kotak® Institutional Equities

INDIA DAILY

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News Roundup

Corporate

- ONGC led consortium including IOC and OIL has found huge oil and gas reserves in the Farsi Block in Persian Gulf. It is estimated to have 10 tn cubic feet of natural gas and 1 bn barrels of oil. (ET)
- Canara Bank looking to acquire Dena Bank, appoints E&Y to explore the possibility of the Deal (BS)
- Holcim increases its stake in ACC to 41% by acquiring another 3% for Rs5.3 bn (FE)
- Tata Tea enters into a 70:30 JV with Chinese company Zhejiang Tea. Initial investment by two companies would be $16 bn to set up a facility in China (ET)

Economic and political

- Government considering to bar real estate companies from issuing ADRs and GDRs. It is believed that ADRs and GDRs being easily transferable defeats the lock-in period stipulation present in the FDI guidelines hence the restriction is necessary (ET)
- SC has allowed the field trials of genetically modified seeds in the country. This will pave the way for the commercialisation of 16 transgenic cotton hybrids. (BL)

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

EQUITY MARKETS

	Change, %			
India	**8-May**	**1-day**	**1-mo**	**3-mo**
Sensex	13,765	(0.8)	4.5	(5.3)
Nifty	4,077	(0.8)	6.1	(2.6)
Global/Regional indices				
Dow Jones	13,309	(0.0)	5.9	5.8
Nasdaq Composite	2,572	0.0	4.2	4.6
FTSE	6,550	(0.8)	2.4	2.6
Nikkie	17,656	(0.0)	(0.5)	0.9
Hang Seng	20,706	(0.9)	2.5	0.1
KOSPI	1,581	(0.1)	5.3	10.7

Value traded - India

	Moving avg, Rs bn			
	8-May		**1-mo**	**3-mo**
Cash (NSE+BSE)	137.0		128.1	125.2
Derivatives (NSE)	271.3		249.6	288.2
Deri. open interest	492.2		444.5	611.9

Forex/money market

	Change, basis points			
	8-May	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.8	-	(210)	(333)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	(3)	(3)	35

Net investment (US$mn)

	4-May		**MTD**	**CYTD**
FIIs	50		1,257	40
MFs	14		234	(303)

Top movers -3mo basis

	Change, %			
Best performers	**8-May**	**1-day**	**1-mo**	**3-mo**
Balaji Telefilms	162	(1.9)	26.9	25.7
GESCO	256	(0.0)	21.6	22.1
Thomas Cook	614	8.5	23.6	21.5
SAIL	136	0.7	14.6	19.6
Wockhardt	411	(1.4)	0.2	19.5
Worst performers				
Polaris	162	(2.6)	(5.4)	(26.3)
Tata Motors	726	(0.3)	3.1	(19.9)
Ingersoll Rand	291	(0.1)	7.6	(19.8)
Ashok Leyland	38	(1.8)	4.2	(19.8)
Arvind Mills	45	(1.3)	2.7	(19.5)

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Energy

GAIL.BO, Rs293	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	325
52W High -Low (Rs)	340 - 210
Market Cap (Rs bn)	247.9

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	180.4	224.3	241.6
Net Profit (Rs bn)	21.4	22.7	24.5
EPS (Rs)	25.3	26.9	28.9
EPS gth	*(9.3)*	*6.0*	*7.6*
P/E (x)	11.6	10.9	10.1
EV/EBITDA (x)	6.6	5.7	4.8
Div yield (%)	3.4	3.4	3.8

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.3	-	-
FIIs	21.5	0.8	(0.0)
MFs	2.2	0.5	(0.3)
UTI	-	-	(0.8)
LIC	6.3	1.3	0.5

GAIL (India): 4QFY07 reported numbers good but government policy rearing its ugly head again

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- **Tax write-back took care of high subsidy loss**
- **EBITDA adjusted for higher subsidy loss was in line with expectations**
- **Revised earnings and 12-month SOTP-based target price to Rs325 from Rs295 previously**

GAIL (India) reported 4QFY07 net income at Rs6.8 bn versus our expected Rs5.1 bn and Rs6.7 bn in 3QFY07. However, the result is helped by a tax write-back of Rs3.4 bn but impacted by high subsidy loss of Rs5 bn (versus our expected Rs2.64 bn). GAIL's 4QFY07 subsidy loss amount has increased significantly versus Rs3.15 bn in 3QFY07 and Rs9.86 bn in 9MFY07. We are perplexed by the large figure in 4QFY07 as industry gross under-recoveries on sale of subsidized products was likely lower in 4QFY07 versus 3QFY07 as per our computations. We have made moderate changes to our earnings model to reflect (1) higher product (LPG, petrochemical) prices, (2) higher subsidy losses and (3) stronger rupee. We have rolled-forward our 12-month SOTP-based target price to FY2009 and now have a target price of Rs325 versus Rs295 previously. Key downside risks stem from higher-than-expected subsidy losses and weaker-than-expected commodity prices.

EBITDA is in line adjusted for higher subsidy loss. GAIL reported 4QFY07 EBITDA at Rs6 bn, below our expected Rs8.4 bn. However, adjusted for Rs2.38 bn of extra subsidy loss (Rs5.02 bn versus our expected Rs2.64 bn), the reported EBITDA is exactly in line with our expectations. However, we note that the subsidy figure has been provided on a provisional basis in the absence of communication from the government. We are not sure about the basis of the computation as our calculations suggest that gross under-recoveries were lower in 4QFY07 versus 3QFY07. It is possible that the government has changed the share of upstream companies to more than the normally applicable one-third. This will likely create uncertainty about future earnings of the upstream companies, in our view.

Operating parameters not yet available; tax write-back helped net income. The company has not provided sales and production volume data (likely available a day later), which makes it difficult to comment on the operating numbers (other than the subsidy issue). The company had a tax write-back of Rs3.4 bn pertaining to past several previous years, which helped prop up the bottom line. The management explained that it had created more tax provision versus actual assessment.

Earnings revisions. We have made several revisions to our earnings model—(1) higher crude and resultant petrochemical and LPG prices, (2) higher subsidy losses and (3) stronger rupee. Exhibit 3 gives our key assumptions and Exhibit 4 gives key financials.

FY2008. We have reduced FY2008E EPS modestly to Rs26.9 from Rs28.5 previously. The downward revision primarily reflects a steep increase in subsidy loss to Rs12 bn compared to Rs9 bn previously. We have also raised LPG and petrochemical prices by about 8% but the positive impact of the price increase is partly eroded by a stronger rupee (Rs43/US$ versus Rs45/US$ previously).

We model GAIL's gas transportation volume at 90 mcm/d for FY2008E versus 82 mcm/d in FY2007. The increase reflects additional volumes in GAIL's Dahej-Panvel-Dabhol pipeline, which it will commission by end-May 2007. This pipeline (12 mcm/d capacity) will carry gas from Petronet LNG's Dahej terminal to the Dabhol power plant.

FY2009. We have fine-tuned FY2009E EPS to Rs28.9 from Rs28 previously. The upward revision reflects higher LPG (+8.3%) and petrochemical (+9.6%) prices, which in turn reflects our higher crude price view (US$60/bbl versus US$55/bbl previously on Dated Brent basis). We have also increased subsidy loss to Rs9 bn compared to Rs7.5 bn assumed previously. However, the subsidy figure is difficult to factor in noting the influence of several key variables—(1) global crude price, (2) domestic selling price of four controlled products, which depends on the government of India and (3) amount of oil bonds given by the government to downstream oil companies, which will influence the share of the upstream companies such as GAIL.

FY2010. We have raised FY2010E EPS to Rs31.5 from Rs29.2 previously. The upward revision reflects (1) higher product (LPG, polyethylene) prices and (2) same subsidy amount of Rs6 bn. We model gas transportation volumes to remain constant at 96 mcm/d.

However, GAIL has announced several new pipelines in anticipation of new gas supply from Reliance's KG D-6 block. As of now, we have not built in the capex or the volumes from the new pipelines pending more details from the management. The total capex is Rs180 bn and GAIL's capacity will increase to 280 mcm/d from the current 140 mcm/d.

GAIL interim results, March fiscal year-ends (Rs mn)

			qoq			yoy			yoy	
	2008E	4Q 2007	3Q 2007	*% chg*	4Q 2007	4Q 2006	*% chg*	FY2007	FY2006	*% chg*
Sales (a)	224,254	38,834	51,062		38,834	42,078		160,472	163,513	
Total expenditure	190,881	32,810	42,421	*(22.7)*	32,810	35,034	*(6.3)*	130,499	128,534	*1.5*
(Inc)/dec in stock	(753)	(284)	588		(284)	84		(753)	(249)	
Purchase	153,217	23,368	30,568	*(23.6)*	23,368	25,396	*(8.0)*	94,290	99,096	*(4.8)*
Raw material	21,132	4,527	5,559	*(18.6)*	4,527	4,427	*2.3*	17,851	14,758	*21.0*
Staff cost	3,128	816	651	*25.4*	816	528	*54.7*	2,923	2,213	*32.1*
Other expenditure	14,157	4,383	5,055	*(13.3)*	4,383	4,599	*(4.7)*	16,187	12,717	*27.3*
EBITDA	**33,373**	**6,024**	**8,641**	***(30.3)***	**6,024**	**7,044**	***(14.5)***	**29,973**	**34,979**	***(14.3)***
Other income	6,105	1,129	1,846	*(38.9)*	1,129	844	*33.7*	5,450	4,555	*19.6*
Interest	829	221	271	*(18.3)*	221	292	*(24.4)*	1,071	1,173	*(8.7)*
Depreciation	6,248	1,471	1,439	*2.3*	1,471	1,391	*5.8*	5,754	5,595	*2.8*
Pretax profits	**32,401**	**5,461**	**8,778**	*(37.8)*	**5,461**	**6,205**	*(12.0)*	**28,598**	**32,766**	*(12.7)*
Tax	6,577	1,779	2,158	*(17.6)*	1,779	1,729	*2.9*	7,941	9,221	*(13.9)*
Deferred	2,346	274	(34)	*(905.0)*	274	383	*(28.6)*	190	445	*(57.3)*
Prior period adjust.	3,399	3,399	—		3,399	—		3,399	—	
Net income	**26,878**	**6,807**	**6,655**	*2.3*	**6,807**	**4,093**	*66.3*	**23,867**	**23,101**	*3.3*
Tax rate (%)	27.5	37.6	24.2		37.6	34.0		28.4	29.5	
Volume data										
Gas sales (mcm/d)		—	69.7		—	68.4		—	67.6	
Gas transmission (mcm/day)		—	80.4		—	78.3		—	78.9	
LPG transported ('000 tonnes)		—	728		—	690		—	2,228	
LPG production ('000 tonnes)		—	269		—	274		—	1,042	
LPG sales ('000 tonnes)		—	269		—	265		—	1,039	
Other liquids prodn ('000 tonnes)		—	80		—	76		—	283	
Other liquids sales ('000 tonnes)		—	80		—	77		—	283	
Polymers ('000 tonnes)-prodn		—	94		—	104		—	312	
Polymers ('000 tonnes)-sales		—	97		—	107		—	313	
Subsidy payment		(5,020)	(3,150)	*59.4*	(5,020)	(5,380)	*(6.7)*	(14,880)	(10,640)	*39.8*
Segment revenue (Sales/Income)										
Transmission services										
(1) Natural gas		4,762	6,413	*(25.7)*	4,762	5,635	*(15.5)*	22,144	23,020	*(3.8)*
(2) LPG		915	994	*(7.9)*	915	944	*(3.1)*	3,440	3,082	*11.6*
Natural gas trading		29,701	31,494	*(5.7)*	29,701	25,495	*16.5*	120,208	100,430	*19.7*
Petrochemicals		7,437	7,306	*1.8*	7,437	6,729	*10.5*	25,702	19,415	*32.4*
LPG and liquid hydrocarbons		4,332	6,261	*(30.8)*	4,332	4,682	*(7.5)*	21,219	22,017	*(3.6)*
Telecom		69	71	*(1.8)*	69	45	*55.3*	254	183	*38.4*
Unallocated		984	1,764	*(44.2)*	984	740	*33.0*	5,097	4,082	*24.9*
Total		48,200	54,302	*(11.2)*	48,200	44,270	*8.9*	198,063	172,229	*15.0*
Less: Inter-segment revenue		6,844	7,279	*(6.0)*	6,844	5,480	*24.9*	27,155	18,919	*43.5*
Sales/Income from operations		**41,356**	**47,024**	***(12.1)***	**41,356**	**38,790**	***6.6***	**170,908**	**153,310**	***11.5***
Segment results (Profit before tax and interest)										
Transmission services										
(1) Natural gas		2,767	4,548	*(39.1)*	2,767	4,011	*(31.0)*	15,154	17,260	*(12.2)*
(2) LPG		487	603	*(19.2)*	487	497	*(2.0)*	1,906	1,583	*20.4*
Natural gas trading		492	563	*0.0*	492	(615)	*(180.1)*	1,943	592	*228.3*
Petrochemicals		3,008	2,775	*8.4*	3,008	2,645	*13.7*	9,545	7,139	*33.7*
LPG and liquid hydrocarbons		(732)	905	*(180.9)*	(732)	249	*(394.1)*	1,022	6,046	*(83.1)*
Telecom		5	1	*980.0*	5	(4)	*(228.6)*	10	(18)	*(154.8)*
Total		6,028	9,394	*(35.8)*	6,028	6,782	*(11.1)*	29,579	32,603	*(9.3)*
Less: Interest		221	271	*(18.3)*	221	292	*(24.4)*	1,071	1,173	*(8.7)*
Less: Other unallocable exp (net)		346	345	*0.3*	346	285	*21.5*	(90)	(1,336)	*(93.3)*
Total PBT		**5,461**	**8,778**	***(37.8)***	**5,461**	**6,205**	***(12.0)***	**28,598**	**32,766**	***(12.7)***
Capital employed										
Transmission services										
(1) Natural gas		37,011	35,682		37,011	27,568		37,011	27,568	
(2) LPG		10,510	10,672		10,510	11,079		10,510	11,079	
Petrochemicals		19,128	19,070		19,128	19,753		19,128	19,753	
LPG and liquid hydrocarbons		8,970	10,218		8,970	9,374		8,970	9,374	
Telecom		475	293		475	308		475	308	
Total		**76,094**	**75,936**		**76,094**	**68,081**		**76,094**	**68,081**	

Note:
(a) 4QFY07 sales and raw materials exclude internal consumption; corresponding figures of other quarters include internal consumption.

Source: Kotak Institutional Equities estimates, company reports.

We value GAIL stock at Rs325 per share

Sum-of-the-parts valuation of GAIL, FY2009 basis (Rs bn)

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		
	Replacement cost	EBITDA	EV/RC	EV/EBITDA	Replacement cost basis	EBITDA basis	EV (Rs/share)
Natural gas/LPG transportation		16		6.0		99	117
LPG production		16		2.5		41	49
Petrochemicals		8		3.5		29	34
Oil and gas upstream	18		1.00		18		22
Subsidy sharing scheme		(9)		1.0		(9)	(11)
Investments	69		0.80		56		66
ONGC shares	48		0.80		38		45
Others	22		0.80		17		20
Total		**32**				**160**	**276**
Debt					(41)	(41)	(48)
Implied value of share (Rs/share)							**325**

Source: Kotak Institutional Equities estimates.

We model moderate increase in gas volumes between FY2006 and FY2010

Key assumptions behind GAIL model, March fiscal year-ends, 2002-2010E

	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E
Volumes									
Natural gas transportation, gross (mcm/day)									
HBJ pipeline	33	33	32	32	32	32	32	32	32
Other pipelines	29	30	31	36	37	38	40	40	40
Regassified LNG									
Dahej-Vijaipur pipeline (transmitted and sold)				2	7	9	9	9	9
Dahej-Vijaipur pipeline (transmitted)				1	4	6	6	6	6
Dahej-Uran pipeline							6	12	12
Panvel-Dabhol pipeline							4	6	8
Elimination of double-counted volumes (a)					(1)	(3)	(7)	(9)	(11)
Total gas transmission	**62**	**63**	**63**	**72**	**80**	**82**	**90**	**96**	**96**
LPG (000 tonnes)									
Sold	996	1,113	1,089	1,089	1,039	1,080	1,100	1,100	1,100
Transported	1,312	1,521	1,841	2,138	2,228	2,500	2,750	2,800	2,800
Petrochemicals (000 tonnes)									
Polyethylene									
Domestic sales	213	234	225	279	271	335	365	410	410
Exports	38	55	40	40	40	10	10	—	—
Total petrochemicals	**251**	**289**	**265**	**319**	**311**	**345**	**375**	**410**	**410**
Prices									
Natural gas (Rs/cubic meter)									
Natural gas ceiling price	2.85	2.85	2.85	2.85	3.52	4.21	5.24	5.83	6.42
Regassified LNG including transportation			6.61	6.50	6.47	6.93	6.74	5.61	7.27
Transmission plus marketing charges									
HBJ pipeline, Dahej-Vijaipur pipeline (from FY2007)	1.15	1.15	1.15	1.15	1.15	0.99	0.96	0.96	0.97
Dahej-Vijaipur, Dahej-Uran, Panvel-Dabhol pipeline			0.69	0.67	0.69	0.99	1.04	1.04	1.05
Other pipelines			0.40	0.41	0.42	0.40	0.42	0.44	0.46
LPG									
LPG (US$/tonne)	268	314	319	399	510	531	523	485	485
Transmission charges (Rs/tonne)									
Jamnagar-Loni	1,350	1,414	1,436	1,522	1,522	1,522	1,522	1,522	1,522
Vizag-Secunderabad			1,450	1,450	1,450	1,450	1,450	1,450	1,450
Other assumptions									
Polyethylene, HDPE (US$/tonne)	560	590	680	990	1,055	1,315	1,315	1,250	1,200
Import tariff, Polyethylene	41%	36%	28%	17%	10%	5%	5%	4%	4%
Import tariff, LPG	10%	10%	10%	7%	0%	0%	0%	0%	0%
Exchange rate (Rs/US$)	47.6	48.4	46.0	45.0	44.3	45.3	43.0	43.0	43.0
Subsidy losses		—	4,280	11,380	10,640	14,880	12,000	9,000	6,000

Note:
(a) Gas transported through the HVJ or DV pipeline and then to smaller pipelines.

Source: Company, Kotak Institutional Equities estimates.

GAIL (India) Ltd: Profit model, balance sheet, cash model of GAIL 2004-2010E, March fiscal year-ends (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	116,395	135,914	163,513	180,409	224,254	241,642	271,951
EBITDA	**30,667**	**36,040**	**35,731**	**29,973**	**32,621**	**34,402**	**35,979**
Other income	2,440	3,491	4,555	5,450	6,105	7,145	8,985
Interest	(1,380)	(1,341)	(1,174)	(1,071)	(829)	(656)	(656)
Depreciation	(6,640)	(9,467)	(5,595)	(5,754)	(6,248)	(6,579)	(6,619)
Pretax profits	25,088	28,723	33,518	28,598	31,649	34,312	37,688
Tax	(8,373)	(8,898)	(9,221)	(7,941)	(6,577)	(8,849)	(10,546)
Deferred taxation	(1,078)	(277)	(445)	(190)	(2,346)	(1,002)	(512)
Net profits	**18,693**	**19,539**	**23,101**	**23,867**	**22,726**	**24,461**	**26,630**
Earnings per share (Rs)	**22.1**	**23.1**	**27.3**	**28.2**	**26.9**	**28.9**	**31.5**
Balance sheet (Rs mn)							
Total equity	74,452	86,261	99,733	113,907	126,740	140,317	155,075
Deferred taxation liability	12,276	12,552	12,997	13,187	15,532	16,534	17,046
Total borrowings	21,335	19,974	19,166	16,757	11,000	11,000	11,000
Current liabilities	30,302	34,742	37,522	44,520	50,719	52,994	57,351
Total liabilities and equity	**138,364**	**153,529**	**169,418**	**188,371**	**203,991**	**220,845**	**240,472**
Cash	15,680	34,468	44,959	29,662	37,211	59,137	83,241
Other current assets	25,391	29,671	28,309	37,743	40,380	40,078	40,411
Total fixed assets	89,574	81,550	81,716	106,532	111,966	107,196	102,387
Investments	7,720	7,840	14,434	14,434	14,434	14,434	14,434
Total assets	**138,364**	**153,529**	**169,418**	**188,371**	**203,991**	**220,845**	**240,472**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	23,954	26,912	25,165	24,361	25,215	24,897	24,777
Working capital changes	580	49	5,950	(2,436)	3,561	2,577	4,024
Capital expenditure	(26,924)	(1,472)	(5,811)	(30,570)	(11,681)	(1,810)	(1,810)
Investments	(841)	(120)	(6,462)	—	—	—	—
Other income	1,826	2,416	3,995	5,450	6,105	7,145	8,985
Free cash flow	**(1,405)**	**27,787**	**22,837**	**(3,196)**	**23,200**	**32,809**	**35,976**
Ratios (%)							
Debt/equity	24.6	20.2	17.0	13.2	7.7	7.0	6.4
Net debt/equity	6.5	(14.7)	(22.9)	(10.2)	(18.4)	(30.7)	(42.0)
ROAE (%)	23.2	21.1	21.8	19.9	16.9	16.4	16.2
ROACE (%)	**16.2**	**18.0**	**19.7**	**15.4**	**15.7**	**15.5**	**15.4**

Source: Kotak Institutional Equities estimates.

Transmission

JYTS.BO, Rs184	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	225
52W High -Low (Rs)	210 - 59
Market Cap (Rs bn)	15.2

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	10.3	15.1	18.3
Net Profit (Rs bn)	0.5	0.9	1.1
EPS (Rs)	6.6	10.7	13.1
EPS gth	*81.2*	*61.1*	*23.0*
P/E (x)	27.8	17.2	14.0
EV/EBITDA (x)	13.0	9.3	7.7
Div yield (%)	0.3	0.3	0.3

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	n/a	-	-
FIIs	n/a	-	-
MFs	n/a	-	-
UTI	n/a	-	-
LIC	n/a	-	-

Jyoti Structures: 4QFY07 result update: Marginally lower than estimates, upgrade TP

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- **Jyoti Structures (JSL) reported net income of Rs159 mn, up 53% yoy. JSL ended the year with net earnings of Rs545 mn, up 97%.**
- **Outstanding order backlog stands at Rs20 bn, higher than Rs11 bn at start of current fiscal. This is significant considering a 39% growth in revenue for the current year.**
- **We expect revenues to grow at CAGR of 33.6% over FY2007-09 and net earnings to grow 40.8% over the same period following higher order flows from Powergrid and higher Rural Electrification jobs.**
- **We roll our SOTP-based target price to FY2009, which leads to revision in TP to Rs225 (from Rs185 earlier) and Outperform rating on the stock.**

Jyoti Structures (JSL), in its 4QFY07 results reported a PAT of Rs159 mn, up 53% on yoy basis. Revenue, at Rs3.0 bn, grew by 29% and EBITDA margins (at 12.8%) improved 224 bps on yoy basis. The closing backlog at Rs20 bn (higher than what we had estimated earlier) would ensure a significant growth (39%) in revenues over the next two years. We maintain our Outperform rating on JSL and revise SOTP-based target price up to Rs225/ share (Rs185 earlier).

EBITDA margins for the quarter improved by 224 bps on yoy basis. During 2007, JSL executed multiple jobs for Ajmer VVNL, which reduced operating costs and improved operating profit margins. Besides, lower steel and zinc prices also helped. The management guided for operating margins in excess of 12% in FY2008 (vs. our estimates of 11.5%), which if fructifies will likely provides an upside to our estimates.

Order backlog at Rs20bn surprise us. JSL's order-backlog stands at Rs20 bn, almost twice of its backlog last year. This is despite a 40% growth in revenues, which is commendable in our opinion. It also implies order inflow growth of 100% over last year. Besides, a large part of backlog (27%) consists of distribution projects, which are of lower gestation, and hence would speed up execution time.

We expect revenues to grow at CAGR of 33.6% over FY2007-09. Our comfort stems from high order backlog as well as reasonably clear spending plans from Powergrid. Besides, the stated order-backlog does not include a probable order from Reliance Energy Transmissions; if at all that company manages to get the tender and gives the construction contract to Jyoti (which JSL was confident of receiving).

We now build Gulf-jyoti in valuations. Our communication with the management suggests that the Gulf-jyoti joint venture plant would commence trial runs in June 2007. Jyoti has booked an order from Dubai Electric and Water agency (DEWA) under its standalone entity, the construction work of which it intends to undertake in the Gulf-jyoti joint venture. Jyoti Structures will own 30% equity in the joint venture, besides charging a 15% of net earnings for managing the plant. Accordingly, our SOTP-based target price now includes value of jyoti's stake in the JV based on 45% profit sharing.

We roll our SOTP-based target price forward to FY2009, which leads to upward revision and TP now stand at Rs225/share (vs. Rs185 earlier)**.** We now include Jyoti's stake in Gulf-Jyoti JV as part of our SOTP-based valuation—which comprises of Rs7 of Gulf-Jyoti stake and Rs220 of standalone business of JSL. At target price, the stock would trade at 9X FY2009E EV/EBITDA and 16X FY2009E earnings. We maintain an Outperform rating on the stock.

Jyoti structures, Interim results, March fiscal-year ends (Rs mn)

	4Q 2007	4Q 2006	Yoy growth (%)	4Q 2007	3Q 2007	QoQ growth (%)	2007	2006	Yoy growth (%)
Revenue	**3,043**	**2,364**	**28.8**	**3,043**	**2,572**	**18.4**	**10,250**	**7,381**	**38.9**
Expenditure	**(2,654)**	**(2,115)**		**(2,654)**	**(2,213)**		**(8,996)**	**(6,633)**	
Stock adjustment	(172)	99		(172)	(89)		(441)	187	
Raw materials	(1,456)	(1,274)		(1,456)	(1,490)		(5,441)	(4,449)	
Staff costs	(87)	(41)		(87)	(64)		(266)	(185)	
Other expenditure	(940)	(899)		(940)	(572)		(2,847)	(2,186)	
EBITDA	**389**	**249**	**56.1**	**389**	**358**	**8.6**	**1,254**	**748**	**67.6**
OPM (%)	*12.8*	*10.5*		*12.8*	*13.9*		*12.2*	*10.1*	
Other income	1	15		1	3		8	21	
Depreciation	(16)	(16)		(16)	(15)		(58)	(48)	
EBIT	374	247		374	346		1,204	720	
Interest costs	(100)	(60)		(100)	(77)		(329)	(258)	
PBT	274	187		274	269		875	462	
Taxes	(114)	(83)		(114)	(95)		(330)	(185)	
PAT	**159**	**104**	**53.3**	**159**	**174**	**(8.4)**	**545**	**277**	**97.0**
Calculations (%)									
Raw material to revenue	53.5	49.7		53.5	61.4		57.4	57.7	
Total costs to revenue	87.2	89.5		87.2	86.1		87.8	89.9	
Effective tax rate	41.8	44.4		41.8	35.3		37.7	40.1	

Source: Company data

Jyoti structures, SOTP valuation, March fiscal-year ends (Rs mn)

	EV	Per share (Rs)	Remarks
Standalone business of Jyoti structures	17,969	217	Valued at DCF to firm basis, 2009E
30% stake in Gulf jyoti	608	7	Valued at 12X 2008E earnings, inclusive of value from management contract
Value of equity in Jyoti structures	**18,576**	**224**	
Target price		**225**	

Note:

(a) We have valued Jyoti's stake in the joint venture based on 45% net earnings share, which includes 15% of net earnings under a management contract

Source: Kotak Institutional Equities estimates

Jyoti structures, Discounted cash-flow model, March fiscal-year ends (Rs mn)

	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	1,254	1,732	2,031	1,712	1,841	1,979	2,127	2,287	2,401	2,540	
Tax	(276)	(463)	(609)	(565)	(608)	(653)	(702)	(755)	(793)		
Change in working capital	(725)	(696)	(645)	(603)	(250)	(250)	(250)	(250)	(150)		
Post-tax operating cash flow	**253**	**572**	**777**	**544**	**983**	**1,076**	**1,175**	**1,282**	**1,458**		
Capex	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(50)		
Free cash flow	**153**	**472**	**677**	**444**	**883**	**976**	**1,075**	**1,182**	**1,408**	**25,614**	
Discounted cash flow-now	154	427	548	322	574	568	561	552	590		
Discounted cash flow: 1-yr forward	153	476	612	359	641	634	626	617	658	624	
Discounted cash flow: 2-yr forward	-	472	683	401	715	708	699	688	735	696	660

	Now		**+ 1-year**		**+ 2-years**	
PV of cash flows	4,296	29%	5,400	32%	6,458	35%
PV of terminal value	10,725	71%	11,347	68%	12,005	65%
EV	15,021	100%	16,748	100%	18,463	100%
Less: Net debt	977		595		495	
Add: Investment in associates (1X BV)	-		-		-	
Equity value (Rs mn)	14,045		16,153		17,969	
Number of shares (mn)	82.9		82.9		82.9	
Equity value (Rs/share)	**170**		**195**		**217**	
Equity value (US mn)	321		369		411	
Exit FCF multiple (X)	18.2		18.2		18.2	
Exit EBITDA multiple (X)	10.1		10.1		10.1	

Calculation of weighted average cost of capital-WACC	
Terminal growth - g (%)	5.8
Risk free rate-Rf (10-year government bond) (%)	8.0
Market risk premium—(Rm-Rf) (%)	5.0
Beta (x)	1.1
Cost of equity-Ke (%)	13.5
Cost of debt-Kd (%)	9.0
Tax rate (%)	33.7
Debt/Capital (%)	25.0
Equity/Capital (%)	75.0
WACC (%)	**11.6**

Jyoti Structures, Profit Model, March fiscal year-ends, 2004-2009E, (Rs mn)

	2004	2005	2006E	2007E	2008E	2009E
Net Revenues	3,006	4,288	6,971	10,250	15,059	18,299
Other operating income	—	—	—	—	—	—
Gross operating revenues	**3,006**	**4,288**	**6,971**	**10,250**	**15,059**	**18,299**
Operating expenses						
Cost of goods sold	(1,826)	(2,773)	(4,274)	(6,283)	(9,382)	(11,401)
Staff costs	(119)	(149)	(193)	(250)	(234)	(234)
SG&A expenses	(693)	(865)	(1,631)	(2,463)	(3,711)	(4,634)
Total expenditure	**(2,638)**	**(3,787)**	**(6,098)**	**(8,996)**	**(13,327)**	**(16,268)**
(% oe revenues)	*87.7*	*88.3*	*87.5*	*87.8*	*88.5*	*88.9*
EBITDA	**368**	**501**	**873**	**1,254**	**1,732**	**2,031**
EBITDA Margin (%)	*12.3*	*11.7*	*12.5*	*12.2*	*11.5*	*11.1*
Net finance cost	(242)	(282)	(382)	(329)	(280)	(250)
Other income	1	5	21	8	5	5
PBDT	**127**	**224**	**513**	**933**	**1,457**	**1,786**
Depreciation and amortisation	(45)	(43)	(57)	(58)	(70)	(80)
Pretax profits before extra-ordinaries	**82**	**181**	**456**	**875**	**1,387**	**1,706**
Exceptional items	—	—	—	—	—	—
Prior period items	—	—	—	—	—	—
Profit before tax	**82**	**181**	**456**	**875**	**1,387**	**1,706**
Current tax	(5)	(56)	(177)	(276)	(463)	(609)
Deferred tax	(32)	(8)	(5)	(50)	(40)	(10)
Minority / Associate earnings	—	—	—	—	—	—
Reported PAT	45	117	274	548	883	1,087
Adjusted net profit	**45**	**117**	**274**	**548**	**883**	**1,087**
Primary EPS (using wtd avg shares)	0.8	1.8	3.4	6.6	10.7	13.1
Diluted EPS	0.8	1.8	3.4	6.6	10.7	13.1
Shares outstanding (mn)	54.2	62.0	75.1	82.9	82.9	82.9
Margins (%)						
Gross margin	39.2	35.3	38.7	38.7	37.7	37.7
EBITDA margin	12.3	11.7	12.5	12.2	11.5	11.1
PBT margin	2.7	4.2	6.5	8.5	9.2	9.3
Net profit margin (w/o extraordinaries)	1.5	2.7	3.9	5.3	5.9	5.9
Effective tax rate (%)	45.0	35.5	39.8	37.3	36.3	36.3
Growth (% p.a)						
Revenues	—	42.6	62.6	47.0	46.9	21.5
EBITDA	—	35.9	74.5	43.5	38.1	17.3
PBT	—	119.9	152.3	91.9	58.6	23.0
Net profit (w/o extraordinaries)	—	157.7	135.4	99.9	61.1	23.0
Diluted EPS	—	118.7	90.3	92.2	61.1	23.0

Jyoti Structures, Balance Sheet, March fiscal year-ends, 2004-2009E, (Rs mn)

	2004	2005	2006E	2007E	2008E	2009E
Equity						
Share capital	118	138	153	166	166	166
General reserves and surplus	464	761	1,001	2,362	3,195	4,233
Net worth	**583**	**899**	**1,154**	**2,528**	**3,361**	**4,398**
Revaluation reserve	—	—	—	—	—	—
Deferred tax liability	41	49	54	104	144	154
Debt						
Secured	892	1,151	1,609	1,409	1,409	1,409
Unsecured	35	110	142	142	142	142
Total Debt	**927**	**1,261**	**1,751**	**1,551**	**1,551**	**1,551**
Current liability and provisions	1,948	2,304	2,570	3,198	4,324	5,692
Total capital	**3,499**	**4,514**	**5,528**	**7,380**	**9,380**	**11,795**
Assets						
Cash and cash equivalents	163	175	39	574	796	1,254
Inventory	533	925	1,219	1,629	2,156	2,705
Sundry Debtors	1,993	2,395	3,123	4,066	5,361	6,825
Loans and Advances	334	525	474	474	474	474
Gross block	706	767	904	929	954	979
Less: Accumulated depreciation	(271)	(310)	(350)	(408)	(478)	(558)
Net fixed assets	436	457	554	521	476	421
Capital -WIP	14	15	17	17	17	17
Net fixed assets (incl. C-WIP)	**450**	**472**	**572**	**539**	**494**	**439**
Investments	27	23	102	99	99	99
Miscallenous expenditure	—	—	—	—	—	—
Total Assets	**3,499**	**4,514**	**5,528**	**7,381**	**9,380**	**11,795**
Leverage and return raitos (%)						
Debt/Equity	159.0	140.2	151.8	61.4	46.1	35.3
Debt/Capitalisation	26.5	27.9	31.7	21.0	16.5	13.1
Net Debt/Equity	131.1	120.8	148.4	38.7	22.5	6.8
Net Debt/Capitalisation	21.8	24.1	31.0	13.2	8.0	2.5
Net Debt/EBITDA (x)	2.1	2.2	2.0	0.8	0.4	0.1
ROE	8.7	15.1	25.2	29.8	30.0	28.0
ROCE	11.1	15.5	18.7	21.1	23.0	22.3

Jyoti Structures, Cash flow, March fiscal year-ends, 2004-2009E, (Rs mn)

	2004	2005	2006E	2007E	2008E	2009E
Operating						
Pre-tax profits and ex-ordinary items	83	176	440	875	1,387	1,706
Depreciation & amortisations	45	43	57	58	70	80
Taxes paid	(5)	(58)	(181)	(276)	(463)	(609)
Dividend and Other income	0	0	-	-	-	-
Interest expense	179	197	259	320	280	250
Interest paid	(179)	(197)	(259)	(320)	(280)	(250)
FX (Gain) / loss	—	—	—	—	—	—
Ex-od (incl prior period)	1	4	(13)	—	—	—
Other non-cash items	—	—	16	—	—	—
Working Capital changes	(156)	(553)	(674)	(725)	(696)	(645)
Cash flow from operations	(33)	(389)	(355)	(68)	297	532
Operating, excl. WC	123	165	319	656	993	1,177
Investing						
Capex incl capital issue expense	(19)	(64)	(144)	(25)	(25)	(25)
(Purchase)/Sale of assets / bussiness	—	—	—	—	—	—
(Purchase)/Sale of investments	—	0	(78)	—	—	—
Advances to subsidiary	5	—	—	—	—	—
Interest/dividend recd	—	—	—	—	—	—
Cash flow from investing	(14)	(64)	(222)	(25)	(25)	(25)
Financing						
Equity capital issues	95	222	15	871	—	—
Net from borrowings	(2)	261	458	(200)	—	—
Effect of FX changes	—	—	—	—	—	—
Dividends paid (incl. tax)	—	(17)	(31)	(43)	(50)	(50)
Others	(1)	(1)	—	—	—	—
Cash flow from financing	92	465	442	628	(50)	(50)
Net chg in CCE	45	12	(135)	535	222	457
Beginning cash	118	163	175	39	574	796
Ending cash	163	175	39	574	796	1,254

Industrials

ABB.BO, Rs4204	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	4,575
52W High -Low (Rs)	4227 - 1920
Market Cap (Rs bn)	178.2

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	42.7	61.7	76.3
Net Profit (Rs bn)	3.4	5.1	6.5
EPS (Rs)	80.3	121.4	152.7
EPS gth	*55.6*	*51.2*	*25.8*
P/E (x)	52.4	34.6	27.5
EV/EBITDA (x)	31.0	19.8	15.2
Div yield (%)	0.3	0.3	0.4

Shareholding, December 2006

	Pattern	% of Portfolio	Over/(under) weight
Promoters	52.1	-	-
FIIs	17.2	0.4	(0.1)
MFs	3.1	0.5	(0.1)
UTI	-	-	(0.5)
LIC	9.9	1.4	0.9

ABB: Annual report highlights—significant improvement in RoIC

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ABB is investing to grow, and this is evident in the steep increases in installed capacities across product categories. These investments have resulted in disproportionately high revenues, reflecting in a higher fixed asset turnover ratio of 8.3x (vs 7.2x in CY2005). ABB has ended CY2006 with a net cash of Rs6.2 bn (Rs147/share). It has generated FCF of Rs1.9 bn (up 630%). Low capex in relation to sales and profit growth has resulted in disproportionate improvement in FCF. The incremental RoIC is high at 68%, and has improved significantly from 30%, in CY2005. ABB remains our best pick on T&D investments and additionally offers exposure to broad-based capex via its industrial automation and products division. The new annual report is yet another testimony ABB management's persistent efforts to capture growth opportunities, without losing focus on cash flows and RoIC. We retain OP with target price of Rs4,575/share

Major capacity expansions across product categories

ABB's capacity augmentation initiative is evident in the steep increases in installed capacities across product categories. Switchgear capacities have increased by 144%, motors by 73%, electronic control units by 43%, transformers by 20% and process control instruments by 21%. These expansions have lowered the capacity utilization levels (which had exceeded 90% in many key product categories in CY2005), leaving adequate headroom for strong growth going forward. In its management discussion and analysis, ABB has mentioned several sub-categories where it has expanded its product range: low tension circuit breakers, relays, compact sub-stations and distribution transformers upto 100KVA, in the power segment, and low voltage electrical motors in the industrial products segment.

The above expansions have cost ABB Rs865 mn (~20% of gross block). Clearly, these investments have resulted in disproportionately high revenues, reflecting in a higher fixed asset turnover ratio of 8.3x (vs 7.2x in CY2005).

Going forward, the company plans to expand LV motors, HT motors, drives, LV switchgear, power and distribution transformers. A global manufacturing facility for low-end relays, and a new factory for distribution automation products is planned at Vadodara. We believe ABB would invest Rs3 bn through CY2009 in these initiatives.

Sales growth more volume-led than price-led

Key product categories registered strong volume growth. For example, motors – 56%, switchgear – 16%, transformers – 30%, control and supply units – 41% and process control instruments – 26%.

Pricing seems to have improved in some products – for example, 9% in transformers, 4% for motors and 5% for switchgear. However many categories registered marginal rise or even a decline. The sedate rise in prices despite steep increases in material cost is reflective of the fact that the market place for both T&D and automation products remains intensely competitive. The strong volume growth stems from the buoyant demand.

Lower provisions the key source of margin improvement

ABB registered an EBIDTA margin improvement of 50bps despite a material cost ratio increase of 160bps. A significant portion of the improvement has arisen from lower bad debt write-offs and provision (75bps), lower commissions and discounts (40bps).

Cash of Rs6.2 bn (Rs147/share), substantial FCF improvement

ABB has ended CY2006 with a net cash of Rs6.2 bn (Rs147/share). It has generated FCF of Rs1.9 bn (up 630%). Low capex in relation to sales and profit growth mainly brought about the disproportionate improvement in FCF. The working capital to sales ratio has remained constant at 22 days of sales (compared to 20 days in CY2005). The debtor days continue to rise, seem to have risen to 134 days of sales (by 7 days) possibly due to the growing dominance of state utility projects in the revenue mix. The incremental RoIC is high at 68%, and has improved significantly from 30%, in CY2005.

Retain OP with target price of Rs4,575/share

ABB is our best pick on T&D investments and additionally offers exposure to broad-based capex via its industrial automation and products division. The new annual report is yet another testimony ABB management's persistent efforts to capture growth opportunities, without losing focus on cash flows and RoIC.

ABB - capacity expansion, volume and price growth, CY2006

	% increase in capacity	% volume growth	% change in prices
Power Transformers (MVA)	20.0	30.3	9.4
Switchgear (Nos)	143.9	16.4	5.3
Motors/ Alternators/ Generators upto 20MW (HP)	72.5	56.4	4.1
Electronic control & supply units for var. speed drives (Nos)	42.9	41.3	0.1
Process control instruments	21.0	9.8	37.0
PLCC equipment (Nos)	-	59.1	34.3
Multiplexers	-	(30.9)	(19.1)
Telemetering eqpmt (Nos)	-	(72.7)	61.2
Turbochargers (Nos)	-	37.0	(21.1)
Power capacitors of all types (MVAR)	-	(2.8)	0.8

Source: Company data

ABB - key numbers and assumptions, December year-ends 2005-2009E

	2005	2006	2007E	2008E	2009E
Sales mix (Rs mn)					
Vertical					
Power products & systems	18,314.2	25,194.9	36,352.9	44,043.7	53,650.3
Automation products and systems	11,316.1	17,189.6	25,309.7	32,245.5	37,082.4
Unallocated	0.1	355.5	29.5	36.5	43.4
Geographical					
Domestic	27,255.9	38,370.1	58,026.6	71,927.1	85,717.7
Exports	2,374.6	4,370.0	3,665.5	4,398.6	5,058.4
Total sales	**29,630.5**	**42,740.1**	**61,692.1**	**76,325.8**	**90,776.1**
Order assumptions (Rs mn)					
Orders received	38,213.0	55,889.8	64,190.1	71,720.0	80,169.5
% growth	**47.7**	**46.3**	**14.9**	**11.7**	**11.8**
Order backlog - year end	21,938.6	35,443.9	37,971.4	33,402.1	22,838.9
% growth	**64.3**	**61.6**	**7.1**	**(12.0)**	**(31.6)**
Order execution days	164.5	188.9	209.8	181.7	134.4
Bill to book ratio	91.3	85.0	91.3	103.3	123.5
PROFIT MODEL					
Net Sales	**29,630.5**	**42,740.1**	**61,692.1**	**76,325.8**	**90,776.1**
EBIDTA	**3,181.7**	**4,767.1**	**7,644.9**	**9,779.1**	**12,045.3**
Other income	510.9	736.9	800.0	850.0	900.0
Interest	(66.4)	(7.3)	0.0	0.0	0.0
PBDT	3,626.2	5,496.8	8,444.9	10,629.1	12,945.3
Depreciation	(231.4)	(264.6)	(340.0)	(450.0)	(550.0)
Pretax profits	3,394.8	5,232.1	8,104.9	10,179.1	12,395.3
Tax	(1,208.0)	(1,829.0)	(2,958.3)	(3,715.4)	(4,524.3)
PAT (A)	**2,186.8**	**3,403.1**	**5,146.6**	**6,463.7**	**7,871.0**
One-time items	0.0	0.0	0.0	0.0	0.0
PAT (R)	2,186.8	3,403.1	5,146.6	6,463.7	7,871.0
EPS	**51.6**	**80.3**	**121.4**	**152.5**	**185.7**
No. equity shares	42.4	42.4	42.4	42.4	42.4
Ratios					
Raw materials	71.9	73.6	74.3	75.0	75.4
Employee cost inflation	31.1	35.3	23.8	17.9	9.8
Tax rate	35.6	36.5	36.5	36.5	36.5
EBIDTA margin	10.7	11.2	12.4	12.8	13.3
PBT margin	11.5	12.2	13.1	13.3	13.7
Revenue growth		**44.2**	**44.3**	**23.7**	**18.9**
EPS growth		**55.6**	**51.2**	**25.6**	**21.8**
BALANCE SHEET MODEL					
Share Capital	423.8	423.8	423.8	423.8	423.8
Reserves & Surplus	8,466.7	11,386.6	15,858.2	21,590.7	28,674.2
Total Shareholders Funds	8,890.5	11,810.4	16,282.0	22,014.5	29,098.0
Total Debt	27.3	15.4	95.0	95.0	95.0
Total Liabilities	**9,068.5**	**11,973.9**	**16,525.1**	**22,257.6**	**29,341.1**
Gross Block	4,141.6	5,145.2	6,145.2	7,145.2	8,645.2
Less: Accum. Depreciation	1,875.0	2,073.4	2,413.4	2,863.4	3,413.4
Net Block	2,266.6	3,071.8	3,731.8	4,281.8	5,231.8
Capital Work in Progress	384.2	246.2	50.0	50.0	50.0
Investments	871.5	773.5	773.5	773.5	773.5
Net Current Assets	5,630.5	8,047.7	12,135.1	17,317.6	23,451.1
Cash	4,009.7	5,464.4	8,441.2	13,611.6	19,966.1
Deferred Tax Assets	(84.3)	(165.3)	(165.3)	(165.3)	(165.3)
Total Assets	**9,068.5**	**11,973.9**	**16,525.1**	**22,257.6**	**29,341.1**
Ratios					
BVPS	167.4	209.8	278.7	384.2	519.4
Fixed Asset T/O ratio	6.3	7.2	8.3	10.0	10.7
RoE	23.2	27.4	32.9	36.6	33.8
RoCE	22.6	27.3	32.4	36.1	33.3

Source: Company data, Kotak Institutional Equities estimates

Energy

Sector coverage view	Attractive

		Price, Rs	
Company	**Rating**	**8-May**	**Target**
ONGC	OP	922	1,100
IOC	IL	455	450
BPCL	OP	343	400
HPCL	OP	282	335
GAIL	IL	293	325
Castrol	OP	269	300
Petronet LNG	U	45	47
Cairn	U	130	110
RPL	OP	80	100
GSPL	OP	54	53

GAIL's subsidy payment for 4QFY07 would suggest high subsidy payment for ONGC also

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- **4QFY07 results of R&M companies should be very strong assuming the provisional/ reported subsidy figures are correct**
- **ONGC's subsidy burden for 4QFY07 will be likely significantly higher versus 3QFY07**
- **Policy uncertainty will increase and hurt sentiment further for the sector (if any is left)**

GAIL's 4QFY07 subsidy figure would suggest that the upstream companies (GAIL, ONGC, Oil India) will likely make significantly higher subsidy payments to the downstream oil companies (BPCL, HPCL, IOCL) versus 3QFY07 and expectations. GAIL's provisional 4QFY07 figure at Rs5.02 bn is significantly higher versus Rs3.15 bn in 3QFY07 and versus the quarterly run rate of around Rs3.3 bn suggested by 9MFY07 subsidy of Rs9.86 bn. We would note that the government has not officially communicated the subsidy figure to GAIL; however, we assume that it would have got some indication from the government to provide for such a precise amount. We do not advocate investment on such fickle issues; nonetheless, the potentially higher subsidy receipt of the downstream oil companies may result in a positive surprise for 4QFY07. The government has already given Rs49.7 bn of oil bonds (same as 3QFY07) to the downstream oil companies; the higher subsidy receipt from upstream companies, moderately high refining margins and similar level of marketing losses would suggest very strong 4QFY07 results.

A bad development for upstream companies if final subsidy figures are same as provisional/reported figures. We would think that the higher-than-expected subsidy figure for GAIL would not augur well for ONGC also. A press article over the weekend had reported a figure of Rs46.7 bn for ONGC versus subsidy payment of Rs22 bn in 3QFY07 and our estimate of Rs21.4 bn. The press article had correctly reported the subsidy loss figure for GAIL. Accordingly, we assume the figure for ONGC is authentic also. More important than the quarterly impact, we see the inexplicable increase in subsidy for the upstream companies as hugely negative for sentiment as it will create uncertainty about government policy on subsidy-sharing.

The government may have revised the subsidy-sharing formula or may review the figures later. We are surprised by the steep increase in subsidy figure for 4QFY07 as gross under-recovery for 4QFY07 was likely same as 3QFY07, as per our computations. However, we would note that the government is yet to communicate the official subsidy figures to the upstream companies. We are not sure about the basis of GAIL's provisional figure but its rather precise numbers would suggest that it has got some guidance and/or unofficial communication from the government. However, we would note that the government may yet review the figures unless it has increased the share of upstream oil companies to a higher figure from one-third of gross under-recoveries, which has been the norm since FY2005.

Economy

Sector coverage view	N/A

UP's summer 2007 polls: Art of the impossible

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- **UP polls: Fractured mandate likely opens multiple political outcomes**
- **BJP-supported government: Opposition control of north India likely to spark countervailing populist policies at the Center**
- **Congress-supported government: Strengthens UPA, base to fight BJP in MP in 2008**
- **Political risks: On the rise in the run up to 2009 general elections, no upheaval**

We believe poilitical risks will likely escalate in the run up to the 2009 general elections. Although we do not envisage any immediate upheaval, a fractured mandate in UP opens multiple possibilities. If it wins UP, the opposition BJP-led NDA will come to control the whole of the Hindi heartland. This will mount a formidable challenge to the ruling Congress-led UPA at the very start-up to the summer 2009 general elections sparking off countervailing populist policies. If the Congress is able to install a non-BJP - perhaps Mayawati-led - government in UP, it will gain a critical foothold in north India to challenge the BJP in Madhya Pradesh (and Rajasthan) in December 2008. We do not also rule out the possibility of an attempt to revive a 'third' force with a power-sharing agreement between the SP and BSP.

The importance of being UP: gateway to summer 2009 general elections. Uttar Pradesh typically holds the key to national power with 76 seats in the 544-member parliament.

- The BJP-led National Democratic Alliance would mount a formidable political challenge to the ruling Congress-led United Progressive Alliance at the very start-up to the 2009 general elections if it is able to install a government of its choice in UP.
- If it wins UP, the BJP-led NDA will come to control the almost entire Hindi heartland: Bihar, Chattisgarh, Madhya Pradesh, Punjab, Rajashthan, and Uttarakhand, accounting for more than a third of parliamentary seats.
- It is this threat of losing northern India that has scaled up the stakes for the Congress in the present UP assembly polls.
- While it is hardly likely to be in a position to form its own government, the party needs to win sufficient seats to outbid the BJP in propping a key regional leader – Mayawati appears its best bet - in office.
- This will also provide the party the north Indian base necessary to take on the BJP in the December 2008 Madhya Pradesh (and Rajasthan) assembly polls on the eve of the summer 2009 general elections.
- Besides, Rahul Gandhi, the Nehru-Gandhi heir, has put his political legitimacy to test by personally leading the Congress campai,gn in UP.

Possible outcomes: No holds (or scruples) barred (Congress-BJP coalition apart!). The key objective of the Congress, as we have noted, would be prevent the BJP from seizing power in UP.

- Since the party is unlikely to form a government of its own, it will likely try to prop up Mayawati with an eye on the national scheduled caste vote: after all, the aam (common) of its aam admi (common man) slogan. Our reading of opinion polls suggest that this stands a fair chance on May 11.
- This will also enable the Congress to avoid the ruling SP, its estranged ally. Pushed to the wall, the party may, however, be willing to make up with the SP in the name of fighting ‘communal forces’.
- The BJP would ideally like to form its own government to strengthen its bid for national office in 2009.

- If opinion polls prove correct, the BJP may, however, have to settle for a less ambitious scheme of supporting one of the regional parties to battle 'pseudo-secularism'.
- We also expect the Left to try to sew up an alliance between the regional parties – the BSP and SP – in a bid to revive the 'third' force to promote 'true' federalism, secularism and, of course, not foregetting, socialism.

A look at the dramatis personae: No lack of prima donnas. The ruling Samajwadi Party, led by third-time chief minister Mulayam Singh Yadav, has been traditionally backed by a powerful coalition of backward castes (- Yadavs are about 10% -) and minorities (20% of population). In the past, Yadav has allied with each and every of the other four contenders to win office.

- The Bahujan Samaj Party, led by Mayawati, yet another three-time chief minister, espouses the cause of scheduled castes (20% of population). Mayawati has also earlier allied with each of the other four contenders.
- The Rashtriya Lok Dal, led by Ajit Singh, purports to represent Jats, a powerful agricultural caste. Like the other regional leaders, he too has also allied with all the other contenders.
- The Bharatiya Janata Party, led by party chief Rajnath Singh and Kalyan Singh, is thought to bank on the caste Hindu vote (30% of population). The party has previously tied up with all the three regional parties to keep the Congress out of UP.
- The Congress party, led by Rahul Gandhi, is hoping to regain lost ground on the back of the Nehru-Gandhi charisma. The party – like the BJP – has allied with each and every regional party to keep the BJP out of office

Exhibit 1: Exit polls show a split mandate

Legislative seats of political parties

			Exit polls			
		2002	**IE-CNN-IBN**	**NDTV-IMRB**	**Times HANSA**	**Memo: MPs**
1	Bahujan Samaj Party	98	152-162	117-127	116-126	19
2	Bharatiya Janata Party +	106	80-90	108-118	114-124	11
3	Indian National Congress	25	25-33	35-45	25-35	10
4	Samajwadi Party	145	99-111	113-123	100-110	36

Source: Indian Express-CNN-IBN, NDTV-IMRB, Times Now Hansa.

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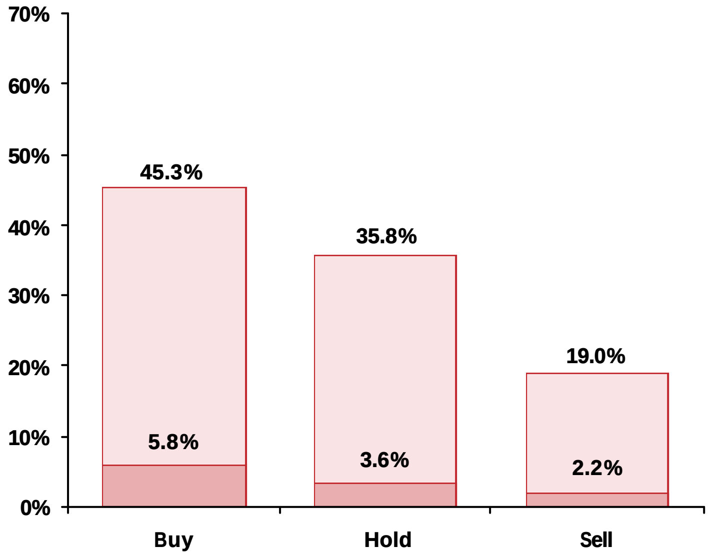

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Source: Kotak Institutional Equities. As of March 31, 2007

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