Kotak Institutional Equities

INDIA DAILY

June 03, 2008

EQUITY MARKETS

		Change, %		
India	**2-Jun**	**1-day**	**1-mo**	**3-mo**
Sensex	16,063	(2.1)	(8.7)	(3.7)
Nifty	4,740	(2.7)	(9.3)	(4.3)
Global/Regional indices				
Dow Jones	12,504	(1.1)	(4.2)	2.0
Nasdaq Composite	2,492	(1.2)	0.6	10.3
FTSE	6,008	(0.8)	(3.3)	3.2
Nikkie	14,200	(1.7)	1.1	9.3
Hang Seng	24,556	(1.1)	(6.4)	4.1
KOSPI	1,830	(1.0)	(1.0)	9.4

Value traded - India

		Moving avg, Rs bn		
	2-Jun		**1-mo**	**3-mo**
Cash (NSE+BSE)	164.7		198.9	194.5
Derivatives (NSE)	358.8		339.5	491
Deri. open interest	630.9		640	637

Forex/money market

		Change, basis points		
	2-Jun	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.4	0	172	201
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	(1)	20	56

Net investment (US$mn)

	30-May		**MTD**	**CYTD**
FIIs	63		-	(3,485)
MFs	0		-	1,367

Top movers -3mo basis

		Change, %		
Best performers	**2-Jun**	**1-day**	**1-mo**	**3-mo**
Chambal Fert	83	(0.5)	18.3	54.6
Shipping Corp	276	(1.8)	9.3	30.6
Thomas Cook	102	(0.3)	2.0	29.8
Nestle India	1,732	(2.0)	(0.7)	23.7
Infosys	1,951	(0.6)	9.1	32.9
Worst performers				
SAIL	154	(5.2)	(16.2)	(33.4)
Reliance Cap	1,135	(5.4)	(26.4)	(30.5)
Thermax	427	(0.2)	(14.7)	(33.5)
SBI	1,395	(3.5)	(23.5)	(27.4)
Siemens India	552	(1.3)	(4.5)	(27.0)

Contents

News Roundup

Corporate

- The country’s biggest retailer, Future Group, has boycotted the Cadbury brand following conflict with the chocolate maker Cadbury India over the latter allegedly giving better deals to international retailers. (ET)
- Axis Bank and Yes Bank are securitizing loans worth over Rs1,000 crore that were extended to Hindustan Petroleum Corporation and Bharat Petroleum Corporation. (BS)

Economic and political

- The government has cut the minimum export price of onions by US$25 to US$160 with effect from June 1 to boost exports and provide support to domestic prices that have crashed owing to a bumper output. (BS)
- The rise of biofuels is not only adding the global food price crisis but also poses a risk for peasants, pushed off their land to make way for energy crops, according to a new report by Food Agricultural Organisation. (ET)
- The proposal to increase royalty rates for minerals by changing the calculation method—from the specific rates to the ad valorem system based on mineral prices — has been put on hold for three months. (ET)

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

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Strategy

Sector coverage view	N/A

Nine months into the job and our respect for the 'other' side has increased

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- **BSE-30 Index has fallen 8.7% since our report '*Hitting the wall*' of May 6, 2008**
- **Portfolio construction remains difficult despite correction; made changes to our model portfolio**
- **4QFY08 results have not been reassuring about future earnings**

We continue to be cautious on the Indian market despite its 9% correction since our last update (*'Hitting the wall*, *unless earnings offer a boost ahead'* dated May 6, 2008) where we had highlighted a +5 to -15% range for the market in the next few months. We have made certain changes in our model portfolio to factor in (1) changes in market conditions post our May 6, 2008 report and (2) sharp difference in performance of various sectors and resultant changes in weights of sectors in the BSE-30 Index (see Exhibit 1). We continue to prefer sectors with high earnings visibility even though valuations of those sectors now appear relatively rich versus other sectors. We have revised our BSE-30 Index fair band to 15,000-19,000 based on FY2009E earnings and to 18,000-22,000 based on FY2010E earnings. We now use a band of 12.5-15 multiple range instead of 14-16.5 previously to factor in a higher cost of equity (increase in risk-free rate and increase risk to earnings).

The dilemma continues despite recent market correction. The recent market correction notwithstanding, we are not yet sufficiently excited by the Indian market's valuations (see Exhibit 2) to recommend an unequivocal buy given high degree of risks to earnings across most sectors. The Indian market is trading at 15.1X FY2009E reported earnings and 12.5X FY2009E earnings adjusted for the valuation of embedded assets. Our implied equity risk premium for the market is 4.4% currently (see Exhibit 3), sober but not sufficiently high, which would make us believe it is discounting potential risks to earnings.

Admittedly, we continue to find it difficult to construct a portfolio given (1) a continued re-rating of sectors with relatively high earnings visibility (consumer, pharmaceuticals and technology) and (2) high earnings risks in most other sectors. We continue to place a premium on earnings visibility and quality of earnings. Exhibit 4 gives the breakdown of valuations by sectors and Exhibit 5 shows the change in valuations of sectors over the past six months.

Continue to prefer market-neutrality; we have a portfolio since we have to have one. We continue to recommend a largely market-neutral portfolio with a few deviations in high-conviction ideas (more conviction about what to avoid than what to buy). However, our ideal strategy would have been to be out of the market (along with a six-month sabbatical) given (1) our cautious view of the market since November 2007 (see our November 1, 2007 reported titled *20 going on 18 perhaps* and December 13, 2007 report titled *It's a Marathon*) and (2) the onerous task of portfolio construction in these trying times. The good thing is that we now have more appreciation for the work of investors managing portfolios as opposed to those making recommendations on paper.

Exhibit 9 has our model portfolio. We discuss key areas of deviation from the benchmark weights and major changes below.

1. **Continue to stay overweight on consumers, metals and pharmaceuticals despite large outperformance of these sectors.** We have increased the overweight on ITC stock to 300 bps (8.2% weight in portfolio), which is out top pick in the sector. We have a 7.7% weight on metals (7% previously) versus 6.2% weight in the BSE-30 Index with our preferred stock being Jindal Steel and Power. We have increased our recommended weight on the pharmaceuticals sector to 7.2% from 5% previously versus a BSE-30 weight of 2.2%. We have raised the weight of Sun Pharma to 3% from 1% previously and also included it in our Top-10 list. Our pharmaceuticals team has recently revised Sun's 12-month fair valuation to Rs1,720 from Rs1,500 previously.

2. **Increased weight on utilities (6.6% versus 5.2% previously and 3.5% weight in BSE-30 Index).** We have included NTPC in the model portfolio with an equal weight (1.8%) after the stock's massive underperformance over the past few months. We continue to prefer Tata Power in the sector followed by Lanco Infratech.

3. **Continue to stay hugely underweight on cement, energy and telecom.** Despite the large under-performance of the cement and energy sectors over the past one month (June 2, 2008 and May 5, 2008) and current reasonable valuations, we are not confident about FY2009E earnings of these sectors given cost and pricing issues. The telecom sector has outperformed the market over this period led by proposed corporate action. However, we see significant earnings pressure ahead although it may take another 3-6 months for pricing pressures to emerge. For investors keen to invest or stay invested in the sector, our preferred pick is Bharti—in fact, it is the only one. Bharti stock trades at a discount to both RCOM and Idea Cellular despite cheaper valuations, superior financials and execution.

4. **Neutral on banking versus moderate overweight previously.** We have a 20.4% weight on banks versus 25.4% previously and 21% weight in the BSE-30 Index; the weight of the banking sector has come down over the past one month after the sector's underperformance due to concerns about (1) higher interest rates and (2) potential increase in NPLs particularly in the agriculture sector. However, we are reluctant to go hugely underweight despite a difficult macro-environment for two reasons—(1) current valuations factor in a reasonably bleak outlook for banks and (2) HDFC, HDFC Bank and ICICI Bank offer high-quality exposure to the Indian financial sector, which will grow rapidly over the next several years.

Exhibit 10 has our Top-10 list. The key changes are (1) inclusion of Sun Pharmaceuticals instead of a mid-cap. infrastructure basket (we have included Lanco in the model portfolio) and (2) swapping SBI with HDFC Bank; we had interchanged the two the last time around on the premise that SBI stock will hold up on account of its 'cheap' valuations; this was admittedly a mistake.

Earnings, earnings, earnings. We continue to be worried about the possibility of further earnings downgrades in FY2009E led by (1) steep increase in input costs (automobiles, construction, downstream oil), (2) deterioration in supply-demand balance of domestic and global commodities (cement, chemicals, refining) and (3) further increase in interest rates, which may affect earnings of the banking sector, if banks are unable to pass on the increase through higher lending rates; nonetheless, higher lending rates may dampen demand for credit and also result in potentially higher NPLs.

Exhibit 11 shows the changes to our earnings estimates for the BSE-30 Index (ex-energy). As can be seen, we now expect growth at 16.5% for FY2009E versus over 20% in 2HCY07. Exhibit 12 shows that 4QFY08 results were marginally ahead of our estimates despite significant one-off factors, which boosted earnings.

Significant changes in the sector bechmark weights

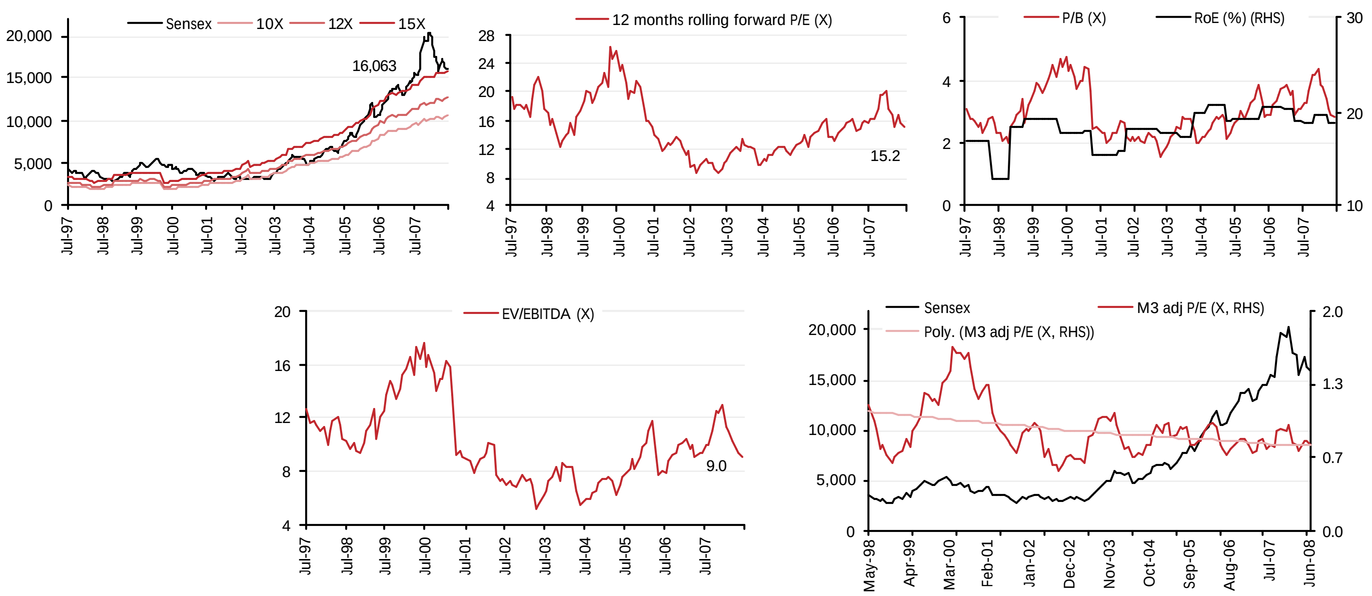
Change in sector benchmark weights since May 5, 2008

	Benchmark weight (%)		Change
	5-May-08	2-Jun-08	(bps)
Automobiles	3.6	3.9	30
Banking	22.9	21.0	(190)
Cement	2.9	2.7	(20)
Consumers	7.1	7.5	40
Diversified	1.5	1.2	(30)
Energy	18.3	17.1	(120)
Industrials	9.7	9.5	(20)
Metals	5.4	6.2	80
Pharmaceuticals	1.9	2.2	30
Property	1.5	1.3	(20)
Technology	12.9	15.1	220
Telecom	8.2	8.8	60
Utilities	4.1	3.5	(60)
Total	**100**	**100**	**—**

Source: BSE, Kotak Institutional Equities.

1-year rolling forward P/E has fallen from May 2008 levels

1-year rolling forward P/E, P/B, ROE, EV/EBITDA and M3 growth rate adjusted valuations



Source: BSE-30, Kotak Institutional Equities.

Equity risk premium at sober levels

Equity risk premium (%) for BSE Universe, using our proprietary tool, Whizdom

Equity risk	Implied BSE-30 Index		
premium	Rf = 8%	Rf = 7.5%	Rf = 7%
5.5	13,629	14,656	15,853
5.0	14,834	16,000	17,371
4.5	15,726	17,042	18,607
4.0	16,736	18,234	20,041
3.5	17,890	19,615	21,727
3.0	19,223	21,233	23,745
2.5	20,783	23,162	26,211
2.0	22,637	25,509	29,313

Source: Kotak Institutional Equities estimates.

Valuation summary of BSE-30 sectors

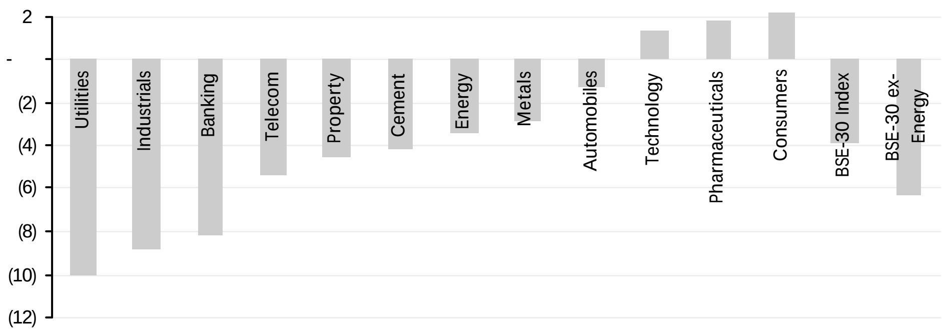
	Mkt cap.	Adj mkt cap.	EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Div. yield (%)		RoE (%)		
	(US$ mn)	(US$ mn)	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2008E	2009E	2010E
Automobiles	16,597	10,144	5.8	11.1	5.6	15.0	13.5	12.8	9.7	8.7	8.0	3.2	2.0	1.7	1.4	1.6	21.3	14.7	13.6
Banking	71,209	54,607	43.9	5.3	26.0	20.2	19.2	15.2	—	—	—	2.7	2.2	2.0	1.2	1.2	13.1	11.7	13.2
Cement	10,849	7,066	19.1	(1.6)	(4.6)	8.9	9.0	9.5	4.8	4.7	4.5	2.2	1.8	1.5	2.4	2.6	24.3	19.5	16.0
Consumers	31,317	19,518	15.1	13.2	15.6	27.1	23.9	20.7	19.1	15.2	13.0	9.3	8.2	7.1	2.7	2.5	34.4	34.1	34.2
Diversified	5,358	3,215	20.8	80.3	56.7	37.3	20.7	13.2	16.2	11.1	9.9	5.3	4.3	3.3	0.0	0.0	14.1	20.9	25.4
Energy	114,682	44,642	22.1	18.8	33.8	13.1	11.0	8.3	6.7	5.7	4.1	2.5	2.0	1.8	2.0	2.2	18.9	18.4	21.3
Industrials	38,593	24,633	25.1	30.6	27.6	31.8	24.4	19.1	17.3	13.6	10.6	7.0	5.2	4.2	0.6	0.6	21.9	21.5	21.8
Metals	23,157	16,210	(0.6)	26.5	(1.4)	14.2	11.3	11.4	8.2	6.8	6.9	2.0	1.7	1.5	1.3	1.3	14.0	15.3	13.4
Pharmaceuticals	8,314	5,630	23.9	1.1	25.1	24.1	23.9	19.1	16.7	16.5	13.5	5.1	4.6	4.0	1.6	1.8	21.3	19.1	20.9
Property	22,642	3,396	305.2	20.7	11.8	12.2	10.1	9.0	10.5	8.5	6.8	4.8	3.4	2.6	0.9	1.2	39.2	33.7	28.8
Technology	73,911	39,245	19.3	18.6	14.0	21.7	18.3	16.0	15.9	13.0	10.8	6.8	5.4	4.4	1.8	1.8	31.2	29.6	27.6
Telecom	65,404	22,892	71.6	30.4	22.7	22.3	17.1	13.9	13.9	10.2	8.1	5.5	4.2	3.3	0.2	0.3	24.5	24.4	23.7
Utilities	37,749	9,229	14.7	6.2	8.8	18.1	17.1	15.7	11.4	12.6	13.6	2.5	2.3	2.1	2.1	2.3	13.6	13.4	13.7
BSE-30	**519,783**	**260,428**	**30.3**	**17.2**	**21.0**	**17.7**	**15.1**	**12.5**	**10.3**	**8.9**	**7.4**	**3.5**	**2.8**	**2.4**	**1.4**	**1.5**	**19.7**	**18.8**	**19.6**
BSE-30 ex-Energy	**405,101**	**215,786**	**34.1**	**16.5**	**15.5**	**19.7**	**16.9**	**14.6**	**12.6**	**10.6**	**9.3**	**3.9**	**3.2**	**2.7**	**1.3**	**1.4**	**20.0**	**19.0**	**18.8**
BSE-30 ex-Energy, Com.	**371,095**	**192,510**	**39.8**	**16.8**	**18.3**	**20.9**	**17.9**	**15.1**	**14.0**	**11.6**	**10.0**	**4.3**	**3.5**	**3.0**	**1.3**	**1.3**	**20.6**	**19.4**	**19.6**

Note:
(a) EV/EBITDA excludes Banking sector.

Source: Company, Kotak Institutional Equities estimates.

Significant de-rating in most sectors

Change in P/E ratio of BSE-30 Sensex sectors between June 2, 2008 and December 12, 2007 (X)

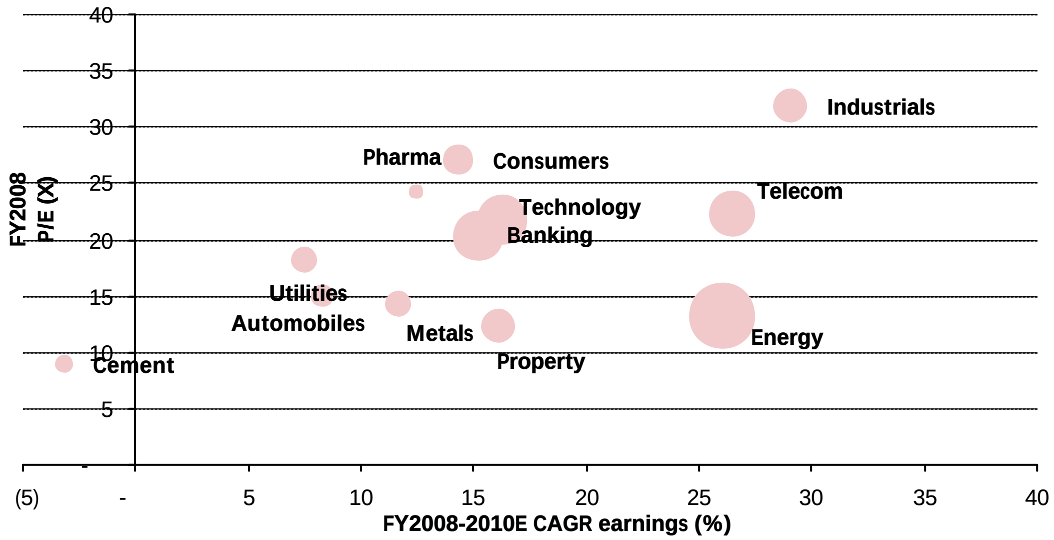


Note:
(a) The dates pertain to June 2, 2008 and our December 13, 2007 *It's a Marathon* report.

Source: Kotak Institutional Equities estimates.

Limited opportunity to invest in sectors/stocks with high earnings growth and reasonable valuations

BSE-30 sectors earnings growth (%) and P/E (X)



Source: Kotak Institutional Equities estimates.

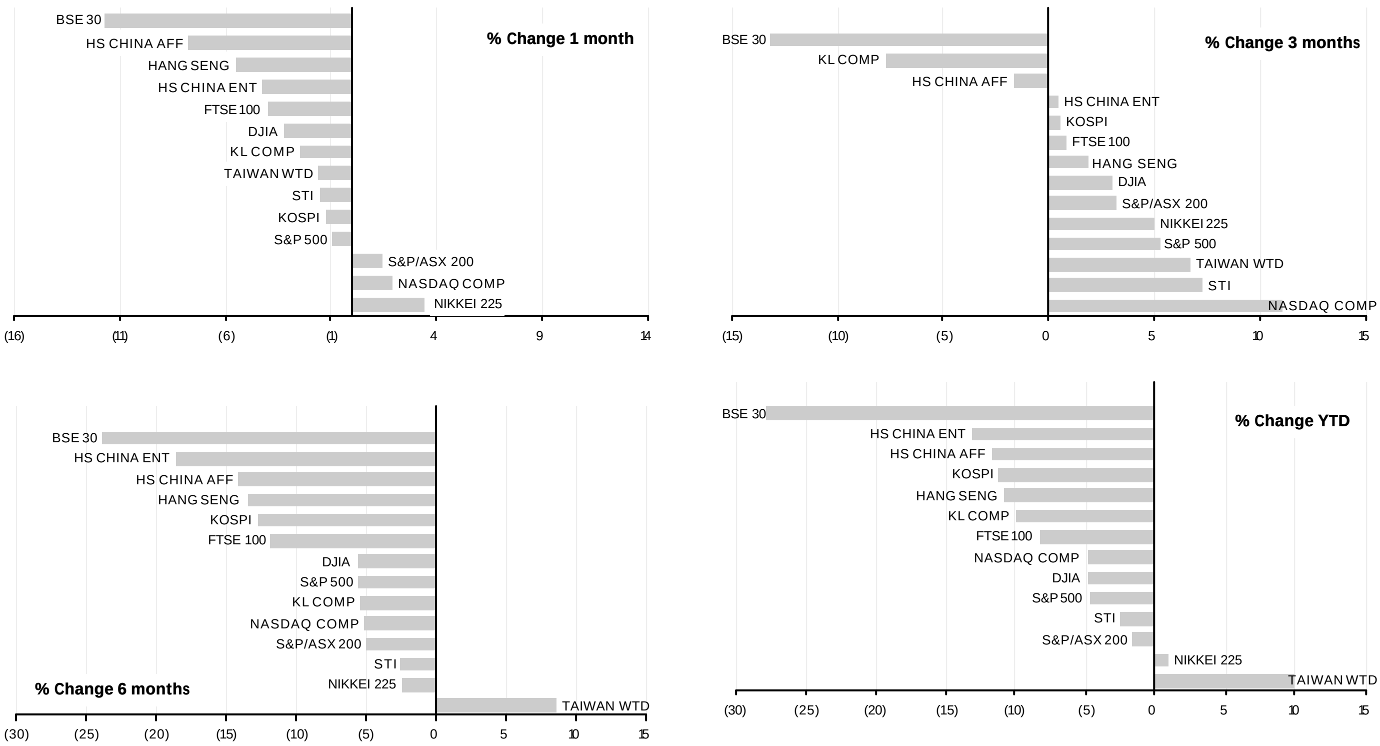
BSE-30 Index has fallen 1,537 points (8.7%) since our report *"Hitting the wall"* dated May 6, 2008

Sector-wise contribution to the BSE-30 Index fall

	Points (#)
Banking	(637)
Energy	(468)
Industrials	(165)
Utilities	(153)
Diversified	(77)
Automobiles	(71)
Cement	(62)
Property	(57)
Consumers	(29)
Telecom	(26)
Pharmaceuticals	9
Metals	49
Technology	150
Total	**(1,537)**

Source: Bloomberg.

BSE-30 Index is one of the worst performing on a currency-adjusted basis
Currency-adjusted performance (in US$ terms) of global indices (%)



Source: Bloomberg.

Over-weighting Consumers and Pharmaceuticals
Kotak Institutional Equities Model Portfolio

Company	2-Jun Price (Rs)	Rating	Weightage (%) BSE-30	Weightage (%) KS reco.	Diff. (bps)
Mahindra & Mahindra	595	ADD	1.1	—	(111)
Maruti Suzuki	787	BUY	1.0	2.5	150
Tata Motors	556	SELL	1.8	—	(176)
Automobiles			**3.9**	**2.5**	**(136)**
State Bank of India	1,380	ADD	3.6	—	(355)
PSU Banking			**3.6**	**—**	**(355)**
HDFC	2,510	REDUCE	5.5	5.5	—
HDFC Bank	1,305	BUY	4.3	5.8	150
ICICI Bank	761	ADD	7.7	9.2	150
Pvt. Banking/Financing			**17.4**	**20.4**	**300**
ACC	621	REDUCE	0.6	—	(64)
Ambuja Cements	92	REDUCE	0.7	—	(69)
Grasim Industries	2,220	ADD	1.4	—	(138)
Jaiprakash Associates	211	BUY	1.2	1.2	—
Cement			**3.9**	**1.2**	**(271)**
Hindustan Unilever	234	ADD	2.3	2.3	—
ITC	219	BUY	5.2	8.2	300
Consumers			**7.5**	**10.5**	**300**
Oil & Natural Gas Corporation	839	BUY	3.3	0.8	(250)
Reliance Industries	2,333	RS	13.9	11.3	(257)
Energy			**17.1**	**12.1**	**(507)**
Bharat Heavy Electricals	1,590	REDUCE	2.5	—	(247)
Larsen & Toubro	2,898	BUY	7.0	9.0	200
Industrials			**9.5**	**9.0**	**(47)**
Hindalco Industries	182	ADD	1.5	—	(150)
Jindal Steel & Power	2,221	ADD	—	3.0	300
Tata Steel	866	ADD	4.7	4.7	—
Metals			**6.2**	**7.7**	**150**

Company	2-Jun Price (Rs)	Rating	Weightage (%) BSE-30	Weightage (%) KS reco.	Diff. (bps)
Cipla	207	REDUCE	0.9	—	(95)
Sun Pharmaceuticals	1,450	BUY	—	3.0	300
Ranbaxy Laboratories	514	BUY	1.2	1.2	—
Pharmaceuticals			**2.2**	**4.2**	**205**
DLF	563	BUY	1.3	2.8	150
Real estate		**—**	**1.3**	**2.8**	**150**
Infosys Technologies	1,939	BUY	8.6	9.8	125
Satyam Computer Services	520	BUY	3.1	4.1	100
TCS	969	REDUCE	2.1	—	(215)
Wipro	494	ADD	1.3	1.3	—
Technology		**—**	**15.1**	**15.2**	**10**
Bharti Airtel Limited	866	REDUCE	5.2	4.7	(50)
Reliance Communications	552	SELL	3.6	—	(358)
Telecom		**—**	**8.8**	**4.7**	**(408)**
Lanco Infratech	495	BUY	—	0.6	60
NTPC	161	ADD	1.8	1.8	—
Reliance Infrastructure	1,166	NR	1.7	2.2	50
Tata Power	1,292	ADD	—	2.0	200
Utilities		**—**	**3.5**	**6.6**	**310**
Biocon	458	BUY	—	0.6	60
Dishman Pharma & chemicals	317	BUY	—	0.6	60
Divi's Laboratories	1,481	BUY	—	0.6	60
Jubilant Organosys	350	BUY	—	0.6	60
Piramal Healthcare	352	BUY	—	0.6	60
Pharmaceutical mid-cap. basket		**—**	**—**	**3.0**	**300**
BSE-30	**16,063**	**—**	**100.0**	**100.0**	**—**

Note:
(1) Weights are with respect to June 2, 2008 prices.

Source: Bloomberg, BSE, Kotak Institutional Equities.

Biased towards solid long-term stocks
Kotak Institutional Equities Top-10 List

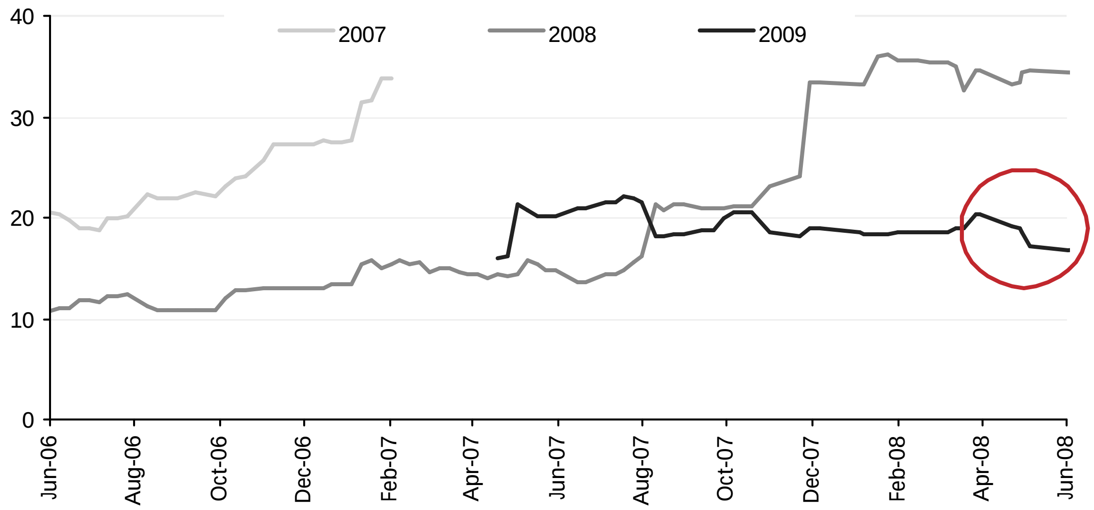
Companies	Sector	Rating	Mkt cap. (US$ mn)	CMP (Rs)	Target (Rs)	EPS (Rs) 2008E	EPS (Rs) 2009E	EPS (Rs) 2010E	P/E (X) 2008E	P/E (X) 2009E	P/E (X) 2010E	EV/EBDITA (X) 2008E	EV/EBDITA (X) 2009E	EV/EBDITA (X) 2010E
ITC	Consumer products	BUY	19,409	220	250	8.4	9.5	11.0	26.3	23.2	20.1	17.4	15.3	12.9
Larsen & Toubro	Industrials	BUY	20,374	2,920	3,600	77.9	116.7	148.9	37.5	25.0	19.6	20.7	15.0	11.7
ICICI Bank	Banking	ADD	20,083	765	933	39.9	35.4	46.2	19.2	21.6	16.6	—	—	—
DLF	Property	BUY	22,822	568	850	46.2	55.7	62.3	12.3	10.2	9.1	10.9	8.8	7.0
HDFC Bank (1)	Banking	BUY	13,893	1,311	1,500	46.0	53.4	76.0	28.5	24.5	17.2	—	—	—
Maruti Suzuki	Automobiles	BUY	5,366	787	1,000	59.9	72.1	79.6	13.1	10.9	9.9	7.5	6.2	5.4
Jindal Steel and Power	Metals	ADD	8,138	2,241	2,900	80.4	111.6	117.0	27.9	20.1	19.2	17.4	12.9	11.7
Tata Power	Utilities	ADD	7,121	1,296	1,540	29.7	38.1	39.9	43.7	34.0	32.5	28.6	25.5	25.7
Sun Pharmaceuticals (2)	Pharmaceuticals	BUY	7,095	1,446	1,720	71.5	86.7	73.7	20.2	16.7	19.6	16.5	13.1	14.2
Mid-cap. pharmaceutical basket														
Biocon	Pharmaceuticals	BUY	1,082	459	700	22.4	24.6	32.8	20.5	18.6	14.0	13.1	12.6	9.4
Dishman Pharma & Chemicals	Pharmaceuticals	BUY	621	324	515	14.9	20.5	27.1	21.7	15.8	12.0	16.0	11.2	8.8
Divi's Laboratories	Pharmaceuticals	BUY	2,295	1,508	1,915	51.4	65.9	95.7	29.3	22.9	15.7	24.0	18.4	12.5
Jubilant Organosys	Pharmaceuticals	BUY	1,477	346	530	22.8	23.7	27.9	15.2	14.6	12.4	12.1	11.3	8.9
Piramal Healthcare	Pharmaceuticals	BUY	1,745	354	470	17.6	21.9	26.7	20.1	16.2	13.3	14.6	11.3	9.1
BSE-30				**16,063**										

Note:
(1) HDFC Bank replaced with State Bank of India.
(2) Sun Pharmaceuticals replaced with Mid-cap infrastructure basket.

Source: Kotak Institutional Equities estimates.

Sensex (ex-energy) earnings growth has declined over the past few weeks

Expected growth in sensex ex-energy earnings for FY2007, FY2008E and FY2009E (%)



Note:

(1) Sharp rise in FY2008E in the month of November 2007 is due to inclusion of DLF stock in place of Dr Reddy's stock in BSE-30 Index.

Source: Kotak Institutional Equities estimates.

No major earnings surprises in 4QFY08 results

Sector-wise earnings surprises/(disappointments) in 4QFY08

	4QFY08 net profit		Difference
	Expected	Actual	(%)
Automobiles	12,918	9,055	(29.9)
Banking	71,183	81,795	14.9
Cement	15,166	13,771	(9.2)
Consumers	15,566	15,524	(0.3)
Energy	84,263	44,943	(46.7)
Industrials	32,541	33,211	2.1
Media	1,324	1,366	3.2
Metals	34,038	41,183	21.0
Pharmaceuticals	7,225	6,521	(9.7)
Property	914	864	(5.5)
Technology	47,462	45,906	(3.3)
Telecom	35,276	37,669	6.8
Transportation	4,569	5,571	21.9
Utilities	20,438	15,992	(21.8)
KIE Universe	**382,883**	**353,372**	**(7.7)**
KIE Universe ex-Energy	**298,620**	**308,429**	**3.3**
BSE-30 Universe	**219,038**	**228,828**	**4.5**
BSE-30 Universe ex-Energy	**192,460**	**189,698**	**(1.4)**

Note:

(1) Excludes the companies which have not reported their 4QFY08 results.

(2) BSE-30 universe excludes DLF and Jaiprakash Associates.

Source: Company data, Kotak Institutional Equities estimates.

Pharmaceuticals

SUN.BO, Rs1446	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,720
52W High -Low (Rs)	1520 - 855
Market Cap (Rs bn)	300.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	33.6	39.9	42.9
Net Profit (Rs bn)	14.9	18.0	15.3
EPS (Rs)	71.5	86.7	73.7
EPS gth	*71.3*	*21.2*	*(15.0)*
P/E (x)	20.2	16.7	19.6
EV/EBITDA (x)	16.5	13.1	14.2
Div yield (%)	0.6	0.8	0.9

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	63.7	-	-
FIIs	19.1	0.6	(0.0)
MFs	3.4	0.6	(0.1)
UTI	-	-	(0.7)
LIC	-	-	(0.7)

Sun Pharmaceuticals: Upgrade price target to Rs1,720 factoring Effexor XR opportunity

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- **4QFY08 revenues at Rs12.8 bn, 51% above our estimates, driven by 'exclusivity' gains largely on account of Protonix launch**
- **EBITDA margin at 65%, 10% above our estimates, and PAT at Rs7.2 bn driven by higher proportion of sales from 'exclusivity' products**
- **We estimate PAT for FY2009E and FY2010E to increase 6% and 7%, respectively**
- **Maintain BUY rating with a SOTP-based target price of Rs1,720 (Rs1,500)**

4QFY08 results better than our estimates at all levels due to three exclusivity products—most of the gains came from Protonix. EBITDA margins ex-R&D at 65% were the highest ever due to higher proportion of sales from exclusivity products. We increase PAT estimates for FY2009E and FY2010E by 6% and 7%, respectively, to include sales from Ethyol and Effexor XR in our forecasts. Our forecasts are based on conservative forecasts for Protonix and could provide upside in FY2010E. Sun is trading at 16X FY2009E and 19X FY2010E. We maintain BUY rating with a SOTP-based price target of Rs1,720 (Rs1,500 earlier).

4QFY08 revenues at Rs12.8 bn, 51% above our estimates, driven by product exclusivities. Revenues were driven by (1) Protonix with sales of around US$135-140 mn, in our view, vs. our estimate of US$31 mn. Sun launched generic Protonix in US on January 30, 2008 after Wyeth, the patent owner, launched its authorized generic version. Teva has not sold its generic version post the launch of authorized generic by Wyeth (2) Trileptal (oxcarbazepine) launched in October 2007 in which Sun shares 180-day exclusivity. We estimated US$58 mn of revenues from Trileptal in the past six months with US$15 mn sales this quarter and (3) Ethyol (amifostine). Sun launched this product 'at risk' on March 31, 2008, and therefore a large part of revenues are likely to be booked in FY2009E.

EBITDA margin at 65%, 10% higher than our estimates, and PAT at Rs7.2 bn driven by exclusivity products. EBITDA margins, ex-R&D, at 65% were the highest ever on the back of (1) launch of generic Protonix this quarter, (2) operating leverage gains and (3) cost savings on almost all items. Material costs at 14% was significantly lower than our estimates of 22%. This was due to high-margin exclusivity opportunities. R&D costs at 6% of sales were lower than previous quarter and our estimate of 11%. PAT at Rs7.2 bn was significantly higher than our estimates due to (1) higher other income of Rs556 mn vs our estimates of Rs200 mn (2) lower effective tax rate at 3.5% vs our estimates of 4%.

We estimate PAT for FY2009E and FY2010E to increase 6% and 7%, respectively. We estimate sales growth of 19% in FY2009E and 8% in FY2010E. We increase our PAT estimates by 6% and 7% to reflect FY2008 performance and include gains from Ethyol and Effexor XR in our forecasts.

1. **Protonix revenues left unchanged at US$220 mn for FY2009E and US$100 mn for FY2010E.** We estimate that Sun has included revenues of ~US$135-140 mn of sales from Protonix in FY2008. We model EBITDA margin in excess of 80% till end-FY2009E and in excess of 45% in FY2010E for Protonix. We believe our forecast is conservative given 4QFY08 revenues and could provide upside in FY2009E. We will relook our estimates later during the year.

Protonix faces patent expiry on July 19, 2010 and the only remaining challenger to this patent is Schwarz Pharma. It faces 30 months stay to action that expires in February 2009. Thus, we see a market consisting of Wyeth, Teva, Sun and authorized generic till February 2009, at least. Competitive scenario thereafter depends on FDA granting approval to Schwarz and its decision to launch the product.

2. **Ethyol (amifostine).** Sun launched generic Ethyol injectable 'at risk' on March 31. We estimate US$14 mn of sales in FY2009E and US$7 mn in FY2010E. We model EBITDA margin in excess of 80% during exclusivity and in excess of 45% in FY2010E.
3. **Effexor XR equivalent.** Sun could launch this product post approval later this year. We include US$50 mn of sales from this product in FY2010E and expect gradual pickup in sales since this will be a non-AB rated product approval. We model EBITDA margins at 60% for this product in FY2010E since initial marketing costs would be high. Effexor XR is based on product technology developed by SPARC, therefore Sun would have to provide for royalty on sales on this product to SPARC. Management hinted at revealing this number later in the year post which we may revise our margin assumption.
4. We reduce sales growth rates for API business since capacities will be diverted towards US business.
5. We expect the Indian finished dosages business to grow at 15% during FY2009-2010E, lower than the 25% reported in FY2008 due to competition from new players expanding into chronic segments. This may turn out to be a conservative assumption.

Adjusting for revenues from exclusivity products, sales growth is strong at 18% for FY2009E and 26% for FY2010E (see Exhibit 6, sales growth excluding exclusivities was 20% for FY2008). Sales growth rates for all other businesses are left unchanged. Including sales from two new products and higher Rs/US$ rate (39.8 for FY2009E and 39.5 for FY2010E) leads to a 3% change in FY2010E revenues from our earlier estimates. We estimate EBITDA margins, ex-R&D, to increase to 55.2% in FY2009E from FY2008 margin of 54.7%. There are no changes to our estimates below the EBITDA line (see Exhibit 4).

Taro deal update. Sun and Taro have made allegations and counter allegations relating to planned merger. Taro wants to walk out the proposed deal as management thinks the company is now on the path of recovery and it is worth much more than what Sun is offering (maximum $10.25 per share). Sun thinks Taro is surviving due to emergency help given by Sun and Taro can't walk out of the proposed merger. We are not in a position to make comments on the legal issues such as ability of Taro to repudiate the merger and hence refrain from commenting on these issues. However, it is worth noting the following points.

In May 2007, Sun made an equity investment of approximately $41 million at $6 per share to help Taro avoid an impending payment default on certain of its debt obligations (see Exhibit 5).

On August 2, 2007, Sun exercised its warrant to acquire 3,000,000 of the company's ordinary shares at $6 per share. In total, Sun has purchased 9,787,550 ordinary shares from the company for approximately $59 million. In addition, in July 2007, Sun purchased 58,500 ordinary shares in open market transactions and on February 19, 2008, Sun purchased 3,712,557 ordinary shares at $10.25 per share from Brandes, raising Sun's current ownership in the company to 13,558,557 ordinary shares. Sun also has a warrant to purchase an additional 3,787,500 ordinary shares at an exercise price of $6 per share. Assuming these warrants are exercised, Sun will own 17.346m shares at average cost of $6.9.

Best-case scenario—Sun and Taro renegotiate the deal and agree to merge at revised price. Sun is clearly interested in the deal but does not appear to be price-insensitive buyer. Timing for the deal and price that Sun may have to pay for it remains uncertain.

Worst-case scenario—Taro continues as an independent company and Sun Pharma remains a financial investor for the foreseeable future. Sun's holding in Taro so far and warrants that it continues to hold could lead to 17.3m shares at average price of $6.9. Currently, Taro share price is comfortably higher than Sun's average cost of acquisition. Thus, it will not have any negative financial implication currently. In future, Sun will have to mark to market gains/losses from its shareholding in Taro every quarter.

One thing remains certain that resolution of the differences will be a long-drawn process and headline news could make Sun's share price volatile. Our model does not include any benefit from the proposed merger while the balance sheet shows investment made in Taro so far as a long-term investment.

Maintain BUY rating with a SOTP-based target price of Rs1,720. We continue to use SOTP method for valuation. There is no change in the multiples that we have used for valuing each of Sun's business. We do not assign any multiple to the profit estimates of the two exclusivity products. These get added to the valuation in the form of higher cash balance. We assign a multiple of 19 (15% premium to multiple assigned to generics business) to value profits from Effexor XR equivalent product in FY2010E. Due to the 7% increase in FY2010E PAT and rolling forward, we change our price target to Rs1,720 (from Rs1,500 earlier).

Exhibit 1: Interim results—Sun, March fiscal year-ends (Rs mn)

	4QFY07	3QFY08	4QFY08	4QFY08 KIE	Growth (%, yoy)	Growth (%, qoq)	Chg (% vs KIE)
Gross revenues	**5,725**	**8,309**	**12,798**	**8,457**	**124**	**54**	**51**
Excise duty	240	269	226	272	(6)	(16)	(17)
Net Sales	**5,485**	**8,040**	**12,572**	**8,186**	**129**	**56**	**54**
Material cost	1,807	1,909	1,878	1,900	4	(2)	(1)
Stock changes	(598)	(129)	(161)	(100)	NM	NM	NM
Staff costs	664	764	786	800	18	3	(2)
Indirect taxes	172	137	183	140	6	33	30
Others	1,253	1,008	1,693	1,050	35	68	61
R&D	716	805	786	900	10	(2)	(13)
Operating costs	**4,014**	**4,493**	**5,165**	**4,690**	**29**	**15**	**10**
EBITDA	**1,471**	**3,547**	**7,407**	**3,495**	**404**	**109**	**112**
Net interest (income)	(285)	—	—	—	**NM**	**NM**	**NM**
Depreciation	196	245	268	270	37	10	(1)
Other income	829	179	556	200	(33)	210	178
PBT	**2,388**	**3,481**	**7,695**	**3,425**	**222**	**121**	**125**
Tax	5	116	270	137	4,894	133	97
Deferred tax	(23)	—	—	—	NM	NM	NM
PAT before minority	**2,406**	**3,365**	**7,425**	**3,288**	**209**	**121**	**126**
Minority interests	183	181	197	80	7	9	145
PAT for shareholders	**2,223**	**3,184**	**7,228**	**3,208**	**225**	**127**	**125**
India	**3,265**	**3,937**	**3,834**	**3,881**	**17**	**(3)**	**(1)**
API	139	177	218	132	57	23	65
Finished dosage	3,122	3,758	3,615	3,747	16	(4)	(4)
Others	4	2	1	2	(89)	(77)	(75)
International	**2,459**	**4,372**	**8,964**	**4,577**	**265**	**105**	**96**
API	479	466	705	470	47	51	50
Finished dosage	1,981	3,902	8,241	4,106	316	111	101
Caraco	1,286	1,274	1,180	1,328	(8)	(7)	(11)
Rest of the world	516	669	609	627	18	(9)	(3)
Sun ANDAs	164	276	252	314	53	(9)	(20)
Able Labs and other	15	—	—	—	NM	NM	NM
180 days exclusivity	—	1,683	6,200	1,838	NM	268	237
Others	—	5	18	—	NM	271	NM
Total	**5,725**	**8,309**	**12,798**	**8,457**	**124**	**54**	**51**

Source: Company data, Kotak Institutional Equities.

Exhibit 2: SOTP-based price target, FY2009-FY2010E

	PAT (Rs mn)		P/E	Valuation (Rs mn)	
	FY2009E	FY2010E	(X)	FY2009E	FY2010E
India finished dosage	6,211	7,066	25.3	157,131	178,759
India API	53	44	10.0	528	436
International finished dosage	1,029	1,458	21.5	22,118	31,348
International API	814	910	13.0	10,583	11,831
Caraco business	1,519	1,797	16.5	25,062	29,653
Sun Pharma ANDAs	499	2,150	16.5	8,236	35,482
Hungary	166	217	15.0	2,486	3,253
Cranbury/Bryan facilities	84	158	15.0	1,267	2,375
US -180 days exclusivity	7,122	—	NM		
Effexor XR equivalent	—	959	19.0	—	18,191
Total (ex interest income)	**17,497**	**14,758**		**227,413**	**311,328**
Value per share (Rs)					**1,497**
Cash per share (Rs)					219
Share price target (Rs)					**1,716**

Source: Kotak Institutional Equities estimates.

Exhibit 3: Forecasts and valuation, March fiscal year-ends, 2006-2010E

	Net sales		Adjusted EBITDA		Net Profit		EPS	ROCE	ROE	P/E
	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs)	(%)	(%)	(X)
2006	16,368	38.1	6,439	39.3	5,732	44.7	30.9	13.4	42.1	45.4
2007	21,321	30.3	9,163	42.3	7,843	36.8	41.7	16.1	36.0	33.6
2008	33,565	57.4	18,365	100.4	14,869	89.6	71.5	31.8	37.6	19.6
2009E	39,932	19.0	22,052	20.1	18,024	21.2	86.7	29.4	30.4	16.2
2010E	42,931	7.5	20,134	(8.7)	15,328	(15.0)	73.7	20.3	20.9	19.0

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 4: Sales breakup, March fiscal year-ends, 2009-2010E (Rs mn)

	Current estimates		Earlier estimates		% change	
	2009E	2010E	2009E	2010E	2009E	2010E
India	**17,887**	**20,433**	**18,088**	**20,657**	**(1)**	**(1)**
Finished dosage	16,977	19,523	17,128	19,697	(1)	(1)
API	900	900	950	950	(5)	(5)
Others	10	10	10	10	—	—
International	**23,297**	**23,928**	**22,752**	**22,361**	**2**	**7**
Finished dosage - RoW	3,540	4,919	3,375	4,663	5	5
API - RoW	2,683	3,062	2,608	3,346	3	(8)
Caraco - US	5,980	7,241	6,003	7,227	(0)	0
Sun Pharma ANDAs	1,330	1,715	1,990	2,625	(33)	(35)
Sun - 180 days exclusivity opportunity	9,367	4,227	8,396	3,750	12	13
Cranbury / Bryan facilities	398	790	380	750	5	5
Effexor XR equivalent	—	1,975	—	—	—	—
Others	—	—	—	—	—	—
Total	**41,184**	**44,361**	**40,840**	**43,018**	**1**	**3**
EBITDA	18,852	16,334	17,811	15,436	6	6
PAT	18,024	15,328	17,064	14,286	6	7

Source: Company, Kotak Institutional Equities estimates.

Exhibit 5: Sun Pharma shareholding in Taro

	Price (US$)	No .of shares	Total cost (US$ mn)
Original purchase	6	3	18
Warrants	6	7	41
Market Purchase		0	0
Brandes	10	4	38
Total	7	14	97
Warrant	6	4	23
Total Potential	**7**	**17**	**120**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 6: Breakup of financials, March fiscal year-ends (Rs mn)

	FY2009E	FY2010E
Revenues		
Base	31,817	40,135
Protonix+Ethyol	9,367	4,227
Total	**41,184**	**44,361**
EBITDA		
Base	13,894	18,147
Protonix+Ethyol	8,158	1,986
Total	**22,052**	**20,134**
EBITDA margin		
Base	44	45
Protonix+Ethyol	87	47
Total	**54**	**45**

	FY2009E	FY2010E
PAT (ex interest income)		
Base	10,374	13,129
Protonix+Ethyol	7,122	1,629
Total	**17,497**	**14,758**
EPS		
Base	50	63
Protonix+Ethyol	34	8
Interest income	3	3
Total	**87**	**74**
P/E		
Base	28	22
Base+exclusivity (ex interest income)	17	20
Base+exclusivity	16	19

Source: Company data, Kotak Institutional Equities estimates.

Utilities

NTPC.BO, Rs161	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	210
52W High -Low (Rs)	291 - 149
Market Cap (Rs bn)	1,331

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	370.6	412.8	458.8
Net Profit (Rs bn)	73.6	77.6	84.0
EPS (Rs)	8.9	9.4	10.2
EPS gth	*3.8*	*6.3*	*9.6*
P/E (x)	18.1	17	15.8
EV/EBITDA (x)	13.1	14.4	14.6
Div yield (%)	2.2	2.3	3.2

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	89.5	-	-
FIIs	5.1	1.1	(3.2)
MFs	0.7	0.8	(3.4)
UTI	-	-	(4.2)
LIC	-	-	(4.2)

NTPC: Valuations reasonable—pay for stable operations and growth

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- **Current market price discounting 15.9 GW of capacity addition**
- **Valuation attractive compared to regional peers**
- **Insulation from price escalation of commodities**
- **Retain ADD with DCF-based target price of Rs210**

NTPC's share price has corrected sharply over the last few weeks and is trading at reasonable levels, in our view. Our reverse-valuation exercise based on the current market price suggests that the stock price discounts a capacity addition of 15.9 GW as against our estimate of 17 GW capacity addition and the company's target of adding another 20.5 GW during the next four years. NTPC is trading at a P/E of 15.8X and P/B of 2.2X on FY2010E compared to average P/E of 16X and P/B of 1.7X on for utility companies in Asia. We note NTPC has a superior return and growth profile compared to regional peers. Due to its regulated return structure, its earnings are insulated from commodity price escalation (both on capital equipment and coal costs) as well. We maintain our earnings estimates of Rs9.5 for FY2009E and Rs10.3 for FY2010E. Slow earnings growth projected for next two years could accelerate on account of (1) higher UI charges or incentives, (2) higher prior period income and (3) early commercialization of new capacities compared to our estimates. We retain our ADD rating with a DCF-based target price of Rs210/share.

Current market price discounting 15.9 GW of capacity addition. Our reverse-valuation exercise, based on the current market price, suggests that the stock price discounts a capacity addition of 15.9 GW (see Exhibit) as against our estimate of 17 GW capacity addition and company's target of adding another 20.5 GW during the next four years. The CMP of NTPC clearly does not consider capacity additions beyond 2012. We note that NTPC plans to add 25 GW MW in the XIIth plan period to reach an installed capacity of 75 GW by FY2017. We value NTPC's extant capacity of 29.4 GW using DCF-equity at Rs74/share. NTPC has bonds valued at Rs25/share from the one-time settlement scheme and cash and liquid investments worth Rs8/share. Taking the capital WIP at book value (Rs17/share) leaves a residual value of Rs37/share (Rs305 bn), which accounts for 15.9 GW of capacity addition using a P/B of 1.6X. We note that NTPC has already ordered equipment and construction is in progress on 16.7 GW.

The Government of India has also approved the bulk tendering of seven units of 660 MW for induction of super-critical technology, clearing the way for further order placement. NTPC will get the benefit of competitive bidding while BHEL will have to match the lowest bid for supplying three units if it does not emerge as the lowest bidder. We note NTPC is unlikely to face any funding issues—cash and bonds worth Rs33/share is enough to fund equity for more than 20 GW of generation capacity.

We build in 46.5 GW generation capacity by FY2012. We project installed generation capacity of 46.5 GW for NTPC by the end of FY2012 as against their target of reaching 50 GW. Out of the 22,340 MW capacity addition planned during the XIth plan—1,990 MW has been commissioned (including 250 MW in JV) and 16,680 MW is under construction. Bids have been invited or are under evaluation for the balance 3,760 MW. We note a high degree of preparedness for the XIth plan projects with land acquisition, environmental and other clearances in place. Environmental clearance for Pakri Barwadih mine has also been received. Ministry of Coal has approved the mining plan and government has issued the notification for land acquisition.

Valuation attractive compared to regional peers. NTPC stock has corrected sharply over the past few weeks and is now trading at reasonable levels. NTPC is trading at a P/E of 15.8X and P/B of 2.2X on FY2010E. Utility companies in Asia are trading at an average P/E of 16X and P/B of 1.7X on CY2009E (Bloomberg consensus). We note NTPC's superior return profile—reported RoE of ~14% compared to an average ROE of 11% for Asian utility stocks. NTPC will also likely have a much superior growth profile and strong balance sheet compared to its peers in Asia.

Insulation from price escalation of commodities. We believe NTPC, with the bulk of its operational and planned capacity based on regulated returns, is best placed to absorb any cost pressures on capital equipment due to increase in steel prices and other construction costs. The Boiler-Turbine-Generator (BTG) procurement contract for NTPC normally has a price-variation clause built in for key commodities and the central regulator has typically allowed higher costs due to escalation in prices in the past to be recovered through tariffs. Only 2,120 MW out of the 50,000 MW power capacity by FY2012 is being planned as merchant power plants—Korba (500 MW), Farakka (500 MW), Tapovan Vishnugad (520 MW) and Loharinag Pala (600 MW).

Retain ADD with DCF-based target price of Rs210. Our DCF model using a cost of equity of 11% and terminal growth rate of 4.5% (beyond FY2012) gives a value of Rs210/share for NTPC. A stable regulatory regime and cost-pass-through structure with virtually no offtake risk gives us the confidence to assume a cost of equity lower than the market-wide cost of equity.

Current market price barely factors in capacity ordered out

Implied capacity addition for NTPC

	Value	Comments
1. Value of existing business (Rs/share)		
Generation business (Coal and gas, including JVs)	74	DCF-to-equity (Disc. rate:11%)
2. Value of cash and investments (Rs/share)		
Treasury (8.5% tax free)	25	Market value
Cash and marketable securities	8	Market value
Capital WIP	17	Book value
3. CMP (Rs/share)	**161**	
Implied value enhancement from future projects (Rs/share) [3-(1+2)]	37	
Implied value enhancement from future projects (Rs mn)	305,065	
Assumed P/B ratio for value enhancement (X)	1.6	
Equity investment in future projects (Rs mn)	190,666	Value enhancement / P/B
Proportion of equity investment (%)	30	
Overall investment in future projects (Rs mn)	635,552	Assuming replacement cost of Rs40 mn/MW
4. Implied capacity addition (MW)	**15,889**	**Against 16,680 MW under-construction and likely to commission by FY2012**

Source: Kotak Institutional Equities estimates.

Expected commissioning or NTPC's projects (MW)

FY2008	1,990
FY2009	2,820
FY2010	3,600
FY2011	6,620
FY2012	7,400
Total	**22,430**

Source: Company.

NTPC: Profit model, balance sheet, cash model 2007-2011E, March fiscal year-ends (Rs mn)

	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)					
Net sales	326,317	370,636	413,754	459,829	505,683
EBITDA	**93,137**	**109,264**	**118,804**	**138,783**	**151,606**
Other income	27,449	23,290	21,363	13,209	10,784
Interest	(8,063)	(11,134)	(12,261)	(14,335)	(19,639)
Depreciation	(20,754)	(21,098)	(22,318)	(25,640)	(32,321)
Extraordinary items	(2,695)	0	0	0	0
Pretax profits	89,074	100,322	105,588	112,017	110,430
Tax	(20,427)	(26,584)	(26,936)	(27,039)	(23,401)
Net profits	**68,647**	**73,738**	**78,652**	**84,978**	**87,028**
Earnings per share (Rs)	**8.7**	**8.9**	**9.5**	**10.3**	**10.6**
Balance sheet (Rs mn)					
Total equity	485,968	525,200	567,046	602,316	638,437
Deferred taxation liability	6,568	7,685	8,576	10,087	13,631
Total borrowings	244,844	376,646	587,320	822,644	1,059,460
Currrent liabilities	70,263	69,820	78,623	87,992	95,973
Total liabilities and equity	**807,643**	**979,351**	**1,241,564**	**1,523,040**	**1,807,501**
Cash	133,146	115,773	66,857	17,416	20,876
Current assets	88,681	97,928	107,833	117,279	127,390
Total fixed assets	424,873	611,417	921,688	1,274,885	1,576,654
Investments	160,943	154,233	145,187	113,460	82,582
Total assets	**807,643**	**979,351**	**1,241,564**	**1,523,040**	**1,807,501**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	89,474	94,836	100,970	110,618	119,350
Working capital	(7,485)	(10,600)	(1,678)	(3,301)	(2,431)
Capital expenditure	(78,392)	(207,642)	(332,589)	(378,837)	(334,090)
Investments	31,948	6,710	9,047	31,727	30,879
Free cash flow	**35,545**	**(116,695)**	**(224,250)**	**(239,794)**	**(186,293)**
Ratios					
P/E (X)	18.6	18.0	16.8	15.6	15.2
EV/EBITDA (X)	13.6	13.0	14.3	14.4	14.8
P/B (X)	2.7	2.5	2.3	2.2	2.0
RoAE (%)	15.1	14.4	14.2	14.3	13.8

Source: Kotak Institutional Equities estimates.

DCF-equity based target price of Rs210/share assuming 11% cost of equity and 4.5% terminal growth rate

Sensitivity of our target price to cost of equity and terminal growth rate

		Terminal growth rate (%)				
		0	**1.5**	**3**	**4.5**	**6**
Cost of equity (%)	8	211	248	306	416	689
	9	183	209	249	316	449
	10	161	180	209	253	329
	11	143	158	179	209	258
	12	128	140	156	178	211
	13	116	125	137	154	178

Source: Kotak Institutional Equities estimates.

Metals

STRL.BO, Rs919	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	1,000
52W High -Low (Rs)	1150 - 477
Market Cap (Rs bn)	650.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	250.4	261.1	258.8
Net Profit (Rs bn)	42.6	40.9	39.8
EPS (Rs)	60.1	57.7	56.1
EPS gth	*(27.7)*	*(4.0)*	*(2.6)*
P/E (x)	15.3	15.9	16.4
EV/EBITDA (x)	8.2	7.2	7.0
Div yield (%)	-	-	-

Sterlite Industries: Acquisition of Asarco attractive on the face of it—await more details before altering estimates

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- **Sterlite Industries acquires Asarco—a Chapter XI US-based integrated copper smelting company—for US$2.6 bn**
- **Sterlite acquires all operating assets including three open-pit mines, copper smelter, refinery, rod and cake plant; ring-fences itself from all asbestos and environmental liabilities**
- **To fund the acquisition through a mix of debt and existing cash resources; half of the acquisition value (US$1.3 bn) can be raised through non-recourse debt in the books of Asarco**
- **Valuation appears attractive on the face of the transaction—we await more details before taking a view; maintain estimates, retain ADD rating with a target price of Rs1,000/share**
- **Sterlite acquires all operating assets of Asarco—stays clear of associated liabilities**

Sterlite has acquired Asarco—a Chapter XI US-based copper mining, smelting and refining company for US$ 2.6 bn. The management has indicated that it would be acquiring all the operating assets of the company sans associated asbestos and environmental liabilities. The operating assets acquired include three open-pit mines with estimated reserves of upto 5 mn tons of contained copper which could last upto 28 years of operations. Sterlite has also acquired its copper smelter at Arizona and a copper refinery, rod and cake plant in Texas. Asarco has a smelting capacity of 230,000 tons p.a. and a refining capacity of 500,000 tons p.a. Management has indicated that Sterlite has ring-fenced itself from all asbestos and environmental liabilities associated with Asarco's ceased operations and that the acquisition is debt free.

Sterlite may fund acquisition through mix of debt and existing cash resources

The acquisition price of US$ 2.6 bn will likely be funded through a mix of debt and existing cash resources. The management of Sterlite has indicated that the acquisition price of US$ 2.6 bn includes working capital to the extent of US$500 mn. Sterlite plans to fund the acquisition through a non-recourse debt based on the balance sheet of Asarco to the extent of half the acquisition price paid. The balance would be paid through existing cash resources—we estimate Sterlite's current cash resources to be at US$ 4.8 bn.

Production gains to drive EBITDA growth

Asarco reported revenues of US$1.9 bn and an EBITDA of US$640 mn for CY2007. Management appeared confident of EBITDA growth from production gains and given Sterlite's successful track record of turning round companies and its execution capabilities. Asarco's cash cost of US cents 150 / pound appears decent in the wake of current copper prices. We expect production to grow as Asarco has sufficient capacity to absorb incremental mining production—the management indicated that additional mining production could be used internally as Asarco has extra smelting and refining capacity. Besides, we believe the additional copper concentrate produced at Asarco could be used to feed Indian copper production. A key concern relating to the acquisition could be the environmental claims that Sterlite may have to assume on the mining operations to be carried out by Asarco in future.

Acquisition appears to be attractive on the face of the transaction; we await details

Sterlite's management has indicated that Asarco's cost of operations is 150c/lb translating to a cost of US$3,300/ton at the refined copper stage. At US$5,500/ton of copper prices and approximate premium of US$300/ton, Asarco has an EBITDA of US$2,500/ton. Based on these calculations, Asarco is valued at an EV/EBTIDA of 4X CY2007 earnings—appears to be pretty attractive on the face of the transaction. We await more details pertaining to environmental liabilities on future production and funding details before taking a view on the acquisition. We maintain our estimates for Sterlite as of now and retain our ADD rating on the stock with a target price of Rs1,000/share.

SOTP-based target price of Sterlite Industries is Rs1,000/ share

SOTP-based target price of Sterlite, March fiscal year-ends, 2009E basis (Rs mn)

	EBITDA (Rs bn)	Multiple (X)	EV (Rs bn)	Sterlite's stake (%)	Attributable EV (Rs bn)	EV (Rs/ share)
Hindustan Zinc	54	7	376	65	244	345
Bharat Aluminium	21	8	169	51	86	122
Sterlite (copper business)	9	6	47	100	47	66
Vedanta Alumina (b)	18	8	146	30	43	61
Copper Mines of Tasmania (a)						36
Sterlite energy (c)					65	92
Total Enterprise Value					**485**	**721**
Net debt / (cash)					(189)	(267)
Attibutable market capitalization					**674**	**988**
Target price (Rs/ share)						**1,000**

Notes:

(a) Copper Mines of Tasmania has been valued on DCF basis, as the mine-life is only 6 years.

(b) EBITDA of Vedanta Alumina enhanced to reflect income tax exemptions.

(c) We have valued investments in Sterlite energy 3X book.

Source: Kotak Institutional Equities

Construction

PUJL.BO, Rs287	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	370
52W High -Low (Rs)	656 - 214
Market Cap (Rs bn)	92.2

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	77.5	105.6	137.1
Net Profit (Rs bn)	3.2	4.8	6.9
EPS (Rs)	10.1	14.9	21.6
EPS gth	*93.0*	*47.6*	*45.0*
P/E (x)	28.5	19.3	13.3
EV/EBITDA (x)	15.9	11.3	8.4
Div yield (%)	0.3	0.5	0.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.7	-	-
FIIs	24.4	0.3	0.1
MFs	12.6	0.8	0.6
UTI	-	-	(0.2)
LIC	-	-	(0.2)

Punj Lloyd: Problems localized in a single contract wherein breakeven may be realized, maintains margin guidance; Reiterate BUY

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- **Management believes that Rs3 bn of auditor qualification is recoverable based on negotiation with clients; Rs1.2 bn has already been approved**
- **Management very confident of managing rising commodity price environment; maintains margin guidance at 11-11.5%**
- **Management reiterates ambition of emerging as a global EPC major; targeting large orders of over US$1 bn**
- **Downgrade estimates and revise target price to Rs370 (from Rs420 earlier); reiterate BUY rating**

Management sees the Rs3 bn of 'likely losses' noted by auditors as an auditor qualification and not a post-facto loss, as the amount is likely recoverable based on discussions with the client (Rs1.2 bn has already been approved by the client). Punj has retained its EBITDA margin guidance of 11-11.5% for Punj orders and 7-7.5% for Sembawang orders (apart from legacy orders of about Rs7 bn that are likely to yield not more than 1%). Management believes that 90% of the order book is protected from commodity price increases through (1) price escalation clauses or (2) back-to-back ordering. Management reiterated its ambition of becoming a global EPC major. Punj is eyeing several large opportunities in the global EPC space, with single-order values of about US$ 1 bn, and expects some opportunity to likely materialize in FY2009. We revise our estimates downwards, revise target price to Rs370 (from Rs420 earlier) and reiterate BUY rating.

Management believes Rs3 bn of auditor qualification recoverable; Rs1.2 bn escalation already approved by client; highlight that issue pertains only to one particular order

Management believes that the Rs3 bn of 'likely losses' noted by auditors in the financial statements of Simon Carves (UK) is only an auditor qualification and not a post-facto loss as the amount is likely recoverable based on discussions with the client. All the losses pertain to a single LDPE plant order for SABIC, which was worth GBP140 mn at the time of award (current backlog is about GBP11 mn). However, subsequent design and scope changes as well as delays etc led to cost escalations. The client has agreed to enhance the order value by Rs1.2 bn (likely to be formalized in June 2008) post the finalization of FY2008 accounts. The order is estimated to be completed by November 2008 and the entire amount to be recovered is likely to be crystallized then (as clients typically settle such claims towards the end of contracts). Management was confident of recovering the amount based on its comfort with the client and the fact that its relations with the client extend beyond this order (based on fresh orders that may be awarded by SABIC). Write-off of Rs679 mn in 3QFY08 was also related to the same order, though that was write-off of profits recognized on the order in earlier years. Post recovery of the amount, management is confident of at least breaking-even on this project. We highlight that this issue pertains to only a particular order and is not a generic problem confronting Sembawang or Simon Carves. We believe that Sembawang, excluding Simon Carves, has likely made profits during the quarter.

No further provisions on legacy orders envisaged; all provisions had already been made in 3QFY08

Management reiterated that it had already provided for all possible losses on Sembawang's legacy orders (currently about Rs7 bn) in 3QFY08 itself, so as to reach a stage of break-even on all such orders. These were losses that were foreseen till 3QFY08 and the situation remains unchanged as of 4QFY08. All the legacy orders are likely to be executed in about another nine months.

Management very confident of managing rising commodity price environment; maintains margin guidance at 11-11.5%

Punj Lloyd has retained its EBITDA margin guidance of 11-11.5% for Punj Lloyd orders and 7-7.5% for Sembawang orders (apart from legacy orders of about Rs7 bn that are likely to yield not more than 1%). Management believes that 90% of the order book is protected from commodity price increases through (1) price escalation clauses (primarily steel and cement) in civil works-related contracts or (2) back-to-back ordering of sub components in EPC or turnkey contracts (such ordering is typically done within eight weeks of contract award). Any impact on the balance 10% of the order book is likely to be not more than 1-1.5% in terms of margins and that may also be absorbed in the contingencies that Punj typically builds in each contract, according to management. All fresh contracts of Punj now contain price variation clauses and hence no problems on this account are foreseen in the future. We highlight that the proportion of orders where Punj Lloyd is covered for commodity price escalation is far ahead of our expectation and addresses one of the central concerns for near-term earnings.

Management reiterates ambition of emerging as a global EPC major; targeting large orders of over US$1 bn

Management reiterated its ambition of becoming a global EPC major and stressed that it is developing its organizational capabilities towards that end (and hence more focused on long-term achievements rather than quarterly results that may contain blips). Management highlighted that it is geography agnostic and would continue to cherry-pick high-margin orders across its global footprint (India contributed only 30% to order backlog of Punj Lloyd at the end of FY2008, Exhibit 1). Punj is eyeing several large opportunities in the global EPC space, with single-order values of about US$ 1 bn, and expects some opportunity to likely materialize in FY2009. We highlight that such orders will demonstrate Punj's ability to win large orders (and customer confidence in its abilities) and set it apart from smaller players in India (as currently only L&T has executed such large orders among Indian construction companies). We believe that given its strong order backlog (of Rs196 bn, that provides it comfort and revenue security to some extent), Punj may target larger orders only (that are likely higher-margin). Hence, order booking may become more bunched-up (we highlight that the recent pipeline order from Petronas Malaysia is about US$500 mn, Exhibit 2) with fewer order inflows. To execute its large backlog and achieve strong growth, Punj will continue to enhance its capacities. In addition to about Rs4.5 bn incurred in FY2008, Punj Lloyd is likely to undertake further capex of Rs4 bn in FY2009E.

Results broadly in-line with expectations led by higher-than-expected margins and lower-than-expected other income

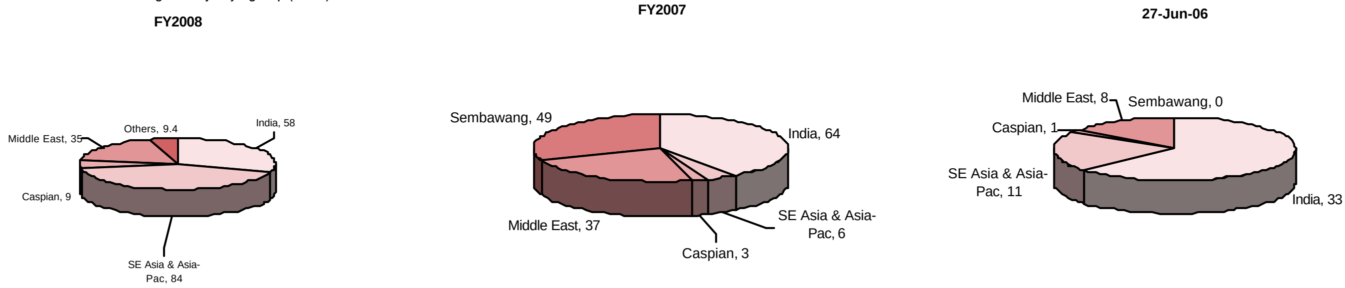
Punj Lloyd reported 4QFY08 consolidated revenues of Rs23.5 bn (up 38% yoy) and PAT of Rs1.2 bn (up 33% yoy) (Exhibits 3-4). Revenue growth was led by 88% growth in revenues of the standalone entity to Rs15 bn. Subsidiary revenues decreased by 6% yoy. Consolidated EBITDA margins in 4QFY08 expanded by 60 bps yoy to 10.6% versus 10% a year ago led by project execution-mix changes at the standalone entity (standalone margins expanded by 710 bps to 16.1% in 4QFY08). Interest and depreciation in 4QFY08 increased 26% and 24% (yoy) respectively, led by the increased capex. Other income was a negative of Rs183 mn primarily due to reversal of derivative gains recognized in earlier quarters of Rs218 mn (such a reversal was necessitated by a change in accounting policy whereby derivative gains are not to be recognized). Net current assets at Rs22.5 bn (excluding cash of Rs77 mn) (73 days of sales) suggests strong improvement in working capital utilization for the company at the end of FY2008.

Downgrade estimates and revise target price to Rs370 (from Rs420 earlier); reiterate BUY rating

We have revised our execution estimate to Rs106 bn (from Rs114 bn earlier) and Rs137 bn (from Rs152 bn earlier) for FY2009E and FY2010E respectively based on lower-than-expected order booking during the year. We have revised our EPS for FY2009E and FY2010E to Rs14.9 (From Rs16.9) and Rs21.6 (from Rs24.7). We revise our our FY2009E DCF-based target price to Rs370 (from Rs420 earlier, Exhibit 5) based on the changes in our earnings estimates. Our DCF valuation implies 25X Fy2009E earnings and 17X FY2010E earnings. We highlight that we continue to value Pipavav Shipyard, Ramprastha JV, Upstream business and civil aviation business at investment value. We reiterate our BUY rating based on likely strong growth in both Punj Lloyd group as well as Sembawang led by continued order inflows across various geographies and business segments.

Exhibit 1: Proportion of order backlog contributed by Indian gepgraphy has declined to 30% at the end of FY2008 from 40% at the end of FY2007

Geographical mix of order backlog of Punj Lloyd group (Rs bn)



Note:
Orderbacklog of SEC was about Rs69 bn at the end of FY2008

Source: Company data, Kotak Institutional Equities.

Exhibit 2: Strong order inflows continue for Punj Lloyd so far in this financial year
Key orders won by Punj Lloyd in FY2008 so far (Rs mn)

Date	Segment	Area	Client	Value (Rs mn)	Group entity	Description
7-Mar-08	Oil and Gas	Pipeline	Petronas, Malaysia	20,000	Punj Lloyd	EPC of a 512 km, 36" diameter onshore natural gas pipeline in Malaysia with support from local partners
14-Feb-08	Civil, Infrastructure and Power	Buildings	Marina Bay Sands Pte Ltd, Singapore	11,192	Sembawang Engineers and Constructors	Construction of the North Podium in the integrated resort comprising casino, theatres and retail arcade
12-Dec-07	Process	Process	Indian Oil Corporation	5,900	Punj Lloyd	Construction of coker unit & block for the Vadodara refinery in Gujarat
30-Nov-07	Civil, Infrastructure and Power	Infrastructure	Land Transport Authority, Singapore	12,720	Sembawang Engineers and Constructors	Construction of the MRT station in Marina Bay in Singapore
5-Nov-07	Process	Process	Jurong Aromatics Corporation Pte Ltd, Singapore	17,700	Sembawang Engineers and Constructors	EPC work for a new mega aromatics plant at Jurong island
12-Oct-07	Oil and Gas	Pipeline	Qatar Petroleum	3,890	Punj Lloyd	EPC on LSTK basis of 46 km of 18" multi-product pipeline
6-Aug-07	Process	Process	Bharat Oman Refineries Limited	5,900	Punj Lloyd	Lump-sum turnkey contract for building a sulphur block at Bina Refinery
2-Aug-07	Civil, Infrastructure and Power	Buildings	Sentosa Pte Ltd, subsidiary of Genting Group	6,660	Sembawang Engineers and Constructors	Sub-structural works at Sentosa Integrated Resort Development
27-Jul-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	3,180	Punj Lloyd	Laying of pipeline & associated facilities for East-West Pipeline project
23-Jul-07	Oil and Gas	Tankage	Saudi Kayan Petrochemical Company (SABIC)	1587(a)	Dayim Punj Lloyd Construction Contracting Company Ltd	EPC of tanks at Jubail Industrial city, Saudi Arabia
20-Jul-07	Process	Process	Gulf Fluor	500(b)	Simon Carves Ltd.	Fluorides plant incorporating a new Sulphuric Acid plant
14-May-07	Oil and Gas	Pipeline	GAIL (India) Ltd	1,227	Punj Lloyd	Phase II of Panvel — Dabhol Pipeline
16-Apr-07	Oil and Gas	Pipeline	Oman Gas Company	5,300	Punj Lloyd	24", 40 Km pipeline
19-Apr-07	Oil and Gas	Pipeline	Ras Laffan Olefins Company Ltd, USA	1,935	Punj Lloyd	Ethylene pipeline
23-Apr-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	1,802	Punj Lloyd	48", 122 Km pipeline
Total				**99,492**		

(a) Estimated share of Punj Llyod
(b) Estimated order value

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 3. Punj Lloyd (standalone) - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			12 months		
	4QFY08	4QFY07	*(% chg)*	4QFY08	3QFY08	*(% chg)*	FY2008	FY2007	*(% chg)*
Net sales	**14,994**	**7,983**	***87.8***	**14,994**	**12,438**	***20.6***	**44,886**	**22,397**	***100.4***
Operating costs	**(12,574)**	**(7,264)**	***73.1***	**(12,574)**	**(11,380)**	***10.5***	**(39,741)**	**(20,544)**	***93.4***
Material consumed and cost of goods sold	(4,953)	(2,607)	*90.0*	(4,953)	(4,355)	*13.7*	(16,254)	(5,902)	*175.4*
Contractor charges	(2,839)	(1,667)	*70.3*	(2,839)	(3,509)	*(19.1)*	(9,963)	(4,960)	*100.9*
Staff Cost	(1,210)	(734)	*64.7*	(1,210)	(928)	*30.4*	(3,585)	(2,366)	*51.6*
Other Expenditure	(3,572)	(2,256)	*58.3*	(3,572)	(2,588)	*38.0*	(9,939)	(7,317)	*35.8*
EBITDA	**2,421**	**719**	***236.8***	**2,421**	**1,058**	***128.8***	**5,144**	**1,853**	***177.7***
Other income	72	210	*(65.9)*	72	145	*(50.4)*	532	658	*(19.2)*
Interest costs	(301)	(261)	*15.4*	(301)	(239)	*25.8*	(1,133)	(692)	*63.6*
Depreciation	(318)	(242)	*31.4*	(318)	(294)	*7.9*	(1,134)	(845)	*34.2*
PBT	**1,874**	**427**	***339.1***	**1,874**	**669**	***180.1***	**3,409**	**973**	***250.3***
Taxes	(577)	(195)	*195.9*	(577)	(277)	*107.9*	(1,195)	(357)	*234.4*
PAT	**1,297**	**232**	***459.6***	**1,297**	**392**	***231.2***	**2,214**	**616**	***259.5***
Key ratios									
Material consumed and cost of goods sold	33.0	32.7		33.0	35.0		36.2	26.4	
Contractor charges	18.9	20.9		18.9	28.2		22.2	22.1	
Staff Cost	8.1	9.2		8.1	7.5		8.0	10.6	
Other Expenditure	23.8	28.3		23.8	20.8		22.1	32.7	
EBITDA margin (%)	**16.1**	**9.0**		**16.1**	**8.5**		**11.5**	**8.3**	
PAT margin (%)	8.7	2.9		8.7	3.1		4.9	2.8	
Effective tax rate (%)	30.8	45.7		30.8	41.5		35.1	36.7	

Source: Company data, Kotak Institutional Equities.

Exhibit 4. Punj Lloyd (consolidated) - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			12 months		
(in Rs mn)	4QFY08	4QFY07	*(% chg)*	4QFY08	3QFY08	*(% chg)*	FY2008	FY2007	*(% chg)*
Net sales	**23,467**	**17,036**	***37.8***	**23,467**	**21,170**	***10.8***	**77,529**	**51,266**	***51.2***
Operating costs	**(20,981)**	**(15,329)**	***36.9***	**(20,981)**	**(20,126)**	***4.2***	**(71,122)**	**(47,523)**	***49.7***
Material consumed and cost of goods sold	(7,478)	(2,989)	*150.2*	(7,478)	(7,614)	*(1.8)*	(28,285)	(16,370)	*72.8*
Contractor charges	(5,966)	(6,461)	*(7.7)*	(5,966)	(6,747)	*(11.6)*	(21,339)	(14,181)	*50.5*
Staff Cost	(2,889)	(2,019)	*43.1*	(2,889)	(2,392)	*20.8*	(8,924)	(6,369)	*40.1*
Other Expenditure	(4,648)	(3,860)	*20.4*	(4,648)	(3,373)	*37.8*	(12,575)	(10,602)	*18.6*
EBITDA	**2,486**	**1,707**	***45.7***	**2,486**	**1,045**	***138.0***	**6,407**	**3,743**	***71.2***
Other income	(183)	164	*(211.9)*	(183)	459	*(139.9)*	811	794	*2.1*
Interest costs	(326)	(258)	*26.3*	(326)	(284)	*14.5*	(1,292)	(825)	*56.5*
Depreciation	(409)	(329)	*24.3*	(409)	(365)	*12.0*	(1,462)	(1,062)	*37.8*
PBT	**1,568**	**1,283**	***22.2***	**1,568**	**854**	***83.7***	**4,464**	**2,650**	***68.4***
Taxes	(374)	(398)	*(6.0)*	(374)	(308)	*21.4*	(1,235)	(690)	*79.1*
PAT	**1,194**	**885**	***34.9***	**1,194**	**546**	***118.8***	**3,229**	**1,960**	***64.7***
Minority interest/Exceptional items	(17)	-		(17)	-		356	-	
Reported PAT	**1,177**	**885**	***33.1***	**1,177**	**546**	***115.8***	**3,584**	**1,960**	***82.8***
Key ratios									
Material consumed and cost of goods sold	31.9	17.5		31.9	36.0		36.5	31.9	
Contractor charges	25.4	37.9		25.4	31.9		27.5	27.7	
Staff Cost	12.3	11.8		12.3	11.3		11.5	12.4	
Other Expenditure	19.8	22.7		19.8	15.9		16.2	20.7	
EBITDA margin (%)	**10.6**	**10.0**		**10.6**	**4.9**		**8.3**	**7.3**	
PAT margin (%)	5.1	5.2		5.1	2.6		4.2	3.8	
Effective tax rate (%)	23.9	31.0		23.9	36.1		27.7	26.0	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 5 Punj Lloyd Consolidated- DCF model, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**105,605**	**137,063**	**176,224**	**219,161**	**269,102**	**326,412**	**388,912**	**447,249**	**514,336**	**591,486**	**662,465**
Revenue growth (%)	36.2	29.8	28.6	24.4	22.8	21.3	19.1	15.0	15.0	15.0	12.0
EBITDA	**9,313**	**12,805**	**16,524**	**20,544**	**25,250**	**30,641**	**36,514**	**42,489**	**48,862**	**56,191**	**62,934**
EBITDA (%)	8.8	9.3	9.4	9.4	9.4	9.4	9.4	9.5	9.5	9.5	9.5
Depreciation	(1,762)	(1,989)	(2,252)	(2,549)	(2,882)	(3,249)	(3,652)	(3,834)	(4,026)	(4,227)	(4,439)
EBIT	7,551	10,815	14,272	17,995	22,368	27,392	32,862	38,654	44,836	51,964	58,495
Tax	(2,121)	(3,002)	(3,970)	(5,006)	(6,231)	(7,636)	(9,162)	(12,756)	(14,796)	(17,148)	(19,303)
Change in net working capital	**(6,054)**	**(6,745)**	**(6,019)**	**(8,623)**	**(10,112)**	**(11,526)**	**(12,592)**	**(11,987)**	**(13,785)**	**(15,853)**	**(14,585)**
Capex	(3,000)	(3,500)	(4,000)	(4,500)	(5,000)	(5,500)	(6,000)	(6,261)	(7,201)	(8,281)	(9,275)
Free cash flow	**(1,861)**	**(443)**	**2,535**	**2,416**	**3,907**	**5,979**	**8,759**	**11,484**	**13,080**	**14,910**	**19,772**
PV of each cash flow	(1,861)	(393)	2,003	1,697	2,439	3,318	4,320	5,035	5,098	5,165	6,089

PV of cash flows	32,910	28%	FCF in terminal year (Rs mn)	19,772
PV of terminal value	85,240	72%	Exit FCF multiple: (1+g)/(WACC-g)	14.0
EV	118,150	100%	Terminal value of FCF (Rs mn)	276,802
Debt	(677)		Exit EBITDA multiple	4.4
Equity value	118,827			
Equity value (Rs/share)	**371**			

				Sensitivity of DCF value to WACC, Terminal Growth rate				
Weighted average cost of capital-WACC						WACC (%)		
Terminal growth - g (%)	5.0			**11.5**	**12.0**	**12.5**	**13.0**	**13.5**
Risk free rate-Rf (%)	8.0	Terminal	**3.0**	363	335	311	289	269
Market risk premium—(Rm-Rf) (%)	5.5	growth	**4.0**	400	366	337	311	289
Beta (x)	1.1	rate (%)	**5.0**	447	406	**371**	340	313
Cost of equity-Ke (%)	13.6		**6.0**	512	459	414	377	344
Cost of debt-Kd (%)	12.0		**7.0**	606	533	474	425	384
Tax rate (%)	33.9							
Debt/Capital (%)	43.1							
Equity/Capital (%)	56.9							
WACC (%)	11.1							
Used WACC (%)	**12.5**							

Source: Company data, Kotak Institutional Equities estimates

Economy

Sector coverage view	N/A

RBI's special market operations can significantly impact exchange rate and interest rates

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- **RBI to provide rupee liquidity to oil companies through designated banks by outrights or repos against oil bonds to a maximum of Rs10 bn (about US$237 mn) a day**
- **Oil companies can purchase equivalent forex from RBI through designated banks at market exchange rates**
- **RBI operations are not constrained as the ceiling of Rs10 bn is applicable to daily operations and not outstanding**
- **Special market operations are money neutral and positive for the rupee**

RBI on May 30, 2008 announced special market operations, on an *ad hoc* basis, against oil bonds to meet the oil companies' forex requirements. We believe the facility has the potential to significantly impact exchange rate and interest rates in the Indian economy. Though the facility is capped at Rs10 bn on any single day, the ceiling is not applicable to outstanding, and potentially if the RBI chooses to do so, it can mop up the entire stock of oil bonds outstanding with oil companies in 2-3 months. The special market operations give RBI enough room to carry out its market operations flexibly. The daily cap is not a constraining factor and it can make a significant impact on exchange rate and interest rates.

Long-term repos may be preferred to outright purchases

We believe the cap of daily open market operations against oil bonds at Rs10 bn is moderate. **We also expect RBI to conduct it special market operations more through long-term repos than outright purchases.** RBI in its press release has stated that it would conduct its special market operations through outright transactions or repos. However, it has not clarified the tenor or the terms of the repos (such as haircuts to be applied) or when these operations would begin. Normally, RBI issues a notification along with a press release clarifying the terms and conditions. However, it has chosen not to do so, at least immediately. We, however, believe:

- Repos would be of a longer term in the range of 30-90 days (90 days may be preferred to avoid transaction costs in rolling over the repos).

This would be in contrast with its typical one-day repos extended to the banks under its Liquidity Adjustment Facility (LAF).

- Repos would be preferable to outrights, as RBI may not be keen to accept oil bonds in its books on a permanent basis.

It may, however, do some outright purchases as this would soften the oil bond secondary market yields and improve the market acceptability of the paper.

Size of the daily operation moderate, but overall operations not constrained by size

We believe the size of the daily open market operations against oil bonds at Rs10 bn is moderate. However, this is unlikely to act as a constraint in RBI's overall operations which is only bounded by the oil bonds with the oil companies. At the current exchange rate of Rs42.25 vs. US dollar, oil bonds can help oil companies purchase of a maximum of US$237 bn of foreign exchange on any given day against up to the Rs10 bn of rupee liquidity made available through repo.

We believe:

- The daily cap is moderate in relation to the daily requirements of the oil companies. It constitutes only a fraction of the total turnover foreign exchange markets, but can significantly impact exchange rates improving supply by 9.5% a day for spot forex merchant purchases.

Total daily forex turnover in the Indian forex markets during March 2008 was US$53 bn. The turnover includes both merchant and inter-bank transactions covering the spot, forward and forward cancellation in both rupee-foreign currency and foreign currency-foreign currency trades. Spot rupee-foreign currency purchases of foreign currency averages about US$2.5 bn. Therefore, in this thin market, a supply of US$237 mn can improve supply by 9.5% of the spot merchant purchases. This can significantly impact the dollar demand-supply balance and impact the future path of the exchange rate.

- Daily supply of Rs10 bn constitutes only about 1-2% of the daily money market turnover of about Rs800 bn in overnight markets (call, CBLO and market repo), but it constituted about 14% of the daily average LAF repo injections during 4QFY08.
- Rs10 bn a day can potentially take out the entire stock of oil bonds of about Rs600 bn (for issuances against subsidies till FY2008) with oil companies in 2-3 months.

If this happens we may still end up with stable gilt yields in FY2009 and see no significant tightening of lending and deposit rates. However, RBI is unlikely to take such aggressive operations and may mop up only a moderate amount depending upon evolving movements of gilt yields and exchange rates.

Special operations are money neutral but positive for rupee exchange rate

Though special operations de facto extend RBI credit to the commercial sector, in terms of monetary accounting it is most likely to be shown as RBI credit to the government. This is so because the oil bonds are the liability of the government, notwithstanding the fact that the liquidity is being released to the oil companies against such bonds. So, while the oil bonds continue to have a non-SLR status, net RBI credit to the government would rise. However, this would be offset by equal contraction in net foreign exchange assets of RBI. As a result, the transaction would be reserve money neutral and would have no monetary impact.

RBI's forex reserves would, however, come down to the extent it provides forex to the oil companies. The operations would have the same impact on reserves as it would have in case of RBI interventions. With a cap of Rs10 bn a day, RBI can potentially erode reserves by US$237 mn per day. If full limit is utilized on all days, the reserve loss could add up to a little under US$6 bn in a month (assuming 25 working days). This could put a significant upward pressure on rupee.

Actual RBI operations can be calibrated and reserve loss could be much less. The net impact of (1) ECB relaxations, (2) raising of FII investment caps in G-sec and corporate bond markets and (3) special market operations is that rupee could stabilize around 42.20 levels in the near term. The latest move is a significant positive for rupee and should decisively quell rupee weakening tendency seen in May 2008.

Automobiles

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**2-Jun**	**Target**
Hero Honda	REDUCE	788	710
Tata Motors	SELL	564	525
Maruti Suzuki	BUY	787	1,000
Mah & Mah	ADD	592	720

May '08 sales: Motorcycle volumes grow led by new launches, passenger car growth remains robust

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- **Hero Honda: May '08 volumes up 9.5% yoy**
- **Bajaj Auto: Motorcycle volumes grow 7.6% yoy; 3-wheeler segment performs badly**
- **TVS Motors: Motorcycle volumes grow 10% yoy led by launch new bike**
- **Maruti: Domestic volume grows 14.6% yoy led by strong growth in mid-size and compact car segment**
- **Tata Motors: M&HCV volumes do well yet again; passenger car sales decline**
- **M&M: UV volume growth continues to be strong; tractor volume grows 16% yoy on account of low base**

Two-wheeler volumes have recorded a positive growth in May-2008 led mainly by launches of new variants as well as growth in the > 125 cc higher-end bikes. Passenger car volume growth has been quite strong in May '08 led mainly by the compact car segment. While Maruti recorded an overall growth of 16% yoy, its main competitor Hyundai recorded a volume growth of 51% yoy led by a sharp increase in the sales of i-10 and the Santro. We expect domestic car industry growth to be robust led by a strong growth in the compact car segment. Tata Motors recorded a strong M&HCV growth indicating that the CV cycle is turning positive even as LCV growth continues to remain robust.

Hero Honda: May '08 volumes up 9.5% yoy

Hero Honda's 2-wheeler volumes were up 9.5% yoy and 9.1% mom in May '08. We believe that volumes were boosted by increased demand for Hunk as well as for the newly launched Splendor NXG. We expect volume growth for 2-wheelers to be muted on account of a pull back by financiers in extending credit for 2-wheelers.

Bajaj Auto: Motorcycle volumes grow 7.6% yoy; 3-wheeler segment performs badly

Bajaj Auto reported a 7.6% yoy increase in motorcycle volumes in May '08 while overall 2-wheeler volumes increased 6.9% yoy for the month. The growth in motorcycle volumes was led mainly by pre-ponement of the marriage season. We believe that the shift in preference towards >125 cc bikes will likely boost Bajaj's growth prospects. The management has indicated that it intends to strengthen its position in this category by launching four new bikes in the segment—we expect the first of these new 125 cc+ bikes to be launched in Sep '08. Besides, Bajaj also intends to launch one new 3-wheeler each in the goods as well as passenger segment.

TVS Motors: Motorcycle volumes grow 10% yoy led by launch new bike

TVS Motors recorded a 10.2% yoy growth in motorcycle volumes. This was largely on account of the launch of the new variant of Apache RTR. Overall 2-wheeler volumes grew 4.3% yoy led largely by the success of the new bike. TVS intends to launch two new scooters in the next couple of months. Besides, TVS would also be launching the fuel injection variant of the Apache RTR in June in a bid to boost volume growth. We expect the new launches to bring about some positive growth for TVS in the coming months even as 2-wheeler financing continues to be a concern as financiers continue to be reluctant to finance 2-wheelers. We believe that given this situation, it would be tough for TVS to compete with Hero Honda and Bajaj Auto, especially in the motorcycle segment.

Maruti: Domestic volume grows 14.6% yoy led by strong growth in mid-size and compact car segment

Maruti reported strong volume growth in May '08—better-than-expectation in our view. Domestic volumes grew 14.6% yoy and 7.7% mom in May '08. Export volumes grew by a sharp 41% yoy during the month. Overall sales were up 16.2% yoy. The growth was led by a strong growth in the compact car and mid-size car segment. Compact car segment volumes grew 14.5% yoy led by increased sales of Swift and Wagon-R while mid-size car segment grew 18.7% yoy—mid-car segment growth was on account of a strong demand for the newly launched Swift Dzire. Our channel checks indicate that the new Dzire has received a good response resulting in a long waiting list for the car. Meanwhile, the entry-segment volumes grew 25% mainly due to advanced dispatches of the M-800 Duo (LPG variant) which is to be launched in Jun '08. We expect Maruti's volume growth to remain robust—we expect Maruti's FY2009E domestic volume to grow at 12.6% yoy. We continue to be positive on Maruti given the strong product profile and the volume visibility.

Tata Motors: M&HCV volumes do well yet again; passenger car sales decline

Tata Motors reported strong M&HCV volume growth of 11.8% yoy for the month of May '08—we note that M&HCV volumes have been growing in each of months since Feb-2008. We believe that this is an indicator towards a revival of M&HCV growth. Meanwhile LCV volume growth has returned to double digit growth following a slower growth in the previous month—LCV volumes grew 17.3% yoy in May '08. Overall, domestic CV sales grew 14.5% yoy in May '08 while exports declined marginally. Tata Motors' UV volumes grew a sharp 47% yoy in May '08 while passenger car sales were down 5.3% yoy during the month as Indica sales slowed down sharply. We believe that the CV cycle has started to turn positive resulting in growth in M&HCV volumes. We expect Tata Motors' M&HCV volumes to grow 8% yoy in FY2009E while the launch of the new compact car and the Nano should boost its prospects in the passenger car segment.

M&M: UV volume growth continues to be strong; tractor volume grows 16% yoy off low base

M&M's UV volumes grew 18.8% yoy in May '08 but declined 3.8% mom. Logan volumes declined 45% yoy—sales were higher in the previous year as Logan was launched in May '07. M&M's tractor sales were up 16.3% yoy in May '08 mainly on account of low base in the previous year. Reluctance of the financiers in extending credit for tractors continues to hurt volume growth in the tractor segment—we expect tractor growth to be under pressure on account of issues related to financing. Meanwhile, we expect UV sales to be robust lead by increased demand for Scorpio as well as Bolero. M&M's UV exports increased 69% yoy.

Reported monthly sales of top two-wheeler companies - May 2008

	May-08	May-07	yoy %	Apr-08	mom %	YTD, FY2009	YTD, FY2008	yoy %
Bajaj Auto								
Ungeared Scooters	1,286	2,319	-44.5%	849	51.5%	2,135	3,707	-42.4%
Motorcycles	179,649	167,008	7.6%	203,081	-11.5%	382,730	331,312	15.5%
Total 2-Wheelers	**180,935**	**169,327**	**6.9%**	**203,930**	**-11.3%**	**384,865**	**335,019**	**14.9%**
3 Wheelers	20,576	24,110	-14.7%	17,913	14.9%	38,489	48,470	-20.6%
TVS Motor								
Motorcycles	54,717	49,651	10.2%	58,202	-6.0%	112,919	103,150	9.5%
Total 2-Wheelers	**112,770**	**108,151**	**4.3%**	**109,937**	**2.6%**	**164,654**	**213,044**	**-22.7%**
Hero Honda								
Total 2-Wheelers	312,317	285,109	9.5%	286,252	9.1%	598,569	547,653	9.3%

Source: Company.

4-wheelers May 2008 sales performance

	May-08	May-07	yoy %	Apr-08	mom %	YTD, FY2009	YTD, FY2008	yoy %
Tata Motors								
M&HCV	11,742	10,500	11.8%	11,248	4.4%	22,990	20,892	10.0%
LCV	11,940	10,175	17.3%	9,753	22.4%	21,693	19,390	11.9%
Domestic CV sales	23,682	20,675	14.5%	21,001	12.8%	44,683	40,282	10.9%
CV Exports	2,924	2,946	-0.7%	1,911	53.0%	4,835	5,914	-18.2%
Total CV	**26,606**	**23,621**	**12.6%**	**22,912**	**16.1%**	**49,518**	**46,196**	**7.2%**
UV	5,071	3,447	47.1%	3,673	38.1%	8,744	6,844	27.8%
Passenger Cars	14,662	15,490	-5.3%	11,564	26.8%	26,226	30,004	-12.6%
Total	**46,339**	**42,558**	**8.9%**	**38,149**	**21.5%**	**84,488**	**83,044**	**1.7%**
Mahindra & Mahindra								
UVs	13,048	10,986	18.8%	13,560	-3.8%	26,608	20,574	29.3%
LCVs	1,009	1,006	0.3%	776	30.0%	1,785	1,648	8.3%
Logan	1,531	2,786	-45.0%	1,713	-10.6%	3,244	2,786	-
Tractors	9,470	8,142	16.3%	8,628	9.8%	18,098	17,202	5.2%
3 Wheelers	3,708	2,536	46.2%	3,343	10.9%	7,051	4,541	55.3%
Total	**28,766**	**25,456**	**13.0%**	**28,020**	**2.7%**	**56,786**	**46,751**	**21.5%**
						-	-	
Maruti Udyog								
Entry (A) segment	6,830	5,456	25.2%	4,458	53.2%	11,288	11,780	-4.2%
Van-segment	6,092	6,496	-6.2%	7,705	-20.9%	13,797	12,614	9.4%
Compact (B) segment	44,539	38,889	14.5%	43,121	3.3%	87,660	72,767	20.5%
Mid-size (C) segment	5,946	5,009	18.7%	4,187	42.0%	10,133	7,133	42.1%
MUV	736	102	621.6%	68	982.4%	804	310	159.4%
Domestic	**64,143**	**55,952**	**14.6%**	**59,539**	**7.7%**	**123,682**	**104,604**	**18.2%**
Exports	4,858	3,448	40.9%	2,797	73.7%	7,655	5,148	48.7%
Total	**69,001**	**59,400**	**16.2%**	**62,336**	**10.7%**	**131,337**	**109,752**	**19.7%**

Source: Company, Kotak Institutional Equities.

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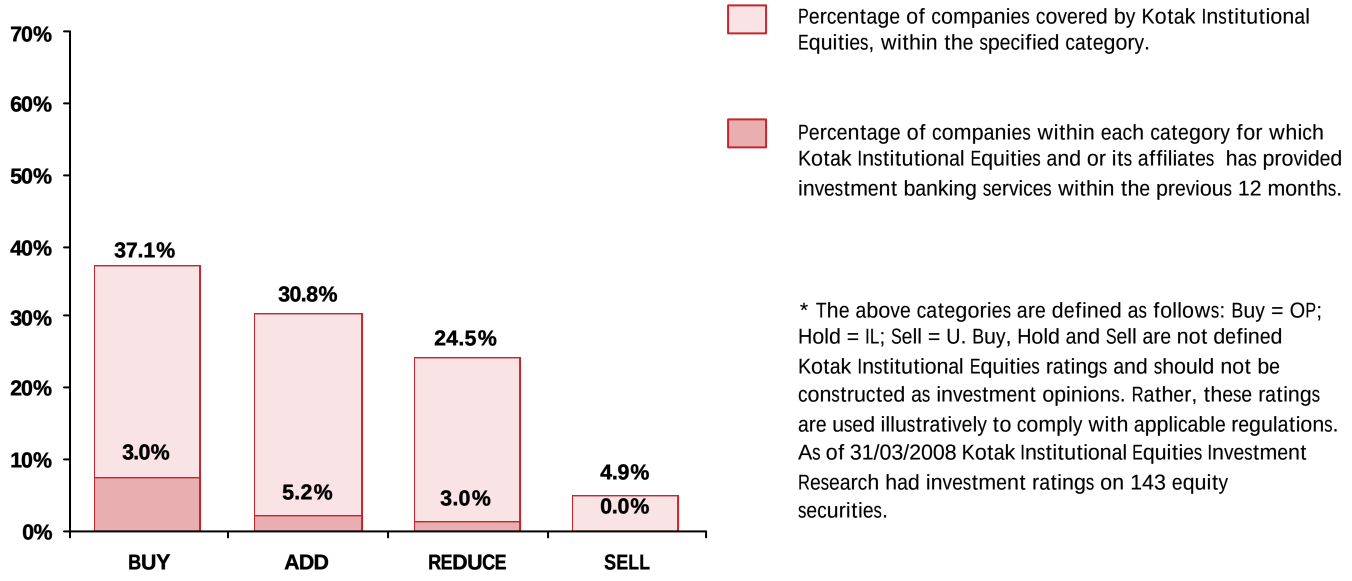

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Source: Kotak Institutional Equities. As of March 31, 2008

Ratings and other definitions/identifiers

New rating system

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
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