MORNING INSIGHT

kotak Kotak Securities

PRIVATE CLIENT RESEARCH

JANUARY 25, 2012

Economy News

- Even as it maintained status quo on interest rates, the RBI, in a bid to ease liquidity pressures in the banking system, cut the Cash Reserve Ratio, the amount of cash that banks have to mandatorily park with it, by 50 basis points from 6 percent to 5.50 percent of deposits. (BL)
- Competition Commission of India, in a common order has disposed of two cases filed respectively by the Gujarat Government and South Gujarat Textile Processing Association against the BG group-run Gujarat Gas Company (GGCL) accusing both for charging unfair prices. (BL)
- The government would do away with the practice of releasing the weekly food inflation data as the figures were not portraying the "holistic" picture of the price situation. (BS)

Corporate News

- **Strides Arcolab Ltd** has sold its 94 per cent shareholding in Ascent Pharmahealth Ltd - its subsidiary with operations in Australia and South-East Asia - to Watson Pharmaceuticals Inc. (BL)
- **Cairn-Vedanta** deal gets final Cabinet nod ending all uncertainties over the deal. (BL)
- **IOC's** subsidiary -IOT Infrastructure & Energy Services Ltd (IOT) has got Rs 1 bn funding from India Infrastructure Development Fund (IIDF), a private equity fund managed by UTI Capital. (BL)
- **Lupin** has lined up more manufacturing facilities to support products in segments including dermatology and asthma in overseas markets. (BL)
- **KEC International**, an RPG Group company, has secured two orders worth Rs 3.7 bn for construction of transmission lines. (BL)
- **Jaypee group** will launch an open offer for acquisition of 7.63 crore shares of Andhra Cements at Rs 12 apiece tomorrow. (BS)
- Board of state-owned transmission utility **Power Grid Corporation** has approved two projects entailing a total investment of Rs 17 bn. (BS)
- **GMR Infrastructure** has withdrawn its bid to modernise and expand an airport in Croatia, but is preparing to bid on similar projects in Brazil. (BS)
- **State Bank of India (SBI)** has more than doubled the minimum income requirements to Rs 2.5 lakh for availing its car-loans, worrying that its aggressive plan to tap the bottom of the car-buyers pyramid could saddle it with dodgy assets. (ET)
- **Essar group** and the CBI were asked by the Delhi High Court to seek a decision from the Supreme Court whether the charges against them in a case arising out of 2G scam probe could be heard by a magistrate or the Special Court going into the scam. (BS)
- The Competition Commission of India (CCI) has approved the proposed amalgamation of IVRCL Assets and Holdings with parent **IVRCL** and the demerger of its real estate business into a new company. (BS)
- ONGC Videsh Ltd (OVL), the overseas arm of state-owned **Oil and Natural Gas Corp. Ltd,** is in talks with Russia's OAO Novatek to acquire a 15% stake in its subsidiary **OAO Yamal LNG** for developing a natural gas field. (Mint)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange

Equity

	24 Jan 12	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	16,996	1.5	8.0	(1.5)
NIFTY Index	5,127	1.6	8.8	(1.2)
BANKEX Index	11,286	3.2	18.4	3.4
BSET Index	5,569	0.9	(1.9)	(3.7)
BSETCG INDEX	10,209	3.3	25.1	(3.4)
BSEOIL INDEX	8,271	1.0	4.3	(8.0)
CNXMcap Index	6,954	1.8	12.4	(0.8)
BSESMCAP INDEX	6,338	0.7	12.9	(6.8)
World Indices				
Dow Jones	12,676	(0.3)	3.1	8.3
Nasdaq	2,787	0.1	6.4	5.6
FTSE	5,752	(0.5)	4.3	4.1
NIKKEI	8,785	0.2	5.7	1.2
HANGSENG	19,943	1.3	8.0	11.6

Value traded (Rs cr)

	24 Jan 12	% Chg - Day
Cash BSE	4,624	118.2
Cash NSE	14,226	40.1
Derivatives	205,306	83.6

Net inflows (Rs cr)

	23 Jan 12	% Chg	MTD	YTD
FII	(13)	(101.3)	7,079	7,079
Mutual Fund	(157)	(52.7)	(1,220)	(1,220)

FII open interest (Rs cr)

	23 Jan 12	% Chg
FII Index Futures	18,892	6.5
FII Index Options	41,683	2.0
FII Stock Futures	30,385	0.1
FII Stock Options	1,484	(13.8)

Advances / Declines (BSE)

24 Jan 12	A	B	S	Total	% total
Advances	161	1,124	307	1,592	54
Declines	41	876	288	1,205	41
Unchanged	1	106	35	142	5

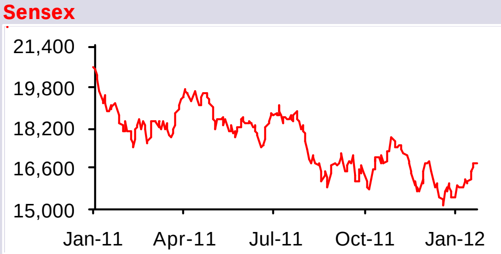
Commodity

	24 Jan 12	% Chg 1 Day	1 Mth	3 Mths
Crude (NYMEX) (US$/BBL)	99.3	0.3	(0.4)	6.5
Gold (US$/OZ)	1,667.4	(0.5)	3.7	(1.9)
Silver (US$/OZ)	32.1	(0.0)	10.3	(3.0)

Debt / forex market

	24 Jan 12	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	NA	NA	NA	NA
Re/US$	50.1	50.1	52.7	49.8

Sensex



ECONOMY UPDATE

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RBI MONETARY POLICY: THIRD QUARTER REVIEW FOR FY12

Growth wins over inflation... cycle turns ...CRR reduced by 50 bps

RBI has started its monetary policy easing with 50 bps cut in CRR to 5.5% from 6%, injecting Rs.320 billion of primary liquidity into the banking system. However, it has also indicated that, unless there is credible fiscal consolidation in the budget it would be constrained from lowering the rates. RBI revised the GDP forecast downward to 7% for FY12, but maintained the inflation forecast at 7% by March end. We expect reduction in repo and reverse repo rates to begin from the next policy meeting.

The CRR cut by 50bps would inject Rs.320 bn of primary liquidity in the system and in turn partly alleviate the structural liquidity deficit witnessed in the banking system (Rs.1200 bn of average borrowing under LAF window). We believe this has to do more with the change in stance rather than easing of monetary policy; however, RBI has given enough indications of softer bias in coming months. We believe this step is aimed at injecting primary liquidity in the system, mitigating the downward risk to growth and at the same time curtail inflationary expectations.

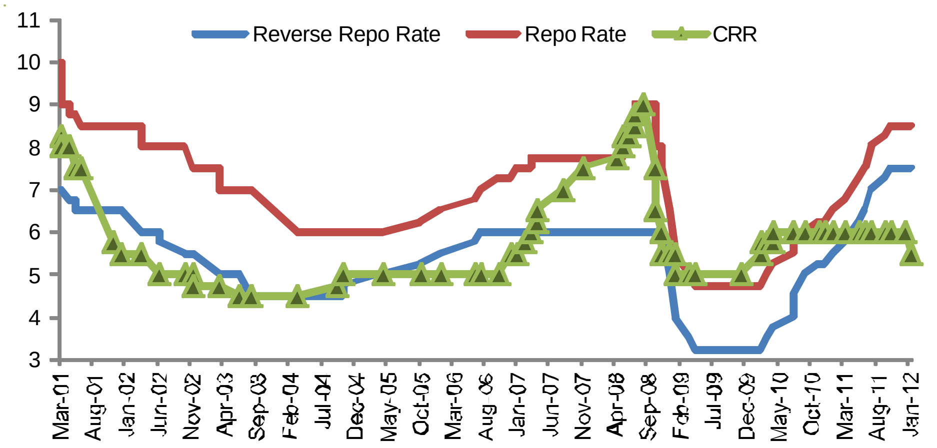
Policy Measures Announced

- Cuts CRR by 50 bps to 5.5% from 6%
- No change in repo rate; remains at 8.5%
- Reverse repo remains at 7.5% (100 bps below repo rate);
- MSF rate at 9.5% (100 bps above repo rate)

In its guidance RBI states that "…The reduction can also be viewed as a reinforcement of the guidance that future rate actions will be towards lowering them..." this in our opinion strengthens its earlier guidance of rate cuts, which is likely to begin from next policy itself.

We expect in total 75-100 bps reduction in rate in FY13. However, RBI has also warned against fiscal slippages. It has also stated that, unless there is credible fiscal consolidation in the budget it would be constrained from lowering the rates. In our opinion RBI is all set to cut rates in April, unless the budget disappoints.

Exhibit 1: Policy Rates



Source: MOSPI

RBI is looking for strong signs of fiscal consolidation to shift the balance of aggregate demand from public to private and from consumption to capital formation, which is critical to create the space for lowering the policy rate without the risk of inflation.

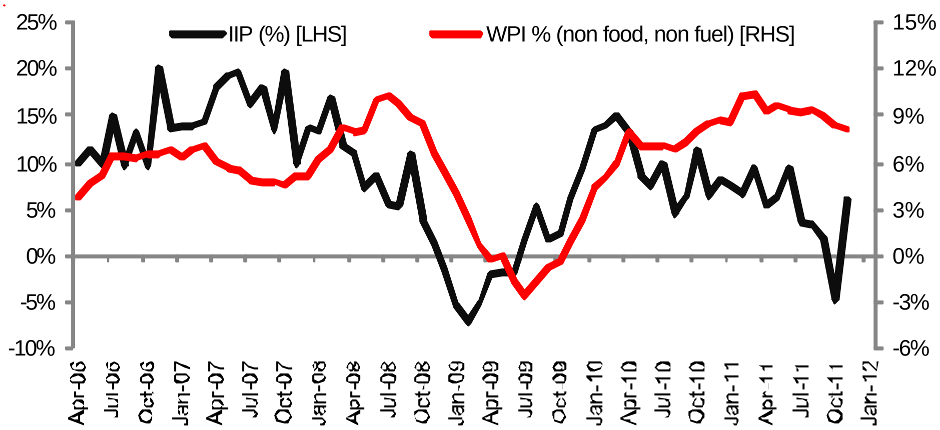
RBI maintains that in absence of credible fiscal consolidation, it would be constrained from lowering the policy rate in response to decelerating private consumption and investment spending. RBI has called for exploitation of the opportunity to begin process of fiscal consolidation in a credible and sustainable way.

In admission to continued structural inflationary pressures RBI notes that "…excluding vegetables, food articles inflation moderated only marginally from 8.0 per cent in November to 7.1 per cent in December in contrast to the sharp decline in food articles inflation (including vegetables) from 8.5 per cent to 0.7 per cent during the same period."

RBI also acknowledged that there is "... sizeable suppressed inflation in the fuel group as administered prices do not fully reflect the market prices."

RBI revised FY12 GDP growth estimated downward from 7.6% to 7%, we expect FY13 growth guidance to come at 7.5% (to be announced in April).

Exhibit 2: Inflation and Growth Tradeoff



Source: Bloomberg

Money supply (M3) growth, moved closer to projected growth rate of 15.5% and came in at 15.6% in December from levels of 17.2% in April. However, non-food credit growth moderated from 21.3% at end-March to 15.7% by end-December 2011, a rate below the indicative projection of 18%.

Beyond the budgeted estimate of Rs.4.17 trillion, the Central Government announced an increase in borrowings through dated securities of about Rs.530 billion in September and further Rs.400 billion in December, resulting in the revised gross (net) borrowings for the year work out to about Rs.5.100 trillion (Rs.4.36 trillion). Government also announced an increase in the borrowing through net issuances of Treasury Bills by Rs.1.025 trillion over the budgeted amount of Rs.150 billion for 2011-12. As against increased borrowing of Rs.1.78 trillion, RBI has conducted OMOs aggregating over Rs.700 billion during November 2011-mid January 2012. However further OMOs would be dependent upon liquidity easing due to the CRR cut.

RESULT UPDATE

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KPIT CUMMINS

PRICE: RS.152 **RECOMMENDATION: BUY**
TARGET PRICE: RS.201 **FY13E P/E: 8.8X**

- **KPIT's 3QFY12 results were a mixed bag for us. While CC revenue growth of 6% beat our expectations, EBIDTA margin improvement fell short. A higher other income component led to an in-line PAT performance. The near-4% volume growth came on the back of high growth rates in the past four quarters. Margins improved on the back of rupee depreciation and despite the seasonal impact (200bps) and mix change in favour of lower-margin business (SAP).**
- **Management commentary suggests decent visibility on revenues going ahead. We opine that, the company is strategically well positioned with focus verticals doing well. It has also made well - directed acquisitions which should help it penetrate clients and geographies. These acquisitions should scale up going ahead.**
- **Strong additions to the pipeline and additions to client acquisition resources should lead to consistent revenue growth ahead. KPIT is now increasingly focusing on non-linear revenues and has filed about 39 patents. 6-7% of overall revenues (mostly from auto electronics) currently accrue from non-linear initiatives. KPIT plans to have 25% of revenues from these initiatives in 3 years' time. We believe this is an important lever to protect and sustain margins.**
- **KPIT will be holding a major trial of Revolo WEF April 1. 200 vehicles are proposed to be converted into plug-in hybrid models by installing Revolo kits. These traials will run for 6 months. The non-linear nature of revenues should improve profitability, we believe. We have not yet accounted for these revenues in our projections.**
- **We fine tune our FY12E and FY13E estimates on the back of the changed assumption on the exchange rate. We expect FY12E earnings at Rs.15.2 per share (Rs.15.5 earlier) and FY13E earnings to be Rs.17.3 per share (Rs.17.5 earlier). Our PT stands at Rs.201 (Rs.211 earlier) based on FY13E earnings. There could be upsides based on Revolo financials. At our TP, the stock will be valued at about 13x FY13E earnings, a suitable discount to larger peers. We maintain BUY. KPIT has declared a 1 : 1 bonus issue.**
- **Slower-than-expected recovery in demand from major user economies and a sharper-than-expected appreciation in rupee remain the key risks for earnings. Revolo earnings can provide significant upsides, if successful.**

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	10,230	14,753	19,126
Growth (%)	39.8	44.2	29.6
EBITDA	1,522	2,074	2,609
EBITDA margin (%)	14.9	14.1	13.6
PBT	1,103	1,722	2,071
Net profit	947	1,347	1,528
EPS (Rs)	10.8	15.2	17.3
Growth (%)	(1.3)	40.4	13.4
CEPS (Rs)	15.6	21.3	23.6
BV (Rs/share)	69.1	76.6	93.1
Dividend / share (Rs)	0.8	0.8	0.8
ROE (%)	19.1	21.0	20.4
ROCE (%)	18.2	22.3	22.5
Net cash (debt)	991	(517)	620
NW Capital (Days)	90.1	82.5	78.8
P/E (x)	14.0	10.0	8.8
P/BV (x)	2.2	2.0	1.6
EV/Sales (x)	1.2	0.9	0.7
EV/EBITDA (x)	8.2	6.7	4.9

Source: Company, Kotak Securities - Private Client Research

3QFY12 results

(Rs mn)	3QFY12	2QFY12	% chg	3QFY11	% chg
Turnover	**3788.5**	**3250.2**	**16.6**	**2737.5**	**38.4**
Expenditure	3208.7	2806.6		2352.0	
EBDITA	**579.9**	**443.6**	**30.7**	**385.5**	**50.4**
Depreciation	133.3	115.5		85.0	
EBIT	**446.6**	**328.1**	**36.1**	**300.5**	**48.6**
Interest	15.9	12.9		6.3	
Other Income	108.4	110.0		8.2	
PBT	**539.1**	**425.2**	**26.8**	**302.4**	**78.3**
Tax	128.2	87.7		49.3	
PAT	**410.9**	**337.5**	**21.7**	**253.0**	**62.4**
Minority Int	5.3	1.2		0.0	
Adjusted PAT	405.6	336.3	20.6	253.0	60.3
EPS (Rs)	**4.6**	**3.8**		**2.9**	
OPM (%)	15.3	13.6		14.1	
GPM (%)	11.8	10.1		11.0	
NPM (%)	10.8	10.4		9.2	

Source : Company

USD revenues up 4.3% QoQ; volumes grow by 4%

- Headline revenue growth was at 16.6% QoQ in INR terms, largely aided by a 12% depreciation in rupee QoQ.
- In USD terms, revenues grew by 4.3%. CC revenue growth was at about 6%. This growth was aided by a near 4% rise in volumes, largely on-site. On-site volumes grew by about 6.5% QoQ and offshore volumes were almost 2.5% higher, according to the management.
- The volume growth was impacted to the extent of 200bps by the lower number of billing days in the quarter.
- The 4% volume growth came in the backdrop of a 5% growth reported in 2Q, 4% in 1Q and 10% growth reported each in 4Q and 3Q.
- Average realizations were likely higher by about 1% partly due to a change in business mix. Like-to-like improvement was marginal, we understand. Realisations were flat in 2Q but had improved in 3 out of the four quarters in FY11.

New accounts and Cummins

- KPIT is benefiting from the continuing demand in its focus verticals. The company has been able to win several new orders from existing and new accounts.
- The company added two accounts during the quarter. According to the management, the order pipeline is robust.
- Within customers, Cummins account saw revenues grow by 23% QoQ and it now contributes about 24% of KPIT's revenues.
- Cummins itself is witnessing a revival in its own fortunes and KPIT is looking at more options to penetrate it further. Cummins is looking at increasing spend on engineering & R&D as well as on IT services.
- The environment is positive and the company is not experiencing any constraints in this account.
- KPIT has enough clarity on the work it wants to do within Cummins and expects to get more orders from this client.

Services

- Within services, SAP and Auto & Allied Engineering (A&E) have seen good growth rates QoQ.
- The A&E practice is benefiting from increasing spends on infotainment, Powertrain and AUTOSAR.
- KPIT has become the first Indian company to develop a, in-vehicle infotainment platform which is compliant with GENIVI.
- SAP practice is also witnessing traction, especially in the mid-market Utility industry, according to the management. Utilities are focusing on smart grid adoption.
- In the Small & Medium Enterprises (SME) space, KPIT has already started its engagement with the first customer, while it has signed the second deal in 2Q.
- Large companies in emerging markets are also increasingly adopting SAP, thus increasing demand potential for companies like KPIT.
- The company has acquired new accounts spread across different industry verticals, which include some large value deals of USD 10mn+ in the manufacturing & automotive industry and also a few small size/ mid-size deals in Energy & Utility companies.
- The like-to-like growth in IES was 4.5% QoQ (DFS was part of IES SBU).

- In IES, the company has witnessed increased traction from existing clients for Manufacturing Execution Systems (MES), Enterprise Application Integration (EAI) and testing services.
- The semiconductor business (SSG) revenues have been volatile and have grown sharply by about 40% QoQ. However, this is on a small base. The revenue for the quarter was $2.35mn.
- KPIT plans to continue with the operational improvements which will help in adjusting the cost structure to be in line with the growth in business volume and also help in improving the quality of revenues.

Revenue break - up

Rs mns	3QFY12	2QFY12	YoY (%)	3QFY11	QoQ (%)
Integrated Enterprise Solns	1384.33	1251.00	10.66	1084.03	27.70
Auto & Engineering	1043.36	896.08	16.44	727.89	43.34
SAP	1263.48	980.26	28.89	860.66	46.80
Semicon Solns Group	96.99	108.23	-10.39	64.88	49.49

Source : Company

- Semiconductor Solutions business continues to remain impacted and was revenues de-grow on a sequential basis.
- Within verticals, the focus verticals of Auto / Engineering and Energy / Utilities grew at a fast pace.
- Within auto, companies are looking more at issues like green technology, hybrid vehicles, vehicle connectivity, infotainment, etc. KPIT is deeply involved in these areas and is looking at enhancing presence in these areas.
- In E&U, the trend is towards smart grids and increased security. US utilities are expected to spend $8.5bn on smart grid enterprise IT between 2011 and 2015. KPIT is once again already involved in these fiels and sees good traction in these segments.

Revenue break - up

Rs mns	3QFY12	2QFY12	YoY (%)	3QFY11	QoQ (%)
Auto / Trans / Maft	2687.21	2156.82	24.59	1711.73	56.99
Energy / Utilities	415.22	324.37	28.01	296.47	40.06
Defense / Govt	44.70	72.48	-38.32	7.39	504.84
Others	641.40	696.52	-7.91	722.14	-11.18

Source : Company

- Geography-wise, US revenues increased by 21%% QoQ.
- Revenues from Europe grew by 10% QoQ.
- We will closely watch the evolving situation in Europe.

Partnership with PACCAR

- The company has set up the initial team for this partnership and plans to scale it up in the next 2 - 3 quarters.
- KPIT has entered into a partnership with PACCAR, which is a global technology leader in the design, manufacture and customer support of light, medium and heavy duty trucks. It launched its first technical center in Pune in partnership with KPIT Cummins.
- This partnership is a significant achievement as it is one of the largest deals in our business history and it is spread across different business units.

- The technical center will focus on engineering, IT and component sourcing for worldwide production and aftermarket operations. The center will employ approximately 200 people.
- We view this as a reflection of the company's capabilities in the automotive sector.

Non-linear revenues is the focus

- The company has been focusing on non-linear initiatives.
- As part of its efforts in this direction, the company has entered into an engagement with a Japanese Tier I for AUTOSAR license sale for their new vehicle program.
- The company has filed for three more patents during the quarter which takes the total number of filed patents to 39.
- Currently, about 6-7% of overall revenues (mostly from auto electronics) currently accrue from non-linear initiatives. KPIT plans to have 25% of revenues from these initiatives in 3 years' time. We believe this is an important lever to protect and sustain margins.

SYSTIME integration in progress

- The integration of SYSTIME is complete and the cross selling of services between clients has already started yielding results in terms of business. The combined entity has already closed a few orders.
- We note that, with the SYSTIME acquisition, KPIT has acquired strong Oracle and JD Edwards practice.
- The initial target of KPIT was to rationalize costs by consolidating offices, moving staff, etc. This process has already started. The results are expected to be seen by 4QFY12, we understand.
- KPIT is also looking at increasing the productivity of the sales and delivery teams. SYSTIME's margins are target to reach KPIT's levels in FY13.
- SYSTIME had mid-single digit margins at the start of the fiscal, we believe.
- KPIT has acquired an additional 7.5% stake in SYSTIME. The company will be consolidating SYSTIME's financials like-by-line WEF 4QFY12.
- We see the acquisition of a 50% stake in SYSTIME (to buy remaining stake over a 3-year period) as a good strategic fit for KPIT.
- The combined practice has been able to compete more effectively in the Oracle / JD Edwards market.
- The investment has brought in 600+ JDE and 200+ Oracle Technology practitioners from SYSTIME and this will make it a 2000+ strong combined practice.
- Oracle continues to add 400+ customers for JPE every year. This throws open a big market for KPIT in terms of providing implementation / integration services. The investment is expected to bring in 25 key customers to KPIT.
- This partnership has also added capabilities in providing solutions and services in JDE ERP and Hyperion space, to KPIT Cummins' clients, thus increasing the wallet share of KPIT.
- Moreover, cross selling opportunities of services to SYSTIME clients have further aided KPIT's growth rates.

REVOLO - no certainty on start of commercial production

- KPIT will be holding a major trial of Revolo WEF April 1. 200 vehicles are proposed to be converted into plug-in hybrid models by installing Revolo kits. These trials will run for 6 months.
- The company is looking to have some support from the regulatory side. We understand that, the launch will happen only after it gets the regulatory support.
- We expect the commercial production to start sometime in the next fiscal.
- Revolo is a plug-in parallel hybrid solution which will also make the motor and engine to work simultaneously.
- This has been developed in-house by KPIT and will be manufactured in a 50 : 50 JV with Bharat Forge.
- While KPIT will bring in its IP, Bharat Forge is expected to bring in its manufacturing capabilities.
- The product has already been tested on various four-wheelers by Automotive Regulatory Authority of India (ARAI).
- We understand that, with an estimated pay-back period of about 2.5 - 3 years for commercial operators and the focus on green technologies, the product has the potential to be successful.
- We have not assumed any revenues from this JV in our estimates.

Employee strength up marginally

- The total employee strength of KPIT stood at 6707 (6544) as at the quarter end.
- However, if we look at the average number of employees in the development team, the number has increased only marginally over the past three quarters. We are slightly concerned about this and will watch this number closely.
- Capacity utilization fell by about 75bps QoQ.

EBITDA Margins - higher on rupee and utilisation

- EBIDTA margins improved QoQ on the back of rupee depreciation and improved capacity utilization. The improvement was lower than our estimates.
- The improvement in margins came on the back of the currency depreciation (300bps). However, the lower number of billing days took away about 200bps from the profitability. In 2Q, there was an extraordinary expense (integration expenses, provision for doubtful debts) of more than Rs.20mn. Excluding this, the improvement in margins was marginal.
- During the quarter, SAP revenues formed a larger part of the revenues (33% v/s 30% QoQ).
- This business has lower margins of about 8% as it is still investing in the mid-market segment.
- We believe that, the company has a few levers which will allow it to improve margins going ahead.
- The company is operating at about 72% and 91% utilization rates for off-shore and on-site, which it plans to take up to 73% and 95%, respectively.
- Moreover, it is also looking at a higher off-shore proportion to sustain and improve margins. Currently, about 52% of revenues come from off-shore services. KPIT is also looking at non-linear revenues (39 patents filed) to improve profitability.
- Going forward, if billing rates improve, they may provide further cushion to margins. The management has also indicated that it will rationalize low-margin, non-focus projects with a view to improve profitability.

Earnings estimates tweaked

- We have fine-tuned our FY12 and FY13 earnings estimates on changed exchange rate assumption.
- We estimate FY12 revenues to grow by 44% led by volumes. SYSTIME's financial are included WEF 4Q. Organic revenue growth is maintained at 38%.
- PAT is expected to grow by 42% to Rs.1.35bn.
- For FY13, we expect revenues to grow by 30%, largely on the back of higher volumes. SYSTIME revenues will be for the full 12 months as against 3 months in FY12.
- Rupee is expected to average 49 / USD in FY13, which may impact margins positively. Margins are expected to be lower YoY due to salary impact and the relatively low margins of SYSTIME.
- PAT is expected to grow by 13% to Rs.1.53bn, an EPS of Rs.17.3

Valuations and recommendation

We maintain BUY on KPIT Cummins with a price target of Rs.201

- The stock is currently quoting at 8.8x FY13E earnings.
- We have accorded KPIT valuations higher than comparable peers, based on the higher revenue growth and potential upsides to margins. Our PT is at Rs.201. At our target price, KPIT's FY13E earnings will be discounted 13x.
- We maintain **BUY**.

Risks and concerns

Slower-than-expected recovery in demand from major user economies and a sharper-than-expected appreciation in rupee remain the key risks for earnings. Revolo earnings can provide significant upsides, if successful.

RESULT UPDATE

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DB CORP

PRICE: RS.188 **RECOMMENDATION: BUY**
TARGET PRICE: RS.288 **FY13E P/E: 13.7X**

- **DB Corp reported a weak set of financials for 3QFY12, due to weakness in advertising revenues (9% growth y/y), rise in newsprint expenses, provisioning of forex losses, and pre-operative expenses on account of new editions of the company. We note that the quarter suffers from the impact of a high base (3QFY11 advertising revenues rose 29%).**
- **We cut our estimates to include impact of higher provisions, higher expenses on account of new editions. We estimate Rs 11.5/ Rs 13.7 in FY12/ FY13 EPS. Our revised estimates are 13%/7% below prior estimates.**
- **Positives that constitute our investment view remain: DB Corp has continued to prove its strength in launching new editions, as well as maintaining readership shares in its key markets, has a high exposure to faster growing regions of the Indian economy.**
- **Turnaround Visibility Poor, Valuations Cheap: DB Corp trades at 13.7 PER FY13E, which is cheap in our opinion. We concede that visibility in two key drivers of profits (advertising revenues and newsprint expenses) is weak, given weakening consumption trends, and persistently high newsprint prices. However, we note that reasons to expect a decline in newsprint prices are emerging, on account of weakening pulp prices. We maintain BUY on DB Corp, with a price target of Rs.288 (unchanged).**

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	12,652	14,488	16,706
Growth (%)	19.0	14.5	15.3
EBITDA	4,031	3,734	4,148
EBITDA margin (%)	31.9	25.8	24.8
PBT	3,587	3,112	3,745
Net profit	2,585	2,101	2,509
EPS (Rs)	14.2	11.5	13.7
Growth (%)	42.0	(19.1)	19.5
CEPS (Rs)	16.5	13.9	16.3
BV (Rs/share)	44.9	52.5	62.1
Dividend / share (Rs)	2.0	3.0	3.5
ROE (%)	35.4	23.6	23.9
ROCE (%)	24.0	18.3	18.6
Net cash (debt)	(641)	352	1,588
NW Capital (Days)	72	71	71
P/E (x)	13.3	16.4	13.7
P/BV (x)	4.2	3.6	3.0
EV/Sales (x)	2.7	2.3	1.9
EV/EBITDA (x)	8.6	9.0	7.8

Source: Company, Kotak Securities - Private Client Research

3QFY12 Results Summary

Rs mn, FY Ends Mar	3QFY12	3QFY11	Chg., y/y	2QFY12	Chg., q/q
Revenues:	**3,914**	**3,472**	**12.7**	**3539**	**10.6**
- o/w Advertising	3,059	2,810	8.9	2735	11.8
- o/w Circulation	632	540	17.0	601	5.2
-o/w Other	223	132	68.5	203	9.6
Expenses:	**2,894**	**2,305**	**25.6**	**2768**	**4.6**
-Raw Material Expenses	1,345	1,065	26.4	1245	8.1
(Driver) : NP Prices (Rs/ MT)	31,771	27,868	14.0	31166	1.9
(Driver): NP Quantity (MT)	42,344	38,198	10.9	39944	6.0
-Personnel Expenses	609	469	29.7	613	-0.7
-Selling and Distribution	200	195	3.0	219	-8.4
-General and Admin. Exp.	261	195	34.0	239	8.8
-Other Operating Exp.	479	382	25.5	451	6.1
EBITDA	**1,019**	**1,168**	**-12.7**	**771**	**32.2**
Margin (%)	26.0	33.0		21.8	
Depreciation	133	110	20.3	124	7.2
Interest Expenses	81	34	136.1	67	20.4
Other Income	24	38	-35.5	20	23.9
PBT	**830**	**1061**	**-21.7**	**600**	**38.4**
Provision for Tax	269	253	6.5	197	36.4
Effective Tax Rate (%)	32.4%	23.9%		32.9%	
PAT	**561**	**808**	**-30.5**	**403**	**39.4**
Shares O/S	183	183		183	
EPS (Rs)	**3.1**	**4.4**	**-30.5**	**2.2**	**39.4**

Source: Company Reports

DB Corp has reported an expectedly weak result for the quarter: 1/ revenues growth was weak at 13%, on account of weakness in advertising revenues, which grew 9% - the first sign of significant weakness in advertising revenues in the markets that DB Corp operates in. We note that the quarter suffers from a high base effect - 3QFY11 saw 29% growth in advertising revenues, 2/ Raw material prices rose significantly on account of higher newsprint prices (up 14%, y/y), as well as higher circulation, which has led to a significant weakening in the margins of the company. Margins have also weakened on account of strong growth in G&A expenses as well as other operating expenses, which include: a/ forex losses of Rs 78mn, and b/ pre-operative expenses related with new editions of the company. Mature editions of the company have brought in EBITDA margin of 34%.

On the conference call, the management noted that: 1/ weakness in advertising revenues has come in largely from national advertisers, while local advertising continues to grow at 11%, 2/ the stronger sectors in the past nine months have been autos, electronics and lifestyle, while real estate has been weak. Most other categories have been stagnant in advertising spending, 3/ a part of rise in expenses is on account of acquisition of MP Printers in the last quarter, on which count, the company has booked revenues of Rs 125mn in the past quarter.

Outlook

We cut our estimates following weak 3QFY12 results, and inclusion of provisions in the estimates. The changes made to our estimates are summarized below:

Change in Estimates

	Revised Est		Prior Est		Chg (%)	
	FY12	FY13	FY12	FY13	FY12	FY13
Revenues	14,488	16,706	14,488	16,706	0	0
EBITDA	3,734	4,148	3,984	4,348	-6	-5
PAT	2,101	2,509	2,422	2,704	-13	-7

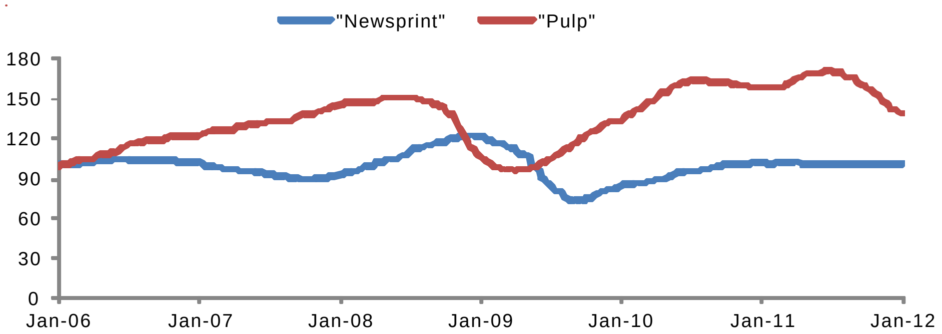
Source: Kotak Securities - Private Client Research

We have held a positive stance on DB Corp for the following reasons : 1/ strong track record in development and maintenance of strong readership shares in markets as well as strong focus on readership quality, 2/ high exposure to areas with strong economic growth, 3/ cheap valuations. We note that post recent correction, the stock trades at 13.7x PER FY13E our revised earnings.

We recommend BUY on DB Crop with a price target of Rs.288

That there are significant issues with the visibility in print media companies' revenues as well as costs is undeniable. However, we note that: 1/ expectations from the companies' revenues are not very strong. We expect 13% advertising revenue growth in DB Corp from the coming year, 2/ newsprint prices are showing signs of peaking out - following the declines in pulp, we believe there is reason for hope that international newsprint prices to fall, which may impact EPS positively in FY13 .

Pulp and Newsprint Prices



Source: Bloomberg

We maintain a **BUY** rating on DB Corp with a price target of Rs 288 (unchanged)

RESULT UPDATE

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ZEE ENTERTAINMENT

PRICE: RS.119 **RECOMMENDATION: SELL**
TARGET PRICE: RS.97 **FY13E P/E: 19.5X**

- **Zee Entertainment reported a mixed set of results in 3QFY12. Advertising revenues declined 10% y/y - the key disappointment of the quarter. However, subscription revenues have registered impressive growth in the quarter - on account of 14% growth in domestic subscription revenues q/q. The company has outperformed our EBITDA expectation for the quarter, while PAT was below expectations on higher taxes (one-off items).**
- **Advertising revenues have come in weaker than our expectations, while domestic subscription revenues have come in higher than our expectations. EBITDA margin has come in well higher than our expectations, on account of improvement in margins of the company's sports business. We make the following changes to our estimates following the quarter: revenues revised -6%/-7%(FY12/FY13), PAT revised +2%/-1% (FY12/ FY13). We expect Rs 6.0/ Rs 6.1 in FY12/ FY13 EPS.**
- **WE maintain our negative view on Zee Entertainment following the results. Reasons for our negative view include - 1/ weak (viewership) performance of entertainment channels of the company, 2/ high market shares in subscription revenues, which leave little scope for improvement, and downsides from higher competition, 3/ intensifying competition in the Hindi GEC space which has potential to cause significant changes in the value chain of broadcasters, 4/ Valuations, at 19.5x, do not recognize medium-term stagnation/ long-term risks in the company profits. SELL, with a price target of Rs 97.**

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	30,136	29,382	32,153
Growth (%)	37.0	-2.5	9.4
EBITDA	8,266	7,670	8,046
EBITDA margin (%)	27.4	26.1	25.0
PBT	8,922	8,315	8,841
Net profit	6,173	5,902	5,963
EPS (Rs)	6.3	6.0	6.1
Growth (%)	3.4	(4.4)	1.0
CEPS (Rs)	6.4	6.4	6.5
Book value (Rs/share)	31.5	34.6	38.1
Dividend per share (Rs)	2.0	2.2	2.4
ROE (%)	17.9	18.2	16.8
ROCE (%)	18.1	18.8	17.0
Net cash (debt)	3,841	5,108	7,088
NW Capital (Days)	138	166	166
P/E (x)	18.9	19.7	19.5
P/BV (x)	3.8	3.4	3.1
EV/Sales (x)	3.3	3.3	3.0
EV/EBITDA (x)	12.0	12.8	11.9

Source: Company, Kotak Securities - Private Client Research

3QFY12 Results Summary

ZEEL, Rs mn (FY Ends Mar)	3QFY12	3QFY11	% chg, y/y	2QFY12	% chg, q/q
Revenues:	**7,548**	**8,249**	**-8.5**	**7,184**	**5.1**
- Advertising Revenues	3,955	4,398	-10.1	3,949	0.1
- Subscription Revenues	3,262	2,818	15.7	2,910	12.1
- Domestic Subn.	2,223	1,807	23.0	1,947	14.2
- International Subn.	1,038	1,011	2.7	963	7.8
-Other Revenues	332	1,033	-67.9	324	2.3
Expenses	**5,389**	**6,008**	**-10.3**	**5,108**	**5.5**
- Content and Programming	3,422	4,152	-17.6	3,224	6.1
- SG&A Expenses	1,236	1,169	5.7	1,197	3.2
- Employee Expenses	731	687	6.5	688	6.3
EBITDA	**2,160**	**2,241**	**-3.6**	**2,076**	**4.0**
Margin (%)	28.6	27.2	1.4ppt	28.9	-0.3ppt
Depreciation and Amortization	74	78	-4.6	78	-5.1
EBIT	**2,085**	**2,164**	**-3.6**	**1,997**	**4.4**
Interest Expenses	182.2	23.7	668.8	56	227.1
Other Income	340	232	46.3	279	21.7
PBT	**2,243**	**2,372**	**-5.4**	**2,221**	**1.0**
Prior Period Items	-55.2	0	NM	0	NM
Provision for Taxes	811.7	817.6	-0.7	621	30.7
Effective Tax Rate	36.2	34.5	1.7ppt	28.0	8.2ppt
PAT before Minority Interest	1,376	1,555	-11.5	1,600	-14.0
Minority Interest	-17.2	-45.4	NM	40	NM
Profit After Tax	**1,393**	**1,600**	**-12.9**	**1,560**	**-10.7**

Source: Company

- Zee Entertainment reported the following financials for 3QFY12: Revenues Rs 7.5Bn, EBITDA Rs 2.16Bn, and PAT Rs 1.4 Bn. Advertising revenues declined 10% y/y, while subscription revenues rose 15.7% y/y; EBITDA surprised positively on account of lower losses from sports (Losses of Rs 100mn in 3QFY12 versus losses of Rs 1030mn last year). Reported PAT declined 12.9% y/y. We note that the effective tax rate has been higher for the quarter, on account of deferred tax and forex gains.
- The key positive surprise in the quarter has been the strength in domestic subscription revenues, which registered a growth of 12.7% q/q, and reduced losses from sports (as there were no major events in the quarter). The key negatives are: 1/ weakness in advertising revenues of the company, which have declined 10% y/y, and 2/ soft growth in international revenues of the company, which have grown 2.7% y/y despite significant depreciation in the rupee.
- On the conference call, the management noted that: 1/ several contracts came in for renewal in the current quarter, which have led to a rise in domestic subscription revenues. While q/q growth of this magnitude is not sustainable, the subscription revenues themselves are, 2/ advertising revenues have been on account of both a declining yield and declining volumes.

Outlook

- We change our estimates for the company, to account for higher subscription revenues, and lower advertising revenues. We improve our margin expectations on lower than expected losses in sports. Net impact of our changes is a -6%/-7% change in revenues and a 2%/-1% change in our PAT EPS estimates. The changes to our estimates are summarised as under:

Estimates Revision (Rs mn)

Year end Mar	Revised Estimates		Prior Estimates		Change (%)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Revenues	29,382	32,153	29,981	33,338	-6	-7
EBITDA	7,670	8,046	7,489	8,389	4	-3
Margin (%)	26.1	25.0	25.0	25.2		
PAT	5,902	5,963	5,917	6,174	2	-1
EPS (Rs)	6.0	6.1	6.0	6.3	2	-1

Source: Kotak Securities - Private Client Research

- Our investment view on Zee Entertainment (SELL) is based on the following: 1/ We think Zee Entertainment's subscription revenues (41% of total revenues) are likely to stagnate over the long-term, except for DTH segment. The company has about 60% share in all international subscription revenues, while it is the #4 Hindi GEC in the Indian market; the company's analogue revenues, although not provided separately by the company anymore, are, we believe in the region of Rs 4Bn - 16% of the total subscription revenues obtained by Indian broadcasters in the analogue stream (as per our estimates). These market shares seem optimised, given viewership of Zee Entertainment channels. 2/ Advertising revenues are related with viewership shares, and are likely to show a down-trend in line with viewership. 3/ Therefore, we expect long-term industry-underperformance in subscription revenues, and a short/ medium term trend of reduction in advertising revenues; which means that Zee Entertainment will underperform Indian broadcasting industry growth rates overall. 4/ This will cause stagnation in earnings of the company. Accordingly, we expect a period of long-term de-rating of the stock, which will come to a stop if the company is able to shore up strong viewership, thus placing a halt on advertising revenue slide.

- Zee Entertainment has thus far played to our expectations - relative position of the company has shown weakening trends in Hindi for the larger part of the last year(GEC, movies), and the company's Marathi channel. Advertising revenues of the company have declined 10% - the company says the same is on account of sports, while advertising revenues from entertainment channels have remained roughly flat. Susbscription revenues have likely received benefits from Mediapro JV. International revenues growth has been weak (y/y), considering the decline in the rupee.
- While ratings of the Hindi GEC of the company has improve in recent weeks (~180 GRPs, up from ~140 at bottom), we note that competition has intensified significantly in the Hindi GEC space over the past year. Not only are there 4 contenders for top channels with Zee at #4, there is significant action in the so-called 'second-rung GEC' space. SAB has proved itself stable at over 100 GRPs, and Life OK (the relaunched Star One) has begun to register 100 plus GRPs. There has perhaps never been so much competition in the Hindi GEC space. Moreover, unlike 2008 which saw a launch of Hindi GECs such as Colors, 9X, and NDTV Imagine, the competition is fairly well-funded/ profitable now.

We recommend SELL on Zee Entertainment with a price target of Rs.97

- We continue to believe that Zee Entertainment is weakly positioned, and there is potential for either a/ a rise in expenses disproportionate to revenue growth, thereby leading to earning downgrades, or b/ a contraction in multiples on account of weak earnings growth, or c/ both, in so far as we take competitive position as a given. We maintain **SELL**, with a price target of Rs 97 (unchanged).

RESULT UPDATE

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CAIRN INDIA LTD. (CIL)

PRICE: RS.351 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.365 **FY13E P/E: 6.6X**

- **Cairn has reported better than expected results mainly on account of 1). Forex gain due to depreciation of rupee against the dollar (Rs.3015 Mn), 2). Lower opex, and 3). Higher other income.**
- **In Q3FY12E, the PAT has increased by 12.53% YoY and 196.4% QoQ (partly due to base effect) to Rs.22.62 Bn.**
- **Management maintains its guidance of exiting Mangala and Bhagyam field with 175 Kbopd by end of FY12, subject to approval. Further highlighted, production rate of 240 kbopd to be met from MBA field in CY2013, subject to approval.**
- **The Company is working on dividend policy which is expected to be released in next two quarters.**
- **Mangala field is continuing production at peak rate of 125 kbopd. Further, production from Saraswati oil field, which commenced in May'11, is ~250 bopd.**
- **CIL has sold ~87.3 kbopd crude oil (Net working Interest) in Q3FY12 from Rajasthan field.**

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	102,779	132,987	172,168
Growth (%)	533	29	29
EBITDA	84,117	109,320	118,266
EBITDA Margin (%)	81.8	82.2	68.7
PBT	68,900	98,568	108,876
Net Profit	63,283	94,668	101,255
EPS (Rs.)	33.3	49.7	53.2
Growth (%)	509.2	49.5	7.0
CEPS	40.4	57.2	61.1
BV (Rs/Share)	211	260	307
DPS (Rs.)	0.00	0.00	5.32
ROE (%)	17.1	21.1	18.3
ROCE (%)	18.9	23.6	23.4
Net Debt/ (Cash)	(18,065)	(115,585)	(225,684)
NW Capital (Days)	27	77	58
EV/Sales (x)	6	5	4
EV/EBITDA (X)	7.93	6.10	5.64
P/E (X)	10.6	7.1	6.6
P/CEPS (X)	8.7	6.1	5.8
P/BV (X)	1.66	1.35	1.14

Source: Company, Kotak Securities - Private Client Research

- In Q3FY12, Cairn India shared Rs. 5727 Mn as profit petroleum with the GOI in RJ-ON-90/1 block at the rate of 20% as per the PSC. Further, royalty (net) paid to GOI is Rs.6,285 Mn.
- As on 31st Dec'11, Gross cumulative Rajasthan development capital expenditure is at US$ 3,323 Mn, of which US$ 100 Mn (including $49 Mn on Bhagyam field) was spent during Q3FY12. Management has stated that further investments are planned to augment processing capacity and pipeline infrastructure.
- Bhagyam field commences production: In Jan'12, Cairn has commenced production from the Bhagyam oilfield in Rajasthan post approval granted by GOI. The Company expects to ramp-up the crude oil production from Bhagyam field to approved plateau rate of 40 Kbopd. The approval was pending since 4Q 2011. Post this approval, CIL has approval to ramp-up the production from Rajasthan field to 165 Kbopd from current 125 Kbopd. Management has guided that it will exit FY12 with a production rate of 175 Kbopd.
- According to the Company's management Mangala field, the biggest of the 18 discoveries in Rajasthan block, can produce 150 kbopd as against current output of 125 Kbopd (20% higher). Bhagyam, the second biggest field in the Rajasthan block, can produce 60 Kbopd as opposed to current approved peak output of 40 Kbopd (50%), while Aishwariya can contribute 25 Kbopd as compared to earlier 10 Kbopd (150%) and other fields can produce 65 Kbopd, subject to required approvals.
- We believe the key triggers for Cairn India in the immediate near future are 1). Higher crude oil prices on account of geo-political concerns, 2). Rupee depreciation against dollar due to large current account deficit, etc and 3). Production ramp-up approval by GOI.
- Cash (Net debt) as on 31st Dec'11 was Rs.64.6 Bn (Rs.33.9/Share)
- We expect FY12E EPS of Rs.49.7 and FY13E EPS of Rs.53.2
- Stock is fairly valued at 5.64x EV/EBIDTA and 6.6x P/E based on FY13E earnings estimates.
- We believe the fair value of the stock is Rs. 365/Share (earlier Rs.355/share). We maintain Accumulate rating on Cairn India Ltd as we believe post change in management control the process of approvals and production ramp-up should speed up.

Cairn India Ltd. (Consolidated)

(Rs mn)	Q3FY12 Dec 11	Q3FY11 Dec 10A	YoY (%)	QoQ (%)
Net Sales/Income from ops	**30,968**	**30,964**	**0.0**	**16.8**
Incr/(Decr) in stock	114	(49)	(331.6)	207.8
VoP	**31,082**	**30,915**	**0.5**	**17.0**
Total Expenditure	7,389	5,497	34.4	25.1
EBIDTA	**23,692**	**25,418**	**(6.8)**	**14.7**
Depreciation	3,787	2,871	32	20.5
EBIT	**19,905**	**22,548**	**(12)**	**13.7**
Other income	4,138	342	1111	(30.2)
Interest-net	240	742	(68)	(80.5)
PBT	**23,803**	**22,147**	**7**	**7.2**
Tax	1,184	2,046	(42)	15.1
Current Tax	3,979	4,600	(14)	310.9
MAT	(2,734)	(3,442)	(21)	(1227.3)
Deferred tax	(61)	888	(107)	(66.3)
PAT	**22,619**	**20,101**	**12.53**	**196.4**
Operational Cash flow	21,353	20,391	4.7	8.5
EPS (Rs)	**11.89**	**10.59**	**1.3**	**7.9**
Margins (%)				
EBITDA Margin	76.51	82.09	(5.6)	(1.4)
EBIT Margin	64.28	72.82	(8.5)	(1.7)
Adj PAT Margin	73.04	64.92	8.1	44.3
Other Income/PBT	17.38	1.54	15.8	(9.3)
Tax/PBT (%)	4.97	9.24	(4.3)	0.3
Operating expenses (Incl Royalty+ Cess)	4,653	4,576	2	(1.18)
staff costs+FBT	273	315	(13)	16.2
Exploration cost	1,763	216	717	353.5
Other Admistration exp.	701	390	80	22
Total	**7,389**	**5,497**	**34**	**25**
Operating to Sales (%)	15.0	14.8	0.25	(2.73)
Staff to Sales (%)	0.9	1.0	(0.14)	(0.00)
Exploration to Sales (%)	5.7	0.7	5.00	4.23
Other Adm to Sales (%)	2.3	1.3	100.41	0.09

Source: Company; Note: Other income include Forex gains

Q3FY12 net profit below our estimates:

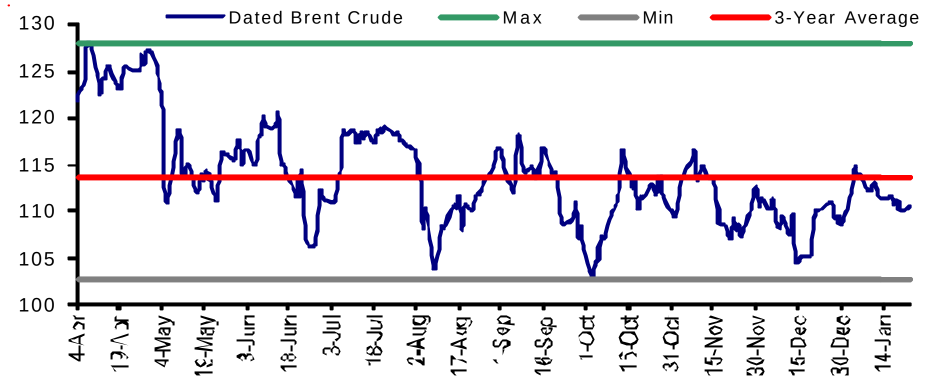
- Cairn India's revenues for Q3FY12 has increased by 16.8% QoQ (due to base effect) but was flat on YoY to Rs.30.96 Bn while PAT has increased by 12.53% YoY and 196.4% QoQ (due to base effect) to Rs.22.69 Bn resulting in an EPS of Rs. 11.89 for Q3FY12.
- In Q3FY12, production volume was lower both on sequential and YoY basis. In Q3FY12, net working interest production was 98.96 Kboed down by 1.3% YoY and 0.3% QoQ basis. The average daily sales from Rajasthan were 87.287 Kbopd (net working interest).
- CIL's average sales realization was $98.4/boe in Q3FY12 as against $100.3/bbls in Q2FY12. Further, average crude oil realization was $101.1/bbls in Q3FY12 as against $102.8/bbls in Q2FY12. This has also resulted in lower than our expected top line. However, partly it got mitigated by rupee depreciation. The average exchange realization for Q3FY12 was Rs.50.73/$ as against Rs.45.6/$ in Q2FY11 and Rs.44.84/$ in Q3FY11.
- In Q3FY12, the employee cost has increased by 16.2% QoQ but was lower by 13% YoY to Rs.273 Mn. This includes stock option charge of Rs.116.8 Mn for Q3FY12.

- In Q3FY12, exploration cost has increased significantly by 353% QoQ to Rs.1763 Mn on account of the plugged and abandoned well in Sri Lanka. Other administration expenses has also increased by 22% QoQ and by 80% YoY to Rs.701 Mn.
- CIL has net forex gain of Rs.3.015 Bn due to depreciation of rupee against the US$.
- Cash flow from operations (CFO) had increased by 4.7% YoY and 8.5% QoQ to Rs.21.35 Bn in Q3FY12. CFO is PAT (excluding other income and exceptional item) prior to non-cash expenses and exploration cost.
- Depreciation cost has increased by 32%YoY and 20.5% QoQ to Rs.3.78 Bn
- In Q3FY12, Interest expenses has reduced by 80.5% QoQ to Rs.240 Mn mainly due to repayment of Rs.1000 Mn of NCD in Q3FY12.
- As on 31st Dec'11, Gross cumulative Rajasthan development capital expenditure is at US$ 3,323 Mn, of which US$ 100 Mn (including $49 Mn on Bhagyam field) was spent during Q3FY12. Management has stated that further investments are planned to augment processing capacity and pipeline infrastructure.

Key risk remains -

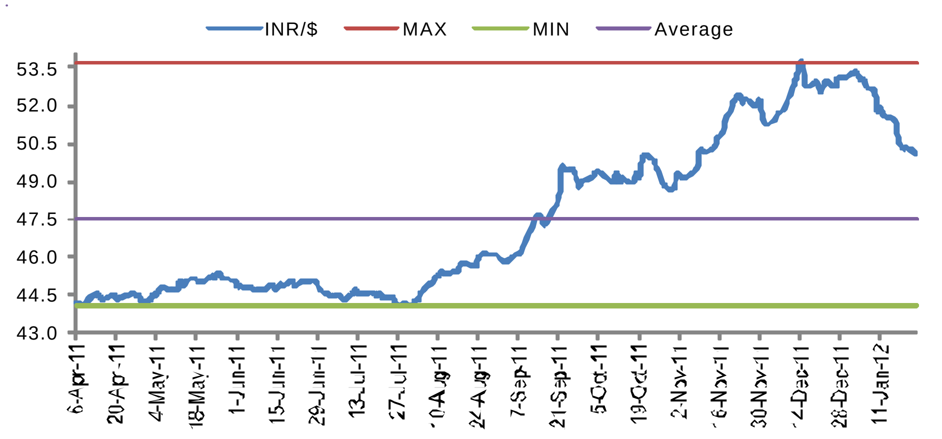
- Any significant fall in the crude oil prices will impact the realization.
- Exchange fluctuation risk
- Delay in getting government approval for increasing the production from the Rajasthan block can impact over valuations.

Brent crude price movement



Source: Bloomberg

Rupee - dollar exchange rates



Source: Bloomberg

RESULT UPDATE

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INDRAPRASTHA GAS (IGL)

PRICE: RS.335 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.380 **FY13E P/E: 12.8x**

- **IGL has posted lower than expected results mainly on account of 1). Higher raw material cost, 2) increased other manufacturing expenses and 3). Higher interest cost burden.**
- **In Q3FY12, IGL's net revenue has increased by 10.8% QoQ and up by 45.5% YoY to Rs. 6615 Mn mainly on account of higher volume growth and marginal increase in realization. However, its bottom line was lower by 10.5% QoQ but up by 3.3% YoY to Rs. 691 Mn.**
- **IGL's raw material cost has increased due to 1). Rupee depreciation and 2). Lower supply of cheap domestic gas from KG-D6. In order to pass-on the same, the Company has hiked the CNG prices by Rs.1.75/kg to Rs.33.75/ Kg in Delhi and by Rs.2/kg to Rs.37.9/kg in Noida, Greater Noida and Ghaziabad on 31st Dec'11.**
- **Further, OMCs has not increased retail fuel prices in spite of higher crude oil price and weak rupee due to higher inflation and state elections. We believe post state elections OMCs will increase retail fuel price which will give further levy to IGL to hike price of CNG and PNG, if required.**
- **IGL sources gas from APM, long term R-LNG and spot R-LNG. The gas is priced in dollar terms and the dollar has appreciated by 8.35% vis-à-vis rupee in Q3FY12, resulting in higher raw material cost.**
- **However, in Q4FY12, the rupee has appreciated by 6% (till date) which will result in lower raw material cost for IGL. The full benefit of the same will be reflected in Q4FY12. Further, we expect due to seasonality factor and lower global GDP growth the price of spot LNG should also come down in Q4FY12.**
- In Q4FY12, IGL is not planning to revise PNG prices as the Company is strongly focusing on volume growth in this segment. Also, currently majority of the volumes are coming from CNG segment.
- The Company is trying to enter into long term LNG supply agreement in order to reduce its dependence on costlier spot cargoes. In this regard, IGL is in talks with its promoters GAIL & BPCL and others.
- IGL's revenues are expected to grow with the increase in realization and huge demand of natural gas both in CNG and PNG segment.
- As mandated by Delhi government, LCVs will be converted into CNG which will boost the CNG sales.
- In FY12E, IGL will be investing ~Rs.6 Bn in Delhi and NCR to expand its network and in FY13E Rs.5 Bn.
- Management has guided that additional 50 stations will be operational by March'12 once approval is granted.
- The management has guided that in addition to catering to the demand of households, the thrust would be on tapping industrial and commercial customers who have huge demand potential. Also, private vehicles will continue to be a growth driver for CNG sales in the coming years.
- We expect FY12E EPS of Rs. 21.3 and FY13EPS of Rs. 26.1. The management believes that the strong trends in CNG and PNG segment will continue and IGL is best placed to benefit from rising gas consumption in India.
- Key risk remains in terms of 1). Gas supply, 2). Further rise in gas prices both domestic and LNG, 3). Cost and time run in project execution and 4). Any major regulation by PNGRB on marketing margin. However, we expect IGL to pass on increasing input cost in a phased manner to its customers.

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	19,515	27,806	35,857
Growth (%)	60.9	42.5	29.0
EBIDTA	4,965	6,239	7,478
EBIDTA margin (%)	25.4	22.4	20.9
PBT	3,857	4,381	5,435
Net profit	2598	2979	3656
EPS (Rs)	18.4	21.3	26.1
Growth (%)	20.3	15.6	22.7
CEPS (Rs)	25.8	31.3	37.2
BV/Share (Rs.)	71.7	87.4	108.3
DPS (Rs)	5.0	4.8	4.4
ROE (%)	27.0	25.8	26.0
ROCE (%)	21.9	19.7	19.0
Net Debt	4,460	7,390	8,673
NW Capital (days)	-19.4	-22.5	-24.0
EV/Sales (x)	2.7	1.9	1.4
EV/EBIDTA (x)	10.4	8.3	6.9
P/E (x)	18.2	15.7	12.8
P/BV (x)	4.7	3.8	3.1
P/CEPS (X)	13.0	10.7	9.0

Source: Company, Kotak Securities - Private Client Research

- Based on our estimates, the stock at current market price of Rs.335 is trading at 6.9x EV/EBIDTA and 12.8x P/E on FY13E earnings.
- Based on our DCF valuation model, the fair value of IGL is Rs. 380 (earlier Rs. 450). This reflects the concern of cap on the marketing margins.
- Also, looking at the growth potential in the City gas distribution, rich experience, huge demand of natural gas and strong promoter background of IGL, we are bullish on the growth prospects of IGL. However, looking at the limted upside and the recent outperformance, we recommend Accumulate.

Result Table

(Rs mn)	Unit	Q3FY12	Q3FY11	YoY (%)	QoQ (%)
Net Sales	**Rs. Mn**	**6615.4**	**4546**	**45.5**	**10.8**
Net Sales	Rs/Scm	21.1	18.1	16.2	7.4
Add: Closing Stock	Rs. Mn	3.07	-0.87	-452.3	4.5
Raw Material					
Less: Raw Material	Rs. Mn	4233	2599	62.9	18.11
Purchase Rate	Rs./Scm	13.49	10.37	30.0	14.46
Purchase Rate	Rs./Kg	10.30	7.92	30.0	14.46
Qty Purchased	MSCM	314	251	25.2	3.19
Gross Margin	Rs. Mn	2386	1947	22.5	-0.10
Gross Margin	Rs./Scm	7.60	7.8	-2.2	-3.19
Gross Margin	%	36.1	42.8	-6.8	-3.9
Less: Opex	Rs. Mn	897	680	31.9	10.2
Salaries,Wages & Bonus	Rs. Mn	107	99	7.9	6.8
Salaries,Wages & Bonus	Rs./Scm	0.34	0.40	-13.9	3.5
Other Mfg Exp Excl Excise	Rs. Mn	791	581	36.0	10.6
Other Mfg Expenses	Rs./Scm	2.5	2.3	8.6	7.2
EBIDTA	**Rs. Mn**	**1488**	**1267**	**17.5**	**(5.4)**
EBIDTA per unit of sales	Rs./Scm	4.74	5.05	-6.2	-8.3
EBIDTA Margin	%	22.5	27.9	-5.4	-3.9
Add: Other Income	Rs. Mn	30.7	31	0.4	46.7
Less: Depreciation	Rs. Mn	368	262	40.7	6.8
Less: Depreciation	Rs./Scm	1.2	1.0	12.3	3.5
EBIT	**Rs. Mn**	**1151**	**1036**	**11.2**	**-7.9**
EBIT	Rs./Scm	3.7	4.1		
Less: Interest	Rs. Mn	135	41	228.7	15.1
Less: Interest	Rs./Scm	0.43	0.16		
PBT	**Rs. Mn**	**1016**	**994**	**2.2**	**-10.3**
EBT	Rs./Scm	3.2	4.0		
Less: Tax	Rs. Mn	324	325	-0.1	-10.0
Tax	Rs./Scm	1.0	1.3		
PAT	**Rs. Mn**	**691**	**670**	**3.3**	**-10.5**
PAT	Rs./Scm	2.20	2.7		
PAT	%	10.5	14.7	-4.3	-2.5
EPS	**Rs/Share**	**4.9**	**4.8**	**3.3**	**-10.5**
PAT	Rs/SCM	2.20	2.67	-17.5	-13.2
Equity	Rs. Mn	1400	1400		
Expenses Ratio					
RW/Net Sales (Excise)	%	64.0	57.2	6.8	3.9
Staff Cost	%	1.6	2.2	-0.6	-0.1
Other Mfg Exp Excl Excise	%	12.0	12.8	-0.8	0.0
Cash EPS	Rs/Share	7.6	6.7	13.8	-0.4
Other Income/Net Sales (%)	3.0	3.1	-0.1	1.2	
Tax rate (%)		31.9	32.7	-0.7	0.1

Source: Company data, Kotak Securities - Private Client Research

Segment-wise break-up

(Rs mn)	Unit	Q3FY12	Q3FY11	YoY (%)	QoQ (%)
A). CNG-Gross Sales	Rs. Mn	5700	4252	34.1	8.7
CNG Gross Sales	Rs/SCM	23.48	20.51	14.5	5.7
CNG Gross Sales	Rs/Kg	31.70	27.47	15.4	7.3
CNG- Net Sales	Rs. Mn	5700	4252	34.1	8.7
CNG- Net Sales	Rs/Scm	23.5	20.5		
Less: Excise Duty	Rs. Mn	721	541	33.3	8.7
Excise Duty	Rs/SCM	3.0	2.6		
Excise Duty	Rs/Kg	4.0	3.5		
Excise Duty/Net Sales (%)	%	12.64	12.71	-0.1	0.0
Sales Volume	MSCM	243	207	17.1	2.9
Sales Volume	Mn Kg	180	155	16.1	1.4
CNG-Net Sales - Excise	Rs. Mn	4979	3711	0.3	8.7
CNG-Net Sales - Excise	Rs/SCM	20.5	17.9		
CNG-Net Sales - Excise	Rs/Kg	27.7	24.0		
B). PNG-Sales	Rs. Mn	1636	835	95.9	17.8
Sales realisation	Rs./Scm	23.01	19	19.3	13.0
Sales Volume	MSCM	71	43	64.2	4.3
Total Sales Volume	MSCM	313.83	251	25.2	3.2

Source: Company data and Kotak Securities - Private Client Research

Result Analysis

- Net revenue for Q3FY12 was at Rs.6.6 Bn up by 45.5% YoY and up by 10.8% on sequential basis. Higher sales were a result of both increases in volume and price revision undertaken by IGL.
- During Q3FY12, IGL sold 180 mn kg of CNG thereby registering a growth of 16.1% YoY and 1.4% sequential. IGL sold 71 mn SCM of PNG in Q3FY12 showing strong 64.2% YoY and 4.3% sequential growth.
- Segment wise revenue analysis: IGL has registered revenue of Rs.5.7 Bn in CNG business a 34.1% YoY and 8.7% sequential growth. However, PNG segment has registered revenue of Rs.1.63 Bn resulting in a 95.9% YoY and 17.8% QoQ growth.
- Blended gross realization is higher by 16.2% YoY and 7.4% QoQ to Rs.21.1/Scm (net of excise). On QoQ basis, the realization improved mainly due to 13% realization growth in PNG segment. In Sep'11, IGL has hiked the price of PNG in Delhi, Noida, Greater Noida and Ghaziabad. The PNG rates in Delhi have increased by Rs.3.05/SCM and Rs.8/SCM to Rs.22/SCM for consumption up to 30 SCM per two months and to Rs.34/SCM for consumption above 30 units in two months resulting in over 16% and 30% hike respectively. Similarly, the price in Noida, Greater Noida and Ghaziabad also increased to Rs.23.5/SCM for consumption up to 30 SCM in two months and Rs.34/ SCM beyond consumption of 30 SCM in two months. The prices are higher in Uttar Pradesh due to differential tax structure. As the price hike took in the last month of Q2FY12 the full benefit is reflected in this quarter.
- In Q3FY12, the EBIDTA margin stood at 22.5%, which is down by 5.4% on YoY basis and down by 3.9% on QoQ basis. Margins have fallen mainly due to higher raw material cost.

- The raw material cost has increased by 18.1% QoQ and up by 62.9% on YoY basis to Rs. 4.23 Bn. The raw material cost as a percentage of revenue is up by 680 bps YoY basis and up by 400 bps on QoQ basis. In order to meet the rising demand of natural gas, IGL not only source Administered Price Mechanism (APM) gas but also source higher priced long-term liquid natural gas as well as spot gas. Higher proportion of RLNG and rupee depreciation has led to significant increase in raw material cost. We would like to highlight here that the gas supplied by RIL and ONGC is fixed by government in US dollar terms. Hence any rupee depreciation increases the cost for IGL.
- PNG segment has witnessed higher growth in volumes as compare to CNG segment.
- The staff cost (as a percentage of sales) has fallen both on QoQ and YoY basis.
- In absolute terms, EBIDTA was at Rs.1.488 Bn up by 17.5% YoY basis but down by 5.4% QoQ. Another important factor to monitor is EBIDTA per unit of sales. The same has decreased by 8.3% QoQ and 6.2% YoY to Rs. 4.74/SCM.
- Other income of the company has increased by 46.7% on QoQ basis to Rs.30.7 Mn as against 0.4% YoY basis due to use of funds for expansion purpose.
- The depreciation cost has gone up by 40.7% on YoY basis and 6.8% QoQ basis to Rs.368 Mn as the company has expanded the number of stations in & around Delhi and capitalized pipelines.
- In Q3FY12, the Company paid an interest of Rs.135 Mn which is higher by 228.7% YoY and 15.1% QoQ basis. The debt in the books has increased. Hence, higher debt and higher interest rate has resulted in higher interest outgo.
- PBT for Q3FY12 was at Rs.1.02 Bn up 2.2% YoY and down 10.3% on a sequential basis.
- Bottom line for Q3FY12 was at Rs.691 Mn up 3.3% YoY but down by 10.5% on sequential basis thereby translating into Q3FY12 EPS of Rs.4.9 and CEPS of Rs.7.6.
- In Q3FY12, the PAT margin stood at 10.5%, which is down by 250 bps on QoQ basis and by 430 bps on YoY.

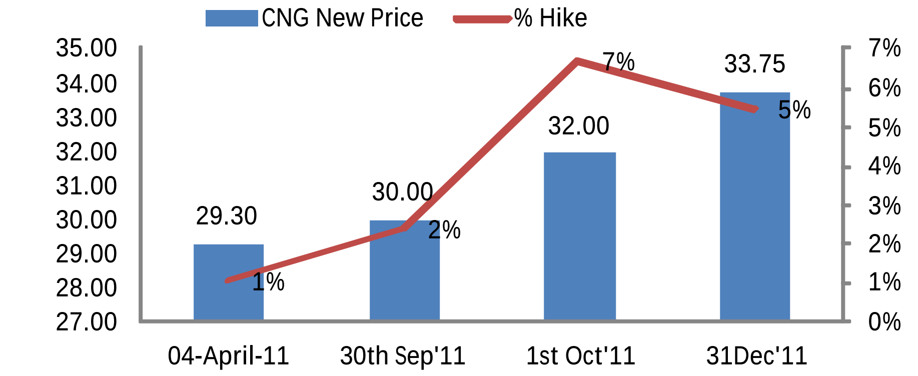
Recent Developments

Strong pricing power: CNG price hike - Reflecting strong pricing power

On 31st Dec'11, IGL has increased CNG prices by Rs.1.75/kg to Rs.33.75/kg and by Rs. 2/kg to 37.9/Kg in Noida, Greater Noida and Ghaziabad. However, the befit of the same will be reflected in Q4FY12. The hike in price is more than Delhi due to different tax rates. Management said the hike was mainly on account of rupee depreciation and import of costlier RLNG. IGL and Mahanagar Gas Ltd in Mumbai have bought liquefied natural gas (LNG) at ~USD 17 per mmBtu, to meet the shortfall.

The natural gas purchased is quoted in dollar terms hence IGL's raw material prices increased due to depreciation of the rupee against dollar.

CNG price hike



Source: Kotak Securities - Private Client Research

Domestic natural gas supply cut impact

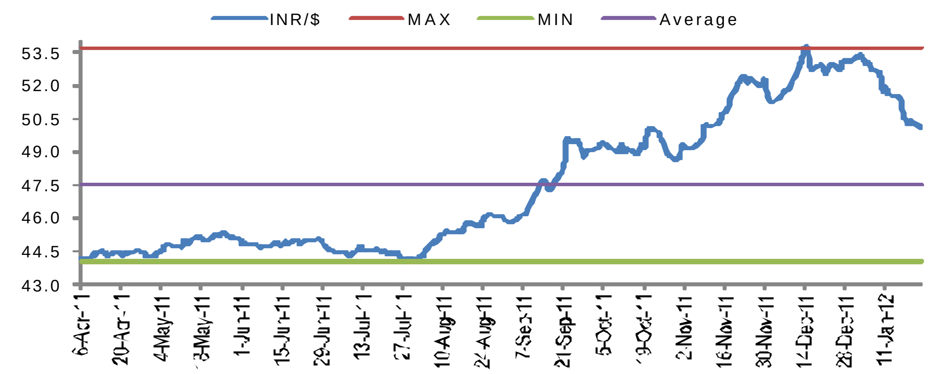
IGL was earlier sourcing ~0.308 MMSCMD of gas from KG-D6 but with the drop in the gas production in the KG-D6 block the supply to IGL was completely stopped. Later IGL resorted to source costly spot LNG to meet the ever-increasing demand, which has contributed to the higher cost of sourcing the gas.

IGL also source ~2.7 mmscmd of gas from domestic fields of ONGC at APM prices (regulated), and buys another 0.6 mmscmd of LNG at the international market price.

Rupee appreciation will lower raw material cost

In Q4FY12, the rupee has appreciated by 6% (till date) which has resulted in lower raw material cost for IGL as all its gas purchased are denominated in dollar terms. The full benefit of the same will be reflected in Q4FY12. Further, we expect due to seasonality factor and lower global GDP growth the price of spot LNG should also come down in Q4FY12.

Chart of INR against dollar



Source: Bloomberg

Earnings estimates

We expect IGL to book CNG gas volume of ~701 Mn Kgs and PNG 277 MSCMPA of natural gas in FY12E. We expect IGL to report EPS of Rs.21.3 and CEPS of Rs.31.3 in FY12E and EPS of Rs.26.1 and cash EPS of Rs.37.2 in FY13E. We have assumed a capex of Rs.6 Bn in FY12E and Rs.5 Bn in FY13E. Out of this around 50% will be invested in CNG and balance in PNG.

Valuation & Recommendation

We recommend ACCUMULATE on Indraprastha Gas with a price target of Rs.380

Based on our DCF valuation model, the fair value of IGL is Rs. 380 and we recommend **ACCUMULATE** on IGL. Also, looking at the growth potential in the City gas distribution, rich experience, huge demand of natural gas and strong promoter background of IGL, we are bullish on the growth prospects of IGL.

MANAGEMENT MEET UPDATE

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MERCATOR LTD

PRICE: RS.23 **RECOMMENDATION: BUY**
TARGET PRICE: RS.40 **FY13E P/E: 7.2x**

We recently interacted with the management of Mercator to get an update on the latest developments in the business areas of Mercator Limited. The stock has fallen 53% in the last one year despite efforts of the company to diversify the business of the company as a hedge against the poor performing shipping segment. Company currently has diversified into mining and has 3 mines in Indonesia with an estimated reserve of 75 mn tonnes. It also has a Floating and Production Unit (FPU) and two oil blocks in Cambay basin in Gujarat in the offshore sector. We believe the coal and the offshore segment would drive the top line and profitability over FY11 to FY13E with contribution of coal (mining and trading) increasing from 47% in FY11 to 62% in FY13E. IPO of Oorja Holding (mining business) is also expected in H2FY13E which would be value accretive. Shipping segment would continue to go through a bad phase atleast for the next 3 to 4 quarters. We believe the fall in stock price and IPO of Oorja holding offers an attractive opportunity for investors to participate in the story which also has the backing of the value of shipping assets.

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	28,259	34,230	40,333
Growth (%)	56.2	21.1	17.8
EBITDA	6,386	5,313	5,144
EBITDA margin (%)	22.5	17.4	14.8
PBT	965	822	971
Net profit	440	664	784
EPS (Rs)	1.8	2.7	3.2
Growth (%)	(17.3)	50.9	18.1
CEPS (Rs)	14.2	15.5	16.3
BV (Rs/share)	94.6	96.7	99.4
Dividend / share (Rs)	1.0	2.1	2.1
ROE (%)	1.9	2.8	3.3
ROCE (%)	5.3	3.8	3.4
Net cash (debt)	(25,354)	(23,702)	(21,511)
NW Capital (Days)	(51.1)	(23.7)	(27.1)
EV/EBITDA (x)	4.8	5.5	5.3
P/E (x)	12.8	8.5	7.2
P/Cash Earnings	1.6	1.5	1.4
P/BV (x)	0.2	0.2	0.2

Source: Company, Kotak Securities - Private Client Research

Coal business to play a significant role - Oorja Holding Pvt Limited (OHPL)

Mercator's coal business (mining and trading) is under its 100 % subsidiary OHPL. This company acquired coal mines in Indonesia and Mozambique in 2007. In Indonesia, OHPL owns 100% in two mines in Petangis (proven reserve of 15 mn tonnes) and 50% in mines in Kalimantan (proven reserve of 60 mn tonnes). Coal business picked up significantly in FY11. The coal mining and trading business generated revenue of Rs 13.4 bn and EBIT ~ Rs 1 bn in FY11 contributing ~47% of the revenues.

Mines owned by Mercator

	No of Mines	Proven Reserves	Ownership	Production per month	Status
Petangis Mines	Two	15 mn tonnes	100%	80,000 tonnes	Operational
Batuah Kalimantan Mines	One	60 mn tonnes	50%	2 lakh tonnes by FY13	Mar-12

Source: Company

Quarterly performance of coal segment for Mercator Coal Mining and Coal trading

(Rs mn)	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Sales	1237	2291	2747	4043	4283	4687	4282
QOQ growth	-17.1	85.2	19.9	47.2	5.9	9.4	-9
YoY growth		439.1	343.8	170.8	246.2	104.6	56
Operating Expd	1222	2139	2552	3698	3941	4246	3932
Operating profit	**15**	**152**	**195**	**345**	**342**	**441**	**350**
Margins (%)	1.21	6.63	7.10	8.53	7.98	9.41	8.17

Source: Company

Estimation of performance of coal segment

	FY09	FY10	FY11	FY12E	FY13E	FY14E
Mined	300,000	700,000	850,000	1,014,000	1,915,200	2,284,800
Procured for trading	0	1,000,000	4,900,000	6,125,000	7,656,250	9,570,313
Total traded tonnes	**300,000**	**1,700,000**	**5,750,000**	**7,139,000**	**9,571,450**	**11,855,113**
Revenues (Rs Mn)						
Mining revenues			2052	2689	5079	6059
Trading revenues			11829	16244	20304	25380
Total	**770**	**4383**	**13881**	**18933**	**25383**	**31440**

Source: Company; Kotak Securities - Private Client Research

Coal mining and trading business is a fast growing and a low Ebidta margin business for the company.

Indicative cost structure per tonne for Mercator Limited ($/tonne)

Gross calorific value	5300
Market price ($/tonne)	**50**
Excavation	15
Road/Rail	3
Loading Jetty	5
Barges	10
Unloading	5
Road/Rail	3
Royalty	4
Total cost	**45**

Source: Company

New coal pricing policy in Indonesia has not impacted the company.

New Indonesian policy which aligns the selling price of coal with international markets under the benchmark prices called the HBA Index has not impacted the company. Management indicated that the company is already selling coal at international market prices to traders and power producers and would not be impacted because of this new policy. It also indicated the new policy would not dent the demand for coal as Mercator is primarily involved in sale of coal with a calorific value of 5300 and this coal is one of the most cost effective coal available to Indian customers from Indonesia.

Listing of Oorja Holdings on the anvil - Value accretive, expected in 2HFY13E

Mercator is looking forward to get the 100% mining subsidiary listed (Oorja holding ltd) which would lead to value unlocking for the parent company. We believe the listing of Oorja holding would be at average multiple of global mining cum trading companies and may provide an upside of ~20 % from the current levels. Mercator may get the subsidiary listed in 2HFY13E. We estimate the equity value of Oorja holding at ~ Rs 7 bn which is 4.5 x EV/EBIDTA FY13E. Listing of Oorja Holding (coal business) may provide some momentum to the stock.

Equity issuance of Oorja holding (Rs mn)

Based on		**FY13E**
Total Oorja sales	25,383	25,383
EBIDTA Margin (%)	8.0	8.0
EBIDTA	2,031	2,031
Target EV/EBIDTA	4.0	4.5
Enterprise value	8,123	9,138
Net Debt	1,750	1,750
Equity Value of Oorja	6,373	7,388
Dilution 25% of pre issue capital	1,593	1,847
Impact on consolidated numbers		
Consolidated Equity Value	6,000	6,000
Add: equity raised in subsidiary	1,593	1,847
Less: minority interest	1,500	1,500
Post issue consolidated equity	6,093	6,347
No of equity shares of MLL (mn)	236	236
Price per share for MLL	**25.8**	**26.9**

Source: Kotak Securities - Private Client Research

Offshore business - small part of the business but generates healthy cash flow.

In the offshore segment the company currently operates a Floating Production Unit (FPU) - A FPU is a combination of Mobile Offshore Production Unit (MOPU) and a Floating Storage and Offloading Unit (FSO) which is on long term contract with Afren Plc. - a U.K. based company having its operations in Nigeria. The MOPU has a processing capacity of 50,000 barrels oil per day while the FSO has storage capacity of 1.2 mn barrels oil. The day rate for the FPU is $115,000 per day with an opex of $40,000. Mercator Limited had earlier made a capital commitment of $120 mn for the FPU completely through debt. We estimate the FPU to be generating ~Rs 500 mn of free cash flow for the company per annum.

Another project in the offshore segment involves conversion of a Mobile Offshore Drilling Unit (MODU) into Mobile Offshore Production Unit (MOPU) for ONGC. Mercator and Gulf Piping Company, Abu Dhabi had won the EPC contract In November 2011. The scope of work for this project includes Surveys, Design, Engineering, Procurement, Fabrication, Transportation, Jack up, Hook-up, Testing, Certification/Inspection, Pre-commissioning, Start-up and Commissioning of entire facilities including demolition of existing Drilling equipment for the conversion to Mobile Offshore Production Unit (MOPU).

Assets in oil and gas segment obtained under NELP VII

In December 2008, Mercator signed Production Sharing Contracts with the Government of India for exploration of crude in two blocks under the Seventh New Exploration Licensing Policy round (NELP-VII). Mercator is the operator of these blocks. The "S-Type" blocks are situated onshore in the prolific Cambay Basin of Gujarat. Currently seismic studies are on at the blocks, results for which are expected in the next two quarters. These blocks can be potential assets for the company if oil is discovered on them. We are currently not factoring any value from these blocks in our estimates.

Tough phase for shipping business continues - Supply side pressure continues

In the dry market, the BDI is at 1,000 points level mark with weak expectations for the forthcoming days. Even the tanker market is very soft with oversupply of ships and minimum tonnage available. We are not bullish on the shipping business for the next 3 to 4 quarters primarily due to oversupply of ships in the bulk segment (net supply of 7 to 8%) and even in the tanker segment (net supply of 4%) in CY12E.

Tough phase has made the management prudent - dry bulk market may show signs of recovery post Q3FY13

We have seen that the shipping sector has deteriorated significantly in the last two years and that has impacted the earnings of the shipping companies. We read it as a positive signal for the sector in the medium term, as most companies including Mercator was forced to be disciplined and be prudent given their falling profitability.

One of the positive developments for the dry bulk industry (key area of Mercator Limited) has been the percentage fall in order book. The dry bulk order book as a percentage of the total fleet has come down to ~34% in January 2012 from 51% in December 2010. Along with demand picking up and new build supplies tapering off, we may see the sector bottoming by Q3FY13. **We believe investors should position in advance, as stocks move ahead of industry fundamentals.**

Fall in dry bulk order book

	Jan-12	Dec-10	Jun-10
Dry bulk fleet	575,002	494,938	461,276
Orderbook	196,450	252,214	259,126
Orderbook as % of fleet	34.2	51.0	56.2

Source: Bloomberg

Current shipping fleet of Mercator Limited

Tanker fleet (crude and product)

In the tanker segment company currently owns 4 tankers (total dwt = 0.61 mn Dwt) and 3 Medium Range product carriers (total dwt = 0.13 mn dwt). It has also taken a chemical tanker with a capacity of 20,000 dwt on charter. Management indicated that in the tanker segment the company has more than 70% of the ships on medium to long term time charters.

Bulk carrier fleet

In the bulk segment company owns a fleet 15 bulk carriers (total dwt = 1.34 mn dwt) and has taken 3 Post Panamax (each of 92,000 dwt) on charter. In the bulk segment management indicated that, the company has more than 60% of the fleet on medium to long term time charters.

As shipping markets are currently going through a bad phase, time charters which typically have freight rates above the spot market in a bearish scenario, is helping Mercator Limited generate cash flows which is just enough to cover the operational and capital cost associated with these shipping assets.

Dredging Segment

In the dredging segment, Mercator Limited owns 6 Trailer Suction Hopper Dredgers having capacities ranging from 4,500 m3 to 7,000 m3. All the dredgers are deployed on short term to medium term contracts across various ports in the country for maintenance dredging.

Company not looking to sell any asset

As asset prices, especially the second hand asset prices are highly depressed, Mercator is not looking forward to discard or sell any of their assets at current market prices. The average age of the fleet of Mercator is 10 years.

5 year old asset prices

($ mn)	Current	Sep-11	Jun-11	Dec-10	YoY fall (%)	QoQ fall (%)
Aframax	33.3	38.0	40.0	44.8	34.6	14.3
Suezmax	49.0	57.0	57.0	62.0	26.5	16.3
VLCC	57.0	81.0	81.0	89.5	57.0	42.1
Handy Size	19.0	21.0	25.5	27.0	42.1	10.5
Supramax	25.0	26.5	31.3	32.3	29.0	6.0
Panamax	26.5	29.6	37.8	39.5	49.1	11.7
Capesize	37.0	41.2	54.0	55.5	50.0	11.4

Source: Bloomberg

Estimation of Replacement value of shipping assets as on January 2012

Bulk Carriers	354
Tankers	139
Dredgers	60
Gross NAV ($ mn)	553
Conversion (Rs per $)	50
Gross NAV (Rs mn)	24885
Net debt (shipping business)	15000
Net NAV (Rs mn)	9885
Equity capital	245
NAV per share	**40.3**
Discount (%)	40
Value per share	24.2

Source: Kotak Securities - Private Client Research

Net Asset Value (NAV) has fallen by 15% in the last one quarter

Asset prices (especially second hand) across categories have fallen by more than 15% QoQ as most of the ship owners are resorting to distress sales of shipping assets as they are not able to cover even the operating cost associated with the asset. We estimate a new NAV for Mercator's at 40 per share (earlier Rs 45).

Consolidated Capex - company to invest primarily in mining business

Going forward the company would be primarily concentrating and investing in the mining business. The management indicated that the investment would be ~Rs.2.5 bn per annum over FY12E-FY14E. Such investments would give a fillip to the mining and trading volumes for the company. This would act as a hedge for the company against the cyclical shipping business.

Margins to fall over FY11 to FY13E as contribution of coal in overall revenues increase

Ebidta margin of ~30% (FY11) of Mercator's core business of shipping has been on a decline with falling shipping freight rates. Further we estimate the share of low Ebidta margin (10%) coal business to increase to 63% in FY13E from 47% in FY11. We estimate the above two factors would drag down the Ebidta margin of the company from ~23% in FY11 to ~17% in FY12E and further to ~15% in FY13E.

Debt of the company to recede going forward

Improved profitability, huge depreciation, negative working capital and small capex would help the company generate free cash flow of ~Rs 4 bn over FY11 to FY13E.

Change of name to Mercator Limited

Recently the name of the company has been changed from Mercator Lines Limited to Mercator Limited.

Valuation - We now value Mercator Limited at Rs 40 per share

We recommend BUY on Mercator with a price target of Rs.40

We do SOTP valuation for Mercator Limited. We value the Shipping (including dredging business) at 40% discount to NAV or replacement value which is Rs.24 per share (NAV = Rs.40 per share), the mining business at 3x FY13 EV/EBIDTA (discount to global average) and low margin coal trading at 2x FY13E EV/EBIDTA which is Rs.15 per share and the offshore business at 6.0 x FY13E EV/EBIDTA (20% discount to global average) which is Rs 3 per share. We reiterate BUY with a changed price target of Rs 40 (earlier Rs38). In our latest valuation we have increased the discount from 30% to 40% for the shipping assets to capture any further downside in the asset prices, while the value of the fast growing mining business has increased from Rs 11 per share to Rs 15 per share.

Valuation table

Segment	Parameter	Multiple	Value
Shipping	NAV	40% discount	21.8
Coal Mining	EV/EBIDTA	3 x	15.2
Coal Trading	EV/EBIDTA	2 x	
Offshore	EV/EBIDTA	6 x	3
Fair value			**39.9**

Source: Kotak Securities - Private Client Research

FINANCIALS: MERCATOR LTD

Profit and Loss Statement (Rs mn)

(Year-end March)	FY10	FY11	FY12E	FY13E
Net sales	**18,087**	**28,259**	**34,230**	**40,333**
- Operating expenses	11,638	21,903	28,266	34,364
Bunker Cost	2,013	1,755	3,637	3,637
Employee Cost	502	618	787	807
Vessel hire charges	1,848	2,825	1,324	1,271
Port Charges	473	500	998	998
Mining Expense	3,672	12,330	16,755	22,337
Other Opn expenses	3,130	3,875	4,764	5,313
Operating profit	**6,449**	**6,386**	**5,313**	**5,144**
+ Other income	110	(172)	50	50
- Depreciation	3,409	3,067	3,120	3,207
- Interest	2,058	2,152	2,072	1,841
- Tax	50	135	41	49
PAT	1,042	830	781	923
+ (Associates-Minorities)	(510)	(390)	(117)	(138)
Consolidated PAT	**532**	**440**	**664**	**784**

Source: Kotak Securities - Private Client Research

Cash Flow Statement (Rs mn)

Year-end March)	FY10	FY11	FY12E	FY13E
Consolidated PAT	532	440	664	784
Non-cash items	3,401	3,045	3,128	3,217
Cash profit	3,933	3,485	3,792	4,001
Inc. in WC	(6,791)	(4,183)	721	814
CF from Opns	**(2,858)**	**(698)**	**4,513**	**4,816**
Capex	2,512	(4,649)	(2,625)	(2,625)
Investments	(326)	461	(215)	-
CF from Investments	**2,186**	**(4,188)**	**(2,840)**	**(2,625)**
Dividends	(280)	(69)	(138)	(138)
Equity raised	-	9	-	-
Debt raised	2,803	1,564	(1,313)	(1,272)
Inc. in Minority Int	197	390	117	138
Misc. items	-	-	-	-
CF from financing	**2,720**	**1,894**	**(1,333)**	**(1,272)**
Net cash flow	2,048	(2,992)	340	919
+ Opening cash	8,313	10,361	7,370	7,710
Closing cash balance	**10,361**	**7,370**	**7,710**	**8,628**

Source: Kotak Securities - Private Client Research

Balance sheet (Rs mn)

Year-end March)	FY10	FY11	FY12E	FY13E
Equity Capital	236	245	245	245
Reserves	22,482	22,853	23,379	24,026
DTL	92	70	78	88
Networth	22,810	23,168	23,703	24,359
Debt	31,160	32,724	31,412	30,140
Minority interests	3,150	3,540	3,657	3,796
Capital employed	**57,120**	**59,433**	**58,772**	**58,294**
Fixed Assets	52,058	53,640	53,145	52,563
Investments	746	285	500	500
Working capital	(6,045)	(1,862)	(2,583)	(3,397)
Cash	10,361	7,370	7,710	8,628
Capital deployed	**57,120**	**59,433**	**58,772**	**58,294**

Source: Kotak Securities - Private Client Research

Ratio Analysis

Year-end March)	FY10	FY11	FY12E	FY13E
Topline growth (%)	(18.2)	56.2	21.1	17.8
Bottomline growth (%)	(85.8)	(17.3)	50.9	18.1
Operating margins (%)	35.7	22.5	17.4	14.8
FDEPS (Rs/share)	2.3	1.8	2.7	3.2
CEPS (Rs/share)	16.7	14.2	15.5	16.3
DPS (Rs/share)	1.0	0.2	0.5	0.5
BV (Rs/share)	96.7	94.6	96.7	99.4
PER (x)	10.2	12.8	8.5	7.2
P/C (x)	1.4	1.6	1.5	1.4
Dividend yield (%)	4.3	1.0	2.1	2.1
P/B (x)	0.2	0.2	0.2	0.2
EV/Sales (x)	1.5	1.1	0.9	0.7
EV/ EBITDA (x)	4.1	4.8	5.5	5.3
Debt/Equity (x)	1.4	1.4	1.3	1.2
WC turn (days)	(190.5)	(51.1)	(23.7)	(27.1)
Dividend payout (%)	52.6	15.7	20.8	17.6
ROE (%)	2.3	1.9	2.8	3.3
ROCE(%)	5.5	5.3	3.8	3.4

Source: Capitaline, Kotak Securities - Private Client Research

Bulk deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
24-Jan	Areva T&D	Grid equipment	B	90,376,365	179.0
24-Jan	Areva T&D	Alstom Grid SAS	S	90,376,365	179.0
24-Jan	Aroma Ent	Adroit Trade Link Pvt Ltd	B	44,000	16.2
24-Jan	Aroma Ent	Rajyog Share And Stock Brokers	B	25,000	16.2
24-Jan	Aroma Ent	Adroit Tradelink Pvt Ltd	B	25,000	16.2
24-Jan	Aroma Ent	Surman Securities Pvt Ltd	S	48,000	16.2
24-Jan	Aroma Ent	Jain Babita	S	49,300	16.2
24-Jan	Arrow Securi	Fiber Texfab Pvt Ltd	B	40,000	17.1
24-Jan	Arrow Securi	Aanir Shares Services	S	42,000	17.1
24-Jan	Arunjyoti Ent	Narender Amirchetty	B	26,502	29.0
24-Jan	Arunjyoti Ent	Anupam Narain Gupta	B	28,000	30.0
24-Jan	Arunjyoti Ent	Sandhya Akula	S	27,000	29.0
24-Jan	Capman Fin	Golden Medows Export Pvt Ltd	B	36,510	9.2
24-Jan	Essen Supp	Gateway Leasing Pvt Ltd	B	40,300	55.8
24-Jan	Essen Supp	Brij Mohan Gupta	S	40,000	55.8
24-Jan	Gujarat Medi	Gold Dust Trading Co	B	60,000	19.8
24-Jan	Gujarat Medi	Yogesh Agarwal	S	60,000	19.8
24-Jan	Kanchan Intl	Shyam Lal Chouthwani	S	20,000	70.8
24-Jan	Koutons Retl	IFCI Ltd.	S	196,122	15.3
24-Jan	Marvel Capital	Geetaben V Kakadiya	B	50,000	19.8
24-Jan	Marvel Capital	Mahan Trading Pvt Ltd	S	31,000	19.8
24-Jan	Pasupati Fin	Amit Krishnakant Thakker	B	30,000	30.8
24-Jan	Pasupati Fin	Pasupati Olefin Limited	S	75,000	30.0
24-Jan	Pasupati Fin	Vipul Mohan Joshi	S	30,000	30.7
24-Jan	Prabhav Inds	Nareshkumar Kishanlal Saraf	B	269,586	4.3
24-Jan	Prabhav Inds	Vora Financial Services Pvt Ltd	B	305,000	4.3
24-Jan	Raymed Labs	Rabindra Kapoor	B	25,000	27.0
24-Jan	Ruchi Soya	Evershine Oleochem Pvt Ltd	B	2,302,000	89.0
24-Jan	Ruchi Soya	Bnp Paribas Arbitrage	S	2,302,000	89.0
24-Jan	Spectacle	Jigar Praful Ghoghari	B	300,000	5.0
24-Jan	Sungold Cap	Nurjahanbanu Mohmmedsafi Shaikh	B	36,000	14.0
24-Jan	Sungold Cap	Vajidahmed Bashirahmed Shaikh	S	36,000	14.0
24-Jan	Transpek Inds-$	Hridaynath Consultancy Pvt Ltd	B	35,632	84.3
24-Jan	Transpek Inds-$	Paramjit Mann	S	35,000	83.9
24-Jan	Tutis Tech-$	Nayan Kunverji Thakkar HUF	B	150,000	16.1
24-Jan	Tutis Tech-$	Gopalsamuduram Chandrasekhar S	S	149,950	16.1
24-Jan	Vax Housing	Subhkaran Tilokchand Agarwal	B	75,000	15.8
24-Jan	Vax Housing	Champalal Gopiram Agarwal	S	50,000	15.8
24-Jan	Max India	Federated Kaufmann Fund	S	1,704,116	155.0

Source: BSE

Forthcoming events

Company/Market

Date	Event
25-Jan	Alstom Proj, Asahi India, BEML, BoB, Deepak Fert, IRB Infra, JB Chemicals, Kirloskar Ind, MIRC Elect, Oracle Fin, Patni Computer, REC, Sesa Goa, Sterlite Tech, Tata Comm, Tata Global, Union Bank, Vijaya Bank earnings expected
27-Jan	Bank of India, Bharat Elect, BHEL, Blue Star, Canara Bank, Guj State Fert, NTPC, Petronet LNG, Pfizer, Swaraj Engines earnings expected

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
L&T	1,352	5.8	13.2	5.5
ICICI Bank	888	3.7	11.9	8.5
SBI	2,041	5.2	8.5	5.1
Losers				
Coal India	330	(1.5)	(1.1)	4.1
Hindustan Unilever	393	(0.6)	(0.9)	1.8
Sun Pharma	516	(1.3)	(0.8)	0.5

Source: Bloomberg

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