kotak Institutional Equities

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Corporate

- Oil and Natural Gas Corporation (ONGC) will seek concessions from the Andhra Pradesh government for setting up a 15 million tonne a year (mtpa) refinery at Kakinada. The company plans to invest Rs 19,000-20,000 crore in the refinery. *(BS)*
- Property developer Indiabulls Real Estate (IREL), which was spun off from Indiabulls Financial Services, is planning to raise nearly $600 million (nearly Rs 2,500 crore) through a GDR issue to fund its projects *(BS)*
- Essar Global announced the acquisition of Canadian steel major Algoma in an all-cash deal worth $1.6 billion (nearly Rs 6,800 crore). The acquisition would take place through the wholly owned subsidiary, Essar Steel Holdings. *(BS)*
- Jet Airways today said that it would run Air Sahara as a 100 per cent subsidiary under the brand name of Jetlite. Jetlite would be positioned as a value carrier between a full-service and a low-cost carrier. *(BS)*

Economic and political

- The spot rupee jumped to a near nine-year high on Monday, moving past the 42 per dollar mark on big inflows and absence of RBI intervention. The rupee ended at 41.85/86 per dollar as against the last weekend close of 42.51/52 per dollar. *((BS)*
- Against the advance estimates of 9.2 per cent gross domestic product (GDP) growth of the economy in 2006-07, the National Council of Applied Economic Research (NCAER) projects GDP growth to slow down in the inaugural year of the Eleventh Five-Year Plan (2007-12) to 8.3 per cent.*(BL)*

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

EQUITY MARKETS

		Change, %		
India	**16-Apr**	**1-day**	**1-mo**	**3-mo**
Sensex	13,696	2.3	10.2	(3.0)
Nifty	4,013	2.5	11.2	(1.6)
Global/Regional indices				
Dow Jones	12,612	0.5	4.1	0.2
Nasdaq Composite	2,492	0.5	5.0	(0.2)
FTSE	6,496	0.5	6.0	4.5
Nikkie	17,628	1.5	5.3	2.5
Hang Seng	20,758	2.0	9.5	3.6
KOSPI	1,532	0.7	7.3	10.2

Value traded - India

			Moving avg, Rs bn	
	16-Apr		**1-mo**	**3-mo**
Cash (NSE+BSE)	135.5		108.0	124.9
Derivatives (NSE)	332.2		274.3	376.5
Deri. open interest	518.8		564.3	574.4

Forex/money market

		Change, basis points		
	16-Apr	**1-day**	**1-mo**	**3-mo**
Rs/US$	41.9	(62)	(216)	(235)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	7	11	38

Net investment (US$mn)

	13-Apr		**MTD**	**CYTD**
FIIs	108		#N/A	40
MFs	48		#N/A	(303)

Top movers -3mo basis

		Change, %		
Best performers	**16-Apr**	**1-day**	**1-mo**	**3-mo**
BEL	1,764	4.5	25.0	37.8
SAIL	128	1.7	24.6	31.7
Punjab Tractors	305	(0.5)	(2.1)	23.9
Wockhardt	426	0.2	17.4	21.5
Bharti Tele	802	2.7	11.8	19.6
Worst performers				
Ingersoll Rand	277	4.4	(3.6)	(29.2)
Acc	787	5.1	9.0	(28.6)
Tvs Motor	58	0.9	(5.2)	(27.5)
Century Tex	572	3.3	12.7	(25.8)
MRF	3,254	(0.0)	(3.4)	(23.6)

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Technology

TCS.BO, Rs1280	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	1,400
52W High -Low (Rs)	1399 - 728
Market Cap (Rs bn)	1,253

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	186.3	237.8	299.5
Net Profit (Rs bn)	41.3	51.6	63.1
EPS (Rs)	42.2	52.8	64.5
EPS gth	*43.3*	*25.0*	*22.3*
P/E (x)	30.3	24.3	19.8
EV/EBITDA (x)	24.3	19.1	15.4
Div yield (%)	0.9	1.6	2.0

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	82.5	-	-
FIIs	7.0	1.3	(2.8)
MFs	1.6	1.8	(2.2)
UTI	-	-	(4.1)
LIC	1.7	1.8	(2.2)

Tata Consultancy Services : Slips on operating margin performance. Maintain IL rating

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- **4QFY07 operating margin below our expectations**
- **Maintaining margins in FY2008 a challenge**
- **FY2008 revenue growth—unlikely to be as good as FY2007**
- **Stock fairly valued. Maintain IL rating**

TCS' 4QFY07 operating performance was below our expectations. While revenue growth of 5.9% was consistent with our expectations, sequential decline of 50bps in operating margin (EBIT) surprised us negatively. Moving into FY2008, we believe that TCS has to deal with incremental challenges of higher onsite wage increase (3-5%), rupee appreciation and non-availability of normal levers such as utilization improvement and shift in revenue mix offshore to maintain operating margins. Consequently, we believe that the consensus, which currently factors operating margin improvement in FY2008, will likely revise down estimates post these results. We have revised our FY2008 earnings estimate to Rs52.8 from Rs53.1 and FY2009 earnings estimate to Rs64.5 from Rs64.6 earlier. Maintain our In-Line rating on the stock with a Mar '09 DCF based target price of Rs1,400/ share.

Revenue growth for 4QFY07 in line with our expectations: TCS reported 5.9% qoq growth in revenues to Rs51.46 bn, in line with our expectations. Revenue growth was led by a 26% qoq growth in domestic revenues; international revenues grew at a modest 4.1% qoq. Volumes grew 6.42% qoq, per capita blended realization improved 89bps, while rupee appreciation had a negative impact of 1.9% on revenue growth. Growth was led by the telecom vertical and the top 5 relationships. Customer metrics (such as US$50 mn relationships) did not show any material improvement from the previous quarter. Growth in banking and finance vertical was a modest 1% qoq.

4QFY07 operating margin below our expectations: OPM declined 50bps to 25.6% as compared to our expectation of 26.1% for Mar '07 quarter. The company attributes the entire decline to rupee appreciation. For FY2007, TCS's operating margin decline stands at 60bps to 24.9%, as against its guidance of a flat margin for FY2007. The company achieved net income of Rs11.72 bn in 4QFY07, 1% ahead of our expectations and aided by Rs578 mn gain on sale of 40% stake in JV with Sitel.

FY2008 revenue growth—unlikely to be as good as FY2007: We expect robust revenue growth for TCS in FY2008 though the growth rate will likely be lower than the 39% achieved in FY2007. We attribute two factors for a likely lower growth in FY2008 (a) acquisitions/ multiple structured large deals signed in 2HFY06 ramped up in FY2007; we do not see a similar magnitude of large deal ramp up and (b) financial services, the largest vertical of the company deals with maturing client base. We model a 33% revenue growth for TCS in FY2008, still higher than the industry growth rate. Similar to FY2007, we expect revenue growth in FY2008 to be driven by increased traction in new service offerings such as remote infrastructure management, assurance services, and BPO. We forecast net employee hiring of 27,600 in FY2008, 4,850 higher than FY2007 levels.

Maintaining margins in FY2008 a challenge: TCS has guided for stable margins for FY2008. We believe that TCS faces multiple challenges in the form of (a) likely onsite wage increase of 3-5% versus a lower number in FY2007 (especially select categories of H1/ L1 visa holders) (b) rupee appreciation; rupee has already appreciated 7% to 41.9 from the average rate in FY2007; we factor in a Re/$ rate of 43 for FY2008 in our model and (c) important levers such as utilization improvement and offshore have already been utilized. We model a 20 bps decline in OPM (despite aggressive assumptions) in FY2008. The company however indicates that it has further levers for margin management including (a) offshore shift in revenues—challenging in our view (b) improvement in performance of subsidiaries/ GDCs and (c) further pricing improvements.

TCS remains positive on magnitude of pricing improvement: TCS reiterated that it is getting pricing increase of 3-5% on all existing contracts that are coming for renegotiation. In addition the company indicated that new customers are coming in at 5-10% higher prices. TCS appears to be the most optimistic among the tier-I companies on the extent of pricing improvements.

Receivables days—no sign of improvement: Receivables days at 89 in Mar '07 quarter continue to be on the higher side compared to peers. TCS management indicates that it is proactively working to improve collection cycle.

Fine tuning estimates: We revise our FY2008 and FY2009 EPS estimates downwards by 0.7% and 0.1% respectively to Rs52.8 and Rs64.5 from Rs53.1 and Rs64.6 earlier, respectively. Change in EPS estimates is driven by—(a) change in our Re/US$ exchange rate assumptions to 43 from 44.5 earlier (b) change in OPM assumptions—we model a 20bps decline in EBIT margins in FY2008 and 60bps in FY2009. We maintain our In-Line rating on the stock with a Mar '09 DCF based target price of Rs1,400/ share.

TCS has limited scope of expansion in utilization rate, which is already among the highest in the industry

Quarter ended	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
Tata Consultancy Services	76.9	74.8	75.0	75.5	75.8	77.3	75.2	75.0	74.7
Infosys Technologies	72.7	72.8	71.6	67.6	67.7	70.6	67.5	66.6	66.9
Wipro (a)	73.0	72.0	70.0	68.0	70.0	72.0	69.0	67.0	tbd
Satyam Computer Services	80.2	82.0	82.1	82.0	80.1	79.1	79.1	76.3	tbd
Patni Computer Systems	64.7	67.5	67.7	68.1	67.8	70.2	72.3	73.7	tbd
Tech Mahindra	72.1	69.0	64.6	72.7	72.1	74.0	68.7	67.1	tbd
Hexaware Technologies	72.0	66.8	67.4	70.2	71.0	71.5	72.0	68.2	tbd
Mphasis BFL	72.1	76.7	77.4	75.3	73.5	73.6	75.1	78.5	tbd

(a) Wipro Technologies only

Note: Capacity utilization rate, excluding support but including trainees, tbd = results yet to be declared

Source: Company reports, Kotak Securities estimates.

Comments TCS Interim Results (consolidated, US GAAP)

Rs mn	4QFY06	3QFY07	4QFY07	% chg. qoq	% chg. yoy	Deviation from Kotak estimates 4QFY07	Deviation from Kotak estimates % chg.	Comments
Revenues	**37,234**	**48,605**	**51,464**	**5.9**	**38.2**	**51,495**	**(0.1)**	Revenues in line with expectations. Revenue growth driven by strong growth in domestic business. International revenues grew 4.1% qoq (Re terms). Overall volume growth was 6.42%, while pricing improvement (blended) was 0.9%
Cost of revenues	(20,379)	(27,041)	(28,144)	4.1	38.1	(28,133)	0.0	
Gross profit	**16,855**	**21,564**	**23,320**	**8.1**	**38.4**	**23,362**	**(0.2)**	
SG&A expenses	(7,658)	(8,891)	(10,147)	14.1	32.5	(9,899)	2.5	
EBIT	**9,197**	**12,673**	**13,173**	**3.9**	**43.2**	**13,464**	**(2.2)**	EBIT margin declined 48bps due to a) rupee appreciation and b) higher SG&A expenses
Other Income	(40)	300	898	199.5	(2,349)	243	269.4	Includes Rs578 mn profit from sale of 40% stake in the Sitel JV
Profit Before Tax	9,157	12,972	14,070	8.5	53.7	13,707	2.7	
Provision for Tax	(898)	(1,828)	(2,188)	19.7	143.8	(1,984)	10.3	
Net income before minority interest	**8,260**	**11,144**	**11,882**	**6.6**	**43.9**	**11,723**	**1.4**	
Income from affiliates	33	17	4			1	257	
Minority Interest	(103)	(115)	(158)	37.8	54.1	(151)	4.6	
Net income	**8,190**	**11,047**	**11,728**	**6.2**	**43.2**	**11,573**	**1.3**	Net income growth marginally ahead of our expectations on account of higher other income
Extraordinary items	(232)	-	-			-		
Net income	**7,958**	**11,047**	**11,728**	**6.2**	**47.4**	**11,573**	**1.3**	
EPS (Rs/ share)	8.4	11.3	12.0	6.2	43.2	11.8	1.3	
No of shares outstanding (mn)	978.6	978.6	978.6	-	-	978.6	-	
As % of revenues								
Gross Profit Margin (%)	45.3	44.4	45.3			45.4		
Operating Margin (EBIT)	24.7	26.1	25.6			26.1		
EBITDA (%)	27.0	28.4	28.4			28.7		Operating margin below our expectations. FY2007 EBIT margins (24.9%) 60 bps below company's stated target of FY2006 levels (25.5%)
SG&A Expenses (%)	20.6	18.3	19.7			19.2		
Tax Rate	9.8	14.1	15.6			14.5		
Revenue Mix (%)								
Onsite	59.0	54.3	54.1			-		
Offshore	41.0	45.7	45.9			-		
Revenues (Rs mn)								
Onsite	19,456	24,314	25,228	3.8	29.7	-		
Offshore	13,504	20,463	21,404	4.6	58.5	-		
International Revenues	**32,960**	**44,777**	**46,632**	**4.1**	**41.5**	**-**		
Domestic Revenues	4,273	3,828	4,832	26.2	13.1			

Source: Kotak Institutional Equities estimates

Key changes in FY2008 and FY2009 estimates

	New		Old		Change	
Rs mn	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**	**FY2008E**	**FY2009E**
Revenues	**237,836**	**299,533**	**240,741**	**303,917**	**(1.2)**	**(1.4)**
EBITDA	63,889	78,154	66,501	81,389	(3.9)	(4.0)
Depreciation	(5,074)	(6,102)	(5,398)	(6,641)	(6.0)	(8.1)
EBIT	58,815	72,053	61,103	74,748	(3.7)	(3.6)
Net Profit	**51,624**	**63,135**	**52,012**	**63,215**	**(0.7)**	**(0.1)**
EPS (Rs/ share)	**52.8**	**64.5**	**53.1**	**64.6**	**(0.7)**	**(0.1)**
Re/$ rate	**43.0**	**43.0**	**44.5**	**44.5**	**(3.5)**	**(3.5)**
EBIT margin	**24.7**	**24.1**	**25.4**	**24.6**		

Source: Kotak Institutional Equities Esimates

TCS: Consolidated Income Statement (US GAAP), Rs mn

Rs mn	2006	2007E	2008E	2009E	2010E
Revenues	**132,455**	**186,334**	**237,836**	**299,533**	**373,056**
Cost of revenues	(71,720)	(104,126)	(133,270)	(169,221)	(209,675)
Gross profit	**60,735**	**82,207**	**104,566**	**130,312**	**163,381**
Selling, marketing, general & administrative exper	(26,422)	(35,333)	(45,751)	(58,260)	(72,619)
Research and development	(419)	(433)			
EBIT (before amortization)	**33,894**	**46,442**	**58,815**	**72,053**	**90,762**
Other income (expense)					
Other Income, net	190	1,943	1,658	2,136	3,049
Income bf taxes and minority interest	**34,084**	**48,385**	**60,473**	**74,189**	**93,810**
Income Taxes	(4,989)	(6,700)	(8,306)	(10,453)	(22,131)
Income before share of equity in affiliates	**29,095**	**41,685**	**52,167**	**63,736**	**71,679**
Equity in earnings of affiliate	16	44	4	4	4
Minority Interest	(279)	(417)	(547)	(604)	(617)
Income from continuing operations	**28,831**	**41,312**	**51,624**	**63,135**	**71,066**
Extraordinary items	-	-	-	-	-
Net Profit- Reported	**28,831**	**41,312**	**51,624**	**63,135**	**71,066**
EPS (Rs/ share)	**29.5**	**42.2**	**52.8**	**64.5**	**72.6**
No of shares outstanding (mn)	978.6	978.6	978.6	978.6	978.6
Margins (%)					
Gross Profit margin	45.9	44.1	44.0	43.5	43.8
EBITDA Margin	27.7	27.2	26.9	26.1	26.3
EBIT Margin	25.6	24.9	24.7	24.1	24.3
NPM	21.8	22.2	21.7	21.1	19.0
Growth Rates (%)					
Revenues	36.2	40.7	27.6	25.9	24.5
Gross Profit	34.8	35.4	27.2	24.6	25.4
EBIT	25.9	37.0	26.6	22.5	26.0
Income bf taxes	23.1	42.0	25.0	22.7	26.4
Income before affiliates earnings	23.2	43.3	25.1	22.2	12.5
Income from continuing operations	22.4	43.3	25.0	22.3	12.6

Source: Kotak Institutional Equities estimates

Energy

PLNG.BO, Rs46	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	47
52W High -Low (Rs)	68 - 36
Market Cap (Rs bn)	35

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	55.1	78.0	81.9
Net Profit (Rs bn)	3.1	4.0	3.8
EPS (Rs)	4.2	5.3	5.1
EPS gth	*62.5*	*27.1*	*(4.2)*
P/E (x)	11.1	8.8	9.2
EV/EBITDA (x)	6.7	7.1	7.8
Div yield (%)	2.7	3.2	2.2

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	50.0	-	-
FIIs	15.1	0.1	(0.0)
MFs	-	-	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Petronet LNG : Strong 4QFY07 results on expected lines but longer-term issues exist

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- **Strong 4QFY07 results on large spot LNG volumes**
- **Critical issue is long-term competitiveness of business model—LNG versus domestic gas**
- **Continue to recommend switching at right times to other gas plays (GAIL, GSPL)**

PLNG reported 4QFY07 net income at Rs1.06 bn, ahead of our Rs939 mn estimate; higher other income and lower other expenditure compensated for higher taxation. FY2007 net income is Rs3.1 bn (+71% yoy). We see FY2008 as another strong year with increased spot volumes driving EPS 26% yoy to Rs5.3. However, we would use a price rally on potential positive news (stake sale to Qatar Investment Authority [if any], signing of gas supply agreement for Kochi terminal, award of EPC contracts) to reduce positions in the stock. We continue to recommend investors switch out of PLNG to other gas plays (GAIL and GSPL) given growing uncertainty about PLNG's business model. We expect a large increase in domestic gas supply to create issues about acceptance of high-priced LNG in the domestic market. We have cut our 12-month DCF-based target price to Rs47 from Rs54 and maintain our U rating on the stock; we have reduced our assumption for longer-term re-gasification tariffs; we have historically found re-gasification tariffs as being high. Key risk to stock view is higher-than-expected re-gasification tariffs.

Cut re-gasification tariffs to build in more moderate return on investment; the price of imported LNG is key. We have historically found PLNG's re-gasification tariffs high. We compute PLNG's FY2007 CROCI at 21.6%, which we find high given the nature of its business. We model a 5% increase in re-gasification tariff in FY2008 as part of its agreement with the gas off-takers. However, we believe a high re-gasification tariff would be difficult to sustain once supply of cheaper domestic gas increases meaningfully. We now assume PLNG's re-gasification tariff to increase 3.75% in FY2009E, 2.5% per annum between FY2009E and FY2012E and model flat tariffs beyond that until FY2017E, the terminal year of our DCF model. We had previously assumed a 2.5% per annum increase throughout our forecast period. Our revised earnings model shows a 16.8% CROCI for FY2013-FY2017E, which is still on the higher side, in our view. We expect the underlying price of imported LNG to be critical for PLNG's new investments to generate value. We are getting increasingly concerned about the competitiveness of imported LNG versus domestic gas.

Update on gas supply and demand in India and PLNG's new projects. Exhibits 1 and 2 give our estimated supply and demand of gas in India. We expect supply to exceed demand unless we see a more competitive pricing for gas versus coal in the critical power sector. We expect domestic supply to increase to 72 bcm in FY2012E versus demand of 88 bcm.

We expect a significant portion of our expected increase in demand to come from the power sector (38 bcm out of 57 bcm total). Thus, we believe it would be imperative for PLNG to supply competitively-priced LNG if it has to compete with domestic gas. The price of domestic gas itself would have to be competitive versus coal for it to be a meaningful fuel for the power sector; India has abundant reserves of coal and ongoing deregulation of the coal sector will further enhance attractiveness of coal as the fuel of choice for the power sector.

We assume PLNG will start its 5 mtpa expanded capacity at Dahej in December 2008 and its new 2.5 mtpa terminal at Kochi in June 2010. However, we note that PLNG is yet to finalize LNG supply for both Dahej (2.5 mpta out of required 5 mtpa) and Kochi (entire 2.5 mtpa). PLNG has been in talks with the Gorgon consortium for 2.5 mtpa of gas. However, the Gorgon project continues to suffer from delays and is unlikely to supply LNG before FY2012, in our view.

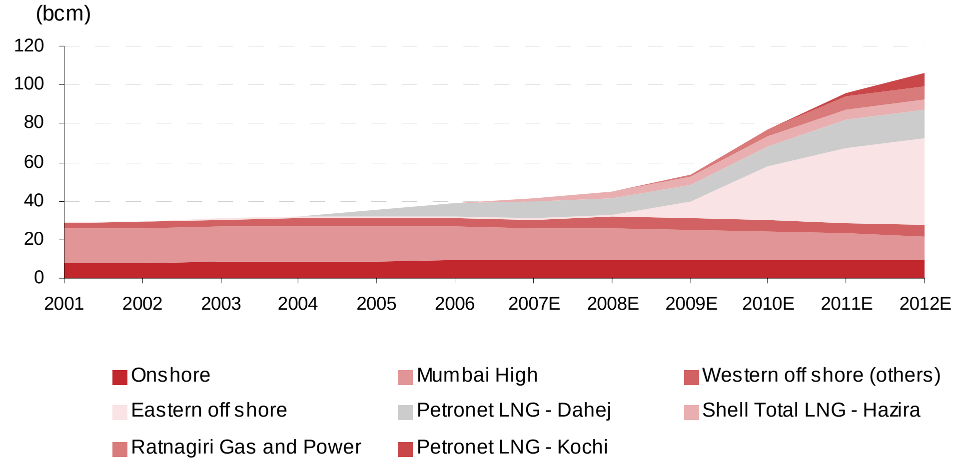
Details of 4QFY07 and FY2007 results. PLNG sold 73.4 tn BTU of LNG in 4QFY07 (-7.7% qoq and +22.2% yoy) and 287 tn BTU of LNG in FY2007 (+16% yoy). The additional volumes reflect more spot cargoes. We expect spot cargoes to increase in FY2008 (which in turn will drive revenues and profits for FY2008E) due to higher imports to feed Ratnagiri Gas and Power's to-be-commissioned new power block and the current 740 MW one; the latter is running sporadically on naphtha currently.

We have revised FY2008E and FY2009E EPS to Rs5.3 and Rs5.1, respectively from Rs4.9 and Rs4.0, respectively, previously. The changes primarily reflect higher spot volumes (1.5 mtpa for both the years) and fine-tuning on FY2007 results. We note that the strong result for FY2007 and our expected strong performance for FY2008 and FY2009 reflect PLNG's (1) additional volumes (significantly above its stated capacity) and (2) re-gasification tariffs, which is fixed on base volumes and not adjusted to reflect its true capacity. We note that the additional volumes lead to higher gross contribution margin (additional volumes X tariffs), which contributes directly to pre-tax profits.

We model PLNG's re-gasification tariffs to increase 5% in FY2008E to US$0.63/mn BTU and by 3.75% in FY2009E to US$0.65/mn BTU. However, we are less confident about PLNG's ability to push through further increases once supply of domestic gas increases rapidly from FY2009.

We project steep ramp up in domestic supply from FY2009

Supply of natural gas in India, March fiscal year-ends, 2001-2012E (bcm)

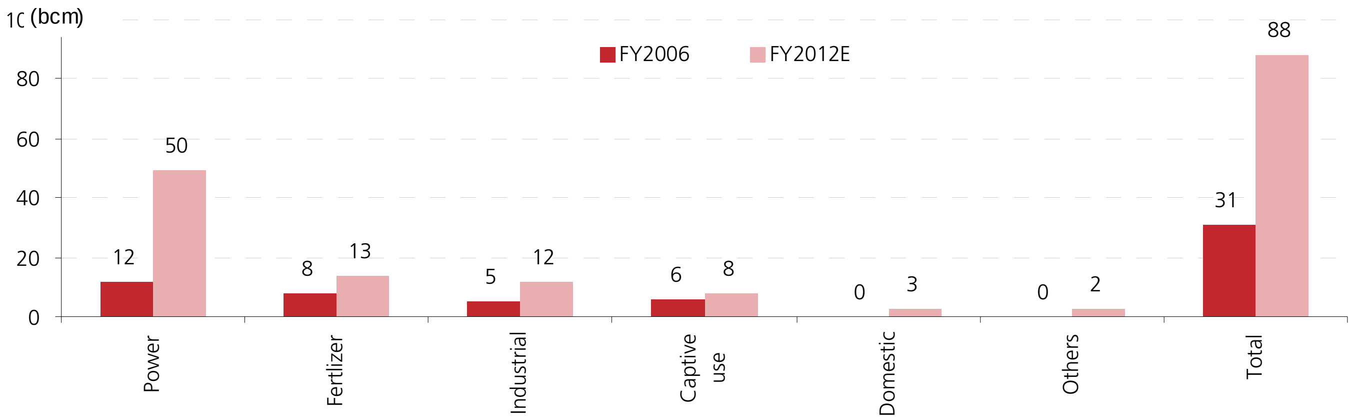


Note: Eastern offshore includes potential gas from Reliance's field in KG basin.

Source: Kotak Institutional Equities estimates.

Current supply constrained demand set to increase sharply

Segment wise demand for natural gas, current versus potential (bcm)



Source: Ministry of petroleum and natural gas, Kotak Institutional Equities estimates.

We model Petronet's volumes scaling up to 9 mtpa by FY2010

Key volume/price assumptions for Petronet LNG

	2005	2006	2007E	2008E	2009E	2010E	2011E
Volume assumptions							
Sales volume (mn tonnes)	2.5	4.8	5.4	6.3	6.6	8.8	12.4
Price assumptions							
LNG purchase price (FOB) (US$/mn BTU)	2.5	2.5	3.3	4.3	4.3	4.6	4.7
Landed cost (incl. import tariff) (US$/mn BTU)	2.9	2.9	3.8	4.9	4.8	5.2	5.25
Re-gasification charges (US$/mn BTU)	0.53	0.57	0.58	0.63	0.65	0.54	0.55
Escalation in re-gasification charges (%)	**5.0**	**5.0**	**5.0**	**5.0**	**3.8**	**2.5**	**2.5**
Sales price (US$/mn BTU)	3.5	3.5	4.4	5.5	5.5	5.7	5.8
Other assumptions							
Rupee/US dollar exchange rate	45.0	44.3	45.3	44.0	44.0	44.0	44.0

Source: Kotak Institutional Equities estimates.

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

	2005	2006	2007E	2008E	2009E	2010E	2011E
Profit model (Rs mn)							
Net sales	19,453	38,197	55,090	77,957	81,885	112,395	161,327
EBITDA	**1,505**	**4,707**	**6,481**	**6,821**	**7,484**	**7,629**	**11,204**
Other income	133	194	366	316	290	293	306
Interest	(1,094)	(1,116)	(1,070)	(890)	(1,009)	(1,809)	(2,028)
Depreciation	(968)	(1,010)	(1,020)	(1,116)	(1,525)	(2,077)	(3,097)
Extraordinary items	—	175	—	—	—	—	—
Pretax profits	(424)	2,950	4,756	5,132	5,241	4,036	6,385
Tax	—	(256)	(6)	(581)	(594)	—	—
Deferred taxation	140	(745)	(1,617)	(594)	(851)	(1,585)	(2,421)
Net profits	**(284)**	**1,949**	**3,133**	**3,956**	**3,796**	**2,451**	**3,964**
Earnings per share (Rs)	**(0.4)**	**2.4**	**4.2**	**5.3**	**5.1**	**3.3**	**5.3**
Balance sheet (Rs mn)							
Total equity	8,770	10,719	12,755	15,395	18,313	19,887	22,534
Deferred taxation liability	(140)	605	2,222	2,816	3,667	5,253	7,674
Total borrowings	12,599	12,599	13,599	18,099	27,599	32,599	29,099
Currrent liabilities	3,585	1,725	2,539	3,548	3,722	5,072	7,237
Total liabilities and equity	**24,814**	**25,648**	**31,115**	**39,859**	**53,302**	**62,811**	**66,545**
Cash	2,980	2,506	3,513	2,659	2,780	2,748	3,133
Current assets	2,753	2,946	4,350	4,567	4,424	6,217	8,694
Total fixed assets	18,903	18,627	21,683	31,064	44,530	52,277	53,148
Investments	179	1,569	1,569	1,569	1,569	1,569	1,569
Total assets	**24,814**	**25,648**	**31,115**	**39,859**	**53,302**	**62,811**	**66,545**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	437	3,524	5,328	4,853	4,891	4,995	8,505
Working capital	628	(2,057)	(590)	793	317	(443)	(312)
Capital expenditure	(18,969)	(335)	(4,000)	(10,000)	(14,000)	(9,000)	(3,297)
Investments	(179)	(1,390)	—	—	—	—	—
Free cash flow	**(18,083)**	**(258)**	**738**	**(4,354)**	**(8,792)**	**(4,448)**	**4,896**
Other income	128	184	366	316	290	293	306
Ratios (%)							
Debt/equity	146	111	91	99	126	130	96
Net debt/equity	111	89	67	85	113	119	86
RoAE	(3.2)	19.5	23.8	23.8	18.9	10.4	14.3
RoACE	**2.1**	**11.9**	**14.6**	**14.3**	**10.5**	**6.6**	**8.9**
Adjusted CROCI	**8.9**	**21.3**	**25.4**	**23.8**	**17.3**	**18.4**	**17.2**
Key assumptions							
Sales volume (mn tonnes)	2.5	4.8	5.4	6.3	6.6	8.8	12.4
LNG purchase price (FOB) (US$/mn BTU)	2.5	2.5	3.3	4.3	4.3	4.6	4.7
Re-gasification charges (US$/mn BTU)	0.53	0.57	0.58	0.63	0.65	0.54	0.55
Sales price (US$/mn BTU)	3.5	3.5	4.4	5.5	5.5	5.7	5.8
Rupee/US dollar exchange rate	45.0	44.3	45.3	44.0	44.0	44.0	44.0

Source: Kotak Institutional Equities estimates.

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

	qoq			yoy			yoy		
	4Q 2007	3Q 2007	*Chg (%)*	4Q 2007	4Q 2006	*Chg (%)*	2007	2006	*Chg (%)*
Net sales	**15,388**	**15,760**	***(2)***	**15,388**	**9,417**	***63***	**55,090**	**38,372**	***44***
Total expenditure	(13,397)	(14,026)	*(4)*	(13,397)	(8,140)	*65*	(48,609)	(33,665)	*44*
Raw material	(13,198)	(13,677)	*(4)*	(13,198)	(7,883)	*67*	(47,465)	(32,710)	*45*
Staff cost	(29)	(26)	*13*	(29)	(26)	*11*	(121)	(110)	*10*
Other expenditure	(170)	(323)	*(48)*	(170)	(230)	*(26)*	(1,024)	(845)	*21*
EBITDA	**1,991**	**1,733**	***15***	**1,991**	**1,278**	***56***	**6,481**	**4,707**	***38***
Other income	148	88	*69*	148	67	*121*	366	194	*88*
Depreciation	(252)	(257)	*(2)*	(252)	(251)	*0*	(1,020)	(1,010)	*1*
Interest	(259)	(276)	*(6)*	(259)	(265)	*(2)*	(1,070)	(1,116)	*(4)*
Profit before tax	**1,629**	**1,288**	***27***	**1,629**	**829**	***97***	**4,756**	**2,775**	***71***
Extraordinary/prior period items	—	—		—	175		0	175	*0*
Current tax	—	—		—	(87)		0	(256)	*(100)*
Deferred tax liabilities/assets	(567)	(435)	*30*	(567)	(255)	*(146)*	(1,617)	(745)	*0*
Fringe benefit tax	(2)	(2)		(2)	0		(6)	0	*0*
Profit after tax	**1,060**	**851**	***25***	**1,060**	**661**	***60***	**3,133**	**1,949**	***61***
Adj Profit after tax	**1,060**	**851**	***25***	**1,060**	**545**	***94***	**3,133**	**1,833**	***71***
Tax rate	34.9	33.9		34.9	34.1		34.0	36.1	
Sales quantity (tn BTU)	73	79	*(8)*	73	60	*22*	287	247	*16*

Source: Company, Kotak Institutional Equities estimates.

Our DCF-based target price for PLL is Rs47

Calculation of equity value of PLL using discounted cash flow analysis (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	6,821	7,484	7,629	11,204	15,156	14,894	14,684	14,585	14,479	14,366
Adjusted tax expense	(682)	(708)	—	—	(1,366)	(2,202)	(3,320)	(3,715)	(4,086)	(4,322)
Change in working capital	793	317	(443)	(312)	1,182	495	(132)	(196)	(241)	(296)
Operating cash flow	**6,932**	**7,093**	**7,186**	**10,892**	**14,972**	**13,187**	**11,231**	**10,674**	**10,152**	**9,749**
Capital expenditure	(10,000)	(14,000)	(9,000)	(3,297)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(2,500)
Free cash flow	**(3,068)**	**(6,907)**	**(1,814)**	**7,595**	**13,972**	**12,187**	**10,231**	**9,674**	**9,152**	**7,249**
Discounted cash flow-now	(2,741)	(5,486)	(1,281)	4,766	7,791	6,041	4,508	3,789	3,185	2,242
Discounted cash flow-1 year forward		(6,172)	(1,441)	5,362	8,768	6,796	5,071	4,262	3,584	2,523
Discounted cash flow-2 year forward			(1,621)	6,032	9,864	7,648	5,705	4,795	4,032	2,839

	Now	+ 1-year	+ 2-years
Discount rate (%)	12.5%	12.5%	12.5%
Total PV of free cash flow	22,814	30,996	46,052
Terminal value assumption			
Growth in perpetuity	0.0%	0.0%	0.0%
FCF in 2018E	7,249	7,249	7,249
Exit FCF multiple (X)	8.0	8.0	8.0
Exit EV/EBITDA multiple (X)	4.0	4.0	4.0
Terminal value	57,988	57,988	57,988
PV of terminal value	17,938	17,938	17,938
Total company value	**40,752**	**48,934**	**63,990**
Net debt	8,517	13,871	23,250
Equity value	32,235	35,063	40,740
Shares outstanding (mn)	750	750	750
Estimated share price using DCF	**43.0**	**46.8**	**54.3**

Sensitivity of 12-month DCF to WACC and perpetual growth

WACC (%)	Perpetual growth (%)				
	-1.0%	**-0.5%**	**0.0%**	**0.5%**	**1.0%**
11.5%	50.7	52.2	53.8	55.6	57.5
12.0%	47.4	48.7	50.1	51.7	53.4
12.5%	44.3	45.5	**46.8**	48.1	49.6
13.0%	41.4	42.5	43.6	44.9	46.2
13.5%	38.7	39.7	40.7	41.8	43.0

Fiscal Year end (March 31, XXXX)	March-08	March-09	March-10	March-11	March-12	March-13	March-14	March-15	March-16	March-17
Today	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07	17-Apr-07
Days left	349	714	1,079	1,444	1,810	2,175	2,540	2,905	3,271	3,636
Years left	0.96	1.96	2.96	3.96	4.96	5.96	6.96	7.96	8.96	9.96
Discount factor at WACC	**0.89**	**0.79**	**0.71**	**0.63**	**0.56**	**0.50**	**0.44**	**0.39**	**0.35**	**0.31**

Source: Kotak Institutional Equities estimates.

Pharmaceuticals

AVPH.BO, Rs1218	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,470
52W High -Low (Rs)	2125 - 1160
Market Cap (Rs bn)	28.1

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	8.8	9.8	10.9
Net Profit (Rs bn)	1.7	1.9	2.1
EPS (Rs)	73.5	82.4	92.5
EPS gth	*8.2*	*12.1*	*12.2*
P/E (x)	16.6	14.8	13.2
EV/EBITDA (x)	9.1	7.5	6.3
Div yield (%)	2.6	2.7	2.8

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	60.4	-	-
FIIs	9.4	0.0	(0.1)
MFs	13.1	0.4	0.3
UTI	1.3	0.3	0.2
LIC	4.2	0.1	0.0

Aventis Pharma : Dip in exports impact growth

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- **Net profit is up 17% in Q1; aided by high other income**
- **Dip in exports constrained revenue growth to 6% in the quarter, while rise in material cost resulted in a 2% dip in operating profit**
- **We expect earnings growth of 12% for the next two years**
- **Maintain IL rating**

Revenues for the quarter grew by 6%, operating profit was down 2% and net profit was up 17% to Rs433 mn. EBITDA margin for the quarter was down 180bps to 23.2%, as material cost rose120 bps. Other income includes Rs50 mn as write-back of indirect taxes, and this has helped beat our estimate of Rs412 mn net profit. Overall, we expect revenue growth of 10-11% for the next two years and earnings growth of 12%. We estimate cash/share of Rs155, after paying a dividend of Rs32.5/share in CY2006. The stock is down 35% in the last 12 months, and is trading at 15X CY2007 earnings. Given the attractive valuations ' we think that more than earnings, the focus is on two subjects (1) path forward regarding integration of parent's wholly-owned subsidiary, and (2) potential termination of marketing rights for Rabipur vaccine (~10% of sales), after Novartis AG's buyout of Chiron. However, if such a transfer happens, it will likely happen at market related value thus limiting the downside. Finally any adverse change in domestic pricing policy can also materially impact estimates. Maintain IL rating and price target of Rs1470. Our price target implies a 15% discount to December 2007 DCF-based fair value.

Dip in exports impacts topline growth. Net sales increased by 6% to Rs2.1 bn in CY2006. Domestic formulation sales grew by 11%, while exports dipped by 10%. We expect buoyancy in domestic business to continue and have modeled 12-13% growth over the next two years. However our estimates for exports is a modest 6% growth, which dipped 1% in CY2006. Exports constituted 20% of quarter's sales. Most of exports are to group companies (mainly to the CIS and Europe), either formulations or intermediates.

EBITDA margin is down 180bps to 23.2%, owing to higher material cost. Material cost has gone up by 120 bps to 48.6%. There is some impact of increased Lantus sales, which has significantly lower gross margin (~14%). The low gross margin is a result of the product being under price control, whereby it only gets a 50% markup over imported price. However the company is reimbursed certain marketing costs from the parent, which helps shore up the operating margin of this product. We have modeled operating margin of 25.8% in CY2007 and 25.9% in CY2008. Overall, we expect revenue growth of 10-11% for the next two years and earnings growth of 12%.

Strategic brands are driving domestic growth in domestic formulations. Strategic brands constitute over 30% of the company's domestic sales, and have been the key growth driver. We do not have individual brand wise growth for 2006. However we understand that the key brands like Amaryl, Cardace, Clexane, Frisium, Lantus, Rabipur and Targocid are all doing well. We expect these same brands to continue to drive growth. The company expects Lantus to be its largest brand in 3-4 years, the world's first and only once-daily twenty-four hour basal insulin.

Aventis is the ninth largest formulations company in India, and more importantly, it is extremely strong in its focus segments - oncology and metabolic diseases. Most new drugs from the parent's pipeline have been launched in India and Aventis done well to convert them into successful brands. Now branded generics too would be added to its portfolio, thus driving the growth momentum. Management integration with the local Sanofi arm has long been completed, but the legal merger is still awaited. While this is a key concern, we believe that products from the Aventis pipeline will be launched through the listed company.

Aventis - results table; y/e December (Rs mn)

	Q1CY06	Q2CY06	Q3CY06	Q4CY06	Q1CY07	yoy growth %	CY2006	CY2007
Sales	2,119	2,364	2,572	2,312	2,265	7	9,367	10,381
Excise Duty	114	136	141	136	136		527	592
Net Sales	**2,005**	**2,228**	**2,431**	**2,176**	**2,129**	6	**8,840**	**9,790**
Domestic	1,535	1,712	1,795	1,540	1,706	11	6,582	7,396
Exports	470	516	636	636	423	(10)	2,258	2,393
Expenses	**1,503**	**1,609**	**1,744**	**1,749**	**1,635**		**6,633**	**7,261**
Inc/Dec in Stock in trade	(238)	76	(116)	53	(228)			
Materials	1,188	961	1,252	1,059	1,262		4,286	4,670
Staff Cost	179	195	203	208	210	17	785	848
Other Exp	374	377	405	429	391	5	1,562	1,744
EBITDA	**502**	**619**	**687**	**427**	**494**	(2)	**2,207**	**2,528**
Depreciation	43	42	43	51	45		179	178
Interest Income	40	52	119	64	95		275	322
Other Income	46	37	37	46	105		194	204
Pre-exceptional PBT	**545**	**666**	**800**	**486**	**649**	19	**2,497**	**2,876**
Exceptional Items							0	0
PBT	**545**	**666**	**800**	**486**	**649**		**2,497**	**2,876**
Tax	188	231	266	193	199		878	978
Deferred Tax	(12)	(4)	(4)	(54)	17		(74)	0
PAT	**369**	**439**	**538**	**347**	**433**	17	**1,693**	**1,898**
Adj. PAT	**369**	**439**	**538**	**347**	**433**	17	**1,693**	**1,898**
Ratios (%)								
Material consumed(% of revenues)	47.4	46.5	46.7	51.1	48.6		48.5	47.7
Staff cost (% of revenues)	8.9	8.8	8.4	9.6	9.9		8.9	8.7
Other expenses (% of revenues)	18.7	16.9	16.7	19.7	18.4		17.7	17.8
EBITDA margin (%)	25.0	27.8	28.3	19.6	23.2		25.0	25.8
Tax/PBT (%)	32.3	34.1	32.8	28.6	33.3		32.2	34.0
Adjusted net profit margin (%)	18.4	19.7	22.1	15.9	20.3		19.2	19.4

Transportation

JET.BO, Rs632	
Rating	U
Sector coverage view	Cautious
Target Price (Rs)	400
52W High -Low (Rs)	1010 - 475
Market Cap (Rs bn)	54.6

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	72.3	105.5	138.0
Net Profit (Rs bn)	(0.5)	(3.1)	1.6
EPS (Rs)	(6.2)	(35.5)	18.7
EPS gth	*(115.2)*	-	-
P/E (x)	(101.9)	(17.8)	33.7
EV/EBITDA (x)	35.8	11.2	5.1
Div yield (%)	(0.2)	(1.2)	0.6

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.0	-	-
FIIs	8.6	0.1	(0.1)
MFs	1.7	0.1	(0.1)
UTI	-	-	(0.2)
LIC	2.8	0.1	(0.1)

Jet Airways : Sahara takeover valuation is expensive and turnaround target appears ambitious

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- **Jet Airways' takeover of Sahara Airlines appears expensive**
- **Promise of first-year break-even appears difficult to achieve**
- **The acquisition may however offer several long-term benefits**
- **Impending equity issuance, capex and potential losses in international operations may overshadow medium-term stock performance**
- **Maintain Underperform**

Jet Airways will takeover Air Sahara at a revised adjusted EV of Rs36.7 bn, including the capitalized value of operating leases and amount already spent. Jet plans to rechristen the airline 'Jetlite' and operate it as a wholly-owned no-frills subsidiary. The management's promise that Jetlite would break-even in the very first year (FY2008) would require drastic improvements in efficiency, pricing and load factors and hence is difficult to achieve, in our view. In the best-case event that the airline does break-even in Year-1, the implied EV/EBIDTAR of the acquisition is 11.6x, which appears expensive at least in the near term. However, the acquisition makes sense from a long-term perspective considering less competition, more rational pricing potential in the domestic market and ability to plug a key gap in Jet's product offering. Our Underperform rating on the stock stems from medium term concerns, viz. continued losses on international operations, longer-than-expected turnaround path of Jetlite, capex and equity issuance overhang. In the absence of past or future financial estimates of Air Sahara, we retain our estimates and target price of Rs400/share.

Jet will take over Sahara Airlines at an adjusted EV of Rs36.7 bn

Jet has agreed to a cash payout of Rs14.5 bn for acquiring Sahara Airlines. Of this, Jet had already paid Rs5 bn as advance and had deposited Rs4 bn as bank guarantee. This leaves Rs5.5 bn to be paid over 4 equal annual installments beginning March 2008. At 12% discount rate, the NPV of the cash payments works out to Rs13.2 bn. After considering Rs1.8 bn already invested in Sahara's operations and the capitalized value of off-balance sheet operating leases (Rs3.1 bn per annum multiplied by a factor of 7), the adjusted EV of the acquisition works out to Rs36.7 bn (Exhibit 1).

Sahara planes will fly as Jetlite, Jet Airways' wholly owned low-fare subsidiary

Jet plans to rechristen the airline 'Jetlite' and operate it as a wholly-owned no-frills subsidiary. The management would likely have to provide consolidated income and balance sheet numbers on a quarterly basis going forward.

- Jetlite would operate 25 aircraft, all leased, with a total estimated seat capacity of 3,675.
- We estimate Jetlite would have accumulated losses of Rs7 bn, which can be adjusted against future profits of the airline.
- Jetlite's leases would last for 2-3 years on an average. Lease rentals were negotiated 6-7 years back and have increased around 10% in the meantime.
- The average fleet age is 8 years, higher than Jet's 6 years

First-year break-even target implies EBIDTAR of around Rs3.2 bn

The management of Jet Airways has promised that Jetlite would break-even in the very first year (FY2008). The target implies an EBIDTAR of around Rs3.2 bn, in our estimate, assuming: a) an annual operating lease rental burden of Rs3.1 bn, b) all aircraft are leased, so there is no interest burden and c) no taxes due to accumulated losses

Turnaround strategy: pricing power, better aircraft utilization and load factors, cost savings

The management turnaround strategy hinges on a) more efficient utilization of existing aircraft, b) migrating the low-yielding customers of Jet to Jetlite and thus raising load factors, c) raising ticket prices in select routes and time slots for both carriers wherever the combine has a significant market share and d) optimizing administrative overheads in order to bring down unit costs. Under the agreement, Jet would take over the cabin crew and pilots of Sahara but administrative personnel would probably return to the Sahara group. The combine would optimize the use of its engineering staff and also be in a better bargaining position to negotiate maintenance and spares-related overheads.

Management's turnaround target probably assumes everything will fall in place

A first-year break-even will face the following barriers, in our view:

a) Infrastructure bottlenecks (i.e. airports) may constrain more efficient aircraft utilization in the near term

b) Given that Sahara is currently operating at just 65% load factor, a major jump may be difficult even if Jet tries to migrate some of its low-yielding passengers

c) Competitive factors may constrain significant pricing improvements. In fact, the migration to low-fare model would exert a downward pressure on yields

d) Given India's no-frills airlines have limited costing flexibility given low internet penetration (limiting online ticket distribution) and lack of alternative low-cost airports, the cost savings may be limited

Thus, a number of factors would have to fall in place smoothly for the airline to break-even in Year-1 itself (Exhibit 2).

Valuation expensive from near-term perspective

Assuming that the management executes its turnaround guidance to perfection, the implied adjusted EV/EBIDTAR of the acquisition is 11.6x, implying an operating cash yield of 8.6%. This is expensive at least in the near term. In the absence of financial estimates for Air Sahara, either past or future, it is difficult to say if the acquisition is really value-accretive.

The acquisition may however make sense from the long-term point of view

The acquisition of Sahara Airlines eliminates a key competitor for Jet Airways. This could improve pricing power for the Indian aviation market, considering a) Sahara Airlines, which was in a sell-out mode, may have been heavily discounting its fares and b) as part of a large unlisted conglomerate, the financial accountability may have been low.

We consider the absence of a no-frills airline as a key gap in Jet's domestic product offering. The low-fare segment of air traffic is growing at 45-50%. A no-frills airline offering reliable services and intelligent route structuring could gain market share and operate at decent load factors in our view. While Jet Airways was capturing the discount-travelers via its yield management system (YMS), we believe even the best of YMS is based on estimates and hence would have its limitations.

We have concerns on capex overhang and international operations

Our Underperform rating on the stock stems from medium term concerns, viz. continued losses on international operations, longer-than-expected turnaround path of Jetlite, capex and equity issuance overhang. In the absence of past or future financial estimates of Air Sahara, we retain our estimates and target price of Rs400/share.

Exhibit 1: The adjusted EV of the acquisition is Rs36.7 bn

Already paid	9.0
PV of future payments of Rs5 bn	4.2
Aleady invested in operations	1.8
Capitalised value of off-balance sheet operating leases	21.7
Total	**36.7**

Source: Kotak Institutional Equities

Exhibit 2: Financial estimates of Air Sahara under various scenarios

	I: current situation	II: sharp turnaround	III: mild turnaround	IV: ideal case scenario
Current seat capacity (# of seats)	3,675.0	3,675.0	3,675.0	3,675.0
Aircraft utilisation/day (no. hrs)	8.0	9.0	8.5	10.0
ASKM (mn)	7,511.7	8,450.7	7,981.2	9,389.6
Seat factor (%)	65.0	75.0	70.0	85.0
RPK (mn)	4,882.6	6,338.0	5,586.8	7,981.2
Yield (Rs/RPK)	4.0	4.5	4.3	4.5
Revenues (Rs mn)	19,530.4	28,521.0	23,744.0	35,915.3
Operating cost (Rs/ASK)	3.50	3.00	3.25	3.00
Operating cost (Rs mn)	26,291.0	25,352.0	25,938.8	28,168.9
EBIDTAR (Rs mn)	**(6,760.5)**	**3,169.0**	**(2,194.8)**	**7,746.4**
EBIDTAR margin (%)	**(34.6)**	**11.1**	**(9.2)**	**21.6**
Adjusted EV of the deal (Rs mn)		36,700.0		36,700.0
EV/EBIDTAR		11.6		4.7
Comments	We believe Sahara may be making huge losses, although these numbers are not confirmed	Management seems to be primising a sharp turnaround	We believe a benign turnaround is more realistic	Ideal case of 22% EBIDTAR margin

Source: Kotak Institutional Equities

Utilities

CESC.BO, Rs400	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	396
52W High -Low (Rs)	410 - 198
Market Cap (Rs bn)	33.7

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	25.2	25.4	27.4
Net Profit (Rs bn)	3.0	2.4	3.0
EPS (Rs)	36.0	29.0	35.0
EPS gth	*32.8*	*(20.0)*	*21.3*
P/E (x)	11.1	13.8	11.4
EV/EBITDA (x)	6.4	6.9	5.2
Div yield (%)	1.4	1.1	1.3

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	39.5	-	-
FIIs	30.3	0.1	0.0
MFs	3.8	0.1	0.0
UTI	-	-	(0.1)
LIC	7.4	0.2	0.1

CESC : Plans to merge the holding company of RPG's retail business with CESC; retain In Line

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- **RPG's retail business to be merged with CESC - utilize the balance sheet strength of CESC**
- **Real estate development through a 100% subsidiary and capture full value**
- **Retain In Line rating on the stock with target price of Rs396/share**

The board of CESC is meeting on April 17 to consider the proposal for merging the holding company of Spencer Retail (RPG's retailing business) with itself. The retailing business will likely utilize the balance sheet strength of CESC for financing the growth. The retail business of RPG is currently held privately and we do not have details about its financials. We will wait for more clarity on the financials of the retail business and proposed swap ratio for the merger before reviewing our estimates. CESC now plans to undertake real estate development on identified surplus land in Kolkata on its own and capture the full value. We retain our In Line rating on the stock and revise our target price to Rs396/share (from Rs375 previously), primarily to reflect higher value from real estate development. We have also fine-tuned our assumptions for the core business valuation.

Retail business to utilize the balance sheet strength of CESC. CESC plans to merge the holding company of RPG's retail business to utilize the strong balance sheet of CESC. A strong balance sheet support will enable financing of growth plans of the retail business at lower cost. Media reports indicate RPG's retail business turnover at Rs7 bn derived from 220 stores occupying an area of about 700,000 sq. ft. RPG group plans to invest Rs10-12 bn during the next 15-18 months to open 20-30 new stores per month and add 1.5 mn sq.ft. of retail space. The expansion plan spans all four divisions in the retail business—Spencer's Retail, RPG Cellucom, Books & Beyond and Music World.

SOTP-based target price increased to Rs396/share (Rs375 previously). We have increased our SOTP-based target price to Rs396/share:

Higher value from real estate business. We now assign a higher valuation (Rs27/share compared to Rs14/share previously) to CESC's real estate business. Earlier we had taken 50% value for CESC's real estate ventures as CESC was planning to bring in a real estate developer as a 50% partner. CESC has now floated a 100% subsidiary to manage its real estate ventures and plans to develop the real estate business from the prime lands owned by CESC on its own.

CESC's core business valued at Rs260/share. We value CESC's operational power generation, transmission and distribution business in Kolkata at Rs260/share (previously Rs258/share). We have increased our cost of equity assumption to 11% from 10% previously. We believe that the differential between cost of equity and assured return on equity will likely continue to attract investments in the sector. We have kept the return of equity constant at 14% instead of our earlier assumption of the RoE declining to 12.5%. The 250 MW expansion project at Budge Budge contributes additional Rs23/share (including Rs10/share in Capital-WIP invested till date) to our target price.

CESC Sum-of-parts valuation

	Methodology	Key assumptions				FY2007E Book value per share (Rs)	Per share value (Rs)-new
Kolkata generation, transmission & distribution	**DCF to equity** Disc. rate: 11% Terminal year growth: 2.5%	The business enjoys very high predictability of cash flows. We value enhancement on account of 250 MW expansion at Budge Budge captured separately				162	260
Real-estate	**DCF** Disc. rate: 11% Terminal year growth: 3%	**Mall**		**35 acre land at Mulajore**			27
		Area for lease (sq ft)	400,000	Area for sale (sq ft)	2,500,000		
		Rental (Rs/sq ft)	100	Rate (Rs/sq ft)	600		
		Inflation in rental (%)	3				
		CESC's share (%) (A)	50	CESC's share (%) (A)	50		
		CESC's retainable share of A (%)	67	CESC's retainable share of A (%)	67		
Investments	**Book value**	1% Cumulative optionally convertible preference shares of Integrated Coal Mining Ltd. (Rs mn)			300	4	4
Residual Book		Represents equity raising & retained earnings in the form of marketable securities & cash				15	
Cash and investible surplus on books	**Market value**	Marketable securities & cash on books (Rs bn):			6.1		40
		Less Regulatory liability/unallocable debt (Rs mn)			-2.7		
		Net cash and investible surplus (Rs mn)			**3.4**		
New Projects: Budge Budge 3rd unit	DCF to equity Disc. rate: 11% Terminal year growth: nil	Likely enhancement is 1.3X (on the full investment of Rs36/share) based on our valuation framework. Likely investment by March 2007 is Rs10/share.				10	23
Total						**192**	**353**
Value enhancement from incr. capacity							43
Target price							**396**

Source: Kotak Institutional Equities estimates

CESC Limited, March fiscal year-ends, 2005-2009E

	2005	2006	2007E	2008E	2009E
Net revenues	**23,212**	**25,159**	**25,242**	**25,357**	**27,422**
Operating costs	(15,679)	(18,002)	(18,375)	(19,554)	(20,272)
EBITDA	**7,533**	**7,157**	**6,867**	**5,804**	**7,150**
Depreciation & amortization	(2,915)	(2,539)	(1,636)	(1,705)	(1,755)
EBIT	4,618	4,619	5,230	4,099	5,395
Interest (expense)	(3,347)	(3,013)	(2,738)	(2,185)	(2,145)
Treasury income	18	94	209	150	200
Other income/(expense)	642	643	640	746	1,057
Special appropriation for deferred payments	(35)	(69)	—	—	—
Pre-tax profit	1,896	2,273	3,341	2,810	4,507
Income tax	(129)	(200)	(375)	(315)	(1,274)
Profit after tax	**1,767.4**	**2,073.4**	**2,967**	**2,494**	**3,233**
Extraordinary income/(expense)	(295)	(299)	—	—	—
Net profit	**1,472**	**1,775**	**2,967**	**2,494**	**3,233**
EPS (Rs)	**25.2**	**26.5**	**36.0**	**29.6**	**38.3**
Diluted EPS (Rs)	25.2	26.5	36.0	29.6	38.3
CEPS (Rs)	66.6	58.9	55.9	49.8	59.2
Dividend per share (Rs)	2.5	2.5	3.6	4.4	5.8
Weighted avg. shares (mn)	70.3	78.4	82.3	84.3	84.3
Share outstanding (mn)	74.4	82.3	84.3	84.3	84.3
Ratios (%)					
Revenue growth	**(1.2)**	**8.4**	**0.3**	**0.5**	**8.1**
EBIDTA margin	32.5	28.4	27.2	22.9	26.1
EBIDTA growth(%)	(11.8)	(5.0)	(4.1)	(15.5)	23.2
Income tax rate	6.8	8.8	11.2	11.2	28.3
Dividend payout ratio	9.9	9.4	10	15	15
PBT growth (%)	14.7	19.9	47.0	(15.9)	60.4
EPS growth	**0.3**	**5.2**	**36.2**	**(17.9)**	**29.6**

Source: Company data, Kotak Institutional Equities estimates.

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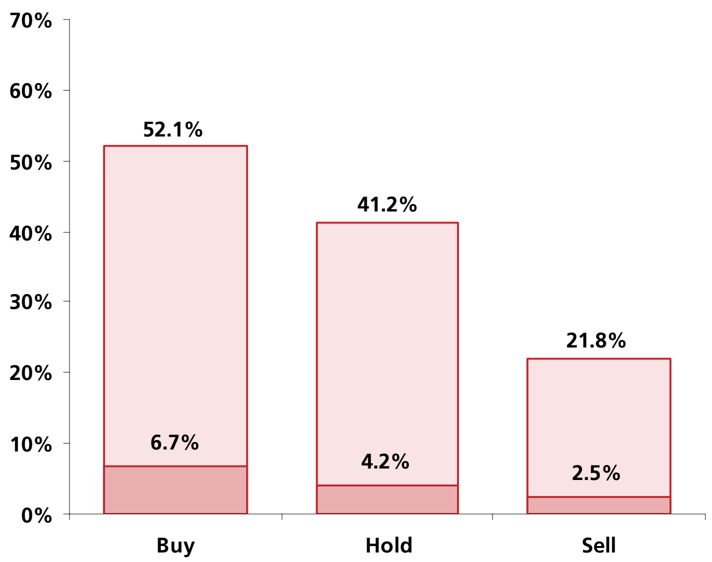

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Source: Kotak Institutional Equities. As of March 31, 2007

Ratings and other definitions/identifiers

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