kotak® Institutional Equities

INDIA DAILY

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Contents

Results

Jindal Steel & Power: 2QFY08 result update: Stronger than expected EBITDA; we raise target price, maintain OP

BHEL: Strong results with higher than expected margins and large one-time other income

HDFC: High margins support operational profits, retain IL.

Maruti Suzuki: 2Q FY2008 results marginally ahead of our estimates; raise target price, retain OP

Mahindra & Mahindra: 2QFY2008 net profit declines 26% yoy

Punjab National Bank: PAT and NII growth below our estimate, retain OP

Pantaloon Retail: Lower than expected selling costs leads to margin expansion - Maintain Inline

HPCL: Strong 2QFY08 results due to receipt of oil bonds; 2HFY08 likely painful

Jet Airways: Losses due to international expansion and low domestic yields; Other income earns profit

Sobha Developers: 2QFY2008 revenues inline with our estimates; Margins higher than our estimates

Oriental Bank of Commerce: Profit supported by lower provisioning, while core income suffers

Jagran Prakashan: Moderately weak 2QFY08 results; maintain estimates; retain OP

J&K Bank: PAT exceeds estimate supported by non-interest income

Jyoti Structures: 2QFY08 results: Inline with estimates; maintain estimates, TP and Outperform rating

Change in recommendations

Reliance Petroleum: We already model for about two refineries; downgraded to U on explosion in stock price

Updates

Indian Overseas Bank: IOB delivers on quantity, disappoints on quality

Banks/Financial Institutions: RBI guidelines on preference shares net positive, allows significant leveraging capability to banks

Economy: RBI Mid-term Review: 25 bps rate cut possible; no CRR change likely

EQUITY MARKETS

		Change, %		
India	**29-Oct**	**1-day**	**1-mo**	**3-mo**
Sensex	19,978	3.8	15.5	30.9
Nifty	5,906	3.6	17.6	33.0
Global/Regional indices				
Dow Jones	13,870	0.5	(0.2)	3.8
Nasdaq Composite	2,817	0.5	4.3	9.1
FTSE	6,706	0.7	3.7	8.1
Nikkie	16,581	(0.7)	(1.2)	(4.1)
Hang Seng	31,640	0.2	16.6	39.1
KOSPI	2,049	(0.7)	5.3	7.5

Value traded - India

			Moving avg, Rs bn	
	29-Oct		**1-mo**	**3-mo**
Cash (NSE+BSE)	302.4		283.8	205.1
Derivatives (NSE)	714.5		570.0	657.8
Deri. open interest	972.9		739.9	726.0

Forex/money market

		Change, basis points		
	29-Oct	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.4	15	(41)	(110)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	-	(8)	(4)

Net investment (US$mn)

	26-Oct		**MTD**	**CYTD**
FIIs	(64)		4,091	17,109
MFs	181		(632)	14

Top movers -3mo basis

		Change, %		
Best performers	**29-Oct**	**1-day**	**1-mo**	**3-mo**
Reliance Energy	1,722	3.1	42.8	120.7
SAIL	277	5.2	33.6	89.0
Neyveli Lignite	135	1.8	28.6	71.4
Engineers India	813	12.0	34.2	70.8
Tata Tele	48	9.8	9.2	69.3
Worst performers				
i-Flex	1,592	0.4	(15.8)	(27.4)
Punjab Tractors	218	(1.8)	(11.5)	(18.1)
Essel Propack	53	0.9	(11.8)	(11.3)
Pfizer	693	3.6	(3.1)	(9.5)
Container Corp	2,006	(3.9)	(4.5)	(8.8)

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Metals

JNSP.BO, Rs8885	
Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	9,400
52W High -Low (Rs)	9220 - 1780
Market Cap (Rs bn)	274

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	36.8	46.6	62.8
Net Profit (Rs bn)	8.6	11.1	16.2
EPS (Rs)	280.8	361.2	526.4
EPS gth	*47.6*	*28.6*	*45.7*
P/E (x)	31.6	24.6	16.9
EV/EBITDA (x)	19.8	15.3	11.2
Div yield (%)	0.2	0.2	0.3

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	59.0	-	-
FIIs	23.3	0.4	0.0
MFs	4.7	0.4	0.1
UTI	-	-	(0.3)
LIC	-	-	(0.3)

Jindal Steel & Power: 2QFY08 result update: Stronger than expected EBITDA; we raise target price, maintain OP

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- **JSP's 2Q net earnings, at Rs2.5 bn were 15% above our estimates, as capacity expansions drives higher volume growth**
- **2Q EBITDA margins at 42.5% were sequentially as well as on yoy basis higher by 330 bps, as recent increase in raw-material prices does not impact JSP's margins (unlike competition)**
- **We raise FY2008E earnings estimates by 13% to account for higher-than-expected 2Q performance.**
- **We now account for our expectations of higher steel/plate prices and raise FY2009E net earnings estimates by 30%**
- **We make several changes to our valuation methodology and raise target price on JSP to Rs9,400/ share (from Rs4,500 earlier). Maintain Outperform rating.**

JSP, in its 2QFY08E results, declared net earnings of Rs2.5bn, up 77% and 15% higher than our estimates. EBITDA margins increased 330bps on qoq/yoy basis, as higher volumes and stable costs delivered higher EBITDA. We raise FY2008E net earnings estimate by 13% to account for better 2Q performance. We also raise FY2009E estimates by 30% based on our revised assumption of steel/plate prices. We raise target price to Rs9,400 (from Rs4,500) following several reasons. Retain Outperform.

JSP's 2Q net earnings, at Rs2.5 bn were 15% higher than our estimates and increased 77% on yoy basis as higher volumes countered sober realizations and impact from stronger rupee. EBITDA, at Rs5.4 bn increased 75% yoy.

EBITDA margins, at 42.5% increased 330bps on qoq/yoy basis, as increasing raw material costs does not impact JSP's operating margins (source of most raw materials is captive). The improvement in EBITDA reported by JSP in the current quarter is higher than that reported by its peers (Tata Steel and JSW Steel).

We raise FY2008E earnings by 13% to account for JSP's better-than-expected performance in the current quarter. We expect volumes to improve in 2HFY08E (on yoy basis) as JSP continues to benefit from its capacity expanded last year. We also expect JSP to stabilize its plate mill and receive approval for sale of plates under API-grade by end of FY2008E. That, coupled with our expectation of continued strength in plate prices (and steel prices generally; refer to our report released on 29th October, 2009) leads to a 30% revision in expected net earnings for FY2009E. We now expect 45% growth in net earnings for FY2009E.

We increase our SOTP-based target price to Rs9,400 (from Rs4,500 earlier) based on several of these reasons – (a) We roll our valuation-basis forward and now value JSP based on FY2009E EBITDA, (b) We now accord a value to JSP for its probable sale of power on spot-price basis and (c) We now accord value to JSP for its probable investments to develop the El Mutun mine in Bolivia. We discuss all of them in detail.

a) **We roll our valuation-basis forward** and now value JSP based on FY2009E EBITDA, which increases target price as we expect EBITDA to grow 39% in FY2009E. We expect higher EBITDA following (a) Our expectation of stable steel prices in FY2009E; albeit higher resource prices and (b) our expectation of continued strength in plate prices versus our earlier expectation of softer plate prices.

b) **We now accord a value to JSP for its probable sale of power on spot-price basis**. JSP will likely commission 1000MWs of merchant-power over the next 4 quarters on a modular basis (250MWs each quarter). JSP has not signed long term-PPA for sale of this power yet, which leads us to believe that JSP might want to sell incremental power on spot-basis. Our utilities analyst believes that JSP can realize a price of Rs4.5/ unit for sale in spot markets for the next 3 years. We make this assumption in our model, which results in value accretion of Rs900/share of JSP.

c) **We now accord value to JSP for its probable investments in El Mutun mine, Bolivia**. Bolivia's government had awarded JSP a contract to develop EL Mutun (a site believed to contain one of the world's largest iron ore deposits; more than 40bn tons of probable reserves) in a bidding process in Jun-2006 and signed the contract to develop it in Jul-2007. The contract is currently awaiting a nod from Bolivian House of Senate.

The head of senate's economic development committee, senator Carlos D'Arlach has recently been quoted by the press stating that the political decision to approve the project has already been taken. We expect the contract to be signed into law in the November session, if the reports turn out true.

Since the company has not made any communication to this effect, under restrictive set of assumptions, we now value JSP's value-accretion from development of El Mutun mine at Rs1,710/ share (assuming just 20% probability of this project fructifying). We would await communication from the company before building higher probability, but believe, that the project will likely add a great value to JSP's shareholders, if JSP is successful in executing its plans.

We believe that many triggers exists that can make a case for incremental value generation from current prices. We list them here:

a) **We currently value JSP's stake** in El Mutun assuming an execution probability of just 20%. We believe this project can add great value, if JSP is successful in executing its plans.

b) **JSP's existing coal mine in Chhattisgarh** can support an incremental 1500MWs for the next 20 years. The company has floated a tender to order 1320MWs and will likely place order for equipments in the next 3-4 months, in our estimate. We have not yet captured the full value that this project can potentially add.

We continue to maintain an Outperform rating on the stock with target price of Rs9,400.

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

				% change			1st half			
	2Q 2008	1Q 2008	2Q 2007	qoq	yoy	2008E	1H 2008	1H 2007	% change	Comments on interim results
Quantitative details ('000 tons)										
Steel sales	291,028	132,610	193,746	119.5	50.2	750,050	423,638	402,356	5.3	Expansions coming in play; volumes on a rise. Expect full year volumes to be higher
Sponge iron sales	292,214	117,133	155,983	149.5	87.3	975,065	409,347	274,856	48.9	
Power sales (mn units)	604	243	343	148.5	76.1	-	847	639	32.6	
Earnings drivers										
Average US HRC prices (US/ton)	570	610	685	(6.6)	(16.8)	-	590	669	(11.8)	Prices down severly on yoy basis; expect them to catch up to EU prices
Average UK HRC prices (US/ton)	655	645	633	1.6	3.5	-	650	612	6.2	Prices strong so far; expect to run down towards US average
Average INR:USD	40.53	41.26	46.37	(1.8)	(12.6)	41.00	40.89	43.82	(6.7)	Rupee appreciated strongly over last year; was flattish on qoq basis
Interim results										
Net revenues	**12,690**	**12,231**	**7,896**	3.8	60.7	**46,594**	**24,922**	**14,558**	71.2	Volumes propel revenue growth despite softer realizations
Expenditure	**(7,284)**	**(7,440)**	**(4,812)**			**(26,773)**	**(14,723)**	**(8,224)**		
Stock adjustment	(55)	(44)	(13)			-	(99)	651		
Raw materials	(4,505)	(4,162)	(2,583)			(6,381)	(8,667)	(4,731)		
Employee cost	(339)	(305)	(238)			(1,229)	(645)	(465)		
Other costs	(2,385)	(2,928)	(1,978)			(19,164)	(5,313)	(3,680)		
EBITDA	**5,407**	**4,792**	**3,085**	12.8	75.3	**19,821**	**10,199**	**6,334**	61.0	
Other income	29	96	33			290	125	65		
Depreciation	(1,178)	(1,115)	(642)			(4,231)	(2,293)	(1,263)		
EBIT	4,258	3,773	2,475			15,880	8,031	5,136		
Interest	(791)	(371)	(330)			(1,649)	(1,162)	(888)		
Pre-tax profits - as reported	3,467	3,402	2,145			14,231	6,869	4,248		
Unusual or infrequent items	-	-	-			-	-	-		
Pre-tax profits - as adjusted	**3,467**	**3,402**	**2,145**	1.9	61.6	**14,231**	**6,869**	**4,248**	61.7	
Taxes	(692)	(901)	(573)			(3,110)	(1,593)	(1,145)		Low ETR owing to higher provisions made in 1Q 2008
Reported profits - as reported	2,775	2,501	1,572			11,121	5,276	3,103		
Extra-ordinary items	-	-	-			-	-	-		
Reported profits - as adjusted	**2,775**	**2,501**	**1,572**	10.9	76.5	**11,121**	**5,276**	**3,103**	70.0	
Reported profits - as adjusted	**2,775**	**2,501**	**1,572**	10.9	76.5	**11,121**	**5,276**	**3,103**	70.0	
Ratios										
Costs as % of revenue (%)	57.5	60.8	60.9				59.1	56.5		
EBITDA margin (%)	42.5	39.2	39.1				40.9	43.5		
ETR (%)	20.0	26.5	26.7				23.2	26.9		Low ETR owing to higher provisions made in 1Q 2008
EPS (Rs/share)	90.1	81.2	51.1				171.3	100.8		

Source: Company data, Kotak Institutional Equities estimates

Jindal Steel and Power, Summary financials, March fiscal year-ends, 2007-10E (Rs mn)

Income statement	2007	2008E	2009E	2010E
Net revenues	**36,815**	**46,594**	**62,766**	**71,318**
Expenditure	**(21,174)**	**(26,773)**	**(35,247)**	**(42,890)**
Raw materials	(5,605)	(6,381)	(7,865)	(8,462)
Employee expenses	(910)	(1,229)	(1,597)	(1,997)
Other expenditure	(14,659)	(19,164)	(25,785)	(32,432)
EBITDA	**15,641**	**19,821**	**27,519**	**28,428**
Non-operating income	290	290	290	290
Depreciation	(3,365)	(4,231)	(5,426)	(7,231)
EBIT	12,567	15,880	22,383	21,487
Interest expenses	(1,501)	(1,649)	(1,642)	(1,887)
Adjusted pre-tax profits	11,066	14,231	20,741	19,600
Unusual or infrequent items	-	-	-	-
Reported pre-tax profits	**11,066**	**14,231**	**20,741**	**19,600**
Current taxes	(1,071)	(2,135)	(3,111)	(2,940)
Deferred taxes	(1,348)	(976)	(1,422)	(1,344)
Reported net income	**8,648**	**11,121**	**16,208**	**15,317**
Adjusted net income	**8,648**	**11,121**	**16,208**	**15,317**
EPS (Rs), based on wtd avg shares	**280.8**	**361.2**	**526.4**	**497.4**
EPS (Rs), based on fully diluted shares	**280.8**	**361.2**	**526.4**	**497.4**
Year-end shares outstanding (mn)	30.8	30.8	30.8	30.8
Weighted average shares outstanding (mn)	30.8	30.8	30.8	30.8
Fully diluted shares outstanding (mn)	30.8	30.8	30.8	30.8

Balance sheet	2007	2008E	2009E	2010E
Equity capital	154	154	154	154
Reserves and surplus	26,336	36,841	52,356	66,903
Deferred tax liability	4,201	5,176	6,598	7,942
Total Equity	**30,691**	**42,171**	**59,108**	**74,999**
Secured loans	26,235	20,465	25,954	30,247
Unsecured loans	9,646	9,646	9,646	9,646
Total borrowings	**35,881**	**30,111**	**35,600**	**39,893**
Current liabilities	11,196	13,180	16,460	18,195
Total capital	**77,767**	**85,461**	**111,168**	**133,087**
Cash	425	468	514	566
Inventory	8,082	10,229	13,779	15,657
Debtors	4,257	5,388	7,258	8,247
Other current assets	5,910	5,910	5,910	5,910
Total current assets	**18,675**	**21,995**	**27,462**	**30,380**
Gross block	45,482	52,487	73,152	94,284
Less: Depreciation	(8,788)	(13,019)	(18,445)	(25,676)
Net block	36,694	39,468	54,708	68,609
Add: Capital work-in-process	14,588	16,188	21,188	26,288
Total fixed assets	**51,282**	**55,656**	**75,896**	**94,897**
Investments	7,803	7,803	7,803	7,803
Miscellaneous expenditure	7	7	7	7
Total assets	**77,767**	**85,461**	**111,168**	**133,087**

Cash flow statement	2007	2008E	2009E	2010E
Cash flow from operating activities				
PBT	11,066	14,231	20,741	19,600
Add: Depreciation	3,365	4,231	5,426	7,231
Add: Non cash expenses	-	-	-	-
Less: net interest	-	-	-	-
Less: Taxes paid	(1,071)	(2,135)	(3,111)	(2,940)
Add: Working capital changes	(1,444)	(1,294)	(2,140)	(1,131)
Total operating cash flow	**11,916**	**15,033**	**20,916**	**22,760**
Operating Cash flow w/o working capital	13,360	16,327	23,056	23,891
Cash flow from investing activities				
Capital expenditure	(16,177)	(8,605)	(25,666)	(26,232)
Investments	(3,500)	-	-	-
Interest and dividend received	-	-	-	-
Total investing cash flow	**(19,677)**	**(8,605)**	**(25,666)**	**(26,232)**
Cash flow from financing activities				
Share issuances	-			
Loans	8,427	(5,770)	5,489	4,294
Less: Dividends paid (including dividend tax)	(554)	(616)	(693)	(770)
Total financing cash flow	**7,873**	**(6,386)**	**4,796**	**3,524**
Net change in cash	**112**	**42**	**47**	**51**
Opening cash	313	425	468	514
Closing cash	425	468	514	566

Ratios (%)	2007	2008E	2009E	2010E
Effective tax rate	21.9	21.9	21.9	21.9
EBITDA margins	42.5	42.5	43.8	39.9
EBIT margins	34.1	34.1	35.7	30.1
Net debt/equity	114.4	69.5	58.8	52.0
Net debt/capitalization	53.4	41.0	37.0	34.2
ROACE	14.9	17.4	18.7	14.7
ROAE	28.2	26.4	27.4	20.4

Key assumptions	2007	2008E	2009E	2010E
Sponge iron production ('000t)	1,196	1,219	1,260	1,370
Pig iron production ('000t)	397	595	1,071	1,489
Steel production ('000t)	775	1,100	2,000	2,300
Finished steel average realization (Rs/t	33,489	34,340	32,199	32,144

Valuations (X)	2007	2008E	2009E	2010E
Price to Diluted earnings	9.2	7.1	4.9	5.2
EV/EBITDA	7.3	5.5	4.2	4.2
EV/Sales	3.1	2.3	1.8	1.7
M.cap/Sales	2.2	1.7	1.3	1.1
Price to book	2.6	1.9	1.3	1.1

Per share numbers (Rs)	2007	2008E	2009E	2010E
Reported Earnings	280.8	361.2	526.4	497.4
Diluted Earnings	280.8	361.2	526.4	497.4
Cash earnings	390.1	498.6	702.6	732.2
Free cash	(138.4)	208.8	(154.2)	(112.8)
Book	994.8	1,367.7	1,917.7	2,433.8

Source: Company data, Kotak Institutional Equities estimates

Jindal Steel and Power, SOTP-based valuation, March 2009E (Rs mn)

	EBITDA	Multiple	Enterprise value			
	(Rs mn)	(X)	(Rs mn)	(US$ mn)	(Rs/share)	Valuation basis
Existing steel business			**163,406**	**4,085**	**5,307**	
Steel business	27,519	7.2	198,137		6,435	
Less: Net debt			(34,730)		(1,128)	FY2009E net debt, adjusted for cash
Existing merchant power business			**94,400**	**2,360**	**2,360**	
Stake in Jindal Power (100% holding)					1,200	1-yr DCF-to-firm basis
800MW sold on spot sales basis (note 1)					900	Assuming JSP sells incremental 800MWs on spot basis (at Rs4.5/unit) (higher rates till 2011E)
Option value for incremental 1000MWs					260	Assuming JSP can set-up incremental 1000MWs on existing mine
Value accretion from development of El Mutun, Bolivia (note 2, 3)			**52,646**	**1,316**	**1,710**	DCF-to-firm basis
Arrived market capitalization			**310,453**	**7,761**	**9,376**	
Target price					**9,400**	

Notes:

1. Our base-case assumptions assume power sales on long term sale price basis. This value is assuming Jindal Power sells 800MWs for Rs4.5/unit till FY2010E, and then on LT-PPA rates
2. Based on our assumption of extraction of 15bn tons of iron ore extraction over FY2026 and based on long term iron ore prices of US$ 35/ton
3. We apply a factor of 20% to discount cash flows and assume just 20% probability of completion of commissioning of the project

Source: Kotak Institutional Equities estimates

Industrials

BHEL.BO, Rs2612	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	2,025
52W High -Low (Rs)	2698 - 970
Market Cap (Rs bn)	1,279

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	172.4	218.0	268.6
Net Profit (Rs bn)	24.1	32.5	41.2
EPS (Rs)	49.3	66.4	84.1
EPS gth	*44.1*	*34.7*	*26.6*
P/E (x)	53.0	39.3	31.1
EV/EBITDA (x)	29.0	21.9	17.3
Div yield (%)	0.4	0.6	0.7

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	67.7	-	-
FIIs	19.5	2.1	(0.3)
MFs	5.1	3.2	0.9
UTI	-	-	(2.4)
LIC	1.9	1.1	(1.3)

BHEL: Strong results with higher than expected margins and large one-time other income

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- **BHEL beats expectations with higher than expected margins and other income**
- **One time other income from settlement of long running income tax dispute related to tax on exchange losses**
- **Order inflows remain strong, sustains growth visibility for the future**
- **Maintain estimates, target price and rating unchanged at Rs2,025/share**

BHEL has reported net revenues of Rs39.6 bn (up 19% yoy) and profit after tax of Rs4.7 bn (adjusted for one time exceptional gains) versus our expectation of revenues of Rs42.5 bn and profit after tax of Rs4.7 bn. Operating margins have expanded 390 bps to 17.5% (from 13.7% earlier) on a yoy basis led by (a) operating leverage ' both employee expenses and other expenses have declined as % of sales by 100 bps and 180 bps respectively and (b) lower material cost as % of sales by 100 bps. We would keenly watch out for any one time items in the BHEL 2QFY08 results that can partially explain sharp EBITDA margin turnaround. BHEL's order backlog at Rs726 bn, provides 2.8 years of revenue visibility based on estimated following four quarters revenues, compared to a visibility of 2.3 years at the end of 2QFY07. We highlight positive developments such as (a) supercritical order from JV with TNEB, (b) bidding for units of 600 MW, (c) physical execution problems that competition has faced and (d) intention to leverage skills in related areas such as defense, railways and oil and gas. We also highlight recent news reports related to (a) delays in project execution on account of BHEL and (b) increased traction in private sector investments (with award of coal blocks) in power generation that may reduce the market share of BHEL in overall power capacity addition of India. We will revisit our estimates, rating and target price post the conference call today.

BHEL beats expectations with higher than expected margins and other income

BHEL has reported net revenues of Rs39.6 bn (up 19% yoy) and profit after tax of Rs4.7 bn (adjusted for one time exceptional gains) versus our expectation of revenues of Rs42.5 bn and Profit after tax of Rs4.7 bn. Operating margins have expanded 390 bps to 17.5% (from 13.7% earlier) on a yoy basis led by (a) operating leverage – both employee expenses and other expenses have declined as % of sales by 100 and 180 bps respectively and (b) lower material cost as % of sales by 100 bps (Exhibits 1 and 2). We would keenly watch out for any one time items in the BHEL 2QFY08 results that can partially explain sharp EBITDA margin turnaround.

One time other income from settlement of long running income tax dispute related to tax on exchange losses

BHEL has reported one time exceptional other income of Rs2.2 bn (adjusted for corresponding effects on interest and taxes) related to receipt of refund from the income tax department. This refund is a consequence of income tax department losing its case in Delhi High court, relating to the issue of tax liability on exchange losses booked by the company during FY1991-92.

Order inflows remain strong, sustains growth visibility for the future

BHEL has reported an order backlog of Rs726 bn (Rs624 bn and Rs457 bn at the end of 1QFY08 and 2QFY07 respectively. Order backlog of Rs726 bn implies that order inflows in 2QFY08 should have been of the order of Rs142 bn (up 33% qoq and 45% yoy). BHEL's order backlog at Rs726 bn, provide 2.83 years of revenue visibility based on estimated following four quarters revenues, compared to a visibility of 2.3 years at the end of 2QFY07 (Exhibit 3). Order inflows may be directed by the power ministry's plan to complete the order award process by March 2008 for XIth plan projects.

JV with TNEB, bidding for units of 600 MW, physical execution problems that competition has faced and intention to diversify make us incrementally positive on the stock

First ever supercritical order from joint venture with TNEB : BHEL has signed a joint venture with TNEB to jointly develop a 2X800 MW power project in TamilNadu with equity participation from BHEL. This implicitly results in order for 2 supercritical 800 MW units. This also removes overhang about when would BHEL win supercritical orders and thus is a very positive development for the company. There were discussions about a similar project in Uttar Pradesh (OBRA) also, which may now be finalized keeping the TNEB agreement as a model one.

BHEL starts to bid for 600 MW units : New reports suggest that BHEL has started to bid for 600 MW units also versus only 500 MW units earlier. We had earlier highlighted that absence of 600 MW in the configuration mix is a key reason for loss of some orders to competition. This is because if a generation utility allowed flexible bids on both 500 and 600 MW configuration then the 600 MW unit size was at an advantage in terms of per MW project cost.

Other contractors face problem in execution on the ground in India : News reports suggest that CSEB has revoked bank guarantee of China National Machinery for the Korba power plant contract. This contract was placed on the Chinese EPC company recently and they have failed to start work on the project in time. We believe global firms would have to rope in Indian partners such as Reliance Energy etc for project execution on the ground and can only be supplier of equipment.

Order inflows continue : New reports suggest that BHEL seems set to bag contract for Barh Stage II project worth 1,320 MW (2X660 MW) as there is no other bidder for the same. Barh Stage I is being done by a Russian Company, Technopromoexport.

Intention to diversify in related sectors : BHEL also intends to build its presence in defense including opportunity from offset clauses, railways (traction equipment) and Oil and gas (upstream platforms and rigs). At this stage size of businesses in these segments is small, but oculd be ramped up going forwards.

Continued reports of substantial project delays and increasing emphasis on private sector investments in power generation are negatives

Delays in project execution continue : As per news reports delays in project execution continue with NTPC's Chairman and Chief Minister of Madhya Pradesh recently expressing dissatisfaction due to delays in project execution on part of BHEL., .

Private sector investments in power generation gain traction : Government may award coal blocks to private sector utilities to catalyze them to invest in power generation. Larger share of power generation capacity addition being executed by private sector is a negative medium term development as the private sector does not necessarily order equipment from BHEL, as is usually the case with the public sector.

Maintain estimates, target price (Rs2,025/share) and rating unchanged

We retain our estimates and DCF based target price of Rs2,025/share. Key catalysts include a) negotiated order for 800MW supercritical units from NTPC and b) continued strong order execution. Risks include a) slowing down of near term order flow, b) potential competition in the long term, emanating from Chinese and Korean suppliers as well as discussions to have another domestic manufacturer of power plant equipments apart from BHEL. We will revisit our estimates, rating and target price post the conference call today.

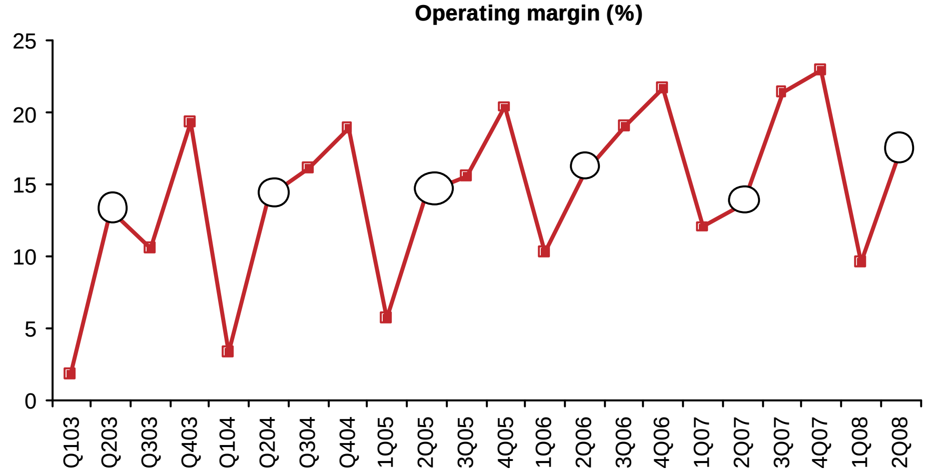
Exhibit 1. BHEL 2QFY08 result - key numbers (Rs mn)

				yoy			qoq			yoy	
	FY07	**FY08E**	**2QFY08**	**2QFY07**	***% change***	**2QFY08**	**1QFY08**	***% change***	**1HFY08**	**1HFY07**	***% change***
Gross Sales	188,385	239,564	44,393	36,654	21.1	44,393	35,696	24.4	80,089	65,527	22.2
Less: Excise duty	(16,010)	(21,561)	(4,739)	(3,243)	46.2	(4,739)	(3,356)	41.2	(8,096)	(5,552)	45.8
Net revenues	**172,375**	**219,889**	**39,654**	**33,412**	**18.7**	**39,654**	**32,339**	**22.6**	**71,993**	**59,975**	**20.0**
(Inc)/Dec in WIP	1,812	-	3,798	2,912	30.4	3,798	(143)	(2,753.9)	3,655	2,961	23.4
Raw material consumption	(98,740)	(123,783)	(25,434)	(21,480)	18.4	(25,434)	(19,008)	33.8	(44,442)	(36,983)	20.2
Staff cost	(24,511)	(26,532)	(6,296)	(5,660)	11.2	(6,296)	(6,039)	4.2	(12,335)	(10,369)	19.0
Other items	(18,028)	(22,491)	(4,769)	(4,621)	3.2	(4,769)	(4,042)	18.0	(8,812)	(7,839)	12.4
Total Expenditure	(139,466)	(172,806)	(32,702)	(28,848)	13.4	(32,702)	(29,233)	11.9	(61,934)	(52,230)	18.6
EBIDTA	**32,909**	**47,083**	**6,952**	**4,563**	**52.3**	**6,952**	**3,107**	**123.8**	**10,059**	**7,745**	**29.9**
Other income	7,615	7,062	2,334	1,699	37.4	2,334	2,063	13.1	4,397	2,900	51.6
EBIDT	40,524	54,145	9,286	6,262	48.3	9,286	5,170	79.6	14,456	10,645	35.8
Interest	(433)	(107)	(19)	(136)	(86.3)	(19)	(22)	(14.4)	(40)	(267)	(85.0)
Depreciation	(2,730)	(2,958)	(694)	(667)	4.2	(694)	(689)	0.8	(1,384)	(1,305)	6.0
PBT	**37,361**	**51,080**	**8,573**	**5,460**	**57.0**	**8,573**	**4,459**	**92.2**	**13,032**	**9,073**	**43.6**
Tax	(13,214)	(18,557)	(3,887)	(1,860)	109.0	(3,887)	(1,570)	147.6	(5,458)	(3,106)	75.7
PAT	**24,147**	**32,523**	**4,685**	**3,600**	**30.1**	**4,685**	**2,889**	**62.2**	**7,574**	**5,967**	**26.9**
Exceptional item			2,191			2,191			2,191		
Reported PAT			6,877			6,877			9,766		
Key ratios (%)											
Raw Material to Sales	56.2	56.8	54.6	55.6		54.6	59.2		56.7	56.7	
Excise duty to sales	8.5	9.0	10.7	8.8		10.7	9.4		10.1	8.5	
Staff Cost to sales	14.2	12.2	15.9	16.9		15.9	18.7		17.1	17.3	
Other exp to sales	10.5	10.3	12.0	13.8		12.0	12.5		12.2	13.1	
OPM	19.1	21.6	17.5	13.7	*3.9*	17.5	9.6		14.0	12.9	
EBIDTA margin	23.5	24.8	23.4	18.7		23.4	16.0		20.1	17.7	
Effective tax rate	35.4	36.3	45.3	34.1		45.3	35.2		41.9	34.2	
Order Backlog	550		726	457		726	624		726	457	
Order Inflow	347		142	97		142	106		248	143	
Revenue mix (%)											
Power	72.0	-	72.7	72.3		72.7	74.8		72.7	73.0	
Industry	28.0	-	27.3	27.7		27.3	25.2		27.3	27.0	
EBIT margin (%)											
Power	25.8	-	23.1	21.3		23.1	19.4		23.1	20.2	
Industry	16.3	-	14.1	12.2		14.1	3.7		14.1	9.0	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 2. Operating margin at 17.5% in 2QFY08 has been the highest in last five years

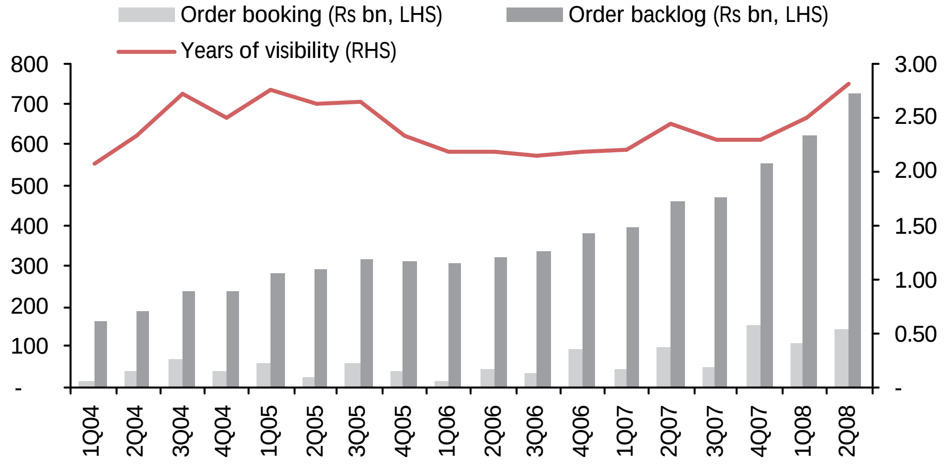
Operating margin trend for BHEL over the last five years (%)



Source: Company data, Kotak Institutional Equities estimates.

Exhibit 3. BHEL's order backlog provides highest visibility amongst the industrial stocks at 2.8 years

Order booking, Order backlog & visibility trend for BHEL, March fiscal year-ends



Source: Company data, Kotak Institutional Equities.

Banking

HDFC.BO, Rs2813	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	2,200
52W High -Low (Rs)	2838 - 1397
Market Cap (Rs bn)	807

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	22.1	33.9	35.9
Net Profit (Rs bn)	15.7	22.6	23.8
EPS (Rs)	62.1	79.0	82.9
EPS gth	*24*	*27.3*	*4.9*
P/E (x)	45.3	35.6	33.9
P/B (x)	14.5	6.6	5.9
Div yield (%)	0.7	1.0	1.0

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	68.3	5.1	3.5
MFs	2.2	1.0	(0.7)
UTI	-	-	(1.6)
LIC	1.1	0.4	(1.2)

HDFC: High margins support operational profits, retain IL

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- **HDFC's net profit up 76% y-o-y to Rs6.46 bn, 7% above estimates,**
- **Capital gains had a large contribution to reported profits- in line with expectations,**
- **Increase in spreads on the back of lower bulk borrowing rate improved core income,**
- **Raise estimates and increase price target to Rs2,200 (from Rs1700), retain IL.**

HDFC reported net profit of Rs6.46 bn, up 76% y-o-y. Disbursements growth remained strong at 25% in 2QFY08. Increase in NIMs on the back of higher spreads and infusion of equity on account of recent preferential allotment to Carlyle and Citigroup has supported growth in net income.

We are raising our earnings estimates by 15% for FY2008 primarily to factor higher capital gains for FY2008, lower interest expenses and fee income. Raise target price to Rs2,200 (from Rs1700 earlier). Retain IL. Given high expectations on valuation of its subsidiaries and strong core growth on the back of benign interest rate environment, we expect HDFC to trade at a premium to our fair value estimate and retain IL rating. The stock trades at 27.5X PER and 6.2X PBR standalone FY2009.

Key highlights

- HDFC's net operating income increased 83% yoy mainly driven by 160% growth in profit on sale of investments. HDFC booked capital gains of Rs3.13 bn (Rs2.43 bn post tax) during 2QFY08 on account of sale of its stake in Intelenet.
- Operational income (excluding capital gains) grew 61% yoy for 2QFY08 on the back of higher interest spreads (2.4% as against 2.16% in 2QFY07), strong asset growth of 24%. HDFC reported 25% growth in disbursements–somewhat lower than 29% during 1QFY08 yet higher than large banks. We note that HDFC has been charging lower interest rates than its competitors for the last few quarters – thus supporting higher growth.
- We factor total capital gains of Rs2.8 bn in our estimates for 2HFY08. HDFC proposes to sell 8% stake in HDFC Standard Life Insurance to Standard Life to increase the latter's stake to 26% (maximum permitted by the regulations). HDFC will likely earn capital gains on this transaction. However, the transfer will be done at predetermined formula linked to RoEs of HDFC, and not market value.
- HDFC's unrealized gains were up 30% qoq to Rs113 bn. Excluding value of HDFC Bank, unrealized gains were up 18% qoq to Rs11 bn.

HDFC

Quarterly results, (Rs mn)

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	YoY(%)	2Q08E	Actual vs KS(%)
Operating income	12,457	14,468	14,545	17,285	18,269	22,019	52	21,729	1
Interest on loans	10,372	11,811	12,467	13,852	15,795	16,864	43	17,777	(5)
Fees and other charges	71	161	125	328	102	59	(64)	242	(76)
Dividend	384	242	25	528	426	123	(49)	150	(18)
Sale of investment	471	1,222	742	819	260	3,182	160	3,310	(4)
Lease income	40	45	69	(45)		74	63	0	
Other op income	1,120	986	1,118	1,802	1,687	1,718	74	250	587
Interest expense	8,014	9,137	9,475	10,042	12,451	12,238	34	12,894	(5)
Net operating income	**4,443**	**5,331**	**5,070**	**7,242**	**5,818**	**9,781**	**83**	**8,835**	**11**
Op. inc. excl. gains, capital gains and lease income	**3,932**	**4,064**	**4,260**	**6,468**	**5,557**	**6,526**	**61**	**5,525**	**18**
Net Fund based income	4,372	5,170	4,945	6,914	5,716	9,722	88	8,593	13
Net Fund based income excl gains	3,862	3,903	4,134	6,140	5,455	6,467	66	5,283	22
Other exp.	667	686	614	474	765	823	20	800	3
Other exp.	442	452	374	261	485	504	12	500	1
Staff expenses	225	234	240	214	280	319	36	300	6
PBDT	3,776	4,645	4,456	6,768	5,052	8,958	93	8,035	11
Depreciation	37	39	47	52	37	40	3	40	0
Other income	28	95	39	45	34	39	(59)	40	(3)
PBT	3,767	4,701	4,448	6,761	5,050	8,957	91	8,035	11
Tax	799	1,021	893	1,261	1,322	2,493	144	2,009	24
PAT	**2,968**	**3,681**	**3,555**	**5,501**	**3,728**	**6,464**	**76**	**6,026**	**7**
Tax rate	21	22	20	19	26	28	28	25	11
PBT excl. capital gains, other income and lease income	**3,228**	**3,339**	**3,598**	**5,942**	**4,755**	**5,663**	**70**	**4,685**	**21**

Other details - Rs bn	**1Q07**	**2Q07**	**3Q07**	**4Q07**	**1Q08**	**2Q08**	**YoY(%)**	**2Q08**	**YoY(%)**
Approval for the quarter	60	87	79	107	77	112	29	113	(1)
Disbursement for the quarter	44	69	62	87	56	86	25	90	(4)
DSA sales (%)	67	65	70	65	65	65			
HDFC Bank	25	25	28	25	25	27			
Disb excl HDFC Bank	33	40	42	40	40	38		17	122
Outstanding (Rs bn)	473	499	546	565	590	620	24	624	(1)
Loan portfolio incl. Pref. & debt	492	513	527	580	605	634	24	642	(1)
Individuals	320	340		374		620			
Loans securitised during the year									
Annualised NII (Rs mn)	9,432	10,696	11,968	15,239	13,373	18,504	73		
NIMs	1.92	2.08	2.3	2.6	2.2	2.9			
NPAs (Rs mn)	6,665	6,537	6,884	5,338	7,203	7,194	10		
NPL ratio (%)	1.41	1.31	1.26	0.9	1.22	1.2			
CAR (%)	13.3	13.5	13.7	13	13.8	17			
Tier I (%)	7.8	8.1	8.1	7.60	8.3	12			
Avg spread(%)	2.14	2.16	2.16	2.18	2.22	2.40			
Unrealized gains	59,204	74,891	79,346	69,480	87,565	113,602	52		
Less: Gains on HDFC Bank	50,992	61,528	71,444	63,180	78,169	102,559	67		
Net gain	8,212	13,363	7,902	6,300	9,396	11,043	(17)		

Balance sheet (Rs mn)	**1Q07**	**2Q07**	**3Q07**	**4Q07**	**1Q08**	**2Q08**	**YoY(%)**
Sharecapital	2,496	2,496	2,501	2,530	2,530	2,716	9
Reserves	44,815	48,185	51,781	52,984	56,486	94,411	96
Term loans	193,483	212,915	219,568	242,242	210,594	203,931	(4)
Bonds/debentures/CPs	188,339	189,314	201,171	225,844	292,346	310,554	64
Deposits	107,164	112,049	113,862	103,844	120,738	115,036	3
Total liabilities and shareholders funds	**536,297**	**564,959**	**588,882**	**627,444**	**682,694**	**726,647**	**29**
Loans	472,734	498,871	527,487	565,124	590,427	620,200	24
Individuals	320,368	340,118	366,568	373,625	395,236	418,740	23
Corporate bodies	144,388	149,661	150,488	178,585	181,636	185,945	24
Others	7,978	9,092	10,431	12,914	13,555	15,515	71
Investments	37,969	32,057	35,688	36,662	57,819	82,610	158
Deferred tax	989	1,042	1,127	1,231	1,304	1,354	30
Current assets	45,291	50,228	42,393	50,566	61,666	48,338	(4)
Current liabilities	23,151	19,635	20,085	28,269	30,649	28,020	43
Fixed assets	2,466	2,396	2,272	2,131	2,128	2,165	(10)
Total assets	**536,297**	**564,959**	**588,882**	**627,444**	**682,694**	**726,647**	**29**

Source: Company, Kotak Insitutional Equities estimates.

HDFC- Sum of parts based valuation

	HDFC's holding (%)	Value of companies (Rs mn)	Value per share (Rs)	Comments
HDFC- mortagage business			1,264	Based on residual growth model using terminal RoE of 20%, cost of equity of 12%
Value of subsidiaries and associates			**838**	
HDFC Bank	22.0	578,461	403	Based on market price
HDFC Standard Life MF	60.0	61,187	128	10% of AUM in FY2009E of Rs611 bn
Insurance	51.0	74,000	258	NBAP analysis, giving value for 74% stake
Gruh Finance	62.0	5,469	12	Based on market price
IDFC	1.9	196,900	13	Based on market price
HDFC Venture capital				
HDFC Property Fund	80.5	1,500	4	Rs10bn of fund assuming value of 15%
HDFC IT Corridor Fund	80.5	697	2	Rs4.64bn of fund assuming value of 15%
Real estate fund	100.0	5,040	18	US$800 mn assuming value of 15%
Equity investments			**61**	
BVPS of non-strategic investments			22	
Unrealised gains on above			39	
Total value per share			**2,163**	

Source:Kotak Institutional Equities estimates.

Automobiles

MRTI.BO, Rs1188	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	1,110
52W High -Low (Rs)	1252 - 713
Market Cap (Rs bn)	343.5

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	146.5	184.1	224.3
Net Profit (Rs bn)	15.6	21.8	25.7
EPS (Rs)	54.0	75.3	88.9
EPS gth	*31.4*	*39.3*	*18.0*
P/E (x)	22.0	15.8	13.4
EV/EBITDA (x)	13.0	9.3	8
Div yield (%)	0.4	0.4	0.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	58.7	-	-
FIIs	12.9	0.4	(0.3)
MFs	6.1	1.1	0.4
UTI	-	-	(0.7)
LIC	8.1	1.3	0.7

Maruti Suzuki: 2Q FY2008 results marginally ahead of our estimates; raise target price, retain OP

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- **Volume growth on account of new models boosts profits**
- **2QFY2008 net profit at Rs4.7 bn grows 27% yoy**
- **Operating margin at 15.6% flat on a yoy basis**
- **Increase EPS estimates by 20% and 6% for FY2008E and FY2009E respectively**
- **Increase target price to Rs1,200 (Rs1,110 previously)'retain OP rating**

Maruti reported 2Q net profit at Rs4.7 bn (we estimated Rs4.5bn)'a growth of 27% yoy but a decline of 7% qoq. 2Q EBITDA margins (including operational other income) at 15.6% remained flat on a yoy basis but declined 120 bps qoq. Net sales at Rs45 bn grew 33% yoy mainly on account of higher volumes and better realizations on account of higher sales of higher-margin models. We increase our earnings estimates for FY2008E and FY2009E respectively factoring higher realizations on account of increased sales of higher-margin models. We increase target price to Rs1,200 (Rs1,110 previously)—retain OP rating on the stock.

Higher sales on account of increase in volumes and improved realizations

2Q FY2008 net sales at Rs45.5 bn grew 33% yoy and 16% qoq. The growth was mainly on account of (1) higher volumes—volumes grew 21% yoy and 13% qoq led mainly by strong demand for its new models and (2) average realizations grew 9% yoy as sales of higher-margin models increased. We believe that Maruti's volumes would record a strong growth despite a slowdown in the passenger car sales. We expect Maruti's volumes to grow 20% each year for FY2008E and FY2009E respectively.

EBITDA marginally ahead of our expectations as raw material costs rise 140 bps

2Q EBITDA at Rs7.1 bn was marginally ahead of our expectation of Rs6.9 bn. EBITDA margin at 15.6% was flat on a yoy basis but decline 120 bps on a qoq basis. This was mainly on account of increase in raw material costs—raw material costs as a percentage of sales increased 140 bps yoy while employee costs for the quarter remained flat. Other expenditure for 2Q was higher mainly on account of increased royalty payments as the company sold increased volumes of models with a higher royalty charge.

Net profit at Rs4.7 bn grows 27% yoy

2Q net profit at Rs4.7 bn grew 27% yoy but declined 7% yoy. The net profit for 2Q was impacted by higher interest costs as a result of the foreign currency loan that Maruti took over as a part of its merger with its subsidiary Maruti Suzuki Automobiles India Ltd.

Expansion on-track—capacity to increase by FY2009

Maruti's capacity expansion plan is on track. The expansion of Manesar plant (currently having a capacity of 100,000 vehicles) shall be complete by mid-FY2009 and the capacity shall stand increased to 200,000 vehicles. Maruti plans to manufacture Swift (both diesel and petrol variants) and the SX4 at its Manesar plant.

We increase our earnings estimates, increase target price to Rs1,200 (Rs1,110 previously); retain OP rating

Maruti's average realizations have improved 10% on a yoy basis. We have made adjustments in our model to factor higher average realizations on account of greater sales of higher-margin models and tweak our estimates accordingly. We increase our EPS estimates to Rs75.3 (Rs62.4 previously) and Rs88.9 (Rs 84.1 previously) for FY 2008E and FY2009E respectively. We value Maruti's core business at 8X FY2009E EV/EBITDA based on which our revised target price for the stock is Rs1,200 (Rs1,110 previously). We maintain OP rating on the stock.

Maruti Suzuki India, quarterly results, March fiscal year-ends (Rs mn)

			qoq			yoy		
	2007	2008E	2Q 2008	1Q 2008	Change (%)	2Q 2008	2Q 2007	Change (%)
Net Sales	**146,539**	**184,083**	**45,474**	**39,308**	**15.7**	**45,474**	**34,192**	**33.0**
Expenditure	(126,635)	(153,844)	(39,496)	(33,560)	17.7	(39,496)	(29,436)	34.2
(Increase)/decrease in stocks	(2,007)	(1,141)	435	1,471	(70.4)	435	377	15.2
Consumption of Raw materials	(101,374)	(125,158)	(35,155)	(31,041)	13.3	(35,155)	(25,947)	35.5
Staff cost	(2,884)	(3,516)	(909)	(805)	13.0	(909)	(714)	27.4
Other expenditure	(20,370)	(24,030)	(3,866)	(3,186)	21.4	(3,866)	(3,152)	22.6
Operating other income	2,958	3,284	1,105	833	32.7	1,105	612	80.5
EBITDA	**22,862**	**33,522**	**7,083**	**6,580**	**7.6**	**7,083**	**5,368**	**31.9**
Other income	3,026	3,533	780	1,400	(44.3)	780	605	28.9
Interest (net)	(376)	(675)	(140)	(151)	(7.1)	(140)	(31)	355.5
Depreciation	(2,714)	(3,408)	(881)	(822)	7.2	(881)	(596)	47.8
Profit before extra-ordinary it	**22,798**	**32,972**	**6,841**	**7,007**	**(2.4)**	**6,841**	**5,346**	**28.0**
Extra-ordinary items	—	—	—	—		—	—	
Profit before tax	**22,798**	**32,972**	**6,841**	**7,007**	**(2.4)**	**6,841**	**5,346**	**28.0**
Tax	7,178	11,207	2,176	2,011	8.2	2,176	1,672	30.2
Profit after tax	**15,620**	**21,765**	**4,665**	**4,996**	**(6.6)**	**4,665**	**3,674**	**27.0**
Adjusted PAT	**15,620**	**21,765**	**4,665**	**4,996**	**(6.6)**	**4,665**	**3,674**	**27.0**
Volumes	**674,924**	**809,000**	**191,325**	**169,669**	**12.8**	**191,325**	**157,683**	**21.3**
Average realisation	**254,931**	**265,949**	**279,079**	**272,255**	**2.5**	**279,079**	**254,988**	**9.4**
Margins (%)								
EBITDA margin	15.6	18.2	15.6	16.7	(1.17)	15.6	15.7	(0.13)
Net profit margin	10.7	11.8	10.3	12.7	(2.45)	10.3	10.7	(0.49)
Key ratios								
RM costs (% of net sales)	69.2	68.0	77.3	79.0	(1.66)	77.3	75.9	1.42
Staff costs (% of net sales)	2.0	1.9	2.0	2.0	(0.05)	2.0	2.1	(0.09)
Effective tax rate (%)	31.5	34.0	31.8	28.7	3.10	31.8	31.3	0.54
EPS (Rs/share)	54.0	75.3	16.1	17.3		16.1	12.7	

Source: Company data, Kotak Institutional Equities estimates.

Maruti Suzuki India, change in estimates, March fiscal year-ends (Rs mn)

	Revised estimates			Old estimates			% change		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Net sales	184,083	224,346	260,914	176,990	219,094	257,222	4.0	2.4	1.4
EBITDA	33,522	41,490	46,858	27,729	39,055	46,176	20.9	6.2	1.5
PAT	21,765	25,680	27,559	18,046	24,298	27,490	20.6	5.7	0.3
EPS (Rs/share)	75.3	88.9	95.4	62.4	84.1	95.1	20.6	5.7	0.3
Sales volume (vehicles sold)	809,000	967,000	1,110,000	809,000	967,000	1,110,000	-	-	-
Average realisation (Rs/vehicle)	227,543	232,002	235,058	218,777	226,571	231,731	4.0	2.4	1.4

Source: Kotak Institutional Equities estimates

Maruti, Valuation details (FY2009E basis)

	EBITDA (Rs mn)	EV/EBITDA (X)	EV (Rs mn)	Value (Rs/share)	Comments
FY2009E	41,490	8.0	331,922	1,149	Based on Maruti's historical average EBITDA multiple and FY2009E EBITDA
Less: net debt			(13,466)	(47)	FY2009E net debt
Market capitalisation			**345,388**	**1,195**	
Target price				**1,200**	

Volume assumptions for Maruti Suzuki, March fiscal year-ends,

	2006	2007	2008E	2009E	2010E
Segment-wise sales (no of vehicles)					
Entry (A) segment	89,000	79,245	80,000	75,000	50,000
Van-Segment	67,000	83,091	80,500	90,000	100,000
Compact (B) segment	335,000	440,375	535,500	638,000	756,000
Mid-size (C) segment	32,038	29,697	55,000	75,000	75,000
MUV	4,000	3,221	3,000	4,000	4,000
Domestic	**527,038**	**635,629**	**754,000**	**882,000**	**985,000**
Exports	34,781	39,295	55,000	85,000	125,000
Total	**561,819**	**674,924**	**809,000**	**967,000**	**1,110,000**
Segment-wise sales growth(yoy %)					
Entry (A) segment	(23.4)	(11.0)	1.0	(6.3)	(33.3)
Van-Segment	3.0	24.0	(3.1)	11.8	11.1
Compact (B) segment	23.5	31.5	21.6	19.1	18.5
Mid-size (C) segment	8.1	(7.3)	85.2	36.4	-
MUV	(23.1)	(19.5)	(6.9)	33.3	-
Domestic	**8.1**	**20.6**	**18.6**	**17.0**	**11.7**
Exports	(28.8)	13.0	40.0	54.5	47.1
Total	**4.8**	**20.1**	**19.9**	**19.5**	**14.8**

Source: SIAM, Kotak Institutional Equities estimates

Automobiles

MAHM.BO, Rs796

Mahindra & Mahindra: 2QFY2008 net profit declines 26% yoy

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- **M&M's 2Q net profit at Rs2.9 bn down 26% yoy**
- **Operating margin at 13.7% flat on a yoy basis**
- **Net sales at Rs28 bn increases 14% on account of 19% increase in volumes**

M&M reported 2QFY08 net profit at Rs2.9 bn ' down 26% yoy but up 49% qoq. 2Q EBITDA margins at 13.7% remained flat on a yoy basis but was up and 300 bps qoq. Volumes increased 19% yoy and 3% qoq while average realisations declined 4% yoy. 2Q FY2008 adjusted net profit for M&M grew 15% yoy as the corresponding quarter in FY2007 included gains from listing of shares of its subsidiary Tech Mahindra.

Net sales increase 14% led by growth in UV volumes

Net sales of M&M at Rs28 bn increased 14% yoy and 7% qoq. This was led mainly by increase in overall volumes by 19% on a yoy basis. The increase in volumes was mainly on account of higher UV sales—UV sales for the quarter grew 20% yoy while tractor volumes for 2Q FY2008 were lower by 6% yoy. The decline in tractor sales was mainly on account of high interest rates and tighter credit norms being followed by tractor-financiers. Average realisations per vehicle for 2Q declined 4% yoy.

2Q adjusted net profit up 15% yoy

2Q FY2008 net profit at Rs2.9 bn declined 26% yoy. However, 1Q FY2008 included a one-time gain on account of divestment of shares in subsidiary Tech Mahindra. 2Q FY2008 net profit adjusted for this one-time gain grew 15% yoy. EBITDA margin at 13.7% was flat on a yoy basis. The decrease in raw material costs—raw material cost as a percentage of net sales declined 530 bps yoy—was offset by a sharp incresae in employee costs (150 bps yoy) and a 20% increase in other costs. Interest cost at Rs82 mn was higher (as against net interest earned in 1QFY2007) due to the funds raised by the company to funds its expansion as well as acquisition plans.

Tractor volumes to remain flat; UV to record strong growth

We believe that the tractor volumes for M&M would remain flattish for FY2008 on account of the impact of high interest rates and tighter financing norms adopted by the financiers. The company management in the analyst-meet has guided a flattish volume growth in its tractor business. The acquisition of Punjab Tractors (PTL) is complete and the company is in the process of streamlining its operations as PTL would operate as a subsidiary of M&M. Meanwhile, we believe UV volumes would continue to grow strongly boosted by the increased demand for its Bolero and Scorpio.

M&M, quarterly results, March fiscal year-ends (Rs mn)

		qoq			yoy	
	2Q 2008	1Q 2008	Change (%)	2Q 2008	2Q 2007	Change (%)
Net Sales	**28,024**	**26,128**	**7.3**	**28,024**	**24,501**	**14.4**
Expenditure	(24,189)	(23,357)	3.6	(24,189)	(21,209)	14.1
(Increase)/decrease in stocks	1,845	102	1,707.8	1,845	2,319	(20.4)
Consumption of Raw materials	(19,700)	(17,976)	9.6	(19,700)	(18,532)	6.3
Staff cost	(2,303)	(1,891)	21.7	(2,303)	(1,642)	40.3
Other expenditure	(4,032)	(3,591)	12.3	(4,032)	(3,354)	20.2
EBITDA	**3,835**	**2,771**	**38.4**	**3,835**	**3,292**	**16.5**
Other income	692	316	118.8	692	478	44.7
Interest (net)	(82)	51	(261.2)	(82)	155	(153.1)
Depreciation	(577)	(571)	1.0	(577)	(501)	15.0
Profit before extra-ordinary items	**3,867**	**2,567**	**50.6**	**3,867**	**3,424**	**12.9**
Extra-ordinary items	-	(16)		-	1,815	
Profit before tax	**3,867**	**2,551**	**51.6**	**3,867**	**5,239**	**(26.2)**
Tax	1,008	640	57.5	1,008	1,374	(26.7)
Profit after tax	**2,859**	**1,912**	**49.6**	**2,859**	**3,865**	**(26.0)**
Adjusted PAT	**2,859**	**1,922**	**48.8**	**2,859**	**2,482**	**15.2**
Volumes	**75,806**	**73,654**	**2.9**	**75,806**	**63,989**	**18.5**
Average realisation	**418,225**	**399,330**	**4.7**	**418,225**	**433,953**	**(3.6)**
Margins (%)						
EBITDA margin	13.7	10.6	3.08	13.7	13.4	0.25
Net profit margin	10.2	7.3	2.89	10.2	15.8	(5.57)
Key ratios						
RM costs (% of net sales)	70.3	68.8	1.50	70.3	75.6	(5.34)
Staff costs (% of net sales)	8.2	7.2	0.98	8.2	6.7	1.52
Effective tax rate (%)	26.1	25.1	0.98	26.1	26.2	(0.17)
Segmental revenues						
Automotive Segment	18,019	15,045	19.8	18,019	15,565	15.8
Farm Equipment Segment	9,164	10,385	(11.8)	9,164	8,833	3.7
Other segments	1,650	1,301	26.8	1,650	1,151	43.4
Total	**28,833**	**26,731**	**7.9**	**28,833**	**25,549**	**12.9**
Less: Intersegment revenues	809	603	34.1	809	644	25.6
Net Sales/Income from Operations	**28,024**	**26,128**	**7.3**	**28,024**	**24,905**	**12.5**
PBIT						
Automotive Segment	2,554	1,317	93.9	2,554	2,324	9.9
Farm Equipment Segment	1,148	1,390	(17.4)	1,148	1,264	(9.2)
Other segments	23	37	(37.8)	23	39	(40.7)
Total	**3,724**	**2,744**	**35.7**	**3,724**	**3,627**	**2.7**
Capital employed						
Automotive Segment	15,192	11,829	28.4	15,192	11,645	30.5
Farm Equipment Segment	9,355	8,694	7.6	9,355	7,456	25.5
Other segments	434	293	48.3	434	79	450.0
Total	**24,981**	**20,816**	**20.0**	**24,981**	**19,180**	**30.2**

Source: Company data, Kotak Institutional Equities estimates.

Banking

PNBK.BO, Rs539	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	620
52W High -Low (Rs)	594 - 400
Market Cap (Rs bn)	170.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	72.4	76.5	84.4
Net Profit (Rs bn)	15.4	18.1	18.7
EPS (Rs)	48.8	57.3	59.2
EPS gth	*7.0*	*17.2*	*3.4*
P/E (x)	11.0	9.4	9.1
P/B (x)	1.9	1.6	1.3
Div yield (%)	2.4	1.4	1.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.8	-	-
FIIs	20.1	0.5	(0.0)
MFs	8.1	1.2	0.6
UTI	-	-	(0.5)
LIC	2.1	0.3	(0.3)

Punjab National Bank: PAT and NII growth below our estimate, retain OP

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- **PNB reported net profit of Rs5.4 bn in 2QFY08, which implied a growth of 7% yoy and was 4% lower than our estimates**
- **Flat NII, sharp growth in reported NPLs and good traction in non-interest income are the key highlights of the quarterly results**
- **We are revising down our target price to Rs620 (Rs670), however, we retain our OP rating on PNB, given compelling valuations**

PNB reported net profit of Rs5.4 bn in 2QFY08, which implied a growth of 7% yoy and was 4% lower than our estimates. Net interest income (NII) of the bank (adjusted for the investment amortization expense) in the current quarter was flat at Rs12.9 bn and there was a sharp increase in the reported NPLs at the bank. The non-interest income continues to show good traction growing by 21% yoy and the company continues to have the progressive policy of making provisions for meeting its liabilities under the revised AS-15 guidelines. We have revised up our earnings estimates by 4% for FY2008 and down by 7% and 4% for FY2009 and FY2010 respectively. We are revising down our target price to Rs620 (Rs670), however, we retain our OP rating on PNB, given compelling valuations of 9X PER and 1.34X PBR.

Disappointing NII growth and healthy non-interest income contribution sums up the quarterly performance:

- NII was flat at Rs12.9 bn in 2QFY08 compared to the 2QFY07 results. Continued pressure on margin and lower growth in balance sheet size were the prime reasons for the subdued growth in NII.
- Pressure on NIM was due to (a) fall in CASA ratio at the bank to 43% as of September 2007 from the 49% reported as on September 2006, (b) mobilization of high cost deposits to the tune of Rs150 bn (10% of deposits) under special deposit scheme and (c) higher growth in deposits (in absolute terms) compared to loan growth.
- We expect the pressure on margins to persist for another two quarters, though this could improve marginally qoq as the bank has already started adjusting down its deposit rates.
- Non-interest income (ex-treasury) continues to remain healthy and increased by 21% yoy in 2QFY08 to Rs3.6 bn.

Reported NPLs increased sharply in 2QFY08:

- Gross NPLs of PNB increased sequentially by 30% to Rs47 bn as of September 30, 2007, while the net NPLs doubled to Rs18.7 bn from Rs9.4 bn as of June 30, 2007.
- The management has attributed this sharp increase in NPLs to delays in commissioning of certain infrastructure projects and slippage on certain accounts due to administrative reasons. We believe this also reflects likely clean up of the loan book by the new management.
- Despite the increase in NPLs, PNB made 31% lower NPL provision compared to 2QFY07, which helped the bank to report small profit growth.

Employee expenses remain key driver of operating expenses.

- Employee expenses of PNB increased by 26%yoy to Rs6.4 bn in 2QFY08. Management has indicated that it has made Rs2 bn of provisions to meet its pension obligations under the revised AS-15 guidelines. Of this Rs1.5 bn was on account of the incremental provisions to meet pension obligations on the projected unit method for the current quarter.

Punjab National Bank, Quarterly results, Rs mn

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	% chg	2QFY08KS	Actual Vs KS
Interest income	26,405	27,643	29,483	31,944	33,633	35,381	28.0		
Loans	16,956	18,351	19,460	21,772	24,109	25,126	36.9		
Investments	8,940	8,738	9,297	8,921	8,943	8,983	2.8		
Balance with RBI & banks	455	474	614	1,021	529	1,070	125.9		
Others	54	81	111	230	52	201	149.5		
Interest expense	13,476	14,015	15,024	17,714	19,850	21,716	54.9		
Net interest income	**12,929**	**13,628**	**14,459**	**14,230**	**13,782**	**13,665**	**0.3**	**14,718**	**(7.2)**
NII post amortization cost	**12,229**	**12,868**	**13,679**	**13,130**	**13,012**	**12,915**	**0.4**	**14,718**	**(12.3)**
Non-int.income	3,513	2,840	4,471	5,184	5,089	4,678	64.7	4,700	(0.5)
Other income excl treasury	3,023	2,970	3,181	4,184	3,769	3,598	21.1	3,700	(2.7)
- fee income	2,430	2,175	2,130	2,965	2,750	2,600	19.5		
Sale of invts.	490	(130)	1,290	1,000	1,320	1,080	(930.8)	1,000	8.0
Invt amortization cost	700	760	780	1,100	770	750	(1.3)	770	(2.6)
Total income	**16,442**	**16,468**	**18,929**	**19,414**	**18,871**	**18,343**	**11.4**	**19,418**	**(5.5)**
Op. expenses	6,969	7,580	8,123	10,591	8,770	9,043	19.3	9,100	(0.6)
Employee cost	4,792	5,108	5,813	7,811	6,411	6,418	25.6	6,500	(1.3)
Other cost	2,176	2,472	2,310	2,779	2,359	2,625	6.2	2,600	1.0
Operating profit	**9,473**	**8,888**	**10,807**	**8,824**	**10,101**	**9,300**	4.6	**10,318**	(9.9)
Provisions and cont.	4,338	1,018	4,817	6,127	3,842	1,529	50.1	2,270	(32.7)
Investment Depreciation	3,868	(1,400)	1,240	3,300	1,693	(510)	(63.6)	-	
Investment Amortization	700	760	NA	NA	770	750		770	(2.6)
NPLs	384	1,886	2,242	3,006	1,379	1,306	(30.7)	1,500	(12.9)
PBT	5,135	7,870	5,990	2,697	6,259	7,771	(1.3)	8,048	(3.4)
Tax	1,460	2,820	1,691	320	2,009	2,386	(15.4)	2,414	(1.2)
Net profit	**3,675**	**5,050**	**4,299**	**2,377**	**4,251**	**5,385**	**6.6**	**5,634**	**(4.4)**
Tax rate (%)	28	36	28	12	32	31		30	
Key balance sheet details (Rs bn)									
Total Deposit	1,172	1,284	1,302	1,399	1,426	1,500	17		
CASA (%)	49%	49%	47%	46%	44%	43%			
Advances	775	823	876	966	956	1,014	23		
Investments	431	449	447	452	NA	NA			
Asset quality details (%)									
CAR	12.3	12.7	12.9	12.3	12.4	12.6			
Tier I	9.7	10.1	9.4	9.0	NA	NA			
Tier II	2.6	2.7	3.5	3.3	NA	NA			
Asset quality details									
Gross NPLs (Rs bn)	30.9	30.2	32.7	33.9	36.3	47.2	56.1		
Gross NPL ratio (%)	4.0	3.7	3.7	3.5	3.8	4.6			
Net NPLs (Rs bn)	2.7	1.5	3.7	7.3	9.4	18.7	1,159		
Net NPL ratio (%)	0.4	0.2	0.4	0.8	1.0	1.9			
Yield management measures (%)									
Yield on investments	8.16	7.74	7.76	7.82	7.61	6.88			
Yield on advances	8.76	8.97	9.11	9.17	10.23	10.20			
Average cost of deposits	4.38	4.35	4.40	4.53	5.46	5.55			
NIM	4.10	4.16	4.21	4.07	3.83	3.86			

Source: Company, Kotak Institutional Equities estimates.

Retailing

PART.BO, Rs640	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	425
52W High -Low (Rs)	647 - 365
Market Cap (Rs bn)	93.9

Financials

June y/e	2007	2008E	2009E
Sales (Rs bn)	34.8	52.8	73.8
Net Profit (Rs bn)	0.9	1.5	2.2
EPS (Rs)	6.1	10.5	15.0
EPS gth	*27.5*	*75.3*	*44.0*
P/E (x)	105.7	61.1	42.8
EV/EBITDA (x)	41.4	29.0	21.0
Div yield (%)	0.5	0.6	0.7

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.7	-	-
FIIs	25.9	0.3	0.0
MFs	9.9	0.6	0.4
UTI	-	-	(0.2)
LIC	-	-	(0.2)

Pantaloon Retail: Lower than expected selling costs leads to margin expansion - Maintain In-Line

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- **PRIL reported operating net earnings of Rs297 mn (vs our expectation of Rs205 mn), up 84% on a yoy basis**
- **EBITDA margin for the quarter was strong at 8.8% (vs expectation of 6.6%), up from 6.9% in 1QFY07 and 5.6% last quarter. EBITDA was Rs150 mn higher, essentially on account of flat qoq selling expenses. This has also led to EBITDA margins being 220bps higher than our expectation**
- **Sales, at Rs10.8 bn, grew 80% on yoy basis but were 11% below expectation. On a qoq basis, sales have only grown 7% from last quarter, as against the mid-teen growth seen in the last few quarters**
- **We maintain In-line rating on the stock and target price of Rs. 425. We await more clarity from management on inventory writeoffs**

PRIL, in its 1QFY08 results, reported net earnings of 297mn, a decline of 23% yoy. However, adjusting for Rs338 mn income from investments in 1QFY07, operational income has increased 84% yoy. While sales were 11% lower than expectation at Rs10.8 bn (80% yoy growth), EBITDA margins were 220bps above expectation, due to lower selling costs. We maintain our In-line rating on the stock.

EBITDA margins jump 320bps qoq

Standalone EBITDA margins came in at 8.8%, 320bps higher than 4QFY07 and 220bps higher than our expectation. While raw material and staff costs were broadly inline, the margin expansion was primarily on account of lower than expected selling costs. Selling costs have marginally declined on a qoq basis (versus our expectation of Rs 410mn increase), leading to reported EBITDA of Rs956 mn (vs our expectation of Rs808 mn).

Sales growth 80% yoy, but qoq growth weak at 7% only. Same store sales grow 13%

Sales, at Rs10.8 bn in 1QFY08, were up 80% yoy but 11% lower than expectation. On a qoq basis, sales growth was only 7%, as against the mid-teens growth of previous quarters While lifestyle sales have grown 56% yoy to Rs3.2bn, value sales have grown 85% yoy to Rs7.9 bn. Same store sales have grown 13% in the quarter.

Net operating income grew 84% yoy, reversing decline of last quarter

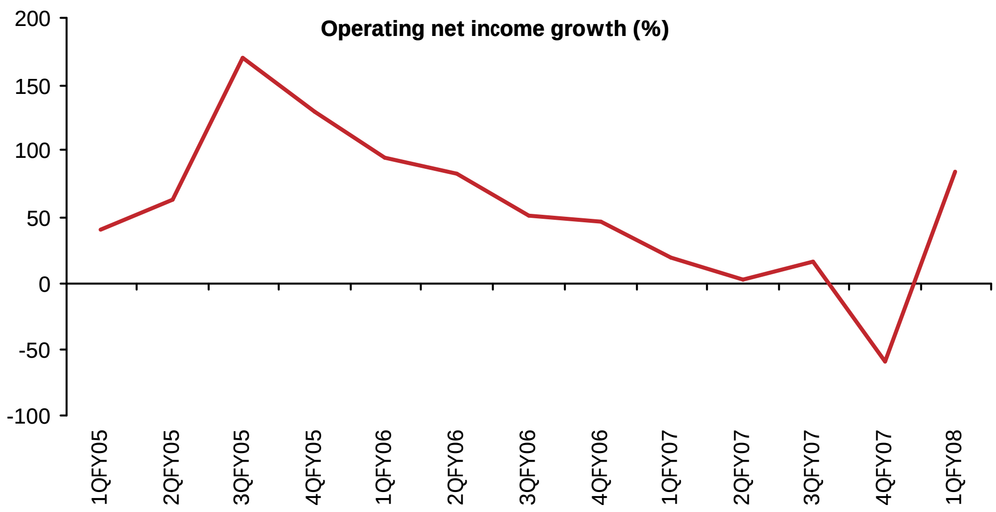
Reported PAT in 1QFY08 was down 23% yoy to Rs297 mn (vs expectation of Rs205 mn). However, adjusting for Rs 338mn income from sale in investments in 1QFY07, net operating income increased 84% yoy in the quarter.

We maintain our target price and In-line rating

We maintain our SOTP based target price of Rs 425 We await more clarity from management on inventory writeoffs.

Operating Net Income growth in 1Q08 has increased sharply in the quarter

Year-over-Year growth in operating net income, June fiscal year-ends (%)



Source: Company data; compiled by Kotak Institutional Equities.

Interim Results of Pantaloon retail, June fiscal year-ends (Rs mn)

		YoY			QoQ			
	SA 2008E	1Q2008	1Q2007	% chg	1Q2008	4Q2007	% chg	Consol 2007A
Net sales	**50,422**	**10,864**	**6,034**	80%	**10,864**	**10,196**	7%	**34,686**
Total expenditure	(46,808)	(9,909)	(5,618)	76%	(9,909)	(9,629)	3%	(33,346)
Raw materials	(33,617)	(7,446)	(3,975)	87%	(7,446)	(7,208)	3%	(23,311)
Staff Costs	(3,324)	(642)	(454)	41%	(642)	(579)	11%	(2,705)
Other expenditure	(9,867)	(1,821)	(1,189)	53%	(1,821)	(1,842)	-1%	(7,330)
EBITDA	**3,614**	**956**	**415**	130%	**956**	**568**	68%	**1,340**
EBITDA margin (%)	7.2	8.8	6.9		8.8	5.6		3.9
Operating other income	40	7	17	-59%	7	0	2173%	79
Depreciation	(491)	(153)	(67)	129%	(153)	(126)	21%	(482)
Net finance cost	(682)	(352)	(125)	182%	(352)	(337)	5%	(1,001)
PBT	**2,481**	**458**	**241**	90%	**458**	**105**	336%	**(64)**
Extraordinaries (b)			338			177		862
Tax	(876)	(162)	(193)	-16%	(162)	(95)	70%	(597)
Prior period/Minorities ('c)					0	(6)		154
Reported PAT	**1,605**	**297**	**386**	-23%	**297**	**181**	64%	**355**
Operating net income (a)	**1,605**	**297**	**161**	84%	**297**	**66**	349%	**138**
Income tax rate (%)	35	35	33		35	34		75

Notes:

a) Operating net income is after adjusting the tax impact on extraordinary item.

b) Extraordinaries represent profit on sale of investments.

c) The consolidated numbers have a minority contribution of Rs156 mn.

Source: Company data; compiled by Kotak Institutional Equities

Segment Revenue

Revenue	1Q2008	1Q2007	YoY % chg
Lifestyle Retailing	3,288	2,114	56%
Value Retailing	7,902	4,277	85%
Home retailing	1,548	0	
Total	**12,738**	**6,391**	99%
less: SIS and consignment sales	736	0	
Total Retail Sales	**12,002**	**6,391**	88%

Source: Company data; compiled by Kotak Institutional Equities.

Key model assumptions for standalone business of PRIL, June fiscal year-ends (Rs mn)

	FY2004	FY2005	FY2006	FY2007E	FY2008E	FY2009E	FY2010E
Number of stores (#)	39	64	97	177	253	336	413
New stores opened (#)	17	25	33	72	76	83	77
Total retail space ('000 sq. ft.)	**944**	**1,866**	**2,771**	**5,543**	**8,191**	**11,141**	**13,749**
Incr. in total retail space ('000 sq.ft.)	423	922	905	2,772	2,648	2,950	2,608
Weighted avg. sales per sq. ft. (Rs)	9,631	8,391	8,349	8,365	7,686	7,640	7,458
Total revenues (Rs mn)	**6,583**	**10,841**	**19,608**	**34,775**	**52,780**	**73,849**	**92,820**
Total revenues (US$ mn)	146	241	436	773	1,173	1,641	2,063
Share of revs from value retailing (%)	48.6	56.9	67.3	71.5	72.6	73.7	73.5
Avg. 'same store' sales growth (%)	**20**	**28**	**34**	**17**	**16**	**15**	**9**
Gross margin-GM (%)	31.8	32.2	31.8	33.5	32.1	31.3	30.5
EBITDA margin (%)	8.5	8.0	7.2	6.9	6.7	6.7	6.5
EBIT margin (%)	7.3	7.2	6.4	6.1	5.8	5.9	5.6
Net profit margin (%)	**3.0**	**3.6**	**3.3**	**2.6**	**2.9**	**3.0**	**2.9**
Other metrics							
Employee cost/sales (%)	**4.2**	**4.7**	**5.7**	**6.9**	**6.5**	**5.8**	**5.8**
Sales/average capital employed (X)	2.0	2.5	2.3	2.4	2.8	3.1	3.4
Net FG inventory-days of sales	**67**	**83**	**89**	**85**	**75**	**70**	**60**
GMROF (Rs/sq.ft)	2,614	2,253	2,222	2,608	2,284	2,146	1,990
GMROL (Rs '000/employee)	709	638	656	649	692	773	829
Average capex/sq.ft. (Rs)	1,708	735	1,333	983	969	964	966
Capex/sales (%)	17.7	8.8	16.0	11.7	12.6	12.6	12.9
RoACE (excl. cash) (%)							

Source: Company, Kotak Institutional Equities.

Pantaloon retail, Income statement, March fiscal year end, FY2002-09E (Rs mn)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Gross operating revenue	**4,448**	**6,583**	**10,841**	**19,608**	**32,367**	**52,035**	**73,020**	**91,943**
Operating expenses								
Cost of goods sold	3,146	4,563	7,330	13,364	22,095	35,230	50,083	63,782
Staff costs	168	275	507	1,059	2,061	3,324	4,167	5,260
SG&A expenses	760	1,187	2,138	3,702	6,056	9,867	13,715	16,795
Total expenditure	**4,074**	**6,025**	**9,974**	**18,125**	**30,212**	**48,422**	**67,966**	**85,837**
(% of revenues)	*91.6*	*91.5*	*92.0*	*92.4*	*93.3*	*93.1*	*93.1*	*93.4*
EBITDA	**374**	**558**	**866**	**1,482**	**2,155**	**3,613**	**5,054**	**6,105**
EBITDA margin (%)	*8.4*	*8.5*	*8.0*	*7.6*	*6.7*	*6.9*	*6.9*	*6.6*
Other income	8	13	43	42	31	40	40	40
Depreciation	64	88	133	208	369	491	657	822
EBIT	**318**	**484**	**776**	**1,316**	**1,817**	**3,163**	**4,437**	**5,323**
Net finance cost	177	239	244	335	898	682	959	1,117
Pretax profits before extra-ordinaries	142	244	532	981	919	2,481	3,478	4,206
Exceptional items	(5)	—	—	—	889	—	—	—
Prior period items	(2)	(1)	(0)	(1)	6	—	—	—
Profit before tax	**149**	**245**	**532**	**982**	**1,802**	**2,481**	**3,478**	**4,206**
Current tax	9	15	75	128	414	440	615	743
Deferred tax	11	31	70	149	196	435	610	738
Reported PAT	130	199	387	705	1,192	1,605	2,253	2,725
Adjusted net profit	**122**	**199**	**386**	**704**	**603**	**1,605**	**2,253**	**2,725**
Calculations								
Margins (%)								
Gross margin	29.3	30.7	32.4	31.8	31.7	32.3	31.4	30.6
SGnA to sales	17.1	18.0	19.7	18.9	18.7	19.0	18.8	18.3
EBITDA margin	8.4	8.5	8.0	7.6	6.7	6.9	6.9	6.6
EBIT margin	7.2	7.3	7.2	6.7	5.6	6.1	6.1	5.8
PBT margin	3.4	3.7	4.9	5.0	5.6	4.8	4.8	4.6
Net profit margin (w/o extraordinaries)								
Effective tax rate (%)	13.2	18.6	27.3	27.0	33.7	33.7	33.7	33.7

Source: Company data for historical, Kotak Institutional Equities for forecasts.

Pantaloon retail, Balance sheet, March fiscal year end, FY2002-09E (Rs mn)

	FY2003	FY2004	FY2005	FY2006	FY2007E	FY2008E	FY2009E	FY2010E
Equity								
Share capital	182	191	220	269	294	294	294	294
General reserves/surplus	343	391	714	1,279	2,292	3,310	4,902	6,893
Capital reserve	1,329	366	1,281	3,721	8,279	8,279	8,279	8,279
Net worth	**1,854**	**949**	**2,215**	**5,269**	**10,864**	**11,882**	**13,474**	**15,465**
Deferred tax liability	**29**	**60**	**130**	**279**	**693**	**1,129**	**1,739**	**2,477**
Debt								
Secured loans	1,413	2,153	2,562	4,281	3,781	6,781	9,281	9,281
Unsecured loans	42	214	300	1,733	1,733	1,733	1,733	1,733
Total debt	**1,455**	**2,366**	**2,862**	**6,014**	**5,514**	**8,514**	**11,014**	**11,014**
Current liabilities and provisions	665	729	1,449	2,623	3,754	5,419	7,397	9,172
Total capital	**4,003**	**4,105**	**6,656**	**14,185**	**20,825**	**26,943**	**33,624**	**38,128**
Assets								
Cash and cash equivalents	81	138	215	218	1,171	1,364	1,324	1,658
Inventory	1,144	1,576	2,759	5,070	8,318	11,092	14,444	15,604
Sundry debtors	223	176	123	170	93	110	110	110
Loans and advances	214	410	941	3,366	3,512	4,571	5,751	7,065
Gross block	**1,230**	**1,847**	**2,511**	**3,660**	**6,384**	**8,950**	**11,795**	**14,314**
Less: accumulated depreciation	157	243	374	566	905	1,395	2,052	2,874
Net fixed assets	**1,073**	**1,604**	**2,137**	**3,094**	**5,479**	**7,555**	**9,743**	**11,440**
Capital – WIP	33	144	158	861	861	861	861	861
Net fixed assets (incl. C-WIP)	**1,106**	**1,748**	**2,295**	**3,955**	**6,340**	**8,415**	**10,604**	**12,300**
Investments	53	53	319	1,406	1,406	1,406	1,406	1,406
Miscellaneous expenditure	5	4	3	—	—	—	—	—
Intangibles (brands etc.)	1,177	—	—	—	—	—	—	—
Total assets	**4,003**	**4,105**	**6,656**	**14,185**	**20,825**	**26,943**	**33,624**	**38,128**
Leverage and return ratios (%)								
Debt/equity	78	235	122	108	48	65	72	61
Debt/capitalization	44	70	55	52	32	40	42	38
Net debt/equity	76	256	124	109	42	61	70	57
Net debt/capitalization	43	72	55	52	29	38	41	36
Net debt/EBITDA (X)	**3.7**	**4.0**	**3.1**	**3.9**	**1.7**	**2.0**	**1.9**	**1.5**

Source: Company data for historical, Kotak Institutional Equities for forecasts.

PRIL cash flow statement, June fiscal year-ends (Rs mn)

	FY2003	FY2004	FY2005	FY2006	FY2007E	FY2008E	FY2009E	FY2010E
Operating								
Pre-tax profits and extraordinary items	142	244	531	919	1,369	2,378	3,390	4,123
Depreciation & amortization	64	88	133	208	339	491	657	822
Taxes paid	(3)	(27)	(41)	(105)	(399)	(422)	(600)	(729)
Dividend and other income	2	(0)	(11)	(0)	—	—	—	—
Interest expense	177	231	275	335	740	682	959	1,117
Interest paid	(177)	(231)	(275)	(335)	(740)	(682)	(959)	(1,117)
Foreign exchange loss/(gain)	5	8	(31)	—	—	—	—	—
Extraordinaries (incl. prior period items)	(8)	(1)	(0)	(10)	889	—	—	—
Other non-cash items	1	1	1	1	—	—	—	—
Working capital changes	(129)	(515)	(1,009)	(2,244)	(2,365)	(2,177)	(2,550)	(684)
Cash flow from operations	**73**	**(202)**	**(427)**	**(1,232)**	**(168)**	**269**	**897**	**3,533**
Operating, excl. working capital	**203**	**313**	**582**	**1,013**	**2,198**	**2,446**	**3,447**	**4,217**
Investing								
Capex incl. capital issue expenses	(428)	(730)	(682)	(1,868)	(2,724)	(2,566)	(2,845)	(2,519)
(Purchase)/sale of assets/businesses	1	—	1	—	—	—	—	—
(Purchase)/sale of investments (incl. inv. in subsic	(2)	—	(255)	(2,625)	—	—	—	—
Advances to subsidiary			(4)	148	—	—	—	—
Interest/dividend received	—	—	(0)	—	—	—	—	—
Cash flow from investing	**(429)**	**(730)**	**(939)**	**(4,345)**	**(2,724)**	**(2,566)**	**(2,845)**	**(2,519)**
Financing								
Proceeds from issue of share capital	43	107	914	2,492	4,582	—	—	—
Net proceeds from borrowings	357	911	531	3,152	(500)	3,000	2,500	—
Effect of FX changes	(5)	(8)	31		—	—	—	—
Dividends paid (incl. tax)	—	(21)	(32)	(63)	(514)	(587)	(660)	(734)
Cash flow from financing	**396**	**989**	**1,443**	**5,581**	**3,569**	**2,413**	**1,840**	**(734)**
Net change in cash/cash equivalents	40	58	76	3	678	116	(108)	280
Beginning cash	40	81	138	215	218	895	1,011	902
Ending cash	**81**	**138**	**215**	**218**	**895**	**1,011**	**902**	**1,182**
Discretionary cash flow	40	37	44	(59)	164	(471)	(769)	(453)
Free Cash flow	**(355)**	**(932)**	**(1,109)**	**(3,100)**	**(2,891)**	**(2,297)**	**(1,948)**	**1,014**

Source: Company data for historical, Kotak Institutional Equities for forecasts.

Energy

HPCL.BO, Rs237	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	300
52W High -Low (Rs)	337 - 223
Market Cap (Rs bn)	80.5

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	890.0	876.9	880.0
Net Profit (Rs bn)	13.5	9.1	9.2
EPS (Rs)	40.0	26.8	27.2
EPS gth	*503.8*	*(33.1)*	*1.7*
P/E (x)	5.9	8.9	8.7
EV/EBITDA (x)	4.0	5.3	4.5
Div yield (%)	7.6	4.2	4.2

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.0	-	-
FIIs	13.5	0.2	(0.1)
MFs	7.8	0.6	0.3
UTI	-	-	(0.3)
LIC	15.5	1.1	0.8

HPCL: Strong 2QFY08 results due to receipt of oil bonds; 2HFY08 likely painful

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- **Bumper 2QFY08 results due to receipt of oil bonds for 1HFY08**
- **Future looks bleak given current high levels of crude price unless government intervenes positively**
- **Earnings forecasts and valuations continue to be academic**

HPCL reported 2QFY08 net income at Rs8.5 bn compared to a net loss of Rs0.8 bn in 1QFY08 and our expected net income of Rs10.2 bn. The variance in the results was on account of (1) Rs23.6 bn of oil bonds versus Rs25 bn of oil bonds assumed by us and (2) lower discount from upstream companies of Rs9.4 bn versus our estimated Rs10.2 bn. There is not much merit in the quarterly analysis of the results for the downstream companies as the results are impacted by the timing of receipt of oil bonds and government control on the business. We have revised our FY2008E, FY2009E and FY2010E EPS estimates to Rs26.8, Rs27.2 and Rs42.7, respectively versus Rs31.8, Rs34 and Rs46.4, respectively, previously due to higher marketing losses resulting from the recent surge in crude price. However, we note that the earnings forecast and valuations remain largely academic in light of the current unpredictable operating environment. Our 12-month fair valuation for the stock based on 40% discount to fair value (5X normalized EBITDA plus value of investments) is Rs300 versus Rs325 previously.

Issue of oil bonds bolstered 2QFY08 results; however, compensation likely inadequate given current level of under-recoveries. HPCL booked Rs23.6 bn of oil bonds in 2QFY08, which represents compensation for 1HFY08. HPCL's gross under-recovery was higher at Rs27.9 bn (+3.1% qoq). We note that the recent steep increase in crude oil prices without any affirmative government action (as yet) in the form of (1) commensurate increase in domestic selling prices and/or (2) issue of higher amount of old bonds renders earnings estimates impossible; it was anyway difficult previously.

The government has decided to give oil bonds of Rs235 bn in FY2008E although it may review this amount later. We compute that oil bonds of Rs235 bn may be insufficient for the downstream oil companies to sustain net income at FY2007 levels in light of the steep recent increase in global crude oil prices and consequently higher under-recoveries for the Indian downstream oil companies. We model HPCL's FY2008E net income at Rs9.1 bn (Rs26.8 EPS) based on (1) receipt of Rs47.2 bn of oil bonds and (2) discount of Rs42.7 bn from the upstream companies. If the share of the upstream companies of gross under-recoveries were to increase to 40% versus 33% assumed by us, HPCL's net income would increase to Rs14.7 bn (Rs43.4 EPS). We note that the share of under-recoveries of the upstream companies in FY2007 was 41.5%.

Operating details of 2QFY08. HPCL sold 5 mn tons of products in 2QFY08 (+7.1% yoy and – 7.4% qoq) led by strong demand for diesel, gasoline, jet fuel and LPG. It processed 4.3 mn tons of crude versus 3.9 mn tons in 1QFY08 and 4.2 mn tons in 2QFY07. HPCL's 2QFY08 refining margin was US$4.2/bbl versus US$8.4/bbl in 1QFY08 and US$2.6/bbl in 2QFY07. In 2QFY08, inventory gains were Rs1.3 bn and forex gains Rs0.9 bn.

Key changes to and major assumptions behind earnings model

We discuss our key assumptions and the major changes to our earnings model below but note that the exercise is largely academic given likely large under-recoveries in 2HFY08 on account of very high crude oil prices and limited clarity on the amount of oil bonds and subsidy sharing.

1. **Compensation (oil bonds) from the government.** We model HPCL receiving oil bonds of Rs47.2 bn, Rs38.7 bn and Rs23.1 bn, respectively in FY2008E, FY2009E and FY2010E, respectively based on 20.08% share of oil bonds, same as its share of oil bonds received for 1HFY08. We assume the government will issue oil bonds of Rs235 bn, Rs193 bn and Rs115 bn for FY2008E, FY2009E and FY2010E, respectively to the state-owned R&M companies compared to Rs241 bn of oil bonds issued in FY2007.

2. **Refining margins—likely to remain strong.** We model refining margins at US$4.8/bbl for FY2008E (US$5.2/bbl assumed previously), US$4.5/bbl for FY2009E and US$4.0/bbl in FY2010E compared to US$4.1/bbl in FY2007. We expect global refining margins to recover from current low levels and remain strong over the next few years due to (1) likely strong global demand for oil and (2) limited refining capacity addition. The yoy decline in FY2009E refining margins is due to our assumption of lower tariff protection in FY2009E versus in FY2008E (tariff differential of 0.4% versus 1.2% in FY2008E).

3. **Crude throughput.** We model the completion of the expansion and modernization projects of HPCL's Mumbai and Visakh refineries by February 2008 compared to December 2007 assumed previously. Accordingly, we have reduced the crude throughput for FY2008E to 15.5 mn tons (1HFY08 throughput was 8.16 mn tons) from 16.7 mn tons assumed previously. We model crude throughput at 18.5 mn tons for FY2009E and 19.3 mn tons for FY2010E.

4. **Exchange rate.** We have revised our rupee-dollar exchange rates for FY2008E, FY2009E and FY2010E to Rs40/US Dollar, Rs39/US Dollar and Rs38/US Dollar, respectively compared to Rs41/US Dollar previously for all the years.

Other updates. HPCL is in process of the formalizing an agreement with Reliance Industries for supply of gas from KG D-6 block to its refineries in Mumbai and Visakhapatanam from July 2008 to March 2012. This will likely boost HPCL's refining margins as the use of gas will allow HPCL to sell liquid refined products at market prices rather than use a portion of it (about 6%) to generate heat for refining. Thus, HPCL will benefit from the difference between product prices (linked to crude oil price) and gas price (likely significantly lower than crude oil price or fuel oil). We have not factored in likely savings that will accrue from the use of gas instead of refined products pending finalization of the agreement.

Interim results of Hindustan Petroleum (Rs mn)

		qoq			yoy			yoy		
	2008E	2Q 2008	1Q 2008	% chg	2Q 2008	2Q 2007	% chg	1H 2008	1H 2007	% chg
Net sales	876,903	242,344	218,817	11	242,344	243,675	(1)	461,161	450,416	2
Increase/(decrease) in stock	—	25,954	(3,757)	—	25,954	5,969	—	22,197	9,029	—
Raw materials	(328,140)	(90,004)	(78,157)	15	(90,004)	(100,016)	(10)	(168,161)	(190,425)	(12)
Staff cost	(8,206)	(2,067)	(1,805)	15	(2,067)	(2,202)	(6)	(3,872)	(3,859)	0
Product purchase	(511,474)	(150,771)	(128,882)	17	(150,771)	(121,223)	24	(279,652)	(235,466)	19
Others	(12,882)	(12,282)	(7,502)	64	(12,282)	(9,740)	26	(19,784)	(18,398)	8
Total expenditure	(860,701)	(229,169)	(220,102)	4	(229,169)	(227,212)	1	(449,271)	(439,119)	2
EBITDA	**16,202**	**13,176**	**(1,285)**	***(1,125)***	**13,176**	**16,462**	***(20)***	**11,891**	**11,296**	***5***
Other income	12,111	2,808	3,351	(16)	2,808	1,925	46	6,159	2,946	109
Interest	(6,627)	(1,399)	(1,334)	5	(1,399)	(983)	42	(2,732)	(1,579)	73
Depreciation	(7,931)	(2,017)	(1,798)	12	(2,017)	(1,742)	16	(3,815)	(3,443)	11
Pretax profits	**13,756**	**12,568**	**(1,066)**	***(1,279)***	**12,568**	**15,663**	***(20)***	**11,502**	**9,220**	***25***
Extraordinaries	—	—	—	—	—	—	—	—	—	—
Tax	(3,373)	(2,064)	(15)	13,657	(2,064)	(3,168)	(35)	(2,079)	(3,189)	(35)
Deferred tax	(1,302)	(1,974)	212	(1,032)	(1,974)	(275)	618	(1,762)	112	(1,669)
Net income	**9,080**	**8,530**	**(869)**	***(1,081)***	**8,530**	**12,220**	***(30)***	**7,661**	**6,143**	***25***
Adjusted net income	**9,080**	**8,530**	**(869)**	***(1,081)***	**8,530**	**12,220**	***(30)***	**7,661**	**6,143**	***25***
Tax rate (%)	34.0	32.1	18.5		32.1	22.0		33.4	33.4	
Volume data										
Crude throughput (mn tons)		4.3	3.9	9.2	4.3	4.2	2.4	8.2	8.3	(1.7)
Domestic sales volume (mn tons)		5.0	5.4	(7.4)	5.0	4.6	7.1	10.3	9.6	8.3
Pipeline throughput (mn tons)		1.8	1.8	4.6	1.8	1.7	8.9	3.6	3.3	7.8
Refining margin (US$/bbl)		4.2	8.4		4.2	2.6		6.2	5.9	
Inventory gain/(loss)		1,300	900	44.4	1,300	100	1,200	2,200	800	175
Receipt from upstream companies		9,369	9,010	4.0	9,369	12,287	(23.7)	18,379	24,648	(25.4)
Receipt from refining companies		—	—		—	303		—	1,207	
Reciept of oil bonds from government		23,555	—		23,555	29,060	(18.9)	23,555	29,060	(18.9)
Subsidy gain/(loss)		(27,900)	(27,050)	3.1	(27,900)	(32,790)	(14.9)	(54,950)	(67,860)	(19.0)

Source: Company, Kotak Institutional Equities estimates.

Normalized earnings forecasts are significantly higher versus actual forecasts

Comparison of normalized marketing margins with FY2009 estimates (Rs/ton)

	2009E	Normalized
LPG	(10,000)	1,500
Naphtha	2,000	500
Gasoline	(2,750)	1,700
Jet fuel	2,000	1,400
Kerosene	(16,250)	600
Diesel	(1,000)	1,500
Light diesel oil	1,000	500
Low sulphur heavy stock	1,600	500
Fuel oil	1,600	500
Bitumen	1,800	1,000
EPS (Rs)	**27.2**	**61.7**
EBITDA (Rs bn)	**25.3**	**42.9**
EV (5X normalised EBITDA) (Rs bn)		215
Value of investments (Rs bn)		48
Net debt (Rs bn)		93
Equity value (Rs/share)		503
Equity value at 40% discount (Rs/share)		**302**

Note:
(a) Our normalized earnings estimates are based on normalized marketing margins and actual refining margin estimates for FY2009.

Source: Kotak Institutional Equities estimates.

Earnings sensitivity of HPCL to refining margins, import duties and marketing margins (Rs mn)

	Fiscal 2008E			Fiscal 2009E			Fiscal 2010E		
	Downside	Base Case	Upside	Downside	Base Case	Upside	Downside	Base Case	Upside
Refining margins									
Refining margins (US$/bbl)	3.8	4.8	5.8	3.5	4.5	5.5	3.0	4.0	5.0
Net profits (Rs mn)	6,007	9,080	12,154	5,653	9,233	12,813	10,838	14,458	18,078
EPS (Rs)	17.7	26.8	35.9	16.7	27.2	37.8	32.0	42.7	53.3
% upside/(downside)	**(33.8)**		**33.8**	**(38.8)**		**38.8**	**(25.0)**		**25.0**
Import tariffs									
Tariff protection	0.7	1.2	1.7	(0.1)	0.4	0.9	0.2	0.7	1.2
Net profits (Rs mn)	8,447	9,080	9,714	8,436	9,233	10,029	13,629	14,458	15,287
EPS (Rs)	24.9	26.8	28.7	24.9	27.2	29.6	40.2	42.7	45.1
% upside/(downside)	**(7.0)**		**7.0**	**(8.6)**		**8.6**	**(5.7)**		**5.7**
Marketing margins									
Transportation fuels margins (Rs/ton)	(3,504)	(3,354)	(3,204)	(1,569)	(1,419)	(1,269)	1,398	1,548	1,698
Net profits (Rs mn)	8,363	9,080	9,798	8,476	9,233	9,990	13,263	14,458	15,653
EPS (Rs)	24.7	26.8	28.9	25.0	27.2	29.5	39.1	42.7	46.2
% upside/(downside)	**(7.9)**		**7.9**	**(8.2)**		**8.2**	**(8.3)**		**8.3**

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of HPCL, March fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	512,001	597,020	708,609	889,959	876,903	879,982	883,418
EBITDA	**31,858**	**20,511**	**8,056**	**24,036**	**16,202**	**25,267**	**32,857**
Other income	3,794	3,295	3,285	6,845	12,111	6,530	5,241
Interest	(557)	(816)	(1,587)	(4,230)	(6,627)	(7,888)	(6,353)
Depreciation	(6,054)	(6,584)	(6,902)	(7,040)	(7,931)	(9,922)	(9,842)
Pretax profits	29,042	16,406	2,851	19,611	13,756	13,987	21,903
Extraordinary items	—	1,471	2,201	3,030	—	—	—
Tax	(10,225)	(5,897)	(898)	(6,625)	(3,373)	(2,918)	(5,934)
Deferred taxation	(540)	793	(97)	(365)	(1,302)	(1,836)	(1,511)
Prior period adjustment	762	—	—	61	—	—	—
Net profits	**19,039**	**12,773**	**4,056**	**15,712**	**9,080**	**9,233**	**14,458**
Earnings per share (Rs)	**56.2**	**34.8**	**6.6**	**40.0**	**26.8**	**27.2**	**42.7**
Balance sheet (Rs mn)							
Total equity	77,428	84,409	87,357	95,987	101,101	106,368	114,617
Deferred tax liability	14,541	13,748	13,844	14,209	15,511	17,348	18,858
Total borrowings	17,008	21,854	66,638	105,175	107,675	93,175	73,175
Currrent liabilities	76,551	69,887	79,549	101,195	83,157	89,843	91,783
Total liabilities and equity	**185,528**	**189,896**	**247,389**	**316,566**	**307,444**	**306,734**	**298,433**
Cash	1,971	2,016	426	868	608	603	751
Current assets	92,331	93,007	109,674	113,779	112,124	115,546	115,530
Total fixed assets	70,743	77,305	97,013	130,644	146,914	150,288	156,854
Investments	20,484	17,568	40,276	71,275	47,798	40,298	25,298
Total assets	**185,528**	**189,896**	**247,389**	**316,566**	**307,444**	**306,735**	**298,434**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	29,062	15,977	10,126	23,966	4,411	14,461	20,570
Working capital changes	(13,410)	(3,614)	(5,351)	8,936	(13,755)	4,059	1,956
Capital expenditure	(8,895)	(12,849)	(25,298)	(38,510)	(22,410)	(13,296)	(16,409)
Investments	(342)	2,995	(22,884)	(31,704)	23,477	7,500	15,000
Other income	1,052	800	941	2,067	9,483	5,736	5,241
Free cash flow	**7,466**	**3,310**	**(42,466)**	**(35,246)**	**1,206**	**18,460**	**26,358**
Ratios (%)							
Debt/equity	18.5	22.3	65.8	95.4	92.3	75.3	54.8
Net debt/equity	16.4	20.2	65.4	94.7	91.8	74.8	54.3
RoAE	22.0	13.4	4.1	14.9	8.0	7.7	11.2
RoACE	**18.9**	**10.1**	**2.5**	**8.8**	**7.0**	**7.8**	**9.7**
Key assumptions							
Crude throughput (mn tons)	13.7	13.9	14.0	16.7	15.5	18.5	19.3
Effective tariff protection (%)	7.4	5.6	3.1	1.4	1.2	0.4	0.7
Net refining margin (US$/bbl)	4.4	4.5	3.9	4.3	4.8	4.5	4.0
Sales volume (mn tons)	20.1	20.6	20.1	23.4	24.2	25.0	25.8
Marketing margin (Rs/ton)	1,861	1,688	(463)	(710)	(1,321)	(252)	1,527
Subsidy under-recoveries (Rs mn)	(12,870)	(26,708)	(29,671)	(18,899)	(38,293)	(28,662)	(17,627)

Source: Kotak Institutional Equities estimates.

Transportation

JET.BO, Rs923	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	800
52W High -Low (Rs)	980 - 533
Market Cap (Rs bn)	79.7

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	70.6	100.7	138.4
Net Profit (Rs bn)	(0.0)	0.0	4.9
EPS (Rs)	(0.2)	0.2	57.0
EPS gth	*(103.5)*	*-*	*37,636*
P/E (x)	(3,814)	5,936	16.2
EV/EBITDA (x)	30.9	12.4	6.1
Div yield (%)	0.1	0.0	1.3

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	9.7	0.1	(0.1)
MFs	2.2	0.1	(0.1)
UTI	-	-	(0.2)
LIC	2.8	0.2	(0.1)

Jet Airways: Losses due to international expansion and low domestic yields; Other income earns profit

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- **' Losses mount as yields fall; Other income earns profit**
- **' Domestic sector continues to suffer due to over-capacity; lowering of yields to achieve higher seat factors**
- **' Capacity expansion of international operations impacts profitability; situation to likely continue in the near-term**
- **' Signs of improvement in performance of Jet Lite; however we expect the turnaround to be slow**
- **' Maintain target price and under perform rating due to visible near-term challenges**

Jet Airways reported revenues and PAT of Rs18.2 bn and Rs284 mn respectively versus our expectation of Rs20.3 bn and loss of Rs233 mn. Excluding gain of Rs3.1 bn (profit on sale and lease back of four aircrafts) and Rs735 mn (net exchange gain on restatement in accordance with AS11), Jet would have reported a loss (before tax) of Rs3.5 bn. EBITDAR margin in 2QFY08 has declined to 1.3% compared to 2.1% a year ago. The poor performance is attributable to (1) a seasonally weak quarter, (2) capacity ramp-up in the international segment and (3) fall in yields in the domestic segment. We expect capacity expansion in the international segment to continue to impact performance, atleast in the near-term. The over-capacity situation in the domestic segment continues, with lowering of yields to achieve higher seat factors. There are signs of improvement in the performance of Jet Lite; we however expect the turnaround process to be slow. We highlight that in 1HFY08 Jet has achieved only 14% of our full-year EBITDAR estimates. We maintain our target price of Rs800/share based on 6X adj. EV/EBITDAR which implies about 14X PER based on FY2009E earnings. We retain our underperform rating as we see several near-term challenges.

Losses mount as yields fall; Other income earns profit

Jet Airways reported revenues and PAT of Rs18.2 bn (up 12.6% yoy) and Rs284 mn (loss of Rs551 mn in 1Q07) respectively versus our expectation of Rs20.3 bn and loss of Rs233 mn. Excluding gain of Rs3.1 bn (profit on sale and lease back of four aircrafts) and Rs735 mn (net exchange gain on restatement in accordance with AS11), Jet would have reported a loss (before tax) of Rs3.5 bn. EBITDAR margin has declined to 1.3% compared to 2.1% a year ago.

The poor performance is attributable to (1) seasonally weak quarter, given the monsoons, (2) capacity ramp-up in the international segment (flights to New York and Toronto were launched in this quarter) and (3) fall in yields in the domestic segment. The capacity ramp-up has entailed substantial initial set-up phase costs without corresponding revenues (1) employee cost ratio has increased to 16% (from 14% a year ago), as a large number of pilots, technicians and other support staff were hired (13% qoq increase in employee costs), (2) S&D expenses ratio increased to 4.4% (from 3.2% a year ago), for advertising the newly launched flights, (3) other operating expenses ratio increased to 32% from 29% (15% qoq increase in other expenses), (4) depreciation increased by 80% yoy (31% qoq; delivery of 5 new aircraft in the quarter, including 4 wide-bodied aircraft) and (5) interest costs increased by 104% yoy (83% qoq). Fuel costs increase was marginal at 2.5%, due to (1) operation of a lower number of domestic flights compared to last year (attributable to route rationalization), (2) lower fuel prices (average rate of Rs39.8 in 2Qfy08 compared to Rs44.1 a year ago) and (3) increasing proportion of international flights (that take the benefit of lower fuel prices at their global destinations).

Domestic sector continues to suffer due to over-capacity; lowering of yields to achieve higher seat factors

In the domestic segment seat factors increased to 66.3% in 2QFY08 from 65.6% a year ago. Despite the increase in seat factors, domestic segment revenues declined by 8.6% to Rs12.5 bn, led by a fall in yields. For both the international and domestic segments combined, we estimate the yields to have fallen by 13% yoy. We note that the fall in yields is despite (1) likely improvement in pricing due to consolidation in the industry, (2) slower capacity addition in the industry in this quarter compared to the last few quarters and (3) route rationalization by Jet (and discontinuation of loss-making routes). This highlights the over-capacity in the industry and the intense competition (as fares are reduced to achieve higher seat factors) (Exhibit 2 & 3). Domestic sector profitability may have been aided by lower fuel costs in this quarter compared to last year. However, with the likely increase in ATF prices (led by the increase in oil prices), this situation is expected to reverse in the coming quarter.

Capacity expansion of international operations impacts profitability; situation to likely continue in the near-term

International segment continues to gain prominence with a contribution of 31% to revenues, compared to 17% last year. International segment seat factors at 67.5% in 2QFY08 have improved both yoy (58.9% in 2QFY07) and qoq (65.5% in 1QFY08). The yoy improvement in international segment seat factors has been higher than the domestic segment. We however estimate that the fall in yields in the international segment is more than the domestic segment. Jet would have likely offered lower fares to gain a foothold in the international markets.

Jet will continue its international expansion in 3Q08 with new flights to Dhaka (from Delhi and Kolkata) and increase in frequency of the Delhi-Kathmandu flights. Further it plans to start operations to Qatar, Kuwait, Bahrain and Oman from January 2008. We highlight that though the Gulf routes are profitable, Jet will likely face fierce competition, especially from the Air India-Indian Airlines combine (as the Gulf routes constitute the most significant portion of their profits). Further Jet has not yet received permission to fly on the higher density Dubai and Abu Dhabi routes. Media reports suggest that the Kingfisher-Deccan Aviation combine is also framing plans to operate international flights as soon as it becomes eligible (Deccan Aviation will be eligible next year and Kingfisher a year after that). The government is anyways deliberating on scrapping the five year domestic experience eligibility criteria for starting international operations. So though Jet has a head-start, profitability on international routes is likely to be impacted by increasing competition intensity.

Signs of improvement in performance of Jet Lite; however we expect the turnaround to be slow

Management has shared some details on Jet Lite for 1HFY08 that indicate an improvement in its performance (1) Negative EBITDAR of Rs529 mn (versus negative of Rs1.7 bn in FY07), (2) Cost per ASKM at Rs 3.1 (versus Rs4.3 in FY07), (3) RPKM of Rs3.4 (versus Rs3.6 in FY07; the RPKM will likely improve significantly as the second half of the year is typically better), (4) Seat factors of 71% (versus 68% in FY07) and (5) operations of 20 aircrafts in October (out of a total of 24). Management expects all 24 aircraft to be operational by November and Jet Lite to turn profitable in 3QFY08. We believe that superior performance in 3QFY08 may likely be achieved due to the festive season. However, Jet Lite will continue to face several challenges that will likely impede its turnaround (1) establishment of the business model as a value carrier, (2) substantial costs and investments for overhaul of aircrafts including repairs, reconfiguration and rebranding, (3) lack of full synergies with Jet due to different business models, (4) continued challenging environment in the domestic sector with impending capacity additions and fuel price increments, (5) start-up costs for likely launch of international operations.

We highlight risk to our full year estimates

We highlight that in 1HFY08 Jet has achieved only 14% of our full-year EBITDAR estimates. In 1HFY07 Jet had achieved 24% of FY07 EBITDAR. EBITDAR in 1HFY08 has increased only by 4% yoy, while our full-year estimate is higher by 74% compared to FY07. Though the second half of the year is usually much better compared to the first, it seems difficult for Jet to meet our full-year estimates given the ramp-up in international operations and the challenging environment in the domestic sector.

Maintain target price and under perform rating due to visible near term challenges

We maintain our target price of Rs800/share based on 6X adj. EV/EBITDAR which implies about 14X PER based on FY2009E earnings. We retain our underperform rating as we see several near term challenges (1) profitability from international operations would be impacted with launch of several new international routes over the near term and competition from likely new entrants, (2) turnaround of JetLite would test execution skills of management during revival as well as running two separate business models under the same roof, (3) increase in oil prices will severely impact margins, (4) the overcapacity situation in the domestic markets will not likely ease given the capacity expansion plans of all major carriers. We will revisit our estimates post the management conference call today.

Jet Airways - Strong operating performance in 2QFY08

Exhibit 1: Jet Airways - 2QFY08 - key number

			yoy			qoq			yoy		
	FY2007	**FY2008E**	**2QFY08**	**2QFY07**	**% change**	**2QFY08**	**1QFY08**	**% change**	**1HFY08**	**1HFY07**	**% change**
Revenues	**70,578**	**100,737**	**18,186**	**16,150**	**12.6**	**18,186**	**18,067**	**0.7**	**36,252**	**32,616**	**11.1**
Operating expenses	(60,499)	(83,177)	(17,940)	(15,817)	13.4	(17,940)	(15,831)	13.3	(33,771)	(30,219)	11.8
Employee costs	(9,381)	(10,982)	(2,863)	(2,247)	27.4	(2,863)	(2,634)	8.7	(5,497)	(4,537)	21.2
Fuel	(24,276)	(32,852)	(6,960)	(6,792)	2.5	(6,960)	(5,996)	16.1	(12,955)	(12,650)	2.4
Commission	(5,589)	(10,926)	(1,507)	(1,569)	(3.9)	(1,507)	(1,286)	17.3	(2,793)	(3,117)	(10.4)
S&D exps	(2,420)	(1,063)	(798)	(516)	54.7	(798)	(855)	(6.7)	(1,653)	(1,028)	60.7
Other op exps	(18,833)	(27,353)	(5,813)	(4,694)	23.8	(5,813)	(5,061)	14.9	(10,874)	(8,887)	22.4
EBIDTAR	**10,079**	**17,560**	**245**	**334**	**(26.5)**	**245**	**2,236**	**(89.0)**	**2,481**	**2,397**	**3.5**
Lease rentals	(6,458)	(5,700)	(1,253)	(1,576)	(20.5)	(1,253)	(1,532)	(18.2)	(2,786)	(3,027)	(8.0)
EBIDTA	**3,621**	**11,860**	**(1,008)**	**(1,242)**	**(18.8)**	**(1,008)**	**703**	**(243.3)**	**(305)**	**(629)**	**(51.6)**
Other income	3,435	950	4,356	2,062	111.3	4,356	1,764	147.0	6,120	2,384	156.7
Depreciation	(4,141)	(8,241)	(1,743)	(967)	80.3	(1,743)	(1,328)	31.3	(3,071)	(1,854)	65.6
EBIT	2,915	4,569	1,605	(147)		1,605	1,139	40.9	2,744	(100)	
Interest	(2,402)	(3,726)	(1,180)	(578)	104.1	(1,180)	(644)	83.1	(1,824)	(1,221)	49.5
EBT	**514**	**844**	**425**	**(725)**	**(158.6)**	**425**	**495**	**14.1**	**920**	**(1,320)**	**(169.7)**
Tax	(234)	(287)	(141)	174		(141)	(186)	(24.0)	(327)	319	
PAT	**279**	**557**	**284**	**(551)**		**284**	**309**	**8.2**	**592**	**(1,001)**	
Key ratios											
% of revenues											
Employee costs	13.3	10.9	15.7	13.9		15.7	14.6		15.2	13.9	
Fuel costs	34.4	32.6	38.3	42.1		38.3	33.2		35.7	38.8	
Commission	7.9	10.8	8.3	9.7		8.3	7.1		7.7	9.6	
S&D	3.4	1.1	4.4	3.2		4.4	4.7		4.6	3.2	
Others	26.7	27.2	32.0	29.1		32.0	28.0		30.0	27.2	
EBIDTAR margin	**14.3**	**17.4**	**1.3**	**2.1**		**1.3**	**12.4**		**6.8**	**7.3**	
EBIDTA margin	**5.1**	**11.8**	(5.5)	(7.7)		(5.5)	3.9		(0.8)	(1.9)	
EBIT margin	**4.1**	**4.5**	8.8	(0.9)		8.8	6.3		7.6	(0.3)	
PBT margin	**0.7**	**0.8**	2.3	(4.5)		2.3	2.7		2.5	(4.0)	
Tax rate	**45.6**	**34.0**	**33.3**	**24.0**		**33.3**	**37.6**		**35.6**	**24.2**	

Source: Company data, Kotak Institutional Equities estimates.

Sharp decline in seat factors in domestic segment on a yoy basis and in international segment on a qoq basis, yields decline on a qoq basis in domestic segment

Exhibit 2: Jet Airways - key operating statistics

			yoy			qoq			qoq		
	FY2007	FY2008E	2QFY08	2QFY07	(% chg)	2QFY08	1QFY08	(% chg)	1HFY08	1HFY07	(% chg)
ASK (mn)	**17,700**	**27,696**	**5,419**	**4,386**	**23.6**	**5,419**	**4,757**	**13.9**	**10,176**	**8,423**	**20.8**
RPK (mn)	12,307	18,923	3,621	2,786	30.0	3,621	3,287	10.2	6,908	5,727	20.6
Seat factor (%)	69.5	68.3	66.8	63.5		66.8	69.1		67.9	68.0	
Domestic	**70.2**	**71.6**	66.3	65.6		**66.3**	**71.2**				
International	68.0	65.1	67.5	58.9		67.5	65.5				
Yield (Rs/RPK)	**5.3**	**4.8**	**4.6**	**5.3**	(13.0)	**4.6**	**5.0**	(8.6)	**4.8**	**5.3**	(8.3)

Source: Company data, Kotak Institutional Equities estimates.

Domestic profitability falls on a qoq basis with decline in yields and in international segment with decline in seat factors

Exhibit 3: Jet Airways - Segment wise details

			yoy			qoq	
	FY2007	2QFY08	2QFY07	(% chg)	2QFY08	1QFY08	(% chg)
Domestic							
Revenue	57,004	12,526	13,708	(8.6)	12,526	13,708	(8.6)
International							
Revenue	13,574	5,660	2,733	107.1	5,660	4,359	29.8
PBT	(1,867)	(1,181)	(1,114)	(6.0)	(1,181)	(817)	(44.6)

Source: Company data, Kotak Institutional Equities estimates.

Property

SOBH.BO, Rs976	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	960
52W High -Low (Rs)	1179 - 620
Market Cap (Rs bn)	71.1

Financials

April y/e	2007E	2008E	2009E
Sales (Rs bn)	11.9	16.6	25.7
Net Profit (Rs bn)	1.6	2.2	3.0
EPS (Rs)	22.2	30.3	41.2
EPS gth	*1.0*	*36.5*	*35.7*
P/E (x)	43.9	32.2	23.7
EV/EBITDA (x)	29.8	20.5	14.7
Div yield (%)	0.6	0.3	0.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	87.0	-	-
FIIs	7.5	0.1	0.1
MFs	0.5	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Sobha Developers: 2QFY2008 revenues inline with our estimates; Margins higher than our estimates

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- **2QFY2008 revenues in line with estimates; grow 2% on a yoy basis**
- **Land bank quantity as well as quality improving**
- **Retain IL rating with revised target price of Rs960**

Sobha Developers (Sobha) reported operating revenues of Rs3.3 bn (v/s our expectation of Rs3.2 bn) and PAT of Rs0.6 bn (v/s our expectation of Rs0.5 bn) for 2QFY2008. Operating margin of 26.6% is better than our expectations of 22.8%. Higher operating margins have resulted from higher revenue booking from higher margin residential projects and better price realizations. Earlier, we had estimated pricing reductions in FY2008 to the extent of 10% and increasing 5% thereafter but now we predict pricing correction of 5%in FY2008 and stable prices in FY2009. We also increase revenue bookings for higher margin projects while lowering overall sales expectations. As a result we revise our revenue estimates to Rs16.6 bn for FY2008 (Rs17.7 bn earlier) and Rs25.7 bn for FY2009 (Rs26.8 bn earlier). We revise out PAT estimates to Rs2.21 bn in FY2008 (Rs2.24 bn earlier) and Rs3.0 bn in FY2009 (Rs3.02 bn earlier). We note that there has been significant improvement in the quality as well as quantity of land bank. As a result we base our target price on a 10% premium to NAV and revise our target price to Rs960 (Rs870 earlier).

We change the timing of pricing corrections; lower our sales expectations

Earlier, we had estimated pricing reductions in FY2008 to the extent of 10% and increasing 5% thereafter but now we predict pricing correction of 5%in FY2008 and stable prices in FY2009. Since pricing reductions have been delayed, we also lower our sales expectations. We expect Sobha to sell 2.0 mn sq. ft of residential real estate in Bangalore in FY2008 vis-a-vis 2.3 mn sq. ft earlier. We note real estate revenues grew at a much slower pace growing at 10% in 1HFY2008 (Exhibit 2). As a result we revise our revenue estimates to Rs16.6 bn for FY2008 (Rs17.7 bn earlier) and Rs25.7 bn for FY2009 (Rs26.8 bn earlier).

Sobha is in the process of launching residential projects into three more cities in the next quarter and should be able to launch projects in five cities by the end of FY2008—Bangalore, Pune, Mysore, Chennai and Gurgaon. Management has indicated that the company is intending to launch first project in Pune in first week of November. For its expansion in Gurgaon, Sobha has signed a JDA with QVC Realty and Chintel. The land cost for the 192 acre 6.5 mn sq. ft project is Rs1.8 bn and Sobha has already paid Rs1.4 bn.

Land reserves quality of Sobha continues to improve

Exhibit 3 highlights improvement in land reserves quality of Sobha. Sobha has got access to 4,000 acres of land reserves of which it has paid Rs14.3 bn and amount outstanding is Rs9.4 bn. We highlight the fact that amount outstanding has been continuously declining indicating improvement in ownership status of land bank. The amount paid as % of total payments has risen to 60% compared to 53.3% at the end of June 2007 and 42% at end-FY2007. This was a key area to be monitored and we believe that land quality risk has decreased significantly. Management has highlighted that already 3,200 acres of land reserves have been registered.

The land acquisition process for Sobha continues to be strong. Sobha has added close to 500 acres in 2QFY2008 and 800 acres in FYTD2008. We note that land acquired is the recent past has not been factored into our NAV and thus there is upside potential to our NAV. Currently, we have factored 140 mn sq. ft to our NAV calculations.

Sobha to develop twin tower in Hyderabad

Reliance Energy and Sobha Developers have won a project to develop one of the tallest towers. Key assumptions made by us for NAV calculation are as below:

- Ownership pattern: Reliance Energy (66%); Sobha (23%); APIIC (11%)
- Total cost of project: Rs64 bn; Equity – Rs18 bn, Debt – Rs46 bn
- Saleable area – 11.3 mn sq. ft

As per detailed calculation sheet attached, base case NAV of the project is Rs28/share for Sobha Developers and base case assumption is rental rate of Rs100/sq. ft in FY2012 when the tower is likely to get completed. We note that NAV is very sensitive to rental/month.

We increase our Mar'09 based target price to Rs960/share; retain In-line rating

Based on changes as discussed above, our March 2009 based NAV is revised to Rs875/share (Rs867 earlier). We note that our NAV is based on land reserves of 3,149 acres with developable potential of 140 mn sq. ft while current land bank is 4,000 acres. We have also not factored Hyderabad Tower project into our estimates. As a result, we base our target price at 10% premium to NAV and our revised target price is Rs960/share (Rs870 earlier).

Sobha Developers :2QFY2008 results

				% chg.		Kotak estimates				
(in Rs mn)	2QFY2007	1QFY2008	2QFY2008	qoq	yoy	2QFY07	deviation	FY07	FY08E	% chg.
Net sales	**3,261**	**2,677**	**3,308**	**23.6**	**1.4**	**3,194**	**3.6**	**11,865**	**16,594**	**39.9**
Operating costs	**(2,625)**	**(2,006)**	**(2,429)**	**21.1**	**(7.5)**	**(2,467)**		**(9,303)**	**(12,600)**	**35.4**
(Increase)/Decrease intock in inventories		264	1,840	596.8				1,017		
Land cost expenses		(131)	(1,561)	1,091.9				(1,832)	(1,394)	
Construction expenses		(1,082)		(100.0)				(4,952)	(8,630)	
Raw material consumption		(282)	(2,064)	(2,064.3)				(1,051)		
Production expenses		(57)		(100.0)				(236)		
Staff cost		(221)	(247)	12.1				(707)	(917)	
Other administrative expenses		(498)	(396)	(20.5)				(1,542)	(1,659)	
EBITDA	**636**	**671**	**879**	**31.1**	**38.2**	**727**	**20.9**	**2,562**	**3,994**	**55.9**
Other income	1	15	22	45.9	2,089.0	10.0		29	34	15.7
Interest costs		(101)	(133)	31.5		(120.0)		(481)	(904)	87.9
Depreciation		(83)	(88)	6.0		(80.0)		(244)	(417)	71.0
PBT	**436**	**502**	**680**	**35.6**	**56.0**	**537**		**1,866**	**2,706**	**45.0**
Taxes	(65)	(93)	(118)	27.4	82.2	(64.4)		(251)	(495)	97.3
PAT	**371**	**409**	**562**	**37.5**	**51.4**	**472**	**18.9**	**1,615**	**2,211**	**36.9**
Key ratios										
EBITDA margin (%)	19.5	25.1	26.6			22.8		21.6	24.1	
PAT margin (%)	11.4	15.3	17.0			14.8		13.6	13.3	
Effective tax rate (%)	14.9	18.5	17.4			12.0		13.5	18.3	

Source: Company data, Kotak Institutional Equities

Revenue growth for Sobha is showing a declining trend

(Rs mn)	Q1 FY07	Q2 FY07	Q3 FY07	Q1 FY08	Q2 FY08
Real estate business including charges collected	1,039	1,912	1,989	1,533	1,725
Contractual income	1,015	1,349	987	1,144	1,529
Other income	3	1	9	15	76
Total income	2,057	3,262	2,985	2,692	3,330
Cost of Sales	1,612	2,517	2,180	1,787	2,294
Cost of sales %	78	77	73	66	69
GP	445	745	805	905	1,036
GP %	22	23	27	34	31
Unallocable expenses	4	3	4	1	4
PBDIT	355	636	683	870	901
PBDIT %	17	19	23	32	27
PBT	176	436	491	501	680
PBT %	9	13	16	19	20
PAT	169	371	456	408	562
PAT %	8	11	15	15	17
Comaprison to correspondng period of previous years (Growth in %)					
Total income		105	77	31	2
GP		121	68	103	39
PBDIT		120	62	145	42
PBT		105	45	185	56
PAT		118	49	141	51
Real estate GP	248	482	641	705	776
Contractual GP	197	264	165	200	260
Real estate GP %	24	25	32	46	45
Contractual GP%	19	20	17	17	17

Source: Company, Kotak Institutional Equities

Land bank expanding beyond Bangalore; payables decreasing

Land bank details as on Aug-06, Mar-07, Jun- 07, Sep-07

	Aug-06			Mar-07			Jun-07			Sep-07		
Location	Land (acres)	Paid (mn)	Payable (mn)	Land (acres)	Paid (mn)	Payable (mn)	Land (acres)	Paid (mn)	Payable (mn)	Land (acres)	Paid (mn)	Payable (mn)
Bangalore	1,758	4,248	13,352	1,768	5,606	11,850	1,625	6,465	8,359			
Mysore	12	90	107	63	90	264	156	201	1,675			
Pune	256	209	324	329	550	420	117	669	285			
Chennai	330	315	120	482	467	—	527	1,000	—			
Cochin	155	618	—	419	1,784	—	498	2,405	—			
Trissur	55	200	248	62	468	—	15	86	—			
Coimbatore	26	24	—	26	24	—	12	3	—			
Hosur							623	969	—			
Gurgaon												
Total	**2,592**	**5,704**	**14,151**	**3,149**	**8,989**	**12,534**	**3,574**	**11,798**	**10,319**	**4,000**	**14,290**	**9,400**
% of total cost		**28.7**	**71.3**		**41.8**	**58.2**		**53.3**	**46.7**		**60.3**	**39.7**

Note: This does not include 162 acres of land allocated to on-going projects in June'07

Source: Company, Kotak Institutional Equities.

Hyderabad project NAV accretion is very sensitive to interest rates (Rs mn)

NAV of the project

		Rental (Rs/sq. ft/month)			
		90	**100**	**110**	**120**
	11	5.1	11.6	18.0	24.4
	12	3.9	10.1	16.3	22.6
WACC(%)	**13**	2.8	8.8	14.8	20.8
	14	1.7	7.5	13.3	19.1
	15	0.7	6.3	11.9	17.5
	16	(0.2)	5.2	10.6	15.9

NAV accretion (Rs/share) for Sobha

		Rental (Rs/sq. ft/month)			
		90	**100**	**110**	**120**
	11	16	36	57	77
	12	12	32	52	71
WACC(%)	**13**	9	28	47	66
	14	5	24	42	60
	15	2	20	38	55
	16	(1)	16	33	50

Year ending March 31,	**2008**	**2009**	**2010**	**2011**	**2012**
Income					13,560
Operating costs					1,356
EBIDTA					12,204
EBIDTA margin (%)					90
Depreciation					
Interest					
PBT					12,204
Tax					2,441
PAT					9,763
Cash accrual					9,763
% Complete	**10**	20	40	30	
Construction cost	**(6,400)**	**(12,800)**	**(25,600)**	**(19,200)**	
Value at capitalization rate of 10%					97,632
WACC (%)	**13**				
	1	1.1	1.3	1.4	1.6
PV	**(6,400)**	**(11,327)**	**(20,049)**	**(13,307)**	**59,880**
		(3,570)			
NAV		8,797			
Total Cost (Rs mn)	**64,000**				

Source: Kotak Institutional Equities.

We estimate March 2009 based NAV at Rs875/share

		Valuation (Rs bn)	Rs/share
Land Reserves (growth rate in selling price = 5%, discount rate = 13%)	**10% premium to NAV**	76.5	1,049
Less: Land cost to be paid		(8.0)	(110)
Less: Net Debt		(11.2)	(154)
Contractual business		6.6	90
Fair price			**875**

Source: Kotak Institutional Equites

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

	2005	2006	2007	2008E	2009E	2010E
Total revenues	**4,629**	**6,277**	**11,865**	**16,594**	**25,732**	**37,615**
Land costs	(1,054)	(781)	(1,832)	(1,394)	(2,545)	(3,500)
Construction costs	(2,344)	(2,975)	(5,222)	(8,630)	(13,474)	(20,006)
Employee costs	(221)	(286)	(707)	(917)	(1,430)	(2,231)
SG&A costs	(376)	(829)	(1,542)	(1,659)	(2,445)	(3,385)
EBITDA	**634**	**1,407**	**2,563**	**3,994**	**5,838**	**8,493**
Other income	23	8	29	34	41	53
Interest	(109)	(219)	(481)	(904)	(1,430)	(1,760)
Depreciation	(74)	(112)	(244)	(417)	(579)	(756)
Pretax profits	**473**	**1,083**	**1,866**	**2,706**	**3,871**	**6,030**
Extraordinary items	—	—	—	—	—	—
Current tax	(123)	(188)	(251)	(488)	(886)	(1,750)
Deferred tax	(11)	(0)		(7)	16	41
Net income	**339**	**892**	**1,615**	**2,211**	**3,001**	**4,321**
Adjusted net income	**339**	**892**	**1,615**	**2,211**	**3,001**	**4,321**
EPS (Rs)						
Primary	5.3	14.0	24.5	30.3	41	59
Fully diluted	5.3	14.0	24.5	30.3	41	59
Shares outstanding (mn)						
Year end	63	63	73	73	73	73
Primary	63	63	66	73	73	73
Fully diluted	63	63	66	73	73	73
Cash flow per share (Rs)						
Primary	7	15	34	36	48	68
Fully diluted	7	15	34	36	48	68
Growth (%)						
Net income (adjusted)	281	163	82	36	36	44
EPS (adjusted)	281	161	76	24	36	44
DCF/share	277	114	133	4	35	41
Cash tax rate (%)	26	17	13	18	23	29
Effective tax rate (%)	28	17	13	18	22	28

Source: Kotak Institutional Equities estimates.

Banking

ORBC.BO, Rs231	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	240
52W High -Low (Rs)	273 - 157
Market Cap (Rs bn)	57.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	22.6	23.9	27.2
Net Profit (Rs bn)	5.8	5.7	6.3
EPS (Rs)	33.0	32.6	34.8
EPS gth	*2.9*	*(1.1)*	*6.8*
P/E (x)	7.0	7.1	6.6
P/B (x)	1.2	1.1	1.0
Div yield (%)	2.0	2.0	2.2

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.1	-	-
FIIs	19.0	0.2	(0.0)
MFs	3.9	0.2	0.0
UTI	-	-	(0.2)
LIC	13.8	0.6	0.4

Oriental Bank of Commerce: Profit supported by lower provisioning, while core income suffers

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- **OBC reported PAT of Rs2.4 bn (before amortization of GTB goodwill) in 2QFY08, a decline of 24% yoy but 10% ahead of estimates**
- **Write-back of provisions and lower effective tax rate helped earnings at the bank**
- **Downgrading stock to Underperform from In Line earlier**

OBC reported PAT of Rs2.4 bn (before amortization of GTB goodwill) in 2QFY08, a decline of 24% yoy but 10% ahead of estimates. Net interest income (NII) declined 3% yoy to Rs4 bn likely indicating the pressure on margin due to drop in CASA ratio and lower growth in advances compared to deposits growth. Write-back of provisions and lower effective tax rate helped earnings at the bank. We believe the bank will benefit from a rate cut as it has significant high cost bulk deposits and lower CASA ratio. However, this may take some time to percolate into its quarterly earnings and the stock will likely continue to underpeform in the short term. We have marginally tweaked our estimates and retain our target price of Rs240 per share, but are downgrading stock to Underperform.

Pressure on margin continues with NII declining in absolute terms

- OBC's NII declined by 3% yoy to Rs4 bn in 2QFY08 likely due to margin pressure on the back of lower credit growth, lower CASA ratio and lagged impact of deposit repricing. OBC's NIM declined to 2.4% in 2QFY08 compared to 2.7% in 1QFY08.
- CASA ratio reduced to 27% as of June 2007 and was likely a key reason for increase in funding costs to 6.88% (6.6% in 1QFY08 and 5.6% in 2QFY07) for the company.
- The incremental growth in deposits was Rs47 bn in 2QFY08 compared to an incremental credit growth of Rs18 bn, which further increased margin pressure.

Write back of provisions and lower effective tax rate aid PAT

- OBC reported write back of Rs191 mn in its overall provisions - details not available for now
- Company continues to have a healthy asset quality with net NPL ratio of 0.6% and gross NPL ratio of 3.0% as of September 2007. Gross NPLs declined 6% qoq to Rs13.9bn, while net NPLs increased marginally to Rs2.9bn
- The effective tax rate of the company was 19% in 2QFY08 compared to 27% in 1QFY08 and 2QFY07, which also aided profits for the current quarter.

OBC, Quarterly results, (Rs mn)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	% chg	2Q08KS	Actual Vs KS
Interest income	11,353	12,822	13,136	14,336	15,341	16,457	28.3		
Loans	7,169	7,823	8,474	9,528	11,039	11,586	48.1		
Investments	3,899	4,320	3,891	3,876	3,985	4,495	4.1		
Balance with RBI & banks	269	421	771	865	317	272	(35.4)		
Others	17	259	0	67	1	103	(60.1)		
Interest expense	7,244	8,695	8,924	9,874	10,910	12,462	43.3		
Net interest income	**4,110**	**4,128**	**4,212**	**4,462**	**4,431**	**3,995**	**(3.2)**	**4,458**	**(10.4)**
Non-int.income	1,687	1,579	1,330	1,437	1,512	1,425	(9.7)	1,200	18.8
Other income excluding treasury	1211	950	1,037	950	1,356	296	(68.8)	1,200	(75.3)
Sale of invts.	476	629	293	487	156	1,129	79.6	-	
Total income	**5,797**	**5,707**	**5,542**	**5,899**	**5,943**	**5,420**	(5.0)	**5,658**	(4.2)
Op. expenses	2,287	2,566	2,476	2,650	2,642	2,698	5.2	2,750	(1.9)
Employee cost	1,332	1,313	1,304	1,261	1,440	1,446	10.1	1,450	(0.3)
Other cost	955	1,253	1,173	1,390	1,202	1,253	(0.0)	1,300	(3.7)
Operating profit	3,510	3,141	3,066	3,249	3,301	2,722	(13.3)	2,908	(6.4)
Provisions and cont.	1,477	(737)	81	1,616	556	(191)	(74.1)	200	(195.5)
Investment Depreciation	2,096	(640)	150	1,900	790	—	(100.0)	—	
NPLs	(620)	(357)	(65)	(237)	(251)	—	(100.0)	200	(100.0)
PBT	2,033	3,878	2,985	1,633	2,745	2,913	(24.9)	2,708	7.6
Tax	481	771	550	462	741	551	(28.5)	569	(3.1)
Net profit	**1,553**	**3,108**	**2,436**	**1,171**	**2,004**	**2,362**	**(24.0)**	**2,139**	**10.4**
Tax rate (%)	23.6	19.9	18.4	28.3	27.0	18.9		21.0	
Extraordinary items	612	612	612	623	612	612		612	
Profit after ext items	940	2,495	1,823	549	1,392	1,750	(29.9)	1,527	14.6
PBT-invt gains+extra. item	3,653	2,610	2,842	3,046	3,379	1,784	(31.6)	2,708	(34.1)
PBT-invt gains+ Prov	**4,510**	**1,516**	**2,858**	**4,425**	**3,684**	**1,593**	**5.1**	**3,108**	**(48.7)**
Key balance sheet items (Rs bn)									
Deposits	545	598	607	640	645	692	15.7		
CASA	167	182	183	193	181	187	2.8		
CASA ratio (%)	30.6	30.4	30.1	30.1	28.0	27.0			
Advances	364	387	415	454	451	469	21.3		
Investments	199	200	199	200	203	NA			
Capital adequacy details									
CAR	12.1	13.3	13.1	12.5	13.9	13.59			
Tier I	10.4	NA	10.6	10.1	10.5	10.38			
Tier II	1.7	NA	2.5	2.5	3.4	3.21			
Asset quality details									
Gross NPLs (Rs bn)	20.5	18.5	17.5	14.5	14.9	13.9	(24.9)		
Gross NPLs (%)	5.6	4.8	4.2	3.2	3.3	3.0			
Net NPLs (Rs bn)	1.6	1.7	1.8	2.2	2.8	2.9	71.8		
Net NPLs (%)	0.5	0.5	0.5	0.5	0.7	0.6			
Yield management measures (%)									
Yield on advances	8.1	8.5	8.5	8.8	10.0	10.1			
Yield on investments	8.2	8.1	8.0	8.0	7.9	8.1			
Cost of deposits	5.3	5.60	5.7	6.1	6.60	6.9			
Net interest margin	2.60	2.54	2.80	2.70	2.70	2.42			

Source: Company, Kotak Institutional Equities estimates.

Banking

JKBK.BO, Rs745	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	850
52W High -Low (Rs)	800 - 398
Market Cap (Rs bn)	36.1

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	9.5	9.9	11.8
Net Profit (Rs bn)	2.7	3.2	3.5
EPS (Rs)	56.6	66.6	72.8
EPS gth	*55.2*	*17.8*	*9.3*
P/E (x)	13.2	11.2	10.2
P/B (x)	2.0	1.8	1.5
Div yield (%)	1.5	1.8	2.0

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	53.2	-	-
FIIs	34.7	0.2	0.1
MFs	1.1	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

J&K Bank : PAT exceeds estimate supported by non-interest income

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- **PAT up 28% yoy, 22% ahead of estimates**
- **Core performance disappointing, NII growth flat, lower provisions drive profit growth**
- **Reducing target price, retain OP given valuations**

J&K Bank reported a PAT of Rs1.1 bn in 2QFY08 ' growth of 28%yoy and 22% ahead of our estimates. However, the core performance of the bank in the current quarter was disappointing with (a) net interest income in 2QFY08 remaining flat at Rs1.95bn yoy and (b) non-interest income (ex-treasury) grew by just 5%yoy. Higher treasury income and lower provision expenses were the prime drivers of earnings in the current quarter. We have revised down our earnings estimates by 7% for FY2009 and 8% for FY2010 to factor in lower margins, and provisions. While we are disappointed with the results, we still find value in the bank, though we expect pressure on performance in the short term. We are reducing our target price to Rs850 (Rs 750 for J&K Bank and Rs105 for its holding in Met Life Insurance) from Rs875 per share, and retain our OP rating on the stock.

NII in 2QFY08 was flat compared to 2QFY07

- J&K Bank reported NII of Rs1.95 bn in 2QFY08, which was flat yoy and 8% lower than our estimate.
- Reported net interest margin (NIM) of the bank was 2.97% in 2QFY08, up 7 bps sequentially, but down 37 bps yoy.
- Decline in CASA ratio to 35.2% as of September 2007 from 40.9% as of September 2006 was reflected in the cost of deposits rising to 6.14% in 2QFY08 from 5.17% in 2QFY07.
- Incremental growth in deposits in 2QFY08 was Rs12 bn, while the incremental growth in (a) advances and (b) cash and balances with RBI was Rs7.5 bn and Rs6.4 bn respectively. Implying that earnings base for the bank was much lower than its resource base, which also impacted margin.
- We expect the bank margins to improve sequentially, but this will be significantly below the last year base, impacting NII growth at J&K Bank in 3Q and 4Q.

Higher other income and lower provisions account for most of the profits:

- In 2QFY08, J&K Bank reported yoy growth of 44% in non-interest income to Rs581mn, and an 84% yoy reduction in provision to Rs40 mn.
- The company has changed its accounting policy of recognizing fee income from government business from the current fiscal. It used to record the entire fee income from the government business in 4Q of the fiscal. However, from the current year the company has started recording it on a quarterly basis. Adjusted for the entry of Rs60 mn on account of the change in accounting policy, non-interest income (ex-treasury) increased by 5% yoy.
- Treasury income was up 138%yoy to Rs175 mn and was the prime source of revenues for the bank.
- Provision expenses were lower for J&K Bank as it did not have any investment depreciation hit in the current quarter neither did the bank make any provisions for NPL.

Decline in NPLs a positive

- While J&K Bank reported a yoy increase of 57% in net NPL to Rs1.6 bn as of September 2007, these declined qoq by around 2%. Bank had classified some of its legacy accounts as NPLs in 3QFY07 and 4QFY07, which led to an increase in reported NPLs at the bank. Since this development, the reported NPLs have come down over the last two quarters.
- The gross NPLs stood at 2.6%, while the net NPL stood at 0.9%.

CAR healthy.

- J&K Bank had a healthy CAR of 12.9% as of September 2006 with a Tier I ratio of 12.2%.
- Company has made preferential allotment of 4.1 mn warrants to J&K government at a price of Rs686 per share to enable the state government to retain its majority stake in the bank post the proposed GDR issue. The government has the option to exercise the warrants within 18 months of the date of issue. In case the government does not exercise the warrant the bank can forfeit the 10% payment made on these warrants.
- We believe the government holding will likely fall to around 51% post the GDR issue from 51% now.

J&K Bank quarterly performance (Rsmn)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	% chg	2Q08KS	Actual Vs KS
Interest income	4,547	4,621	4,631	5,210	5,751	5,967	29.1		
Loans	3,141	3,257	3,393	3,754	4,402	4,600	41.2		
Investments	1,286	1,281	1,146	1,368	1,266	1,325	3.5		
Balance with RBI & banks / others	119	84	93	88	82	42	(49.5)		
Interest expense	2,760	2,688	2,680	3,187	3,854	4,016	49.4		
Net interest income	**1,786**	**1,933**	**1,951**	**2,024**	**1,896**	**1,951**	**0.9**	**2,117**	**(7.8)**
Non-int.income	272	404	379	760	418	641	58.7	359	78.7
Other income exld treasury	245	330	279	683	398	466	41.1	359	29.8
Treasury income	28	74	100	77	21	175	137.2		
Total income	2,058	2,337	2,329	2,784	2,314	2,592	10.9	2,434	6.5
Operating expenses	829	908	888	1,094	943	1,034	13.9	1,009	2.5
Employee cost	524	552	522	599	610	599	8.3	635	(5.8)
Other cost	305	356	366	495	333	436	22.4	374	16.6
Operating profit pre provisions	1,229	1,429	1,442	1,690	1,372	1,558	9.0	1,425	9.3
Provisions and cont.	346	249	353	680	190	40	(83.9)	250	(84.0)
Investment Depreciation	91	(50)	-	145	-	-	(100.0)	-	
Credit provisions	200	200	300	454	190	40	(80.0)	190	(78.9)
Standard asset provisions	50	-	-	334	90	40			
PBT	884	1,180	1,089	1,010	1,182	1,518	28.6	1,175	29.2
Tax	260	340	250	557	289	380	11.8	294	29.3
Net profit	**624**	**840**	**839**	**453**	**892**	**1,138**	**35.4**	**881**	**29.1**
Tax rate (%)	29.4	28.8	23.0	55.2	24.5	25.0		25.0	
PBT-invt gains+ Prov	1,147	1,299	1,290	1,554	1,291	1,383	6.5	1,365	1.3
Key balance sheet items (Rs bn)									
Total Deposits	207	204	203	252	247	260	27.3		
Savings deposits	51	53	54	58	59	60	12.3		
Current deposits	25	31	28	35	30	32	3.1		
Term deposits	130	120	121	159	159	168	40.1		
CASA ratio (%)	37.0	40.9	40.4	37.0	35.8	35.2	-		
Advances	131	140	148	171	174	181	29.1		
Investments	82	75	69.9	74	77	80	7.1		
AFS	31	23	NA	NA	22	21	(8.3)		
HTM	51	51	NA	NA	56	58	13.8		
Assets	238	233	NA	286	282	293	25.7		
Capital adequacy details (%)									
CAR	12.99	13.20	14.57	13.24	13.01	12.86			
Tier I	12.57	12.79	14.10	12.60	12.37	12.19			
Tier II	0.42	0.41	0.47	0.64	0.64	0.67			
Asset quality details									
Gross NPLs (Rs mn)	3,458	3,760	4,051	5,018	4,872	4,778	27.1		
Gross NPL ratio (%)	2.6	2.6	2.7	2.9	2.8	2.6			
Net NPLs (Rs mn)	945	1,050	1,088	1,936	1,693	1,652	57.4		
Net NPL ratio (%)	0.7	0.8	0.7	1.1	1.0	0.9			
Balance sheet snapshot (Rs mn)									
Capital	485	485	NA	485	485	485	-		
Reserves and surplus	17,510	17,510	NA	19,602	19,602	19,602	12.0		
Deposits	206,996	203,920	NA	251,943	247,437	259,539	27.3		
Borrowings	2,615	3,188	NA	6,202	6,902	4,131	29.6		
Other liabilities and provisions	10,394	8,270	NA	8,233	7,484	9,379	13.4		
Total	**237,999**	**233,373**	**NA**	**286,465**	**281,910**	**293,136**	**25.6**		
Cash and balance with RBI	11,088	8,604	NA	18,548	15,377	21,785	153.2		
Balance with banks etc	6,340	4,765	NA	17,590	10,121	3,856	(19.1)		
Investments	81,742	74,647	NA	73,922	77,042	79,895	7.0		
Advances	131,294	140,199	NA	170,799	173,512	181,019	29.1		
Fixed assets	1,903	1,876	NA	1,834	1,844	1,897	1.1		
Other assets	5,633	3,283	NA	3,772	4,014	4,685	42.7		
Total	**237,999**	**233,373**	**NA**	**286,465**	**281,910**	**293,136**	**25.6**		
Yield measures (%)									
Cost of Deposits (Annualised)	4.89	5.17	5.04	5.58	5.93	6.14			
Yield on Advances (Annualised)	9.10	9.57	9.41	9.40	10.23	10.38			
Yield on Investments (Annualised)	5.99	6.55	6.34	6.20	6.71	6.75			
Net Interest Margins (Annualised)	2.93	3.34	3.56	3.23	2.90	2.97			

Source:Company, Kotak Institutional Equities estimates.

Forecasts and valuation (Rs mn)

March y/e	Profit after tax (Rs mn)	EPS (Rs)	P/E (X)	BVPS (Rs)	P/B (X)	Adjt. BVPS (Rs)	AP/B (X)	RoA (%)	RoE (%)
2007	2,744	56.6	13.2	414.2	1.8	371.1	2.0	1.0	14.4
2008E	3,232	66.6	11.2	465.9	1.6	425.2	1.8	1.0	15.1
2009E	3,531	72.8	10.2	522.3	1.4	489.9	1.5	0.9	14.7
2010E	4,114	84.8	8.8	588.1	1.3	556.7	1.3	0.9	15.3

Source: Bank, Kotak Institutional Equities.

J&K Bank old and new estimates

	Old estimates			New estimates			% change			yoy growth (%)		
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Net Interest income	8,639	10,688	12,895	7,955	9,808	12,465	(7.9)	(8.2)	(3.3)	3.6	23.3	27.1
NIM (%)	2.76	2.83	2.94	2.54	2.60	2.84						
Loan (Rs bn)	219	260	303	219	260	303	-	-	-	28.0	19.0	16.5
Other income	1,793	2,054	2,378	1,906	1,983	2,174	6.3	(3.4)	(8.6)	4.6	4.1	9.6
Fee	1,123	1,347	1,616	1,006	1,127	1,262	(10.4)	(16.4)	(21.9)	12.0	12.0	12.0
Treasury	21	-	-	250	150	150						
Total income	10,432	12,741	15,273	9,861	11,791	14,639	(5.5)	(7.5)	(4.2)	3.8	19.6	24.2
Operating expense	4,289	4,977	5,626	4,284	4,970	5,621	(0.1)	(0.1)	(0.1)	15.0	16.0	13.1
Employee expense	2,550	2,973	3,316	2,504	2,920	3,256	(1.8)	(1.8)	(1.8)	13.8	16.6	11.5
Other expense	1,740	2,004	2,310	1,780	2,050	2,365	2.3	2.3	2.4	16.9	15.2	15.3
Provisions	1,408	2,107	2,969	824	1,628	2,969	(41.5)	(22.7)	-	(49.3)	97.6	82.3
NPLs	1,168	1,915	2,815	584	1,436	2,815	(50.0)	(25.0)	-	(51.1)	145.9	96.0
Invt depreciation	-	-	-	-	-	-						
Invt amortization	240	192	154	240	192	154						
PBT	4,734	5,658	6,679	4,752	5,193	6,050	0.4	(8.2)	(9.4)	14.5	9.3	16.5
Tax	1,562	1,867	2,204	1,521	1,662	1,936	(2.7)	(11.0)	(12.2)	8.1	9.3	16.5
PAT	**3,172**	**3,791**	**4,475**	**3,232**	**3,531**	**4,114**	**1.9**	**(6.8)**	**(8.1)**	**17.8**	**9.3**	**16.5**
PBT - treasury + provisions	5,882	7,572	9,494	5,087	6,479	8,715	(13.5)	(14.4)	(8.2)	(2.5)	27.4	34.5

Source: Kotak Institutional Equities.

Media

JAGP.BO, Rs660	
Rating	OP
Sector coverage view	Cautious
Target Price (Rs)	735
52W High -Low (Rs)	720 - 256
Market Cap (Rs bn)	39.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	6.0	7.5	9.4
Net Profit (Rs bn)	0.7	1.3	1.8
EPS (Rs)	12.2	21.0	29.8
EPS gth	*44.5*	*72.1*	*41.7*
P/E (x)	54.1	31.5	22.2
EV/EBITDA (x)	32.0	18.6	12.8
Div yield (%)	1.1	1.7	2.5

Jagran Prakashan: Moderately weak 2QFY08 results; maintain estimates; retain OP

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- **Strong revenue growth overshadowed by higher employee and SG&A expenses**
- **Relatively lower growth in RM costs (weak newsprint prices, appreciating rupee) supported EBITDA**
- **Retain 12-month DCF-based target price of Rs735**

JAGP reported moderately weak 2QFY08 results with net income at Rs220 mn (+25% yoy, -37% qoq). Revenues increased 25% yoy to Rs1.8 bn in 2QFY08 driven by 25% yoy growth in print ad revenues despite weak spending from some key advertising categories such as 2-W automobiles. JAGP's 1HFY08 revenues and net income stood at Rs3.6 bn (FY2008E = Rs7.5 bn) and Rs568 mn (FY2008E = Rs1.29 bn). JAGP reported 2QFY08 EBITDA at Rs390 mn (+34% yoy, -24% qoq). We retain our earnings estimates and 12-month DCF-based target price of Rs735. Key downside risks stem from the pace of ad growth and competition.

Strong revenue growth led by print and outdoor ad revenues. JAGP's 2QFY08 revenues increased 25% yoy (-3% qoq) from Rs1.4 bn in 2QFY07 (see Exhibit 1) led by the following factors.

1. JAGP's 2QFY08 print ad revenues grew a strong 25% yoy to Rs1.2 bn. Strong growth in the rapidly-expanding education (back-to-school season), retailing, and telecom sectors compensated for weak ad spend in the automobiles sector, especially in 2-wheelers.
2. JAGP's 2QFY08 outdoor ad revenues increased 200% yoy to Rs105 mn led by rapid expansion in new cities. JAGP had over 1,200 properties in several cities across India at end-2QFY08. We expect the outdoor business to contribute Rs437 mn (~6% of total revenues) to JAGP's revenues in FY2008E and break even at the operating level by end-FY2008.
3. Circulation revenues increased 10% yoy and 5% qoq to Rs463 mn from Rs420 mn and Rs442 mn in 2QFY07 and 1QFY08, respectively. The growth reflects modest cover price increases in extant editions and increased circulation of JAGP's new print brand, I-Next.

EBITDA depressed by higher employee and SG&A costs. JAGP reported 2QFY08 EBITDA at Rs390 mn (+34% yoy, -24% qoq) despite higher employee and SG&A costs, which grew 31% yoy and 29% yoy, respectively. JAGP has been investing in its new media initiatives (I-Next, City Plus, outdoor and digital media) and we expect investments to continue in the next 2-3 quarters. JAGP's new editions are in an expansion phase currently with one new edition of I-Next (Meerut) and four editions of City Plus (Delhi, Bangalore) launched during 2QFY08. We expect JAGP's EBITDA to be likely affected by initial losses of these initiatives; however, we expect long-term value creation in these businesses.

Weak global newsprint prices and strong rupee supported 2QFY08 EBITDA. JAGP's 2QFY08 raw material costs increased 16% yoy compared to yoy revenue growth of 25%. The relatively lower growth in raw materials helped boost EBITDA despite steep increase in employee and SG&A costs. We attribute the relatively weaker growth in raw material costs to (1) decline in global newsprint prices and (2) stronger rupee.

Lower other income, higher depreciation. 2QFY08 other income declined 28% yoy to Rs37 mn from Rs52 mn in 2QFY07; we note that interest income on large cash balance in 2QFY07 reflecting money raised in JAGP's IPO led to high other income. Depreciation during 2QFY08 increased 47% yoy to Rs83 mn versus Rs56 mn in 2QFY07, largely as a result of investments in building color capacity for flagship daily Dainik Jagran and youth-oriented full color newspaper, I-Next; we note that color ads are usually priced at a 60-70% premium to B/W ads (see Exhibit 4) and these investments will help JAGP in realizing higher yields going forward.

Other developments

1. JAGP's board has decided to split the shares in the ratio of 5:1. This will increase the number of shares (Rs2 face value) to 301 mn.

2. JAGP has declared an interim dividend of Rs5 per share (Rs10 face value). We model Rs11.5 dividend for FY2008E.

Jagran Prakashan consolidated interim results, March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2008E	2Q 2008	1Q 2008	% chg	2Q 2008	2Q 2007	% chg	1H 2008	1H 2007	% chg
Revenues	**7,472**	**1,772**	**1,834**	***-3%***	**1,772**	**1,417**	***25%***	**3,606**	**2,800**	***29%***
Advertisement revenues	4,957	1,166	1,267	*-8%*	1,166	934	*25%*	2,433		
Circulation revenues	1,753	463	442	*5%*	463	420	*10%*	904		
Outdoor revenues	437	105	90	*17%*	105	35	*200%*	195		
Other revenues	326	38	35	*9%*	38	28	*38%*	74		
Total expenditure	**(5,384)**	**(1,382)**	**(1,319)**	***5%***	**(1,382)**	**(1,127)**	***23%***	**(2,701)**	**(2,162)**	***25%***
Inc/(Dec) in inventories	—	1	(0)		1	(0)		1	(0)	
Raw material costs	(2,298)	(665)	(638)	*4%*	(665)	(572)	*16%*	(1,304)	(1,094)	*19%*
Employee costs	(834)	(216)	(204)	*6%*	(216)	(165)	*31%*	(420)	(331)	*27%*
Other expenditure	(2,252)	(501)	(477)	*5%*	(501)	(389)	*29%*	(978)	(737)	*33%*
EBITDA	**2,089**	**390**	**515**	***-24%***	**390**	**291**	***34%***	**905**	**637**	***42%***
EBITDA margin (%)	**28.0**	**22.0**	**28.1**		**22.0**	**20.5**		**25.1**	**22.8**	
Other income	264	37	89	*-58%*	37	52	*-28%*	126	123	*2%*
Interest & finance charges	(74)	(14)	(20)	*-27%*	(14)	(20)	*-27%*	(34)	(37)	*-7%*
Depreciation	(368)	(83)	(70)	*18%*	(83)	(56)	*47%*	(153)	(104)	*47%*
Pretax profits	**1,911**	**330**	**513**	***-36%***	**330**	**266**	***24%***	**843**	**619**	***36%***
Extraordinary items	—	—	—		—	—		—	(17)	
Provision for tax	(650)	(110)	(166)	*-34%*	(110)	(91)	*21%*	(276)	(198)	*39%*
Net income	**1,261**	**220**	**348**	***-37%***	**220**	**175**	***25%***	**568**	**404**	***40%***
PBT (%)	25.6	18.6	28.0		18.6	18.8		23.4	22.1	
Tax rate (%)	*34.0*	*33.3*	*32.3*		*33.3*	*34.1*		*32.7*	*32.0*	

Source: Company, Kotak Institutional Equities estimates.

We model Jagran's revenues to grow strongly led by growth in print and outdoor advertisement revenues

Derivation of revenues of Jagran Prakashan, March fiscal year-ends, 2005-2013E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E
Advertisement revenues									
Kanpur	479	607	771	959	1,157	1,367	1,620	1,835	2,080
NCR	334	427	530	657	806	953	1,129	1,279	1,449
Lucknow	263	332	416	516	632	747	885	1,003	1,137
Others	1,255	1,705	2,170	2,825	3,687	4,437	5,195	5,906	6,651
Total print advertisement revenues	**2,332**	**3,071**	**3,887**	**4,957**	**6,282**	**7,505**	**8,828**	**10,022**	**11,317**
Outdoor revenues	—	14	170	437	806	1,349	1,914	2,426	2,813
Total outdoor advertisement revenues	**—**	**14**	**170**	**437**	**806**	**1,349**	**1,914**	**2,426**	**2,813**
Total advertisement revenues	**2,332**	**3,085**	**4,057**	**5,394**	**7,089**	**8,854**	**10,742**	**12,448**	**14,130**
Other revenues									
Circulation revenues	1,375	1,603	1,668	1,753	1,879	1,981	2,066	2,156	2,223
Digital media	11	42	138	207	289	376	451	496	546
Others	52	71	114	119	125	132	138	145	152
Total revenues	**3,770**	**4,802**	**5,976**	**7,472**	**9,382**	**11,342**	**13,398**	**15,245**	**17,051**
Growth (%)	**—**	**27.4**	**24.5**	**25.0**	**25.6**	**20.9**	**18.1**	**13.8**	**11.8**

Source: Company data, Kotak Institutional Equities estimates.

Profit model, balance sheet and cash model of Jagran Prakashan, March fiscal year-ends, 2005-2012E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model								
Net sales	3,764	4,805	5,982	7,472	9,382	11,342	13,398	15,245
EBITDA	**259**	**702**	**1,198**	**2,089**	**3,076**	**4,045**	**4,931**	**5,816**
Other income	10	63	248	264	253	254	248	249
Interest	(68)	(76)	(85)	(74)	(93)	(120)	(112)	(87)
Depreciation	(176)	(201)	(237)	(368)	(521)	(631)	(710)	(762)
Pretax profits	**25**	**488**	**1,124**	**1,911**	**2,715**	**3,548**	**4,357**	**5,216**
Extraordinary items	(5)	(30)	27	—	—	—	—	—
Current tax	(2)	(57)	(372)	(570)	(871)	(1,158)	(1,452)	(1,743)
Deferred taxation	(6)	(84)	(17)	(79)	(52)	(48)	(29)	(30)
Net income	**13**	**317**	**762**	**1,261**	**1,792**	**2,342**	**2,876**	**3,443**
Adjusted net income	16	338	744	1,261	1,792	2,342	2,876	3,443
Earnings per share (Rs)	**0.4**	**8.2**	**12.4**	**20.9**	**29.8**	**38.9**	**47.8**	**57.2**
Balance sheet								
Total equity	687	4,867	5,111	5,561	6,200	7,035	8,060	9,288
Deferred taxation liability	284	368	384	463	515	564	592	622
Total borrowings	1,304	1,165	1,067	966	1,600	1,700	1,400	1,000
Current liabilities	398	359	652	727	759	780	845	895
Total liabilities and equity	**2,672**	**6,759**	**7,215**	**7,717**	**9,074**	**10,079**	**10,897**	**11,805**
Cash	113	1,746	1,013	458	625	495	441	533
Other current assets	1,298	1,654	2,108	2,534	2,947	3,366	3,823	4,231
Total fixed assets	1,255	1,598	2,645	3,277	4,054	4,770	5,185	5,593
Investments	7	1,760	1,446	1,446	1,446	1,446	1,446	1,446
Miscellaneous expenditure	—	2	2	2	2	2	2	2
Total assets	**2,672**	**6,759**	**7,215**	**7,717**	**9,074**	**10,079**	**10,897**	**11,805**
Free cash flow								
Operating cash flow, excl. working capital	194	655	846	1,445	2,112	2,768	3,366	3,986
Working capital changes	(60)	(358)	(230)	(351)	(382)	(398)	(393)	(357)
Capital expenditure	(342)	(550)	(1,243)	(1,000)	(1,298)	(1,347)	(1,125)	(1,171)
Income from investments	5	31	179	264	253	254	248	249
Free cash flow	**(204)**	**(223)**	**(448)**	**358**	**686**	**1,277**	**2,097**	**2,708**
Ratios (%)								
Debt/equity	57	18	16	14	19	18	14	9
Net debt/equity	55	(12)	1	8	13	14	10	5
ROAE (%)	—	11.5	12.5	20.5	24.9	28.1	30.8	33.7
ROACE (%)	**—**	**5.0**	**5.3**	**8.7**	**11.3**	**13.1**	**14.7**	**16.3**

Source: Company, Kotak Institutional Equities estimates.

Dainik Jagran's (DJ) color rates are at 60-70% premium to black-and-white (B&W) rates

Color and B&W tariffs of Dainik Jagran for display ads (Rs/sq. cm)

	Rack rates (Rs)		Premium
	Color	B/W	(%)
DJ all editions + I-next	3,915	2,340	67
DJ UP + Uttaranchal + I-next	2,430	1,440	69
DJ Delhi + NCR	567	333	70
DJ Bihar	567	333	70
DJ Punjab	450	270	67
DJ MP	378	225	68
DJ Jharkhand	342	207	65
DJ Haryana	315	189	67

Notes:

(a) Dainik Jagran ad rates are applicable starting March 9, 2007.

Source: Company data, compiled by Kotak Institutional Equities.

JYTS.BO, Rs252	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	275
52W High -Low (Rs)	288 - 113
Market Cap (Rs bn)	20.9

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	10.3	15.1	18.3
Net Profit (Rs bn)	0.5	0.9	1.1
EPS (Rs)	6.6	10.7	13.1
EPS gth	*81.2*	*61.1*	*23.0*
P/E (x)	38.1	23.6	19.2
EV/EBITDA (x)	17.5	12.6	10.5
Div yield (%)	0.2	0.2	0.2

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	28.0	-	-
FIIs	26.3	0.1	0.1
MFs	8.8	0.1	0.1
UTI	5.6	0.6	0.6
LIC	-	-	-

Jyoti Structures: 2QFY08 results: Inline with estimates; maintain estimates, TP and Outperform rating

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- **Jyoti Structures (JSL) reported net income of Rs170 mn (versus our estimates of Rs190 mn), up 48% yoy.**
- **EBITDA margins, at 12.5% (inline with estimates) improved 140bps on yoy and 14bps on a qoq basis.**
- **We expect revenues to grow at CAGR of 33.6% over FY2007-09 and net earnings to grow 50% over the same period following higher order flows from Powergrid and higher Rural Electrification jobs.**
- **We retain our earnings estimates, target price of Rs275/share and Outperform rating on the stock**

Jyoti Structures (JSL), in its 2QFY08 results reported a PAT of Rs170 mn, up 48% on yoy basis. Revenue, at Rs3.2 bn, grew by 31% and EBITDA margins (at 12.5%) improved 142 bps on yoy basis. The closing backlog at Rs24 bn (higher than what we had estimated earlier) would ensure a significant growth in revenues over the next two years. We maintain our Outperform rating on JSL and SOTP-based target price up to Rs275/ share.

EBITDA margins for the quarter improved by 142 bps on yoy basis. We continue to expect strong margins going forward as (a) Operating leverage pushes in higher margins in old orders already accepted and (b) we expect new orders to flow-in at higher operating margins.

Order backlog at Rs24bn continues to stay strong. JSL's order-backlog stands at Rs24 bn, 20% higher than outstanding backlog at start of year. In addition, a large part of backlog (25%) consists of distribution projects, which are of lower gestation, and hence would speed up execution time.

We expect revenues to grow at CAGR of 45% over FY2007-09. Our comfort stems from high order backlog as well as reasonably clear spending plans from Powergrid. Besides, the stated order-backlog does not include a probable order from Reliance Energy Transmissions; which Jyoti was pretty confident of receiving.

We now build Gulf-jyoti in valuations. Our communication with the management suggests that the Gulf-jyoti joint venture plant would commence trial runs in December 2007. Jyoti has booked an order from Dubai Electric and Water agency (DEWA) under its standalone entity, the construction work of which it intends to undertake in the Gulf-jyoti joint venture. Jyoti Structures will own 30% equity in the joint venture, besides charging a 15% of net earnings for managing the plant. Accordingly, our SOTP-based target price now includes value of jyoti's stake in the JV based on 45% profit sharing.

We retain our SOTP-based target price. We retain our target price at Rs275/share**.** We now value Jyoti's stake in Gulf-Jyoti JV as part of our SOTP-based valuation—which comprises of Rs7 of Gulf-Jyoti stake and Rs290 of standalone business of JSL. At target price, the stock would trade at 19X FY2009E earnings. We maintain an Outperform rating on the stock.

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

	2Q 2008	2Q 2007	Yoy growth (%)	2Q 2008	1Q 2008	QoQ growth (%)	2008E	2007	Yoy growth (%)
Revenue	**3,182**	**2,426**	**31.1**	**3,182**	**2,967**	**7.2**	**15,835**	**9,708**	**63.1**
Expenditure	**(2,783)**	**(2,157)**		**(2,783)**	**(2,599)**		**(13,919)**	**(8,454)**	
Stock adjustment	22	(17)		22	11		-	-	
Raw materials	(2,037)	(1,460)		(2,037)	(1,774)		(9,976)	(5,882)	
Staff costs	(90)	(60)		(90)	(75)		(293)	(267)	
Other expenditure	(678)	(620)		(678)	(761)		(3,650)	(2,306)	
EBITDA	**398**	**269**	**48.0**	**398**	**367**	**8.4**	**1,916**	**1,254**	**52.8**
OPM (%)	*12.5*	*11.1*		*12.5*	*12.4*		*12.1*	*12.9*	
Other income	4	2		4	1		10	8	
Depreciation	(16)	(14)		(16)	(16)		(66)	(58)	
EBIT	386	257		386	352		1,860	1,204	
Interest costs	(106)	(79)		(106)	(95)		(384)	(329)	
PBT	280	178		280	256		1,476	875	
Taxes	(111)	(64)		(111)	(96)		(509)	(325)	
PAT	**170**	**115**	**47.8**	**170**	**160**	**5.8**	**967**	**550**	**75.8**
Calculations (%)									
Raw material to revenue	63.3	60.9		63.3	59.4		63.0	60.6	
Total costs to revenue	87.5	88.9		87.5	87.6		87.9	87.1	
Effective tax rate	39.5	35.7		39.5	37.5		34.5	37.1	

Source: Company data

Jyoti Structures, SOTP, March fiscal year-ends, 2009E basis (Rs mn)

	EBITDA (Rs mn)	Multiple (X)	EV (Rs mn)	Value (Rs/share)	Comments
Standalone power transmission business	2,352	10.2	24,038	290	Based on 35% discount to EECU [a]
Stake in Gulf jyoti			580	7	Based on DCF-to-firm
Enterprise value			**24,618**	**297**	
Net debt			1,863	22	Based on current net debt
Market capitailzation			**22,755**	**275**	
Target price (Rs)				**275**	

Jyoti Structures, Income statement, March fiscal year-ends, 2006-10E (Rs mn)

	2006	2007E	2008E	2009E	2010E
Net revenues	**6,978**	**9,708**	**15,835**	**20,276**	**22,626**
Expenditure	**(6,230)**	**(8,454)**	**(13,919)**	**(17,924)**	**(20,115)**
Raw materials	(4,261)	(5,882)	(9,976)	(12,673)	(14,028)
Employee expenses	(185)	(267)	(293)	(322)	(355)
Other expenditure	(1,784)	(2,306)	(3,650)	(4,929)	(5,732)
EBITDA	**748**	**1,254**	**1,916**	**2,352**	**2,512**
Non-operating income	21	8	10	10	10
Depreciation	(48)	(58)	(66)	(75)	(85)
EBIT	720	1,204	1,860	2,287	2,436
Interest expenses	(258)	(329)	(384)	(395)	(290)
Adjusted pre-tax profits	462	875	1,476	1,892	2,146
Unusual or infrequent items	—	—	—	—	—
Reported pre-tax profits	**462**	**875**	**1,476**	**1,892**	**2,146**
Taxes	(185)	(325)	(509)	(653)	(740)
Reported net income	**277**	**550**	**967**	**1,239**	**1,406**
Adjusted net income	**277**	**550**	**967**	**1,239**	**1,406**
EPS (Rs), based on weighted average shares	4.0	7.3	12.0	15.2	17.0
EPS (Rs), based on fully diluted shares	**3.3**	**6.6**	**11.7**	**15.0**	**17.0**
Year-end shares outstanding (mn)	69.1	80.7	80.7	82.9	82.9
Weighted average shares outstanding (mn)	69.1	74.9	80.7	81.8	82.9
Fully diluted shares outstanding (mn)	82.9	82.9	82.9	82.9	82.9
Ratios (%)					
Effective tax rate	40.1	37.1	34.5	34.5	34.5
EBITDA margins	10.7	12.9	12.1	11.6	11.1
EBIT margins	10.3	12.4	11.7	11.3	10.8
DPS (Rs)					
Growth (%)					
Revenue	-	39.1	63.1	28.0	11.6
EBITDA	-	67.7	52.8	22.8	6.8
Adjusted net earnings	-	98.8	75.8	28.1	13.4
Fully diluted EPS	-	98.8	75.8	28.1	13.4

Jyoti Structures, Balance sheet, March fiscal year-ends, 2006-10E (Rs mn)

	2006	2007E	2008E	2009E	2010E
Equity capital	138	161	161	166	166
Reserves and surplus	1,078	2,597	3,481	4,637	5,960
Deferred tax liability	78	77	77	77	77
Total Equity	**1,294**	**2,835**	**3,719**	**4,880**	**6,202**
Secured loans	1,203	1,515	1,815	1,615	865
Unsecured loans	406	80	80	80	80
Total borrowings	**1,609**	**1,595**	**1,895**	**1,695**	**945**
Current liabilities	2,699	2,803	4,502	5,658	6,269
Total capital	**5,602**	**7,233**	**10,116**	**12,233**	**13,417**
Cash	38	92	32	42	79
Inventory	1,213	763	1,302	1,667	1,860
Debtors	2,487	3,635	5,857	7,500	8,369
Other current assets	1,150	1,970	1,970	1,970	1,970
Total current assets	**4,889**	**6,461**	**9,161**	**11,178**	**12,278**
Gross block	853	936	1,086	1,236	1,386
Less: Depreciation	(322)	(375)	(440)	(516)	(601)
Net block	531	561	646	720	785
Add: Capital work-in-process	15	2	2	2	2
Total fixed assets	**546**	**563**	**648**	**722**	**787**
Investments	166	185	285	305	325
Miscellaneous expenditure	—	—	—	—	—
Total assets	**5,601**	**7,209**	**10,093**	**12,205**	**13,390**
Ratios (%)					
Debt/equity	124.4	56.3	51.0	34.7	15.2
Debt/capitalization	55.4	36.0	33.8	25.8	13.2
Net debt/equity	121.4	53.0	50.1	33.9	14.0
Net debt/capitalization	54.8	34.6	33.4	25.3	12.2
ROACE					
ROAE					

Jyoti Structures, Cash flow statement, March fiscal year-ends, 2005-2010E (Rs mn)

	2006	2007	2008E	2009E	2010E
Operating					
Pre-tax profits and ex-od	440	875	1,476	1,892	2,146
Depreciation & amort	57	58	66	75	85
Taxes paid	(181)	(334)	(509)	(653)	(740)
Dividend and OI	—	—	—	—	—
Interest expense	259	329	384	395	290
Interest paid	(259)	(329)	(384)	(395)	(290)
FX (Gain) / loss	—	—	—	—	—
Ex-od (incl prior period)	(13)	79	—	—	—
Other non-cash items	16	(5)	—	—	—
WC changes	(674)	(1,395)	(1,061)	(852)	(451)
Cash flow from operations	**(355)**	**(722)**	**(28)**	**463**	**1,040**
Operating, excl. WC	**319**	**674**	**1,033**	**1,315**	**1,491**
Investing					
Capex	(144)	(84)	(150)	(150)	(150)
(Pur)/Sale of bussiness	—	—	—	—	—
(Pur)/Sale of invts	(78)	(68)	(100)	(20)	(20)
Advances to subsidiary	—	—	—	—	—
Interest/dividend recd	—	—	—	—	—
Cash flow from investing	**(222)**	**(152)**	**(250)**	**(170)**	**(170)**
Financing					
Equity capital issues	15	1,019	—	—	—
Net from borrowings	458	(43)	300	(200)	(750)
Effect of FX changes	—	—			
Dividends paid (incl. tax)	(31)	(48)	(83)	(83)	(83)
Others	—	—			
Cash flow from financing	**442**	**928**	**217**	**(283)**	**(833)**
Net chg in CCE	(135)	54	(61)	10	37
Beginning cash	175	39	93	32	42
Ending cash	**39**	**93**	**32**	**42**	**79**

Energy

RPET.BO, Rs222	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	170
52W High -Low (Rs)	223 - 56
Market Cap (Rs bn)	998.6

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	0.0	0.0	135.5
Net Profit (Rs bn)	(0.0)	(0.1)	19.5
EPS (Rs)	(0.0)	(0.0)	4.3
EPS gth	-	-	-
P/E (x)	-	-	51.3
EV/EBITDA (x)	-	-	39.8
Div yield (%)	-	-	-

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	3.1	0.2	(1.4)
MFs	1.0	0.4	(1.2)
UTI	-	-	(1.6)
LIC	1.9	0.7	(0.8)

Reliance Petroleum: We already model for about two refineries; downgraded to U on explosion in stock price

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- **Downgraded stock to U from IL on incomprehensible valuations**
- **Difficult to justify current valuations unless we make very aggressive assumptions in perpetuity**
- **We are already amongst the most bullish on RPET's margins, earnings**

We have downgraded Reliance Petroleum (RPET) stock to U from IL noting the fact that the stock is trading well above our 12-month target price of Rs170 (9X FY2010E EPS discounted back) and its strong outperformance over the past two months. RPET stock has rallied 45% since October 1 and 92% since September 1 versus the BSE-30 Index's 15.5% and 30.4% rise over the same periods. We had downgraded the stock to IL from OP on October 11 at Rs177. We are flabbergasted by the velocity of movement in certain Indian stocks and attribute it solely to liquidity. We retain our earnings estimates. Key upside risk stems from continued high liquidity in the Indian market.

Difficult to justify current valuations. We use 9X FY2010E EPS of Rs21.9 discounted back to October-2008 (17 months) at 12.5% cost of equity to set our 12-month target price of Rs170. We continue to like Reliance Petroleum's fundamentals as we believe it is in a strong position to benefit from the likely tight refining supply-demand balance, which we expect to continue until CY2011 (FY2012) and potentially beyond.

1. **P/E approach already captures reinvestment upside from generated free cash flow.** We use 9X P/E multiple to value RPET stock, which we believe is reasonable in the context of cost of equity of 12.5% and modest growth in perpetuity (inflation). We model FY2010E EPS at Rs21.9, which we assume to sustain in perpetuity. However, our EPS estimate is Rs12.8 only on a full tax payment basis in FY2019E. We note that our P/E valuation methodology implicitly assumes that RPET will be in a position to sustain earnings in perpetuity through reinvestment of the large cash generated by RPET's upcoming refinery into a new refinery or some other value-creating opportunity. Thus, we assume that RPET will be in a position to overcome the likely decline in earnings when RPET's upcoming refinery loses its taxation benefits—100% tax exemption in the first five years, 50% in the next five years and 50% in the next five subject to investment.

   We note that our 12-month DCF-based valuation for RPET's upcoming refinery is Rs122 (see Exhibit 1); this assumes free cash is distributed back to shareholders and not reinvested in a new refinery. Thus, our multiple-based valuation approach already largely captures the option value of generated free cash flow. In fact, the stock's current stock price would suggest that it is discounting cash flows of two 'RPET' refineries.

2. **Bullish view on refining margins built in earnings model.** We assume very strong refining margins in perpetuity, which leaves little scope for upward revisions to refining margins or to earnings. We assume very strong refining margins for RPET at US$17.3/bbl for FY2010E and US$16.2/bbl for FY2011E (Exhibit 2), which result in an EPS of Rs21.9 for FY2010E and Rs21.3 for FY2011E (see Exhibit 3). We note that this includes about US$2.5/bbl of contribution from use of cheaper gas instead of internally-produced fuels; nonetheless, we believe the underlying margin of US$13.5-14/bbl is fairly aggressive.

We note that RPET's earnings are highly sensitive to refining margins and weaker-than-expected margins could significantly impact RPET's margins and earnings. Exhibit 4 gives sensitivity of RPET's earnings to exchange rate and refining margins; a US$1/bbl decline in refining margins impacts RPET's earnings by about 8%. Global refining margins are still quite weak despite a recovery in the most recent weeks (see Exhibit 5). We model strong refining margins through CY2010 (FY2011) due to (1) likely strong global demand for oil and (2) limited refining capacity additions (Exhibit 6). The IEA expects oil demand to grow at 1.6 mb/d in 2007 and 2008, followed by 1.8 mb/d in 2009 and 1.9 mb/d in 2010.

Our DCF-based fair price for RPL is Rs122

DCF valuation for Reliance Petroleum (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
EBITDA	—	**28,307**	**123,578**	**114,442**	**105,273**	**105,039**	**104,775**	**104,484**	**104,165**	**103,818**	**103,443**	**103,039**	**103,039**	**103,039**	**103,039**
Tax expense	—	(501)	(2,558)	(2,303)	(2,049)	(2,081)	(15,561)	(16,435)	(17,177)	(17,806)	(18,341)	(33,621)	(34,007)		
Working capital changes	(5,290)	(11,132)	(40,926)	885	823	(9)	(10)	(10)	(11)	(12)	(13)	(13)	(15)		
Cash flow from operations	**(5,290)**	**16,673**	**80,095**	**113,024**	**104,047**	**102,948**	**89,204**	**88,038**	**86,977**	**86,000**	**85,089**	**69,405**	**69,017**		
Capital expenditure	(67,500)	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)		
Free cash flow to the firm	**(72,790)**	**74**	**78,095**	**111,024**	**102,047**	**100,948**	**87,204**	**86,038**	**84,977**	**84,000**	**83,089**	**67,405**	**67,017**	**67,017**	**67,017**
Discount factor at WACC	**0.95**	**0.85**	**0.76**	**0.68**	**0.60**	**0.54**	**0.48**	**0.43**	**0.38**	**0.34**	**0.31**	**0.27**	—	—	—
Discounted cash flow	(69,176)	63	59,166	75,102	61,614	54,420	41,974	36,976	32,597	28,770	25,409	18,404			
Discounted cash flow-1 year forward		70	66,266	84,114	69,029	60,951	47,011	41,413	36,520	32,222	28,458	20,612	18,298		
Discounted cash flow-2 year forward			74,218	94,207	77,312	68,286	52,652	46,382	40,902	36,100	31,873	23,086	20,494	18,298	

	Now	+ 1-year	+ 2-years
Total PV of free cash flow (a)	**365,317**	**504,963**	**583,810**
FCF one-year forward	67,017	67,017	67,017
Terminal value	558,476	558,476	558,476
PV of terminal value (b)	**170,781**	**170,781**	**170,781**
Total PV (a) + (b)	**536,098**	**675,744**	**754,591**
Net debt	54,574	127,364	130,628
Equity value	481,523	548,380	623,963
Equity value (US$ mn)	**9,765**	**11,252**	**12,853**
Shares outstanding (mn)	4,500	4,500	4,500
Equity value/per share (Rs)	**107**	**122**	**139**

Sensitivty of share price to different levels of WACC and growth rate (Rs)

		WACC (%)						
		11.0	**11.5**	**12.0**	**12.5**	**13.0**	**13.5**	**14.0**
Growth rate (%)	**-**	**135**	**128**	**122**	116	111	106	101
	1.0	**141**	**133**	**126**	120	114	109	104
	2.0	**148**	**139**	**132**	**125**	119	113	108
	3.0	**157**	**147**	**139**	**131**	**124**	117	112
	4.0	**168**	**157**	**147**	**138**	**130**	**123**	116
	5.0	**184**	**170**	**158**	**147**	**138**	**130**	**122**
	6.0	**205**	**187**	**172**	**159**	**148**	**138**	**129**
	7.0	**238**	**213**	**192**	**175**	**161**	**149**	**139**

Discount rate (%)	**12.0**
Growth from 2020 to perpetuity (%)	—
Exit free cash multiple (X)	8.3
Exit EBITDA multiple (X)	5.4

RPL earnings model assumptions, March fiscal year-ends, 2009E-2015E

	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Rs/US$	39.0	38.0	38.0	38.0	38.0	38.0	38.0
Import tariff on crude oil (%)	—	—	—	—	—	—	—
Refinery yield (US$/bbl)	75.2	75.2	74.1	73.0	73.0	73.0	73.0
Cost of crude (US$/bbl)	57.7	57.7	57.7	57.7	57.7	57.7	57.7
Landed cost of crude (US$/bbl)	58.0	57.9	57.9	57.9	57.9	57.9	57.9
Net refining margin (US$/bbl)	**17.2**	**17.3**	**16.2**	**15.1**	**15.1**	**15.1**	**15.1**
Crude throughput (mn tons)	**6.0**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**
Fuel and loss (mn tons)	0.1	—	—	—	—	—	—
Production of main products (mn tons)	5.9	29.0	29.0	29.0	29.0	29.0	29.0
Fuel and loss-own fuel used (%)	2.0	—	—	—	—	—	—
Fuel & loss equivalent-gas used (%)	6.0	8.0	8.0	8.0	8.0	8.0	8.0
Cost of natural gas (US$/mn BTU)	5.3	5.3	5.3	5.3	5.3	5.3	5.3

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Reliance Petroleum 2009-2014E, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E
Profit model						
Net revenues	135,515	631,583	622,338	613,094	613,094	613,094
EBITDA	**28,307**	**123,578**	**114,442**	**105,273**	**105,039**	**104,775**
Other income	222	463	1,292	3,806	5,627	5,481
Interest (expense)/income	(3,637)	(8,362)	(2,793)	—	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**19,905**	**100,889**	**98,041**	**94,072**	**95,550**	**95,032**
Extraordinary items	—	—	—	—	—	—
Tax	(424)	(2,362)	(2,239)	(2,049)	(2,081)	(15,561)
Deferred taxation	—	—	—	—	—	1,624
Net income	**19,481**	**98,527**	**95,802**	**92,022**	**93,469**	**81,095**
Earnings per share (Rs)	**4.3**	**21.9**	**21.3**	**20.4**	**20.8**	**18.0**
Balance sheet						
Total equity	153,860	241,857	327,129	377,034	361,149	347,367
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	135,170	79,670	—	—	—	—
Current liabilities	9,487	40,061	40,040	40,019	40,019	40,019
Total liabilities and equity	**298,516**	**361,587**	**367,169**	**417,053**	**401,168**	**385,762**
Cash	4,542	8,904	28,291	92,026	89,247	87,055
Other current assets	25,174	96,673	95,767	94,924	94,933	94,943
Net fixed assets	266,520	253,729	240,830	227,823	214,707	201,483
Capital work-in-progress	—	—	—	—	—	—
Investments	2,280	2,280	2,280	2,280	2,280	2,280
Deferred expenditure	—	—	—	—	—	—
Total assets	**298,516**	**361,587**	**367,169**	**417,053**	**401,168**	**385,762**
Free cash flow						
Operating cash flow, excl. working capital	24,246	112,854	109,409	103,224	102,957	89,214
Working capital changes	(11,132)	(40,926)	885	823	(9)	(10)
Capital expenditure	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	222	463	1,292	3,806	5,627	5,481
Free cash flow	**(3,264)**	**70,392**	**109,586**	**105,853**	**106,575**	**92,685**
Ratios (%)						
Debt/equity	87.9	32.9	0.0	—	—	—
Net debt/equity	84.9	29.3	(8.6)	(24.4)	(24.7)	(25.1)
ROAE (%)	13.5	49.8	33.7	26.1	25.3	22.9
ROACE (%)	**8.3**	**34.9**	**30.4**	**26.1**	**25.3**	**22.9**

Source: Kotak Institutional Equities estimates.

Reliance Petroleum has high leverage to refining margins

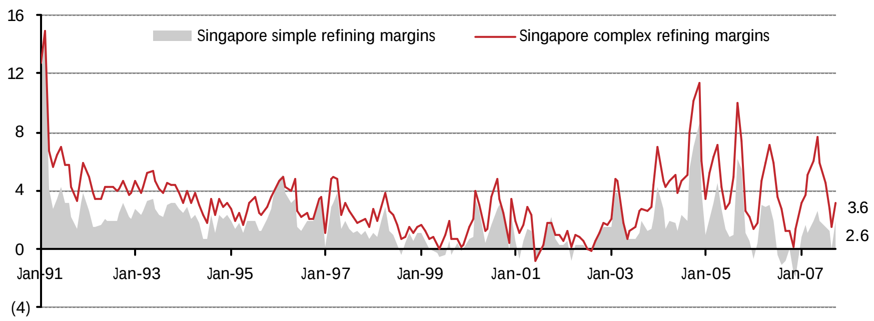
Sensitivity of RPL's earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	38.0	39.0	40.0	37.0	38.0	39.0	37.0	38.0	39.0
Net profits (Rs mn)	18,650	19,481	20,313	94,787	98,527	102,266	92,291	95,802	99,313
EPS (Rs)	4.1	4.3	4.5	21.1	21.9	22.7	20.5	21.3	22.1
% upside/(downside)	**(4.3)**		**4.3**	**(3.8)**		**3.8**	**(3.7)**		**3.7**
Refining margins (US$/bbl)									
Margins (US$/bbl)	16.2	17.2	18.2	16.3	17.3	18.3	15.2	16.2	17.2
Net profits (Rs mn)	17,807	19,481	21,156	90,645	98,527	106,408	87,920	95,802	103,684
EPS (Rs)	4.0	4.3	4.7	20.1	21.9	23.6	19.5	21.3	23.0
% upside/(downside)	**(8.6)**		**8.6**	**(8.0)**		**8.0**	**(8.2)**		**8.2**

Source: Kotak Institutional Equities estimates.

Global refining margins are still weak despite recovery in recent weeks

Singapore refining margins (US$/bbl)



Simple refining margins, March fiscal year-ends (US$/bbl)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	1.69	(0.32)	1.29	0.51	0.30	1.05	1.69	3.02	2.52	2.25
2Q	0.14	(0.08)	2.47	0.45	0.07	1.20	3.13	2.78	(0.70)	0.99
3Q	0.94	0.14	1.74	1.06	1.44	1.57	6.46	2.22	(1.25)	1.84
4Q	0.62	1.86	0.21	(0.03)	2.98	2.88	2.08	1.09	1.25	
Average	**0.85**	**0.40**	**1.43**	**0.50**	**1.20**	**1.67**	**3.34**	**2.28**	**0.45**	**1.65**

Weekly margins

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
2.64	2.02	1.84	0.85	(0.87)

Complex refining margins, March fiscal year-ends (US$/bbl)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	2.89	0.43	1.86	1.34	0.79	1.24	4.57	4.93	6.24	6.58
2Q	1.14	1.19	3.96	0.58	0.14	2.35	5.80	6.11	2.46	2.91
3Q	1.42	0.41	2.25	1.22	1.56	3.23	9.04	3.94	0.98	3.13
4Q	1.28	2.64	1.60	0.65	3.70	5.44	5.02	2.77	4.11	
Average	**1.68**	**1.17**	**2.42**	**0.95**	**1.55**	**3.06**	**6.10**	**4.44**	**3.45**	**4.53**

Weekly margins

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
3.61	3.45	3.34	2.11	0.75

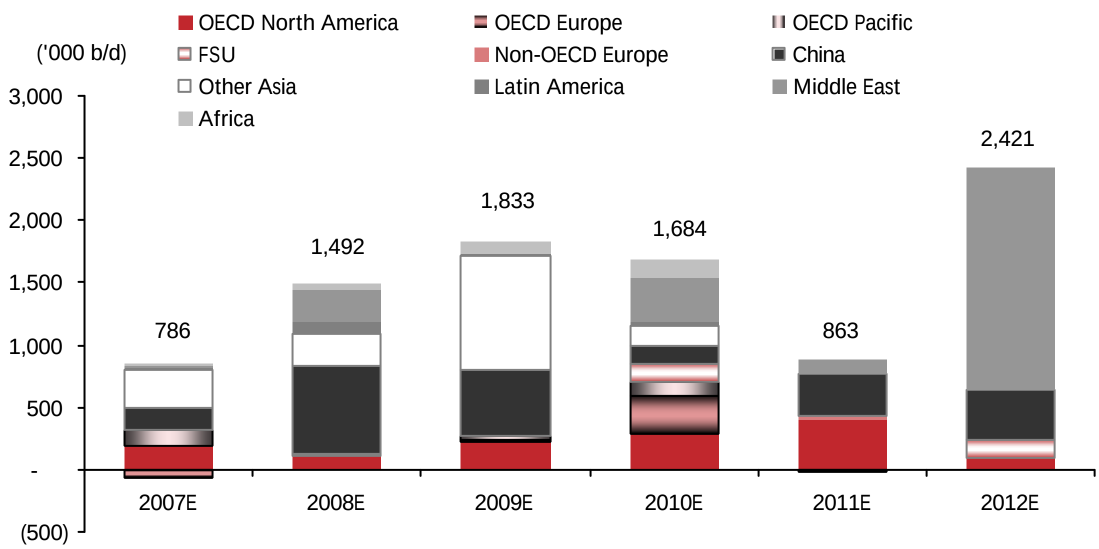
Singapore refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
Simple	0.40	1.43	0.50	1.20	1.67	3.34	2.28	0.45	1.65
Complex	0.43	1.86	1.34	0.79	1.24	4.57	4.93	3.45	4.53

Source: Bloomberg, Kotak Institutional Equities.

Limited supply additions to global refining capacity

Global refinery capacity addition, 2007-2011E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates.

Banking

IOBK.BO, Rs135	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	150
52W High -Low (Rs)	151 - 89
Market Cap (Rs bn)	73.4

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	34.2	37.1	41.3
Net Profit (Rs bn)	10.1	11.7	12.3
EPS (Rs)	18.5	21.5	22.6
EPS gth	*29.6*	*16.6*	*5.5*
P/E (x)	7.3	6.3	6.0
P/B (x)	1.8	1.6	1.3
Div yield (%)	2.6	3.4	3.7

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	61.2	-	-
FIIs	18.2	0.2	(0.0)
MFs	2.9	0.1	(0.0)
UTI	-	-	(0.2)
LIC	2.1	0.1	(0.1)

Indian Overseas Bank: IOB delivers on quantity, disappoints on quality

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- **IOB disappointed on its numbers in 2QFY08 with provisions and lower expenses accounting for most of PAT in the current quarter**
- **NII growth was flat on a yoy basis at 3%**
- **We would be making a detailed comment on the results post discussion with the management**

IOB disappointed on its numbers in 2QFY08, breaking its impeccable past record. A large part of its growth in PAT of 28% (41% higher than our estimates) was driven by lower provisions. Net interest income (NII) in 2QFY08 was flat at Rs6.3 bn and grew only by 3% yoy on the back of margin pressure. Margin declined to 3.4% in 1HFY08 from 4.0% in 1HFY07. Decline in CASA ratio (100bps qoq) and higher deposit growth (37%) compared to loan growth (25%) are the likely reasons for pressure on NIM. Flat operating expenses at Rs3.5 bn (8% lower than estimates) and low provisions of Rs83 mn in the current quarter (90% lower than our estimate) were key profit drivers. Asset quality remained healthy with net NPL ratio of 0.35% and gross NPL ratio of 2.1% as of September 30, 2007. Capital adequacy ratio of the bank at 13.3% as of September 30, 2007 is comfortable. We would be making a detailed comment on the results post discussion with the management

Indian Overseas Bank, Quarterly results (Rs mn)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	% chg	2Q08KS	Actual Vs KS
Interest income	12,409	13,721	14,737	17,454	18,462	19,303	40.7		
Interest on advances	8,337	9,392	9,924	11,358	12,890	13,059	39.0		
Income from invts	3,880	3,945	4,362	4,846	4,944	5,675	43.8		
Bal with RBI	192	384	451	1,250	628	570	48.3		
Interest expenses	6,653	7,602	8,686	9,771	11,372	12,982	70.8		
Net interest income	**5,755**	**6,119**	**6,051**	**7,682**	**7,090**	**6,321**	**3.3**	**7,037**	**(10.2)**
NII adjusted for invst depn	**5,255**	**5,569**	**5,419**	**7,032**	**6,470**	**6,321**	**13.5**	**6,832**	**(7.5)**
Non-interest income	2,511	1,520	1,980	2,555	1,616	1,745	14.8	1,804	(3.3)
Total income	8,267	7,639	8,031	10,237	8,706	8,066	5.6	8,473	(4.8)
Operating expenses	3,302	3,491	3,116	3,970	3,614	3,486	(0.2)	3,793	(8.1)
Employee	2,342	2,413	2,133	2,423	2,431	2,239	(7.2)	2,500	(10.4)
Others	960	1,078	982	1,547	1,183	1,247	15.7	1,293	(3.6)
Operating profit	4,965	4,148	4,916	6,267	5,092	4,580	10.4	4,680	(2.1)
Provisions	2,299	541	1,251	2,470	1,620	83	(84.6)	1,450	(94.3)
PBT	2,666	3,607	3,665	3,798	3,472	4,497	24.7	3,230	39.2
Taxation	445	1,108	1,197	900	787	1,300	17.3	969	34.2
Net profit	**2,220**	**2,499**	**2,468**	**2,898**	**2,685**	**3,197**	**28.0**	**2,261**	**41.4**
Tax rate	17	31	33	24	23	29		30	
Key balance sheet items (Rs bn)									
Deposits	532	570	592	687	702	783	37.3		
CASA ratio	38.2	37.7	36.0	34.9	32.8	32.0			
Advances	379	411	441	479	486	513	24.8		
Investments	181	198	224	242	264.4	303.0	53.3		
Asset quality details									
Gross NPA (Rs bn)	11.88	12.19	11.22	11.20	11.37	10.77	(11.6)		
Gross NPLs (%)	3.13	2.96	2.54	2.34	2.34	2.10			
Net NPA (Rs bn)	1.8	2.2	2.1	2.6	2.4	1.8	(20.8)		
Net NPLs (%)	0.48	0.57	0.48	0.55	0.50	0.35			
Yield management measures (%)									
Yield on advances	9.05	9.49	9.46	9.58	10.49	10.50			
Yield on investments	8.41	8.33	8.17	8.13	8.00	7.95			
Cost of deposits	4.78	4.99	5.34	5.24	5.93	6.43			
Cost of funds	0.00	0.00	0.00	0.00	6.11	6.47			
NIM	4.01	4.01	3.72	4.16	3.71	3.39			
Capital adequacy details (%)									
CAR (%)	13.37	14.66	13.95	13.21	13.31	13.31			
Tier I	9.14	8.90	0.00	8.20	NA	0.00			

Source: Company, Kotak Institutional Equities estimates.

Banking

Sector coverage view	Attractive

Company	Rating	Price, Rs 29-Oct	Target
SBI	L	2,118	2,000
HDFC	L	2,813	2,200
HDFC Bank	L	1,639	1,300
ICICI Bank	OP	1,249	1,200
Corp Bk	OP	415	470
BoB	OP	326	330
PNB	OP	539	620
OBC	U	231	240
Canara Bk	L	284	250
LIC Housing	L	360	270
Axis Bank	L	925	850
IOB	OP	135	150
Shriram Transp	U	263	200
SREI	L	137	110
MMFSL	L	240	265
Andhra	OP	89	120
IDFC	L	197	145
PFC	U	235	150
Centurion Bank	U	43	35
Federal Bank	OP	391	410
J&K Bank	OP	745	850
India Infoline	L	1,106	1,050
Indian Bank	L	143	145

RBI guidelines on preference shares net positive, allows significant leveraging capability to banks

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- **Indian Banks can now raise close to 40% (earlier 15%) of their total Tier I capital in the form of preference shares and other innovative Tier I instruments.**
- **Likely to provide significant relief to both public and private banks**
- **The higher proportion of alternate capital will also enable banks to increase their RoE through higher leverage**

The RBI guidelines on preference share issuance provide some cheer, midst rather disappointing quarterly performance from PSU banks. Based on the new policy, the banking sector can raise close to 40% (earlier 15%, and appears rather liberal) of their total Tier I capital in the form of preference shares and other innovative Tier I instruments (i.e. perpetual debt). These guidelines will provide significant relief to both private and public banks alike as the former segment has been growing their asset book rapidly (requiring frequent capital raising), while the latter is constrained by their government holding. The higher proportion of alternate capital will also enable banks to increase their RoE through higher leverage. Based on first read it appears that participation in these instruments will not be constrained by the overall corporate debt limit, however, the regulatory limits applicable on equity instruments will also apply on the preference instruments i.e. 20% in the case of PSU banks. However, amount raised as Tier I preference shares will not carry any SLR and CRR requirements, while the amount raised as upper Tier II instruments would be treated as part of NDTL for calculating SLR and CRR requirements of banks.

Key highlights

- Indian banks will be allowed to issue the following types of preference shares in Indian Rupees. Issuance of these instruments in foreign currency will not be permitted at this stage.

1. Tier I capital - Perpetual Non-Cumulative Preference Shares (PNCPS). This will be treated on par with equity, and hence, the coupon payable on these instruments will be treated as dividend.
2. Upper Tier II capital:

   a) Perpetual Cumulative Preference Shares (PCPS)

   b) Redeemable Non-Cumulative Preference Shares (RNCPS)

   c) Redeemable Cumulative Preference Shares (RCPS)

   These will be treated as liabilities and the coupon payable thereon will be treated as interest (charged to Profit and Loss Account).

- The outstanding amount of Tier 1 preference shares along with Innovative Tier 1 instruments shall not exceed 40% of total Tier 1 capital at any point of time. Tier 1 preference shares issued in excess of the overall ceiling of 40%, shall be eligible for inclusion under Upper Tier 2 capital, subject to limits prescribed for Tier 2 capital.

	Tier I Preference	Upper Tier 2 Preference
Maturity	Perpetual	15 years
Limit	The outstanding amount of Tier 1 preference shares along with Innovative Tier 1 instruments shall not exceed 40% of total Tier 1 capital at any point of time. Tier 1 preference shares issued in excess of the overall ceiling of 40%, shall be eligible for inclusion under Upper Tier 2 capital, subject to limits prescribed for Tier 2 capital.	The outstanding amount of these instruments along with other components of Tier 2 capital shall not exceed 100% of Tier 1 capital at any point of time.
Options	There will be no 'put option' or 'step up option'.	There will be no 'put option'. The issuing bank may have a step-up option which may be exercised only once during the whole life of the instrument, in conjunction with the call option, after the lapse of ten years from the date of issue. The step-up shall not be more than 100 bps. The limits on step-up apply to the all-in cost of the debt to the issuing banks.
	Banks may issue the instruments with a call option at a particular date provided: (1) The call option on the instrument is permissible after the instrument has run for at least ten years; and (2) Call option shall be exercised only with the prior approval of RBI	Banks may issue the instruments with a call option at a particular date provided: (1) The call option on the instrument is permissible after the instrument has run for at least ten years; and (2) Call option shall be exercised only with the prior approval of RBI
Dividend/Coupon	The rate of dividend payable to the investors may be either a fixed rate or a floating rate referenced to a market determined rupee interest benchmark rate.	The coupon payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.
Payment of coupon	The company will not pay dividend if it does not meet the minimum CAR requirement, or has accumulated losses.	The coupon will be payable only if the bank's CRAR before and after such payment remains above the minimum regulatory requirement. Secondly, the bank does not have a net loss – either accumulated loss at the end of the previous financial year/half year loss incurred during the current financial year. The unpaid coupon will be treated as a liability for cumulative preference shares and may be paid in later years subject to the bank complying with the above requirements. In the case of non-cumulative redeemable preference shares, deferred coupon will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.
Other conditions	Should be fully paid-up, unsecured and free of any restrictive clauses	Should be fully paid-up, unsecured and free of any restrictive clauses
Foreign investment	Investments by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue. A single FII or NRI cannot hold will in excess of 10% and 5% respectively. The overall non-resident holding of preference shares and equity shares in public sector banks will be subject to the statutory/regulatory limit. Foreign investment in these instruments would be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time.	Investments by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue. A single FII or NRI cannot hold will in excess of 10% and 5% respectively. The overall non-resident holding of preference shares and equity shares in public sector banks will be subject to the statutory/regulatory limit. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. However, investment by FIIs in these instruments will be subject to separate ceiling of US$ 500 million.
CRR/SLR	Will not attract CRR and SLR requirements	Will attract CRR and SLR requirements
Investment by banks/FIs	Indian banks investment in such capital along with other instruments (such as perpetual debt) will be restricted to an overall ceiling of all 10% of investing bank's capital.	Indian banks investment in such capital along with other instruments (such as perpetual debt) will be restricted to an overall ceiling of all 10% of investing bank's capital.
Computing CRAR		The redeemeable preference shares will be subject(both cumulative and non-cumulative) shall be subjected to a progressive discount for capital adequacy purposes over the last five years of their tenor. The discount rate will be 20% in insturments where balance maturity is more than four years and less than five years and will increase to 100% when maturity is less than one year.

Source: RBI.

Economy

Sector coverage view	N/A

RBI Mid-term Review: 25 bps rate cut possible; no CRR change likely

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- **Rate decision difficult. Odds are that RBI may cut 25 bps to play safe, though fears of asset price escalation loom large**
- **Expect no change in CRR in policy with liquidity surpluses coming down; but possible soon after**
- **GDP projections to be retained; significant changes in other macroeconomic projections likely**

RBI policy due at noon on Oct 30,'07. A cut in policy rate would be positive for the interest-rate sensitive stocks, especially banks. Faced with the difficult choice, RBI could surprise the markets by cutting its policy rates now rather than in November—after the US Fed meeting on Oct 31, '07. The policy is likely to focus on dwell at length on macroeconomic problems and policy dilemmas associated with capital flows. In terms of action, the options are limited. However, we could see some measures further easing capital outflows as also some fresh curbs on inflows into the real estate sector.

In our comment dated Oct 15, '07: *"Industrial output up, inflation down"* we maintained that capital inflows had become unmanageable. We had predicted that RBI may raise CRR by 50 bps to kill the short-term hot flows presently entering the Indian stock and real estate markets. While our assessment of impending policy action to curb capital flows turned out to be correct, the choice of instrument turned out to be different as RBI could convince MOF and SEBI to place capital controls on P-notes, which was a long-standing first choice of the RBI. This has substantially changed our assessment of what RBI might do on Oct 30,'07.

Hobson's choice

RBI is facing a Hobson's choice which, in its opinion, leads to only one solution—to moderate capital flows through restrictions. If it cuts now, the stock prices already recovering from the P-note dent could spiral out of control and invite another round of capital inflows. The last time the Fed cut its target policy rate by 50 bps on Sep18,'07, net investment by FIIs of US$8.9 bn were made in a month's time, more than the US$8.7 bn seen this fiscal (till Sep 18). This prompted the P-note capital controls. If Fed cuts another 25 bps on Oct. 31,'07, the interest rate differential would widen dramatically. We could see a surge in capital inflows. If it does cut, we could see a short-run euphoria in stock markets and another bout of capital inflows, but this could be followed by a sobering of capital inflows ahead with reduced arbitrage if interest rates fall along the spectrum. With impossible trinity being evidenced with full brazen force, the choice has to fall on modulating capital account flows through policy interventions.

What would the US Fed do?

Market expectations currently indicate that Fed would cut its target by 25 bps to 4.5% to forestall the subprime-related liquidity concerns. The Fed funds futures have already priced in the same. The odds are that Fed may comply this time again. The Fed knows that any further cuts risks generating conditions which gave rise to the asset price bubble in the first place. The sub-prime was an outcome. Greenspan may have committed the folly of lowering the target rate too many times and too fast to an all-time low of 1.0%. Bernanke may not like to repeat the mistake. But if it does not cut this month-end, it could risk market upheaval. US monetary policy has become endogenous. The FOMC knows that its credibility is at stake. But the next scheduled FOMC meeting would be on Dec.11,'07 and the Fed would like to complete the process of its easing now.

Will RBI cut rates in anticipation of a Fed cut?

RBI policy precedes that of the Fed and it may be forced to play it safe. The short-term interest rate differential is currently wide at 125 basis points under current surplus liquidity conditions and 3.0 percentage points if the system moves from liquidity surplus to deficit mode. A further increase in differential to 325 basis points after another Fed cut can be scary in terms of expected flows.

Factors in favour of rate cut:

- Pricing of financial products ahead could get influenced by the repo rate at which the RBI injects liquidity and a cut in repo rate would reduce arbitrage.
- A cut in the repo rate could reduce sterilization costs by softening yields in short-term dated securities.
- Headline inflation rate is down to 3.1%, down from 6.4% when the annual policy was framed. Inflation expectations are also clearly down.
- RBI had then indicted an inflation target of 5.0% for the year and 4.0-4.5% over the medium-term. The inflation rate can now be predicted to remain in line with the medium-term target even after the base effects push it upwards by end of FY2007. Inflation is falling for manufacturing products as well, indicating that from demand side, monetary easing is now enabled.
- Industrial growth could decelerate ahead from November and consumer durables output is falling this year on concerns of a demand recession.
- Yoy non-food credit growth has decelerated to nearly 22%, down from about 32% a year ago and is now in a more comfort zone, though sectoral credit issues remain.
- Though monetary growth (M3) at about 21% remains high compared with targeted 17.0-17.5%, the increase is explained by a switch from postal deposits to bank deposits following the extension of tax benefits to the latter and as such should not be treated as additional liquidity in the system.
- A cut in the interest rate may be a short-term positive for the rupee and can regenerate appreciation pressures, but in the long run the exchange rate could depreciate with lower interest rate differential.

Factors against a rate cut are:

- A policy rate cut at this stage could result in a runaway increase in stock prices rendering the P-notes capital control totally ineffective.
- It can refuel credit growth to sensitive sectors such as housing and commercial real estate negating the moderation which has been achieved with difficulty. Another asset price bubble would then become inevitable.
- Consumer price inflation though falling still remains high. For instance, CPI for agricultural labour for Sep '07 shows an inflation rate of 7.9% even after a fall of nearly 1-percentage point from the previous month.
- Latent inflation from incomplete pass-through of global oil prices could easily require an adjustment of more than 1-percentage point in inflation rates
- August IIP numbers confirmed that there is no slowdown in the economy and the investment boom continues, making a rate cut somewhat unnecessary.
- RBI had in March this year placed a cap on LAF absorptions to Rs30 bn a day, partly for lowering interest rate differential to curb currency carry trade. But, the policy did not work and it now believes that only long-term capital flows are interest sensitive.

On balance, therefore, a rate cut possibility cannot be ruled out. The rate cut this time could be at both ends. A cut in reverse repo would make RBI's LAF absorptions less costly. While policies are not dictated by central bank balance sheet considerations, it would afford central bank some cushion in a year where its balance sheet would be severely hit by exchange rate appreciation. A cut in the repo rate on the other hand would help central government balance sheet in terms of lowering sterilization costs.

Why no CRR change expected in policy, but soon after?

The marginal liquidity surpluses in money markets as reflected in daily LAF absorptions have reduced from about Rs600 bn in the second week of Oct'07 to under Rs20 bn currently. After the MSS limit were hiked to Rs.2000 bn earlier this week, RBI has effectively sterilized nearly Rs.200 bn through its operations. Good credit growth for couple of weeks took away additional amount. Government has built up cash balances by over Rs150 bn this month, further siphoning off excess liquidity through its aggressive market borrowings. With festival demand picking up, currency expansion could further absorb surplus liquidity. In sum, liquidity surpluses are far more manageable now than they appeared earlier this month. So policy may wait and watch. But as capital flow pressure resume RBI would be required to undertake aggressive dollar purchases to hold exchange rate, which it now believes has already appreciated far too much in this FY. In face of large expected interventions, RBI would not hesitate to use CRR tool aggressively as anticipated by us earlier. Therefore, it is likely that CRR would not be changed in the policy, but the policy would give sufficient indication that RBI would use the instrument should large capital inflows renew. With SENSEX at 20k-levels and the exchange rate again coming under pressure in face of capital flows, a CRR hike could take place in late November itself.

Macroeconomic projections

RBI is likely to keep its real GDP growth projection at 8.5%, while lowering inflation projection from 5.0% to 4.0-4.5%, in line with its medium-term target. While highlighting this achievement, RBI would caution that latent inflation remains. It would also indicate that M3 growth projection of 17.0-17.5% would be surpassed due to the switch from postal to bank deposits, but is not a serious concern. In face of credit growth deceleration and Basel II conservatism preventing banks from lending, RBI would make some noise encouraging banks to lend to productive sectors. It will also tweak the monetary policy stance to caution that monetary policy would respond even more speedily ahead to capital flows volatility.

Expected sectoral impact of monetary policy

The policy is also likely to include several measures regarding the forex markets and capital account management. It may indicate further restrictions on inflows for real estate sector, while easing overseas borrowing restrictions for banks. While we do not believe it would opt for introducing currency futures as part of this policy, it would probably place the report of its internal group in the public domain to invite comments. There could be some further steps to move away from the concept of underlying for hedging in forex markets to allow dynamic hedging based on economic exposures. Indications of further changes on FDI and ECB policy is possible as the authorities want to slow down flows to the real estate sector, while allowing greater access to power sector for meeting their rupee expenditures. These changes are, however, more likely to succeed policy.

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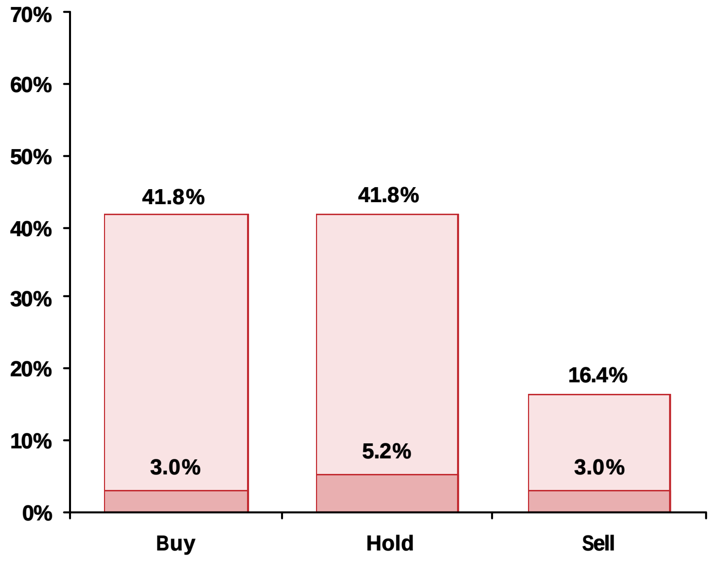

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Source: Kotak Institutional Equities. As of September 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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