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UPDATE

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Tariffs in bilateral perk up post-monsoon, headwinds signal weakness. Short-term tariffs in the bilateral market improved marginally in the month of October as per latest data released by CERC, though at Rs5/kwh the improvement falls significantly short of the pre-monsoon tariffs. Price trends for power traded on the exchange highlight continued weakness in the short-term market that will likely translate into subdued earnings from merchant sales for companies such as Jindal Steel & Power.

Tariffs in bilateral trades marginally up, though significantly short of pre-monsoon tariffs

Short-term tariffs in the bilateral market have improved in the month of October 2009, inching up to Rs5.07/kwh compared to the average tariff of Rs4.8/kwh in four months prior. However, the improvement falls significantly short of Rs7/kwh average tariffs reported prior to the onset of the monsoon season. We note that the corresponding tariffs in the power exchanges in the month of October 2009 were Rs4.8/kwh, which have since deteriorated to ~Rs3/kwh in the month of November and December 2009. Lower farm load, improved hydro-generation and moderate climate are likely reasons for softening short-term tariffs.

Short-term markets contributed 8.7% of total generation; expect exchanges to gain prominence

Short-term markets contributed ~8.7% of the total generation in the month of October 2009, having transacted 5,662 MU out of total electricity generation of 64,896 MU during the period. Out of the total electricity traded in the short-term market ~49% (2,771 MU) was through bilateral trades, 11.3% (639 MU) were traded through power exchanges, while the balance sale was through the unscheduled interchange (UI) mechanism. We expect the sales mix in the short-term market to shift in favor of power exchange, which has recently introduced longer duration contracts and reduce dependence on the UI mechanism as the proposed increase in UI charges comes into effect.

3QFY10E results may be short of expectations for pure merchant plays

The lower-than-estimated merchant tariffs in the bilateral market in October, coupled with continued weakness in exchange-traded power (as reflected in average price for the quarter), may likely result in weak tariffs for companies such as Jindal Steel and Power (JSPL) in the ensuing quarter. We note that JSPL traded ~457 MU in the bilateral market, making it the market leader with 16.6% market share overall bilateral trades. Lanco Amarkantak was the leading private utility exporter in the UI segment having injected ~148 MU, however, as the power was sold on 'infirmit' basis the same would be appropriated against capital cost incurred and not recognized as revenues for the quarter.

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Exhibit 1: Tariffs for sale of power through bilateral trades have improved marginally in October, though short of the summer tariffs of Rs7/kwh

Details of tariff (Rs/kwh) and volume (MU) of power traded in the short-term market

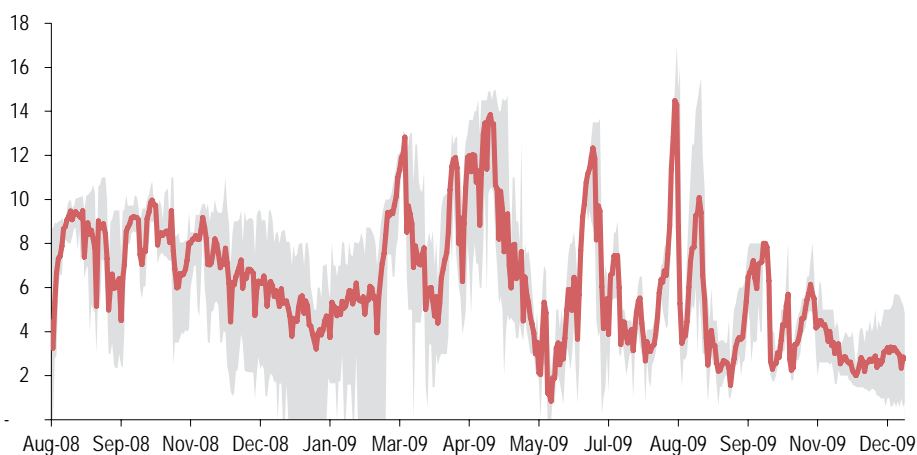
	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09
Price of power traded (Rs/unit)							
Through traders	7.2	6.8	5.1	4.8	4.6	4.7	5.1
Through Exchange							
IEX	10.1	6.8	7.4	4.8	7.4	4.0	4.7
PXIL	10.2	8.7	9.6	4.9	6.2	4.3	5.2
Through UI							
NEW grid	5.4	4.2	4.9	4.1	6.3	5.0	4.2
SR grid	6.0	4.0	5.1	4.7	5.9	4.2	5.8
Volume of electricity (MU)							
Generation	62,486	63,466	62,646	62,936	65,563	63,188	64,896
Long term PPA's	58,054	58,809	57,580	57,215	59,774	57,593	59,234
Short term power sales	4,432	4,656	5,066	5,721	5,789	5,595	5,662
Bilateral	2,210	2,317	2,418	3,021	3,369	2,858	2,772
Power exchange	406	342	530	495	494	527	639
Unscheduled Interchange (UI)	1,816	1,997	2,119	2,205	1,927	2,210	2,251
Composition of power sales							
Long term PPA's (%)	92.9	92.7	91.9	90.9	91.2	91.1	91.3
Short term power sales (%)	7.1	7.3	8.1	9.1	8.8	8.9	8.7
Short term power trading profile (%)							
Bilateral	49.9	49.8	47.7	52.8	58.2	51.1	49.0
Direct bilateral	9.2	7.3	10.5	8.7	8.5	9.4	11.3
Unscheduled Interchange (UI)	41.0	42.9	41.8	38.5	33.3	39.5	39.8

Note: Calculation of composition of power sales ignores auxiliary consumption.

Source: CERC, Kotak Institutional Equities

Exhibit 2: Tariffs in the power exchange highlight further deterioration of prices

Details of average tariff in the power exchange (Rs/kwh)



Source: IEX, Kotak Institutional Equities

Exhibit 3: Summary valuation of utility companies

	Category	Rating	Mkt Cap. (US\$ bn)	Price 23-Dec	Target price	EV/EBITDA (X)				P/E (X)			
						2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Reliance Infrastructure	Int	BUY	5.2	1,070	1,250	22.7	20.1	15.8	11.0	17.1	16.8	15.6	11.7
Tata Power	Int	ADD	7.1	1,339	1,400	13.4	12.9	11.3	8.2	21.2	19.1	16.2	12.7
CESC	Int	ADD	1.0	390	375	7.9	6.7	5.6	4.8	12.2	10.4	9.3	8.6
NTPC	Gen	REDUCE	40.4	230	190	19.3	15.6	13.9	11.6	23.4	20.7	18.6	15.6
Lanco Infratech	Div	ADD	2.9	558	575	32.4	22.0	11.6	9.5	38.4	28.4	16.6	15.2
Reliance Power	Gen	REDUCE	7.5	147	160	(354.4)	905.9	90.5	30.0	144.1	59.7	48.0	25.8
Jindal Steel and Power	Div	SELL	14.4	727	530	14.4	11.6	9.4		3.7	17.7	14.8	

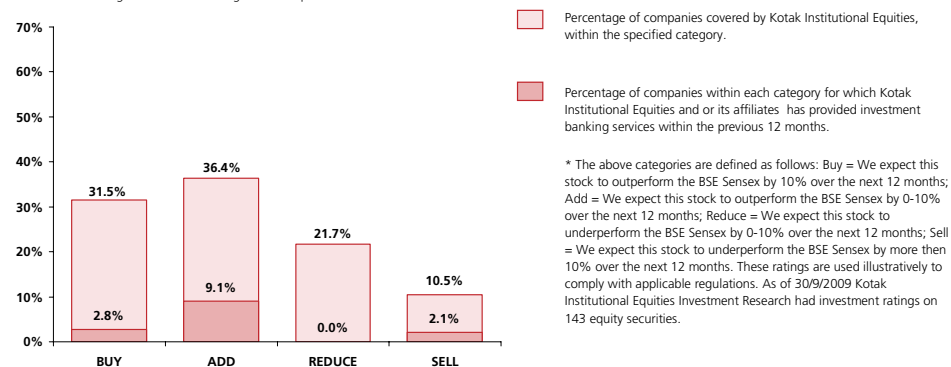
	P/BV (X)				Div Yield (%)	ROCE (%)				ROE (%)			
	2009	2010E	2011E	2012E	2010E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Reliance Infrastructure	1.4	1.3	1.2	1.1	0.8	6.9	5.8	5.9	7.0	4.9	6.1	7.8	10.1
Tata Power	2.6	2.3	2.1	1.8	1.0	7.5	7.2	6.3	6.7	13.3	14.5	13.4	14.1
CESC	1.7	1.5	1.3	1.2	1.2	10.8	10.4	10.9	11.0	14.9	15.0	14.8	14.2
NTPC	3.2	3.0	2.7	2.5	1.8	10.6	10.2	10.5	11.3	14.3	14.9	15.2	16.6
Lanco Infratech	5.9	3.9	3.1	2.6	—	12.0	9.1	11.9	11.0	16.4	16.9	20.7	18.4
Reliance Power	2.6	2.5	2.3	2.1	—	—	2.3	2.1	3.4	1.8	4.2	5.0	8.7
Jindal Steel and Power	8.7	5.9	4.2		0.1	25.3	24.0	19.0		50.9	39.7	33.0	

Source: Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of September 30, 2009

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

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