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INDIA DAILY

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News Roundup

Corporate

- **Indivision India Partners**, the private equity arm of the **Future Group**, is close to picking up a stake—which could be in the range of 40-50%—in food and beverages entity **Blue Foods**, which operates a chain of restaurants in the country. (ET)
- **Vodafone Essar** (VEL, earlier Hutchison Essar) has sought damages, which could be upwards of Rs1,000 crore, from the Ruias of the **Essar** group for not transferring the shares of Mumbai-based **BPL Mobile** to the company. (ET)
- The promoters of **East India Hotels** (EIH) Ltd brand and the largest hotel chain after the Tata-owned **Indian Hotels** and **ITC Welcome Group**, are in advanced discussions with leading corporate houses and private equity firms to divest a strategic stake, possibly 26%. (BS)
- The BPO arm of **Countrywide Financial** in India, CFC India Services, is merging with **Bank of America**'s non-banking subsidiary, **Continuum Solutions**, as part of BankAm's US$2.5 bn global takeover of the loss-making Countrywide. (ET)
- German real estate fund **MPC Synergy** has picked up equity in various special purpose vehicles floated by real estate developer **Phoenix Mills** for Rs1,300 crore. (BS)
- US-based private equity major **General Atlantic** is learnt to be in final stages of talks with **Wockardt Hospitals** to invest US$140-150 mn. (ET)
- **ABG Shipyard** has decided to set upa greenfield shipyard in south Gujarat with an investment of Rs1,200 crore. (ET)
- **Jindal Steel and Power** (JSPL) is close to acquiring a state-owned coal mine in Mozambique for Rs200-250 crore. (ET) In other mining news, **Larsen & Toubro** is close to buying equity stake in coal mines in Australia and Indonesia. (BL)

Economic and political

- The government is planning to raise the limit for subsidized farm loans from Rs3 lakh at present to Rs5 lakh. (BS)
- India's annual rate of inflation zoomed to a 16-year high of 12.63% for the week ended August 9 compared with 12.44% the week before, but an unfazed finance ministry said prices had stabilized. (ET)

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

EQUITY MARKETS

India	21-Aug	Change, % 1-day	1-mo	3-mo
Sensex	14,244	(3.0)	1.0	(15.8)
Nifty	4,284	(3.0)	1.0	(14.8)
Global/Regional indices				
Dow Jones	11,430	0.1	(1.5)	(9.5)
FTSE	5,370	(0.0)	0.1	(13.1)
Nikkie	12,667	(0.7)	(3.9)	(9.4)
Hang Seng	20,392	(2.6)	(9.5)	(18.6)
KOSPI	1,482	(2.0)	(5.1)	(19.3)

Value traded - India

	21-Aug		Moving avg, Rs bn 1-mo	3-mo
Cash (NSE+BSE)	124.8		190.6	182.0
Derivatives (NSE)	520.1		439.4	395
Deri. open interest	826.4		758	827

Forex/money market

	21-Aug	Change, basis points 1-day	1-mo	3-mo
Rs/US$	43.5	0	79	56
6mo fwd prem, %	0.7	(25)	71	24

Net investment (US$mn)

	20-Aug		MTD	CYTD
FIIs	(71)		(283)	(7,029)
MFs	18		(224)	2,435

Top movers -3mo basis

Best performers	21-Aug	Change, % 1-day	1-mo	3-mo
CIPLA LTD	237	(1.7)	(0.5)	16.4
SUN PHARMACEUTI	1,450	(4.1)	3.9	10.5
OIL & NATURAL GA	1,010	(2.5)	4.8	9.1
CROMPTON GREAV	251	(1.3)	7.7	8.5
GLENMARK PHARM	648	(2.3)	(1.5)	3.7
Worst performers				
HOUSING DEVELOP	304	(3.4)	(15.6)	(50.0)
ABAN OFFSHORE LI	2,282	(1.9)	(11.1)	(45.4)
RELIANCE POWER L	155	(3.3)	8.9	(43.4)
INDIABULLS REAL E	293	(7.0)	(5.4)	(43.0)
CENTURY TEXTILES	461	(6.7)	(3.7)	(42.4)

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Economy

Sector coverage view N/A

Fiscal situation back on track for FY2009; may yet hit a few bumps ahead

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- **FRBM target of GFD/GDP ratio of 3% may be met**
- **GOI may issue off-budget bonds of Rs1.2 trn in FY2009 against on- and off-budget subsidies of over Rs2.8 tn; bulk of fertilizer subsidies may be paid in cash**
- **FRBM-II regime likely to be announced; may follow with inflation mandate for RBI**
- **Interest rates to stay firm on further monetary policy tightening and moderate additional market borrowing**

A fiscal surprise is likely to be in store for FY2009. Against widely expressed fears on the street that GFD/GDP ratio may be 4.5% or more (1.5X of FRBM target of 3%), it is now possible that the GFD/GDP ratio may be kept in line with the FRBM target of 3.0% but above budget estimate (BE) of 2.5%. Following its confidence vote in Parliament, the government is actively working towards turning around the fiscal mess left by the oil price shock and under-funded budget against the spending extravaganza. As a result of this, total tax and non-tax revenue receipts may exceed the budget estimate by nearly Rs1 trn and more or less offset the Rs1.2 trn expenditure shock which may arise from on-budget cash subsidies, Pay Commission and farm debt waiver.

Fiscal surprise

There appears to be a dramatic improvement in the fiscal scenario from the situation which had emerged during May 2008. Our discussions with senior officials, industry representatives and academia earlier this month have given us the confidence that the fiscal situation would be under control unless global crude prices firm up again. The recent improvement has been on account of:

- Fiscal initiatives taken by the government after winning the vote of confidence
- Fall in global crude price to below US$115/b from US$145/b in early-July

Additional market borrowing could be Rs300 bn or less on the back of fiscal initiatives

We are now of the opinion that the government would:

- Resort to nil or moderate additional market borrowing, depending upon how its fiscal plans progress. The amount of additional market borrowing could be Rs297 bn or less
- Issue off-budget bonds (mostly oil bonds) in lieu of subsidies of up to Rs1.2 trn in FY2009
- Maximize non-tax revenue through PSU disinvestment and other means
- Agree to further monetary tightening, and
- Announce an FRBM-II regime towards the end of the year

GFD/GDP may be 3.0 in line with FRBM target (5.0% including off-budget bonds)

MOF is working towards meeting the FRBM target of gross fiscal deficit (GFD) at 3% of the GDP as well as restrict off-budget bond issuances to much below the market expectations of Rs2-2.5 trn that prevailed about a quarter ago (see Exhibit). If oil prices average about US$115/b during FY2009 it looks possible for the government to restrict off-budget bond issuances to about Rs1.2 trn by paying most fertilizer subsidies in cash. More importantly, with bond issuance restricted to Rs1.2 tn, even if these bonds are brought on-budget, the FRBM target of incremental liabilities to be capped at 5% of GDP in FY2009 may be met.

Non-tax revenue likely to more than offset Pay Commission, farm debt waiver

We believe the expenditures in FY2009 on farm debt waiver (likely to be Rs250 bn) and wage hikes and arrears relating to the Pay Commission (estimated at about Rs295 bn) are likely to be met by:

- 3G license fee (our estimate: Rs300 bn, including earnest money and attendant licenses)
- Disinvestment (our estimates: Rs400 bn (if NHPC and BSNL comes through); GOI likely to work towards larger amount
- Larger surplus transfer of Rs36 bn by RBI and about 50 bn from other PSUs

GOI is hoping that it can rake in up to Rs400 bn from 3G license fee, but considering the experience with the 2G licensing, we expect the amount to fall short. GOI has built-in disinvestment receipts of Rs101.65 bn in the budget, but if it succeeds in aggressively pushing the disinvestment as per the current plan it could rake in additional Rs300 bn. No specific amounts are targeted as yet as it would depend on the political acceptability and the equity valuations. GOI hopes to realize additional non-tax revenue. While all of it is unlikely to materialize, we may still see nearly Rs700 bn of extra non-tax revenue come in. This would help to attain an acceptable GFD/ GDP ratio.

Accounting treatment and possible road blocks to decide disinvestment impact

The road to aggressive disinvestment is likely to meet stiff political and workers' union resistance and some plans could face delays through legal actions by some stakeholders. So, it may be a bit early to count the chickens. If not much headway is possible on disinvestment within the tenure of the present government we may see GFD/GDP ratio of about 3% being surpassed. In any case, it may be added that the reduction of GFD through disinvestment this year may be accounting benefit as disinvestment proceeds have to be credited through a contra-entry with some lag, but that may not occur as disinvestment may materialize only towards the end of FY2009. Even if disinvestments help lower GFD/GDP ratio close to the FRBM target of 3.0%, this improvement may get reversed in the following year.

We expect tax revenue to surpass the budget estimate by about Rs350 bn

We expect total tax revenue to exceed the budget estimate by about Rs350 bn. In our view, direct tax collection may grow at about 30% for the full year against a budgeted growth of 19%. Indirect taxes may, however, fall marginally short at 14% growth against the budgeted 15%. Probability of upside to the above estimates exceeds downside risks.

Direct tax collections during April-July 2008 are up 47% against the corresponding period last year and a budget estimate of 19% for the full year. Corporate income tax grew 50%, while personal income tax grew 43% on a yoy basis. Indirect tax collections are largely in line with the budget. Though having recorded 12% growth in the first four months against budget estimate of 15% they can be considered on track as excise collections pick up later in the year.

Apart from higher revenue collection, minor saving of up to Rs14 bn may also come in the form of lower interest outgo on MSS taking into account the budget provisions and likely issuance and roll over costs.

GOI may work towards FRBM-II

Stung by the criticism that FRBM has failed to arrest fiscal deterioration as on-budget deficit targets have lost relevance in the face of off-budget liabilities, GOI is considering towards moving to an FRBM-II regime by the next year on expiry of the fiscal rules so far set under the FRBM Act, 2003. FRBM-II regime is likely to be more transparent, bringing transparency in off-budget liabilities and adopting a balance-sheet approach to fiscal sustainability. It may also stress-test debt against various risks. Besides, it may provide for cyclically adjusting deficits and debt targets to overcome the problem of pro-cyclical fiscal rules and policies.

Bumpy track ahead

The fiscal tram may be back on track in FY2009, but the road may still be bumpy ahead. Uncertainty remains about future subsidies (especially if oil prices rise once again or fertilizer prices remain frozen indefinitely). The addition to liabilities would add to the interest costs in future budgets, which would make future fiscal targets that much more difficult to achieve. FRBM-II would need to take cognizance of the increased interest costs and probably aim at generating primary surpluses in the short run.

FRBM-II regime may be followed by greater inflation mandate for RBI

GOI may work towards giving RBI a greater inflation mandate, if not a single objective framework. The Mistry Committee report and the draft Raghuram Rajan Committee report have recommended such a framework. GOI may take the opportunity of committing once again to fiscal rules under FRBM-II to push for central bank to take responsibility for keeping inflation low. The details of how an inflation target might be set under the new regime still needs to be worked out. In our view, this is not going to be easy in the Indian context where inflation is predominantly a supply-side phenomenon and its predictability is low.

Interest rates may stay firm

In our view, the interest rates are likely to stay firm on the back of (1) further monetary policy tightening and (2) additional market borrowing of moderate magnitude.

In spite of reasonable chances of GOI springing a surprise of GFD/GDP ratio being met at a BE of 2.5%, additional market borrowing may be difficult to avoid, except in case the disinvestment program turns out to be larger than anticipated here. This is so because the deficit ratios could look lower in the face of larger-than-budgeted nominal GDP, which may increase by 17% (real GDP growth of 7.7% plus GDP deflator inflation of 9.3%) against a budget estimate of 13%. It will still be consistent with additional market borrowing of Rs297 bn (0.5% of GDP). Such borrowing would keep gilt yields high. However, the hardening may be moderated by expected lower issuances of MSS for which a headroom of RS792 bn existed for FY2009 against a budgeted incremental MSS liabilities of Rs298 bn. We expect MSS issuances to be half of the headroom.

Furthermore, we believe that as inflation moves up to our anticipated trajectory of 13-14% band during 3QFY09, RBI would tighten at least once more. A 50 bps repo rate hike and another 50 bps CRR hike is a possibility. The CRR hike could occur in early October coinciding with expected large government spending following the expected clearance of supplementary budget provisions in the monsoon session of Parliament. Between now and early October, the repo rate could be moved up by up to 50 bps in one or two hikes. We understand that the official view in Delhi is that monetary policy is still loose. While we believe that such tightening could be avoided in face of signs that growth has begun to slowdown and investment is also likely to moderate in FY2010, the likelihood of further tightening appears high.

Expect liquidity to remain tight through this year

We have retained some of our earlier estimates for key indicators and tweaked others, a quick look:

- **Gilt yields could further harden** and the 10-year benchmark could touch 9.5% before softening to 9% by the end of FY2009E.
- **Short-term rates may remain high**, with inversion of yield curve, as is presently the case with the OIS segment, where the 1-year OIS is at 9.85% while the 5-year OIS is at 9.55%. In our view, this inverted shape is a lead indicator that growth is slowing down and is indicative of where the market sees the gilt yields ahead.
- **Liquidity is expected to remain tight through FY2009**. The system is short by about Rs300-350 bn considering the current LAF levels. From August 30 a CRR hike of 25 bps would kick in. This would be followed by advance tax collections sucking out another Rs400 bn in mid-September. Further monetary policy tightening in October could keep system short of liquidity, even though some easing may occur on account of government spending.
- **If GOI resorts to additional market borrowing, pressures on interest rates may remain** even in 4QFY09 when this is likely to be undertaken. This may happen even as RBI may front-load the GOI's borrowing calendar for 2HFY09 in anticipation of additional market borrowing. Further pressures may arise with oil bond redemptions of nearly Rs140 bn towards the end of the year. We, therefore, expect 10-year gilt to trade around 9.2% or more for most part of the year, but soften to around 9.0% in the last week of March. However, in view of the improved fiscal position, we are revising our end FY2009E 10-year benchmark gilt yield to 9.0% from 9.2%.

Rise in subsidies bill unlikely to widen gross fiscal deficit

select budgetary heads of the central government (in Rs bn)

	On budget subsidies					Off budget bonds	
	FY2008BE	**FY2008RE**	**FY2009BE**	**FY2009KIE**	**Overshooting**	**FY2008KIE**	**FY2009KIE**
Subsidies	**546**	**697**	**714**	**1,705**	**991**		
Food	257	315	327	400	73	..	..
Fertilizers	225	305	310	960	650	123	240
Petroleum	28	29	29	29	0	353	881
Farm debt waiver	..	..	0	250	250	..	..
Interest subsidies	23	27	28	32	4	..	..
Others	13	22	21	34	13	..	..
Sixth Pay Commission related expense	..	..	0	295	295	..	..
MSS interest outgo	37	84	140	126	(14)	..	..
Total of select expenditure heads		**781**	**854**	**2,126**	**1,272**	**476**	**1,121**
Direct tax receipts	2,675	3,048	3,650	3,961	311		
Indirect tax receipts	2,806	2,807	3,227	3,207	(20)		
Total tax revenue (gross)	5,481	5,855	6,877	7,168	291		
3G-licensing fee	..	..	0	300	300		
Disinvestment	417	361	102	400	298		
additional transfer of RBI profit	84	114	114	150	36		
Dividends & profits (excl. transfer of RBI profits)	255	247	318	368	50		
Total non-tax revenue	826	933	958	1,642	684		
Total of tax and non-tax revenues	**6,307**	**6,788**	**7,835**	**8,810**	**975**		
Gross fiscal deficit (GFD)	**1,509**	**1,437**	**1,333**	**1,630**	**297**		
GDP	46,337	46,936	53,038	54,915	54,915	46,936	54,915
Gross fiscal deficit/GDP (%)	**3.3**	**3.1**	**2.5**	**3.0**	**0.5**	**1.0**	**2.0**

Note:

(1) BE: Budget estimate

(2) RE: Revised estimate in the budget

Source: Ministry of Finance, Kotak Institutitional Equities (KIE) estimates.

Banking

PNBK.BO, Rs446	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	650
52W High -Low (Rs)	721 - 330
Market Cap (Rs bn)	140.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	78.3	84.9	100.3
Net Profit (Rs bn)	20.5	21.6	25.1
EPS (Rs)	65.0	68.5	79.7
EPS gth	*33.0*	*5.4*	*16.4*
P/E (x)	6.9	6.5	5.6
P/B (x)	1.5	1.2	1.0
Div yield (%)	2.9	3.1	3.6

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.8	-	-
FIIs	20.0	0.4	0.0
MFs	6.4	0.7	0.3
UTI	-	-	(0.4)
LIC	5.1	0.5	0.1

Punjab National Bank: PNB focusing on moderate growth, lower risk and healthy profitability

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- **PNB has indicated a clear focus on moderate growth and maintaining credit standards**
- **Valuations appear attractive at 1.2X APBR FY2009**
- **Moderation in commodity prices likely to provide trigger for stock price performance**

A number of large PSU banks have reported high credit growth in the recent quarter, but Punjab National Bank's (PNB's) management continues to focus on moderate asset growth (20% yoy). The management indicated that the key areas of focus will be on maintaining credit standards and enhancing IT capabilities to roll out its financial inclusion initiatives rather than increasing market share. We expect the bank to deliver 13-15% earnings growth over the next three years (management target is 20%), keep NPLs in check and deliver RoE of 17-18%. Our earnings estimates likely carry upside risk as the bank's moderate growth strategy and recent hefty 100 bps hike in PLR may lead to margin expansion (currently not factored in our estimates). PNB, which trades at 1.2XAPBR and 6.5X PER FY2009, remains amongst our top picks within the public bank space. We believe that a correction in international oil and commodity prices will likely reduce the risk of further tightening by the RBI, and an improvement in the banking sector stock performance, providing a trigger to stocks like PNB.

Key takeaways from the meeting with the management

Moderate loan growth v/s market share gain. Loan growth is likely to remain moderate at around 20% yoy for the current fiscal and in line with the trend reported in 1QFY09. This is v/s the 26% growth reported by the industry and around 30-40% reported by large banks like SBI, BoB and BoI. Key areas of focus on the advances side are SME, agriculture and retail sector particularly education (62% growth yoy in 1QFY09). The bank has 10 Mid Corporate Branches (MCBs) & 35 SME branches to cater to mid sized and small size business segments, respectively.

Possible margin expansion hereon. The company has guided that it will maintain its credit discipline of pricing its products in line with the rising funding costs. PNB was amongst the first few banks to raise lending rates by 100 bps. We believe the bank should be in a position to report higher NIM in 2QFY09 from the 3.3% reported in the recent quarter. We believe that NII growth for the bank should improve with this expansion in margin.

Investment portfolio derisked, leading to lower earnings volatility. In June 2008, PNB's investment portfolio stood at Rs604 bn, of which 80% was in Gsec. Over the past two years, the bank has derisked its portfolio and currently has just 13% in the AFS category, down from 44% in FY2006. The modified duration on this portfolio too stands lowered to 1.73 years from 4.19 years in March 2006. We prefer PNB's strategy to other banks with higher duration and AFS book as it has significantly reduced the risk of earnings volatility.

Increasing focus on financial Inclusion. Over the past year, the bank has increased its focus on financial inclusion. The bank proposes to use biometric technology and smart cards to cover 30,000 villages, and 75 mn people by 2010. Up until now, PNB has opened over 768 000 "No Frills Accounts". To achieve these targets, the bank will be recruiting business correspondents/ business facilitators and has launched pilots in 27 identified sites (20 in rural +7 in urban). The bank plans to provide comprehensive schemes covering finance, and insurance (health and life). We are fairly positive on the developments in rural India (look for our forthcoming report on the changing face of rural economics) and believe banks like PNB will benefit from these initiatives.

Provision on account of agri loan waiver. PNB's management also indicated that it might have to incur an additional provision of Rs2 bn on account of the recent RBI accounting guidelines towards treatment of loans that are covered under the agriculture debt relief scheme. Note that the banking sector is asking the government to pay interest on the deferred payment. In case this is granted, the provision requirement will reduce significantly.

Revisiting subsidiary/associate strategy. The company is looking at selling its 74% stake in PNB Gilts (PD business). The company had an equity base of Rs5.3 bn with a capital adequacy of 35% as of March 2008, which is much above the stipulated 15%. In the event of the company not finding an attractive valuation for this stake, management indicated that it could look at merging this entity with itself and enhancing its capital adequacy. PNB's management also indicated that it is looking to re-work its alliance with the Principal group, which has not proved to be particularly rewarding. The life insurance venture has yet to take off and as per the existing agreement, PNB can sell only the mutual fund products of the JV. We believe PNB is keen to move away from this arrangement to improve its fee income.

Automobiles

MAHM.BO, Rs540	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	640
52W High -Low (Rs)	874 - 420
Market Cap (Rs bn)	139.3

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	115.6	131.4	149.8
Net Profit (Rs bn)	9.5	9.5	9.6
EPS (Rs)	38.1	36.9	37.2
EPS gth	*(2.0)*	*(2.9)*	*0.6*
P/E (x)	14.2	14.6	14.5
EV/EBITDA (x)	10.4	10.1	9.3
Div yield (%)	2.0	1.7	1.8

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	22.6	-	-
FIIs	33.3	0.7	0.3
MFs	5.2	0.6	0.2
UTI	-	-	(0.4)
LIC	15.1	1.6	1.2

Mahindra & Mahindra: Annual report highlights—strong capex going forward; increase in debt levels; lower price target to Rs640/share

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- **Strong capex going forward as M&M pulls out of Chennai JV with Nissan and Renault and focuses on building capacity in Chakkan—guides for a capex of Rs60 bn in the next three years**
- **We believe M&M would have to fund additional capex and incremental investment in subsidiaries and JVs through additional incremental debt and sale of stake in subsidiaries**
- **Revise earnings estimates downwards by 6.3% and 8.7% for FY2009E and FY2010E, respectively**
- **Lower target price to Rs640/share (Rs720/share previously)—retain ADD rating**

M&M incurred quite a high capex of Rs7.5 bn during FY2008. Moreover, M&M has guided for a large capex program of Rs60 bn for its various expansion plans. We believe that a large part of this will be funded by raising additional debt and sale of stake in its subsidiaries and factor in higher debt in our model. Current debt-equity at 0.6X is comfortable and we expect it to increase marginally to 0.7X in FY2009E. We believe that higher interest costs would put pressure on the company's profits going forward. We revise our EPS estimates downwards by 6.3% and 8.7% for FY2009E and FY2010E, respectively, to Rs40.8/share and Rs41/share. We have lowered our SOTP-based target price to Rs640/share from Rs720/share, previously. We retain our ADD rating on the stock.

Strong capex going forward to be funded by debt and stake sale in subsidiaries

FY2008 net debt–equity increased to 0.6X from 0.5X in the previous year as M&M raised a large amount of debt to fund its capex as well investment in subsidiaries. During FY2008, M&M raised (a) ECB of US$ 50 mn with an average maturity of six years, (b) Rs 2 bn by way of private placement of non-convertible debentures with a maturity of three years, (c) Rs1 bn through FCNR(B) loan and (d) Rs1 bn through the issue of commercial paper. Most of the money raised was used to fund its ongoing capex plans as well as its investment in subsidiaries and joint-ventures. We expect the debt level to go up as M&M would have to raise money by way of debt or a stake sale in its subsidiaries to fund (a) its capex plans—the company plans to incur Rs60 bn for its various expansion plans over the next three years and (b) its investments in subsidiaries and joint-ventures including acquisitions.

We note that M&M has raised Rs7 bn in May 2008 by issuing 9.4 mn debentures to Golboot Holdings—an entity controlled by Goldman Sachs—at a price of Rs745/ debenture. These debentures are compulsorily convertible into 9.4 mn shares at Rs745/ share within 18 months.

Acquisitions continue through the year

During FY2008, M&M acquired substantial stake in Punjab Tractors Ltd (PTL), Swaraj Engines Ltd and Swaraj Automotives Ltd with a view to consolidating its presence in the tractor segment. The acquisition of PTL is a strategic fit for the company and M&M aims to leverage the Swaraj brand to increase market share in the tractor space. Besides, the acquisition would enable M&M to increase capacity as PTL has idle capacity. We note that M&M recently announced the merger of PTL with M&M. Moreover, M&M also announced its intention to enter the 2-wheeler industry with the acquisition of the assets of Kinetic Motors for a cash consideration of Rs1.1 bn and a 20% stake to the shareholders of PTL in the newly formed company which would acquire the assets of KMC.

Revise earnings estimates downwards by 6.3% and 8.7% for FY2009E and FY2010E, respectively

We factor in higher debt required by M&M to fund its ongoing capex program, increased inorganic activity and investments in subsidiaries. Consequently, we expect interest costs to rise substantially to Rs2 bn and Rs2.5 bn for FY2009E and FY2010E (versus Rs1.6 bn and Rs1.9 bn previously), respectively. We revise our EPS estimates downwards by 6.3% and 8.7% for FY2009E and FY2010E, respectively, to Rs40.8/ share and Rs41/share (versus our earlier estimate of Rs43.5 and Rs44.9, respectively). We have lowered our margin estimates marginally to 10.7% and 10.3% for FY2009E and FY2010E, respectively (versus 11.3% and 11.2% earlier), to factor higher input costs.

Lower target price to Rs640/share (Rs720/share previously)—retain ADD rating

We value the standalone auto business of M&M at Rs298/share based on 6X FY2010E EV/EBITDA. Besides, we value the stake of M&M in its various subsidiaries at Rs271/ share—we have reduced the value ascribed to its stake in Mahindra Holidays owing to unfavourable market conditions. We have lowered our SOTP-based target price to Rs640/share from Rs720/share, previously. We retain our ADD rating on the stock.

M&M, change in estimates, March fiscal year-ends, 2009E-2010E (Rs mn)

	Revised estimates		Old estimates		% change	
	2009E	2010E	2009E	2010E	2009E	2010E
Net sales	131,390	149,771	132,252	149,731	(0.7)	0.0
EBITDA	14,109	15,494	14,955	16,779	(5.7)	(7.7)
PAT	10,533	10,594	11,207	11,571	(6.0)	(8.4)
EPS (Rs/share)	40.8	41.0	43.5	44.9	(6.3)	(8.7)
Sales volume (vehicles sold)	313,388	339,526	313,171	339,297	0.1	0.1

Source: Kotak Institutional Equities estimates.

M&M, SOTP-based valuation, FY2010E basis

	EBITDA (Rs mn)	Multiple (X)	Value (Rs mn)	Value per share (Rs)	Comment
M&M standalone business	15,494	6.0	92,961	360	Based on 6X EV/EBITDA FY2010E earnings
Less: Net debt			15,949	62	
Total				**298**	
Subsidiaries				**271**	
Tech Mahindra				150	Based on KIE target price of Rs900/per share
Mahindra Lifespace Developers Ltd				39	Based on KIE target price of Rs 810/share
Punjab Tractors				44	Valued at Current market price
Mahindra & Mahindra Financial Services Ltd				39	Based on KIE target price of Rs 215/share
Other investments				70	
SOTP-based value				**640**	
Target price				**640**	

Note

(1) The subsidiaries have been valued at a holding company discount of 20%.

Source: Company data, Kotak Institutional Equities estimates

M&M, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2006-2010E (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	82,513	100,682	115,625	131,390	149,771
EBITDA	**9,958**	**13,048**	**14,034**	**14,109**	**15,494**
Other income	753	1,530	1,092	2,960	3,635
Interest	184	675	(242)	(2,045)	(2,557)
Depreciaiton	(2,000)	(2,096)	(2,387)	(2,594)	(4,064)
Profit before tax	**8,895**	**13,157**	**12,497**	**12,430**	**12,507**
Current tax	(2,854)	(3,657)	(2,788)	(2,661)	(2,676)
Deferred tax	430	157	(247)	(235)	(237)
Net profit	**8,571**	**10,684**	**11,034**	**10,533**	**10,594**
Earnings per share (Rs)	**34.8**	**43.0**	**44.4**	**40.8**	**41.0**
Balance sheet (Rs mn)					
Equity	30,556	35,727	44,068	52,120	67,128
Total Borrowings	7,260	16,360	25,871	38,627	41,627
Current liabilities	20,516	26,656	32,510	35,533	39,526
Total liabilities	**58,332**	**78,743**	**102,449**	**126,281**	**148,281**
Net fixed assets	15,544	18,712	23,609	42,015	58,950
Investments	16,691	22,375	42,151	47,151	49,151
Cash	7,303	13,261	8,612	5,079	3,547
Other current assets	20,188	24,221	27,941	31,902	36,497
Miscellaneous expenditure	181	176	135	135	135
Total assets	**59,906**	**78,743**	**102,449**	**126,281**	**148,281**
Free cash flow (Rs mn)					
Operating cash flow excl. working capital	6,919	9,712	10,730	12,448	13,817
Working capital changes	(50)	1,978	(2,472)	(937)	(603)
Capital expenditure	(2,747)	(4,819)	(7,171)	(21,000)	(21,000)
Free cash flow	**4,122**	**6,870**	**1,087**	**(9,489)**	**(7,786)**
Ratios					
Operating margin (%)	12.1	13.0	12.1	10.7	10.3
PAT margin (%)	10.4	10.6	9.5	8.0	7.1
Debt/equity (X)	0.2	0.5	0.6	0.7	0.6
Net debt/equity (X)	0.1	0.0	0.0	0.3	0.2
Book Value (Rs/share)	123.3	142.9	176.6	201.4	259.6
RoAE (%)	32.9	32.4	27.8	22.0	17.8
RoACE (%)	**25.7**	**22.8**	**18.4**	**15.1**	**12.6**

Source: Company, Kotak Institutional Equities estimates.

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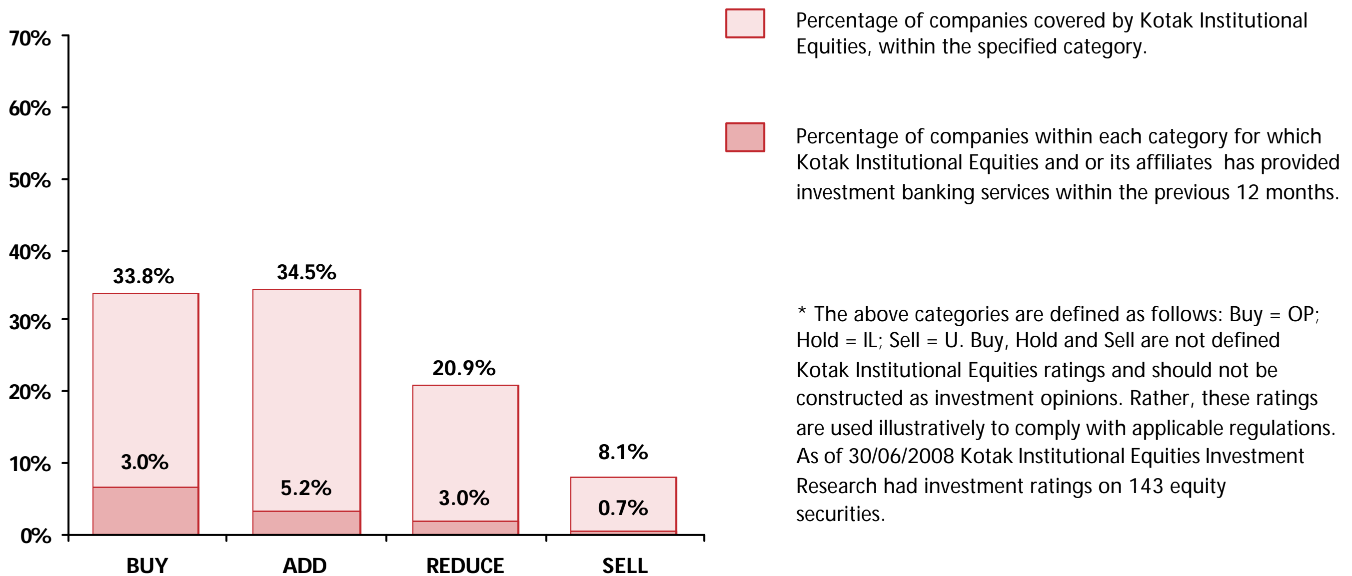

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Source: Kotak Institutional Equities. As of June 30, 2008

Ratings and other definitions/identifiers

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