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BSE-30:17,616

**Happy new year, hapless old feeling.** In our view, macro factors and large global liquidity continue to dominate bottom-up stock-picking, valuations and fundamentals. We see little value in most-large stock names and suggest investors book profits in large-cap. stocks that are most vulnerable to (1) earnings disappointments and (2) likely interest rate shock.

### Very little value in most large-cap. stocks; book profits selectively

We find the Indian market's (BSE-30 Index) valuation expensive after a 81% rise in CY2009. The broad market is trading at 16X FY2011E 'EPS' and 16.9X FY2011E 'EPS' on free-float adjusted basis. On an ex-Energy basis, the market is trading at 17.9X FY2011E 'EPS'. Most India-specific sectors are trading at 16X-22X FY2011E earnings. Finally, we have not seen any evidence of meaningful earnings upgrades. Our bottom-up BSE-30 Index fair valuation is 17,250 based on the individual 12-month fair valuations of BSE-30 stocks.

### RIL and interest-rate sensitive stocks best SELLS, in our view

We suggest investors book profits in (1) expensive stocks with potential scope for earnings disappointments (RIL, HDFC) and (2) interest rate-sensitive stocks, particularly those with weak fundamentals (real estate), weak balance sheets and/or utilities with exposure to interest rates.

### Interest rate shock likely given the government's precarious fiscal position

We expect interest rates to rise 150-200 bps during the course of CY2010E due to (1) high borrowing program of the Indian central and state governments led by high fiscal deficit and (2) accelerating inflation. We model FY2011E GFD/GDP of the central government at 6.6% and the combined deficit of central and state governments at 9.8%.

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Kotak Institutional Equities  
Research

Important disclosures appear  
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## Revisions to our Model Portfolio

Exhibit 1 presents our revised Model Portfolio and Exhibit 2 is our revised Top-10 list. We discuss the key changes below.

### Exhibit 1: We are underweight Banking, Energy and Telecom Kotak Institutional Equities Model Portfolio

Company	7-Jan		Weightage (%)		Diff. (bps)	Company	7-Jan		Weightage (%)		Diff. (bps)
	Price (Rs)	Rating	BSE-30	KS reco.			Price (Rs)	Rating	BSE-30	KS reco.	
Hero Honda	1,653	REDUCE	1.3	—	(125)	Larsen & Toubro	1,668	ADD	6.9	7.9	100
Mahindra & Mahindra	1,156	ADD	1.9	2.4	50	Nagarjuna Construction Co.	172	BUY	—	1.0	100
Maruti Suzuki	1,453	SELL	1.6	1.1	(50)	<b>Industrials/Construction</b>			<b>10.0</b>	<b>12.5</b>	<b>250</b>
Tata Motors	786	ADD	2.0	—	(205)	Hindalco Industries	175	BUY	1.8	2.3	50
<b>Automobiles</b>			<b>6.8</b>	<b>3.5</b>	<b>(330)</b>	Sterlite Industries	916	ADD	2.6	2.6	—
Bank of Baroda	537	ADD	—	1.0	100	Tata Steel	650	BUY	3.1	2.6	(50)
Corporation Bank	441	BUY	—	1.0	100	<b>Metals</b>			<b>7.5</b>	<b>7.5</b>	<b>—</b>
Punjab National Bank	923	BUY	—	1.0	100	Biocon	290	BUY	—	0.5	50
State Bank of India	2,293	BUY	5.0	6.5	150	Piramal Healthcare	388	NR	—	0.5	50
Union Bank	269	BUY	—	1.0	100	Sun Pharmaceuticals	1,540	ADD	1.0	1.0	—
<b>PSU Banking</b>			<b>5.0</b>	<b>10.5</b>	<b>550</b>	<b>Pharmaceuticals</b>			<b>1.0</b>	<b>2.0</b>	<b>100</b>
HDFC	2,646	ADD	5.1	1.6	(350)	DLF	375	SELL	1.2	—	(120)
HDFC Bank	1,713	REDUCE	5.0	2.0	(300)	<b>Real estate</b>			<b>1.2</b>	<b>—</b>	<b>(120)</b>
ICICI Bank	886	ADD	7.5	7.5	—	Infosys Technologies	2,525	BUY	9.4	10.4	100
<b>Pvt. Banking/Financing</b>			<b>17.7</b>	<b>11.2</b>	<b>(650)</b>	TCS	714	ADD	3.2	3.2	—
ACC	913	REDUCE	0.7	—	(72)	Wipro	678	ADD	1.5	2.5	100
Grasim Industries	2,675	REDUCE	1.4	—	(140)	<b>Technology</b>			<b>14.1</b>	<b>16.1</b>	<b>200</b>
Jaiprakash Associates	159	ADD	1.4	2.9	150	Bharti Airtel	329	REDUCE	3.3	—	(332)
<b>Cement</b>			<b>3.5</b>	<b>2.9</b>	<b>(62)</b>	Reliance Communications	184	SELL	1.0	—	(101)
Hindustan Unilever	265	BUY	2.2	3.2	100	<b>Telecom</b>			<b>4.3</b>	<b>—</b>	<b>(433)</b>
ITC	256	BUY	5.1	6.6	150	NTPC	228	REDUCE	2.1	1.1	(100)
<b>Consumers</b>			<b>7.3</b>	<b>9.8</b>	<b>250</b>	Reliance Infrastructure	1,166	BUY	1.3	2.8	150
Oil & Natural Gas Corporation	1,225	BUY	4.0	5.5	150	Tata Power	1,481	ADD	1.9	3.4	150
Reliance Industries	1,106	SELL	12.3	6.2	(605)	<b>Utilities</b>			<b>5.4</b>	<b>7.4</b>	<b>200</b>
<b>Energy</b>			<b>16.2</b>	<b>11.7</b>	<b>(455)</b>	<b>Cash</b>			<b>—</b>	<b>5.0</b>	<b>500</b>
Bharat Heavy Electricals	2,410	ADD	3.1	2.6	(50)	<b>BSE-30</b>			<b>17,616</b>	<b>100.0</b>	<b>100.0</b>
IVRCL	384	BUY	—	1.0	100						

Note:

(a) Weights are with respect to January 7, 2010 prices.

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: We include Jaiprakash Associates in our Top-10 list  
Kotak Institutional Equities Top-10 List

Companies	Sector	Rating	Mkt cap.	CMP	Target	EPS (Rs)			P/E (X)			EV/EBDITA (X)		
			(US\$ mn)	(Rs)	(Rs)	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E
State Bank of India	Banking	BUY	31,880	2,293	2,400	143.7	154.8	174.4	16.0	14.8	13.1	—	—	—
Oil & Natural Gas Corporation	Energy	BUY	57,371	1,225	1,325	89.6	103.0	127.8	13.7	11.9	9.6	4.9	4.2	3.3
Infosys Technologies	Technology	BUY	31,741	2,525	2,800	102.4	105.9	119.6	24.6	23.9	21.1	18.6	17.1	14.2
Hindustan Unilever	Consumer products	BUY	12,639	265	320	9.5	10.6	12.2	27.8	25.0	21.8	21.3	18.7	16.2
ITC	Consumer products	BUY	21,124	256	290	8.7	10.8	12.8	29.6	23.8	20.0	18.1	14.7	12.5
Reliance Infrastructure	Utilities	BUY	5,781	1,166	1,250	62.7	63.7	68.6	18.6	18.3	17.0	23.3	21.3	16.9
Jaiprakash associates	Diversified	ADD	7,322	159	165	2.0	4.0	7.4	79.4	39.4	21.4	28.7	17.9	15.0
Tata Power	Utilities	ADD	8,007	1,481	1,400	50.2	63.3	70.3	29.5	23.4	21.1	13.3	14.5	14.0
Larsen & Toubro	Industrials	ADD	21,948	1,668	1,725	50.1	57.0	69.9	33.3	29.2	23.9	21.2	16.3	13.8
<b>PSU bank basket</b>														
Bank of Baroda	Banking	ADD	4,299	537	560	60.9	68.5	71.1	8.8	7.8	7.6	—	—	—
Corporation Bank	Banking	BUY	1,384	441	515	62.3	61.1	60.8	7.1	7.2	7.3	—	—	—
Punjab National Bank	Banking	BUY	6,370	923	930	98.0	110.4	118.6	9.4	8.4	7.8	—	—	—
Union Bank	Banking	BUY	2,977	269	310	34.2	34.8	37.7	7.9	7.7	7.1	—	—	—
<b>BSE-30</b>			<b>17,616</b>											

Source: Company, Kotak Institutional Equities estimates

- ▶ **Reduced weight on banks and financial institutions.** We have reduced our suggested weight on banks and financial institutions by 250 bps to 21.6% in light of (1) likely increase in CRR and policy rates and (2) higher wholesale borrowing costs. This implies an underweight position of 100 bps versus 150 bps overweight earlier. We continue to be relatively more positive on PSU banks given their inexpensive valuations, limited impact of higher G-Sec yield on investment portfolio (see Exhibit 3, which shows sensitivity of FY2010E net incomes of banks under our coverage to higher G-Sec yields at end-FY2010 versus our currently assumed 7.5%) and high CASA deposits (see Exhibit 4) versus private banks and NBFCs. Higher interest rates and wholesale borrowing costs would adversely impact HDFC and ICICI Bank.

Exhibit 3: Earnings of banks could be impacted by 4-7% if the yield on 10-year G-sec hardens to 8% by March 2010

Sensitivity of earnings of bank stocks to G-sec yields, March fiscal year-end, 2010E

	Current estimate (Rs mn)	MTM losses (Rs mn)	Impact on PAT (%)
<b>Public banks</b>			
Andhra Bank	7,452	348	(3.0)
BoB	25,023	1,040	(2.7)
Bol	23,726	2,094	(5.7)
Canara Bank	23,164	1,436	(4.0)
Corporation Bank	9,230	918	(6.5)
Indian Bank	14,294	591	(2.7)
IOB	12,342	1,060	(5.6)
OBC	9,860	1,104	(7.3)
PNB	34,803	1,362	(2.5)
SBI	98,248	10,146	(6.7)
Union Bank	17,580	2,202	(8.1)
<b>Old private banks</b>			
Federal Bank	5,379	306	(3.7)
J&K Bank	4,529	371	(5.3)

Note:

- Investment book as of September 2009 used in the calculations.
- Calculations assume a parallel shift of 50 bps in the yield curve.

Source: Company, Kotak Institutional Equities estimates

**Exhibit 4: Companies with higher CASA ratio may benefit from rising interest rates**  
 CASA ratio of companies under KIE coverage, March fiscal year-ends, 2007-2011E (%)

	2007	2008	2009	2010E	2011E
<b>Public banks</b>					
Andhra Bank	34.5	33.6	31.4	31.5	31.5
BoB	33.2	31.2	29.6	28.5	28.5
BoI	32.2	30.6	26.8	26.2	26.2
Canara Bank	31.5	31.5	30.1	30.0	30.0
Corporation Bank	34.1	35.0	31.4	29.0	30.0
Indian Bank	35.4	32.3	31.6	31.6	31.6
IOB	34.9	33.5	30.3	32.0	34.0
OBC	30.3	27.9	23.7	26.0	26.0
PNB	46.2	43.0	38.9	38.9	39.0
SBI	48.5	47.0	41.6	39.9	39.9
Union Bank	34.5	34.9	30.1	31.5	31.5
<b>Old private banks</b>					
Federal Bank	25.2	25.1	24.5	26.0	26.0
J&K Bank	39.8	39.2	38.1	37.0	37.0
<b>New private banks</b>					
Axis Bank	39.9	45.7	43.1	41.9	43.5
HDFC Bank	57.7	54.5	44.4	47.0	46.0
ICICI Bank	21.8	26.1	28.7	34.3	36.3

Source: Company, Kotak Institutional Equities estimates

- ▶ **Reduced weight on energy sector further.** We now recommend a weight of 11.7% on the energy sector versus a weight of 16.2% in the BSE-30 Index. We have removed GAIL from our Model Portfolio and Top-10 list as the stock is trading well above our 12-month fair valuation of Rs365 and is partly factoring in a large portion of potential upsides—(1) Rs50/share in case of unchanged gas transmission tariff for HVJ-DV pipeline versus our assumed 37% reduction to tariff and (2) Rs25/share from a potential government decision to allow GAIL to charge a marketing margin of US\$0.11/mn BTU on gas produced from nominated blocks of ONGC and OIL.

We continue to recommend an underweight position on RIL since we see large downside risks to our earnings estimates from (1) weaker-than-expected refining and chemical margins and (2) higher-than-expected taxation due to non-availability of income tax exemption on gas production from RIL's KG D-6 block. We note that our earnings estimates are already below estimates by 12% and 10% for FY2010E and FY2011E, respectively. Our FY2010E and FY2011E EPS estimate would drop by 11% and 14% to Rs44 and Rs60, respectively, without the aforementioned tax exemption. Finally, RIL stock offers 18.6% potential downside to our 12-month SOTP-based fair valuation of Rs900.

- ▶ **Increased weight on construction and infrastructure sectors.** We have increased the weight of the infrastructure sector (including Jaiprakash Associates) by 300 bps and included IVRCL, JPA and Nagarjuna Construction in our Model Portfolio. We have also included JPA in our Top-10 list instead of GAIL. Exhibit 5 gives our SOTP-based valuation for JPA. We like JPA's (1) diversified business model that offers exposure to fast-growing construction, infrastructure, power and real estate sectors and (2) pragmatic pricing strategy in real estate.

**Exhibit 5: We value Jaiprakash Associates at Rs165/share on FY2011E estimates**  
SOTP-based valuation of Jaiprakash Associates, March fiscal year-ends, 2011E (Rs)

Business	Valuation base (Rs bn)		Multiple (X)		Valuation (c)	
	Other	EBITDA	Multiple	EV/EBITDA	(Rs bn)	(Rs/share)
Cement		15		6	91	48
Construction		19		7	134	71
Real estate (a)	98				98	52
Power (a)	125				125	66
Hotels		0.3		7	2.2	1
Net debt (b)					(138)	(73)
<b>Total</b>					<b>313</b>	<b>165</b>

Notes:

(a) We value the real estate business on NAV and the power business on DCF-equity.

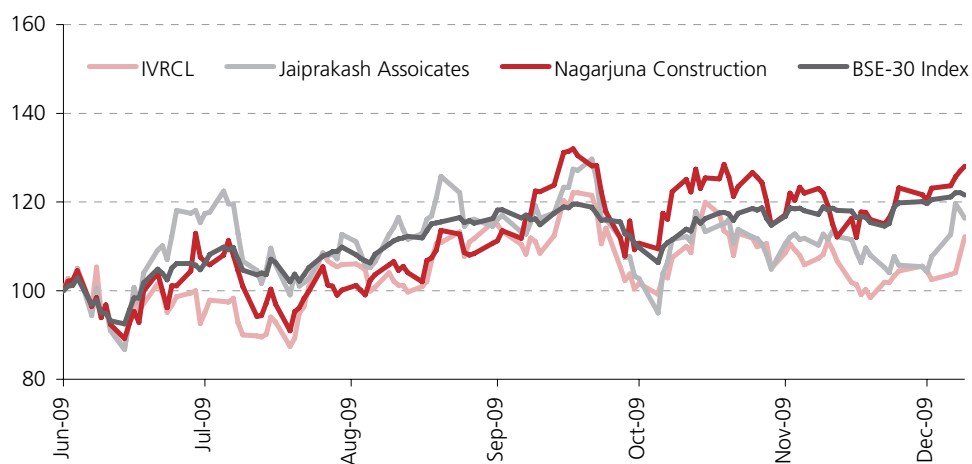
(b) Net debt excludes debt attributable to power business.

(c) We use 1.89 bn shares (excluding treasury shares) for per share computations.

Source: Kotak Institutional Equities estimates

We note the construction sector has underperformed the broad market over the past six months (see Exhibit 6, which shows relative performance of IVRCL, JPA and NCCL since June 30, 2009) for various reasons—(1) slowdown in execution and release of orders by the state government in Andhra Pradesh on account of other preoccupations—demise of the previous chief minister, floods and a political agitation seeking the creation of another state out of Andhra Pradesh and (2) disappointments in earnings in 2QFY10. Exhibit 7 shows the changes in FY2010E and FY2011E EPS for construction stocks under our coverage over the past six months.

**Exhibit 6: Construction sector has underperformed the broader market in recent times**  
Price performance of IVRCL Infra, Jaiprakash Associates, Nagarjuna Constructions versus BSE-30 Index



Source: Bloomberg, Kotak Institutional Equities

**Exhibit 7: Significant increase in FY2010E-11E earnings estimates of construction stocks**

Trends in earnings estimates of construction stocks over the past six months, March fiscal year-ends, 2010E-11E (Rs)

		Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
<b>Nagarjuna</b>	2010E	7.5	7.5	7.5	7.5	7.5	7.8	7.8
	2011E	8.8	8.8	8.8	8.8	9.2	10.0	10.0
<b>IVRCL</b>	2010E	18.0	18.3	18.3	18.3	18.3	19.8	19.8
	2011E	22.2	22.5	22.5	22.5	22.5	23.7	23.7
<b>JPA</b>	2010E	4.5	4.5	4.0	4.0	4.0	4.0	4.0
	2011E	6.6	6.6	7.3	7.3	7.3	7.4	7.4

Source: Kotak Institutional Equities estimates

However, we expect order booking to increase meaningfully in FY2011E led by (1) potential release of large orders in the road sector by the central government and (2) potential implementation of the backlog of projects in Andhra Pradesh upon the resolution of ongoing issues. In any case, we note that these companies have large order books that will enable them to tide over the current 'slack' phase (see Exhibit 8, which gives the current order book and revenue visibility of IVRCL, JPA and NCCL).

**Exhibit 8: Order book visibility has remained stable for construction stocks through the downturn**

Order backlog, booking and visibility (X) of construction stocks, March fiscal year-ends, 2009-10E

	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10
<b>IVRCL Infrastructure</b>						
Order backlog (Rs bn)	124	138	143	135	139	146
Order booking (Rs bn)	13	26	17	8	15	19
<b>Order visibility (years)</b>	<b>2.5</b>	<b>2.7</b>	<b>2.6</b>	<b>2.2</b>	<b>2.2</b>	<b>2.2</b>
<b>Nagarjuna Construction</b>						
Order backlog (Rs bn)	122	124	124	122	139	143
Order booking (Rs bn)	17	13	10	88	29	18
<b>Order visibility (years)</b>	<b>2.9</b>	<b>2.7</b>	<b>2.6</b>	<b>2.4</b>	<b>2.6</b>	<b>2.7</b>
<b>Jaiprakash Associates (a)</b>						
Order backlog (Rs bn)				406	398	391
<b>Order visibility (years)</b>				<b>7.9</b>	<b>6.7</b>	<b>5.9</b>

Note:

(a) A significant portion (Rs300bn) of JPA order backlog is on account of Ganga Expressway project, which is a long-term project and likely to start execution in 1-2 years time.

Source: Company, Kotak Institutional Equities

**Very hard to get excited about the market given multiple issues**

- ▶ Overall market valuations look fully valued on FY2011E earnings. We find the market fully valued at 16X FY2011E 'EPS' (16.9X on free-float basis) and 17.9X FY2011 ex-energy 'EPS'. Exhibit 9 gives the valuations of the broad market broken down by sectors. As can be seen, most India-specific sectors that play on the perennial themes of consumption and investment are trading at rich multiples.

Exhibit 9: BSE-30 Index is trading at 16X FY2011E and at 17.9X FY2011E ex-Energy 'EPS'  
Valuation summary of BSE-30 sectors

	Adj mkt cap.		EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Div. yield (%)		RoE (%)		
	Mkt cap. (US\$ mn)	cap. (US\$ mn)	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2009	2010E	2011E
Automobiles	33,716	19,706	(30.8)	106.9	10.3	40.4	19.5	17.7	22.4	12.0	10.7	4.8	3.7	3.1	0.7	0.8	12.0	18.7	17.2
Banking	86,932	65,206	16.7	13.4	18.2	22.8	20.1	17.0	—	—	—	2.9	2.6	2.3	1.1	1.2	12.8	12.9	13.7
Cement	9,128	6,095	(15.0)	29.2	(16.9)	12.8	9.9	12.0	6.9	5.2	5.6	2.5	2.0	1.8	1.8	1.8	19.3	20.6	15.0
Consumers	33,763	21,106	8.6	19.3	17.3	28.9	24.2	20.7	19.2	15.2	12.9	9.3	8.0	6.9	2.1	2.3	32.0	33.1	33.5
Diversified	7,322	4,027	(30.8)	101.5	84.2	79.4	39.4	21.4	25.0	16.7	14.4	5.1	4.0	3.5	0.0	0.0	6.4	10.3	16.2
Energy	128,028	46,802	(0.3)	9.9	31.8	17.0	15.4	11.7	8.3	6.9	5.4	2.3	2.1	1.8	1.5	1.6	13.7	13.4	15.7
Industrials	47,779	28,794	19.4	31.2	22.6	36.0	27.4	22.4	21.0	15.4	12.7	7.8	5.7	4.7	0.7	0.7	21.6	20.7	20.8
Metals	36,826	21,561	(0.3)	(48.5)	92.2	13.1	25.4	13.2	8.4	10.5	7.1	2.2	1.7	1.5	0.8	0.4	17.1	6.7	11.4
Pharmaceuticals	6,985	2,794	22.3	(34.3)	13.1	17.5	26.7	23.6	13.8	19.3	16.4	4.4	3.9	3.5	0.9	0.9	25.3	14.7	14.7
Property	13,870	3,468	(42.3)	(51.0)	27.8	14.0	28.5	22.3	13.1	17.5	15.4	2.6	2.5	2.3	0.8	0.8	18.8	8.6	10.2
Technology	84,078	40,509	15.9	14.5	14.1	25.9	22.6	19.8	18.9	15.5	12.8	7.8	6.3	5.2	0.9	1.2	30.3	27.7	26.4
Telecom	35,664	12,482	21.6	(19.1)	(9.4)	10.6	13.1	14.4	7.4	7.7	7.6	2.2	1.9	1.7	0.6	0.7	20.9	14.5	11.7
Utilities	55,004	15,545	14.5	14.4	10.9	23.6	20.6	18.6	14.2	13.2	12.4	2.9	2.6	2.4	1.3	1.6	12.4	12.8	13.0
<b>BSE-30</b>	<b>579,094</b>	<b>288,096</b>	<b>3.5</b>	<b>4.3</b>	<b>21.1</b>	<b>20.2</b>	<b>19.4</b>	<b>16.0</b>	<b>11.6</b>	<b>10.3</b>	<b>8.6</b>	<b>3.3</b>	<b>2.8</b>	<b>2.5</b>	<b>1.1</b>	<b>1.2</b>	<b>16.3</b>	<b>14.5</b>	<b>15.6</b>
<b>BSE-30 ex-Energy</b>	<b>451,067</b>	<b>241,294</b>	<b>4.9</b>	<b>2.4</b>	<b>17.0</b>	<b>21.4</b>	<b>20.9</b>	<b>17.9</b>	<b>13.3</b>	<b>12.2</b>	<b>10.5</b>	<b>3.7</b>	<b>3.1</b>	<b>2.8</b>	<b>1.0</b>	<b>1.1</b>	<b>17.5</b>	<b>15.0</b>	<b>15.5</b>
<b>BSE-30 ex-Energy, Com.</b>	<b>405,113</b>	<b>213,637</b>	<b>6.9</b>	<b>9.4</b>	<b>12.9</b>	<b>23.0</b>	<b>21.1</b>	<b>18.7</b>	<b>15.1</b>	<b>13.1</b>	<b>11.7</b>	<b>4.0</b>	<b>3.4</b>	<b>3.0</b>	<b>1.0</b>	<b>1.2</b>	<b>17.5</b>	<b>16.3</b>	<b>16.3</b>

Note:

(a) EV/EBITDA excludes Banking sector

Source: BSE, Kotak Institutional Equities estimates

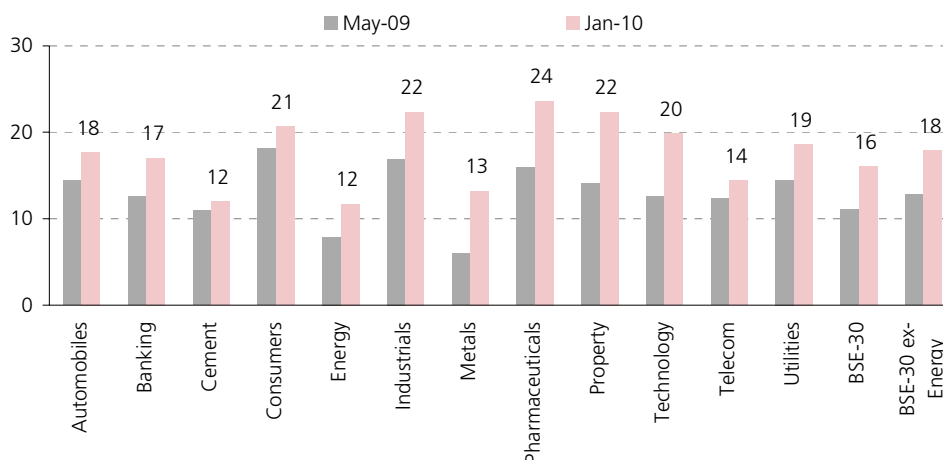
Exhibit 10: BSE-30 Index is trading at 16.9X FY2011E and at 18X FY2011E ex-Energy 'EPS' on free-float basis  
Valuation summary of BSE-30 sectors

	Mkt cap. (Rs mn)	Adj mkt cap. (Rs mn)	Adjusted net profit			Adjusted P/E			Contribution (%)		
			2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E
Automobiles	1,539,534	899,805	21,600	45,999	50,914	41.7	19.6	17.7	4	7	7
Banking	3,969,521	2,977,464	118,252	136,101	163,195	25.2	21.9	18.2	20	22	21
Cement	416,825	278,299	22,221	28,275	24,121	12.5	9.8	11.5	4	4	3
Consumers	1,541,697	963,764	33,214	39,945	46,951	29.0	24.1	20.5	5	6	6
Diversified	334,361	183,899	2,317	4,668	8,596	79.4	39.4	21.4	0	1	1
<b>Energy</b>	<b>5,846,057</b>	<b>2,137,116</b>	<b>114,857</b>	<b>123,378</b>	<b>167,638</b>	<b>18.6</b>	<b>17.3</b>	<b>12.7</b>	<b>19</b>	<b>20</b>	<b>22</b>
Industrials	2,181,704	1,314,809	37,361	46,697	57,355	35.2	28.2	22.9	6	7	7
Metals	1,681,550	984,549	81,629	38,431	79,558	12.1	25.6	12.4	13	6	10
Pharmaceuticals	318,965	127,586	7,271	4,778	5,404	17.5	26.7	23.6	1	1	1
Property	633,349	158,337	11,337	5,551	7,092	14.0	28.5	22.3	2	1	1
Technology	3,839,204	1,849,759	73,033	79,847	90,668	25.3	23.2	20.4	12	13	12
Telecom	1,628,503	569,976	53,958	43,637	39,518	10.6	13.1	14.4	9	7	5
Utilities	2,511,621	709,820	29,185	34,047	37,549	24.3	20.8	18.9	5	5	5
<b>BSE-30</b>	<b>26,442,891</b>	<b>13,155,183</b>	<b>606,235</b>	<b>631,355</b>	<b>778,561</b>	<b>21.7</b>	<b>20.8</b>	<b>16.9</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>BSE-30 ex-Energy</b>	<b>20,596,835</b>	<b>11,018,067</b>	<b>491,378</b>	<b>507,977</b>	<b>610,923</b>	<b>22.4</b>	<b>21.7</b>	<b>18.0</b>			
<b>BSE-30 ex-Energy, Com.</b>	<b>18,498,459</b>	<b>9,755,219</b>	<b>387,527</b>	<b>441,271</b>	<b>507,244</b>	<b>25.2</b>	<b>22.1</b>	<b>19.2</b>			

Source: BSE, Kotak Institutional Equities estimates

We believe that the sharp re-rating in several sectors over the past few months reduces the scope for further meaningful expansion from current levels. Exhibit 11 compares the current P/E multiples of the sectors in the BSE-30 Index on FY2011E earnings versus the same in May 2009. More important, the re-rating suggests that stock prices have increased much more rapidly than earnings. The same, perhaps unsurprisingly, reflects in our 12-month target prices for stocks in the BSE-30 Index (see Exhibit 12), which have increased disproportionately in most cases compared to the increase in earnings.

**Exhibit 11: Significant re-rating across the board in the Indian stock market**  
P/E ratio for BSE-30 Index sectors, March fiscal year-end, 2011E (X)



Source: Kotak Institutional Equities estimates

**Exhibit 12: Target prices of many companies in the BSE-30 are up but no meaningful change yet in Index earnings**

EPS and target prices of BSE-30 Index companies, March fiscal year-ends, 2010E-11E (Rs)

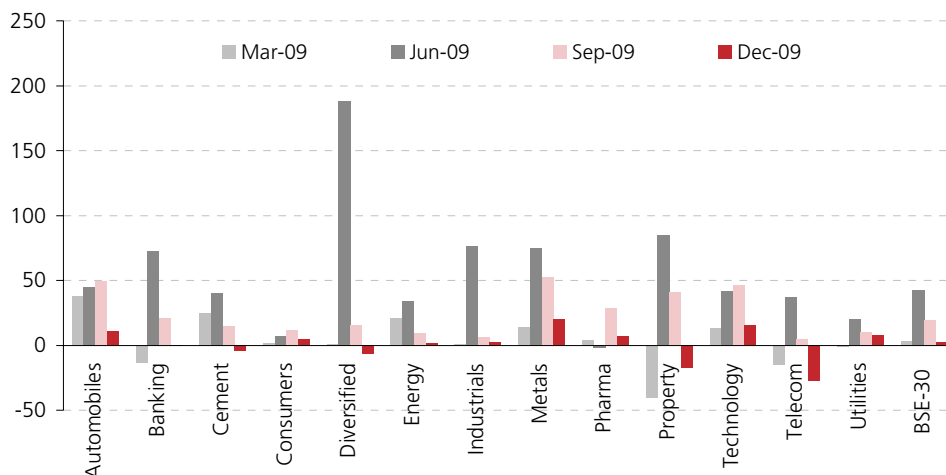
	2010E EPS (Rs)			2011E EPS (Rs)			Target price (Rs)		
	Current	May-09	Chg. (%)	Current	May-09	Chg. (%)	Current	May-09	Chg. (%)
Tata Motors	26	19	37	30	17	81	810	195	315
TCS	33	26	28	37	28	34	725	255	184
M&M	69	35	99	77	34	124	1,265	450	181
L&T	57	52	11	70	55	28	1,725	650	165
Hindalco	4	2	81	13	8	53	135	55	145
Tata Steel	30	56	(47)	73	87	(16)	600	280	114
Wipro	31	27	13	35	29	20	675	325	108
Infosys	106	104	2	120	116	3	2,800	1,500	87
ICICI Bank	37	33	14	46	38	18	880	475	85
JPA	4	5	(23)	7	8	(5)	165	95	74
DLF	13	16	(18)	17	17	(3)	320	190	68
BHEL	92	89	4	113	105	7	2,425	1,475	64
Maruti Suzuki	79	58	37	83	64	31	1,250	780	60
Sterlite Industries	38	41	(8)	45	51	(10)	780	490	59
Hero Honda	103	84	23	113	91	24	1,580	1,000	58
Grasim Industries	285	188	51	271	193	41	2,325	1,500	55
HDFC	100	93	7	117	109	7	2,650	1,730	53
SBI	155	124	25	174	145	20	2,400	1,600	50
ITC	11	10	10	13	11	14	290	200	45
Tata Power	63	90	(30)	70	101	(31)	1,400	1,000	40
ONGC	103	104	(1)	128	138	(7)	1,325	950	39
HDFC Bank	65	64	1	85	75	13	1,600	1,150	39
Hindustan Unilever	11	10	3	12	12	5	320	235	36
Reliance Infra.	64	59	8	69	63	9	1,250	970	29
ACC	84	55	52	53	42	26	800	625	28
Reliance Industries	48	64	(24)	69	88	(22)	900	825	9
NTPC	11	11	4	12	12	3	190	180	6
RCOM	15	20	(27)	13	21	(39)	150	180	(17)
Sun Pharma	58	86	(33)	65	94	(31)	1,400	1,800	(22)
Bharti Airtel	24	26	(9)	22	30	(28)	300	388	(23)

Source: Kotak Institutional Equities estimates



Exhibit 13 shows the performance of various sectors in the BSE-30 Index in the four quarters of CY2009. As can be seen, different sectors had performed at different times during the course of the year based on events and earnings momentum. The 'churn and catch-up' movements in sectors have resulted in a massive re-rating across the board without any major earnings upgrades for the Index.

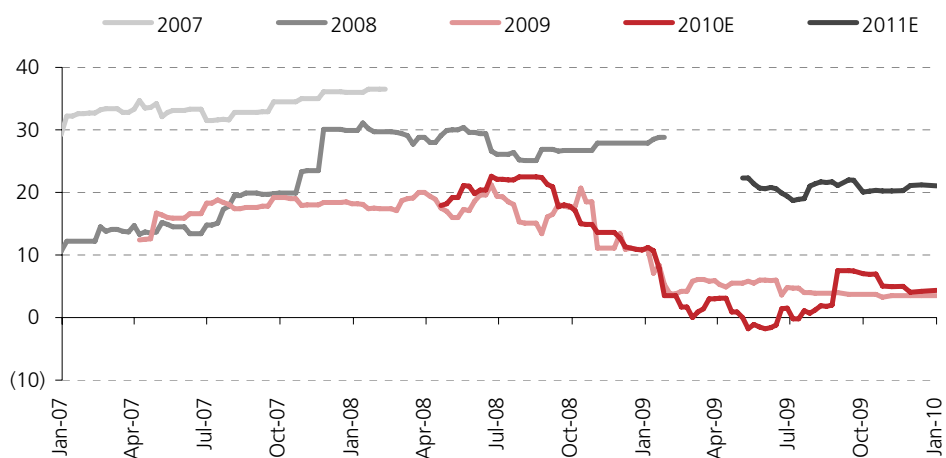
**Exhibit 13: Various sectors have performed at different periods of time in the year**  
 Quarterly performance of BSE-30 sectors in CY2009 (%)



Source: Bloomberg, Kotak Institutional Equities

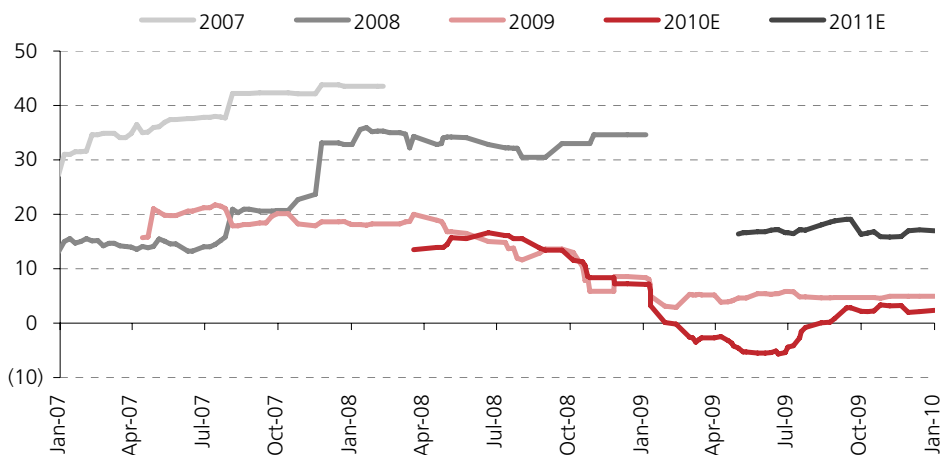
- ▶ **No major earnings upgrades barring in smaller sectors.** Exhibits 14 and 15 show the movement in earnings for the BSE-30 Index and BSE-30 Index ex-energy basis. We currently project FY2011E BSE-30 Index earnings to grow 21.1% following on a 4.3% growth in FY2010E. We note that our earnings projections have not changed meaningfully over the past few months with upgrades in the smaller sectors such as automobiles and cement being offset by downgrades in energy and telecom sectors. Exhibit 16 tracks the change in earnings for FY2010E and FY2011E for various sectors starting December 2008.

**Exhibit 14: No major changes to earnings over the past few months**  
 Expected growth in BSE-30 Index earnings, March fiscal year-ends, 2007-11E (%)



Source: Kotak Institutional Equities estimates

Exhibit 15: No major changes to earnings over the past few months  
Expected growth in BSE-30 Index ex-energy earnings, March fiscal-year ends, 2007-11E (%)



Source: Kotak Institutional Equities estimates

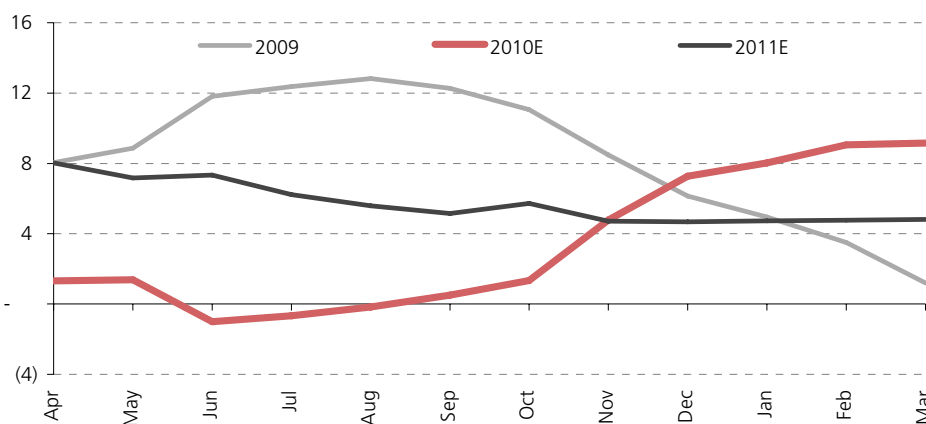
Exhibit 16: No major upgrades in Index earnings though significant upgrades/downgrades in earnings of various sectors  
Earnings growth of BSE-30 Index sectors, March fiscal year-end, 2010E-11E (%)

	Earnings growth (%)												Current
	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	
<b>2010E</b>													
Automobiles	(5)	19	21	20	25	31	30	52	54	61	105	97	107
Banking	5	3	0	0	(1)	(4)	(4)	1	1	12	12	14	13
Cement	(21)	(22)	(22)	(21)	(21)	(12)	(1)	14	14	14	29	29	29
Consumers	15	14	14	14	14	12	13	16	16	16	19	19	19
Diversified	31	33	33	33	33	20	126	124	124	124	100	102	101
Energy	21	12	7	18	18	7	18	4	7	20	11	10	10
Industrials	26	29	29	26	29	31	27	30	34	36	31	31	31
Metals	(19)	(34)	(49)	(46)	(45)	(48)	(48)	(48)	(50)	(50)	(41)	(49)	(48)
Pharmaceuticals	NA	49	45	48	48	5	8	(46)	(46)	(46)	(34)	(34)	(34)
Property	6	(26)	(24)	(24)	(24)	(45)	(45)	(45)	(50)	(50)	(50)	(51)	(51)
Technology	6	5	5	9	6	1	0	7	9	10	13	13	14
Telecom	23	3	3	(4)	(4)	(1)	(1)	1	3	3	(2)	(19)	(19)
Utilities	14	11	18	19	20	19	14	15	18	17	16	14	14
<b>BSE-30 Index</b>	<b>10.8</b>	<b>3.5</b>	<b>—</b>	<b>3.0</b>	<b>3.2</b>	<b>(1.7)</b>	<b>1.4</b>	<b>0.7</b>	<b>2.0</b>	<b>7.4</b>	<b>6.9</b>	<b>4.0</b>	<b>4.3</b>
<b>BSE-30 ex-Energy</b>	<b>6.7</b>	<b>0.1</b>	<b>(2.6)</b>	<b>(2.6)</b>	<b>(2.5)</b>	<b>(5.1)</b>	<b>(4.7)</b>	<b>(0.6)</b>	<b>0.2</b>	<b>2.8</b>	<b>5.3</b>	<b>1.8</b>	<b>2.4</b>
<b>2011E</b>													
Automobiles						13	14	7	7	7	10	9	10
Banking						17	17	15	15	18	21	18	18
Cement						(7)	(7)	(5)	(5)	(5)	(17)	(17)	(17)
Consumers						14	15	15	15	15	17	17	17
Diversified						50	46	70	70	70	82	84	84
Energy						29	26	30	31	29	32	32	32
Industrials						17	17	17	19	25	26	26	23
Metals						55	62	79	79	79	65	92	92
Pharmaceuticals						41	30	35	35	35	13	13	13
Property						8	7	7	19	18	18	28	28
Technology						10	11	12	13	14	13	13	14
Telecom						11	11	11	12	12	(11)	(9)	(9)
Utilities						12	12	12	12	12	11	11	11
<b>BSE-30</b>						<b>20.7</b>	<b>19.9</b>	<b>21.0</b>	<b>21.7</b>	<b>22.0</b>	<b>19.9</b>	<b>21.1</b>	<b>21.1</b>
<b>BSE-30 ex-Energy</b>						<b>16.9</b>	<b>17.2</b>	<b>17.5</b>	<b>18.1</b>	<b>19.1</b>	<b>15.5</b>	<b>17.0</b>	<b>17.0</b>

Source: Kotak Institutional Equities estimates

- **Higher inflation, large fiscal deficit to lead to increase in interest rates.** Our cautious view on interest rate-sensitive sectors reflects our concerns about a likely steep increase in interest rates over the next 12 months. We expect interest rates to harden by 150-200 bps over the next 12-15 months led by (1) steep increase in inflation and (2) credit gap led by the government's high borrowing program. Exhibit 17 shows our projected inflation trajectory for the balance period of FY2010E and for FY2011E. More important, we note that the price index has increased significantly in FY2010 even though headline inflation has been low in 1HFY10 due to base effects. Also, we expect the government's high borrowing program in FY2011E (see Exhibit 18) stemming from a high fiscal deficit in FY2011E (see Exhibit 19) to result in upward pressure on G-Sec yields and interest rates.

**Exhibit 17: Inflation headed for 9% in by end FY2010E after deflation**  
Headline WPI inflation rate (yoy), March fiscal year-ends, 2009-2011E (%)



Note:

(a) WPI data is actuals till November, 2009 and Kotak Institutional Equities estimates thereafter.

Source: Government of India, Kotak Institutional Equities estimates

**Exhibit 18: Excess supply likely to exert further pressure on G-sec yields in FY2011E**  
Demand and supply of SLR securities, March fiscal year-ends, 2008-2012E (Rs bn)

	2008	2009	2010E	2011E	2012E	2012E (a)
<b>1. Demand for SLR securities (2+3+4)</b>	<b>2,252</b>	<b>2,674</b>	<b>2,961</b>	<b>3,606</b>	<b>4,427</b>	<b>4,427</b>
2. required from banks	1,559	1,674	1,778	2,202	2,743	2,743
3. from insurance companies	534	760	915	1,098	1,318	1,318
4. from others	159	240	268	306	367	367
<b>5. Supply of SLR securities (6+7+8)</b>	<b>2,919</b>	<b>2,777</b>	<b>3,870</b>	<b>5,490</b>	<b>5,860</b>	<b>5,090</b>
6. Net market borrowing of center	1,107	2,620	4,180	4,190	4,550	4,075
7. T-bills financing	256	850	100	100	100	100
8. State government issuances	562	1,038	1,200	1,200	1,210	915
9. MSS	1,057	(803)	(860)	—	—	—
10. OMO	(62)	(928)	(750)	—	—	—
<b>11. Excess demand (1-5)</b>	<b>(667)</b>	<b>(102)</b>	<b>(909)</b>	<b>(1,884)</b>	<b>(1,433)</b>	<b>(663)</b>
<i>Memo items</i>						
NDTL	34,813	41,830	48,941	57,751	68,723	68,723
SLR ratio (% of NDTL)	25	24	25	25	25	25

Note:

(a) Assuming GST & DTC are rolled out at the start of FY2012E.

Source: Kotak Institutional Equities estimates

**Exhibit 19: Combined fiscal deficit may improve modestly ahead in FY2010E and FY2011E**  
GFD/GDP ratios in India, March fiscal year-ends, 2007-12E (%)

	2008A	2009RE	2010BE (F)	2010E	2011E	2012E	2012E(e)
Center	2.7	7.9	7.3	7.3	6.6	6.4	5.8
On-budget	2.7	6.1	6.8	7.1	6.3	6.0	5.4
Off-budget	NA	1.8	0.5	0.2	0.3	0.4	0.4
State	2.3	2.7	3.3	3.5	3.2	2.9	2.3
<b>Total</b>	<b>5.0</b>	<b>10.6</b>	<b>10.6</b>	<b>10.8</b>	<b>9.8</b>	<b>9.3</b>	<b>8.1</b>

Note:

- (a) 2008A represents actual government financials for FY2008.
- (b) 2009RE represents FY2009 revised estimates.
- (c) 2010BE (F) represents FY2010 Budget estimates.
- (d) 2010E-2012E are KIE estimate.
- (e) 2012E(e) are estimates with GST and DTC implementation.

Source: Ministry of finance, RBI, Kotak Institutional Equities estimates

### Stocks that can increase 30-40% or that can decline 20-30%

We list large-cap. stocks that could buck expectations, upwards or downwards, in CY2010. A meaningful surprise can result from (1) large earnings changes (up or down) and/or (2) meaningful re-rating due to unexpected developments (operating, M&A-related or regulatory). We are ignoring market euphoria or fear as a third reason for large changes in stock prices since such waves of sentiment do not sustain for long.

Exhibit 20 shows that the scope for large earnings upgrades and/or re-rating is limited in most sectors. As a matter of abundant caution, we caution that we could get this wrong as the events of CY2009 have shown.

**Exhibit 20: More downside risks than upside risks across various sectors**  
Assessment of risks to earnings and multiples of various sectors

	Earnings		FY2011E (X)	P/E multiple	
	Upside	Downside		Upside	Downside
Automobiles	Maruti	HH, TTMT	17.7		
Banking		HDFC	17.0		HDFC, ICICIBK
Cement			12.0		
Consumers		HUL	20.7		HUL
Energy		RIL	11.7		
Industrials	Construction		22.4		
Media	SUNTV	ZEEL	NA		
Metals	STLT, TATA		13.2	TATA	
Pharmaceuticals			23.6		CIPLA
Property		DLF, UT	22.3		DLF, UT
Technology			19.8		
Telecom		BRTI, RCOM	14.4		
Utilities		JSPL	18.6		NTPC, merchant

Notes:

- (a) FY2011E multiple for a sector represents composite multiple for stocks in that sector in the BSE-30 Index.

Source: Kotak Institutional Equities estimates

- ▶ **Scope for large positive surprise.** We see government-owned energy companies and commodity stocks amongst the few stocks with large potential upside.
  - **Government-owned energy companies.** We have waited a long time (a large part of our careers, in fact) for a favorable resolution of the subsidy issue. The current government appears keen to address the issue through a combination of (1) budgetary support for under-recoveries on cooking fuels, (2) price deregulation of auto fuels and (3) a transparent subsidy-sharing system for the upstream oil companies. Exhibit 21 compares our base-case fair valuation of BPCL, HPCL and IOCL based on 8X FY2011E EPS plus the value of investments with their likely fair valuations at higher multiples. We expect these stocks to trade at higher multiples if (1) the government bears the entire subsidy on cooking fuels and (2) the government deregulates pricing of auto fuels. Exhibit 22 shows that the FY2011E EPS and fair valuation of ONGC and OIL will increase sharply versus our FY2011E base-case scenario if (1) they do not have to bear any subsidies on auto or cooking fuels and (2) they receive market prices (say, US\$4.2/mn BTU) for all the gas sold by them.

**Exhibit 21: Fair valuation of oil marketing companies can increase steeply under full deregulation**  
Fair valuation of BPCL, HPCL and IOCL, FY2011E (Rs/share)

	BPCL	HPCL	IOCL
<b>Fair valuation using P/E multiple of 8X</b>	<b>674</b>	<b>545</b>	<b>402</b>
Fair valuation using P/E multiple of 9X	738	606	440
Fair valuation using P/E multiple of 10X	803	667	479

Source: Kotak Institutional Equities estimates

**Exhibit 22: Earnings and fair valuation of upstream companies to jump sharply in case of full deregulation**

EPS and fair valuation of ONGC and OIL, FY2011E (Rs/share)

	EPS		Fair valuation	
	ONGC	OIL	ONGC	OIL
<b>Base case</b>	<b>128</b>	<b>123</b>	<b>1,278</b>	<b>1,233</b>
Assuming nil subsidy burden	135	130	1,352	1,296
Assuming full deregulation of gas price (US\$4.2/mn BTU)	144	142	1,443	1,423

Source: Kotak Institutional Equities estimates

- **Metal companies.** Exhibit 23 compares the FY2011E EPS, fair valuation and commodity/metal price assumption of Hindalco, Hindustan Zinc, Sesa Goa, Sterlite and Tata Steel under two scenarios of (1) current spot prices for key products for each of the companies and (2) 10% higher product prices with our-base EPS and fair valuation. We look at Tata Steel in more detail since volume assumptions are also material (see Exhibit 24). We note that our FY2011E EPS and fair valuation would increase to Rs1,613 versus our base-case assumption of Rs600 if we assume (1) domestic steel prices at US\$685/ton (HRC, 10% higher versus our base-case assumption, (2) realization for Corus's volumes at US\$740/ton (10% higher) and (3) capacity utilization at 90% versus our base-case assumption of 75%.

Exhibit 23: Significant upside to metal stocks FY2011E EPS and fair valuations if commodity prices sustain at current levels

Earnings and valuation sensitivity of metal stocks to commodity prices, March fiscal year ends, 2011E

	Base case	Spot prices	10% higher prices
<b>Hindalco</b>			
Aluminium (US\$/ton)	2,200	2,230	2,420
Copper (US\$/ton)	6,000	7,375	6,600
EPS (Rs/share)	12.6	13.3	16.5
<b>Upside/(Downside) (%)</b>		<b>5.6</b>	<b>31.0</b>
Valuation (Rs/share)	134	139	170
<b>Upside/(Downside) (%)</b>		<b>3.7</b>	<b>26.9</b>
<b>Hindustan Zinc</b>			
Zinc (US\$/ton)	1,700	2,560	1,870
Lead (US\$/ton)	1,800	2,430	1,980
EPS (Rs/share)	30.4	38.9	32.1
<b>Upside/(Downside) (%)</b>		<b>28.0</b>	<b>5.6</b>
Valuation (Rs/share)	1,094	1,705	1,222
<b>Upside/(Downside) (%)</b>		<b>55.9</b>	<b>11.7</b>
<b>Sesa Goa (a) (b)</b>			
Blended iron ore (US\$/ton)	58	68	61
EPS (Rs/share)	30.4	38.9	32.1
<b>Upside/(Downside) (%)</b>		<b>28.0</b>	<b>5.6</b>
Valuation (Rs/share)	265	325	277
<b>Upside/(Downside) (%)</b>		<b>22.6</b>	<b>4.5</b>
<b>Sterlite</b>			
Aluminium (US\$/ton)	2,200	2,230	2,420
Copper (US\$/ton)	6,000	7,375	6,600
Zinc (US\$/ton)	1,700	2,560	1,870
Lead (US\$/ton)	1,800	2,430	1,980
EPS (Rs/share)	45.3	70.4	53.1
<b>Upside/(Downside) (%)</b>		<b>55.4</b>	<b>17.2</b>
Valuation (Rs/share)	777	979	839
<b>Upside/(Downside) (%)</b>		<b>26.0</b>	<b>8.0</b>
<b>Tata Steel</b>			
India Steel (US\$/ton)	625	600	685
Europe Steel (US\$/ton)	675	650	740
EPS (Rs/share)	72.7	48.9	133.2
<b>Upside/(Downside) (%)</b>		<b>(32.7)</b>	<b>83.2</b>
Valuation (Rs/share)	603	373	1,187
<b>Upside/(Downside) (%)</b>		<b>(38.1)</b>	<b>96.8</b>

Notes:

- (a) Sesa Goa -The blended realization is based on spot-to-contract mix of 80%.
- (b) Sesa Goa - Assuming unchanged contract prices and thus, increase of 5% in blended realizations.
- (b) Tata Steel - Base case assumes 75% capacity utilization level for Tata Steel Europe (Corus).
- (c) Tata Steel - Assuming 90% capacity utilization for Corus for our sensitivity analysis.

Source: Kotak Institutional Equities estimates

Exhibit 24: Higher-than-expected steel demand expected to benefit Tata Steel disproportionately  
Sensitivity of Tata Steel to utilization levels and commodity prices, March fiscal year ends, 2011E

	Base case	Spot prices	10% higher prices
<b>Tata Steel</b>			
India Steel (US\$/ton)	625	600	685
Europe Steel (US\$/ton)	675	650	740
EPS (Rs/share)	72.7	82.3	178.8
<b>Upside/(Downside) (%)</b>		<b>13.2</b>	<b>145.9</b>
Valuation (Rs/share)	603	682	1,613
<b>Upside/(Downside) (%)</b>		<b>13.1</b>	<b>167.5</b>

Notes:

- (a) Base case assumes 75% capacity utilization level for Tata Steel Europe (Corus).
- (b) Assuming 90% capacity utilization for Corus for our sensitivity analysis.

Source: Kotak Institutional Equities estimates

- ▶ **Scope for negative surprise.** We see scope for a 20-30% decline in prices of most large-cap. stocks. As discussed earlier, we find most large-cap. stocks expensive after their significant re-rating over the past 9-12 months. We highlight our concerns regarding the following three stocks.
  - **Bharti.** Our telecom team projects Bharti's FY2012E and FY2013E EPS at Rs24.2 and Rs26.1. This would suggest a fair valuation of Rs320-360 (based on 12-14X FY2013E EPS) in middle of CY2012 or whenever the market starts discounting FY2013E EPS; it may be too early to discount FY2013E even under the current 'euphoric' market conditions. In our view, the street is being overly optimistic in factoring in a consolidation in the Indian market. We expect an eventual consolidation but believe it is too early to take a call on its nature or timing.

Also, we do not rule out irrational price competition for an extended period of time — until eventual consolidation. Accordingly, we believe the stock would give ample opportunities for an entry at lower levels over the next 12-18 months. In our view, price competition has just started and pricing will continue to deteriorate, led by (1) likely low capacity utilization in networks of new players, (2) the launch of wireless services by several new players (DB-Etisalat, MTS, TATA-Docomo in several circles and Uninor) and (3) implementation of MNP in CY2010E, which will result in price competition in the post-paid segment too.

- **HDFC.** In our view, HDFC stock may be de-rated significantly if it fails to meet with the street's expectations on returns and earnings. HDFC stock trades at 4.6X FY2011E book on a consolidated basis and 5.8X FY2011E book on a core mortgage basis. We see likely pressure on HDFC's spreads over the next 12-15 months from (1) increased competition in the mortgage business, which may restrict HDFC's flexibility on lending rates and (2) likely increase in wholesale borrowing costs. We note that most mortgage players now offer differential interest-rate schemes with fixed rates of 8-8.5% for the first 12-36 months and floating rates thereafter. Exhibit 25 gives the hypothetical ROE of HDFC under various scenarios of spreads (2.5%-3%) on mortgage loans in FY2011E—our assumption for HDFC's spread on mortgage loans for FY2011E is 2.9%, which implies a 30 bps improvement over our assumed 2.6% in FY2010E.

**Exhibit 25: HDFC's core RoE will decline sharply if spreads compress**  
Du Pont analysis for HDFC in various scenarios (% of average assets)

	Base case	Case I	Case II	Case III
<b>Spread (%)</b>	<b>2.90</b>	<b>3.00</b>	<b>2.75</b>	<b>2.50</b>
<b>Net interest income</b>	<b>2.7</b>	<b>2.8</b>	<b>2.5</b>	<b>2.3</b>
Provision expenses	0.1	0.1	0.1	0.1
<b>NII post provisions</b>	<b>2.61</b>	<b>2.70</b>	<b>2.46</b>	<b>2.23</b>
Other income (incl. fees)	0.6	0.6	0.6	0.6
<b>Operating expenses</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
PBT	2.91	3.00	2.76	2.53
Tax	0.8	0.8	0.8	0.7
<b>ROA</b>	<b>2.09</b>	<b>2.16</b>	<b>1.99</b>	<b>1.82</b>
Assets to equity (X)	20	20	20	20
<b>RoE</b>	<b>41.8</b>	<b>43.2</b>	<b>39.8</b>	<b>36.4</b>

Source: Kotak Institutional Equities estimates

- **Reliance Industries.** Exhibit 26 shows our trough-case valuation at Rs700 for RIL stock compared to our Rs900 base-case valuation. Our trough-case scenario assumes (1) a US\$1/bbl lower refining margin versus our base-case margin of US\$9.1/bbl, (2) US\$50/ton lower chemical margins for key products versus our base-case assumptions, (3) an unfavorable decision in the ongoing RIL-NTPC and RIL-RNRL legal cases and the government's insistence on a price of US\$4.2/mn BTU for computing royalty, income tax and its share of profit petroleum and (4) no income tax exemption on gas production from KG D-6 block versus our current assumption of 100% exemption for the first seven years. We note that our trough-case assumptions are not very hard to envisage given (1) the current low levels of chemical and refining margins and (2) likely large surplus in global chemical and refining over the next 12-18 months.

**Exhibit 26: Trough case SOTP valuation of Reliance is Rs700 per share on FY2011E estimates**

Sum-of-the-parts valuation of Reliance Industries in the trough case scenario, FY2011E basis (Rs)

	Valuation base (Rs bn)		Multiple (X)		EV (Rs bn)	Valuation (Rs/share)
	Other	EBITDA	Multiple	EV/EBITDA		
Chemicals (a)		66		7.5	495	170
Refining & Marketing (b)		109		7.5	821	281
Oil and gas—producing		18		5.0	92	31
Gas—developing (DCF-based)	538				538	184
KG D-6 (c)	162				162	56
NEC-25	132				132	45
CBM	70				70	24
KG D-3	46				46	16
KG D-9	72				72	25
MN D-4	56				56	19
Oil—KG-DWN-98/3	83				83	28
Investments other than valued separately	49				49	17
Loans & advances to affiliates	4				4	1
Retailing	40		80%		32	11
SEZ development	75		80%		60	21
<b>Total enterprise value</b>					<b>2,174</b>	<b>745</b>
Net debt adjusted for 50% of C-WIP of E&P assets					119	41
<b>Implied equity value</b>					<b>2,055</b>	<b>704</b>

Note:

(a) We reduce chemical margins by US\$50/ton for polymers and polyesters from our base case assumptions.

(b) We reduce refining margins by US\$1/bbl from our base case assumptions.

(c) We use US\$4.2/mn BTU to compute share of profit petroleum, royalty and tax payments to government.

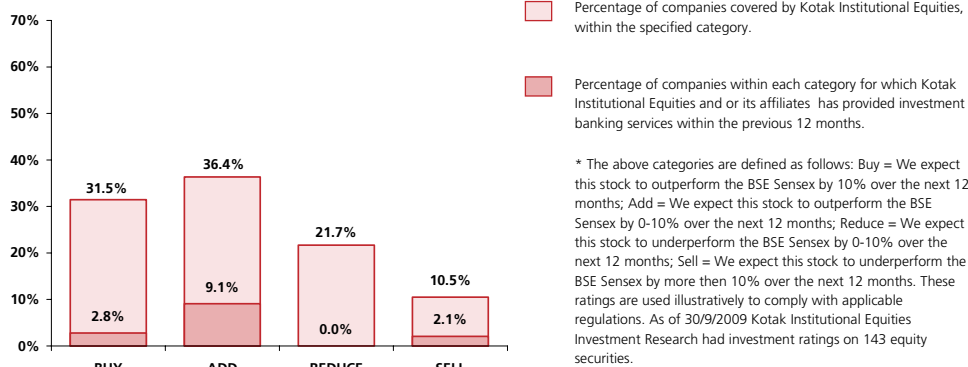
Source: Kotak Institutional Equities estimates

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