



Economy News

- ▶ Diesel consumers can heave a sigh of relief: The Government is not considering deregulation of the fuel's prices. The Petroleum Secretary, Mr S. Sundareshan, told reporters on Wednesday. As recommended by the Kirit Parikh Committee, the Government deregulated petrol prices at the refinery gate and at the retail level from June 26. But diesel prices were not deregulated. (BL)
- ▶ The finance ministry yesterday said it was expecting the first set of new bank licences over the next few months. "The Reserve Bank of India will issue banking licences in due course of time. We hope some of the licences will be issued this financial year," financial services secretary R Gopalan said. (BS)
- ▶ In a first, Gujarat is planning to build an over the sea dam in the northern portion of the Gulf of Khambat (Cambay) with an investment of over Rs 500bn. The 35-kilometre dam project named Kalpasar Dam Alignment would lead to a sweet water reservoir. Besides, it will also have a road and rail overbridge, which will reduce the distance between Bhavnagar and Surat by 200km. While, the main dam help generate tidal power, the reservoir is expected to supply water for drinking and agricultural purposes. (ET)

Corporate News

- ▶ **Biocon Ltd** will set up its first overseas manufacturing and research facility in Malaysia with an initial investment of around Rs 7.15bn, the company announced on Wednesday. The USFDA-compliant plant would be operational by 2014 and make high-end biosimilars and biopharmaceuticals for the global market. It is said to be the biggest biotechnology investment in Malaysia. (BL)
- ▶ The Jharkhand government has on Wednesday decided to take back the land, given to **Hindustan Copper's (HCL)** Ghatsila unit, for not paying dues worth Rs 0.64bn, state Land Reforms Minister Mathura Mahato said. The government has decided to take back 1,079 acres land, which was given to HCL about five decades ago. The company's unit has also been shut down. (BS)
- ▶ **Phillips Carbon Black Ltd (PCBL)** plans to invest approximately Rs 12.5bn in the next three years towards capacity addition in India and Vietnam. On the cards are plans to set up a greenfield carbon black unit in South India and diversification into carbon chemicals manufacturing in the East. The company's facilities at Mundra and Cochin are implementing carbon black and co-generation capacity expansion programmes. The projects are scheduled to be implemented in a year, enhancing PCBL's production capacity from 3,60,000 tonnes to 4,10,000 tonnes and cogeneration capacity from 60.5 MW to 76 MW. (BL)
- ▶ **Adani Enterprises** said it has bagged the rights to develop a coal block in Orissa, which has estimated reserves of 1.6 billion tonnes. The diversified conglomerate will also develop a 2,000-Mw power plant as part of its deal with the PSU consortium that selected the billionaire Gautam Adani-led company as Mine Developer and Operator (MDO) for the Chendipada coal block. (BS)
- ▶ **Indian Hotels Company (IHCL)**, that operates Taj group of hotels and resorts, will be raising around Rs 8.5bn in two tranches through a preferential allotment of shares to its main promoters – Tata Sons Ltd. The entire capital raised will be used for the retirement of debt. The company's standalone debt as on September 30, 2010 stood at Rs 23.6bn and consolidated debt till date is Rs 42.1bn. (BL)

Equity

	27 Oct 10	% Chg		
		1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	20,005	(1.1)	(0.6)	10.7
NIFTY Index	6,013	(1.1)	(0.4)	10.7
BANKEX Index	13,892	(1.2)	(0.1)	21.0
BSET Index	6,044	(1.0)	1.7	9.1
BSETCG INDEX	15,929	(1.0)	0.1	6.7
BSEOIL INDEX	10,924	(0.8)	1.7	4.4
CNXMcap Index	9,459	(0.4)	2.2	13.0
BSESMCAP INDEX	10,816	(0.3)	5.2	15.6
World Indices				
Dow Jones	11,126	(0.4)	2.5	6.0
Nasdaq	2,503	0.2	5.2	10.5
FTSE	5,646	(1.1)	1.2	6.1
Nikkei	9,387	0.1	(1.2)	(3.8)
Hangseng	23,165	(1.9)	5.1	10.2

Value traded (Rs cr)

	27 Oct 10	% Chg - Day
Cash BSE	5,520	22.0
Cash NSE	16,828	6.4
Derivatives	206,568	43.0

Net inflows (Rs cr)

	26 Oct 10	% Chg	MTD	YTD
FII	699	(38.6)	24,267	112,551
Mutual Fund	(344)	(461.6)	(5,362)	(28,118)

FII open interest (Rs cr)

	26 Oct 10	% Chg
FII Index Futures	20,227	2.0
FII Index Options	63,897	(1.0)
FII Stock Futures	45,386	(1.0)
FII Stock Options	1,239	(6.7)

Advances / Declines (BSE)

	27 Oct 10	A	B	S	Total	% total
Advances	61	730	175	966	38	
Declines	141	1116	226	1,483	58	
Unchanged	3	73	16	92	4	

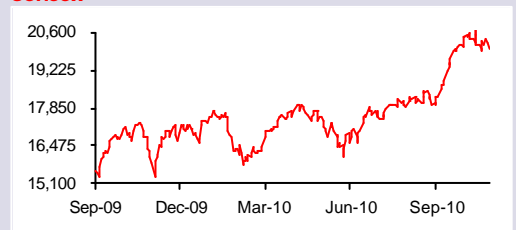
Commodity

	27 Oct 10	% Chg		
		1 Day	1 Mth	3 Mths
Crude (NYMEX) (US\$/BBL)	81.9	(0.1)	7.5	6.4
Gold (US\$/OZ)	1,322.6	(1.2)	1.3	14.3
Silver (US\$/OZ)	23.5	(1.5)	8.9	35.0

Debt / forex market

	27 Oct 10	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	NA	8.18	7.86	7.72
Re/US\$	44.47	44.44	45.02	46.68

Sensex



RESULT UPDATE**Dipen Shah**dipen.shah@kotak.com
+91 22 6621 6301**PATNI COMPUTER SYSTEMS LTD****PRICE: Rs.465****TARGET PRICE: Rs.478****RECOMMENDATION: REDUCE****CY11E P/E: 11.5x**

- ❑ PCS' Q3CY10 results in USD terms were almost in line with estimates. Volume growth of 6.3% was partly on the back of delayed revenue recognition on one project and also full consolidation of CHCS financials, we believe. Margins were impacted largely due to the lower capacity utilization levels on higher hiring. PAT fell on lower other income component (post dividend payout).
- ❑ The management echoed the views expressed by larger peers on the macro scene. The company is experiencing better deal flows and has won 3 large deals, each of more than \$30mn. In 2Q, likely supply constraints had impacted delivery. PCS has added 1663 net employees. 4Q is also expected to see about 1500 gross additions, according to the management.
- ❑ The revenue growth guidance for 4QCY10 is muted at about 1% - 2% as milestones in new projects are expected to be reached towards end of 4Q. PAT excluding forex and other income is projected to remain around 3QCY10 levels. We have been voicing the need for Patni to improve its account management and delivery initiatives for achieving a consistent revenue growth profile.
- ❑ We tweak CY10 EPS estimates to Rs.42 (Rs.44) and introduce CY11E earnings at Rs.40.5 per share. Higher tax rates and lower other income (dividend paid in CY10) are expected to impact PAT growth in CY11. We downgrade the stock to REDUCE with a PT of Rs.478. Since our ACCUMULATE recommendation, the Patni stock has under-performed the sector. Lower-than-guided revenues for 4QCY10 may keep the stock subdued in the near term. We continue to prefer larger peers over Patni.
- ❑ A sharper-than-expected appreciation in the rupee and a slower-than-anticipated recovery in user markets are the risks to our projections.

Summary table

(Rs mn)	CY09	CY10E	CY11E
Sales	31620	31819	37655
Growth (%)	-1.2	0.6	18.3
EBITDA	6090	5929	7088
EBITDA margin (%)	19.3	18.6	18.8
Net profit	5724	5459	5249
Net debt	-6642	-1563	-4230
EPS (Rs)*	44.1	42.0	40.4
Growth (%)	28.9	-4.6	-3.8
DPS (Rs)	7.5	69.0	6.0
ROE (%)	18.6	17.6	16.7
ROCE (%)	19.4	21.3	22.2
EV/Sales (x)	1.7	1.8	1.5
EV/EBITDA (x)	8.8	9.9	7.9
P/E (x)	10.6	11.1	11.5
P/BV (x)	1.8	2.1	1.8

Source: Company, Kotak Securities - Private Client Research

3QCY10 results - PAT down QoQ, largely in line with expectations

(Rs mn)	3QCY10	2QCY10	% chg	3QCY09	% chg
Revenues	7967	7776	2.4	8040	-0.9
Expenditure	6551	6315		6436	
EBDITA	1416	1461	-3.1	1605	-11.7
Depreciation	196	197		193	
EBIT	1220	1264	-3.5	1412	-13.6
Other Income	329	520		175	
PBT	1549	1784	-13.2	1587	-2.4
Tax	268	311		-129	
PAT*	1281	1473	-13.0	1716	-25.3
PAT after EO items	1281	1473		1716	-25.3
Shares (mns)	130	130		130	
EPS (Rs)	9.2	11.5		13.2	
Margins					
OPM (%)	17.8	18.8		20.0	
GPM (%)	15.3	16.3		17.6	
NPM (%)	16.1	18.9		21.3	

Source : Company

Account mining to be vital if revenue growth is to gain traction, we believe

- Patni's revenues grew by 2.4% QoQ in INR terms (Convenience translation - Patni's revenues being translated at INR 44.56/\$ v/s 46.51/\$ QoQ).
- In USD terms, revenue growth was at 6.7%, largely led by a 6.3% volume growth.
- The performance is better than the 2.3% de-growth in 2Q. However, we believe that, some projects were delayed in 2Q and spilled over in 3Q, leading to this expected growth of about 6%.
- Also, about 2% growth came due to consolidation of CHCS for the full 3 months. On an organic basis, the growth was about 4% QoQ - below most industry peers.
- The management has indicated better traction in the market and that the company is participating in a larger number of large deals in the range of \$30mn - \$50mn. During the quarter, PCS won 3 large deals, each of \$30mn+.
- Geographically, revenues from APAC grew by 17% QoQ, but USA and Europe saw tepid growth of 1 - 2% QoQ.
- In the previous quarter also, Americas had seen revenues de-grow by 1% on a QoQ basis.
- Among verticals, financial services saw revenues de-grow sequentially, which was disappointing. Peers have indicated significant traction in this vertical.
- Manufacturing / Retail reported a muted 2% rise and relatively new verticals like communications and media, reported a sequential decline.
- The communications vertical and has been facing head-winds over the past few quarters because of client issues in the Virtual Network Operator segment and this was the second successive quarter of declines.
- We believe Patni's top accounts management has to scale up meaningfully to drive growth over the medium term. We believe this also largely explains the difference in growth rates between Patni and larger names in the sector.

Strong employee addition

- In 3Q, PCS has added 1663 employees, which is about 10% of the previous quarter's strength.
- Consequently, the utilization rates have fallen to 74%.
- The management has also indicated that 4Q may see additions of about 1500 employees on a gross basis.
- Supply constraints in select competencies had impacted delivery in the previous quarter, we understand, reflecting the need for better account management and delivery initiatives.

EBITDA margins down on lower utilisation levels

- EBITDA margins were down by about 100bps (180bps fall in 2Q) and fell short of our expectations.
- The company added a large number of employees and consequently, utilisation levels fell by about 100bps to 74%.
- The company needed to recruit at a faster pace if it is to create some bench to take advantage of large projects it hopes will come through, at a later point.
- The management has indicated that, it will continue hiring at a fast pace to meet potential business requirements, though this may impact margins in the short term.

Lower other income

- Other income fell from Rs.322mn to Rs.112mn during the quarter. The company paid Rs.9.27bn as special dividend during the quarter and financed this by selling off its investments.
- Forex gains came in at Rs.217mn v/s Rs.198mn QoQ. INR movement led to MTM gains on forex hedges, which were greater than the losses on translation of assets.

Downgrade earnings estimates for CY10; introduce CY11 estimates

- We have moderated our growth projections for CY10.
- We now expect revenues to grow by 1% YoY in CY10. With margins expected to remain under pressure, we expect EPS for CY10 to be Rs.42, a marginal de-growth over CY10.
- Commentary from the industry players is indicating markedly improved traction in business and also optimism for the near - to - medium term.
- For Patni, velocity of business still remains sober and is expected to pick up gradually. We once again reiterate the need for better account management and execution.
- The company hopes to return to a stable QoQ growth trajectory in the near future; it also believes that given its renewed approach to business it will be able to comfortably have a COGR of about 3 - 3.5%, which is disappointing.
- Going forward Patni intends to focus on its five to six key verticals and aims to specialize in some sub verticals (e.g., billing systems in the telecom vertical, industrial automation in product engineering). It is also working on geographical diversification with the setting up of focused regional set ups in the US, EMEA, APAC and SAARC geographies.
- We introduce CY11 estimates where we assume volume growth to be about 19%. Margins are expected to remain range bound on the back of potential salary increments and rupee appreciation (assumed at Rs.45 / USD for the fiscal).
- With tax benefits set to expire in March 2011, we have assumed tax rates for CY11 to be 25%. Consequently, PAT is expected to fall YoY to Rs.5.25bn - an EPS of Rs.40.4.

Downgrade to REDUCE. Prefer larger peers.

- We maintain our valuation discount for Patni vis-à-vis industry peers.
- We are of the opinion that, sustained execution could increase the scope for a re-rating as PCS still trades at 11.5x CY11E EPS (40-50% discount to larger names).
- We revise our price target to Rs.478 v/s Rs.528 earlier to reflect moderated earnings estimates and reduction in cash reserves post payment of special dividend of Rs.63 per share.
- We downgrade the stock to **REDUCE**. We continue to prefer larger peers over Patni.

We now recommend to REDUCE on Patni Computer Systems with a revised price target of Rs.478

RESULT UPDATE

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CUMMINS INDIA LIMITED**PRICE: Rs. 738****TARGET PRICE: Rs.850****RECOMMENDATION: BUY****FY12E P/E: 16.7x**

- ❑ CIL reported revenues ahead of our expectation; significant expansion in operating margins helped exceeding profit estimates.
- ❑ EBITDA margins improved significantly due to higher revenues and effective cost control measures. Improved efficiency and prolific six sigma drive led to margin expansion.
- ❑ We expect that the company is likely to maintain dominant position in the domestic market in future. Tremendous up tick in revenues from domestic business along with recovery in the exports would aid cash flow generation over next two years.
- ❑ We change our recommendation to BUY' with a DCF based one year price target of Rs 850 (Rs 710 earlier) on company's stock.

Summary table : Consolidated

(Rs mn)	FY10	FY11E	FY12E
Sales	29,016	45,226	60,821
Growth (%)	-14	57	35
EBITDA	5,842	9,379	12,032
EBITDA margin (%)	20	21	20
Net profit	4,438	6,790	8,725
Net cash (debt)	1,914	1,739	1739
EPS (Rs)	22.4	34.3	44.1
Growth (%)	2.5	53.0	28.5
CEPS	24.2	36.5	46.3
DPS (Rs)	9.0	9.0	10.0
ROE (%)	30.0	37.8	37.2
ROCE (%)	41.3	54.3	53.1
EV/Sales (x)	4.9	3.1	2.3
EV/EBITDA (x)	23.7	14.7	11.2
P/E (x)	32.9	21.5	16.7
P/Cash Earnings	30.5	20.2	15.9
P/BV (x)	9.4	7.2	5.5

Source: Company, Kotak Securities - Private Client Research

Financial performance

(Rs mn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)
Net Sales / Income from Opns	10,914	6,278	73.8	9,279	17.6
Other Income	205	165	24.6	97	112.5
Total Income	11,119	6,443	72.6	9,376	18.6
Purchase of traded goods	340	170	99.5	266	27.8
Consumption of Raw Materials	6,589	3,750	75.7	5,460	20.7
Staff Cost	672	479	40.5	530	26.9
Other Expenditure	1,141	745	53.3	1,049	8.8
Operating Expenditures	8,742	5,143	70.0	7,305	19.7
PBDIT	2,172	1,135	91.4	1,975	10.0
Interest & Finance Charges	4	8	-46.1	4	0.0
Depreciation	93	99	-6.0	93	-0.2
Profit / (Loss) before tax	2,281	1,193	91.2	1,974	15.5
Tax provision	602	316	90.7	572	5.2
Profit / (Loss) after tax	1,679	877	91.3	1,402	19.7
EPS	8.5	4.4	91.4	7.1	19.8
OPM (%)	19.9	18.1		21.3	
Raw material cost to sales %	59.3	58.2		58.8	
Tax rate %	26.4	26.4		29.0	

Source: company

Result highlights

- Revenues grew by 74% YoY to Rs 10.9 bn in Q2FY11 on back of substantial growth in engine business.
- Engine business grew by 81% on account of strong performance in the power generation and industrial segment. Increasing spending on infrastructure projects and considerable improvement in capital expenditure by the corporate India augers well for the company.

Segment Breakup

(Rs mn)	Q2FY11	Q2FY10	YoY (%)
Revenue			
Engine business	9914	5462	81.5
Other	761	702	8.5
Total	10675	6164	73.2
EBIT			
Engine business	1749	814	115.0
Other	303	222	36.5
Total	2053	1036	98.1
EBIT (%)			
Engine business	17.6	14.9	
Other	39.8	31.6	
Capital Employed			
Engine business	10242	8212	24.7
Other	439	184	138.0
Total	10681	8396	27.2

Source: company

- We opine that higher productivity, implementation of various cost rationalization measures across the board and focused six sigma implementation drive resulted in margin expansion for the company. EBITDA% for the quarter stood at 19.9% vis-à-vis 18.1% in Q1FY10.
- While improved efficiency and optimum utilization of resources led to increase in operating profits, reduced financial charges resulted in a 91% YoY PAT growth at Rs 1679 mn in Q1FY11.

Power Generation Business offers immense growth

- The company comprehends a sharp recovery in power generation business and expects the resurrection of USD 15 bn market size (before economic meltdown in FY08) going forward given the enormous demand stimulated by sectors such as Telecom, Commercial construction, IT, ITES, Retail etc.
- Moreover, company has reiterated its positive outlook for the segment from long term perspective mainly driven by 1) implementation of stringent emission norms inducing demand for Tier II emission compliant power generators 2) increasing cost of power increases viability for alternate sources of power 3) tremendous potential demonstrated by Indian infrastructure development programme.
- The management expects to maintain its dominant market presence in higher KV (600KV+) segment that accounts for nearly 60% of segment sales composition. Demand for these products remains strong and we expect that Cummins has an inherent advantage by having a local manufacturing capability over its multinational peer group.
- CIL has been constantly deploying capacity in sub KV (125KV-600KV) segment where competition is mainly established by local manufacturers. We expect that the company would sustain the pricing premium over domestic peer group, given its strong brand perception and superior value proposition offerings in terms of product quality, compliant with laid emission norms and superior post sales services to the end users.

Industrial segment

- We expect the segment to grow by 25% in FY11E on account of sustained investments in infrastructure projects. Demand for earth moving and other equipment would determine demand for company's engine business.
- We also believe that the massive investments in road construction activity with increasing interest of global OEMs in the Indian market auger well for company's 130-150 HP engines. Market for 20T/21T class excavators by the construction sector and 450 CFM portable compressor market looks attractive.
- Though high pressure water well market lacks activity, mining sector is likely to register resilience in demand for Parts & ReCon engine manufactured by the Company. We expect that impetus would continue to persist in strengthening of railway infrastructure giving boost to demand for 500 KVA generator sets and 40-50 liter engine sets.
- Recent developments indicate emphasis on vertical integration by the major OEMs adding to their in house manufacturing capacity for the critical components including few products that are manufactured by companies like CIL.

Capacity expansion at Phaltan

- CIL is getting ready to establish another incremental capacity of 60,000 of 5.9 litre. engines (mainly used in medium to heavy trucks) and this facility should be in place by roughly October-December quarter of next year
- The company is also contemplating setting up a rebuild center for complete overhaul, repairs, and upgrades for engines.
- Aside from that, CIL is also investing in a reconditioning operation, that of engines, generators as well as components, engine components.

Earnings Outlook

- We tweak our earning estimates upward to factor favourable environment for the domestic business. Export sales are likely to grow by 90% YoY on a lower base of FY10.
- We project a 57% growth in revenues in FY11E driven by all the segments. The table below highlights the changes we have now build in our earnings forecast.
- We believe that the company would maintain margins over FY11E and FY12E and expect EPS to grow at a CAGR of 40% over FY10-12E.

FY11E Estimates

(mn)	Old	New	Change (%)
Revenues	41609	45226	8.7
EBITDA	8435	9379	11.2
PAT	6129	6790	10.8
EPS (Rs)	31.0	34.3	10.8

Source: Kotak Securities - Private Client Research

Change in target price

- Upward revision in earnings by 10%.
- Improved growth outlook in exports and in domestic business.

Upgrade to 'BUY'

Adequate upside of 15% to the current price of Rs 738.

**We recommend BUY on
Cummins India Ltd with a
revised price target of Rs.850**

Valuations

- In view of the significant earnings revision effected by us we arrive at a DCF based one year price target of Rs 850.
- At current price of Rs 738, stock is trading at a P/E of 21.5x and 16.7x and EV/EBITDA of 14.7x and 11.2x on FY11E and FY12E earnings respectively.
- We change our recommendation to **BUY** with a one year price target of Rs 850 (710 earlier) on company's stock.

RESULT UPDATE

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PIRAMAL GLASS LTD (PGL)

PRICE: Rs.137
TARGET PRICE: Rs.156

RECOMMENDATION: BUY
CONS. FY12E P/E:10.7x

- ❑ PGL has reported excellent set of Q2FY11 results which are above our estimates on the profitability front primarily due to forex gain
- ❑ Share of higher margin C&P business increases by 600 bps to 49% of total revenues
- ❑ Higher margin premium C&P business grows by 15% YoY to ~Rs.610 mn
- ❑ US and Sri Lanka operations are now profitable at net level
- ❑ Remain positive on medium to long term growth prospects due to sustained client acquisition in the high margin premium C&P business
- ❑ Maintain earning estimates with FY11E EPS at Rs.9.3 and FY12E EPS at Rs.12.8
- ❑ Due to 14% upside potential from current levels we upgrade PGL to BUY with increased price target of Rs.156 (Rs.132 earlier) as we have shifted the valuation base to FY12.

Cons. summary table

(Rs mn)	FY10	FY11E	FY12E
Sales	11,260	12,483	13,401
Growth (%)	11.6	10.9	7.4
EBITDA	2,381	2,900	3,289
EBITDA margin (%)	21.1	23.2	24.5
Net profit	44	749	1,028
Net debt	9,753	8,662	7,328
EPS (Rs)	0.6	9.3	12.8
Growth (%)	(104)	1,590	37
DPS (Rs)	-	-	-
ROE (%)	1.8	22.2	21.5
ROCE (%)	9.2	15.0	16.5
EV/Sales (x)	1.8	1.6	1.4
EV/EBITDA (x)	8.7	6.8	5.6
P/E (x)	248.8	14.7	10.7
P/CEPS (x)	11.6	6.4	5.4
P/BV (x)	4.4	2.6	2.1

Source: Company, Kotak Securities - Private Client Research

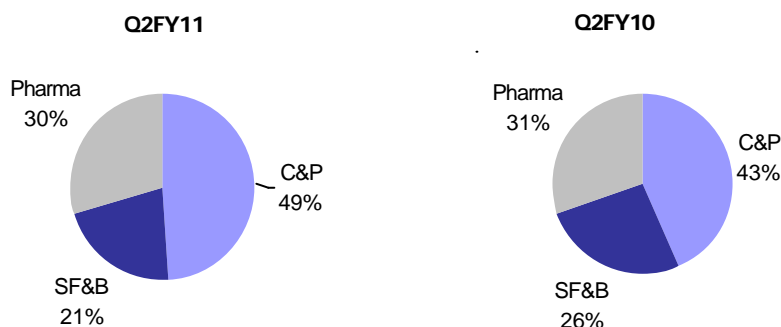
Piramal Glass - Cons. results table

(Rs mn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	H1FY11
Net Sales	3,067	2,990	2.6	2,824	8.6	5,891
Incr / dec in stock	(145)	94	(255.2)	(126)	15.7	(271)
Raw materials	691	626	10.4	647	6.8	1,338
Cost of traded goods	14	42	(67.4)	7	85.1	21
Staff cost	604	530	13.8	582	3.8	1,186
Energy cost	472	440	7.1	433	8.9	905
Freight cost	240	156	54.0	195	23.4	435
Other exp.	511	474	7.8	458	11.4	969
Total exp.	2,386	2,362	1.0	2,197	8.6	4,583
EBIDTA	681	628	8.6	627	8.6	1,308
Depreciation	231	229	1.2	229	1.1	460
EBIT	450	399	12.8	399	12.9	848
Interest	171	310	(44.7)	170	0.8	341
PBT	279	89	212.8	229	21.9	507
Extraordinary gain	25	(69)	-	(21)	-	4
Tax & deferred tax	69	15	372.1	32	118.2	101
PAT	234	6	4,007.0	176	33.3	410
minority int	27	0	9,033.3	11	161.0	38
NPAT	207	5	3,727.8	165	25.2	372
Adj. PAT	182	74	145.5	186	(2.4)	368
Equity (Rs. mn)	804	804		804		804
Ratios						
Operating profit margin (%)	22.2	21.0	+120 bps	22.2		22.2
EPS (Rs)	2.6	0.1		2.1		4.6
CEPS (Rs)	5.4	2.9		4.9		10.3
Raw Materials / Sales (%)	17.8	24.1		18.5		18.1
Staff cost / sales (%)	19.7	17.7		20.6		20.1
Energy / sales (%)	15.4	14.7		15.3		15.4
Freight / sales (%)	7.8	5.2		6.9		7.4
Other exp / sales (%)	16.6	15.8		16.2		16.4
TAX / PBT (%)	24.9	16.5		13.9		19.9

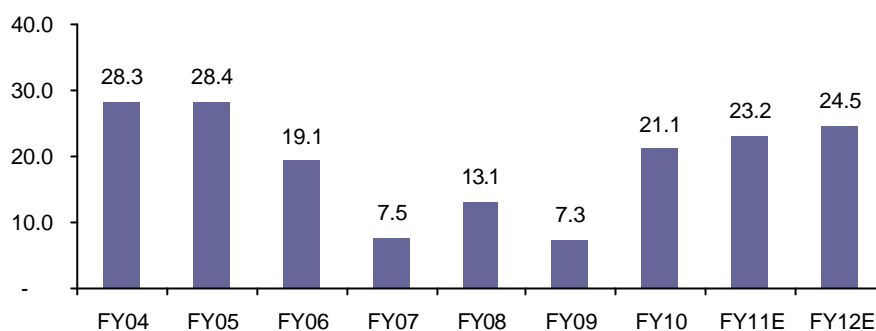
Source: Company

- Consolidated revenues for Q2FY11 were at Rs.3.0 bn, which is up 2.6% YoY and up 8.6% on QoQ basis. This was due to 8.6% YOY growth in the revenues of Indian business, 12.6% YOY growth in the revenues of US business and 7.9% YOY growth in the revenues of Sri Lankan business.
- The revenue growth would have been higher at 8.4%, as it took hit of currency translation loss of around 4% and 1.7% of revenue is postponed to Q3FY11 as it is now sold through its French subsidiary instead of being sold directly to the client.
- The operating margin during Q2FY11 is up 120 bps to 22.2% on YoY basis on account of increase in share of high margin C&P business to 21% of total revenues as against 18% in Q2FY10. Also US and Sri Lankan operations have now turned profitable.
- EBIDTA for the Q2FY11 was at Rs.681 mn up 8.6% YoY and up 8.6% on QoQ basis.
- The depreciation cost is flat as there is no major capex program for the company.
- The interest cost is down sharply by 44.7% on YoY basis to Rs.171 mn as the company has now obtained low cost debt for its US subsidiary and also it is using the cash generated from the operations to repay the high cost debt.
- The company reported PBT of Rs.279 mn for the Q2FY11 up 212.8% YoY and up 21.9% on QoQ basis.
- PGL reported PAT of Rs.207 mn for the Q2FY11 v/s Rs.5 mn for Q2FY10, thereby translating into quarterly EPS of Rs.2.6 and quarterly CEPS of Rs.5.4.
- For H1FY11 EPS stood at Rs.4.6
- The US and Sri Lankan operation have turned around and reported PAT in Q2FY11 as against net loss in Q2FY10.

Cons. Revenue breakup (%)



Source: Company

Cons. EBIDTA (%)

Source: Company, Kotak Securities - Private Client Research

Cosmetic & Perfumery (C&P) revenues grew by 16% to Rs.1.5 bn

- In Q2FY11 the revenues of the C&P business grew sharply by 16% on YoY basis to Rs.1.5 bn. Within C&P business the revenues of premium C&P has increased by 15.0% YoY and the revenues of mass C&P has increased by 15.4% YOY.
- PGL is aggressively gaining market share from its competitors in Europe. The clients include multinational companies like Unilever, Revlon, L'Oreal, Avon, P&G, Estee Lauder and LVMH among others.
- Going forward we expect C&P to further grow as recently PGL has bagged the worlds second largest C&P producer i.e. Coty. This is significant as Coty has annual glass consumption of Euro 100 mn. Thus now 17 of the top 20 customers are now clients of PGL. This is significant as 80% of the global premium C&P business is controlled by top 20 players.
- We feel that the growth of C&P industry will be driven by the emerging economies primarily due to a growing young population, working women and their increasing disposable income. The availability of major international brands and setting up of large retail stores across the country will also provide fillip to the demand.

Specialty Food & Beverages (SF&B) business de-grew by 15.0% to Rs.650 mn

- In Q2FY11 the revenues of the SF&B business de-grew by 15% on YoY basis to Rs.650 mn. This was primarily due to the shift of capacity from low margin Indian SF&B business to high margin C&P business. The domestic markets in Sri Lanka are picking up however in US there has been recessionary impact on the specialty brands leading to de-growth in revenues.
- Going forward, in SF&B space, PGL would continue to focus on high end liquor, wine and food. PGL strengths lie in localization, unique design and decoration. This business is freight intensive and hence PGL has the advantage of multiple locations in India, Sri Lanka and US.
- PGL caters to leading customers UB group, Diageo, Cadbury Schweppes, Smuckers and other niche local liquor manufacturers from its US & Sri Lanka operations.

Pharmaceuticals business was flat on YoY basis to Rs.900 mn

In Q2FY11 the revenues of the Pharma business were flat on YoY basis to Rs.900 mn. This is commendable due to the fact that in India there has been a shift towards PET mainly for oral dosage syrups and formulations. Going forward we expect the demand for injectibles to grow as more and more pharma companies obtain US FDA approval for their injectibles manufacturing facilities in India. The strategy of the company would be to improve product mix in terms of higher margin products and focus on exports which are expected to be around 40%.

Debt reduction to continue going forward

The company has been successful in bringing down the total debt from Rs.13.6 bn in March 2009 to Rs.9.4 bn in September 2010. This was primarily due rights issue and positive cash generation during the year. Going forward we expect the debt to further come down due to no major capex requirement and positive cash flows which would be used to repay the debt. Also the company has negotiated lower interest rates for current year as compared to last year. The company also has some surplus land in Sri Lanka which can be sold off to repay a part of the debt.

Long term positives for PGL

- PGL is one of the niche players in the flaconage i.e. small glass bottles industry which caters to segments like Cosmetic and Perfumery (C&P), Pharmaceuticals and specialty Food and Beverages (SF&B).
- PGL enjoys 5% market share in the \$2.0 bn global C&P market and it enjoys market leadership with 26% market share in nail polish bottles. In fact PGL is the only player from Asia with marquee client list.
- Recently PGL has bagged the worlds second largest C&P producer i.e. Coty. This is significant at Coty has annual glass consumption of Euro 100 mn. Thus now 17 of the top 20 customers are now clients of PGL. This is significant as 80% of the global premium C&P business is controlled by top 20 players.
- We expect the company to increase the contribution of high margin premium C&P business from 12% in FY09 to 31% of total revenues by FY12E.
- PGL has successfully turned around the acquisitions of US and Sri Lanka. Going forward we expect US and Sri Lankan business to report sharp jump in profitability on account of economies of scale and cost reduction. Also shifting of some business of US to low cost Indian operations would lead to sharp jump in overall operating profitability for PGL. This is well supported by the fact that now 21% of US sales are being supplied from India as against 15% on YoY basis.
- Over next two years i.e. from FY10 to FY12E we expect the revenues of PGL to grow at CAGR of 9.1% with no additional capex and in fact reduction of 80 TPD capacity.
- PAT is expected to grow multifold from Rs.44 mn in FY10 to Rs.1050 mn in FY12E due to focus on high margin business; reduction in interest costs due to positive cash flows and no major capex requirement.

Maintain earning estimates

We maintain earning estimates and expect PGL to report Cons. EPS of Rs.9.3 in FY11E moving upto Rs.12.8 in FY12E.

Price target revised to Rs.156

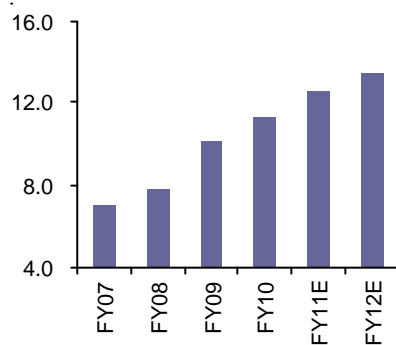
We have valued PGL on DCF method of valuation with 13.6% WACC (no change) and 4.0% terminal growth rate (3.0% earlier). Since the US and Sri Lankan operation have turned around and we feel that it is sustainable we have assigned higher terminal growth rate of 4.0% as against 3.0% earlier. We have also shifted the valuation base to FY12 and the price target is also revised upwards to Rs.156 as against Rs.132 earlier.

Valuation & Recommendation

- At the current price of Rs.137, trades at 2.1x book value, 10.7x earnings and 5.4x cash earnings based on FY12E.
- We remain positive on the medium to long term growth prospects of PGL primarily on account of focus on high margin business; reduction in interest costs due to positive cash flows and no major capex requirement which are likely to lead to significant growth in PAT over next few years.
- Due to 14% upside potential from the current levels we upgrade PGL to **BUY** from ACCUMULATE earlier with increased price target of Rs.156.

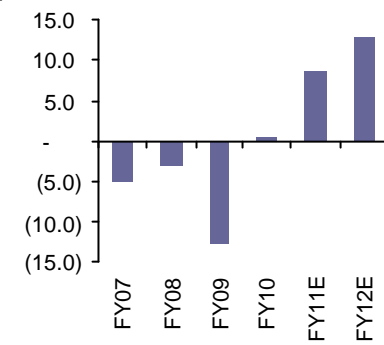
We upgrade Piramal Glass to BUY with an increased price target of Rs.156

Consolidated Revenues (Rs bn)



Source; Company, Kotak Securities - Private Client Research

Cons. EPS



Source; Company, Kotak Securities - Private Client Research

RESULT UPDATE

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EVEREST KANTO CYLINDERS LTD (EKC)

PRICE: Rs. 131
TARGET PRICE: Rs. 150

RECOMMENDATION: BUY
CONS. FY12E P/E:13.7x

- ❑ EKC has reported good set of Q2FY11 results which are above our estimates on the profitability front due to execution of higher margin jumbo cylinders order and forex gain of Rs.99 mn
- ❑ Indian and Dubai operations report sharp jump in profitability due to revival in demand and sale of jumbo cylinders
- ❑ US and China operations continue to report losses
- ❑ Volumes up 25.0% YoY and up 11.6% QoQ to 2.0 lakh cylinders
- ❑ Revise FY11E Cons. EPS to Rs.7.1 (Rs.7.5 earlier)
- ❑ Introduce FY12 earning estimates with Cons. EPS of Rs.9.5
- ❑ Good long term potential on account of increasing gas availability, various CGD projects and de-regulation of petrol prices
- ❑ Due to 15% upside potential from current levels we continue to recommend BUY on EKC with increased price target of Rs.150 (Rs.135 earlier)

Cons. Summary table - FV Rs.2

(Rs mn)	FY10	FY11E	FY12E
Sales	6,497	8,014	10,031
Growth (%)	(24.2)	23.4	25.2
EBITDA	556	1,443	2,006
EBITDA margin (%)	8.6	18.0	20.0
Net profit	415	758	1,023
Net cash (debt)	(4,416)	(4,043)	(4,107)
EPS (Rs)	4.1	7.1	9.5
Growth (%)	(69.8)	82.7	34.9
CEPS	9.7	13.3	16.8
DPS (Rs)	1.2	1.2	1.0
ROE (%)	6.7	10.9	12.0
ROCE (%)	5.2	8.3	10.3
EV/Sales (x)	2.7	2.3	1.8
EV/EBITDA (x)	31.8	12.5	9.0
P/E (x)	31.9	18.5	13.7
P/CEPS	13.5	9.8	7.8
P/BV (x)	2.2	1.9	1.5

Source: Company, Kotak Securities - Private Client Research

EKC Q2FY11 Result update - Consolidated

(Rs mn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	H1FY11
Net Sales	2,035	1,449	40.4	1,381	47.4	3,415.3
Increase / decrease in stock	228	(148)	(254.3)	47	389.1	275.1
raw materials	831	1,001	(17.0)	789	5.3	1,620.1
staff cost	186	198	(6.1)	182	2.4	367.6
other exp.	389	237	64.4	287	35.9	676.0
total exp.	1,635	1,288	26.9	1,304	25.4	2,939
EBIDTA	400	162	147.7	77	422.9	477
Depreciation	166	198	(16.6)	159	4.0	324.7
EBIT	235	(37)	(735.5)	(83)	(383.6)	152
Interest	19	30	(34.8)	30	(36.5)	49.7
Other income	32	19	67.9	14	121.5	46.3
Extraordinary loss/ (gain)	(81)	14	-	112	-	30.6
PBT	328	(61)	(636.7)	(211)	(255.3)	117.8
Tax & deferred tax	82	(7)	(1,277.1)	(96)	(185.7)	(13.7)
PAT	246	(54)	(553.8)	(115)	(313.5)	132
Adj. PAT	165	(41)	(506.7)	(3)	(6,434.6)	162
Equity Rs. mn	214.30	202.3	5.9	214.30		214.30
sh. Mn FV Rs. 2	107.15	101.2		107.15		107.15
Ratios						
Operating profit margin (%)	19.7	11.1		5.5		14.0
Raw Materials / Sales (%)	52.1	58.9		60.5		55.5
Staff Exp / Sales (%)	9.1	13.7		13.2		10.8
Other Exp / sales (%)	19.1	16.3		20.8		19.8
Tax / PBT (%)	25.1	11.5		45.5		(11.6)
EPS (Rs.)	2.3	(0.5)		(1.1)		1.2
CEPS (Rs)	3.8	1.4		0.4		4.3
Cylinders Sold (Lakh)	2.0	1.6	25.0	1.8	11.6	3.9
Avg. Relalizations (Rs./cylinder)	9,951	8,859	12.3	7,534	32.1	8,808

Source: Company, Kotak Securities - Private Client Research

Segmental Results

	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	H1FY11
Revenues (Rs. mn)						
India	1,169	928	25.9	771	51.5	1,940
Dubai	719	269	167.1	585	23.0	1,304
China	122	176	(30.6)	23	421.8	146
USA	167	253	(34.1)	86	93.9	253
PBIT (Rs. mn)						
India	170	28	512.3	(88)	(293.2)	82
Dubai	178	7	2,441.4	144	23.2	322
China	(32)	(6)	403.2	(33)	(4.5)	(65)
USA	(65)	(50)	29.8	(98)	(33.9)	(162)
PBIT (%)						
India	14.5	3.0	386.3	(11.4)	(227.5)	4.2
Dubai	24.7	2.6	851.4	24.7	0.2	24.7
China	(26.0)	(3.6)	624.9	(141.9)	(81.7)	(44.6)
USA	(38.7)	(19.7)	97.0	(113.6)	(65.9)	(64.2)

Source: Company

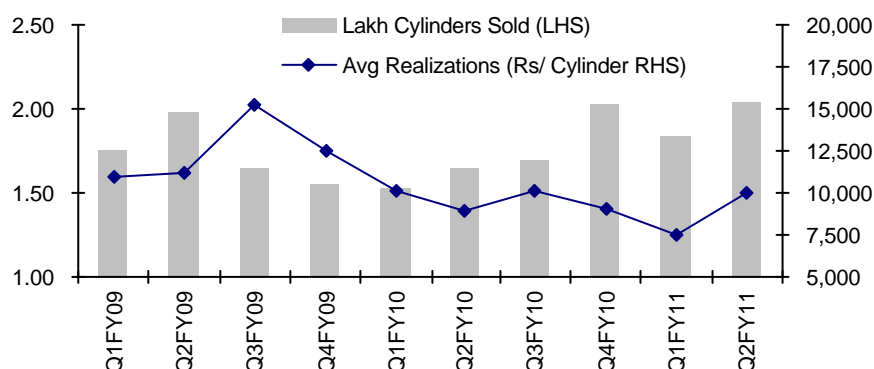
Q2FY11 Details

Segment	Cylinders sold nos.	Avg Realization Rs./cylinder	Revenues Rs. mn
India Industrial	78837	3,582	282
India CNG	56258	9,771	550
India Jumbo	269	919,331	247
CNG Dubai	51404	12,970	667
CNG China	17524	6,968	122
USA Jumbo	195	851,795	166
Total	204487	9,948	2034

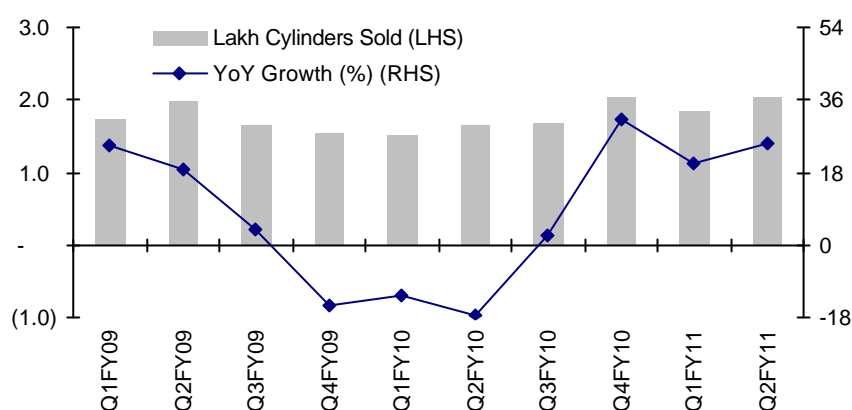
Source: Company

- On a consolidated basis EKC sold 2.0 lakh cylinders in Q2FY11, which is up 25.0% YoY and up 11.6% on sequential basis. The volume growth was primarily on account of execution of large order of jumbo cylinders and pick up in demand from the industrial cylinders. Also there was scaling up of production in China operations.
- The average realization per cylinder is up sharply by 12.3% YoY and up 32.1% on QoQ basis to Rs.9951 per cylinder primarily due to execution of large order of jumbo cylinders which typically have higher average realizations than CNG and industrial cylinders.

Lakh cylinders sold & Average realizations graph



Source: Company

Lakh cylinders sold & YoY growth graph

Source: Company

- On a consolidated basis, EKC reported revenues of Rs.2.0 bn in Q2FY11, up 40.4% YoY and up 47.4% on sequential basis. This was primarily due to increased sale of jumbo cylinders and industrial cylinders.
- On YoY basis the revenues of China operations are down 30.6% and US operation is down 34.1%. While Indian business is up 25.9% YoY and Dubai is up sharply 167.1% on YoY basis. Dubai unit has picked up due to reemergence of demand from Iran, Pakistan and Bangladesh and is now operating at peak capacities.
- EKC reported EBIDTA of Rs.400 mn in Q2FY11 up sharply 147.7% YoY and up 422.9% QoQ basis primarily due to execution of higher margin order of jumbo cylinders.
- PBIT of the Dubai business is up sharply from 2.6% in Q2FY10 to 24.7% in Q2FY11 primarily due to resumption of supplies to Iran market. PBIT of the Indian business is up sharply from 3.0% in Q2FY10 to 14.5% in Q2FY11 primarily due to sale of jumbo cylinders.
- The depreciation cost is lower on account of change in method of depreciation from WDV to SLM to make more appropriate allocation of depreciation over the expected useful and economic life of the asset.
- The interest cost is down sharply on YoY basis to Rs.19 mn as the company has repaid the high cost loans. The total consolidated debt of the company has been brought down from Rs.4.7 bn in June 2010 to Rs.4.0 bn in September 2010.
- For Q2FY11 EKC reported PBT of Rs.328 mn v/s PBT loss of Rs.61 mn.
- For Q2FY11 the company reported PAT of Rs.246 mn v/s net loss of Rs.54 mn, however this includes foreign exchange gain of Rs.99 mn related to restatement of ECB loans.

High cost inventory fully accounted for

As of 30th September 2010 the company has fully disposed off the high cost inventory and thus going forward due rising raw material prices we do not expect any further inventory write downs. The company has also been successful in bringing down the total inventories from Rs.3.1 bn in June 2010 to Rs.2.7 bn in September 2010.

Expansions update

The two lakh per annum industrial cylinder plant of EKC in Gujarat with billet piercing technology and one lakh per annum CNG cylinder plant at Kandla have commenced commercial production and they are expected to stabilize their production by December 2010. The three lakh CNG cylinders per annum plant using steel plates in Kandla SEZ is expected to be operational by March 2011.

Change in earning estimates (FY11E)

(Rs. mn)	Old	Revised	% shift
Net sales	8,014	8,014	-
EBIDTA (%)	20.0	18.0	(10.0)
PAT	801	758	(5.3)
Equity	214	214	-
EPS (Rs.)	7.5	7.1	(5.3)
CEPS (Rs.)	13.7	13.3	(2.9)
Lakh Cylinders Sold	8.3	8.3	-
Avg. Realizations (Rs/cylinder)	9656	9,656	-

Source: Kotak Securities - Private Client Research

Change in FY11 earning estimates

- We have revised our estimates to account for higher other income and lower than expected operating profitability in industrial and CNG cylinders and continued losses from China and US operations.
- In FY11E we now expect EKC to sell 8.3 lakh cylinders (no change) at an average realization of Rs.9656 per cylinder (no change).
- We expect EKC to report revenues of Rs.8.0 bn (no change), EBIDTA margins of 18.0% (down 200 bps) and PAT of Rs.758 mn (down 5.3%) in FY11E.
- Accordingly we expect EKC to report lower EPS of Rs.7.1 and CEPS of Rs.13.3 as against our earlier estimate of Rs.7.5 and Rs.13.7 respectively.

Cylinders sold

	FY08	FY09	FY10	FY11E	FY12E
Volume (Lakh nos.)	6.5	6.9	6.9	8.3	9.7
YoY Growth (%)		7.0	(0.6)	20.8	16.6
CNG (%)	63.0	68.5	61.0	66.9	69.7
Industrial (%)	37.0	31.2	38.8	32.9	30.0
Jumbo (%)	-	0.3	0.2	0.2	0.3
Total (%)	100.0	100.0	100.0	100.0	100.0

Source: Company, Kotak Securities - Private Client Research

Revenue breakup

(Rs mn)	FY10	FY11E	FY12E
CNG	3,851	5,559	6,881
Industrial	1,042	956	1,088
Jumbo	1,604	1,500	2,063
Total	6,497	8,014	10,031

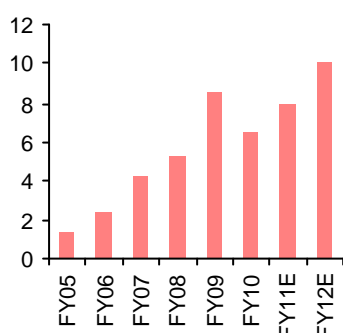
Source: Company, Kotak Securities - Private Client Research

Earning Estimates

(Rs mn)	FY11E	FY12E	% Shift
Revenues	8,014	10,031	25.2
EBIDTA (%)	18.0	20.0	11.1
PAT	758	1,023	34.9
Equity	214.3	214.3	-
EPS (Rs.)	7.1	9.5	34.9
CEPS (Rs.)	13.3	16.8	25.9
Lakh Cylinders Sold	8.3	9.7	16.6
Avg. Realizations (Rs/cylinder)	9,656	10,366	7.4
WACC (%)	13.1	13.1	-
Terminal Growth (%)	4.0	4.0	-
Target Price (Rs.)	135	150	11.1

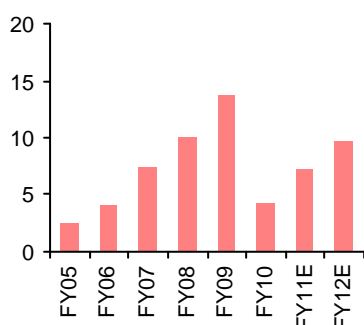
Source: Kotak Securities - Private Client Research

Consolidated Revenues (Rs bn)



Source: Company, Kotak Securities - Private Client Research

Cons. EPS (Rs) - FV Rs.2



Source: Company, Kotak Securities - Private Client Research

We recommend BUY on EKC with an increased price target of Rs.150

Introduce FY12 earning estimates on increased earnings visibility

- We are introducing FY12 earning estimates on account of earnings visibility due to pick up in the global and Indian economy, resumption of sales to Iran and increased demand from OEM and industrial cylinders in India. Also we expect huge demand of CNG cylinders for the automobiles in India on account of increasing gas availability and various CGD projects.
- For FY12E, we expect EKC to sell 9.7 lakh cylinders (up 16.6% YoY) at an average realization of Rs.10366 per cylinder (up 7.4% YoY).
- In FY12E, we expect EKC to report revenues of Rs.10.0 bn (up 25.2%), EBIDTA margins of 20.0% (up 200 bps) and PAT of Rs.1.0 bn (up 34.9%).
- Accordingly we expect EKC to report higher EPS of Rs.9.5 and CEPS of Rs.16.8 in FY12E.
- Over next two years i.e. from FY10 to FY12E we expect the revenues of EKC to grow at CAGR of 24.3% and PAT to grow at CAGR of 56.8%. PAT growth is expected to be higher on account sale of jumbo cylinders and revival in demand for the industrial and CNG cylinders.

Price target increased to Rs.150

We have valued the consolidated entity on DCF method of valuation with 13.1% WACC and 4.0% terminal growth rate (no change). We have shifted the valuation base to FY12 and thus the price target is increased to Rs.150 as against Rs.135 earlier.

Valuation & Recommendation

- At the current price of Rs.131, EKC is trading at 1.6x book value, 13.7x earnings and 7.8x cash earnings based on FY12E.
- We remain positive on the medium to long term growth prospects of the company primarily on account of expected huge demand of CNG cylinders for the automobiles in India on account of increasing gas availability, various CGD projects and de-regulation of petrol prices.
- Due to 15% upside potential from the current levels we continue to recommend **BUY** on EKC with increased price target of Rs.150.

CONSOLIDATED FINANCIALS: EKC (FV Rs.2)

Profit and Loss Statement (Rs. mn)

(Year-end March)	FY10	FY11E	FY12E
Revenues	6,497	8,014	10,031
% change yoy	(24.2)	23.4	25.2
EBITDA	556	1,443	2,006
% change yoy	(79.1)	159.3	39.1
Depreciation	569	669	776
EBIT	(13)	773	1,231
% change yoy	(100.6)	(6,277.6)	59.2
Net Interest	114	116	106
Other Income	603	200	100
Earnings Before Tax	477	857	1,224
% change yoy	(68.8)	79.6	42.8
Provisions and amortisations			
Tax	(62)	(99)	(202)
as % of EBT	-13.0	-11.5	-16.5
Net Income adj	415	758	1,023
% change yoy	(69.8)	82.7	34.9
Preference dividend	0.0	1.0	2.0
Adj Net income for equityholders	415	757	1,021
Extraordinary income			
Reported Net Income	415	757	1,021
Shares outstanding (mn)	101.2	107.2	107.2
EPS (Rs)	4.1	7.1	9.5
DPS (Rs)	1.2	1.0	1.0
CEPS (Rs)	9.7	13.3	16.8

Source: Company, Kotak Securities - Private Client Research

Cash Flow Statement

Year end Mar 31 (Rs mn)	FY10	FY11E	FY12E
PBDIT	556	1,443	2,006
Tax and adjustments	43	(99)	(202)
Cash flow from operations	600	1,344	1,805
Net Change in Working Capital	1,064	(244)	(242)
Net Cash from Operations	1,663	1,099	1,563
Capital Expenditure	(577)	(1,500)	(1,500)
Cash from investing	582	200	100
Net Cash from Investing	4	(1,300)	(1,400)
Interest paid	(114)	(116)	(106)
Issue of Shares	-	810	-
Dividends Paid	(142)	(121)	(121)
Debt Raised	(1,205)	(766)	-
Net cash from financing	(1,461)	(192)	(227)
Net change in cash	207	(393)	(64)
Free cash flow	1,086	(401)	63
cash at end	599	207	143

Source: Company, Kotak Securities - Private Client Research

Balance sheet (Rs. mn)

(Year-end March)	FY10	FY11E	FY12E
Cash and cash equivalents	599	207	143
Accounts receivable	928	1,098	1,237
Stocks	3,391	3,842	4,260
Loans and Advances	746	800	900
Others	-	-	-
Current Assets	5,665	5,947	6,539
LT investments	45	45	45
Net fixed assets	5,446	7,975	9,369
Deferred tax assets			
CWIP	1,621	-	-
Total Assets	12,777	13,967	15,953
Payables	1,239	1,647	2,061
Others	202	225	225
Current liabilities	1,441	1,872	2,286
LT debt	5,016	4,250	4,250
Other lia(defed tax+minority int)	111	111	111
Equity & reserves	6,209	7,734	9,306
Preference capital	-	-	-
Total Liabilities	12,777	13,967	15,953
BVPS (Rs)	59.4	70.2	84.8

Source: Company, Kotak Securities - Private Client Research

Ratio Analysis

(Year-end March)	FY10	FY11E	FY12E
EBITDA margin (%)	8.6	18.0	20.0
EBIT margin (%)	-0.2	9.6	12.3
Net profit margin (%)	6.4	9.5	10.2
Adjusted EPS growth (%)	-69.8	82.7	34.9
Receivables (days)	52.2	50.0	45.0
Inventory (days)	190.5	175.0	155.0
Sales / Net Fixed Assets (x)	1.2	1.0	1.1
ROE (%)	6.7	10.9	12.0
ROCE (%)	5.2	8.3	10.3
EV/ Sales (x)	2.7	2.3	1.8
EV/EBITDA (x)	31.8	12.5	9.0
Price to earnings (x)	31.9	18.5	13.7
Price to book value (x)	2.2	1.9	1.5
Price to cash earnings (x)	13.5	9.8	7.8

Source: Company, Kotak Securities - Private Client Research

RESULT UPDATE

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GATI LTD

PRICE: Rs.75
TARGET PRICE: Rs.84

RECOMMENDATION: BUY
CONS. FY11E P/E: 19.6x

- ❑ **GATI (year end June) reported its Q1FY11 results which are below our estimates on the profitability front due to lower than expected profitability in the EDC and supply chain business**
- ❑ **Fuel price hikes could be passed on to the customers only with a lag**
- ❑ **Strong growth in revenues on the back of pick up in Global and Indian economy**
- ❑ **Looking to demerge coast-to-coast shipping business**
- ❑ **Set up Redsun Supply Chain Solutions business**
- ❑ **Maintain FY11 earning estimates with EPS of Rs.3.8**
- ❑ **Due to 12% upside potential from the current levels we continue to recommend BUY on GATI with unchanged price target of 84**

Cons. Summary table - June end

(Rs mn) - FV Rs.2	FY09	FY10	FY11E
Sales	7,904	9,261	10,665
Growth (%)	10.3	17.2	15.2
EBITDA	497	801	1,128
EBITDA margin (%)	6.3	8.7	10.6
Net profit	(187)	95	326
Net debt	4,554	4,527	4,696
EPS (Rs)	(2.2)	1.1	3.8
Growth (%)	(194.4)	(150.9)	242.8
DPS (Rs)	0.8	0.4	0.5
ROE (%)	(6.9)	3.5	11.4
ROCE (%)	2.5	8.1	12.2
EV/Sales (x)	1.4	1.2	1.0
EV/EBITDA (x)	22.0	13.6	9.8
P/E (x)	(34.1)	67.2	19.6
P/CEPS (x)	82.5	17.4	10.3
P/BV (x)	2.4	2.3	2.1

Source: Company, Kotak Securities - Private Client Research

Standalone results GATI Ltd. - June end

(Rs mn)	Q1FY11	Q1FY10	YoY (%)	Q4FY10	QoQ (%)
Net Sales	2,250	1,700	32.4	2,066	8.9
staff cost	261	208	25.3	243	7.5
operating exp.	1,559	1,107	40.8	1,372	13.6
Admin exp.	199	163	22.0	202	(1.6)
Repairs & Maintenance	23	18	32.4	45	(48.7)
Total Expenditure	2,042	1,496	36.5	1,862	9.6
EBIDTA	208	204	2.2	204	2.2
Other income	16	16	(1.3)	17	(7.7)
Depreciation	54	67	(19.9)	55	(2.2)
EBIT	170	153	11.5	166	2.7
Interest	109	118	(7.6)	103	6.4
PBT	61	35	77.1	63	(3.5)
Tax & deferred tax	24	12	100.8	15	63.4
PAT	37	23	64.8	49	(23.4)
Equity share Capital	170.3	169.8		170.3	
Equity shares o/s (mn) FV Rs. 2	85.2	84.9		85.2	
Ratios					
Operating profit margin (%)	9.3	12.0	-270 bps	9.9	-60 bps
Staff cost / net sales (%)	11.6	12.3		11.8	
Operating exp / net sales (%)	69.3	65.1		66.4	
Admin / net sales (%)	8.8	9.6		9.8	
Tax / PBT (%)	38.8	34.2		22.9	
EPS Reported (Rs)	0.4	0.3		0.6	
EPS (Rs)	0.4	0.3		0.6	
CEPS	1.1	1.1		1.2	

Source: Company

- The revenues for Q1FY11 were at Rs.2.2 bn, up 32.4% YoY, and up 8.9% on sequential basis. The express distribution and supply chain division recorded revenues of Rs.2.0 bn up 32.0% YoY and up 9.3% on sequential basis. The growth is led by pick up in the Indian economy and industrial activity which led to increased revenues for the express distribution and supply chain management business of the company.

- The coast to coast shipping business recorded revenues of Rs.285 mn, up 34.9% YoY and up 4.8% on QoQ basis primarily due pick up in the EXIM activity boosting its coast-to-coast shipping business and lower base effect.
- However the operating margins during Q1FY11 were down 270 bps YoY and down 60 bps on QoQ basis to 9.3%. This was due to pressure on the profitability of its express distribution and supply chain management business.
- The PBIT margins of the Express distribution and supply chain business has reduced sharply from 13.5% in Q1FY10 to 10.8% in Q1FY11. This was primarily due to the fuel price hikes which it could pass on to its customers only with a lag. However we feel that the effect should even out going forward and thus we maintain our earning estimates.
- The shipping business has turned around and recorded PBIT of Rs.11 mn v/s BBIT loss of Rs. 8 mn on YoY basis. This was primarily due to pick up in volumes in the coast to coast shipping business of GATI.
- The operating profit for Q1FY11 was at Rs.208 mn, up 2.2% YoY and up 2.2% on QoQ basis.
- PBT for Q1FY11 stands at Rs.61 mn up 77.1% YoY and down 3.5% on QoQ basis.
- PAT for Q1FY11 stands at Rs.37 mn which is up 64.8% YoY and down 23.4% on sequential basis.
- Q1FY11 EPS stands at Rs.0.4

Looking to demerge coast-to-coast shipping business

- The coast-to-coast shipping business of GATI was severely impacted in FY10 on account of global economic turbulence. Lower volumes coupled with lower rates impacted the profitability of the shipping business. In order to have better focus and to turnaround the shipping business, GATI has approved a scheme of demerger of coast-to-coast shipping business of the company into a wholly owned subsidiary with effect from 1st July 2010.
- Currently it is operating with seven ships out of which four are owned and balance three on charter. We feel going forward it would induct a strategic partner or enter into a JV in the shipping business which would enable it to grow the shipping business at a fast clip with increasing profitability.

Focus on higher margin business

- The company has the strategy in place to focus on its core business of Express distribution and supply chain management. With impressive assets like 18 Express distribution centers and more than 2 mn square feet of warehouse space we feel GATI is ideally poised to capture the opportunities in supply chain management business.
- Indian economy is expected to continue to grow more than 8% per annum going forward for next few years and thus we expect good growth in the value added logistics business of GATI going forward. The management is also seeing business picking up on a day to day basis and thus have decided to focus on its higher margin SCM business.

Set up RedSun Supply Chain Solutions

- GATI has set up a separate Supply Chain Solutions company i.e. RedSun Supply Chain Solutions Ltd, which is wholly owned subsidiary of the company. The brand GATI RedSun, would offer both cold & ambient supply chain solutions. This move would allow GATI to bring into alignment its existing subsidiary and the Kausar brand as a product offering under the new division. Under RedSun it would offer complete E2E cold chain solutions including temperature sensitive storage and product life cycle management.

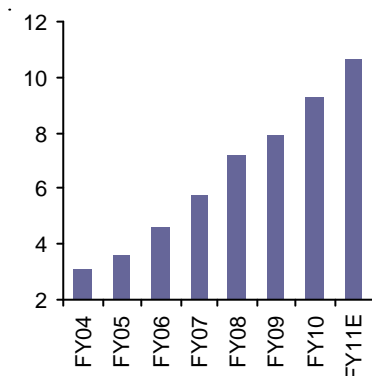
- RedSun would focus on Auto, Telecom and Consumer Electronics sector and it aims to be the market leader in supply chain business in the country. The sustained growth in Indian economy and industrial activity and expected introduction of GST by April 2011 has led to huge demand for the supply chain solutions (SCS) business. SCS is typically a higher margin business as it involves detailed planning and execution of various activities leading end-to-end multimodal transportation and distribution of goods including reverse logistics. We feel this is a positive step towards becoming a focused SCS player.

Valuation & Recommendation

We recommend BUY on GATI with unchanged price target of Rs.84

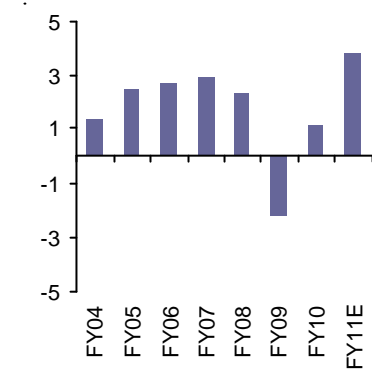
- We maintain earning estimates and expect GATI to report Cons. EPS of Rs.3.8 in FY11E.
- At the current market price of Rs.75, the stock trades at 2.1x P/BV, 19.6x P/E and 10.3x P/CEPS based on FY11E.
- We are positive on the medium to long term growth prospects of GATI primarily due to its ability to take advantage of the emerging opportunity in EDC and SCM space with strong base of assets like 18 Express distribution centers and more than 2 mn sq. ft of warehouse space and capability to reach and deliver in 622 out of 626 districts in India.
- Due to 12% upside potential from the current level we continue to recommend **BUY** on GATI with unchanged price target of 84.

Cons. net sales (Rs. bn)



Source; Company, Kotak Securities - Private Client Research

Cons. EPS (Rs. - FV Rs.2)



Source; Company, Kotak Securities - Private Client Research

RESULT UPDATE

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GUJARAT STATE PETRONET LTD (GSPL)

PRICE: Rs.118
TARGET PRICE: Rs.115

RECOMMENDATION: REDUCE
FY11E P/CEPS: 8.7x

- ❑ GSPL reported disappointing set of Q2FY11 results which are below our estimates on the profitability front due to sharp increase in staff cost and other expenditure
- ❑ Volume up 13.7% YoY to 36.1 MMSCMD - However revenues down 0.1% YoY
- ❑ Key risk remain in terms of capping of margins by PNGRB at 18% pre tax ROCE
- ❑ At current rates GSPL is earning more than 20% pre tax ROCE
- ❑ Stock fairly valued at current levels
- ❑ Due to 3% downside potential from the current levels we continue to recommend REDUCE on GSPL with unchanged price target of Rs.115

Summary table

(Rs mn)	FY09	FY10	FY11E
Sales	4,875	9,920	11,098
Growth (%)	16.7	103.5	11.9
EBITDA	4,249	9,297	10,274
EBITDA margin (%)	87.2	93.7	92.6
Net profit	1,234	4,138	4,493
Growth (%)	23.6	235.2	8.6
Net debt	10,535	10,854	4,579
EPS (Rs)	2.2	7.4	8.0
Growth (%)	23.6	235.0	8.6
CEPS (Rs)	5.2	11.6	13.5
DPS (Rs)	0.5	0.5	0.5
ROE (%)	10.5	29.8	26.0
RoIC (%)	9.9	20.7	19.4
EV/Sales (x)	15.8	7.8	6.4
EV/EBITDA (x)	18.1	8.3	6.9
P/E (x)	53.7	16.0	14.8
P/BV (x)	5.5	4.2	3.5
P/CEPS (x)	22.6	10.2	8.7

Source: Company, Kotak Securities - Private Client Research

Q2FY11 performance - GSPL

(Rs mn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	H1FY11
Net Sales	2,545	2,548	(0.1)	2,545	(0.0)	5,090
Staff cost	42	(16)	(369.1)	26	63.0	68
O & M	96	71	34.9	82	17.9	178
Admin & Other	70	49	44.1	29	139.5	99
Total exp.	208	104	99.5	137	52.4	345
EBIDTA	2,336	2,443	(4.4)	2,408	(3.0)	4,745
Other income	68	59	15.8	30	128.3	98
Depreciation	760	587	29.5	687	10.6	1,447
EBIT	1,645	1,915	(14.1)	1,751	(6.1)	3,396
Interest	242	250	(3.5)	224	7.7	466
PBT	1,403	1,665	(15.7)	1,527	(8.1)	2,930
Tax & deferred tax	488	564	(13.5)	476	2.5	964
PAT	915	1,101	(16.8)	1,051	(12.9)	1,966
Equity shares o/s (mn)	562.2	562.0		562.2		562.2
Ratios						
Operating profit margin (%)	91.8	95.9	-410 bps	94.6	-280 bps	93.2
Staff cost / Sales (%)	1.6	(0.6)		1.0		1.3
O & M / sales (%)	3.8	2.8		3.2		3.5
Admin / Sales (%)	2.8	1.9		1.1		2.0
Tax / PBT (%)	34.8	33.9		31.2		32.9
EPS (Rs)	1.6	2.0		1.9		3.5
CEPS (Rs)	3.0	3.0		3.1		6.1

Source: Company

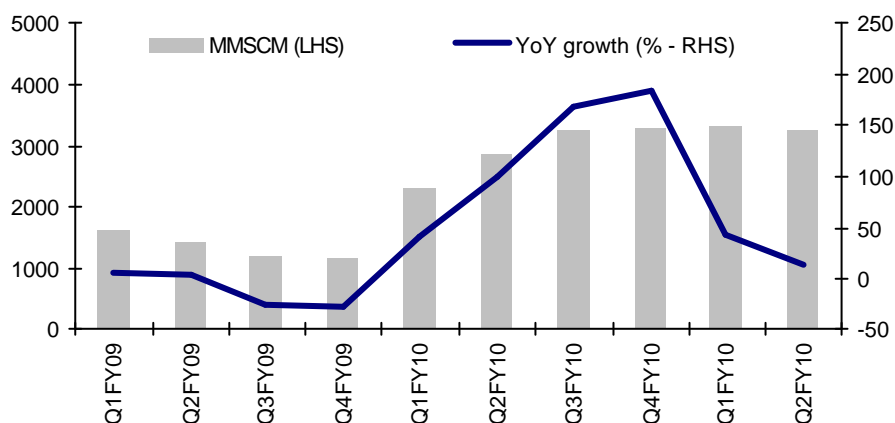
Volume Performance - GSPL

	Q2FY11	Q2FY10	YoY%	Q1FY11	QoQ (%)	H1FY11
Gas Volumes - MMSCMD	36.1	31.8	13.7	36.7	(1.6)	36.4
Gas Volumes - MMSCM	3250	2859	13.7	3304	(1.6)	6553
Avg. Realisations (Rs./per TCM)	783	891	(12.1)	770	1.6	777

Source: Company

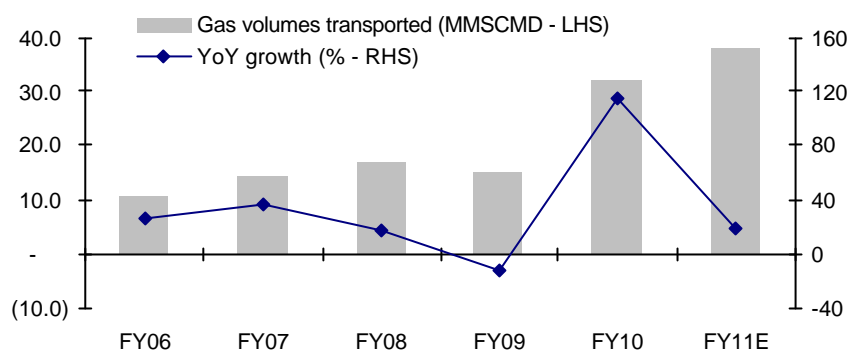
- In Q2FY11 the company transported 36.1 MMSCMD of gas thereby recording volume growth of 13.7% on YoY basis. This was due to increased gas supply from the Reliance KG basin. Also due to doubling of capacity at Petronet LNG led to increased volumes that were transported through its pipelines.
- However the volumes are down 1.6% on QoQ basis due to lower demand from power and fertilizer sector due to heavy monsoon.
- Revenues for Q2FY11 were at Rs.2.5 bn down by 0.1% YoY and flat on sequential basis. The average tariffs were at Rs.783 per TCM in Q2FY11 that recorded decline of 12.1% on YoY basis. This is primarily due to increased short distance transportation of gas which typically earns lower gas transmission charges thereby pulling the averages down.
- The company recorded lower operating margin of 91.8%, which is down 410 bps YoY and down 280 bps on sequential basis. This is primarily due to sharp increase in staff cost and other expenditure. This is well supported by the fact that admin expenses to sales ratio has increased sharply from 1.9% in Q2FY10 to 2.8% in Q2FY11 and staff cost has also increased sharply by 63.0% on sequential basis to Rs.42 mn
- In Q2FY11 operational profit registered de-growth by 4.4% YoY and down 3.0% on QoQ basis to Rs.2.3 bn.
- The depreciation is up by 29.5% on YoY to Rs.760 mn due to commissioning of new pipelines and few spur lines.
- PBT for Q2FY11 was at Rs.1.4 bn down 15.7% YoY and down 8.1 on QoQ basis.
- PAT for Q2FY11 was at Rs.915 mn down 16.8% YoY and down 12.9% on QoQ basis thereby translating into quarterly EPS of Rs.1.6 and CEPS of Rs.3.0.
- H1FY11 EPS stands at Rs.3.5 and CEPS stands at Rs.6.1

Quarterly gas volumes transported (MMSCM) & YoY growth (%)



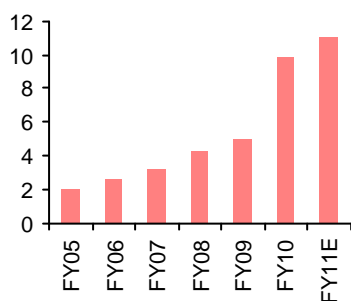
Source: Company

Annual gas volumes transported (MMSCMD) & YoY growth (%)



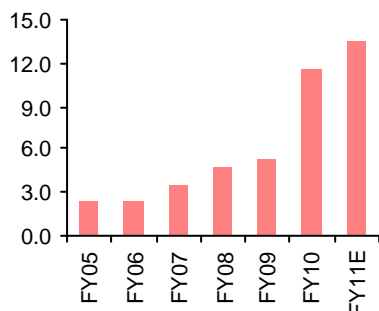
Source: Company, Kotak Securities - Private Client Research

Revenues (Rs bn)



Source: Company, Kotak Securities - Private Client Research

CEPS (Rs)



Source: Company, Kotak Securities - Private Client Research

Key risk remains - margins to be capped at 12% post tax ROCE

- The key risk in GSPL is its pipeline tariffs which were at Rs.777 per TCM in H1FY11. This is expected to lead to 19.4% pre ROCE for GSPL in FY11E.
- PNGRB has already stated its intent to cap the cross country natural gas pipeline returns at 12% post tax ROCE or 18.18% pre tax ROCE. However due to lack of clarity from PNGRB, GSPL continues to charge such high tariffs for transportation of natural gas through its pipelines. We have assumed only marginal decline in pipeline tariffs which result in more than 20% pre tax ROCE.
- Currently GSPL is operating in only state of Gujarat and is not covered by this regulation. However going forward we do not rule out the possibility that all the natural gas pipelines in the country would come under PNGRB guidance of maximum return of 12% post tax ROCE.
- Going forward the major growth in GSPL is expected to come from interstate pipelines across Gujarat, Rajasthan, Maharashtra and Andhra Pradesh. Thus its returns are expected to be capped going forward.
- GSPL has already given EOI for four interstate pipelines amounting to 5675 kms. Out of these PNGRB has already invited bids for the first three pipelines. As of now we have not considered any interstate pipelines in our earning estimates as we await further details. We would incorporate them into our earning estimates as and when GSPL wins any bidding of inter state natural gas pipeline.
- We believe there is significant risk to GSPL's pipeline tariffs which would significantly impact its revenues and profits going forward.

Maintain earning estimates

Till there is any official communication from PNGRB we maintain our earning estimates and expect GSPL to transport 38.0 MMSCMD of natural gas in FY11E. We expect GSPL to report EPS of Rs.8.0 and CEPS of Rs.13.5 in FY11E.

Valuation & Recommendation

- On the basis of our estimates, the stock at current market price of Rs.118 is trading at fair valuations of 6.9x EV/EBIDTA, 14.8x P/E and 8.7x P/cash earnings on the basis of FY11 earning estimates.
- We feel that the risk reward ratio is not favorable at the current point of time and we recommend investors to book profits in GSPL. This is primarily on account of fair valuation and risk to its earning on account of potential capping of margins at 12% post tax ROCE by PNGRB.
- Due to 3% downside potential from the current levels we continue to recommend REDUCE on GSPL with unchanged price target of Rs.115.

We continue to recommend REDUCE on GSPL with an unchanged price target of Rs.115

RESULT UPDATE**Sanjeev Zarbade**

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THERMAX LTD**PRICE: Rs.795****TARGET PRICE: Rs.866****RECOMMENDATION: ACCUMULATE****FY11E P/E: 23.1x**

Thermax's numbers are ahead of expectations on the revenue as well profit front. Thermax's numbers confirm our belief of a return to higher growth trajectory after two years of stagnation. The order intake has been strong in FY10, thereby putting the company in an enviable position to target higher growth in FY11 and onwards. The company's cost optimisation efforts should keep margins intact despite the increase in EPC business. We expect some large order wins in the current year in the power EPC business, which should be a key stock price driver.

Valuations are firm at 23.1x FY11 earnings but deservedly so given ability to deliver higher growth levels than the peers and robust cash generation.

Stock has underperformed in the previous quarter in line with our "Reduce" rating. Fundamentally, we remain positive on the stock and upgrade it to Accumulate in view of the strong execution track record translating into robust revenue growth coupled with recent underperformance in the stock. Move rating to ACCUMULATE with a price target of Rs 866 (Rs 828 earlier).

Summary table

(Rs mn)	FY10	FY11E	FY12E
Sales	34,062	52,123	69,983
Growth (%)	-2	53	34
EBITDA	3,981	6,161	8,166
EBITDA margin (%)	11.7	11.8	11.7
Net profit	2,666	4,108	5,452
Net cash (debt)	7,134	8,801	13,956
EPS (Rs)	22.4	34.5	45.8
Growth (%)	-7.7	54.1	32.7
CEPS	16.5	38.6	50.4
DPS (Rs)	5.0	5.0	5.0
ROE (%)	14.2	32.2	32.4
ROCE (%)	33.7	45.0	45.6
EV/Sales (x)	2.6	1.6	1.2
EV/EBITDA (x)	22.4	13.9	9.9
P/E (x)	35.5	23.1	17.4
P/Cash Earnings	48.4	20.6	15.8
P/BV (x)	8.8	6.7	5.0

Source: Company, Kotak Securities - Private Client Research

Financial performance

(Rs mn)	Q2 FY11	Q2 FY10	YoY (%)	H1 FY11	H1 FY10	YoY (%)
Net Sales	10,478	6,678	57	18,266	11,906	53
other income from operations	436	125	248	546	273	100
Total Operating Expenditure	9,631	6,011	60	16,569	10,698	55
Raw Matl costs	7,176	4,020	79	12,100	7,219	68
Purchase of trading goods	279	248	12	604	385	57
Staff costs	970	736	32	1,722	1,259	37
Other costs	1,206	1,007	20	2,142	1,835	17
PBIDT	1,283	792	62	2,243	1,482	51
Other Income	133	142	(6)	273	245	11
Interest	5	1	246	10	6	68
PBDT	1,412	933	51	2,506	1,721	46
Depreciation	105	104	1	211	199	6
PBT	1,307	830	58	2,296	1,521	51
Tax	414	288	44	741	515	44
Adj Profit After Tax	893	541	65	1,555	1,006	55
Rep Profit After Extra-ord item	893	541	65	1,555	1,006	55
EPS (Rs)	7.5	4.5	65	13	8	55
RM costs to sales (%)	68	60		66	61	
Other costs to sales (%)	11.5	15.1		11.7	15.4	
PBIDTM (%)	12.2	11.9		12.3	12.4	
Tax rate (%)	32	35		32	34	

Source: Company

Result Highlights

- Revenue for the quarter is up 57% yoy to Rs 10.5 bn. Revenue growth has come higher than expectations.
- For FY10, revenues were down 4% mainly due to subdued order intake in FY09. Instances of clients going slow on project execution were also responsible for fall in revenues. However, the situation has turned around and the company has begun the year with a good order backlog, which should drive revenues for FY11 and FY12
- The energy segment has posted a growth of 71% due to upsurge in corporate capex in industries like Metals, Cement and Refineries.

Segment revenues

(Rs mn)	Q2 FY11	Q2 FY10	% change
Segment- Energy	8910	5213	71%
Segment - Enviro	2482	1649	51%

Source: Company

- Operating margins for the quarter remained largely stable on yoy as well as qoq basis.
- Material costs have increased in the quarter possibly due to change in revenue mix towards higher share of project work.
- Staff costs also rose higher than expected as the company may have recruited people in view of the increased quantum of work to be executed in the current year.
- The management has indicated recent orders are at desirable margins, which should put upward thrust on margins in FY11.

Segment Margins

(%)	Q2 FY11	Q2 FY10
Segment- Energy	11.2%	12.4%
Segment - Enviro	12.1%	11.9%

Source: Company

Order backlog is healthy but order intake has slowed down in Q2 FY11

- Order backlog is up 43% yoy to Rs 66.0 bn, thus imparting a revenue visibility of 21 months based on trailing four quarters revenues.
- We estimates order intake in the quarter in the range of Rs 13.2 bn, down 36% yoy and 24% qoq.
- During the quarter, the company has not announced any major order win.
- EPC orders from the Power sector constitute roughly 46% of the order backlog and the average execution period of the same is close to 20-24 months higher than the execution period of the total order backlog (between 15-20 months).
- On order outlook, the company has maintained that order inquiries have been better every quarter. The company expects to win some large orders in the power sector business as it has started bidding for 300 MW power projects.
- The company intends to secure higher order intake in the current year as the business confidence as also the balance sheets of the corporate sector is in a better shape.

Update on Thermax's entry in manufacture of supercritical boilers

In Q4 FY10, Thermax Ltd and Babcock & Wilcox power generation group announced the formation of a JV to engineer, manufacture and supply supercritical boilers for the Indian power sector. The JV will manufacture boilers for size above 300 MW in subcritical and 660 MW plus in supercritical technology. Thermax will own 51% of the venture with an annual capacity of 3000 MW in the first phase. There will be a phased indigenization programme for technology absorption.

Thermax has had a long association with the B&W group for over 20 years. In 2008, Thermax had signed an agreement for technology transfer for subcritical boilers with B&W.

Entry into super-critical technology based boilers was important for the company as the power generation market is shifting towards more efficient and enviro friendly equipments. This is where supercritical technology scores over the conventional thermal power projects.

Thermax will be investing Rs 1.7 bn in FY11-12 towards its equity contribution in the manufacturing facility.

The company has been in talks with the government for land for setting up the manufacturing facility. It is eligible for bidding in bulk order from NTPC-DVC for 800 MW units, which will be announced in the next few months.

Future Initiatives - Nuclear and Solar Power

- The company is positioning itself for emerging opportunity in the nuclear power arena and intends to partner with the world leaders (Areva, GE and Toshiba) to co-produce equipments. It also targets the water-treatment business in the nuclear power sector. However, meaningful traction in the nuclear power business will be visible only from FY13 onwards.
- The company has also initiated moves in the solar power sector. Thermax is designing the plant to operate with solar energy, with biomass as support energy source to meet round-the clock energy requirements. This power plant will be designed using air condensers to economise on the water requirements for power generation. Thermax will also manage the operation & maintenance of the solar thermal power plant at Shive village for a period of five years

Earnings Outlook - Revenue growth forecast to gain momentum in FY11 onwards

- We expect pace of project execution to accelerate in FY11. This coupled with advantage of beginning the year on a higher order backlog should translate into robust revenue growth.
- The company has cash worth Rs 7.3 bn equivalent to Rs 61 per share.

Change in Earnings Estimates FY11E

(Rs mn)	Earlier	Revised
Revenue Rs mn	45,996	52,123
EBITDA (%)	12.3%	11.8%
EPS Rs	32.1	34.5
% change		7.5%

Source: Company

Valuation - Stock has underperformed since Q1 FY11 mainly as a result of valuations building in near-term earnings growth

We recommend ACCUMULATE on Thermax with a revised price target of Rs.866

- Thermax is trading at 23.1x and 17.4x FY11 and FY12 earnings respectively.
- We believe stock should trade at a premium valuation in view of the strong expected earnings growth, growth potential from power sector and robust cash generation.
- The strong cash flow from operations supports our DCF based target price of Rs 866 (Rs 828 earlier). At our target price, the stock would trade at 19x FY12 earnings.
- We upgrade the stock to **ACCUMULATE** in view of the strong execution of orders translating into robust revenue growth coupled with recent underperformance in the stock.

DCF model Summary

	(Rs mn)
WACC (%)	13.5
NPV of cash flows 2011-24	55516
TV	28094
Profit growth between FY11-19 (%)	18

Source: Kotak Securities - Private Client Research

RESULT UPDATE

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UNION BANK OF INDIA

PRICE: Rs.393
TARGET PRICE: Rs.400RECOMMENDATION: ACCUMULATE
FY12E P/E: 8.5x; P/ABV: 1.7x

Q2FY11 Results: NII came ahead of expectations; however, net profit disappoints on back of spike in NPA provisions, higher opex & lower treasury profit. Higher slippage continues to be an overhang on the stock; we downgrade the stock to ACCUMULATE.

- ❑ The bank's net interest income (NII) rose whopping 72.6% in Q2FY11 on back of sharp improvement in NIM (93 bps) from 2.42% in Q2FY10 to 3.35% in Q2FY11 along with strong loan growth of 27.1% YoY.
- ❑ Net profit declined 39.9% mainly due to spike in provisions & contingencies from Rs.1.35 bn in Q2FY10 to Rs.5.99 bn in Q2FY11, 93.5% rise in compensation for employees along with subdued treasury profit (down by 18.7% YoY).
- ❑ NIM after bottoming out in Q1FY10 has witnessed consistent improvement during last couple of quarters. It improved further to 3.35% in Q2FY11 as compared to 3.03% in Q1FY11 and 2.42% in Q2FY10.
- ❑ We opine that deterioration in asset quality is likely to impact the stock performance in near term. Gross NPA rose sharply 77.4% YoY (28.8% QoQ) during Q2FY11 due to sharp increase in slippage (Rs.11.3 bn in Q2FY11). Despite higher provisions, net NPA rose sharply at 555.8% YoY (27.2% QoQ) during Q2FY11. Cumulative restructured account stands at Rs.51.16 bn (~4.0% of total advances) at the end of Q2FY11.
- ❑ We are factoring in higher credit costs (1.05% for FY11 as against 0.72% in FY10) due to recent deterioration in its asset quality. As a result, we are revising our earning estimates downward for FY11E & FY12E. We are also rolling over target price to FY12E estimates and recommend ACCUMULATE on the stock from BUY earlier with the revised TP of Rs.400 (Rs.367 earlier) based on P/ABV of 1.75x its FY12E adjusted book value.

Result Performance

(Rs mn)	Q2FY11	Q2FY10	YoY (%)
Interest on advances	27757.9	23413.5	18.6
Interest on Investment	9851.2	8637.2	14.1
Interest on RBI/ banks' balances	561.2	138.1	306.4
Other interest	1352.1	130.0	940.1
Total Interest earned	39522.4	32318.8	22.3
Interest expenses	24164.0	23421.8	3.2
Net interest income	15358.4	8897.0	72.6
Other income	5096.4	5290.2	-3.7
Net Revenue (NII + Other income)	20454.8	14187.2	44.2
Operating Expenses	9148.5	6086.4	50.3
Payments to / Provisions for employees	5919.4	3058.5	93.5
Other operating expenses	3229.1	3027.9	6.6
Operating profit	11306.3	8100.8	39.6
Provisions & contingencies	5988.9	1349.8	343.7
Provision for taxes	2283.5	1700.0	34.3
Net profit	3033.9	5051.0	-39.9
EPS (Rs.)	6.01	10.00	-39.9

Source: Company

Robust NII growth at 72.6%; however, net profit disappoints

The bank's net interest income (NII) rose whopping 72.6% in Q2FY11 to Rs.15.36 bn in Q2FY11 from Rs.8.90 bn in Q2FY10 on back of sharp improvement in NIM (93 bps) from 2.42% in Q2FY10 to 3.35% in Q2FY11 along with strong loan growth of 27.1% YoY.

Net profit declined 39.9% to Rs.3.03 bn in Q2FY11 from Rs.5.05 bn in Q2FY10 mainly due to spike in provisions & contingencies from Rs.1.35 bn in Q2FY10 to Rs.5.99 bn in Q2FY11, 93.5% rise in compensation for employees along with subdued treasury profit (down by 18.7% YoY).

Subdued non-interest income due to lower treasury gains

Non-interest income declined modestly 3.7% YoY to Rs.5.10 bn in Q2FY11 from Rs.5.29 bn in Q2FY10 due to lower treasury profit (Rs.1.87 bn in Q2FY11 as against Rs.2.30 bn in Q2FY10).

During the same period, core fee-income component grew moderately at 8.8% to Rs.2.36 bn in Q2FY11 from Rs.2.17 bn in Q2FY10, a departure from the ~15% average growth witnessed during last 5 years. However, management has guided that fruits of technological initiatives would start paying results in the future.

Non-interest income

(Rs bn)	Q2FY10	Q1FY11	Q2FY11	YoY gr (%)	QoQ gr (%)
Core Fee Income	2.17	2.00	2.36	8.8	18.0
Profit on sale of Investments	2.30	1.55	1.87	-18.7	28.1
Profit on Exchange Transactions	0.40	0.42	0.43	7.5	-15.7
Recovery from W/O accounts	0.42	0.38	0.44	4.8	15.8
Total non-interest income	5.29	4.35	5.10	-3.6	17.2

Source: Company

Strong business growth; margin improved both YoY as well as QoQ with better liability management

Total business of the bank rose 22.4% YoY (2.7% QoQ) to Rs.3042.0 bn at the end of Q2FY11 from Rs.2485.0 bn at the end of Q2FY10.

- Gross advances grew 27.1% YoY (1.3% QoQ) to Rs.1264.2 bn at the end of Q2FY11 from Rs.994.3 bn at the end of Q2FY10 mainly driven by retail, SME and agriculture segments, which grew 53.9%, 15.4% and 14.8%, respectively.
 - Retail advances grew 53.9% YoY to Rs.145.6 bn at the end of Q2FY11 from Rs.94.6 bn at the end of Q2FY10.
 - SME loan book grew 15.4% YoY to 227.7 bn at the end of Q2FY11 from Rs.197.3 bn at the end of Q2FY10.
 - Agriculture loan increased 14.8% to Rs.179.1 bn at the end of Q2FY11 from Rs.156.0 bn at the end of Q2FY10.
- Total deposits of the bank rose 19.3% YoY to Rs.1777.8 bn at the end of Q2FY11 from Rs.1490.7 bn at the end of Q2FY10. CASA mix (low cost deposits) remained stable both YoY as well as QoQ at ~33% levels at the end of Q2FY11.

Trend in Deposit Mix

(Rs bn)	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Gr (YoY)
CASA	437	491	489	540	558	581	18.3
Current deposits	143	166	141	162	161	161	-3.0
Saving deposits	294	325	348	377	397	420	29.1
CASA (%)	30.4	33.0	32.3	31.7	30.4	32.7	
Term Deposits	1001	999	1022	1161	1156	1196	19.7
Total Deposits (Rs. bn)	1438.9	1490.7	1510.9	1700.4	1714.8	1777.8	19.3

Source: Company

Bank also witnessed improvement in C/D ratio to 71.1% at the end of Q2FY11 from 66.7% at the end of Q2FY10. We believe there is little scope to further raise the C/D ratio on sustainable basis and hence deposit mobilization is likely to drive the loan growth, going forward. We expect bank to raise deposit rates to mobilize more resources in the future.

NIM after bottoming out in Q1FY10 has witnessed consistent improvement during last couple of quarters. It improved further to 3.35% in Q2FY11 as compared to 3.03% in Q1FY11 and 2.42% in Q2FY10. Q2FY11 includes one time extraordinary income of Rs.0.62 bn, excluding which NIM would have been 3.21%.

This improvement in NIM has come on back of sharp decline in cost of funds (75 bps YoY) vis-à-vis 27 bps improvement in blended yield on assets. We are forecasting NIM at 3.05% and 2.87% during FY11 & FY12, respectively.

Asset quality deteriorates very sharply; higher slippages continue to be an overhang

Higher slippages (3.73% annualized during Q2FY11) continue to be an overhang on the stock. The average run rate of slippage during last 4 quarters has been 2.76%, which is on the higher side and hence negative for the stock. Q2FY11 saw slippage of Rs.11.3 bn of which Rs.4.2 bn was account of Agri Debt Waiver Scheme of 2008.

Management has guided that provisioning would remain at elevated levels but the pace of slippages will slow down. They also expect substantial recovery and upgradation in the gross NPA accounts which is likely to boost its earnings, going forward.

We opine that deterioration in asset quality is likely to impact the stock performance in near term. Gross NPA rose very sharply at 77.4% YoY (28.8% QoQ) during Q2FY11 due to sharp increase in slippage (Rs.11.3 bn in Q2FY11). Despite higher credit costs, net NPA rose sharply at 555.8% YoY (27.2% QoQ) during Q2FY11.

In percentage terms, gross NPA and net NPA stand at 2.79% and 1.18% at the end of Q2FY11. Cumulative restructured account stands at Rs.51.16 bn (~4.0% of total advances) at the end of Q2FY11. Till date, Rs.7.51 bn slipped into NPA from restructured book (Rs.0.76 bn slipped in Q2FY11).

Historically, bank has been reporting higher coverage ratio (~93% during FY09). However, with deterioration in asset quality, it has come down to 70% at the end of Q2FY11. In last 4 quarters, PCR has come down from 88.4% at the end of Q2FY10 to 58.5% (excluding the technical W/O). With the rise in credit costs (1.05% for FY11 & 0.65% for FY12 as against 0.72% in FY10) on back of deterioration in asset quality is likely to impact the earnings of the bank, going forward.

However this problem is aggravated more in the situation when its provision coverage ratio is sitting at the bare minimum of 70% as required by the regulator.

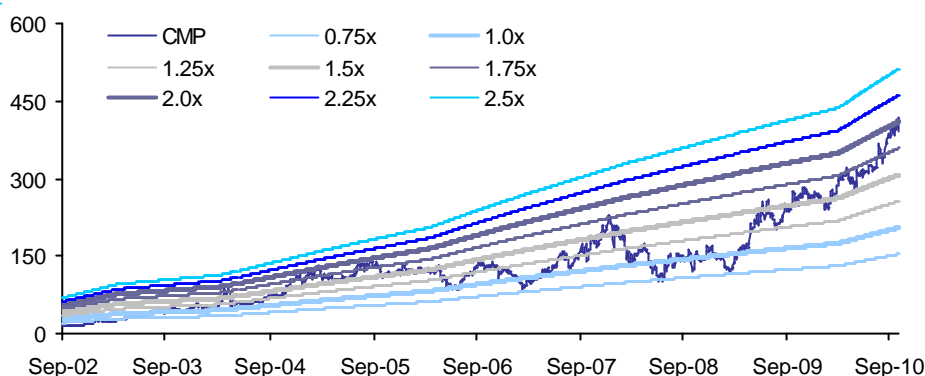
Valuation & recommendation

We are factoring in higher credit costs due to recent deterioration in its asset quality. As a result, we are revising our earning estimate downward for FY11E & FY12E and now expect earnings to grow only 6.1% CAGR during FY10-12E. We expect RoA to come below 1.0% and RoE at ~20% during FY11-12.

We now recommend to ACCUMULATE on Union Bank of India with a revised price target of Rs.400

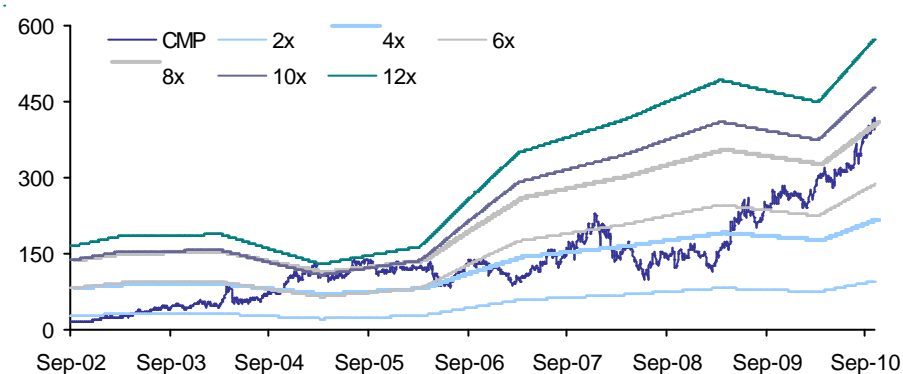
We now expect net profit for FY11E and FY12E to be 18.87 bn and Rs.23.35 bn. This would result into an EPS of Rs.37.4 and Rs.46.2 for FY11E and FY12E, respectively. Adjusted book value for FY11E and FY12E is estimated to be Rs.175.3 and Rs.225.6, respectively

Rolling 1-year forward P/ABV



Source: Company, Kotak Securities - Private Client Research

Rolling 1-year forward P/E band



Source: Company, Kotak Securities - Private Client Research

At the current market price of Rs.393, the stock is trading at 8.5x its FY12E earnings and 1.7x its FY12E ABV. We are also rolling over target price to FY12E estimates and recommend ACCUMULATE on the stock from BUY earlier with the revised TP of Rs.400 (Rs.367 earlier) based on P/ABV of 1.75x its FY12E adjusted book value.

Key data

(Rs bn)	FY09	FY10	FY11E	FY12E
Interest income	118.89	133.03	155.34	188.01
Interest expense	80.76	91.10	100.05	125.83
Net interest income	38.14	41.92	55.29	62.18
Other income	14.83	19.75	18.65	22.49
Gross profit	30.82	36.59	41.96	46.41
Net profit	17.27	20.75	18.87	23.35
Gross NPA (%)	2.0	2.2	2.8	2.4
Net NPA (%)	0.3	0.8	1.0	0.5
Net interest margin (%)	3.2	2.7	3.1	2.9
RoE (%)	27.2	26.2	19.7	20.6
RoAA (%)	1.2	1.2	0.9	0.9
Dividend Yield (%)	1.3	1.4	1.5	1.5
EPS (Rs)	34.2	41.1	37.4	46.2
Adjusted BVPS (Rs)	133.2	155.3	175.3	225.6
P/E (x)	11.5	9.6	10.5	8.5
P/ABV (x)	2.9	2.5	2.2	1.7

Source: Company, Kotak Securities - Private Client Research

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
Tata Steel	615	1.5	1.9	7.0
M&M	729	1.7	1.7	2.0
Reliance Com	183	4.0	1.6	4.8
Losers				
ICICI Bank	1,107	(2.2)	(9.5)	3.6
HDFC	678	(2.6)	(8.0)	5.0
ITC	168	(2.3)	(6.9)	5.0

Source: Bloomberg

Forthcoming events

Company/Market

Date	Event
28-Oct	Adani Ent, Alok Ind, Andhra Bank, Balaji Tele, BoB, Cairn India, Colgate, IRB Infra, Kirloskar Bros, Mercator Lines, Monsanto India, ONGC, Orchid Chem, PNB, PTC India, SAIL, Sun TV Network, Whirlpool, Zee Entert earnings expected
29-Oct	ABB, BEL, BHEL, Blue Star, Federal Bank, Hero Honda, Hindustan Cons, ICICI Bank IOB, ITC, M&M, Moser Baer, Nestle India, Nirma, Silverline Tech, Syndicate Bank, Tata Chem, Uco Bank earnings expected

Source: BSE

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