kotak® Institutional Equities

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EQUITY MARKETS

		Change, %		
India	**23-Jan**	**1-day**	**1-mo**	**3-mo**
Sensex	8,674	(1.6)	(7.0)	(0.3)
Nifty	2,679	(1.3)	(6.3)	3.7
Global/Regional indices				
Dow Jones	8,116	0.5	(4.7)	(3.1)
FTSE	4,209	3.9	(0.2)	8.4
Nikkie	7,950	3.5	(9.0)	11.0
Hang Seng	12,579	(0.6)	(11.3)	(0.3)
KOSPI	1,093	(2.0)	(2.2)	16.5

Value traded - India

			Moving avg, Rs bn	
	23-Jan		**1-mo**	**3-mo**
Cash (NSE+BSE)	117.4		87.6	30.1
Derivatives (NSE)	368.1		511.3	536
Deri. open interest	569.1		651	740

Forex/money market

		Change, basis points		
	23-Jan	**1-day**	**1-mo**	**3-mo**
Rs/US$	49.2	0	80	(66)
10yr govt bond, %	5.9	(13)	72	(192)

Commodity market

		Change, %		
	23-Jan	**1-day**	**1-mo**	**3-mo**
Gold (US$/OZ)	903.3	(0.0)	3.9	23.6
Silver (US$/OZ)	12.1	0.0	12.8	33.2
Crude (US$/BBL)	45.9	0.1	28.5	(22.4)

Net investment (US$mn)

	22-Jan		**MTD**	**CYTD**
FIIs	(62)		(728)	(728)
MFs	(28)		(376)	(377)

Top movers -3mo basis

		Change, %		
Best performers	**23-Jan**	**1-day**	**1-mo**	**3-mo**
Ntpc Limited	180	0.7	1.7	43.0
Jindal Steel & Powe	780	(3.3)	(9.5)	40.2
Bharat Petroleum C	367	(4.8)	(2.1)	34.3
India Cements Limit	102	(0.4)	7.8	45.8
Power Finance Corp	129	(2.2)	5.0	42.7
Worst performers				
Housing Developme	90	(6.7)	(29.2)	(34.5)
Satyam Computer S	39	31.3	(71.4)	(86.5)
Unitech Limited	27	(4.9)	(25.3)	(36.8)
Aban Offshore Limi	453	(6.6)	(32.5)	(30.3)
Glenmark Pharmac	204	(5.8)	(31.7)	(21.4)

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Utilities

NTPC.BO, Rs180	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	160
52W High -Low (Rs)	227 - 113
Market Cap (Rs bn)	1,483

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	370.9	403.4	438.3
Net Profit (Rs bn)	76.9	74.4	80.3
EPS (Rs)	9.3	9.0	9.7
EPS gth	*9.3*	*(3.8)*	*9.2*
P/E (x)	19.3	19.9	18.5
EV/EBITDA (x)	13.4	14.4	13.6
Div yield (%)	1.9	1.9	2.0

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
1.7	43.0	(4.2)	(19.3)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	89.5	-	-
FIIs	4.2	1.0	(3.3)
MFs	0.5	0.6	(3.7)
UTI	-	-	(4.3)
LIC	-	-	(4.3)

NTPC: 3QFY09—prior-period revenues aid profit growth. CERC regulations to benefit earnings growth

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- **Reported revenues and profits boosted by prior-period revenues of Rs5.2 bn**
- **Higher fuel costs aid revenue growth, energy sales grow 3.5% yoy**
- **Revised tariff structure improves profitability and implied valuation multiple**
- **Potential upside on our estimates if NTPC retains tax benefit under 80IA**

NTPC reported net sales of Rs112.8 bn, EBITDA of Rs32.2 bn and net profit of Rs22.6 bn as against our estimate of Rs102.4 bn, Rs28.2 bn and Rs18.6 bn, respectively, for 3QFY09. The outperformance was largely on account of prior revenues of Rs5.2 bn booked during the quarter as against our estimate of Rs1.1 bn. Revenue growth during the quarter was also aided by (1) higher fuel costs (28% yoy) and (2) marginal increase in generation (3.5% yoy)—aided by commercialization of 500 MW each at Sipat and Kahalgaon. We estimate the IRR of a new thermal power project at 92% plant availability under the new CERC regulations to improve by 150 bps implying a P/B of 1.37X compared to 1.24X under the prevailing CERC regulations. We assume the tax rate recoverable from tariffs to be the same as the effective tax rate of the project. The DCE-equity implied P/B improves to 1.54X for a new project if the generation company is allowed to recover effective tax rate of 33.99% from tariffs and retain the benefits of tax exemption under 80IA. We maintain our EPS estimates at Rs9 for FY2009E and Rs9.7 for FY2010E and will revisit our estimates after the conference call with the management. We retain our REDUCE rating with a DCF-based target price of Rs160/share. Retention of 80IA benefits by NTPC and recovery of tax from beneficiaries at effective tax rate of 33.99% is a key upside risk to our estimates.

Reported revenues and profits boosted by prior-period revenues of Rs5.2 bn. Reported revenues and profits for 3QFY09 include prior-period revenues of 5.2 bn (our estimate Rs1.1 bn), compared to Rs1.1 bn prior-period revenues in 3QFY08. Adjusting for prior-period revenues, EBITDA declined 7% yoy and increased 11% qoq. Adjusted EBITDA for the nine-months ended December 31, 2008 has increased by 2% yoy only—limited due to marginal capacity addition and reduced depreciation recovery from old plants. In our view, earnings growth for the current fiscal will be impacted by higher prior-period income during the previous year (Rs11.3 bn), as most tariff orders have been cleared resulting in lower prior-period income during the current fiscal (Rs7 bn in nine months so far).

Higher fuel costs aid revenue growth, energy sales grow 3.5% yoy. NTPC reported revenue growth of 21% yoy for 3QFY09, aided by 28% yoy growth in fuel costs. Adjusted for prior-period income, revenues grew 17% yoy. Increase in energy sales (3.5% yoy) was aided by commencement of commercial operation of 1,000 MW—at Sipat (500 MW) in June 2008 and Kahalgaon (500 MW) in August 2008. We expect the growth in generation to increase in 4QFY09 with two additional units at Sipat (550 MW) and Kahalgaon (500 MW) having commenced commercial generation from January 2009.

Revised tariff structure improves profitability and implied valuation multiple. Our DCF-equity (using a cost of equity of 12.5% and three-year implementation period) of the cash flows for a new coal-based generating station as per the revised tariff regulations, gives a P/B of 1.37X on 92% plant availability and 1.24X on 85% plant availability. A similar DCF-equity as per the current tariff regulations gives a P/B of 1.24X for a new coal-based generating station. Exhibit 2 gives the buildup of effective RoE under the existing and proposed regulations. In our base case, we assume the tax rate recoverable from tariffs to be the same as the effective tax rate of the project. We use NTPC's tax rate of 25% for deducting the tax expense on incentives, savings and UI charges.

The DCE-equity implied P/B (at 92% plant availability) improves to 1.54X for a new project if NTPC is allowed to recover effective tax rate of 33.99% from tariffs and retain the benefits of tax exemption under 80IA. Mr R Krishnamoorthy, Member-CERC, highlighted in a conference call that the generation company will be allowed to retain the benefits of tax exemption under 80IA and recover full tax from the beneficiaries. While as per the Member-CERC, the revised regulations are unlikely to make a big change in the effective tariffs as well as the effective RoEs, we estimate this to be highly value accretive for a new project. Typically a new power project pays MAT at 11.33% during the first 15 years of operation, while it will be able to recover much higher amounts on account of taxation from the beneficiary (at 33.99%).

New CERC regulations likely to improve earnings growth. We have maintained our EPS estimates of Rs9 for FY2009E and Rs9.7 for FY2010E and will revisit our estimates after the conference call with the management. The revised tariff structure will likely enhance NTPC's earnings by 5-7% as—(1) it gets the benefit of higher depreciation rate in tariffs (AAD recovered in tariffs not shown as part of revenues by NTPC), (2) benefits on account of revised tariff regulations get negated largely by tax on incentives, savings and UI Charges. The exact benefit of incentives on availability for the operating power plants will also depend on the annual fixed charges which would vary for each power plant. However, the improvement in earnings could be substantial if NTPC is able to retain the benefits of tax exemption under Section 80IA. In such a scenario, NTPC will recover 33.99% effective tax from the beneficiaries while pay only 11.33% under MAT on a new project.

DCF-equity based target price of Rs160/share. We retain our REDUCE rating on the stock. Our DCF-equity using 12% cost of equity and 4% terminal growth rate gives a target price of Rs160/share. Key upside risks to our earnings estimates and target price emanate from—(1) NTPC retaining the benefit of tax exemption under 80IA, (2) faster execution of projects compared to our estimates timelines. We note our target price is highly sensitive to cost of equity assumption. Exhibit 3 gives the sensitivity of our target price to cost of equity and return on equity assumptions. We estimate the equity IRR of a thermal power project to improve by 230 bps if NTPC is allowed to recover tax from beneficiaries at effective rate of 33.99% and retains the tax benefits under 80IA (pay MAT of 11.33% only).

Exhibit 1: Financial results for NTPC, March yearends (Rs bn)

	yoy		yoy	
	2009E	**3QFY09**	**3QFY08**	**(% chg)**
Net sales	**415.6**	**112.8**	***93.3***	**20.9**
Operating costs				
Cost of fuel	(262.0)	(70.0)	(54.8)	27.82
Personnel costs	(24.9)	(6.6)	(4.8)	37.1
Other expenses	(18.1)	(4.0)	(4.0)	(0.6)
Total expenses	(305.0)	(80.6)	(63.6)	
EBITDA	**110.6**	**32.2**	***29.7***	**8.3**
EBITDA margin (%)	26.6	28.5	31.8	
Other income	30.9	8.5	7.6	
Interest & finance charges	(19.9)	(5.1)	(4.7)	
Depreciation	(22.3)	(5.6)	(5.3)	
PBT	**99.3**	**30.0**	***27.4***	**9.6**
Provision for tax (net)	(24.9)	(7.4)	*(9.6)*	
Net profit	**74.4**	**22.6**	**17.8**	**26.9**
Extraordinary	5.3	-	-	
EBITDA margin (%)	26.6	28.5	31.8	
Tax rate (%)	25.1	24.7	35.0	
Adjusted EBITDA calculations				
Net sales	**407.6**	**107.5**	***92.2***	**16.7**
Cost of fuel	(262.0)	(70.0)	*(54.8)*	
Personnel costs	(24.9)	(6.6)	*(4.8)*	
Other expenses	(24.3)	(5.6)	*(5.3)*	
Total expenses	(311.2)	(82.2)	*(64.9)*	
EBITDA (w/o prior period revenues)	**96.4**	**25.4**	***27.3***	**(7.1)**
Prior period revenue	8.0	5.2	1.1	366.1
Key operating parameters				
Units generated (bn units)	208	52.5	*50.7*	3.5

Source: Company data, Kotak Institutional Equities

Exhibit 2: Gains from new regulations could be substantial if NTPC retains the benefit of tax exemption under 80IA

Effective return on equity (%) for first year of operation of project under existing and proposed tariff regulations

	Extant regulations	**Final regulations (a)**	**Final regulations (b)**
	FY2004-09	**FY2009-14**	**FY2009-14**
Pre-tax return on equity		17.5	23.5
Tax deducted		-2.0	-2.7
Assured post-tax return on equity	**14.0**	**15.5**	**20.8**
Savings on fuel costs	2.7	0.8	0.8
Savings on O&M		1.1	1.1
Savings on interest on working capital	1.9	1.7	1.7
Incentives	1.8	2.9	3.0
Effective RoE	**20.3**	**22.0**	**27.4**
Tax deduction on savings and incentives (@25%)	0.0	-2.1	-2.1
Post-tax RoE	**20.3**	**20.0**	**25.3**
IRR (%)	**16.2**	**17.7**	**20.0**
Implied P/B (X) at 12.5% cost of equity	**1.24**	**1.37**	**1.54**

Notes:
(a) Final CERC regulations assuming the benefit of tax exemption under Section 80IA is passed to beneficiaries as reduction in tax recoverable.
(b) Final CERC regulations assuming NTPC retains benefit of tax exemption under Section 80IA and recovers tax from beneficiaries at the effective tax rate (33.99%).
(c) We use the effective tax rate of NTPC (~25%) for estimating tax outgo on incentives and savings etc.

Source: Kotak Institutional Equities estimates

Exhibit 3: DCF based target price of Rs160/share assuming 12% cost of equity and 4% terminal growth rate

Sensitivity of our target price to cost of equity and effective RoE

		Effective RoE (%)				
		-500 bps	-250 bps	Current RoE	+250 bps	+500 bps
Cost of equity (%)	9.0	200	232	264	297	329
	10.0	164	191	217	244	271
	11.0	139	162	184	207	229
	12.0	121	140	**160**	179	198
	13.0	107	124	141	158	175
	14.0	95	111	126	141	156

Source: Kotak Institutional Equities estimates

Exhibit 4: NTPC: Profit model, balance sheet, cash model 2006-2011E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)						
Net sales	**261,429**	**326,317**	**370,910**	**415,620**	**454,591**	**516,296**
EBITDA	**63,621**	**93,137**	**108,176**	**102,472**	**117,573**	**139,023**
Other income	23,800	27,449	29,203	30,882	25,875	25,006
Interest	(6,648)	(8,063)	(10,678)	(11,711)	(14,319)	(21,414)
Depreciation	(20,477)	(20,754)	(21,385)	(22,309)	(25,336)	(32,236)
Pretax profits	60,296	91,769	105,316	99,333	103,793	110,379
Tax	(2,022)	(20,427)	(28,401)	(24,893)	(23,444)	(19,807)
Net profits	**58,274**	**71,342**	**76,915**	**74,440**	**80,349**	**90,572**
Extraordinary items	(72)	(2,695)	(2,752)	5,319	—	—
Earnings per share (Rs)	**7.1**	**8.7**	**9.3**	**9.0**	**9.7**	**11.0**
Balance sheet (Rs mn)						
Total equity	449,587	485,968	526,386	572,383	617,482	668,319
Deferred taxation liability	4,409	6,568	13,735	15,303	16,612	19,456
Total borrowings	201,973	244,844	274,460	344,017	439,428	636,855
Currrent liabilities	61,402	70,263	79,299	88,310	94,876	106,398
Total liabilities and equity	**717,371**	**807,643**	**893,880**	**1,020,013**	**1,168,398**	**1,431,028**
Cash	84,714	133,146	149,332	157,237	150,579	96,002
Current assets	72,531	88,681	106,156	118,456	127,414	142,405
Total fixed assets	367,235	424,873	485,720	596,752	750,808	1,067,231
Investments	192,891	160,943	152,672	147,569	139,598	125,391
Total assets	**717,371**	**807,643**	**893,880**	**1,020,013**	**1,168,398**	**1,431,028**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	78,679	89,474	95,555	102,068	105,685	122,808
Working capital	(6,544)	(7,485)	(8,439)	(3,289)	(2,732)	(4,494)
Capital expenditure	(65,279)	(78,392)	(82,232)	(133,341)	(179,392)	(348,658)
Investments	15,086	31,948	8,271	5,104	7,971	14,208
Free cash flow	**21,942**	**35,545**	**13,155**	**(29,458)**	**(68,468)**	**(216,137)**
Key assumptions						
Realization (Rs/unit)	1.6	1.8	2.0	2.0	2.0	2.1
Energy Sales (MU)	159,019	176,530	187,988	194,084	217,735	240,918
PLF (%)	85.7	87.1	88.3	86.9	90.3	90.1

Source: Kotak Institutional Equities estimates

Banking

SBI.BO, Rs1042	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,600
52W High -Low (Rs)	2359 - 966
Market Cap (Rs bn)	658

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	257	329	378
Net Profit (Rs bn)	67.3	86.6	82.3
EPS (Rs)	106.6	137.1	130.3
EPS gth	*23.5*	*28.7*	*(4.9)*
P/E (x)	9.8	7.6	8.0
P/B (x)	1.6	1.4	1.3
Div yield (%)	2.1	2.1	2.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(16.2)	(1.1)	(27.9)	(54.1)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	59.4	-	-
FIIs	18.2	2.8	0.0
MFs	4.5	3.7	0.8
UTI	-	-	(2.8)
LIC	4.4	2.9	0.1

SBI: Huge accretion of deposits; steady operational performance; retain BUY

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- **Significant accretion of deposits and sharp moderation in incremental loan growth are key features of the 3QFY09 results**
- **PAT was Rs24.8 bn (up 37% yoy); treasury gains were higher than expect but lower in comparison to other banks**
- **NPLs under control thus far; retain BUY rating**

State Bank of India (SBI) reported PAT of Rs24.8 bn (up 37% yoy) and 9% ahead of estimates. The key highlights for the current quarter were: (1) significant accretion of deposits of Rs732 bn, which was 72% of incremental deposits observed in FY2008, (2) moderation in incremental loan growth, (3) relatively lower treasury Rs6.7 bn in comparison to other banks and (4) no negative surprises on reported NPLs. Consolidated earnings increased 51% yoy and NII was up 37% yoy. In addition, fee income growth remained strong and opex was higher due to higher provision for pension liabilities. Revise our earnings estimates upwards 8% for FY2009E and by around 6-7% for FY2010E and FY2011E to factor in the 3QFY09 results. Retain BUY rating on the stock.

Retain BUY on reasonable valuations. We believe our current estimates are conservative and likely factor in the impact on earnings due to lower NIM, lower fee income and higher credit provisions on account of likely NPLs over the next three-four quarters. Our expectations on treasury profits are modest at around Rs18 bn and Rs14 bn in FY2010E and FY2011E compared to Rs9.5 bn observed in FY2008. Further, our long-term RoE expectation of the company is 15% and our valuation of its banking subsidiaries at 1X APBR FY2010E, which is undemanding, in our view. We believe post the sharp correction in stock price over the past month by 18%, the stock is attractively valued at 4.7X PER and 0.6X PBR FY2009E (standalone banking business) and retain BUY rating.

Net interest income growth remains high, will likely moderate. SBI's net interest income for 3QFY09 was up 35% yoy to Rs57.6 bn and in line with our expectations. This revenue stream of the company was aided by (1) equity infusion of Rs167 bn in 4QFY08, (2) one-time impact of SBS merger (effective from August 14, 2008), (3) strong pricing power in early part of 3QFY09. The benefit of equity capital infusion will taper off by next quarter. The assets are likely to reprice faster than liabilities in a softening interest rate environment and lead to stress on NIM of the company. We model a 20 bps decline in NIM in FY2010E compared to FY2009E. The company would have to significantly reduce its interest rates on deposits and moderate its deposit mobilization to support its NIM in the next few years.

Margins up 32 bps yoy to 3.15%; expect moderation in future periods Margins improved 32bps yoy to 3.15% and it remained flat on qoq basis. Loan yields improved by 51 bps yoy and 18 bps qoq to 10.42% in 9MFY09. This is despite the 75 bps PLR cut during the quarter which demonstrates pricing power of banks in the current environment. Cost of deposits increased remained flat qoq at 5.95%. We are surprised by stable deposit costs as deposits during the quarter were likely contracted at higher rates. Yield on investments improved to 7.48% in 9MFY09 from 6.95% in 9MFY08 (down just 10 bps qoq). We believe SBI has been able to build its investment book at relatively higher yields and is sitting on huge unrealized gains which it could realize over the next few quarters.

Deposit growth was exceptionally strong. The strong brand equity of SBI helped the company reap windfall gains during the liquidity crisis and improve its market share in deposits. The incremental growth in deposits at SBI was Rs732 bn in 3QFY09-72% of the incremental deposits observed at the bank in FY2008, which translated to over 40% of market share in incremental deposits of the banking system during this period. The loan growth, however, came off sharply in 3QFY09 compared to previous quarters. The incremental growth in loans was Rs104 bn (Rs502 bn observed in 2QFY09) and was the lowest since 2QFY08. Overall deposits increased by 36% yoy to Rs6.92 bn and loans grew by 29% yoy. CASA deposits grew 21% yoy and savings bank deposits grew 27% yoy.

Investment book has increased sharply; huge unrealized gains. A faster increase in deposits compared to loans implied that there was a significant rise in investments of SBI. The investment book of SBI increased to Rs2.5 tn as of December 2008 compared to Rs1.95 tn as of September 2008. The sharp rise in investment portfolio in a falling Gsec yield environment has likely resulted in significant gains for the company and could be realized in future periods when NPLs are likely to rise. Again, a point to note here is its investment yields have not declined much during the quarter, despite a huge build up of deposits, indicating huge unrealized gains on its books. The bank has not booked huge gains during the quarter, in comparison to other banks wherein treasury gains have been very large. The write-back of depreciation was also lower than our expectation, as we believe the bank might have taken mark-to-market losses on its equity book during the quarter (await clarity from the management)

The other positive of the significant deposit accretion at SBI is to reduce the reliance of the company on deposit mobilization to fund its loan growth. The company will likely be able to fund its loan growth by running down its investment book. The management stated that it's SLR/NDTL has increased to 30%. This cushion on the liability side should enable the company to reduce interest rates on its deposits and protect its NIM.

Fee income continues to be healthy and aids earnings. SBI continues to report strong momentum in its non-interest revenues. The non-interest income (excluding treasury) in 2QFY09 was Rs25.5 bn (up 24% yoy). The fee income was up 57% yoy at Rs16.1 bn likely reflecting better utilization of the core banking solution for cross-selling and improved pricing power in the current environment. We have assumed a moderation in the fee income growth in FY2010E to 14% yoy compared to the expected 28% yoy in FY2009E.

Treasury income of SBI was Rs6.7 bn, which was a modest 5% yoy growth and insignificant compared to its investment book of Rs2.45 tn. The company will likely book higher treasury income in future periods when the NPLs are likely to increase and protect its overall earnings.

Operating expenses increased due to one-off higher pension provisions In 3QFY09, operating expenses increased 37% yoy to Rs45 bn as the bank made Rs7.5 bn provision for pension liabilities under revised AS-15 guidelines. The management indicated that this is a one-time cost to adjust to the lower GSec yield (during the quarter yields had declined by over 200 bps). Even other operating expenses increased by 32% yoy due to aggressive branch/ATM expansion and marketing expenses.

Asset quality appears to be healthy as of now. Gross NPL ratio and net NPL ratio of SBI as of 3QFY09 stood at 2.6% and 1.4%. The company's provision coverage ratio stands at 48% and is amongst the lowest in the industry. The gross NPLs as of December 2008 were Rs133 bn-Rs 7 bn higher than the Rs126 bn reported as of September 2008. The NPL provisions made by the company were Rs5.2 bn in 3QFY09 implying that the incremental slippages were similar to the trend observed in previous quarters. We currently model incremental delinquencies of 2.8% in FY2009E and 4% in FY2010E to factor the expected moderation in economic growth over the next year.

Consolidated performance was even stronger in 3QFY09 The consolidated performance has been stronger, as most subsidiary banks reported strong growth in core earnings. Consolidated NII grew 37% yoy and earnings grew 51% yoy largely driven by 102% earnings growth of subsidiary banks.

State Bank of India, Quarterly results, Rs mn

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg	3QFY09KS	Actual Vs KS
Income earned	126,668	135,767	137,992	155,665	180,303	42.3	164,596	9.5
Income on advances	92,711	96,035	100,140	114,821	128,366	38.5	121,710	5.5
Income on investments	32,711	32,118	35,079	38,287	41,804	27.8	40,201	4.0
Interest on balance with RBI	1,247	7,615	2,773	2,557	10,134	713	2,685	277.4
Interest expense	84,105	87,761	89,815	101,112	122,722	45.9	106,167	15.6
Interest on deposits	71,057	74,199	77,694	85,742	102,057	43.6	90,029	13.4
Interest on borrowings	6,908	8,065	7,311	9,433	7,890	14.2	9,905	(20.3)
Other sundry interest	6,140	5,497	4,810	5,936	12,774	108.0	6,233	104.9
NII adjt for invest. amortization	**42,564**	**48,006**	**48,177**	**54,554**	**57,582**	**35.3**	**58,429**	**(1.5)**
Other income	26,972	28,172	24,039	23,431	32,256	19.6	24,603	31.1
Fees, commission	10,237	30,602	12,850	13,314	16,090	57.2		
Invt. income	6,436	2,965	2,228	1,616	6,740	4.7	2,600	159.2
Forex income	4,314	(1,016)	1,692	2,933	3,340	(22.6)		
Dividend	230	21	3,854	71	96	(58.2)		
Other income excl. treasury	20,536	25,207	21,810	21,816	25,516	24.3	22,003	16.0
Total income	**69,536**	**76,178**	**72,215**	**77,985**	**89,838**	**29.2**	**83,032**	**19.4**
Operating expenses	32,938	32,447	32,592	36,053	45,011	36.7	37,855	18.9
Staff expenses	18,139	20,442	20,352	21,173	21,990	21.2	22,231	(1.1)
Pension contributions	3,808	(4,746)	958	1,039	8,466	122.3	1,091	675.8
Other operating expenses	10,991	16,751	11,282	13,841	14,556	32.4	14,533	0.2
Pre-provision operating profit	36,598	43,732	39,623	41,932	44,826	22.5	45,177	(0.8)
Provisions and extr. Ord.	8,044	16,192	15,495	6,106	1,968	(75.5)	9,478	(79.2)
Loan loss provisions (incl. standard asset prov)	6,642	13,159	(2,111)	10,930	5,151	(22.4)	16,000	(67.8)
Standard assets	2,200	2,490	363	1,820	-	-	1,500	(100.0)
Investment depreciation	575	2,168	16,566	(4,803)	(3,416)	(694.2)	(8,000)	(57.3)
Other provisions	828	865	1,040	(22)	239	-	(22)	
PBT	**28,553**	**27,540**	**24,129**	**35,826**	**42,858**	**50.1**	**35,699**	**20.1**
Less tax	10,467	8,707	7,721	13,229	18,074	72.7	12,851	40.6
Profit after tax	**18,087**	**18,833**	**16,408**	**22,597**	**24,784**	**37.0**	**22,847**	**8.5**
PBT - investment income+ invt dep.	22,692	26,743	38,467	29,407	32,702	44.1	25,099	30.3
PBT - invest income+ provisions-extr. Items	**29,333**	**35,902**	**32,355**	**40,338**	**37,853**	**29.0**	**41,099**	**(7.9)**
Fees to PBT (%)	35.9	111.1	53.3	37.2	37.5			
Treasury income/PBT (%)	20.5	2.9	(59.4)	17.9	23.7			
Cost income ratio (%)	47.4	42.6	45.1	46.2	50.1			
Tax rate (%)	36.7	31.6	32.0	36.9	42.2			
Key balance sheet data (Rs bn)								
Advances gross	3,956	4,473	4,483	5,001	5,103	29.0		
Advances net	3,903	4,168	4,432	4,934	5,038	29.1		
Housing finance	425	451	461	506	521	22.4		
Deposits	5,101	5,374	5,619	6,197	6,929	35.8		
Low cost deposits (%)	41.1	43.1	41.2	39.7	36.6			
Investments	NA	1,895	2,000	1,950	2,450			
HTM	NA	NA	1,340	1,365	1,622			
AFS	NA	NA	660	585	828			
AFS duration (years)	NA	NA	3.0	2.5	1.8			
Yield management ratios (%)								
Cost of deposits	5.6	5.6	5.7	5.9	6.0			
Yield on advances	9.9	9.9	9.8	10.2	10.4			
Yield on resources	7.0	6.9	7.4	7.6	7.5			
Net interest margin								
Net interest margin (adj. Amortization)	2.8	3.1	3.0	3.2	3.2			
Asset quality details								
Gross NPLs (Rs bn)	106	136	114	126	133	25.1		
Gross NPLs (%)	2.7	3.0	2.5	2.5	2.6			
Net NPLs (Rs bn)	56	74	63	66	69	22.4		
Net NPLs (%)	1.4	1.8	1.4	1.3	1.4			
Capital adequacy details (%)								
CAR	12.3	13.5	13.0	12.1	13.4			
Tier I	7.5	9.1	9.3	8.7	9.2			
Tier II	4.8	4.3	3.7	3.5	4.2			

Source: Company, Kotak Institutional Equities estimates.

SOTP valuation of SBI

Subsidiaries	SBI holding (%)	NW FY2009E (Rs mn)	Multiple assumed (X)	Value FY2010 (Rs mn)	Value per share FY2010 (Rs)	Methodology adopted
SBI standalone					**1,151**	**Residual income model**
Non banking subsidiaries						
SBI Life				120,197	170	Based on appraisal value
SBI MF	63			24,517	39	5% of AUM of Rs324 bn
NSE	8%			12,480	20	NSE value assumed to be Rs130 bn, which is based on last transaction
UTI MF	25%			18,533	29	Valued at 5% of AUM of Rs528 bn
MCX	5.00%			2,420	4	MCX valued at US$1.1 bn, which is based on last transaction
SBI Caps	86%			6,966	11	10X 2008 PAT
SBI Cards	60%			-	-	NA
SBI DFHI	57%			6,835	11	1X FY2008 networth
SBI Factors	54%			603	1	1X FY2008 networth
Value of all non-bank subsidiaries					**285**	
SBI Associate banks						
State Bank of Bikaner and Jaipur	75%	14,355	1.00	14,355		BV multiple based on RoE
State Bank of Hyderabad	100%	33,307	1.00	33,307		BV multiple based on RoE
State Bank of Mysore	92%	14,987	1.00	14,987		BV multiple based on RoE
State Bank of Patiala	100%	27,686	1.00	27,686		BV multiple based on RoE
State Bank of Saurashtra	100%	-	1.00	-		BV multiple based on RoE
State Bank of Travancore	75%	15,074	1.00	15,074		BV multiple based on RoE
State Bank of Indore	98%	15,455	1.00	15,455		BV multiple based on RoE
Banking subsidiaries and associates		120,865		120,865		
post discount of 10%		**108,778**		**108,778**	**172**	
Value of all subsidiaries					**457**	
Total value of the bank					**1,608**	

Source: Companies, Kotak Institutional Equities estimates.

State Bank of India (Old and new estimates Rsmn)

March fiscal year-ends, 2009-2011E (Rs mn)

	New estimates			New estimates			% change		
	2009E	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**
NII post invt amortization	215,172	243,377	295,736	218,547	249,757	301,586	1.6	2.6	2.0
Loan growth	27.4	18.0	18.8	27.4	18.0	18.8			
NIM assumed (%)	3.0	2.8	2.9	2.9	2.8	2.8			
Loan loss provisions	42,656	69,482	102,893	42,656	75,272	102,893	-	8.3	-
Other income	103,574	120,974	133,426	110,151	128,150	138,026	6.3	5.9	3.4
Fee income	73,928	85,017	97,770	75,702	86,301	98,383	2.4	1.5	0.6
Treasury income	9,000	14,000	12,000	12,000	18,000	14,000	33.3	28.6	16.7
Operating expenses	152,799	175,966	190,537	152,844	176,021	190,601	0.0	0.0	0.0
Employee expenses	96,171	109,822	118,607	96,171	109,822	118,607	-	-	-
Investment depreciation	-	-	-	-	-	-			
Extraordinary items	-	-	-	-	-	-			
PBT	123,292	118,904	135,731	133,198	126,615	146,117	8.0	6.5	7.7
Tax	43,152	41,616	47,506	46,619	44,315	51,141	8.0	6.5	7.7
Net profit	**80,139**	**77,287**	**88,225**	**86,579**	**82,299**	**94,976**	**8.0**	**6.5**	**7.7**
PBT - treasury+loan loss pro	156,947	174,386	226,625	163,854	183,887	235,010	4.4	5.4	3.7

Source: Kotak Institutional Equities estimates.

Banking

ICBK.BO, Rs364	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	500
52W High -Low (Rs)	1314 - 282
Market Cap (Rs bn)	405

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	160.5	162.0	175.5
Net Profit (Rs bn)	41.6	38.2	38.6
EPS (Rs)	39.9	34.3	34.7
EPS gth	*15.4*	*(14.0)*	*1.1*
P/E (x)	9.1	10.6	10.5
P/B (x)	0.9	0.8	0.8
Div yield (%)	3.0	2.8	2.7

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(12.8)	15.1	(44.6)	(71.2)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	64.9	6.5	4.7
MFs	7.7	4.0	2.2
UTI	-	-	(1.8)
LIC	8.4	3.5	1.7

ICICI Bank: Weak operational performance; treasury helps; upgrade to ADD on inexpensive valuations

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* **ICICI Bank reported 3QFY09 PAT of Rs12.7 bn, up 3% yoy and 30% above estimates led by high treasury income**
* **Operational performance was weaker than expected**
* **Upgrade to ADD on inexpensive valuations with a target price of Rs500**

ICICI Bank reported PAT of Rs12.7 bn in 3QFY09, marginally higher than the 3QFY08 PAT and 30% ahead of our estimates. The liquidity crisis of October 2008 had an adverse impact on the financial performance of the company and better-than-expected PAT was largely on account of higher treasury profits. We believe the strain on the financials of the company on account of the liquidity crisis is likely to persist for a few more quarters and consequently core operating profits are likely to be under stress. We revise our estimates for ICICI Bank by 7% for FY2009E and cut estimates by 7-8% for FY2010E and FY2011E. We also cut our target price to Rs500. However, we upgrade our rating on the stock to ADD from REDUCE on account of the inexpensive valuations of 0.5X PBR (standalone) FY2010E.

Key operational highlights of 3QFY09

Balance sheet was flat while NIM remains stable

- Balance sheet has remained flat qoq; Loans decline 1.4% yoy (4% qoq) and deposits down 9% yoy (6% qoq). CASA deposits were at 27% as of December 2008 compared to 30% as of September 2008. Absolute amount of CASA deposits declined 9% qoq
- Net interest income (NII) for 3QFY09 was Rs19.9 bn, which was flat on a yoy basis and 5% lower than our expectations.
- Our calculations indicate that the company's net interest margin (NIM) based on period balances has declined to 2.3% in 3QFY09 compared to 2.4% in 2QFY09. The company's reported NIM in 3QFY09 based on daily average balances is 2.4% same as that reported in 2QFY09.

Treasury saves the day; fee income decline sharply

- Non-interest revenues increased 4% yoy to Rs25.1 bn in 3QFY09 largely driven by treasury profits of Rs9.8 bn largely emanating from fixed income. The bank probably had taken an aggressive interest rate call and has made huge treasury gains from a decline in interest rates.
- The company's fee income declined 25% yoy to Rs13.5 bn on back of moderation of activity on the corporate banking side and much lower retail distribution fees.

Operating expenses continues to be under control

- ICICI Bank's overall operational expenses for 3QFY09 were Rs17.3 bn—a decline of 18% yoy and marginally (4%) below estimates. A large part of the decline in costs was due to lower employee and direct marketing expenses. The management believes it should be able to maintain the current levels of operational efficiency given the low growth in retail assets, lower increases in employee costs and improved process efficiencies.

Asset quality—in line with historical trend

- The incremental slippage in asset quality was around Rs12 bn in 3QFY09, in line with the trend observed over the past few quarters. The bank made a provision of Rs10 bn towards NPLs during the quarter. It is likely that the slippages will come off over the next two-three quarters given the moderation in loan growth and shift in focus to non-retail assets.
- ICICI Bank has started to write off fully provided retail loans and would continue with that strategy in order to reduce its reported gross NPLs.

Details on key international subsidiaries

- ICICI Bank, UK had a total asset base of US$7.6 bn as of December 2008, down from US$8.7 qoq. The company reported PAT of US$1.4 mn in 9MFY09 after factoring in an MTM impact (US$80 mn) on its investments book. Further, an impact of US$71 mn on AFS book was taken through the reserves (does not impact capital adequacy ratio). Capital adequacy ratio of ICICI UK stood at 18.6% as of December 2008. This subsidiary was able to attract US$530 mn in retail term deposits in 3QFY09 and total deposits were around US$4.1 bn as of December 2008.
- ICICI Bank, Canada had an overall asset base of Canadian dollar (CAD) 6.5 bn (up qoq from CAD5.5 bn) as of December 2008 and recorded a PAT of CAD32.9 mn in April-December 2008 period. The capital adequacy ratio of this entity stood at 16.1% as of December 2008.

ICICI Prudential Life

- ICICI Life insurance received Rs99.2 bn of premium income (inclusive of renewal premium) during 9MFY09.
- APE declined by 40% during 3QFY09. New Business profit for ICICI Bank declined 40% yoy to Rs19 bn during 3QFY09. The company has reported a new business profit (NBP) margin of 18.9% in 9MFY09.

Near-term challenges likely; expect pricing benefits on liabilities next year

1. Growth, margins and NII to remain under stress for some time

The liquidity crisis of October 2008 and the management's strategy of focusing on improving its liability profile will imply lower asset growth for the company over the next few quarters. We expect loans to decline 8% in FY2009 and grow by just 7% in FY2010.

We believe improvement in CASA ratio is likely to be a challenge in the current scenario. It is to be noted that the savings deposits have declined on a sequential basis to Rs386 bn as of December 2008 compared to 432 bn as of September 2008. Increasing the savings deposits of the company is likely to involve time and concerted actions by the company.

On the asset side, the company has been focusing on reducing exposure to the riskier assets. This strategy could lead to lower yields on its loan assets and exert a downward pressure on NIM. The issue of lower yield on advances is likely reflected in the company's 'interest income on advances' declining to Rs56.6 bn in 3QFY09 compared to Rs57.1 bn in 2QFY09 and Rs57.5 bn in 1QFY09 despite the average loan assets (based on period-end numbers) remaining around Rs2.2 tn in these quarters. During this same period most banks have reported a smart increase in their yield on advances.

A declining rate scenario would mean significant deposit repricing benefit for ICICI Bank. However, we expect the benefits of this repricing would start to show up only from 2QFY10E onwards. In the interim, we expect interest costs to increase and margins to decline as the high cost borrowings of 3QFY09E to be drag on its NII.

2. Lower loan loss provisions, control on operational costs and higher treasury profits will be critical for earnings

The lower loan growth for ICICI Bank over the past few quarters would result in a faster peaking of NPLs for ICICI Bank compared to many other banks. We expect delinquencies to peak in the 4QFY2009 and thereafter there is likely to be some moderation. Thus, incremental loan loss provisions are unlikely to increase substantially unlike other banks. We expect loan loss provisions to increase by just 3% in FY2010E.

The ability of ICICI Bank to maintain tight control over its operational costs (as demonstrated in 9MFY09) will be critical for supporting its earnings. We have reduced our operating expenses by 5% in FY2010E to factor in the 3QFY09 performance of the company.

ICICI Bank could also use the softening Gsec yield environment to book higher treasury gains and boost its income. The company had treasury income of Rs9.8 bn in 3QFY09, which was significantly higher than the Rs6.7 bn reported by SBI and which has a substantially higher investment book.

Upgrade to ADD recommendation given the valuations

While near-term challenges for ICICI Bank continue, we believe the market is assuming rather low levels of normalized profits in perpetuity given the current valuation of 0.5X PBR FY2010E (standalone). Our estimate of fair value of ICICI Bank's subsidiaries is likely conservative at Rs174 per share. We do not assign any value to the investments made by ICICI in any of its international subsidiaries and value its stake in insurance subsidiary at Rs125 per share at 14X NBP (12.7% margin).

We also assume a long-term RoE of 14.5% for the company's core banking operations for arriving at our fair value estimate of Rs500. We upgrade the stock to ADD from REDUCE given the recent sharp correction of 30%+ over the past three weeks and inexpensive valuations.

ICICI Bank quarterly results, Rs mn

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg	3QFY09KS	Actual Vs KS
Interest income	81,238	82,692	81,107	80,100	80,051	(1.5)	84,105	(4.8)
Interest on advances	57,522	58,262	57,542	57,114	56,584	(1.6)	57,114	(0.9)
Interest on investments	21,720	22,488	21,072	19,691	20,158	(7.2)	19,691	2.4
Balance with RBI	1,997	1,943	2,494	3,295	3,308	65.7	3,295	0.4
Interest expenses	59,521	59,498	58,021	56,874	58,457	(1.8)	61,423	(4.8)
Net interest income	**21,717**	**23,194**	**23,087**	**23,226**	**21,594**	**(0.6)**	**22,681**	**(4.8)**
NII. aft adjt invt amortiz.	**19,597**	**20,795**	**20,898**	**21,476**	**19,904**	**1.6**	**20,931**	**(4.9)**
Non-interest income	24,266	23,617	15,382	18,773	25,145	3.6	19,946	26.1
Commission and fees	17,850	19,280	19,580	18,760	13,470	(24.5)	15,946	(15.5)
Investment income	2,820	1,640	(5,940)	(1,530)	9,760	246.1	3,000	225.3
Other income (incld income from sel	3,596	2,700	1,742	1,543	1,915	(46.7)	1,000	91.5
Total income	**45,983**	**46,811**	**38,469**	**42,000**	**46,740**	**1.6**	**42,627**	**9.6**
Total income excluding treasury	43,163	45,171	44,409	43,530	36,980	(14.3)	39,627	(6.7)
Operating expenses	21,276	21,505	19,139	17,400	17,341	(18.5)	18,153	(4.5)
Salary	5,705	4,666	5,232	4,881	5,030	(11.8)	5,369	(6.3)
Other costs	11,408	13,255	11,624	11,075	11,282	(1.1)	11,629	(3.0)
DMA cost	4,163	3,584	2,283	1,445	1,030	(75.3)	1,156	(10.9)
Preprovision profit	24,707	25,306	19,330	24,599	29,398	19.0	24,474	20.1
Provisions	9,724	11,874	10,114	10,985	11,770	21.0	11,550	1.9
Loan loss provisions	7,600	9,475	7,925	8,680	10,080	32.6	9,500	6.1
Provision on standard assets	640	250	(300)	555	0	(100.0)	300	0.0
Investments amortization	2,120	2,399	2,189	1,750	1,690	(20.3)	1,750	(3.4)
Profit before tax	14,983	13,432	9,215	13,614	17,628	17.7	12,924	36.4
Tax	2,681	1,933	1,935	5,796	4,910	83.1	3,102	58.3
Deferred tax	0	0	0	(2,325)	0	0.0	0	0.0
Profit after tax	**12,302**	**11,498**	**7,280**	**10,142**	**12,718**	**3.4**	**9,822**	**29.5**
Effective tax rate(%)	18	14	21	26	28	0.0	24	0.0
PBT-invt inc+dep	9,035	11,792	15,155	15,144	7,868	(12.9)	9,924	(20.7)
PBT-Invt income+NPL provisions	**19,763**	**21,267**	**23,080**	**23,824**	**17,948**	**(9.2)**	**19,424**	**(7.6)**

Source: Company, Kotak Institutional Equities estimates.

ICICI Bank quarterly results-- key balance sheet items

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg
Key balance sheet items (Rs bn)						
Deposits	**2,298**	**2,443**	**2,345**	**2,234**	**2,091**	**(9.0)**
Savings	380	391	435	432	386	1.6
Current	240	244	212	237	190	(20.8)
CASA ratio (%)	27.2	26.0	27.6	29.9	27.6	
Customer assets	**2,246**	**2,392**	**2,357**	**2,349**	**2,290**	**2.0**
Retail loans including CV	1,323	1,317	1,320	1,210	1,145	(13.5)
Retail loans to Customer assets (%)	58.9	55.0	56.0	51.5	50.0	
Housing loans	668	668	656	617	607	(9.2)
Auto loans	170	178	170	160	149	(12.4)
Two wheelers	35	27	28	25	23	0.0
Personal loans	138	132	138	117	115	(17.0)
Credit cards	79	84	85	85	80	1.5
Commercial vehicles	180	190	190	170	149	(17.3)
Corporate and project finance	832	875	907	1,139	1,060	27.3
Agri	90	200	130	0	85	0.0
SME	0	0	0	67	85	0.0
International lending	453	477	566	577	553	22.1
Balance sheet snapshot (Rs bn)						
Cash advances	310	380	356	356	271	(12.6)
SLR Investments	764	750	720	650	680	(10.9)
Advances	2,155	2,256	2,241	2,220	2,125	(1.4)
Retail	1,323	1,317	1,320	1,210	1,145	(13.5)
Housing loans	668	668	656	617	607	(9.2)
Other investments	290	364	360	321	385	33.1
Other assets	249	247	265	302	283	13.7
Total assets	**3,767**	**3,998**	**3,942**	**3,850**	**3,744**	**(0.6)**
		2,206	2,249	2,231	2,173	
Networth	465	465	474	486	500	7.6
Equity capital	11	11	11	11	11	0.1
Reserves and surplus	454	454	463	475	489	7.8
Preference capital	4	4	4	4	4	0.0
Deposits	2,298	2,444	2,345	2,234	2,091	(9.0)
Total borrowings	816	864	938	948	991	21.4
ICICI borrowings	0	0	0	0	0	0.0
Other liabilities	184	221	181	177	159	(13.8)
Total liabilities	**3,767**	**3,998**	**3,942**	**3,850**	**3,744**	**(0.6)**

Source: Company, Kotak Institutional Equities estimates.

ICICI Bank -- yield management measures, asset quality and capital adequacy details

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg
Yield management measures (%)						
Yield on advances	11.0	NA	10.5	10.8	10.5	
Yield on earnings assets	9.3	NA	9.0	NA	9.4	
Cost of deposit	7.4	7.3	7.2	7.0	7.4	
Cost of funds	7.4	7.3	0.0	6.9	7.2	
NIM	**2.3**	**2.4**	**2.4**	**2.4**	**2.4**	
Asset quality details						
Gross NPLs to advances	3.4	3.7	4.1	4.6	4.5	
Gross NPLs to adv. lagged	4.0	4.1	4.5	4.8	4.3	
Net NPLs to advances	1.5	1.6	1.8	1.9	2.1	
Gross NPLs (Rs bn)	72	84	93	103	96	33.0
Provisions and w/off (Rs bn)	39	48	52	60	52	31.2
Net NPLs (Rs bn)	33	36	41	43	45	35.3
Restructured assets (Rs bn)	46	48	47	47	50	7.8
Total rest. assets and NPLs	79	84	88	90	95	19.2
Gross NPLs in retail (Rs bn)	46	55	63	70	66	41.9
Non collateral accounts (Rs bn)	27	37	42	47	44	63.9
Retail ratio (%) excld non-collateral	1.76	1.65	1.89	2.28	2.28	
Net NPLs in retail (Rs bn)	21.8	24.0	26.0	26.8	29.1	33.5
Non collateral accounts (Rs bn)	9.8	16.1	17.4	15.3	16.0	63.2
Capital adequacy details						
CAR (%)	15.8	14.0	13.4	14.0	15.6	
Tier I (%)	12.1	11.8	11.3	11.0	12.1	
Tier II (%)	3.7	2.2	2.1	3.0	3.5	

Source: Company, Kotak Institutional Equities estimates.

ICICI Bank (Old and new estimates)

March fiscal year-ends, 2009-2011E (Rs mn)

	Old estimates			New estimates			% change in estimates		
	2009E	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**
Net interest income	84,978	92,650	110,664	86,169	91,887	110,755	1.4	(0.8)	0.1
Spread	1.9	2.2	2.5	1.8	2.0	2.4			
NIM (%)	2.6	2.8	3.0	2.43	2.60	2.89			
Customer assets (Rs bn)	2,363	2,547	2,937	2,291	2,449	2,826	(3.0)	(3.9)	(3.8)
Loan loss provisions	35,695	36,990	41,813	35,611	36,510	38,359	(0.2)	(1.3)	(8.3)
Other income	78,881	92,223	110,794	79,338	85,984	96,881	0.6	(6.8)	(12.6)
Fee income	63,901	73,973	91,939	59,058	65,434	75,726	(7.6)	(11.5)	(17.6)
Treasury income	4,000	7,000	7,000	8,000	8,000	8,000	100.0	14.3	14.3
Operating expenses	75,883	89,691	108,472	72,062	84,719	100,766	(5.0)	(5.5)	(7.1)
Employee expenses	20,454	22,380	28,008	20,258	22,165	26,532	(1.0)	(1.0)	(5.3)
Investment amortization	11,181	7,181	7,181	4,000	0	0	(64.2)	(100.0)	(100.0)
PBT	46,868	56,778	69,760	52,420	55,229	67,098	11.8	(2.7)	(3.8)
Tax	11,248	15,330	19,533	14,153	14,912	18,787	25.8	(2.7)	(3.8)
Net profit	**35,619**	**41,448**	**50,227**	**38,267**	**40,317**	**48,311**	**7.4**	**(2.7)**	**(3.8)**
PBT-treasury+provisions	**78,563**	**86,768**	**104,573**	**80,031**	**83,739**	**97,457**	**1.9**	**(3.5)**	**(6.8)**

Source: Kotak Institutional Equities estimates.

SOTP valuation of ICICI Bank

	ICICI Share (%)	FY2010	Valuation methodoly adopted
Value of ICICI standalone	**100**	**347**	Based on Residual growth model
Subsidiaries			
ICICI Financial Services	**94**	**149**	
ICICI Prudential Life	74*	125	14X NBAP, margin assumed is 12.7%
General Insurance	74*	9	1X FY2008 PBR
Mutual Fund	51*	15	3% of AUMs
Other subsidiaries/associates			
ICICI Securities Ltd	100	7	PER of 5X FY2008 EPS
ICICI Securities Primary Dealer	100	1	PBR of 1X FY2008 BVPS
ICICI Homes Ltd	100	8	PBR of 1X FY2008 BVPS
ICICI Bank UK	100	0	NA
ICICI Bank Canada	100	0	NA
ICICI Bank Euroasia	100	0	NA
Venture capital/MF	100	9	10% of AUM of US$2 bn
Value of subsidiaries		**174**	`
Value of company		**521**	

Source: Company, Kotak Instititional Equities estimates.

Forecasts and valuation for ICICI Bank
March fiscal year-ends, 2005-2011E

	PAT	EPS	P/E	BVPS	P/B	RoE	EPS excl. dividend	P/E (standalone)	BVPS (standalone)	P/B (standalone)
	(Rs bn)	(Rs)	(X)	(Rs)	(X)	(%)	(Rs)	(X)	(Rs)	(X)
2005	20.1	27.2	13.4	170	2.1	19.5	24.7	7.7	142	1.3
2006	25.4	32.8	11.1	250	1.5	14.6	28.4	6.7	217	0.9
2007	31.1	34.6	10.5	270	1.3	13.4	29.6	6.4	225	0.8
2008	41.6	39.9	9.1	418	0.9	11.7	28.9	6.6	341	0.6
2009E	38.3	34.4	10.6	440	0.8	8.0	29.4	6.4	334	0.6
2010E	40.3	36.2	10.0	464	0.8	8.0	30.8	6.2	345	0.5
2011E	48.3	43.4	8.4	495	0.7	9.1	37.4	5.1	371	0.5

Source: Company, Bloomberg, Kotak Institutional Equities.

Telecom

RLCM.BO, Rs160	
Rating	SELL
Sector coverage view	Cautious
Target Price (Rs)	200
52W High -Low (Rs)	706 - 147
Market Cap (Rs bn)	330.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	190.7	228.7	285.2
Net Profit (Rs bn)	57.5	60.6	49.3
EPS (Rs)	26.5	26.7	22.2
EPS gth	*86.4*	*0.7*	*(16.5)*
P/E (x)	6.1	6.0	7.2
EV/EBITDA (x)	5.7	6.6	6.1
Div yield (%)	0.5	0.5	-

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(21.7)	(19.9)	(68.2)	(75.9)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	66.1	-	-
FIIs	11.8	1.4	(0.7)
MFs	2.5	1.5	(0.6)
UTI	-	-	(2.1)
LIC	5.6	2.7	0.6

Reliance Communications: 3QFY09 results disappoint; balance sheet stretched. Maintain SELL

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- **3QFY09 performance below expectations**
- **Balance sheet size does not provide headroom for further leverage; equity funding necessary**
- **Retain SELL, target price reduced to Rs200**

Reliance Communications' (RCOM) reported 3QFY09 net income of Rs14.1 bn (down 7.9% qoq and +2.7% yoy) was aided by aggressive accounting policy—in our view—on interest income/expenses, negligible tax provisioning and income from cancellation of FCCBs bought back. EBITDA of Rs23.5 bn (+2.2% qoq, +11.7% yoy) increased marginally and was lower-than-consensus expectations by 3%. We reduce our FY2010E and FY2011E EPS to Rs22.2 and Rs23.7, respectively. The stock has corrected significantly and is trading at 6.7X FY2010E EV/EBITDA. While the stock may appear inexpensive on a P/E basis, it needs to be viewed in the context of the company's aggressive accounting policies (on below-EBITDA line items). We also believe that the balance sheet is stretched and the company may have to resort to equity infusion in the near future. We maintain our SELL rating and assign a 30% discount to our fair value for the core business. We add Rs30/share of option value for the company's tower assets in our target price; note the downside risk to this estimate as well in the absence of any external tenancy. Our revised target price for RCOM stands at Rs200/share (Rs265 earlier).

Balance sheet size does not provide headroom for further leverage; equity funding would ease the pressure. Exhibit 2 gives the situation of debt, current liabilities and net debt/EBITDA of RCOM. At end-December 2008, RCOM reported net debt of Rs183 bn. In addition, we estimate equipment payables of Rs110 bn. RCOM has further indicated that it would spend Rs90 bn on capex for 4QFY09E (Rs250 bn in FY2009E) and Rs150 bn in FY2010E. The company would effectively have a net debt/EBITDA ratio of 3X at end-FY2009E and 3.2X at end-FY2010E, stretched in our view. The leverage will increase in case 3G auctions are conducted—note that RCOM has expressed interested in GSM, CDMA as well as BWA auctions. The interest coverage ratio stands at 5X on FY2009E and 4.7X on FY2010E financials.

RCOM's balance sheet, in our view, does not provide headroom for further leverage. The company would also require flexibility to raise funds in case a significant increase in competitive intensity and irrational pricing/tariffs impacts near-term profitability and cash flows. RCOM, in our view, may look for equity funding over the next 12 months to create a war chest to meet any challenges and grow in case of significant opportunities.

We highlight that RCOM's foreign currency debt of Rs178 bn is of long-term duration. Exhibit 3 gives the break-up of overseas borrowings of RCOM—note that we have aggregated this data from RBI' website. Short-term debt, buyers credit and equipment payable may aggregate to ~Rs170 bn, in our view.

Aggressive accounting policies...

At the risk of repetition, we again highlight the reasons for assigning a 30% discount to the core business fair value of RCOM.

1. Despite having net debt of Rs183 bn, the company had net finance income of Rs1.5 bn in 3QFY09. Exhibit 4 details our estimated break-up of the finance charge into interest expense and forex gain/other items. In our view, the company had Rs3.5 bn of forex gains and other items included in the 3QFY09 P&L.

2. RCOM adjusts gains/losses relating to foreign currency loans against the carrying value of fixed assets. In 3QFY09, RCOM capitalized Rs8.3 bn of translation losses on foreign currency loans and Rs2.1 bn on FCCBs. RCOM had changed accounting policy relating to foreign currency borrowings in the June 2008 quarter. Till FY2008, these items were routed through the P&L.

3. Gains/losses on derivative instruments used to hedge underlying foreign currency loans are routed through the P&L. Further, gains/losses on cash and other monetary assets (net of monetary liabilities) outside India are also routed through the P&L—we note that this is consistent with the accounting rules.

4. RCOM had Rs53 bn of FCCBs outstanding at end-March 2008 (some of it may have been bought back). These instruments were issued in two tranches; the first one convertible into equity at Rs486 (conversion due in 2011) and the second at Rs666 (conversion due in 2012). These instruments are significantly out of money. RCOM, however, is adjusting the premium payable on redemption of these instruments (if not converted) against the reserves rather than P&L. On the other hand, gains from buyback of FCCBs were routed through P&L (may be permissible but does not appear to be prudent).

5. Tax provisioning continues to be at negligible levels. Tax provision in 3Q was Rs153 mn, 1% of PBT. For the 9MFY09, the company had a tax write-back of Rs608 mn. The company attributes this to multiple benefits accruing from creation of deferred tax asset in RTIL, 80IA benefits, exclusion of eligible expenses while computing MAT payment etc. We had expected a higher tax rate noting strong treasury income and MAT payment requirements.

6. The gap in revenues reported to TRAI continues to be high though it has reduced in the September 2008 quarter. *Please refer to our note on RCOM on July 16, 2008 for details*. In the September 2008 quarter, the gap reduced to 26.8% from 30.3% of gross revenues. The gap in net revenues, strangely enough, has increased to a staggering 64.5%. Please refer to Exhibit 5 for details.

… **however, a few encouraging signs**

Though negatives abound, we note that there are improvements too:

1. **RCOM's stake in Reliance Infratel and Reliance Globalcom increases to 90%.** RCOM's equity interest in RTIL and Globalcom has increased by an additional 10% to 90% in each of the entities. RCOM Shareholders Trust transferred the equity back to RCOM in both these entities in the December 2008 quarter—the company indicates that the transfer has been done at a nominal value. We accordingly lower minority interest charge for FY2010E to Rs1.9 bn from Rs3.4 bn earlier and for FY2011E to Rs2.1 bn from Rs3.8 bn earlier. Note that RCOM had earlier transferred 20% economic interest, without a fair-value consideration, in RTIL and Globalcom to a trust formed in Mauritius. The rationale for the transfer was to create an efficient tax planning mechanism in case RCOM wanted to monetize the value in RTIL and Globalcom. **We highlight that RCOM is yet to receive US$338 mn raised from placement of equity in RTIL to select investors—the money is still lying with Mauritius trust.**

2. **Increase in access charges and license fees.** Access charges and license fees have increased from the low in the previous quarter despite phasing out ADC on ILD calls. This is a small mercy though, given that access charges have declined in absolute terms over the past seven quarters despite the significant increase in traffic and relatively stable on-net traffic for CDMA service providers (see Exhibit 6). Exhibit 7 compares the interconnection costs and license & spectrum fees as a percentage of revenues for Bharti and RCOM.

Reducing estimates once again—significant value accretion from GSM launch would be difficult. RCOM launched its new GSM network in 12 circles (counting Chennai/Tamil Nadu as one) in January 2009, and announced an aggressive and innovative tariff structure. We believe the launch strategy was both disruptive and innovative. Instead of big-bang advertising campaign, RCOM focused on innovative plans and word-of-mouth publicity, which has generated impressive traction in the market. RCOM's GSM launch offer was Rs5-10/day of free local calls (to any network, effectively amounting to 150-300 free local minutes per month) for 90 days for no upfront payment (except Rs25 charged for the SIM card). Subsequently, the company increased the tariff SIM card cost to Rs49 and requires an additional recharge of Rs50 to be eligible for free outgoing calls.

We believe this strategy was driven by three considerations (1) eligibility for additional 1.8 MHZ spectrum allocation. Exhibit 8 details the subscriber-linked spectrum allocation criteria; (2) test the optimize network quality, reduce dark spots etc and (3) gain critical subscriber base and test the usage with innovative tariff plans.

RCOM indicates it has seen impressive subs addition post the new GSM launch; the challenge would be to retain this subs base and maintain usage levels. We have seen companies adopting similar subsidized pricing structures in the DTH business and reporting impressive subs additions; the challenge has been increasing ARPU from these subs. RCOM itself saw a sharp decline in minutes usage among its CDMA subs after it phased out its free on-net minutes. In addition, 'low-usage' subscribers are the ones typically prone to switch mobile service providers.

In our view, RCOM also needs critical mass of high-end subs base to earn reasonable ROI. The marginal subs, which presumably RCOM may have got, do not matter much for valuations. We have constantly highlighted the low NPV (US$65-75) of a low-usage lifetime customer (see Exhibit 9). Our analysis of RCOM's initial launch suggests a best-case NPV of US$50-60 for a low-usage subscriber under the new plan. Thus, the key to value accretion for a new operator or an incumbent rolling out a fresh network, in our view, is either (1) gain a disproportionate share of net adds leveraging aggressive pricing; relative market share movements over the next 12-24 months would be a good indicator of success/failure or (2) utilize the empty network to create a service differentiation for the high-usage subs and thereby upset the apple cart in the high-value segment. Our analysis suggests that the 7-8% post-paid subs in the Indian market account for 20-25% of revenues and an even higher share of EBITDA. RCOM's strategy to address this high-ARPU segment of the market is not clear from its launch pricing; we would thus reserve our comment on this aspect. Success in the post-paid segment would also be contingent on successful implementation of MNP.

Post the GSM launch; we make the following changes our earnings model (see Exhibit 10 for a summary of changes to the model)

1. We model net subs add of 8 mn for 4QFY09E and 26 mn for FY2010. This compares with 15.6 mn net adds in 9MFY09. We model net sub add share of 24.1% for FY2010E and 23.5% for FY2011E. We believe RCOM's GSM will partly cannibalize its CDMA subs base. RCOM may far exceed our subs estimates; what matters however is the ARPU that the new subs generate.
2. We reduce our ARPU assumption to Rs220-223 for FY2010-12E from Rs245-250 earlier. We also reduce our RPM assumption to Rs0.53, Rs0.51 and Rs0.50 for FY2010E, FY2011E and FY2012E, respectively. We also lower our MOU assumptions to by 2-3% for FY2010-12E to 420-440.
3. We do not model any benefits of reduction in USO levy to 3% (excluding metros) from 5%. This benefit is available starting April 1, 2009 in circles with coverage of 95% of developmental blocks. DoT is yet to clarify the definition of developmental blocks. We also do not assume any potential increase in spectrum charges. Note that the DoT, as a part of the 3G policy, has recommended increase in spectrum charges by 1-2% (see Exhibit 11). The Telecom Commission has also approved an increase in spectrum charges but the same has not been notified by the Cabinet.

4. RCOM has Rs191 bn of capital work in progress, a large portion of which pertains to GSM expansion. We model CWIP to reduce to Rs50 by end-FY2010E. We model depreciation and amortization charges to increase to Rs55 bn in FY2010E from Rs38 bn in FY2009E.

We lower our mobile business EBITDA margin to 36.3%, 36.7% and 36.7% for FY2010E, FY2011E and FY2012E from 38.7%, 39.1% and 39.2%, earlier. RCOM has already taken a part of the OPM hit in the current and previous quarters reflected in the disproportionate growth in network operating expenses. The company in our view would take a further hit on account of accelerated network rollout (increasing network opex further) and increased subscriber acquisitions costs. We also lower FY2010E EPS to Rs22.2 (Rs33.1 earlier) and FY2011E EPS to Rs23.7 (Rs36.1 earlier).

Analysis of 3QFY09 results

Another weak operating quarter. RCOM's revenues, EBITDA and net income was aided by Rs640 mn from cancellation of FCCBs bought back. Adjusted for this (and after making a similar adjustment for money received from TCOM post settlement of FLAG arbitration case), EBITDA grew 3.5% qoq, while net income declined 6.5%. Adjusted EBITDA margin was flat qoq. EBITDA margin declined 60 bps qoq, on account of expenses of network opex resulting from new GSM network rollout. Network operating expenses now stand at 20% of revenues versus 18.2% in the previous quarter and 11.2% in 3QFY08. RCOM's 3QFY09 revenues of Rs58.5 bn (+3.6% qoq, +20% yoy) were also lower than our estimate of Rs59 bn.

Wireless segment—modest revenue growth and steep decline in EBITDA margins. RCOM's 3QFY09 wireless segment's revenues grew 1.8% qoq to Rs44.1bn. Yoy growth in revenues was a modest 11.5%. MOUs, RPM and ARPU continued their downward trajectory. MOUs declined 3.1% qoq and 8.7% yoy to 410; RPM declined 4.3% and 19% yoy to Rs0.61. ARPU declined 7.4% qoq and 26% yoy to Rs251. We believe the impact on metrics may have been driven by the deteriorating performance of the payphone business (2.3 mn payphones at end-September 2008) and weak profile of incremental CDMA subs on the network. Non-voice revenues was stable on a qoq basis. The total minutes carried by RCOM's network grew 6.3% qoq and 37.3% yoy to 72.1 bn minutes.

EBITDA margin declined 120 bps qoq to 37.7%. RCOM attributes this to the impact of tariff pressure and increase in overheads in the run-up to the launch of GSM operations in the remaining 14 circles. RCOM believes margins will likely recover in the subsequent quarters. We, however, believe margins may come under further pressure on the launch of GSM operations as active and passive infrastructure opex precedes the optimum utilization of networks and the company steps up its sales and marketing spend. Further, the introductory offer of RCOM is unlikely to generate significant revenues.

Long-distance segment—strong performance. RCOM's LD segment EBITDA grew 20% qoq to Rs4.3 bn; EBITDA margin increased 430 bps sequentially to 25.7%. Revenues (adjusted for the TCOM refund in the previous quarter) grew 5% qoq to Rs16.8 bn. RCOM attributes the improvement in profitability to (1) ADC reduction, (2) reduction and consolidation of back office processes of Vanco acquisition to India from Europe earlier and (3) increase in network volumes. The company further stated that the current profitability is sustainable. Note that the previous quarter results were impacted by one-time integration costs of Vance and e-wave acquisitions.

Broadband segment—profitability dips. EBITDA margin in the broadband division dipped to 42% from 49% in the previous quarter. RCOM attributes the decline to slowdown in spending in SMB segment resulting in pressure on realizations. RCOM's broadband segment's revenues increased 8.6% qoq to Rs6.5 bn in 3QFY09 led by a 6% increase in subscriber base to 1.7 mn (+76,000 subs in 3QFY09). The company expects to retain profitability at the current levels.

Passive infrastructure division. RCOM expects to have 50,000 towers by end-FY2009. The company further expects to add 5,000-15,000 towers for FY2010E. RCOM also intends to participate in the USO tender of 11,000 towers to be rolled out in the rural areas. RTIL currently has a tenancy of 1.7X, all of it captive, presumably.

DTH business update. RCOM has added 1 mn subs since the launch of BIG TV (DTH operations) in August 2008. The company clubs revenues from the DTH business in the others segment. Surprisingly, EBITDA losses in the 'others' segment has barely increased, despite aggressive customer acquisition. RCOM indicates that most of its subs lease the set-top box rather than an outright purchase. Effectively, RCOM collects monthly rental from subs and depreciates the set-top boxes over the useful life.

Consolidated interim results for Reliance Communication (Rs mn)

			qoq		yoy			yoy		
	FY2009E	3Q 2009	2Q 2009	% chg	3Q 2009	3Q 2008	% chg	9M 2009	9M 2008	% chg
Gross sales	**228,678**	**58,502**	**56,450**	***3.6***	**58,502**	**48,742**	***20.0***	**168,174**	**137,564**	***22.3***
Operating costs										
Interconnection costs and license and spectrum cha	(35,315)	(8,693)	(8,324)	*4.4*	(8,693)	(11,188)	*(22.3)*	(26,176)	(30,621)	*(14.5)*
Network operating costs	(42,461)	(11,666)	(10,266)	*13.6*	(11,666)	(5,446)	*114.2*	(30,060)	(15,446)	*94.6*
Employee costs	(16,963)	(4,383)	(4,589)	*(4.5)*	(4,383)	(3,087)	*42.0*	(12,489)	(8,607)	*45.1*
G&A expenses	(41,469)	(10,235)	(10,255)	*(0.2)*	(10,235)	(7,956)	*28.6*	(30,406)	(24,065)	*26.3*
Operating costs	(136,208)	(34,977)	(33,434)	*4.6*	(34,977)	(27,677)	*26.4*	(99,131)	(78,739)	*25.9*
EBITDA	**92,470**	**23,525**	**23,016**	***2.2***	**23,525**	**21,065**	***11.7***	**69,043**	**58,825**	***17.4***
EBITDA margin (%)	40.4	40.2	40.8	—	40.2	43.2	—	41.1	42.8	—
Net finance cost	6,163	1,496	2,353	*(36.4)*	1,496	1,518	*(1.4)*	6,189	3,917	*58*
Depreciation and amortization	(38,560)	(10,069)	(9,180)	*9.7*	(10,069)	(7,252)	*38.8*	(27,887)	(20,198)	*38.1*
Extraordinary item	(1,645)	(358)	(647)	—	(358)	-	—	(1,645)	12,218	—
PBT	**58,427**	**14,595**	**15,542**	***(6.1)***	**14,595**	**15,331**	***(4.8)***	**45,700**	**54,762**	***(16.5)***
Provision for tax	(2,317)	(153)	567	—	(153)	(1,379)	—	608	(3,108)	—
Deferred tax (liability)/asset	2,800	—	—		—	—		—	—	
Minority loss/(income)	(2,074)	(339)	(800)		(339)	(223)		(1,774)	(12,671)	
Reported net income	**56,836**	**14,103**	**15,309**	***(7.9)***	**14,103**	**13,729**	***2.7***	**44,535**	**38,983**	***14.2***
Wireless segment (a)										
Revenues	175,327	44,119	43,356	*1.8*	44,119	39,567	*11.5*	128,662	110,527	*16.4*
Net revenues	152,367	34,445	33,626	*2.4*	34,445	28,892	*19.2*	99,351	80,858	*22.9*
EBITDA	67,280	16,616	16,859	*(1.4)*	16,616	15,819	*5.0*	50,098	44,081	*13.6*
EBIT	—	9,657	10,318	*(6.4)*	9,657	10,738	*(10.1)*	30,461	30,258	*0.7*
EBITDA margin (%)	**38.4**	**37.7**	**38.9**		**37.7**	**40.0**		**38.9**	**39.9**	
Subscribers ('000)	69,374	61,345	56,046	*9.5*	61,345	40,964	*49.8*	61,345	40,964	*49.8*
Prepaid	64,257	56,683	51,394	*10.3*	56,683	36,458	*55.5*	56,683	36,458	*55.5*
Postpaid	5,116	4,662	4,652	*0.2*	4,662	4,506	*3.5*	4,662	4,506	*3.5*
Total (a)	69,374	61,345	56,046	*9.5*	61,345	40,964	*49.8*	61,345	40,964	*49.8*
Cellular subscribers (%)										
Prepaid	93	92	92		92	89		92	89	
Postpaid	7	8	8		8	11		8	11	
ARPU (Rs/mth)	254	251	271	*(7.4)*	251	339	*(26.0)*	267	351	*(24.0)*
MOU (min/mth)	419	410	423	*(3.1)*	410	449	*(8.7)*	419	473	*(11.6)*
Blended	419	410	423	*(3.1)*	410	449	*(8.7)*	419	473	*(11.6)*
Revenue/min: RPM = ARPU/MOU	**0.61**	**0.61**	**0.64**	***(4.3)***	**0.61**	**0.76**	***(19.0)***	**0.64**	**0.74**	***(14.1)***
Total estimated volume (mn mins)	289,660	72,100	67,800	*6.3*	72,100	52,500	*37.3*	201,900	149,000	*35.5*
Capex (Rs mn)	199,430	32,508	33,260	*(2.3)*	32,508	60,605	*(46.4)*	122,694	125,263	*(2.1)*
EBITDA per min - blended (Rs)	**0.23**	**0.23**	**0.25**		**0.23**	**0.30**		**0.25**	**0.30**	
SMS as % of wireless revenues	—	1.3	1.2		1.3	1.2				
Non-voice as % of wireless ARPU revenues	—	7.4	7.3		7.4	6.4				
Long distance segment (b)										
Revenues	65,915	16,783	16,915	*(0.8)*	16,783	13,299	*26.2*	48,958	39,493	*24.0*
Net revenues	39,233	12,129	11,578	*4.8*	12,129	7,078	*71.4*	33,745	21,695	*55.5*
EBITDA	15,534	4,315	3,608	*19.6*	4,315	3,428	*25.9*	11,145	9,943	*12.1*
EBIT	—	2,264	1,766	*28.2*	2,264	1,935	*17.0*	5,615	5,736	*(2.1)*
EBITDA margin (%)	23.6	25.7	21.3		25.7	25.8		22.8	25.2	
Total ILD minutes (mn)	7,793	1,906	1,946	*(2.1)*	1,906	1,747	*9.1*	5,578	5,025	*11.0*
Total DLD minutes	32,067	8,576	7,856	*9.2*	8,576	5,795	*48.0*	23,073	17,287	*33.5*
LD RPM (net)	0.5	—	—	—	—	—	—	—	—	—
Capex (Rs mn)	30,000	5,675	10,624	*(46.6)*	5,675	22,393	*(74.7)*	25,942	24,032	*7.9*
Broadband										
Revenues	25,322	6,542	6,023	*8.6*	6,542	4,564	*43.3*	18,168	12,768	*42.3*
Net revenues	22,710	5,682	5,184	*9.6*	5,682	3,947	*44.0*	15,681	11,024	*42.2*
EBITDA	11,851	2,760	2,941	*(6.2)*	2,760	2,222	*24.2*	8,415	6,160	*36.6*
EBIT	—	1,926	2,160	*(10.8)*	1,926	1,617	*19.1*	6,060	4,397	*37.8*
EBITDA margin (%)	46.8	42.2	48.8		42.2	48.7		46.3	48.2	
Capex (Rs mn)	10,522	1,104	3,674	*(70.0)*	1,104	5,034	*(78.1)*	7,808	9,806	*(20.4)*
Lines ('000)	—	1,335	1,259	*6.0*	1,335	901	*48.2*	1,335	901	*48.2*
ARPL (Rs/month)	—	1,681	1,668	*0.8*	1,681	1,797	*(6.5)*	1,686	1,865	*(9.6)*
Towns (#)	—	42	42	—	42	42	—	42	42	—
Buildings connected (#)	—	892,301	857,982	*4.0*	892,301	901,000	*(1.0)*	892,301	901,000	*(1.0)*

Note:
(a) Wireless includes CDMA, GSM and Fixed Wireless services; also includes mobile handset sales.
(b) Long distance includes NLD, ILD services and revenues from FLAG.

Source: Company

Assessing RCOM's debt position

(Rs mn)	FY2008	FY2009E	FY2010E	FY2011E
Gross debt	258,217	328,217	398,217	395,367
Cash and equivalents	118,778	52,590	35,855	43,817
Net debt	139,439	275,627	362,362	351,550
EBITDA	81,992	92,470	113,116	141,780
Net debt/TTM EBITDA (X)	**1.7**	**3.0**	**3.2**	**2.5**
Cash interest to be paid (a)		18,657	24,257	32,943
Interest coverage ratio (X)		**5.0**	**4.7**	**4.3**

Note:
(a) Assuming 8% pre-tax blended cost of debt.
(b) Excluding cash interest on FCCBs for FY2009E and FY2010E; including accrued interest on first FCCB tranche in FY2011E.

Source: Company, Kotak Institutional Equities estimates

Break-up of RCOM's LT FC borrowings

Date of issue	Type	Borrower	Amount in USD mn	Maturity Period	Date of maturity
Mar-06	FCCB	Reliance Communication Ventures Ltd	500	5 years	Mar-11
Feb-07	FCCB	Reliance Communications Ltd	500	5 years	Feb-12
Feb-07	FCCB	Reliance Communications Ltd	500	5 years	Feb-12
Mar-07	ECB	Reliance Communications Infrastructure Limited	250	5 years 2 months	May-12
Mar-07	ECB	Reliance Communications Infrastructure Limited	250	7 years 8 months	Oct-14
Apr-07	ECB	Reliance Communications Ltd	500	5 years 11 months	Mar-13
Sep-07	ECB	Reliance Communications Ltd.	500	5 years 11 months	Aug-13
Mar-08	ECB	Reliance Communications Ltd	280	3 years	Mar-11
Mar-08	ECB	Reliance Communications Ltd	116	3 years 6 months	Sep-11
Apr-08	ECB	Reliance Communications Ltd	250	6 years 11 months	Mar-15
May-08	ECB	Reliance Communications Ltd	150	6 years 11 months	Apr-15
May-08	ECB	Reliance Communications Ltd	50	10 years 5 months	Oct-18
Jun-08	ECB	Reliance Communications Ltd	750	10 years	Jun-18

Source: RBI's website, Kotak Institutional Equities

We estimate forex gains and other income of Rs3.52 bn booked in net finance income in 3QFY09 depite net debt of Rs183 bn

Rs mn	1QFY09	2QFY09	3QFY09
Rupee loans	61,870	83,667	88,348
Foreign currency loans	143,297	157,068	178,374
Less: FCCB (b)	56,975	62,196	64,296
ex-FCCB FC loans	86,322	94,873	114,079
Estimated interest rate on Re loans (%)		10.0	10.0
Estimated interest rate on FC loans (%)		7.0	7.0
Estimated interest on Re loans		1,819	2,150
Estimated interest on FC loans		1,585	1,828
Estimates total interest cost		**3,405**	**3,979**
Cash on books + investments	79,187	90,092	83,565
Estimated yield on cash balance (%)		10.0	9.0
Estimated interest income		**2,116**	**1,954**
Net finance (cost)/income reported		2,353	1,496
Estimated forex gains/ other income		**3,642**	**3,521**

Note:
(a) Interest rates and yield on cash balances both pre-tax.
(b) Adjusted for Re/US$ movement; FY2008 annual report states FCCBs at Rs53 bn.

Source: Kotak Institutional Equities estimates

Gap in revneues reported to the TRAI and the investor community increased substantially in September 2008 quarter

	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Reliance Communications								
Gross revenues	**36,213**	**37,669**	**41,259**	**39,409**	**43,076**	**43,187**	**41,786**	**45,535**
UASL	26,356	28,261	31,382	29,063	32,883	33,146	31,608	34,182
Adjusted gross revenues	**23,944**	**25,449**	**28,571**	**27,337**	**30,297**	**29,148**	**30,185**	**28,535**
UASL	20,174	21,662	24,654	22,329	25,662	25,589	24,778	22,902
License Fees	**2,019**	**2,152**	**2,411**	**2,254**	**2,495**	**2,429**	**2,500**	**2,347**
UASL	1,793	1,924	2,176	1,954	2,217	2,216	2,175	2,009
Spectrum charges	**416**	**416**	**507**	**495**	**518**	**509**	**491**	**446**
UASL	416	416	507	495	518	509	491	446
Gross wireless revenues reported to investors	**27,520**	**29,682**	**33,730**	**37,230**	**39,567**	**41,608**	**41,187**	**43,356**
Net wireless revenues reported to investors	**19,308**	**20,673**	**24,244**	**27,722**	**28,892**	**31,757**	**31,280**	**33,626**
Reported Interconnection & access charges	**8,212**	**9,009**	**9,486**	**9,508**	**10,675**	**9,851**	**9,907**	**9,730**
Difference between revenues disclosed to the investor community and the TRAI (%)								
Gross Revenues	**4.4**	**5.0**	**7.5**	**28.1**	**20.3**	**25.5**	**30.3**	**26.8**
Net revenues	**7.5**	**7.0**	**10.3**	**39.4**	**26.0**	**38.9**	**41.5**	**64.5**

Source: TRAI reports, Company

On-net minutes for the CDMA operators have not moved meaningfully over the past two years

On-net/off-net breakup of intra-circle minutes (83-88% of total outgoing minutes) for CDMA operators, 1QFY07-2QFY09

	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Fixed	12	11	9	8	9	9	9	6	5	5
Mobile	88	89	91	92	91	91	91	94	95	95
Of which										
On-net	**58**	**58**	**63**	**62**	**60**	**53**	**59**	**59**	**59**	**62**
Off-net	30	31	28	30	31	38	32	35	36	33

Source: TRAI performance indicator reports

We find the decline in RCOM's interconnection costs as well as license and spectrum fees perplexing

Interconnection costs and license & spectrum fees, RCOM and Bharti, March fiscal-year ends, 1QFY08-3QFY09 (Rs mn)

	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09
RCOM							
Gross revenues	43,037	45,785	48,742	53,114	53,222	56,450	58,502
Interconnection costs	**(6,702)**	**(6,829)**	**(7,821)**	**(6,845)**	**(6,289)**	**(5,367)**	**(5,633)**
As % of gross revenues	**15.6**	**14.9**	**16.0**	**12.9**	**11.8**	**9.5**	**9.6**
Net revenues	36,335	38,956	40,921	46,269	46,933	51,084	52,869
License fees and spectrum charges	**(2,985)**	**(2,917)**	**(3,367)**	**(3,117)**	**(2,870)**	**(2,958)**	**(3,059)**
As % of net revenues	**8.2**	**7.5**	**8.2**	**6.7**	**6.1**	**5.8**	**5.8**
Bharti							
Gross revenues	59,046	63,374	69,639	78,191	84,833	90,203	96,334
Interconnection costs	**(9,071)**	**(9,317)**	**(10,424)**	**(12,298)**	**(12,426)**	**(12,902)**	**(13,426)**
As % of gross revenues	**15.4**	**14.7**	**15.0**	**15.7**	**14.6**	**14.3**	**13.9**
Net revenues	49,975	54,057	59,215	65,893	72,407	77,301	82,908
License fees and spectrum charges	**(5,827)**	**(6,281)**	**(6,991)**	**(7,801)**	**(8,532)**	**(9,096)**	**(10,030)**
As % of net revenues	**11.7**	**11.6**	**11.8**	**11.8**	**11.8**	**11.8**	**12.1**

Source: Companies, Kotak Institutional Equities

Subscriber-linked spectrum allocation for GSM and CDMA players

GSM spectrum allocation criteria (mn subs)

	Spectrum (MHz)				
Earlier	**2 X 6.2**	**2 X 8**	**2 X 10**	**2 X 12.4**	**2 X 15**
Delhi/ Mumbai	**0.3**	**0.6**	**1.0**	**1.6**	**2.1**
Chennai/ Kolkata	0.2	0.4	0.6	1.0	1.3
A	0.4	0.8	1.4	2.0	2.6
B	0.3	0.6	1.0	1.6	2.1
C	0.2	0.4	0.6	0.9	1.2

Revised	**2 X 6.2**	**2 X 7.2**	**2 X 8.2**	**2 X 9.2**	**2 X 10.2**	**2 X 11.2**	**2 X 12.2**	**2 X 13.2**	**2 X 14.2**	**2 X 15**
Delhi/ Mumbai	0.5	1.5	1.8	2.1	2.6	3.2	4.0	4.8	5.7	6.5
Chennai/ Kolkata	0.5	1.5	1.8	2.1	2.6	3.2	4.0	4.8	5.7	6.5
A	0.8	3.0	4.1	5.3	6.8	8.2	9.0	9.8	10.7	11.6
B	0.8	3.0	4.1	5.3	6.8	8.2	9.0	9.8	10.7	11.6
C	0.6	2.0	3.1	4.2	5.2	6.2	7.0	7.8	8.7	9.6

CDMA spectrum allocation criteria (mn subs)

	Spectrum (MHz)							
	3rd carrier		**4th carrier**		**5th carrier**		**6th carrier**	
Service area	**2 X 3.75**		**2 X 5**		**2 X 6.25**		**2 X 7.5**	
	Earlier	**Revised**	**Earlier**	**Revised**	**Earlier**	**Revised**	**Earlier**	**Revised**
Delhi/ Mumbai	0.3	**0.5**	1.0	**2.0**	1.6	**3.0**	2.1	**5.0**
Chennai/ Kolkata	0.2	**0.5**	0.6	**2.0**	1.0	**3.0**	1.3	**5.0**
A	0.4	**0.8**	1.2	**5.0**	2.0	**8.0**	2.6	**10.0**
B	0.3	**0.8**	1.0	**5.0**	1.6	**8.0**	2.1	**10.0**
C	0.15	**0.6**	0.5	**4.0**	0.9	**6.0**	1.2	**8.0**

Source: TRAI, DoT, compiled by Kotak Institutional Equities

No significant value-accretion from lifelong subscribers, in our view

NPV of a Rs99 sub																	
Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	
Revenues	1,200	1,320	1,440	1,584	1,742	1,830	1,921	2,017	2,118	2,224	2,335	2,452	2,574	2,703	2,838	2,980	
Monthly ARPU	100	110	120	132	145	152	160	168	176	185	195	204	215	225	237	248	
EBITDA margin (%)	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	
Tax rate (%)	11	11	11	11	11	12	12	12	12	12	34	34	34	34	34	34	
Operating cash flow	505	553	601	658	721	749	785	823	863	905	772	807	843	881	921	964	
Initial capex (Rs)	(2,765)																
Initial capex (US$)	(70)																
Maintenance capex									(55)	(55)	(55)	(55)	(55)	(55)	(55)	(277)	
Change in working capital	177																
Free cash flow	(2,083)	553	601	658	721	749	785	823	808	849	717	751	788	826	866	687	5,496
Terminal growth rate (%)	0	5															
WACC (%)	12.5	12.5															
NPV (Rs)	**3,097**	**3,654**															
NPV (US$)	**63**	**75**															

Source: Kotak Institutional Equities estimates

Summary of key changes to the RCOM model, March fiscal year-ends, 2008-2017E

	Unit	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Mobile market subs old	mn	358	452	522	571	608	636	658	675	688
Mobile market subs new	mn	372	484	552	600	633	656	673	684	694
Revision	*(%)*	*4%*	*7%*	*6%*	*5%*	*4%*	*3%*	*2%*	*1%*	*1%*
RCOM mobile subs old	mn	66.7	86.7	101.7	112.3	120.1	126.1	130.7	134.3	137.2
RCOM mobile subs new	mn	69.4	95.7	111.3	122.1	129.6	134.8	138.4	141.1	143.1
Revision	***(%)***	***4%***	***10%***	***9%***	***9%***	***8%***	***7%***	***6%***	***5%***	***4%***
Blended ARPU (incl. inroaming) est. old	Rs	264	250	245	247	249	252	254	255	257
Blended ARPU (incl. inroaming) est. new	Rs	254	223	222	221	221	221	221	221	221
Revision	*(%)*	*-4%*	*-11%*	*-9%*	*-10%*	*-11%*	*-12%*	*-13%*	*-13%*	*-14%*
Blended RPM est. old	Rs	0.61	0.58	0.56	0.56	0.57	0.58	0.58	0.58	0.59
Blended RPM est. new	Rs	0.61	0.53	0.51	0.50	0.50	0.50	0.50	0.50	0.50
Revision	*(%)*	*-1%*	*-9%*	*-10%*	*-11%*	*-12%*	*-13%*	*-14%*	*-14%*	*-15%*
Blended MOU est. old	Rs	433	433	437	437	437	438	438	439	439
Blended MOU est. new	Rs	419	424	438	439	440	441	441	442	443
Revision	*(%)*	*-3%*	*-2%*	*0%*	*0%*	*1%*	*1%*	*1%*	*1%*	*1%*
Consolidated revenues old	(Rs bn)	231	299	361	412	452	486	513	535	558
Consolidated revenues new	(Rs bn)	229	285	351	394	426	452	473	490	506
Revision	*(%)*	*-1%*	*-5%*	*-3%*	*-4%*	*-6%*	*-7%*	*-8%*	*-8%*	*-9%*
Consolidated EBITDA old	**(Rs bn)**	**95**	**124**	**152**	**174**	**191**	**206**	**218**	**229**	**239**
Consolidated EBITDA new	**(Rs bn)**	**92**	**113**	**142**	**158**	**173**	**183**	**193**	**203**	**211**
Revision	***(%)***	***-2%***	***-9%***	***-7%***	***-9%***	***-10%***	***-11%***	***-11%***	***-11%***	***-12%***
Mobile EBITDA margin old	(%)	38.9	38.7	39.1	39.2	39.4	39.5	39.7	40.0	40.2
Mobile EBITDA margin new	(%)	38.4	36.3	36.7	36.7	36.9	36.9	37.4	37.9	38.2
Revision	*(bps)*	*-48*	*-243*	*-240*	*-249*	*-249*	*-256*	*-233*	*-209*	*-196*
Adjusted PAT old	**(Rs bn)**	**58.0**	**71.3**	**78.0**	**94.0**	**108.6**	**118.4**	**125.2**	**127.0**	**127.4**
Adjusted PAT new	**(Rs bn)**	**58.5**	**47.4**	**50.5**	**61.5**	**75.1**	**84.3**	**93.3**	**99.1**	**93.2**
Revision	***(%)***	***1%***	***-34%***	***-35%***	***-35%***	***-31%***	***-29%***	***-26%***	***-22%***	***-27%***
Diluted EPS estimate old	**(Rs)**	**26.3**	**33.1**	**36.1**	**43.6**	**50.3**	**54.9**	**58.0**	**58.8**	**59.1**
Diluted EPS estimate new	**(Rs)**	**26.7**	**22.2**	**23.7**	**28.8**	**35.2**	**39.5**	**43.7**	**46.5**	**43.7**
Revision	***(%)***	***1%***	***-33%***	***-35%***	***-34%***	***-30%***	***-28%***	***-25%***	***-21%***	***-26%***
Capex old	**(Rs bn)**	**180.1**	**93.1**	**82.7**	**72.7**	**74.4**	**76.7**	**78.3**	**79.6**	**84.5**
Capex new	**(Rs bn)**	**241.0**	**35.0**	**94.3**	**75.4**	**77.2**	**78.9**	**79.1**	**79.6**	**84.0**
Revision	***(%)***	***34%***	***-62%***	***14%***	***4%***	***4%***	***3%***	***1%***	***0%***	***-1%***
Mobile capex /sales old	*(%)*	101	34	22	17	16	16	15	14	14
Mobile capex /sales new	*(%)*	114	46	27	18	18	17	16	16	15
Revision	*(pps)*	*12.5*	*11.3*	*4.4*	*1.3*	*1.6*	*1.7*	*1.6*	*1.5*	*1.6*

Source: Kotak Institutional Equities estimates

Proposed changes in spectrum charges

Changes to spectrum usage charges

Spectrum (upto)	Existing charges	Proposed (a)
MHz	% of AGR	% of AGR
4.4	2	3
6.2	3	4
8.0	**4**	**5**
10.0	**4**	**6**
12.0	**5**	**7**

Note:
(a) Per recent press reports

Source: DOT, Press reports

Number of Payphones operator-wise ('000s)

	Mar-08	Jun-08	Sep-08
# of PCOs			
BSNL	2,052	1,999	1,915
MTNL	239	235	235
Bharti	202	197	189
HFCL Infotel	37	34	32
Tata Teleservices	1,569	1,568	1,544
Reliance Communications	**2,046**	**2,149**	**2,319**
Shyam Telelink	42	39	35
Total PCOs	**6,186**	**6,221**	**6,269**
Qoq addition (#)			
BSNL		(52)	(84)
MTNL		(4)	-
Bharti		(6)	(8)
HFCL Infotel		(3)	(2)
Tata Teleservices		(1)	(24)
Reliance Communications		**103**	**170**
Shyam Telelink		(2)	(5)
Total PCOs		**35**	**48**

Source: TRAI

RCOM's balance sheet shows certain odd movements over the past few quarters

RCOM's balance sheet for the most recent quarters (Rs mn)

	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
Equity												
Share capital	10,223	10,223	10,223	10,223	10,220	10,223	10,223	10,314	10,320	10,320	10,320	10,320
Reserves and surprlus	107,212	112,032	170,063	191,392	193,708	204,940	206,456	229,822	246,107	253,877	271,278	280,329
Equity	**117,435**	**122,255**	**180,286**	**201,615**	**203,928**	**215,163**	**216,679**	**240,136**	**256,427**	**264,197**	**281,598**	**290,649**
Minority interest	96	99	99	96	59	63	23,419	23,223	24,311	18,707	11,621	11,014
Debt	103,332	119,075	123,660	114,283	155,438	171,514	158,029	179,664	215,681	207,542	240,735	266,722
Current liabilities	80,170	102,320	117,885	125,770	136,016	134,619	168,401	220,988	199,267	238,240	251,144	272,944
Provisions	18,705	19,776	46,236	44,891	43,173	46,207	44,109	43,793	42,420	44,011	40,680	36,954
Total capital	**319,738**	**363,525**	**468,166**	**486,655**	**538,614**	**567,566**	**610,637**	**707,804**	**738,106**	**772,697**	**825,778**	**878,283**
Assets												
Cash	37,995	94,665	103,082	99,477	137,200	148,669	124,306	112,494	115,981	77,654	88,478	80,747
Inventories	4,076	3,982	3,970	2,788	4,821	4,182	3,122	3,768	4,059	4,330	4,408	5,111
Debtors	16,808	17,271	19,509	20,132	18,316	18,683	22,988	29,708	27,224	26,617	33,803	47,441
Other current assets	765	1,547	1,434	4,453	3,264	15,967	14,849	20,750	23,058	26,121	29,346	32,167
Loans and advances	23,668	21,459	24,551	23,773	32,662	26,478	49,226	72,466	42,834	56,118	53,368	64,911
Gross block	**228,295**	**234,730**	**327,706**	**351,683**	**349,456**	**356,144**	**374,339**	**408,870**	**463,640**	**503,993**	**540,804**	**582,120**
Less: Depreciation	47,573	53,299	60,569	69,296	55,940	60,717	70,000	80,825	89,814	102,050	115,352	128,634
Depreciation for the quarter	**5,457**	**5,514**	**6,237**	**6,524**	**6,378**	**6,192**	**6,754**	**7,252**	**7,856**	**8,638**	**9,180**	**10,069**
Net block	180,722	181,431	267,137	282,387	293,516	295,427	304,339	328,045	373,826	401,943	425,452	453,486
Capital work in progress	31,305	40,733	**46,121**	**51,161**	**36,907**	**46,214**	**79,505**	**139,228**	**148,327**	**178,381**	**189,309**	**191,602**
Goodwill	2,237	2,308	2,237	2,237								
Investments	22,163	129	125	247	11,925	11,946	11,942	1,345	2,797	1,533	1,614	2,818
Total assets	**319,739**	**363,525**	**468,166**	**486,655**	**538,611**	**567,566**	**610,277**	**707,804**	**738,106**	**772,697**	**825,778**	**878,283**

Note:

(a) Mar-06 and Jun-06 quarters balance sheets are on pro forma basis; we assume these are comparable with Sep-06 and Dec-06 quarter balance sheet of RCOM.

Source: Company's quarterly financial reports

Our one-year forward value for RCOM is Rs200 (including Rs30/share of option value of towerco and applying 30% discount to core business fair value)

Discounted cash flow valuation of Reliance Communications (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	**92,470**	**113,116**	**141,780**	**158,466**	**172,504**	**183,254**	**193,495**	**202,931**	**211,111**
Tax	(2,852)	(4,065)	(9,238)	(10,175)	(11,385)	(12,054)	(12,778)	(18,101)	(34,395)
Change in working capital	12,101	(54,610)	(13,446)	(5,606)	2,400	2,269	785	727	2,306
Post-tax operating cash flow	**101,718**	**54,442**	**119,096**	**142,685**	**163,518**	**173,469**	**181,502**	**185,558**	**179,022**
Capex	(241,050)	(134,998)	(94,270)	(75,368)	(77,162)	(78,897)	(79,137)	(79,615)	(84,005)
Free cash flow	**(139,331)**	**(80,556)**	**24,826**	**67,318**	**86,356**	**94,572**	**102,366**	**105,943**	**95,017**

	Now	+ 1-year	WACC and terminal year assumptions	
PV of cash flows	89,591	296,221	**Terminal growth (%)**	**5.0**
PV of terminal value	468,796	492,235	**WACC (%)**	**13.0**
EV	558,387	788,456		
Net debt	139,439	275,627		
Equity value (Rs mn)	**418,948**	**512,829**		
Equity value (US$ mn)	**8,728**	**10,684**		
RCL shares (mn)	2,100	2,100		
Equity value (Rs/RCOM share)	**199**	**244**		
Exit FCF multiple (X)	12.5	12.5		
Exit EBITDA multiple (X)	**5.6**	**5.6**		

Key assumptions (%)	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenue growth	19.9	24.7	23.2	12.3	8.1	6.0	4.6	3.7	3.3
EBITDA growth	12.8	22.3	25.3	11.8	8.9	6.2	5.6	4.9	4.0
EBITDA margin	**43.0**	**40.4**	**39.7**	**40.4**	**40.2**	**40.5**	**40.5**	**41.0**	**41.4**
Capex/sales	105.4	47.3	26.8	19.1	18.1	17.5	16.7	16.2	16.6
Cash tax rate	4.0	5.7	11.3	11.3	11.3	11.3	11.3	15.2	26.8
Effective tax rate	(0.8)	3.7	11.3	11.3	11.3	11.3	12.2	14.2	25.0
Return on avg. capital employed	**8.4**	**7.6**	**8.2**	**9.1**	**10.1**	**10.7**	**11.4**	**11.4**	**10.5**

Source: Kotak Institutional Equities estimate

RCL's condensed financial statement, March year ends, 2007-2017E

	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Profit model (Rs mn)											
Revenue	144,683	190,678	228,678	285,167	351,187	394,420	426,197	451,939	472,513	490,160	506,241
EBITDA	57,218	81,992	92,470	113,116	141,780	158,466	172,504	183,254	193,495	202,931	211,111
EBIT	32,565	53,939	53,909	58,545	75,765	86,545	96,053	101,648	107,554	111,658	117,350
Net interest income / (expense)	(1,039)	6,401	6,163	(7,343)	(16,542)	(14,689)	(8,728)	(3,791)	1,707	6,956	10,878
Tax	(611)	(2,836)	483	(1,901)	(6,710)	(8,141)	(9,894)	(11,087)	(13,364)	(16,797)	(32,120)
Net profit	30,909	56,416	58,495	47,435	50,460	61,456	75,059	84,279	93,283	99,073	93,226
Fully diluted EPS	**15.0**	**26.5**	**26.7**	**22.2**	**23.7**	**28.8**	**35.2**	**39.5**	**43.7**	**46.5**	**43.7**
Balance sheet (Rs mn)											
Cash	72,006	8,782	36,403	19,668	27,630	25,508	32,556	34,303	46,238	95,186	146,546
Other current assets	59,124	97,035	111,606	129,519	139,195	145,531	150,188	153,961	156,976	159,563	161,919
Fixed assets	330,422	523,126	725,615	806,041	834,296	837,743	838,454	835,745	828,941	817,283	807,527
Other long term assets	—	—	1,772	2,772	2,772	2,772	2,772	2,772	1,787	3,031	5,306
Short tem debt	(61,630)	(35,396)	58,413	58,413	54,563	(16,187)	(16,187)	(16,187)	(16,187)	(16,187)	(16,187)
Other current liabilities	161,482	200,776	227,448	190,751	186,981	187,711	194,768	200,810	204,610	207,923	212,587
Long term debt	158,899	183,617	253,617	323,617	324,617	272,256	200,185	110,185	17,648	—	—
Other long term liabilities	26	1,028	—	—	—	—	—	—	—	—	—
Shareholders funds (incl. minorities)	229,363	314,573	371,573	420,874	473,387	603,428	680,859	767,629	863,526	918,980	960,554
Net (debt)/ cash	(102,377)	(249,435)	(291,814)	(378,549)	(367,737)	(246,748)	(167,629)	(75,881)	28,590	95,186	146,546
Free cash flow (Rs mn)											
EBITDA	**57,218**	**81,992**	**92,470**	**113,116**	**141,780**	**158,466**	**172,504**	**183,254**	**193,495**	**202,931**	**211,111**
Change in working capital	29,812	1,425	12,101	(54,610)	(13,446)	(5,606)	2,400	2,269	785	727	2,306
Cash tax (paid)	(611)	(1,645)	(2,317)	(2,901)	(6,710)	(8,141)	(9,894)	(11,087)	(12,379)	(18,040)	(34,395)
Cash interest (paid)	(7,111)	(4,858)	(15,100)	(20,550)	(22,310)	(17,953)	(13,164)	(8,535)	(3,515)	(397)	—
Capex on PP&E and intangibles	(65,953)	(212,261)	(241,050)	(134,998)	(94,270)	(75,368)	(77,162)	(78,897)	(79,137)	(79,615)	(84,005)
Miscallenous	(309)	15,689	8,359	(6,456)	(7,439)	(2,505)	1,172	308	479	2,131	3,525
Free cash flow	**13,046**	**(119,658)**	**(145,537)**	**(106,398)**	**(2,395)**	**48,894**	**75,856**	**87,311**	**99,727**	**107,737**	**98,542**
Ratios (%)											
Sales growth	36.1	31.8	19.9	24.7	23.2	12.3	8.1	6.0	4.6	3.7	3.3
EBITDA growth	145.1	43.3	12.8	22.3	25.3	11.8	8.9	6.2	5.6	4.9	4.0
EPS growth	590.6	76.7	0.7	(16.5)	6.4	21.8	22.1	12.3	10.7	6.2	(5.9)
FCF growth	7,321.6	NM	NM	NM	(97.7)	(2,141.7)	55.1	15.1	14.2	8.0	(8.5)
EBITDA margin	**39.5**	**43.0**	**40.4**	**39.7**	**40.4**	**40.2**	**40.5**	**40.5**	**41.0**	**41.4**	**41.7**
Net margin	21.4	29.6	25.6	16.6	14.4	15.6	17.6	18.6	19.7	20.2	18.4
FCF margin	9.0	(62.8)	(63.6)	(37.3)	(0.7)	12.4	17.8	19.3	21.1	22.0	19.5
RoAE	17.8	21.7	18.4	12.9	12.1	12.1	12.3	12.2	12.0	11.7	10.4
ROAE (excl. cash and int. income)	**19.6**	**20.0**	**12.5**	**10.2**	**11.5**	**12.2**	**12.3**	**12.2**	**12.0**	**11.9**	**11.0**
RoACE	12.6	13.4	11.1	8.9	8.6	9.2	10.2	10.8	11.4	11.2	10.0
ROACE (excl. cash and int. income)	**12.4**	**11.8**	**8.4**	**7.6**	**8.2**	**9.1**	**10.1**	**10.7**	**11.4**	**11.4**	**10.5**
Net debt/EBITDA (X)	1.8	3.0	3.2	3.3	2.6	1.6	1.0	0.4	(0.1)	(0.5)	(0.7)
Net debt/equity (X)	0.4	0.8	0.8	0.9	0.8	0.4	0.2	0.1	(0.0)	(0.1)	(0.2)
Total debt/capital (X)	0.4	0.5	0.8	0.9	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Tax rate (%)	2.0	2.2	4.0	5.7	11.3	11.3	11.3	11.3	11.3	15.2	26.8

Source: Kotak Institutional Equities estimates

Metals

STRL.BO, Rs239	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	365
52W High -Low (Rs)	990 - 165
Market Cap (Rs bn)	169.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	247.1	222.1	163.3
Net Profit (Rs bn)	45.6	34.8	28.7
EPS (Rs)	64.3	49.1	40.5
EPS gth	*(22.6)*	*(23.8)*	*(17.5)*
P/E (x)	3.7	4.9	5.9
EV/EBITDA (x)	3.2	4.8	6.1
Div yield (%)	-	-	-

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(4.1)	10.5	(60.3)	(69.5)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	60.6	-	-
FIIs	21.1	1.1	0.2
MFs	3.6	1.0	0.0
UTI	-	-	(0.9)
LIC	2.0	0.4	(0.5)

Sterlite Industries: Stock not cheap without reason, but still a BUY

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- **3QFY09 net income at Rs5.13 bn (-41.4% yoy, -60.5% qoq)**
- **Commodity prices force to revisit projects**
- **Cheap on valuations, maintain BUY with TP of Rs365/share (Rs405/share earlier)**

Sterlite Industries reported 3QFY09 net income at Rs5.13 bn results, 30% below our estimates. While results were expected to be weak, the nil sales of zinc concentrates, sharp fall in by-product realizations and a significantly higher share in losses of associates have certainly taken us by surprise. We have revised our FY2009 and FY2010 EBITDA lower by 9.8% and 5.2%, respectively, factoring in lower commodity and by-product prices and revise our FY2009 and FY2010 net earnings higher by 12.1% and 15.5%, respectively, on account of higher other income and lower tax rates. Current commodity prices have put to question the need for the huge capacity expansions across almost all business segments which we address individually later. We believer current earnings are clearly bottom cycle earnings evident from the fact that 50% of producers are facing cash losses. We reiterate our BUY rating on the stock with a TP of Rs365/share (Rs405/share) earlier.

Project rationale—Can be questioned—but the Rubicon has been crossed

While commodity prices are clearly calling for cutbacks as almost 50% of global producers are facing cash losses. It would baffle anybody's logic for the need to go-ahead with investing US$8.5 bn at VAL and the US$1 bn expansion at BALCO and rather buy ailing producers some of whom may be more than happy to get rid of their cash burning operations. In fact Sterlite has grown out of buying poorly profitable BALCO and HZL for a song due to profitability in those businesses on account of poor management capability and weak commodity prices.

After enjoying four years of extraordinarily high commodity prices, rapid capacity expansion which sometime were more than six-nine months ahead of schedules and steady fund raisings from foreign investors the following large big-ticket projects are now underway which is a sharp diversion from earlier strategy.

- **Vedanta Aluminium—big by any standards and a lot depends on it**

US$8.5 bn investment to setup 500,000 ton aluminium smelter which is grand in its size and the speed and delivery is commendable given the fact that its competitors are struggling to get anywhere close in spite of starting work on their respective project three-five years earlier. Clearly, earnings assumptions have been whacked out of shape given current prices and when it commissions shortly, the timing could not have been worse. Also, the management has guided that the project has been conceived with an average aluminium price of US$1,200 the project is still profitable. Also, for Sterlite shareholders since the exposure is 30% it not something to lose sleep over.

- **BALCO—remarkable success, however forever re-investing may not be the best idea**

Form a humble 100,000 ton aluminium smelter it has grown to 3.5X its original size. Its earnings grew at a whopping CAGR of 134% over the past seven years. Another round of capacity expansion is underway which would make it 7X its original size. Clearly the strategy looks to be crowding out any competitive activity in the sector as clearly there would be loads of aluminium at least domestically for time to come.

- **Sterlite Energy—business plan changed for somebody else's problems**

Sterlite is setting up a 2400 MW of power plant in Jharsuguda, a line of business which is increasingly attracting steel manufacturers and all and sundry infrastructure players. However, though in the short-term the decision to transfer power from merchant to captive use at VAL is only logical given the current aluminium prices.

- **Hindustan Zinc—time to return some cash**

Capacity is being expanded even further from 720,000 tons to more than 1 mn tons. This is one expansion nobody would complain much about. But a better idea would be to give back proportionate cash back to investors who are increasing worried at the cash being diverted to fund the spate of expansions in unrelated businesses.

- **ASARCO—work in progress**

Sterlite had earlier signed a definitive agreement to buy ASARCO LLC for purchase of its operating assets for US$2.6 bn which it had repudiated during a court-ordered status conference. ASCARCO has announced that it is terminating its contract with Sterlite and would draw on the US$50 mn letter of credit when it signed the purchase contract on May 30, 2008.

However, Sterlite has confirmed that the letter of credit has not yet been drawn on and is still in the reckoning for the asset and is re-negotiating with the management of ASARCO and would pursue the acquisition. Clearly valuing ASARCO appropriately would be a challenge given that it is operating in the USA which is not an attractive place to produce copper given the stiff anti-pollution laws and also due to the recent surge in the value of the dollar.

Results below expectations—understandable in current environment

Net earnings at Rs5.1bn were lower 60.5% qoq and 41.4%yoy. EBITDA was lower 69.5% qoq and 64% yoy on account of sharply lower commodity and by-product prices which were lower 30-50% qoq. Also, higher cost of crude oil related inputs which have lag also adversely impacted margins. Results are below our expectations due to nil sales of zinc concentrates, sharp fall in by-product realizations and a significantly higher share in losses of associates have certainly taken us by surprise.

Commodity price outlook

Aluminium

Aluminium at US$1,400/ton fell to multi-year lows despite restocking by China's State Reserve Bureau and Yunan province. Chinese aluminium demand which grew 38% in CY2007 is expected to see a decline of 10% yoy in 4QCY08. Reported stocks at various global exchanges grew by a record 500,000 tons in December 2008 and are now at 15-year highs. Meanwhile, producers continue to announce production cutbacks aggregating to 5.1 mn tons, which is 13% of expected CY2009 output.

Copper smelting

Prospects of Sterlite's copper smelting business have improved significantly over the past few months due to a sharp increase in recent long-term deals having been concluded at 60% higher rates than last year. However, there has also been a sharp fall in by-product realizations which have significantly come off from their recent peaks. Copper smelting margins improvements are on account of increased availability of copper concentrates. Sterlite is among the world's lowest cost copper smelter globally.

Zinc

The recent sharp 33% qoq drop in zinc metal prices has led to a sharp cut-back in zinc mining output and led to a spate of mine closures. Cumulative reported mine closures has been to the order of 1.6 mn tons so far which represent about 15% of global output. While zinc prices are expected to remain subdued in the near term owing to current surpluses and high inventories, we believe a swift supply-side response would help markets return to balance, albeit with a lag. However, end-user segments such as construction (45%) transport (25%) and consumer/electrical goods (23%) have seen rapid demand destruction and would take several months to see any meaningful revival.

Revision in estimates

We revise our FY2009 and FY2010 EBITDA lower by 9.8% and 5.2%, respectively, factoring in lower commodity prices and revise our FY2009 and FY2010 estimated net earnings higher by 12.1% and 15.5%, respectively, on account of higher other income and lower tax rates.

Valuations—it's not cheap without a reason

If one were to strip out the cash lying in the books, the stock is available at Rs58/share which discounts current quarters annualized financial income adjusted EPS by 3.3X. Given that the management has clearly stated that it would be pursuing ASARCO, investors would naturally apply a 'possible acquisition' discount as given the current commodity price outlook, however, low the acquisition price would be it would be treated as expensive.

Since current income is clearly bottom cycle where evidently more than 50% of producers are facing cash losses and that it does not include income from power business and the various capacity expansions underway in several business, we would view this as an opportunity to BUY rather than being more pessimistic at this stage where also few catalysts are visible to be optimistic. We reiterate our BUY rating on the stock with a TP of Rs365/share (Rs405/share) earlier.

Sterlite Industries (Consolidated), Interim results, March fiscal year-ends (Rs mn)

				% change		
	3Q 2009	2Q 2009	3Q 2008	qoq	yoy	Comments on interim results
Quantitative details ('000 tons)	1					
Copper mined metal content	7	6	7	16.7	-	Volumes in line
Copper cathode	76	81	77	(6.2)	(1.3)	Production lower due to uplanned shutdown
Aluminium ingots	92	91	89	1.1	3.4	Volumes in line
Zinc mined metal content	171	167	136	2.4	25.7	
Zinc cathode	152	122	104	24.6	46.2	Highest ever zinc production
Earnings drivers	-	-	-	-	-	
Average INR:USD	48.76	43.76	39.47	11.4	23.5	
Average Zinc prices	1,207	1,807	2,646	(33.2)	(54.4)	Massive collapse in realisations following credit crisis
Average Aluminium prices	1,863	2,837	2,502	(34.3)	(25.5)	
Interim results						
Net revenues	**45,362**	**68,110**	**52,332**	(33.4)	(13.3)	Sharp drop in net realisations due to the sharp drop in LME prices
Expenditure	**(39,709)**	**(49,588)**	**(36,616)**			
Stock adjustment	(3,416)	(1,052)	707			
Raw materials	(21,829)	(33,002)	(25,173)			
Employee cost	(2,013)	(1,926)	(1,784)			
Other costs	(12,451)	(13,607)	(10,366)			
EBITDA	**5,653**	**18,522**	**15,717**	(69.5)	(64.0)	Margins lower due to the sharp realisation impact
Other income	5,852	3,948	3,009	48.2	94.5	Increase in yields on cash balances drive other income
Depreciation	(1,654)	(1,667)	(2,142)			
EBIT	9,851	20,804	16,584			
Interest	(1,220)	(581)	(681)			
Pre-tax profits - as reported	8,632	20,224	15,904			
Unusual or infrequent items	145	100	-			
Pre-tax profits - as adjusted	**8,486**	**20,124**	**15,904**	(57.8)	(46.6)	
Taxes	(1,163)	(2,916)	(4,138)			
Reported profits - as reported	7,323	17,208	11,766			
Less: Minority earnings	(2,186)	(4,439)	(3,213)			
Reported profits - as adjusted	**5,137**	**12,769**	**8,553**	(59.8)	(39.9)	
Recurring net earnings	**5,012**	**12,684**	**8,553**	(60.5)	(41.4)	Earnings lowest in last many quarters
Ratios						
Costs as % of revenue (%)	87.5	72.8	70.0			
EBITDA margin (%)	12.5	27.2	30.0			
ETR (%)	13.7	14.5	26.0			
EPS (Rs/share)	7.1	17.9	12.1			
Segmental information						
Segmental revenue	**44,982**	**67,619**	**58,101**	**(33.5)**	**(22.6)**	
Copper	22,933	34,585	27,878	(33.7)	(17.7)	
Aluminium	8,362	11,172	10,711	(25.2)	(21.9)	
Zinc and lead	10,174	17,212	18,540	(40.9)	(45.1)	
Others	3,513	4,649	973	(24.4)	261.3	
EBIT	**9,851**	**20,804**	**16,584**	**(52.6)**	**(40.6)**	
Copper	998	4,692	1,858	(78.7)	(46.3)	
Aluminium	1,095	2,269	1,452	(51.7)	(24.6)	
Zinc and lead	2,332	9,040	10,320	(74.2)	(77.4)	
Others	(95)	1,101	638	(108.6)	(114.9)	
Unallocated	5,521	3,702	2,316	49.1	138.4	

Equities estimates

SOTP-based target price of Sterlite Industries is Rs415/share

SOTP-based target price of Sterlite, March fiscal year-ends, 2010E basis (Rs mn)

	EBITDA	Multiple	EV	Sterlite's stake	Attributable EV	EV
	(Rs bn)	(X)	(Rs bn)	(%)	(Rs bn)	(Rs/ share)
Zinc business	26	4.0	104	64.9	67	76
Aluminium business	6	4.0	24	51.0	12	14
Copper smelting business	9	4.0	35	100.0	35	49
Vedanta Aluminium (VAL) (a)						15
Copper mining						2
Power business (b)						45
Total enterprise value					**114**	**201**
Net cash /(debt)					**117**	**165**
Cash / (Net debt)					138	195
Share of debt in Associates (VAL)					(21)	(30)
Attibutable market capitalization					**231**	**365**
Target price (Rs/share)						**365**

Notes:

(a) Given that VAL is currently on an investment phase and the poor outlook on aluminium we have applied a 50% discount to Sterlite equity investment in VAL

(b) We have valued investments in the power business (Sterlite energy) on DCF-to-equity implying a P/BV of 1.3X

(c) We have applied holding company discount of 20% in case of stake in Hindustan Zinc, BALCO, Sterlite Energy and CMT.

Source: Kotak Institutional Equities estimates

Sterlite Industries, change in estimates, March fiscal year-ends (Rs mn)

	Revised estimates		Old estimates		% change	
	2009E	2010E	2009E	2010E	2009E	2010E
Net sales	222,061	163,312	235,523	225,580	(5.7)	(27.6)
EBITDA	50,287	40,572	55,742	42,799	(9.8)	(5.2)
PAT	34,754	28,669	32,393	25,250	7.3	13.5
EPS (Rs/share)	49.1	40.5	45.7	35.6	7.3	13.5

Source: Kotak Institutional Equities estimates.

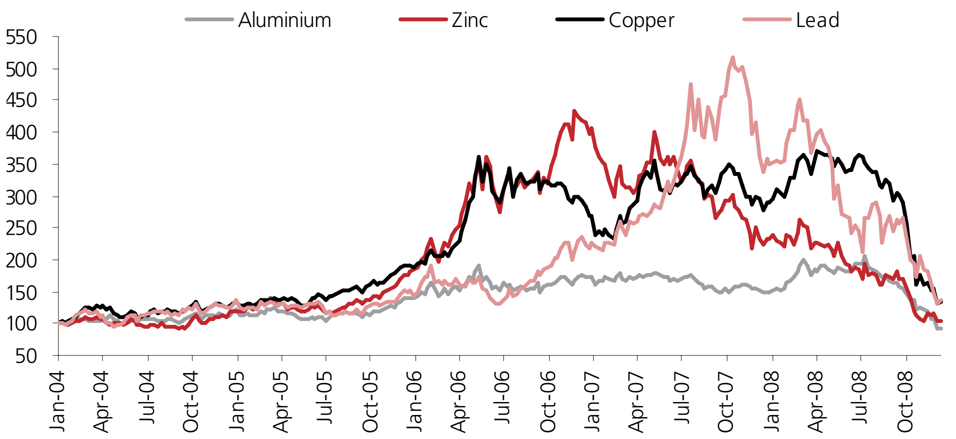
Sterlite Industries, Key assumptions, March fiscal year-ends, 2009-11E

	2009E	2010E	2011E
Aluminium price (US$/ton)	2,200	1,700	1,900
Zinc price (US$/ton)	1,550	1,300	1,400
Copper price (US$/ton)	5,800	3,000	3,300

Source: Kotak Institutional Equities estimates.

Commodity prices-back to where they started from

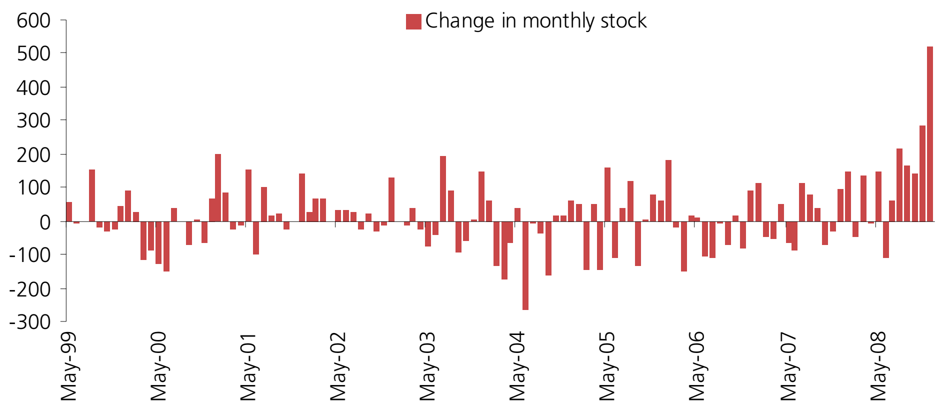
LME metals prices (indexed), Sterlite stock price chart (indexed), March fiscal year-ends



Source: Bloomberg

Aluminium inventory has jumped to 15-year highs in the last few months

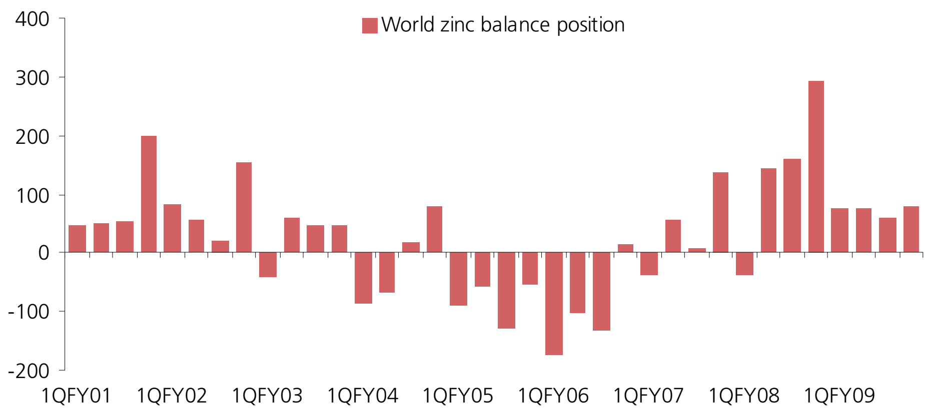
Reported change in aluminium inventory (monthly, '000 tons)



Source: CRU, Kotak Institutional Equities

Zinc balance expected to reduce in the coming months

Zinc world balance position, December fiscal year-ends ('000 tons)



Source: CRU, Kotak Institutional Equities

Sterlite Industries (consolidated), Profit model, balance sheet and cash flow model, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)						
Net sales	131,272	243,868	247,054	222,061	163,312	184,640
EBITDA	**36,899**	**94,589**	**78,682**	**50,287**	**40,572**	**50,741**
Other income	3,343	6,817	15,661	19,131	18,560	18,093
Interest	(2,353)	(3,791)	(3,186)	(3,733)	(3,603)	(3,675)
Depreciaiton	(5,269)	(8,039)	(5,950)	(8,706)	(9,269)	(10,656)
Profit before tax	**32,518**	**88,004**	**84,679**	**56,979**	**46,260**	**54,503**
Taxes	(10,165)	(24,118)	(21,027)	(8,361)	(6,856)	(8,352)
Less: Minority interest	(5,568)	(19,045)	(18,591)	(11,690)	(9,229)	(11,924)
Add: share in associates	(4)	-	-	(2,174)	(1,506)	(1,506)
Net profit	**16,781**	**44,842**	**45,061**	**34,754**	**28,669**	**32,721**
Earnings per share (Rs)	**60.3**	**82.3**	**64.2**	**49.1**	**40.5**	**46.2**
Balance sheet (Rs mn)						
Equity	60,530	99,815	223,024	245,553	267,332	292,385
Deferred tax liability	7,511	9,174	13,537	12,816	14,586	16,814
Total Borrowings	68,822	82,365	106,981	111,783	133,499	155,443
Current liabilities	34,113	48,636	50,401	31,846	27,994	28,973
Total liabilities	**170,976**	**239,990**	**393,942**	**401,997**	**443,411**	**493,615**
Net fixed assets	85,497	97,176	124,367	129,745	164,926	182,021
Investments	24,952	52,219	162,941	140,758	140,758	140,758
Cash	11,153	11,134	24,536	38,998	54,331	82,875
Other current assets	49,269	79,460	82,099	92,496	83,395	87,962
Miscellaneous expenditure	105	0	0	-	-	-
Total assets	**170,976**	**239,990**	**393,942**	**401,997**	**443,411**	**493,615**
Cash flow model (Rs mn)						
Operating cash flow excl. working capital	28,131	75,568	61,736	55,195	48,833	57,102
Working capital changes	(8,339)	(18,647)	2,032	961	6,750	(3,537)
Capital expenditure	(11,783)	(20,871)	(30,119)	(19,475)	(42,950)	(27,700)
Free cash flow	**8,009**	**36,049**	**33,648**	**36,682**	**12,633**	**25,865**
Ratios						
Debt/equity (X)	1.0	0.8	0.5	0.4	0.5	0.5
Net debt/equity (X)	0.2	(0.2)	(0.6)	(0.5)	(0.5)	(0.5)
RoAE (%)	28.9	50.7	26.1	14.0	10.6	11.1
RoACE (%)	**14.7**	**29.0**	**17.7**	**10.6**	**8.1**	**8.1**

Source: Company, Kotak Institutional Equities estimates.

Telecom

IDEA.BO, Rs43	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	55
52W High -Low (Rs)	130 - 34
Market Cap (Rs bn)	138.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	67.2	103.6	157.5
Net Profit (Rs bn)	10.4	8.6	9.3
EPS (Rs)	3.9	2.6	2.8
EPS gth	*78.5*	*(33.2)*	*6.0*
P/E (x)	10.8	16.2	15.3
EV/EBITDA (x)	8.6	5.7	5.3
Div yield (%)	-	-	-

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(11.3)	8.5	(51.6)	(63.7)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	49.0	-	-
FIIs	9.4	0.4	(0.3)
MFs	1.7	0.3	(0.4)
UTI	-	-	(0.7)
LIC	2.3	0.4	(0.3)

Idea Cellular : Rapid network expansion to keep profitability under pressure. Maintain REDUCE

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- **Valuations partly reflect the risks to profitability**
- **Margins—near-term impact from aggressive network rollout; long-term profitability concerns, especially in new circles persist**
- **Maintain REDUCE with a revised DCF-based target price of Rs55/share**

We reduce our long-term assumptions on Idea further on the back of increased competitive intensity and potential regulatory changes. Our near-term estimates are further impacted by mismatch between upfront costs on network rollout and revenues. We moderate our RPM numbers further to Rs0.54 for FY2010E, Rs0.53 for FY2011E and Rs0.51 on a steady state. We assume long-term EBITDA margins of 27% as compared to 30% earlier, fair given that a fifth or a sixth operator in any circle has significantly lower margins than the leader (spectrum in 1800 MHz band also hurts margins). We now model network rollout in all circles by end-FY2010E. We have reduced our FY2009E, FY2010E and FY2011E EPS to Rs2.6 (-19%), Rs2.8 (-18%) and Rs3.6 (-20%), respectively. We believe Idea can create significant value after two-three years assuming flawless execution (a misstep can also destroy value); however, we have little visibility on it and have to contend with deteriorating competitive environment. We maintain our REDUCE rating with a revised 12-month DCF-based target price of Rs55/share (Rs70 earlier). Our estimates (earnings and cash flows) are consolidated for proportionate stake in Indus Towers; accordingly we do not assign a separate option value for the tower business.

Valuations partly reflect the risks to profitability. We have long argued that the street's pricing and profitability assumptions may be at risk in a more competitive environment. Recent aggressive tariff introduction by RCOM and consequent response by the GSM operators points towards deteriorating competitive environment. We are also concerned about a potential reduction in termination charges that may accelerate downward pressure on RPM (while Idea will get impacted in old circles its competitiveness will likely improve in new circles). Exhibit 3 gives key changes to our earnings model. Exhibit 4 is our summary earnings model and Exhibit 5 is our DCF valuation model for Idea.

We lower our 12-month DCF-based target price stands to Rs55 (including value for Indus towers). Our model builds in long-term ROCE of 12% and terminal year growth rate of 4%. We believe our model reflects realistic level of ROCE in a highly competitive and somewhat commoditized market, which would make returns in excess of cost of capital difficult.

We have made the following adjustments to our earnings model

1. **Spice acquisition.** We model Spice financials on JV accounting method for 4QFY09E and fully consolidate the financials for FY2010E. We assume Idea would swap its shares in exchange for Telekom Malaysia's (and Green Acres') stake in Spice. Exhibit 6 explains the entire Spice transaction including its funding through a preferential allotment of shares to Telekom Malaysia. Note that Spice has a presence in two circles i.e. Punjab and Karnataka with a subscriber base of 3.8 mn as of end-December 2008 and spectrum in the 900 MHZ band. We also use the revised equity share count of 3,236 mn in our model.

2. **Indus Towers and Providence PE deal.** We incorporate proportionate consolidation of the Indus JV starting March 2009 quarter. Idea management indicates they have transferred 11,100 towers to Indus as part of its equity contribution. Idea also indicates it has 6,730 towers in Madhya Pradesh, Himachal Pradesh and Maharashtra circles which would remain with the company. The management indicated that the IRUs for old tower usage (towers to be transferred by the JV partners) will become effective starting January 2009. We note that rental payment for towers constructed by Indus is already consolidated by Idea. These changes would impact Idea's FY2010E EBITDA margin and FY2011E EBITDA margin by 400-500 bps. On consolidation of Indus, the transaction works out to be EPS neutral.
3. **Lower cash inflow from the Providence Equity deal.** ABTL, a subsidiary of Idea that holds 16% stake in Indus and Bihar circle license, received Rs21 bn from Providence Equity Partners for a 16.1% stake. The money received is lower than the original deal value of Rs27.25 bn. The deal valuation remains the same; dilution in subsidiary would be lower at 16.1% versus 20%. The issue appears to be procedural in nature with only P5 getting FIPB approval to invest (its affiliates did not get the approval)**.** Note that we had factored in cash inflow of Rs27 bn from this deal earlier.
4. **We model start of operations in the Orissa circle in 1QFY10E, Tamil Nadu/ Chennai in 2QFY10E and the remaining circles in 2HFY10E.** Launch in Orissa and Chennai/Tamil Nadu circles delayed by six months; the company attributes this to delay in grant of microwave spectrum by DoT. The management indicated that the EBITDA break-even target in new circles will continue to be 20-30 months, which in our view may be aggressive. The management also appears to focus on small and measured rollout rather than a big-bang rollout witnessed in Mumbai.

Margins—near-term impact from aggressive network rollout; long-term profitability concerns, especially in new circles, persist. The Idea management cited aggressive network expansion and significant increase in rental paying sites as the primary reasons for the drag on operating margins. Idea has added 18,100 new sites over the past twelve months as compared to 28,000 by Bharti. Further, the management indicates that the number of rental paying sites has increased to 21,459 in December 2008 from 8,721 in the December 2007 quarter (see Exhibits 7 and 8). This has resulted in network operating expenses increasing from 17.1% of revenues in 3QFY08 to 22.2% of revenues in 3QFY09. While we concede that expenses are running ahead of revenues, we believe further eight new network launches over the next 12 months would make any meaningful leverage difficult. Surprisingly, depreciation and amortization charges have kept pace with revenues despite a significant increase in sites taken on rental; this may again possibly be due to revenue expense mismatch during the initial phase of new network launches.

On the other hand, Idea also suffers from competitive disadvantage due to (1) challenges of being a non-integrated player. Idea's interconnection costs have increased further to 18.6% of revenues versus 17.2% in 3QFY08. Idea does not own an integrated national backbone leading to dependence on other players for carrying long-distance traffic. Bharti had increased NLD carriage charges in mid-1QFY09. We do highlight that Idea has increased captive NLD minutes to 25% from negligible levels at the beginning of the year and targets to take this up to 50% over the next two to three quarters, (2) greater sales and marketing costs. Sales and marketing costs are still low though growing in absolute terms; Idea S&M spends stand at 13.1% of revenues, it is still lower than Bharti (14% of revenues in 3QFY09). Competition has taken a slew of measures including increased ad spend, increase in distributor commissions etc. to accelerate subs addition and (3) pace of decline in tariff appears to be faster than the economies of scale on costs.

Taking all these factors into consideration we believe the overall EBITDA margins would remain well below 30% for the next few years as Idea remains in an investment phase. On a longer term; we model profitability of 30% from existing circles; 20% from new circles and 25% from Spice circles. In any case we struggle to positive NPV case for rollout of operations in new circles. A number of factors work against the company including spectrum in the 1800 MHz band, lower quality of incremental subscribers, lower tariffs, stiffer competition etc. Further, financials are impacted as the company would be in an investment mode in at least 10 of the 23 circles (not counting Punjab and Karnataka), not an enticing prospect. In any case, the company had delays in achieving EBITDA break-even in the three circles in which it launched operations 24-30 months back. We believe EBITDA break-even in new circles for Idea may take even longer.

Company can manage 2G capex without equity funding. Idea's balance sheet has strengthened significantly after (1) cash inflow from 15% preferential allotment to Telekom Malaysia as a part of the Spice acquisition transaction and (2) sale of 16.1% stake in ABTL (which holds Idea's 16% stake in Indus towers and license for the Bihar circle) to Providence Equity partners for Rs21 bn. These two transactions have led to a net cash inflow of ~Rs57 bn into Idea after paying for Spice acquisition (including the non-compete fees paid to the Modi group). As a result, we estimate Idea's net debt to EBITDA at 1.7X at end-FY2009E versus 2.7X at end-FY2008. We expect net debt/EBITDA of 2.4X at end-FY2010E and 2.2X at end-FY2011E. Note Idea has capex plan of Rs60 bn for FY2010E largely comprising active component similar to FY2009E levels. The planned capex includes potential outlay for Spice Communications as well. The company will however need equity funding for a 3G rollout, in our view.

HIGHLIGHTS of the EARNINGS CALL

Bihar and Mumbai circle losses may increase further. Idea management indicated that losses typically peak in the second quarter of new network launch. The company has accelerated the expansion in Bihar—that may result in further losses at the EBITDA level for the next two-three quarters. In Mumbai, Idea started with a big-bang network launch. As a result incremental losses would be somewhat limited and may peak by the March 2009 quarter.

Capex guidance of Rs60 bn for FY2010E. Idea has guided for a capex of Rs65 bn for FY2009E. The capex guidance includes capex for the existing circles including Mumbai and Bihar and capex on NLD backbone. The company reduced capex guidance of Rs75-80 bn primarily on the account of push in launch of new network in Orissa and TN/Chennai. For FY2010E, Idea has guided for capex of Rs60 bn—this comprises largely active capex across all circles. The guidance does not factor in any 3G capex.

Indus rental payout may impact EBITDA margins by 400-500 bps. Idea believes its EBITDA margins may be impacted by 400-500 bps on rental payments to Indus using tenancy slot. Note that the company has signed IRU agreements for using towers with Indus. Depreciation charges may lower by 2-3%, leading to net PBT impact of 2-3%. The balance impact will be offset by consolidating proportionate stake in Indus JV (16%).

Idea 3QFY09 quarterly performance (Rs mn)

	Dec-07	Sep-08	Dec-08	qoq (%)	yoy (%)	Dec-08 E	Deviation (%)	Comments
Idea Cellular (standalone)								
Revenues	17,081	22,992	26,209	14.0	53.4	25,635	2.2	
EBITDA	**5,672**	**6,024**	**6,805**	**13.0**	**20.0**	**7,050**	(3.5)	EBITDA performance below expectations; impacted by higher-than-expected losses in the two new circles, Mumbai and Bihar
EBIT	3,395	2,992	3,226	7.8	(5.0)	3,715	(13.2)	
PAT	**2,368**	**1,441**	**2,562**	**77.8**	**8.2**	**2,175**	**17.8**	**Net income outperformance driven by below-EBITDA line items**
EBITDA margin (%)	33.2	26.2	26.0			27.5		EBITDA margin impacted by full quarter operations in Mumbai and Bihar circles as opposed to only 5 weeks in Mumbai circle in the previous quarter
EBIT margin (%)	19.9	13.0	12.3			14.5		
Wireless ARPU (Rs/sub/month)	279	261	266	1.9	(4.7)	260	2.3	Improvement in ARPU surprising
Wireless MOU (min/sub/month)	377	417	410	(1.7)	8.8	421	(2.6)	
Wireless RPM (Rs/min)	0.74	0.63	0.65	3.7	(12.3)	0.62	5.1	
Wireless EPM (Rs/min)	0.25	0.17	0.17	1.9	(33.1)	0.16	7.0	
Idea Cellular (consolidated, with Spice)								
Revenues			27,311			26,757	2.1	
EBITDA			**6,974**			**7,201**	(3.2)	
EBIT			3,037			3,589	(15.4)	
PAT			**2,195**			**1,908**	**15.0**	**Consolidated performance helped by lower-than-expected losses for Spice and lower than expected net finance charges**

Source: Kotak Institutional Equities estimates

Detailed standalone (ex-Spice) interim results for Idea Cellular Limited (Rs mn)

	qoq			yoy			yoy		
	3Q 2009 (S)	2Q 2009	% chg	3Q 2009 (S)	3Q 2008	% chg	9M 2009 (S)	9M 2008	% chg
Gross sales	**26,209**	**22,992**	***14.0***	**26,209**	**17,081**	***53.4***	**70,936**	**47,476**	***49.4***
Total operating costs	(19,404)	(16,968)	*14.4*	(19,404)	(11,409)	*70.1*	(50,949)	(31,570)	*61.4*
EBITDA	**6,805**	**6,024**	***13.0***	**6,805**	**5,672**	***20.0***	**19,987**	**15,906**	***25.7***
EBITDA margin (%)	26.0	26.2		26.0	33.2		**28.2**	**33.5**	
Net finance cost	(600)	(1,497)	*(59.9)*	(600)	(782)	*(23.2)*	(3,623)	(2,353)	*53.9*
Other income	—	45	*(100.0)*	—	22	*(100.0)*	91	835	*(89.2)*
Depreciation & Amortization	(3,579)	(3,032)	*18.0*	(3,579)	(2,277)	*57.2*	(9,360)	(6,171)	*51.7*
PBT	**2,626**	**1,540**	***70.6***	**2,626**	**2,635**	***(0.3)***	**7,095**	**8,216**	***(13.7)***
Current tax (expense)/income	(63)	(99)	*(36.3)*	(63)	(268)	*(76.4)*	(459)	(560)	*(18.1)*
Deferred tax (liability)/asset	—	—	—	—	—	—	—	—	—
Reported net income	**2,563**	**1,441**	***77.9***	**2,563**	**2,368**	***8.2***	**6,636**	**7,656**	***(13.3)***
Key operational metrics									
Cellular subscribers ('000)									
Prepaid	32,261	28,557	*13.0*	32,261	19,496	*65.5*	32,261	19,496	*65.5*
Postpaid	1,950	1,823	*7.0*	1,950	1,558	*25.2*	1,950	1,558	*25.2*
Total	34,211	30,380	*12.6*	34,211	21,054	*62.5*	34,211	21,054	*62.5*
ARPU (Rs/mth)									
Blended	266	261	*1.9*	266	279	*(4.7)*	270	291	*(7.2)*
MOU (min/mth)									
Blended	410	417	*(1.7)*	410	377	*8.8*	417	370	*12.7*
Churn (%)									
Prepaid	4.4	4.0	—	4.4	4.9	—	—	—	—
Postpaid	2.7	2.5	—	2.7	2.9	—	—	—	—
Revenue/min: RPM = ARPU/MOU									
Blended revenue/min (incl. in-roaming)	0.65	0.63	*3.7*	0.65	0.74	*(12.3)*	0.65	0.79	*(17.7)*
Estimated volume (mn mins)									
Total estimated volume (mn mins)	40,254	36,315	*10.8*	40,254	22,457	*79.2*	109,656	58,388	*87.8*
EBITDA per min - blended (Rs)	0.17	0.17	*1.9*	0.17	0.25	*(33.1)*	0.18	0.27	*(33.1)*
VAS as % of wireless revenues	9.5	9.8	—	9.5	8.0	—	9.5	8.2	—

Source: Company

Idea Cellular--summary of key changes to the earnings model, March fiscal year-ends, 2009E-2017E

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues (Rs mn)									
Revised	103,595	157,539	192,758	218,324	235,730	247,882	257,122	263,204	267,923
Old	106,489	161,219	195,755	221,650	241,880	257,145	269,518	278,420	285,263
Change (%)	**(2.7)**	**(2.3)**	**(1.5)**	**(1.5)**	**(2.5)**	**(3.6)**	**(4.6)**	**(5.5)**	**(6.1)**
EBITDA (Rs mn)									
Revised	26,947	36,004	44,903	54,122	60,127	63,951	67,058	69,289	71,102
Old	29,408	40,404	49,692	60,205	67,074	72,624	77,648	81,637	84,930
Change (%)	**(8.4)**	**(10.9)**	**(9.6)**	**(10.1)**	**(10.4)**	**(11.9)**	**(13.6)**	**(15.1)**	**(16.3)**
EBITDA margin (%)									
Revised	26.0	22.9	23.3	24.8	25.5	25.8	26.1	26.3	26.5
Old	27.6	25.1	25.4	27.2	27.7	28.2	28.8	29.3	29.8
Change (bps)	**(160.4)**	**(220.8)**	**(209.0)**	**(237.2)**	**(222.4)**	**(244.4)**	**(273.0)**	**(299.6)**	**(323.4)**
EBIT Margin (%)									
Revised	13.2	10.6	11.0	12.1	13.0	13.7	14.3	14.5	14.9
Old	15.9	12.5	12.9	14.4	15.3	15.4	15.9	16.5	17.3
Change (bps)	**(273.2)**	**(192.5)**	**(191.3)**	**(225.8)**	**(230.9)**	**(171.9)**	**(164.6)**	**(201.9)**	**(235.8)**
EPS (Rs)									
Revised	2.6	2.8	3.6	4.6	5.0	6.3	7.6	8.4	9.0
Old	3.3	3.4	4.5	5.7	7.2	8.2	8.9	10.0	11.1
Change (%)	**(18.9)**	**(18.7)**	**(20.4)**	**(19.0)**	**(30.4)**	**(22.9)**	**(14.3)**	**(16.0)**	**(19.6)**
Subscribers (mn)									
Revised	42.7	57.2	66.1	72.4	76.8	79.9	82.0	83.6	84.8
Old	40.6	52.3	61.3	67.7	72.5	76.2	79.0	81.2	82.9
Change (%)	**5.2**	**9.3**	**7.8**	**6.9**	**5.9**	**4.9**	**3.9**	**3.0**	**2.3**
MOU (min/month)									
Revised	425	435	440	444	448	452	455	455	456
Old	449	459	464	468	472	476	479	480	480
Change (%)	**(5.3)**	**(5.2)**	**(5.2)**	**(5.1)**	**(5.1)**	**(5.1)**	**(5.0)**	**(5.1)**	**(5.1)**
ARPU (Rs/month)									
Revised	278	235	231	232	232	232	233	233	233
Old	260	254	250	249	249	249	250	250	249
Change (%)	**7.1**	**(7.3)**	**(7.7)**	**(6.6)**	**(6.6)**	**(6.6)**	**(6.6)**	**(6.7)**	**(6.7)**
RPM (Rs/min)									
Revised	0.65	0.54	0.53	0.52	0.52	0.51	0.51	0.51	0.51
Old	0.58	0.55	0.54	0.53	0.53	0.52	0.52	0.52	0.52
Change (%)	**13.1**	**(2.2)**	**(2.7)**	**(1.6)**	**(1.6)**	**(1.6)**	**(1.7)**	**(1.7)**	**(1.7)**
EPM (Rs/min)									
Revised	0.18	0.15	0.15	0.16	0.16	0.16	0.17	0.17	0.17
Old	0.17	0.16	0.16	0.17	0.17	0.17	0.17	0.18	0.18
Change (%)	**6.7**	**(4.0)**	**(3.9)**	**(3.6)**	**(3.2)**	**(4.2)**	**(5.2)**	**(6.0)**	**(6.6)**
Capex (Rs mn)									
Revised	67,649	63,303	47,813	38,762	32,084	30,673	29,452	27,507	27,206
Old	80,230	60,170	48,962	39,834	30,968	29,738	28,781	29,544	28,961
Change (%)	**(15.7)**	**5.2**	**(2.3)**	**(2.7)**	**3.6**	**3.1**	**2.3**	**(6.9)**	**(6.1)**
Capex/sales (%)									
Revised	65.3	40.2	24.8	17.8	13.6	12.4	11.5	10.5	10.2
Old	75.3	37.3	25.0	18.0	12.8	11.6	10.7	10.6	10.2
Change (bps)	**(1,004)**	**286**	**(21)**	**(22)**	**81**	**81**	**78**	**(16)**	**0**

Source: Kotak Institutional Equities estimates.

Idea Cellular's condensed financial statements, March year ends, 2007-2013E

	2007	2008	2009E	2010E	2011E	2012E	2013E
Profit model (Rs mn)							
Revenue	43,664	67,200	103,595	157,539	192,758	218,324	235,730
EBITDA	14,653	22,518	26,947	36,004	44,903	54,122	60,127
EBIT	7,934	13,750	13,638	16,658	21,179	26,489	30,542
Net interest income / (expense)	(2,842)	(2,602)	(4,617)	(6,731)	(8,129)	(9,185)	(8,667)
Tax	(0)	(725)	(440)	(601)	(1,090)	(1,688)	(4,853)
Net profit	5,092	10,423	8,540	9,052	11,498	14,963	16,254
Fully diluted EPS	**2.2**	**3.9**	**2.6**	**2.8**	**3.6**	**4.6**	**5.0**
Balance sheet (Rs mn)							
Cash	18,199	4,975	16,448	16,122	15,693	16,341	19,108
Other current assets	6,461	10,525	19,104	27,652	32,976	37,413	40,449
Fixed assets	49,323	89,270	144,786	190,291	215,920	228,575	232,601
Other long term assets	11,838	17,954	21,704	20,156	18,616	17,089	15,563
Short tem debt	7,305	10,605	8,846	9,846	7,346	4,846	—
Other current liabilities	21,520	27,022	37,135	41,989	46,313	48,910	51,236
Long term debt	35,200	54,549	54,549	91,549	106,549	106,549	99,549
Other long term liabilities	11	661	714	714	914	1,414	2,214
Shareholders funds (incl. minorities)	21,798	35,446	133,816	142,868	154,366	169,329	185,583
Net (debt)/ cash	(24,306)	(60,180)	(46,947)	(85,272)	(98,201)	(95,054)	(80,441)
Free cash flow (Rs mn)							
EBITDA	**14,653**	**22,518**	**26,947**	**36,004**	**44,903**	**54,122**	**60,127**
Change in working capital	2,221	1,387	(3,695)	(1,000)	(1,840)	(710)	2,567
Cash tax (paid)	(0)	(500)	(240)	(601)	(890)	(1,188)	(4,053)
Cash interest (paid)	(3,039)	(4,517)	(5,664)	(7,792)	(9,166)	(10,229)	(9,657)
Capex on PP&E and intangibles	(22,819)	(55,726)	(67,649)	(63,303)	(47,813)	(38,762)	(32,084)
Miscallenous	(1,004)	985	(6,343)	(2,695)	840	(1,130)	(3,277)
Free cash flow	**(9,989)**	**(35,853)**	**(56,644)**	**(39,386)**	**(13,966)**	**2,104**	**13,623**
Ratios (%)							
Sales growth	47.2	53.9	54.2	52.1	22.4	13.3	8.0
EBITDA growth	37.3	53.7	19.7	33.6	24.7	20.5	11.1
EPS growth	149.8	78.5	(33.2)	6.0	27.0	30.1	8.6
FCF growth	(336.9)	NM	NM	NM	(64.5)	(115.1)	547.5
EBITDA margin	**33.6**	**33.5**	**26.0**	**22.9**	**23.3**	**24.8**	**25.5**
Net margin	11.7	15.5	8.2	5.7	6.0	6.9	6.9
FCF margin	(22.9)	(53.4)	(54.7)	(25.0)	(7.2)	1.0	5.8
RoAE	30.9	36.4	10.1	6.5	7.7	9.2	9.2
ROAE (excl. cash and int. income)	**73.4**	**59.0**	**10.0**	**6.6**	**7.9**	**9.5**	**9.5**
RoACE	15.1	16.2	9.6	7.6	8.1	9.3	9.1
ROACE (excl. cash and int. income)	**17.9**	**18.6**	**9.7**	**7.7**	**8.2**	**9.6**	**9.4**
Net debt/EBITDA (X)	1.7	2.7	1.7	2.4	2.2	1.8	1.3
Net debt/equity (X)	1.1	1.7	0.4	0.6	0.6	0.6	0.4
Total debt/capital (X)	1.9	1.8	0.5	0.7	0.7	0.0	0.0
Tax rate (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company, Kotak Institutional Equities estimates

Discounted cash flow valuation of Idea Cellular (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	26,947	36,004	44,903	54,122	60,127	63,951	67,058	69,289	71,102
Tax	(269)	(940)	(1,390)	(1,773)	(5,736)	(7,544)	(9,138)	(9,857)	(10,446)
Change in working capital	1,387	(3,695)	(1,000)	(1,840)	(710)	2,567	3,226	3,426	4,425
Post-tax operating cash flow	**28,064**	**31,369**	**42,513**	**50,510**	**53,681**	**58,974**	**61,147**	**62,858**	**65,082**
Capex	(61,643)	(63,303)	(47,813)	(38,762)	(32,084)	(30,673)	(29,452)	(27,507)	(27,206)
Free cash flow	**(33,579)**	**(31,933)**	**(5,299)**	**11,748**	**21,597**	**28,301**	**31,694**	**35,351**	**37,876**

	+ 1-year	WACC and growth in perpetuity assumptions	
PV of cash flows	61,651	**Terminal growth - g (%)**	**4.0**
PV of terminal value	129,114	**WACC (%)**	**14.5**
EV	190,765		
Net debt	13,887		
Equity value (Rs mn)	**176,878**		
Equity value (US$ mn)	**3,685**		
Shares outstanding (mn)	3,236		
Equity value (Rs/Idea share)	**55**		
Exit FCF multiple (X)	9.5		
Exit EBITDA multiple (X)	**5.3**		

Key assumptions (%)	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenue growth	54.2	52.1	22.4	13.3	8.0	5.2	3.7	2.4	1.8
EBITDA growth	19.7	33.6	24.7	20.5	11.1	6.4	4.9	3.3	2.6
EBITDA margin	**26.0**	**22.9**	**23.3**	**24.8**	**25.5**	**25.8**	**26.1**	**26.3**	**26.5**
Capex/sales	59.5	40.2	24.8	17.8	13.6	12.4	11.5	10.5	10.2
Cash tax rate	1.8	5.3	6.3	6.4	18.2	21.6	24.1	24.9	25.1
Effective tax rate	4.9	6.0	8.4	9.8	22.2	21.1	19.6	21.1	24.0
Return on avg. capital employed	**9.7**	**7.7**	**8.2**	**9.6**	**9.4**	**9.9**	**10.6**	**11.2**	**12.1**

Source: Kotak Institutional Equities estimates

Idea--Spice acquisition transaction dynamics

Pre-deal			
Spice		**Transaction prices**	
# of shares	690	Spice (Rs/share)	77.3
% holding		Idea (Rs/share)	156.96
BK Modi group	40.8		
Telekom Malaysia (TM)	39.2		
Others	20.0		
Transaction dynamics			
Idea pays Spice group for 40.8% in Spice (Rs mn)	21,759		
Idea pays Spice Group for non- compete agreement	5,440		
Idea shares issued to TM for 49.2% stake in Spice (mn)	166.3	Swap ratio of 49:100	
Post-share swap equity share of Telekom Malaysia (in Idea)	5.9		
Further equity issuance to TM	464.7		
TM pays to Idea	72,944		
Post-equity issuance TM holding in Idea	19.3		
Open offer (residual 20% at open offer price of Rs77.3)			
Shares issued to Green Acre for Spice share swap	34		
Total amount that Idea pays in cash (Rs mn)	27,199		
Idea gets from TM (Rs mn)	72,944		
Debt assumed (Rs mn)	9,890		
Net cash inflow to Idea	35,855		
New equity issued	664.9		
As % of Post-deal equity	20.1		

Source: Company, Kotak Institutional Equities estimates

Sharp increase in network operating costs impacted margins in 3QFY09

Break-up of cost elements, 1QFY08-3QFY09

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
Revenues	14,773	15,622	17,081	19,724	21,735	22,992	27,305
Interconnection costs	(2,396)	(2,550)	(2,930)	(3,445)	(3,957)	(4,271)	(5,083)
License fee and spectrum charges	(1,599)	(1,551)	(1,736)	(1,965)	(2,446)	(2,571)	(2,983)
Network operating costs	(1,896)	(2,380)	(2,915)	(3,262)	(3,756)	(4,485)	(6,055)
Employee costs	(708)	(878)	(954)	(885)	(1,022)	(1,323)	(1,457)
Sales and marketing expenses	(2,283)	(2,514)	(2,185)	(2,648)	(2,465)	(3,279)	(3,568)
Other expenses	(764)	(643)	(688)	(897)	(931)	(1,041)	(1,190)
Total operating costs	(9,645)	(10,516)	(11,409)	(13,103)	(14,577)	(16,968)	(20,336)
EBITDA	5,128	5,106	5,672	6,621	7,158	6,024	6,969
As % of revenues							
Interconnection costs	16.2	16.3	17.2	17.5	18.2	18.6	18.6
License fee and spectrum charges	10.8	9.9	10.2	10.0	11.3	11.2	10.9
Network operating costs	**12.8**	**15.2**	**17.1**	**16.5**	**17.3**	**19.5**	**22.2**
Employee costs	4.8	5.6	5.6	4.5	4.7	5.8	5.3
Sales and marketing expenses	15.5	16.1	12.8	13.4	11.3	14.3	13.1
Other expenses	5.2	4.1	4.0	4.5	4.3	4.5	4.4
Total operating costs	65.3	67.3	66.8	66.4	67.1	73.8	74.5
EBITDA margin (%)	34.7	32.7	33.2	33.6	32.9	26.2	25.5

Source: Company, Kotak Institutional Equities

Aggressive network rollout over the past 12 months has impacted EBITDA margins

	Dec-07	Sep-08	Dec-08	qoq (%)	yoy (%)
Revenues (Rs mn) - Idea standalone	17,081	22,992	26,209	14.0	53.4
EBITDA (RS mn) - Idea standalone	5,672	6,024	6,805	13.0	20.0
EBITDA margin (%)	33.2	26.2	26.0		
Network sites (#)	**21,197**	**33,377**	**39,289**	**17.7**	**85.4**
Rent-paying sites (#)	**8,721**	**16,628**	**21,459**	**29.1**	**146.1**
Owned sites (#)	12,476	16,749	17,830	6.5	42.9

Source: Company

EBITDA margin improvement of 150 bps in old circles a positive

Idea's margin performance, 4QFY07-3QFY09

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
Revenues (Rs mn)								
Old circles (a)	**13,195**	**14,776**	**15,643**	**17,103**	**19,852**	**21,781**	**22,940**	**25,726**
New circles (b)							**52**	**483**
Total	**13,195**	**14,776**	**15,643**	**17,103**	**19,852**	**21,781**	**22,992**	**26,209**
EBITDA (Rs mn)								
Old circles	**4,473**	**5,136**	**5,128**	**5,694**	**6,734**	**7,203**	**6,390**	**7,570**
New circles							**(366)**	**(765)**
Total	**4,473**	**5,136**	**5,128**	**5,694**	**6,734**	**7,203**	**6,024**	**6,805**
EBITDA margin (%)								
Old circles	**33.9**	**34.8**	**32.8**	**33.3**	**33.9**	**33.1**	**27.9**	**29.4**
New circles							**(704)**	**(158)**
Total	**33.9**	**34.8**	**32.8**	**33.3**	**33.9**	**33.1**	**26.2**	**26.0**

Note:
(a) A.P., Delhi, Gujarat, M.P., Maharashtra, Haryana, Kerala, U.P. (West), H.P., Rajasthan, U.P.(East)
(b) Mumbai

Source: Company data

Transportation

CCRI.BO, Rs671	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	800
52W High -Low (Rs)	1000 - 540
Market Cap (Rs bn)	87

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	33	37	40
Net Profit (Rs bn)	7.5	8.9	9.5
EPS (Rs)	57.7	68.3	72.9
EPS gth	*8.1*	*18.8*	*7.0*
P/E (x)	11.6	9.8	9.2
EV/EBITDA (x)	7.8	6.4	5.8
Div yield (%)	1.9	2.3	2.4

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
11.2	(6.6)	(18.6)	(14.5)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	63.1	-	-
FIIs	26.5	0.5	0.2
MFs	3.2	0.3	(0.0)
UTI	-	-	(0.3)
LIC	2.6	0.2	(0.1)

Container Corporation: Results in line—volume decline likely countered by higher realization and better margins; reiterate REDUCE

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- **Results in line with expectation both at revenue and margin levels**
- **Expect decline in volumes led by higher competition as well as decline in overall traffic numbers**
- **Higher TEU realization and better margin would probably help counter the expected volume decline**
- **We maintain our earnings estimates and target price of Rs800/share; reiterate REDUCE**

Container Corporation reported flat revenue growth for 3QFY09 at Rs8.46 bn marginally above our estimates of Rs8.25 bn. Operating profit margin was up 160 bps yoy to 28.9% versus our estimate of 28.5%. The margin expansion was led by lower rail freight expenses as a percentage of sales which was down 300 bps yoy. We expect a decline in volumes for this quarter due to lower exim trade volumes as well as increasing domestic competition from the private sector. However, we believe higher per TEU realization and better margins would partially help to counter this decline in volumes. We maintain our earnings estimates of Rs68.3 and Rs72.9 for FY2009E and FY2010E, respectively. We maintain our SOTP-based target price of Rs800 and reiterate our REDUCE rating on the share.

We will be revising our estimates post today's conference call at 11:00 am.

Results in line with expectation both at revenue and margin levels

Concor has declared 3QFY09 revenues of Rs8.46 bn (flat on a yoy basis) versus our expectation of Rs8.25 bn. Operating profit reported was Rs2.4 bn (up 6% yoy) versus our expectation of Rs2.35 bn. This implied an operating profit margin of 28.9%, up 160 bps yoy, versus our expectation of 28.5%. The margin expansion was due to lower rail freight expenses as a percentage of sales down 300 bps yoy from 57.9% in 3QFY08 versus 54.8% in this quarter. PAT reported was at Rs2.06 bn (7% growth on a yoy basis) versus our expectation of Rs2.05 bn.

For the nine month period ended December 31, 2008, revenues reported was up 5.4% yoy at Rs25.7 bn versus Rs24.4 bn in the last year. Operating margin was up 180 bps yoy and profit after tax reported was up 14% yoy to Rs6.3 bn for the same period.

Expect decline in volumes led by higher competition as well as decline in overall traffic numbers

We expect decline in container volumes for Container Corporation for this quarter due to poor Exim trade performance during the October–December period. We were expecting 5% volume decline in the exim segment on a yoy basis. Domestic volume for Concor has been shrinking for 1HFY2009, probably led by private sector competition. Domestic volumes declined 7% yoy during the first half of FY2009. We were expecting 10% volume decline in the domestic segment during this quarter.

Indian Ports Association declared traffic number at various ports. Country-wide there has been 5% growth during the period April-December to 5.14 mn TEUs in 9MFY09 so far. However October-December traffic has fallen 4.75% to 1.585 mn TEUs from 1.664 mn TEUs country-wide. Specifically JNPT itself has handled 0.955 mn TEUs versus 1.031 mn TEUs last year in the third quarter of October-December.

Higher TEU realization and better margin would probably help counter the expected volume decline

We believe the expected volume decline would have been partially countered by (1) higher per TEU realization (on back of haulage charge increase) and (2) better margins on a yoy basis (based on withdrawal of discounts and lower empties etc.). Both these factors were visible in 1HFY09 also. However, physical achievement numbers are not available yet and would be available post the company's conference call.

We maintain our earnings estimates and target price of Rs800/share; reiterate REDUCE

We maintain our earnings estimates of Rs68.3 and Rs72.9 for FY2009E and FY2010E, respectively. We highlight that our estimates factor in (1) decline in Concor's market share—we assume Concor's exim volume growth at about 5% and 8% in FY2009E and FY2010E, respectively, and -5% and 7% for domestic volume growth in FY2009E and FY2010E and (2) steady decline in EBIT margins to factor in increasing competition. We maintain our SOTP-based target price of Rs800 which comprises (1) Rs757 for the core rail business (based on March-FY2010E DCF using a WACC of 13.5%), (2) Rs25 per share for the JNPT terminal JV, (3) Rs8.8 per share for the HAL JV and (4) Rs8.6 per share for all other JVs combined.

We maintain our REDUCE rating on the share since earnings growth would remain under pressure from lower-than-expected volume growth volumes as well as potential discounts that may be passed on to revive volumes.

Key risks arise from (1) increasing competition from private players, (2) slower growth in Indian containerized trade, (3) continued sluggishness in the domestic segment and (4) further haulage rate hikes by Indian Railways.

We would be revisiting our estimates post today's conference call at 11:00 am, wherein we expect further details on volumes, pricing, other businesses and competition.

Exhibit 1. Concor - 3QFY09 - key numbers (Rs mn)

	yoy			qoq			yoy		
	3QFY09	3QFY08	% change	3QFY09	2QFY08	%change	9MFY09	9MFY08	%change
Net Sales	**8,459**	**8,432**	***0.3***	**8,459**	**9,034**	***(6.4)***	**25,721**	**24,404**	***5.4***
Staff cost	(167)	(142)	*17.8*	(167)	(156)	*7.4*	(474)	(362)	*30.9*
Rail freight exp	(4,639)	(4,880)	*(4.9)*	(4,639)	(4,983)	*(6.9)*	(14,107)	(14,222)	*(0.8)*
Others	(1,211)	(1,110)	*(1.9)*	(1,211)	(1,207)	*(5.2)*	(3,621)	(3,115)	*2.8*
Total exp	**(6,017)**	**(6,131)**	***(2.1)***	**(6,017)**	**(6,346)**	***(5.7)***	**(18,202)**	**(17,699)**	***3.1***
Operating profit	**2,442**	**2,301**	***6.1***	**2,442**	**2,688**	***(9.1)***	**7,520**	**6,705**	***12.2***
Other Income	506	417	*21.4*	506	480	*5.3*	1,438	1,092	*31.8*
EBIDTA	2,948	2,718	*8.5*	2,948	3,168	*(7.0)*	8,958	7,797	*14.9*
Interest	-	-		-	-		-	-	
Depreciation	(283)	(275)	*2.9*	(283)	(275)	*3.0*	(833)	(794)	*4.9*
PBT	**2,665**	**2,442**	***9.1***	**2,665**	**2,893**	***(7.9)***	**8,125**	**7,003**	***16.0***
Tax	(601)	(512)	*17.3*	(601)	(654)	*(8.2)*	(1,804)	(1,460)	*23.6*
Prior period	-	(1)		-	(2)		(2)	(1)	
PAT	**2,064**	**1,929**	***7.0***	**2,064**	**2,237**	***(7.7)***	**6,319**	**5,542**	***14.0***
Key ratios (%)									
Rail freight exps/Sales	54.8	57.9		54.8	55.2		54.8	58.3	
Other exp/Sales	14.3	13.2		14.3	13.4		-	12.8	
Employee exp/Sales	2.0	1.7		2.0	1.7		1.8	1.5	
Operating profit margin	**28.9**	**27.3**		**28.9**	**29.8**		**29.2**	**27.5**	
Pretax margin	31.5	29.0		31.5	32.0		31.6	28.7	
Effective tax rate	22.5	21.0		22.5	22.6		22.2	20.8	
PAT margin	24.4	22.9		24.4	24.8		24.6	22.7	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2. We have an SOTP-based target price of Rs800 per share

Business segment	Valuation methodology	Multiple value (X)	Total value (Rs mn)	Value per share (Rs)
Core rail operations	DCF - FY2010E-based	NA	98,615	758.7
HAL JV	P/E multiple - FY2010E-based	10.0	1,148	8.8
All other JVs	P/B multiple - based on FY2007	2.0	1,112	8.6
JNPT terminal	DCF - FY2010E-based	NA	3,278	25.2
Total				**801.3**

Source: Company, Kotak Institutional Equities estimates

Exhibit 3. We value Concor's rail business at Rs759/ share

DCF valuation of Concor's rail business, March fiscal year-ends, 2010E-2019E (Rs mn)

	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**39,984**	**44,922**	**50,470**	**56,703**	**62,731**	**69,403**	**76,789**	**84,966**	**94,019**	**104,041**
Growth (%)	19.1	15.9	18.2	10.0	10.0	10.0	10.0	10.0	10.0	10.0
EBIT	9,898	10,781	11,608	12,475	11,919	12,493	13,822	15,294	16,923	18,727
EBIT margin	24.8	24.0	23.0	22.0	19.0	18.0	18.0	18.0	18.0	18.0
Tax rate	22.7	26.0	28.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
EBIT*(1-tax rate)	**7,654**	**7,978**	**8,358**	**8,732**	**8,343**	**8,745**	**9,675**	**10,706**	**11,846**	**13,109**
Depreciation	1,479	1,750	1,900	2,050	2,150	2,250	2,350	2,400	2,500	2,600
Change in working capital	(75)	(148)	(166)	(187)	(181)	(200)	(222)	(245)	(272)	(301)
Capital expenditure	(4,750)	(5,000)	(5,000)	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)
Free Cash Flows	**4,308**	**4,580**	**5,091**	**6,595**	**6,312**	**6,795**	**7,804**	**8,860**	**10,075**	**11,409**
Growth (%)	68.6	6.3	11.2	29.5	(4.3)	7.6	14.9	13.5	13.7	13.2
Years discounted	-	1	2	3	4	5	6	7	8	9
Discount factor	1.00	0.88	0.78	0.68	0.60	0.53	0.47	0.41	0.36	0.32
Discounted cash flow	**4,308**	**4,035**	**3,952**	**4,511**	**3,804**	**3,607**	**3,650**	**3,652**	**3,658**	**3,650**

Target price calculation	**Rs mn**
Sum of free cash flow	38,828
Discounted terminal value	45,086
Enterprise value	83,913
Net debt	(14,702)
Net present value-equity	98,615
Shares o/s	130
NPV/share (Rs)	**759**
WACC used	13.5%

Terminal value Calculation	**Rs mn**
Cash flow in terminal year	11,409
Growth to perpetuity (g)	5.0%
Capitalisation rate (WACC-g)	8.5%
Terminal value	140,929
Discount period (years)	9
Discount factor	0.32
Discounted terminal value	**45,086**

Terminal multiples	
EV/EBIDTA	12.4

Source: Company, Kotak Institutional Equities estimates

Banking

CNBK.BO, Rs174	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	220
52W High -Low (Rs)	324 - 135
Market Cap (Rs bn)	71.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	58.5	69.0	75.2
Net Profit (Rs bn)	15.7	18.8	15.8
EPS (Rs)	38.2	45.9	38.6
EPS gth	*10.1*	*20.3*	*(15.9)*
P/E (x)	4.6	3.8	4.5
P/B (x)	1.0	0.8	0.8
Div yield (%)	4.6	3.4	3.4

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(9.2)	(0.2)	(7.3)	(36.4)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	73.2	-	-
FIIs	13.3	0.2	(0.1)
MFs	2.3	0.2	(0.1)
UTI	-	-	(0.2)
LIC	2.4	0.1	(0.1)

Canara Bank: Rise in NPLs and fast loan growth are a concern; retain REDUCE

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- **Loan growth continues to remain strong - 31% yoy and 8% qoq**
- **Reported NPLs rise sharply; gross NPLs up 60% qoq and net NPL up 55% qoq**
- **We revise estimates, retain REDUCE with price target of Rs220**

Canara Bank continues to maintain a robust growth in advances of 31% yoy, which is ahead of the industry levels. We are, however, concerned that the company's focus on loan growth given the lower Tier I capital and relatively low head room on the Tier II capital could lead to further equity infusion over the next few quarters and also led to higher slippages in asset quality. Company's PAT for 3QFY09 was Rs7 bn—a robust increase of 53% yoy and 19% ahead of our estimates. Despite relatively undemanding valuations of 0.8X PBR FY2010E and strong PAT growth in 3QFY09, we retain REDUCE rating with a target price of Rs220 given our concerns on loan growth and lower Tier I ratio.

Higher loan growth and margins drive net interest income. Canara Bank's 3QFY09 earnings benefited from the sharp loan growth of 31% yoy and improved pricing power on advances—net interest income (NII) increased 33% yoy to Rs12.4 bn (and 3% higher than our estimates). The yields improved to 10.7% in 2QFY09 compared to 10.5% in 2QFY09 and 10.2% in 3QFY09 in line with the trend observed in the industry. The sharper rise in yield on advances compared to cost of funds led to the company's net interest margin (NIM) improving to 2.75% in 3QFY09 vis-à-vis 2.7% reported in 2QFY09. The yoy growth comparisons for FY2009E are likely distorted given the low base—the company's NII declined yoy in the previous year (FY2008).

Robust loan growth continues. Canara Bank's loan book increased to Rs1.3 tn as of December 2008—a growth of 31% yoy. The incremental loan growth in 3QFY09 was Rs96 bn, which was the highest incremental loan growth in a quarter in the past three years. We believe this sharp growth in loans in the current environment could lead to issues of NPLs over the next few quarters and lead to further stress on its financials.

The impact of higher loan growth could be on the capital requirements of the company. Canara Bank's capital adequacy ratio was healthy at around 13.4%, while the Tier I ratio was relatively low at 7.5% as of September 2008. This implies that the headroom for raising additional Tier II capital is limited and company will likely have to moderate its asset growth in the future or raise equity. Hence, we have adjusted our financial model by lowering our loan growth assumptions and reducing our dividend payout ratios for future years.

Rise is NPLs concerning

Canara Bank is one of the few banks which has reported a sharp increase in gross NPLs. Gross NPLs increased by Rs9.4 bn in 3QFY09 to reach Rs25.2 bn as of December 2008 likely indicating stress on its underlying asset quality. The management indicated that the increase in NPLs is on account of 1) Dabhol (now Ratnagiri Gas) project exposure of Rs4 bn, 2) NPLs of Rs3 bn are 'technical' in nature and will likely reverse in the future and 3)Rs2 bn of normal slippages.

Non-interest income growth benefited from higher fee income and treasury profits. Canara Bank's non-interest revenues increased 33% yoy in 3QFY09 to Rs7.6 bn. These revenues were driven by higher treasury profits of Rs3.4 bn (Rs960 mn in 3QFY08) and fee income of Rs3.6 bn (Rs2.7 bn in 3QFY08). We believe the fee income of the company benefited from the robust loan growth and better pricing environment in the current quarter. We expect moderation in these revenues over the next few quarters given the expected reduction in loan growth.

Other key highlights for the quarter

* Canara Bank's provisions for 3QFY09 were Rs3.5 bn largely on account of NPL provisions compared to Rs3.1 bn of provisions made in 1HFY09. Despite these high levels of provisions, the company's gross NPL increased sharply to Rs25.2 bn (up 60% qoq). Gross NPL ratio and net NPL ratio stood at 1.9% and 1.3% as of December 2008.
* The company's effective tax rate was 18.6% in 3QFY09, which remains amongst the lowest in the industry. Canara Bank likely has made high loan write-offs to benefit from these lower tax rates. However, we note that the effective tax rate of this company continues to remain low compared to its peers for an extended period of time and the reasons for the same are not completely clear to us.

Canara Bank, Quarterly results, Rs mn

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg	3QFY09KS	Actual Vs KS
Interest income	35,502	37,880	37,305	41,092	46,254	30.3	45,201	2.3
Interest on advances	24,680	26,215	27,004	30,537	34,841	41.2		
Income from investments	10,159	9,436	9,851	10,027	10,653	4.9		
Others	663	2,229	450	528	760	14.6		
Interest expense	26,158	28,665	27,114	29,602	33,811	29.3	33,155	2.0
Net interest income	**9,344**	**9,215**	**10,191**	**11,490**	**12,442**	**33.2**	**12,047**	**3.3**
Non-int.income	**5,704**	**7,393**	**3,915**	**3,388**	**7,575**	**32.8**	**4,500**	**68.3**
Sale of invts.	960	1,010	(220)	35	3,440	258.3	1,000	244.0
fee income	2,670	2,060	3,480	2,683	3,610	35.2	-	-
Other income excl treasury	4,744	6,383	4,080	3,352	4,135	(12.9)	3,500	18.1
Total income	**15,048**	**16,608**	**14,106**	**14,877**	**20,017**	**33.0**	**16,547**	**21.0**
Op. expenses	7,230	6,976	6,841	7,142	7,877	9.0	8,000	(1.5)
Employee cost	4,447	3,569	4,213	4,218	5,040	13.3	4,500	(6.3)
Other cost	2,783	3,407	2,628	2,925	2,838	2.0	3,500	(16.4)
Profit pre provisions	7,818	9,632	7,265	7,735	12,140	55.3	8,547	(9.5)
Provisions and cont.	2,230	4,001	5,639	1,441	3,526	58.1	1,000	44.1
Investment depreciation	(503)	350	4,000	(60)	(74)	(85.2)	(2,000)	-
NPLs	2,541	3,401	1,550	1,530	3,570	40.5	3,000	(49.0)
PBT	**5,588**	**5,631**	**1,626**	**6,294**	**8,614**	**54.1**	**7,547**	**14.1**
Tax	1,000	1,000	400	1,000	1,600	60.0	1,660	(3.6)
Net profit	**4,588**	**4,631**	**1,226**	**5,294**	**7,014**	**52.9**	**5,886**	**19.2**
Tax rate (%)	17.9	17.8	24.6	15.9	18.6		22.0	
PBT-invt gains+/-extra. item								
PBT-invt gains+ provisions -	**6,667**	**8,372**	**7,396**	**7,729**	**8,670**	**30.0**	**7,547**	**2**
Key balance sheet items (Rs bn)								
Deposits	1,442	1,540	1,563	1,715	1,748	21.3		
CASA ratio (%)	32	32	34	32	30			
Advances	986	1,072	1,099	1,193	1,289	30.8	8.1	
Total retail loans	172	176	175	178	180	4.6		
Priority sector	394	434	424	449	460	16.8		
Agriculture advances	163	180	177	188	189	15.8		
SME	170	142	192	203	214	25.9		
Investments	504	498	505	-	524	3.9		
AFS (%)	42	40	37	26	28			
Duration (years)	2	1	1	2	-			
Yield management measures (%)								
Yield on advances	10.2	10.2	10.1	10.5	10.7			
Yield on investments	7.9	7.9	7.9	7.9	-			
Cost of deposits	6.8	6.8	5.9	6.6	6.8			
Cost of funds	6.1	6.2	5.9	6.1	6.2			
Net interest margin	2.4	2.4	2.6	2.7	2.8			
Asset quality details					0.60			
Gross NPLs (Rs bn)	15.2	14.2	14.5	15.7	25.2	65.0	59.8	
Gross NPL ratio (%)	1.5	1.3	1.3	1.3	1.9			
Net NPLs (Rs bn)	8.7	9.0	9.4	10.6	16.5	89.5	55.3	
Net NPL ratio (%)	0.9	0.8	0.9	0.9	1.3			
Capital adequacy details (%)								
CAR	13.7	13.3	12.7	13.2	13.4			
Tier I	NA	7.0	6.8	7.2	7.5			

Source: Company, Kotak Institutional Equities estimates.

Canara Bank -- Old and new estimates
March fiscal year-ends, 2009-2011E (Rs mn)

	Old estimates			New estimates			% change		
	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E
Net interest income	43,174	50,804	59,222	46,669	51,920	60,533	8.1	2.2	2.2
Loan growth (%)	25.5	15.0	13.8	25.5	15.0	13.8			
NIM (%)	2.27	2.29	2.35	2.45	2.34	2.40			
Loan loss provisions	10,883	18,814	19,863	10,883	19,537	23,173	-	3.8	16.7
Other income	19,818	21,255	22,659	22,318	23,255	23,659	12.6	9.4	4.4
Fee income	8,049	8,854	9,740	8,049	8,854	9,740	-	-	-
Treasury income	1,500	2,000	2,000	4,000	4,000	3,000			
Operating expenses	30,563	34,523	37,611	30,563	34,523	37,611	-	-	-
Employee expenses	17,762	20,223	21,840	17,762	20,223	21,840	-	-	-
Depreciation on investments	1,940	-	-	4,000	-	-			
PBT	14,949	13,456	18,306	18,832	15,837	17,556	26.0	17.7	(4.1)
Net profit	**14,949**	**13,456**	**18,306**	**18,832**	**15,837**	**17,556**	**26.0**	**17.7**	**(4.1)**
PBT-treasury + loan loss provi	**24,332**	**30,269**	**36,168**	**25,715**	**31,374**	**37,729**	**5.7**	**3.6**	**4.3**

Source: Company, Kotak Institutional Equities estimates.

Banking

UNBK.BO, Rs144	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	220
52W High -Low (Rs)	219 - 96
Market Cap (Rs bn)	72.8

Financials

May y/e	2008	2009E	2010E
Sales (Rs bn)	41.7	52.9	60.0
Net Profit (Rs bn)	13.9	17.5	17.1
EPS (Rs)	27.5	34.7	33.8
EPS gth	*2.0*	*26.2*	*(2.4)*
P/E (x)	5.2	4.2	4.3
P/B (x)	1.0	0.8	0.7
Div yield (%)	2.8	3.6	3.5

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(8.8)	3.7	7.3	(28.0)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	55.4	-	-
FIIs	19.3	0.2	0.0
MFs	8.9	0.6	0.3
UTI	-	-	(0.2)
LIC	2.1	0.1	(0.1)

Union Bank: Delivers strong operational performance; retain BUY

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* **PAT of Rs6.7 bn, up 84% yoy and 44% above estimates**
* **We like company's strategy of maintaining moderate growth, cost competitiveness and focus on asset quality**
* **We retain BUY with price target of Rs220**

Union Bank of India reported healthy operational profits (PBT - treasury + provisions) of Rs7.6 bn—a robust growth of 58% yoy. This robust operational performance helped the company report PAT of Rs6.7 bn (up 84% yoy) and 44% ahead of estimates. We like the company's strategy of focusing on moderate loan growth, improving operational efficiency and maintaining healthy asset quality. In line with the trend observed in the 3QFY09 financial results of other banks, Union Bank made higher provisions on its loan book to improve its coverage ratio. We revise our estimates up by 6% for FY2009E and 2-3% for FY2010E-2011E to factor in the results. Given the valuations of 4.3X PER and 0.9X PBR Y2010E, we retain BUY recommendation with a price target of Rs220.

Asset growth remains in line with the industry trend. Union Bank of India continues to focus on asset growth—advances increased by 25% yoy as of December 2008 and were in line with the industry growth rate. The company's incremental growth in loans in 3QFY09 were Rs64 bn and higher than the trend observed in the past few quarters. Deposits grew 31% yoy and CASA deposit growth remained healthy at 20%.

Healthy provisions improve cushion against slippages. The asset quality as of December 2008 with gross NPL ratio of 1.7% with a coverage ratio of 92% provides cushion on the asset quality front. The incremental slippage ratio in 9mFY09 was around 1.1%—similar to the trend of the previous quarters. Even for FY2009E, the management is comfortable with this ratio. The management indicated that during 3Q, it restructured just a couple of accounts aggregating Rs600 mn.

Union Bank followed the prudent strategy of making Rs1.7 bn of NPL provisions in 3QFY09 and increasing the provision coverage. The company had a write-back of Rs2.9 bn on its investment book in 3QFY09 benefiting from the lower Gsec yields. Consequently, the company had a benefit of Rs450 mn of write-back of overall provision expenses in 3QFY09, which aided its profits.

Net interest income contribution remained high given the environment. Union Bank had Rs11.3 bn of net interest income (NII), which was up 50% yoy and 8% ahead of estimates. The company also saw an improvement in NIM to 3.2% in 3QFY09 compared to 3% in 2QFY09 and 2.7% in 3QFY08 reflecting the strong pricing power of banks in the current environment. We model a 15 bps decline in FY2010E compared to FY2009E to factor in likely faster repricing of assets compared to liabilities in a falling interest rate environment.

Non-interest revenues were also buoyant. Union Bank of India had non-interest revenues of Rs3.9 bn in 3QFY09, largely driven by healthy core fee income (up 44% yoy) of Rs2.7 bn. We believe the company's fee income benefited from higher processing charges on its loan assets and are likely to come off in the future. The company continues to hold Rs152 bn of investments in the available-for-sale (AFS) category with duration of 1.4 years and could enable it to book higher treasury income. We currently project Rs1.4 bn of treasury income for FY2010E and Rs1.2 bn in FY2011E compared to the Rs2.9 bn booked in FY2008, which is likely conservative.

Operational expenses were higher largely on account of one-off items. Union Bank of India had significantly higher operational expenses of Rs6.7 bn (up 33% yoy) and 36% ahead of estimates. This sharp increase in costs on account of (1) ad-hoc wage hike provisions of Rs800 mn for likely liabilities on account of negotiations of employee unions with IBA, (2) one-off expenses on account of advertising expenses to burnish its brand image and (3) expenses on account of opening new branches.

Capital adequacy is relatively lower. Union Bank of India had a CAR of 12.3% (as per Basle I) as of December 2008, with a Tier I ratio of 7.9%. We believe that given the relatively lower level of CAR, the company might have to approach the equity markets for fund raising over the next 12-18 months. The management has indicated that a rating of its advances portfolio could help increase its Tier I ratio (under Basle II) by another 70 bps and help its growth.

Union Bank of India Quarterly results, Rs mn

	3QFY08	4QFY08	1QFY09	2QFY09	3QFY09	% chg	3QFY09KS	Actual Vs
Interest income	24,226	25,664	25,332	28,313	32,617	34.6	30,861	5.7
Loans	17,562	18,135	18,414	21,410	24,646	40.3		
Investments	6,358	6,472	6,823	6,724	7,273	14.4		
Balances with RBI	140	104	84	167	243	73.3		
Others	166	953	11	12	455	174.1		
Interest expense	16,705	17,685	17,232	18,560	21,333	27.7	20,416	4.5
Net interest income	**7,521**	**7,979**	**8,100**	**9,753**	**11,284**	**50.0**	**10,445**	**8.0**
Non-int.income	3,835	3,467	2,217	2,833	3,921	2.3	2,974	31.8
sale of invts.	1,560	400	80	(380)	980	-37.2	500	96.0
Non-int income excl treasury	2,275	3,067	2,137	3,213	2,941	29.3	2,474	18.9
Total income	11,356	11,446	10,317	12,586	15,205	33.9	13,420	13.3
Op. expenses	4,997	2,539	4,157	5,589	6,656	33.2	4,900	35.8
Employee cost	2,794	571	2,247	2,916	3,225	15.4	2,600	24.0
Other cost	2,203	1,968	1,910	2,672	3,432	55.8	2,300	49.2
Operating profit	6,359	8,907	6,160	6,997	8,548	34.4	8,520	0.3
Provisions and cont.	1,108	3,652	2,957	2,033	(449)	-140.5	1,970	(122.8)
Investment Depreciation	(640)	1,100	3,390	(540)	(2,910)	354.7	-1,000	-
NPLs	1,520	2,560	(510)	2,400	1,660	9.2	2,800	-
Other provisions	239	(140)	77	170	800	0.0	170	-
PBT	5,251	5,255	3,203	4,965	8,997	71.4	6,550	37.4
Tax	1,600	44	920	1,350	2,280	42.5	1,899	20.0
Net profit	**3,651**	**5,211**	**2,283**	**3,615**	**6,717**	**84.0**	**4,650**	**44.4**
Tax rate (%)	30.5	0.8	28.7	27.2	25.3		29.0	
PBT-invt gains+ provisions	**4,799**	**8,507**	**6,080**	**7,377**	**7,568**	**57.7**	**8,020**	**(5.6)**
Key balance sheet items (Rs bn)								
Total Deposit	992	1,039	1,072	1,159	1,296	30.7		
Term deposits	664	677	700	776	903	36.0		
CASA ratio (%)	33.1	34.9	34.8	33.1	30.4			
Gross advances	743	759	759	865	930	25.2		
Total retail loans	151	161	162	93	98	-35.3		
Retail loans to Advances (%)	20.4	-	21.3	10.8	10.5			
Investments	331	341	353	347	412	24.4		
AFS	98	96	115	115	152	54.9		
Duration (years)	2.4	3.0	2.7	2.2	1.4			
HTM	233	241	238	231	260	11.6		
Duration (years)	4.6	3.8	4.1	4.2	4.5			
Yield management measures (%)								
Cost of funds	5.99	5.76	5.60	NA	6.10			
Cost of deposits	6.32	NA	6.06	6.25	6.54			
Yield on advances	10.33	10.12	10.13	11.16	11.53			
Yield on investments	7.48	7.67	7.71	7.52	7.51			
Yield of funds	8.62	8.56	8.55	8.75	9.32			
NIM	2.70	2.80	2.73	3.01	3.22			
Capital adequacy details (%)								
CAR	13.0	12.5	12.2	12.5	12.3			
Tier I	7.8	7.5	7.5	7.6	7.5			
Tier II	5.3	5.1	4.7	4.9	4.8			
Asset quality details								
Gross NPLs (Rs bn)	15.6	16.6	15.8	16.7	15.6	0.2		
Gross NPLs (%)	2.1	2.2	2.1	1.9	1.7			
Net NPLs (Rs bn)	2.6	1.3	1.1	1.2	1.3	(50.3)		
Net NPLs (%)	0.4	0.2	0.2	0.1	0.1			

Source: Company.

Union Bank-- Old and new estimates

March fiscal year-ends, 2009-2011E (Rs mn)

	Old estimates			New estimates			% change		
	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E
Net interest income	38,335	44,361	52,605	40,796	46,593	54,771	6.4	5.0	4.1
NIM (%)	2.92	2.81	2.87	3.11	2.95	2.98			
Loan growth (%)	27.17	19.67	13.22	27.17	19.67	13.22			
Loan loss provisions	7,178	12,462	14,475	7,178	12,462	14,475	-	-	-
Other income	11,720	13,410	14,303	12,120	13,410	14,303	3.4	-	-
Fee income	3,612	4,153	4,652	3,612	4,153	4,652	-	-	-
Treasury income									
Operating expenses	18,903	21,732	24,197	20,425	23,123	25,757	8.1	6.4	6.4
Employee expenses	9,915	11,631	12,938	11,036	12,608	14,025	11.3	8.4	8.4
Investment dep/amortization	1,000	-	-	1,000	-	-	-		
PBT	22,974	23,577	28,235	24,313	24,419	28,842	5.8	3.6	2.2
Net profit	**16,541**	**16,504**	**19,764**	**17,505**	**17,093**	**20,189**	**5.8**	**3.6**	**2.2**
PBT- treasury + provisions	31,152	36,039	42,710	32,491	36,880	43,317	4.3	2.3	1.4

Source: Company, Kotak Institutional Equities estimates.

Industrials

BAJE.BO, Rs780	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	950
52W High -Low (Rs)	1927 - 545
Market Cap (Rs bn)	62.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	42.1	48.9	55.0
Net Profit (Rs bn)	8.4	8.4	8.9
EPS (Rs)	102.0	105.5	111.8
EPS gth	*11.2*	*3.4*	*6.0*
P/E (x)	7.7	7.4	7.0
EV/EBITDA (x)	3.0	2.3	2.0
Div yield (%)	2.7	3.2	3.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
10.0	21.5	(31.3)	(57.1)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	75.9	-	-
FIIs	7.1	0.1	(0.1)
MFs	6.8	0.4	0.2
UTI	-	-	(0.2)
LIC	4.5	0.2	0.0

Bharat Electronics: Execution disappoints yet again; however, strong margin expansion continues. Reiterate ADD

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- **Low execution leads to yet another quarter of disappointing revenues; strong margin expansion continues**
- **Margin expansion helps meet profit estimates despite lower-than-expected revenues**
- **Highlight risk to full-year estimates based on low revenue growth so far**
- **Reiterate downside risk to earnings due to potential higher wage provisioning requirement**
- **Maintain earnings estimates and target price of Rs950; reiterate ADD**

Bharat Electronics reported 3QFY09 net revenues of Rs6.7 bn versus our expectation of Rs7.7 bn probably led by lower-than-expected execution. Operating profit margin continued to expand— increasing by 480 bps yoy to 23.9% in this quarter versus 19.2% in the previous quarter. Margin expansion was contributed by decline in other expenses as % of sales by 700 bps. We highlight that BEL has executed about 39% of our estimated revenues for FY2009E so far, versus an execution of 44% of total FY2008 revenues in 9MFY08. Hence, we believe our near-term revenue forecast has potential inherent risks. Additionally potential higher employee wage provisioning requirements pose a downside risk to our estimates. We maintain our earnings estimate of Rs105.5 per share and Rs111.8 per share for FY2009E and FY2010E, respectively. We retain our DCF-based target price of Rs950/share and our ADD rating on the stock. We highlight that the stock has outperformed the Sensex by 28.6% since our previous update on October 27, 2008.

Low execution leads to yet another quarter of disappointing revenues; strong margin expansion continues

Bharat Electronics reported relatively flat revenue growth for 3QFY09, with revenues growing at 1.3% yoy to Rs6.7 bn from Rs6.6 bn last year (see Exhibit 1). Operating profit margin expanded by about 480 bps on a yoy basis to 23.9% in this quarter versus 19.2% in the previous year. Employee costs as a percentage of sales increased by 230 bps yoy driven by (1) merging of dearness allowance with basic salary for BEL employees and (2) higher provisions for employee wage revisions. However sharp rise in employee cost was offset by a 700 bps yoy decline in other expenses as a percentage of sales. Despite this strong expansion profit after tax grew by only 8.7% due to lower-than-expected other income which declined 30% yoy.

For the nine-month period ended December 31, 2008, BEL reported revenues of Rs18.4 bn (up 3.8%) and operating profit margin expansion of 60 bps to 16.2% from 15.5% in 9MFY08. Profit after tax for the nine-month period declined 2.3% to Rs2.56 bn from Rs2.6 bn in the previous year. This was due to an exceptionally low first quarter performance for the company.

Margin expansion helps meet profit estimates despite lower-than-expected revenues

BEL reported low yoy revenue growth of 1.3% for 3QFY09 to Rs6.7 bn versus our expectation of a 17% yoy revenue growth (see Exhibit 2). The lower-than-expected revenues (about 13.6% below estimates) were probably due to lower-than-expected execution. However, higher-than-expected operating margin expansion helped meet our profit estimates. Material cost as a percentage of sales was at 42.4% in 3QFY09 versus our estimate of 50% leading to the higher-than-expected operating margin. This led to a profit after tax of Rs1.23 bn, about 2.6% above our estimate of Rs1.19 bn.

Highlight risk to full-year estimates based on low revenue growth so far

We highlight that even though BEL has executed about 39% of our estimated revenues for FY2009E so far versus an execution of 44% of total FY2008 revenues in 9MFY08. Hence, we believe our near-term revenue forecast has potential inherent risks. In order to meet our full-year estimates BEL has to report revenues of Rs28.6 bn, a growth of 25% yoy, in 4QFY09. However, we also highlight that BEL has historically reported revenues that are fourth quarter loaded, in FY2008 fourth quarter contributed to about 56% of full-year revenues, and hence our estimates might be met.

Reiterate downside risk to earnings due to potential higher wage provisioning requirement

We highlight that BEL may be required to make additional provisions for employee costs (higher than our estimates for FY2009). BEL is making provisions at a rate of Rs110 mn per quarter for employee cost hikes related to the Sixth Pay Commission. However, we would like to also highlight that BEL's rate of provisioning need not be the same as BHEL, since BEL is A rated while BHEL is an A+ rated organization (reflected by the fact that average cost per employee is higher by 33% for BHEL).

Maintain earnings estimates and target price of Rs950/share; reiterate ADD

We maintain our earnings estimate of Rs104.4 and Rs111.1 for FY2009E and FY2010E, respectively. We maintain our DCF-based target price of Rs950 (see Exhibit 3) and reiterate our ADD rating on the stock.

We highlight key risks arising from (1) potential long-term increase in competition given that several firms may be awarded the Raksha Udyog Ratna status, (2) lack of publicly available data points/news flows to justify more optimism and (3) infrequent investor communication and disclosures. Key upside risks arise from (1) non-defense/overseas orders, (2) strong execution over the next few quarters.

Exhibit 1. BEL - key numbers - 3QFY09 (Rs mn)

	yoy			qoq			yoy		
	3QFY09	3QFY08	*% change*	3QFY09	2QFY09	*% change*	9MFY09	9MFY08	*% change*
Net Sales	**6,709**	**6,622**	**1.3**	**6,709**	**7,877**	**(14.8)**	**18,425**	**17,755**	**3.8**
Raw Material Consumed	(7,402)	(4,348)	70.2	(7,402)	(5,021)	47.4	(15,249)	(11,119)	37.2
Stock Adjustment	4,560	1,535	197.1	4,560	1,234	269.5	6,597	2,429	171.6
Employee Expenses	(1,774)	(1,601)	10.8	(1,774)	(1,832)	(3.2)	(5,197)	(4,327)	20.1
Other Expenses	(487)	(940)	(48.2)	(487)	(562)	(13.3)	(1,599)	(1,983)	(19.4)
Total Expenditure	**(5,103)**	**(5,354)**	**(4.7)**	**(5,103)**	**(6,181)**	**(17.4)**	**(15,448)**	**(14,999)**	**3.0**
EBITDA	**1,606**	**1,269**	**26.6**	**1,606**	**1,696**	**(5.3)**	**2,976**	**2,756**	**8.0**
Other Income	456	647	(29.5)	456	532	(14.3)	1,601	1,800	(11.1)
PBIDT	**2,062**	**1,916**	**7.7**	**2,062**	**2,228**	**(7.4)**	**4,577**	**4,556**	**0.5**
Interest	(0)	(0)	26.7	(0)	(71)	(99.5)	(71)	(2)	3,661.6
PBDT	2,062	1,915	7.7	2,062	2,158	(4.4)	4,506	4,554	(1.1)
Depreciation	(270)	(234)	15.2	(270)	(256)	5.4	(766)	(666)	15.0
PBT	**1,792**	**1,681**	**6.6**	**1,792**	**1,902**	**(5.8)**	**3,740**	**3,889**	**(3.8)**
Tax	(565)	(552)	2.4	(565)	(594)	(5.0)	(1,179)	(1,267)	(6.9)
PAT	**1,228**	**1,130**	**8.7**	**1,228**	**1,308**	**(6.1)**	**2,560**	**2,621**	**(2.3)**
Extraordinaries	-	-		-	-		-	-	
Reported PAT	**1,228**	**1,130**	**8.7**	**1,228**	**1,308**	**(6.1)**	**2,560**	**2,621**	**(2.3)**
Key ratios (%)									
Material cost ratio	42.4	42.5		42.4	48.1		47.0	48.9	
Employee cost ratio	26.4	24.2		26.4	23.3		28.2	24.4	
Other exps ratio	7.3	14.2		7.3	7.1		8.7	11.2	
EBITDA margin	**23.9**	**19.2**		**23.9**	**21.5**		**16.2**	**15.5**	
PBIDT margin	30.7	28.9		30.7	28.3		24.8	25.7	
PBT margin	26.7	25.4		26.7	24.1		20.3	21.9	
Effective tax rate	31.5	32.8		31.5	31.2		31.5	32.6	
PAT margin	18.3	17.1		18.3	16.6		13.9	14.8	

Source: Company, Kotak Institutional Equities

Exhibit 2. BEL - 3QFY09 actual numbers versus our estimates (Rs mn)

	3QFY09	3QFY09E	*% variation*	4QFY09E	4QFY09	*% change*
Net Sales	**6,709**	**7,761**	**(13.6)**	**28,613**	**22,847**	**25.2**
Raw Material Consumed	(2,842)	(3,881)	(26.8)	(9,493)	(9,520)	(0.3)
Employee Expenses	(1,774)	(1,900)	(6.7)	(2,384)	(2,265)	5.2
Other Expenses	(487)	(700)	(30.4)	(2,506)	(1,437)	74.4
Total Expenditure	**(5,103)**	**(6,481)**	**(21.3)**	**(20,979)**	**(15,562)**	**34.8**
EBITDA	**1,606**	**1,281**	**25.4**	**7,635**	**7,285**	**4.8**
Other Income	456	756	(39.7)	1,056	538	96.3
PBIDT	**2,062**	**2,037**	**1.2**	**8,691**	**7,823**	**11.1**
Interest	(0)	-		69	(1)	
PBDT	2,062	2,037	1.2	8,760	7,823	12.0
Depreciation	(270)	(252)	7.1	(234)	(261)	(10.3)
PBT	**1,792**	**1,785**	**0.4**	**8,526**	**7,562**	**12.7**
Tax	(565)	(589)	(4.2)	(2,812)	(2,178)	29.1
PAT	**1,228**	**1,196**	**2.6**	**5,714**	**5,384**	**6.1**
Extraordinaries	-	-		-	212	(100.0)
Reported PAT	**1,228**	**1,196**	**2.6**	**5,714**	**5,596**	**2.1**
Key ratios (%)						
Material cost ratio	42.4	50.0		56.2	51.9	
Employee cost ratio	26.4	24.5		8.3	9.9	
Other exps ratio	7.3	9.0		8.8	6.3	
EBITDA margin	**23.9**	**16.5**		**26.7**	**31.9**	
PBIDT margin	30.7	26.2		30.4	34.2	
PBT margin	26.7	23.0		29.8	33.1	
Effective tax rate	31.5	33.0		33.0	28.0	
PAT margin	18.3	15.4		20.0	24.5	

Source: Company, Kotak Institutional Equities estimates

Exhibit 3: DCF for BEL, March fiscal year ends 2009E-2020E, (Rs mn)

Year	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues	48,923	55,007	57,757	60,645	63,677	66,861	70,204	73,714	77,400	80,496	83,716	87,064
Growth (%)	16.3	12.4	5.0	5.0	5.0	5.0	5.0	5.0	5.0	4.0	4.0	4.0
EBIT (excl finl income)	10,544	11,178	8,664	9,097	9,552	10,029	8,424	8,846	9,288	9,659	10,046	10,448
Growth (%)	5.8	6.0	(22.5)	5.0	5.0	5.0	(16.0)	5.0	5.0	4.0	4.0	4.0
EBIT Margins	22	20	15	15	15	15	12	12	12	12	12	12
Effective tax rate	32.4	32.3	32.3	32.3	32.3	32.3	32.3	32.3	32.3	32.3	32.3	32.3
EBIT*(1-tax rate)	**7,133**	**7,564**	**5,862**	**6,155**	**6,463**	**6,786**	**5,701**	**5,986**	**6,285**	**6,536**	**6,798**	**7,070**
Growth (%)	2.3	6.0	(22.5)	5.0	5.0	5.0	(16.0)	5.0	5.0	4.0	4.0	4.0
Depreciation / Amortisation	1,087	1,154	1,154	1,250	1,350	1,450	1,600	1,650	1,800	1,950	2,050	2,051
Change in Working Capital	(561)	(4,894)	(825)	(866)	(910)	(955)	(1,003)	(1,053)	(1,106)	(929)	(966)	(1,005)
Capital Expenditure	(1,000)	(1,000)	(1,250)	(1,500)	(1,750)	(2,000)	(2,250)	(2,500)	(2,750)	(3,000)	(3,000)	(3,000)
Free Cash Flows	**6,658**	**2,824**	**4,941**	**5,039**	**5,154**	**5,281**	**4,048**	**4,083**	**4,229**	**4,558**	**4,882**	**5,116**
Growth (%)	58.4	(57.6)	75.0	2.0	2.3	2.5	(23.4)	0.9	3.6	7.8	7.1	4.8
Years discounted	-	-	1	2	3	4	5	6	7	8	9	10
Discount factor	1	1.00	0.88	0.78	0.68	0.60	0.53	0.47	0.41	0.36	0.32	0.28
Discounted cash flow	**6,658**	**2,824**	**4,354**	**3,912**	**3,525**	**3,182**	**2,149**	**1,910**	**1,743**	**1,655**	**1,562**	**1,442**

WACC calculation	
Risk-free rate (Rf)	8.5%
Beta (B)	1.0
Equity risk premium	5.0%
Expected market Return (Rm)	13.5%
Cost of Equity (Ke)	13.5%
Cost of Debt (Kd) (Post-tax)	8.0%
WACC (Beta implied)	13.5%
WACC assumed	**13.5%**

Terminal value calculation	
Cash flow in terminal year	5,116
g	4.0%
Capitalisation rate	9.5%
Terminal value	56,008
Discount period (years)	10
Discount factor	0.3
Discounted value	15,787

NPV calculation	Rs mn
Sum of free cash flow	34,915
Terminal value	15,787
Enterprise value	50,701
Add Investments	-
Net debt	(24,595)
Net present value-equity	75,296
Shares o/s	80.0
NPV /share(Rs)	**941**

Source: Company, Kotak Institutional Equities estimates

Pharmaceuticals

NICH.BO, Rs215	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	340
52W High -Low (Rs)	389 - 180
Market Cap (Rs bn)	44.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	28.5	33.0	36.8
Net Profit (Rs bn)	3.7	3.3	4.3
EPS (Rs)	17.7	15.6	20.3
EPS gth	*66.8*	*(12.0)*	*30.3*
P/E (x)	12.1	13.8	10.6
EV/EBITDA (x)	9.2	10.2	7.5
Div yield (%)	2.0	1.9	2.1

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(6.5)	6.9	(27.9)	(9.6)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	49.6	-	-
FIIs	24.8	0.3	0.1
MFs	2.6	0.2	(0.1)
UTI	-	-	(0.2)
LIC	4.0	0.2	(0.0)

Piramal Healthcare: Results below forecasts, cut price target

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- **Revenues at Rs8.3 bn and margins at 22%; lower than our forecasts**
- **KIE FY2010-11E PAT reduced due to lower CMG revenues and higher interest cost**
- **Maintain BUY with SOTP-based target price of Rs340 (Rs410 earlier)**

Revenues at 8.3 bn were lower than our forecasts by 8% due to lower custom manufacturing (CMG) revenues at Rs2.5 bn vs KIE Rs3 bn. EBITDA margins before R&D and forex at 22%, 100 bps lower than our forecasts due to higher materials cost. PAT at Rs599 mn, 30% below our forecasts due to higher interest costs, up 53% qoq. Piramal Healthcare (PH) maintained its FY2009E guidance given earlier—sales growth 16% (9M 16.3%), EBITDA margin (excluding forex losses) at 20.5% (20%) and EPS of Rs21 (14.5). However, PH reduced its guidance of revenues from Indian assets to Rs3.7 bn from Rs4 bn (YTD 2.3 bn). FY2009E KIE PAT changed to reflect YTD forex losses of Rs989 mn. FY2010-11E KIE PAT reduced 17% to reflect (1) lower CMG revenues and (2) higher interest costs. The stock trades at 11X FY2010E and 9X FY2011E earnings. Maintain BUY rating with a SOTP-based target price of Rs340 (Rs410 earlier).

Revenues at 8.3 bn was lower than our forecasts by 8% due to:

1) Pharma solutions (CMG segment) revenue at Rs2.5 bn, 19% lower than our forecasts. Pharma solution business from India assets at Rs800 mn vs KIE Rs1.2 bn was down 12% qoq. Revenues from international assets at Rs1.7 bn vs KIE Rs1.9 bn was down 5% qoq. The dip in revenues was due to clients cutting down on inventory levels. 4% of sales for PH comes from US biotech companies and this segment has seen a slowdown.

2) However, India finished dosage sales were Rs4 bn with yoy sales growth at 22%, was 3% above our forecasts. This was due to increased marketing and selling spend which increased to 13.5% of sales this quarter from 11% in 3QFY08. The growth rates for the India finished dosages have been above industry growth rates at 20% and 27% in 1QFY09 and 2QFY09, respectively.

EBITDA margins before R&D and forex at 22% was 100 bps lower than our forecasts. The company has demerged its NCE research operation in 4QFY08 and reported forex-related loss this quarter as opposed to a gain last year. Therefore, we look at EBITDA margins, excluding R&D and forex item, to make meaningful comparisons.

Adjusted EBITDA margin was down 150 bps qoq at 22% this quarter, 100 bps lower than KIE due to (1) higher materials cost at 39.5% of sales vs KIE 36% and (2) other expenses at 11% of sales vs KIE 10%. However, personnel cost at 14% was lower than KIE 16% due to personnel reduction at international CMG facilities (290 employed at Morpeth currently).

PAT at Rs599 mn, 30% below our forecasts due to higher interest costs, up 53% qoq. PAT was lower than our forecasts due to (1) lower EBITDA and (2) higher interest costs, up 53% qoq at Rs260 mn. The interest costs have been increasing through FY2009 from Rs120 mn in 1QFY09 to Rs170 mn in 2QFY09. The increase in interest costs this quarter has been due to increasing debt due to Minrad acquisition (working capital loan of Rs650 mn) and debt provided to Piramal LifeSciences (Rs750 mn) and increase in interest rates.

Debt position to rise to 1.1X by March 2009 from 1X currently. PH reported a significant jump in debt levels as of December 2008 from March 2008 levels due to

1) acquisition of Khandelwal and Haemaccel, and Minrad,

2) ongoing codeine phosphate project and

3) loans provided to Minrad and associate company.

The company had earlier guided towards moving back to 0.7X by March 2009 which was the FY2008 year ending position. However, with the acquisitions (Rs3 bn spent YTD) PH debt/equity ratio has moved up to 1X and is expected at 1.1X at end of March 2009. PH has a total debt of Rs12.7 bn currently which is expected to increase to Rs14.5 bn by March 2009.

FY2010-11E KIE PAT reduced by 17%. Our forecasts for FY2009-10E are based on US$ rate of Rs45 now. We revise our FY2009E PAT estimates down marginally due to

1) YTD reported MTM losses at Rs989 mn. However, we do not include any forex gain/loss in FY2010E estimates,

2) higher interest costs to reflect YTD interest costs and

3) EBITDA margin assumptions left unchanged.

FY2010-11E PAT reduced by 17% due to (1) higher interest costs (see Exhibit 4), (2) lower sales growth assumptions for CMG business. PH expects CMG revenues from international assets to decline yoy as more work is transferred to its Indian facilities. We forecast revenues from Indian assets to grow at 30% yoy in dollar terms in FY2010-11E and revenues from Morpeth to decline 10% yoy in FY2010-11E and (3) EBITDA margin assumptions are left unchanged.

Impact of proposed Minrad acquisition. Piramal has announced plans to acquire Minrad for US$40 mn. Transaction is to close by March 2009. Piramal has given advance of Rs650 mn to Minrad and Rs160 mn to its distributor for working capital. Full purchase consideration is to be paid by March, mostly through debt funds. We have included this payment in our cash flow forecasts and expect PH to reach net debt level of Rs14.5 bn by end FY2009E.

We have not included the revenue and profit effect of Minrad in our forecast. The PH management expects US$65 mn revenues, 25% EBITDA and EPS contribution of Rs1 in FY2010E. There is no clarity about its EPS contribution in FY2011E. Our price target may increase by Rs18-20 from Rs340 when the merger is completed and its effect is included in revenue statement.

Maintain BUY rating with SOTP-based target price reduced to Rs340. Management maintains FY2009E guidance—sales growth 16%, EBITDA margin (excluding forex losses) 20.5% and EPS of Rs21. We estimate EPS at Rs15.6 versus company guidance of Rs21. Our forecast is lower than management since we include forex-related loss incurred YTD (Rs989 mn) in PAT while the management does not include it.

We estimate 3% growth in adjusted PAT before forex (see Exhibit 3) in FY2010E rising to 18% in FY2011E. Growth rate will increase to 8% when Minrad acquisition is included in forecasts.

Due to the (1) decline in FY2010-11E KIE PAT by 17% versus earlier estimate and (2) rolling forward price target to January with multiples unchanged, we revise target price downwards to Rs340 (from Rs410) (see Exhibit 5). At the target price, PH will trade at 17X FY2010E and 14X FY2011E (multiple will be lower after including Minrad acquisition).

Interim sales, March fiscal year-ends, (Rs mn)

	3QFY08	2QFY09	3QFY09	3QFY09 KIE	Growth (%, yoy)	Growth (%, qoq)	Chg (% vs. KIE)
Net sales	**7,249**	**8,893**	**8,326**	**9,065**	**15**	**(6)**	**(8)**
Change in stock	25	(522)	(332)	—	NM	NM	NM
Consumption of raw materials	2,844	2,780	3,622	2,085	27	30	74
Conversion cost	0	1,088	—	1,178	NM	NM	NM
Personnel cost	1,103	1,421	1,172	1,500	6	(18)	(22)
R&D	429	231	200	236	(53)	(13)	(15)
Marketing and selling	841	1,227	1,124	1,300	34	(8)	(14)
Other expenses	870	842	942	950	8	12	(1)
Total Expenditure	6,037	7,474	7,080	7,599	17	(5)	(7)
EBITDA	**1,212**	**1,418**	**1,246**	**1,466**	**3**	**(12)**	**(15)**
Non operating other income	40	1	—	—	(100)	(80)	NM
Interest	122	170	261	190	115	53	37
Depreciation	269	288	295	300	9	2	(2)
PBT	**861**	**960**	**690**	**976**	**(20)**	**(28)**	**(29)**
Current Tax	46	114	72	122	58	(37)	(41)
Deferred tax	24	—	—	—	NM	NM	NM
Fringe benefit tax	9	—	—	—	NM	NM	NM
PAT	**782**	**846**	**619**	**854**	**(21)**	**(27)**	**(28)**
Exceptional expenses (income)	56	96	—	—	NM	NM	NM
PAT post exceptional	726	751	619	854	(15)	(18)	(28)
Minority	1	(17)	(20)	(15)	NM	NM	NM
PAT post minority	**728**	**734**	**599**	**839**	**(18)**	**(18)**	**(29)**
Healthcare solutions	3,371	4,491	4,109	3,978	22	(9)	3
Pharma solutions- India assets	554	912	806	1,200	45	(12)	(33)
Pharma solutions- international assets	1,917	1,840	1,756	1,950	(8)	(5)	(10)
Diagnostic solutions	315	454	425	450	35	(6)	(6)
Others	1,091	1,196	1,230	1,487	13	3	(17)
Total	**7,249**	**8,893**	**8,326**	**9,065**	**15**	**(6)**	**(8)**

Source: Company data, Kotak Institutional Equities.

Forecasts and valuation, March fiscal year-ends, 2007-2011E

	Net sales		EBITDA		Net Profit		EPS	ROCE	ROE	P/E
	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs)	(%)	(%)	(X)
2007	24,198	52.9	3,313	67.6	2,181	85.0	10.6	16.4	20.8	20.2
2008	28,453	17.6	5,142	55.2	3,369	54.5	17.7	23.7	30.9	12.1
2009E	33,035	16.1	5,756	11.9	3,131	(7.1)	15.6	19.9	26.0	13.8
2010E	36,777	11.3	7,617	32.3	4,252	35.8	20.3	21.5	28.9	10.6
2011E	41,545	13.0	8,807	15.6	5,014	17.9	24.0	23.7	27.4	9.0

Source: Company, Kotak Institutional Equities estimates.

Profit and loss statement, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Net sales	**15,825**	**24,198**	**28,453**	**33,035**	**36,777**	**41,545**
Operating expenses						
Materials	(7,780)	(10,829)	(10,930)	(12,306)	(13,234)	(14,725)
Selling and administration	(3,366)	(4,591)	(6,867)	(9,032)	(9,194)	(10,386)
Employee cost	(1,927)	(4,200)	(4,709)	(5,060)	(5,718)	(6,461)
R&D	(775)	(1,265)	(806)	(882)	(1,014)	(1,166)
Total expenditure	**(13,849)**	**(20,885)**	**(23,312)**	**(27,279)**	**(29,160)**	**(32,738)**
EBITDA	**1,977**	**3,313**	**5,142**	**5,756**	**7,617**	**8,807**
Depreciation and amortisation	(688)	(818)	(947)	(1,163)	(1,400)	(1,550)
EBIT	**1,288**	**2,495**	**4,195**	**4,593**	**6,217**	**7,257**
Net finance cost	(173)	(305)	(463)	(842)	(1,300)	(1,469)
Other income	401	525	367	—	—	—
Pretax profits before extra-ordinaries	**1,517**	**2,715**	**4,098**	**3,751**	**4,917**	**5,788**
Current tax	(95)	(315)	(445)	(325)	(615)	(723)
Deferred tax	(114)	(45)	105	(113)	—	—
Fringe benefit tax	(30)	(29)	(37)	—	—	—
Reported net profit	**1,279**	**2,327**	**3,722**	**3,313**	**4,302**	**5,064**
Preference dividend	(28)	—	—	—	—	—
Minority interests	(4)	(1)	(14)	(51)	(50)	(50)
Prior period Items	(35)	(102)	—	—	—	—
Reported net profit after minority interests	**1,211**	**2,224**	**3,708**	**3,262**	**4,252**	**5,014**
Exceptional items	(33)	(43)	(339)	(132)	—	—
Reported net profit after minority interests and excep. Items	**1,178**	**2,181**	**3,369**	**3,131**	**4,252**	**5,014**
PBT excl forex loss/(gain)	1,517	2,715	4,045	4,741	4,917	5,788
PAT excl forex loss/(gain)	**1,275**	**2,326**	**3,660**	**4,136**	**4,252**	**5,014**
% yoy growth		**82%**	**57%**	**13%**	**3%**	**18%**

Source: Company, Kotak Institutional Equities estimates.

Current versus earlier estimates, March fiscal year-ends, FY2010-FY2011E (Rs mn)

	Current estimates		Earlier estimates		% change	
	2010E	2011E	2010E	2011E	2010E	2011E
Net sales	**36,777**	**41,545**	**38,485**	**43,920**	**(4)**	**(5)**
EBITDA	**7,617**	**8,807**	**7,825**	**9,136**	**(3)**	**(4)**
Other income	—	—	—	—	NM	NM
Depreciation	(1,400)	(1,550)	(1,300)	(1,400)	8	11
Financial charges	(1,300)	(1,469)	(600)	(600)	117	145
PBT	**4,917**	**5,788**	**5,925**	**7,136**	**(17)**	**(19)**
Tax	(615)	(723)	(741)	(892)	(17)	(19)
PAT	**4,302**	**5,064**	**5,184**	**6,244**	**(17)**	**(19)**
Minority interest in loss (profits)	(50)	(50)	(50)	(50)	—	—
PAT	**4,252**	**5,014**	**5,134**	**6,194**	**(17)**	**(19)**

Source: Company, Kotak Institutional Equities estimates.

SOTP-based price target, FY2010-FY2011E

	PAT (Rs mn)		P/E	Valuation (Rs mn)	
	FY2010E	FY2011E	(X)	FY2010E	FY2011E
Healthcare solutions	2,396	2,787	16.0	38,334	44,588
Pharma solutions	1,148	1,434	13.0	14,922	18,636
Diagnostic services	248	299	13.0	3,223	3,881
Other	511	545	12.3	6,256	6,682
Total	**4,302**	**5,064**		**62,734**	**73,788**
Business share price value				**0**	**340**
NPV of research pipeline					**0**
Share price target					**344**

Source: Kotak Institutional Equities.

Banking

SRTR.BO, Rs194	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	215
52W High -Low (Rs)	472 - 160
Market Cap (Rs bn)	39.3

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	12.0	17.3	19.9
Net Profit (Rs bn)	3.9	5.8	5.7
EPS (Rs)	19.2	28.6	27.0
EPS gth	*85.7*	*49.0*	*(5.6)*
P/E (x)	10.1	6.8	7.2
P/B (x)	2.2	1.9	1.6
Div yield (%)	2.6	4.4	4.4

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(1.8)	(8.8)	(31.5)	(50.4)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	42.0	-	-
FIIs	14.2	0.1	(0.0)
MFs	1.7	0.1	(0.1)
UTI	-	-	(0.2)
LIC	-	-	(0.2)

Shriram Transport Finance: Operating performance robust, challenges in CV sector worry us

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- **STFC reported PAT (3QFY09) of Rs1.49 bn, up 40% yoy and 27% above estimates**
- **Strong loan growth, NIM declines but above estimates**
- **NPLs currently low; challenges in CV industry increase asset quality risk**
- **We revise estimates, downgrade recommendation to REDUCE with price target of Rs215**

Shriram Transport Finance's (STFC) core income (PBT excluding provisions) was up 41% yoy, 16% above estimates due to better-than-expected NIM despite challenges on the borrowings side. Disbursements declined 25% yoy—in line with expectations as the company went 'slow' during the quarter. NPLs were under control (gross NPLs up 20 bps qoq to 1.9%) likely due to a pick-up in collections during the second half of the quarter. We remain concerned on the current slowdown in the CV industry as indicated by—1) reduction in freights rates, 2) 48% yoy decline in CV sales in 3QFY09 and 3) rise in NPLs for banks in CV finance. We are revising our estimates and raising our cost of equity assumption to factor in higher risks to asset quality. Consequently, we are reducing price target to Rs215 from Rs250; revise recommendation to REDUCE from ADD. The stock currently trades at 6.7X PER and 1.6XPBR FY2010E.

Revise recommendation to REDUCE. We are concerned about the challenges in the CV industry which directly affect STFC's business. We believe STFC's target segment—the small CV operators, have marginal cash flows and are highly vulnerable to the slowdown. Given the risks to its asset quality and growth of STFC, we are revising our disbursements assumptions and provisions estimates (given below) and raising the cost of equity to 15% from 14.5% in the past. Nevertheless, we believe STFC's business model remains amongst the most profitable in the NBFC space—core RoA (over 2%) and RoE (over 18%)

Key highlights of 3QFY09 results

Disbursements decline in line with expectations. STFC reported disbursements of Rs23 bn, down 25% yoy and 2% above estimates. The company has been going 'slow' due to liquidity pressures on the borrowing side and NPL risks on the asset quality. Given the deterioration in the macro scenario and income generating capability of CV operators, STFC has tightened lending norms. The company focused on used vehicles, the contribution of new CV finance to overall disbursements was low at 8% in 3QFY09down from 20-30% in the past.

..And may continue to decline. We are now tweaking down our loan growth assumptions—factoring in a 16% decline in disbursements in 4QFY09E resulting in disbursements growth of 4% for FY2009E. As the current trends will likely continue to have an impact in FY2010E, we are factoring in a 5% yoy decline in disbursements during FY2010E.

NIM better than expectations. STFC's reported spreads declined to 5.4% in 3QFY09 from 6.4 % in 2QFY09. NIM (as per our calculations) declined to 7.5% in 3QFY09 from 8.1% in 2QFY09 but above our estimate of 6.9%. The difference is likely on account of (1) higher share of used CV business which earns higher yields, (2) re-pricing of loans in December 2008. We believe NIM will rise in 4QFY09E to about 8% (based on our calculations) due to lower borrowings cost. Consequently, we have raised our NIM estimates by about 40 bps for FY2009E and FY2010E.

Provision cost may increase considerably. We believe the NPL ratio will rise for STFC from the current levels—gross NPLs of 1.9% as on December 2008 from 1.7% in September 2008 and 1.6% in December 2007. Several banks have reported increase in NPLs from the CV business during 3QFY09. We would like to highlight that STFC follows a 180 days-past-due NPL recognition norm while banks follow 90 days-past-due norm and hence the NPLs for STFC will likely rise with a lag. Banks primarily focus on large fleet operators who have a better financial profile than the small operators serviced by STFC; hence delinquencies at STFC may be higher.

We have reduced our provision cost estimate for 4QFY09 to factor in the current trends but raised it marginally for FY2010E, thus factoring in a 66% yoy growth in provisions. The ratio of provision costs to average assets now stands at 2.1% for FY2010E versus 1.5% for FY2009E.

Shriram Transport Finance - Old and New estimates

March fiscal years, 2009-2010E (Rs mn)

	Old estimates		New estimates		% change	
	2009E	**2010E**	**2009E**	**2010E**	**2009E**	**2010E**
Net interest income *(a)*	16,595	19,681	17,338	19,893	4	1
Loans (including securitised loans)	241,525	271,336	238,027	265,841	(1)	(2)
YoY(%)	**24.1**	**12.3**	**22.3**	**11.7**	**-**	**-**
NIM (%)	**8.2**	**8.1**	**8.6**	**8.3**	**-**	**-**
NPL provisions	3,258	5,145	3,071	5,091	(6)	(1)
Operating expenses	5,311	6,032	5,464	6,032	3	-
Employee	2,055	2,429	2,207	2,429	7	-
Others	3,257	3,603	3,257	3,603	-	-
PBT	8,026	8,504	8,803	8,770	10	3
Tax	2,729	2,976	2,993	3,069	10	3
PAT	**5,297**	**5,528**	**5,810**	**5,700**	**10**	**3**
PBT-provisions- extraordinaries	**11,284**	**13,649**	**11,874**	**13,860**	**5**	**2**

Note

(a) includes income on securitised assets

Source: Kotak Institutional Equities estimates

Shriram Transport Finance - Quarterly results
1Q08-3Q09 (Rs mn)

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	YoY(%)	3Q09E	Actual vs KS (%)
Total operational income	4,636	5,603	6,602	7,630	8,353	9,053	9,780	48	9,110	7
Income on securitised loans	255	300	346	510	825	710	850	145		
Total interest expense	2,306	2,869	3,681	3,934	4,287	4,683	5,542	51	5,117	8
Interest expenditure	2,306	2,869	3,681	3,934	4,287	4,683	5,542	51	5,117	8
Mark to market loss on Swaps			-		-					
Net operational income (before provisions)	**2,329**	**2,734**	**2,920**	**3,696**	**4,067**	**4,369**	**4,238**	**45**	**3,993**	**6**
Net operational income (without Swap losses)	2,329	2,734	2,920	3,696	4,067	4,369	4,238	45	3,993	6
Net interest income	2,075	2,434	2,574	3,186	3,242	3,659	3,388	32	3,993	(15)
Provision and credit costs	569	630	526	667	632	680	752	43	800	(6)
Net operational income after provisions	**1,761**	**2,105**	**2,395**	**3,030**	**3,435**	**3,689**	**3,486**	**46**	**3,193**	**9**
Other income	76	92	6	15	2	6	76	1,183		
Total income	**2,405**	**2,826**	**2,926**	**3,711**	**4,068**	**4,375**	**4,313**	**47**	**3,993**	**8**
Operating expenses	**697**	**726**	**784**	**1,272**	**1,220**	**1,314**	**1,292**	**65**	**1,389**	**(7)**
Employee expenses	254	260	285	402	480	522	516	81	526	(2)
ESOP cost			-		-					
Other expenses	401	412	449	664	641	723	681	52	749	(9)
Depreciation	42	54	50	206	99	70	95	100	113	(16)
Due to reassessment				149						
Pretax income	**1,140**	**1,471**	**1,617**	**1,773**	**2,217**	**2,380**	**2,269**	**40**	**1,805**	**26**
Tax provisions	398	511	547	654	781	723	776	42	632	23
Net Profit	**750**	**959**	**1,070**	**1,118**	**1,436**	**1,657**	**1,493**	**40**	**1,173**	**27**
PBT (excl provisions and extraordinaties)	**1,708**	**2,100**	**2,143**	**2,439**	**2,849**	**3,061**	**3,021**	**41**	**2,605**	**16**
Tax rate (%)	35	35	34	37	35	30	34		35	
Other details										
Disbursements (Rs mn)	20,116	26,760	30,540	38,480	28,250	36,539	23,043	(25)	22,500	2
Pre-owned	14,468	20,270	22,003	26,200	22,415	29,211	21,287			
New	5,648	6,490	8,537	12,280	5,835	7,328	1,756			
Securitisation during the period (Rs mn)			11,000							
O/s Truck assets (Rs mn)	95,846	118,790	118,004	151,190	164,280	180,379	186,666			
Off balance sheet truck assets (Rs mn)	33,480	29,460	48,666	44,010	42,500	45,121	41,294			
Total truck assets under management (Rs mn)	129,326	148,250	166,670	195,200	206,780	225,500	227,960	37	236,775	42
Used vehicle / total assets under management (%)	71	71	71	NA	72	70	72			
New vehicle / total assets under management (%)	29	29	29	NA	28	30	28			
Yield on assets (%)	17.1	17.8	17.4	17.5	17.2	17.6	17.7			
Cost of funds (%)	10.0	11.1	11.3	10.8	11.1	11.2	12.4			
Difference (%)	7.2	6.7	6.2	6.7	6.1	6.4	5.4			
RoA (%)		2.94	2.81	2.57	3.13	3.36	2.8			
RoE (%)		29.67	27.46	24.76	30.41	32.38	27.2			
NIMs (KS calc - %)	7.5	7.9	7.4	8.2	8.1	8.1	7.5		6.9	
Gross NPLs(%)	1.97	1.9	1.6	1.6	1.7	1.7	1.9			
Net NPLs(%)	1.19	1.0	1.0	0.9	0.9	0.9	0.9			
Debt equity ratio (X)		8.6	7.6	8.1	7.6	8.0	7.6			
Balance Sheet (Rs mn)										
Fixed assets		1,641.6	1602.9	1,426.4	1,336	1,270	1,402.4			
Loans and advances		472.4	673.8	688.6	810	821	748.9			
Cash and bank		12,261.6	23,548.0	12,502.6	14,650	16,751	19,891.1			
Investments		2,158.0	7,363.8	13,851.2	3,564	7,273	381.7			
Truck receivables		118,820.7	130,294.1	151,191.3	163,050	180,379	186,665.8			
Current assets		2,171.6	3,515.1	1,784.4	1,646	2,249	3,196.2			
Total		137,526	166,998	181,445	185,057	208,742	212,286			
Shareholders funds		13,255.8	17,946	18,164	19,619	21,298	22,602			
Equity capital		1,911.3	2,031.4	2,031.6	2,033	2,035	2,035.4			
Reserves		11,344.5	15,915.0	16,132.0	17,586	19,263	20,566.9			
Loans		114,280.1	137,227.2	147,863.5	148,845	171,058	172,686.4			
Current liabilities		9,123.8	10,957.6	15,058.1	16,409	16,202	16,813.6			
Deferred tax liabilities		866.2	866.2	359.2	184	184	183.8			
Total		137,526	166,997	181,444	185,057	208,742	212,286			

Source: Company, Kotak instutional equities estimates.

Consumer Products

GOCP.BO, Rs131	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	160
52W High -Low (Rs)	147 - 87
Market Cap (Rs bn)	33.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	11.0	13.0	14.9
Net Profit (Rs bn)	1.6	1.7	2.3
EPS (Rs)	7.1	6.7	8.7
EPS gth	*18.7*	*(5.5)*	*31.2*
P/E (x)	18.6	19.7	15.0
EV/EBITDA (x)	16.1	17.4	12.2
Div yield (%)	2.7	3.0	3.0

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(4.2)	24.3	5.0	16.2

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	69.3	-	-
FIIs	18.6	0.1	0.1
MFs	1.3	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Godrej Consumer Products: In-line quarter, return of growth drivers evident

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- **19% revenue growth led by 15% volume growth in soaps, the impact of input-cost inflation is likely behind us**
- **We continue to believe that hair color marketing mix requires a relook**
- **We await more clarity on the GCPL's share pledges by Godrej Industries (promoter)**
- **Retain ADD, TP raised to Rs160/share, buy for a 20% upside**

GCPL reported broadly in-line results—strong 19% sales growth, EBITDA and PAT declined 24% and 6%, respectively. EBITDA decline was due to higher consumption cost as the company benefited from lower palm prices for only one month during the quarter. Soaps sales growth at 22% (volume growth +15%) met our expectations and surprised the street positively—likely indicates downtrading in the category (augurs well for GCPL with economy segment focus). Hair color sales growth of 14% was mostly price-led. While we are excited about the prospects of higher volume growth and margin expansion in soaps in FY2010E, the inability of GCPL to make headway in hair color business remains a worry. We model EPS of Rs6.7/share and Rs8.7 for FY2009E and FY2010E, respectively. We forecast 20% earnings CAGR over FY08-10E and reiterate our ADD rating. We expect minimal price reductions in the popular segment in soaps (where GCPL is strong) and modest volume growth in hair color. Considering the improvement in business fundamentals for GCPL, we remove the 15% discount to DCF assigned previously and revise the TP to Rs160/share (from Rs140/share). At our target price, the stock would trade at 18XFY10E.

Top up; bottom down—the last quarter of input-cost inflation impact, in our view

GCPL results were broadly in line with our expectations. Strong 19% sales growth was led by 22% growth in soaps (likely 15% volume growth) and 14% in hair color (mostly price-led). However, EBITDA and PAT declined 24% and 6%, respectively. EBITDA margins declined 800 bps to 14.2% (versus our expectation of 580 bps dip) due to higher consumption cost of palm oil—the company had likely benefited from lower input costs only for one month during the quarter. Soaps volume growth of 15% is in line with our expectations, but likely a surprise for street. We reiterate that the success of Godrej likely indicate consumer trading down in the soaps category. Hair color business growth of 14% was mostly price-led. Toiletries business had a modest growth of 8%—the relaunch of 'Cinthol' in April 2008 has likely fallen short of expectations. International businesses had a good quarter with 'Keyline' (+19%) and 'Rapidol' (+10%) growing well.

Return of growth drivers in soaps is evident. We believe that the positioning of 'Godrej No.1' in the popular segment (value-for-money) with a product formulation comparable to leading competition brands (which are priced higher) inherently helps the brand gain during times of consumer downtrading. The likely 15% volume growth for soaps business during 2HCY08 likely indicates rationalization in consumer spends in the category. GCPL's performance is especially commendable considering that the 50% market leader HUL has likely seen a 10% volume decline in the category and that the category itself has registered modest growth.

GCPL will be the biggest beneficiary of the correction in input costs as the industry leader HUL's soap portfolio is skewed towards premium products (popular and mass segment contributes only 38% of soap sales). However, we keenly watch out for any likely impact on retail prices of GCPL soaps as HUL, Wipro and ITC has cut prices (or higher grammage) of products in the mid-segment. However, the impact of price cuts by HUL on GCPL will likely be minimal, in our view. We highlight that the mass segment in soaps (two-third of GCPL's sales) has witnessed the least price increases over the past three years—price increases in top-end +35%, premium +38%, popular +48% and mass +25%.

We highlight that during the period 2003-2006, GCPL's success in soaps business was built on two pillars, (1) lower input costs channeled to fund higher trade spends and (2) consumer downtrading. We believe the correction in commodity costs, if sustained, augurs well for GCPL to regain its core strength. We model EBITDA margins to decline 560 bps in FY09E to 14.7% (lowest ever in company's history) and recover 260 bps to 17.3% in FY2010E.

We reiterate that hair color marketing mix likely requires a relook. The hair color business continues to face growth challenges as (1) category growth has slowed down from ~25% over the past three years to ~15% now and (2) inability of GCPL with its 'value for money' image to penetrate the top-end crème market. However, with the powder hair color business accounting for over 90% of GCPL's business, we believe the market share losses have likely bottomed out at ~33% levels. We highlight that volume growth in the powder category remains a challenge for GCPL and the price increase in September quarter supports this view (11% MRP increase, one-third of the price increase reinvested as higher retailer margins). We await more clarity on hair color business in the concall next week.

We await more clarity on the GCPL's share pledges by Godrej Industries (promoter)

On Friday, January 23, 2009, GCPL informed the exchanges that Godrej Industries, one of the promoters of GCPL, have pledged 19.5 mn shares of GCPL with JP Morgan on October 21, 2008. Godrej Industries holds 20% in GCPL and the pledged shares works out to 7.8% of GCPL's equity. We await more clarity from management during the concall scheduled for 2:00 PM on Tuesday, January 27th, 2009. Call in numbers are +91 22 2781 3034.

Proposed buyback—likely support to stock price in the near term, no medium-term impact

GCPL has recently announced a buyback of shares at a maximum of Rs150/share (CMP Rs121/share) through open market purchases. The maximum outlay is Rs149 mn (less than 0.5% of current market capitalization of Rs31 bn). We believe the buyback announcement is only to indicate to market the fair value of stock as perceived by the company and will likely have no meaningful impact as (1) the outlay involved is very small and (2) the company had recently raised Rs4 bn (in April 2008) through a rights issue. The company has bought back 0.72 mn shares till January 23—about two-third of the outlay of the funds earmarked for buyback.

Expect 20% EPS CAGR over FY08-10E; reiterate ADD, TP raised to Rs160/share

We tweak the EPS estimates for FY2009E to account for nine-month performance. Our FY2010E estimates remain unchanged and model EPS of Rs6.7/share (Rs7.3 previously) and Rs8.7 for FY2009E and FY2010E, respectively. We forecast 20% earnings CAGR over FY08-10E and reiterate ADD rating. In FY2010, we expect minimal price reductions in the popular segment in soaps (where GCPL is strong) and modest volume growth in hair color. Considering the improvement in business fundamentals for GCPL, particularly in soaps, we remove the 15% discount to DCF assigned previously and revise the target price to Rs160/share (from Rs140/share). At our target price, the stock would trade at 18XFY10E.

Key triggers to watch out are (1) ability to retain retail prices and hence higher margin expansion, (2) inability of ITC's 'Superia' and 'Vivel' to gain market shares and (3) ability to increase the contribution of liquid hair dye from the current 10% to hair color sales.

Godrej Consumer Products Limited -Quarterly summary, March yearends (Rs mn)

	yoy			Our est.	yoy	Consolidated yoy		
	3QFY09	3QFY08	% chg	3QFY09E	% chg	3QFY09	3QFY08	% chg
Sales	**2,722**	**2,291**	**18.8**	**2,735**	**19.4**	**3,421**	**2,728**	**25.4**
Material costs	(1,642)	(1,059)				(1,998)	(1,218)	
Employee costs	(108)	(137)				(181)	(182)	
A&P expenditure	(189)	(148)				(257)	(212)	
Other expenses	(396)	(438)				(502)	(546)	
Total expenses	(2,334)	(1,782)				(2,938)	(2,159)	
EBITDA	**388**	**509**	**(23.9)**	**450**	**(11.6)**	**483**	**568**	**(15.0)**
Depreciation	(34)	(39)		(44)		(51)	(48)	
EBIT	**353**	**470**		**406**		**432**	**520**	
Other income	21	23		25		15	15	
Interest	75	(20)		56		42	(29)	
PBT	**449**	**473**	**(5.1)**	**487**	**3.0**	**489**	**506**	**(3.5)**
Tax	(60)	(59)		(74)		(88)	(76)	
Net profit	**389**	**415**	**(6.1)**	**414**	**(0.3)**	**401**	**430**	**(6.9)**
EBITDA margin (%)	14.2	22.2		16.4		14.1	20.8	
Tax rate (%)	13.3	12.4		15.1		18.1	15.0	
Sales break up								
Soaps	1,638	1,341	22.1	1,635	21.9			
Hair Colour	570	501	13.9	575	14.9			
Toiletries	127	117	8.8	128	9.9			
Liquid Detergents	314	279	12.5	320	14.8			
Total Godrej Brands	**2,648**	**2,237**	**18.4**	**2,658**	**18.8**			
Contract manufacturing	-	-						
Sale of by-products/others	74	54	36.5	77	42.9			
TOTAL	**2,722**	**2,291**	**18.8**	**2,735**	**19.4**			

Source: Company data, Kotak Institutional Equities estimates

Keyline Brands, Quarterly summary (Rs mn)

	2Q 2008	3Q 2008	4Q 2008	1Q 2009	2Q 2009	3Q 2009
Sales	531	302	473	620	592	336
EBIT	51	32	61	106	49	36
PBT	41	21	52	97	41	26
Tax	(13)	(8)	(19)	(31)	(14)	(10)
Net profit	28	13	33	66	25	16
Sales growth (%)	15	17.1	(4.1)	58.6	11.5	11.3
EBIT growth (%)	(31)	28.0	(20.8)	194.4	(3.9)	12.5
EBIT margin (%)	9.6	10.6	12.9	17.1	8.3	10.7

Rapidol Pty Limited, Quarterly summary (Rs mn)

	2Q 2008	3Q 2008	4Q 2008	1Q 2009	2Q 2009	3Q 2009
Sales	117	146	112	116	119	143
EBIT	11	25	24	18	17	22
PBT	10	25	20	19	20	26
Tax	(3)	(6)	(7)	(5)	(5)	(8)
Net profit	7	19	13	14	15	18
Sales growth (%)		0.7	10.9	(2.5)	1.7	(2.1)
EBIT growth (%)		(7.4)	166.7	5.9	54.5	(12.0)
EBIT margin (%)	9.4	17.1	21.4	15.5	14.3	15.4

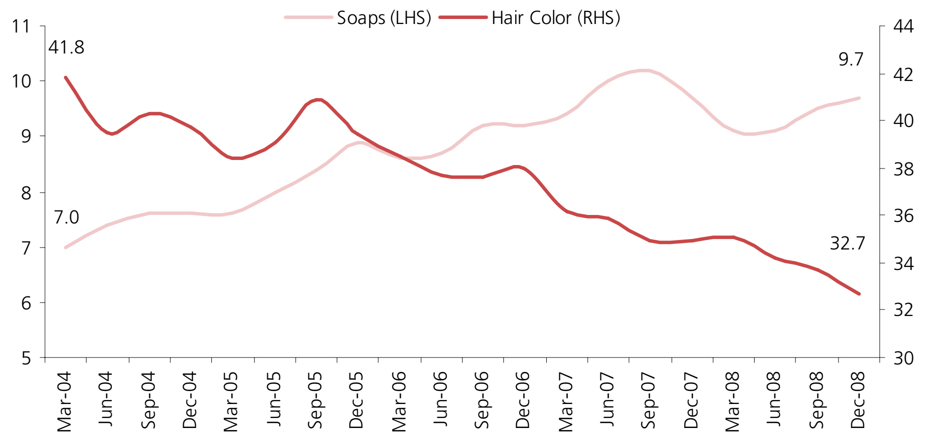
Kinky Group Pty Limited, Quarterly summary (Rs mn)

	2Q 2008	3Q 2008	4Q 2008	1Q 2009	2Q 2009	3Q 2009
Sales				108	127	170
EBIT				23	18	31
PBT				9	4	7
Tax				(8)	(7)	(10)
Net profit				1	(3)	(3)

Source: Company data

Share gains in soaps likely to continue; hair color likely to bottom-out

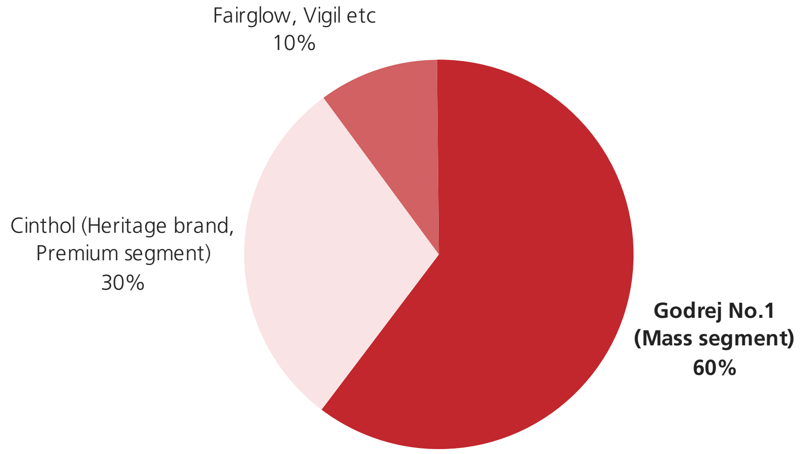
Value market shares in soaps and hair color, %



Source: Company data, Kotak Institutional Equities.

Higher contribution from popular/mass segment augurs well

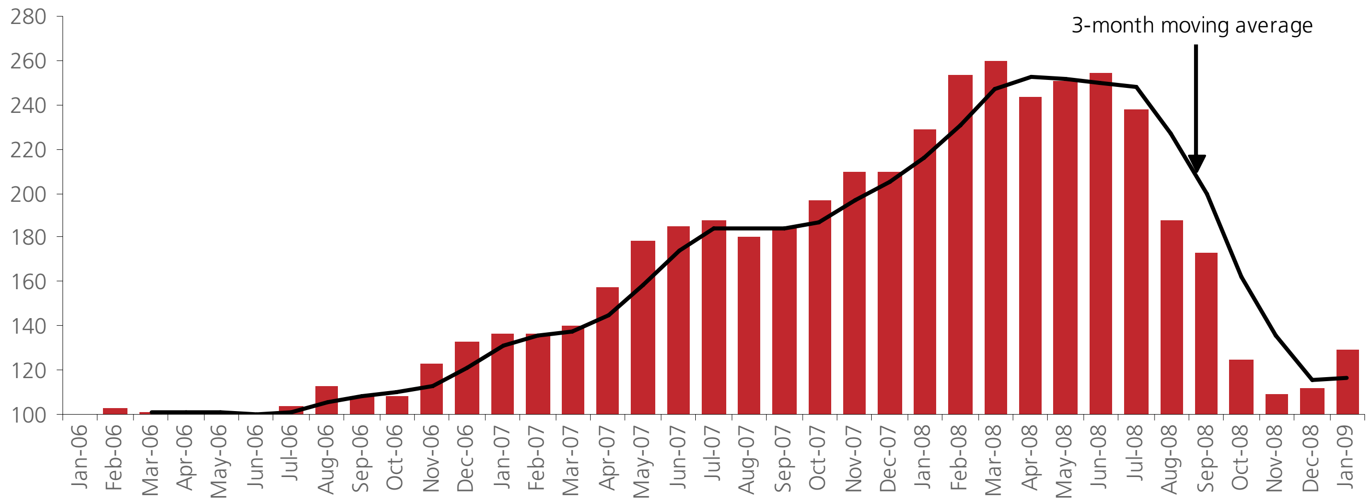
GCPL soaps' sales mix, %



Source : Company, Kotak Institutional Equities

Likely cost comfort in soaps augurs well for VFM players like Godrej

Crude palm oil price trends (January 2006 = Index 100)



Source: Bloomberg, Kotak Institutional Equities

GCPL, change in estimates, March fiscal year-ends (Rs mn)

	FY09E			FY10E		
	New	Old	Change (%)	New	Old	Change (%)
Net Sales	13019	13032	(0.1)	14918	14936	(0.1)
EBIDTA	1908	1985	(3.9)	2587	2605	(0.7)
Net profit	1720	1875	(8.3)	2257	2256	0.1
EPS (Rs)	6.7	7.3	(8.3)	8.7	8.7	0.1
Sales growth (%)	18.1	18.2		14.6	14.6	
EPS growth (%)	(5.5)	3.0		31.2	20.3	

Source: Kotak Institutional Equities estimates.

GCPL: Profit model, balance sheet, 2007-2011E, March fiscal year-ends (Rs mn)

	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)					
Net sales	9,515	11,026	13,019	14,918	16,773
EBITDA	**1,797**	**2,148**	**1,908**	**2,587**	**2,901**
Other income	66	60	108	232	364
Interest	(135)	(151)	234	78	(26)
Depreciation	(142)	(182)	(211)	(264)	(319)
Extraordinary items	99	0	0	0	0
Pretax profits	1,684	1,875	2,040	2,633	2,920
Tax	(243)	(283)	(320)	(376)	(422)
Net profits	**1,440**	**1,592**	**1,720**	**2,257**	**2,498**
Earnings per share (Rs)	**5.9**	**7.1**	**6.7**	**8.7**	**9.7**
Balance sheet (Rs mn)					
Total equity	1,220	1,687	6,489	7,538	8,829
Total borrowings	1,736	1,871	945	945	945
Currrent liabilities	2,617	3,227	3,478	3,777	4,225
Deferred tax liability	80	89	109	109	109
Total liabilities and equity	**5,653**	**6,874**	**11,021**	**12,370**	**14,108**
Cash	475	426	232	968	2,018
Current assets	2,300	3,093	2,750	3,190	3,713
Total fixed assets	1,992	2,399	2,659	3,682	3,847
Investments	0	0	5,345	4,495	4,495
Goodwill	886	956	35	35	35
Total assets	**5,653**	**6,874**	**11,021**	**12,370**	**14,108**
Key assumptions					
Revenue Growth (%)	36.0	15.9	18.1	14.6	12.4
EBITDA Margin(%)	18.9	19.5	14.7	17.3	17.3
EPS Growth (%)	12.6	18.7	(5.5)	31.2	10.7

Source: Kotak Institutional Equities estimates.

Construction

PUJL.BO, Rs92	
Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	125
52W High -Low (Rs)	480 - 91
Market Cap (Rs bn)	29.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	77.5	119.0	121.2
Net Profit (Rs bn)	3.2	5.2	5.4
EPS (Rs)	10.0	16.1	16.8
EPS gth	*323.5*	*61.8*	*4.0*
P/E (x)	9.3	5.7	5.5
EV/EBITDA (x)	5.6	4.6	4.0
Div yield (%)	0.4	0.8	0.8

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(39.0)	(43.9)	(65.7)	(79.4)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.4	-	-
FIIs	17.7	0.3	(0.0)
MFs	18.2	1.4	1.1
UTI	-	-	(0.3)
LIC	-	-	(0.3)

Punj Lloyd: Cost escalation dispute and forex loss mar performance. Reiterate REDUCE

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- **Several one-offs lead to negative operating margins and net income**
- **Standalone reports strong revenue growth as well as margin expansion**
- **Deferral in execution of 10% of backlog acknowledged; however, backlog still remains strong**
- **Marginal changes to earnings estimates; reiterate REDUCE with a target price of Rs105**

Punj Lloyd reported strong consolidated revenue growth of 47.4% to Rs31.2 bn in 3QFY09 from Rs21.2 bn in the previous year. The company reported a net loss of Rs2.3 bn for this quarter versus a net profit of Rs917 mn in 3QFY08. The negative EBITDA margin was mainly due to (1) provision of Rs2.1 bn towards SABIC order executed by its subsidiary, Simon Carves Ltd (SCL) and (2) a foreign exchange loss of Rs779 mn on loans take by SCL. Adjusted for these one-offs also EBITDA margin would have been 6.1%, lower than our expectations of 9%. Standalone however reported strong performance with 44% yoy revenue growth to Rs17.9 bn and 430 bps margin expansion. Management acknowledged slower-than-expected execution in about 10% of the backlog. However, the backlog adjusted for these orders also remains strong at about Rs20 bn. We have marginally revised our earnings estimates and reiterate REDUCE with a target price of Rs105 based on (1) clouded outlook on capital expenditure in the key segments and geographies in which the company operates and (2) likely negative repercussions on the company from ongoing dispute with client.

Several one-offs lead to negative operating margins and net income for the company

Punj Lloyd reported strong consolidated revenue growth of 47.4% to Rs31.2 bn in 3QFY09 from Rs21.2 bn in the previous year (see Exhibit 1). Consolidated EBITDA, including other income, was negative at Rs726 mn resulting in negative EBITDA margin of 3.1%. The company reported a net loss of Rs2.3 bn for this quarter versus a net profit of Rs917 in 3QFY08. The negative EBITDA margin was mainly due to (1) provision of Rs2.1bn towards SABIC order executed by its subsidiary, Simon Carves Ltd (SCL) and (2) a foreign exchange loss of Rs779 mn on loans take by SCL. Both these items have been routed through the other expenses line in the income statement. Adjusted for these one-offs also, EBITDA margin would have been 6.1%, lower than our expectations of 9%. The profit of the company was further depressed by higher interest expense (up 118% yoy) of Rs620 mn due to (1) higher debt levels of Rs33 bn at the group level and (2) higher cost of loans.

For the nine-month period ended December 31, 2008, Punj Lloyd reported revenue growth of 61% and EBITDA margin of 4.5%. Profit after tax reported was Rs160 mn versus Rs2.4 bn for the same period in the previous year.

Strong standalone performance led by strong revenue growth as well as margin expansion

Punj Lloyd reported strong results at the standalone level with revenues growing at 44% yoy to Rs17.9 bn in 3QFY09 (see Exhibit 2). Operating profit margin expanded 430 bps yoy to 12.8% in this quarter versus 8.5% in 3QFY08. The increase in other expenses as a percentage of sales was countered by a sharp decrease in material and contractor costs as a percentage of sales declining by 11.6 percentage points yoy. For 9MFY09, the company reported a yoy 64% growth in the standalone revenues with a margin expansion of 250 bps yoy. Standalone profit after tax reported was Rs2.5 bn, up 171% yoy from Rs917 mn in the previous year.

Management confident of recovering the Rs2.3 bn of advance payment and a performance bond called by SABIC

The company has currently made provisions for only the costs incurred for the SABIC order of Rs2.1 bn. The performance as well as bank guarantee invoked by SABIC against Punj Lloyd for a total amount of GBP28.5 mn is not included in the provisions. This continues to remain as receivables in the company's financials. The management stated that they are fairly confident of recovering this amount from SABIC. SCL has presently commenced litigation proceedings against SABIC with an aim to recover the GBP28.5 mn (about Rs2.3 bn) in respect of the advance payment bond and a performance bond called by SABIC.

Strong order backlog of Rs219 bn provides two years of revenue visibility; acknowledges slower-than-expected execution in about Rs20 bn orders

Order inflows for the company continue to remain strong with the company reporting an order backlog of Rs219 bn, up 136% yoy. The order backlog provides a revenue visibility of about 1.8 years based on FY2009E expected earnings. The company reported an order inflow of Rs104 bn in FY2009E so far (see Exhibit 4). The order backlog of the company continues to remain geographically diversified (see Exhibit 5). The company does seem to be continuing to shifting focus away from India to other international geographies with India contributing to only about 20% to 25% of the order book. The infrastructure and pipelines segment continues to hold a majority stake (about 33% each) in the order book with Process and Plants segment reducing its stake from 47% in 9MFY08 to 31% at the end of 9MFY09 (see Exhibit 6).

Management acknowledged slower-than-expected execution in orders worth Rs20 bn such as (1) Rs17.7 bn Jurong Aromatics complex, (2) Rs8 bn Dighi port project, (3) Rs0.95 bn Goindwal Sahib project and (4) Rs0.33 bn Ador power plant in Indonesia.

Marginally revise earnings estimates, reiterate REDUCE with a target price of Rs105

We have revised our consolidated earnings estimates to Rs9.6 from Rs16.1 to build in (1) write-off of Rs2 bn on SABIC order and (2) forex losses of Rs1 bn. We have broadly maintained our FY2010E consolidated earnings estimate of Rs16.4. We have cut our FY2010 DCF-based target price to Rs105 from Rs125 (implying about 7X 2010E earnings versus 8X FY2010E earnings earlier; see Exhibit 7). We reiterate our REDUCE rating on the stock based on (1) clouded outlook on capital expenditure in the key segments and geographies in which the company operates and (2) likely negative repercussions on the company from ongoing dispute with client.

Exhibit 1. Punj Lloyd (consolidated) - 3QFY09 - key numbers (Rs mn)

	yoy			qoq			yoy		
(in Rs mn)	3QFY09	3QFY08	(% chg)	3QFY09	2QFY09	(% chg)	9MFY09	9MFY08	(% chg)
Net Sales	**31,200**	**21,170**	***47.4***	**31,200**	**29,261**	***6.6***	**86,948**	**54,062**	***60.8***
Expenditure	**(32,163)**	**(20,126)**	***59.8***	**(32,163)**	**(26,536)**	***21.2***	**(83,070)**	**(50,138)**	***65.7***
Material	(8,453)	(7,614)	*11.0*	(8,453)	(10,470)	*(19.3)*	(25,951)	(20,806)	*24.7*
Contractor charges	(13,011)	(6,747)	*92.8*	(13,011)	(8,420)	*54.5*	(30,475)	(15,373)	*98.2*
Staff cost	(3,176)	(2,392)	*32.7*	(3,176)	(2,687)	*18.2*	(9,139)	(6,036)	*51.4*
Other expenditure	(7,523)	(3,373)	*123.0*	(7,523)	(4,959)	*51.7*	(17,506)	(7,923)	*120.9*
Operatin profit	**(963)**	**1,045**	***(192.2)***	**(963)**	**2,724**	***(135.3)***	**3,878**	**3,924**	***(1.2)***
Other Income	237	459	*(48.3)*	237	280	*(15.4)*	612	994	*(38.4)*
EBITDA	**(726)**	**1,503**	***(148.3)***	**(726)**	**3,005**	***(124.2)***	**4,489**	**4,918**	***(8.7)***
Interest	(620)	(284)	*118.1*	(620)	(490)	*26.5*	(1,479)	(967)	*53.0*
Depreciation	(433)	(365)	*18.5*	(433)	(439)	*(1.3)*	(1,263)	(1,053)	*19.9*
Profit before Tax	**(1,779)**	**854**	***(308.3)***	**(1,779)**	**2,076**	***(185.7)***	**1,748**	**2,898**	***(39.7)***
Tax	(416)	(308)	*34.8*	(416)	(647)	*(35.7)*	(1,593)	(864)	*84.5*
Profit after Tax	**(2,194)**	**546**	***(502.2)***	**(2,194)**	**1,429**	***(253.6)***	**155**	**2,035**	***(92.4)***
Minority interest & Associates	(72)	371	*(119.4)*	(72)	12	*(685.4)*	132	372	*(64.4)*
Net Profit	**(2,266)**	**917**	***(347.2)***	**(2,266)**	**1,441**	***(257.3)***	**287**	**2,406**	***(88.1)***
Key ratios									
Material	27.1	36.0		27.1	35.8		29.8	38.5	
Contractor charges	41.7	31.9		41.7	28.8		35.0	28.4	
Staff cost	10.2	11.3		10.2	9.2		10.5	11.2	
Other expenditure	24.1	15.9		24.1	16.9		20.1	14.7	
OPM Margin	**(3.1)**	**4.9**		**(3.1)**	**9.3**		**4.5**	**7.3**	
EBITDA Margin	(2.3)	7.0		(2.3)	10.2		5.1	8.9	
PBT margin (%)	(5.7)	4.0		(5.7)	7.1		2.0	5.4	
PAT margin (%)	(7.0)	4.3		(7.0)	4.9		0.2	4.5	
Effective tax rate (%)	23.4	36.1		23.4	31.2		91.1	29.8	

Source: Company, Kotak Institutional Equities

Exhibit 2. Punj Lloyd (standalone) - 3QFY09 - key numbers (Rs mn)

	yoy			qoq			yoy		
	3QFY09	3QFY08	(% chg)	3QFY09	2QFY09	(% chg)	9MFY09	9MFY08	(% chg)
Net Sales	**17,907**	**12,438**	***44.0***	**17,907**	**15,615**	***14.7***	**49,108**	**29,892**	***64.3***
Expenditure	**(15,619)**	**(11,380)**	***37.3***	**(15,619)**	**(13,779)**	***13.4***	**(43,407)**	**(27,168)**	***59.8***
Material	(5,416)	(4,355)	*24.4*	(5,416)	(6,571)	*(17.6)*	(16,709)	(11,300)	*47.9*
Contractor charges	(3,830)	(3,509)	*9.1*	(3,830)	(2,816)	*36.0*	(11,065)	(7,124)	*55.3*
Staff cost	(1,440)	(928)	*55.2*	(1,440)	(1,393)	*3.3*	(4,160)	(2,376)	*75.1*
Other expenditure	(4,933)	(2,588)	*90.6*	(4,933)	(2,999)	*64.5*	(11,473)	(6,368)	*80.2*
EBITDA	**2,289**	**1,058**	***116.3***	**2,289**	**1,836**	***24.6***	**5,701**	**2,724**	***109.3***
Other Income	204	145	*41.2*	204	223	*(8.6)*	558	460	*21.2*
PBIDT	**2,493**	**1,203**	***107.3***	**2,493**	**2,060**	***21.0***	**6,259**	**3,184**	***96.6***
Interest	(573)	(239)	*139.5*	(573)	(419)	*36.8*	(1,313)	(832)	*57.9*
Depreciation	(290)	(294)	*(1.4)*	(290)	(271)	*7.0*	(836)	(816)	*2.4*
Profit before Tax	**1,629**	**669**	***143.6***	**1,629**	**1,370**	***19.0***	**4,110**	**1,536**	***167.6***
Tax	(664)	(277)	*139.4*	(664)	(489)	*35.8*	(1,549)	(618)	*150.5*
Current	(588)	(228)	*158.3*	(588)	(554)	*6*	(1,466)	(484)	*203*
Deferred	(68)	(38)	*77.6*	(68)	72	*(195)*	(60)	(96)	*(37)*
Fringe benefit tax	(8)	(11)	*(29.8)*	(8)	(7)	*14*	(23)	(38)	*(40)*
Profit after Tax	**965**	**392**	***146.5***	**965**	**880**	***10***	**2,561**	**917**	***179***
Exceptional items	(72)	-		(72)	-		(72)	-	
Net Profit	**893**	**392**	***128.1***	**893**	**880**	***1***	**2,489**	**917**	***171***
Key ratios									
Material	30.2	35.0		30.2	42.1		34.0	37.8	
Contractor charges	21.4	28.2		21.4	18.0		22.5	23.8	
Staff cost	8.0	7.5		8.0	8.9		8.5	7.9	
Other expenditure	27.5	20.8		27.5	19.2		23.4	21.3	
OPM Margin	**12.8**	**8.5**		**12.8**	**11.8**		**11.6**	**9.1**	
PBIDT margin (%)	13.8	9.6		13.8	13.0		12.6	10.5	
PAT margin (%)	5.0	3.1		5.0	5.6		5.1	3.1	
Effective tax rate (%)	(40.8)	(41.5)		(40.8)	(35.7)		(37.7)	(40.3)	

Source: Company, Kotak Institutional Equities

Exhibit 3. Punj Lloyd (subsidiaries) - 3QFY09 - key numbers (Rs mn)

	yoy			qoq			yoy		
	3QFY09	3QFY08	(% chg)	3QFY09	2QFY09	(% chg)	9MFY09	9MFY08	(% chg)
Net Sales	**13,293**	**8,733**	***52.2***	**13,293**	**13,645**	***(2.6)***	**37,839**	**24,171**	***56.6***
Expenditure	**(16,544)**	**(8,746)**		**(16,544)**	**(12,757)**		**(39,663)**	**(22,970)**	
Material	(3,037)	(3,259)	*(6.8)*	(3,037)	(3,899)	*(22.1)*	(9,242)	(9,506)	*(2.8)*
Contractor charges	(9,181)	(3,238)	*183.5*	(9,181)	(5,604)	*63.8*	(19,410)	(8,249)	*135.3*
Staff cost	(1,736)	(1,464)	*18.6*	(1,736)	(1,294)	*34.2*	(4,979)	(3,660)	*36.0*
Other expenditure	(2,590)	(785)	*229.8*	(2,590)	(1,960)	*32.1*	(6,032)	(1,556)	*287.8*
Operating Profit	**(3,251)**	**(13)**	***23,984.4***	**(3,251)**	**888**	***(466.2)***	**(1,823)**	**1,200**	***(251.9)***
Other Income	33	314	*(89.5)*	33	57	*(41.9)*	54	533	*(89.9)*
EBITDA	**(3,218)**	**301**	***(1,169.6)***	**(3,218)**	**945**	***(440.6)***	**(1,769)**	**1,734**	***(202.1)***
Interest	(47)	(45)	*4.4*	(47)	(71)	*(34.0)*	(165)	(135)	*22.6*
Depreciation	(143)	(71)	*101.1*	(143)	(168)	*(14.9)*	(428)	(237)	*80.6*
Profit before Tax	**(3,408)**	**185**	***(1,943.2)***	**(3,408)**	**706**	***(582.7)***	**(2,362)**	**1,362**	***(273.4)***
Tax	248	(31)	*(903.9)*	248	(158)	*(257.6)*	(44)	(245)	*(82.2)*
Current	(20)	49	*(140)*	(20)	554	*(104)*	(340)	130	*(361)*
Deferred	269	(78)	*(443)*	269	(72)	*(475)*	299	(35)	*(945)*
Fringe benefit tax	(1)	(1)	*(50)*	(1)	7	*(109)*	(3)	9	*(134)*
Profit after Tax	**(3,160)**	**154**	***(2,152)***	**(3,160)**	**548**	***(676)***	**(2,406)**	**1,117**	***(315)***
Key ratios									
Material	22.8	37.3		22.8	28.6		24.4	39.3	
Contractor charges	69.1	37.1		69.1	41.1		51.3	34.1	
Staff cost	13.1	16.8		13.1	9.5		13.2	15.1	
Other expenditure	19.5	9.0		19.5	14.4		15.9	6.4	
Operating margin (%)	**(24.5)**	**(0.2)**		**(24.5)**	**6.5**		**(4.8)**	**5.0**	
PBT margin (%)	(25.6)	2.1		(25.6)	5.2		(6.2)	5.6	
PAT margin (%)	(23.8)	1.8		(23.8)	4.0		(6.4)	4.6	
Effective tax rate (%)	7.3	16.7		7.3	22.3		(1.8)	18.0	

Source: Company, Kotak Institutional Equities

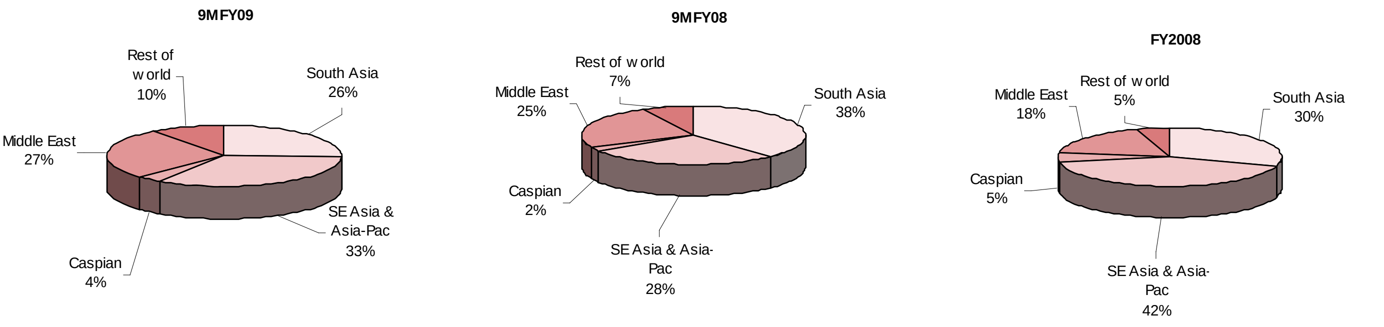
Exhibit 4. Strong order inflows continue for Punj Lloyd so far in this financial year
Key orders won by Punj Lloyd in FY2008 and FY2009 so far (Rs mn)

Date	Segment	Area	Client	Value (Rs mn)	Group entity	Description
15-Jan-09	Infrastructure	Infrastructure	Housing and Infra board	13,112	Punj Lloyd	EPC of utilities in Souk AlJuma, Tripoli, Libya
7-Jan-09	Infrastructure	Buildings	Housing and Infra board	10,501	Punj Lloyd	EPC of infra in Tripoli, Libya
7-Jan-09	Oil and Gas	Pipeline	Cairn India	1,046	Punj Lloyd	EPC of pipeline
6-Jan-09	Infrastructure	Airports	Airports Authority of India	2,640	Punj Lloyd	Sikkim's first greenfield airport
23-Dec-08	Infrastructure	Buildings	Municipal Corp, Delhi	3,040	Punj Lloyd	Parking facility near JN Stadium, N Delhi
20-Oct-08	Oil and Gas	Fuel Terminal	PT Shell Indonesia	1,012	PT Punj Lloyd Indonesia	EPC Services Contract of New Fuel Terminal
23-Sep-08	Oil and Gas	Pipeline	Qatar Petroleum	36,360	Punj Lloyd	EPC contract of laying of 211 km of pipeline with associated stations and infrastructure
NA	Oil and Gas	Infrastructure	Waha Oil Company, Libya	1,900	Punj Lloyd	Deploying two onshore rigs.
9-Sep-08	Process	Process	FWP Joint Venture, Singapore	1,670	Punj Lloyd Pte Ltd	Mechanical works on select utilities
18-Jul-08	Process	Process	Tecnicas Reunidas, Spain and Abu Dhabi Polymers Company	4,640	Punj Lloyd	Mechanical works for Borouge project
3-Jul-08	Process	Process	GVK Power Limited, Hyderabad	10,050	Punj Lloyd	Balance of Plant work (BOP) and entire Civil work on EPC basis
6-Jun-08	Process	Process	Indian Oil Corporation Limited	6,490	Punj Lloyd	Lump-sum turnkey contract to upgrade the refinery at Barauni
30-Apr-08	Process	Process	PT Makmur Sejahtera Wisesa, Indonesia	3,300	PT Punj Lloyd Indonesia and Punj Lloyd Pte Ltd, Singapore	EPC project for 2x30 MW Coal Power Plant in Kalimantan Island, Indonesia
11-Apr-08				18,640	Punj Lloyd Ltd and Punj Lloyd Pte Ltd., Singapore	
11-Apr-08				970	Sembawang Infrastructure (India) Pvt Ltd	
Orders won in FY2009 so far				**115,370**		
31-Mar-08	Process	Process	Tecnimont S.p.A (Italy)	2,720	Punj Lloyd	Mechanical work PE3 and PH areas
7-Mar-08	Oil and Gas	Pipeline	Petronas Carigali Sdn Bhd, Malasia	20,150	Punj Lloyd	EPC and commissioning of a 512 km, 36 inch diameter onshore natural gas pipeline and associated facilities
14-Feb-08	Civil, Infrastructure and Power	Buildings	Marina Bay Sands Pte Ltd, Singapore	11,192	Sembawang Engineers and Constructors	Construction of the North Podium in the integrated resort comprising casino, theatres and retail arcade
12-Dec-07	Process	Process	Indian Oil Corporation	5,900	Punj Lloyd	Construction of coker unit & block for the Vadodara refinery in Gujarat
30-Nov-07	Civil, Infrastructure and Power	Infrastructure	Land Transport Authority, Singapore	12,720	Sembawang Engineers and Constructors	Construction of the MRT station in Marina Bay in Singapore
5-Nov-07	Process	Process	Jurong Aromatics Corporation Pte Ltd, Singapore	17,700	Sembawang Engineers and Constructors	EPC work for a new mega aromatics plant at Jurong island
12-Oct-07	Oil and Gas	Pipeline	Qatar Petroleum	3,890	Punj Lloyd	EPC on LSTK basis of 46 km of 18" multi-product pipeline
6-Aug-07	Process	Process	Bharat Oman Refineries Limited	5,900	Punj Lloyd	Lump-sum turnkey contract for building a sulphur block at Bina Refinery
2-Aug-07	Civil, Infrastructure and Power	Buildings	Sentosa Pte Ltd, subsidiary of Genting Group	6,660	Sembawang Engineers and Constructors	Sub-structural works at Sentosa Integrated Resort Development
27-Jul-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	3,180	Punj Lloyd	Laying of pipeline & associated facilities for East-West Pipeline project
23-Jul-07	Oil and Gas	Tankage	Saudi Kayan Petrochemical Company (SABIC)	1587(a)	Dayim Punj Lloyd Construction Contracting Company Ltd	EPC of tanks at Jubail Industrial city, Saudi Arabia
20-Jul-07	Process	Process	Gulf Fluor	500(b)	Simon Carves Ltd.	Fluorides plant incorporating a new Sulphuric Acid plant
14-May-07	Oil and Gas	Pipeline	GAIL (India) Ltd	1,227	Punj Lloyd	Phase II of Panvel — Dabhol Pipeline
16-Apr-07	Oil and Gas	Pipeline	Oman Gas Company	5,300	Punj Lloyd	24", 40 Km pipeline
19-Apr-07	Oil and Gas	Pipeline	Ras Laffan Olefins Company Ltd, USA	1,935	Punj Lloyd	Ethylene pipeline
23-Apr-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	1,802	Punj Lloyd	48", 122 Km pipeline
Total orders won in FY2008				**257,182**		

(a) Estimated share of Punj Llyod
(b) Estimated order value

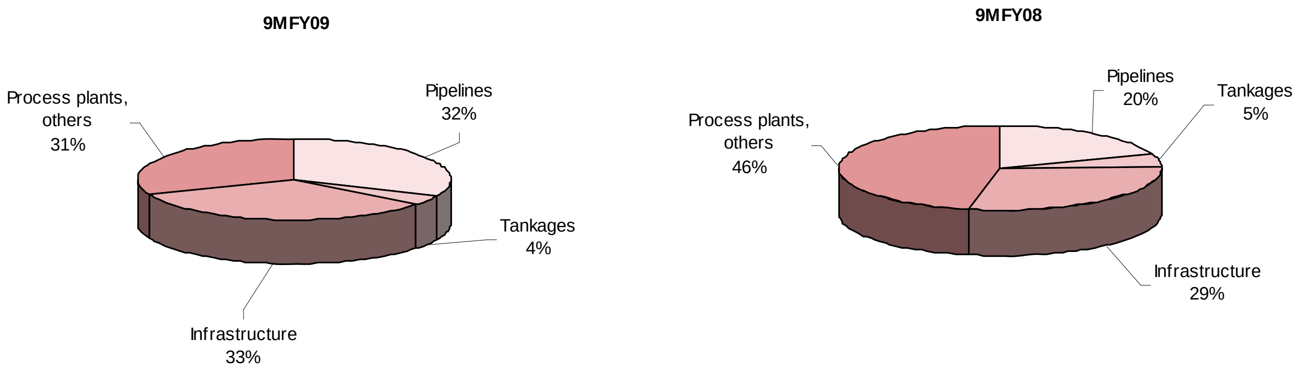
Source: Company, Kotak Institutional Equities

Exhibit 5. Geographical mix of order backlog of Punj Lloyd group (Rs bn)



Source: Company, Kotak Institutional Equities

Exhibit 6. Sector-wise order backlog of Punj Lloyd group (Rs bn)



Source: Company, Kotak Institutional Equities

Exhibit 7. Punj Lloyd Consolidated- DCF model, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**118,980**	**121,198**	**126,670**	**138,787**	**155,871**	**177,220**	**200,088**	**220,096**	**242,106**	**266,316**	**292,948**
Revenue growth (%)	53.5	1.9	4.5	9.6	12.3	13.7	12.9	10.0	10.0	10.0	10.0
EBITDA	**7,640**	**11,514**	**12,034**	**13,185**	**14,808**	**16,836**	**19,008**	**19,809**	**21,790**	**23,968**	**26,365**
EBITDA (%)	6.4	9.5	9.5	9.5	9.5	9.5	9.5	9.0	9.0	9.0	9.0
Depreciation	(1,713)	(1,956)	(2,200)	(2,519)	(2,875)	(3,269)	(3,700)	(3,885)	(4,079)	(4,283)	(4,497)
EBIT	5,927	9,557	9,834	10,666	11,933	13,567	15,308	15,924	17,710	19,685	21,868
Tax	(1,600)	(2,685)	(2,779)	(3,033)	(3,393)	(3,857)	(4,352)	(5,255)	(5,844)	(6,496)	(7,216)
Change in net working capital	**(16,757)**	**(488)**	**311**	**(3,120)**	**(4,531)**	**(5,599)**	**(6,015)**	**(5,482)**	**(6,030)**	**(6,633)**	**(7,296)**
Capex	(1,935)	(2,500)	(4,000)	(4,500)	(5,000)	(5,500)	(6,000)	(3,852)	(4,237)	(4,661)	(5,127)
Free cash flow	**(12,652)**	**5,840**	**5,565**	**2,532**	**1,884**	**1,879**	**2,641**	**5,220**	**5,678**	**6,179**	**6,726**
PV of each cash flow	(12,652)	5,840	4,904	1,965	1,289	1,132	1,402	2,442	2,340	2,244	2,152

PV of cash flows	25,710	FCF in terminal year (Rs mn)	6,726
PV of terminal value	26,581	Exit FCF multiple: (1+g)/(WACC-g)	12.4
EV	52,291	Terminal value of FCF (Rs mn)	83,086
Debt	18,031	Exit EBITDA multiple	3.2
Equity value	34,259		
Equity value (Rs/share)	**106**		

Weighted average cost of capital-WACC								
			Sensitivity of DCF value to WACC, Terminal Growth rate					
				WACC (%)				
Terminal growth - g (%)	5.0			**12.5**	**13.0**	**13.5**	**14.0**	**14.5**
Risk free rate-Rf (%)	8.0	Terminal	**3.0**	104	96	89	82	76
Market risk premium—(Rm-Rf) (%)	6.0	growth	**4.0**	114	105	97	89	82
Beta (x)	1.1	rate (%)	**5.0**	127	116	**106**	97	89
Cost of equity-Ke (%)	15.1		**6.0**	144	130	118	107	98
Cost of debt-Kd (%)	12.0		**7.0**	167	148	133	120	109
Tax rate (%)	33.9							
Debt/Capital (%)	46.4							
Equity/Capital (%)	53.6							
WACC (%)	11.8							
Used WACC (%)	**13.5**							

Source: Company, Kotak Institutional Equities estimates

Technology

TEML.BO, Rs209	
Rating	BUY
Sector coverage view	Cautious
Target Price (Rs)	320
52W High -Low (Rs)	990 - 204
Market Cap (Rs bn)	26.1

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	37.7	44.6	44.7
Net Profit (Rs bn)	7.8	8.9	7.7
EPS (Rs)	59.1	67.6	58.7
EPS gth	*25.7*	*14.5*	*(13.2)*
P/E (x)	3.5	3.1	3.6
EV/EBITDA (x)	3.1	1.7	1.5
Div yield (%)	2.6	2.9	3.0

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(21.6)	(44.2)	(72.2)	(70.8)

Tech Mahindra: Weak quarter. Maintain BUY, only on inexpensive valuations

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- **3QFY09 revenues significantly below our expectations**
- **Good margin performance; challenges ahead**
- **Currency—the biggest drag on earnings and stock performance**

Tech Mahindra reported disappointing all round performance for the December 2008 quarter. Revenues declined 14% qoq to US$232 mn versus our expectations of US$242 mn. BT revenues declined 18% qoq to US$132 mn (down 5% on constant currency). Non-BT revenues declined 7.5% qoq to US$100 mn. OPM at 28.1% remained steady and ahead of our expectations though partly aided by higher-than-expected GBP/INR realization of 79 (spot is currently at 66.8). Net income of Rs2.2 bn was ahead of our expectation of Rs1.95 mn and primarily led by higher-than-expected GBP/Re realization. Currency is turning out be a major challenge—we had factored in GBP/US$ rate of 1.47 for FY2010E and GBP/INR rate of 70. Taking into consideration the currency headwinds and weak execution, we reduce our earnings estimates further; we now model cross currency rate of GBP/US$ rate of 1.3 and GBP/INR rate of 62 for FY2010E and FY2011E. We lower our FY2010E EPS by 17% to Rs58.7 and FY2011E EPS by 20% to Rs52.8. We maintain our BUY rating on the stock; however, the following factors need to materialize if the stock has to perform in the near term (1) stability in GBP versus other currencies, (2) articulation of free cash utilization—it is surprising TM does not even have a dividend payout policy in place and (3) demonstrate consistent large deal wins without the use of cash/equity structures.

Steep revenue decline—huge negative surprise. TM's reported revenues declined 14% to US$232 mn, significantly lower than our expected US$242 mn. Revenue weakness was spread across both BT and non- BT clients. Non-BT revenues declined 7.5% qoq to US$100 mn; the management attributed this to the weak economic environment. BT revenues declined 18.3% qoq and 11.6% yoy to US$132 mn; on a constant currency basis revenues declined 5% to GBP81 mn. BT Global Services (BTGS) contract continues to scale up well; revenues increased 9% qoq to US$35 mn (+27% in constant currency). BT's core business, however, continues to be a concern with billing decline qoq and yoy on US$ basis as well as constant currency basis. Management indicates that the billing in the BT account has already peaked with key programs such as OpenReach and 21CN on a ramp down.

Good margin performance; challenges ahead. TM's EBITDA margin remained stable at 28.1% primarily on the back of rupee depreciation. However, OPM will be under severe pressure going forward on account of appreciation of Re against the GBP. Note that the spot GBP/INR rate has move to 66.5 versus 79 realized for the December quarter. A 1% appreciation of rupee against the GBP impacts TM's OPM adversely by 40 bps. TM does have a few operational levers up its sleeve including utilization rates (a low 67% in the December 2008 quarter) which can offset some part of currency headwinds; however, most of these are volume-based levers and growth in volumes is critical to prevent a sharp correction in margins. We model EBITDA margin decline of 400 bps for TM in FY2010E, primarily factoring currency changes.

Update on the earlier announced large deal with BT. TM indicated it would be the sole and prime vendor for the GBP500 mn deal with BTGS. However, only GBP350 mn of revenues would be incremental to TM—a negative surprise, we thought that all the revenues from this deal would be incremental; revenues will likely accrue over a period of five years. TM will assume sole responsibility for deal execution; accordingly it would not recover back anything from US$110 mn upfront payment made in 2QFY09 to secure the deal.

The new deal involves large scale systems consolidation for the BTGS business. TM would be the prime vendor and may sub-contract out a portion of the business to consultants. 60% of the deal value will accrue in the first three years. TM would be responsible for transformation of the IT architecture, governance and business processes that support the business. The program is directed at global consolidation of systems and service management. TM management indicates that the profitability of the deal would be similar to/higher than the corporate-average *before* amortization of upfront payment to secure the deal; we highlight that this is a divergence from the management's earlier comments—that the margins on the deal would be similar to corporate average margins *post* amortization of upfront payment. The work on this program will start from April 1, 2009.

The way forward. TM has disappointed us on execution and growth in the past three quarters especially on the non-BT revenues. The company has to demonstrate better growth, communication and deals wins in the normal course to win confidence of investors. With the slowdown in the pace of new deal awards among TSP accounts worldwide, we believe revenues may decline in FY2010E in US$ terms (growth in constant currency). We share our thoughts on the business in detail

1. **BTGS.** Despite negative press for BT on the performance of GS division and likely change in the management, we still forecast strong growth rate in BTGS revenues for TM. We model revenues of US$232 mn for FY2010E and US$306 mn for FY2011E. We believe that execution and pace of ramp-up has been consistent with the management's plans. In addition, we model potential revenues from GBP350 mn five-year deal from BT. This contract will likely start April 2009 and may potentially deliver revenues of ~US$50 mn in FY2010E.

2. **BT core.** BT core business may remain under pressure especially after peaking out of certain high profile programs such as 21 CN and OpenReach. Revenues from this segment may remain weak and uncertain. TM is attempting to protect revenues from this segment through conversion of revenues to annuity business. Note that the company had converted an existing deal into annuity business through a five-year US$350 mn applications contract from the wholesale division of BT. We forecast revenues of US$340 mn from BT core business for FY2010E, implying a yoy decline of 27%.

3. **Non-BT revenues.** Performance from the non-BT segment was the big disappointment in the December 2008 quarter. We believe a combination of factors including ramp down from TEM clients, push pack in decision making of large deals which TM may have been bidding for and weak external environment/execution may have been the key reasons for disappointment. Still non-BT revenues may show an uptick from the March quarter led in the initial phase by ramp-up from US$220 mn five-year from AT&T (US$70 mn incremental). We believe the company may need to close additional deals in this segment soon for growth in FY2010E.

Reduce estimates for FY2010E and FY2011E. We lower our FY2010E EPS to Rs58.7 from Rs70.4 earlier and FY2011E EPS to Rs52.8 from Rs66.3 earlier. We build earnings decline of 13% for FY2010E and 10% for FY2011E. The revision is led by two factors (1) lower volume growth projection of 10% versus 13% earlier (for FY2010E) and (2) change in currency assumptions. Maintain our BUY rating on the stock noting inexpensive valuations (3.3X FY2009E and 3.8X FY2010E earnings) post the recent steep correction in the stock price. Our target price of Rs320/share implies an upside of 53% from current levels.

Reduction in non-employee costs driving OPM performance

	Dec-07	Sep-08	Dec-08	qoq (%)	yoy (%)
Revenues	**9,704**	**11,648**	**11,322**	**(2.8)**	**16.7**
Employee costs	**3,826**	**4,721**	**4,816**	**2.0**	**25.9**
Total non-employee costs	**3,744**	**3,666**	**3,327**	**(9.2)**	**(11.1)**
Total costs	**7,570**	**8,386**	**8,143**	**(2.9)**	**7.6**
EBITDA	**2,134**	**3,262**	**3,179**	**(2.6)**	**49.0**
As % of revenues					
Employee costs	**39.4**	**40.5**	**42.5**		
Non-employee costs	**38.6**	**31.5**	**29.4**		
EBITDA margin (%)	**22.0**	**28.0**	**28.1**		

Source: Company data

Key changes in FY2009-11 estimates, March fiscal year-ends

	New			Old			Change (%)		
	2009E	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**	**2009E**	**2010E**	**2011E**
Revenues (Rs mn)	**44,556**	**44,739**	**48,295**	**47,584**	**53,166**	**59,180**	**(6.4)**	**(15.9)**	**(18.4)**
Revenues (US$ mn)	**991**	**932**	**1,028**	**1,058**	**1,109**	**1,260**	**(6.4)**	**(15.9)**	**(18.5)**
Revenue growth (%)	**5.9**	**(5.9)**	**10.3**	**13.2**	**4.8**	**13.7**			
EBITDA (Rs mn)	11,725	9,979	10,186	11,860	11,654	12,409	(1.1)	(14.4)	(17.9)
Net Profit (Rs mn)	8,859	7,690	6,922	9,527	9,225	8,680	(7.0)	(16.6)	(20.2)
Fully diluted EPS (Rs/share)	**67.6**	**58.7**	**52.8**	**72.7**	**70.4**	**66.3**	**(7.0)**	**(16.6)**	**(20.2)**
Re/$ rate	45.0	48.0	47.0	45.0	48.0	47.0	0.0	0.1	0.1
EBITDA margin (%)	26.3	22.3	21.1	24.9	21.9	21.0			

Source: Kotak Institutional Equities estimates

Tech Mahindra interim results, March year end (Rs mn)

	3QFY08	2QFY09	3QFY09	% change qoq	% change yoy	Kotak Estimates	% Deviation	Comments on QoQ performance
Revenues	**9,704**	**11,648**	**11,322**	**(2.8)**	**16.7**	**11,503**	**(1.6)**	Revenue decline of 14% qoq disappointing; reveneus at US$232 mn significantly below our estimate of US$242 mn. Volume growth of 3% qoq disappointed, even as depreciation of GBP versus USD impacted US$ revenues
Cost of revenues	(6,144)	(6,867)	(6,572)	(4.3)	7.0	(7,344)	(10.5)	
Gross profit	**3,560**	**4,781**	**4,750**	**(0.6)**	**33.4**	**4,159**	**14.2**	
SG&A expenses	(1,431)	(1,520)	(1,570)	3.3	9.7	(1,594)	(1.5)	
EBITDA	**2,129**	**3,261**	**3,180**	**(2.5)**	**49.4**	**2,565**	**24.0**	Margins flat qoq on account of aggressive cost rationalization and a surprisingly high GBP/Re realization of Rs79 for the quarter
Depreciation	(206)	(267)	(286)	7.1	38.8	(292)	(2.1)	
EBIT	**1,923**	**2,994**	**2,894**	**(3.3)**	**50.5**	**2,273**	**27.3**	
Interest	(16)	-	-			-		
Other income	300	(320)	(397)	24.1	(232.3)	(120)		Includes US$9 mn of forex loss, same as last quarter
Profit before tax	**2,207**	**2,674**	**2,497**	**(6.6)**	**13.1**	**2,152**	**16.0**	
Tax	(213)	(321)	(269)	(16.2)	26.3	(238)		
Net profit	**1,994**	**2,353**	**2,228**	**(5.3)**	**11.7**	**1,915**	**16.4**	
Minority interest	1	-	(1)			-		
Net income	**1,995**	**2,353**	**2,228**	**(5.3)**	**11.7**	**1,915**	**16.3**	**Net income ahead of expectations on account of better-than-expected OPM performance**
Extraordinaries	-	673	-			-		UK payee tax write-back of US$15.3 mn in 2QFY09
Net profit- reported	**1,995**	**3,026**	**2,228**			**1,915**	**16.3**	
EPS -Diluted (Rs)	**15.2**	**18.0**	**17.0**	**(5.3)**	**11.7**	**14.6**		
Shares outstanding (mn)	131.0	131.0	131.0	-	-	131.0		
Margins (%)								
Gross profit margin	36.7	41.0	42.0			36.2		
EBITDA margin	21.9	28.0	28.1			22.3		
EBIT margin	19.8	25.7	25.6			19.8		
NPM	20.6	20.2	19.7			16.6		
Employee Metrics								
Software Professionals	18,448	20,273	20,779					
Sales & Support	1,003	1,128	1,123					
BPO professionals	3,704	3,734	3,527					
Total Employees	23,155	25,135	25,429					
Other Metrics								
BT revenues (% of total)	61.0	60.0	57.0					
Revenues (%)								
BT	5,919	6,989	6,454	(7.7)	9.0			BT core business down 13% qoq in constant currency even as BTGS witnesses sharp ramp up
Non-BT	3,785	4,659	4,868	4.5	28.6			Modest growth in non-BT revenues disappointing
Revenue Mix (%)								
Onsite	44.0	40.0	40.0					
Offshore	56.0	60.0	60.0					

Source: Kotak Instutional Equities estimates

Tech Mahindra- consolidated Indian GAAP profit & loss statement. March fiscal year ends

Rs mn	2007	2008	2009E	2010E	2011E
Revenues	**29,290**	**37,661**	**44,556**	**44,739**	**48,295**
Direct cost	(17,536)	(23,854)	(26,722)	(28,130)	(30,873)
Gross profit	**11,754**	**13,807**	**17,834**	**16,610**	**17,422**
SG&A expenses	(4,387)	(5,549)	(6,109)	(6,631)	(7,235)
EBITDA	**7,368**	**8,258**	**11,725**	**9,979**	**10,186**
Depreciation	(515)	(796)	(1,107)	(1,371)	(1,747)
EBIT	**6,852**	**7,462**	**10,618**	**8,607**	**8,439**
Other income	77	1,044	(592)	597	738
Interest	(61)	(62)	—	—	—
Profit before tax	**6,868**	**8,444**	**10,026**	**9,205**	**9,177**
Tax	(740)	(748)	(1,167)	(1,514)	(2,254)
Net profit	**6,128**	**7,696**	**8,859**	**7,690**	**6,922**
Minority interest	(1)	5	—	—	—
Net income	**6,127**	**7,701**	**8,859**	**7,690**	**6,922**
Extraordinaries	(4,910)	(4,401)	—	—	—
Net profit- reported	**1,218**	**3,295**	**8,859**	**7,690**	**6,922**
EPS (Rs/share)	**51.4**	**63.2**	**71.1**	**59.6**	**53.0**
Fully Diluted EPS (Rs/Share)	**47.0**	**59.1**	**67.6**	**58.7**	**52.8**
No of shares outstanding (mn)	119.1	121.9	124.6	129.1	130.5
Fully diluted number of shares (mn)	*130.4*	*130.4*	*131.0*	*131.0*	*131.0*
Margins (%)					
Gross profit margin	40.1	36.7	40.0	37.1	36.1
EBITDA margin	25.2	21.9	26.3	22.3	21.1
EBIT margin	23.4	19.8	23.8	19.2	17.5
NPM	20.9	20.4	19.9	17.2	14.3
Growth rates (%)					
Revenues	135.7	28.6	18.3	0.4	7.9
Gross profit	133.7	17.5	29.2	-6.9	4.9
EBITDA	175.0	12.1	42.0	-14.9	2.1
EBIT	200.3	8.9	42.3	-18.9	-2.0
Net profit	160.3	25.6	15.1	-13.2	-10.0

Source: Kotak Instutional Equities estimates

Banking

MMFS.BO, Rs206	
Rating	SELL
Sector coverage view	Attractive
Target Price (Rs)	190
52W High -Low (Rs)	335 - 162
Market Cap (Rs bn)	19.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	7.7	8.5	9.2
Net Profit (Rs bn)	1.8	1.8	2.2
EPS (Rs)	20.8	18.5	22.6
EPS gth	*32.6*	*(11.2)*	*22.0*
P/E (x)	9.9	11.1	9.1
P/B (x)	1.6	1.4	1.2
Div yield (%)	2.224	2.249	2.743

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
9.1	3.4	(19.5)	(26.7)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.6	-	-
FIIs	23.8	0.1	0.1
MFs	0.3	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Mahindra & Mahindra Finance: Core performance remains a concern, retain SELL

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- **MMFSL reported PAT of Rs445 mn, up 5% yoy and 18% above estimates**
- **Higher-than-expected NIM supported earnings**
- **Subdued disbursements, high NPLs remain a concern**
- **We revise estimates, retain SELL with price target of Rs190**

Mahindra and Mahindra Financial Services (MMFSL) reported core profits (PBT excluding gains on securitization and provisions) of Rs1.26 bn, up 17% yoy and 11% above estimates. Despite challenges in raising debt at competitive rates, the company managed to report an improvement in NIM likely on account of increase in lending rates on new loans and subvention from manufacturers. Disbursements were down 1% yoy on a low base (15% yoy decline in 3QFY08 as well). Consequently, loan book declined 5% qoq. With increased slippages and lower loan growth, the gross NPL ratio moved up to 10.1% in 3QFY08 from 9.4% in 2QFY08 and 8.7% in 3QFY07. We expect the current trends to continue over the next few quarters—NIM will remain high as bulk borrowing rates decline, loan growth will remain challenging in the backdrop of a slowdown in the auto industry. We are raising our estimates for FY2009E by 10% to factor in higher NIM. The impact on FY2010E estimates is marginal as increase in NIM somewhat offsets the lower loan growth estimate. Retain price target of Rs190 and SELL recommendation. The stock currently trades at 9.2X PER and 1.2X PBR FY2010E.

Key highlights

Smart re-pricing of loans drives NIM. MMFSL's NIMs (as per our calculations) increased to 10.5% in 3QFY09 from 10.1% in 2QFY09 and 9.8% in 3QFY08. The company raised its lending rates for new loans by over 200-250 bps, which has likely supported NIMs. Given the small tenure of loans, the share of disbursements during 3QFY09 to overall loan book was somewhat high at about 18%. Hence, the rise in lending rates for new loans had a significant impact on overall NIMs. On the borrowings side, MMFSL increased its focus on banks and insurance companies—the share of mutual funds has declined to 30% in 3QFY09 from 51% in 3QFY08.

Loan growth will remain subdued. MMFSL has now resumed financing of non-M&M vehicles, a segment in which disbursements were freezed in 3QFY08 due to liquidity challenges. However, with a slowdown in the auto industry, we believe MMFSL will find it challenging to deliver growth in business despite improvement on the liquidity front. We expect the loan book to decline 1% yoy in FY2010E (disbursements growth of 10%) versus 10% loan growth assumption earlier (disbursements growth of 12%).

Asset quality remains a concern. MMFSL reported gross NPL ratio of 10.1% for 3QFY09 versus 9.4% in 2QFY09 and 8.7% in 3QFY08. The high NPLs ratio, despite concerted efforts of the management, remains a cause for concern. The management has highlighted that recoveries picked up in December 2009 and will remain a focus area in 4QFY09 as well.

Mahindra & Mahindra Financial Services

Old and new estimates, March fiscal-years 2009-2010E (Rs bn)

	Old estimates		New estimates		% change	
	2009E	**2010E**	**2009E**	**2010E**	**2009E**	**2010E**
Net interest income	7,041	7,807	7,428	7,607	5.5	(2.6)
Loan book (Rs bn)	70.5	77.3	71.8	71.0	1.9	(8.1)
Loan growth (%)	7	10	9	(1)		
NIM (%)	9.7	10.0	10.2	10.1		
NPL provisions	3,141	2,955	3,103	2,893	(1)	(2)
Other income	1,350	1,550	1,100	1,550	(19)	0
Securitization	1,250	1,400	1,000	1,400	(20)	0
Operating expenses	2,767	3,121	2,686	2,950	(3)	(5)
Employee	1,172	1,302	1,172	1,288	0	(1)
Others	1,594	1,819	1,513	1,663	(5)	(9)
PBT	**2,483**	**3,281**	**2,739**	**3,314**	**10**	**1**
Tax	885	1,152	975	1,163	10	1
PAT	**1,598**	**2,130**	**1,764**	**2,151**	**10**	**1**
PBT-securitisation income	1,233	1,881	1,739	1,914	41	2
PBT-secu income+ provisions	4,374	4,836	4,842	4,807	11	(1)
EPS(Rs)	**17**	**22**	**19**	**23**	**10**	**1**

Source: Kotak Institutional Equities estimates.

Mahindra Finance

Quarterly results, 3Q08-3Q09 (Rs mn)

	3Q08	4Q08	1Q09	2Q09	3Q09	YoY(%)	3Q09E	Actual vs KS (%)
Total interest income	2,899	3,033	2,800	3,118	3,320	15	3,203	4
Total interest expense	1,263	1,180	1,103	1,312	1,412	12	1,415	(0)
Net interest income	**1,636**	**1,853**	**1,697**	**1,806**	**1,907**	**17**	**1,788**	**7**
Provisions and write/off	**714**	**599**	**880**	**698**	**788**	**10**	**750**	**5**
Net interest income (after prov.)	922	1,255	818	1,109	1,119	21	1,038	8
Other income	338	580	194	191	247	(27)	230	7
Income from securitization	288	515	146	158	213	(26)	200	6
Total income pre loan loss provision	1,974	2,433	1,891	1,998	2,154	9	2,018	7
Operating expenses	**606**	**671**	**593**	**754**	**679**	**12**	**679**	**0**
Employee expenses	246	271	260	313	295	20	310	(5)
Depreciation	23	22	21	19	22	(2)	19	16
Other expenses	337	379	311	421	362	7	350	3
Pretax income	**654**	**1,163**	**419**	**546**	**687**	**5**	**589**	**17**
Tax provisions	229	409	151	194	242	5	212	14
Net Profit	**425**	**754**	**268**	**352**	**445**	**5**	**377**	**18**
Tax rate	35	35	36	36	35	0	36	(2)
PBT before securitisation income and provisions	**1,080**	**1,246**	**1,153**	**1,086**	**1,262**	**17**	**1,139**	**11**
PBT bef sec income post prov	**366**	**648**	**273**	**388**	**474**	**30**	**389**	**22**
Other operational details								
Disbursements (Rs bn)	13.8	13.0	15.0	19.8	14	(1)		
Outstanding assets (Rs bn)	71.0	70.2	72.1	79.0	75	6		
Outstanding loans (Rs bn)	67.2	66.4	68.3	74.8	71	5	73	(2)
Receivables securitised during the period (Rs mn)	2,080	3,029	1,280	1,450	2,010			
Income on securitisation/ loans securitised during the period(%)	14	17	11	11	11			
Total income/ average assets (%)	17.0	18.4	16.1	16.4	17.9			
Interest / average assets (%)	6.6	6.7	6.1	6.3	6.9			
Difference (%)	10.4	11.7	10.0	10.1	11.0			
Gross NPLs (Rs mn)	6,487	5,572	7,501	7,866	8,082			
Gross NPL ratio (%)	8.7	7.6	9.8	9.4	10.1			
NPAs (Rs mn)	2,909	2,053	3,084	3,137	2,857			
Net NPL ratio (%)	4.1	2.9	4.3	4.0	3.8			
CAR (%)	15	20.7	19.9	17.8	18.9			
Tier I (%)	11	16.8	16.6	15.8	16.8			
Exp/ ave assets (%)	3.7	3.8	3.7	3.7	3.8			
NIMs - KS calculations (%)	9.8	11.1	10.1	10.1	10.5		9.7	
Balance sheet (Rs mn)								
Sharecapital	841	953	954	955	955			
Reserves	7,948	12,176	12,452	12,805	13,251			
ESOP	17	14	12	13	14			
Total Borrowings	56,931	50,682	52,073	59,212	53,737			
Current Liabilities	5,285	6,393	6,645	6,061	7,067			
Total liabilities and shareholders funds	**71,022**	**70,218**	**72,136**	**79,046**	**75,024**			
Loans & Avd	67,237	66,435	68,267	74,772	70,857			
Investments	31	31	58	58	57			
Deferred tax	1,048	1,254	1,316	1,418	1,560			
Current Assets	2,400	2,177	2,190	2,444	2,207			
Fixed assets	306	308	305	354	343			
Total assets	**71,022**	**70,218**	**72,136**	**79,046**	**75,024**			
Segmentwise mix								
Disbursements (% of total)								
Auto/ utility vehicles		34	40	36	41			
Tractors		24	23	20	22			
Cars		23	23	29	24			
Commercial vehcles		7	8	8	7			
Refinance and others		12	6	7	6			
AUMs (% of total)								
Disbursements								
Auto/ utility vehicles		38	38	39	39			
Tractors		25	25	24	24			
Cars		23	23	24	24			
Commercial vehcles		7	7	8	8			
Refinance and others		7	7	5	5			
Funding Mix								
%age of total								
Banks	41	50	49	53	56			
Insurance	4	5	3	7	11			
Mutual funds	51	41	45	36	30			
Others	4	4	4	3	4			

Source: Company, Kotak Institutional Equities estimates.

Consumer products

JYOI.BO, Rs56	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	127
52W High -Low (Rs)	168 - 42
Market Cap (Rs bn)	4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	3.8	4.3	4.9
Net Profit (Rs bn)	0.5	0.5	0.8
EPS (Rs)	6.5	7.2	10.6
EPS gth	*(8.6)*	*10.2*	*47.3*
P/E (x)	8.6	7.8	5.3
EV/EBITDA (x)	4.9	4.4	2.9
Div yield (%)	4.1	4.2	5.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(25.0)	7.8	(36.9)	(65.0)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	69.5	-	-
FIIs	5.3	0.0	0.0
MFs	9.7	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Jyothy Laboratories: 2QFY09: Ujala volume growth surprises positively

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- **Good portfolio performance to drive 25% sales growth**
- **Vim's anti-bacterial campaign helps Exo establish the core proposition**
- **Retain ADD, target price revised to Rs127/share**

Good portfolio performance in Ujala, Maxo and Exo brands helped Jyothy Laboratories Limited (JLL) report sales growth of 24.8% for 2QFY09. However, EBITDA margins declined 290 bps to 13.4% due to (1) higher consumption costs and (2) impact of excise exemption withdrawal for Maxo. The company reported 2.6% and 2.0% growth in EBITDA and PAT respectively. 15% volume growth in 'Ujala' surprised us positively. 'Stiff n Shine' likely to witness a communication revamp, 'Exo' achieving Rs1 bn annualized sales are highlights. JLL has taken the lead in roll back of trade margins in 'Maxo' and competition has followed. We highlight that availability of management bandwidth is the key risk which JLL faces as they diversifies into services business. Accounting for higher-than-expected input cost impact and for marginal rolling forward of Exo national launch, we cut earnings estimates for FY2009E and FY2010E by 10% and 7%, respectively. At a CMP of Rs56/share, the stock trades at 5.2XFY10E. As per management, JLL had Rs13/share of net cash as on 31st December 2008. Retain ADD with a revised TP of Rs127/share. We forecast earnings CAGR of 26% over FY08-10E. At our TP, the stock would trade at 12XFY10E.

Good portfolio performance—Ujala volume growth surprises positively

Jyothy Laboratories Limited (JLL) reported a 24.8% growth in sales for 2QFY09. 15% volume growth in 'Ujala', price increases in 'Ujala' (in July 2008), reversal of consumer promotions in Maxo and market share gains in 'Exo' were the highlights of the quarter. However, EBITDA margin declined 290bps to 13.4% due to (1) higher consumption costs in key inputs of HDPE and LAB and (2) withdrawal of excise exemption in Assam and Jammu & Kashmir. We estimate that about a third of the margin decline in the current quarter is likely due to excise impact and hence will likely pull down margins in FY2009E.

The company has taken the lead in rolling back trade margins in 'Maxo' and the competition has followed suit. In July 2008, the company has increased the retail price of the key SKU, 'Ujala' 75 ml pack to Rs12 from Rs11 (9% increase). We highlight that cost pressures are abating for JLL and the ability of the company to retain cost comfort in Ujala portfolio is high (as manifested by the fact that Ujala fabric whitener has a 74% value market share and a 58% volume share—indicating pricing power and presence of brand equity as entry barrier)

Maxo & Exo grow well; detergents could positively surprise

Maxo continues to grow well, +30% growth for the quarter. It's heartening to see improvement in segment margins for Maxo as it indicates reversal of trade and consumer promotions. We would keenly watch the competitive dynamics in this category which has a crucial bearing on profitability. We believe that the structural growth drivers for the mosquito coil category are intact (lower penetration in India than Bangladesh and Pakistan, unavailability of power in rural areas) and JLL is well placed to capture the growth. Exo registered growth of 78% for the quarter and clocked sales of Rs250 mn for the quarter. Exo market shares are ~5% at national level and over 20% in South India. The recent anti-bacterial campaign by HUL's Vim has in fact helped register Exo's core proposition among consumers. We recall that HUL has launched a me-too product 'Vim anti-bacterial' after Exo was launched on this new differentiated platform. The company is likely to launch Exo nationally post June/July 2009 on a calibrated basis (rather than a full-blown national launch). We believe that growth conditions are conducive for JLL's detergent business (Ujala detergent powder)—product likely to do well in current environment when consumers are looking for premium product at popular price.

Diversification into laundry services is a worry

JLL is diversifying into the services business with the launch of 'Fabric Spa'—laundry services targeting both institutional and retail segment. A new company 'Jyothy Fabricare Services Business Limited' (JFSL) is formed wherein JLL and Mr. Ullas Kamath (Deputy MD) will have 75% and 25% stake, respectively. At a project cost of Rs400 mn (1:1 Debt : Equity), the company is launching the services in Bangalore currently. We highlight that the availability of management bandwidth is the key risk which JLL faces as they diversify into the services business.

Retain ADD, we model 26% earnings CAGR over FY2008-10E

Accounting for higher-than-expected input cost impact and for marginal rolling forward of Exo national launch, we cut earnings estimates for FY2009E and FY2010E by 10% and 7% respectively. We estimate EPS of Rs7.2/share and Rs10.6/share for FY2009E and FY2010E, respectively. We have scaled down our sales estimates by 4% and 3% for FY2009E and FY2010E respectively as well. At the CMP of Rs56/share, the stock trades at 5.2XFY10E. As per management, JLL had Rs13/share of net cash as on December 31, 2008. Retain ADD with a revised TP of Rs127/share (Rs148/share previously). We forecast earnings CAGR of 26% over FY08-10E. At our TP, the stock would trade at 12XFY10E.

The long-term sustainable competitive advantages built by the company are intact—the 'Ujala' brand and a distribution system with direct distribution strength matching that of HUL (which has 40X higher sales to support the distribution breadth and depth).

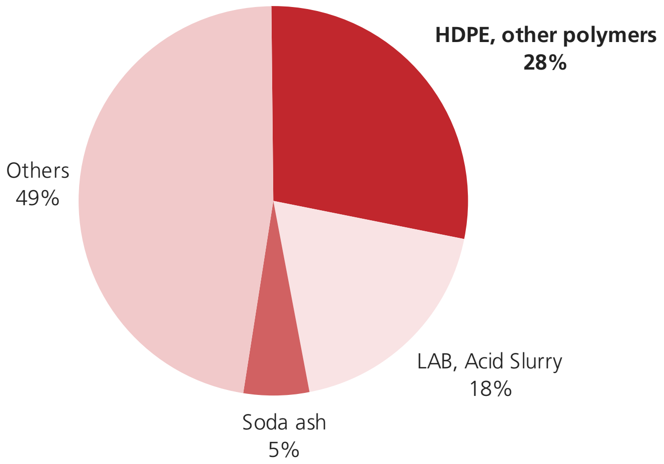
Jyothy Laboratories - Quarterly summary, June yearends (Rs mn)

	2QFY09	2QFY08	yoy % chg
Net sales	**1,192**	**955**	**24.8**
Material cost	(663)	(479)	
Employee cost	(151)	(128)	
Other overheads	(217)	(192)	
- Advertising & Promotions	(65)	(71)	
Total expense	(1,032)	(799)	
EBITDA	**160**	**156**	**2.6**
Depreciation	(23)	(20)	
EBIT	138	136	1.5
Other income	27	23	
Net interest	(1)	(0)	
PBT	**163**	**158**	**3.1**
Tax	(23)	(21)	
PAT	**140**	**137**	**2.0**
Extraordinary Income (loss)	(5)	63	
Net profit	**135**	**200**	**(32.7)**
EBITDA margin (%)	13.4	16.3	
Effective tax rate (%)	14.2	13.2	
Costs as % of net sales			
Material cost	55.6	50.2	
Employee cost	12.7	13.4	
Other overheads	18.2	20.1	
- Advertising & Promotions	5.4	7.5	
Segmental sales			
Soaps and detergent	725	577	25.8
Homecare	466	362	28.8
Others	1	17	(96.8)
Total	**1,192**	**955**	**24.8**
Segment PBIT			
Soaps and detergent	196	190	3.1
Homecare	(12)	(13)	(3.9)
Others	(1)	(0)	729.1
Total	**183**	**178**	**3.0**

Source: Company data, Kotak Institutional Equities.

Siginificant cost comfort emerging in key inputs

Key inputs for Jyothy Laboratories as a % of RMPM



Source : Kotak Institutional Equities

Jyothy Labs, change in estimates, June fiscal year-ends (Rs mn)

	FY09E			FY10E		
	New	Old	Change (%)	New	Old	Change (%)
Sales	4331	4515	(4.1)	4938	5067	(2.5)
EBIDTA	657	730	(10.0)	893	934	(4.5)
Net profit	526	588	(10.6)	772	828	(6.8)
EPS	7.2	8.1	(10.6)	10.6	11.4	(6.8)
Sales growth (%)	15.4	20.3		14.0	12.2	
Profit growth (%)	10.4	23.5		46.8	40.8	

Source: Kotak Institutional Equities estimates.

Jyothy Labs: Profit model, balance sheet, cash model 2006-2010E, June year-ends (Rs mn)

	2006	2007	2008	2009E	2010E
Profit model (Rs mn)					
Net sales	3,019	3,619	3,754	4,331	4,938
EBITDA	**457**	**527**	**629**	**657**	**893**
Other income	121	126	79	108	160
Interest	(1)	(2)	(7)	(10)	(10)
Depreciation	(52)	(58)	(74)	(92)	(100)
Pretax profits	525	594	628	665	943
Tax	(90)	(74)	(152)	(139)	(171)
Net profit	**435**	**520**	**476**	**526**	**772**
Earnings per share (Rs)	**6.0**	**7.2**	**6.6**	**7.2**	**10.6**
Balance sheet (Rs mn)					
Total equity	2,525	2,937	3,286	3,760	4,320
Total borrowings	1	2	2	2	2
Currrent liabilities	291	419	561	463	524
Total liabilities and equity	**2,875**	**3,413**	**3,938**	**4,367**	**5,039**
Cash	1,277	768	955	1,028	1,353
Current assets	672	999	1,061	1,167	1,313
Total fixed assets	909	1,629	1,905	2,155	2,355
Investments	17	17	17	17	17
Total assets	**2,875**	**3,413**	**3,938**	**4,367**	**5,039**
Free cash flow (Rs mn)					
Operating cash flow	511	295	749	497	840
Capital expenditure	(30)	(700)	(344)	(300)	(300)
Investments	(96)	(105)	(171)	(172)	(214)
Free cash flow	**386**	**(509)**	**234**	**25**	**326**
Key assumptions					
Revenue Growth (%)	13.8	19.9	3.7	15.4	14.0
EBITDA Margin(%)	15.1	14.6	16.8	15.2	18.1
EPS Growth (%)	58.1	19.5	(8.4)	10.4	46.8

Source: Kotak Institutional Equities estimates

Consumer products

ASPN.BO, Rs921	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	800
52W High -Low (Rs)	1334 - 826
Market Cap (Rs bn)	88

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	34.2	41.3	46.2
Net Profit (Rs bn)	3.8	3.4	4.3
EPS (Rs)	39.3	35.7	44.3
EPS gth	*40.4*	*(9.2)*	*24.3*
P/E (x)	23.5	25.8	20.8
EV/EBITDA (x)	14.2	15.4	12.0
Div yield (%)	1.8	1.9	2.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
5.5	(5.9)	(17.1)	(8.2)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	50.1	-	-
FIIs	15.3	0.3	(0.1)
MFs	1.5	0.1	(0.2)
UTI	-	-	(0.3)
LIC	8.0	0.6	0.3

Asian Paints: Good business hits bad times

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- **Reasonable topline growth in line with our expectations; higher TiO_2 prices impact margins**
- **Expect a challenging March quarter as well**
- **Revise rating to REDUCE (from ADD) and TP to Rs800/share**

Asian Paints' (APNT) 3QFY09 results were below expectations despite reasonable sales growth. APNT was significantly impacted by higher input prices of Titanium Dioxide (up 25% yoy as per management, TiO_2 accounts for 30% of RM and 20% of net sales). Net sales grew 9.8% yoy versus our expectation of 13.4%. EBITDA and PAT were 48% and 50% lower yoy as APNT was hit due to (1) flat sales volumes, (2) price reduction with retrospective effect, (3) higher consumption costs as the company carried higher cost input inventory and (4) rupee depreciation negating cost comfort in Mineral Turpentine oil, other key RM. We were expecting a muted 2H for paint volumes as suggested by our dipstick survey of dealers in December. However, the extent of high-cost inventory impact on margins came as a surprise. Revisions for FY2009E and FY2010E—Sales 20.9% (24.8% previously) and 11.8% (15.7% previously), EBITDA margin of 12.4% (15.2% previously) and 14.2% (15.2% previously) and EPS decline of 9.2% (15.1% growth previously) and 24.3% (12.6% previously). Net, we model EPS of Rs35.7/share (Rs45.2/share previously) and Rs44.3/share (Rs50.9/share previously). We revise target price to Rs800/share from Rs1075/share. Our TP includes Rs80/share for international operations at a reasonable 6X EV/EBITDA. At our TP, the stock would trade at 16XFY2010E, 20% lower than the 10-year average PE of 19.5X. Revise rating to REDUCE (from ADD).

3QFY2009 profits 57% below estimate despite reasonable topline growth, EBITDA margins decline 890 bps yoy due to very high COGS

APNT's 3QFY09 results disappointed the street despite reasonable topline growth of 9.8% versus our expectation of 13.4%. Management indicated that the decorative paint volumes for the quarter were flat while industrial and automotives declined. In our earlier note dated December 15, 2008 titled *"Color-less in short term"*, we had highlighted that (2) slowdown in new real estate construction and existing home sales and (3) lower consumer confidence could likely act as a dampener to paint sales in near-term. We were expecting a muted 2H for paint volumes as suggested by our dipstick survey of dealers in December. Higher primary sales in 1H as stockists increased the inventory levels in anticipation of price increases was also a reason.

However, the extent of high-cost inventory impact on margins was a surprise. APNT was significantly impacted by higher input prices of Titanium Dioxide (up 25% yoy as per management, TiO_2 accounts for 30% of RM and 20% of net sales). EBITDA and PAT were 48% and 50% lower yoy as APNT was hit due to (1) flat sales volumes, (2) price reduction with retrospective effect, (3) higher consumption costs as the company carried higher cost input inventory and (4) rupee depreciation negating cost comfort in Mineral Turpentine oil, other key RM.

What to expect in the near term?

Management expects firm TiO_2 prices to sustain during the March quarter as well, whereas the impact of old higher priced RM inventory would be lower. Moreover, modest benefits due to a correction in crude-linked inputs are also expected (MTO or mineral turpentine oil being the key). Net, we forecast a challenging March quarter as well—sales growth of 10% (mostly pricing benefit of 1HFY09), EBITDA margin decline of 410 bps and PAT decline of 16.7%.

We believe that continuing Sixth Pay Commission payouts would likely prevent a sharp deceleration in paint sales in 1HCY09E. However, we would temper expectations that the Sixth Pay Commission payouts will provide support for a significant period of time as we believe (1) government employees typically reside in government-owned quarters and hence may chose not to spend on painting and (2) even though government employees have job security, we believe they would tend to batten down after seeing the decline in overall consumer confidence is observed across the economy, chosing to play safe by saving rather than spending.

What are the buffers?

An analysis of the correlation between the company's paints volume growth vis-à-vis GDP growth rate indicates a lag correlation of 0.65 (GDP growth in year 1 versus paints volume growth in year 2). Moreover, the mean and mode of the multiplier relationship between paints volume growth and GDP growth works out to 2.1 (please refer to Exhibits at the end of this note). We model 11.8% sales growth for FY10E (10% volume growth and 1% realization growth) inline with long-term correlation trends with GDP.

Our trade sources indicate that the demand for exterior paints continues to be strong led by South Indian states—augurs well for the company as exteriors account for about one-third of sales. The sales of low-end primers / wood finishes / ancillaries are areas of concern while sales of emulsions are expected to provide buffer. In our view, the likely sales mix of APNT is Emulsions 35%, Distempers 20%, Enamels 25% and Primers / wood finishes / ancillaries 20%. While we agree that initial painting in new construction can be usually done with cheaper quality paints, consumer trading down in repainting is sub-optimal for consumer and is generally avoided.

After a 15% price increase in 1HFY09, the company implemented a 7% reduction in prices in 3QFY09. However, the management indicated that the intent is "*to meet planned profits even if volumes fall*". We endorse the management's strategy as we believe the current demand condition is constrained by a lack of consumer confidence, hence the ability to activate demand through price reductions is limited. However, we believe that Asian Paints is likely to resort to price cuts inline with competition to maintain market shares.

Downgrade to REDUCE (from ADD), TP revised to Rs800/share (Rs1,075/share previously)

Earnings revisions for FY2009E and FY2010E—Sales 20.9% (24.8% previously) and 11.8% (15.7% previously), EBITDA margin of 12.4% (15.2% previously) and 14.2% (15.2% previously) and EPS decline of 9.2% (15.1% growth previously) and 24.3% (12.6% previously). Net, we model EPS of Rs35.7/share (Rs45.2/share previously) and Rs44.3/share (Rs50.9/share previously). We revise target price to Rs800/share from Rs1075/share. Our TP includes Rs80/share for international operations at a reasonable 6X EV/EBITDA. At our TP, the stock would trade at 16X FY2010E, 20% lower than the 10-year average PE of 19.5X. Over the past five years, the minimum, maximum and average P/E commanded by Asian Paints stock was 15.9X, 31.5X, 22.2X, respectively, and the average over the last ten years was 19.5X. Revise rating to REDUCE (from ADD).

Exhibit 1: Asian Paints (unconsolidated) quarterly summary, March yearends (Rs mn)

		yoy		Our est.	yoy
	3QFY09	3QFY08	% chg	3QFY09	% chg
Net sales	**10,064**	**9,162**	**9.8**	**10,386**	**13.4**
Material cost	(6,371)	(5,262)		-	
Employee cost	(598)	(494)		-	
Other overheads	(2,300)	(1,865)		-	
Total expense	(12,255)	(10,114)		-	
EBITDA	**795**	**1,541**	**(48.4)**	**1,747**	**13.3**
Depreciation	(158)	(112)		(161)	
EBIT	637	1,430		1,586	
Other income	174	169		202	
Net interest	(26)	(27)		(25)	
PBT	**785**	**1,572**	**(50.0)**	**1,764**	**12.2**
Tax	(279)	(494)		(585)	
PAT	**506**	**1,077**	**(53.0)**	**1,178**	**9.4**
Extraordinary income (loss)	(5)	(1)			
Net profit	**501**	**1,077**	**(53.5)**	**1,178**	**9.4**
EBITDA margin (%)	7.9	16.8		16.8	
Effective tax rate (%)	35.5	31.4		33.2	
Costs as % of net sales					
Material cost	63.3	57.4			
Employee cost	5.9	5.4			
Other overheads	22.9	20.4			

Source: Company data, Kotak Institutional Equities

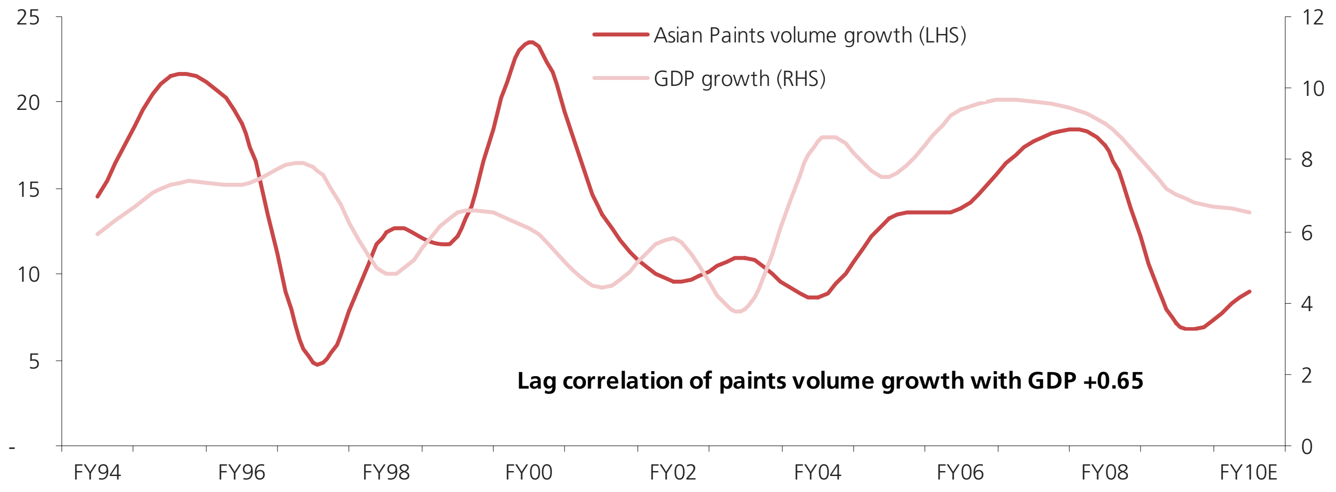
Asian Paints (Consolidated) quarterly summary, March yearends (Rs mn)

		yoy	
	3QFY09	3QFY08	% chg
Net sales	**13,210**	**11,776**	**12.2**
Total operating expenses	(12,117)	(9,921)	
EBITDA	**1,093**	**1,856**	**(41.1)**
Depreciation	(202)	(150)	
EBIT	891	1,706	
Other income	122	132	
Net interest	(66)	(54)	
PBT	**946**	**1,783**	**(46.9)**
Tax	(291)	(537)	
PAT	**656**	**1,246**	**(47.4)**
Extraordinary income (loss)	(6)	(0)	
Minority interest & share of profit in associates	(60)	(58)	
Net profit	**590**	**1,189**	**(50.3)**
EBITDA margin (%)	8.3	15.8	
Effective tax rate (%)	30.7	30.1	

Source: Company data, Kotak Institutional Equities

Exhibit 2: Paints volume growth has high correlation to GDP growth

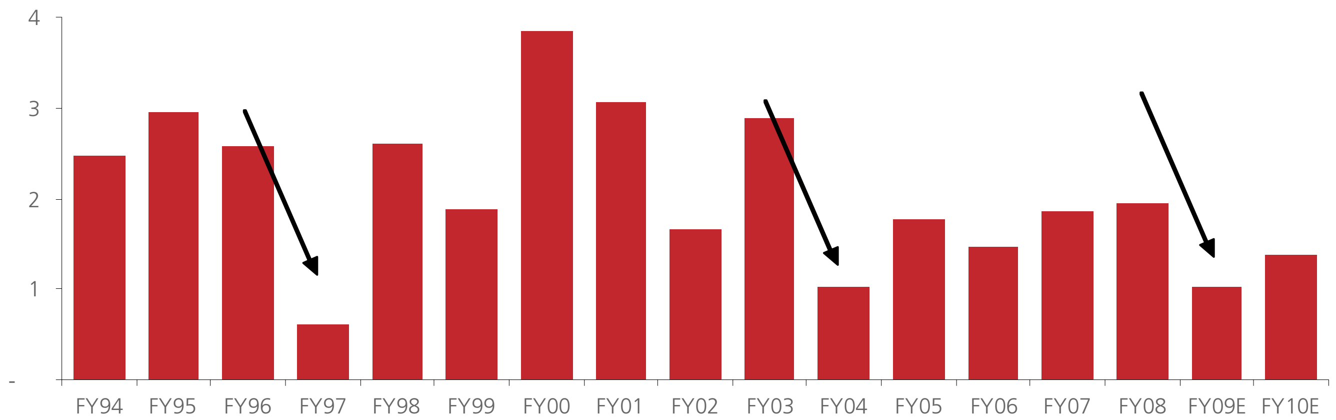
Asian Paints' volume growth and India's GDP growth (%)



Source: Kotak Institutional Equities

Exhibit 3: Volume growth in FY10E likely cushioned by ability to ignite demand by price reductions

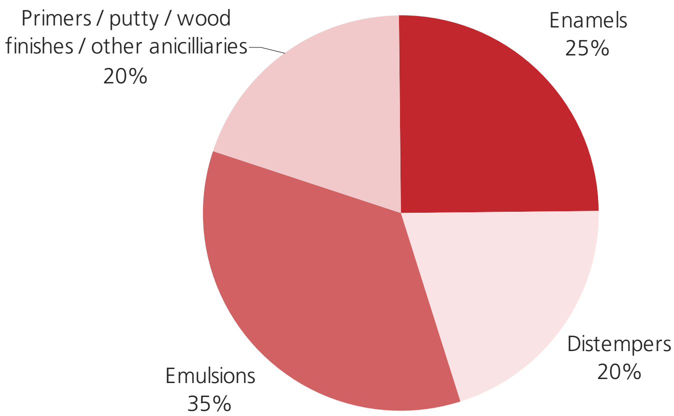
Index of Asian Paints' volume growth to GDP growth (X)



Source: Kotak Institutional Equities

Exhibit 4: Asian Paints' decorative business is dominated by emulsions

Asian Paints estimated sales mix, %



Source : Industry sources, Kotak Institutional Equities

Exhibit 5: Mix deterioration is a significant risk

Indexed price to paint 1 square feet area using emulsions, distempers and enamels of Asian Paints

	Painting	Re-painting
Emulsions		
Interior Wall Finish - Lustre	100	73
Interior Wall Finish - Matt	100	73
Premium Emulsion	90	64
Tractor Emulsion	84	58
Distempers		
Tractor Acrylic Distemper	71	47
Tratcor Synthetic Distemper	56	43
Utsav Acrylic Distemper	46	34
Enamels		
Luxury Ultra Gloss Enamel	77	58
Apcolite Premium Gloss Enamel	59	44
Apcolite Premium Satin Enamel	59	46
Premium Semi Gloss Enamel	46	34
Gattu General Purpose Synthetic Enamel	39	28

Source : Market sources, Kotak Institutional Equities

Exhibit 6: Asian Paints, change in estimates, March fiscal year-ends (Rs mn)

	FY09E			FY10E		
	New	Old	Change (%)	New	Old	Change (%)
Sales	41311	42649	(3.1)	46185	49330	(6.4)
EBIDTA	5105	6494	(21.4)	6576	7516	(12.5)
Net profit	3421	4335	(21.1)	4253	4880	(12.8)
EPS	35.7	45.2	(21.1)	44.3	50.9	(12.8)
Sales growth (%)	20.9	24.8		11.8	15.7	
Profit growth (%)	(9.2)	15.1		24.3	12.6	
EBITDA margin (%)	12.4	15.2		14.2	15.2	

Source: Kotak Institutional Equities estimates.

Exhibit 7: Asian Paints: Profit model, balance sheet, cash model 2006-2011E, March fiscal year-ends (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)						
Net sales	**23,112**	**28,196**	**34,170**	**41,311**	**46,185**	**52,147**
EBITDA	**3,439**	**4,200**	**5,540**	**5,105**	**6,576**	**7,476**
Other income	439	405	626	675	738	875
Interest	(38)	(69)	(83)	(92)	(141)	(141)
Depreciation	(455)	(454)	(438)	(589)	(801)	(846)
Pretax profits	3,384	4,082	5,645	5,099	6,372	7,363
Tax	(1,171)	(1,400)	(1,880)	(1,679)	(2,119)	(2,465)
Net profits	**2,213**	**2,682**	**3,766**	**3,421**	**4,253**	**4,898**
Earnings per share (Rs)	**23.1**	**28.0**	**39.3**	**35.7**	**44.3**	**51.1**
Dividend per share (Rs)	**12.5**	**13.0**	**15.0**	**17.5**	**20.0**	**22.5**
Balance sheet (Rs mn)						
Total equity	6,223	7,441	9,285	10,742	12,750	15,123
Total borrowings	911	1,257	947	1,647	1,647	1,647
Currrent liabilities	5,408	6,482	9,516	12,025	13,195	14,946
Deferred tax liability	285	221	315	359	398	357
Total liabilities and equity	**12,827**	**15,401**	**20,063**	**24,773**	**27,990**	**32,073**
Cash	284	425	414	567	1,537	3,218
Current assets	6,550	8,167	10,029	12,611	13,909	15,672
Total fixed assets	3,247	3,465	5,392	7,303	8,252	8,891
Investments	2,746	3,344	4,229	4,229	4,229	4,229
Total assets	**12,827**	**15,401**	**20,063**	**24,710**	**27,926**	**32,009**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	2,150	2,802	4,176	3,753	4,804	5,368
Working capital	(522)	282	27	(87)	(314)	(191)
Capital expenditure	(507)	(673)	(2,365)	(2,500)	(1,750)	(1,485)
Investments etc	(1,048)	(2,171)	(1,914)	(949)	(1,770)	(2,010)
Free cash flow	**73**	**241**	**(75)**	**217**	**970**	**1,681**
Key assumptions (%)						
Revenue growth	19.8	22.0	21.2	20.9	11.8	12.9
EBITDA margin	14.9	14.9	16.2	12.4	14.2	14.3
EPS growth	24.3	21.2	40.4	(9.2)	24.3	15.2

Source: Kotak Institutional Equities estimates.

Property

DLF.BO, Rs161	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	235
52W High -Low (Rs)	980 - 144
Market Cap (Rs bn)	275

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	144.4	125.1	118.8
Net Profit (Rs bn)	78.6	58.1	46.3
EPS (Rs)	46.1	34.1	27.2
EPS gth	*263.2*	*(26.1)*	*(20.3)*
P/E (x)	3.5	4.7	5.9
EV/EBITDA (x)	3.9	5.1	5.7
Div yield (%)	2.5	2.5	2.5

Property

UNTE.BO, Rs27	
Rating	SELL
Sector coverage view	Neutral
Target Price (Rs)	24
52W High -Low (Rs)	459 - 22
Market Cap (Rs bn)	44

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	41	36	36
Net Profit (Rs bn)	16.8	11.2	8.9
EPS (Rs)	10.3	6.9	5.5
EPS gth	*28.5*	*(33.4)*	*(20.5)*
P/E (x)	2.6	3.9	4.9
EV/EBITDA (x)	5.2	6.8	8.1
Div yield (%)	0.9	-	-

DLF Limited, Unitech: Housing finance, technology companies—3QFY09 results indicate worsening conditions; revise estimates for DLF, Unitech

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- **HDFC approvals for 3QFY09 decline yoy as well as qoq; worst growth since 1994**
- **Technology companies guiding for lower growth and continued challenging environment; will affect commercial demand**
- **Unitech will likely have limited equity value; target price becoming meaningless**
- **Revise DLF's rating to ADD (from BUY) and Unitech's rating to SELL (from REDUCE)**

We revisit our estimates for FY2009-11E for DLF and Unitech post weak results by housing finance companies and weak guidance by technology companies. HDFC's approvals for 3QFY09 declined 8% yoy, indicating lower residential demand. Technology companies have guided for difficult conditions. Lower-than-expected growth for IT companies will limit hiring, further affecting commercial real estate demand. We also drop projects of Unitech in Southern India as there have been excessive delays in launches. Furthermore, high customer advance of Unitech indicate that cashflows will depend on new launches, which we find very limited. We find that equity value of Unitech is becoming very limited and NAV calculation is becoming a meaningless exercise. We revise our rating for Unitech to SELL (REDUCE earlier) and target price to Rs24 from Rs45 for Unitech. Our NAV is revised to Rs334 for DLF (Rs410 earlier) and we increase discount to NAV to 30% from 20% earlier. Consequently, our target price for DLF is revised to Rs235 (Rs325 earlier) and we revise our rating to ADD (BUY earlier).

Housing finance companies see decline in loan approvals indicating low demand

HDFC's disbursements grew by 18% in 3QFY09. This is below the previous quarters—28% and 23% yoy in 1QFY09 and 2QFY09, respectively. Loan approvals declined 8% yoy which will likely imply lower growth in the forthcoming quarters. We note that HDFC has consistently delivered over 20% disbursements growth since 1994 (Exhibit 1). The company has reported 22% disbursements growth over the past nine months. In the previous cycle demand pick-up took 12-14 months and we expect demand pick-up will exhibit a similar behaviour in the current cycle as well. We delay new launches of both DLF and Unitech by 6-12 months.

Revise estimates to factor in lower commercial revenues

Continued slowdown in IT will affect commercial demand, and hence we reduce our volume assumptions by further 20% for FY2010-11E and now estimate 50% de-growth for FY2010E versus 30% earlier. Various IT managements have guided for continued slowdown ahead and thus IT hirings are going to be subdued resulting in lower commercial demand. We assume lower new launches and slower construction as DLF, Unitech realign construction with client occupation plans. We note that amongst real estate companies, DLF is one of the few companies to have resources and a good quality land bank and will likely benefit from lower competition as demand improves.

We drop Unitech's South India projects as all projects have been delayed by 2-3 years

Unitech has 177 mn sq. ft (42% of total land bank under consideration for valuation) in three cities of South India viz. Hyderabad, Kochi and Chennai. However, it is yet to launch a single project in this region. Exhibit 2 highlights Unitech's initial plan for project launches according to which 14 projects were to be launched in FY2008. Most of the projects that had to become operational in the past 24 months are yet to start such as Faridabad (earlier expected start April 2007), Chennai (November 2006 and June 2007), Kochi (February 2007, September 2007 and December 2007), and Hyderabad (December 2006, February 2007 and October 2007).

We are dropping Unitech projects in Southern India as there is limited visibility of project launches. We would incorporate them into our model as and when launches take place.

Calculation of Unitech's target price is becoming a meaningless exercise. Currently, larger portion of Unitech's EBITDA is going into making interest payments. Unitech needs to make interest payments of Rs3.5 bn/quarter at an average cost of 14% while its average EBIDTA for the past three quarters has been Rs6 bn thus leaving limited surplus for debt repayments. Consequently, surplus available for equity shareholders is going to be even more limited. Operational momentum in the company is weak with limited launches in the past 3-4 quarters and thus debt serviceability will likely worsen in our view. Furthermore, Unitech has large customer advances of Rs67 bn indicating cashflows from ongoing projects will lag EBITDA.

We reduce our revenue estimates to Rs36.2 bn (earlier Rs39.7 bn) in FY2009E and Rs36.2 bn (earlier Rs42.1 bn) in FY2010E to reflect changes. Our NAV is revised to Rs47/share (Rs90 earlier). Our NAV include Rs20 for telecom business after factoring in 20% holding company discount. Unitech has large debt of Rs50/share (as of September 2008), thus making NAV calculations very sensitive. We would keenly watch for improvement in financial position and higher operational activity.

Revise DLF estimates to factor in lower commercial revenues, residential demand

We have lowered our commercial volume estimates by 36% to 18.5 mn sq. ft in FY2009-11 period versus 29 mn sq. ft assumed earlier. We also assume lower residential volumes by 25-30% for FY2009-10E thus resulting in sales of 23 mn sq. ft for FY2009-10E as against 10 mn sq. ft in the second half of FY2008 inspite of large number of new launches at reduced prices. DLF is in the process of launching projects across multiple locations—Hyderabad (Kompally, Kokapet), Gurgaon (Regal Towers), Pune (Talegaon) and Delhi (SBM).

Accordingly, we revise our FY2009E and FY2010E revenue estimates to Rs125 bn (Rs144 bn earlier) and Rs119 bn (Rs164 bn earlier) and PAT estimates to Rs58 bn (Rs68 bn earlier) and Rs46 bn (Rs65 bn earlier). For our NAV calculations, we also drop receivables of Rs50 bn (Rs29/share) to be on the conservative side. Our revised NAV is Rs334/share (earlier Rs410/share) after incorporating new estimates. Our revised target price is Rs235/share (earlier Rs325/share) which is based on a 30% discount to our March 2010-based NAV. We have increased discount to NAV to 30% from 20% to factor in higher uncertainty of project launches on the commercial as well as residential side.

We reduce our EPS estimates to account for lower commercial and residential volumes

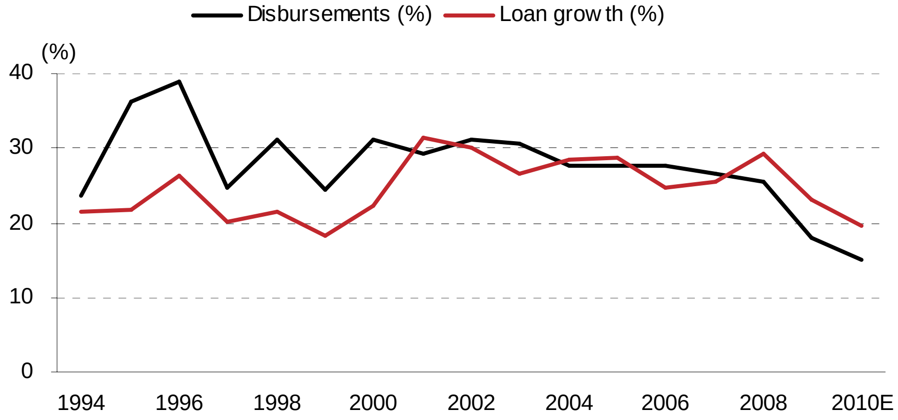
Changes in our EPS estimates for FY2009E, FY2010E (Rs)

	Rating		New TP	Old TP	TP change	New NAV	Old NAV	NAV change	New EPS estimates		Old EPS estimates		% change in EPS	
	New	Old	(Rs/share)	(Rs/share)	(%)	(Rs/share)	(Rs/share)	(%)	FY2009E	FY2010E	FY2009E	FY2010E	FY2009E	FY2010E
DLF	ADD	BUY	235	325	(27.7)	334	410	(18.4)	33.8	26.9	39.4	37.7	(14.3)	(28.6)
Unitech	SELL	REDUCE	24	45	(46.7)	47	90	(47.3)	6.9	5.5	8.1	7.6	(15.1)	(28.1)

Source: Kotak Institutional Equities estimates.

HDFC's disbursement growth has been above 20% since FY1994

YoY growth in disbursements and outstanding loans, March fiscal year-ends, 1994-2010E (%)



Source: Company, Kotak Institutional Equities estimates

Unitech's projects have been significantly delayed

Launch schedule for Unitech projects post October 2006

	Area			Original schedule		
	(acres)	(mn sq. ft)	Stake (%)	Start date	End date	Current status
Gurgaon						
G1	258	3.8	50	Oct-07	Oct-10	Not launched
G5	21	1.8	62	Nov-06	May-09	Launched
G8	4	0.4	65	Apr-07	Apr-10	Not launched
G9	4	0.3	42.5	Aug-07	Aug-10	Not launched
G10	7	0.7	67	Apr-07	Apr-10	Not launched
G12	410	14.2	50	Jun-07	Jun-13	Not launched
Faridabad						
F1	10	0.9	75	Apr-07	Apr-10	Not launched
Noida						
N2	340	16.6	51	Jan-07	Jan-12	Launched a small portion
Greater noida						
GN1	183	15.8	100	Mar-07	Nov-11	Launched a small portion
Kolkata						
K2	100	6.7	45	Mar-07	Mar-13	Launched
K3	4,840	142.2	40	Jan-08	Jan-20	Not launched
Chennai						
C1	2,040	101.1	100	Jun-07	Jun-13	Not launched
C2	45	4.1	50	Nov-06	Nov-09	Not launched
Kochi						
K1	353	21.3	100	Sep-07	Apr-12	Not launched
K2	70	7.6	90	Dec-07	Dec-11	Not launched
K3	250	9.5	75	Feb-07	Feb-11	Not launched
Bangalore						
B1	36	4.0	100	Sep-07	Mar-11	Not launched
B3	53	5.8	67	Jan-07	Apr-10	Launched
Hyderabad						
H1	119	9.4	100	Feb-07	Oct-11	Not launched
H2	36	3.8	65	Feb-07	Feb-10	Not launched
H3	120	5.5	75	Dec-06	Dec-10	Not launched
H4	84		50	Oct-07	Oct-11	Not launched
Mohali						
M1	350	12.0	100	Jun-07	Jun-12	Launched
Agra						
A1	1,500	31.3	100	Aug-07	Aug-15	
Varanasi						
V1	1,500	34.0	100	Aug-07	Aug-15	

Source: Unitech corporate presentation, September 2006.

Unitech's March' 10 based target price is Rs24/share

	March '10 based NAV			
	Growth rate in selling prices per annum			
	0%	3%	5%	10%
Valuation of land reserves	**102**	**120**	**133**	**172**
Residential projects	44	58	68	99
Commercial projects	28	30	32	35
Retail projects	29	32	33	37
Add: Hotel business	10	10	10	10
Add: Consultancy fees received from Unitech Corporate Parks, JVs	10	10	10	10
Less: Net debt as on March 31, 2009	(89)	(89)	(89)	(89)
Less: Land cost to be paid as on March 31, 2009	(20)	(20)	(20)	(20)
NAV (Rs bn)	14	31	44	83
NAV/share (Rs)	8	19	27	51
Valuation for telecom business	**33**	**33**	**33**	**33**
Total no. of shares (mn)				**1,624**
Valuation/share (Rs)				**47**
Target price@50% discount to NAV				**24**

Source: Kotak Institutional Equities estimates

We have removed all the land bank in South India from the consideration set

	Land area	March' 2010 based NAV (Rs bn)			
Location	**mn sq. ft**	**0%**	**3%**	**5%**	**10%**
Bangalore	0	0	0	0	0
Chennai	0	0	0	0	0
Delhi	0.3	2	2	2	2
Faridabad	1	0	0	0	0
Greater NOIDA	19	10	11	11	13
Gurgaon	50	43	46	48	55
Hyderabad	0	0	0	0	0
Kochi	0	0	0	0	0
Kolkata	109	8	16	23	43
Mohali	13	2	3	3	5
Noida	22	27	29	31	35
Siliguri	13	(0)	0	1	1
Vishakapatnam	0	0	0	0	0
Mumbai	4	11	13	14	17
Total	**230**	**102**	**120**	**133**	**172**

Source: Kotak Institutional Equities estimates

Revenue model of Unitech Ltd, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008E	2009E	2010E	2011E
Apartments						
Apartment volumes (mn sq. ft)	—	—	6.2	5.0	5.2	5.3
Revenues	5,110	12,970	20,357	15,493	16,365	17,270
Rate/sq. ft	—	—	3,302	3,101	3,133	3,264
Commercial						
Commercial volumes (mn sq. ft)	—	—	1.4	1.1	1.6	2.3
Revenues	—	—	7,531	6,360	8,784	12,228
Rate/sq. ft	—	—	5,385	5,850	5,480	5,255
Plot sales						
Plot sale volumes (mn sq. ft)	—	—	1.6	3.0	—	—
Revenues	—	—	1,439	2,467	—	—
Rate/sq. ft	—	—	900	831	—	—
Retail rental revenues						
Total retail stock	—	—	1	1	1	3
Total retail lease rentals	—	—	1,409	1,409	1,268	1,347
Rate/sq. ft	—	—	189	189	170	513
Construction revenues,sale of transmission towers	2,656	3,389	2,834	2,543	2,302	2,105
Sale of investments	—	15,788	4,000	4,000	3,000	—
Income from Unitech Corporate Parks	—	—	1,245	1,374	1,465	1,550
Revenues from real estate	**7,766**	**32,148**	**38,816**	**33,646**	**33,184**	**34,500**
Others	1,647	736	5,380	2,556	2,974	3,466
Revenues	**9,412**	**32,883**	**44,196**	**36,202**	**36,158**	**37,966**
% growth	43	249	34	(18)	—	5
Revenue mix (%)						
Housing	54.3	39.4	46.1	42.8	45.3	45.5
Commercial	—	—	17.0	17.6	24.3	32.2
Plot development	—	—	3.3	6.8	—	—
Retal rental revenues	—	—	3.2	3.9	3.5	3.5
Others	45.7	60.6	30.5	28.9	26.9	18.8
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Kotak Institutional Equities estimates

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

	2006	2007	2008	2009E	2010E	2011E
Total revenues	**9,412**	**32,883**	**41,400**	**36,202**	**36,158**	**37,966**
Land costs	(1,971)	—	—	(1,878)	(2,242)	(3,293)
Construction costs	(4,165)	(11,167)	(14,159)	(11,746)	(13,167)	(15,128)
Employee costs	(366)	(568)	(1,067)	(1,468)	(1,909)	(2,481)
SG&A costs	(1,077)	(1,129)	(3,888)	(1,539)	(1,537)	(1,614)
EBITDA	**1,834**	**20,018**	**22,287**	**19,572**	**17,305**	**15,451**
Other income	133	1,000	1,401	1,184	1,254	1,332
Interest	(465)	(3,020)	(2,804)	(5,860)	(6,631)	(9,327)
Depreciation	(112)	(80)	(205)	(250)	(296)	(400)
Pretax profits	**1,390**	**17,919**	**20,678**	**14,646**	**11,632**	**7,055**
Extraordinary items	—	—	—	—	—	—
Current tax	(521)	(4,864)	(3,967)	(3,470)	(2,713)	(1,271)
Deferred tax	8	—	(19)	(14)	(49)	(21)
Net income	**874**	**13,055**	**16,692**	**11,163**	**8,869**	**5,763**
Adjusted net income	**874**	**13,055**	**16,614**	**11,163**	**8,869**	**5,763**
EPS (Rs)						
Primary	0.5	8.0	10.2	6.9	5.5	3.5
Fully diluted	0.5	8.0	10.2	6.9	5.5	3.5
Shares outstanding (mn)						
Year end	1,623	1,623	1,623	1,623	1,623	1,623
Primary	1,623	1,623	1,623	1,623	1,623	1,623
Fully diluted	1,623	1,623	1,623	1,623	1,623	1,623
Cash flow per share (Rs)						
Primary	0.8	10.8	12.2	2.4	0.5	0.2
Fully diluted	0.8	10.8	12.2	2.4	0.5	0.2
Growth (%)						
Net income (adjusted)	151.0	1,394	27.3	(32.8)	(20.5)	(35.0)
EPS (adjusted)	151.0	1,394	27.3	(32.8)	(20.6)	(35.0)
DCF/share	150.5	1,217	13.3	(80.3)	(80.1)	(66.7)
Cash tax rate (%)	37.5	27.1	19.2	23.7	23.3	18.0
Effective tax rate (%)	36.9	27.1	19.3	23.8	23.7	18.3

Source: Kotak Institutional Equities estimates

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

	2006	2007	2008E	2009E	2010E	2011E
Equity						
Share capital	125	1,623	3,247	3,247	3,247	3,247
Reserves/surplus	2,472	18,320	32,757	43,920	52,787	58,550
Total equity	**2,597**	**19,944**	**36,003**	**47,167**	**56,034**	**61,797**
Deferred tax liability/(asset)	151	20	60	74	123	144
Liabilities						
Secured loans	9,557	39,499	62,311	81,325	80,026	81,026
Unsecured loans	893	306	23,212	23,212	22,369	22,369
Total borrowings	**10,449**	**39,805**	**85,524**	**104,537**	**102,394**	**103,394**
Currrent liabilities & Provisions	31,087	71,118	111,048	87,933	76,425	69,259
Minority Interest	237	13	1,159	1,159	1,159	1,159
Total capital	**44,521**	**130,900**	**233,793**	**240,868**	**236,134**	**235,752**
Assets						
Cash	3,899	10,227	14,083	16,025	5,773	439
Current assets	34,762	106,851	172,979	167,408	171,059	173,633
Gross block	4,530	6,470	11,120	11,241	13,063	13,722
Less: accumulated depreciation	911	475	661	911	1,207	1,607
Net fixed assets	3,620	5,995	10,459	10,330	11,857	12,115
Capital work-in-progress	1,268	2,153	20,982	21,815	22,155	24,275
Total fixed assets	**4,887**	**8,148**	**31,442**	**32,145**	**34,011**	**36,390**
Intangible assets	824	1,126	1,126	1,126	1,126	1,126
Investments	145	4,548	14,165	24,165	24,165	24,165
Misc. expenses	5	—	—	—	—	—
Total assets	**44,522**	**130,900**	**233,794**	**240,869**	**236,134**	**235,753**
Key ratios (%)						
Debt/equity	380.3	199.4	237.1	221.3	182.3	166.9
Debt/capitalization	79.2	66.6	70.3	68.9	64.6	62.5
Net debt/equity	238.4	148.2	198.1	187.4	172.1	166.2
Net debt/capitalization	70.4	59.7	66.5	65.2	63.2	62.4
RoAE	**36.2**	**115.0**	**59.3**	**26.8**	**17.2**	**9.8**
RoACE	**12.2**	**41.8**	**20.9**	**11.4**	**9.0**	**8.3**

Source: Kotak Institutional Equities estimates

Our target price for DLF is Rs235/share

NAV sensitivity for DLF for different growth rate in selling prices

		March '10 based NAV			
		Growth rate in selling prices (%)			
	Valuation methodology	**0%**	**3%**	**5%**	**10%**
Valuation of land reserves		**536**	**609**	**662**	**816**
Residential		163	197	223	298
Retail		181	196	207	239
Commercial		192	215	232	279
Add: 22 Hotel sites	1X land acquisition cost	25	25	25	25
Add: Construction JV	5X FY2010E P/E	12	12	9	12
Add: Investments in power business		15	15	15	15
Less: Net debt as on March 31, 2009		(115)	(115)	(115)	(115)
Less: Land cost to be paid as on March 31, 2009		(20)	(20)	(20)	(20)
NAV (Rs bn)		453	526	576	733
NAV/share (Rs)		**263**	**305**	**334**	**426**
Target price@30% discount to NAV				**234**	

Source: Kotak Institutional Equities estimates

We value DLF's land bank at Rs727 bn

Key details of developable area (mn sq. ft) and NAV (Rs bn)

	Land area	NAV (Rs bn) Growth rates in selling prices (%)			
	(mn sq. ft)	0%	3%	5%	10%
Bangalore	31.1	12	14	16	20
Chandigarh	22.4	6	9	11	18
Chennai	33.2	22	25	27	34
Coimbatore	0.7	1	1	1	1
Delhi	37.0	106	115	122	141
Goa	22.4	10	13	15	20
Gujarat	13.9	21	24	27	34
Gurgaon	228.8	211	242	265	332
Haryana	5.9	10	11	12	14
HP	0.5	0	0	0	0
Hyderabad	46.6	33	39	43	54
Jaipur	0.3	1	1	1	1
Kerala	7.8	4	4	5	6
Kolkata	8.9	6	6	6	6
Lucknow	9.8	1	1	2	3
Indore	5.6	3	3	4	5
Mumbai	9.8	38	42	44	52
Nagpur	12.0	8	10	12	17
Noida	10.5	23	25	26	31
Orissa	2.0	3	3	4	4
Pune	8.4	4	5	5	7
Punjab	5.3	11	12	13	14
UP	1.6	3	3	3	3
Total	**524.5**	**536**	**609**	**662**	**816**

Source: Kotak Institutional Equities estimates

Revenue model of DLF, March fiscal year-ends, 2005-2010E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Housing						
Housing volumes (mn sq. ft)	1.5	1.9	6.7	7.8	12.8	18.5
Revenues	3,818	9,732	32,677	36,226	37,910	57,376
Rate/sq. ft	2,624	5,145	4,887	4,634	2,966	3,103
Commercial						
Commercial volumes (mn sq. ft)	0.5	4.4	8.0	6.1	4.5	4.5
Revenues	3,997	19,041	56,322	42,401	27,008	23,323
Rate/sq. ft	—	4,306	7,061	6,948	5,963	5,230
Retail						
Retail volumes (mn sq. ft)	0.1	0.9	2.3	2.9	3.8	4.0
Revenues	213	8,823	35,000	32,805	33,811	29,147
Rate/sq. ft	2,742	9,431	15,196	11,463	8,864	7,269
Retail (leased)						
Cumulative volumes (mn sq. ft)	—	—	—	0.5	1.3	4.2
Revenues	—	—	—	1,157	3,438	5,376
Rate/sq. ft/month	—	—	—	214	224	106
Commercial (leased)						
Cumulative volumes (mn sq. ft)	—	3.0	3.0	7.7	11.1	11.1
Revenues	422	1,546	3,010	5,808	7,160	8,081
Rate/sq. ft/month	—	50	60	63	54	61
Revenue from real estate	**9,622**	**39,143**	**127,008**	**118,397**	**109,329**	**123,303**
Others	1,915	2,200	7,934	6,693	9,452	11,696
Revenues	**11,536**	**41,343**	**134,943**	**125,090**	**118,780**	**135,000**
% growth	89.7	258.4	226.4	(7.3)	(5.0)	13.7
Revenue mix (%)						
Housing	33.1	23.5	24.2	29.0	31.9	42.5
Commercial	34.6	46.1	41.7	33.9	22.7	17.3
Retail	1.8	21.3	25.9	26.2	28.5	21.6
Leased property	3.7	3.7	2.2	5.6	8.9	10.0
Others	16.6	5.3	5.9	5.4	8.0	8.7
Total	**90**	**100**	**100**	**100**	**100**	**100**

Note:
(a) For FY2004-FY2006, full details of revenues by category is not available. Thus, the sum of indivudal revenue categories does not add up to reported revenues.

Source: Kotak Institutional Equities estimates

Profit model of DLF, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Total revenues	**11,536**	**39,233**	**144,375**	**125,090**	**118,780**	**135,000**
Land costs	(4,416)	(6,319)	(37,774)	(10,049)	(11,794)	(19,213)
Construction costs	—	—	(2,223)	(30,301)	(35,468)	(46,141)
Employee costs	(397)	(922)	(2,998)	(3,214)	(3,815)	(4,836)
SG&A costs	(1,966)	(3,958)	(4,229)	(5,211)	(4,449)	(4,332)
EBITDA	**4,757**	**28,034**	**97,151**	**76,314**	**63,254**	**60,477**
Other income	883	1,108	2,464	3,358	2,592	3,873
Interest	(1,685)	(3,076)	(3,100)	(3,424)	(4,273)	(2,188)
Depreciation	(361)	(571)	(901)	(2,712)	(3,106)	(4,307)
Pretax profits	**3,594**	**25,494**	**95,614**	**73,536**	**58,468**	**57,855**
Profit/(loss) share of associates	—	—	—	—	—	—
Current tax	(2,537)	(6,058)	(17,146)	(15,649)	(12,619)	(17,415)
Deferred tax	870	—	(176)	235	470	507
Net income	**1,927**	**19,436**	**78,293**	**58,122**	**46,318**	**40,946**
Reported net income	**1,917**	**19,425**	**78,203**	**58,122**	**46,318**	**40,946**
EPS (Rs)						
Primary	12.7	13.0	47.1	34.1	27.2	24.0
Fully diluted	12.7	13.0	46.7	33.8	26.9	23.8
Shares outstanding (mn)						
Year end	1,511	1,530	1,705	1,705	1,705	1,705
Primary	152	1,496	1,661	1,705	1,705	1,705
Fully diluted	152	1,496	1,678	1,722	1,722	1,722
Cash flow per share (Rs)						
Primary	18.4	4.2	46.4	28.9	23.5	21.8
Fully diluted	18.4	4.2	45.9	28.6	23.3	21.6
Growth (%)						
Net income (adjusted)	122	913	303	(26)	(20)	(12)
EPS (adjusted)	103	2	259	(28)	(20)	(12)
DCF/share	273	(77)	1,000	(38)	(19)	(7)
Cash tax rate (%)	70.6	23.8	17.9	21.3	21.6	30.1
Effective tax rate (%)	46.4	23.8	18.1	21.0	20.8	29.2

Source: Kotak Institutional Equities estimates

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

	2006	2007	2008	2009E	2010E	2011E
Equity						
Share capital	378	3,059	3,410	3,410	3,410	3,410
Reserves/surplus	9,122	36,613	193,473	243,820	282,363	311,646
Total equity	**9,500**	**39,672**	**196,883**	**247,230**	**285,772**	**315,055**
Deferred tax liability/(asset)	93	187	359	124	(347)	(853)
Liabilities						
Secured loans	39,560	92,053	80,534	119,328	94,328	94,328
Unsecured loans	1,760	7,275	42,237	—	—	—
Total borrowings	**41,320**	**99,328**	**122,771**	**119,328**	**94,328**	**94,328**
Currrent liabilities	18,469	42,429	72,157	79,227	82,839	96,425
Total capital	**69,435**	**181,708**	**396,065**	**449,803**	**466,488**	**508,849**
Assets						
Cash	1,950	4,155	21,421	4,500	10,582	23,820
Current assets	35,113	124,639	244,579	306,070	283,181	285,479
Gross block	11,237	17,787	51,626	77,491	88,744	123,063
Less: accumulated depreciation	1,891	2,412	3,435	7,578	10,684	14,991
Net fixed assets	9,346	15,375	48,191	69,913	78,059	108,071
Capital work-in-progress	6,239	26,497	51,840	38,848	59,193	31,007
Total fixed assets	**15,585**	**41,872**	**100,031**	**108,760**	**137,253**	**139,078**
Intangible assets	—	—	—	—	—	—
Investments	16,789	11,042	30,033	30,033	35,033	60,033
Misc. expenses	—	—	—	—	—	—
Total assets	**69,437**	**181,708**	**396,065**	**449,803**	**466,488**	**508,849**
Leverage ratios (%)						
Debt/equity	430.7	249.2	62.2	48.2	33.0	30.0
Debt/capitalization	81.2	71.4	38.4	32.5	24.8	23.1
Net debt/equity	410.4	238.8	51.4	46.4	29.3	22.4
Net debt/capitalization	80.4	70.5	33.9	31.7	22.7	18.3
RoAE	**21.3**	**78.6**	**66.0**	**26.1**	**17.4**	**13.7**
RoACE	**4.5**	**22.9**	**35.3**	**17.6**	**13.2**	**10.6**

Source: Kotak Institutional Equities estimates

Technology

HCLT.BO, Rs107	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	140
52W High -Low (Rs)	325 - 102
Market Cap (Rs bn)	74.4

Financials

June y/e	2008	2009E	2010E
Sales (Rs bn)	76.4	105.3	115.2
Net Profit (Rs bn)	10.6	13.8	13.0
EPS (Rs)	15.3	18.7	17.3
EPS gth	*(19.0)*	*22.4*	*(7.7)*
P/E (x)	7	5.7	6.2
EV/EBITDA (x)	3.2	3.9	3.6
Div yield (%)	7.5	11.2	11.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(14.2)	(29.0)	(50.2)	(55.5)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	67.3	-	-
FIIs	17.7	0.4	(0.0)
MFs	1.9	0.2	(0.2)
UTI	-	-	(0.4)
LIC	2.7	0.2	(0.2)

HCL Technologies: Aggressive efforts to overcome organic growth challenges could make the next two years a tight-rope walk; maintain REDUCE

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- **Organic revenue challenges continue; aggressive response demands flawless execution**
- **FY2009—organic revenue growth likely to trail peers**
- **Quarterly dividend cut to Rs2/share from Rs3/share in the past two quarters**
- **Inexpensive valuations and high dividend yield may provide valuation support**

HCLT's December 2008 performance once again highlighted the unique organic growth challenges (in addition to the industry-wide demand headwinds) facing the company. Revenues at US$511.5 mn (with US$25 mn incremental revenues from acquisitions) came in 2.5% below our expectations; EBITDA at US$111.4 mn was 2% ahead of our expectations, while net income of US$73.1 mn was in line with expectations. More importantly, organic revenues declined for the second quarter in a row highlighting kinks in the company's organic growth engine. The company has resorted to inorganic means (four acquisitions over the past 12 months) and innovative deal structures (outcome-based pricing, free transition on several large deals) to overcome its weak vertical positioning and lack of scalability given its single-service provider status with many large existing clients. We believe such means inherently carry additional risk and HCLT will have to demonstrate flawless execution to maintain margins and sustain any revenue momentum it gains. We revise our EPS estimates downwards to factor in (1) lower growth in revenues given increased demand headwinds, (2) margin pressure on account of new large deals and weak pricing environment and (3) amortization of intangibles related to Axon acquisition. Our revised EPS estimates for FY2009E and FY2010E stand at Rs18.7 (Rs19.4 earlier) and Rs17.3 (Rs18.8 earlier), respectively. We maintain REDUCE despite inexpensive valuations and reduce our target price to Rs140/share (Rs160 earlier).

Organic revenue challenges continue; aggressive response demands flawless execution. We have long highlighted the inherent challenges in the business model of HCLT. Unlike its tier-I peers, HCLT has been a horizontal-focused company trying to create a niche for itself in chosen horizontals (and a few micro-verticals). While the strategy helped HCLT post reasonable growth rates over the past few years, the inherent non-scalability of the model has started hurting the company's organic revenue growth trajectory (organic revenues declined qoq in each of the past two quarters, see Exhibits 1 and 2). HCLT remains weak relative to other tier-I players on the applications side especially in verticals that matter for scalability. The company has tried to address the challenge aggressively through innovative engagement structures and acquisitions; we discuss our concerns with each of these strategies below

1. **Innovative engagement structures—free transition on large deals, outcome-based pricing.** HCLT indicated that it has resorted to offering free transition (for knowledge transfer and offshore shift of work) to clients to win large deals in the market. While this is not uncommon, the extent of free transition offered of up to 10-15% of overall deal size (computed on present value of part of the savings delivered which HCLT can retain) has surprised us. HCLT faces two significant challenges on such deals (1) the company is assuming significant execution risks. We trust the company to have adequate safeguards in case of cost/execution slippages as well as potential contractual liabilities (2) we view the free transition as akin to making upfront payments to win a large deal (though the management contends it is an investment at the front-end). HCLT has indicated it would incur US$25 mn of cash costs on such transitions in 2HFY09E, implying free transition on ~US$200-250 mn worth of deals (which would equate 15-20% of the deals signed by the company over the past two quarters). We highlight that the company capitalizes these transition costs (in accordance with the US GAAP) and amortizes them over the period of the contract. An increase in proportion of such deals (and the associated cash costs) could have been one of the factors driving a reduction in the company's quarterly dividend to Rs2/share from Rs3/share in the past two quarters (we discuss this in detail later). We also highlight that the company will have little leeway on execution of such deals (given that 10-15% of margins are given away as free transition) if it has to deliver corporate-level margins on these. We expect these deals to be margin dilutive.

2. **Acquisitions.** HCLT has made four acquisitions over the past 12 months—three relatively small ones in the BPO segment, and the large (~US$700 mn) acquisition of Axon, a UK-based company addressing the SAP space. Examples of successful acquisitions by Indian IT companies are few, and we highlight some of the challenges that HCLT will likely need to encounter on Axon specifically (apart from the general slowdown in discretionary IT spend impacting package implementation business)

   - Retention of the existing senior management team and consultants. HCLT management indicated it has seen no attrition in the Axon senior/middle management till date; however, it has not shared details on retention plans of the Axon team.

   - HCLT's ability to ramp up its offshore SAP capabilities quickly to complement the onsite presence gained through the acquisition; this is critical to drive margin synergies, as well as to further enhance the company's SAP positioning versus other Indian players.

   - Other issues. Issues like realignment of compensation structures, various administration policies, etc.

   - Heavy client concentration in the business especially noting that some of the contracts may come up for renewal.

We credit the current CEO for remarkable execution in face of the historical weakness in the enterprise segment of business. However, the next level of challenges is significant and would test the execution strength of the company, especially in a weakening demand environment. On the other hand, the above strategies, if executed well will likely create sustainable competitive differentiation in the medium/long term. We remain skeptical of the same but would not discount it completely, given the remarkable track record of the current CEO. Success of the HCLT strategy may have wider implications for the industry; we would monitor the progress very closely.

Free cash flow profile may weaken. We believe the above strategies will weaken free cash generation, increase working capital cycle and consume more cash for growth. In effect, the model becomes more capital intensive as opposed to the "capital light" model for the rest of the players. We forecast, declining ROIC for HCLT for the next three years—an average of 32% versus ~40% witnessed over the past two years. As highlighted earlier, the company has already reduced the dividend payout to Rs2 per quarter from Rs3 earlier. Receivables cycle, in any case, has been elongating for HCLT (see Exhibit 3). While the appetite may be low for another acquisition, we still see gaps to be plugged in the service portfolio of the company.

December 2008 quarter revenue performance disappoints: HCLT reported revenues of US$511.5 mn for the December 2008 quarter (up 1.4% qoq and up 11% yoy), 2.5% below our expectations. Revenues were aided by incremental US$25 mn of revenues from acquisitions; organic revenues declined 3.9% qoq, after declining by 1.5% qoq in the September 2008 quarter. Revenue growth was driven by the IMS segment which grew 7% qoq and 20% yoy to US$84.5 mn. Core software and BPO segments both disappointed posting organic revenue declines during the quarter.

Net income of US$73.1 mn (up 1.5% qoq, down 8.5% yoy), was in line with our estimates. EBITDA at US$111.4 mn (up 1.9 % qoq, and up 18.6% yoy) was ahead of our estimate despite significant revenue miss as the company rationalized costs further. EBITDA margin expanded 10 bps qoq versus our expectation of a 90 bps decline. OPM performance was driven by (1) rupee depreciation benefit of 129 bps and (2)114 bps benefit from higher utilization. Consolidation of acquisitions (Axon for 15 days and Liberate for the full quarter) impacted margins by 93 bps.

Impact of forex losses offset by higher-than-expected interest income. HCLT reported a forex loss of US$29.1 mn, comprising (1) MTM losses on unassigned hedges of US$13.6 mn, (2) translation losses of US$9.5 mn and (3) US$7.3 mn losses transferred from the OCI on account of certain cash flow hedges becoming ineffective. Impact of the same was offset by large interest income booking of US$24 mn. The company now has US$1.58 bn of hedges outstanding (down US$300 mn qoq) for the next seven quarters. These hedges are taken at an average rate of 41.14. As a result we expect a weak 2HFY09E and FY2010E for HCLT. The company has ~US$210 mn of unamortized forex losses residing in other comprehensive income line in the balance sheet; these losses would start impacting the P&L in the form of lower realization or at the forex line (in other income) starting March 2009 quarter.

Quarterly dividend reduced to Rs2/share fro Rs3/share. HCLT cut its quarterly dividend to Rs2/share from Rs3/share in the past two quarters in anticipation of incremental cash requirements over the next few quarters. The company specifically highlighted (1) US$25 mn of cash costs for transitioning large deals in 2HFY09E, (2) expected loss of ~US$210 mn on forex hedges over the next seven quarters (if the Re remains at current levels), (3) payout of bridge loan taken for Axon (HCLT will likely refinance the loan) and (4) capex plans of US$61 mn for 2HFY09E. The street has been skeptical of HCLT's ability to continue its quarterly dividend payout and the same would be watched closely over the next few quarters, in our view.

Revision in estimates. We have revised our revenue estimates for FY2009E and FY2010E down by 1.1% and 2.4%, respectively, to US$2.2 bn and US$2.4 bn. The reduction in revenue estimates is driven primarily by a 1.2% and 3% cut in FY2009E and FY2010E IT services revenue estimates. We have increased our FY2009E and FY2010E EBITDA margin estimates by 50 bps and 80 bps, respectively, to reflect our revised Re/US rate assumption for the company. However, we reduce our EBIT estimates by 1.4% and 1.2% for FY2009E and FY2010E to factor in the intangible amortization costs related to Axon acquisitions. Our EPS estimate for FY2009E stands revised downwards by 3.6% to Rs18.7, while we reduce our FY2010E EPS estimate by 8.1% to Rs17.3.

Inexpensive valuations and high dividend yield may provide valuation support. HCLT is trading at 6.2X FY2010E and 6X FY2011E EPS. Inexpensive valuations, coupled with high dividend yield (7.5% at CMP), may limit downside in the stock. However, we maintain our REDUCE rating on the stock given our concerns on the ability of the company to sustain a robust revenue growth trajectory and margin performance in the near to medium term. Revise our DCF-based target price down to Rs140/share (Rs160 earlier).

Revenues declined 3.9% qoq, adjusted for acquisitions and hedging gains

(US$ mn)	4QFY08	1QFY09	2QFY09
Reported revenues	**504.0**	**504.7**	**511.5**
qoq growth (%)		**0.1**	**1.3**
Less:			
Acquisition contribution	5.0	11.8	37.0
Hedging gains	2.3	3.8	4.7
Adjusted revenues	**496.7**	**489.1**	**469.8**
qoq growth (%)		**(1.5)**	**(3.9)**

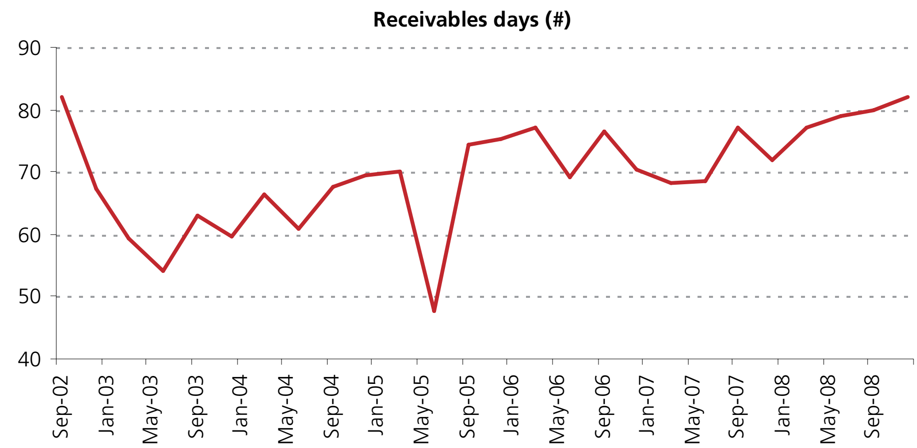
Source: Company, Kotak Institutional Equities estimates

Significant weakening in revenue growth trajectory across business lines despite contribution from acquisitions

	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
Revenues - US$mn										
IT services	222	243	262	282	309	335	357	371	369	363
Infrastructure services	40	46	50	59	65	71	72	76	79	85
BPO	38	42	50	54	55	55	56	57	57	64
Total	**301**	**331**	**362**	**396**	**429**	**461**	**485**	**504**	**505**	**512**
Growth qoq (%)										
IT services	10.0	9.2	8.1	7.6	9.5	8.3	6.5	4.0	(0.7)	(1.4)
Infrastructure services	17.0	16.6	8.2	18.1	9.1	9.1	1.6	6.4	3.5	7.0
BPO	5.8	9.4	18.3	8.7	2.0	0.5	1.8	0.2	1.2	11.2
Total	**10.3**	**10.2**	**9.4**	**9.2**	**8.4**	**7.5**	**5.2**	**3.9**	**0.1**	**1.3**
Growth yoy (%)										
IT services	31.6	36.6	40.2	39.8	39.0	38.0	36.0	31.4	19.2	8.5
Infrastructure services	80.7	73.7	71.3	74.4	62.6	52.2	42.8	28.7	22.1	19.7
BPO	29.3	41.3	41.7	48.7	43.5	31.9	13.5	4.6	3.8	14.8
Total	**36.2**	**41.4**	**44.0**	**45.3**	**42.7**	**39.2**	**33.8**	**27.4**	**17.7**	**11.0**

Source: Company

DSO continues to rise



Source: Company

Key Changes to our FY2009-11E estimates

	Revised			Old			Change (%)		
US$ mn	**FY2009E**	**FY2010E**	**FY2011E**	**FY2009E**	**FY2010E**	**FY2011E**	**FY2009E**	**FY2010E**	**FY2011E**
Revenues	**2,197**	**2,413**	**2,605**	**2,222**	**2,474**	**2,668**	**(1.1)**	**(2.4)**	**(2.4)**
- Software Services	*1,605*	*1,745*	*1,865*	*1,625*	*1,799*	*1,924*	*(1.2)*	*(3.0)*	*(3.1)*
- BPO	*251*	*273*	*288*	*272*	*301*	*318*	*(7.4)*	*(9.4)*	*(9.5)*
- Infrastructure Services	*340*	*396*	*452*	*326*	*374*	*427*	*4.5*	*5.9*	*5.9*
Revenue growth yoy (%)	**16.9**	**9.9**	**7.9**	**18.3**	**11.3**	**7.9**			
EBITDA	457	476	493	451	468	511	1.3	1.8	(3.6)
EBIT	363	371	389	369	375	409	(1.4)	(1.2)	(4.9)
Net Income	**271**	**251**	**266**	**292**	**294**	**319**	**(7.0)**	**(14.4)**	**(16.6)**
EBITDA margin (%)	20.8	19.7	18.9	20.3	18.9	19.1			
EBIT	16.5	15.4	14.9	16.6	15.2	15.3			
Re/ US$ rate	47.9	47.7	46.7	46.2	44.5	44.5	**3.7**	**7.3**	**5.0**
EPS Rs/ share	**18.7**	**17.3**	**17.9**	**19.4**	**18.8**	**20.4**	**(3.6)**	**(8.1)**	**(12.4)**

Source: Kotak Institutional Equities estimates

HCL Technologies (year-ending June) - Comments on 2QFY09 financial performance

Rs mn	1QFY08	4QFY08	1QFY09	2QFY09	QoQ % chg.	YoY % chg.	Kotak Estimates	% Deviation	Comments on QoQ performance
CONSOLIDATED									
Revenues	**17,092**	**21,688**	**23,693**	**24,908**	**5.1**	**37.1**	**25,315**	**(1.6)**	Overall revenue growth of 1.4% qoq to US$511 mn disapoointing (2.5% lower than our expectations). Revenues include US$37 mn incremental from acquisitions (Axon and other BPO acquisitions). Organic revenues declined ~3.9% qoq after a 1.5% decline in Sep 2008 quarter - disappointing
Cost of Revenues	(10,948)	(13,107)	(14,543)	(15,155)	4.2	32.4	(15,830)	**(4.3)**	
Gross profit	**6,144**	**8,581**	**9,150**	**9,753**	**6.6**	**45.1**	**9,485**	**2.8**	
SG&A expenses	(2,693)	(3,692)	(4,018)	(4,332)	7.8	43.3	(4,213)	**2.8**	
EBITDA (including RSU expenses)	**3,450**	**4,888**	**5,131**	**5,421**	**5.7**	**46.5**	**5,272**	**2.8**	
EBIDTA adjusted for non cash RSU charges	**3,638**	**5,086**	**5,314**	**5,601**	**5.4**	**44.2**	**5,465**	**2.5**	
Depreciation	(681)	(852)	(906)	(971)	7.2	33.9	(991)	**(2.0)**	
EBIT	2,769	4,036	4,225	4,450	5.3	49.6	4,281	**3.9**	EBIT margin improvement surprising given that the company consolidated Axon (with 12-13% EBIT margins) for a part of the quarter
Interest expense							(71)		
Other Income (net of interest expense)	502	(2,642)	(418)	(213)	(49.0)	(139.2)	(201)	**6.2**	Includes forex loss of US$29.1 mn (versus loss of US$20.8 mn in the previous quarter and our estimate of US$13 mn)
Earnigs before tax	**3,271**	**1,394**	**3,807**	**4,237**	**11.3**	**20.4**	**4,081**	**3.8**	
Provision for Tax	(347)	(202)	(441)	(684)	55.0	92.9	(530)	**28.9**	
Earnings after & before share of earnings in affiliates	**2,924**	**1,192**	**3,366**	**3,553**	**5.6**	**12.3**	**3,550**	**0.1**	
Share of income (loss) of equity investees	0	0	0	0			-		
Minority Interest	(28)	22	14	0			-		
Net Income (before extraordinaries)	**2,896**	**1,213**	**3,380**	**3,553**	**5.1**	**13.0**	**3,550**	**0.1**	Net income in line with expectations despite outperformance at the EBIT level on account of higher-than-expected forex losses
EPS	**4.2**	**1.8**	**4.9**	**5.1**	**5.1**	13.0	**5.1**	**0.1**	
No of shares outstanding	690.0	690.0	690.0	690.0			690.0		
Margins (%)									
Gross Profit margin	35.9	39.6	38.6	39.2			37.5		
EBITDA Margin	20.2	22.5	21.7	21.8			20.8		
EBIT Margin	16.2	18.6	17.8	17.9			16.9		
NPM	16.9	5.6	14.3	14.3			14.3		
Software Services Business									
Revenues	**12,315**	**15,973**	**17,299**	**17,697**	**2.3**	**34.1**	**18,071**	**(2.1)**	Revenues declined by 1.4% qoq in US$ terms despite US$18 mn (approx) incremental revenues from Axon acquisition.
Cost of Revenues	(7,598)	(9,364)	(10,140)	(10,271)	1.3	27.9	(10,810)	**(5.0)**	
Gross profit	4,717	6,610	7,159	7,426	3.7	43.7	7,262	**2.3**	
S G & A expenses	(2,084)	(2,831)	(3,056)	(3,060)	0.1	31.8	(3,102)	**(1.4)**	
EBITDA	**2,634**	**3,778**	**4,103**	**4,366**	**6.4**	**53.5**	**4,160**	**5.0**	
Depreciation	(418)	(572)	(601)	(628)	4.5	38.6	(639)	**(1.7)**	
EBIT	2,215	3,206	3,502	3,738	6.7	56.3	3,521	**6.2**	90 bps improvement in EBIT margins despite Axon consolidation impressive
Margins (%)									
Gross Profit margin	38.3	41.4	41.4	42.0			40.2		
EBITDA Margin	21.4	23.7	23.7	24.7			23.0		
EBIT Margin	18.0	20.1	20.2	21.1			19.5		
BPO Services									
Revenues	**2,195**	**2,431**	**2,685**	**3,097**	**15.3**	**41.9**	**3,389**	**(8.6)**	11.3% sequential revenue growth in US$ terms aided by full quarter consolidation of Liberata and CPS. Organic revenues declined >20% qoq as (1) GBP depreciation versus the US$ impacted significantly. A good chunk of HCLT's BPO revenues are GBP invoiced and (2) ramp down from the large client that the company recently lost, continued
Cost of Revenues	(1,347)	(1,360)	(1,723)	(1,959)	13.7	50.6	(2,245)	**(12.7)**	
Gross profit	**849**	**1,071**	**962**	**1,138**	**18.3**	**28.9**	**1,144**	**(0.5)**	
S G & A expenses	(279)	(387)	(455)	(707)	55.3	124.3	(586)	**20.7**	
EBITDA	**570**	**684**	**507**	**431**	**(15.0)**	(24.0)	558	**(22.8)**	Sharp decline in EBITDA margins driven by full quarter impact of consolidation of low-margin acquisitions
Depreciation	(135)	(125)	(146)	(155)	6.5	15.7	**(186)**	**(16.6)**	
EBIT	**434**	**559**	**361**	**276**	**(23.6)**	**(36.3)**	**373**	**(25.9)**	
Margins (%)									
Gross Profit margin	38.7	44.1	35.8	36.7			33.8		
EBITDA Margin	26.0	28.1	18.9	13.9			16.5		
EBIT Margin	19.8	23.0	13.5	8.9			11.0		
Infrastructure Services									
Revenues	**2,582**	**3,283**	**3,709**	**4,115**	**11.0**	**47.7**	**3,854**	**6.8**	An impressive quarter with 7% sequential and 20% yoy growth despite demand and currency headwinds
Direct Cost	(1,817)	(2,186)	(2,497)	(2,745)	9.9	42.5	(2,582)	**6.3**	
Gross Profit	**765**	**1,097**	**1,211**	**1,370**	**13.1**	**59.5**	**1,272**	**7.7**	
SG&A	(331)	(473)	(507)	(565)	11.4	46.3	(525)	**7.6**	
EBITDA	**434**	**624**	**704**	**805**	**14.3**	**70.2**	**747**	**7.8**	
Depreciation & Amortization	(127)	(155)	(160)	(188)	17.8	36.3	(166)	**13.3**	
EBIT	**307**	**469**	**545**	**617**	**13.3**	**84.2**	**581**	**6.2**	Margins largely in line with expectations
Margins (%)									
Gross Profit margin	29.6	33.4	32.7	33.3			33.0		
EBITDA Margin	16.8	19.0	19.0	19.6			19.4		
EBIT Margin	11.9	14.3	14.7	15.0			15.1		

Source: Company, Kotak Institutional Equities estimates

HCL Technologies- Profit and Loss Statement, June Year End

Rs mn	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Revenues	**60,337**	**76,394**	**105,262**	**115,230**	**121,741**
RSU expenses	612	759	747	764	561
Direct Costs	37,604	46,904	64,094	71,335	76,930
Gross Profit	**22,122**	**28,731**	**40,421**	**43,131**	**44,250**
SG&A	9,370	12,572	18,510	20,386	21,226
EBIDTA (excl other income)	**12,752**	**16,159**	**21,911**	**22,745**	**23,024**
Depreciation	2,534	3,033	3,667	4,017	4,319
Amortization			834	1,031	538
EBIT	10,218	13,126	17,411	17,697	18,168
Interest income/(Expenses)	4,262	(1,195)	(2,278)	(3,105)	(914)
Earnings Before Tax	14,480	11,931	15,133	14,592	17,254
Tax	1,489	1,281	2,148	2,589	4,831
Income bef share of equity investees	**12,990**	**10,650**	**12,985**	**12,004**	**12,423**
Share of income (loss) of equity investees	—	(9)	(4)	—	—
Minority Interest	52	20	(19)	—	—
Net Income	**12,938**	**10,621**	**13,000**	**12,004**	**12,423**
EPS (Rs.) fully diluted	**18.9**	**15.3**	**18.7**	**17.3**	**17.9**
Margins (%)					
Gross Profit Margin	36.7	37.6	38.4	37.4	36.3
Operating margin	21.1	21.2	20.8	19.7	18.9
EBIT margin	16.9	17.2	16.5	15.4	14.9
Net Profit	21.5	13.9	12.3	10.4	10.2
Net Income margin	21.4	13.9	12.4	10.4	10.2
Tax Rate	10.3	10.7	14.2	17.7	28.0
Growth (%)					
Revenue Growth	37.1	26.6	37.8	9.5	5.7
Gross Profit	37.0	29.9	40.7	6.7	2.6
EBITDA	33.3	26.7	35.6	3.8	1.2
EBIT	35.6	28.5	32.6	1.6	2.7
Net Profit	73.4	(18.0)	21.9	(7.6)	3.5
Net Income	73.1	(17.9)	22.4	(7.7)	3.5

Source: Company, Kotak Institutional Equities estimates

Consumer products

HLL.BO, Rs247	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	245
52W High -Low (Rs)	270 - 180
Market Cap (Rs bn)	537.9

Financials

December y/e	2007	2008E	2009E
Sales (Rs bn)	137.2	163.5	183.2
Net Profit (Rs bn)	17.7	20.0	23.4
EPS (Rs)	8.1	9.2	10.7
EPS gth	*15.4*	*12.9*	*17.0*
P/E (x)	30.4	26.9	23.0
EV/EBITDA (x)	24.6	21.5	17.6
Div yield (%)	4.3	3.5	4.1

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(4.2)	2.1	6.9	29.5

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	52.1	-	-
FIIs	13.9	1.3	(0.4)
MFs	4.4	2.1	0.4
UTI	-	-	(1.7)
LIC	6.4	2.5	0.8

Hindustan Unilever: Chasing margins at the cost of losing market positions? Reiterate REDUCE

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- **Volume growth of 2% for HUL—are we going back to 2003?**
- **Margins managed by huge cutback in adspends**
- **Market share losses are a worry; significant deterioration in market position is scary**
- **Defensiveness premium of the stock faces highest risk of erosion; reiterate REDUCE**

HUL reported sales growth of 16.8%, adjusted EBITDA growth of 10.9% and adjusted PAT growth of 12.7% for 4QCY08. Volume growth of just 2.3%—the lowest in almost six years—indicates significant rationalization in detergents consumption (due to 80% price increase in 'Wheel' in three years) and likely re-emergence of regional competition in soaps. Market share losses are a worry; significant deterioration in market position in soaps, skincare and oralcare is unnerving. The huge cutback in adspends seen in conjunction with declining volume trend and paucity of innovations indicate a tough CY2009 for topline growth. Our channel sources indicate that HUL faces significant competitive pressures in most categories in CY09, Beiersdorf AG (Nivea) being the key to watch out for. We reiterate that development of the Foods category (for HUL) will be a slow accretive process which will likely bear fruit over 5-10 years. We maintain our EPS forecast of Rs10.7/share for CY09E (+17%) and introduce a CY10E forecast of Rs12.1/ share (+12.7%). We will revisit our estimates (likely downward) post the management concall on January 28. At a CMP of Rs247/share the stock trades at 23XCY09E. A 160% premium to Sensex multiple (highest in a decade) is unjustified for a business which is incrementally showing signs of significant weakness. Defensiveness premium of the stock faces highest risk of erosion; reiterate REDUCE.

Long story short - volume growth of 2% for 40% market leader in HPC

HUL reported FMCG sales growth of 21% in 4QCY08 (all of pricing growth, volume growth of just 2.3%, mix is likely negative) led by 25% growth in soaps & detergents and 11% growth in personal products. Key drivers, in our view:

1. Strong pricing-led growth in detergents at the cost of market shrinkage
2. Soaps volumes for HUL likely declined in double digits, the nearest competitor Godrej Consumer likely had 15% volume growth, with category growth estimated at over 5%. HUL witnessed flat volumes in soaps in Jan-Sep 2008, in our view
3. We estimate detergents volumes for the quarter was likely negative as well
4. Personal products (PP) likely had a high single digit volume growth. We believe that the PP business is witnessing significant mix deterioration as the segment growth of just 11% would suggest
5. Continuing growth in price-pointed packs driven by the recruitment of new consumers and likely rationalization in consumer spends—contrary to other markets, per gram/ml prices of sachets/low-unit-packs are significantly cheaper than large packs in India. For example, a 9 gm Fair & Lovely costs Rs6 (per gm price of 66 paisa), whereas the next most widely distributed pack is a 25 gm pack costing Rs35 (per gm price of 140 paisa)

We expected the strong sales growth seen in the quarter (our estimate 15%, actual 16.8%), but not the volume growth of 2.3%, which was below our estimate of 3% and much below the Street's expectations of over 5%. We have been highlighting that the volume growth trajectory is trending down as the full impact of aggressive price increases (across categories to offset input cost inflation) starts kicking in now.

On a tangent, we highlight the 3QFY09 results of Asian Paints (APNT). The company reported a 50% decline in EBITDA due to (1) higher input costs and (2) a 7% reduction in prices—half the price increases in 1HFY09. We believe that the reduction of prices is the management's prerogative considering the current market conditions and the view on market shares. In our view, there is opportunity to drive category growth and higher volume growth for HUL if the company adopts a calibrated series of pre-emptive price cuts or consumer offers (initiated by HUL, rather than following competition).

Continuing concerns, carried over from the last quarter

We believe the markets will now recognize the concerns we have been highlighting in our last few updates—'Volume growth curve has likely peaked' dated October 27, 2008 and 'Value adjustments in key HPC categories inevitable' dated November 11, 2008

1. Continued significant market share losses in key categories—personal wash (470 bps), shampoo (180 bps), skin (270 bps), toothpaste (40 bps) and coffee (70 bps)
2. We reiterate that likely volume decline in detergents indicate consumer is rationalizing on quantum of usage (resulting in longer-than-expected purchase cycles)—impact of earlier packsize reductions to manage margins are visible now
3. Likely double-digit volume decline in soaps indicate that the company is paying a heavy price for the unbridled price increases taken to manage margins when faced with input cost inflation. Our channel checks indicate that regional players and other national players have started passing on the benefit of lower input costs since October itself
4. Our biggest worry is the likely loss of market positions in key categories like soaps (one-fourth of HUL's sales) and oralcare
5. The huge cutback in adspends was another disappointment for the street including us. While we appreciate that quarterly trends in adspends to sales can show cyclicality, what surprises us is the trend reversal since June 2008 as well as the paucity of meaningful launches / relaunches (HUL had just 4 innovations / activation during this quarter which is the peak winter season – Dove deo (less than 1% of sales), Gelato icecream (less than 2% of sales), Surf Excel Quick wash (about 2% of sales) and Bru coffee (about 2% of sales)
6. Market sources indicate limited success for 'Amaze' brainfood which continues to be test marketed for over a year now. We reiterate that Amaze' brain food marketing mix is likely to undergo a review. We believe that the pricing for Amaze at 1.4X price premium to competition has likely resulted in consumer resistance
7. We highlight that CY2008 was guided as the year of mega announcements in the Foods category. We reiterate that development of Foods category (for HUL) will be a slow accretive process which will likely bear fruit over 5-10 years

Defensiveness premium of the stock faces highest risk of erosion; reiterate REDUCE

We model 17% earnings growth for HUL in CY09E on the back of 100 bps expansion in EBITDA margins. We see revenue growth slowing down to 12% in CY09E (from 19% in CY08E) due to (1) higher base of CY2008 and (2) deceleration in volume growth to low single digits. We note that yet-to-be-anniversaried price increases provide about 8% topline growth for CY09E as of now. We believe that holding on to the MRP in key categories is difficult from now on and competitive pressures warrant higher trade spends.

At the current market price of Rs247/share the stock trades at 23X CY09E. We believe a 160% premium to the Sensex multiple (highest in a decade) is unjustified for a business which is incrementally showing signs of significant weakness. Reiterate REDUCE. The defensiveness premium of the stock is at significant risk, in our view.

Key upside risks to our estimates include (1) ability to channelize emerging cost comfort to below-the-line activities and attain higher volume growth, (2) ineffective competition from regional competition and price warriors.

HUL-Quarterly summary, March yearends (Rs mn)

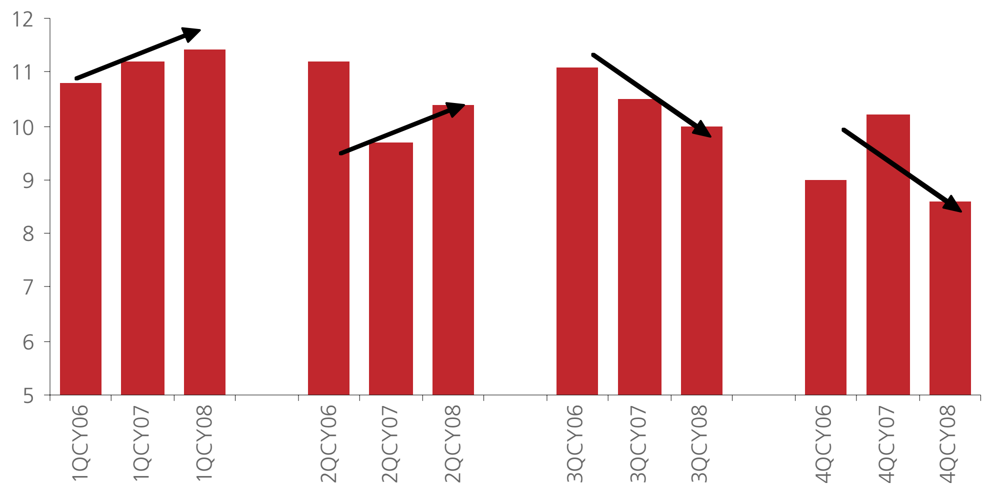
	yoy			Our est.	
	4QFY09	4QFY08	% chg	4QFY09	% chg
Net sales	**43,077**	**36,874**	**16.8**	**42,174**	**14.4**
Material cost	(23,201)	(19,001)			
Employee cost	(2,209)	(1,945)			
Other overheads	(10,737)	(10,297)			
- Advertising & Promotions	(3,710)	(3,759)			
Total expense	(36,147)	(31,242)			
EBITDA @	**6,931**	**5,632**	**23.1**	**6,661**	**18.3**
Depreciation	(406)	(369)			
EBIT	6,525	5,263			
Other income	1,001	1,441			
PBT	**7,526**	**6,704**	**12.3**	**7,912**	**18.0**
Tax	(901)	(1,568)		(1,674)	
PAT #	**6,625**	**5,136**	**29.0**	**6,238**	**21.4**
Extraordinary Income (loss)	(468)	1,178			
Net profit	**6,157**	**6,314**	**(2.5)**	**6,238**	**(1.2)**
EBITDA margin - reported (%)	16.1	15.3		15.8	
Effective tax rate (%)	12.0	23.4		21.2	
Costs as % of net sales					
Material cost	53.9	51.5			
Employee cost	5.1	5.3			
Other overheads	24.9	27.9			
- Advertising & Promotions	8.6	10.2			
Segment revenue					
- Soaps and Detergents	21,234	17,007	24.9		
- Personal Products	11,923	10,711	11.3		
- Beverages	5,106	4,121	23.9		
- Foods	1,715	1,454	17.9		
- Ice Creams	343	296	15.9		
- Exports	2,668	3,467	(23.1)		
- Others	739	677	9.1		
Segment PBIT margins (%)					
- Soaps and Detergents	16.5	16.7			
- Personal Products	32.8	32.7			
- Beverages	12.8	14.8			
- Foods	(2.3)	6.5			
- Ice Creams	(8.3)	3.2			
- Exports	5.8	6.9			
- Others	(34.5)	(38.8)			

@ Adjusted EBITDA growth is 10.9%
 # Assuming normal tax rates, PAT growth is 12%

Source: Company data, Kotak Institutional Equities

Cutback in adspends to manage margins or paucity in innovation funnel?

HUL adspends as a % of sales



Source: Company, Kotak Institutional Equities.

Market shares indicates significant deterioration in leadership position

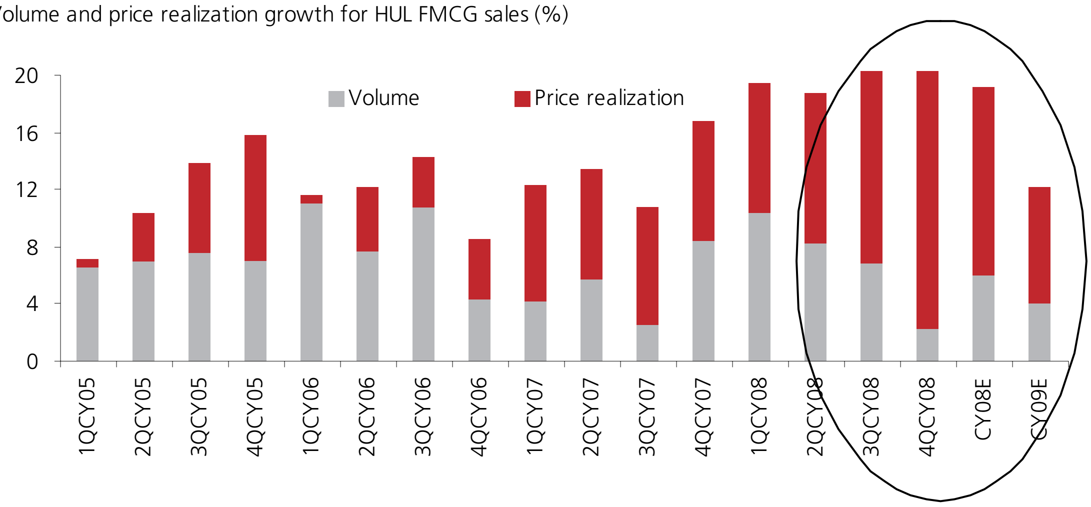
Value market shares for Oct-Dec 2008 (%), market share movements (bps)

Category	Market share	yoy	qoq	Remarks
Detergents	38.2	90	30	Price hikes ahead of competition leading to value share gains. Price hikes have likely hurt consumption
Soaps	49.6	(470)	(60)	Downtrading
Hair	46.0	(180)	(20)	Category getting crowded with entry of many new players and existing players getting aggressive
Skincare	53.1	(270)	(100)	Consumer fatigue in Fair and Lovely?
Toothpaste	29.1	(40)	(50)	Non-focus category with objective to maintain current position, will likely relaunch 'Pepsodent' in CY2009
Tea	22.7	0	(60)	
Instant coffee	43.8	(70)	(510)	

Source: Company data for market share, Kotak Institutional Equities.

Quality of growth likely to deteriorate further

Volume and price realization growth for HUL FMCG sales (%)



Source: Company data, Kotak Institutional Equities estimates.

Margins maintained at the cost of market shares in Soaps & Detergents and Personal products ?

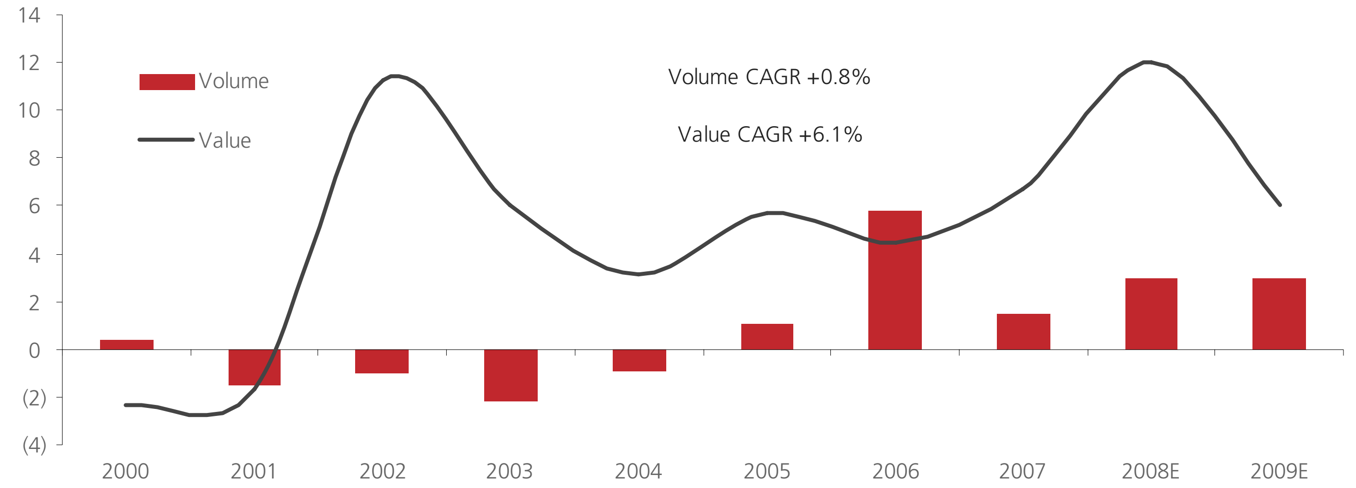
Sales, profit growth and EBIT margins for 4QCY08

Segment	Sales growth (%)	Profit growth (%)	EBIT margin change (bps)	Remarks
Soaps & Detergents	24.9	23.6	(20)	Severe cost pressure in key inputs of LAB, CPO, price increases across the portfolio
Personal Products	11.3	11.6	10	Price increases in large packs to neutralise SKU-level mix deterioration
Beverages	23.9	6.8	(200)	Higher tea and coffee commodity prices managed through packsize reductions
Foods	17.9	(141.2)	(880)	Higher sales of Knorr, Kissan
Ice Creams	15.9	(398.9)	(1150)	Higher brand investments
Exports	(23.1)	(35.0)	(110)	
Others (includes Water)	9.1	(2.9)	430	Water business expanded to 700 cities in 20 states

Source: Company data for financials, Kotak Institutional Equities for remarks.

Soaps business is value-led, signifying higher sensitivity to pricing and mix changes

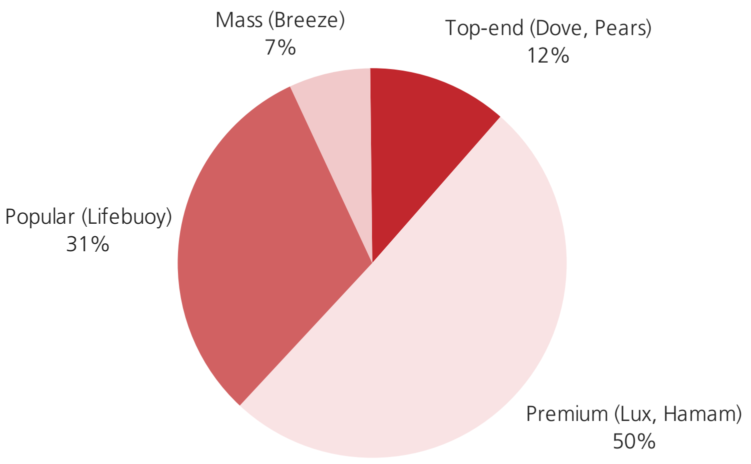
HUL Soaps volume and value growth, %



Source: Company, Kotak Institutional Equities

Higher contribution from premium segment puts category value growth at risk for HUL

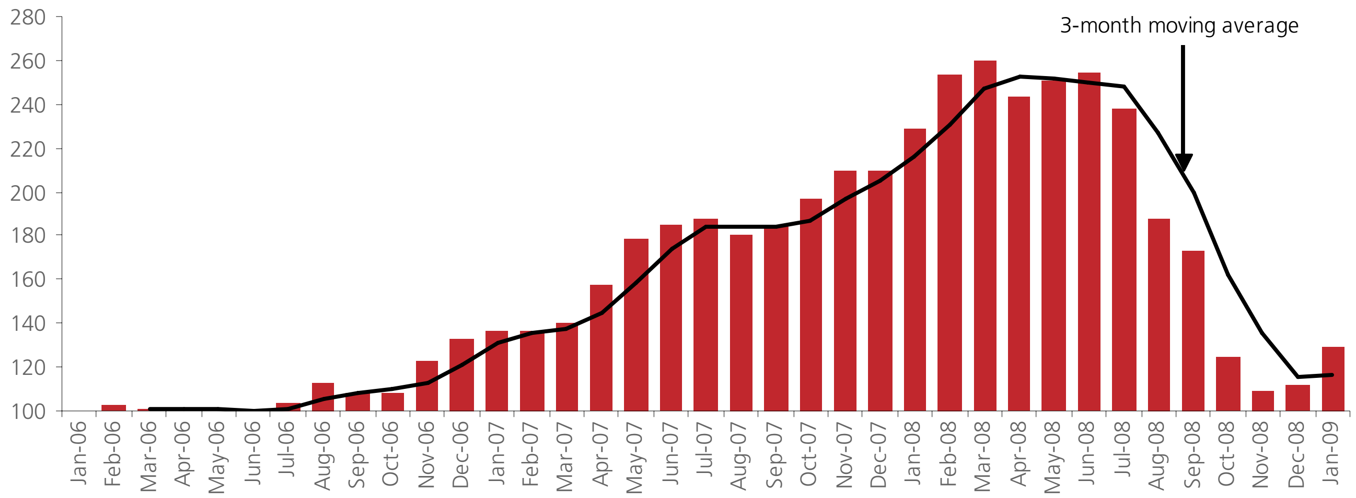
HUL soaps' sales mix, %



Source : Kotak Institutional Equities

Limited ability to retain emerging cost comfort in soaps category

Crude palm oil price trends (January 2006 = Index 100)



Source: Bloomberg, Kotak Institutional Equities

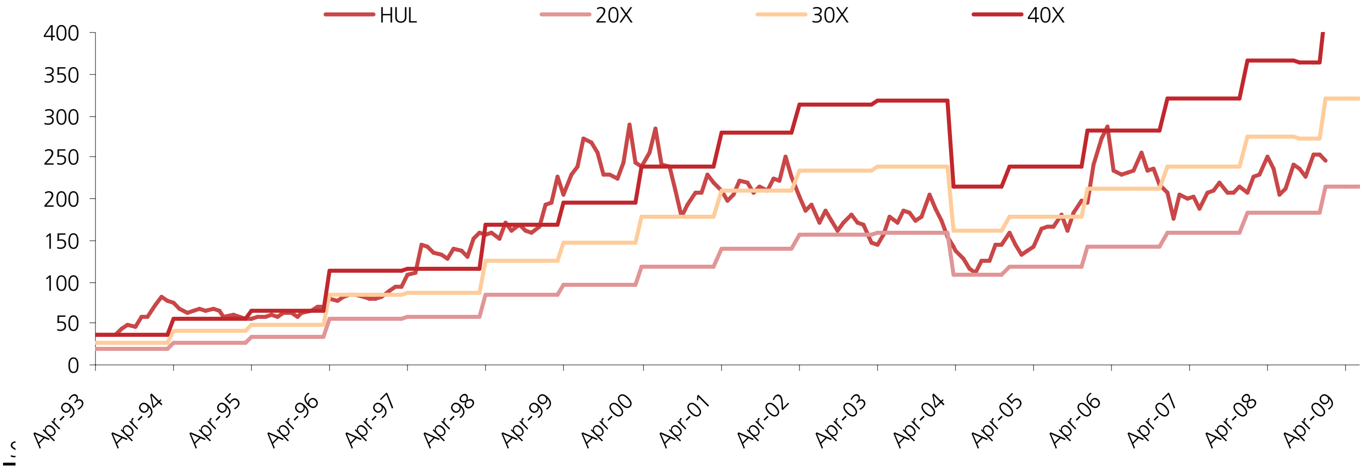
HUL: Profit model, balance sheet, cash model 2006-2010E, December year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	121,034	137,178	163,452	183,230	205,574
EBITDA	**16,621**	**18,874**	**21,288**	**25,719**	**28,917**
Other income	3,545	4,627	4,800	4,955	6,163
Depreciation	(1,302)	(1,384)	(1,541)	(1,810)	(2,105)
Pretax profits	18,757	21,862	24,546	28,789	32,901
Tax	(2,950)	(3,782)	(3,530)	(4,339)	(5,533)
Deferred taxation	(268)	(389)	(803)	(1,054)	(1,002)
Net profit	**15,539**	**17,690**	**20,213**	**23,397**	**26,365**
Earnings per share (Rs)	**7.0**	**8.0**	**9.2**	**10.7**	**12.1**
Balance sheet (Rs mn)					
Total equity	27,235	14,392	15,473	16,739	18,166
Total borrowings	726	885	885	885	885
Currrent liabilities	45,231	51,110	57,408	63,627	71,430
Total liabilities and equity	**73,191**	**66,387**	**73,766**	**81,252**	**90,481**
Cash	4,169	2,009	1,178	2,428	5,104
Current assets	27,527	30,765	33,502	37,098	41,610
Total fixed assets	15,110	17,081	20,134	23,828	26,870
Investments	24,139	14,408	17,632	17,632	17,632
Deferred tax asset	2,245	2,124	1,321	267	(736)
Total assets	**73,191**	**66,387**	**73,766**	**81,252**	**90,481**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	20,209	20,860	22,346	26,347	29,565
Working capital	(471)	3,092	4,783	1,635	2,411
Capital expenditure	(1,576)	(3,355)	(4,593)	(5,505)	(5,148)
Investments	(4,309)	9,294	(3,224)	0	0
Free cash flow	**13,852**	**29,890**	**19,312**	**22,477**	**26,828**
Key assumptions					
Revenue Growth (%)	9.4	13.3	19.2	12.1	12.2
EBITDA Margin(%)	13.9	13.7	13.0	14.0	14.1
EPS Growth (%)	18.3	13.8	14.5	17.0	12.7

Note: The company has extended the financial year ending 31 December 2008 to 31 March 2009 and will declare 15 months annual results. The above mentioned estimates are for 12 month periods to facilitate meaningful comparison.

Source: Kotak Institutional Equities estimates.

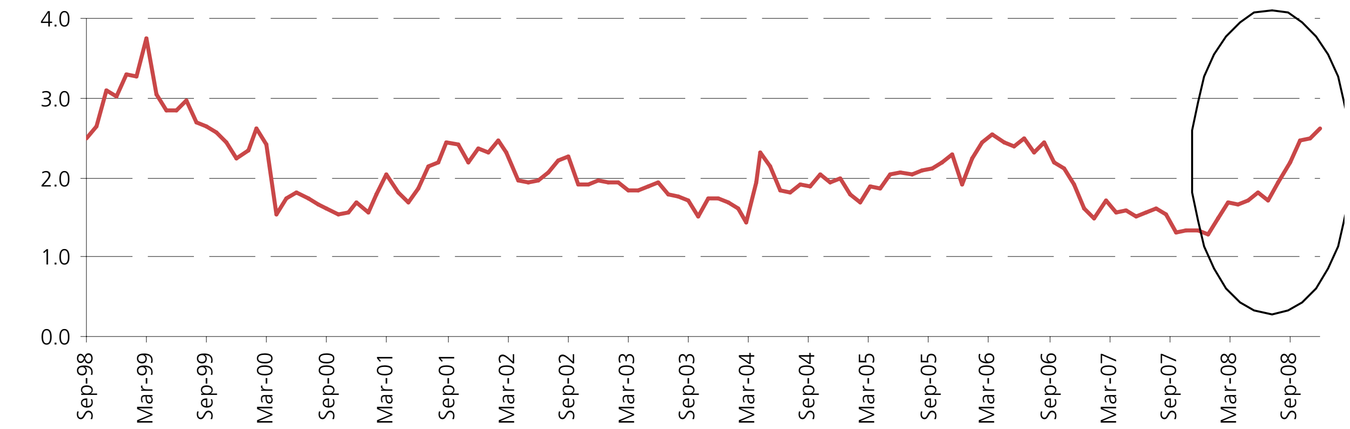
HUL - P/E bands (one year forward)



Source : Kotak Institutional Equities

Stock likely to underperform from now on given the significant deterioration in quality of growth

Relative P/E of HUL over Sensex (x)



Source : Kotak Institutional Equities

HUL has outperformed Sensex by 53% over the last 1 year, stock likely to underperform from now on given the deterioration in quality of growth

Company	Price (Rs)	Mkt Cap (Rs mn)	Rating	TP (Rs)	Absolute Change, % 1-mo	6-mo	1-Year	Relative Change, % 1-mo	6-mo	1-Year	52 Week High	Low
Hindustan Unilever	247	537,398	REDUCE	245	(4)	7	29	6	34	53	270	180
ITC	170	642,171	ADD	200	(4)	(11)	(13)	6	22	25	232	132
Nestle India	1,496	144,199	ADD	1740	6	(2)	8	15	28	39	1,870	1,220
Colgate-Palmolive	417	56,641	REDUCE	400	3	14	1	12	39	34	492	340
Godrej Consumer Products	131	33,864	ADD	160	(4)	5	16	6	33	44	147	87
GlaxoSmithkline Consumer	570	23,972	ADD	700	3	(7)	(9)	13	24	28	766	452
Asian Paints	921	88,318	REDUCE	800	6	(17)	(8)	14	17	28	1,334	826
Jyothy Laboratories	56	4,078	ADD	127	(25)	(37)	(65)	(13)	4	-	168	42
Tata Tea	622	38,471	BUY	1100	5	(17)	(6)	14	17	30	940	430
Consumer Products		**1,569,112**	**Cautious**		**(2)**	**(4)**	**2**	**7**	**27**	**35**		
Sensex	**8,674**				**(10)**	**(42)**	**(51)**					

Note : Closing prices as of 23rd January 2009.

Source : Kotak Institutional Equities

Pharmaceuticals

DIVI.BO, Rs931	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,980
52W High -Low (Rs)	1635 - 840
Market Cap (Rs bn)	60.1

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	10.4	14.3	18.6
Net Profit (Rs bn)	3.5	5.3	6.5
EPS (Rs)	53.2	80.4	100.2
EPS gth	*85.8*	*51.0*	*24.7*
P/E (x)	17.5	11.6	9.3
EV/EBITDA (x)	14.2	9.1	6.9
Div yield (%)	0.1	0.1	0.2

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
(28.0)	(12.5)	(35.0)	(37.0)

Shareholding, September 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	53.4	-	-
FIIs	14.7	0.2	(0.0)
MFs	15.1	1.1	0.9
UTI	-	-	(0.3)
LIC	-	-	(0.3)

Divis Laboratories: Slowdown in research to hurt in 2009

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- **3QFY09 revenues and PAT below forecast due to demand slowdown**
- **We reduce FY09/10 forecasts expecting slower ramp up in R&D budgets**
- **Maintain BUY rating with a SOTP-based target price reduced to Rs1,300 due to lower valuation multiples used. (from Rs1,980)**

Divis Labs (DLL) reported revenues of Rs2.6 bn, down 7% yoy and 46% below KIE. This decline was caused by delays in orders from clients and lower than expected sales of generic Keppra. EBITDA margin before forex loss at 41% Vs 46% KIE. All fixed expenses were lower than KIE. Material cost was 37.5% vs. 35% KIE due to adverse sales mix. Forex loss of Rs140 mn is included in other expenses. PAT at Rs795 mn, 57% lower than KIE due to (1) lower than forecast revenues (2) higher forex related losses (3) higher other income. FY2009 PAT estimate revised down by 8% to reflect YTD performance while FY2010E PAT estimate revised down by 26% due to lower sales and EBITDA margin assumptions. The stock trades at 12X FY2010E and 10X FY2011E. We think that this quarter result do not show beginning of the end of outsourcing story but underlines discretionary nature of orders. Our conservative assumptions show adjusted growth of 9% in FY2010 followed by 21% in FY2011. FY2010 is likely to show 25% sales growth but margin decline due to Rupee appreciation. Maintain BUY rating with a SOTP-based target price reduced to Rs1,300. (from Rs1,980) We lower target price multiples used in our SOTP-based valuation to reflect current economic environment and slowdown in earnings growth in FY2010E.

2QFY09 revenues Rs2.6bn, 46% below KIE. The revenues were lower than expected at $54m compared to $101m KIE and $76m the previous quarter. Revenues from custom synthesis business suffered from slower client activity. Research expenses in discovery stage are discretionary and can be easily pushed ahead by a few weeks.

Management comments on revenue disappointment. Divis says they did not see any delay in delivery taking but order flow did slow down past quarter. We think this slowdown could persist in 2009. Expense control will be a key measure by innovators as they battle patent expiry and slowing sales growth in developed countries. We do not see a reversal in trend of outsourcing to India but next couple of quarters could be more challenging than previously forecast.

Management informed us that generic Keppra sales were not material in this quarter against $20m KIE. This is a real surprise to us. We expected Divis to be supplier to Mylan from launch in November. While company did not clarify the reasons for low sales this quarter, it mentioned that they are a supplier of API to several companies that received approval for generic Keppra in US market in January. Thus, we forecast revenues of $28m from this product in FY2010E.

EBITDA margins at 41% vs KIE 46%. Due to the presence of forex loss this quarter, we look at EBITDA margin excluding forex to make comparisons meaningful. Due to substantial export business (94% of sales), DLL hedges some of its export exposure and had also undertaken some forex derivative transactions.

Material costs were higher than expected at 37.5% (KIE was 35%). Management mentioned that share of custom synthesis business was about 48% compared to 52% previous quarter. Generic business is typically more material intensive than custom synthesis. Another reason was near absence of generic Keppra which we thought was a high margin opportunity.

All fixed cost items were lower than KIE except forex loss which was higher than KIE. Manufacturing expenses were Rs198m vs. KIE rs345m. This is partly due to lower sales level. Personnel costs were Rs170m vs. Rs200m KIE. Other expenses were Rs205m vs. Rs394m. Again, this reduction is partly due to lower sales level.

PAT at Rs795 mn, 57% lower than KIE This was due to (1) lower than forecast revenues (2) higher forex related losses (3) higher other income. Divis performance appears very poor due to very high revenue shortfall and very high EBITDA that it earns. It is worth noting that Divis reported 41% EBITDA margin despite disappointing revenues.

Lowering PAT for FY2009E and 2010E FY2009 PAT estimate revised down by 8% to reflect YTD performance while FY2010E PAT estimate revised down by 26% due to lower sales and EBITDA margin assumptions.

Our forecasts for FY2009-10E are based on US$ rate of Rs45 now. We revise our PAT estimates as follows (see exhibit 3)

- FY2009E – We forecast PAT of Rs1160m for the last quarter. This is comparable to Rs935m PAT achieved this quarter adjusting for forex losses. While base business revenues are likely to increase to $61m from $53m in December08, we forecast revenues of $5m from generic Keppra. We expect EBITDA margin to increase to 44% from 41% this quarter as higher sales will lead to operating leverage in the results. We have believed that generic Keppra (levitracetam) could become a large generic product for Divis and we think it could become one of the top five products in the next three years. Its existing products carbidopa, levidopa, ipomidol, dextromethorphan can increase further. Its largest product naproxen has seen reduction in prices over the past few years but volume expansion and cost reduction has helped Divis expand margin even in this product.
- FY2010E PAT estimate revised down by 26% due to lower revenues. We now forecast revenues of Rs14.7bn compared to rs18.6bn and EBITDA margin assumption (40% vs 41.5% earlier) and stable exchange rate at Rs45 for FY2009-10E whereby Divis will not gain from Rupee depreciation. We do not build in any further currency loss in FY2010E estimates and include YTD currency loss seen till date in FY2009E PAT forecasts.
- Our FY2009 sales forecast is $261m including $5m for generic Keppra and $5m for carotenoids. We forecast revenues of $323m in FY2010. This includes $28m from generic Keppra, $10m from new generic products and $10m from carotenoids.

Maintain BUY rating with a SOTP-based target price reduced to Rs1,300. (from Rs1,980) We revise target price multiples used in our SOTP-based valuation. We continue to use SOTP method for valuation. We revise the target price multiples downwards that we have used for valuing custom manufacturing and caretenoids business of Divis. This is due to current economic environment as well slower growth in Divis business in the near term. (see exhibit 4)

Due to the (1) decrease in FY2010E KIE PAT by 28% vs earlier estimate and 29% reduction in FY2011E; (2) rolling forward price target to January and (3) revision of target price multiples, we revise price target downwards to Rs1,300.(from Rs1,980).

We believe that share price will suffer in the short term despite a sizable correction before the results. While macro story of outsourcing continues to hold, we believe investors may not be keen to invest till there is a clear evidence of demand recovery. It is likely that March 09 results may not be sufficient for investors since these results could be strong due to deferment of revenues by clients from 4Q2008. We do not see immediate catalyst for Divis share price to perform.

Interim results- Divis, March fiscal year-ends (Rs mn)

	3QFY08	2QFY09	3QFY09	3QFY09 KIE	Growth (%, yoy)	Growth (%, qoq)	Chg (% vs. KIE)
Net sales	2,841	3,305	2,648	4,928	**(7)**	**(20)**	**(46)**
Change in stock	44	(428)	(477)	—	NM	NM	NM
Consumption of raw materials	1,168	1,490	1,470	1,725	26	(1)	(15)
Personnel cost	135	170	170	200	26	0	(15)
Manufacturing exp	181	181	198	345	9	9	(43)
Other expenses	211	313	345	454	63	10	(24)
Total Expenditure	1,739	1,726	1,705	2,724	(2)	(1)	(37)
EBITDA	**1,103**	**1,579**	**943**	**2,204**	**(15)**	**(40)**	**(57)**
Other income	44	50	77	15	74	53	411
Interest	18	18	16	25	(11)	(12)	(35)
Depreciation	91	119	123	130	35	3	(6)
PBT	**1,038**	**1,491**	**880**	**2,064**	(15)	(41)	(57)
Current tax	61	111	59	170	(3)	(47)	(65)
Deferred tax	(15)	26	26	25	**NM**	**(1)**	**4**
FBT	1	1	0	1	(70)	(40)	(76)
PAT	**991**	**1,354**	**795**	**1,868**	**(20)**	**(41)**	**(57)**

Source: Company data, Kotak Institutional Equities.

Forecasts and valuation, March fiscal year-ends, 2007-2011E

	Net Revenue		EBITDA		Net Profit		EPS	ROCE	ROE	P/E
	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs)	(%)	(%)	(X)
2007	7,273	89.1	2,414	103.0	1,859	167.3	28.6	37.1	42.5	32.5
2008	10,365	42.5	4,133	71.2	3,476	87.0	53.2	46.1	49.8	17.5
2009E	11,725	13.1	4,990	20.7	4,262	22.6	65.3	39.5	40.4	14.2
2010E	14,329	22.2	5,745	15.1	4,711	10.5	72.2	33.2	32.2	12.9
2011E	17,444	21.7	6,995	21.8	5,778	22.6	88.5	31.0	29.8	10.5

Source: Company, Kotak Institutional Equities estimates.

Change in estimates, March fiscal year-ends, (Rs mn)

	Current estimates		Earlier estimates		% change	
	2010E	**2011E**	**2010E**	**2011E**	**2010E**	**2011E**
Net sales	14,329	17,444	18,593	23,880	(23)	(27)
EBITDA	5,745	6,995	7,692	9,565	(25)	(27)
EBITDA margin	40	40	41	40	(1)	0
Net profit	4,711	5,778	6,545	8,091	(28)	(29)

Source: Company data, Kotak Institutional Equities.

SOTP based price target, FY2010-FY2011E

	PAT (Rs mn)		P/E	Valuation (Rs mn)	
	FY2010E	FY2011E	(X)	FY2010E	FY2011E
Generics	2,315	2,622	12.0	27,776	31,465
Custom manufacturing	2,341	2,942	15.0	35,109	44,134
Carotenoids	106	214	15.0	1,586	3,210
Total	**4,761**	**5,778**		**64,470**	**78,809**
Value per share (Rs)				**998**	**1,220**
Cash per share (Rs)				78	134
Share price target					**1,308**

Source: Company data, Kotak Institutional Equities.

Economy

Sector coverage view	N/A

RBI pre-policy report: Risks to growth may persist, but inflation pressures may abate

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- **RBI warns of slower growth—'second round impact' if global recession worsens**
- **Market expects real GDP growth to slow down to 6.8% in FY2009; 6.2% in 2HFY10**
- **Business expectations worsen considerably**
- **Credit to industry expanding at 30.2% yoy versus 24.8% overall , led by oil companies**

RBI's pre-policy report on macro-economic and monetary developments released last evening, a prelude to this mornings policy announcement at 11.15 am (India Time), indicates that RBI expects growth to continue moderating ahead, while inflation concerns could recede on softening oil and commodity prices. From the language, it appears that RBI may not be averse to some further monetary policy easing in the forthcoming policy, in contrast to our expectations that RBI may hold for now and ease gently in February. Market and business expectations have worsened. However, credit growth remains high and oil firms' demand for credit seems to have stayed high in 3QFY09.

RBI's growth concerns significant

Our reading of the RBI's pre-policy report suggests that its growth concerns are significant and clearly override any inflation concerns if they remain. Talking of macroeconomic concerns, RBI says that "downside risks for economic growth emanate from the ongoing economic slowdown, and deterioration in global financial markets along with the corresponding slowing down in domestic demand." While it notes that positive factors include expected increase in consumption demand, it goes on to add that if global recession is deeper and the recovery is long drawn, "emerging markets would have to contend with second round effects in the form of potential terms of trade losses, erosion of export competitiveness and restricted external financing."

On inflation, RBI states that going forward, the outlook on international commodity prices, including oil, indicate further downward pressure to domestic prices.

Market forecasts see growth slowing down

RBI report disseminates the results of some of its surveys it conducts. These show:

1) Professional forecasters' median forecast sees real GDP growth slowing down to 6.8% (down from 7.7% in September survey) in FY2009 and 6.2% in 2HFY10 (down from 7.7% in September)
2) Their forecast for FY2009 industrial growth lowered to 4.9% from 7.0% earlier
3) They expect saving and investment rates in FY2009 to drop to 33% and 34.9%, respectively
4) End-FY2009 10-year G-sec yield is seen at 5.9% (down from of 8.5% in September)
5) Trade deficit is seen to narrow to US$51.4 bn in 2HFY09 (from US$69.2 bn in 1HFY09), but drop back to US$68.8 bn in 1HFY10
6) RBI's industrial outlook survey of manufacturing companies shows that outlook index declined 37.4%qoq and 55.8% yoy for 4QFY09 but more respondents appear optimistic than pressimistic
7) RBI's business expectations index dropped 5.9% qoq and 5.6% yoy

We see better growth than professional forecaster's median

Unlike in the last round of surveys where we expected growth to slowdown faster than indicated in the professional forecasters' survey, our assessment this time is the reverse. We expect:

- Real GDP growth at 6.6% in FY2009E (though we expect official Advance Estimates to place it at just under 7.0%, we expect downward revisions later)
- Real GDP growth at 6.7% in FY2010E propped up by new capacities, especially in mining sector and continued fiscal stimulus
- 10-year gilt yield at 5.25% at end FY2009 with one more cut in policy rates; but a reversal in gilt yields in FY2010 with 10-year at 7.0% at end-FY2010

Petroleum and infrastructure still driving high credit demand

The RBI report also disseminates the sector-wise credit disbursement data which is available only at quarterly intervals. The analysis of the same (see Exhibits 1 and 2) shows:

1. Credit flow over the latest period (from August 29 to December 19, 2008) has improved considerably to agriculture sector. Share of industry in the overall credit has also improved and it accounted for 55.6% of the total credit disbursed during this period.
2. Credit flow to housing dropped significantly over this period, with its growth coming down to 8.8% yoy from 14.6% yoy a year ago and 13.0% yoy at the start of the period. As a result, housing accounted for only 1.9% of the incremental credit during this quarter against 4.5% in the preceding quarter.
3. In spite of global oil prices receding in 3QFY09, oil companies' demand for credit remained high during this period. Incremental credit flow to this sector was Rs172 bn compared with Rs152 bn in the preceding quarter they continue to account for one-fifth of the total credit flow to industry over this period. Over the year, it accounted for 18% of the incremental credit, compared with just 3.7% a year ago. Credit flow to these firms has increased 115% yoy.
4. In contrast to the oil firms, credit to iron and steel industry has decelerated.
5. Infrastructure industry accounted for nearly one-thirds of the incremental credit flow in the latest period, compared with just 8% in the preceding quarter.

Overall credit growth has remained by and large robust with a 24.8% yoy increase, higher than 21.8% yoy a year ago, but lower than 26.8% a quarter ago. However, in our view, RBI is unlikely to be worried about high credit growth in the present context where the focus is on slowdown in overall activity.

Exhibit 1: Industry continues to drive high credit growth

Deployment of gross bank credit in major sectors (Rs bn)

						yoy (%)			% share over the year		% share in quarter	
	22-Dec-06	21-Dec-07	23-May-08	29-Aug-08	19-Dec-08	latest	year ago	quarter ago	latest	year ago	latest	quarter ago
Non-food Gross Bank Credit (1 to 4)	**16,252**	**19,800**	**21,748**	**23,149**	**24,702**	**24.8**	**21.8**	**26.8**	**100.0**	**100.0**	**100.0**	**100.0**
1 Agriculture and Allied Activities	**1,978**	**2,359**	**2,648**	**2,625**	**2,895**	**22.7**	**19.3**	**18.5**	**10.9**	**10.7**	**17.4**	**(1.6)**
2 Industry (Small, Medium and Large)	**6,263**	**7,825**	**8,585**	**9,323**	**10,186**	**30.2**	**24.9**	**30.6**	**48.2**	**44.0**	**55.6**	**52.7**
Small Scale Industries	1,008	1,367	1,763	1,306	1,468	7.4	35.6	9.7	2.1	10.1	10.5	(32.6)
3 Personal Loans	**4,282**	**4,962**	**5,280**	**5,521**	**5,685**	**14.6**	**15.9**	**17.4**	**14.7**	**19.2**	**10.6**	**17.2**
(i) Housing	2,179	2,497	2,625	2,688	2,717	8.8	14.6	13.9	4.5	9.0	1.9	4.5
(ii) Advances against Fixed Deposits	359	405	422	441	501	23.6	12.8	7.3	2.0	1.3	3.8	1.3
(iii) Credit Cards	119	173	266	291	294	69.6	45.3	86.3	2.5	1.5	0.2	1.8
(iv) Education	134	195	214	238	268	37.0	45.7	38.4	1.5	1.7	1.9	1.7
(v) Consumer Durables	86	91	83	80	91	0.6	5.9	(7.9)	0.0	0.1	0.7	(0.2)
4 Services	**3,730**	**4,653**	**5,232**	**5,680**	**5,936**	**27.6**	**24.8**	**35.3**	**26.2**	**26.0**	**16.5**	**31.9**
(vi) Transport Operators	225	292	352	360	381	30.6	29.9	27.5	1.8	1.9	1.4	0.5
(vii) Professional & Other Services	195	261	319	385	407	55.6	34.3	56.0	3.0	1.9	1.4	4.7
(viii) Trade	994	1,171	1,224	1,294	1,401	19.7	17.8	21.7	4.7	5.0	6.9	4.9
(ix) Real Estate Loans	380	516	610	682	765	48.1	35.8	46.3	5.1	3.8	5.3	5.1
(x) Non-Banking Financial Companies	385	615	720	770	861	40.1	59.6	62.7	5.0	6.5	5.8	3.6
memo: Priority sector	**5,654**	**6,762**	**7,400**	**7,665**	**7,641**	**13.0**	**19.6**	**20.8**	**17.9**	**31.2**	**(1.6)**	**18.9**

Note: (1) Sector-wise deployment of credit (SDC) data are provisional and based on select banks and select branches

(2) Full break-up of personal loans and services is not available

(3) Shares are calculated on flow, i.e. incremental credit during the period

Source: Reserve Bank of India, Kotak Institutional Equities

Exhibit 2: Petroleum and Infrastructure driving industrial credit expansion

Deployment of gross bank credit in major industries (Rs bn)

						yoy (%)			% share over the year		% share in quarter	
	22-Dec-06	21-Dec-07	23-May-08	29-Aug-08	19-Dec-08	latest	year ago	quarter ago	latest	year ago	latest	quarter ago
Industry (Small, Medium and Large)	**6,263**	**7,825**	**8,585**	**9,323**	**10,186**	**30.2**	**24.9**	**30.6**	**100.0**	**100.0**	**100.0**	**100.0**
Industry (-) petro, steel & metals	5,163	6,461	7,073	7,551	8,130	25.8	25.1	27.0	70.7	83.1	67.1	64.9
1 Food Processing	344	448	505	504	527	17.6	30.2	25.6	3.3	6.7	2.6	(0.1)
2 Textiles	695	861	939	970	1,020	18.4	24.0	23.1	6.7	10.7	5.8	4.2
3 Paper & Paper Products	101	126	138	144	158	25.4	23.9	23.9	1.4	1.5	1.5	0.8
4 Petroleum, Coal Products & Nuclear Fuels	313	371	473	625	797	114.5	18.6	91.8	18.0	3.7	20.0	20.6
5 Chemicals and Chemical Products	513	583	654	699	747	28.0	13.7	27.1	6.9	4.5	5.6	6.1
6 Rubber, Plastic & their Products	80	95	111	121	128	34.0	18.8	30.4	1.4	1.0	0.7	1.4
7 Iron and Steel	589	777	788	883	968	24.7	31.8	33.7	8.1	12.0	9.9	12.8
8 Other Metal & Metal Products	197	216	251	264	291	34.8	9.3	27.4	3.2	1.2	3.1	1.8
9 Engineering	385	497	526	566	637	28.3	29.0	24.4	6.0	7.1	8.3	5.4
10 Vehicles, Vehicle Parts and Transport Equipments	203	279	300	332	358	28.3	37.6	27.5	3.3	4.9	3.0	4.3
11 Gems & Jewellery	218	249	248	273	281	13.0	14.2	15.1	1.4	2.0	1.0	3.3
12 Construction	162	222	261	310	349	57.0	37.3	48.3	5.4	3.9	4.5	6.7
13 Infrastructure	1,249	1,712	2,033	2,094	2,372	38.5	37.1	35.8	28.0	29.7	32.3	8.2
14 Others	1,213	1,389	1,357	1,539	1,553	11.8	14.5	18.7	7.0	11.2	1.7	24.6

Note: (1) Credit data for industries is based on Sector-wise deployment of credit (SDC) data, which are provisional and based on select banks and select branches

(2) Shares are calculated on flow, i.e. incremental credit during the period

Source: Reserve Bank of India, Kotak institutional Equities

Economy

Sector coverage view	N/A

KIE Conference Call: Monetary policy still has considerable room for further easing says Montek Singh Ahluwalia

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- **Montek sees FY2009 fiscal gap at 6.5% of GDP against 3.6% expected at start of the year**
- **CRR and repo rate still too high and scope for further easing**
- **Government helping infrastructure financing, but wary of direct equity stake**

In a Kotak Institutional Equities (KIE) Conference Call on January 23, 2009, key policy maker Mr Montek Singh Ahluwalia, said the Center's on-and-off-budget fiscal deficit is likely to be 6.5% of the GDP or more. He said the fiscal deficit was kept high in view of the need for stimulus on cyclical considerations. He expected the fiscal gap to reduce moderately next year, but added that monetary policy still had considerable room for further easing. The current CRR and repo rate were too high and they could be lowered to low levels seen currently elsewhere in some countries. He also added that the government was doing whatever it can to reduce risk aversion and provide financing support for infrastructure investment.

Kotak Institutional Equities held a conference call with Mr Montek Singh Ahluwalia, Deputy Chairman, Planning Commission, on the two fiscal stimulus packages announced by the government. Mr Ahluwalia focused on the policy options in face of the slowing growth trajectory of the Indian economy, due largely to the impact of the falling growth rates in the US and elsewhere.

Government working towards preventing excessive risk perception

Noting that currently risk aversion was significant, Mr Ahluwalia assured institutional investors that the government was keen to prevent excessive risk perception as that could become a self-fulfilling prophecy. He said that key measures on the fiscal side have been taken and the focus would now be on implementing and carrying this forward. The size of fiscal stimulus was comparable with other countries if the size of the fiscal deficits was seen. He also added that in India, the fiscal stimulus package has been focused on supporting investment rather than consumption. However, the immediate challenge was the heightened risk aversion amongst banks that was affecting lending. The government did not want to direct banks to lend, but was assuring public sector banks banks to step up lending by measures such as possible recapitalization next year. Even though this invited some risks of NPAs, public sector banks can benefit from the competitive edge that they may gain by lending now.

Center's fiscal gap seen at 6.5% of GDP

He said that though at the start of the year, total on-and-off-budget fiscal gap of the Center was seen at about 3.6% of GDP, it is now likely to be about 6.5% or more. Of this about 1.5% of GDP was on account of lower taxes, which act as automatic stabilizer if not a pure fiscal stimulus. The expenditure stimulus provided is of an order of about 2% of GDP. Fiscal policy may need to maintain expansionary stance even next year as private investment is expected to remain low till global financial conditions improve, which may be a year.

Monetary policy still has considerable room for further easing

Asked how he sees the burden sharing between monetary and fiscal policies next year, Mr Ahluwalia noted that several countries have lowered policy rates to near zero and suggested that there was still considerable room for further monetary policy easing. He said that the CRR at 5% and the repo rate at 5.5% were still high. The government is not looking to take administrative measures to bring down interest rates in specific sectors of the economy. The monetary transmission from the policy rates to the economy might be taking greater time than expected given legacy issues in the economy. On large spread between corporate bonds and gilts, Mr Ahluwalia said policy makers were using available instruments, especially on improving liquidity and lowering short-term rates and that transmission could take some time. Mr Ahluwalia also saw some scope of fiscal improvement next year, though it may take longer to put FRBM targets back on rail. The focus on fiscal stimulus would be on implementation ahead, but monetary policy could act if needed, even after elections are notified.

Balance of payment likely to improve next year

The Deputy Chairman of the Planning Commission said from the viewpoint of external flows, most estimates predict an improvement in the balance of payments position based on lower oil import bill and other factors. The forex reserves of the country were at a comfortable level. He added that the country's record on attracting FDI was satisfactory and though FDI may be slowing a bit now, but we are far from any reversals. From a policy point of view, there was merit in keeping a non-discriminatory approach between FDI and domestic investment. He added that as of now he did not anticipate any significant pressure on the rupee next year, especially as capital flows may return to more normalized levels from June 2009.

Government helping infrastructure investments but wary of direct equity stake

Discussing the concerns relating to infrastructure spending, Mr Ahluwalia clarified that the government was not too keen to take direct equity stake in infrastructure projects, but was nevertheless stepping up public investment in this area as a counter-cyclical measure. He added that India Infrastructure Finance Company Limited would be providing up to 20% of project cost, including quasi-equity, so that private investment can raise debt. He also assured that projects related to the Commonwealth Games in New Delhi would be completed on time.

KIE view on further stimulus

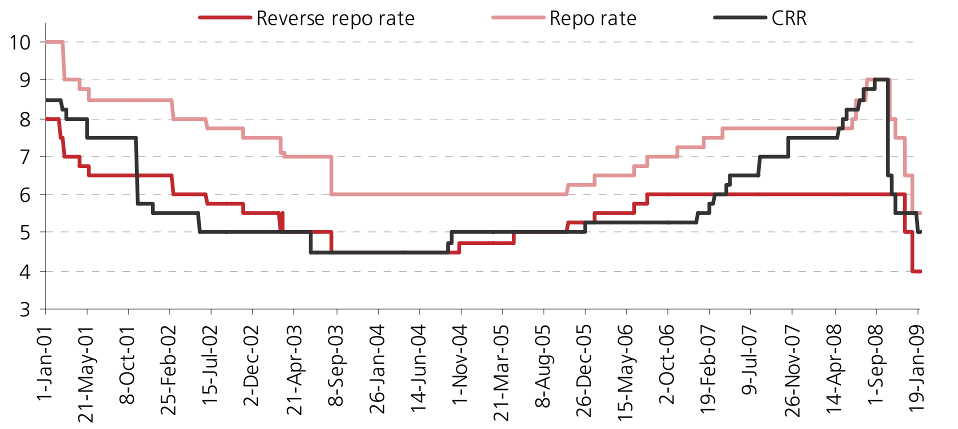
KIE views that policy options on further monetary stimulus could get constrained, as RBI has already undertaken front-loaded monetary policy easing (see Exhibit 1). As such, it is not clear if further CRR or policy rate cut would necessarily occur in the January 27, 2009 policy. But given the indication by Mr Ahluwalia in his conference call, the odds for a 50 bps cut in repo and reverse repo rate have increased. See also our Economy note of January 23, 2009, *RBI's policy meet on January 27, 2009 – Pause likely before small easing ahead* for our view of no change and the considerations behind the same.

Our view on the fiscal gap is that GFD/GDP ratio (on-and-off-budget) is even likely to exceed the 6.5% indicated by Mr Ahluwalia. We see Center's on-budget deficit at 6% of GDP and the off-budget deficit at 1.5% (see Exhibit 2). We also see the state's fiscal deficit at 2.7% of GDP. The combined deficit, therefore, works out to be over 10% of GDP, pretty much in line with the similar large expected gap in the case of the US this year.

(Full transcript is expected to be available next week and may be obtained on email request at mridul.saggar@kotak.com)

Exhibit1: Large front-loaded monetary easing implies smaller easing ahed

RBI's repo, reverse repo rates and cash reserve ratio (%)



Source: Reserve Bank of India

Exhibit 2: Fiscal stimulus to widen fiscal gap in FY2009E, but small headroom may come in FY2010E

Select budgetary heads of the central government, March fiscal year-ends, 2008-10E (Rs bn)

	On budget subsidies/expenses				Off budget subsidies/expenses		
	2009BE (a)	2009E (b)	(b) - (a)	2010E	2008	2009E	2010E
Subsidies	**714**	**1,391**	**676**	**1,013**	**476**	**799**	**300**
Food	327	387	60	360	_	_	_
Fertilizers	310	758	449	400	123	140	200
Petroleum	29	29	0	30	353	659	100
Farm debt waiver	0	150	150	150	_	_	_
Interest subsidies	28	32	4	35	_	_	_
Others	21	35	14	38	_	_	_
Sixth Pay Commission & pensions	0	248	248	354	_	_	_
NREG	144	249	105	249	_	_	_
IMF Quota increase	0	86	86	0			
MSS interest outgo	140	95	-45	30			
added interest outgo				87			
Fiscal stimulus expenditures	0	200	200	600			
Total of select expenditure heads	**998**	**2,269**	**1,271**	**2,333**	**476**	**799**	**300**
Direct tax receipts	3,650	3,515	-135	3,925			
Indirect tax receipts	3,227	2,985	-242	3,354			
Fiscal stimulus indirect tax revenue loss	3,227	2,835	-150	2,904			
Total tax revenue (gross)	**6,877**	**6,350**	**-527**	**6,829**			
3G-licensing fee	0	0	0	230			
Disinvestment	102	10	-92	150			
Additional transfer of RBI profit	114	150	36	150			
Dividends & profits (excl. transfer of RBI profits)	318	274	-44	330			
Total non-tax revenue	**958**	**858**	**-100**	**1,284**			
Total of tax and non-tax revenues	7,835	7,208	-627	8,113			
Gross fiscal deficit (GFD)	**1,333**	**3,231**	**1,898**	**2,390**			
GDP	53,038	54105	54105	59,566	47,131	54105	59,566
Gross fiscal deficit/GDP (%)	**2.5**	**6.0**	**3.5**	**4.0**	**1.0**	**1.5**	**0.5**

Note:

(1) 2009E takes into account the first and the second supplementary budgets

(2) Average price of oil is assumed at US$70/b for FY2010E.

(3) we assume that 3G licensing auction process may not get completed this year; but if it does the GFD/GDP ratio drops to 5.1% in FY2009 but rises to 4.4% in FY2010

Source: Ministry of Finance, Kotak Institutitional Equities estimates

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

Company	23-Jan-09 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2008	EPS (Rs) 2009E	EPS (Rs) 2010E	EPS growth (%) 2008	EPS growth (%) 2009E	EPS growth (%) 2010E	PER (X) 2008	PER (X) 2009E	PER (X) 2010E	EV/EBITDA (X) 2008	EV/EBITDA (X) 2009E	EV/EBITDA (X) 2010E	Price/BV (X) 2008	Price/BV (X) 2009E	Price/BV (X) 2010E	Dividend yield (%) 2008	Dividend yield (%) 2009E	Dividend yield (%) 2010E	RoE (%) 2008	RoE (%) 2009E	RoE (%) 2010E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Automobiles																													
Bajaj Auto	458	REDUCE	66,200	1,346	145	59.3	62.1	67.9	(53.4)	4.7	9.3	7.7	7.4	6.7	5.6	5.5	4.7	4.1	3.4	2.8	4.4	4.4	4.4	21.0	40.1	36.4	375	(18.0)	—
Hero Honda	847	REDUCE	169,066	3,436	200	48.5	60.2	74.4	12.8	24.3	23.5	17.5	14.1	11.4	11.0	9.3	7.8	5.4	4.4	3.5	2.2	2.4	2.4	34.0	34.8	34.3	890	5.1	8.9
Mahindra & Mahindra	265	ADD	68,306	1,388	258	38.1	18.2	17.6	(2.0)	(52.2)	(3.3)	7.0	14.6	15.1	5.7	11.1	9.2	1.6	1.3	1.2	4.1	3.5	3.6	27.8	13.5	11.3	365	37.9	5.0
Maruti Suzuki	515	SELL	148,893	3,026	289	59.9	46.5	51.5	10.8	(22.4)	10.8	8.6	11.1	10.0	4.9	5.8	5.1	1.7	1.5	1.3	1.0	1.0	1.0	22.2	14.6	14.2	435	(15.6)	15.5
Tata Motors	135	SELL	75,147	1,527	556	36.5	25.0	19.5	(22.4)	(31.4)	(21.8)	3.7	5.4	6.9	3.2	6.2	6.1	0.9	0.4	0.5	7.7	10.3	10.3	24.7	12.4	7.9	120	(11.1)	10.4
Automobiles		**Cautious**	**527,612**	**10,724**					**(0.8)**	**(18.8)**	**3.6**	**8.1**	**9.9**	**9.6**	5.4	7.0	6.3	**2.0**	**1.6**	**1.4**	**3.2**	**3.5**	**3.5**	**24.6**	**15.6**	**14.4**			
Banks/Financial Institutions																													
Andhra Bank	54	ADD	26,336	535	485	11.9	12.2	11.3	7.0	3.2	(7.6)	4.6	4.4	4.8	—	—	—	0.9	0.8	0.8	7.4	5.6	5.2	18.0	17.2	14.2	75	38.1	0.5
Axis Bank	384	ADD	137,468	2,794	358	32.2	47.0	53.9	37.7	46.0	14.6	11.9	8.2	7.1	—	—	—	1.7	1.5	1.4	1.5	2.3	2.7	17.6	17.9	17.8	750	95.2	42.1
Bank of Baroda	232	ADD	84,930	1,726	366	39.3	47.8	45.3	39.8	21.8	(5.4)	5.9	4.9	5.1	—	—	—	1.0	0.8	0.8	3.4	4.2	4.0	14.6	15.0	12.9	370	59.2	6.5
Bank of India	231	ADD	121,223	2,464	526	40.6	54.4	51.3	76.6	33.9	(5.8)	5.7	4.2	4.5	—	—	—	1.5	1.2	1.0	1.7	2.5	2.3	27.6	28.4	21.5	330	43.2	15.5
Canara Bank	174	REDUCE	71,463	1,453	410	38.2	45.9	38.6	10.1	20.3	(15.9)	4.6	3.8	4.5	—	—	—	1.0	0.8	0.8	4.6	3.4	3.4	15.0	16.7	12.5	220	26.2	4.8
Central Bank of India	37	SELL	14,953	304	404	11.6	9.4	17.1	(24.6)	(18.6)	81.0	3.2	3.9	2.2	—	—	—	0.7	0.5	0.4	5.4	—	—	15.3	11.6	16.7	55	48.6	0.5
Corporation Bank	174	BUY	24,901	506	143	51.3	54.1	57.9	37.2	5.6	6.9	3.4	3.2	3.0	—	—	—	0.6	0.5	0.5	6.0	6.4	6.8	18.4	17.2	16.2	310	78.6	0.5
Federal Bank	141	BUY	24,030	488	171	34.4	31.7	32.3	0.5	(7.7)	1.8	4.1	4.4	4.4	—	—	—	0.6	0.6	0.5	2.8	4.2	4.3	13.6	13.1	12.1	280	99.3	1.5
Future Capital Holdings	139	BUY	8,795	179	63	(4.5)	4.5	28.8	(689.8)	(198.6)	546.1	(30.8)	31.2	4.8	—	—	—	1.2	1.2	0.9	—	—	—	(6.7)	3.8	21.4	440	216.3	0.4
HDFC	1,389	ADD	398,713	8,104	287	85.8	75.0	85.8	38.2	(12.6)	14.5	16.2	18.5	16.2	—	—	—	3.3	2.9	2.6	1.8	1.6	1.9	27.8	16.7	16.9	1,700	22.4	73.9
HDFC Bank	872	BUY	369,297	7,506	423	46.0	53.5	67.1	28.7	16.4	25.4	19.0	16.3	13.0	—	—	—	3.2	2.5	2.2	0.8	1.1	1.3	17.7	17.3	17.9	1,350	54.7	45.5
ICICI Bank	364	ADD	404,848	8,229	1,113	39.9	34.3	34.7	15.4	(14.0)	1.1	9.1	10.6	10.5	—	—	—	0.9	0.8	0.8	3.0	2.8	2.7	11.7	8.0	7.7	500	37.4	115.8
IDFC	54	ADD	69,439	1,411	1,294	5.7	6.4	7.2	3.0	13.3	11.8	9.4	8.3	7.4	—	—	—	1.2	1.1	1.0	2.2	2.1	2.3	17.6	14.2	14.2	85	58.4	16.3
India Infoline	41	ADD	11,912	242	287	5.6	4.9	4.3	85.6	(12.0)	(12.5)	7.4	8.4	9.6	#REF!	#REF!	#REF!	1.0	1.0	0.9	2.9	6.8	6.0	20.7	11.5	9.8	60	44.8	3.7
Indian Bank	121	BUY	52,196	1,061	430	22.5	27.4	28.5	33.9	21.4	4.1	5.4	4.4	4.3	—	—	—	1.2	1.0	0.8	2.5	2.9	3.0	23.4	22.1	19.4	195	60.6	1.4
Indian Overseas Bank	60	BUY	32,879	668	545	22.1	23.4	24.0	19.2	5.9	2.9	2.7	2.6	2.5	—	—	—	0.7	0.6	0.5	6.2	8.2	9.1	27.2	23.8	20.6	130	115.4	1.1
J&K Bank	300	ADD	14,543	296	48	74.2	79.6	76.3	31.2	7.3	(4.1)	4.0	3.8	3.9	—	—	—	0.7	0.6	0.6	5.2	5.5	5.3	16.8	15.9	13.6	500	66.7	0.1
LIC Housing Finance	206	ADD	17,526	356	85	45.5	58.1	58.5	38.7	27.6	0.8	4.5	3.5	3.5	—	—	—	0.9	0.8	0.7	4.8	6.2	6.2	—	—	—	330	60.0	5.1
Mahindra & Mahindra Financial	206	SELL	19,603	398	95	20.8	18.5	22.6	32.6	(11.2)	22.0	9.9	11.1	9.1	—	—	—	1.6	1.4	1.2	2.2	2.2	2.7	16.9	12.8	14.2	190	(7.6)	0.2
Oriental Bank of Commerce	131	ADD	32,846	668	251	23.9	36.0	31.2	(27.6)	50.9	(13.3)	5.5	3.6	4.2	—	—	—	0.7	0.6	0.6	3.6	5.5	4.8	6.2	14.7	11.6	215	64.0	2.1
PFC	129	ADD	148,521	3,019	1,148	11.4	12.2	15.8	2.4	7.4	29.8	11.4	10.6	8.2	—	—	—	1.5	1.4	1.2	2.7	2.9	3.7	13.5	13.6	15.5	145	12.1	1.8
Punjab National Bank	407	BUY	128,202	2,606	315	65.0	82.3	87.1	33.0	26.6	5.8	6.3	4.9	4.7	—	—	—	1.3	1.1	1.1	3.2	4.0	4.3	18.0	19.6	18.2	685	68.5	9.5
Shriram Transport	193	REDUCE	39,113	795	203	19.2	28.6	27.0	85.7	49.0	(5.6)	10.0	6.7	7.1	—	—	—	2.2	1.9	1.6	2.6	4.5	4.4	26.9	28.8	23.6	215	11.6	1.2
SREI	35	BUY	4,105	83	116	11.4	7.6	7.6	57.4	(33.5)	(0.2)	3.1	4.6	4.6	—	—	—	0.6	0.4	0.4	3.4	6.5	7.9	23.1	13.9	12.8	100	183.3	0.3
State Bank of India	1,042	BUY	657,676	13,367	631	106.6	137.1	130.3	23.5	28.7	(4.9)	9.8	7.6	8.0	—	—	—	1.6	1.4	1.3	2.1	2.1	2.2	16.8	16.5	13.9	1,600	53.6	116.5
Union Bank	144	BUY	72,787	1,479	505	27.5	34.7	33.8	64.0	26.2	(2.4)	5.2	4.2	4.3	—	—	—	1.0	0.8	0.7	2.8	3.6	3.5	26.8	27.6	22.0	220	52.7	4.2
Banks/Financial Institutions		**Attractive**	**2,988,306**	**60,738**					**36.9**	**19.7**	**3.2**	**9.1**	**7.6**	**7.4**	**—**	**—**	**—**	**1.4**	**1.2**	**1.1**	**2.4**	**2.6**	**2.7**	**15.4**	**16.0**	**15.3**			
Cement																													
ACC	475	REDUCE	89,510	1,819	189	64.1	56.2	43.4	13.0	(12.3)	(22.6)	7.4	8.4	10.9	3.7	3.9	5.3	2.0	1.7	1.6	4.9	4.9	4.9	33.3	23.5	16.4	550	15.9	5.5
Ambuja Cements	66	REDUCE	100,629	2,045	1,522	7.6	7.8	5.4	(11.2)	2.8	(30.5)	8.7	8.5	12.2	4.0	4.1	5.7	2.0	1.6	1.5	3.9	4.5	3.2	26.6	21.0	12.7	60	(9.2)	2.9
Grasim Industries	1,133	ADD	103,839	2,111	92	284.6	220.9	176.1	32.6	(22.4)	(20.3)	4.0	5.1	6.4	2.9	3.4	3.6	1.1	1.0	0.9	2.7	2.9	2.9	33.1	20.3	14.1	1,400	23.6	5.9
India Cements	102	BUY	28,666	583	282	24.5	22.7	20.1	n/a	(7.3)	(11.3)	4.2	4.5	5.1	3.8	3.2	3.4	0.8	0.7	0.6	1.8	2.1	2.1	25.8	18.6	14.5	145	42.6	2.4
Shree Cement	461	BUY	16,055	326	35	90.2	109.0	70.5	99.5	20.9	(35.3)	5.1	4.2	6.5	2.2	2.5	2.7	2.5	1.6	1.3	1.7	1.7	1.7	56.9	46.6	22.6	850	84.4	0.1
UltraTech Cement	396	BUY	49,578	1,008	125	81.4	73.0	54.2	28.5	(10.3)	(25.7)	4.9	5.4	7.3	3.5	4.0	4.4	1.5	1.2	1.0	1.9	2.1	2.1	45.2	29.5	17.9	525	32.6	1.3
Cement		**Cautious**	**388,276**	**7,892**					**19.3**	**(11.2)**	**(23.4)**	**5.6**	**6.3**	**8.2**	**3.3**	**3.6**	**4.2**	**1.5**	**1.2**	**1.1**	**3.3**	**3.6**	**3.2**	**26.8**	**19.8**	**13.6**			
Consumer (Discretionary)																													
Radico Khaitan	72	REDUCE	7,352	149	102	2.2	1.7	3.3	(41.4)	(24.7)	93.1	32.0	42.5	22.0	11.9	12.8	10.4	2.9	2.7	2.4	0.8	—	—	11.7	6.7	11.7	65	(9.4)	0.3
United Breweries	70	REDUCE	16,803	342	240	2.1	1.9	2.4	(2.2)	(11.4)	31.0	33.2	37.5	28.6	11.0	8.6	6.5	2.8	1.6	1.5	—	—	—	8.0	3.6	5.4	85	21.4	0.1
United Spirits	479	BUY	45,112	917	94	28.9	32.7	48.0	(52.0)	13.2	46.9	16.6	14.6	10.0	9.2	9.0	7.7	2.0	2.0	1.5	0.4	0.4	0.5	14.0	13.5	16.8	900	87.9	9.8
Consumer (Discretionary)		**Neutral**	**69,267**	**1,408**					**(3.6)**	**12.8**	**43.8**	**20.3**	**18.0**	**12.5**	**9.6**	**9.2**	**7.7**	**2.2**	**1.7**	**1.5**	**0.3**	**0.2**	**0.3**	**10.9**	**9.7**	**12.3**			
Consumer products																													
Asian Paints	921	REDUCE	88,318	1,795	96	39.3	35.7	44.3	40.4	(9.2)	24.3	23.5	25.8	20.8	14.2	15.4	12.0	9.2	8.0	6.7	1.8	1.9	2.2	45.0	34.2	36.2	800	(13.1)	0.8
Colgate-Palmolive (India)	417	REDUCE	56,641	1,151	136	17.1	19.1	21.7	16.8	11.7	13.8	24.4	21.8	19.2	20.2	17.9	15.2	30.9	30.6	30.2	3.1	3.9	4.4	100.4	141.4	159.6	400	(4.0)	0.9
GlaxoSmithkline Consumer (a)	572	ADD	24,066	489	42	38.7	44.4	49.3	26.9	14.7	11.2	14.8	12.9	11.6	7.5	6.8	5.8	3.6	3.1	2.7	2.1	2.5	2.8	27.4	26.5	25.1	700	22.3	0.2
Godrej Consumer Products	131	ADD	33,864	688	258	7.1	6.7	8.7	18.7	(5.5)	31.2	18.6	19.7	15.0	16.1	17.4	12.2	19.1	5.1	4.4	2.7	3.0	3.0	109.6	42.1	43.1	160	22.0	0.3
Hindustan Unilever	247	REDUCE	537,891	10,933	2,179	8.1	9.2	10.7	15.4	12.9	17.0	30.4	26.9	23.0	24.6	21.5	17.6	37.4	34.7	32.1	4.3	3.5	4.1	85.2	134.3	145.7	245	(0.7)	21.4
ITC	170	ADD	642,171	13,052	3,769	8.3	8.7	9.8	15.4	4.6	12.8	20.6	19.7	17.4	13.1	12.1	10.7	5.1	4.5	4.0	2.1	2.2	2.3	27.7	25.4	25.2	200	17.4	20.3
Jyothy Laboratories	57	ADD	4,133	84	73	6.5	7.2	10.6	(8.6)	10.2	47.3	8.7	7.9	5.4	5.0	4.5	3.0	1.2	1.1	0.9	4.1	4.1	5.1	13.5	13.0	16.5	127	123.0	
Nestle India (a)	1,496	ADD	144,199	2,931	96	44.5	56.4	68.1	31.3	26.8	20.7	33.6	26.5	22.0	20.2	16.7	14.1	27.9	21.4	16.7	1.8	2.3	2.8	94.8	91.4	85.4	1,740	16.3	1.0
Tata Tea	622	BUY	38,471	782	62	54.2	64.3	68.7	3.9	18.7	6.8	11.5	9.7	9.1	5.1	4.8	4.2	0.9	0.8	0.7	5.6	3.0	3.2	11.9	11.0	10.9	1,100	76.8	1.0
Consumer products		**Cautious**	**1,569,754**	**31,906**					**17.2**	**8.8**	**15.5**	**23.7**	**21.8**	**18.8**	**15.6**	**14.3**	**12.3**	**7.3**	**6.4**	**5.7**	**2.9**	**2.8**	**3.1**	**31.0**	**29.6**	**30.3**			
Constructions																													
Consolidated Construction Co.	156	ADD	5,763	117	37	24.0	26.9	33.6	67.6	11.9	24.8	6.5	5.8	4.6	4.4	3.5	3.0	1.3	1.1	0.9	1.6	2.5	3.1	27.7	20.1	21.1	290	86.0	0.1
IVRCL	89	BUY	12,087	246	135	15.5	16.4	18.2	27.2	5.3	11.3	5.7	5.5	4.9	5.9	5.2	4.5	0.8	0.7	0.6	1.6	0.9	0.9	14.4	13.0	12.8	230	157.6	14.7
Nagarjuna Construction Co.	46	BUY	10,607	216	229	7.2	7.5	9.1	14.5	4.6	22.1	6.5	6.2	5.1	6.1	5.8	5.3	0.7	1.2	0.6	2.4	2.9	3.5	12.6	10.5	11.7	115	148.4	3.2
Punj Lloyd	92	REDUCE	29,886	607	323	10.0	9.6	16.4	323.5	(4.0)	71.5	9.3	9.6	5.6	5.6	7.0	4.3	1.1	0.9	0.9	0.4	0.5	0.8	16.8	10.8	16.3	105	13.6	28.5
Sadbhav Engineering	323	BUY	4,229	86	13	40.5	62.6	78.1	68.2	54.4	24.8	8.0	5.2	4.1	5.2	2.9	2.0	1.4	1.0	0.8	1.2	1.5	1.9	16.3	19.6	20.5	820	154.0	0.1
Construction		**Attractive**	**62,573**	**1,272**					**94.7**	**5.6**	**37.7**	**7.5**	**7.1**	**5.2**	**5.7**	**5.7**	**4.3**	**0.9**	**0.8**	**0.7**	**1.1**	**1.2**	**1.5**	**12.5**	**11.8**	**14.2**			

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

	23-Jan-09		Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			PER (X)			EV/EBITDA (X)			Price/BV (X)			Dividend yield (%)			RoE (%)			Target price	Upside	ADVT-3mo
Company	Price (Rs)	Rating	(Rs mn)	(US$ mn)	(mn)	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	(Rs)	(%)	(US$ mn)
Energy																													
Bharat Petroleum	367	REDUCE	120,180	2,443	328	41.3	30.4	42.8	(21.2)	(26.4)	41.0	8.9	12.1	8.6	4.1	4.7	3.5	0.9	0.9	0.8	1.2	0.8	1.2	11.8	7.9	10.1	370	0.9	6.2
Cairn india	152	BUY	283,926	5,771	1,868	(0.1)	3.5	12.5	(105)	(3,032)	259	(1,275)	43	12.1	35.1	22.6	8.0	0.9	0.9	0.8	—	—	—	(0.1)	2.1	6.9	240	57.9	15.8
Castrol India (a)	324	ADD	40,078	815	124	20.1	23.1	25.2	64.6	15.1	8.8	16.1	14.0	12.9	9.3	8.0	7.3	9.7	9.3	8.9	4.3	5.6	6.2	59.5	67.8	70.7	380	17.2	0.3
GAIL (India)	199	REDUCE	252,934	5,141	1,268	20.4	25.1	25.8	21.0	22.9	3.1	9.8	8.0	7.7	4.7	4.6	5.6	1.8	1.5	1.3	3.3	4.0	4.0	18.1	19.6	17.4	220	10.3	11.0
GSPL	26	BUY	14,829	301	563	1.8	2.7	3.7	10.1	47.6	37.7	14.6	9.9	7.2	5.6	5.4	4.0	1.2	1.1	1.0	1.9	2.8	3.9	8.8	11.5	14.2	60	127.7	1.6
Hindustan Petroleum	273	REDUCE	92,567	1,881	339	33.5	26.0	33.6	(16.4)	(22.3)	29.0	8.2	10.5	8.1	7.2	5.6	3.9	0.8	0.7	0.6	1.1	0.9	1.1	9.6	6.8	8.0	270	(1.1)	7.8
Indian Oil Corporation	433	REDUCE	510,940	10,385	1,179	61.3	32.4	53.8	31.0	(47.2)	66.0	7.1	13.4	8.1	4.3	8.4	6.5	1.1	1.1	0.9	1.3	0.7	1.3	17.4	8.1	12.1	450	3.9	3.7
Oil & Natural Gas Corporation	647	BUY	1,382,790	28,105	2,139	92.7	112.2	123.0	9.1	21.0	9.6	7.0	5.8	5.3	2.4	2.0	1.8	1.4	1.2	1.1	4.9	5.6	7.0	19.6	21.0	20.0	1,000	54.7	40.3
Petronet LNG	34	ADD	25,200	512	750	6.3	5.5	5.9	—	(12.6)	6.6	5.3	6.1	5.7	3.7	5.6	4.4	1.3	1.1	0.9	4.5	4.5	4.5	26.7	19.2	17.2	52	54.8	1.7
Reliance Industries	1,156	ADD	1,587,394	32,264	1,373	105.0	97.7	115.7	25.5	(6.9)	18.4	11.0	11.8	10.0	7.5	6.9	4.4	1.8	1.5	1.2	1.0	1.2	1.4	19.0	14.3	14.6	1,400	21.1	242.2
Reliance Petroleum	77	REDUCE	345,150	7,015	4,500	-	(0.0)	7.1	n/a	n/a	n/a	n/a	n/a	10.8	n/a	n/a	8.6	2.6	2.6	2.2	—	—	2.6	-	(0.0)	22.0	85	10.8	37.7
Energy		**Neutral**	**4,655,988**	**94,634**					**13.0**	**3.1**	**28.7**	**9.7**	**9.4**	**7.3**	**5.0**	**5.2**	**4.0**	**1.4**	**1.2**	**1.1**	**2.3**	**2.5**	**3.2**	**14.9**	**13.1**	**15.0**			
Industrials																													
ABB	446	REDUCE	94,522	1,921	212	23.2	25.5	29.8	44.5	10.0	16.6	19.2	17.5	15.0	11.0	9.8	8.1	5.8	4.5	3.6	0.5	0.6	0.7	34.8	29.2	26.9	500	12.1	5.2
BGR Energy Systems	142	ADD	10,188	207	72	12.1	16.3	23.4	(67.4)	34.0	43.8	11.7	8.7	6.1	6.8	5.3	4.6	2.2	1.8	1.4	1.4	1.8	2.7	31.4	22.5	26.5	225	59.0	0.7
Bharat Electronics	780	ADD	62,432	1,269	80	102.0	105.5	111.8	11.2	3.4	6.0	7.7	7.4	7.0	3.0	2.3	2.0	1.9	1.6	1.3	2.7	3.2	3.2	27.7	23.1	20.8	950	21.7	1.0
Bharat Heavy Electricals	1,321	BUY	646,534	13,141	490	58.4	72.2	98.0	22.9	23.7	35.6	22.6	18.3	13.5	11.8	9.3	7.0	6.0	4.8	3.8	1.2	1.2	1.6	29.2	29.2	31.5	1,475	11.7	61.2
Larsen & Toubro	641	REDUCE	379,950	7,723	593	37.9	50.7	58.5	20.8	33.5	15.4	16.9	12.7	11.0	11.8	8.5	7.5	3.2	2.4	2.0	1.3	3.1	3.1	22.7	21.8	20.2	840	31.0	64.9
Maharashtra Seamless	123	BUY	8,707	177	71	29.4	37.4	37.9	(23.5)	27.6	1.2	4.2	3.3	3.3	2.4	2.0	1.9	0.8	0.6	0.5	4.1	4.6	4.6	19.7	21.1	18.0	250	102.5	0.4
Siemens	188	REDUCE	63,336	1,287	337	18.2	14.2	17.2	60.4	(22.2)	21.6	10.3	13.3	10.9	5.4	5.2	5.2	3.4	2.8	2.3	1.3	1.9	2.4	39.9	23.1	23.2	270	43.7	5.9
Suzlon Energy	49	BUY	76,546	1,556	1,567	6.6	7.1	10.2	9.5	8.4	42.9	7.4	6.9	4.8	4.7	7.1	5.5	0.8	0.8	0.7	2.0	2.0	2.0	16.3	11.8	14.9	125	155.9	59.6
Industrials		**Neutral**	**1,342,214**	**27,281**					**24.6**	**18.6**	**25.5**	**16.1**	**13.6**	**10.8**	**9.2**	**7.8**	**6.5**	**3.3**	**2.7**	**2.2**	**1.3**	**1.9**	**2.1**	**20.8**	**20.1**	**20.8**			
Infrastructure																													
IRB Infrastructure	108	ADD	36,028	732	332	3.4	7.0	14.0	150.9	104.8	99.7	31.6	15.4	7.7	11.9	10.0	5.3	2.2	1.9	1.5	—	—	—	10.7	13.1	21.4	130	19.9	0.3
Media																													
DishTV	19	REDUCE	12,270	249	644	(9.6)	(7.4)	(4.1)	n/a	(23.1)	(44.2)	(2.0)	(2.6)	(4.6)	(7.6)	(10.2)	(47.0)	(2.7)	(1.9)	(5.7)	—	—	—	167.9	86.7	NA	22	15.5	1.0
HT Media	53	BUY	12,474	254	234	4.3	3.1	4.8	4.7	(28.5)	53.7	12.3	17.2	11.2	6.6	7.8	5.1	1.4	1.4	1.3	0.8	0.8	1.5	12.2	8.2	11.8	115	116.0	0.1
Jagran Prakashan	49	BUY	14,772	300	301	3.3	3.2	4.6	33.5	(2.7)	45.1	15.1	15.5	10.7	8.2	8.6	6.0	2.7	2.6	2.4	4.1	3.9	4.7	18.7	17.3	23.2	84	71.3	0.0
Sun TV Network	149	BUY	58,619	1,191	394	8.3	9.2	11.1	30.7	10.7	20.8	17.9	16.2	13.4	9.5	8.4	7.1	3.9	3.5	3.1	1.7	2.7	3.7	24.8	23.3	25.0	210	41.2	2.5
Zee Entertainment Enterprises	92	BUY	39,693	807	434	8.9	8.2	9.3	62.6	(7.5)	13.7	10.3	11.2	9.8	7.7	8.2	7.2	1.3	1.2	1.1	2.2	2.5	2.9	14.2	11.8	12.2	145	58.4	5.2
Zee News	31	BUY	7,337	149	240	1.5	1.9	2.1	396.2	24.0	6.9	19.8	16.0	14.9	10.7	9.0	8.0	3.5	3.0	2.6	1.3	1.3	1.6	19.2	20.5	18.9	38	24.2	0.3
Media		**Attractive**	**145,166**	**2,951**					**30.8**	**(16.6)**	**67.7**	**27.1**	**32.5**	**19.4**	**11.1**	**10.9**	**7.7**	**2.6**	**2.4**	**2.0**	**1.8**	**2.3**	**3.0**	**9.5**	**7.3**	**10.5**			
Metals																													
Hindalco Industries	44	SELL	76,239	1,550	1,753	13.8	9.5	7.3	(10.0)	(30.9)	(23.8)	3.2	4.6	6.0	5.5	4.8	5.2	0.4	0.2	0.3	—	—	—	14.4	10.6	7.1	40	(8.0)	14.7
National Aluminium Co.	186	SELL	119,616	2,431	644	25.3	17.1	9.4	(31.5)	(32.6)	(44.7)	7.3	10.9	19.6	3.0	4.9	5.8	1.3	1.2	1.1	3.2	1.9	1.1	18.3	11.1	5.8	135	(27.3)	3.4
Jindal Steel and Power	780	BUY	120,159	2,442	154	101.8	87.5	77.7	123.0	(14.1)	(11.2)	7.7	8.9	10.0	6.7	6.1	6.6	2.8	2.1	1.7	0.6	0.8	0.9	43.8	27.2	19.1	1,250	60.2	15.1
JSW Steel	187	SELL	34,913	710	187	86.1	6.8	16.4	16.1	(92.1)	142.0	2.2	27.6	11.4	4.4	7.0	7.3	0.4	0.3	0.3	7.5	1.1	1.1	20.7	9.9	3.1	140	(25.0)	6.0
Hindustan Zinc	322	BUY	136,182	2,768	423	104.0	66.5	59.0	(1.0)	(36.1)	(11.2)	3.1	4.8	5.5	1.1	1.5	1.6	1.1	0.9	0.8	1.6	2.3	3.1	43.6	20.8	15.7	470	45.8	2.1
Sesa Goa	68	ADD	53,847	1,094	787	18.9	22.0	13.3	145.9	16.3	(39.8)	3.6	3.1	5.2	2.4	1.9	2.7	1.9	1.3	1.2	5.1	10.2	10.2	67.7	50.5	24.4	100	46.2	11.5
Sterlite Industries	239	BUY	169,507	3,445	708	64.3	49.1	40.5	(22.6)	(23.8)	(17.5)	3.7	4.9	5.9	3.2	4.8	6.1	0.7	0.7	0.6	—	—	—	26.1	14.0	10.6	365	52.6	22.1
Tata Steel	166	BUY	136,697	2,778	822	75.7	130.0	107.2	43.8	71.6	(17.5)	2.2	1.3	1.6	3.5	2.6	2.7	0.4	0.3	0.3	8.7	7.8	7.8	46.3	38.0	27.6	350	110.5	50.5
Metals		**Neutral**	**847,160**	**17,219**					**12.7**	**0.1**	**(21.6)**	**3.6**	**3.6**	**4.5**	**3.6**	**3.6**	**4.0**	**0.7**	**0.6**	**0.5**	**2.8**	**2.7**	**2.7**	**19.9**	**16.4**	**11.5**			
Pharmaceutical																													
Biocon	108	BUY	21,550	438	200	23.3	5.0	14.5	126.0	(78.4)	186.6	4.6	21.4	7.5	5.8	8.8	4.6	1.5	1.4	1.2	0.1	0.0	0.1	17.6	6.6	17.3	230	113.5	0.5
Cipla	186	REDUCE	144,615	2,939	777	9.0	9.6	12.4	4.9	6.4	28.8	20.6	19.4	15.1	15.2	14.1	11.0	3.9	3.4	2.9	1.1	1.3	1.6	20.1	18.6	20.8	220	18.2	5.8
Dishman Pharma & chemicals	120	BUY	9,792	199	81	14.7	15.4	28.1	30.5	4.6	82.8	8.2	7.8	4.3	8.0	7.6	4.7	1.7	1.4	1.1	0.0	0.0	0.0	26.8	19.9	29.0	400	232.2	0.3
Divi's Laboratories	931	BUY	60,073	1,221	65	53.2	65.3	72.2	85.8	22.6	10.5	17.5	14.3	12.9	14.2	11.0	9.3	7.1	4.8	3.6	0.1	0.1	0.1	49.8	40.4	32.2	1,300	39.7	3.9
Dr Reddy's Laboratories	432	BUY	73,124	1,486	169	26.1	28.7	37.8	(57.2)	10.0	31.7	16.6	15.1	11.4	8.2	6.8	5.6	1.6	1.5	1.3	0.9	0.9	0.9	10.3	10.3	12.2	675	56.2	4.5
Glenmark Pharmaceuticals	204	BUY	54,128	1,100	266	25.8	36.2	43.8	98.4	40.1	20.9	7.9	5.6	4.6	7.4	4.4	3.5	3.6	1.9	1.4	0.1	0.1	0.1	57.4	43.8	35.3	725	256.1	5.2
Jubilant Organosys	127	BUY	22,663	461	179	22.4	10.9	30.1	72.3	(51.2)	175.8	5.7	11.6	4.2	6.4	10.5	5.2	1.8	1.3	1.2	1.0	1.3	1.7	37.0	14.6	32.4	475	274.5	0.4
Lupin	585	BUY	51,777	1,052	89	49.8	49.1	59.4	30.2	(1.3)	20.8	11.7	11.9	9.8	14.0	10.2	8.4	4.0	2.5	2.2	1.6	1.6	2.0	37.9	26.7	24.0	950	62.5	1.6
Piramal Healthcare	215	BUY	44,862	912	209	17.7	15.6	20.3	66.8	(12.0)	30.3	12.1	13.8	10.6	9.2	10.2	7.5	4.1	3.4	2.7	2.0	1.9	2.1	30.9	26.0	28.9	340	58.4	0.5
Ranbaxy Laboratories	188	ADD	78,827	1,602	419	23.3	(8.1)	13.0	70.4	NA	NA	8.1	NA	14.5	7.8	(113.8)	5.5	2.6	1.6	0.9	4.0	5.5	6.3	32.3	(8.8)	8.4	340	80.8	9.4
Sun Pharmaceuticals	1,072	BUY	221,956	4,511	207	74.7	89.0	79.8	78.9	19.2	(10.4)	14.4	12.0	13.4	12.0	9.1	9.4	4.3	3.2	2.7	1.0	1.0	1.3	38.3	31.8	22.7	1,765	64.7	16.9
Pharmaceuticals		**Attractive**	**783,368**	**15,922**					**34.1**	**(12.0)**	**41.2**	**13.1**	**14.8**	**10.5**	**10.0**	**10.2**	**7.0**	**3.2**	**2.4**	**1.9**	**1.2**	**1.4**	**1.7**	**24.5**	**16.5**	**17.8**			
Property																													
DLF	161	ADD	274,984	5,589	1,705	46.1	34.1	27.2	263.2	(26.1)	(20.3)	3.5	4.7	5.9	3.9	5.1	5.7	1.4	1.1	1.0	2.5	2.5	2.5	66.5	26.2	17.4	235	45.7	87.7
Housing Development & Infrastruc	90	ADD	24,767	503	275	51.2	33.4	30.5	118.6	(34.7)	(8.9)	1.8	2.7	3.0	3.1	4.9	4.8	0.7	0.6	0.5	4.3	5.6	6.7	64.5	22.9	17.7	165	83.5	57.1
Indiabulls Real Estate	95	ADD	24,372	495	258	16.4	4.0	5.1	2,383.9	(75.4)	25.8	5.8	23.4	18.6	(584.9)	54.1	(9.6)	0.4	0.4	0.4	0.3	0.1	0.0	10.6	1.7	2.0	180	90.3	37.8
IVR Prime Urban Developers	32	BUY	2,040	41	64	27.0	2.9	7.8	552.8	(89.4)	171.9	1.2	11.1	4.1	0.0	15.9	7.9	0.2	0.2	0.2	12.6	15.7	22.0	31.9	1.9	5.1	120	277.4	0.2
Mahindra Life Space Developer	136	BUY	5,707	116	42	16.8	10.2	10.8	307.7	(39.2)	5.3	8.1	13.3	12.6	14.7	19.3	10.4	0.7	0.6	0.6	2.0	2.9	2.9	8.4	4.8	4.9	410	202.1	0.2
Phoenix Mills	67	BUY	9,712	197	145	12.4	5.2	9.2	89.5	(57.8)	74.5	5.4	12.8	7.3	6.7	12.5	5.2	0.7	0.6	0.6	1.5	—	—	22.1	5.1	8.4	215	220.7	0.1
Puravankara Projects	33	ADD	6,958	141	213	11.2	9.3	9.9	67.3	(17.1)	5.8	2.9	3.5	3.3	6.2	8.7	8.2	0.6	0.5	0.5	6.1	6.1	9.2	34.2	15.8	15.0	90	176.1	0.3
Sobha	81	REDUCE	5,876	119	73	31.7	26.8	25.7	42.9	(15.6)	(4.2)	2.5	3.0	3.1	6.3	5.6	6.3	0.6	0.5	0.4	8.1	5.0	5.0	25.3	17.9	15.0	105	30.3	0.5

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation Summary of Key Indian Companies

Company	23-Jan-09 Price (Rs)	Rating	Mkt cap. (Rs mn)	Mkt cap. (US$ mn)	O/S shares (mn)	EPS (Rs) 2008	EPS (Rs) 2009E	EPS (Rs) 2010E	EPS growth (%) 2008	EPS growth (%) 2009E	EPS growth (%) 2010E	PER (X) 2008	PER (X) 2009E	PER (X) 2010E	EV/EBITDA (X) 2008	EV/EBITDA (X) 2009E	EV/EBITDA (X) 2010E	Price/BV (X) 2008	Price/BV (X) 2009E	Price/BV (X) 2010E	Dividend yield (%) 2008	Dividend yield (%) 2009E	Dividend yield (%) 2010E	RoE (%) 2008	RoE (%) 2009E	RoE (%) 2010E	Target price (Rs)	Upside (%)	ADVT-3mo (US$ mn)
Property		**Cautious**	**398,165**	**8,093**					**193.3**	**(30.6)**	**(16.2)**	**3.3**	**4.7**	**5.6**	**4.2**	**5.5**	**6.0**	**1.0**	**0.9**	**0.8**	**2.5**	**2.4**	**2.5**	**32.1**	**18.3**	**13.6**			
Retail																													
Pantaloon Retail	163	REDUCE	27,995	569	172	7.9	11.9	17.8	90.0	49.9	49.9	20.6	13.7	9.2	10.7	7.7	6.4	1.5	1.1	1.0	0.4	0.5	0.6	8.2	8.8	10.7	165	1.4	1.1
Titan Industries	919	BUY	40,812	830	44	35.1	48.5	54.7	55.2	38.4	12.8	26.2	19.0	16.8	17.7	12.0	10.2	8.7	6.3	4.8	0.9	1.0	1.2	37.7	38.5	32.6	1,280	39.2	2.9
Vishal Retail	53	ADD	1,182	24	22	18.1	14.9	20.6	37.2	(17.6)	38.4	2.9	3.5	2.6	4.8	4.2	3.1	0.4	0.4	0.3	—	—	—	20.2	11.5	14.0	125	137.0	0.2
Retail			**69,988**	**1,423**					**31.9**	**40.5**	**31.4**	**21.7**	**15.5**	**11.8**	**11.8**	**8.4**	**6.9**	**2.7**	**2.0**	**1.7**	**0.7**	**0.8**	**0.9**	**12.4**	**12.7**	**14.6**			
Technology																													
HCL Technologies	107	REDUCE	74,365	1,511	695	15.3	18.7	17.3	(19.0)	22.4	(7.7)	7.0	5.7	6.2	3.2	3.9	3.6	1.5	1.2	1.1	7.5	11.2	11.2	21.4	21.3	18.1	140	30.8	4.0
Hexaware Technologies	20	SELL	2,843	58	142	7.7	2.9	3.8	(13.7)	(62.4)	32.1	2.6	6.9	5.3	(0.3)	0.9	0.5	0.4	0.4	0.4	4.5	8.0	8.0	15.1	5.8	7.4	25	25.0	0.1
Infosys Technologies	1,205	BUY	691,469	14,054	574	79.1	101.6	107.7	18.0	28.5	5.9	15.2	11.9	11.2	11.6	8.3	7.4	5.0	3.8	3.1	2.8	2.1	2.2	36.1	36.6	30.5	1,500	24.5	59.1
Mphasis BFL	150	REDUCE	31,274	636	208	12.2	22.3	23.4	67.6	81.7	5.0	12.3	6.7	6.4	7.3	4.3	3.4	2.7	0.3	1.6	2.3	2.7	3.0	23.6	34.6	28.4	190	26.7	0.6
Mindtree	200	BUY	7,898	161	40	26.7	21.0	37.1	12.3	(21.6)	76.9	7.5	9.5	5.4	6.6	3.0	2.8	1.5	1.3	1.0	1.3	—	—	21.3	11.9	17.8	400	100.1	0.1
Patni Computer Systems	113	SELL	14,482	294	129	33.2	26.3	30.8	29.2	(20.8)	16.9	3.4	4.3	3.7	0.2	0.3	(0.7)	0.5	0.5	0.4	1.9	2.3	2.7	19.2	14.1	12.0	160	42.1	0.4
Polaris Software Lab	43	SELL	4,197	85	98	7.4	14.9	12.7	(27.6)	100.0	(14.9)	5.7	2.9	3.4	2.0	0.8	0.6	0.6	0.5	0.5	4.1	4.1	4.1	11.7	20.4	15.0	50	17.1	1.1
TCS	486	REDUCE	475,751	9,670	979	51.3	53.9	55.7	21.5	5.1	3.3	9.5	9.0	8.7	7.5	6.3	6.0	3.8	3.1	2.6	2.9	3.9	4.6	47.0	37.8	32.1	550	13.1	23.3
Tech Mahindra	209	BUY	26,078	530	125	59.1	67.6	58.7	25.7	14.5	(13.2)	3.5	3.1	3.6	3.1	1.7	1.5	2.1	1.3	0.9	2.6	2.9	3.0	70.7	53.1	31.6	320	52.9	2.3
Wipro	214	ADD	312,210	6,346	1,462	22.2	25.1	26.2	12.6	12.8	4.3	9.6	8.5	8.2	7.6	5.8	5.1	2.4	2.0	1.7	2.9	3.5	3.7	27.9	25.7	22.6	280	31.1	12.2
Technology		**Cautious**	**1,640,567**	**33,345**					**15.7**	**16.7**	**3.4**	**10.5**	**9.0**	**8.7**	**7.8**	**6.0**	**5.5**	**3.2**	**2.5**	**2.1**	**3.0**	**3.3**	**3.6**	**30.3**	**28.1**	**24.4**			
Telecom																													
Bharti Airtel Ltd	613	BUY	1,163,697	23,652	1,898	35.3	44.2	52.1	65.0	25.1	18.0	17.4	13.9	11.8	10.6	8.0	6.7	5.2	3.8	2.8	—	0.6	1.0	39.1	31.4	27.5	725	18.2	74.2
IDEA	43	REDUCE	138,516	2,815	3,236	3.9	2.6	2.8	78.5	(33.2)	6.0	10.8	16.2	15.3	8.6	5.7	5.3	3.9	1.0	1.0	—	—	—	36.4	10.1	6.7	55	28.5	5.5
MTNL	70	REDUCE	43,785	890	630	7.1	5.1	5.5	(11.0)	(28.4)	7.6	9.7	13.6	12.6	1.4	2.0	1.8	0.4	0.4	0.4	5.8	8.6	8.6	3.5	2.2	2.4	80	15.1	1.4
Reliance Communications	160	SELL	330,862	6,725	2,064	26.5	26.7	22.2	86.4	0.7	(16.5)	6.1	6.0	7.2	5.7	6.6	6.1	1.1	1.0	0.8	0.5	—	—	16.8	18.4	12.9	200	24.8	64.9
Tata Communications	427	REDUCE	121,610	2,472	285	10.9	13.6	14.0	(36.3)	24.0	3.2	39.0	31.4	30.5	16.3	13.4	12.2	1.8	1.8	1.7	1.1	1.2	1.5	4.4	5.4	5.2	400	(6.3)	4.1
Telecom		**Cautious**	**1,798,470**	**36,554**					**65.7**	**13.2**	**3.3**	**12.5**	**11.0**	**10.6**	**8.6**	**7.4**	**6.5**	**2.4**	**1.8**	**1.6**	**0.5**	**0.8**	**0.9**	**19.6**	**16.8**	**14.9**			
Transportation																													
Container Corporation	665	REDUCE	86,404	1,756	130	57.7	68.3	72.9	7.8	18.3	6.8	11.5	9.7	9.1	7.7	6.3	5.7	2.7	2.3	1.9	2.0	2.3	2.5	25.8	25.3	22.6	800	20.3	0.7
Transportation		**Cautious**	**86,404**	**1,756**					**7.8**	**18.3**	**6.8**	**11.5**	**9.7**	**9.1**	**7.7**	**6.3**	**5.7**	**2.7**	**2.3**	**1.9**	**2.0**	**2.3**	**2.5**	**23.6**	**23.1**	**20.9**			
Utilities																													
CESC	228	BUY	28,529	580	125	27.8	31.9	36.9	(23.3)	14.9	15.8	8.2	7.2	6.2	4.2	4.0	5.1	0.9	0.8	0.7	1.8	2.0	2.3	12.5	11.7	11.9	450	97.1	0.7
Lanco Infratech	104	BUY	23,008	468	222	14.8	17.5	26.0	75.2	18.2	48.3	7.0	5.9	4.0	7.6	11.3	9.8	1.3	1.0	0.8	—	—	—	19.7	19.2	23.0	370	257.5	9.0
NTPC	180	REDUCE	1,482,947	30,141	8,245	9.3	9.0	9.7	7.9	(3.2)	7.9	19.3	19.9	18.5	13.4	14.4	13.6	2.7	2.5	2.3	1.9	1.9	2.0	14.9	13.2	13.1	160	(11.0)	30.1
Reliance Infrastructure	487	BUY	112,522	2,287	231	37.6	59.9	56.2	13.9	59.4	(6.2)	13.0	8.1	8.7	8.6	8.7	8.9	0.7	0.7	0.6	1.3	1.5	1.7	4.3	6.2	6.7	970	99.1	79.8
Reliance Power	98	REDUCE	235,002	4,776	2,397	0.4	1.3	2.5	—	252.9	82.7	257.8	73.1	40.0	—	—	—	1.7	1.6	1.6	—	—	—	1.3	2.3	4.2	120	22.4	14.2
Tata Power	709	BUY	157,732	3,206	223	31.8	66.1	88.7	19.5	107.7	34.1	22.3	10.7	8.0	11.1	8.3	8.3	1.8	1.5	1.3	1.5	1.6	1.7	9.6	15.5	17.6	1,140	60.9	13.2
Utilities		**Attractive**	**2,039,740**	**41,458**					**12.2**	**13.7**	**13.3**	**20.3**	**17.9**	**15.8**	**12.7**	**13.3**	**13.3**	**2.1**	**1.9**	**1.8**	**1.6**	**1.6**	**1.7**	**10.3**	**10.8**	**11.3**			
Others																													
Aban Offshore	453	BUY	17,167	349	38	72.3	147.5	410.7	(1,066)	104.0	178.5	6.3	3.1	1.1	11.1	6.9	3.8	2.0	1.1	0.6	0.8	1.1	1.8	51.7	47.1	57.4	1,100	142.7	11.9
Educomp Solutions	1,745	BUY	33,186	675	19	35.2	63.9	108.1	114	81.7	69.2	49.6	27.3	16.1	26.5	11.2	7.0	10.8	4.5	3.7	0.1	0.3	0.5	33.5	23.3	24.3	2,550	46.1	67.4
Havells India	110	BUY	6,681	136	61	26.6	19.7	34.5	40	(25.9)	75.1	4.2	5.6	3.2	5.0	4.9	3.4	1.0	0.8	0.6	2.2	2.9	3.8	33.7	16.5	22.2	365	230.6	0.2
Jaiprakash Associates	62	BUY	86,523	1,759	1,403	4.9	5.3	7.1	7	8.6	33.4	12.6	11.6	8.7	10.9	9.6	8.3	1.7	1.5	1.3	0.0	0.0	0.0	15.4	13.9	16.3	105	70.3	41.7
Jindal Saw	199	BUY	12,214	248	61	66.6	86.9	82.9	(43)	30.6	(4.7)	3.0	2.3	2.4	2.7	1.3	1.0	0.4	0.3	0.3	3.6	6.6	7.5	12.5	14.4	12.3	500	151.1	0.5
PSL	72	BUY	3,136	64	44	21.1	43.5	58.3	4	106.2	34.1	3.4	1.7	1.2	3.2	2.8	1.9	0.6	0.4	0.3	7.1	8.3	10.4	11.3	14.9	17.5	280	289.2	0.2
Welspun Gujarat Stahl Rohren	72	BUY	13,648	277	189	20.6	25.9	36.6	94	25.9	41.6	3.5	2.8	2.0	5.5	3.3	2.1	0.8	0.6	0.5	2.6	5.2	5.5	27.1	23.9	26.6	220	204.3	3.0
Others			**172,556**	**3,507**					**24.3**	**65.2**	**54.1**	**9.9**	**6.0**	**3.9**	**8.7**	**6.3**	**4.7**	**1.4**	**1.1**	**0.9**	**0.8**	**1.3**	**1.6**	**14.5**	**18.7**	**22.7**			
KS universe (b)			**19,621,602**	**398,813**					**25.9**	**5.6**	**9.1**	**10.0**	**9.5**	**8.7**	**#REF!**	**#REF!**	**#REF!**	**1.8**	**1.5**	**1.3**	**2.1**	**2.3**	**2.6**	**18.0**	**16.0**	**15.4**			
KS universe (b) ex-Energy			**14,965,613**	**304,179**					**30.7**	**6.5**	**3.0**	**10.1**	**9.5**	**9.2**	**#REF!**	**#REF!**	**#REF!**	**2.0**	**1.6**	**1.4**	**2.0**	**2.2**	**2.4**	**19.3**	**17.2**	**15.6**			
KS universe (d) ex-Energy & ex-Commodities			**13,730,177**	**279,069**					**35.9**	**8.8**	**8.9**	**11.7**	**10.8**	**9.9**	**#REF!**	**#REF!**	**#REF!**	**2.2**	**1.9**	**1.6**	**2.0**	**2.1**	**2.3**	**18.9**	**17.2**	**16.5**			

Note:
(a) 2007 means calendar year 2006, similarly for 2008 and 2009 for these particular companies.
(b) EV/Sales & EV/EBITDA for KS universe excludes Banking Sector.
(c) Rupee-US Dollar exchange rate (Rs/US$)= 49.20

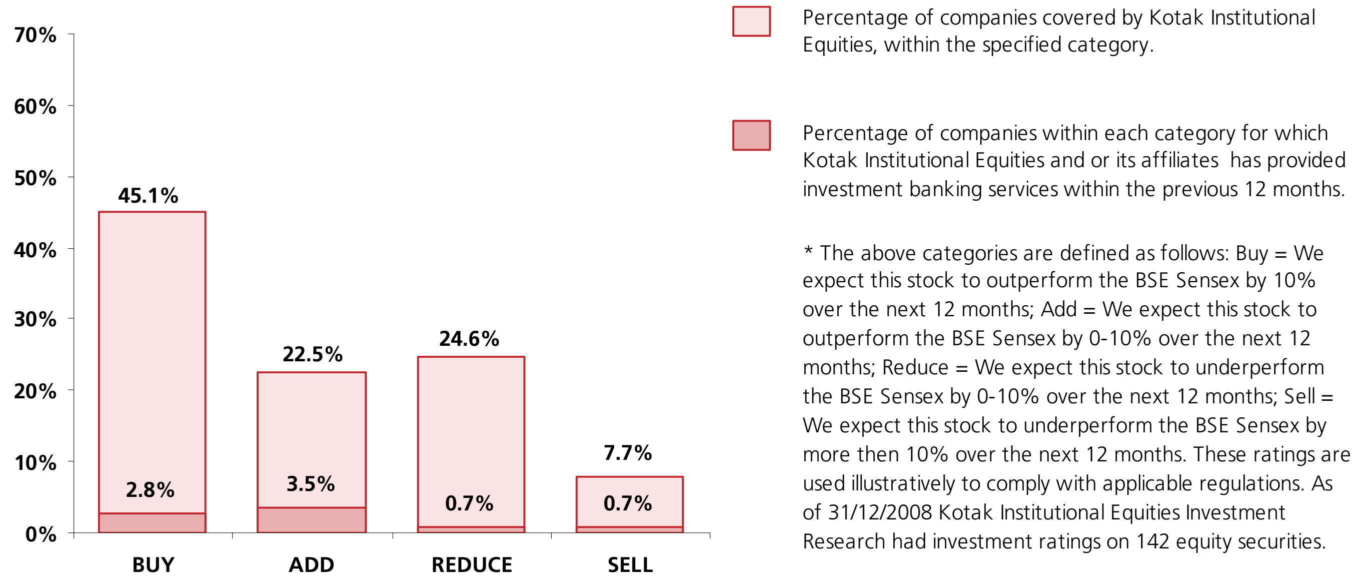
659
60.5

Source: Company, Bloomberg, Kotak Institutional Equities estimates

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Aman Batra, Manish Karwa, Kawaljeet Saluja, Rahul Jain, Lokesh Garg, Prashant Vaishampayan, Nischint Chawathe, Manoj Menon."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = We expect this stock to outperform the BSE Sensex by 10% over the next 12 months; Add = We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months; 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 Sensex by more then 10% over the next 12 months. These ratings are used illustratively to comply with applicable regulations. As of 31/12/2008 Kotak Institutional Equities Investment Research had investment ratings on 142 equity securities.

Source: Kotak Institutional Equities — As of December 31, 2008

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
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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