kotak Institutional Equities

INDIA DAILY

April 09, 2007

EQUITY MARKETS

India	5-Apr	1-day	1-mo	3-mo
		Change, %		
Sensex	12,856	0.5	1.3	(7.2)
Nifty	3,752	0.5	2.6	(5.8)
Global/Regional indices				
Dow Jones	12,560	0.2	2.9	1.3
Nasdaq Composite	2,471	0.5	3.6	1.5
FTSE	6,397	0.5	4.2	2.8
Nikkei	17,701	1.2	3.1	2.7
Hang Seng	20,210	1.0	8.3	(0.0)
KOSPI	1,497	0.9	5.2	8.9

Value traded - India

	5-Apr		1-mo	3-mo
	Moving avg, Rs bn			
Cash (NSE+BSE)	99.8		112.0	126.7
Derivatives (NSE)	249.6		338.7	252.6
Deri. open interest	444.5		511.7	512.8

Forex/money market

	5-Apr	1-day	1-mo	3-mo
	Change, basis points			
Rs/US$	42.9	######	(127)	(146)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	-	16	60

Net investment (US$mn)

	4-Apr		MTD	CYTD
FIIs	(1)		#N/A	40
MFs	(24)		#N/A	(303)

Top movers -3mo basis

Best performers	5-Apr	1-day	1-mo	3-mo
	Change, %			
SAIL	115	2.2	10.3	35.0
BEL	1,650	4.3	9.8	29.3
Punjab Tractors	304	0.2	(1.9)	23.9
Bharti Tele	746	(0.2)	(0.6)	19.6
Wockhardt	392	0.3	5.9	14.3
Worst performers				
Century Tex	510	0.3	(3.1)	(29.5)
Acc	722	1.0	(7.5)	(29.5)
Tvs Motor	57	0.9	(0.6)	(29.1)
Ingersoll Rand	272	0.4	(8.6)	(25.6)
Grasim	2,113	2.4	2.1	(25.2)

Contents

Results

National Thermal Power Corp.: FY2007 provisional results: operational performance inline/ maintain IL

Updates

Oil & Natural Gas Corporation: Further good news; don't ignore it this time too

Reliance Communications: 5 mn wireless subs deactivated but no impact on revenues, profitability as per company

GAIL (India): New developments; value creation will depend on acquisition price or regulations

UTI Bank: Increasing risk due to changes in management, downgrading stock to Underperform

Zee Entertainment Enterprises: None of the recent events can really explain recent re-rating of already very high multiples

Lupin: Strikes a good deal with Servier; the innovator of Perindopril

Mahindra Gesco Developers: eGoM go ahead likely to provide more clarity on SEZ policy

Economy: Indian interest rate outlook: Rising political mercury escalates pop monetarism, policy risks

News Roundup

Corporate

- EXL Service Holdings, an IT services provider, is on the lookout to acquire companies in Eastern Europe, the Philippines, South Africa and China. The acquisitions, in each of the geographies, could be in the range of US$25-50 mn in revenue and will add capabilities in the verticals such as research and analytics where EXL is already fast gaining ground (BS)
- Sri Lanka-based MAS Holdings would invest US$700 mn to set up a textile SEZ in the remote Chintavaram village in Andhra Pradesh. (FE)
- Reliance Communications Limited, India's second-biggest mobile services firm, has disconnected over 4.2 mn subscribers, equivalent to 15% of its customers, following its inability to reverify documentation of its entire prepaid user base by the March 31 deadline set for cellular companies by the Union government. (Mint)

Economic and political

- State Bank of India, the country's largest lender, hiked its benchmark prime lending rate by 0.50 per cent from 12.25 per cent to 12.75 per cent. The new rate will come into effect from April 9, the bank said in a press release**.** (FE)
- The government is unlikely to roll back the duty of Rs300 per metric tonne on export of iron ore imposed in Budget 2007-08, despite intense lobbying by the mining industry. (BS)

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

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Utilities

NTPC.BO, Rs159	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	160
52W High -Low (Rs)	163 - 91
Market Cap (Rs bn)	1,309

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	301.8	357.5	409.2
Net Profit (Rs bn)	66.1	72.3	80.8
EPS (Rs)	8.0	8.8	9.8
EPS gth	*15.8*	*10.8*	*13.8*
P/E (x)	19.8	18.1	16.2
EV/EBITDA (x)	18.2	16.0	15.7
Div yield (%)	2.0	2.2	2.5

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	89.5	-	-
FIIs	6.8	1.2	(2.6)
MFs	0.7	0.7	(3.1)
UTI	-	-	(3.8)
LIC	-	-	(3.8)

National Thermal Power Corporation: FY2007 provisional results: operational performance inline/ maintain IL

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- **Operational performance during FY2007 in line with expectations.**
- **Mining plan for Pakri Barwadih approved.**
- **Retain IL rating with target price of Rs160/share.**

NTPC reported provisional net sales of Rs306.4 bn and net profit of Rs67.2 bn as against our estimate of Rs301.8 bn and Rs66.1 bn respectively for FY2007. Operational performance was in line with our expectations as the PLF of coal-based power plants during FY2007 improved to 89.43% (our estimate of 89.7%) as compared to 87.54% last year. Gross generation at 188.67 bn units was 10.4% higher than last year and marginally higher than our estimate of 187.6 bn units. While higher than expected fuel expenses likely contributed to a better topline; higher UI charges/other income likely contributed to higher than projected profits. We retain our EPS estimates for FY2008 and FY2009 unchanged at Rs8.8 and Rs9.8 respectively. We will revisit our estimates when more operational and financial details are available. We retain our IL rating on the stock; our DCF-based target price has increased to Rs160/share (Rs150 previously).

Operational performance in line with expectations. PLF of coal-based power plants stood at 89.43% against our estimate of 89.7%. Gross generation of electricity increased by 10.4% yoy to 188.67 bn units as against our estimate of 187.6 bn units. Higher natural gas /naphtha based generation likely contributed to higher than our estimated sales estimate, due to usage of costlier fuel.

Plans underway to increase capacity to 50 GW by FY2012 and 75 GW by FY2017. Our estimates factor in an installed capacity of 78 GW by FY2017. NTPC has current installed capacity of 27.4 GW (including 1.1 GW in joint ventures). During the 10th plan (FY2002-07) NTPC added 7,155 MW of generation capacity, including 740 MW at the Ratnagiri JV and 705 MW acquired at Badarpur from the Government of India. During FY2007, NTPC added generation capacity at Vindhyachal III (1000 MW), Unchahar III (210 MW) and Kahalgaon II (500 MW). Generation capacity of 11,360 MW is currently under construction, with NTPC's foray into hydropower generation gaining momentum. Construction has started at Koldam (800 MW) in Himachal Pradesh and Loharinag Pala (600 MW) and Vishnugad (520 MW) in Uttaranchal. CCEA approval has been accorded for the Nabinagar Thermal power project in joint venture with the Railways.

Mining plan for Pakri Barwadih approved. NTPC has received Ministry of Coal's approval for the mining plan to mine 15 mn tpa of coal from the Pakri Barwadih mine. NTPC is the largest consumer of domestic coal (111 mn tonnes in FY2007) and the captive mine will add to fuel security of NTPC.

Energy

ONGC.BO, Rs844	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	1,100
52W High -Low (Rs)	1009 - 620
Market Cap (Rs bn)	1,806

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	979	1,013	1,001
Net Profit (Rs bn)	201.3	225.9	227.4
EPS (Rs)	94.1	105.6	106.3
EPS gth	*28.2*	*12.2*	*0.7*
P/E (x)	9.0	8.0	7.9
EV/EBITDA (x)	3.9	3.4	3.1
Div yield (%)	4.1	4.7	4.1

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	9.1	2.7	(3.7)
MFs	1.2	2.1	(4.3)
UTI	-	-	(6.4)
LIC	2.2	3.7	(2.7)

Oil & Natural Gas Corporation: Further good news; don't ignore it this time too

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- **New 'significant' oil and gas discovery in Egypt (North Ramadan block)**
- **DGH accepts ONGC's discovery in KG-DWN-98/3 block**
- **Sentiment should improve on positive developments**

We see (1) OVL's discovery of oil and gas in 70%-owned North Ramadan block in Gulf of Suez, Egypt and (2) the acceptance by the DGH of ONGC's gas discovery in KG-DWN-98/2 block as a positive for the stock. ONGC's press release does not give details of reserves of the discovery in the North Ramadan block but describes it as significant. In another development, the DGH has accepted ONGC's 'large' reported gas discovery in the KG-DWN-98/2 block but has asked for more appraisal wells, which ONGC would anyway have done to delineate the discovery and get a better estimate of the reserves. Finally, we see likely strong 4QFY07 results as allaying fears about irrational government policy; we estimate ONGC's 4QFY07 subsidy burden as similar to 3QFY07 levels. We retain our 12-month 9X normalized FCF-based target price of Rs1,100 (no value factored for new discoveries). Key downside risks stem from higher-than-expected subsidy losses.

"Significant" discovery of oil and gas in North Ramadan block in Egypt. OVL's first exploration well in the 290 sq. km block resulted in oil discovery (with a natural flow rate of 2,979 b/d) and gas discovery (with a flow rate of 1.5 mcf/d). The crude is sweet and light (36.5° API). As part of the committed phase-1 exploration program, OVL and its consortium partner (IPR Red Sea Inc.) will drill another two wells.

Confirmation of gas discovery in KG-DWN-98/3 block by DGH. ONGC has estimated original-gas-in-place at 5-15 tcf in two structures. We expect it to drill a few appraisal wells to delineate the size of the discovery and get a better estimate of the reserves. ONGC had previously offered to do conventional testing (in addition to MDT) to substantiate its claims of a gas discovery before the DGH.

4QFY07 results will likely be strong barring any unexpected DD&A-related charges. We estimate 4QFY07 standalone net income at Rs47.7 bn (+2% qoq and +55% yoy). We model 4QFY07 subsidy loss at Rs21.4 bn versus Rs22 bn in 3QFY07 and Rs34 bn in 4QFY06 given (1) overall industry under-recoveries are moderately lower in 4QFY07 versus 3QFY07 and (2) the government has issued Rs50 bn of oil bonds to the downstream oil companies in 4QFY07 (same as 3QFY07). 4QFY07 crude price is about US$2/bbl lower qoq but we would note that in 3QFY07, ONGC had provided for very high DD&A (Rs25.6 bn including Rs7.2 bn of dry wells write-offs and Rs6 bn of survey expenses). We note that ONGC's 9MFY07 DD&A was Rs66.4 bn, which puts the normal quarterly DD&A run rate at about Rs22 bn.

ONGC has built a strong portfolio of overseas assets

Details of ONGC's investments in overseas projects

	ONGC share (%)	ONGC proven reserves Gas (mn boe)	Oil (mn bbls)	Total (mn boe)	Production Start date	('000 b/d) (a)	Consortium partners
Producing fields/under development							
Lan Tay/Lan Do, Vietnam	45	117	5	122	2003	9	BP (35%), Petro-Vietnam (20%)
Greater Nile, Sudan	25		151	151	2003	66	CNPC (40%), Petronas (30%), Sudapet (5%)
Sakhalin-I, Russia (b)	20		448	448	2006	50	ExxonMobil (30%), Sodeco (30%)
		626		626	2008	35	RN Astra (8.5%), SMNG (11.5%)
Block 5A, Sudan	24		40	40	2006	12	Petronas (69%), Sudapet (5%)
Block A-1, Myanmar	20	170		170		18	Daewoo (60%), GAIL (10%), KOGAS (10%)
Omimex de Colombia	50		300	300		20	Sinopec International Petroleum Exploration and Production Corporation (50%)
Total		**913**	**945**	**1,857**		**210**	
Exploration blocks							
Block-8, Iraq	100						Not applicable
Farsi, Iran	40						IOC (40%), Oil India (20%)
Block 5B, Sudan	24						Petronas (41%), Sudapet (10%), Lundin Petroleum (24.5%)
Block 24, Syria	60						IPR International (40%)
NC 188, Libya	49						TPOC (51%)
NC 189, Libya	49						TPOC (51%)
WA 306 P, Australia	55						Antrim Energy (32.5%), Magellan Petroleum (12.5%)
CI-112, Côte d'Ivoire	30						Vanco Energy (50%), OIL (10%), Petroci (10%)
North Ramadan, Egypt	70						IPR Red Sea Inc. (30%)
Najwat Najam, Qatar	100						Not applicable
Block-25-29, 35, 36, Cuba	30						Repsol-YPF (40%), Norsk Hydro (30%)
Block A-3, Myanmar	20						Daewoo (60%), GAIL (10%), KOGAS (10%)
Block 127, 128, Vietnam	100						Not applicable
Block BC-10, Brazil	15						Shell (50%), Petrobras (35%)
Block OPL-209, 212, Nigeria							Mittal Investments Sarl (49.98%)
Block OPL-245, Nigeria							Mittal Investments Sarl (49.98%)

(a) Unit refers to million tonnes per annum of oil equivalent where product is natural gas.

Source: Company, Kotak Institutional Equities estimates.

We believe ONGC stock is attractively valued at current price

Estimation of fair value of ONGC stock based on normalized free cash flow (Rs mn)

	2008E	2009E	2010E
Crude price assumption (US$/bbl)	**45.0**	**45.0**	**45.0**
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	207,385	236,966	247,796
Add: OCF after normalizing natural gas price	26,328	17,789	19,470
Add: OCF after removing subsidies	81,402	61,874	40,457
Recurring OCF	315,116	316,628	307,722
Recurring capex			
Production per annum (mn bbls)	380	388	380
Replacement or F&D costs (US$/bbl)	5.5	5.5	5.5
Recurring capex	94,106	96,113	94,000
Free cash flow	**221,009**	**220,515**	**213,722**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,989,083	1,984,638	1,923,502
(Net debt)/cash	254,527	409,560	527,545
Investments	88,236	88,239	88,512
Equity value	2,331,847	2,482,437	2,539,559
Equity value per share (Rs)	**1,090**	**1,161**	**1,187**

Source: Kotak Institutional Equities estimates.

Telecom

RLCM.BO, Rs397	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	400
52W High -Low (Rs)	518 - 186
Market Cap (Rs bn)	812.6

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	148.0	208.0	269.0
Net Profit (Rs bn)	29.5	47.1	58.4
EPS (Rs)	13.9	22.5	28.0
EPS gth	*543.1*	*61.5*	*24.2*
P/E (x)	28.5	17.7	14.2
EV/EBITDA (x)	14.5	10.5	8.0
Div yield (%)	-	-	-

Reliance Communications: 5 mn wireless subs deactivated but no impact on revenues, profitability as per company

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- **Completes re-verification of 85% of wireless base at end-FY2007; deactivates the rest**
- **Says no impact on revenues and ARPU, which we find astonishing**
- **Begets issue about defunct subs remaining in system and execution**

A press release of RCL states that it has completed verification of 85% of its sub base at end-March 2007 and de-activated 15% of its sub base (5 mn). RCL does not expect any impact on revenues and profitability and expects its ARPU to increase by 12% due to a lower subscriber base. RCL believes that the deactivated subs are defunct subs ('did not contribute materially to revenues in the last quarter' as per RCL's press release), which were not contributing to revenues. However, this begets issues about (1) RCL keeping 'defunct' subs alive if it is reasonably confident that the deactivated subs are non-revenue generating subs and (2) RCL's execution ability being weaker than believed due to lower additions versus reported in the past. We retain our 12-month DCF-based target price of Rs400 but would ike more clarifications on the aforementioned issues. Key risk is level of profitability.

85% of end-March 2007 subscriber verified; 15% deactivated but no impact on revenues as per RCL. RCL's press release states that there will not be any adverse impact on its revenues and profitability despite it deactivating 15% of its wireless subscriber base at end-March 2007. RCL had 32.4 mn wireless subs at end-February 2007 and has added 1.2 mn subs in March 2007; without deactivation, it would have had 33.4 mn subs at end-FY2007. A 15% deactivation base would suggest about 28 mn subs at end-FY2007. RCL's press release also confirms a wireless subs base of 'over 28 mn'.

Execution and market share in the future. We would wait for the sub data of other operators (we suspect others will also report a decline in sub base) before reviewing our forecasts of RCL's future subs and market share. If RCL's end-March 2007 market share is meaningfully lower than historical data (others do not show a similar decline in their sub bases), we may have to build in lower market share to reflect RCL's true position and execution capabilities. A meaningfully sub base would suggest that RCL's monthly additions and execution capabilities are both exaggerated. In our view, RCL would have to demonstrate better execution to reach a higher market share in the future.

Key macro assumptions for Reliance Communications, March fiscal year-ends, 2006-2016E

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Wireless											
Market subscribers (mn)	90	164	239	312	370	411	445	475	503	528	551
Market penetration (%)	8	14	21	27	31	34	37	39	41	42	44
RCL subs including fixed wireless (mn)	20	35	50	64	75	83	89	95	100	104	109
RCL market share (%)	**22.5**	**21.1**	**21.0**	**20.6**	**20.3**	**20.1**	**20.0**	**19.9**	**19.8**	**19.8**	**19.7**
Market revenues (Rs bn)	366	534	760	976	1,189	1,346	1,468	1,583	1,693	1,802	1,908
RCL's revenues (Rs bn)	74	108	155	198	235	267	292	314	335	355	374
RCL's market share (%)	20	20	20	20	20	20	20	20	20	20	20
RCL subs (mn)	23	35	50	64	75	83	89	95	100	104	109
RCL prepaid subs ('000)	16	29	43	56	65	72	78	83	88	92	87
RCL postpaid subs ('000)	4	5	7	8	9	10	11	11	12	12	12
RCL FWP & PCO subs ('000)	3	4	5	6	7	7	8	8	8	9	9
RCL blended ARPU (Rs/month)	354	314	305	288	281	282	283	285	287	290	293
RCL prepaid ARPU (Rs/month)	340	290	267	253	248	250	251	253	255	257	260
RCL postpaid ARPU (Rs/month)	511	495	493	488	482	479	485	490	495	501	505
RCL blended MOU (mins/month)	531	443	439	432	432	437	440	443	447	451	454
RCL prepaid MOU (mins/month)	492	406	407	401	403	409	412	415	419	423	427
RCL postpaid MOU (mins/month)	676	611	621	622	627	631	636	641	646	651	656
RCL blended RPM (Rs) (ARPU/MOU)	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
RCL prepaid RPM (Rs/min) (ARPU/MOU)	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
RCL postpaid RPM (Rs/min) (ARPU/MOU)	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
RCL overall RPM (Rs/min)	**1.0**	**1.0**	**0.9**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**
Blended EBIDTA per min (Rs)	0.31	0.37	0.34	0.33	0.32	0.32	0.32	0.31	0.31	0.31	0.31
EBITDA margin (%)	**30**	**37**	**38**	**39**	**40**	**40**	**40**	**40**	**40**	**40**	**40**
Capex/incremental min (Rs)	1.1	1.1	1.1	0.8	0.8	0.7	0.7	0.6	0.6	0.6	0.6
Capex incl. maintenance capex/incremental min (Rs)	1.1	1.1	1.1	0.9	0.8	0.8	0.9	1.0	1.2	1.3	1.4
Capex/incremental sub (US$)	137	71	113	93	102	103	94	90	90	89	86
Capex incl. maintenance capex/incremental sub (US$)	137	71	115	96	109	119	128	144	177	201	219
Domestic long distance											
Market revenues (Rs bn)	103	108	129	156	176	193	208	222	236	250	263
Revenues to DLD operator (net of orig.)	62	70	84	101	114	125	135	145	154	162	171
RCL's revenues (Rs bn)	12	13	19	23	25	28	30	32	33	35	37
RCL's market share (%)	19	18	22	22	22	22	22	22	22	22	21
International long distance											
Market revenues (Rs bn)	67	66	71	77	82	92	102	111	120	129	139
RCL's IDD revenue (Rs bn)	19	20	20	21	22	24	27	29	32	34	37
RCL's market share (%)	28	30	29	28	27	26	27	27	27	27	27
Market minutes (bn mins)	11	15	19	23	27	31	36	39	42	46	50
RCL's share of mins (%)	40	36	35	33	31	30	29	29	29	29	29

Source: Kotak Institutional Equities estimates.

Consolidated profit and loss for Reliance Infocomm, March fiscal year-ends, 2004-2016E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenues											
Wireless	73,627	108,413	154,964	197,684	235,023	266,636	291,745	313,960	334,927	354,832	373,983
Global business	51,858	53,567	66,314	79,189	90,947	104,410	115,174	123,596	130,819	138,532	146,587
Broadband	5,118	11,751	19,422	27,860	36,432	44,462	51,634	57,845	63,276	68,272	73,197
Others	3,011	4,112	4,523	4,976	5,473	6,020	6,622	7,285	8,013	8,814	9,696
Less: Intersegment eliminations	(27,341)	(29,825)	(37,183)	(40,736)	(45,768)	(52,120)	(56,848)	(60,785)	(64,275)	(68,020)	(71,859)
Consolidated revenues	**106,273**	**148,018**	**208,039**	**268,974**	**322,108**	**369,407**	**408,327**	**441,899**	**472,761**	**502,430**	**531,604**
Interconnection costs	(31,340)	(27,030)	(35,612)	(43,097)	(47,710)	(54,398)	(60,022)	(64,490)	(68,735)	(72,836)	(76,946)
License fees and spectrum charges	(9,065)	(11,503)	(16,472)	(21,358)	(26,151)	(29,949)	(33,033)	(35,746)	(38,227)	(40,590)	(42,893)
Network operating costs	(15,346)	(16,614)	(22,217)	(28,708)	(35,713)	(41,643)	(46,186)	(50,648)	(54,624)	(58,318)	(62,035)
Sales and marketing expenses	(10,358)	(13,554)	(19,674)	(24,796)	(29,630)	(33,043)	(35,946)	(38,548)	(40,931)	(43,272)	(45,619)
Employee costs	(8,394)	(9,968)	(14,797)	(19,447)	(23,756)	(27,436)	(30,108)	(33,451)	(36,731)	(38,644)	(40,614)
G&A costs	(8,429)	(11,606)	(16,207)	(20,325)	(24,040)	(27,174)	(29,663)	(31,865)	(33,820)	(35,652)	(37,782)
Consolidated EBITDA	**23,341**	**57,743**	**83,060**	**111,243**	**135,107**	**155,764**	**173,369**	**187,152**	**199,691**	**213,119**	**225,717**
Other income incl. Interest income	2,702	6,347	4,994	3,190	2,584	2,605	4,216	8,889	14,985	20,624	25,830
Interest expense	(3,905)	(7,266)	(6,855)	(7,090)	(6,783)	(5,256)	(1,210)	—	—	—	—
Amortization of entry fee	(3,386)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)	(3,347)
Amortization of goodwill	—	—	—	—	—	—	—	—	—	—	—
Depreciation	(13,600)	(22,004)	(28,180)	(37,707)	(44,609)	(50,034)	(54,282)	(58,153)	(62,183)	(66,469)	(70,957)
Pretax profits	**5,151**	**31,472**	**49,672**	**66,289**	**82,951**	**99,731**	**118,746**	**134,541**	**149,146**	**163,926**	**177,242**
Extraordinary income/(charges)	(374)	(360)	—	—	—	—	—	—	—	—	—
Prior Period Adjustments	—	—	—	—	—	—	—	—	—	—	—
Current tax expense	(151)	(1,962)	(2,596)	(7,438)	(9,307)	(11,190)	(13,323)	(15,096)	(16,734)	(40,810)	(57,674)
Deferred tax (liability)/asset	(187)	—	—	(403)	(709)	(632)	(239)	353	2,033	3,238	4,423
Minority interest expense	(6)	—	—	—	—	—	—	—	—	—	—
Reported net profits	**4,433**	**29,151**	**47,076**	**58,448**	**72,935**	**87,909**	**105,183**	**119,798**	**134,445**	**126,354**	**123,990**
Adjusted net profits	**4,781**	**29,488**	**47,076**	**58,448**	**72,935**	**87,909**	**105,183**	**119,798**	**134,445**	**126,354**	**123,990**
Adjusted EPS (Rs)											
Year end	2.2	14.3	23.0	28.6	35.7	43.0	50.3	57.3	64.3	60.4	59.3
Primary	2.2	14.3	23.0	28.6	35.7	43.0	50.3	57.3	64.3	60.4	59.3
Fully diluted	2.2	13.9	22.5	28.0	34.9	42.0	50.3	57.3	64.3	60.4	59.3
Shares outstanding (mn)											
Year end	2,045	2,045	2,045	2,045	2,045	2,045	2,091	2,091	2,091	2,091	2,091
Primary	2,045	2,045	2,045	2,045	2,045	2,045	2,091	2,091	2,091	2,091	2,091
Fully diluted	2,045	2,091	2,091	2,091	2,091	2,091	2,091	2,091	2,091	2,091	2,091
Growth (%)											
Revenues	97	39	41	29	20	15	11	8	7	6	6
EBITDA	(57)	147	44	34	21	15	11	8	7	7	6
Net profits	—	517	60	24	25	21	20	14	12	(6)	(2)
EPS	—	543	61	24	25	21	20	14	12	(6)	(2)
Margin (%)											
EBITDA	22.0	39.0	39.9	41.4	41.9	42.2	42.5	42.4	42.2	42.4	42.5
Net profits	4.5	19.9	22.6	21.7	22.6	23.8	25.8	27.1	28.4	25.1	23.3
Current tax rate (%)	3.2	6.3	5.2	11.2	11.2	11.2	11.2	11.2	11.2	24.9	32.5
Effective tax rate (%)	7.1	6.3	5.2	11.8	12.1	11.9	11.4	11.0	9.9	22.9	30.0
DPS (for a Rs5 share)	—	—	—	—	5.4	8.6	12.6	17.2	22.5	24.2	23.7
Dividend pay-out (%)	—	—	—	—	15.0	20.0	25.0	30.0	35.0	40.0	40.0

Source: Kotak Institutional Equities estimates.

GAIL (India): New developments; value creation will depend on acquisition price or regulations

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Energy

GAIL.BO, Rs293	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	295
52W High -Low (Rs)	323 - 210
Market Cap (Rs bn)	247.4

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	183.5	231.6	238.6
Net Profit (Rs bn)	22.2	24.1	23.7
EPS (Rs)	26.2	28.5	28.0
EPS gth	*(6.1)*	*8.6*	*(1.6)*
P/E (x)	11.1	10.3	10.4
EV/EBITDA (x)	6.1	5.3	4.9
Div yield (%)	3.4	3.4	3.4

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.3	-	-
FIIs	21.5	0.8	(0.0)
MFs	2.2	0.5	(0.3)
UTI	-	-	(0.8)
LIC	6.3	1.3	0.5

- **Decision on Dabhol-LNG terminal due this week; GAIL to be one of the bidders**
- **GAIL, Reliance group carve up gas network in India; value creation will depend on regulations**
- **We will factor in new capex once more clarity emerges on timing, regulations**

The Empowered Group on Ministers on the Dabhol project will take a decision on April 11 regarding the future of the 5 mtpa under-construction LNG terminal. GAIL is keen to acquire the terminal to augment gas supplies but will have to compete with others (other part-owners) for the asset. Also, GAIL has finalized its medium-term pipeline network and got approvals from the government to invite EOI for five new pipelines; it will build another three pipelines in extant ROUs. We expect GAIL and Reliance to carve up the long distance gas network in India with other smaller players like GSPL and other state bodies building intra-state networks. The value creation from the new investment (Rs180 bn) will depend on emerging regulations. We retain our 12-month SOTP-based target price of Rs295. Key downside risk is higher-than-expected subsidy losses and negatives from emerging gas transportation regulations.

GAIL and Reliance group carve up gas network in India; emerging regulations will determine the amount of value creation. Exhibit 1 gives the existing and emerging gas pipeline network in India while Exhibit 2 gives details of GAIL's proposed new eight pipelines. We await (1) formulation of gas pipeline transportation regulations, (2) visibility on supply of natural gas and (3) details about the timing of development (3-4 years as per the press release of GAIL) of new pipelines before valuing GAIL's proposed capex (Rs180 bn) in eight new pipelines. The government is in the process of creating a downstream regulator (Petroleum and Natural Gas Regulatory Board), which will design a regulatory mechanism for the gas transportation and distribution sectors. In our view, the key variables are (1) methodology of fixation of return-earning base, (fixed in perpetuity or declining with depreciation as in cost of services methodology), (2) method of computation of regulated returns (IRR or ROE) and (3) rate of return (for example, GAIL earns 12% ROE on its regulated pipelines currently versus 14% ROE in the power generation and transmission sector). However, we note that GAIL's new pipelines will enjoy certain tax benefits (under Section 80IA), which will likely push returns to above regulated levels.

Strong volume growth starting FY2010E likely irrespective of regulations, returns. The uncertainty surrounding regulations and returns notwithstanding, we expect strong volume growth for GAIL; this had been an area of concern previously for us. However, a cooperation agreement with Reliance Industries will allow GAIL to (1) expand in most parts of India without competition from Reliance and (2) access gas from Reliance's large discoveries in the eastern offshore region.

AFGHANISTAN
PAKISTAN
CHINA
NEPAL
BHUTAN
BANGLADESH
MYANMAR (BURMA)
SRI LANKA
Jammu and Kashmir
Himachal Pradesh
Punjab
Haryana
Uttaranchal
Rajasthan
Uttar Pradesh
Bihar
Gujarat
Madhya Pradesh
Jharkhand
Chhattisgarh
Orissa
Maharashtra
Karnataka
Andhra Pradesh
Tamil Nadu
Kerala
Meghalaya
Arunachal Pradesh
Assam
Nagaland
Manipur
Mizoram
Tripura
Sikkim
Bay of Bengal
Nangal
Hisar
Jhajjar
Dadri
Delhi
Gurgaon
Bawana
Babrala
Shahjahanpur
Chainsa
Mathura
Auraiya
Lucknow
Jagdishpur
Kota
Vijaipur
Ahmedabad
Khera
Jamnagar
Anand
Dahej
Hazira
Lakshmi
Tapti
Mumbai High
Mumbai
Panvel
Panna-Mukta
Uran
Pune
Hyderabad
Dabhol
Rajahmundry
Vishakhapatnam
Kakinada
KG-DWN-98/3 (RIL-Niko gas find)
Vijayawada
Krishna Godavari
Ravva fields
Bangalore
Mangalore
Chennai
Pondicherry
Kochi
Kayamkalum
Haldia
Budge Budge
Paradip
Digboi
Guwahati
Bongaigaon
Block A-1
Kathmandu
28" (610 km)
36" (310 km)
24" (415 km)
18" (217 km)
30" (351 km)
30" (876 km)
18" (110 km)
42" (610 km)
36" (640 km)
42" (504 km)
1,400 km
30" (730 km)
30" (840 km)
LNG re-gasification terminal
Proposed/planned LNG re-gasification terminal
Existing gas pipelines - GAIL
Proposed gas pipeline
GAIL gas pipelines under construction
Others
Off-shore fileds (ONGC)
On-shore fileds (ONGC)
Off-shore fields (Pvt./JV)
New oil/gas finds
Coal producing areas

Details of GAIL's proposed new gas pipelines

	Capex (Rs mn)	Length (Kms)	Capacity (mcm/d)
Dadri-Bawana-Nangal pipeline	25,000	610	25
Chainsa-Gurgaon-Jhajar-Hissar	10,000	310	25
Jagdishpur-Haldia	20,000	876	12
Dabhol-Bangalore	25,000	730	12
Kochi-Kanjirrkod-Bangalore/Mangalore	25,000	840	12
Dahej-Vijapur expansion	75,000	610	
Vijaipur-Dadri		505	
Vijaipur-Auraiya-Jagdishpur		571	
Total	**180,000**	**5,052**	

Source: Company, compiled by Kotak Institutional Equities.

We value GAIL stock at Rs295 per share

Sum-of-the-parts valuation of GAIL, FY2008 basis (Rs bn)

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		
	Replacement cost	EBITDA	EV/RC	EV/EBITDA	Replacement cost basis	EBITDA basis	EV (Rs/share)
Natural gas/LPG transportation		16		6.0		94	111
LPG production		18		2.5		45	54
Petrochemicals		8		3.5		28	33
Oil and gas upstream	18		1.00		18		22
Subsidy sharing scheme		(9)		1.0		(9)	(11)
Investments	64		0.80		52		61
ONGC shares	41		0.80		33		39
Others	23		0.80		19		22
Total		**33**				**158**	**270**
Debt					(20)	(20)	(24)
Implied value of share (Rs/share)							**294**

Source: Kotak Institutional Equities estimates.

Banking

UTBK.BO, Rs451	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	350
52W High -Low (Rs)	615 - 222
Market Cap (Rs bn)	125.8

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	26.0	32.7	40.6
Net Profit (Rs bn)	6.6	7.9	9.5
EPS (Rs)	23.7	28.4	34.2
EPS gth	*37.3*	*20.2*	*21.1*
P/E (x)	19.0	15.9	13.2
P/B (x)	3.9	3.2	2.7
Div yield (%)	1.1	1.3	1.5

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.2	-	-
FIIs	40.7	0.8	0.4
MFs	6.9	0.9	0.4
UTI	1.3	1.2	0.7
LIC	-	-	(0.5)

UTI Bank: Increasing risk due to changes in management, downgrading stock to Underperform

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- **Dr.P.J Nayak has conveyed his decision to step down as CMD of UTI Bank post July 31,2007**
- **Increases uncertainties relating to UTI Bank's strategies and prospects**
- **Downgrading price target to Rs350 (earlier Rs435) and rating on the stock to Underperform (earlier In-Line)**

RBI has asked UTI Bank board to split the post of Chairman and the Managing Director currently held by Dr P.J Nayak. Consequently, Dr Nayak has informed the board that he will not be continuing as the CMD post 31 July 2007, when his present term expires. Recently, the board of UTI Bank had asked Dr Nayak to continue for another two years term, which was subject to RBI approval. Over the last 7.5 years, Dr Nayak has been instrumental in turning around the bank and putting it on a strong footing. We believe his retirement will likely increase uncertainties relating to UTI Bank's strategies and prospects, impact UTI Bank's plans of raising Tier 1 (which is around 6.96%) and the premium valuation currently assigned to the bank. Long term issue relating to ownership of the bank is also unclear as the current key shareholder Specified Undertaking of the Unit Trust of India (SUUTI) will at some stage have to offload its holding. We are increasing our discount rate on UTI Bank to 13% from 12%,consequently reducing our target price to Rs350 from Rs435 per share and downgrading the stock to underperform from IL.

Media

ZEE.BO, Rs268	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	200
52W High -Low (Rs)	373 - 151
Market Cap (Rs bn)	113.5

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	14.7	17.6	19.8
Net Profit (Rs bn)	2.3	3.2	4.1
EPS (Rs)	5.3	7.5	9.5
EPS gth	*8.6*	*39.9*	*27.1*
P/E (x)	50.3	35.9	28.3
EV/EBITDA (x)	33.9	23.3	18.1
Div yield (%)	0.4	0.6	0.8

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	43.9	-	-
FIIs	31.9	0.6	0.2
MFs	8.9	1.1	0.6
UTI	-	-	(0.4)
LIC	4.7	0.5	0.1

Zee Entertainment Enterprises: None of the recent events can really explain recent re-rating of already very high multiples

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- **CAS to be extended to other parts of the three identified metros by mandate; this is as per expectations**
- **Too early to give meaningful value for possible broadcast rights of ICL; market has already given Rs10 bn value**
- **ZEEL's TV ratings steady but watch for entry of several new channels**

We find it hard to understand the continuous re-rating of ZEEL's multiples without any significant developments and are reluctant to ascribe major value to some of the recent developments (extension of mandatory CAS to other zones of CAS-mandated cities, proposed creation of India Cricket League [ICL] by the Essel group). In fact, we have struggled to get to grips with multiples of media stocks in general over the past six months. ZEEL stock currently trades at 23X FY2010E EPS after our projected 29% CAGR in EPS over FY2007-2010E—Rs11.5 EPS for FY2010E versus Rs5.3 in FY2007E. We assume the street is expecting significantly higher earnings growth but our growth projections show that we are quite optimistic about the growth prospects of the sector and ZEEL. We retain our 12-month DCF-based target price of Rs200 with key upside risk being higher-than-expected advertisement and subscription revenues.

CAS to be extended to other parts of the already-mandated cities but this is as per expectations; CAS has not been very successful so far. We see limited positive surprise to subscription revenues from a decision of the Ministry of Information and Broadcasting (MIB), TRAI and industry players to extend a CAS to other parts (including suburbs and adjoining 'cities') of the CAS-mandated cities by mandate over the next 6-9 months. We expect the TRAI to issue details on the implementation schedule later but this development is on expected lines given extant government legislation and the Delhi High Court's order. We would be reluctant to expect a big positive surprise in domestic-pay revenues from this development. The implementation of a CAS in zone-1 of the CAS-mandated cities has not been as successful as earlier street expectations. As per press reports and industry estimates, the number of CAS-enabled homes as yet in zone-1 is only 0.5 mn out of 1.63 mn CAS-enabled homes. Industry players have attributed the low penetration to (1) rampant piracy, (2) weak execution (mix-up of boxes and cards in several cases) and (3) satisfaction of households with FTA channels. We expect penetration to increase over a period of time.

ICL and value creation. We are surprised (but shouldn't be by now) by the market's propensity to create 'instant' market capitalization in the media sector on developments or expectation of developments. The Essel group's proposed India Cricket League (ICL) will start with a corpus of Rs1 bn; ZEEL's market capitalization has increased by Rs10 bn since April 3, when ZEEL's major shareholder first made the announcement; there have been no other major development in this period. ZEEL would at best have the broadcasting rights of the cricket matches (even this is uncertain since Essel group can give the rights to the highest bidder). The success of the league (and positive impact on ZEEL) would depend on several factors—(1) acquiescence of the Board of Cricket Control in India (BCCI) to allow ICL to use stadiums of BCCI-affiliated state associations; (2) ICL's ability to create strong teams if ICL is seen as a 'breakaway' league rather than a parallel one; and (3) stadium and TV audience interest in professional cricket.

Association of country and city in team sports is very high. We are not sure if spectators will pay to watch or TV audiences will find enthralling a group of disparate professionals with no allegiance to a country, region or city slugging it out in a 20-20 over format. This would mean about four hours of cricket, which is much higher than most professional sports. Also, most professional leagues (NBA or EPL) have teams built around cities and thus, have strong associations with the loyal fans of those cities. We note that domestic cricket tournaments (centered around teams from states and cities) in India generate negligible stadium attendance or TV viewership. Finally, the fact that Indians are not really big cricket fans but big 'Indian cricket team' fans is sobering; notice the steep decline in Cricket World Cup ratings following the Indian team's early exit.

Nonetheless, we expect some of the aforementioned issues to evolve over a period of time; after all, it too several decades to create institutions like NBA or EPL. Also, we like the Essel group's initiative in that it will at least stir the cricket administration into more affirmative action.

ZEEL's ratings steady but STAR's ratings on a downslide. We assume the street is expecting ZEEL network to benefit from STAR's troubles (exit of key professionals and decline in ratings of key channel, STAR Plus). We note that ZTV's ratings have declined modestly over the past one month when STAR Plus's ratings have come off significantly; the latter could be due to impact of cricket world cup also.

However, we doubt the street is factoring in any negative impact from entry of several new channels in the Indian market (59 at last count in terms of approvals pending with the MIB) including several well-funded and likely well-run Hindi general entertainment channels. We believe the street is completely ignoring the ongoing fragmentation of the market with its resultant negative impact on (1) lower advertisement revenues for any particular channel, and (2) likely higher programming costs required for a channel to distinguish itself from the clutter.

Consolidated profit model, balance sheet, cash model of Zee Telefilms 2004-2006 and of ZEEL 2007-2010E, March fiscal year-ends (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Profit model (Rs mn)							
Total revenues	**13,702**	**13,079**	**16,544**	**14,679**	**17,568**	**19,844**	**22,430**
EBITDA	**4,309**	**4,351**	**2,695**	**3,389**	**4,850**	**6,109**	**7,430**
Other income	776	521	639	585	554	599	750
Interest	(583)	(207)	(188)	(281)	(208)	(61)	(2)
Depreciation	(320)	(329)	(360)	(248)	(274)	(287)	(299)
Amortization	—	—	—	—	—	—	—
Pretax profits	**4,183**	**4,336**	**2,787**	**3,446**	**4,922**	**6,361**	**7,879**
Extraordinary items	26	(140)	19	—	—	—	—
Tax	(1,103)	(1,123)	(528)	(1,004)	(1,514)	(2,045)	(2,654)
Deferred tax	54	99	(9)	19	19	19	19
Minority interest	(192)	(50)	(117)	(144)	(186)	(213)	(250)
Net income	**2,969**	**3,123**	**2,153**	**2,317**	**3,242**	**4,121**	**4,994**
Recurring net income	**2,942**	**3,263**	**2,134**	**2,317**	**3,242**	**4,121**	**4,994**
Earnings per share (Rs)	**7.1**	**7.5**	**4.9**	**5.3**	**7.5**	**9.5**	**11.5**
Balance sheet (Rs mn)							
Total equity	10,881	13,426	21,286	27,503	30,076	33,348	37,312
Deferred tax balance	11	(219)	(148)	(167)	(186)	(205)	(224)
Minority interest	1,251	397	458	602	788	1,001	1,251
Total borrowings	4,722	5,304	4,901	3,308	1,308	40	—
Currrent liabilities	3,937	4,642	4,346	2,679	2,998	3,198	3,459
Total capital	**20,802**	**23,550**	**30,844**	**33,925**	**34,983**	**37,382**	**41,798**
Cash	1,126	1,571	1,286	1,759	1,723	3,250	6,739
Current assets	15,115	13,921	13,574	13,664	14,833	15,791	16,818
Net fixed assets	4,157	4,263	12,948	12,901	12,826	12,740	12,641
Investments	328	3,744	3,024	5,589	5,589	5,589	5,589
Deferred expenditure	75	51	12	12	12	12	12
Total assets	**20,802**	**23,550**	**30,844**	**33,925**	**34,984**	**37,382**	**41,798**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	2,627	3,182	1,931	2,104	3,128	4,003	4,774
Working capital	(169)	(1,515)	(3,950)	(1,757)	(850)	(758)	(766)
Capital expenditure	(819)	(998)	(383)	(200)	(200)	(200)	(200)
Investments	(60)	(1,380)	418	(2,565)	—	—	—
Other income	626	364	488	585	554	599	750
Free cash flow	**2,205**	**(346)**	**(1,496)**	**(1,833)**	**2,633**	**3,645**	**4,558**
Revenue model (Rs mn)							
Advertising	6,355	5,698	6,566	7,021	8,498	9,766	10,969
Subscription-domestic	2,173	2,746	2,952	3,279	3,973	4,677	5,776
Subscription-overseas	2,620	2,964	3,097	3,705	4,390	4,660	4,907
Subscription-cable	1,168	1,002	978	—	—	—	—
Others	1,385	669	2,950	674	707	742	778
Total revenues	**13,702**	**13,079**	**16,544**	**14,679**	**17,568**	**19,844**	**22,430**

Source: Kotak Institutional Equities estimates.

Consolidated profit and loss statement for Zee Telefilms, March fiscal year-ends, 2004-2006, ZEEL, 2007-2010E (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Advertisement	**6,355**	**5,698**	**6,566**	**7,021**	**8,498**	**9,766**	**10,969**
Subscription	**6,026**	**6,533**	**7,174**	**6,984**	**8,363**	**9,336**	**10,683**
Domestic pay-TV	2,173	2,746	2,952	3,279	3,973	4,677	5,776
Overseas	2,620	2,964	3,097	3,705	4,390	4,660	4,907
Domestic subscription	1,168	1,002	978	—	—	—	—
Others	64	(179)	146	—	—	—	—
Education	131	106	162	161	169	177	186
Others	1,190	742	2,641	514	539	565	593
Total revenues	**13,702**	**13,079**	**16,544**	**14,679**	**17,568**	**19,844**	**22,430**
Programming/Content	(2,520)	(2,611)	(4,247)	(5,302)	(6,394)	(7,042)	(7,946)
Broadcasting	(618)	(675)	(515)	(503)	(514)	(523)	(533)
Distribution	(1,837)	(1,534)	(2,565)	(1,472)	(1,604)	(1,709)	(1,796)
Employees	(727)	(858)	(1,089)	(951)	(1,079)	(1,150)	(1,226)
SG&A	(3,691)	(3,051)	(3,431)	(2,775)	(2,827)	(2,995)	(3,167)
Total expenses	**(9,393)**	**(8,728)**	**(13,848)**	**(11,290)**	**(12,718)**	**(13,735)**	**(15,000)**
EBITDA	**4,309**	**4,351**	**2,695**	**3,389**	**4,850**	**6,109**	**7,430**
Other income	776	521	639	585	554	599	750
Interest expense	(583)	(207)	(188)	(281)	(208)	(61)	(2)
Depreciation	(320)	(329)	(360)	(248)	(274)	(287)	(299)
Amortization	—	—	—	—	—	—	—
Pretax profits	**4,183**	**4,336**	**2,787**	**3,446**	**4,922**	**6,361**	**7,879**
Extraordinary items	26	(140)	19	—	—	—	—
Tax	(1,103)	(1,123)	(528)	(1,004)	(1,514)	(2,045)	(2,654)
Deferred tax	54	99	(9)	19	19	19	19
Minority interest	(192)	(50)	(117)	(144)	(186)	(213)	(250)
Net income	**2,969**	**3,123**	**2,153**	**2,317**	**3,242**	**4,121**	**4,994**
Recurring net income	**2,942**	**3,263**	**2,134**	**2,317**	**3,242**	**4,121**	**4,994**
Fully diluted EPS	**7.1**	**7.5**	**4.9**	**5.3**	**7.5**	**9.5**	**11.5**
Key ratios							
EBITDA growth (%)	**14.7**	**1.0**	**(38.1)**	**25.8**	**43.1**	**26.0**	**21.6**
EPS growth (%)	**18.2**	**5.2**	**(34.6)**	**8.6**	**39.9**	**27.1**	**21.2**
EBITDA margin (%)	31.5	33.3	16.3	23.1	27.6	30.8	33.1
Tax rate (%)	24.9	24.4	19.1	28.6	30.4	31.9	33.4
Shares o/s year end (mn)	412	412	413	435	435	435	435
Shares o/s fully diluted (mn)	412	435	435	435	435	435	435

Source: Kotak Institutional Equities estimates.

Pharmaceuticals

LUPN.BO, Rs635	
Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	640
52W High -Low (Rs)	678 - 406
Market Cap (Rs bn)	51.0

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	20.2	23.5	27.2
Net Profit (Rs bn)	3.0	3.0	3.6
EPS (Rs)	34.3	33.6	40.9
EPS gth	*74.6*	*(2.1)*	*21.9*
P/E (x)	18.5	18.9	15.5
EV/EBITDA (x)	12.0	13.1	11.4
Div yield (%)	0.6	0.8	0.9

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	52.3	-	-
FIIs	13.6	0.1	(0.1)
MFs	7.1	0.3	0.2
UTI	2.4	0.8	0.7
LIC	1.8	0.1	(0.1)

Lupin: Strikes a good deal with Servier; the innovator of Perindopril

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- **Receives Euro20 mn from Servier of France, for sale of intellectual property relating to Perindopril**
- **Lupin has said that it will launch the product in international markets, post regulatory approvals**
- **Maintain OP.**

Lupin has received Euro20 mn from Servier, for sale of intellectual property related to Perindopril (an anti hypertensive). Lupin has said that it will launch the product in international markets, post approval. This payment results into a 34% increase in FY2007 EPS. After a strong 75% earnings growth in FY2007E, we now expect a 2% dip in FY2008 and 22% growth in FY2009. Near term (in May), launch of generic Cefdinir in the US is an important catalyst. Thus far, the company has also exhibited good product picking capability for the US market, and key approvals have come much ahead of competition. Overall, we believe the company is making sensible moves, for instance focusing on partnerships in most new markets, and the continued focus on emerging markets and APIs. Our March 2008 DCF based price target is Rs640 (Rs630 earlier), or 19x FY2008 earnings. The payment from Servier has added Rs8 to our price target. Key risk is (1) delay in launch of generic Cefdinir and (2) share rise in raw material prices, which might start impacting margins.

Our model assumes US$600 mn revenues in FY2009, implying an annualized growth rate of 16%. We expect EBITDA margin (excluding other operating income) to rise to 15% in FY2008, up from 14% in FY2006. This is primarily a result of modest increase in G&A expenses. After a strong 75% earnings growth in FY2007E, we expect a 2% dip in FY2008 and 22% growth in FY2009. FY2007 earnings include a one-time payment of Euro20 mn (US$13 mn after tax) from Servier of France, regarding sale of intellectual property on Perindopril. Key assumption for next year is that existing basket of products will likely hold on (or marginal decline in the key products) and the company makes good money from generic Cefdinir (US$30 mn sales).

Property

MGDL.BO, Rs593	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	945
52W High -Low (Rs)	1300 - 375
Market Cap (Rs bn)	21.1

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	3.8	5.5	11.0
Net Profit (Rs bn)	0.4	0.7	1.8
EPS (Rs)	10.1	16.3	44.4
EPS gth	-	-	-
P/E (x)	58.8	36.5	13.4
EV/EBITDA (x)	27.9	19.8	9.9
Div yield (%)	0.4	0.6	0.8

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	56.9	-	-
FIIs	25.2	0.1	0.1
MFs	2.0	0.0	0.0
UTI	-	-	-
LIC	-	-	-

Mahindra Gesco Developers: eGoM go ahead likely to provide more clarity on SEZ policy

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- **eGoM gives go ahead to SEZ policy; imposes a few restrictions**
- **We raise discount factor on Karla SEZ from 50% to 90% pending clarity on land acquisition.**
- **Retain outperform rating with a revised target price of Rs945**

The empowered group of ministers (eGoM) on Special Economic Zones (SEZs), in its meeting on Thursday, decided to lift the 10-week-old freeze on all approvals and notifications. On Thursday, eGoM cleared 83 SEZ projects for notification, thus removing the last hurdle with respect to SEZ policy. Key issues raised by eGoM include increase in processing area, capping SEZ size and no forcible land acquisition. We revise our target price to Rs945/share as we assign higher discount factor to Karla SEZ. Our target price results in an upside of 58% and we retain outperform rating on the company. Key risk to our target price is unfavorable land acquisition policy.

EGoM go ahead likely to provide more clarity on SEZ policy

An empowered committee headed by Pranab Mukherjee was set up to look into the matter of SEZs and come up with fresh inputs. eGoM on its meeting on April 5th has given the go ahead for 83 SEZs to become operational. As per press reports, key issues raised by eGoM are as follows:

1) **Increase in processing area.** Processing area in SEZs is likely to be raised to 50% of total area from 35% earlier. This limitation is likely being imposed to ensure that SEZs do not get developed as residential enclaves. We note that we have estimated processing area in Jaipur SEZ to be more than 60%.

2) **SEZ size**. eGoM has recommended limitation of SEZ size to 5,000 hectares. This move is likely to affect a few developers who will have to revise their developmental plans. However, companies are looking at various options to comply with upper limit on SEZs, for e.g. splitting of SEZs. We note than all SEZs promoted by MGDL satisfy this criterion.

3) **Land acquisition**. eGoM has recommended that SEZs would only be cleared in locations where farmers had voluntarily sold their land to the developer. In case of those zones for which land has not been acquired yet, government may prefer to wait for the unveiling of the new relief and rehabilitation policy conceived in response to protests to SEZs. We await more clarity on this issue as certain press reports indicate that state governments will not be allowed to enter into joint ventures with private developers.

4) SEZ developers to provide one job per family for families, which are likely displaced by setting up of SEZ.

SEZ policy will likely remain under heavy political debate

SEZ policy remains under heavy political debate and several political parties have expressed reservations about the same. Political parties have raised issues on all fronts, viz., tax concessions, land acquisition, sectoral caps and SEZ size. On the other hand, various state governments are also competing against each other to get SEZs from their state approved in order to attract investment.

Current status of MGDL's SEZs

The current status of two largest SEZs of MGDL is as below:

Mahindra World City Jaipur Limited (MWCJL). MWCJL has received 1,000 acres of land and formal approval for its IT SEZ. Already Infosys and Wipro have shown interest in acquiring large parcels of land. Land acquisition of balance 2,000 acres is being managed by Jaipur Development Authority (JDA). This process is in advanced stage and land transfer to MWCJL is likely in the next three months.

Mahindra World City Maharashtra Limited (MWCML). Land acquisition for MWCML is likely to take place only once rehabilitation policy of the union government gets finalized. There is likely to be delay in land acquisition and there is a possibility that cost of acquisition may also increase. We need to monitor both land acquisition costs as well as timeline for this SEZ closely.

We retain our outperform rating; target price revised to Rs945/share

We raise discount factor on Karla SEZ from 50% to 90% pending clarity on land acquisition. We are building in discount to factor in potential execution issues and delays in approvals, construction of the different SEZs. As a result, we revise our target price to Rs945/share with contribution from Karla SEZ reducing to Rs39/ share from Rs195/share. Our target price results in an upside of 58% and we retain outperform rating on the company. We will be closely watching policy developments as well as any land acquisitions delays faced by its subsidiaries.

MGDL - Derivation of SOTP based target price

	Valuation Methodology	Valuation of business (Rs bn)	Probability (%)	Value contribution (Rs bn)	Value contribution
SEZs					
Chennai SEZ	DCF	9.1	100.0	9.1	218
Karla SEZ	DCF	16.2	10.0	1.6	39
Jaipur SEZ	DCF	13.5	90.0	12.1	288
Thane SEZ	DCF	0.7	100.0	0.7	17
Total			100.0	23.6	562
Mahindra Gesco standalone					
Residential properties	NAV	4.0	100.0	4.0	95
Commercial property	NAV	1.6	100.0	1.6	38
Terminal value in FY2008 (EV EBITDA multiple of 6)		4.5	100.0	4.5	107
Less: Debt				(0.8)	(19)
Total				9.3	222
Cash raised		6.8	100.0	6.8	162
Equity valuation (Rs/share)					945
Fully diluted no of shares (mn)				42.0	

Economy

Sector coverage view	N/A

Indian interest rate outlook: Rising political mercury escalates pop monetarism, policy risks

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- **Politics escalates policy risks - CRR, strong INR - till inflation peaks off (1QFY08E)**
- **Real lending rates already almost neutral, further action to impact growth**
- **Congress party panel blames excessive money supply for inflation, poll defeats**
- **Exit polls predict hung UP assembly in May 2007; BJP wins municipal Delhi polls**

We grow increasingly concerned about excessive monetary tightening as political pressures force monetary policy into an unwinnable fight against supply-side inflation. Real lending rates - currently 7.25% - will already likely close in on the 7.8% potential real GDP growth rate in FY2008E. Distortions in monetary policy - threat of 'surprise' CRR hikes, unduly strong Rupee at an REER of 108+ - will likely persist till inflation tops off (in 1QFY08 in our view). Media reports suggest that a Congress party panel has blamed the reverses in the Punjab and Uttarakhand assembly polls on inflation arising from excessive money supply growth driven "entirely by the inflow of foreign funds". In the meanwhile, initial exit polls predictably forecast a hung-assembly in Uttar Pradesh in May 2007.

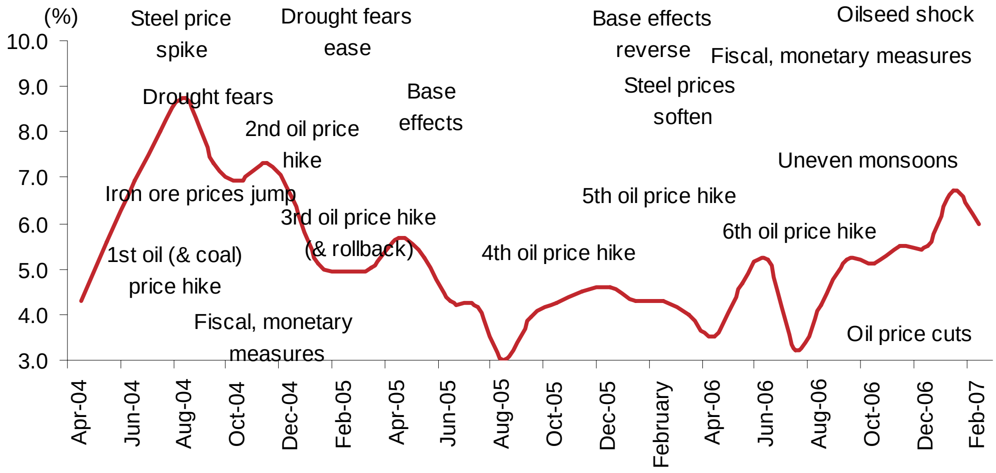
Excessive monetary tightening an emerging risk. We grow increasingly concerned at the way political pressure is forcing monetary policy – 'surprise' CRR hikes, higher-than-warranted Rupee at 108+ REER – into an unwinnable fight against supply-side inflation.

- It is thus not a coincidence, as we constantly stress, that headline inflation continues to follow its own wayward course despite all of Governor Reddy's hawkish posturing (Exhibit 1).
- For all the talk about overheating (to which we do not subscribe), inflation actually works out 5.4% within the RBI's 5-5.5% inflation band, net of rising oilseed/ edible oil/ oilcake prices.
- While the RBI obviously cannot fight an oilseed shock, further monetary tightening will likely impact growth, especially with real lending rates rapidly approaching neutral.
- After the latest CRR hike, real lending rates – currently 7.25% - will likely close in on the 7.8% real GDP growth rate on the back of a persistent credit gap even assuming (1) a 1% SLR cut and (2) a moderation in credit offtake to 21% (Exhibit 2).
- The India story's best bet: a 1QFY08E inflation peak off – which we expect – that allows the government/RBI to showcase a victory and pause monetary tightening (Exhibit 3).

Congress party blames excessive money supply for higher inflation, poll reverses. Media reports suggest that a Congress party panel, led by Veerappa Moily, a former Karnataka chief minister, has endorsed – surprise, surprise! – party president Sonia Gandhi's view that inflation lost the party elections in Punjab and Uttarakhand.

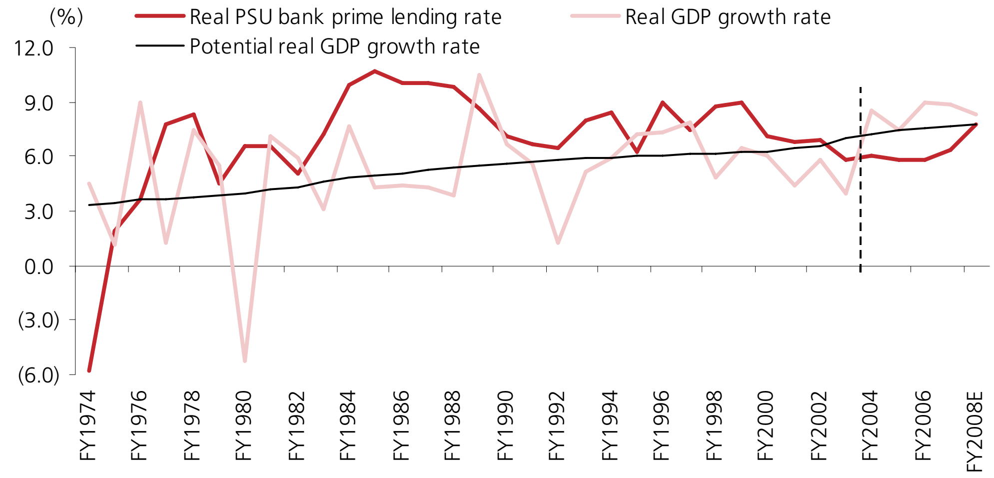
- Mrs Gandhi was, of course, absolutely right: Indian voters do punish governments – perhaps not always rationally - for high inflation. Her party, however, seem unwilling to accept the simple home-truth that agricultural prices do shoot up when monsoons fail and governments facing polls at this unfortunate time often pay a political price that may not always be fully deserved.
- Making a scapegoat of the Rain God is presumably too dangerous for a party so badly in need of divine blessings in the forthcoming UP polls. Mr Moily, at least, has decided to play safe by targeting a paper god - the RBI – by blaming the higher inflation on excessive M3 growth – admittedly running at 22% ahead of the optimal 17.5% consistent with 5% inflation expectations.
- This sudden rediscovery of monetarism – poor Milton Friedman obviously died four months too early – unfortunately ends up carricaturing a long-term relationship between money, prices and output into a data-point by data-point affair. Viewed over the two years, an optimal 17.6% M3 growth is well-aligned to optimal 5% inflation (Exhibit 4).
- And then there is, as always, in the best Congress tradition, the Foreign Hand. The higher money supply, Mr Moily has reportedly discovered , was fuelled "…entirely by the inflow of foreign funds…", never mind that a looming SLR deficit is escalating the onus of primary liquidity generation on forex intervention.
- Although foreign funds are evil, foreign central banks still appear to have a lesson to teach. It is because the RBI did not follow the quick response of central banks around the world in 2004 at the first hint of inflation, the good Mr Moily reportedly laments, that "…instead of calibrated changes in interest rates, consumers are now faced with sudden increase, sharper than expected…".
- The Congress, the media reports, does not, however, want higher interest rates - no siree! – in its quest for monetary discipline. This apparently reflects the party's growing concern – as reported in the press - that higher interest rates, especially in the housing loan segment, might further alienate an electorate already reeling under rising food prices.

Exhibit 1: Monetary policy is naturally powerless against supply-side inflation
E1



Source: Ministry of Industry, Government of India.

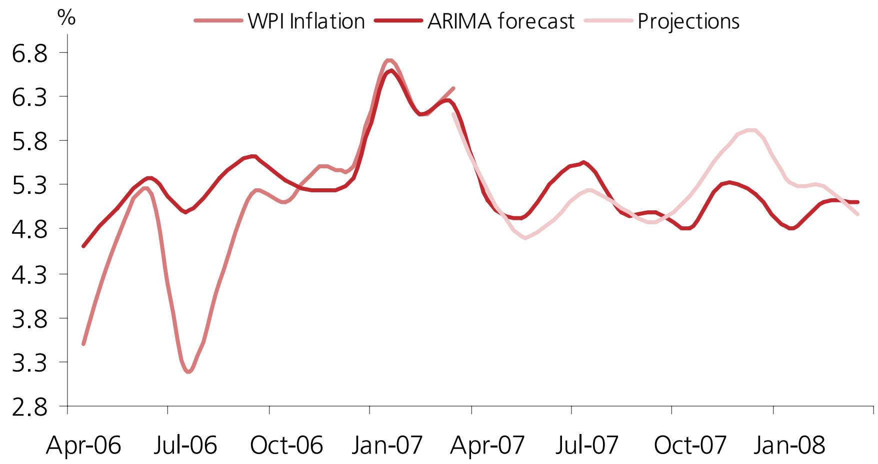
Exhibit 2: Interest rates already nuetral, further tightening will likely impact growth
Real PSU bank prime lending rate, real GDP growth rate (%)



Source: CSO, RBI, Kotak Institutional Equities.

Exhibit 3: We expect an inflation peak off to take the panic out of monetary policy

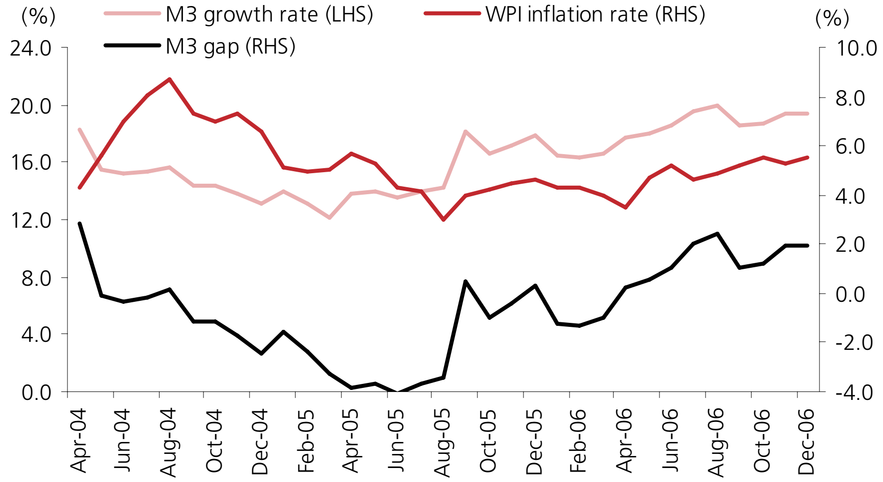
WPI, WPI (ARIMA forecast) y-o-y %



Source: Ministry of Industry, Government of India.

Exhibit 4: Pop monetarism apart, money gap is nuetral over the cycle

Broad money growth rate, WPI inflation (%)



Source: Ministry of Industry, Government of India, RBI.

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Kotak Institutional Equities Research coverage universe

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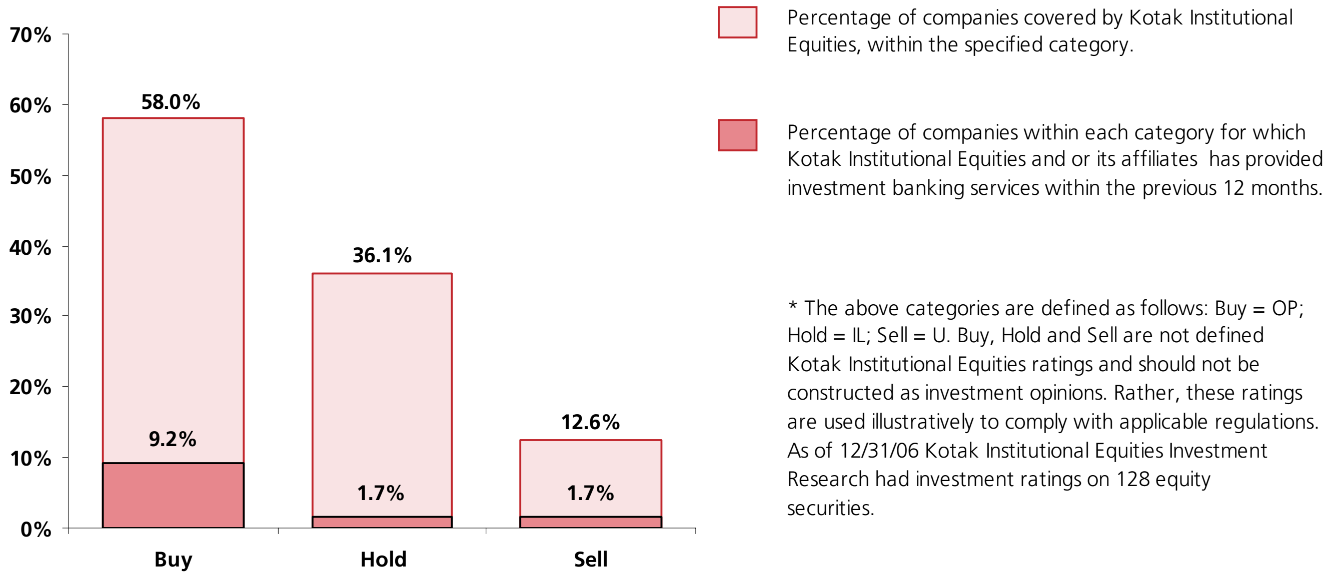

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 12/31/06 Kotak Institutional Equities Investment Research had investment ratings on 128 equity securities.

Source: Kotak Institutional Equities. *As of December 31, 2006*

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Definitions of ratings

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