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News Round-up

- ▶ Tata Motors (TTMT IN) plans to expand the production capacity of mini-truck Ace and its family in expectation of rising demand. *(BSTD)*
- ▶ Reliance Industries (RIL IN) will buy Mahendra Nahata-promoted Infotel Broadband Services for USD 1.02 bn. *(BSTD-Sat)*
- ▶ DrReddy's Laboratories (DRRD IN) received a major setback in the US yesterday, as a court there granted a motion seeking a preliminary injunction to block the launch of its generic version of Sanofi-Aventis' anti-allergic drug, Allegra D24. *(BSTD-Sun)*
- ▶ The board of Hindustan Unilever (HUVR IN) has approved the buyback of shares announced last week at a maximum of INR 280 apiece. The company's outgo would not exceed USD 134 mn. *(BSTD-Sat)*
- ▶ Welspun India (WLSI IN) said it planned to invest USD 63 mn to streamline its two production facilities to enhance output of products. *(BSTD)*
- ▶ Media baron Kalanithi Maran boards Spicejet (SJET IN) with an investment of USD 159 mn. Picks up 37.75% at INR 47.25 a share. *(BSTD-Sun)*
- ▶ ITC (ITC IN) forays into fairness creams segment. *(BSTD-Sat)*
- ▶ Nalco (NACL IN) is set to finalise the terms of its joint venture agreement with two foreign partners for a USD 3.82 smelter and power plant project in Indonesia within next couple of months. *(BSTD-Sat)*
- ▶ Sterlite Industries (STLT IN) informed the BSE that it has got shareholders' approval to increase its authorized share capital to USD 106 mn from USD 39 mn. *(BSTD-Sat)*
- ▶ Jindal Steel & Power (JSP IN) has submitted its bid to acquire 60% stake in African steelmaker Zimbabwe Iron & Steel Co. *(ECNT-Sat)*
- ▶ Dish TV (DITV IN) has said that its boards of directors have resolved to implement a business restructuring plan that includes transfer the non-DTH related business of the co to Integrated Subscriber Management Services Ltd (ISMSL) and merger of Agrani Satellite Services Ltd (ASSL) with ISMSL pursuant to a scheme of arrangement. *(THBL)*

Source: ECNT= Economic Times, BSTD = Business Standard, FNLE = Financial Express, THBL = Business Line.

EQUITY MARKETS

India	Change %			
	11-Jun	1-day	1-mo	3-mo
Sensex	17,065	0.8	0.4	(0.6)
Nifty	5,119	0.8	0.5	(0.3)
Global/Regional indices				
Dow Jones	10,211	0.4	(3.9)	(3.9)
Nasdaq Composite	2,244	1.1	(4.4)	(5.2)
FTSE	5,164	0.6	(1.9)	(8.2)
Nikkei	9,876	1.8	(5.6)	(8.1)
Hang Seng	19,872	1.2	(1.4)	(6.3)
KOSPI	1,692	1.0	(0.2)	1.8
Value traded – India				
Cash (NSE+BSE)	175	166	174	
Derivatives (NSE)	882	853	662	
Deri. open interest	1,367	1,271	1,194	

Forex/money market

	Change, basis points			
	11-Jun	1-day	1-mo	3-mo
Rs/US\$	46.8	(12)	154	123
10yr govt bond, %	7.6	8	3	(39)
Net investment (US\$m)				
	10-Jun	MTD	CYTD	
FIs	83	84	4,684	
MFs	45	47	(282)	

Top movers -3mo basis

Best performers	Change, %			
	11-Jun	1-day	1-mo	3-mo
BJFIN IN Equity	464.1	(0.5)	(13.6)	40.3
IBULL IN Equity	134.1	2.2	(9.2)	26.0
DRRD IN Equity	1466.1	(2.1)	13.5	24.9
BJAUT IN Equity	2295.0	2.3	5.1	24.6
AL IN Equity	62.8	(0.3)	(6.4)	23.7
Worst performers				
ABAN IN Equity	657.9	1.9	(20.9)	(47.2)
GRASIM IN Equity	1819.6	2.8	(31.0)	(37.1)
PUNJ IN Equity	115.9	(0.9)	(19.7)	(34.6)
NMDC IN Equity	256.8	0.2	(11.9)	(29.2)
SUEL IN Equity	53.9	(0.1)	(17.9)	(28.9)

Closing old trades, starting new. We have closed three trades—(1) Long HDFC Bank, Short ICICI Bank (+10.1%), (2) Long M&M, Short Maruti (+6.9%) and (3) Long Tata Steel, Short Hindalco (-11.3%). We have initiated three new ones—(1) Long L&T, Short Siemens, (2) Long Infosys, Short Bharti and (3) Long Grasim, Short Ambuja Cements. We retain our Long ONGC, Short Cairn trade.

Trade #1—Long ONGC, Short Cairn; waiting for potential positive development on deregulation

The trade has given a negative return of 6.4% since February 12, 2010. A surprise upgrade in reserves by Cairn in March 2010 offset a decline in crude oil prices, the basis of our negative view on Cairn stock and the trade. Cairn stock is discounting US\$91/bbl in perpetuity. ONGC will benefit significantly from any potential deregulation of auto and cooking fuel prices. One of our triggers for the positive view on ONGC in the trade—natural gas price increase—has already unfolded. An EGOM meeting is due over the next few weeks to evaluate the issue of deregulation.

Trade #2—Long L&T, Short Siemens

We initiate a Long L&T, Short Siemens trade to derive advantage from (1) L&T's likely strong performance in 1QFY11E resulting from robust order booking in 4QFY10 and high margins, (2) likely positive news flow in L&T from NTPC's 660 MW bulk tender and possible disappointment in 2HFY10E (September year-end) revenues of Siemens and (3) likely correction in Siemens expensive valuations; the stock has moved up recently on expectations of an 'ABB-type' open offer.

Trade #3—Long Infosys, Short Bharti

We recommend a Long Infosys, Short Bharti to benefit from likely weak performance of Bharti stock over the next few weeks. Recent developments in the India telecom sector are quite negative, in our view, and will likely have a debilitating impact on Bharti's FY2011E and FY2012E EPS. The market has largely ignored these issues focusing on Bharti's guidance for Zain. We have chosen Infosys on the Long side given its likely strong 1QFY11E performance despite concerns about its revenues from the Euro area.

Trade #4—Long Grasim, Short Ambuja Cements

We expect Grasim Industries to outperform Ambuja Cements in the near term due to (1) large valuation gap between the valuations of Grasim Industries (7.6X on FY2011E EPS) and Ambuja Cements (14.6X on FY2011E EPS), (2) sharp underperformance of Grasim (16%) over the past three months (partially on account of dilution of ownership in cement business), and (3) cushion of earnings from VSF business for Grasim that may partially offset the likely deterioration in the business environment for the cement business.

INDIA

JUNE 14, 2010

BSE-30: 17,065

QUICK NUMBERS

- Closing (1) Long HDFC Bank, Short ICICI Bank with a gross return of +10.1% and (2) Long M&M, Short Maruti with +6.9%
- Keeping Long ONGC, Short Cairn trade despite negative return of 6.4% since February 12, 2010
- Starting three new trades with target gross return of +10%

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KIE Alpha-Bet trades

Statistics of trades, current price, initiation price, gross expected/actual return

	Stock	Current price (Rs)	Initiation price (Rs)	Return (%)
Trade 1 (Started Feb 12, 2010)				
Buy	Oil & Natural Gas Corp.	1,180	1,087	9
Sell	Cairn India	301	260	16
	Starting ratio (X)	3.9	4.2	(6.4)
Target return (%)				8.0
Trade 2				
Buy	Larsen & Toubro		1,677	
Sell	Siemens		718	
	Starting ratio (X)		2.3	
Target return (%)				10.0
Trade 3				
Buy	Infosys Technologies		2,631	
Sell	Bharti Airtel		274	
	Starting ratio (X)		9.6	
Target return (%)				10.0
Trade 4				
Buy	Grasim Industries		1,820	
Sell	Ambuja Cements		115	
	Starting ratio (X)		15.8	
Target return (%)				10.0
Closed trade (Feb 10, 2010 - Jun 11, 2010)				
Buy	Tata Steel	474	522	(9)
Sell	Hindalco	140	137	2
	Starting ratio (X)	3.4	3.8	(11.3)
Return (%)				(11.3)
Closed trade (April 27, 2010 - Jun 11, 2010)				
Buy	HDFC Bank	1,946	1,980	(2)
Sell	ICICI Bank	846	947	(11)
	Starting ratio (X)	2.3	2.1	10.1
Return (%)				10.1
Closed trade (April 27, 2010 - Jun 11, 2010)				
Buy	Mahindra & Mahindra	607	537	13
Sell	Maruti Suzuki	1,357	1,283	6
	Starting ratio (X)	0.4	0.4	6.9
Return (%)				6.9
Closed trade (Feb 10, 2010 - Apr 27, 2010)				
Buy	HDFC Bank	1,946	1,594	22
Sell	Axis Bank	1,246	1,025	22
	Starting ratio (X)	1.6	1.6	0.5
Return (%)				0.5
Closed trade (Feb 10, 2010 - Apr 22, 2010)				
Buy	Jaiprakash Associates	153	128	19
Sell	ACC	920	870	6
	Starting ratio (X)	0.2	0.1	12.4
Return (%)				12.4

Source: Kotak Institutional Equities estimates

JUNE 14, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **1,043**

Target price (Rs): **985**

BSE-30: **17,065**

Been there, done that; so, why again? RIL's acquisition of a 95% stake in Infotel Broadband shortly after completion of BWA license auction demonstrates RIL's keen interest in the Indian telecom sector. We are disappointed with RIL's decision to invest in the Indian telecom sector; there are enough opportunities in the global E&P arena. It remains to be seen if RIL will restrict itself to a presence in BWA or enter other areas including Voice. We note that RIL's first entry into telecom was not very successful.

Company data and valuation summary

Reliance Industries

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	1,185-841	EPS (Rs)	49.6	62.9	80.2
Market Cap. (Rs bn)	3,114.1	EPS growth (%)	(1.8)	26.6	27.5
Shareholding pattern (%)		P/E (X)	21.1	16.6	13.1
Promoters	41.1	Sales (Rs bn)	1,924.6	2,495.6	2,624.2
FIs	21.3	Net profits (Rs bn)	162.4	205.6	262.2
MFs	2.6	EBITDA (Rs bn)	309.4	397.9	449.7
Price performance (%)		EV/EBITDA (X)	11.3	8.4	6.9
Absolute	1M 3M 12M	ROE (%)	11.4	13.2	15.3
Rel. to BSE-30	0.3 2.4 (11.4)	Div. Yield (%)	1.3	1.6	2.0
	(0.1) 3.0 (20.9)				

Aggressive bidding and pan-India presence shows serious intent for BWA at least

IBL management stated that RIL and Infotel Broadband Ltd (IBL) were in talks through the bidding process, and that the talks firmed up as bid prices rose (source: Economic Times). We note that IBL outbid all the major incumbent players who did not get any BWA license barring Bharti Airtel in four circles only.

The key question is whether BWA is just the beginning for more investments in telecom

RIL's entry into broadband wireless access (BWA) raises a key question—whether the company will restrict its investment to BWA or eventually enter the broader telecom segment. We would not be surprised if it does so although the management denied it. BWA is a very niche market and RIL can possibly look at the bigger telecom sector through the acquisitions of extant operators. We believe the Indian telecom sector will likely see consolidation over the next 12-24 months. RIL can offer voice services (Voice over WiMAX) with the acquisition of a UAS license (at a paltry cost of Rs16.6 bn).

BWA license fee monetization may be a tall task, in our view

Our preliminary analysis suggests that BWA economics may be quite poor at the bid price. We note that broadband internet penetration is quite low in India currently and it has grown slowly despite the presence of cable and DSL for the past few years. Also, mobile operators provide a variety of wireless internet connectivity options to handheld devices and PC/laptop and 3G is another option given the ubiquity of mobile handsets in India.

Retain SELL rating with a 12-month fair valuation of Rs985

We note that current chemical and refining margins are quite weak and RIL's FY2011E EPS will likely fall short of our Rs63 estimate if current margins persist through FY2011E. The large and growing surplus in chemicals due to the start of several new crackers in Asia/ME and continued surplus in refining will likely prevent a sustainable recovery in margins, in our view.

QUICK NUMBERS

- **Rs128 bn for pan-India BWA license**
- **Rs48 bn for 95% stake in Infotel Broadband**
- **Winning bid for pan-India BWA license 7.3X reserve price**

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Where there is cash, there are opportunities

We make a few observations on RIL's telecom entry below.

- ▶ **RIL involved in talks with Infotel through bidding process** (source: Economic Times). RIL announced its acquisition of a 95% stake for Rs48 bn in IBL, the company that won BWA licenses in all the 22 circles, hours after the conclusion of the auction process.
- ▶ **Aggressive bids from IBL/RIL muscling out established incumbents.** IBL/RIL outbid all the major incumbent players with only Bharti getting BWA licenses in four circles. All the other major established players such as Idea Cellular, RCOM, Vodafone and Tata Group, did not win a single BWA license. Even Bharti seems to have bid aggressively to meet the gaps in its 3G portfolio; only the Karnataka circle is an overlap between 3G and BWA licenses. Exhibit 1 gives the list of winners in the recently concluded BWA license auction.

Provisional results of the BWA spectrum auction

Rs mn	Bharti	Vodafone	TTSL	Idea	RCOM	Aircel	Qualcom	Tikona	Spice ISP	Augere	Infotel Broadband	BSNL/MTN L	Total payout	BWA clearing price	Reserve price
Metros															
Delhi							22,410				22,410	22,410	67,231	22,410	1,600
Mumbai							22,930				22,930	22,930	68,789	22,930	1,600
Chennai + TN						20,695					20,695	20,695	62,084	20,695	1,600
Kolkata	5,232										5,232	5,232	15,696	5,232	600
A circles															
Andhra Pradesh						10,591					10,591	10,591	31,774	10,591	1,600
Gujarat								6,139			6,139	6,139	18,416	6,139	1,600
Karnataka	15,433										15,433	15,433	46,298	15,433	1,600
Maharashtra	9,156										9,156	9,156	27,469	9,156	1,600
B circles															
Haryana							1,199				1,199	1,199	3,597	1,199	600
Kerala							2,587				2,587	2,587	7,760	2,587	600
Madhya Pradesh										1,247	1,247	1,247	3,740	1,247	600
Punjab	3,323										3,323	3,323	9,968	3,323	600
Rajasthan								973			973	973	2,920	973	600
Uttar Pradesh (east)								1,425			1,425	1,425	4,275	1,425	600
Uttar Pradesh (west)								1,839			1,839	1,839	5,516	1,839	600
West Bengal and A&N islands						710					710	710	2,129	710	600
C circles															
Assam						330					330	330	991	330	150
Bihar						993					993	993	2,978	993	150
Himachal Pradesh								207			207	207	620	207	150
North East						213					213	213	638	213	150
Orissa						636					636	636	1,909	636	150
J&K						213					213	213	638	213	150
Total payout - operatorwise	33,144	—	—	—	—	34,380	49,125	10,582	—	1,247	128,478	128,478	385,433	128,478	17,500
# of circles won	4	—	—	—	—	8	4	5	—	1	22	22			

Source: DoT, Kotak Institutional Equities

We note that the winning bid for one slot (20 MHz) of pan-India spectrum was Rs128 bn or 7.3X the reserve price of Rs17.5 bn. In contrast, the winning bid for a pan-India 3G slot of spectrum (no single entity got a pan-India license though) was Rs167.5 bn or 4.8X the reserve price of Rs35 bn.

- ▶ **BWA is a niche area, broadband penetration is low and several broadband offerings already exist in the market.** We note that broadband penetration is quite low in India currently, which may be viewed as an opportunity by RIL. However, we note that other broadband options such as DSL, cable have been available for some time and broadband penetration is low despite the presence of these fixed-line options for the past several years. This would suggest that RIL will likely face challenges in growing the business to recoup its Rs128 bn investment in license fee alone over the next 20 years (the period of the license). Exhibit 2 shows the growth of broadband subscribers in India broken down by the type of service. Exhibit 3 shows that the operating scale requirements for a viable BWA business will be quite challenging for RIL.

DSL is the dominant BB technology in India, currently

Break-up of BB subs in India by access technology, June 2007 - March 2010

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
BB subs ('000)												
DSL	1,984	2,174	2,591	3,281	3,724	4,184	4,711	5,364	5,737	6,239	6,767	7,571
Cable modem	265	319	342	376	419	461	485	474	487	525	590	637
Ethernet LAN	84	101	101	107	108	122	155	244	275	319	332	388
Fibre	21	22	22	51	45	59	73	42	35	38	32	46
Radio	20	28	29	39	57	56	73	72	62	65	74	79
Leased line and others	49	28	43	20	30	20	28	21	24	25	25	29
Total	2,422	2,672	3,128	3,874	4,382	4,903	5,526	6,218	6,620	7,210	7,820	8,750
% of total												
DSL	81.9	81.4	82.8	84.7	85.0	85.3	85.3	86.3	86.7	86.5	86.5	86.5
Cable modem	10.9	11.9	10.9	9.7	9.6	9.4	8.8	7.6	7.4	7.3	7.5	7.3
Ethernet LAN	3.4	3.8	3.2	2.8	2.5	2.5	2.8	3.9	4.2	4.4	4.2	4.4
Fibre	0.9	0.8	0.7	1.3	1.0	1.2	1.3	0.7	0.5	0.5	0.4	0.5
Radio	0.8	1.0	0.9	1.0	1.3	1.1	1.3	1.2	0.9	0.9	1.0	0.9
Leased line and others	2.0	1.1	1.4	0.5	0.7	0.4	0.5	0.3	0.4	0.3	0.3	0.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
qoq net adds ('000)												
DSL		190	416	690	443	461	527	652	373	502	529	804
Cable modem		54	23	34	43	42	23	(11)	14	38	65	47
Ethernet LAN		17	0	6	1	14	33	89	30	44	13	56
Fibre		1	1	28	(6)	14	14	(31)	(7)	3	(6)	14
Radio		7	1	10	18	(1)	17	(1)	(10)	3	9	4
Leased line and others		(20)	15	(23)	9	(10)	8	(7)	2	1	1	4
Total		249	457	746	508	521	623	692	402	590	610	930
qoq growth (%)												
DSL		9.6	19.1	26.6	13.5	12.4	12.6	13.8	7.0	8.7	8.5	11.9
Cable modem		20.4	7.3	9.9	11.4	10.1	5.0	(2.3)	2.9	7.7	12.3	8.0
Ethernet LAN		20.4	0.1	6.4	0.8	13.4	26.9	57.4	12.4	16.0	4.0	16.9
Fibre		5.3	3.6	125.8	(11.6)	30.6	24.6	(42.2)	(16.9)	8.9	(16.1)	44.6
Radio		35.2	3.7	36.1	46.0	(1.6)	30.0	(1.1)	(13.8)	4.3	14.5	6.0
Leased line and others		(41.9)	53.5	(53.6)	47.3	(32.2)	40.8	(24.3)	11.6	2.9	2.1	15.4
Total		10.3	17.1	23.8	13.1	11.9	12.7	12.5	6.5	8.9	8.5	11.9

Source: TRAI, Kotak Institutional Equities

BWA business case looks challenging

A look at the operating scale requirements for a viable BWA business case

	Focused rollout	Comments	Wider rollout
Spectrum payout (US\$ mn) = A	2,856	Pan-India spectrum payout of Rs128.5 bn	2,856
# of cell sites	40,000	Top 200 cities/towns coverage @300 sites per city	60,000
Capex/cell site (US\$)	100,000	Including core network and backhaul; assuming passive infra leasing	100,000
Total capex (US\$ mn) = B	4,000		6,000
Total capital invested (US\$ mn) = A + B	6,856	Not treating EBITDA losses in the initial years as investments	8,856
Target ROIC (%)	12.0	Average cost of capital for a greenfield network rollout in India	12.0
Required EBIT*(1-tax rate) (US\$)	823		1,063
Tax rate (%)	20	Conservative assumption; no tax-breaks available	20
Required EBIT (US\$ mn)	1,028		1,328
Depreciation and amortization (US\$ mn)	463	Spectrum payout amortization over 20 years and network capex depreciation at 8%	623
Target EBITDA (US\$ mn)	1,491		1,951
Target EBITDA/month (US\$ mn)	124		163
Assumed steady-state EBITDA margin (%)	40		40
Target revenues/month (US\$ mn)	311		406
Target annual revenues (US\$ mn)	3,728		4,878
Assumed ARPU (US\$/sub/month)	12	Current BB ARPU is ~US\$15/sub/month	10
Required subs base (mn)	26		41
Current BB subs base pan-India (mn)	9	end-April 2010	9
Subs per cell site	647		677
Current wireless subs per cell-site (Bharti)	1,217	Mar 2010 quarter	1,217

Source: Kotak Institutional Equities estimates

- ▶ Aggressive bidding may be a precursor to a larger push into telecom. We would not be surprised if RIL eventually enters the broader telecom space with (1) acquisition of an extant 2G/voice operator and/or (2) acquisition of an UAS (universal access license). The latter's cost is only Rs16.6 bn for a pan-India license; however, availability of 2G spectrum would be an issue. We note that RIL had a presence in the Indian telecom sector through RCOM, which was de-merged as part of a restructuring of Reliance Industries Group in 2006.

RIL can offer voice services over WiMAX. However, RIL would have to contend with handset, economics and reach issues if it decides to pursue voice over WiMAX. In our view, incumbent telecom operators would have an advantage over BWA for plain-vanilla voice application given their much higher scale (volumes of minutes), lower handset costs and wider reach. We doubt RIL would want to compete with 2G voice operators but will likely offer voice as an add-on service to data connectivity for high-end subscribers.

We note that the Indian telecom market is very competitive with a number of players offering voice services at very competitive rates. We note that RIL will have to contend with established players offering 3G services that will compete with RIL's BWA service. There is hardly any difference in the services offered by 3G and BWA service providers. We note that wireless internet connectivity is available on mobile handsets and PC/laptops currently in India even without a 3G service.

- ▶ **Been there, done that.** We note that RIL used to have a meaningful presence in the Indian telecom sector prior to 2006 when it de-merged the telecom entity (RCOM) as part of its restructuring. We note that RCOM has low financial returns (see Exhibit 4) but that may reflect the hyper competition in the Indian telecom sector (see Exhibit 5). We would highlight that RCOM took a large write-off of Rs43.1 bn in FY2006 immediately after RIL Group restructuring.

RCOM financials/valuation - a snapshot

Return ratios	
FY2010E ROACE (%)	12.5
FY2010E CROCI (%)	16.1
Valuation metrics	
Current share price (Rs/share)	173
Shares outstanding (mn)	2,133
Market capitalization (Rs bn)	368
end-FY2010E net debt (Rs bn) (b)	199
Enterprise value (Rs bn)	567

Note:

(a) RoACE/CROCI computation based on adjusted capital employed/ adjusted cash invested - adjusted for revaluation of fixed (tangible as well as intangible assets).

(b) Based on reported gross debt and cash balance in the 4QFY10 quarterly report. RCOM includes buyer's credit and capex creditors in current liabilities in its quarterly reports.

Source: Company, Kotak Institutional Equities estimates

Potential # of 2G, 3G, and BWA networks in various circles

(#)	2G (a)			3G	BWA	Unique players
	GSM	CDMA	Total			
Metros + A circles						
Delhi	12	4	16	4	3	14
Mumbai	11	4	15	4	3	14
Chennai + TN	11	4	15	4	3	13
Kolkata	10	4	14	4	3	13
Andhra Pradesh	12	4	16	4	3	13
Gujarat	11	4	15	4	3	14
Karnataka	12	4	16	4	3	13
Maharashtra	12	4	16	4	3	13
B circles						
Haryana	12	4	16	4	3	14
Kerala	11	4	15	4	3	14
Madhya Pradesh	11	4	15	4	3	14
Punjab	12	5	17	5	3	14
Rajasthan	12	4	16	4	3	14
Uttar Pradesh (east)	11	4	15	4	3	14
Uttar Pradesh (west)	11	4	15	4	3	14
West Bengal and A&N islands	10	4	14	5	3	13
C circles						
Assam	10	4	14	4	3	14
Bihar	12	4	16	5	3	14
Himachal Pradesh	11	4	15	5	3	15
North East	10	4	14	4	3	14
Orissa	11	4	15	4	3	14
J&K	10	4	14	5	3	14
Pan-India						

Note:

(a) Including networks not launched yet.

Source: Kotak Institutional Equities

Meanwhile, back at the ranch

We suggest investors continue to focus on RIL's core chemical, refining and E&P businesses, areas which contribute to the bulk of RIL's valuation. The constant news around RIL stock—periodic new E&P discoveries, overseas acquisitions and now an entry into telecom—may at times dilute focus from its core businesses.

- ▶ **Chemical margins.** Exhibit 6 shows that chemical margins have weakened recently with the start of new chemical crackers in Asia and the Middle East. Exhibit 7 gives a list of ethylene crackers that have recently started operations and their corresponding capacities.

Chemical margins have declined sharply in the recent weeks
Asia chemical margins, calendar year-ending (US\$/ton)

	Annual average prices					Quarterly average					Monthly average				Recent			
	2006	2007	2008	2009	2010	3Q09	4Q09	1Q10	2Q10	2Q10 vs 1Q10 (%)	Feb	Mar	Apr	May	May 21	May 28	Jun 4	Jun 11
Ethylene chain																		
Ethylene – naphtha	549	441	336	274	488	349	312	497	475	(4.5)	556	394	467	482	457	358	246	251
HDPE – 1.015 x ethylene	88	171	258	270	44	219	177	48	38	(22.4)	43	121	6	69	150	214	235	192
LLDPE – 1.015 x ethylene	87	185	317	307	143	286	252	168	105	(37.4)	146	226	95	115	200	199	255	237
LDPE – 1.015 x ethylene	94	291	422	331	268	301	319	287	240	(16.4)	279	332	213	267	330	409	405	402
HDPE – naphtha	655	629	611	556	550	583	504	564	530	(5.9)	617	532	492	569	623	587	495	457
LLDPE – naphtha	654	643	670	594	649	650	579	683	598	(12.5)	720	637	581	615	673	572	515	502
LDPE – naphtha	660	749	775	618	774	664	646	802	732	(8.7)	854	743	698	767	803	782	665	667
Propylene chain																		
Propylene – naphtha	509	373	353	336	506	415	362	506	507	0.0	524	519	530	483	498	377	435	394
PP – 1.01 x propylene	125	244	265	151	67	119	89	59	79	34.4	87	16	29	129	139	200	99	127
PP – naphtha	645	628	630	495	586	544	461	577	598	3.5	624	548	572	624	648	587	545	532
Styrene chain																		
Benzene – naphtha	278	325	153	126	239	206	174	247	228	(7.7)	246	185	242	213	220	163	142	131
Styrene – 0.81 x benzene	139	163	131	157	126	130	84	143	99	(30.9)	182	172	103	96	120	97	141	132
– 0.29 x ethylene																		
Polystyrene – 0.98 styrene	90	132	161	132	150	152	128	147	154	4.6	154	155	134	173	206	181	156	170
PS – naphtha	649	730	571	508	658	590	490	681	623	(8.5)	739	640	619	627	678	557	530	527
Vinyl chain																		
EDC – (0.3 x ethylene)	11	85	35	109	148	179	99	130	174	33.9	137	177	168	181	200	215	209	209
PVC – 1.025 (0.235 x ethylene + 0.864 x EDC)	249	294	405	283	276	264	293	290	257	(11.4)	273	314	262	251	275	268	298	294
PVC – naphtha	250	249	199	244	300	298	203	303	295	(2.8)	337	307	275	315	367	322	274	277
Polyester/intermediates																		
PSF – 0.85 x PTA – 0.34 x MEG	240	324	347	269	337	264	233	290	409	41.3	282	362	353	466	—	506	—	—
PFY – 0.85 x PTA – 0.34 x MEG	391	541	578	425	624	454	475	566	712	25.7	567	582	623	801	—	841	—	—
PTA – 0.67 x PX	124	123	126	179	266	199	219	264	270	2.3	292	292	301	239	226	264	254	264
PX – naphtha	572	435	337	422	304	402	322	320	279	(12.8)	315	266	276	283	305	246	229	221
MEG – naphtha	270	419	105	77	200	93	107	246	131	(46.8)	296	186	168	94	111	102	52	48
MEG – 0.6 x ethylene	174	433	235	135	195	128	192	235	135	(42.3)	237	244	190	81	94	144	174	165

Source: Platts, Kotak Institutional Equities estimates

Large new capacity additions in ethylene in CY2010YTD

Major additions to ethylene capacity in Asia and Middle-East, calendar year-end, 2010YTD ('000 tons)

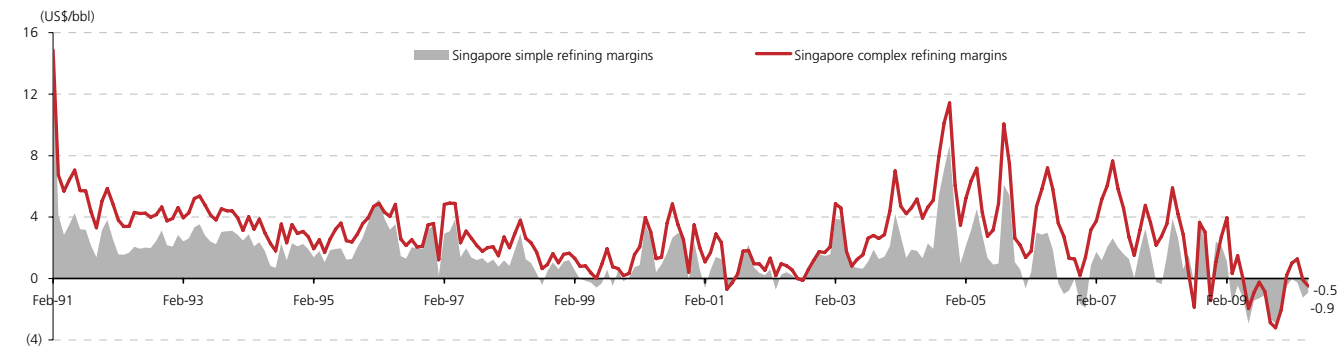
China	
Sinopec Tianjin	1,000
Sinopec Zhenhai	1,000
Total China	2,000
India	
Haldia	150
Indian Oil Corp.	857
Total India	1,007
Iran	
Morvarid PC	500
Total Iran	500
Qatar	
Ras Laffac OC	1,300
Total Qatar	1,300
Singapore	
Shell Singapore	800
Total Singapore	800
Thailand	
PTT Polyethylene	1,000
Total Thailand	1,000
United Arab Emirates	
Borouge	1,400
Total United Arab Emirates	1,400
Total capacity addition	8,007

Source: Kotak Institutional Equities estimates

- ▶ **Refining margins.** Exhibit 8 shows that refining margins continue to be at abysmally low levels despite demand recovery and strong global oil demand in CY2010E (+1.7 mn b/d). We expect (1) continued refining capacity additions (see Exhibit 9) and increased NGL supply (see Exhibit 10) to likely act as an overhang on refining margins.

Complex refining margins remain subdued in the recent weeks

Singapore refining margins (US\$/bbl)



Simple refining margins, March fiscal year-ends (US\$/bbl)											
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 YTD
1Q	1.3	0.5	0.3	1.0	1.7	3.0	2.5	2.3	2.4	(1.5)	(1.0)
2Q	2.5	0.4	0.1	1.2	3.1	2.8	(0.7)	1.0	1.7	(1.3)	
3Q	1.7	1.1	1.4	1.6	6.5	2.2	(1.2)	2.3	1.3	(2.5)	
4Q	0.2	(0.0)	3.0	2.9	2.1	1.1	1.2	0.2	0.7	(0.3)	
Average	1.4	0.5	1.2	1.7	3.3	2.3	0.5	1.5	1.5	(1.4)	(1.0)

Complex refining margins, March fiscal year-ends (US\$/bbl)											
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 YTD
1Q	1.9	1.3	0.8	1.2	4.6	4.9	6.2	6.6	4.3	(0.1)	(0.2)
2Q	4.0	0.6	0.1	2.3	5.8	6.1	2.5	2.9	0.7	(0.7)	
3Q	2.3	1.2	1.6	3.2	9.0	3.9	1.0	3.9	1.0	(2.7)	
4Q	1.6	0.6	3.7	5.4	5.0	2.8	4.1	2.8	2.4	0.8	
Average	2.4	0.9	1.5	3.1	6.1	4.4	3.4	4.0	2.1	(0.7)	(0.2)

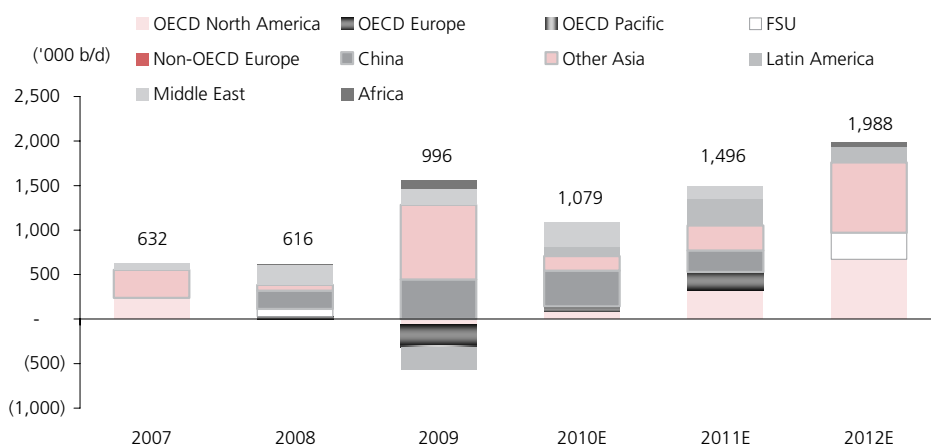
Weekly margins				
Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(0.6)	(0.7)	(0.3)	(0.3)	(1.1)

Weekly margins				
Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(0.0)	0.0	0.2	0.1	(1.0)

Source: Bloomberg, Kotak Institutional Equities estimates

Significant supply additions to global refining capacity

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



Source: Kotak Institutional Equities estimates

NGL capacity to increase by 1.9 mn b/d in CY2010-12E

Estimated global crude demand, supply and prices, Calendar year-ends, 2005-14E

	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Demand (mn b/d)										
Total demand	84.1	85.2	86.4	86.0	84.8	86.4	87.7	88.9	90.0	91.1
Yoy growth	1.6	1.1	1.2	(0.4)	(1.3)	1.7	1.3	1.2	1.1	1.1
Supply (mn b/d)										
Non-OPEC	49.8	50.4	50.9	50.8	51.5	52.3	53.1	52.7	52.4	52.2
Yoy growth	1.0	0.6	0.5	(0.1)	0.7	0.8	0.8	(0.4)	(0.3)	(0.2)
OPEC										
Crude	30.4	30.5	30.5	31.2	28.7	28.7	28.4	29.6	30.8	31.8
NGLs	4.3	4.4	4.3	4.4	4.7	5.4	6.2	6.6	6.8	7.1
Total OPEC	34.7	34.9	34.8	35.6	33.4	34.1	34.6	36.2	37.6	38.9
Total supply	84.7	85.6	85.7	86.4	84.9	86.4	87.7	88.9	90.0	91.1
Total stock change	0.7	0.2	(0.8)	0.4	0.1					
OPEC crude capacity			34.4	34.2	34.7	35.5	35.0	34.8	35.5	35.8
Implied OPEC spare capacity			3.9	2.9	6.0	6.7	6.6	5.2	4.7	4.0
Demand growth (yoy, %)										
	1.9	1.3	1.4	(0.4)	(1.5)	2.0	1.5	1.4	1.2	1.2
Supply growth (yoy, %)										
Non-OPEC	2.0	1.2	1.0	(0.2)	1.4	1.6	1.5	(0.8)	(0.6)	(0.4)
OPEC	3.0	0.6	(0.3)	2.4	(6.4)	2.3	1.4	4.6	3.9	3.5
Total	1.6	1.1	0.1	0.8	(1.8)	1.9	1.5	1.4	1.2	1.2
Dated Brent (US\$/bbl)										
	54.4	65.8	72.7	102.0	62.0	75.0	75.0	80.0	80.0	80.0

Source: Kotak Institutional Equities estimates

RIL: Profit model, balance sheet, cash model, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)									
Net sales	809,113	1,114,927	1,334,430	1,418,475	1,924,610	2,495,632	2,624,219	2,724,442	2,738,544
EBITDA	139,991	198,462	233,056	233,139	305,807	394,344	446,093	475,950	474,360
Other income	6,829	4,783	8,953	20,599	24,605	22,242	18,850	29,700	49,547
Interest	(8,770)	(11,889)	(10,774)	(17,452)	(19,972)	(24,183)	(9,511)	(6,497)	(5,555)
Depreciation & depletion	(34,009)	(48,152)	(48,471)	(51,953)	(104,965)	(131,342)	(125,123)	(143,021)	(147,844)
Pretax profits	104,041	143,205	182,764	184,332	205,474	261,062	330,310	356,132	370,507
Extraordinary items	3,000	2,000	47,335	—	—	—	—	—	—
Tax	(9,307)	(16,574)	(26,520)	(12,634)	(31,118)	(54,394)	(70,513)	(85,076)	(91,336)
Deferred taxation	(7,040)	(9,196)	(8,999)	(18,605)	(12,000)	(1,061)	2,425	12,624	18,010
Net profits	90,693	119,434	194,580	153,093	162,357	205,606	262,222	283,679	297,181
Adjusted net profits	88,152	117,789	152,605	153,093	162,357	205,606	262,222	283,679	297,181
Earnings per share (Rs)	31.6	40.5	52.5	50.6	49.6	62.9	80.2	86.7	90.9
Balance sheet (Rs mn)									
Total equity	430,543	673,037	847,853	1,263,730	1,371,706	1,512,531	1,695,575	1,885,681	2,089,288
Deferred taxation liability	49,708	69,820	78,725	97,263	109,263	110,324	107,899	95,276	77,265
Minority interest	—	33,622	33,622	—	—	—	—	—	—
Total borrowings	218,656	332,927	493,072	739,045	624,947	337,340	130,999	128,774	128,514
Current liabilities	164,545	192,305	251,427	357,019	404,148	383,752	400,931	411,346	411,771
Total liabilities and equity	863,452	1,301,712	1,704,700	2,457,057	2,510,064	2,343,947	2,335,403	2,521,076	2,706,838
Cash	21,461	18,449	42,822	221,765	134,626	19,215	49,827	290,474	545,981
Current assets	224,283	286,566	402,721	325,358	489,165	503,780	517,367	530,380	531,775
Total fixed assets	626,745	899,403	1,081,638	1,693,869	1,653,987	1,588,666	1,535,924	1,467,935	1,396,795
Investments	(9,038)	97,294	177,519	216,065	232,286	232,286	232,286	232,286	232,286
Deferred expenditure	—	—	—	—	—	—	—	—	—
Total assets	863,452	1,301,712	1,704,700	2,457,057	2,510,064	2,343,947	2,335,403	2,521,076	2,706,838
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	119,520	164,285	180,718	174,508	222,605	311,559	360,290	381,159	373,474
Working capital	(32,188)	(13,075)	(31,071)	(37,983)	(53,015)	(35,011)	3,591	(2,597)	(971)
Capital expenditure	(94,273)	(247,274)	(239,691)	(247,128)	(219,427)	(61,550)	(65,645)	(72,772)	(71,754)
Investments	(32,364)	(105,760)	(78,953)	(10,392)	14,206	—	—	—	—
Other income	5,159	4,143	6,132	16,195	22,043	22,242	18,850	29,700	49,547
Free cash flow	(34,146)	(197,681)	(162,865)	(104,800)	(13,587)	237,240	317,087	335,490	350,296
Ratios (%)									
Debt/equity	45.5	44.8	53.2	54.3	42.2	20.8	7.3	6.5	5.9
Net debt/equity	41.1	42.3	48.6	38.0	33.1	19.6	4.5	(8.2)	(19.3)
RoAE	19.9	20.3	18.9	13.6	11.8	13.5	15.5	15.2	14.5
RoACE	13.8	13.9	12.7	11.2	9.3	11.2	13.9	13.8	13.0

Source: Company, Kotak Institutional Equities estimates

JUNE 14, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **274**

Target price (Rs): **290**

BSE-30: **17,065**

Euphoria unwarranted—reiterate REDUCE. We find the market's excitement on Bharti's 'new' disclosures on financial targets for Zain and funding cost for the acquisition a tad unsettling. We note (1) the financial targets for Zain, as laid out by Bharti, are for the consolidated Zain entity and do not adjust for Zain's sub-100% ownership in 9 of the 15 operating assets that Bharti has acquired, and (2) funding costs are on an unhedged basis and one needs to be cognizant of the interest rate and currency risks that come with the low unhedged funding cost. Reiterate REDUCE.

Company data and valuation summary

Bharti Airtel

Stock data

52-week range (Rs) (high,low) 485-230

Market Cap. (Rs bn) 1,038.6

Shareholding pattern (%)

Promoters 67.8

FIs 18.0

MFs 3.0

Price performance (%)

Absolute (3.9) (7.0) (36.0)

Rel. to BSE-30 (3.5) (6.4) (42.2)

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	24.0	21.4	24.2
EPS growth (%)	7.5	(10.8)	13.2
P/E (X)	11.4	12.8	11.3
Sales (Rs bn)	396.2	422.0	481.7
Net profits (Rs bn)	91.0	81.3	92.1
EBITDA (Rs bn)	160.3	161.5	180.6
EV/EBITDA (X)	6.4	6.1	5.2
ROE (%)	24.1	17.0	16.5
Div. Yield (%)	1.1	1.5	1.8

A closer look at the 'new' disclosures

- ▶ **Consolidated (with-Zain) revenues of US\$12 bn and EBITDA of US\$4.7 bn in FY2010** – implies revenues and EBITDA of US\$3.6 bn and US\$1.2 bn for Zain in FY2010E, respectively. We note that Zain does not own 100% in 9/15 operating assets that Bharti has bought – Bharti's proportionate revenue ownership was 80.6% and EBITDA ownership was 79.6% (9MCY09). While Bharti will consolidate revenues and EBITDA on a 100% consolidation basis (and take minority interest charge below the PBT line), we would urge investors to adjust for minority ownership when considering consolidated revenues or EBITDA for Bharti.
- ▶ **FY2013E revenue and EBITDA target of US\$5 bn and US\$2 bn for Zain Africa; end-FY2013 subs target of 100 mn** – implies a revenue CAGR of 11.6% over the next 3 years, EBITDA margin of 40% in FY2013E (~800 bps expansion in 3 years), and sub net adds of ~55 mn in three years. Bharti's stated target implies a target ARPU of ~US\$4.5 in FY2013E, a 37% decline from 9MCY09 levels of US\$7.2. Bharti's targets clearly indicate (1) the company's intention to roll-out its low-price, high-volume strategy in Zain Africa markets, banking on minutes elasticity, and (2) cost-control-driven margin expansion strategy.
- ▶ **Interest cost of 2.25% on the US\$9 bn funding tied up for equity payout.** Bharti indicated that it has raised funds for the acquisition at a rate of 2.25% (interest payout of US\$200 mn per annum). We note that the total acquisition EV of US\$10.7 bn includes Zain debt of US\$1.7 bn and US\$9 bn of staggered cash payout to Zain (US\$7.9 bn already paid + US\$400 mn within 6 months + US\$700 mn after 12 months). Even as the low 2.25% interest cost makes the deal EPS neutral as early as FY2012E (or even FY2011E with aggressive operating assumptions), we note (1) on reported LIBOR + 190 bps funding, the reference LIBOR appears to be 1-month LIBOR (please see Exhibit 2) – does this mean a reset every month?, and (2) 2.25% is the interest cost unhedged for either interest rate risk (a fixed-for-floating swap) or currency risk (debt is in US\$ and earnings are in various African currencies) – the moot point here being that the low 2.25% interest cost comes bundled with inherent LIBOR and currency risks.

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Interest rate and currency risks merit attention

As discussed earlier, it would not take a lot of operational improvement at Zain Africa for the deal to turn EPS accretive at a funding cost of 2.25% — Bharti can achieve this by FY2012E with reasonable 15% revenue CAGR (FY2010-12E) and a 230 bps improvement in EBITDA margin (see Exhibit 1) over 9MCY09 levels. The equation becomes challenging, and the acquisition starts looking expensive, as one starts looking closely at the floating interest rate risk and currency risk associated with an open unhedged debt position.

- ▶ **LIBOR** – debt issuance linked to 1-month LIBOR (implied by management comments post Zain deal closure) appears surprising to us. Nevertheless, even 1-month LIBOR has averaged 3.12% over the past 5 and 2.70% over the past 10 years, and is currently close to multi-year lows. Commenting on interest rate cycle turns is outside our domain – however, we would urge investors to be cognizant of the risk. A fixed-for-floating swap typically costs ~200-250 bps, per our channel checks.
- ▶ **Currency risk** – depreciation in the operating currencies (versus the US\$/Re) of the assets that Bharti is buying (12 currencies across the 15 operating assets) will hit Bharti negatively at three levels – (1) translation into reporting currency i.e the Indian Rupee, (2) higher cost of equipment imports, invoiced in US\$, European currencies or Asian currencies, and (3) higher effective interest cost as the interest payouts would be in US\$. Once again, commenting on the future direction of African currencies is outside our domain; we do highlight that a lot of these countries have a commodity-export-dependent economy. Exhibit 3 lists the currencies in various operating assets of Zain Africa that Bharti has bought.

We continue to find the acquisition expensive

Exhibit 4 depicts our estimates of the impact of the acquisition on Bharti's financials, while Exhibit 5 gives the impact assuming Bharti's guided 2.25% interest cost for Zain acquisition funding.

We highlight that we build in fairly benign assumptions – (1) revenue growth of 15% for FY2011E, 12E, and 13E (2) margin expansion of 420 bps over the next 3 years, and (3) Zain generates sufficient cash flows to pay local taxes and take care of its capex requirements. We continue to find the acquisition expensive – even if Bharti achieves its US\$2 bn EBITDA target by FY2013E (US\$1.6 bn proportionate EBITDA), the acquisition EV consideration of US\$10.36 bn (taking proportionate 80% of Zain's net debt of US\$1.7 bn being assumed by Bharti) implies a 3-year forward EV/EBITDA multiple of 5.7X, on the expensive side of emerging market wireless valuations.

BWA spectrum auction result – moderate short-term negative impact; could have substantial long-term impact

Results of the recently concluded BWA spectrum auctions threw up a surprise in the form of Infotel Broadband emerging as a pan-India winner and then later announcing a 95% stake sale to Reliance Industries. Bharti has won BWA spectrum in four circles (Karnataka, Maharashtra, Punjab, and Kolkata) and will pay a total of Rs33 bn for the same. Direct EPS impact on account of the interest and amortization expenses of this payout is marginal – 4.2% in FY2011E, and 5.2% in FY2012E. However, the entry of Reliance Industries in the sector could have major long-term implications – we have discussed the impact of BWA spectrum auction result in detail in a separate note published today.

Reiterate negative stance on the sector and the stock

We remain Cautious on the Indian telecom sector — the recently concluded BWA auctions and the announced entry of Reliance Industries in the sector adds another reason to be so. Even as Bharti remains the best-in-class on execution, the competitive challenges in the domestic wireless market (only set to intensify with 3G/MNP rollout) and the tall task of Zain's turnaround keeps us from turning bullish on the stock, yet.

Known negatives may be in the price, but the unknowns, the two key ones being RIL's telecom strategy, and DoT's final decision on TRAI's spectrum recommendations (especially on license renewal and spectrum refarming, which if accepted have substantial long-term implications) are not reflected in the price, in our view. We reiterate our REDUCE rating on the stock and would advise selling on any news flow-driven jump in the stock price.

Exhibit 1: Zain acquisition could be EPS accretive as early as FY2012E with funding cost of 2.25%

	FY2011E	FY2012E
Proportionate revenues (US\$ mn)	3,486	4,008
Growth yoy (%)	15.0	15.0
EBITDA margin (%)	32.0	34.2
EBITDA (US\$ mn)	1,115	1,371
Depreciation (US\$ mn)	900	1,035
Incremental EBIT (US\$ mn)	215	336
Incremental net debt (US\$ mn)	9,660	10,360
Interest cost (%)	2.3	
Incremental interest burden (US\$ mn)	(287)	(336)
Net EBIT impact (US\$ mn)	(72)	0
PBT/PAT impact (a) (US\$mn)	(72)	0
Per share impact (Rs/share)	(0.8)	0.0

Note:

(a) Assuming no tax benefits

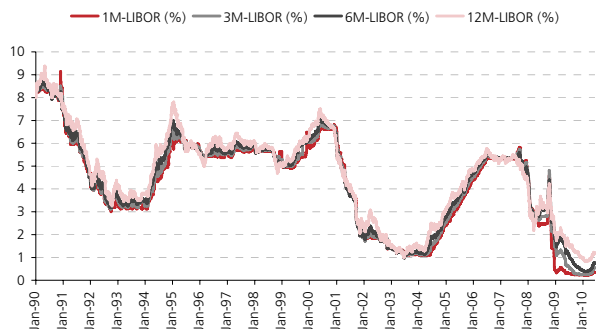
Source: Kotak Institutional Equities estimates

Exhibit 2: Libor rates are at multi-year lows

	Current rate	1-year average	3-year average	5-year average	10-year average	20-year average
Libor 1 month rate	0.35	0.26	2.02	3.12	2.70	4.06
Libor 3 months rate	0.54	0.35	2.24	3.30	2.80	4.17
Libor 6 months rate	0.75	0.62	2.43	3.45	2.92	4.28
Libor 1 year rate	1.18	1.15	2.62	3.60	3.10	4.48

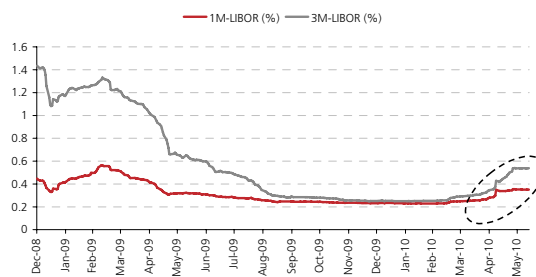
Source: Company, Kotak Institutional Equities

Libor rates are at multi-year lows



Source: Company, Kotak Institutional Equities

Libor rates have started inching up



Source: Company, Kotak Institutional Equities

Exhibit 3: Zain acquisition exposes Bharti to multiple currencies

Country	Currency	Revenue contribution (%)	Current rate vs US\$	Currency average rate					% change in currency				
				6-month	1-Year	3-Year	5-Year	10-Year	1-month	3-month	6-month	1-Year	3-Year
Burkina Faso	CFA Francs BCEAO	3.3	541	494	470	466	489	561	(2.1)	(13.7)	(21.1)	(15.7)	(9.9)
Chad	CFA Francs BEAC	3.7	541	494	470	466	489	561	(2.1)	(13.7)	(21.0)	(15.7)	(9.9)
Congo Brazzaville	CFA Francs BEAC	5.6	541	494	470	466	489	561	(2.1)	(13.7)	(21.0)	(15.7)	(9.9)
Dem Rep of Congo	Congo Francs	8.9	896	906	869	693	610	462	0.0	1.8	1.0	(16.5)	(60.7)
Gabon	CFA Francs BEAC	7.0	541	494	470	466	489	561	(2.1)	(13.7)	(21.0)	(15.7)	(9.9)
Ghana	Ghanian Cedis	1.3	14,315	14,231	14,426	12,246	11,015	9,572	(0.7)	(1.3)	(0.4)	3.7	(54.2)
Kenya	Kenya Shillings	4.3	81	78	77	73	72	75	(3.3)	(5.5)	(7.1)	(3.6)	(21.8)
Madagascar	Malagasy Ariary	2.1	2,229	2,134	2,038	1,884	1,972	1,695	(6.9)	(3.0)	(14.6)	(14.3)	(19.7)
Malawi	Malawi Kwacha	4.1	151	150	145	142	139	113	(0.0)	0.0	(3.6)	(7.2)	(7.3)
Niger	CFA Francs BCEAO	4.1	541	494	470	466	489	561	(2.1)	(13.7)	(21.1)	(15.7)	(9.9)
Nigeria	Nigerian Naira	36.1	151	151	151	135	133	129	(0.1)	(0.5)	(1.0)	(2.1)	(18.7)
Sierra Leone	Sierra Leonean Leones	1.2	3,911	3,900	3,734	3,253	3,066	2,616	(0.4)	(0.6)	(1.1)	(21.1)	(31.2)
Tanzania	Tanzania Shillings	7.6	1,455	1,378	1,346	1,271	1,253	1,117	(3.3)	(7.4)	(9.0)	(10.6)	(15.6)
Uganda	Uganda Shillings	2.8	2,224	2,085	2,022	1,874	1,847	1,831	(3.4)	(6.9)	(14.9)	(2.9)	(35.0)
Zambia	Zambian Kwacha	7.8	5,140	4,756	4,774	4,351	4,167	4,259	(5.0)	(10.2)	(9.7)	(3.5)	(32.1)
Total		100.0											

Note:
Revenue contribution if for 9M CY09

Source: Bloomberg, Company, Kotak Institutional Equities

Exhibit 4: 3G, BWA and Zain impact on Bharti's financials, assuming 5% cost of Zain acquisition funding

	FY2011	FY2012	FY2013	FY2014
Current EPS estimate (Rs/share) (a)	21.4	24.2	26.9	29.8
Total Impact on EPS	(7.2)	(7.8)	(6.2)	(3.8)
EPS post impact	14.2	16.5	20.7	26.0
% impact on EPS	(33.5)	(32.0)	(23.0)	(12.8)
Net debt (US\$ mn)	12,440	11,829	10,676	9,169
EBITDA (US\$ mn)	4,714	5,451	6,234	7,018
Net debt /EBITDA (X)	2.6	2.2	1.7	1.3
BWA Payout (US\$ mn)	737			
3G Payout (US\$ mn)	2,732			
Total Payout 3G + BWA	3,469			
Assumptions				
Incremental 3G Capex (US\$ mn)	150	250	150	100
Incremental BWA Capex (US\$ mn)	100	400	200	200
Total Incremental Capex (US\$ mn)	250	650	350	300
End of period subs - 3G (mn subs)	1.3	5.2	10.3	15.5
End of period subs - Wimax (mn subs)	0.2	0.5	0.8	1.0
Incremental ARPU (US\$/sub/month) - 3G	3.9	3.5	3.1	2.8
Incremental ARPU (US\$/sub/month) - Wimax	14.0	13.0	12.0	11.0
Incremental EBITDA margin (%) - 3G and Wimax	40	40	40	40
Interest cost (%)	9.0			
Depreciation rate (%)	10.0			
Zain acquisition impact (assuming consolidation begins April 1, 2010)				
Proportionate revenues (US\$ mn)	3,486	4,008	4,610	5,301
Growth yoy (%)	15.0	15.0	15.0	15.0
EBITDA margin (%)	32.0	34.0	36.0	38.0
EBITDA (US\$ mn)	1,115	1,363	1,660	2,014
Depreciation (US\$ mn)	900	1,035	1,190	1,369
Incremental EBIT (US\$ mn)	215	328	469	646
Incremental net debt (US\$ mn)	9,660	10,360	10,360	10,360
Interest cost (%)	5.0			
Incremental interest burden (US\$ mn)	(472)	(580)	(586)	(586)
Net EBIT impact (US\$ mn)	(256)	(252)	(117)	60
PBT/PAT impact assuming no tax benefits (US\$ mn)	(256)	(252)	(117)	60
Per share impact (Rs/share)	(3.0)	(3.0)	(1.4)	0.7
3G + BWA Impact on EPS				
Incremental revenues (US\$ mn)	23	189	384	555
Total Incremental EBITDA (US\$ mn)	9	76	154	222
Incremental depreciation (US\$ mn)	(13)	(58)	(108)	(140)
Spectrum payout amortization (US\$ mn)	(87)	(173)	(173)	(173)
Incremental interest cost (US\$ mn)	(323)	(360)	(394)	(407)
Tax rate (%)	15.3	21.7	22.5	23.5
PAT impact (US\$ mn)	(350)	(403)	(404)	(381)
Per share impact (Rs/share)	(4.1)	(4.8)	(4.8)	(4.5)
Current EPS estimate (Rs/share)	21.4	24.2	26.9	29.8
EPS post impact (Rs/share)	17.3	19.5	22.1	25.3
3G + Wimax + Zain Impact on net debt				
Net debt post 3G (US\$ mn)	2,724	2,252	1,390	237
-Debt due to Zain (US\$ mn)	10,360	10,360	10,360	10,360
-EBITDA generation (US\$ mn)	(1,115)	(1,363)	(1,660)	(2,014)
-Interest payment (US\$ mn)	472	580	586	586
Total net debt post impact (US\$ mn)	12,440	11,829	10,676	9,169
EBITDA post 3G impact (US\$ mn)	3,599	4,088	4,574	5,004
-EBITDA due to Zain (US\$ mn)	1,115	1,363	1,660	2,014
EBITDA post Zain impact (US\$ mn)	4,714	5,451	6,234	7,018

Note:

(1) Not factoring in any moratorium that Bharti may get on interest payments.

(2) Assuming zero FCF for Zain standalone business

Source: Kotak Institutional Equities estimates

Exhibit 5: 3G, BWA and Zain impact on Bharti's financials, assuming Bharti's guided 2.25% interest cost on Zain acquisition funding

	FY2011	FY2012	FY2013	FY2014
Current EPS estimate (Rs/share) (a)	21.4	24.2	26.9	29.8
Total Impact on EPS	(5.0)	(4.9)	(3.2)	(0.9)
EPS post impact	16.4	19.4	23.6	28.9
% impact on EPS	(23.3)	(20.1)	(12.1)	(2.9)
Net debt (US\$ mn)	12,256	11,585	10,429	8,921
EBITDA (US\$ mn)	4,714	5,451	6,234	7,018
Net debt /EBITDA (X)	2.6	2.1	1.7	1.3
BWA Payout (US\$ mn)	737			
3G Payout (US\$ mn)	2,732			
Total Payout 3G + BWA	3,469			
Assumptions				
Incremental 3G Capex (US\$ mn)	150	250	150	100
Incremental BWA Capex (US\$ mn)	100	400	200	200
Total Incremental Capex (US\$ mn)	250	650	350	300
End of period subs - 3G (mn subs)	1.3	5.2	10.3	15.5
End of period subs - Wimax (mn subs)	0.2	0.5	0.8	1.0
Incremental ARPU (US\$/sub/month) - 3G	3.9	3.5	3.1	2.8
Incremental ARPU (US\$/sub/month) - Wimax	14.0	13.0	12.0	11.0
Incremental EBITDA margin (%) - 3G and Wimax	40	40	40	40
Interest cost (%)	9.0			
Depreciation rate (%)	10.0			
Zain acquisition impact (assuming consolidation begins April 1, 2010)				
Proportionate revenues (US\$ mn)	3,486	4,008	4,610	5,301
Growth yoy (%)	15.0	15.0	15.0	15.0
EBITDA margin (%)	32.0	34.0	36.0	38.0
EBITDA (US\$ mn)	1,115	1,363	1,660	2,014
Depreciation (US\$ mn)	900	1,035	1,190	1,369
Incremental EBIT (US\$ mn)	215	328	469	646
Incremental net debt (US\$ mn)	9,660	10,360	10,360	10,360
Interest cost (%)	2.3			
Incremental interest burden (US\$ mn)	(287)	(336)	(339)	(339)
Net EBIT impact (US\$ mn)	(72)	(8)	131	307
PBT/PAT impact assuming no tax benefits (US\$ mn)	(72)	(8)	131	307
Per share impact (Rs/share)	(0.8)	(0.1)	1.5	3.6
3G + BWA Impact on EPS				
Incremental revenues (US\$ mn)	23	189	384	555
Total Incremental EBITDA (US\$ mn)	9	76	154	222
Incremental depreciation (US\$ mn)	(13)	(58)	(108)	(140)
Spectrum payout amortization (US\$ mn)	(87)	(173)	(173)	(173)
Incremental interest cost (US\$ mn)	(323)	(360)	(394)	(407)
Tax rate (%)	15.3	21.7	22.5	23.5
PAT impact (US\$ mn)	(350)	(403)	(404)	(381)
Per share impact (Rs/share)	(4.1)	(4.8)	(4.8)	(4.5)
Current EPS estimate (Rs/share)	21.4	24.2	26.9	29.8
EPS post impact (Rs/share)	17.3	19.5	22.1	25.3
3G + Wimax + Zain Impact on net debt				
Net debt post 3G (US\$ mn)	2,724	2,252	1,390	237
-Debt due to Zain (US\$ mn)	10,360	10,360	10,360	10,360
-EBITDA generation (US\$ mn)	(1,115)	(1,363)	(1,660)	(2,014)
-Interest payment (US\$ mn)	287	336	339	339
Total net debt post impact (US\$ mn)	12,256	11,585	10,429	8,921
EBITDA post 3G impact (US\$ mn)	3,599	4,088	4,574	5,004
-EBITDA due to Zain (US\$ mn)	1,115	1,363	1,660	2,014
EBITDA post Zain impact (US\$ mn)	4,714	5,451	6,234	7,018

Note:

(1) Not factoring in any moratorium that Bharti may get on interest payments.

(2) Assuming zero FCF for Zain standalone business

Source: Company, Kotak Institutional Equities estimates

Exhibit 6: Zain does not own 100% in 9 of the 15 operating assets

Country	Zain's ownership (%)	9MCY09 Revenues (US\$ mn)	9MCY08 Revenues (US\$ mn)	9MCY09 EBITDA (US\$ mn)	9MCY08 EBITDA (US\$ mn)
Burkina Faso	100.0	91	99	38	42
Chad	100.0	101	92	44	37
Congo B.	90.0	154	175	43	68
DRC	98.5	244	280	51	59
Gabon	90.0	192	207	80	97
Ghana	75.0	35		(29)	
Kenya	95.0	118	121	14	(10)
Madagascar	100.0	57	61	12	10
Malawi	100.0	112	93	47	38
Niger	90.0	113	95	53	42
Nigeria	65.7	986	1,194	331	399
Sierra Leone	100.0	33	37	2	10
Tanzania	60.0	207	242	79	95
Uganda	100.0	76	105	9	19
Zambia	78.9	213	266	97	129
Total		2,732	3,067	871	1,035
Zain's proportionate share		2,201	2,447	693	812

Source: Company, Kotak Institutional Equities

Exhibit 7: Consolidated profit and loss for Bharti Airtel, March fiscal year-ends, 2008-2017E (Rs mn)

	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues									
Wireless	303,601	324,872	337,053	389,105	433,608	465,389	488,246	505,258	518,247
Fixed line	33,517	34,164	35,375	38,805	41,590	44,002	46,263	48,489	50,681
DLD	41,835	42,174	44,754	49,068	52,856	56,131	58,981	61,488	63,718
ILD	26,102	24,987	26,036	27,907	29,410	30,990	32,657	34,417	36,277
Enterprise services	16,945	16,437	18,080	19,708	21,284	22,348	23,466	24,639	25,871
Others	3,611	5,825	9,903	11,883	13,071	14,378	15,816	17,398	19,138
Less: Intersegment eliminations	(98,485)	(87,733)	(92,745)	(98,826)	(103,810)	(108,256)	(112,438)	(116,369)	(120,033)
Consolidated revenues	369,615	396,150	421,992	481,742	536,951	578,878	612,322	640,536	664,149
Interconnection costs	(52,903)	(44,807)	(47,607)	(56,464)	(66,924)	(72,451)	(76,368)	(79,263)	(81,438)
License fees and spectrum charges	(38,266)	(40,876)	(42,624)	(48,975)	(54,078)	(58,209)	(61,478)	(64,194)	(66,542)
Network operating costs	(59,355)	(75,962)	(89,091)	(104,240)	(116,125)	(124,409)	(130,900)	(136,341)	(140,580)
Sales and marketing expenses	(26,762)	(30,469)	(37,268)	(43,853)	(49,120)	(53,320)	(56,803)	(59,872)	(62,621)
Employee costs	(16,992)	(16,925)	(17,764)	(19,888)	(22,268)	(24,417)	(26,439)	(28,425)	(30,358)
G&A costs	(23,774)	(26,844)	(26,107)	(27,744)	(29,522)	(30,878)	(32,219)	(33,323)	(34,254)
Consolidated EBITDA	151,563	160,267	161,531	180,577	198,914	215,194	228,116	239,117	248,356
Other income incl. Interest income	645	1,094	5,725	6,442	7,634	10,313	13,289	16,191	18,857
Interest expense	(11,613)	5,783	(1,789)	(661)	—	—	—	—	—
Amortization of entry fee	(2,122)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)
Depreciation	(45,344)	(59,309)	(67,035)	(67,560)	(75,055)	(78,926)	(82,983)	(88,267)	(90,586)
Pretax profits	93,129	106,687	97,285	117,651	130,345	145,433	157,274	165,893	175,479
Extraordinary income/(charges)	—	—	—	—	—	—	—	—	—
Prior period adjustments	—	—	—	—	—	—	—	—	—
Current tax expense	(7,371)	(22,145)	(18,750)	(27,766)	(36,040)	(40,255)	(45,021)	(53,940)	(56,960)
Deferred tax (liability)/asset	756	8,186	3,820	2,186	6,733	6,071	6,888	11,123	9,551
Minority interest expense	(1,759)	(1,994)	(2,120)	(3,103)	(3,720)	(4,034)	(4,584)	(5,064)	(5,482)
Equity in earnings of affiliates	(56)	292	1,097	3,123	4,648	5,904	7,171	8,271	9,238
Reported net profits	84,699	91,026	81,332	92,091	101,966	113,119	121,729	126,284	131,826
Adjusted net profits	84,699	91,026	81,332	92,091	101,966	113,119	121,729	126,284	131,826
Adjusted EPS (Rs)	22.3	24.0	21.4	24.2	26.9	29.8	32.1	33.3	34.7
Shares outstanding (mn)	3,797	3,798	3,798	3,798	3,798	3,798	3,798	3,798	3,798
Current tax rate (%)	7.9	20.8	19.3	23.6	27.6	27.7	28.6	32.5	32.5
Effective tax rate (%)	7.1	13.1	15.3	21.7	22.5	23.5	24.2	25.8	27.0
Growth (%)									
EBITDA	33.9	5.7	0.8	11.8	10.2	8.2	6.0	4.8	3.9
Net profits	26.4	7.5	(10.6)	13.2	10.7	10.9	7.6	3.7	4.4
EPS	26.4	7.5	(10.8)	13.2	10.7	10.9	7.6	3.7	4.4
Margin (%)									
EBITDA	41.0	40.5	38.3	37.5	37.0	37.2	37.3	37.3	37.4
Net profits	22.9	23.0	19.3	19.1	19.0	19.5	19.9	19.7	19.8
EBIT	28.2	25.2	22.1	23.2	22.9	23.3	23.5	23.4	23.6

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: Consolidated balance sheet for Bharti Airtel, March fiscal year-ends, 2009-2017E (Rs mn)

	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Equity									
Share capital	18,985	18,988	18,988	18,988	18,988	18,988	18,988	18,988	18,988
Warrants	—	—	—	—	—	—	—	—	—
Reserves/surplus	284,960	394,711	467,157	548,140	627,891	707,688	784,987	855,733	920,914
Total equity	303,945	413,699	486,145	567,128	646,879	726,676	803,975	874,721	939,902
Minority shareholding	10,704	28,489	30,609	33,713	37,433	41,467	46,051	51,115	56,597
Deferred tax liability	7,556	667	(3,153)	(5,339)	(12,072)	(18,144)	(25,032)	(36,155)	(45,706)
Liabilities									
Secured loans	118,801	64,619	50,396	—	—	—	—	—	—
Unsecured loans	—	—	—	—	—	—	—	—	—
Total borrowings	118,801	64,619	50,396	—	—	—	—	—	—
Current liabilities	162,941	138,934	159,573	168,059	166,975	166,618	167,716	169,964	172,570
Total capital	603,947	646,408	723,570	763,561	839,215	916,617	992,710	1,059,644	1,123,363
Assets									
Cash and equivalents	49,070	77,133	109,284	108,043	160,647	223,500	288,920	348,569	403,816
Current assets	95,009	62,214	68,395	73,896	78,566	83,503	88,675	94,127	99,846
Gross block	532,177	626,158	732,074	833,390	923,325	1,007,108	1,089,569	1,172,545	1,257,795
Less: accumulated depreciation	147,750	207,059	274,094	341,654	416,709	495,635	578,619	666,885	757,471
Net fixed assets	384,427	419,099	457,980	491,736	506,616	511,472	510,950	505,660	500,324
Capital work-in-progress	24,709	24,709	24,709	24,709	24,709	24,709	24,709	24,709	24,709
Total fixed assets	409,136	443,808	482,689	516,445	531,324	536,181	535,659	530,369	525,032
Entry fees unamortized	40,364	52,675	51,527	50,379	49,231	48,083	46,935	45,787	44,639
Investments	10,341	10,551	11,649	14,772	19,419	25,323	32,494	40,765	50,003
Deferred expenditure	27	27	27	27	27	27	27	27	27
Deferred tax asset	—	—	—	—	—	—	—	—	—
Total assets	603,947	646,408	723,570	763,561	839,215	916,617	992,710	1,059,644	1,123,363
Leverage ratios (%)									
Debt/equity	39.1	15.6	10.4	—	—	—	—	—	—
Debt/capitalization	28.1	13.5	9.4	—	—	—	—	—	—
Net debt/equity	22.9	(3.0)	(12.1)	(19.1)	(24.8)	(30.8)	(35.9)	(39.8)	(43.0)
Net debt/capitalization	18.7	(3.1)	(13.8)	(23.5)	(33.0)	(44.4)	(56.1)	(66.2)	(75.3)
RoAE	32.2	25.4	18.1	17.5	16.8	16.5	15.9	15.0	14.5
RoAE (excl cash and interest income)	38.9	30.0	21.5	21.0	20.7	21.9	22.9	23.3	24.1
ROACE	25.4	16.9	14.9	15.6	14.9	14.8	14.3	13.1	12.9
RoACE (excl cash and interest income)	29.5	21.1	17.9	18.6	19.0	19.9	20.5	20.6	21.0

Source: Company, Kotak Institutional Equities estimates

JUNE 14, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **419**

Target price (Rs): **365**

BSE-30: **17,065**

Time to reap. We advise investors to book profits noting (1) that the stock is trading 15% above our revised 12-month target price of Rs365 and (2) the stock's strong outperformance (23%) over the past three months. We find the risk-reward balance unfavorable at current levels with the stock's 21.4X CY2010E EPS discounting positives of (1) steep margin expansion and (2) price increases in CY2009/early CY2010. A likely diesel price increase may cut into lubes consumption. Key upside risks stem from (1) lower-than-expected LOBS prices and (2) higher-than-expected growth in sales volumes.

Company data and valuation summary

Castrol India (a)

Stock data

52-week range (Rs) (high,low)	442-164
Market Cap. (Rs bn)	103.6

Shareholding pattern (%)

Promoters	25.1
FIs	45.2
MFs	9.6

Price performance (%)

	1M	3M	12M
Absolute	10.2	22.5	150.8
Rel. to BSE-30	9.8	23.2	123.9

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	15.4	19.6	20.6
EPS growth (%)	44.6	27.0	5.3
P/E (X)	27.2	21.4	20.3
Sales (Rs bn)	23.2	26.5	27.8
Net profits (Rs bn)	3.8	4.8	5.1
EBITDA (Rs bn)	6.1	7.6	8.0
EV/EBITDA (X)	16.1	13.1	12.3
ROE (%)	83.8	101.6	99.2
Div. Yield (%)	3.0	3.7	3.8

QUICK NUMBERS

- **Expensive valuations at 21.4X CY2010E EPS and 20.3X CY2011E EPS**
- **Rs1/US\$ increase in exchange rate impacts EPS by 2.5%**
- **US\$25/ton increase in raw material costs will impact EPS by 3.2%**

Valuations look expensive with stock trading at 20.3X CY2011E EPS

We believe the recent outperformance (23% in the past three months) offers a good opportunity to book profits. We are surprised by the sharp jump in the stock price over the past three months despite negative developments arising from (1) higher import tariff on LOBS, (2) weakening rupee and (3) high LOBS prices despite correction in crude oil prices. The stock is trading above our 12-month target price of Rs365 based on 18X 12-month forward EPS. Castrol stock has historically traded in a P/E band of 14-18X (see Exhibit 1) and has traded at a peak multiple of 21X 12-month forward P/E. We would be cautious in ascribing a higher multiple in light of modest earnings growth in CY2011E and beyond.

Higher LOBS prices may impact margins; likely diesel price increase demand

(1) We see downside risk to our earnings from likely higher LOBS prices. LOBS prices have increased in the past month despite lower crude prices reflecting tight global supplies. Castrol's earnings are sensitive to changes in LOBS prices; a US\$25/ton increase in raw material costs will impact Castrol's EPS by 3.2%. We assume LOBS prices at US\$900/ton (+US\$179/ton yoy) to reflect higher crude prices yoy. (2) We expect the government to raise diesel prices over the next few months and/or deregulate diesel prices. This may hurt the economics of freight operators which may delay consumption of replacement products such as lubes and tyres.

Weakening rupee does not auger well for earnings

Depreciation in the value of rupee versus the US dollar would be negative for earnings as it will increase the cost of raw materials (LOBS and additives), which constitute a significant portion of its overall costs. Castrol imports its entire requirement of LOBS and additives, the prices of which are linked to dollar prices. A Rs1/US\$ increase would reduce Castrol's CY2010E and CY2011E EPS to Rs19.1 and Rs20.1, respectively, from our base case estimate of Rs19.6 and Rs20.6.

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Castrol has traded at a peak multiple of 21X 12-month forward P/E
12-month forward P/E for Castrol India, 2002-10YTD (X)



Source: Bloomberg, Company, Kotak Institutional Equities estimates

Our assumption of 7.8% yoy volume growth seems reasonable

We assume 7.8% yoy growth in sales volumes for CY2010E versus management guidance of 4%. Thus, we do not see significant upside to our volume assumption. On the contrary, we do not rule out downside risk given the eminent rise in diesel prices, which could result in lower lubes consumption; freight operators and single-truck operators typically increase the run between lube changes to contain the impact of higher diesel prices on freight economics.

Key assumptions

Exhibit 2 gives our key assumptions behind our earnings model. We discuss the same in detail below.

Castrol: Key assumptions, December year-ends, 2004-11E

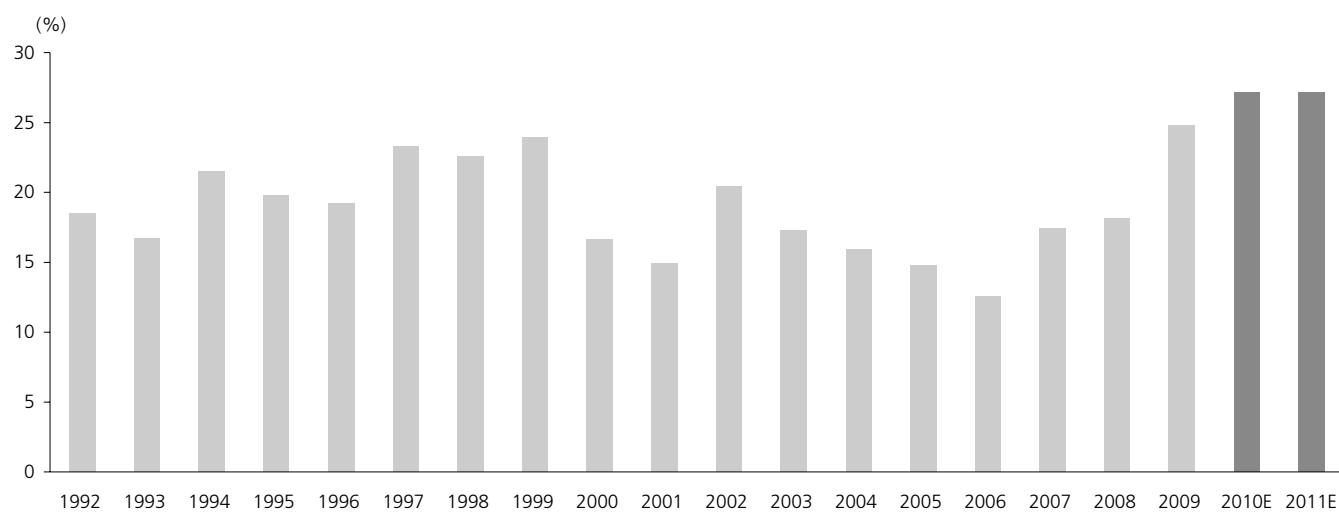
	2004	2005	2006	2007	2008	2009	2010E	2011E
Volume (Kilo litres)								
Industrial grades	50,306	50,788	50,585	43,773	31,928	28,003	30,804	31,728
Automotive grades	173,277	174,936	174,236	175,093	180,927	174,919	188,038	191,798
Traded items	621	747	1,055	1,114	1,723	1,614	1,775	1,775
Total	224,204	226,471	225,875	219,980	214,578	204,536	220,617	225,301
Growth (%)	5.8	1.0	(0.3)	(2.6)	(2.5)	(4.7)	7.9	2.1
Raw material prices (US\$/ton)								
LOBS prices	423	520	815	786	1,041	721	900	925
Macro assumptions								
INR/US\$	45.3	44.1	45.3	41.3	43.6	48.4	45.0	45.3
Realization (Rs/lt)								
Gross realization	58.2	63.2	77.6	85.8	102.8	113.3	120.1	123.6
Raw material cost	34.6	39.1	53.3	48.5	62.1	52.2	58.7	60.3
Net realization	23.6	24.1	24.2	37.3	40.7	61.1	61.4	63.3

Source: Company, Kotak Institutional Equities estimates

- ▶ **Volumes.** We model lube sales volumes to grow 7.8% in CY2010E and 2.1% in CY2011E. We note that the company has guided for 4% yoy volume growth in CY2010E.
- ▶ **Lubes prices.** We model lube realizations to increase by 8% in CY2010E to reflect the price hikes taken by Castrol in January 2010. The company has not effected any price changes since then. We note that Castrol's CY2009 EBITDA margin was an unprecedented 24.8% in CY2009 and we model its EBITDA margin to cross 27% in CY2010E. Castrol's average EBITDA margin CY2001-08 was 16.4% and CY2008 EBITDA margin was 18.1%. Exhibit 3 traces Castrol's yearly EBITDA margin from CY1992.

We model EBITDA margins over 27% for CY2010-11E

EBITDA margins for Castrol, March fiscal year-ends, 1992-2011E (%)



Source: Company, Kotak Institutional Equities estimates

- ▶ **LOBS prices.** We model LOBS prices at US\$900/ton (+US\$179/ton) to reflect higher crude prices yoy. We model yoy increase of US\$25/ton in LOBS prices in CY2011E.
- ▶ **Exchange rate assumption.** We maintain our exchange rate assumption at Rs45/US\$ for CY2010E and at Rs45.3/US\$ for CY2011E.

Castrol has high leverage to exchange rate and raw material prices

Sensitivity of Castrol's earnings to key variables

	CY2010E			CY2011E		
	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate						
Rupee dollar	46.0	45.0	44.0	46.3	45.3	44.3
Net profits (Rs mn)	4,716	4,839	4,963	4,967	5,098	5,228
EPS (Rs)	19.1	19.6	20.1	20.1	20.6	21.1
% upside/(downside)	(2.5)		2.5	(2.6)		2.6
Raw material price						
Raw material price (US\$/ton)	925	900	875	950	925	900
Net profits (Rs mn)	4,685	4,839	4,993	4,938	5,098	5,257
EPS (Rs)	18.9	19.6	20.2	20.0	20.6	21.3
% upside/(downside)	(3.2)		3.2	(3.1)		3.1

Source: Kotak Institutional Equities estimates

Castrol: Profit model, balance sheet, cash model, December year-ends, 2004-11E (Rs mn)

	2004	2005	2006	2007	2008	2009	2010E	2011E
Profit model (Rs mn)								
Net sales	13,051	14,304	17,524	18,883	22,057	23,182	26,501	27,849
EBITDA	2,082	2,117	2,200	3,296	3,997	5,754	7,189	7,571
Other income	221	201	344	348	418	361	375	425
Interest	(29)	(30)	(41)	(38)	(37)	(35)	(50)	(50)
Depreciation	(249)	(189)	(180)	(208)	(257)	(272)	(268)	(313)
Pretax profits	2,026	2,098	2,322	3,398	4,122	5,808	7,247	7,634
Tax	(687)	(694)	(889)	(1,455)	(1,568)	(2,075)	(2,455)	(2,597)
Deferred taxation	9	56	57	236	86	78	47	61
Net profits	1,275	1,468	1,545	2,184	2,624	3,811	4,839	5,098
Earnings per share (Rs)	5.3	5.9	6.1	8.8	10.7	15.4	19.6	20.6
Balance sheet (Rs mn)								
Total equity	3,601	3,901	4,177	4,302	4,756	4,950	5,320	5,804
Deferred taxation liability	174	119	61	(182)	(268)	(346)	(393)	(454)
Total borrowings	37	28	28	28	28	—	—	—
Current liabilities	2,830	3,238	3,619	5,116	4,690	6,812	6,362	6,540
Total liabilities and equity	6,642	7,285	7,885	9,264	9,205	11,416	11,288	11,890
Cash	297	399	892	3,179	2,556	5,258	4,604	5,126
Current assets	3,558	4,422	5,271	4,546	5,199	4,778	5,421	5,664
Total fixed assets	1,498	1,383	1,297	1,333	1,445	1,375	1,257	1,094
Investments	1,289	1,081	425	206	5	5	5	5
Total assets	6,642	7,285	7,885	9,264	9,205	11,416	11,288	11,890
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	1,576	1,544	1,403	2,046	2,772	3,834	4,685	4,924
Working capital	24	(465)	(506)	1,484	(1,193)	1,792	(1,093)	(64)
Capital expenditure	(57)	(89)	63	(243)	(371)	(344)	(150)	(150)
Free cash flow	1,542	991	960	3,287	1,208	5,281	3,441	4,710
Investments	(402)	258	687	224	201	—	—	—
Other income	37	25	9	151	210	188	375	425
Ratios (%)								
Debt/equity	1.0	0.7	0.7	0.7	0.6	—	—	—
Net debt/equity	1.0	0.7	0.7	0.7	0.6	—	—	—
RoAE	34.3	37.7	37.4	52.3	61.0	83.8	101.6	99.2
RoACE	35.7	37.7	37.0	52.4	61.4	84.1	102.3	99.9

Source: Company, Kotak Institutional Equities estimates

JUNE 11, 2010

UPDATE

Coverage view: **Attractive**

Price (Rs): **190**

Target price (Rs): **200**

BSE-30: **17,065**

Potential headwind for Voltas, further corroborated by Blue Star meeting. Voltas could face headwind of (1) margin pressure and (2) slow pick-up in execution of new projects as MEP markets remain sedate. Maintain estimates; recommend REDUCE; TP: Rs200. Takeaways from Blue Star meeting – (1) domestic MEP market unlikely to pick up before end-CY2010, (2) electrical business helped maintain top line though HVAC business declined, (3) key skills are engg and project mgmt rather than equipment.

Company data and valuation summary

Voltas

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	194-105	EPS (Rs)	10.9	11.3	12.6
Market Cap. (Rs bn)	62.8	EPS growth (%)	57.4	3.8	12.1
Shareholding pattern (%)		P/E (X)	17.5	16.8	15.0
Promoters	27.7	Sales (Rs bn)	48.2	54.1	60.3
FIs	9.0	Net profits (Rs bn)	3.6	3.7	4.2
MFs	16.4	EBITDA (Rs bn)	4.8	5.1	5.7
Price performance (%)		EV/EBITDA (X)	11.5	10.3	8.8
Absolute	1M 3M 12M	ROE (%)	38.3	31.3	28.8
Rel. to BSE-30	7.0 11.6 36.1	Div. Yield (%)	1.6	1.8	2.0
	7.5 12.3 22.9				

Voltas could face potential headwind of margin pressure and slow execution pick-up

We believe that Voltas could face potential headwind of (1) margin pressure in EMP and UCP segments, and (2) slow pick-up in execution of new projects as MEP markets in target geographies remain sedate. We have built reasonably strong assumptions for EMP segment – (1) revenue growth of 8% in FY2011E versus yoy flat revenues in 2HFY10, and (2) strong inflows in FY2011-12E (about 15% yoy growth). Management’s target of 15-20% yoy growth in FY2011E appears aggressive in light of sedate inflow and modest run-rate. We expect strong revenue growth in the other two segments; however, that is unlikely to drive overall revenue growth.

Maintain earning estimates; downgrade to REDUCE with a target price of Rs200/share

We maintain estimates of Rs11.3 and Rs12.6 for FY2011E and FY2012E, respectively. We reduce our TP to Rs200 (Rs215 earlier) based on 17X Sep-11E EPS (from 18X Sep-11E). We downgrade the stock to REDUCE based on (1) the recent stock outperformance, (2) continued slowdown in target MEP markets, (2) potential margins pressure and slow execution pick-up of new projects.

Domestic MEP market remains sedate; expansion to electrical works helps BLSTR maintain top line

BLSTR management highlighted that the domestic MEP market is 25% below FY2008 levels due to slow demand from IT and commercial; and pick-up is unlikely before end-CY2010. Expansion to electrical business helped BLSTR maintain top line although HVAC business declined. BLSTR believes that its key skills are system design and project management rather than equipment; and that system performance is more important than product features in commercial contracts.

MEP contract bundling could be a positive; BLSTR expanding to full MEP, water/air, T&D, services

Domestic market is moving to bundling of MEP contracts which is likely to benefit the organized players as (1) addressable contract size could increase to more than double of HVAC, and (2) bundled contracts may see less competition. BLSTR is expanding to full MEP (mechanical, electrical, plumbing), T&D, water/air contracts for processes, and services. We believe that although the expansion plans could fuel long-term growth, Blue Star would face slow demand environment and potentially higher competition from construction and equipment manufacturing firms.

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Potential headwind of margin pressure and slow execution pick-up

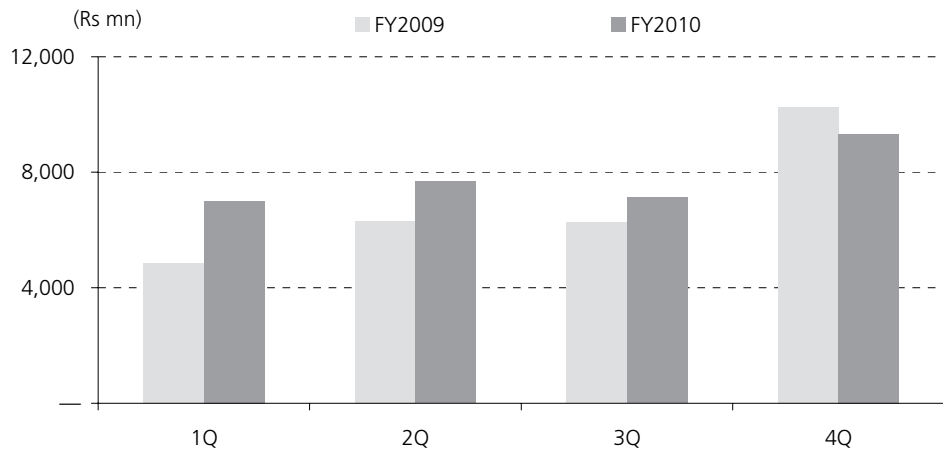
We believe that Voltas could face potential headwind of (1) margin pressure in EMP and UCP segments, and (2) slow pick-up in execution of new projects as MEP markets in target geographies remain sedate. Margins may come under pressure on the back of (1) wearing away of the benefits from completion of large projects in FY2010, (2) likely increase in raw material cost, and (3) aggressive competition. We currently assume that margins would reduce by about 50 bps yoy in FY2011E and FY2012E; however, there may be potential downside to our estimates as margins may shrink more than expected.

Reasonably strong assumptions for EMP with slight margin decline

We believe our segmental assumptions are reasonably strong as we expect EMP revenue growth of about 8% in FY2011E versus yoy flat revenues in 2HFY10. The management's earlier communication of about 15-20% yoy growth in FY2011E appears aggressive in light of sedate inflow and modest run-rate.

EMP segment revenues were flat yoy in 2HFY10

Quarterly EMP segment revenue for Voltas (consolidated), March fiscal year-ends, 2009-10 (Rs mn)



Source: Company, Kotak Institutional Equities

We have also assumed strong inflows in FY2011-12E (about 15% yoy growth) as target markets are showing some early signs of revival. We assume that the margins in the segment would shrink about 50 bps yoy in FY2011E and remain flat yoy in FY2012E. We expect strong revenue growth in engineering products and UCP segments; however, the two segments are unlikely to drive overall revenue growth.

Segment revenues and EBIT estimates for Voltas, March fiscal year-ends, 2007-12E (Rs mn)

	2009	2010	2011E	2012E	
EMP segment					Expect reasonable growth in EMP segment versus yoy flat revenues in 2HFY10. Mgmt target of 15-20% in FY11E appears aggressive.
Revenue	27,668	31,134	33,733	36,120	
Revenue growth (%)	67.4	12.5	8.3	7.1	Assume reasonably strong inflows in FY2011E-12E versus sedate inflow in FY2010.
Orderbook	47,180	47,046	48,963	53,840	
Order inflow	31,848	31,000	35,650	40,998	Margins may reduce due to material cost, competition, and wearing away of benefit from completion of large projects in FY2010
Bill to book ratio (X)	0.47	0.50	0.52	0.52	
Segment EBIT	2,134	3,091	3,120	3,341	Continue to expect robust revenue growth in UCP segment on top of strong FY2010 segment results
Segment EBIT margin (%)	7.7	9.9	9.3	9.3	
Engineering products and services					
Revenue	5,422	4,680	5,637	6,440	
Revenue growth (%)	(5.5)	(13.7)	20.4	14.2	
EBIT	626	768	1,015	1,159	
EBIT margin (%)	11.6	16.4	18.0	18.0	
Unitary cooling products					
Revenue	9,223	11,871	14,227	17,164	
Revenue growth (%)	12.5	28.7	19.9	20.6	
Segment EBIT	550	1,203	1,316	1,588	
Segment EBIT margin (%)	6.0	10.1	9.3	9.3	

Source: Company, Kotak Institutional Equities estimates

Maintain estimates; downgrade to REDUCE with a target price of Rs200/share

We maintain estimates of Rs11.3 and Rs12.6 for FY2011E and FY2012E, respectively. We reduce our TP to Rs200 (Rs215 earlier) based on 17X Sep-11E EPS (versus 18X Sep-11E earlier). We downgrade the stock to REDUCE based on (1) the recent stock outperformance (outperformed BSE-30 Index by 12.3% over the past three months), (2) continued slowdown in target MEP markets, (2) potential headwind of margins pressure and slow pick-up in execution of new projects.

Highlight moderate sensitivity of EMP margins assumptions to EPS and target price

We also highlight moderate sensitivity of EMP margin assumptions to EPS (100 bps decline in EMP margin would reduce FY2011E and FY2012E EPS by about 6%).

Sensitivity of EPS to assumption of EMP segment EBIT margins

EMP margin assumption (%)	8.3	8.8	9.3	9.8	10.3
FY2011E EPS (Rs)	10.6	11.0	11.3	11.7	12.0
FY2012E EPS (Rs)	11.9	12.3	12.6	13.0	13.4
Implied target price at 17X Sep-11 P/E	189	194	200	206	212
(% change)	(5.6)	(2.7)		3.2	6.2

Source: Kotak Institutional Equities estimates

Domestic market remains sedate on slow demand for IT and commercial space

In a recent meeting with Blue Star, the management highlighted that the domestic EMP market continues to be about 25% below FY2008 levels and the projects are moving at a very slow pace. The management believes that a substantial pick-up is unlikely to happen before end-CY2010. Enquiries for new orders as well as pace of execution remains slow, especially in IT and commercial sectors on account of absorption of inventory built up during the slowdown and IT companies potentially reducing new-build space requirement by allocation lower sq. ft area per employee. We believe that Voltas' management may increase focus on Indian EMP market as the level of ordering activity in the Middle East has remained sedate. However, such a shift is not likely to yield immediate results as even the Indian market remains slow, both on inflows and execution.

Blue Star order book has undergone structural shift to long execution projects

The order book of the company has seen a structural shift from short cycle IT and retail projects (with execution cycle of about 1 year) to longer cycle projects for power, hospitals and hotels (with execution cycle of about 2 years) which reduced billing in FY2010. The company expects to see higher billing in FY2011E as the order backlog is now mature. The average execution time of Rs17 bn order book at end-FY2010 (versus Rs13 bn at end-FY2009) stands at 13-14 months.

High debtor level indicates limited project pipeline; may be down by end-FY2011E

Sundry debtors level is a lead indicator of EMP business for Blue Star as about 40% of the business for the company is from repeat customers. Debtors continue to remain at relatively high levels (Rs6.3 bn at end-FY2010 compared to Rs4.8 bn at end-FY2008). The high level of debtors indicates that the clients may not be pursuing new projects actively as they would still need to release funds for the old ones. The management mentioned that the company has not seen any project cancellations so far and has no bad debts on such account. Furthermore, the management expects the debtor levels to ease out by end-FY2011E or so.

BLSTR: Expanding to full MEP (mechanical, electrical, plumbing), water and TFM

Blue Star has already established a reasonable business in electrical with the acquisition of Naseer Electrical in FY2008. Electrical currently contribute about Rs3 bn to the order book. Blue Star has recently acquired D.S. Gupta Construction, a firm specializing in plumbing and firefighting contracts with FY2010 revenues of Rs1.3 bn. The management expects to command about 20%+ market share in electrical and plumbing in about three years. The company further plans to expand into water related contracts such as piping and pumping works to leverage its expertise in heavy mechanical projects. The company would potentially explore entry into water management business – urban water management, desalination and waste water management – in about three years or so. The company also plans to explore opportunities in Total Facility Management (TFM) business, which it believes would gain traction over the next 3-5 years as services business is likely to see the same sort of bundling of contracts as the MEP business. We believe that although the expansion into new businesses would fuel future growth, Blue Star could face slow demand environment and potentially higher competition from civil construction and equipment manufacturing firms in the near term.

Diversify to T&D and water/air works for process like steel; limit commercial to 60%

Blue Star aims to diversity its project business exposure away from IT and commercial projects with a target of about 40% of the business from other sectors in four years. Besides undertaking more projects in infrastructure (airports and metros), the company is also diversifying into T&D and water/air contracts for processes such as steel. The company expects to book revenue of about Rs1 bn from the steel sector in FY2011E. In the power sector, Blue Star plans to focus on substation works and BOP packages. Securing projects in the power sector requires qualifications, which Blue Star expects to meet in about 3-6 months. The company plans to diversify the EMP business by limiting exposure to IT and retail to about 60% of the segment in four years.

BLSTR believes key skills are engineering and project mgmt, not equipment

Blue Star management believes that the key skills of the company are system design and engineering, and project management in heavy mechanical applications. The company admits that it may not be the best equipment provider (certainly lags behind some of the leading Japanese manufacturers); however, argues that system performance metrics such as reliability, energy efficiency and servicing are potentially more important than detailed product features in a typical commercial systems contract. The management expects the AC equipment manufacturing to evolve on the same line as the auto industry where the equipment expertise may be a skill of the component manufacturer while the expertise of the OEMs, such as Blue Star, would be in product design and optimization.

Prefers not to substantially scale up room AC and professional electronics business

The management mentioned that it does not plan to substantially scale up its presence on residential AC business even though the segment may see higher growth than commercial AC. The residential AC products have less margins compared to commercial ones on account of higher competition and lower requirements on system performance parameters such as reliability. The company also mentioned that it does not plan to expand its professional electronics business in the foreseeable future.

MEP contract bundling to be a potential growth driver for organized players

The domestic MEP market appears to be moving towards bundling of MEP contracts versus standalone contracts for each type of works – air conditioning, electrical and plumbing. Bundling of contracts is likely to benefit the organized players, such as Voltas and Blue Star, as (1) the addressable contract size increases significantly, and (2) integrated MEP contracts are likely to see less competition than standalone contracts. As per our understanding, a bundled MEP contract is typically more than double the size of a standalone AC contract. In a meeting with Blue Star, the management mentioned that about 40% of the contracts are already bundled in one form or the other and it expects the bundling to go up to about 75% of the contracts in the next three years (still significantly lower than current level of about 90% bundled contracts in the Middle East). The domestic MEP market is currently dominated by four players – Voltas, Blue Star, Sterling Wilson (an associate of Shapoorji & Pallonji Group) and ETA (an associate of Dubai-based ETA Group).

A bundled MEP contract is typically more than double the size of a standalone HVAC contract

Broad split of value across construction allied activities (Rs / sq. ft)

Building construction	Rs1000-1,200/sq. ft	}	Heating, ventillation and air conditioning	Rs200-250/sq. ft
Mechanical & Electrical	Rs500-800/sq. ft		Electrical	Rs200-250/sq. ft
Glazing solutions	Rs250-500/sq. ft		Plumbing & firefighting	Rs100-150/sq. ft
Interiors	Rs250-1,000/sq. ft		Interiors painting etc.	Rs100-150/sq. ft

Note: All the values are just benchmarks and vary widely based on specifications, height of building etc.

Source: Industry, Kotak Institutional Equities

JUNE 14, 2010

UPDATE

BSE-30: 17,065

BWA spectrum auction results – new players emerge winners. BWA spectrum auction, which closed on Friday, marks the entry of four new players (Reliance Industries, Qualcomm, Tikona, and Augere) in the Indian telecom industry, which won a combined 32 of the 44 available slots. Fresh capital continues to chase the industry; this capital is likely to chase subs/revenue market share in initial years without worrying about profitability – a negative auction outcome, in our view. We reiterate our Cautious sector view.

BWA spectrum auction results – entry of new player to intensify competition further

The BWA (broadband wireless access) spectrum auction for two slots of 20MHz spectrum in the 2.3 GHz band, closed with a pan-India clearing price (per slot) of Rs128.5 bn (US\$2.8 bn) – 7.3X the reserve price. Exhibit 1 depicts the results. Key highlights

- ▶ Infotel Broadband (95% owned by Reliance Industries – acquisition announced post-auction) emerged a pan-India winner. RIL announced 95% stake purchase in Infotel for Rs48 bn post the close of the auctions.
- ▶ The other slot available to private operators was won by Bharti in 4 circles, Aircel in 8 circles, Tikona in 5 circles, Qualcomm in 4 circles, and Augere in 1. Other incumbents in the fray (Vodafone, Idea, RCOM, and the Tata group) did not win any of the circles.
- ▶ Bharti won BWA spectrum in the Karnataka, Kolkata, Maharashtra, and Punjab for a total price of Rs33 bn – this takes Bharti's total payout for 3G and BWA spectrum to Rs156 bn (US\$3.4 bn). In 3 of these 4 circles (Kolkata, Maharashtra, and Punjab), Bharti had not won 3G spectrum, while the company has a ~50% revenue market share in the 4th (Karnataka).

Fresh risk capital continues to chase the industry – difficult to find a positive in that

BWA business potential, viability, and other issues aside (we do present our views on these later in the note), the key facet to focus on, in our view, is this – **new risk capital continues to chase the industry**. As highlighted above, 32 of the 44 slots available to the private players have been won by four new players, at a price that appeared high to the incumbents, reflected in their decision to opt out and also echoed in their post-auction comments; Bharti's and Aircel's strategy was clearly driven by the intent to fill 3G coverage gaps, and protection of strong legacy circles.

A positive spin on the sustained entry of fresh capital in the industry (new UAS licenses bought in 2008 and subsequent network rollouts, a total payout of 767 bn for 3G/BWA spectrum by private players) can be the still-untapped rural penetration and data upside potential in the country. We agree with the possibility of S-curve growth in both rural telephony and data business in India, but note that fresh capital (especially coming from a new entrant) chases subscriber/revenue market share in initial years, without worrying about profitability.

A new player does not worry about the shrinkage of current revenue pie as long as it can grow revenues by gaining market share. Market share gain for a new player demands pricing aggressiveness, given weakness on coverage, brand, and distribution strength as compared to incumbents. The rationality (a new player can not build a business case being a price warrior) argument does not hold when the only chance (however feeble) that a new operator has, of building a business case, is to play the price card in the initial phase – rationality bounded by the market/competitive dynamics.

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BWA spectrum will be used for high-speed wireless data networks rollout; voice services may be offered on these networks, at some point

Operators will rollout Wimax (Worldwide Interoperability for Microwave Access) or TD-LTE (Time Division – Long-term Evolution; Qualcomm, winner in 4 circles including Delhi and Mumbai intends to rollout TD-LTE network) networks using the 2.3GHz BWA (broadband wireless access) spectrum won in the auction. Key aspects

- ▶ Wimax (based on IEEE 802.16 standard) and TD-LTE are both high-speed internet access technologies, which allow operators to offer Broadband speed (≥ 256 kbps in India) data services.
- ▶ Operators can offer voice services on Wimax networks (Sprint in the US and a few operators in Europe offer voice on Wimax networks). Technologically feasible, the same is also allowed by regulation – DoT response to a question in the pre-auction Q&A document suggests that 'Service conditions including allowing Internet Telephony will depend on whether the winner of the BWA spectrum holds UAS or ISP licence (and the type of ISP licence)'. Of course, the commercial viability of wireless voice services on Wimax or TD-LTE will depend on the handset ecosystem as well as reach issues.
- ▶ There have been 598 Wimax network deployments in 148 countries worldwide as at end-May-2010 covering a total population of 622 mn. Total number of Wimax subs worldwide stands at 6.5 mn (*Source: Wimax Forum*).

Competitive implications – new entrants pursuing data opportunity caps the upside for incumbents

Broadband penetration (BB) in India is low – at 9 mn subs, it stood at $<1\%$ at end-April 2010. It is widely believed that BB penetration in India has been constrained by access/supply/reach issues, rather than demand. Wimax and 3G, wireless access technologies with high through-put, are expected to bridge the access gap and spur exponential growth in the BB market in India. We highlight that Wimax is likely to address the residential and SMB segment in the country and not cater to the large-enterprise demand (which is met by leased-line and fiber access). Our view on the current market size, potential opportunity and other issues

- ▶ At an average of 10.6 mn subs for FY2011E, and approximate ARPU of US\$14/sub/month (MTNL's reported BB ARPU was Rs592 for the March 2010 quarter), the FY2011E estimated industry BB revenue pie works out to ~US\$1.8 bn. DSL is the dominant BB access technology in India currently (87% of total subs, see Exhibit 2).
- ▶ Household penetration is a better metric to consider, while looking at the long-term potential of BB services – an average family of 5 could have 3-5 wireless connections, but would typically not have more than 2 (more likely 1) BB connection. India has an estimated 230 mn households (~130 mn TV/~100 mn cable and satellite households, a better indicator of addressable population).
- ▶ Exhibit 3 depicts the # of BB subs and BB penetration in select countries.
- ▶ Wireless BB access networks (3G/Wimax) will likely cannibalize some of the existing fixed BB revenue base as well, in our view. In addition, the entry of new players with Wimax spectrum will limit the 3G data upside for 3G winners (incumbents).

- ▶ A surprising facet of the auction was the inability (balance sheet constraints) or unwillingness (signaling weak business case at the clearing levels) of incumbents to price out new players. We also note that the new players are well-capitalized (RIL, Qualcomm) or are serious pure-play BB players (Tikona, Augere). We highlight that Vodafone, which was the only incumbent in the auction that has run 3G networks in other countries, has settled for 3G spectrum in only nine circles and Wimax spectrum in none.
- ▶ Exhibit 4 looks at the economics of running a pan-India broadband wireless network at a spectrum payout of US\$2.8 bn. A steady-state ROIC of 12% (close to the WACC for a green-field network rollout) requires revenues of US\$3.7 bn at 40% EBITDA margin, assuming a network rollout of 40,000 cell sites (Top 100 cities coverage @400 sites per city). At an average ARPU of US\$12/sub/month, this implies required subs base of 26 mn – or 647 subs per cell site, which is challenging, in our view.

**We do not see competitive intensity easing; valuations do not excite either.
Reiterate Cautious coverage view**

Competitive intensity in the low-end voice segment is already high with the recent 2G entrants focusing on urban low-end churn to gain subscribers. We expect competitive intensity in the high-end segment of the market to increase with MNP rollout and 3G network launches. Data usage increase, expected to usher the next phase of strong growth in the Indian telecom market, has already attracted enough interest to keep operators honest and returns in check. Traditional M&A-led consolidation does not seem imminent with unfavorable regulations and stretched balance sheets of most incumbents (a new player buying stake in an incumbent does not consolidate the industry).

Most importantly, negatives are still not in the price – Bharti, Idea, and RCOM, trade at adjusted (for Zain/3G/BWA in Bharti's case, for 3G in Idea's and RCOM's) FY2012E EV/EBITDA of 6.4X, 7.2X and 7.2X respectively, expensive, in our view. We reiterate our Cautious coverage view on the sector.

Exhibit 1: Provisional results of the BWA spectrum auction

Rs mn	Voda					Spice		Infotel		BSNL/MT	Total payout	Reserve price		
	Bharti	fone	TTSL	Idea	RCOM	Aircel	Qualcom	Tikona	ISP	Augere			Broadband	NL
Metros														
Delhi						22,410					22,410	22,410	67,231	1,600
Mumbai						22,930					22,930	22,930	68,789	1,600
Chennai + TN						20,695					20,695	20,695	62,084	1,600
Kolkata	5,232										5,232	5,232	15,696	600
A circles														
Andhra Pradesh						10,591					10,591	10,591	31,774	1,600
Gujarat							6,139				6,139	6,139	18,416	1,600
Karnataka	15,433										15,433	15,433	46,298	1,600
Maharashtra	9,156										9,156	9,156	27,469	1,600
B circles														
Haryana						1,199					1,199	1,199	3,597	600
Kerala						2,587					2,587	2,587	7,760	600
Madhya Pradesh									1,247		1,247	1,247	3,740	600
Punjab	3,323										3,323	3,323	9,968	600
Rajasthan							973				973	973	2,920	600
Uttar Pradesh (east)								1,425			1,425	1,425	4,275	600
Uttar Pradesh (west)								1,839			1,839	1,839	5,516	600
West Bengal and A&N islands						710					710	710	2,129	600
C circles														
Assam						330					330	330	991	150
Bihar						993					993	993	2,978	150
Himachal Pradesh							207				207	207	620	150
North East						213					213	213	638	150
Orissa						636					636	636	1,909	150
J&K						213					213	213	638	150
Total payout - operator	33,144	—	—	—	—	34,380	49,125	10,582	—	1,247	128,478	128,478	385,433	17,500
# of circles won	4	—	—	—	—	8	4	5	—	1	22	22		

Note:

(a) Vodafone, Idea, Tata Communications, Spice, RCOM, the other bidders in the auction, were not declared provisional winners in any circle.

Source: DoT

Exhibit 2: List of provisional winners of BWA spectrum

Player	Circles won	Remarks
Bharti Airtel	Maharashtra, Karnataka, Punjab, Kolkata Chennai + TN, A.P., West Bengal, Assam,	Incumbent operator; Has a fixed broadband offering in 95 cities; does not have a wireless BB offering
Aircel	Biharm, North east, Orissa and J&K	Incumbent operator; Does not have a fixed/wireless BB offering
Qualcomm	Delhi, Mumbai, Haryana, Kerala	US-based chipset-maker
Tikona networks	Gujarat, Rajasthan, UP(E), UP(W), H.P.	Has a wireless BB offering in select cities (in unlicensed spectrum band)
Infotel Broadband	Pan-India	Likely a subsidiary of the HFCL group; offers BB services in the Punjab circle, Reliance Industries acquired 95% stake for Rs48 bn
Augere	M.P.	An international player running Wimax BB operations in Bangladesh and Pakistan; promoted by Sanjiv Ahuja, the ex-CEO of Orange

Source: DoT, Kotak Institutional Equities

Exhibit 3: DSL is the dominant BB technology in India, currently
Break-up of BB subs in India by access technology, June 2007 - March 2010

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
BB subs ('000)												
DSL	1,984	2,174	2,591	3,281	3,724	4,184	4,711	5,364	5,737	6,239	6,767	7,571
Cable modem	265	319	342	376	419	461	485	474	487	525	590	637
Ethernet LAN	84	101	101	107	108	122	155	244	275	319	332	388
Fibre	21	22	22	51	45	59	73	42	35	38	32	46
Radio	20	28	29	39	57	56	73	72	62	65	74	79
Leased line and others	49	28	43	20	30	20	28	21	24	25	25	29
Total	2,422	2,672	3,128	3,874	4,382	4,903	5,526	6,218	6,620	7,210	7,820	8,750
% of total												
DSL	81.9	81.4	82.8	84.7	85.0	85.3	85.3	86.3	86.7	86.5	86.5	86.5
Cable modem	10.9	11.9	10.9	9.7	9.6	9.4	8.8	7.6	7.4	7.3	7.5	7.3
Ethernet LAN	3.4	3.8	3.2	2.8	2.5	2.5	2.8	3.9	4.2	4.4	4.2	4.4
Fibre	0.9	0.8	0.7	1.3	1.0	1.2	1.3	0.7	0.5	0.5	0.4	0.5
Radio	0.8	1.0	0.9	1.0	1.3	1.1	1.3	1.2	0.9	0.9	1.0	0.9
Leased line and others	2.0	1.1	1.4	0.5	0.7	0.4	0.5	0.3	0.4	0.3	0.3	0.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
qoq net adds ('000)												
DSL		190	416	690	443	461	527	652	373	502	529	804
Cable modem		54	23	34	43	42	23	(11)	14	38	65	47
Ethernet LAN		17	0	6	1	14	33	89	30	44	13	56
Fibre		1	1	28	(6)	14	14	(31)	(7)	3	(6)	14
Radio		7	1	10	18	(1)	17	(1)	(10)	3	9	4
Leased line and others		(20)	15	(23)	9	(10)	8	(7)	2	1	1	4
Total		249	457	746	508	521	623	692	402	590	610	930
qoq growth (%)												
DSL		9.6	19.1	26.6	13.5	12.4	12.6	13.8	7.0	8.7	8.5	11.9
Cable modem		20.4	7.3	9.9	11.4	10.1	5.0	(2.3)	2.9	7.7	12.3	8.0
Ethernet LAN		20.4	0.1	6.4	0.8	13.4	26.9	57.4	12.4	16.0	4.0	16.9
Fibre		5.3	3.6	125.8	(11.6)	30.6	24.6	(42.2)	(16.9)	8.9	(16.1)	44.6
Radio		35.2	3.7	36.1	46.0	(1.6)	30.0	(1.1)	(13.8)	4.3	14.5	6.0
Leased line and others		(41.9)	53.5	(53.6)	47.3	(32.2)	40.8	(24.3)	11.6	2.9	2.1	15.4
Total		10.3	17.1	23.8	13.1	11.9	12.7	12.5	6.5	8.9	8.5	11.9

Source: TRAI, Kotak Institutional Equities

Exhibit 4: Broadband penetration in select countries

Country Name	Total BB subs	Total Wimax subs	Population penetration (%)	Household penetration (%)
Australia	5,411,000	110,000	24.18%	66.00%
Bangladesh	175,000	500	0.11%	0.60%
Belgium	3,255,500	20,500	30.07%	70.20%
Brazil	11,967,000	90,000	6.20%	22.40%
Denmark	2,102,000	20,000	37.98%	80.30%
Germany	25,500,000	80,000	31.19%	63.90%
Hong Kong	2,248,000	-	31.99%	95.60%
India	9,000,000	-	0.76%	4.00%
Indonesia	1,205,000	10,000	0.52%	1.80%
Japan	31,925,928	80,000	25.07%	63.00%
Malaysia	2,115,000	180,000	7.47%	34.20%
Pakistan	790,000	225,000	0.47%	3.30%
Poland	4,800,000	19,000	12.58%	33.90%
Singapore	1,668,600	3,600	33.45%	134.30%
South Africa	1,100,000	12,000	2.23%	8.40%
South Korea	16,235,000	350,000	32.62%	88.50%
Spain	9,775,000	60,000	21.24%	60.70%
Sri Lanka	212,000	22,000	1.05%	4.50%
Switzerland	2,746,000	-	35.28%	79.10%
United Kingdom	18,250,000	30,000	29.42%	68.00%
United States	87,800,000	1,100,000	28.37%	73.30%

Note:

(a) Subscriber data is as of Mar-2010

Source: Telegeography

Exhibit 5: BWA business case looks challenging

A look at the operating scale requirements for a viable BWA business case

	Focused rollout	Comments	Wider rollout
Spectrum payout (US\$ mn) = A	2,856	Pan-India spectrum payout of Rs128.5 bn	2,856
# of cell sites	40,000	Top 200 cities/towns coverage @300 sites per city	60,000
Capex/cell site (US\$)	100,000	Including core network and backhaul; assuming passive infra leasing	100,000
Total capex (US\$ mn) = B	4,000		6,000
Total capital invested (US\$ mn) = A + B	6,856	Not treating EBITDA losses in the initial years as investments	8,856
Target ROIC (%)	12.0	Average cost of capital for a greenfield network rollout in India	12.0
Required EBIT*(1-tax rate) (US\$)	823		1,063
Tax rate (%)	20	Conservative assumption; no tax-breaks available	20
Required EBIT (US\$ mn)	1,028		1,328
Depreciation and amortization (US\$ mn)	463	Spectrum payout amortization over 20 years and network capex depreciation at 8%	623
Target EBITDA (US\$ mn)	1,491		1,951
Target EBITDA/month (US\$ mn)	124		163
Assumed steady-state EBITDA margin (%)	40		40
Target revenues/month (US\$ mn)	311		406
Target annual revenues (US\$ mn)	3,728		4,878
Assumed ARPU (US\$/sub/month)	12	Current BB ARPU is ~US\$15/sub/month	10
Required subs base (mn)	26		41
Current BB subs base pan-India (mn)	9	end-April 2010	9
Subs per cell site	647		677
Current wireless subs per cell-site (Bharti)	1,217	Mar 2010 quarter	1,217

Source: Kotak Institutional Equities estimates

Exhibit 6: Indian telecom companies valuation analysis, March fiscal year-ends, 2008-2012E

	Price (Rs)	Target price	P/E (X)					EV/EBITDA (X)				
	11-Jun-10	(Rs)	2008	2009	2010	2011E	2012E	2008	2009	2010	2011E	2012E
Bharti	274	290	15.5	12.2	11.4	12.8	11.3	9.5	7.3	6.4	6.1	5.2
Idea	54	50	13.8	18.7	19.9	41.2	24.0	10.6	7.7	7.2	7.1	5.8
MTNL	54	50	7.5	22.3	(3.4)	(5.2)	(5.8)	0.0	(8.4)	0.3	(1.0)	(2.8)
RCOM	173	140	6.5	5.5	7.8	12.3	9.5	7.5	8.0	7.2	8.0	6.0
TCOM	246	225	22.5	18.1	17.6	16.2	15.7	11.9	9.2	8.2	7.5	5.9

	KS rating	Market cap.	Revenues (Rs bn)					EBITDA (Rs bn)				
		(US\$ bn)	2008	2009	2010	2011E	2012E	2008	2009	2010	2011E	2012E
Bharti	REDUCE	22.2	270	370	396	422	482	113	152	160	162	181
Idea	REDUCE	3.8	67	101	124	141	175	23	28	34	35	43
MTNL	SELL	0.7	47	45	37	38	40	7	2	(9)	(7)	(5)
RCOM	SELL	7.9	191	229	223	223	260	82	93	79	67	83
TCOM	REDUCE	1.5	33	38	42	46	49	6	8	9	10	10

	Net Income (Rs bn)					EPS (Rs)				
	2008	2009	2010	2011E	2012E	2008	2009	2010	2011E	2012E
Bharti	66	84	89	79	89	17.7	22.3	24.0	21.4	24.2
Idea	10	9	9	4	7	3.9	2.9	2.7	1.3	2.3
MTNL	4	1	(10)	(7)	(6)	7.1	2.4	(15.6)	(10.4)	(9.1)
RCOM	56	67	47	30	39	26.5	31.6	22.1	14.1	18.2
TCOM	3	4	4	4	4	10.9	13.6	14.0	15.2	15.7

Source: Bloomberg, Kotak Institutional Equities estimates

JUNE 11, 2010

UPDATE

BSE-30: 17,065

April 2010 IIP: Surprise, Surprise! The first month of FY2011E starts off with IIP surprising on the upside by a huge margin. IIP growth on a yoy basis registered a 17.6% growth against March 2010 growth of 13.9% that was revised upwards from 13.5% and a mere 1.1% in April 2009. Markets were expecting growth of 14.3% while we expected a print of 14.6%. Manufacturing, capital goods and consumer durables were the sectors which came up trumps in April.

IIP growth rate at 17.6%, markets expected 14.3%

IIP growth rate came in at 17.6%, almost matching the 17.7% in December 2009 that was a 14-year high. Markets were expecting a rate of 14.3% and we expected it at 14.6%. In the non-seasonally adjusted data, April is the month where we see a drop in the index by a significant amount from the March levels. On an average the drop from March levels is in the tune of around 11-12%. This month the drop was significantly lower at 9%. Added to this, the base effect is also strong but it does not in any way take away the buoyancy in the numbers. Industrial production has recovered strongly and has seen a V-shaped recovery since 1QFY10.

Manufacturing, capital goods and consumer durables boost April print

On a sector-based classification, we see mining and quarrying maintaining a growth rate similar to last month at 11.4%. Electricity production growth remained muted at 5.7% but manufacturing exceeded expectations and grew at 19.4%, up from 14.7% in March. With a 79% weight in the IIP, this certainly pulled up the overall growth rate (See Exhibit 1). On a use-based classification, the surprise came from the capital goods sector which grew at 72.8%, much higher than 28.4% in March 2010 and (-)5.9% a year ago. Despite the base effects and seasonal effects, this is surely a number which reflects the buoyancy in the sector on the whole. Consumer goods grew at 14.5% of which the major growth came in the consumer durables sector which grew at around 37%, in line with the growth of 30% or more that it has been registering for the previous 5 months. Growth in consumer non-durables remained relatively muted at 6.6% (See Exhibit 2). The core sectors' growth released earlier, was steady at 5.1% with coal production pulling down the growth with (-)2.3% yoy growth. Cement and refinery sectors were on the upside compared to March data with 8.7% and 5.3%, respectively (See Exhibit 3).

Double-digit FY2011E IIP growth possible

It is too early to comment on how the economy as a whole will span out in FY2011E based upon today's data release. Admittedly, this reflects certain buoyancy in the economy, at least on the manufacturing side, but it remains to be seen how the investment cycle plays out over the year. Also, much depends on how the monsoon fares. If the monsoon is good we might see higher growth in the consumer goods space. The risk factor continues to stem from the global economy, specifically the Euro area sovereign situation. If the global recovery is not impeded by a fresh crisis, we expect the IIP growth to come to about 10% in FY2011E, higher than our earlier estimate of 8-9%. However, we expect the current strong numbers to start tapering off from June and 2HFY10 IIP growth dropping to about 7.5% from about 13% in 1HFY11E.

RBI may still hold with likely May inflation at 9.75%

Strong IIP numbers for April are likely to be followed by higher May inflation on Monday (our estimate: 9.75% versus 9.59% for April). In our assessment, the chances of a monetary policy action before the scheduled date of July 27 are still slim as monetary conditions have already tightened as a result of 3G auction payments and deposit and M3 growth is already decelerating sharply. In our view, the odds still favor a 25 bps policy rate hike on the scheduled date.

QUICK NUMBERS

- **IIP growth at 17.6% for April 2010, the second highest in 15 years**
- **Buoyant growth in capital goods (72.8%), manufacturing (19.4%) and consumer durables (37%)**
- **Our FY2011E IIP growth estimate raised to 10% from 8-9% earlier**

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Exhibit 1: April IIP continues the run of double-digit growth rates
Sectoral classification of IIP growth, March fiscal year-ends, 2008-2010 (%)

	Mining (%)			Manufacturing (%)			Electricity (%)			General (%)		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Weights (%)	10.5			79.4			10.2			100.0		
April	6.1	3.4	11.4	6.7	0.4	19.4	1.4	7.1	5.7	6.2	1.1	17.6
May	5.5	3.4		4.5	1.8		2.0	3.3		4.4	2.1	
June	0.1	14.2		6.1	8.0		2.6	8.0		5.4	8.3	
July	2.8	8.7		6.9	7.4		4.5	4.2		6.4	7.2	
August	2.8	11.0		1.7	10.6		0.8	10.6		1.7	10.6	
September	5.8	7.4		6.2	9.7		4.4	7.5		6.0	9.3	
October	3.2	9.1		(0.6)	10.9		4.4	4.0		0.1	10.2	
November	0.7	10.7		2.7	13.1		2.6	1.8		2.5	12.0	
December	2.2	11.1		(0.6)	19.4		1.6	5.4		(0.2)	17.7	
January	0.7	15.3		1.0	17.4		1.8	5.6		1.0	16.3	
February	(0.2)	11.1		0.2	16.1		0.7	6.7		0.2	15.1	
March	1.9	11.8		(0.3)	14.7		6.3	7.7		0.3	13.9	
April-March (FY)	2.6	9.8		2.7	10.9		2.8	6.0		2.7	10.4	

Source: Central Statistical Organization, Kotak Institutional Equities

Exhibit 2: Capital goods continue to grow at unprecedented rate
Use-based classification of IIP growth, March fiscal year-ends, 2008-2010 (%)

	Basic goods			Capital goods			Intermediate goods			Consumer goods			Consumer durables			Consumer non-durables		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Weights (%)	35.6			9.3			26.5			28.7			5.4			23.3		
April	4.0	4.5	8.7	12.4	(5.9)	72.8	3.1	7.9	10.8	8.5	(4.6)	14.5	3.2	17.6	37.0	10.0	(10.5)	6.6
May	3.0	3.8		4.3	(3.6)		1.9	6.6		7.4	(1.1)		2.8	13.2		9.0	(5.5)	
June	2.2	10.7		7.8	13.4		2.8	7.9		9.9	4.4		4.6	16.2		11.6	0.7	
July	5.3	4.7		17.9	1.7		3.0	9.8		5.9	9.7		13.9	22.1		3.4	5.3	
August	3.9	7.7		0.9	9.2		(5.5)	14.4		6.4	10.9		3.9	24.7		7.3	6.1	
September	5.0	5.3		20.8	13.5		(2.5)	11.0		7.4	9.7		14.7	24.1		4.8	4.1	
October	3.2	4.0		4.2	10.2		(4.4)	15.5		(0.9)	12.1		(1.6)	20.0		(0.6)	9.0	
November	2.2	6.0		0.5	11.1		(3.9)	19.6		9.4	12.2		0.3	38.1		12.4	4.5	
December	2.0	8.4		6.6	38.7		(8.9)	22.8		1.7	13.1		(4.2)	45.9		3.2	5.2	
January	(0.7)	11.5		15.9	53.7		(7.2)	21.9		3.6	3.0		2.1	31.7		4.0	(4.7)	
February	(0.1)	8.4		11.8	44.7		(3.0)	15.0		(1.3)	9.1		6.0	30.0		(3.4)	2.5	
March	1.9	10.4		(6.3)	28.4		1.9	13.1		1.3	10.7		8.4	32.6		(1.0)	3.2	
April-March (FY)	2.6	7.1		7.3	19.1		(1.9)	13.6		4.7	7.3		4.5	26.2		4.8	1.4	

Source: Central Statistical Organization, Kotak Institutional Equities

Exhibit 3: Core sector growth muted in April

Sector-wise growth rates in production for six infrastructure industries, March fiscal year-ends, 2009-2011 (%)

	Crude Oil			Refinery			Coal			Electricity			Cement			Finished Steel			General		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Weights (%)	4.2			2.0			3.2			10.2			2.0			5.1			26.7		
April	1.0	(3.1)	5.2	4.3	(4.5)	5.3	10.3	14.3	(2.3)	1.4	6.7	6.0	6.9	11.9	8.7	7.5	(1.3)	4.7	4.6	3.7	5.1
May	3.2	(4.3)		0.1	(4.3)		8.8	10.2		2.0	3.3		3.8	11.8		8.3	2.8		4.4	3.2	
June	(4.7)	4.0		5.6	(3.8)		6.1	14.7		2.6	8.0		6.6	12.7		8.1	3.6		4.4	6.3	
July	(3.0)	(0.4)		11.8	(14.4)		5.5	9.7		4.5	4.2		5.5	13.8		6.3	4.0		5.2	3.2	
August	(1.0)	(2.6)		2.5	3.1		5.9	12.9		0.8	10.6		1.9	17.5		3.3	0.3		2.0	6.5	
September	(0.4)	(0.5)		2.8	3.4		11.2	6.5		4.4	7.9		8.1	6.5		2.3	0.8		4.1	4.5	
October	(0.2)	(2.2)		5.0	7.2		10.6	5.0		4.4	4.7		6.2	5.3		(3.8)	2.5		2.4	3.8	
November	0.5	(1.5)		(1.1)	4.9		9.7	4.7		2.6	3.3		8.7	9.0		(6.3)	11.7		0.8	6.0	
December	(0.3)	1.1		3.0	0.8		11.2	2.5		1.5	6.7		11.6	11.0		(8.0)	9.6		0.7	6.4	
January	(8.1)	9.7		(1.3)	3.8		6.7	5.9		1.8	6.7		8.3	12.4		3.2	15.3		2.2	9.5	
February	(6.2)	3.9		0.5	0.7		6.0	6.8		0.6	7.3		8.3	7.9		2.4	0.9		1.9	4.7	
March	(2.3)	3.5		3.3	(0.4)		5.3	9.2		6.3	7.8		10.1	7.8		(1.8)	9.2		3.3	7.3	
April-March (FY)	(1.8)	0.5		3.0	(0.4)		8.0	8.2		2.7	6.4		7.2	10.5		1.6	4.9		3.0	5.5	

Source: Central Statistical Organization; Kotak Institutional Equities

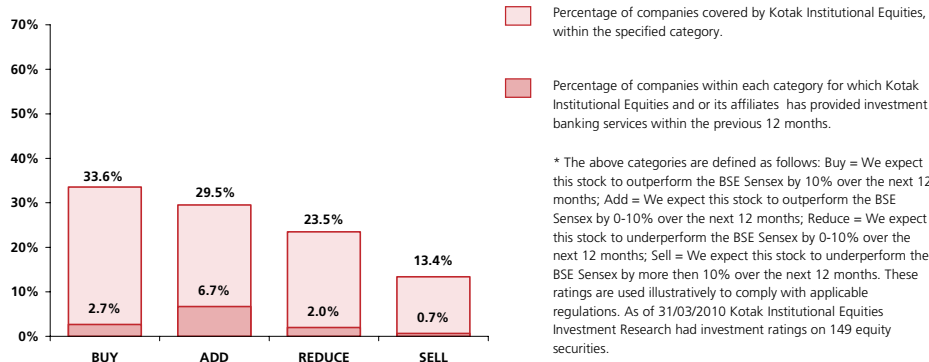
Kotak Institutional Equities: Valuation summary of key Indian companies

Company	11-Jun-10		Mkt cap.		O/S shares (mm)	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)		2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E			
Automobiles																																
Ashok Leyland	63	ADD	83,542	1,783	1,330	2.8	3.9	5.0	84.5	37.5	29.7	22.3	16.2	12.5	13.2	10.2	8.6	2.1	2.0	1.8	2.4	1.6	1.6	11.1	12.7	15.0	60	(4.5)	9.8			
Bajaj Auto	2,295	ADD	332,041	7,088	145	117.5	159.9	173.2	159.8	36.1	8.3	19.5	14.4	13.2	12.3	9.9	9.0	10.5	6.6	4.7	0.9	0.9	0.9	66.6	54.8	39.8	2,330	1.5	11.2			
Hero Honda	2,013	SELL	402,066	8,583	200	111.8	121.5	135.7	74.1	8.7	11.7	18.0	16.6	14.8	11.7	10.9	9.4	11.2	7.6	5.7	1.5	1.6	1.8	59.1	56.6	43.8	1,800	(10.6)	23.6			
Mahindra & Mahindra	607	BUY	350,915	7,491	578	34.9	39.0	43.9	132.5	11.7	12.5	17.4	15.6	13.8	11.5	10.1	9.0	4.3	3.5	2.9	1.6	1.5	1.6	30.0	24.9	22.8	630	3.8	26.9			
Maruti Suzuki	1,357	ADD	392,072	8,370	289	86.4	94.1	104.2	104.9	8.9	10.8	15.7	14.4	13.0	8.5	7.8	6.8	3.3	2.7	2.3	0.4	0.5	0.5	23.3	20.6	18.9	1,400	3.2	18.9			
Tata Motors	765	ADD	456,018	9,735	596	23.9	27.2	35.5	138.9	13.5	30.6	32.0	28.1	21.6	12.7	12.7	11.1	2.2	2.0	1.7	0.7	0.8	0.8	8.1	7.5	8.6	900	17.7	97.3			
Automobiles		Cautious	2,016,655	43,052					118.1	16.4	14.3	19.8	17.0	14.9	11.4	10.4	9.1	3.9	3.3	2.7	1.1	1.1	1.1	19.9	19.1	18.2						
Banks/Financial Institutions																																
Andhra Bank	136	BUY	65,960	1,408	485	21.0	21.1	25.4	56.1	0.6	20.0	6.5	6.4	5.4	—	—	—	1.4	1.2	1.0	3.1	3.1	3.7	24.4	20.2	20.7	160	17.6	5.9			
Axis Bank	1,246	ADD	504,809	10,777	405	62.1	77.4	98.5	22.7	24.7	27.3	20.1	16.1	12.7	—	—	—	3.1	2.7	2.3	1.0	1.2	1.5	18.9	18.1	19.9	1,360	9.2	51.7			
Bank of Baroda	729	BUY	266,488	5,689	366	83.7	89.8	111.0	37.3	7.3	23.6	8.7	8.1	6.6	—	—	—	1.9	1.6	1.4	2.1	2.2	2.7	24.4	21.8	22.6	825	13.2	10.9			
Bank of India	329	REDUCE	173,210	3,698	526	33.1	40.5	56.0	(42.1)	22.2	38.3	9.9	8.1	5.9	—	—	—	1.4	1.2	1.1	2.1	2.6	3.6	14.3	15.9	19.3	360	9.3	5.9			
Canara Bank	432	ADD	177,223	3,783	410	73.7	77.0	93.6	45.8	4.5	21.4	5.9	5.6	4.6	—	—	—	1.4	1.2	1.0	1.9	2.3	2.8	23.0	19.6	20.1	500	15.7	6.6			
Corporation Bank	534	BUY	76,639	1,636	143	81.6	86.7	100.3	31.1	6.3	15.7	6.5	6.2	5.3	—	—	—	1.3	1.1	1.0	3.1	3.3	3.8	21.9	19.9	19.8	650	21.7	1.0			
Federal Bank	332	BUY	56,783	1,212	171	27.2	38.7	48.0	(7.2)	42.3	24.2	12.2	8.6	6.9	—	—	—	1.2	1.1	1.0	1.5	2.1	2.7	10.3	13.4	14.8	360	8.4	5.0			
HDFC	2,809	ADD	806,463	17,216	287	98.4	118.2	143.7	22.7	20.1	21.5	28.5	23.8	19.6	—	—	—	5.3	4.7	4.1	1.3	1.5	1.8	20.0	21.0	22.4	3,200	13.9	39.1			
HDFC Bank	1,946	BUY	890,906	19,019	458	64.4	84.1	110.4	22.1	30.6	31.2	30.2	23.1	17.6	—	—	—	4.1	3.6	3.1	0.6	0.8	1.1	16.1	16.7	19.1	2,200	13.0	32.4			
ICICI Bank	846	REDUCE	943,197	20,135	1,115	36.1	46.5	58.0	6.9	28.9	24.7	23.4	18.2	14.6	—	—	—	1.8	1.7	1.6	1.4	1.8	2.3	8.1	9.8	11.5	980	15.8	92.9			
IDFC	163	ADD	212,388	4,534	1,301	8.2	9.2	11.2	41.1	12.9	21.9	20.0	17.7	14.5	—	—	—	3.0	2.7	2.3	1.0	1.0	1.2	16.1	16.0	17.1	180	10.3	18.4			
India Infoline	92	BUY	28,608	611	312	8.1	8.9	10.0	59.2	9.8	12.5	11.3	10.3	9.1	—	—	—	1.8	1.5	1.2	3.5	2.1	2.6	16.4	15.9	16.1	140	52.6	3.4			
Indian Bank	228	BUY	98,181	2,096	430	35.1	35.5	43.8	25.5	1.1	23.6	6.5	6.4	5.2	—	—	—	1.5	1.2	1.0	2.7	2.7	3.3	24.0	20.3	21.2	280	22.6	4.1			
Indian Overseas Bank	94	BUY	51,266	1,094	545	13.0	15.4	26.4	(46.7)	18.9	71.3	7.3	6.1	3.6	—	—	—	0.8	0.7	0.6	4.4	4.8	5.3	9.6	10.6	16.3	120	27.5	3.1			
J&K Bank	777	BUY	37,694	805	48	105.7	112.3	140.6	25.1	6.3	25.2	7.4	6.9	5.5	—	—	—	1.3	1.2	1.0	2.8	3.0	3.8	17.3	16.9	18.5	850	9.3	0.5			
LIC Housing Finance	970	ADD	92,117	1,967	95	69.7	93.2	104.2	11.4	33.8	11.7	13.9	10.4	9.3	—	—	—	2.8	2.4	2.0	1.5	2.1	2.3	23.6	23.8	22.4	1,050	8.3	21.3			
Mahindra & Mahindra Financial	460	BUY	44,122	942	96	35.7	42.6	49.8	59.3	19.3	16.8	12.9	10.8	9.2	—	—	—	2.6	2.2	1.9	1.7	2.0	2.3	21.4	21.7	21.6	500	8.8	1.2			
Oriental Bank of Commerce	336	ADD	84,106	1,796	251	45.3	52.8	58.6	25.3	16.5	11.0	7.4	6.4	5.7	—	—	—	1.2	1.1	0.9	2.7	3.2	3.5	14.1	15.4	15.3	400	19.2	4.6			
PFC	302	SELL	346,282	7,392	1,148	20.5	22.5	25.9	53.5	9.9	15.1	14.7	13.4	11.6	—	—	—	2.7	2.4	2.1	1.7	1.9	2.1	18.8	18.0	18.2	240	(20.5)	2.5			
Punjab National Bank	1,035	BUY	326,307	6,966	315	123.8	128.0	156.5	26.3	3.4	22.2	8.4	8.1	6.6	—	—	—	2.0	1.7	1.4	2.1	2.5	3.0	26.4	22.7	23.3	1,150	11.1	7.4			
Reliance Capital	682	ADD	167,832	3,583	246	13.8	16.1	14.1	(64.9)	17.0	(12.4)	49.4	42.2	48.2	—	—	—	2.4	2.4	2.3	1.0	0.9	0.8	5.0	5.7	4.8	875	28.3	27.7			
Rural Electrification Corp.	297	ADD	292,909	6,253	987	20.3	24.6	30.7	23.2	21.2	24.9	14.6	12.1	9.7	—	—	—	2.6	2.3	2.0	2.2	2.5	3.1	22.0	20.5	22.2	300	1.1	14.8			
Shriram Transport	589	ADD	131,485	2,807	223	39.2	49.1	62.4	30.1	25.4	27.2	15.0	12.0	9.4	—	—	—	3.6	3.0	2.5	2.0	2.5	3.2	28.4	26.1	27.8	600	1.8	5.1			
SREI	81	NR	9,437	201	116	8.3	7.9	9.9	17.8	(4.8)	25.8	9.8	10.3	8.2	—	—	—	0.8	0.7	0.7	1.5	1.5	1.5	11.1	10.5	12.3	—	—	4.5			
State Bank of India	2,340	BUY	1,485,556	31,714	635	144.4	178.1	223.0	0.5	23.4	25.2	16.2	13.1	10.5	—	—	—	2.3	2.0	1.7	1.7	1.8	1.9	14.8	16.1	17.8	2,700	15.4	95.9			
Union Bank	307	BUY	155,046	3,310	505	41.1	45.8	57.3	20.2	11.5	25.0	7.5	6.7	5.4	—	—	—	1.8	1.4	1.2	1.8	2.2	2.7	26.2	23.7	24.3	380	23.8	4.8			
Banks/Financial Institutions		Attractive	7,525,012	160,645					14.4	17.2	24.4	15.1	12.9	10.4	—	—	—	2.3	2.1	1.8	1.6	1.8	2.1	15.5	16.0	17.4						
Cement																																
ACC	862	SELL	161,906	3,456	188	83.2	61.8	63.4	47.9	(25.7)	2.6	10.4	13.9	13.6	5.6	6.5	5.7	2.5	2.2	2.0	2.7	2.7	2.7	19.4	17.7	830	(3.7)	9.4				
Ambuja Cements	115	SELL	175,149	3,739	1,522	8.0	7.9	8.1	11.4	(1.8)	2.6	14.4	14.6	14.3	8.0	8.3	7.5	2.5	2.2	2.0	1.6	1.9	1.9	29.3	16.7	15.3	98	(14.8)	6.4			
Grasim Industries	1,820	REDUCE	166,839	3,562	92	301.0	240.1	282.0	26.1	(20.2)	17.5	6.0	7.6	6.5	3.9	3.9	3.0	1.3	1.2	1.0	1.8	1.9	1.9	22.9	16.4	16.7	2,100	15.4	10.0			
India Cements	113	SELL	34,571	738	307	10.0	10.4	11.3	n/a	3.1	9.1	11.2	10.9	10.0	5.6	5.6	5.4	0.8	0.8	0.7	1.9	2.8	2.8	8.2	7.7	8.0	110	(2.3)	4.2			
Shree Cement	2,090	BUY	72,801	1,554	35	208.0	221.1	242.5																								

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As of March 31, 2010

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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.

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