kotak Institutional Equities

INDIA DAILY

April 16, 2007

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News Roundup

Corporate

- Tata Consultancy Services (TCS), the country's largest software exporter, is believed to have clinched a $100 million deal spread over five years from Bank of China to provide technology solutions (*BS*)
- The department of telecom (DoT) has urged the finance ministry to investigate the financing arrangements that have enabled Hutchison-Essar (HEL) CEO Asim Ghosh and Max India chairman Analjit Singh to acquire 12.26% stake in HEL.(*ET*)
- ONGC will tap the capital market with a public issue later this fiscal to part-finance its Rs 18,000-crore refinery-cum-petrochemical project. The 15-million-tonne refinery complex will be built to cater to the demand for high-grade fuel in the European and other Western markets (*ET*)

Economic and political

- The Ministry of Information & Broadcasting (I&B) is set to receive a budget outlay of Rs 12,000 crore in the Eleventh Five-Year Plan (2007-2012), a 138 per cent increase over the outlay in the previous Plan (2002-2007) (*BS*)

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

EQUITY MARKETS

		Change, %		
India	**13-Apr**	**1-day**	**1-mo**	**3-mo**
Sensex	13,384	2.1	7.7	(5.2)
Nifty	3,917	2.3	8.6	(4.0)
Global/Regional indices				
Dow Jones	12,612	0.5	4.1	0.2
Nasdaq Composite	2,492	0.5	5.0	(0.2)
FTSE	6,462	0.7	5.4	4.0
Nikkie	17,654	1.7	5.4	2.6
Hang Seng	20,509	0.8	8.2	2.4
KOSPI	1,527	0.4	6.9	9.9

Value traded - India

			Moving avg, Rs bn	
	13-Apr		**1-mo**	**3-mo**
Cash (NSE+BSE)	143.4		108.0	124.9
Derivatives (NSE)	332.2		274.3	376.5
Deri. open interest	518.8		564.3	574.4

Forex/money market

		Change, basis points		
	13-Apr	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.5	-	(153)	(173)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	7	11	38

Net investment (US$mn)

	12-Apr		**MTD**	**CYTD**
FIIs	13		#N/A	40
MFs	(5)		#N/A	(303)

Top movers -3mo basis

		Change, %		
Best performers	**13-Apr**	**1-day**	**1-mo**	**3-mo**
BEL	1,688	2.7	19.6	31.9
SAIL	126	4.1	22.5	29.5
Punjab Tractors	307	0.6	(1.7)	24.6
Wockhardt	425	3.0	17.2	21.3
Bharti Tele	781	1.5	8.9	16.5
Worst performers				
Ingersoll Rand	266	0.4	(7.7)	(32.2)
Acc	748	3.0	3.6	(32.1)
Century Tex	553	4.5	9.1	(28.2)
Tvs Motor	58	2.1	(6.0)	(28.2)
M&M	745	3.6	1.9	(24.4)

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Metals

JSTL.BO, Rs554	
Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	650
52W High -Low (Rs)	555 - 205
Market Cap (Rs bn)	95.3

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	81.5	98.4	111.1
Net Profit (Rs bn)	12.2	15.4	17.8
EPS (Rs)	71.1	89.6	103.3
EPS gth	*30.4*	*26.8*	*15.6*
P/E (x)	7.8	6.2	5.4
EV/EBITDA (x)	4.9	4.9	4.5
Div yield (%)	3.5	3.6	3.6

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	-	-	-
MFs	-	-	-
UTI	-	-	-
LIC	-	-	-

JSW Steel : On the growth path

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- **We initiate coverage with an Outperform rating and a 12-month target price of Rs650**

On the growth path. JSW Steel offers an attractive mix of production growth, declining cost of production and improving product-mix over the next three years in a period of stable but elevated steel prices, in our view. We initiate coverage with an Outperform rating and a 12-month target price of Rs650.

Three levers for outperformance

We estimate steel volume growth of 31%, 14% and 20% for JSW Steel in FY2008, FY2009 and FY2010, respectively, providing a strong buffer against steel price declines, in our view. Strong volume growth, combined with an improving product-mix and falling costs of production in a period of stable but elevated steel prices, will likely see JSW Steel outperform the market in FY2008. We forecast JSW Steel's EPS to grow 29% in FY2007 to Rs71.1, 26% in FY2008 to Rs89.6, 15% in FY2009 to Rs103.3 and 36% in FY2010 to Rs140.0.

Steel price outlook: Stable at elevated levels

We expect regional HRC steel prices to stay range-bound at US$475-525/ton over the next two years. A high floor price established by raw material costs will likely ensure that steel prices do not stay below this band for an extended period of time. Rising steel output in China will limit the upside to this band.

Outperform with a target price of Rs650

Our target price of Rs650 is based on 1.2X FY2009 P/B, equivalent to 6.3X FY2009 P/E and 4.9X FY2009 EV/EBITDA. We expect JSW Steel's P/B valuation to improve further over the next two years, driven by stable ROEs at 20% and a strong growth pipeline. We expect the valuation discount of JSW Steel to Tata Steel to narrow further over the next year.

Key risks

Lower-than-expected steel prices and higher-than-expected iron ore and coking coal prices are the main risks to our estimates for JSW Steel. Any attempt by the government to control steel prices could impact valuations for the stock.

Forecasts and valuations for JSW Steel

	Revenues (Rs mn)	EBITDA (Rs mn)	Net profit (Rs mn)	EPS (Rs)	EV/Sales (X)	EV/EBITDA (X)	P/E (X)
2006	61,801	17,461	8,643	55	2.1	7.3	10.1
2007E	81,454	28,146	12,221	71	1.7	4.9	7.8
2008E	98,359	34,203	15,415	90	1.7	4.9	6.2
2009E	111,068	40,042	17,774	103	1.6	4.5	5.4
2010E	134,989	52,608	24,084	140	1.2	3.0	4.0

Source: Company data, Kotak Institutional Equities estimates

Technology

INFY.BO, Rs2088	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	2,500
52W High -Low (Rs)	2439 - 1225
Market Cap (Rs bn)	1,198

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	138.9	183.8	236.7
Net Profit (Rs bn)	37.5	49.5	61.5
EPS (Rs)	67.0	86.0	106.8
EPS gth	*48.7*	*28.4*	*24.2*
P/E (x)	31.2	24.3	19.5
EV/EBITDA (x)	25.9	19.5	14.9
Div yield (%)	0.6	0.8	1.1

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	16.9	-	-
FIIs	53.2	10.5	6.3
MFs	3.5	4.2	(0.1)
UTI	-	-	(4.3)
LIC	2.0	2.2	(2.1)

Infosys Technologies : Robust revenue growth guidance saves the day. Maintain OP

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- **Revenue growth guidance is robust and realistic**
- **EPS growth guidance of 20-22% in rupee terms—the best it could have been. Guidance assumes 50-100bps decline in EBITDA margin**
- **Where is the rupee headed?—our economist's view.**
- **Maintain Outperform rating with a Mar'09 DCF based target price of Rs2,500.**

Infosys results were below our expectations. However a strong revenue growth guidance of 28-30% (in US$ terms) has allayed some of the fears and recent negative statements on the demand environment. Key metrics such as pricing and growth from large relationships are a further pointer to the good operating environment. While wage inflation (especially onsite) and rupee appreciation may hinder performance, we believe that Infosys is still the best positioned to manage these challenges. EPS guidance of Rs80.29-81.59 (20-22% growth) though weak and builds in operating margin decline, is impacted more by 'non-core' factors such as equity dilution and rupee appreciation. We believe that the FY2008 revenue growth guidance is not unduly conservative and one should not expect a similar outperformance to the guidance as for FY2007. We have adjusted our FY2008 EPS to Rs86 (Rs88.1 earlier) and FY2009 EPS estimate to Rs106.8 (Rs109.2 earlier). Our new estimates build in a Re/US$ rate of 43 (44.5 earlier) and an equity count of 574 mn shares (3% dilution). Further strengthening of the rupee is the key risk to our call. Maintain Outperform rating with a Mar'09 DCF based target price of Rs2,500.

Valuations- Marginal P/E de-rating likely as FY2010 tax impact gets closer: Our target price implies a P/E multiple of 23x on FY2009E EPS, 10% lower than the historic 12-month forward P/E band. We believe that stock performance on FY2009 numbers can lag earnings growth, as concerns related to a potentially weak FY2010 earnings growth (due to increase in tax rate as tax holidays for STPI expire by end-FY2009) gets built into stock price ahead of the actual event.

Revenue growth guidance is robust and realistic: Infosys' revenue growth guidance of 28-30% in US$ terms and 23-25% in rupee terms assumes a CQGR of 6.7% from 2Q-4Q. We forecast a revenue growth rate of 37% (US$ terms) in our model for FY2008. We do not expect Infosys to deliver similar level of outperformance (13.5%) relative to the year beginning guidance as in FY2007. We highlight two reasons for it (a) banking and finance vertical is unlikely to report similar growth, as the company deals with maturing client base and relatively weaker pipeline and (b) growth in FY2007 was also partly aided by a large ramp up from the top client, which may have contributed to an extra 6% growth in FY2007. We expect telecom, insurance and services vertical to lead growth in FY2008

EPS growth guidance of 20-22% in rupee terms-the best it could have been. Infosys' EPS growth guidance has an 8% gap relative to US$ revenue growth guidance. The gap largely builds in (a) 3% equity dilution (Infosys guides on basic shares outstanding) and (b) 4.2% appreciation in the rupee; the guidance is based on a Re/US$ rate of 43.1. We also highlight that the guidance builds in an EBITDA margin decline of 50-100 bps, which the company hopes to make up through improvements in below the EDITDA line items (other income and lower depreciation).

Operating margin—some challenges ahead, though Infosys is better placed than peers: We have modeled a 50bps decline in EBITDA margin for FY2008. We believe that the biggest challenge emanates from a planned 3-6% onsite wage increase; part of the increase would a one-time adjustment. We note that Infosys has the best onsite compensation among Indian IT services players. Such a high increase may have repercussions across the entire Indian IT services industry (especially mid-sized companies). In addition to onsite wages, offshore wage increase of 13-15% and rupee appreciation by 4.2% will also have a bearing on the margin. Combined impact of these factors would be 400bps in our view. We believe that the following factors will likely mitigate the impact on margins

1. **Utilization rate improvement can add 160bps to the OPM:** Infosys' utilization rate excluding trainees has dipped to 72.5%, 4-5% lower than the historic band of 77-78%. The management will likely strive to get the range back to historic levels

2. **Performance of subsidiaries:** We believe that subsidiaries can add 40-50 bps to margin in FY2008. Infosys' subsidiaries viz: Consulting, Progeon, China and Expert (Australia) reported revenues of Rs13.8 bn and net income of Rs741 mn, implying net margin of 5.4% vs. 27.8% for the core business, dragging the consolidated net margins down by 90bps. Progeon is the only subsidiary that has reached steady state in terms of profitability. Potential exists in improving profitability of consulting and Australian business.

3. **Pricing improvement:** We have modeled a 3% onsite and offshore pricing increase for FY2008. This in our view will aid margin by 120-150bps in FY2008. Infosys is getting pricing improvement of 2-3% from existing contracts and 3-5% from new contracts. In FY2007, Infosys reported 4.4% improvement in onsite productivity per employee and 2.7% offshore.

4QFY07 results below our expectations and weak on composition: Infosys missed its rupee revenue growth guidance for the first time in its history. The company reported revenue growth of 3.2% to Rs37.72 bn, lower than the guidance of Rs38.96 bn. In US$ terms, revenues grew 5.1% to US$863 mn, in line with guidance. Volumes grew 3% qoq, is the lowest in the last six quarters. Headcount addition at 2,809 is also lower than the historical rate. As expected, banking and finance vertical grew at a nominal pace (0.8% qoq). Nearly 90% of incremental revenues in 4QFY07 accrued from the telecom vertical. EBITDA margin declined 100 bps to 31.7% qoq. We attribute the decline to a mixture of rupee appreciation and dip in utilization rate. Net income (adjusted for tax refund of Rs1.24 bn), grew 3.8% qoq and was aided by higher other income.

Is lower volume growth and gross employee addition expectation a hint of a looming slowdown? There are several red flags which can raise concerns about slowdown including (a) decline in sequential volume growth to low single digit (b) gross employee addition guidance of 24,500 is lower than the FY2007 additions of 30,900 (and target at the beginning of the previous year at 25,000) and (c) muted 1QFY08 revenue growth guidance of 5%. We believe that while these metrics are useful as lead indicators, metrics such as hiring have to be interlinked with utilization (which has dipped). In addition it is difficult to draw trends on one-quarter data as several factors may influence quarterly performance. The robust guidance along with positive pricing environment points to continuation of strong growth.

On expected lines, 1Q guidance is soft: Infosys has guided for 3.3-3.7% sequential revenue growth and EPS decline of 12.1% to Rs17.84. In US$ denomination, revenue growth guidance stands at 5.1%. Excluding impact of tax write back, EPS decline works out to 1.5% qoq. The company has factored in 200bps decline in EBITDA margin in the next quarter as seasonal factors such as wage increase and higher visa charges will likely hit margin performance.

Management changes: Infosys has announced a few changes to the management team. Kris Gopalakrishnan has been elevated to the role of the CEO and Managing Director. S. Shibulal will take over Kris' role of COO. Nandan Nilekani, has become the Co-Chairman of Infosys and would be in an executive role.

Fine tuning estimates: We have made several changes to our earnings model. We have reduced our EPS estimates for FY2008 and FY2009 to Rs86 and Rs106.8 from Rs88.1 and Rs109.2 respectively. Change in EPS estimates is driven by several factors—(a) we have revised our Re/US$ exchange rate assumptions to 43 from 44.5 earlier (b) we factor in equity dilution of 3% and have increased basic shares outstanding to 574mn (c) increase in onsite and offshore pricing by 3% for FY2008 (d) factor in 5% onsite wage hike assumption in FY2008 vs. 2% earlier leading to a decline in OPM in FY2008.

Where is the rupee headed—our economist's view: Our economist, Indranil Sengupta expects the Rupee to retrace back towards Rs44/US$ levels once the RBI's monetary policy 'normalizes' - presumably as base effects pull down inflation ahead. Monetary tightening has forced private and foreign banks to distress sell forex. Since these banks do not have surplus gilts to furnish at the RBI's 7.75% repo - cash for gilts - window, the alternative would have been to borrow in a volatile call market, where rates are swinging between 2-80%. We do not see how the Rupee can appreciate for long. First, the RBI will still likely need to buy US$15 bn in this fiscal to fund domestic liquidity as banks' hit minimum SLR, shutting down the RBI's repo - cash for gilts - window. Second, the Rupee's real effective exchange rate likely crossed the 108 levels at which the central bank normally intervenes. Third, weakness in the US Dollar - now 1.35/Euro levels - is already in the price.

Subsidiaries dragged Infosys' net profit margins down by 110bps in Mar '07 quarter

Infosys' subsidiary performance over the past few quarters

Revenues - US$mn	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**
Progeon	18.0	20.6	22.5	24.4	28.4	33.9	40.5	44.7
Infosys Australia	18.7	19.3	17.2	17.6	18.4	25.0	23.9	32.0
Infosys Consulting	5.5	8.9	8.3	9.6	10.2	11.6	12.1	13.5
Infosys China	0.8	1.3	2.0	1.8	2.1	3.7	5.0	2.5
Overall - subsidiaries	**43.1**	**50.0**	**50.0**	**53.4**	**59.1**	**74.2**	**81.5**	**92.6**
Net profits - US$mn	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**
Progeon	4.4	5.3	5.5	5.9	6.0	7.7	9.6	8.7
Infosys Australia	0.2	1.1	1.4	1.5	0.8	4.2	3.4	7.5
Infosys Consulting	(2.1)	(1.2)	(2.7)	(2.2)	(4.1)	(3.3)	(6.6)	(11.0)
Infosys China	(0.6)	(0.7)	(1.0)	(1.5)	(2.3)	(1.2)	(0.7)	(2.3)
Overall - subsidiaries	**1.9**	**4.5**	**3.1**	**3.7**	**0.4**	**7.4**	**5.7**	**2.9**
Net profit margin (%)	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**
Progeon	24.6	25.7	24.4	24.0	21.1	22.6	23.6	19.5
Infosys Australia	1.0	5.9	7.9	8.4	4.3	16.8	14.3	23.5
Infosys Consulting	(38.3)	(13.9)	(32.8)	(22.4)	(40.0)	(28.1)	(54.0)	(81.7)
Infosys China	(72.6)	(51.5)	(50.8)	(80.6)	(109.1)	(33.1)	(14.6)	(93.5)
Overall - subsidiaries	**4.4**	**9.0**	**6.3**	**7.0**	**0.7**	**9.9**	**7.0**	**3.1**
Infosys standalone	**26.6**	**27.3**	**26.8**	**26.6**	**28.1**	**27.4**	**27.7**	**28.1**
Infosys consolidated	**25.7**	**26.7**	**25.9**	**25.9**	**26.8**	**26.9**	**26.9**	**27.0**

Note: Mar '07 net margins, both standalone and consolidated, adjusted for tax write-back of Rs1.24 bn

Source: Company

Infosys' per capital revenue productivity is up 6.3% onsite and 4.4% offshore yoy in Mar '07 quarter

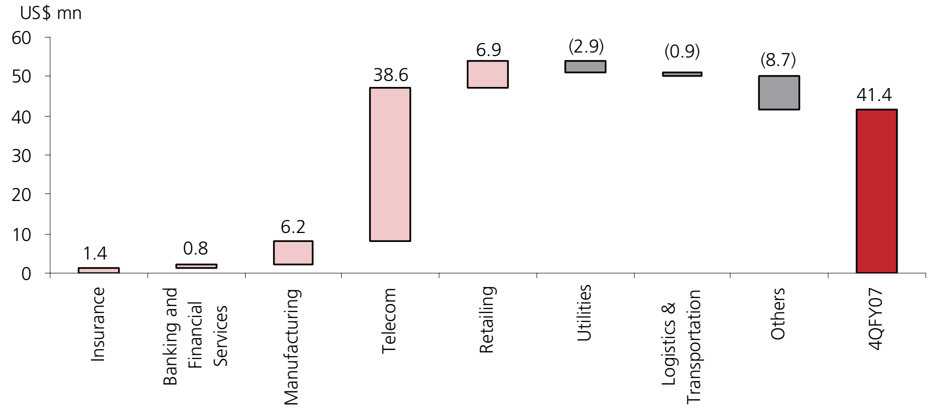
Per capita revenue productivity (US$/ year)

Per capita revenue productivity	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
Onsite (US$/ year)	131,700	129,500	130,782	130,700	131,499	132,895	134,807	137,418	139,818
Offshore (US$/ year)	54,900	54,700	54,821	54,904	55,078	55,180	55,782	56,727	57,510
Blended (US$/ year)	78,400	78,200	78,823	78,892	79,477	80,908	81,900	83,086	84,495
Growth qoq (%)	**Mar-05**	**Jun-05**	**Sep-05**	**Dec-05**	**Mar-06**	**Jun-06**	**Sep-06**	**Dec-06**	**Mar-07**
Onsite (US$/ year)	1.3	(1.7)	1.0	(0.1)	**0.6**	**1.1**	**1.4**	**1.9**	**1.7**
Offshore (US$/ year)	0.9	(0.4)	0.2	0.2	**0.3**	**0.2**	**1.1**	**1.7**	**1.4**
Blended (US$/ year)	0.8	(0.3)	0.8	0.1	**0.7**	**1.8**	**1.2**	**1.4**	**1.7**

Source: Company reports

Telecom vertical accounted for 93.2% of Infosys' incremental revenues of US$41.4 mn in 4QFY07

Contrinution to incremental revenues qoq (US$ mn)



Source: Company reports, Kotak Institutional Equities

34% of total incremental revenues in FY2007 came from top 10 accounts, highest in the past five years

Revenues (US$ mn)	FY2003	FY2004	FY2005	FY2006	FY2007
Total	750	1,045	1,532	2,067	2,944
Top client	44	52	84	91	206
Top 5 clients	176	236	322	368	571
Top 10 clients	280	376	515	626	924
ex-top 10 clients	471	669	1,017	1,441	2,020
Contribution (US$ mn)					
Top client	44	52	84	91	206
Clients # 2-5	132	184	237	277	365
Clients # 6-10	104	140	193	258	353
ex-top 10 clients	471	669	1,017	1,441	2,020
Incremental revenues (US$ mn)	**205**	**295**	**487**	**535**	**877**
Top client	10	9	32	7	115
Clients # 2-5	34	52	54	40	88
Clients # 6-10	21	36	53	65	95
Top 10 clients	**65**	**96**	**139**	**112**	**298**
ex-top 10 clients	140	198	349	424	579
Contribution to incremental revenues (%)					
Top client	5.0	3.0	6.6	1.3	13.1
Clients # 2-5	16.5	17.6	11.0	7.4	10.0
Clients # 6-10	10.2	12.1	10.9	12.2	10.8
Top 10 clients	**31.7**	**32.7**	**28.5**	**20.9**	**34.0**
ex-top 10 clients	68.3	67.3	71.5	79.1	66.0

Source: Company, Kotak Institutional Equities

Comments Infosys Interim Results (consolidated Indian GAAP)

Rs mn	4QFY06	3QFY07	4QFY07	% chg. qoq	% chg. yoy	Deviation from Kotak estimates 4QFY07	% chg.	Comments
Revenues	**26,240**	**36,550**	**37,720**	**3.2**	**43.8**	**38,559**	**(2.2)**	Revenue growth of 5.2% in US$ terms led by a) 2.8% volume expansion, both onsite and offshore and (b) pricing improvement
Software Development Costs	(14,220)	(19,380)	(20,210)	4.3	42.1	(20,574)	**(1.8)**	
Gross profit	**12,020**	**17,170**	**17,510**	**2.0**	**45.7**	**17,985**	**(2.6)**	Gross margin decline on account of rupee appreciation
Selling and marketing exp	(1,520)	(2,360)	(2,680)	13.6	76.3	(2,335)	**14.8**	
Administration exp	(2,170)	(2,850)	(2,860)	0.4	31.8	(3,116)	**(8.2)**	
Total SG&A Expenses	(3,690)	(5,210)	(5,540)	6.3	50.1	(5,451)	**1.6**	
EBITDA	**8,330**	**11,960**	**11,970**	**0.1**	**43.7**	**12,534**	**(4.5)**	EBITDA margin declined on account of rupee appreciation
Depreciation	(1,440)	(1,410)	(1,450)	2.8	0.7	(1,602)	**(9.5)**	
EBIT	6,890	10,550	10,520	(0.3)	52.7	10,932	**(3.8)**	
Interest	-	-	-			-		
Other Income	720	590	1,190	102	65.3	696	**71.1**	Previous quarter financials included a forex los of US$4.5 mn
Provision for investments	-	-	(10)			-		
Profit Before Tax	7,610	11,140	11,720	5.2	54.0	11,627	**0.8**	
Provision for Tax	(810)	(1,300)	(1,510)	16.2	86.4	(1,355)	**11.4**	Includes tax write back of Rs1.24 bn led on account of completion of tax assessment
Net Profit	**6,800**	**9,840**	**10,210**	**3.8**	**50.1**	**10,272**	**(0.6)**	
Minority Interest	(70)	(10)	1,230		(1,857.1)	(12)		
Net Profit- Reported	**6,730**	**9,830**	**11,440**	**16.4**	**70.0**	**10,260**	**11.5**	Net income, adjusted for tax write-back, in line with expectations
EPS (Rs/ share)	12.2	17.6	20.3	15.2	66.2	18.4	**10.5**	
No of shares outstanding (mn)	550.2	557.0	562.8	1.0	2.3	557.5	**0.9**	
As % of revenues								
Gross Profit Margin (%)	45.8	47.0	46.4			46.6		
Operating Margin	31.7	32.7	31.7			32.5		
Selling Expenses	5.8	6.5	7.1			6.1		
Admin Expenses (%)	8.3	7.8	7.6			8.1		
SG&A Expenses (%)	14.1	14.3	14.7			14.1		
Billing Rates (US$/annum)								
Onsite	131,499	137,418	139,754	1.7	6.3			Pricing improvement (1.7% onsite and 1.4% offshore) primarily driven by change in business mix
Offshore	55,078	56,727	57,521	1.4	4.4			
Volumes growth	6.1	8.4	2.8			6.8		
Revenue Mix (%)								
Onsite	52.8	51.6	52.1					
Offshore	47.2	48.4	47.9					
Total Employees	52,715	69,432	72,241					
Guidance (conslidated)	**1QFY08**			**FY2008**				
	Lower end	Upper end		Lower end	Upper end			
Revenues (Rs bn)	38.96	39.13		170.4	173.1			28-30% revenue growth guidance in FY2008 (US$ terms) both robust and realistic
Growth (%)	3.3	3.7		22.6	24.6			
Revenues (US$ mn)	904	908		3,953	4,016			
Growth (%)	4.8	5.2		28.0	30.0			
EPS	17.84	17.84		80.3	81.6			
Growth (%)	(12.1)	(12.1)		20.0	22.0			EPS growth guidance (Re terms) 8% lower than US$ revenue growth guidance on account of (a) rupee appreciation of 4.2% (b) equity dilution of 3% and (c) OPM decline of 50-100bps
Guidance based on Re/ US$ rate of 43.10								

Source: Kotak Institutional Equities

Exhibit: Key changes in FY2008 and FY2009 estimates

	New		Old		Change (%)	
Rs mn	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**
Revenues	**183,765**	**236,719**	**187,238**	**241,567**	**(1.9)**	**(2.0)**
EBITDA	57,065	72,412	59,206	75,270	(3.6)	(3.8)
Depreciation	(6,161)	(7,897)	(7,023)	(8,995)	(12.3)	(12.2)
EBIT	50,904	64,516	52,183	66,275	(2.5)	(2.7)
Net Profit	**49,416**	**61,382**	**49,204**	**60,943**	**0.4**	**0.7**
Net Income (after minorities)	**49,350**	**61,298**	**49,143**	**60,859**	**0.4**	**0.7**
EPS (Rs/ share)	**86.0**	**106.8**	**88.1**	**109.2**	**(2.5)**	**(2.2)**
Volume Growth (%)	**33.3**	**27.6**	**34.3**	**24.8**		
Billing Rates (US$/ manmonth)						
Onsite	11,803	11,886	11,452	11,452	3.1	3.8
Offshore	4,881	4,967	4,727	4,775	3.3	4.0
Margins (%)						
EBITDA	31.1	30.6	31.6	31.2		
EBIT	27.7	27.3	27.9	27.4		
Rs/ US$ rate	43.0	43.0	44.5	44.5	(3.4)	(3.4)

Source: Kotak Institutional Equities Esimates

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

Rs mn	**2006**	**2007**	**2008E**	**2009E**	**2010E**
Income From Software Development					
Overseas	93,542	136,732	180,984	233,814	293,784
Domestic	1,668	2,198	2,781	2,905	3,346
Revenues	**95,210**	**138,930**	**183,765**	**236,719**	**297,130**
Software Development Costs	(50,654)	(74,580)	(100,798)	(131,012)	(165,845)
Gross profit	**44,556**	**64,350**	**82,968**	**105,707**	**131,285**
Selling and marketing exp	(6,005)	(9,290)	(11,553)	(15,185)	(19,172)
Administration exp	(7,639)	(11,150)	(14,349)	(18,110)	(22,659)
Total SG&A Expenses	(13,643)	(20,440)	(25,903)	(33,294)	(41,831)
EBITDA	**30,912**	**43,910**	**57,065**	**72,412**	**89,454**
Depreciation	(4,371)	(5,140)	(6,161)	(7,897)	(10,277)
EBIT	**26,541**	**38,770**	**50,904**	**64,516**	**79,177**
Interest	-	-	-	-	-
Other Income	1,380	3,750	4,831	5,916	8,188
Profit Before Tax	**27,921**	**42,520**	**55,735**	**70,432**	**87,365**
Provision for Tax	(3,132)	(5,100)	(6,320)	(9,050)	(22,459)
Net Profit	**24,790**	**37,420**	**49,416**	**61,382**	**64,906**
Minority Interest	(210)	(110)	(66)	(85)	(85)
Net Income	**24,580**	**37,310**	**49,350**	**61,298**	**64,821**
Extraordinaries	-	1,250	-	-	-
Net Profit- Reported	**24,580**	**38,560**	**49,350**	**61,298**	**64,821**
EPS (Rs/ share)	**45.0**	**67.0**	**86.0**	**106.8**	**112.9**
No of shares outstanding (mn)	550.2	562.8	574.0	574.0	574.0
Margins (%)					
Gross Profit margin	46.8	46.3	45.1	44.7	44.2
EBITDA Margin	32.5	31.6	31.1	30.6	30.1
EBIT Margin	27.9	27.9	27.7	27.3	26.6
NPM	26.0	26.9	26.9	25.9	21.8
Growth Rates (%)					
Revenues	33.5	45.9	32.3	28.8	25.5
Gross Profit	32.4	44.4	28.9	27.4	24.2
EBITDA	32.4	42.0	30.0	26.9	23.5
EBIT	29.6	46.1	31.3	26.7	22.7
Net Profit	34.3	50.9	32.1	24.2	5.7
Net Income	33.1	51.8	32.3	24.2	5.7

Source: Kotak Institutional Equities estimates

Pharmaceuticals

CIPL.BO, Rs232	
Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	275
52W High -Low (Rs)	281 - 178
Market Cap (Rs bn)	178.0

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	34.2	40.6	47.5
Net Profit (Rs bn)	7.1	8.8	10.6
EPS (Rs)	9.3	11.5	13.9
EPS gth	*19.5*	*23.8*	*20.6*
P/E (x)	25.0	20.2	16.7
EV/EBITDA (x)	17.6	14.7	12.4
Div yield (%)	1.0	1.2	1.4

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	39.4	-	-
FIIs	17.6	0.5	(0.1)
MFs	3.4	0.6	(0.0)
UTI	-	-	(0.7)
LIC	6.5	1.1	0.5

Cipla : Indian drug price regulator asks Cipla to pay Rs7.5 bn in an over pricing case

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- **Regulator asks Cipla to pay Rs7.5 bn (Rs10/share) in an over pricing case**
- **This matter has been sub-judice since 2003, and involves five drugs**
- **Likely to have short-term sentiment impact on the stock, but no cash outflow immediately**
- **We have an OP rating on the stock**

We note that this development has no relation with the ongoing discussions of a new pricing policy (regulating/monitoring of drug prices). This claim is in relation to five drugs (Salbutamol, Cloxacillin, Ciprofloxacin, Theophylline and Norfloxacin), on which the regulator believes that Cipla and a few other companies had overcharged (between 1995 and 2003). Currently prices of 74 drug ingredients are regulated. This matter is sub-judice and difficult to comment. However other companies involved in this litigation had adhered to the Supreme Court's directive and paid up half of the claim amount. Cipla however was able to get a stay on this order from another court. Incase, Cipla has to pay up this amount, it would be a charge of Rs10/share. It is likely that this news will have a short-term impact on the stock price. We have an OP rating on the stock; considering the likely stable growth outlook. In the last three years, sales have grown at an annualized rate of 25%. We think 18-20% topline growth is likely to sustain for the next 3-4 years, backed by multiplicity of products and countries, particularly developing countries. This we believe should help sustain 20% CAGR in net profit. The forthcoming Q4 results are however likely to be modest in earnings growth (4% only), on a high base.

The National Pharmaceutical Pricing Authority (NPPA) has asked Cipla to pay a fine of Rs 7.48 bn for overcharging for five price-controlled drugs between 1995 and 2003. Initially, the claim amount was Rs3.6 bn, but has now gone up on account of interest arrears. The company has said that it has received legal advice that the notices were not tenable and sustainable.

The authority had first raised such a demand with Cipla and other pharmaceutical companies in 2003. The companies had contested the claim in the courts. The Supreme Court had asked the company to pay half the amount and directed the Bombay High Court to assess the overcharged amount.

While the other companies paid half the overcharged amount heeding the Supreme Court directive, Cipla has continued its legal battle. It had also obtained a stay on possible recovery by the NPPA.

Economy

Sector coverage view	N/A

India's Rupee: Looking good, feeling shaky

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- **Rupee at Rs42.52/USD, running ahead of fundamentals; Rs44/USD FY2008E**
- **US Dollar weakening supports anti-inflationary strong Rupee policy**
- **Inflation peak off likely to rekindle policy preference for export promotion**
- **US$18 bn RBI forex intervention to fund 8.3% FY2008E real GDP growth**

We believe that the Rupee is running ahead of fundamentals. While the Rupee could hover around Rs42-43/USD in the near term, we do not see how this extraordinary appreciation—3.8% in the past month—can last long. First, we believe that the government will give up its anti-inflationary strong Rupee policy in favor of the traditional preference for export promotion once inflation peaks off (in 1QFY08E). Second, the RBI will need to buy US$18 bn in FY2008E to fund 8.3% real GDP growth will at home, especially as a looming SLR deficit shuts down the RBI LAF repo window, notwithstanding all the current lamentations about forex flows fuelling inflation. Third, although we are US Dollar bearish, the sharp decline in the US Dollar since March 2007 appears to be a bit overdone given that the US Fed will likely not ease monetary policy till 2HFY08. Immediate risks - the G-7 meeting and the Iranian central bank pruning US Dollar investments to 20% minimum in particular—seem behind us.

Government likely to give up strong Rupee policy if inflation abates. We expect the government to give up its present strong Rupee policy in favor of the traditional preference for a weaker currency to promote exports if inflation abates.

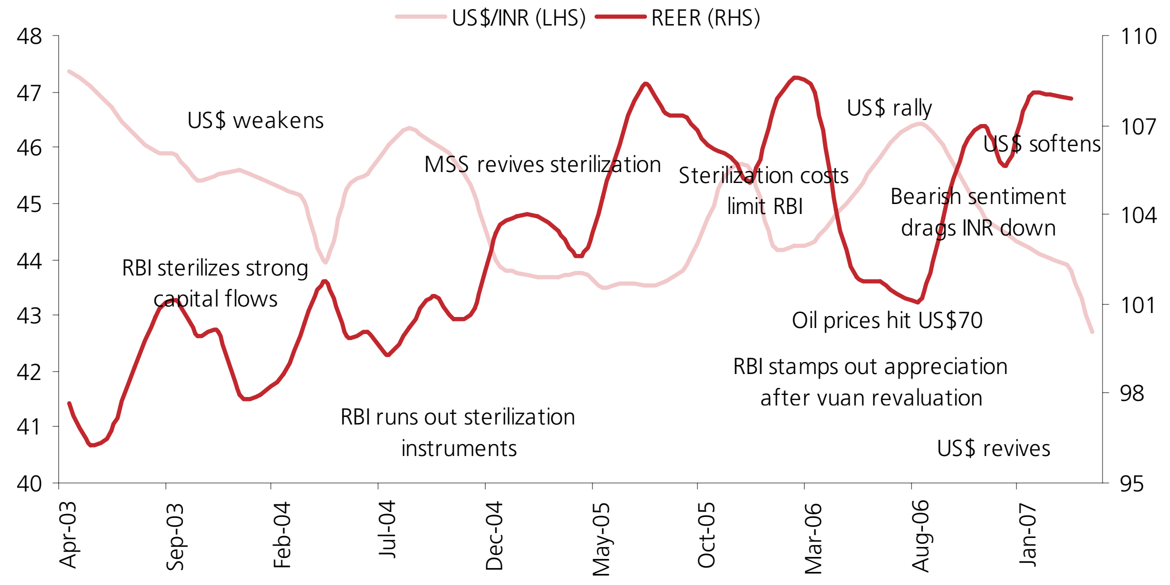
- The ruling Congress party blames inflation for recent poll reverses in Punjab and Uttarakhand and is keen to contain the increase in prices at a time politically sensitive UP is going to to polls.
- It is, therefore, willing to accept a strong Rupee policy – there are rumours of policy acceptance of Rs41/USD in the near-term – to counter 'imported inflation' from rising metal prices. We have long highted that the oilseed shock adds 80+bps to headline WPI inflation, and are pleased to learn that the government cut import taxes.
- The Rupee has been driven up by distress forex sales by private and foreign banks to meet the hikes in CRR to combat inflation. Since these banks do not have the surplus SLR to furnish at the RBI's 7.75% repo window, they are otherwise left at the mercy of PSU banks at a time inter-bank call rates are swinging 4-70%.
- We note that the Rupee's real effective exchange rate has likely crossed the 108 levels beyond which the RBI usually intervenes (Exhibit 1).
- We do not expect the government to abandon its decades-old policy preference for a weaker Rupee to promote exports if the present inflationary pressures peak off in 1QFY08E as we expect (Exhibit 2).

Likely US$ 18 bn RBI forex intervention in FY2008E to fund 8.3% real GDP growth. We have long highlighted that the RBI needs to buy US$18 bn of forex to fund 8.3% real GDP growth, consistent with 5% WPI inflation (Exhibit 3) notwithstanding its lamentations of the difficulties of sterilization.

- The onus of primary liquidity generation, we constantly highlight, is beginning to fall on forex intervention as a looming SLR deficit contracts the RBI's repo window.
- Having bought up US$20 bn in the past few months, Governor Reddy can afford to wait a while before further intervention.
- Given that the opportunities for this scale of forex intervention – strong capital flows, weak US Dollar – does not match the seasonality of credit demand, the RBI, in any case, faces a short-term problem in sterilization – warehousing, really - of the Rupee liquidiy in the interim.
- The RBI is, therefore, happily playing along with the Congress Foreign Hand theory of inflation driven by excess money supply fuelled "...entirely by the inflow of foreign funds...", doing the party in.

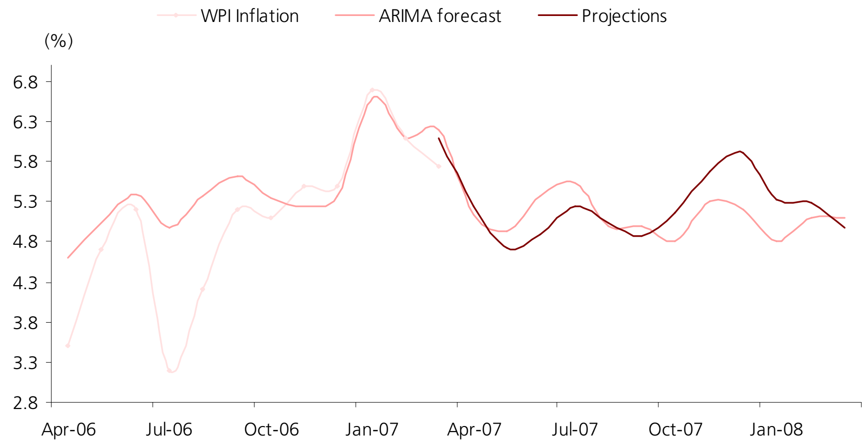
Exhibit 1: The REER of the Rupee is at 108 levels which typically set off forex intervention

US$/INR, REER of the Rupee



Source: RBI, x-rates.com

Exhibit 2: An inflation peak off will normalize exchange rate policy
WPI, WPI (auto-regressive integrated moving average - ARIMA - forecast) y-o-y %



Source: Ministry of Industry, Government of India, Kotak Institutional Equities estimates.

Exhibit 3: The RBI needs to buy US$18 bn to sustain a FY2008 8.3% real GDP growth rate
Monetary projections (Rsbn)

●	The demand for overall liquidity is arrived by a broad money (M3) demand function:
	M3 growth rate = 1.4 x real GDP growth rate + inflation rate ...(1)
	where the income elasticity of money demand is estimated at 1.4
●	Estimated 8.3% real GDP growth rate and 5% inflation rate in FY2008 requires an M3 growth rate of 16.6%.
●	In absolute terms, this works out to Rs5470 bn (US$124 bn).
●	The supply of liquidity is arrived by a money supply function:
	M3 growth = 4.7 x Reserve money growth ...(2)
	where the money multiplier is taken at 4.7 (assuming constant 6.5% CRR).
	Reserve money = RBI's net domestic assets + RBI's net foreign assets ...(3)
●	Primary liquidity of Rs1164 bn/US$26.5 bn (= 5470/4.7) is needed to support our FY2008 scenario.
●	FY2008 likely begins with a domestic liquidity overhang of about Rs374 bn (US$8.5 bn)
●	These include: balances in the Market Stabilization Scheme, adjusted for RBI's LAF repos.
●	This implies that the RBI will need to buy about Rs790 bn / US$18 bn of foreign currency to produce the necessary primary liquidity.

Source: RBI, Kotak Institutional Equities.

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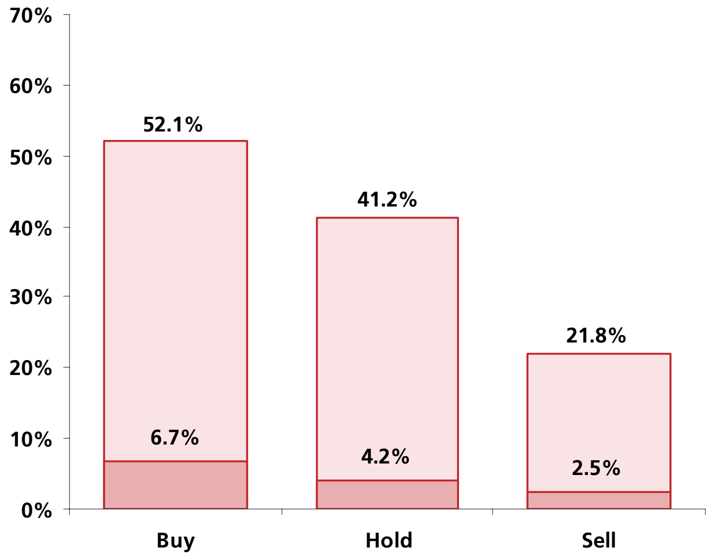

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Source: Kotak Institutional Equities. As of March 31, 2007

Ratings and other definitions/identifiers

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