kotak® Institutional Equities

INDIA DAILY

July 20, 2007

EQUITY MARKETS

		Change, %		
India	**19-Jul**	**1-day**	**1-mo**	**3-mo**
Sensex	15,550	1.6	7.9	11.9
Nifty	4,562	1.4	7.4	11.7
Global/Regional indices				
Dow Jones	14,000	0.6	3.8	8.0
Nasdaq Composite	2,720	0.8	4.6	7.7
FTSE	6,640	1.1	(0.1)	2.4
Nikkie	18,180	0.4	(0.2)	4.2
Hang Seng	23,125	0.5	6.6	12.4
KOSPI	1,965	1.4	10.1	28.2

Value traded - India

			Moving avg, Rs bn	
	19-Jul		**1-mo**	**3-mo**
Cash (NSE+BSE)	177.4		161.4	146.2
Derivatives (NSE)	458.8		374.2	335.5
Deri. open interest	891.8		710.4	581.1

Forex/money market

		Change, basis points		
	19-Jul	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.4	(1)	(34)	(142)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	3	(32)	(22)

Net investment (US$mn)

	17-Jul		**MTD**	**CYTD**
FIIs	232		1,759	8,315
MFs	(26)		112	(259)

Top movers -3mo basis

		Change, %		
Best performers	**19-Jul**	**1-day**	**1-mo**	**3-mo**
RELIANCE CAPITAL	1,179	0.7	6.6	63.8
BALAJI TELEFILMS L	260	2.2	14.4	54.2
STATE BANK OF IND	1,596	1.3	12.0	48.5
MOSER BAER INDIA	322	4.7	8.7	45.5
ACC LIMITED	1,150	1.5	35.5	45.4
Worst performers				
POLARIS SOFTWARI	136	(3.0)	(13.6)	(32.8)
RAYMOND LIMITED	294	(1.1)	(6.5)	(20.2)
SUN PHARMACEUTI	981	(1.6)	(6.6)	(16.9)
CIPLA LTD	205	(0.4)	(2.3)	(12.6)
UNITED PHOSPHORI	300	(1.6)	(2.1)	(12.1)

Contents

News Roundup

Corporate

- Reliance Communications (RCom) today announced the sale of 5 per cent stake in its tower subsidiary, Reliance Telecom Infrastructure (RTIL), to seven institutional investors for $337.5 mn (Rs 1,358 crore), putting the valuation of RTIL at US$ 7bn (Rs 27,000 crore) The value of the tower business has been pegged at Rs 135 per share. (BS)
- A year after it won the mining bid, Jindal Steel and Power (JSPL) signed a contract on Wednesday with the Bolivian government to develop the vast El Mutun iron ore mines, and set up a 1.7 million tonne steel plant with an investment of $2.1 billion (Rs 8,400 crore). JSPL will build a 450MW power plant near the El Mutun mines, and will be allowed to exploit 50% of the reserves. (BS)
- Wipro said on Thursday that it was looking for acquisitions in Germany and Canada to take advantage of the growing markets there (BL)
- The GMR Group has bagged the Rs 500-crore project for development of the multi-product SEZ at Hosur in the bidding called for by the Tamil Nadu Industrial Development Corporation (Tidco).(BL)

Economic and political

- The Securities and Exchange Board of India (Sebi) is reviewing the registration norms for foreign institutional investors (FIIs), in a move to encourage direct entry by hedge funds. (BS)

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

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Technology

WIPR.BO, Rs505	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	610
52W High -Low (Rs)	690 - 441
Market Cap (Rs bn)	732.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	149.4	184.8	234.7
Net Profit (Rs bn)	28.5	33.5	42.4
EPS (Rs)	19.7	23.1	29.2
EPS gth	*38.8*	*17.1*	*26.4*
P/E (x)	25.6	21.9	17.3
EV/EBITDA (x)	20.0	17.1	12.6
Div yield (%)	1.1	1.3	1.7

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	79.6	-	-
FIIs	6.7	0.9	(2.0)
MFs	1.1	0.9	(2.0)
UTI	-	-	(2.9)
LIC	1.0	0.8	(2.1)

Wipro: Visible signs of an improving growth trajectory. Maintain OP rating

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- **1QFY08 results—strong revenue performance**
- **2QFY08 guidance strong—visible signs of an improving growth trajectory**
- **OPM—enough levers to mitigate some of the headwinds**
- **Maintain Outperform with a Mar' 09 end DCF based target price of Rs610/share**

Wipro reported robust 1QFY08 operating performance. Global IT services revenues grew 5.1% qoq to US$726.1 mn, 2.1% ahead of company's guidance and 1.1% ahead of our expectations. Adjusted net income declined 10.2% qoq to Rs7.1 bn, in line with our estimate. More important, robust revenue growth guidance (Global IT services) of 7% qoq for 2QFY08 in conjunction with the guidance outperformance in 1QFY08 should allay concerns around revenue growth for FY2008. There are enough indicators to support our thesis of an improving yoy revenue growth trajectory—(a) robust 2QFY08 guidance which does not factor in any improvement in Telecom OEM revenues (b) strong hiring numbers—14,000 campus offers made last year (c) good revenue momentum in scalable services and verticals like package implementation, infrastructure management, financial services and telecom service providers. We however, have been negatively surprised by the extent of forex losses during the quarter, which would impact FY2008 OPM, in our view. We are reducing our Re/US$ estimate to 40.5 and 40 for FY2008 and FY2009 from 42 earlier. Consequently, our revised EPS estimates for FY2008 and FY2009 stand 5% and 3.9% lower at Rs23.1 and Rs29.2 respectively (Rs24.3 and Rs30.4 earlier). Maintain OP with a revised Mar '09 DCF-based target price of Rs610 (Rs655 earlier).

1QFY08 results—strong revenue performance: Global IT services (Wipro Technologies (WT) + BPO) revenues stood at US$726mn (qoq growth of 5.1% in US$ terms, 4.9% growth in the IT services business to US$662.3 mn and 7% qoq in BPO to US$63.6 mn), 1.1% ahead of our estimate of US$718 mn. Growth in WT's Global IT services was a mix of volumes growth of 6.5% sequentially and blended pricing decline of 0.2%. We note that the 2.2% revenue outperformance is among the highest for Wipro in the previous few quarters. The revenue performance is even more impressive given marginal growth in the Telecom OEM revenues.

Extent of forex losses and increase in attrition the negative surprises in 1Q performance: Wipro's EBIT margins in the Global IT business declined 270bps qoq to 21%. Margin decline was driven by (a) sharp appreciation in the rupee and (b) forex losses of Rs617 mn—we note that Wipro follows the cash flow method of accounting as opposed to mark-to-market accounting followed by some of its peers; ex-forex losses, margin decline qoq was 70bps, impressive given the extent of rupee appreciation. Wipro's attrition rates increased to 20.1% from 16.8% in the previous quarter. The company attributes the increase in attrition to seasonal factors (people leaving for higher studies) and higher involuntary attrition.

2QFY08 guidance strong—visible signs of an improving growth trajectory: Wipro has given sequential revenue growth guidance of 7% to US$777 mn. We note that the guidance does not factor in any improvement in revenues from the Telecom OEM clients. We believe that there are sufficient indicators that growth will likely pick up further from the Sep' 07 quarter including (a) 14,000 campus offers, which along with TCS is the highest in the industry (b) ramp up of strategic deals signed up in financial services and telecom service provider vertical, which reflected in strong growth in both these verticals (9.3% and 19.5% qoq respectively) in the Jun '07 quarter (c) increasing participation of Wipro in large total outsourcing deals—it closed a 5-year US$130 mn deal with a utility company in the UK during the quarter and indicates that it is participating in 12-13 such deals (d) growing base of large accounts; number of US$50 mn relationships have increased to 10 from 8 in the last quarter. More important, dedicated focus on potential US$100 mn+ and US$50 mn+ relationships will be the sustainable aspect of the business (e) Revenue growth is likely to revive in the telecom OEM clients starting Dec '07 quarter—these accounts had marginal growth in the Jun '07 quarter and (f) sustained momentum in the BPO business, which has grown at a CQGR of 8.8% in the past four quarters—also, net hiring in BPO (1,600) during the quarter is among the highest in a single quarter. Consequently, we factor in 34% US$ revenue growth for Wipro in FY2008, higher than the industry average.

OPM—enough levers to mitigate some of the headwinds: We factor in an EBIT margin decline of 150bps in FY2008 and 30bps in FY2009 for Wipro's Global IT business. We note that Wipro has advanced its wage revision cycle for all its offshore employees to September quarter as opposed to a staggered cycle earlier. This would mean a margin pressure of 150bps in the Sep '07 quarter. In addition, the forex losses during the Jun '07 quarter put additional pressure on FY2008 margins. We believe that the company will be able to partially mitigate some of the margin pressure through levers such as (a) pricing improvements—the company indicates that it is getting pricing improvements in renegotiated and new contracts, though the impact is yet to be reflected in reported realizations (b) broadening of employee pyramid and (c) scale efficiencies.

BPO—revenue momentum continues, margin resilience impressive. Wipro BPO reported sequential revenue growth of 7% to US$63.6 mn. We expect the robust performance in the BPO business to continue into FY2008, wherein we forecast growth rate of 40%. More important, EBIT margin decline for Wipro's BPO business was restricted to 290bps despite 9% appreciation in the rupee, which exerted a downward pressure of around 700bps on OPM. Margin performance was driven by (a) improvement in realizations driven by a change in business mix—45% of revenues now come from integrated services as opposed to 30% in the previous quarter (b) G&A optimization (c) broadening of employee pyramid. The company reiterated its target of maintaining BPO EBIT margins in the 20-22% range in the medium term.

Fine tuning estimates: We have fine-tuned our estimates for Wipro. Our revised EPS estimates for FY2008 and FY2009 now stand at Rs23.1 (Rs24.3 earlier) and Rs29.2/ share (Rs30.4 earlier) respectively. This is primarily driven by a change in our Re/US$ estimates to 40.5 and 40 for FY2008 and FY2009 from 42 earlier. Maintain Outperform rating with a revised Mar' 09 DCF based target price of Rs610/ share (Rs655 earlier). At the target price, the implied P/E multiple works out to 21x FY2009 estimated EPS.

Wipro outperformed its revenue growth guidance by 2.2% in 1QFY08

Revenue guidance versus actuals, 1QFY06-1QFY08

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08
Wipro									
Revenues (US$ mn)									
Guidance	395	422	463	510	533	577	633	685	711
Actual (a)	399	431	473	512	539	589	641	691	726
Growth qoq (%)									
Guidance	5.4	5.9	7.5	7.7	4.0	7.0	7.5	6.9	2.9
Actual (a)	6.4	8.1	9.9	8.2	5.3	9.2	8.8	7.8	5.1
Outperformance (% pts)	**0.9**	**2.2**	**2.4**	**0.5**	**1.2**	**2.2**	**1.3**	**0.9**	**2.2**

Note:

(a) Guidance and actual revenues for Wipro's Global IT (IT services + BPO) business only

(b) Wipro's guidance and actuals for 1QFY07 and 2QFY07 factor in acquisitions

Source: Company, Kotak Institutional Equities estimates

Wipro: Key changes in FY2008-FY2010 estimates

	Revised			Earlier			Change (%)		
Rs mn	**FY2008**	**FY2009**	**FY2010**	**FY2008**	**FY2009**	**FY2010**	**FY2008**	**FY2009**	**FY2010**
Revenues- US$ mn	**3,285**	**4,299**	**5,306**	**3,312**	**4,348**	**5,352**	**(0.8)**	**(1.1)**	**(0.9)**
- Wipro Technologies	2,992	3,904	4,802	3,020	3,966	4,862	(0.9)	(1.6)	(1.2)
- Wipro BPO	293	395	504	292	383	490	0.2	3.2	2.8
Rupee/ US$ rate	40.5	40.0	40.0	42.0	42.0	41.0	*(3.5)*	*(4.8)*	*(2.5)*
EBITDA (Rs mn)	34,554	43,900	52,426	37,338	47,825	55,748	*(7.5)*	*(8.2)*	*(6.0)*
EBITDA margin (%)	26.0	25.5	24.7	26.9	26.2	25.4	*(3.2)*	*(2.5)*	*(2.8)*
EBIT margin (%) (ex forex gains)	22.6	22.3	21.6	23.6	23.1	22.4	*(4.3)*	*(3.5)*	*(3.5)*
EPS/ share Rs	**23.1**	**29.2**	**32.2**	**24.3**	**30.4**	**33.4**	**(5.0)**	**(3.9)**	**(3.7)**

Note: (1) EBITDA and EBIT margin relates to only Wipro BPO and Wipro Technologies

(2) Revenues relates to Wipro Technologies and Wipro BPO

Source: Kotak Institutional Equities Estimates

Comments on Wipro 1QFY08 Results (US GAAP)

Rs mn	1QFY07	4QFY07	1QFY08	% chg. qoq	% chg. yoy	Kotak estimates	% deviation	Comments
- Wipro Technologies	22,414	27,718	27,460	(0.9)	22.5	26,860	2.2	5.1% qoq revenue growth in US$ terms for Global IT services, higher than company's guidance of 2.9% and our expectation of 3.9%. Led by 6.5% volume growth. Offshore realizations remained stable while onsite realizations declined 0.6% qoq. The company has guided for a 7% qoq growth in Global IT services revenues to US$777 mn for 2QFY08
- BPO Services	2,099	2,639	2,570	(2.6)	22.4	2,552	0.7	BPO revenues grew 7% qoq ($ terms).
- India & AsiaPac IT Services	1,608	2,461	2,486	1.0	54.6	2,493	(0.3)	
- India & AsiaPac IT Products	2,748	5,339	4,088	(23.4)	48.8	4,671	(12)	Seasonally weak quarter for domestic business
- Consumer Care and Lighting	1,650	2,107	2,221	5.4	34.6	2,227	(0)	
- Others	793	3,081	3,007	(2.4)	279.0	2,182	37.8	
Total revenues	**31,312**	**43,345**	**41,832**	(3.5)	33.6	**40,985**	**2.1**	
Operating Income	**6,509**	**8,187**	**6,864**	(16.2)	5.4	**7,638**	**(10.1)**	
- Wipro Technologies	5,513	6,470	5,656	(12.6)	2.6	6,037	(6.3)	Global IT OPM declined 280bps. Margin decline driven by rupee appreciation, forex losses of Rs620 mn (the company follows cash flow method of accounting as opposed to mark to market). Ex-currency EBIT margin decline was 70bps qoq
- BPO Services	399	660	569	(13.8)	42.8	511	11.4	
- Indian & AsiaPax IT services & Products	353	727	501	(31.1)	41.8	701	(28.5)	
- Consumer care & Lighting	231	328	305	(7.1)	32.3	306	(0.2)	
- Others	14	1	(167)		(1,311.9)	84	(298.7)	
Other income/ (expense)	508	983	991	0.8	95.3	799	24.0	
Pre-tax profits (pre-extraordinary)	**7,017**	**9,170**	**7,855**	(14.3)	11.9	**8,437**	(6.9)	
Extraordinaries	-	-	-			-		
Pre-tax profit (after non-recurring)	7,017	9,170	7,855	(14.3)	11.9	8,437	(6.9)	
Income taxes	(979)	(1,296)	(839)	(35.2)	(14.3)	(1,320)	(36.4)	Low tax rates due to (a) forex losses and (b) lower profitability of domestic business
Net income	**6,038**	**7,874**	**7,016**	(10.9)	16.2	**7,117**	**(1.4)**	
Equity in earnings of affiliates	65	39	87	122.2	33.1	58	50.6	
Minority interest	-	-	-			-		
Income from continuing operations	**6,103**	**7,913**	**7,103**	(10.2)	16.4	**7,175**	**(1.0)**	**Net income in line with expectations**
EPS- Continuing Operations	4.3	6.0	4.9	(17.5)	15.3	5.0	(1.0)	
MARGINS								
Operating margin	**20.8**	**18.9**	**16.4**			**18.6**	**(12.0)**	
Operating margin- Global IT services	**24.1**	**23.5**	**20.7**			**22.3**	**(6.9)**	
- Wipro Technologies	**24.6**	**23.3**	**20.6**			**22.5**		
- BPO	**19.0**	**25.0**	**22.1**			**20.0**		
- Indian & AsiaPax IT services & Products	8.1	9.3	7.6			9.8	(22.1)	
- Consumer care & Lighting	14.0	15.6	13.7			13.7	0.1	
- Others	1.7	0.0	(5.6)			3.9	(244.2)	
Net Income Margin	19.5	18.3	17.0			17.5	(3.0)	
Billing Rates (US$/manmonth)								
Onsite	10,979	11,254	11,192	(0.6)	1.9	11,310	(1.0)	
Offshore	4,251	4,214	4,213	(0.0)	(0.9)	4,235	(0.5)	
Volumes growth	5.5	5.4	6.5			4.1		
Revenue Mix (%)								
Onsite	53.4	55.2	55.2			54.2		
Offshore	46.6	44.8	44.8			45.8		

Guidance of US$777 mn for 2QFY08, implying a sequential revenue growth of 7%.

Source: Company, Kotak Institutional Equities

Wipro: Profit & Loss Statement Statement (Consolidated US GAAP Statements)- March fiscal year ends

Rs mn	2006	2007	2008E	2009E	2010E
Revenues					
Global IT Services & Products					
- Services	80,698	110,922	132,929	172,041	212,362
- Products	28	-	-	-	-
India & AsiaPac IT Services & Products					
- Services	6,097	8,369	10,706	12,576	13,582
- Products	10,380	15,520	19,025	22,666	24,026
Consumer Care and Lighting	5,625	7,559	9,577	11,013	12,335
Others	3,279	7,063	12,595	16,373	20,466
Revenues	**106,107**	**149,431**	**184,831**	**234,669**	**282,771**
Cost of revenues	(71,779)	(102,483)	(129,396)	(162,869)	(197,062)
Gross profit	**34,328**	**46,949**	**55,436**	**71,800**	**85,709**
Selling and marketing exp	(11,992)	(16,719)	(21,343)	(26,871)	(32,493)
EBIT (before amortization)	**22,336**	**30,230**	**34,093**	**44,929**	**53,216**
Exchange Gain/ (losses)	(288)	(0)	129	-	-
Amortization of Goodwill & Intangible Assets	(64)	(269)	(291)	(248)	-
EBIT (after amortization)	**21,984**	**29,961**	**33,931**	**44,681**	**53,216**
Other Income, net	1,276	2,667	3,951	3,810	4,435
PBT- before extraordinary items	**23,260**	**32,628**	**37,882**	**48,491**	**57,651**
Gain/(loss) on sale of stock of affiliate	-	-	-	-	-
PBT	**23,260**	**32,628**	**37,882**	**48,491**	**57,651**
Income Taxes	(3,264)	(4,423)	(4,808)	(6,613)	(11,517)
Income before share of equity in affiliates	**19,995**	**28,205**	**33,074**	**41,878**	**46,135**
Equity in earnings of affiliate	288	318	462	508	543
Minority Interest	(1)	-	-	-	-
Income from continuing operations	**20,282**	**28,523**	**33,536**	**42,386**	**46,678**
Income Tax Benefit	-	700	-	-	-
Adjustments	-	39	-	-	-
Net Profit- Reported	**20,282**	**29,262**	**33,536**	**42,386**	**46,678**
EPS (Rs/ share)	**14.2**	**19.7**	**23.1**	**29.2**	**32.2**
EPS (before amortization of intangibles)	**14.3**	**19.9**	**23.3**	**29.4**	**32.2**
Margins (%)					
Gross Profit margin	32.4	31.4	30.0	30.6	30.3
EBITDA Margin	24.0	22.9	21.1	21.7	21.4
EBIT Margin	20.7	20.0	18.4	19.0	18.8
NPM	19.1	19.1	18.1	18.1	16.5
Growth Rates (%)					
Revenues	30.4	40.8	23.7	27.0	20.5
Gross Profit	25.7	36.8	18.1	29.5	19.4
EBIT (before amortization & exchange gains)	23.5	35.3	12.8	31.8	18.4
EBIT (after amortization & exchange gains)	23.1	36.3	13.3	31.7	19.1
Income before affiliates earnings	26.9	41.1	17.3	26.6	10.2
Income from continuing operations	28.1	40.6	17.6	26.4	10.1

Source: Kotak Institutional Equities estimates

Industrials

LART.BO, Rs2377	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	2,725
52W High -Low (Rs)	2450 - 979
Market Cap (Rs bn)	679.4

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	203.5	264.3	346.8
Net Profit (Rs bn)	18.3	25.1	32.6
EPS (Rs)	65.1	88.0	112.4
EPS gth	*71.9*	*35.2*	*27.8*
P/E (x)	36.5	27.0	21.1
EV/EBITDA (x)	23.8	17.1	13.3
Div yield (%)	0.4	0.4	0.4

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	-	-	-
FIIs	20.7	1.6	(0.1)
MFs	5.6	2.6	1.0
UTI	9.4	33.3	31.6
LIC	16.0	6.7	5.1

Larsen & Toubro: Beats expectations as margins expand further and strong order inflows sustain

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- **Beats expectations on strong margin expansion; revenue growth in-line**
- **Order inflow momentum remain exceptionally strong, forward visibility stands at 1.7 years**
- **Revise earnings estimate for FY2008E and FY2009E to Rs88 (from Rs73 earlier) and Rs113 (from Rs88 earlier), raise target price to Rs2,725/share (from Rs2,125 earlier)**
- **Reiterate outperform rating based on strong investment momentum and visible near-term catalysts**

L&T has reported standalone revenues and profit after tax of Rs45.1 bn and Rs3.8 bn versus our expectation of Rs44.6 bn and Rs2.1 bn respectively. Adjusted for other income from exchange gain on FCCBs, PAT has grown by 57% to Rs2.9 bn and operating margins have expanded by 120 bps on a yoy basis. Order inflows remain exceptionally strong with inflows of Rs98.8 bn (up 32% yoy) and the order backlog at end of 1QFY08 is Rs422.6 bn, providing a visibility of 1.7 years based on forward four quarters revenues.

L&T beats expectations on back of strong execution and significant margin expansion

L&T has reported 1QFY08 standalone revenues of Rs45.1 bn (up 30% yoy) and profit after tax of Rs3.8 bn (up 140% yoy) versus our expectation of revenues of Rs44.6 bn and PAT of Rs2.1 bn. Reported street expectations was revenues of about Rs44 bn and PAT of Rs2.44 bn. Adjusting for exchange gains of about Rs1,335 mn in 1QFY08 and losses of Rs400 mn in 1QFY07 on FCCBs, PAT has increased by 57% yoy in 1QFY08 to Rs2.9 bn from Rs1.8 bn in 1QFY07. Margin have expanded significantly by 120 bps to 9.4% from 8.2% last year versus management guidance and our expectation that beyond the expansion in margins in FY2007, further scope for margin expansion is limited. The margin expansion may be attributable to (1) operating leverage, as employee and S,G&A expenses as a percentage of sales have fallen and (2) Shift of subcontractors to pure labor contractors with raw material as free supply from L&T, thus keeping a part of margins in-house. Evidently, subcontracting expenses as a percentage of sales have fallen, while raw material consumption and manufacturing expenses as a percentage of sales have increased. We believe better job selection and efficiencies from working on large projects versus no of small ones have also contributed to margin expansion (Exhibit 1 & 2).

Order inflow momentum remain exceptionally strong, forward visibility stands at 1.7 years

Order inflows remain exceptionally strong with order booking of Rs98.8 bn in 1QFY08 (up 32% yoy) and the visibility based on forward four quarters stands at 1.7 years up from 1.6 years at the end of FY2007. Order inflow momentum has sustained beyond 1QFY07 and L&T has announced an order inflow of Rs31.8 bn in the month of July 2007, so far. Order inflow in the recent past has been led by potentially higher margin process segment, particularly metals and petrochemicals (Exhibit 3 and 4).

We revise our estimates upwards based on higher margin and growth expectations, raise target price to Rs2,725/share

We revise our FY2008E and FY2009E earnings estimates upwards by 20% to Rs88 from Rs73 and 28% to Rs113 from Rs84 respectively based on (a) higher margin expectation versus earlier and (b) sustained growth outlook with strong order inflows. We have revised our SOTP based target price to Rs2,725 from Rs2,125 earlier based on (1) higher valuation of the core business led by stronger visibility and better margins – revised to Rs2,130 from Rs1,570 earlier. Our valuation for the core company implies P/E of 23.6X and EV/EBITDA of 16.9X based on FY2009E standalone earnings. We have not separately valued the power equipment manufacturing and shipbuilding business as we believe it is too early to ascribe a definite value to them but we believe our higher valuation for core business encompasses that value. Our target price is based on DCF for core company valuation and SOTP to account for subsidiaries and associates (Exhibit 5 and 6).

Reiterate outperform based on strong growth visibility led by infrastructure and industrial investments

We reiterate our outperform rating even after strong out-performance (over BSE-Sensex) of about 25% and 38% over the recent three and six month period based on:

1. **Strong momentum in infrastructure and industrial investments** across sectors led by strong economic growth and L&T's positioning in terms of breadth of skills and execution depth to leverage this opportunity
2. **Strong near-term growth visibility** for L&T with strong order inflow momentum and order backlog providing visibility of 1.7 years based on forward four quarter revenues.
3. **Ability to build sizeable businesses in related segments of engineering** such as power equipment manufacturing, shipbuilding, defense and hydro-power construction, further diversifying its revenue stream.
4. **Potential for increasing international presence**, particularly in Middle-East, thus expanding the breadth of spending that it could target.
5. **Value add in BOT infrastructure subsidiary could have positive surprise.** For instance, we have valued the Hyderabad airport (excluding real estate) in GMR Infrastructure's portfolio at Rs89.2 bn. We believe that structure of concession for Bangalore airport is same as Hyderabad airport and thus assuming similar valuation, L&T's 17% stake in Bangalore airport could be potentially valued at Rs54/share. This does not count the upside based on real estate available for development and the fact that Bangalore is a larger airport in terms of passengers.
6. **Possible value unlocking in subsidiaries** such as L&T Infotech, L&T Infrastructure Development Projects Ltd could serve as near-term catalysts for further valuation upside.
7. **Valuation not too expensive, given scale and breadth** as L&T trades at 21.1X our revised EPS of Rs112.9 in FY2009E. Kotak industrial coverage universe trades at 21X FY2009E earnings. We believe that multiple is justified given the fact that L&T is very well diversified in terms of presence across sectors by itself or through subsidiaries and associates. We believe that even the consolidated earnings do not fully capture the entire value, particularly of infrastructure portfolio where in several projects would contribute to earnings beyond FY2009 only.

Execution challenges, slowdown in infrastructure/industrial capex spending pose key risks

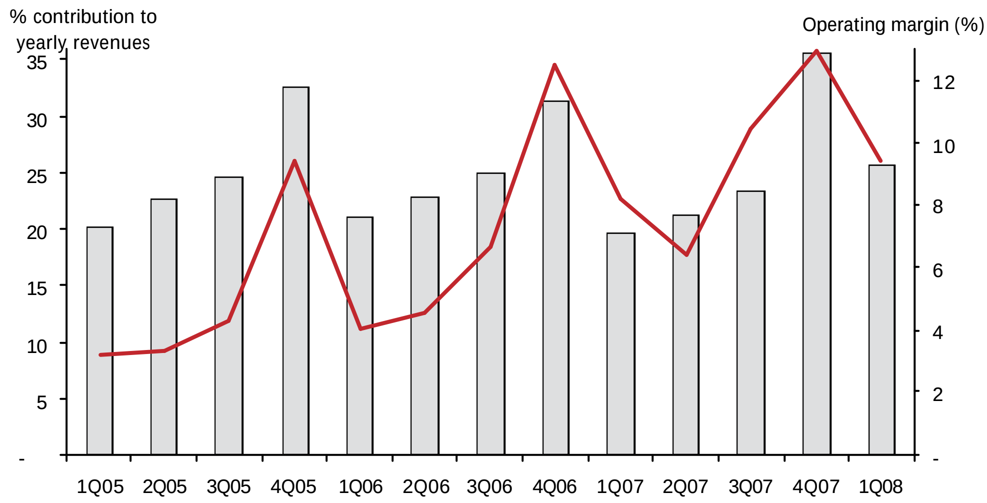
Key risks emerge from (a) execution challenges in a tight demand-supply environment for technical and managerial skills, and (b) slowdown in infrastructural and industrial capital expenditure with increase in interest rates or slower economic growth.

Exhibit 1: L&T - key nos (Rs mn)

	yoy			qoq		
	1QFY08	1QFY07	(% chg)	1QFY08	4QFY07	(%chg)
Gross sales	**45,739**	**35,318**	**30**	**45,739**	**63,657**	**(28)**
Less: Excise duty	(687)	(549)	25	(687)	(1,175)	(42)
Net sales	**45,052**	**34,769**	**30**	**45,052**	**62,482**	**(28)**
Expenses	(40,822)	(31,929)	28	(40,822)	(54,384)	(25)
Stock	27	(60)	(145)	27	(397)	(107)
RM	(11,012)	(7,455)	48	(11,012)	(16,542)	(33)
Trading goods	(3,018)	(2,257)	34	(3,018)	(3,336)	(10)
Total RM consumption	**(14,004)**	**(9,772)**	**43**	**(14,004)**	**(20,275)**	**(31)**
Subcontracting charges	(8,439)	(7,892)	7	(8,439)	(10,340)	(18)
Construction materials	(9,523)	(7,875)	21	(9,523)	(13,515)	(30)
Employee	(3,130)	(2,494)	26	(3,130)	(3,104)	1
Other mfg. expenses	(2,786)	(1,115)	150	(2,786)	(1,685)	65
Other S,G&A	(2,939)	(2,781)	6	(2,939)	(5,464)	(46)
Total other expenses	(5,725)	(3,896)	47	(5,725)	(7,149)	(20)
Operating profit	**4,230**	**2,840**	**49**	**4,230**	**8,098**	**(48)**
Other income	780	474	64	780	2,041	(62)
EBIDTA	5,010	3,315	51	5,010	10,140	(51)
Interest	(157)	(158)	(0)	(157)	(63)	148
Depreciation	(424)	(309)	37	(424)	(698)	(39)
PBT	4,429	2,848	56	4,429	9,378	(53)
Tax	(1,542)	(1,013)	52	(1,542)	(2,371)	(35)
Net profit	**2,887**	**1,835**	**57**	**2,887**	**7,008**	**(59)**
Extraordinary items	881	(264)		881	-	
Reported profit	**3,768**	**1,571**	**140**	**3,768**	**7,008**	**(46)**
Key ratios						
Excise duty/Grass sales (%)	1.5	1.6		1.5	1.8	
Raw materials/sales (%)	52.2	50.8		52.2	54.1	
Subcontracting charges (%)	18.7	22.7		18.7	16.5	
Employee expenses/sales (%)	6.9	7.2		6.9	5.0	
Other manufacturing expenses (%)	6.2	3.2		6.2	2.7	
S G and A expenses/sales (%)	6.5	8.0		6.5	8.7	
Operating profit margin (%)	**9.4**	**8.2**		**9.4**	**13.0**	
EBIDTA margin (%)	11.1	9.5		11.1	16.2	
PBT Margin (%)	9.8	8.2		9.8	15.0	
Tax rate (%)	34.8	35.6		34.8	25.3	
Segment results						
Revenues						
E&C	34,919	26,189	33	34,919	48,973	(29)
Electrical	5,411	4,244	28	5,411	6,932	(22)
Machinery & Industrial	4,227	3,368	25	4,227	6,641	(36)
Others	2,910	2,103	38	2,910	2,514	16
Revenue mix (%)						
E&C	73.6	72.9		73.6	75.3	
Electrical	11.4	11.8		11.4	10.7	
Machinery & Industrial	8.9	9.4		8.9	10.2	
Others	6.1	5.9		6.1	3.9	
EBIT Margin (%)						
E&C	8.5	7.6		8.5	13.6	
Electrical	14.5	15.9		14.5	13.8	
Machinery & Industrial	21.2	17.2		21.2	20.6	
Others	4.2	9.4		4.2	9.9	
EBIDTA Margin (%)						
E&C	9.6	8.4		9.6	14.7	
Electrical	16.7	18.1		16.7	16.9	
Machinery & Industrial	22.1	18.2		22.1	21.8	
Others	6.0	12.0		6.0	17.4	

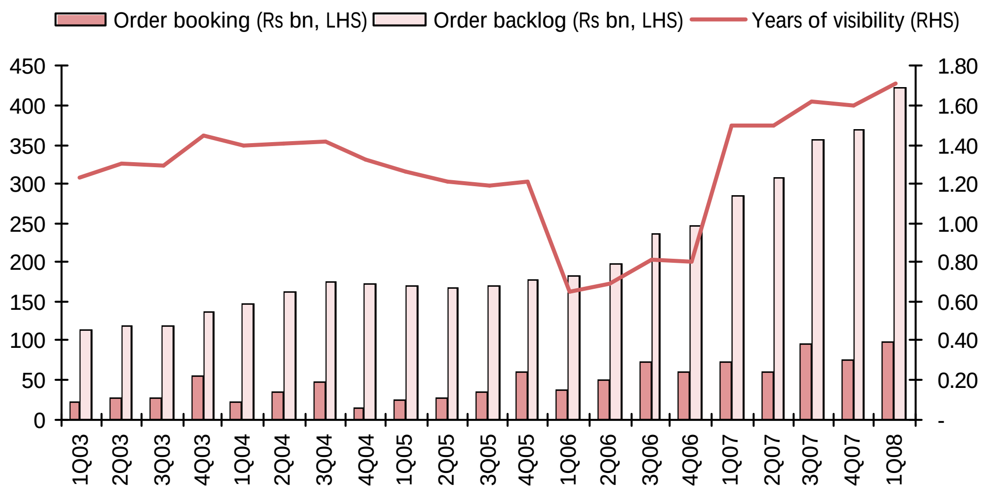
Source: Company data, Kotak institutional equities estimates.

Exhibit 2: 1Q08 has seen the highest margin achieved in the first quarter, for the past few years
Revenue and margin performance of L&T over the last 13 quarters



Source: Company, Kotak Institutional Equities

Exhibit 3. Order flows remain strong, order books provide 1.7 years of revenue visibility
Order booking, Order backlog & Visibility trend for L&T, March fiscal year-ends, (Rs mn)



Source: company data, Kotak institutional equities estimates

Exhibit 4. Order inflows since 4QFY07 have remained strong
Major orders booked by L&T since 4QFY07

Date	Customer	Sector	Size of Order (Rs bn)	Nature of Work
17-Jul-2007	Tata Steel	Process	9.8	Supply and installation of blast furnace
16-Jul-2007	Tata Steel	Process	6.2	Supply & installation of sinter plant and other packages
16-Jul-2007	Various companies in the Gulf	Process	7.2	Manufacture and supply of process modules for handling & processing of gas
13-Jul-2007	Abu Dhabi Water & Electricity Authority	Infrastructure	3.7	Design and commissioning of substations
13-Jul-2007	Power Grid Corporation of India Limited	Infrastructure	2.0	Turnkey construction of substations
13-Jul-2007	Different entities in the water and utilities sector	Infrastructure	2.9	Various projects in the water sector
10-Jul-2007	Indian Oil Corporation Limited	Process	5.4	Order for motor spirit quality upgradation unit
21-Jun-2007	BigLift Shipping BV, Netherlands	Others	3.8	Construction of two ships
19-Jun-2007	Victory Heights Golf Residential and Development LLC, UAE	Others	6.1	Residential building project in Dubai, in JV with Eastern Contracting LLC
12-Jun-2007	Oil & Natural Gas Corporation	Oil & gas	8.8	Re-construction of offshore facilities at NQ complex in Mumbai High north field
12-Jun-2007	Steel Authority of India Limited	Power	1.1	Turnkey construction of substation and associated transmission networks
7-Jun-2007	ENOC Processing Company LLC, Dubai	Process	2.1	Mechanical erection of new process plants
18-May-2007	Irrigation & Command Area Development Dept, Govt of AP	Infrastructure	2.7	Engineer-Procure-Construct lift irrigation
8-May-2007	Abu Dhabi Water & Electricity Authority	Infrastructure	2.1	Supply and installation of power cables and fibre optic cables
25-Apr-2007	Nakheel, UAE	Others	2.0	Residential project in Dubai
	Total large order booking since 4QFY07 so far		**65.9**	

Source: Company, Kotak Institutional equities estimates.

Exhibit 5. L&T - segmental numbers, March fiscal year-ends, 2006-2009E, (Rs mn)

	FY2006	1Q07	FY2007	1Q08	FY2008E	FY2009E
Engineering and Construction						
Order backlog	243,300	274,630	353,330	396,900	587,102	821,603
Revenues	**113,460**	**25,820**	**131,300**	**33,220**	**172,967**	**234,780**
EBITDA	9,090	2,170	15,040	3,190	21,188	28,761
EBITDA margin (%)	**8.0**	**8.4**	**11.5**	**9.6**	**12.3**	**12.3**
% yoy growth		8	16	29	32	36
Electrical and Electronics						
Revenues	**14,190**	**3,820**	**18,450**	**5,030**	**23,063**	**27,675**
EBITDA	2,390	690	3,190	840	4,036	4,843
EBITDA margin (%)	**16.8**	**18.1**	**17.3**	**16.7**	**17.5**	**17.5**
% yoy growth		32	30	32	25	20
Machinery and Industrial products						
Revenues	**14,390**	**3,290**	**17,950**	**4,170**	**22,438**	**28,047**
EBITDA	2,110	600	**3,230**	920	**4,151**	**5,189**
EBITDA margin (%)	**14.7**	**18.2**	**18.0**	**22.1**	**18.5**	**18.5**
% yoy growth		6	25	27	25	25
Others						
Revenues	**5,930**	**1,840**	**8,440**	**2,650**	**10,550**	**12,660**
EBITDA	600	220	**870**	160	**1,108**	**1,329**
EBITDA margin (%)	**10.1**	**12.0**	**10.3**	**6.0**	**10.5**	**10.5**
% yoy growth		(36)	42	44	25	20
Total						
Revenues	**147,970**	**34,770**	**176,140**	**45,070**	**229,017**	**303,162**
EBITDA	14,190	3,680	22,330	5,110	30,483	40,122
EBITDA margin (%)	**9.6**	**10.6**	**12.7**	**11.3**	**13.3**	**13.2**
YoY growth		6	19	30	30	32

Source: Kotak Institutional Equities estimates.

Exhibit 6. Sum of the Parts valuation for SOTP gives a target price of Rs2,725/share

	Original invt (Rs mn)	Mkt value (Rs mn)	Implied val on 09 estimates (x)			L&T's stake %	Value of L&T's stake (Rs mn)	Value per share of L&T (Rs)	Basis for Valuation	
			P/E	P/B	EV/EBIDTA					
Core company valuation			**23.6**	**6.2**	**16.9**		**598,203**	**2,126**		
Key subsidiaries - services	1,192	70,344	-	-	-		70,344	250		
L&T Finance	1,042	18,380	13.3	3.5	NA	100	18,380	65	Relative P/E	10% discount to average banking sector P/E multiple o 14.7
L&T Infotech	150	51,964	16.2	5.9	11.6	100	51,964	185	Relative P/E	20% discount to average IT sector P/E multiple of 28.7
Key subsidiaries - manufacturing	911	60,644					31,533	112		
Tractor Engineers	3	2,423	17.0	3.4	10.2	100	2,423	9	Relative P/E	20% discount to average industrials sector P/E multiple of 21.5
Associate companies*	908	58,221	17.0	NA	NA	50	29,111	103	Relative P/E	20% discount to average industrial sector P/E multiple of 21.5
Power SPVs	873	6,236					3,558	13		
L&T Power Invt Pvt Ltd	211	211	-	-	-	100	211	1	At original investment	At original investment
HPL Cogeneration	312	5,465	4.9	1.0	2.0	51	2,787	10	Relative P/E	Lowest P/E multiple among utilities
India Infra Developers	350	561	22.9	0.7	4.7	100	561	2	Relative P/E	Lowest P/E multiple among utilities
Infrastructure SPVs	7,877	39,387				79	31,116	111		
Other subsidiaries	626	-					1,252	4		
Total subsidiaries	**5,286**						**137,803**	**490**		
UltraTech Cement	143	120,295				11.5	13,834	49	Market value	Market value
Other associate companies	138	275.20				0	275	1	2X investment	Book value of investment
Integrated JVs	294	587.60				0	588	2	2X investment	Book value of investment
Total associates and IJVs	**574**	**121,158**				**-**	**14,697**	**52**		
Financial investments	**12,368**	**12,368**				**-**	**12,368**	**44**		
Grand total	**18,228**	**133,525**	**30.8**	**8.0**	**-**	**-**	**763,071**	**2,712**		

* includes L&T Komatsu, L&T Case, Audco India and EWAC Alloys

Source: Company, Kotak Institutional Equities estimates

Cement

ACC.BO, Rs1150	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	900
52W High -Low (Rs)	1192 - 680
Market Cap (Rs bn)	217.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	57.5	67.7	73.7
Net Profit (Rs bn)	10.7	13.5	14.6
EPS (Rs)	56.7	71.7	77.6
EPS gth	*93.7*	*26.4*	*8.2*
P/E (x)	20.3	16.0	14.8
EV/EBITDA (x)	12.1	9.8	8.6
Div yield (%)	1.5	1.5	1.5

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	38.0	-	-
FIIs	20.2	0.5	(0.0)
MFs	2.7	0.4	(0.1)
UTI	-	-	(0.5)
LIC	12.9	1.6	1.1

ACC: 2QCY07 performance inline with expectations; retain Underperform rating

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- **Volumes growth accompanied by higher realizations improve profitability.**
- **Targeting installed capacity of 27.5 mn tpa by end-CY2009.**
- **Restructuring core cement business.**

ACC reported 28% yoy increase in net revenues at Rs18.68 bn (our estimate of Rs18.04 bn), 19% increase in EBITDA at Rs5.4 bn (our estimate of Rs5.5 bn) and 28% increase in net profits at Rs3.6 bn (our estimate of Rs3.5 bn) for 2QCY07. Reported profits for the quarter at Rs3.5 bn include provision for taxation for prior period amounting to Rs0.2 bn. Sales volumes increased by 15.3% yoy as increased capacities at Lakheri and Kymore began commercial production. Improvement in realizations (11% yoy) further strengthened the financial performance. Our EPS estimates remain unchanged at Rs71.7 for CY2007 and Rs77.6 for CY2008 respectively. We retain our Under-perform rating on the stock with target price of Rs900/share.

Volumes growth accompanied by higher realizations improve profitability. Higher cement volumes and 11% improvement in realizations resulted in ACC reporting a strong 19% EBITDA growth. Higher operating costs and excise duty as compared to March quarter were compensated by price increases taken during the quarter.

Targeting installed capacity of 27.5 mn tpa by end-CY2009. ACC is working on several projects spread across its manufacturing facilities to increase the production capacity to 27.5 mn tpa by end-CY2009 from the current 21 mn tpa. The expansion project at Lakheri (capacity increase of 0.6 mn tpa and 25 MW captive power plant) along with the augmentation of capacity at Kymore have started commercial production during the quarter. ACC is augmenting grinding capacities at Tikaria, Wadi and Sindri in 2007 to increase the total cement capacity to 23.1 mn tpa. Capacity expansion at Bargarh Cement in Orissa (by 1.2 mn tpa) will likely get completed in 2008. ACC also plans to increase the capacity at Wadi in Karnataka by 3 mn tpa by end-2009.

Restructuring core cement business. ACC has sold its entire holding in its subsidiary ACC Nihon for a consideration of Rs300 mn. The board has further approved the de-merger of the RMC business into a separate subsidiary, subject to shareholder approval pending which the results of the RMC business have been included in the standalone results.

Unexciting growth prospects in the absence of pricing power. We expect the earnings growth during CY2008 to be muted in the absence of significant price increases and moderate volumes growth (8-9%). We expect capacity addition during FY2009 to be ahead of incremental cement demand. After the sharp price increases during the last 18 months, which have buoyed the sales of cement manufacturers, we expect prices to stabilize in CY2008 as new capacities come on stream.

Retain Underperform rating with target price of Rs900/share. ACC is trading at 8.6X EV/EBITDA on CY2008E. On an asset valuation basis, ACC is trading at EV/ton of US$204/tonne—much above the replacement cost of $85-100/tonne. We retain our Underperform rating on the stock.

Quarterly results for ACC Limited, December yearends (Rs mn)

	yoy			Our Estimates	
	June 2007	June 2006	% chg	June 2007	% chg
Sales	**18,680**	**14,621**	***28***	**18,046**	***23***
Operating costs					
Raw materials	(2,697)	(1,532)	*76*	(2,111)	*38*
Employee costs	(939)	(818)	*15*	(950)	*16*
Freight costs	(2,530)	(2,180)	*16*	(2,906)	*33*
Power costs	(2,865)	(2,532)	*13*	(2,955)	*17*
Purchased cement	(285)	(153)	*86*	(137)	*(11)*
Other expenditure	(3,920)	(2,849)	*38*	(3,483)	*22*
Total operating costs	(13,236)	(10,065)	*32*	(12,540)	*25*
EBITDA	**5,444**	**4,556**	***19***	**5,506**	***21***
EBITDA margin (%)	29.1	31.2		30.5	
Other income	283	156	*82*	160	*3*
Interest	23	(147)	*(115)*	(50)	*(66)*
Depreciation	(633)	(579)	*9*	(700)	*21*
PBT	**5,116**	**3,985**	***28***	**4,916**	***23***
Current tax (expense)/income	(1,417)	(1,100)		(1,327)	
Deferred tax (liability)/asset	-	-		-	
Net income	**3,699**	**2,885**	***28***	**3,588**	***24***
Extraordinaries	**(187)**	**1,171**		**-**	
Reported net income	**3,512**	**4,056**		**3,588**	
Sales, mn tonnes	**5.3**	**4.6**	***14.0***	**5.3**	***14.0***
Realization (Rs/tonne)	**3,540**	**3,158**	***12***	**3,420**	***8***
Operating costs (Rs/tonne)					
Raw materials	511	331	*54*	400	*21*
Employee costs	178	177	*1*	180	*2*
Freight costs	479	471	*2*	551	*17*
Power & fuel costs	543	547	*(1)*	560	*2*
Purchased cement	54	33	*63*	26	*(22)*
Other expenditure	743	615	*21*	660	*7*
Profitability (Rs/tonne)	**1,032**	**984**	***5***	**1,043**	***6***

Source: Company data, Kotak Institutional Equities estimates

Calculation of target prices using our multi-stage valuation process

	ACC
Dec 2007 CROGCI/WACC (X)	1.95
Assigned premium of EV/GCI to CROGCI/WACC (%)	14.5
Assigned EV/GCI (X)	2.23
GCI (Rs bn)	67.2
EV (Rs bn)	150.1
Net debt (Rs bn)	(13.5)
Market cap (Rs bn)	164
No. of shares (fully diluted)	189
Implied price (Rs)	867
Target price (Rs)	**900**

Source: Kotak Institutional Equities estimates

Technology

TEML.BO, Rs1479	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	1,500
52W High -Low (Rs)	2050 - 365
Market Cap (Rs bn)	180.3

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	29.3	41.1	62.8
Net Profit (Rs bn)	6.2	8.6	12.5
EPS (Rs)	47.0	66.0	96.0
EPS gth	*124.3*	*40.5*	*45.6*
P/E (x)	31.5	22.4	15.4
EV/EBITDA (x)	24.4	18.1	11.4
Div yield (%)	0.2	0.3	0.3

Tech Mahindra: Results below expectations'a few concerns emerging. Maintain In-line rating

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- **Revenue growth slows down as the BT account consolidates**
- **Revenue growth likely to remain moderate for another quarter, pick up Dec '07 quarter onwards**
- **Operating margins to remain under pressure in FY2008**
- **Reducing EPS estimates on change in Re/US$ rate assumption**
- **Maintain In-Line rating with a reduced Mar' 09 end DCF based target price of Rs1,500.**

Tech Mahindra (TM) reported 6.7% qoq revenue growth (US$ terms) to US$211 mn in Jun ’07 quarter, significantly below our expectations. BT relationship had a marked slowdown with a mere 2% qoq growth. Growth was driven by non-BT accounts, which grew 16% qoq. Net income declined 13% qoq to Rs1.7 bn for Jun’ 07 quarter, in line with our expectations. We believe that overall revenue growth for TM will remain moderate in the Sep ’07 quarter before picking up again in the Dec ’07 quarter on the back of BTGS deal ramp up. We expect OPM to remain under pressure in FY2008 on account of rupee appreciation and investments in the BTGS deal. We are reducing our EPS estimates for FY2008 and FY2009, largely on the back of revision in our Re/US$ estimates to 40.5 and 40 from 43 earlier. We reduce our FY2008 EPS estimate by 10.2% to Rs66 and FY2009 EPS number by 8.2% to Rs96. Accordingly we reduce our Mar’ 09 end DCF based target price to Rs1,500 (Rs1,850 earlier). We maintain our IL rating.

Revenue growth slows down as BT engagements consolidate: TM revenues grew 6.7% qoq in US$ terms to US$211 mn and 0.2% in Re terms to Rs8.76 bn. Growth was led by non-BT relationships which grew 16% qoq (US$ terms to US$76 mn. BT account grew a modest 2% qoq in US$ terms and BT’s concentration fell to 64% of overall revenues. We note that BT revenues were still up a healthy 79.6% yoy in US$ terms. Slowdown in BT revenue growth was led by (a) consolidation in some of the BT’s projects as a result of organizational changes within BT and (b) seasonality—June being the first quarter of BT’s fiscal year, budgets were likely in the process of being finalized. We believe that growth in BT account (ex-BTGS) will likely moderate out to 5-7% qoq in the next few quarters (details below in the note).

EBITDA margin decline of 3.3% qoq is in line with our expectations: EBITDA margins declined 330 bps to 22.1%, as a result of (a) rupee appreciation (b) wage revisions and (c) higher visa expenses. The company maintained a higher bench with around 400-600 people being trained for BT-GS deal. Net income was better than our expectation and primarily was aided by a forex gain of US$2.5 mn. We note that the company has changed its accounting policy by moving away from mark to market of FX hedges to a cash flow hedge method of accounting.

Revenue growth to remain moderate in the Sep ’07 quarter, pick up again subsequently: We expect growth in FY2008 to be back-ended. We model revenue growth of 59.6% to US$1.02 bn for FY2008 (implying a CQGR of 12.5% from 2Q-4QFY08) and 54% to US$1.57 bn for FY2009. TM has multiple revenue streams which we discuss in detail

a) **BT business (excluding BTGS):** We expect growth from BT's core business to moderate out to 5-7% qoq. This moderation will happen after several quarters of ramp ups (which incidentally got synchronized) around migration, platforms, Openreach and 21CN. We note that BT has recently undergone organizational changes and is moving away from its earlier verticalized organization structure. We believe that the slowdown in BT revenue growth for TM during Jun '07 was partially driven by the changes happening at BT. We expect growth in BT account to have a moderate uptick from Sep '07 quarter.

b) **Non-BT relationships:** We do not expect a repeat of FY2007 performance in non-BT revenue streams. We categorize the non-BT relationships into (a) AT&T—growing at a fair clip though law of large numbers may catch up. AT&T relationship in our view is on track to achieve revenues of US$100 mn+ for FY2008 as compared to US$65 mn for FY2007 (b) Alcatel—going through a product consolidation phase after merger with Lucent (c) Motorola—a potentially US$50 mn+ relationship, has been slow of the blocks (d) System integration revenues—the build out phase of which relates to network and applications have been completed. These contracts have moved to maintenance phase, leading to substantial revenues to be replaced in FY2008; and (e) BPO business— a bright spot has ramped up to 2000+ people in three quarters, but still small to make a meaningful impact on overall revenues. Tech Mahindra has won a few new clients for its BPO practice including a large TSP (inbound back office processing), a hardware company (remote L1 tech support) in the US, and a retail bank in the UK (portfolio analysis, credit appraisal, etc.).

c) **BT GS—in transition phase, expect strong ramp up in FY2009:** We have modeled revenues of US$50 mn from the BT GS deal for FY2008 and US$200 mn for FY2009. We expect revenues from the BT GS deal to become meaningful only from 3QFY08. Revenues in our view will accelerate to a peak level by the eight to the tenth quarter. TM has a large team of people working on identifying various buckets of IT, ITO, and BPO work to be transitioned. TM indicates that services as a part of this contract may be evenly split between IT and BPO. In the initial phase service transition would be focused on the UK market, where BT has a pool of significant pool of sub-contractors, reflecting an initial potential addressable opportunity for TM. We note that TM adds ADM capabilities to BT GS' range of service offerings that include network management, data center operations and application hosting.

Operating margin—to remain under pressure in FY2008: We forecast margin decline of 140bps in FY2008. The decline in FY2008 largely emanates from (a) rupee appreciation (10.2% to 40.5 against an average realization of 45.2 in FY2007) and (b) initial losses on knowledge transfer; sales force and capability build out for the BTGS deal. In our view, BTGS deal will have higher profitability (without amortization charges related to the contract acquisition) than the corporate average over the longer term. TM will be able to partly mitigate the impact from the above factors through levers such as better utilization of employee pyramid and potential improvement in utilization rate.

Changes to our model—largely rupee related: We reduce our FY2008 EPS by 10.2% to Rs66 and FY2009 EPS by 8.2% to Rs96. The change is largely attributable to change in our rupee/ US$ forecast (to 40.5 and 40 for FY2008 and FY2009 from 43 earlier) and modest tinkering with our revenue growth rate. The stock may look inexpensive on P/E multiples though we highlight that there is a mismatch between revenue and costs. TM had written off US$118.6 mn upfront payment made to BT for securing US$1 bn BT Global Services (BT GS) contract as an extraordinary item in the P&L in the Mar' 07 quarter. This inflates future profits (FY2008-FY2012). We advocate cash flow based valuations as (a) the large deals (which appears to the strategy of TM) may have an element of upfront payment, which is not appropriately captured in an income statement, and (b) it captures working capital management effectively (an area requiring a lot of attention). We reduce our Mar '09 DCF based target price to Rs1,500 from Rs1,850 earlier on the back of change in Re/US$ assumption and marginal revision in our revenue estimates. We maintain our In-Line rating on the stock.

Tech Mahindra: Key changes to FY2008-10 estimates

	New			Old			Change (%)		
Rs mn	**FY2008**	**FY2009**	**FY2010**	**FY2008**	**FY2009**	**FY2010**	**FY2008**	**FY2009**	**FY2010**
Revenues (Rs mn)	**41,084**	**62,771**	**81,905**	**47,395**	**70,731**	**92,661**	**(13.3)**	**(11.3)**	**(11.6)**
Revenues (US$ mn)	**1,015**	**1,568**	**2,046**	**1,101**	**1,643**	**2,111**	**(7.8)**	**(4.6)**	**(3.1)**
EBITDA	9,763	14,937	19,183	11,858	17,215	22,053	(17.7)	(13.2)	(13.0)
Net Profit	8,604	12,525	14,782	9,583	13,641	15,493	(10.2)	(8.2)	(4.6)
EPS (Rs/ share)	**70.6**	**100.5**	**114.5**	**78.6**	**109.5**	**120.0**	**(10.2)**	**(8.2)**	**(4.6)**
Fully diluted EPS	**66.0**	**96.0**	**113.4**	**73.5**	**104.6**	**118.8**	**(10.2)**	**(8.2)**	**(4.6)**
Re/ $ rate	40.5	40.0	40.0	43.0	43.0	43.9	(6.0)	(7.0)	(8.8)
EBITDA margin	23.8	23.8	23.4	25.0	24.3	23.8			

Source: Kotak Institutional Equities estimates

Tech Mahindra interim results, March year end

				% change		Kotak		
Rs mn	1QFY07	4QFY07	1QFY08	qoq	yoy	Estimates	% Deviation	Comments on QoQ performance
Revenues	**5,871**	**8,745**	**8,763**	**0.2**	**49**	**9,304**	**(5.8)**	Revenue growth of 6.7% in US$ terms. The BT account grew 2% qoq (now accounts for 64% of revenues) while non-BT accounts grew by a strong 16%
Cost of revenues	(3,724)	(5,135)	(5,492)	7.0	47	(5,836)	(5.9)	
Gross profit	**2,147**	**3,610**	**3,271**	**(9.4)**	**52**	**3,468**	**(5.7)**	Gross margin in line with expectations
SG&A expenses	(839)	(1,392)	(1,338)	(3.9)	60	(1,415)	(5.4)	
EBITDA	**1,308**	**2,218**	**1,933**	**(12.8)**	**48**	**2,054**	**(5.9)**	EBITDA margins declined 330bps qoq to 22.1%, in line with expectations. Margin decline was driven by (a) rupee appreciation (b) wage hikes and (c) onsite shift in revenues.
Depreciation	(108)	(158)	(168)	6.3	56	(227)	(25.9)	
EBIT	**1,200**	**2,060**	**1,765**	**(14.3)**	**47**	**1,827**	**(3.4)**	
Interest		(49)	(15)	(69)		**(2)**		
Other income	10	154	131	(15)	1,210	129		
Profit before tax	**1,210**	**2,165**	**1,881**	**(13.1)**	**55**	**1,954**	**(3.7)**	
Tax	(144)	(204)	(183)	(10.3)	27	(262)		Tax rates at 9.7% significantly below expectations
Net profit	**1,066**	**1,961**	**1,698**	**(13.4)**	**59**	**1,692**	**0.4**	
Minority interest	-	-	-			-		
Net income	**1,066**	**1,961**	**1,698**	**(13.4)**	**59**	**1,692**	**0.4**	
Extraordinaries	-	(5,249)	-			-		
Net profit- reported	**1,066**	**(3,288)**	**1,698**		**59**	**1,692**	**0.4**	Net income in line with expectations despite lower than expected revenues on account of lower tax rates and depreciation
EPS -Diluted (Rs)	**9.5**	**15.0**	**13.0**	**(13.4)**	**37.4**	**13.0**		
Shares outstanding (mn)	112.4	130.4	130.4	-	16.0	130.4		
-								
Margins (%)								
Gross profit margin	36.6	41.3	37.3			37.3		
EBITDA margin	22.3	25.4	22.1			22.1		
EBIT margin	20.4	23.6	20.1			19.6		
NPM	18.2	22.4	19.4			18.2		
Employee Metrics								
Software Professionals	11,721	17,181	18,092					
Sales & Support	645	813	1,035					
BPO professionals		1,755	2,019					
Total Employees	12,366	19,749	21,146					
Other Metrics								
BT revenues (% of total)	58.0	67.0	64.0					Non-BT revenues grew 16% qoq versus 2% growth in BT
Revenues (%)								
BT	3,405	5,859	5,608	(4.3)	65			
Non-BT	2,466	2,886	3,155	9.3	28			
Revenue Mix (%)								
Onsite	34.0	41.0	43.0					Onsite concentration increased as a result of initiation of new projects
Offshore	66.0	59.0	57.0					

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

Rs mn	2006	2007	2008E	2009E	2010E
Revenues	**12,427**	**29,290**	**41,084**	**62,771**	**81,905**
Direct cost	(7,397)	(17,536)	(25,191)	(38,674)	(51,073)
Gross profit	**5,030**	**11,754**	**15,893**	**24,097**	**30,832**
SG&A expenses	(2,351)	(4,387)	(6,130)	(9,159)	(11,649)
EBITDA	**2,679**	**7,367**	**9,763**	**14,937**	**19,183**
Depreciation	(397)	(516)	(805)	(1,126)	(1,373)
EBIT	**2,282**	**6,851**	**8,958**	**13,812**	**17,809**
Other income	340	75	723	453	809
Interest		(61)	(15)	-	-
Profit before tax	**2,622**	**6,865**	**9,666**	**14,264**	**18,619**
Tax	(268)	(741)	(1,062)	(1,740)	(3,837)
Net profit	**2,354**	**6,124**	**8,604**	**12,525**	**14,782**
Minority interest	(0)				
Net income	**2,354**	**6,124**	**8,604**	**12,525**	**14,782**
Extraordinaries	-	(4,910)	-	-	-
Net profit- reported	**2,354**	**1,214**	**8,604**	**12,525**	**14,782**
EPS (Rs/share)	**20.9**	**51.4**	**70.6**	**100.5**	**114.5**
Fully Diluted EPS (Rs/Share)		**47.0**	**66.0**	**96.0**	**113.4**
Margins (%)					
Gross profit margin	40.5	40.1	38.7	38.4	37.6
EBITDA margin	21.6	25.2	23.8	23.8	23.4
EBIT margin	18.4	23.4	21.8	22.0	21.7
NPM	18.9	20.9	20.9	20.0	18.0
Growth rates (%)					
Revenues	31.4	135.7	40.3	52.8	30.5
Gross profit	44.4	133.7	35.2	51.6	28.0
EBITDA	98.4	175.0	32.5	53.0	28.4
EBIT	121.8	200.2	30.8	54.2	28.9
Net profit	130.1	160.1	40.5	45.6	18.0
Net income					
As percentage of Sales					
Revenues	100.0	100.0	100.0	100.0	100.0
Software development expenses	59.5	59.9	61.3	61.6	62.4
Gross profit	40.5	40.1	38.7	38.4	37.6
Selling expenses	5.0	0.7	3.0	4.0	3.6
Administrative expenses	14.0	2.2	8.6	10.6	10.6
S G & A expenses	18.9	15.0	14.9	14.6	14.2
EBITDA	21.6	25.2	23.8	23.8	23.4
Depreciation	3.2	1.8	2.0	1.8	1.7
EBIT	18.4	23.4	21.8	22.0	21.7
Net profit	18.9	20.9	20.9	20.0	18.0
Tax rate	10.2	10.8	11.0	12.2	20.6

Source: Kotak Institutional Equities estimates

Automobiles

ASOK.BO, Rs39

Ashok Leyland: 1QFY2008 net profit up 28% yoy

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- **1Q net profit at Rs882 mn grows 28% yoy, drops 49% qoq**
- **1Q EBITDA margins at 10.8% grows 220bps yoy; declines 80bps qoq**

Ashok Leyland (ALL) reported 1Q net profit at Rs882 mn grew 28% yoy but drops 49% qoq. 4Q EBITDA margins at 10.8% grew 220 bps yoy but dropped 80 bps qoq. The yoy growth in net profit was due to lower volumes in 1QFY2007 and a lower base. The qoq decline is due to the slowdown in the CV industry post the rise in the interest rates in the last six months. Net sales at Rs16.2 bn grew 14% yoy but dropped 29% qoq as the total CV volumes grew 6% on a yoy basis while it dropped 30% qoq. The borrowing costs have gone up on account of borrowings for capacity expansion.

We estimate a 2.5% volume growth for ALL in FY2008 in line with the industry growth. We believe that post the monsoons, the demand for CVs would pick as historically, the monsoons have been a lean season. The onset of the festive season aided by good monsoons and the interest rates having peaked out would propel demand 2HFY2008 onwards. Going forward, ALL expects margins to be under pressure on account of rising raw material costs. ALL has recently entered into a JV with Alteams of Finland to make high-pressure die-cast aluminum products for the telecommunications and automotive sectors.

Ashok Leyland: 1QFY2008 results

				% chg.		
(in Rs mn)	**1QFY07**	**4QFY07**	**1QFY08**	**qoq**	**yoy**	**FY07**
Net sales	**14,239**	**22,910**	**16,211**	**(29.2)**	**13.9**	**71,682**
Operating costs	**(13,026)**	**(20,261)**	**(14,468)**	**(28.6)**	**11.1**	**(64,655)**
(Inc/Dec in Stock)	821	(1,680)	1,267	(175.4)	54.3	647
Raw Materials	(11,267)	(15,379)	(12,937)	(15.9)	14.8	(54,038)
Staff Cost	(1,291)	(1,163)	(1,391)	19.6	7.7	(4,807)
Other Expenditure	(1,289)	(2,038)	(1,408)	(30.9)	9.2	(6,457)
EBITDA	**1,213**	**2,649**	**1,743**	**(34.2)**	**43.7**	**7,027**
Other income	139	169	76	(55.3)	(45.6)	708
Interest costs	(5)	(19)	(128)	579.0	2,367.7	(53)
Depreciation	(328)	(481)	(413)	(14.2)	26.0	(1,506)
Extraordinairies	(65)	(30)	(35)			(131)
PBT	**954**	**2,288**	**1,243**	**(45.7)**	**30.3**	**6,045**
Taxes	(262)	(573)	(361)	(36.9)	37.7	(1,632)
PAT	**692**	**1,715**	**882**	**(48.6)**	**27.5**	**4,413**
Adj. PAT	**734**	**1,735**	**905**	**(47.9)**	**23.3**	
Key ratios						
Volumes	17,067	26,129	18,163	(30.5)	6.4	83,133
Net realizations (Rs/vehicle)	834,284	876,785	892,552	1.8	7.0	862,249
RM/Net sales (%)	84.9	59.8	75.5	15.7	(9.4)	76.3
RM/VOP (%)	15,145.0	21,289.3	17,554.1	(3,735.2)	2,409.1	76.1
EBITDA per vehicle (Rs)	71,058	101,392	95,963	(5.4)	35.0	84,525
EBITDA margin (%)	8.5	11.6	10.8	(0.8)	2.2	9.8
PAT margin (%)	4.9	7.5	5.4	(2.0)	0.6	6.2
Effective tax rate (%)	27.5	25.0	29.1	4.0	1.6	27.0

Source: Company data, Kotak Institutional Equities

Cement

SHCM.BO, Rs1437	
Rating	IL
Sector coverage view	Cautious
Target Price (Rs)	1,300
52W High -Low (Rs)	1592 - 795
Market Cap (Rs bn)	50.1

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	13.5	18.6	22.2
Net Profit (Rs bn)	3.5	4.4	4.7
EPS (Rs)	101.6	125.5	135.9
EPS gth	*114.9*	*24.1*	*8.5*
P/E (x)	14.1	11.5	10.6
EV/EBITDA (x)	9.2	6.8	6.0
Div yield (%)	0.3	0.4	0.4

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	63.7	-	-
FIIs	7.2	0.0	(0.1)
MFs	6.8	0.2	0.1
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Shree Cement: 1QFY08 operating profits inline with expectations, retain Inline

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- **Maintaining a healthy volumes growth**
- **Average realizations marginally improved as compared to 4QFY07**
- **Retain IL with target price of Rs1,300/share**

Shree Cement reported 37.6% increase in sales at Rs4.2 bn (our est. Rs4.2 bn), 33% increase in EBITDA at Rs1.80 bn (our est. Rs1.8 bn), which was inline with our estimates. Shree Cement reported a 27% increase in net profits against our estimates of 16.5%increase, primarily on account of higher other income of Rs126 mn (our estimate Rs27 mn). The operating performance of the company was largely in line with our estimates with volumes growth of 23% yoy due to the increased production capacity which now stands at 6.2 mn tpa after the commissioning of the fourth production line. We retain our Inline rating on the stock. Our target price of Rs1,300/share implies EV/ EBITDA of 8.2X and P/E of 10.4X on FY2008E.

Maintaining a healthy volumes growth. Shree Cement sold 1.4 mn tonnes of cement during 1QFY08, an increase of 23% yoy and 11% qoq. Shree Cement achieved higher volumes than its rated capacity through increased blending and optimization of capacities. Shree Cement's fourth production line of 1.4 mn tpa capacity has been commissioned in March 2007. We expect the company to add another 3 mn tpa capacity by FY2009 to service the high growth markets around the national capital region (NCR).

Average realizations marginally improved as compared to 4QFY07. Average realizations for Shree Cements were up 11.1% on yoy basis and 1% on a sequential quarter basis. The EBITDA/tonne also increased by 7.8% yoy due to better realizations. We expect the growth in realization to stabilize as new capacities get commissioned in FY2009.

Retain Inline with target price of Rs1300/share. The results of the company have been inline with our estimates and we retain target price of Rs1300/share with an earnings estimate of Rs125.5/share for FY2008 and Rs135.9/share for FY2009, which implies a P/E of 10.4X on FY2008E and 9.6X on FY2009E. The stock has a downside ~10% from the current market price of Rs1437/share.

Shree Cement - quarterly performance (Rs mn)

	y-o-y			q-o-q		Our est.	
	Jun-07	Jun-06	Change (%)	Mar-07	Change (%)	Jun-07	Change (%)
Net sales	**4,258**	**3,094**	**37.6**	**3,783**	**12.6**	**4,233**	**36.8**
Raw materials	(442)	(409)		(417)		(471)	
Power & fuel	(823)	(472)		(722)		(833)	
Freight	(620)	(434)		(535)		(597)	
Personnel	(154)	(114)		(210)		(154)	
Others	(395)	(291)		(185)		(368)	
Total expenditure	(2,434)	(1,719)		(2,069)		(2,423)	
EBITDA	**1,824**	**1,375**	**32.7**	**1,714**	**6.4**	**1,811**	**31.7**
EBITDA (%)	*43*	*44*		*45*		*43*	
Other income	126	30		91		27	
Interest	(39)	(54)		(16)		(94)	
Depreciation	(358)	(248)		(1,547)		(335)	
Pre-tax profits	**1,553**	**1,103**	**40.8**	**242**	**541.6**	**1,408**	**27.6**
Tax	(383)	(184)		(3)	-	(338)	-
Net income	**1,170**	**919**	**27.3**	**239**	**389.7**	**1,070**	**16.5**
Extraordinary	(1)	-		-		-	
Reported income	**1,169**	**919**	**27.2**	**239**	**389.3**	**1,070**	**16.5**
Sales ('000 tonnes)	1,403	1,141	23.0	1,261	11.3	1,388	21.7
Realization (Rs/tonne)	3,034	2,712	11.9	3,000	1.1	3,049	12.4
Cost (Rs/tonne)	1,734	1,507	15.1	1,640	5.7	1,745	15.8
Raw materials	315	358	(12.1)	331	(4.8)	339	(5.4)
Power & fuel	587	413	41.9	572	2.5	600	45.1
Freight	442	380	16.2	424	4.1	430	13.1
Personnel	110	100	9.8	167	(34.3)	111	10.9
Others	282	255	10.5	147	92.2	265	4.0
Operating profit (Rs/tonne)	1,300	1,205	7.9	1,359	(4.4)	1,304	8.2
Tax rate (%)	24.7	16.7	-	1.3	-	24.0	-

Source: Company data, Kotak Institutional Equities

Shree Cement Limited, Profit model, March fiscal year-ends, 2004-2009E

(Rs mn)

	2004	2005	2006	2007E	2008E	2009E
Net sales	**4,732**	**5,821**	**6,677**	**13,500**	**18,583**	**22,208**
Raw materials	(710)	(721)	(896)	(1,626)	(2,245)	(2,897)
Power costs	(898)	(1,385)	(1,373)	(2,224)	(3,444)	(4,484)
Freight cost	(894)	(904)	(1,005)	(1,675)	(2,402)	(2,923)
Employee costs	(249)	(264)	(330)	(528)	(712)	(950)
Other expenses	(637)	(757)	(702)	(1,502)	(1,892)	(2,281)
Operating profits	**1,344**	**1,790**	**2,371**	**5,945**	**7,888**	**8,673**
Operating margin %	28.4	30.7	35.5	44.0	42.4	39.1
Other income	29	21	35	142	107	107
EBITD	1,373	1,811	2,406	6,088	7,995	8,780
Interest	(410)	(213)	(141)	(176)	(402)	(442)
Depreciation	(461)	(541)	(503)	(1,014)	(1,421)	(1,680)
Pretax profits	**502**	**1,058**	**1,761**	**4,898**	**6,172**	**6,658**
Tax	(17)	(24)	(29)	(1,178)	(1,667)	(1,801)
Deferred tax	(70)	4	(59)	(179)	(134)	(124)
Net profits	**415**	**1,037**	**1,674**	**3,541**	**4,371**	**4,733**
Extraordinaries	(7)	(497)	(1,483)	-	-	-
Reported net profits	**408**	**540**	**190**	**3,541**	**4,371**	**4,733**
Diluted EPS (Rs)	**11.9**	**29.8**	**48.0**	**101.6**	**125.5**	**135.9**
Reported EPS (Rs)	**11.7**	**15.5**	**5.5**	**101.6**	**125.5**	**135.9**
Diluted avg shares (mn)	34.8	34.8	34.8	34.8	34.8	34.8
Growth (%)						
Sales	3.9	23.0	14.7	102.2	37.7	19.5
EBITDA	27.2	31.9	32.8	153.0	31.3	9.8
Net income	25.2	150.1	61.4	111.6	23.4	8.3
EPS	25.2	150.1	61.4	111.6	23.4	8.3
Tax rate (%)	3.3	2.3	1.6	24.0	27.0	27.0
Total Tax rate	17.3	2.0	5.0	27.7	29.2	28.9

Source: Company data, Kotak Institutional Equities estimates.

Calculation of target prices using our multi-stage valuation process

	Shree Cement
March 2008 CROGCI/WACC (x)	2.28
Assigned premium of EV/GCI to CROGCI/WACC (%)	(30)
Assigned EV/GCI (x)	1.61
GCI (Rs bn)	28.8
EV (Rs bn)	46.2
Net debt (Rs bn)	1.57
Market capitalization (Rs bn)	44.6
No. of shares (fully diluted)	34.8
Target price (Rs)	**1,300**

Source: Kotak Institutional Equities estimates.

Forecasts and valuations

	Revenue		EBITDA		Net profit	EPS	EV/EBITDA	P/E
	(Rs mn)	Gth(%)	(Rs mn)	Gth(%)	(Rs mn)	(Rs)	(X)	(X)
2005	5,821	23.0	1,811	31.9	1,037	29.8	29.2	48.3
2006	6,677	14.7	2,406	32.8	1,674	48.0	22.3	29.9
2007	13,680	104.9	6,117	154.3	1,770	50.8	8.9	28.3
2008E	18,583	35.8	7,995	30.7	4,371	125.5	6.7	11.5
2009E	22,208	19.5	8,780	9.8	4,733	135.9	5.9	10.6

Source: Company data, Kotak Institutional Equities estimates

Chemicals

RELI.BO, Rs1896	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	1,525
52W High -Low (Rs)	1925 - 940
Market Cap (Rs bn)	2,642

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,052	934	1,119
Net Profit (Rs bn)	107.1	99.1	141.6
EPS (Rs)	77.1	71.1	97.4
EPS gth	*22.2*	*(7.8)*	*37.0*
P/E (x)	24.6	26.7	19.5
EV/EBITDA (x)	14.4	15.6	10.1
Div yield (%)	0.6	0.6	0.8

Shareholding, March 2007

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

Reliance Industries: Clarifications on (1) Reliance-RNRL legal dispute and (2) price discovery for KG-D6 gas; the two are not the same

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- **Status quo on legal dispute between Reliance and RNRL for another eight weeks (minimum)**
- **Stay order on sale of D6 gas to third parties stays; unlikely Reliance can sign contracts with third parties without clarity on legal dispute**
- **Court allows government to continue process of price discovery but this is largely irrelevant**

Our talks with investors reveal varying degree of understanding among investors regarding (1) ongoing Reliance-RNRL legal dispute and (2) price discovery for KG-D6 block. We note that the two issues are separate although newspaper reports have mixed the two adding to the already large extant confusion. We clarify that the government has really no role in pricing of NELP gas other than approving the basis/formula of pricing of gas. Similarly, the RIL-RNRL gas dispute will be decided by the judiciary based on the legal aspects; the government theoretically has no role regarding volume and price arrangements between Reliance and RNRL. We retain our 12-month fair value of Rs1,525 for Reliance stock despite the stock price telling us not to do so; RIL's market capitalization has increased an incredible US$6 bn in the past five trading sessions. Key upside risk stems from higher-than-expected margins and new discoveries.

Clarification on July 19 press articles; it is status quo as of now, unlike a great breakthrough as made out by press reports. We note that the division bench of the Mumbai High Court on July 18 has not stayed the previous stay order of a single bench, which has 'stayed' sale of D6 gas to third parties until the resolution of the ongoing legal dispute between Reliance and RNRL. It has only allowed the government to continue with the process of price discovery; the process is on anyway. The Mumbai High Court will take up the Reliance-RNRL case again after eight weeks. We can hopefully see some sensible out-of-court settlement between these two parties in this period.

The government has really no role to play in the pricing of NELP gas except for approving the basis/formula of pricing. We note that the New Exploration and Licensing Policy (NELP) and the production sharing contract (PSC) signed between the government and a contractor (Reliance in KG-D6 block, for example) restricts the role of the government to approving the basis/formula for gas pricing as long as the pricing is based on "arms-length prices to the benefits of parties to the contract." We expect the market to eventually determine the pricing of non-regulated gas in India (as it should be) and expect the power sector and the price of alternative fuels (primarily domestic coal) to determine the price of gas for bulk consumption.

The government is currently examining the formula proposed by Reliance for determining price of KG-D6. A committee of secretaries (COS) comprising secretaries of the key ministries (petroleum, finance, power and fertilizer) had discussions with various companies (Reliance, RNRL, ONGC, NTPC) and ministries (power, fertilizer) involved in the production and consumption of gas. The COS has now referred the issue to a group of ministers (GOM).

It appears the government is sharply divided on the pricing of gas. We understand from press articles that the petroleum ministry is largely in agreement with the proposed formula. It has suggested a minor modification to the pricing formula—removal of the foreign exchange part of the formula. At Rs40.4/US$,crude price = US$65/bbl and c=1, we compute a price of US$4.54/mn BTU similar to the US$4.5/mn BTU assumed in our earnings model. On the other hand, the power and fertilizer ministries have (expectedly) argued for a lower price for gas versus the formula price; the fertilizer ministry has reportedly sought gas at US$5/mn BTU (delivered), which would suggest a wellhead price of around US$4/mn BTU (net of transportation tariff and state sales tax).

The government (executive) may not have a role to play in the ongoing legal dispute between RIL and RNRL; the judiciary will decide but we are not sure what the judiciary can say on something it has already sanctioned. We note that ongoing dispute between Reliance and RNRL is a legal one and the government has no role to play in the same. The judiciary (presumably the Supreme Court; we assume the matter will end there) will decide on the legal aspects of the dispute. However, we are not even sure what role the judiciary will play in this case except for enforcing the scheme of de-merger of Reliance Industries, which has been approved by shareholders and sanctioned by the Mumbai High Court. The outcome of the legal dispute will depend on the agreement between Reliance and RNRL regarding the supply of gas by Reliance to RNRL. We do not rule out a sensible out-of-court settlement between the two parties but we think the impact on Reliance can be neutral to highly negative under various outcomes.

1. **Scenario 1—Reliance sells contracted amount of gas to RNRL at market price; neutral impact.** This would be neutral versus street expectation since it would not matter who Reliance sells gas to as long as it receives market price. We believe the street is factoring a selling price of about US$4.5/mn BTU for the price of gas. We model US$4.5/mn BTU for FY2009E and FY2010E and bring it down moderately after that assuming Reliance will sell gas to NTPC at a lower price of US$2.46/mn BTU. We note that we value Reliance stock on FY2010E EPS, which is based off US$4.5/mn BTU gas price assumption for KG-D6 gas.
2. **Scenario 2—Reliance sells contracted amount of gas to RNRL at US$2.46/mn BTU; large negative impact**. As per the agreement between Reliance and RNRL, Reliance will supply gas to RNRL at a price and commercial terms, which are "no worse than the agreement with NTPC." This presumably means that Reliance will sell gas 28-40 mcm/d of gas to RNRL at a price of US$2.46/mn BTU, which would be significantly lower than street and our expectations. This scenario would lead to large drop in the profits of Reliance and valuation of KG-D6 block.
3. **Scenario 3—Reliance sells contracted amount of gas to RNRL at US$2.46/mn BTU but the government uses a market price for royalty, income tax and share of profit petroleum; negative valuation of D6 block in that case.** Under this unlikely but possible scenario, we see negative valuation (not just negative impact versus our and street expectations) for Reliance's D6 block. This situation may arise if (1) the judiciary rules in favor of RNRL and orders Reliance to supply 28-40 mcm/d of gas to RNRL at US$2.46/mn BTU and (2) the government insists on a market price for determination of royalty, income tax and its share of profit petroleum.

Telecom

RLCM.BO, Rs579	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	450
52W High -Low (Rs)	587 - 231
Market Cap (Rs bn)	1,184

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	144.7	205.7	271.6
Net Profit (Rs bn)	32.0	47.9	68.1
EPS (Rs)	14.7	22.2	31.6
EPS gth	*576.6*	*51.4*	*42.1*
P/E (x)	39.5	26.1	18.4
EV/EBITDA (x)	20.8	14.8	11.1
Div yield (%)	0.1	0.2	0.3

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	66.8	-	-
FIIs	14.7	2.1	(0.9)
MFs	2.3	2.0	(1.0)
UTI	-	-	(3.0)
LIC	3.3	2.6	(0.4)

Reliance Communications: The first of the 'Towers of Babel'; ambitious targets, optimistic assumptions, elusive tenants

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- **Deal values RTIL at Rs135/share; option value based on deal valuation is Rs68/share**
- **RTIL's projections suggest it will have the infrastructure to support 50% of FY2010E Indian wireless subsribers**
- **Target price revised to Rs450 from 400 previously including Rs33/share option value of tower business**

Reliance Communications (RCL) announced a placement of 5% of its stake in its tower subsidiary (Reliance Infratel, RTIL) to a group of seven undisclosed institutional investors for US$338 mn. The deal values RTIL at an equity value of US$6.75 bn (Rs135/share of RCL) and will result in a capital gain of about Rs11 bn (likely to be booked in 2QFY08). In an analyst meeting, RCL management disclosed (1) tower roll-out plans (40,000 by March 2008 and 50,000 by March 2010), (2) potential tenancy per tower (4X) and (3) capex recovery charge per tenant of 11-13%. We find the 'deal' valuation of RTIL steep in light of (1) optimistic assumptions on tenancy and capex recovery charge, (2) aggressive and similar strategy of other large operators (Bharti, TTSL) and (3) potential limited base of external tenants (smaller operators). In our recent report on the Indian telecom tower industry (Towers of Babel), we had ascribed a valuation (EV) of US$4.6 bn for RTIL and an option value of Rs33/share for RCL. We now formally include the option value of RTIL in our 12-month DCF-based target price; accordingly, we revise our target price to Rs450 (Rs400 earlier). The target price would be higher by Rs34 if we use RTIL's valuation benchmark with 50% external tenancy.

RCL's projections seem very aggressive to us. RCL management stated in the analyst meeting that its 50,000 towers would have an average tenancy of four by FY2010E. This would suggest 200,000 cells or the capability to support 200 mn subs assuming 1,000 subs/cell. We project 370 mn wireless subs by March 2010, which would suggest RTIL would have the capacity to support 50% of India's then wireless subscriber base. Even assuming 500 mn subs by FY2010, RCL's infrastructure would have the capability to support 40% of then subscribers. We find this very ambitious especially as most large operators would have their own towers and that too, designed similarly for sharing.

Expect excess capacity—most have similar ambitions and others will build towers for self-use. Independent tower companies such as Quipo, GTL Infra, Essar and Xcel, operator-promoted companies such as RTIL, Bharti's tower company, TTSL and US tower companies such as Crown Castle and American Tower Company have ambitious plans to participate in the Indian telecom tower opportunity. However, the number of external tenants may be limited given (1) certain operators will build towers for self-use and for external tenants (Bharti and TTSL) and (2) certain operators may build towers for self-use (BSNL and MTNL). Also, we expect Vodafone-Essar to prefer Bharti or Essar's tower company over RTIL. This would leave smaller operators (Idea, Spice, Aircel), who control less than 20% of the market, as potential external tenants for RTIL and other independent tower companies. ISPs may be an addressable segment for RTIL although we suspect the numbers from this segment may be small initially and will be largely restricted to urban areas.

Aggressive roll-out plans, funding through debt. RCL intends to ramp up the number of towers to 40,000 by March 2008 and 50,000 by March 2010 from 14,000 in April 2007. RCL highlighted that by March 2008 it will have 80% of its towers with tenancy of four, 6% with tenancy of three, 4% with tenancy of two and 10% with single tenancy. Also, by FY2010, all the towers would have capability to host four tenants. We find this intriguing given that a fair portion of the towers would be rooftop-based towers and may not have tenancy of more than two. RCL intends to connect all the towers with optic fiber rather than microwave for backhaul, which can be a competitive advantage, in our view.

RTIL has equity value of Rs47 bn (which includes asset revaluation reserves). The company has a planned capex outlay of Rs80 bn for FY2008,which will largely be financed by debt; this would take the enterprise value of RTIL to US$9 bn by end March 2008 (including US$2.5 bn of debt).

Capital recovery charge or IRR assumption of RCL looks optimistic. We find RCL's assertion that it would have 11-13% capital recovery charge from each of its tenants (first and subsequent) untenable. According to RCL, the savings for external tenants would in form of sharing of operational costs only. In our view, this would defeat the basic principle of sharing; an operator would set up its own towers if there is no savings in leasing versus building (capex). Also, RTIL's proposed charge would suggest that a tower with four tenants will have a payback period of two years, which is remarkable for any business globally and even more so for a utility-type business.

We note that independent tower companies are pricing capital recovery charge at 15-16% with three tenants as against RCL's expectation of around 35%. Our valuation model is based on 11-13% IRR from the first tenant, 12-14% with the second tenant and 14-16% with three tenants. We are maintaining our assumptions and would review it as more data on roll-out of towers and uptake of tenancy becomes available.

RTIL's valuation appears to be based on aggressive assumptions

RTIL's targets for towers and tenancy, March fiscal year-ends

	Apr-07	2008E	2010E
# of towers	**14,000**	**40,000**	**50,000**
Tenancy slots	**30,000**	**100,000**	**200,000**
Average tenancy	2.1	2.5	4.0
Tenancy distribution (%)			
With 1 tenant	100	10	—
With 2 tenants	—	4	—
With 3 tenants	—	6	—
With 4+ tenants	**—**	**80**	**100**

Source: Company.

We forecast 50,000 towers for RTIL by FY2010, consistent with company's assumptions

Estimates of tower portfolio distribution among Bharti, Reliance, and others, March fiscal year-ends, 2007-2017E

# of towers	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Bharti Airtel	65,000	85,000	95,000	100,000	105,000	110,000	115,000	118,000	121,000	124,000
Reliance	35,000	45,000	50,000	55,000	60,000	65,000	70,000	75,000	78,000	81,000
Others	93,419	118,551	141,459	152,869	155,483	158,454	159,885	162,754	166,130	169,675
Total	**193,419**	**248,551**	**286,459**	**307,869**	**320,483**	**333,454**	**344,885**	**355,754**	**365,130**	**374,675**

Source: Kotak Institutional Equities estimates.

We find RTIL's tenancy assumptions optimistic; we assume an average tenancy of 2.6 for ground-based and 1.7 for roof-top towers by FY2019

Average tenancy for ground-based and roof-top towers, 2007E-2019E

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Average tenancy overall	**1.1**	**1.2**	**1.3**	**1.4**	**1.5**	**1.6**	**1.7**	**1.8**	**1.9**	**2.0**	**2.1**	**2.1**	**2.1**
Ground based towers													
Average tenancy	**1.2**	**1.4**	**1.6**	**1.7**	**1.8**	**2.0**	**2.1**	**2.2**	**2.3**	**2.4**	**2.5**	**2.5**	**2.6**
# of towers (%)													
1 tenant	80	70	60	50	45	40	35	30	25	20	15	15	15
2 tenants	20	20	25	30	28	25	22	20	19	18	17	16	15
3 tenants	—	10	15	20	27	35	43	50	56	62	68	69	70
Rooftop towers													
Average tenancy	**1.1**	**1.2**	**1.2**	**1.3**	**1.3**	**1.4**	**1.4**	**1.5**	**1.5**	**1.6**	**1.6**	**1.6**	**1.6**
# of towers (%)													
1 tenant	90	85	80	75	70	65	60	55	50	45	40	40	40
2 tenants	10	15	20	25	30	35	40	45	50	55	60	60	60

Source: Kotak Institutional Equities estimates

We model a 14.5% IRR for a hypothetical tower company with 70% GBTs and 30% RTTs; GBTs typically have higher IRR than RTTs

Hypothetical model of a telecom tower company (mix of GBTs and RTTs), March fiscal year-ends, 2008-2022E (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
Revenues	**27**	**65**	**75**	**85**	**94**	**102**	**105**	**108**	**111**	**115**	**118**	**122**	**125**	**129**	**133**
Number of towers (#)	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Ground-based towers (#)	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70
Rooftops towers (#)	30	30	30	30	30	30	30	30	30	30	30	30	30	30	30
GBT tenancy (X)	1.3	1.6	2.0	2.3	2.7	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
RTT tenancy (X)	1.1	1.3	1.5	1.6	1.8	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
GBT rental per month (Rs '000)	40	39	38	37	35	34	35	36	38	39	40	41	42	44	45
RTT rental per month (Rs '000)	25	24	24	23	22	21	22	23	23	24	25	26	26	27	28
EBITDA margin (%)	30	35	40	45	50	55	59	63	67	68	69	70	71	72	73
EBITDA	**8**	**23**	**30**	**38**	**47**	**56**	**62**	**68**	**75**	**78**	**82**	**85**	**89**	**93**	**97**
Effective tax rate (%)	34	34	34	34	34	34	34	34	34	34	34	34	34	34	34
Tax (Rs mn)	(3)	(8)	(10)	(13)	(16)	(19)	(21)	(23)	(25)	(27)	(28)	(29)	(30)	(32)	(33)
Operating cash flow	**5**	**15**	**20**	**25**	**31**	**37**	**41**	**45**	**49**	**52**	**54**	**56**	**59**	**61**	**64**
Capex	(255)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)
Cash outflow	(255)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)
Free cash flow	**(250)**	**2**	**7**	**12**	**18**	**24**	**28**	**32**	**37**	**39**	**41**	**44**	**46**	**49**	**51**
IRR (%)	**14.5**														
NPV (Rs mn)	**134**														

IRR sensitivity to WACC and terminal growth rate

		WACC (%)				
		8.0	**9.0**	**10.0**	**11.0**	**12.0**
	2.0	14.4	13.7	13.1	12.6	12.2
g	**3.0**	15.4	14.5	13.7	13.2	12.7
(%)	**4.0**	16.6	15.4	**14.5**	13.8	13.2
	5.0	18.2	16.6	15.4	14.5	13.8
	6.0	20.8	18.3	16.7	15.5	14.6

Key assumptions:	
Terminal year growth rate (%)	4.0
WACC (%)	10.0

Source: Kotak Institutional Equities estimates

RTIL may add an incremental US$1.2 bn to the parent company's EV (option value of Rs33/ share)

Derivation of incremental value for RCOM from its tower business (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
EBITDA	(284)	(144)	193	790	1,762	3,116	4,808	6,855	9,175	11,748	14,722	17,494
Tax	—	—	—	—	—	—	—	(505)	(1,143)	(1,891)	(2,765)	(3,559)
Change in working capital	(9)	(20)	(22)	(31)	(47)	(64)	(78)	(94)	(104)	(113)	(131)	(123)
Post-tax operating cash flow	**(293)**	**(164)**	**171**	**759**	**1,715**	**3,052**	**4,730**	**6,257**	**7,928**	**9,744**	**11,826**	**13,812**
Capex	(4,350)	(2,296)	(1,213)	(1,321)	(1,396)	(2,223)	(2,370)	(2,473)	(1,686)	(2,415)	(3,275)	(4,265)
Free cash flow	**(4,643)**	**(2,460)**	**(1,042)**	**(562)**	**319**	**829**	**2,360**	**3,784**	**6,242**	**7,328**	**8,551**	**9,547**

	Now		+ 1-year		WACC and growth in perpetuity assumptions	
PV of cash flows	4,796	8%	13,454	20%	**Terminal growth - g (%)**	**4.0**
PV of terminal value	51,881	92%	53,956	80%	**WACC (%)**	**10.0**
EV	56,676		67,410			
EV (US$ mn)	**1,349**		**1,605**			
Exit FCF multiple (X)	16.7					
Exit EBITDA multiple (X)	9.1					

Key assumptions (%)												
Revenue growth	NA	215.0	76.2	60.9	57.4	49.1	40.4	34.4	28.4	24.1	22.4	17.2
EBITDA growth	NA	NA	NA	NA	123.0	76.8	54.3	42.6	33.8	28.0	25.3	18.8
EBITDA margin (incremental tenants)	**(126)**	**(20)**	**15**	**39**	**56**	**66**	**73**	**77**	**80**	**83**	**85**	**86**

Note:

(a) We have assumed that RCOM would occupy two slots (CDMA + GSM) in all its towers

(b) The DCF value shown is the incremental value to RCOM from its tower business. Our estimated value for RCOM's overall tower business is US$4.6 bn

Source: Kotak Institutional Equities estimates.

Our 1-year forward DCF-based enterprise value of RCOM's tower business is US$4.6 bn

DCF value derivation of RTIL (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
EBITDA	4,432	8,526	12,183	15,886	20,230	25,461	31,644	38,721	46,189	53,996	62,384	70,644
Tax	—	—	—	—	—	—	(1,289)	(3,346)	(5,975)	(9,220)	(12,926)	(16,470)
Change in working capital	(364)	(290)	(222)	(208)	(238)	(278)	(320)	(364)	(372)	(376)	(418)	(415)
Post-tax operating cash flow	**4,068**	**8,236**	**11,961**	**15,678**	**19,992**	**25,183**	**30,035**	**35,011**	**39,842**	**44,400**	**49,039**	**53,759**
Capex	(43,589)	(23,268)	(12,734)	(14,188)	(15,410)	(17,217)	(19,408)	(21,621)	(18,157)	(21,018)	(24,423)	(28,225)
Free cash flow	**(39,521)**	**(15,032)**	**(774)**	**1,490**	**4,582**	**7,967**	**10,627**	**13,390**	**21,685**	**23,382**	**24,617**	**25,534**

	Now	+ 1-year	WACC and growth in perpetuity assumptions	
PV of cash flows	(2,101)	47,310	**Terminal growth - g (%)**	**4.0**
PV of terminal value	138,751	144,301	**WACC (%)**	**10.0**
EV	136,650	191,611		
EV (US$ mn)	**3,254**	**4,562**		
Exit FCF multiple (X)	16.7			
Exit EBITDA multiple (X)	6.0			

Key assumptions (%)												
Revenue growth	NA	80	34	24	22	21	20	19	16	14	14	12
EBITDA margin (%)	50	54	57	60	63	65	68	70	71	73	74	75
EBIT margin (%)	**9**	**14**	**21**	**27**	**32**	**36**	**40**	**44**	**47**	**49**	**51**	**52**

Source: Kotak Institutional Equities estimates.

Banking

HDBK.BO, Rs1212	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,250
52W High -Low (Rs)	1274 - 695
Market Cap (Rs bn)	420.1

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	52.3	68.9	88.7
Net Profit (Rs bn)	11.4	16.5	21.9
EPS (Rs)	35.7	47.5	61.5
EPS gth	*28.5*	*32.9*	*29.4*
P/E (x)	33.9	25.5	19.7
P/B (x)	6.5	3.5	3.1
Div yield (%)	0.5	0.8	1.0

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	21.6	-	-
FIIs	51.3	2.6	1.5
MFs	3.1	0.9	(0.1)
UTI	-	-	(1.1)
LIC	3.0	0.8	(0.2)

HDFC Bank : Raises US$600 mn at close to market price, retain IL

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- **HDFC Bank has completed its follow-on ADR offering for close to US$600 mn**
- **Revising our estimates post capital issuance and 1QFY08 results**
- **Revise target price to Rs1,250 from Rs1,200 earlier, retain IL rating on the stock**

HDFC Bank has completed the follow-on offering of its American Depositary receipts (ADRs) at US$92.1 at a marginal 0.2% discount to the ADR price and at a premium of 3.3% to the local price. Including the 15% green shoe option, HDFC Bank will be raising close to US$700 mn through this deal. This is in addition to the preferential equity allotment made to HDFC (on June 29, 2007) of 13.6 mn for a consideration of Rs13.9 bn. Post the capital issuance and 1QFY08 results, we are updating our estimates for the bank. We are revising our target price to Rs1,250 from Rs1,200. The increase in our target price is primarily on account of higher BVPS (FY2008) post the capital issue. We continue to maintain an IL rating on the stock at current valuations of 3.6X FY2008 and 3.1X PBR FY2009.

Change in estimates for HDFC Bank

	Old estimates			New estimates			% change		
Rs bn	**FY2008E**	**FY2009E**	**FY2010E**	**FY2008E**	**FY2009E**	**FY2010E**	**FY2008E**	**FY2009E**	**FY2010E**
Net loan growth (%)	41.9	38.5	27.3	47.8	44.3	32.8			
Retail loan to total loans (%)	42.5	40.1	38.7	41.0	37.2	34.5			
Total assets	1,181	1,546	1,929	1,219	1,585	1,971	3.2	2.5	2.2
Total income	64.7	82.4	102.3	68.9	88.7	111.6	6.6	7.6	9.1
Net interest income	**45.9**	**59.5**	**74.3**	**48.5**	**64.7**	**82.5**	**5.9**	**8.8**	**11.0**
Other income	18.8	22.9	27.9	20.4	24.0	29.1	8.2	4.5	4.1
Expenses	32.0	41.7	52.3	32.6	43.0	53.8	2.0	2.9	3.0
Employee cost	10.6	14.2	18.1	11.3	15.4	19.6	5.9	8.6	8.5
Other cost	21.4	27.6	34.2	21.4	27.6	34.2	0.0	0.0	0.0
Loan loss provisions	8.8	11.1	14.7	9.9	11.9	16.3	12.4	6.7	11.1
PBT	21.3	27.4	33.8	23.9	31.7	39.9	11.8	15.8	18.2
PAT	**14.7**	**18.9**	**23.3**	**16.5**	**21.9**	**27.5**	**11.8**	**15.8**	**18.2**
% growth yoy	**29.0**	**28.3**	**23.3**	**44.2**	**32.8**	**25.9**			
PBT-treasury+provisions	30.8	39.1	49.1	33.8	44.2	56.9	9.8	12.9	15.9
EPS (Rs)	46.1	59.2	73.0	47.5	61.5	77.4	3.0	3.9	6.1
BVPS (Rs)	236.7	282.1	337.9	334.8	381.8	441.2	41.4	35.4	30.5

Source: Company, Kotak Institutional Equities.

Automobiles

Freight rates drop in June

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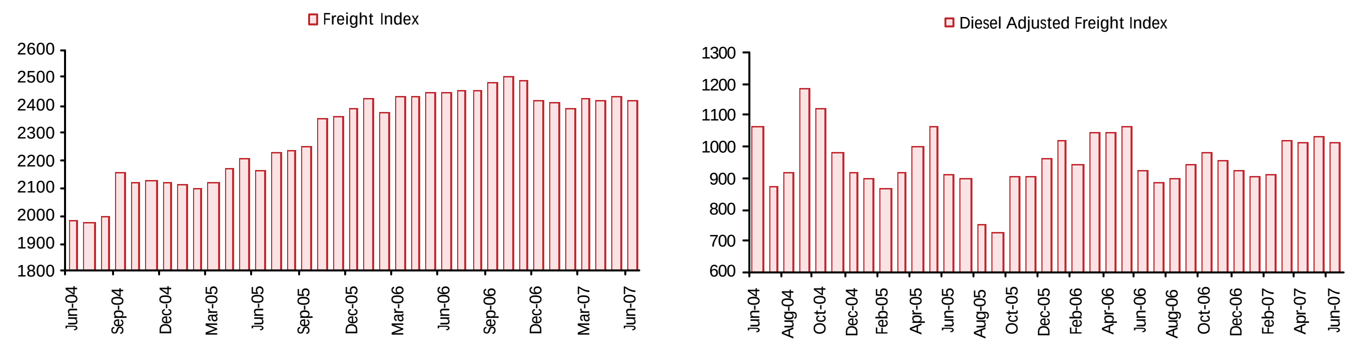
- **Freight rates drop in June: Freight index down 0.6%; DAFI down 2.2%**

Freight rates in India declined in June after increasing in the previous month. Our freight index is down 0.6% mom in June while our diesel adjusted freight index (DAFI) too dropped 2.2% mom. The M&HCV sales for the month of June grew 12.6% mom. On a yoy basis, our freight index declined 1.1% while the DAFI was up 10%. On the volumes side, total CV volumes have gone up by 4% yoy in June. Freight rates have historically remained relatively flat during the monsoon months and have always moved up by Sept-Oct. We expect freight rates to recover post the monsoon season by Sept-Oct which coincides with the festive season wherein demand picks up. We believe that the trend would continue and the CV growth should pick towards 2HFY2008.

Description of our proprietary Freight Index

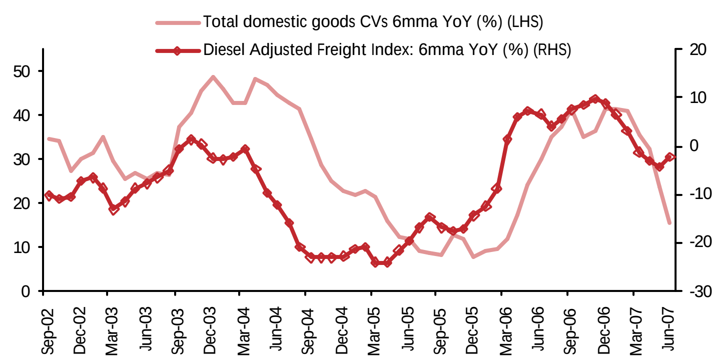
We track freight rates across 26 routes in India using our proprietary freight index (FI). We adjust the freight rates for diesel prices and arrive at a "Diesel adjusted freight index" (DAFI), which is a measure of the operating profitability of freight operators. Historically, our DAFI has been a good leading indicator to CV industry growth rates. DAFI growth rates have historically risen and fallen ahead of CV cycle upturns and downturns respectively.

Our freight index is down 0.6% mom while diesel adjusted freight index dropped 2.2% mom in June



Source: Kotak Institutional Equites

Our diesel adjusted freight index has historically been a good leading indicator for the CV cycle

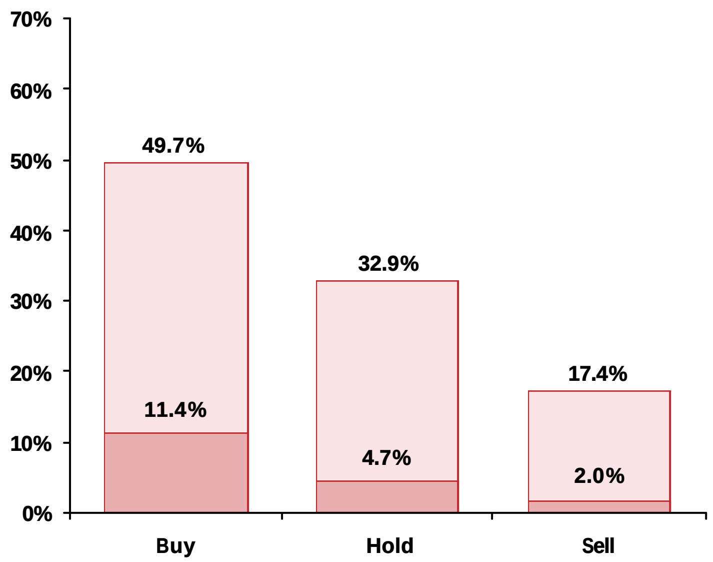


Source: SIAM, Kotak Institutional Equites

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Kawaljeet Saluja, Lokesh Garg, Aman Batra, Amit Agarwal, Sanjeev Prasad, Tabassum Inamdar."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 06/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities.

As of June 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.
IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.
U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

Other ratings/identifiers

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