kotak® Institutional Equities

INDIA DAILY

August 26, 2008

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News Roundup

Corporate

- Reliance Industries Ltd is planning to transfer 80% of its participatory interest in D6 block of Krishna Godavari basin to four unlisted subsidiaries. Valued at nearly $50 bn with 14 trillion cubic feet of gas reserves, this is the most valuable asset held by the company. (ET)
- The government has issued a notice to oil companies including Oil & Natural Gas Corp, Reliance Industries, Cairn India and British Gas, who are also the members of Panna-Mukta & Tapti and Ravva fields for non-payment of dues. (ET)
- Oil marketing companies such as Bharat Petroleum Corp, Indian Oil Corp and Hindustan Petroleum Corp have sought a total of $4 bn as a direct foreign exchange loan from the RBI to finance their credit needs. (FE)
- State-run Bharat Sanchar Nigam Ltd, Bharti Airtel, Tata Communications and Saudi Telecom are investing around $400 mn in an undersea cable - The Europe India Gateway cable. (FE)
- DLF Ltd, India's largest listed realty firm, plans to enter housing development projects overseas to overcome a slump in the domestic property market. (BS)
- Mahindra Holidays and Resorts, part of the $4.5 bn Mahindra & Mahindra Group, has acquired assets of AGS Hotels in Ooty for Rs300 mn. (TOI)

Economic and political

- Faced with continuing liquidity squeeze, some banks have begun pushing for making special government securities eligible for repurchase operations of the RBI. The special government securities include oil, fertilizer and FCI bonds against subsidy dues. (BL)
- Standard & Poor's has launched an equity index of 60-listed Indian companies to provide international investors with information on tradeable exposure to the largest and most liquid scrips in the country. (Hindu)

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

EQUITY MARKETS

		Change, %		
India	**25-Aug**	**1-day**	**1-mo**	**3-mo**
Sensex	14,450	0.3	1.2	(11.6)
Nifty	4,335	0.2	0.5	(11.1)
Global/Regional indices				
Dow Jones	11,386	(2.1)	0.1	(8.8)
FTSE	5,506	2.5	2.9	(9.6)
Nikkie	12,710	(1.3)	(4.7)	(7.2)
Hang Seng	20,947	(0.7)	(7.9)	(13.2)
KOSPI	1,500	(0.1)	(6.1)	(16.7)

Value traded - India

			Moving avg, Rs bn	
	25-Aug		**1-mo**	**3-mo**
Cash (NSE+BSE)	106.3		190.6	182.0
Derivatives (NSE)	459.8		531.6	413
Deri. open interest	837.6		831	833

Forex/money market

		Change, basis points		
	25-Aug	**1-day**	**1-mo**	**3-mo**
Rs/US$	43.8	0	124	105
6mo fwd prem, %	0.7	(25)	71	24

Net investment (US$mn)

	22-Aug		**MTD**	**CYTD**
FIIs	(28)		(283)	(7,029)
MFs	41		(224)	2,435

Top movers -3mo basis

		Change, %		
Best performers	**25-Aug**	**1-day**	**1-mo**	**3-mo**
CIPLA LTD	237	(0.1)	4.9	19.0
CROMPTON GREAV	263	3.5	8.2	10.7
OIL & NATURAL GA	1,015	(0.5)	3.1	13.4
SUN PHARMACEUTI	1,475	1.6	4.5	7.3
DIVI'S LABORATORI	1,472	(1.2)	5.3	4.5
Worst performers				
HOUSING DEVELOP	304	(1.7)	(17.4)	(45.9)
ABAN OFFSHORE LI	2,171	(2.0)	(19.6)	(43.9)
RELIANCE POWER L	155	(1.1)	(8.1)	(41.1)
UNITECH LIMITED	160	0.7	(2.9)	(38.3)
INFRASTRUCTURE D	94	1.7	(3.1)	(36.3)

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

Energy

RELI.BO, Rs2232	
Rating	RS
Sector coverage view	Cautious
Target Price (Rs)	-
52W High -Low (Rs)	3298 - 1774
Market Cap (Rs bn)	2,934

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,334	1,689	2,507
Net Profit (Rs bn)	142.5	147.5	270.4
EPS (Rs)	101.7	97.4	171.9
EPS gth	*23.0*	*(4.2)*	*76.4*
P/E (x)	21.9	22.9	13.0
EV/EBITDA (x)	13.1	11.3	6.0
Div yield (%)	0.6	0.7	0.9

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.2	-	-
FIIs	21.5	9.3	0.7
MFs	2.7	6.3	(2.3)
UTI	-	-	(8.6)
LIC	4.9	10.1	1.5

Reliance Industries: Negative refining margins, weakening chemical margins and continued stalemate on gas

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

Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **Singapore refining margins decline further led by decline in diesel cracks**
- **Chemical margins to likely decline from current still decent levels**
- **Legal dispute on gas continues while production is not too far away**

Refining margins continue their slide led by further decline in diesel cracks. We compute Singapore complex gross refining margins at -US$2.7/bbl in the most-recent week versus -US$1.6/bbl in the previous week (week ended August 15, 2008) and US$4.3/bbl in 2QCY08. Also, we believe that chemical margins may head down led by global demand weakness and significant capacity addition. Finally, RIL's ongoing legal dispute with RNRL may result in possible unfavorable outcomes for RIL or be in line with market expectations at best. We retain our cautious stance on RIL (RS, TP: NA).

Refining margins continue to be very weak; risks to RIL's earnings exist. We see potential downside risks to our earnings estimates of RIL given its earnings are highly sensitive to refining margins and weaker-than-expected margins could significantly impact their earnings. A US$1/bbl decline in refining margins impacts RIL's FY2009E (standalone) EPS by 6%. Exhibit 1 shows the sensitivity of RIL's (standalone) EPS to changes in refining margins, respectively. The current weak refining margins and more important, likely continued weakness in refining margins do not augur well for earnings of RIL.

Steep contraction in diesel cracks. Refining margins have declined sharply in the recent weeks led by (1) weak global demand and (2) sharp decline in product (diesel) cracks. We compute Singapore complex gross refining margins at -US$2.7/bbl in the most-recent week versus -US$1.6/bbl in the previous week (week ended August 15, 2008) and US$4.3/bbl in 2QCY08 (see Exhibit 2); others may have different estimate of margins depending on assumed product slate and crude but the direction and order of magnitude would be similar.

The sharp decline in the refining margins has been led by implosion in diesel cracks; diesel cracks were at US$16/bbl in the most-recent week versus US$35.7/bbl in July 2008 (see Exhibit 3). The sharp decline in diesel cracks follows the implosion in gasoline cracks, which had dwindled to negligible levels in early-July and continues to languish at very low levels (US$2.1/bbl in the most-recent week).

Margins may bounce back from current very low levels, but will likely remain low for the next 1-2 years. We could see a short-term rebound from current very low levels but we believe that refining margins will likely remain weak for the next 12 months at least led by (1) weak global demand and (2) large refining capacity additions from 2HCY08.

1. **Significant capacity addition.** We expect significant refining capacity coming online from 2HCY08, which includes capacity addition of 0.9 mb/d in China and RPET's 580,000 b/d refinery (see Exhibit 4). We expect refining capacity addition of 1.4 mb/d, 1.7 mb/d and 1.7 mb/d in CY2008E, CY2009E and CY2010E (see Exhibit 5). In addition, we note natural gas liquids (NGLs) supply would also increase by 0.4 mb/d, 0.8 mb/d and 0.6 mb/d in CY2008E, CY2009E and CY2010E (see Exhibit 6).
2. **Demand weakness.** High crude prices have resulted in weakness in demand as indicated by recent consumption data. The demand for petroleum products in the US has declined by 1 mn b/d in August 2008 versus demand in August 2007 (see Exhibit 7). In addition, the refinery utilization rates have declined to 86.2% in August 2008; this is significantly lower than 91.4% in August 2007 (Exhibit 8).

Chemical margins may have peaked. Chemical margins have also started declining after peaking in early August (see Exhibit 9). Margins are still decent currently but we expect margins to deteriorate given significant additions to global capacity (see Exhibits 10 and 11). We project a sharp decline in operating rates for ethylene, the key chemical product; interestingly, our projected rates for global ethylene resemble the plunge in operating rates in 1999-2001. Downstream demand seems to have weakened after peaking in May 2008 as indicated by decline in operating rates to 60-70%.

Ongoing legal dispute on gas supply and pricing between RIL and RNRL—neutral at best to hugely negative. We note that a delay in the resolution of the ongoing legal dispute between RIL and RNRL may potentially delay gas production from RIL's KG D-6 gas block. Also, an unfavorable decision for RIL by the Mumbai High Court (or the Supreme Court, if the matter reaches it eventually) will be a negative for RIL's earnings versus street expectations.

We note that RIL is currently barred from selling gas (40 mcm/d set aside for NTPC/RNRL) to outside parties (other than internal consumption, NTPC and RNRL) by a stay order of a single-judge bench of the Mumbai High Court. A two-member bench is now hearing arguments from the legal counsels of RIL and RNRL to decide on the case. A further negative could be RIL not being able to use gas for refining processes. The gas utilization policy of the government of India is silent on the use of KG D-6 gas does not even mention use of gas for industrial use in the list of 'approved' usages. The street expects RIL to use gas for refining processes leading to higher refining margins than possible otherwise.

We do not see an immediate solution to the dispute and expect the matter to eventually reach the Supreme Court unless the parties resolve the issue between themselves. RIL and RNRL have been in legal dispute for the past 20 months and the Mumbai High Court has given a lot of time to the two parties (four months in October 2007-February 2008) apart from various court breaks to settle the issue amicably.

Finally, we note that the courts will take a view on the legal aspects of the case only —whether the 'agreement' between RIL and RNRL is valid or not. It will decide on the legal aspects of the agreement (whatever that may be—the one between RIL and RNRL, which is in the public domain or the family separation agreement, which is not in the public domain). We note that the executive or legislative branches of the government have no role in a legal dispute and would have to simply abide by the decision of the judiciary.

Finally, the Mumbai High Court had approved the Scheme of Demerger of Reliance Industries, which states that "RIL proposes to use part of its gas discoveries for the generation of power for which purpose an appropriate gas supply agreement will be entered into between RIL and Global Fuel Management Services [erstwhile RNRL] pursuant to which gas will be supplied to Reliance Energy Ltd...." RNRL's contention is that the agreement between RIL and RNRL is not appropriate since it was signed when RNRL was still under the control of RIL.

We see the following outcomes of the dispute; there are only two outcomes always—yes or no, buy or sell.

1. **Mumbai High Court (and eventually the Supreme Court if the matter goes there) decides in favor of RIL.** This would be neutral versus expectations since the street (including us) has assumed that RIL will sell gas at US$4.2/mn BTU, the government-fixed price for the first five years of production.

2. **Mumbai High Court (and eventually the Supreme Court if the matter goes there) decides in favor of RNRL.** This would be negative versus street expectations since RIL will have to supply 28 mcm/d of gas at US$2.34/mn BTU to RNRL and yet compensate the government for its share of profit petroleum, royalty and income tax on the basis of the government-fixed price of US$4.2/mn BTU.

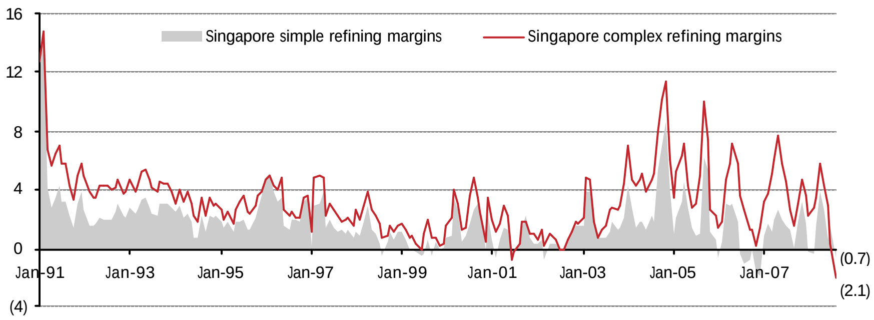
Reliance has high leverage to refining margins

Sensitivity of RIL's standalone (without RPET) earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	41.0	42.0	43.0	40.5	41.5	42.5	40.0	41.0	42.0
Net profits (Rs mn)	135,448	141,049	146,651	203,294	210,035	216,777	199,729	206,425	213,120
EPS (Rs)	89.5	93.2	96.9	129.2	133.5	137.8	126.9	131.2	135.5
% upside/(downside)	**(4.0)**		**4.0**	**(3.2)**		**3.2**	**(3.2)**		**3.2**
Chemical prices									
Change in prices (%)	(5.0)		5.0	(5.0)		5.0	(5.0)		5.0
Net profits (Rs mn)	137,728	141,049	144,371	206,105	210,035	213,965	202,593	206,425	210,256
EPS (Rs)	91.0	93.2	95.4	131.0	133.5	136.0	128.8	131.2	133.6
% upside/(downside)	**(2.4)**		**2.4**	**(1.9)**		**1.9**	**(1.9)**		**1.9**
Refining margins (US$/bbl)									
Margins (US$/bbl)	13.8	14.8	15.8	14.2	15.2	16.2	12.9	13.9	14.9
Net profits (Rs mn)	131,903	141,049	150,196	203,554	210,035	216,517	200,021	206,425	212,828
EPS (Rs)	87.2	93.2	99.2	129.4	133.5	137.6	127.1	131.2	135.3
% upside/(downside)	**(6.5)**		**6.5**	**(3.1)**		**3.1**	**(3.1)**		**3.1**

Source: Kotak Institutional Equities estimates

Sinagpore refining margins have declined significantly in the recent month
Singapore refining margins (US$/bbl)



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

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
1Q	(0.32)	1.29	0.51	0.30	1.05	1.69	3.02	2.52	2.25	2.40
2Q	(0.08)	2.47	0.45	0.07	1.20	3.13	2.78	(0.70)	0.99	0.70
3Q	0.14	1.74	1.06	1.44	1.57	6.46	2.22	(1.25)	2.32	
4Q	1.86	0.21	(0.03)	2.98	2.88	2.08	1.09	1.25	0.25	
Average	**0.40**	**1.43**	**0.50**	**1.20**	**1.67**	**3.34**	**2.28**	**0.45**	**1.45**	**1.75**

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

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
1Q	0.43	1.86	1.34	0.79	1.24	4.57	4.93	6.24	6.58	4.31
2Q	1.19	3.96	0.58	0.14	2.35	5.80	6.11	2.46	2.91	(0.62)
3Q	0.41	2.25	1.22	1.56	3.23	9.04	3.94	0.98	3.91	
4Q	2.64	1.60	0.65	3.70	5.44	5.02	2.77	4.11	2.78	
Average	**1.17**	**2.42**	**0.95**	**1.55**	**3.06**	**6.10**	**4.44**	**3.45**	**4.05**	**2.43**

Weekly margins (simple)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(1.51)	(0.63)	0.15	2.58	1.83

Weekly margins (complex)

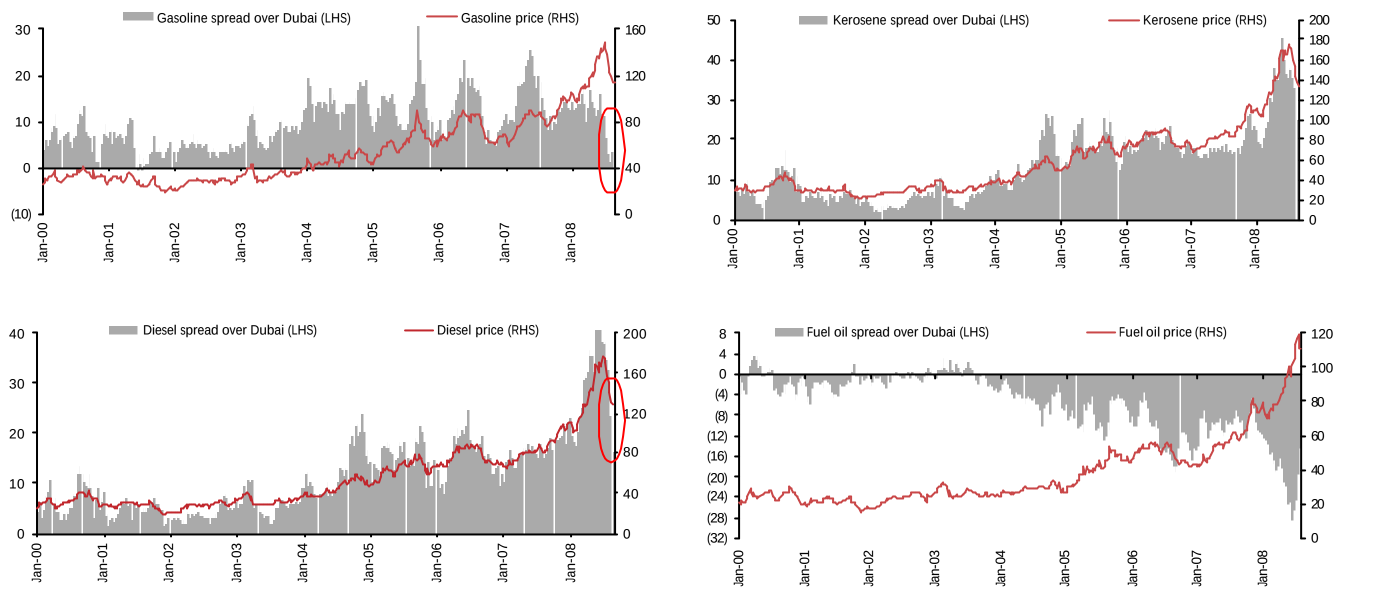
Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(2.74)	(1.61)	(2.10)	0.02	(0.19)

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

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD
Simple	0.40	1.43	0.50	1.20	1.67	3.34	2.28	0.45	1.45	1.75
Complex	0.43	1.86	1.34	0.79	1.24	4.57	4.93	3.45	4.05	2.43

Source: Bloomberg

Product cracks have declined sharply in the recent week
Spread between Arab Gulf product prices and Dubai crude (US$/bbl)



Source: Bloomberg

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

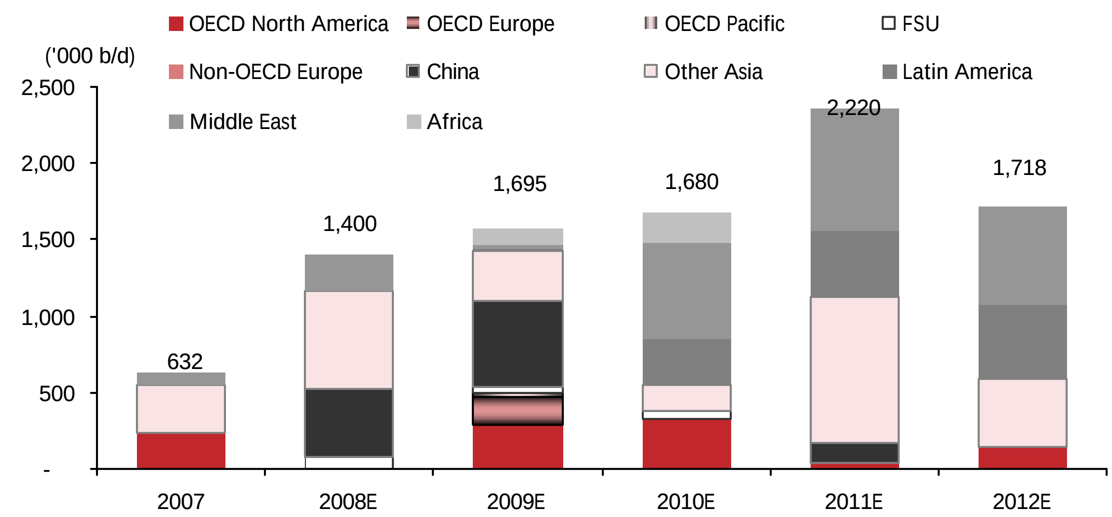
Upcoming refining capacity addition (b/d)

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

Source: Oil & Gas journal, Kotak Institutional Equities estimates

Significant supply additions to global refining capacity

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



Source: IEA, Kotak Institutional Equities estimates

Expect high crude prices to cool off led by comfortable supply and demand weakness

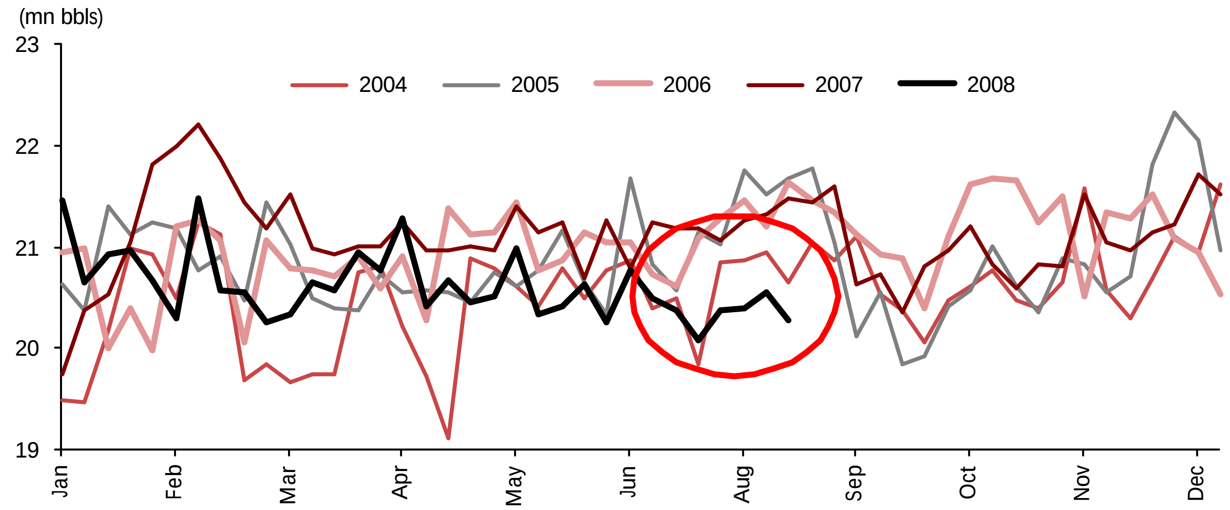
Estimated global crude demand, supply and prices, Calendar year-ends

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E
Demand (mb/d)										
Total demand	82.5	83.8	84.7	86.0	86.9	87.7	89.2	90.7	92.4	94.1
Yoy growth	3.3	1.3	0.9	1.3	0.9	0.9	1.5	1.5	1.7	1.8
Supply (mb/d)										
Non-OPEC	48.8	48.6	49.1	49.6	49.9	50.5	50.6	50.7	50.7	51.1
Yoy growth	0.6	(0.2)	0.5	0.5	0.3	0.6	0.1	0.1	0.0	0.4
OPEC										
Crude	29.5	30.7	30.9	31.6	31.8	31.3	32.1	33.2	34.6	35.9
NGLs	4.2	4.5	4.6	4.8	5.1	5.9	6.5	6.8	7.1	7.2
Total OPEC	**33.7**	**35.2**	**35.5**	**36.4**	**37.0**	**37.2**	**38.6**	**40.1**	**41.7**	**43.1**
Total supply	**83.4**	**84.6**	**85.4**	**86.0**	**86.9**	**87.7**	**89.2**	**90.7**	**92.4**	**94.1**
Total stock change	1.0	0.7	0.8							
OPEC crude capacity				**34.4**	**35.3**	**36.4**	**37.4**	**37.3**	**37.6**	**37.9**
Implied OPEC spare capacity				**2.8**	**3.5**	**5.2**	**5.3**	**4.0**	**2.9**	**2.0**
Demand growth (yoy, %)	**4.2**	**1.6**	**1.1**	**1.5**	**1.0**	**1.0**	**1.7**	**1.7**	**1.8**	**1.9**
Supply growth (yoy, %)										
Non-OPEC	**1.2**	**(0.4)**	**1.0**	**1.0**	**0.6**	**1.2**	**0.1**	**0.2**	**0.0**	**0.8**
OPEC	**8.4**	**4.5**	**0.9**	**2.5**	**1.5**	**0.7**	**3.8**	**3.8**	**4.1**	**3.2**
Total	**4.4**	**1.4**	**0.9**	**0.7**	**1.0**	**1.0**	**1.7**	**1.7**	**1.8**	**1.9**
Dated Brent (US$/bbl)	**38.3**	**54.4**	**65.8**	**72.7**	**110.0**	**95.0**	**90.0**	**90.0**	**90.0**	**75.0**

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

Demand has started weakening in US

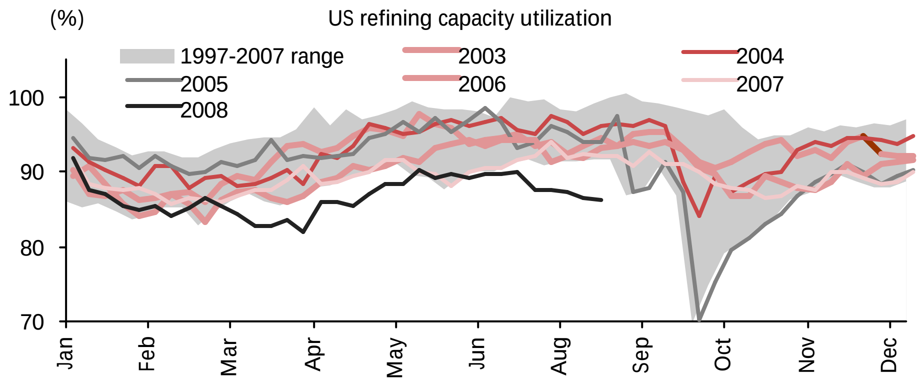
US demand for petroleum products (mn bbls)



Source: EIA, DOE

US refining utilization rates are at low levels

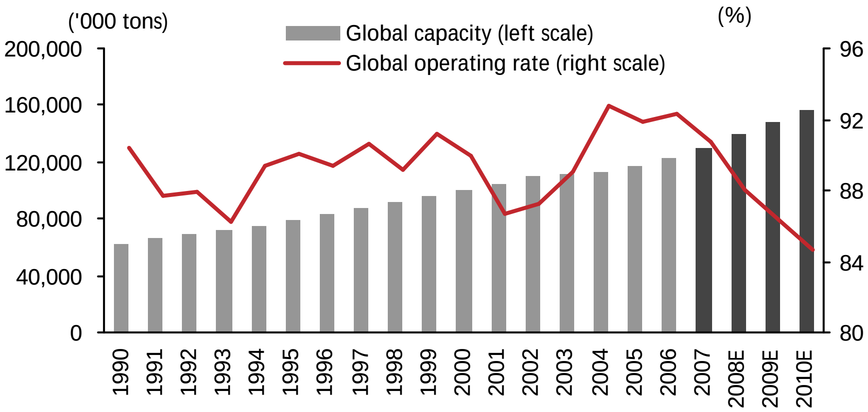
US refining utilization rates (%)



Source: EIA, DOE

Continued steep decline in operating rates through CY2010E

Ethylene capacity and operating rates, 1991-2010E



Source: Kotak Institutional Equities estimates

Asia chemical margins (US$/ton)

Calendar year-ending

	Annual average prices				Quarterly average				3Q08 vs. 2Q08	Monthly average				Recent			
	2005	2006	2007	2008 YTD	4Q07	1Q08	2Q08	3Q08	(%)	Apr	May	June	July	Aug 1	Aug 8	Aug 15	Aug 22
Ethylene chain																	
HDPE – 1.015 x ethylene	147	88	171	210	207	208	237	135	(43)	256	235	220	135	218	269	300	340
LLDPE – 1.015 x ethylene	175	87	185	234	198	262	223	184	(18)	276	216	177	184	318	409	460	420
LDPE – 1.015 x ethylene	243	94	291	339	378	364	335	279	(17)	388	349	267	279	423	509	560	570
HDPE – naphtha	548	655	629	669	609	687	660	640	(3)	680	626	673	640	675	677	678	626
LLDPE – naphtha	577	654	643	693	601	740	646	689	7	701	606	631	689	775	817	838	706
LDPE – naphtha	644	660	749	798	781	843	758	784	3	813	740	720	784	880	917	938	856
Propylene chain																	
Propylene – naphtha	424	509	373	423	276	330	471	557	18	372	434	606	557	530	557	483	366
PP – 1.01 x propylene	154	125	244	238	292	265	192	291	51	234	178	164	291	389	334	260	286
PP – naphtha	587	645	628	675	579	607	678	865	28	619	627	788	865	935	907	758	666
Styrene chain																	
Benzene – naphtha	339	278	325	176	191	175	184	155	(15)	163	217	171	155	215	206	149	104
Styrene – 0.81 x benzene	131	139	163	120	178	136	114	88	(23)	132	102	106	88	90	108	150	175
– 0.29 x ethylene																	
Polystyrene – 0.98 styrene	125	90	132	108	130	90	107	164	53	108	69	144	164	200	204	203	176
PS – naphtha	670	649	730	566	629	561	560	600	7	556	527	596	600	665	662	648	586
Vinyl chain																	
EDC – (0.3 x ethylene)	99	11	85	31	58	35	24	38	55	31	24	18	38	67	84	99	104
PVC – 1.025 (0.235 x ethylene	281	249	294	395	321	349	435	414	(5)	448	452	405	414	481	504	501	492
+ 0.864 x EDC)																	
PVC – naphtha	326	250	249	157	163	181	145	120	(17)	216	147	72	120	237	272	278	206
Polyester/intermediates																	
PSF – 0.85 x PTA – 0.34 x MEG	247	240	324	322	303	333	278	420	51	334	283	217	420	—	—	—	—
PFY – 0.85 x PTA – 0.34 x MEG	398	391	541	616	535	651	553	700	27	629	528	502	700	—	—	—	—
PTA – 0.67 x PX	201	124	123	112	110	127	103	97	(5)	120	100	89	97	153	158	114	127
PX – naphtha	414	572	435	350	271	290	389	418	7	347	357	463	418	361	389	392	335
MEG – naphtha	384	270	419	144	708	308	59	(94)	(261)	138	49	(12)	(94)	(80)	(53)	(142)	(164)
MEG – 0.6 x ethylene	345	174	433	277	805	383	235	80	(66)	272	244	189	80	83	122	42	92

Large new capacity additions in ethylene in CY2008-10E

Major additions to ethylene capacity in Asia and Middle-East, calendar year-ends, 2008-2010E ('000 tons)

	2008	2009	2010
China			
Fujian Petrochemical		800	
Lanzhou Petrochemical	360		
PetroChina Dushanzi		1,000	
PetroChina Fushun			800
Shanghai Secco Petrochemical			500
Sinopec Tianjin			800
Sinopec Zhenhai			1,000
Total China	**360**	**1,800**	**3,100**
India			
Haldia Petrochemicals	180		
Indian Oil Corp.			800
Total India	**180**	**—**	**800**
Iran			
Arya Sasol	500		
Jam Petrochemical	1,320		
NPCL, Illam		318	
Total Iran	**1,820**	**318**	**—**
Korea			
Lotte Daesan		560	
Samsung Total	200		
Total Korea	**200**	**560**	**—**
Kuwait			
Equate	850		
Total Kuwait	**850**	**—**	**—**
Qatar			
QAPCO	200		
Qatar Petrochemical /Chevron/Total		1,300	
Total Qatar	**200**	**1,300**	**—**
Saudi Arabia			
Petro-Rabigh		650	650
Petrokemya			800
Saudi ChevronPhillips Petrochem	300		
SEPC	1,000		
SHARQ	600	600	
Yanbu Petrochemical Complex	1,300		
Total Saudi Arabia	**3,200**	**1,250**	**1,450**
Singapore			
Shell Singapore			800
Total Singapore	**—**	**—**	**800**
Total Asia	**6,810**	**5,228**	**6,150**
Total globe (including expansions)	**9,700**	**8,038**	**8,280**

Source: OGJ, Kotak Institutional Equities estimates.

Power, fertilizer and internal consumption to account for the bulk of KG D-6 gas sales

Supply and potential sales of gas from RIL's KG D-6 block (mcm/d)

		Comments
Reliance KG D-6 gas peak production	**80**	**This could increase to 120 mcm/d**
1. Firm demand		
Consumption in RIL and RPET refineries and RIL's chemical plants	15	
Shortfall of gas for power sector in KG-basin area	5	Shortage of about 5 mcm/d
Conversion of FO/naphtha urea units to gas	10	Most units can switch to gas quickly as pipeline infrastructure exists
Consumption in BPCL and HPCL Mumbai refineries	4	
Sub-total	**34**	
2. Firm demand in short/medium term		
Replacement of FO/LSHS from industrial units	20	This will likely take time given wide disperson of consumption
New power generation capacity in KG-basin area	13	3,433 MW of new capacity
Sub-total	**33**	
3. Likely demand in medium term		
NTPC gas supply	10	Construction of 2 X 1,300 MW power plants not commenced
RNRL/REL gas supply	40	Construction of 10,280 MW power plant not commenced
New power generation plants in KG-basin area	8	2,100 MW plant of AP GENCO
City gas distribution	5	Submitted plans to various state governments; will take time
Sub-total	**64**	
Total	**131**	

Source: Kotak Institutional Equities estimates.

Technology

INFY.BO, Rs1706	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	2,100
52W High -Low (Rs)	2142 - 1212
Market Cap (Rs bn)	979.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	166.9	214.9	260.2
Net Profit (Rs bn)	45.4	58.6	67.8
EPS (Rs)	79.1	102.1	118.1
EPS gth	*18.0*	*29.1*	*15.7*
P/E (x)	21.6	16.7	14.5
EV/EBITDA (x)	17.1	12.9	10.4
Div yield (%)	1.9	1.4	1.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	16.5	-	-
FIIs	52.5	5.7	3.5
MFs	2.9	1.7	(0.5)
UTI	-	-	(2.2)
LIC	3.7	1.9	(0.2)

Infosys Technologies: Axon acquisition—financially neutral, strategically positive

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

- **Bridges the SAP scale gap with peers**
- **Provides access to some marquee clients**
- **Integration of a 'pure onsite' company and high client concentration the key risks**
- **Reiterate BUY with a target price of Rs2,100/share**

Infosys has proposed acquisition of Axon Group PLC, a UK-based SAP consulting and implementation firm, for an all-cash consideration of £407.1 mn. Axon is a global SAP consulting and implementation provider with a team size of over 2000+ and CY2008E revenues of £243 mn. We view the proposed acquisition positively for several reasons (1) The acquisition strengthens Infosys' SAP practice and will position it favorably for large global rollouts; note that Infosys (2,100 SAP consultants) has been lagging peers such as Wipro (2,700 team size), Satyam (~5,000) and TCS (~4,000) in terms of size as well partnership (and engagement) with SAP, (2) it brings on board non-overlapping client base in Europe (61% of revenues) and US. Some of the clients disclosed by Infosys management and in the public domain are Xerox, BP, Goodrich, TXU Energy, Barclays, Union Pacific etc, (3) Axon is a well recognized SAP consulting firm with high level of engagement with SAP. Recently, it was a recipient of SAP diamond circle for CY2007, (4) Profitability, growth rates and metrics are consistent with Infosys' industry leading status; Axon had revenue/employee of US$290,000+ in CY2007, operating margin (EBIT) of 14.9% and is expected to grow at 20% (including acquisitions) in CY2008. The transaction would be EPS neutral (assuming consensus numbers for CY2008 and CY2009) without assuming synergy benefits. Key risks: (1) integration of this proposed acquisition especially given that Axon has a higher consulting focus with a sizeable onsite presence and (2) Axon has an extremely high client concentration for a company with pure SAP consulting focus—Top 5 clients accounted for 54% of revenues and Top 10, 64% in 1HCY07 . Reiterate BUY with an end-March 2009 DCF-based target price of Rs2,100.

Deal details. The deal consideration of £407.1 mn (all-cash for all the outstanding shares and in-the-money options outstanding) values Axon Global at 20.1X CY2007 earnings and 2X CY2007 sales. Axon is listed on the London Stock Exchange and had a peak market cap of £625 mn (fully diluted). The acquisition is subject to shareholders' and regulatory approvals; Infosys has indicated that the acquisition will likely close by November 2008. Axon is a widely held company with the top 10 investors holding close to 55% of the total outstanding equity. Three founding members of Axon, holding 17.9% of the company's total outstanding equity have irrevocably undertaken to vote in favor of the Scheme of arrangement (for the acquisition) and the resolutions to be passed at the Court meeting and the General meeting.

Business, financials and growth of Axon Group PLC; Axon Group is a well recognized player in the SAP consulting and implementation space, especially in the EMEA market. The company was founded in 1994 and has grown its presence outside the EMEA market in the recent years through inorganic means; the company made three acquisitions in the US in CY2006. Axon is particularly strong in business consulting and solutions implementation space, which together accounted for 88% of its CY2007 revenues of £204 mn; applications management formed the other 12% of its revenues.

Axon offers service offerings across verticals with the key verticals being government, utilities, aerospace, defence, etc. The company's key clients include BP, Xerox, TXU energy, Goodrich, Union Pacific, Air Canada, Pratt and Whitney, etc. Infosys indicated minimal client overlap between the two companies, implying an opportunity to drive cross-sell of services across client base. The company has a 350-people delivery center in Malaysia in addition to its strong presence in the EMEA, and North America markets.

Axon reported revenues of £204 mn for CY2007, EBIT (post intangible amortization and option expenses) of £30.5 mn, and PAT of £20.2 mn. EBIT margins (ex amortization of intangibles) at 16.7% appear healthy relative to globally established players. Axon had cash and equivalents of £25.3 mn on its books as on Dec 31, 2008. The company's revenue CAGR of 50.3% over the past three years has been aided by several acquisitions during the period.

Acquisition would be marginally EPS dilutive assuming no synergy benefits

	FY2009E	FY2010E
Current net profit estimate (Rs mn)	58,593	67,781
Current EPS estimate (Rs/share)	102.1	118.1
Add:		
Axon Group net profit (£ mn) (a)	7.8	24.4
Axon Group net profit (Rs mn)	632.7	1,981.3
Less:		
Interest income on acquisition payout of £407.1 mn (Rs mn) (b)	(826.4)	(2,479.2)
Net impact (Rs mn)	**(193.7)**	**(498.0)**
Net EPS impact (Rs/share)	**(0.3)**	**(0.9)**
EPS accretion/(dilution) (%)	**(0.3)**	**(0.7)**

Note:
(a) Using consensus GAAP net profit estimates of £22.1 mn for CY2008, £23.8 mn for CY2009 and £26.2 mn for CY2010
(b) Assuming post-tax yield on cash balance of 7.5%
(c) Assuming no synergy benefits
(d) Using £/Re exchange rate of 81.2
(e) Assuming 4 months consolidation in FY2009E

Source: Kotak Institutional Equities estimates

Profit and loss statement of Axon Group PLC (£ mn), December fiscal year-ends, 2004-2007

	2004	2005	2006	2007
Revenues	**60.3**	**87.9**	**137.5**	**204.5**
Cost of revenues	(43.0)	(62.9)	(96.1)	(145.9)
Option expenses	(0.3)	(0.8)	(1.4)	(2.3)
Gross profits	**17.0**	**24.1**	**40.0**	**56.3**
G&A expenses	(11.2)	(13.3)	(19.4)	(22.2)
EBITA	**5.7**	**10.8**	**20.6**	**34.1**
Amortization of intangibles	(0.1)	(0.8)	(2.6)	(3.6)
EBIT	**5.6**	**10.0**	**17.9**	**30.5**
Interest costs	(0.0)	(0.3)	(0.7)	(1.3)
Interest and other income	1.0	0.7	0.5	0.4
PBT	**6.6**	**10.4**	**17.7**	**29.5**
Tax	(1.9)	(3.4)	(5.3)	(9.3)
PAT	**4.7**	**7.0**	**12.4**	**20.2**
Growth yoy (%)				
Revenues		45.8	56.5	48.7
EBITA		88.2	90.7	65.4
EBIT		76.8	79.8	69.8
PBT		57.2	70.5	66.9
PAT		49.3	76.8	63.0
Margins (%)				
Gross profit	28.2	27.5	29.1	27.5
EBITA	9.5	12.3	15.0	16.7
EBIT	9.4	11.4	13.0	14.9
PBT	11.0	11.8	12.9	14.4
PAT	7.8	8.0	9.0	9.9

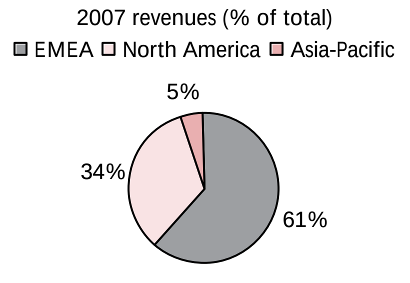
Source: Axon annual reports

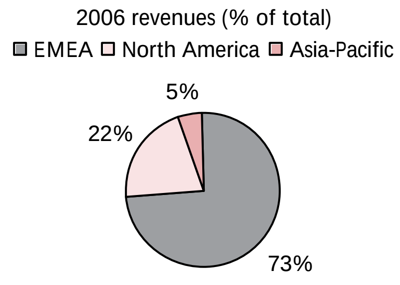
Balance Sheet of Axon Group PLC (£ mn), December fiscal year-ends, 2004-2007

	2004	2005	2006	2007
Assets				
Net fixed assets	0.7	1.3	1.8	2.3
Deferred tax asset	1.9	2.9	7.6	7.1
Goodwill	7.1	27.3	47.3	53.8
Other intangible assets	0.4	2.2	5.7	5.3
Receivables	17.5	34.3	43.5	46.6
Cash and cash equivalents	20.5	13.2	12.2	25.3
Total assets	**48.1**	**81.1**	**118.0**	**140.4**
Liabilities				
Shareholder's equity	34.4	48.0	57.0	80.6
Minority interest	0.0	0.0	—	—
Deferred tax liability	—	0.5	1.4	0.8
Long-term provisions	1.1	10.2	15.9	5.1
Payables	11.3	21.4	37.1	51.6
Bank Loan	—	—	6.0	—
Current tax liabilities	1.3	1.0	0.6	2.3
Total liabilities	**48.1**	**81.1**	**118.0**	**140.4**

Source: Axon annual reports

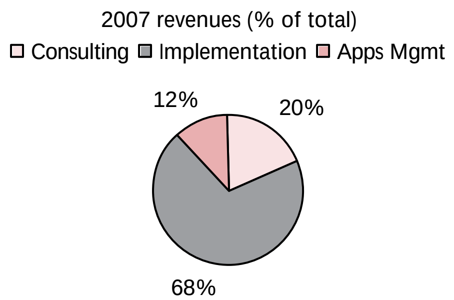
Axon's North America revenues were boosted by acquisitions in CY2007

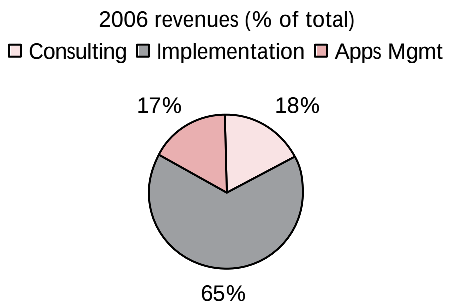




Source: Company

SAP implementation forms bulk (68%) of Axon's revenues





Source: Company

Top ten shareholders in Axon Group PLC

Shareholder	# of shares (mn)	Shareholding (%)	Filing date
Mark Oliver Hunter (a)	7,348,127	11.43	03-Apr-2008
Standard Life Investments Ltd.	4,529,610	7.04	12-Mar-2008
BlackRock Investment Management (UK) Ltd.	4,149,157	6.45	31-Dec-2007
AEGON Asset Management UK p.l.c.	3,852,325	5.99	10-Jun-2008
JPMorgan Asset Management U.K. Limited	3,083,162	4.79	11-Jan-2008
Renovo Group Plc	2,939,908	4.57	31-Dec-2007
Scottish Widows Investment Partnership Ltd.	2,758,945	4.29	27-Mar-2008
Donald Mackellar Kirkwood (a)	2,409,857	3.75	31-Dec-2007
GlobeFlex Capital, L.P.	2,337,912	3.64	31-Dec-2007
Cardell (Stephen)	2,300,000	3.58	16-May-2008

Note:
(a) Among the three founders of Axon who have irrevocably undertaken to vote in favor of the Scheme of arrangement for the acquisition

Source: Bloomberg

Infosys Technologies: Consolidated Indian GAAP Income Statement (Rs mn)

Rs mn	2007	2008	2009E	2010E	2011E
Revenues	**138,930**	**166,920**	**214,907**	**260,204**	**311,873**
Software Development Costs	(74,580)	(92,070)	(118,522)	(143,907)	(177,285)
Gross profit	**64,350**	**74,850**	**96,385**	**116,297**	**134,588**
Selling and marketing exp	(9,290)	(9,160)	(12,306)	(15,177)	(18,036)
Administration exp	(11,150)	(13,310)	(16,581)	(20,998)	(25,068)
Total SG&A Expenses	(20,440)	(22,470)	(28,887)	(36,175)	(43,103)
EBITDA	**43,910**	**52,380**	**67,499**	**80,122**	**91,485**
Depreciation	(5,140)	(5,980)	(6,969)	(8,388)	(10,217)
EBIT	**38,770**	**46,400**	**60,530**	**71,734**	**81,268**
Interest	—	—	—	—	—
Other Income	3,750	7,040	7,679	9,720	10,376
Profit Before Tax	**42,520**	**53,440**	**68,209**	**81,454**	**91,644**
Provision for Tax	(5,100)	(8,060)	(9,616)	(13,673)	(18,489)
Net Profit	**37,420**	**45,380**	**58,593**	**67,781**	**73,154**
Minority Interest	(110)	—	—	—	—
Net Income	**37,310**	**45,380**	**58,593**	**67,781**	**73,154**
Extraordinaries	1,250	1,210	310	—	—
Net Profit- Reported	**38,560**	**46,590**	**58,903**	**67,781**	**73,154**
EPS (Rs/ share)	**67.0**	**79.1**	**102.1**	**118.1**	**127.4**
No of shares outstanding (mn)	562.8	574.0	574.0	574.0	574.0
Margins (%)					
Gross Profit margin	46.3	44.8	44.8	44.7	43.2
EBITDA Margin	31.6	31.4	31.4	30.8	29.3
EBIT Margin	27.9	27.8	28.2	27.6	26.1
NPM	26.9	27.2	27.3	26.0	23.5
Growth Rates (%)					
Revenues	45.9	20.1	28.7	21.1	19.9
Gross Profit	44.4	16.3	28.8	20.7	15.7
EBITDA	42.0	19.3	28.9	18.7	14.2
EBIT	46.1	19.7	30.5	18.5	13.3
Net Profit	50.9	21.3	29.1	15.7	7.9
Net Income	51.8	21.6	29.1	15.7	7.9

Source: Kotak Institutional Equities estimates.

Pharmaceuticals

SUN.BO, Rs1475	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,780
52W High -Low (Rs)	1521 - 860
Market Cap (Rs bn)	306.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	33.6	41.1	45.2
Net Profit (Rs bn)	14.9	17.5	16.1
EPS (Rs)	71.5	84.3	77.5
EPS gth	*71.3*	*17.9*	*(8.1)*
P/E (x)	20.6	17.5	19.0
EV/EBITDA (x)	16.9	13.2	13.7
Div yield (%)	0.6	0.7	0.9

Sun Pharmaceuticals: Update of Taro acquisition plans

Prashant Vaishampayan : prashant.vaishampayan@kotak.com, +91-22-6634-1127

Priti Arora : priti.arora@kotak.com, +91-22-6749-3596

- **Two parallel cases underway in US and Israeli courts between Sun Pharma and Taro. We highlight important issues from Dr. Barrie Levitt's interview in Israeli media**
- **Sun Pharma believes the 'special tender offer' rules are not applicable to their offer or the option agreement. Israeli court to decide on Taro's suit asking for a special offer in late August/September**
- **Sun Pharma reaffirms commitment to Taro's facilities in Israel and its employees**
- **FTC clears Sun's open offer for Taro shares. Sun to divest three products relating to carbamazepine to Torrent**
- **Taro's strong presence in dermatology segment in US and Canada make it an important asset for Sun**
- **Maintain BUY rating with a SOTP-based target price of Rs1,780. Sun remains one of our top two picks in large cap pharma sector**

Two parallel cases are underway in US and Israeli courts between Sun Pharma and Taro. Sun Pharma believes the 'special tender offer' rules are not applicable to their offer or the option agreement. The Israeli court will decide on Taro's action to force Sun to make a special offer in late August/September. Taro's strong presence in dermatology segment in US and Canada make it an important asset for Sun. Maintain BUY rating with a SOTP-based target price of Rs1,780

Two parallel cases underway in US and Israeli courts of law. There are currently two parallel cases running in the US and Israel

1) Sun Pharma filed an action in the Supreme Court of the State of New York in June 2008 against Taro and its Board of Directors. The action asserting fraud claims against Taro and its directors asks the Court to order the controlling shareholders to honor their promises under the Option Agreement. In addition, Sun Pharma asks for an order declaring that the Merger Agreement was not properly terminated.

2) In an effort to block Sun from exercising the option, Taro's independent directors initiated legal action in Israel to force Sun to make a special offer to purchase before it could acquire Taro's founders' shares.

The Tel Aviv District Court held a hearing in mid-July on the option Taro chairman and controlling shareholder Dr. Barrie Levitt awarded Sun on Taro's founders shares. Israeli newspaper reported that Judge Michal Agmon-Gonen noted that, "We learned in first year law school that contracts must be honored," at the start of the hearing. "Taro's request suggests that its controlling shareholders are not really interested in honoring agreements," she added. This suggests that the hearing has gone in favor of Sun Pharma.

We highlight important issues from the interview with Dr. Barrie Levitt which appeared in Globes. Dan Shohet interviewed Dr. Levitt for Israeli newspaper Globes on August 20. Mr. Shohet reported that the agreement with Sun on the sale of the company his parents founded, was not easy for Dr. Levitt who claimed he had no choice. "We were facing a credit stranglehold, we were on the verge of becoming insolvent as we had to repay money we had borrowed—and never before has this company had to declare itself insolvent, we have always met our liabilities," Dr. Levitt points out.

After the merger, Levitt was supposed to have retired. “I was willing to go,” he recalls. “Sun asked to me stay on, but I was not prepared, mentally, to stay on and work for an Indian company.”

Dr. Levitt says, “We feel that keeping Taro Israeli is in the interest of the country. The fear we have is quite simple; I think that Mr. Shanghvi has to act in the interests of Sun’s shareholders in India, just as I have to act in the interests of Taro’s Israeli shareholders here in Israel.”

He adds, “I feel that what is important to Sun is Taro’s intellectual capital, our patents, and even more importantly—our reputation and integrity. Words come easy, and they may say they intend to remain in Israel, but we have invested $150 mn in the plant in Haifa—those are not words, but actions. With the surplus production Sun has in India, I am worried because of what this could mean for our employees and for the State of Israel.”

“No one assumed that we would ever find ourselves dealing with the options agreement. We all thought the shareholders were going to approve the merger. But it was the shareholders themselves who went to court to get it stopped.”

Dr. Levitt was told by Mr Shohet that Sun claims that they were surprised by the request for a special purchase offer. They say they are required by the agreement to make an ordinary purchase offer. Dr. Levitt responded, “I presume that Sun did know what their liabilities were under Israeli law as regards a special purchase offer. It is important to understand that I’m not the one who is asking for a special purchase offer, it is required by law. I would never sign an agreement that deprives shareholders of rights to which they are entitled by law.”

Dr. Levitt says that Taro’s revenue for the first half of 2008 stood at $166.2 mn, with net profit totaling $20.6 mn. Taro’s cash flow for the first six months of the year totaled $23 mn.

“Obviously, you can ask me how you can be sure I’m not lying, given that Taro still hasn’t published any financial reports,” Dr. Levitt says, “But it is common knowledge that we had to restate the financials because of issues relating to the timing of recognition of revenue in 2002-2006, so all told, the revenue for those years is correct and agreed on, and the only question is how to distribute it over the years. I believe that there will be no skeletons in the cupboard in the restated financials.”

Mr. Shohet asked when the shareholders will know for sure. Dr. Levitt had no answer. “I wish I knew how long this process is going to take. I have three accountancy firms in the US working on it, and I hope it will be completed in the near future.”

“There are number of companies that are willing to buy Sun’s share in Taro for US$10.25 a share and even more,” Dr. Levitt says. “Our goal is to finish the restatement of our financials, get the share relisted on Nasdaq, and then let the market determine the company’s price.”

Sun Pharma believes the “special tender offer” rules are not applicable to their offer or the Option Agreement. The Israeli Companies Law specifies that a “special tender offer” is required if (i) the purchase would result in the purchaser owning more than 45% of the voting power of the company, and (ii) at the time of such purchase, no other person owns more than 45% of the voting power of the company.

The "special tender offer" rules in Israel provide for the following. Acquirer has to obtain approval of a majority of the votes of offerees who expressed a position in the Offer. Shareholders may accept a special tender offer by tendering their shares, not respond to the offer, or object to the offer being completed by submitting notices of objection. Special tender offer is successful if the number of ordinary shares tendered represents no less than 5% of the voting power of the Company; and a four calendar-day period has elapsed after the offering period. During this four-day period all other shareholders who have not tendered their ordinary shares have an opportunity to tender.

Sun never expected that it would have to make a special purchase offer in order to exercise the options agreement it signed with the Levitt and Moros families. Mr. Shanghvi spoke to Globes and said, "Our understanding of Israeli law was that if we buy the stake of a shareholder who holds 45%, then there is no need for a special purchase offer." Taro is now claiming that the Levitt and Moros families (headed by the cousins, Dr. Barrie Levitt, and Daniel Moros), do not constitute a single entity, and the share allocation to Sun following the agreement lowered their jointly held stake to less than 45%.

Sun Pharma believes the "special tender offer" rules are not applicable to their offer or the Option Agreement. It has established a trust to allow it to consummate this Offer before resolution of that issue by the courts. Sun Pharma has obtained an expert opinion from a professor of Israeli corporate law that the "special tender offer" rules are not applicable in this case.

The Trust created by Sun Pharma is an irrevocable trust governed by Israeli law and administered by Ubank Trust Company Ltd. All Ordinary Shares accepted for payment by Sun Pharma will immediately be transferred by the Depositary to the Trustee. 2,590 out of the 2,600 Founders' Shares subject to the Option Agreement will also be delivered to the Trust. The remaining 10 Founders' Shares will be retained by Sun Pharma.

Sun Pharma will arrange the shareholding in such a manner that it will own Ordinary Shares and Founders' Shares representing in the aggregate no more than 44.9% of the effective voting rights of Taro after excluding shares held in the Trust. Sun Pharma will not have any investment power, voting power or other control over the Founders' Shares and Ordinary Shares held by the Trust. The Trust is designed to ensure that Sun Pharma does not control shares representing more than 44.9% of the Effective Voting Rights of Taro.

Sun Pharma beneficially owned 14,356,427 Ordinary Shares of Taro ~36.39% of the economic ownership and 24.26% of the voting rights as of June 27, 2008 (based on 39,453,118 Ordinary Shares and 2,600 Founders' Shares issued and outstanding) (see Exhibit 1).

Israeli court to decide on Taro's action to force Sun to make a special offer in late August/September. In late August/September, the judge will decide on Taro's motion to change Sun's offer to purchase into a special offer to purchase, which would require at least half of Taro's shareholders to agree to sell their holdings at the offer price.

In response to the letter from Mayor of Haifa, Sun Pharma reaffirms commitment to Taro's facilities in Israel and employees. According to press reports, the Mayor of Haifa sent a letter to the Minister of Industry expressing concern that after completing the purchase and merger process, Sun intends to close the production lines in Israel and transfer them to India. In response to this, Sun Pharma reiterates that it has no plans to close Taro facilities or lay off people.

"We believe the current management of Taro is significantly under utilizing its facilities and has considerably reduced its investment in R&D, which is so vital for the future of a pharma company. Sun Pharma will reverse this. When some of the world's largest and most respected companies, including pharmaceutical companies, manufacture and conduct research for global markets in Israel, and compete effectively, I see a good opportunity for Sun Pharma doing the same using these facilities," said Mr Dilip Shanghvi.

"I visited the plant in Haifa twice, and on each occasion I returned to India optimistic and excited about the things we could do there," says Dilip Shanghvi, in a telephone interview with "Globes." "The plant in Haifa suffers from an unexploited production capacity. We most certainly intend to move production there, and not the reverse."

FTC clears Sun's open offer for Taro shares. Sun to divest three products relating to carbamazepine to Torrent. On August 13, 2008, the U.S. Federal Trade Commission (FTC) granted early termination of the antitrust waiting period for tender offer by Sun Pharma, for all outstanding ordinary shares of Taro. The offer is scheduled to expire at 5:00 p.m., New York City time, on Tuesday, September 2, 2008 unless extended.

Sun has agreed to divest assets relating to carbamazepine, (generic Tegretol) as part of the terms specified by FTC for approving Sun's acquisition of Taro. The commission has approved Torrent Pharmaceuticals as the upfront purchaser of these assets. The FTC had raised objections to the merger since it may have led to higher prices for carbamazepine range due to high market share of the combined entity:

1) Immediate-release tablets. Taro controls half of the generic market followed by Teva and Sun's US subsidiary Caraco.

2) Chewable tablets. Teva is the leading firm (65% share) in the segment followed by Taro and Sun.

3) Extended-release carbamazepine tablets. Sun and Taro are the only companies expecting FDA approval for this product.

Taro's strong presence in dermatology segment in US and Canada make it an important asset for Sun

1) Taro has a strong presence in dermatology, cardiovascular, neuropsychiatry and anti-inflammatory segments (see Exhibit 2).

2) Taro entered the U.S. market in 1988, after establishing its Canadian subsidiary in 1984 and receiving approval of its first topical product in the United States. The U.S. has become Taro's largest market, accounting for more than 85% of global sales. It has more than 100 ANDA drug approvals in the US. One NDA as well as 26 ANDAs were awaiting approval with the USFDA in May 2007 (see Exhibit 3).

3) Taro has large sites with necessary regulatory approvals in Canada and Israel. It also manufactures APIs, including complex chemistry and steroids at its site in Israel making it vertically integrated. Taro has invested US$225 mn in the three years (2002-2005) in creating new manufacturing facilities (see Exhibit 4).

Maintain BUY rating with a SOTP-based target price of Rs1,780. We continue to rate the stock as BUY and it remains one of our top two picks in large cap pharma sector.

Exhibit 1: Sun Pharma share holding in Taro

		Price US$	No of shares (mn)	Total cost US$m
Original purchase	21-May-07	6	7	41
Warrants	2-Aug-07	6	3	18
Market Purchase	23-Jul-07	8	0	0
Brandes	19-Feb-08	10	4	38
Harel	23-Jun-08	10	1	8
Total		**7**	**14**	**105**
Warrant		6	5	27
Levitt family		8	5	37
Total Post warrant		**7**	**24**	**168**
Taro's no of shares today (mn)		39		
Total no of shares after warrant issue (mn)		44		
Sun current shareholding		**36%**		
Sun holding post warrant			**54%**	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 2: Taro - sales by geography (%)

	2005	2004	2003
USA	85	86	88
Canada	9	7	6
Israel	5	6	5
Other	1	1	1

Source: Company data

Exhibit 3: Taro - sales by segment (%)

	2005	2004	2003
Dermatology	69	68	67
Cardiovascular	15	13	15
Anti-inflammatory	9	9	9
Neuropsychiatric	5	6	6
Other	2	4	3

Source: Company data

Exhibit 4: Taro - principal facilities as of Dec, 31, 2006

Location	Square Footage	Main Use
Haifa Bay, Israel	325,000	Pharmaceutical manufacturing, production laboratories, offices, warehousing, chemical production (including tank farm and chemical finishing plant), and research facility
Haifa Bay, Israel	10,000	Warehouse, maintenance
Yakum, Israel	15,000	Administrative offices
Brampton, Canada	250,800	Pharmaceutical manufacturing, production laboratories, laboratories, administration, distribution and warehousing
Brampton, Canada	75,400	Administration and warehousing
Hawthorne, New York	124,000	Administrative offices and research laboratory
South Brunswick, New Jersey	315,000	Distribution facility
Roscrea, Ireland	124,000	Pharmaceutical manufacturing, research laboratories and warehousing

Source: Company data

Utilities

RLEN.BO, Rs986	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,250
52W High -Low (Rs)	2641 - 660
Market Cap (Rs bn)	227.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	83.5	93.3	116.4
Net Profit (Rs bn)	10.8	11.5	11.6
EPS (Rs)	46.0	49.7	50.2
EPS gth	*26.1*	*8.0*	*0.9*
P/E (x)	21.4	19.8	19.6
EV/EBITDA (x)	20.8	38.7	30.5
Div yield (%)	0.7	0.6	0.6

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	35.9	-	-
FIIs	21.1	0.8	0.0
MFs	5.0	1.1	0.3
UTI	-	-	(0.8)
LIC	11.2	2.1	1.3

Reliance Infrastructure: Key takeaways from visit to Dahanu plant and revision in estimates to reflect change in accounting policy

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

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

- **Revision in EPS estimates to reflect change in accounting policy**
- **Energy sale in Mumbai distribution business grew by 4.7% yoy**
- **Retain BUY rating and target price of Rs1,250**

We recently visited Reliance Infrastructure's 500 MW thermal power plant in Dahanu near Mumbai. The operating asset has been running at more than 100% PLF for past several years and has become more environment friendly with the installation of Flue Gas De-sulphurization unit (FGD). We have created regulatory asset for Mumbai and booked revenues in FY2009 in line with accounting policy adopted by the company. Our consolidated EPS estimate for FY2009 has increased to Rs49.7 (from Rs48 previously). Our EPS estimates for FY2010 and FY2011 have declined to Rs50.2 (from Rs56 previously) and Rs55.3 (from Rs61 previously), respectively. We believe that a strong and liquid balance sheet, predictable cash flows of existing business puts the company in an excellent position to exploit emerging opportunities in power and infrastructure development. We retain our BUY rating and target price of Rs1,250/share.

Highlights from visit to Dahanu Thermal Power Plant.

RELI's Dahanu Thermal Power Plant (DTP) operates consistently at a PLF in excess of 100%. Each unit (2*250 MW configuration) generates power at 260 MW, as the management optimally utilizes latent capacity in the BHEL manufactured main plant equipment. The recently installed flue gas de-sulphurization unit (FGD) has resulted in increased auxiliary consumption (~9% against 7.5% previously) and reduced SOX emissions (29 ton/day against 55 ton/day previously). However, we note that installation of the FGD unit yields higher return on equity invested (as capex has been incurred) and regulator has increased the operating norms for auxiliary consumption for tariff determination. DTP uses a blend of washed domestic and imported coal to meet its annual requirement of 2.1 mn tpa (of which 0.4 mn tpa is imported).

DTP also houses a technical training institute that facilitates training of fresh engineers (both from within the company and outside) in key aspects associated with operation of power plants. In our view the training institute will help RELI and group company RPWR to develop human resource for its EPC and power business respectively, given RPWRs ambitious plans of adding 28.2 GW. We note that the facilities at training institute will be further enhanced upon setting up of a simulation power plant during the course of the year.

Creating regulatory asset for Mumbai and booking revenues in line with accounting policy adopted. We have adjusted our model for Mumbai distribution business and booked additional revenue of Rs3.56 bn during FY2009. This is in line with the accounting policy adopted by RELI, which had recognized revenues of Rs0.89 bn during 1QFY09 towards the regulatory asset being created during FY2009. This regulatory asset will be amortized with higher tariff recoveries in FY2010 and FY2011. Consequently we have reduced revenues for FY2010 and FY2011 by Rs1.78 bn each year. We have also fine-tuned our estimates to reflect the additional data available from the abridged annual report. Our consolidated EPS estimate for FY2009 has increased to Rs49.7 (from Rs48 previously). Our EPS estimates for FY2010 and FY2011 have declined to Rs50 (from Rs56 previously) and Rs55 (from Rs61 previously), respectively.

Power business in RELI to provide stable cash flows and sedate growth. The earnings growth from the regulated power business is a function of capex incurred to increase the return-yielding equity base. We expect sedate growth in Mumbai license area as it needs lesser capex compared to Delhi where large investments are being made to improve the T&D infrastructure and reduce losses. Consequently, we use a low terminal year growth of 2% in our DCF-equity for Mumbai license area. The power sale in Mumbai distribution circle grew by a moderate 4.7% during FY2008, slowing down from 6% and 8.3% growth recorded during FY2006 and FY2007 respectively. The tariff realized in Mumbai license area increased by ~36% yoy in FY2008 reflecting the full recovery of higher fuel and power purchase costs.

Strong growth expected from EPC business and other infra projects. We expect RELI's EPC business to benefit from the large capacity addition planned (~28,200 MW) by its subsidiary Reliance Power as well as increased orders from IPPs/state generation companies. We note that the order book of the company stood at Rs210 bn at the end of 1QFY09 (Rs50 bn in 1QFY2008). This includes the EPC contract of Rs128 bn from Reliance Power for the 3,960 MW Sasan UMPP. Infrastructure projects do not currently contribute to the revenues and profits. However, we expect significant contribution of infrastructure projects over the next few years as implementation of some of these projects (road projects, metro projects) is gathering momentum.

SOTP-based target price of Rs1,250/share. We retain our BUY rating and target price of Rs1,250/share. Our SOTP-based target price comprises—(1) Rs173/share from the existing generation, transmission and distribution businesses, (2) Rs115/share for the EPC business, (3) Rs673/share for 45% stake in Reliance Power valued at 20% discount to our target price of Rs180/share, (4) Rs19/share as the equity—value of the five BOT road projects under-construction and (5) cash and investible surplus in books of Rs272/share.

Reliance Infrastructure, Sum-of-the-parts valuation

	Methodology	Key assumptions	Per share value (Rs)
BSES (Mumbai distribution, Dahanu)	**DCF-equity** CoE: 12% Terminal year growth: 2%	The business enjoys a stable regulated regieme and very high predictability of cash flows. We have not built in any incremental generation capacity in Mumbai.	130
Other generating assets - BAPL, RSPCL, BSES Kerala Power, Windmills	**DCF-equity** CoE: 12% Terminal year growth: Nil	We assign a value of 1.8X Price to Book as FCFe for these projects is likely to be ~16-18%. Gas power stations are liable to get returns based on availability, irrespective of lower PLF caused by unavailability of natural gas.	29
Delhi distribution 26% equity stake	**DCF-equity** CoE: 12% Terminal year growth: 4%	Distcoms earn 16% RoE on achieving the specified A,T&C loss reduction. The distcoms earn higher returns in the event of bettering the benchmarks. Our valuation takes a hit due to past capex of Rs5.35 bn disallowed by the regulator.	15
EPC business	**EV/EBITDA** 8X FY2010E - inline with the Engineering sector in Kotak coverage universe	FY2008 / FY2010E: Revenues (Rs mn) 14,444 / 33,220; EBITDA (Rs mn) 1,412 / 3,322; EBITDA % 9.8 / 10.0	115
Road projects 5 BOT projects under construction	**DCF-equity** CoE:15%	RELI has spent ~Rs5 bn till March 2008 out of the total projected capex of Rs30 bn. Our DCF-equity valuation implies a weighted average P/B of 1.7X for these five projects.	19
Reliance Power Limited 45% stake	**DCF-equity** CoE: 12.5% - 15%	We use a 20% discount to our target price of Rs180/share for RPWR.	673
Cash and investible surplus on books	**Book value**	Marketable securities & cash on books (Rs mn) 86,928; Less unallocable debt (Rs mn) (24,772); Net cash and investible surplus (Rs mn) 62,156	269
Total			**1,250**

Source: Company data, Kotak Institutional Equities estimates.

Change in estimates for Reliance Infrastructure (consolidated), March fiscal year-ends (Rs mn)

	Revenues			EBITDA			Net profit		
	New	**Old**	**% Chg.**	**New**	**Old**	**% Chg.**	**New**	**Old**	**% Chg.**
2008	83,462	82,948	0.6	19,456	19,456	(0.0)	10,849	10,849	(0.0)
2009E	93,283	89,165	4.6	18,284	17,627	3.7	11,484	11,186	2.7
2010E	116,443	117,290	(0.7)	20,079	20,881	(3.8)	11,590	12,993	(10.8)
2011E	166,930	167,705	(0.5)	25,715	26,508	(3.0)	12,775	14,201	(10.0)

Source: Kotak Institutional Equities estimates.

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

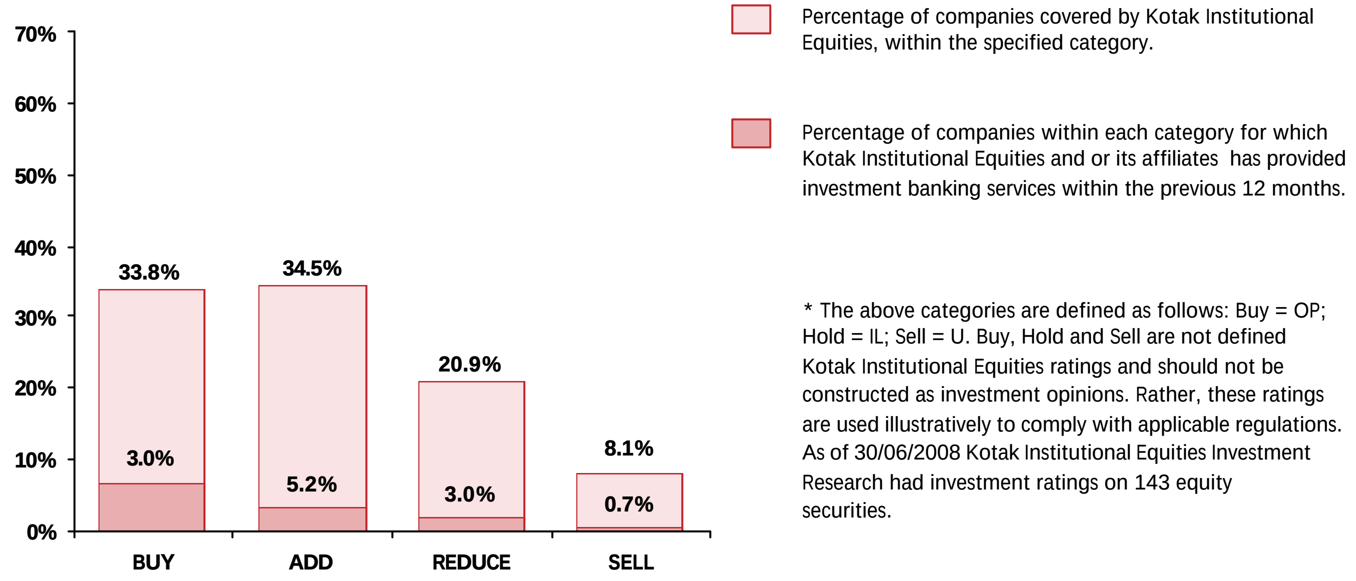
	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)						
Net sales	68,489	83,462	93,283	116,443	166,930	191,772
EBITDA	**5,503**	**5,318**	**6,644**	**9,284**	**15,846**	**22,241**
Other income	9,257	14,138	11,640	10,795	9,869	9,436
Interest	(3,130)	(4,021)	(3,820)	(4,487)	(6,645)	(8,985)
Depreciation	(3,032)	(3,074)	(3,940)	(4,456)	(5,063)	(5,587)
Extraordinary items	—	933	(1,869)	—	—	—
Pretax profits	8,598	12,361	10,524	11,136	14,008	17,105
Tax	(238)	(1,891)	(1,613)	(1,641)	(3,501)	(4,853)
Minority interest / share of associates	(15)	379	2,574	2,095	2,268	6,678
Net profits	**8,345**	**10,849**	**11,484**	**11,590**	**12,775**	**18,930**
Earnings per share (Rs)	**36.5**	**46.0**	**49.7**	**50.2**	**55.3**	**82.0**
Balance sheet (Rs mn)						
Total equity	95,344	163,587	172,063	186,191	200,232	217,903
Deferred taxation liability	2,511	2,678	2,349	2,303	2,052	1,716
Minority interest	0	513	513	513	513	513
Total borrowings	66,304	59,036	76,201	90,527	97,647	89,146
Currrent liabilities	32,729	38,615	40,881	53,507	82,386	95,717
Service line deposits form customers	246	202	202	202	202	202
Total liabilities and equity	**197,134**	**264,630**	**292,209**	**333,242**	**383,032**	**405,195**
Cash	22,263	1,154	320	1,085	3,990	15,992
Current assets	78,730	96,361	99,363	111,771	139,172	153,290
Total fixed assets	43,919	50,118	83,529	113,388	132,873	128,916
Investments	52,222	116,997	108,997	106,997	106,997	106,997
Total assets	**197,134**	**264,630**	**292,209**	**333,242**	**383,032**	**405,195**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital		15,023	13,226	15,998	17,587	24,181
Working capital		(11,745)	(735)	218	1,478	(788)
Capital expenditure		(9,274)	(37,351)	(34,315)	(24,547)	(1,630)
Investments		(21,541)	8,000	2,000	—	—
Free cash flow		**(27,536)**	**(16,859)**	**(16,099)**	**(5,482)**	**21,763**

Source: Company data, Kotak Institutional Equities estimates.

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

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 30/06/2008 Kotak Institutional Equities Investment Research had investment ratings on 143 equity securities.

Source: Kotak Institutional Equities. As of June 30, 2008

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
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Corporate Office
Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

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

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