kotak® Institutional Equities

INDIA DAILY

August 23, 2007

EQUITY MARKETS

India	22-Aug	1-day	1-mo	3-mo
		Change, %		
Sensex	14,249	1.9	(9.4)	(0.8)
Nifty	4,153	1.9	(10.1)	(2.2)
Global/Regional indices				
Dow Jones	13,236	1.1	(5.1)	(2.1)
Nasdaq Composite	2,553	1.2	(5.1)	(0.9)
FTSE	6,196	1.8	(6.5)	(6.4)
Nikkie	16,294	2.5	(9.3)	(8.0)
Hang Seng	22,877	2.4	(2.1)	10.0
KOSPI	1,814	3.1	(9.0)	10.2

Value traded - India

	22-Aug		1-mo	3-mo
			Moving avg, Rs bn	
Cash (NSE+BSE)	147.9		162.3	154.9
Derivatives (NSE)	517.5		480.7	334.4
Deri. open interest	830.9		906.3	627.3

Forex/money market

	22-Aug	1-day	1-mo	3-mo
		Change, basis points		
Rs/US$	40.9	-	63	35
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	(6)	9	(23)

Net investment (US$mn)

	21-Aug		MTD	CYTD
FIIs	(2)		1,759	8,011
MFs	(4)		111	205

Top movers -3mo basis

Best performers	22-Aug	1-day	1-mo	3-mo
		Change, %		
Chambal Fert	50	15.5	39.0	46.6
Thermax	605	(0.4)	1.1	31.9
Rashtriya Chem	49	5.1	(1.9)	27.2
Reliance Energy	725	4.7	1.4	27.1
BHEL	1,667	4.8	(5.6)	22.7
Worst performers				
Escorts	76	(8.1)	(32.6)	(40.8)
Polaris	108	(0.6)	(18.5)	(34.7)
Balrampur Chini	51	(3.7)	(26.3)	(32.7)
Punjab Tractors	226	(4.6)	(17.3)	(26.1)
IOC	376	(0.1)	(11.4)	(25.1)

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News Roundup

Corporate

- Kingfisher Airlines and Air Deccan, in which Kingfisher holds a 26% stake, are jointly exploring the possibility of starting co-branded flights to the US, in order to best utilize Air Deccan's eligibility to fly international routes starting from August, 2008. (ET)
- Pharma major Ranbaxy Laboratories Ltd on Wednesday launched Roliflo OD, a Novel Drug Delivery System (NDDS) product for chronic urological disorder in India. (BL)
- Real estate firm DLF has bagged the Durgapur Township Project in West Bengal, a public-private partnership model that would attract investment up to Rs40 bn. (BL)
- GAIL (India) will infuse an additional Rs4.8 bn equity in Dabhol power project to help the beleaguered unit complete the construction of a liquefied natural gas terminal, taking its stake in the parent company Ratnagiri Gas and Power to 32.9% from 28.3% presently. (BS)
- Cigarettes major ITC plans to scale up its retail venture Chaupal Fresh from 3 outlets currently to 40 by the end of FY2007 and 140 FY2009 with a presence in all major cities of the country. (BS)
- Wipro Technologies will be setting up a global development centre in Egypt targeting the IT export services for the Middle East region and strengthen Wipro's global delivery model. (ET)

Economic and political

- The Securities and Exchange Board of India (SEBI) said is considering a waiver of the entry load for direct applications received by asset management companies. (BL)
- Credit rating agency Moody's has ruled out any change in India's sovereign rating saying that the US sub-prime market crisis and the political standoff over the Indo-US nuclear deal will not seriously dent the country's economy and policy framework. (ET)
- With the telecom equipment manufacturing base in the country evolving rapidly, the central government has set a target of US$10 bn for equipment exports by FY2012 and set up an Export Promotion Forum (EPF) for the same. (BL)

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

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Strategy

Sector coverage view	N/A

Alpha Bet: Closing ACEM-ACC trade on it meeting return expectation; others so far, so good

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- **We are closing out our long ACEM/short ACC pair trade. The trade has delivered returns of +9% since July 27, 2007 (initiation date**
- **We keep open our (1) Long RCOM/Short Idea and (2) Long HPCL/Short Cairn/GAIL trades**

We are closing our Ambuja Cements (ACEM)-ACC trade with a gross return of 9% from initiation of trade (July 27). The valuation gap between the two stocks has closed now. We keep open our (1) Long RCOM/Short Idea and (2) Long HPCL/Short Cairn/GAIL trades. The trades have delivered 3.2% and 3.5% return, respectively since initiation based on events in line with our expectations.

Trade 1: Long RCOM, short Idea: Bigger and cheaper (+3.2% since trade inception)

We keep our long RCOM, short Idea pair trade and expect to derive further relative out-performance from (1) potential delay in issue of new GSM spectrum, which will affect Idea negatively; the telecom minister stated August 22, 2007 that the government will finalize a spectrum policy by end-2007, (2) likely reduction in Idea's premium to RCOM on appreciation of difference in earnings quality of the companies and (3) likely listing of FLAG Telecom.

Trade 2: Long HPCL, short GAIL/Cairn: Crude plays (+3.5% since trade inception)

We continue to recommend the trade given our identified short-term catalyst for the trade—decline in crude oil prices—is working in favor of the trade. Crude oil prices (Dated Brent basis) have come off sharply (13.7% or –US$10.8/bbl) from our trade inception date. However, this positive factor for HPCL has been largely ignored by the street among the larger issues clouding the market (high volatility amidst sub-prime mortgage and political uncertainty issues) and the downstream oil sector (delay in issue of oil bonds, delay in increase in price of auto fuels).

Trade 3: Closed Long Ambuja Cements, short ACC trade

We are closing out our long ACEM/short ACC pair trade. The trade has delivered returns of +9% since July 27, 2007 (initiation date) in line with our expected 8% gross return. ACEM stock has moved up 3.1% in a weak market. On the other hand, ACC stock has fallen 5.9%. These returns are adjusted for dividend pay-outs. The valuation gap between ACEM and ACC, the basis for the pair trade, has now closed.

Telecom

VSNL.BO, Rs374	
Rating	OP
Sector coverage view	Cautious
Target Price (Rs)	550
52W High -Low (Rs)	515 - 342
Market Cap (Rs bn)	106.5

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	40.4	45.1	49.6
Net Profit (Rs bn)	4.9	5.2	5.9
EPS (Rs)	17.2	18.1	20.6
EPS gth	*(7.8)*	*5.3*	*13.7*
P/E (x)	21.8	20.7	18.2
EV/EBITDA (x)	8.8	8.8	7.8
Div yield (%)	1.2	1.2	1.3

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	76.2	-	-
FIIs	8.1	0.2	(0.3)
MFs	1.7	0.2	(0.2)
UTI	-	-	(0.4)
LIC	8.7	0.9	0.5

VSNL: Tax ruling as reported by CNBC unlikely to have a cash flow impact; maintain OP

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- **CNBC reported that VSNL has lost 80IA income tax case; amount involved is Rs8-10 bn**
- **VSNL management stated that it has not received any intimation from ITAT**
- **Cash flow impact unlikely as VSNL has already paid Rs8 bn (tax and interest) under protest**

CNBC reported that VSNL has lost the 80IA income tax case amounting to Rs8-10 bn in the Income Tax Appellate Tribunal (ITAT). The dispute pertains to applicability of 80IA tax benefits to investment in earth stations. VSNL indicates that it has not received any intimation or order on this case. We believe this is unlikely to impact VSNL materially as it has already paid Rs8 bn under protest although it may have not recognized the Rs6.85 bn as an expense. A negative ruling will impact reserves negatively but will have no impact on cash flow. We believe that the recent correction in the stock price offers an attractive buying opportunity; the stock has a 45% upside to our 12-month SOTP DCF based target price of Rs550. Key catalysts for stock performance includes (a) listing of Flag Telecom, which will likely establish a valuation benchmark for VSNL's global undersea cable system under the erstwhile Tyco Global Network (TGN); we have valued this asset at the acquisition price of US$130 mn; (b) further improvement in performance of the consolidated entity led by better utilization of cable capacity and cost rationalization; and (c) any positive news de-merger of the telecom business from surplus real estate, though this may take some time in our view.

Number of ongoing disputes with income-tax; Rs12.3 bn paid under protest till date. VSNL has paid Rs12.3 bn (Rs43/share) under protest in three disputes with the Indian Income Tax Authorities. We discuss each of the case in greater detail.

1. **Section 80IA benefits.** The income tax authorities have taken a position that profit generated from earth station is not eligible for 80IA tax exemption. VSNL has paid Rs8 bn for tax and interest till end-March 2006 though this amount does not include potential penalties. CNBC reported that the ITAT has ruled against VSNL with the total amount involved being Rs8-10 bn. VSNL indicates that it has not received any intimation from tax authorities on this case. Even if it is true, VSNL will likely contest this case in the High Court. The decision of this case will not have any bearing on our future earnings estimates as the timeframe for tax benefits has already expired. The unrecognized impact of the above payment in income statement is Rs6.85 bn. We clarify that that any adverse ruling will not have a negative cash flow impact but will impact reserves.
2. **Reimbursement of DoT Levy.** The Indian tax authorities have taken the position that VSNL has not paid tax on certain reimbursements it had received from the Government in FY1994. The case is in appeal in ITAT; VSNL has paid Rs3.4 bn under protest (including interest but excluding penalties as quantified up to March 31, 2006) in connection with such reimbursements. VSNL has not provided for this amount in its books.
3. **ICO Global loss write-off.** VSNL had written off Rs5.2 bn towards investment in the equity shares of ICO Global Communications Inc., which filed for bankruptcy protection in the United States in 2000. VSNL has provided and paid Rs2 bn in respect of tax and interest under protest. VSNL has appealed in the Income Tax Appellate Tribunal.

In addition, VSNL has also has cases pending in respect of applicability of license fees as a deductible expense. We believe that this case is likely to be ruled in favor of VSNL noting that MTNL was allowed deduction recently in a similar case recently.

Our sum-of-the-parts 12-month target price for VSNL is Rs550/share

	Estimated value		Value in SOTP		
	(Rs bn)	(Rs/share)	(Rs bn)	(Rs/share)	Comments
1. Core business					
Enterprise value (EV)	54	190	54	190	12-month forward DCF (discounting FY2008 onwards)
Net cash/(debt)	8	29	8	29	As of end-March 2008
Total	**62**	**219**	**62**	**219**	
2. Investments					
TATA Teleservices (TTSL)	32	112	32	112	Valuation based on US$5 bn equity value for TTSL
Tyco Global Network (TGN)	6	20	5.7	20	Valued at book value (100% taken in SOTP)
Teleglobe (TG)	8	28	8.1	28	Valued at book value (100% taken in SOTP)
SNO (South Africa)	0	0	0	0	No NPV ascribed (i.e. neither capex nor revenues modeled)
Total	**46**	**160**	**46**	**160**	
3. Others					
Surplus real estate	69	242	48	170	70% of estimated market value of surplus land
Total	**69**	**242**	**48**	**170**	
Grand total [1]+[2]+[3]	**177**	**622**	**156**	$\boxed{\textbf{549}}$	**12-month forward target price is Rs550**

Source: Kotak Institutional Equities estimates.

Pipes

JIND.BO, Rs603	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	790
52W High -Low (Rs)	728 - 285
Market Cap (Rs bn)	33.8

Financials

September y/e	2007	2008E	2009E
Sales (Rs bn)	49.6	37.7	51.4
Net Profit (Rs bn)	2.8	3.1	5.0
EPS (Rs)	51.7	53.8	87.1
EPS gth	*68.0*	*4.1*	*61.9*
P/E (x)	11.7	11.2	6.9
EV/EBITDA (x)	7.1	5.2	3.3
Div yield (%)	1.0	1.1	1.1

Jindal Saw: Unexpected from the expected sale of US operations to adversely impact near-term valuations

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- **JSAW to realize about $206 mn post tax for its share in the US facilities and another US$50-60 mn from the working capital and recoveries of loans**
- **We believe the sale proceeds just about compensates the loss of business with very little impact on DCF-based valuation; the allocation of deal value between the pipe and plate mill continues to puzzle**
- **Maintaining Outperform rating and target price of Rs790 per share; however, note that near-term valuations will remain under pressure on account of bad sentiment due to lower-than-expected cash inflow from the stake sale**

We believe the sale of US operations does not add much value to JSAW as the amount realized just about compensates the loss of value from the US business. JSAW will realize US$206 mn post tax for its stake sale and another US$50-60 mn from working capital release and recovery of advances given to the US entities. We believe this amount is lower-than-expected; we had estimated a US$225 mn inflow on US$800 mn enterprise valuation. We note that this lower-than-expected cash inflow from its stake sale has adversely impacted the sentiment, which will have a bearing on the near-term valuations. However, we note that despite loss in revenues and earnings from US operations, JSAW will be able to maintain its EBITDA and grow net earnings by 11% on a yoy basis in FY2008. We maintain Outperform rating and 12-month target price of Rs790 per share.

Sale of US operations—allocation of valuation puzzling and punishing for sentiment

JSAW along with majority stakeholders in US operations sold US operations to JSW for a combined enterprise value of US$900 mn. However the allocation of the sale proceeds to various units continues to puzzle as the amount assigned to the pipe mill is higher whereas the main earnings are generated from the plate mill which also has a higher replacement cost. We believe this allocation of value leaves a smaller share of the proceeds for JSAW which is the minority shareholder in both the units. (see Exhibit 1 and 2). JSAW will realize US$206 mn (Rs8.5 bn) as sale proceeds and a further $50-60 mn from working capital release and recovery of advances to the subsidiaries.

Valuation—No change as sale proceeds just about compensates the loss of business

We maintain our 12-month DCF-based target price of Rs790 per share for JSAW as the cash realisation from the sale of US operations just about compensates the loss of earnings, leaving negligible impact on the DCF valuation. We believe the transaction does not add any significant value but disturbs the sentiments due to the unexpected allocation of deal value to the different assets.

Financials—Margins to improve as low margin segment is sold off

We expect the EBITDA margin for JSAW to improve to 16.1% in FY2008E and 17.2% in FY2009E from 10.5% in FY2006 as US operations no longer form part of the entity. US operations contributed to more than a third of revenues and have low EBITDA margins of 7-9% as against the higher EBITDA margins from Indian operations. The share in total revenues of seamless and DI which have very high margins in the range of 18-22% will increase resulting in improvement in the overall margin. We expect net earnings to grow at 44% CAGR over FY2006-09E based on better margins and higher volumes.

Change in volume estimates—higher domestic volumes as exports increase

We have increased our volume estimates for the domestic facilities based on management's guidance of increasing exports to HSAW to USA and South-east Asian countries from the domestic facilities. JSAW has a non-compete agreement with JSW steel, whereby it cannot sell LSAW pipes and plates in USA for a period of three years. However, it can continue to sell HSAW pipes. We believe with the upcoming 200,000 tons HSAW capacity in March 2008, JSAW would increasingly export HSAW pipes to USA from its Indian facilities. Further with new opportunities opening up in West Asia and Africa the exports of LSAW pipes would also increase as management increases focus towards the nearby markets.

Cash inflow to reduce leverage and provide funds for further expansion

We believe the net cash flow of Rs8.5 bn from the sale of US operations will be utilized to repay the short term loans to reduce leverage and also for further capacity expansion. Management believes there are large untapped opportunities in West Asia, Africa, Southern America and South-East Asia where it is considering setting up Greenfield capacities or acquisitions. We believe this to be a strategic shift in the market focus moving from North America to other developing countries where strong infrastructural development is required. JSAW is also considering domestic expansion to cater to the growing demand from water segment in Asia.

Forecasts and valuation (consolidated)

September year-end	Sales (Rs mn)	EBITDA (Rs mn)	Adj. PAT (Rs mn)	EPS (Rs)	RoAE (%)	P/E (X)	EV/EBITDA (X)
2006	38,731	4,066	1,563	29.5	15.3	20.5	9.9
2007E	49,620	5,953	2,775	48.2	18.9	12.5	7.4
2008E	37,680	6,061	3,089	53.8	14.0	11.2	5.4
2009E	51,419	8,824	4,953	87.1	16.4	6.9	3.5
2010E	56,264	9,624	5,709	101.0	16.2	6.0	2.6

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 1: Allocation of deal value to various USA units (US$ mn)

	Ent. Value (1)	Net debt (2)	Equity value
Total deal value	**900**	**125**	**775**
Value for pipe mill	530	74	456
Value for plate mill	320	44	276
Value for double joint mill	50	7	43

Note: (1) Enterprise value allocated as per company information
(2) Estimated net debt allocated in the ratio of Enterprise value

Source: Company, Kotak Institutional Equities estimates.

Exhibit 2: Cash proceeds to JSAW from sale of USA plants

	Equity Value (US$ mn)	JSAW's stake (%)	Cash flows (US$ mn)	Cash flows (Rs mn)
Pipe mill	456	19.4	89	
Plate mill	276	49.0	135	
Double joint mill	43	100.0	43	
Total cash flows	**775**		**267**	**10,931**
Tax on capital gains (22.6%)			60	2,477
Post tax realisation			**206**	**8,454**

Source: Kotak Institutional Equities estimates.

Exhibit 3: Our DCF-based valuation for Jindal Saw is Rs790/ share

DCF valuation of Jindal Saw, September fiscal year-ends

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal Value
EBITDA	5,953	6,061	8,824	9,624	9,477	9,227	8,519	8,180	8,217	8,255	8,295	
Tax expense	(1,491)	(3,889)	(2,159)	(2,682)	(3,130)	(3,033)	(2,769)	(2,576)	(2,587)	(2,527)	(2,541)	
Changes in working capital	(1,823)	1,300	(3,478)	(588)	262	995	853	638	(20)	(20)	(21)	
Cash flow from operations	**2,639**	**3,473**	**3,187**	**6,354**	**6,609**	**7,188**	**6,604**	**6,241**	**5,610**	**5,709**	**5,733**	
Capital expenditure	(3,188)	(2,240)	(270)	(366)	(467)	(478)	(490)	(502)	(515)	(528)	(1,082)	
Free cash flow to the firm	**(549)**	**1,232**	**2,917**	**5,989**	**6,143**	**6,710**	**6,114**	**5,739**	**5,095**	**5,181**	**4,651**	**42,914**
Dicounted cash flow-now	(542)	1,082	2,276	4,153	3,787	3,677	2,978	2,485	1,961	1,772	1,414	
Discounted cash flow-1 year forward		1,217	2,560	4,672	4,260	4,137	3,350	2,796	2,206	1,994	1,591	
Discounted cash flow-2 year forward		0.0%	2,880	5,257	4,793	4,654	3,769	3,145	2,482	2,243	1,790	
Discount rate		12.5%										
Growth from 2017 to perpetuity		1.5%										
Discount factor at WACC	**0.99**	**0.88**	**0.78**	**0.69**	**0.62**	**0.55**	**0.49**	**0.43**	**0.38**	**0.34**	**0.30**	

	+ 1-year		+ 2-years	
Total PV of free cash flow (a)	**28,784**	**66%**	**31,013**	**65%**
PV of terminal value (b)	14,681	34%	16,516	35%
EV (a) + (b)	43,465		47,529	0%
EV (US$ mn)	**1,073**		**1,174**	**0%**
Net debt	(1,097)		(3,321)	
Equity value	**44,562**		**50,850**	
No. of shares	56.0		56.0	
Implied share price (Rs)	**796**		**908**	
Exit EV/EBITDA multiple (X)	5.2			
Exit FCF multiple (X)	**9.2**			

Sensitivity of share price to WACC and growth rate (Rs)

Growth Rate	WACC 11.5%	12.0%	12.5%	13.0%	13.5%
0.0%	822	790	761	734	709
0.5%	835	802	772	743	717
1.0%	850	815	783	754	726
1.5%	867	830	**796**	765	736
2.0%	885	845	810	777	747
2.5%	905	863	825	790	759
3.0%	927	882	842	805	772

Source: Company, Kotak Institutional Equities estimates.

Exhibit 4: Sales volumes assumptions, September fiscal year-ends, FY2006-2010E ('000 tons)

	2006	2007E	2008E	2009E	2010E
New estimates					
HSAW	25	38	100	193	228
LSAW	320	280	360	420	480
LSAW - USA	116	175	-	-	-
Seamless	40	70	96	188	188
DI	91	130	156	182	195
Plates (a)	218	300	-	-	-
Old estimates					
HSAW	25	38	88	175	228
LSAW	320	280	320	400	480
LSAW - USA	116	175	200	250	275
Seamless	40	70	96	188	188
DI	91	130	156	182	195
Plates (a)	218	300	334	402	436
Change					
HSAW	-	-	13	18	-
LSAW	-	-	40	20	-
LSAW - USA	-	-	(200)	(250)	(275)
Seamless	-	-	-	-	-
DI	-	-	-	-	-
Plates (a)	-	-	(334)	(402)	(436)

Note:
(a) Plate sales is net of plates consumed for pipe making in USA

Source: Company, Kotak Institutional Equities estimates.

Exhibit 5: Income statement, September fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Net revenues	**10,856**	**23,138**	**38,731**	**49,620**	**37,680**	**51,419**	**56,264**
Operating expenses							
Stock adjustment	702	1,904	3,174	—	—	—	—
Raw materials	(7,601)	(17,809)	(27,282)	(30,806)	(25,193)	(34,029)	(37,495)
Manufacturing expense	(1,772)	(2,794)	(7,051)	(8,852)	(2,614)	(3,425)	(3,719)
Employee costs	(253)	(411)	(838)	(908)	(1,212)	(1,593)	(1,741)
Selling expenses	(395)	(950)	(2,285)	(2,605)	(2,261)	(3,085)	(3,235)
Other expenses	(190)	(277)	(384)	(496)	(339)	(463)	(450)
Total expenditure	**(9,509)**	**(20,336)**	**(34,666)**	**(43,667)**	**(31,619)**	**(42,595)**	**(46,641)**
EBITDA	**1,347**	**2,802**	**4,066**	**5,953**	**6,061**	**8,824**	**9,624**
EBITDA margin (%)	*12.4*	*12.1*	*10.5*	*12.0*	*16.1*	*17.2*	*17.1*
Net finance cost	(408)	(985)	(1,290)	(1,100)	(522)	(317)	37
Other income	68	105	144	70	75	75	75
PBDT	**1,006**	**1,923**	**2,920**	**4,923**	**5,614**	**8,582**	**9,735**
Depreciation and amortisation	(230)	(365)	(537)	(697)	(906)	(1,048)	(1,048)
Pretax profits before extra-ordinaries	**777**	**1,558**	**2,383**	**4,226**	**4,708**	**7,534**	**8,687**
Exceptional items	6	(56)	137	—	10,870	—	—
Profit before tax	**783**	**1,501**	**2,520**	**4,226**	**15,578**	**7,534**	**8,687**
Current tax	(190)	(370)	(694)	(1,183)	(3,748)	(2,072)	(2,693)
FBT	—	(4)	(10)	(15)	(18)	(20)	(25)
Deferred tax	(25)	(133)	(164)	(253)	(329)	(489)	(260)
Minority / associate earnings	—	—	2	—	—	—	—
Reported net profit	**568**	**994**	**1,653**	**2,775**	**11,483**	**4,953**	**5,709**
Adjusted net profit	**564**	**1,032**	**1,563**	**2,775**	**3,089**	**4,953**	**5,709**
Primary EPS (using wtd. avg. shares)	14.5	26.2	30.8	51.7	53.8	87.1	101.0
Diluted EPS	14.5	21.3	29.5	48.2	53.8	87.1	101.0
Year end no. of shares (mn)	39.0	47.1	48.4	56.0	56.0	56.0	56.0
Weighted avg. no. of shares (mn)	39.0	39.2	48.3	52.2	56.0	56.0	56.0
Fully diluted no. of shares (mn)	39.0	48.4	50.5	56.0	56.0	56.0	56.0
Margins (%)							
EBITDA margin	12.4	12.1	10.5	12.0	16.1	17.2	17.1
PBT margin	7.2	6.7	6.2	8.5	12.5	14.7	15.4
Net profit margin (w/o extraordinaries)	5.2	4.5	4.0	5.6	8.2	9.6	10.1
Effective tax rate (%)	27.4	33.8	34.5	34.3	26.3	34.3	34.3
Growth yoy (%)							
Revenues	—	113.1	67.4	28.1	(24.1)	36.5	9.4
EBITDA	—	108.0	45.1	46.4	1.8	45.6	9.1
PBT	—	100.5	53.0	77.4	11.4	60.0	15.3
Net profit (w/o extraordinaries)	—	83.0	51.5	77.5	11.3	60.3	15.3
Diluted EPS	—	47.2	38.4	63.4	11.7	61.9	16.0

Source: Company, Kotak Institutional Equities estimates.

Exhibit 6: Cash flow statement, September fiscalyear-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Operating							
Pre-tax and pre Extraordinary	777	1,558	2,383	4,226	4,708	7,534	8,687
Depreciation & amortization	230	365	537	697	906	1,048	1,048
Taxes paid	(341)	(300)	(253)	(1,198)	(3,766)	(2,092)	(2,718)
Dividend and other income	(143)	(165)	(289)	(70)	(75)	(75)	(75)
Interest expense	365	816	1,309	1,100	522	317	(37)
Interest paid	(314)	(880)	(1,446)	(1,100)	(522)	(317)	37
Foreign exchange loss/(gain)	—	33	(22)	—	—	—	—
Extraordinary	6	(56)	137	—	—	—	—
Other non-cash items	9	1	18	157	—	—	—
Working capital changes	(1,060)	(6,135)	(2,231)	(1,823)	1,300	(3,478)	(588)
Cash flow from operations	**(472)**	**(4,764)**	**144**	**1,989**	**3,073**	**2,937**	**6,355**
Operating, excl. working capital	**588**	**1,371**	**2,375**	**3,812**	**1,773**	**6,415**	**6,942**
Investing							
Capital investment	(2,997)	(2,114)	(2,851)	(3,188)	(2,240)	(270)	(366)
Purchase/ sale of assets/ business	6	6	35	—	10,931	—	—
Investment changes	29	(94)	345	—	—	—	—
Advances to subsidiary	—	—	—	—	—	—	—
Interest/dividend received	154	177	351	70	75	75	75
Cash flow from investing	**(2,807)**	**(2,025)**	**(2,120)**	**(3,118)**	**8,766**	**(195)**	**(291)**
Financing							
Share capital	—	3,730	489	1,049	—	—	(300)
Net proceeds from borrowings	3,479	4,349	4,190	(1,566)	(4,288)	(2,000)	(1,500)
Effect of forex changes	—	—	—	—	—	—	—
Dividends paid (incl. tax)	(108)	(109)	(308)	(276)	(485)	(518)	(518)
Cash flow from financing	**3,370**	**7,970**	**4,371**	**(793)**	**(4,773)**	**(2,518)**	**(2,318)**
Net chg in CCE	91	1,182	2,395	(1,922)	7,066	224	3,746
Beginning cash	253	345	1,526	3,922	2,000	9,066	9,291
Ending cash	**345**	**1,526**	**3,922**	**2,000**	**9,066**	**9,291**	**13,037**
Discretionary cash flow	(17)	1,073	2,088	(2,198)	6,581	(293)	3,229
Free cash flow	**(3,577)**	**(6,987)**	**(3,014)**	**(1,475)**	**348**	**2,149**	**5,471**

Source: Company, Kotak Institutional Equities estimates.

Exhibit 7: Balance sheet, September fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Equity							
Share capital	390	471	484	560	560	560	560
Convertible warrants	—	—	117	—	—	—	—
Reserves (excl Reval)	3,035	6,451	8,031	14,913	25,836	30,230	35,375
Net worth	**3,424**	**6,922**	**8,631**	**15,473**	**26,396**	**30,790**	**35,935**
Preference capital	—	1,000	1,000	1,000	1,000	1,000	700
Minority interest	—	—	151	151	151	151	151
Deferred tax liability	466	599	763	1,016	1,345	1,834	2,094
Debt	**7,630**	**11,979**	**16,217**	**11,107**	**6,818**	**4,818**	**3,318**
Secured	5,511	6,713	8,679	7,113	5,318	4,318	3,318
Unsecured	2,119	5,266	7,539	3,994	1,500	500	—
Current liability and provisions	6,437	5,012	12,303	14,264	10,233	13,391	14,560
Total capital	**17,958**	**25,512**	**39,066**	**43,011**	**45,944**	**51,985**	**56,758**
Assets							
Cash and cash equivalents	345	1,526	3,922	2,000	9,066	9,291	13,037
Inventory	4,518	9,262	13,967	16,314	12,904	16,905	18,498
Sundry debtors	4,104	3,335	7,608	8,836	7,226	9,861	10,020
Loans and advances	2,093	2,658	2,480	2,480	2,135	2,135	2,135
Current assets	**11,060**	**16,782**	**27,976**	**29,630**	**31,332**	**38,191**	**43,689**
Gross block (net off revaluation)	5,091	8,633	11,049	13,584	18,024	18,295	18,660
Less: Accumulated depreciation	1,573	1,980	2,499	3,238	4,186	5,276	6,366
Net fixed assets	3,518	6,653	8,550	10,346	13,838	13,019	12,294
Capital -WIP	2,350	1,177	1,546	2,200	—	—	—
Pre-operative exp	167	32	158	—	—	—	—
Net fixed assets (incl. C-WIP & Pre-op)	**6,035**	**7,862**	**10,254**	**12,546**	**13,838**	**13,019**	**12,294**
Investments	862	868	836	836	775	775	775
Miscallenous expenditure	—	1	—	—	—	—	—
Total assets	**17,958**	**25,512**	**39,066**	**43,011**	**45,944**	**51,985**	**56,758**
Leverage and return ratios (x)							
Debt/Equity	2.0	1.7	1.1	0.7	0.3	0.2	0.1
Debt/Capitalisation	0.7	0.6	0.5	0.4	0.2	0.2	0.1
Net debt/Equity	1.9	1.5	0.8	0.6	(0.0)	(0.1)	(0.2)
Net debt/Capitalisation	0.7	0.6	0.4	0.4	(0.0)	(0.1)	(0.3)
Net debt/EBITDA	5.4	4.1	2.4	1.7	(0.2)	(0.4)	(0.9)
ROAE (%)	14.5	18.1	15.3	18.9	14.0	16.4	16.2
ROACE (%)	7.5	10.5	10.2	12.6	10.8	13.9	14.1

Source: Company, Kotak Institutional Equities estimates.

Telecom

Sector coverage view			Cautious

		Price, Rs	
Company	**Rating**	**22-Aug**	**Target**
Bharti	U	848	750
Rcom	U	495	500
Idea Cellular	U	109	110

DoT threatens introduction of MNP; spectrum policy by yearend 2007

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- **MNP may be introduced in a phased manner**
- **If implemented, MNP would increase competition and may be negative for GSM operators; RCOM may stand to benefit**
- **Continued delay in allocation of spectrum may hurt Idea's expansion plans**

Various press articles and a brief interview by the Indian communication and IT minister with a business channel (CNBC) indicate that (1) new spectrum policy will likely be decided by the end of 2007 and (2) the DOT is once again considering introduction of MNP. We believe that the recent simultaneous price increase by two large operators may have triggered the government's action on MNP. The GSM cellular operators are naturally opposed to MNP and have cited large costs to support their stance. We think the introduction of MNP may take some time (we think conditions are ripe though) as the DOT will likely need to follow a consultation process and operators will probably try and oppose/delay the process. We maintain our 12-month DCF-based target prices of Rs750, Rs500 and Rs110 on Bharti, RCL and Idea respectively. Key upside/downside risks stem from higher/lower-than-expected profitability.

Impact of MNP—negative for competition and GSM operators, positive for RCOM. The introduction of MNP will likely be negative for GSM operators but moderately positive for Reliance Communications (RCL). We expect competition to increase following the introduction of MNP, which will likely impact RPM, opex and capex negatively. However, we expect MNP to be positive for RCL's GSM initiative, if the government gives it GSM spectrum under the revised spectrum policy. We see no reason for the government to prohibit operators from offering two different services on a single universal license or deny spectrum to operators accordingly; the current policy allows so and RCL is already offering both CDMA and GSM services in certain (8) circles.

We are modeling spectrum allocation in April 2008 for existing operators who have applied for licenses, paid the license fees and are awaiting spectrum allocation. Any further delay in finalization of the spectrum policy and spectrum allocation will likely negatively impact our subscriber estimates for Idea.

Not too early for MNP. We believe conditions (reasonable penetration in cities and covered areas) may be ripe for introduction of MNP even though GSM cellular operators may believe that the Indian market does not require MNP as the market is sufficiently competitive. The high profitability of operators would suggest that competition has not been destructive as once feared by the street (including us). In fact, the returns of Indian operators have been pleasantly high. We model Bharti's ROAE and ROACE in FY2008E at 45% and 32%, respectively, which we believe is amongst the highest amongst global telecom operators. Undoubtedly Bharti's execution has been superb; however, we believe the high financial returns also illustrates that competition has been rather docile.

MNP may stir up things nicely. The introduction of MNP (by December 2007 if the DOT is indeed serious about it) would coincide with finalization of spectrum policy and would introduce some real competition in the Indian market. Spectrum allocation to existing GSM operators who do not have a pan-Indian presence will likely increase the competitive intensity. In addition, RCL would have the opportunity to attack the high-end subs of GSM operators, a key reason for its GSM foray, provided the spectrum policy is favorable and it gets GSM spectrum for its proposed GSM foray in the balance 15 non-GSM circles.

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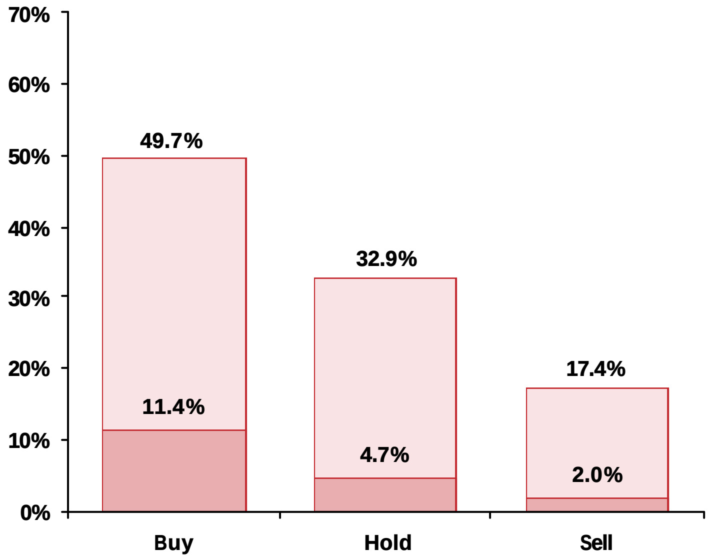

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Source: Kotak Institutional Equities. As of June 30, 2007

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