kotak® Institutional Equities

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News Roundup

Corporate

- The Indian cricket board's official Twenty20 league, the Indian Premier League (IPL), has secured five-year title sponsorship rights worth Rs200 crore ahead of its launch in April, organizers said on Wednesday. Real estate developer DLF Ltd won the sponsorship deal. (Mint)
- Close on the heels of IBM and TCS asking staff to leave on account of poor performance, Yahoo! India, it is learnt, has shown the door to 45 full-time employees across all levels. (BS)
- Damac Properties, the largest private sector developer in the Middle East, has firmed up plans to invest over $5 billion over the next three to five years in India's burgeoning real estate market. (FE)
- Twenty five Indian companies raised a total of $8.3 billion on the Nasdaq Portal Market in 2007, a senior Nasdaq official said. They include Reliance Industries, Suzlon Energy, Axis Bank, DLF, Power Finance Corporation, Idea Cellular, IDFC and Mundra Ports. The Nasdaq Portal Market facilitates trading in those securities that are not registered with the US market regulator SEC and are referred to as 144A securities. (BL)

Economic and political

- Chandrasekhar Bhaskar Bhave is set to take over as the next chairman of the Securities and Exchange Board of India (Sebi). Mr Bhave, who heads the country's leading depository, National Securities Depository, was chosen by the government after a meeting between the prime minister and finance minister, sources said. (ET)
- Sebi has stated that art funds cannot be set up without obtaining a certificate of registration from it. Failing this, the regulator can take civil or criminal action against the funds or companies. (BS)

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

EQUITY MARKETS

		Change, %		
India	**13-Feb**	**1-day**	**1-mo**	**3-mo**
Sensex	16,949	2.1	(18.2)	(15.0)
Nifty	4,929	1.9	(20.6)	(17.0)
Global/Regional indices				
Dow Jones	12,552	1.4	(1.8)	(5.1)
Nasdaq Composite	2,374	2.3	(4.2)	(10.2)
FTSE	5,880	(0.5)	(5.4)	(8.6)
Nikkie	13,433	2.8	(4.8)	(13.3)
Hang Seng	23,792	2.7	(10.1)	(18.4)
KOSPI	1,675	2.6	(5.2)	(15.1)

Value traded - India

			Moving avg, Rs bn	
	13-Feb		**1-mo**	**3-mo**
Cash (NSE+BSE)	188.5		223.8	127.4
Derivatives (NSE)	375.6		684.5	673
Deri. open interest	679.4		1,259	969

Forex/money market

		Change, basis points		
	13-Feb	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.7	0	46	44
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.5	(1)	(6)	(43)

Net investment (US$mn)

	12-Feb		MTD	CYTD
FIIs	(29)		1,249	(4,271)
MFs	(25)		(69)	1,923

Top movers -3mo basis

		Change, %		
Best performers	**13-Feb**	**1-day**	**1-mo**	**3-mo**
Punjab Tractors	241	2.5	(24.6)	19.3
Apollo Tyres	43	(2.7)	(22.7)	18.6
BPCL	419	0.6	(10.2)	15.9
Asian Paints	1,142	(0.9)	1.5	13.8
Thomas Cook	63	(3.7)	(34.9)	12.2
Worst performers				
MRF	4,229	0.4	(34.2)	(44.5)
Moser Baer	172	(2.7)	(40.9)	(39.9)
Arvind Mills	44	(1.0)	(44.3)	(37.9)
Neyveli Lignite	135	(0.4)	(45.1)	(37.1)
Titan Inds	991	0.3	(36.5)	(36.5)

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Consumer Products

HLL.BO, Rs193	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	230
52W High -Low (Rs)	244 - 166
Market Cap (Rs bn)	426.0

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	121.0	135.6	151.9
Net Profit (Rs bn)	15.5	17.7	20.5
EPS (Rs)	7.0	8.0	9.3
EPS gth	*18.3*	*14.0*	*15.6*
P/E (x)	27.4	24.0	20.8
EV/EBITDA (x)	21.5	18.7	16.0
Div yield (%)	3.5	5.4	4.5

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.4	-	-
FIIs	13.2	0.7	(0.5)
MFs	3.9	1.4	0.1
UTI	-	-	(1.2)
LIC	7.4	2.4	1.1

Hindustan Unilever: 4QCY07 results—High quality growth; confident outlook for 2008

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- **Pivotals—detergents and skin lead growth**
- **'Amaze' arrived—poised to succeed if the flavor clicks**
- **HUL needs to plug the gaping losses too**
- **We retain ADD rating and DCF-based target price of Rs230/share**

HUL reported sales growth of 16.8%, EBITDA growth of 12.8% and PAT growth of 23.5% for the quarter ended December 2007 as against our estimates of 12.8%, 18.9% and 16.6%, respectively. Core FMCG business grew by an impressive 18% with volumes growth of 8.4% in a highly conducive growth environment. The FMCG growth at 18% surprised the street positively. Significantly higher ad spends (up 32% yoy) were partly financed by higher price realizations in HPC business. Marginally higher effective tax rate due to certain factories going out of fiscal benefit period limited net profit growth to 15.3%. Management exuded high level of confidence in delivering sustained profitable growth in the face of commodity prices and competition headwinds. We believe the stock will likely revert to our DCF-based target price of Rs230 in the near-term due to strong underlying growth in core portfolio of detergents and skin. Dividend yield (4%) and cheap valuations (21X CY09, lowest in over five years) limits downside. We have finetuned our estimates to reflect better sales growth while build in lower other income. We estimate HUL's EPS at Rs9.2 (Rs9.4 previously) for CY2008 and Rs10.6 (Rs10.8 previously) for CY2009. We retain ADD rating and target price of Rs230/share.

Pivotals—detergents and skin lead growth

HUL reported FMCG growth of 18% yoy during the quarter led by 18.3% growth in soaps & detergents and 19% growth in personal products. We believe the following were the key drivers (as highlighted in our earlier note dated February 5, 2008):

1. Beneficial base effect (personal products business grew at 2.5% in 4QCY06)
2. Late Diwali, resulting in festival sales getting captured in the December quarter of 2007
3. Extended and harsh winter in north and east India
4. Additional fiscal benefit from new facility for Lakme in Haridwar
5. Replenishment of pipeline inventory in oral and skin

We highlight that the detergent category is in a sweet spot for growth now with gross margins returning to the 20-25% bracket. The bitter price battle between HUL and P&G from 2004 coupled with a tough input costs scenario (caustic soda, soda ash, linear alkyl benzene) had brought down the profitability of this category to ~15% gross margin levels. In the past three years, HUL and P&G have gained a combined market share of over 5% mostly from regional players. We believe that with P&G gaining substantially in urban areas and in distribution depth in rural, the tidings are favorable in this category for a sustained albeit slow margin improvement. Moreover, the likely return of pricing power in detergents will aid HUL in financing the investment requirements of categories with hyper-competition (shampoo, skin) and of the nascent foods and water business.

'Amaze' arrived—poised to succeed if the flavor clicks

In line with its stated strategy in foods portfolio, HUL has recently launched a health drink under the 'Kissan Amaze' brand. The product is under the functional food (brain food) platform and is targeted at children. The size of the malted drink category in India is estimated at Rs15 bn and is growing at about 10%. HUL's current food business is estimated at about Rs5 bn and Amaze can potentially become a big part of the portfolio. We are excited about the opportunity which HUL is tapping in the category. Amaze will compete against Horlicks, Complan, Bournvita, Boost, Protinex etc. The product positioning as a brain food with key functional differentiator places Amaze with a significant high chance to succeed. However, we believe HUL needs to get the flavor (taste) right in this product—(1) it's a product for kids and hence the flavor (taste) has to be popular, and (2) intake of health drink is linked to habit and hence it is difficult to persuade customers to switch. We keenly await the market feedback of the new launch.

Unilever has earlier said it will focus on products providing the goodness of tea, fruits and vegetables, milk, soy and oils. The Amaze brand is from the Unilever's global foods portfolio and was launched in Turkey in January 2007. We expect the company to launch flanking products under the health and nutrition platform, including a breakfast cereal. The pricing for Amaze is at a significant premium to the competition (Amaze at about Rs140 for 400 gm, Horlicks at about Rs120 for 500 gms). The product is launched in multiple formats like malted drink (comparable to malted beverages like Complan, Horlicks, Bournvita), energy bars, cubes etc. The product was launched in Tamil Nadu and Karnataka. We believe this is a significant statement of intent by the company after the experiences in processed foods in the early part of this decade.

However, HUL needs to plug the gaping losses too.

Tea: HUL continues to lose market share to Tata Tea in Tea category. We believe the brand rationalization led growth in Brooke Bond and Lipton during the 2003-06 period has run its course. HUL needs to rejuvenate the tea portfolio with relevant launches in top-end tea, we believe the company will relaunch the tea portfolio in late 2008.

Toothpaste: HUL's market share in toothpaste touched a ten-year low of 29.5% in December 2007. Over the past three years, the share losses in Pepsodent (to Colgate, Babool) were limiting the category growth as CloseUp continued to perform well. The company has recently launched Pepsodent 'Mahapack'—flow wrapped toothpaste of 30 gms priced at Rs6. We believe this SKU (stock keeping unit) could be a success for HUL given the value proposition. In our note dated January 3, 2008, we had highlighted that HUL would be uncomfortable if its market share dipped below 30% and is expected to look at various options to prevent further market share loss. Though oral care is a non-focus category for parent Unilever, it contributes significantly to HUL's EBITDA. We estimate HUL's oral care business at Rs7.5 bn, with gross margins of about 45%. However, we believe the likelihood of a price-based competition is low. We expect HUL to have higher resource allocation for categories with hyper-competition (shampoo, skin) and investment requirements of foods and water business.

We retain ADD rating and DCF-based target price of Rs230/share.

We estimate EPS growth of 15% in CY2008 with improvement in detergents profitability and mix improvement in personal products. We believe HUL can potentially cutback in A&P to counter any disappointment caused by slower sales growth or more than anticipated cost pressures. The macro environment remains robust and we expect the FMCG sales growth momentum (especially in rural areas) exhibited during CY2006 and 2007 to retain during CY2008 as well. We believe the stock will perform in line with the broader markets given the expected better near-term performance.

We estimate HUL to maintain the annual payout at 90% and Rs8/share dividend for CY2008 providing a 4% yield at the current market price of Rs192. In August 2007, the company had announced a proposal for buyback of its shares up to Rs6.3 bn. The company has completed the buyback through open market purchases at an average price of about Rs207.

We believe the stock will likely revert to our DCF-based target price of Rs230 in the near-term due to strong underlying growth in core portfolio of detergents and skin. Dividend yield (4%) and cheap valuations (21X CY09, lowest in over five years) limits the downside. We estimate HUL's EPS at Rs9.2 (Rs9.4 previously) for CY2008 and Rs10.6 (Rs10.8 previously) for CY2009. We retain ADD rating and target price of Rs230/share.

Exhibit 1: HUL-Quarterly summary, December year-ends (Rs mn)

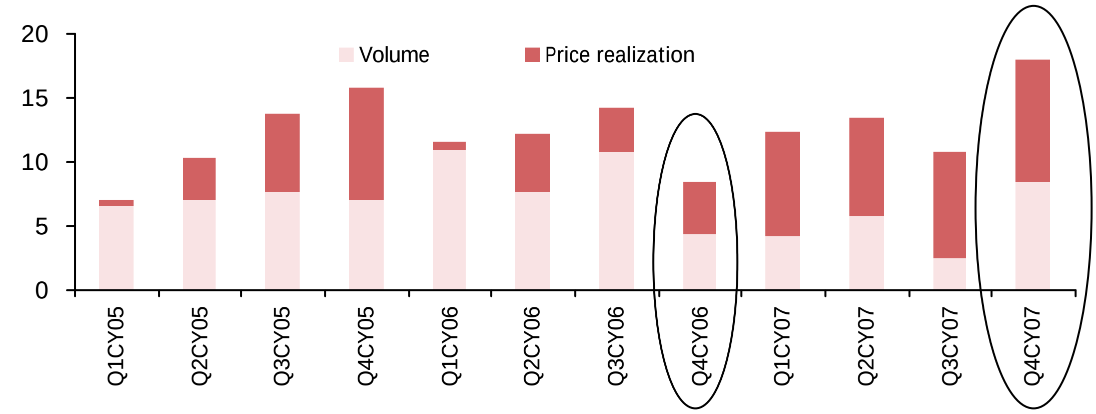
		yoy			yoy			Our est.	yoy
	4QCY07	**4QCY06**	**% chg**	**2007**	**2006**	**% chg**		**4QCY07**	**% chg**
Net sales	**36,874**	**31,561**	**16.8**	**137,178**	**121,034**	**13.3**	*	**35,592**	**12.8**
Material cost	(19,001)	(17,115)		(73,109)	(65,028)			(18,519)	
Employee cost	(1,945)	(1,336)		(7,678)	(6,428)			(1,484)	
Other overheads	(10,286)	(8,111)		(37,534)	(33,097)			(9,642)	
- Advertising & Promotions	(3,759)	(2,840)		(14,229)	(12,729)			(3,550)	
Total expenses	(31,232)	(26,561)		(118,320)	(104,554)			(29,645)	
EBITDA	**5,642**	**5,000**	**12.8**	**18,857**	**16,480**	**14.4**		**5,947**	**18.9**
Depreciation	(369)	(342)		(1,384)	(1,302)			(362)	
EBIT*	5,273	4,658	13.2	17,474	15,179			5,584	19.9
Other income	1,597	1,070		4,627	3,545			1,210	
Net interest	(26)	(18)		(255)	(107)			(39)	
PBT	**6,844**	**5,709**	**19.9**	**21,845**	**18,617**	**17.3**		**6,755**	**18.3**
Tax	(1,321)	(918)		(4,172)	(3,218)			(1,166)	
PAT	**5,523**	**4,791**	**15.3**	**17,674**	**15,399**	**14.8**		**5,589**	**16.6**
Extraordinary income (loss)	791	320		1,581	3,154			-	
Net profit	**6,314**	**5,111**	**23.5**	**19,255**	**18,553**	**3.8**		**5,589**	**9.3**
EBITDA margin (%)	15.3	15.8		13.7	13.6			16.7	
Effective tax rate (%)	19.3	16.1		19.1	17.3			17.3	
Costs as % of net sales									
Material cost	51.5	54.2		53.3	53.7			52.0	
Employee cost	5.3	4.2		5.6	5.3			4.2	
Other overheads	27.9	25.7		27.4	27.3			27.1	
- Advertising & Promotions	10.2	9.0		10.4	10.5			10.0	
Broad category sales									
Domestic FMCG	32,784	27,774	18.0	121,554	107,139	13.5		31,887	14.8
HPC	27,066	22,868	18.4	99,436	88,731	12.1		26,281	14.9
Foods	5,718	4,906	16.6	22,119	18,408	20.2	*	5,606	14.3
Exports	3,437	3,473	(1.1)	13,423	12,789	5.0			
Others	653	314	108.2	2,201	1,106	98.9			
Discontinued business	-	-		-	-				
Total	**36,874**	**31,561**		**137,178**	**121,034**				

* Adjusted for impact of merger of Modern Foods, net sales growth and Foods segment growth is lower at 8.9% and 11.8%

Source: Company data, Kotak Institutional Equities.

Exhibit 2: Detergents and skin category lead volume growth in 4QCY07

Volume, price realization growth for FMCG in percentage



Source: Company data, Kotak Institutional Equities.

Exhibit 3: Market shares indicates pockets of significant losses except Laundry

Value market shares (%) for December quarter 2007

Category	Market share	yoy	Remarks
Detergents	37.5	290	Excellent activation, product mix management and benefits of favorable competition
Personal Wash	54.3	(100)	Price hikes hurting volumes
Skincare	54.5	(20)	Relaunch of Fair & Lovely
Hair	47.8	(70)	Losses in Clinic portfolio, may have to correct price - value equation in Clinic Plus
Toothpaste	29.5	(90)	Non-focus category with objective to maintain current position, Pepsodent 'Mahapack' launched in January 2008
Tea	22.7	(20)	Tata Tea gaining at the middle and low-end
Coffee	44.0	110	Both instant and conventional coffee gain

Source: Company data for market share, Kotak Institutional Equities.

Exhibit 4: Gains galore

Sales growth and EBIT margins in percentage

Segment	Sales growth %	EBIT margin (%) 4QCY07	EBIT margin (%) 4CY06	Remarks
Soaps and Detergents	18.3	17.2	15.6	Price increases ahead of cost inflation, higher fiscal benefits
Personal Products	19.1	33.4	31.9	Fair & Lovely relaunch, price hikes, mix improvement
Beverages	11.3	15.4	19.7	Higher adspend in Tea, higher coffee commodity prices
Foods	41.2	7.0	6.3	Improved profitability in atta
Ice Creams	10.8	3.9	10.7	Severe winter impact, possible downtrading
Exports	(1.1)	7.1	5.9	
Others (includes Water)	56.0	(36.6)	(41.3)	Incremental investment in Water

Source: Company data for financials, Kotak Institutional Equities for remarks.

HUL: Profit model, balance sheet, cash model 2005-2009E, December year-ends (Rs mn)

	2005	2006	2007E	2008E	2009E
Profit model (Rs mn)					
Net sales	110,605	121,034	137,178	154,745	174,811
EBITDA	**14,433**	**16621**	**18857**	**22239**	**26278**
Other income	3,048	3,545	4,627	4,417	4,767
Interest	(192)	(107)	(255)	(208)	(58)
Depreciation	(1,245)	(1,302)	(1,384)	(1,528)	(1,697)
Extraordinary items	976	3,155	1,581	-	-
Pretax profits	17,021	21,912	23,426	24,920	29,290
Tax	(2,530)	(2,950)	(3,812)	(4,531)	(5,850)
Deferred taxation	(410)	(268)	(359)	(364)	(385)
Net profits	**14,081**	**18,694**	**19,255**	**20,026**	**23,055**
Earnings per share (Rs)	**6.0**	**7.0**	**8.0**	**9.2**	**10.6**
Balance sheet (Rs mn)					
Total equity	23,056	27,235	17,193	18,276	19,524
Total borrowings	569	726	726	726	726
Currrent liabilities	41,183	45,231	54,205	57,338	64,609
Total liabilities and equity	**64,809**	**73,191**	**72,124**	**76,341**	**84,858**
Cash	3,550	4,169	4,682	4,299	7,396
Current assets	24,080	27,527	31,309	34,961	39,259
Total fixed assets	14,835	15,110	16,248	17,559	19,068
Investments	20,142	24,139	17,999	17,999	17,999
Deferred tax asset	2,201	2,245	1,886	1,523	1,137
Total assets	**64,809**	**73,191**	**72,124**	**76,341**	**84,858**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	15,908	20,209	21,202	22,072	25,426
Working capital	5,858	(471)	1,513	1,121	1,428
Capital expenditure	(904)	(1,576)	(2,522)	(2,838)	(3,206)
Investments	2,452	(4,309)	6,141	-	-
Free cash flow	**23,314**	**13,852**	**26,334**	**20,355**	**23,647**
Key assumptions					
Revenue Growth (%)	11.4	9.4	12.3	13.9	13.0
EBITDA Margin(%)	13.2	13.9	14.1	14.4	15.0

Source: Kotak Institutional Equities estimates.

Energy

RPET.BO, Rs145	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	175
52W High -Low (Rs)	295 - 65
Market Cap (Rs bn)	652

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	0.0	0.0	171.6
Net Profit (Rs bn)	-	-	20.2
EPS (Rs)	-	-	4.5
EPS gth	-	-	-
P/E (x)	-	-	32.3
EV/EBITDA (x)	-	-	26.9
Div yield (%)	-	-	-

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	2.3	0.2	(1.5)
MFs	0.6	0.3	(1.4)
UTI	-	-	(1.7)
LIC	1.8	0.8	(0.9)

Reliance Petroleum: Upgraded to ADD—recent correction and likely good refining cycle provide upside

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- **Refining margins to be healthy unless global downturn is more severe versus expectations**
- **Risk-reward balance more favorable after recent steep correction**
- **Upgraded to ADD (SELL previously); no change in target price of Rs175**

We have upgraded RPET stock to ADD from SELL noting the steep decline in the stock price over the past one month (36%); the stock now offers good potential upside to our 12-month target price of Rs175 based on 9X annualized FY2009E EPS. We like Reliance Petroleum's fundamentals and its very competitive position among global refining companies. It is probably best placed to take advantage of the likely healthy refining margins over the next few years. We expect refining margins to decline moderately due to significant capacity addition in CY2008-10E but still be well above mid-cycle levels. Key downside risk stems from lower-than-expected refining margins due to potential slowdown in global economic growth, which may impact demand for refined products.

Risk-reward balance more favorable after recent correction. We believe RPET stock offers good opportunity after the recent correction in the stock prices. RPET stock has declined sharply by 36% over the past month, significantly under-performing the local index (BSE Sensex) which declined by 19% over the same period. The stock now offers 21% potential upside to our 12-month target price of Rs175 based on 9X annualized FY2009E EPS. Our 12-month DCF valuation for RPET stock comes to Rs114; however, we use a multiple-based valuation approach to value the stock to factor in (1) reinvestment of generated cash in a new refinery or any other business, which would sustain earnings and cash flows at FY2010E levels (or annualized FY2009E levels), and (2) reinvestment of generated cash in a value-accretive business (ROE > COE). Without reinvestment of generated cash, we note that RPET's earnings will decline from FY2014E even if refining margins sustain due to higher taxation. RPET has 100% income tax exemption on exports for the first five years of operations (FY2009-13E), 50% for the next five (FY2014-18E) and up to 50% for the final five subject to reinvestment in the business.

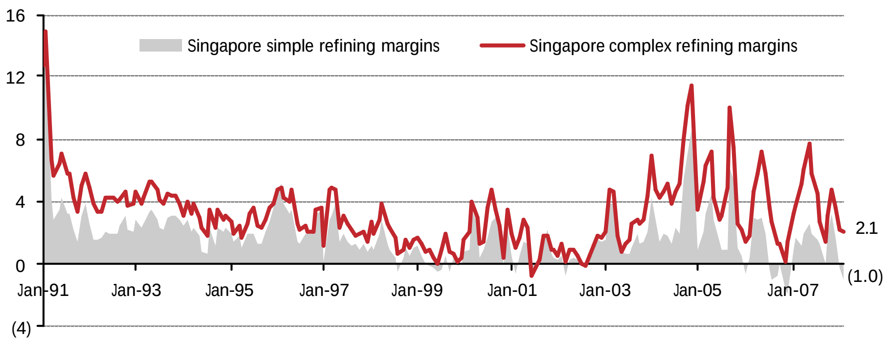
Maintain moderately positive view on refining cycle—refining margins to decline marginally but still remain high. We maintain our positive view of refining cycle with reasonably strong refining margins led by high global operating rates; we expect global refining rates to remain at around 87% over the next few years (Exhibit 2). We model FY2010-12E refining margins for RPET at US$15.9/bbl, US$15/bbl and US$14.9/bbl, respectively. Exhibit 3 shows the sensitivity of RPET's EPS to changes in refining margins and exchange rate.

We model refining margins to decline moderately over CY2008E-10E with incremental supply largely matching incremental demand. Our base-case scenario of declining margins assumes that oil demand grows reasonably strongly with growth led by China, Middle East and India with a modest decline from US in CY2008E. However, we may have to revisit our demand assumptions in case of a recession in the US. We expect refining capacity addition of 1.3 mb/d, 1.8 mb/d and 1.7 mb/d in CY2008E, CY2009E and CY2010E, respectively (Exhibit 4). In addition, we note natural gas liquids (NGLs) supply would also increase by 0.4 mb/d, 0.8 mb/d and 0.6 mb/d in CY2008E, CY2009E and CY2010E (Exhibit 5).

Exhibit 6 gives the status of certain large refining projects, ongoing and announced. We note that many of these projects have slipped considerably from their original schedules and any further delay in completion of some of the projects will push capacity utilization to very high levels; high operating rates could also potentially lead to more frequent unplanned outages due to plant breakdowns, leading to spikes in product prices and thus, refining margins.

We expect refining margins to remain strong despite slight moderation led by capacity additions in CY2008-10E

Singapore refining margins (US$/bbl)



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

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	1.69	(0.32)	1.29	0.51	0.30	1.05	1.69	3.02	2.52	2.25
2Q	0.14	(0.08)	2.47	0.45	0.07	1.20	3.13	2.78	(0.70)	0.99
3Q	0.94	0.14	1.74	1.06	1.44	1.57	6.46	2.22	(1.25)	2.32
4Q	0.62	1.86	0.21	(0.03)	2.98	2.88	2.08	1.09	1.25	(0.36)
Average	**0.85**	**0.40**	**1.43**	**0.50**	**1.20**	**1.67**	**3.34**	**2.28**	**0.45**	**1.56**

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

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
1Q	2.89	0.43	1.86	1.34	0.79	1.24	4.57	4.93	6.24	6.58
2Q	1.14	1.19	3.96	0.58	0.14	2.35	5.80	6.11	2.46	2.91
3Q	1.42	0.41	2.25	1.22	1.56	3.23	9.04	3.94	0.98	3.91
4Q	1.28	2.64	1.60	0.65	3.70	5.44	5.02	2.77	4.11	2.15
Average	**1.68**	**1.17**	**2.42**	**0.95**	**1.55**	**3.06**	**6.10**	**4.44**	**3.45**	**4.16**

Weekly margins (simple)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
(1.01)	(0.99)	(0.53)	(0.26)	0.12

Weekly margins (complex)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
2.05	1.75	2.09	1.96	2.30

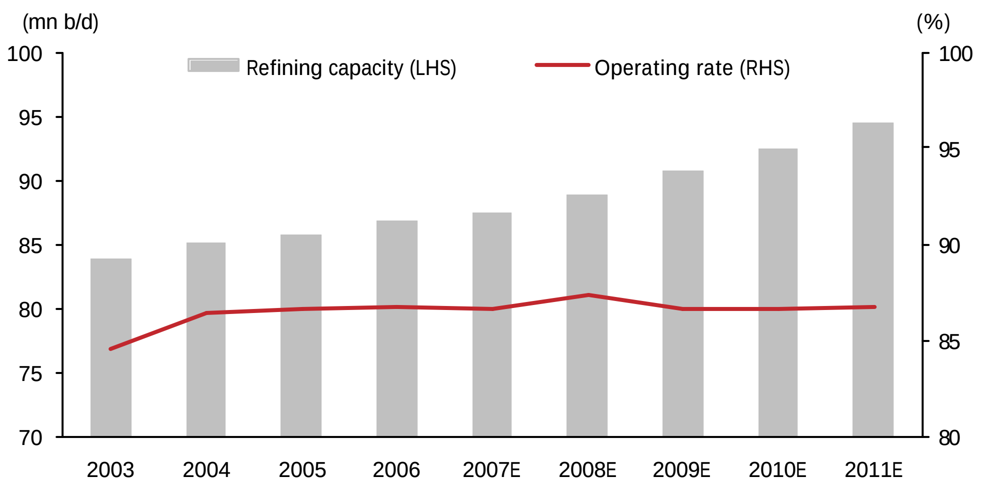
Singapore refining margins, March fiscal year-ends (US$/bbl)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 YTD
Simple	0.40	1.43	0.50	1.20	1.67	3.34	2.28	0.45	1.56
Complex	0.43	1.86	1.34	0.79	1.24	4.57	4.93	3.45	4.16

Source: Bloomberg, Kotak Institutional Equities.

Global refining operating rates will likely remain high

Global refining capacity versus operating rate, calendar year-ends, 2003-2011E



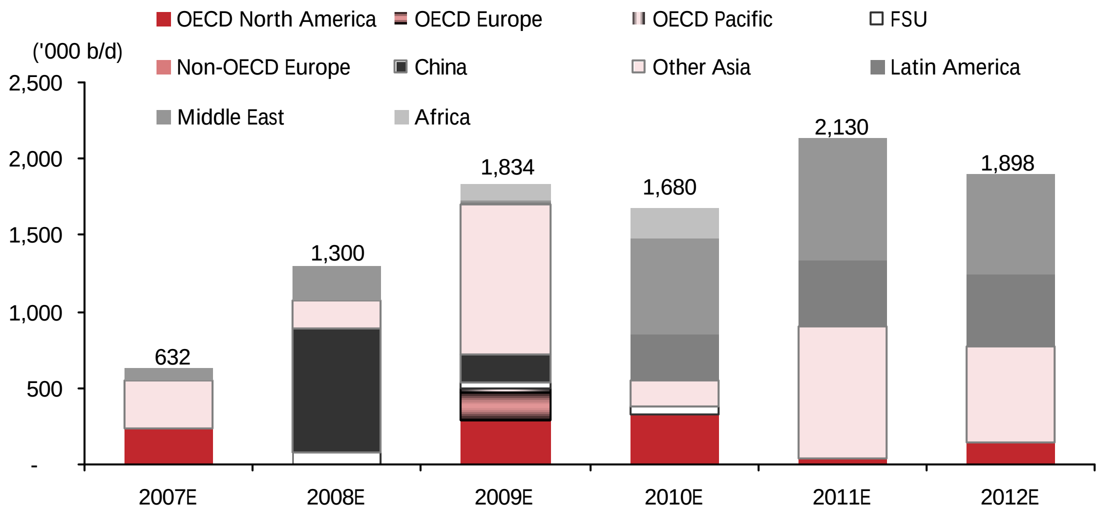
Source: IEA, BP Statistical Review of World Energy, 2007, Kotak Instiutional Equities estimates.

Reliance Petroleum has high leverage to refining margins
Sensitivity of RPL's earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	37.5	38.5	39.5	36.5	37.5	38.5	36.0	37.0	38.0
Net profits (Rs mn)	19,337	20,176	21,108	84,128	87,642	91,157	78,498	81,761	85,024
EPS (Rs)	4.3	4.5	4.7	18.7	19.5	20.3	17.4	18.2	18.9
% upside/(downside)	**(4.2)**		**4.6**	**(4.0)**		**4.0**	**(4.0)**		**4.0**
Refining margins (US$/bbl)									
Margins (US$/bbl)	14.7	15.7	16.7	14.9	15.9	16.9	14.0	15.0	16.0
Net profits (Rs mn)	18,155	20,176	22,290	79,861	87,642	95,424	74,087	81,761	89,435
EPS (Rs)	4.0	4.5	5.0	17.7	19.5	21.2	16.5	18.2	19.9
% upside/(downside)	**(10.0)**		**10.5**	**(8.9)**		**8.9**	**(9.4)**		**9.4**

Source: Kotak Institutional Equities estimates.

Large additions to global refining capacity
Global refinery capacity addition, calendar year ends, 2007-2012E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates.

Significant additions to NGLs supply in CY2008-2010E

Estimated global crude demand, supply and prices, Calendar year-ends

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Demand (mb/d)									
Total demand	82.5	83.9	84.8	85.8	87.8	89.5	91.4	93.3	95.3
Yoy growth	3.3	1.4	0.9	1.0	2.0	1.7	1.9	1.9	2.0
Supply (mb/d)									
Non-OPEC	48.8	48.6	49.1	49.7	50.7	51.5	51.8	52.1	52.5
Yoy growth	0.6	(0.2)	0.5	0.6	1.0	0.8	0.3	0.3	0.4
OPEC									
Crude	29.5	30.8	31.5	31.3	31.7	31.7	32.9	34.3	35.7
NGLs	4.2	4.5	4.6	4.8	5.4	6.3	6.7	6.9	7.1
Total OPEC	**33.7**	**35.3**	**36.1**	**36.1**	**37.1**	**38.0**	**39.6**	**41.2**	**42.8**
Total supply	**83.4**	**84.6**	**85.4**	**85.8**	**87.8**	**89.5**	**91.4**	**93.3**	**95.3**
Total stock change	1.0	0.7	0.8						
OPEC crude capacity				**34.4**	**35.5**	**36.1**	**37.1**	**37.9**	**38.4**
Implied OPEC spare capacity				**3.1**	**3.8**	**4.4**	**4.2**	**3.6**	**2.6**
Demand growth (yoy, %)	**4.2**	**1.7**	**1.1**	**1.2**	**2.3**	**1.9**	**2.1**	**2.1**	**2.1**
Supply growth (yoy, %)									
Non-OPEC	**1.2**	**(0.4)**	**1.0**	**1.2**	**2.0**	**1.6**	**0.6**	**0.6**	**0.8**
OPEC	**8.4**	**4.7**	**2.4**	**(0.0)**	**2.7**	**2.4**	**4.2**	**4.0**	**3.9**
Total	**4.4**	**1.4**	**0.9**	**0.5**	**2.3**	**1.9**	**2.1**	**2.1**	**2.1**
Dated Brent (US$/bbl)	**38.3**	**54.4**	**65.8**	**72.7**	**75.0**	**75.0**	**75.0**	**70.0**	**70.0**

Source: IEA, BP Statistical Review of World Energy, and various government and industry sources.

Most large refining projects are still in the planning or early project stage

Status of large (>200,000 b/d) refining projects, ongoing and announced

Company	Location	Capacity addition (b/d)	Expected completion	Status
Kuwait National Petroleum Co.	Al-Zour, Kuwait	615,000	2010	Engineering
Reliance Petroleum	**Jamnagar, India**	**580,000**	**2008**	**Under construction**
Petrobras/PDVSA	Abreu e Lima, Brazil	500,000	2014	Planning
ConocoPhillips	Fujairah, United Arab Emirates	500,000		Feasibility study
Saudi Aramco	Jubail, Suadi Arabia	400,000	2011	Engineering
Saudi Aramco	Yanbu, Saudi Arabia	400,000	2012	Engineering
PDVSA	Cabruta, Venezuela	400,000	2011	Engineering
Motiva Enterprises LLC	Port Arthur, Texas, USA	325,000	2010	Engineering
Ministry of Energy and Mines	Jaraminjo, Manabi, Ecuador	300,000	2012	Planning
Kuokuang Petrochemical Technology Corp.	Yunlin Co., Taiwan	300,000	2012	Planning
HPCL Mittal	**Bhatinda, India**	**300,000**	**2011**	**Under construction**
Shell	Ft. Saskatchewan Sarnia, ON, Canada	250,000	2014	Planning
US Army Corps of Engineers	Northern Iraq, Iraq	250,000	2012	Engineering
CNOOC	**Daya Bay, Huizhou, Guangdong, China**	**240,000**	**2008**	**Construction**
Sinopec	**Qingdao, China**	**205,500**	**2008**	**Under construction**
Sonangol	Lobito, Angola	200,000	2010	Engineering
Petrobras/PDVSA	Abreu e Lima, Brazil	200,000	2010	Construction
Petrochina	Dagang, Qinzhou, China	200,000	2008	Engineering

Source: Oil & Gas journal.

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

	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Rs/US$	38.5	37.5	37.0	37.0	37.0	37.0	37.0
Import tariff on crude oil (%)	—	—	—	—	—	—	—
Refinery yield (US$/bbl)	78.7	78.8	77.9	77.7	77.7	77.4	77.4
Cost of crude (US$/bbl)	62.7	62.7	62.7	62.7	62.7	62.7	62.7
Landed cost of crude (US$/bbl)	63.0	62.9	62.9	62.8	62.8	62.8	62.8
Net refining margin (US$/bbl)	**15.7**	**15.9**	**15.0**	**14.9**	**14.9**	**14.6**	**14.6**
Crude throughput (mn tons)	**7.5**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**
Fuel and loss (mn tons)	0.2	—	—	—	—	—	—
Production of main products (mn tons)	7.4	29.0	29.0	29.0	29.0	29.0	29.0
Fuel and loss-own fuel used (%)	2.0	—	—	—	—	—	—
Fuel & loss equivalent-gas used (%)	6.0	8.0	8.0	8.0	8.0	8.0	8.0
Cost of natural gas (US$/mn BTU)	5.3	5.3	5.3	5.3	5.3	5.3	5.3

Source: Kotak Institutional Equities estimates.

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

	2009E	2010E	2011E	2012E	2013E	2014E
Profit model						
Net revenues	171,605	654,043	635,489	633,824	633,824	631,326
EBITDA	**29,127**	**112,955**	**101,455**	**99,869**	**99,634**	**96,905**
Other income	128	124	162	1,872	3,503	3,439
Interest (expense)/income	(3,612)	(8,587)	(3,043)	—	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**20,656**	**89,702**	**83,675**	**86,733**	**88,022**	**85,120**
Extraordinary items	—	—	—	—	—	—
Tax	(481)	(2,059)	(1,914)	(1,913)	(1,941)	(13,728)
Deferred taxation	—	—	—	—	—	1,624
Net income	**20,176**	**87,642**	**81,761**	**84,820**	**86,081**	**73,017**
Earnings per share (Rs)	**4.5**	**19.5**	**18.2**	**18.8**	**19.1**	**16.2**
Balance sheet						
Total equity	154,664	231,777	303,009	345,711	331,082	318,672
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	134,670	84,670	—	—	—	—
Current liabilities	12,292	42,837	42,260	42,239	42,239	42,239
Total liabilities and equity	**301,626**	**359,284**	**345,269**	**387,950**	**373,320**	**359,287**
Cash	1,910	2,123	3,198	59,104	57,581	56,971
Other current assets	30,805	101,041	98,850	98,632	98,641	98,442
Net fixed assets	266,631	253,840	240,941	227,934	214,818	201,594
Capital work-in-progress	—	—	—	—	—	—
Investments	2,280	2,280	2,280	2,280	2,280	2,280
Deferred expenditure	—	—	—	—	—	—
Total assets	**301,626**	**359,284**	**345,269**	**387,950**	**373,320**	**359,287**
Free cash flow						
Operating cash flow, excl. working capital	25,034	102,309	96,498	97,956	97,693	83,177
Working capital changes	(13,961)	(39,690)	1,614	196	(9)	199
Capital expenditure	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	128	124	162	1,872	3,503	3,439
Free cash flow	**(5,399)**	**60,743**	**96,274**	**98,024**	**99,187**	**84,815**
Ratios (%)						
Debt/equity	87.1	36.5	0.0	—	—	—
Net debt/equity	85.8	35.6	(1.1)	(17.1)	(17.4)	(17.9)
ROAE (%)	14.0	45.4	30.6	26.2	25.4	22.5
ROACE (%)	**8.6**	**31.7**	**27.4**	**26.2**	**25.4**	**22.5**

Source: Kotak Institutional Equities estimates.

Energy

ONGC.BO, Rs944	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	1,325
52W High -Low (Rs)	1387 - 750
Market Cap (Rs bn)	2,019

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	932	1,041	1,058
Net Profit (Rs bn)	180.6	216.0	240.4
EPS (Rs)	84.4	101.0	112.4
EPS gth	*15.0*	*19.6*	*11.3*
P/E (x)	11.2	9.3	8.4
EV/EBITDA (x)	4.5	3.8	3.3
Div yield (%)	3.3	3.5	3.5

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	8.6	2.0	(3.1)
MFs	1.0	1.5	(3.6)
UTI	-	-	(5.1)
LIC	2.2	2.9	(2.2)

Oil & Natural Gas Corporation: Compelling valuations with some catalysts

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- **Valuations attractive; time to buy despite subsidy share overhang**
- **Solid earnings, cash flow and dividend yield; attractive features in current market conditions**
- **Retain ADD rating with 12-month target price of Rs1,375**

We find ONGC's valuations attractive at current prices and see a 20-30% upside over the next 12 months. We believe the market is penalizing the stock due to concerns about higher subsidy share for ONGC under the current scenario of high under-recoveries and weak financial health of the downstream companies. However, it appears that the government is committed to sharing a larger portion of the gross under-recoveries through issue of oil bonds to the downstream oil companies. We find ONGC's valuations compelling on current and normalized cash flows and earnings and also see potential catalysts (although not imminent) such as (1) potential new discoveries, (2) potential acquisition of stakes in discovered blocks in Russia, (3) increase in gas price, and (4) partial resolution of the subsidy issue through retail price increase, lower taxation or increase in amount of oil bonds. We reiterate our ADD rating on the stock with 9X normalized FCF-based 12-month target price of Rs1,325 (including valuation for new discoveries in KG basin and Mahanadi basin). Key downside risks are (1) lower-than-expected commodity prices, and (2) higher-than-expected subsidy losses.

Attractive valuations and fundamentals in place. We find ONGC's valuations compelling on current and normalized cash flows and earnings. We believe ONGC's current valuation (8.4X FY2009E EPS or 5.1X FY2009E DACF) reflects the street's concern that ONGC will continue to suffer from subsidy losses in perpetuity; we discuss this issue in detail later in the note. Our reverse valuation exercise suggests that ONGC stock price is currently discounting US$42/bbl in perpetuity.

We believe ONGC stock offers attractive risk-reward balance at current levels. ONGC stock has declined sharply by 27% over the past month, under-performing the local index (BSE Sensex), which declined by 19% over the same period. We do not see any issues with ONGC's fundamentals barring the subsidy issue.

1. **Compellingly valued on normalized earnings.** We use US$60/bbl (Dated Brent basis) normalized price to arrive at the fair valuation of ONGC stock of Rs1,325 (see Exhibit 1). We see potential upside to our long-term price assumptions. Exhibit 2 gives the range of fair valuation of ONGC at various levels of normalized crude price. Our fair valuation also includes contribution from ONGC's recent gas discoveries in KG and Mahanadi basins (Rs63/share or US$3.5 bn). Based on a normalized price of US$60/bbl, the stock is currently trading at 5.7X normalized FCF.
2. **Attractive on current valuations at 8.4X FY2009E EPS.** ONGC is currently trading at 9.2X FY2008E EPS and 8.4X FY2009E EPS. However, adjusted for subsidy losses (which we believe will not last in perpetuity) and full deregulation of gas price the stock is trading at 5.8X FY2008E EPS. On EV/DACF, the stock is currently trading at 5.4X FY2009E (Exhibit 3).
3. **Decent dividend yield of 3.5%.** ONGC stock also offers a decent dividend yield of 3.5% at current levels. We model dividend of Rs33 for FY2008E and FY2009E compared to Rs31 in FY2007.

Overseas assets could be a potential trigger. We doubt the street is according any value to OVL's assets other than the extant producing ones (Vietnam, Sudan, Sakhalin-1 and Columbia). Exhibit 4 shows ONGC's portfolio of overseas assets. We also note that the Indian government is negotiating with Russia for stakes for OVL in certain developed fields in Russia (Sakhalin-3 reported by the press) as part of a larger cooperation arrangement in the energy sector.

Overhang of likely higher subsidy burden on upstream companies hurting sentiment for the stock; higher oil bonds in 3QFY08 should help address this concern. We believe the street is concerned about the likelihood of a higher subsidy burden on upstream companies in the current scenario of large under-recoveries. This concern stems from experience of FY2007 when the government inadvertently increased the share of upstream companies of gross under-recoveries to 41.5% from the normal subsidy share of 33.33%; the share of ONGC was 34% in FY2007 versus the expected 28%. However, we think the FY2007 was an aberration and the government will revert to the previous formula for FY2008E and beyond. Our belief is further strengthened by the issue of higher oil bonds by the government to downstream oil companies in 3QFY08. The government has issued oil bonds worth Rs203 bn to the downstream companies for 9MFY08; this constitutes 42.5% of the total under-recovery of Rs479 bn for the same period (Exhibit 5). Our conversations with oil company officials confirm that the government will bear 42.5% of gross under-recoveries through oil bonds.

Exhibit 6 gives details of our computation of gross under-recovery in FY2008E. Based on actual gross under-recovery until February 2008 and extrapolation of February 2008 subsidy under-recovery figure (Rs90 bn) for March 2008, we compute gross under-recovery at Rs732 bn in FY2008E versus Rs494 bn in FY2007 (government estimates). We model Rs200 bn of subsidy loss for ONGC in FY2008E and Rs160 bn in FY2009E against Rs170 bn in FY2007. We believe the market is penalizing ONGC's valuation by valuing the stock on reported or estimated earnings/cash flow, which include large subsidy losses. In other words, the market is ascribing a multiple to 'lost' earnings or implicitly assuming that the losses (Rs56/share based on FY2008E subsidy loss) will remain in perpetuity.

We value ONGC stock at Rs1,325 on US$60/bbl normalized crude price

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

	2008E	2009E	2010E
A. Core business valuation			
Normalized crude price assumption (US$/bbl)	60.0	60.0	60.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	199,936	222,364	217,816
Add: OCF after normalizing natural gas price	30,064	29,685	25,452
Add: OCF after removing subsidies	126,750	111,101	94,547
Recurring OCF	356,750	363,151	337,814
Recurring capex			
Production per annum (mn bbls)	377	397	390
Replacement or F&D costs (US$/bbl)	8.0	8.0	8.0
Recurring capex	120,670	122,256	117,043
Free cash flow	**236,080**	**240,894**	**220,771**
Free cash flow multiple (X)	9	9	9
Enterprise value	2,124,718	2,168,050	1,986,940
(Net debt)/cash	256,637	410,593	524,274
Investments	103,863	103,863	104,140
Equity value	2,485,218	2,682,506	2,615,354
Equity value of core business (Rs/share)	**1,162**	**1,254**	**1,223**
B. New discoveries valuation			
KG-DWN-98/2 block (Rs/share)	44	49	55
MN-DWN-98/3 block (Rs/share)	13	14	16
Equity value of new discoveries (Rs/share)	**56**	**63**	**71**
Total equity value per share (Rs/share)	**1,218**	**1,317**	**1,294**

Source: Kotak Institutional Equities estimates.

ONGC's valuation is highly leveraged to normalised crude prices

Valuation sensitivity of ONGC to normalised crude price (Rs/share)

	Equity value (Rs/share)	Change from base case (%)
Normalized crude prices		
US$75/bbl	1,690	28
US$70/bbl	1,566	19
US$65/bbl	1,442	9
US$60/bbl	**1,317**	
US$55/bbl	1,193	(9)
US$50/bbl	1,067	(19)
US$45/bbl	941	(29)

Source: Kotak Institutional Equities estimates.

Including catalysts, ONGC is attractively valued
Valuations of ONGC with and without catalysts (X)

	2007	2008E	2009E
Market capitalization (Rs bn)	2,019	2,019	2,019
Net debt (Rs bn)	(221)	(293)	(447)
EV (Rs bn)	1,798	1,726	1,572
1. Base case			
DACF (Rs bn)	265	309	311
EPS (Rs)	82	102	112
EV/DACF	6.8	5.6	5.1
P/E	11.5	9.2	8.4
2. Assuming gas price increase and no subsidy losses			
DACF (Rs bn)	424	437	413
EPS (Rs)	165	162	160
EV/DACF	4.2	3.9	3.8
P/E	5.7	5.8	5.9

Note: (a) We assume gas price at Rs5/cu m in case of full deregulation.

Source: Kotak Institutional Equities estimates.

ONGC has built a strong portfolio of overseas assets through recent acquisitions
Details of ONGC's investments in overseas projects

	ONGC share (%)	Proven reserves, ONGC 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	20		448	448	2006	50	ExxonMobil (30%), Sodeco (30%)
		626		626	2008	35	RN Astra (8.5%), SMNG (11.5%)
Block 5A, Sudan	24		40.0	40.0	2006	12	Petronas (69%), Sudapet (5%)
Block A-1, Myanmar	20	170		170		18	Daewoo (60%), GAIL (10%), KOGAS (10%)
Omimex de Colombia Ltd	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 International (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 AD-2, AD-3, AD-9, Myanmar	100						Not applicable
Block 127, 128, Vietnam	100						Not applicable
Block BC-10, Brazil	15						Shell (50%), Petrobras (35%)
Block ES 470, Brazil							
Block SM 1413, Brazil							
Block OPL-209, 212, Nigeria	50						Mittal Investments Sarl (49.98%)
Block OPL-246, Nigeria	50						Mittal Investments Sarl (49.98%)
Block RC8, RC9, Columbia	50						Ecopetrol (50%)
Block RC10, Columbia	40						Ecopetrol (40%), Petrobras (20%)

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

Source: Company, Kotak Institutional Equities estimates.

GAIL's share of upstream losses has declined in 9MFY08 versus 9MFY07

Share of various participants of under-recoveries, March fiscal year-ends, 2006-2009E (Rs bn)

	2006	2007	2008E	2009E	9M 2008	9M 2007	yoy % chg
Dated Brent crude oil price (US$/bbl)	57	65	79	92	74	67	*11*
Subsidy loss	**400**	**494**	**732**	**1,092**	**479**	**405**	***18***
Payment by government (oil bonds)	**115**	**241**	**313**	**467**	**203**	**192**	***6***
Share of BPCL	22	53	71	105	46	43	*6*
Share of HPCL	23	49	65	98	43	39	*8*
Share of IOCL	70	138	176	264	115	109	*5*
Net under-recovery of oil companies	**285**	**253**	**419**	**625**	**275**	**214**	***29***
Share of refining companies	27	—	—	—	—	3	—
Share of upstream companies	**140**	**205**	**244**	**364**	**160**	**149**	***7***
Share of ONGC	120	170	207	309	135	124	*9*
Share of GAIL	11	15	14	21	9.3	9.9	*(6)*
Share of Oil India	10	20	23	34	15	16	*(5)*
Net under-recovery of R&M companies	**118**	**48**	**175**	**261**	**116**	**64**	***80***
Pre-tax profits of R&M companies	**74**	**96**			**139**	**66**	

Note:

(a) Share of oil bonds assumed at 42.7% based on actual under-recoveries and oil bonds issued for 9M 2008.

(b) We use US$91.8/bbl Dated Brent (January 2008 average) to compute under-recoveries for FY2009E; our official crude forecast is US$75/bbl.

Source: Kotak Institutional Equities estimates.

Gross under-recovery in FY2008E will be significantly higher than FY2007 levels

Estimation of gross under-recovery in FY2008E

	FY2007	FY2008E
Government estimate of gross under-recovery	**494**	
KIE estimated gross under-recovery in April 2007-February 2008		642
KIE estimated gross under-recovery in February 2008 (a)		90
KIE estimated gross under-recovery in balance of FY2008 (b)		90
KIE estimated gross under-recovery in FY2008E		**732**
Subsidy loss on diesel in FY2007 or in February 2008 (Rs/l)	2.0	6.8
Subsidy loss on gasoline in FY2007 or in February 2008 (Rs/l)	1.6	7.2
Subsidy loss on LPG in FY2007 or in February 2008 (Rs/cylinder)	187	326
Subsidy loss on kerosene in FY2007 or in February 2008 (Rs/l)	16.5	19.7
Crude oil (Dated Brent) price in FY2007 or in January 2008 (US$/bbl)	**64.8**	**91.8**

Note:

(a) Based on January international product prices and January retail domestic prices; Dated Brent price in January 2008 was US$91.8/bbl.

(b) Gross under-recovery for balance of FY2008 computed using February 2008E gross under-recovery.

Source: MOPNG, Kotak Institutional Equities estimates.

ONGC's earnings are highly leveraged to crude prices
Earnings sensitivity of ONGC to key variables

	2008E			2009E			2010E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Exchange rate									
Rs/US$	39.0	40.0	41.0	37.5	38.5	39.5	36.5	37.5	38.5
Net profits (Rs mn)	206,805	218,431	230,054	228,437	240,367	252,295	242,656	254,582	266,506
Earnings per share (Rs)	96.7	102.1	107.6	106.8	112.4	118.0	113.4	119.0	124.6
% upside/(downside)	**(5.3)**		**5.3**	**(5.0)**		**5.0**	**(4.7)**		**4.7**
Average crude prices									
Crude price (US$/bbl)	77.0	79.0	81.0	73.0	75.0	77.0	73.0	75.0	77.0
Net profits (Rs mn)	207,001	218,431	229,855	228,591	240,367	252,137	243,109	254,582	266,051
Earnings per share (Rs)	96.8	102.1	107.5	106.9	112.4	117.9	113.7	119.0	124.4
% upside/(downside)	**(5.2)**		**5.2**	**(4.9)**		**4.9**	**(4.5)**		**4.5**
Cess									
Cess on domestic crude (Rs/ton)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	210,405	218,431	226,457	232,094	240,367	248,640	246,257	254,582	262,906
Earnings per share (Rs)	98.4	102.1	105.9	108.5	112.4	116.2	115.1	119.0	122.9
% upside/(downside)	**(3.7)**		**3.7**	**(3.4)**		**3.4**	**(3.3)**		**3.3**
Natural gas prices									
Natural gas price ceiling (Rs/'000 cum)	3,750	4,250	4,750	4,000	4,500	5,000	4,250	4,750	5,250
Net profits (Rs mn)	213,013	218,431	223,844	234,984	240,367	245,746	249,305	254,582	259,855
Earnings per share (Rs)	99.6	102.1	104.7	109.9	112.4	114.9	116.6	119.0	121.5
% upside/(downside)	**(2.5)**		**2.5**	**(2.2)**		**2.2**	**(2.1)**		**2.1**

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of ONGC, March fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	433,264	635,956	742,532	931,571	1,040,768	1,058,120	1,063,669
EBITDA	**192,480**	**269,526**	**318,069**	**352,991**	**419,303**	**431,760**	**441,761**
Other income	18,220	21,811	28,446	45,408	37,142	45,472	56,347
Interest	(6,964)	(3,950)	(955)	662	(1,279)	(1,235)	(1,013)
Depreciation and depletion	(65,480)	(73,466)	(98,007)	(119,502)	(113,613)	(127,742)	(116,650)
Pretax profits	138,255	213,921	247,553	279,559	341,553	348,256	380,446
Tax	(46,101)	(74,003)	(71,523)	(88,621)	(109,945)	(120,516)	(137,424)
Deferred tax	(4,218)	(770)	(16,585)	(6,797)	(15,149)	14,083	13,906
Net profits	86,811	138,943	159,706	176,873	220,325	241,823	256,928
Net profits after minority interests	**87,979**	**137,639**	**157,201**	**175,819**	**218,431**	**240,367**	**254,582**
Earnings per share (Rs)	**41.1**	**64.4**	**73.5**	**82.2**	**102.1**	**112.4**	**119.0**
Balance sheet (Rs mn)							
Total equity	415,582	488,912	578,830	671,200	804,527	963,221	1,110,221
Deferred tax liability	54,250	57,911	71,557	80,435	94,640	77,716	64,305
Liability for abandonment cost	80,292	80,941	128,675	151,857	151,857	151,857	151,857
Total borrowings	60,961	39,028	22,259	21,139	22,039	12,747	45,488
Currrent liabilities	85,376	128,346	152,162	193,614	111,359	111,769	110,818
Total liabilities and equity	**696,461**	**795,138**	**953,483**	**1,118,245**	**1,184,422**	**1,317,310**	**1,482,688**
Cash	95,721	101,843	91,132	205,499	278,676	423,340	569,761
Current assets	133,039	178,421	240,479	198,697	198,628	192,531	192,844
Total fixed assets	419,213	471,543	568,252	644,303	637,372	631,693	650,369
Goodwill	11,661	10,753	14,172	27,686	27,686	27,686	27,686
Investments	30,811	26,961	35,480	36,615	36,615	36,615	36,888
Deferred expenditure	6,017	5,617	3,969	5,446	5,446	5,446	5,141
Total assets	**696,461**	**795,138**	**953,484**	**1,118,245**	**1,184,423**	**1,317,311**	**1,482,688**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	120,499	178,158	225,995	248,050	252,935	240,773	242,582
Working capital changes	24,950	18,839	44,082	1,408	(85,029)	(38,961)	39,087
Capital expenditure	(56,366)	(102,727)	(110,836)	(139,466)	(49,138)	(54,915)	(36,550)
Investments	(10,608)	(9,887)	(28,640)	53,822	—	—	—
Other income	9,765	12,964	14,539	20,996	37,797	45,847	56,347
Free cash flow	**88,240**	**97,347**	**145,141**	**184,809**	**156,565**	**192,744**	**301,466**
Ratios (%)							
Debt/equity	14.7	8.0	3.8	3.1	2.7	1.3	4.1
Net debt/equity	(8.4)	(12.8)	(11.9)	(27.5)	(31.9)	(42.6)	(47.2)
RoAE	20.2	27.4	26.5	25.4	26.7	25.0	23.2
RoACE	**19.2**	**24.1**	**22.8**	**21.8**	**22.2**	**21.6**	**20.5**
Key assumptions							
Rs/dollar rate	46.0	45.0	44.3	45.3	40.0	38.5	37.5
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	79.0	75.0	75.0
Ceiling/actual natural gas price (Rs/'000 cm)	2,850	2,850	3,515	4,211	4,250	4,500	4,750
Subsidy loss (Rs bn)	26.9	41.0	119.6	170.2	200.0	160.0	140.0

Source: Kotak Institutional Equities estimates.

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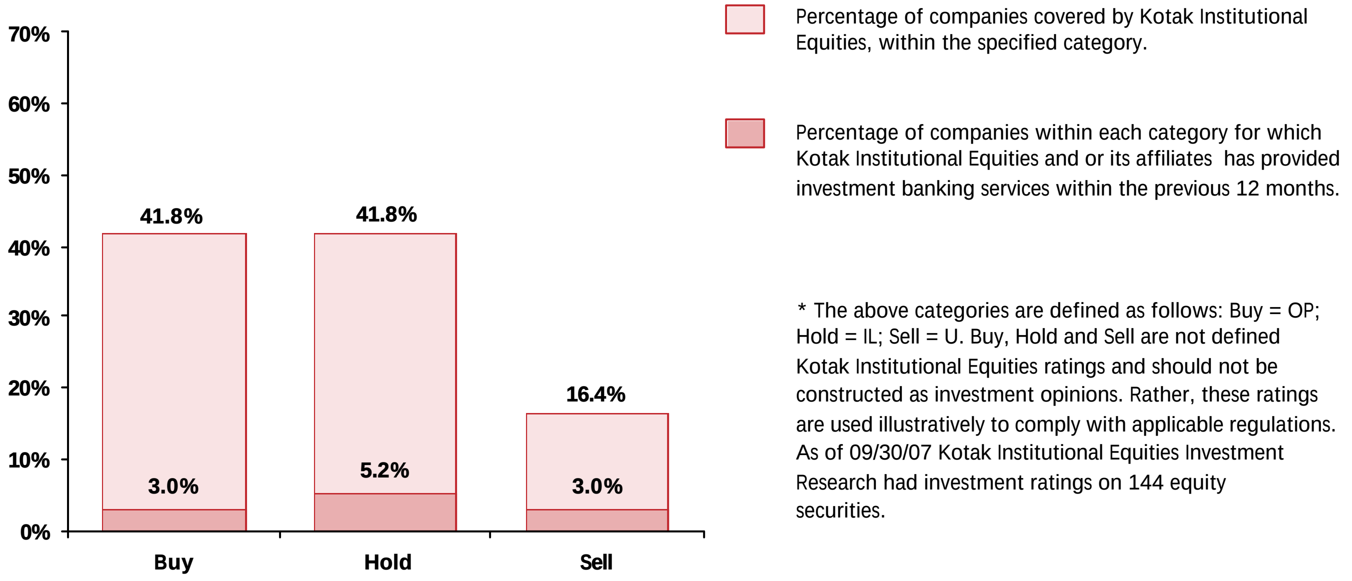

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Source: Kotak Institutional Equities. As of September 30, 2007

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