kotak® Institutional Equities

INDIA DAILY

June 25, 2007

EQUITY MARKETS

		Change, %		
India	**22-Jun**	**1-day**	**1-mo**	**3-mo**
Sensex	14,467	(0.2)	0.9	8.9
Nifty	4,252	(0.4)	0.1	10.1
Global/Regional indices				
Dow Jones	13,360	(1.4)	(1.1)	7.0
Nasdaq Composite	2,589	(1.1)	1.2	5.7
FTSE	6,567	(0.4)	(0.0)	3.6
Nikkie	18,096	(0.5)	3.5	3.5
Hang Seng	21,971	(0.1)	7.1	11.6
KOSPI	1,770	(0.0)	7.6	22.3

Value traded - India

			Moving avg, Rs bn	
	22-Jun		**1-mo**	**3-mo**
Cash (NSE+BSE)	143.1		136.5	132.1
Derivatives (NSE)	379.4		334.4	399.4
Deri. open interest	760.4		627.3	588.9

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Forex/money market

		Change, basis points		
	22-Jun	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.8	(0)	18	(254)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	(2)	1	20

Net investment (US$mn)

	19-Jun		**MTD**	**CYTD**
FIIs	160		109	4,056
MFs	37		26	(84)

Top movers -3mo basis

		Change, %		
Best performers	**22-Jun**	**1-day**	**1-mo**	**3-mo**
Balaji Telefilms	226	(1.2)	1.5	91.5
GESCO	342	5.7	34.0	73.4
Reliance Cap	1,091	(0.2)	11.7	62.8
Moser Baer	449	1.6	1.3	50.6
SBI	1,456	0.7	12.1	41.7
Worst performers				
Polaris	156	(0.8)	(8.5)	(16.4)
Bajaj Auto	2,175	(0.1)	0.2	(14.2)
Wipro	517	(1.3)	(4.7)	(13.9)
Tata Motors	684	(0.4)	(5.8)	(13.3)
Cipla	210	(0.1)	2.3	(13.2)

News Roundup

Corporate

- JM Financial looking to acquire 50% in ASK Securities for Rs5 bn (ET)
- SBI planning to raise Rs150 bn to fund its growth plans which includes Rs70 bn equity and the remainder debt (FE)
- GAIL's Rs70 bn petrochemical complex at Kochi has been shelved for the time being due to technical reasons (BS)

Economic and political

- Government is considering exempting oil companies from paying excise duties of Rs10 bn for the period 2000-2005 in relation to the issue regarding the differential pricing of LPG and kerosene (ET)
- Energy Co-ordination Committee (ECC) headed by the Prime Minister will meet on Tuesday to decide about gas pricing, gas sourcing and gas allocation. (BS)

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

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Chemicals

RELI.BO, Rs1704	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	1,400
52W High -Low (Rs)	1785 - 877
Market Cap (Rs bn)	2,374

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,052	957	1,146
Net Profit (Rs bn)	107.2	96.4	140.5
EPS (Rs)	76.9	71.5	98.5
EPS gth	*21.8*	*(7.0)*	*37.6*
P/E (x)	22.2	23.8	17.3
EV/EBITDA (x)	13.0	13.8	8.9
Div yield (%)	0.6	0.7	0.8

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.5	-	-
FIIs	23.1	7.2	0.5
MFs	2.5	4.8	(1.9)
UTI	-	-	(6.7)
LIC	4.5	7.8	1.1

Reliance Industries: KG D-6 block gas sales and valuation: Between a rock and a hard place

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- **We think the street is taking this issue too lightly; things could potentially worsen**
- **Government has a legal contract but so (has)/will RNRL as per scheme of de-merger of Reliance**
- **KG D-6 gas sales, pricing and valuations may be impacted if both the 'contracts' are enforced under unfavorable terms**

We see the Mumbai High Court's decision on restraining Reliance Industries' gas sales to third parties (other than to NTPC, RNRL and captive consumption) as leading to complications regarding KG D-6 gas sales and potentially impacting its valuation. We expect the government to try and enforce its contract with Reliance since (1) it has a valid production sharing contract (PSC) with Reliance, (2) it is the owner of natural resources in India and (3) India requires natural gas. On the other hand, an agreement (whatever that may be in the future) between Reliance and RNRL may be to the disadvantage of RIL if RNRL is able to force a lower-than-market gas price. We understand the Mumbai High Court has ruled that the 'agreement' entered into between Reliance and RNRL does not conform to the scheme of de-merger of Reliance Industries sanctioned by the Mumbai High Court. In the worst case, Reliance may be forced to honor its 'contracts' with the government and RNRL on unfavorable terms, which may squeeze valuations of KG D-6 block meaningfully. We retain our 12-month target price of Rs1,400 based on 9X FY2010E EPS discounted back. Key risks are higher-than-expected chemical and refining margins and new hydrocarbon discoveries.

KG D-6 sales, pricing—a big mess and things could potentially worsen. The Mumbai High Court's judgment and potential tough government stance will likely lead to a messy situation, in our view. It potentially puts Reliance in the unhappy situation on honoring its production sharing contract (PSC) with the government at market price of gas and entering into an 'unfavorable' agreement with RNRL regarding supply and pricing of gas. This may lead to a severe impact on gas sales, pricing and thus, valuations of KG D-6 block, a critical component of Reliance's valuation. We expect the government to enforce its contract with Reliance given (1) it has a valid PSC with Reliance, (2) it is the owner of all natural resources in India, and (3) India requires natural gas. Based on the above, the government may insist that Reliance produce and sell gas as it would do normally. It is almost certain that the government will use a market price for purposes of computation of its royalty, income tax and most important, its share of profit petroleum whether gas is sold at the market price or at a lower-than-market price to gas consumers. On the other hand, RNRL may force (through a judicial order) Reliance to sell the 'agreed' quantity of gas to it at the 'agreed' price (same price as gas to be sold to NTPC; US$2.46/mn BTU). This could potentially squeeze the valuation of KG D-6 significantly (see Exhibit 1).

Where will Reliance sell the gas? NTPC and REL/RNRL plants are nowhere in the picture. We assume that Reliance can sell to others (other than own consumption, NTPC, RNRL) in the short-term; however, if this is not the case, then valuation of KG D-6 block will decline meaningfully. Exhibit 2 gives our assumed break-up of sales of gas produced from Reliance's KG D-6 block. RIL and RPL can consume about 20 mcm/d of gas for heat and power generation out of the peak production of 80 mcm/d. However, we note that there is no progress on the power projects of NTPC (Kawas, Gandhar expansions) and REL (Dadri, Patalganga); the power plants will likely take 18-24 months for construction from zero date.

We assume Reliance will be 'allowed' to sell gas to third parties until the power projects of NTPC and REL come up. We think that this is fair and logical in a power/energy short country such as India. It is possible that Reliance may get a good price for the gas sold to power and fertilizer projects (most of them are desperate for gas) for the first few years until the gas is diverted to NTPC/RNRL. We model Reliance will receive US$4/mn BTU (at Rs43/US Dollar) wellhead price in perpetuity, which is about US$0.5/mn BTU lower than the price suggested by the formula used by Reliance at US$65/bbl Dated Brent crude price, exchange rate of Rs41/US Dollar and c of 1. However, there have been rumblings about the price from Andhra Pradesh government and the Andhra Pradesh electricity distribution utility. Also, we believe Reliance will ultimately have to sell a large portion of its gas to power projects (NTPC, REL and others) at substantially lower prices; we do not see large incremental demand for gas except from the power sector and the power sector has the option to use cheaper coal to produce power.

Genesis of the dispute between Reliance and RNRL. We note that the genesis of the current dispute between Reliance and RNRL lies in the scheme of arrangement/de-merger of Reliance Industries. The Mumbai High Court had sanctioned the scheme of arrangement of de-merger of Reliance Industries on December 19, 2005. According to the scheme of de-merger of Reliance Industries as sanctioned by the Mumbai High Court, Reliance and RNRL were to enter into an agreement for the supply of gas by Reliance Industries to RNRL. Reliance Industries and RNRL entered into a gas supply master agreement (GSMA) and gas supply and purchase agreement (GSPA) on January 12, 2006. However, RNRL has contested the 'agreement' and an amendment of the 'agreement' on January 27, 2006 since RNRL was still under the control of Reliance Industries on January 12, 2006 when the GSMA and GSPA was signed between Reliance and RNRL. The ADAE group (the new management of RNRL) took control of RNRL in February, 2007.

The Mumbai High Court had upheld the petition of RNRL and ruled that the January 2006 'agreement' between Reliance Industries and RNRL is not in accordance with the scheme of de-merger of Reliance Industries. It has stated in its ruling that Reliance is under obligation to supply gas to power projects of RNRL/REL as per the scheme of the de-merger of Reliance Industries approved by the shareholders of Reliance and sanctioned by the Mumbai High Court. Also, it has ruled that the rejection of the pricing pattern between RIL and RNRL by the government does not prohibit Reliance and RNRL from entering into a suitable supply arrangement.

'Agreement' between Reliance and RNRL for whatever it is worth. We give below the key details of the disputed 'agreement' between RIL and RNRL based on information available in the information memorandum of RNRL and a legal document signed between RIL and RNRL. However, we would clarify that this is not the 'final' agreement as the ADAE group has contested the 'agreement' as discussed above. Nonetheless, we assume that the terms of the final 'agreement' (as and when there is one) cannot be better (for RIL) than the terms of the disputed 'agreement'.

1. Reliance would supply to 28 mcm/d of gas out of the first 40 mcm/d of gas produced from blocks of Reliance to RNRL, in which Reliance has a participating interest.
2. If NTPC does not lift 12 mcm/d of gas, RNRL would be entitled to NTPC's 12 mcm/d portion also.
3. The price and commercial terms of the aforementioned volume sold to RNRL would be similar to Reliance's contract with NTPC.
4. The price to be paid by RNRL based on Reliance's 'agreement' with NTPC for the 28 mcm/d (or 40 mcm/d) would be US$2.46/mn BTU (broken down between US$2.34/mn BTU of commodity charge and US$0.12/mn BTU of marketing charge).
5. RNRL is entitled to 40% of the incremental gas volumes (beyond the first 40 mcm/d).
6. The agreement covers all extant and future reserves in blocks, in which RIL or its affiliates have a participating interest (excluding the PMT fields) up to June 18, 2005.

Valuation of KG D-6 gas block has high leverage to gas price assumptions

Valuation of KG D-6 gas block at different gas price and production levels (Rs/share)

Gas price (US$/mn BTU)	Gas production versus base case (X)				
	1.0	**1.2**	**1.4**	**1.6**	**2.0**
2.0	(71)	(42)	(14)	14	66
2.5	9	49	91	124	178
3.0	81	128	164	**200**	**245**
3.5	141	182	**220**	**250**	**313**
4.0	**184**	**227**	**271**	**303**	**373**
4.5	**220**	**273**	**308**	**342**	**393**
5.0	**257**	**307**	**344**	**394**	**410**
5.5	**308**	**325**	**386**	**414**	**469**
6.0	**324**	**370**	**398**	**413**	**545**

Note:

(a) Our base case valuation of Rs184/share for KG D-6 block is based on 17 tcf of gas production, US$4/mn BTU gas price and US$8.8 bn capex.

(b) In our valuation of Reliance, we use 9X FY2010E EPS of Rs154, which includes contribution of Rs44 from gas production from KG D-6 block.

(c) Constant capex assumed in all volume scenarios but this need not be the case.

Source: Kotak Institutional Equities estimates.

New power plants of NTPC, REL, others critical for gas consumption; internal 'sales' insufficient given large supply

Supply and potential sales of gas from KG D-6 block (mcm/d)

		Comments
Reliance KG D-6 gas peak production	**80**	**This could increase to 120 mcm/d**
1. Firm demand		
Consumption in RIL and RPL refineries	20	
Shortfall + new power generation capacity in KG basin area	8	Shortage of about 3 mcm/d; planned new capacity of 1,878 MW
Sub-total	**28**	
2. Potential demand in short/medium-term		
Conversion of FO/naphtha urea units to gas	11	Most units can switch to gas quickly as pipeline infrastructure exists
Replacement of FO/LSHS from industrial units	18	50% of all FO/LSHS consumed in India
Sub-total	**28**	
3. Possible demand in medium/long-term		
NTPC gas supply	10	Construction of 2 X 1,300 MW power plants not commenced
RNRL/REL gas supply	11	Construction of 2,720 MW power plant not commenced
City gas distribution	5	Submitted plans to various state governments; will take time
Sub-total	**26**	
Total	**82**	

Source: Kotak Institutional Equities estimates.

Our 12-month fair value of Reliance stock is Rs1,400

Valuation of Reliance stock (Rs)

	FY2010E EPS (Rs)	P/E (X)	Valuation (Rs/share)	Comments
Chemicals, refining, E&P (a) (b)	173	9	1,557	Consolidated FY2010E EPS including Reliance Petroleum
E&P (higher reserves in KG-DWN-98/3)			—	We model 17 tcf of gas production from KG-DWN-98/3 block
E&P (NEC-25, CBM)			44	Based on KG D-6 reserves and valuation
Investments			143	
IPCL and other investments			31	
Retailing			112	US$3.75 bn valuation; ~US$1 bn equity invested in Reliance Retail as of end-FY2007
SEZ development			—	SEZs will require investment for the first few years
Valuation based on FY2010E EPS			**1,744**	
12-month forward valuation			**1,407**	**12.5% discount rate; discounted to June 2008**

Notes:

(a) FY2010E EPS is Rs154 on 1.513 bn shares without considering merger of IPCL but conversion of 120 mn warrants issued to the major shareholder.

(b) FY2010E EPS is adjusted for treasury shares or computed using 1.343 bn shares.

(c) Number of shares outstanding after merger of IPCL will be 1.57 bn including 199 mn treasury shares.

Source: Kotak Institutional Equities estimates.

Technology

TCS.BO, Rs1140	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	1,300
52W High -Low (Rs)	1399 - 800
Market Cap (Rs bn)	1,116

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	186.3	233.2	294.4
Net Profit (Rs bn)	41.3	50.7	61.6
EPS (Rs)	42.2	51.8	62.9
EPS gth	*43.3*	*22.8*	*21.3*
P/E (x)	27.0	22.0	18.1
EV/EBITDA (x)	21.6	17.4	13.9
Div yield (%)	1.0	1.8	2.2

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	81.6	-	-
FIIs	7.1	1.4	(2.8)
MFs	2.0	2.4	(1.8)
UTI	-	-	(4.2)
LIC	1.7	1.8	(2.4)

Tata Consultancy Services: A repeat of FY2007 revenue growth rate unlikely in FY2008. Maintain IL rating

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- **FY2008 revenue growth-unlikely to be as good as FY2007**
- **OPM pressure likely to be high, levers somewhat limited**

We met with TCS management recently. Key takeaways from the meetings are (a) Margin management remains the key challenge for the company in FY2008; sharp rupee appreciation makes the challenge even stiffer. We believe that TCS has fewer margin levers at its disposal than its tier I peers, given little room to improve utilization rates and improve onsite offshore mix (b) Revenue momentum remains strong though TCS may not be able to repeat the spectacular performance of FY2007 (39% yoy growth), in our view (c) Key account management and non-linear revenue growth through asset-leveraged solutions continue to be the focus areas. The recent run down may provide some near-term upside but we prefer Infosys (faster growth) and Wipro (low expectations and revenue growth acceleration). We maintain our In-Line rating on the stock with a Mar '09 DCF based target price of Rs1,300/ share.

FY2008 revenue growth—unlikely to be as good as FY2007: We believe that FY2007 revenue growth of 39% (US$ terms) is unlikely to be repeated since (a) Growth in FY2007 was led by traction in top 10 accounts and rapid ramp up in some of the large deals won in the second half of FY2006; a repeat performance may be unlikely as some of these accounts may enter into a phase of consolidation and (b) financial services vertical, which grew a strong 46% yoy in FY2007 deals with maturing client base and may not contribute as strongly in FY2008. We model a 34% revenue growth for TCS in FY2008, still higher than the industry growth rate. Similar to FY2007, we expect revenue growth in FY2008 to be driven by increased traction in new service offerings such as remote infrastructure management, assurance services, and BPO.

OPM pressure likely to be high, levers somewhat limited: Despite aggressive assumptions, we model OPM (EBIT margin) decline of 60bps for FY2008. The elements contributing to margin pressure (cumulative of 500 bps) are well known including (a) wage inflation-the company has passed on increments of 2-4% onsite and 14-15% offshore; impacting margins by 250 bps and (b) rupee appreciation; rupee has already appreciated 9%+ to 40.7 from the average rate in FY2007; we factor in a Re/$ rate of 42 for FY2008 in our model. The levers available to offset the impact such as utilization improvement and onsite-offshore mix have already been optimized. Pricing (we model 3.7% onsite and 3% offshore increase) and variable compensation structure (discussed below) are the only meaningful areas to offset the impact of the above factors.

Variable costs provide some, though not meaningful, margin cushion: TCS follows an EVA (economic value added) linked variable compensation structure. Variable compensation is linked to the corporate, individual, and business unit performances with the average weightage being 50%, 40%, and 10% respectively. EVA is a function of the company's net operating profit after tax (NOPAT) and cost of capital and is thus linked to the company's profitability. Variable comp forms 30% of TCS' offshore salary payout (or approximately 4% of revenues). The company indicates that it has around 15-20% of the variable comp at its disposal to manage margins given the current rupee scenario, thus providing a cushion of 60-80bps, not meaningful in our view.

Key account management and non-linear revenue growth remain focus areas: TCS reiterated its focus on increasing bandwidth to keep increasing the large account (high potential) list. Increasing non-linearity in the business through asset leveraged solutions also remains a key target area for the company. This is important, in our view, given the challenges on the margin front and increasing supply side pressures.

Valuations-modest upside likely: Many of the Indian IT services stocks have corrected in the last three months and are trading a somewhat reasonable valuation. TCS stock has declined 12.5% in the past 3 months and now trades at 22xFY2008E and 18.1xFY2009E earnings. We believe that modest upside in the stock is likely but prefer Infosys (faster growth rate) and Wipro (low expectations and growth acceleration). We maintain our In-Line rating on the stock with a Mar '09 DCF based target price of Rs1300/ share. Note that our EPS estimates are based on Re/US$ rate of 42 for FY2008, 42 for FY2009 and 41 for FY2010.

TCS' revenue growth in FY2007 was driven by its top-10 accounts; we believe that a repeat performance is unlikely

TCS - international revenues only

Revenues (US$ mn)	FY2003	FY2004	FY2005	FY2006	FY2007
Total	949	1,324	1,877	2,571	3,674
Top 5 clients	241	304	362	437	680
Top 10 clients	374	479	572	707	1,044
ex-top 10 clients	575	845	1,304	1,864	2,631
Number of clients	**479**	**548**	**621**	**748**	**800**
Contribution to total revenues (%)					
Top 5 clients	25.4	23.0	19.3	17.0	18.5
Top 10 clients	39.4	36.2	30.5	27.5	28.4
Growth yoy (%)					
Total		39.5	41.8	37.0	**42.9**
Top 5 clients		26.3	19.0	20.7	**55.5**
Top 10 clients		28.0	19.4	23.5	**47.6**
ex-top 10 clients		47.0	54.4	42.9	**41.2**
Average revenue per client (US$ mn)					
Top 5 clients	48.2	60.9	72.4	87.4	136.0
Top 10 clients	**37.4**	**47.9**	**57.2**	**70.7**	**104.4**
ex-top 10 clients	1.2	1.6	2.1	2.5	3.3
Overall	2.0	2.4	3.0	3.4	4.6

Note: FY2006 revenues include revenues from Tata Infotech consolidation.

Source: Company, Kotak Institutional Equities

TCS has limited scope of expansion in utilization rate, which is already among the highest in the industry

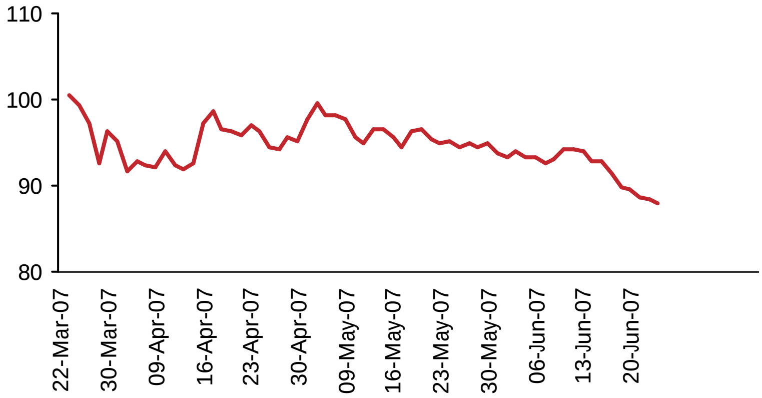
Quarter ended	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
Tata Consultancy Services	**76.9**	**74.8**	**75.0**	**75.5**	**75.8**	**77.3**	**75.2**	**75.0**	**74.7**
Infosys Technologies	72.7	72.8	71.6	67.6	67.7	70.6	67.5	66.6	66.9
Wipro (a)	73.0	72.0	70.0	68.0	70.0	72.0	69.0	67.0	68.0
Satyam Computer Services	80.2	82.0	82.1	82.0	80.1	79.1	79.1	76.3	78.6
Patni Computer Systems	64.7	67.5	67.7	68.1	67.8	70.2	72.3	73.7	72.8
Tech Mahindra	72.1	69.0	64.6	72.7	72.1	74.0	68.7	67.1	67.0
Hexaware Technologies	72.0	66.8	67.4	70.2	71.0	71.5	72.0	68.2	70.7
Mphasis BFL	72.1	76.7	77.4	75.3	73.5	73.6	75.1	78.5	71.9

(a) Wipro Technologies only

Note: Capacity utilization rate, excluding support but including trainees, tbd = results yet to be declared

Source: Company reports, Kotak Securities estimates.

TCS' stock price has declined 12.5% in the past three months



Source: Bloomberg

TCS: Consolidated Income Statement (US GAAP), Rs mn

Rs mn	2006	2007	2008E	2009E	2010E
Revenues	**132,455**	**186,334**	**233,171**	**294,402**	**350,852**
Cost of revenues	(71,720)	(104,126)	(131,265)	(166,913)	(201,142)
Gross profit	**60,735**	**82,207**	**101,906**	**127,489**	**149,710**
Selling, marketing, general & administrative expenses	(26,422)	(35,333)	(44,781)	(57,130)	(68,218)
Research and development	(419)	(433)			
EBIT (before amortization)	**33,894**	**46,442**	**57,126**	**70,358**	**81,492**
Other Income, net	190	1,943	2,675	2,130	3,062
Income bf taxes and minority interest	**34,084**	**48,385**	**59,801**	**72,489**	**84,555**
Income Taxes	(4,989)	(6,700)	(8,531)	(10,348)	(17,240)
Income before share of equity in affiliates	**29,095**	**41,685**	**51,270**	**62,141**	**67,315**
Equity in earnings of affiliate	16	44	4	4	4
Minority Interest	(279)	(417)	(534)	(591)	(577)
Income from continuing operations	**28,831**	**41,312**	**50,740**	**61,554**	**66,741**
Extraordinary items	-	-	-	-	-
Net Profit- Reported	**28,831**	**41,312**	**50,740**	**61,554**	**66,741**
EPS (Rs/ share)	**29.5**	**42.2**	**51.8**	**62.9**	**68.2**
Margins (%)					
Gross Profit margin	45.9	44.1	43.7	43.3	42.7
EBITDA Margin	27.7	27.2	26.7	25.9	25.3
EBIT Margin	25.6	24.9	24.5	23.9	23.2
NPM	21.8	22.2	21.8	20.9	19.0
Growth Rates (%)					
Revenues	36.2	40.7	25.1	26.3	19.2
Gross Profit	34.8	35.4	24.0	25.1	17.4
EBIT	25.9	37.0	23.0	23.2	15.8
Income bf taxes	23.1	42.0	23.6	21.2	16.6
Income before affiliates earnings	23.2	43.3	23.0	21.2	8.3
Income from continuing operations	22.4	43.3	22.8	21.3	8.4

Source: Kotak Institutional Equities estimates

Cement

GRAS.BO, Rs2495	
Rating	OP
Sector coverage view	Cautious
Target Price (Rs)	2,850
52W High -Low (Rs)	2908 - 1736
Market Cap (Rs bn)	229

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	141.0	152.7	174.6
Net Profit (Rs bn)	19.7	21.2	24.1
EPS (Rs)	214.6	230.7	262.4
EPS gth	*98.9*	*7.5*	*13.7*
P/E (x)	11.6	10.8	9.5
EV/EBITDA (x)	6.4	5.6	4.9
Div yield (%)	1.1	1.3	1.3

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	25.2	-	-
FIIs	34.3	1.1	0.4
MFs	6.9	1.3	0.7
UTI	1.7	2.5	1.9
LIC	7.6	1.3	0.7

Grasim Industries: Expect better performance from cement and VSF

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We expect improvement in margins for Grasim's VSF business, as the division benefits from better realizations. We believe that VSF realizations may improve further aided by strong demand growth and VSF price increases in the international markets. Cement price increases effected post-budget would likely result in marginal improvement in margins for the cement business as well. Cement and VSF together contributed 85% to the revenues and 93% to the EBITDA of Grasim in FY2007. We have revised our EPS estimates to Rs230.7 (from Rs215.6 previously) for FY2008 and Rs262.6 (from Rs238.5 previously) for FY2009 to factor in better performance of the VSF and cement divisions. Our SOTP-based target price based on FY2009E has increased to Rs2,850 from Rs2,440 previously. With increase in value of Idea Cellular, investments now contribute about 9% to our SOTP-based target price. We retain our Outperform rating.

VSF realizations expected to further improve. We believe that VSF realizations may improve further aided by strong demand growth and VSF price increases in the international markets. Grasim has a virtual monopoly in the domestic market for VSF and typically changes its product prices once every quarter. Our discussion with textile and yarn indicate a change of preference for poly-viscose over poly-cotton in recent times, thereby resulting in a sharp surge in VSF's demand. VSF prices have therefore inched up and created a price-gap with cotton as well. International Cotton Advisory Committee (ICAC) estimates consumption of cotton during 2007/08 to exceed cotton production. The resulting decline in inventory is likely to result in higher prices for cotton and provide support to VSF prices.

Cement-strong volumes growth to provide prices. We expect cement prices to remain stable or marginally weaken in FY2009, when large cement capacities get commissioned reversing the current supply deficit environment. We expect strong volumes growth in Grasim's cement business to support earnings if cement prices weaken in FY2009. We estimate Grasim's cement volume growth during FY2008 and FY2009 at 8% and 23% respectively. We expect the brownfield expansion of 4 mn tpa at Shambhupura in Rajasthan to commission during 1QFY2009 and the 4mn tpa greenfield plant at Kotputli in Rajasthan to commission towards the end of 2QFY2009.

Value on investments at Rs25.2 bn. The value of Grasim's investments have seen a steady rise after the listing of Idea Cellular. Grasim holds 6.5% stake in Idea Cellular, the mobile telephone service provider of the group. We estimate the value of Grasim's investments (comprising L&T, Hindalco, Aditya Birla Nuvo and Idea Cellular) at Rs25.2 bn (Rs19 bn previously). We use the current market prices for arriving at the value of investments in the listed companies and use a 20% discount for our SOTP calculations.

Sum-of-the-parts value at Rs2,850/share. Our SOTP-based target price has increased to Rs2,850/share from Rs2,440/share previously as we factor in increased value of investments and better near-term performance of the cement and VSF divisions. We value the cement business at 7X EV/EBITDA on FY2009E, near to the lower end of ACC's historic trading range of 6X-14X. We value the steady cash streams from VSF and allied chemicals business using DCF model. On comparative valuations on FY2009E, our assigned valuation implies 5.0X EV/EBITDA for chemicals business and 4.3X EV/EBITDA for the VSF business. We value the sponge iron division at net asset value, much below the estimated replacement cost.

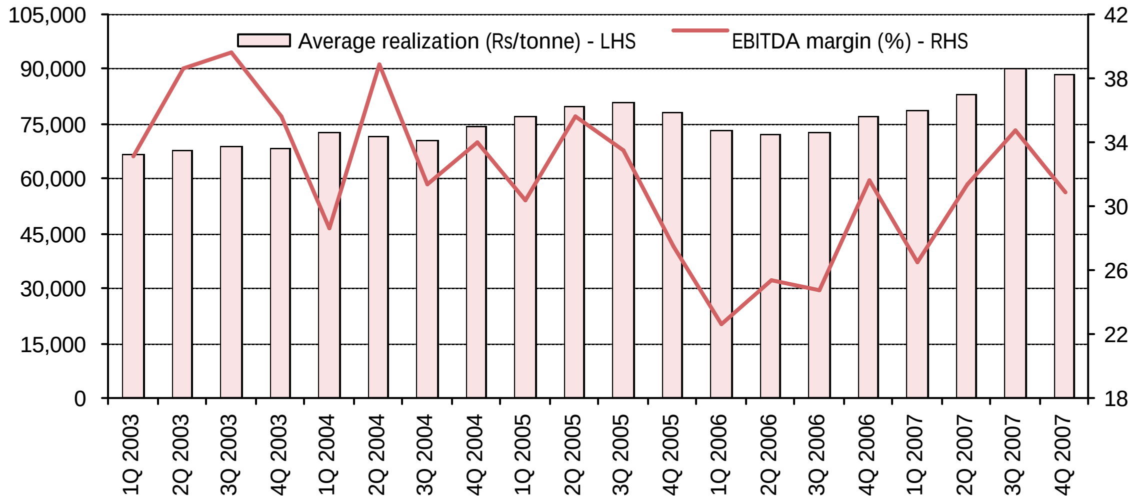
Consolidated financials of Grasim Industries

	Revenue (Rs mn)	EBITDA (Rs mn)	Net profit (Rs mn)	EPS (Rs)	EV/EBITDA (X)	P/E (X)
2005	94,100	23,128	9,763	106.5	11.1	23.5
2006	102,003	22,858	9,891	107.9	11.2	23.2
2007	140,952	42,901	19,675	214.6	6.1	11.7
2008E	152,701	46,435	21,156	230.7	5.6	10.9
2009E	174,604	53,098	24,062	262.4	4.8	9.6

Source: Company data, Kotak Institutional Equities estimates

EBITDA margin of 22% at the bottom of cycle

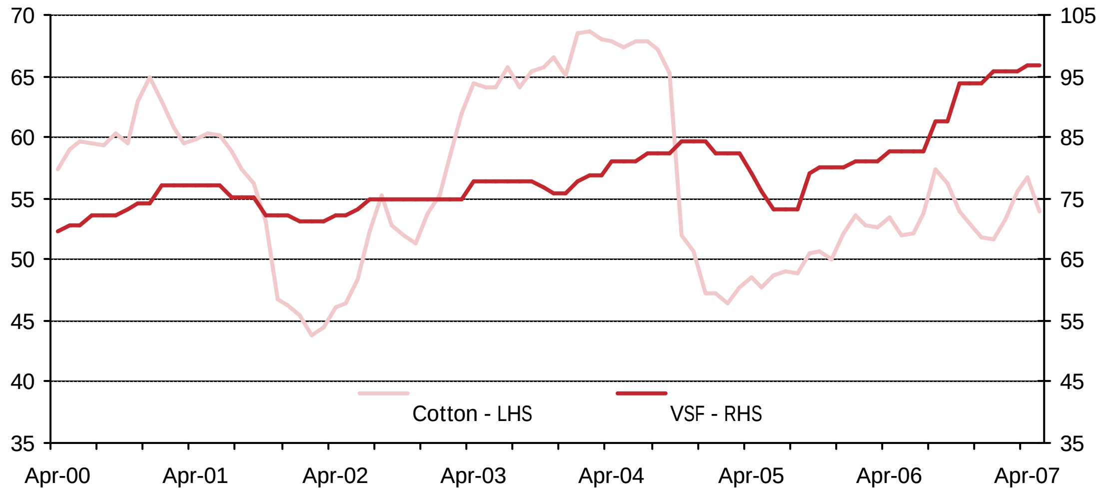
VSF business - realizations and margins



Source: Company data.

Strong demand for VSF has created a price-gap with Cotton

Domestic prices of cotton (S.6 variety) and VSF (Rs/kg)



Source: CRIS Infac, Kotak Institutional Equities.

Consumption growth to outpace production increase - expectations of firm cotton prices
Global cotton dynamics

	2005-06	2006-07	2007-08 Proj
Production (mn tonnes)	24.7	25.3	25.1
Consumption (mn tonnes)	24.9	26.1	26.8
Ending stocks (mn tonnes)	12.3	12.2	11.0
Cotlook A Index (US cents/lb)	**56**	**58**	**62**

Source: International Cotton Advisory Committee Press Release - June 2007

Operating assumptions for Grasim Industries, 2006-2009E
(Rs million)

	2006	2007	2008E	2009E
Cement division				
Average Realization, Rs per bag	107.12	148.90	152.73	150.96
Change, %	*11.0*	*39.0*	*2.6*	*(1.2)*
Volume, million tonnes	14.3	14.8	16.1	19.9
Change, %	*16.7*	*3.6*	*8.2*	*23.7*
VSF				
Average Realization, Rs per ton	67,880	84,996	89,245	84,783
Change, %	*(9.8)*	*25.2*	*5.0*	*(5.0)*
Volume, '000 tons	242.4	246.5	258.3	303.8
Change, %	*6.9*	*1.7*	*4.8*	*17.6*
Sponge Iron				
Average Realization, Rs per ton	13,247	13,125	14,044	14,044
Change, %	*0.2*	*(0.9)*	*7.0*	-
Volume, '000 tons	478	571	571	571
Change, %	*(38.1)*	*19.4*	-	-

Source: Company data, Kotak Institutional Equities estimates

SOTP valuation of Grasim
(Rs mn)

Sum of the Parts		**Methodology**
Cement	225,179	7X EV/EBITDA - compared to ACC's historic average EV/EBITDA of 10X
VSF	32,599	DCF value implying an EV/EBITDA of 4.3X on FY2009E
Sponge iron	1,508	Net asset value
Others (Chemicals)	5,910	DCF value implying an EV/EBITDA of 5X on FY2009E
Value of key investments	25,118	20% discount to current market price
Total EV	**290,314**	
Net debt	30,102	
Market capitalization	260,212	
Number of shares o/s (mn)	91.7	
Implied share price (Rs)	**2,838**	
Target price (Rs)	**2,850**	

Ourtarget price implies EV/tonne of US$141/tonne for cement business.

Source: Company data, Kotak Institutional Equities estimates

Banking

ICBK.BO, Rs954	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,000
52W High -Low (Rs)	1007 - 465
Market Cap (Rs bn)	857.4

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	135.6	172.4	220.4
Net Profit (Rs bn)	31.1	35.7	48.0
EPS (Rs)	34.6	39.7	53.4
EPS gth	*5.6*	*14.9*	*34.4*
P/E (x)	27.6	24.0	17.9
P/B (x)	3.5	3.2	2.8
Div yield (%)	0.9	1.0	1.3

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	71.5	9.0	6.3
MFs	4.4	3.4	0.7
UTI	-	-	(2.7)
LIC	7.8	5.5	2.8

ICICI Bank: Equity issue oversubscribed, FIPB turns down investment in IFS

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- **ICICI Bank local issue was oversubscribed 11.5X and ADR 5X**
- **FIPB turns down proposal of foreign investment in IFS, a key disappointment**

ICICI Bank closed its US$5bn of issuance over the weekend. The bank will be issuing close to 207mn share, 23% of its existing shares outstanding (assuming green shoe is exercised) at an average price of Rs962 per share. We are factoring this issue in our model and revising our earnings estimate (Exhibit below). In another simultaneous development the Foreign Investment Promotion Board (FIPB) has turned down the proposal of foreign investment in ICICI Financial Services (IFS). Post this issue, ICICI Bank trades at 1.27X FY2009 PBR (assuming valuation for IFS holds) as against expected RoE of 11.5-12%. We believe the significant positive response to the issue will likely get impacted in the short term given the disappointing news on IFS. However, we believe the market will likely assign a higher PBR multiple to ICICI Bank stock overtime given its strong brand, franchise and potential to gain market share in a growing economy and would recommend buying on dips. We retain our IL rating and target price of Rs1,000.

Issue oversubscribed: The bank received over 11.5X subscription for its local offering (qualified institutional buyers category being subscribed 21.6X, non-Institutional investors category being subscribed 6.1X and retail individual investors category being subscribed 1.0X) and around 5X for its ADR offering. The bank will be issuing close to 207mn share, 23% of its existing share outstanding (assuming green shoe is exercised) at an average price of Rs962 per share. The ADR was priced at Rs1,002, a premium of 5% over the local share of Rs954 per share, local institutional issue was priced at Rs940 and the retail at Rs900 per share. Post this issuance, ICICI Bank Tier I will almost double to around 14% from 7.4% in March 2007.

Disappointment on IFS, atleast for now: In another simultaneous development the Foreign Investment Promotion Board (FIPB) has turned down the proposal of foreign investment in ICICI Financial Services (IFS). IFS will house three key subsidiaries of ICICI Bank vis ICICI Prudential Life, ICICI General Insurance and ICICI Asset Management. ICICI Bank had received firm commitments from investors for investing around Rs26.5bn in this company for a 5.9% stake effectively valuing the entity at US$11bn. We believe that IFS has clearance from IRDA but needs clearance from RBI for the NBFC license and FIPB for the foreign investment. ICICI officials indicated that they would be reapplying with FIPB shortly. Our sensitivity analysis shows that our target price for ICICI Bank will fall to around Rs930 per share if we were to assume lower value of US$7bn for IFS. Our current base case scenario assumes a value of US$8.8bn.

ICICI Bank (Old and new estimates Rs mn)

	Old estimates			New estimates			% change in estimates			YoY change (%)		
	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2010E	FY2008E	FY2009E	FY2009E
Net interest income	89,155	114,572	141,886	101,655	142,542	184,720	14.0	24.4	30.2	53.2	40.2	29.6
Spread	2.26	2.39	2.50	2.27	2.35	2.43						
NIM (%)	2.49	2.64	2.74	2.74	2.91	2.90						
Customer assets (Rs bn)	2,557	3,017	3,547	2,769	3,679	4,814	8.3	21.9	35.7	31.4	32.9	30.9
Loan loss provisions	26,690	32,792	40,590	26,687	37,760	52,228	(0.0)	15.1	28.7	23.6	41.5	38.3
Other income	83,225	105,786	126,791	79,690	100,182	118,616	(4.2)	(5.3)	(6.4)	17.0	25.7	18.4
Fee income	66,427	88,773	112,226	58,770	78,540	99,290	(11.5)	(11.5)	(11.5)	35.7	33.6	26.4
Treasury income	5,000	4,000	2,000	5,000	4,000	2,000	-	-	-	(55.2)	(20.0)	(50.0)
Profit on sale of loans	900	1,225	1,326	1,259	1,715	1,857	39.9	40.0	40.0	(2,022.0)	36.2	8.3
Operating expenses	91,222	111,759	135,585	93,005	118,624	148,431	2.0	6.1	9.5	39.0	27.5	25.1
Employee expenses	22,926	30,158	39,213	23,172	31,917	43,196	1.1	5.8	10.2	43.3	37.7	35.3
Investment amortization	8,492	7,218	6,135	8,489	6,791	5,093	(0.0)	(5.9)	(17.0)	(18.4)	(20.0)	(25.0)
PBT	45,975	68,589	86,367	53,164	79,549	97,584	15.6	16.0	13.0	45.7	49.6	22.7
Tax	10,244	20,577	25,910	12,041	21,478	26,348	17.5	4.4	1.7	123.9	78.4	22.7
Net profit	**35,732**	**48,012**	**60,457**	**41,123**	**58,071**	**71,236**	**15.1**	**20.9**	**17.8**	**32.2**	**41.2**	**22.7**
PBT-treasury+provisions	**67,666**	**97,381**	**124,957**	**74,850**	**113,308**	**147,812**	**10.6**	**16.4**	**18.3**	**59.5**	**51.4**	**30.5**

Source: Kotak Institutional Equities.

Forecasts and valuation (Rs mn)

March y/e	Profit after tax (Rsmn)	EPS (Rs)	P/E (x)	BVPS (Rs)	P/B (x)	RoA (%)	RoE (%)	EPS excl treasury & dividend (Rs)	P/E ICICI Bank Stand alone (X)	BVPS (adjt for subsidiaries) (Rs)	P/B ICICI Bank stand alone (X)
2006	25,401	32.8	29.1	249.6	3.8	1.2	14.6	18.7	28.4	217.4	2.45
2007	31,102	34.6	27.6	270.4	3.5	1.0	13.4	17.2	31.0	225.1	2.37
2008E	41,123	37.2	25.7	428.5	2.2	1.0	11.5	28.2	18.9	387.5	1.38
2009E	58,071	52.5	18.2	465.6	2.0	1.1	11.7	44.0	12.1	420.5	1.27
2010E	71,236	64.4	14.8	511.2	1.9	1.1	13.2	57.2	9.3	466.0	1.14

ICICI Bank SOTP value (Rs per share)

	ICICI Share (%)	Assuming ICICI Financial Services value at US$7 bn	Ascribing 20% discount on ICICI Financial Services US$8.8 bn	Assuming ICICI Financial Services value at US$11 bn	Valuation methodoly adopted
Value of ICICI standalone	**100**	574	574	574	Based on Residual growth model
Subsidiaries					
ICICI Financial Services	**94**				
ICICI Prudential Life	74*	243	306	382	
General Insurance	74*				
Mutual Fund	51*				
Other subsidiaries/associates					
ICICI Securities Ltd	100	25	25	25	PER of 45X FY2007 EPS
ICICI Securities Primary Delaer	100	19	19	19	PBR of 5X FY2007 BVPS
ICICI Homes Ltd	100	6	6	6	PBR of 2X FY2007 BVPS
ICICI Bank UK	100	14	14	14	PBR of 2X FY2007 BVPS
ICICI Bank Canada	100	6	6	6	PBR of 2X FY2007 BVPS
ICICI Bank Euroasia	100	4	4	4	PBR of 2X FY2007 BVPS
3i	11.18	2	2	2	Market value
Venture capital/MF	100	19	19	19	15% of AUM FY2009E of US$2.6bn
ICICI One Source	25	11	11	11	20% premium over Market value
NCDEX	8	1	1	1	Valued at US$300 mn based on last transaction
ARCIL	29.7	2	2	2	Based on value assigned by IDFC at Rs7.15bn
NSE	6.5	7	7	7	Based on value assigned by recent divestment
Value of subsidiaries		**358**	**421**	**497**	
Value of company		**932**	**995**	**1,071**	

* IFS will own 74% stake each in ICICI Prudential Life and ICICI Lombard and 51% in the AMC business

Source: Kotak Instititional Equities

Valuation of ICICI Bank stand alone ascribing different valuations to IFS

	Assuming value of US$7bn		Base case value of US$8.8bn		Assuming value of US$11bn	
March y/e	PER standalone (X)	PBR standaline (X)	PER standalone (X)	PBR standaline (X)	PER standalone (X)	PBR standaline (X)
2006	31.78	2.74	28.4	2.45	24.36	2.10
2007	34.61	2.64	31.0	2.37	26.53	2.03
2008E	21.11	1.54	18.9	1.38	16.18	1.18
2009E	13.54	1.42	12.1	1.27	10.38	1.09
2010E	10.41	1.28	9.3	1.14	7.98	0.98

Source: Kotak Instititional Equities

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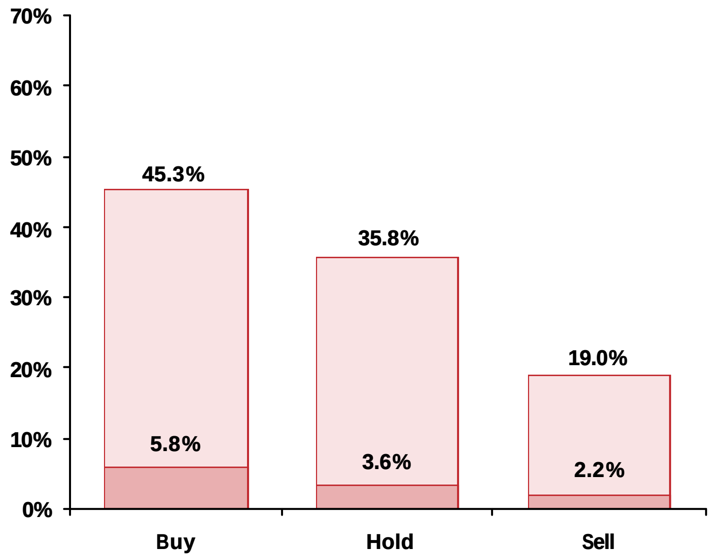

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Source: Kotak Institutional Equities. As of March 31, 2007

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