9	400	17.2	1.2	
Siemens	670	REDUCE	225,762	4,911	337	14.2	16.1	24.6	(22.2)	13.5	52.7	47.2	41.6	27.3	23.1	20.1	16.0	10.0	8.2	6.7	0.4	0.7	0.7	23.3	21.6	27.0	635	(5.2)	8.6	
Suzlon Energy	71	REDUCE	118,738	2,583	1,679	7.2	(2.2)	2.9	9.9	(130.8)	(231.4)	9.8	(31.8)	24.2	7.3	12.1	7.7	1.1	1.0	1.0	—	—	—	0.3	11.5	(3.4)	4.2	80	13.2	73.1
Volta	153	BUY	50,503	1,099	331	6.9	9.4	10.3	29.8	36.2	9.0	22.1	16.2	14.9	12.1	8.7	7.7	6.3	5.0	4.0	1.0	1.7	1.8	33.0	34.1	29.8	185	21.2	4.9	
Industrials																														
Infrastructure																														
GMR Infrastructure	55	ADD	201,154	4,376	3,667	0.8	0.6	0.6	(33.5)	(24.5)	(3.1)	71.5	94.7	97.8	26.6	19.0	14.0	2.4	2.0	1.8	—	—	—	4.4	3.2	3.0	68	24.0	7.9	
GVK Power & Infrastructure	42	ADD	66,248	1,441	1,579	0.8	0.8	1.0	(20.6)	2.5	34.2	55.0	53.7	40.0	50.7	17.9	16.4	2.9	2.1	2.0	—	—	0.7	4.8	4.5	5.1	50	19.2	11.1	
IRB Infrastructure	260	ADD	86,282	1,877	332	5.3	10.6	13.5	54.3	101.2	27.0	49.1	24.4	19.2	24.2	12.3	11.0	4.7	3.7	2.8	0.5	—	—	10.1	17.0	16.6	200	(23.0)	6.0	
Mundra Port and SEZ	655	BUY	264,407	5,752	403	10.7	15.1	24.1	105.6	40.8	59.5	61.1	43.4	27.2	35.9	28.2	18.1	9.0	7.3	5.6	(0.5)	—	—	15.5	18.5	23.2	725	10.6	7.1	
Infrastructure																														
Media																														
DishTV	39	REDUCE	41,898	911	1,063	(6.6)	(2.5)	(1.1)	(31.9)	(61.6)	(57.6)	(6.0)	(15.6)	(36.8)	(38.3)	61.2	18.7	(6.7)	10.3	14.2	—	—	—	83.9	248.6	(32.4)	38	(3.6)	6.0	
HT Media	145	NR	34,087	741	235	0.8	5.7	7.3	(80.5)	572.1	29.5	171.8	25.6	19.7	38.7	12.3	10.4	4.0	3.5	3.2	0.2	0.7	1.4	2.3	14.6	17.0	—	—	0.6	
Jagran Prakashan	120	ADD	36,110	786	301	3.0	5.9	6.6	(6.6)	92.8	13.2	39.4	20.4	18.1	22.4	12.3	10.5	6.4	5.9	5.4	1.7	2.9	3.3	16.7	30.1	31.1	130	8.4	0.7	
Sun TV Network	372	REDUCE	146,657	3,190	394	9.1	12.1	14.6	9.5	32.7	20.8	41.0	30.9	25.6	21.8	17.8	14.4	8.3	7.2	6.3	0.7	1.1	1.6	22.5	25.3	26.3	295	(20.7)	3.8	
Zee Entertainment Enterprises	250	REDUCE	108,695	2,364	434	8.4	10.3	12.7	(4.8)	22.2	22.9	29.6	24.3	19.7	20.5	17.7	13.9	3.1	2.8	2.6	0.8	1.0	1.2	11.8	12.6	14.1	235	(6.2)	5.9	
Zee News	57	NR	13,705	298	240	1.9	2.4	2.9	20.4	28.2	20.0	30.7	23.9	20.0	15.0	11.7	10.0	5.6	4.7	4.0	0.7	0.7	1.2	20.1	21.8	22.0	—	—	1.2	
Media																														
Metals																														
Hindalco Industries	150	ADD	286,511	6,233	1,911	2.8	4.3	13.3	(77.9)	56.9	205.5	54.1	34.5	11.3	15.3	8.1	7.0	1.5	1.1	1.0	—	—	—	9.6	6.3	7.8	160	6.7	46.9	
National Aluminium Co.	367	SELL	236,430	5,143	644	19.7	10.1	28.0	(22.0)	(49.0)	178.6	18.6	36.5	13.1	9.0	15.7	6.1	2.3	2.2	1.9	1.4	0.5	0.5	12.8	6.1	15.4	320	(12.8)	7.2	
Jindal Steel and Power	608	SELL	564,544	12,281	928	32.8	40.6	47.0	139.1	23.7	15.9	18.5	15.0	12.9	12.3	9.6	7.8	7.3	4.9	3.5	0.2	0.2	0.2	50.9	39.2	31.8	530	(12.9)	52.0	
JSW Steel	1,022	SELL	191,145	4,158	187	14.7	68.1	93.7	(83.2)	363.6	37.5	69.5	15.0	10.9	11.9	8.1	7.2	2.1	1.7	1.3	0.1	0.3	0.5	11.7	12.4	13.3	850	(16.8)	62.3	
Hindustan Zinc	1,077	BUY	455,088	9,900	423	64.6	93.5	105.4	(38.0)	44.8	12.8	16.7	11.5	10.2	13.1	7.6	5.5	3.1	2.4	2.0	0.4	0.5	0.5	20.2	23.5	21.3	1,400	30.0	16.9	
Sesa Goa	374	REDUCE	331,264	7,206	887	25.3	25.9	38.9	29.0	2.5	50.5	14.8	14.4	9.6	13.0	11.9	6.9	6.9	4.5	3.1	0.6	0.9	0.9	46.6	32.8	33.8	350	(6.3)	45.8	
Sterite Industries	746	ADD	627,283	13,645	840	46.8	44.9	54.2	(25.8)	(4.0)	20.7	16.0	16.6	13.8	11.7	9.0	6.8	2.3	1.7	1.6	—	—	—	14.0	11.0	11.9	850	13.9	40.8	
Tata Steel	561	BUY	497,610	10,825	887	110.1	3.2	78.7	45.3	(97.1)	2,331.6	5.1	173.2	7.1	5.7	18.3	6.2	1.7	2.0	1.6	2.6	1.4	1.4	24.0	(2.3)	24.5	700	24.8	135.4	
Metals																														
Pharmaceutical																														
Biocon	268	BUY	53,590																											

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of December 31, 2009

Ratings and other definitions/identifiers**Rating system**

Definitions of ratings

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

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

Other definitions

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

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Corporate Office

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

Overseas Offices

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

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

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