

Contents

Updates

Reliance Industries: It's a bird, it's a plane, it's the Reliance stock price

Reliance Petroleum: Revised 12-month target price to Rs170 from Rs125

Sun TV Network: Things starting to get lively in Tamil broadcasting and TV distribution markets

GSPL, Petronet LNG: Is it gas? Or simply hot air?

Metals: Strong resource prices confront weak end-product demand; spot steel prices may get firm

Strategy: Alpha Bet: Closing JSP/Tata Steel

News Roundup

Corporate

- Ranbaxy Laboratories Ltd has dropped a bid to sell a generic version of Novartis AG's blood pressure medicine Diovan before a patent expires in five years. (FE)
- The Mittal group could be a prospective partner in HPCL's exploration arm Prize Petroleum Company (PPCL), which is planning a rights issue. (ET)
- Tata group, the salt-to-software conglomerate, is in talks to buy UK-based speciality tea company Liberty Tea to expand its presence in the global beverages market and gain a larger share of the retail shelf space. (ET)
- Reliance Industries (Ltd) (RIL) has said that it had discovered oil in the deepwater block KG-D4 in the Krishna Basin for the first time. (FE)
- The Munjals of Hero Honda are close to tying up with German insurer Ergo to enter the life insurance sector. Ergo is part of the Munich Re group. (ET)
- Carlsberg A/S, the largest Nordic brewer, plans to buy Parag Breweries of India and build two new plants in the country. (FE)

Economic and political

- India will not attend the seventh trilateral meeting on the US\$8 bn Iran gas pipeline project slated for the third week of September in Tehran unless some crucial bilateral issues with Pakistan are resolved first. (FE)
- More than two-thirds of the 437 senior executives polled by market research agency C fore Consulting on behalf of *Financial Express* said they did not want a mid-term poll, although almost six out of ten felt one was probably likely. (FE)
- The Cabinet has said that the Delhi-Mumbai Industrial Corridor (DMIC) will be a private entity, where the government will hold only 49% equity, allowing private infrastructure companies to participate in 51% equity of the company. (FE)

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

EQUITY MARKETS

India	Change, %			
	21-Sep	1-day	1-mo	3-mo
Sensex	16,564	1.3	14.8	14.5
Nifty	4,838	1.9	15.5	13.8
Global/Regional indices				
Dow Jones	13,767	(0.4)	5.2	1.6
Nasdaq Composite	2,654	(0.5)	5.3	1.4
FTSE	6,429	(0.5)	5.6	(2.5)
Nikkei	16,310	(0.6)	2.6	(10.6)
Hang Seng	25,637	(0.3)	18.0	16.8
KOSPI	1,907	(0.1)	9.9	6.3
Value traded - India				
		Moving avg, Rs bn		
	21-Sep	1-mo	3-mo	
Cash (NSE+BSE)	219.4	159.8	163.2	
Derivatives (NSE)	759.3	400.8	417.3	
Deri. open interest	943.4	852.2	728.6	

Forex/money market

	Change, basis points			
	21-Sep	1-day	1-mo	3-mo
Rs/US\$	39.7	-	(139)	(100)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	(3)	(13)	(30)

Net investment (US\$m)

	19-Sep	MTD	CYTD
FIs	609	2,026	10,400
MFs	123	(8)	746

Top movers -3mo basis

Best performers	Change, %			
	21-Sep	1-day	1-mo	3-mo
Reliance Energy	988	4.4	42.7	76.2
Neyveli Lignite	102	3.9	39.8	63.5
Chambal Fert	51	0.9	18.4	49.0
Thermax	716	0.6	17.9	41.6
SAIL	188	2.1	33.7	38.5
Worst performers				
i-Flex	1,855	(1.9)	(1.5)	(27.4)
Polaris	114	(2.3)	4.7	(27.3)
Punjab Tractors	241	1.4	1.8	(19.7)
Cipla	169	(0.3)	(4.7)	(19.5)
HCL Tech	275	(3.0)	(5.0)	(17.9)

Kotak Institutional Equities Research

kotak.research@kotak.com

Mumbai: +91-22-6634-1100

Energy**RELI.BO, Rs2274**

Rating	U
Sector coverage view	Neutral
Target Price (Rs)	1,800
52W High -Low (Rs)	2294 - 1138
Market Cap (Rs bn)	3,305

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	1,115	1,067	1,288
Net Profit (Rs bn)	120.6	127.7	187.1
EPS (Rs)	83.0	87.9	123.6
EPS gth	31.5	5.9	40.7
P/E (x)	27.4	25.9	18.4
EV/EBITDA (x)	16.8	15.4	10.2
Div yield (%)	0.5	0.5	0.7

Shareholding, June 2007

	% of		Over/(under)
	Pattern	Portfolio	weight
Promoters	43.5	-	-
FIs	23.6	8.1	0.6
MFs	2.4	4.8	(2.7)
UTI	-	-	(7.5)
LIC	4.3	7.9	0.4

Reliance Industries: It's a bird, it's a plane, it's the Reliance stock price

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **Reliance's stock price giving us vertigo**
- **We and our fair valuation are transfixed by the speed of increase in market cap.**
- **Modified earnings model to incorporate FY2007 annual report, incorporated IPCL**

The gravity-defying upward movement of Reliance stock price over the past few weeks is having the same stunning effect on us that Superman typically has. We have dusted our earnings model in order to catch up with Reliance's rampaging stock price but to no avail. Our revised 12-month fair valuation is Rs1,800 (Rs1,650 previously) based on 9X FY2010E EPS of Rs184 discounted back to September 2008 plus value of investments. Our valuation model implicitly assumes (1) earnings in perpetuity for the E&P segment—production from new discoveries will overcome impact of higher taxation and lower share of profit petroleum in initially-producing blocks such as PMT and KG D-6 and (2) zero taxation for RPL in perpetuity. We have revised our FY2008E, FY2009E and FY2010E consolidated EPS (consolidated with Reliance Petroleum; Reliance Retail valued separately) to Rs88, Rs124 and Rs184 from Rs81, Rs106 and Rs174 on higher chemical prices.

Developments since April 1, 2007—not enough to justify surge in market cap., in our view

The surge. Reliance's stock price has gone up 66% since March 31, 2007 and its market capitalization increased by a staggering US\$33 bn. There have been certain positive developments in Reliance, particularly in the E&P segment. However, we find it hard to justify the increase in valuations based on known developments and expectations of events, which we have duly factored in our earnings and valuation models. We note that the market has been very prompt in rewarding the stock through increased market capitalization based on news and speculation in the Indian press. Exhibit 3 shows the reaction of Reliance's stock price to news flows and the impact on market capitalization on days of the news. However, we would ascribe some of the increase to (1) general market bullishness, (2) Reliance's strong prospects, (3) higher visibility on earnings of RPL and E&P segment and (4) confidence in Reliance management to create value from new initiatives.

Evaluating impact of recent material developments

- 1. Rupee appreciation.** Reliance's earnings have high leverage to changes in the exchange rate as can be seen in Exhibit 4. The Indian Rupee has appreciated by Rs3.6/US Dollar since April 2007. The Indian market has largely ignored the impact of the recent appreciation in the Indian rupee in case of Reliance while penalizing other sectors with high exposure to the exchange rate (IT sector in particular).
- 2. New oil and gas discoveries.** Exhibit 5 shows the E&P discoveries made by Reliance since early 2007. Reliance has made significant discoveries in its prolific D-6 block and in other blocks. However, it is yet to disclose reserves in the new discoveries. We believe the new discoveries and potential new discoveries in blocks such as MN-DWN-2003/1 block would have to significantly higher versus reserves announced to date in order to justify Reliance's current valuation.

In Exhibit 6, we show that Reliance's current stock price is implying 55 tcf of additional gas reserves (recoverable). This compares with about 24 tcf of net recoverable reserves assumed by us in the valuation exercise. The 55 tcf of additional gas reserves being implied by today's stock price would mean that Reliance would need to bring on stream, the equivalent of 110 tcf of recoverable gas reserves—assuming a typical discovery-to-production period of six years and cost of capital of 12%.

- 3. Approval of gas price formula for KG D-6 block by government.** The Indian government recently approved a modified pricing formula for gas from KG D-6 block. The approved formula is largely in line with street expectations and should not be a reason for the recent sharp re-rating of the stock. Although there is some confusion about the approved formula regarding the biddable component (C) of the formula $(2.5 + C + (60-25)^{0.15})$, the gas price as per the formula whether C is zero or a positive integer decided through bidding later should not be too different from the street's assumptions. We model gas price at US\$4.2/mn BTU assuming C is zero (as per the official press release of the ministry of petroleum and natural gas) in the first five years of production (FY2009-FY2013) and increase the gas price to US\$4.5/mn BTU later. Our blended price is lower since we assume that Reliance will have to honor its 'agreement' with NTPC for supply of 12 mcm/d at US\$2.34/mn BTU for 17 years.
- 4. No decision on ongoing legal cases with NTPC and RNRL.** The market has largely ignored any potential negative developments from the ongoing legal disputes of Reliance with NTPC and RNRL. Reliance had bid to supply 12 mcm/d of gas to NTPC at US\$2.34/mn BTU in an international competitive bidding. Reliance and RNRL have signed a gas supply master agreement (GSMA) under which Reliance will supply about 44 mcm/d of gas to RNRL at US\$2.34/mn BTU (same terms and conditions as the NTPC contract). We are not sure about the other terms and conditions of the GSMA, which make the RIL-RNRL contract valid or invalid from a legal perspective since the GSMA is a matter of contention.

We believe that Reliance will have to supply gas to NTPC and RNRL although the price of gas is not certain. Also, we believe the decision of the judiciary (whatever that may be depending on the legal aspects of the case) will prevail over any government-approved formula. Thus, we believe the outcome of the legal disputes has very large implications for Reliance's future earnings and valuation.

If we assume US\$2.34/mn BTU in our earnings model for supply of 54 mcm/d of gas to NTPC and RNRL for 17 years, our DCF valuation for KG D-6 block would drop to US\$2.2 bn versus US\$6.6 bn currently. The value would drop further if the government insists on a price of US\$4.2/mn BTU or as suggested by the approved formula for computation of (1) the government's share of profit petroleum, (2) income tax and (3) royalty. Our FY2010E EPS of Rs184 (without adjusting for treasury shares) would decline to Rs160 if we assume US\$2.34/mn BTU as the price of gas instead of US\$4.2/mn BTU.

Revised earnings model

For those interested in mundane things like earnings models and earnings, we give our earnings revisions and key assumptions behind our earnings model below.

- 1. Refining margins—strong for a long time to come.** We model Reliance's FY2008, FY2009 and FY2010 refining margins (standalone refinery only) at US\$13.6/bbl, US\$13.8/bbl and US\$15.5/bbl. For RPL refinery, we model FY2010E refining margin at US\$16.7/bbl. The improvement in latter years reflects use of gas from KG D-6 block to run the refineries (for heat and power generation) instead of internally produced fuels. Reliance's refineries will save about US\$2-2.5/bbl (higher refining margins in other words) through substitution of costly liquid fuels with cheaper gas.
- 2. Chemical margins—model local selling prices at large premium to import parity prices.** We assume chemical margins to decline gradually through to FY2010E but still remain at well above mid-cycle levels. In our model, we assume significantly higher prices versus import parity prices to match our assumptions with Reliance's reported list price; in case of plastics in particular, the premium of Reliance's list prices to import parity prices has expanded significantly over the past few months (see Exhibit 7). For example, Reliance's list price for the month of September for PP is Rs66.25/kg, which would translate into a landed (import parity price) of US\$1,550/tonne. Far East Asia prices as reported by Platt's have hovered between US\$1,358-1,375/tonne over the past few weeks.

Our upward revisions to earnings primarily reflect the upward revision in chemical prices. Reliance's 1QFY08 chemical segment results had surprised us and the street positively. We assume Reliance is in a position to sell its products at higher prices compared to import parity prices against the traditional discount to import parity prices.

- 3. Gas volumes and price for KG D-6 block.** We model gas 20 mcm/d of gas production from KG D-6 block in FY2009E implying Reliance starts production in 2HFY09. For FY2010E, we model 60 mcm/d of gas and for FY2011E and beyond for the next several years 80 mcm/d. Increasing FY2010E gas production to 80 mcm/d would result in our FY2010E EPS increasing to Rs197 and our 12-month fair valuation increasing to Rs1,900.
- 4. Exchange rate—modeled appreciation in rupee versus stable exchange rate previously.** We have revised our Indian Rupee-US Dollar rate assumptions to Rs40/US Dollar for FY2009E (Rs41 previously) and Rs39/US Dollar for FY2010E (Rs41). We believe that continued strong capital inflows into India will likely provide impetus to the Indian Rupee versus the US Dollar in particular despite the continued large deficit in the BOP.

Our 12-month fair value of Reliance stock is Rs1,800

Valuation of Reliance stock (Rs)

	<u>FY2010E EPS</u> (Rs)	<u>P/E</u> (X)	<u>Valuation</u> (Rs/share)	<u>Comments</u>
Chemicals, refining, E&P (a) (b)	211	9	1,900	Consolidated FY2010E EPS including Reliance Petroleum
Valuation based on FY2010E EPS			1,592	12.5% discount rate; discounted to September, 2008
E&P (higher reserves in KG-DWN-98/3, other blocks)	—	—	—	We model 17 tcf of gas production from KG-DWN-98/3 block
E&P (NEC-25, CBM)	—	—	57	Based on KG D-6 reserves and valuation
Investments	—	—	130	
Other investments	—	—	7	
Retailing	—	—	123	US\$4.25 bn valuation; ~US\$1 bn equity invested in Reliance Retail as of end-FY2007
SEZ development	—	—	—	SEZs will require investment for the first few years
12-month forward valuation			1,779	

Note:

(a) FY2010E EPS is Rs184 on 1.573 bn shares after considering conversion of 120 mn warrants issued to the major shareholder.

(b) FY2010E EPS is adjusted for treasury shares or computed using 1.372 bn shares.

Source: Kotak Institutional Equities estimates.

The street is implying about US\$23 bn as value of potential oil and gas discoveries

Estimation of implied valuation of new businesses of Reliance Industries (US\$ bn)

		Comments
1. Valuation of extant businesses		Chemicals, RIL refinery, extant oil and gas
FY2008E EPS of Reliance (Rs)	87.9	Moderately higher than FY2007 EPS
FY2008E EPS adjusted for treasury shares (Rs)	101.9	Adjusted for 199 mn treasury shares
Effective tax rate in FY2008E (%)	23.1	
FY2008E EPS adjusted for tax rate	87.4	Normalized for 34% tax rate for extant earnings
Appropriate P/E multiple (X)	9.0	Generous given above mid-cycle margins, earnings and cost of equity of 12.5%
Valuation of extant businesses (Rs)	787	
Valuation of extant businesses	27	Reasonable in the context of replacement value, returns
2. Valuation of investments		RPL, IPCL, others (without Reliance Retail)
Reliance Petroleum	457	3.375 bn shares at Rs170, our 12-month target price for RPL
Others	8	
Total value of investments	465	
Valuation of RIL ex-new E&P, retailing, SEZs	1,252	
Current stock price	2,274	
3. Valuation of new businesses		Emerging E&P business, retailing, SEZs
Market-ascribed value of new businesses	1,022	
Market-ascribed value of new businesses (US\$ bn)	37	
Estimated valuation of retailing (US\$ bn)	4.3	Reliance has invested about US\$1 bn in Reliance Retail as at end-FY2007
Estimated valuation of SEZs (US\$ bn)	—	Value will take time to emerge
Market-ascribed value of emerging E&P business	32	Seems very high to us based on official reserves, announced discoveries
Estimated value of Reliance's stake in KG D-6 (gas)	5.9	Based on gas production of 17 tcf, US\$8.8 bn capex, US\$4.5/mn BTU net price
Estimated value of Reliance's stake in KG D-6 (oil)	1.8	0.5 bn bbls of OOIP assumed versus current announced reserves of 180 mn bbls
Estimated value of Reliance's stakes in NEC-25, CBM	2.1	
Implied value of new discoveries	23	Higher reserves in KG D-6, NEC-25, Cauvery-III-D5, GS-01, MN-D4 blocks?

Source: Kotak Institutional Equities estimates.

A summary of news flow regarding Reliance Industries and change in stock price

Changes in price, market capitalization post press announcements since April 2007

Date	News	Change in next 2 trading days	
		Stock price (Rs)	Mcap. (US\$ mn)
22-Sep	RIL set for global play in luxury space	—	—
21-Sep	RIL makes oil discovery in KG-DWN-98/1 block	—	—
19-Sep	RIL, GVK line up for Navi Mumbai airport	134	4,868
14-Sep	RIL to pump US\$ 2bn in to shipbuilding, dredging	1	36
12-Sep	Govt. approves RIL gas price at US\$4.2 per mBtu	41	1,489
11-Sep	RIL buys Hualon-Malaysian polyester firm	26	944
6-Sep	Rohm & Haas to pick up substantial stake in proposed JV with RIL at Jamnagar to set up a 0.2 mtpa capacity acrylic acid and related esters plant	4	145
5-Sep	RIL agrees to buy majority stake in Gulf Africa Petroleum Corporation-acquiring 250 fuel stations and storage terminals in Tanzania, Uganda, Kenya	11	400
3-Sep	RIL in process to set up optic fibre cable network in AP, Karnataka, TN, Maharashtra and Gujarat	12	436
27-Aug	RIL ventures in to construction business. Plans to set up Rs4.5 bn pre-engineered building facility along with Dubai-based Mammut group in Gujarat	105	3,814
23-Aug	RIL strikes black gold yet again in KG basin	28	1,017
10-Aug	RIL in negotiations to expand its downstream business in new geographies like Central America-eyes Guatemala to fire US retail plan	(13)	(472)
9-Aug	RIL & Nitesh Estate in race to buy Hindustan Unilever's Brookefields property in Bangalore	(65)	(2,361)
9-Aug	RIL in talks to acquire an equity stake in Haryana-based Modern Dairies which would strengthen its presence in high volume, low margin liquid milk market	(65)	(2,361)
8-Aug	Approval to RIL Maha Mumbai SEZ extended	36	1,308
7-Aug	RIL plans to invest up to US\$14 bn in oil exploration and production business	94	3,415
25-Jul	RIL plans to set up 4,000 Mw gas-based power generation capacity	29	1,053
24-Jul	RIL is planning to build the biggest greenfield fertiliser capacity in the country	25	908
17-Jul	RIL makes gas and oil discovery in Cauvery basin block	43	1,562
12-Jul	Reliance group's Navi Mumbai SEZ cleared	67	2,434
19-Jun	RIL and Yashraj films in talks to set up multiplexes, run entertainment channels and produce soap operas for television	61	2,216
13-Jun	RIL bids for 3 blocks in Australia	6	218
21-May	RIL has got approval from the Karnataka State High Level Clearance Committee for taking up city gas distribution activities in the state	76	2,761
18-May	RIL wins bid to build underground parking facilities in Bandra-Kurla complex	77	2,797
15-May	RIL makes two gas discoveries in KG D-6 and GS-01 blocks	13	472
11-May	RIL lines up Rs30 bn home solutions retail venture	40	1,453
11-Apr	RIL plans to enter hospitality business and in talks with Walt Disney, Ritz Carlton and Four Seasons for managing some of their hotels	6	218
7-Apr	RIL bids for US\$1.1bn Vizhinjam port	26	944
Total change since March 31, 2007		906	32,910
Total change on 'news' days		818	29,714

Note:

(a) Change in next 2 trading days implies that if the news article is reported on Jan 1, change in price from Jan 2 over Dec 31.

(b) Exchange rate: 1US\$=Rs40

Source: Business Standard, Economic Times, Financial Express, Kotak Institutional Equities.

Reliance has high leverage to changes in exchange rate

Sensitivity of RIL's standalone (without RPL) earnings to key variables

	Fiscal 2008E			Fiscal 2009E			Fiscal 2010E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	40.0	41.0	42.0	39.0	40.0	41.0	38.0	39.0	40.0
Net profits (Rs mn)	121,892	127,808	133,724	166,309	173,095	179,881	205,218	212,766	220,315
EPS (Rs)	83.9	87.9	92.0	109.9	114.4	118.9	130.4	135.2	140.0
% upside/(downside)	(4.6)		4.6	(3.9)		3.9	(3.5)		3.5
Chemical prices									
Change in prices (%)	(5.0)		5.0	(5.0)		5.0	(5.0)		5.0
Net profits (Rs mn)	122,004	127,808	133,612	167,399	173,095	178,792	207,627	212,766	217,906
EPS (Rs)	83.9	87.9	91.9	110.6	114.4	118.1	132.0	135.2	138.5
% upside/(downside)	(4.5)		4.5	(3.3)		3.3	(2.4)		2.4
Refining margins (US\$/bbl)									
Margins (US\$/bbl)	12.6	13.6	14.6	12.8	13.8	14.8	14.5	15.5	16.5
Net profits (Rs mn)	119,371	127,808	136,245	164,937	173,095	181,253	206,619	212,766	218,913
EPS (Rs)	82.1	87.9	93.7	109.0	114.4	119.8	131.3	135.2	139.1
% upside/(downside)	(6.6)		6.6	(4.7)		4.7	(2.9)		2.9

Source: Kotak Institutional Equities estimates.

Reliance has made new discoveries over the past few months but not yet disclosed reserves

Oil and gas discoveries of Reliance since January 2007

	Block	Area (sq. km)	Consortium	Reliance' stake (%)	Comments
1	KG-DWN-98/3	7,645	Reliance, Niko	90	Oil and gas discovery in MA-2 well in February 2007
2					KG-D6-AA1, KG-D6-Q1 wells in deeper areas of block in February 2007
3					R1 well in August 2007 encountered two significant gas-bearing zones
4	NEC-OSN-97/2	14,535	Reliance, Niko	90	Dhirubhai-32 (7th) gas discovery
5	GS-OSN-2000/1	8,841	Reliance, Hardy	90	Gas discovery in May 2007
6	CY-DWN-2001/2	14,325	Reliance	100	Oil and gas discovery in July 2007
7	KG-DWN-98/1	8,100	Reliance	100	Dhirubhai-36 oil discovery in September 2007: first oil discovery in the block
8	MN-DWN-2003/1	17,050	Reliance, Niko	85	Date of drilling yet to be decided

Note:

(a) We have included the MN-DWN-2003/1 (MN D-4) block given high expectations from this block.

Source: Company, Rigzone, Kotak Institutional Equities estimates.

Reliance's current stock price is implying additional recoverable reserves of 55~ tcf of gas today

Valuation of Reliance's E&P segment and implied valuation for potential discoveries (US\$ bn)

		Comments
DCF valuation of KG D-6 block, gas for D1 & D3 fields	5.9	15.4 tcf of net recoverable gas reserves
Valuation of KG D-6 block, oil for MA-1 field	1.8	450 mn bbls of net proved reserves of oil at EV/bbl of US\$10
Valuation of Reliance's stakes in NEC-25, CBM	2.1	5.7 tcf of net recoverable gas reserves
Total valuation of extant announced reserves	10	
Total recoverable reserves (tcf)	24	
Implied valuation of E&P segment	32	
Implied valuation of new E&P discoveries	23	
Implied additional recoverable reserves in stock price (tcf)	55	This is what Reliance needs to announce today
# of years from discovery to production	6	KG D-6 first gas discovered in Oct-02, production in 2HFY09
Cost of capital (%)	12.0	
Additional gas reserves required to be added in six years (tcf)	108	This is what Reliance needs to bring in production in six years

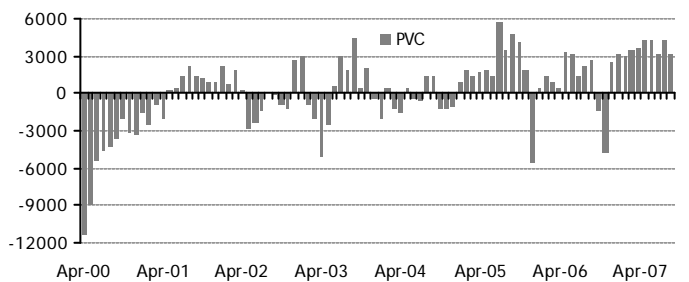
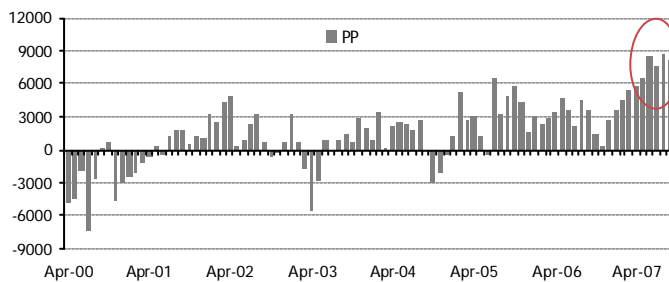
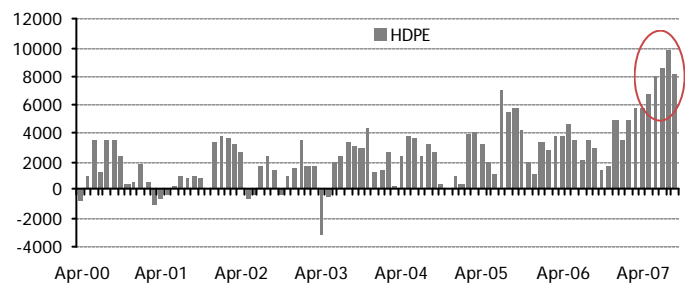
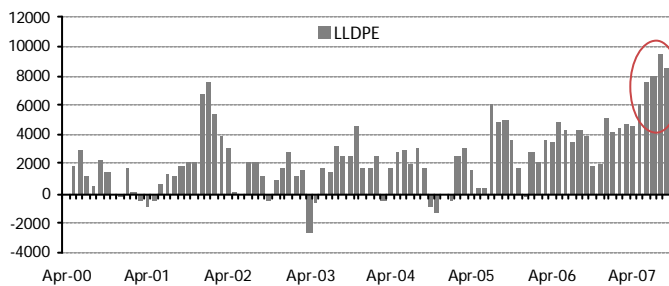
Note:

(a) The above exercise assumes for simplicity that all future gas and oil discovery would have similar PSC terms as the KG D-6 block.

Source: Kotak Institutional Equities estimates.

Premium of Reliance's list prices to import parity prices has expanded significantly over the past few months

Reliance list price versus import price—plastics (Rs/ton)



Source: Platts, Kotak Institutional Equities.

We model strong refining margins for RIL and RPL refinery through FY2010

Major assumptions of RIL and RPL refineries, March fiscal year-ends, 2006-2010E (US\$/bbl)

	2006	2007	2008E	2009E	2010E
RIL refinery					
Rupee-dollar exchange rate	44.3	45.3	41.0	40.0	39.0
Import tariff on crude (%)	5.1	5.1	2.5	2.0	3.1
Refinery yield	61.9	71.6	72.8	72.7	75.1
Cost of crude	49.5	56.9	57.8	57.8	57.8
Landed cost of crude	52.1	59.8	59.2	58.9	59.5
Net refining margin	9.8	11.8	13.6	13.8	15.5
Crude throughput (mn tons)	30.5	31.8	32.0	32.0	32.0
Fuel and loss-own fuel used (%)	7.6	7.6	7.6	5.7	—
Fuel & loss equivalent-gas used (%)				1.9	7.6
Cost of natural gas used (US\$/mn BTU)			4.3	5.2	5.2
Domestic sales of gasoline and diesel (mn tons)	3.7	2.0	0.7	1.0	3.6
Exports of gasoline and diesel (mn tons)	10.0	12.3	13.7	13.7	12.0
RPL refinery					
Rupee-dollar exchange rate				40.0	39.0
Import tariff on crude oil (%)				0.4	0.3
Refinery yield (US\$/bbl)				72.8	73.4
Cost of crude (US\$/bbl)				56.6	56.6
Landed cost of crude (US\$/bbl)				56.8	56.7
Net refining margin (US\$/bbl)				16.0	16.7
Crude throughput (mn tons)				6.0	29.0
Fuel and loss (mn tons)				0.1	—
Production of main products (mn tons)				5.9	29.0
Fuel and loss-own fuel used (%)				2.0	—
Fuel & loss equivalent-gas used (%)				6.0	8.0
Cost of natural gas (US\$/mn BTU)				5.3	5.3

Source: Kotak Institutional Equities estimates.

Reliance Industries consolidated with Reliance Petroleum: Profit model, balance sheet, cash model, March fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	510,715	656,223	809,113	1,114,927	1,066,519	1,287,528	1,850,579
EBITDA	91,148	123,820	139,991	198,462	216,241	307,700	474,410
Other income	11,381	14,498	6,829	4,783	8,000	10,170	15,201
Interest	(14,347)	(14,687)	(8,770)	(11,889)	(14,604)	(13,352)	(12,424)
Depreciation & depletion	(32,470)	(37,235)	(34,009)	(48,179)	(43,641)	(59,239)	(82,314)
Pretax profits	55,711	86,397	104,041	143,177	165,996	245,279	394,873
Extraordinary items	7,300	4,290	3,000	2,000	—	—	—
Tax	(3,510)	(7,050)	(9,307)	(16,574)	(39,741)	(58,158)	(85,274)
Deferred taxation	(7,900)	(7,920)	(7,040)	(9,196)	1,443	4,609	6,180
Minority interest	—	—	—	—	—	(4,659)	(25,753)
Net profits	51,601	75,717	90,693	119,406	127,697	187,071	290,025
Adjusted net profits	45,623	72,135	88,152	117,761	127,697	187,071	290,025
Earnings per share (Rs)	32.7	51.7	63.3	81.0	87.9	123.6	184.3
Balance sheet (Rs mn)							
Total equity	344,525	404,033	430,543	673,037	780,359	1,093,076	1,338,389
Deferred taxation liability	34,748	42,668	49,708	69,820	68,378	63,769	57,589
Minority interest	—	—	—	33,622	33,595	38,253	61,374
Total borrowings	209,447	187,846	218,656	332,927	422,825	237,462	112,642
Current liabilities	122,855	171,315	164,545	192,305	201,643	208,176	234,994
Total liabilities and equity	711,574	805,863	863,452	1,301,712	1,506,799	1,640,736	1,804,988
Cash	2,242	36,087	21,461	18,449	43,750	91,592	209,302
Current assets	218,159	248,438	224,283	286,566	312,069	337,022	410,935
Total fixed assets	351,460	350,823	626,745	899,403	1,013,685	1,054,827	1,027,457
Investments	139,714	170,515	(9,038)	97,294	137,294	157,294	157,294
Deferred expenditure	—	—	—	—	—	—	—
Total assets	711,574	805,863	863,452	1,301,712	1,506,799	1,640,736	1,804,988
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	83,301	107,002	119,520	164,285	159,006	233,882	375,984
Working capital	20,265	46,875	(32,188)	(13,075)	(16,165)	(18,420)	(47,095)
Capital expenditure	(43,191)	(52,440)	(94,273)	(247,274)	(163,324)	(98,887)	(54,216)
Investments	(68,430)	(48,192)	(32,364)	(105,760)	(40,000)	(20,000)	—
Other income	5,902	3,032	5,159	4,143	8,000	10,170	15,201
Free cash flow	(2,153)	56,276	(34,146)	(197,681)	(52,484)	106,745	289,874
Ratios (%)							
Debt/equity	55.2	42.1	45.5	44.8	49.8	20.5	8.1
Net debt/equity	54.6	34.0	41.1	42.3	44.7	12.6	(6.9)
RoAE	12.7	17.6	19.9	20.3	16.7	19.2	23.1
RoACE	9.7	13.0	13.8	13.9	11.5	14.8	21.9

Source: Kotak Institutional Equities estimates.

Energy**RPET.BO, Rs155**

Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	170
52W High -Low (Rs)	159 - 56
Market Cap (Rs bn)	697.3

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	0.0	0.0	135.6
Net Profit (Rs bn)	(0.0)	(0.1)	19.0
EPS (Rs)	(0.0)	(0.0)	4.2
EPS <i>gth</i>	-	-	-
P/E (x)	-	-	36.6
EV/EBITDA (x)	-	-	29.7
Div yield (%)	-	-	-

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIs	3.1	0.2	(1.4)
MFs	1.0	0.4	(1.2)
UTI	-	-	(1.6)
LIC	1.9	0.7	(0.8)

Reliance Petroleum: Revised 12-month target price to Rs170 from Rs125

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **P/E versus DCF—reinvestment of cash can support P/E valuation methodology**
- **Continue to be positive on refining due to sustained global supply-demand imbalance**
- **Maintain OP rating with a revised 12-month target price of Rs170**

We have fine-tuned our earnings model of RPL to factor in (1) stronger rupee and (2) lower price of gas (US\$5.25/mn BTU delivered versus US\$5.5/mn BTU previously) based on the recently-approved formula by the government for KG D-6 block. Our revised FY2010E, FY2011E and FY2012E EPS are Rs22.7 (Rs23.5 previously), Rs21.2 (Rs22.6) and Rs20.4 (Rs22.9). More important, we have changed our valuation methodology to P/E from DCF to factor in the likely reinvestment of large cash generated by RPL. We use 9X FY2010E EPS of Rs22.7 discounted back to September-2008 (18 months) at 12.5% cost of equity to set our 12-month target price. Key downside risks stem from (1) a slowdown in global economic growth, which may impact demand for refined products and thus, refining margins and (2) stronger-than-expected rupee.

P/E versus DCF—voting for P/E assuming RPL will reinvest cash to sustain/grow earnings. We have changed our valuation methodology to P/E from DCF to factor in the likely reinvestment of large cash generated by RPL's upcoming refinery into a new refinery. The reinvestment will help sustain earnings and cash flows once higher taxation results in lower cash flows and earnings of the upcoming refinery. Needless to add, we assume the reinvested cash will create positive value from a favorable macro-environment.

We have long agonized over this debate although it is conceptually superfluous since both methodologies should yield the same valuation. We have historically preferred DCF 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. The valuation would be higher if RPL reinvests in a new refinery and we use DCF to value the cash flows of a new refinery or refineries also rather than distributing the FCF as dividend to shareholders. We note that RPL's SEZ refinery will enjoy 100% income tax exemption on exports (practically the entire volumes) for the first year 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.

Investors unhappy with our change in valuation methodology and wanting to throw a brick at us may throw two bricks at us. We have been guilty of a similar felony in case of valuation of Reliance Industries stock. We had switched to P/E valuation some time back to increase our valuations for the stock; the only problem is that we cannot still justify the stock's current market price (see related comment). We use 9X FY2010E EPS to value the stock assuming Reliance will be able to find and sell additional gas and oil from new areas once earnings from KG D-6 block decline due to (1) increase in share of government of profit petroleum and (2) increase in income tax (MAT for the first seven years).

A favorable refining scenario through 2012 supports reinvestment case. We would be surprised if RPL does not reinvest the cash flows in a new refinery given (1) likely large cash flows (Rs289 bn in FY2010-FY2012E), (2) likely delay in most planned refineries and (3) RPL/Reliance's excellent execution capabilities. RPL's decision to invest in a new refinery would depend on supply-demand balance in the early part of the next decade. However, our base-case scenario of robust global demand for oil (see Exhibit 1) and new refining capacity lagging incremental demand (see Exhibit 2) lends support to our view regarding reinvestment of cash in a new refinery.

We see potential delays in most refining projects, which are currently due for 2010 and 2011 (see Exhibit 3) and note that delays in completion of some of the planned refineries projects will push capacity utilization to very high levels. This could potentially lead to more frequent unplanned outages due to plant breakdowns, leading to spikes in product prices and thus, refining margins; refineries globally have been recently suffering from more frequent outages compared to a few years ago.

Exchange rate remains an issue but we build in sufficient appreciation. We model raised our rupee-US Dollar exchange forecast to Rs40/US\$ for FY2009E, Rs39/US\$ for FY2010E and Rs38/US\$ for FY2011E from Rs41, Rs41 and Rs41 previously. We note that the direction of the Indian rupee would depend heavily on capital inflows into India; our base case for some time has been that India will witness strong capital inflows, sufficient to counter a large BOP deficit.

Exhibit 4 gives sensitivity of RPL's earnings to exchange rate and refining margins; a Rs1/US\$ change in exchange rate impacts RPL's refining margins by about 4%. We note that our 12-month forward DCF valuation is Rs121. A Rs1/US\$ annual increase in the Indian Rupee/US Dollar exchange rate through FY2020E resulting in exchange rate rising to Rs29/US\$ by FY2020E will result in our DCF valuation dropping to Rs104. However, this scenario assumes that the underlying margins remain the same in US Dollar terms; this is extremely unlikely, in our view, if the US Dollar keeps on depreciating against all major currencies.

Expect global demand for oil to remain robust

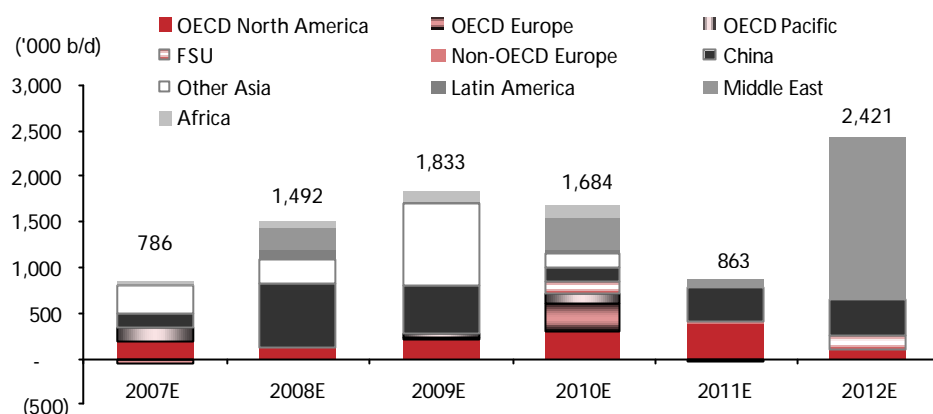
Estimated global crude demand, supply and prices, Calendar year-ends

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Demand (mb/d)									
Total demand	82.3	83.7	84.5	85.9	88.0	89.8	91.7	93.6	95.6
Yoy growth	3.1	1.4	0.8	1.4	2.1	1.8	1.9	1.9	2.0
Supply (mb/d)									
Non-OPEC	49.1	49.0	49.4	50.0	51.1	51.5	51.8	52.1	52.5
Yoy growth	0.9	(0.1)	0.4	0.6	1.1	0.4	0.3	0.3	0.4
OPEC									
Crude	29.1	30.3	30.5	31.1	31.4	32.0	33.2	34.6	36.0
NGLs	4.2	4.5	4.6	4.9	5.5	6.3	6.7	6.9	7.1
Total OPEC	33.3	34.8	35.1	36.0	36.9	38.3	39.9	41.5	43.1
Total supply	83.2	84.4	85.2	86.0	88.0	89.8	91.7	93.6	95.6
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				3.3	4.1	4.1	3.9	3.3	2.3
Demand growth (yoy, %)									
	3.9	1.7	1.0	1.7	2.4	2.0	2.1	2.1	2.1
Supply growth (yoy, %)									
Non-OPEC	1.9	(0.2)	0.8	1.2	2.2	0.8	0.6	0.6	0.8
OPEC	7.1	4.5	0.9	2.3	2.6	3.8	4.2	4.0	3.9
Total	4.1	1.4	0.9	0.9	2.4	2.0	2.1	2.1	2.1
Dated Brent (US\$/bbl)									
	38.3	54.4	65.8	70.0	68.0	66.0	70.0	70.0	70.0

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

Limited supply additions to global refining capacity

Global refinery capacity addition, 2007-2012E ('000 b/d)



Source: IEA, Kotak Institutional Equities estimates.

We expect delay in most refining projects which are currently due for 2010 and 2011

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, Saudi Arabia	400,000	2011	Engineering
Saudi Aramco	Yanbu, Saudi Arabia	400,000	2012	Engineering
PDVSA	Cabruta, Venezuela	400,000	2010	Planning
Motiva Enterprises LLC	Port Arthur, Texas, USA	325,000	2010	Engineering
Ministry of Energy and Mines	Jaraminjo, Manabi, Ecuador	300,000	2010	Planning
Kuokuang Petrochemical Technology Corp.	Yunlin Co., Taiwan	300,000	2010	Planning
Shell	Ft. Saskatchewan Sarnia, ON, Canada	250,000	2013	Planning
US Army Corps of Engineers	Northern Iraq, Iraq	250,000	2009	Engineering
CNOOC	Daya Bay, Huizhou, Guangdong, China	240,000	2008	Planning
Sinopec	Qingdao, China	205,500	2008	Under construction
Sonangol	Lobito, Angola	200,000		Planning
Petrobras/PDVSA	Perambuco State, Brazil	200,000	2010	Planning
Petrochina	Dagang, Qinzhou, China	200,000	2008	Engineering

Source: Oil & Gas journal.

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	39.0	40.0	41.0	38.0	39.0	40.0	37.0	38.0	39.0
Net profits (Rs mn)	18,230	19,029	19,828	98,232	101,963	105,695	91,999	95,503	99,006
EPS (Rs)	4.1	4.2	4.4	21.8	22.7	23.5	20.4	21.2	22.0
% upside/(downside)	(4.2)		4.2	(3.7)		3.7	(3.7)		3.7
Refining margins (US\$/bbl)									
Margins (US\$/bbl)	15.0	16.0	17.0	15.7	16.7	17.7	14.7	15.7	16.7
Net profits (Rs mn)	17,311	19,029	20,746	93,874	101,963	110,053	87,620	95,503	103,385
EPS (Rs)	3.8	4.2	4.6	20.9	22.7	24.5	19.5	21.2	23.0
% upside/(downside)	(9.0)		9.0	(7.9)		7.9	(8.3)		8.3

Source: Kotak Institutional Equities estimates.

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

	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Rs/US\$	40.0	39.0	38.0	38.0	38.0	38.0	38.0
Import tariff on crude oil (%)	—	—	—	—	—	—	—
Refinery yield (US\$/bbl)	72.8	73.4	72.4	71.2	71.2	71.2	71.2
Cost of crude (US\$/bbl)	56.6	56.6	56.6	56.6	56.6	56.6	56.6
Landed cost of crude (US\$/bbl)	56.8	56.7	56.7	56.7	56.7	56.7	56.7
Net refining margin (US\$/bbl)	16.0	16.7	15.7	14.6	14.6	14.6	14.6
Crude throughput (mn tons)	6.0	29.0	29.0	29.0	29.0	29.0	29.0
Fuel and loss (mn tons)	0.1	—	—	—	—	—	—
Production of main products (mn tons)	5.9	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	135,602	638,112	612,506	603,262	603,262	603,262
EBITDA	27,845	127,084	114,122	104,948	104,714	104,450
Other income	222	463	1,292	3,806	5,627	5,481
Interest (expense)/income	(3,637)	(8,362)	(2,793)	—	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	19,443	104,395	97,722	93,747	95,225	94,707
Extraordinary items	—	—	—	—	—	—
Tax	(415)	(2,431)	(2,219)	(2,028)	(2,060)	(15,495)
Deferred taxation	—	—	—	—	—	1,624
Net income	19,029	101,963	95,503	91,719	93,165	80,836
Earnings per share (Rs)	4.2	22.7	21.2	20.4	20.7	18.0
Balance sheet						
Total equity	153,407	244,841	329,814	379,414	363,581	349,843
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	135,170	79,670	—	—	—	—
Current liabilities	9,526	40,268	39,247	39,227	39,227	39,227
Total liabilities and equity	298,102	364,779	369,061	418,641	402,808	387,445
Cash	4,084	11,347	31,715	95,146	92,420	90,271
Other current assets	25,218	97,422	94,235	93,391	93,400	93,410
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	298,102	364,779	369,061	418,641	402,808	387,445
Free cash flow						
Operating cash flow, excl. working capital	23,793	116,291	109,110	102,920	102,654	88,955
Working capital changes	(11,138)	(41,461)	2,166	823	(9)	(10)
Capital expenditure	(16,599)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	222	463	1,292	3,806	5,627	5,481
Free cash flow	(3,723)	73,293	110,568	105,549	106,272	92,426
Ratios (%)						
Debt/equity	88.1	32.5	0.0	—	—	—
Net debt/equity	85.5	27.9	(9.6)	(25.1)	(25.4)	(25.8)
ROAE (%)	13.2	51.2	33.2	25.9	25.1	22.7
ROACE (%)	8.2	35.9	30.0	25.9	25.1	22.7

Source: Kotak Institutional Equities estimates.

Media**SUTV.BO, Rs356**

Rating	U
Sector coverage view	Cautious
Target Price (Rs)	310
52W High -Low (Rs)	462 - 264
Market Cap (Rs bn)	140.2

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	6.8	9.5	12.2
Net Profit (Rs bn)	2.5	3.9	5.3
EPS (Rs)	6.3	10.0	13.4
EPS gth	20.8	57.4	34.6
P/E (x)	56.1	35.7	26.5
EV/EBITDA (x)	31.4	19.8	14.5
Div yield (%)	0.4	0.7	1.1

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	93.0	-	-
FIs	4.4	0.0	(0.1)
MFs	0.9	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Sun TV Network: Things starting to get lively in Tamil broadcasting and TV distribution markets

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Amit Kumar : amit.ckumar@kotak.com, +91-22-6634-1392

Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **Kalaighar TV makes strong entry with two hit movie telecasts on launch day**
- **Cable networks unhappy with Sun Direct DTH's pricing strategy; plan to retaliate against Sun's channels**
- **We retain our U rating and 12-month DCF-based target price of Rs310**

We believe recent developments in Tamil broadcasting and cable markets do not augur well for Sun TV. (1) Kalaighar TV has made a big-bang entry into the Tamil language broadcasting space. We await the official rating performance of the channel but suspect it may do well given films and film-based content are extremely popular in Tamil regional language genre. (2) Cable networks in Tamil Nadu are unhappy about the pricing strategy of Sun Direct DTH platform and have threatened to boycott Sun Network's channels. Thus, we see increasing risks to our assumptions of Sun's revenues and profitability from (1) strong competition across South-Indian regional language markets (2) proposed cable TV network by Tamil Nadu government and disruption by other cable networks and (3) increasing cost of programming and film telecast rights. We are a bit surprised by the recent sharp increase in Sun TV stock price given a potentially deteriorating environment. We retain our U rating on the stock and 12-month target price of Rs310. Key upside risks stem from higher-than-expect ad and subscription revenues.

Kalaighar TV—grand curtain raiser but the show has just begun. Kalaighar TV channel, promoted by the family of the chief minister of Tamil Nadu, officially launched on September 15. It started impressively, telecasting two recent Tamil hits on its launch day, followed up with the television premiere of acclaimed director Mani Ratnam's new movie ('Ayudha Ezhuthu'). We note that movies and film-based programming is very popular in the Tamil broadcasting market. Exhibit 1 lists the top 10 Tamil movie features (along with TRP ratings) till date in CY2007. We are not inclined to attribute the success or failure of a channel solely to its initial performance but believe Kalaighar TV may emerge as a strong competitor in a market dominated by Sun TV in the past. It is presumably well funded (it has purchased the telecast rights of the three biggest Tamil hits) and has roped in experienced production houses and directors for its programming.

Cable networks unhappy with pricing strategy of Sun Direct; threaten boycott of Sun Network's channels. According to press reports, cable networks in Tamil Nadu are upset by the proposed pricing strategy of Sun Direct, the DTH arm of Sun TV group. The cable networks have threatened to boycott Sun TV Network's channels and also stop payment of pay-TV revenues to Sun TV. We note that Sun TV Network does not own any stake in Sun Direct but a rapid uptake of Sun Direct's DTH service would be positive for Sun TV Network's domestic pay-TV subscription revenues.

According to press reports, Sun Direct plans to price its package of 75 channels and 15 FM channels at Rs75 plus taxes. It will give the consumer premise equipment (CPE) free and charge Rs999 for installation. Sun Direct's pricing (package is valid in Tamil Nadu only) will pit it in direct competition with cable operators in Tamil Nadu given the average monthly subscription charge will be substantially higher than Rs75; we note that the minimum subscription charge for free-to-air channels is Rs78 plus taxes.

Greater competition across markets; too early to gauge impact on Sun TV but risk exists. Exhibit 2 lists the regional language channels that will start operations over the next few months. We see potential risks to Sun TV Network's high market share and resultant high profitability from the entry of new channels. Extant channels have also renewed their investment in programming and distribution. We expect the maximum impact in the lucrative Rs5 bn Tamil and Rs4 bn Telugu markets. We note that Sun's channels (Sun TV and KTV in Tamil market, Gemini TV and Teja TV in Telugu market) are the market leaders in their respective categories (see Exhibits 3 and 4). The Tamil Nadu government plans to start cable distribution in the state, which should also benefit other broadcasters. We note that Sumangli Cable Vision, the leading multi-system operator in the state of Tamil Nadu, is an affiliate of Sun TV Network.

Valuations are expensive; our benign assumptions for Sun TV may be at risk. The street has largely ignored the entry of new competition in the key Tamil market in the recent euphoria in the Indian stock market. Sun TV Network's market capitalization has increased by Rs10.8 bn since the launch of Kalaignar TV. In our opinion, Sun TV Network valuations are expensive with the stock trading at 26.5X FY2009 EPS after our projected 2.1X increase in EPS to Rs13.4 in FY2009E from Rs6.3 in FY2007. Additionally, we see risks to our assumptions of Sun's ad revenue and profitability. We model Sun's ad revenues to grow at or above the Indian ad market, which implies Sun will be able to maintain its market share in all its key markets. We model Sun's PBT margin to rise to 71.6% in FY2010E from 57.1% in FY2007, which implies relatively smaller increase in programming costs. However, this remains to be seen in the light of emerging competition; new channels may fragment the market further and make it more difficult for Sun to acquire quality programming and film rights at realistic prices.

Movies and film-based programming is popular in Tamil market

TRP ratings of top 10 Tamil movie features till date in CY2007 (%)

	Movie feature	Channel	Genre	TRP rating
1	TMF M KUMARAN SON OF MAHAL	Sun TV	Feature Films	3.42
2	TMF SANDAI KOZHI	Sun TV	Feature Films	3.40
3	TMF ANNIYAN	Sun TV	Feature Films	3.15
4	TMF SARAVANAA	Sun TV	Feature Films	2.86
5	TMF DHOOL	Sun TV	Feature Films	2.81
6	TMF MOUNAM PESIYATHEY	Sun TV	Feature Films	2.75
7	TMF PUNNAGAI DESAM	Sun TV	Feature Films	2.63
8	TMF AAI	Sun TV	Feature Films	2.55
9	TMF AYYA	Sun TV	Feature Films	2.36
10	THE MAKING OF SHIVAJI THE BOSS	Sun TV	Film Based Magazine	2.31

Source: TAM Media Research, compiled by Kotak Institutional Equities.

32 new regional language channels will start operations over the next few months

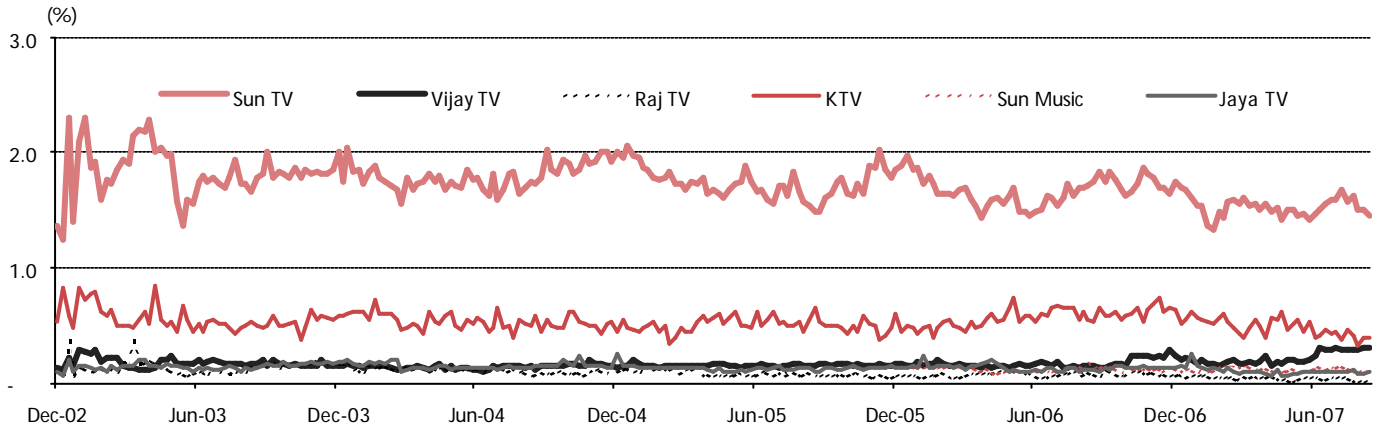
List of extant and proposed regional language channels

	Tamil	Telugu	Marathi	Kannada	Malayalam	Punjabi	Bengali	Gujarati
Existing								
	Aasirvatham	DD8 Saptagiri	DD10 Sahyadri	DD9 Chandana	Amrita TV	Balle Balle	24 Ghanta TV	DD11 Gujarati
	Brindavan TV	Eenadu TV	ETV Marathi	ETV Kannada	Asianet	DD Punjabi	Aakaash Bangla	ETV Gujarati
	Chutti TV	ETV2 News	Star Majha	Suvarna	Asianet News	ETC Punjabi	Atn Bangla	Gurjari
	DD5 Podhigai	Gemini Music	Mi Marathi	TV9 Karnataka	Asianet Plus	Lashkara TV	Bangla Akhon	Zee Gujarati
	Imayam	Gemini News	Star Majaa	U2	Asianet Interactive	NRI TV	BTV World	
	Jaya TV	Gemini TV	Zee 24 Taas	Udaya Movies	DD4 Malayalam	PBC TV	DD7 Bangla	
	Kalaignar TV	Maa Telugu	Zee Marathi	Udaya TV	Indiavision	PTC News	ETV Bangla	
	KTV	Manna Telugu	Zee Talkies	Udaya Varthegalu	Jeevan TV	Punjab News	Kolkata TV	
	Makkal TV	Sanskriti		Ushe TV	Kairali	Punjab Today	NTV	
	Raj Digital Plus	Siti Telugu		Zee Kannada	Kiran TV	Punjab TV	Sangeet Bangla	
	Raj Musix	Teja TV			Manorama News	Zee Punjabi	Star Ananda	
	Raj TV	TV9 News			People TV		Tara Muzik	
	Sun Music	Vissa			Surya TV		Tara Newz	
	Sun News	Zee Telugu					Zee Bangla	
	Sun TV							
	Vijay TV							
	Win TV							
Total existing channels	17	14	8	10	13	11	14	4
Proposed								
	Asianet	Asianet	Asianet	Kasturi	Jaihind TV	Gurbani	INX Group	INX Group
	DMK TV (3)	Bhakti	IBN Lokmat	Sun Kids	Sun Kids	INX Group		Triveni news
	Jaya Plus	Maa TV (3)						TV9 Gujrati
	Maga TV	N TV						
	Raj News	STAR-Balaji						
	Raj Youth	Sun Kids						
	Vasanth TV	TV1						
	Zee News (Tamil)	Subhavaartha						
Total proposed channels	10	10	2	2	2	2	1	3
Total existing and proposed	27	24	10	12	15	13	15	7

Source: Kotak Institutional Equities estimates

Sun TV leads the lucrative Tamil market by a wide margin

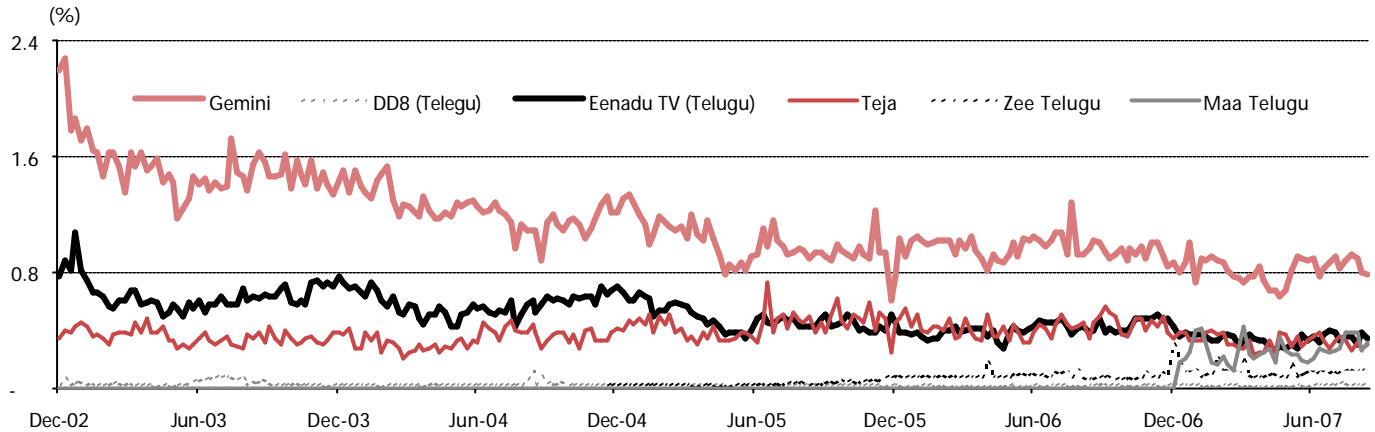
Prime-time (7:30-11:30 PM) ratings of major Tamil channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Sun's Gemini TV has seen its ratings decline over the last few months; Maa Telugu has made an impressive entry recently

Prime-time (7:30-11:30 PM) ratings of major Telugu channels (%)



Source: TAM Media Research, compiled by Kotak Institutional Equities.

Consolidated profit model, balance sheet, cash model of Sun TV for 2006 and SunTV Network for 2007-2012E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	3,219	6,780	9,465	12,234	14,525	16,847	19,188
EBITDA	2,035	3,874	5,977	8,073	9,951	11,795	13,617
Other income	172	411	789	910	1,196	1,550	1,974
Interest (expense)/income	(65)	(64)	(18)	—	—	—	—
Depreciation	(147)	(294)	(525)	(630)	(515)	(436)	(381)
Amortization	—	(56)	(235)	(235)	(235)	(235)	(195)
Pretax profits	1,995	3,871	5,989	8,118	10,398	12,675	15,015
Tax-cash	(709)	(1,509)	(2,059)	(2,852)	(3,614)	(4,377)	(5,163)
Tax-deferred	16	108	(18)	51	38	27	17
Minority interest	—	(9)	21	(25)	(50)	(72)	(96)
Net profits after minority interests	1,302	2,461	3,932	5,292	6,771	8,253	9,773
Earnings per share (Rs)	5.3	6.3	10.0	13.4	17.2	20.9	24.8
Balance sheet (Rs mn)							
Total equity	3,071	11,932	14,714	18,277	22,628	27,930	34,210
Deferred Tax	32	(56)	(38)	(88)	(127)	(153)	(170)
Total borrowings	2,333	867	—	—	—	—	—
Current liabilities	741	1,693	1,633	1,766	1,845	1,930	2,023
Total capital	6,209	14,478	16,329	19,999	24,441	29,874	36,325
Cash	732	6,494	6,348	9,522	13,507	18,355	24,121
Current assets	2,440	3,221	5,143	6,338	7,356	8,397	9,458
Total fixed assets	2,830	3,543	2,910	2,405	2,040	1,779	1,599
Intangible assets	206	1,220	1,927	1,732	1,537	1,342	1,146
Total assets	6,209	14,478	16,329	19,999	24,441	29,874	36,325
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	1,722	3,239	4,721	6,350	7,579	8,784	9,956
Working capital	(251)	(1,992)	(1,982)	(1,063)	(938)	(956)	(968)
Capital expenditure	(2,091)	(433)	(793)	(125)	(150)	(175)	(200)
Investments	(326)	(849)	(821)	(1,129)	(1,242)	(1,366)	(1,503)
Other income	80	402	789	910	1,196	1,550	1,974
Free cash flow	(619)	814	1,946	5,161	6,490	7,654	8,788
Ratios (%)							
Debt/equity	76.0	7.3	—	—	—	—	—
Net debt/equity	52.1	(47.2)	(43.1)	(52.1)	(59.7)	(65.7)	(70.5)
RoAE	36.1	32.9	29.6	32.2	33.3	32.8	31.6
RoACE	26.6	26.8	29.9	33.0	34.1	33.6	32.3

Source: Kotak Institutional Equities estimates.

Energy**GSPT.BO, Rs62**

Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	59
52W High -Low (Rs)	65 - 37
Market Cap (Rs bn)	33.9

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	3.2	4.5	6.7
Net Profit (Rs bn)	0.9	1.2	2.3
EPS (Rs)	1.6	2.3	4.3
EPS gth	40.0	39.9	85.7
P/E (x)	38.1	27.2	14.6
EV/EBITDA (x)	14.3	10.9	7
Div yield (%)	0.8	1.1	2.1

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	39.1	-	-
FIs	21.9	0.1	0.0
MFs	4.0	0.1	0.0
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Energy**PLNG.BO, Rs72**

Rating	U
Sector coverage view	Neutral
Target Price (Rs)	53
52W High -Low (Rs)	75 - 41
Market Cap (Rs bn)	54.1

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	55.1	68.1	71.9
Net Profit (Rs bn)	3.1	4.2	3.9
EPS (Rs)	4.2	5.7	5.2
EPS gth	62.5	36.6	(8.3)
P/E (x)	17.3	12.7	13.9
EV/EBITDA (x)	9.5	9.2	9.7
Div yield (%)	1.7	2.1	1.4

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	50.0	-	-
FIs	11.2	0.1	(0.1)
MFs	0.9	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

GSPL, Petronet LNG: Is it gas? Or simply hot air?

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Gundeep Singh : gundeep.singh@kotak.com, +91-22-6634-1286

- **Recent euphoria about gas sector stocks inexplicable**
- **Gas volumes will increase sharply but we caution about pricing issues**
- **A fair degree of absurdity in behavior of certain 'conflicting' stocks**

We are surprised by the street's optimism about Indian gas sector stocks as implied by the recent sharp increases in their stock prices given no real developments in certain cases or potentially negative developments in others. The street seems to be positive about every aspect of the gas business in India. We concur about the positive impact from likely steep increase in gas supply but would caution about potential negative developments in case of pricing arising from competition or from inimical regulations. We retain our 12-month DCF-based target price of Rs53 for PLNG. We have revised our 12-month DCF-based target price to Rs59 from Rs58 previously on incorporation of FY2007 annual report and roll-forward. We have fine-tuned earnings estimates for GSPL.

GSPL (Rs62, IL)—watch out for regulatory developments. GSPL's future earnings will depend on the nature of future regulations on the gas transportation business. The newly constituted Petroleum and Natural Gas Regulatory Board will take a view on the regulatory framework. The key variables that will have an impact on GSPL's earnings will be (1) reasonable rate of return, (2) total capital employed (or return-earning asset) on which the reasonable rate of return will apply. As per the draft regulations on natural gas pipelines formulated by the ministry of petroleum and natural gas, capital employed has been defined as gross fixed assets less depreciation plus normative working capital; this is in line with COS (Cost of Services) methodology followed globally and would mean that GSPL's tariff for a pipeline (and earnings from the pipeline) would decline over a period of time due to a declining return-earning asset base. However, if the regulator allows for a constant return-earning asset base, as in the case of the power sector, GSPL's earnings will remain largely constant over time.

Exhibit 1 gives the sensitivity of GSPL's FY2009E and FY2010E net income to different regulatory frameworks. We will wait for regulatory developments before reviewing our tariff assumptions. However, we note that our model results in GSPL's ROAE rising to 18.5% in FY2009E and 19.9% in FY2010E. We find the stock's P/B high (2.5X FY200E book value) unless backed by strong growth in earnings without any damage from unfavorable developments on pricing. We have fine-tuned our earnings model to incorporate its FY2007 annual report. Our revised FY2008E, FY2009E and FY2010E EPS estimates are Rs2.3, Rs4.3 and Rs5.3 versus Rs2, Rs4.1 and Rs5.2 previously.

PLNG (Rs72, U)—more domestic gas is negative for PLNG. We continue to harbor strong reservations about the business model of PLNG, particularly if gas reserves in India turn out to be significantly higher versus announced. We find it odd that the street is according very high valuation to Reliance Industries' emerging E&P business on the expectation of future discoveries. However, the same expectation does not oddly reflect in concerns about PLNG's future prospects and earnings. PLNG's future expansion plans would depend on its ability to source LNG at competitive prices.

The recent environmental clearance from the government of Western Australia for the Gorgon Project will enable the Gorgon Project partners (Chevron, ExxonMobil, Shell) to proceed with development of Gorgon gas fields. This has presumably addressed the issue of LNG availability for PLNG's Kochi 2.5 mtpa LNG import terminal. PLNG has an agreement with ExxonMobil to import 2.5 mtpa of LNG but is yet to sign a firm Gas Supply and Purchase Agreement (GSPA).

However, the vital issue of pricing of imported LNG either from Gorgon for Kochi terminal or from Qatar for Dahej terminal expansion (2.5 mtpa) remains unaddressed. We doubt PLNG will be able to get LNG at competitive prices. PetroChina recently signed an agreement with Woodside Petroleum for supply of 2-3 mtpa from the proposed Browse development in offshore North-West Australia. Although pricing details are not available, the price is reportedly US\$10/mn BTU (source: Upstream). We doubt the Indian market can absorb similar high-priced LNG, especially if expectations (the street's and ours) of new gas supply from Reliance, ONGC and GSPC turn out to be correct.

Indraprastha Gas Ltd, (IGL, Rs123, NR)—a regulatory review will likely result in significant reduction to selling prices. We have long harbored concerns about the pricing policy of IGL for the CNG it sells in the Delhi market. IGL benefits from three forms of arbitrage—(1) low pricing of gas versus crude oil; IGL prices its CNG relative to liquid fuels, whose prices depend on crude oil prices; (2) subsidized APM gas versus free market price gas; and (3) 12% sales tax on diesel versus nil on CNG. IGL's very high ROAE and ROACE (both 30% for FY2007) highlight its super-normal profitability and profits.

In fact, the Monopolies and Restrictive Trade Practices Commission (MRTPC) is examining a complaint on the pricing of PNG (piped natural gas) in Delhi. As per the complaint, the price of PNG for a customer in Delhi is higher than the price in Mumbai and Gujarat despite IGL getting subsidized APM gas from GAIL at substantially lower prices versus market prices. We can corroborate that the price of PNG (for domestic consumer) in Delhi at Rs15.4/kg is higher than the price of PNG in Mumbai (Rs12.52/kg) and in Gujarat supplied by GSPC (Rs12.5/kg).

Reliance Natural Resources Ltd (RNRL, Rs75, NR)—too early to give it meaningful value; it may not benefit even if wins legal case with Reliance Industries. We are amazed by the more than 50% increase in market capitalization of RNRL over the past month. RNRL stock price surged 35% on September 21 on the announcement that it had applied for city gas distribution licenses in Mumbai, Delhi, Gurgaon and Noida. Given the presence of other players in these markets and the reasonably high penetration of CNG, PNG in these markets, we are surprised at the market's reaction.

Finally, we would clarify that RNRL may not benefit from potential low price of gas from Reliance's KG D-6 block even if it wins its ongoing legal case with Reliance Industries. The NELP does not allow trading of gas and RNRL will have to sell gas at the same price as the purchase price, in our view. Thus, RNRL may merely serve as a vehicle to supply gas to proposed power plants of RADAG.

The nature of regulations will be critical for GSPL's returns and thus, tariffs

Hypothetical example of impact of earnings of various regulatory methodologies and debt-equity ratio

	2009E			2010E		
	Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
1. Computation of regulated earnings based on gross block (no reduction to return-earning asset)						
Gross block at end of period (Rs mn)	28,135	28,135	28,135	28,386	28,386	28,386
Debt (%)	—	50	70	—	50	70
Equity (%)	100	50	30	100	50	30
Asset financed by equity (Rs mn)	28,135	14,067	8,440	28,386	14,193	8,516
Asset financed by debt (Rs mn)	—	14,067	19,694	—	14,193	19,870
Post-tax return on equity (%)	14.0	14.0	14.0	14.0	14.0	14.0
Net profit	3,939	1,969	1,182	3,974	1,987	1,192
Current market capitalization (Rs mn)	33,732	33,732	33,732	33,732	33,732	33,732
Implied P/E on regulated earnings (X)	8.6	17.1	28.5	8.5	17.0	28.3
KIE net income (Rs mn)	2,314	2,314	2,314	2,871	2,871	2,871
P/E (X)	14.6	14.6	14.6	11.7	11.7	11.7
KIE ROAE (%)	18.5	18.5	18.5	19.9	19.9	19.9
KIE CROCI (%)	18.8	18.8	18.8	19.3	19.3	19.3
2. Computation of regulated earnings based on net block (Cost of Services methodology)						
Net block at end of period (Rs mn)	21,120	21,120	21,120	19,027	19,027	19,027
Debt (%)	—	50	70	—	50	70
Equity (%)	100	50	30	100	50	30
Asset financed by equity (Rs mn)	21,120	10,560	6,336	19,027	9,513	5,708
Asset financed by debt (Rs mn)	—	10,560	14,784	—	9,513	13,319
Post-tax return on equity (%)	14.0	14.0	14.0	14.0	14.0	14.0
Net profit	2,957	1,478	887	2,664	1,332	799
Current market capitalization (Rs mn)	33,732	33,732	33,732	33,732	33,732	33,732
Implied P/E on regulated earnings (X)	11.4	22.8	38.0	12.7	25.3	42.2
KIE net income (Rs mn)	2,314	2,314	2,314	2,871	2,871	2,871
P/E (X)	14.6	14.6	14.6	11.7	11.7	11.7
KIE ROAE (%)	18.5	18.5	18.5	19.9	19.9	19.9
KIE CROCI (%)	18.8	18.8	18.8	19.3	19.3	19.3

Note:

(1) Our projected net debt-to-capitalization ratio for GSPL at end-FY2009E is 42% and at end-FY2010E is 26%.

Source: Kotak Institutional Equities estimates.

GSPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)							
Net sales	2,035	2,635	3,176	4,546	6,731	8,081	8,521
EBITDA	1,293	1,942	2,677	3,925	6,009	7,200	7,539
Other income	20	45	175	88	52	34	33
Interest	(363)	(413)	(457)	(868)	(927)	(759)	(474)
Depreciation	(656)	(791)	(1,026)	(1,705)	(2,082)	(2,345)	(2,344)
Pretax profits	293	783	1,369	1,440	3,053	4,130	4,754
Tax	(15)	(2)	(70)	—	(346)	(1,225)	(1,696)
Deferred taxation	(119)	(315)	(409)	(194)	(393)	(34)	80
Net profits	160	467	894	1,246	2,314	2,871	3,138
Earnings per share (Rs)	0.6	1.2	1.6	2.3	4.3	5.3	5.8
Balance sheet (Rs mn)							
Total equity	4,037	9,075	9,659	10,466	11,959	13,810	13,276
Deferred tax liability	193	508	917	1,111	1,504	1,538	1,458
Total borrowings	4,436	5,786	8,638	11,571	9,736	5,486	3,986
Current liabilities	571	1,771	1,845	885	880	881	882
Total liabilities and equity	9,237	17,140	21,059	24,033	24,079	21,715	19,602
Cash	426	2,372	1,811	1,653	570	369	326
Current assets	408	995	2,126	2,473	2,296	2,226	2,250
Total fixed assets	8,392	13,651	17,029	19,814	21,120	19,027	16,933
Investments	—	—	—	—	—	—	—
Deferred expenditure	11	123	93	93	93	93	93
Total assets	9,237	17,140	21,059	24,033	24,079	21,715	19,602
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	844	1,562	2,212	2,914	4,598	5,214	5,369
Working capital changes	(193)	471	(1,058)	(1,306)	172	71	(24)
Capital expenditure	(1,799)	(6,049)	(4,404)	(4,350)	(3,250)	(250)	(250)
Investments	—	—	—	—	—	—	—
Other income	10	40	146	88	52	34	33
Free cash flow	(1,138)	(3,976)	(3,103)	(2,653)	1,573	5,069	5,129
Ratios (%)							
Debt/equity	104.9	60.4	81.7	99.9	72.3	35.7	27.1
Net debt/equity	51.2	37.6	45.0	50.0	42.0	26.3	21.3
RoAE	4.6	6.8	8.8	11.2	18.5	19.9	20.9
RoACE	8.0	9.9	10.0	10.9	15.2	15.6	17.0
Key assumptions							
Volumes-old pipelines (mcm/d)	8.3	10.4	12.6	15.0	17.0	20.0	25.0
Volumes-new pipelines (mcm/d)	—	—	1.7	4.9	13.1	24.6	30.6
Volumes (mcm/d)	8.3	10.5	14.3	19.9	30.1	44.6	55.6

Source: Kotak Institutional Equities estimates.

Petronet LNG: Profit model, balance sheet, cash model March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)							
Net sales	19,453	38,197	55,090	68,108	71,894	104,442	144,403
EBITDA	1,505	4,707	6,481	7,027	7,695	7,875	10,928
Other income	133	194	366	439	353	269	277
Interest	(1,094)	(1,116)	(1,070)	(1,090)	(1,019)	(1,780)	(1,957)
Depreciation	(968)	(1,010)	(1,020)	(1,062)	(1,384)	(2,022)	(2,511)
Extraordinary items	—	175	—	—	—	—	—
Pretax profits	(424)	2,950	4,756	5,313	5,645	4,342	6,737
Tax	—	(256)	(6)	(602)	(1,052)	—	(763)
Deferred taxation	140	(745)	(1,617)	(467)	(688)	(1,645)	(1,439)
Net profits	(284)	1,949	3,133	4,245	3,905	2,697	4,534
Earnings per share (Rs)	(0.4)	2.4	4.2	5.7	5.2	3.6	6.0

Balance sheet (Rs mn)							
Total equity	8,770	10,719	12,755	15,684	18,711	20,530	23,748
Deferred taxation liability	(140)	605	2,472	2,939	3,627	5,272	6,711
Total borrowings	12,599	12,599	13,832	16,432	24,432	28,932	28,932
Current liabilities	3,585	1,725	5,877	6,682	6,945	9,201	11,970
Total liabilities and equity	24,814	25,648	34,936	41,737	53,715	63,935	71,362
Cash	2,980	2,506	3,405	3,422	940	1,045	1,150
Current assets	2,753	2,946	7,478	6,086	6,161	8,744	10,837
Total fixed assets	18,903	18,627	21,273	29,449	43,833	51,365	56,595
Investments	179	1,569	2,780	2,780	2,780	2,780	2,780
Total assets	24,814	25,648	34,936	41,737	53,715	63,935	71,362

Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	437	3,524	4,927	5,097	4,855	5,540	7,633
Working capital	628	(2,057)	(710)	2,198	187	(327)	677
Capital expenditure	(18,969)	(335)	(36)	(9,000)	(15,000)	(9,000)	(7,166)
Investments	(179)	(1,390)	(1,211)	—	—	—	—
Free cash flow	(18,083)	(258)	2,970	(1,705)	(9,958)	(3,787)	1,144
Other income	128	184	326	439	353	269	277

Ratios (%)							
Debt/equity	146	111	91	88	109	112	95
Net debt/equity	111	89	68	70	105	108	91
RoAE	(3.2)	19.5	23.6	25.1	19.1	11.2	16.1
RoACE	2.1	11.9	14.5	16.0	11.3	7.5	10.3
Adjusted CROCI	8.9	21.3	25.1	30.1	17.2	19.7	15.0

Key assumptions							
Sales volume (mn tonnes)	2.5	4.8	5.6	6.3	6.6	8.8	11.8
LNG purchase price (FOB) (US\$/mn BTU)	2.5	2.5	3.3	3.8	3.8	4.4	4.6
Re-gasification charges (US\$/mn BTU)	0.53	0.57	0.58	0.66	0.68	0.56	0.58
Sales price (US\$/mn BTU)	3.5	3.5	4.4	5.0	5.1	5.6	5.7
Rupee/US dollar exchange rate	45.0	44.3	45.3	42.0	42.0	42.0	42.0

Source: Kotak Institutional Equities estimates.

Metals

Sector coverage view

Cautious

Company	Rating	Price, Rs	
		21-Sep	Target
Hindalco	U	160	140
NALCO	U	280	210
Tata Steel	IL	741	670
Hindustan Zinc	IL	755	725
JSPL	OP	5,371	4,500
Sterlite	OP	697	580
Sesa	IL	2,320	1,950
JSW	IL	725	580

Strong resource prices confront weak end-product demand; spot steel prices may get firm

Jigar Mistry : jigar.mistry@kotak.com, +91-22-6749-3571

Amit Agarwal : agarwal.amit@kotak.com, +91-22-6749-3390

- **Marginal steelmaking cost driven up by rising resource prices and higher freight rates**
- **International trade still points towards continued weakness in steel prices**
- **Higher steelmaking cost may push spot steel prices up; we continue to hold that long-term prices will face pressure from increasing capacities**
- **We reiterate our preference for resource-rich companies like Jindal Steel & Power (JSP) over non-integrated companies like Tata Steel and JSW Steel**
- **Rising resource prices and freight rates increases marginal steel making cost**

Cumulatively, the rise in resource prices and freight rates increased marginal steelmaking costs by almost by US\$100/ton. Whereas iron ore prices and freight rates have risen 30% in the past couple of months, metallurgical coals and met coke prices have increased by 20% (see Exhibit 1).

Iron ore prices to China have risen a staggering US\$26/ton (30%) over the past month to touch US\$114/ton. China's strong appetite for iron ore, coupled with increasing speculation before annual benchmark negotiations, could be possible reasons.

Australian hard coals imported into India reach US\$150/ton; met coke price reach US\$275/ton up 20% on average over the past month. Higher melt rates in Japan and the resultant increase in coke imports (up 17% ytd), coupled with constrained release of licenses from China (13.4mnt export license released versus annual ytd-July exports of 15.5mnt).

The freight rate from India to China has increased to US\$40/ton, up US\$12/ton over past couple of months. Chronic tightness in met coal market and port congestions (largely at Australia's ports) is believed to be key reason.

International trade still points towards continued weakness in steel prices

International trade continues to point towards continued weakness in steel prices, with Chinese exports remaining strong and US imports falling drastically. Steel prices have fallen 10% from top in US, 6% from top in China and have managed to stay stable in Europe (see Exhibit 2).

As we had expected, Chinese steel exports have continued to stay strong, despite the imposition of export taxes (Exhibit 3 for details). In addition, US imports on YTD-Jul 07 basis continued to stay sluggish, down 26% (Exhibit 4 for details).

Higher steelmaking prices might push spot steel prices up; continue with our stance on lower long-term steel prices

As we had discussed above, steel making costs have increased by almost US\$100/ton over the last couple of months, led by strong resource prices and higher freight rates. This might lead to higher spot prices, although marginal steel making capacity forms small part of global steelmaking capacities.

Meanwhile, incremental resource imports into China will likely result in higher production for October 2007 and consequently lower prices in China.

We continue to maintain that high incremental EBITDA margins (for plants that buy resources on contract) and ROIC will likely invite higher capacities going forward, leading to lower steel prices from current levels (see Exhibit 5 for details).

In addition, we also believe that end-user demand has to improve (from important geographies like US and Europe) for higher resource prices to be ultimately passed on in form of higher steel prices. Currently, US demand has been low and EUROFER has been pointing towards slowing steel consumption (see Exhibits 6 and 7 for details).

Reiterate our preference for resource-rich JSP versus non-integrated Tata Steel and JSW Steel

We expect 20% increase in annually negotiated iron ore prices and 10% increase in metallurgical coal prices for supplies in CY2008. Ruling spot prices (iron ore US\$115, hard coal US\$155) are much higher than contract rates negotiated last year (iron ore US\$49, hard coal US\$90), which may imply that negotiations might happen at rates which are higher than our estimates.

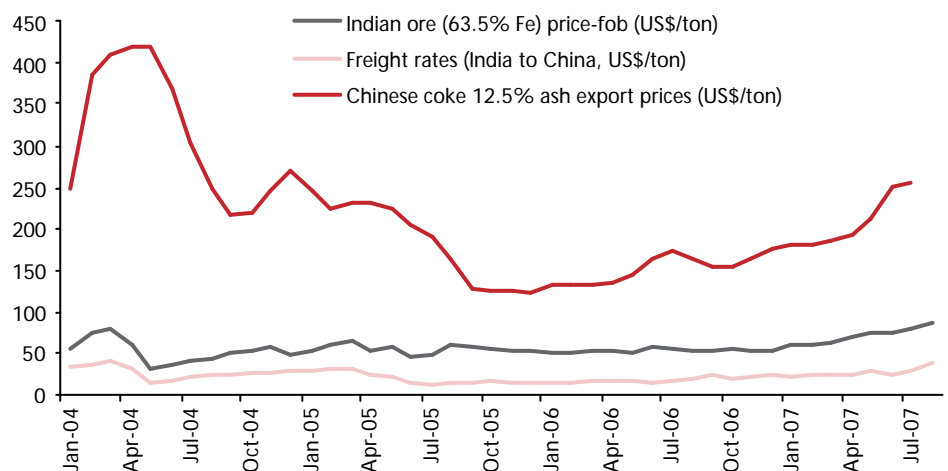
In such a scenario, we continue to prefer resource-rich companies like Jindal Steel & Power (JSP) over non-integrated Tata Steel and JSW steel. In addition to the resource upside mentioned above, JSP has 2 more potential positives.

- JSP's merchant plant might deliver higher-than-expected revenues. JSP is yet to tie-up 650MW (of 1000MW) of merchant power, which, if supplied on short-term supply arrangements might yield higher revenues and earnings than currently built-in by us (see Exhibit 8).
- Sustained high plate prices might offer upside to steel business earnings. JSP's 1 mtpa plate mill will likely stabilize by 2QFY08. This may result in 2HFY08 EBITDA being higher than our current expectations. Also, continued strength in plate prices will provide upside to our estimates for JSP's steel segment.

However, Corus' (and therefore, Tata Steel's) earnings sensitivity to steel prices is much higher than peers, a continued strength in which might lead to the stock's out-performance versus peers. Also, recently acquired plate-mill in US by JSW steel can provide upside to earnings and JSW valuations (we currently value the acquisition at acquisition cost).

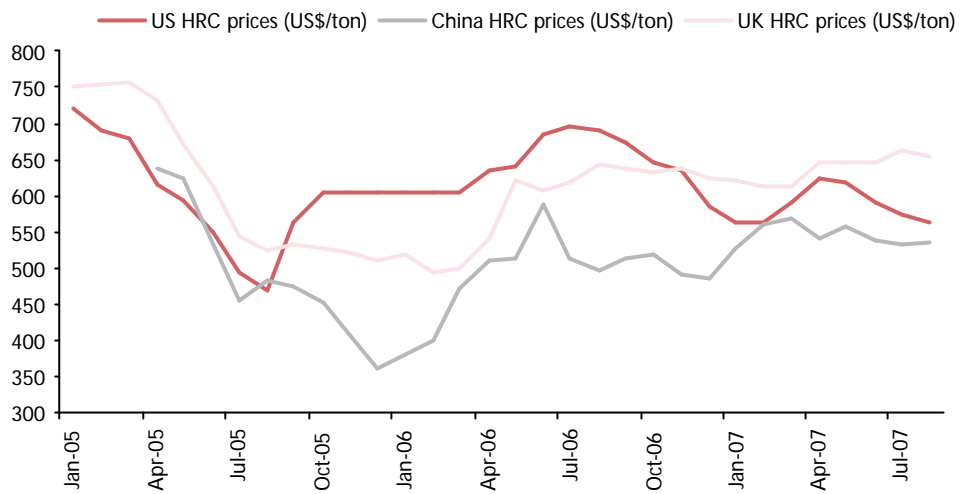
Exhibit 1: Iron ore and freight rates have increase 30% in the last couple of months

Freight rates from India to China and Indian iron ore prices



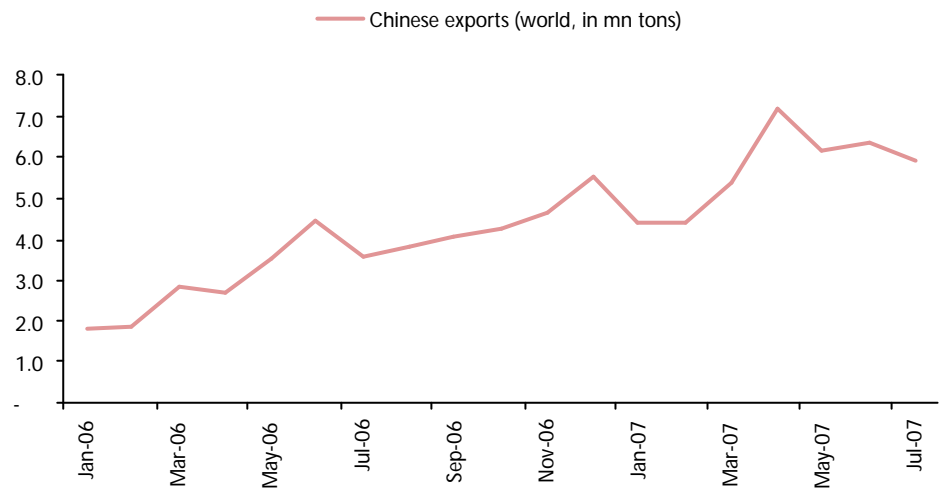
Source: CRU, Kotak Institutional Equities

Exhibit 2: HRC prices in US and China have fallen 10% and 6% respectively from their highs
 HRC prices in US, China and UK



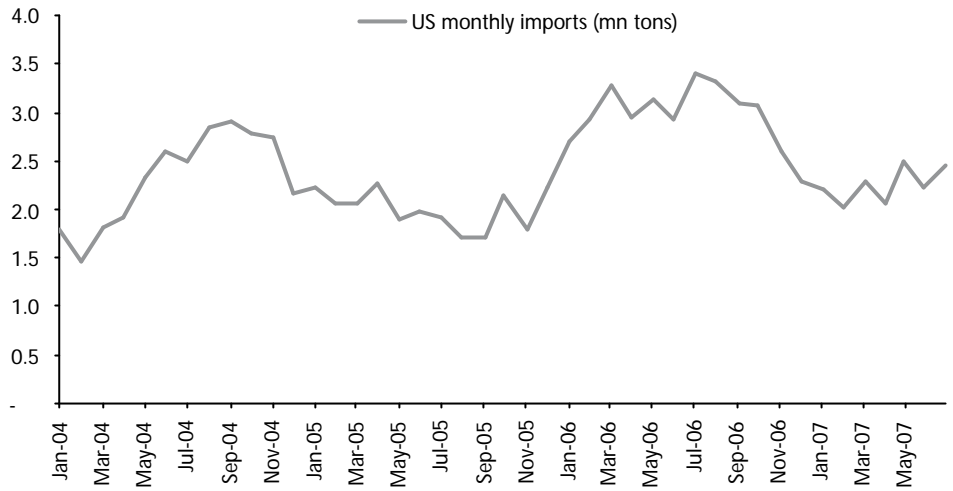
Source: CRU, Kotak Institutional Equities

Exhibit 3: Chinese exports have continued to stay strong despite imposition of export taxes



Source: Steelhome, Kotak Institutional Equities

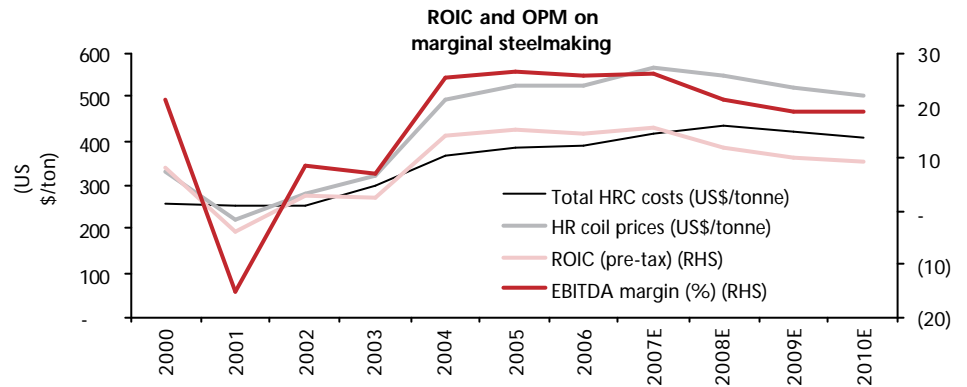
Exhibit 4: US imports have been sluggish, down 26% on YTD basis (cumulative upto Jul'07)



Source: US Census Bureau Kotak Institutional Equities

Exhibit 5: Expect ROIC and EBITDA margin on marginal steel making to peak out in 2007

ROIC and EBITDA margins on marginal steelmaking, December fiscal year-ends (US\$/tonne)



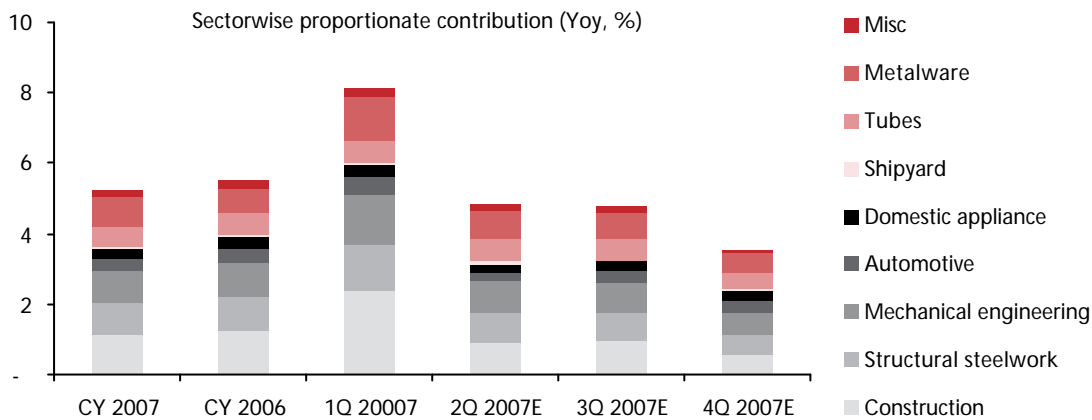
Notes:

- (a) Marginal steelmaking implies making steel using purchased iron ore, coking coal and power.
- (b) HRC costs include costs upto EBITDA level and capital charge.
- (c) Capital employed for computing ROIC includes our estimates of working capital.
- (d) Total cost for HRC is computed using our estimates for iron ore and coal, and normal inflation for other costs.

Source: CRU, GFMS-MC, James F King, IISI, Kotak Institutional Equities estimates

Exhibit 6: Construction segment likely to slow down overall steel consumption in EU in coming quarters

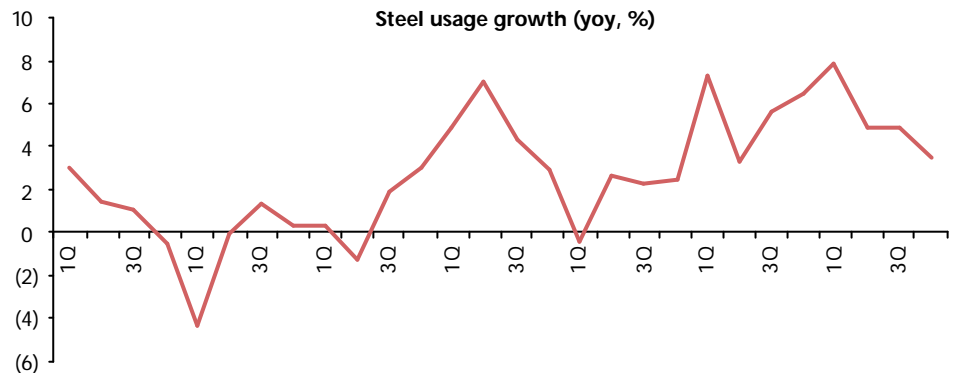
Year-over-year change in key steel-using sectors (%)



Source: Eurofer estimates, compiled by Kotak Institutional Equities

Exhibit 7: Steel consumption growth to fall drastically in EU

Total steel usage year-over-year growth (%)



Source: Eurofer estimates, compiled by Kotak Institutional Equities

Exhibit 8: Potential upside from our assumption of Rs2.25/unit

Sensitivity of JPL's valuation (Rs/share) to tariff realized for merchant power

	Tariff realized for merchant power				
	2.00	2.25	2.50	2.75	3.00
9.50	990	1,297	1,601	1,905	2,207
10.00	957	1,253	1,547	1,840	2,132
11.00	897	1,174	1,449	1,723	1,996
11.50	870	1,139	1,405	1,670	1,934
12.00	845	1,105	1,363	1,620	1,876

Source: Kotak Institutional Equities estimates.

Strategy

Sector coverage view

N/A

Alpha Bet: Closing JSP/Tata Steel

Sanjeev Prasad : sanjeev.prasad@kotak.com, +91-22-6634-1229

Puneet Jain : puneet.j@kotak.com, +91-22-6634 1255

Bhavesh Shah : bhavesh.shah@kotak.com, +91-22-6634-1498

- **Closing JSP/Tata Steel trade with gross positive return of 11% since inception**
- **JSP stock appreciated by 16.3% and Tata Steel stock increased by 5.3%**
- **Open trades: Long RCOM/Short Idea; Long ICICI Bank/Short Infosys; Long Suzlon/Short GMR & MTNL**

We are closing our long JSP and short Tata Steel trade with a gross positive return of 11% since we initiated the trade (September 14). We had recommended the trade owing to the valuation gap arising from (1) rising prices of resources (iron ore and coking coal) that will likely hit Corus in CY2008 but aid JSP's revenues, (2) possibility of higher-than-expected revenues from JSP's merchant power plant and (3) sustained high plate prices, which might provide an upside to JSP's earnings. Since the inception of the trade, JSP's stock has appreciated by 16.3% whereas Tata Steel stock has increased by 5.3%, resulting in a gross return of 11% (outperforming the Sensex by 4.8%).

Alpha-Bet trades

Statistics of trades, current price, initiation price, gross current/actual return (%)

	Stock	Current price (Rs)	Initiation price (Rs)	Return (%)
Trade 1				
Buy	RCOM	579	567	2.1
Sell	Idea Cellular	127	130	(2.6)
Current return (%)				4.7
Trade 2				
Buy	ICICI Bank	965	907	6.4
Sell	Infosys Technologies	1,822	1,830	(0.5)
Current return (%)				6.9
Trade 3				
Buy	Suzlon	1,465	1,372	6.8
Sell	GMR Infrastructure	801	766	4.6
	MTNL	156	145	7.2
Current return (%)				0.9
Closed trades				
14 September-21 September 2007				
Buy	JSP	5,371	4,619	16.3
Sell	Tata Steel	741	704	5.3
Return (%)				11.0
18 July-14 September 2007				
Buy	HPCL	251	259	(3.1)
Sell	Cairn (50%)	161	158	1.9
	GAIL (50%)	312	331	(5.6)
Return (%)				(1.3)
27 July-22 August 2007				
Buy	Ambuja Cements	133	129	3.1
Sell	ACC	963	1,023	(5.9)
Return (%)				9.0
18 July-27 July 2007				
Buy	Bajaj Auto	2,321	2,282	1.7
Sell	Aditya Birla Nuvo	1,386	1,576	(12.1)
Return (%)				13.8

Note:

(a) Price of HPCL is including dividend of Rs12.0 per share.

(b) Price of Gail is including dividend of Rs2.0 per share.

(c) Price of Ambuja Cement is including dividend of Rs2.5 per share.

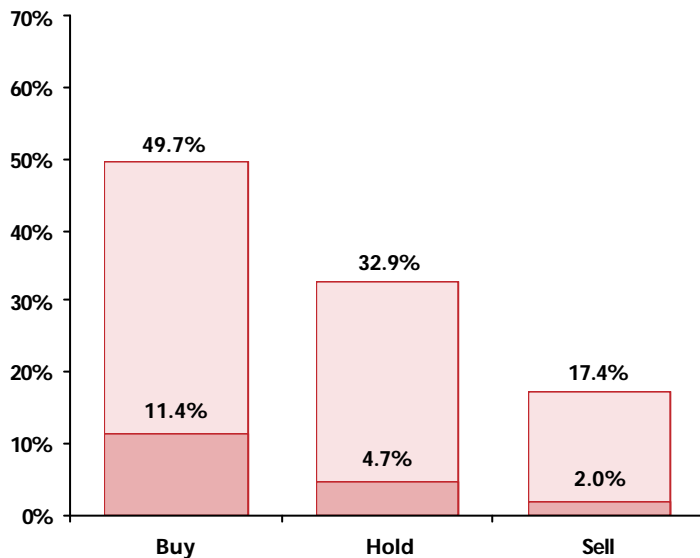
(d) Price of ACC is including dividend of Rs10.0 per share.

Source: Bloomberg, Kotak Institutional Equities estimates.

"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: Sanjeev Prasad, Jigar Mistry."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



- Percentage of companies covered by Kotak Institutional Equities, within the specified category.
- Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* 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 06/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities.

As of June 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

- OP = Outperform.** We expect this stock to outperform the BSE Sensex over the next 12 months.
- IL = In-Line.** We expect this stock to perform in line with the BSE Sensex over the next 12 months.
- U = Underperform.** We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

Other ratings/identifiers

- NR = Not Rated.** The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
- CS = Coverage Suspended.** Kotak Securities has suspended coverage of this company.
- NC = Not Covered.** Kotak Securities does not cover this company.
- RS = Rating Suspended.** Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
- NA = Not Available or Not Applicable.** The information is not available for display or is not applicable.
- NM = Not Meaningful.** The information is not meaningful and is therefore excluded.

**Corporate Office
Kotak Securities Ltd.**

Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices**Kotak Mahindra (UK) Ltd.**

6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc.

50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

Copyright 2007 Kotak Institutional Equities (Kotak Securities Limited). All rights reserved.

Kotak Securities Limited and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We along with our affiliates are leading underwriter of securities and participants in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationships with a significant percentage of the companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. Investors should assume that Kotak Securities Limited and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may participate in the solicitation of such business. Our research professionals are paid in part based on the profitability of Kotak Securities Limited, which include earnings from investment banking and other business. Kotak Securities Limited generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, Kotak Securities Limited generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Kotak Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. Kotak Securities Limited does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment.

Certain transactions -including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. For the purpose of calculating whether Kotak Securities Limited and its affiliates holds beneficially owns or controls, including the right to vote for directors, 1% of more of the equity shares of the subject issuer of a research report, the holdings does not include accounts managed by Kotak Mahindra Mutual Fund. Kotak Securities Limited and its non US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies affectively assume currency risk. In addition options involve risks and are not suitable for all investors. Please ensure that you have read and understood the current derivatives risk disclosure document before entering into any derivative transactions.

This report has not been prepared by Kotak Mahindra Inc. (KMInc). However KMInc has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed. Any reference to Kotak Securities Limited shall also be deemed to mean and include Kotak Mahindra Inc.

Kotak Securities Ltd.

Bakhtawar, 1st floor, 229 Nariman Point, Mumbai 400 021, India.

Tel: +91-22-6634-1100 Fax: +91-22-2288-6453