kotak® Institutional Equities

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News Roundup

Corporate

- Reliance Energy's wholly owned subsidiary Rosa Power Supply has tied up long-term loans of around Rs20 bn for the first stage of its 600 mw power project (BS).
- Jet Airways will have to invest Rs2 bn immediately to revive its 100 per cent subsidiary and value carrier JetLite, which is expected to make profits by October-November this year (BS).

Economic and political

- Indo-Thai free trade agreement (FTA), which will initially cover goods and include services and investment at a later stage, is likely to be signed by September (BS).
- The software and ITeS exports from India are expected to exceed $31.3 billion during the year 2006-07, up by 32% compared to the previous year (ET).
- Centre has given 60-day deadline to state governments for clearing SEZ proposals, else these would be taken off the list of cases to be considered by BoA for SEZs. There are 170 SEZs proposals pending with the respective state governments (ET).

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

EQUITY MARKETS

		Change, %		
India	**26-Jun**	**1-day**	**1-mo**	**3-mo**
Sensex	14,501	0.1	1.1	10.5
Nifty	4,286	0.6	0.9	12.2
Global/Regional indices				
Dow Jones	13,338	(0.1)	(1.3)	7.6
Nasdaq Composite	2,574	(0.1)	0.7	5.6
FTSE	6,559	(0.4)	(0.2)	4.2
Nikkie	17,933	(0.7)	2.6	3.3
Hang Seng	21,780	(0.1)	6.1	10.5
KOSPI	1,742	(0.4)	5.9	19.9

Value traded - India

			Moving avg, Rs bn	
	26-Jun		**1-mo**	**3-mo**
Cash (NSE+BSE)	140.8		135.7	132.8
Derivatives (NSE)	525.7		425.3	344.5
Deri. open interest	800.8		663.3	592.5

Forex/money market

		Change, basis points		
	26-Jun	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.9	-	45	(236)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	3	3	21

Net investment (US$mn)

	25-Jun		MTD	CYTD
FIIs	122		624	4,571
MFs	(7)		30	(80)

Top movers -3mo basis

		Change, %		
Best performers	**26-Jun**	**1-day**	**1-mo**	**3-mo**
Balaji Telefilms	214	(2.0)	(3.8)	73.5
GESCO	336	(3.4)	31.6	68.8
Reliance Cap	1,115	1.5	14.2	68.2
Titan Inds	1,279	8.8	19.3	52.3
Moser Baer	442	0.3	(0.3)	47.2
Worst performers				
Bajaj Auto	2,128	(0.5)	(2.0)	(15.2)
Polaris	155	0.3	(8.7)	(13.7)
Wipro	509	(1.3)	(6.2)	(13.2)
Cipla	206	0.2	0.7	(13.1)
Raymond	304	(0.5)	(7.5)	(11.0)

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Strategy

Sector coverage view	N/A

Fly On The Wall: Theme – India-Pakistan / Sins & Synergies

- **An India-Pakistan war can be ruled out while chances of a Kargil-type escalation are increasingly remote**
- **The state of the India-Pakistan relationship has little impact on India's economy, society and polity**

This sums up the 10 articles written by thought leaders in our second issue of Fly On The Wall, our thematic product. The issue looks at the India-Pakistan relationship and its implications for India. Our first issue of FOTW was on India: The Countries Within, flagging several trends and phenomena affecting a wide section of society. This second issue pans outwards, and looks at the country without and its impact on the countries within.

This issue of Fly On The Wall examines several questions global analysts ask. How dangerous is the relationship between India and Pakistan to regional stability? How dangerous is it to India's economic prospects? Are the two countries loose canons engaged in a chauvinistic pursuit of geopolitical one-upmanship or are they genuinely working towards constructive engagement? What do the people of the two countries think about the other side?

Transportation

JET.BO, Rs809	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	800
52W High -Low (Rs)	832 - 475
Market Cap (Rs bn)	70

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	70.6	100.7	138.4
Net Profit (Rs bn)	(0.0)	0.0	4.9
EPS (Rs)	(0.2)	0.2	57.0
EPS gth	*(103)*	*-*	*37,636*
P/E (x)	(3,342)	5,201	14
EV/EBITDA (x)	28.2	11.6	5.7
Div yield (%)	0.1	0.0	1.5

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	9.9	0.1	(0.1)
MFs	1.4	0.1	(0.1)
UTI	-	-	(0.2)
LIC	2.8	0.1	(0.1)

Jet Airways: Sharp turnaround in international operations help beat expectations, however improvement would be tough to sustain

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- **Higher yields, cut in expenses and maturity of international routes has helped post strong results**
- **April-May operating performance belies the hope that challenging times are over**
- **Air Sahara financials not available yet, revival and turnaround of Air Sahara into JetLite is challenging both operationally and financially**
- **Revise target price to Rs800 (from Rs400 previously) on back of improved performance, changing industry dynamics, maintain underperform rating due to visible near term challenges**

Jet Airways reported a profit of Rs880 mn in 4Q07 (versus our estimate of Rs65 mn) and reported street expectations of Rs550 mn. EBITDAR margin in the domestic segment has improved 220 bps on a yoy basis on back of higher yields and cut back in unprofitable flights inspite of lower seat factors, a tradeoff for improving yields. International segment has reported strong results on back of maturing of several routes reflected in higher seat factors and improving yields. based on improved profitability and ongoing consolidation in the industry that would help sustain rational prices in our view, we revise our target price based on 6X adj. EV/EBITDAR to Rs800/share (from Rs400 earlier). Our earlier target price was based on price to book in an environment of continuously declining profitability. We maintain our Underperform rating on the stock because of several near-term challenges (a) introduction of several international routes would put pressure on profitability, (b) turnaround of Air Sahara into JetLite would test execution skills at revival and sustaining two different business models and (c) sustainability of improvement is doubtful as near term operating performance for April & May 07 reveal a sharp drop in seat factors in the domestic segment, while seat factors in international segment have been flat at last year levels.

Results beat expectations on back of higher yields and cost cutting in areas such as selling and distribution expenses

Jet Airways reported a profit of Rs880 mn in 4Q07 (versus our estimate of Rs65 Mn) and reported street expectations of Rs550 mn. Strong result has been led by (a) improvement in yield across both international and domestic segment, (b) lower sales and distribution expenses, (c) availing MAT credit entitlement of Rs468 mn and (d) low interest expenses potentially because of capitalization of some portion of it. EBITDAR margin has improved to 23.2%, a sharp sequential improvement of 730 bps and yoy improvement of 430 bps.

Sharp turnaround in domestic segment inspite of lower seat factors led by higher yields, cut in expenses and unprofitable flights

In the domestic segment EBITDAR margin has improved 220 bps on a yoy basis (750 bps improvement in qoq basis) in 4QFY07 led by (a) about 9% improvement in yields, (b) lower sales and distribution expenses, (c) lower fuel costs and (d) cut in unprofitable flights (combining/cancelling flights that were not covering costs, also evident from flat block hours and no of departures on a yoy basis inspite of higher capacity). This improvement in EBITDAR margin has been possible inspite of sharp drop of about 300 bps in seat factors possibly a trade-off of attempt to improve yields.

International operations turn profitable as several routes mature, however addition of new routes would again put pressure

International segment has reported an EBITDAR margin of about 20.5% sharp improvement over just 1% in 4QFY06 and 13.7% in 3QFY07. We believe improvement is led by maturing of several routes and seasonal strength reflected in about 1010 bps improvement in seat factors. Improvement in yields and lower fuel cost has also contributed to this turnaround. However, this improvement because of maturing of existing routes would get diluted as Jet launches several new routes in the coming year in the international segment including long haul routes such as Mumbai-Newark, Mumbai-San Francisco and Delhi Toronto etc.

April-May operating performance belies the hope that challenging times are over

Operating performance data for April to May reveal a sharp drop of 540 bps in seat factors in the domestic segment on a yoy basis, while improvement in seat factors in international segment has not been sustained possibly because of introduction of new routes recently. Thus we believe challenges are likely to continue for Jet Airways in terms of maintaining the improvement in profitability seen in 2HFY07.

Air Sahara financials not available yet, revival and turnaround of Air Sahara into JetLite is challenging both operationally and financially

While Jet Airways has not made Air Sahara financials as due diligence is still not complete, management is hoping to build a low cost business model with higher reliability and brand it as JetLite. Efforts to revive Air Sahara as JetLite include (a) recovery of unutilized fleet and (b) cost cutting by reduction in headcount, office space, renegotiation of contracts and elimination of duplicate resources in areas such as maintenance etc. Apart from Rs1.8 bn already invested in Air Sahara's operations, Jet may need to further invest US$40-50 mn in order to revive the airline. While there are synergy benefits that are available to the group after the merger, we believe that keeping these two airlines separate focused on different segments limits the synergies possible, and introduces risk of mutual cannibalization between Jet Airways and JetLite.

Revise target price on back of improved performance, changing industry dynamics, Maintain underperform rating due to visible near term challenges

We revise our target price to Rs800/share (from Rs400 earlier) on back of improved profitability and ongoing consolidation in the industry that would sustain rational prices in our view. We had earlier set our target price at floor of book value as profitability of the business took a sharp dip. Our revised target price is based on 6X adj. EV/EBITDAR which implies about 14X PER based on FY2009 earnings. We retain our underperform rating as we see several near term challenges (a) profitability from international operations would be impacted with the launch of several new international routes over the near term, (b) turnaround of Air Sahara into JetLite would test execution skills of management during revival as well as running two separate business models under the same roof.

Exhibit 1: Jet Airways - 4QFY07 - key numbers

Jet Airways - Strong operating performance in 4QFY07

			yoy			qoq			yoy	
	FY2007E	4QFY07	4QFY06	% change	4QFY07	3QFY07	% change	FY07	FY06	% change
Revenues	**18,605.4**	**19,782.7**	**16,253.0**	**21.7**	**19,782.7**	**19,356.8**	**2.2**	**70,577.8**	**56,937.3**	**24.0**
Operating expenses	(17,267.2)	(15,184.0)	(13,174.8)	15.3	(15,184.0)	(16,273.8)	(6.7)	(60,499.0)	(43,312.0)	39.7
Employee costs	(2,582.6)	(2,582.8)	(1,892.2)	36.5	(2,582.8)	(2,261.1)	14.2	(9,381.2)	(5,671.5)	65.4
Fuel	(6,469.3)	(5,510.8)	(4,827.5)	14.2	(5,510.8)	(6,115.2)	(9.9)	(24,276.4)	(16,789.3)	44.6
Commission	(2,826.3)	(1,584.8)	(1,816.3)	(12.7)	(1,584.8)	(2,065.2)	(23.3)	(5,589.0)	(5,652.6)	(1.1)
S&D exps	(862.7)	(777.1)	(703.6)	10.4	(777.1)	(614.4)	26.5	(2,419.5)	(2,087.6)	15.9
Other op exps	(4,526.3)	(4,728.5)	(3,935.2)	20.2	(4,728.5)	(5,217.9)	(9.4)	(18,832.9)	(13,111.0)	43.6
EBIDTAR	**1,338.2**	**4,598.7**	**3,078.2**	**49.4**	**4,598.7**	**3,083.0**	**49.2**	**10,078.8**	**13,625.3**	**(26.0)**
Lease rentals	(1,731.6)	(1,752.3)	(1,221.0)	43.5	(1,752.3)	(1,679.1)	4.4	(6,458.0)	(4,340.0)	48.8
EBIDTA	**(393.5)**	**2,846.4**	**1,857.2**	**53.3**	**2,846.4**	**1,403.9**	**102.7**	**3,620.8**	**9,285.3**	**(61.0)**
Other income	262.3	107.6	3,442.6	(96.9)	107.6	943.6	(88.6)	3,435.3	4,417.4	(22.2)
Depreciation	(1,209.6)	(1,209.6)	(1,060.4)	14.1	(1,209.6)	(1,077.1)	12.3	(4,141.0)	(4,064.1)	1.9
EBIT	(1,340.8)	1,744.4	4,239.4	(58.9)	1,744.4	1,270.4	37.3	2,915.1	9,638.6	(69.8)
Interest	(530.5)	(530.0)	(629.8)	(15.8)	(530.0)	(651.0)	(18.6)	(2,401.5)	(2,416.0)	(0.6)
EBT	**(1,871.3)**	**1,214.4**	**3,609.6**	**(66.4)**	**1,214.4**	**619.4**	**(96.1)**	**513.6**	**7,222.6**	**(92.9)**
Tax	(346.0)	(334.3)	(1,338.4)	(75.0)	(334.3)	(219.0)	52.6	(234.2)	(2,702.2)	(91.3)
PAT	**(2,217.3)**	**880.1**	**2,271.2**	**(61.2)**	**880.1**	**400.4**	**(119.8)**	**279.4**	**4,520.4**	**(93.8)**
Key ratios										
% of revenues										
Employee costs	13.9	13.1	11.6		13.1	11.7		13.3	10.0	
Fuel costs	34.8	27.9	29.7		27.9	31.6		34.4	29.5	
Commission	15.2	8.0	11.2		8.0	10.7		7.9	9.9	
S&D	4.6	3.9	4.3		3.9	3.2		3.4	3.7	
Others	24.3	23.9	24.2		23.9	27.0		26.7	23.0	
EBIDTAR margin	**7.2**	**23.2**	**18.9**		**23.2**	**15.9**		**14.3**	**23.9**	

Source: Company data, Kotak Institutional Equities estimates

Exhibit 2: Jet Airways - key operating statistics

Yields have improved across both domestic and international segment

			yoy			qoq			yoy	
	FY2007E	4QFY07	4QFY06	(% chg)	4QFY07	3QFY07	(% chg)	FY07	FY06	(% chg)
ASK (mn)	**4,523**	**4,679**	**3,925**	**19.2**	**4,679**	**4,598**	**1.8**	**17,700.0**	**13,300.0**	**33.1**
Domestic	3,023	2,985	2,976	0.3	2,985	3,068	(2.7)	12,156.0	10,683.0	13.8
International	1,500	1,694	949	78.5	1,694	1,530	10.7	5,543.0	2,617.0	111.8
RPK (mn)	3,068	3,396	2,813	20.7	3,396	3,184	6.7	12,307.0	9,576.0	28.5
Domestic	2,086	2,098	2,182	(3.8)	2,098	2,149	(2.4)	8,537.0	7,875.0	8.4
International	983	1,298	631	105.7	1,298	1,035	25.4	3,770.0	1,701.0	121.6
Seat factor (%)	67.8	72.6	71.7		72.6	69.2		69.5	72.0	
Domestic	**69.0**	**70.3**	**73.3**		**70.3**	**70.0**		**70.2**	**73.7**	
International	65.5	76.6	66.5		76.6	67.6		68.0	65.0	
Yield (Rs/RPK)	**5.3**	**5.3**	**5.4**	(1.9)	**5.3**	**5.5**	(4.0)	**5.3**	5.6	(6.9)
Domestic	6.4	6.8	6.2	8.9	6.8	6.6	3.4	6.3	6.3	1.5
International	3.1	3.0	2.6	12.0	3.0	3.4	(13.4)	3.1	2.8	10.3

Source: Company data, Kotak Institutional Equities estimates

Exhibit 3: Jet Airways - Segment wise details

Maturing of international routes and higher yields help post Jet Airways the highest EBITDAR margin ever in the international segment

		yoy			qoq			yoy	
	4QFY07	4QFY06	(% chg)	4QFY07	3QFY07	(% chg)	FY07	FY06	(% chg)
Domestic									
Revenue	15,094.0	13,938.0	8.3	15,094.0	14,901.0	1.3	57,004.0	50,141.0	13.7
EBITDAR	3,639.0	3,052.0	19.2	3,639.0	2,469.0	47.4	9,096.0	13,518.0	(32.7)
EBITDAR margin	**24.1**	**21.9**		**24.1**	**16.6**		**16.0**	27.0	
PBT	1,184.0	4,052.0	(70.8)	1,184.0	732.0	61.7	2,421.0	8,935.0	(72.9)
International									
Revenue	4,689.0	2,315.0	102.5	4,689.0	4,455.0	5.3	13,574.0	6,796.0	99.7
EBITDAR	961.0	24.0	3,904.2	961.0	612.0	57.0	984.0	107.0	819.6
EBITDAR margin	**20.5**	**1.0**		**20.5**	**13.7**		**7.2**	1.6	
PBT	68.0	(443.0)	115.3	68.0	(110.0)	161.8	(1,867.0)	(1,713.0)	(9.0)

Source: Company data, Kotak Institutional Equities estimates

Exhibit 4: Jet Airways - Monthly operating statistics

While performance in 4QFY07 is better than 4QFY06, operating data for April & May 07 suggests a dip in comparison to previous year

Domestic	**Jan-06**	**Feb-06**	**Mar-06**	**Apr-06**	**May-06**	**Jan-07**	**Feb-07**	**Mar-07**	**Apr-07**	**May-07**
ASKMS (mn)	975	932	1049	1012	1053	1027	943	1015	980	1015
RPKMS (mn)	717	718	747	771	810	753	677	667	690	730
Seat Factor (%)	73.5	77.0	71.2	76.2	76.9	73.3	71.8	65.7	70.4	71.9
No of Flights	9075	8671	9663	9327	9631	9505	8727	9485	9131	9454

International	**Jan-06**	**Feb-06**	**Mar-06**	**Apr-06**	**May-06**	**Jan-07**	**Feb-07**	**Mar-07**	**Apr-07**	**May-07**
ASKMS	327	294	328	317	328	544	546	603	581	605
RPKMS	204	200	227	220	203	428	422	448	388	377
Seat Factor	62	68	69	69	62	79	77	74	67	62
Flights	430	386	434	420	434	652	671	736	712	736

Domestic & International	**Jan-06**	**Feb-06**	**Mar-06**	**Apr-06**	**May-06**	**Jan-07**	**Feb-07**	**Mar-07**	**Apr-07**	**May-07**
ASKMS	1,302	1,226	1,377	1,329	1,381	1,571	1,489	1,618	1,561	1,620
RPKMS	921	918	974	991	1,013	1,181	1,099	1,115	1,078	1,107
Seat Factor	71	75	71	75	73	75	74	69	69	68
Flights	9,505	9,057	10,097	9,747	10,065	10,157	9,398	10,221	9,843	10,190

Source: Company data, Kotak Institutional Equities

Exhibit 5: Snapshot of operating assumptions for Jet Airways and profit and loss model

	2005	2006	2007E	2008E	2009E
Domestic passenger					
ASK (mn)	9,666.0	10,683.0	12,155.0	13,719.9	15,376.7
RPK (mn)	6,992.0	7,875.0	8,538.0	9,818.7	11,291.5
Seat factor (%)	72.3	73.7	70.24	71.6	73.4
Passenger yield (Rs/RPK)	5.9	6.1	5.7	6.1	6.3
International passenger					
ASK (mn)		2,617.0	5,543.0	13,975.8	21,897.9
RPK (mn)		1,701.0	3,770.0	9,104.6	14,454.1
Seat factor (%)		65.0	68.01	65.1	66.0
Passenger yield (Rs/RPK)		3.3	3.0	3.4	3.5
Overall passenger					
ASK (mn)	9,666.0	13,300.0	17,698.0	27,695.7	37,274.6
RPK (mn)	6,992.0	9,576.0	12,308.0	18,923.3	25,745.6
Seat factor (%)	72.3	72.0	69.5	68.3	69.1
Passenger yield (Rs/RPK)	5.9	5.6	5.7	4.8	4.7
Operating revenue (Rs mn)					
International	-	5,594.8	13,578.0	30,573.6	49,984.9
Domestic	41,186.2	48,341.0	57,004.0	60,082.6	70,822.3
Total passenger	41,186.2	53,935.8	70,582.0	90,656.2	120,807.2
Cargo	1,855.9	2,917.7	5,386.0	9,627.3	17,136.0
Other revenue	338.0	365.0	419.8	453.4	489.7
Total revenue	**43,380.1**	**56,937.0**	**70,578.0**	**100,737.0**	**138,432.8**
Operating expenditure (Rs mn)					
Staff	3,747.4	5,672.0	9,381.0	10,982.3	12,744.0
Fuel	10,517.3	16,789.0	25,234.9	32,851.9	43,810.2
Maintenance	3,568.9	4,647.8	6,012.2	7,911.5	9,736.1
Commission costs	4,208.1	5,652.6	8,008.0	10,926.2	14,322.7
Depreciation and amortization	4,570.0	4,064.0	4,141.0	9,064.2	13,782.0
Lease rentals	1,985.7	4,340.0	6,437.3	5,700.0	5,700.0
Airport and traffic control	2,387.8	3,091.5	4,036.4	5,215.5	6,849.9
Others	4,858.3	7,459.1	11,087.3	15,289.1	20,502.0
Total operating expenditure	**35,843.5**	**51,716.0**	**71,097.0**	**97,940.8**	**127,446.9**
Operating profit (Rs mn)	**7,536.6**	**5,221.0**	**(519.0)**	**2,796.2**	**10,986.0**
Operating margins (%)	17%	9%	-1%	3%	8%
EBITDA (Rs mn)	12,106.6	9,285.0	3,622.0	11,860.4	24,768.0
EBITDA margin (%)	28%	16%	5%	12%	18%
EBITDAR (Rs mn)	**14,092.3**	**13,625.0**	**10,059.3**	**17,560.4**	**30,468.0**
EBITDAR margin (%)	32%	24%	14%	17%	22%
Profit after tax (Rs mn)	**3,919.9**	**4,520.0**	**423.1**	**13.4**	**4,917.3**

Source: Company data, Kotak Institutional equities estimates

Energy

ONGC.BO, Rs936	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	1,075
52W High -Low (Rs)	990 - 673
Market Cap (Rs bn)	2,002

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	948	988	1,011
Net Profit (Rs bn)	171.8	203.0	215.6
EPS (Rs)	80.3	94.9	100.8
EPS gth	*9.4*	*18.2*	*6.2*
P/E (x)	11.7	9.9	9.3
EV/EBITDA (x)	4.8	4.2	3.7
Div yield (%)	3.3	3.5	3.5

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	8.7	2.7	(3.9)
MFs	1.3	2.4	(4.2)
UTI	-	-	(6.6)
LIC	2.3	3.9	(2.7)

Oil & Natural Gas Corporation: Analyst meeting highlights; reiterate positive view and 12-month target price of Rs1,075

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- **Reserve replacement ratio of 1.35X and finding cost of US$1.5/bbl for FY2007 very encouraging**
- **Earnings uncertainty prevails but FY2007 was an exceptionally abnormal year**
- **Fine-tuned estimates but the bigger picture is long-term catalysts, attractive valuations**

We retain our positive view on ONGC stock and our 12-month 9X normalized FCF-based target price of Rs1,075 and have made several changes to our earnings model post 4QFY07 results analyst meeting. Despite uncertainty emanating from government policy, we see limited downside to ONGC's earnings. On the other hand, we see several positive triggers (although long-term) in the form of (1) resolution of subsidy issues (FY2007 impact on EPS = Rs48/share); (2) higher gas price (FY2007 impact on EPS of lower gas price = Rs12/share assuming long-term gas price of Rs6/cu m) and (3) new hydrocarbon discoveries; FY2007 reserve accretion for ONGC alone at 1.2 bn bbls of in-place and 480 mn bbls of proved reserves versus production of 354 mn bbls is very heartening, in our view. We have fine-tuned FY2008E and FY2009E EPS to Rs95 and Rs101 versus Rs99 and Rs99, respectively, previously. Key downside risks to our target price stem from (1) lower-than-expected commodity prices and (2) higher-than-expected subsidy losses.

Explanation for growth in earnings for FY2008 versus FY2007. We model FY2008E consolidated EPS at Rs95 versus Rs84 in FY2007 although we admit that it is very tricky to accurately establish ONGC's earnings given (1) uncertainty on subsidy losses (note the sharp increase in FY2007) and (2) uncertainty on DD&A; exploration success or failure can depress or increase dry well costs meaningfully. We attribute our expected yoy increase in earnings to (1) higher crude price of US$68/bbl (Dated Brent) versus US$64.8/bbl in FY2007; a US$1/bbl increase in crude price adds Rs3 to ONGC's earnings assuming constant subsidy loss; (2) significantly lower employee costs of Rs12 bn; FY2007 employee costs of Rs29.8 bn included one-off costs of Rs12.9 bn; (3) modestly higher gas price; (4) higher crude sales volume at 32.3 mn tonnes compared to 30.2 mn tonnes in FY2007 primarily due to contribution from OVL (Colombia, Russia, Sudan); (5) likely lower depreciation (Rs4.5 bn) due to full write-off of Mumbai High-Uran Trunk pipeline, commissioned in July 2005 and fully depreciated by July 2006; and (6) no extraordinary write-offs in OVL as was the case in FY2007. On the flip side, we model higher FY2008E subsidy loss at Rs175 bn versus Rs170.2 bn in FY2007 and lower other income (Rs21 bn versus Rs43.5 bn in FY2007, which included Rs11.6 bn of transfer of surplus from the gas pool account).

Key changes to and major assumptions behind earnings model

We discuss our key assumptions and the major changes to our earnings model below. Exhibit 1 gives the major assumptions behind our earnings model and Exhibit 2 gives sensitivity of ONGC's EPS to key variables (rupee-dollar rate, crude oil price, natural gas price).

1. **Crude oil price assumptions.** We have increased our crude oil price (Dated Brent) forecasts for FY2008E, FY2009E and FY2010E to US$68/bbl, US$65/bbl, US$65/bbl versus US$65/bbl, US$60/bbl and US$60/bbl to reflect (1) continued tight global supply conditions due to strong OPEC discipline in maintaining oil production despite increased global demand on stronger-than-expected global economic growth and (2) downside risks to supply for both OPEC (Nigeria) and non-OPEC countries.

2. **Natural gas price assumptions.** We have fine-tuned our gas price assumptions noting a likely gas price increase for APM gas sold to power and fertilizer sectors to around Rs3.7/cu m versus Rs3.2/cu m currently. The ministry of petroleum and natural gas is currently reviewing the recommendations of the Tariff Commission, which has recommended price of APM gas to increase to Rs3.6/cu m for July 2005-June 2010 period.
3. **Oil and gas production.** We model oil and gas sales for FY2008E, FY2009E and FY201E at 52.2 mn tonnes (oil + oil equivalent of gas), 54.2mn tonnes and 53.2 mn tonnes versus 50.3mn tonnes in FY2007. The growth in volume for FY2008E over FY2007 reflects contribution from Colombia (50% stake acquired in September 2006), Russia (full contribution from Sakhalin-1 oil and moderate increase in gas production) and Sudan (Block 5A, which commenced production in Jun3 2006).
4. **Exchange rate.** We have revised our rupee-dollar exchange rates for FY2008E, FY2009E and FY2010E to Rs42/US Dollar for all the years versus Rs43/US Dollar previously for all the years.

Reserves addition for FY2007 is very encouraging

ONGC added 80.3 mn tonnes of proved reserves (586 mn bbls of oil and oil equivalent of gas) in FY2007 broken down between 65.6 mn tonnes in ONGC-operated fields in India, 10 mn tonnes in overseas joint ventures and 4.8 mn tonnes in domestic joint venture fields. It made 22 discoveries in FY2007 out of which 9 (three deep-water, one shallow-water and five onshore) are new prospects and 13 are new pools of hydrocarbons within extant discovered areas. Out of the 170 mtoe of in-place reserves added in FY2007, 101 mtoe is from new finds and the balance 69 mtoe from extant areas.

We are encouraged by the addition of 66 mn tonnes or 480 mboe of proved reserves in ONGC alone (without overseas and domestic joint ventures), which result in reserves replacement ratio of 1.35X. We also find the low finding cost of US$1.5/bbl (as given by the management in the analyst meeting heartening. ONGC has not had major exploration success over the past few years (reserve replacement ratio of 0.6X between FY2002 and FY2006) but the performance in FY2007 will likely allay concerns about ONGC's ability to find hydrocarbons at low finding cost. We give details on ONGC's key discoveries below.

KG-DWN-98/2 block (90% stake). ONGC management clarified that KG-DWN-98/2 block has in-place reserves of 2.09 tcf in the northern structure; various press reports had put the reserves at 2.09-14.8 tcf previously. The management explained that it is yet to drill in another prospective structure in the vicinity of the first discovery (UD-1 well). If ONGC is able to find gas in the other structure, it will be able to establish contiguity of the two structures as it is hopeful about. We believe this will result in significantly higher reserves. The total size of the prospective area with various explored and unexplored structures is 565 sq. kms; the size of the block is 9,757 sq. kms. ONGC has offered a 15% stake in this block to Petrobras.

MN-DWN-98/3 block (100% stake). ONGC management has put a figure of 5-15 bcm (0.18-0.53 tcf) of in-place reserves of gas in this 10,005 sq. kms block. ONGC owns 100% stake in the block and has offered a 40% stake to Petrobras.

MN-OSN-2000/2 block (40% stake). ONGC management estimates in-place reserves of 5 bcm for this shallow-water block of 8,330 sq. kms.

Natural gas price increase and moderate volume growth are key earnings drivers

Key assumptions, March fiscal year-ends, 2003-2010E

	2003	2004	2005	2006	2007	2008E	2009E	2010E
Rs/US$ rate	48.4	46.0	45.0	44.3	45.3	42.0	42.0	42.0
Subsidy share scheme loss (Rs bn)	**—**	**26.9**	**41.0**	**119.6**	**170.2**	**175.0**	**150.0**	**125.0**
Import tariff on crude oil (%)	10.0	10.0	9.7	5.1	5.1	5.2	3.1	2.6
Crude/natural gas prices								
Crude price								
Crude price, WTI (US$/bbl)						68.0	67.0	67.0
Crude price, Dated Brent (US$/bbl)	**27.0**	**28.7**	**40.6**	**57.2**	**64.8**	**68.0**	**65.0**	**65.0**
Net crude price, ONGC-India (Rs/tonne)	7,284	6,255	9,196	10,390	10,689	10,001	9,956	10,812
Net crude price, ONGC-India (US$/bbl)	20.6	18.6	28.0	32.1	32.4	32.6	32.5	35.3
Natural gas price								
Ceiling natural gas price, India (Rs/cu m)	**2.85**	**2.85**	**2.85**	**3.52**	**4.21**	**4.25**	**4.50**	**4.75**
Ceiling natural gas price, India (US$/mn BTU)	1.57	1.66	1.69	2.12	2.49	2.70	2.86	3.02
Net natural gas price, ONGC-India (Rs/cu m)	2.24	2.18	2.18	3.11	3.76	3.79	4.02	4.26
Net natural gas price, ONGC-India (US$/mn BTU)	1.24	1.27	1.29	1.88	2.22	2.41	2.56	2.71
International operations								
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.4	3.2	3.2	3.1	3.2	3.0	3.0	3.0
Net crude price, OVL-Sudan (Rs/tonne)	4,253	4,285	5,893	8,118	9,384	9,134	8,735	8,735
Net crude price, OVL-Russia (Rs/tonne)	—	—	—	8,320	9,633	9,382	8,968	8,968
Sales volumes—Domestic fields (a)								
Crude oil (mn tonnes)	23.9	23.9	24.1	22.5	24.4	24.5	24.7	24.6
Natural gas (bcm)	21.1	21.1	20.6	20.5	20.3	20.2	20.2	19.4
Sales volumes—Overseas fields								
Crude oil (mn tonnes)	0.2	3.3	3.7	4.6	5.8	7.8	9.3	9.1
Natural gas (bcm)	0.0	0.5	1.3	1.8	2.2	2.1	2.4	2.4
Total sales								
Crude oil (mn tonnes)	24.1	27.3	27.8	27.0	30.2	32.3	34.0	33.7
Natural gas (bcm)	21.1	21.6	22.0	22.3	22.5	22.3	22.6	21.8
Total sales (mn toe)	**42.9**	**46.6**	**47.4**	**46.9**	**50.3**	**52.2**	**54.2**	**53.2**
Total sales (mn boe)	**313**	**340**	**346**	**342**	**367**	**381**	**396**	**389**
Crude oil (%)	56	59	59	58	60	62	63	63
Natural gas (%)	44	41	41	42	40	38	37	37

(a) Includes ONGC's share of production from joint venture fields.

Source: Company data, 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$	41.0	42.0	43.0	41.0	42.0	43.0	41.0	42.0	43.0
Net profits (Rs mn)	192,677	203,036	213,392	205,278	215,595	225,910	225,400	235,875	246,348
Earnings per share (Rs)	90.1	94.9	99.8	96.0	100.8	105.6	105.4	110.3	115.2
% upside/(downside)	**(5.1)**		**5.1**	**(4.8)**		**4.8**	**(4.4)**		**4.4**
Average crude prices									
Crude price (US$/bbl)	66.0	68.0	70.0	63.0	65.0	67.0	63.0	65.0	67.0
Net profits (Rs mn)	190,699	203,036	215,364	202,788	215,595	228,394	222,846	235,875	248,898
Earnings per share (Rs)	89.2	94.9	100.7	94.8	100.8	106.8	104.2	110.3	116.4
% upside/(downside)	**(6.1)**		**6.1**	**(5.9)**		**5.9**	**(5.5)**		**5.5**
Cess									
Cess on domestic crude (Rs/tonne)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	194,877	203,036	211,194	207,375	215,595	223,815	227,566	235,875	244,183
Earnings per share (Rs)	91.1	94.9	98.7	97.0	100.8	104.6	106.4	110.3	114.2
% upside/(downside)	**(4.0)**		**4.0**	**(3.8)**		**3.8**	**(3.5)**		**3.5**
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)	197,607	203,036	208,459	210,177	215,595	221,008	230,671	235,875	241,074
Earnings per share (Rs)	92.4	94.9	97.5	98.3	100.8	103.3	107.8	110.3	112.7
% upside/(downside)	**(2.7)**		**2.7**	**(2.5)**		**2.5**	**(2.2)**		**2.2**

Source: 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$/bbl)	**50.0**	**50.0**	**50.0**
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	174,214	199,497	213,310
Add: OCF after normalizing natural gas price	32,240	29,752	24,976
Add: OCF after removing subsidies	118,936	103,487	84,094
Recurring operating cash flow	**325,390**	**332,736**	**322,380**
Recurring capex			
Production per annum (mn bbls)	381	396	389
Replacement or F&D costs (US$/bbl)	8.0	8.0	8.0
Recurring capex	128,002	132,934	130,555
Free cash flow	**197,388**	**199,803**	**191,824**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,776,492	1,798,224	1,726,418
(Net debt)/cash	242,606	384,245	476,388
Investments	81,899	81,899	82,174
Equity value	2,100,997	2,264,368	2,284,981
Equity value per share (Rs)	**982**	**1,059**	**1,068**

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	947,866	987,994	1,011,076	1,050,439
EBITDA	**192,480**	**269,526**	**318,069**	**343,514**	**391,016**	**403,360**	**439,566**
Other income	18,220	21,811	28,446	43,474	20,847	21,025	21,902
Interest	(6,964)	(3,950)	(955)	(1,408)	(922)	(758)	(536)
Depreciation and depletion	(65,480)	(73,466)	(98,007)	(118,637)	(109,410)	(109,020)	(106,834)
Pretax profits	138,255	213,921	247,553	266,943	301,531	314,607	354,098
Tax	(46,101)	(74,003)	(71,523)	(91,806)	(105,013)	(107,312)	(128,168)
Deferred tax	(4,218)	(770)	(16,585)	(4,021)	8,412	9,755	12,290
Net profits	86,811	138,943	159,706	175,867	204,930	217,051	238,220
Net profits after minority interests	**87,979**	**137,639**	**157,201**	**174,813**	**203,036**	**215,595**	**235,875**
Earnings per share (Rs)	**41.1**	**64.4**	**73.5**	**81.7**	**94.9**	**100.8**	**110.3**
Balance sheet (Rs mn)							
Total equity	415,582	488,912	578,830	678,783	796,672	930,440	1,058,535
Deferred tax liability	54,250	57,911	71,557	77,504	68,148	55,553	43,757
Liability for abandonment cost	80,292	80,941	128,675	128,675	128,675	128,675	128,675
Total borrowings	60,961	39,028	22,259	18,278	16,178	6,886	45,185
Currrent liabilities	85,376	128,346	152,162	88,228	88,251	88,805	87,580
Total liabilities and equity	**696,461**	**795,138**	**953,483**	**991,469**	**1,097,924**	**1,210,359**	**1,363,732**
Cash	95,721	101,843	91,132	135,465	258,784	391,131	521,573
Current assets	133,039	178,421	240,479	201,440	174,041	167,526	170,998
Total fixed assets	419,213	471,543	568,252	600,942	611,477	598,079	617,571
Goodwill	11,661	10,753	14,172	14,172	14,172	14,172	14,172
Investments	30,811	26,961	35,480	35,480	35,480	35,480	35,753
Deferred expenditure	6,017	5,617	3,969	3,969	3,969	3,969	3,663
Total assets	**696,461**	**795,138**	**953,484**	**991,467**	**1,097,923**	**1,210,358**	**1,363,730**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	120,499	178,158	225,995	200,280	229,407	238,976	254,922
Working capital changes	24,950	18,839	44,082	(10,270)	24,578	(55,075)	35,654
Capital expenditure	(56,366)	(102,727)	(110,836)	(103,311)	(65,780)	(41,550)	(32,550)
Investments	(10,608)	(9,887)	(28,640)	—	—	—	—
Other income	9,765	12,964	14,539	44,199	21,502	21,400	21,902
Free cash flow	**88,240**	**97,347**	**145,141**	**130,899**	**209,707**	**163,751**	**279,929**
Ratios (%)							
Debt/equity	14.7	8.0	3.8	2.7	2.0	0.7	4.3
Net debt/equity	(8.4)	(12.8)	(11.9)	(17.3)	(30.5)	(41.3)	(45.0)
RoAE	20.2	27.4	26.5	25.1	25.3	23.5	22.8
RoACE	**19.2**	**24.1**	**22.8**	**20.7**	**21.9**	**20.6**	**20.3**
Key assumptions							
Rs/dollar rate	46.0	45.0	44.3	45.3	42.0	42.0	42.0
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	68.0	65.0	65.0
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	175.0	150.0	125.0

Source: Kotak Institutional Equities estimates.

Energy

RPET.BO, Rs107	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	125
52W High -Low (Rs)	108 - 51
Market Cap (Rs bn)	480.4

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	-	-	133.8
Net Profit (Rs bn)	(0.0)	(0.1)	17.6
EPS (Rs)	(0.0)	(0.0)	3.9
EPS gth	-	-	-
P/E (x)	-	-	27.2
EV/EBITDA (x)	-	-	23.0
Div yield (%)	-	-	-

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	3.1	0.2	(1.0)
MFs	0.1	0.0	(1.1)
UTI	-	-	(1.1)
LIC	1.8	0.5	(0.6)

Reliance Petroleum: Revised target price to Rs125 to reflect higher refining margins

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- **Higher consumption of gas instead of liquid fuels to increase refining margins**
- **Stronger global refining margins to continue due to supply-demand imbalance**
- **Maintain OP rating with a revised 12-month DCF-based target price of Rs125**

We have revised our earnings model of RPL to factor in (1) stronger global refining margins and (2) higher consumption of gas instead of liquid fuels to generate heat to run critical refinery processes. We believe RPL is in a very strong position to benefit from the likely tight refining supply-demand balance which is expected to continue until 2010 (FY2011) and potentially beyond. We model RPL to use higher quantity of gas instead of liquid fuels (produced and used internally by refineries typically) to generate heat to run critical refinery processes. The above-mentioned changes result in higher refining margin of US$15.6/bbl for FY2010E and US$15.4/bbl for FY2011E compared to US$14.3/bbl and US$13.3/bbl respectively, previously; we note that our margins for FY2011E and beyond are boosted by US$2.4/bbl due to use of gas for internal heating versus use of liquid fuels. We have also revised our rupee dollar forecast throughout our forecast period to Rs42/US Dollar compared to Rs43/US Dollar previously. Key downside risks stems from a slowdown in global economic growth, which may impact demand for refined products and thus, refining margins.

Raised earnings forecasts. We have revised our FY2010E, FY2011E and FY2012E EPS to Rs22.2, Rs23.1 and Rs22.7, previously versus Rs20.3, Rs19.5 and Rs19, respectively, previously. Our FY2009E EPS is unchanged at Rs3.9 but we note that the low figure versus subsequent years reflects only four months of operations in FY2009. Our revised earnings for FY2010-FY2012E reflect higher refining margins of around US$2/bbl from FY2011 reflecting (1) use of gas for entire heating requirement, which adds about US$1.2/bbl to the refining margins of all the years versus our previous assumptions and (2) moderately higher underlying margins. Our assumption of a stronger rupee partly dilutes the positive impact from higher refining margins.

Continue to prefer DCF to value RPL stock but the market may simply look at earnings. We prefer DCF valuation to value RPL stock as RPL's earnings (and cash flows) will decline over a period of time (even with constant refining margins) due to higher taxation. RPL's SEZ refinery will enjoy 100% income tax exemption on exports (practically the entire volumes) for the first five years of operations (FY2009-FY2013E), 50% tax exemption for the next five (FY2014-FY2018E) and some more tax exemptions in the next five subject to certain capex. We would be surprised if RPL does not re-invest the cash flows in a new refinery given (1) likely large cash flows (Rs303 bn in FY2010-FY2012E), (2) likely delay in most planned refineries and (3) RPL/Reliance's excellent execution capabilities. It is possible the market may value RPL stock on earnings of the first few years (assuming those earnings sustain in perpetuity) and apply a reasonable multiple of 7X-9X depending on cost of equity (say 12.5%) and market conditions.

Higher gas consumption instead of liquid fuels. We had previously assumed that RPL will use gas for 50% of its requirement given limited visibility on gas sales due to a pending legal case. The Mumbai High Court has recently ruled that Reliance can use gas for captive consumption but cannot sell gas to third parties except NTPC and RNRL; thus, we do not see any issue regarding internal consumption of gas. We model RPL to use gas instead of liquid fuels (produced and used internally by refineries typically) to generate heat to run critical refinery processes.

The use of gas will allow RPL to sell liquid refined products at market prices rather than use a portion of the products (about 8%) to generate heat for refining. Thus, RPL will benefit from the difference between product prices (linked to crude oil price) and gas price (likely significantly lower than crude oil price in equivalent terms). We estimate that this would boost RPL's refining margins by US$2.4/bbl (8% of difference between crude oil price of US$60/bbl and likely gas price of US$5.25/mn BTU equivalent to US$30/bbl equivalent crude oil price). We assume RPL will use gas for 75% of its heating requirement in FY2010E and 100% of its requirement from FY2011E.

Likely strong global refining margins through 2010. We expect global refining margins to remain strong through 2010 (FY2011) due to (1) likely strong global demand for oil and (2) limited refining capacity additions. The IEA expects oil demand to grow at 1.6 mb/d in 2007 and 2008, followed by 1.8 mb/d in 2009 and 1.9 mb/d in 2010 (see Exhibit 5). We see potential delays in most refining projects, which are currently due for 2010 and 2011 and note that delay in completion of some of the projects will push capacity utilization to dangerously 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.

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

	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Rs/US$	42.0	42.0	42.0	42.0	42.0	42.0	42.0
Import tariff on crude oil (%)	—	—	—	—	—	—	—
Refinery yield (US$/bbl)	69.3	69.9	69.8	68.6	68.6	68.6	68.6
Cost of crude (US$/bbl)	54.2	54.2	54.2	54.2	54.2	54.2	54.2
Landed cost of crude (US$/bbl)	54.4	54.4	54.3	54.3	54.3	54.3	54.3
Net refining margin (US$/bbl)	**14.9**	**15.6**	**15.4**	**14.3**	**14.3**	**14.3**	**14.3**
Crude throughput (mn tonnes)	**6.0**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**	**29.0**
Fuel and loss (mn tonnes)	0.2	0.6	—	—	—	—	—
Production of main products (mn tonnes)	5.8	28.4	29.0	29.0	29.0	29.0	29.0
Fuel and loss-own fuel used (%)	4.0	2.0	—	—	—	—	—
Fuel & loss equivalent-gas used (%)	4.0	6.0	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 2009-2020E, March fiscal year-ends (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E
Profit model						
Net revenues	133,844	647,390	650,407	643,025	643,025	643,025
EBITDA	**26,482**	**125,201**	**122,913**	**115,326**	**115,092**	**114,828**
Other income	188	176	1,104	4,248	6,325	6,078
Interest (expense)/income	(3,637)	(8,112)	(2,543)	—	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**18,047**	**102,474**	**106,575**	**104,567**	**106,301**	**105,683**
Extraordinary items	—	—	—	—	—	—
Tax	(400)	(2,483)	(2,519)	(2,345)	(2,384)	(17,522)
Deferred taxation	—	—	—	—	—	1,624
Net income	**17,648**	**99,992**	**104,056**	**102,222**	**103,917**	**89,785**
Earnings per share (Rs)	**3.9**	**22.2**	**23.1**	**22.7**	**23.1**	**20.0**
Balance sheet						
Total equity	152,026	241,488	335,014	395,118	377,457	362,198
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	135,170	74,670	—	—	—	—
Current liabilities	9,573	41,521	41,500	41,500	41,500	41,500
Total liabilities and equity	**296,769**	**357,679**	**376,514**	**436,617**	**418,957**	**402,073**
Cash	2,970	2,884	33,919	107,693	103,139	99,470
Other current assets	24,999	98,785	99,484	98,820	98,829	98,839
Net fixed assets	266,520	253,729	240,830	227,823	214,707	201,483
Capital work-in-progress	—	—	—	—	—	—
Investments	2,280	2,280	2,280	2,280	2,280	2,280
Deferred expenditure	—	—	—	—	—	—
Total assets	**296,769**	**357,679**	**376,514**	**436,617**	**418,957**	**402,073**
Free cash flow						
Operating cash flow, excl. working capital	22,445	114,607	117,851	112,981	112,707	97,307
Working capital changes	(10,871)	(41,839)	(720)	663	(9)	(10)
Capital expenditure	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	188	176	1,104	4,248	6,325	6,078
Free cash flow	**(4,836)**	**70,944**	**116,235**	**115,893**	**117,023**	**101,375**
Ratios (%)						
Debt/equity	88.9	30.9	0.0	—	—	—
Net debt/equity	87.0	29.7	(10.1)	(27.3)	(27.3)	(27.5)
ROAE (%)	12.3	50.8	36.1	28.0	26.9	24.3
ROACE (%)	**7.7**	**35.8**	**32.7**	**28.0**	**26.9**	**24.3**

Source: Kotak Institutional Equities estimates.

Reliance Petroleum has high leverage to refining margins

Sensitivy 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	41.0	42.0	43.0	41.0	42.0	43.0	41.0	42.0	43.0
Net profits (Rs mn)	16,919	17,648	18,376	96,573	99,992	103,410	100,685	104,056	107,427
EPS (Rs)	3.8	3.9	4.1	21.5	22.2	23.0	22.4	23.1	23.9
% upside/(downside)	**(4.1)**		**4.1**	**(3.4)**		**3.4**	**(3.2)**		**3.2**
Refining margins (US$/bbl)									
Margins (US$/bbl)	13.9	14.9	15.9	14.6	15.6	16.6	14.4	15.4	16.4
Net profits (Rs mn)	15,848	17,648	19,447	91,292	99,992	108,691	95,356	104,056	112,756
EPS (Rs)	3.5	3.9	4.3	20.3	22.2	24.2	21.2	23.1	25.1
% upside/(downside)	**(10.2)**		**10.2**	**(8.7)**		**8.7**	**(8.4)**		**8.4**

Source: Kotak Institutional Equities estimates.

Our DCF-based target price for RPL is Rs125

DCF valuation for Reliance Petroleum (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
EBITDA	—	**26,482**	**125,201**	**122,913**	**115,326**	**115,092**	**114,828**	**114,537**	**114,218**	**113,871**	**113,496**	**113,092**	**113,092**	**113,092**	**113,092**
Tax expense	—	(480)	(2,679)	(2,579)	(2,345)	(2,384)	(17,522)	(18,379)	(19,104)	(19,717)	(20,236)	(37,092)	(37,454)		
Working capital changes	(5,290)	(10,871)	(41,839)	(720)	663	(9)	(10)	(10)	(11)	(12)	(13)	(13)	(15)		
Cash flow from operations	**(5,290)**	**15,131**	**80,683**	**119,614**	**113,644**	**112,698**	**97,297**	**96,148**	**95,103**	**94,142**	**93,248**	**75,987**	**75,623**		
Capital expenditure	(67,500)	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)		
Free cash flow to the firm	**(72,790)**	**(1,468)**	**78,683**	**117,614**	**111,644**	**110,698**	**95,297**	**94,148**	**93,103**	**92,142**	**91,248**	**73,987**	**73,623**	**73,623**	**73,623**
Discount factor at WACC	**0.92**	**0.81**	**0.72**	**0.64**	**0.57**	**0.51**	**0.45**	**0.40**	**0.36**	**0.32**	**0.28**	**0.25**	—	—	—
Discounted cash flow	(66,609)	(1,194)	56,890	75,589	63,760	56,195	43,002	37,763	33,184	29,192	25,697	18,521			
Discounted cash flow-1 year forward		(1,343)	64,002	85,038	71,753	63,220	48,377	42,483	37,344	32,841	28,909	20,836	18,430		
Discounted cash flow-2 year forward			72,002	95,668	80,722	71,145	54,424	47,793	42,012	36,958	32,522	23,440	20,733	18,430	

	Now	+ 1-year	+ 2-years
Total PV of free cash flow (a)	**371,989**	**511,888**	**595,849**
FCF one-year forward	73,623	73,623	73,623
Terminal value	588,985	588,985	588,985
PV of terminal value (b)	**165,867**	**165,867**	**165,867**
Total PV (a) + (b)	**537,856**	**677,755**	**761,716**
Net debt	54,574	127,364	132,200
Equity value	483,282	550,391	629,516
Equity value (US$ mn)	**9,765**	**11,252**	**12,853**
Shares outstanding (mn)	4,500	4,500	4,500
Equity value/per share (Rs)	**107**	**122**	**140**

Sensitivty of share price to different levels of WACC and growth rate (Rs)

		WACC (%)						
		11.0	**11.5**	**12.0**	**12.5**	**13.0**	**13.5**	**14.0**
Growth rate (%)	**-**	**143**	**135**	**129**	**122**	117	111	106
	1.0	**149**	**141**	**133**	**127**	120	115	109
	2.0	**156**	**147**	**139**	**132**	**125**	119	113
	3.0	**166**	**156**	**146**	**138**	**130**	**123**	117
	4.0	**178**	**166**	**155**	**146**	**137**	**129**	122
	5.0	**195**	**180**	**167**	**155**	**145**	**136**	**128**
	6.0	**218**	**198**	**182**	**168**	**156**	**145**	**136**
	7.0	**252**	**225**	**203**	**185**	**170**	**157**	**146**

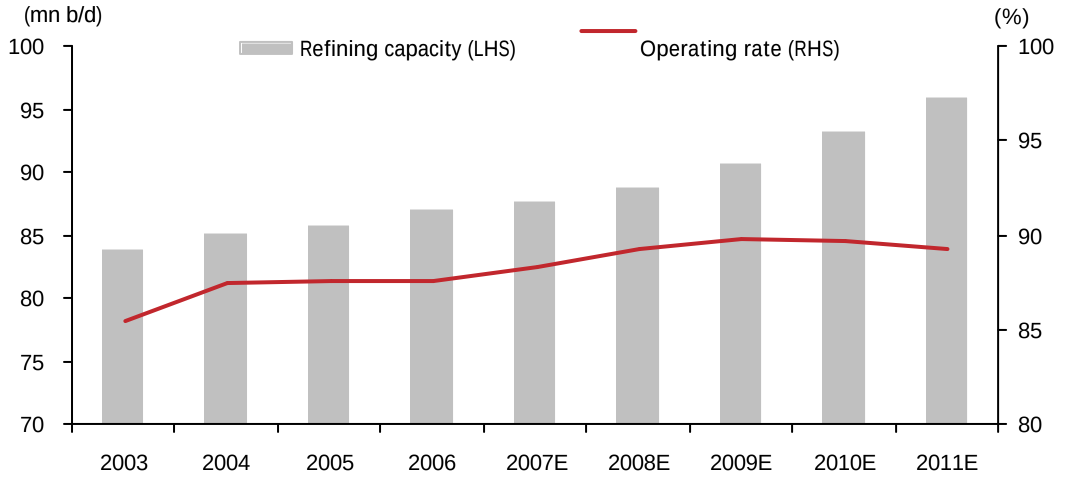
Discount rate (%)	**12.5**
Growth from 2020 to perpetuity (%)	—
Exit free cash multiple (X)	8.0
Exit EBITDA multiple (X)	5.2

Expect high crude prices to sustain backed by strong demand growth
Estimated global crude demand, supply and prices, Calendar year-ends

	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E
Demand (mb/d)									
Total	79.2	82.3	83.7	84.5	86.1	87.7	89.5	91.4	93.4
Yoy growth	1.5	3.1	1.4	0.8	1.6	1.6	1.8	1.9	2.0
Supply (mb/d)									
Non-OPEC	48.2	49.2	49.0	49.4	50.2	51.5	52.3	52.6	53.0
Yoy growth	0.1	1.0	(0.2)	0.4	0.8	1.3	0.8	0.3	0.4
OPEC									
Crude	27.4	29.0	30.2	30.5	31.0	30.9	31.2	32.4	33.7
NGLs	3.7	4.2	4.5	4.6	4.9	5.3	6.0	6.4	6.7
Total	**31.1**	**33.2**	**34.7**	**35.1**	**35.9**	**36.2**	**37.2**	**38.8**	**40.4**
Total	**79.9**	**83.2**	**84.5**	**85.1**	**86.1**	**87.7**	**89.5**	**91.4**	**93.4**
Total stock change	0.5	1.0	0.7	0.8	0.0				
Demand growth (yoy, %)	**2.0**	**3.9**	**1.7**	**1.0**	**1.9**	**1.9**	**2.1**	**2.1**	**2.2**
Supply growth (yoy, %)									
Non-OPEC	**1.9**	**2.1**	**(0.4)**	**0.8**	**1.6**	**2.6**	**1.6**	**0.6**	**0.8**
OPEC	**6.4**	**6.8**	**4.5**	**1.2**	**2.1**	**0.9**	**2.8**	**4.3**	**4.1**
Total	**3.6**	**4.1**	**1.6**	**0.7**	**1.1**	**1.9**	**2.1**	**2.1**	**2.2**
Dated Brent ($/bbl)	**31.1**	**38.3**	**54.4**	**65.8**	**68.0**	**65.0**	**65.0**	**65.0**	**55.0**

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

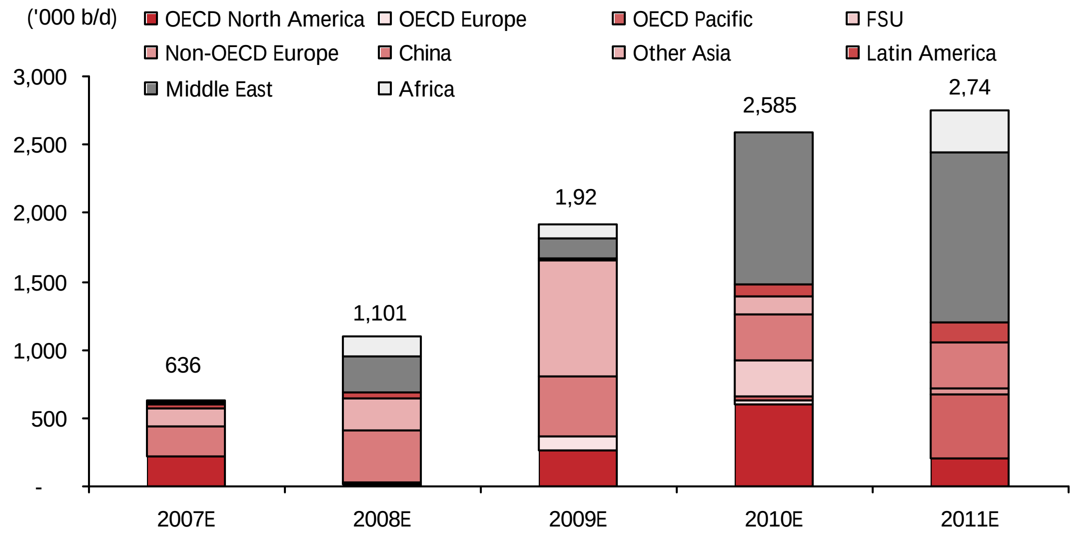
Global refining operating rates will likely remain high given tightening demand-supply balance
Global refining capacity versus operating rate



Source: IEA, BP Statistical Review of World Energy, 2006, Kotak Instiutional Equities estimates.

Limited supply additions to global refining capacity

Global refinery capacity addition, 2007-2011E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates.

Technology

HCLT.BO, Rs327	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	360
52W High -Low (Rs)	366 - 228
Market Cap (Rs bn)	227.4

Financials

June y/e	2007E	2008E	2009E
Sales (Rs bn)	60.0	76.8	97.6
Net Profit (Rs bn)	12.1	12.6	15.4
EPS (Rs)	17.6	18.1	22.1
EPS gth	*54.5*	*3.2*	*22.0*
P/E (x)	18.6	18.0	14.8
EV/EBITDA (x)	16.4	13.2	10.4
Div yield (%)	2.4	2.4	2.4

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	67.5	-	-
FIIs	13.5	0.4	(0.3)
MFs	3.1	0.6	(0.1)
UTI	-	-	(0.7)
LIC	2.7	0.5	(0.2)

HCL Technologies: Transformation initiative showing promising signs but too early to call it a victory

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- **Strengthening vertical capabilities critical to sustainable profitable growth**
- **Transformation initiatives showing positive results—into phase II now**
- **Focus on total IT outsourcing and flexibility on engagement models for clients outside G-200**
- **Margin challenges—near term as well as long term**
- **Maintain In-Line rating with a Jun '09 DCF based target price of Rs360/ share**

We met up with the HCL Technologies (HCLT) management recently. We believe that the transformation initiatives of the company have provided better employee experience, operating excellence, improving customer experience and building a clear value proposition for the client. This reflects in consistent quarter on quarter growth of 7.4-10.3% over the last five quarters. However, we believe that the next level of profitable (and sustainable) growth hinges on creation of business model differentiators (retail, life sciences etc) and strengthening capabilities in verticals scalable offshore (financial services), an area that has been the company's weakness in the past. We maintain our IL rating with an unchanged Jun '09 DCF based target price of Rs360/ share. Further equity dilution through issuance of RSUs remains an overhang on the stock.

Strengthening vertical capabilities critical to sustainable profitable growth: We view strengthening of vertical capabilities as critical on two counts (a) it prevents commoditization of the services and (b) it is critical to get into core applications (especially for large clients) portfolio. Note that HCLT has a significant number of Tier 1 accounts with large applications budget where it is offering only single service (either of BPO or infrastructure management). We believe that even though HCLT is organized on vertical lines, the true revenue tracking measure is horizontal driven. Aggressive outsourcing by clients and competition in HCLT's focus areas makes it imperative for the company to bridge this gap. We view acquisitions as the likely scenario especially in the financial services domain.

Transformation initiatives showing positive results—into phase II now: HCLT has been implementing several changes in its organization and business model as part of the transformation initiative it started around 18 months back. Prime focus of the phase I of the initiative was on increasing employee satisfaction, revamping the sales and delivery structure, and creating differentiated verticals and service lines. We note that HCLT has replaced several of its senior managers with people from other tier-I companies to bring in new 'thinking' in the organization. It has also undertaken several other employee initiatives like 360 degree feedback and increased transparency of top management actions. These actions have helped the company curb its attrition rates among the middle and senior management to sub-3% levels. HCLT has recently started the phase II of its transformation process.

Focus on total IT outsourcing and flexibility on engagement models for clients outside G-200: We note that HCLT has won several large deals in the past few quarters, notably DSG, Skandia, Autodesk, and Teradyne on the back of (a) its experience in multi-service deals (b) strength in infrastructure management services (c) ability to structure and price the deal as a single contract versus separate contracts for separate services and (d) ability and willingness to enter into different engagement models. Execution is however critical to manage profitability on such contracts, an area where HCLT appears to have delivered well. However HCLT's focus on clients outside G-200 increases risk to revenue profile.

Margin challenges—near term as well as long term: Near term margin challenges for

HCLT are similar to that of peers—(a) limited levers in the form of SG&A efficiencies (b) rupee appreciation and (c) wage hikes of 13-15% offshore and 3-5% onsite. Also, any further issuance of RSUs will have a negative impact on OPM. We are factoring in a 60bps decline in OPM in the Jun '07 quarter and 60bps decline in FY2008 over FY2007. Longer term margin challenges arise from horizontal driven approach that may create risk of commoditization of services. Risk also emanates from focus on smaller clients that are more sensitive to economic pressures and are candidates for M&A.

Valuations—equity dilution remains an overhang: HCLT had 50.6 mn options outstanding as on Mar 31, 2007 (including 14.6 mn options granted at below the market price). This amounts to 7.6% of the company's current shares outstanding. We believe that the potential equity dilution accruing from current options outstanding and further grants will remain an overhang. We note that our EPS estimates of Rs18.1 and Rs22.1 for FY2008 and FY2009 respectively are based on equity shares of 695 mn. We maintain out In-Line rating on the stock with a Jun'09 DCF-based target price of Rs360/share.

HCLT's revenue growth rates have been strong in the past few quarters

Revenues - US$mn	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
IT services	148.4	162.6	168.9	177.7	187.1	202.1	222.3	242.7	262.4
Infrastructure services	18.9	21.9	22.0	26.7	29.3	34.0	39.8	46.4	50.2
BPO	29.5	29.7	29.7	29.7	35.1	36.3	38.4	42.0	49.7
Total	**196.8**	**214.1**	**220.6**	**234.2**	**251.5**	**272.4**	**300.5**	**331.1**	**362.3**

Growth qoq (%)	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
IT services	2.6	9.5	3.9	5.2	5.3	8.0	10.0	9.2	8.1
Infrastructure services	23.3	15.5	0.8	21.3	9.7	16.0	17.0	16.6	8.2
BPO	17.1	0.7	0.1	0.1	18.0	3.5	5.8	9.4	18.3
Total	**6.3**	**8.8**	**3.1**	**6.1**	**7.4**	**8.3**	**10.3**	**10.2**	**9.4**

Source: Company reports

HCL Technologies- Profit and Loss Statement, June Year End

Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Revenues	**33,700**	**44,002**	**59,992**	**76,842**	**97,577**
RSU expenses		279	637	706	706
Direct Costs	21,166	27,576	37,409	48,527	62,335
Gross Profit	**12,534**	**16,147**	**21,946**	**27,610**	**34,536**
SG&A	4,810	6,577	9,138	11,636	14,594
EBIDTA (excl other income)	**7,723**	**9,570**	**12,809**	**15,974**	**19,942**
Depreciation	1,555	2,032	2,523	3,169	3,812
EBIT	6,168	7,538	10,285	12,805	16,129
Interest income/(Expenses)	991	578	2,810	1,212	1,678
Earnings Before Tax	7,159	8,116	13,096	14,018	17,807
Tax	674	626	989	1,402	2,416
Income bef share of equity investees	**6,485**	**7,490**	**12,107**	**12,616**	**15,391**
Share of income (loss) of equity investees	(27)	0	0	(9)	(4)
Minority Interest	442	16	44	0	0
Net Income	**6,016**	**7,473**	**12,063**	**12,607**	**15,387**
Less: Extraordinary items	0	(1,290)	0	0	0
Net Income	**6,016**	**6,183**	**12,063**	**12,607**	**15,387**
EPS (Rs.) fully diluted	**9.5**	**11.4**	**17.6**	**18.1**	**22.1**
Margins (%)					
Gross Profit Margin	37.2	36.7	36.6	35.9	35.4
Operating margin	22.9	21.7	21.4	20.8	20.4
EBIT margin	18.3	17.1	17.1	16.7	16.5
Net Profit	19.2	17.0	20.2	16.4	15.8
Net Income margin	17.9	17.0	20.1	16.4	15.8
SG&A expenses	14.3	14.9	15.2	15.1	15.0
Tax Rate	9.4	7.7	7.6	10.0	13.6
Growth (%)					
Revenue Growth	28.9	30.6	36.3	28.1	27.0
Gross Profit	32.7	28.8	35.9	25.8	25.1
EBITDA	39.4	23.9	33.8	24.7	24.8
EBIT	40.7	22.2	36.5	24.5	26.0
Net Profit	8.6	15.5	61.6	4.2	22.0
Net Income	14.3	24.2	61.4	4.5	22.0
No of shares (mn)	634.7	656.6	686.0	695.0	695.0

Source: Company, Kotak Institutional Equities estimates

Healthcare

APLH.BO, Rs525	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	500
52W High -Low (Rs)	577 - 382
Market Cap (Rs bn)	27.1

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	9.5	11.5	13.5
Net Profit (Rs bn)	0.6	0.9	1.0
EPS (Rs)	12.1	16.3	19.7
EPS gth	*20.3*	*34.6*	*20.7*
P/E (x)	43.4	32.2	26.7
EV/EBITDA (x)	18.8	16.4	13.7
Div yield (%)	1.0	1.0	1.2

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	31.1	-	-
FIIs	54.9	0.2	0.1
MFs	0.3	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Apollo Hospitals : Net up 20% in FY2007

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- **FY2007 consolidated revenue is up 25%, while pre-exceptional net profit is up 20% to Rs644 mn (versus our estimate of Rs600 mn)**
- **Key challenge for the company is execution and risks include frequent equity dilution.**
- **We will review our estimates post discussion with the management.**

For FY2007 (consolidated numbers), revenues are up 25% and EBITDA is up 27%, however lower minority interest limited EPS growth to 24% - see results table. Including the profit on stake sale in Lanka Hospital net profit is Rs954 mn. Earnings growth in FY2008 (35%) will be led by better profitability in mature hospitals, turnaround in new hospitals and share of profit in the healthcare BPO. RoCE was only 11% in FY2007, which we estimate will rise to 15% in FY2010. This we believe needs to improve further. This will likely improve when the company improves its capital structure, unlike the current debt-equity ratio of 0.4X. In the short-term, the company seems to be in favour of low leverage, which can be used later for inorganic opportunities. We will review our estimates, once segmental details are available and post discussion with the management.

Key challenge for the company is execution, and risks include improper capital structure and frequent equity dilution. In a scenario of rising real estate and finance cost, economics of the hospitals business is likely to deteriorate, unless matched by price hikes. We believe that Apollo is in a sweet spot, having the largest network and prime properties (most of it owned). The company has been taking prices hikes; also a function of higher occupancy. We note that the company has surplus land beside its existing hospital in Hyderabad (market value is in excess of US$150mn, or Rs125/share), however usage is likely to be limited to the healthcare/hospitality sector. The promoter group has 1.5 warrants at Rs442 each, convertible into 1.5 mn shares (3% dilution) within the next 16 months.

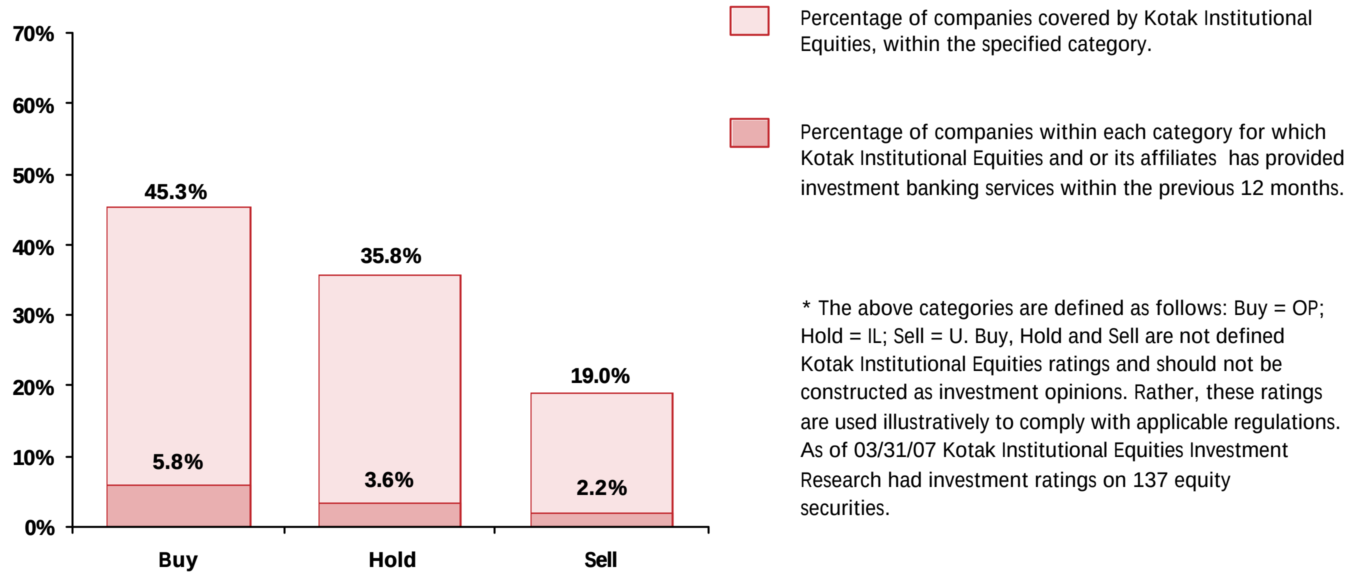
Apollo Hospitals - results table (Rs mn)

	Standalone									Consolidated				
	Q4FY06	FY2006	1QFY07	2QFY07	3QFY07	4QFY07	FY2007	Q4, yoy growth %	FY07, yoy growth %	FY2005	FY2006	FY2007	FY2008E	FY07, yoy growth %
Net Sales	1,920	7,078	2,041	2,207	2,328	2,334	8,910	22	26	6,607	7,596	9,495	11,492	25
Total Expenditure	1,673	5,929	1,689	1,840	1,948	2,015	7,492			5,476	6,396	7,974	9,705	
- Material cost	996	3,602	1,033	1,124	1,188	1,206	4,551	21	26	2,991	3,729	4,709	5,681	26
- Staff cost	272	984	290	305	349	334	1,278	23	30	1,016	1,127	1,422	1,721	26
- Other exp	81	323	92	97	85	91	365	12	13	398	518	541	693	4
- General & Admin	303	943	262	292	298	350	1,202	16	27	987	923	1,188	1,461	29
- Selling exp	21	77	12	22	28	34	96	62	25	84	99	114	149	15
EBITDA	247	1,149	352	367	380	319	1,418	29	23	1,131	1,200	1,521	1,787	27
Depreication	69	261	74	76	75	83	308			311	378	407	554	
EBIT	178	888	278	291	305	236	1,110			820	822	1,114	1,232	
Interest	27	117	29	45	45	45	164			242	244	270	283	
Other income	31	112	11	27	13	34	85			14	95	71	75	
PBT	182	883	260	273	273	225	1,031	24	17	591	673	915	1,024	36
Current Tax	51	266	77	98	89	71	335			231	269	340	311	
Deferred Tax	7	15	10	(2)	5	7	20			(27)	(31)	(14)	51	
Less: Minority interest										(32)	(46)	0	(25)	
Add: Share in Associates										28	39	55	180	
Exceptional (income)/cost				(325)			(325)			64	0	(310)	0	
Rep. PAT	124	602	173	502	179	147	1,001			384	520	954	867	
Adj. PAT	124	602	173	177	179	147	676	19	12	448	520	644	867	24
Operating ratios (%)														
- Material cost	51.9	50.9	50.6	50.9	51.0	51.7	52.0			45.3	49.1	49.6	49.4	
- Staff cost	14.2	13.9	14.2	13.8	15.0	14.3	14.3			15.4	14.8	15.0	15.0	
- Other exp	4.2	4.6	4.5	4.4	3.7	3.9	4.1			6.0	6.8	5.7	6.0	
- General & Admin	15.8	13.3	12.8	13.2	12.8	15.0	13.5			14.9	12.1	12.5	12.7	
- Selling exp	15.8	13.3	12.8	13.2	12.8	15.0	13.5			14.9	12.1	12.5	12.7	
- EBITDA margin	12.9	16.2	17.2	16.6	16.3	13.7	15.9			17.1	15.8	16.0	15.5	
- EBIT margin	9.3	12.5	13.6	13.2	13.1	10.1	12.5			12.4	10.8	11.7	10.7	
- Tax rate	31.9	31.8	33.5	35.2	34.4	34.7	34.4			34.4	35.4	35.6	35.4	
- Net margin	6.5	8.5	8.5	8.0	7.7	6.3	7.6			6.8	6.8	6.8	7.5	

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

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* 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 03/31/07 Kotak Institutional Equities Investment Research had investment ratings on 137 equity securities.

Source: Kotak Institutional Equities. As of March 31, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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