kotak® Institutional Equities

INDIA DAILY

August 27, 2008

EQUITY MARKETS

		Change, %		
India	**26-Aug**	**1-day**	**1-mo**	**3-mo**
Sensex	14,482	0.2	1.5	(11.0)
Nifty	4,338	0.1	0.6	(10.7)
Global/Regional indices				
Dow Jones	11,413	0.2	0.4	(9.0)
FTSE	5,471	(0.6)	2.2	(9.7)
Nikkie	12,764	(0.1)	(4.3)	(8.1)
Hang Seng	21,276	1.0	(6.4)	(12.4)
KOSPI	1,480	(0.7)	(7.4)	(18.9)
Value traded - India				
			Moving avg, Rs bn	
	26-Aug		**1-mo**	**3-mo**
Cash (NSE+BSE)	123.1		190.6	182.0
Derivatives (NSE)	497.8		531.6	441
Deri. open interest	859.3		831	855

Forex/money market

		Change, basis points		
	26-Aug	**1-day**	**1-mo**	**3-mo**
Rs/US$	43.8	0	130	89
6mo fwd prem, %	0.7	(25)	71	24

Net investment (US$mn)

	22-Aug		**MTD**	**CYTD**
FIIs	(28)		(283)	(7,029)
MFs	41		(224)	2,435

Top movers -3mo basis

		Change, %		
Best performers	**26-Aug**	**1-day**	**1-mo**	**3-mo**
CIPLA LTD	239	0.7	5.7	16.4
OIL & NATURAL GA	1,016	0.1	3.3	14.9
CROMPTON GREA\	267	1.8	10.1	9.1
SUN PHARMACEUTI	1,488	0.9	5.4	8.0
HINDUSTAN UNILEV	247	1.6	6.1	6.5
Worst performers				
HOUSING DEVELOP	300	(1.4)	(18.5)	(48.0)
ABAN OFFSHORE LI	2,144	(1.2)	(20.6)	(47.2)
INDIABULLS REAL E	287	(5.2)	(2.9)	(41.0)
RELIANCE POWER L	156	0.5	(7.6)	(39.6)
UNITECH LIMITED	160	(0.0)	(2.9)	(35.5)

Contents

Updates

News Roundup

Corporate

- **ONGC Videsh** (OVL) has put in a formal bid to acquire US-based oil firm **Imperial Energy** at 1,250 pence per share. Imperial Energy, with assets in the Russian Federation and CIS countries, is valued at US$2.58 billion at the bid price. (ET)
- Domestic airlines, pummeled by surging crude oil prices in the past two years, are planning to hike fares for the seventh time this year. (ET)
- **Tata Sons**, the unlisted company for Tata group firms, is considering options to sell part of its stake in India's largest software exporter Tata Consultancy Services to fund the group's expansion plans, especially in telecom. (ET)
- The investment arm of the **Government of Singapore** (GIC) may pick up slightly below 10% stake in Asset Reconstruction Company of India (Arcil), subject to approval from the Foreign Investment Promotion Board (FIPB). (ET)
- **Reliance Industries** said it plans to transfer 80% of its participating interest in the D6 block of the KG basin to four subsidiaries to enhance flexibility to raise finances. (ET)
- **Cairn Energy** has revised the oil production forecast from its Rajasthan fields. The company is expecting to produce 16% more oil (1.75 lakh barrels a day, up from the earlier estimate of 1.5 lakh barrels) once it starts production in the second half of 2009. (BL)

Economic and political

- India has brought down the number of people living below US$1 a day by 2 percentage points to 24.3% in three years up to 2005, as Asia's third-largest economy accelerated to 7% plus growth in those years, latest data from the World Bank reveal (indicating that 4.7 million people came out of poverty in this period.) (BS)

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

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Energy

ONGC.BO, Rs1016	
Rating	BUY
Sector coverage view	Cautious
Target Price (Rs)	1,225
52W High -Low (Rs)	1387 - 779
Market Cap (Rs bn)	2,173

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,113	1,318	1,307
Net Profit (Rs bn)	198.5	276.5	319.1
EPS (Rs)	92.8	129.3	149.2
EPS gth	*9.1*	*39.3*	*15.4*
P/E (x)	10.9	7.9	6.8
EV/EBITDA (x)	4.1	3.1	2.7
Div yield (%)	3.1	3.5	4.4

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	6.9	1.8	(3.2)
MFs	1.6	2.3	(2.7)
UTI	-	-	(5.1)
LIC	2.4	2.9	(2.2)

Oil & Natural Gas Corporation: OVL announces deal to acquire Imperial Energy; first-cut analysis suggests a decent price for the acquisition

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- **US$2.3 bn for about 920 mn boe of oil and gas 2P reserves (primarily oil)**
- **Key would be production ramp-up and specifics of PSCs of imperial Energy**
- **Retain positive view on ONGC with 12-month target price of Rs1,225; upside risks exist**

Our first-cut analysis of the proposed acquisition by OVL (ONGC's 100% subsidiary) of Imperial Energy plc, an AIM-listed company, with significant assets in Russia and Kazakhstan, suggest that the acquisition price is reasonable. At US$2.5/bbl EV/boe (2P basis), the acquisition looks inexpensive although we do not use EV/boe as a valuation benchmark or any indicator of valuation. In our view, value creation would depend on Imperial's ability to ramp up production over the next few years and the specifics of Imperial's PSCs with the respective governments. We see the subsidy issue as more relevant for ONGC stock in the medium term. We maintain our BUY rating on ONGC with 12-month fair value of Rs1,225 (based on 9X normalized FCF using US$50/bbl normalized crude price). Key downside risk stems from higher-than-expected subsidy losses.

Details of the proposed acquisition. OVL has proposed to acquire 100% of Imperial Energy at 1,250 pence/share or US$2.3 bn (market value); the company has negligible net debt. We note that the stock has traded around this price recently and has traded between 652 p and 1,392 p over the past 12 months (see Exhibit 1); the stock came off in April/May due to a rights issue and lower-than-expected ramp-up in production in 1QCY08. We are not inclined to use EV/boe to make a judgment on the acquisition valuation and will build a detailed financial model before commenting on valuations of the proposed deal. In the interim, we use the stock price as the best indicator of the acquisition price paid by OVL. We note that Imperial is in the process of ramping up production and its near-term financials will not capture the potential of its future earnings based on the company's production target, reasonably large reserves and large resource base. Imperial will spend about US$600 mn in CY2008-09E as capex to build out its production program through more production wells, 2D and 3D seismic surveys and pipeline infrastructure.

Exhibit 2 gives the management's production target over the next few years; the company is targeting production of 80,000 bpd in end-CY2011E versus only 2,284 b/d in CY2007; production effectively started 3QCY07 and its CY2007 financials (per boe metrics) may not be relevant. The company's proposed 80,000 b/d production target for end-CY2011 is about 35% of our estimated production for OVL in FY2012E (before Imperial's contribution) and 7.5% of our estimated production for ONGC (consolidated before Imperial's contribution).

Exhibit 3 gives details of Imperial's reserves. Imperial had only 175 mn boe of proved reserves at end-CY2007, which is very small in the context of ONGC's 6.4 bn boe (at end-FY2007). However, we find Imperial's 2P and 3P reserves exciting at 920 mn boe and 3.4 bn boe, respectively. The 2P and 3P reserves are very similar to the reserves of Cairn, which has a market capitalization of US$10.6 bn. However, Cairn's production profile is far superior to that of Imperial (CY2010E production is about 2X Imperial's CY2012E target). The other differentiating factor would be the nature of the PSCs of the two entities and the sharing of profit petroleum for Imperial with the respective governments. We highlight that Russia's fiscal regime for E&P is one of the toughest globally.

US$2.3 bn acquisition price on market capitalization of US$50 bn is a modest figure; more important issue is subsidy. We note that the proposed acquisition will have a modest impact on ONGC's valuations immediately but can provide reasonable upside to ONGC's reserves if Imperial can establish more 1P reserves from its large resource base over a period of time. Also, Imperial's financials are unlikely to impact ONGC's consolidated financials in the medium term given the size of ONGC's balance sheet and profits.

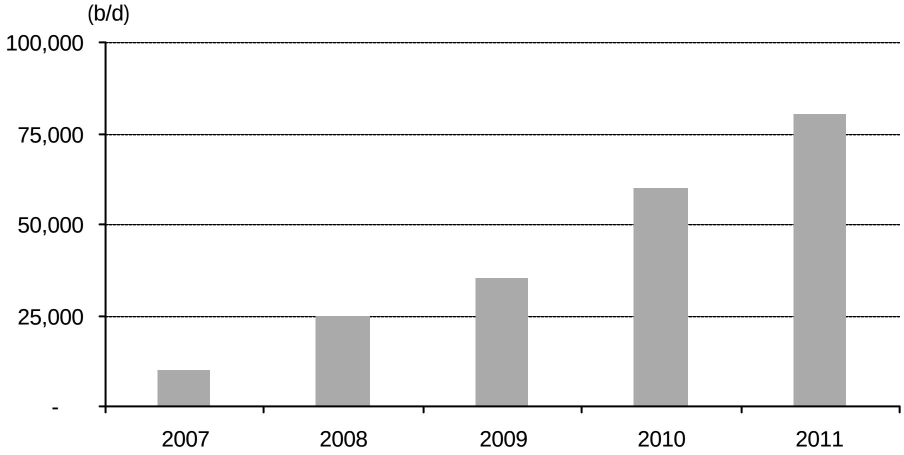
We see the subsidy issue as more important for ONGC in the medium term. We forecast ONGC's FY2009E consolidated EPS at Rs129 based on US$110/bbl crude price (Dated Brent) and Rs500 bn subsidy loss. However, we see upside risks to our estimates if (1) the government were to cap ONGC's subsidy loss at around Rs380 bn and/or (2) the government fixed ONGC's net realization at US$75/bbl as per a recommendation of a government-appointed committee. In the first scenario, our FY2009E EPS would increase to Rs163 and in the second scenario, our FY2009E EPS would come to Rs175. Incidentally, the difference between Rs500 bn and Rs380 bn is slightly more than the price to be paid by OVL for the proposed acquisition of Imperial. It would be so much better for India's future energy security if the government were to use ONGC's finances judiciously to enhance India's energy security rather than let it absorb large subsidy losses.

Historical stock price of Imperial Energy, 2004-2008 (GBp)

Source: Bloomberg, compiled by Kotak Institutional Equities

Imperial is targeting 80,000 b/d of oil production by end-CY2011E

End-of-year target production of Imperial Energy, calender year-ends, 2007-2011 (b/d)



Source: Company, compiled by Kotak Institutional Equities.

920 mn boe of 2P reserves

Oil and gas reserves in various fields of Imperial Energy, calender year-end, 2007 (mn boe)

	Oil (mn bbls)			Gas (mn boe)			Total (mn boe)		
	1P	2P	3P	1P	2P	3P	1P	2P	3P
Buranovskoye	—	—	1.1	—	—	—	—	—	1.1
Central Festivalnoye	7.9	79.7	139.5	0.8	3.1	3.1	8.7	82.8	142.6
Chagvinskoye	—	—	195.2	—	—	2.6	—	—	197.8
Dvoinoye	1.2	5.2	6.9	0.2	0.3	0.4	1.4	5.5	7.3
Festivalnoye	18.9	136.4	513.5	2.8	12.2	28.1	21.7	148.6	541.6
Golovnoye	—	2.0	8.3	—	0.1	0.2	—	2.1	8.5
Kiev-Eganskoye	17.1	107.0	575.2	1.3	3.6	6.0	18.4	110.6	581.2
Maiskoye	13.6	73.7	119.0	0.9	2.1	2.3	14.5	75.8	121.3
Middle Glukhovskoye	9.3	25.3	469.4	2.4	2.6	9.8	11.7	27.9	479.2
North Chertalinskoye	7.5	46.4	183.5	2.4	4.8	9.3	9.9	51.2	192.8
North Festivalnoye	42.3	127.1	218.9	10.0	10.1	10.1	52.3	137.2	229.0
Nyulginskoye	—	—	49.0	—	—	0.7	—	—	49.7
Snezhnoye	24.1	93.5	156.8	7.2	9.8	10.1	31.3	103.3	166.9
South Festivalnoye	—	132.0	403.5	—	5.3	7.0	—	137.3	410.5
South Maiskoye	2.9	25.7	188.0	0.2	0.8	3.1	3.1	26.5	191.1
Tamratskoye	1.3	9.7	58.9	0.3	1.4	3.8	1.6	11.1	62.7
Vodorazdelnoye	—	—	20.1	—	—	2.0	—	—	22.1
Total	**146**	**864**	**3,307**	**29**	**56**	**99**	**175**	**920**	**3,405**

Source: DeGolyer and MacNaughton, compiled by Kotak Institutional Equities

Imperial's historical financials may not be indicative of future potential

Select operational and financial data of Imperial Energy, calender year-ends, 2006-2007

	2007	2006	Change (%)
Total production (bbls)	833,799	127,000	557
Total oil sales (US$ mn)	19.9	3.1	542
Operating loss (US$ mn)	(39.0)	(15.2)	157
Operating cash inflow/(outflow)	1.1	(30.5)	(104)
Year-end cash and cash equivalents	131.7	95.3	38
Average realized price (US$/bbl)	33.4	24.4	37
Average cash operating cost (US$/bbl) (a)	29.8	44.9	(34)

Notes:

(a) Cash operating costs are cost of sales excluding depletion and amortization.

Source: Company, compiled by Kotak Institutional Equities

Shareholding pattern of Imperial Energy as of August 26, 2008 (%)

Name	Shareholding (%)
Baillie Gifford and Company	9.2
Schroders Plc	8.2
Dutsche Bank AG	6.8
Levine Peter Michael	6.1
Legal and General Group Plc	4.7
Citigroup Global Markets UK	3.5
London and Amsterdam Company	3.5
Directors and related holdings	3.2
Sloane Robinson LLP	2.8
HBOS Plc	2.6
Blackrock Inc	2.4
Standard Life Investments	2.4
Barclays Plc	2.4
SR Global Fund	2.3
JP Morgan Asset Management	2.3
Legal and General Investments	2.3
Sloane Robinson Investments	2.2
Fidelity Investments	2.0
Others	31.3
Total	**100**

Source: Bloomberg, compiled by Kotak Institutional Equities.

We value ONGC stock at Rs1,225 on US$50/bbl normalized crude price

Estimation of fair value of ONGC stock based on normalized free cash flow (Rs mn)

	2009E	2010E	2011E
A. Core business valuation			
Normalized crude price assumption (US$/bbl)	50.0	50.0	50.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	(39,027)	75,792	136,244
Add: OCF after normalizing natural gas price	33,209	25,799	22,802
Add: OCF after removing subsidies	341,591	240,644	202,766
Recurring OCF	335,773	342,236	361,812
Recurring capex			
Production per annum (mn bbls)	397	390	392
Replacement or F&D costs (US$/bbl)	9.0	9.0	9.0
Recurring capex	149,943	145,624	144,749
Free cash flow	**185,830**	**196,612**	**217,063**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,672,470	1,769,509	1,953,568
(Net debt)/cash	421,778	591,438	769,418
Investments	89,396	94,339	99,280
Equity value	2,183,644	2,455,285	2,822,266
Equity value of core business (Rs/share)	**1,021**	**1,148**	**1,319**
B. New discoveries valuation			
KG-DWN-98/2 block (Rs/share)	49	55	62
MN-DWN-98/3 block (Rs/share)	15	16	18
Equity value of new discoveries (Rs/share)	**64**	**71**	**80**
Total equity value per share (Rs/share)	**1,085**	**1,219**	**1,399**

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of ONGC, March fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)									
Net sales	467,124	707,083	807,603	966,542	1,112,856	1,318,269	1,306,779	1,357,689	1,359,565
EBITDA	**196,494**	**281,195**	**310,054**	**358,001**	**396,431**	**491,757**	**511,291**	**541,720**	**516,836**
Other income	23,752	17,595	27,350	45,378	55,402	54,641	65,954	75,396	90,523
Interest	(5,028)	(2,512)	(537)	394	(8,705)	(6,782)	(4,460)	(4,552)	(5,228)
Depreciation and depletion	(65,525)	(73,465)	(97,726)	(119,550)	(131,142)	(126,468)	(104,045)	(95,812)	(92,818)
Pretax profits	149,693	222,813	239,141	284,222	311,986	413,148	468,740	516,752	509,313
Tax	(46,101)	(74,690)	(71,196)	(88,986)	(103,319)	(128,296)	(144,346)	(149,316)	(148,281)
Deferred tax	(7,779)	(4,744)	(13,612)	(9,264)	(7,799)	(2,597)	(2,110)	(6,127)	(4,762)
Net profits	95,523	143,175	154,596	178,414	203,543	282,255	322,284	361,310	356,270
Net profits after minority interests	**94,219**	**140,670**	**153,542**	**176,922**	**200,230**	**276,471**	**319,149**	**359,026**	**354,163**
Earnings per share (Rs)	**44.1**	**65.8**	**71.8**	**82.7**	**93.6**	**129.3**	**149.2**	**167.9**	**165.6**
Balance sheet (Rs mn)									
Total equity	415,582	488,912	578,830	670,137	791,309	979,588	1,184,768	1,406,230	1,622,596
Deferred tax liability	54,250	57,911	71,557	80,976	88,775	91,371	93,481	99,607	104,370
Liability for abandonment cost	80,292	80,941	128,675	151,857	151,857	151,857	151,857	151,857	151,857
Total borrowings	60,961	39,028	28,767	21,826	33,342	33,765	53,392	80,292	68,692
Currrent liabilities	85,376	128,346	142,435	187,051	126,940	116,134	116,629	118,746	122,448
Total liabilities and equity	**696,461**	**795,138**	**950,264**	**1,111,847**	**1,192,223**	**1,372,714**	**1,600,127**	**1,856,733**	**2,069,964**
Cash	95,721	101,843	90,743	206,262	296,582	455,543	644,830	849,710	1,083,099
Current assets	133,039	178,421	240,210	192,652	200,490	207,427	206,350	233,633	236,360
Total fixed assets	419,213	471,543	565,722	643,219	619,259	633,852	668,115	687,617	664,732
Goodwill	11,661	10,753	14,172	27,686	27,686	27,686	27,686	27,686	27,686
Investments	30,811	26,961	35,753	36,888	43,066	43,066	48,006	52,947	52,948
Deferred expenditure	6,017	5,617	3,663	5,141	5,141	5,141	5,141	5,141	5,141
Total assets	**696,461**	**795,138**	**950,264**	**1,111,848**	**1,192,223**	**1,372,715**	**1,600,127**	**1,856,734**	**2,069,966**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	133,261	187,001	216,736	252,772	236,515	288,103	315,830	350,622	328,993
Working capital changes	25,630	18,787	46,461	(4,990)	(66,300)	(80,989)	32,541	(4,147)	976
Capital expenditure	(56,301)	(103,418)	(113,738)	(135,049)	(53,154)	(74,700)	(94,098)	(81,369)	(38,938)
Investments	(10,608)	(9,887)	(28,912)	53,822	(6,179)	—	(4,940)	—	—
Other income	9,767	13,049	14,537	20,422	54,402	55,016	65,954	75,396	90,523
Free cash flow	**101,749**	**105,532**	**135,083**	**186,976**	**165,284**	**187,430**	**315,286**	**340,503**	**381,553**
Ratios (%)									
Debt/equity	14.7	8.0	5.0	3.3	4.2	3.4	4.5	5.7	4.2
Net debt/equity	(8.4)	(12.8)	(10.7)	(27.5)	(33.3)	(43.1)	(49.9)	(54.7)	(62.5)
RoAE	21.6	28.0	25.9	25.5	24.8	28.7	27.6	26.2	22.2
RoACE	**20.6**	**24.6**	**22.0**	**22.1**	**21.3**	**25.4**	**24.5**	**23.6**	**20.4**
Key assumptions									
Rs/dollar rate	46.0	45.0	44.3	45.3	40.3	42.0	41.5	41.0	40.0
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	78.9	110.0	95.0	90.0	90.0
Ceiling/actual natural gas price (Rs/'000 cm)	2,850	2,850	3,515	4,211	4,250	4,250	4,750	5,000	5,250
Subsidy loss (Rs bn)	26.9	41.0	119.6	170.2	220.0	500.0	350.0	290.0	290.0

Source: Kotak Institutional Equities estimates.

Technology

INFY.BO, Rs1698	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	2,100
52W High -Low (Rs)	2142 - 1212
Market Cap (Rs bn)	974.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	166.9	214.9	260.2
Net Profit (Rs bn)	45.4	58.6	67.8
EPS (Rs)	79.1	102.1	118.1
EPS gth	*18.0*	*29.1*	*15.7*
P/E (x)	21.5	16.6	14.4
EV/EBITDA (x)	17.0	12.8	10.3
Div yield (%)	2.0	1.4	1.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	16.5	-	-
FIIs	52.7	7.9	5.0
MFs	3.9	3.2	0.3
UTI	-	-	(2.9)
LIC	3.6	2.5	(0.4)

Infosys Technologies: Axon results and why we think the proposed acquisition will provide sweet sap

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- **Axon's 1HCY08 results—strong on revenues, weak on margins**
- **Several positives from the acquisition; integration challenges the key risk**
- **Risk of a counter-bid low, in our view**
- **Reiterate BUY with a target price of Rs2,100/share**

Axon's 1HCY08 results depict strong revenue growth and margin pressure, both driven by robust growth in the US geography; we highlight that Axon's NA operations have lower margins than its EMEA business. Revenues in 1HCY08 grew 23% yoy to £124 mn, while EBIT margins at 13.3% were 100 bps below 1HCY07. We reiterate our positive stance on Infosys' proposed acquisition of Axon given (1) it helps Infosys bridge the gap in the scale of its SAP offerings compared to peers, thereby strengthening its relationship with SAP, (2) it positions Infosys better to participate in large SAP global rollout bids, (3) it provides Infosys domain expertise in some of its new (and smaller) verticals like government, utilities, aerospace, etc. and (4) provides Infosys access to marquee client names like Barclays, Xerox, Union Pacific, Air Canada and Goodrich; we note that there is minimal overlap in the client base of the two companies. EPS accretion from the deal hinges on Infosys' ability to improve Axon's margins to its own onsite margin levels (3-4 %pts higher, in our view). We maintain our BUY rating on Infosys with a target price of Rs2,100.

Axon's 1HCY08 results—strong on revenues, weak on margins. Axon reported 1HCY08 revenues of £124 mn, up 23% yoy, and aided partially by a couple of small acquisitions. Revenue growth was driven by strong momentum in the North America geography, which now contributes to 40% of Axon's revenues. EBIT margin declined 100 bps yoy, despite 200 bps benefit from G&A rationalization. Margin decline was driven by faster revenue growth in the low-margin North America business. Axon expects strong revenue growth to continue in 2HCY08, driven by a strong order book and increasing traction in the NA market.

Sweet sap: If successful, acquisition likely to enhance Infosys offerings

- We see enhanced scale in SAP offerings as the key positive for Infosys from the acquisition. Infosys has been lagging behind other tier-I Indian IT players in the SAP space (despite the strong 65% SAP revenue CAGR over the past three years). Its consultant strength of 2,100 is lower than Wipro (~2,700), Satyam (~5,000), as well as TCS (4,000). Axon acquisition will help bring Infosys on an equal footing in the SAP implementation market.
- Complementary verticals and client base provide Infosys with opportunities to (a) enhance its domain expertise in new verticals and (b) to cross-sell services to new clients.
- The acquisition enhances Infosys' ability to compete for and win more large deals and global SAP rollout bids in the market. We believe this would have been one of the primary motivators behind the deal.
- Enhances Infosys' consulting team strength—Infosys has been focused on building its consulting organization for the past four years.

- Integration challenges are the key risk to the acquisition, in our view. Axon is one of the largest acquisitions made by an Indian IT company. Also, the pure onsite nature of Axon's business and its high cost per consultant (~US$11,200/month in CY2007) could impede successful integration. In comparison (though not strictly), Infosys' average onsite cost per employee was US$7,070/month in 1QFY09.
- High client concentration (top-5 clients contributed 50% to 1HCY08 revenues, top-10, 61%) of Axon is also another key risk. On the positive side though, high client concentration also indicates Axon's ability to take on large SAP rollouts.

Risk of a counter-bid low, in our view. Axon's stock price rose to levels higher than Infosys' offer price of 600 pence in the LSE post the announcement of Infosys' acquisition proposal. This perhaps indicates anticipation of a counter-bid, in our view. However, we highlight that unlike in acquisitions of product companies, we have not seen many instances of counter-bids in the pursuit of acquisitions of services companies. We would assign a low probability to a counter-bid for Axon, and expect the acquisition to consummate in the timeframe specified by Infosys (by end-November 2008).

Interim results of Axon Group PLC (£ mn), December fiscal year-ends, 2007-2008

	1HCY07	1HCY08	yoy change (%)
Revenues	**96.7**	**123.9**	**28.2**
Cost of revenues	(69.0)	(92.0)	33.4
Option expenses	(0.9)	(2.0)	113.6
Gross profits	**26.8**	**29.9**	**11.8**
G&A expenses	(11.3)	(11.8)	4.5
EBITA	**15.5**	**18.1**	**17.2**
Amortization of intangibles	(1.7)	(1.6)	(2.5)
EBIT	**13.8**	**16.5**	**19.6**
Interest costs	(0.6)	(0.6)	11.7
Interest and other income	0.2	0.4	101.5
PBT	**13.4**	**16.3**	**21.2**
Tax	(5.0)	(5.4)	8.4
PAT	**8.4**	**10.8**	**28.8**
Margins (%)			
Gross profit	27.7	24.2	
EBITA	16.0	14.6	
EBIT	14.3	13.3	
PBT	13.9	13.1	
PAT	8.7	8.7	

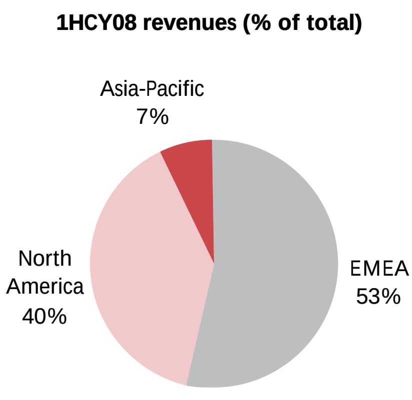
Source: Axon interim reports

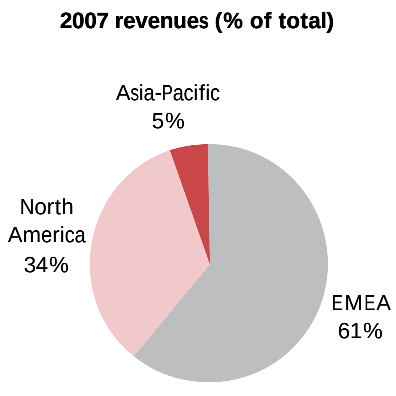
Profit and loss statement of Axon Group PLC (£ mn), December fiscal year-ends, 2004-2007

	2004	2005	2006	2007
Revenues	**60.3**	**87.9**	**137.5**	**204.5**
Cost of revenues	(43.0)	(62.9)	(96.1)	(145.9)
Option expenses	(0.3)	(0.8)	(1.4)	(2.3)
Gross profits	**17.0**	**24.1**	**40.0**	**56.3**
G&A expenses	(11.2)	(13.3)	(19.4)	(22.2)
EBITA	**5.7**	**10.8**	**20.6**	**34.1**
Amortization of intangibles	(0.1)	(0.8)	(2.6)	(3.6)
EBIT	**5.6**	**10.0**	**17.9**	**30.5**
Interest costs	(0.0)	(0.3)	(0.7)	(1.3)
Interest and other income	1.0	0.7	0.5	0.4
PBT	**6.6**	**10.4**	**17.7**	**29.5**
Tax	(1.9)	(3.4)	(5.3)	(9.3)
PAT	**4.7**	**7.0**	**12.4**	**20.2**
Growth yoy (%)				
Revenues		45.8	56.5	48.7
EBITA		88.2	90.7	65.4
EBIT		76.8	79.8	69.8
PBT		57.2	70.5	66.9
PAT		49.3	76.8	63.0
Margins (%)				
Gross profit	28.2	27.5	29.1	27.5
EBITA	9.5	12.3	15.0	16.7
EBIT	9.4	11.4	13.0	14.9
PBT	11.0	11.8	12.9	14.4
PAT	7.8	8.0	9.0	9.9

Source: Axon annual reports

Decline in OPM was driven by higher proportion of revenues from lower-margin NA geography





Source: Company

Axon is the largest acquisition made by an Indian IT service company; the large size and 'pure onsite' nature brings with itself unique integration challenges

IT services acquisitions made by Infosys, Wipro, and TCS over the past seven years

	Date	Target	Country	Business Description	Consideration (mn)	Sales (mn)	Price/Sales
Infosys							
	Aug-08	Axon Group PLC	UK	SAP consulting and implementation	£407.1	£204.0	2.0
	Dec-03	Expert Information Services	Australia	IT Services Consulting	$23.0	$32.9	0.7
Wipro							
	Aug-07	Infocrossing	US	Data centers, IMS	$600.0	$251.0	2.4
	Oct-06	3D Networks & Planet PSG	Singapore	Infrastructure Management Services	$73.0	$36.0	2.0
	Jun-06	Saraware Oy	Finland	R&D Services (Telecom)	EUR 25.0	EUR 14.7	1.7
	Jun-06	Enabler	Portugal	Retail Solutions	EUR 41.0	EUR 29.3	1.4
	May-06	Quantech Global Services	US	Mechanical Engineering Design & Anaytics	$10.0	NM	NM
	Feb-06	cMango Inc	US	IT consulting	$32.0	$12.8	2.5
	Dec-05	mPower & MPACT	US	Payments market	$28.0	$18.0	1.6
	Dec-05	NewLogic	Austria	Chip (SoC) Design	EUR 47.0	EUR 13.8	3.4
	Apr-03	NerveWire	US	IT Services - BFSI, Hi-Tech	$18.7	$20.8	0.9
	Nov-02	AMS Global Energy Practice	US	IT Services - Energy, Utilities	$26.0	$23.6	1.1
TCS							
	Nov-06	TCS Management	Australia	IT Services Consulting	$13.0	$4.3	3.0
	Nov-06	TKS-Teknosoft (75% stake)	Switzerland	IT Services - BFSI	$80.0	$57.0	1.4
	Nov-05	Comicrom	Chile	BPO	$23.0	$32.9	0.7
	Oct-05	Financial Network Services	Australia	Core Banking Solutions	$26.0	$21.7	1.2
	Oct-05	Pearl Group BPO	UK	Insurance BPO	INR 4,261.0	INR 4,278.0	1.0
	May-04	Phoenix Global Solutions	US	Insurance BPO	$13.0	$11.8	1.1

Source: Kotak Institutional Equities

Infosys Technologies: Consolidated Indian GAAP income statement (Rs mn)

Rs mn	2007	2008	2009E	2010E	2011E
Revenues	**138,930**	**166,920**	**214,907**	**260,204**	**311,873**
Software Development Costs	(74,580)	(92,070)	(118,522)	(143,907)	(177,285)
Gross profit	**64,350**	**74,850**	**96,385**	**116,297**	**134,588**
Selling and marketing exp	(9,290)	(9,160)	(12,306)	(15,177)	(18,036)
Administration exp	(11,150)	(13,310)	(16,581)	(20,998)	(25,068)
Total SG&A Expenses	(20,440)	(22,470)	(28,887)	(36,175)	(43,103)
EBITDA	**43,910**	**52,380**	**67,499**	**80,122**	**91,485**
Depreciation	(5,140)	(5,980)	(6,969)	(8,388)	(10,217)
EBIT	**38,770**	**46,400**	**60,530**	**71,734**	**81,268**
Interest	—	—	—	—	—
Other Income	3,750	7,040	7,679	9,720	10,376
Profit Before Tax	**42,520**	**53,440**	**68,209**	**81,454**	**91,644**
Provision for Tax	(5,100)	(8,060)	(9,616)	(13,673)	(18,489)
Net Profit	**37,420**	**45,380**	**58,593**	**67,781**	**73,154**
Minority Interest	(110)	—	—	—	—
Net Income	**37,310**	**45,380**	**58,593**	**67,781**	**73,154**
Extraordinaries	1,250	1,210	310	—	—
Net Profit- Reported	**38,560**	**46,590**	**58,903**	**67,781**	**73,154**
EPS (Rs/ share)	**67.0**	**79.1**	**102.1**	**118.1**	**127.4**
No of shares outstanding (mn)	562.8	574.0	574.0	574.0	574.0
Margins (%)					
Gross Profit margin	46.3	44.8	44.8	44.7	43.2
EBITDA Margin	31.6	31.4	31.4	30.8	29.3
EBIT Margin	27.9	27.8	28.2	27.6	26.1
NPM	26.9	27.2	27.3	26.0	23.5
Growth Rates (%)					
Revenues	45.9	20.1	28.7	21.1	19.9
Gross Profit	44.4	16.3	28.8	20.7	15.7
EBITDA	42.0	19.3	28.9	18.7	14.2
EBIT	46.1	19.7	30.5	18.5	13.3
Net Profit	50.9	21.3	29.1	15.7	7.9
Net Income	51.8	21.6	29.1	15.7	7.9

Source: Kotak Institutional Equities estimates.

Consumer products

HLL.BO, Rs247	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	260
52W High -Low (Rs)	256 - 169
Market Cap (Rs bn)	538.4

Financials

December y/e	2007	2008E	2009E
Sales (Rs bn)	137.2	154.7	174.8
Net Profit (Rs bn)	17.7	20.0	23.1
EPS (Rs)	8.1	9.2	10.6
EPS gth	*15.3*	*13.8*	*15.1*
P/E (x)	30.5	26.8	23.3
EV/EBITDA (x)	24.5	20.9	17.7
Div yield (%)	4.3	3.5	4.1

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	52.1	-	-
FIIs	14.4	1.0	(0.3)
MFs	3.7	1.3	0.0
UTI	-	-	(1.3)
LIC	7.3	2.3	1.0

Hindustan Unilever: Channel checks indicate moderation in volume growth, retain REDUCE and target price of Rs260/share

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- **Channel checks indicate 6% volume growth for HUL in June-August**
- **Crude palm oil price correction provides cost comfort, significant margin expansion unlikely**
- **Street excitement about HUL's Foods business over the top—expect new niche categories**
- **Expect a good September quarter aided by 2.5% volume growth in base**
- **History of HUL's market shares losses in all key categories over a 1, 3 and 8 year period is discomfiting**
- **Retain target price of Rs260/share, reiterate REDUCE, sell into strength**

We recently met key distributors and trade marketing partners of HUL in North and South India. Volume growth has tapered down to 6% in June-August from 9% in the last three quarters. The deceleration in volume growth is on the back of a favorable base (2.5% volume growth in base). HUL is developing Foods business on three planks: (1) child and adult nutrition (2) cooking aids and soups and (3) vitality-based snacking (salt free / sugar free). Expect development of niche categories in foods by HUL over the next 3-5 years. Significant margin expansion from the recent 20% price correction in CPO is unlikely. History of market share losses for HUL in all key categories over a 1, 3 and 8 year horizon suggests that there is competition with significant market share ambitions and hence the ability for HUL to retain gains from cost comfort is limited. At the current market price of Rs247/share, the stock trades at 27XCY08E and 24XCY09E. Current PE is at a 1-year high and a 3-year average. We retain our target price of Rs260/share, REDUCE rating and advise clients to sell into strength. We believe that business fundamentals do not support a case for absolute stock performance from here. Key upside risks to our estimates include (1) decline in crude oil prices resulting in cost comfort (2) effective price increases through pack-size reduction in HPC without significantly impacting product demand and (3) inability of ITC to gain market shares in HPC categories.

Channel checks indicate moderation in volume growth

We recently met key distributors and trade marketing partners of HUL in North and South India. Key takeaways from our meetings are:

1. Volume growth is tapering down to about 6% levels in June-August from 9% in the the past three quarters. Category wise, indicative volume growth is: Soaps -1%, Detergents +8%, Personal products +6%
2. We highlight that the deceleration in volume growth is on the back of a favorable base (only 2.5% volume growth in July-September 2007)
3. The 'T-20' sales incentive scheme helped in achieving volume growth of about 9% in Jan-June 2008. The extension of 'T-20' as 'S-20' for the rest of the year is yet to be a success
4. Infiltration of consumer promotions meant for modern retail into general trade—some portion of market share gains in modern retail is effectively market share losses in general trade plus sales loss

5. Sustenance of good growth in detergents confirms that the category is in a sweet spot for sales growth. Market share gains in detergents are expected to continue as higher prices of key inputs like LAB, Soda ash and Caustic soda are driving out marginal players
6. Modest success for HUL's LUP offering 'Pepsodent Mahapack' and 'Amaze' healthfood launched in early 2008
7. Higher trade promotions in 'Rin' detergent brand—to counter P&G's 'Tide'

However, we are enthused by the structural changes in HUL sales system. We believe that some of the initiatives undertaken by the company over the past few years are critical in helping HUL leverage size and scale, these are (1) continuous replenishment system for primary sales, (2) appointment of Activation Executives to improve efficacy of activation at point-of-purchase and (3) consolidation of distributors, providing percolation of scale benefits to the distribution system.

Expect development of niche categories in Foods

In a recent management interaction, HUL indicated that the foods business will be developed on three planks, (1) child nutrition and adult nutrition (2) cooking aids and soups and (3) vitality-based snacking (salt free / sugar free etc). While we are excited about the niches which HUL is trying to build (for example, category captaincy for 'Knorr' brand in soups/cooking aids and healthfood under the brainfood platform without taking on malted health drinks directly), we highlight that it will be a slow accretive process which will likely bear fruit over 3-5 years.

Recent correction in crude palm prices provides cost comfort

Crude palm oil (key input for soaps) prices have corrected 20% in the past month and are 35% below the peak touched in March 2008. We estimate that CPO will account for about 16% of HUL's input costs; a 10% correction in price adds 70 bps to EBITDA and 4% to EPS. However, significant margin expansion is unlikely as (1) industry volume growth is likely to be -1% in soaps (therefore the chances of a price cut to stimulate demand is high) (2) we are likely to see an increase in advertisement and promotion to block ITC's aggressive marketing of its personal care brands and (3) higher margins in soaps can be channeled for cross-subsidizing the personal products category.

Moreover, the history of market shares losses for HUL in all key categories over a 1, 3 and 8 year horizon (Exhibit X) suggests that there is competition with significant market share ambitions and hence the ability for HUL to retain gains from cost comfort is limited.

Retain target price of Rs260/share, reiterate REDUCE, sell into strength

We believe HUL will deliver 15% earnings CAGR over CY2007-09E. A favorable base will likely aid topline growth for the September quarter as well, yet-to-be-anniversaried price increases will provide about 7% topline growth for the next few quarters. We believe pricing power is limited from here and competitive pressures warrant higher adspends. At the current market price of Rs247/share, the stock trades at 27XCY08E and 24XCY09E. Current PE is at a 1-year high and at a last 3-year average. Noting limited upside to our DCF-based one-year target price of Rs260/share and on a relative basis (11% upside in Sensex), we reiterate our REDUCE rating and advise clients to sell into strength. The stock has demonstrated excellent defensive characteristics and has delivered a relative return (vis-à-vis Sensex) of 15%, 25% and 22% over the past 3, 6 and 12 months, respectively. We believe that business fundamentals do not support a case for absolute stock performance from here.

Key upside risks to our estimates include (1) decline in crude oil prices resulting in cost comfort for HUL (2) effective price increases through pack-size reduction in HPC without significantly impacting product demand and (3) inability of ITC to gain market shares in HPC categories.

History of consistent market share losses doesnot provide confidence in sustainable growth

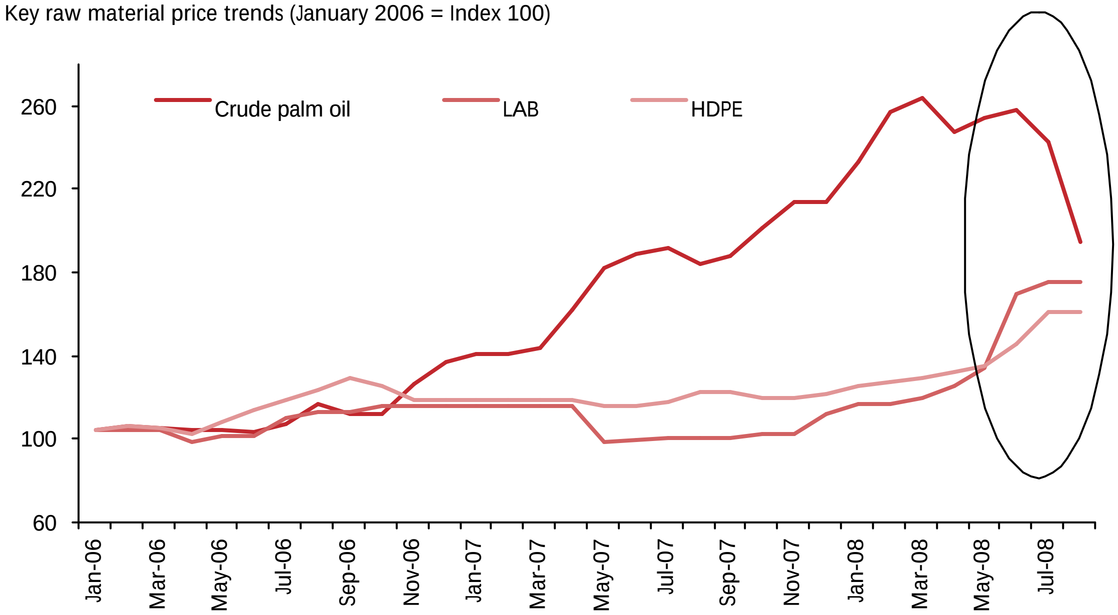
Changes in value market shares (bps)

Timeline	Period	Soaps	Detergents	Toothpaste	Shampoo	Skin	Tea
2000-2008	8-years	(650)	(320)	(540)	(1940)	(260)	(1320)
2005-2008	3-years	(220)	150	(210)	(70)	(380)	(560)
2006-2008	1-year	(230)	400	(40)	(180)	(250)	(30)

Source: Company, Kotak Institutional Equities.

Short term cost comfort emerging in key inputs

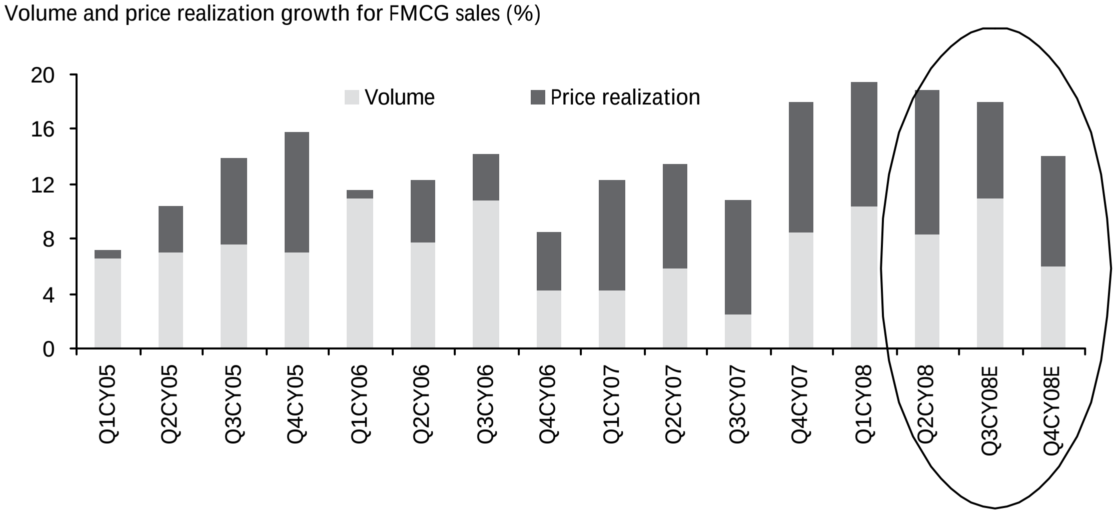
Key raw material price trends (January 2006 = Index 100)



Source: Bloomberg, Reliance Industries, Kotak Institutional Equities.

Pricing-led growth to contribute about 7% for rest of CY08E

Volume and price realization growth for FMCG sales (%)



Source: Company data, Kotak Institutional Equities estimates.

HUL: Profit model, balance sheet, cash model 2005-2008E, December year-ends (Rs mn)

	2005	2006	2007	2008E	2009E
Profit model (Rs mn)					
Net sales	110,605	121,034	137,178	161,678	183,162
EBITDA	**14,433**	**16,621**	**18,883**	**22,014**	**25,695**
Other income	3,048	3,545	4,448	4,469	4,905
Interest	(192)	(107)	(204)	(225)	(75)
Depreciation	(1,245)	(1,302)	(1,384)	(1,487)	(1,662)
Extraordinary items	976	3,155	1,581	0	0
Pretax profits	17,021	21,912	23,324	24,772	28,864
Tax	(2,530)	(2,950)	(3,782)	(4,481)	(5,742)
Deferred taxation	(410)	(268)	(389)	(563)	(589)
Net profits	**14,081**	**18,694**	**19,153**	**19,728**	**22,533**
Earnings per share (Rs)	**6.0**	**7.0**	**8.0**	**9.1**	**10.4**
Balance sheet (Rs mn)					
Total equity	23,056	27,235	14,392	15,459	16,678
Total borrowings	569	726	885	885	885
Currrent liabilities	41,183	45,231	51,110	56,111	63,341
Total liabilities and equity	**64,809**	**73,191**	**66,387**	**72,456**	**80,905**
Cash	3,550	4,169	2,009	(1,338)	1,368
Current assets	24,080	27,527	30,765	36,041	40,676
Total fixed assets	14,835	15,110	17,081	18,560	20,258
Investments	20,142	24,139	14,408	17,632	17,632
Deferred tax asset	2,201	2,245	2,124	1,561	972
Total assets	**64,809**	**73,191**	**66,387**	**72,456**	**80,905**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	15,908	20,209	20,741	21,848	24,888
Working capital	5,858	(471)	3,092	959	1,748
Capital expenditure	(904)	(1,576)	(3,355)	(2,965)	(3,360)
Investments	2,452	(4,309)	9,294	(3,224)	0
Free cash flow	**23,314**	**13,852**	**29,772**	**16,618**	**23,276**
Key assumptions					
Revenue Growth (%)	11.4%	9.4%	13.3%	17.9%	13.3%
EBITDA Margin(%)	13.2%	13.9%	14.0%	13.6%	14.0%

Source: Kotak Institutional Equities estimates.

Media

SUTV.BO, Rs242	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	260
52W High -Low (Rs)	443 - 225
Market Cap (Rs bn)	95.2

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	8.7	11.0	13.2
Net Profit (Rs bn)	3.3	3.8	4.7
EPS (Rs)	8.3	9.7	12.0
EPS gth	*30.7*	*16.7*	*23.6*
P/E (x)	29.1	25.0	20.2
EV/EBITDA (x)	15.4	12.9	10.6
Div yield (%)	1.0	1.2	2.5

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	77.0	-	-
FIIs	7.2	0.1	(0.2)
MFs	1.4	0.1	(0.2)
UTI	-	-	(0.3)
LIC	-	-	(0.3)

Sun TV Network: FY2008 annual report review—higher-than-expected capex, investments in FM radio

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- **Annual report reveals higher-than-expected capex and investments in FM radio**
- **However, FY2008 core EBITDA stronger than reported EBITDA given one-offs**
- **Some pressure on film acquisitions; aggressive competition jacking up prices**
- **Retain REDUCE with 12-month DCF based TP of Rs260 (Rs265 previously)**

We have revised downwards our FY2009E, FY2010E and FY2011E EPS estimates for Sun Networks to Rs9.7, Rs12.0 and Rs14.7, respectively, from Rs10, Rs12.7 and Rs15.2, after incorporating detailed financial statements available in Sun's FY2008 annual report—(1) higher-than-expected capital expenditure and investments in the FM radio business and (2) lower other income and higher depreciation as a result. Nonetheless, we expect Sun's FY2009E, FY2010E and FY2011E EBITDA to grow strongly to Rs6.5 bn, Rs7.8 bn and Rs9.3 bn, respectively, from Rs5.3 bn in FY2008 led by (1) robust 15% CAGR in ad revenues and (2) strong 19% CAGR in domestic pay-TV revenues. However, rich valuations leave little room for any significant upside and we retain our REDUCE rating with 12-month DCF-based TP of Rs260 (Rs265 previously). Key upside risks stem from higher-than-expected ad and subscription revenues.

FY2008 annual report analysis

Higher-than-expected capital expenditure. Sun TV Network reported consolidated capital expenditure of Rs1.8 bn in FY2008, which includes Rs985 mn spend on purchase of an aircraft; the capex on core operations was largely in line with our estimates. The management had attributed the purchase of the aircraft at the time of the purchase to increased travel by the management after start of the company's radio operations (spread over 45 cities).

We otherwise find Sun's balance sheet to be clean and strong with cash holdings of Rs4.3 bn as of end-FY2008. We believe this will hold the company in good stead in successfully completing existing expansion plans in its core operations (niche TV channels, FM radio) and any potential M&A opportunities. We also highlight Rs2.5 bn of free cash flow Sun TV is expected to generate in FY2009E, which can be used to increase dividend payout to shareholders (27% in FY2008).

Clarifications—strategic alliance with Red FM a lot more expensive than previously disclosed. We find the acquisition cost of Sun TV's (through its 64.1% subsidiary South Asia FM Limited—SAFL) 48.9% stake in Red FM's three radio stations (Delhi, Mumbai and Kolkata) to be far higher than previously understood by us and the street. We had previously understood the transaction to be an equity 'swap' as disclosed in the company's communication to the stock exchanges.

However, Sun's annual report reveals an investment of Rs1.8 bn by SAFL for the 48.9% stake in the three radio stations of Red FM; the promoters of Radio Today (erstwhile owners of Red FM) have incidentally acquired new licenses for Delhi, Mumbai and Kolkata for Rs236 mn. As part of the transaction, Red FM promoters and other companies have invested Rs762 mn into SAFL. We have highlighted our issues with Sun TV's disclosures previously (see our note "*Management clarifies on high 4QFY08 SG&A expenses belatedly; better disclosures will help*" dated July 04, 2008). Exhibit 1 gives details on the transaction.

Moderate pressure on film acquisition costs but already built into our model We note the increasing competitive intensity in the South Indian regional broadcasting segment (see Exhibits 2-5), driven by entry of new broadcasters and renewed investment by extant broadcasters. Sun TV has maintained its leadership position in the market but is starting to feel the pressure of competition; Sun TV's spend on acquisition of film rights has increased to Rs1.1 bn in FY2008 versus Rs806 mn in FY2007, the increase being attributed by Sun TV management to increase in number of films acquired as well as pressure on acquisition costs due to competition.

However, core EBITDA growth remains strong. We highlight Rs494 mn of provisions and write-offs related to bad and doubtful debt in FY2008 audited results, which is 5.7% of Sun's FY2008 revenues. We note the company had reviewed its debtors' position in 4QFY08 and written-off receivables related to pre-merger Gemini and Udaya TV accounts; thus, Sun TV's underlying FY2009 EBITDA was significantly ahead of reported EBITDA. Sun TV also reported significant synergies post merger of Gemini and Udaya TV with the company as its cost of programming and production declined to Rs458 mn in FY2008 from Rs541 mn in FY2007, despite the expansion in the FM radio business.

Earnings changes; rich valuations. After accounting for one-offs and synergy benefits of the merger, our EBITDA estimates for FY2009E and FY2010E have increased marginally to Rs6.5 bn (Rs6.4 bn previously) and Rs7.8 bn (Rs7.8 bn), respectively. However, our EPS estimates for FY2009E and FY2010E stand reduced to Rs9.7 (Rs10 previously) and Rs12.0 (Rs12.7), respectively, due to (1) lower other income and (2) higher depreciation on account of higher-than-expected capex and investments in the radio business, as highlighted previously. Sun TV stock is richly valued at 25X FY2009E and 20.2XFY2010E consolidated EPS and leaves little room for any upside; we also see scope for negative surprises from Sun TV's FM radio business given (1) it has been a laggard in this segment and (2) large amount of ad inventory in the market post launch of over 200 radio channels in a short period of time.

Sun TV/SAFL's valuation of three Red FM radio stations is above our expectation

Valuation of Red FM's three stations in Delhi, Mumbai and Kolkata (Rs bn)

		Comments
SAFL's stake in Red FM (%)	48.9	According to Sun TV FY2008 annual report
SAFL's investment in Red FM	1.83	According to Sun TV FY2008 annual report
Post-money equity valuation of Red FM	3.74	
Pre-money equity valuation of Red FM	1.91	
Debt on books of Red FM (assumed)	1.00	Red FM has been making losses for some time
Enterprise value of Red FM	**2.91**	
License fee paid by Red FM for its licenses	**0.51**	**For Delhi, Mumbai and Kolkata, in FY2007**
License fee paid by Radio Today for its licenses (a)	**0.24**	**For Delhi, Mumbai and Kolkata, in FY2007**

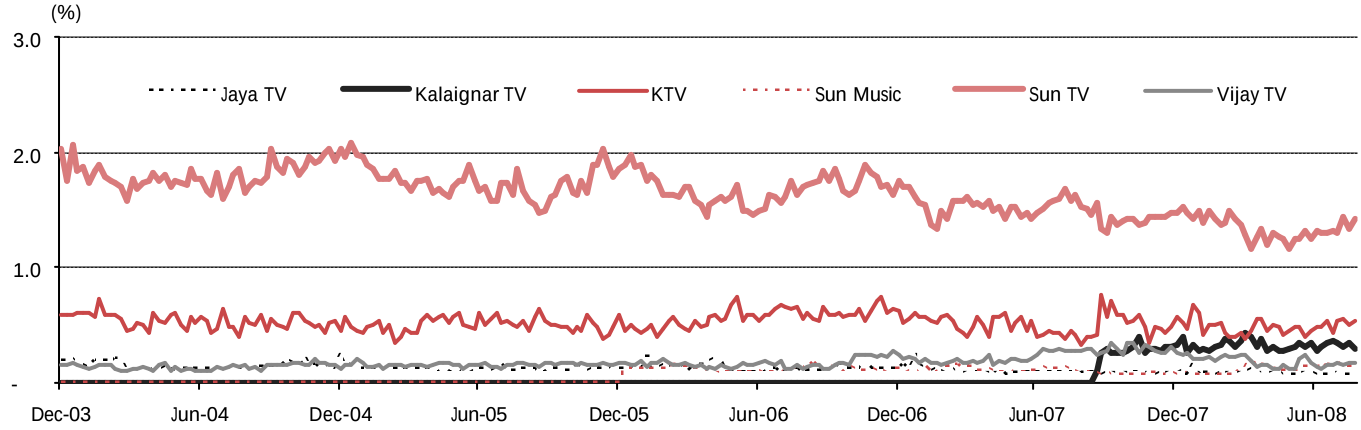
Notes:

(a) Radio Today is the erstwhile owner of Red FM.

Source: Kotak Institutional Equities estimates.

Sun TV leads the lucrative Tamil market; Kalaignar TV has been unable to leverage upon its impressive entry

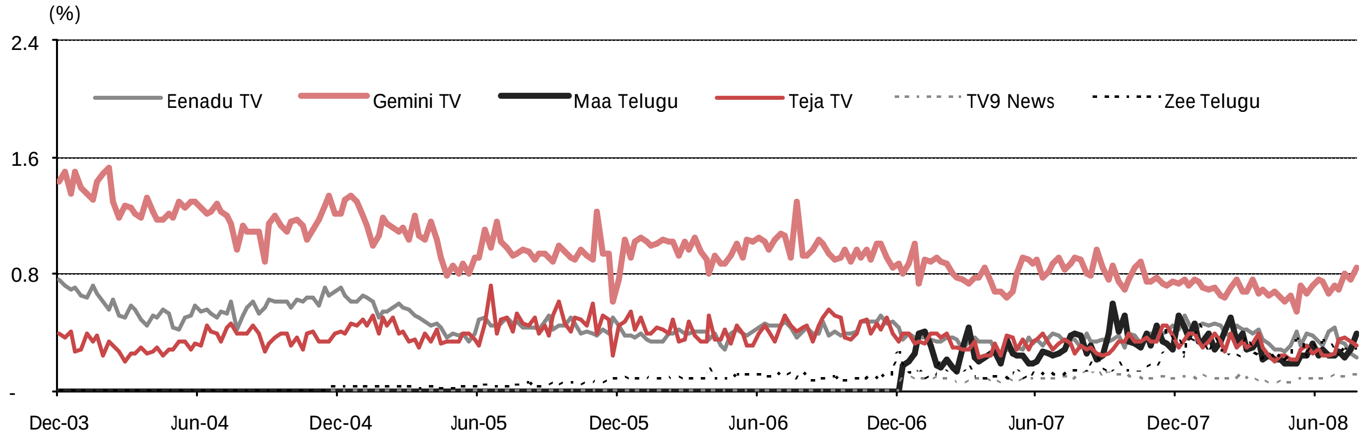
Prime-time (7:30-11:30 PM) ratings of major Tamil channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Sun's Gemini TV ratings have picked up in the last few months; new competition (Maa Telugu and Zee telugu) is not far behind

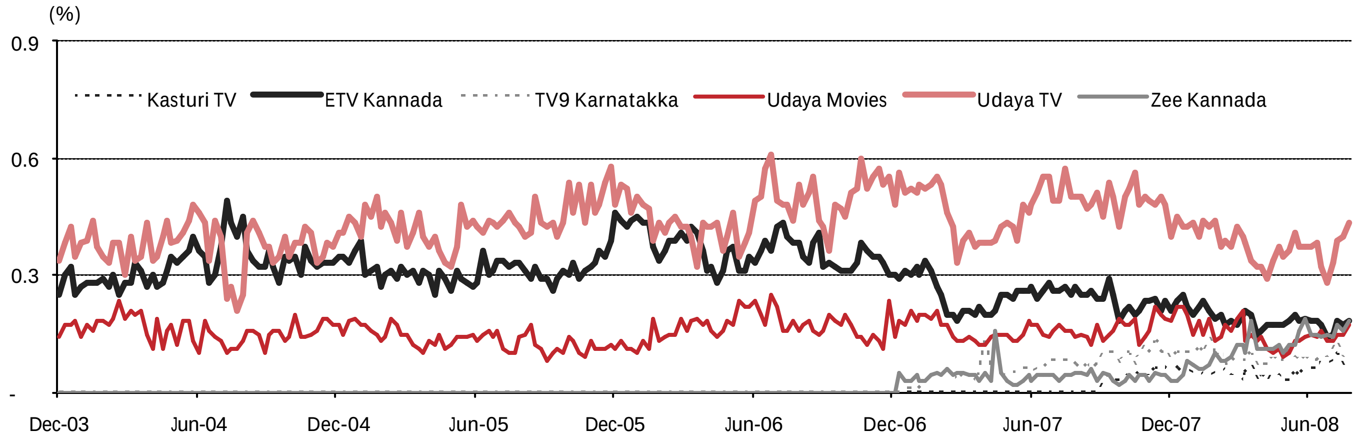
Prime-time (7:30-11:30 PM) ratings of major Telugu channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Sun's Udaya TV ratings have have been volatile over the last few months; Zee Kannada has done well in the last few months

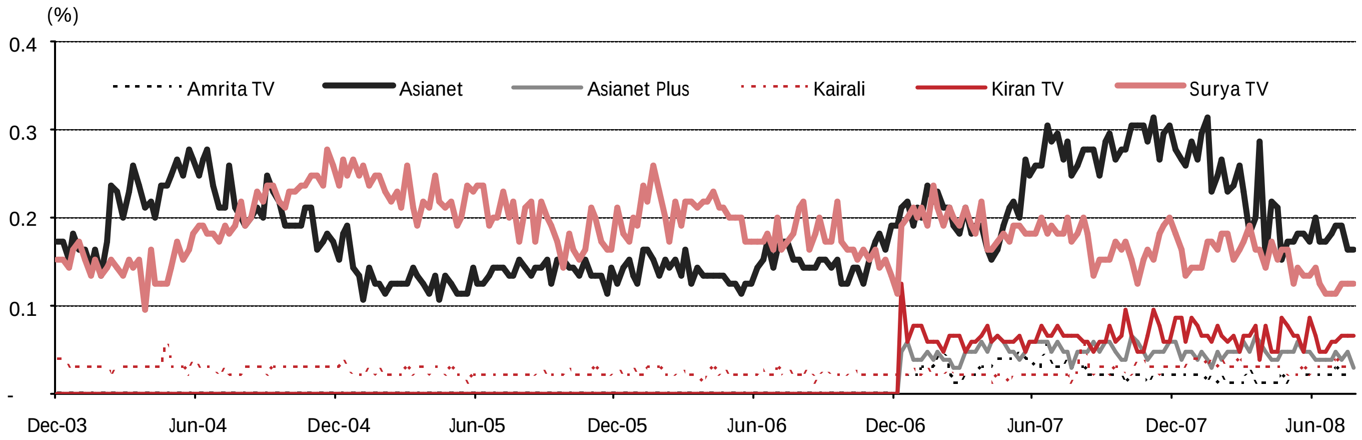
Prime-time (7:30-11:30 PM) ratings of major Kannada channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Asianet leads the Malayalam market, ahead of Sun's Surya and Kiran TV channels

Prime-time (7:30-11:30 PM) ratings of major Malayalam channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Our DCF-based target price for Sun TV is Rs260

DCF analysis of SunTV Network (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBITDA	**6,467**	**7,785**	**9,287**	**10,761**	**12,137**	**13,531**	**15,034**	**16,670**	**18,311**	**18,617**	—	—
Tax expense	(2,044)	(2,308)	(2,856)	(3,394)	(3,877)	(4,361)	(4,879)	(5,439)	(5,999)	(6,153)	—	—
Changes in working capital	(1,607)	(871)	(867)	(900)	(885)	(923)	(978)	(1,063)	(1,129)	(307)	—	—
Cash flow from operations	**2,816**	**4,606**	**5,564**	**6,467**	**7,375**	**8,246**	**9,177**	**10,168**	**11,184**	**12,157**	—	—
Capital expenditure	(1,050)	(375)	(400)	(425)	(450)	(475)	(500)	(525)	(550)	(575)	—	—
Cash flow to minority shareholders	181	(1)	(71)	(129)	(142)	(157)	(173)	(200)	(227)	1	—	—
Free cash flow	**1,947**	**4,231**	**5,093**	**5,913**	**6,782**	**7,615**	**8,504**	**9,443**	**10,406**	**11,583**	**12,220**	**12,892**
PV of free cash flow	**1,813**	**3,486**	**3,714**	**3,815**	**3,872**	**3,847**	**3,802**	**3,735**	**3,643**	**3,588**	—	—
Discounted cash flow-1 year forward		3,939	4,197	4,312	4,375	4,347	4,296	4,222	4,116	4,054	3,785	—
Discounted cash flow-2 year forward			4,743	4,873	4,946	4,913	4,855	4,771	4,653	4,581	4,277	3,993

	Now	+ 1-year	+ 2-years	
Total PV of free cash flow (a)	35,315	41,645	46,604	
FCF in terminal year	11,583	12,220	12,892	
Adjusted FCF in terminal year	11,537	12,220	12,892	Adjusting for FM radio business, which will end in FY2016/FY2017
Terminal value in terminal year	153,830	162,930	171,891	
PV of terminal value (b)	53,845	57,030	60,167	
Total company value (a) + (b)	**89,161**	**98,676**	**106,771**	
Value per share of Sun TV (Rs)	226	250	271	
Net debt/(cash)	(5,627)	(3,602)	(4,136)	
Value to equity holders	**94,787**	**102,278**	**110,908**	
Value to equity holders (Rs/Sun TV share)	**241**	**260**	**281**	

Source: Kotak Institutional Equities estimates.

We model Sun's revenues to grow strongly led by growth in pay-TV and FM radio revenues

Derivation of revenues of Sun TV/Sun TV Network, March fiscal year-ends, 2005-2013E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E
Advertisement revenues									
Sun TV	1,038	1,085	1,491	1,902	2,229	2,556	2,930	3,294	3,704
K TV	100	123	141	162	186	210	231	254	279
Sun News	28	39	47	55	63	71	80	88	97
Sun Music	2	94	122	163	188	211	237	261	287
Sun Kids	—	—	—	101	139	166	198	230	266
Sun Documentary	—	—	—	64	164	196	233	271	313
Sun Sports	—	—	9	103	145	147	147	161	177
Surya TV	226	386	476	574	633	714	805	896	998
Kiran TV	3	28	40	59	84	94	106	116	128
Gemini TV	—	—	467	625	736	835	939	1,044	1,161
Teja TV	—	—	44	51	58	65	72	79	87
Gemini News	—	—	35	41	47	53	59	65	72
Gemini Music	—	—	75	100	115	129	146	160	176
Udaya TV	—	—	428	538	615	698	785	873	971
Udaya Movies	—	—	43	49	56	63	70	77	84
Udaya Varthegulu (News)	—	—	25	29	34	38	42	47	51
Udaya TV 2	—	—	30	40	46	52	58	64	70
Total TV ad revenues	**1,397**	**1,755**	**3,472**	**4,655**	**5,538**	**6,299**	**7,138**	**7,981**	**8,923**
Radio	144	158	135	89	711	1,514	1,873	2,289	2,461
Total advertisement revenues	**1,542**	**1,913**	**3,608**	**4,745**	**6,249**	**7,812**	**9,011**	**10,270**	**11,384**
Broadcast revenues (or slot sales)									
Sun TV	455	531	607	721	847	932	1,025	1,128	1,241
Surya TV	38	60	60	73	78	86	95	104	115
Gemini TV	—	—	332	385	442	486	535	589	647
Udaya TV	—	—	86	117	130	143	157	173	190
Total broadcast revenues	**493**	**591**	**1,085**	**1,296**	**1,498**	**1,647**	**1,812**	**1,993**	**2,193**
Total ad and broadcast revenues	**2,034**	**2,504**	**4,692**	**6,041**	**7,746**	**9,460**	**10,824**	**12,264**	**13,577**
Pay-TV revenues									
Sun TV	398	447	667	1,106	1,340	1,590	1,942	2,303	2,689
Surya TV	—	—	—	—	47	160	204	249	299
Gemini TV	—	—	693	816	898	990	1,162	1,317	1,463
Udaya TV	—	—	310	393	434	480	578	676	769
Total pay-TV revenues	**398**	**447**	**1,669**	**2,315**	**2,718**	**3,219**	**3,886**	**4,545**	**5,219**
International revenues	88	183	339	370	462	477	486	483	480
Others	10	18	42	12	37	52	65	78	91
Sumangali Cable Vision (SCV)	356	—	—	—	—	—	—	—	—
Total revenues	**2,886**	**3,152**	**6,742**	**8,738**	**10,963**	**13,208**	**15,260**	**17,370**	**19,367**
Growth (%)	**7**	**9**	**114**	**30**	**25**	**20**	**16**	**14**	**11**

Source: Company, Kotak Institutional Equities estimates.

Consolidated profit model of Sun TV/SunTV Network, March fiscal year-ends, 2005-2013E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Net sales	**2,903**	**3,219**	**6,780**	**8,699**	**10,963**	**13,208**	**15,260**	**17,370**
Broadcasting costs	(75)	(71)	(95)	(112)	(131)	(130)	(128)	(125)
Production costs	(1,009)	(683)	(1,608)	(1,444)	(2,100)	(2,690)	(3,057)	(3,441)
Employee costs	(419)	(300)	(698)	(958)	(1,164)	(1,392)	(1,531)	(1,684)
SG&A costs	(95)	(131)	(506)	(924)	(1,101)	(1,212)	(1,257)	(1,359)
EBITDA	**1,306**	**2,035**	**3,874**	**5,261**	**6,467**	**7,785**	**9,287**	**10,761**
Other income	107	172	411	556	437	500	586	624
Interest (expense)/income	(35)	(65)	(64)	(159)	(138)	52—	—	—
Depreciation	(153)	(147)	(294)	(377)	(624)	(795)	(721)	(664)
Amortization	—	—	(56)	(148)	(235)	(235)	(235)	(195)
Pretax profits	**1,224**	**1,995**	**3,871**	**5,133**	**5,908**	**7,203**	**8,917**	**10,526**
Extraordinary inc/(chrg)	—	—	—	—	—	—	—	—
Prior period adjustments	—	—	—	—	—	—	—	—
Tax-cash	(454)	(709)	(1,509)	(1,947)	(2,153)	(2,461)	(3,057)	(3,608)
Tax-deferred	(3)	16	108	(67)	(126)	(30)	(16)	(12)
Minority interest	—	—	(9)	148	181	(1)	(71)	(129)
Net income	**768**	**1,302**	**2,461**	**3,267**	**3,811**	**4,712**	**5,773**	**6,777**
Shares outstanding year-end (mn)	248.0	248.0	394.1	394.1	394.1	394.1	394.1	394.1
Shares primary (mn)	248.0	248.0	388.1	394.1	394.1	394.1	394.1	394.1
Shares fully diluted (mn)	248.0	248.0	388.1	394.1	394.1	394.1	394.1	394.1
EPS primary (Rs)	**3.1**	**5.3**	**6.3**	**8.3**	**9.7**	**12.0**	**14.7**	**17.2**
EPS fully diluted (Rs)	**3.1**	**5.3**	**6.3**	**8.3**	**9.7**	**12.0**	**14.7**	**17.2**
Cash flow per share (Rs)	**5.0**	**6.9**	**8.3**	**10.4**	**12.8**	**16.4**	**19.4**	**22.3**
Growth (%)								
Net income	(1)	70	89	33	17	24	23	17
EPS	(28)	70	21	31	17	24	23	17
Gross cash flow	8	39	88	26	23	28	18	15
Tax rate-cash (%)	**37**	**36**	**39**	**38**	**36**	**34**	**34**	**34**
Tax rate-effective (%)	**37**	**35**	**36**	**39**	**39**	**35**	**34**	**34**
Dividend per share (Rs)	—	2	2	3	3	6	11	13
Dividend pay-out ratio (%)	—	45	24	30	31	50	75	75

Source: Company, Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of Sun TV for 2006 and SunTV Network for 2007-2012E, March fiscal year-ends, (Rs mn)

	2006	2007	2008	2009E	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	3,219	6,780	8,699	10,963	13,208	15,260	17,370
EBITDA	**2,035**	**3,874**	**5,261**	**6,467**	**7,785**	**9,287**	**10,761**
Other income	172	411	556	437	500	586	624
Interest (expense)/income	(65)	(64)	(159)	(138)	(52)	—	—
Depreciation	(147)	(294)	(377)	(624)	(795)	(721)	(664)
Amortization	—	(56)	(148)	(235)	(235)	(235)	(195)
Pretax profits	**1,995**	**3,871**	**5,133**	**5,908**	**7,203**	**8,917**	**10,526**
Tax-cash	(709)	(1,509)	(1,947)	(2,153)	(2,461)	(3,057)	(3,608)
Tax-deferred	16	108	(67)	(126)	(30)	(16)	(12)
Minority interest	—	(9)	148	181	(1)	(71)	(129)
Net profits after minority interests	**1,302**	**2,461**	**3,267**	**3,811**	**4,712**	**5,773**	**6,777**
Earnings per share (Rs)	**5.3**	**6.3**	**8.3**	**9.7**	**12.0**	**14.7**	**17.2**
Balance sheet (Rs mn)							
Total equity	3,071	11,932	14,485	16,914	18,859	19,567	20,397
Deferred Tax	32	(56)	11	137	166	183	194
Total borrowings	2,333	867	695	—	—	—	—
Currrent liabilities	741	1,693	2,516	2,651	2,814	2,916	3,022
Total capital	**6,209**	**14,478**	**18,311**	**20,124**	**22,264**	**23,160**	**24,236**
Cash	732	6,494	4,297	4,136	5,857	6,301	6,807
Current assets	2,440	3,221	4,542	6,284	7,319	8,287	9,293
Total fixed assets	2,830	3,543	5,048	5,681	5,261	4,939	4,700
Intangible assets	206	1,220	2,620	2,219	2,024	1,829	1,633
Total assets	**6,209**	**14,478**	**18,311**	**20,124**	**22,264**	**23,160**	**24,236**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	1,722	3,239	4,091	5,048	6,481	7,651	8,792
Working capital	(251)	(1,992)	(1,235)	(1,607)	(871)	(867)	(900)
Capital expenditure	(2,091)	(433)	(1,811)	(1,050)	(375)	(400)	(425)
Investments	(326)	(849)	(3,837)	(872)	(1,208)	(1,422)	(1,639)
Other income	80	402	523	437	500	586	624
Free cash flow	**(619)**	**814**	**1,046**	**2,391**	**5,235**	**6,384**	**7,467**
Ratios (%)							
Debt/equity	76.0	7.3	4.8	—	—	—	—
Net debt/equity	52.1	(47.2)	(24.9)	(24.5)	(31.1)	(32.2)	(33.4)
RoAE	36.1	32.9	24.8	24.2	26.1	29.8	33.6
RoACE	**26.6**	**26.8**	**24.2**	**24.8**	**27.3**	**31.0**	**34.9**

Source: Kotak Institutional Equities estimates.

Property

HDIL.BO, Rs300	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	610
52W High -Low (Rs)	1114 - 254
Market Cap (Rs bn)	82.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	23.8	28.5	38.7
Net Profit (Rs bn)	14.1	15.6	17.5
EPS (Rs)	51.2	56.6	63.6
EPS gth	*118.6*	*10.6*	*12.3*
P/E (x)	5.9	5.3	4.7
EV/EBITDA (x)	6.5	5.9	5.0
Div yield (%)	1.3	2.7	2.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.5	-	-
FIIs	9.3	0.1	(0.1)
MFs	0.9	0.1	(0.2)
UTI	-	-	(0.2)
LIC	-	-	(0.2)

Housing Development & Infrastructure: Work on slum rehab on track

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- **Work on slum rehabilitation in Kurla is on track, incorporating the project into financials**
- **Another property in Mumbai (Andheri (W) launched earlier-than-expected**
- **Retain BUY rating on HDIL and target price of Rs610/share**

We visited the Kurla site where HDIL's airport slum rehabilitation project (SRA) has begun. The work is on track and HDIL has already completed around 15-20% of the rehab work with most buildings reaching the plinth level. HDIL would be constructing 6 mn sq. ft of rehab area to rehabilitate 20,000 families in the first phase of the project. The project will generate TDRs of around 8 mn sq. ft and HDIL is already selling TDRs in the range of Rs2,200-3,800/sq. ft. HDIL will also construct 6 mn sq. ft of commercial space in the next four years and plans to sell FSI to generate cash flows sooner. HDIL has also launched the commercial property in Four Bungalows and we would note that the site will also have a metro station. We are not yet incorporating Kurla project into profit forecast since we don't have full clarity on accounting treatment. We maintain our BUY rating on HDIL with a target price of Rs610/ share which is at par with our Mar '09-based NAV. We highlight that current stock price is factoring in more than a 35% correction in real estate prices to our pricing estimates.

Phase 1 of the airport SRA project on track—cashflows start earlier than expected

HDIL has started the phase I of the airport SRA project in 53 acres of land in Kurla where it would rehabilitate around 20,000 families out the total 85,000 families. We note that HDIL had paid Rs19 bn for acquiring this land and is fully paid. HDIL is constructing 6 mn sq. ft of rehabilitation area for which the management expects to incur Rs6 bn (at Rs1,000/sq. ft) of which HDIL has already incurred Rs3 bn. HDIL has given construction contracts to 10 local builders with a construction guideline of 12 months. These contracts have been given at Rs801/sq. ft with escalation allowed to the extent of 25%. The project will likely consist of 150 G+9 storey structures with strata retail at the ground floor of these buildings. Management takes 200 families to be rehabilitated to the site every week to show them the development.

The rehab project will generate 8 mn sq. ft (6*1.33) of construction TDRs besides 1.2 mn sq. ft of land TDRs. HDIL has already started selling TDRs in the range of Rs2,200 to Rs3,800/sq. ft (average Rs2,600/sq.ft) depending on the area where it is going to be utilized. We note that demand for TDRs is generally coming from small projects of less than 100,000 sq. ft. Management has indicated that HDIL has already sold TDRs of more than 0.5 mn sq. ft.

This project will also generate large commercial area of 6 mn sq. ft (assuming 50% loading), which will result in faster-than-expected cash inflow. Already, preliminary work has begun in terms of clearing of factory shed and excavation. HDIL is also contemplating selling FSI in order to generate faster cashflows. HDIL expects to sell FSI in this commercial project in the range of Rs7,000 to Rs8,000/sq. ft. We would like to note that Kohinoor, which has a residential project adjacent to HDIL's site, is selling at Rs8,700/sq. ft while a commercial/retail property will command a minimum 50% premium to residential prices. Exhibit 1 shows current snapshots of the project site. HDIL expects to incur a total construction cost of Rs12 bn on the commercial project over a period of 3-4 years.

Progress of this project allows the following changes to our model

Sale of TDRs. We were considering sale of TDRs starting from FY2010. Since HDIL has already launched sale of TDRs, we now build in sale of 1.5 mn sq. ft in FY2009. We keep the sale price of TDRs unchanged at Rs2,500/sq. ft.

Increase in saleable area. Since HDIL has launched a commercial area in Kurla, we incorporate this 6 mn sq. ft area fully into our NAV estimates (earlier 2 mn sq. ft). Hence, the saleable area goes up to 14 mn sq. ft (10 mn sq. ft earlier). Also, we model cash inflow to start from FY2010 (FY2011 earlier).

Reduce selling price assumptions. We revise our selling price assumption to a conservative level of Rs15,000/sq. ft (Rs21,000 earlier). We also believe that since HDIL is offering a large area, it will have to offer competitive pricing to attract clientele.

As a result of these changes, our NAV is marginally revised to Rs60.5 bn (Rs60.8 bn earlier). Further, we have taken a discount of 25% for this project to incorporate any delays, lower selling prices. Discount of 25% is equivalent to selling prices of saleable area being Rs12,500/sq. ft. Key upside risks to our NAV are, (1) lower tax rates—we have built in 34% tax rates and (2) faster-than-expected cashflow on sale of FSI. Key downside risks are (1) lower selling prices and (2) longer time period for sale of TDRs.

HDIL starts a large commercial project in Andheri (W), Mumbai

We also note that HDIL has launched a commercial project at Four Bungalows (Andheri (W), Mumbai) where it has 30+ acres of land. HDIL would be constructing 1.8 mn sq. ft of commercial/retail space and we estimate rentals of Rs150/sq. ft given that the site will also have a metro station (Versova—Andheri link) and will be a good catchment area. We highlight that this project will likely command a premium since area around this project site is already well exploited. We were earlier estimating the project to get completed in end-FY2013 but we now prepone completion by 18 months to mid-CY2011. This will likely be a G+18 storey structure and will emerge as the largest business complex in the region.

Various projects under execution provide revenue visibility

Exhibit 4 gives details of various ongoing projects of HDIL. Most of these projects are in an advanced stage of execution and will contribute to revenues in FY2009-10E. For FY2009E, we expect minimal risk to our estimates as all projects from which revenues are likely to be booked are under execution. However, we expect any shortfall to be made up by revenue and profit booking from airport slum rehabilitation project that is currently not factored into our estimates. We highlight the fact that HDIL follows an accounting policy of "project completion" and books revenues when a project is fully completed.

We retain our BUY rating, target price

We retain our target price of Rs610/ share (adjusted for bonus issue), which is based at parity with our March '09 based NAV. We assign a 25% discount to the airport SRA project to factor in longer execution timeframe.

We note that slum rehabilitation projects should attract a slight discount to NAV on account of their riskier nature but we believe a discount is not warranted on account of the following reasons.

1. **Ability to win large scale rehabilitation/redevelopment projects.** Mumbai airport slum rehabilitation project clearly demonstrates HDIL's ability to win large-scale projects in slum rehabilitation/redevelopment.

2. SEZ development in Vasai Virar region. HDIL's 100% owned subsidiary Privilege Power and Infrastructure Pvt. Ltd has got in-principle approval for 2,245 hectare Special Economic Zone in Vasai-Virar region. We note that this area is gaining prominence as observed by us at a recently-held property exhibition in Mumbai on account of better connectivity with mainland Mumbai. We believe that this SEZ has a NAV accretion potential of Rs27 bn or Rs100/share at a valuation of Rs5 mn/acre.

We expect cash inflows from airport slum rehabilitation project in FY2009

Cashlow projection of airport slum rehabilitation project

		FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
HDIL has full benefits/ costs								
Rehabilitation area constructed (mn sq. ft)		7.4	7.4	7.4	7.4			
Cost of construction (Rs bn)		(9.3)	(9.3)	(9.3)	(9.3)			
Purchase of land		37.5						
Sale of TDR (mn sq. ft)		1.5	4.0	6.0	6.0	6.0	6	8.3
Selling price assumption of TDR (Rs/sq. ft)								
Sale Inflow from TDR (Rs bn)		3.8	10.0	15.0	15.0	15.0	15.0	20.6
		1.0	1.1	1.3	1.5	1.7	1.9	2.2
		(43.0)	0.6	4.4	3.8	8.9	7.8	9.4
NPV (Rs bn)	(8.1)							
HDIL gets 55% share of land								
		FY2009	**FY2010**	**FY2011**	**FY2012**	**FY2013**	**FY2014**	**FY2015**
Saleable area constructed (mn sq. ft)			2	2	3	4	2	2
Selling price (Rs/sq. ft)			15,000	15,000	15,000	15,000	15,000	15,000
Construction cost(Rs/sq. ft)			3,000	3,000	3,000	3,000	3,000	3,000
Sale Inflow (Rs bn)			23	25	41	58	30	30
Construction cost (Rs bn)			(5)	(5)	(8)	(12)	(6)	(6)
Taxes (Rs bn)			6	7	11	16	8	8
			10	10	15	18	8	7
NPV (Rs bn)	69							

Source: Kotak Institutonal Equities, Company

Large NAV accretion for HDIL on account of the slum rehabilitation project

NAV accretion from slum rehabilitation assuming different selling prices

	NAV (Rs bn)	NAV/share (Rs)
11,000	38	176
13,000	49	229
15,000	61	282
17,000	72	336
19,000	83	389
21,000	95	442
23,000	106	496

Source: Kotak Institutional Equities

Progress on airport SRA project

Source: Kotak Institutional Equities

Large number of ongoing projects provide large revenue visbility

Key details of ongoing projects of HDIL

		FY2009E	FY2010E	Project size (mn sq. ft)	Selling price (Rs/sq. ft)	Current status
SRA						
Bharat Nagar	BKC	4,691	6,255	1.1	28,350	Under execution
Bharat Nagar	BKC	6,615	5,788	1.1	15,750	Under execution
Motilal Nehru Nagar	BKC	1,884	-	0.2	22,050	Under execution
Grande	Bandra (W)	463	-	0.0	14,175	Under execution
Rajiv Nagar & Hanuman Nagar	Bandra (W)	532	1,595	0.1	14,175	Under execution
Heriatge	Santacruz (W)	1,800	-	0.2	9,000	Sold
Gilbert Hill	Andheri (W)	700	2,101	0.3	9,450	Under execution
Pant Nagar	Ghatkopar (E)	2,407	802	0.5	5,670	Under execution
Prem Nagar	Jogeshwari	-	1,904	0.4	4,725	Under execution
Malad Market	Malad	-	340	0.1	11,340	Under execution
Malwani	Malad (W)	-	1,054	0.9	4,725	Under execution
Malwani	Malad (W)	-	4,861	0.6	8,400	Under execution
Heritage Retail		900	-	0.1	9,000	Sold
Total		**19,993**	**24,701**			
Commercial						
Recondo, Worli'		-	3,181	0.1	28,350	Under execution
Sharda Sadan, Dadar		170	-	0.0	18,900	Under execution
Harmony, Oshiwara		3,265	3,265	0.3	18,900	Under execution
Royal Garden	Vasai	-	-	2.9	4,500	To start construction
Agashi	Agashi	-	813	0.6	4,500	Under execution
Dreams	Mumbai	4,147	-	0.4	14,000	0.15 mn sq. ft sold
Total		**7,582**	**7,258**			
Residential						
Centre Point		529	-	0.0	13,500	Under execution
Dongre Phase 1	Virar	-	1,349	2.6	2,025	To start construction
Royal Garden	Vasai	-	2,275	1.0	2,250	To start construction
Part Shingoan/Chandansar I	Virar	-	-	1.5	2,025	To start construction
Agashi	Agashi	-	1,809	3.4	1,710	To start construction
Pune JV	Pune	-	1,102	1.2	2,700	Under execution
Blue Star	Kochi	-	-	2.0	2,250	To start construction
Dreams		278	-	2.0	2,700	Under execution
Total		**807**	**6,534**			

Source: Kotak Institutional Equities estimates.

Our target price of Rs610 is at par with NAV

NAV sensitivity to growth rate in selling prices

	March '09 based NAV			
	Growth rate in selling prices			
	0%	3%	5%	10%
Valuation (Rs bn)	**97.3**	**107.0**	**114.4**	**132.9**
Residential projects	25	32	36	49
Commercial/retail projects	40	42	44	47
Slum rehabilitation projects	32	33	34	37
Add: BKC rental property	1.5	1.5	1.5	1.5
Add: Investment in subsidiaries	5.0	5.0	5.0	5.0
Net debt	(27.6)	(27.6)	(27.6)	(27.6)
Add: Mumbai slum rehabilitation project	45.4	45.4	45.4	45.4
Add: Land cost paid for airport SRA	30.0	30.0	30.0	30.0
NAV (Rs bn)	**152**	**161**	**169**	**187**

Number of shares	
Total no of shares	275.8
Price/share	**612**

Source: Kotak Institutional Equities.

Current stock price incorporating 30%+ decline in real estate prices

		Fair price (Rs/share)				
		Reduction in FY2009E selling prices (%)				
	612	**5**	**10**	**15**	**20**	**30**
WACC (%)	**13**	619	566	514	461	356
	14	599	548	496	445	**343**
	15	580	530	480	430	**330**
	16	561	513	464	415	**318**
	17	544	496	449	402	**307**
	18	527	481	434	388	296
	19	511	466	421	376	286

Source: Kotak Institutonal Equities, Company

Profit model of HDIL, March fiscal year-ends, 2005-2010E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Total revenues	**4,377**	**12,165**	**23,804**	**28,542**	**38,664**	**67,184**
Land costs	(3,767)	(10,116)	(47,040)	(1,435)	(1,269)	(2,873)
Construction costs	855	4,879	40,703	(6,356)	(13,618)	(32,070)
Employee costs	(11)	(84)	(122)	(367)	(734)	(900)
SG&A costs	(79)	(222)	(431)	(856)	(1,160)	(2,016)
EBITDA	**1,376**	**6,622**	**16,914**	**19,527**	**21,883**	**29,326**
Other income	24	0	529	500	500	500
Interest	(106)	(430)	(1,408)	(2,413)	(2,658)	(2,658)
Depreciation	(4)	(10)	(15)	(29)	(48)	(74)
Pretax profits	**1,291**	**6,182**	**16,021**	**17,585**	**19,678**	**27,094**
Profit/(loss) share of associates	—	—	—	—	—	-
Current tax	(149)	(758)	(1,910)	(1,973)	(2,144)	(6,940)
Deferred tax	(2)	(4)	(7)	(13)	(14)	(16)
Net income	**1,139**	**5,420**	**14,103**	**15,599**	**17,519**	**20,138**
EPS (Rs)						
Primary	4.9	23.4	53.8	57	64	73
Fully diluted	4.9	23.4	53.8	57	64	73
Shares outstanding (mn)						
Year end	231	231	275	275	275	275
Primary	231	231	262	275	275	275
Fully diluted	231	231	262	275	275	275
Cash flow per share (Rs)						
Primary	5	26	53	46	52	62
Fully diluted	5	26	53	46	52	62
Growth (%)						
Net income (adjusted)	681	376	160	11	12	15
EPS (adjusted)	134	376	130	5	12	15
DCF/share	103	409	104	(13)	13	18
Cash tax rate (%)	12	12	12	11	11	26
Effective tax rate (%)	12	12	12	11	11	26

Source: Kotak Institutional Equities estimates.

Balance sheet of HDIL, March fiscal year-ends, 2006-2011E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Equity							
Share capital	100	500	1,800	2,143	2,143	2,143	2,143
Reserves/surplus	611	1,350	5,468	34,272	47,358	62,362	79,359
Total equity	**711**	**1,850**	**7,268**	**36,415**	**49,501**	**64,505**	**81,502**
Deferred tax liability/(asset)	3	4	8	15	28	42	58
Liabilities							
Secured loans	403	1,965	3,757	19,461	37,965	37,965	37,965
Unsecured loans	511	—	—	11,667	—	—	—
Total borrowings	**914**	**1,965**	**3,757**	**31,127**	**37,965**	**37,965**	**37,965**
Currrent liabilities	1,741	4,163	7,864	7,477	18,821	32,600	38,024
Total capital	**3,369**	**7,982**	**18,897**	**75,034**	**106,315**	**135,112**	**157,549**
Assets							
Cash	19	397	48	3,505	4,449	10,356	18,728
Current assets	2,740	6,387	16,947	68,903	98,721	121,506	135,416
Gross block	37	56	249	576	677	829	1,056
Less: accumulated depreciation	4	6	13	32	61	109	183
Net fixed assets	33	49	236	544	616	720	874
Capital work-in-progress	—	10	3	52	—	—	—
Total fixed assets	**33**	**60**	**239**	**596**	**616**	**720**	**874**
Intangible assets	—	—	—	—	—	—	—
Investments	577	1,133	1,650	2,006	2,506	2,506	2,506
Misc. expenses	—	6	13	24	24	24	24
Total assets	**3,369**	**7,982**	**18,897**	**75,034**	**106,315**	**135,112**	**157,548**
Leverage ratios (%)							
Debt/equity	128.1	105.9	51.6	85.4	76.7	58.8	46.5
Debt/capitalization	56.2	51.4	34.0	46.1	43.4	37.0	31.8
Net debt/equity	125.4	84.5	51.0	75.8	67.7	42.8	23.6
Net debt/capitalization	55.6	45.8	33.8	43.1	40.4	30.0	19.1
RoAE	**41.7**	**88.7**	**118.7**	**64.5**	**36.3**	**30.7**	**27.6**
RoACE	**22.1**	**45.4**	**78.1**	**39.1**	**22.9**	**20.9**	**19.9**

Source: Kotak Institutional Equities estimates.

Economy

Sector coverage view	N/A

Rupee breaches 44 intra-day, may swing back to 43.60 in a month

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- **Rupee breaches 44 intra-day, closes at 43.89, the lowest in 17 months**
- **Rupee has depreciated 4.3% in the past 13-working days, in line with US dollar appreciation**
- **RBI appears wary to defend rupee in face of dollar appreciation in spite of inflation**
- **Contrary to market expectations, we think rupee could swing back to 43.60 in a month from now**

Sharp appreciation of the US dollar (USD) against major G-7 currencies, with the notable exception of the yen has caused the Indian rupee (INR) to depreciate at a dramatic pace of 4.3% within 13 working days. The movement has been helped by local technical factors and likely RBI aversion to defend the rupee strongly. However, we believe that over the next month, the rupee may swing back to 43.60 on the back of the euro-dollar (EUR/USD) bottoming out and tighter liquidity conditions in the Indian money market. If the dollar appreciation halts over the next few days, we may see a trading range of 43.60-43.75 for INR/USD over the next few days, but if the USD continues its recent trend, the rupee could severely test the 44.0 mark, which could be strongly defended by the RBI in a bid to combat inflation. We see sharp swings in the rupee exchange rate through FY2009 in a wide band of 42-44, with a likely average of Rs42.75 versus the USD (versus our earlier estimate of 42.00).

The rupee has depreciated to 43.89 at the close of August 26 from 42.00 on August 6. This 4.3% depreciation over 13-working days has been one of the fastest ever depreciation of the rupee.

Global currency movements aided by local factors caused depreciation

We believe that the movement has been largely caused by global currency movements (see Exhibits 1 and 2). The sharp appreciation of the US dollar vis-à-vis the Euro (5.2%), Pound (6.0%) and Australian dollar (6.2%) over the past 13 working days explain much of the rupee movement. Local factors have aided this movement. In our view, there could be several reasons for rupee depreciation:

- Sharp USD appreciation against G-7 currencies, with the notable exception of the yen
- RBI is likely to have abstained from significant interventions to protect the rupee
- Local factors which may have affected interventions, such as (a) the strike in the State Bank of India (SBI) on August 18, (b) local holiday in Mumbai on August 19 when RBI was closed and (c) the strike in nationalized banks on August 20 , all of which provided a 3-day period for large FX players to weaken the rupee without fear of much intervention
- Renewed large demand for forex from oil companies in the face of the fall in global crude prices prompting them to make bulk purchases which pushed up USD demand as RBI ceased Special Market Operations (SMOs)
- Expected easing of liquidity conditions in the money market on the back of large redemptions of Rs145 bn slated during August 28-31, which exceeds the amount of Rs100 bn expected to be mopped up by a 25 bps reserve requirement (CRR) increase that kicks in on August 30.

US dollar appreciation in overshooting zone and can reverse soon

The main factor behind the rupee depreciation versus the USD appreciation could dissipate in the next few weeks. We believe the USD is close to its near-term peak and its rally could end within weeks. Our reasons are as follows:

1. The current USD rally was prompted by technical factors and fears that the US slowdown would lower growth globally sparking flight to dollar as a perceived safe heaven. We feel this argument is overstretched. 1QCY08 COEFER data reveals continued slow movement away from USD and into Euro in reserves. Share of EUR in reserves has increased to 27% in 2008 from 18% in 2000, while that of the USD has dropped to 63% from 71%. We consider it a paradox that the USD continues to be considered a safe heaven despite US credit markets being the epicenter of the current global economic turmoil.
2. The USD has appreciated 8.7% since its July 15, 2008 low of 1.5912 (intra-day low was at 1.6037). A similar rally was seen at the start of CY2008 when the USD touched a high at around the current level (1.464), petering out in early February. The USD in August has already recouped its losses for the year.
3. In real terms, returns on USD assets continue to be negative, making the current USD rally unsustainable
4. The current rally was aided by technical factors like the stop-loss triggers, which may now fade out
5. In nominal terms, the USD has depreciated 43.7% against the EUR since its high of October 25, 2000. In trade-weighted real terms, it has depreciated by about 25% since the 2002 high, but the depreciation is still not enough to correct the US current account deficit (CAD) or global imbalances. It is possible that we could see some improvement in CAD with a lag in response to USD depreciation which could get an added boost if oil prices fall, but current macro-economic data is not supportive of a sustained rally for the USD.

We expect RBI to intervene firmly once dollar appreciation abates

In view of the current inflation concerns and the likely trajectory of 13-14% headline inflation in 3QFY09, we believe RBI would be wary of letting rupee the depreciate too much and too fast. As such, once the dollar appreciation abates, RBI could step in lot more aggressively and try to reverse some of the current movement.

In the near term too, we expect RBI to defend the psychologically important level of 44.0 versus the USD. In our view, there were some signs of it in the reversal of rupee towards the close of yesterday, August 26. There are good chances that RBI may sell dollars in the coming days as the large G-sec redemptions would afford a window for the same.

Movements in Indian money market liquidity likely to support rupee in September

Contrary to market expectations of rupee weakening further in near term to 44.50, in our view, the rupee could stage a recovery to 43.60 in September on the back of expected tight liquidity conditions. We expect the Indian money market to tighten in September as the 25 bps CRR hike kicks in from the start and is followed by advance tax collections during the second and the third week. If tax collections remain good, the money markets could become tight and prompt some dollar selling easing pressure on the rupee. This could be aided by markets preparing for further monetary policy tightening by RBI in face of rising inflation.

We expect average exchange rate of Rs42.75 versus USD for FY2009

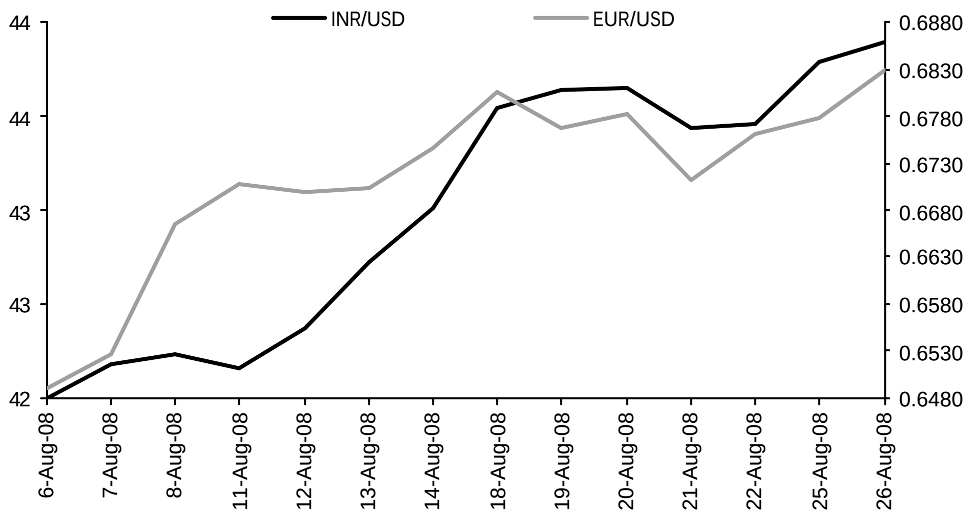
Factoring in the strong dollar appreciation which has already occurred, as also the likelihood of inflation staying high over the next three-months, we have revised our exchange rate expectations. Our currency view now suggests an average INR/USD exchange rate closer to 42.75 instead of 42.0 earlier. We have also revised our USD/EUR forecasts (see Exhibit 3).

We recognize that future exchange rate movements may not be predictable in view of large uncertainties that prevail. However, we rate the chances of rupee recovery high in 4QFY09 as the inflation rate falls towards the 10% mark, which could see large capital inflows renewing. Our confidence in the rupee staging a recovery also stems from the likely BOP surplus of US$35 bn or more if oil prices don't firm up again.

Despite FII net sales of US$3.7 bn in FY2009 so far, we do not see capital inflows drying up as FDI inflows, including private equity, are expected to remain strong. Total capital account inflows may exceed US$65 bn and provide strength to the Indian rupee, offsetting the adverse inflation impact. If capital flows drop, we expect a policy response liberalizing the capital inflows.

Exhibit 1: Rupee depreciation in August 2008 tracks Euro depreciation vs. US dollar

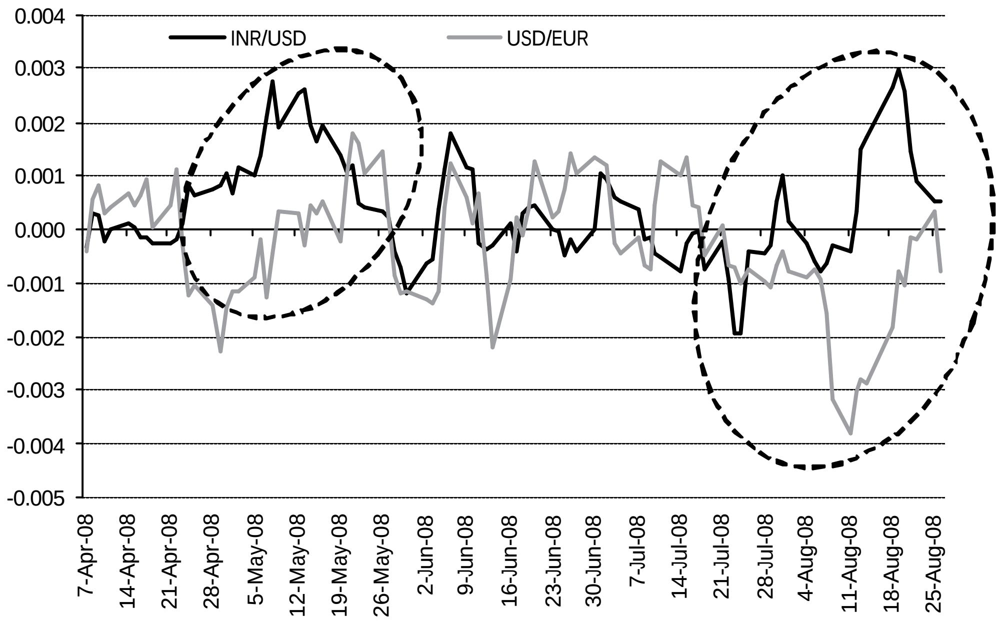
INR/USD on LHS, EUR/USD on RHS



Source: Bloomberg

Exhibit 2: Indian rupee volatility broadly tracks USD/EUR exchange rate

5-day moving average of daily returns from exchange rate



Source: Bloomberg

Exhibit 3: Rupee likely to rally in 4QFY09 on lower inflation, renewed capital inflows

INR/USD and USD/EUR exchange rates; appreciation/depreciation (%)

	2007	2008	2009E	2010E
Average Rate				
INR/USD	45.25	40.26	42.75	42.00
USD/Euro	1.28	1.42	1.52	1.57
Average depreciation (+)/appreciation (-)				
INR/USD	2.2	(12.4)	5.8	(1.8)
USD/Euro	2.2	9.9	6.6	3.2
End-period Rate				
INR/USD	43.47	40.11	42.25	41.50
USD/Euro	1.34	1.58	1.53	1.60
End-period depreciation (+)/appreciation (-)				
INR/USD	(2.7)	(8.4)	5.1	(1.8)
USD/Euro	2.2	15.2	(3.3)	4.4

Source: Bloomberg, Kotak Institutional Equities estimates

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Kotak Institutional Equities Research coverage universe

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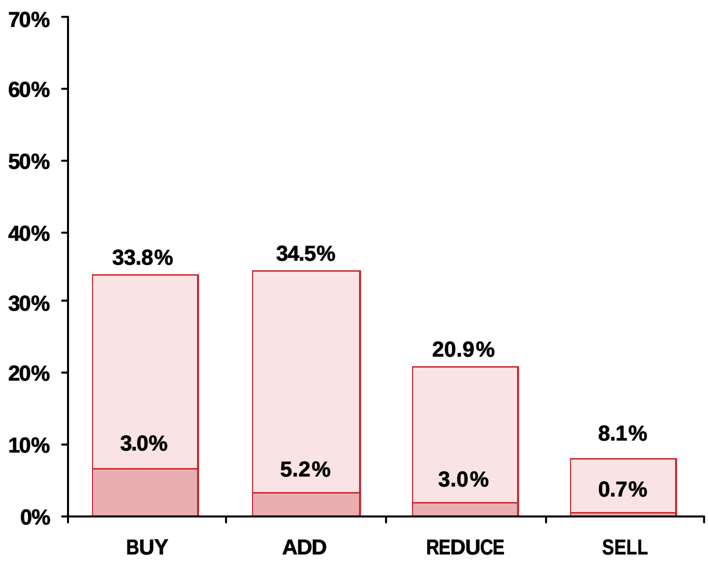

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Source: Kotak Institutional Equities. As of June 30, 2008

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

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REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
SELL: We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

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

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