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Updates

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Power Finance Corporation: Company clarifies the suspension of the AG&SP scheme

News Roundup

Corporate

- A US-based buyout fund and diamond industry giant De Beers are learnt to have evinced interest in jewellery maker and retailer Rajesh Exports for acquiring a 51% stake from its promoters. (ET)
- BSNL, MTNL said regulator Trai's directive on opening up domestic leased circuits would lead to hoarding last-mile connections by the private sector, making the two public sector companies uncompetitive. (BS)

Economic and political

- In a move that could boost profitability of exporters, the government is considering issue of duty-free scrips to offset various state-level taxes. (ET)
- There will be no caps on mutual fund companies managing overseas fortunes of Indian investors, provided the corpus is only made up of permissible foreign exchange holdings of individuals. (FE)
- Concerned over low use of computers in the country, the government has decided to offer its employees and students easy loans to buy PCs. (FE)
- China has threatened the US with litigation at the WTO for imposing anti-subsidy duties on its paper exports. (BS)
- India-focused hedge funds have delivered a return of 19.6% so far this year and are one of the best performing groups of hedge funds in the last five and a half years, says a study by Hedge Fund Net (HFN). (BL)

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

EQUITY MARKETS

India	Change, %			
	14-Sep	1-day	1-mo	3-mo
Sensex	15,604	(0.1)	10.3	10.2
Nifty	4,518	(0.2)	10.0	8.3
Global/Regional indices				
Dow Jones	13,443	0.1	2.8	(1.4)
Nasdaq Composite	2,602	0.0	3.9	(0.9)
FTSE	6,289	(1.2)	3.7	(6.6)
Nikkie	16,127	1.9	5.6	(10.3)
Hang Seng	24,804	(0.4)	21.7	18.0
KOSPI	1,872	0.1	14.3	5.6
Value traded - India				
		Moving avg, Rs bn		
	14-Sep	1-mo	3-mo	
Cash (NSE+BSE)	187.2	154.7	160.0	
Derivatives (NSE)	471.8	284.9	287.6	
Deri. open interest	844.5	862.0	674.4	

Forex/money market

	Change, basis points			
	14-Sep	1-day	1-mo	3-mo
Rs/US\$	40.4	-	(90)	(23)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	-	(11)	(37)

Net investment (US\$m)

	13-Sep	MTD	CYTD
	FIs	(11)	834
MFs	20	37	787

Top movers -3mo basis

Best performers	Change, %			
	14-Sep	1-day	1-mo	3-mo
Reliance Energy	883	(0.8)	22.7	66.1
Neyveli Lignite	95	(1.1)	25.4	55.4
Chambal Fert	50	(4.4)	33.3	45.3
Thermax	678	(2.1)	9.4	36.7
BHEL	1,898	(0.7)	21.7	36.6
Worst performers				
Polaris	116	(1.4)	(0.8)	(26.9)
i-Flex	1,911	(0.4)	(0.6)	(21.9)
Novartis India	290	(0.1)	(3.2)	(18.8)
Punjab Tractors	238	(0.2)	(3.5)	(18.3)
Cipla	172	(1.7)	(6.2)	(17.9)

Kotak Institutional Equities Research

kotak.research@kotak.com

Mumbai: +91-22-6634-1100

Technology**SATY.BO, Rs431**

Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	570
52W High -Low (Rs)	525 - 396
Market Cap (Rs bn)	289.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	64.9	81.8	104.6
Net Profit (Rs bn)	14.0	17.0	21.1
EPS (Rs)	21.4	25.3	31.5
EPS <i>gth</i>	41.7	18.0	24.5
P/E (x)	20.1	17.0	13.7
EV/EBITDA (x)	16.3	13.0	9.7
Div yield (%)	1.8	2.3	2.8

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	8.8	-	-
FIs	67.4	3.1	2.1
MFs	5.9	1.6	0.6
UTI	-	-	(1.0)
LIC	1.5	0.4	(0.6)

Satyam Computer Services: Key takeaways from the analyst meet. Reiterate Outperform

Kawaljeet Saluja : kawaljeet.saluja@kotak.com, +91-22-6634-1243

Rohit Chordia : rohit.chordia@kotak.com, +91-22-6634-1397

- **Maintains positive stance on demand environment**
- **Reiterates revenue, margin guidance for FY2008**
- **Investments in future growth engines—new service lines and verticals**
- **Maintain Outperform with a Mar '09 DCF-based target price of Rs570/share**

Satyam maintained its positive stance on the underlying demand environment in the recently held analyst meet. It reiterated its revenue and margin guidance (35.5% growth and 125bps decline, respectively) for FY2008; we expect substantial outperformance on the revenue guidance. Satyam and its other large peers have seen no indication of budget reductions or project ramp-downs thus far but we believe that one should keep a close eye on the October-November timeframe for early signals of a slowdown in IT spending, if any; we will closely monitor the September quarter results of some of the large IT spenders. Nevertheless, any cut in IT spending is not likely to have a meaningful impact on our FY2008 estimates as CY2008 budget cuts will start impacting volumes and/or pricing only in FY2009. We maintain our Outperform rating on Satyam with a March-2009 DCF-based target price of Rs570/share. Key risks to our call are a slowdown in the US economy and any further appreciation in the rupee.

Demand environment buoyant, no indicators of IT spending cuts from clients.

Satyam indicated that it continues to see strong demand in the market. It has not seen any indications of an IT spending cut from any of its clients. Also, there has been no slowdown in the number of new RFPs in the market. Satyam is confident of increasing its success rate within large deals; it indicates that its large deal pipeline has grown 4X in the past 12 months. We believe that it is too early to take a call on IT spending in CY2008 and the earliest indicators would be the Sep' 07 quarter results of the large corporations in the US.

On track to outperform its FY2008 guidance. Satyam reiterated its FY2008 revenue growth (35.5% yoy), margin (125 bps decline), and EPS (Rs24.7) guidance. We believe Satyam will report substantial outperformance to its revenue guidance (build in 40% revenue growth in FY2008 in our model). We also expect EPS outperformance (Rs25.3 against guidance of Rs24.7), driven again by revenue outperformance. As we noted in a comment last week, the key drivers of outperformance for Satyam will likely be (1) strong ramp-up in some of the recently won large deals, (2) increasing traction in the package implementation practice and (3) acceleration in growth of new service lines and verticals like engineering services, BPO, IMS, etc.

Focused on building capabilities and scale in new service lines and verticals.

Satyam highlighted some of its fastest-growing service lines (IMS, BPO) and verticals (retail, travel and logistics, media and entertainment, energy and utilities) as the future growth engines of the company. We discuss some of these in brief in Exhibit 1.

Satyam highlighted some of its future growth engines in the analyst meet

Service line/ vertical	Revenues (US\$ mn) (a)	% of Satyam's revenues	Growth (%) (b)	Comments
Infrastructure management services	84.5	4.9	10.0	<ol style="list-style-type: none"> 1. Still a sub-scale service line as compared to other tier-I Indian players 2. Has often served as an entry-point into new accounts; opens up good opportunities to cross-sell 3. Growth strategies include--(a) broadening capabilities (b) leveraging alliances to gain entry into new markets; and (c) expanding data centre capabilities
Retail, Transportation and Logistics	119.0	6.9	8.9	<ol style="list-style-type: none"> 1. Focus on developing point solutions for these verticals on ERP (SAP, Oracle) platforms 2. Has recently won large deals in both these verticals (Qantas, US\$54 mn, and a large UK retailer, US\$130 mn) 3. Growth would be driven by better account mining; the company has built up a client base of 50+ and 40+ accounts in Retail and T&L, respectively, with several F-500/G-500 accounts
TIMES (c)	379.0	22.0	9.5	<ol style="list-style-type: none"> 1. Focus was on the media and entertainment sub-vertical 2. Still a small practice for Satyam; around 1000 employees 3. Among the nascent verticals for IT offshoring; ample opportunity in the legacy modernization space
BPO	48.0	2.7	17.4	<ol style="list-style-type: none"> 1. Among the fastest growing service lines for Satyam, albeit off a small scale 2. Top 3 services for Satyam BPO (Nipuna) are engineering services support, animation and visualization, and technical help-desk services

Note:

(a) Jun '07 revenues annualized

(b) COGR over last eight quarters

(c) Telecom, Infrastructure, Media, Entertainment, Semiconductor

Source: Company, Kotak Institutional Equities

We expect Satyam to deliver meaningful outperformance to its 2QFY08 guidance

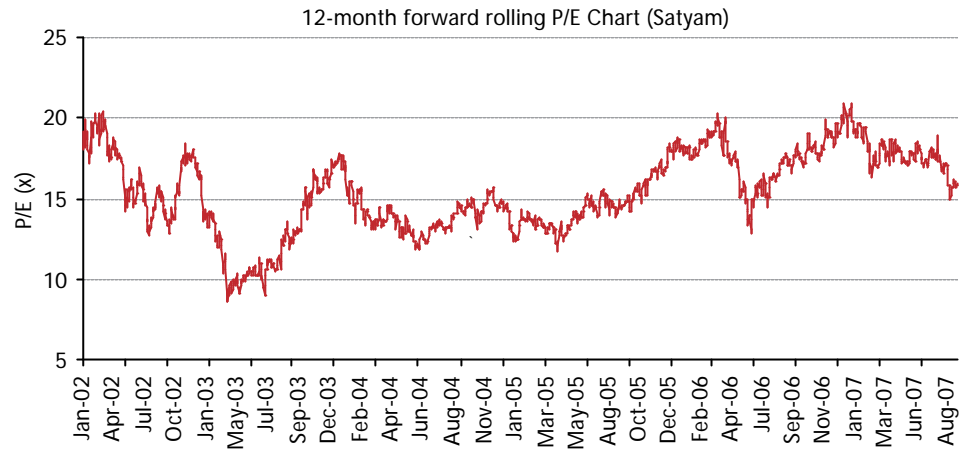
Guidance and actual revenues, 1QFY06-2QFY08E

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08E
Revenues (US\$ mn)										
Guidance	236	259	280	299	310	339	373	395	434	479
Actual	246	268	282	301	323	352	376	411	452	
Growth qoq (%)										
Guidance	4.9	5.2	4.5	6.0	3.1	5.0	6.1	5.1	5.6	6.0
Actual	9.4	8.9	5.2	6.7	7.2	9.1	6.7	9.4	10.0	
Outperformance (% pts)	4.5	3.6	0.7	0.7	4.2	4.2	0.6	4.3	4.5	?

Note:

(a) Consolidated US GAAP guidance and actuals

Source: Company, Kotak Institutional Equities estimates

Satyam is trading at attractive valuations

Source: Bloomberg, Kotak Institutional Equities estimates

Satyam- Consolidated Indian GAAP Income Statement, Fiscal year ends March (Rs mn)

Rs mn	2006	2007	2008E	2009E	2010E
Overseas	45,967	61,881	80,462	103,372	126,550
Domestic	1,959	2,970	1,297	1,231	1,393
Revenues	47,926	64,851	81,758	104,603	127,943
Personal Expenses	(28,053)	(38,602)	(50,119)	(64,165)	(79,866)
Administrative Expenses	(8,212)	(10,872)	(13,330)	(17,279)	(20,728)
Total Operating Expenses	(36,265)	(49,474)	(63,448)	(81,445)	(100,594)
Operating Profits	11,661	15,377	18,310	23,159	27,349
Depreciation	(1,373)	(1,484)	(1,711)	(2,197)	(2,746)
EBIT	10,289	13,893	16,600	20,961	24,603
Interest	(55)	(159)	(33)	-	-
Other Income	1,168	1,833	2,797	3,213	3,806
Profit Before Tax	11,401	15,566	19,363	24,174	28,409
Provision for Tax	(1,509)	(1,520)	(2,383)	(3,025)	(5,991)
Net Profit	9,892	14,046	16,979	21,149	22,418
Share of loss in associate company	(73)	1	-	-	-
Net Income	9,819	14,047	16,979	21,149	22,418
Extraordinaries	1,598	-	-	-	-
Net Profit- Reported	11,417	14,047	16,979	21,149	22,418
EPS (Rs/ share)	15.1	21.4	25.3	31.5	33.4
No of shares outstanding (mn)	648.9	655.0	671.0	671.0	671.0
Margins (%)					
EBITDA Margin	24.3	23.7	22.4	22.1	21.4
EBIT Margin	21.5	21.4	20.3	20.0	19.2
NPM	20.2	21.1	20.1	19.6	17.0
Growth Rates (%)					
Revenues	36.1	35.3	26.1	27.9	22.3
EBITDA	34.3	31.9	19.1	26.5	18.1
EBIT	36.7	35.0	19.5	26.3	17.4
Net Profit	37.2	42.0	20.9	24.6	6.0

Source: Kotak Institutional Equities estimates

Banking**PWFC.BO, Rs194**

Rating	U
Sector coverage view	Attractive
Target Price (Rs)	125
52W High -Low (Rs)	206 - 85
Market Cap (Rs bn)	222.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	15.5	18.7	21.9
Net Profit (Rs bn)	11.5	12.9	14.7
EPS (Rs)	11.1	11.2	12.8
EPS <i>gth</i>	9.5	1.2	14.3
P/E (x)	17.5	17.3	15.2
P/B (x)	2.3	2.2	2.0
Div yield (%)	0.7	1.8	2.1

Shareholding, June 2007

	% of		Over/(under)
	Pattern	Portfolio	weight
Promoters	89.8	-	-
FIs	4.9	0.1	0.1
MFs	1.2	0.2	0.2
UTI	-	-	-
LIC	-	-	-

Power Finance Corporation: Company clarifies the suspension of the AG&SP scheme

Nischint Chawathe : nischint.chawathe@kotak.com, +91-22-6749-3588

Ramnath Venkateswaran : ramnath.venkateswaran@kotak.com, +91-22-6634-1240

- **PFC clarifies that the suspension of the AG&SP scheme will not impact its operations and profitability**
- **We retain our 'Underperform' rating on the stock given rich valuations of 2.0XAPBR FY2009 for a sustainable RoE of 14%**

Power Finance Corporation (PFC) has clarified that the suspension of Accelerated Generation and Supply Program (AG&SP) will not impact its operations and profitability. In our note of August 24, 2007, PFC titled 'Flagging developments that could adversely impact profits', we had flagged this unfavorable business development for PFC. We take cognizance of this assurance from PFC. We would like to highlight that we had anyway not modified our estimates to factor any likely impact of suspension of the AG&SP scheme. We believe the current valuations of the stock are rich at 2.0X APBR FY2009 for a sustainable RoE of 14%. We retain our 'Underperform' rating on the stock.

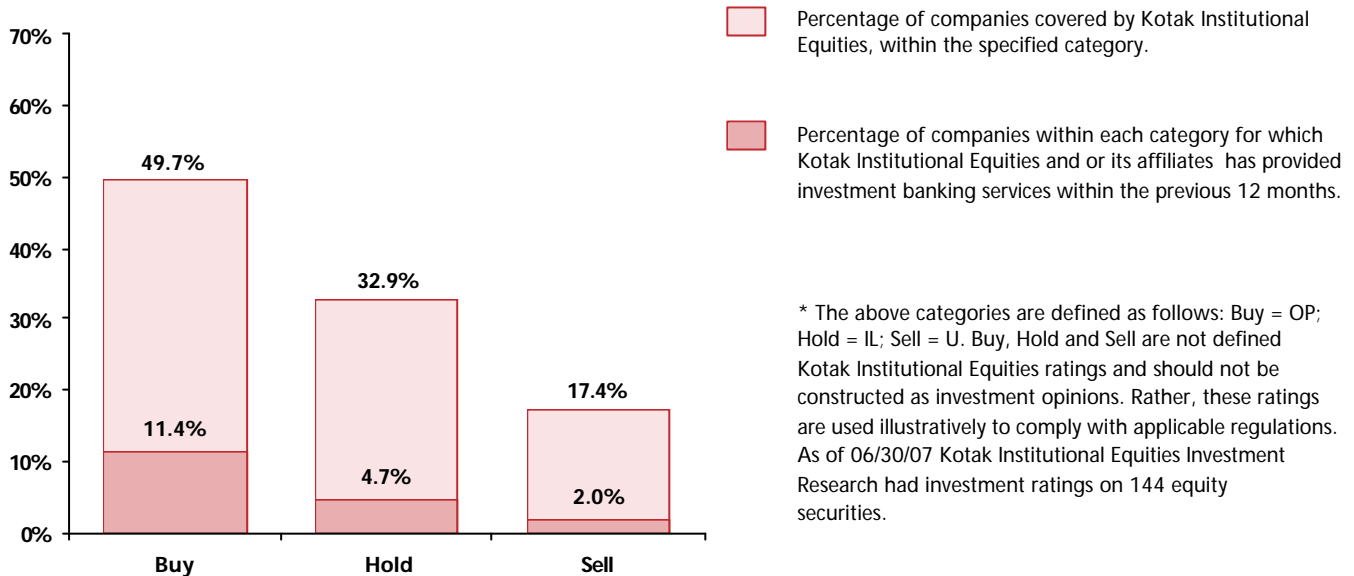
A quick recap of the AG&SP scheme

- The Government of India (GoI) started the AG&SP scheme in FY1998 to help state power utilities renovate and modernize existing generation units and also aid new generation units
- AG&SP scheme was modified in FY2003 and extended only to renovation, modernization and life extension schemes of the existing generation projects
- Under this scheme, PFC and Rural Electrification Corporation (REC) were given interest subsidies to on-lend to the power utilities for projects identified
- Interest subsidy provided by GoI was 4% until FY2002, which was reduced to 3% starting FY2003
- PFC and REC used to receive interest subsidy from GoI budget, which was then passed on to state power utilities over the life of the loan. Consequently, power utilities used to pay an effective interest, which was equal to prevailing nominal rate of PFC/REC less the interest subsidy provided by GoI
- As per the IPO prospectus of PFC, the company had Rs92.7 bn (24% of outstanding loans) as on September 30, 2006 under the AG&SP scheme
- GoI has suspended the continuation of the AG&SP scheme starting the current fiscal year

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Source: Kotak Institutional Equities.

As of June 30, 2007

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Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.

IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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Corporate Office
Kotak Securities Ltd.

Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices

Kotak Mahindra (UK) Ltd.

6th Floor, Portsocken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc.

50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

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Kotak Securities Ltd.

Bakhtawar, 1st floor, 229 Nariman Point, Mumbai 400 021, India.

Tel: +91-22-6634-1100 Fax: +91-22-2288-6453