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News Round-up

- ▶ Excessive spending by government and slide in rupee neutralizing tight monetary policy; RBI report. A survey shows that economic growth rate may slow to 7.6% from 7.9% forecasted earlier. (ECNT)
- ▶ Future tense for power companies. Coal shortage and lower merchant tariffs will hurt performance and return ratios. (BSTD)
- ▶ The telecom ministry has accepted the finance ministry's stance that the state-owned BSNL must not be entrusted with the USD 4 bn project to build a national broadband network to take high-speed Internet to the hinterlands. A special purpose vehicle (SPV) with equity participation from BSNL and MTNL (MTNL IN) and other public sector units such as RailTel, Gail and PowerGrid, among others, will now undertake the project as demanded by the finance ministry. (ECNT)
- ▶ Infosys (INFO IN) has signed a MoU with the Dalian High-tech Zone (DHTZ) in China, to establish a branch company of Infosys Technologies (China) . (BSTD)
- ▶ TCS (TCS IN) announced Scotwest and Capital Credit Unions had chosen TCS BaNCS core banking as its IT platform to transform its infrastructure and address emerging opportunities in community banking in the United Kingdom. (BSTD)
- ▶ JSW Steel (JSTL IN) is considering a bid for New Hope Corp, the Australian coal producer valued at USD 5.2 bn. (TTOI)

Source: ECNT= Economic Times, BSTD = Business Standard, FNLE = Financial Express, THBL = Business Line.

EQUITY MARKETS

| India | Change % | | |
|--------------------------------|----------|-------|-------------|
| | 24-Oct | 1-day | 1-mo 3-mo |
| Sensex | 16,939 | 0.9 | 4.8 (10.2) |
| Nifty | 5,098 | 1.0 | 4.7 (10.2) |
| Global/Regional indices | | | |
| Dow Jones | 11,914 | 0.9 | 10.6 (5.4) |
| Nasdaq Composite | 2,699 | 2.4 | 8.7 (5.0) |
| FTSE | 5,548 | 1.1 | 9.5 (6.4) |
| Nikkei | 8,815 | (0.3) | 3.0 (12.3) |
| Hang Seng | 18,919 | 0.8 | 7.1 (15.1) |
| KOSPI | 1,899 | 0.1 | 11.9 (11.7) |
| Value traded – India | | | |
| Cash (NSE+BSE) | 112 | 129 | 136 |
| Derivatives (NSE) | 1,505 | 2,000 | 1,542 |
| Deri. open interest | 1,397 | 1,426 | 1,463 |

Forex/money market

| | Change, basis points | | | |
|-------------------------------|----------------------|-------|-------|------|
| | 24-Oct | 1-day | 1-mo | 3-mo |
| Rs/US\$ | 49.8 | 0 | 38 | 542 |
| 10yr govt bond, % | 8.8 | (2) | 50 | 50 |
| Net investment (US\$m) | | | | |
| | 21-Oct | MTD | CYTD | |
| FIs | (36) | (159) | (309) | |
| MFs | (11) | 15 | (282) | |

Top movers -3mo basis

| Best performers | Change, % | | | |
|-------------------------|-----------|-------|--------|--------|
| | 24-Oct | 1-day | 1-mo | 3-mo |
| BJAUT IN Equity | 1694.4 | 3.2 | 9.4 | 17.1 |
| ACEM IN Equity | 151.1 | 0.5 | 4.4 | 15.0 |
| ACC IN Equity | 1134.4 | 1.5 | 6.1 | 13.5 |
| UTCEM IN Equity | 1129.5 | 0.8 | (2.8) | 12.9 |
| MM IN Equity | 809.9 | 1.0 | 4.4 | 8.2 |
| Worst performers | | | | |
| IVRC IN Equity | 35.0 | (0.9) | (4.9) | (49.1) |
| RCAPT IN Equity | 334.2 | 0.1 | (16.9) | (44.4) |
| HDIL IN Equity | 90.7 | (0.5) | (9.4) | (42.4) |
| IBREL IN Equity | 67.7 | (0.9) | (9.3) | (41.6) |
| ADE IN Equity | 461.1 | (0.2) | (19.1) | (38.6) |

OCTOBER 24, 2011
RESULT

 Coverage view: **Neutral**

 Price (Rs): **207**

 Target price (Rs): **230**

 BSE-30: **16,939**

Keeps the date, again. Good growth in cigarettes and margin expansion of 130 bps to 31.5% are key positives. The growth in excise (difference between gross and net sales) of ~11% is entirely volume growth and mix improvement (Exhibit 1), in our view. Overall results were in line. Potential to implement further price increases in cigarettes in 2HFY12E exists (which could create buffer for FY2013E). However, we agree with investors that absolute returns in the ITC stock in the near term could potentially be constrained because of the taxation overhang. Retain ADD.

Company data and valuation summary

| ITC | | | | | | | | |
|-------------------------------|---------|----------------------|-------|----------------|---------|------|------|------|
| Stock data | | Forecasts/Valuations | | | | | | |
| | | 2011 | 2012E | 2013E | | | | |
| 52-week range (Rs) (high,low) | 211-148 | EPS (Rs) | 6.4 | 7.9 | 9.0 | | | |
| Market Cap. (Rs bn) | 1,589.5 | EPS growth (%) | 20.7 | 22.5 | 14.1 | | | |
| Shareholding pattern (%) | | P/E (X) | 32.3 | 26.4 | 23.1 | | | |
| Promoters | 0.0 | Sales (Rs bn) | 211.7 | 249.4 | 288.1 | | | |
| FIs | 14.9 | Net profits (Rs bn) | 49.9 | 60.3 | 68.8 | | | |
| MFs | 3.4 | EBITDA (Rs bn) | 76.1 | 90.7 | 104.3 | | | |
| Price performance (%) | | EV/EBITDA (X) | 20.1 | 17.0 | 14.6 | | | |
| Absolute | 8.0 | 1M | 3M | 12M | ROE (%) | 33.2 | 34.9 | 34.3 |
| Rel. to BSE-30 | 3.0 | 10.3 | 45.2 | Div. Yield (%) | 2.2 | 1.8 | 2.2 | |

Cigarette volume and mix growth of 11%

ITC reported net sales of Rs59.7 bn (+18%, KIE Rs59.1 bn), EBITDA of Rs21.1 bn (+18%, KIE Rs21.3 bn) and PAT of Rs15.1 bn (+25%, KIE Rs14.5 bn).

- ▶ **Segment sales.** Cigarette sales growth of 14% was driven by volume growth of ~9%. The volume growth is partly driven by favorable base effect (cigarette volumes were flat in 2QFY11). Other FMCG sales grew by 27% driven by stationery, personal care and packaged foods business – biscuits, staples and snacks. Higher soya, coffee and wheat sales led to 15% sales growth in the agri business. Hotel sales grew by 4% and paperboard segment sales grew by +10%.
- ▶ **Segment PBIT margins.** Cigarette margins improved 130 bps to 31.5% likely on account of the benefit of the price hike taken in YTDCY2011 (in line with expectations), mix improvement, phasing benefit of certain costs and likely higher trade promotions in base (Marlboro-linked trade expenses in base, in our view). Other FMCG margin improved by 16% (lower losses) – all segments of the packaged foods business are now profitable, including snacks. The quarter likely had launch expense of Vivel skin care (expanding the product reach), men's grooming range under Fiam Di Wills brand and continuing spends on talcum powder under Fiam brand.
- ▶ Other income increased +39% on account of higher cash position and higher yields. Staff costs were flat yoy due to phasing of expenses. Working capital (WC) is flat qoq at Rs143 bn. We note that ITC had higher WC in 1QFY12 due to strategic stocking, higher unit prices of inventories etc.

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Retain ADD; earnings visibility and potential for increase in payout are positives

Our earnings estimates are broadly maintained (EPS of Rs7.9 and Rs9.0 for FY2012E and FY2013E, respectively); maintain ADD rating and TP of Rs230. We value ITC on P/E (25X) as our underlying themes on ITC are intact, (1) strong EPS CAGR of ~18% over FY2011-13E, (2) sustaining strong trends in cigarettes, (3) likely improvement in RoCE and (4) higher dividend payout. Key risks are (1) unexpected higher losses in other FMCG, and (2) any aggressive marketing strategy (including trade discounting) by Philip Morris to promote Marlboro.

What to look for in FY2012-13E?

- ▶ Impact of pictorial warnings slated to be released in India in December 2011.
- ▶ Any global developments in the tobacco industry and their rub-off effect on India – (1) proposal for plain packaging on cigarette packs in Australia, and (2) harsh set of graphic warnings to be introduced on cigarette packs in US from September 2012.
- ▶ Any increase in VAT on cigarettes by State governments (in FY2013E) where the rates are at the lower-end of 12.5%. Current weighted average VAT impact for ITC is ~17%. Moreover, the likelihood of increase in excise duty in the Central budget of February, 2012 is high considering that cigarette excise was not increased in two out of last three years.

Exhibit 1: Volume and mix growth of 11%
Cigarette segment performance

| | 2QFY12 | 2QFY11 | % yoy change |
|--------------------------|---------------|---------------|--------------|
| Gross sales (Rs mn) | 54,860 | 48,104 | 14 |
| Excise (Rs mn) | 25,178 | 22,603 | 11 |
| Net sales (Rs mn) | 29,681 | 25,501 | 16 |
| Segment expenses (Rs mn) | 12,392 | 10,919 | 13 |
| Segment PBIT (Rs mn) | 17,289 | 14,582 | 19 |
| PBIT margin (%) | | | |
| On gross sales | 31.5 | 30.3 | |
| On net sales | 58.2 | 57.2 | |

Source: Company

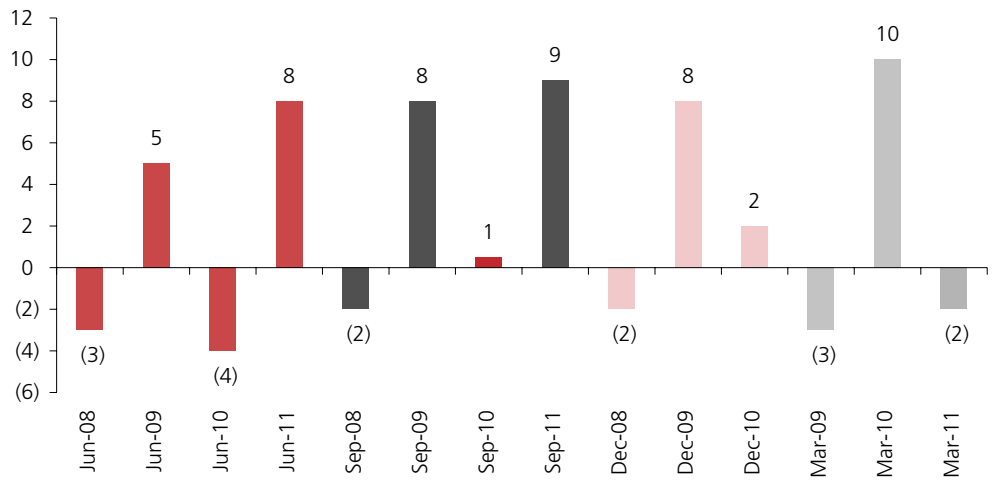
Interim results of ITC Limited, March fiscal year-ends (Rs mn)

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | (% chg) | | |
|--------------------------------|----------------|---------------|----------------|----------------|------------|-----------|------------|
| | | | | | 2QFY12E | 2QFY11 | 1QFY12 |
| Net sales | 59,742 | 59,129 | 50,612 | 57,675 | 1 | 18 | 4 |
| Total expenditure | (38,662) | (37,837) | (32,723) | (38,841) | | 18 | (0) |
| Material cost | (23,191) | (21,429) | (18,532) | (22,992) | | 25 | 1 |
| Staff cost | (2,650) | (3,020) | (2,612) | (3,942) | | 1 | (33) |
| Other expenditure | (12,821) | (13,389) | (11,579) | (11,906) | | 11 | 8 |
| EBITDA | 21,080 | 21,291 | 17,889 | 18,834 | (1) | 18 | 12 |
| OPM (%) | 35.3 | 36.0 | 35.3 | 32.7 | | | |
| Other income | 2,918 | 2,247 | 2,105 | 2,366 | | 39 | 23 |
| Interest | (142) | (176) | (54) | (165) | | 165 | (14) |
| Depreciation | (1,701) | (1,692) | (1,640) | (1,665) | | 4 | 2 |
| Pretax profits | 22,155 | 21,670 | 18,300 | 19,370 | 2 | 21 | 14 |
| Tax | (7,012) | (7,166) | (5,833) | (6,043) | | 20 | 16 |
| Net income | 15,143 | 14,504 | 12,467 | 13,327 | 4 | 21 | 14 |
| Income tax rate (%) | 31.6 | 33.1 | 31.9 | 31.2 | | | |
| Cost as a % of Sales | | | | | | | |
| Material cost | 38.8 | 36.2 | 36.6 | 39.9 | | | |
| Staff cost | 4.4 | 5.1 | 5.2 | 6.8 | | | |
| Other expenditure | 21.5 | 22.6 | 22.9 | 20.6 | | | |
| Segment results | | | | | | | |
| Revenue | | | | | | | |
| Cigarettes | 54,860 | 54,244 | 48,104 | 52,699 | | 14 | 4 |
| Other FMCG | 13,453 | 12,873 | 10,577 | 12,011 | | 27 | 12 |
| Hotel | 2,343 | 2,536 | 2,247 | 2,525 | | 4 | (7) |
| Agri business | 14,345 | 15,542 | 12,496 | 17,071 | | 15 | (16) |
| Paperboards, paper & packaging | 10,554 | 11,154 | 9,596 | 10,113 | | 10 | 4 |
| Total | 95,555 | 96,349 | 83,021 | 94,420 | | 15 | (1) |
| Less: Intersegment revenue | (10,059) | (10,874) | (9,400) | (12,197) | | 7 | (18) |
| Gross sales | 85,495 | 85,475 | 73,621 | 82,222 | | 16 | 4 |
| EBIT | | | | | | | |
| Cigarettes | 17,289 | 15,869 | 14,582 | 15,767 | | 19 | 10 |
| Other FMCG | (559) | (637) | (669) | (763) | | (16) | (27) |
| Hotel | 434 | 518 | 399 | 513 | | 9 | (15) |
| Agri business | 2,388 | 1,588 | 2,024 | 1,571 | | 18 | 52 |
| Paperboards, paper & packaging | 2,897 | 2,394 | 2,456 | 2,270 | | 18 | 28 |
| Total | 22,449 | 19,732 | 18,792 | 19,358 | | 19 | 16 |
| EBIT margins (%) | | | | | | | |
| Cigarettes | 31.5 | 29.3 | 30.3 | 29.9 | | 4 | 5 |
| Other FMCG | (4.2) | (4.9) | (6.3) | (6.4) | | (34) | (35) |
| Hotel | 18.5 | 20.4 | 17.7 | 20.3 | | 4 | (9) |
| Agri business | 16.6 | 10.2 | 16.2 | 9.2 | | 3 | 81 |
| Paperboards, paper & packaging | 27.5 | 21.5 | 25.6 | 22.4 | | 7 | 22 |
| Capital employed | | | | | | | |
| Cigarettes | 38,990 | | 37,093 | 36,745 | | 5 | 6 |
| Other FMCG | 19,242 | | 17,652 | 20,498 | | 9 | (6) |
| Hotel | 29,893 | | 25,529 | 28,489 | | 17 | 5 |
| Agri business | 14,874 | | 9,966 | 19,029 | | 49 | (22) |
| Paperboards, paper & packaging | 40,059 | | 36,464 | 38,713 | | 10 | 3 |
| Total | 143,057 | | 126,703 | 143,474 | | 13 | (0) |

Source: Company, Kotak Institutional Equities estimates

Good volume growth in 2QFY12

Quarterly cigarette volume growth (%)

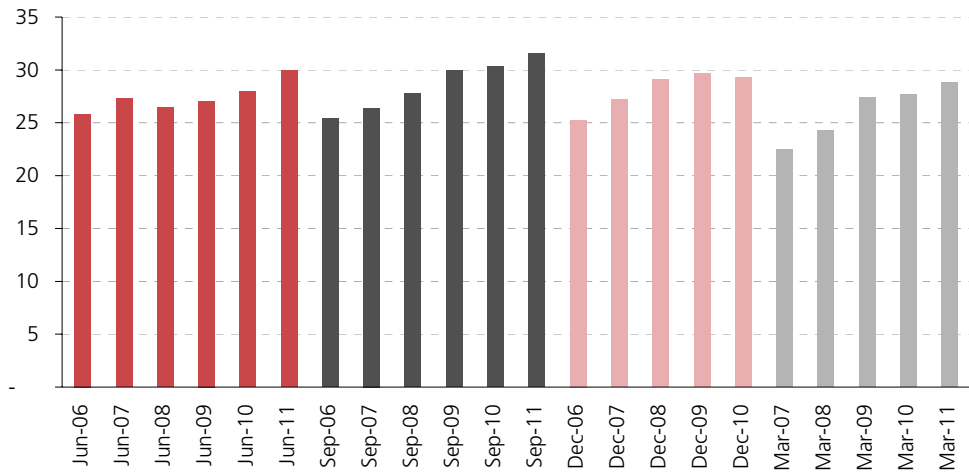


Note:

(1) Cigarette volume growth based on KIE estimates

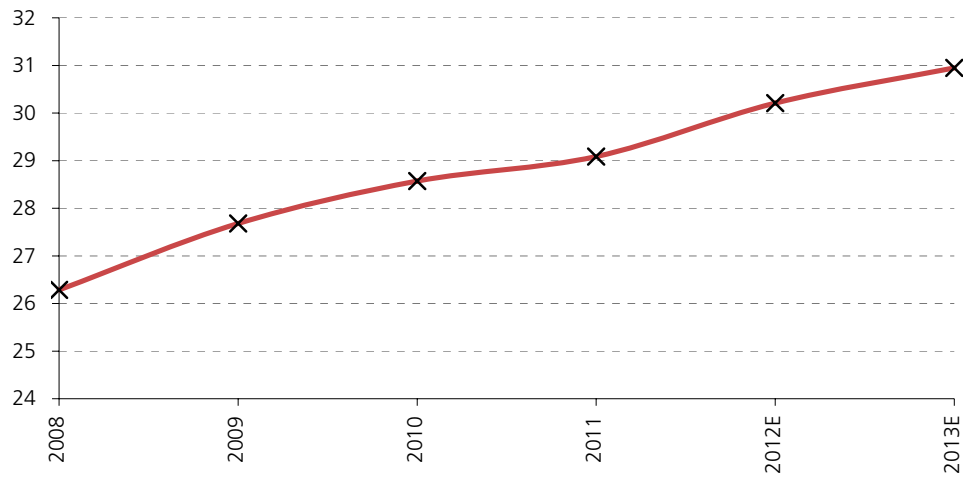
Source: Kotak Institutional Equities estimates

ITC's quarterly cigarette margins (%)



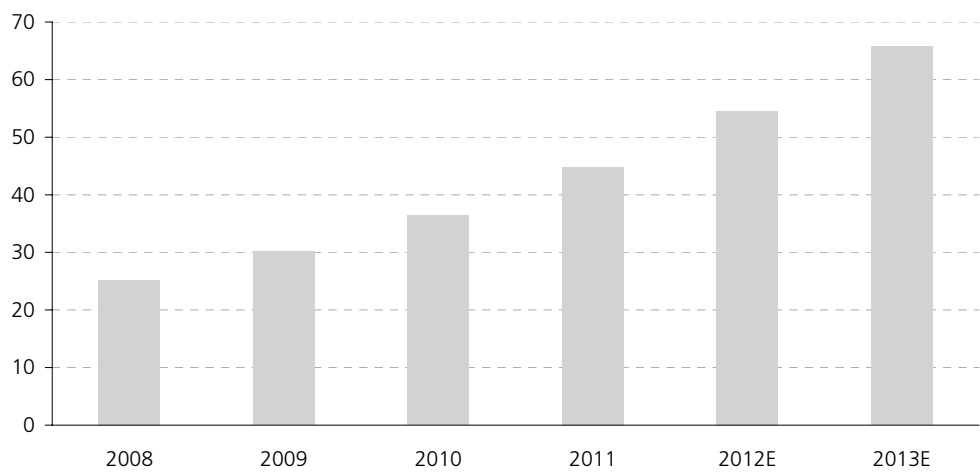
Source: Company, Kotak Institutional Equities

Premiumization is key for sustained improvement in cigarette margins
 Cigarette margins, March fiscal year-ends, 2008-2013E (%)



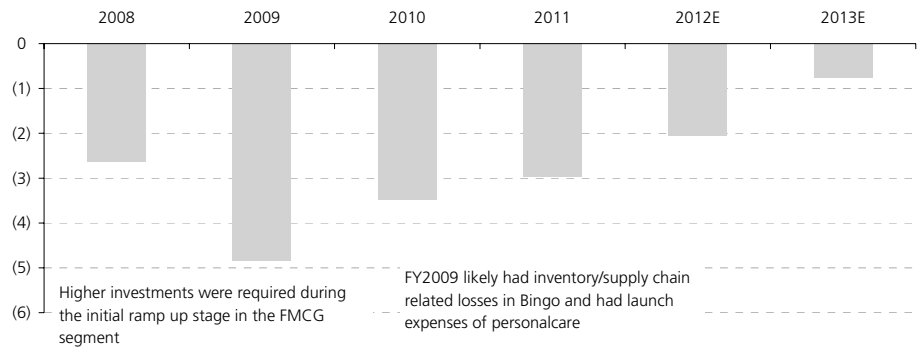
Source: Kotak Institutional Equities estimates

Steady growth in FMCG sales
 FMCG sales, March fiscal year-ends, 2007-2013E (Rs bn)



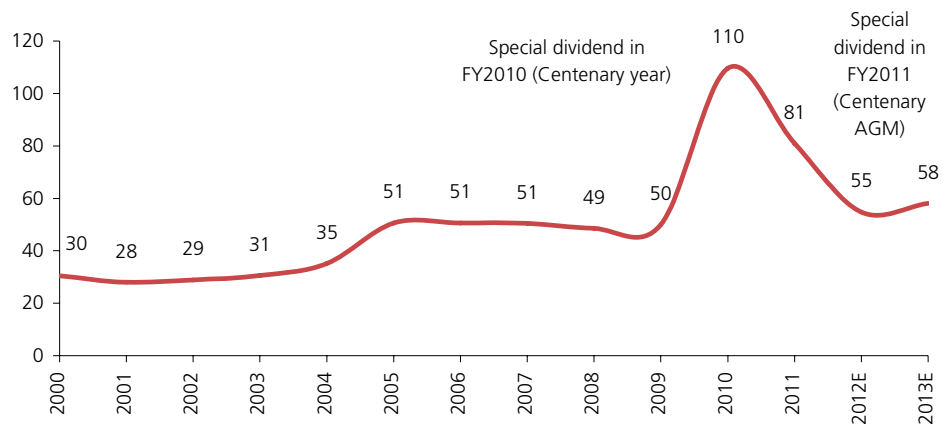
Source: Kotak Institutional Equities estimates

We expect FMCG business to break even by 4QFY13E
 FMCG losses, March fiscal year-ends, 2007-2013E (Rs bn)



Source: Kotak Institutional Equities estimates

Dividend payout could potentially increase
 Dividend payout ratio, March fiscal year-ends, 2000-2013E (%)



Source: Company, Kotak Institutional Equities

Seven states have increased VAT in the state budget

| State/region | Contribution to ITC cigarette sales (Value, %) | Current VAT on cigarettes | Whether budget presented or not | |
|------------------|--|---------------------------|---------------------------------|----------------------------|
| | | | Yes / No | Any recent change in VAT |
| Andhra Pradesh | 13 | 20.0 | Yes | Yes, increased from 12.5% |
| Bihar | 3 | 13.5 | Yes | Yes, increased from 12.5% |
| Chattisgarh | 3 | 12.5 | Yes | No |
| Gujarat | 3 | 25.0 | Yes | Yes, increased from 20% |
| Haryana | 4 | 20.0 | Yes | No |
| Himachal Pradesh | 2 | 16.0 | Yes | Yes, increased from 13.75% |
| Karnataka | 9 | 15.0 | Yes | No |
| Kerala | 12 | 12.5 | Yes | No |
| Madhya Pradesh | 3 | 12.5 | Yes | No |
| Maharashtra | 9 | 20.0 | Yes | No |
| Rajasthan | 3 | 40.0 | Yes | Yes, increased from 20% |
| Tamilnadu | 11 | 14.5 | Yes | Yes, increased from 12.5% |
| Uttar Pradesh | 4 | 13.5 | Yes | No |
| West Bengal | 8 | 20.0 | Yes | Yes, increased from 12.5% |

Source: Kotak Institutional Equities

Relative P/E of ITC versus BSE 30 Index (X)



Source: Bloomberg, Kotak Institutional Equities

ITC: Profit model, balance sheet, cash flow model, March fiscal year-ends, 2008-2014E (Rs mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Profit model (Rs mn) | | | | | | | |
| Net sales | 140,012 | 156,119 | 181,532 | 211,676 | 249,387 | 288,052 | 330,332 |
| EBITDA | 44,703 | 48,686 | 60,823 | 71,636 | 85,602 | 98,212 | 114,994 |
| Other income | 6,109 | 5,349 | 6,147 | 8,188 | 9,909 | 11,260 | 12,793 |
| Interest | (173) | (284) | (730) | (583) | (581) | (579) | (576) |
| Depreciation | (4,385) | (5,494) | (6,087) | (6,560) | (7,170) | (7,967) | (8,844) |
| Pretax profits | 46,255 | 48,258 | 60,153 | 72,682 | 87,760 | 100,926 | 118,367 |
| Tax | (14,517) | (15,622) | (19,543) | (22,806) | (27,440) | (32,120) | (37,419) |
| Net profits | 31,738 | 32,636 | 40,610 | 49,876 | 60,320 | 68,806 | 80,948 |
| Earnings per share (Rs) | 4.2 | 4.3 | 5.4 | 6.5 | 7.9 | 9.0 | 10.5 |
| Balance sheet (Rs mn) | | | | | | | |
| Total equity | 120,577 | 137,351 | 140,644 | 159,533 | 186,155 | 214,524 | 267,930 |
| Deferred taxation liability | 5,451 | 8,672 | 7,850 | 8,019 | 8,019 | 8,019 | 8,019 |
| Total borrowings | 2,144 | 1,776 | 1,077 | 992 | 992 | 992 | 992 |
| Current liabilities | 44,323 | 47,036 | 80,491 | 85,628 | 74,763 | 80,476 | 79,864 |
| Total liabilities and equity | 172,495 | 194,835 | 230,062 | 254,171 | 269,929 | 304,011 | 356,804 |
| Cash | 5,703 | 10,310 | 11,263 | 22,432 | 19,511 | 32,944 | 65,258 |
| Current assets | 64,490 | 71,287 | 70,016 | 79,407 | 90,267 | 103,893 | 115,226 |
| Total fixed assets | 72,956 | 84,860 | 91,514 | 96,785 | 104,604 | 111,627 | 120,773 |
| Investments | 29,346 | 28,378 | 57,269 | 55,547 | 55,547 | 55,547 | 55,547 |
| Total assets | 172,495 | 194,834 | 230,062 | 254,171 | 269,929 | 304,011 | 356,804 |
| Free cash flow (Rs mn) | | | | | | | |
| Operating cash flow | 37,112 | 41,493 | 49,853 | 55,859 | 68,636 | 77,930 | 91,099 |
| Working capital | (6,634) | (4,991) | 6,541 | 249 | (8,998) | (6,002) | (4,192) |
| Capital expenditure | (21,239) | (17,407) | (12,751) | (11,841) | (15,000) | (15,000) | (18,000) |
| Free cash flow | 9,238 | 19,095 | 43,643 | 44,267 | 44,637 | 56,928 | 68,908 |
| Key ratios (%) | | | | | | | |
| Sales growth | 13.2 | 11.5 | 16.3 | 16.6 | 17.8 | 15.5 | 14.7 |
| EBITDA margin | 31.9 | 31.2 | 33.5 | 33.8 | 34.3 | 34.1 | 34.8 |
| EPS growth | 17.1 | 2.8 | 23.8 | 21.1 | 20.9 | 14.1 | 17.6 |

Source: Kotak Institutional Equities estimates

OCTOBER 24, 2011

RESULT

 Coverage view: **Attractive**

 Price (Rs): **426**

 Target price (Rs): **535**

 BSE-30: **16,939**

A nice quarter but 2HFY12 less certain. GAIL reported 2QFY12 net income at ₹10.9 bn (+18.5% yoy and +11.1% qoq) versus our expected ₹12 bn; the negative variance reflects (1) higher subsidy burden at ₹5.7 bn versus our expected ₹3.9 bn and (2) foreign exchange loss of ₹500 mn. The qoq growth in net income was driven by (1) better performance of the petrochemical, LPG and liquid hydrocarbons segments and (2) 17% qoq lower subsidy burden. We maintain BUY rating on the stock with a revised 12-month SOTP-based target price of ₹535.

Company data and valuation summary

GAIL (India)

Stock data

52-week range (Rs) (high,low) 538-400

Market Cap. (Rs bn) 540.0

Shareholding pattern (%)

Promoters 57.3

FIs 13.7

MFs 4.1

Price performance (%)

| | 1M | 3M | 12M |
|----------------|-------|-------|--------|
| Absolute | 0.9 | (8.7) | (15.6) |
| Rel. to BSE-30 | (3.7) | 0.9 | 0.5 |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|-------|-------|-------|
| EPS (Rs) | 28.2 | 31.8 | 33.8 |
| EPS growth (%) | 13.8 | 12.8 | 6.5 |
| P/E (X) | 15.1 | 13.4 | 12.6 |
| Sales (Rs bn) | 324.6 | 292.7 | 311.8 |
| Net profits (Rs bn) | 35.7 | 40.3 | 42.9 |
| EBITDA (Rs bn) | 59.9 | 66.5 | 78.0 |
| EV/EBITDA (X) | 8.7 | 9.0 | 8.1 |
| ROE (%) | 17.5 | 17.1 | 15.8 |
| Div. Yield (%) | 1.8 | 2.0 | 2.2 |

A healthy operational quarter

GAIL reported 2QFY12 EBITDA at ₹16.8 bn (+6.2% qoq and +15% yoy), lower versus our estimate of ₹18.5 bn. The negative variance reflects (1) higher subsidy burden at ₹5.7 bn versus our expected ₹3.9 bn and (2) higher other expenditure at ₹7.4 bn (+39.4% qoq and +46.5% yoy) versus our expected ₹5.7 bn. The surprise on other expenditure reflects (1) higher survey expenses and write-off of dry well expenditure at ₹939 mn versus ₹474 mn in 1QFY12 and (2) foreign exchange loss of ~₹500 mn. 2QFY12 was an operationally good quarter given (1) 1.6% qoq increase in gas transmission volumes to 118.6 mcm/d, (2) increase in profitability of petrochemical business with reported EBIT at ₹4 bn (+66% qoq) and (3) increase in profitability of LPG and other hydrocarbons business with reported EBIT at ₹3.5 bn (+54% qoq).

Share of upstream companies kept at 33.3% of the gross under-recoveries in 2QFY12

We note that the Government has kept the share of upstream companies at 33.33% of the gross under-recoveries in 2QFY12. However, the share of GAIL among the upstream companies increased to 7.9% in 2QFY12 versus 4.6% in 1QFY12. However, we expect the Government to increase the share of upstream companies in 2HFY12E given its fiscal constraints and accordingly assume upstream companies to bear 45% of gross under-recoveries in FY2012E and 40% in FY2013-14E; we assume GAIL's share at 7% in FY2012E, 7.5% in FY2013E and 8% in FY2014E.

Maintain BUY rating with SOTP-based target price of ₹535

We maintain our BUY rating on GAIL given 26% potential upside to our revised SOTP-based target price of ₹535 (₹560 previously) based on FY2013E estimates. We have revised GAIL's gas transmission volumes to reflect a slow ramp-up in gas supply in India. We model gas transmission volumes for FY2012E and FY2013E at 119 mcm/d and 125 mcm/d. Key downside risk stems from (1) higher-than-expected subsidy burden and (2) lower-than-expected gas transmission tariffs.

Revised earnings for (1) higher subsidy, (2) lower transmission volumes and (3) weaker Rupee

We have revised our FY2012-14E estimates to ₹31.8, ₹33.8 and ₹36.2 versus ₹34.3, ₹36 and ₹41 to reflect (1) lower gas transmission volumes, (2) higher share of upstream companies, (3) weaker Rupee and (4) other minor changes.

QUICK NUMBERS

- **118.6 mcm/d of gas transmission volumes in 2QFY12**
- **GAIL's share at 7.9% of subsidy burden on upstream companies**
- **26% upside from current levels**

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2QFY12 results highlights

Exhibit 1 gives details of GAIL's 2QFY12 results and compares the same with 1QFY12 and 2QFY11 results. We discuss key highlights below.

GAIL interim results, March fiscal year-ends (₹ mn)

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | (% chg.) | | | yoy | | 2012E | |
|---|----------------|---------------|----------------|----------------|---------------|-------------|-------------|----------------|----------------|-------------|---------------|
| | | | | | 2QFY12E | 2QFY11 | 1QFY12 | 1HFY12 | 1HFY11 | | (% chg.) |
| Sales | 97,264 | 101,431 | 81,282 | 88,890 | (4.1) | 19.7 | 9.4 | 186,154 | 152,440 | 22.1 | 292,744 |
| Total expenditure | 80,509 | 82,901 | 66,712 | 73,118 | (2.9) | 20.7 | 10.1 | 153,626 | 123,324 | 24.6 | 230,156 |
| (Increase)/decrease in stock | (912) | | (555) | (1,875) | | | | (2,787) | (1,270) | | — |
| Purchase | 65,926 | 70,291 | 55,741 | 62,114 | (6.2) | 18.3 | 6.1 | 128,040 | 101,583 | 26.0 | 174,055 |
| Raw material | 6,316 | 5,060 | 4,938 | 5,788 | 24.8 | 27.9 | 9.1 | 12,103 | 10,279 | 17.7 | 22,066 |
| Staff cost | 1,779 | 1,820 | 1,538 | 1,782 | (2.3) | 15.7 | (0.2) | 3,561 | 3,172 | 12.3 | 7,677 |
| Other expenditure | 7,400 | 5,730 | 5,050 | 5,309 | 29.1 | 46.5 | 39.4 | 12,709 | 9,559 | 33.0 | 26,359 |
| EBITDA | 16,755 | 18,530 | 14,570 | 15,772 | (9.6) | 15.0 | 6.2 | 32,528 | 29,116 | 11.7 | 62,587 |
| Other income | 1,160 | 1,456 | 1,499 | 647 | (20.3) | (22.6) | 79.4 | 1,807 | 1,976 | (8.6) | 3,890 |
| Interest | 226 | 359 | 117 | 208 | (37.1) | 92.7 | 8.8 | 434 | 323 | 34.5 | 1,849 |
| Depreciation | 2,008 | 1,829 | 1,626 | 1,782 | 9.8 | 23.5 | 12.7 | 3,789 | 3,226 | 17.5 | 7,802 |
| Pretax profits | 15,682 | 17,797 | 14,326 | 14,429 | (11.9) | 9.5 | 8.7 | 30,111 | 27,544 | 9.3 | 56,826 |
| Tax | 6,447 | 4,458 | 3,215 | 3,417 | 44.6 | 100.5 | 88.7 | 9,864 | 7,325 | 34.7 | 12,330 |
| Deferred | (1,709) | 1,238 | 1,875 | 1,166 | | | | (544) | 2,115 | | 4,196 |
| Net income | 10,944 | 12,102 | 9,236 | 9,847 | (9.6) | 18.5 | 11.1 | 20,791 | 18,104 | 14.8 | 40,300 |
| EPS (Rs) | 8.6 | 9.5 | 7.3 | 7.8 | | | | 16.4 | 14.3 | | 31.8 |
| Tax rate (%) | 30.2 | 32.0 | 35.5 | 31.8 | | | | 31.0 | 34.3 | | 29.1 |
| Volume data | | | | | | | | | | | |
| Gas sales (mcm/d) | 84 | | 79 | 83 | 6.3 | 1.7 | | 83 | 82 | 1.7 | |
| Gas transmission (mcm/d) | 119 | 120 | 115 | 117 | 3.2 | 1.2 | | 118 | 116 | 2.0 | 119 |
| LPG transported ('000 tons) | 796 | 838 | 799 | 817 | (0.4) | (2.6) | | 1,613 | 1,587 | 1.6 | 3,300 |
| LPG production ('000 tons) | 298 | | 268 | 270 | 11.2 | 10.4 | | 568 | 544 | 4.4 | |
| LPG sales ('000 tons) | 298 | 275 | 274 | 268 | 8.8 | 11.2 | | 566 | 548 | 3.3 | 1,165 |
| Other liquids production ('000 tons) | 81 | | 69 | 80 | 17.4 | 1.3 | | 161 | 154 | 4.5 | |
| Other liquids sales ('000 tons) | 80 | 71 | 73 | 81 | 9.6 | (1.2) | | 161 | 155 | 3.9 | 351 |
| Polymers ('000 tons)-production | 111 | | 93 | 109 | 19.4 | 1.8 | | 220 | 192 | 14.6 | |
| Polymers ('000 tons)-sales | 129 | 104 | 107 | 88 | 20.6 | 46.6 | | 217 | 195 | 11.3 | 440 |
| Subsidy payment | (5,666) | (3,921) | (3,464) | (6,819) | 63.6 | (16.9) | | (12,485) | (7,919) | 57.7 | (37,076) |
| Segment revenue (Sales/Income) | | | | | | | | | | | |
| Transmission services | | | | | | | | | | | |
| (1) Natural gas | 9,800 | | 9,793 | 9,389 | 0.1 | 4.4 | | 19,189 | 18,762 | 2.3 | |
| (2) LPG | 1,098 | | 1,141 | 1,142 | (3.7) | (3.8) | | 2,240 | 2,276 | (1.6) | |
| Natural gas trading | 75,754 | | 62,894 | 72,054 | 20.4 | 5.1 | | 147,808 | 117,411 | 25.9 | |
| Petrochemicals | 9,376 | | 7,209 | 6,369 | 30.1 | 47.2 | | 15,746 | 13,585 | 15.9 | |
| LPG and liquid hydrocarbons | 9,887 | | 7,367 | 8,138 | 34.2 | 21.5 | | 18,026 | 15,182 | 18.7 | |
| Other segment | 257 | | 143 | 220 | 79.5 | 17.1 | | 477 | 295 | 61.9 | |
| Total | 106,173 | | 88,547 | 97,313 | 19.9 | 9.1 | | 203,486 | 167,510 | 21.5 | |
| Less: Inter-segment revenue | 9,183 | | 7,507 | 8,639 | 22.3 | 6.3 | | 17,822 | 15,510 | 14.9 | |
| Sales/Income from operations | 96,990 | | 81,041 | 88,674 | 19.7 | 9.4 | | 185,664 | 152,000 | 22.1 | |
| Segment results (Profit before tax and interest) | | | | | | | | | | | |
| Transmission services | | | | | | | | | | | |
| (1) Natural gas | 5,562 | | 7,206 | 6,520 | (22.8) | (14.7) | | 12,083 | 13,612 | (11.2) | |
| (2) LPG | 722 | | 787 | 690 | (8.2) | 4.7 | | 1,412 | 1,520 | (7.1) | |
| Natural gas trading | 2,866 | | 1,602 | 3,131 | 78.9 | (8.5) | | 5,997 | 3,181 | 88.5 | |
| Petrochemicals | 4,041 | | 2,716 | 2,434 | 48.8 | 66.0 | | 6,474 | 5,562 | 16.4 | |
| LPG and liquid hydrocarbons | 3,521 | | 1,752 | 2,285 | 101.0 | 54.1 | | 5,806 | 4,085 | 42.1 | |
| Telecom and other segments | (818) | | (479) | (335) | 71.0 | 144.2 | | (1,153) | (499) | 131.3 | |
| Total | 15,894 | | 13,584 | 14,725 | 17.0 | 7.9 | | 30,619 | 27,461 | 11.5 | |
| Less: Interest | 226 | | 117 | 208 | 92.7 | 8.8 | | 434 | 323 | 34.5 | |
| Less: Other unallocable exp (net) | (14) | | (859) | 88 | (98.4) | (115.7) | | 74 | (406) | (118.2) | |
| Total PBT | 15,682 | | 14,326 | 14,429 | 9.5 | 8.7 | | 30,111 | 27,544 | 9.3 | |
| Capital employed | | | | | | | | | | | |
| Transmission services | | | | | | | | | | | |
| (1) Natural gas | 132,061 | | 97,724 | 123,064 | | | | 132,061 | 97,724 | | |
| (2) LPG | 8,119 | | 8,345 | 8,270 | | | | 8,119 | 8,345 | | |
| Petrochemicals | 15,448 | | 16,168 | 16,082 | | | | 15,448 | 16,168 | | |
| LPG and liquid hydrocarbons | 11,258 | | 10,609 | 6,356 | | | | 11,258 | 10,609 | | |
| Telecom and other segments | (736) | | (382) | (672) | | | | (736) | (382) | | |
| Total | 166,151 | | 132,463 | 153,100 | | | | 166,151 | 132,463 | | |

Source: Company, Kotak Institutional Equities estimates

- ▶ **Operating highlights—strong operational quarter.** GAIL reported a strong operational quarter with yoy growth in sales volumes for all segments. GAIL's gas transportation volumes increased 1.2% qoq and 3.2% yoy to 118.6 mcm/d. LPG and other liquid sales volume at 378,000 tons was higher compared to 349,000 tons in 1QFY12 and 347,000 tons in 2QFY11. GAIL sold 129,000 tons of polymers in 2QFY12 versus 88,000 tons in 1QFY12 and 107,000 tons in 2QFY11.
- ▶ **Gas transmission segment—impacted by forex loss and higher depreciation.** GAIL's transportation EBIT declined 23% yoy to ₹5.6 bn reflecting (1) foreign exchange loss of ~₹500 mn on foreign exchange loans and (2) higher depreciation charge due to capitalization of assets in 1HFY12; GAIL capitalized assets worth ₹17 bn in 1QFY12 and ₹5.7 bn in 2QFY12. GAIL reported gas transmission volume at 118.6 mcm/d versus 117 mcm/d in 1QFY12 and 115 mcm/d in 2QFY11; our estimate was 120 mcm/d.
- ▶ **Petrochemicals segment—bumper performance.** The chemical segment's EBIT increased 66% qoq and 48.8% yoy to ₹4 bn led by increase in polymer sales. GAIL's polymer sales volumes increased 46.6% qoq (+20.6% yoy) to 129,000 tons. The qoq increase in sales of petrochemical segment reflects (1) significantly lower demand in the previous quarter and (2) shutdown of plant for 20 days in 1QFY12. We note that the realization of the petrochemical segment was at ₹72.7/kg versus ₹72.4/kg in 1QFY12 and ₹67.4/kg in 2QFY11.
- ▶ **LPG and liquid hydrocarbons production segment—strong performance.** The LPG and liquid hydrocarbons segment's EBIT increased 101% yoy to ₹3.5 bn due to (1) increase in LPG prices and (2) higher LPG sales volumes. GAIL sold 298,000 tons of LPG in 2QFY12 versus 268,000 tons in 1QFY12 and 274,000 tons in 2QFY11. Sales volumes of other liquid hydrocarbons were at 80,000 tons versus 81,000 tons in 1QFY12 and 73,000 tons in 2QFY11.
- ▶ **Subsidy burden.** GAIL's subsidy burden was at ₹5.7 bn (₹6.8 bn in 1QFY12 and ₹3.5 bn in 2QFY11) versus our expected ₹3.9 bn. The qoq decline in subsidy burden reflects the twin benefits of (1) higher retail prices and (2) lower duties on regulated products. **However, the share of GAIL in the subsidy burden increased to 7.9% among the upstream companies versus 4.7% in 1QFY11 reflecting higher share of kerosene and LPG in overall under-recoveries.**
- ▶ **Other expenditure.** GAIL reported higher other expenditure at ₹7.4 bn versus ₹5.3 bn in 1QFY12. The qoq increase in other expenditure reflects (1) higher survey expenses and write-off of dry well expenditure at ₹939 mn versus ₹474 mn in 1QFY12 and (2) foreign exchange loss of ~₹500 mn on foreign-denominated debt.
- ▶ **Other income.** GAIL reported 2QFY12 other income at ₹1.2 bn (+79.4% qoq and -22.6% yoy) versus our expected ₹1.5 bn.

Delay in pipelines imminent; however, factored in our estimates and current stock price

We do not rule out delays in the commissioning of new gas pipelines of GAIL given slower-than-expected ramp-up in domestic gas production. Exhibit 2 gives our gas supply model for India with projections until FY2017E and Exhibit 3 gives the current status of GAIL's new pipelines. We expect domestic gas production in India to increase modestly to 147 mcm/d by FY2014E and 183 mcm/d by FY2017E. We do see a significant jump in supply of imported LNG led by (1) higher volumes at PLNG's Dahej terminal and (2) start of new LNG terminals at Dabhol and Kochi. GAIL has also delayed the commissioning of its various projects in light of limited visibility of ramp-up in domestic gas.

We see modest increase in domestic gas production over the next few years

Supply of natural gas in India, March fiscal year-ends, 2008-17E (mcm/d)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E |
|--------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Mumbai High | 45 | 46 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 |
| Gujarat | 8 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |
| North-East | 9 | 9 | 9 | 9 | 10 | 10 | 11 | 11 | 11 | 11 |
| Rajasthan | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| TN/AP | 7 | 8 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |
| Eastern offshore | | | | | | | | | | |
| KG-D6 (RIL-Niko) | — | — | 39 | 56 | 45 | 45 | 50 | 65 | 80 | 80 |
| NEC-25 (RIL-Niko) | — | — | — | — | — | — | — | — | — | 6 |
| Deen Dayal (GSPC) | — | — | — | — | — | — | 3 | 5 | 6 | 6 |
| ONGC | — | — | — | — | 2 | 3 | 5 | 5 | 5 | 5 |
| PY-3 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Ravva | 2 | 2 | 1 | 2 | 1 | 1 | 1 | 1 | 1 | 1 |
| Western offshore | | | | | | | | | | |
| Lakshmi | 1 | 1 | 1 | 1 | 1 | 0 | 0 | — | — | — |
| Panna-Mukta | 6 | 5 | 5 | 4 | 6 | 5 | 5 | 5 | 4 | 4 |
| Tapti | 9 | 12 | 8 | 7 | 7 | 7 | 6 | 6 | 6 | 5 |
| LNG and CBM | | | | | | | | | | |
| Petronet LNG - Dahej | 24 | 24 | 30 | 33 | 40 | 40 | 39 | 47 | 48 | 48 |
| Petronet LNG - Kochi | — | — | — | — | — | 3 | 10 | 16 | 18 | 18 |
| RGPL - Dabhol | — | — | — | — | 1 | 2 | 6 | 8 | 15 | 18 |
| Shell Total LNG - Hazira | 8 | 6 | 3 | 4 | 8 | 11 | 14 | 14 | 14 | 14 |
| CBM gas | — | — | — | — | 1 | 2 | 3 | 3 | 3 | 3 |
| Total gas supply | 120 | 119 | 160 | 178 | 183 | 193 | 215 | 247 | 273 | 281 |

Source: Company, Kotak Institutional Equities estimates

Several delays in pipeline projects

Status of pipeline projects

| Pipeline projects | Original schedule | Revised schedule |
|---|--------------------------|-------------------------|
| Bawana-Nangal pipeline | April-11 | December-11 |
| Spurlines to Bawana-Nangal pipeline | June-11 | July-12 |
| Dahej-Vijaipur Pipeline (Phase-II) | April-11 | September-11 |
| Compressors at Jhabua and Vijaipur | April-11 | December-11 |
| Compressors at Kailaras and Chainsa | April-11 | December-11 |
| Vijaipur-Kota pipeline (VKPL) upgradation and spurlines | June-11 | March-12 |
| Kochi-Kootanad Pipeline (Phase-I) | March-12 | August-12 |
| Dabhol-Bnagalore Pipeline (Phase-I) | March-12 | August-12 |

Source: Company, Kotak Institutional Equities

We have accordingly revised our estimates for GAIL's transmission volumes to 119 mcm/d for FY2012E, 125 mcm/d for FY2013E and 135 mcm/d for FY2014E versus current volumes of ~119 mcm/d. We expect modest ramp-up in GAIL's transmission volumes from (1) higher LNG imports, (2) incremental production from ONGC's new and marginal fields and (2) potential increase in RIL's gas volumes from 2HFY14E.

We highlight that the current stock price is discounting a bleak scenario with respect to GAIL's transmission volumes. We ascribe the small gap between GAIL's stock price and our estimated fair valuation of its extant businesses to the market's subdued expectations about potential value creation from new pipelines. Our reverse valuation exercise suggests that the market is ascribing negligible value for the new pipelines (see Exhibit 4). We value GAIL's extant businesses (existing pipelines, LPG production and chemicals) at about ₹305/share. To this we add (1) ₹83/share as value of investments and (2) ₹15/share for valuation of GAIL's E&P business. This translates into fair value of around ₹409, which would result in implied value of ₹17/share (US\$0.5 bn) for the new pipelines versus end-FY2011 capital wip of ₹46/share.

Current stock price is implying fair value of ₹17/share for new gas pipelines

Reverse valuation for GAIL, FY2012E basis (₹/share)

| | Valuation base (Rs bn) | | Multiples (X) | | EV (Rs bn) | | Value (Rs/share) |
|--|------------------------|--------|---------------|-----------|------------------------------|-----------------|------------------|
| | Market value | EBITDA | EV/RC | EV/EBITDA | Replacement/ market value | EBITDA basis | |
| 1. Valuation of extant businesses | | | | | | | |
| Natural gas/LPG transportation (a) | | 41.7 | | 6.0 | | 250 | 197 |
| LPG production (b) | | 10.0 | | 5.0 | | 50 | 40 |
| Petrochemicals (c) | | 14.5 | | 6.0 | | 87 | 69 |
| Value of extant businesses (A) | | | | | | | 305 |
| 2. Valuation of investments | | | | | | | |
| ONGC shares (@Rs276/share) | 57 | | 1.0 | | 57 | | 45 |
| Others (@cmp or book value) | 49 | | 1.0 | | 49 | | 38 |
| Value of investments (B) | | | | | | | 83 |
| 3. Valuation of E&P segment | | | | | | | |
| Estimated value of Myanmar gas | 14 | | 1.0 | | 14 | | 11 |
| Estimated value of Cambay (CB-ONN-2001/1) oil | 6 | | 1.0 | | 6 | | 4 |
| Value of E&P segment (C) | | | | | | | 15 |
| Enterprise value (A) + (B) + (C) | | | | | | | 404 |
| Net debt/(cash) (d) | | | | | | (4) | (5) |
| Fair value excluding potential value from new gas pipelines | | | | | | | 409 |
| Implied value of new gas pipelines | | | | | | | 17 |

Notes:

- (a) Based on 2QFY12 reported EBIT for gas transmission segment.
- (b) Based on LPG production and estimated subsidy burden for FY2012E.
- (c) Based on 1HFY12 reported EBIT for petrochemical segment.
- (d) Adjusted net debt as on March 31, 2011.

Source: Company, Kotak Institutional Equities estimates

Earnings estimates and key assumptions—being as conservative as possible

Exhibit 5 gives our key assumptions for GAIL. We have revised our FY2012E-14E EPS estimates to ₹31.8, ₹33.8 and ₹36.2 from ₹34.3, ₹36 and ₹41 to reflect more conservative assumptions regarding subsidies and gas transmission volumes. We note that GAIL has already clocked ₹16.4 in 1HFY12. We discuss the key assumptions behind our earnings model below.

Key assumptions behind GAIL model, March fiscal year-ends, 2007-2014E

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|------------|------------|------------|------------|------------|------------|------------|------------|
| Volumes | | | | | | | | |
| Natural gas transportation, gross (mcm/day) | | | | | | | | |
| HBJ pipeline | 32 | 32 | 32 | 32 | 32 | 32 | 32 | 32 |
| Dahej-Vijaypur-GREP upgradation | | | | | | 4 | 9 | 13 |
| Dadri-Bawana-Nangal (transmitted and sold) | | | | 1 | 2 | 3 | 3 | 5 |
| Dadri-Bawana-Nangal (transmitted) | | | | | 1 | 4 | 7 | 10 |
| Chainsa-Jhajjar-Hissar (transmitted and sold) | | | | | 2 | 2 | 6 | 5 |
| Chainsa-Jhajjar-Hissar (transmitted) | | | | | 1 | 3 | 5 | 10 |
| Other pipelines (transmitted) | | | | | 16 | 16 | 16 | 16 |
| Other pipelines | 39 | 40 | 39 | 49 | 39 | 38 | 35 | 35 |
| Regassified LNG | | | | | | | | |
| Dahej-Vijaipur pipeline (transmitted and sold) | 6 | 9 | 9 | 15 | 13 | 13 | 13 | 13 |
| Dahej-Vijaipur pipeline (transmitted) | 4 | 6 | 6 | 10 | 13 | 13 | 13 | 13 |
| Dahej-Uran pipeline (transmitted and sold) | | 6 | 9 | 12 | 6 | 6 | 6 | 6 |
| Dahej-Uran pipeline (transmitted) | | | | | 6 | 6 | 6 | 6 |
| Panvel-Dabhol pipeline (transmitted and sold) | | 4 | 6 | 8 | 3 | 3 | 3 | 3 |
| Panvel-Dabhol pipeline (transmitted) | | | | | 5 | 5 | 5 | 5 |
| Dabhol-Bangalore pipeline | | | | | | | 2 | 5 |
| Kochi-Bangalore/Mangalore pipeline | | | | | | | 2 | 5 |
| Elimination of double-counted volumes (a) | (3) | (15) | (18) | (21) | (20) | (28) | (37) | (46) |
| Total gas transmission | 77 | 82 | 83 | 107 | 118 | 119 | 125 | 135 |
| Total gas sales | | | | | 83 | 84 | 91 | 101 |
| LPG (000 tons) | | | | | | | | |
| Sold | 1,037 | 1,039 | 1,092 | 1,101 | 1,073 | 1,165 | 1,165 | 1,165 |
| Transported | 2,490 | 2,754 | 2,744 | 3,160 | 3,337 | 3,300 | 3,350 | 3,350 |
| Petrochemicals (000 tons) | | | | | | | | |
| Polyethylene | | | | | | | | |
| Domestic sales | 337 | 381 | 423 | 410 | 420 | 440 | 445 | 480 |
| Exports | 10 | 10 | — | — | — | — | — | — |
| Total petrochemicals | 347 | 391 | 423 | 410 | 420 | 440 | 445 | 480 |
| Prices | | | | | | | | |
| Natural gas (Rs/cubic meter) | | | | | | | | |
| Natural gas ceiling price | 4.21 | 4.21 | 4.59 | 5.75 | 7.55 | 7.71 | 7.71 | 7.71 |
| Regassified LNG including transportation | 6.93 | 6.44 | 7.05 | 2.24 | 2.23 | 2.18 | 2.18 | 2.18 |
| Transmission plus marketing charges | | | | | | | | |
| HBJ pipeline, Dahej-Vijaipur pipeline (from FY2007) | 0.99 | 0.96 | 1.05 | 1.08 | 1.26 | 1.26 | 1.26 | 1.26 |
| Dahej-Vijaypur-GREP upgradation | | | | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 |
| Dadri-Bawana-Nangal | | | | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 |
| Chainsa-Jhajjar-Hissar | | | | 0.55 | 0.55 | 0.55 | 0.55 | 0.55 |
| Dahej-Vijaipur, Dahej-Uran, Panvel-Dabhol pipeline | 0.99 | 1.03 | 1.04 | 1.26 | 1.26 | 1.21 | 1.21 | 1.21 |
| Dabhol-Bangalore pipeline | | | | | | | 2.13 | 2.13 |
| Kochi-Bangalore/Mangalore pipeline | | | | | | | 1.55 | 1.55 |
| Other pipelines | 0.40 | 0.42 | 0.44 | 0.44 | 0.46 | 0.46 | 0.46 | 0.46 |
| LPG | | | | | | | | |
| LPG (US\$/ton) | 531 | 702 | 685 | 612 | 749 | 970 | 885 | 843 |
| Transmission charges (Rs/ton) | | | | | | | | |
| Jamnagar-Loni | 1,522 | 1,522 | 1,522 | 1,522 | 1,522 | 1,522 | 1,522 | 1,522 |
| Vizag-Secunderabad | 1,450 | 1,450 | 1,450 | 1,450 | 1,450 | 1,450 | 1,450 | 1,450 |
| Other assumptions | | | | | | | | |
| Polyethylene, HDPE (US\$/ton) | 1,315 | 1,500 | 1,360 | 1,340 | 1,415 | 1,480 | 1,430 | 1,405 |
| Import tariff, Polyethylene | 5% | 5% | 5% | 5% | 5% | 5% | 5% | 5% |
| Import tariff, LPG | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Exchange rate (Rs/US\$) | 45.3 | 40.3 | 45.8 | 47.4 | 45.6 | 47.3 | 49.8 | 48.5 |
| Subsidy losses | 14,880 | 13,137 | 17,812 | 13,267 | 21,112 | 37,076 | 29,490 | 24,608 |

Note:

(a) Gas transported through the HVJ or DV pipeline and then to smaller pipelines.

Source: Company, Kotak Institutional Equities estimates

- ▶ **Subsidy burden.** We model subsidy burden on GAIL for FY2012E, FY2013E and FY2014E at ₹37.1 bn, ₹29.5 bn and ₹24.6 bn. We assume that upstream companies will bear 45% of total under-recoveries for FY2012E and GAIL will bear 7% of subsidy burden on upstream companies. We note that the upstream companies have borne 33.3% of the gross under-recoveries in 1HFY12. However, we believe that the government will likely increase the subsidy burden on upstream companies in 2HFY12 given its fiscal constraints. We assume upstream companies to bear 40% in FY2013-14E.
- ▶ **Gas transportation volumes.** We have cut our assumption of GAIL's gas transportation volumes given slower-than-expected ramp-up of gas volumes from RIL's KG D-6 block. We now estimate GAIL's transmission volumes for FY2012E at 119 mcm/d versus 117.9 mcm/d in 1HFY12 and 118 mcm/d in FY2011.

We model transmission volumes for FY2013E and FY2014E at 125 mcm/d and 135 mcm/d led by (1) increased supply from higher LNG imports and (2) higher gas production from RIL's KG D-6 block (FY2014E). We note that GAIL would benefit from start of LNG terminals at Dabhol (4QFY12) and Kochi (3QFY13).
- ▶ **Crude oil and LPG price assumptions.** We model FY2012E, FY2013E and FY2014E crude oil (Dated Brent) price assumptions at US\$110/bbl, US\$100/bbl and US\$95/bbl.
- ▶ **Rupee-dollar exchange rate.** We model exchange rate for FY2012E, FY2013E and FY2014E at ₹47.27/US\$, ₹49.75/US\$ and ₹48.5/US\$.

We value GAIL stock at ₹535 per share

Sum-of-the-parts valuation of GAIL, FY2013E basis (₹ bn)

| | Valuation base (Rs bn) | | Multiples (X) | | EV (Rs bn) | | EV (Rs/share) |
|--|------------------------|--------|---------------|-----------|------------|--------------|---------------|
| | Other | EBITDA | Other | EV/EBITDA | Other | EBITDA basis | |
| Natural gas transportation | | | | | | | |
| HVJ pipeline | 52 | | | | 52 | | 41 |
| DV pipeline | 41 | | | | 41 | | 32 |
| DUPD pipeline | 29 | | | | 29 | | 23 |
| DBN pipeline | 38 | | | | 38 | | 30 |
| CGJH pipeline | 19 | | | | 19 | | 15 |
| DV GREP pipeline | 180 | | | | 180 | | 142 |
| DB pipeline | 66 | | | | 66 | | 52 |
| KBM pipeline | 45 | | | | 45 | | 35 |
| Short distance pipelines | | 5.9 | | 5.0 | | 29 | 23 |
| Total natural gas transportation | | | | | | | 394 |
| Other businesses | | | | | | | |
| LPG transportation | | 3.7 | | 6.0 | | 22 | 18 |
| LPG production | | 13.7 | | 5.0 | | 68 | 54 |
| Petrochemicals | | 15.5 | | 5.0 | | 78 | 61 |
| Oil and gas upstream | 19 | | 1.0 | | 19 | | 15 |
| Total other business segments | | | | | | | 148 |
| Investments | | | | | | | |
| ONGC shares | 78 | | 0.8 | | 63 | | 49 |
| Others | 47 | | 0.8 | | 38 | | 30 |
| Investments | 125 | | 0.8 | | 100 | | 79 |
| Total | | | | | | 198 | 620 |
| Net debt/(cash) | | | | | 106 | 106 | 83 |
| Implied value of share (Rs/share) | | | | | | | 537 |

Source: Kotak Institutional Equities estimates

GAIL (India) Ltd: Profit model, balance sheet, cash model of GAIL, March fiscal year-ends, 2007-2014E (₹ mn)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|--|----------------|----------------|----------------|----------------|-----------------|-----------------|-----------------|----------------|
| Profit model (Rs mn) | | | | | | | | |
| Net sales | 160,472 | 180,082 | 237,760 | 249,964 | 324,586 | 292,744 | 311,821 | 332,752 |
| EBITDA | 30,649 | 39,275 | 40,647 | 46,688 | 54,718 | 62,587 | 74,040 | 81,862 |
| Other income | 5,450 | 5,564 | 7,966 | 5,411 | 5,186 | 3,890 | 3,936 | 4,303 |
| Interest | (1,071) | (796) | (870) | (700) | (829) | (1,849) | (5,413) | (6,801) |
| Depreciation | (5,754) | (5,710) | (5,599) | (5,618) | (6,503) | (7,802) | (11,371) | (13,721) |
| Pretax profits | 29,274 | 38,333 | 42,144 | 45,781 | 52,572 | 56,826 | 61,191 | 65,643 |
| Tax | (7,941) | (12,525) | (13,941) | (13,750) | (14,352) | (12,330) | (11,942) | (13,450) |
| Deferred taxation | (190) | (10) | (62) | (636) | (2,437) | (4,196) | (6,341) | (6,240) |
| Net profits | 24,619 | 26,015 | 28,037 | 31,398 | 35,611 | 40,300 | 42,908 | 45,953 |
| Earnings per share (Rs) | 19.4 | 20.5 | 22.1 | 24.8 | 28.1 | 31.8 | 33.8 | 36.2 |
| Balance sheet (Rs mn) | | | | | | | | |
| Total equity | 113,929 | 130,049 | 147,696 | 167,990 | 192,533 | 220,303 | 249,205 | 279,679 |
| Deferred taxation liability | 13,187 | 13,197 | 13,259 | 13,896 | 16,332 | 20,528 | 26,869 | 33,109 |
| Total borrowings | 13,379 | 12,659 | 12,001 | 14,804 | 23,100 | 96,900 | 131,700 | 115,500 |
| Current liabilities | 45,512 | 60,604 | 81,548 | 103,784 | 88,149 | 67,579 | 68,587 | 70,102 |
| Total liabilities and equity | 186,007 | 216,509 | 254,505 | 300,473 | 320,115 | 405,310 | 476,361 | 498,390 |
| Cash | 26,604 | 44,730 | 34,562 | 41,715 | 21,314 | 17,230 | 19,911 | 23,273 |
| Other current assets | 50,851 | 59,370 | 87,804 | 95,412 | 90,148 | 97,198 | 104,240 | 106,817 |
| Total fixed assets | 93,913 | 97,500 | 114,767 | 142,616 | 182,827 | 265,057 | 326,386 | 342,475 |
| Investments | 14,638 | 14,909 | 17,373 | 20,730 | 25,825 | 25,825 | 25,825 | 25,825 |
| Total assets | 186,007 | 216,509 | 254,505 | 300,473 | 320,115 | 405,310 | 476,361 | 498,390 |
| Free cash flow (Rs mn) | | | | | | | | |
| Operating cash flow, excl. working capital | 23,920 | 33,692 | 30,456 | 33,480 | 42,110 | 45,160 | 52,817 | 58,853 |
| Working capital changes | (10,151) | (388) | (5,573) | 12,454 | (12,420) | (27,619) | (6,034) | (1,062) |
| Capital expenditure | (20,449) | (12,419) | (25,535) | (35,702) | (46,322) | (86,783) | (68,833) | (27,052) |
| Investments | (205) | (270) | (2,464) | (3,358) | (5,095) | — | — | — |
| Other income | 3,884 | 4,042 | 5,243 | 4,705 | 4,090 | 3,890 | 3,936 | 4,303 |
| Free cash flow | (3,002) | 24,658 | 2,127 | 11,580 | (17,637) | (65,352) | (18,114) | 35,042 |
| Ratios (%) | | | | | | | | |
| Debt/equity | 10.5 | 8.8 | 7.5 | 8.1 | 11.1 | 40.2 | 47.7 | 36.9 |
| Net debt/equity | (10.4) | (22.4) | (14.0) | (14.8) | 0.9 | 33.1 | 40.5 | 29.5 |
| ROAE (%) | 20.5 | 19.2 | 18.4 | 18.3 | 18.2 | 17.9 | 16.6 | 15.6 |
| ROACE (%) | 16.1 | 17.8 | 17.5 | 17.2 | 16.9 | 14.6 | 12.5 | 12.1 |
| Key assumptions | | | | | | | | |
| Gas transmission volumes (mcm/d) | 77 | 82 | 83 | 107 | 118 | 119 | 125 | 135 |
| Petrochemical sales volumes (000 tons) | 347 | 391 | 423 | 410 | 420 | 440 | 445 | 480 |
| LPG sales volumes (000 tons) | 1,037 | 1,039 | 1,092 | 1,101 | 1,073 | 1,165 | 1,165 | 1,165 |
| LPG transmission volumes (000 tons) | 2,490 | 2,754 | 2,744 | 3,160 | 3,337 | 3,300 | 3,350 | 3,350 |
| Subsidy losses (Rs mn) | 14,880 | 13,137 | 17,812 | 13,267 | 21,112 | 37,076 | 29,490 | 24,608 |

Source: Company, Kotak Institutional Equities estimates

OCTOBER 24, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): **116**

Target price (Rs): **165**

BSE-30: **16,939**

Zinc does well, other segments struggle. Sterlite's reported 2QFY12 EBITDA of Rs24.8 bn (+62.3% yoy, -10% qoq) was broadly in line. Net income of Rs9.9 bn (-1% yoy, -39.1% qoq) was impacted by VAL and forex losses. Sterlite announced interim dividend of Re1/share, a positive in our view. We find valuations of Sterlite attractive and believe that concerns of viability of VAL project and fuel shortage for Sterlite Energy (SEL) are built into the current market price. We have tweaked our EPS estimates lower by 20.4% and 11.8% for FY2012-13E and cut our TP to Rs165 (Rs185 earlier). BUY.

Company data and valuation summary

Sterlite Industries

Stock data

52-week range (Rs) (high,low) 196-104

Market Cap. (Rs bn) 389.4

Shareholding pattern (%)

Promoters 53.2

FIs 25.9

MFs 3.3

Price performance (%)

Absolute 1M (5.5) 3M (31.4) 12M (31.1)

Rel. to BSE-30 (9.9) (24.2) (18.0)

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|-------|--------|-------|
| EPS (Rs) | 15.2 | 13.5 | 16.7 |
| EPS growth (%) | 26.2 | (10.9) | 23.7 |
| P/E (X) | 7.6 | 8.6 | 6.9 |
| Sales (Rs bn) | 304.3 | 376.4 | 422.0 |
| Net profits (Rs bn) | 51.0 | 45.5 | 56.2 |
| EBITDA (Rs bn) | 80.5 | 93.4 | 116.2 |
| EV/EBITDA (X) | 4.8 | 4.0 | 2.9 |
| ROE (%) | 13.0 | 10.5 | 11.7 |
| Div. Yield (%) | 1.0 | 1.1 | 1.1 |

VAL and forex loss hurt net income; operational performance in line with our estimate

Sterlite's reported 2QFY12 EBITDA of Rs24.8 bn (+62.3% yoy, -10% qoq) was in line with our estimate of Rs24.5 bn. Performance was powered by zinc and copper segments, while aluminium (major cost increase) and power segments were a drag. Net income of Rs9.9 bn (-39.1% qoq, -1% yoy) was impacted by (1) Rs4.7 bn forex losses on MTM of FCCB and hedges undertaken for up-streaming of cash from zinc international business and (2) Rs2.4 bn loss from consolidation of VAL operations. VAL reported PBDT loss of Rs6.2 bn and net loss of Rs8.2 bn.

New projects fail to deliver; Sterlite Energy and VAL report losses

Lack of availability of raw materials is hurting new projects—(1) aluminium cost of production (COP) of US\$2,554/tonne was higher than LME aluminium price. COP includes impact of restart of pots after outage in 1QFY12. VAL may convert part of the debt extended by Vedanta and Sterlite into equity, and (2) SEL's COP increased to Rs2.9/unit due to limited coal availability forcing power plant to be run at sub-optimal level, and qoq unchanged PLF of 44%. Concern on coal availability for SEL is unlikely to recede. We cut SEL FY2012-13E EBITDA estimates by 70.5% and 52.9%.

Balance sheet in good shape even after eliminating Hindustan Zinc cash; dividend payout increased

Sterlite has net debt of Rs82 bn after eliminating cash of HZ. Net debt/ EBITDA, ex-HZ operations, is comfortable, in our view, as long as Sterlite does not increase loans extended to VAL. Sterlite did not lend any cash to VAL in 2QFY12. On the positive side, Sterlite and Hindustan Zinc have stepped up dividend payout. The dividend payout structure is tax efficient.

Cut estimate on lower commodity price assumption

We make a few changes to our estimates and factor in lower zinc-lead and aluminium price forecasts and lower profitability of SEL for FY2012-14E. We lower our consolidated FY2012-13E EPS estimates by 20.4% and 11.8% to Rs13.5 and Rs16.7 (Exhibit 3). We maintain our BUY rating with a revised TP of Rs165/share (Rs185/share earlier) based on end-2013E financials. Sterlite stock is trading at distressed levels with valuation for the business being justified on HZ fair value alone.

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Trading close to distressed levels, downside risk limited

Sterlite has underperformed the broader market by 31% in the past three months primarily owing to the recent freefall in commodity prices emanating from the weak sentiment globally. The stock is currently trading at valuations of 4.3X FY2012E and 2.8X FY2013E adjusted EBITDA, inexpensive and attractive in our view. Current valuations of Sterlite can be explained by the zinc business alone (CMP of HZ without holdco discount + fair value for Zinc International); effectively no value is assigned to excess cash, copper, Balco and power business. Exhibits 1 and 2 detail a few sensitivities.

Exhibit 1: Sterlite Industries fair value impact under various scenarios

| | Base Case | | Scenario 1 | | Scenario 2 | | Scenario 3 | |
|--|--------------------|------------|--------------------|------------|--------------------|------------|--------------------|------------|
| | Price (US\$/tonne) | Rs/share | Price (US\$/tonne) | Rs/share | Price (US\$/tonne) | Rs/share | Price (US\$/tonne) | Rs/share |
| Aluminium business - BALCO | 2,400 | 0 | 2,400 | 0 | 2,110 | (4) | 1,899 | (6) |
| Copper smelting & mining business | 14.5 c/lb | 52 | 14.5 c/lb | 52 | 14.5 c/lb | 54 | 14.5 c/lb | 52 |
| Zinc business: Hindustan Zinc & Zinc International | 2,125 | 129 | 1,425 | 80 | 1,793 | 106 | 1,614 | 94 |
| Other businesses | | 10 | | 10 | | 10 | | — |
| Less: investments and loans to VAL | | (26) | | (26) | | (26) | | (26) |
| Target price (Rs/ share) | | 165 | | 116 | | 141 | | 113 |

Note:

1. Scenario 1 is the implied value of the zinc business at the CMP of Sterlite, given other businesses being constant
2. Scenario 2 is the value of Sterlite at spot commodity prices (as at 23rd Oct, 2011)
3. Scenario 3 is the distressed case value of Sterlite with 10% further correction in current spot commodity prices and no value for power business

Source: Kotak Institutional Equities estimates

Exhibit 2: Stress test for Sterlite's earnings and fair value at various commodity price levels

| | FY2012E | | | | FY2013E | | | |
|--|------------|------------|-------------|--------------|------------|------------|-------------|--------------|
| | Base case | Spot | Base (-) 5% | Base (-) 15% | Base case | Spot | Base (-) 5% | Base (-) 15% |
| Zinc prices (US\$/ tonne) | 2,075 | 1,793 | 1,971 | 1,764 | 2,125 | 1,793 | 2,019 | 1,806 |
| Lead prices (US\$/ tonne) | 2,150 | 1,841 | 2,043 | 1,828 | 2,250 | 1,841 | 2,138 | 1,913 |
| Consolidated EBITDA (Rs mn)- proportionate | 369 | 369 | 369 | 369 | 1,417 | 1,417 | 1,417 | 1,417 |
| EV/EBITDA (X)- proportionate (at CMP) | 4.3 | 4.8 | 4.5 | 4.9 | 2.8 | 3.9 | 3.1 | 3.7 |
| EPS (Rs/ share) | 13.5 | 12.2 | 13.1 | 12.0 | 16.7 | 12.9 | 15.5 | 13.1 |
| P/E (X) | 8.6 | 9.5 | 8.9 | 9.6 | 6.9 | 9.0 | 7.5 | 8.8 |
| Target price | | | | | 165 | 141 | 157 | 143 |

Note:

1. Spot prices are as on 23rd Oct, 2011

Source: Kotak Institutional Equities estimates

Key change to our estimates and target price

We cut our FY2012-14E EPS estimates by 20.4%, 11.8% and 10.3% to Rs13.5, Rs16.7 and Rs19.4, respectively. We attribute the following reasons for cut

- ▶ Change in FY2012-14E zinc price assumption to US\$2,075/tonne, US\$2,125/tonne and US\$2,300/tonne from US\$2,150/tonne, US\$2,200/tonne and US\$2,250/tonne earlier.
- ▶ Cut in FY2012 aluminium price assumption to US\$2,275/tonne from US\$2,400/tonne previously while retaining our FY2013-14E aluminium price assumptions of US\$2,400/tonne and US\$2,450/tonne.
- ▶ Sterlite Energy—we push out commissioning of 3rd and 4th units to March 2013 and June 2013 from June 2012 and September 2012 earlier. We cut Sterlite Energy EBITDA estimate by 70.5%, 52.9% and 37.3% for FY2012-14E.

- ▶ Cut in aluminium prices leads to increase in losses for VAL. We increase VAL's FY2012-13E losses in our model to Rs17.2 bn and Rs7 bn from Rs11.1 bn and Rs4.8 bn earlier. Sterlite share of losses in VAL amounts to Rs5.1 bn and Rs2.1 bn for FY2012-13E.

We also build in revised Re/US\$ rate of 47.3, Rs49.8 and Rs48.5 versus Rs44.8, Rs45.6 and Rs45 earlier for FY2012-14E. We also build in potential implementation of mining tax in valuation model by lowering multiples assigned to the Hindustan Zinc business.

Exhibit 3: Sterlite Industries (consolidated), change in estimates, March fiscal year-ends, 2012E-14E (Rs mn)

| | Revised estimates | | | Old estimates | | | % change | | |
|------------------------------|-------------------|-------------|-------------|---------------|-------------|-------------|---------------|---------------|---------------|
| | 2012E | 2013E | 2014E | 2012E | 2013E | 2014E | 2012E | 2013E | 2014E |
| Prices (US\$/tonne) | | | | | | | | | |
| Aluminium | 2,275 | 2,400 | 2,450 | 2,400 | 2,400 | 2,450 | (5.2) | - | - |
| Zinc | 2,075 | 2,125 | 2,300 | 2,150 | 2,200 | 2,250 | (3.5) | (3.4) | 2.2 |
| Copper | 8,000 | 7,600 | 7,600 | 8,800 | 8,360 | 8,360 | (9.1) | (9.1) | (9.1) |
| Lead | 2,150 | 2,250 | 2,350 | 2,250 | 2,300 | 2,350 | (4.4) | (2.2) | - |
| Sterlite Consolidated | | | | | | | | | |
| Net sales | 376,389 | 421,990 | 466,702 | 389,711 | 438,830 | 477,243 | (3.4) | (3.8) | (2.2) |
| EBITDA | 93,440 | 116,178 | 133,689 | 105,576 | 125,635 | 142,607 | (11.5) | (7.5) | (6.3) |
| EPS (Rs) | 13.5 | 16.7 | 19.4 | 17.0 | 19.0 | 21.7 | (20.4) | (11.8) | (10.3) |
| Sterlite Standalone | | | | | | | | | |
| Net sales | 166,370 | 166,663 | 163,563 | 171,645 | 167,600 | 166,015 | (3.1) | (0.6) | (1.5) |
| EBITDA | 9,261 | 8,735 | 8,527 | 8,776 | 8,801 | 8,267 | 5.5 | (0.8) | 3.1 |
| Hindustan Zinc | | | | | | | | | |
| Revenues | 110,966 | 135,611 | 145,398 | 114,404 | 131,879 | 138,496 | (3.0) | 2.8 | 5.0 |
| EBITDA | 60,720 | 77,007 | 82,225 | 64,051 | 73,847 | 76,656 | (5.2) | 4.3 | 7.3 |
| BALCO | | | | | | | | | |
| Revenues | 43,077 | 53,114 | 64,599 | 45,163 | 58,449 | 69,599 | (4.6) | (9.1) | (7.2) |
| EBITDA | 5,265 | 7,573 | 10,471 | 10,256 | 14,107 | 18,691 | (48.7) | (46.3) | (44.0) |
| Jharsuguda IPP | | | | | | | | | |
| Net sales | 14,976 | 21,374 | 45,827 | 19,329 | 39,226 | 60,756 | (22.5) | (45.5) | (24.6) |
| EBITDA | 1,887 | 5,238 | 13,335 | 6,392 | 11,117 | 21,261 | (70.5) | (52.9) | (37.3) |
| Re/ US\$ rate | 47.3 | 49.8 | 48.5 | 44.8 | 45.6 | 45.0 | 5.6 | 9.0 | 7.8 |

Source: Kotak Institutional Equities estimates

Scramble for coal hurts extant operations, puts to risk future expansions

The acute shortage of coal exasperated by (1) curtailed output from Singareni Collieries—affected by the political unrest in Andhra Pradesh, and (2) excessive rains and flooding in key coal producing fields for Coal India has led to a dent in availability (and pricing of coal) impacting not only the power but also fuel-intensive aluminum and zinc operations. The situation is further exacerbated by firm prices of imported coal and a weakening domestic currency.

While the current impasse on coal supplies may get addressed over the next few weeks, it exposes the fragile fuel supply and raises questions on future expansions. We have revised our earning estimates for the power business to reflect lower dependence on linkage coal for the first two units at Jharsuguda and have delayed commercial generation from the remaining two units until June 2013, by which time either the domestic supply situation would have been addressed and/or contribution from captive coal blocks stepped up. We note that SEL had committed capital of Rs60 bn as of March 2011, of which contribution from STLT was to the tune of Rs52 bn—combination of equity commitments (Rs12 bn) and interest-free loans (Rs40 bn). We lower our fair value assumption for Jharsuguda IPP to Rs32 bn (Rs10/share) to reflect lower dependence on linkage coal and potential delay in commercial generation of the last two units.

Increase in COP of aluminium business is a concern

Balco reported loss of Rs170 mn due to increase in COP of aluminium business. COP of Balco increased by 7.7% qoq to US\$2,133/tonne. Sterlite attributes the increase to higher alumina and carbon costs. As indicated earlier, VAL's aluminium cost of production also increased to US\$2,554/tonne led by restart of pots after outage in 1QFY12 and higher coal costs.

VAL reports loss of Rs8.2 bn; no additional funding provided by Sterlite but equity infusion round the corner

The Sterlite management indicated part of loan extended by the company and Vedanta Resources to VAL may be converted into equity. VAL is thinly capitalized; Sterlite expects VAL to run at a debt:equity ratio of 70:30. Note that Sterlite owns 29.5% in VAL and Vedanta Resources the balance 70.5%.

Vedanta Aluminium (VAL) reported net loss of Rs8.2 bn in 2QFY12 as against a loss of Rs3.6 bn in 1QFY12. Sterlite share of losses in the same was Rs2.4 bn. Cost of production of VAL increased sharply by 9% qoq to US\$2,554/tonne of hot metal. Cost increase was owing to (1) higher coal costs; this accounted for US\$230/tonne increase in COP qoq. VAL was forced to draw down power from grid due to insufficient availability of coal for its CPP, (2) usage of higher amount of imported alumina, and (3) power outage problem at the 500 ktpa smelter in June 2011 resulting in damage to around 170 pots. VAL has restarted 115 of the 170 pots that were damaged. COP for VAL would remain at elevated levels owing to the aforementioned problem.

Loans extended to VAL by Sterlite remained unchanged from June 2011 levels. Loans extended by Sterlite is materially higher than its equity stake in the VAL. VAL has total balance sheet size of Rs311 bn comprising Rs20 bn of equity and Rs291 bn of debt. Out of total debt of Rs291 bn, Rs135 bn is extended by Vedanta Resources and Sterlite and balance Rs156 bn through external sources.

Exhibit 4: Status of investment in Vedanta Aluminium as of June 30, 2011 (Rs bn)

| Investment in VAL | Sterlite | Vedanta | External | Total |
|---------------------|----------|---------|----------|-------|
| Equity | 5.8 | 13.8 | — | 19.5 |
| Quasi Equity / Debt | 89.4 | 41.0 | 151.3 | 281.6 |
| Total funding | 95.2 | 54.8 | 151.3 | 301.2 |

Source: Company, Kotak Institutional Equities estimates

Exhibit 5: Status of investment in Vedanta Aluminium as of September 30, 2011 (Rs bn)

| Investment in VAL | Sterlite | Vedanta | External | Total |
|---------------------|----------|---------|----------|-------|
| Equity | 5.6 | 13.9 | — | 19.5 |
| Quasi Equity / Debt | 89.4 | 45.9 | 156.0 | 291.3 |
| Total funding | 95.0 | 59.8 | 156.0 | 310.8 |

Source: Company, Kotak Institutional Equities estimates

Discussion on divisional performance

Sterlite's 2QFY12 results were ahead of our expectations. Performance across different segments is as under:

- Zinc, lead and silver segment.** HZ reported EBITDA of Rs14.7 bn (+30.2% yoy, -8% qoq), 4.8% lower than our estimate of Rs15.4 bn. Underperformance can be attributed to (1) lower refined zinc deliveries at 184 kt versus our expectations of 192 kt, HZ took annual plant shutdown in 2QFY12 and (2) no sale of any zinc-lead metal-in-concentrate. Net income fell 10% sequentially to Rs13.4 bn, marginally lower than our estimate. Net income was impacted by Rs238 mn of employee VRS expenses. COP of zinc declined US\$27 qoq to US\$847/tonne excluding royalty.

- ▶ **Zinc international.** Zinc International produced 77 kt and 37 kt of mined and refined zinc in 2QFY12 in line with our estimates. Revenues and PBDT from zinc international for 2QFY12 was Rs11.6 bn and Rs5.3 bn versus our estimate of Rs10.9 bn and Rs4.3 bn, respectively. COP for 2QFY12 was US\$1,242/tonne as against US\$1,189 in the previous quarter.
- ▶ **Copper segment.** 2QFY12 copper business EBIT of Rs3.1 bn (+95.8% yoy, +6.2% qoq) was 29.2% ahead of our estimate of Rs2.4 bn benefiting from strong Tc/Rc. Tc/Rc for 2QFY12 averaged around 13c/lb in 2QFY12 versus 11.7c/lb in 2QFY11. Copper cathode production and mined metal production of 87 kt and 5 kt in 2QFY12 as against our estimates of 81 kt and 6 kt, respectively. The net cost of production was -3.7c/lb in 2QFY12 as compared to -2.9c/lb in 1QFY12 and 7.3c/lb in 2QFY11 led by higher by-product credits (acid sales).
- ▶ **Aluminium segment.** Aluminium segment reported 2QFY12 EBIT of Rs77 mn (-93.9% yoy, -95.2% qoq), as against our estimate of Rs981 mn. COP rose substantially to US\$2,133/tonne in 2QFY12 as against US\$1,981/tonne in the previous quarter on the back of higher power and fuel costs owing to elevated coal prices. We do not expect any meaningful decline in COP in the immediate quarters. We would not be surprised if the company reports loss at the EBITDA level in 3QFY12.
- ▶ **Power segment.** 2QFY12 EBIT of Rs0.5 bn fell 39% qoq despite higher power sales from the first two units of the 2,400 MW IPP at Jharasuguda. COP in the power segment increased 3.8% qoq to Rs2.7/unit, reflecting the high cost of production at Jharasuguda IPP (Rs2.9/unit.) Average power realizations decreased qoq by 7.9% to Rs3.3/ unit. Power sales in 2QFY12 were 1,615 MU comprising (1) 1,134MU from 2,400 MW Jharasuguda IPP, (2) 387 MU from Balco, and (3) 94 MU from Hindustan Zinc's wind power generation capability. PLF of SEL's first two units was flat at ~44%. Operations were impacted by coal availability.

Exhibit 6: Interim results of Sterlite Industries, March fiscal year-ends (Rs mn)

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | (% chg.) | | |
|--|----------------|---------------|---------------|---------------|--------------|--------------|---------------|
| | | | | | 2QFY12E | 2QFY11 | 1QFY12 |
| Net sales | 101,957 | 98,350 | 60,844 | 98,607 | 3.7 | 67.6 | 3.4 |
| Total expenditure | (77,137) | (73,859) | (45,554) | (71,024) | 4.4 | 69.3 | 8.6 |
| Inc/(Dec) in stock | (14) | — | 3,935 | 698 | — | (100.4) | (102.0) |
| Raw materials | (48,196) | (45,321) | (31,640) | (45,954) | 6.3 | 52.3 | 4.9 |
| Staff cost | (3,970) | (4,428) | (2,225) | (3,850) | (10.3) | 78.4 | 3.1 |
| Power and fuel | (10,568) | (8,404) | (5,744) | (7,640) | 25.7 | 84.0 | 38.3 |
| Other expenditure | (14,389) | (15,705) | (9,880) | (14,277) | (8.4) | 45.6 | 0.8 |
| EBITDA | 24,820 | 24,491 | 15,289 | 27,583 | 1.3 | 62.3 | (10.0) |
| Other income | 5,972 | 3,916 | 5,779 | 8,416 | 52.5 | 3.4 | (29.0) |
| Interest | (3,559) | (1,879) | 3 | (1,740) | 89.4 | NM | 104.5 |
| Depreciation | (4,450) | (4,536) | (2,123) | (4,200) | (1.9) | 109.6 | 6.0 |
| Pretax profits | 22,784 | 21,992 | 18,948 | 30,059 | 3.6 | 20.2 | (24.2) |
| Extraordinaries/sales tax benefit | (299) | — | (212) | (44) | — | — | — |
| Tax | (5,049) | (4,618) | (4,555) | (6,137) | 9.3 | 10.8 | (17.7) |
| Net income before minority interest | 17,436 | 17,374 | 14,181 | 23,878 | 0.4 | 23.0 | (27.0) |
| Minority interest | (5,030) | (5,286) | (3,853) | (6,420) | (4.9) | 30.5 | (21.7) |
| Share of associates | (2,428) | (1,525) | (247) | (1,061) | 59.2 | 882.6 | 128.9 |
| PAT after minority interest | 9,978 | 10,563 | 10,080 | 16,397 | (5.5) | (1.0) | (39.1) |
| Adjusted PAT | 10,277 | 10,563 | 10,292 | 16,442 | (2.7) | (0.1) | (37.5) |
| Ratios | | | | | | | |
| ETR (%) | 22.5 | 21.0 | 24.3 | 20.4 | | | |
| EPS (Rs) | 3.0 | 3.1 | 3.0 | 4.9 | | | |
| Volume details ('000 tonnes) | | | | | | | |
| Copper mined metal content | 5 | 6 | 6 | 6 | (12.3) | (16.7) | (16.7) |
| Copper cathode | 87 | 81 | 68 | 74 | 7.8 | 27.9 | 17.6 |
| Balco | 60 | 61 | 68 | 61 | (2.1) | (11.8) | (1.6) |
| Mined metal content | 210 | 211 | 205 | 188 | (0.3) | 2.4 | 11.7 |
| Zinc cathode | 185 | 193 | 176 | 193 | (4.2) | 5.0 | (4.1) |
| Silver (tonnes) | 49 | 40 | 44 | 47 | 22.6 | 11.4 | 4.3 |
| Wheeled units (mn units) | 1,615 | 2,140 | 414 | 1,652 | (24.5) | 290.1 | (2.2) |
| Average realizations (Rs/tonne) | | | | | | | |
| Copper | 557,545 | 517,687 | 392,834 | 562,990 | 7.7 | 41.9 | (1.0) |
| Aluminium | 114,255 | 115,629 | 105,584 | 124,044 | (1.2) | 8.2 | (7.9) |
| Zinc and lead | 176,677 | 149,200 | 111,747 | 185,032 | 18.4 | 58.1 | (4.5) |
| Power (Rs/unit) | 3.3 | 3.3 | 3.5 | 3.6 | - | (4.5) | (7.9) |
| EBIT (Rs mn) | | | | | | | |
| Copper | 3,090 | 2,392 | 1,579 | 2,911 | 29.2 | 95.8 | 6.2 |
| Aluminium | 77 | 981 | 1,258 | 1,594 | (92.2) | (93.9) | (95.2) |
| Zinc and lead | 16,502 | 17,216 | 10,029 | 18,126 | (4.1) | 64.5 | (9.0) |
| Power | 528 | 670 | 567 | 866 | (21.2) | (6.9) | (39.0) |

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: SOTP-based target price of Sterlite Industries is Rs165/share
SOTP-based target price of Sterlite, March fiscal year-ends, 2013E basis (Rs mn)

| | EBITDA (Rs bn) | Multiple (X) | EV (Rs bn) | Net debt (Rs bn) | Implied M Cap (Rs bn) | Sterlite's stake (%) | Attributable M Cap (Rs bn) | Holding Co discount % | Contribution Rs/ share |
|------------------------------------|-------------------|-----------------|---------------|---------------------|--------------------------|-------------------------|-------------------------------|-----------------------------|---------------------------|
| BALCO | 8 | 6.3 | 47 | 45.8 | 1.5 | 51.0 | 1 | 15.0 | 0 |
| Copper business | | | | | | | | | |
| Copper smelting business | 9 | 6.0 | 52 | (116) | 167.9 | 100.0 | 168 | — | 50 |
| Copper mining | | | | | | | | | 2 |
| Zinc business | | | | | | | | | |
| Hindustan Zinc | 77 | 5.5 | 424 | (229) | 653 | 64.9 | 424 | 15.0 | 107 |
| Zinc International | 16 | 3.5 | 55 | 20 | 75 | 100.0 | 75 | — | 22 |
| Other businesses | | | | | | | | | 10 |
| Less: investments and loans to VAL | | | | | | | 89 | | (26) |
| Target price (Rs/ share) | | | | | | | | | 165 |

Source: Kotak Institutional Equities estimates

Exhibit 8: Sterlite Industries, Consolidated Balance Sheet details (Rs mn)

| | As on | | |
|--------------------------|----------------|----------------|----------------|
| | 30/09/11 | 30/09/10 | 31/03/11 |
| Share Capital | 3,361 | 3,361 | 3,361 |
| Reserves & Surplus | 435,593 | 387,054 | 410,994 |
| Deferred tax liability | 22,253 | 17,359 | 21,789 |
| Total Borrowings | 149,428 | 92,234 | 117,287 |
| Minority Interest | 114,340 | 91,700 | 102,913 |
| Current liabilities | 63,233 | 37,516 | 67,539 |
| Provisions | 13,387 | 7,235 | 20,590 |
| Total liabilities | 801,595 | 636,459 | 744,471 |
| Net fixed assets | 364,539 | 254,563 | 335,475 |
| Cash | 103,493 | 74,060 | 99,124 |
| Inventory | 48,151 | 41,827 | 51,547 |
| Sundry Debtors | 20,658 | 8,450 | 15,950 |
| Other current assets | 3,651 | 1,736 | 3,331 |
| Loans and advances | 137,416 | 83,053 | 109,439 |
| Investments | 123,570 | 172,769 | 129,553 |
| Deferred tax asset | 118 | — | 52 |
| Total assets | 801,595 | 636,459 | 744,471 |

Source: Company, Kotak Institutional Equities estimates

Exhibit 9: Sterlite Industries (consolidated), Key assumptions, March fiscal year ends, 2009-14E (Rs mn)

| | 2009 | 2010 | 2011E | 2012E | 2013E | 2014E |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| Volumes (tonnes) | | | | | | |
| Zinc | 552,330 | 577,685 | 712,603 | 769,125 | 826,260 | 835,050 |
| Lead | 60,564 | 64,391 | 57,229 | 83,250 | 125,800 | 125,800 |
| Copper | 312,572 | 333,244 | 303,327 | 335,619 | 335,605 | 335,584 |
| Aluminium metal | 356,513 | 267,802 | 247,412 | 267,453 | 268,770 | 268,770 |
| Refined silver | 103 | 139 | 147 | 200 | 351 | 396 |
| Average realization (Rs/tonne) | | | | | | |
| Zinc | 70,353 | 99,421 | 106,469 | 105,419 | 113,577 | 119,864 |
| Lead | 86,385 | 105,922 | 114,877 | 112,210 | 122,205 | 124,571 |
| Copper cathode | 272,349 | 303,652 | 398,148 | 405,098 | 405,426 | 395,239 |
| Aluminium ingots | 113,566 | 96,607 | 118,384 | 124,725 | 138,251 | 137,500 |
| Silver (Rs mn/tonne) | 20 | 25 | 37 | 46 | 45 | 46 |
| LME assumptions (US\$/tonne) | | | | | | |
| Zinc | 1,563 | 1,936 | 2,186 | 2,075 | 2,125 | 2,300 |
| Lead | 1,655 | 1,990 | 2,244 | 2,150 | 2,250 | 2,350 |
| Aluminium | 2,227 | 1,900 | 2,257 | 2,275 | 2,400 | 2,450 |
| Divisional EBITDA mix (US\$ mn) | | | | | | |
| Hindustan Zinc | 597 | 988 | 1,218 | 1,285 | 1,548 | 1,695 |
| Sterlite (standalone) | 184 | 108 | 229 | 196 | 176 | 176 |
| BALCO | 167 | 182 | 135 | 111 | 152 | 216 |
| Anglo American Zinc assets | — | — | 110 | 337 | 326 | 374 |
| Power | (2) | (2) | 73 | 40 | 105 | 275 |
| Others | 81 | 9 | 3 | 8 | 28 | 20 |
| Total | 1,027 | 1,285 | 1,768 | 1,977 | 2,335 | 2,756 |
| USD:INR | 45.8 | 47.3 | 45.6 | 47.3 | 49.8 | 48.5 |

Source: Company, Kotak Institutional Equities estimates

Exhibit 10: Sterlite Industries, Key assumptions, March fiscal-year ends, 2002-2011E (Rs mn)

| | 2010 | 2011 | 2012E | 2013E | 2014E |
|-------------------------------|--------|-------|-------|-------|-------|
| Valuation Matrix | | | | | |
| P/E (X) | 9.6 | 7.6 | 8.6 | 6.9 | 6.0 |
| EV/EBITDA (X) | 4.4 | 3.5 | 2.7 | 1.7 | 0.7 |
| EV/ EBITDA (X)- proportionate | 7.6 | 5.8 | 4.3 | 2.8 | 1.4 |
| Price to Book (X) | 1.1 | 0.9 | 0.9 | 0.8 | 0.7 |
| EV/ Revenues (X) | 1.1 | 0.9 | 0.7 | 0.5 | 0.2 |
| P/FCF (X) | (15.1) | 553.8 | 69.7 | 13.3 | 5.6 |
| FCF Yield (%) | (6.6) | 0.2 | 1.4 | 7.5 | 17.9 |
| P/CEPS | 8.7 | 6.4 | 6.2 | 5.1 | 4.4 |
| EV/Invested Capital | 0.9 | 0.7 | 0.6 | 0.5 | 0.3 |
| Dividend Yield (%) | 0.8 | 1.0 | 1.1 | 1.1 | 1.1 |
| Leverage ratios | | | | | |
| Debt/ Equity (X) | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Net debt/ Equity (X) | (0.3) | (0.3) | (0.3) | (0.4) | (0.5) |
| Net debt/ EBITDA (X) | (2.0) | (1.4) | (1.5) | (1.7) | (2.2) |

Source: Company, Kotak Institutional Equities estimates

Exhibit 11: Sterlite Industries, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2009-2014E (Rs mn)

| | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|----------------|-----------------|----------------|----------------|----------------|------------------|
| Profit model (Rs mn) | | | | | | |
| Net sales | 211,442 | 244,103 | 304,285 | 376,389 | 421,990 | 466,702 |
| EBITDA | 47,041 | 60,718 | 80,495 | 93,440 | 116,178 | 133,689 |
| Other income | 21,543 | 19,594 | 24,724 | 27,351 | 26,428 | 30,449 |
| Interest | (3,973) | (3,424) | (3,012) | (10,685) | (9,144) | (12,220) |
| Depreciation | (7,007) | (7,498) | (10,301) | (17,619) | (20,570) | (23,661) |
| Profit before tax | 57,604 | 69,390 | 91,905 | 92,486 | 112,892 | 128,256 |
| Extraordinaries | 2,258 | (2,970) | (568) | (283) | — | — |
| Current tax | (8,795) | (11,038) | (18,165) | (16,771) | (25,180) | (28,174) |
| Deferred tax | (1,461) | (1,291) | 48 | (4,252) | (5,331) | (6,066) |
| Net income before minorities | 49,607 | 54,091 | 73,220 | 71,180 | 82,381 | 94,016 |
| Minority interest | (12,671) | (17,241) | (19,945) | (20,923) | (24,102) | (26,513) |
| Share of profit/loss from associates | (1,536) | 588 | (2,850) | (5,088) | (2,065) | (2,170) |
| Net income | 35,400 | 37,437 | 50,425 | 45,169 | 56,214 | 65,332 |
| Adjusted net income | 34,847 | 40,407 | 50,993 | 45,452 | 56,214 | 65,332 |
| EPS (Rs) | 12.3 | 12.0 | 15.2 | 13.5 | 16.7 | 19.4 |
| Balance sheet (Rs mn) | | | | | | |
| Equity | 256,132 | 370,120 | 414,355 | 454,500 | 505,690 | 565,999 |
| Deferred tax liability | 14,076 | 15,524 | 21,789 | 26,041 | 31,372 | 37,438 |
| Total Borrowings | 70,135 | 92,600 | 117,287 | 152,011 | 160,844 | 158,266 |
| Minority Interest | 68,132 | 84,096 | 102,913 | 123,836 | 147,938 | 174,452 |
| Current liabilities | 42,051 | 49,319 | 88,128 | 77,234 | 69,662 | 70,678 |
| Total liabilities | 450,526 | 611,659 | 744,471 | 833,623 | 915,506 | 1,006,833 |
| Net fixed assets | 102,319 | 109,858 | 175,056 | 210,083 | 267,502 | 283,132 |
| Capital work-in-progress | 69,786 | 110,844 | 121,501 | 105,179 | 62,490 | 41,990 |
| Goodwill | — | 12,799 | 38,918 | 38,918 | 38,918 | 38,918 |
| Cash | 55,048 | 33,378 | 99,124 | 141,769 | 181,396 | 254,112 |
| Other current assets | 61,312 | 141,737 | 180,267 | 188,070 | 195,597 | 199,079 |
| Investments | 162,062 | 203,045 | 129,553 | 149,551 | 169,551 | 189,551 |
| Deferred tax asset | — | — | 52 | 52 | 52 | 52 |
| Total assets | 450,526 | 611,659 | 744,471 | 833,623 | 915,506 | 1,006,833 |
| Free cash flow (Rs mn) | | | | | | |
| Operating cash flow excl. working capital | 40,654 | 44,554 | 57,344 | 60,613 | 79,788 | 91,124 |
| Working capital changes | 13,636 | (8,487) | (3,154) | (18,696) | (15,099) | (2,466) |
| Capital expenditure | (40,095) | (61,819) | (53,487) | (36,325) | (35,299) | (18,790) |
| Free cash flow | 14,195 | (25,752) | 704 | 5,591 | 29,390 | 69,868 |
| Ratios | | | | | | |
| Debt/equity (X) | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Net debt/equity (X) | (0.5) | (0.3) | (0.3) | (0.3) | (0.4) | (0.5) |
| RoE (%) | 14.5 | 12.9 | 13.0 | 10.5 | 11.7 | 12.2 |
| RoACE (%) | 10.3 | 9.7 | 9.5 | 9.0 | 9.5 | 10.1 |

Source: Company, Kotak Institutional Equities estimates

OCTOBER 24, 2011
RESULT

 Coverage view: **Neutral**

 Price (Rs): **227**

 Target price (Rs): **240**

 BSE-30: **16,939**

Good 2Q, uncertain outlook. Titan's 2QFY12 results were ahead of estimates.

Positive surprises are (1) jewelry margin expansion despite high gold and diamond prices (reported 30 bps, proforma 110 bps) driven by operating leverage and (2) good volume growth of 19% in watches. Negative surprises are (1) jewelry volume growth of just 3% and same store volume decline of 3% and (2) significant gross margin pressure in watches. While short-term concerns on demand conditions remain, we like Titan's strategy of continuing to invest for the future (Helios, Eye Plus, large format stores and expansion in Tanishq) even during times of uncertainty.

Company data and valuation summary

Titan Industries

Stock data

| | |
|-------------------------------|---------|
| 52-week range (Rs) (high,low) | 238-140 |
| Market Cap. (Rs bn) | 201.1 |

Shareholding pattern (%)

| | |
|-----------|------|
| Promoters | 53.3 |
| FIs | 12.5 |
| MFs | 5.6 |

| Price performance (%) | 1M | 3M | 12M |
|-----------------------|-------|------|------|
| Absolute | 1.3 | 2.3 | 41.4 |
| Rel. to BSE-30 | (3.4) | 13.0 | 68.3 |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|------|-------|-------|
| EPS (Rs) | 4.8 | 6.8 | 8.3 |
| EPS growth (%) | 69.1 | 40.4 | 22.0 |
| P/E (X) | 46.8 | 33.3 | 27.3 |
| Sales (Rs bn) | 65.2 | 80.3 | 95.9 |
| Net profits (Rs bn) | 4.3 | 6.0 | 7.4 |
| EBITDA (Rs bn) | 5.8 | 8.4 | 10.2 |
| EV/EBITDA (X) | 34.2 | 23.2 | 18.5 |
| ROE (%) | 47.1 | 47.2 | 43.5 |
| Div. Yield (%) | 0.6 | 1.0 | 1.3 |

Good results at the margin, headwind of low consumer sentiment exists

Titan reported net sales of Rs21 bn (+36%, KIE Rs19.7 bn), EBITDA of Rs2.0 bn (+15%, KIE Rs1.8 bn) and PAT of Rs1.5 bn (+20%, KIE Rs1.4 bn).

- ▶ Jewelry sales increased 45% yoy driven by volume growth of 3% (same store volume decline of 3%) and the balance being higher gold and diamond prices. During 2QFY12, gold prices were higher by ~50% and diamond prices have been inflationary for the last six months to the extent of ~30-40%. However, surprisingly, the price increases in diamonds seems to have not affected its demand wherein the share of diamonds in the jewelry segment has been maintained at 28% for 2Q (28% in FY2011 and 24% in 1QFY12). There appears to be limited impact of implementation of producing the PAN card for bill value more than Rs0.5 mn, in our view. Jewelry EBIT margin expanded 30 bps to 9.2% likely driven by increasing scale of operations and better mix due to studded jewelry sales, in our view (80 bps impact due to excise duty).
- ▶ Watches sales grew by 16% on the back of 19% volume growth. Average realizations were lower due to faster growth in Zoop (watches for kids), Sonata super fiber (mass market positioning) and Fastrack. Watches EBIT margin declined 520 bps to 16.1% due to (1) input cost inflation not neutralized by price increases and (2) incubation costs of Helios venture. The watches business continues to witness lower footfalls and higher conversions, in our view.

Takeaways from the call with management

- ▶ While the drop in consumer sentiment has impacted jewelry volume sales, in 3QFY12E, it expects a performance similar to 2QFY12 (~45% value sales growth).
- ▶ Eyewear sales growth was lower yoy during 2Q due to promotions preponed to 1QFY12 (the 'Others' segment which includes eyewear had registered growth of 53% in 1QFY12). In our view, this is a smart move as the company has avoided the crowded 'off-season' sales period of July-August (a period when there is a higher competitive activity for consumer share of wallet).

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- ▶ The outstanding under Golden Harvest scheme (consumer pays installments for 11 or 18 months and company adds the last installment and consumer can buy jewelry in the 12th or 19th month) is ~Rs8 bn and it accounts for ~20% of jewelry sales. The cost of the 'free installment' is accounted as a discount in the month of consumer purchasing the jewelry.
- ▶ Input cost inflation (on watch movements and components which are typically imported from Switzerland, Japan etc.) has impacted watches and eyewear margins during 2QFY12. The company has taken ~7% price increase in watches in October which will likely help it recover the cost inflation entirely. Price increases include steep increase in premium brands like Nebula (gold plated watches) to the extent of ~27% as well.
- ▶ While the jewelry margins expanded 30 bps during the quarter, the impact of excise duty absorbed was ~80 bps. The proforma jewelry margins for 2QFY12 have expanded by ~110 bps yoy to ~10%.
- ▶ The company is test marketing leather accessories under the 'Titan' brand in Bangalore. It currently has accessories under the Fastrack brand targeted at the young population.

Retain ADD; our positive bias stays

Our earnings estimates are broadly maintained—we forecast EPS of Rs6.8 and Rs8.3 in FY2012E and FY2013E, respectively. While short-term concerns on demand conditions remain, we like Titan's strategy of continuing to invest for the future (Helios, Eye Plus, large format stores and expansion in Tanishq) even during times of uncertainty.

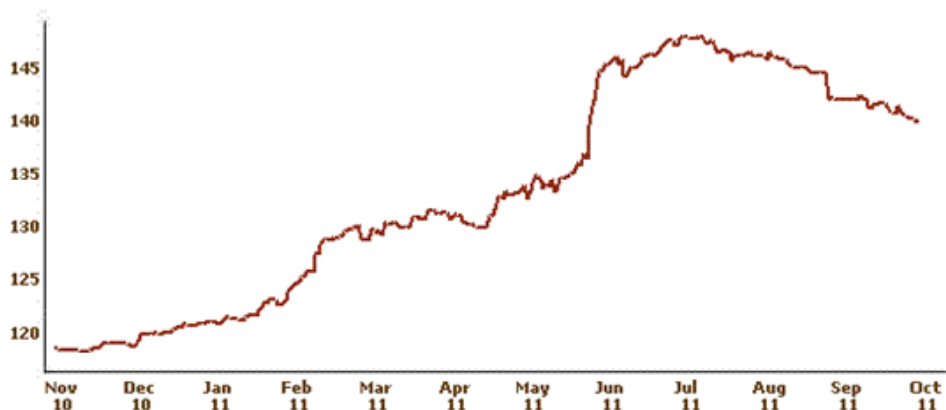
Our optimism stems from the fact that Titan has demonstrated capability for ramping up newer ventures and it has three such ventures at this point, (1) Helios top-end watch outlets, (2) ramp-up of accessories business of Fastrack brand and (3) Titan Eye+ eyewear outlets. It had delivered EPS CAGR of 42% over FY2006-11, we forecast EPS CAGR of 27% over FY2011-14E. Key risks are (1) any potential government regulation to curb probable money laundering through gold, (2) any higher-than-expected slowdown in discretionary spending, (3) higher gold leasing costs, and (4) losses in the eyewear business.

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

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | (% change) | | |
|-----------------------------------|-----------------|-----------------|-----------------|-----------------|------------|-----------|----------|
| | | | | | 2QFY12E | 2QFY11 | 1QFY12 |
| Net sales | 20,963 | 19,726 | 15,361 | 20,206 | 6 | 36 | 4 |
| Total expenditure | (18,961) | (17,897) | (13,624) | (18,361) | 6 | 39 | 3 |
| Material cost | (15,590) | (14,455) | (11,148) | (15,087) | 8 | 40 | 3 |
| Staff cost | (987) | (1,020) | (824) | (1,022) | (3) | 20 | (3) |
| Advertising | (907) | (920) | (615) | (902) | (1) | 48 | 1 |
| Other expenditure | (1,476) | (1,502) | (1,038) | (1,351) | (2) | 42 | 9 |
| EBITDA | 2,002 | 1,829 | 1,737 | 1,846 | 9 | 15 | 8 |
| OPM (%) | 9.6 | 9.3 | 11.3 | 9.1 | | | |
| Other income | 201 | 242 | 81 | 230 | | 150 | (13) |
| Interest | (2) | (23) | (24) | (11) | | (91) | (80) |
| Depreciation | (106) | (102) | (86) | (99) | | 23 | 7 |
| Pretax profits | 2,096 | 1,945 | 1,707 | 1,966 | 8 | 23 | 7 |
| Tax | (567) | (516) | (430) | (532) | | 32 | 7 |
| Net income | 1,529 | 1,430 | 1,278 | 1,434 | 7 | 20 | 7 |
| Exceptional items | (47) | | | | | | |
| PAT | 1,482 | 1,430 | 1,278 | 1,434 | | | |
| Income tax rate (%) | 27.1 | 26.5 | 25.2 | 27.1 | | | |
| Cost as % of sales | | | | | | | |
| Material cost | 74.4 | 73.3 | 72.6 | 74.7 | | | |
| Staff cost | 4.7 | 5.2 | 5.4 | 5.1 | | | |
| Advertising | 4.3 | 4.7 | 4.0 | 4.5 | | | |
| Other expenditure | 7.0 | 7.6 | 6.8 | 6.7 | | | |
| Segmental revenues | | | | | | | |
| Watches | 4,174 | | 3,584 | 3,131 | | 16 | 33 |
| Jewelry | 16,312 | | 11,246 | 16,337 | | 45 | (0) |
| Others | 499 | | 531 | 738 | | (6) | (32) |
| Segmental EBIT | | | | | | | |
| Watches | 672 | | 764 | 458 | | (12) | 47 |
| Jewelry | 1,499 | | 998 | 1,450 | | 50 | 3 |
| Others | (14) | | (47) | (36) | | (70) | (61) |
| Segmental EBIT margin (%) | | | | | | | |
| Watches | 16.1 | | 21.3 | 14.6 | | | |
| Jewelry | 9.2 | | 8.9 | 8.9 | | | |
| Segmental capital employed | | | | | | | |
| Watches | 4,508 | | 2,832 | 2,915 | | 59 | 55 |
| Jewelry | 6,266 | | 2,179 | (368) | | 188 | (1,804) |
| Others | 1,343 | | 986 | 1,309 | | 36 | 3 |
| Unallocated | 1,261 | | 4,080 | 8,013 | | (69) | (84) |

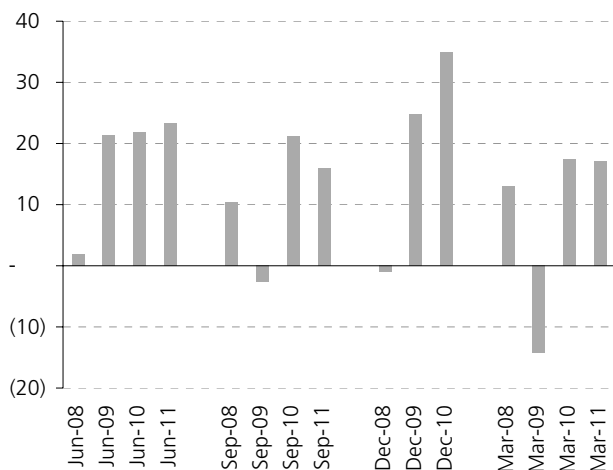
Source: Company, Kotak Institutional Equities estimates

Diamond price has started correcting
Diamond price index



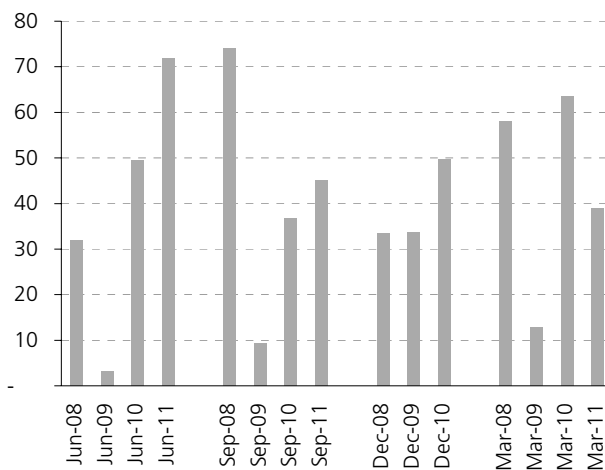
Source: Kotak Institutional Equities

16% sales growth in 2QFY12 led by 19% volume growth
Quarterly sales growth in watches (%)



Source: Company, Kotak Institutional Equities

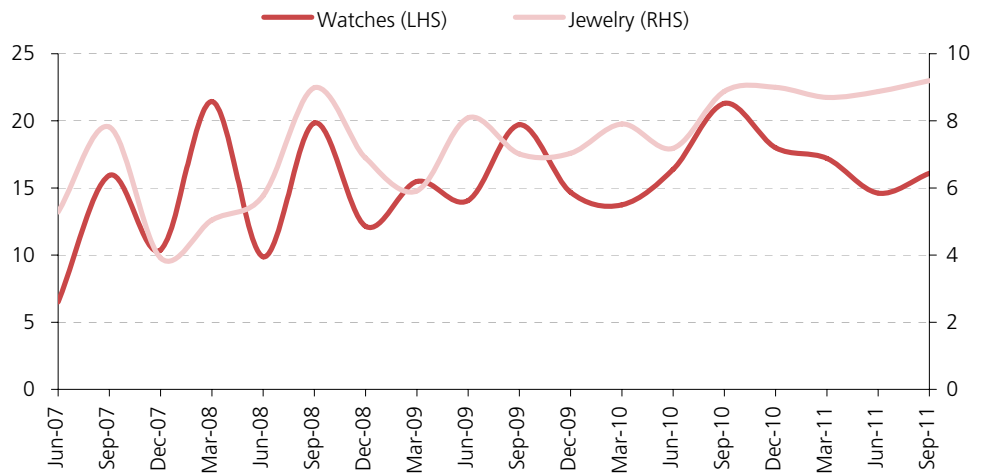
Good 2QFY12
Quarterly sales growth in jewelry (%)



Source: Company, Kotak Institutional Equities

Improvement in jewelry margins

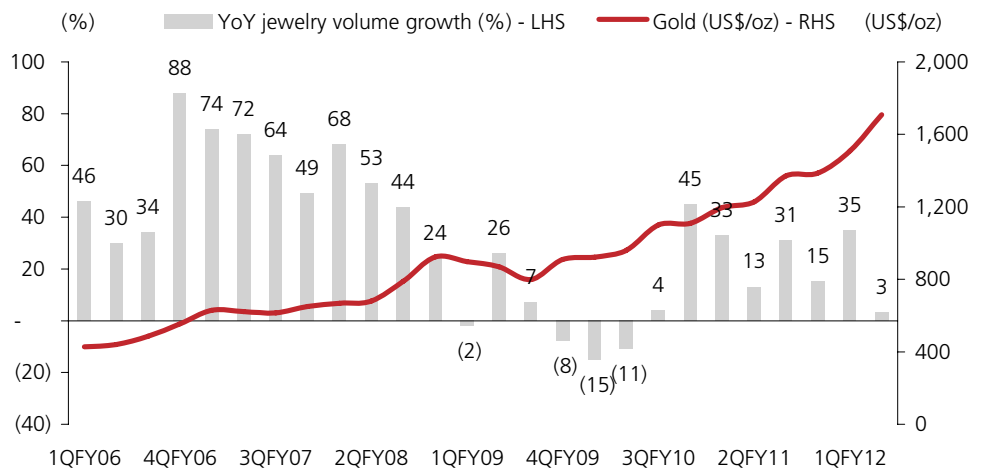
Quarterly EBIT margin in watches and jewelry (%)



Source: Company, Kotak Institutional Equities

Jewelry volumes impacted due to volatility in gold prices

Trend in jewelry volume growth and gold prices



Source: Kotak Institutional Equities

Profit model, balance sheet, cash model for Titan Industries, March fiscal year-ends, 2008-2014E (Rs mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|--|---------------|---------------|---------------|---------------|---------------|---------------|----------------|
| Profit model | | | | | | | |
| Net sales | 29,969 | 38,326 | 46,772 | 65,216 | 80,286 | 95,906 | 113,501 |
| EBITDA | 2,388 | 3,329 | 3,960 | 5,812 | 8,371 | 10,213 | 12,322 |
| Interest (expense)/income | (208) | (288) | (254) | (82) | (115) | (118) | (125) |
| Depreciation | (333) | (423) | (607) | (345) | (409) | (442) | (468) |
| Other income | 45 | 53 | 127 | 553 | 424 | 434 | 466 |
| Pretax profits | 1,892 | 2,671 | 3,226 | 5,939 | 8,270 | 10,087 | 12,195 |
| Tax | (373) | (697) | (818) | (1,686) | (2,096) | (2,556) | (3,091) |
| Deferred taxation | (73) | 65 | 134 | 32 | (137) | (167) | (202) |
| Profit after tax | 1,446 | 2,039 | 2,542 | 4,285 | 6,037 | 7,364 | 8,902 |
| Associate income / (loss) | 110 | — | — | — | — | — | — |
| Adjusted net profit | 1,556 | 2,039 | 2,542 | 4,285 | 6,037 | 7,364 | 8,902 |
| Earnings per share (Rs) | 1.8 | 2.2 | 2.9 | 4.8 | 6.8 | 8.3 | 10.0 |
| Balance sheet | | | | | | | |
| Total equity | 4,458 | 5,579 | 7,319 | 10,776 | 14,477 | 18,724 | 26,588 |
| Deferred taxation liability | 252 | 188 | 54 | 96 | 233 | 400 | 602 |
| Total borrowings | 2,103 | 1,666 | 730 | 1,126 | 1,126 | 1,126 | 1,126 |
| Current liabilities | 9,123 | 10,401 | 12,949 | 15,550 | 17,245 | 20,762 | 21,205 |
| Total liabilities and equity | 15,936 | 17,833 | 21,052 | 27,549 | 33,080 | 41,012 | 49,521 |
| Cash | 554 | 564 | 1,973 | 3,391 | 8,106 | 13,405 | 17,756 |
| Other current assets | 12,481 | 14,259 | 16,262 | 20,910 | 21,336 | 23,911 | 27,986 |
| Total fixed assets | 2,877 | 2,995 | 2,801 | 3,232 | 3,622 | 3,681 | 3,763 |
| Investments | 23 | 16 | 16 | 16 | 16 | 16 | 16 |
| Total assets | 15,936 | 17,833 | 21,052 | 27,549 | 33,080 | 41,012 | 49,521 |
| Free cash flow | | | | | | | |
| Operating cash flow, excl. working capital | 1,742 | 2,363 | 2,373 | 4,758 | 6,160 | 7,539 | 9,106 |
| Working capital changes | (905) | (906) | 781 | (2,569) | 230 | 163 | (1,555) |
| Capital expenditure | (509) | (665) | (426) | (800) | (800) | (500) | (550) |
| Investments | (213) | 7 | — | — | — | — | — |
| Other income | 50 | 77 | 111 | 409 | 424 | 434 | 466 |
| Free cash flow | 165 | 876 | 2,839 | 1,798 | 6,013 | 7,636 | 7,467 |
| Key assumptions | | | | | | | |
| Revenue growth | 43.3 | 27.9 | 22.0 | 39.4 | 23.1 | 19.5 | 18.3 |
| EBITDA margin | 8.0 | 8.7 | 8.5 | 8.9 | 10.4 | 10.6 | 10.9 |
| EPS growth | 55.2 | 26.4 | 29.3 | 69.1 | 40.4 | 22.0 | 20.9 |

Source: Kotak Institutional Equities estimates

OCTOBER 24, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): **212**

Target price (Rs): **340**

BSE-30: **16,939**

Transition exercise completes; post-correction, play for recoveries. Union Bank's reported earnings were below our expectations primarily due to higher slippages. We expect recoveries to pick up as the bank has completed the last leg of transition (to system-based NPL recognition) which has driven high (3.5%) slippages from small-ticket loans even as trends in core slippages will likely be weaker than expected. We revise our earnings by 7-14% for FY2012-14E primarily to factor higher provisions and lower fees. Maintain BUY with a TP of ₹340 (from ₹425 earlier).

Company data and valuation summary

Union Bank

Stock data

52-week range (Rs) (high,low) 427-209

Market Cap. (Rs bn) 111.2

Shareholding pattern (%)

Promoters 57.1

FIs 14.3

MFs 8.2

Price performance (%)

Absolute (12.6) (31.3) (48.7)

Rel. to BSE-30 (16.6) (24.1) (39.0)

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|-------|-------|-------|
| EPS (Rs) | 39.5 | 43.0 | 56.1 |
| EPS growth (%) | (3.9) | 9.0 | 30.3 |
| P/E (X) | 5.4 | 4.9 | 3.8 |
| NII (Rs bn) | 62.2 | 69.4 | 79.0 |
| Net profits (Rs bn) | 20.8 | 22.7 | 29.5 |
| BVPS | 211.3 | 244.4 | 287.4 |
| P/B (X) | 1.0 | 0.9 | 0.7 |
| ROE (%) | 20.9 | 19.0 | 21.2 |
| Div. Yield (%) | 3.8 | 4.1 | 5.3 |

QUICK NUMBERS

- Slippages high at 5%; gross NPLs increase 37% qoq
- NIMs improve 10 bps qoq despite higher slippages
- Revise TP to ₹340 (from ₹425 earlier)

Slippages nearing peak; shifting focus to recoveries; maintain BUY

We believe that Union Bank is close to peak slippages as its NPL transition exercise has been completed. Akin to Indian Bank (post 1QFY11 results), we expect Union Bank to shift focus to recoveries/upgrades. Large slippages at Union Bank for the quarter are definitely disappointing; however, we believe that the overhang of the transition exercise is behind us.

We have revised down our earnings by 7-14% for FY2012-14E largely due to higher loan-loss provisions and lower core fee income. We expect loan-loss provisions at 1% levels (from about 0.7-0.8% levels earlier) to build in risk to core slippages in the current environment. Expect margins to remain strong but overall loan growth will likely moderate at 15% CAGR for FY2011-13E. On revised earnings, we expect the bank to report 19% CAGR in EPS for FY2011-13E and RoEs in the range of 20%. The stock is trading at 0.9X book and 5X FY2013E EPS. We have revised our TP to ₹340 (from ₹425 earlier) primarily factoring the above changes.

A bitter pill towards the end as the last leg of migration gets completed; gross NPLs rise 37% qoq

Union Bank completed the last leg of NPL transition which resulted in the sharp rise in slippages, primarily driven by small-ticket and agriculture loans. Slippages rose to 5% (annualized, 3.5% pertaining to small-ticket loans) for the quarter. The bank reported ₹7 bn from agriculture, ₹4 bn from various government-related schemes and the balance were normal slippages (1.5% levels).

We expect trends to improve (similar to Indian Bank which reported the transition exercise in 1QFY11). On the back of 1HFY12 performance, we expect slippages at 2.3% for FY2012-13E as underlying NPLs in segments like priority-sector loans (agriculture etc.) look fairly weak. We are broadly expecting loan-loss provisions at 1% levels for FY2011-13E from 0.8% levels.

Gross NPLs increased sharply—37% qoq to ₹51.4 bn (3.5% of loans) while net NPLs increased 56% qoq to ₹29.6 bn (2% of loans). Provision coverage ratio is at 42% (61% including technically w/off as compared to 68% in 1QFY12) as slippages were not fully provided at current coverage ratio levels. Loan-loss provisions were at 1.4% (annualized) for the quarter.

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NIMs improve 10 bps qoq to 3.2%; comfort to rising credit costs

NIMs improved 10 bps qoq to 3.2% despite a sharp rise in slippages largely driven by improvement in asset yields. NII grew by 8% yoy (5% qoq) to ₹16.6 bn. Lending yields improved 40 bps to 11.3% while cost of deposits increased by 30 bps to 6.9%. Investment yields improved by 30 bps during the quarter.

Improvement in NIMs is giving some headroom for the bank to make higher provisions for the underlying slippages being reported by the bank. We have marginally revised our estimates for FY2012-13E, factoring the strong performance in 1HFY12.

Loan growth slower than industry at 17% yoy; CASA ratio stable qoq at 32%

Loan growth for the quarter slowed down to 17% yoy (1% qoq) to ₹1.5 tn. During the quarter, corporate loan growth was at 20+% yoy and retail loans were flat yoy. SME loans have slowed in recent months at 6% yoy. Given the sharp rise in slippages, we expect the management focus to shift from loan growth to strengthening balance sheet. Hence, we are revising loan growth to 15% CAGR (from 18% levels) for FY2011-13E.

Deposit growth was lower than industry average at 10% yoy (2% qoq decline) to ₹2 tn. CASA ratio was flat at 32%. Current deposits declined 7% yoy while savings deposits grew by 14% yoy.

Other highlights of the quarter

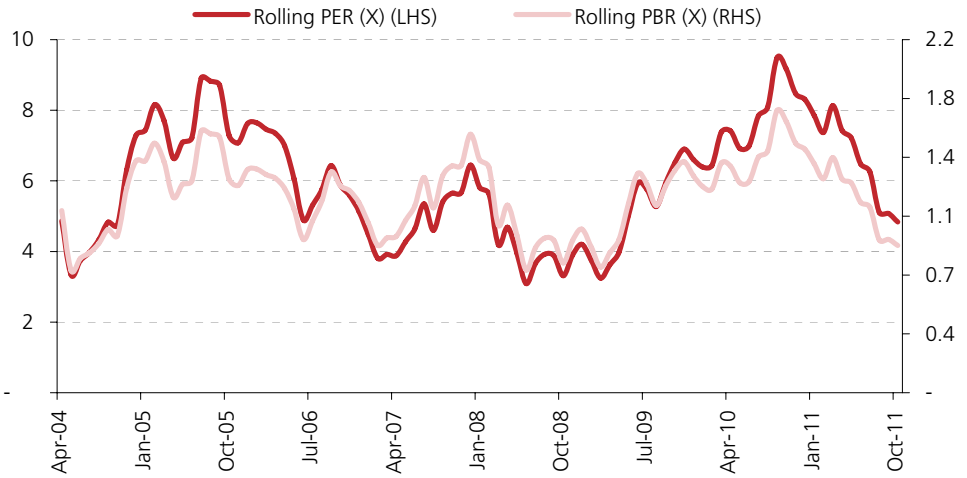
- ▶ Non-interest income was flat at ₹5 bn mainly due to weak core fee income performance. Core fee income growth was muted at 4% yoy while exchange income grew by 27% yoy. Treasury profit declined 24% to ₹1 bn.
- ▶ Overall CAR is at 12.5% with Tier-1 ratio at 8.5% (including profit is about 9%). As compared to the previous quarter, we note that Tier-1 ratio declined 40 bps primarily due to marginal deterioration of the underlying loan book resulting in higher risk-weights for similar exposure. We note that the bank will be one of the likely beneficiaries of capital infusion from Gol in FY2012E. However, given the current growth projections and healthy return ratios (about 20% levels) we don't see this acting as an impediment for growth.

Union Bank of India – estimate changes
March fiscal year-ends, 2012-2014E (₹ mn)

| | New estimates | | | Old estimates | | | % change | | |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|
| | 2012E | 2013E | 2014E | 2012E | 2013E | 2014E | 2012E | 2013E | 2014E |
| Net interest income | 69,397 | 79,013 | 91,655 | 66,822 | 77,534 | 90,525 | 3.9 | 1.9 | 1.2 |
| NIM (%) | 2.9 | 2.9 | 2.9 | 2.7 | 2.7 | 2.7 | | | |
| Loan growth (%) | 13.8 | 16.8 | 17.7 | 17.9 | 17.8 | 17.7 | | | |
| Loan loss provisions | 16,137 | 17,685 | 20,742 | 9,868 | 11,627 | 13,691 | 63.5 | 52.1 | 51.5 |
| Other income | 22,504 | 25,829 | 27,481 | 24,513 | 27,568 | 30,004 | (8.2) | (6.3) | (8.4) |
| Fee income | 3,832 | 4,330 | 5,066 | 4,197 | 4,868 | 5,696 | (8.7) | (11.1) | (11.1) |
| Treasury income | 4,500 | 6,000 | 6,000 | 5,500 | 6,000 | 6,000 | (18.2) | — | — |
| Operating expenses | 39,926 | 44,578 | 50,038 | 42,155 | 47,322 | 53,239 | (5.3) | (5.8) | (6.0) |
| Employee expenses | 25,191 | 27,504 | 30,170 | 27,312 | 30,101 | 33,174 | (7.8) | (8.6) | (9.1) |
| PBT | 32,638 | 41,879 | 47,657 | 37,512 | 45,153 | 52,599 | (13.0) | (7.2) | (9.4) |
| Net profit | 22,659 | 29,494 | 33,563 | 26,418 | 31,799 | 37,043 | (14.2) | (7.2) | (9.4) |
| PBT -treasury + NPL provisions | 44,276 | 53,565 | 62,399 | 41,880 | 50,780 | 60,290 | 5.7 | 5.5 | 3.5 |

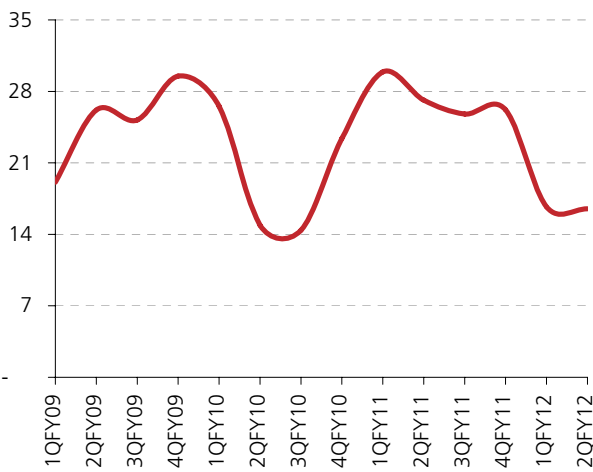
Source: Company, Kotak Institutional Equities estimates

Union Bank of India Rolling PER and PBR (X)
April 2004-October 2011



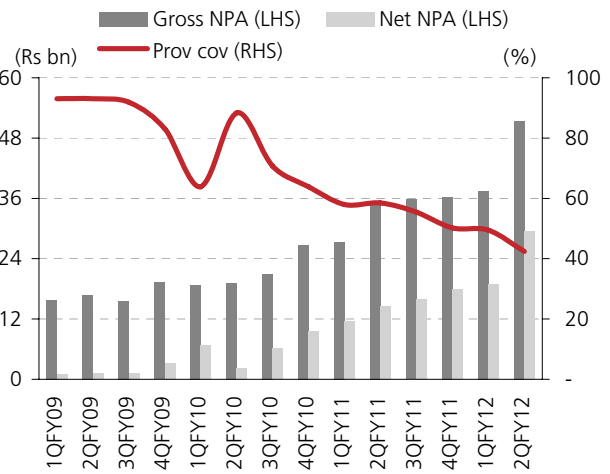
Source: Kotak Institutional Equities

Loan growth below industry average
March fiscal year-ends, 2QFY09-2QFY12 (%)



Source: Company, Kotak Institutional Equities

Asset quality and coverage showed deterioration in 2QFY12
Gross, net NPL and provision coverage ratio, 2QFY09-2QFY12



Source: Company, Kotak Institutional Equities

Union Bank of India, quarterly performance
March fiscal year-ends, 2QFY11-2QFY12 (₹ mn)

| | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | % chg | 2QFY12E | Actual Vs KS |
|--|---------------|---------------|---------------|---------------|---------------|-------------|---------------|-----------------|
| Interest income | 39,522 | 41,995 | 46,153 | 49,157 | 51,104 | 29.3 | 50,481 | 1.2 |
| Loans | 27,758 | 30,644 | 34,576 | 37,542 | 38,586 | 39.0 | 38,120 | 1.2 |
| Investments | 9,851 | 10,738 | 10,335 | 10,634 | 11,409 | 15.8 | 10,927 | 4.4 |
| Others | 1,913 | 613 | 1,242 | 982 | 1,109 | (28.5) | 1,435 | (57.2) |
| Interest expense | 24,164 | 25,836 | 28,987 | 33,255 | 34,492 | 42.7 | 34,681 | (0.5) |
| Net interest income | 15,358 | 16,158 | 17,165 | 15,902 | 16,612 | 8.2 | 15,800 | 5.1 |
| Non-int. income | 5,096 | 4,936 | 6,006 | 4,840 | 5,009 | (1.7) | 5,693 | (12.0) |
| Treasury Income | 1,310 | 1,080 | 1,710 | 1,130 | 1,000 | (23.7) | 1,300 | (23.1) |
| Non-int income excl treasury | 3,786 | 3,856 | 4,296 | 3,710 | 4,009 | 5.9 | 4,393 | (8.7) |
| Total income | 20,455 | 21,094 | 23,171 | 20,742 | 21,622 | 5.7 | 21,494 | 0.6 |
| Op. expenses | 9,149 | 8,483 | 14,475 | 9,084 | 9,571 | 4.6 | 9,475 | 1.0 |
| Employee cost | 5,919 | 5,202 | 10,526 | 5,918 | 5,914 | (0.1) | 6,214 | (4.8) |
| Other cost | 3,229 | 3,281 | 3,949 | 3,166 | 3,657 | 13.3 | 3,261 | 12.1 |
| Operating profit | 11,306 | 12,611 | 8,695 | 11,658 | 12,051 | 6.6 | 12,019 | 0.3 |
| Provisions and cont. | 5,989 | 4,000 | 1,533 | 4,284 | 6,228 | 4.0 | 3,110 | 100.3 |
| Investment Depreciation | -340 | 200 | 200 | 700 | 820 | (341.2) | 250 | |
| NPLs | 6,290 | 3,610 | 1,170 | 3,700 | 4,950 | (21.3) | 2,100 | 135.7 |
| Other provisions | -91 | -160 | -727 | 4 | 428 | (569.8) | 160 | 0.0 |
| PBT | 5,317 | 8,612 | 7,163 | 7,374 | 5,823 | 9.5 | 8,909 | (34.6) |
| Tax | 2,284 | 2,816 | 1,187 | 2,730 | 2,297 | 0.6 | 2,583 | (11.1) |
| Net profit | 3,034 | 5,796 | 5,976 | 4,644 | 3,525 | 16.2 | 6,325 | (44.3) |
| Tax rate (%) | 42.9 | 32.7 | 16.6 | 37.0 | 39.5 | | | |
| PBT-invt gains+ provisions | 9,996 | 11,531 | 6,985 | 10,528 | 11,051 | 37.2 | 10,719 | |
| Key balance sheet items (Rs bn) | | | | | | | | |
| Total Deposit | 1,778 | 1,867 | 2,025 | 1,992 | 1,956 | 10.0 | | |
| Term deposits | 1,197 | 1,245 | 1,382 | 1,364 | 1,328 | 11.0 | | |
| CASA (%) | 32.7 | 33.3 | 31.8 | 31.5 | 32.1 | | | |
| Gross advances | 1,264 | 1,338 | 1,530 | 1,456 | 1,473 | 16.5 | | |
| Investments | 593 | 590 | 584 | 601 | 620 | 4.5 | | |
| AFS | 161 | 151 | 141 | 103 | 119 | | | |
| Duration (years) | 2.6 | 2.0 | 1.8 | 1.6 | 1.9 | | | |
| HTM | 431 | 437 | 439 | 493 | 498 | | | |
| Duration (years) | 5.5 | 5.3 | 5.2 | 5.0 | 4.8 | | | |
| Yield management measures (%) | | | | | | | | |
| Cost of funds | 5.1 | 5.2 | 5.5 | 6.2 | 6.3 | | | |
| Cost of deposits | 5.4 | 5.5 | 5.9 | 6.6 | 6.9 | | | |
| Yield on advances | 9.6 | 10.0 | 10.4 | 10.9 | 11.3 | | | |
| Yield of funds | 8.3 | 8.4 | 8.8 | 9.1 | 9.3 | | | |
| NIM | 3.4 | 3.4 | 3.4 | 3.1 | 3.2 | | | |
| Capital adequacy details (%) | | | | | | | | |
| CAR | 12.5 | 11.9 | 13.0 | 12.9 | 12.5 | | | |
| Tier I | 7.9 | 7.4 | 8.7 | 8.9 | 8.5 | | | |
| Tier II | 4.7 | 4.4 | 4.3 | 4.0 | 4.0 | | | |
| Asset quality details | | | | | | | | |
| Gross NPLs (Rs bn) | 35.2 | 35.8 | 36.2 | 37.5 | 51.4 | 45.7 | | |
| Gross NPLs (%) | 2.8 | 2.7 | 2.4 | 2.6 | 3.5 | | | |
| Net NPLs (Rs bn) | 14.6 | 16.0 | 18.0 | 18.9 | 29.6 | 102.2 | | |
| Net NPLs (%) | 1.2 | 1.2 | 1.2 | 1.3 | 2.0 | | | |
| Provision coverage ratio | 58.5 | 55.4 | 50.2 | 49.4 | 42.4 | | | |
| Provision coverage ratio (tech w/o) | 70.1 | 70.2 | 67.6 | 68.2 | 60.5 | | | |

Source: Company, Kotak Institutional Equities

Union Bank of India: Growth rates and key ratios
March fiscal year-ends, 2009-2014E (%)

| | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---------------------------------------|------------|------------|------------|------------|------------|------------|
| Growth rates (%) | | | | | | |
| Net loan | 29.8 | 23.6 | 26.5 | 13.8 | 16.8 | 17.7 |
| Customer assets | 25.3 | 25.0 | 25.6 | 13.5 | 16.5 | 17.4 |
| Investments excld. CPs and debentures | 24.0 | 22.6 | 8.8 | 8.7 | 18.4 | 14.7 |
| Net fixed and leased assets | 6.1 | (1.3) | (0.5) | (2.8) | 4.2 | 4.1 |
| Cash and bank balance | 58.3 | (1.3) | 27.4 | 6.5 | 13.7 | 14.0 |
| Total Asset | 29.7 | 21.2 | 20.9 | 11.1 | 15.8 | 15.8 |
| Deposits | 33.5 | 22.6 | 19.1 | 11.7 | 16.8 | 16.7 |
| Current | 11.2 | 23.3 | 20.9 | 11.7 | 16.8 | 16.7 |
| Savings | 17.1 | 32.2 | 18.5 | 11.7 | 16.8 | 16.7 |
| Fixed | 43.4 | 19.7 | 19.0 | 11.7 | 16.8 | 16.7 |
| Net interest income | 29.7 | 9.9 | 48.3 | 11.6 | 13.9 | 16.0 |
| Loan loss provisions | 8.4 | 13.0 | 64.1 | 20.6 | 9.6 | 17.3 |
| Total other income | 19.5 | 34.0 | 3.2 | 10.4 | 14.8 | 6.4 |
| Net fee income | 4.1 | 12.3 | 3.7 | 5.0 | 13.0 | 17.0 |
| Net capital gains | 10.9 | 78.2 | (18.9) | (3.1) | 33.3 | — |
| Net exchange gains | 29.6 | (4.7) | 33.0 | 3.0 | 8.0 | 8.0 |
| Operating expenses | 38.1 | 13.3 | 57.5 | 1.1 | 11.7 | 12.2 |
| Employee expenses | 36.3 | 17.6 | 91.9 | (3.1) | 9.2 | 9.7 |
| Key ratios (%) | | | | | | |
| Yield on average earning assets | 8.7 | 7.7 | 7.9 | 8.7 | 8.6 | 8.4 |
| Yield on average loans | 10.4 | 9.0 | 8.9 | 10.0 | 9.7 | 9.5 |
| Yield on average investments | 7.5 | 7.2 | 7.2 | 7.7 | 7.5 | 7.3 |
| Average cost of funds | 6.1 | 5.5 | 5.1 | 6.2 | 6.0 | 5.9 |
| Interest on deposits | 6.1 | 5.5 | 5.1 | 6.3 | 6.0 | 5.9 |
| Difference | 2.6 | 2.2 | 2.7 | 2.5 | 2.5 | 2.5 |
| Net interest income/earning assets | 2.8 | 2.4 | 3.0 | 2.9 | 2.9 | 2.9 |
| New provisions/average net loans | 0.8 | 0.8 | 1.0 | 1.0 | 1.0 | 1.0 |
| Interest income/total income | 76.8 | 74.9 | 79.8 | 79.4 | 79.9 | 81.0 |
| Other income / total income | 27.9 | 32.0 | 24.7 | 24.5 | 24.6 | 23.1 |
| Operating expenses/total income | 44.6 | 44.8 | 50.7 | 45.7 | 45.1 | 44.2 |
| Operating profit /AWF | 1.5 | 1.3 | 1.2 | 1.2 | 1.3 | 1.3 |
| Tax rate | 26.8 | 26.8 | 29.6 | 30.6 | 29.6 | 29.6 |
| Dividend payout ratio | 14.6 | 15.7 | 20.2 | 20.2 | 20.2 | 20.2 |
| Share of deposits | | | | | | |
| Current | 20.6 | 22.2 | 22.1 | 22.1 | 22.1 | 22.1 |
| Fixed | 69.9 | 68.3 | 68.2 | 68.2 | 68.2 | 68.2 |
| Savings | 20.6 | 22.2 | 22.1 | 22.1 | 22.1 | 22.1 |
| Loans-to-deposit ratio | 69.6 | 70.2 | 74.6 | 75.9 | 75.9 | 76.6 |
| Asset quality (%) | | | | | | |
| Gross NPL | 2.0 | 2.2 | 2.4 | 3.0 | 3.0 | 2.8 |
| Net NPL | 0.3 | 0.8 | 1.2 | 1.7 | 1.6 | 1.5 |
| Slippages | 1.6 | 1.8 | 2.5 | 2.5 | 2.2 | 2.0 |
| Provision coverage (ex write-off) | 83.1 | 63.9 | 50.2 | 44.1 | 47.1 | 47.9 |
| Dupont analysis (%) | | | | | | |
| Net interest income | 2.7 | 2.4 | 2.9 | 2.8 | 2.8 | 2.8 |
| Loan loss provisions | 0.5 | 0.5 | 0.6 | 0.7 | 0.6 | 0.6 |
| Net other income | 1.0 | 1.1 | 1.0 | 0.9 | 0.9 | 0.8 |
| Operating expenses | 1.6 | 1.5 | 1.8 | 1.6 | 1.6 | 1.5 |
| Invnt. depreciation | (0.0) | (0.0) | 0.1 | 0.1 | 0.0 | 0.0 |
| (1- tax rate) | 73.3 | 73.2 | 70.4 | 69.4 | 70.4 | 70.4 |
| ROA | 1.2 | 1.2 | 1.0 | 0.9 | 1.0 | 1.0 |
| Average assets/average equity | 22.2 | 22.2 | 21.5 | 20.7 | 20.2 | 19.9 |
| ROE | 27.2 | 26.2 | 20.9 | 19.0 | 21.2 | 20.5 |

Source: Company, Kotak Institutional Equities

Union Bank Income statement and balance sheet
March fiscal year-ends, 2009-2014E (₹ mn)

| | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Income statement | | | | | | |
| Total interest income | 118,894 | 133,027 | 164,526 | 212,091 | 236,257 | 269,800 |
| Loans | 88,934 | 96,964 | 120,312 | 161,207 | 180,996 | 208,459 |
| Investments | 28,309 | 34,823 | 40,027 | 46,041 | 49,923 | 55,262 |
| Cash and deposits | 1,652 | 1,240 | 4,187 | 4,843 | 5,338 | 6,079 |
| Total interest expense | 80,758 | 91,103 | 102,364 | 142,694 | 157,244 | 178,145 |
| Deposits from customers | 73,895 | 85,278 | 95,379 | 134,016 | 148,267 | 169,168 |
| Net interest income | 38,136 | 41,924 | 62,162 | 69,397 | 79,013 | 91,655 |
| Loan loss provisions | 7,211 | 8,151 | 13,379 | 16,137 | 17,685 | 20,742 |
| Net interest income (after prov.) | 30,925 | 33,773 | 48,783 | 53,259 | 61,328 | 70,913 |
| Other income | 14,733 | 19,747 | 20,388 | 22,504 | 25,829 | 27,481 |
| Net fee income | 3,133 | 3,518 | 3,649 | 3,832 | 4,330 | 5,066 |
| Net capital gains | 3,215 | 5,728 | 4,644 | 4,500 | 6,000 | 6,000 |
| Net exchange gains | 3,386 | 3,227 | 4,290 | 4,417 | 4,768 | 5,148 |
| Operating expenses | 22,141 | 25,078 | 39,500 | 39,926 | 44,578 | 50,038 |
| Employee expenses | 11,519 | 13,545 | 25,997 | 25,191 | 27,504 | 30,170 |
| Depreciation on investments | (249) | (706) | 1,096 | 2,900 | 700 | 700 |
| Other Provisions | 292 | 819 | (959) | 300 | — | — |
| Pretax income | 23,566 | 28,329 | 29,534 | 32,638 | 41,879 | 47,657 |
| Tax provisions | 6,300 | 7,580 | 8,735 | 9,979 | 12,386 | 14,094 |
| Net Profit | 17,266 | 20,749 | 20,799 | 22,659 | 29,494 | 33,563 |
| % growth | 24.5 | 20.2 | 0.2 | 8.9 | 30.2 | 13.8 |
| PBT - Treasury + Provisions | 27,605 | 30,865 | 38,406 | 47,476 | 54,265 | 63,099 |
| % growth | 21.0 | 11.8 | 24.4 | 23.6 | 14.3 | 16.3 |
| Balance sheet | | | | | | |
| Cash and bank balance | 159,849 | 157,767 | 200,984 | 214,006 | 243,374 | 277,508 |
| Cash | 4,210 | 3,926 | 4,020 | 4,221 | 4,432 | 4,653 |
| Balance with RBI | 85,710 | 120,756 | 172,085 | 184,906 | 214,062 | 247,974 |
| Balance with banks | 9,918 | 10,931 | 6,534 | 6,534 | 6,534 | 6,534 |
| Net value of investments | 429,970 | 544,035 | 583,991 | 625,198 | 720,007 | 809,586 |
| Govt. and other securities | 348,574 | 426,529 | 464,061 | 506,211 | 601,020 | 690,599 |
| Shares | 3,896 | 6,823 | 7,437 | 7,437 | 7,437 | 7,437 |
| Debentures and bonds | 36,512 | 34,950 | 32,086 | 32,086 | 32,086 | 32,086 |
| Net loans and advances | 965,342 | 1,193,153 | 1,509,861 | 1,717,622 | 2,005,600 | 2,361,078 |
| Fixed assets | 23,352 | 23,054 | 22,928 | 22,295 | 23,235 | 24,186 |
| Net Owned assets | 23,352 | 23,054 | 22,928 | 22,295 | 23,235 | 24,186 |
| Other assets | 31,242 | 33,609 | 42,080 | 42,080 | 42,080 | 42,080 |
| Total assets | 1,609,755 | 1,951,618 | 2,359,844 | 2,621,201 | 3,034,295 | 3,514,437 |
| Deposits | 1,387,028 | 1,700,397 | 2,024,613 | 2,261,706 | 2,640,906 | 3,081,952 |
| Borrowings and bills payable | 105,015 | 110,122 | 149,626 | 149,626 | 149,626 | 149,626 |
| Other liabilities | 30,308 | 36,861 | 59,070 | 67,098 | 79,457 | 93,837 |
| Total liabilities | 1,522,352 | 1,847,381 | 2,233,309 | 2,478,430 | 2,869,989 | 3,325,415 |
| Preference shares | — | — | 1,110 | 1,110 | 1,110 | 1,110 |
| Paid-up capital | 5,051 | 5,051 | 5,243 | 5,243 | 5,243 | 5,243 |
| Reserves & surplus | 82,352 | 99,187 | 121,292 | 137,528 | 159,063 | 183,778 |
| Total shareholders' equity | 87,404 | 104,238 | 126,535 | 142,771 | 164,306 | 189,022 |

Source: Kotak Institutional Equities, Company

OCTOBER 24, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): **639**

Target price (Rs): **825**

BSE-30: **16,939**

Keeping the faith. Mahindra Finance (MMFSL) reported yet another quarter of strong growth. Loan book was up 54% yoy driving 27% growth in core earnings. PAT growth was muted at 17% due to higher provisions and absence of securitization income. Normal monsoons, strong earnings buoyancy in rural India and auto manufacturer's focus on rural markets will likely continue to drive strong traction at Mahindra Finance. We tweak estimates; retain BUY with price target of Rs825.

Company data and valuation summary

Mahindra & Mahindra Financial

| Stock data | | Forecasts/Valuations | | | |
|---------------------------------|------------------------------|----------------------|-------|-------|-------|
| | | 2011 | 2012E | 2013E | |
| 52-week range (Rs) (high,low) | 940-586 | EPS (Rs) | 45.2 | 55.7 | 70.7 |
| Market Cap. (Rs bn) | 65.4 | EPS growth (%) | 26.1 | 23.2 | 26.9 |
| Shareholding pattern (%) | | P/E (X) | 14.1 | 11.5 | 9.0 |
| Promoters | 57.4 | NII (Rs bn) | 12.6 | 16.5 | 21.8 |
| FIs | 34.5 | Net profits (Rs bn) | 4.6 | 5.7 | 7.2 |
| MFs | 3.5 | BVPS | 240.7 | 272.5 | 321.0 |
| Price performance (%) | | P/B (X) | 2.7 | 2.3 | 2.0 |
| Absolute | 1M (3.3) 3M (10.6) 12M (2.5) | ROE (%) | 22.0 | 21.1 | 22.8 |
| Rel. to BSE-30 | (7.7) (1.2) 16.1 | Div. Yield (%) | 1.6 | 1.9 | 2.4 |

Business traction strong

MMFSL reported PAT of Rs1.35 bn, up 17% yoy but 5% below estimates. Stronger-than-expected loan growth and NIM were somewhat offset by higher operating expenses; consequently, core earnings were up 27% yoy.

- ▶ **Strong loan growth.** Mahindra Finance reported loan growth of 14% qoq and 54% yoy. Disbursements were up 32% yoy. The company has not sold down/ securitized loans in last two quarters, thereby boosting growth in loans on balance sheet; loans under management increased by 42% yoy.
- ▶ **Monsoon improved in September.** We believe that better monsoon has boosted business at MMFSL. Trends in monsoon were weak in July (average cumulative deficit of 4% below normal) and August (1% below normal); however, with the pick-up in September, monsoon was cumulatively 2% above average levels.
- ▶ **New product lines drive superior growth.** MMFSL's growth has been strong across product lines. Disbursements mix was broadly stable: tractors at 20% of total, UVs at 27% of total. The company continued to finance about 9,000 Maruti cars in 2QFY12. The management has highlighted that addition of new products over the last few quarters provided a further boost to its growth.

QUICK NUMBERS

- **Loan growth up 54% yoy**
- **PAT up 17% yoy**

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- ▶ **Raising loan growth estimates for FY2012E.** We are raising our loan growth estimates to 44% for FY2012E from 26% earlier. In 2QFY12, qoq loan growth was strong at 14% on the back of 12% qoq growth in 1QFY12—thus the company has already delivered 25% YTD loan growth even as we are yet to enter the busy season (2H). Our auto analyst expects growth in UVs at 12.5% in FY2012E; Mahindra tractors will likely grow by 17% yoy while domestic car sales will likely decline marginally. Higher growth in semi-urban and rural areas and increasing product lines will drive faster growth at MMFSL. The company has likely benefitted from auto manufacturers' focus in rural India. Several companies have provided interest rate subventions to push products sales. For instance, in case of car finance, MMFSL has tied up with Tata and Hyundai though Maruti continues to drive about 80% of its car finance volumes.

Margins decline yoy—in line with macro trends

MMFSL reported NIM (as per KS calculations) of 10.5% (our estimate was 10.7%), up from 10.1% in 1QFY12 but down from 12.5% in 2QFY11. Rise in lending rates has pulled down NIM in 1HFY12 on a yoy basis. MMFSL has raised its lending rates for new loans by 1% in June 2011; this has likely driven qoq improvement in NIM. We expect NIM to remain under pressure in the current scenario and hence, we are revising down our NIM estimate by 60-90 bps.

Operating expenses rise as well

MMFSL's operating expenses increased by 27% yoy to Rs1.5 bn; operating expenses ratio was stable at 3.9% to 4% qoq. We believe that MMFSL will resume focus on cost control if demand moderates. Notably, in the last two years, the company has focused on high growth—MMFSL opened 88 branches in FY2011 and is targeting 50 in FY2012E (25 branches till September 2011).

NPLs decline marginally qoq; seasonal trends on track

MMFSL's credit cost was up 56% yoy to Rs523 mn—this includes standard asset provisions of Rs50 mn. Gross NPL ratio was 4%, down from 4.6% in 1QFY12; net NPL ratio was stable at 1%. We are modeling credit cost (including standard asset provisions) of 1.7% of average assets in FY2013E on the back of 1.4% for FY2012E (1.3% in 2QFY12).

Regulatory clarity awaited, lower dependence on securitization is positive

RBI has set up a committee of bankers to review the priority-sector framework for the banking system. The report of this committee and the final reports on the revised draft securitization guidelines are awaited by NBFCs.

We believe that MMFS is well-placed to manage the transition due to its lower dependence on loan securitization/ sell-down; securitization income and provision write-back were 13% of PBT in FY2012E. We are not assuming any income on loan sell-down in our estimates.

Mahindra Finance will likely not be able to book upfront income on loan sell-down/ securitization if the current draft is finalized; we are not assuming any upfront income on loan sell-down in our estimates.

Loan sell-down (bilateral transactions with banks akin a bank loan) will likely be replaced by securitization (involves issuance of a debt instrument). The draft proposes a 'pari passu' sharing of losses in bilateral deals. We believe that it's hence challenging to expect 'AAA' rating for the transaction. The structure for loan securitization (that involves senior and subordinate tranches) can merit a high credit rating for the senior tranche due to the credit support provided by the subordinate.

Mahindra Finance, Quarterly results (Rs mn)

| | 1Q11 | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 | YoY (%) | 2Q12E | Actual vs KS (%) |
|---|--------------|--------------|--------------|--------------|--------------|--------------|-----------|--------------|---------------------|
| Total interest income | 3,817 | 4,547 | 5,097 | 5,762 | 5,477 | 6,492 | 43 | | |
| Total interest expense | 1,315 | 1,518 | 1,813 | 1,956 | 2,160 | 2,589 | 71 | | |
| Net interest income | 2,502 | 3,029 | 3,285 | 3,806 | 3,317 | 3,903 | 29 | 3,936 | (1) |
| Provisions and write/off | 543 | 335 | 545 | 144 | 561 | 523 | 56 | 500 | 5 |
| Net interest income (after prov.) | 1,959 | 2,694 | 2,740 | 3,661 | 2,756 | 3,380 | 25 | 3,436 | (2) |
| Other income | 197 | 242 | 202 | 261 | 163 | 158 | (35) | 175 | (10) |
| Income from securitization | 107 | 149 | 106 | 154 | - | - | (100) | - | - |
| Others | 90 | 93 | 96 | 107 | 163 | 158 | 69 | 175 | (10) |
| Total income pre provisions | 2,699 | 3,271 | 3,487 | 4,067 | 3,480 | 4,061 | 24 | 4,111 | (1) |
| Operating expenses | 1,046 | 1,194 | 1,209 | 1,482 | 1,406 | 1,520 | 27 | 1,470 | 3 |
| Employee expenses | 365 | 369 | 310 | 470 | 519 | 510 | 38 | 520 | (2) |
| Depreciation | 28 | 34 | 39 | 56 | 44 | 49 | 45 | 50 | (1) |
| Other expenses | 652 | 791 | 860 | 957 | 842 | 961 | 22 | 900 | 7 |
| Pretax income | 1,111 | 1,742 | 1,733 | 2,440 | 1,513 | 2,017 | 16 | 2,141 | (6) |
| Tax provisions | 366 | 577 | 574 | 874 | 491 | 660 | 14 | 707 | (7) |
| Net Profit | 744 | 1,165 | 1,159 | 1,566 | 1,022 | 1,357 | 17 | 1,435 | (5) |
| Tax rate (%) | 33 | 33 | 33 | 36 | 32 | 33 | (1) | 33 | (1) |
| PBT bef. secu.,provisions and other ir | 1,547 | 1,928 | 2,172 | 2,430 | 2,074 | 2,540 | 32 | 2,641 | (4) |
| PBT bef sec income post prov | 1,004 | 1,593 | 1,627 | 2,286 | 1,513 | 2,017 | 27 | 2,141 | (6) |

Source: Company, Kotak Institutional Equities estimates

Mahindra Finance, Quarterly operational details (%)

| | 1Q11 | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 | YoY (%) | 2Q12E | Actual vs KS (%) |
|---|--------|--------|--------|--------|---------|---------|---------|-------|---------------------|
| Other operational details | | | | | | | | | |
| Value of asset financed (Rs bn) | 29 | 34 | 42 | 40 | 38 | 45 | 32 | | |
| Outstanding assets (Rs bn) | 97 | 111 | 122 | 138 | | | | | |
| Outstanding loans (Rs bn) | 91 | 103 | 115 | 125 | 139 | 159 | 54 | 154 | 3 |
| NIMs - KS calculations (%) | 11.4 | 12.5 | 12.1 | 12.7 | 10.1 | 10.5 | (15.9) | 10.7 | (2.2) |
| Cost to income (%) | 38.7 | 36.5 | 34.7 | 36.5 | 40.4 | 37.4 | | | |
| Exp/ ave assets (%) | 4.3 | 4.4 | 4.1 | 4.4 | 4.0 | 3.5 | | | |
| Total income/ average assets (%) | 16.6 | 17.0 | 17.4 | 17.9 | 16.2 | 16.5 | | | |
| Interest / average assets (%) | 5.5 | 5.5 | 5.7 | 5.8 | 6.2 | 6.3 | | | |
| Difference (%) | 11.1 | 11.5 | 11.7 | 12.1 | 10.0 | 10.2 | | | |
| Gross NPLs (Rs mn) | 7,105 | 6,744 | 7,104 | 5,488 | 6,776 | 6,688 | | | |
| Gross NPL ratio (%) | 6.9 | 5.8 | 5.6 | 4.0 | 4.6 | 4.0 | | | |
| NPAs (Rs mn) | 1,247 | 1,182 | 1,306 | 744 | 1,373 | 1,654 | | | |
| Net NPL ratio (%) | 1.3 | 1.1 | 1.1 | 0.6 | 1.0 | 1.0 | | | |
| CAR (%) | 17.4 | 16.5 | 17.4 | 20.3 | 18.7 | 17.3 | | | |
| Tier I (%) | 15.4 | 14.7 | 13.9 | 17.0 | 15.8 | 14.7 | | | |
| Segmentwise mix | | | | | | | | | |
| Disbursements | | | | | | | | | |
| Auto/ utility vehicles | 34 | 30 | 30 | 29 | 27 | 27 | | | |
| Tractors | 22 | 21 | 22 | 22 | 22 | 20 | | | |
| Cars | 29 | 33 | 33 | 33 | 32 | 32 | | | |
| Commercial vehicles | 7 | 7 | 6 | 7 | 10 | 11 | | | |
| Refinance and others | 8 | 9 | 9 | 9 | 9 | 10 | | | |
| AUMs | | | | | | | | | |
| Auto/ utility vehicles | 33 | 34 | 30 | 31 | 30 | 32 | | | |
| Tractors | 23 | 22 | 23 | 23 | 23 | 20 | | | |
| Cars | 30 | 30 | 33 | 31 | 31 | 31 | | | |
| Commercial vehicles | 8 | 8 | 8 | 9 | 10 | 11 | | | |
| Refinance and others | 6 | 6 | 6 | 6 | 6 | 6 | | | |
| Funding Mix (excludes assignments) | | | | | | | | | |
| (Rs mn) | 69,130 | 82,220 | 90,519 | 96,750 | 103,154 | 124,226 | | | |
| Banks | 36,990 | 48,370 | 49,730 | 66,317 | 70,057 | 76,127 | | | |
| Insurance | 6,730 | 6,730 | 6,480 | 11,660 | 12,110 | 11,988 | | | |
| Mutual funds | 14,970 | 15,690 | 19,290 | 10,190 | 11,774 | 25,224 | | | |
| Others | 10,440 | 11,430 | 15,019 | 8,583 | 9,213 | 10,887 | | | |
| %age of total | | | | | | | | | |
| Banks | 54 | 59 | 55 | 69 | 68 | 61 | | | |
| Insurance | 10 | 8 | 7 | 12 | 12 | 10 | | | |
| Mutual funds | 22 | 19 | 21 | 11 | 11 | 20 | | | |
| Others | 15 | 14 | 17 | 9 | 9 | 9 | | | |

Source: Company

Mahindra Finance
Quarterly balance sheet (Rs mn)

| | 1Q11 | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 |
|---|---------------|----------------|----------------|----------------|----------------|----------------|
| Balance sheet (Rs mn) | | | | | | |
| Sharecapital | 960 | 961 | 961 | 1,025 | 1,025 | 1,025 |
| Reserves | 17,060 | 18,230 | 19,404 | 23,876 | 24,920 | 26,294 |
| ESOP | 11 | 10 | — | — | — | — |
| Total Borrowings | 69,131 | 82,215 | 90,519 | 96,750 | 103,154 | 124,218 |
| Current Liabilities | 10,240 | 9,571 | 11,225 | 15,890 | 17,944 | 15,547 |
| Total liabilities and shareholders funds | 97,402 | 110,987 | 122,109 | 137,541 | 147,042 | 167,084 |
| Loans & Avd | 91,488 | 102,965 | 114,817 | 124,649 | 139,308 | 158,587 |
| Investments | 831 | 2,400 | 1,201 | 6,745 | 2,338 | 2,576 |
| Deferred tax | 2,130 | 2,192 | 2,329 | 2,167 | 2,183 | 2,237 |
| Current Assets | 2,449 | 2,819 | 3,029 | 3,161 | 2,350 | 2,745 |
| Fixed assets | 504 | 611 | 733 | 818 | 863 | 947 |
| Total assets | 97,402 | 110,987 | 122,109 | 137,541 | 147,042 | 167,084 |

Source: Company

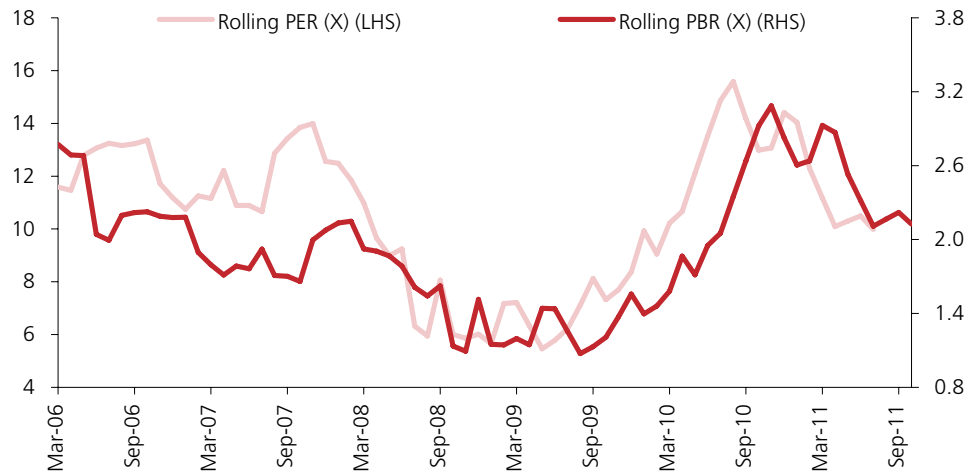
Mahindra Finance

Old and new estimates, March fiscal years-ends, 2012-2013E (Rs mn)

| | Old estimates | | New estimates | | % change | |
|-----------------------------|---------------|---------------|---------------|---------------|------------|----------|
| | 2012E | 2013E | 2012E | 2012E | 2011E | 2012E |
| Net interest income | 16,332 | 20,874 | 16,455 | 21,766 | 1 | 4 |
| Loan book (Rs bn) | 157 | 197 | 180 | 224 | 15 | 14 |
| Loan growth (%) | 26 | 26 | 44 | 25 | | |
| NIM (%) | 10.7 | 11.0 | 10.0 | 10.1 | — | — |
| NPL provisions | 2,110 | 3,534 | 2,281 | 3,633 | 8 | 3 |
| Other income | 600 | 700 | 600 | 700 | — | — |
| Securitization | — | — | — | — | — | — |
| Operating expenses | 6,235 | 7,504 | 6,293 | 8,066 | 1 | 7 |
| Employee | 1,813 | 2,179 | 1,813 | 2,215 | — | 2 |
| Others | 4,422 | 5,326 | 4,480 | 5,851 | 1 | 10 |
| PBT | 8,587 | 10,535 | 8,480 | 10,766 | (1) | 2 |
| Tax | 2,808 | 3,445 | 2,775 | 3,525 | (1) | 2 |
| PAT | 5,779 | 7,090 | 5,705 | 7,242 | (1) | 2 |
| PBT-securitisation income | 8,587 | 10,535 | 8,480 | 10,766 | (1) | 2 |
| PBT-secu income+ provisions | 10,697 | 14,070 | 10,762 | 14,400 | 1 | 2 |
| EPS(Rs) | 56 | 69 | 56 | 71 | (1) | 2 |

Source: Kotak Institutional Equities estimates

Mahindra Finance
Rolling 1-year forward PER and PBR (X)



Source: Kotak Institutional Equities estimates

Mahindra Finance, Key assumptions and ratios, March fiscal year-ends, 2008-2013E

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| Growth in key parameters (%) | | | | | | |
| Total interest income | 42 | 15 | 13 | 34 | 50 | 33 |
| Total interest expense | 41 | 12 | (2) | 32 | 86 | 34 |
| Net interest income | 44 | 17 | 22 | 35 | 30 | 32 |
| Loan loss provisions | 101 | 15 | (22) | (29) | 46 | 59 |
| Total income | 48 | 13 | 22 | 27 | 26 | 32 |
| Operating expenses | 29 | 6 | 22 | 52 | 28 | 28 |
| Employee expenses | 49 | 22 | 9 | 18 | 20 | 22 |
| Net loans | 13 | 3 | 22 | 49 | 44 | 25 |
| Total assets | 12 | 6 | 22 | 51 | 40 | 24 |
| Total Borrowings | 3 | 3 | 24 | 50 | 53 | 27 |
| Shareholders fund | 69 | 12 | 18 | 44 | 17 | 18 |
| Asset management measures (%) | | | | | | |
| Yield on average earning assets | 17.8 | 19.0 | 18.9 | 18.5 | 18.9 | 18.9 |
| Average cost of funds | 9.1 | 9.9 | 8.6 | 8.2 | 10.0 | 9.8 |
| Difference | 8.7 | 9.1 | 10.3 | 10.3 | 8.9 | 9.1 |
| Net interest income/earning assets | 9.9 | 10.6 | 11.4 | 11.1 | 10.0 | 10.1 |
| Spreads on lending business | 8.7 | 9.1 | 10.3 | 10.3 | 8.9 | 9.1 |
| Net interest income/EA (after prov) | 7 | 7 | 9 | 10 | 9 | 9 |
| Tax rate | 35 | 34 | 34 | 34 | 33 | 33 |
| Dividend payout ratio | 25 | 25 | 21 | 22 | 22 | 22 |
| Profitability measures (%) | | | | | | |
| Interest income/total income | 85 | 87 | 88 | 93 | 96 | 97 |
| Other income / total income | 15 | 13 | 12 | 7 | 4 | 3 |
| Operating expenses/total income | 33 | 30 | 30 | 36 | 37 | 36 |
| Payout ratio | 25 | 25 | 21 | 22 | 22 | 22 |
| Equity/assets (EoY) | 19 | 20 | 19 | 18 | 15 | 14 |
| ROA decomposition - % of avg. assets | | | | | | |
| Net interest income | 9.9 | 10.6 | 11.3 | 11.0 | 10.0 | 10.1 |
| Loan loss provisions | 3.7 | 3.9 | 2.7 | 1.4 | 1.4 | 1.7 |
| Net other income | 1.7 | 1.5 | 1.6 | 0.8 | 0.4 | 0.3 |
| Gains on securitization | 1.6 | 1.4 | 1.3 | 0.5 | 0.0 | 0.0 |
| Operating expenses | 3.8 | 3.7 | 3.9 | 4.3 | 3.8 | 3.7 |
| (1- tax rate) | 65.1 | 65.9 | 66.1 | 65.9 | 67.3 | 67.3 |
| ROA | 2.7 | 3.0 | 4.2 | 4.1 | 3.5 | 3.4 |
| Average assets/average equity | 6.4 | 5.2 | 5.2 | 5.4 | 6.1 | 6.8 |
| ROE | 16.9 | 15.4 | 21.5 | 22.0 | 21.1 | 22.8 |

Source: Company, Kotak Institutional Equities estimates

Mahindra Finance, Income statement & balance sheet, March fiscal year-ends, 2008-2013E (Rs mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|---|---------------|---------------|---------------|----------------|----------------|----------------|
| Income statement | | | | | | |
| Total interest income | 11,120 | 12,748 | 14,366 | 19,223 | 28,743 | 38,210 |
| Total interest expense | 4,560 | 5,099 | 5,017 | 6,602 | 12,288 | 16,444 |
| Net interest income | 6,560 | 7,649 | 9,349 | 12,621 | 16,455 | 21,766 |
| Provisions and write/off | 2,463 | 2,824 | 2,215 | 1,566 | 2,281 | 3,633 |
| Other income | 1,148 | 1,098 | 1,321 | 902 | 600 | 700 |
| Gains on securitisation of loans | 1,074 | 977 | 1,110 | 516 | — | — |
| Operating expenses | 2,525 | 2,667 | 3,250 | 4,932 | 6,293 | 8,066 |
| Pretax income | 2,720 | 3,256 | 5,205 | 7,026 | 8,480 | 10,766 |
| Tax provisions | 950 | 1,111 | 1,762 | 2,393 | 2,775 | 3,525 |
| Net Profit | 1,770 | 2,145 | 3,443 | 4,633 | 5,705 | 7,242 |
| PBT - securitization income + provisioning expe | 4,109 | 5,103 | 6,310 | 8,076 | 10,762 | 14,400 |
| EPS (Rs) | 21 | 22 | 36 | 45 | 56 | 71 |
| BPS (Rs) | 138 | 154 | 180 | 243 | 284 | 337 |
| ABVPS (Rs) | 131 | 147 | 177 | 241 | 273 | 321 |
| Balance sheet | | | | | | |
| Net loans | 66,090 | 68,233 | 83,510 | 124,649 | 179,521 | 224,175 |
| Total Investments | 31 | 1,097 | 2,159 | 6,746 | 7,083 | 7,437 |
| Cash & deposits | 2,153 | 2,763 | 2,420 | 2,976 | 3,303 | 3,667 |
| Loans and advances and other assets | 383 | 186 | 335 | 183 | 183 | 183 |
| Deferred tax assets | 1,254 | 1,787 | 2,069 | 2,167 | 2,276 | 2,389 |
| Net fixed assets | 305 | 371 | 408 | 718 | 418 | 272 |
| Capital work in progress | 3 | 3 | 68 | 100 | 102 | 104 |
| Total assets | 70,218 | 74,440 | 90,969 | 137,539 | 192,886 | 238,228 |
| Liabilities | | | | | | |
| Total loans and bonds | 50,682 | 51,406 | 59,784 | 88,412 | 139,522 | 180,318 |
| Total Borrowings | 50,682 | 52,130 | 64,577 | 96,749 | 147,859 | 187,822 |
| Current liabilities | 6,394 | 7,617 | 9,087 | 15,889 | 15,889 | 15,889 |
| Total liabilities | 57,075 | 59,747 | 73,664 | 112,638 | 163,748 | 203,711 |
| Share capital | 953 | 957 | 960 | 1,025 | 1,025 | 1,025 |
| Reserves | 12,190 | 13,735 | 16,326 | 23,875 | 28,113 | 33,492 |
| Shareholders fund | 13,143 | 14,692 | 17,286 | 24,900 | 29,138 | 34,517 |

Source: Company, Kotak Institutional Equities estimates

OCTOBER 24, 2011

RESULT

Coverage view: **Cautious**

Price (Rs): **37**

Target price (Rs): **40**

BSE-30: **16,939**

Positive on sales, inflows; but still high debt, working capital cause concern. Suzlon reported strong wind business sales of 421 MW and revenues of Rs26.7 bn, broadly in line); though higher other expenses and interest cost led to a net loss of Rs2.36 bn, higher loss versus our estimate of a loss of Rs383 mn. Inflows of 432 MW (entirely from domestic) surprised positively. However, balance sheet remains strained with high working capital (up Rs4.8 bn from end-FY2011) and debt (up Rs11.7 bn). Retain REDUCE.

Company data and valuation summary

Suzlon Energy

Stock data

52-week range (Rs) (high,low) 66-34

Market Cap. (Rs bn) 64.1

Shareholding pattern (%)

Promoters 54.8

FIs 13.2

MFs 3.9

Price performance (%)

| | 1M | 3M | 12M |
|----------------|-------|--------|--------|
| Absolute | (4.4) | (30.7) | (38.4) |
| Rel. to BSE-30 | (8.8) | (23.4) | (26.6) |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|--------|---------|-------|
| EPS (Rs) | (6.0) | 1.9 | 3.8 |
| EPS growth (%) | (4.6) | (132.4) | 96.6 |
| P/E (X) | (6.1) | 18.8 | 9.6 |
| Sales (Rs bn) | 178.8 | 233.1 | 259.8 |
| Net profits (Rs bn) | (10.7) | 3.4 | 6.7 |
| EBITDA (Rs bn) | 11.1 | 23.2 | 27.3 |
| EV/EBITDA (X) | 14.0 | 6.8 | 5.6 |
| ROE (%) | (15.8) | 4.9 | 9.2 |
| Div. Yield (%) | 0.0 | 0.5 | 0.5 |

Strong sales, in line with estimates; however, high interest expense leads to net loss

Suzlon reported strong 2QFY12 wind business sales of 421 MW, a strong growth of 17% over 2QFY11 sales of 360 MW and marginally lower than our estimate of 450 MW. Suzlon reported 2QFY12 wind business revenues of Rs26.7 bn, up 22% yoy (in line with our estimate of Rs27 bn). However, higher other expenses led to lower-than-expected EBITDA margin of 5.1% versus our estimate of 9.5%. Suzlon also reported higher-than-expected interest cost at Rs2.96 bn, up almost 50% yoy and 25% sequentially. Higher-than-expected other expenses and interest cost led to a net loss of Rs2.36 bn in 2QFY12, a much higher loss versus our estimate of a loss of Rs383 mn.

432 MW inflows (entirely domestic) surprise positively; retains FY2012E guidance

Suzlon reported strong 2QFY12 inflows of 432 MW, versus weak inflows in the past two quarters. The inflows surprised positively against low announcements made in 2QFY12. The inflows were entirely driven by the domestic market with zero inflows from international markets. We build in execution of 2,075 MW in FY2012E for Suzlon's wind business led by 1,724 MW in domestic and 350 MW for international market. Suzlon has retained its FY2012E consolidated revenue guidance of Rs240-260 bn (Rs95 bn recorded in 1HFY12) and EBIT margin of 7-8% (6.3% margin in 1H).

Balance sheet remains stretched with high working capital and debt levels

Suzlon reported high wind business net working capital of about Rs41.7 bn, an increase of about Rs4.8 bn versus FY2011-end levels. Furthermore, the company also reported higher gross external debt of Rs124 bn, about Rs11.7 bn higher than end-FY2011 levels. Rs5 bn of the increase in debt levels was attributed to currency translation on recent Rupee depreciation.

Revise estimates; retain target price of Rs40/share and reiterate REDUCE rating

We revise our estimates to Rs1.9 and Rs3.8 for FY2012E and FY2013E on (1) aligning assumptions to 1H trend (higher domestic and lower international sales, higher employee, other and interest expenses), (2) increased sales estimates for REpower and (3) higher EUR-INR conversion rate benefit. We retain REDUCE (TP: Rs40) as (1) we wait for data points pointing to sustainable business upside, (2) high debt and working capital levels cause concern.

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Strong sales, in line with estimates; however, high interest expense leads to net loss

Suzlon reported strong 2QFY12 wind business sales of 421 MW, a strong growth of 17% over 2QFY11 sales of 360 MW and marginally lower than our estimate of 450 MW. Suzlon reported 2QFY12 wind business revenues of Rs26.7 bn, up 22% yoy (in line with our estimate of Rs27 bn). However, higher other expenses led to lower-than-expected EBITDA margin of 5.1% versus our estimate of 9.5%. Other expenses at Rs5.3 bn increased to about 20% of sales versus 15.8% of sales in 1QFY12 (other expenses increased in absolute terms as well, up 30% qoq). Suzlon also reported higher-than-expected interest cost at Rs2.96 bn, up almost 50% yoy and 25% sequentially (likely on higher debt levels). Higher-than-expected other expenses and interest cost led to a net loss of Rs2.36 bn for the quarter, a much higher loss versus our estimate of a loss of Rs383 mn.

For the half year ending September 30, 2011, Suzlon reported wind business revenues of Rs52.7 bn, up 45% yoy on sales of 858 MW (versus 568 MW of sales in 1HFY11). The company recorded 1HFY12 EBITDA margin of 8.4% versus a loss of 7.9% in 1HFY11. However, high interest costs led to a net loss of Rs2.1 bn in 1HFY12.

Suzlon Energy - 2QFY12 wind business results (Rs mn)

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | % change | | | 1HFY12 | 1HFY11 | %change |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|---------------|----------------|---------------|-----------------|-----------------|-------------|
| | | | | | vs est. | yoy | qoq | | | |
| MW sales | 421 | 450 | 361 | 437 | (6.4) | 16.6 | (3.7) | 858 | 568 | 51.1 |
| Income from operations | 26,760 | 27,000 | 21,880 | 25,900 | (0.9) | 22.3 | 3.3 | 52,660 | 36,290 | 45.1 |
| Expenditure | (25,400) | (24,435) | (21,830) | (22,830) | 3.9 | 16.4 | 11.3 | (48,230) | (39,160) | 23.2 |
| Raw material cost | (16,510) | | (14,440) | (16,870) | | 14.3 | (2.1) | (33,380) | (25,030) | 33.4 |
| Staff cost | (2,700) | | (2,380) | (2,440) | | 13.4 | 10.7 | (5,140) | (4,650) | 10.5 |
| Other exp. (excl. forex) | (5,320) | | (5,050) | (4,090) | | 5.3 | 30.1 | (9,410) | (8,000) | 17.6 |
| FX gain/ (loss) | (870) | | 40 | 570 | | | | (300) | (1,480) | |
| EBITDA | 1,360 | 2,565 | 50 | 3,070 | (47.0) | 2,620.0 | (55.7) | 4,430 | (2,870) | NA |
| Other income | 270 | 261 | 390 | 280 | 3.6 | (30.8) | (3.6) | 550 | 540 | 1.9 |
| PBDIT | 1,630 | 2,826 | 440 | 3,350 | (42.3) | 270.5 | (51.3) | 4,980 | (2,330) | NA |
| Interest & finance charges | (2,960) | (2,408) | (1,980) | (2,370) | 22.9 | 49.5 | 24.9 | (5,330) | (4,190) | 27.2 |
| Depreciation | (880) | (800) | (850) | (790) | 9.9 | 3.5 | 11.4 | (1,670) | (1,650) | 1.2 |
| PBT | (2,210) | (383) | (2,390) | 190 | NA | NA | NA | (2,020) | (8,170) | NA |
| Tax | (150) | — | (670) | 60 | | (77.6) | (350.0) | (90) | (470) | (80.9) |
| PAT | (2,360) | (383) | (3,060) | 250 | NA | NA | NA | (2,110) | (8,640) | NA |
| One-time items | 2,190 | — | 50 | — | | | | 2,190 | (1,850) | |
| Associates/Minority interest | (220) | — | — | (10) | | | | (230) | 10 | |
| adjusted PAT | (390) | (383) | (3,010) | 240 | NA | NA | NA | (150) | (10,480) | NA |
| Key ratios (%) | | | | | | | | | | |
| Material cost/sales | 61.7 | | 66.0 | 65.1 | | | | 63.4 | 69.0 | |
| Staff cost/sales | 10.1 | | 10.9 | 9.4 | | | | 9.8 | 12.8 | |
| Other exp. (excl. forex)/sales | 19.9 | | 23.1 | 15.8 | | | | 17.9 | 22.0 | |
| Forex/ sales | 3.3 | | (0.2) | (2.2) | | | | 0.6 | 4.1 | |
| EBITDA margin | 5.1 | 9.5 | 0.2 | 11.9 | | | | 8.4 | (7.9) | |
| PBDIT margin | 6.1 | 10.5 | 2.0 | 12.9 | | | | 9.5 | (6.4) | |
| Pre-tax margin | (8.3) | (1.4) | (10.9) | 0.7 | | | | (3.8) | (22.5) | |
| Tax rate | (6.8) | - | (28.0) | (31.6) | | | | (4.5) | (5.8) | |
| PAT margin | (8.8) | (1.4) | (14.0) | 1.0 | | | | (4.0) | (23.8) | |

Source: Company, Kotak Institutional Equities estimates

Consolidated results

At the consolidated level, Suzlon reported 2QFY12 revenues of Rs51.3 bn, up 34% yoy from Rs38 bn in 2QFY11. EBITDA margin was at 7.5%, a significant expansion over 3.9% margins in 2QFY11. Suzlon reported a consolidated net loss (excluding exceptional items) of Rs1.6 bn (on high interest costs) versus a loss of Rs3.7 bn in 2QFY11.

Suzlon Energy - 2QFY12 consolidated results (Rs mn)

| | 2QFY12 | 2QFY11 | 1QFY12 | % change | | 1HFY12 | 1HFY11 | % change |
|---------------------------------|-----------------|-----------------|-----------------|---------------|---------------|-----------------|-----------------|----------------|
| | | | | yoy | qoq | | | |
| Income from operations | 51,309 | 38,193 | 43,797 | 34.3 | 17.2 | 95,106 | 62,238 | 52.8 |
| Expenditure | (47,438) | (36,711) | (38,894) | 29.2 | 22.0 | (86,331) | (64,753) | 33.3 |
| (Incr.)/Decr. in stock in trade | (852) | 3,776 | (2,425) | | | (3,277) | 3,226 | (201.6) |
| Raw material consumption | (32,188) | (29,146) | (25,705) | 10.4 | 25.2 | (57,893) | (46,364) | 24.9 |
| Staff cost | (4,845) | (4,080) | (4,663) | 18.8 | 3.9 | (9,509) | (8,056) | 18.0 |
| Other expenditure | (9,553) | (7,262) | (6,100) | 31.6 | 56.6 | (15,653) | (13,559) | 15.5 |
| EBITDA | 3,871 | 1,482 | 4,904 | 161.2 | (21.1) | 8,775 | (2,515) | (448.9) |
| Other income | 236 | 197 | 322 | 19.6 | (26.8) | 557 | 432 | 28.9 |
| PBDIT | 4,107 | 1,679 | 5,225 | 144.6 | (21.4) | 9,332 | (2,083) | (548.0) |
| Interest & finance charges | (3,576) | (2,671) | (2,979) | 33.9 | 20.0 | (6,554) | (5,282) | 24.1 |
| Depreciation | (1,479) | (1,373) | (1,411) | 7.8 | 4.8 | (2,891) | (2,638) | 9.6 |
| PBT | (948) | (2,365) | 836 | (59.9) | NA | (113) | (10,003) | (98.9) |
| Tax | (658) | (1,323) | (140) | | | (798) | (1,086) | (26.5) |
| PAT | (1,606) | (3,688) | 695 | NA | NA | (911) | (11,089) | (91.8) |
| One-time items included in PAT | 2,192 | - | - | | | 2,192 | (1,836) | (219.4) |
| Associates/Minority interest | - | (4) | (94) | | | (94) | 110 | (185.3) |
| Adjusted PAT | 586 | (3,692) | 601 | NA | NA | 1,188 | (12,815) | (109.3) |
| Key ratios (%) | | | | | | | | |
| Material cost | 64.4 | 66.4 | 64.2 | | | 64.3 | 69.3 | |
| Staff cost | 9.4 | 10.7 | 10.6 | | | 10.0 | 12.9 | |
| Other expenditure | 18.6 | 19.0 | 13.9 | | | 16.5 | 21.8 | |
| EBITDA margin | 7.5 | 3.9 | 11.2 | | | 9.2 | (4.0) | |
| PBDIT margin | 8.0 | 4.4 | 11.9 | | | 9.8 | (3.3) | |
| Pre-tax margin | (1.8) | (6.2) | 1.9 | | | (0.1) | (16.1) | |
| Tax rate | (69.4) | (56.0) | 16.8 | | | (709.0) | (10.9) | |
| PAT margin | (3.1) | (9.7) | 1.6 | | | (1.0) | (17.8) | |

Source: Company, Kotak Institutional Equities

Strong developments in SE Forge business

Suzlon's SE Forge subsidiary recorded strong results with a revenue growth of 46% in 1HFY12 to Rs2.2 bn. EBITDA also grew significantly to Rs320 mn for 1HFY12 from Rs50 mn in 1HFY11 and loss of Rs250 mn in FY2010. Key positive developments in the business include (1) recently signed two major third party agreements worth Rs2 bn from two large wind players, (2) increasing proportion of third-party (non-Suzlon) business, (3) widening product portfolio and (4) operating leverage led improved EBITDA margins.

SE Forge 2QFY12 results summary (Rs mn)

| | 2QFY12 | 2QFY11 | % change | 1HFY12 | 1HFY11 | % change |
|--------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Revenues | 1,020 | 940 | 8.5 | 2,170 | 1,490 | 45.6 |
| Raw material cost | (460) | (570) | (19.3) | (1,080) | (880) | 22.7 |
| Employee cost | (70) | (70) | - | (140) | (130) | 7.7 |
| Other operating expenses | (280) | (240) | 16.7 | (620) | (430) | 44.2 |
| EBITDA | 210 | 60 | 250.0 | 330 | 50 | 560.0 |
| Interest cost | (210) | (180) | 16.7 | (400) | (350) | 14.3 |
| Depreciation | (190) | (180) | 5.6 | (370) | (350) | 5.7 |
| PBT | (190) | (300) | NA | (430) | (640) | NA |
| Key ratios (%) | | | | | | |
| Raw material cost/sales | 45.1 | 60.6 | | 49.8 | 59.1 | |
| Employee cost/sales | 6.9 | 7.4 | | 6.5 | 8.7 | |
| Other expenses/sales | 27.5 | 25.5 | | 28.6 | 28.9 | |
| EBITDA margin | 20.6 | 6.4 | | 15.2 | 3.4 | |

Source: Company, Kotak Institutional Equities

432 MW inflows surprise positively (entirely domestic); maintains guidance

Suzlon reported 2QFY12 strong order inflows of 432 MW, versus relatively weak inflows in the past two quarters. The order inflows surprised positively against low order inflow announcements made in 2QFY12. The order inflows were entirely contributed by the domestic market with zero inflows from international markets.

Order inflow, backlog and sales trend for Suzlon, March fiscal year-ends, FY2007-1QFY12 (MW)

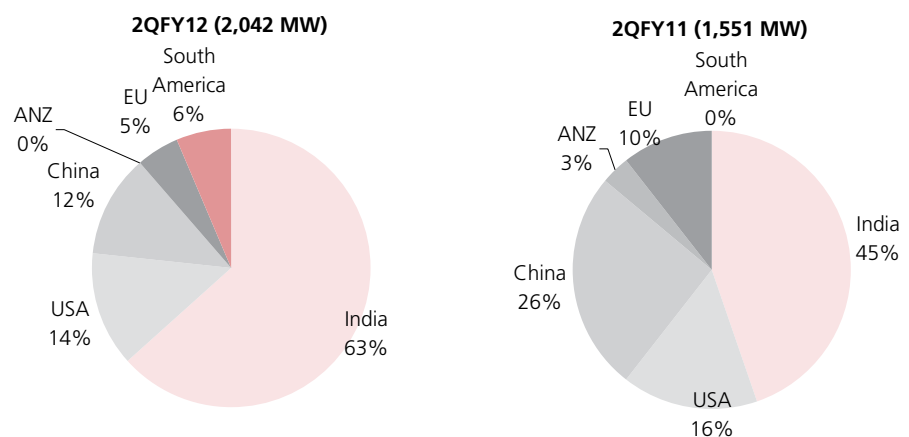
| | FY2007 | FY2008 | FY2009 | 1Q10 | 2Q10 | 3Q10 | 4Q10 | FY2010 | 1Q11 | 2Q11 | 3Q11 | 4Q11 | FY2011 | 1Q12 | 2Q12 |
|----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Backlog | | | | | | | | | | | | | | | |
| Domestic | 267 | 160 | 75 | 66 | 123 | 314 | 230 | 230 | 580 | 693 | 1,624 | 1,353 | 1,353 | 1,255 | 1,291 |
| International | 1,692 | 3,294 | 1,388 | 1,435 | 1,366 | 1,170 | 896 | 896 | 878 | 857 | 954 | 878 | 878 | 775 | 751 |
| Total | 1,958 | 3,454 | 1,463 | 1,501 | 1,489 | 1,484 | 1,126 | 1,126 | 1,458 | 1,550 | 2,578 | 2,231 | 2,231 | 2,030 | 2,042 |
| Sales | | | | | | | | | | | | | | | |
| Domestic | 956 | 976 | 749 | 58 | 129 | 140 | 361 | 688 | 139 | 290 | 325 | 415 | 1,169 | 304 | 396 |
| International | 500 | 1,335 | 2,041 | 65 | 154 | 264 | 289 | 772 | 68 | 71 | 136 | 77 | 352 | 133 | 25 |
| Total | 1,456 | 2,311 | 2,790 | 123 | 283 | 404 | 650 | 1,460 | 207 | 361 | 461 | 492 | 1,521 | 437 | 421 |
| Inflows | | | | | | | | | | | | | | | |
| Domestic | 1,036 | 870 | 815 | 49 | 186 | 331 | 227 | 793 | 489 | 403 | 1,255 | 144 | 2,291 | 205 | 432 |
| International | 1,659 | 2,937 | 137 | 111 | 84 | 68 | 16 | 279 | 51 | 50 | 233 | — | 334 | 32 | — |
| Total | 2,695 | 3,807 | 952 | 160 | 270 | 399 | 243 | 1,072 | 540 | 453 | 1,488 | 144 | 2,625 | 237 | 432 |

Source: Kotak Institutional Equities, Company

Domestic market continued to dominate the sales during the quarter with only 25 MW (of the total 421 MW) sales, only 6% of sales, in international geographies. Domestic market contributes to a majority (1,291 MW) of the order backlog of the company (of 2,042 MW). Indian market now contributes a significant proportion (about 63%) of the total order backlog of the company versus only 45% of the backlog at the end of 2QFY11.

Emerging markets likely to drive orders

Geographical break-up of order book of Suzlon



Source: Company, Kotak Institutional Equities

Maintains FY2012 guidance of Rs240-260 bn revenues and EBIT margin of 7-8%

The management has retained its FY2012E consolidated revenue guidance of Rs240-260 bn (Rs95 bn recorded in 1HFY12) and EBIT margin of 7-8% (versus 6.3% margin in 1HFY12).

We build in execution of 2,075 MW in FY2012E for Suzlon’s wind business led by 1,724 MW of execution in the domestic market and 350 MW for the international market. Domestic sales would be primarily led by execution of the existing backlog (of 1,353 MW at end-FY2011). Near-term sales would be led by execution of the large 1,000 MW Caparo order won in 3QFY11, but Suzlon would need to replace this with new order wins to build in revenue visibility beyond FY2012E. Despite the company’s strong foothold in the domestic market, we believe Suzlon would have to build traction in international orders versus the sharp slowdown in FY2010.

Order backlog, booking and execution, March fiscal year-ends, 2008-13E (MW)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Order backlog | | | | | | |
| Domestic | 160 | 75 | 230 | 1,353 | 929 | 472 |
| International | 3,294 | 1,388 | 896 | 878 | 728 | 694 |
| Total backlog | 3,454 | 1,463 | 1,126 | 2,231 | 1,656 | 1,165 |
| Order inflows | | | | | | |
| Domestic | 870 | 664 | 843 | 2,292 | 1,300 | 1,430 |
| International | 2,937 | 135 | 280 | 334 | 200 | 300 |
| Total inflows | 3,807 | 799 | 1,123 | 2,626 | 1,500 | 1,730 |
| Execution | | | | | | |
| Domestic | 976 | 749 | 688 | 1,169 | 1,724 | 1,887 |
| International | 1,335 | 2,041 | 772 | 352 | 350 | 334 |
| Total execution | 2,311 | 2,790 | 1,460 | 1,521 | 2,075 | 2,221 |

Source: Kotak Institutional Equities, Company

Balance sheet remains stretched

Suzlon’s balance sheet remains stretched with high debt and working capital levels. Suzlon reported a high net working capital of Rs41.7 bn at end-1HFY12 from about Rs37 bn at end-FY2011. Working capital levels have remained relatively flat since end-FY2010 levels significantly below expectations given the aim to reduce the working capital by at least Rs10 bn by the end-FY2011. Working capital levels are significantly higher than FY2009-end levels of about 100-110 days of sales. Note our estimates build in some improvement in working capital levels to FY2009-levels of about 105 days of sales. We assume payment of about Rs10 bn from sticky debtors (Edison Mission) to come through in FY2012E thereby leading to lowered debtor levels.

Working capital levels remain high

Working capital details of Suzlon’s wind business, March fiscal year-ends, 2009-1HFY11 (Rs mn)

| | 2009 | 2010 | FY2011 | | | | 1QFY12 | 2QFY12 | FY2012E | FY2013E |
|----------------------------|----------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|---------|
| | | | 1QFY11 | 2QFY11 | 3QFY11 | FY2011 | | | | |
| In Rs mn | | | | | | | | | | |
| Inventories | 38,780 | 28,770 | 29,100 | 30,130 | 32,410 | 31,440 | 32,070 | 35,300 | 38,485 | |
| Sundry debtors | 63,540 | 47,260 | 37,980 | 33,040 | 41,800 | 41,560 | 45,100 | 48,950 | 44,517 | |
| Loans and advances | 18,290 | 16,360 | 15,240 | 18,880 | 16,330 | 16,630 | 16,460 | 17,610 | 21,992 | |
| Current assets | 120,610 | 92,390 | 82,320 | 82,050 | 90,540 | 89,630 | 93,630 | 101,860 | 101,019 | |
| Current liabilities | 73,460 | 53,810 | 47,180 | 46,330 | 50,750 | 52,730 | 52,150 | 60,210 | 65,063 | |
| Net working capital | 47,150 | 38,580 | 35,140 | 35,720 | 39,790 | 36,900 | 41,480 | 41,650 | 35,956 | |
| As days of sales | | | | | | | | | | |
| Inventories | 89 | 109 | | | | 125 | | 105 | 105 | |
| Sundry debtors | 146 | 179 | | | | 165 | | 130 | 130 | |
| Loans and advances | 42 | 62 | | | | 66 | | 60 | 60 | |
| Current assets | 277 | 350 | | | | 357 | | 295 | 295 | |
| Current liabilities | 169 | 204 | | | | 210 | | 190 | 190 | |
| Net working capital | 108 | 146 | | | | 147 | | 105 | 105 | |

Build in some improvement in working capital on payment from sticky debtors of Rs10 bn in FY2012E

Source: Company, Kotak Institutional Equities

Gross external debt also increases

Suzlon reported gross external debt of Rs124 bn at end-1HFY12 versus Rs112 bn at end-FY2011 level led by increase in Foreign Currency Convertible Bonds (FCCBs). The company issued new FCCBs to the tune of about US\$175 mn in April 2011. Part of the increase in the reported debt level (to the tune of about Rs5 bn) was on translation impact of recent Rupee depreciation.

Gross external debt increases yoy

Details of debt of Suzlon's wind business, March fiscal year-ends, 2009-1HFY11 (Rs mn)

| | FY2009 | FY2010 | FY2011 | | | FY2011 | 1QFY12 | 2QFY12 |
|----------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | | | 1QFY11 | 2QFY11 | 3QFY11 | | | |
| Acquisition loans | 34,020 | 20,830 | 21,550 | 20,850 | 20,730 | 20,740 | 20,790 | 22,770 |
| FCCBs | 25,360 | 21,510 | 22,250 | 21,530 | 21,410 | 21,360 | 29,240 | 32,030 |
| WCap, Capex, other loans | 65,140 | 62,840 | 64,730 | 68,320 | 68,980 | 70,230 | 68,330 | 69,250 |
| Gross external debt | 124,520 | 105,180 | 108,530 | 110,700 | 111,120 | 112,330 | 118,360 | 124,050 |
| Loans from promoters | — | 11,750 | 11,750 | — | — | — | — | — |
| Total gross debt | 124,520 | 116,930 | 120,280 | 110,700 | 111,120 | 112,330 | 118,360 | 124,050 |
| Cash | 1,359 | 15,410 | 12,580 | 12,600 | 9,450 | 10,230 | 9,550 | 8,460 |
| Net debt | 123,161 | 101,520 | 107,700 | 98,100 | 101,670 | 102,100 | 108,810 | 115,590 |

Source: Company, Kotak Institutional Equities

Debt coverage/service ratios remain sub optimal with EBITDA barely sufficient to service debt (interest coverage ratio of 1.7-2X for FY2012E-13E and net debt/ EBITDA ratio of over 4X).

Key debt service ratios of Suzlon's consolidated business, March fiscal year-ends, 2011-13E

| | 2011 | 2012E | 2013E |
|-----------------------|------|-------|-------|
| Interest coverage (X) | 0.6 | 2.0 | 2.3 |
| Net debt/ EBITDA (X) | 11.5 | 4.2 | 3.5 |
| Net debt/ Equity (X) | 1.4 | 1.4 | 1.2 |

Source: Kotak Institutional Equities estimates

Hansen stake sale would ease debt levels to some extent—already built into estimates

Suzlon recently completed the sale of its remaining 26% in Hansen resulting in sales proceeds of US\$187 mn - presently not reflected in Sept-end reported debt and cash levels as was received in October. The cash from the sales proceeds would be partly utilized towards squeeze out proceedings in REpower and the remaining (about 50%) would be used towards de-leveraging the balance sheet of the company. We have already built in the benefit from the Hansen stake sale into our estimates - Suzlon's wind business net debt is expected to decline to about Rs97 bn by end-FY2012E versus FY2011-end level of Rs102 bn.

Revise earnings estimates; retain target price of Rs40 and reiterate REDUCE

We have revised our earnings estimates to Rs1.9 and Rs3.8 from Rs0.7 and Rs2.6 for FY2012E and FY2013E, respectively. Key changes in assumptions driving EPS estimate revision are (1) increase in India execution estimate (to 1,724 MW from 1,465 MW) and lower overseas execution estimate (to 350 MW from 590 MW) in FY2012E based in 1H trend, (2) higher employee and other expenses for Suzlon's wind business based on 2QFY12 reported numbers (higher costs are partially offset higher gross margins leading to only marginal revision in EBITDA margin), and (3) higher sales estimates for REpower business as well as factoring higher Eur-INR conversion rate in consolidation.

We retain our target price of Rs40/share based on an average of 6-7X EV/EBITDA valuation (from 7X EV/EBITDA earlier). We believe that a 6-7X EV/EBITDA multiple appears reasonable for a company with high working capital levels.

We retain our REDUCE rating on the company based on (1) low traction in international markets related to sales as well as margin pressure, (2) high working capital and debt levels, (3) strained cash flows, (4) headwinds in India business originating from difficulty in scaling up annual execution (land acquisition, transmission etc.), lack of full regulatory support (non implementation of RPO mandate by some states), likely withdrawal of accelerated depreciation etc.

Target price of Rs40/share
 Estimation of target price of Suzlon Energy

| | FY2013E - using 7X | Using 6X EV/EBITDA |
|-------------------------------------|-------------------------------|-------------------------------|
| REpower | | |
| EV/EBITDA multiple | 7 | 6 |
| FY2013E EBITDA (Euro mn) | 166 | 166 |
| EV (Euro mn) | 1,160 | 994 |
| Net debt (Euro mn) | (106) | (106) |
| Market capitalisation (Euro mn) | 1,266 | 1,100 |
| Repower per share price (Euro) | 138 | 120 |
| Suzlon's stake in REpower (%) | 100 | 100 |
| Contr to Suzlon MCap (Rs mn) | 86,857 | 75,491 |
| Suzlon wind business (Rs mn) | | |
| MW sales | 2,221 | 2,221 |
| EV/EBITDA multiple (X) | 7 | 6 |
| FY2013E EBITDA | 14,352 | 14,352 |
| EV of wind business | 100,467 | 86,115 |
| Net debt as on Mar' 2013E | 105,819 | 105,819 |
| Mcap. of Suzlon wind business | (5,352) | (19,705) |
| Mcap. contr of Hansen & Repower | 86,857 | 75,491 |
| Mcap. Incl. Hansen and Repower | 81,505 | 55,786 |
| No. of shares (mn) | 1,746 | 1,746 |
| Suzlon target price (Rs) | 47 | 32 |

Source: Company, Kotak Institutional Equities estimates

Key risks originate from continued negative execution surprises related to sectoral and company specific problems; we highlight that Suzlon did not have a strong execution track record when the sector scenario was buoyant. Furthermore, over the long term, the competitive intensity of the sector would increase, with new players from China and other industrial companies joining the renewable energy bandwagon.

Wind business financials of Suzlon Energy, March fiscal year-ends, 2008-13E (Rs mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|--|-----------------|------------------|-----------------|-----------------|------------------|------------------|
| Income statement | | | | | | |
| Total MW sales | 2,311 | 2,790 | 1,460 | 1,521 | 2,075 | 2,221 |
| Sales | 114,665 | 159,120 | 96,350 | 91,750 | 124,990 | 133,782 |
| Total Expenditure | (97,529) | (143,240) | (96,930) | (90,780) | (112,718) | (119,430) |
| Raw Material cost | (78,130) | (104,810) | (63,910) | (60,610) | (81,243) | (86,958) |
| Manpower | (5,179) | (8,970) | (9,110) | (9,410) | (10,539) | (11,066) |
| Other op exp | (14,220) | (29,460) | (23,910) | (20,760) | (20,936) | (21,405) |
| EBITDA | 17,136 | 15,880 | (580) | 970 | 12,271 | 14,352 |
| Other income | 1,968 | 2,460 | 820 | 1,240 | 850 | 1,053 |
| Financial charges | (4,603) | (7,780) | (9,720) | (9,930) | (10,671) | (10,671) |
| Depreciation | (1,703) | (2,600) | (3,120) | (3,590) | (3,602) | (3,707) |
| Profit before tax | 12,798 | 7,960 | (12,600) | (11,310) | (1,152) | 1,028 |
| Tax | (1,493) | (30) | (2,360) | 270 | — | (226) |
| One-off costs | — | (8,963) | — | — | 8,280 | 1 |
| Profit after tax | 11,305 | (1,030) | (14,960) | (11,040) | 7,128 | 802 |
| Balance sheet | | | | | | |
| Share capital | 2,994 | 2,997 | 3,114 | 3,491 | 3,491 | 3,491 |
| Reserves and surplus | 62,990 | 62,450 | 53,480 | 53,947 | 61,075 | 61,876 |
| Total shareholders funds | 66,084 | 65,527 | 56,754 | 58,500 | 64,766 | 65,567 |
| Total loan funds | 86,430 | 124,520 | 116,940 | 112,330 | 112,330 | 112,330 |
| Total sources of funds | 153,284 | 192,227 | 176,264 | 173,400 | 179,666 | 180,467 |
| Net fixed assets | 17,320 | 25,710 | 25,050 | 23,910 | 21,308 | 18,602 |
| Investments | 57,560 | 98,620 | 92,860 | 99,470 | 104,470 | 104,470 |
| Cash and bank balance | 48,870 | 13,590 | 16,374 | 9,730 | 14,532 | 15,511 |
| Net current assets (excl. cash) | 29,200 | 47,150 | 38,580 | 36,890 | 35,956 | 38,485 |
| Total application of funds | 153,284 | 192,227 | 176,264 | 173,400 | 179,666 | 180,467 |

Source: Company, Kotak Institutional Equities estimates

REpower Systems financials, March fiscal year-ends, 2008-13E (EUR mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|-----------------------------------|--------------|----------------|----------------|----------------|----------------|----------------|
| Income statement | | | | | | |
| Income from operations | 153 | 1,241 | 1,344 | 1,314 | 1,576 | 1,837 |
| Expenditure | (148) | (1,149) | (1,225) | (1,201) | (1,436) | (1,671) |
| Raw material costs | (120) | (981) | (1,001) | (950) | (1,158) | (1,350) |
| Staff cost | (14) | (81) | (97) | (118) | (114) | (129) |
| Sales and distribution costs | (13) | (87) | (127) | (133) | (163) | (192) |
| EBITDA | 5 | 91 | 119 | 113 | 140 | 166 |
| EBITDA margin (%) | 3.3 | 7.4 | 8.9 | 8.6 | 8.9 | 9.0 |
| Other income | 2 | 6 | 5 | 6 | 7 | 8 |
| Interest & finance charges | (2) | (6) | (20) | (11) | (7) | (7) |
| Depreciation | (2) | (15) | (21) | (27) | (33) | (36) |
| PBT | 3 | 77 | 84 | 81 | 108 | 131 |
| Tax | (2) | (25) | (26) | (23) | (35) | (43) |
| PAT | 1 | 52 | 58 | 58 | 73 | 89 |
| Balance Sheet | | | | | | |
| Share holder's Funds | 329 | 408 | 483 | 519 | 591 | 680 |
| Capital | 9 | 9 | 9 | 9 | 9 | 9 |
| Reserves and Surplus | 320 | 399 | 474 | 510 | 582 | 671 |
| Loan Funds | 18 | 41 | 76 | 102 | 102 | 102 |
| Total sources of funds | 347 | 449 | 559 | 621 | 693 | 782 |
| Net Block | 110 | 148 | 200 | 270 | 300 | 320 |
| Cash & Bank Balances | 178 | 101 | 216 | 320 | 175 | 208 |
| Investments | 5 | 7 | 6 | 2 | 2 | 2 |
| Net Current Assets | 55 | 193 | 130 | 3 | 216 | 252 |
| Total application of funds | 347 | 449 | 552 | 621 | 693 | 782 |

Source: Company, Kotak Institutional Equities estimates

Consolidated financials of Suzlon Energy, March fiscal year-ends, 2008-13E (Rs mn)

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|--|------------------|------------------|------------------|------------------|------------------|------------------|
| Income statement | | | | | | |
| Sales | 136,794 | 260,817 | 206,197 | 178,791 | 233,069 | 259,772 |
| Total Expenditure | (116,901) | (232,902) | (195,732) | (170,847) | (211,194) | (234,053) |
| Raw Material cost | (88,702) | (168,568) | (136,282) | (124,540) | (160,682) | (179,561) |
| Manpower | (17,753) | (42,675) | (37,996) | (29,542) | (32,138) | (34,607) |
| Other op exp | (10,446) | (21,658) | (21,454) | (16,764) | (18,375) | (19,885) |
| EBITDA | 19,894 | 27,915 | 10,465 | 7,945 | 21,875 | 25,719 |
| Other income | 2,646 | 4,488 | 2,290 | 3,177 | 1,330 | 1,581 |
| Financial charges | (5,969) | (10,539) | (14,580) | (13,331) | (11,126) | (11,126) |
| Depreciation | (2,894) | (5,731) | (6,630) | (6,574) | (5,850) | (6,152) |
| Profit before tax | 13,676 | 16,133 | (8,455) | (8,783) | 6,230 | 10,023 |
| Tax | (1,993) | (2,881) | (3,561) | (1,853) | (2,399) | (3,149) |
| One-off costs | (1,512) | (8,963) | 2,119 | (2,533) | — | — |
| Profit after tax | 10,301 | 2,365 | (9,826) | (13,240) | 3,403 | 6,690 |
| EPS (Rs) | 6.6 | 1.6 | (6.3) | (7.4) | 1.9 | 3.8 |
| Balance sheet | | | | | | |
| Share capital | 2,994 | 2,997 | 3,114 | 3,555 | 3,491 | 3,491 |
| Reserves and surplus | 78,019 | 79,291 | 60,362 | 61,701 | 63,302 | 68,190 |
| Total shareholders funds | 81,013 | 82,287 | 63,476 | 65,256 | 66,794 | 71,681 |
| Minority interest | 10,244 | 23,135 | 3,285 | 3,067 | 3,546 | 4,129 |
| Total loan funds | 99,346 | 148,696 | 126,679 | 122,637 | 119,317 | 119,317 |
| Total sources of funds | 190,628 | 254,143 | 193,465 | 190,985 | 189,686 | 195,157 |
| Net fixed assets | 42,954 | 80,884 | 44,695 | 47,221 | 41,888 | 40,554 |
| Goodwill | 13,923 | 71,770 | 61,047 | 66,163 | 66,163 | 66,163 |
| Investments | 31,418 | 51 | 10,923 | 9,669 | 14,669 | 14,669 |
| Cash and bank balance | 69,602 | 30,698 | 29,043 | 31,213 | 26,565 | 29,790 |
| Net current assets (excl. cash) | 32,949 | 72,607 | 48,723 | 38,058 | 50,761 | 55,744 |
| Total application of funds | 190,628 | 254,143 | 193,465 | 190,985 | 189,686 | 195,157 |

Source: Company, Kotak Institutional Equities estimates

OCTOBER 24, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): 135

Target price (Rs): 180

BSE-30: 16,939

Strong revenues; but margin decline and high interest cost mar net-level results.

Sadbhav Engineering reported strong revenue of Rs4.3 bn (up 65% yoy) in line with our estimate. However lower-than-expected EBITDA margin at 10.5% (down 150 bps yoy, our estimate of 11%) and high interest cost (of Rs154 mn, up 22% qoq) led to a miss at the net PAT level (reported Rs181 mn, 21% below estimate). Key things to watch for are order inflows (BOT, cash construction) so as to maintain growth momentum post sedate inflows in FY2012E so far. Retain BUY (TP: Rs180/share).

Company data and valuation summary

Sadbhav Engineering

Stock data

52-week range (Rs) (high,low) 158-91

Market Cap. (Rs bn) 20.2

Shareholding pattern (%)

Promoters 47.6

FIs 23.1

MFs 17.6

Price performance (%)

Absolute 1M (1.0) 3M (7.1) 12M (9.9)

Rel. to BSE-30 (3.6) 2.6 7.3

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|------|-------|-------|
| EPS (Rs) | 7.8 | 10.8 | 11.9 |
| EPS growth (%) | 51.0 | 38.9 | 10.6 |
| P/E (X) | 17.4 | 12.5 | 11.3 |
| Sales (Rs bn) | 22.1 | 28.8 | 32.4 |
| Net profits (Rs bn) | 1.2 | 1.6 | 1.8 |
| EBITDA (Rs bn) | 2.3 | 3.0 | 3.3 |
| EV/EBITDA (X) | 10.3 | 8.3 | 7.5 |
| ROE (%) | 18.1 | 20.4 | 18.6 |
| Div. Yield (%) | 0.4 | 0.4 | 0.4 |

Strong revenue growth (in-line) likely on back of strong execution of BOT projects

Sadbhav Engineering reported strong revenue growth of 65% in 2QFY12 to Rs4.3 bn, in line with our estimates. The strong growth was likely led by strong execution of its large BOT project portfolio (close to 50% of FY2011 year-end backlog). The company is also likely to have benefitted from start of execution of (1) Rs14 bn Rohtak-Panipat project (achieved appointed date in Apr-11) and (2) Rs14 bn NHAI cash project. 1H sales at Rs10.4 bn have grown 52% yoy.

Sharper-than-expected margin contraction and high interest cost mar net results

Sadbhav reported EBITDA margin of 10.5% versus our estimate of 11% and 2QFY11 EBITDA margin of 12%. The 150 bps yoy margin decline was primarily on higher construction expenses (up 300 bps) partly buffered by lower other expenses as percent of sales (down 170 bps). The company also reported higher-than-expected interest cost of Rs154 mn for the quarter (versus our estimate of Rs118 mn), a 22% increase on a sequential basis. The lower-than-expected margin and high interest cost led to a net PAT of Rs181 mn, up 32% yoy, about 21% below our estimate of Rs230 mn.

New orders key with progress in execution of existing BOT assets; inflows sedate in FY2012E so far

New order inflows is key to meet our FY2012E and FY2013E estimates for Sadbhav with strong progress in the execution of the existing BOT projects. Our estimates build in order inflow of Rs35 bn in FY2012E, a growth of about 45% over FY2011 inflows of Rs24 bn. We expect the company to win about 2-3 large BOT projects in FY2012E leading to Rs15 bn of order inflows in that segment. Note that order inflows have remained relatively muted in FY2012E so far; the company has announced only two EPC orders to the tune of about Rs2.2 bn.

Retain estimates; reiterate BUY with a target price of Rs180/share

We retain our estimates of Rs10.8 and Rs11.9 for FY2012E and FY2013E. Reiterate BUY with a target price of Rs180/share based on (1) attractive valuations, (2) strong order book which provides near-term revenue visibility, and (3) strong balance sheet quality.

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Sadbhav, 2QFY12 results (standalone), March fiscal year-ends (Rs mn)

| | 2QFY12 | 2QFY12E | 2QFY11 | 1QFY12 | % change | | | 1HFY12 | 1HFY11 | % change |
|---------------------------|----------------|----------------|----------------|----------------|---------------|-------------|---------------|----------------|----------------|-------------|
| | | | | | vs est. | yoy | qoq | | | |
| Operational income | 4,304 | 4,323 | 2,609 | 6,129 | (0.4) | 65.0 | (29.8) | 10,433 | 6,862 | 52.0 |
| Total expenditure | (3,851) | (3,848) | (2,295) | (5,451) | 0.1 | 67.8 | (29.3) | (9,302) | (6,041) | 54.0 |
| Construction expenses | (3,468) | | (2,025) | (5,153) | | 71.3 | (32.7) | (8,621) | (5,005) | 72.2 |
| Employee expenses | (91) | | (49) | (92) | | 87.7 | (1.1) | (184) | (118) | 55.9 |
| Other expenses | (292) | | (221) | (206) | | 31.9 | 41.8 | (497) | (348) | 43.1 |
| EBITDA | 453 | 476 | 314 | 678 | (4.8) | 44.2 | (33.2) | 1,131 | 821 | 37.8 |
| Other income | 52 | 60 | 2 | 16 | (12.4) | 2,103.0 | 226.8 | 68 | 4 | |
| Depreciation | (70) | (80) | (67) | (69) | (11.8) | 5.6 | 1.3 | (140) | (131) | 6.4 |
| Net Interest | (154) | (118) | (42) | (126) | 30.5 | 267.2 | 22.4 | (280) | (102) | 173.2 |
| PBT | 281 | 338 | 208 | 499 | (16.7) | 35.1 | (43.6) | 780 | 592 | 31.8 |
| Taxes | (100) | (108) | (71) | (161) | (7.7) | 40.7 | (38.0) | (260) | (199) | |
| Net PAT | 181 | 230 | 137 | 338 | (21.0) | 32.1 | (46.3) | 519 | 393 | 32.3 |
| Key ratios (%) | | | | | | | | | | |
| Construction exp./ sales | 80.6 | | 77.6 | 84.1 | | | | 82.6 | 72.9 | |
| Staff cost/ sales | 2.1 | | 1.9 | 1.5 | | | | 1.8 | 1.7 | |
| Other exp./ sales | 6.8 | | 8.5 | 3.4 | | | | 4.8 | 5.1 | |
| EBITDA margin | 10.5 | 11.0 | 12.0 | 11.1 | | | | 10.8 | 12.0 | |
| PBT margin | 6.5 | 7.8 | 8.0 | 8.1 | | | | 7.5 | 8.6 | |
| Effective tax rate | 35.5 | 32.0 | 34.0 | 32.2 | | | | 33.4 | 33.6 | |
| PAT margin | 4.2 | 5.3 | 5.3 | 5.5 | | | | 5.0 | 5.7 | |
| EPS | 1.2 | 1.5 | 0.9 | 2.3 | # | | | # | 3.5 | 2.6 |

Source: Company, Kotak Institutional Equities estimates

Details of key orders secured by Sadbhav Engg since FY2008

| Date | Client | Segment | Size (Rs mn) | Order details |
|---|--|-------------|---------------|---|
| Aug-11 | Bihar State Road Development Corp. Ltd | Road | 1,009 | Improvement/Upgradation of road |
| Apr-11 | Sardar Sarovar Narmda Nigam Ltd | Irrigation | 1,228 | EPC of Radhanpur Sub Branch Canal, Manpura Sub Branch Canal |
| Total order inflows announced in FY2012 so far | | | 2,237 | |
| Mar-11 | Narmada Development Division | Irrigation | 2,096 | Execution of Omkareshwar Right Lift Canal |
| Mar-11 | Narmada Development Division | Irrigation | 3,119 | Execution of Omkareshwar Right Lift Canal |
| Oct-10 | National Highway Authority of India (NHAI) | Road | 14,114 | 2-laning, improvement Works on NH-69A, B |
| Aug-10 | Road Construction Department, Govt. of Jha | Road | 2,299 | Improvement Works on Govindpur- Sahibganj State Project |
| Jun-10 | Western Coalfields Ltd (Coal India Ltd) | Mining | 921 | Material removal and coal evacuation |
| Total order inflows announced in FY2011 so far | | | 22,549 | |
| Feb-10 | NHAI Bijapur - Hungund project | Road (BOT) | 12,250 | 4-laning of 100 km of NH-13 in Karnataka |
| Feb-10 | Northern Coalfields Ltd (Coal India Ltd) | Mining | 1,368 | Removal of over burden of first dig |
| Nov-09 | NHAI Rohtak-Panipat BOT project | Road (BOT) | 13,500 | 4-laning of 80 km of NH-71A in Haryana |
| Nov-09 | NHAI Hyderabad-Yadgiri BOT project | Road (BOT) | 4,900 | 4-laning of NH-202 in Andhra Pradesh |
| Sep-09 | Jharkhand Road Projects Impl. Co. Ltd | Road (Cash) | 2,250 | Improvement Works of Ranchi Ring Road - Section V |
| Sep-09 | Jharkhand Road Projects Impl. Co. Ltd | Road (Cash) | 2,520 | Improvement Works of Ranchi Ring Road - Section III |
| Sep-09 | Mahanadi Coalfields Ltd | Mining | 2,254 | Mining project |
| Jul-09 | Western Coalfield Ltd (WCL) | Mining | 681 | Removal of all types of material in all kinds of strata |
| Total order inflows announced in FY2010 | | | 39,723 | |
| Mar-09 | Maharashtra State Road Dev. Corp. | Road (BOT) | 8,012 | Maharashtra Border Check Post Project |
| Jan-09 | National Highways Authority of India | Road (BOT) | 11,000 | 4/6 laning of MP/ Mah Border- Dhule section of NH- 3 |
| Oct-08 | Greater Visakhapatnam Municipal Corp. | Road (Cash) | 828 | BRTS corridor from Pendurthi to DRM via NAD Junction |
| Oct-08 | Surat Municipal Corporation | Road (Cash) | 544 | Construction of pavement and allied works |
| Oct-08 | Gujarat Industries Power Company Ltd | Mining | 2,683 | Excavation work at Mangrol lignite mines |
| Jan-09 | Government of Andhra Pradesh | Irrigation | 516 | Canal network system |
| Apr-08 | Government of Andhra Pradesh | Irrigation | 868 | Main canal and distributory system |
| Total order inflows announced in FY2009 | | | 24,451 | |
| Nov-07 | Government of Chhattisgarh | Road (Cash) | 990 | Rehabilitation and upgrading of roads |
| Sep-07 | Madhya Pradesh Road Dev. Corp. Ltd | Road (Cash) | 1,965 | Shivpuri-Sheopur and Seoni-Chiraidongri projects |
| Jul-07 | National Highways Authority of India | Road (Cash) | 1,622 | Four lane Agra bypass |
| Jan-08 | Western Coalfield Limited | Mining | 476 | Removal of all types of material in all kinds of strata |
| Sep-07 | Northern Coalfield Ltd | Mining | 2,452 | Removal of over burden of first dig |
| Feb-08 | Narmada Control Authority | Irrigation | 3,102 | Omkareshwar Project Canal System (Phase-III) |
| Jun-07 | Government of Andhra Pradesh | Irrigation | 905 | Canal network system |
| Total order inflows announced in FY2008 | | | 11,512 | |

Source: NHAI, Company

Sadbhav Engg balance sheet, at end-September 2011 (Rs mn)

| | Sep-09 | Mar-10 | Sep-10 | Mar-11 | Sep-11 |
|---|--------------|---------------|---------------|---------------|---------------|
| Shareholders funds | 3,651 | 3,915 | 4,748 | 6,257 | 6,796 |
| Share capital | 125 | 125 | 131 | 150 | 150 |
| Reserves & surplus | 3,526 | 3,790 | 4,617 | 6,108 | 6,646 |
| Loan funds | 3,285 | 4,242 | 4,207 | 3,961 | 4,557 |
| Deferred tax liability | 115 | 141 | 150 | 161 | 163 |
| Total sources of funds | 7,051 | 8,298 | 9,105 | 10,379 | 11,516 |
| Fixed assets | 1,537 | 2,101 | 2,202 | 2,298 | 2,228 |
| Investments | 1,293 | 1,441 | 3,518 | 3,264 | 3,310 |
| Cash & bank balances | 136 | 448 | 313 | 846 | 684 |
| Current assets | 7,933 | 9,643 | 12,036 | 13,495 | 12,214 |
| Inventories | 194 | 540 | 513 | 692 | 825 |
| Sundry debtors | 3,585 | 4,408 | 5,139 | 6,869 | 5,543 |
| Loans & advances | 4,147 | 4,668 | 6,357 | 5,861 | 5,655 |
| Other current assets | 7 | 28 | 27 | 73 | 191 |
| Current liabilities & provisions | 3,851 | 5,336 | 8,963 | 9,524 | 6,921 |
| Current liabilities | 3,270 | 5,273 | 8,770 | 8,269 | 5,407 |
| Provisions | 581 | 63 | 193 | 1,255 | 1,513 |
| Net working capital (excl. cash) | 4,082 | 4,308 | 3,073 | 3,971 | 5,293 |
| Miscellaneous expenditure | 4 | | | | |
| Total application of funds | 7,051 | 8,298 | 9,105 | 10,379 | 11,516 |
| As days of sales | | Mar-10 | Sep-10 | Mar-11 | Sep-11 |
| Current assets | | 280 | 379 | 223 | 174 |
| Inventories | | 16 | 16 | 11 | 12 |
| Sundry debtors | | 128 | 162 | 113 | 79 |
| Loans & advances | | 136 | 200 | 97 | 80 |
| Other current assets | | 1 | 1 | 1 | 3 |
| Current liabilities & provisions | | 155 | 282 | 157 | 98 |
| Current liabilities | | 153 | 276 | 137 | 77 |
| Provisions | | 2 | 6 | 21 | 22 |
| Net working capital (excl. cash) | | 125 | 97 | 66 | 75 |

Source: Company, Kotak Institutional Equities

New orders key with progress in execution of existing BOT assets; inflows sedate in FY2012E so far

New order inflows is key to meet our FY2012E and FY2013E estimates for Sadbhav with strong progress in the execution of the existing BOT projects. Our estimates build in order inflow of Rs35 bn in FY2012E, a growth of about 45% over FY2011 inflows of Rs24 bn. We expect the company to win about 2-3 large BOT projects in FY2012E leading to Rs15 bn of order inflows in that segment. Note that order inflows have remained relatively muted in FY2012E so far; the company has announced only two EPC orders to the tune of about Rs2.2 bn.

Segmental revenue, order inflow and backlog for Sadbhav Engg (standalone), March fiscal year-ends, 2009-13E (Rs mn)

| | 2009 | 2010 | 2011 | 2012E | 2013E |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Total standalone | | | | | |
| Order inflows | 29,349 | 39,266 | 24,046 | 34,924 | 40,699 |
| Yoy growth (%) | 145.6 | 33.8 | (38.8) | 45.2 | 16.5 |
| Revenues | 10,625 | 12,569 | 22,092 | 28,823 | 32,413 |
| Yoy growth (%) | 21.8 | 18.3 | 75.8 | 30.5 | 12.5 |
| Order backlog | 46,407 | 67,686 | 69,640 | 75,741 | 84,027 |
| Roads (BOT) | | | | | |
| Order inflows | 23,671 | 30,650 | 1,930 | 15,000 | 17,250 |
| Revenues | 5,934 | 6,475 | 12,282 | 13,008 | 14,005 |
| Yoy growth (%) | 100.5 | 9.1 | 89.7 | 5.9 | 7.7 |
| Order backlog | 24,737 | 43,502 | 33,150 | 35,142 | 38,387 |
| Roads (others) | | | | | |
| Order inflows | 2,624 | 4,700 | 15,318 | 10,722 | 12,867 |
| Yoy growth (%) | (9.9) | 79.1 | 225.9 | (30.0) | 20.0 |
| Revenues | 1,716 | 3,329 | 5,780 | 9,841 | 11,423 |
| Yoy growth (%) | (44.3) | 93.9 | 73.6 | 70.3 | 16.1 |
| Order backlog | 7,161 | 8,532 | 18,070 | 18,951 | 20,395 |
| Irrigation | | | | | |
| Order inflows | | | 4,397 | 5,000 | 5,750 |
| Yoy growth (%) | | | | - | 15.0 |
| Revenues | 1,462 | 752 | 1,254 | 3,023 | 3,611 |
| Yoy growth (%) | 53.3 | (48.5) | 66.7 | 141.0 | 19.5 |
| Order backlog | 7,388 | 6,447 | 9,590 | 11,568 | 13,707 |
| Mining | | | | | |
| Order inflows | 3,291 | 4,105 | 2,401 | 4,202 | 4,832 |
| Yoy growth (%) | 12.7 | 24.7 | 25.0 | 75.0 | 15.0 |
| Revenues | 1,475 | 2,021 | 2,776 | 2,951 | 3,374 |
| Yoy growth (%) | 454.4 | 37.0 | 37.4 | 6.3 | 14.3 |
| Order backlog | 7,121 | 9,205 | 8,830 | 10,080 | 11,538 |

Source: Company, Kotak Institutional Equities estimates

Equity requirement for BOT projects mostly financed particularly with strong standalone balance sheet

We estimate that the current portfolio of BOT projects would require equity investment of about Rs8 bn over the next 2-3 years. Possible sources of funds include (1) internal accruals of standalone construction—cumulative cash flows of about Rs3 bn, and (2) cash from PE investment in Sadbhav Infrastructure Private Ltd (SIPL) of Rs4 bn. Hence financing for about Rs1 bn of the equity requirement for the BOT projects is yet to be tied up. Potential sources for the same could be (1) cash generation from BOT projects itself (Border check post projects has provision for partial CODs), (2) incremental debt raising at the parent level and (3) further dilution in SIPL. The management has cited additional sources of cash from (1) possible securitization of Ahmedabad ring road project (achieving critical mass) and (2) savings from early completion of projects (Bijapur, Dhule).

Total equity requirement and potential funding sources for BOT projects of Sadbhav (Rs mn)

| Project | Sadbhav Stake | 2011E | 2012E | 2013E | Total |
|--|----------------------------|--------------|--------------|--------------|--------------|
| Ahmedabad Ring Road | Sadbhav-80%, PBA-20% | | | | — |
| Mumbai Nasik | Sadbhav-20%, Gammon-80% | | | | — |
| Aurangabad-Jalna | Sadbhav-51%, PBA-49% | | | | — |
| Nagpur-Seoni | Sadbhav-51%, SREI-49% | | | | — |
| Maharashtra Border- Dhule | Sadbhav-20%, HCC Laing-80% | 285 | 570 | — | 950 |
| Maharashtra border check post | Sadbhav-90%, SREI-10% | 770 | 770 | 1,026 | 2,565 |
| Hyderabad-Yadgiri | Sadbhav-60%, GKC-40% | 180 | 180 | 240 | 600 |
| Rohtak-Panipat | Sadbhav-100% | 825 | 825 | 1,100 | 2,750 |
| Bijapur - Hungund | Sadbhav-77%, MCL-23% | 330 | 330 | 440 | 1,100 |
| Total | | 2,390 | 2,675 | 2,806 | 7,965 |
| Sources of equity | | | | | |
| FCF from construction | | 1,583 | 630 | 725 | 2,938 |
| Ahmedabad Ring Road | | (54) | (38) | (8) | (101) |
| Total of operating sources | | 1,529 | 592 | 716 | 2,838 |
| Equity deficit | | 860 | 2,083 | 2,090 | 5,032 |
| From SIPL divestment | | | | | 4,000 |
| Remaining equity to be financed | | | | | 1,032 |

Source: Company, Kotak Institutional Equities estimates

Ahead of schedule in several under-construction projects

The management cited that they are well ahead of scheduled in most of the projects under construction. The management also expects to complete the Hyderabad-Yadgiri and Rohtak-Panipat project at least six months ahead of schedule.

Sadbhav currently has nine BOT projects in its portfolio of which three are operational and six are under construction. The company has completed the financial closure and received appointed date for all its projects (recently received appointed date for Rohtak-Panipat project in Apr-11). The financial closure of its projects allows the company to start execution as well as facilitates the company to bid for further projects.

Ahead of schedule in several under-construction projects

Details of BOT projects of Sadbhav Engineering

| | Cost Invested so far (Rs mn) | Cost Invested so far (Rs mn) | Length (km) | App. date | CoD | Status |
|------------------------|---------------------------------|---------------------------------|----------------|--------------|--------|---|
| Ahmedabad Ring Road | 4,571 | 4,571 | 76 | Operational | | FY2011 toll collections of Rs634 mn (22% yoy growth) |
| Aurangabad-Jalna | 2,770 | 2,770 | 69 | Operational | | FY2011 toll collections of Rs237 mn |
| Mumbai Nasik | 7,020 | 7,020 | 100 | Operational | | Expects to receive partial CoD soon |
| Nagpur-Seoni (Annuity) | 4,890 | 2,929 | 56 | | | Project is under suspension and matter is subjudice |
| Mah Border- Dhule | 14,200 | 9,490 | 97 | Dec-09 | Jun-12 | Almost 60% of physical work completed; has recognized 49% work so far |
| Mah border check post | 14,300 | 4,754 | NA | | | Has received possession of 12 locations; expect to complete 8 by Mar-2012 |
| Rohtak-Panipat | 13,500 | 1,491 | 80 | Apr-11 | Oct-13 | No revenues booked (even though executed some of the work) |
| Hyderabad-Yadgiri | 4,800 | 2,330 | 35 | Jul-10 | May-12 | 45% of work already completed |
| Bijapur - Hungund | 12,250 | 7,901 | 100 | Sep-10 | Mar-13 | About 45-50% work completed |
| Total | 78,301 | 43,256 | 613 | | | |

Source: Company, Kotak Institutional Equities

Our SOTP valuation for Sadbhav is Rs185/share

| Business | Value (Rs mn) | Stake (%) | Per share (Rs) | Comments |
|------------------------------------|--------------------------|----------------------|---------------------------|--|
| Construction business (a) | 13,549 | 100 | 90 | 5X FY2013E EBITDA for construction business |
| BOT projects (b) | 16,402 | 78 | 85 | FY2012E-based DCF valuation of projects |
| Cash coming in from pvt. equity | 4,000 | | | |
| Existing portfolio of BOT projects | 10,152 | | | |
| Ahmedabad Ring Road | 3,125 | | | |
| Mumbai Nasik | 175 | | | |
| Aurangabad-Jalna | 347 | | | |
| Nagpur-Seoni | 136 | | | |
| Dhule | 1,068 | | | |
| MBCPNL | 1,512 | | | |
| Rohtak-Panipat | 1,537 | | | |
| Hyderabad-Yadgiri | 780 | | | |
| Bijapur-Hungund | 1,472 | | | |
| Value of incremental projects | 2,250 | | | |
| Total (a) + (b) | 29,951 | | 176 | |
| Target price | | | 180 | |

Source: Company, Kotak Institutional Equities, Kotak Institutional Equities estimates

Financials of Sadbhav Engg (standalone), March fiscal year-ends, 2006-13E (Rs mn)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E |
|-------------------------------------|--------------|----------------|---------------|----------------|---------------|----------------|----------------|
| Profit model | | | | | | | |
| Total income | 4,886 | 8,721 | 10,625 | 12,569 | 22,092 | 28,823 | 32,413 |
| Expenses | (4,307) | (7,749) | (9,530) | (11,198) | (19,832) | (25,853) | (29,080) |
| EBITDA | 579 | 972 | 1,095 | 1,371 | 2,260 | 2,970 | 3,333 |
| Interest (expense)/income | (54) | (157) | (214) | (331) | (427) | (480) | (556) |
| Depreciation | (149) | (139) | (157) | (233) | (269) | (308) | (364) |
| Other income | 6 | 30 | 108 | 158 | 195 | 195 | 215 |
| Pretax profits | 381 | 706 | 832 | 966 | 1,760 | 2,377 | 2,628 |
| Tax | (129) | (221) | (179) | (297) | (576) | (761) | (841) |
| Adjusted net income | 263 | 489 | 639 | 642 | 1,163 | 1,616 | 1,787 |
| EPS (Rs) | 2.4 | 4.1 | 5.1 | 5.1 | 7.8 | 10.8 | 11.9 |
| Balance sheet | | | | | | | |
| Total equity | 1,466 | 2,861 | 3,435 | 3,915 | 6,257 | 7,768 | 9,450 |
| Deferred taxation liability | 93 | 97 | 110 | 141 | 161 | 161 | 161 |
| Total borrowings | 730 | 1,503 | 2,111 | 4,242 | 3,961 | 4,802 | 5,302 |
| Total liabilities and equity | 2,290 | 4,461 | 5,656 | 8,298 | 10,379 | 12,731 | 14,913 |
| Net fixed assets | 1,119 | 1,430 | 1,545 | 2,101 | 2,298 | 2,639 | 3,075 |
| Investments | 461 | 1,205 | 1,246 | 1,441 | 3,264 | 4,764 | 5,764 |
| Net current assets (excl. cash) | 433 | 1,706 | 2,756 | 4,308 | 3,971 | 4,895 | 5,682 |
| Cash | 251 | 103 | 100 | 448 | 846 | 433 | 391 |
| Total assets | 2,290 | 4,461 | 5,656 | 8,298 | 10,379 | 12,731 | 14,913 |
| Free cash flow | | | | | | | |
| Cash flow from operations | 278 | (283) | 430 | 830 | 31 | 1,285 | 1,705 |
| Pre-tax income | 381 | 706 | 832 | 966 | 1,760 | 2,377 | 2,628 |
| Depreciation & amortization | 149 | 139 | 157 | 233 | 269 | 308 | 364 |
| Taxes paid | (62) | (221) | (235) | (393) | (518) | (761) | (841) |
| Interest expense | 54 | 121 | 128 | 238 | 284 | 482 | 556 |
| Working capital changes | (260) | (1,095) | (464) | (218) | (1,774) | (924) | (787) |
| Cash flow from investing | (588) | (1,397) | (854) | (2,316) | (271) | (2,150) | (1,800) |
| Capital investment | (232) | (451) | (278) | (770) | (479) | (650) | (800) |
| Investment changes | (356) | (946) | (576) | (1,546) | 208 | (1,500) | (1,000) |
| Free cash flow | (310) | (1,680) | (424) | (1,486) | (240) | (865) | (95) |
| Ratios | | | | | | | |
| EBITDA margin (%) | 11.8 | 11.1 | 10.3 | 10.9 | 10.2 | 10.3 | 10.3 |
| PAT margin (%) | 5.4 | 5.6 | 6.0 | 5.1 | 5.3 | 5.6 | 5.5 |
| Debt/equity (X) | 46.8 | 50.8 | 59.6 | 104.6 | 61.7 | 60.6 | 55.2 |
| Net debt/equity (X) | 30.7 | 47.4 | 56.7 | 93.5 | 48.5 | 55.1 | 51.1 |
| RoAE (%) | 16.8 | 16.5 | 18.0 | 15.8 | 18.1 | 20.4 | 18.6 |
| RoACE (%) | (349.7) | 36.2 | 17.7 | 14.2 | 46.2 | 51.7 | 29.5 |

Source: Company, Kotak Institutional Equities estimates

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RESULT

Coverage view: **Attractive**

Price (Rs): **139**

Target price (Rs): **145**

BSE-30: **16,939**

Margin remains a concern. Polaris reported a quarter of strong revenue growth led by pass-through revenues from its products business. Upward revision in FY2012E revenue guidance and good traction in the products space are positives, but the underlying structural deficiencies keep us cautious on the stock. We raise our FY2012E/2013E EPS estimates to Rs20.3/20.8, driven by revised currency and US\$ revenue growth assumptions, and target price to Rs145 (from Rs130 earlier). Retain REDUCE.

Company data and valuation summary

Polaris Software Lab

Stock data

| | |
|-------------------------------|---------|
| 52-week range (Rs) (high,low) | 214-115 |
| Market Cap. (Rs bn) | 13.9 |

Shareholding pattern (%)

| | |
|-----------|------|
| Promoters | 29.0 |
| FIs | 25.8 |
| MFs | 10.5 |

Price performance (%)

| | 1M | 3M | 12M |
|----------------|-----|--------|--------|
| Absolute | 9.2 | (22.3) | (19.2) |
| Rel. to BSE-30 | 4.2 | (14.1) | (3.8) |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|------|-------|-------|
| EPS (Rs) | 19.3 | 20.3 | 20.8 |
| EPS growth (%) | 25.7 | 5.0 | 2.8 |
| P/E (X) | 7.2 | 6.9 | 6.7 |
| Sales (Rs bn) | 15.9 | 20.6 | 22.4 |
| Net profits (Rs bn) | 1.9 | 2.0 | 2.1 |
| EBITDA (Rs bn) | 2.1 | 2.7 | 2.8 |
| EV/EBITDA (X) | 4.1 | 3.0 | 2.5 |
| ROE (%) | 20.2 | 18.0 | 16.0 |
| Div. Yield (%) | 2.7 | 2.8 | 3.0 |

Another quarter of good revenue performance and margin disappointment

The key highlights of Polaris' 2QFY12 were its surprisingly strong 10.6% sequential US\$ revenue growth to US\$111.3 mn (6.2% above our estimates) and an equally disappointing miss at the EBITDA level, which came in 6.3% below our estimate. Revenue growth was led by substantial system integration component in one of the company's recently won products deals (presumably the RBI one). The company has raised its FY2012E US\$ revenue growth guidance to US\$440-450 mn and EPS guidance to Rs22.7-23.5. We note that FY2012E EPS guidance builds in substantial forex gains and gains from real estate asset sale.

Margin weakness – a structural issue

Polaris' EBITDA margin contracted 70 bps to 12.2% from 12.9% in 1QFY12. This decline came as a disappointment in a quarter with multiple margin aids in the form of Rupee depreciation, completion of wage hike cycles, increase in the extent of offshoring and good traction from the high margin products business. More telling is the fact that the 5.7% US\$ revenue growth CQGR in the nine quarters post June 2009 has resulted in a mere 1.3% Re EBITDA CQGR. This substantiates our belief that Polaris' margin challenges are structural – services business has very few operational margin levers, while small deal sizes and increasing SI component continue to dampen products business margins. We see few levers to improve (ex-currency) margins, with utilization still high at 80% and limited headroom on the SG&A and offshoring front.

Raise EPS estimates; retain REDUCE

While the company has revised its EPS guidance upwards, we note that it includes a substantial kicker from asset monetization. Inherent volatility in the products business, macro concerns and low confidence on margin trajectory keep us negative on the stock. However, driven by our revised currency and US\$ revenue growth assumptions, we raise our EPS estimates for FY2012E/13E to Rs20.3/20.8, respectively. We value the stock at 7X FY2013E earnings multiple to arrive at a target price of Rs145 (increased from Rs130 earlier); retain REDUCE. Rupee staying at depreciated levels poses upside risk to our estimates and might provide short-term upside to the stock as well.

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Earnings call highlights

- ▶ The management attributed the sharp increase in receivables collection cycle in recent quarters (to 57 in 2QFY12 from a low of 44 in 3QFY11) to change in commercial terms with a few large clients. The company indicated that it had started offering clients a 1-2% cash discount for paying early; it has now done away with such discounts and the credit period has hence expanded.
- ▶ 2QFY12 earnings included kickers from forex gain of Rs134 mn and asset sale gain of Rs40 mn. Polaris' 1HFY12 earnings include forex gain of Rs194 mn and asset sale gain of Rs60 mn. Adjusted EPS for 1HFY12 works out to Rs7.9/share as against Rs9.9 reported.
- ▶ Net cash at end-September 2011 stood at Rs3.07 bn. Exhibit 3 depicts the company's net cash trajectory for the past 12 quarters.

Exhibit 1: Key changes to estimates, FY2012E-13E

| | Revised | | Earlier | | Change (%) | |
|--------------------------|-------------|-------------|-------------|-------------|------------|-------------|
| | FY2012E | FY2013E | FY2012E | FY2013E | FY2012E | FY2013E |
| Revenues (US\$ mn) | 444 | 491 | 430 | 473 | 3.2 | 3.8 |
| Revenues (Rs mn) | 20,641 | 22,413 | 19,258 | 21,598 | 7.2 | 3.8 |
| Revenue growth, US\$ (%) | 27.6 | 10.6 | 23.6 | 10.0 | | |
| EBITDA (Rs mn) | 2,705 | 2,844 | 2,454 | 2,530 | 10.2 | 12.4 |
| EBIT (Rs mn) | 2,269 | 2,342 | 2,056 | 2,072 | 10.4 | 13.0 |
| Net profit (Rs mn) | 2,022 | 2,078 | 1,876 | 1,890 | 7.7 | 10.0 |
| EPS (Rs) | 20.3 | 20.8 | 18.8 | 19.0 | 7.7 | 10.0 |
| EBITDA margin (%) | 13.1 | 12.7 | 12.7 | 11.7 | | |
| EBIT margin (%) | 11.0 | 10.4 | 10.7 | 9.6 | | |
| Re/US\$ rate | 46.5 | 45.6 | 44.7 | 45.6 | 3.8 | (0.0) |

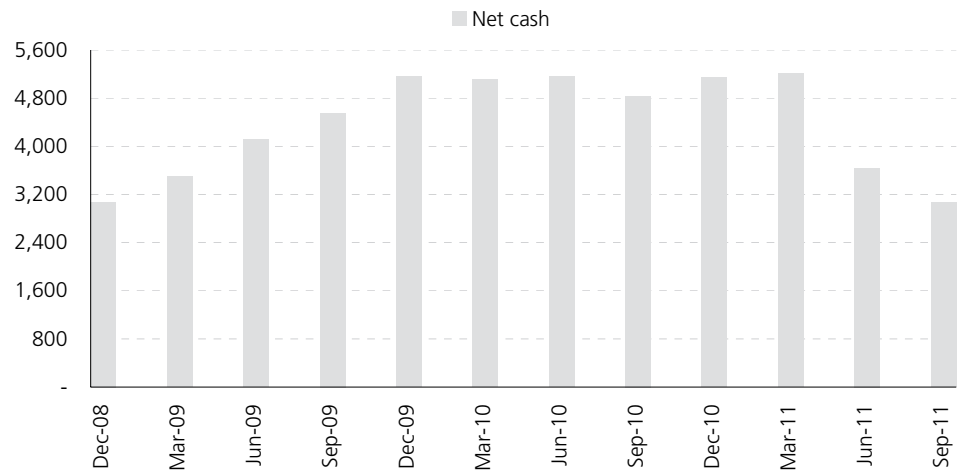
Source: Kotak Institutional Equities estimates

Exhibit 2: Polaris Software Interim Results - 2QFY12 (Rs mn)

| | 2QFY11 | 1QFY12 | 2QFY12 | qoq | yoy | KIE | % Deviation |
|-----------------------------|--------------|--------------|--------------|-------------|-------------|--------------|--------------|
| | | | | % chg. | % chg. | | |
| Revenues (US\$ mn) | 83.6 | 100.7 | 111.3 | 10.6 | 33.2 | 104.9 | 6.2 |
| Total Revenues | 3,883 | 4,502 | 5,097 | 13.2 | 31.3 | 4,856 | 5.0 |
| Cost of Revenues | (2,551) | (3,085) | (3,605) | 16.8 | 41.3 | (3,298) | 9.3 |
| Gross Profit | 1,332 | 1,417 | 1,493 | 5.4 | 12.0 | 1,557 | (4.1) |
| SG&A Expenses | (726) | (838) | (871) | 4.0 | 20.0 | (894) | (2.5) |
| EBITDA | 606 | 579 | 622 | 7.4 | 2.5 | 664 | (6.3) |
| Other income | 50 | 116 | 223 | 91.7 | 346.7 | 100 | 121.9 |
| Interest expense | (3) | (5) | (6) | | | (5) | |
| EBDT | 654 | 691 | 839 | 21.4 | 28.3 | 759 | 10.4 |
| Depreciation | (84) | (96) | (112) | 16.9 | 32.7 | (98) | 14.5 |
| Minority interest | | | 1 | | | | |
| Pretax profits | 569 | 595 | 728 | 22.4 | 27.9 | 662 | 10.0 |
| Provision for Tax | (90) | (169) | (188) | 11.4 | 109.6 | (167) | 12.8 |
| Net Profit | 479 | 426 | 539 | 26.7 | 12.5 | 495 | 9.0 |
| Extraordinaries | 2 | 20 | | | | 100 | |
| Net Profit reported | 482 | 446 | 539 | 21.0 | 12.0 | 595 | (9.3) |
| EPS - recurring (Rs) | 4.8 | 4.3 | 5.4 | 26.7 | 12.5 | 5.0 | |
| Margins (%) | | | | | | | |
| Gross margin | 34.3 | 31.5 | 29.3 | | | 32.1 | |
| SG&A expenses | 18.7 | 18.6 | 17.1 | | | 18.4 | |
| EBITDA margin | 15.6 | 12.9 | 12.2 | | | 13.7 | |
| EBIT margin | 13.4 | 10.7 | 10.0 | | | 11.7 | |
| Net profit margin | 12.4 | 9.9 | 10.6 | | | 12.2 | |
| Tax rate | 15.8 | 28.5 | 25.9 | | | 25.2 | |

Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Polaris' net cash position for the last 12 quarters (Rs mn)



Source: Company, Kotak Institutional Equities

Exhibit 4: Condensed consolidated financials for Polaris, March fiscal year-ends, 2010-2013E (Rs mn)

| | 2010 | 2011 | 2012E | 2013E |
|--------------------------------|--------------|---------------|---------------|---------------|
| Profit & Loss Model | | | | |
| Revenues | 13,538 | 15,863 | 20,641 | 22,413 |
| EBITDA | 2,220 | 2,139 | 2,705 | 2,844 |
| Depreciation | (350) | (337) | (436) | (502) |
| EBIT | 1,870 | 1,802 | 2,269 | 2,342 |
| Other Income | (73) | 494 | 473 | 493 |
| PBT | 1,788 | 2,285 | 2,720 | 2,813 |
| Tax | (255) | (359) | (699) | (735) |
| Net Profit | 1,533 | 1,926 | 2,022 | 2,078 |
| Balance Sheet (Rs mn) | | | | |
| Total Equity | 8,725 | 10,325 | 12,152 | 13,752 |
| Borrowings | 25 | 83 | 83 | 83 |
| Total capital | 8,749 | 10,408 | 12,235 | 13,834 |
| Net fixed Assets | 2,271 | 2,937 | 3,307 | 3,580 |
| Investments | 3,897 | 3,843 | 3,843 | 3,843 |
| Goodwill | 506 | 644 | 644 | 644 |
| Working Capital | 2,041 | 2,891 | 4,347 | 5,674 |
| - Cash | 1,237 | 1,423 | 2,114 | 3,175 |
| - Current Assets | 3,830 | 5,274 | 7,145 | 7,789 |
| - Current Liabilities | 3,026 | 3,805 | 4,912 | 5,290 |
| Total assets | 8,749 | 10,408 | 12,235 | 13,834 |
| Free Cash Flow (Rs mn) | | | | |
| Cash generated from operations | 2,163 | 2,085 | 2,220 | 2,139 |
| Working Capital Changes | 871 | (914) | (765) | (265) |
| Capital expenditure | (429) | (941) | (807) | (774) |
| Tax | (290) | (359) | (699) | (735) |
| Free Cash Flow | 2,315 | (129) | (50) | 364 |

Source: Company, Kotak Institutional Equities estimates

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UPDATE

Coverage view: **Cautious**

Price (Rs): **1,694**

Target price (Rs): **1,665**

BSE-30: **16,939**

Earnings growth expected to moderate. We believe Bajaj Auto is fairly valued at this juncture as we expect volume growth to moderate and competitive intensity in the two-wheeler sector to escalate which are likely to impact Bajaj Auto's EBITDA margins. We maintain our SELL rating on the stock as we believe fair valuations and limited scope of earnings surprises is likely to limit any upside in the stock price. We revise our target price to Rs1,665 (from Rs1,585).

Company data and valuation summary

Bajaj Auto

Stock data

| | |
|-------------------------------|-------------|
| 52-week range (Rs) (high,low) | 1,706-1,166 |
| Market Cap. (Rs bn) | 490.4 |

Shareholding pattern (%)

| | |
|-----------|------|
| Promoters | 50.0 |
| FIs | 15.9 |
| MFs | 2.6 |

Price performance (%)

| | 1M | 3M | 12M |
|----------------|-----|------|------|
| Absolute | 9.4 | 17.0 | 14.0 |
| Rel. to BSE-30 | 4.4 | 29.3 | 35.7 |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|-------|-------|-------|
| EPS (Rs) | 90.4 | 109.2 | 119.0 |
| EPS growth (%) | 43.9 | 20.8 | 9.0 |
| P/E (X) | 18.8 | 15.5 | 14.2 |
| Sales (Rs bn) | 160.0 | 196.3 | 223.8 |
| Net profits (Rs bn) | 26.2 | 31.6 | 34.4 |
| EBITDA (Rs bn) | 34.2 | 40.6 | 44.0 |
| EV/EBITDA (X) | 14.3 | 12.0 | 11.1 |
| ROE (%) | 84.9 | 54.1 | 44.2 |
| Div. Yield (%) | 2.4 | 2.4 | 2.4 |

Volume growth likely to moderate in FY2013E

We expect volume growth to remain strong in 2HFY12E for Bajaj Auto driven by market share improvement but expect volume growth to moderate in FY2013E due to high base effect, increase in penetration levels and slower-than-expected recovery in economic growth in FY2013E. We also expect Bajaj Auto's EBITDA margins to trend downwards as competition intensifies in both domestic and export markets. Honda and Bajaj Auto are going to launch cheaper 100-125cc bikes in FY2013E to challenge Hero Motocorp's dominance in the lower-end motorcycle segment while Honda has launched a 125cc bike in Africa at Rs31,000.

Company plans to focus on exports to boost volumes

Rajiv Bajaj in his recent interaction with investors highlighted that Bajaj Auto plans to focus on increasing market share in export markets where the company has a strong footprint and then focus on entering new markets like Brazil. We believe as both Hero Motocorp and Honda plan to challenge Bajaj Auto in his dominant export markets, profitability of Bajaj Auto in the export markets are likely to come down.

We revise our earnings upwards to factor in 2Q miss and Rupee depreciation

We have increased our earnings estimates to Rs109.2 and Rs119.0 from Rs103.9 and Rs114.1 for FY2012/2013E, respectively driven by 60-100 bps increase in our EBITDA margin assumptions. Our revision in earnings estimates factors in recent price increases taken by the company in domestic and export markets and depreciation of Rupee versus Dollar.

We have increased our target price to Rs1,665 (from Rs1,585 earlier) primarily based on our earnings revisions. Our target price is based on 14X multiple on FY2013E EPS estimate.

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Conference call takeaways

We attended the conference call hosted by Bajaj Auto management on 2QFY12 results performance. Key takeaways are as follows:

- ▶ Company maintained its guidance of achieving 4.5 mn unit of volumes in FY2012E of which export volumes are likely to touch 1.5 mn units. Company expects domestic motorcycle industry volume growth to moderate to 13-14% yoy due to high base effect. We estimate Bajaj Auto's volumes to grow by 21% yoy in 2HFY12E driven by strong growth in exports and gain in market share in the domestic motorcycle industry.
- ▶ Company indicated that due to high inflation customers have been shifting towards lower priced and more fuel efficient bikes. We expect domestic premium motorcycle segment to grow in single digits in 2HFY12E as we expect this trend to continue.
- ▶ Management indicated that company benefitted from sharp depreciation of Rupee versus Dollar in 2QFY12E and its average Rs/USD rate for 2QFY12 was 47.8 versus 47.0 in 1QFY12 which led to EBITDA margin improvement. Company has hedged its export exposures for FY2012E and FY2013E through a range forward contract. Company has hedged FY2012E exports between Rs 47-50/ US\$ and FY2013E exports at Rs47-52/US\$. We expect EBITDA margins to improve further in 3QFY12E as benefits of sharp depreciation of rupee accrue to the company.
- ▶ Company has also increased prices by 1.25% in the domestic market and by 3.5% in the export markets from October 1, 2011. Government had discontinued the DEPB scheme from October 1, 2011 and instead introduced a modified duty drawback scheme. Under the new scheme, Bajaj Auto will receive 5.5% of export revenues as incentives versus 9% earlier. In addition to this Bajaj also receives 3% of export revenues under the focus market scheme. Bajaj Auto has increased export prices to offset the impact due to reduction in export incentives. We believe export profitability will be under pressure in FY2013E as Honda ramps up its distribution network in Africa and challenges Bajaj Auto.
- ▶ Company will launch new Pulsar range in Feb 2012, Kawasaki bike in 4QFY12E and a new economy segment motorcycle in FY2013E.
- ▶ Company indicated that material costs are stable and unlikely to come down in 2HFY12E. Conversion cost of vendors is expected to increase as their fixed costs are going up.
- ▶ Company's tax rate will rise from 27% to 29% in FY2013E as income tax benefit at Pantnagar plant reduces from 100% exemption on profits to 30% exemption on profits made at Pantnagar plant.

We maintain our SELL rating on the stock with a revised target price of Rs 1,665 (from 1,585 earlier) as we increase our earnings estimates by 4-5% to factor in Rupee depreciation against Dollar and recent increase in prices taken in both domestic and export markets. Our economics forecasts Rs/US\$ rate of 49.75 for FY2013E. Our target price is based on 14X FY2013E EPS.

We revise our earnings forecast upwards to factor in benefit of INR depreciation and price increase in exports

Earnings revision table, March fiscal year-ends, 2012-2013E (Rs mn)

| | New estimates | | Old estimates | | % change | |
|----------------------------|---------------|---------------|---------------|---------------|------------|------------|
| | 2012E | 2013E | 2012E | 2013E | 2012E | 2013E |
| Volumes (units) | 4,526,832 | 5,090,705 | 4,470,672 | 5,060,065 | 1.3 | 0.6 |
| Average net realization | 45,169 | 45,564 | 43,945 | 44,321 | 2.8 | 2.8 |
| Net sales | 204,473 | 231,951 | 196,462 | 224,265 | 4.1 | 3.4 |
| EBITDA | 40,612 | 43,992 | 37,993 | 40,324 | 6.9 | 9.1 |
| EBITDA margin (%) | 19.9 | 19.0 | 19.3 | 18.0 | | |
| Adjusted net profit | 31,591 | 34,427 | 30,079 | 33,029 | 5.0 | 4.2 |
| EPS | 109.2 | 119.0 | 103.9 | 114.1 | 5.0 | 4.2 |

Source: Company, Kotak Institutional Equities estimates

Key reasons for our SELL rating

- ▶ We expect Bajaj Auto's EBITDA margins to trend downwards as competition increases in both domestic and export markets. Honda and Bajaj Auto are going to launch cheaper 100-125cc bikes in FY2013E to challenge Hero Motocorp's dominance in the lower end motorcycle segment while Honda has launched a 125cc bike in Africa at Rs31,000.
- ▶ We also expect Bajaj Auto's strategy to improve market share in the domestic motorcycle market could be margin dilutive as it challenges dominance of Hero Motocorp in the lower-end motorcycle segment.
- ▶ We also believe that stock is fairly valued at this juncture.

We forecast earnings to increase at 15% CAGR over FY2011-2013E

Bajaj Auto profit and loss, balance sheet and cash flow model, March fiscal year-ends, 2009-2014E (Rs mn)

| | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---------------|---------------|---------------|----------------|----------------|----------------|
| Profit model (Rs mn) | | | | | | |
| Net sales | 88,280 | 119,459 | 166,408 | 204,473 | 231,951 | 265,314 |
| EBITDA | 12,097 | 26,175 | 34,168 | 40,612 | 43,992 | 50,300 |
| Other income | 1,043 | 976 | 3,339 | 4,152 | 6,092 | 7,802 |
| Interest | (210) | (60) | (17) | - | - | - |
| Depreciation | (1,298) | (1,365) | (1,228) | (1,489) | (1,595) | (1,681) |
| Profit before tax | 11,632 | 25,726 | 36,262 | 43,275 | 48,489 | 56,421 |
| Extra-ordinary items | (2,071) | (1,624) | 7,246 | - | - | - |
| Taxes | (3,016) | (7,075) | (10,110) | (11,684) | (14,062) | (16,362) |
| Net profit | 6,545 | 17,027 | 33,398 | 31,591 | 34,427 | 40,059 |
| Adjusted net profit | 7,963 | 18,171 | 26,152 | 31,591 | 34,427 | 40,059 |
| Adjusted earnings per share (Rs) | 27.5 | 62.8 | 90.4 | 109.2 | 119.0 | 138.4 |
| Balance sheet (Rs mn) | | | | | | |
| Equity | 18,697 | 29,283 | 49,102 | 67,150 | 88,034 | 114,549 |
| Deferred tax liability | 42 | 17 | 297 | 297 | 297 | 297 |
| Total borrowings | 15,700 | 13,386 | 3,252 | 3,146 | 3,146 | 3,146 |
| Current liabilities | 24,376 | 28,579 | 39,553 | 45,911 | 49,691 | 54,023 |
| Total liabilities | 58,814 | 71,265 | 92,204 | 116,504 | 141,168 | 172,015 |
| Net fixed assets | 15,481 | 15,211 | 15,483 | 16,244 | 17,399 | 17,967 |
| Investments | 18,085 | 40,215 | 47,952 | 65,702 | 83,702 | 101,702 |
| Cash | 1,369 | 1,014 | 5,565 | 4,360 | 7,290 | 16,565 |
| Other current assets | 21,884 | 14,824 | 23,161 | 30,156 | 32,735 | 35,738 |
| Miscellaneous expenditure | 1,996 | - | 43 | 43 | 43 | 43 |
| Total assets | 58,814 | 71,265 | 92,204 | 116,504 | 141,168 | 172,015 |
| Free cash flow (Rs mn) | | | | | | |
| Operating cash flow excl. working capital | 8,870 | 18,874 | 24,352 | 24,946 | 27,834 | 32,546 |
| Working capital changes | (4,744) | 8,498 | (4,215) | (636) | 1,201 | 1,328 |
| Capital expenditure | (3,861) | (1,078) | (1,614) | (2,250) | (2,750) | (2,250) |
| Free cash flow | 265 | 26,293 | 18,523 | 22,060 | 26,285 | 31,624 |
| Ratios | | | | | | |
| EBITDA margin (%) | 13.7 | 21.9 | 20.5 | 19.9 | 19.0 | 19.0 |
| PAT margin (%) | 9.0 | 15.2 | 15.7 | 15.4 | 14.8 | 15.1 |
| Debt/equity (X) | 0.8 | 0.5 | 0.1 | 0.0 | 0.0 | 0.0 |
| Net debt/equity (X) | 0.8 | 0.4 | (0.0) | (0.0) | (0.0) | (0.1) |
| Book Value (Rs/share) | 64.6 | 101.2 | 169.7 | 232.0 | 304.2 | 395.8 |
| RoAE (%) | 37.7 | 70.9 | 84.9 | 54.1 | 44.2 | 39.4 |
| RoACE (%) | 18.7 | 42.5 | 64.7 | 46.3 | 37.1 | 33.0 |

Source: Company, Kotak Institutional Equities estimates

OCTOBER 24, 2011

UPDATE

Coverage view: **Cautious**

Price (Rs): **115**

Target price (Rs): **100**

BSE-30: **16,939**

Pricing power remains under pressure. Exide's pricing power in the 4-wheeler replacement segment continues to remain under pressure as the company lost market share in 2QFY12 despite reducing prices by 10-12% in September 2011. Company's 4-wheeler replacement volumes declined by 6% yoy while its competitors indicated that their replacement volumes grew by low single digits in 2QFY12. We maintain SELL rating on the stock and revise our target price to Rs100 (from Rs115 earlier).

Company data and valuation summary

Exide Industries

Stock data

52-week range (Rs) (high,low) 188-110

Market Cap. (Rs bn) 97.5

Shareholding pattern (%)

Promoters 46.0

FIs 16.1

MFs 4.2

Price performance (%)

| | 1M | 3M | 12M |
|----------------|--------|--------|--------|
| Absolute | (12.4) | (23.3) | (26.7) |
| Rel. to BSE-30 | (16.4) | (15.3) | (12.8) |

Forecasts/Valuations

| | 2011 | 2012E | 2013E |
|---------------------|------|--------|-------|
| EPS (Rs) | 7.5 | 4.5 | 6.1 |
| EPS growth (%) | 18.0 | (39.5) | 35.6 |
| P/E (X) | 15.4 | 25.4 | 18.7 |
| Sales (Rs bn) | 45.5 | 47.0 | 53.8 |
| Net profits (Rs bn) | 6.3 | 3.8 | 5.2 |
| EBITDA (Rs bn) | 8.8 | 5.7 | 7.5 |
| EV/EBITDA (X) | 11.1 | 17.0 | 12.9 |
| ROE (%) | 25.5 | 13.4 | 16.3 |
| Div. Yield (%) | 1.3 | 1.1 | 1.1 |

We believe Exide's peak margins are unlikely to revert

We believe Exide's peak EBITDA margins of 20-22% are unlikely to revert despite factoring in increase in smelter contribution over the next few years due to the following reasons – (1) Exide now enjoys only 8-9% premium over Amara Raja (which was earlier 15-20%) and is losing market share as there is no difference in performance of both batteries, (2) both players have increased capacities which will put pressure on pricing, (3) new players like Southern batteries and Base batteries are setting up large automotive battery capacities which could further escalate competition but this is not a near-term threat but more longer term threat in our view and (4) Exide may also have to take further pricing actions if its competitors cut prices, since lead prices have declined, to hold on to its market share.

Replacement battery demand for 4-wheelers likely to come back

We agree with the management that replacement battery demand is likely to grow at steady 12-15% over the next few years and this slowdown in demand could continue only for a few quarters as customer sentiment is weak but customers cannot delay battery replacement by more than 4 years, in our view. However, we believe Exide's volume growth will come at lower EBITDA margins as company will not be able to increase prices ahead of its competitors again in the battery market.

We revise our earnings downwards by 23-34% over FY2012-2013E

We have reduced our earnings estimates to Rs4.5/6.1 from Rs6.8/7.9 in FY2012 and FY2013E, respectively as we factor in slowdown in 4-wheeler replacement volumes and decline in inverter battery demand. We have also cut our EBITDA margin estimates by 2.4-4.3% as we factor in reduced pricing power of Exide.

We maintain our SELL rating on the stock and reduce our target price to Rs100 (from Rs115 earlier). Our target price is based on sum-of-the-parts valuation methodology. We value standalone business at Rs86/share and 50% stake in insurance business at Rs12/share.

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Pricing power impacted while market share losses continue

We maintain our SELL rating on the stock and revise our earnings downwards by 23-34% over FY2012-2013E, respectively as we believe pricing power of Exide has been impacted while company is also losing market share as pricing still remains at a premium to its competitors. We believe battery replacement demand will recover in FY2013-2014E but expect Exide to lose market share as it is still sells its automotive batteries at 8-9% premium to Amararaja and we expect Exide's ability to price its batteries at 15-20% premium has been significantly impacted.

We see following structural issues with Exide which are likely to lead to lower profitability for the company

- ▶ Exide has been losing market share to competitors over the last one year as it has been selling its batteries at a significant premium to its competitors and competitors like Amararaja started offering higher warranties on their batteries. We believe Exide will continue to lose market share in the automotive battery segment till it continues to sell its batteries at a premium to competitors as customers realize there is no significant difference in quality between Amaron and Exide.
- ▶ We do believe replacement demand for battery will recover in FY2013E but believe competitors could cut prices to gain market share further as lead prices have come off quite sharply. Exide will also have to follow as its capacity utilization levels have declined to 75% in 2QFY12 from 92% in 1QFY12. Both Exide and Amararaja have increased capacities significantly in both 4-wheeler and 2-wheeler battery segment which are likely to put pressure on pricing which is quite evident over the last one year.
- ▶ We expect competition in the automotive battery segment to intensify over the next few years. Two south based industrial battery manufactures (Southern batteries and Base batteries) have already announced to set up Rs 1.8 and Rs 4.3 bn of capacities over the next couple of years.
- ▶ Over the longer term we expect inverter battery business (which forms 13% of Exide's revenues) to decline significantly as power situation improves in the country. However we could see a spurt in demand in the near term due to shortage of power in the country. We believe Exide's ability to charge a premium in the inverter segment is also waning as it has been forced to cut inverter battery prices by 15% as its competitors Luminous, Sukam and Microtec cut inverter battery prices by 15% in March and Exide followed in August 2011.

Hence we believe Exide will not be able to revert back to its historical peak margins and are likely to grow volumes at lower margins.

Conference call takeaways

We attended the conference call hosted by management on 2QFY12 results. Key takeaways are as follows:

- ▶ **4-wheeler replacement demand impacted by market share loss.** Exide indicated that their 4 wheeler OEM volumes grew by 8% yoy in 2QFY12 while 4 wheeler replacement volumes declined by 6% yoy. Our interaction with other battery manufacturers indicate that replacement demand has grown in low single digits in 2QFY12 and Exide might have lost market share. Exide continues to have 8-9% premium over Amararaja despite a 10-12% price cut done in September.
- ▶ **2-wheeler battery volumes remain robust.** 2 wheeler OEM volumes grew by 39% yoy while 2 wheeler replacement volumes grew by 14% yoy in 2QFY12.

▶ **Industrial battery volumes were impacted by decline in inverter volumes.**

Industrial battery volumes declined by 5% yoy driven by 15% yoy decline in inverter battery volumes. Company mentioned that inverter volumes have picked up in October due to power shortage and price correction but it is too early to suggest that this demand will continue.

- ▶ Company indicated that 2QFY12 EBITDA margins were impacted by high cost lead inventory as they were late to realize that replacement demand has slowed down which we find very surprising given Exide's vast distribution network and experience in the battery business. Company also indicated that there was no change in inventory valuation during the quarter and neither did lead prices at which inventory valuation was done declined during the quarter. Automotive and industrial EBITDA margins stood at 9.2% during the quarter.
- ▶ Company's EBITDA margins were also impacted by Rs148.8 mn forex loss during the quarter excluding which margins could have been around 9%. Company indicated that margins should improve to mid double digits in 3QFY12E which we believe could be difficult as full impact of price cuts will be visible in 3QFY12E and company still has inventory of high lead cost and recent price correction of lead will be visible only in 4QFY12E.
- ▶ We believe company's pricing power has started to wane and it may no longer enjoy premium pricing in future and maintain its market share. Risks emanate from competition further reducing prices of their batteries as they benefit from lower lead prices and Exide may need to follow.
- ▶ Company plans to launch inverter in February 2012 to compete with Luminous, Sukam and Microtec which have been taking market share from Exide in the inverter business as they have been using their batteries in the inverters that they sell.
- ▶ Pune smelter made a profit of Rs12 mn while Bangalore smelter made a loss of Rs70 million in 2QFY12.

We have revised our earning estimates downwards by 23-34% over FY2012-2013E as we reduce our volume estimates on 4 wheeler replacement demand and inverter battery volumes. We have also cut our EBITDA margin estimates by 2.4-4.3%, respectively over FY2012-2013E as we believe Exide may not be able to reach its historical high margins given increase in competition in the market.

We revise our earning estimates downwards by 23-34% over FY2012-2013E
Earnings revision table, March fiscal year-ends, 2012-2013E (Rs mn)

| | New estimates | | Old estimates | | % change | |
|-----------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | 2012E | 2013E | 2012E | 2013E | 2012E | 2013E |
| Net sales | 47,032 | 53,843 | 50,262 | 56,613 | (6.4) | (4.9) |
| EBITDA | 5,708 | 7,528 | 8,094 | 9,282 | (29.5) | (18.9) |
| Margin (%) | 12.1 | 14.0 | 16.1 | 16.4 | (24.6) | (14.7) |
| Net Profit | 3,835 | 5,202 | 5,768 | 6,747 | (33.5) | (22.9) |
| Standalone EPS | 4.5 | 6.1 | 6.8 | 7.9 | (33.5) | (22.9) |

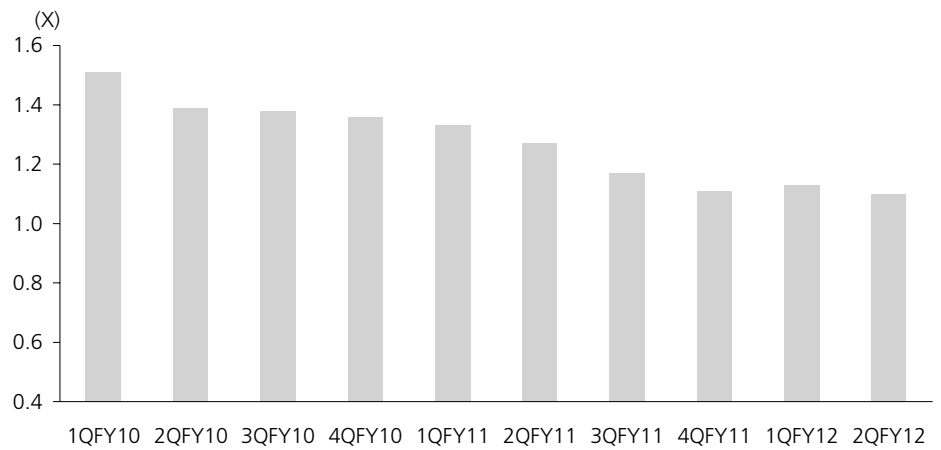
Source: Kotak Institutional Equities estimates

Exide Industries sum-of-the-parts valuation methodology
March fiscal year-ends

| | EPS (Rs) | PE (X) | Per share value |
|-----------------------------|---------------------|-------------------|------------------------|
| Standalone FY2013 EPS | 6.1 | 14 | 86 |
| ING Vysya (50% stake value) | | | 12 |
| SOTP based value | | | 98 |
| SOTP based value | | | 100 |

Source: Kotak Institutional Equities estimates

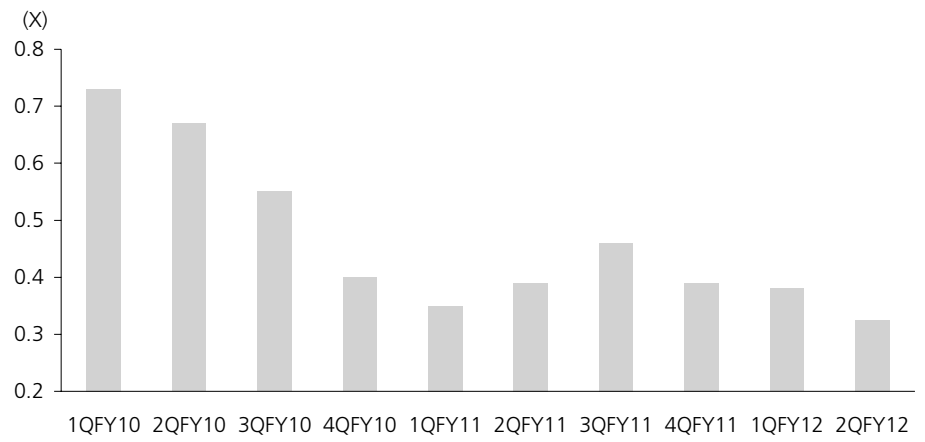
Replacement/OEM 4 wheeler volume mix continues to decline
four-wheeler volume mix, March fiscal year-ends, 1QFY10-2QFY12 (X)



Source: Company

Replacement/OEM volume mix also declined sharply

Two wheeler volume mix, March fiscal year-ends, 1QFY10-2QFY12



Source: Company

We expect Exide's automotive battery volumes to increase at a 14% CAGR over the next two years
Volume assumptions, March fiscal year-ends, 2010-2014E (units)

| | 2010 | 2011 | 2012E | 2013E | 2014E |
|--|---------------|---------------|---------------|---------------|---------------|
| 4 wheeler volumes (mn units) | | | | | |
| 4wh - OEM | 3.1 | 3.8 | 3.9 | 4.5 | 5.2 |
| YoY change (%) | | 23.7 | 3.0 | 14.0 | 15.0 |
| 4 wh - Replacement | 4.3 | 4.7 | 4.3 | 4.9 | 5.6 |
| YoY change (%) | | 8.5 | (7.1) | 11.9 | 15.0 |
| Total 4 wheeler volumes | 7.4 | 8.5 | 8.3 | 9.4 | 10.8 |
| YoY change (%) | | 14.9 | (2.6) | 12.9 | 15.0 |
| Replacement/OEM mix (X) | 1.39 | 1.22 | 1.10 | 1.08 | 1.08 |
| 2 wheeler volumes (mn units) | | | | | |
| 2wh - OEM | 5.5 | 7.8 | 10.2 | 11.7 | 13.5 |
| YoY change (%) | | 42.4 | 30.0 | 15.0 | 15.0 |
| 2 wh - Replacement | 3.2 | 3.1 | 3.8 | 4.3 | 4.9 |
| YoY change (%) | | (4.2) | 23.3 | 15.0 | 11.9 |
| Total 2 wheeler volumes | 8.7 | 10.9 | 14.0 | 16.1 | 18.3 |
| YoY change (%) | | 25.3 | 28.1 | 15.0 | 14.2 |
| Replacement/OEM mix (X) | 0.58 | 0.39 | 0.37 | 0.37 | 0.36 |
| Overall automotive volumes (mn units) | | | | | |
| Total OEM volumes | 8.6 | 11.7 | 14.1 | 16.2 | 18.7 |
| Total Replacement volumes | 7.5 | 7.7 | 8.1 | 9.2 | 10.4 |
| Total auto volumes | 16.1 | 19.4 | 22.2 | 25.4 | 29.1 |
| YoY change (%) | | 20.5 | 14.7 | 14.2 | 14.5 |
| Automotive revenues (Rs mn) | 23,650 | 29,180 | 31,790 | 37,038 | 43,246 |
| YoY change (%) | | 23.4 | 8.9 | 16.5 | 16.8 |
| Automotive ASPs (Rs/unit) | 1,469 | 1,504 | 1,429 | 1,457 | 1,487 |
| YoY chg (%) | | 2.4 | (5.0) | 2.0 | 2.0 |
| Industrial battery volumes (mn units) | | | | | |
| Industrial battery volumes | 5.7 | 4.4 | 4.2 | 4.5 | 4.9 |
| YoY change (%) | | (22.8) | (5.0) | 8.0 | 8.0 |
| Industrial revenues (Rs mn) | 13,789 | 15,996 | 14,892 | 16,405 | 18,072 |
| YoY change (%) | | 16.0 | (6.9) | 10.2 | 10.2 |
| Industrial ASPs (Rs/unit) | 2,419 | 3,635 | 3,563 | 3,634 | 3,707 |
| YoY change (%) | | 50.3 | -2.0 | 2.0 | 2.0 |
| Submarine battery revenues (Rs mn) | 500 | 360 | 350 | 400 | 450 |
| Total volumes (mn units) | 21.8 | 23.8 | 26.4 | 29.9 | 34.0 |
| YoY change (%) | | 9.2 | 11.0 | 13.2 | 13.5 |
| Net revenues (Rs mn) | 37,940 | 45,536 | 47,032 | 53,843 | 61,767 |
| YoY change (%) | | 20.0 | 3.3 | 14.5 | 14.7 |

Source: Company, Kotak Institutional Equities estimates

We forecast a 9% decline in earnings CAGR over FY2011-2013E

Exide profit and loss, balance sheet and cash flow model, March fiscal year-ends, 2009-2014E (Rs mn)

| | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---------------|---------------|---------------|----------------|---------------|---------------|
| Profit model (Rs mn) | | | | | | |
| Net sales | 33,930 | 37,940 | 45,536 | 47,032 | 53,843 | 61,767 |
| EBITDA | 5,448 | 8,894 | 8,788 | 5,708 | 7,528 | 9,101 |
| Other income | 65 | 121 | 1,038 | 694 | 964 | 1,202 |
| Interest | (479) | (103) | (57) | (31) | (34) | (9) |
| Depreciation | (679) | (807) | (835) | (969) | (1,131) | (1,232) |
| Profit before tax | 4,354 | 8,106 | 8,934 | 5,402 | 7,327 | 9,062 |
| Tax expense | (1,510) | (2,735) | (2,740) | (1,567) | (2,125) | (2,628) |
| Adjusted net profit | 2,844 | 5,371 | 6,335 | 3,835 | 5,202 | 6,434 |
| Adjusted earnings per share (Rs) | 3.6 | 6.3 | 7.5 | 4.5 | 6.1 | 7.6 |
| Balance sheet (Rs mn) | | | | | | |
| Equity | 12,504 | 22,198 | 27,425 | 29,985 | 33,912 | 39,071 |
| Total Borrowings | 3,172 | 900 | 22 | 300 | 50 | 50 |
| Deferred Tax Liability | 412 | 590 | 675 | 675 | 675 | 675 |
| Current liabilities | 4,866 | 5,929 | 7,964 | 7,450 | 8,252 | 9,186 |
| Total liabilities | 20,954 | 29,616 | 36,086 | 38,410 | 42,889 | 48,981 |
| Net fixed assets | 6,853 | 7,144 | 9,018 | 11,749 | 13,118 | 13,886 |
| Investments | 6,682 | 13,354 | 13,780 | 11,440 | 14,640 | 17,840 |
| Cash | 337 | 29 | 148 | 711 | 295 | 383 |
| Other current assets | 7,082 | 9,089 | 13,140 | 14,510 | 14,835 | 16,872 |
| Total assets | 20,954 | 29,616 | 36,086 | 38,410 | 42,889 | 48,981 |
| Free cash flow (Rs mn) | | | | | | |
| Operating cash flow | 3,456 | 6,355 | 7,115 | 4,805 | 6,333 | 7,666 |
| Working capital changes | 488 | (637) | (2,015) | (1,885) | 477 | (1,103) |
| Capital expenditure | (1,515) | (1,098) | (2,708) | (3,700) | (2,500) | (2,000) |
| Change in investments | (1,499) | (6,672) | (426) | 2,340 | (3,200) | (3,200) |
| Free cash flow | 1,804 | 3,683 | 1,209 | (1,980) | 3,110 | 3,362 |
| Ratios | | | | | | |
| EBITDA margin (%) | 16.1 | 23.4 | 19.3 | 12.1 | 14.0 | 14.7 |
| PAT margin (%) | 8.4 | 14.2 | 13.9 | 8.2 | 9.7 | 10.4 |
| Net debt/equity (X) | 0.2 | 0.0 | (0.0) | (0.0) | (0.0) | (0.0) |
| Book Value (Rs/share) | 15.6 | 26.1 | 32.3 | 35.3 | 39.9 | 46.0 |
| RoAE (%) | 25.0 | 31.0 | 25.5 | 13.4 | 16.3 | 17.6 |
| RoACE (%) | 34.3 | 38.1 | 34.9 | 20.7 | 24.5 | 25.9 |

Source: Company, Kotak Institutional Equities estimates

Market volatility due to European concerns hurts our inter-sector trades. We are closing two of our trades initiated on July 29, 2011—(1) Long AXSB, Short LT with a gross return of 12.4% and (2) Long HDFC, Short ACC which is down 19.2% since initiation. We keep the following trades open—(3) Long ITC, Short APNT currently 2% in the money and (4) Long Cadila, Short Ranbaxy which is down 10.6% since initiation.

Book profits for Long AXSB, Short LT trade at 12.4%

The trade has returned 12.4% since initiation on July 29, 2011 as LT corrected more than AXSB during the period. While AXSB has fallen ~12.6%, LT saw a sharper correction falling ~25% in the same duration. Axis Bank recorded a strong 2QFY12 as NIMs expanded by 50 bps qoq and NII grew 24% yoy. In comparison, LT saw in-line revenues and margins for 2QFY12 with EBITDA margin of 10.4% and a standalone sales growth of 21% yoy. The major worries for LT revolve around reduced order inflow guidance for FY2012E (to 5% from 15-20% earlier).

Long ITC, Short APNT—trade currently 2% in the money

We expect ITC to outperform Asian Paints (APNT) based on the following factors—(1) ITC's relatively cheaper valuations versus APNT's, (2) likely stronger performance of ITC in terms of earnings growth as strong underlying demand could assist cigarette volumes (5% in FY2012E), (3) likely slowdown in paints volumes due to high inflation and extended weakness in real estate demand and (4) pressure on APNT's FY2012E EBITDA on the back of rising input costs and competitive intensity. 2QFY11 results strengthen our view as APNT's gross margin declined 390 bps yoy to 40.8% as price increases lagged cost inflation. Domestic volume growth in the three quarters of CY2011 was 12%, 11% and 8% clearly depicting deceleration in volume growth. Comparatively, ITC's net profit of Rs15.1 bn beat Street estimates (of Rs14.7 bn) growing 21% yoy. In accordance with our view, cigarette volumes showed strong growth (~16% yoy).

Long HDFC, Short ACC—booking loss of 19.2%

We close the trade 19.2% out of the money. Contrary to our expectations, ACC outperformed the broader market (up 12.1%) while HDFC corrected (down 7%) along with the rest of the Indian financial space reflecting (1) lower global risk appetite, (2) increased competition in mortgage segment and (3) negative impact of new NHB regulations. HDFC's 2QFY11 results showed in-line performance (20% earnings growth) but loan growth declined to 19% yoy (from 22% in 1QFY11). This highlighted the risks of increased competition and slowdown in the housing sector. On the other hand, cement prices continue to hold up despite large supply-demand balance possibly due to coordinated supply management by cement players.

OCTOBER 25, 2011

UPDATE

BSE-30: 16,939

QUICK NUMBERS

- Booking profits in AXSB-LT at 12.4%
- Booking loss in HDFC-ACC at 19.2%

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KIE Alpha Bet trades

Statistics of trades, current price, initiation price, expected return

| | Stock | Current price (Rs) | Initiation price (Rs) | Return (%) |
|--|-------------------------------|-----------------------|--------------------------|---------------|
| Open trades | | | | |
| Trade duration July 29, 2011 - | | | | |
| Buy | ITC | 207 | 208 | (0.7) |
| Sell | Asian Paints | 3,050 | 3,134 | (2.7) |
| Current return (%) | | | | 2.0 |
| Expected return (%) | | | | 10.0 |
| Trade duration June 9, 2011 - | | | | |
| Buy | Cadila Healthcare | 756 | 907 | (16.6) |
| Sell | Ranbaxy Laboratories | 505 | 538 | (6.1) |
| Current return (%) | | | | (10.6) |
| Expected return (%) | | | | 8.0 |
| Closed trades | | | | |
| Trade duration July 29, 2011 - October 24, 2011 | | | | |
| Buy | Axis Bank | 1,169 | 1,338 | (12.6) |
| Sell | Larsen & Toubro | 1,294 | 1,726 | (25.0) |
| Total trade return (%) | | | | 12.4 |
| Expected return (%) | | | | 10.0 |
| Trade duration July 29, 2011 - October 24, 2011 | | | | |
| Buy | HDFC | 641 | 689 | (7.0) |
| Sell | ACC | 1,134 | 1,012 | 12.1 |
| Total trade return (%) | | | | (19.2) |
| Expected return (%) | | | | 10.0 |
| Trade duration March 9, 2011 - March 30, 2011 | | | | |
| Buy | Punjab National Bank | 1,218 | 1,076 | 13.2 |
| Sell | Bank of India | 479 | 470 | 1.9 |
| Total trade return (%) | | | | 11.3 |
| Expected return (%) | | | | 10.0 |
| Trade duration March 9, 2011 - May 4, 2011 | | | | |
| Buy | Oil & Natural Gas Corporation | 310 | 271 | 14.1 |
| Sell | GAIL (India) | 447 | 441 | 1.2 |
| Total trade return (%) | | | | 12.9 |
| Expected return (%) | | | | 10.0 |
| Trade duration March 9, 2011 - May 17, 2011 | | | | |
| Buy | HDFC Bank | 2,252 | 2,206 | 2.1 |
| Sell | HDFC | 632 | 673 | (6.1) |
| Total trade return (%) | | | | 8.2 |
| Expected return (%) | | | | 8.0 |
| Trade duration April 15, 2011 - May 17, 2011 | | | | |
| Buy | Maruti Suzuki | 1,210 | 1,278 | (5.3) |
| Sell | Hero Honda | 1,803 | 1,665 | 8.3 |
| Total trade return (%) | | | | (13.6) |
| Expected return (%) | | | | 10.0 |
| Trade duration March 9, 2011 - June 8, 2011 | | | | |
| Buy | Crompton Greaves | 267 | 260 | 2.7 |
| Sell | Siemens | 878 | 857 | 2.4 |
| Total trade return (%) | | | | 0.2 |
| Expected return (%) | | | | 10.0 |
| Trade duration March 9, 2011 - June 8, 2011 | | | | |
| Buy | Ultratech Cement | 1,030 | 1,020 | 1.0 |
| Sell | ACC | 1,025 | 1,004 | 2.1 |
| Total trade return (%) | | | | (1.0) |
| Expected return (%) | | | | 8.0 |
| Trade duration June 9, 2011 - July 01, 2011 | | | | |
| Buy | LIC Housing Finance | 241 | 227 | 6.1 |
| Sell | Shriram Transport | 655 | 674 | (2.9) |
| Total trade return (%) | | | | 9.0 |
| Expected return (%) | | | | 10.0 |
| Trade duration May 17, 2011 - July 01, 2011 | | | | |
| Buy | Sterlite Industries | 170 | 168 | 1.0 |
| Sell | Hindalco Industries | 187 | 193 | (3.3) |
| Total trade return (%) | | | | 4.3 |
| Expected return (%) | | | | 10.0 |
| Trade duration June 9, 2011 - July 29, 2011 | | | | |
| Buy | Infosys Technologies | 2,767 | 2,872 | (3.6) |
| Sell | Wipro | 358 | 441 | (18.8) |
| Total trade return (%) | | | | 15.2 |
| Expected return (%) | | | | 10.0 |

Source: Kotak Institutional Equities

September 2011: Results calendar

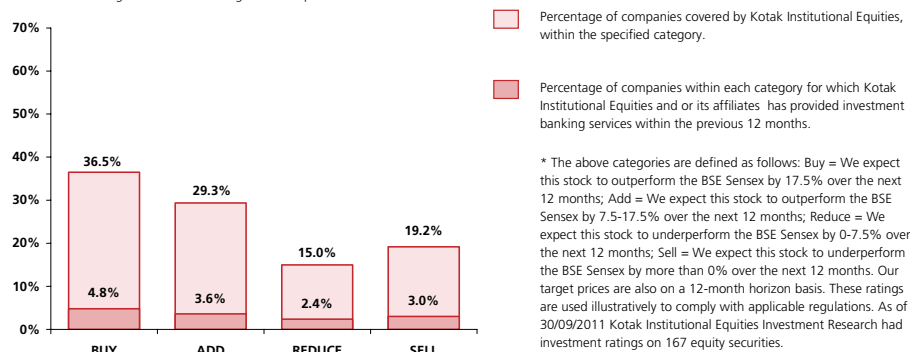
| Mon | Tue | Wed | Thu | Fri | Sat |
|----------------------|---------------------------|-----------------------|---------------------|---------------------------------|-----------------------------|
| 24-Oct | 25-Oct | 26-Oct | 27-Oct | 28-Oct | 29-Oct |
| Container Corp | Dr Reddy's Laboratories | Muthoot Finance | | BELM | Indian Overseas Bank |
| GAIL | Engineers India | | | Bharat Electronics | LIC Housing Finance |
| ITC | KEC International | | | NHPC | Maharashtra Seamless |
| JM Financial | Kotak Mahindra Bank | | | Redington India | Mahindra Holidays & Resorts |
| MMFSL | NTPC | | | Tata Global Beverages | Maruti Suzuki |
| Pfizer | Oracle Financial Services | | | | |
| Sterlite Industries | Sesa Goa | | | | |
| Tata Coffee | | | | | |
| Titan Industries | | | | | |
| Union Bank of India | | | | | |
| 31-Oct | 1-Nov | 2-Nov | 3-Nov | 4-Nov | 5-Nov |
| Bank of Baroda | ACC | Karur Vysya Bank | Ashok Leyland | Apollo Hospital Enterprises | Carborudum Universal |
| Bata India | Aditya Birla Nuvo | L&T Finance Holding | Jubilant foodworks | Bharti Airtel | Motherson Sumi |
| BPCL | Ambuja Cements | Piramal Life Sciences | SAIL | Glaxosmithkline Consumers | MTNL |
| Canara Bank | Bajaj Electricals | | SunTV Network | Glaxosmithkline Pharmaceuticals | |
| Castrol India | Central Bank of India | | TVS Motor Co. | Marico | |
| Century Textiles | Punjab National Bank | | Welspun Corp | ONGC | |
| Colgate Palmolive | | | | | |
| Corporation Bank | | | | | |
| Dabur India | | | | | |
| Dena Bank | | | | | |
| EIH | | | | | |
| Gujarat Pipavav Port | | | | | |
| Havells India | | | | | |
| Hindustan Unilever | | | | | |
| ICICI Bank | | | | | |
| Indian Bank | | | | | |
| Jammu & Kashmir Bank | | | | | |
| Karnataka Bank | | | | | |
| Punjab & Sind Bank | | | | | |
| SJVN | | | | | |
| UCO Bank | | | | | |
| United Bank of India | | | | | |
| Vijaya Bank | | | | | |
| Wipro | | | | | |
| 7-Nov | 8-Nov | 9-Nov | 10-Nov | 11-Nov | 12-Nov |
| Madras Cement | ABB | Apollo Tyres | Cadila Healthcare | Dishman Pharma | Shipping Corp of India |
| Punj Llyod | Aban Offshore | Bharat Forge | GVK Power & Infra | Jet Airways | |
| | Godrej Industries | Lupin | Hindalco Industries | JK Cement | |
| | IDFC | Power Finance Corp | VA Tech Wabag | Lanco Infratech | |
| | | Ranbaxy Laboratories | Cummins | Shree Cements | |
| | | Tata Communications | | Tata Chemicals | |
| | | Voltas | | | |
| 14-Nov | 15-Nov | 16-Nov | 17-Nov | 18-Nov | 19-Nov |
| India Cements | Tata Power | | | | |
| Mahindra & Mahindra | | | | | |
| Tata Motors | | | | | |

Source: BSE, NSE, Kotak Institutional Equities

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2011

Ratings and other definitions/identifiers

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ADD. We expect this stock to deliver 7.5-17.5% returns over the next 12 months.

REDUCE. We expect this stock to deliver 0-7.5% returns over the next 12 months.

SELL. We expect this stock to deliver less than 0% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

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