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### News Round-up

- ▶ Shares of state-run northeast explorer **Oil India Ltd** settled at over **8% over their issue price** on Wednesday, the day of debut on the Bombay Stock Exchange. The scrip **closed at Rs 1,140** on the BSE (Rs 1,135, up 7.48% on the NSE), though it had opened marginally down. (ET)
- ▶ **Tata Teleservices Ltd (TTSL) joined state-owned BSNL for sharing infrastructure** across the nation, in a first such partnership that would help the private firm expand its GSM network. The agreement, which is **valid for 15 years**, will be applicable to both TTSL and TTSL (Maharashtra) Ltd in all of India's 22 telecom circles. (BS)
- ▶ **Taro filed a fresh suit against Sun Pharmaceuticals**, alleging that the Indian drug major had kept Taro shareholders in the dark over the US regulatory action against Sun's subsidiary Caraco. Taro also alleged that Sun used confidential information about Taro, which it gathered as part of the proposed merger transaction, to harm Taro's business relationships and undermine Taro's revenues. (BS)
- ▶ **ValueFirst Messaging**, an enterprise mobility and communication services company, today **acquired Cellnext Solutions**, a subsidiary of Escorts — an engineering conglomerate operating in agri-machinery, construction and material handling equipment sectors, along with railway equipment and auto components. (BS)
- ▶ Glenmark Pharmaceuticals Ltd's subsidiary **Glenmark Generics Ltd (GGL)**, which on Wednesday **filed the draft red herring prospectus (DRHP)** with Securities and Exchange Board of India (Sebi) for an initial public offer (IPO), is looking **to raise Rs5.5-6 bn** from the share sale. (BS)
- ▶ **Talks between Bharti Airtel and MTN Group** to create the world's third-largest mobile operator **collapsed** for the second time in just over a year on Wednesday over South Africa's reluctance to allow a flagship corporate to lose its national character. (ET)
- ▶ **Hindustan Construction Company Ltd (HCC)** has **signed a memorandum of understanding (MoU)** with **AMEC Plc**, a UK-based engineering and project management company, to provide consultancy and engineering services for nuclear power plants in India. (BS)

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

### EQUITY MARKETS

India	Change %			
	30-Sep	1-day	1-mo	3-mo
Sensex	17,127	1.6	10.1	16.9
Nifty	5,084	1.5	9.9	17.1
<b>Global/Regional indices</b>				
Dow Jones	9,712	(0.3)	4.3	14.2
Nasdaq Composite	2,122	(0.1)	7.8	15.0
FTSE	5,134	(0.5)	6.5	18.3
Nikkie	10,006	(1.3)	(5.0)	0.7
Hang Seng	20,955	(0.3)	5.5	14.0
KOSPI	1,656	(1.0)	2.0	17.3
<b>Value traded - India</b>				
Cash (NSE+BSE)	266.1	245.6	240.3	
Derivatives (NSE)	554.1	601.1	524	
Deri. open interest	867.1	713	602	

### Forex/money market

	Change, basis points			
	30-Sep	1-day	1-mo	3-mo
Rs/US\$	48.1	5	(75)	-
10yr govt bond, %	7.2	-	(20)	16
<b>Net investment (US\$m)</b>				
	29-Sep		MTD	CYTD
FIs	230		-	10,936
MFs	(22)		-	575

### Top movers -3mo basis

	Change, %			
	30-Sep	1-day	1-mo	3-mo
<b>Best performers</b>				
TTMT IN Equity	591.2	(0.2)	14.6	97.3
BHFC IN Equity	276.9	0.8	27.6	95.4
HCLT IN Equity	340.8	1.7	14.5	79.4
ABAN IN Equity	1594.1	2.6	0.8	78.3
RBXY IN Equity	403.5	1.0	26.2	63.9
<b>Worst performers</b>				
BJFIN IN Equity	278.5	0.1	(1.6)	(26.0)
ADE IN Equity	665.9	(1.0)	(4.9)	(17.0)
MSEZ IN Equity	519.9	(1.2)	(2.9)	(14.5)
SUEL IN Equity	91.6	(1.0)	(3.8)	(14.2)
MTNL IN Equity	91.5	0.7	(2.6)	(10.2)

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**OCTOBER 01, 2009**
**INITIATING COVERAGE**

Coverage view: **Attractive**

Price (Rs): **1,141**

Target price (Rs): **1,350**

BSE-30: **17,127**

**East side story.** We expect Oil India (OIL) to likely create significant value from its current large oil and gas reserves and solid exploration abilities. We initiate coverage with a BUY rating and 12-month target price of Rs1,350 based on 10X FY2011E EPS. Our positive view stems from OIL's production profile, attractive valuations and strong financials.

**Oil India Limited**

Company data	Stock data	High	Low	Price performance	1M	3M	12M	
Rating: BUY	52-week range			Absolute (%)				
	Priced at close of:	September 30, 2009		Rel. to BSE-30 (%)				
Current price (Rs)	Capitalisation	Forecasts/valuation			2009	2010E	2011E	
1,141	Market cap (Rs bn)	274			EPS (Rs)	101.2	123.1	133.5
	Net debt/(cash) (Rs bn)	(60)			P/E (X)	11.3	9.3	8.5
	Free float (%)	21.6			RoAE (%)	22.8	22.6	20.9
	Shares outstanding (mn)	240			EV/EBITDA (X)	6.5	4.6	4.1

Source: Company, Kotak Institutional Equities estimates

**Attractive valuations—BUY rating with 12-month target price of Rs1,350**

We initiate coverage on OIL with a BUY rating and 12-month target price of Rs1,350 based on 10X FY2011E EPS. We find OIL's valuations attractive at current levels with the stock trading at 8.5X FY2011E EPS and 6.1X FY2011E EV/DACF. Our reverse valuation analysis indicates that OIL stock is discounting US\$60/bbl crude oil price in perpetuity, which seems low—factoring in the risks to earnings that emanate from an uncertain subsidy-sharing mechanism.

**Upside potential—favorable subsidy-sharing, natural gas price increase and new discoveries**

We highlight that subsidy-sharing mechanism will likely be the key to OIL's earnings and stock performance. We expect OIL to benefit significantly from a more favorable subsidy-sharing scheme versus the current uncertain one. We currently model upstream companies to bear 50% share of auto fuel subsidy in the absence of a clear policy. We see a potential EPS upside of Rs20/share from the increase of natural gas prices. Finally, the establishment of additional reserves in existing producing blocks or announcement of new discoveries will be a positive.

**Strong cash flow generation, net income driven by volume growth, higher crude price**

We expect OIL's EPS to increase to Rs123 in FY2010E and Rs134 in FY2011E versus Rs101 in FY2009 led by (1) higher crude price (net realized basis), (2) higher volumes and (3) more favorable subsidy-sharing scheme. We expect OIL to generate strong free cash flows of Rs62 bn over FY2010-12E. We model oil and gas production to increase to 112,350 boe/d in FY2012E compared to 97,950 boe/d in FY2009. We assume Dated Brent crude price at US\$65/bbl in FY2010E and FY2011E and US\$75/bbl on a normalized long-term basis.

**Key risks—unfavorable subsidy-sharing scheme, lower-than-expected crude price, regulations**

We see three key risks to OIL's revenues, earnings and valuation—(1) unfavorable subsidy-sharing scheme, which may result in higher-than-expected burden for upstream companies, (2) sharp decline in crude price, which would be negative for OIL's cash flows and earnings and (3) unfavorable developments in E&P regulations.

**QUICK NUMBERS**

- **OIL trading at 8.5X FY2011E EPS and 6.1X FY2011E EV/DACF**
- **Current stock price discounting US\$60/bbl crude oil price in perpetuity**
- **EPS to increase to Rs123 in FY2010E and Rs134 in FY2011E versus Rs101 in FY2009**

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## Moderate growth in volumes over the next few years

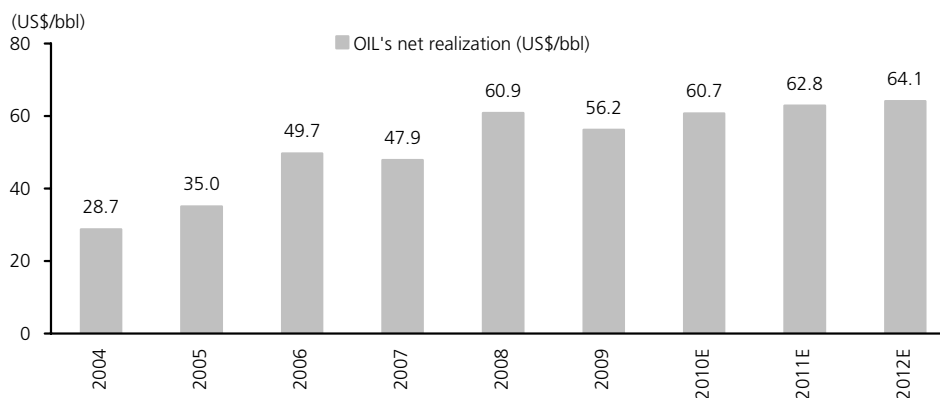
Key assumptions, March fiscal year-ends, 2006-2012E

	2006	2007	2008	2009	2010E	2011E	2012E
Rs/US\$ rate	44.3	45.3	40.3	45.8	48.0	47.8	47.5
Subsidy share scheme loss (Rs mn)	9,775	19,938	23,051	30,233	5,250	2,750	7,500
Import tariff on crude oil (%)	5.1	5.1	5.2	0.9	—	—	—
<b>Crude/natural gas prices</b>							
<b>Crude price</b>							
Crude price, Bonny Light (US\$/bbl)	57.2	64.8	78.9	83.0	65.0	65.0	70.0
Net crude price, OIL-India (US\$/bbl)	49.7	47.9	60.9	56.2	60.7	62.8	64.1
<b>Natural gas price</b>							
Ceiling natural gas price, India (Rs/cu m)	3.52	3.20	3.20	3.20	3.60	4.00	4.50
Ceiling natural gas price, India (US\$/mn BTU)	2.12	1.89	2.12	1.87	2.00	2.24	2.53
Net natural gas price, OIL-India (Rs/cu m)	3.16	2.88	2.88	2.88	3.24	3.60	4.05
Net natural gas price, OIL-India (US\$/mn BTU)	1.91	1.70	1.91	1.68	1.80	2.01	2.28
<b>Sales volumes—Domestic fields</b>							
Crude oil (mn tons)	3.1	3.0	3.0	3.4	3.5	3.6	3.6
Natural gas (bcm)	1.7	1.8	1.8	1.7	1.8	2.2	2.2
<b>Total sales (mn toe)</b>	<b>4.7</b>	<b>4.6</b>	<b>4.7</b>	<b>4.9</b>	<b>5.1</b>	<b>5.6</b>	<b>5.6</b>
<b>Total sales (mn boe)</b>	<b>34</b>	<b>34</b>	<b>34</b>	<b>36</b>	<b>37</b>	<b>41</b>	<b>41</b>
Crude oil (%)	67	66	65	68	68	65	65
Natural gas (%)	33	34	35	32	32	35	35

Source: Company, Kotak Institutional Equities estimates

## OIL's net realization has improved over the past few years

OIL's net crude price realization, March fiscal year-ends, 2004-2012E (US\$/bbl)



Source: Company, Kotak Institutional Equities estimates

## Profit model, balance sheet, cash model of OIL, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
<b>Profit model (Rs mn)</b>							
Net sales	55,502	53,892	60,819	72,414	83,489	90,717	92,916
<b>EBITDA</b>	<b>26,554</b>	<b>22,292</b>	<b>23,852</b>	<b>28,339</b>	<b>39,989</b>	<b>45,284</b>	<b>46,427</b>
Other income	3,639	5,335	6,770	9,372	12,250	17,350	18,975
Interest	(152)	(151)	(383)	(26)	(38)	(24)	(9)
Depreciation and depletion	(3,314)	(2,595)	(3,093)	(3,768)	(9,839)	(13,971)	(15,045)
Pretax profits	26,728	24,881	27,145	33,916	42,362	48,640	50,348
Tax	(9,347)	(7,406)	(8,538)	(11,910)	(14,214)	(16,399)	(17,144)
Deferred tax	(498)	(1,020)	(707)	(343)	(185)	(134)	30
<b>Net profits</b>	<b>16,883</b>	<b>16,454</b>	<b>17,901</b>	<b>21,663</b>	<b>27,963</b>	<b>32,107</b>	<b>33,235</b>
<b>Earnings per share (Rs)</b>	<b>78.9</b>	<b>76.9</b>	<b>83.6</b>	<b>101.2</b>	<b>123.1</b>	<b>133.5</b>	<b>138.2</b>
<b>Balance sheet (Rs mn)</b>							
Total equity	58,483	68,491	79,330	93,310	136,105	153,354	171,209
Deferred tax liability	7,013	8,033	8,655	8,998	9,184	9,317	9,287
Liability for abandonment cost	10	11	11	15	15	15	15
Total borrowings	3,341	8,140	1,749	565	375	213	—
Current liabilities	11,668	10,320	17,541	30,914	32,753	33,892	34,152
<b>Total liabilities and equity</b>	<b>80,515</b>	<b>94,995</b>	<b>107,286</b>	<b>133,801</b>	<b>178,432</b>	<b>196,791</b>	<b>214,663</b>
Cash	31,015	32,757	42,808	60,700	89,811	97,319	106,833
Current assets	14,540	22,350	18,957	22,853	26,111	27,435	27,838
Total fixed assets	30,658	35,813	40,633	45,361	57,623	67,150	75,105
Investments	4,302	4,075	4,887	4,887	4,887	4,887	4,887
<b>Total assets</b>	<b>80,515</b>	<b>94,995</b>	<b>107,286</b>	<b>133,801</b>	<b>178,432</b>	<b>196,791</b>	<b>214,663</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	19,843	18,357	20,104	27,246	20,737	21,362	21,775
Working capital changes	5,884	(8,696)	7,435	2,368	(1,418)	(185)	(143)
Capital expenditure	(6,108)	(9,370)	(9,492)	(8,496)	(17,101)	(15,998)	(15,500)
Investments	(2,482)	226	(811)	—	—	—	—
Other income	1,670	2,892	4,214	5,470	12,250	17,350	18,975
<b>Free cash flow</b>	<b>18,807</b>	<b>3,409</b>	<b>21,450</b>	<b>26,587</b>	<b>14,469</b>	<b>22,529</b>	<b>25,107</b>
<b>Ratios (%)</b>							
Debt/equity	5.7	11.9	2.2	0.6	0.3	0.1	0.0
Net debt/equity	(33.1)	(32.8)	(31.9)	(31.9)	(41.9)	(41.4)	(42.5)
RoAE	28.1	23.2	21.8	22.8	22.6	20.9	19.4
<b>RoACE</b>	<b>28.0</b>	<b>23.0</b>	<b>21.5</b>	<b>22.7</b>	<b>22.6</b>	<b>20.8</b>	<b>19.4</b>
<b>Key assumptions</b>							
Rs/dollar rate	44.3	45.3	40.3	45.8	48.0	47.8	47.5
Crude fob price (US\$/bbl)	57.2	64.8	78.9	83.0	65.0	65.0	70.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,600	4,000	4,500
Subsidy loss (Rs bn)	9.8	19.9	23.1	30.2	5.3	2.8	7.5

Source: Company, Kotak Institutional Equities estimates

For further details, please refer our initiating coverage report on OIL.

OCTOBER 1, 2009

UPDATE

BSE-30: 17,127

**Upgrade cycle to continue.** We expect the revenue upgrade cycle to continue and expect Tier-I names to report strong performance in the Sep'09 quarter. Pick-up in demand from the financial services vertical, lower project cancellations and favorable cross-currency movements will contribute to outperformance of guidance. We recommend playing the IT demand recovery story through Tier-I names. Infosys and Wipro are our top picks. Rupee appreciation is the key risk to our call.

#### Expect 2 to 4.5% sequential revenue growth from Tier 1 companies.

We expect Tier-I companies to report US\$ revenue growth of 2% to 4.5%, highest in the past six quarters. We expect Infosys to report sequential revenue growth of 4.5% versus flat revenue guidance and Wipro to report revenue growth of 3% versus guidance of 0.2%-2%. We attribute the likely outperformance to (1) release of IT budgets after delays in finalization, (2) uptick in demand from the financial services vertical and gains from vendor consolidation and (3) favorable cross-currency movements that will likely help revenue growth by 1-2% pts.

#### Expect upgrade in FY2010E constant currency revenue and EPS guidance of Infosys

We expect 4% upward revision in FY2010E US\$ revenue guidance from Infosys; revenue guidance likely to be reset to 1% decline to 1% growth versus 3-5% decline earlier. We note that the upgrades would not be driven by a sudden surge in demand but extreme conservatism adopted by Infosys for the Sep'09 quarter and FY2010E guidance. We expect Infosys to guide for 2% qoq growth for the Dec'09 quarter. We expect Infosys to increase FY2010E EPS guidance to Rs100-102 from Rs94.6-96 earlier.

#### Key metrics to watch—pricing and hiring

We expect reported constant currency pricing to decline by 0.5% to 1% qoq. The decline will be led by the impact of contracts renegotiated in 1HCY09. We do not expect incremental pricing pressure in the latest negotiation cycle; we would watch closely for management comments on pricing. We would monitor recruitment trends for companies which have adopted just in time hiring (Wipro and HCLT) to gauge the extent of improvement in the demand environment.

#### Play the IT demand recovery through Tier-I names

We expect Tier-I names to trade at an up-cycle multiple of 17-21X. Infosys and Wipro are our top picks. With the exception of Mindtree, we are Cautious on mid-sized companies on account of (1) under-investment in sales and marketing may lead to a significant lag in volumes recovery and (2) indiscriminate personnel decisions will likely hurt margins.

#### QUICK NUMBERS

- Cover highlight
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## Results preview for the quarter ending Sep'09 (Rs mn)

Key financials	Sep-08	Jun-09	Sep-09	%qoq	%yoy	Comments/What to look for
<b>TCS: Results (October 16)</b>						
Revenues (US\$ mn)	1,574	1,480	1,517	2.5	(3.6)	• Expect 2.5% sequential growth in US\$ revenues--0.7% constant currency and 1.8% cross-currency movement benefit.
Revenues	69,534	72,070	73,274	1.7	5.4	• We build in OPM expansion of 70 bps qoq, despite margin Re appreciation. Driven by improvement in utilization and sustained flow-through impact of cost-cutting measures taken by the company over the past few quarters.
Operating profit	18,197	19,619	20,422	4.1	12.2	• We build in forex losses of Rs700 mn versus Rs841 mn in the previous quarter.
Adjusted net profit	12,615	15,203	15,362	1.0	21.8	• Expect investor focus on (1) change in demand environment over the past three months, (2) status of vendor rationalization decisions, (3) pricing renegotiations with key clients and (4) status on execution and profitability of large deals.
Operating profit margin (%)	26.2	27.2	27.9			
<b>Wipro: Results (October 27)</b>						
Total revenues	64,094	63,188	64,390	1.9	0.5	• We expect 3.1% sequential growth in US\$ revenue to US\$1,065 mn against company's guidance of US\$1,035-1,053 mn. We build in constant currency growth of 1.7% qoq and cross-currency movement benefit of 1.4%.
Global IT revenues (US\$ mn)	1,110	1,033	1,065	3.1	(4.1)	• Expect 30 bps sequential expansion in EBIT margins for the IT services business.
Global IT revenues	47,523	48,205	49,559	2.8	4.3	• Expect Wipro to guide for a 1-2% sequential revenue growth for the Dec 2009 quarter.
Operating profit	11,321	10,903	11,997	10.0	6.0	• Expect investor focus on (1) hiring status; Wipro had deferred the joining dates of its campus joiners, (2) commentary on the demand outlook in key verticals like BFSI, TSP, and Telecom OEMs, and (3) trends on pricing renegotiations
Adj. net profit	9,462	9,796	10,696	9.2	13.0	• Our estimates for the Sep 2009 quarter are based on IFRS. Historical financials are US GAAP based.
Total Operating profit margin (%)	17.7	17.3	18.6			
Global IT - OPM (%) (b)	20.8	22.1	22.4			
<b>Infosys Technologies: Results (October 09)</b>						
Revenues (US\$ mn)	1,218	1,121	1,171	4.5	(3.8)	• We expect revenues of US\$1,171 mn (+4.5% qoq) for the Sep 2009 quarter versus company's guidance of US\$1,110 - 1,130 mn. Our estimate builds in 3% constant currency revenue growth (mostly volume-led) and 1.6% cross-currency movement benefit.
Revenues	54,180	54,720	56,601	3.4	4.5	• Expect a 100 bps sequential decline in EBITDA margins on account of (1) Re appreciation, (2) higher sales and marketing costs and (3) impact of local hiring on gross margins.
Operating profit	17,940	18,680	18,735	0.3	4.4	• Infosys has Rs310 mn of forex gains in the previous quarter; we build in forex losses of Rs150 mn for the quarter, primarily driven by MTM losses on translation of GBP receivables (GBP end-of-quarter rate lower for Sep 2009 than June 2009 quarter).
Adjusted net profit	14,320	15,270	14,999	(1.8)	4.7	• Expect Infosys to guide for a 2% sequential revenue growth for the Dec 2009 quarter; expect meaningful upward revision in full-year revenues and EPS guidance.
Operating profit margin (%)	33.1	34.1	33.1			• Expect investor focus on (1) status of IT budget flows and decision-making, (2) commentary on vendor rationalization situations and (3) pricing scenario among existing and new clients.
<b>HCL Technologies: Results (October 27/28)</b>						
Revenues (US\$ mn)	505	607	627	3.2	24.2	• Expect 3.2% sequential growth in consolidated US\$ revenues; we build in ~2.2% cross-currency benefits and a moderate 1% constant currency revenue growth.
Revenues	23,693	29,085	30,099	3.5	27.0	• Previous quarter financials included US\$8 mn pass-through revenues.
Operating profit	5,131	6,280	6,494	3.4	26.6	• Expect flat margins for the quarter.
Adjusted net profit	3,380	3,147	3,052	(3.0)	(9.7)	• Previous quarter net income includes forex loss of US\$21 mn. We build in forex losses of US\$32.5 mn for the Sep 2009 quarter.
EBITDA margin (%)	21.7	21.6	21.6			
<b>Patni Computer Systems: Results (October 4th week)</b>						
Revenues (US\$ mn)	183.5	161.9	167.3	3.3	(8.8)	• We expect the company to beat the upper end of its US\$ revenue guidance of US\$163-165 mn; our estimate of US\$167.3 mn revenues implies a qoq growth of 3.3% and a yoy decline of 8.8%.
Revenues	8,141	7,755	8,031	3.6	(1.3)	• Expect flat operating margins (ex-forex items) for the quarter.
Operating profit	1,102	1,162	1,197	3.0	8.6	• We factor in forex losses of US\$3.5 mn for the quarter. The company had a forex loss of US\$4.1 mn in the previous quarter. We build in interest income of US\$3.6 mn for Sep 2009 versus US\$11.2 mn in the previous quarter. A substantial portion of Patni's treasury investments matures in the June quarter and the company books large realization gains in the June quarter every year.
Adjusted net profit	1,078	1,373	1,112	(19.0)	3.2	• We expect net income (ex forex loss) of US\$26.6 mn, ahead of the company's guidance of US\$22.5-23.5 mn.
Operating profit margin (%)	13.5	15.0	14.9			• Expect investor focus on (1) initiatives taken by the new senior management team to revive organic revenue engine, and (2) cash utilization plans. Patni had ~US\$350 mn of cash on books as at end-June 2009.

Source: Company, Kotak Institutional Equities estimates

## Results preview for the quarter ending Sep 2009 (Rs mn)

Key financials	Sep-08	Jun-09	Sep-09	%qoq	%yoy	Comments/What to look for
<b>Polaris Software Lab: Results (October 4th week)</b>						
Revenues (US\$ mn)	80.2	66.6	67.5	1.3	(15.8)	• Expect a modest 1.3% sequential growth in US\$ revenue, driven primarily by cross-currency movement benefits.
Revenues	3,511	3,255	3,262	0.2	(7.1)	• We expect a 210 bps qoq decline in operating margins on account of (1) Re appreciation, and (2) expense normalization; Polaris has cut people as well as other operating costs aggressively through the downturn.
Operating profit	575	552	484	(12.3)	(15.8)	• Client acquisition pace and account mining remain the key; the company needs to make its Intellect wins count by mining these accounts.
Adjusted net profit	344	318	311	(2.2)	(9.6)	• Expect investor focus on (1) revenue outlook and impact of ongoing vendor consolidation (likely negative for Polaris) in some of the company's major clients and (2) pricing trends in the BFSI vertical.
Operating profit margin (%)	16.4	17.0	14.9			
<b>Hexaware Technologies: Results (October 4th week)</b>						
Revenues (US\$ mn)	66.3	53.6	55.0	2.6	(17.1)	• We expect Hexaware to report revenues of US\$55 mn, +2.6% qoq, and ahead of the company's guidance of US\$52.5-54.5 mn.
Revenues	2,946	2,591	2,632	1.6	(10.7)	• Expect 110bps sequential decline in operating margin on account of marginal Re appreciation during the quarter, an uptick in gross hiring, and increased S&M investments.
Operating profit	393	558	537	(3.8)	36.7	• We build in forex losses of Rs120 mn at the other income level
Adjusted net profit	115	396	355	(10.5)	207.9	• Expect investor focus on (1) efforts being made to revive the revenue growth engine, and (2) sustainability of recent cost control initiatives.
Operating profit margin (%)	13.3	21.5	20.4			
<b>MindTree Consulting: Results (October 26)</b>						
Revenues (US\$ mn)	73.0	62.1	65.2	5.1	(10.7)	• We expect a 5.1% sequential growth in US\$ revenues; we build in ~4% constant currency growth with 1% growth accruing from favorable cross-currency movements.
Revenues	3,120	3,048	3,155	3.5	1.1	• Expect 180 bps sequential expansion in margins on account of (1) higher utilization, and (2) non-recurrence of one-off margin-impacting events (like execution issues with a FP contract).
Operating profit	867	507	580	14.4	(33.1)	• We model forex loss of Rs20 mn versus gain of Rs305 mn in the June 2009 quarter. MT had booked massive gains on its large MTM forex hedge book in the previous quarter.
Adjusted net profit	373	567	331	(42)	(11)	• Expect investor focus on (1) status of large BFSI and manufacturing accounts like AIG, Volvo, and Unilever, and (2) hedging philosophy going forward; we highlight that company's forex policy is a key investor concern.
Operating profit margin (%)	27.8	16.6	18.4			
<b>Mphasis BFL: Results (November/December)</b>						
Revenues (US\$ mn)		232	244	5.3		• Expect a strong 5.3% sequential growth in revenues driven by sustained momentum in some of the new deal ramp-ups and favorable cross-currency movements.
Revenues		11,056	11,657	5.4		• We build in OPM expansion of 110 bps into our Oct 2009 quarter estimates.
Operating Profit		2,919	3,207	9.8		• We build in an effective tax rate of 9.7% versus 6% in the previous quarter.
Adjusted net Profit		2,293	2,450	6.9		• Expect investor focus on (1) further clarity on HP/EDS' offshoring strategy in India and (2) movement in billing rates.
Operating profit margin (%)		26.4	27.5			

Note:

(a) Result date yet to be announced for some companies; tentative date indicated based on past pattern for each company.

Source: Company, Kotak Institutional Equities



OCTOBER 1, 2009

UPDATE

Coverage view: **Cautious**

Price (Rs): **419**

Target price (Rs): **425**

BSE-30: **17,127**

**MTN deal off—neutral for Bharti, negative for sector.** The proposed Bharti-MTN deal has been called off for lack of buy-in from the SA government. We view the event as structurally neutral for Bharti but negative for the Indian wireless sector. We expect Bharti to get more aggressive in protecting its turf from new and (expanding) extant competition in the domestic market. Bharti's balance sheet strength and superior execution skills underline our positive bias on the stock. Cautious sector view stays.

#### Company data and valuation summary

Bharti Airtel

##### Stock data

52-week range (Rs) (high,low)	518-242
Market Cap. (Rs bn)	1,590.0

##### Shareholding pattern (%)

Promoters	67.4
FIs	19.6
MFs	3.5

##### Price performance (%)

	1M	3M	12M
Absolute	(0.8)	1.6	5.9
Rel. to BSE-30	(10.0)	(13.1)	(19.3)

##### Forecasts/Valuations

	2009	2010E	2011E
EPS (Rs)	22.3	26.9	30.6
EPS growth (%)	26.4	20.5	13.8
P/E (X)	18.7	15.6	13.7
Sales (Rs bn)	369.6	424.9	487.4
Net profits (Rs bn)	84.7	102.1	116.3
EBITDA (Rs bn)	151.6	177.0	197.3
EV/EBITDA (X)	11.0	9.2	8.0
ROE (%)	31.4	28.0	24.6
Div. Yield (%)	0.5	0.7	1.0

#### Proposed Bharti-MTN deal called off; lack of approvals from SA government the deal-breaker

Bharti has disengaged itself from conversations with MTN on the proposed transaction between the two companies. Bharti has cited lack of buy-in and necessary approvals from the South African government as the key reason for the decision to call off the proposed deal.

#### Structurally neutral for Bharti; we were positive on the deal

We view the event as structurally neutral for Bharti. We were positive on the deal from Bharti's perspective given that (1) it would have provided Bharti a timely diversification of revenues and use of expected free cash generation in an increasingly challenging phase in the domestic market, and (2) MTN is a company with very attractive operating assets, presence in several growth markets, and leadership position in many of those. The deal call-off dilutes just a tad our relatively positive stance on the stock. Bharti is not immune to the structural pressure on Indian wireless operating metrics, though it still remains the best-positioned to limit the overall damage.

#### Bharti has expressed intent to continue its international expansion focus

Bharti has been on the lookout for international expansion opportunities to utilize the expected free cash flow generation and to diversify its operations (not surprising given the impending growth slowdown in the Indian market). The company has expressed its intent to continue to look out for such opportunities. We highlight that the capital-intensive nature of the telecom business leaves very few attractive acquisition opportunities in most markets. Bharti has a track record of very strong capital discipline; however, possibility of a sub-optimal acquisition is a risk that one needs to bear in mind, in our view.

#### Bharti stock may see a near-term rally as the deal overhang ends

We see near-term upside to Bharti's stock price given the market's 'net' negative response to the proposed deal. Bharti has underperformed the BSE Sensex by 20% since it announced its intent to do the deal. We expect the stock to react to the competitive moves in the Indian wireless market post the expected near-term rally. We discuss our view on the competitive scenario developing in the Indian wireless market below.

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### Expect Bharti to get more aggressive in India; negative for the sector

We expect Bharti to focus on protecting its turf in the domestic market with renewed zeal over the coming months. We had been surprised with Bharti's measured and somewhat muted response to the aggressive introductory offers of the new entrants in the market. While that has changed a little with the pan-India launch of 'Airtel Advantage' plan last week, we would expect Bharti to respond more aggressively to new competition over the coming months.

Bharti has been able to protect its absolute subs net adds despite the increased competitive intensity; however, the company has seen its usage market share drop meaningfully. Our channel checks also indicate that Bharti has an internal threshold on usage market share loss beyond which it would respond more aggressively to new competition.

In our view, the choice for Bharti is to either (1) get aggressive on pricing and make business case unviable for the new competition right away or (2) let the competition survive for a while (and possibly die a natural death) to avoid deeper structural damage to the industry pricing and profitability structure. Bharti appears to have chosen the latter thus far, but we do not think that a 24% subs market share gives Bharti sufficient control over the industry pricing structure to prevent its deterioration. We expect a change in stance from Bharti, sooner rather than later. This, in our view, could be a major negative for the sector. We remain Cautious on the sector and reiterate our REDUCE rating on Idea and SELL on RCOM. Maintain ADD on Bharti.

#### Indian telecom companies valuation analysis, March fiscal year-ends, 2008-2012E

	Price (Rs)	Target price	P/E (X)					EV/EBITDA (X)				
	30-Sep-09	(Rs)	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	419	425	23.7	18.7	15.6	13.7	12.2	14.4	10.9	9.2	8.0	6.7
Idea	75	65	19.1	25.9	22.4	20.9	19.0	13.0	9.6	8.0	7.1	6.2
MTNL	92	50	12.8	29.8	(19.1)	(23.3)	(36.3)	3.3	12.3	9.9	7.6	5.9
RCOM	309	240	11.7	11.2	14.6	13.5	10.5	10.8	9.2	9.0	7.2	5.2
TCOM	485	400	44.3	35.7	34.6	32.0	30.9	22.8	17.4	15.6	14.3	12.5

	KS rating	Market cap.	Revenues (Rs bn)					EBITDA (Rs bn)				
		(US\$ bn)	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	SELL	31.8	270	370	425	487	539	113	152	177	197	218
Idea	REDUCE	4.7	67	101	132	168	188	23	28	37	44	50
MTNL	0	1.2	47	44	39	42	44	7	2	3	5	6
RCOM	ADD	12.7	191	229	258	316	366	82	93	101	124	150
TCOM	SELL	2.8	33	38	42	46	49	6	8	9	10	10

	Net Income (Rs bn)					EPS (Rs)				
	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	66	84	100	114	128	17.7	22.3	26.9	30.6	34.4
Idea	10	9	10	12	13	3.9	2.9	3.4	3.6	4.0
MTNL	4	1	(3)	(2)	(2)	7.1	3.1	(4.8)	(3.9)	(2.5)
RCOM	56	59	45	49	63	26.5	27.7	21.2	23.0	29.4
TCOM	3	4	4	4	4	10.9	13.6	14.0	15.2	15.7

Source: Bloomberg, Kotak Institutional Equities estimates

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

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
<b>Revenues</b>										
Wireless	217,861	303,601	349,231	400,596	439,060	472,377	496,467	515,286	531,667	545,995
Fixed line	28,484	33,517	35,843	40,621	44,690	48,163	51,408	54,448	57,317	60,014
DLD	22,103	41,835	47,375	52,579	56,888	60,480	63,365	65,670	67,506	68,960
ILD	21,067	26,102	28,787	31,564	34,371	37,087	40,023	43,216	46,693	50,487
Enterprise services	13,217	16,945	18,640	20,131	21,238	22,300	23,415	24,585	25,815	27,105
Others	2,431	3,611	4,694	6,103	7,323	8,055	8,861	9,747	10,722	11,794
<i>Less: Intersegment eliminations</i>	<i>(40,936)</i>	<i>(98,485)</i>	<i>(93,748)</i>	<i>(101,579)</i>	<i>(107,683)</i>	<i>(112,527)</i>	<i>(116,633)</i>	<i>(120,143)</i>	<i>(123,351)</i>	<i>(126,182)</i>
<b>Consolidated revenues</b>	<b>270,250</b>	<b>369,615</b>	<b>424,901</b>	<b>487,351</b>	<b>538,915</b>	<b>583,610</b>	<b>619,320</b>	<b>650,043</b>	<b>678,987</b>	<b>705,302</b>
Interconnection costs	(41,110)	(52,903)	(46,909)	(53,583)	(57,936)	(63,241)	(67,703)	(71,530)	(75,221)	(78,203)
License fees and spectrum charges	(26,900)	(38,266)	(43,159)	(50,394)	(55,669)	(60,129)	(63,607)	(66,560)	(69,280)	(71,888)
Network operating costs	(33,002)	(59,355)	(77,141)	(95,865)	(108,230)	(115,779)	(121,341)	(125,999)	(130,759)	(134,846)
Sales and marketing expenses	(19,058)	(26,760)	(34,527)	(39,566)	(43,778)	(47,120)	(49,915)	(52,367)	(54,606)	(56,686)
Employee costs	(14,768)	(16,992)	(19,434)	(21,734)	(24,402)	(26,454)	(28,366)	(30,228)	(32,146)	(34,050)
G&A costs	(22,187)	(23,776)	(26,723)	(28,880)	(30,903)	(32,563)	(33,868)	(35,236)	(36,431)	(37,497)
<b>Consolidated EBITDA</b>	<b>113,225</b>	<b>151,563</b>	<b>177,008</b>	<b>197,329</b>	<b>217,998</b>	<b>238,324</b>	<b>254,520</b>	<b>268,124</b>	<b>280,545</b>	<b>292,133</b>
Other income incl. Interest income	4,136	645	5,450	3,887	7,403	11,438	16,965	21,618	25,163	27,636
Interest expense	(4,054)	(11,613)	(3,028)	(1,354)	(225)	—	—	—	—	—
Amortization of entry fee	(1,829)	(2,122)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)
Depreciation	(34,942)	(45,344)	(58,991)	(63,312)	(69,713)	(74,935)	(77,727)	(80,886)	(85,143)	(86,358)
<b>Pretax profits</b>	<b>76,536</b>	<b>93,129</b>	<b>119,290</b>	<b>135,403</b>	<b>154,315</b>	<b>173,678</b>	<b>192,609</b>	<b>207,707</b>	<b>219,416</b>	<b>232,263</b>
Extraordinary income/(charges)	—	—	—	—	—	—	—	—	—	—
Prior period adjustments	—	—	—	—	—	—	—	—	—	—
Current tax expense	(8,414)	(7,371)	(21,840)	(24,583)	(28,186)	(32,038)	(44,327)	(58,174)	(70,276)	(74,254)
Deferred tax (liability)/asset	36	756	4,321	2,293	(727)	(4,952)	1,901	7,282	11,557	9,984
Minority interest expense	(1,151)	(1,759)	(1,469)	(2,708)	(3,523)	(4,075)	(4,381)	(4,849)	(5,329)	(5,776)
Equity in earnings of affiliates	—	(56)	1,779	5,880	8,858	10,454	11,826	13,294	14,717	16,098
<b>Reported net profits</b>	<b>67,007</b>	<b>84,699</b>	<b>102,081</b>	<b>116,285</b>	<b>130,737</b>	<b>143,068</b>	<b>157,628</b>	<b>165,260</b>	<b>170,085</b>	<b>178,315</b>
<b>Adjusted net profits</b>	<b>67,007</b>	<b>84,699</b>	<b>102,081</b>	<b>116,285</b>	<b>130,737</b>	<b>143,068</b>	<b>157,628</b>	<b>165,260</b>	<b>170,085</b>	<b>178,315</b>
<b>Adjusted EPS (Rs)</b>	<b>17.7</b>	<b>22.3</b>	<b>26.9</b>	<b>30.6</b>	<b>34.4</b>	<b>37.7</b>	<b>41.5</b>	<b>43.5</b>	<b>44.8</b>	<b>47.0</b>
Shares outstanding (mn)	3,796	3,797	3,797	3,797	3,797	3,797	3,797	3,797	3,797	3,797
Current tax rate (%)	11.0	7.9	18.3	18.2	18.3	18.4	23.0	28.0	32.0	32.0
Effective tax rate (%)	10.9	7.1	14.7	16.5	18.7	21.3	22.0	24.5	26.8	27.7
<b>Growth (%)</b>										
EBITDA	52.3	33.9	16.8	11.5	10.5	9.3	6.8	5.3	4.6	4.1
Net profits	65.0	26.4	20.5	13.9	12.4	9.4	10.2	4.8	2.9	4.8
EPS	65.0	26.4	20.5	13.8	12.4	9.4	10.2	4.8	2.9	4.8
<b>Margin (%)</b>										
EBITDA	41.9	41.0	41.7	40.5	40.5	40.8	41.1	41.2	41.3	41.4
Net profits	24.8	22.9	24.0	23.9	24.3	24.5	25.5	25.4	25.0	25.3
EBIT	28.3	28.2	27.5	27.3	27.3	27.8	28.4	28.6	28.6	29.0

Source: Company, Kotak Institutional Equities estimates

## Consolidated balance sheet for Bharti Airtel, March fiscal year-ends, 2008-2017E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
<b>Equity</b>										
Share capital	18,979	18,985	18,985	18,985	18,985	18,985	18,985	18,985	18,985	18,985
Warrants	—	—	—	—	—	—	—	—	—	—
Reserves/surplus	203,606	284,960	384,183	496,981	620,789	745,090	872,040	994,630	1,109,965	1,221,351
<b>Total equity</b>	<b>222,585</b>	<b>303,945</b>	<b>403,168</b>	<b>515,966</b>	<b>639,774</b>	<b>764,075</b>	<b>891,025</b>	<b>1,013,615</b>	<b>1,128,950</b>	<b>1,240,336</b>
Minority shareholding	3,013	10,704	12,173	14,880	18,403	22,478	26,858	31,707	37,036	42,812
Deferred tax liability	1,940	7,556	3,235	942	1,669	6,621	4,720	(2,562)	(14,119)	(24,103)
<b>Liabilities</b>										
Secured loans	90,969	118,801	79,151	23,836	—	—	—	—	—	—
Unsecured loans	—	—	—	—	—	—	—	—	—	—
<b>Total borrowings</b>	<b>90,970</b>	<b>118,801</b>	<b>79,151</b>	<b>23,836</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>
Current liabilities	154,135	162,941	165,220	172,428	176,209	180,426	182,949	186,071	190,363	194,283
<b>Total capital</b>	<b>472,643</b>	<b>603,947</b>	<b>662,946</b>	<b>728,052</b>	<b>836,054</b>	<b>973,599</b>	<b>1,105,552</b>	<b>1,228,832</b>	<b>1,342,230</b>	<b>1,453,329</b>
<b>Assets</b>										
Cash	55,006	49,070	31,960	42,671	118,535	235,216	352,978	465,045	568,939	668,410
Current assets	58,776	95,009	100,711	108,767	118,031	125,454	133,455	141,972	151,040	160,645
Gross block	408,408	532,177	660,944	765,862	850,739	929,809	1,003,049	1,074,485	1,146,496	1,219,928
Less: accumulated depreciation	102,406	147,750	206,741	270,053	339,765	414,700	492,428	573,314	658,457	744,816
<b>Net fixed assets</b>	<b>306,002</b>	<b>384,427</b>	<b>454,203</b>	<b>495,809</b>	<b>510,974</b>	<b>515,109</b>	<b>510,622</b>	<b>501,171</b>	<b>488,039</b>	<b>475,112</b>
Capital work-in-progress	24,709	24,709	24,709	24,709	24,709	24,709	24,709	24,709	24,709	24,709
Total fixed assets	330,711	409,136	478,912	520,518	535,683	539,818	535,330	525,880	512,748	499,821
Entry fees unamortized	11,698	40,364	39,216	38,068	36,920	35,772	34,624	33,476	32,328	31,180
Investments	16,425	10,341	12,121	18,000	26,858	37,312	49,138	62,432	77,148	93,246
Deferred expenditure	27	27	27	27	27	27	27	27	27	27
Deferred tax asset	—	—	—	—	—	—	—	—	—	—
<b>Total assets</b>	<b>472,643</b>	<b>603,947</b>	<b>662,946</b>	<b>728,051</b>	<b>836,054</b>	<b>973,599</b>	<b>1,105,551</b>	<b>1,228,831</b>	<b>1,342,229</b>	<b>1,453,328</b>
<b>Leverage ratios (%)</b>										
Debt/equity	40.9	39.1	19.6	4.6	—	—	—	—	—	—
Debt/capitalization	29.0	28.1	16.4	4.4	—	—	—	—	—	—
Net debt/equity	16.2	22.9	11.7	(3.7)	(18.5)	(30.8)	(39.6)	(45.9)	(50.4)	(53.9)
Net debt/capitalization	13.9	18.7	10.5	(3.8)	(22.7)	(44.5)	(65.6)	(84.8)	(101.6)	(116.9)
RoAE	39.7	32.2	28.9	25.3	22.6	20.4	19.0	17.4	15.9	15.1
<b>RoAE (excl cash and interest income)</b>	<b>45.5</b>	<b>38.9</b>	<b>30.6</b>	<b>26.6</b>	<b>25.0</b>	<b>25.3</b>	<b>26.8</b>	<b>27.4</b>	<b>27.8</b>	<b>29.0</b>
ROACE	29.2	25.4	21.3	21.3	20.8	19.5	17.3	15.2	13.6	13.1
<b>RoACE (excl cash and interest incom)</b>	<b>31.9</b>	<b>29.5</b>	<b>23.2</b>	<b>22.7</b>	<b>22.7</b>	<b>23.2</b>	<b>24.3</b>	<b>24.5</b>	<b>24.5</b>	<b>25.2</b>

Source: Company, Kotak Institutional Equities estimates

**OCTOBER 1, 2009**
**UPDATE**

Coverage view: **Attractive**

Price (Rs): **1,408**

Target price (Rs): **1,330**

BSE-30: **17,127**

**No certainty on resolution of problems at Detroit plant.** Caraco (CPD) has entered into a consent decree with US FDA. We are unable to estimate when the products may be allowed back into the market. Taro has filed a suit alleging non disclosure of material information to its shareholder. Positive response to possible resolution to CPD problems has taken the share price beyond our revised price target of Rs1,330. We think profit booking is likely in the short term.

### Company data and valuation summary

Sun Pharmaceuticals

Stock data		Forecasts/Valuations			
		2009	2010E	2011E	
52-week range (Rs) (high,low)	1,600-953	EPS (Rs)	87.8	47.6	64.2
Market Cap. (Rs bn)	291.5	EPS growth (%)	17.6	(45.8)	34.9
<b>Shareholding pattern (%)</b>		P/E (X)	16.0	29.6	21.9
Promoters	63.7	Sales (Rs bn)	42.7	35.3	44.2
FIs	18.1	Net profits (Rs bn)	18.2	9.9	13.3
MFs	3.5	EBITDA (Rs bn)	19.5	10.5	14.8
<b>Price performance (%)</b>		EV/EBITDA (X)	13.2	23.6	16.3
Absolute	1M 3M 12M	ROE (%)	30.2	13.3	16.1
Rel. to BSE-30	8.6 7.6 (26.1)	Div. Yield (%)	1.0	1.0	1.0

### Consent decree—first step in a long and expensive process

Caraco (CPD) has entered into a consent decree regarding its drug manufacturing operations at Detroit. The decree provides a series of measures that, when satisfied, will permit CPD to resume manufacturing and distributing products manufactured in Detroit facilities. CPD is working expeditiously to satisfy the requirements of the decree and has already retained independent cGMP experts for review of its operations and to facilitate a successful result.

### Difficult to estimate when the process will be complete

We think that it is impossible to provide a timetable on the re-opening of Detroit facility for commercial manufacturing, given the various steps involved in reaching the final destination. Since independent experts and US FDA will be conducting regular review of progress, completion is not entirely within CPD management control. This process clearly adds a large (but not quantifiable) cost to CPD over the next several quarters. However, US FDA has not imposed any fine on CPD.

### Taro files another lawsuit against SUNP in US

Taro filed a lawsuit against SUNP in the United States District Court for the Southern District of New York alleging, among other things, that SUNP failed to disclose material information to Taro shareholders. Taro seeks to enjoin use of SUNP's improper tender offer materials as well as damages and injunctive relief. The filing of the present complaint is in addition to ongoing pending litigation involving Taro, Sun and others in Israel and New York State courts.

### We expect some profit booking ahead of 2QFY10E results

Results of 2QFY10E (late October) may be crucial as investors may want to see what SUNP can deliver under normal environment. SUNP share price is now above our price target and we think some profit booking is likely in the short term as investors would note that consent decree does not lead to revenues from Detroit plant in the short term. We are our raising price target to Rs1,330 as we roll it forward to September 2010. There are no changes to estimates and rating.

### QUICK NUMBERS

- **CPD enters consent decree with US FDA, no fine imposed**
- **Independent check on quality imposed for the next five years**
- **We do not include revenues from Detroit facility in FY2010-11E estimates**

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### CPD announced consent decree with US FDA

Caraco (CPD) announced that it has entered into a consent decree regarding its drug manufacturing operations at Detroit. The decree provides a series of measures that, when satisfied, will permit CPD to resume manufacturing and distributing products manufactured in Detroit facilities. CPD is working expeditiously to satisfy the requirements of the decree and has already retained independent cGMP experts for review of its operations and to facilitate a successful result.

Under terms of the consent decree, CPD cessation of manufacturing operations will continue until it receives written notification from independent experts and the FDA that it is in compliance with the decree and regulations and can resume operations. CPD is allowed to distribute FDA approved products manufactured by third parties such as SUNP.

Under this decree CPD has agreed to the following:

- ▶ Bring its methods, facilities and controls used to manufacture and all processes related to it in conformity with CGMP
- ▶ Establish and document management control over quality assurance and control
- ▶ Establish and follow adequate written procedures for storage and handling of components
- ▶ Maintain accurate and complete inventory records of each component
- ▶ Submit a protocol that identifies work plan for CGMP expert and methodology to be used to ensure that CPD corrective plan is implemented
- ▶ Get a written report from CGMP expert that facilities have been inspected, all past CGMP deviations have been corrected, facility is CGMP compliant
- ▶ Retain an independent quality expert to audit the facilities periodically for five years after all problems have been resolved

We think that it is impossible to provide a timetable on re-opening of Detroit facility for commercial manufacturing, given the various steps involved in reaching the final destination. Since independent expert and US FDA will be conducting regular reviews of progress, completion is not entirely within CPD management control. This process clearly adds a large (but not quantifiable) cost to CPD over the next several quarters. However, US FDA has not imposed any fine on CPD.

### Taro's lawsuit against SUNP

Taro filed a lawsuit against SUNP in the United States District Court for the Southern District of New York alleging, among other things, that SUNP failed to disclose to Taro shareholders material information such as:

- ▶ the recent action by USFDA against CPD in which the FDA seized US\$20 mn in products, effectively closing down manufacturing operations of CPD
- ▶ the fact that the FDA action apparently grew out of a long pattern of failure to comply with regulatory requirements governing the manufacture of drugs at CPD under SUNP controlling hand
- ▶ the impact these events and other serious lapses of operational diligence and corporate governance would have on Taro, its operations, business and its shareholders if SUNP were to gain control of Taro

- ▶ the harm that SUNP has inflicted on CPD minority public shareholders in order to advantage SUNP and its shareholders
- ▶ suits filed by shareholders of CPD alleging violations of securities law and failure to disclose material facts
- ▶ recent disclosures by CPD of the resignation of CPD outside independent director over serious corporate governance issues at CPD.

Taro also alleges that SUNP misappropriated confidential information about Taro gathered as part of the proposed merger transaction. Taro alleges that SUNP illegally used such confidential information to disrupt and harm Taro's customer relationships and undermine Taro's revenues. Taro alleges in its complaint violations of the provisions of the Williams Act and unlawful use and disclosure of Taro's proprietary and confidential business information in violation of a non-disclosure agreement. As a remedy, Taro seeks, among other things, to enjoin use of SUNP's improper tender offer materials as well as damages and injunctive relief.

We are unable to express any opinion on this case and would await further developments in US courts.

#### **Assumptions underlying our FY2010-11E estimates**

We use Rs/US\$ forecast of Rs47 for FY2010E and Rs47.75 for FY2011E. Our FY2010-11E PAT estimates are based on the following key assumptions

#### **Exclusion of sales of exclusivity products**

SUNP was selling selectively generic Protonix and Ethyol, products that were launched "at-risk". SUNP has mentioned that it had sold some quantities in 1QFY10 and may sell in future. This is a high-margin product with EBITDA margin of nearly 80% and management decision to launch can bring high volatility to estimates. We exclude any additional sales from these products from 2QFY10E. We expect no further revenues from exclusivity products in FY2011E.

#### **No sales of CPD manufactured products**

We exclude any revenues from CPD manufactured products from 2QFY10E. CPD will continue to distribute SUNP products for which it will make about 12% gross margin. CPD has entered into agreement with Forest and will be distributing some of its generic products if allowed by US FTC. We will include these sales if the deal is approved by US FTC. We believe that the consent decree announced does not provide any definite timetable for approval of CPD facility and we continue to exclude revenues from these products.

#### **Increasing sales from SUN ANDAs in FY2010E**

Sun expects to file 30 ANDAs in FY2010E. ANDAs for 73 products were approved by end June 2009 compared to 53 at the end of 2008. ANDAs representing 111 products awaited USFDA approval as of June 2009. With this strong pipeline, we expect revenues from SUN ANDAs excluding exclusivity sales to grow to US\$94 mn in FY2010E and US\$128 mn in FY2011E.

#### **Indian revenues impacted by channel inventory created in Jan-Mar 2009**

SUNP has clarified that 1QFY10 sales were impacted fully by this adjustment and from 2QFY10E, sales will return to normal. After adding the sales that took place in previous quarter we arrive at growth rate of 23% in 1QFY10. We are modeling gross sales growth of 19% for the next three quarters. Net increase will be higher as excise duty rate was reduced to 4% in December 2008.

### EBITDA for 1QFY10 impacted by several one-off items

Most notable being the inventory adjustment in India and provision of US\$8.4 mn for inventory impounded by US police. We calculate that recurring EBITDA margin of SUNP to be about 30% for 1QFY10. We add back R&D expenses of nearly 10% to arrive at the sustainable EBITDA margin of the business. This is used in estimate for the next three quarters.

One head of expense that could throw up a surprise in the next three quarters is Overheads or Other Expenses. This has shown a very volatile trend in the past three quarters and have ranged from Rs1.2 bn to Rs3.6 bn. In 1QFY10, SUNP reported Rs2 bn under this expense and has provided no details of the expenses included here. It did mention that increasing litigation costs and forex movement related expenses are a significant part of the expenses but did not quantify the number. We are modeling in Rs1.7 bn in 2Q, Rs1.8 bn in 3Q and Rs1.9 bn in 4QFY10. Part of this reduction is due to lower headcount at CPD in response to continuing problems with FDA.

### Profit and loss, March fiscal year-ends, 2007-2011E

	FY2007	FY2008	FY2009E	FY2010E	FY2011E
<b>Net sales</b>	<b>21,321</b>	<b>33,565</b>	<b>42,723</b>	<b>35,301</b>	<b>44,159</b>
Materials	(5,767)	(7,222)	(8,556)	(10,153)	(13,248)
Selling and administration	(2,616)	(3,759)	(5,543)	(5,680)	(5,792)
Employee cost	(1,989)	(2,331)	(3,401)	(4,642)	(5,368)
R&D	(2,440)	(2,725)	(3,099)	(3,343)	(3,974)
Others	(1,785)	(2,017)	(3,484)	(2,174)	(2,208)
<b>Total expenditure</b>	<b>(14,597)</b>	<b>(18,054)</b>	<b>(24,084)</b>	<b>(25,991)</b>	<b>(30,590)</b>
<b>EBITDA</b>	<b>6,724</b>	<b>15,511</b>	<b>18,640</b>	<b>9,309</b>	<b>13,569</b>
Depreciation and amortisation	(813)	(969)	(1,233)	(1,591)	(1,950)
<b>EBIT</b>	<b>5,910</b>	<b>14,543</b>	<b>17,407</b>	<b>7,719</b>	<b>11,619</b>
Net finance cost	(127)	(88)	—	—	—
Other income	2,551	1,539	2,085	2,403	2,400
<b>Pretax profits before extra-ordinaries</b>	<b>8,335</b>	<b>15,994</b>	<b>19,492</b>	<b>10,122</b>	<b>14,019</b>
Current tax	(91)	(1,288)	(1,192)	(99)	(391)
Deferred tax	158	804	481	(450)	(450)
<b>Reported net profit</b>	<b>8,402</b>	<b>15,509</b>	<b>18,780</b>	<b>9,573</b>	<b>13,178</b>
Minority Interests	559	640	603	(284)	(120)
<b>Reported net profit after minority interes</b>	<b>7,843</b>	<b>14,869</b>	<b>18,177</b>	<b>9,857</b>	<b>13,298</b>

Source: Kotak Institutional Equities estimates, Company

### We are raising our price target to Rs1,330 as we roll forward to Sep' 2010

There are three big contributors to SUNP's share price target. Cash accounts for 18% of the target price while Indian finished dosage and international finished dosage business, excluding US, account for most of the remaining part of the target price. We think these parts are not impacted by problems with CPD. Even if there is slowdown in SUNP products distributed by CPD, its contribution to the share price target is limited.

SUNP is now above our target price but we are still continuing with the ADD rating. This rating is a relative to the Sensex. We think the share price has responded to this event which is a step in right direction but it is the first step of a journey that can be time and money consuming.

KIE estimates are significantly below consensus estimates on Datastream and Bloomberg. We think this is likely due to exclusion of high-margin generic Protonix in our estimates. This exclusion is not likely to impact our share price target materially since we would include only cash generated by limited period opportunity in price target and do not assign a valuation multiple to these limited period opportunities. We estimate that US\$50 mn revenues from generic Protonix would add only Rs10 to our price target.



Results for the quarter ending September will be crucial to maintain the momentum. Comparison with June 2009 results will not be relevant due to non-recurring costs incurred during this quarter. We think results for 2QFY10 will include a large one-time cost relating to reduction of workforce at Detroit plant.

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**SOTP based price target, FY2011-FY2012E**

	PAT (Rs mn)		P/E (X)	Valuation (Rs mn)	
	FY2011E	FY2012E		FY2011E	FY2012E
India finished dosage	6,418	7,218	20.0	128,353	144,352
India API	99	104	10.0	994	1,036
International finished dosage	2,168	2,773	16.0	34,684	44,375
International API	1,482	1,737	13.0	19,265	22,582
Caraco business	120	80	—	—	—
Sun Pharma ANDAs	1,755	2,149	15.0	26,327	32,231
Hungary	127	141	15.0	1,900	2,115
US -180 days exclusivity	—	—	NM	—	—
Effexor XR equivalent	—	—	15.0	—	—
<b>Total (ex interest income)</b>	<b>12,168</b>	<b>14,201</b>		<b>211,523</b>	<b>246,691</b>
<b>Value per share (Rs)</b>				<b>1,021</b>	<b>1,191</b>
Cash per share (Rs)				196	245
<b>Share price target (Rs)</b>					<b>1,327</b>

Source: Company, Kotak Institutional Equities estimates

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**Normalized EPS**

	FY2008	FY2009	FY2010E	FY2011E
<b>EPS (Rs)</b>				
Base adding back one-time costs	39.8	60.7	41.4	58.7
Generic Trileptal+Protonix+Ethyol	28.4	23.4	0.7	0.0
Interest income	6.9	5.7	5.5	5.4
One-time expenses	0.0	(2.4)	0.0	0.0
<b>Total</b>	<b>75.1</b>	<b>87.4</b>	<b>47.6</b>	<b>64.2</b>
<b>P/E (X)</b>				
Base			34.0	24.0
<b>Total</b>			<b>29.6</b>	<b>21.9</b>

Source: Kotak Institutional Equities estimates, Company

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October 01, 2009

**ADD**

OCTOBER 1, 2009

UPDATE

Coverage view: **Attractive**

Price (Rs): **1,534**

Target price (Rs): **1,500**

BSE-30: 17,127

**AGM highlights; reiterate ADD.** BEL's AGM indicated the company expects to (1) reach the "excellent" rating MoU target of Rs52 bn for FY2010E (broadly in line with estimates), (2) have a FY2010E-end order backlog of Rs125-130 bn (implying strong inflows of Rs75-80 bn in FY2010E) and (3) see margin compression led by rising competition (partly built into estimates though opportunities could offset rising competition, in our view). Reiterate ADD with a target price of Rs1,500/share.

## Company data and valuation summary

Bharat Electronics

### Stock data

52-week range (Rs) (high,low)	1,571-545
Market Cap. (Rs bn)	122.7

### Shareholding pattern (%)

Promoters	75.9
FIs	6.1
MFs	7.1

### Price performance (%)

	1M	3M	12M
Absolute	10.0	11.6	73.6
Rel. to BSE-30	(0.1)	(4.5)	32.4

### Forecasts/Valuations

	2009	2010E	2011E
EPS (Rs)	103.8	115.1	125.7
EPS growth (%)	1.8	10.9	9.1
P/E (X)	14.8	13.3	12.2
Sales (Rs bn)	47.5	54.5	61.0
Net profits (Rs bn)	7.5	9.2	10.1
EBITDA (Rs bn)	11.5	12.8	13.8
EV/EBITDA (X)	8.4	7.0	6.2
ROE (%)	20.7	21.6	20.1
Div. Yield (%)	1.2	1.6	1.6

## QUICK NUMBERS

- **Confident of achieving "excellent" rating MoU target of Rs52 bn for FY2010E**
- **Management expects Rs125-130 bn of backlog at end-FY2010E**
- **Margins likely to compress with rising competition**

## Management confident of attaining "excellent" MoU target; strong inflows in FY10 so far

The management highlighted its confidence in achieving its FY2010E MoU sales target of Rs52 bn for "excellent" rating performance. This is broadly in line with our estimates of Rs52.7 bn of standalone revenues for FY2010E. The revenue mix is expected to remain broadly unchanged at 85% and 15% for defense and non-defense segments, respectively.

The company reported an order backlog of Rs121 bn as on September 25, 2009 with strong order inflows of Rs34 bn since end-FY2009. The management highlighted that it expects to end FY2010E with an order backlog of Rs125-130 bn implying order inflows of Rs75-80 bn (yoy growth of 37-40%) in FY2010E.

## Margins likely to fall with rising competition; however, private participation remains tepid so far

The management highlighted that private sector competition is likely to increase led by the opening up of the defense electronics space to private participation with favourable policies such as DPP 2008 etc. The management highlighted likely fall in company margins with this rise in competition. We have currently built in a decline in EBITDA margin to 22.6% in FY2010E from 23.2% in FY2009. The margins are expected to decline to 20.7% in FY2012E. However, we highlight that despite the opening up of the sector to private participation, actual movement in the private sector has remained quite tepid so far. We believe that rising opportunities could make up for the loss in market share due to competition in defense space.

## Retain estimates and target price of Rs1,500/share; reiterate ADD

We maintain our earnings estimates of Rs115.1 and Rs125.7 for FY2010E and FY2011E. We reiterate our ADD rating on the stock with a target price of Rs1,500/share based on (1) 7-8% upside to our target price (2) strong cash flow generation characteristics with low capex and working capital requirements, (3) a-cyclical nature of business provides relatively stable revenue visibility, (4) cash balance of Rs330/share at the end of FY2009 and (e) relatively low valuation of 11X P/E based on FY2011E earnings.

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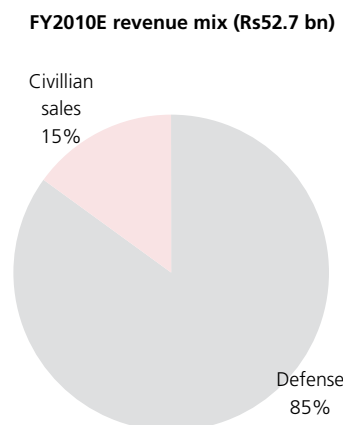
**Management confident of meeting MoU target for “excellent” in FY2010E**

In its Annual General Meeting held on September 25, 2009 the BEL management highlighted their confidence of meeting their FY2010E MoU target of Rs52 bn for “excellent” performance rating. This is broadly in line with our estimates of Rs52 bn of standalone revenues and Rs54 bn of consolidated revenues for FY2010E. Also highlight that the annual report cited Rs49 bn of the FY2009-end order backlog is scheduled to be executed in FY2010E, remaining in FY2011E.

**Revenue mix likely to remain broadly unchanged**

The management also highlighted that the revenue mix between defense (85%) and non-defense (15%) is likely to remain broadly around the same. However, we believe that this mix could change going forward as the company starts to lose market share in the defense segment and offset orders are expected to increase their stake in the total revenue pie.

**Estimate revenue mix likely to remain broadly unchanged in FY2010E**  
 Estimated revenue mix of BEL, March fiscal year-ends, 2010E (%)



Source: Kotak Institutional Equities estimates

**Margins likely to fall led by higher competition; however, private participation remains tepid so far**

Private sector competition is likely to increase led by the opening up of the defense electronics space to private participation with favourable policies such as DPP 2008 etc. The management highlighted likely fall in company margins with this rise in competition. With rising competition BEL would be required to compete on technology, quality, price and after sales support on a global basis. We have currently built in a decline in an EBITDA margin to 22.6% in FY2010E from 23.2% in FY2009. The margins are expected to decline to 20.7% in FY2012E. Furthermore, with 26% FDI being permissible in the defense sector, technology acquisition is becoming incrementally difficult as foreign companies are likely to prefer to directly sell their product or enter into JVs with Indian companies rather than transfer their technology to BEL.

However, we highlight that despite opening up the sector to private participation, the actual movement has been relatively lukewarm so far. The opportunities arising out of the offset areas could outpace the loss in market share in the defense sector due to private sector competition. Hence, we highlight upside potential to our margins based on strong performance in offset segment.

**Potential for margin upside from lower-than-expected employee costs**

We highlight potential for upside to our estimates led by lower-than-expected employee costs in FY2010E. The management highlighted that employee costs are likely to remain flat on a yoy basis at Rs7.5 bn in FY2010E. They cited that the increase in wage rates would be offset by a corresponding decline in employee count. This would imply a potential upside of about 150-200 bps to our margins estimates.

Standalone and consolidated income statement of Bharat Electronics, March fiscal year-ends, 2008-12E (Rs mn)

	Standalone					Consolidated				
	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
<b>Net sales</b>	<b>40,603</b>	<b>45,836</b>	<b>52,711</b>	<b>59,066</b>	<b>66,187</b>	<b>42,067</b>	<b>47,469</b>	<b>54,488</b>	<b>61,023</b>	<b>68,343</b>
Total expenditure	(30,556)	(35,224)	(40,792)	(46,261)	(52,464)	(31,852)	(36,708)	(42,411)	(48,056)	(54,433)
<b>EBITDA</b>	<b>10,047</b>	<b>10,611</b>	<b>11,919</b>	<b>12,805</b>	<b>13,724</b>	<b>10,215</b>	<b>10,762</b>	<b>12,077</b>	<b>12,966</b>	<b>13,909</b>
Other income	2,389	2,296	2,670	3,106	3,508	2,456	2,348	2,720	3,156	3,558
Interest	(2)	(108)	(10)	(10)	(10)	(3)	(108)	(10)	(10)	(10)
Depreciation	(926)	(1,056)	(1,150)	(1,237)	(1,325)	(1,007)	(1,128)	(1,237)	(1,324)	(1,412)
<b>PBT</b>	<b>11,506</b>	<b>11,743</b>	<b>13,430</b>	<b>14,663</b>	<b>15,896</b>	<b>11,661</b>	<b>11,873</b>	<b>13,551</b>	<b>14,788</b>	<b>16,046</b>
Tax	(3,446)	(3,511)	(4,298)	(4,692)	(5,087)	(3,503)	(3,568)	(4,340)	(4,736)	(5,139)
<b>PAT</b>	<b>8,061</b>	<b>8,233</b>	<b>9,132</b>	<b>9,971</b>	<b>10,810</b>	<b>8,157</b>	<b>8,305</b>	<b>9,211</b>	<b>10,052</b>	<b>10,907</b>
Extraordinaries	207	(775)	—	—	—	216	(775)	—	—	—
<b>Reported PAT</b>	<b>8,267</b>	<b>7,458</b>	<b>9,132</b>	<b>9,971</b>	<b>10,810</b>	<b>8,373</b>	<b>7,530</b>	<b>9,211</b>	<b>10,052</b>	<b>10,907</b>
<b>Key metrics (%)</b>										
Revenue growth		12.9	15.0	12.1	12.1		12.8	14.8	12.0	12.0
<b>EBITDA margin</b>	<b>24.7</b>	<b>23.2</b>	<b>22.6</b>	<b>21.7</b>	<b>20.7</b>	<b>24.3</b>	<b>22.7</b>	<b>22.2</b>	<b>21.2</b>	<b>20.4</b>
PBT margin	28.3	25.6	25.5	24.8	24.0	27.7	25.0	24.9	24.2	23.5
Effective tax rate	29.9	29.9	32.0	32.0	32.0	30.0	30.1	32.0	32.0	32.0
PAT margin	19.9	18.0	17.3	16.9	16.3	19.4	17.5	16.9	16.5	16.0
EPS (Rs)	103.3	93.2	114.2	124.6	135.1	104.7	94.2	115.2	125.7	136.4

Source: Company, Kotak Institutional Equities estimates

### Management guides for strong growth in order inflows in FY2010E

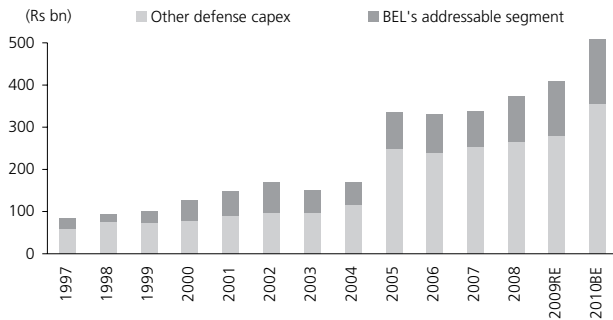
The company cited new order inflows of Rs34 bn since FY2009-end leading to an order backlog of Rs121 bn as on September 25, 2009 versus Rs104 bn at FY2009-end. The management highlighted that it expects to end FY2010E with an order backlog about Rs20-25 bn higher than that of FY2009-end backlog (i.e. about Rs125-130 bn). This would require order inflows of Rs75-80 bn in FY2010E implying strong yoy growth of about 37%-40% in order inflows. We have currently built in order inflows of about Rs60 bn in FY2010E leading to an estimated order backlog of Rs111 bn at the end of FY2010E. The company expects offset opportunities of around US\$300 mn over the next three to five years of which US\$20 mn is expected in FY2010E.

### Strong growth in defense capex provides comfort to revenue stability

We peg the company's earnings growth rate beyond FY2009 at 12-13%. We highlight that defense capital expenditure in India has grown at a CAGR of about 15.4% over the past 13 years. Within this, BEL's addressable segment has grown at about 17% CAGR over the same period. The FY2010E budget estimates a capital expenditure of Rs548 bn towards the defense sector within which BEL's addressable segment amounts to about Rs191 bn, as per our estimate.

Going forward, we believe India would maintain its defense spend to GDP ratio at about 2%, implying that defense capex would rise at the nominal GDP growth rate of 12-12.5%. We believe BEL's earnings would grow in line with defense capital spend, at 12-13%. We highlight that overseas orders and non-defense orders would provide an upside to our estimates.

Defense capex rose at 15.4% CAGR over last 13 years...  
Defense capex, March fiscal year-ends, 1997-2010BE



Source: Defense budget documents

...while BEL's addressable segment has grown at 17% CAGR  
Defense capex, March fiscal year-ends, 2005-2009BE

	2006	2007	2008	2009	2010
	Actual	Actual	Actual	RE	BE
Land	0.7	1.0	0.5	0.8	1.3
Construction	25.5	36.7	40.0	44.4	62.4
Aircraft	123.0	117.8	112.6	134.2	153.1
H&M vehicles	5.8	8.1	16.6	13.1	9.3
<b>Other equipment</b>	<b>90.7</b>	<b>83.0</b>	<b>108.1</b>	<b>129.4</b>	<b>191.1</b>
Naval fleet	47.9	62.4	58.6	40.0	68.4
Naval dockyards	6.1	4.8	7.3	8.6	10.4
R&D	25.3	24.5	27.0	30.9	37.2
Other capex	5.6	6.3	6.4	8.5	15.0
<b>Grand total capex</b>	<b>330.7</b>	<b>338.3</b>	<b>374.6</b>	<b>410.0</b>	<b>548.2</b>

Source: Expenditure budget of Government of India

### Retain ADD rating with a target price of Rs1,500/share

We maintain our earnings estimate of Rs115.2 and Rs125.7 for FY2010E and FY2011E respectively and retain our P/E multiple-based target price of Rs1,500/share. Our target price is based on 12X FY2011E P/E multiple, in line with about 20% discount to Sensex multiple that the stock has traded over a period of time.

We maintain our ADD rating on the stock based on (1) 7-8% upside to our target price (2) strong cash flow generation characteristics with low capex and working capital requirements, (3) a-cyclical nature of business provides relatively stable revenue visibility, (4) cash balance of Rs330/share at the end of FY2009 and (e) relatively low valuation of 11X P/E based on FY2011E earnings.

We highlight risks related to (1) potential long-term increase in competition given that several firms may be awarded the Raksha Udyog Ratna status and (2) could miss large part of offset related upside as that may be dominated by private sector manufacturing and design companies.

### Other takeaways from the AGM

- ▶ Management expects FY2010E employee cost is expected of around Rs7.5 bn. The cost of pay hike which was effective since Jan 2007 has been completely paid out. On other liabilities, final amount for gratuity has been decided and is not expected to go up further.
- ▶ 7 units now have Aerospace AS9100 certification which makes them eligible for international aircraft business
- ▶ Expect FY2010E R&D expense at 5–6% of turnover (FY2009 was 5.25% of turnover)
- ▶ Company expected to incur a capital expenditure of Rs3.2 bn in FY2010E and Rs3.9 bn in FY2011E

## Consolidated financials of Bharat Electronics, March fiscal year-ends, 2007-12E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
<b>Income statement</b>						
<b>Net sales</b>	<b>40,485</b>	<b>42,067</b>	<b>47,469</b>	<b>54,488</b>	<b>61,023</b>	<b>68,343</b>
Total expenditure	(30,791)	(31,852)	(36,708)	(42,411)	(48,056)	(54,433)
<b>EBITDA</b>	<b>9,694</b>	<b>10,215</b>	<b>10,762</b>	<b>12,077</b>	<b>12,966</b>	<b>13,909</b>
Other income	1,978	2,456	2,348	2,720	3,156	3,558
Interest	(8)	(3)	(108)	(10)	(10)	(10)
Depreciation	(933)	(1,007)	(1,128)	(1,237)	(1,324)	(1,412)
<b>PBT</b>	<b>10,731</b>	<b>11,661</b>	<b>11,873</b>	<b>13,551</b>	<b>14,788</b>	<b>16,046</b>
Tax	(3,398)	(3,503)	(3,568)	(4,340)	(4,736)	(5,139)
<b>PAT</b>	<b>7,333</b>	<b>8,157</b>	<b>8,305</b>	<b>9,211</b>	<b>10,052</b>	<b>10,907</b>
Extraordinaries	(9)	216	(775)	—	—	—
<b>Reported PAT</b>	<b>7,325</b>	<b>8,373</b>	<b>7,530</b>	<b>9,211</b>	<b>10,052</b>	<b>10,907</b>
<b>Balance sheet</b>						
Share Capital	800	800	800	800	800	800
Reserves & Surplus	26,127	32,644	38,446	45,407	53,209	61,866
<b>Total Shareholders Funds</b>	<b>26,927</b>	<b>33,444</b>	<b>39,246</b>	<b>46,207</b>	<b>54,009</b>	<b>62,666</b>
<b>Total Debt</b>	<b>23</b>	<b>21</b>	<b>18</b>	—	—	—
<b>Total Liabilities</b>	<b>26,951</b>	<b>33,465</b>	<b>39,265</b>	<b>46,207</b>	<b>54,009</b>	<b>62,666</b>
<b>Net Block</b>	<b>4,139</b>	<b>4,370</b>	<b>4,886</b>	<b>4,899</b>	<b>4,825</b>	<b>4,663</b>
Capital Work in Progress	352	354	499	499	499	499
Cash and bank balance	20,931	24,616	26,577	32,860	37,680	43,124
<b>Net current assets (excl. cash)</b>	<b>19</b>	<b>2,700</b>	<b>5,822</b>	<b>6,469</b>	<b>9,525</b>	<b>12,900</b>
Deferred Tax Assets	1,501	1,425	1,480	1,480	1,480	1,480
<b>Total Assets</b>	<b>26,951</b>	<b>33,465</b>	<b>39,265</b>	<b>46,207</b>	<b>54,009</b>	<b>62,666</b>

Source: Company, Kotak Institutional Equities estimates

**OCTOBER 1, 2009**
**UPDATE**

Coverage view: **Neutral**

Price (Rs): **47**

Target price (Rs): **48**

BSE-30: **17,127**

**BUY for 21-30% likely return in likely scenarios for Zee Tamil.** We present our scenario analysis for ZEEN—(1) base case value of Rs48 (2% return) assuming losses from Zee Tamil in perpetuity, (2) value of Rs57 (21% return) given likely pull back from large investments in Zee Tamil, (3) value of Rs61 (30% return) given the likely uptick in Zee Tamil ratings and modest profits in the long term and (4) value of Rs63 (34% return) given closure of Zee Tamil channel (unlikely, in our view).

**Company data and valuation summary**

Zee News

**Stock data**

52-week range (Rs) (high,low) 52-24

Market Cap. (Rs bn) 11.2

**Shareholding pattern (%)**

Promoters 54.1

FII's 3.4

MFs 21.8

**Price performance (%)**

Absolute 1M 3M 12M

Rel. to BSE-30 (2.8) (3.4) (10.4)

**Forecasts/Valuations**

2009 2010E 2011E

EPS (Rs) 1.9 2.1 2.7

EPS growth (%) 20.4 11.7 29.6

P/E (X) 25.0 22.4 17.3

Sales (Rs bn) 5.2 6.1 7.3

Net profits (Rs bn) 0.4 0.5 0.6

EBITDA (Rs bn) 1.0 1.2 1.5

EV/EBITDA (X) 12.5 10.6 8.8

ROE (%) 20.1 19.2 21.4

Div. Yield (%) 0.9 0.9 1.5

**Our scenario analysis for ZEEN reveals potential for 21-30% returns**

- ▶ Exhibit 1 presents our scenario analysis exercise for ZEEN taking into account the various likely (and unlikely) end-games for the Zee Tamil channel, which is the key overhang on ZEEN stock currently given large investments into the channel (largely program/film rights and carriage fees) but continued weak operating (ratings) performance.
- ▶ Our base-case scenario (see Exhibit 2) assumes continued investment by ZEEN into Zee Tamil and continued weak operating (ratings) performance of the channel; we model Zee Tamil's FY2010E, FY2011E and FY2012E EBITDA losses at Rs500mn, Rs475mn and Rs350mn. However, we believe this is unlikely since (1) ZEEN has the option of pulling back investments given weak ratings or (2) it is likely that ratings performance will improve over time.
- ▶ Our first likely scenario assumes pull back from large investments by ZEEN in Zee Tamil; our DCF-valuation of ZEEN increases to Rs57 (21% return) with P/E valuation at 19.6X FY2010E and 14.1 FY2011E EPS estimates, at significant discount to peers (ZEEL, SUNTV). We highlight that Tamil is a lucrative (ad revenues of Rs7.0bn) but challenging market given Sun TV's strong position (broadcasting as well as distribution) there. ZEEN is likely to hold its ground, understand the nuances and look at strategic rating gains in the market.
- ▶ Our second likely scenario assumes (1) pull back from large investments by ZEEN in Zee Tamil currently but (2) renewed investment led by modest ratings gains over time; our DCF-valuation of ZEEN increases to Rs60 (30% return). ZEEN is eyeing the large gap between the leader (Sun TV) and runners-up (Kalaingar TV). It is likely to shift its focus from competing directly against Sun TV in primetime to complementing Sun TV through differentiated content in non-primetime and near-primetime (6.00-7.30 PM and 10.30-12.00 PM) slots.
- ▶ Our discussion with the management leads us to believe that ZEEN has no plans to exit the Tamil market. Our DCF-valuation of ZEEN rises to Rs63 (34% return) in this hypothetical scenario, which we present to highlight (1) the impact of large operating losses in Zee Tamil on near-term financials and (2) valuation gap versus peers (see Exhibit 3).

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## Scenario analysis on Zee Tamil for ZEEN, March fiscal -year ends, 2009-2012E (Rs mn)

	Base case (conservative)				Scenario 1 (a, likely)				Scenario 2 (b, likely)				Scenario 3 (c, optimistic)			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Revenues	5,221	6,123	7,299	8,686	5,221	6,123	7,249	8,586	5,221	6,123	7,349	8,786	5,221	6,123	7,089	8,327
EBITDA	836	1,101	1,422	1,844	836	1,225	1,661	2,019	836	1,225	1,661	2,195	836	1,349	1,901	2,195
EPS	1.9	2.1	2.7	3.7	1.9	2.4	3.3	4.2	1.9	2.4	3.3	4.7	1.9	2.7	4.0	4.7
<b>EV/EBITDA (X)</b>	<b>16.3</b>	<b>12.4</b>	<b>9.6</b>	<b>7.4</b>	<b>16.3</b>	<b>11.1</b>	<b>8.2</b>	<b>6.8</b>	<b>16.3</b>	<b>11.1</b>	<b>8.2</b>	<b>6.2</b>	<b>16.3</b>	<b>10.1</b>	<b>7.2</b>	<b>6.2</b>
<b>P/E (X)</b>	<b>25.3</b>	<b>22.6</b>	<b>17.4</b>	<b>12.7</b>	<b>25.3</b>	<b>19.6</b>	<b>14.1</b>	<b>11.2</b>	<b>25.3</b>	<b>19.6</b>	<b>14.1</b>	<b>10.1</b>	<b>25.3</b>	<b>17.1</b>	<b>11.8</b>	<b>10.1</b>
<b>12-month DCF valuation (Rs)</b>				<b>48</b>				<b>57</b>				<b>61</b>				<b>63</b>
<b>12-month return from CMP (%)</b>				<b>2</b>				<b>21</b>				<b>30</b>				<b>34</b>

## Notes:

- (a) Investments in Zee Tamil is pulled back. Assuming modest EBITDA losses (50% of our base case by FY2012E, 25% thereafter).  
(b) Ratings of Zee Tamil pick up with lagged effect on financials. Assuming FY2012E breakeven and modest cash profits thereafter.  
(c) Zee Tamil channel is closed with immediate effect. Assuming no incremental losses on account of Zee Tamil channel.

Source: Company data, Kotak Institutional Equities estimates

## ZEEN financials without Zee Tamil, March fiscal year-ends, 2008-2015E (Rs mn)

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
<b>ZEEN (base case)</b>								
Revenues	3,675	5,221	6,123	7,299	8,686	9,971	11,351	12,884
<b>Growth (%)</b>		<b>42.1</b>	<b>17.3</b>	<b>19.2</b>	<b>19.0</b>	<b>14.8</b>	<b>13.8</b>	<b>13.5</b>
EBITDA	678	836	1,101	1,422	1,844	2,216	2,650	3,097
<b>EBITDA margin (%)</b>	<b>18.4</b>	<b>16.0</b>	<b>18.0</b>	<b>19.5</b>	<b>21.2</b>	<b>22.2</b>	<b>23.3</b>	<b>24.0</b>
PAT	371	446	499	646	887	1,093	1,366	1,649
<b>PAT margin (%)</b>	<b>10.1</b>	<b>8.5</b>	<b>8.1</b>	<b>8.9</b>	<b>10.2</b>	<b>11.0</b>	<b>12.0</b>	<b>12.8</b>
<b>ZEEN (excl. Zee Tamil)</b>								
Revenues	3,675	5,221	6,070	7,089	8,251	9,356	10,551	11,868
<b>Growth (%)</b>		<b>42.1</b>	<b>16.2</b>	<b>16.8</b>	<b>16.4</b>	<b>13.4</b>	<b>12.8</b>	<b>12.5</b>
EBITDA	678	836	1,349	1,901	2,195	2,515	2,912	3,324
<b>EBITDA margin (%)</b>	<b>18.4</b>	<b>16.0</b>	<b>22.2</b>	<b>26.8</b>	<b>26.6</b>	<b>26.9</b>	<b>27.6</b>	<b>28.0</b>
PAT	371	446	658	958	1,118	1,290	1,538	1,798
<b>PAT margin (%)</b>	<b>10.1</b>	<b>8.5</b>	<b>10.8</b>	<b>13.5</b>	<b>13.6</b>	<b>13.8</b>	<b>14.6</b>	<b>15.1</b>

Source: Company data, Kotak Institutional Equities estimates

## Operational and financial comparison of Sun TV and Zee News

Market	Position	
	Sun TV	ZEEN
Tamil	Leader	NA
Telugu	Leader	Runners-up
Bengali	NA	Runners-up
Kannada	Leader	Runners-up
Marathi	NA	Leader
Malyalam	Runners-up	NA
<b>Financial performance</b>		
Market cap (Rs mn)	129,179	11,175
FY2010E EV (Rs mn)	125,839	13,470
FY2010E EBIT (Rs mn)	6,173	986
<b>FY2010E EV/EBIT</b>	<b>20.4</b>	<b>13.7</b>
Adj. FY2010E EBIT (Rs mn) (a)	6,711	1,482
<b>Adj. FY2010E EV/EBIT</b>	<b>18.8</b>	<b>9.1</b>

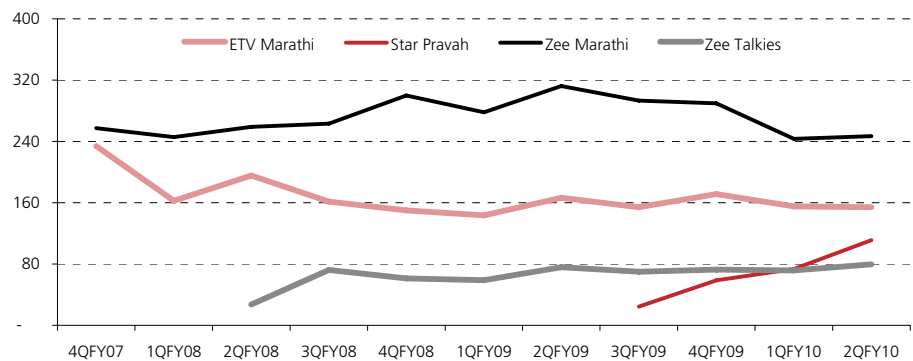
## Notes:

- (a) Excluding the financials of recently launched Zee Tamil.

Source: Company data, Kotak Institutional Equities estimates

**Marathi, Telugu channels to be the key drivers in the near term.** Exhibits 4-5 present the continued robust ratings performance of Zee Marathi and Telugu; we also highlight the strong ratings performance of Zee Talkies, the Marathi cinema channel. More important, we highlight that no one channel contributes more than 20% to ZEEN revenues and its strong bouquet/network of channels across genres (GE, Cinema, News) and markets (Hindi, Marathi, Telugu, Bengali etc.), which ensures that competition in any one market does not have a disproportionate impact on financial performance (unlike the case with peers ZEEL and SUNTV) and opportunities for cross-selling to advertisers (e.g. the HUL roadblock on Zee Network recently).

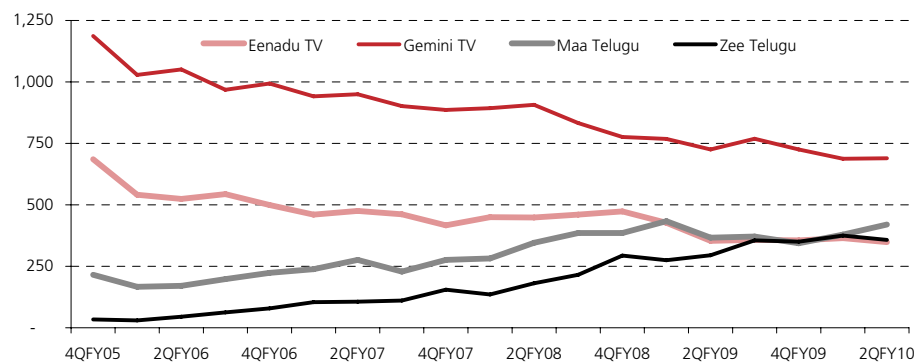
#### Trends in GRPs for key Marathi language channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities

We also highlight that the long period of relative under-performance in Zee Telugu (1-4% market share for the first two years of operations, prior to 4QFY07) before the strong uptick in its ratings; Zee Telugu currently has about 14-15% share of the Telugu broadcasting market and (along with Maa Telugu) has overtaken the long-time number two channel, Eenadu TV (ETV). We expect robust competitive intensity in the market to benefit ZEEN given a reduction in the gap between GRPs (ratings) and ad rates versus the market leader (Gemini TV). We model EBITDA breakeven in Zee Telugu in FY2010E and significant EBITDA contribution (Rs180mn) in FY2011E. We expect Zee Marathi and Telugu to be the key drivers of earnings growth in the near term but Bangla, News and Kannada channels will also contribute over time.

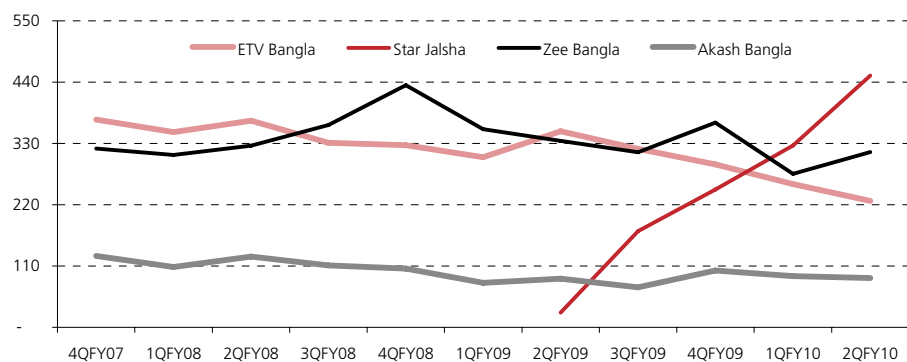
#### Trends in GRPs for key Telugu language channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities

**Key risks include weak ratings of Zee Bangla.** Exhibit 6 presents the weak ratings performance of Zee Bangla versus competition in the Bengali market. Star Jalsha has become the leader in the market with strong growth in its GRPs (ratings) pushing Zee Bangla to the number two position. However, Zee Bangla has been able to hold on to its ratings performance and Star Jalsha has gained mainly at the expense of other competition (ETV Bangla) and through market expansion. We expect the loss of leadership position and market share to have a significant impact on Zee Bangla; we model a 5% decline and a modest 10% growth in Zee Bangla's FY2010E and FY2011E revenues versus robust 10% and 15% growth expected in the Bangla market. However, we estimate Zee Bangla's contribution to ZEEN revenues at only 16% (FY2009) and thus, we believe the impact is largely factored into the stock price.

Trends in GRPs for key Bengali language channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities

**Earnings revisions.** We have fine tuned our FY2010E and FY2011E earnings estimates to Rs2.1 (Rs2.2 previously) and Rs2.7 (Rs2.7) on account of minor changes to our model, which we discuss below. We retain our ADD rating on the stock with revised 12-month DCF-based target price of Rs48 (Rs45 previously) on account of the above-mentioned changes and DCF roll forward.

- ▶ **Zee Gujarati.** ZEEN has closed its Gujarati general entertainment channel; the ZEEN management believes that the Gujarati market is well served by the Hindi GE channels and there was limited utility in continuing with the loss-making (albeit small) operation. We have accordingly adjusted our financials for the same.
- ▶ **Advertising revenues.** We model ZEEN's FY2010E and FY2011E ad revenues at Rs4.75bn (Rs4.9bn previously) and Rs5.6bn (Rs5.8bn) to account for (1) closure of Zee Gujarati channel and (2) 5% decline in Zee Bangla's FY2010E revenues (versus flat revenues in FY2010E over FY2009 previously).
- ▶ **Operating costs.** We model ZEEN's FY2010E and FY2011E operating costs at Rs5.0bn (Rs5.2bn previously) and Rs5.9bn (Rs6.15bn) on account of (1) closure of Zee Gujarati channel and (2) moderate savings on account of correction in cost of content (programs and film rights) in the market.

## Consolidated financial summary of Zee News, March fiscal year-ends, 2007-2013E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E	2013E
<b>Profit model (Rs mn)</b>							
Net sales	2,405	3,675	5,221	6,123	7,299	8,686	9,971
<b>EBITDA</b>	<b>77</b>	<b>678</b>	<b>836</b>	<b>1,101</b>	<b>1,422</b>	<b>1,844</b>	<b>2,216</b>
Interest income	131	14	176	122	113	116	121
Interest expense	(51)	(5)	(211)	(306)	(339)	(372)	(389)
Depreciation	(52)	(85)	(95)	(115)	(140)	(157)	(175)
<b>Pretax profits</b>	<b>104</b>	<b>601</b>	<b>706</b>	<b>801</b>	<b>1,056</b>	<b>1,431</b>	<b>1,773</b>
Tax-cash	(53)	(247)	(260)	(271)	(383)	(515)	(649)
Tax-deferred	7	15	1	(22)	(11)	(7)	(3)
Minority interest	16	2	(1)	(10)	(16)	(22)	(28)
<b>Net profits after minority interests</b>	<b>75</b>	<b>371</b>	<b>446</b>	<b>499</b>	<b>646</b>	<b>887</b>	<b>1,093</b>
<b>Earnings per share (Rs)</b>	<b>0.3</b>	<b>1.5</b>	<b>1.9</b>	<b>2.1</b>	<b>2.7</b>	<b>3.7</b>	<b>4.6</b>
<b>Balance sheet (Rs mn)</b>							
Total equity	1,813	2,071	2,406	2,792	3,242	3,848	4,520
Deferred Tax	1	(18)	(19)	2	13	20	23
Minority interest	36	51	54	64	80	102	130
Total borrowings	13	117	2,017	2,317	2,617	2,917	2,917
Current liabilities	973	1,407	1,624	1,589	1,663	1,904	2,133
<b>Total capital</b>	<b>2,835</b>	<b>3,628</b>	<b>6,081</b>	<b>6,764</b>	<b>7,616</b>	<b>8,792</b>	<b>9,724</b>
Cash	41	39	508	489	321	541	554
Current assets	1,501	2,013	2,883	3,080	3,639	4,282	4,883
Total fixed assets	808	812	1,047	1,132	1,192	1,236	1,286
Investments	484	764	1,644	2,063	2,463	2,734	3,000
<b>Total assets</b>	<b>2,835</b>	<b>3,628</b>	<b>6,081</b>	<b>6,764</b>	<b>7,616</b>	<b>8,792</b>	<b>9,724</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	7	555	410	524	700	957	1,178
Working capital	(273)	(306)	(582)	(233)	(485)	(401)	(373)
Capital expenditure	(300)	(96)	(342)	(200)	(200)	(200)	(225)
Investments	964	(279)	(883)	(419)	(400)	(271)	(266)
Other income	122	—	64	122	113	116	121
<b>Free cash flow</b>	<b>(566)</b>	<b>154</b>	<b>(514)</b>	<b>91</b>	<b>15</b>	<b>355</b>	<b>580</b>
<b>Ratios (%)</b>							
Debt/equity	0.7	5.6	83.8	83.0	80.7	75.8	64.5
Net debt/equity	(1.5)	3.7	62.7	65.5	70.8	61.7	52.3
RoAE	8.2	19.2	20.1	19.2	21.4	24.9	26.0
<b>RoACE</b>	<b>1.5</b>	<b>18.2</b>	<b>14.3</b>	<b>13.2</b>	<b>14.6</b>	<b>16.9</b>	<b>18.1</b>

Source: Company data, Kotak Institutional Equities estimates

OCTOBER 1, 2009

UPDATE

BSE-30: 17,127

**Structural weakness emerges with 1QFY10 CAD at 2.1% of GDP.** The current account deficit (CAD) in 1QFY10 at 2.1% of GDP against market expectations of a small surplus has exposed the structural weakness in India's external account. It has shattered the sense of complacency generated by incomplete DGCIS foreign trade data. India's economy remains vulnerable to any sharp surge in global oil prices ahead, though new capacities have somewhat reduced these vulnerabilities.

#### 1QFY10 CAD at 2.1% GDP—imports on BOP basis exceed DGCIS data by US\$13.8 bn

1QFY10 imports on a BOP basis (RBI data based on foreign currency receipts captured by custodian banks) were US\$64.8 bn versus US\$50.9 bn as per customs (DGCIS data based on shipment). This left CAD at US\$5.8 bn (2.1% of GDP), up sequentially from US\$1.7 bn (0.6% of GDP) in 4QFY09, but down from US\$9.0 bn (3.0% of GDP) in 1QFY09. In our view, the difference in RBI and DGCIS data is on account of (1) poor trade data collection by DGCIS due to incomplete computerization of port handling, (2) defence imports that are captured only in RBI data and (3) possible overinvoicing of imports.

#### Capital account turns positive in 1QFY10

Strong FII and FDI inflows adding to US\$15 bn has turned the capital account, which was in surplus of US\$6.7 bn in 1QFY10 against deficits of US\$4.2 bn in 3QFY09 and US\$5.2 bn in 4QFY09. Banking capital, ECB and short-term trade credit outflows, however, moderated the capital account.

#### BOP likely to remain comfortable in FY2010E but there is no scope for complacency

We expect strong capital flows in FY2010E to leave overall BoP in surplus of about US\$42 bn, leading to strong reserve accretion and moderate rupee appreciation. However, we see no scope for complacency as the 1QFY10 BoP data suggests structural weakness that could widen CAD and turn the BOP into deficit should global commodity prices harden and capital flows moderate again.

#### QUICK NUMBERS

- CAD/GDP ratio rises to 2.1% in 1QFY10 from 0.6% in 4QFY09
- BOP data shows imports higher by US\$14 bn from DGCIS trade data
- Capital account turns surplus (US\$6.7 bn) after deficits in 2HFY09

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### Current account gap still wide

Overall BOP in 1QFY10 was in balance (marginal surplus of US\$0.1 bn) (see Exhibit). However, the street was hoping that current account in FY2010 may also turn surplus and may have got rude shock. The Balance of Payments (BOP) data released by the Reserve Bank of India (RBI) on September 30, 2009 show that CAD was still US\$5.8 bn in 1QFY10. In our calculations, this is 2.1% of GDP, which is the long-term average. The merchandise trade deficit in 1QFY10 was at 9.5% of GDP. We assess that CAD is still sustainable from the BOP point of view. However, this still leaves us worried as a CAD of 2.1% came with an average crude oil import price of US\$64/b. CAD had risen to 3.7% of GDP in 1HFY09, when average crude oil import price was at US\$117/b. Capital inflows had moderated at that point, but not reversed as they did in 2HFY09 on back of severe risk aversion in global financial markets.

CAD of 1QFY10, though manageable, should be a warning against complacency as deficit has persisted in spite of favorable conditions of (1) low global commodity prices and (2) revival of capital inflows that has averted any financing strains on BOP. It suggests that India's external accounts remain slightly vulnerable to structural deficits. In case a double-whammy—a surge in global oil or non-oil commodity prices combined with a sudden stoppage of capital inflows—plays out, BOP could come under stress.

Thankfully, India's forex reserves have risen back to US\$281 bn, after having depleting to under US\$250 bn in November 2008-February 2009 period from a high of US\$315 bn in May 2008 and should provide sufficient insurance to forestall any currency crisis.

### What explains the difference between RBI and DGCIS trade data

Wide gap in CAD was contrary to street expectations of a small surplus. Clearly the expectations were driven by the trade data of Directorate General of Commercial Intelligence & Statistics (DGCIS) of the Ministry of Commerce, which is the 140-years old official agency collecting trade statistics. However, imports were higher by US\$13.8 bn and exports were higher by US\$4.2 bn in RBI's BOP data. In 1QFY09, this difference was only US\$2.9 bn. In full year FY2009, the difference was US\$6.8 bn.

In our view, the difference in merchandise trade data of RBI and DGCIS data is largely on account of:

- ▶ Poor trade data collection by DGCIS as about a quarter of the trade does not get captured under their electronic data interchange (EDI) and has to be manually collected later due to incomplete computerization of port handling. As a result, revisions in DGCIS data are sizeable. For instance, recently, DGCIS has revised its export figures for FY2009 to US\$183 bn from its original estimate of US\$169 bn (a revision of US\$14 bn).
- ▶ Defence related imports that are captured in RBI data but not in DGCIS data and typically explain half of the difference in imports in the two datasets.
- ▶ Difference in timing and exchange rate as RBI records data on payment basis (foreign currency receipts (against exports)/ payments (against imports) by custodian banks, while DGCIS records trade data at shipment point as per documents with the customs.
- ▶ Possible underinvoicing/overinvoicing of exports and imports that are often associated with traders trying to benefit from exchange rate movements, as also to support circular flow of money across geographies.

### Invisibles return to past levels in 1QFY10 after dropping in 4QFY10

Net invisibles receipts rose again to US\$20.2 bn in 1QFY10 after dropping to US\$12.4 bn in 4QFY09, when they were impacted by the global recession. In the five preceding quarters, net invisibles had averaged US\$22.6 bn, staying above US\$20 bn mark in each of these quarters.

- ▶ Software exports dropped 3.3% sequentially and 8.2% yoy in this quarter to US\$10.4 bn. KIE data shows that US\$ revenue earnings of top 13 Information Technology companies in 1QFY10 had recorded a 2.9% growth sequentially and 1.0% yoy to US\$5.8 bn and thus accounted for 56% of the software exports as per BoP data. This may mean persisting degrowth in case of smaller IT companies.
- ▶ Transfers, which are almost entirely on account of private remittances, jumped back to US\$12.9 bn in 1QFY10, after having dropped to US\$9.6 bn in 4QFY09 from a high of US\$13.5 bn in 4QFY08. The onset of global recovery and fiscal stimulus in advanced economies may have helped shore up transfers.

### Capital account turnaround with net inflows of US\$6.7 bn

Capital inflows into Indian economy returned in 1QFY10 after two quarters outflows. Key highlights of the capital account in 1QFY10 are:

- ▶ Net foreign investments of US\$15.1 bn that matches the excessive capital inflow period of 2Q and 3Q of FY2008.
- ▶ Net FDI inflows of US\$6.8 bn, with inward FDI at US\$9.5 bn and outward FDI at US\$2.6 bn. About half of this net inward FDI came through Mauritius route, mainly in manufacturing (19.2%), real estate (15.6%), financial services (15.4%), construction (12.2%) and business services (11.7%).
- ▶ FII inflows were at US\$8.2 bn (as per RBI data sourced from custodians) compared with their net investments of US\$7.4 bn (as per SEBI data).
- ▶ Banking capital outflows persisted for the third quarter in succession was at US\$3.4 bn, which though less than the outflow of US\$5 bn in the stressed 3QFY09, was marginally higher than 4QFY09.
- ▶ There were net outflows of US\$0.4 bn under External Commercial Borrowings (ECB), mainly on account of redemptions of US\$2.4 bn
- ▶ Outflows (US\$3.1 bn) also persisted for the third successive quarter in case of short-term trade credit (supplier's credit and buyer's credit of less than 3 years).

### Retain our FY2010E projections of 1.5% CAD/GDP ratio

Our Economy note of July 1, 2009, '*Current account turns, but capital outflows persist*' had suggested a comfortable BOP position with a CAD/GDP ratio of about 1.5% in the full year FY2010E. We retain this projection. Our assessment is that trade gap may be wider at 9.4% of GDP (earlier 8.4% of GDP), but invisibles surplus would also be larger at 7.1% of GDP (from 6.9% of GDP).

We also see the likelihood of adequate capital flows. There is substantive risk of excessive capital flows in FY2010 on par with that in FY2008 if the current run rate is maintained. However, we expect some moderation ahead on account of worsening inflation, bad fiscal and likely monetary policy tightening. Factoring in this base case we see:



- ▶ Total capital account flows at US\$62 bn, up from just US\$9 bn in FY2009.
- ▶ With CAD in FY2010E at US\$18.5 bn, we expect a BOP surplus of US\$42 bn against deficit of US\$19 bn last year. As a result, FY2010E is likely to see strong reserve accretion.
- ▶ As a result, BOP Our INR/USD average of 47 in FY2010E instead of 48, i.e. depreciation of 2% over FY2009
- ▶ We continue to see possibility of moderate appreciation of INR/USD and retain our exchange rate assumption of Rs47/USD for exchange rate projections as of now.

**Exhibit: Capital flows improving; CAD may shrink but less than street expectation in FY2010E**  
India's quarterly balance of payments, March fiscal year-ends, 2008-2011E (US\$ bn)

	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10E	2QFY10E	3QFY10E	4QFY10E	2008	2009	2010E
<b>Current account</b>	<b>(9.0)</b>	<b>(12.5)</b>	<b>(13.0)</b>	<b>5.3</b>	<b>(5.8)</b>	<b>(2.1)</b>	<b>(4.3)</b>	<b>(6.3)</b>	<b>(17.0)</b>	<b>(29.3)</b>	<b>(18.5)</b>
GDP	296	293	290	280	273	278	329	339	841	1,167	1,218
% of GDP	(3.0)	(4.3)	(4.5)	1.9	(2.1)	(0.7)	(1.3)	(1.9)	(2.0)	(2.5)	(1.5)
Trade balance	(31.4)	(38.7)	(34.7)	(14.1)	(26.0)	(23.7)	(25.1)	(29.9)	(91.6)	(118.9)	(104.7)
% of GDP	(10.6)	(13.2)	(12.0)	(5.0)	(9.5)	(8.5)	(7.6)	(8.8)	(10.9)	(10.2)	(8.6)
- Exports	49.1	49.0	37.3	36.2	38.8	42.5	46.9	50.1	166.2	171.5	178.3
- Imports	80.5	87.7	72.0	50.2	64.8	66.2	72.0	80.0	257.8	290.4	283.0
o/w Oil imports	29.4	33.2	17.5	11.7	12.8	15.1	16.7	18.1	79.7	93.2	62.7
o/w Non-oil imports	51.2	54.5	54.5	38.6	52.0	51.1	55.3	61.9	178.1	197.2	220.3
Invisibles (net)	22.4	26.2	21.7	19.3	20.2	21.6	20.8	23.6	74.6	89.6	86.2
- Services	11.6	14.1	13.2	11.0	9.0	10.8	11.3	12.7	37.6	49.8	43.8
o/w Software	11.3	11.3	10.9	10.7	10.4	10.8	11.2	11.9	37.2	44.2	44.3
- Transfers	11.7	12.9	10.2	9.6	12.9	12.1	11.3	12.5	41.9	44.3	48.8
- Other invisibles	(0.9)	(0.8)	(1.6)	(1.2)	(1.7)	(1.3)	(1.8)	(1.6)	(4.9)	(4.5)	(6.4)
<b>Capital account</b>	<b>11.2</b>	<b>7.6</b>	<b>(4.2)</b>	<b>(5.2)</b>	<b>6.7</b>	<b>19.8</b>	<b>19.1</b>	<b>15.9</b>	<b>108.0</b>	<b>9.3</b>	<b>61.6</b>
Foreign investment	4.8	3.6	(5.3)	0.6	15.1	15.5	10.0	6.4	45.0	3.6	47.0
- FDI	9.0	4.9	0.4	3.2	6.8	7.0	5.0	4.1	15.4	17.5	22.9
- FII	(5.2)	(1.4)	(5.8)	(2.6)	8.2	8.4	4.8	2.0	20.8	(15.0)	23.4
- ADRs/GDRs	1.0	0.1	0.0	0.0	0.0	0.1	0.2	0.3	8.8	1.2	0.6
Banking capital	2.7	2.1	(5.0)	(3.3)	(3.4)	(0.8)	1.1	2.4	11.8	(3.4)	(0.7)
- NRI deposits	0.8	0.3	1.0	2.2	1.8	1.1	1.0	0.9	0.2	4.3	4.8
Short-term credit	2.4	1.3	(4.0)	(5.5)	(3.1)	1.1	2.2	2.7	17.2	(5.8)	2.9
ECBs	1.5	1.7	3.9	1.1	(0.4)	1.1	2.9	2.4	22.6	8.2	6.0
External assistance	0.4	0.5	1.0	0.8	0.1	1.6	1.7	0.5	2.1	2.6	3.9
Other capital account items	(0.5)	(1.6)	5.2	1.1	(1.6)	1.3	1.2	1.5	9.3	4.1	2.4
E&O	0.1	0.2	(0.6)	0.8	(0.8)	0.0	0.0	0.0	1.2	0.6	(0.8)
<b>Overall balance</b>	<b>2.3</b>	<b>(4.7)</b>	<b>(17.8)</b>	<b>0.9</b>	<b>0.1</b>	<b>17.8</b>	<b>14.8</b>	<b>9.6</b>	<b>92.2</b>	<b>(19.4)</b>	<b>42.3</b>
<b>memo: RBI's net forex purchases</b>	<b>(0.8)</b>	<b>(8.9)</b>	<b>(22.8)</b>	<b>0.6</b>	<b>(2.9)</b>						
<b>Assumptions</b>											
Average exchange rate (Rs/US\$)	41.74	43.75	48.76	49.78	48.68	48.41	47.20	46.50	40.26	45.93	47.70
Average Indian crude basket price (US\$/b)	119.2	114.9	54.4	44.9	59.2	70.0	73.0	77.7	78.2	84.0	70.0

Source: RBI and Kotak Institutional Equities



### Kotak Institutional Equities: Valuation summary of key Indian companies

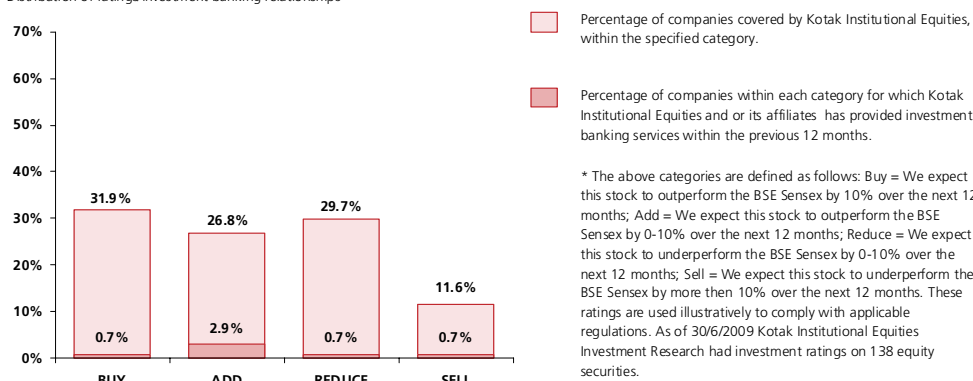
Company	30-Sep-09		Mkt cap.		O/S shares		EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price		ADVT-3mo
	Price (Rs)	Rating	(Rs mn)	(US\$ mn)	(mn)	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	(Rs)	(%)	(US\$ mn)	
<b>Energy</b>																														
Bharat Petroleum	574	BUY	188,185	3,912	328	20.6	79.8	65.0	(50.1)	287.1	(18.5)	27.9	7.2	8.8	7.6	5.0	5.4	1.4	1.2	1.1	1.3	6.1	5.0	5.3	18.9	13.8	675	17.6	9.7	
Cairn India	262	REDUCE	496,642	10,324	1,897	8.3	25.4	30.2	93	207	18.9	32	10	8.7	15.4	7.0	6.1	1.4	1.4	1.4	—	7.6	9.5	4.6	13.6	16.1	225	(14.1)	19.8	
Castrol India (a)	501	ADD	1,287	124	21.3	31.1	32.0	20.8	45.9	3.0	23.5	16.1	15.6	13.4	9.6	9.2	13.8	12.1	10.9	3.0	4.4	4.6	61.2	80.2	73.5	480	(4.2)	1.1		
GAIL (India)	359	ADD	455,575	9,470	1,268	22.2	20.9	22.9	8.7	(5.8)	9.6	16.2	17.2	15.7	8.7	9.9	9.9	2.8	2.6	2.3	1.9	2.2	2.2	17.5	14.7	14.8	355	(1.2)	19.2	
GSPL	84	REDUCE	47,077	979	563	2.2	3.5	6.7	21.7	58.3	92.7	38.1	24.1	12.5	13.0	7.6	4.8	3.5	3.2	3.2	0.9	1.4	8.0	9.6	13.9	25.7	65	(22.3)	8.7	
Hindustan Petroleum	402	BUY	136,248	2,832	339	17.0	73.1	58.5	(49.3)	330.9	(19.9)	23.7	5.5	6.9	3.6	2.2	NA	1.1	1.0	NA	1.3	7.5	6.0	4.4	17.7	12.8	525	30.6	12.2	
Indian Oil Corporation	681	BUY	802,527	16,683	1,179	19.7	101.8	79.3	(67.9)	416.7	(22.1)	34.5	6.7	8.6	9.1	4.6	4.5	1.7	1.5	1.3	1.1	5.9	4.6	4.8	22.6	15.6	800	17.6	9.5	
Oil & Natural Gas Corporation	1,172	BUY	2,506,776	52,110	2,139	89.6	115.8	136.4	(3.4)	29.2	17.8	13.1	10.1	8.6	4.8	3.7	3.0	2.2	1.9	1.7	2.7	3.6	4.1	16.6	18.9	19.8	1,400	19.5	50.5	
Petronet LNG	79	REDUCE	59,250	1,232	750	6.9	7.2	8.6	—	3.6	19.6	11.4	11.0	9.2	8.0	7.2	6.2	2.6	2.2	1.8	2.2	2.5	2.8	23.9	20.6	64	(19.0)	5.5		
Reliance Industries	2,202	SELL	3,207,804	66,683	1,457	103.4	109.1	157.9	(1.5)	5.5	44.7	21.3	20.2	13.9	13.2	9.3	6.8	2.7	2.4	2.1	0.6	0.7	0.9	15.1	13.5	17.1	1,750	(20.5)	211.4	
Reliance Petroleum	131	NR	589,275	12,250	4,500	—	3.1	10.0	n/a	n/a	n/a	n/a	n/a	13.0	n/a	n/a	9.9	4.4	4.3	3.4	—	1.5	1.5	0.6	10.1	29.0	—	—	15.5	
<b>Energy</b>		<b>Attractive</b>	<b>8,551,278</b>	<b>177,763</b>					<b>(6.8)</b>	<b>57.2</b>	<b>18.6</b>	<b>18.5</b>	<b>11.8</b>	<b>9.9</b>	<b>8.7</b>	<b>5.9</b>	<b>5.0</b>	<b>2.2</b>	<b>2.0</b>	<b>1.8</b>	<b>1.4</b>	<b>3.0</b>	<b>3.2</b>	<b>12.0</b>	<b>16.6</b>	<b>17.7</b>				
<b>Industrials</b>																														
ABB	784	REDUCE	166,232	3,456	212	25.8	23.3	30.0	11.3	(9.8)	28.6	30.4	33.7	26.2	18.0	19.0	14.6	7.8	6.6	5.4	0.3	0.4	0.4	29.2	21.3	22.7	660	(15.9)	7.2	
BGR Energy Systems	455	ADD	32,731	680	72	16.0	26.0	35.3	32.2	62.3	35.8	28.4	17.5	12.9	16.1	10.4	8.3	5.8	4.6	3.6	0.7	1.0	1.3	22.3	29.4	31.2	530	16.6	3.0	
Bharat Electronics	1,534	ADD	122,700	2,551	80	103.8	115.1	125.7	1.8	10.9	9.1	14.8	13.3	12.2	7.3	6.1	5.3	3.1	2.7	2.3	1.2	1.6	1.6	20.7	21.6	20.1	1,500	(2.2)	2.8	
Bharat Heavy Electricals	2,329	ADD	1,140,019	23,699	490	63.9	93.3	115.2	9.4	46.1	23.4	36.5	25.0	20.2	20.0	14.0	11.1	8.8	7.0	5.5	0.7	0.9	1.1	26.4	31.2	30.5	2,425	4.1	44.3	
Crompton Greaves	314	ADD	114,984	2,390	367	15.3	17.7	20.3	37.3	15.3	15.0	20.4	17.7	15.4	10.9	9.5	8.1	6.3	4.8	3.8	0.6	0.7	0.8	35.9	30.8	27.6	315	0.4	4.8	
Larsen & Toubro	1,689	ADD	996,121	20,707	590	50.1	62.1	78.4	32.1	24.0	26.1	33.7	27.2	21.6	21.1	15.6	12.8	6.6	4.9	4.0	0.6	0.7	0.7	21.7	20.5	20.4	1,725	2.1	79.2	
Maharashtra Seamless	315	BUY	22,185	461	71	35.9	33.0	35.3	22.2	(7.9)	6.9	8.8	9.5	8.9	5.2	5.4	4.7	1.6	1.4	1.3	1.7	1.6	2.0	20.3	16.0	15.0	285	(9.4)	1.0	
Siemens	557	ADD	187,849	3,905	337	14.2	22.8	22.7	(22.2)	61.0	(0.5)	39.3	24.4	24.5	18.9	14.2	14.4	8.3	6.9	5.6	0.5	1.3	0.8	23.3	30.8	25.2	515	(7.6)	6.6	
Suzlon Energy	92	ADD	153,839	3,198	1,679	7.2	1.5	5.5	9.9	(78.0)	252.9	12.7	59.2	16.8	8.4	10.7	7.9	1.5	1.3	1.2	—	—	—	—	—	—	110	20.1	129.2	
<b>Industrials</b>		<b>Attractive</b>	<b>2,936,659</b>	<b>61,047</b>					<b>13.1</b>	<b>18.6</b>	<b>26.5</b>	<b>29.7</b>	<b>25.0</b>	<b>19.8</b>	<b>16.4</b>	<b>13.4</b>	<b>10.9</b>	<b>5.8</b>	<b>4.6</b>	<b>3.9</b>	<b>0.6</b>	<b>0.8</b>	<b>0.9</b>	<b>19.5</b>	<b>18.5</b>	<b>19.5</b>				
<b>Infrastructure</b>																														
GMR Infrastructure	140	ADD	257,265	5,348	1,834	1.5	0.9	0.9	33.0	(38.3)	(6.8)	91.4	148.1	158.8	31.8	23.1	17.0	3.1	2.6	2.4	—	—	—	4.4	2.6	2.4	135	(3.8)	21.6	
GVK Power & Infrastructure	46	BUY	73,354	1,525	1,579	0.8	0.8	1.0	(20.6)	3.7	31.1	60.9	58.7	44.8	54.3	17.9	16.5	3.2	2.3	2.2	—	—	—	0.6	4.8	4.6	5.1	50	7.6	17.7
IRB Infrastructure	212	ADD	70,345	1,462	332	5.3	10.6	13.5	54.3	101.2	27.0	40.0	19.9	15.7	20.6	10.6	9.7	3.9	3.1	2.6	0.6	—	—	—	10.1	17.3	18.0	200	(5.5)	9.7
<b>Infrastructure</b>		<b>Attractive</b>	<b>400,964</b>	<b>8,335</b>					<b>22.5</b>	<b>16.0</b>	<b>18.8</b>	<b>71.3</b>	<b>61.4</b>	<b>51.7</b>	<b>31.5</b>	<b>18.2</b>	<b>14.7</b>	<b>3.2</b>	<b>2.6</b>	<b>2.4</b>	<b>0.1</b>	<b>—</b>	<b>0.1</b>	<b>4.5</b>	<b>4.2</b>	<b>4.6</b>				
<b>Media</b>																														
DishTV	45	REDUCE	42,445	882	946	(6.6)	(3.3)	(1.5)	n/a	(49.1)	(53.9)	(6.8)	(13.4)	(29.1)	(38.7)	54.4	16.3	(6.8)	(40.1)	(16.8)	—	—	—	83.9	86.7	NA	35	(22.0)	9.9	
HT Media	132	ADD	31,114	647	235	0.8	5.0	6.6	(80.5)	489.0	32.0	156.8	26.6	20.2	35.4	13.1	10.5	3.6	3.3	3.0	0.2	0.8	1.5	2.3	13.0	15.7	125	(5.6)	0.3	
Jagran Prakashan	105	ADD	31,698	659	301	3.0	5.1	6.0	(6.6)	66.7	17.5	34.6	20.7	17.7	19.6	12.0	10.1	5.7	5.2	4.7	1.9	2.9	3.1	16.7	26.2	28.2	110	4.5	1.5	
Sun TV Network	328	REDUCE	129,179	2,685	394	9.1	11.4	13.3	9.5	25.1	17.1	36.1	28.9	24.7	19.1	16.4	13.7	7.3	6.4	5.7	0.8	1.2	1.8	22.5	24.0	24.6	245	(25.3)	2.6	
Zee Entertainment Enterprises	239	REDUCE	103,618	2,154	334	8.4	10.1	12.3	(4.8)	19.6	21.9	28.3	23.6	19.4	19.6	16.7	13.5	3.0	2.7	2.5	0.8	1.0	1.2	11.8	12.4	13.9	175	(26.7)	8.3	
Zee News	47	ADD	11,175	232	240	1.9	2.1	2.7	20.4	11.7	29.6	25.0	22.4	17.3	12.5	10.6	8.8	4.6	3.9	3.4	0.9	0.9	1.5	20.1	19.2	21.4	48	3.0	0.8	
<b>Media</b>		<b>Neutral</b>	<b>349,228</b>	<b>7,260</b>					<b>(21.0)</b>	<b>110.0</b>	<b>47.4</b>	<b>82.5</b>	<b>39.3</b>	<b>26.6</b>	<b>25.4</b>	<b>16.9</b>	<b>12.9</b>	<b>5.6</b>	<b>4.6</b>	<b>4.3</b>	<b>0.8</b>	<b>1.1</b>	<b>1.5</b>	<b>6.7</b>	<b>11.8</b>	<b>16.0</b>				
<b>Metals</b>																														
Hindalco Industries	129	BUY	226,175	4,702	1,753	2.8	3.5	11.1	(77.9)	25.5	218.4	46.6	37.1	11.7	12.7	9.4	7.3	0.8	0.8	0.7	—	—	—	10.3	5.2	6.5	135	4.6	32.2	
National Aluminium Co.	348	SELL	224,252	4,662	644	19.7	13.7	20.4	(22.0)	(30.6)	48.8	17.6	25.4	17.1	9.1	9.7	6.6	2.1	2.0	1.8	1.0	0.6	0.6	12.7	8.1	11.1	290	(16.7)	2.7	
Jindal Steel and Power	587	SELL	90,375	1,879	154	198.0	247.1	236.4	139.3	24.8	(4.3)	17.8	14.3	14.9	16.6	12.2	9.4	7.2	4.8	3.6	0.2	0.2	0.2	51.9	40.3	27.6	358	(39.0)	69.2	
JSW Steel	833	SELL	155,737	3,237	187	13.1	36.8	65.9	(84.7)	180.1	79.1	63.3	22.6	12.6	10.7	10.1	7.5	1												



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#### Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



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As of June 30, 2009

### Ratings and other definitions/identifiers

#### Rating system

Definitions of ratings

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

**REDUCE.** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

**SELL.** We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

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