kotak® Institutional Equities

INDIA DAILY

August 14, 2007

EQUITY MARKETS

		Change, %		
India	**13-Aug**	**1-day**	**1-mo**	**3-mo**
Sensex	15,017	1.0	(1.7)	7.5
Nifty	4,374	0.9	(2.9)	5.8
Global/Regional indices				
Dow Jones	13,237	(0.0)	(4.8)	(0.8)
Nasdaq Composite	2,542	(0.1)	(6.1)	(0.2)
FTSE	6,219	3.0	(7.4)	(5.1)
Nikkie	16,797	(0.0)	(7.9)	(5.0)
Hang Seng	21,922	0.1	(5.1)	4.5
KOSPI	1,835	(0.8)	(6.5)	14.3

Value traded - India

			Moving avg, Rs bn	
	13-Aug		**1-mo**	**3-mo**
Cash (NSE+BSE)	121.8		166.7	154.2
Derivatives (NSE)	316.3		488.8	387.0
Deri. open interest	854.8		817.7	534.5

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Cement: Despatch growth impressive, prices continue to inch upwards

News Roundup

Corporate

- ONGC proposed greenfield refinery at Kakinada in Andhra Pradesh, for which the company had marked an investment of about Rs 22,000 crore, has been found commercially unviable in a pre-feasibility report. (BS)
- Lehman Brothers, the fourth largest securities firm in the US, has clinched a deal to buy institutonal broking business of mumbai-based Brics Securities. (BS)
- Tata Group chairman Ratan Tata indicated that the much-awaited rollout of the Rs1 lakh small car from the Tata Motors' Singur factory could miss the June 2008 deadline due to "vested interests". (ET)
- Indian Hotels Company Ltd (IHCL), a part of Tata Group, announced that it will raise up to Rs190 mn through a rights issue of shares and convertible debentures. (FE)
- Jet Airways' recently-launched flight to New York from Mumbai, has failed to generate a good response so far. According to government data, the first two flights registered only a 40% load factor on the high revenue-generating sector. (FE)
- Nestle India is expanding its liquid milk portfolio with specially formulated milk for people who may be lactose-intolerant or diabetic. The Rs280 mn food major plans to introduce these products in six months. (BS)
- Google has pilot tested its small and medium business (SMB) roadshow in Ahmedabad. This is one of the first few initiatives undertaken by Google to look at creating awareness for its business solutions outside the Internet. (BS)

Economic and political

- Delhi will become the first state in the country to give its residents an option of adopting the time-of-day (TOD) metering, which means shifting peak-hour activities to off-peak hours to benefit from reduced rates. (BS)
- The Budget allocation for higher and technical education in the country is set to treble in the 11th 5-Year Plan (2007-2012) with the Planning Commission expected to allocate over Rs2.6 bn, compared to Rs887 mn the 10th 5-Year Plan. (BS)
- A study by NGO Saadhan has found that 129 MFIs are present in 117 (58.50 per cent) of the 200 poorest districts in the country. The study also shows 33 per cent of MFIs' clients belong to scheduled castes and scheduled tribes. (BS)
- The size of the global Clean Development Mechanism (CDM) market is estimated to be around $20 billion. While India is the leader among the developing countries in this field and is expected to take up 20 to 25 per cent of CDM projects, eastern states like Orissa, Bihar, Jharkhand and West Bengal can benefit out of it. (BS)

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

Forex/money market

		Change, basis points		
	13-Aug	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.6	-	21	(31)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	(1)	1	(18)

Net investment (US$mn)

	10-Aug		**MTD**	**CYTD**
FIIs	(101)		1,759	9,659
MFs	(42)		112	(117)

Top movers -3mo basis

		Change, %		
Best performers	**13-Aug**	**1-day**	**1-mo**	**3-mo**
Thermax	655	2.0	17.2	59.5
Reliance Energy	753	0.7	11.6	47.3
Reliance Cap	1,124	0.9	(5.7)	38.2
BHEL	1,710	0.9	1.6	39.3
SBI	1,613	0.4	3.8	33.8
Worst performers				
Escorts	91	0.9	(22.3)	(27.3)
Polaris	122	0.2	(19.0)	(27.2)
Essel Propack	60	(0.7)	(7.6)	(20.0)
Bharat Forge	273	(0.1)	(13.6)	(21.1)
Raymond	273	(0.1)	(8.9)	(19.2)

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Technology

HCLT.BO, Rs317	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	360
52W High -Low (Rs)	366 - 271
Market Cap (Rs bn)	220.6

Financials

June y/e	2007E	2008E	2009E
Sales (Rs bn)	60.3	76.4	95.6
Net Profit (Rs bn)	12.9	12.8	15.5
EPS (Rs)	18.9	18.4	22.3
EPS gth	*65.7*	*(2.4)*	*21.2*
P/E (x)	16.8	17.2	14.2
EV/EBITDA (x)	15.4	12.5	9.8
Div yield (%)	2.5	2.5	2.5

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	67.5	-	-
FIIs	14.2	0.5	(0.3)
MFs	4.6	0.9	0.2
UTI	-	-	(0.7)
LIC	2.2	0.4	(0.3)

HCL Technologies: Solid revenue growth though margin decline higher than expected. Maintain IL rating

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- **Strong revenue growth; infrastructure services lead the way**
- **Adjusted OPM declines 140 bps qoq**
- **Net income gets a forex boost**
- **Maintain In-Line rating with a Jun '09 DCF-based target price of Rs360/ share**

HCL Technologies (HCLT) reported robust revenue growth though operating margin decline was higher than our expectations. Revenues grew 9.2% qoq to US$396 mn (our expectation was US$393 mn). EBITDA margin (ex-RSU charge) declined 170 bps qoq to 21.6%, as against our expectation of 50 bps decline. Net income (excluding stock compensation charge) of US$120 mn (our expectation was US$92 mn) was led by US$61.5 mn forex gain. We have fine tuned our EPS estimates for FY2008 to Rs18.4 (Rs18.1 earlier) and Rs22.3 (Rs22.1 earlier) for FY2009. We like the near-term growth story of HCLT. However, we believe that the next level of profitable (and sustainable) growth hinges on creation of business model differentiators (retail, life sciences etc) and strengthening capabilities in verticals scalable offshore (financial services), an area that has been the company's weakness in the past. We maintain our IL rating with an unchanged Jun '09 DCF-based target price of Rs360/ share.

Strong revenue growth; infrastructure services lead the way: HCLT reported sequential revenue growth of 9.2% to US$396 mn. The results were characterized by strong growth in all the three major segments i.e. IT services (up 7.6% qoq to US$282 mn), BPO (up 8.5% qoq to US$54 mn) and infrastructure management services (up 18.1% qoq to US$59 mn). We believe that the large multi-service deal strategy for clients outside F-200 is paying dividends. For FY2007, HCLT's revenues grew 42.4% to US$1.39 bn. Key metrics such as large accounts (US$30, 50 and 100 mn accounts), growth from large relationships and growth from new services have shown an impressive positive movement.

Adjusted OPM declines 140 bps qoq: HCLT's reported OPM (EBITDA) declined 170 bps to 21.6%. We find the extent of decline surprising, especially given that gross profit margin decline was limited to 60 bps. Higher investments in sales and marketing led to a 110 bps qoq increase in SG&A expenses (61 bps ex-currency). Including the stock compensation charge for options issued below market price, EBITDA margins declined 140 bps qoq to 20.6%. The following factors led to decline in margins including (1) increase in SG&A expenses (ex-currency) by 61 bps; (2) rupee appreciation impacted margins by 300 bps. The impact of the above factors was partly offset by (1) productivity increase gains of 143 bps and (2) increase in utilization rate that benefited the OPM by 55 bps. For FY2007, HCLT's EBITDA margin was flat at 22.2% excluding impact of stock compensation charge and 21.1%, a decline of 40 bps yoy including stock compensation charge

Net income gets a forex boost: HCLT reported net income of US$120 mn, a qoq growth of 57%. Net income was boosted by forex gains of US$61.5 mn versus US$9.6 mn in the previous quarter. HCLT has US$1.2 bn of forward contracts outstanding at end-June 2007, which have been marked to market at the quarter closing Re/US$ rate. The outstanding forward contracts are significantly higher than the net monetary assets of the company (the company indicates that it has hedged itself for six quarters of net inflows).

Focus on total IT outsourcing and flexibility on engagement models for clients outside G-200 should take care of growth in FY2008…: We model strong 35% growth in US$ terms driven by near term momentum in large deals with mid-sized clients along with excellent positioning in infrastructure services. We note that HCLT has won several large deals in the last six months including Fonterra, Skandia, Teradyne etc on the back of (a) its experience in multi-service deals (b) strength in infrastructure management services (c) ability to structure and price the deal as a single contract versus separate contracts for separate services and (d) ability and willingness to enter into different engagement models. Execution is however critical to manage profitability on such contracts, an area where HCLT appears to have delivered well. However HCLT's focus on clients outside G-200 increases risk to revenue profile.

… though strengthening vertical capabilities critical to sustainable and profitable growth in the longer term: We view strengthening of vertical capabilities as critical on two counts (a) it prevents commoditization of the services and (b) it is critical to get into core applications (especially for large clients) portfolio. Note that HCLT has a significant number of Tier 1 accounts with large applications budget where it is offering only single service (either BPO or infrastructure management). Mining of these large relationships and entry into applications with these clients hinges on pace of investments in domain expertise and solutions. We believe that even though HCLT is organized on vertical lines, the true revenue tracking measure is horizontal driven. Aggressive outsourcing by clients and competition in HCLT's focus areas makes it imperative for the company to bridge this gap. We also believe that step up in domain capabilities is important to ward of pressures from commoditization of services offered on horizontal lines. Risk also emanates from focus on smaller clients that are more sensitive to economic pressures and are candidates for M&A.

Valuations—marginally lower than historic trends: We model EPS decline of 2.4% in FY2008 and a growth of 21.2% in FY2009. Note that the decline is on account of a big boost of Rs3.28 bn of forex income in FY2007, which we are not building in our model for FY2008. The stock trades at 17.2x FY2008 earnings and 14.2xFY2009 earnings, marginally lower than historic trend. We maintain out In-Line rating on the stock with a Jun'09 DCF-based target price of Rs360/share.

Rupee appreciation and higher SG&A expenses led to margin decline in the Jun '07 quarter

	IT services	Infrastructure services	BPO	Overall
EBIT margin 3QFY07 (%)	**20.3**	**12.1**	**19.7**	**19.1**
Impact of margin levers (bps)				
Utilization rate	33	-	230	55
Per capita realization	172	34	110	143
SG&A and depreciation	(100)	172	(40)	(61)
Rupee appreciation	(320)	(169)	(360)	(300)
Others	6.0	(131.0)	-	(13)
Total impact	**(209)**	**(94)**	**(60)**	**(176)**
EBIT margin 4QFY07 (%)	**18.2**	**11.2**	**19.1**	**17.3**

Note:
(a) Other include change in business mix, impact due to pass-through revenues in IMS, etc.
(b) Margins before RSU expensing

Source: Company

Strong revenue growth momentum continued across business lines in the Jun '07 quarter

Revenues - US$mn	**Mar-05**	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**
IT services	148.4	162.6	168.9	177.7	187.1	202.1	222.3	242.7	262.4	282.4
Infrastructure services	18.9	21.9	22.0	26.7	29.3	34.0	39.8	46.4	50.2	59.3
BPO	29.5	29.7	29.7	29.7	35.1	36.3	38.4	42.0	49.7	54.0
Total	**196.8**	**214.1**	**220.6**	**234.2**	**251.5**	**272.4**	**300.5**	**331.1**	**362.3**	**395.7**
Growth qoq (%)	**Mar-05**	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**
IT services	2.6	9.5	3.9	5.2	5.3	8.0	10.0	9.2	8.1	7.6
Infrastructure services	23.3	15.5	0.8	21.3	9.7	16.0	17.0	16.6	8.2	18.1
BPO	17.1	0.7	0.1	0.1	18.0	3.5	5.8	9.4	18.3	8.7
Total	**6.3**	**8.8**	**3.1**	**6.1**	**7.4**	**8.3**	**10.3**	**10.2**	**9.4**	**9.2**

Source: Company

Key Changes to our FY2008 and FY2009 estimates

	Revised		Old		Change (%)	
US$ mn	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**
Revenues	**1,886**	**2,390**	**1,830**	**2,323**	**3.1**	**2.9**
- Software Services	*1,346*	*1,724*	*1,332*	*1,685*	*1.1*	*2.3*
- BPO	*251*	*300*	*229*	*282*	*9.7*	*6.4*
- Infrastructure Services	*288*	*366*	*269*	*357*	*7.3*	*2.5*
EBITDA	384	481	380	475	1.0	1.4
EBIT	307	389	305	384	0.6	1.2
Net Income	**316**	**388**	**300**	**366**	**5.2**	**5.8**
EBITDA margin (%)	20.4	20.1	20.8	20.4		
EBIT	16.3	16.3	16.7	16.5		
Re/ US$ rate	40.5	40.0	42.0	42.0	**(3.6)**	**(4.8)**
EPS Rs/ share	**18.4**	**22.3**	**18.1**	**22.1**	**1.5**	**0.8**

Source: Kotak Institutional Equities estimates

HCL Technologies (year ending June) - Comments on 4QFY07 financial performance

Rs mn	4QFY06	3QFY07	4QFY07	QoQ % chg.	YoY % chg.	Kotak Estimates	% Deviation	Comments on QoQ performance
CONSOLIDATED								
Revenues	**12,538**	**15,767**	**16,120**	**2.2**	**28.6**	**16,150**	**(0.2)**	Overall revenue growth of 9.2% qoq, marginally ahead of our expectations of 8.5% growth. Led by strong performance in Infrastructure services (+18.1% qoq). Software services revenues grew 7.6% qoq
Cost of Revenues	(8,034)	(9,931)	(10,186)	2.6	26.8	(10,249)	**(0.6)**	
Gross profit	**4,504**	**5,836**	**5,934**	**1.7**	**31.7**	**5,901**	**0.6**	Gross margins adjusted for RSU expenses declined marginally by 20bps.
SG&A expenses	(1,777)	(2,363)	(2,607)	10.3	46.7	(2,431)	**7.2**	
EBITDA (including RSU expenses)	**2,727**	**3,473**	**3,327**	**(4.2)**	**22.0**	**3,470**	**(4.1)**	
EBIDTA adjusted for non cash RSU charges	**2,815**	**3,664**	**3,474**	**(5.2)**	**23.4**	**3,642**	**(4.6)**	
Depreciation	(562)	(657)	(693)	5.5	23.4	(689)	**0.6**	
EBIT	2,166	2,816	2,634	(6.5)	21.6	2,781	**(5.3)**	
Other Income	54	614	2,873	368.2	5,189.5	1,425	**101.6**	Other income for 4QFY07 includes US$61.5 mn of mark to market forex gains (vs. US$9.6 mn in the last quarter)
Earnigs before tax	**2,220**	**3,429**	**5,507**	**60.6**	**148.1**	**4,206**	**30.9**	
Provision for Tax	23	(283)	(777)	174.7	(3,409.9)	(286)	**172.1**	
Earnings after & before share of earnings in affiliates	**2,244**	**3,146**	**4,730**	**50.3**	**110.8**	**3,921**	**20.6**	
Share of income (loss) of equity investees	7	(4)	(3)			-		
Minority Interest	(8)	(22)	(7)			-		
Net Income (before extraordinaries)	**2,242**	**3,120**	**4,720**	**51.3**	**110.5**	**3,921**	**20.4**	Adjusted net margin ahead of our expectations on account of higher than expected forex gains
EPS	**3.5**	**4.5**	**6.8**	**51.3**	97.7	**5.7**	**20.4**	
No of shares outstanding	648.0	690.0	690.0			690.0		
Margins (%)								
Gross Profit margin	35.9	37.0	36.8			36.5		
EBITDA Margin	21.8	22.0	20.6			21.5		
EBIT Margin	17.3	17.9	16.3			17.2		
NPM	28.2	19.8	29.3			24.3		
Software Services Business								
Revenues	**9,301**	**11,420**	**11,505**	**0.7**	**23.7**	**11,734**	**(2.0)**	Revenue growth of 7.6% in US$ terms led by (a) 6.5% overall volume growth, 6.2% offshore and 7.2% onsite and (b) 1.8% improvement in offshore pricing; onsite flat
Cost of Revenues	(5,826)	(6,915)	(6,987)	1.0	19.9	(7,199)	**(3.0)**	
Gross profit	3,476	4,504	4,518	0.3	30.0	4,534	**(0.4)**	
S G & A expenses	(1,315)	(1,797)	(2,012)	11.9	53.0	(1,847)	**8.9**	
EBITDA	**2,161**	**2,707**	**2,506**	**(7.4)**	**16.0**	**2,688**	**(6.8)**	OPM decline of 190bps qoq driven by a 180bps increase in SG&A expenses (as % of revenues) qoq
Depreciation	(323)	(387)	(416)	7.4	28.9	(375)	**11.1**	
EBIT	1,838	2,320	2,090	(9.9)	13.7	2,313	**(9.6)**	
Margins (%)								
Gross Profit margin	37.4	39.4	39.3			38.6		
EBITDA Margin	23.2	23.7	21.8			22.9		
EBIT Margin	19.8	20.3	18.2			19.7		
BPO Services								
Revenues	**1,671**	**2,163**	**2,198**	**1.6**	**31.5**	**2,152**	**2.1**	Revenue growth of 8.5% qoq in US$ terms impressive. Realizations improved 1.8% qoq
Cost of Revenues	(1,093)	(1,327)	(1,334)	0.5	22.1	(1,337)	**(0.3)**	
Gross profit	**579**	**836**	**864**	**3.4**	**49.3**	**815**	**6.1**	
S G & A expenses	(198)	(261)	(298)	14.1	50.6	(269)	**10.9**	
EBITDA	**381**	**574**	**566**	**(1.5)**	48.7	546	**3.7**	EBITDA margin decline of 80bps qoq lower than our expectations
Depreciation	(131)	(148)	(145)	(2.0)	10.5	**(163)**	**(10.9)**	
EBIT	**249**	**426**	**421**	**(1.3)**	**68.7**	**383**	**9.9**	
Margins (%)								
Gross Profit margin	34.6	38.6	39.3			37.9		
EBITDA Margin	22.8	26.6	25.8			25.4		
EBIT Margin	14.9	19.7	19.2			17.8		
Infrastructure Services								
Revenues	**1,565**	**2,185**	**2,417**	**10.6**	**54.4**	**2,264**	**6.8**	Revenue growth (+18.1% qoq) significantly ahead of our expectations. YoY growth of 74.5% very impressive in a increasingly competitive market. Volumes grew 11.2% qoq while realizations improved 1%
Direct Cost	(1,028)	(1,497)	(1,718)	14.8	67.1	(1,539.5)	**11.6**	
Gross Profit	**538**	**688**	**699**	**1.7**	**30.0**	**724.5**	**(3.5)**	
SG&A	(264)	(305)	(296)	(2.8)	12.0	(315.7)	**(6.2)**	
EBITDA	**273**	**383**	**403**	**5.2**	**47.4**	**408.8**	**(1.4)**	EBITDA margin declined 80bps qoq
Depreciation & Amortization	(108)	(122)	(131)	7.5	21.6	(151.2)	**(13.4)**	
EBIT	**166**	**261**	**272**	**4.2**	**64.1**	**257.5**	**5.6**	
Margins (%)								
Gross Profit margin	34.3	31.5	28.9			32.0		
EBITDA Margin	17.5	17.5	16.7			18.1		
EBIT Margin	10.6	12.0	11.3			11.4		

HCL Technologies- Profit and Loss Statement, June Year End

Rs mn	FY2005	FY2006	FY2007	FY2008E	FY2009E
Revenues	**33,700**	**44,002**	**60,337**	**76,370**	**95,592**
RSU expenses		279	612	680	672
Direct Costs	21,166	27,576	37,604	48,168	60,817
Gross Profit	**12,534**	**16,147**	**22,122**	**27,521**	**34,103**
SG&A	4,810	6,577	9,370	11,960	14,846
EBIDTA (excl other income)	**7,723**	**9,570**	**12,752**	**15,562**	**19,257**
Depreciation	1,555	2,032	2,534	3,145	3,715
EBIT	6,168	7,538	10,218	12,417	15,542
Interest income/(Expenses)	991	578	4,262	1,810	2,244
Earnings Before Tax	7,159	8,116	14,480	14,227	17,786
Tax	674	626	1,489	1,423	2,273
Income bef share of equity investees	**6,485**	**7,490**	**12,990**	**12,804**	**15,513**
Share of income (loss) of equity investees	(27)	-	-	(9)	(4)
Minority Interest	442	16	52	-	-
Net Income	**6,016**	**7,473**	**12,938**	**12,795**	**15,509**
Less: Stock sales incentive	-	-	-	-	-
Net Income after stock sales incentive	**6,016**	**7,473**	**12,938**	**12,795**	**15,509**
Less: Extraordinary items	-	(1,290)	-	-	-
Net Income	**6,016**	**6,183**	**12,938**	**12,795**	**15,509**
EPS (Rs.) fully diluted	**9.5**	**11.4**	**18.9**	**18.4**	**22.3**
Margins (%)					
Gross Profit Margin	37.2	36.7	36.7	36.0	35.7
EBITDA margin	22.9	21.7	21.1	20.4	20.1
EBIT margin	18.3	17.1	16.9	16.3	16.3
Net Profit	19.2	17.0	21.5	16.8	16.2
Net Income margin	17.9	17.0	21.4	16.8	16.2
SG&A expenses	14.3	14.9	15.5	15.7	15.5
Tax Rate	9.4	7.7	10.3	10.0	12.8
Growth (%)					
Revenue Growth	28.9	30.6	37.1	26.6	25.2
Gross Profit	32.7	28.8	37.0	24.4	23.9
EBITDA	39.4	23.9	33.3	22.0	23.7
EBIT	40.7	22.2	35.6	21.5	25.2
Net Profit	8.6	15.5	73.4	(1.4)	21.2
Net Income	14.3	24.2	73.1	(1.1)	21.2

Source: Kotak Institutional Equities estimates

Property

SOBH.BO, Rs797	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	930
52W High -Low (Rs)	1179 - 620
Market Cap (Rs bn)	58.1

Financials

April y/e	2007E	2008E	2009E
Sales (Rs bn)	11.9	19.6	31.7
Net Profit (Rs bn)	1.6	2.6	3.7
EPS (Rs)	22.1	36.1	51.3
EPS gth	*1.0*	*63.2*	*42.2*
P/E (x)	36.0	22.1	15.5
EV/EBITDA (x)	24.7	16.1	11.1
Div yield (%)	0.3	0.4	0.5

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	87.0	-	-
FIIs	7.5	0.1	0.1
MFs	0.5	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Sobha Developers: 1QFY08 revenues below estimates; Margins higher than our estimates

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- **1QFY08 revenues below estimates; grow 30% on a yoy basis**
- **We reduce number of new project launches for FY2008**
- **Retain outperform rating with revised target price of Rs930**

Sobha Developers (Sobha) reported revenues of Rs2.7 bn (v/s our expectation of Rs3.3 bn) and PAT of Rs0.4 bn (v/s our expectation of Rs0.46 bn) for 1QFY08. Operating margin of 25.1% is 330 bps better than our expectations of 21.8%. Higher operating margins have resulted from higher revenue booking from higher margin residential projects and better price realizations. Revenue estimates have been below expectations largely because new project launches have been delayed. Going forward, we delay project launches in new cities by six months. As a result, we revise our revenue estimates to Rs19.6 bn for FY2008 (Rs21.8 bn earlier) and Rs31.7 bn for FY2009 (Rs37.2 bn earlier). We revise out PAT estimates to Rs2.6 bn in FY2008 (Rs2.9 bn earlier) and Rs3.7 bn in FY2009 (Rs4.3 bn earlier). We retain outperform rating on the company and revised target price of Rs930.

We delay new project launches by six months.

We note that Sobha's expansion into new cities has been delayed by regulatory clearances. Sobha is planning to expand its footprint by launching projects in three more cities—Mysore, Coimbatore and Pune. Furthermore, launches in Bangalore have been lower-than-expected to lower sales from ongoing projects. As a result, we lower our sales expectation to 4.4 mn sq. ft in FY2008 compared to 5.8 mn sq. ft earlier.

The land acquisition process for Sobha continues to be strong. Currently, Sobha has access to land reserves of more than 3,500 acres with developable potential of 150 mn sq. ft In the past quarter, Sobha launched a 3.5 mn sq. ft integrated township project in Trissur. Subsequently, Sobha is now executing 30 projects in residential business equivalent to 11 mn sq. ft and four commercial projects totaling 0.3 mn sq. ft. Sobha is also planning to launch 15 projects totaling 10 mn sq.ft including 6.9 mn sq. ft of residential projects over next two quarters.

We lower our Mar'08-based target price to Rs930/share; retain Outperform rating

Due to delay in project launches our NAV for residential business decreases to Rs87.3 bn (Rs87.9 bn earlier). We continue to base our target price at 10% discount to NAV since Sobha needs to pay Rs10 bn (50% of total land cost) to complete acquisition of its land reserves. As a result, our value of residential business goes down to Rs851/share compared to Rs860/share earlier. We revise our target price to Rs930/ share wherein our value of contractual business contributes Rs76/share.

Sobha Developers :1QFY2008 results

(in Rs mn)	1QFY2007	4QFY2007	1QFY2008	% chg. qoq	% chg. yoy	Kotak estimates 1QFY07	% deviation	FY07	FY08E	% chg.
Net sales	**2,054**	**3,573**	**2,677**	**(25.1)**	**30.3**	**3,268.0**	**(18.1)**	**11,865**	**19,608**	**65.3**
Operating costs	**(1,702)**	**(2,673)**	**(2,006)**	**(24.9)**	**17.9**	**(2,557.0)**		**(9,303)**	**(15,406)**	**65.6**
(Increase)/Decrease intock in inventories	287	380	264	(30.5)	(7.9)			1,017		
Land cost expenses	(94)	(754)	(131)	(82.6)	39.2			(1,832)	(1,671)	
Construction expenses	(933)	(1,433)	(1,082)	(24.5)	16.0			(4,952)	(11,054)	
Raw material consumption	(445)	(178)	(282)	58.3	(36.7)			(1,051)		
Production expenses	(67)	(52)	(57)	9.8	(15.1)			(236)		
Staff cost	(144)	(261)	(221)	(15.5)	52.6			(707)	(917)	
Other administrative expenses	(305)	(375)	(498)	32.8	63.3			(1,542)	(1,765)	
EBITDA	**352**	**900**	**671**	**(25.5)**	**90.5**	**711**	**(5.7)**	**2,562**	**4,202**	**64.0**
Other income	3	16	15	(6.3)	400.0	10.0		29	16	(45.0)
Interest costs	(130)	(87)	(101)	16.1	(22.3)	(120.0)		(481)	(821)	70.7
Depreciation	(49)	(67)	(83)	23.9	69.4	(75.0)		(244)	(417)	71.0
PBT	**176**	**762**	**502**	**(34.2)**	**184.8**	**526**		**1,866**	**2,980**	**59.7**
Taxes	(8)	(143)	(93)	(35.0)	1,062.5	(63.0)		(251)	(349)	39.0
PAT	**168**	**619**	**409**	**(34.0)**	**143.1**	**463**	**(11.7)**	**1,615**	**2,631**	**62.9**
Key ratios										
EBITDA margin (%)		25.2	25.1			21.8		21.6	21.4	
PAT margin (%)		17.3	15.3			14.2		13.6	13.4	
Effective tax rate (%)		18.8	18.5			12.0		13.5	11.7	

Source: Company data, Kotak Institutional Equities

Our SOTP band target price revised to Rs930

		Valuation (Rs bn)	Per share
Land Reserves (growth rate in selling price = 5%, discount rate = 14%)	10% Discount to NAV	78.5	1,077
Less: Land cost to be paid		(11.5)	(158)
Less: Net Debt		(5.0)	(69)
Contractual business		5.6	76
Fair price			**927**

Source: Kotak Institutional Equities.

Profit model of Sobha Developers, March fiscal year-ends, 2005-2010E (Rs mn)

	2005	2006P	2007E	2008E	2009E	2010E
Total revenues	**4,629**	**6,277**	**11,865**	**19,608**	**31,655**	**45,393**
Land costs	(1,054)	(781)	(1,832)	(1,671)	(3,275)	(4,413)
Construction costs	(2,344)	(2,975)	(5,222)	(11,054)	(17,428)	(24,617)
Employee costs	(221)	(286)	(707)	(917)	(1,430)	(2,231)
SG&A costs	(376)	(829)	(1,542)	(1,765)	(3,007)	(4,312)
EBITDA	**634**	**1,407**	**2,563**	**4,202**	**6,515**	**9,820**
Other income	23	8	29	16	24	36
Interest	(109)	(219)	(481)	(821)	(1,265)	(1,595)
Depreciation	(74)	(112)	(244)	(417)	(579)	(800)
Pretax profits	**473**	**1,083**	**1,866**	**2,980**	**4,695**	**7,460**
Extraordinary items	—	—	—	—	—	—
Current tax	(123)	(188)	(251)	(342)	(971)	(2,106)
Deferred tax	(11)	(0)		(7)	16	(63)
Net income	**339**	**892**	**1,615**	**2,631**	**3,741**	**5,291**
Adjusted net income	**339**	**892**	**1,615**	**2,631**	**3,741**	**5,291**
EPS (Rs)						
Primary	5.3	14.0	24.5	36.1	51	73
Fully diluted	5.3	14.0	24.5	36.1	51	73
Shares outstanding (mn)						
Year end	63	63	73	73	73	73
Primary	63	63	66	73	73	73
Fully diluted	63	63	66	73	73	73
Cash flow per share (Rs)						
Primary	7	15	29	42	59	84
Fully diluted	7	15	29	42	59	84
Growth (%)						
Net income (adjusted)	281	163	81	63	42	41
EPS (adjusted)	281	161	75	47	42	41
DCF/share	277	114	93	46	41	43
Cash tax rate (%)	26	17	11	11	21	28
Effective tax rate (%)	28	17	12	12	20	29

Source: Kotak Institutional Equities estimates.

Metals

Company	Rating	Price, Rs 13-Aug	Target
Tata Steel	U	644	640
JSPL	OP	3,863	4,500
Sesa	IL	1,786	1,950
JSW	IL	629	700

CISA estimates might go for a toss—July steel exports data

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- **China exported 5.9mnt of steel in Jul-07, up 66% on a yoy basis. China Iron and Steel Association (CISA) has predicted de-growth of 31% for Jul-Dec 2007**
- **CISA's full-year steel exports estimates will likely go for a toss unless drastic measures are taken to curb exports or reduce production**
- **We maintain our estimates of lower steel prices for balance part of 3Q and first half of 4Q CY07. Steel stocks have corrected in recent past; we maintain our rating for the time being**

We believe CISA's estimates of steel exports for CY2007 might turn out to be very conservative, given the strong growth it reported for Jan-Jul 2007. We maintain our estimates of lower steel prices for the next six months, as also our ratings ('U' on Tata Steel, 'IL' on JSW Steel and Sesa Goa and 'OP' on JSPL

China exported 5.9 mnt of steel in Jul-07

China exported 5.9 mnt of steel in July-07, up 66% on yoy basis. Net exports (net of imports) stood at 4.6 mnt, up 122% on a yoy basis. YTD (Jan-Jul 2007) gross exports at 40 mnt are up 92% on yoy basis. It was widely believed that exports from China would slow down drastically given the recently imposed licensing requirements and export-tax of 5-10%. However, Jun-Jul 2007 (post export duties) export average at 6.1 mnt is higher than Jan-May 2007 (pre duties) average of 5.5 mnt. In addition, domestic steel prices in China have increased, thereby suggesting that exports might not slow as widely expected. Exhibit 1 gives details on gross and net steel exports by China over the past two years.

CISA steel exports estimates would likely go for a toss

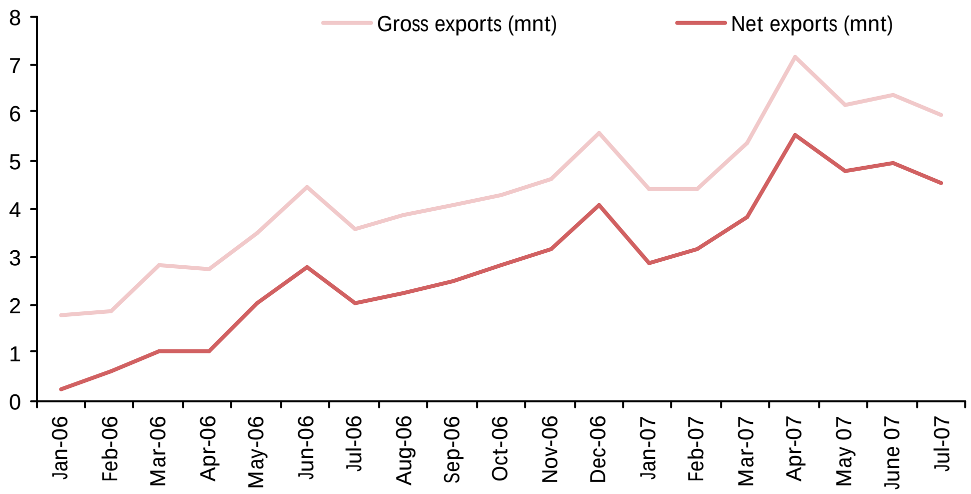
We believe that CISA's gross steel exports estimates for CY2007 would likely go for a toss given developments over the past few months unless drastic measures are taken to reduce production or curb exports. CISA had estimated that gross-exports will likely slow down to 18 mnt in Jul-Dec 07, down 31% yoy. To achieve those numbers , Chinese exports will have to slow down to 11.9 mnt for Aug-Dec 07, down 47% yoy. We believe this would be a challenge given two factors: (a) Monthly steel production in China is on a rise and growth rates in China higher than in the rest of the world and (b) apparent consumption growth in Jan-Jun 07 of 12.3% has to rise to 13.3% for Jul-Dec 07 for CISA numbers to be realized, which looks difficult. Exhibit 2 shows our analysis of CISA estimates.

Maintain our call of lower steel prices

We maintain our call of lower steel prices for the rest of 3Q and first half of 4QCY07. We continue to believe that (a) China will continue to export despite the recently imposed tax, (b) US net imports will likely slow down and (c) European imports will likely slow down. Steel stocks have corrected after our report, however, we continue to maintain our ratings ('U' on Tata Steel, 'IL' on JSW Steel and Sesa Goa and 'OP' on JSPL).

Steel-export growth has been much faster in the past than expected by CISA

Gross and net export of steel products, December fiscal-year ends (million tonnes)



Source: Steelhome, CISA, Kotak Institutional Equities estimates

CISA steel-exports estimates might go for-a-toss

Analysis of CISA claims on production and net exports, December fiscal year-ends (million tonnes)

	2006	2007E	Incremental volume	Growth (%)	Comments
Production	**423**	**480**	**57**	**13.5**	2007E are CISA estimates
Jan-Jun production	199	238	39	19.5	
Implied Jul-Dec production	224	242	18	8.1	CISA expects production growth to slow down
Gross-exports	**43**	**52**	**9**	**19.9**	2007E are CISA estimates
Jan-Jun gross-exports	17	34	17	97.8	Strong growth in 1st half exports
Implied Jul-Dec gross-exports	26	18	(8)	(31.4)	CISA expects gross-exports to de-grow in 2nd half of CY2007
Adjusted consumption	**380**	**428**	**48**	**12.7**	Production less gross exports (see note a)
Jan-Jun adjusted-consumption	182	204	22	12.1	
Implied Jul-Dec adjusted-consumption	198	225	26	13.3	

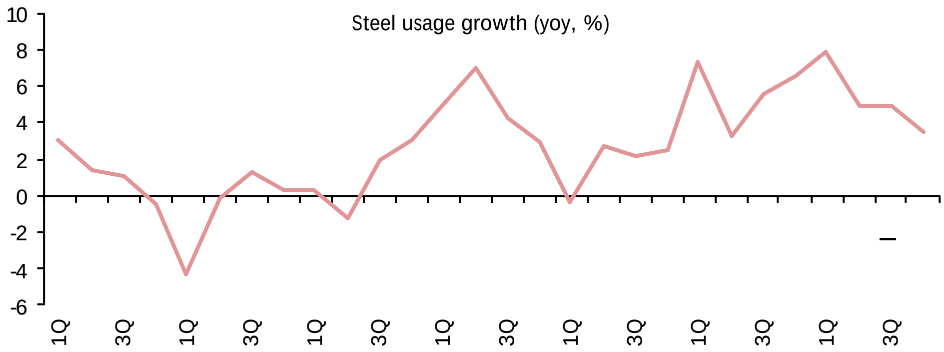
Notes

(a) Adjusted consumption is production adjusted for gross-exports. Ideally, we compare apparent consumption which is production adjusted for net exports; CISA however, has not given its forecast for net exports for CY2007.

Source: CISA, Steelhome, Kotak Insitutional Equities estimates

EU consumption growth to reduce in 3/4Q CY07

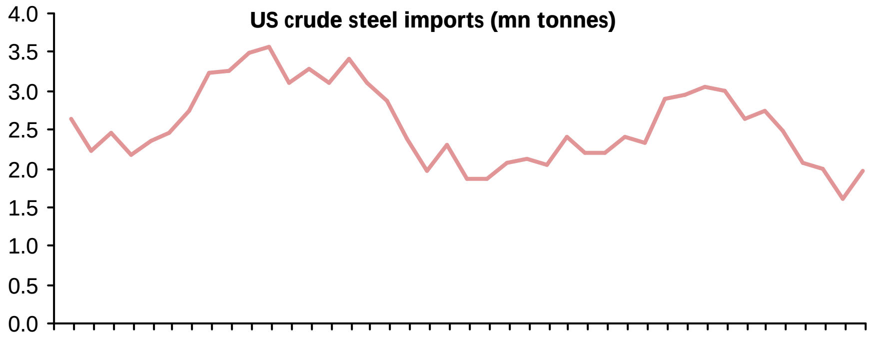
Total steel usage year-over-year growth (%)



Source: Eurofer estimates, compiled by Kotak Institutional Equities

US crude steel imports have moderated in 2007

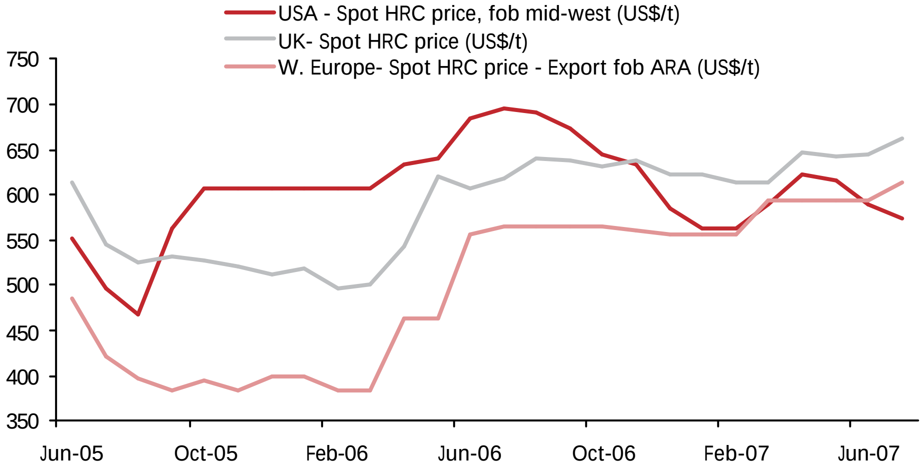
US crude steel imports, Jan 2004 to recently published data (million tonnes)



Source: US Census Bureau, Kotak Institutional Equites

US steel prices have moderated, European steel prices expected to follow suit

Spot HRC prices in US, UK and Western Europe, June'05-July'07, US$/t



Source: CRU, Kotak Institutional Equities

Cement

Sector coverage view			Cautious

		Price, Rs	
Company	**Rating**	**13-Aug**	**Target**
Gujarat Ambuj	IL	130	130
ACC	U	1,012	900
Grasim	IL	2,937	2,900
India Cements	IL	221	200
UltraTech Cem	U	906	750
Shree Cement	IL	1,258	1,300

Despatch growth impressive, prices continue to inch upwards

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- **Impressive despatch growth of 12% yoy in July 2007**
- **Average cement prices increase to Rs229/bag, led by increase in cement prices in South India**
- **We retain Cautious view on the sector**

Impressive despatch growth of 12% yoy in July 2007. Cement despatches recorded an impressive growth of 12% yoy in July 2007. The YTD growth for the industry now stands at 8.6% against our estimate of 10% for FY2008. All the major cement producers have reported double-digit volumes growth in the month of July 2007. We expect despatches for Ambuja Cements to be affected in the month of August 2007 due to the incessant rains and flooding which forced a shutdown of the company's facilities in the state of Gujarat. We note that the facilities are fully insured against loss arising due to floods and the company is currently in the process of assessing damages.

Cement prices move up to Rs229/bag (Rs225/bag in June) led by price increases in South India. All India average cement prices during July 2007 increased to Rs229/bag, 15% yoy increase. Prices in South India continued to surge ahead of the rest of the regions with a Rs6/bag increase during the month of July 2007. Barring the south, prices in the rest of the country increased by Rs2/bag on an average. We note that the current supply-demand balance remains in favor of cement manufacturers, who are likely to retain their pricing power (barring any government intervention) till the first few months of FY2009. Commissioning of new capacities in 1QFY2009 will likely change this pricing equation, in our view.

We retain our Cautious view on the sector. We note that while the next few quarters will be good for cement manufacturers, new capacities getting commissioned in FY2009 will likely change the currently favorable demand-supply environment. We estimate 30 mn tpa of new capacity to get commissioned in FY2009, far exceeding the incremental cement demand. Government intervention remains a key risk to the sector in the interim.

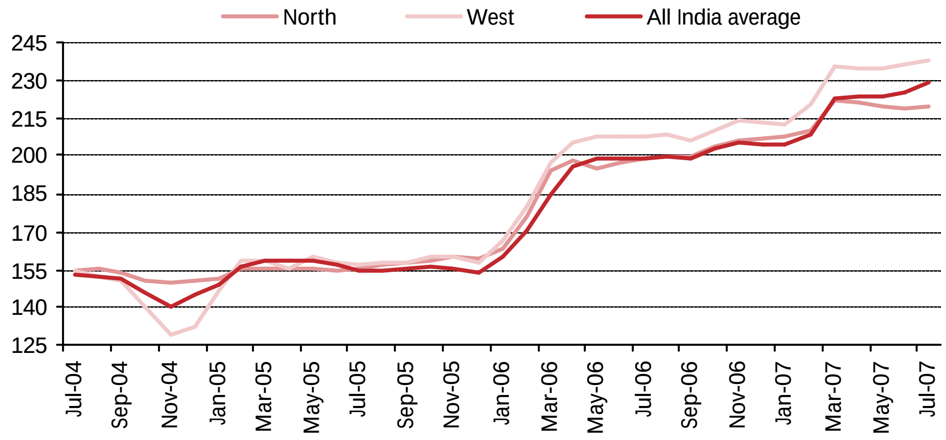
Exhibit 1: Cement despatch growth rates for major companies

	Jul-07	Growth (%)	
	(mn tons)	y-o-y	YTD
ACC	1.62	13.6	10.8
Gujarat Ambuja	1.39	19.6	4.0
UltraTech	1.08	13.6	2.1
Grasim Industries	1.31	12.8	9.8
Shree Cement	0.44	39.3	26.6
India Cements	0.81	7.6	4.8
Madras Cements	0.47	(2.7)	8.4
Industry	**13.3**	**12.0**	**8.6**

Source: CMA, Kotak Institutional Equities.

Exhibit 2: Cement prices moved up marginally during July

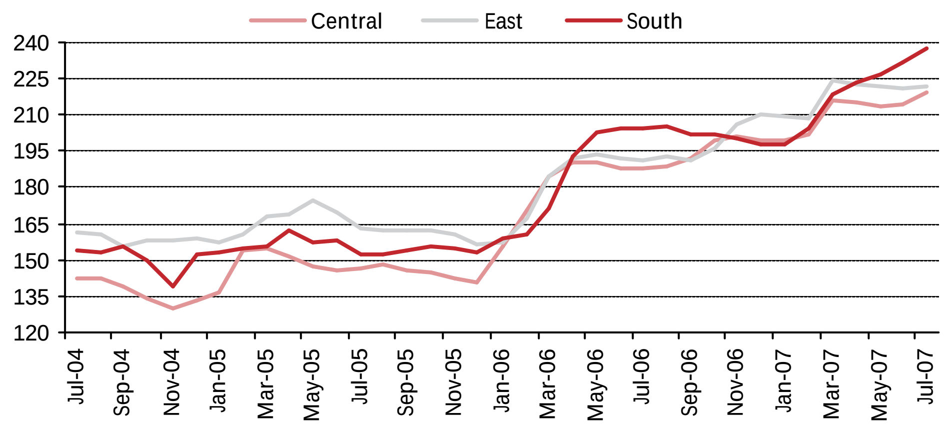
Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities.

Exhibit 3: Cement prices in South have increased more sharply than other regions

Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities.

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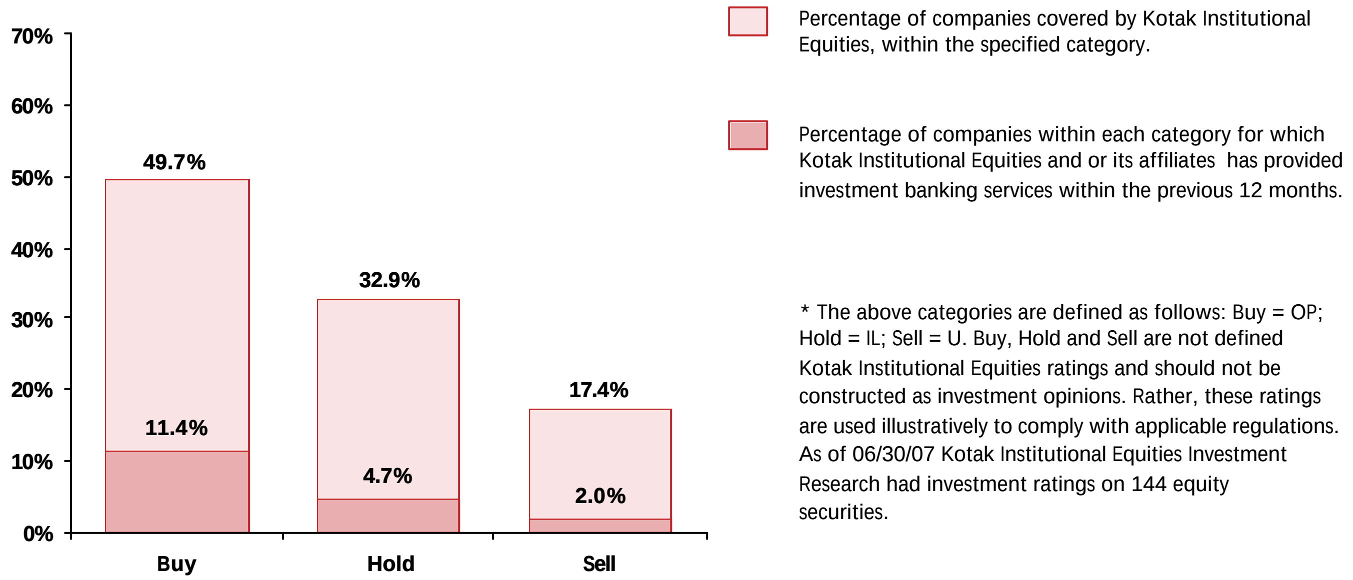

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Source: Kotak Institutional Equities. As of June 30, 2007

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