MONTHLY EQUITY COMMENTARY - MAY

Earnings growth raises expectations

The Sensex continued its unabated march and scaled yet another peak, that of 12000, in merely 19 trading sessions. The rally was fueled by better-than-expected results for the January-March quarters, which in many cases were also full year results. A few interesting aspects of the results were better capacity utilization at a higher rate, better pricing power and hence improved margins. This is despite rising raw material prices, employee expenses, interest and freight costs. In such a scenario, most companies have been able to pass on the increased cost of production without impacting their profitability. Also, higher demand both domestically and from exports, have brought the pricing power to the corporates.

After a long gap, we saw foreign institutional investors (FIIs) withdraw money from the domestic stock market on a monthly basis in April 2006. Unlike previous occasions where the market corrected significantly on FIIs withdrawing money, this time a larger participation from domestic institutions and, most importantly, resident individuals helped the indices not only to sustain but also continue their march forward. This augurs well for the long-term prospects of the market.

Superior growth in earnings and, most importantly, the guidance for future years by companies were largely responsible for such a rapid 1000-point rally, which came in a record short span of 19 trading sessions. A new breed of real estate companies dominated the entire market with their spectacular rise over last few months. Surge in housing demand from the middle and upper class with insatiating demand from shopping malls and offices have fueled the growth of the real estate sector.

On the other hand, prices of commodities, particularly the metal pack, are at multi-year highs and we still do not see any signs of it cooling down. Both ferrous and non-ferrous metals are witnessing sustained momentum on the back of both genuine demand-supply gap and trading activities.

At the Sensex's 12000 levels, we expect high volatility to continue despite good earnings growth by the companies and better visibility for future years. We, however, are quite positive on the long-term attractiveness of the market and believe the domestic market would continue to post 15-20% annual returns over the next couple of years. However, as we expect volatility to be higher, sentiments prevailing over valuations cannot be ruled out either.

Though we remain positive on the market, we believe repetition of the stellar performance of CY04 and CY05 would be extremely difficult in the current year. We continue to remain positive on the themes mentioned in our earlier January commentary. These would include lifestyle products and services, global competitiveness and sectors providing long-term economic stability.

The market still has a strong appetite for quality investment opportunities, which is very much visible from the subscription pattern of Reliance Petrochemical's IPO or listing of some of the recent IPOs. Liquidity continues to be in the driving seat and is now getting good support from corporate performance.

> *"Superior earning growth despite rise in commodities, frieght and employee expenses, coupled with broader support from domestic institutions and resident Indian investors helped the market to maintain its onward journey. Amid higher volatility, we recommend to invest in well-researched stocks, which remains key for outperformance."*

Funds flow

Rs bn	Apr 06*	YTD06	CY05	Cy04
FII	(13)	160	493	388
MF	16	46	128	(9)

*Source: SEBI (*upto 24th Apr)*

Hardening interest rate & rising commodity prices-Potential risk

TThe two factors, which can play spoilsport and dampen sentiments are hardening interest rates and rising commodity prices including crude prices. Serious credit offtake at over 30% rate, global rise in interest rates by central banks and the frictional liquidity crisis has led to a rise in interest rates by over 100 bps. Banks have resorted to a hike in rates in the personal loan segment after feeling the heat of deposit mobilization at higher rates. More than the interest cost, the larger threat is on the valuation front where the value could be eroded significantly with the rise in risk-free rates.

Crude oil prices, on the other hand, once again moved above $73 per barrel on lower US inventory and supply side constraints.

A consistent rise in the prices of metals, which being positive for the metal companies, may raise the costs for the user segments. In case the user industries are not able to pass on the cost increases, it may impact the profitability in future quarters.

These factors may also put further pressure on the so-far-stable inflation scenario. Besides having its sentimental impact, this may pull down valuations too and hence, we see this as a serious threat to the on-going party.

Outlook for May 2006

We remain positive on the prospects of the domestic stock market. Liquidity is expected to remain sufficient. We further believe the opportunity, which the local stock market provides is still favorable on risk-return profile and scores well compared to most of the emerging markets. Volatility and hence risk, therefore, are expected to remain high as well.

We mentioned in our previous comments during April 2006 about better results from Corporate India, which, so far, has been proven right. Most of the companies have not only posted decent revenue and profit growth but also improved their operating margins. It is important to note here that such convincing results are coming across the sectors, for example, software, private banks, auto, cement, construction, engineering, capital goods and others.

Though the mid-cap space is once again seeing a lot of buying in the past couple of weeks, we continue to maintain our bias towards large cap stocks along with selected mid-cap stocks, which are providing a value-buy opportunity based on strong fundamentals.

We continue to recommend:

- Remain invested
- Maintain bias towards large cap stocks
- Invest in selected small/mid caps, which are well researched and provide upside based on valuation

We recommend our investors the following scrips

Recommendation

Sector	Companies
Auto & auto ancillaries	Amtek India, Amtek Auto, Bharat Forge, ISMT, Subros
Financial	SBI, ICICI Bank, Federal Bank, Allahabad Bank, Dewan Housing, Sundaram Finance, Shriram City Union
Capital goods & engg.	Easun Reyrolle, BHEL, Siemens, ABB, Areva T&D
Cement	ACC, Shree Cement, Birla Corp
Construction	Era Construction, Murudeshwar Ceramics, IVRCL
FMCG	ITC, Dabur, REI Agro
IT & ITES	Infosys, TCS, Allsec, Megasoft
Logistics	GATI, Gateway Distriparks, Aegis Logistics
Pharma	Orchid Chemicals, Sashun Chemicals & Jubilant Organosys
Sugar	Bajaj Hindusthan, Balrampur Chini, KCP Sugar, Dwarikesh Sugar, EID Parry
Others	Graphite

Source: Kotak Securities - Private Client Research

Sensex for last one year

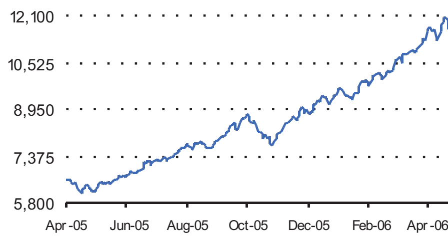
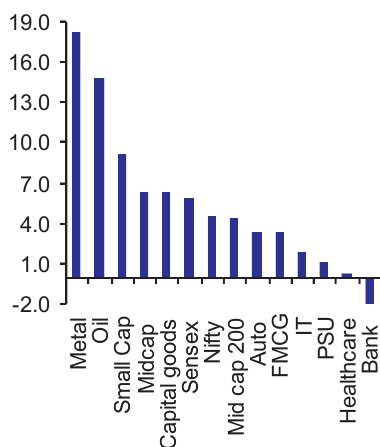


Table: Sensex cruise- time line

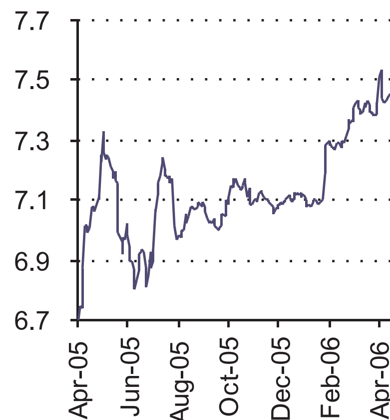
Date	SENSEX
14-May-03	3,044
19-Aug-03	4,007
3-Nov-03	5,063
2-Jan-04	6,027
21-Jun-05	7,077
8-Sep-05	8,053
9-Dec-05	9,067
7-Feb-06	10,082
27-Mar-06	11,079
20-Apr-06	12,039

Source: Bloomberg

Monthly sectoral movement (% chg in Apr)



Interest rate



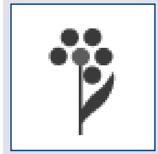
Oil price (US$/bbl)

ORCHID CHEMICALS & PHARMACEUTICALS

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 347** | **TARGET PRICE: Rs. 445**

28 March 2006

Awadhesh Garg



Orchid Chemicals & Pharmaceuticals, a tier two player with diversified competencies in APIs, formulations and drug discovery, has begun to benefit from its strategy to penetrate the generics business in regulated markets. The establishment of new facilities both in bulk drugs and formulations for the regulated markets, securing of approvals from international regulatory authorities and the generation of intellectual property have resulted in a strategic transformation in its business profile.

Orchid has made sizeable investments in intellectual properties (R&D) and infrastructure. With these investments it is poised to achieve a significant increase in performance in the coming fiscal through regulated market entry and diversification of business in terms of multiple therapeutic groups.

Orchid's key growth drivers viz. niche generics (cephalosporins, betalactams & carbapenems), increasing presence in regulated markets and drug discovery and drug delivery research, have prompted us to initiate coverage on the company with a BUY recommendation. The target price is Rs.445 over a 12-month horizon, an upside of 27% over current levels.

Investment argument

- Rich product pipeline: Orchid expects to be present on Day one of patent expiry of tazobactam/ piperacillin (global market size $480mn), cefdinir ($380mn) and cefepime ($120mn). Of these, generic Zosyn (Tazo+Pip) is a lucrative opportunity where Orchid expects minimal competition -- at least till November 2007 when the process patent expires. In addition, it expects to be the first generic in Ceftiofur ($150mn), a veterinary injectable.
- New products doing well: Orchid has launched Ceftriaxone ($750mn) in the US market in August 2005 (two weeks after Lupin and Sandoz) and Cefprozil ($240mn) in December 2005. It believes that the generic prices are now roughly 75-80% below the branded price and has orders in hand constituting roughly 40% of the total generic market.
- Positive surprise from anti-diabetic molecule: The agreement with Bexel to further increase its stake in the drug discovery JV to 75% will accrue significant value to Orchid once the out-licensing initiative of BLX-1002 (novel anti-diabetic molecule) is completed.
- Strong platform to meet global demand: Orchid has been investing heavily in building facilities and R&D to meet the requirements of regulated markets. The company's asset base has crossed Rs.10bn, which has placed the company among the top five in the pharma space. The company does not expect any significant capex over the next few years, save for carbapenems and scale-up of NPNC facilities.
- Valuations: At CMP Rs.347, the stock is available at 15x FY07E and 11x FY08E fully diluted earnings and 9x and 7x EV/EBIDTA of FY07 and FY08 estimates respectively, which looks attractive.

Key risks and concerns

- Greater than anticipated pricing pressure or lower market share could act as a cap for generic business.
- Any delay in ANDA filings and/or approval and any delay in launch by its global partners would impact the profitability of the company
- Volatile pricing in less regulated markets.
- Global consolidation risk..

Valuation and recommendation

- We have valued Orchid Chemicals on the basis of the DCF method (WACC - 11.8%; terminal growth - 3%). The method has yielded a value of Rs.445 per share.
- At our target price of Rs.445 per share, the stock will be valued at 8.9x EV/EBIDTA, 2.5X P/B and 14.3x P/E on the basis of FY08E earnings.
- Our target price provides an upside of 27%. We recommend BUY.

Summary table

Rs mn	FY05E	FY06E	FY07E
Sales	7,223	9,057	11,272
Growth (%)	6.3	25.4	24.4
EBITDA	1,564	2,505	3,250
EBITDA margin (%)	21.7	27.7	28.8
Net profit	221	866	1,487
Net Margin (%)	3.1	9.6	13.2
EPS diluted (Rs)	6.4	13.1	22.4
Growth (%)	82.5	203.1	171.8
DPS (Rs)	4.0	4.0	4.0
RoE (%)	4.8	9.7	14.7
RoCE (%)	5.4	9.2	13.7
EV/Sales (x)	2.3	3.4	2.6
EV/EBITDA (x)	10.7	12.2	9.0
P/E (x)	31.7	26.7	15.4
P/BV (x)	1.5	2.6	2.3

Source: Company & Kotak Securities - Private Client Research

EASUN REYROLLE

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 789** | **TARGET PRICE: Rs. 1,126**

29 March 2006

Sanjeev Zarbade

Easun Reyrolle is one of the top three players in the control relays and control panels segment in India. Over the years, the company has been introducing new products in its portfolio and is now gearing up to take up turnkey projects in the power distribution segment. On the back of strong demand for its products, the company has posted impressive growth in earnings in the current year. Moreover, given the healthy order backlog, we foresee robust growth continuing in the future. We recommend a BUY with a target price of Rs.1,126.

Investment argument

- Strong presence in the control relays and panels segment. Easun Reyrolle is one of the leading companies in the field of power management providing end-to-end solutions covering power system protection, control and automation solutions. In the segment of relays and control panels, the company ranks third in the domestic market behind ABB and Areva T&D.
- Access to technology from foreign strategic partner. VA Tech, which is owned by Siemens AG, is a strategic partner in Easun with a 23% stake. VA Tech is among the global frontrunners in transmission and distribution products. Over the years, thanks to the strong association with Reyrolle Protection (owned by VA Tech), Easun has been able to develop strong in-house expertise thereby offering products and solutions to suit the complex Indian power system conditions.
- Expanding product portfolio to maintain growth. Easun's focus is on providing "one-touch" access to customers by giving them integrated solutions. Towards this end, the company acquired the switchgear technology from one of its associate companies. Easun is setting up a new factory to make switchgears, which should be commissioned by September 2006. Revenue potential from this plant is estimated at Rs.1.0bn on full capacity.
- Turnkey projects foray to take Easun up the value chain. In line with the strategy to move up the value chain, the company has decided to enter turnkey projects. In this segment, Easun will focus on substation projects and automation projects (SCADA systems). To expand its business portfolio, the company is also considering inorganic growth.

Valuation

- On the back of a comfortable order backlog, Easun is strongly placed to report robust earnings numbers. We estimate earnings to grow at CAGR of 30% over next two years.
- At the current price, the stock is trading at 12.7x and 9.8x FY07E and FY08E earnings respectively.
- We recommend a BUY with target price of Rs.1,126, implying an upside of 41% from current levels.

Concerns

- Very high working capital of 152 days of sales
- Inadequate liquidity in the stock

Summary table

Rs mn	FY06E	FY07E	FY08E
Sales	1,094	1,468	2,041
Growth (%)	113.5	34.1	39.1
EBITDA	243	335	428
EBITDA margin (%)	22.2	22.8	21.0
Net profit	160	209	271
Net cash (debt)	(186)	(220)	(130)
EPS (Rs)	48.1	62.9	81.3
Growth (%)	346.5	30.6	29.3
CEPS	54.9	70.6	89.9
DPS (Rs)	13.7	12.9	12.9
RoE (%)	54.7	45.8	38.4
RoCE (%)	51.4	47.9	48.9
EV/Sales (x)	2.6	2.0	1.4
EV/EBITDA (x)	11.7	8.6	6.5
P/E (x)	16.6	12.7	9.8
P/Cash Earnings	14.5	11.3	8.9
P/BV (x)	8.1	5.4	3.7

Source: Company & Kotak Securities - Private Client Research

AMTEK INDIA

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 125** | **TARGET PRICE: Rs. 160**

30 March 2006

Avinash Gorakshakar

We recently met the management of Amtek India (AIL) and came out positive about the future prospects of the company. Some of the key takes away from the meet are discussed below:
AIL's expansion plans to increase its existing casting capacity at Bhiwadi to 70,000 tpa from the existing 30,000 tpa, estimated to cost Rs 450 mn, are on track and are expected to be completed by March 2006. The company is looking to further increase the capacity to 1,25,000 tpa by December 2006.

AIL also plans to raise the capacity of the machined castings from 12.5 mn to 18 mn in the 12 months. Given the buoyancy in the auto industry and the strong positioning of the company (Tier I supplier) we expect this to positively impact the company's revenues and profits.

There has been a delay in AIL's proposed plan of SigmaCast's Line shifting to its existing unit based at Bhiwadi. Earlier, we had expected two lines to get shifted by December 2005 end. However, according to the management, one line will be shifted by March 2006 and another in December 2006. The proposed shifting of the other two lines is expected to be completed by December 2007.

The management also sounded quite confident about capturing a major slice of the business once Maruti Udyog commences manufacture of the diesel Swift. Additionally, MUL's plans to manufacture and export engines also augur well for the company. This will be both turnover and earnings accretive for the company in future.

According to MUL, the engine manufacturing facility is expected to become operational from December 2006 onwards. Amtek is confident that it will corner around 50% of the diesel engine output manufactured by Maruti here initially, which will progressively go up once volumes stabilize.

With the realignment of operations, we expect more outsourcing business from both SigmaCast and GWK UK leading to higher exports as well as improved margins for the company. On a consolidated basis, the management expects the bottomline to be positively impacted as a result of the cost savings initiatives undertaken for the group. The company management is also confident that its share of outsourcing business from GWK UK would also increase gradually and be more significantly reflected in FY07E financials.

We believe that AIL looks well positioned to reap the benefits of capacity expansion. It's Sigma Cast operations and the potential outsourcing upside from GWK UK's operations fully in FY07E. Hence, we expect our consolidated topline estimates to further improve to Rs 8.25 bn (Earlier estimated at Rs 7.36 bn). EBIDTA is slated to improve to Rs 1.80 bn (Rs 1.60 bn estimated earlier) followed by a PAT of Rs 1.01 bn as compared to Rs 798 mn estimated earlier.

AIL had issued FCCBs aggregating $75 mn in order to finance capacity expansion and to acquire companies abroad. After the conversion of these FCCBS, the final equity of AIL will be Rs 170 mn.
We had initiated a BUY on AIL at Rs.100.8, and, since then, the stock is near our price target of Rs126.

We believe Amtek India is a value and growth play and maintain BUY on the stock with a target price of Rs 160. The stock currently trades at 11x and 9x earnings for FY06E and FY07E, respectively. At our target price, the AIL stock would trade at 13x FY07E and offers a 28% upside from current price levels.

Standalone Key financials (Rs mn)

Period Ended	H1FY06	H1FY05	Grth %
Net sales	2,236	1,624	37.7
Other income	47	60	(20.5)
Total expenditure	1,647	1,245	32.3
Operating profits	589	379	55.5
OPM (%)	26.4	23.3	12.9
Interest	70	59	18.4
Depreciation	137	119	14.8
PBT	430	260	65.2
Prov for tax	116	22	428.2
Profit after tax	314	238	31.6
Equity capital	118	118	
EPS (Rs)	5.3	4.0	

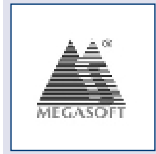
Source: Company

MEGASOFT

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 143** | **TARGET PRICE: Rs. 180**

31 March 2006

Dipen Shah



We see Megasoft as a productcentric company operating in niche and potentially high growth areas of mobile telephony and life sciences. The company has access to stateofthe-art products in both the verticals through its strong R&D capabilities and a couple of acquisitions. We believe, that the increasing acceptance of existing products and the commercial launch of new products (VOISE, a first of its kind product globally) will allow Megasoft to report consistent and high growth rates in the future. Megasoft's alliance-led approach has already provided it a global reach, through companies like Teleglobe, HP and GSMA (GSM Association). We believe the traditional software consulting business will increasingly re-align itself to the product-centric practices and be a predictive cash flow segment for the company. We expect Megasoft's revenues and profits to grow at a CAGR of 33% and 44%, respectively, over FY05 FY07E (December year end). At the current levels of Rs.143, the stock trades at 11x our FY07E earnings and 2.7x our FY07E book value. Our DCF-based price target of Rs.180 provides an upside of 26% from the current price levels. BUY.

Investment Argument

- Changing Business Model. Megasoft is transforming itself from an on-site software consulting services business to a telecom and life sciences products company post the acquisition of a telecom products company, Xius, in early 2004. We expect the products business to grow at a CAGR of 67% over FY05 FY07E and contribute 54% of the overall revenues in FY07E as compared to 34% in FY05. We expect the consulting business's revenues to grow predicatively at an 11% CAGR.
- Positioned in potentially rapid growth domains. Megasoft has, through its own R&D and product acquisitions, built a suite of products that are targeted at areas which have the potential to witness fast growth rates in the future; mobile telephony and life sciences. The global mobile and roaming subscriber bases are expected to witness rapid growth in the coming years. Megasoft has established client relations and/or alliances in geographies like Middle East, Africa and Asia Pacific, which are expected to account for sizeable chunk of this growth.
- Alliances could be the ace in the pack. Megasoft has entered into agreements with large networks / corporations like Teleglobe, HP and GSMA, which are expected to provide a substantial reach to Megasoft, in turn, reducing the time-to-market significantly. These alliances have already opened up newer markets and opportunities to cross-sell its offerings in target areas where the growth is expected to be rapid.
- Proven R&D skill set to help remain 'ahead of the curve' The company (Xius) has strong R&D skills, which has led to the development of the existing suite of products. The company has recently developed and launched VOISE which, we believe, is the first of its kind product in the world, in the niche and high growth area of MVNOs (Mobile Virtual Network Operators) and MVNEs (Mobile Virtual Network Enablers). All the products have been developed on a patent pending WISE platform that has advantages like 'switch independence'. We believe that, WISE provides Megasoft with the technological expertise to continue introducing new revenue producing products for the wireless operators, with significant cost savings.
- Sustained high growth. We expect Megasoft's revenues to grow at a CAGR of 33% to Rs.2.04bn in FY07E. The margins are expected to expand in line with the increasing contribution of higher margin products business to the overall revenues of the company. Consequently, PAT is expected to grow at a CAGR of 44% to Rs.420mn in FY07E, leading to an EPS of Rs.13, on a fully diluted equity capital of Rs.324mn (post conversion of FCCBs).

Valuations

The stock is available at attractive valuations of 11x FY07E earnings and 2.7x FY07E book value.

At our target price, Megasoft will be trading at 13.5x our FY07E (December end) earnings and these will be at a discount to the expected valuations of comparable peers like Subex. We accord Subex a relatively higher multiple on account of the leading position of its products and its relatively greater scale.

Our DCF valuations incorporate a 4% growth in perpetuity and a 14% WACC. Based on these, we arrive at a fair value of Rs.180, a 26% gain from the current levels. BUY.

Summary table

Year end Dec	FY05	FY06E	FY07E
Sales	1,154	1,541	2,039
Growth (%)	35.9	33.5	32.3
EBITDA	271	406	560
EBITDA margin (%)	23.5	26.3	27.5
Net profit	201	314	419
Net debt (cash)	63	(514)	(823)
EPS (Rs)	7.9	9.7	13.0
Growth (%)	432.9	22.9	33.4
CEPS	9.7	11.8	15.1
DPS (Rs)	0.0	3.0	4.0
RoE (%)	39.8	30.8	27.5
RoCE (%)	26.6	25.9	29.7
EV/Sales (x)	3.2	2.7	1.9
EV/EBITDA (x)	13.6	10.1	6.8
P/E (x)	18.1	14.7	11.0
P/Cash Earnings	14.8	12.1	9.4
P/BV (x)	5.2	3.4	2.7

Source: Company & Kotak Securities - Private Client Research

FEDERAL BANK

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 196** | **TARGET PRICE: Rs. 248**

31 March 2006

Jay Prakash Sinha

GDR listing on LSE completed

Federal Bank has completed the process of its GDR listing on London Stock Exchange. With this, the process of GDR issuance is completed. Post the GDR issue, the banks networth as per our estimates would be around Rs.12.36bn and the capital adequacy is close to 13%. With sufficient capital, the bank is now in a position to fuel its credit growth and also meet the forthcoming Basel II requirements.

Details of the GDR

No. of shares, mn	20
Price in USD	3.97
Conversion rate*	44.15
Total value, Rs mn*	3506
Incremental equity capital, Rs mn	200
Equity premium, Rs mn*	3306
GDR listing on	London Stock Exchange

**Source: Kotak Securities Private Client Research Estimates*

We have incorporated this for calculation of our estimates. We continue to maintain our BUY recommendation with a revised price target of Rs.248, an upside of 27% from the current level.

Key data (Rs bn)

	2005	2006E	2007E	2008E
Interest income	11.91	13.64	16.09	18.65
Interest expense	6.89	8.14	9.33	10.65
Net interest income	5.02	5.51	6.76	8.00
Other income	2.22	2.09	2.31	2.54
Gross profit	4.10	4.06	5.22	6.35
Net profit	0.90	1.87	2.32	3.09
Gross NPA (%)	7.1	6.0	5.3	4.1
Net NPA (%)	2.2	1.7	1.3	0.5
Net interest margin (%)	3.1	2.9	3.0	3.1
RoE (%)	13.1	19.1	17.3	19.5
RoAA (%)	0.6	1.0	1.1	1.3
Dividend Yield (%)	1.3	1.3	1.3	1.3
EPS (Rs)	24.8	27.1	27.1	36.1
Adjusted BVPS (Rs)	80.6	123.3	149.7	193.4
P/E (x)	7.9	7.2	7.2	5.4
P/ABV (x)	2.4	1.6	1.3	1.0

Source: Company & Kotak Securities - Private Client Research

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 123** | **TARGET PRICE: Rs. 137**

31 March 2006

Jay Prakash Sinha

Plans to double sales and profit by 2010

The Dabur management has indicated that the company is progressing well towards doubling its sales and profitability by 2010. The plan is to increase sales to Rs.40bn and achieve profitability of Rs.4bn by the end of FY10. It would be possible with both organic and inorganic growth of the company.

Dabur is continuing its growth in a favorable environment, which is helping almost all the players within the FMCG space. After a long gap, demand from rural sector has picked up. This has changed the market dynamics with companies pricing power coming back to FMCG companies. HLL has recently raised prices on some of its products. Earlier on two occasions we have observed price hikes, but it was more because of pressure from rising raw material prices. However, the recent hike along with the withdrawal of freebies indicates that pricing power is coming back to these companies.

Dabur is focusing on areas where it is not so strong like southern India, where it plans to increase its sales from the existing 10% to 15% by FY10. Acquisition of Balsara product range is definitely helping the company in such penetration. Similarly, the home care segment is another area where Dabur is increasing its presence either through Balsara products or its own products. Again, in international markets, where businesses have grown to 9% of total sales, it would get a boost to take it to 15% level by 2010.

Inorganic growth cannot be ruled out at this point in time. The company has good amount of cash in hand to fund such acquisitions, if any. It has already proved successful in mergers by way of turning the loss-making Balsara products into a profit-making one. Our estimate suggests that during FY06, the acquired entity would make a profit of Rs.119mn on a sales of Rs.1.89bn.

Valuation and recommendation

We continue to maintain our BUY with a price target of Rs.137, based on average of our DCF valuation and one-year forward P/E estimates of 24.6x.

Key data (Rs mn)

	FY05	FY06E	FY07E	FY08E
Sales	12,262	18,258	19,895	21,692
Growth (%)	13.3	48.9	9.0	9.0
EBITDA	1,864	2,997	3,414	3,908
EBITDA margin (%)	15.2	16.4	17.2	18.0
Net profit	1,477	2,212	2,562	2,976
Growth (%)	45.9	49.8	15.8	16.2
Net cash (debt)	1,769	2,107	4,040	6,179
EPS (Rs)(@)	5.2	6.6	4.5	5.2
Growth (%)	57.6	26.9	36.4	15.6
ROE (%)	48.7	54.2	45.3	39.1
ROCE (%)	42.4	49.1	42.3	37.2
EV/Sales (x)	2.9	3.8	3.5	3.2
EV/EBITDA (x)	18.8	23.4	20.6	18.0
P/E (x)	23.8	18.6	27.5	23.7

(@-Equity capital has doubled from Rs.286.6mn to Rs.573.3mn post 1:1 bonus in Jan 2006) (Source: Company & Kotak Securities Private Client Research estimates)

MURUDESHWAR CERAMICS LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 114** | **TARGET PRICE: Rs. 178**

3 April 2006

Teena Virmani

Murudeshwar Ceramics (MCL) is a pioneer in the vitrified tile segment having a nationwide network with strong sales, especially in the southern and western regions. The company sells its tiles under the brand name Naveen Diamontile, managing a 30% market share in the vitrified tile segment. It manufactures vitrified tiles of different ranges, sizes and color with its plants located in Hubli and Karaikal. It is also expanding its capacity in the vitrified tiles segment and restarting its ceramic tile production to become a one-stop shop for tiles under a single roof. The total enhanced capacity of the company would be 13.5 mn square meter per annum (inclusive of both vitrified and ceramic tiles) enhanced by 200% from 4.5 mn square meter per annum earlier. It also enjoys the best operating margins in the tiles industry. With a noticeable growth in the housing segment, expansion in the capacity of vitrified tiles and revival of the ceramic tile business, the company would be able to manage a 23% CAGR in revenues and a higher 32% CAGR in net profit from FY05-FY08. Currently the stock is trading at P/E multiples of 6.1x FY07E and 5.2 x FY08E earnings. We recommend a BUY with a target price of Rs 178 over a one year time frame based on DCF method of valuation, implying an upside of 58% from current levels.

Key investment positives

- **Boom in construction to drive growth.** The real estate and construction boom have played a key role in bolstering demand for ceramic and vitrified tiles. Demand for tiles has picked up not only from the retail side but also from the institutional segment. MCL is adequately positioned to benefit from this increased demand since it has 30% market share in the vitrified segment and approximately 60% of its sales come from the institutional segment.
- **Capacity expansion to drive growth.** MCL is expanding its capacity by 200% from the existing 4.5 mn sq meter per annum in vitrified segment in FY05 to 6.3 mn sq meter per annum in the vitrified segment and 7.2 mn sq meter per annum in the ceramic tile segment by FY07. This expansion is expected to drive a growth in revenues at a CAGR of 23% between FY05-FY08.
- **Highest operating margins in the industry.** MCL enjoys the best operating margins in the tiles industry due to higher price realizations from vitrified tiles as compared to ceramic tiles. Moreover, the company also owns quarry and processing unit for its basic raw materials. There are locational advantages available at the Karaikal plant of the company, resulting in saving power and fuel costs.
- **Wide Marketing and distribution network.** It has a very strong sales and marketing network in southern and western India in the retail as well as institutional segment with a large number of showrooms and warehouses.
- **Very Attractive valuations.** At the current market price of Rs 113, the scrip is trading at 6.1x FY07E and 5.2x FY08E earnings. On Price-Book value, the stock appears to be very cheap and is trading at 0.8 times FY07E and 0.7 times FY08E book value. On EV/EBITDA multiples, stock is available at 4.6 times FY07E and 4 times FY08E estimates.

Key concerns

- Cheaper imports from China
- Small players selling at throwaway prices
- Bottlenecks in improving capacity utilization
- Increase in power costs
- Demand slowdown in the user segment

Valuation and Recommendation

We have arrived at a target price of Rs.178 based on the DCF method of valuation which provides an upside of 58% from the current levels. At our target price, stock would be trading at 8.3x FY08E earnings and 5.4x FY08E EV/EBITDA.

Peer valuation

The table below shows that MCL is currently trading at a significant discount as compared to its peers. This is despite it being a leader in the vitrified tiles market, having highest operating margins in the ceramic industry and carrying out a 200% increase in its capacity. Since its new plant has also become operational, we believe that with increase in the revenues, this discounting should narrow down.

Valuation

Company	Price (Rs)	P/E (x) FY06E	P/E (x) FY07E	P/E (x) FY08E	P/BV (x) FY06E	P/BV (x) FY07E	P/BV (x) FY08E	EV/EBITDA (x) FY06E	EV/EBITDA (x) FY07E	EV/EBITDA (x) FY08E
MCL	114	8.2	6.1	5.2	0.8	0.8	0.7	5.3	4.6	4.0
Kajaria	44	11.4	10.7	8.6	2.3	1.9	1.6	7.4	6.7	5.6
Nitco Tiles	201	20.1	13.4	9.6	1.6	1.4	1.2	9.0	7.3	5.7

Source: Kotak Securities - Private Client Research and Industry estimates

Summary table

Rs mn	FY05	FY06E	FY07E	FY08E
Sales	1,791	2,015	3,021	3,289
Growth (%)		12.5	49.9	8.9
EBITDA	485	582	752	819
EBITDA margin (%)	27.1	28.9	24.9	24.9
Net profit	164	206	325	377
Net debt	1,325	1,485	1,685	1,435
EPS (Rs)	11.0	13.8	18.6	21.6
Growth (%)		25.6	34.8	16.3
DPS (Rs)	1.5	2.0	2.0	2.0
ROE (%)	9.8	10.7	14.5	14.7
ROCE (%)	11.0	11.8	14.2	14.5
EV/Sales (x)	1.6	1.5	1.1	1.0
EV/EBITDA (x)	6.0	5.3	4.6	4.0
P/E (x)	10.3	8.2	6.1	5.2
P/BV (x)	1.0	0.8	0.8	0.7

**Source: Company & Kotak Securities - Private Client Research*

MAGMA LEASING

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 155** | **TARGET PRICE: Rs. 216**

3 April 2006

Jay Prakash Sinha

Magma Leasing (MLL) is a Kolkata based non-banking finance company (NBFC) engaged in the business of financing commercial vehicles, construction equipments, passenger cars and multi-utility vehicles. It has been largely present in eastern and northern India and is now getting into western and southern India as well. The company is largely focused into semi-urban and rural locations, which contributes to nearly 65% of its total business. In the past five years, disbursements grew at a CAGR of 74% while revenue and profitability grew at 32% and 47%, respectively. New push to asset growth has been given with the introduction of two new products, namely used-vehicle finance and large construction equipment finance, besides selling third party products like personal loans and insurance. Due to lower base, rising demands along with foray into new geographies, we expect the company to grow impressively at a CAGR of 30% over the next two years. However, due to change in product mix and fee-based services, profitability is likely to increase at a CAGR of 47% in the similar period. The stock, at the current market price of Rs.155, is trading at 1.6x FY08E adjusted book value, which we believe is attractive as the RoE of the company is expected to go up from 21% to 26.6% by FY08E. We arrive at a fair value of Rs.216 based on average of residual income approach (Rs.208) and price-to-book value approach (Rs.224). We initiate coverage on the stock with a BUY recommendation with a price target of Rs.216 over a 12-month horizon.

Investment Rationale

- Robust asset growth: MLL has posted superior asset growth in the past at a CAGR of 64% between FY02-05. The new products like pre-owned vehicles and strategic construction equipments would add significant growth. We expect the company to post a compounded growth of 30% between FY05-08. Though the existing business is expected to grow at a moderate rate of 12.3%, new business would contribute to the rest growing from Rs.1,500 mn in FY06E to Rs.10,500mn in FY08E thus taking the contribution from new business to 35% of total disbursements.

- Used vehicle financing to improve RoE: A change in product mix with higher volumes of used vehicle financing, where yields are more than double, would impact the company's RoE significantly and take it up from 21% to 26.6% by FY08E. Also, thrust on services and fee-income would add revenues without much of capital requirement.

- Ramp up in fee income: MLL has started distributing third party businesses in insurance and personal loan segments, which is expected to generate revenues of Rs.39mn in FY06E and grow to Rs.111mn by FY08E. Dedicated manpower and captive clients augurs well for the company for such products, where capital requirement is minimal.

- Prudent liability management: Being a small player, the company has continuously set free its capital by way of securitizing its assets, where it enjoys better credit rating as well. This has not only kept the balance sheet strong but has also given clean spread of nearly 4.5% on its assets. However, we expect the spread to squeeze going forward to 3.5% by FY08E.

- Foray into new geographies: MLL has historically been strong in the eastern and northern part of the country. South and west India's contribution in total business is merely 20%. Foray into newer geographies, particularly adjoining ones, would push the product offerings at a higher pace.

- Attractive valuation: The company is trading at 2.0x FY07E and 1.6x FY08E its adjusted book values despite the fact that RoE of the company is set to improve from the existing 21% to over 26.6% by FY08E. We estimate fair P/ABV multiple to be at 2.2x for the company.

Valuation and recommendation

We expect MLL to post an EPS of Rs.14.1, 23.5 and Rs.31.0 in FY06E, FY07E and FY08E, respectively. In the same period, adjusted book value is expected to be Rs.54, 76 and Rs.97, respectively.

Based on FY08 earning estimates, the company is expected to post a RoE of 26.6%, which translates the fair value to be at 2.3x its adjusted book value. We believe that FY08 estimates would get factored in a 12 months timeframe, which is equal to Rs.224. This is well supported by our residual income valuation of the stock at Rs.208. Based on the average of the two we arrive at a fair value of Rs.216 (again based on FY08E estimates). We recommend a BUY on the stock with a price target of Rs.216 over 12-month horizon, an upside of 39%.

Peer valuation

	CMP (Rs)	RoE (x)			P/ABV (x)			P/E (x)		
		FY06E	FY07E	FY08E	FY06E	FY07E	FY08E	FY06E	FY07E	FY08E
Magma leasing	155	19.8	25.0	26.6	2.9	2.0	1.6	11.0	6.6	5.0
Chola Finance	227	11.9	13.7	20.4	3.0	2.8	2.5	22.5	18.3	11.0
Sundaram Finance	393	10.2	10.8	11.7	1.5	1.4	1.3	15.1	13.2	11.2
Shriram Transport	128	25.8	25.8	25.4	3.8	3.1	2.6	13.9	11.7	9.9
Shriram City Union	165	38.2	38.5	32.7	6.4	4.7	3.4	13.4	9.9	8.7

Source: Kotak Securities - Private Client Research

Risks and concerns

- Interest rate rise in the economy may impact margins and profitability for the company.
- General slowdown / poor agricultural output / poor monsoon can impact the business of the company
- Tightening of regulatory norms could impact the business of the company
- Given the higher margins in the business, stiff competition going ahead cannot be ruled out.
- So far, the company has maintained zero NPA. However, with the new product launches decline in asset quality would remain a big concern.

Summary table

Rs mn	FY05	FY06E	FY07E	FY08E
Total income	988	1,328	1,808	2,275
Gross profit	263	349	575	749
Net profit	139	204	338	446
EPS (Rs)	10	14	23	31
BV/share (Rs)	56	60	85	108
Adj BVPS (Rs)	56	54	77	97
D/E Ratio (x)	3.7	3.5	3.1	3.1
CAR (%)	31.4	35.9	33.9	31.3
Net NPA (%)	-	2.0	2.0	2.0
RoNW (%)	20.1	19.8	25.0	26.6
RoAA (%)	3.9	4.0	5.2	5.6
NIM (%)	15.6	13.1	12.2	11.2
DPS, Rs	1.5	1.5	1.5	1.5
Div yield (%)	1.0	1.0	1.0	1.0
P/E (x)	15.4	11.0	6.6	5.0
P/ABV(x)	2.8	2.9	2.0	1.6

**Source: Company & Kotak Securities - Private Client Research*

SHASUN CHEMICALS & DRUGS

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 106** | **TARGET PRICE: Rs. 127**

3 April 2006

Awadhesh Garg

Acquisition of Rhodia's Pharma Custom Synthesis business

Shasun

Shasun Chemicals, through its 100% subsidiary Shasun Pharma Solutions Ltd. UK, has completed its first ever acquisition of the pharmaceutical custom synthesis business of the Rhodia Group. The deal is of the nature of assets purchase (UK manufacturing sites at Dudley in Northumberland, England and Annan in Scotland) for an approximate sum of $30-35 mn. It includes all of Rhodia's development and custom manufacturing services catering to innovator and emerging pharmaceutical clients in the US, Europe and Asia. The capacity of both the plants put together is 525 Cu.M and are US FDA inspected and approved for many products. The main focus of business is contract manufacturing technologies like hydrolytic kinetic resolution (HKR), aromatic bond formation (ABF) and Radical Trifluoromethylation, with patents are part of this transaction. All products and building blocks related to these technologies, which include associations with scientists at Harvard and MIT are also part of the transaction.

Rhodia had bought these facilities for a sum of $575mn in 2002. Since this business does not fit with the business strategy, Rhodia has decided to hive it off.

Financial Strength

In 2005, the acquired business has generated revenues of 60 mn euros with net loss at operating level of 9 mn euros The company expects 10-15% growth going forward from this business and will be profitable at operating level by next year due to continuous focus on improving capacity utilization and restructuring. The company expects breakeven level at 55-60% of capacity utilization.

So far 10 products have been commercialized with around 35-40% of sales. The products include API and intermediates.

Customer base to remain intact

The Shasun management has strongly reiterated that they have met with all existing key customers of the business during the due diligence process and have confirmed their intention to maintain their relationships under the new ownership. This acquisition further includes retaining the current management team of the acquired business and the existing employees (total strength being 349). The business includes a strong pipeline of pre-launch products, which are at an advanced Phase III stage trials, with a potential of significant future growth.

Investment rationale and valuation

We expect Shasun to register 12.6% CAGR in sales and 20.3% CAGR growth at net level during FY06-08E. In our projections we have not factored in any growth and synergies from this acquisition, though we have assumed that by FY07 the company will be able to break even the Rhodia's business. Hence, it will not impact the consolidated financials negatively.

CRAMS business acquisition of Rhodia facilities, contract research - Rs.250 mn facility completed in FY06 and contract manufacturing for formulations commissioned in Pondicherry in FY06 would be the key growth drivers going forward.

At Rs106, the stock is trading at 12.6x FY06E and 10.9x FY07E earnings. Our price target based on DCF model is Rs127, which provides an upside of 20%. (WACC 10.8%, Beta 0.75, Terminal Growth 3%). We recommend Buy.

Summary table

Year end Dec	FY05	FY06E	FY07E
Sales	3,135	3,477	3,895
Growth (%)	23.5	10.9	12.0
EBITDA	515	645	763
EBITDA margin (%)	16.4	18.6	19.6
Net profit	311	383	441
Net Margin (%)	9.9	11.0	11.3
EPS diluted (Rs)	6.8	8.4	9.6
Growth (%)	121.8	123.1	115.2
DPS (Rs)	0.8	1.5	1.5
RoE (%)	23.1	23.2	21.9
RoCE (%)	27.0	26.6	27.1
EV/Sales (x)	1.3	1.6	1.4
EV/EBITDA (x)	8.1	8.8	7.4
P/E (x)	11.0	12.6	10.9
P/BV (x)	2.5	2.9	2.4

Source: Company & Kotak Securities - Private Client Research

Financials: Shasun Chemicals & Drugs

Profit and loss statement (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
Revenues	3,135	3,477	3,895	4,479
% Change Y-o-Y	23.5	10.9	12.0	15.0
Total Expenditure	2,620	2,832	3,132	3,555
EBITDA	515	645	763	923
% Change Y-o-Y	46.2	25.3	18.2	21.1
Other Income	179	150	150	150
Depreciation	217	228	271	298
EBIT	478	567	642	775
Interest	34	54	54	54
Profit before tax	444	511	588	721
Tax	133	128	147	180
as % of PBT	29.9	25.0	25.0	25.0
Net Income	311	383	441	541
% Change Y-o-Y	22.0	23.1	15.2	22.6
Shares outstanding (Mn)	45.8	45.8	45.8	45.8
EPS (Rs)	6.8	8.4	9.6	11.8
CEPS (Rs)	7.5	9.6	10.8	13.0
BVPS (Rs)	29	36	44	54
DPS (Rs)	0.8	1.5	1.5	1.5

Cash flow statement (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
PAT	311	383	441	541
Depreciation	279	256	300	334
Change in NWC	145	195	90	126
Operating Cash Flow	445	444	652	750
Investments	0	-	-	-
Capex	563	500	500	500
Investment Cash Flow	(563)	(500)	(500)	(500)
Loans	336	-	-	-
Dividend	78	78	78	78
Issue of capital	5	-	-	-
Financial Cash Flow	263	(78)	(78)	(78)
Change in Cash	122	(134)	73	171
Opening Cash	30	151	17	90
Closing Cash	151	17	90	262

Balance sheet (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
Shareholder's Equity	92	92	92	92
Reserves	1,256	1,561	1,924	2,387
Total Networth	1,348	1,652	2,015	2,478
Secured Loans	893	893	893	893
Unsecured Loans	-	-	-	-
Total Loans	893	893	893	893
Net deferred tax liability	206	231	260	297
Total Liability	2,446	2,776	3,169	3,668
Net Fixed Assets	1,736	2,008	2,237	2,438
Investments	1	1	1	1
Inventory	609	717	803	923
Debtors	491	589	660	759
Cash & Bank Balance	151	17	90	262
Loans & Advances	225	251	281	323
Current Liabilities	666	717	803	923
Provisions	105	90	100	115
Net Current Assets	706	768	931	1,228
Total Assets	2,446	2,776	3,169	3,668

Ratio analysis

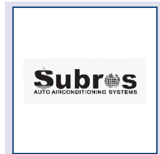
Year end March	FY05	FY06E	FY07E	FY08E
Debt-Equity Ratio	0.7	0.5	0.4	0.4
Gearing (%)	36.5	32.2	28.2	24.3
Current Ratio	1.9	2.0	2.0	2.2
Inventory Turnover	4.3	4.0	3.9	3.9
Debtors Turnover	6.6	6.1	6.1	6.1
Fixed Assets Turnover	2.0	1.9	1.8	1.9
Interest coverage (x)	14.1	10.5	12.0	14.5
EBIDTA Margin (%)	16.4	18.6	19.6	20.6
PAT Margin (%)	9.9	11.0	11.3	12.1
RoE (%)	23.1	23.2	21.9	21.8
RoCE (%)	27.0	26.6	27.1	27.8
EV/Sales (x)	1.3	1.6	1.4	1.2
EV/ EBITDA (x)	8.1	8.8	7.4	5.9
Price to earnings (x)	11.0	12.6	10.9	8.9
Price to book value (x)	2.5	2.9	2.4	1.9
Price to cash earnings (x)	9.9	11.0	9.8	8.1

SUBROS LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 171** | **TARGET PRICE: Rs. 280**

10 April 2006

Avinash Gorakshakar



Subros is the largest player in the domestic automotive air-conditioning segment. It caters to the OEM segment to several top Tier-I auto majors like Maruti Udyog, Tata Motors, Hindustan Motors, Force Motors and Reva Electric Car Co. We believe Subros enjoys excellent product delivery capabilities, the best speed-to -market ability, a multi locational capacity presence, long-standing relationships with large OEMs and adequate management bandwidth. We expect Subros to record a healthy RoCE and RoNW of 21% and 22%, respectively, for FY08E with net profits estimated to grow at a CAGR of 31% over the next two years. (FY06-FY08E).

Investment rationale

- Market leader in the automotive air conditioning segment (AAS). Subros is a market leader and the largest player operating in the domestic (AAS) segment where it controls around 44% of the car AC market. Subros manufactures and supplies automotive AAS and fan motor assemblies with technology developed by its collaborators, Denso Corp (13% stake) and Suzuki Motors (13% stake), both from Japan.

  Subros plans to raise its market share in the domestic passenger car AC market to 50% in the next two to three years. We have estimated a volume growth of 17% and 20% during FY07E and FY08E, respectively, which we believe looks reasonable considering the increasing volume requirements of large OEM customers like Maruti, Tata Motors and potential new client wins from the passenger car and CV segments.

- New client additions and expansion of capacity to drive volume growth. Subros is expanding its capacities to 1 mn per annum. (from 750, 000 currently) to meet the incremental demand arising from existing OEM customers and new client additions in both the passenger car and CV segments. The new capacities are being set up at Manesar (Haryana) and Pune in two phases; commissioning of Phase I (Manesar and Pune) has started in October 2005 while Phase II (Manesar) is expected to get started by April-May 2006 onwards.

  Among new orders likely to come include Mahindra & Mahindra's new Scorpio in FY07E and the passenger car Logan expected to be launched by end of FY07E, as well as truck air conditioners to be supplied for Ashok Leyland, Tata Motors and Eicher Motors Ltd.

- Higher localization of imported components to improve EBIDTA margins. Subros has been making consistent efforts to reduce its imported raw material costs through higher localization of components and indigenization with a view to improve EBIDTA margins and also increase productivity levels. Also, the company's product mix is getting shifted gradually to higher end products in both the passenger car and CV segment to ensure that both volume growth and EBIDTA margins are likely to improve.

Valuation

- We expect revenue growth to be sustained at a CAGR of 20% over the next two years (FY06 to FY08E) which should drive EBIDTA growth at a CAGR of 19% YoY over the same period. Our estimate is that Subros would record a 31% CAGR profit growth over the next three years from Rs 211.3 mn in FY05A to Rs 366.2 mn by FY08E.

- The Subros stock trades at 8x FY07E and 6x FY08E. On an EV/EBIDTA basis, the valuations look reasonable at 4x FY07 and 3x FY08E. We recommend a BUY on the stock with a target price of Rs. 280 based on DCF. At our target price, the stock will be valued at 13x and 9x P/E and 6x and 5x CEPS for FY07E and FY08E, respectively.

Risks and concerns

- At present, around 85% of Subros' revenues are accounted by Maruti Udyog and Tata Motors while the balance comes from other customers like Hindustan Motors, Force Motors, Mahindra, etc. Therefore, to a significant extent, Subros' present and future performance is linked to the volume growth shown by both Maruti and Tata Motors in the domestic market.

Summary table

Rs mn	FY06E	FY07E	FY08E
Sales	5,509	6,604	7,978
Growth (%)		19.9	20.8
EBIDTA	574	728	921
EBIDTA Margin (%)	10.4	11.0	11.5
Net Profit	211	265	366
EPs (Rs)	17.6	22.1	30.5
CEPS (Rs)	37.6	46.3	59.7
ROE (%)	18.0	19.3	22.4
ROCE (%)	17.8	18.7	20.6
EV/Sales (x)	0.5	0.4	0.3
EV/EBIDTA (x)	4.4	3.6	3.0
P/E (x)	9.8	7.8	5.7
P/CEPS (x)	4.6	3.7	2.9
P/BV (x)	1.6	1.4	1.2

Source: Company & Kotak Securities - Private Client Research

SIEMENS

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 6114** | **TARGET PRICE: Rs. 6900**

12 April 2006

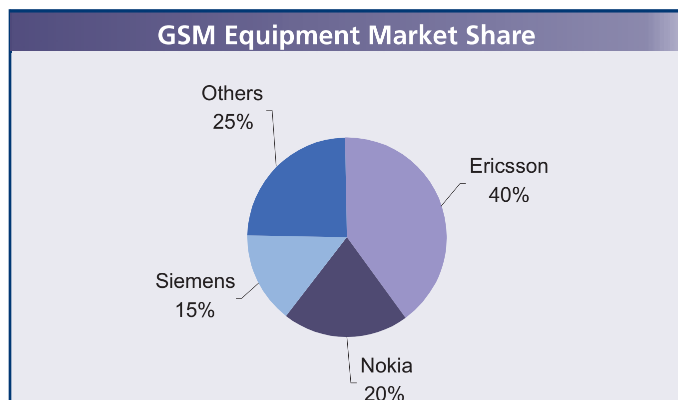
Sanjeev Zarbade

BSNL is planning to float a tender for a 4.5-million GSM network, which will include both mobile equipment and third generation mobile services. The estimated value of BSNL's tender is $4.5-5 billion and the eligibility conditions include local manufacturing of at least 30% of the order size. The bidding process for the contract is scheduled to begin on April 28.

The Siemens AG management has expressed its desire for the tender for both GSM networks as well as 3G services. Siemens has a very good position in 3G, worldwide, in terms of both technology and market share. Siemens AG has 180 customers worldwide covering 90 countries. It has also won more than 35 w-CDMA awards. The management wants to leverage its expertise in 3G in India as well. 3G network services allow users to make video calls, share video files and browse the internet at faster speeds, among other features. 3G services are currently at an infancy state with an expected life cycle of 15 years.

Siemens Public Communications Networks Ltd, now a 100% subsidiary of Siemens Ltd, has, through its mobile networks division, attained market leadership in GSM - R in India with five out of six contracts with Indian Railways. Since the eligibility conditions for the tender require local manufacturing of at least 30% of the order size, the management will have to ramp up its existing manufacturing unit in Kolkata to extend the line of production to mobile equipment if the need arises.

The company's manufacturing facility in Kolkata manufactures fixed lines equipment like switches, transport and access products. It also has an R&D center in Bangalore employing 800 engineers in software. The company has expressed its desire to ramp up this facility for GSM equipment.



Source: Company presentation

The company also retained its supplier position in Hutchison, Idea, BPL, Spice and BSNL. SPCNL has been enhancing its product portfolio to address customers needs. A number of products/solutions with latest technologies and upgrades have been launched like next generation switching, access and optics equipment, migration to Next Generation networks, home entertainment solutions as well as offerings in the mobile networks and software development space.

Financial outlook and analysis

We remain bullish on the prospects of Siemens going forward, given the robust growth expected across its various divisions and the strong parentage that it enjoys. At the current market price of Rs 6,114, the stock is trading at 29.5x and 22.2x, its estimated FY07 and FY08 earnings. We maintain a BUY on the stock with a revised price target of Rs 6,900. At our target price of Rs 6,900, the stock will trade at 25x its estimated FY08 earnings.

Summary table

Rs mn	FY06E	FY07E	FY08E
Sales	42,181	55,371	71,982
Growth (%)	50.8	31.3	30
EBITDA	4,645	6,850	9,079
EBITDA margin (%)	11	12.4	12.6
Net profit	3,642	5,201	6,713
Net cash (debt)	8,060	12,045	18,457
EPS (Rs) (standalone)	108	154	199
EPS (Rs) (cons)*	151	207	276
Growth (%)	64.2	37.3	33.4
CEPS	116	164	210
DPS (Rs)	14.5	14.5	14.5
ROE (%)	40.0	41.1	37.1
ROCE (%)	17.2	20.3	20.3
P/E (x) consolidated	40.5	29.5	22.1

Source: Company & Kotak Securities - Private Client Research

MPHASIS BFL LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 205** | **TARGET PRICE: Rs. 231**

13 April 2006

Dipen Shah

Mphasis BFL Ltd

MphasiS' results for Q4FY06 were below our expectations with muted revenue growth and certain one-time expenses coupled with an increased tax outgo impacting profitability on a sequential basis. The revenues for the quarter stood at Rs. 2.51 bn, registering a growth of 3.3%, sequentially, and the net profit at Rs. 352.3 mn, a degrowth of 14.6% sequentially.

MphasiS has, over the quarters, broadened its range of services and is now focusing more on newer areas like embedded software and consulting. We also expect more profitable revenues from the platform-based BPO services to also start kicking in from FY07. In our opinion, these strategies will lead to greater stability in the revenue stream coupled with improving profitability for MphasiS.

We expect the company to report net profits of Rs. 1.78 bn and Rs. 2.26 bn for FY07 and FY08, respectively. This would translate into an EPS of Rs. 11.1 and Rs. 14 for the corresponding fiscals.

EDS has recently made a conditional offer to acquire a 52% stake in MphasiS and this has been welcomed by the management. In our opinion, the entry of EDS will open up greater opportunities for the company in terms of new client acquisitions and deeper penetration of existing clients on the back of an enhanced range of service offerings.

We are of the opinion that the probability of the open offer being successful is high. If the EDS offer goes through it would provide the company with a larger addressable market. The management is indicated that it will continue with the company even if it becomes a subsidiary of EDS.

The current price discounts our FY08E earnings by 14.6x. Factoring in the positive impact that the entry of EDS could have on the future prospects of MphasiS, we are revising our price target upwards to Rs. 231, which is supported by our DCF analysis. We recommend a BUY on MphasiS with a price target of Rs. 231 over a 12-month horizon. At our target price, the stock will discount our FY08E earnings by 16.5x.

Valuation and recommendation

We have assumed that the EDS open offer will go through smoothly and this would benefit MphasiS in terms of client access and impact its growth rates positively going forward. If there were any hiccups in the deal it would impact our growth rate assumptions for MphasiS and the valuations, negatively.

Rupee appreciation beyond our assumed levels of 43 per dollar by FY08 end could provide a downward bias to our earnings estimates. A steep deceleration in the economies of major global economies could impact revenue growth of domestic vendors.

Q4 FYO6 Results

MphasiS has grown its revenues by 3.3% QoQ to Rs. 2.51 bn, which is lower compared to the 6.6% sequential growth reported in Q3. This can be attributed to the muted growth in business volumes for the company and a 2.2% appreciation in the rupee over the quarter.

Quarterly performance

(Rs. mn)	4QFY06	3QFY06	QoQ (%)	4QFY05	YoY (%)
Turnover	2,505	2,424	3.3	2,051	22.1
Expenditure	1,992	1,858		1,677	
EBIDTA	513	567	(9.4)	373	37.5
Depreciation	140	138		110	
EBIT	373	429	(12.9)	263	41.9
Interest	(10)	(3)		(11)	
ESOP/EO expns	1	5		-	
Other Income	11	(19)		18	
PBT	394	408	(3.4)	293	34.7
Tax	43	-		(16)	
PAT	352	408	(13.8)	308	14.0
EPS (Rs)	2.2	2.5		3.9	
Margin (%)					
EBDITA	20.5	23.4		18.2	
EBIT	14.9	17.7		12.8	
PAT	14.0	16.8		15.0	

Source: Company

Software Services

Revenues in the software services segment during the quarter grew by 4.1% on a sequential basis to Rs. 1.72 bn on the back of increased revenues from the financial services vertical.

The company has now implemented strategic initiatives, which should lead to better prospects for the business going forward. In BFSI, the company is now focusing on the Sarbanes-Oxley (SoX) and Basel compliance projects after acquiring a tool that monitors the compliance of these two aspects for a client.

The company believes the potential for the SoX project is significant and will augment revenues from the BFSI vertical going forward. The deal has been finalized in Q3 of FY06 and we believe it would take time to scale up revenues from this line of business. The software services business added twelve new clients during this quarter including an international airline and a leading technology services company.

Going forward, we believe there will be increased contribution from the BFSI and technology verticals on the back of the new client additions and deeper penetration into existing clients. The software services business added 114 employees during the quarter and the utilization rates dipped by about 200 bps. In our opinion, the utilization rates could be impacted favorably in the coming quarters due to the new employees turning billable.

BPO

BPO revenues continued to grow at a lackluster pace growing by 2.1% to Rs. 781 mn in Q4FY06. This growth in revenues could be attributed to the growth in domestic BPO business that accounted for 14% of BPO revenues in Q4FY06 compared to the 2% in Q2FY06 and 12% in 3QFY06.

We believe the engagement with Bharti Tele is progressing well. For Bharti, the company has been doing incoming voice-based work and will gradually move on to value-added work at a later stage. The SBI account has faced certain delays in scale up due to the lack of extensive networking of branches across India. These may be rectified in 1HFY07.
MphasiS is one of the few players in this business to have a platform-based BPO and enjoys a competitive advantage on that front. Recently, MphasiS had acquired El Dorado, which has a platform that can be implemented across the health benefit management business.

The platform-based BPO would let the company charge clients on a value-added basis as against the current cost plus billing. We believe a platform-based BPO, with its operational and technological advantages will be a strong differentiator for MphasiS.

The BPO segment has added two clients this quarter and has grown existing relationships to newer geographies in Europe. While the international revenues have not grown fast enough in FY06, these are expected to pick up pace in FY07. We believe a higher proportion of international revenues in the BPO segment would also impact the margins favorably.

Employee Additions

The company has continued to add a decent number of employees this quarter with net additions of 591 including 477 in the BPO segment. This addition of employees works out to be an addition of close to 5% on the total employee base.

EBITDA Margins

EBIDTA margins were lower by about 300 bps during the quarter. We believe the reduced margins at 20.4% were on account of higher proportion of onsite revenues from the software services segment, decrease in the employee utilization rates and certain one-time expenses to the tune of Rs. 50 mn.

The utilization rates for the software services business and BPO business came down to 73% (75% in Q3) and 53% (56% in 3QFY06). We believe the fall is due to the employee additions carried out in Q3 and Q4 and the higher proportion of freshers (not billable immediately). In the software services business, on-site revenues formed 60% of 4QFY06 revenues vis-à-vis 57% in the previous quarter.

During the quarter, MphasiS reported certain one-time expenses like a domestic service tax outgo of Rs. 20 mn and sales incentive payment of Rs. 22 mn that led to a decline in the margins.

Increased tax outgo also impacted profit growth

MphasiS reported a tax outgo of Rs. 42.6 mn in Q4 and the effective tax rate stood at 10.8% compared to the near nil tax outgo last quarter. This increase in the tax outgo has been due to the increase in profitability of the US subsidiary that has resulted in higher tax payouts and the company accounting for some deferred tax in India. The reduction in operating margins, coupled with the increased tax outgo led to a sequential degrowth of 14.5% in the net profits (Rs. 352 mn) for the company this quarter.

Future prospects

(Rs mn)	FY06E	YoY %	FY07E	YoY %	FY08E	YoY %
Turnover	9,401	22.8	11,896	26.5	14,945	25.6
Expenditure	7,426		9,386		11,872	
EBDITA	1,975	39.8	2,510	27.1	3,074	22.5
Depreciation	519		603		679	
EBIT	1,456	43.2	1,907	31.0	2,395	25.6
Interest	(17)		(44)		(70)	
ESOP/EO expns	14		-		-	
Other Income	77		52		104	
PBT	1,536	19.8	2,003	30.4	2,569	28.2
Tax	38		222		308	
PAT	1,498	20.3	1,781	18.9	2,261	26.9
EPS (Rs)	9.3		11.1		14.0	
Margin (%)						
EBDITA	21.0		21.1		20.6	
EBIT	15.5		16.0		16.0	
PAT	15.9		15.0		15.1	

Source : Company, Kotak PCG research

We expect the company to achieve revenues of Rs. 11.89 bn in FY07 and Rs. 14.95 bn in FY08. We have assumed the rupee will appreciate to 43 by FY08E.

Going forward, we expect the large number of employees recruited over the previous quarters would turn billable in the future and that could impact the margins favorably. In our projections though, we have assumed the EBITDA margins in FY07E will remain flat from the FY06 levels. We have further assumed the EBITDA margins in FY08E to be marginally lower than FY07E on account of salary hikes and an appreciation in the rupee.

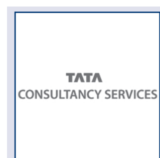
With the tax benefit arising out of accumulated losses (in the US subsidiary) expiring, we expect the company to pay tax at a rate of around 12% for FY07E and FY08E.

Thus, PAT is expected to grow to Rs. 1.78 bn in FY07 and Rs. 2.26 bn in FY08. This would translate into an EPS of Rs. 11.1 and Rs. 14 for FY07 and FY08, respectively.

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 1903** | **TARGET PRICE: Rs. 2092**

18 April 2006

Dipen Shah



The above estimated 8.3% QoQ revenue growth for TCS in Q4 of FY06 reflects a healthy acceptance for new service offerings of the company, increased traction in the Europe geography and also the growing preference of global companies to outsource and offshore their requirements to Indian majors. The profits have also grown by 11% sequentially to Rs. 8,327.4 mn in Q4 of Fy06.

In our opinion, TCS is benefiting from the new service lines introduced by it over the recent past. The company is a major player in areas like infrastructure management, engineering & industrial services and assurance services, where it has added significant number of clients in the current quarter also. Introduction of these new service lines has broadened TCS' range of offerings and is increasingly contributing to the revenue base. In numbers, contribution of non-ADM (Application Development & Maintenance) services has gone up to 31% of revenues in Q4FY06 from the 26% in Q3FY06, reflecting the healthy traction being enjoyed by these new services.

The integration of entities like Tata Infotech, Comicrom and FNS has already started yielding results from 4QFY06, in terms of a broader range of services and the coming on board of significant client accounts from these entities. In our opinion, this integration could help the company to cross sell a greater number of services/offerings to an increased target market, which is witnessed in the client wins registered by FNS (banking) and Comicrom (BPO).

TCS has been able to bag several large deals in the past two quarters, which has also improved visibility for the company going into FY07. With continuing good volume growth and billing rates showing an upward bias for the new client accounts, we believe the growth rates for TCS will remain high.

We expect TCS to report revenues of about Rs. 173 bn in FY07 and Rs. 219 bn in FY08. We have assumed the rupee to appreciate to 43 per dollar by FY08 end. PAT is expected to grow to Rs. 37.9 bn in FY07 and further to Rs. 46.4 bn in FY08, resulting into an EPS of Rs. 77.5 and Rs. 95, respectively. The current price discounts our FY07E earnings by 24x and FY08E earnings by 20x.

At the current levels, we believe our FY07E earnings are fairly priced in. Based on FY08E earnings estimates, we continue to recommend a BUY with a price target of Rs. 2,092. At the target price, our FY08E earnings will be discounted by 22x, which is about a 10% discount to our assumed valuations for Infosys.

4QFY06 results

TCS' 4QFY06 results were above our estimates in terms of revenues and profits.

Quarterly performance

(Rs.mn)	4QFY06*	3QFY06*	QoQ %	4QFY05	YoY %
Turnover	37,328	34,527	8.1	25,846	33.6
Expenditure	27,191	24,760		18,589	
EBIDTA	10,137	9,767	3.8	7,257	34.6
Depreciation	861	738		509	
EBIT	9,276	9,029		6,748	
Interest	0	0		0	
Other Income	16	-154		-360	
PBT	9,293	8,875	4.7	6,387	38.9
Tax	896	1,319		834	
PAT	8,397	7,556	11.1	5,553	36.1
Minority interest	103	48		-115	
Share of profit	33	-3		1	
Adjusted PAT	8,327	7,505	10.9	5,669	32.4
EO items	-232	3		-971	
EPS (Rs)	17.0	15.3		11.6	
EBIDTA (%)	27.2	28.3		28.1	
Net Profit (%)	22.5	21.9		21.5	

*Source : Company * - including all acquired entities*

Revenues

The company reported a healthy growth of 8.1% in business volumes and this, coupled with a higher than estimated revenue share from TIL, led to overall revenues of Rs. 37.32 bn.

The growth in revenues was again led by the Europe geography, where revenues grew by 24% QoQ. This was due to the significant amount of contracts won previously by the company including the ABN AMRO contract and the Pearl deal, which have started to scale up and contribute to the revenues. Domestic revenues have also registered a growth of 7.8% after a de-growth registered in the previous quarter and now contribute to 11.5% of revenues.

Revenues from the prominent client GE have grown by 5.5% QoQ. Consequently, GE now contributes only about 10.3% of the revenues as against 12.5% in Q1FY06. Growth in this quarter was driven mainly by the higher volumes, as billing rates for the existing clients were largely stable. Existing customers have continued to scale up nicely during the quarter. Also, TCS has closed several new deals during the quarter.

Recent acquisitions have started yielding results

TCS had recently acquired Comicrom of Chile, which provides BPO services to banks, pension funds, large corporations and insurance companies in Chile. According to TCS, Comicrom has about 70% of Chile's banks as its customers with a 57% market share of the check processing facility in Chile. Comicrom had revenues of about $35 mn in FY05 with operating margins of about 14%. The company employs about 1257 employees.

The acquisition has started yielding results and TCS acquired two deals in Chile through Comicrom in 3QFY06 and also one client in 4QFY06.

The acquisition of FNS in Australia has provided TCS an entry into the Australian financial services market and the company is already seeing the benefits. TCS increased its portfolio in the important banking and financial services market by bagging three significant wins through FNS during 3QFY06 and three core banking wins in 4QFY06.

Pearl Insurance account is also scaling up

TCS entered the platform-based BPO business in the insurance vertical by acquiring the claims processing business of Pearl Group Ltd, one of the largest insurance companies in the UK. With this, TCS entered the UK life and pension industry.

According to the terms of the deal, revenues of about $850 mn (486 mn pounds) will flow to TCS from Pearl over the next 12 years. As a part of the deal, TCS will acquire the platform on which it will provide claims processing and related services to Pearl Group and its clients. This engagement has already begun to scale up with revenues of close to $5 mn being recognized in Q4FY06.

From TCS' perspective, we believe this deal is of strategic importance. With this deal, TCS will enter the life and pension segments in UK and will further be able to leverage this to spread its presence in the rest of Europe. We note that the Pearl deal, coupled with the ABN Amro deal, has lent good amount of visibility to the company in Europe that is registering good growth rates over the recent quarters.

- **BPO**
  The BPO business continued to progress well with the business having a strength of 4,700 employees, including acquisitions. The division has now started to leverage its acquisitions of Pearl and Comicrom to increase wallet share from existing clients and add new clients. This is evidenced by the client win in the banking space in Europe where TCS plans to leverage its BPO unit Comicrom to deliver services.

- **Consulting services**
  The consulting practice continued to do well with 12 new clients being added and the division winning 77 new engagements during 4QFY06. TCS has implemented the global delivery model in the consulting stream and this has allowed the company to provide better value at competitive rates.

- **IT Infrastructure services**
  TCS is one of the few IT infrastructure outsourcing services providers from India. It is involved in integrated remote management of applications and infrastructure. The practice already has 121 active clients and the business employs 2,795 employees, an addition of more than 400 employees during the quarter.

Recent deal flow: New deal of $500mn bagged by TCS in the financial services practice...

The company has announced a $500mn deal involving application, maintenance and development activities based on a "take or pay" (fixed amount of money paid for completing work within a stipulated time) order for an unnamed client. It is expected that in the first year TCS would employ 2200 people and could subsequently ramp this up depending on the contract. The tenure for the deal though has not been disclosed by the company.

TCS also announces a 1:1 bonus and dividend

The company has also announced its maiden 1:1 bonus ratio along with its quarterly results. The company has also announced a final dividend of Rs.4.5 per share taking the total dividend to Rs.13.5 for 2005-06

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- **EBIDTA margins**
  EBIDTA margins during the quarter were lower at 27.15%, a decline of 110 bps compared to the 28.3% reported in Q3 (including TIL). This reduction in margins was mainly due to an increase in the onsite component of business that rose to 62.8% of revenues (61.4% in Q3) and rupee appreciation of 2.2% during the quarter. An increase in the cost of equipment and software (5.1% of revenues v/s 3.8% in Q3) also impacted profitability.

Future prospects

(Rs.mn)	FY05	FY06E*	YoY %	FY07E*	YoY %	FY08E*	YoY %
Turnover	97,272	132,550	36.3	173,715	31.1	219,872	26.6
Expenditure	68,898	95,543		125,473		159,873	
EBIDTA	28,374	37,008	30.4	48,242	30.4	59,999	24.4
Depreciation	1,575	2,806		4,050		4,700	
EBIT	26,799	34,202		44,192		55,299	
Interest	0	0		54		54	
Other Income	810	257		1,030		1,450	
PBT	27,609	34,459	24.8	45,168	31.1	56,695	25.5
Tax	4,065	4,984		6,775		9,638	
PAT	23,544	29,475	25.2	38,393	30.3	47,057	22.6
Minority interest	79	280		500		660	
Share of profit	18	16		22		31	
PAT after provisions	23,483	29,211	24.4	37,914	29.8	46,428	22.5
EO items	-3,057	243		0		0	
EPS (Rs)	48.9	59.2		77.5		94.9	
EBIDTA (%)	29.2	27.9		27.8		27.3	
Net Profit (%)	24.2	22.2		22.1		21.4	

*Source : Company, Kotak Securities - Private Client Research - * Consolidated with TIL*

We have made appropriate changes our FY07E and FY08E estimates in view of the merger of Tata Infotech Ltd. We have now assumed the rupee to appreciate to Rs.43 per USD by FY08 end

We expect the company to achieve revenues of Rs.173bn in FY07 and Rs.219bn in FY08. While average realizations are assumed to be maintained at 3QFY06 levels.

The EBIDTA margins for are expected to be lower as compared to FY06 mainly due to the salary hikes and expected rupee appreciation. The impact is expected to be partly nullified by the increased move towards off-shore (46% in 4QFY08E v/s 41% in 4QFY06) and provision of higher value added services.

Consolidated PAT is expected to grow to Rs.37.9bn in FY07E and further to Rs.46.43bn in FY08E. The EPS works out to Rs.77.5 per share in FY07E and to Rs.95 per share in FY08E.

19 April 2006 Jay Prakash Sinha

Review of Annual RBI Policy Statement for the year 2006-07

Maintains status quo on benchmark interest rates RBI released its policy statement for FY07 with a cautiously optimistic approach. It expects the GDP growth to remain similar to FY06 with a stable medium-term interest rate regime given that domestic macroeconomic and financial conditions support prospects of sustained growth momentum with stability in India. However given the integration of the Indian economy with the world economy, the adverse consequences of further escalation of international crude prices and/or of disruptive unwinding of global imbalances are likely to be pervasive across economies, including India. The RBI is therefore of the opinion that although domestic factors continue to dominate and shows signs of resilience, we need to assign more weight to global factors than before while formulating the policy stance.

Though the interest rates have been left unchanged, measures like hike in weightage for loans provisioning would put upward pressure on rapidly growing home loans, personal loans, loans against shares etc.

Key Highlights

- Bank Rate, Reverse Repo Rate, Repo Rate and Cash Reserve Ratio kept unchanged.
- GDP growth projection for 2006-07 at 7.5-8.0 per cent.
- Inflation to be contained within 5.0-5.5 per cent during 2006-07.
- M3 projected to expand by around 15.0 per cent for 2006-07. In normal circumstances, the policy preference would be for maintaining a lower order of money supply growth in 2006-07.
- Risk weight on exposures to commercial real estate raised to 150 per cent.
- 'When issued' market in Government securities announced.
- NRI deposit rates are increased by 25bps to attract deposit and ease liquidity scenario further for the banks.

Key Concerns

- Risk of higher energy prices impacting global growth
- Current account imbalances across the globe
- Shift in the global interest rate cycle

Domestic development: Fy06

- The upward revision of real GDP growth to 7.5-8.0 per cent in the Third Quarter Review of January 24, 2006 turned out to be in alignment with the advance estimate of the Central Statistical Organisation at 8.1 per cent for 2005-06, up from 7.5 per cent in the previous year.
- Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, was 4.0 per cent at end-March 2006 and 3.5 per cent as on April 1, 2006 after receding from a peak of 6.0 per cent on April 23, 2005.
- The average price of the Indian basket of international crude varieties (comprising Brent and Dubai Fateh) ruled at around US $ 60.1 per barrel in January-March, 2006 higher by 30.2 per cent than a year ago.
- During 2005-06, the Central Government's net market borrowings at Rs.954bn were 86.5 per cent of the budgeted amount of Rs.1.10tn and gross market borrowings of Rs.1.58tn were 88.5 per cent of the budgeted amount of Rs.1.78tn.

External development: Fy06

- In US dollar terms, merchandise exports increased by 24.7 per cent during 2005-06 as compared with 26.4 per cent in the previous year. Imports showed an increase of 31.5 per cent as compared with 36.4 per cent in the previous year.
- While the increase in oil imports was higher at 46.8 per cent as compared with 45.2 per cent in the previous year, non-oil imports showed an increase of 25.6 per cent as compared with 33.3 per cent in the previous year.
- India's foreign exchange reserves increased by US $ 10.1 billion from US $ 141.5 billion at end-March 2005 to US $ 151.6 billion by end-March 2006.

Key rates unchanged: Higher provisioning to impact interest rates

Although the RBI has not changed the key rates, it has raised the provisioning on loans to commercial real estate, home loans above Rs20 lakhs, personal loans and loans for capital market related activities to 1% of total standard assets from existing 0.4%. Similarly bank loans to venture capital funds have been treated as 'high risk' exposure and will now require 150% risk weightage. Given the increased exposure of loans to builders, the step seems to be prudent so as to enable banks to absorb any downfall in the property market.

Concerns on liquidity management: Banks asked to refocus on deposits

The Third Quarter Review characterised pressures on liquidity as partly frictional and arising from seasonal and transient factors such as the IMD redemption, and partly cyclical and associated with the upturn in credit demand. RBI observed that the banking system was significantly overdrawn in order to sustain the credit disbursements and mismatches between the sources and uses of funds became persistent, forcing them to seek recourse to borrowing and rolling over on an overnight basis, thereby putting pressure on interest rates and liquidity conditions. As such RBI has urged banks to refocus on deposit mobilization with renewed emphasis on stricter credit appraisals on a sectoral basis, monitor loan to value ratios and generally ensure the health of credit portfolios on a durable basis.

Inflation expected to remain benign: Needs continuous monitoring policies

Headline inflation for 2005-06 was lower than anticipated. While increased competition and productivity gains in several sectors have also contributed to some moderation in inflation in the recent period, policy measures have ensured low and stable inflation expectations. Taking into account the real, monetary and global factors having a bearing on domestic prices, containing inflationary expectations would continue to pose a challenge to monetary management. The policy endeavour would be to contain the year-on-year inflation rate for 2006-07 in the range of 5.0-5.5 per cent.

Healthy expansion in M3: In line with overall economic growth

The expansion in M3 is projected at around 15.0 per cent for 2006-07 that is consistent with the projected GDP growth and inflation. The growth in aggregate deposits is projected at around Rs.3.30tn in 2006-07. Non-food bank credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and commercial paper (CP) is expected to increase by around 20 per cent. It needs to be noted that this projected growth of non-food credit implies a calibrated deceleration from a growth of above 30 per cent ruling currently.

Current account deficit to continue: Sustained by the external sector

Higher oil prices and improvement in absorptive capacity of the economy have resulted in a larger trade deficit. This was partly offset by net invisibles, indicative of the rising international competitiveness of India's invisible exports and remittances from Indian nationals working overseas. The current account has remained in deficit for the second consecutive year in 2005-06. Net capital inflows have adequately financed the current account deficit and, as per the RBI's assessment, these trends are likely to continue in 2006-07.

Higher government borrowings for FY07: No need for alarm bells

The Union Budget has placed the fiscal deficit at 3.8 per cent of GDP for the year 2006-07 as against 4.1 per cent in the previous year in the spirit of the FRBM Act, 2003. The net market borrowing program of the Centre for 2006-07 is budgeted at Rs.1.13tn as against Rs.954bn in the previous year. While the size of the Government borrowing program is relatively larger than in the previous year, RBI is quite comfortable given the backdrop of the buoyant growth of the economy, growing appetite of non-banks for government securities and the need for many banks to strengthen their SLR portfolio for statutory as also for liquidity management purposes.

Overall we understand that the policy is largely taking proactive measures in order to face any domestic and global imbalances.

Key Highlights for Fy06

- GDP growth rate higher than expected
- Lower than projected inflation
- Stable long term interest rates
- Higher deposit and money supply growth
- Shift to collaterised markets for money and government securities
- Orderly movement of the exchange rate
- Domestic business outlook continues to remain buoyant
- Current account continued to be in deficit indicating higher economic activity

UTI BANK

RECOMMENDATION: BUY	REPORT DATE PRICE: Rs. 352	TARGET PRICE: Rs. 383

19 April 2006

Jay Prakash Sinha

Robust growth... margins expansion on way

UTI Bank has posted its Q4FY06 result, which is above our estimates due to robust net interest margin growth. However on the full year basis the bank has posted net profit of Rs.4.85bn against our estimate of Rs.4.76bn. Fuelled by robust credit growth, fee income and risk management, the company has been able to generate better than average profitability growth. We have fine-tuned our estimates and upgrade our price target marginally from earlier Rs.381 to Rs.383 over a 12-month horizon, indicating 9% upside from the current market price.

Key highlights of Q4FY06 result

- Net interest income grew by a healthy 59% from Rs.1.96bn to Rs.3.13bn on the back of robust credit growth of 43% for the entire year. Total advances now stands at Rs.223bn while deposit grew by 26% to Rs.401bn. Commendably savings and current account grew by 65% and 11% respectively taking the share of low cost deposit share to 40%. In the quarter the bank has been able to contain its cost of deposit at 5.08% despite sharp run up in short-term rates on account of liquidity crunch in the quarter. Now the bank has 3.37mn savings accounts, which has led to surge in savings deposits.
- Net interest margin continues to be healthy at 2.96% compared to 2.64% a year ago. Net interest income has grown at a CAGR of 61% over last 5 years.
- Retail assets continue to drive growth of the bank, which grew by whooping 55% to Rs.65bn and now constitutes 29% of total advances. Formation of Retail Asset Centres (ARCs) has helped the bank in its retail asset drive. We believe the momentum of retail assets growth to continue, albeit at a moderate pace, with 18 new satellite ARCs in FY06 taking it to 50.
- Other income too has improved significantly by 37% from Rs.1.66bn to Rs.2.28bn in FY06. In FY05, the bank had to suffer one time loss on treasury due to shift of securities from trading account to HTM category. Even the core fee income has grown up by 36% in the year.
- Net NPAs to net NPA declined substantially and now stands below 1% at 0.75% compared to 0.95% in December 05 and 1.07% at the end of Fy05.
- Net income, primarily led by the strong credit flow and net interest income thereon therefore rose by 30% for the quarter and 45% for the full year FY06, resulting into an EPS of Rs.17.08.
- Despite such a strong asset growth, the bank has maintained overall quality of balance sheet, profitability, asset quality and capital adequacy at 11.1%. However, the management has indicated raising capital to fuel its growth further, in the form of hybrid capital without increasing its paid up capital. Given the stance of RBI on hybrid capital, we do not foresee any impediments for the bank in raising hybrid capital or tier II capital at this point in time.
- In the rising interest rate scenario coupled with large credit growth, cost of funds for the bank has increased by 13bps to 4.94% for the year.

Quarterly performance

(Rs mn)	Q4FY06	Q4FY05	% chg
Interest on advances	4,596	2,867	60
Interest on investments	3,444	2,384	44
Int. on other advances	135	76	78
Other interest	151	234	-35
Total interest earned	8,327	5,561	50
Interest expenses	5,198	3,598	44
Net interest income	3,129	1,963	59
Other income	2,281	1,664	37
Employee expenses	625	468	34
Other operating expenses	1,804	1,160	56
Operating profit	2,981	2,000	49
Provisions	682	243	181
Tax provision	782	592	32
Net profit	1,517	1,165	30
EPS, Rs	5.3	5.0	7

Source: Company

Earnings revisited

In the wake of FY06 performance of the company, which has been better than our earlier estimates, we have fine-tuned our estimates for FY07E and FY08E respectively.

Earnings estiamtes

	Old estimates		New estimates	
	FY 07E	FY 08E	FY 07E	FY 07E
Net interest income	12.4	15.26	16.31	21.18
Operating profit	10.9	13.67	12.89	15.98
Net profit	6.2	8.34	6.79	8.44
EPS, Rs	22.3	30	24.4	30.3
Adj. BVPS, Rs	106.8	127.9	109.9	132.0
Recommendation		BUY		BUY
Target price, Rs		381		383
Fair value base year		FY 08E		FY 08E

Source: Kotak securities Private Client Research estimates

Valuation and recommendation

For FY07E, we expect the NII to grow by 51% from Rs.10.78bn to Rs.16.31bn in the revised format. Our revised EPS estimate works out to be Rs.24.4 for FY07E. Similarly we expect NII to grow by another 30% by FY08E to Rs.21.18bn with net profit of Rs.8.44bn resulting into an EPS of Rs.30.3 and an adjusted book value of Rs.132.

The stock at Rs.352 trades at 3.2x its FY07E adjusted book value and 2.7x FY08E ABV. We maintain BUY with a target price of Rs.383 over a 12-month horizon based on FY08E estimates.

Key data

Rs bn	2005	2006	2007E	2008E
Interest income	19.24	28.89	38.65	48.76
Interest exp	11.93	18.11	22.33	27.58
Net int. income	7.31	10.78	16.31	21.18
Other income	4.18	7.30	7.63	9.61
Gross profit	5.66	9.94	12.89	15.98
Net profit	3.35	4.85	6.79	8.44
Gross NPA (%)	1.5	1.5	1.5	1.5
Net NPA (%)	1.4	0.8	1.0	1.0
Net int. margin (%)	2.5	2.6	3.1	3.2
RoE (%)	18.9	18.7	22.1	22.7
RoAA (%)	1.1	1.1	1.2	1.2
Div Yield (%)	0.9	1.1	1.1	1.1
EPS (Rs)	12.2	17.5	24.4	30.3
Adj. BVPS (Rs)	80.0	92.9	109.9	132.0
P/E (x)	28.8	20.1	14.4	11.6
P/ABV (x)	4.4	3.8	3.2	2.7

Source: Company & Kotak securities Private Client Research

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 675** | **TARGET PRICE: Rs. 718**

19 April 2006

Avinash Gorakshakar

Key Highlights of Q1FY06 Performance

Automotive Axles Limited (AAL) has posted moderately disappointing Q2FY06 numbers both in terms of Topline, EBIDTA and bottomline growth.

While Net sales on an overall basis increased by 14% yoy to Rs.1.15 bn as compared to Rs.1.08 bn, exports grew more smartly by 82% YoY. The company has also fared well on the domestic front with revenues growing by 11% yoy. However as compared to a 34% YoY net sales revenue growth in Q1FY06, in Q2FY06 growth in topline has been slower largely because of absence of certain large military orders which were implemented in the Q1FY06.

On a cumulative basis net revenues have however recorded a healthy growth of 23% totalling Rs 2.29 bn (Rs 1.87 bn) with Exports YTD totalling Rs 121 mn as compared to Rs 81 mn earned in the same period last year. - indicating a growth of 49% YoY.

Operating EBIDTA in Q2 FY06 on the other hand has witnessed a 3% YoY drop with EBIDTA margins dropping by 281 bp to 15.62% from 18.43% recorded in Q2 last year. The main reason for the drop in EBIDTA margins has been due to a higher raw material cost to sales ratio on account of the change in product mix and a 39% YoY increase in staff costs which also impacted margins negatively. Also company incurred certain one time costs in this period which increased the % of Other Expenditure to net revenues by 1% to 22% in Q2 from 21% in Q2 last year. On a cumulative basis for H1 FY06 EBIDTA has grown by 13% at Rs 362.48 mn from Rs 320.58 mn in H1 of last year.

With both Depreciation and Interest rising sharply by 26% and 160% respectively during Q2FY06, Profit after tax has come down by 5% YoY. Interest costs have increased due to debt funding of the ongoing capex plans. The management expects to spend around Rs500 mn on capex in FY06E.

Key Financials

(Rs mn)	Q2FY06A	Q2FY05A	YoY %	H1FY06A	H1FY05A	YoY %
Net Sales	1,151	1,008	14.2	2,291	1,873	22.3
Other Income	12	2	456.8	14	14	0.4
Total Expenditure	971	823	18.1	1,928	1,552	24.3
Op Profits	180	186	(3.3)	362	321	13.1
OPM %	15.6	18.4	(15.3)	15.8	17.1	(7.6)
Interest	11	4	159.8	19	8	138.3
Depreciation	33	26	25.5	61	52	17.9
PBT	148	157	(6.2)	296	274	7.8
Prov for Tax	46	51	(9.2)	97	94	3.2
Pat	101	106	(4.7)	199	181	10.2
Equity Capital	151	151		151	151	
EPS (Rs)	6.7	7.0	(4.7)	13.2	12.0	10.2

Source: company

Exports on track for FY06 and FY07E

AAL expect exports to get a big ramp up in FY06E and FY07E where in exports are likely to touch Rs 300 mn plus and Rs 800 mn respectively. AAL has already started exporting axle aggregates to Meritor USA This will gradually migrate towards exports of fully built axles to Meritor USA in the near future once the initial export ramp is fully synchronized.

The Reno-Volvo business for 2 truck models has also commenced and the company expects supplies to get fully commercialized in FY06E.

AAL is also on track of adding Force Motors Limited to its client list for tandem axles for its 30 ton GVW vehicles. AAL has already delivered pilot batches to both these customers and expects to ramp up volumes significantly in the H2 of FY06E.

Future Prospects

While long term prospects for AAL continue to look strong, we believe that in the near term especially during Sept 06 EBIDTA margins are likely to remain under pressure as incremental revenue throughput estimated earlier from new capex plans has got delayed. Incidentally the Axle capacity which is currently around 85000 nos is likely to go up to 105000 nos in current year and is further expected to get further ramped up to 1.50 lac tpa by next year. Additionally the Gear set capacity is expected to touch 1.60 lac nos by May 06.

We hence have now estimated a lower EBIDTA margin of 17.2% in FY06 as compared to 20% EBIDTA margins estimated by us earlier. For FY07E we are however confident that EBIDTA margins would bounce back to 19% on account of higher volumes, and increased export orders which would add to economies of scale for AAL.

We hence continue to reiterate that looking at AAL's superior skill sets and a technologically sophisticated product line up would give it a higher degree of pricing power as compared to other auto vendors. This would ensure that its EBIDTA margins continue to be least impacted, so long as volume growth both in the domestic and export markets continue to remain strong.

AAL is also in the process of looking at several inorganic growth opportunities, which are likely to be announced shortly. We believe that this would done essentially to increase market share and to ramp up its exports where it currently is sitting on huge orders which require faster built up capacity.

Financials

(Rs mn)	FY05A	FY06E	FY06RE	FY07E
Net Sales	3544.6	4400.0	4400.0	5720.0
Other Income	11.0	25.0	25.0	20.0
Op Profits	666.2	870.0	760.0	1090.0
OPM %	18.79	19.77	17.2	19.05
Interest	21.4	25.0	39.0	48.0
Depreciation	108.5	120.0	120.0	140.0
PBT	547.3	750.00	626.0	922.0
Prov for Tax	181.4	247.5	206.5	304.2
Profit After Tax	365.9	502.5	419.4	617.8
Equity Capital	151.12	151.12	151.12	151.12
EPS (Rs)	24.20	33.23	27.75	40.88
CEPS (Rs)	31.39	41.19	35.69	50.15
P/E (x) Mkt Pric Rs 675	27.8	20.3	24.3	16.5
Cash P/E (x) Mkt Pric Rs 675	21.5	16.3	18.9	13.4

Source- Kotak Securities - Private Client Research estimates

Valuation

With AAL enjoying a monopoly status in the industry, and enjoying a strong competitive advantage in terms of product and technology domain coupled with the financial and technical backing of Meritor USA and considering the huge outsourcing potential ahead makes us believe that the best is yet to come from AAL

We hence continue to remain positive on the company's prospects ahead. We had earlier given a target price of Rs 718 for AAL after the Q1FY06 results when the price was Rs 601. The stock has appreciated by 12% since then. We continue to maintain a BUY on AAL with the same target price considering the stronger business momentum expected to kick in from the exports business in FY07E. At Rs.675, the stock trades at 24x and 17x earnings, 19x and 13x cash earnings (CEPS) for FY06E and FY07E respectively. We believe that AAL's EBIDTA and Topline growth in future will largely be driven by the export business which is likely to see significant growth in volumes in the medium term.

What is most re-assuring is that the management is confident of delivering a strong growth of over 100% in the export business over the next 3 years with exports likely to touch Rs 800 mn by FY07E implying a strong topline visibility ahead.

We continue to remain positive on the AAL stock and maintain a BUY with a target price of Rs 718, at which level the stock will be valued at 18xFY07E and a cash P/E of 14x FY07E respectively.

JUBILANT ORGANOSYS

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 250** | **TARGET PRICE: Rs. 317**

19 April 2006

Awadhesh Garg

Jubilant has announced its results for Q4FY06 along with its full year results for FY06. While top line is as per our expectation, we are little disappointed on EBITDA front. EBITDA margin was below our expectation mainly due to high raw material cost (especially in first two quarters) and higher staff costs in Q4. We believe that underlying fundamentals of the company continue to remain strong and our estimates for FY07 and FY08 remain intact.

Q4 FY06 results

- Jubilant has reported 31.8% increased in net sales to Rs4.24bn in Q4 FY06 as compared to Rs3.2bn in last year for the same period, with international sales rising by 63% to Rs2bn. The Pharmaceuticals and Life Science Chemicals business has been the key growth driver recording 57% increase in revenues during the quarter. Besides high growth in CRAMS and drug discovery business, this growth was also supported by revenues of two USA subsidiaries acquired during the year.
- EBITDA grew sharply by 67.8% to Rs693mn due to higher margins in CRAMS business due to increased capacities and improved market conditions and improvement in profitability of Industrial and Performance chemicals businesses, while net profit has seen a lower growth of 40.5% at Rs482mn due to higher depreciation and taxed.
- P&LS business grew by huge 57% to Rs2.19bn while Industrial and performance chemicals have seen growth of 13% each to Rs1.56bn and Rs480mn respectively.
- The API business witnessed an increase in volumes in a stable price scenario resulting in a revenue growth of 22.3% in Q4 FY06. The company has also initiated supply of Oxcarbazepine for the US market.
- During the quarter, Drug discovery business, comprising of Jubilant Biosys and Jubilant Chemsys, more than doubled mainly due to the early stage lead generation collaborative work initiated for Eli Lilly.

Consolidated Results (Fy06)

(Rs mn)	Q4 FY06	Q4 FY05	YoY (%)	FY06	FY05	YoY (%)
Net Sales	4,238	3,215	31.8%	15,054	11,703	28.6%
Expenditure	3,545	2,802		12,884	9,627	
EBIDTA	693	413	67.8%	2,170	2,076	4.5%
Depreciation	155	94		513	381	
EBIT	538	319	68.7%	1,657	1,695	-2.2%
Interest	30	48		173	220	
Other Income	96	110		197	166	
PBT	604	381	58.5%	1,681	1,641	2.4%
Tax	136	41		392	431	
Minority Interest	(14)	(3)		(8)	18	
Reported PAT	482	343	40.5%	1,297	1,192	8.8%
Extra-Ordinary Items	-	-		-	-	
Adjusted PAT	482	343		1,297	1,192	
Equity Shares (Mn)	143	130		143	130	
EPS (Rs)	3.4	2.6	27.8%	9.1	9.2	-1.0%
EBIDTA Margin	16.4%	12.8%		14.4%	17.7%	
EBIT Margin	12.7%	9.9%		11.0%	14.5%	
PAT Margin (%)	11.4%	10.7%		8.6%	10.2%	

Source: company

FY06 results

Major growth came from Pharma & Life Science chemicals business

Revenues for FY06 have increased by 28.6% to Rs15bn as compared to Rs11.7bn in FY05, with international sales rising by 42% to Rs5.95bn. The Pharmaceuticals and Life Science Chemicals (PLSC) business has been the key growth driver recording 41% increase in revenues to Rs.6.8bn as compared to Rs.4.8bn in Fy05.

The CRAMS business, which has been witnessing higher volumes and better price realization, recorded a growth of 46.6% during the year. International sales contributed 72% of the net sales of CRAMS in FY06 vs. 69% in FY05.

Revenues from Industrial chemicals were higher by 20% at Rs6.2bn caused by better volumes that were higher by 20.4% due to de-bottlenecking-led capacity expansion. The prices of acetyls were almost at the same level of previous year. Performance chemicals business recorded sales growth of 19% due to improved performance by key growth units such as Industrial Adhesives, V P Latex, Woodworking solutions and speciality gases.

Business wise Revenues

(Rs mn)	Q4 FY06	Q4 FY05	YoY (%)	FY06	FY05	YoY (%)
Pharma & Life Science	4841	1447	1344	1854	2192	6837
% of Sales	41%	44%	41%	44%	52%	45%
Growth in % (Y-o-Y)	51%	27%	12%	68%	57%	41%
Industrial Chemicals	5194	1331	1440	1895	1566	6232
% of Sales	44%	41%	43%	45%	37%	41%
Growth in % (Y-o-Y)	37%	18%	9%	40%	13%	20%
Performance Chemicals	1668	489	531	485	480	1985
% of Sales	14%	15%	16%	11%	11%	13%
Growth in % (Y-o-Y)	5%	23%	28%	12%	13%	19%
Gross Sales	11703	3267	3315	4234	42381	5054

Source: Company, Kotak Securities - Private Client Research

International business gaining momentum

For FY06, revenues form international markets were up 41.7% to Rs5.95bn driven by strong performance by CRAMS business that witnessed significant increase in international sales and drug discovery services to global pharma companies. Sales from two companies in the USA, acquired in FY06, also support this growth.

Geographical breakup

	FY05	Q106	Q206	Q306	Q406	FY06
Domestic Sales (Net)	7502	2103	2269	2805	2229	9103
% of Sales	64%	64%	68%	62%	53%	60%
Growth in % (Y-o-Y)	19%	18%	15%	58%	13%	21%
Exports Sales	4201	1164	1046	1732	2009	5951
% of Sales	36%	36%	32%	38%	47%	40%
Growth in % (Y-o-Y)	84%	32%	8%	55%	63%	42%
Total Revenues	11703	3267	3315	4537	4238	15054

Source: Company, Kotak Securities - Private Client Research

EBITDA margin remained under pressure

The EBIDTA for the full year of FY06 grew by just 4.5% to Rs.2.17bn. Although the CRAMS, Drug Discovery, API and Performance chemicals businesses reported a strong performance for the year, the Industrial chemicals business faced high input material costs (molasses) during most of the year, affecting overall operating margins. The company has witnessed de-growth in EBITDA by 28.5% in H1FY06 but in subsequent quarters it has seen healthy momentum of recovery. In Q3 EBITDA grew by 29% and in Q4 it grew by huge 67.8% which we believe will continue going forward in view of softer raw material prices in Industrial chemicals business. The staff cost was also significantly higher as the company moved up the value chain into more knowledge based services to global pharmaceuticals and life sciences industry. Due to growing services business especially in the US market, the staff cost went up to 8.4% of gross sales in FY06 as compared to 6.3% in Fy05.

Huge investment in infrastructure to reap India advantage

Jubilant has continued to implement its growth plans, making acquisitions in USA and executing capacity expansions in API and CRAMS. During FY06 it has invested Rs2.3bn on the following capital expenditures.

- Build up two new multipurpose plants for fine chemicals business to increase CRAMS capacity
- Increase the capacity of existing plant of pyridine and picoline to 22,000 TPA along with the increase in capacity of formaldehyde by 64,000 TPA
- Expansion of Kilo Lab facility
- Increase in the APIs capacity by setting up a new multipurpose plant and a dedicated 75 tpa plant for Oxcarbazepine
- Commissioning of power plant at Gajraula which became functional during Fy06

In-principal approval to raise funds upto US$325mn

The company has taken in-principal approval from the board to raise funds upto US$325mn, by way of private placement of equity shares, GDS, ADS or FCCB, to fund acquisition, capital expenditure, expansion, modernization and working capital requirement. We believe this is a concern as it will lead to equity dilution and bring down EPS if company fails to increase earning from capex or acquisition initiatives.

Valuations and recommendation

At CMP Rs. 250, the stock is trading at 18x FY07E and 13.2x FY08E fully diluted earnings and 11.7x and 7.8x EV/EBIDTA of FY07E and FY08E estimates, respectively, which looks attractive. We maintain buy with one year price target of Rs317.

INFOSYS TECHNOLOGIES LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 3278** | **TARGET PRICE: Rs. 3543**

21 April 2006

Dipen Shah

Infosys to buy Citigroup stake in Progeon

Infosys has announced that it will buy out Citicorp International Finance Corporation's 23% stake in its BPO subsidiary, Progeon, for Rs.5.18bn ($115.13 million) in an all-cash deal. This deal values Progeon at $500mn which is at 5.8x FY06 revenues and 4.2x the expected revenues of $125mn in FY07E. Infosys has signed an agreement with Citi in this regard and the transaction is likely to be completed by July 2006 according to the company.

Progeon accounted for four per cent of Infosys' revenues in 2005-06 and has over 7,000 employees. It clocked revenues of $85 million in FY06. It added one new client during the fourth quarter to take its total client base to 22. The management has stated that Progeon is expected to grow its revenues at 45-50% translating into revenues of $125mn for FY07 and add over 3,000 people in the current fiscal. The focus on data-based and value-added services has resulted in higher margins for Progeon at about 25%, which, we believe, are

We see this acquisition of stake in Progeon as moderately EPS accretive in FY08 for Infosys...

Post acquisition of Citi stake, we estimate that in the consolidated financials of Infosys, there would be a reduction in the Other Income component and a removal of the minority interest for the company. Post this development, we have modified our earnings estimates for Infosys. We now expect the company to register an EPS of Rs.117.2 in FY07 and Rs.143.5 in FY08. We note that the accretive impact on the company's EPS is more pronounced in FY08 that has led to an increase to Rs.143.5 from the earlier Rs.142.

Recommendation

We believe that at 28x FY07E earnings, the stock is fairly valued. Based on the changes in our FY08E EPS estimates, we are increasing the price target marginally to Rs.3,543 (v/s Rs.3,512 post Q4FY06 results), at which levels, our FY08E earnings will be discounted 24.7x. We recommend a BUY with a 12-month horizon.

Future prospects

(Rs.mn)	FY06	% Chg	FY07E	% Chg	FY08E	% Chg
Turnover	95,215	33.5	130,275	36.8	167,607	28.7
Expenditure	64,298		89,389		116,245	
EBIDTA	30,917	32.4	40,886	32.2	51,363	25.6
Depreciation	4,371		5,450		6,200	
EBIT	26,546	29.6	35,436	33.5	45,163	27.5
Interest	0		0		0	
Other Income	1,386		2,185		2,540	
PBT	27,932	28.6	37,621	34.7	47,703	26.8
Tax	3,132		5,267		8,109	
Minority interest	200		0		0	
PAT	24,600	33.2	32,354	31.5	39,593	22.4
Provisions	1		0		0	
PAT after provisions	24,600		32,354		39,593	
EPS (Rs)	89.1		117.2		143.5	
EBIDTA (%)	32.5		31.4		30.6	
EBIT (%)	27.9		27.2		26.9	
Net Profit (%)	25.8		24.8		23.6	

Source : Company, Kotak Securities - Private Client Research

- We have assumed the rupee dollar exchange rate of Rs.43 per USD by FY08 end.
- EBIDTA margins are expected to fall due to the expected salary hikes and the expected rupee appreciation to Rs.43 per USD by FY08 end. Off-shore salaries and on-site salaries are expected to go up by 14% and 3%, respectively WEF 1QFY07.

Concerns

- Rupee appreciation beyond our assumed levels of Rs.43 per USD by FY08 end could provide a downward bias to our earnings estimates.
- A steep deceleration the economies of major global economies could impact revenue growth of Indian vendors.

ZENSAR TECHNOLOGIES LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 280** | **TARGET PRICE: Rs. 339**

24 April 2006

Dipen Shah

Zensar's results for 4QFY06 were beyond expectations. While the revenues grew by 15% sequentially, profits before extraordinary items almost doubled QoQ.

This is the second successive quarter where the company has reported double-digit sequential growth in revenues. The growth was brought about by a higher growth in the relatively new advanced technology services (ATS) and BPO businesses. The ATS business includes the higher value-added businesses including solution blue print (SBP) and enjoys relatively higher margins.

We are introducing our FY08 estimates, where we expect the company to earn Rs. 28 per share. This is based on several parameters like deeper penetration into existing large clients, significant client additions, success in new business initiatives and improved profitability in the BPO business (cash break even reached in 4QFY06).

At current levels, the stock trades at 12x FY07 earnings estimates and 10x FY08E estimates. We arrive at a price target of Rs. 339, which is also supported by DCF analysis. We recommend a long-term BUY.

4QFY06 results

(Rs.mn)	4QFY06	3QFY06	% QoQ	4QFY05	% YoY
Income	1,252	1,092.9	15	919	36.3
Expenditure	1,035	945.3		859	
EBIDTA	218	147.6	48	59	268.6
Depreciation	40	39.5		36	
EBIT	177	108.1	64	24	651.9
Interest	4	4.7		3	
Other inc	13	12.5		1	
PBT	187	115.9	61	21	780.0
Tax	5	21.9		4	
Minority Interest	(4)	1.0		(1)	
PAT	185	93.0	100	18	924.7
E.O items	(13)	(8.9)		183	
EPS (Rs)	7.9	4.0		0.8	
Margins (%)					
Operating Profit	17.4	13.5		6.4	
Gross Profit	14.2	9.9		2.6	
Net Profit	14.8	8.5		2.0	

Source : Company

- Revenues during the quarter grew by 15% QoQ, led by growth in the relatively new business segments of ATS and BPO.
- According to the management, the growth was partly brought about by the achievement of a few milestones during the quarter in some of the projects. This led to revenue recognition during 4QFY06 without corresponding increase in expenses.
- For FY06, the ATS and BPO businesses recorded 100% growth and 400% growth, respectively (BPO has a very low base).
- Within ATS, the SBP business is finding increasing acceptance among clients and the company got its first breakthrough in the US, in the form of an insurance company. It is also nearing completion of a project in Thailand.
- ATS is looking at Europe for additional revenues and has employed a senior person from Infosys to head this geography.
- During the quarter, Zensar received a large five-year deal from Fujitsu to set up a dedicated offshore facility to service Fujitsu's European customers. The relationship currently employs 50 employees and is expected to scale up to 1200 employees by the end of the third year.
- The engagement with Nomura saw Zensar finishing its first project and is starting work on the next project.
- During the quarter, Zensar received projects from new as well as existing customers like Home Depot and Marks & Spencer.
- EBDITA margins during the quarter improved by about 400 bps mainly due to a few milestones being reached and also, higher revenues from ATS business. In 3QFY06, the company had provided for some receivables, and the amount was written back in 4QFY06.
- During the quarter, Zensar provided relatively lower tax at about 2.8%, taking the yearly rate to 13%. Consequently, PAT (after minority interest) grew by about 100% to Rs. 185 mn.

Future prospects

(Rs.mn)	FY06	FY07E	% YoY	FY08E	% YoY
Income	4,289	5,642.6	31.6	6,880	21.9
Expenditure	3,747	4,807.6		5,852	
EBDITA	542	834.9	54.1	1,028	23.2
Depreciation	155	199.0		243	
EBIT	387	635.9	64.3	785	23.5
Interest	16	11.5		10	
Other inc	46	52.0		70	
PBT	417	676.4	62.1	845	25.0
Tax	55	121.8		169	
Minority Interest	(5)	7.0		13	
PAT	367	547.7	49.1	663	21.1
E.O items	(28)	-		-	
EPS (Rs.)	15.7	23.4		28.3	
Margins (%)					
EBDITA	12.6	14.8		14.9	
EBIT	9.0	11.3		11.4	
Net Profit	8.6	9.7		9.6	

Source : Company, Kotak Securities - Private Client Research

- We have made changes to our FY07 estimates and are introducing FY08 estimates.
- We expect Zensar to achieve revenues of Rs. 5.64 bn in FY07 and Rs. 6.88 bn in FY08. BPO revenues are expected to rise to Rs. 252 mn in FY08 as against Rs. 104 mn in Fy06.
- EBIDTA margins are expected to improve due to higher offshore revenues, higher revenues from value-added services and improving profitability in the BPO business, which is expected to break-even by 1QFY07.
- PAT is expected to grow to Rs. 663 mn in FY08, leading to earnings of Rs. 28.3 per share.

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 114** | **TARGET PRICE: Rs. 126**

24 April 2006

Apurva Doshi

Government's decision to give the postal department exclusive rights to carry and deliver letters weighing upto 300 grams - Impact on Gati to be insignificant

The government is seeking to give India Post exclusive rights to carry and deliver letters weighing up to 300 grams. This means that only India Post will be allowed to carry and deliver letters weighing upto 300 grams in the country including all the business districts.

The Department of Post has justified the monopoly in carrying these letters below 300 grams on the grounds of universal service obligation (USO), as they operate on national level covering also the economically unviable areas while private courier companies operate only in big business centers where the business is robust with higher profit margins.

The government has also proposed a registration and renewal fee, apart from a contribution towards the universal service obligation. The provision calls for revenue sharing models like levying a fee of up to 10% of revenue on courier companies with a turnover of above Rs. 2.5 mn. It also calls for registration fee of Rs. 1 mn and renewal fee of Rs. 500,00 for national and international level courier companies. For small and medium couriers it calls for registration fee of Rs. 25,000 and renewal fee of Rs. 10,000.

The above proposal, if passed, could negatively impact the earnings of the courier companies. However, within courier companies it is essential to find out the impact as the revenue sharing model will be applicable only for delivering letters weighing up to 300 grams.

GATI Ltd, which is under our coverage, will be impacted very marginally as less then 1% of its revenues of express distribution and supply chain are in terms of letters weighing upto 300 grams.

In Q1FY06, Rs. 3.6 mn out of a turnover of Rs. 704 mn of express distribution and supply chain were on account of couriers weighing upto 500 grams.

In Q2FY06, Rs. 4.5 mn out of turnover of Rs. 830 mn of express distribution and supply chain were on account of couriers weighing upto 500 grams.

However, GATI would have to pay registration and renewal fee, which would have very little impact on the profitability of the company.

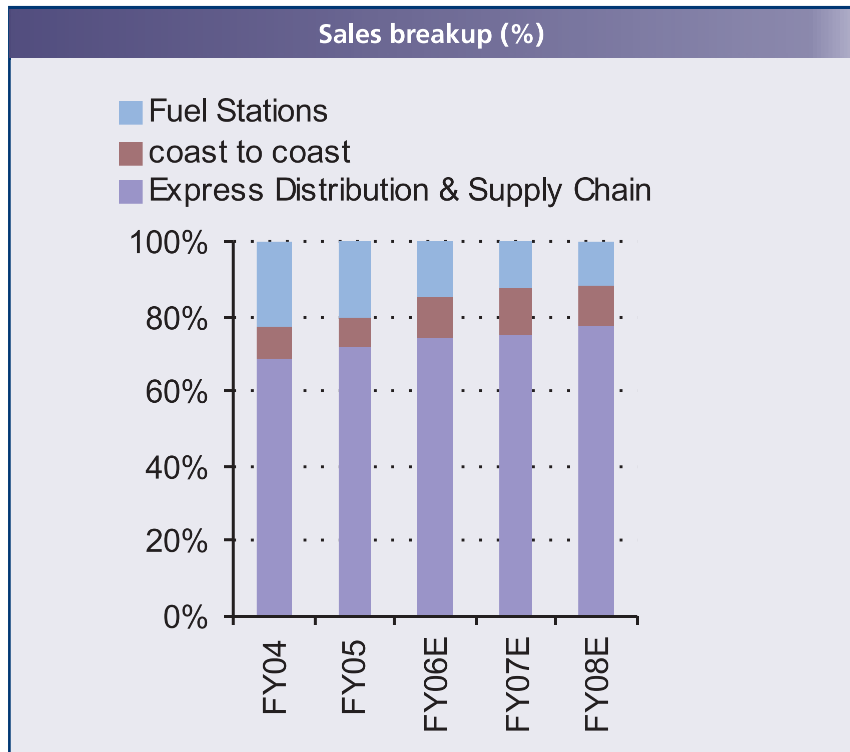
We are positive on the express distribution and supply chain and coast to coast shipping business of GATI.

We maintain our BUY on GATI with a price target of Rs. 126.

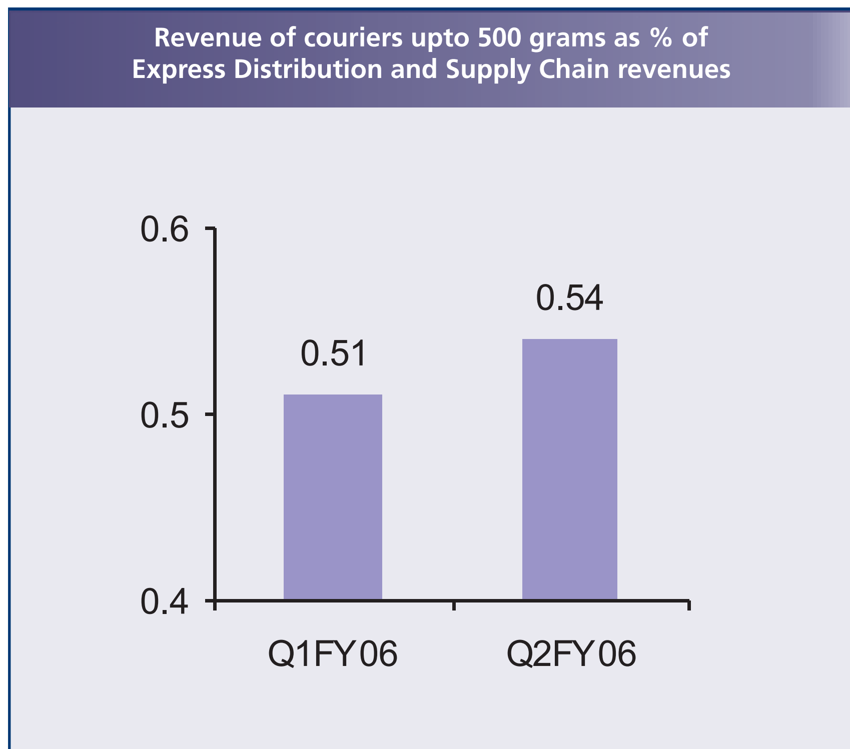
Summary table

Rsmn year end june	FY05	FY06E	FY07E	FY08E
Sales	3,592	4,890	6,215	7,791
Growth (%)	17.3	36.1	27.1	25.4
EBITDA	255	481	700	918
EBITDA margin (%)	7.1	9.8	11.3	11.8
Net profit	104	264	402	547
Net debt	565	(245)	(294)	(644)
EPS (Rs)	12.4	3.7	5.6	7.6
Growth (%)	87.1	154.3	52.1	36.0
DPS (Rs)	3.0	0.6	0.6	0.6
ROE (%)	18.0	13.8	17.0	18.5
ROCE (%)	16.7	15.8	20.4	24.2
EV/Sales (x)	0.4	1.6	1.3	1.0
EV/EBITDA (x)	5.9	16.6	11.3	8.3
P/E (x)	9.2	31.1	20.4	15.0
P/BV (x)	1.7	4.3	3.5	2.8

Source: Company & Kotak Securities - Private Client Research



Source: Company & Kotak Securities - Private Client Research



Source: Company & Kotak Securities - Private Client Research

CANARA BANK

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 261** | **TARGET PRICE: Rs. 284**

25 April 2006

Jay Prakash Sinha

Canara Bank has declared its Q4FY06 results, which is broadly in line with expectations except for a tax write back in Q4FY06 by the bank. Net interest income has risen by a mere 7% from Rs. 9.19 bn to Rs. 9.84 bn during the quarter. Despite a modest growth of 2% in operating profit, net profit for the bank has surged by 382% due to lower provisioning and tax write back by the bank. The bank has achieved a near-industry average in both deposit and credit, which respectively grew by 21% and 31%, on YoY basis. We have fine-tuned our earning estimates and revise our price target from Rs. 263 to Rs. 284 over a 12-month horizon.

Key highlights for the results:

- Strong credit offtake, that is, 31% growth, has enabled the bank to raise its income earned from advances by 30% from Rs. 11.89 bn to Rs. 15.48 bn in Q4FY06. We expect the strong credit offtake to continue in the foreseeable future as well.
- Net interest income of the bank grew at 7% during the quarter, which clearly shows signs of margin pressure for the bank. Given the competition in the banking space, we expect NIM for the bank to be maintained at 2.6% during FY07E and further at 2.5% during FY08E.
- Excluding trading profit, the bank's non-interest income grew at a healthy 21%. Taking the same into account, it came down from Rs. 15.44 bn to Rs. 13.78 bn on a full-year basis.
- Decline in provisions and contingencies helped the bank significantly. During the quarter, provisions more than halved from Rs. 6.98 bn to Rs. 3.18 bn. This decline has largely helped the bank to report almost quadrupling its profit from Rs. 1.02 bn to Rs. 4.94 bn in the quarter.
- EPS grew from Rs.2.5/share to Rs.12.0/share YoY.
- The bank's CAR is maintained at 11.22%, which restricts the credit growth for the bank without infusing more capital going forward.

Quarterly performance (Rs mn)

	Q4FY06	Q4FY05	% change
Int on advances	15,482	11,892	30
Int on investments	7,046	7,413	-5
Int on RBI/ other bal	653	476	37
Other interest	725	548	32
Total interest earned	23,906	20,329	18
Interest expenses	14,069	11,142	26
Net interest income	9,838	9,187	7
Other income	4,145	4,604	-10
Employee expenses	3,878	3,722	4
Other operating expenses	2,392	2,511	-5
Operating profit	7,713	7,558	2
Provisions	3,178	6,975	-54
Taxes	(400)	(440)	
Net profit	4,935	1,023	382
EPS, Rs	12.04	2.50	382

Source: Company

Change in earning estimates

We have fine-tuned our future estimates based on superior credit growth of the bank. The new estimates are as under.

Estimates

Rs bn	Old estimates		New estimates	
	FY 07E	FY 08E	FY 07E	FY 08E
Net interest income	38.03	43.32	42.03	46.23
Net profit	14.82	19.13	17.05	19.44
EPS, Rs	36.2	46.7	41.6	47.4
Adj. BVPS, Rs	156.2	211.6	175.0	205.9
Recommendation		BUY		BUY
Target price, Rs		263		284

Source: Kotak Securities - Private Client Research estimates

Valuation and recommendation

We estimate net earnings of Rs. 17.05 bn and Rs. 19.44 bn for FY07E and FY08E, respectively, for the bank resulting into an EPS of Rs.41.6 and Rs.47.4, respectively. Adjusted book value in the period is estimated to be at Rs. 175 and Rs. 206, respectively. The bank is maintaining its net NPA well below 2% and has now declined to 1% only.

Based on FY08E estimates, our estimate of residual income gives us a fair value of Rs. 244 and fair P/ABV arrived at Rs. 323. We arrive at a fair value of Rs. 284 based on the average of the two methods. We maintain our BUY recommendation with a revised price target of Rs. 284, an upside of 8% from the current levels besides a dividend yield of 2.5% over a 12-month horizon.

Financials

Key data (Rs bn)	FY05	FY06	FY07E	FY08E
Interest income	75.72	87.12	103.29	117.06
Interest expense	44.22	51.30	61.26	70.83
Net interest income	31.50	35.82	42.03	46.23
Other income	17.64	13.78	16.37	18.82
Gross profit	28.06	26.12	33.11	37.77
Net profit	11.10	13.44	17.05	19.44
Gross NPA (%)	3.8	2.0	1.9	1.9
Net NPA (%)	1.9	1.1	1.3	1.5
Net interest margin (%)	2.8	2.7	2.6	2.5
RoE (%)	19.5	20.3	21.8	20.9
RoAA (%)	1.1	1.1	1.2	1.2
Dividend Yield (%)	2.1	2.5	2.5	2.5
EPS (Rs)	27.1	32.8	41.6	47.4
Adjusted BVPS (Rs)	118.7	149.8	175.0	205.9
P/E (x)	9.6	8.0	6.3	5.5
P/ABV (x)	2.2	1.7	1.5	1.3

(Source: Company & Kotak Securities Research estimates)

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For any more information, email us at : **makemoney@kotak.com**

Regd. Office: Kotak Securities Ltd. 1st Floor, Bakhtawar, Nariman Point, Mumbai - 21.