kotak® Institutional Equities

INDIA DAILY

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News Roundup

Corporate

- National Housing Bank (NHB), the principal agency promoting housing finance institutions, is planning to set up a mortgage guarantee company (MGC) in association with US-based United Germany Corp, International Finance Corporation (IFC) and Asian Development Bank (ADB) in 3-4 months. (BS)
- Daiichi Sankyo Co may sell debt to raise half the cost of its US$4.6 bn acquisition of Ranbaxy Laboratories, the biggest Indian pharmaceuticals company. (BS)
- Singur villagers have demanded that Tata Motors give them jobs or return their land. This is a major shift from their past stance in which they had demanded their land back and said they wanted no contact with the company. (BS)
- International activists are turning the heat on India's Oil and Natural gas Corp. Ltd (ONGC) over its operations in the civil war-ravaged African nation Sudan following similar campaigns against Chinese and Malaysian oil firms. (Mint)
- Cairn India and ONGC have near-finalised the plan for joint development of Ambe and North Tapti offshore marginal gas fields in the Gujarat coast. In other news, ONGC Videsh Ltd (OVL) has decided to relinquish the Najwat Najem oil block in Qatar. (BL)

Economic and political

- The petroleum ministry has said that the income tax holiday for gas production will not be available to oil companies bidding for blocks under the seventh round of the New Exploration Licensing Policy (Nelp-VII). (BS)
- In his appearance with Hillary Clinton in New Hampshire, the (US) Democratic Party's presidential candidate Barack Obama said the choice was between giving tax breaks to companies that ship jobs overseas and those which invest in America. (Mint)

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

EQUITY MARKETS

	Change, %			
India	**27-Jun**	**1-day**	**1-mo**	**3-mo**
Sensex	13,802	(4.3)	(15.9)	(11.8)
Nifty	4,137	(4.2)	(15.1)	(12.6)
Global/Regional indices				
Dow Jones	11,347	(0.9)	(10.2)	(7.5)
Nasdaq Composite	2,316	(0.2)	(8.2)	1.6
FTSE	5,530	0.2	(8.7)	(3.0)
Nikkie	13,589	0.3	(5.2)	8.5
Hang Seng	22,042	(0.0)	(10.2)	(3.5)
KOSPI	1,686	0.1	(9.0)	(1.1)

Value traded - India

	Moving avg, Rs bn		
	27-Jun	**1-mo**	**3-mo**
Cash (NSE+BSE)	186.3	192.2	195.3
Derivatives (NSE)	454.1	499.7	643
Deri. open interest	615.2	874	760

Forex/money market

	Change, basis points			
	27-Jun	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.9	0	48	277
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.6	(1)	45	70

Net investment (US$mn)

	26-Jun	MTD	CYTD
FIIs	(116)	(1,382)	(5,255)
MFs	64	135	1,660

Top movers -3mo basis

	Change, %			
Best performers	**27-Jun**	**1-day**	**1-mo**	**3-mo**
Chambal Fert	75	(7.8)	(10.7)	49.9
i-Flex	1,382	(3.2)	0.4	46.8
Ingersoll Rand	315	(0.9)	10.7	17.3
Ranbaxy	524	(1.9)	(0.9)	19.4
GESCO	399	(6.3)	(21.1)	5.9
Worst performers				
BPCL	248	(8.1)	(30.6)	(39.4)
Siemens India	411	(5.9)	(26.6)	(33.3)
Thermax	373	(5.0)	(12.7)	(38.5)
Tata Motors	444	(8.9)	(22.8)	(28.6)
BHEL	1,381	(3.9)	(16.9)	(33.0)

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Property

UNTE.BO, Rs183	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	250
52W High -Low (Rs)	547 - 160
Market Cap (Rs bn)	296.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	48.0	61.7	82.6
Net Profit (Rs bn)	18.6	24.0	30.3
EPS (Rs)	11.5	14.8	18.6
EPS gth	*43*	*28.7*	*26.2*
P/E (x)	15.9	12.4	9.8
EV/EBITDA (x)	12.2	9.4	7.7
Div yield (%)	0.5	1.1	2.2

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.6	-	-
FIIs	6.6	0.4	(0.8)
MFs	0.5	0.2	(1.0)
UTI	-	-	(1.2)
LIC	1.3	0.4	(0.8)

Unitech: 4QFY08 revenues and PAT below estimates due to slower-than-expected sales

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- **4QFY08 revenues much below our estimates, decline 27% on a yoy basis; PAT declines 52% yoy, 31% qoq**
- **We continue to observe delays in project execution; fewer project launches in FY2008 compared to management guidance**
- **We retain our REDUCE rating with a target price of Rs250/share We would revisit our assumption post the conference call today**

Unitech reported operating revenues of Rs11.6 bn (v/s our expectation of Rs17.8 bn) and PAT of Rs3.6 bn (v/s our expectation of Rs5.6 bn) for 4QFY08. Though we should not observe real estate company financials on a qoq basis, 4QFY08 PAT being lowest in five quarters is a matter of concern. We believe the revenues were below expectations mainly due to slower-than-expected sales for Unitech in FY2008. We highlight that a yoy comparison is not relevant because 4QFY07 included one-off profits from sale of assets to Unitech Corporate Parks Plc. We also observe delays in project launches for Unitech. There were fewer launches in FY2008 compared to management guidance as of September, 2006 and our reduced expectations. We also expect Unitech to raise more funds for launching its telecom operations by the end of FY2009 and for its further expansion into Mumbai. We retain our REDUCE rating on Unitech with a target price of Rs250/share. Our target price includes a terminal value of Rs27/share based on 0.5X FY2011E P/B discounted back to March 2009 to account for future investments into new businesses like telecom and the ability to expand further into cities like Mumbai. We will revisit our assumptions after the conference call today.

4QFY08 revenues below estimates due to lower-than-expected sales

Unitech reported 4QFY08 revenues of Rs11.6 bn (decline of 27% yoy, increase of 2% qoq) below our expectation of Rs17.8 bn and PAT of Rs3.6 bn (decline of 52% yoy, decline of 31% qoq) below our expectation of Rs5.6 bn. We would like to note the yoy decline is largely because of the absence of gains from asset sales. Unitech had sold six commercial assets, including IT parks and SEZ, to its affiliate Unitech Corporate Parks Plc in 4QFY07. We believe the lower-than-expected revenues were mainly because of slower sales in most of the projects, which can be attributed to the decline in affordability. We would also like to highlight that the interest costs of Rs434 mn reported by Unitech were much lower than our expectation of Rs2.1 bn, considering that the total debt outstanding for Unitech as of Mar '08 is Rs85.5 bn.

Large number of projects of Unitech have been delayed

Unitech has launched the following properties in FY2008—Grande in Noida, Gateway and Harmony in Kolkata, Uniworld City in Mohali and Greater Noida, South City Gardens in Lucknow, and Heritage Estate in Yelahanka, Bangalore.

Exhibit 3 highlights Unitech's initial plan for project launches according to which 14 projects were to be launched in FY2008. We observe that most of the launches have been delayed. Most of the projects that had to become operational in the last 18 months are yet to start, like Faridabad (earlier expected start Apr 2007), Chennai (November 2006 and June 2007), Kochi (February 2007, September 2007 and December 2007) and Hyderabad (December 2006, February 2007 and October 2007).

Though we have already built delays into our model, project launches have been lower than our ‘reduced’ expectations. We need to closely monitor the launch schedule of the projects as we are still building in significant ramp up in execution for Unitech over the next 3-4 years.

Unitech plans to raise funds for its telecom business and Mumbai real estate projects

Unitech Wireless, which has secured a pan-India GSM licence, has already got the spectrum for five circles. It is planning to launch telecom operations by the last quarter of the current financial year. There have been a few media reports which state that Unitech Wireless, a wholly-owned subsidiary of Unitech, is expected to dilute its holdings by parting with a 26% stake to a foreign partner. We expect to get more clarity on this in the management call.

Lehman Brothers Real Estate Partners (Lehman) had recently agreed to invest US$175 mn to acquire a 50% stake in the initial phase of a 127 acre SRA project on the Western Expressway of Mumbai. The project is being jointly developed by Unitech and their local Mumbai partners (Western Expressway JV). The initial phase entails development of 1 mn sq. ft of commercial estate. Unitech plans to raise more funds for the expansion of projects in Mumbai.

We retain our REDUCE rating and a Mar ’09-based target price of Rs250/share

We retain our REDUCE rating on Unitech with a target price of Rs250/share based on a Mar ’09 NAV of Rs224/share and a terminal value of Rs27/ share based on 0.5X FY2011E P/B discounted back to March 2009 basically to account for future investments into new businesses like telecom and the ability to expand further into cities like Mumbai. We would be revisiting our assumptions post the conference call today.

4QFY08 results of Unitech (Rs mn)

		qoq		yoy		Kotak estimates				Kotak estimates			FY08/FY07	FY09E/FY08
	4QFY2008	3QFY2008	% chg	4QFY2007	% chg	4QFY2008E	% chg	FY2007	FY2008	FY2008E	% chg	FY2009E	(%)	(%)
Net sales	**11,601**	**11,421**	***2***	**15,913**	***(27)***	**17,786**	***(35)***	**32,883**	**41,404**	**47,998**	***(14)***	**61,718**	***26***	***49***
(Increase) / Decrease in stock in trade	(222)	21	*(1,151)*	(67)				26,309	(133)					
Real estate, construction and other expenditure	(6,288)	(3,865)	*63*	(5,809)				(41,573)	(18,021)					
Staff Cost	(272)	(234)	*17*	(179)				(621)	(960)					
EBITDA	**4,818**	**7,344**	***(34)***	**9,859**	***(51)***	**9,669**	***(50)***	**16,998**	**22,290**	**27,077**	***(18)***	**34,690**	***31***	***56***
Other income	371	230	*61*	360	*3*	482	*(23)*	1,000	1,397	1,560	*(10)*		*12*	
Interest costs	(434)	(980)	*(56)*	(466)	*(7)*	(2,084)	*(79)*	(80)	(2,804)	(4,454)	*(37)*		*59*	
Depreciation	(89)	(55)	*62*	(20)	*356*	(254)	*(65)*	0	(205)	(371)	*(45)*		*81*	
Pretax profits	**4,666**	**6,539**	***(29)***	**9,733**	***(52)***	**7,813**	***(40)***	**17,919**	**20,678**	**23,813**	***(13)***	**31,391**	***15***	***52***
Extraordinaries	—	—	—	—	—	—	—	—	—	—	—			
Tax	(973)	(1,307)	(26)	(2,258)	*(57)*	(2,179)	*(55)*	(4,864)	(3,986)	(5,177)	*(23)*			
Deferred tax	—	—	—	—	—	—	—	—	—	(16)	*(100)*			
Net income	**3,694**	**5,232**	***(29)***	**7,475**	***(51)***	**5,633**	***(34)***	**13,055**	**16,692**	**18,620**	***(10)***	**23,966**	***28***	***44***
Adjusted net income	**3,603**	**5,258**	***(31)***	**7,480**	***(52)***	**5,633**	***(36)***	**13,055**	**16,619**	**18,620**	***(11)***			
Key ratios														
EBITDA margin (%)	41.5	64.3	*(35.4)*	62.0	*(33.0)*	54.4	*(23.6)*	51.7	53.8	56.4	*(4.6)*			
PAT margin (%)	31.8	45.8	*(30.5)*	47.0	*(32.2)*	31.7	*0.5*	39.7	40.3	38.8	*3.9*			
Effective tax rate (%)	20.8	20.0	*4.3*	23.2	*(10.1)*	27.9	*(25.3)*	27.1	19.3	21.7	*(11.3)*			

Source: Company, Kotak Institutional Equities estimates.

Segment-wise results for the quarter and full year ended March 31, 2008, March fiscal year ends

	qoq			yoy			yoy		
	4QFY2008	3QFY2008	% chg	4QFY2008	4QFY2007	% chg	FY2008	FY2007	% chg
Segment revenue									
Real estate	9,940	10,173	(2)	9,940	14,844	(33)	36,026	28,772	25
Construction	642	595	8	642	749	(14)	2,130	2,554	(17)
Consultancy	334	308	8	334	(43)	(876)	1,233	169	629
Hospitality	35	33	6	35	25	40	119	91	31
Electrical	302	75	304	302	247	22	670	844	(21)
Others	348	236	47	348	91	285	1,226	453	170
Segment EBIT									
Real estate	2,709	7,661	(65)	2,709	10,712	(75)	20,384	19,557	4
Construction	30	48	(38)	30	43	(30)	99	221	(55)
Consultancy	429	126	242	429	(43)	(1,098)	1,233	169	629
Hospitality	(14)	8	(270)	(14)	2	(675)	0	10	(98)
Electrical	59	(15)	(487)	59	40	(46)	43	37	16
Others	(21)	130	(116)	(21)	17	224	177	39	359
Segment EBIT margins (%)									
Real estate	27	75	(48)	27	72	(62)	57	68	(17)
Construction	5	8	(3)	5	6	(19)	5	9	(46)
Consultancy	129	41	88	129	100	29	100	100	(0)
Hospitality	(39)	24	(64)	(39)	10	(512)	0	11	(99)
Electrical	19	(20)	40	19	16	(20)	6	4	46
Others	(6)	55	(61)	(6)	19	132	14	8	70

Source: Company, Kotak Institutional Equities.

Launch schedule for Unitech projects post October 2006

	Area			Original schedule		
	(acres)	(mn sq. ft)	Stake (%)	Start date	End date	Current status
Gurgaon						
G1	258	3.8	50	Oct-07	Oct-10	Not launched
G5	21	1.8	62	Nov-06	May-09	Launched
G8	4	0.4	65	Apr-07	Apr-10	Not launched
G9	4	0.3	42.5	Aug-07	Aug-10	Not launched
G10	7	0.7	67	Apr-07	Apr-10	Not launched
G12	410	14.2	50	Jun-07	Jun-13	Not launched
Faridabad						
F1	10	0.9	75	Apr-07	Apr-10	Not launched
Noida						
N2	340	16.6	51	Jan-07	Jan-12	Launched a small portion
Greater noida						
GN1	183	15.8	100	Mar-07	Nov-11	Launched a small portion
Kolkata						
K2	100	6.7	45	Mar-07	Mar-13	Launched
K3	4,840	142.2	40	Jan-08	Jan-20	Not launched
Chennai						
C1	2,040	101.1	100	Jun-07	Jun-13	Not launched
C2	45	4.1	50	Nov-06	Nov-09	Not launched
Kochi						
K1	353	21.3	100	Sep-07	Apr-12	Not launched
K2	70	7.6	90	Dec-07	Dec-11	Not launched
K3	250	9.5	75	Feb-07	Feb-11	Not launched
Bangalore						
B1	36	4.0	100	Sep-07	Mar-11	Not launched
B3	53	5.8	67	Jan-07	Apr-10	Launched
Hyderabad						
H1	119	9.4	100	Feb-07	Oct-11	Not launched
H2	36	3.8	65	Feb-07	Feb-10	Not launched
H3	120	5.5	75	Dec-06	Dec-10	Not launched
H4	84		50	Oct-07	Oct-11	Not launched
Mohali						
M1	350	12.0	100	Jun-07	Jun-12	
Agra						
A1	1,500	31.3	100	Aug-07	Aug-15	
Varanasi						
V1	1,500	34.0	100	Aug-07	Aug-15	

Source: Unitech corporate presentation, September 2006.

We observe large delays in expected completion of commercial projects

Current status of various projects as part of Unitech Corporate Parks

	Saleable area (mn sq. ft)			Expected completion date				
	Commercial	Retail	Start Date	Initial	Current	Delay (months)	Leasing status	Others
G1 – ITC (Gurgaon)	3.2	0.05	Feb' 07	Jul'09	Nov'11	30	Not entered into committed leases	1st phase of 1.1 mn sq. ft likely to be completed by May 2010
G2 –IST (Gurgaon)	3.7	0.05	Oct'05	Mar'09	July'10	16	Lease signed for 0.74 mn sq. ft	As at December 2007, completed area amounts to 0.5 mn sq. ft
N1 (Noida)	2.0	0.06	Jul'06	Dec'08	Oct'09	10	Not entered into committed leases	1st phase of 0.3 mn sq. ft likely to be completed by July 2008
N2 (Noida)	3.1	0.06	Jan'07	Jun'09	Feb'11	20	Not entered into committed leases	1st phase of 0.3 mn sq. ft likely to be completed by August 2009
N3 (Greater Noida)	4.9	0.10	Jan'07	Jun'09	Mar'12	33	Not entered into committed leases	1st phase of 1.7 mn sq. ft likely to be completed by March
K1 (Kolkata)	4.3	0.10	Dec'05	Apr'10	Oct'10	6	Lease signed for 0.96 mn sq. ft	
	21.1	**0.42**						

Source: Unitech Corporate Parks Interim Report 2007.

Fewer project launches because of delays

Project launches during the first nine months of FY 2008

	Area		
	acres	(mn sq. ft)	No of apartments
Noida/Greater Noida			
The Grande	40	1.7	670
Capella (Phase 1, Uniworld city)	100	1.0	
Worlds of Wonder, Entertainment City		1.0	
Kolkata			
The Gateway	35	2.7	
Harmony (Phase 8, Uniworld city)		1.0	
Mohali			
Plotted development		5.0	
Total		**12.3**	

Source: Company data, Kotak Institutional equities.

Unitech's March' 09 based NAV is Rs250/ share

	March '09 based NAV			
	Growth rate in selling prices per annum			
	0%	3%	5%	10%
Valuation of land reserves	**284**	**338**	**378**	**492**
Residential projects	152	188	215	295
Commercial projects	66	73	78	91
Retail projects	67	77	85	106
Add: Hotel business	15	15	15	15
Add: Construction business	10	10	10	10
Add: Investments as on March 31, 2008	15	15	15	15
Add: Consultancy fees received from Unitech Corporate Parks, JVs	10	10	10	10
Less: Net debt as on March 31, 2008	(34)	(34)	(34)	(34)
Less: Land cost to be paid as on March 31, 2008	(30)	(30)	(30)	(30)
NAV (Rs bn)	**270**	**324**	**364**	**478**
NAV/share (Rs)	**166**	**200**	**224**	**295**
Terminal value based on 0.5X FY2011E P/B discounted back to FY2009	**44**	**44**	**44**	**44**
Total no. of shares (mn)				**1,624**
Valuation/share (Rs)				**251**

Source: Kotak Instutuional Equities estimates.

Profit model of Unitech Ltd, March fiscal year-ends, 2005-2010E (Rs mn)

	2005	2006	2007	2008	2009E	2010E
Total revenues	**6,573**	**9,412**	**32,883**	**41,404**	**61,718**	**82,576**
Land costs	(1,626)	(1,971)	-	-	(3,512)	(5,760)
Construction costs	(3,116)	(4,165)	(11,167)	(18,154)	(19,425)	(28,432)
Employee costs	(249)	(366)	(568)	(960)	(1,468)	(1,909)
SG&A costs	(734)	(1,077)	(1,129)	-	(2,623)	(3,509)
EBITDA	**848**	**1,834**	**20,018**	**22,290**	**34,690**	**42,966**
Other income	76	133	1,000	1,397	1,680	1,812
Interest	(246)	(465)	(3,020)	(2,804)	(4,454)	(3,812)
Depreciation	(113)	(112)	(80)	(205)	(524)	(737)
Pretax profits	**564**	**1,390**	**17,919**	**20,678**	**31,391**	**40,228**
Extraordinary items	—	—	—	—	—	—
Current tax	(220)	(521)	(4,864)	(3,967)	(7,411)	(9,899)
Deferred tax	4	8	—	(19)	(14)	(73)
Net income	**348**	**874**	**13,055**	**16,692**	**23,966**	**30,256**
Adjusted net income	**348**	**874**	**13,055**	**16,619**	**23,966**	**30,256**
EPS (Rs)						
Primary	0.2	0.5	8.0	10.2	15	19
Fully diluted	0.2	0.5	8.0	10.2	15	19
Shares outstanding (mn)						
Year end	1,623	1,623	1,623	1,623	1,623	1,623
Primary	1,623	1,623	1,623	1,623	1,623	1,623
Fully diluted	1,623	1,623	1,623	1,623	1,623	1,623
Cash flow per share (Rs)						
Primary	0	1	11	11	14	18
Fully diluted	0	1	11	11	14	18
Growth (%)						
Net income (adjusted)		151	1,394	27	44	26
EPS (adjusted)		151	1,394	27	44	26
DCF/share		151	1,217	1	29	28
Cash tax rate (%)	39	38	27	19	24	25
Effective tax rate (%)	38	37	27	19	24	25

Source: Kotak Institutional Equities estimates.

Industrials

BAJE.BO, Rs1031	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	1,350
52W High -Low (Rs)	2180 - 1007
Market Cap (Rs bn)	82.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	42.2	48.2	54.3
Net Profit (Rs bn)	7.8	8.6	9.2
EPS (Rs)	96.9	108.1	115.5
EPS gth	*5.7*	*11.6*	*6.8*
P/E (x)	10.6	9.5	8.9
EV/EBITDA (x)	4.7	3.8	3.4
Div yield (%)	2.4	2.4	2.4

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	75.9	-	-
FIIs	8.5	0.1	(0.1)
MFs	6.3	0.4	0.2
UTI	-	-	(0.2)
LIC	3.1	0.2	(0.1)

Bharat Electronics: Audited numbers better than unaudited results, reiterate ADD rating

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- **Audited numbers are significantly better than unaudited previously released, led by lower other expenses and tax**
- **Maintain estimates and ADD rating**
- **Reduce target price led by higher cost of capital assumption**

BEL has reported standalone FY2008 revenues of Rs40.6 bn (up 3% yoy), EBITDA of Rs10 bn (up 5% yoy) and PAT of Rs8 bn (up 6% yoy, adjusting for extraordinary items) versus that of Rs40.6 bn, Rs9.8 bn and Rs7.5 bn, respectively, as declared in the unaudited results. Outperformance versus unaudited results is driven by (a) lower other expenses, (b) higher other income, (c) lower effective tax rate. We reduce our FY2009E DCF-based target price of Rs1,350 from Rs 1,475 based on higher cost of capital assumption of 13.5% now versus 12.5% earlier. We highlight that BEL is currently trading at 10.1X and 9.5X our FY2009E and FY2010E EPS estimates respectively. We reiterate our ADD rating based on inexpensive valuations and highlight that the stock has outperformed the market by 8.6% since our upgrade to ADD rating on March 31, 2008.

Audited numbers significantly better than unaudited released earlier, led by lower other expenses and tax

BEL has reported standalone FY2008 revenues of Rs40.6 bn (up 3% yoy), EBITDA of Rs10 bn (up 5% yoy) and PAT of Rs8 bn (up 6% yoy, adjusting for extraordinary items) versus that of Rs40.6 bn, Rs9.8 bn and Rs7.5 bn, respectively, as declared in the unaudited results. Outperformance versus unaudited results is driven by (a) lower other expenses by Rs180 mn, (b) higher other income by 36 mn, (c) lower taxes by about 220 mn (effective tax rate has been about 30% lower versus our expectation of 32.5%.

EBITDA margin at 24.7% is higher than 24.2% from the unaudited results. EBITDA margins have expanded 90 bps yoy, due to lower other expenses (that have fallen 20.3% yoy on an absolute basis). Employee expenses in FY2008 have increased 27.5% yoy to constitute 16.2% of sales probably led by higher provision for wage revisions and grant of additional increments. Extraordinary items of Rs212 mn is related to write back of provision for encashment of leave expenses.

Maintain estimates and ADD rating, reduce target price led by cost of capital assumption

We maintain our EPS estimates for FY2009E and FY2010E respectively. We reduce our FY2009E DCF-based target price of Rs1,350 from Rs 1,475 based on higher cost of capital assumption of 13.5% now versus 12.5% earlier (Exhibit 3). We highlight that BEL is currently trading at 10X and 9X our FY2009E and FY2010E EPS estimates, respectively.

We reiterate our ADD rating and highlight that key risks arise from (1) potential long-term increase in competition given that several firms may be awarded the Raksha Udyog Ratna status, (2) lack of publicly available data points/news flows to justify more optimism and (3) infrequent investor communication and disclosures. Key upside risks arise from (a) non-defense/overseas orders, (b) strong execution over the next few quarters and also partly by the base effect of lower-than-expected performance during FY2008.

We highlight that the stock has outperformed the market by 8.6% since our upgrade to ADD rating on March 31, 2008.

Exhibit 1: BEL - key numbers - 4QFY08 (Rs mn)

	yoy			qoq			yoy		
	4QFY08	4QFY07	% change	FY08Unaudited	FY08Prov	4QFY08Prov	FY2008audited	FY2007	% change
Net Sales	**22,937**	**17,342**	***32.3***	**40,603**	**40,502**	***0.2***	**40,603**	**39,527**	***2.7***
Raw material consumed	(12,094)	(9,341)	*29.5*	(20,784)	0		(20,550)	(20,652)	*(0.5)*
Employee expenses	(1,613)	(1,427)	*13.0*	(6,404)	0		(6,592)	(5,170)	*27.5*
Other expenses	(2,245)	(1,725)	*30.1*	(3,596)	0		(3,420)	(4,290)	*(20.3)*
Total expenditure	(15,952)	(12,494)	*27.7*	(30,784)	0		(30,562)	(30,112)	*1.5*
EBITDA	**6,986**	**4,848**	***44.1***	**9,819**	**9,549**		**10,041**	**9,415**	***6.6***
Other Income	522	574	*(9.1)*	2,303	2,477	*(7.0)*	2,339	1,964	*19.1*
PBIDT	7,508	5,423	*38.5*	12,122	12,026	*0.8*	12,380	11,379	*8.8*
Interest	(1)	(0)	*75.0*	(3)	(8)	*(67.5)*	(2)	(8)	*(70.0)*
PBDT	7,507	5,422	*38.5*	12,119	12,018	*0.8*	12,377	11,371	*8.9*
Depreciation	(269)	(252)	*6.9*	(935)	(928)	*0.8*	(926)	(846)	*9.5*
PBT	**7,238**	**5,170**	***40.0***	**11,184**	**11,090**	***0.8***	**11,451**	**10,525**	***8.8***
Tax	(2,402)	(1,599)	*50.2*	(3,669)	(3,549)	*3.4*	(3,446)	(3,343)	*3.1*
PAT	**4,836**	**3,571**	***35.4***	**7,515**	**7,541**	***(0.3)***	**8,005**	**7,182**	***11.5***
Extraordinaries	212	0		65	0		212	0	
Reported PAT	**5,048**	**3,571**	***41.4***	**7,580**	**7,541**	***0.5***	**8,217**	**7,182**	***14.4***
Key ratios (%)									
Material cost ratio	*52.7*	*53.9*		*51.2*	*0.0*		*50.6*	*52.2*	
Employee cost ratio	*7.0*	*8.2*		*15.8*	*0.0*		*16.2*	*13.1*	
Other expenses	*9.8*	*9.9*		*8.9*	*0.0*		*8.4*	*10.9*	
EBITDA margin	*30.5*	*28.0*		*24.2*	*23.9*		*24.7*	*23.8*	
Effective tax rate	*32.2*	*30.9*		*32.6*	*32.0*		*30.1*	*31.8*	
PAT Margin	*22.0*	*20.6*		*18.7*	*18.6*		*20.2*	*18.2*	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 2: BEL - key consolidated numbers - FY2008 (Rs mn)

	yoy		
	FY2008	FY2007	% change
Net Sales	**42,057**	**40,515**	***3.8***
Raw material consumed	(21,672)	(22,211)	*(2.4)*
Employee expenses	(6,658)	(4,870)	*36.7*
Other expenses	(3,507)	(3,774)	*(7.1)*
Total expenditure	(31,837)	(30,855)	*3.2*
EBITDA	**10,220**	**9,659**	***5.8***
Other Income	2,459	1,887	*30.3*
PBIDT	12,678	11,547	*9.8*
Interest	(3)	(6)	*(42.9)*
PBDT	12,675	11,541	*9.8*
Depreciation	(1,007)	(953)	*5.7*
PBT	**11,668**	**10,588**	***10.2***
Tax	(3,503)	(3,343)	*4.8*
PAT	**8,165**	**7,245**	***12.7***
Extraordinaries	212	0	
Reported PAT	**8,377**	**7,245**	***15.6***
Key ratios (%)			
Material cost ratio	*51.5*	*54.8*	
Employee cost ratio	*15.8*	*12.0*	
Other expenses	*8.3*	*9.3*	
EBITDA margin	*24.3*	*23.8*	
Effective tax rate	*30.0*	*31.6*	
PAT Margin	*19.9*	*17.9*	

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 3: DCF analysis with expectation of 10% revenue growth and 18% EBIT margin over the medium term results in a target price of Rs1,350/share

DCF for Bharat Electronics, March fiscal year ends 2009E-2019E, (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	48,170	54,283	59,712	65,683	72,251	79,476	87,424	96,166	105,783	116,361	127,997
Growth (%)	*14.5*	*12.7*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*
EBIT (excl finl income)	10,832	11,581	11,345	11,823	13,005	14,306	15,736	16,348	17,983	19,781	21,760
Growth (%)	*8.3*	*6.9*	*(2.0)*	*4.2*	*10.0*	*10.0*	*10.0*	*3.9*	*10.0*	*10.0*	*10.0*
EBIT Margins	22	21	19	18	18	18	18	17	17	17	17
Effective tax rate	*32.4*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*	*32.3*
EBIT*(1-tax rate)	**7,327**	**7,836**	**7,676**	**8,000**	**8,799**	**9,679**	**10,647**	**11,061**	**12,168**	**13,384**	**14,723**
Growth (%)	*4.7*	*6.9*	*(2.0)*	*4.2*	*10.0*	*10.0*	*10.0*	*3.9*	*10.0*	*10.0*	*10.0*
Depreciation / Amortisation	1,082	1,150	1,150	1,250	1,350	1,450	1,600	1,650	1,800	1,950	2,050
Change in Working Capital	(4,971)	(4,567)	(1,628)	(1,791)	(1,970)	(2,168)	(2,384)	(2,623)	(2,885)	(3,173)	(3,491)
Capital Expenditure	(1,000)	(1,000)	(1,200)	(1,500)	(1,750)	(2,000)	(2,000)	(2,250)	(2,250)	(2,500)	(2,500)
Free Cash Flows	**2,439**	**3,419**	**5,998**	**5,958**	**6,429**	**6,962**	**7,863**	**7,839**	**8,833**	**9,661**	**10,782**
Growth (%)	*(72.1)*	*40.2*	*75.4*	*(0.7)*	*7.9*	*8.3*	*12.9*	*(0.3)*	*12.7*	*9.4*	*11.6*
Years discounted	-	1	2	3	4	5	6	7	8	9	10
Discount factor	1.00	0.88	0.78	0.68	0.60	0.53	0.47	0.41	0.36	0.32	0.28
Discounted cash flow	**2,439**	**3,012**	**4,656**	**4,075**	**3,874**	**3,696**	**3,678**	**3,231**	**3,207**	**3,091**	**3,039**

WACC calculation	
Risk-free rate (Rf)	8.5%
Beta (B)	1.0
Equity risk premium	5.0%
Expected market Return (Rm)	13.5%
Cost of Equity (Ke)	13.5%
Cost of Debt (Kd) (Post-tax)	8.0%
WACC (Beta implied)	13.5%
WACC assumed	13.5%

Terminal value calculation	
Cash flow in terminal year	10,782
g	5.0%
Capitalisation rate	8.5%
Terminal value	133,188
Discount period (years)	10
Discount factor	0.3
Discounted value	37,541

NPV calculation	**Rs mn**	**% of total**
Sum of free cash flow	37,998	36%
Terminal value	37,541	36%
Enterprise value	75,539	
Add Investments	-	
Net debt	(28,794)	28%
Net present value-equity	104,333	
Shares o/s	80.0	
NPV /share(Rs)	**1,304**	

Source: Company data, Kotak Institutional Equities estimates.

Energy

GSPT.BO, Rs57	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	68
52W High -Low (Rs)	114 - 47
Market Cap (Rs bn)	31.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	4.2	6.1	7.9
Net Profit (Rs bn)	1.0	2.0	2.9
EPS (Rs)	1.8	3.6	5.1
EPS gth	*8.5*	*103.8*	*40.2*
P/E (x)	31.9	16	11.2
EV/EBITDA (x)	10.1	7.1	5.0
Div yield (%)	0.9	1.8	2.5

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	37.8	-	-
FIIs	14.8	0.1	(0.0)
MFs	5.7	0.1	0.0
UTI	-	-	(0.1)
LIC	1.0	0.0	(0.1)

GSPL: Better-than-expected 4QFY08 results, upgraded to ADD on favorable reward-risk balance (20%)

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- **Better-than-expected results largely due to lower-than-expected depreciation**
- **Upgraded to ADD (REDUCE previously) with revised 12-month DCF-based target price of Rs68 (Rs65 previously)**
- **Earnings would depend on growth in volumes versus impact of regulations on gas transportation business**

GSPL reported 4QFY08 net income at Rs406 mn (+61% qoq, +110% yoy) versus our estimate of Rs318 mn. 4QFY08 EBITDA at Rs1 bn (+6% qoq, +44.9% yoy) was in line with our expected Rs984 mn. The variance in net income was largely due to lower-than-expected depreciation at Rs413 mn versus our expected Rs483 mn. We have fine-tuned our FY2009E, FY2010E and FY2011E EPS to Rs3.6, Rs5.1and Rs6.3, respectively from Rs4.7, Rs5.5 and Rs6.2, previously. We have upgraded the stock to ADD from REDUCE noting the 14% correction in the stock price over the past month and 20% potential upside to our revised 12-month DCF-based target price of Rs68 (Rs65 previously). We believe that GSPL will likely benefit from higher gas volumes due to increased supply of gas; however, we would watch for the nature of regulation on gas transportation business, which will largely determine GSPL's future earnings. Key downside risks stem from lower-than-expected gas supply.

Risk-reward balance favorable after recent correction; valuations look reasonable. We believe GSPL stock offers a good entry opportunity after its recent correction. GSPL stock has declined by 14% over the past one month and now offers 20% potential upside to our 12-month DCF-based target price of Rs68. At 2.2X P/B (FY2009E book) and 12.5 X FY2009E EPS, GSPL's valuations appear reasonable given the nature of its accounting (high upfront depreciation of pipelines). We focus on cash flow valuation parameters (P/CEPS or DCF) and find the valuations attractive with the stock currently trading at 1.4X FY2009E GCI (EV/GCI) and 1.2X FY2010E GCI.

We expect GSPL to benefit from sharp jump in volumes led by increased supply of gas from FY2009 (Reliance gas and imported LNG from Petronet LNG). We model gas transportation volumes for FY2009-FY2012E at 26.6 mcm/d, 42.6 mcm/d, 55.6 mcm/d and 66.6 mcm/d, respectively, versus 16.8 mcm/d in FY2008.

Finally, we see limited downside risks to our earnings estimates from imminent regulations. The nature of regulations for gas transportation business will likely determine future earnings and stock performance. We believe that GSPL's future earnings will depend on the reasonable rate of return (RROR) allowed by the regulator. We expect RROR at 14% post-tax ROCE on capital employed (gross block less accumulated depreciation plus normative working capital) as has been fixed by the regulator for city gas distribution business. We see no downside risks to our earnings estimate for GSPL if the regulator allows 14% post-tax ROCE or 21.21% pre-tax ROCE. On a capital employed base of Rs29 bn for FY2009E (gross block plus working capital), we compute, GSPL's EBIT at Rs6.1 bn, which is significantly higher than our FY2009E and FY2010E EBIT of Rs3.6 bn and Rs4.9 bn. Even if the capital employed used by the regulator factors in reasonable depreciation (GSPL has an aggressive depreciation policy with a rate of 8.33%), we compute that 'allowed' EBIT will likely be higher versus our estimates.

4QFY08 results highlights

1. **Higher revenues despite lower volumes and flat tariffs qoq in 4QFY08.** GSPL's reported 4QFY08 revenues at Rs1.16 bn (+5% qoq) despite lower volumes at 1.6 bcm (-0.6%qoq). The management has stated that the actual tariffs were flat qoq, even though the computed transmission tariffs (net revenues divided by volumes) were higher at Rs0.72/cu m versus Rs0.68/ cu m in 3QFY08. The management has attributed the increase in revenues, despite lower volumes and flat tariffs to 'take or pay' arrangement with customers. Under the arrangement, if the customers do not take the gas, the amount receivable from the customers gets accounted in the revenues but is not reflected in the volumes.

2. **Lower-than-expected depreciation.** GSPL's 4QFY08 depreciation cost was lower-than-expected at Rs413 mn (-0.1% qoq and +20% yoy) versus our expected Rs483 bn due to lower-than-expected expenditure on smaller pipelines.

3. **Higher employee costs.** GSPL's 4QFY08 employee cost was higher at Rs34 mn (+130% qoq and +175% yoy) reflecting provision of Rs13.6 mn for pay revision of employees effective July 1, 2006.

Earnings revision

We have revised FY2009E, FY2010E and FY2011E EPS to Rs3.6, Rs5.1 and Rs6.3, respectively, from Rs4.7, Rs5.5 and Rs6.2 previously to reflect lower gas transportation volumes in the new pipelines (Bharuch-Anand-Rajkot-Jamnagar pipeline and Mora-Vapi pipeline). We expect gas transmission volumes for FY2009E-12E to scale up to 26.6 mcm/d, 42.6 mcm/d, 55.6 mcm/d and 66.6 mcm/d, respectively versus 16.8 mcm/d in FY2008.

Interim results of GSPL, March fiscal year-ends (Rs mn)

		qoq			yoy			yoy		
	2009E	4Q 2008	3Q 2008	*(% chg.)*	4Q 2008	4Q 2007	*(% chg.)*	2008	2007	*(% chg.)*
Net sales	**6,096**	**1,161**	**1,106**	***4.9***	**1,161**	**831**	***39.7***	**4,179**	**3,176**	***31.6***
Total expenditure	(672)	(131)	(135)	*(2.7)*	(131)	(121)	*8.8*	(534)	(495)	*7.8*
Inc/(Dec) in stock	—	—	—	—	—	—	—	—	—	—
Operating costs	(327)	—	—	—	—	—	—	—	—	—
Gas transportation charges	—	—	—		—	3	—	(14)	(72)	*(80.0)*
Connectivity charges	—	(24)	(28)	*(14.4)*	(24)	(22)	—	(112)	(131)	*(14.1)*
Staff cost	(76)	(34)	(15)	*130.1*	(34)	(12)	*175.4*	(76)	(40)	*91.9*
Other expenditure	(269)	(74)	(92)	*(20.2)*	(74)	(90)	*(18.0)*	(331)	(253)	*31.0*
EBITDA	**5,423**	**1,030**	**972**	***6.0***	**1,030**	**711**	***44.9***	**3,645**	**2,681**	***36.0***
OPM (%)	**89.0**	**88.7**	**87.8**		**88.7**	**85.5**		**87.2**	**84.4**	
Other income	186	88	96	*(8.7)*	88	50	*75.8*	294	175	*68.4*
Interest	(840)	(203)	(208)	*(2.6)*	(203)	(164)	*23.5*	(815)	(457)	*78.6*
Depreciation	(2,015)	(413)	(414)	*(0.1)*	(413)	(345)	*20.0*	(1,632)	(1,026)	*59.1*
Pretax profits	**2,755**	**502**	**446**	***12.5***	**502**	**252**	***99.1***	**1,492**	**1,373**	***8.7***
Extraordinaries/sales tax benefit	—	—	—		—	—		—	—	
Tax	(312)	(134)	(150)	—	(134)	70	—	(410)	(70)	*484.3*
Deferred taxation	(407)	38	(44)	*(187.2)*	38	(130)	*(129.3)*	(82)	(409)	*(79.9)*
Net income	**2,036**	**406**	**252**	***61.0***	**406**	**193**	***110.4***	**999**	**894**	***11.8***
Adjusted profits	**2,036**	**406**	**252**	***61.0***	**406**	**193**	***110.4***	**999**	**894**	***11.8***
Income tax rate (%)	*26.1*	*19.2*	*43.5*		*19.2*	*23.5*		*33.0*	*34.9*	
Pipline volumes										
Pipeline volumes (mcm)	9,691	1,614	1,623	*(0.6)*	1,614	1,398	*15.5*	6,145	5,246	*17.1*
Gas transmission charge (Rs/cu m)	0.63	0.72	0.68	*5.5*	0.72	0.59	*21.0*	0.68	0.61	*12.4*

Source: Company, Kotak Institutional Equities estimates.

DCF valuation of GSPL (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBITDA	5,423	7,064	7,930	8,745	8,623	8,604	8,583	8,562	8,539	8,516	8,516	8,516
Adjusted tax expense	(407)	(1,566)	(2,052)	(2,421)	(2,455)	(2,511)	(2,565)	(2,622)	(2,673)			
Change in working capital	111	(36)	(54)	(50)	6	—	—	—	—			
Operating cash flow	**5,127**	**5,462**	**5,824**	**6,273**	**6,173**	**6,093**	**6,018**	**5,940**	**5,866**			
Capital expenditure	(3,750)	(250)	(250)	(250)	(250)	(250)	(250)	(250)	(250)			
Free cash flow	**1,377**	**5,212**	**5,574**	**6,023**	**5,923**	**5,843**	**5,768**	**5,690**	**5,616**	**4,600**	**4,600**	**4,600**
Discounted cash flow	**1,265**	**4,274**	**4,081**	**3,936**	**3,456**	**3,044**	**2,683**	**2,362**	**2,082**			
Discounted cash flow-1 year forward		4,787	4,571	4,410	3,871	3,409	3,005	2,647	2,332	1,523		
Discounted cash flow-2 year forward			5,120	4,939	4,337	3,818	3,366	2,964	2,612	1,910	1,705	

	Now	+ 1-year	+ 2-years
Discount rate (%)	12.0	12.0	12.0
Total PV of free cash flow	28,707	31,914	32,294
Terminal value assumption			
Growth to perpetuity (%)	—	—	—
FCF in 2018E	4,600	4,600	4,600
Exit FCF multiple (X)	8.3	8.3	8.3
Exit EV/EBITDA multiple (X)	4.5	4.5	4.5
Terminal value	38,335	38,335	38,335
PV of terminal value	14,211	14,211	14,211
Total company value	**42,918**	**46,125**	**46,506**
Net debt	7,983	7,920	3,960
Equity value	34,935	38,205	42,545
Shares outstanding (mn)	562	562	563
Estimated share price using DCF	**62**	**68**	**76**

Fiscal Year end (March 31, XXXX)	March-09	March-10	March-11	March-12	March-13	March-14	March-15	March-16	March-17	March-18	March-19	March-20
Today	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08	30-Jun-08
Days left	274	639	1,004	1,370	1,735	2,100	2,465	2,831	3,196	3,561	3,926	4,292
Years left	0.75	1.75	2.75	3.75	4.75	5.75	6.75	7.76	8.76	9.76	10.76	11.76
Discount factor at WACC	**0.92**	**0.82**	**0.73**	**0.65**	**0.58**	**0.52**	**0.47**	**0.42**	**0.37**	**0.33**	**0.30**	**0.26**

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	4,179	6,096	7,907	8,891
EBITDA	**1,293**	**1,942**	**2,677**	**3,645**	**5,423**	**7,064**	**7,930**
Other income	20	45	175	294	186	162	147
Interest	(363)	(413)	(457)	(815)	(840)	(700)	(428)
Depreciation	(656)	(791)	(1,026)	(1,632)	(2,015)	(2,298)	(2,298)
Pretax profits	293	783	1,369	1,492	2,755	4,228	5,351
Tax	(15)	(2)	(70)	(410)	(312)	(1,344)	(1,900)
Deferred taxation	(119)	(315)	(409)	(82)	(407)	(31)	81
Net profits	**160**	**467**	**894**	**999**	**2,036**	**2,854**	**3,532**
Earnings per share (Rs)	**0.6**	**1.2**	**1.6**	**1.8**	**3.6**	**5.1**	**6.3**
Balance sheet (Rs mn)							
Total equity	4,037	9,075	9,659	11,392	12,763	14,682	14,082
Deferred tax liability	193	508	917	999	1,406	1,437	1,356
Total borrowings	4,436	5,786	8,638	10,093	9,508	5,258	3,758
Currrent liabilities	571	1,771	1,845	878	878	879	880
Total liabilities and equity	**9,237**	**17,140**	**21,059**	**23,362**	**24,555**	**22,256**	**20,076**
Cash	426	2,372	1,811	2,110	1,588	1,298	1,111
Current assets	408	995	2,126	2,289	2,178	2,216	2,271
Total fixed assets	8,392	13,651	17,029	18,869	20,695	18,649	16,601
Investments	—	—	—	—	—	—	—
Deferred expenditure	11	123	93	93	93	93	93
Total assets	**9,237**	**17,140**	**21,059**	**23,362**	**24,555**	**22,256**	**20,076**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	844	1,562	2,212	2,345	4,181	5,019	5,602
Working capital changes	(193)	471	(1,058)	(1,130)	111	(36)	(54)
Capital expenditure	(1,799)	(6,049)	(4,404)	(3,400)	(3,750)	(250)	(250)
Investments	—	—	—	—	—	—	—
Other income	10	40	146	294	186	162	147
Free cash flow	**(1,138)**	**(3,976)**	**(3,103)**	**(1,891)**	**728**	**4,894**	**5,445**
Ratios (%)							
Debt/equity	104.9	60.4	81.7	81.5	67.1	32.6	24.3
Net debt/equity	51.2	37.6	45.0	44.9	40.2	24.6	19.6
RoAE	4.6	6.8	8.8	8.7	15.3	18.8	22.4
RoACE	**8.0**	**9.9**	**10.0**	**8.0**	**13.8**	**14.9**	**18.4**
CROCI	**13**	**13**	**13**	**12**	**17**	**19**	**20**
Key assumptions							
Volumes-old pipelines (mcm/d)	8.3	10.4	12.6	12.7	17.0	20.0	25.0
Volumes-new pipelines (mcm/d)	—	—	1.7	4.1	9.6	22.6	30.6
Volumes (mcm/d)	**8.3**	**10.5**	**14.3**	**16.8**	**26.6**	**42.6**	**55.6**

Source: Kotak Institutional Equities estimates.

Energy

RELI.BO, Rs2183	
Rating	RS
Sector coverage view	Cautious
Target Price (Rs)	-
52W High -Low (Rs)	3298 - 1676
Market Cap (Rs bn)	2,869

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,334	1,668	2,424
Net Profit (Rs bn)	142.5	157.8	277.6
EPS (Rs)	101.7	104.2	176.4
EPS gth	*23.0*	*2.5*	*69.3*
P/E (x)	21.5	20.9	12.4
EV/EBITDA (x)	12.8	10.5	5.6
Div yield (%)	0.6	0.7	1.0

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.2	-	-
FIIs	21.5	9.3	0.7
MFs	2.7	6.3	(2.3)
UTI	-	-	(8.6)
LIC	4.9	10.1	1.5

Reliance Industries: Tax benefit on gas production removed: Sad but true

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- **Petroleum ministry clarifies that the income tax benefit is not available on gas production (for NELP-VII bidding)**
- **Gas utilization policy suggests no gas will be available for internal consumption in FY2009E**
- **Cut earnings estimates for RIL for removal of tax benefits and non-availability of gas for internal consumption initially**

The petroleum ministry has clarified that the seven-year income tax holiday under Section 80 IB of the Income Tax Act available is only for commercial production of crude oil and not for natural gas. This clarification, issued for the benefit of prospective bidders for NELP-VII round, partly addresses confusion that has prevailed since the Union Budget 2009 of whether the government had removed the seven-year income tax exemption on production of gas under the new exploration and licensing policy (NELP). Also, we believe that RIL will not able to use gas for internal use (refinery and chemical plants) from the initial volumes, given the order of priority specified by an Empowered Group of Ministers (EGoM). However, we expect RIL to be able to use gas out of higher production in FY2010E and beyond. We have revised our consolidated EPS estimates for FY2009E, FY2010E and FY2011E to Rs104, Rs176 and Rs170, respectively, from Rs119, Rs193 and Rs188 to factor in the above-mentioned developments. Key upside risks to earnings stem from stronger-than-expected refining and chemical cycle.

Valuations had started to look reasonable but these developments are negative for earnings. We expect the above-highlighted developments to result in a large negative impact on earnings. We compute RIL's FY2009E and FY2010E EPS would drop to Rs104 and Rs176 from Rs119 and Rs193. Our fair valuation of RIL stock would drop to around Rs2,175 from around Rs2,400 previously (see Exhibits 1 and 2). We note that the upstream segment's profits would increase steeply in FY2009E and FY2010E and largely drive RIL's overall earnings (see Exhibit 3).

Our reverse valuation exercise for RIL (Exhibit 4) shows that RIL's valuations at the current stock price appear reasonable. However, the aforementioned tax changes will result in meaningful downgrades to earnings. We note that the implied value of new E&P discoveries has declined to about US$4 bn from a high of US$35 bn in early January 2008 (stock price around Rs3,000).

Removal of tax exemption leads to about Rs17-18 impact on EPS. We have cut our earnings estimates for Reliance Industries to factor in the fact that the seven-year tax exemption under Section 80 IA will be available for production of crude oil only and not for production of natural gas. We assume the clarification issued for NELP-VII bidding will also apply to all new gas production (includiing under previous NELP rounds). This has depressed FY2010E, FY2011E and FY2012E EPS by 9%, 10% and 10%, respectively. Our valuation for RIL's KG D-6 block also declines to US$8.4 bn from US$10.3 bn due to the removal of the tax holiday.

The petroleum ministry has recently clarified that the seven-year income tax holiday available under section 80 IB of the Income Tax Act will 'as of now' be available for commercial production of crude oil only and not for production of natural gas. This clarification was issued on the advice of the ministry of finance to remove the prevailing confusion ahead of the last date of submissions of bid for NELP VII (June 30).

It is possible that the government may review its current position and reinstate the benefit later. We find the fact that tax exemption is available only to crude oil and not to gas illogical given (1) a discovery can be of crude oil or gas and it is impossible to divine the nature of hydrocarbon before a discovery (if any), (2) exploration risks and costs will be same despite the fact that gas is less remunerative versus oil currently and will likely remain so in the future, (3) gas is a hydrocarbon/fossil fuel like crude oil and serves the same purpose (of a fuel) as crude oil, (4) natural gas will play an increasingly important role in improving India's energy security and meeting India's rising deficit of energy and (5) a stable fiscal regime is critical for attracting investments in the E&P sector; the exploration efforts of companies like RIL have only now started to translate into production and a stable fiscal regime is critical to attract more investments (domestic and international) in the sector.

Gas may not be available for internal consumption initially. As per the gas utilization policy finalized by the EGoM, we believe that RIL may not be in a position to utilize the gas for internal consumption (for its refinery, chemical plants and RPET's refinery) immediately. As per the EGoM, production will start at 25 mcm/d in September 2008 and will increase to 40 mcm/d by March 2009. However, we expect RIL to consume around 15 mcm/d for its internal consumption once the production ramps up to 70 mcm/d in FY2010E and 90 mcm/d in FY2011E. We have revised our FY2009E EPS for RIL and RPET to factor in use of liquid fuels for heating purposes instead of gas from RIL's KG D-6 gas. However, we see moderate risk to our FY2010E EPS of RIL and RPET in case RIL is not able to use gas for internal use in FY2010E as well due to (1) slower-than-expected ramp-up in gas volumes and/or (2) commitment to supply higher quantities to high priority sectors.

We are still waiting for resolution for the legal dispute between RIL and RNRL and see any unfavorable development as a further negative for RIL. The Mumbai High Court could eventually remove the stay order on sale of gas to third parties (other than to RIL, RNRL and NTPC) in the interest of the nation. We do not envisage a situation of gas production remaining idle given the huge shortage of gas and energy in India although we note that the government cannot prevail upon the judiciary to lift the stay order. We assume RIL will supply gas to RNRL at an appropriate price when RNRL or its associates are in a position to consume gas (FY2012) and RIL will sell gas to other consumers in the interim period. Exhibit 5 gives our best estimate of the use of RIL's KG D-6 gas.

Valuation of Reliance Industries stock (Rs)

	FY2010E EPS (Rs)	P/E (X)	Valuation (Rs/share)	Comments
Chemicals, refining, E&P (a) (b)	202	10	2,020	Consolidated FY2010E EPS including Reliance Petroleum
Valuation based on FY2010E EPS			**1,849**	**12.5% discount rate; discounted to June, 2009**
E&P (higher reserves in KG-DWN-98/3, other blocks)			—	We model 0.93 tcf of gas per annum production in perpetuity
E&P (NEC-25, CBM)			88	Based on KG D-6 reserves and valuation
New chemical projects (PX, new olefins complex)			26	
Investments			209	
Other investments			1	
Retailing			148	US$4.9 bn valuation; ~US$1 bn equity invested in Reliance Retail as of end-FY2008
SEZ development			60	SEZs will require investment for the first few years
12-month fair valuation			**2,172**	

Notes:
(a) FY2010E EPS is Rs176 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.

SOTP valuation of Reliance is Rs1,900 per share on FY2010E estimates

Sum-of-the-parts valuation of Reliance Industries, FY2010E basis (Rs)

	Valuation base (Rs bn)		Multiple (X)		EV	Value share
	Other	EBITDA	Muliple	EV/EBITDA	(Rs bn)	(Rs)
Chemicals		78		6.0	468	340
Refining & Marketing (a)		64		6.0	385	280
Oil and gas—producing		33		5.0	166	121
Gas—developing (DCF-based) (b)	555	—	100%	—	555	404
Oil—KG-DWN-98/3 (c)	97	—	100%	—	97	71
Investments						
RPL (3.167 bn shares at Rs200)	633	—	100%	—	633	461
Others	2	—	100%	—	2	1
Retailing	204	—	100%	—	204	148
SEZ development	75	—	100%	—	75	54
Total					**2,488**	**1,881**
PV of refining division's future sales tax incentives					2	2
Total value					**2,490**	**1,882**
Net debt					3	2
Implied equity value					**2,487**	**1,880**

Note:

(a) R&M EBITDA computed assuming no use of gas for refining processes.

(b) We value the KG D-6 gas find on DCF and offshore Orissa (NEC-25) and CBM discoveries based on KG D-6's valuation.

(c) 180 mn bbls of recoverable reserves based on gross OOIP of 0.5 bn bbls.

(d) Net debt reflects a standalone (without RPL) scenario; however, we consolidate for RPL otherwise as it a 75% subsidiary.

(e) We use 1.374 bn shares (excluding treasury shares) for our per share computation.

Source: Kotak Institutional Equities estimates.

Upstream segment EBITDA growth to power overall EBITDA growth

Segment breakdown of Reliance's standalone financials, March fiscal year-ends, 2005-2012E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E	2012E
Revenues								
Chemicals	261,572	295,579	480,207	496,602	601,417	574,925	544,971	528,199
Refining & marketing	477,051	661,079	834,161	1,004,123	929,204	945,759	922,119	898,038
Others (incl. Upstream)	26,153	17,707	24,681					
Upstream				50,282	113,411	225,827	248,158	283,852
Inter-divisional sales	(103,579)	(148,544)	(203,348)	(179,540)	(191,348)	(175,765)	(164,008)	(158,418)
Total	**661,197**	**825,822**	**1,135,701**	**1,371,467**	**1,452,683**	**1,570,746**	**1,551,241**	**1,551,672**
EBITDA								
Chemicals	51,107	58,748	93,703	97,976	69,250	77,938	67,400	60,368
Refining & marketing	60,952	70,186	95,065	125,243	85,089	113,263	98,712	93,185
Others (incl. Upstream)	14,207	13,340	17,204	1,963				
Upstream				20,685	84,442	162,719	174,632	200,178
Unallocated	(2,446)	(2,282)	(184)	(2,185)	—	—	—	—
Total	**123,819**	**139,991**	**205,789**	**243,681**	**238,781**	**353,920**	**340,744**	**353,731**
EBIT								
Chemicals	31,911	44,267	67,423	73,862	44,861	53,137	45,146	39,924
Refining & marketing	45,203	52,879	76,643	105,959	66,979	95,064	80,351	74,660
Sales tax incentives	4,290	3,418	2,000	—	—	—	—	—
Others (incl. Upstream)	11,918	11,118	13,002	1,248				
Upstream				15,198	66,578	131,189	134,924	152,389
Unallocated	(2,446)	(2,700)	(274)	(2,628)	—	—	—	—
Total	**90,875**	**108,982**	**158,794**	**193,639**	**178,418**	**279,390**	**260,420**	**266,973**
Pretax profits								
Chemicals	21,870	41,669	61,963	64,376	38,274	50,867	43,639	38,463
Refining & marketing	39,195	45,601	67,328	102,918	64,529	93,473	81,720	75,439
Sales tax incentives	4,290	3,418	2,000	—	—	—	—	—
Others (incl. Upstream)	11,918	11,118	13,002	1,248				
Upstream				15,198	66,578	131,189	134,924	152,389
Other income	14,498	6,829	4,783	8,953	15,210	14,900	22,627	36,558
Unallocated	(2,446)	(2,700)	(274)	44,702	—	—	—	—
Total	**89,324**	**105,935**	**148,802**	**237,396**	**184,591**	**290,430**	**282,910**	**302,849**

Source: Kotak Institutional Equities estimates.

RIL stock price is implying moderate discoveries of hydrocarbons in the future

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**
FY2008 EPS of Reliance (Rs)	105.0	FY2008 EPS included about Rs17 of adventitious gains
FY2008 EPS adjusted for treasury shares (Rs)	121.7	Adjusted for 199 mn treasury shares
Effective tax rate in FY2008 (%)	15.4	
FY2008 EPS adjusted for tax rate	95.0	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)	**855**	
Valuation of extant businesses	**26**	**Reasonable in the context of replacement value, returns**
2. Valuation of investments		**RPL, others (without Reliance Retail)**
Reliance Petroleum	505	3.167 bn shares at 12-month fair valuation of Rs200
Others and cash at end-FY2008E	69	
Total value of investments	**574**	
Valuation of RIL ex-new E&P, retailing, SEZs	**1,429**	
Current stock price	2,183	
3. Valuation of new businesses		**Emerging E&P business, retailing, SEZs**
Market-ascribed value of new businesses	**754**	
Market-ascribed value of new businesses (US$ bn)	**23**	
Estimated valuation of retailing (US$ bn)	4.9	Reliance has invested ~US$1 bn equity in Reliance Retail as of end-FY2008
Estimated valuation of SEZs (US$ bn)	1.8	Value will take time to emerge
Market-ascribed value of emerging E&P business	**16**	**Seems reasonable to us based on official reserves, announced discoveries**
Estimated value of Reliance's stake in KG D-6 (gas)	7.5	Based on gas production of 17 tcf, US$8.8 bn capex, US$4.2/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	1.6	Based on 5.1 tcf of production, US$1.15 bn capex, US$4.5/mn BTU
Estimated value of Reliance's stakes in CBM	1.4	Based on 2.8 tcf of production
Implied value of new discoveries	**4**	

Source: Kotak Institutional Equities estimates.

Power, fertilizer and internal consumption to account for the bulk of KG D-6 gas sales

Supply and potential sales of gas from RIL's KG D-6 block (mcm/d)

		Comments
Reliance KG D-6 gas peak production	**80**	**This could increase to 120 mcm/d**
1. Firm demand		
Consumption in RIL and RPET refineries and RIL's chemical plants	15	
Shortfall of gas for power sector in KG-basin area	5	Shortage of about 5 mcm/d
Conversion of FO/naphtha urea units to gas	10	Most units can switch to gas quickly as pipeline infrastructure exists
Consumption in BPCL and HPCL Mumbai refineries	4	
Sub-total	**34**	
2. Firm demand in short/medium term		
Replacement of FO/LSHS from industrial units	20	This will likely take time given wide disperson of consumption
New power generation capacity in KG-basin area	13	3,433 MW of new capacity
Sub-total	**33**	
3. Likely demand in medium term		
NTPC gas supply	10	Construction of 2 X 1,300 MW power plants not commenced
RNRL/REL gas supply	40	Construction of 10,280 MW power plant not commenced
New power generation plants in KG-basin area	8	2,100 MW plant of AP GENCO
City gas distribution	5	Submitted plans to various state governments; will take time
Sub-total	**64**	
Total	**131**	

Source: Kotak Institutional Equities estimates.

Potential demand from power sector can be large

Potential demand for gas from power sector by FY2012E (mcm/d)

Existing gas based power capacity (MW)	13,989
Gas required to operate at 90% PLF (mcm/d)	55
Gas currently supplied to gas-based plants (a)	33
Potential additional gas consumption by existing gas-based plants	22
Power capacity likely to come by FY2012E (MW)	24,389
Additional demand for gas from projects under implementation	95
Total likely additional demand for gas in medium term (b)	117
Naphtha/gas based power projects at planning stage (MW)	7,952
Potential gas requirement if all planned projects implemented (c)	31
Additional demand for gas in medium term (b) + (c)	148
Probable total future gas requirement from power utilities (a) + (b) + (c)	**181**

Note:
(a) Data excludes electricity generation by captive plants.

Source: Ministry of power, Kotak Institutional Equities estimates.

Potential demand from fertilizer sector exists

Gas consumption (current and potential by FY2012E) in fertilizer sector (mcm/d)

Urea capacity ('000 tons)	
Gas-based capacity	14,718
Naphtha-based capacity (a)	4,182
Fuel oil-based capacity (b)	2,138
Total current capacity	**21,037**
Naphtha/NG-based projects under consideration	7,081
Extant units closed currently (c)	3,898
Demand for natural gas (mcm/d)	
Existing demand from fertilizer units	23.3
Additional demand from conversion of non-gas units (a) + (b) + (c)	14.4
Additional demand from new units	10.0
Potential demand for additional gas (mcm/d)	24.5
Potential demand for gas in medium term (mcm/d)	**47.7**

Source: The Fertilizer Association of India, Kotak Institutional Equities estimates.

Reliance has high leverage to refining margins

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

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	41.0	42.0	43.0	40.5	41.5	42.5	40.0	41.0	42.0
Net profits (Rs mn)	144,825	150,538	156,251	201,382	208,097	214,812	195,406	201,997	208,589
EPS (Rs)	95.7	99.5	103.2	128.0	132.3	136.5	124.2	128.4	132.6
% upside/(downside)	**(3.8)**		**3.8**	**(3.2)**		**3.2**	**(3.3)**		**3.3**
Chemical prices									
Change in prices (%)	(5.0)		5.0	(5.0)		5.0	(5.0)		5.0
Net profits (Rs mn)	146,767	150,538	154,309	203,976	208,097	212,218	198,124	201,997	205,871
EPS (Rs)	97.0	99.5	102.0	129.6	132.3	134.9	125.9	128.4	130.8
% upside/(downside)	**(2.5)**		**2.5**	**(2.0)**		**2.0**	**(1.9)**		**1.9**
Refining margins (US$/bbl)									
Margins (US$/bbl)	11.9	12.9	13.9	13.5	14.5	15.5	12.2	13.2	14.2
Net profits (Rs mn)	141,382	150,538	159,694	201,615	208,097	214,579	195,594	201,997	208,401
EPS (Rs)	93.4	99.5	105.5	128.1	132.3	136.4	124.3	128.4	132.5
% upside/(downside)	**(6.1)**		**6.1**	**(3.1)**		**3.1**	**(3.2)**		**3.2**

Source: Kotak Institutional Equities estimates.

Reliance Petroleum has high leverage to refining margins

Sensitivity of RPL's earnings to key variables

	Fiscal 2009E			Fiscal 2010E			Fiscal 2011E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Rupee-dollar exchange rate									
Rupee-dollar exchange rate	41.0	42.0	43.0	40.5	41.5	42.5	40.0	41.0	42.0
Net profits (Rs mn)	9,508	19,149	11,017	95,096	98,761	102,426	88,699	92,052	95,404
EPS (Rs)	2.1	4.3	2.4	21.1	21.9	22.8	19.7	20.5	21.2
% upside/(downside)	**(50.3)**		**(42.5)**	**(3.7)**		**3.7**	**(3.6)**		**3.6**
Refining margins (US$/bbl)									
Margins (US$/bbl)	11.3	12.3	13.3	15.1	16.1	17.1	14.0	15.0	16.0
Net profits (Rs mn)	7,963	19,149	12,562	89,984	98,761	107,538	83,380	92,052	100,723
EPS (Rs)	1.8	4.3	2.8	20.0	21.9	23.9	18.5	20.5	22.4
% upside/(downside)	**(58.4)**		**(34.4)**	**(8.9)**		**8.9**	**(9.4)**		**9.4**

Source: Kotak Institutional Equities estimates.

RIL consolidated with RPL: Profit model, balance sheet, cash model, March fiscal year-ends, 2005-2012E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E	2012E
Profit model (Rs mn)								
Net sales	656,223	809,113	1,114,927	1,334,430	1,668,096	2,424,103	2,381,419	2,360,701
EBITDA	**123,820**	**139,991**	**198,462**	**233,056**	**264,728**	**484,261**	**456,250**	**464,788**
Other income	14,498	6,829	4,783	8,953	15,279	15,090	22,877	37,987
Interest	(14,687)	(8,770)	(13,247)	(15,509)	(19,793)	(20,741)	(8,852)	(2,311)
Depreciation & depletion	(37,235)	(34,009)	(48,152)	(48,471)	(65,350)	(89,321)	(95,223)	(101,765)
Pretax profits	86,397	104,041	141,846	178,028	194,864	389,289	375,052	398,698
Extraordinary items	4,290	3,000	2,000	47,335	—	—	—	—
Tax	(7,050)	(9,307)	(16,574)	(26,520)	(36,203)	(84,388)	(87,527)	(98,263)
Deferred taxation	(7,920)	(7,040)	(9,196)	(8,999)	2,140	1,957	6,524	10,237
Minority interest	—	—	—	—	(3,040)	(29,253)	(27,266)	(28,362)
Net profits	75,717	90,693	118,076	189,844	157,761	277,605	266,783	282,311
Adjusted net profits	**72,135**	**88,152**	**116,434**	**147,869**	**157,761**	**277,605**	**266,783**	**282,311**
Earnings per share (Rs)	**51.7**	**63.3**	**80.1**	**101.7**	**104.2**	**176.4**	**169.6**	**179.4**
Balance sheet (Rs mn)								
Total equity	404,033	430,543	673,037	847,853	1,134,993	1,377,104	1,608,084	1,831,070
Deferred taxation liability	42,668	49,708	69,820	78,725	76,585	74,629	68,105	57,868
Minority interest	—	—	33,622	33,622	36,188	58,246	78,626	92,036
Total borrowings	187,846	218,656	332,927	493,072	331,230	151,342	56,104	28,702
Currrent liabilities	171,315	164,545	192,305	251,427	281,422	317,688	312,387	305,400
Total liabilities and equity	**805,863**	**863,452**	**1,301,712**	**1,704,700**	**1,860,418**	**1,979,008**	**2,123,306**	**2,315,075**
Cash	36,087	21,461	18,449	42,822	4,034	(10,185)	106,559	255,522
Current assets	248,438	224,283	286,566	402,721	479,529	579,547	573,407	567,209
Total fixed assets	350,823	626,745	899,403	1,081,638	1,166,834	1,162,127	1,155,820	1,189,825
Investments	170,515	(9,038)	97,294	177,519	210,019	247,519	287,519	302,519
Deferred expenditure	—	—	—	—	—	—	—	—
Total assets	**805,863**	**863,452**	**1,301,712**	**1,704,700**	**1,860,418**	**1,979,008**	**2,123,305**	**2,315,075**
Free cash flow (Rs mn)								
Operating cash flow, excl. working cap	107,002	119,520	164,285	180,718	202,401	377,501	357,293	362,329
Working capital	46,875	(32,188)	(13,075)	(31,071)	(46,815)	(63,751)	838	(788)
Capital expenditure	(52,440)	(94,273)	(247,274)	(239,691)	(136,077)	(82,983)	(86,338)	(133,886)
Investments	(48,192)	(32,364)	(105,760)	(78,953)	(32,500)	(37,500)	(40,000)	(15,000)
Other income	3,032	5,159	4,143	6,132	15,279	15,090	22,877	37,987
Free cash flow	**56,276**	**(34,146)**	**(197,681)**	**(162,865)**	**2,289**	**208,358**	**254,671**	**250,642**
Ratios (%)								
Debt/equity	42.1	45.5	44.8	53.2	27.3	10.4	3.3	1.5
Net debt/equity	34.0	41.1	42.3	48.6	27.0	11.1	(3.0)	(12.0)
RoAE	17.6	19.9	20.1	18.3	15.1	21.2	17.2	15.9
RoACE	**13.0**	**13.8**	**13.9**	**12.6**	**11.5**	**19.9**	**17.5**	**16.6**

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	228,509	874,759	851,322	829,658	808,039	807,162
EBITDA	**34,841**	**130,341**	**115,506**	**111,057**	**106,622**	**105,492**
Other income	69	190	251	1,429	2,519	2,374
Interest (expense)/income	(10,756)	(16,881)	(8,715)	(1,630)	—	—
Depreciation	(4,986)	(14,791)	(14,899)	(15,007)	(15,116)	(15,224)
Pretax profits	**19,168**	**98,859**	**92,142**	**95,849**	**94,025**	**92,642**
Extraordinary items	—	—	—	—	—	—
Tax	(19)	(98)	(91)	(95)	(93)	(13,347)
Deferred taxation	—	—	—	—	—	1,624
Net income	**19,149**	**98,761**	**92,052**	**95,754**	**93,932**	**80,920**
Earnings per share (Rs)	**2.3**	**21.9**	**20.5**	**21.3**	**20.9**	**18.0**
Balance sheet						
Total equity	144,752	232,984	314,506	368,142	352,178	338,426
Deferred taxation liability	—	—	—	—	—	(1,624)
Total borrowings	165,775	119,775	26,075	—	—	—
Current liabilities	16,976	60,051	59,348	57,942	56,535	56,535
Total liabilities and equity	**327,503**	**412,810**	**399,929**	**426,084**	**408,713**	**393,337**
Cash	2,272	5,079	7,867	50,267	40,238	38,149
Other current assets	42,881	138,172	135,401	132,163	129,051	128,987
Net fixed assets	266,854	254,063	241,164	228,157	215,041	201,817
Capital work-in-progress	—	—	—	—	—	—
Investments	24,383	24,383	24,383	24,383	24,383	24,383
Deferred expenditure	—	—	—	—	—	—
Total assets	**336,390**	**421,697**	**408,816**	**434,970**	**408,713**	**393,337**
Free cash flow						
Operating cash flow, excl. working capital	15,180	113,362	106,700	109,332	106,529	92,145
Working capital changes	(20,289)	(52,214)	2,067	1,832	1,706	64
Capital expenditure	(39,097)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Investments	—	—	—	—	—	—
Other income	69	190	251	1,429	2,519	2,374
Free cash flow	**(42,447)**	**57,647**	**107,018**	**110,593**	**108,754**	**92,583**
Ratios (%)						
Debt/equity	114.5	51.4	8.3	—	—	—
Net debt/equity	117.9	53.0	8.6	(11.2)	(11.4)	(11.3)
ROAE (%)	7.4	52.3	33.6	28.1	26.1	23.5
ROACE (%)	**7.3**	**34.9**	**29.1**	**27.5**	**26.1**	**23.5**

Source: Kotak Institutional Equities estimates.

Industrials

SUZL.BO, Rs230	
Rating	ADD
Sector coverage view	Cautious
Target Price (Rs)	325
52W High -Low (Rs)	460 - 220
Market Cap (Rs bn)	360.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	136.8	194.5	267.3
Net Profit (Rs bn)	10.6	16.6	25.2
EPS (Rs)	6.8	10.6	16.1
EPS gth	*13.0*	*56.7*	*51.5*
P/E (x)	33.9	21.7	14.3
EV/EBITDA (x)	18.4	14.7	11.0
Div yield (%)	0.4	0.4	0.4

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	65.9	-	-
FIIs	21.4	1.1	0.1
MFs	3.2	0.9	(0.1)
UTI	-	-	(1.0)
LIC	-	-	(1.0)

Suzlon Energy: Generation incentive for an IPP makes wind energy investments viable without using tax shield of accelerated depreciation

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- **Generation incentive for entities not using accelerated depreciation makes wind investments viable for standalone developers**
- **Accelerated depreciation incentive likely to remain primary driver as realized equity returns are significantly higher**
- **Higher interest rates and site specific issues in India pose downside risk to our estimates**
- **Retain estimates and target price, reiterate ADD rating led by favorable macro environment**

The Ministry of New and Renewable Energy sources (MNRE) has constituted a generation-based incentive of Rs0.5/Kwh for a period of 10 years to encourage (a) pure wind power developers to invest in wind energy and (b) incentivize generation rather than just capacity addition. We highlight that this incentive would ramp up the return on equity from wind power projects for standalone entities by 300 bps to about 16.5% from about 14% currently (assuming 12% interest cost, 25% PLF), thus making wind investments viable. We highlight that existing accelerated depreciation benefit incentivizes wind power investments by companies that have strong profits in other businesses, that can be shielded using accelerated depreciation available on wind power. We highlight that accelerated depreciation leads to high equity return of the order of 21% based on 12% interest cost and 25% PLF and is thus likely to remain primary driver of investments. We highlight that higher interest rates as well as site specific issues at established sites in Maharashtra would affect wind power investments in India this year and pose downside risk to our estimates. We reiterate our ADD rating based on likely strong growth led by a favorable macro environment and robust platform of global marketing, research and vertically integrated production capacity.

MNRE's policy to add generation incentive for entities not using accelerated depreciation makes wind investments viable for standalone wind power developers

The Ministry of New and Renewable Energy has announced a scheme of generation-based incentive for grid connected wind power projects for investors who can not use the tax shield of accelerated depreciation benefit. The ministry intends to provide an incentive of Rs0.5/Kwh for a period of 10 years and encourage (a) pure wind power developers to invest in wind energy, (b) incentivize generation rather than just capacity addition. We highlight that this incentive would ramp up the return on equity from wind power projects by 300 bps to about 16.5% from about 14% currently (assuming 12% interest cost, 25% PLF), thus making wind investments viable for standalone entities (Exhibit 1).

Accelerated depreciation incentive likely to remain primary driver as equity returns are significantly higher

We highlight that accelerated depreciation benefits incentivize wind power investments by companies that have strong profits in other businesses which can be shielded using accelerated depreciation available on wind power. We highlight that accelerated depreciation leads to almost immediate repayment of entire equity investments in wind power project and generates high equity return of the order of 21% based on 12% interest cost and 25% PLF over life of the project (Exhibit 2). Returns could be further ramped up based on better debt covenants such as longer repayment terms etc.

Higher interest rates and site specific issues may affect wind power installations in India

We highlight that equity returns from wind power investments are very sensitive to PLF as well as interest rates and thus current site specific issues at established sites in Maharashtra as well higher interest rate scenario would affect wind power investments in India. We highlight downside risk to our execution assumption of about 3,200 MW for FY2009E that assumes about 980 MW of wind power installations by Suzlon in India (flat over FY2008) based on the above two factors.

Reiterate ADD rating led by favorable macro environment

We reiterate our ADD rating. A key downside risks for Suzlon arise from (1) hiccups in execution, (2) commodity price increases, (3) unfavorable currency movement, (4) delays in implementation of large capacity expansion plans, across Suzlon, Hansen and Repower, (5) emergence of competitors (attracted by the high equity returns), especially from low-cost manufacturing countries like China and (6) new technologies, like gearless wind-turbines, becoming more competitive.

Key upside risks arise from stronger-than-expected execution in FY2010E by Suzlon arising from (1) global momentum in wind power equipment demand, (2) strong platform of Suzlon in terms of breadth and depth of manufacturing, marketing and R&D capabilities and (3) significant expansion in vertically integrated capacity that creates opportunities for Suzlon to gain market share in a strong growth market. We are expecting Suzlon to execute about 3,906 MW in FY2010E, however, considering that it would effective capacity to deliver about 5,700 MW of wind power equipment in that year, Suzlon may surpass our execution estimates considerably.

We also highlight that there has been sharp expansion in P/E multiple for wind power equipment stocks probably led by higher prices of conventional fuels which makes wind energy more competitive apart from addressing energy security and environmental concerns and Suzlon is trading at a significant discount to global comparables.

Exhibit 1. Generation incentive bucks up an IRR by about 300 bps with a WTG yielding an equity IRR of 17% at 25% PLF and 11% interest cost for an IPP

Calculation of the economics of setting up a wind energy generator as an IPP

KEY ASSUMPTIONS	
Installed cap (MW)	1.25
State	Maharashtra
Equipment cost (Rs mn)	57.5
Land / other cost (Rs mn)	8.12
Total installation cost (Rs mn)	**65.62**
Assumed PLF (%)	**25.0**
% sold to grid	100
Tax rate (MAT, %)	11.33
Generation credit for ten years (Rs/Kwh)	**0.50**
Interest rates (%)	**12**
Carbon Credits Included	No

Year #		**0**	**1**	**2**	**3**	**4**	**5**	**6**	**19**	**20**
Generation (mn KWH)	Based on assumed PLF		2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74
Wheeling charges (mn KWH)	2% wheeling + 5% T&D loss		0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19
Net generation (mn KWH)			**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**
b) Sold to grid	Based on assumption above		2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55
Unit sale price (Rs/KWH)	MERC buyback rate, 15p esc. p.a for 13 years		3.50	3.65	3.80	3.95	4.10	4.25	5.45	5.45
Carbon Credits sold (Rs mn)										
Generation credit as per policy (Rs mn)			1.37	1.37	1.37	1.37	1.37	1.37		
Sales (Rs mn)			**10.3**	**10.7**	**11.0**	**11.4**	**11.8**	**12.2**	**13.9**	**13.9**
O&M cost (Rs mn)	2% of initial capital cost with 4% cost escalation				1.31	1.36	1.42	1.48	2.46	2.56
Interest (Rs mn)	Assuming 70:30 DER and 12% interest rate		5.51	5.51	4.97	4.38	3.83	3.19	-	-
Depreciation (Rs mn)	5% SLM, assuming useful life of 20 years		2.88	2.88	2.88	2.88	2.88	2.88	2.88	2.88
Pre-tax cost (Rs mn)			8.39	8.39	9.15	8.62	8.13	7.54	5.33	5.43
Pre-tax profit (Rs mn)			1.89	2.27	1.89	2.81	3.68	4.65	8.54	8.44
Less: tax (Rs mn)			0.21	0.26	0.21	0.32	0.42	0.53	0.97	0.96
Net profit (Rs mn)			**1.68**	**2.02**	**1.68**	**2.49**	**3.26**	**4.12**	**7.57**	**7.49**
Cash profit (Rs mn)			**4.55**	**4.89**	**4.55**	**5.36**	**6.14**	**7.00**	**10.45**	**10.36**
Debt repayments			-	4.55	4.89	4.55	5.36	6.14	-	-
Equity cash flows		**(19.7)**	**4.55**	**0.34**	**(0.34)**	**0.81**	**0.77**	**0.86**	**10.45**	**10.36**
Equity IRR (%)	**16.7**									
Equity IRR without generation incentive (%	**13.9**									

Sensitivity of equity IRR to interest rates and PLF assumption

		Interest rates (%)				
	16.71	**10.0**	**11.0**	**12.0**	**13.0**	**14.0**
PLF (%)	**18.0**	8.1	7.1	5.8	4.1	1.4
	20.0	11.4	10.6	9.7	8.7	7.5
	22.0	14.2	13.5	12.7	11.9	11.0
	25.0	18.0	17.4	**16.7**	16.0	15.3
	28.0	21.6	21.0	20.4	19.7	19.1

Source: Kotak Institutional Equities.

Exhibit 2. Accelerated depreciation benefit has been main driver of wind power investments in India with a WTG yielding an equity IRR of 21% at 25% PLF and 12% interest cost

Calculation of the economics of setting up a WTG and using the acclerated depreciationas a tax shield

KEY ASSUMPTIONS	
Installed cap (MW)	1.25
State	Maharashtra
Equipment cost (Rs mn)	57.5
Land / other cost (Rs mn)	8.12
Total installation cost (Rs mn)	65.62
Assumed PLF (%)	**25.0**
% sold to grid	100.00
Tax rate (MAT, %)	**11.33**
Interest rate (%)	12

Year #		0	1	2	3	4	5	6	7	8	9	10	11	12
Generation (mn KWH)	Based on assumed PLF		2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74	2.74
Wheeling charges (mn KWH)	2% wheeling + 5% T&D loss		0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19
Net generation (mn KWH)			**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**	**2.55**
b) Sold to grid	Based on assumption above		2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55
Unit sale price (Rs/KWH)	MERC buyback rate, 15p esc. p.a for 13 years		3.50	3.63	3.76	3.89	4.02	4.15	4.28	4.41	4.54	4.67	4.80	4.93
Carbon Credits sold (Rs mn)														
Sales (Rs mn)			**8.9**	**9.2**	**9.6**	**9.9**	**10.2**	**10.6**	**10.9**	**11.2**	**11.6**	**11.9**	**12.2**	**12.6**
O&M cost (Rs mn)	2% of initial capital cost with 4% cost escalation				1.31	1.36	1.42	1.48	1.54	1.60	1.66	1.73	1.80	1.87
Interest (Rs mn)	Assuming 70:30 DER and 12% interest rate		5.51	5.51	5.11	4.76	4.35	3.87	3.31	2.65	1.90	1.04	0.06	-
Depreciation (Rs mn)	5% SLM, assuming useful life of 20 years		46.00	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58
Accumulated depreciation			46.00	46.58	47.15	47.73	48.30	48.88	49.45	50.03	50.60	51.18	51.75	52.33
Pre-tax cost (Rs mn)			51.51	6.09	6.99	6.70	6.35	5.92	5.42	4.83	4.14	3.34	2.43	2.44
Pre-tax profit (Rs mn)			(42.60)	3.15	2.58	3.20	3.89	4.64	5.48	6.40	7.42	8.54	9.79	10.11
Less: tax (Rs mn)			-	0.35	0.29	0.36	0.44	0.52	0.61	0.72	0.83	0.96	1.10	1.13
Net profit (Rs mn)			**(42.60)**	**2.80**	**2.29**	**2.84**	**3.45**	**4.12**	**4.86**	**5.68**	**6.59**	**7.59**	**8.69**	**8.97**
Tax shield of acc. Dep.			**14.06**											
Cash profit (Rs mn)			**17.46**	**3.38**	**2.86**	**3.42**	**4.03**	**4.70**	**5.44**	**6.26**	**7.16**	**8.16**	**9.26**	**9.55**
Debt repayment			-	3.38	2.86	3.42	4.03	4.70	5.44	6.26	7.16	8.16	0.53	-
Free cash flow to equity		(19.69)	17.46	-	-	-	-	-	-	-	-	-	8.73	9.55
Equity IRR (%)	**21.2**													

Sensitivity of equity IRR to interest rates and PLF assumption

	Interest rates (%)					
	21.15	**10.0**	**11.0**	**12.0**	**13.0**	**14.0**
PLF (%)	**18.0**	9.2	5.8	(19.8)	(21.4)	(22.9)
	20.0	14.6	12.9	10.8	7.8	0.3
	22.5	19.3	18.1	16.8	15.3	13.5
	25.0	23.3	22.3	**21.2**	20.0	18.7
	28.0	27.7	26.8	25.7	24.7	23.6

Source: Kotak Institutional Equities.

Economy

Sector coverage view	N/A

Inflation getting into a vicious cost-push cycle, but unlikely to explode

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- **Inflation rises to 11.42% for the week-ended June 14 (from 11.05% in the preceding week)**
- **Minerals and manufacturing products (chemicals, processed food, textiles and basic metals) account for most of the price rise over this week**
- **We retain our projection that inflation is likely to peak at around 13% in early-October 2008, but upside risks to this projection exceed downside risks**
- **Inflation metrics on the rise but policy options waning**

Headline inflation surged further this week reaching the highest since 17.1% at end-March 1995, which happens to be the peak for the WPI index with the current base year. Inflation this week was slightly above expectations. We are seeing the first signs of inflation getting into a vicious loop of cost-push and rising inflation expectations. However, it has not acquired inertial character as yet and we do not expect inflation to explode exponentially. In our assessment, this week's inflation numbers do not fundamentally alter the inflation path of a peak of around 13% in early October. However, upside risks exceed downside risks to this projection.

Headline inflation rose to 11.4% for the week-ended June 14, 2008 against the street's expectations of 11.2%. This reinforced our belief that headline inflation may touch 13% by end-September or early October. We believe inflation may fall to around 9% by the year end.

Policy options waning

We believe policy options to arrest inflation are fast waning. Further tax cuts are unlikely in view of the already deteriorating fiscal position of the government which is likely to see the gross fiscal deficit touch 4.1% of GDP in FY2009E. Monetary policy has already been tightened with a CRR hike of 125 bps and a repo rate hike of 75 bps within 1QFY09 itself. We expect another round of monetary tightening to dampen the aggregate demand within 1HFY09. However, a larger-than-50-bps hike in CRR and repo rate in FY2009 could potentially throw the economy into a severe downturn. Some key issues worth considering are:

- More than 50 countries worldwide are now running headline inflation into double digits. The policy limitations must therefore be recognized in view of the supply-side shock from the global commodity price cycle.
- Policy efficacy of aggregate demand management through monetary policy may be low considering the present characteristic of the double-digit inflation. This is especially so as it is accompanied by a fiscal stimulus in the current year.
- Inflation in India till recently was predominantly from the supply side, coming from fuel and metals (see Exhibit 1), but is becoming more general now. A moderate and calibrated monetary policy tightening may therefore yield the best results.
- The yield curve has become inverted and if it persists, could indicate a severe downturn ahead.

Price rise more general now and cost push may lead to further price escalation ahead

We believe the nature of price rise that we saw this week is (1) more general and not limited to a few commodities and (2) some of these commodities will have a second round impact as they are used as inputs in other industries. The latter is particularly true in the case of benzene (used as inputs in other chemicals, phenol, after-shave lotion, etc.), PTA (raw material for polyster), methanol (used in other chemicals and in some medicines).

More importantly, a price rise in manganese ore, which is a widely used pigment and oxidation chemical, can affect the prices of several industrially important compounds as also metal alloys industry besides alkaline and dry cell batteries.

- Over four-fifths of the rise in WPI over the week was accounted by manufacturing products. Chemical and chemical products accounted for nearly half of this. This included, increase in the prices over the week of benzene (22%), purified terephthalic acid or PTA (15%), methanol (2.3%) and calcium ammonium nitrate nutrient content fertilizers (6.7%).
- Besides, there were increases in the price of man-made fibre (2.0%), man-made textiles (1.8%) and edible oils (1.4%).
- Prices of toilet soaps, laundry soaps and detergents increased in the 6-9% range during the week.
- In addition to manufactured products, WPI for manganese more than trebled over the week (219.9%). Prices also rose sharply for tea (2.6%), lubricants (18.8%) and iron ore (0.2%).

Exhibit: Supply-side factors drive inflation up but price rise becomes more general over the latest week

Increase in WPI and its major components till June 14, 2008 (%); the weighted contribution of major components to this increase (%)

		Price rise since:					Weighted contribution to increase in WPI since:				
	weight	7-Jun-08	end-Mar. '08	since Oct.13,'08	end-FY2007	FY1994	7-Jun-08	end-Mar.'08	since Oct.13,'08	end-FY2007	FY1994
All commodities	100.0	0.4	4.1	9.8	12.2	136.1	105.1	100.3	99.9	100.1	100.0
Primary articles	**22.0**	**0.2**	**2.6**	**8.6**	**12.6**	**143.0**	**12.2**	**14.5**	**20.2**	**22.2**	**23.1**
Food articles	15.4	0.2	1.7	4.0	8.4	132.0	8.6	6.4	6.6	10.7	15.0
Non-food articles	6.1	(0.5)	4.8	13.8	16.7	138.0	(8.2)	7.1	8.4	8.1	6.2
Minerals	0.5	3.6	3.6	53.6	55.3	552.6	12.1	1.2	5.2	4.4	2.0
Fuel, power, light & lubricant	**14.2**	**0.1**	**9.6**	**15.8**	**17.1**	**274.7**	**7.9**	**49.8**	**34.4**	**30.2**	**28.7**
Coal mining	1.8	0.0	0.0	9.8	9.8	154.4	0.0	0.0	1.9	1.6	2.0
Minerals oils	7.0	0.2	16.1	24.6	26.9	382.0	9.3	49.8	31.5	27.8	19.6
Electricity	5.5	0.0	0.0	1.4	1.5	176.5	0.0	0.0	1.0	0.9	7.1
Manufactured products	**63.7**	**0.6**	**2.7**	**8.0**	**10.2**	**102.8**	**85.0**	**35.9**	**45.3**	**46.7**	**48.2**
Food products	11.5	0.7	2.6	10.2	12.2	108.8	18.0	6.4	10.6	10.2	9.2
Beverages tobacco & tobacco products	1.3	0.0	3.2	7.7	11.4	185.6	0.0	1.3	1.3	1.5	1.8
Textiles	9.8	0.7	5.9	2.4	1.4	35.4	9.8	7.9	1.5	0.7	2.6
Wood & wood product`s	0.2	0.0	9.8	9.8	9.8	137.0	0.0	0.4	0.2	0.1	0.2
Paper & paper products	2.0	0.0	2.5	2.4	3.6	99.4	0.0	1.1	0.5	0.6	1.5
Leather & leather products	1.0	1.1	2.4	0.6	2.2	68.3	2.0	0.4	0.1	0.1	0.5
Rubber & plastic products	2.4	0.0	0.2	2.4	5.8	63.9	0.0	0.1	0.4	0.8	1.1
Chemicals & chemical products	11.9	1.4	2.9	6.0	9.0	117.0	39.8	7.7	6.9	8.4	10.3
Non-metallic mineral products	2.5	0.0	(0.6)	1.3	5.8	113.4	0.0	(0.4)	0.3	1.2	2.1
Basic metals alloys & metals products	8.3	0.3	1.8	20.0	22.5	196.8	9.3	4.6	19.6	17.7	12.1
Machinery & machine tools	8.4	0.4	3.4	3.6	7.0	73.6	6.5	5.1	2.4	3.7	4.5
Transport equipment & parts	4.3	0.0	2.5	5.0	6.5	74.0	0.0	2.0	1.7	1.8	2.3

Note:

(1) Total weighted contribution may not exactly add up to 100 due to rounding off

(2) Figures in bracket reflect negative numbers

Source: Kotak Institutional Equities.

Telecom

Sector coverage view	Cautious

		Price, Rs	
Company	**Rating**	**27-Jun**	**Target**
Bharti	REDUCE	748	840
Rcom	SELL	474	550
MTNL	ADD	92	120
VSNL	REDUCE	375	430
Idea Cellular	REDUCE	97	110

Likely reduction in termination charges—another blow to profitability

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- **Reduction in termination charges likely—DoT asks TRAI to review the same**
- **Expect outgoing tariffs to come down in case of a reduction in termination charges**
- **Impact on individual players will depend on the mix of on-net and off-net calls**

We view the likely reduction in termination charges (paid by the originating operator to the terminating operator) as revenue- as well as EBITDA dilutive for Indian wireless operators. The impact on individual companies will depend on the mix of on-net and off-net calls and the mix of incoming and outgoing traffic. According to press reports, the DOT has asked the TRAI to review the termination charges on a priority basis to better reflect the current economics (costs) of terminating a call. We see the following as the likely fallouts of such a move (1) will lead to further decline in tariffs; we expect the operators to completely pass on any termination charge reduction by lowering their off-net call tariffs, (2) reduce the impact of network effect (with a lag) by reducing the tariff differential between on-net and off-net calls; this could be viewed as a positive for new entrants into the market (it still remains difficult to build a business case for new entrants, though), (3) a reduction in overall revenues of the Indian wireless industry unless the operators hold on to outgoing tariffs, unlikely in our view and (4) decline in profitability as the excess profits on terminating off-net calls come down. We compute an EBITDA impact of 4.8% for Bharti (FY2009E) if it passes on the entire benefit of reduction in termination charges to the consumers.

Reduction in termination charges likely—DoT asks TRAI to review the same. Per press reports, the Department of Telecommunications (DoT) has asked the Telecom Regulatory Authority of India (TRAI) to review the termination charges (paid by the call originating operator to the call terminating operator). The current termination charges stand at Rs0.30/min and were set in 2003 on the basis of costs of terminating a minute. The DoT believes that the rapid surge in volumes over the past few years has likely lowered the cost of terminating a minute (scale efficiencies) and the termination charges should ideally reflect the same. We expect the termination charges to be revised downwards.

Expect outgoing tariffs to decline to the extent of reduction in termination charges. We expect any reduction in termination charges to be passed on to consumers in the form of lower off-net outgoing tariffs, given the intense price competition in the industry. Moreover, we have already seen instances of operators competing on excess termination charges (Virgin's Rs0.1/min credit on incoming calls was effectively passing on a part of excess termination charges to the consumer). We discuss the key implications of a reduction in off-net tariffs below:

- Exhibit 1 gives the impact of reduction in off-net tariffs by Rs0.1 (we assume a 10 paise reduction in termination charges for the purpose of this analysis) on ARPU, MOU, and RPM. A 10 paise reduction in termination charges (completely passed on to the consumer) will likely lead to 10% reduction in RPM, and a 7% increase in MOU, thereby leading to a 4% reduction in ARPU levels.
- Even though the net retention of a wireless operator in case of an off-net outgoing call remains the same if the reduction in tariff is the same as the reduction in termination charges, the industry revenues get impacted by lower termination revenues booked by the operator terminating the off-net call on his network. In essence, a greater impact will be felt by operators with higher proportion of off-net incoming calls on their network.

- Any decline in on-net tariffs in addition to off-net tariffs (especially in plans where on-net and off-net tariffs are the same, the operator may not be able to reduce of-net tariff without reducing on-net tariff as well) will intensify the negative impact on revenues.
- Improves the business case moderately for new operators by enhancing their ability to offer competitive pricing on off-net calls. This is critical given the huge subs base that some of the incumbents (Bharti, Vodafone, RCOM) have garnered for themselves—any new player will have to offer competitive calling rates to subscribers on these networks to be a meaningful player in the industry.

Impact on wireless operators. We compute an impact of 4.8% on the Bharti's FY2009E EBITDA, if the termination charges are reduced to 20 paisa from the current 30 paisa (assuming zero volume elasticity of decline in off-net tariff, see Exhibit 2). The impact would on account of reduction in termination ARPU per sub, which we compute at Rs35/month for FY2009E. For Idea, the impact on EBITDA would be 7.4% on similar assumptions (see Exhibit 3) and with an estimated termination ARPU of 27/ sub/month.

Reduction in termination charges will lead to a decline in RPM as well as ARPU

Impact of a Rs0.10 reduction in termination charges

		Likely	Current	Change (%) likely vs current
Refill amount		345	345	
Recharge coupon for Rs0.50 local M2M tariff				
Service tax @ 12.36%		38	38	
Outgoing ARPU		**307**	**307**	
Fixed (processing) charges		130	130	
Maximum talk value		**177**	**177**	
Blended average tariffs (Rs/min)		**0.75**	**0.80**	**(6)**
Local 'on-net' tariff	40%	0.50	0.50	
Local 'off-net' tariff (d)	40%	0.65	0.75	
Average DLD tariff	20%	1.45	1.50	
Billing pulse (sec)		**60**	**60**	
Effective tariff (Rs/min) (a)		0.83	0.88	
Outgoing MOU (mins)		**215**	**201**	**7**
Share of outgoing MOUs (%)		46	46	
Total MOU (mins)		**467**	**437**	**7**
Termination revenues (b)		**30**	**43**	**(29)**
Gross ARPU (Rs/month) (c)		**337**	**350**	**(4)**
Revenue per minute (RPM)		**0.72**	**0.80**	**(10)**

Note:
(a) Effective tariff assumed 10% higher than the average rate due to a 60-second billing pulse.
(b) Assuming 60% of incoming calls are off-network calls, which result in a termination charge.
(c) Gross ARPU assuming one recharge per month.
(d) Assuming 50% of off-net calls are M2M calls

Source: Companies, Kotak Institutional Equities estimates.

Rs0.1 reduction in termination charges could have a 5-7% negative impact on Bharti's EBITDA

	FY2009E (a)	FY2010E	FY2011E
Total wireless minutes (mn)	355,461	620,989	734,807
% incoming	48	48	48
% off-net within incoming	46	46	46
Reduction in termination charges (Rs/min)	0.1	0.1	0.1
EBITDA impact (Rs mn)	**(7,849)**	**(13,711)**	**(16,225)**
Current EBITDA estimate (Rs mn)	163,448	210,082	246,750
EBITDA impact (%)	**(4.8)**	**(6.5)**	**(6.6)**
Termination ARPU per sub (old) (Rs/sub/month)	**34.9**	**35.1**	**35.3**
Termination ARPU per sub (likely) (Rs/sub/month)	**23.3**	**23.4**	**23.6**

Note:
(a) Assuming termination charges are reduced effective August 1, 2008.

Source: TRAI performance indicators report Dec '07 quarter, Kotak Institutional Equities estimates.

Rs0.1 reduction in termination charges could have a 7-10% negative impact on Idea's EBITDA

	FY2009E (a)	FY2010E	FY2011E
Total wireless minutes (mn)	105,091	190,351	234,517
% incoming	50	50	50
% off-net within incoming	46	46	46
Reduction in termination charges (Rs/min)	0.1	0.1	0.1
EBITDA impact (Rs mn)	**(2,417)**	**(4,378)**	**(5,394)**
Current EBITDA estimate (Rs mn)	32,613	44,369	54,906
EBITDA impact (%)	**(7.4)**	**(9.9)**	**(9.8)**
Termination ARPU per sub (old) (Rs/sub/month)	**27.4**	**27.5**	**27.7**
Termination ARPU per sub (likely) (Rs/sub/month)	**18.2**	**18.3**	**18.5**

Note:
(a) Assuming termination charges are reduced effective August 1, 2008.

Source: TRAI performance indicators report Dec '07 quarter, Kotak Institutional Equities estimates.

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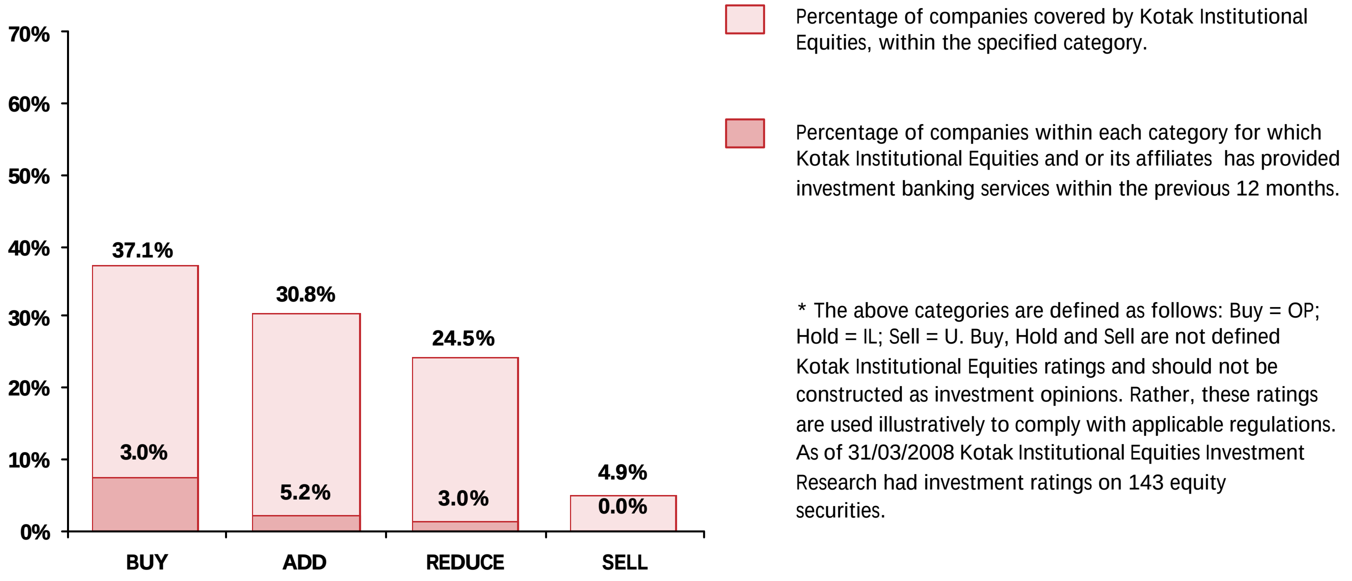

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Source: Kotak Institutional Equities. As of March 31, 2008

Ratings and other definitions/identifiers

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