

Contents

Updates

Lanco Infratech: Progresses on existing projects, bags a large port project

Strategy: Closing trade - reaping more gains

Economy: Rupee likely to breach 43 in near term as RBI appears to be wary of liquidity crunch

News Roundup

Corporate

- Lafarge, the world's second-largest cement maker, has acquired L&T's Ready Mix concrete (RMC) business for US\$349 mn. (ET)
- ArcelorMittal is planning to pick up equity stakes in two joint ventures—in Rampia Coal Mines & Energy (Orissa) and Seregarha Mines (Jharkhand)—to kick off its coal mining operations in the country. (ET)
- The Tata group plans to increase the promoter stake in half-a-dozen globally active subsidiaries by 3-4% through creeping acquisitions and preferential bond and warrant issues in the current financial year to defend them from predatory attacks. (BS)
- SBI and GE Money have decided to revamp SBI cards and expand their relationship to cover personal loans and credit insurance. (BS)

Economic and political

- Canada-based Research in Motion (RIM) may allow the Indian government to intercept non-corporate emails sent over BlackBerrys. (ET)

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

EQUITY MARKETS

India	Change, %			
	14-May	1-day	1-mo	3-mo
Sensex	16,978	1.3	5.1	(6.3)
Nifty	5,012	1.1	2.7	(5.5)
Global/Regional indices				
Dow Jones	12,898	0.5	4.3	4.5
Nasdaq Composite	2,497	0.1	9.2	7.5
FTSE	6,216	0.1	5.2	7.4
Nikkei	14,263	1.0	9.8	4.7
Hang Seng	25,614	0.3	7.2	6.1
KOSPI	1,871	1.5	7.4	10.4
Value traded - India				
		Moving avg, Rs bn		
	14-May	1-mo	3-mo	
Cash (NSE+BSE)	188.1	199.8	193.6	
Derivatives (NSE)	329.2	410.0	380	
Deri. open interest	755.9	610	718	

Forex/money market

	Change, basis points			
	14-May	1-day	1-mo	3-mo
Rs/US\$	42.5	4	242	279
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	3	(8)	45

Net investment (US\$m)

	13-May	MTD	CYTD
	FIs	46	(78)
MFs	(72)	9	1,611

Top movers -3mo basis

Best performers	Change, %			
	14-May	1-day	1-mo	3-mo
Thomas Cook	102	0.3	4.8	47.1
Nestle India	1,876	0.2	23.9	42.0
NALCO	499	3.7	18.8	37.4
i-Flex	1,385	4.4	22.2	35.1
Polaris	109	4.9	20.4	33.0
Worst performers				
Reliance Cap	1,319	2.5	0.4	(36.5)
Thermax	455	(0.3)	(11.1)	(31.2)
BoB	287	(2.7)	(2.0)	(30.3)
IOC	398	(4.8)	(13.6)	(29.1)
BPCL	339	(2.7)	(17.4)	(27.8)

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Utilities**LAIN.BO, Rs514**

Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	670
52W High -Low (Rs)	888 - 154
Market Cap (Rs bn)	114.2

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	33.0	76.1	126.6
Net Profit (Rs bn)	3.9	7.5	15.3
EPS (Rs)	17.6	33.8	69.0
EPS gth	125.3	108.1	122.1
P/E (x)	29	15.2	7.4
EV/EBITDA (x)	24.3	12.9	6.7
Div yield (%)	-	-	-

Shareholding, December 2007

	% of		Over/(under)
	Pattern	Portfolio	weight
Promoters	75.0	-	-
FIs	12.8	0.2	(0.1)
MFs	1.5	0.2	(0.2)
UTI	-	-	(0.4)
LIC	1.5	0.1	(0.2)

Lanco Infratech : Progresses on existing projects, bags a large port project

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- **Big stride in infrastructure development—bags a port project**
- **Lanco Amarkantak nearing commissioning—a milestone for LITL**
- **Good progress in other power projects—earthquake in China a concern**
- **Retain BUY rating with SOTP-based target price of Rs670/share**

Lanco Infratech (LITL) continues to show good progress in executing its project portfolio while adding new projects in the infrastructure development space. In its first big foray in non-power infrastructure development, LITL-led consortium has emerged as an L1 bidder for development of the Rs80 bn Vizhinjam International Container Port Project in Kerala. LITL had recently emerged as the L1 for two power projects (3,300 MW aggregate capacity) in Uttar Pradesh. Lanco Amarkantak phase 1 (300 MW) is nearing completion—meeting its committed deadlines for commissioning and its operating performance will further reinforce LITL credentials as a leading project developer. There are reports of damage to Dong Fang's manufacturing facilities in the recent earthquake in China's Sichuan province, but we note there were no impending deliveries for any of the large projects. Nagarjuna Power and Anpara C are the next big thermal power projects scheduled for commissioning in FY2010-11. We reiterate our BUY rating on LITL with an SOTP-based target price of Rs670/share.

Big stride in infrastructure development—bags a port project. LITL, in consortium with Pembinaan Radzai Sdn. Bhd (PRSB), Malaysia, has emerged as the L1 bidder for development of the Rs80 bn Vizhinjam International Container Port Project in Kerala. The project site is situated about 16 kms south of Thiruvananthapuram and is proposed to be developed as a Container Transshipment hub, given its 15 meter natural draft and proximity to international sea routes. The port is proposed to be developed in four phases with an ultimate capacity of 6.5 Million TEUs (Twenty foot Equivalent Unit). Construction of the initial phase would be completed in 60 months and the other three phases will be initiated after reaching stipulated traffic levels.

LITL is leveraging its core construction expertise to participate in infrastructure projects outside of the power domain. A consortium led by LITL has been short-listed by the Slum Rehabilitation Authority, Mumbai for its Dharavi Redevelopment Project. LITL, in consortium with Genting, is also shortlisted for an airport redevelopment project at Amritsar.

Lanco Amarkantak nearing commissioning—a milestone for LITL. LITL will likely commission phase I (300 MW) of the Lanco Amarkantak project in July/August 2008 (ahead of scheduled commissioning in September 2008 but a couple of months later than June 2008 as guided by the management). Commissioning of Phase I will likely validate LITL's ability to execute large power projects in keeping with time and budgetary commitments. Commissioning of the plant will also address concerns of the investor community on operational efficiencies and suitability of Chinese equipment in Indian soil and coal conditions. LITL has terminated the PPA with PTC (back-to-back selling arrangement with Madhya Pradesh) citing non-compliance of the conditions (approval of the PPA by the state regulator). We note that while the High Court has stayed the termination of the agreement, there could be significant upside to our valuation if Lanco Amarkantak starts operations as a merchant power plant in the prevailing power-deficit environment. Our current valuation of Phase 1 at about Rs22/share will at least double if the project operates as a merchant power plant for the next few years.

Good progress in other power projects—earthquake in China a concern. We note that LITL has shown good progress in achieving critical milestones (land acquisition, environmental clearances etc.) for most of its projects (see Exhibit 1). All the equipment for Lanco Amarkantak have been delivered onsite, but we are concerned on Dong Fang meeting the delivery schedules going forward. Media reports suggest damage to the Dong Fang's turbine manufacturing facility in the recent earthquake in China's Sichuan province. Dong Fang's facility in the city of Deyang is about 100 km away from the quake epicenter of Wenchuan county. However, we note there were no impending deliveries for any of the large projects. Nagarjuna Power and Anpara C are the next big thermal power projects scheduled for commissioning in FY2010-11.

Retain BUY rating with SOTP—based target price of Rs670/share. We note significant progress in most projects, which LITL has taken up, and retain our BUY rating on the stock. Our SOTP value includes—(1) power project portfolio (Rs331/share), (2) value of construction business (Rs241/share), (3) value of real estate business (Rs91/share), (4) BOT road projects (Rs5/share) and (5) value from sale of carbon credits (Rs9/share).

Upside from incremental project portfolio not captured in our target price. Our target price of Rs670/share does not factor in (1) Lanco Kondapalli extension (375 MW), (2) 660 MW (out of 2,640 MW) planned at Babandh project and (3) two projects aggregating 3,300 MW won on competitively bid tariffs in Uttar Pradesh (Sangam and Prayagraj). In case of the first two projects we await firm fuel supply agreements while in the case of projects in UP, we await details of tariff bids and allotment of Lols before ascribing value to these projects. Lanco Kondapalli awaits settlement of the on-going legal dispute with regard to off-take of gas from Reliance Industries' KG-basin in Andhra Pradesh. In our view, progress on the first phase of Babandh project will increase the likelihood of fuel linkages for the balance 660 MW. We expect the two projects in UP would be developed on a fast-track as key project inputs—land, water, rail connection etc. have already been obtained. We note that LITL will require external equity support as well for funding the equity investments in the growing portfolio of projects.

Simultaneous implementation of several projects over the next five year

Status of clearances for Lanco's power projects

Project	Capacity (MW)	Cost (Rs bn)	Fuel	DPR	Land	Environmental clearance	Fuel arrangement	Financial closure	Expected CoD
Lanco Kondapalli	368	10.9	Gas				Commissioned		
Aban Power	120	4.4	Gas				Commissioned		
Clarion Power	12	0.5	Biomass				Commissioned		
Rithwik Power	6	0.3	Biomass				Commissioned		
Lanco Amarkantak	600	26.3	Coal	NA	✓	✓	✓	✓	Apr-09
Lanco Green	70.0	4.2	Hydro	✓	✓	✓	NA	✓	Jul-09
Vamshi Hydro	10	0.6	Hydro	✓	✓	✓	NA	✓	Jun-08
Vamshi Industrial	10	0.6	Hydro	✓	✓	✓	NA	✓	Jun-08
Nagarjuna Power	1,015	43.5	Imported coal	NA	✓	✓	✓	✓	Apr-10
Lanco Energy - Teesta VI	500	30	Hydro	✓	✓	✓	NA	✓	Apr-11
Anpara 'C'	1,200	41.2	Coal	NA	✓	✓	✓	✓	Oct-10
Lanco Hydro (Uttaranchal)	150	9.5	Hydro	✓	WIP	WIP	NA	x	Jul-11
Lanco Kondapalli extn.	375	13	Gas	NA	✓	✓	WIP	x	Dec-09
Lanco Amarkantak extn.	600	24	Coal	NA	✓	✓	✓	x	Dec-10
Babandh, Orissa	2,640	111	Coal	NA	WIP	WIP	WIP	x	Dec-11

Source: Company data, Kotak Institutional Equities estimates.

Lanco: Profit model, balance sheet, cash model 2006-2010E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	1,471	16,058	32,964	76,061	126,627
EBITDA	167	4,198	6,613	16,167	33,134
Other income	13	416	965	852	774
Interest	(36)	(829)	(864)	(1,841)	(3,767)
Depreciation	(19)	(656)	(779)	(2,581)	(3,698)
Extraordinary items	(0)	(1)	—	—	—
Pretax profits	125	3,128	5,936	12,597	26,443
Tax	(33)	(468)	(1,013)	(2,684)	(6,495)
Minority interest	79	(778)	(1,020)	(2,404)	(4,600)
Net profits	171	1,883	3,902	7,509	15,348
Earnings per share (Rs)	5.6	8.5	17.6	33.8	69.0
Balance sheet (Rs mn)					
Total equity	954	15,105	19,033	26,542	41,890
Deferred taxation liability	31	92	5	6	5
Total borrowings	1,495	20,821	61,365	114,482	136,416
Current liabilities	1,581	11,424	14,385	29,849	38,908
Minority interest	41	41	41	41	41
Total liabilities and equity	4,101	47,482	94,829	170,920	217,260
Cash	414	5,050	6,702	14,481	27,256
Current assets (excl cash)	2,264	12,013	16,961	32,665	43,646
Total fixed assets	409	24,390	71,026	123,634	146,217
Investments	1,015	6,029	135	135	135
Deferred expenditure	—	—	5	5	5
Total assets	4,101	47,482	94,829	170,920	217,260
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	128	3,669	5,901	13,608	26,087
Working capital	(230)	95	(1,987)	(240)	(1,922)
Capital expenditure	(211)	(24,637)	(47,415)	(55,189)	(26,281)
Investments	(419)	(5,014)	5,894	—	—
Free cash flow	(732)	(25,888)	(37,607)	(41,821)	(2,116)

Source: Kotak Institutional Equities estimates.

SOTP value of Rs670/share

	Equity value	Equity Inv.		Capacity		Attributable value		
	(Rs mn)	(Rs mn)	P/BV (X)	Gross	Attributable	(%)	(Rs mn)	(Rs/share)
Operating power plants								
Lanco Kondapalli	8,463	3,400	2.5	368	217	59	6,434	
Aban Power	2,387	1,318	1.8	120	61	51	1,697	
Clarion Power	714	224	3.2	12	12	97	741	
Rithwik Power	392	90	4.3	6	5	89	360	
Lanco Electric Utility (Power trading)	640	212	3.0			100	638	
Power plants under construction								
Lanco Amarkantak	9,728	5,135	1.9	600	456	76	7,393	
Lanco Green	1,395	838	1.7	70	63	90	1,256	
Vamshi Hydro	442	139	3.2	10	9	91	402	
Vamshi Industrial	405	145	2.8	10	9	91	369	
Nagarjuna Power	13,119	8,708	1.5	1,015	751	74	9,708	
Lanco Energy - Teesta VI	14,260	5,900	2.4	500	370	74	10,552	
Anpara 'C'	13,397	8,230	1.6	1,200	1,200	100	13,397	
Power plants yet to achieve financial closure								
Lanco Hydro (Uttaranchal)	2,955	1,900	1.6	150	137	91	2,691	
Lanco Amarkantak extn.	8,979	4,800	1.9	600	456	76	6,824	
Orissa power project	38,346	16,632	2.3	2,640	2,640	100	38,346	
Sub total	115,622	57,672	2.0	7,301	6,386		100,810	453
Net equity funding requirement							(24,076)	(108)
Power (A)							76,734	345
Construction (B)							53,602	241
Property development (C)							20,182	91
Road projects (D)							1,006	5
Carbon credits (E)							1,981	9
Grand total (A+B+C+D+E)							153,505	690

Source: Kotak Institutional Equities estimates.

Strategy

Sector coverage view

N/A

Closing trade—reaping more gains

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- **Closing long ITC and short Hindustan Unilever—gross return +10.1%**
- **Trade 1: Long Tata Power, short NTPC**
- **Trade 2: Long DLF, short Unitech**

Closing long ITC, short Hindustan Unilever (HUL)

We had initiated a long ITC, short HUL trade on April 16, 2008 to capture the valuation differential arising from (1) headwinds faced by HUL in its core categories such as soaps, (2) HUL valuations ahead of its core earnings growth and (3) likely resolution of markets concerns about ITC's cigarette volume growth. Soaps market share data for March 2008 indicate 'Lux' and 'Breeze' brands are losing market share. While it is early days to attribute this to the success of ITC's soap launches, channel sources indicate that ITC has been successful in generating trial purchases through a consumer price promotion. Lower-than-expected cigarette volume decline for April month possibly indicates higher upgrading to filter segment than street expectations. Moreover, the Union Budget Bill was passed last week, allowing the sector to proceed with appropriate pricing and tactical action. Since the initiation of the trade, ITC stock has appreciated by 8.8% and HUL stock has corrected by 1.3% giving gross positive return of 10.1%.

Open trades

We continue to recommend Long Tata Power, short NTPC (+7%) and Long DLF, short Unitech (-1.3%). Please refer to our previous report '*Initiating new trades—a brave new world*' dated April 16, 2008 and corresponding update '*Closing trades—simple trades, high return*' dated May 7, 2008.

Alpha-Bet trades

Statistics of trades, current price, initiation price, gross return

	Stock	Current price (Rs)	Initiation price (Rs)	Return (%)
Closed trade (15 April-7 May 2008)				
Long	L&T	2,993	2,807	6.6
Short	BHEL	1,785	1,833	(2.6)
Return (%)				9.2
Closed trade (15 April-14 May 2008)				
Long	ITC	226	208	8.8
Short	HUL	243	246	(1.3)
Return (%)				10.1
Trade 1				
Long	Tata Power	1,357	1,274	6.6
Short	NTPC	190	191	(0.5)
Return (%)				7.0
Trade 2				
Long	DLF	623	617	1.0
Short	Unitech	274	268	2.3
Return (%)				(1.3)

Source: Bloomberg, Kotak Institutional Equities estimates.

Economy

Sector coverage view

N/A

Rupee likely to breach 43 in near term as RBI appears to be wary of liquidity crunch

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- **Rupee had depreciated 5.5% in FY2008; 7.2% in CY2008 till May 14, 2008**
- **Slide steep since May 2 with 4.7% depreciation**
- **After a 75 bps CRR hike, RBI appears wary to defend rupee for fears of liquidity crunch**
- **Rupee may breach 43 in near term, unlikely to bounce back in a big way till the last week of June**

RBI appears to have abandoned its time-tested exchange rate policy and become a passive observer to the sharp slide of Indian rupee over the past nine trading days. Three likely reasons: (1) having hiked CRR by 75 bps in April and May 2008, the huge money market surpluses have already vanished and any dollar sales would suck rupee liquidity out and cause a credit crunch, (2) with global oil prices rising fast, the central bank is increasingly getting worried about the widening trade deficit and may have not been averse to weaker rupee and (3) a quick slide of the rupee may lower the possibility of FII outflows and may kindle new inflows. We expect the rupee to breach 43 in the current week, with the RBI perhaps intervening to shore it up thereafter.

A sudden shift in exchange rate expectations fuelled by RBI's abandonment of its time-tested exchange rate policy has seen Indian rupee (INR) exchange rate vs US dollar (USD) slide like it hasn't ever depreciated before at least in the current decade. INR was almost cheaper by Rs2 in the past nine trading days. This included a 53 paise slide on May 7.

Liquidity concerns prompted RBI to hold back

We believe liquidity concerns have prompted RBI not to intervene in FX markets to halt the rupee slide. Daily LAF balances have seen negligible absorption of Rs20-40 bn over the past three working days. While this may partly be due to frontloading of reserve maintenance by the banks within the reporting fortnight, the liquidity has dried up even after two of the three CRR hikes of 25 bps kicked in. The call money rate was trading near the 7.0% mark by the close of yesterday.

The three CRR hikes kicked in at the start of the fortnights of April 26, May 10 and May 24 and would be followed by spikes associated with further liquidity tightening due to advance tax collections in the second and third week of June.

We expect the rupee to breach 43 in near term; RBI to impart liquidity

In view of expected excessive tightening of liquidity over the next month, we expect the rupee to breach 43 in the near term. Options before the RBI appear limited.

- One option would be to reverse the third CRR hike starting May 24, even though it would be expensive in terms of the central bank's own credibility. This would then enable RBI to come to the defense of the rupee and limit the inflation which is likely to be compounded as a result of rupee depreciation.
- Other option, which in our view is the most likely course of action by the RBI, is to cancel MSS auctions in near term. With government cash balances also low, postponing scheduled G-sec auctions is difficult. In net terms, therefore, liquidity is unlikely to improve from here till the last week of June. RBI would need to provide large injections through its daily repo window.

- RBI is likely to use this window of mid-May to the third week of June to make open market purchases and shore up securities in its portfolio. Its ability to absorb liquidity was tested to its hilt on April 8, 2007 with reverse repo touching Rs790 bn, absorbing all the securities RBI had.

Rising oil prices fuelling rupee weakening sentiments in the market and in RBI

In view of the above and rising oil prices, RBI appears to be prepared to let the rupee depreciate. RBI considers the rupee depreciation tolerable in view of (1) rising trade deficit which may touch 9% of GDP in FY2009, as also CAD/GDP which may be in 2-3% range and (2) its views on trade elasticities do not appear to be clear, but we believe RBI views oil imports as having unit elasticity even while exports are somewhat elastic, the trade balance could therefore improve upon some depreciation. We believe that with yesterday's balance, REER would have come very near zero and rupee may not be overvalued.

RBI abandons time-tested exchange rate policy for the second time in this decade

RBI has abandoned its time-tested exchange rate policy of curbing excessive volatility (read sharp movements and speculations) for the second time in the current decade. The first time was during March-May 2007 when it allowed rupee to appreciate 9.1% by very nearly abstaining from dollar purchases in face of paucity of instruments to sterilize these flows and high inflation. On that occasion, the move helped lower inflation rate.

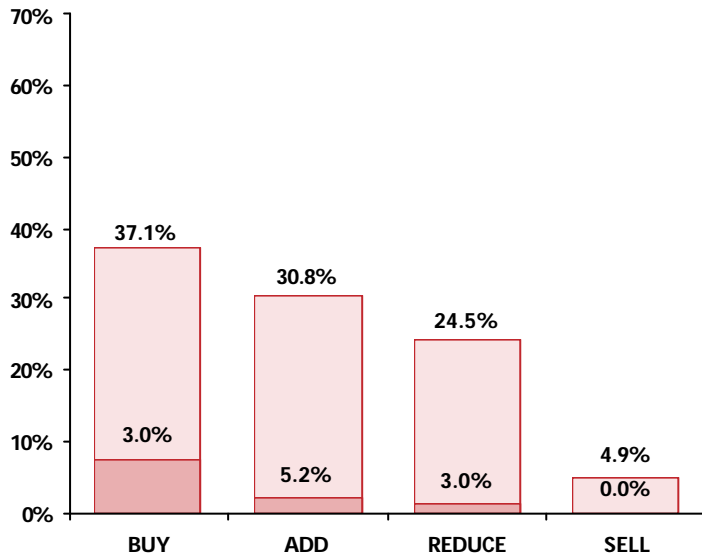
Rupee has been allowed to depreciate in spite of high inflation

With headline inflation running at 7.6% at end-April 2008, there have been clarion calls by some economists for RBI to aid rupee appreciation to moderate inflation. RBI Governor had maintained that the exchange rate was market determined and hence not a policy instrument. In the context of this oft repeated stance, we had interpreted this as a desire to keep exchange rate stable in either direction. A sharp appreciation during March-May 2007 had led to job losses and severe adverse impact on textile, IT and BPO industry. Keeping exchange rate stable was thought to be the best option. This goal has been abandoned at least in the interim.

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Source: Kotak Institutional Equities.

As of March 31, 2008

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL: We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Old rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.

IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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

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NA = Not Available or Not Applicable. The information is not available for display or is not applicable.

NM = Not Meaningful. The information is not meaningful and is therefore excluded.

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