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### News Round-up

- ▶ Reliance Industries (RIL IN) is close to selling a 2.5 acre commercial plot at Bandra-Kurla Complex (BKC) to Wadhwa Group. The deal is expected to be around USD 217 mn in size and will take a month to conclude. *(BSTD-Sun)*
- ▶ Tata Motors (TTMT IN) is looking at setting up an assembly unit in South Africa for medium & small trucks by the end of this financial year in a bid to boost sales in African markets. *(ECNT-Sat)*
- ▶ Tata Motors (TTMT IN) will set up a new manufacturing plant for the Ace and for other similar products, as it tries to defend its share in the segment from increased competition. *(BSTD-Sat)*
- ▶ Cipla (CIPLA IN) has started talks with the govt. to share knowledge on making cancer drugs, which, if successful, could radically lower the prices of a class of medicines that remain largely unaffordable. *(ECNT)*
- ▶ M&M is planning to invest USD 54 mn in the aerospace business. It plans to set up component and aircraft manufacturing facilities in India. *(BSTD-Sun)*
- ▶ Reliance Power's (RPWR IN) request for USD 650 mn in financing to build a coal-fired power plant in India has been rejected by the US Export-Import (Exim) Bank's board. The request was turned down during the lender's preliminary consideration of projects that would generate high levels of carbon emissions. *(BSTD-Sun)*
- ▶ M&M (MM IN) MD Anand Mahindra said the company will invest USD 53.19mn in aero space business. *(ECNT)*
- ▶ SBI (SBIN IN) is likely to fix its base rate, the new lending benchmark banks will follow from the next month, at around 7.75% after factoring in clarifications made by RBI on treatment of concessional loans. *(ECNT)*
- ▶ Indian Bank (INBK IN) will raise USD 106.38mn through bonds during the first week of next month to fund business growth. *(FNLE)*

Source: ECNT= Economic Times, BSTD = Business Standard, FNLE = Financial Express, THBL = Business Line.

### EQUITY MARKETS

India	Change %			
	24-Jun	1-day	1-mo	3-mo
Sensex	17,730	(0.1)	10.7	1.0
Nifty	5,321	(0.0)	10.7	1.1
<b>Global/Regional indices</b>				
Dow Jones	10,153	(1.4)	1.1	(6.4)
Nasdaq Composite	2,217	(1.6)	0.3	(7.5)
FTSE	5,100	(1.5)	3.2	(11.0)
Nikkie	9,774	(1.6)	3.3	(9.7)
Hang Seng	20,733	(0.6)	9.2	(0.2)
KOSPI	1,728	(0.7)	10.7	2.4
<b>Value traded – India</b>				
Cash (NSE+BSE)	217		166	174
Derivatives (NSE)	1,548		1,185	823
Deri. open interest	1,647		1,497	1,256

### Forex/money market

	Change, basis points			
	24-Jun	1-day	1-mo	3-mo
Rs/US\$	46.5	30	(49)	106
10yr govt bond, %	7.6	1	17	(28)
<b>Net investment (US\$m)</b>				
	23-Jun		MTD	CYTD
FIs	80		1,660	6,261
MFs	(50)		104	(282)

### Top movers -3mo basis

Best performers	Change, %			
	24-Jun	1-day	1-mo	3-mo
IBULL IN Equity	140.5	(0.6)	5.7	32.6
BJFIN IN Equity	419.1	0.2	(1.3)	32.2
UNTP IN Equity	194.9	0.5	22.6	28.9
BJAUT IN Equity	2409.0	2.4	19.3	28.1
APNT IN Equity	2460.0	2.1	18.6	25.4
<b>Worst performers</b>				
ABAN IN Equity	744.5	0.4	8.2	(37.3)
GRASIM IN Equity	1798.8	0.4	(22.4)	(36.8)
EDSL IN Equity	546.5	1.0	21.4	(28.4)
PUNJ IN Equity	130.0	3.1	2.6	(27.9)
TATA IN Equity	498.4	0.2	4.6	(21.9)

**The 100 Billion Dollar Club.** We analyze Indian companies and their attributes such as (1) IPR (brand and technology), (2) financial and industrial assets and (3) natural resources that can propel them to US\$100 bn market capitalization over a period of time. We also look at global experience to draw conclusions for India; every decade throws up new and interesting names. Finally, we assess operating factors that are required to achieve and sustain US\$100 bn market capitalization.

### Asset-based companies: A few banks can and will get there

Other than financial services companies, we are skeptical of any other asset-based company entering the US\$100 bn league from India. Asset-based companies require constant reinvestment to grow and return on invested capital is not high enough in 'mature' businesses to create meaningful value. Most will trade at and around book value.

### IPR-based companies: A rarity in India and will likely remain so

Infosys and TCS can make it to the US\$100 bn league on a 15-16% CAGR in earnings up to FY2021E and 14-15X P/E multiple. However, their headcount-led services business could face issues of (1) scalability, (2) manpower and (3) margin pressure. We don't see circumstances changing meaningfully in India for creation of large IPR-based companies.

### Resource-based companies: Few candidates but right policies critical

RIL and ONGC are obvious candidates to get to US\$100 bn market capitalization fairly quickly. For RIL, the migration to a resource-based company from an asset-based cyclical play would be critical. RIL's ROIC has not been very high historically and has been supported by favorable fiscal incentives. For ONGC, a combination of (1) favorable government policies on pricing and (2) volume growth from domestic fields (its R/P and RRR are quite high and lend credibility) and judicious overseas acquisitions could drive its market capitalization to the coveted mark.

### Global experience: Banks, IPR, natural resource plays dominate the league

BFSI companies (23), IPR companies (16) and natural resources companies (23) dominate the top-100 global market capitalization companies currently. This list has changed dramatically in every decade. Not only have the companies in the top-100 list changed over the past three decades with (1) new companies from previously closed economies getting listed and (2) asset-backed industrial companies losing prominence, even sectors in the top-100 list have changed over the past few decades with the emergence of the IT/media era.

JUNE 28, 2010

NEW RELEASE

BSE-30: 17,575

### QUICK NUMBERS

- SBI, HDFC Bank and ICICI Bank key candidates to reach US\$100 bn
- Infosys and TCS may get there but large employee additions challenging
- RIL and ONGC well on course to reach US\$100 bn

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**BFSI, IPR-based and natural resources companies dominate the global market capitalization list**  
Breakdown of Top-100 market capitalization companies by sectors (#)

	2009	2004	1999	1989
Automobilies	2	1	3	9
<b>Banking &amp; Financial Services</b>	<b>21</b>	<b>21</b>	<b>11</b>	<b>25</b>
Chemicals	2	2	1	2
Construction	—	—	—	3
Consumers	10	7	6	4
Diversified	4	4	6	14
Electronics	5	6	10	9
Insurance	2	5	5	2
Media	1	5	5	1
Metals & Mining	5	1	—	4
<b>Oil &amp; Gas</b>	<b>18</b>	<b>8</b>	<b>5</b>	<b>4</b>
<b>Pharmaceuticals</b>	<b>9</b>	<b>14</b>	<b>14</b>	<b>4</b>
Retailing	2	3	4	2
Services	—	1	—	—
<b>Technology</b>	<b>7</b>	<b>8</b>	<b>12</b>	<b>2</b>
Telecom	9	12	18	7
Transportation	—	—	—	5
Utilities	3	2	—	3
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: FactSet, Kotak Institutional Equities

**New countries have emerged on the world map**

Breakdown of Top-100 market capitalization companies by countries (#)

	2009	2004	1999	1989
Argentina	—	—	—	1
Australia	4	1	1	—
Belgium	1	—	—	—
Brazil	4	—	—	1
Canada	1	—	2	1
China	9	—	—	—
Finland	—	1	1	—
France	7	5	3	5
Germany	5	5	5	4
Hong Kong	2	1	2	1
<b>India</b>	<b>1</b>	<b>—</b>	<b>—</b>	<b>—</b>
Indonesia	—	—	—	1
Italy	1	4	2	5
Japan	5	5	12	28
Netherlands	2	3	4	1
Norway	1	—	—	1
Russia	3	1	—	—
Saudi Arabia	1	1	—	—
South Africa	—	—	—	1
South Korea	1	1	—	9
Spain	3	3	1	2
Sweden	—	1	1	—
Switzerland	4	4	4	2
Taiwan	—	—	—	3
Thailand	—	—	—	2
United Kingdom	8	8	8	8
United States	37	56	54	24
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: FactSet, Kotak Institutional Equities

JUNE 28, 2010

UPDATE

BSE-30: 17,574

**In poison there is physic.** The deregulation of petrol prices and the fuel price hikes effected on June 25, 2010 may lead to short run inflation upsurge of >1 ppt, but this poison heals the fiscal malaise and provides a multi-faceted strong positive delta for India's macro-economy. We view this as a crafty step. It takes India far and beyond its cagey approach to reforms that was drilling a fiscal hole and crowding out private investment, adding to long-term structural inflation and current account gaps.

### Spectrum bonanza, subsidy reforms may help attain surprisingly lower fiscal deficit

Pranab-led subsidy reforms may help limit subsidy overshooting. Along with a 1% of GDP windfall extra non-tax revenue from the 3G and BWA auctions, it may help contain FY2011E GFD to 5.1% of GDP versus budgeted 5.5%. This may be despite expenditure overshooting of 1% of GDP, as we expect the tax revenues to overshoot budget estimates with real GDP growing 8-8.5%.

### Fuel price hikes may cause inflation to go up by >1 ppt in July

The fuel price hikes undertaken have a large inflationary impact in the short run. We estimate that the static impact would be a 0.24% rise in headline inflation in June with a much larger 0.94% rise in inflation in July. We also estimate sizeable second-round impact as inflation feeds through to other commodities based on the use of fuels as inputs in final output. The second round impact includes increased transportation costs up to the wholesale level. Retail prices of primary commodities, including food, may rise more.

### RBI may raise policy rates by 50-75 bps in July 2010

We now expect RBI to act more decisively in July 2010 and raise policy rates 50-75 bps, including possibly a pre-policy rate hike in early July of 25 bps. The stiffer-than-before tightening may be prompted by (1) persisting double digit inflation since March 2010, (2) signs that inflation is becoming broad-based with manufacturing inflation rising at an annualized rate of 6.5% over last 3-months and (3) need to quell inflation expectations which may rise again on the back of fuel price hikes. We expect RBI to raise policy rates by another 125 bps in FY2011E.

### Market borrowing may be cut by Rs200 bn; may help soften interest rate hardening

With a probability of a more aggressive rate tightening cycle, keeping interest rates soft may turn out to be more difficult in the current year. However, we expect market borrowing to be cut by Rs200 bn in line with our fiscal projections and expect this to keep a rise in interest rate limited.

### QUICK NUMBERS

- **Static inflation impact of fuel price hikes 0.2 ppt in June; 0.9 ppt in July**
- **RBI may raise policy rates 50-75 bps in July**
- **We see GFD/GDP ratio at 5.1% in FY2011E versus 5.5% FY2011BE and 6.7% FY2010RE**
- **Net market borrowing may fall by only about Rs200 bn from budgeted Rs3.45 tn**

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### 'Pranab-led' if not prancing reforms still does the trick

It may look to be reforms by stealth to some, cagey to others, knavish to some and guileful to others. However, most close observers of India's political economy would agree that bold steps have been taken. A series of reforms in recent past would lower macro-economic costs ahead, even though it brings political and economic pain in the short run. Mr. Pranab Mukherjee, the Finance Minister, has boldly pushed ahead with much needed economic reforms. These may not be in a prancing-style reformist spirit, but neither are they eyewash. In fact, they test the threshold of political economy tolerance but stops short of snapping the chord. We call them 'Pranab-like' — a low-key approach that makes little noise but slips in action when possible. The move to deregulate petrol price and raise the prices of four of the fuels was one such classic move that reflected the old adage that "*in poison there is physic*".

- ▶ **Deregulation of petrol prices, and hiking prices of diesel, LPG and kerosene:** On June 25, 2010, the Empowered Group of Ministers (EGOM) decided to deregulate petrol (i.e gasoline) prices immediately, diesel prices gradually, and raised the retail prices of petrol (7.13%), diesel (5.17%), kerosene (32.19%) and LPG (11.18%).

Some of the earlier examples of the Pranab-led reforms are:

- ▶ **Nutrient based subsidy (NBS) on fertilizers:** On February 18, 2010 the Cabinet approved NBS on decontrolled phosphatic and potassic fertilizers. The scheme was launched from April 1, 2010 linking subsidy to per kilogram of nutrients – N (nitrogen) , P (phosphorous), K (potash) and S (sulphur). The NBS regime enables capping of subsidy on such fertilizers, since the subsidy on the subsidized nutrients and consequently subsidized fertilizers will remain fixed. The retail prices of subsidized fertilizers at farmgate level will is now being decided by the companies.
- ▶ **Hike in urea prices by 10%:** The cabinet also decided on February 18, 2010 to raise urea prices by nearly 10%. The MRP on urea was raised to Rs5,310 per tonne from Rs4830 per tonne effective April 1, 2010.
- ▶ **Hike in natural gas prices by 135%:** The Government with effect from June 1, 2010 increased the price of natural gas to Rs6,818 per thousand cubic meters (US\$3.818 per mBtu), which after adding royalty meant a user price of Rs7,500 per thousand cubic meters (US\$4.12 per mBtu).

### On track to fiscal consolidation with likely pleasant surprises

India is seemingly well on path of fiscal consolidation in FY2011E and the end-year fiscal position may surprise the markets (see Exhibit 1).

- ▶ We expect GFD/GDP ratio in FY2011E to be cut to 5.1% versus budget estimate of 5.5%. A reduction of 0.1 ppt in this is on account of likely higher nominal GDP.
- ▶ If our expectations are realized, this would imply a reduction of 1.6% of GDP reduction in GFD in a single year. It would be no mean achievement considering that interest payments, subsidies and defense expenditures takes away 80% of the revenues of the Union government.
- ▶ This large reduction in fiscal deficit has arisen mainly from the fiscal correction and has been the result of spectrum auctions (3G and BWA licenses) that yielded Rs1.06 tn or Rs710 bn (1% of GDP) over the budgeted revenue from the telecom licenses.
- ▶ However, apart from the one-off from spectrum auctions, subsidies reforms have also helped in limiting the overshooting of expenditures. Subsidies may still overshoot the budgeted amount by about 33%.

Exhibit 1: Government on course to fiscal correction through revenue raising and subsidies reforms  
Major budgetary items of the central government, March fiscal year-ends, 2009A-2011BE (Rs bn)

	2009A	2010BE	2010RE	2011BE	2011E	Change (%) 2010RE/ 20109BE	2011BE/ 2010RE	2011E/ 2010RE
<b>Receipts</b>								
<b>1. Revenue receipts (2 + 3)</b>	<b>5,403</b>	<b>6,145</b>	<b>5,773</b>	<b>6,822</b>	<b>7,741</b>	<b>(6)</b>	<b>18</b>	<b>34</b>
2. Gross tax revenue (a + b)	6,053	6,411	6,331	7,467	7,749	(1)	18	22
2.a. Direct taxes	3,359	3,716	3,886	4,317	4,563	5	11	17
2.a.1. Corporation tax	2,134	2,567	2,551	3,013	3,239	(1)	18	27
2.a.2. Income tax	1,206	1,129	1,314	1,281	1,301	16	(3)	(1)
2.a.3. Other taxes	19	20	21	23	23	5	6	6
2.b. Indirect taxes	2,694	2,695	2,445	3,150	3,185	(9)	29	30
2.b.1. Customs duty	999	980	845	1,150	1,149	(14)	36	36
2.b.2. Excise duty	1,086	1,065	1,020	1,320	1,346	(4)	29	32
2.b.3. Service tax	609	650	580	680	690	(11)	17	19
(2.c) Transfers to States and UTs	1,620	1,669	1,680	2,126	2,126	1	27	27
2.d Net tax revenue	4,433	4,742	4,651	5,341	5,623	(2)	15	21
3. Non-tax revenue	969	1,403	1,122	1,481	2,118	(20)	32	89
3.a Interest receipts	207	192	192	193	193	0	0	0
3.b.1 Dividends & profits of PSEs (ex-banks)	210	211	229	238	240	8	4	5
3.b.2 Dividends & profits of banks & RBI	176	286	291	275	200	2	(6)	(31)
3.c.1 3G licensing	-	350	-	350	677	-	-	-
3.c.2 BWA licensing	-	-	-	-	383	-	-	-
3.d Other non-tax revenue (incl. UTs)	376	713	410	426	426	(43)	4	4
<b>4. Capital receipts (4a + 4b + 4c)</b>	<b>3,437</b>	<b>4,063</b>	<b>4,443</b>	<b>4,265</b>	<b>4,067</b>	<b>9</b>	<b>(4)</b>	<b>(8)</b>
4.a Recovery of loans	61	42	43	51	51	1	21	21
4.b Other receipts (Disinvestments)	6	11	260	400	400	2,218	54	54
4.c Borrowings and other liabilities	3,370	4,010	4,140	3,814	3,616	3	(8)	(13)
4.c.1 Net market borrowing	2,336	3,980	3,984	3,450	3,252	0	(13)	(18)
<b>5. Total receipts (1 + 4)</b>	<b>8,840</b>	<b>10,208</b>	<b>10,215</b>	<b>11,087</b>	<b>11,808</b>	<b>0</b>	<b>9</b>	<b>16</b>
<b>Expenditures</b>								
<b>11. Non-plan expenditure (12 + 13)</b>	<b>6,087</b>	<b>6,957</b>	<b>7,064</b>	<b>7,361</b>	<b>7,867</b>	<b>2</b>	<b>4</b>	<b>11</b>
12. Non-plan revenue expenditure	5,590	6,188	6,419	6,436	6,867	4	0	7
12.a. Interest payments	1,922	2,255	2,195	2,487	2,487	(3)	13	13
12.b. Subsidies	1,297	1,113	1,310	1,162	1,544	18	(11)	18
12.b.1. Food	438	525	560	556	585	7	(1)	4
12.b.2. Fertilizer	766	500	530	500	575	6	(6)	9
12.b.3. Others (incl. on-budget oil)	94	88	220	107	384	150	(52)	74
12.c. Grants to States and UTs	384	486	466	460	460	(4)	(1)	(1)
12.d. Others	2,014	2,335	2,448	2,327	2,377	5	(5)	(3)
13. Non-plan capital exp.	497	769	644	925	1,000	(16)	44	55
<b>14. Plan expenditure (15 + 16)</b>	<b>2,752</b>	<b>3,251</b>	<b>3,152</b>	<b>3,731</b>	<b>3,941</b>	<b>(3)</b>	<b>18</b>	<b>25</b>
15. Plan revenue expenditure	2,348	2,784	2,644	3,151	3,251	(5)	19	23
16. Plan capital expenditure	405	468	508	580	690	9	14	36
<b>17. Total expenditure (11 + 14)</b>	<b>8,840</b>	<b>10,208</b>	<b>10,215</b>	<b>11,087</b>	<b>11,808</b>	<b>0</b>	<b>9</b>	<b>16</b>
18. Revenue expenditure	7,938	8,972	9,064	9,587	10,118	1	6	12
19. Capital expenditure	975	1,236	1,152	1,505	1,690	(7)	31	47
<b>Deficit</b>								
Primary Deficit (PD)	1,448	1,755	1,945	1,327	1,129	11	(32)	(42)
Revenue Deficit (RD)	2,535	2,827	3,291	2,765	2,377	16	(16)	(28)
Gross fiscal deficit (GFD)	3,370	4,010	4,140	3,814	3,616	3	(8)	(13)
<b>GDP FY2000 base</b>	<b>53,218</b>	<b>58,566</b>	<b>59,604</b>	<b>67,054</b>	<b>68,842</b>	<b>1.8</b>	<b>12.5</b>	<b>15.5</b>
<b>PD/GDP (%)</b>	<b>2.5</b>	<b>3.0</b>	<b>3.3</b>	<b>2.0</b>	<b>1.6</b>	<b>8.9</b>	<b>(39.3)</b>	<b>(49.7)</b>
<b>RD/GDP (%)</b>	<b>4.5</b>	<b>4.8</b>	<b>5.5</b>	<b>4.1</b>	<b>3.5</b>	<b>14.4</b>	<b>(25.3)</b>	<b>(37.5)</b>
<b>GFD/GDP (%)</b>	<b>6.1</b>	<b>6.8</b>	<b>6.9</b>	<b>5.7</b>	<b>5.3</b>	<b>1.5</b>	<b>(18.1)</b>	<b>(24.4)</b>
<b>GDP FY2005 base</b>	<b>55,744</b>	<b>61,642</b>	<b>61,642</b>	<b>69,347</b>	<b>71,504</b>	<b>-</b>	<b>12.5</b>	<b>16.0</b>
<b>PD/GDP (%)</b>	<b>2.5</b>	<b>3.0</b>	<b>3.2</b>	<b>1.9</b>	<b>1.6</b>	<b>5.3</b>	<b>(39.3)</b>	<b>(50.0)</b>
<b>RD/GDP (%)</b>	<b>4.5</b>	<b>4.8</b>	<b>5.3</b>	<b>4.0</b>	<b>3.3</b>	<b>10.6</b>	<b>(25.3)</b>	<b>(37.7)</b>
<b>GFD/GDP (%)</b>	<b>6.1</b>	<b>6.5</b>	<b>6.7</b>	<b>5.5</b>	<b>5.1</b>	<b>3.3</b>	<b>(18.1)</b>	<b>(24.7)</b>

Note: (1) A: budgetary actuals, RE: Revised Estimates, BE: Budget Estimates and E: our estimates

Source: Ministry of Finance and Kotak Institutional Equities estimates.

- Food subsidies may overshoot as (1) government seeks to expand PDS to progress on promised 'Right to Food' and (2) procurement is larger as a result of expected normal monsoon.

- ▶ Fertilizer subsidies may get capped with the help of NBS, but on current prices may still touch Rs575 bn.
- ▶ Oil subsidies were grossly underprovided with an allocation of just Rs32 bn, but if oil averages US\$75/b in the rest of FY2011E (US\$76 for full year), it may be now be possible to limit oil subsidy to about Rs310 bn, assuming that a third of Rs540 bn under-recovery is borne by the upstream companies and the burden on downstream companies is limited to Rs50 bn.
- ▶ Reduction in deficit anticipated by us appears possible even with Rs725 bn overshooting in expenditures, as we continue to believe that tax revenues would overshoot budget estimates.

### Consolidated deficit reduction of 2% of GDP likely in FY2011E

Taking into account the central and state finances, it appears to us that the combined deficit of centre and state governments may take place in FY2011E, resulting in India joining the EU states attempting front-loaded fiscal correction (see Exhibit 2). Many debt crisis ridden EU states, however, have much higher fiscal deficits than India.

#### Exhibit 2: India on path to fiscal consolidation

GFD/GDP ratios in India, March fiscal year-ends, 2009-11E (%)

	2009A	2010BE	2010RE	2011BE	2011E
Center	7.9	7.0	6.9	5.5	5.1
On-budget	6.1	6.8	6.7	5.5	5.1
Off-budget	1.8	0.2	0.2	-	-
State	2.6	3.2	3.5	3.3	3.2
<b>Total</b>	<b>10.6</b>	<b>10.6</b>	<b>10.4</b>	<b>8.8</b>	<b>8.3</b>

Source: GOI, RBI and Kotak Institutional Equities estimates

### Fuel price hikes may add 2-ppt to headline inflation

In our calculations, the fuel price hikes are highly inflationary in the short run. We estimate the following:

- ▶ The hike in prices of the four fuels would add only 0.24 ppt to headline inflation in June 2010 as the price level on this count rises only for the last week of the month.
- ▶ The inflationary impact would, however, be felt in July with a direct static impact calculated as weighted increase in price levels captured by WPI index at commodity-level. Such impact would raise headline inflation rates by 1.18 ppt.
- ▶ We estimate the total inflationary impact at 1.96 ppt, including the second-round impact as prices of other commodities rise as a result of the use of these fuels as inputs that may be 0.78 ppt. The second round impact typically decays exponentially, dying down over 1-2 quarters.

Apparently, the inflationary impact of the fuel price hike is large. However, If global crude oil prices remain stable, most of the inflationary impact may be offset in the long run through lower fiscal deficit that too has strong though opaque inflationary potential. However, it is not clear when these benefits would accrue as any rise in global crude prices could generate fresh inflationary potential in a deregulated environment.



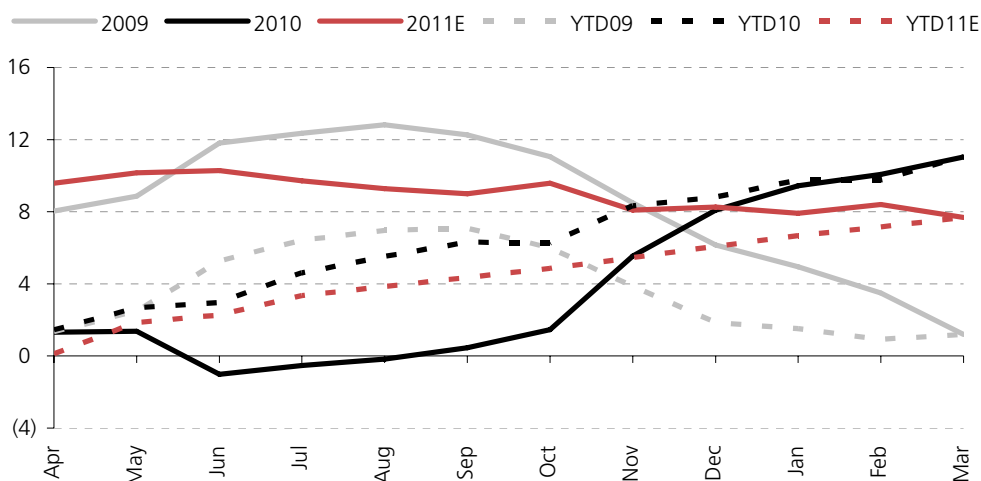
### Inflation persistence may now be stronger in FY2011E

In our calculation, inflation persistence would now be much higher than anticipated before. Our revised projected path of inflation (see Exhibit 3) suggests:

- ▶ End-FY2011E WPI inflation may now be at about 7.7% against our earlier estimate of 6.5-7%
- ▶ Average FY2011E WPI inflation of nearly 9% versus our earlier estimate of 7.9%
- ▶ The above inflation trajectory is considerably higher than the earlier official estimates. The Ministry of Finance had been indicating end-FY2011e inflation at 4-5%, while RBI had pegged it at 5.5%. It remains to be seen how these forecasts get revised. Chairman, PM's Economic Advisory Council indicated an end-year inflation of 6% post the fuel price hikes.

### Exhibit 3: Inflation may average 9% in FY2011E and fall to 7.7% by end-year

Headline WPI inflation rate (yoy), YTD price level change, March fiscal year-ends, 2009-2011E (%)



Source: Ministry of Industry and Kotak Institutional Equities estimates

### RBI may act more decisively

Considering that inflation trajectory may be markedly affected by the fuel price hikes, we now expect RBI to act more decisively in tightening the monetary policy than before.

- ▶ We stay with our call that RBI may raise rates 50 bps in July 2010, likely with an intra-policy 25 bps hike (see our Economy note of April 20, 2010, 'Still walking on the eggshells', in which we pointed out that the RBI was way behind the curve as a conscious policy choice).
- ▶ We expect a 25 bps rate hike before July 27 policy, followed by another 25-50 bps on the policy date. We do not rule out compression of the interest rate corridor by 25 bps by asymmetric change.
- ▶ We also now expect another 125 bps policy rate hike in FY2011E versus our earlier estimate of 75 bps.



### Interest rates may harden moderately; lower market borrowing to help

- ▶ We expect net market borrowing to be reduced by Rs200 bn from an budgeted amount of Rs3.45 tn.
- ▶ This may help substantially offset the impact of rise in policy rates, though some rise now looks inevitable.
- ▶ Whether or not interest rates may harden may be impacted more by the pace of credit expansion in relation to deposit growth.

**JUNE 25, 2010**
**UPDATE**

Coverage view: **Attractive**

Price (Rs): **2,935**

Target price (Rs): **3,200**

BSE-30: **17,575**

**Growth unhindered despite rising real estate prices, retain ADD.** We returned positive from our recent meeting with HDFC's management – growth remains strong despite rising real estate prices across most Indian cities. A gradual rise in interest rates, ease in competitive pressures and strong underlying buoyancy will likely help HDFC in maintaining spreads and growth in the current environment, retain ADD with a target price of Rs3,200.

**Company data and valuation summary**

HDFC

**Stock data**

52-week range (Rs) (high,low)	3,040-1,950
Market Cap. (Rs bn)	842.8

**Shareholding pattern (%)**

Promoters	0.0
FIs	57.8
MFs	3.8

**Price performance (%)**

	1M	3M	12M
Absolute	12.5	13.5	23.5
Rel. to BSE-30	2.5	13.4	0.8

**Forecasts/Valuations**

	2010	2011E	2012E
EPS (Rs)	98.4	118.2	143.7
EPS growth (%)	22.7	20.1	21.5
P/E (X)	29.8	24.8	20.4
NII (Rs bn)	35.8	42.9	52.1
Net profits (Rs bn)	28.3	33.9	41.2
BVPS	529.3	599.2	684.1
P/B (X)	5.5	4.9	4.3
ROE (%)	20.0	21.0	22.4
Div. Yield (%)	1.2	1.4	1.7

**Demand remains strong across geographies**

We expect HDFC to deliver 24% loan growth (pre-securitization) in FY2011E, up from 20% in FY2010. In our recent meeting, HDFC's management highlighted that real estate markets in most parts of the company are currently looking up and will drive growth in new business. Prices in most towns are still somewhat below peaks. Large business drivers are Bangalore, Chennai, cities in Gujarat, and Pune. Prices in Mumbai and NCR are back to an all-time high (or higher in some pockets) though real estate sales have not yet shown signs of slowing down and developers continue to launch new projects.

KIE real estate research indicates that companies in the sector will report strong growth in FY2011E as well – revenue from real estate sales will likely increase by about 40% yoy (driving disbursements) and bookings will rise by 20-25% yoy. Real estate prices in most parts of the country are close to historic peaks even as sales remain strong; the affordability index is just above 2006 levels.

**Reported growth will be front loaded**

The momentum in the sector normally peaks during 4Q. HDFC's business picked up in 2HFY10 and retail growth was back-ended during FY2010. With continued strong momentum in FY2011E, the growth is likely to be front loaded (reported growth in 1HFY11E is likely to be much higher than 2H); disbursements and loan growth may be lower on a high base in 4QFY11 though yoy growth will remain in the range of 20-25%.

**Spreads will likely remain stable**

We believe HDFC's spreads will remain stable yoy in FY2011E as the rise in borrowings cost is offset by higher home loan rates. Unlike FY2009, the rise in interest rates is not sudden; the liquidity crunch is unlikely to be severe. We believe the banking sector will incrementally reduce its focus on mortgages as other segments will also likely pick up. Notably, over the last 2-3 months, large banks have not launched any new home loan product.

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### Investment book will likely provide positive earnings surprises

HDFC has non-strategic equity investments of about Rs10 bn which includes listed and unlisted investments. We believe that the current environment will likely help the company to book capital gains from its unlisted investment book. We are modeling capital gains of Rs2.5 bn for FY2011E and Rs3 bn for FY2012E in our estimates. The buoyant capital markets could result in higher gains from the investment portfolio.

### Insurance businesses will require additional capital for growth

HDFC Standard Life has delivered 61% growth in APE collections during April and May 2010 as against 42% APE growth reported by the insurance industry and 22% growth reported by the private sector. We are modeling an equity infusion of Rs1 bn in HDFC Standard Life and Rs1.5 bn in ERGO during FY2011E.

HDFC has passed on interest rate hike to its customers when demand has been strong  
Spreads, disbursements and loan growth at HDFC, March fiscal year-ends, 2004-2012E

	2004	2005	2006	2007	2008	2009	2010	2011E	2012E
Yield on home loans (%)	9.7	8.4	8.5	9.6	11.1	12.6	10.9	11.0	10.9
Average cost of funds (%)	7.2	6.0	6.0	7.1	8.1	9.7	8.0	8.1	8.1
<b>Spread on housing loan (%)</b>	<b>2.5</b>	<b>2.4</b>	<b>2.6</b>	<b>2.5</b>	<b>3.0</b>	<b>2.8</b>	<b>2.9</b>	<b>2.9</b>	<b>2.8</b>
HDFC's reported spreads (%)	2.2	2.17	2.18	2.18	2.32	2.21	2.30		
Loan growth (pre-loan securitization- %)	28	29	25	26	29	22	20	24	27

Source: Company, Kotak Institutional Equities estimates

### Affordability index just above 2006 levels

Measurement of affordability of housing in India, March fiscal year-ends, 1999-2010E

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Housing loan interest rates (%)	14.5	13.9	12.8	12.1	10.4	8.9	8.0	8.5	9.5	10.5	10.5	8.70
EMI per Rs100,000 on 20 yr loan (Rs)	1,366	1,240	1,160	1,110	995	895	836	868	932	998	998	881
Avg annual household income (for households with annual income > Rs200,000)		577,201	606,061	636,364	668,182	701,591	736,671	788,238	843,414	902,453	947,576	947,576
Income growth (%)			5.0%	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	5.0%	5.0%
Taxes		115,440	121,212	127,273	133,636	140,318	147,334	157,648	168,683	180,491	142,136	142,136
Post tax income		461,761	484,849	509,091	534,546	561,273	589,337	630,590	674,731	721,963	805,439	805,439
Selling prices rise by 5% FY2010E												
Capital price in Koramangala, Bangalore		1,900	1,800	1,750	1,900	2,350	2,800	4,500	4,750	4,750	3,600	3,780
Price of 1,500 sq. ft house (Rs mn)		2.9	2.7	2.6	2.9	3.5	4.2	6.8	7.1	7.1	5.4	5.7
EMI payable assuming 70% LTV		24,738	21,924	20,396	19,850	22,084	24,578	41,013	46,484	49,775	37,724	34,967
Price/income ratio (X)		4.9	4.5	4.1	4.3	5.0	5.7	8.6	8.4	7.9	5.7	6.0
<b>Affordability Index (assuming FY2000 as 100)</b>		<b>100</b>	<b>84</b>	<b>75</b>	<b>69</b>	<b>73</b>	<b>78</b>	<b>121</b>	<b>129</b>	<b>129</b>	<b>87</b>	<b>81</b>
Capital price in Bandra, Mumbai		7,992	8,791	8,000	8,500	8,500	10,000	13,000	16,000	20,000	14,000	17,000
<b>Affordability Index (assuming FY2000 as 100)</b>		<b>100</b>	<b>98</b>	<b>81</b>	<b>74</b>	<b>63</b>	<b>66</b>	<b>83</b>	<b>103</b>	<b>129</b>	<b>81</b>	<b>87</b>

Source: Kotak Institutional Equities

### HDFC's dual rate home loan scheme comparable with peers

HDFC's revised dual rate home loan scheme (launched recently) earns yield of 8.7% as compared to 8.25% charged in the dual rate scheme launched in FY2010 – the rise in yield will largely offset the increase in HDFC's marginal borrowings cost. HDFC's revised dual rate home loan scheme drives about 90% of its incremental retail business. HDFC offers two-year fixed rate home loans (8.25% for the 1st year followed by 9% in the 2nd year) as compared to 8.75% floating rate (for loans up to Rs3 mn) offered otherwise. The average yield on this product works out to 8.7% – somewhat similar to SBI (though SBI's product is fixed for three years) and marginally below LICHF – 8.9%, fixed for three years. HDFC clearly scores over SBI in quality of service.

A comparison of home loan rates for loans up to Rs3 mn

	HDFC (DR2) (%)	HDFC (DR1) (%)	SBI (%)	LICHT (%)
Year 1	8.25	8.25	8.0	8.9
Year 2	9	8.25	8.5	8.9
Year 3		8.25	8.5	8.9
Year 4 onwards	8.75 (1) (2)	8.75 (1)	9.0 (1)	9.75 (1)
Prepayment penalty (%)	3	3	2	2

## Note

DR- Dual rate home loan scheme

(1) Linked to PLR; indicative rate based on current PLR

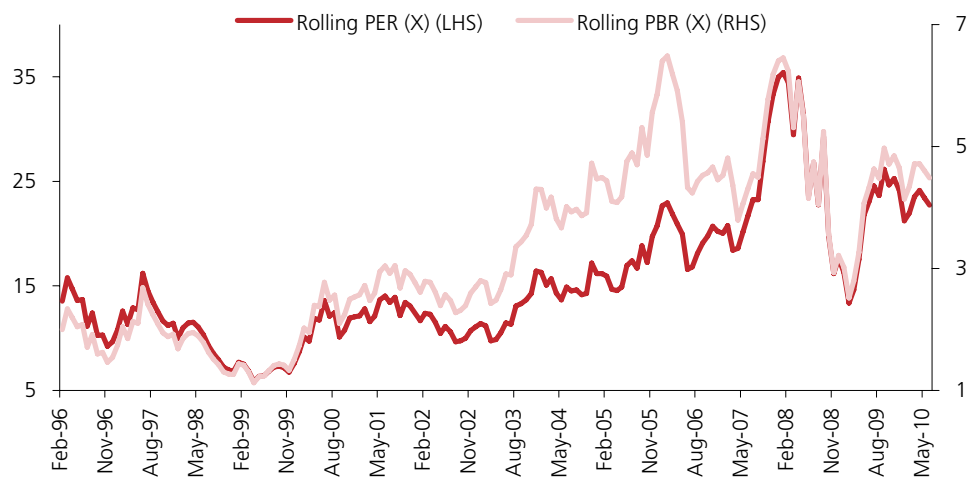
(2) Applicable from year 3

Source: Company

**SOTP-based target price of Rs3,200; retain ADD**

Our target price is the average of the fair value estimate of Rs2,950 (based on FY2011E) and Rs3,400 (based on FY2012E). In our FY2011E-based fair value estimate, we value HDFC's mortgage business at Rs1,691/share—5.9X core PBR and 17X core PER FY2011E. In order to capture the impact of the likely warrant conversion in FY2013E, we have valued the business using a residual growth model as of March 2013E and discounted back the value to March 2011E at 12.5%. At our fair value estimate, the mortgage business will trade at 3.9X core PBR and 15X core PER FY2013E for RoEs of about 26-30% (2% core RoA and leverage of 13-15X). We expect the company to report 20% core PBT CAGR between FY2010 and FY2012E.

HDFC – One year forward rolling PER and PBR (X)



Source: Company, Bloomberg, Kotak Institutional Equities estimates

## HDFC, Sum-of-the-parts-based valuation (FY2011E)

Business/ subsidiaries	HDFC's holding (%)	Value of companies (Rs mn)	Value per share (Rs)	Valuation methodology
HDFC			1,691	Based on residual growth model; exit multiple of 3.9X PBR FY2013E discounted to FY2011E
<b>Value of subsidiaries and associates</b>			<b>1,094</b>	
HDFC Bank	23	904,000	665	Based on target price
HDFC Standard Life MF	60	51,840	110	4% of March 2011E AUMs- 20% growth assumed
-PMS business	60	1,728	4	10% of AUMs (March 2011E - 20% yoy growth)
Life Insurance	72	113,000	265	13.5% margins and 19X NBV multiple
General insurance	74	8,600	20	Based on deal with ERGO
Gruh Finance	62.0	3,759	7	Based on market price
IDFC	1.9	212,628	13	Based on market price
HDFC Venture capital				
HDFC Property Fund	81	1,500	4	Rs10bn of fund assuming value of 15%
HDFC IT Corridor Fund	81	697	2	Rs4.64bn of fund assuming value of 15%
Real estate fund	60	2,520	5	US\$800 mn assuming value of 7.5%
<b>Equity investments</b>			<b>160</b>	
BVPS of non-strategic investments			34	
Unrealised gains on above			126	
<b>Total value per share</b>			<b>2,945</b>	

Source: Kotak Institutional Equities

## HDFC, Sum-of-the-parts-based valuation (FY2012E)

Business/ subsidiaries	HDFC's holding (%)	Value of companies (Rs mn)	Value per share (Rs)	Comments
HDFC			1,902	Based on residual growth model; exit multiple of 3.9X PBR FY2013E discounted to FY2012E
<b>Value of subsidiaries and associates</b>			<b>1,298</b>	
HDFC Bank	23.2	1,084,800	797	Based on HDFC Bank's fair value estimate (FY2012E), 10% holding company discount
HDFC Standard Life MF				
MF business	60.0	54,720	116	4% of March 2012E AUMs- 20% growth assumed
PMS business	60.0	2,074	4	10% of AUMs (March 2012E - 20% yoy growth)
Life insurance	72.0	130,000	310	13.5% margins and 19X NBV multiple
General insurance	74.0	8,600	23	Based on deal with ERGO
Gruh Finance	62.0	8,090	21	Based on market price
IDFC	1.9	255,153	15	Based on market price
HDFC Venture capital				
HDFC Property Fund	80.5	1,500	4	Rs10bn of fund assuming value of 15%
HDFC IT Corridor Fund	80.5	697	2	Rs4.64bn of fund assuming value of 15%
Real estate fund (hosted in MF)	60.0	2,520	5	US\$800 mn assuming value of 7.5%
<b>Equity investments</b>			<b>210</b>	
BVPS of non-strategic investments			34	
Unrealised gains			176	
<b>Total value per share</b>			<b>3,411</b>	

Source: Kotak Institutional Equities

## HDFC, Valuation

March fiscal year-ends, 2008-2012E

March y/e	Profit after tax (Rs mn)	EPS (Rs)	EPS core (Rs)	P/E (X)	PE on core operations (X)	BVPS (Rs)	BVPS Core (Rs)	P/B (X)	P/B on core operations (X)	RoA (%)	RoE (%)	Core RoE (%)
2008	24,362	85.8	56.3	34.2	29.9	421	285	7.0	5.9	3.2	27.8	27.2
2009	22,825	80.2	72.5	36.6	23.2	462	295	6.4	5.7	2.5	18.2	25.0
2010	28,265	98.45	83.0	29.8	20.2	529	227	5.5	7.4	2.6	20.0	30.6
2011E	33,566	116.91	97.9	25.1	17.2	598	287	4.9	5.8	7.9	20.7	38.1
2012E	40,412	140.75	118.0	20.9	14.2	682	362	4.3	4.6	8.5	22.0	36.4
<b>Share price</b>	<b>2935</b>											
Market Capitalisation (Rs mn)	842,783											
Less value of subsidiaries and investments	360,200											
Price adjd for subsidiaries and investments	482,583											
<b>Price per share adjt for subsidiaries and investments</b>	<b>1,681</b>											

Source: Kotak Institutional Equities

## HDFC (standalone), Key ratios, March fiscal year-ends, 2007-2012E (%)

	2007	2008	2009	2010E	2011E	2012E
<b>Spread calc</b>						
Average yield on assets (incl fees)	9.9	11.8	11.7	10.4	10.7	10.8
- interest on housing loans	9.6	11.1	12.6	10.9	11.0	10.9
Average cost of funds	7.1	8.1	9.7	8.0	8.1	8.1
Overall spread	2.9	3.7	2.0	2.4	2.6	2.7
<b>Spread on housing loans</b>	<b>2.5</b>	<b>3.0</b>	<b>2.8</b>	<b>2.9</b>	<b>2.9</b>	<b>2.8</b>
<b>NIMs (post-provision)</b>	<b>3.6</b>	<b>4.8</b>	<b>3.5</b>	<b>3.7</b>	<b>3.7</b>	<b>3.7</b>
<b>NIM (pre provisions)</b>	<b>3.6</b>	<b>4.8</b>	<b>3.6</b>	<b>3.7</b>	<b>3.8</b>	<b>3.7</b>
<b>DU PONT Analysis</b>						
Net total income	3.6	4.8	3.7	3.7	3.7	3.7
Net interest income	2.9	3.7	3.5	3.3	3.3	3.3
Capital gains	0.5	1.0	—	0.2	0.2	0.2
Dividend income	0.2	0.1	0.2	0.2	0.2	0.2
Net other income	0.2	0.1	0.1	0.2	0.2	0.2
Operating expenses	0.4	0.4	0.3	0.3	0.3	0.3
(1- tax rate)	79.8	72.2	70.9	72.2	71.5	71.5
<b>ROA</b>	<b>2.6</b>	<b>3.2</b>	<b>2.5</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>
Average assets/average equity	11.9	8.6	7.4	7.7	7.9	8.5
<b>ROE</b>	<b>31.3</b>	<b>27.8</b>	<b>18.2</b>	<b>20.0</b>	<b>20.7</b>	<b>22.0</b>
<b>Growth(%)</b>						
Net loans	26	29	17	15	21	26
Total assets	23	29	20	15	20	23
Total income	38	51	24	2	20	23
Interest on Housing Loans	40	49	38	—	20	23
Net income before provision	25	69	(4)	17	19	20
Total expenses	12	22	12	2	13	14
PBT	26	71	(5)	22	20	20
PAT	25	55	(6)	24	19	20

Source: Company, Kotak Institutional Equities estimates

HDFC (standalone), P&amp;L and balance sheet, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
<b>Income statement</b>						
Total income excluding fee income	58,069	87,494	108,798	111,066	133,643	164,542
Interest on Housing Loans	48,502	72,164	99,310	99,790	119,328	146,883
Dividends	1,179	686	1,957	2,327	2,948	3,525
Lease rentals	110	155	147	241	217	195
Other operating income	8,279	14,489	7,384	8,708	11,150	13,939
Income from investments	5,026	6,794	7,132	6,614	6,717	8,214
Capital gains	3,253	7,695	252	2,094	2,500	3,000
Income/ gains on securitisation	—	—	—	—	1,933	2,725
Interest payable	36,669	51,429	74,324	70,631	85,504	106,547
<b>Net Income before provision</b>	<b>21,401</b>	<b>36,065</b>	<b>34,474</b>	<b>40,435</b>	<b>48,139</b>	<b>57,995</b>
Provision	250	320	500	580	650	728
<b>Fee income</b>	<b>686</b>	<b>632</b>	<b>1,149</b>	<b>2,317</b>	<b>2,876</b>	<b>3,152</b>
Total income	58,755	88,126	109,948	113,383	136,519	167,694
Staff expenses	913	1,178	1,386	1,467	1,662	1,901
<b>Total expenses</b>	<b>2,192</b>	<b>2,673</b>	<b>2,987</b>	<b>3,056</b>	<b>3,454</b>	<b>3,922</b>
Depreciation	175	166	175	182	192	202
Other income	208	197	229	226	226	226
<b>Profit before tax</b>	<b>19,678</b>	<b>33,735</b>	<b>32,190</b>	<b>39,160</b>	<b>46,945</b>	<b>56,520</b>
Tax	3,974	9,373	9,365	10,895	13,379	16,108
<b>Profit after tax</b>	<b>15,704</b>	<b>24,362</b>	<b>22,825</b>	<b>28,265</b>	<b>33,566</b>	<b>40,412</b>
- . EPS	62	86	80	98	117	141
<b>EPS (core)</b>	<b>45</b>	<b>56</b>	<b>72</b>	<b>83</b>	<b>98</b>	<b>118</b>
Book value	219	421	462	529	598	682
Book value (core)	145	285	295	227	287	362
<b>Balance sheet</b>						
Net loans	565,123	729,980	851,981	979,669	1,189,934	1,505,160
Total Investments	36,663	69,150	104,688	107,274	134,202	140,798
In equity	18,872	38,616	47,525	86,775	89,275	91,775
Fixed securities	17,790	30,534	57,162	20,499	44,927	49,023
Diminution in value of invt	(396)	(548)	(853)	(853)	(853)	(853)
Cash & deposits	14,437	8,586	17,185	31,257	31,257	31,257
Loans and advances and other assets	36,129	32,938	38,523	42,375	42,375	42,375
Deferred tax assets	1,231	1,466	2,158	2,857	2,857	2,857
Fixed assets owned	2,131	2,085	2,034	2,221	2,399	2,591
<b>Total assets</b>	<b>655,713</b>	<b>844,205</b>	<b>1,016,569</b>	<b>1,165,654</b>	<b>1,403,024</b>	<b>1,725,039</b>
<b>Total borrowings and CL</b>	<b>600,199</b>	<b>724,732</b>	<b>885,195</b>	<b>1,013,677</b>	<b>1,231,216</b>	<b>1,529,353</b>
Share capital	2,530	2,840	2,845	2,871	2,871	2,871
Reserves	52,984	116,633	128,529	149,106	168,938	192,815
<b>Shareholders fund</b>	<b>55,514</b>	<b>119,473</b>	<b>131,374</b>	<b>151,977</b>	<b>171,809</b>	<b>195,686</b>

Source: Company, Kotak Institutional Equities estimates



JUNE 28, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **192**

Target price (Rs): **175**

BSE-30: **17,575**

**Proposed tower sale to GTL infrastructure positive, but in the price.** Lack of details on transaction structure notwithstanding, RITL tower sale deal to GTLI is positive for RCOM in at least two ways – (1) higher-than-expected valuations and part-cash nature of the deal, and (2) cash infusion de-leverages RCOM's balance sheet, increasing its ability to slug it out in the competitive dogfight in the sector; this is of course, negative news for the sector. Raise target price on RCOM to Rs175/share (Rs140 earlier) but retain SELL as the positive news flow is more than priced in, already.

#### Company data and valuation summary

Reliance Communications

##### Stock data

52-week range (Rs) (high,low) 320-132

Market Cap. (Rs bn) 410.1

##### Shareholding pattern (%)

Promoters 67.6

FIs 8.3

MFs 1.5

##### Price performance (%)

Absolute 38.4 13.7 (35.9)

Rel. to BSE-30 26.2 13.6 (47.7)

##### Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	22.1	14.1	18.2
EPS growth (%)	(30.2)	(36.2)	29.1
P/E (X)	8.7	13.7	10.6
Sales (Rs bn)	222.5	222.9	260.2
Net profits (Rs bn)	48.8	31.1	40.0
EBITDA (Rs bn)	78.9	67.4	83.0
EV/EBITDA (X)	7.7	8.6	6.5
ROE (%)	11.7	7.4	8.9
Div. Yield (%)	0.4	0.0	0.0

#### The RITL-GTLI tower deal – whatever little is known appears positive for RCOM

A disclaimer at the outset is only apt – we do not know an awful lot about the exact contours of the deal, including some important bits of information to pass a quantitatively refined opinion, yet. We use a bunch of assumptions to evaluate the deal later in the note. Here's what we know

- ▶ GTL Infrastructure has agreed to buy Reliance Infratel's (RITL) tower assets (approximately 50,000 towers, as indicated by RCOM in May 2010) in a cash + stock deal. The transaction is likely to close in the next six months.
- ▶ RITL is owned 95% by RCOM and 5% by a set of PE investors (hereafter referred to as RITL minority shareholders).
- ▶ Optic fibre assets, owned by RITL, are not a part of the transaction. These assets remain with RCOM.
- ▶ Cash part of the transaction consideration accrues to RCOM, while GTLI also issues fresh shares to RCOM shareholders (including the promoters) as well as RITL minority shareholders.
- ▶ RCOM has indicated an **EV of Rs500 bn (US\$11 bn) for the combined entity, post-merger.** We are not sure whether this indicative figure is (1) EV of the post-merger 82,000 towers at a target EV/tower (in which case GTLI shares will likely be issued at substantial premium to market price) or (2) sum of RITL towers' deal EV + GTLI's current EV (in which case GTLI shares will likely be issued at CMP).
- ▶ RITL's tower lease MSA with RCOM is likely to undergo a change with certain pass-through expenses becoming non-pass-through.

And here's how what we know is a positive for RCOM (the company, and not the stock at current market price)

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- ▶ In each of the two ways of looking at the announced deal EV discussed above, the deal appears to have happened at a value (US\$135,000-156,000 per tower) significantly higher than our estimate of fair EV/tower (US\$100,000 per tower). This may not have been a positive if 100% deal payout was in the form of GTLI stock issued at substantial premium (expensive-stock-for-expensive-stock deal,) but
- ▶ Part of the deal consideration will be paid in the form of cash to RCOM. While RCOM has not disclosed the exact quantum of cash coming into the company as part of the transaction, press reports in the past few days have indicated that the company expects its gross debt (at end-4QFY10 grossed up for 3G payout) of Rs330 bn to halve post the transaction. Assuming Rs20 bn of net debt (accruing at consolidated RCOM level) is being transferred to GTLI as part of the sale, we compute Rs145 bn of cash infusion into RCOM. This would reduce RCOM's gross debt (including 3G spectrum payout) to Rs165 bn.
- ▶ RCOM appears to have pulled off a rich (in our view) sale of its tower assets. Cash infusion into the company also de-leverages its balance sheet (end-FY2012E net-debt-to-EBITDA goes down to 1.2X from 2.8X per current estimates), a definite positive in our view. This enhances RCOM's ability to challenge the revenue market leaders in the fiercely competitive Indian wireless market and also provides the necessary balance sheet headroom needed to execute its 3G strategy.

#### Raise RCOM target price to Rs175/share; retain SELL

We take a closer look at the impact of the transaction on RCOM's fair value with two different set of assumptions (regarding the EV assigned to GTLI's current tower base in the announced EV of Rs500 bn). What needs to be understood is this – **one share of RCOM bought today will be equivalent to '1 share of RCOM (ex-towers, plus some cash 'C') + a certain number (X) of GTLI (with RITL towers and an expanded debt as well as equity base to fund the transaction) shares once the transaction is complete.** Not knowing 'C' and 'X' hampers our ability to determine the post-deal fair value of RCOM stock.

In the two scenarios with some assumptions on C and X, which we detail later, fair value of RCOM works out to Rs172 and Rs184 per share – we reset our target price to Rs175/share. The recent run-up in the stock implies downside at current levels – hence, we retain our SELL rating on the stock. Company-indicated 26% stake sale (at RCOM level) to strategic/PE investors at higher-than-fair-value is the key upside risk to our recommendation and rating.

#### The key question – is sum of the parts greater than the whole?

Indian wireless industry's competitive dynamics and RCOM's below-par execution (reflected in weaker-than-peers' and lower-than-WACC return ratios for the past few years) has meant that our RCOM-whole's fair 'going concern' value has been less than the sum of the parts (assets). With RCOM pulling off, what appears to be an overvalued asset-sale transaction to us, we do not rule out the stock continuing to trade at higher than its going-concern 'whole' value in anticipation of more such transactions – the company has already indicated a potential 26% stake sale at the parent level. We also note that the company has indicated a potential stake sale in its GlobalCom subsidiary in the past.

#### RCOM balance sheet de-leveraging – not good news for the sector

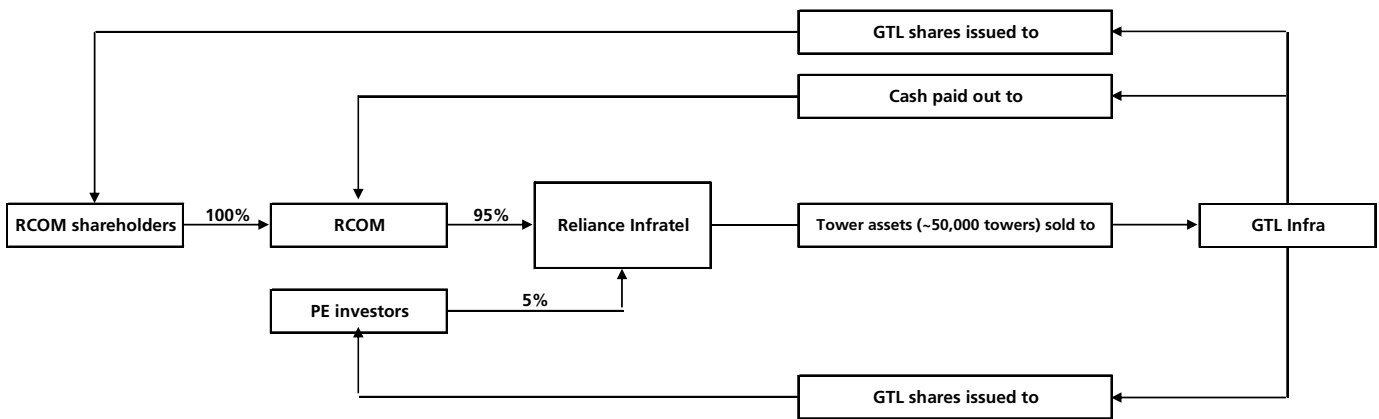
The tower sale deal, and potential further cash infusion likely on parent co stake sale, will de-leverage RCOM's balance sheet and provide the company ample borrowing cushion to slug it out in the intensely competitive Indian wireless market. We note that RCOM has been disruptive with its competitive actions in the past.

From a broader perspective, we note that such ‘tower-sale-and-lease-back’ deals provide ammunition to the wireless industry without necessarily adding substantial value to the sector as a whole. In any case, value created by any transaction in the sector will likely continue to get passed on the end-customer in the value chain (the wireless subscriber) till the wireless industry consolidates and regains some pricing power. Such transactions, thus, only shift the risks to the tower cos, in our view. Come to think of it, consolidation in the wireless industry, which the Street sees as the positive case for the Indian telcos can not be a positive for tower cos, who lose customers. Interestingly, this does not seem to be reflected in the valuations being offered to tower cos in the market transactions.

**Impact on RCOM stock – we mix what we know with some assumptions on what we do not know**

Exhibit 1 depicts the broad dynamics of the deal.

Exhibit 1: The deal - understanding RCOM tower asset sale to GTL Infrastructure



Source: Companies, press reports, Kotak Institutional Equities estimates

The three key missing bits of information to evaluate the deal from a valuation standpoint are – (1) the deal-implied EV of RITL’s tower assets, embedded in the announced combined-entity EV of Rs500 bn, (2) cash and stock proportion, and (3) swap ratio. We make some assumptions and present two scenarios

**Scenario 1 – assuming RITL tower asset EV = Rs500 bn (less) current EV of GTLI**

Exhibit 2 shows how the deal would look like, in numbers with the above assumption; Exhibit 3 shows the broad post-deal fair value impact on RCOM, while Exhibit 4 details the impact computation.

## Exhibit 2: The deal - understanding RCOM tower asset sale to GTL Infrastructure in numbers – Scenario 1

<b>Combined EV of the post-deal GTL infra (Rs bn)</b>	<b>500</b>
Current market cap of GTL Infra (Rs bn) (@CMP of Rs45.65/share)	44
Current net debt of GTL Infra (Rs bn) (a)	106
<b>Current EV of GTL Infra (Rs bn)</b>	<b>150</b>
<b>Implied Deal EV (Rs bn)</b>	<b>350</b>
<b>Implied EV/tower (US\$)</b>	<b>155,717</b>
Net debt of RITL being transferred (assumed) (Rs bn)	20
<b>Equity value realized (Rs bn)</b>	<b>330</b>
<b>Equity value accruing to RCOM shareholders (95% of total) (Rs bn) (b)</b>	<b>314</b>
<b>Of which, cash accrual to RCOM (Rs bn) (c)</b>	<b>145</b>
<b>Share swap portion (Rs bn) (d) - for RCOM shareholders</b>	<b>169</b>
Share swap portion to RITL minority shareholders	17
Total new shares of GTL Infra to be issued (mn) (@45.65/ GTL share)	4,053
Of which, RCOM shareholders receive	3,691
Of which, RITL minority shareholders receive	361
<b>Share swap ratio (applicable to RCOM shareholders) (e)</b>	<b>1.71</b>

Note:

(a) end-FY2010 reported net debt of Rs40 bn + Rs84 bn for the Aircel deal less Rs18 bn already shown as invested.

(b) adjusted for 5% minority interest in Reliance Infratel.

(c) based on press statements of 50% reduction in RCOM's gross debt post deal.

(d) = (b) - (c) .

(e) denotes # of shares of GTL Infra to be received per share of RCOM.

Source: Company, Press reports, Kotak Institutional Equities estimates

## Exhibit 3: Implications of the deal from a RCOM shareholder perspective - Scenario 1

Pre-deal		Post-deal	
<b>Fair value of RCOM (Rs/share)</b>	<b>140</b>	<b>Fair value of RCOM (Rs/share)</b>	<b>184</b>
Broken into (Rs/share)		Broken into (Rs/share)	
EV of core business incl towers	248	EV of core business	170
Net debt	(108)	Net debt	(31)
Equity value	140	Equity value of RCOM	138
		Value of 1.71 shares of GTL Infra	46
		Equity value per share of RCOM held today	184

Source: Kotak Institutional Equities estimates

Exhibit 4: RCOM equity value pre/post-deal - FY2012E basis - Scenario 1

<b>Pre-deal fair value of RCOM</b>	
Consolidated EBITDA (Rs mn)	83,950
Implied EV/EBITDA (X)	6.4
EV (Rs mn)	535,306
Net debt (including 3G payout) (Rs mn)	232,626
Equity value (Rs mn)	302,680
<b>Per share equity value (Rs)</b>	<b>140</b>
<b>Post-deal fair value of RCOM</b>	
Pre-deal consolidated EBITDA (Rs mn)	83,950
Towerco sale impact on EBITDA (Rs mn)	(26,460)
Adjusted EBITDA (Rs mn)	57,490
EV/EBITDA (X)	6.4
EV (Rs mn)	366,585
Net debt (Rs mn)	67,626
Equity value (Rs mn)	298,959
<b>Per share value (Rs)</b>	<b>138</b>
<b>+ value of 1.71 shares of GTL infra</b>	<b>46</b>
<b>Post-deal per share value of RCOM (Rs)</b>	<b>184</b>
<b>Current share price of RCOM (Rs)</b>	<b>194</b>
<b>Potential upside/(downside)</b>	<b>(5)</b>
<b>Post-deal fair value of GTL infra</b>	
Post-deal # of towers	90,000
EV/tower (US\$)	100,000
EV (US\$ mn)	9,000
EV (Rs mn)	405,000
Net debt (Rs mn)	271,000
<b>Equity value (Rs mn)</b>	<b>134,000</b>
<b>Revised share count (mn)</b>	<b>5,010</b>
<b>Fair value (per share)</b>	<b>27</b>

Source: Kotak Institutional Equities estimates

Scenario 2 – assuming ALL towers (RITL's as well as GTLI's) are valued at the same EV; here's GTLI shares (part of the deal) will be issued at a premium to CMP

Exhibit 5 shows how the deal would look like, in numbers with the above assumption; Exhibit 6 shows the broad post-deal fair value impact on RCOM, while Exhibit 7 details the impact computation.

## Exhibit 5: The deal - understanding RCOM tower asset sale to GTL Infrastructure in numbers - Scenario 2

<b>Combined EV of the post-deal GTL infra (Rs bn)</b>	<b>500</b>
<b>Combined # of towers</b>	<b>82,000</b>
<b>EV/tower (Rs mn)</b>	<b>6.10</b>
Tower base - GTL Infra	32,000
<b>Deal-implied EV of GTL Infra (Rs bn)</b>	<b>195</b>
<b>Implied deal-implied share price of GTL infra (b)</b>	<b>93</b>
<b>Implied Deal EV (Rs bn)</b>	<b>305</b>
<b>EV/tower (US\$)</b>	<b>135,501</b>
Net debt of RITL being transferred (assumed) (Rs bn)	20
Equity value realized (Rs bn)	285
<b>Equity value accruing to RCOM shareholders (95% of total) (Rs bn) (b)</b>	<b>271</b>
<b>Of which, cash accrual to RCOM (Rs bn) (c)</b>	<b>145</b>
<b>Share swap portion (Rs bn) (d) - for RCOM shareholders</b>	<b>126</b>
Share swap portion to RITL minority shareholders	14
Total new shares of GTL Infra to be issued (mn) (@93/ GTL share)	1,502
Of which, RCOM shareholders receive	1,349
Of which, RITL minority shareholders receive	153
<b>Share swap ratio (applicable to RCOM shareholders) (e)</b>	<b>0.62</b>

Note:

(a) end-FY2010 reported net debt of Rs40 bn + Rs84 bn for the Aircel deal less Rs18 bn already shown as invested.

(b) adjusted for 5% minority interest in Reliance Infratel.

(c) based on press statements of 50% reduction in RCOM's gross debt post deal.

(d) = (b) - (c) .

(e) denotes shares of GTL Infra to be received per share of RCOM.

Source: Company, Press reports, Kotak Institutional Equities estimates

## Exhibit 6: Implications of the deal from a RCOM shareholder perspective - Scenario 2

Pre-deal		Post-deal	
<b>Fair value of RCOM (Rs/share)</b>	<b>140</b>	<b>Fair value of RCOM (Rs/share)</b>	<b>172</b>
Broken into (Rs/share)		Broken into (Rs/share)	
EV of core business incl towers	248	EV of core business	170
Net debt	(108)	Net debt	(31)
Equity value	140	Equity value of RCOM	138
		Value of 0.62 shares of GTL Infra	34
		Equity value per share of RCOM held today	172

Source: Kotak Institutional Equities estimates

Exhibit 7: RCOM equity value pre/post-deal - FY2012E basis - Scenario 2

<b>Pre-deal fair value of RCOM</b>	
Consolidated EBITDA (Rs mn)	83,950
Implied EV/EBITDA (X)	6.4
EV (Rs mn)	535,306
Net debt (including 3G payout) (Rs mn)	232,626
Equity value (Rs mn)	302,680
<b>Per share equity value (Rs)</b>	<b>140</b>
<b>Post-deal fair value of RCOM</b>	
Pre-deal consolidated EBITDA (Rs mn)	83,950
Towerco sale impact on EBITDA (Rs mn)	(26,460)
Adjusted EBITDA (Rs mn)	57,490
EV/EBITDA (X)	6.4
EV (Rs mn)	366,585
Net debt (Rs mn)	67,626
Equity value (Rs mn)	298,959
<b>Per share value (Rs)</b>	<b>138</b>
<b>+ value of 0.62 shares of GTL infra</b>	<b>34</b>
<b>Post-deal per share value of RCOM (Rs)</b>	<b>172</b>
<b>Current share price of RCOM (Rs)</b>	<b>194</b>
<b>Potential upside/(downside)</b>	<b>(11)</b>
<b>Post-deal fair value of GTL infra</b>	
Post-deal # of towers	90,000
EV/tower (US\$)	100,000
EV (US\$ mn)	9,000
EV (Rs mn)	405,000
Net debt (Rs mn)	271,000
<b>Equity value (Rs mn)</b>	<b>134,000</b>
<b>Revised share count (mn)</b>	<b>2,459</b>
<b>Fair value (per share)</b>	<b>54</b>

Source: Kotak Institutional Equities estimates



JUNE 26, 2010

UPDATE

BSE-30: 17,730

**It's been worth the wait.** We see the recent decision of the Empowered Group of Ministers (EGoM) to (1) increase prices of the four regulated products and (2) deregulate gasoline prices as a precursor to further deregulation of oil prices in India. We see significant upside to our earnings estimates of the six major government-owned energy companies. We await further details on the methodology of deregulation but have fine-tuned estimates and reiterate our BUY ratings on ONGC and OIL.

**Lower under-recoveries will reduce subsidy burden, increase visibility on earnings**

We estimate annual savings of Rs243 bn from the price increases announced on June 25, 2010 (see Exhibit 1). We compute gross under-recoveries at Rs539 bn for FY2011E assuming no under-recoveries on diesel and gasoline for 2HFY11E and Rs400 bn for FY2012E assuming full deregulation of auto fuel prices and no further increase in retail prices for kerosene and LPG (see Exhibit 2). Our previous estimate for FY2011E was Rs778 bn based on US\$75/bbl crude oil.

**EGoM decision a likely precursor to eventual deregulation; may take time though**

We compute marketing margin at -Rs1.1/liter for gasoline and Rs0.1/liter for diesel, post the June 25, 2010 increase in domestic retail selling prices (versus -Rs4/liter and -Rs1.6/liter previously). We use global oil prices and exchange rate for the period June 1-25, 2010 (crude price: US\$74.7/bbl, Dated Brent basis and exchange rate: Rs46.6/US\$) for our calculations of marketing margins.

**All the six government-owned companies stand to benefit meaningfully from full deregulation**

We see the large potential upside to the earnings of the six major government-owned companies in a scenario of full deregulation. Exhibit 3 shows the potential upside to our fair valuation of the stocks in a scenario of full deregulation of auto fuel prices and full compensation of under-recoveries on cooking fuel prices to the downstream oil companies.

**Reinstated ratings of BPCL, HPCL and IOCL at ADD after recent positive developments**

We have reinstated ratings on BPCL, HPCL and IOCL (all three rated as ADD now versus RS previously) noting more visibility on earnings post the recent government action—(1) gasoline price deregulation, (2) likely deregulation of diesel at a later date, (3) price increase of Rs2/liter on diesel, Rs3/liter on kerosene and Rs35/cylinder on LPG. We have raised FY2011E and FY2012E earnings estimates of all the six companies, BPCL, HPCL, IOCL, GAIL, OIL and ONGC.

	EPS (a) (Rs)	P/E (X)	Value of investments (Rs)	Target price (Rs)	Stock price (Rs)	Upside (%)	Rating
BPCL	61	8	173	660	621	6	ADD
GAIL India	32	NA	73	495	484	2	ADD
HPCL	53	8	74	500	402	24	ADD
IOCL	36	8	124	410	378	8	ADD
Oil India	141	10	27	1,440	1,360	6	BUY
ONGC (b)	133	10	55	1,450	1,263	15	BUY

Note:

(a) Average EPS for FY2011-12E.

(b) Fair value of ONGC includes value of new discoveries.

Source: Kotak Institutional Equities estimates

**QUICK NUMBERS**

- Rs243 bn of annual savings from recent price increase
- Rs537 bn of annualized under-recovery post recent changes
- 20-52% potential upside to 12-month fair valuations in case of full deregulation

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Price hikes to reduce annual subsidy burden by Rs243 bn  
Calculation of marketing margins on auto fuels and cooking fuels

	Prior price hike	Post price hike
Rs/US\$	46.6	46.6
<b>International price (US\$/ton) (a)</b>		
LPG	632	632
Kerosene	664	664
Gasoline	695	695
Diesel	625	625
<b>Import duty (%)</b>		
LPG	—	—
Kerosene	—	—
Gasoline	7.7	7.7
Diesel	7.7	7.7
<b>Landed India price (Rs/ton)</b>		
LPG	31,114	31,114
Kerosene	31,451	31,451
Gasoline	34,930	34,930
Diesel	31,480	31,480
<b>India IPP price (incl. transport) (a)</b>		
LPG (Rs/cylinder)	521	521
Kerosene (Rs/liter)	26.9	26.9
Gasoline (Rs/liter)	27.1	27.1
Diesel (Rs/liter)	27.2	27.2
<b>India retail price without taxes</b>		
LPG (Rs/ton)	17,997	20,462
Kerosene (Rs/KL)	7,967	10,822
Gasoline (Rs/KL)	23,155	26,072
Diesel (Rs/KL)	25,626	27,293
<b>India retail price without taxes</b>		
LPG (Rs/cylinder)	256	291
Kerosene (Rs/liter)	8.0	10.8
Gasoline (Rs/liter)	23.2	26.1
Diesel (Rs/liter)	25.6	27.3
<b>Marketing margin or subsidy</b>		
<b>LPG (Rs/cylinder)</b>	<b>(265.4)</b>	<b>(230.4)</b>
<b>Kerosene (Rs/liter)</b>	<b>(18.9)</b>	<b>(16.1)</b>
<b>Gasoline (Rs/liter)</b>	<b>(4.0)</b>	<b>(1.1)</b>
<b>Diesel (Rs/liter)</b>	<b>(1.6)</b>	<b>0.1</b>
<b>Annual consumption (mn tons)</b>		
LPG		13.5
Kerosene		9.1
Gasoline		14.1
Diesel		60.6
<b>Impact of price hike (Rs bn)</b>		
LPG		(33)
Kerosene		(32)
Gasoline		(56)
Diesel		(122)
<b>Annual impact of price hike (Rs bn)</b>		<b>(243)</b>

Note:

(a) International prices for June 2010.

(b) Selling prices include transport costs estimated at Rs1.2/l for diesel and Rs1.3/l for gasoline.

Source: Kotak Institutional Equities estimates

Under-recovery for FY2011-12E will be manageable at US\$75/bbl  
Subsidy loss breakdown, March fiscal year-ends, 2011-12E (Rs bn)

	FY2011E	FY2012E
<b>Crude oil price (US\$/bbl)</b>	<b>76</b>	<b>75</b>
LPG	223	227
Kerosene	186	173
Gasoline	35	—
Diesel	95	—
Auto fuels	130	—
Cooking fuels	409	400
<b>Total subsidy loss</b>	<b>539</b>	<b>400</b>

Note:

(a) We have assumed crude oil price of US\$75/bbl for the remainder of FY2011E.

Source: Kotak Institutional Equities estimates

Earnings and valuations of downstream and upstream companies would jump significantly in a blue-sky scenario  
EPS estimates and fair valuation, March fiscal year-end, 2011E (Rs)

	EPS (Rs)	P/E (X)	Value of investments (Rs)	Fair value (Rs)	Current stock price (Rs)	Upside (%)
<b>Downstream companies</b>						
BPCL	76	8	173	777	621	25
HPCL	67	8	74	613	402	52
IOCL	41	8	124	456	378	21
<b>Upstream companies</b>						
GAIL India	35	NA	NA	583	484	20
Oil India	176	10	27	1,792	1,360	32
ONGC (b)	166	10	55	1,778	1,263	41

Note:

(a) Assuming full deregulation of prices of petroleum products.

(b) Fair value of ONGC includes value of new discoveries.

Source: Kotak Institutional Equities estimates

### Lower under-recoveries likely with partial deregulation and higher domestic retail prices

Exhibit 4 gives our computation of under-recoveries at US\$75/bbl for FY2011E and Exhibit 5 shows our calculations for annualized under-recoveries at various levels of crude oil prices post the most recent price revisions. We compute annual under-recovery of Rs537 bn at US\$75/bbl (Dated Brent basis) post the most recent price changes versus Rs657 bn previously. For FY2011E, we assume (1) full deregulation of gasoline prices from August 1, 2010, (2) deregulation of diesel prices from October 1, 2010 and (3) no further increase in LPG and kerosene prices post the price hike on June 25, 2010.

**Under-recovery for FY2011E at Rs539 bn**

Subsidy loss breakdown, March fiscal year-end, 2011E (Rs bn)

	1-Apr-10 to 25-Jun-10	26-Jun-10 to 31-Mar-11	FY2011E
<b>Crude oil price (US\$/bbl)</b>	<b>80</b>	<b>75</b>	<b>76</b>
LPG	60	163	223
Kerosene	52	134	186
Gasoline	31	5	35
Diesel	68	27	95
Auto fuels	99	31	130
Cooking fuels	111	297	409
<b>Total subsidy loss</b>	<b>211</b>	<b>329</b>	<b>539</b>

Note:

(a) We have assumed crude oil price of US\$75/bbl for the remainder of FY2011E.

Source: Kotak Institutional Equities estimates

**Under-recovery will be manageable at US\$70-75/bbl**

Subsidy loss breakdown at various levels of crude oil price, March fiscal year-end, 2011E (Rs bn)

Crude oil price (US\$/bbl)	70	75	80	85
LPG	178	213	248	284
Kerosene	159	176	192	209
Gasoline	15	48	75	102
Diesel	(104)	100	204	306
Auto fuels	(89)	148	278	408
Cooking fuels	337	389	441	492
<b>Total subsidy loss</b>	<b>249</b>	<b>537</b>	<b>719</b>	<b>900</b>

Note:

(a) Assuming the revised product prices for full year FY2011E.

Source: Kotak Institutional Equities estimates

**Higher marketing margins post the recent price increase**

Exhibit 6 gives the marketing margins or under-recoveries on diesel, gasoline, kerosene and LPG. We highlight the recent changes to prices below and discuss the under-recoveries and likely government action on each of the four products. We use June 1-25, 2010 average crude oil price (US\$74.7/bbl, Dated Brent basis) and exchange rate (Rs46.2/US\$) for our computation of marketing margins or under-recoveries. Exhibit 7 compares the retail price on diesel, gasoline, kerosene and LPG with the corresponding previous retail prices in the four major metros.

**Marketing margins for the regulated products have improved post the price hike**

Marketing margins on regulated petroleum products

	Prior price hike	Post price hike	
Crude price (US\$/bbl)	74.7	74.7	75.0
Exchange rate (Rs/US\$)	46.6	46.6	45.0
LPG (Rs/cylinder)	(265.4)	(230.4)	(224.4)
Kerosene (Rs/liter)	(18.9)	(16.1)	(15.6)
Gasoline (Rs/liter)	(4.0)	(1.1)	(1.1)
Diesel (Rs/liter)	(1.6)	0.1	0.0

Note:

(a) We have assumed actual global prices for June 2010.

Source: Kotak Institutional Equities estimates

### Petroleum product retail prices in four metros post the price hike

Retail prices of regulated petroleum products (Rs/liter)

	Gasoline		Diesel		LPG (a)		Kerosene	
	Old price	New price	Old price	New price	Old price	New price	Old price	New price
Delhi	47.9	51.4	38.1	40.1	281.2	345.4	9.1	12.3
Kolkata	51.7	55.3	38.0	39.9	328.7	365.1	9.3	12.7
Mumbai	52.2	55.9	39.9	42.0	313.5	348.5	9.1	12.3
Chennai	52.1	55.9	38.1	40.1	316.0	352.4	8.4	11.4

Note:

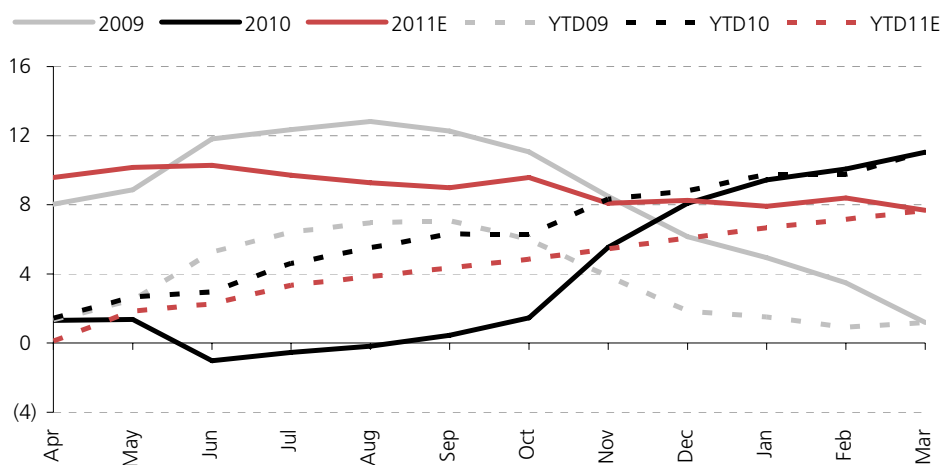
(a) LPG prices are in Rs/cylinder.

Source: Company, Kotak Institutional Equities

- Diesel.** The government has raised retail price of diesel by Rs2/liter. We compute marketing margin on diesel at Rs0.1/liter following the price increase. The government has stated that it will deregulate diesel prices at a later date. We assume current high inflation (WPI of 10.16% in May 2010) and diesel's use as the main transportation fuel in India may have prevented the government from deregulating prices immediately. However, the government may have more flexibility to deregulate prices later once inflation subsides in India in 2HFY11E (see Exhibit 8). We do not expect crude oil prices to increase dramatically from current levels noting comfortable supply-demand balance of crude oil. In our view, deregulation of diesel is critical given its large volumes (62% of consumption of diesel, gasoline, kerosene and LPG) and disproportionately larger impact on overall under-recoveries at higher crude oil prices.

### Inflation may average 9% in FY2011E and fall to 7.7% by end-year

Headline inflation rate, March fiscal year-ends, 2009-11E (%)



Source: Government of India, Kotak Institutional Equities estimates

- Gasoline.** The government has raised retail price of gasoline by Rs3.5/liter and also announced its intention to deregulate gasoline prices. We compute under-recovery on gasoline at Rs1.1/liter. The government will finalize the frequency of price revisions later. We expect fortnightly changes to retail prices.
- Kerosene.** The government has raised retail price of kerosene by Rs3/liter. However, the under-recovery is still quite high at Rs16.1/liter.

- ▶ **LPG.** The government has raised retail price of LPG by Rs35/cylinder, which results in under-recovery of Rs230/cylinder post the price increase.

**Likely positive impact on earnings; subsidy-sharing details still not clear but presumably similar to that in previous years**

Exhibit 9 gives the revisions to our FY2011E, FY2012E, FY2013E and FY2014E EPS of BPCL, HPCL, IOCL, GAIL, OIL and ONGC. We note that there is a fair bit of uncertainty still with respect to (1) the amount of under-recoveries, which is a function of global and domestic retail prices and (2) sharing of under-recoveries between various entities. However, we are in a better position to forecast earnings of the downstream companies given likely manageable under-recoveries. We highlight the major assumptions behind our earnings model and discuss the key changes versus our previous assumptions.

**Positive impact on earnings of downstream and upstream companies**

Revision in EPS estimates, March fiscal year-ends, 2011-14E (Rs)

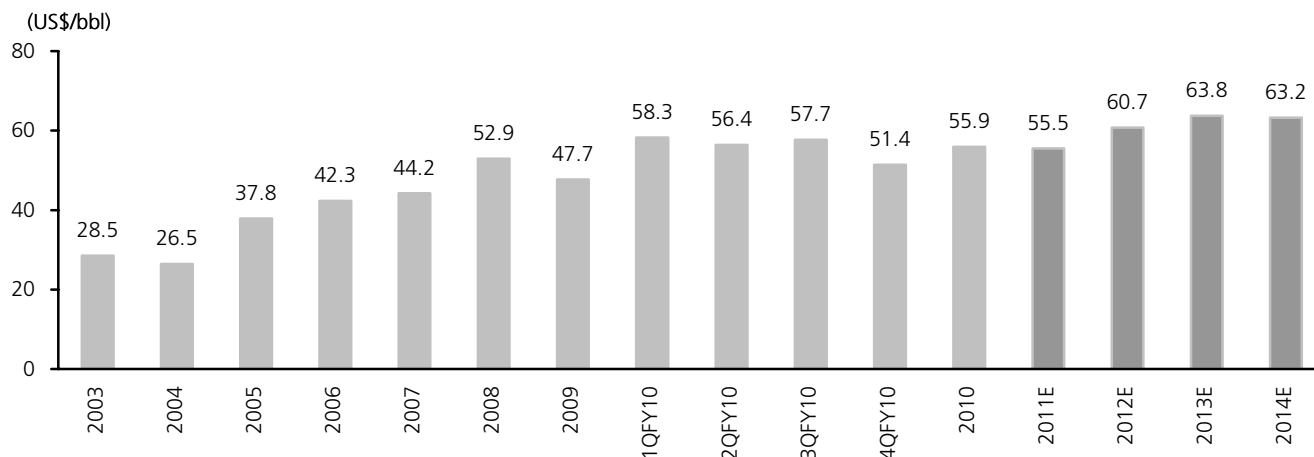
	2011E		2012E		2013E		2014E	
	Old EPS	New EPS	Old EPS	New EPS	Old EPS	New EPS	Old EPS	New EPS
<b>Downstream companies</b>								
BPCL	54	54	59	68	65	75	65	78
HPCL	45	45	56	62	57	66	55	65
IOCL	34	33	35	37	34	37	34	38
<b>Upstream companies</b>								
GAIL India	26	26	37	39	42	44	46	48
Oil India	127	131	141	152	147	163	148	164
ONGC	122	125	130	141	151	166	157	172

Source: Kotak Institutional Equities estimates

- ▶ **Pricing system and amount of under-recoveries.** We assume that the government will fully deregulate pricing of gasoline from August 1, 2010 and of diesel from October 1, 2010. In other words, we do not assume any under-recoveries on auto fuels in FY2012E and beyond. We compute FY2011E and FY2012E under-recoveries for the industry at Rs539 bn and Rs400 bn based on US\$75/bbl crude price assumption.
- ▶ **Sharing of under-recoveries between various entities.** We assume that (1) the upstream will bear one-third of the total under-recoveries, (2) the downstream oil companies will bear a fixed amount of ~Rs50 bn in FY2011E and ~Rs40 bn in FY2012-14E (compared to Rs56 bn in FY2010) and (3) the government will bear the balance. We expect more clarity to emerge on this aspect over the next few weeks but note that our assumptions are broadly in line with the arrangement of the previous years. In any case, the potential upside to earnings is fairly large and moderate changes to our earnings estimates will not change the investment thesis.
- ▶ **Crude oil price assumptions.** We model FY2011E, FY2012E, FY2013E and FY2014E crude price (Dated Brent basis) at US\$75/bbl, US\$75/bbl, US\$80/bbl and US\$80/bbl. For ONGC and OIL, we give the subsidy amount, net crude oil price realizations and other major assumptions in Exhibit 10 and Exhibit 11.

**ONGC's net realization has increased steadily over the past few years**

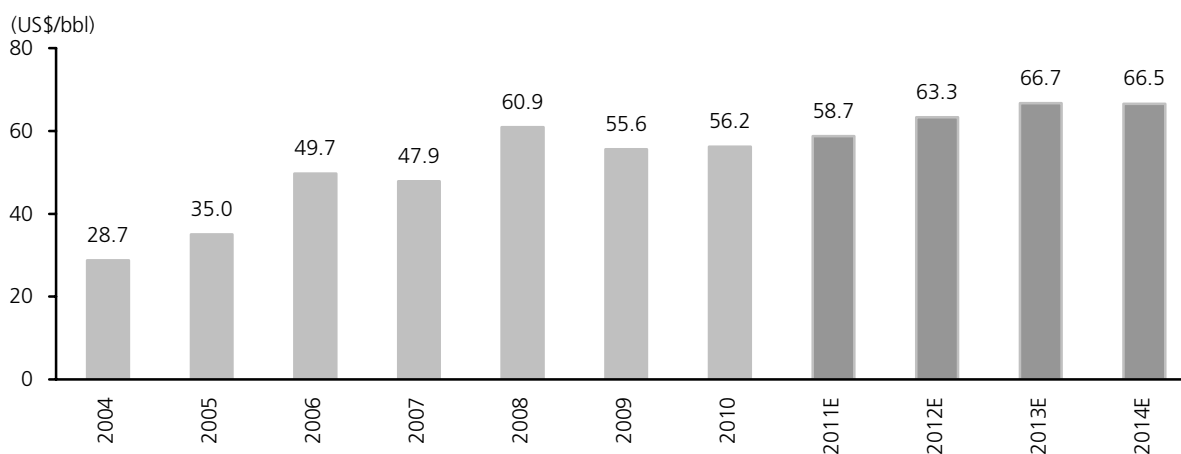
ONGC's net crude price realization, March fiscal year-ends, 2003-2014E (US\$/bbl)



Source: Company, Kotak Institutional Equities estimates

**OIL's net realization has improved over the past few years**

OIL's net crude price realization, March fiscal year-ends, 2004-2012E (US\$/bbl)



Source: Company, Kotak Institutional Equities estimates

- ▶ **Marketing margin assumptions.** Exhibit 12 gives our marketing margin assumptions for BPCL, HPCL and IOCL for diesel, gasoline, kerosene and LPG. As discussed earlier, we assume full deregulation of auto fuel prices by 2HFY11E and do not model any further increase in kerosene and LPG prices through our forecast period.

**Marketing margin assumptions for downstream companies**

Marketing margins for regulated products, 2011-14E (Rs/ton)

	2011E	2012E	2013E	2014E
LPG	(15,293)	(14,296)	(16,920)	(16,920)
Gasoline	(1,877)	1,900	1,900	1,900
Kerosene	(19,439)	(18,377)	(20,192)	(20,192)
Diesel	(690)	1,500	1,500	1,500

Source: Kotak Institutional Equities estimates



- Refining margin assumptions. Exhibits 13-15 give our major assumptions for the refining segment of BPCL, HPCL and IOCL. We assume a gradual improvement in refining margins in FY2011-14E.

BPCL earnings model assumptions, March fiscal year-ends, 2006-15E

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Rs/US\$	44.3	45.3	40.3	45.8	47.4	45.0	45.3	45.3	45.3	45.3
Weighted average duty on products (%)	8.0	6.7	6.6	3.3	2.7	6.2	6.2	6.2	6.2	6.2
Import tariff on crude (%)	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2	5.2
Import 'tariff' on domestic crude (%)	2.6	2.6	2.6	0.5	0.2	2.6	2.6	2.6	2.6	2.6
<b>Effective duty protection (%)</b>	<b>2.9</b>	<b>1.6</b>	<b>1.4</b>	<b>2.4</b>	<b>2.3</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>
Refinery yield (US\$/bbl)	61.1	71.5	89.6	97.5	73.4	85.3	86.2	91.9	91.9	91.9
Cost of crude (US\$/bbl)										
-Imported	55.5	64.0	78.8	90.0	69.8	77.8	77.8	82.8	82.8	82.8
-Domestic	58.9	68.7	84.1	94.9	70.7	78.7	78.7	83.7	83.7	83.7
Landed cost of crude (US\$/bbl)	59.1	68.3	84.0	92.4	70.3	81.5	81.5	86.7	86.7	86.7
<b>Net refining margin (US\$/bbl)</b>	<b>2.1</b>	<b>3.2</b>	<b>5.6</b>	<b>5.2</b>	<b>3.0</b>	<b>3.8</b>	<b>4.7</b>	<b>5.2</b>	<b>5.2</b>	<b>5.2</b>
<b>Crude throughput (mn tons)</b>	<b>17.2</b>	<b>19.8</b>	<b>20.9</b>	<b>20.0</b>	<b>20.4</b>	<b>22.3</b>	<b>22.3</b>	<b>22.3</b>	<b>22.3</b>	<b>22.3</b>
-Imported	11.3	13.5	13.9	13.1	13.7	15.5	15.5	15.5	15.5	15.5
-Domestic	5.9	6.3	7.0	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Production of main products	15.6	17.9	19.0	18.1	18.5	20.2	20.2	20.2	20.2	20.2
Production of other products	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Fuel and loss	1.2	1.3	1.4	1.3	1.3	1.5	1.5	1.5	1.5	1.5
Fuel and loss (%)	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
<b>Sales volume (mn tons)</b>	<b>23.3</b>	<b>24.5</b>	<b>26.7</b>	<b>28.1</b>	<b>29.3</b>	<b>31.1</b>	<b>32.9</b>	<b>34.9</b>	<b>37.0</b>	<b>39.4</b>
<b>Marketing margins (Rs/ton)</b>	<b>(671)</b>	<b>(1,140)</b>	<b>(3,010)</b>	<b>(5,944)</b>	<b>571</b>	<b>229</b>	<b>1,536</b>	<b>1,514</b>	<b>1,511</b>	<b>1,517</b>

Source: Company, Kotak Institutional Equities estimates

HPCL earnings model assumptions, March fiscal year-ends, 2006-15E

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Rs/US\$	44.3	45.3	40.3	45.8	47.4	45.0	45.3	45.3	45.3	45.3
Weighted average duty on products (%)	8.2	6.6	6.5	3.3	2.7	6.1	6.0	6.0	6.0	6.0
Import duty on crude	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2	5.2
Import 'tariff' on domestic crude (%)	2.6	2.6	2.6	0.5	0.2	2.6	2.6	2.6	2.6	2.6
<b>Effective duty protection (%)</b>	<b>3.1</b>	<b>1.4</b>	<b>1.3</b>	<b>2.4</b>	<b>2.3</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>
Refinery yield (US\$/bbl)	63.3	73.1	89.8	96.0	73.3	85.3	86.3	92.1	92.1	92.0
Cost of crude (US\$/bbl)										
-Imported	56.7	64.8	78.1	89.9	70.1	78.1	78.1	83.1	83.1	83.1
-Domestic	57.5	69.3	84.5	95.2	71.0	79.0	79.0	84.0	84.0	84.0
Landed cost of crude	59.4	68.8	83.2	92.0	70.6	81.8	81.9	87.1	87.1	87.1
<b>Net refining margin (US\$/bbl)</b>	<b>3.9</b>	<b>4.3</b>	<b>6.6</b>	<b>4.0</b>	<b>2.7</b>	<b>3.5</b>	<b>4.4</b>	<b>5.0</b>	<b>5.0</b>	<b>5.0</b>
<b>Crude throughput (mn tons)</b>	<b>14.0</b>	<b>16.7</b>	<b>16.8</b>	<b>15.8</b>	<b>15.8</b>	<b>17.0</b>	<b>18.5</b>	<b>19.3</b>	<b>19.3</b>	<b>19.3</b>
-Imported	10.6	12.9	12.6	11.7	11.3	12.4	13.8	14.7	14.7	14.7
-Domestic	3.4	3.8	4.2	4.2	4.5	4.7	4.7	4.7	4.7	4.7
Production of main products	12.7	15.2	15.2	14.4	14.4	15.5	16.9	17.7	17.7	17.7
Production of other products	0.4	0.4	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Fuel and loss	0.9	1.0	1.0	1.0	1.0	1.0	1.1	1.2	1.2	1.2
Fuel and loss (%)	6.3	6.0	6.0	6.1	6.1	6.1	6.1	6.1	6.1	6.1
<b>Sales volume (mn tons)</b>	<b>20.1</b>	<b>23.4</b>	<b>26.2</b>	<b>27.0</b>	<b>27.5</b>	<b>28.8</b>	<b>30.3</b>	<b>32.1</b>	<b>33.9</b>	<b>36.0</b>
<b>Marketing margins (Rs/ton)</b>	<b>(463)</b>	<b>(710)</b>	<b>(2,345)</b>	<b>(5,021)</b>	<b>620</b>	<b>306</b>	<b>1,525</b>	<b>1,492</b>	<b>1,487</b>	<b>1,494</b>

Source: Company, Kotak Institutional Equities estimates

## IOC model assumptions, March fiscal year-ends, 2006-14E

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Rs/US\$	44.3	45.3	40.3	45.8	47.4	45.0	45.3	45.3	45.3
Weighted average duty on products (%)	8.2	6.7	6.5	3.7	2.6	5.9	5.9	5.9	5.9
Import duty on crude (%)	5.1	5.1	5.2	0.9	0.4	5.2	5.2	5.2	5.2
Effective 'import duty' on domestic crude (%)	2.6	2.6	2.6	0.5	0.2	2.6	2.6	2.6	2.6
<b>Effective duty protection (%)</b>	<b>3.1</b>	<b>1.6</b>	<b>1.3</b>	<b>2.8</b>	<b>2.2</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>
Refinery yield (US\$/bbl)	62.9	71.1	91.0	94.8	73.7	81.0	81.9	87.7	87.7
Cost of crude (US\$/bbl)									
Domestic - Northeast	52.9	61.8	74.8	87.3	67.6	71.6	71.6	76.6	76.6
- Gujarat	50.9	58.4	73.8	84.1	64.4	68.4	68.4	73.4	73.4
- Rest of India	58.5	67.2	82.2	92.9	69.2	73.2	73.2	78.2	78.2
Imported	56.7	65.2	80.3	91.3	69.7	73.7	73.7	78.7	78.7
Landed cost of crude (US\$/bbl)	58.0	66.9	82.8	91.1	69.2	76.0	76.0	81.2	81.2
<b>Net refining margin (US\$/bbl)</b>	<b>4.8</b>	<b>4.2</b>	<b>8.2</b>	<b>3.6</b>	<b>4.5</b>	<b>4.9</b>	<b>5.9</b>	<b>6.4</b>	<b>6.4</b>
<b>Crude throughput (mn tons)</b>	<b>38.5</b>	<b>44.0</b>	<b>47.4</b>	<b>51.3</b>	<b>50.7</b>	<b>51.8</b>	<b>51.8</b>	<b>51.8</b>	<b>51.8</b>
Domestic - Northeast	1.5	1.5	1.5	2.1	2.1	2.1	2.1	2.1	2.1
- Gujarat	5.9	5.9	5.9	6.0	5.8	5.8	5.8	5.8	5.8
- Rest of India	2.7	2.7	2.7	4.9	4.8	4.8	4.8	4.8	4.8
Imported	28.4	33.9	37.3	38.3	38.0	39.2	39.2	39.2	39.2
Other products	0.8	1.1	1.1	1.4	1.4	1.4	1.4	1.4	1.4
Fuel and loss	3.1	3.9	4.2	4.5	4.5	4.6	4.6	4.6	4.6
Production of main products	34.6	38.9	42.1	45.4	44.8	45.9	45.9	45.9	45.9
Fuel and loss (%)	8.1	8.9	8.8	8.8	8.8	8.8	8.8	8.8	8.8
<b>Sales volume (mn tons)</b>	<b>50.4</b>	<b>53.4</b>	<b>57.4</b>	<b>61.0</b>	<b>63.6</b>	<b>67.2</b>	<b>71.0</b>	<b>75.1</b>	<b>79.5</b>
<b>Marketing margin (Rs/ton)</b>	<b>26</b>	<b>(633)</b>	<b>(2,203)</b>	<b>(5,253)</b>	<b>850</b>	<b>357</b>	<b>1,509</b>	<b>1,471</b>	<b>1,463</b>

Source: Company, Kotak Institutional Equities estimates

- **Exchange rate assumptions.** We assume rupee-US dollar exchange rate at Rs45/US\$, Rs45.25/US\$, Rs45.25/US\$ and Rs45.25/US\$ for FY2011E, FY2012E, FY2013E and FY2014E.

### 12-month fair valuation still offers large potential upside

Exhibit 16 gives our revised 12-month fair valuation of the six government-owned energy companies and compares the same with our previous 12-month target prices. Exhibit 17 gives our valuation table for the energy companies under our coverage. We discuss the rationale for our valuation methodology and multiples below.

#### Revised fair valuation of the upstream and downstream companies

	EPS (a) (Rs)	P/E (X)	Value of investments (Rs)	New target price (Rs)	Old target price (Rs)	Change (%)
BPCL	61	8	173	660	NA	NA
GAIL India	32	NA	73	495	485	2
HPCL	53	8	74	500	NA	NA
IOCL	36	8	124	410	NA	NA
Oil India	141	10	27	1,440	1,350	7
ONGC (b)	133	10	55	1,450	1,350	7

Note:

(a) Average EPS for FY2011-12E.

(b) Fair value of ONGC includes value of new discoveries.

Source: Kotak Institutional Equities estimates

## Indian energy companies valuation analysis, March fiscal year-ends, 2009-2013E

	Price (Rs)	Target price	P/E (X)					P/CEPS (X)				
	25-Jun-10	(Rs)	2009	2010	2011E	2012E	2013E	2009	2010	2011E	2012E	2013E
BPCL	621	660	30.5	10.0	11.4	9.2	8.3	11.4	42.1	10.5	8.2	6.9
GAIL (India)	484	495	21.9	19.6	18.5	12.5	11.0	20.2	18.5	18.2	11.1	9.3
HPCL	402	500	23.7	7.3	8.9	6.5	6.1	(11.2)	8.8	7.6	5.8	4.5
IOCL	378	410	32.9	7.8	11.1	10.1	9.9	(2.7)	9.7	9.8	8.4	8.0
Oil India	1,360	1,440	13.5	11.8	10.4	8.9	8.3	12.0	13.3	11.7	9.6	8.8
ONGC	1,263	1,450	13.7	13.8	10.1	9.0	7.6	10.0	10.5	8.3	7.1	6.5

	KS	Market cap.	EV/EBITDA (X)					EV/DACF (X)				
	rating	(US\$ mn)	2009	2010E	2011E	2012E	2013E	2009	2010E	2011E	2012E	2013E
BPCL	ADD	4,828	9.1	8.2	7.2	5.5	4.8	12.0	11.3	9.4	7.6	6.6
GAIL (India)	ADD	13,214	14.1	11.9	12.5	9.4	7.9	18.5	16.8	18.0	11.9	9.9
HPCL	ADD	2,934	16.4	6.6	8.1	6.8	6.2	11.2	7.3	8.6	7.4	6.3
IOCL	ADD	19,744	17.5	6.6	7.9	6.6	6.1	22.8	9.1	10.1	8.6	8.1
Oil India	BUY	7,034	9.2	6.0	4.8	3.8	3.2	16.0	8.6	7.2	5.6	4.8
ONGC	BUY	58,141	6.1	5.4	4.5	3.7	2.9	8.3	6.7	5.7	4.7	3.8

Source: Company, Kotak Institutional Equities estimates

- **Upstream oil companies.** We use 10X average FY2011E and FY2012E EPS and add the value of investments to arrive at the fair valuation of OIL and ONGC. We argue for 10X P/E multiple based on 12.5% cost of equity and 2-3% long-term growth in volumes/crude oil prices. We use SOTP-methodology to value GAIL (see Exhibit 18 and 19).

## We value GAIL stock at Rs468 per share

Sum-of-the-parts valuation of GAIL, FY2011E basis (Rs bn)

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		EV (Rs/share)
	Other	EBITDA	Other	EV/EBITDA	Other	EBITDA basis	
<b>Natural gas transportation</b>							
HVJ pipeline		47			47		37
DV pipeline		38			38		30
DUPD pipeline		34			34		27
DBN pipeline		19			19		15
CGJH pipeline		8			8		6
DV GREP pipeline		106			106		83
DB pipeline		13			13		10
KBM pipeline		9			9		7
Short distance pipelines			5.3			37	29
<b>Total natural gas transportation</b>							<b>245</b>
<b>Other businesses</b>							
LPG transportation			2.9		7.0	20	16
LPG production			10.2		7.5	77	60
Petrochemicals			8.2		6.5	54	42
Oil and gas upstream	20			1.0		20	16
<b>Total other business segments</b>							<b>135</b>
<b>Investments</b>							
ONGC shares		69		0.9		62	49
Others		30		0.9		27	21
<b>Investments</b>		<b>99</b>		<b>0.9</b>		<b>89</b>	<b>70</b>
<b>Total</b>						<b>188</b>	<b>450</b>
Net debt/(cash)						(23)	(18)
<b>Implied value of share (Rs/share)</b>							<b>468</b>

Source: Kotak Institutional Equities estimates

## We value GAIL stock at Rs524 per share

Sum-of-the-parts valuation of GAIL, FY2012E basis (Rs bn)

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		EV (Rs/share)
	Other	EBITDA	Other	EV/EBITDA	Other	EBITDA basis	
<b>Natural gas transportation</b>							
HVJ pipeline	48				48		38
DV pipeline	46				46		36
DUPD pipeline	34				34		27
DBN pipeline	25				25		20
CGJH pipeline	15				15		12
DV GREP pipeline	158				158		125
DB pipeline	17				17		14
KBM pipeline	13				13		10
Short distance pipelines		6.2		7.0		43	34
<b>Total natural gas transportation</b>							<b>315</b>
<b>Other businesses</b>							
LPG transportation		2.7		7.0		19	15
LPG production		13.8		7.5		103	81
Petrochemicals		8.6		6.5		56	44
Oil and gas upstream	20		1.0		20		16
<b>Total other business segments</b>							<b>157</b>
<b>Investments</b>							
ONGC shares	77		0.9		69		55
Others	30		0.9		27		21
<b>Investments</b>	<b>107</b>		<b>0.9</b>		<b>96</b>		<b>76</b>
<b>Total</b>						<b>222</b>	<b>548</b>
Net debt/(cash)					31	31	24
<b>Implied value of share (Rs/share)</b>							<b>524</b>

Source: Kotak Institutional Equities estimates

- ▶ **Downstream oil companies.** We use 8X average FY2011E and FY2012E EPS and add the value of investments to arrive at the fair valuation of BPCL, HPCL and IOCL. We use 8X P/E multiple noting (1) low growth and FCF generation in the refining business; a refinery requires periodic capex to meet newer environmental standards and has to invest in fresh refining capacity for volume growth and (2) likely limited growth in profits of the marketing segment (1) post restart of operations by private players in auto fuel retailing after deregulation of auto fuel prices and (2) displacement of certain industrial fuels by natural gas. We note that private players had captured 14% market share in diesel retailing in April 2006 when private players could compete on equal terms with their public sector counterparts.

Exhibits 20-25 give the financial summary statements of BPCL, HPCL, IOCL, GAIL, OIL and ONGC.

## Consolidated profit model, balance sheet, cash model of BPCL, March fiscal year-ends, 2006-2014E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>								
Net sales	965,569	1,102,081	1,340,734	1,223,599	1,331,561	1,414,562	1,572,277	1,649,107
<b>EBITDA</b>	<b>35,362</b>	<b>28,472</b>	<b>27,507</b>	<b>35,495</b>	<b>37,887</b>	<b>47,684</b>	<b>51,515</b>	<b>52,631</b>
Other income	7,332	13,954	15,087	21,563	14,997	12,548	10,789	9,032
Interest	(4,774)	(6,725)	(21,664)	(10,109)	(9,466)	(9,097)	(6,584)	(3,954)
Depreciation	(9,041)	(10,982)	(10,755)	(12,423)	(13,999)	(14,521)	(15,047)	(15,503)
Pretax profits	28,879	24,719	10,176	34,526	29,419	36,614	40,673	42,206
Extraordinary items	(68)	—	—	(10,865)	—	—	—	—
Tax	(9,286)	(9,059)	(5,103)	(8,284)	(6,982)	(11,317)	(12,299)	(13,124)
Deferred taxation	(268)	(1,108)	2,421	—	(2,790)	(845)	(1,212)	(895)
<b>Adjusted net profits</b>	<b>18,101</b>	<b>15,806</b>	<b>7,359</b>	<b>22,437</b>	<b>19,647</b>	<b>24,452</b>	<b>27,162</b>	<b>28,186</b>
<b>Earnings per share (Rs)</b>	<b>50.1</b>	<b>43.7</b>	<b>20.4</b>	<b>62.1</b>	<b>54.3</b>	<b>67.6</b>	<b>75.1</b>	<b>78.0</b>
<b>Balance sheet (Rs mn)</b>								
Total equity	102,735	116,768	121,281	130,736	142,841	157,907	174,643	192,010
Deferred taxation liability	13,826	14,814	12,392	12,392	15,183	16,028	17,240	18,135
Total borrowings	108,292	150,224	211,714	214,686	153,186	116,686	77,686	37,994
Current liabilities	112,767	145,803	128,313	122,514	144,598	147,699	155,835	158,882
<b>Total liabilities and equity</b>	<b>337,620</b>	<b>427,608</b>	<b>473,701</b>	<b>480,327</b>	<b>455,807</b>	<b>438,320</b>	<b>425,403</b>	<b>407,020</b>
Cash	8,640	9,616	4,416	2,459	2,459	2,487	2,205	2,272
Current assets	127,698	187,457	148,469	164,813	178,886	183,726	195,130	199,811
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	118,334	127,354	140,033	166,935	173,341	175,986	176,948	178,816
Investments	82,949	103,182	180,784	146,121	101,121	76,121	51,121	26,121
<b>Total assets</b>	<b>337,621</b>	<b>427,608</b>	<b>473,701</b>	<b>480,328</b>	<b>455,807</b>	<b>438,320</b>	<b>425,403</b>	<b>407,020</b>
<b>Free cash flow (Rs mn)</b>								
Operating cash flow, excl. working capital	29,920	22,988	19,717	5,325	21,439	27,270	32,631	35,553
Working capital	11,451	(25,161)	20,585	(17,221)	7,946	(1,739)	(3,268)	(1,635)
Capital expenditure	(17,908)	(20,665)	(23,323)	(38,414)	(20,405)	(17,166)	(16,008)	(17,371)
Investments	(45,481)	(21,684)	(82,456)	34,663	45,000	25,000	25,000	25,000
Other income	4,337	6,434	6,655	16,640	15,063	12,548	10,789	9,032
<b>Free cash flow</b>	<b>(17,682)</b>	<b>(38,088)</b>	<b>(58,822)</b>	<b>993</b>	<b>69,042</b>	<b>45,914</b>	<b>49,144</b>	<b>50,579</b>
<b>Ratios (%)</b>								
Debt/equity	105.4	128.7	174.6	164.2	107.2	73.9	44.5	19.8
Net debt/equity	97.0	120.4	170.9	162.3	105.5	72.3	43.2	18.6
RoAE	16.3	12.7	5.5	11.1	13.0	14.7	14.9	14.0
<b>RoACE</b>	<b>11.0</b>	<b>7.9</b>	<b>5.1</b>	<b>8.2</b>	<b>8.9</b>	<b>10.5</b>	<b>11.8</b>	<b>12.3</b>
<b>Key assumptions (standalone until FY2005)</b>								
Crude throughput (mn tons)	19.8	20.9	20.0	20.4	22.3	22.3	22.3	22.3
Effective tariff protection (%)	1.6	1.4	2.4	2.3	1.1	1.1	1.1	1.1
Net refining margin (US\$/bbl)	3.2	5.6	5.2	3.0	3.8	4.7	5.2	5.2
Sales volume (mn tons)	24.5	26.7	28.1	29.3	31.1	32.9	34.9	37.0
Marketing margin (Rs/ton)	(1,140)	(3,010)	(5,944)	571	229	1,536	1,514	1,511
Subsidy under-recoveries (Rs mn)	(10,400)	(33,354)	2,728	(12,375)	(11,474)	(8,951)	(9,187)	(8,977)

Source: Company, Kotak Institutional Equities estimates

## Profit model, balance sheet, cash model of HPCL, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>									
Net sales	708,609	889,959	1,043,130	1,249,348	1,084,977	1,201,760	1,282,260	1,428,604	1,496,265
<b>EBITDA</b>	<b>8,056</b>	<b>24,036</b>	<b>15,757</b>	<b>28,707</b>	<b>41,603</b>	<b>35,227</b>	<b>46,867</b>	<b>52,505</b>	<b>54,373</b>
Other income	3,285	6,845	11,980	9,057	7,859	7,347	8,343	8,348	7,473
Interest	(1,587)	(4,230)	(7,925)	(20,828)	(9,038)	(9,112)	(12,607)	(13,183)	(13,412)
Depreciation	(6,902)	(7,040)	(8,508)	(9,813)	(11,644)	(10,593)	(11,117)	(13,448)	(15,321)
Pretax profits	2,851	19,611	11,303	7,122	28,781	22,869	31,486	34,223	33,112
Extraordinary items	2,201	3,030	—	—	(7,530)	—	—	—	—
Tax	(898)	(6,625)	(1,799)	(2,416)	(5,615)	(4,558)	(8,930)	(6,821)	(8,500)
Deferred taxation	(97)	(365)	(2,025)	(343)	(2,046)	(3,069)	(1,528)	(5,000)	(2,499)
Prior period adjustment	—	61	3,870	1,387	(575)	—	—	—	—
<b>Adjusted net profits</b>	<b>2,247</b>	<b>13,568</b>	<b>11,349</b>	<b>5,750</b>	<b>18,555</b>	<b>15,242</b>	<b>21,027</b>	<b>22,402</b>	<b>22,113</b>
<b>Earnings per share (Rs)</b>	<b>6.6</b>	<b>40.0</b>	<b>33.5</b>	<b>17.0</b>	<b>54.7</b>	<b>45.0</b>	<b>62.0</b>	<b>66.1</b>	<b>65.2</b>
<b>Balance sheet (Rs mn)</b>									
Total equity	87,357	95,987	105,633	107,306	115,561	125,247	138,610	152,846	166,899
Deferred tax liability	13,844	14,209	15,960	16,034	18,080	21,149	22,677	27,677	30,175
Total borrowings	66,638	105,175	167,867	227,552	202,052	204,173	209,673	228,173	188,173
Current liabilities	79,549	101,195	124,337	117,558	96,165	111,171	117,809	126,132	128,300
<b>Total liabilities and equity</b>	<b>247,389</b>	<b>316,566</b>	<b>413,797</b>	<b>468,450</b>	<b>431,857</b>	<b>461,740</b>	<b>488,768</b>	<b>534,827</b>	<b>513,548</b>
Cash	426	868	2,940	6,083	1,601	1,620	1,477	1,796	1,476
Current assets	109,674	113,779	190,034	153,844	160,958	180,585	190,411	207,145	212,818
Total fixed assets	97,013	130,644	152,452	166,558	179,317	189,554	206,900	235,906	234,272
Investments	40,276	71,275	68,371	141,965	89,981	89,981	89,981	89,981	64,981
<b>Total assets</b>	<b>247,389</b>	<b>316,566</b>	<b>413,796</b>	<b>468,450</b>	<b>431,857</b>	<b>461,740</b>	<b>488,769</b>	<b>534,828</b>	<b>513,548</b>
<b>Free cash flow (Rs mn)</b>									
Operating cash flow, excl. working capital	10,126	23,966	(18,679)	(12,139)	15,579	17,885	23,482	30,416	31,317
Working capital changes	(5,351)	8,936	(6,504)	48,461	(25,373)	(4,663)	(3,467)	(8,411)	(3,505)
Capital expenditure	(25,298)	(38,510)	(31,638)	(19,275)	(21,137)	(17,157)	(26,615)	(40,369)	(12,544)
Investments	(22,884)	(31,704)	(1,851)	(70,386)	51,984	—	—	—	25,000
Other income	941	2,067	4,692	3,187	4,724	7,388	8,623	8,348	7,473
<b>Free cash flow</b>	<b>(42,466)</b>	<b>(35,246)</b>	<b>(53,980)</b>	<b>(50,151)</b>	<b>25,777</b>	<b>3,453</b>	<b>2,022</b>	<b>(10,016)</b>	<b>47,741</b>
<b>Ratios (%)</b>									
Debt/equity	65.8	95.4	138.1	184.5	151.2	139.5	130.0	126.4	95.5
Net debt/equity	65.4	94.7	135.6	179.6	150.0	138.4	129.1	125.4	94.7
RoAE	4.1	14.9	9.8	4.7	10.1	10.9	13.7	13.1	11.7
<b>RoACE</b>	<b>2.5</b>	<b>8.8</b>	<b>6.4</b>	<b>5.8</b>	<b>8.1</b>	<b>7.5</b>	<b>8.8</b>	<b>9.7</b>	<b>8.7</b>
<b>Key assumptions</b>									
Crude throughput (mn tons)	14.0	16.7	16.8	15.8	15.8	17.0	18.5	19.3	19.3
Effective tariff protection (%)	3.1	1.4	1.3	2.4	2.3	0.9	0.9	0.9	0.9
Net refining margin (US\$/bbl)	3.9	4.3	6.6	4.0	2.7	3.5	4.4	5.0	5.0
Sales volume (mn tons)	20.1	23.4	26.2	27.0	27.5	28.8	30.3	32.1	33.9
Marketing margin (Rs/ton)	(463)	(710)	(2,345)	(5,021)	620	306	1,525	1,492	1,487
Subsidy under-recoveries (Rs mn)	(23,372)	(7,685)	(31,191)	5,587	(12,297)	(11,342)	(9,234)	(9,450)	(9,219)

Source: Company, Kotak Institutional Equities estimates

## Consolidated profit model, balance sheet, cash model of IOCL, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>									
Net sales	1,729,474	2,149,428	2,444,378	3,041,265	2,691,360	3,273,638	3,513,919	3,950,311	4,177,345
<b>EBITDA</b>	<b>82,044</b>	<b>110,451</b>	<b>120,872</b>	<b>61,445</b>	<b>178,821</b>	<b>151,844</b>	<b>175,479</b>	<b>182,789</b>	<b>185,216</b>
Other income	21,310	27,451	43,748	45,155	37,890	31,809	31,679	33,046	32,093
Interest	(12,101)	(17,058)	(17,556)	(41,758)	(16,638)	(9,976)	(18,620)	(19,570)	(16,095)
Depreciation	(24,711)	(28,686)	(29,918)	(31,389)	(34,943)	(47,929)	(49,470)	(52,786)	(53,696)
Pretax profits	66,542	92,157	117,145	33,453	165,130	125,749	139,068	143,479	147,518
Extraordinary items	5,590	24,757	5,374	—	(17,232)	—	—	—	—
Tax	(19,975)	(25,834)	(38,293)	(13,316)	(46,713)	(31,493)	(39,774)	(44,455)	(48,016)
Deferred taxation	(1,282)	(8,040)	(473)	1,435	5,556	(10,278)	(6,421)	(3,205)	(985)
Net profits	51,125	82,729	83,430	25,523	108,238	83,978	92,873	95,819	98,516
<b>Net profits after minority interests</b>	<b>45,362</b>	<b>62,469</b>	<b>74,573</b>	<b>27,437</b>	<b>117,688</b>	<b>82,567</b>	<b>90,855</b>	<b>93,061</b>	<b>95,586</b>
<b>Earnings per share (Rs)</b>	<b>19.4</b>	<b>26.2</b>	<b>31.3</b>	<b>11.5</b>	<b>48.5</b>	<b>34.0</b>	<b>37.4</b>	<b>38.3</b>	<b>39.4</b>
<b>Balance sheet (Rs mn)</b>									
Total equity	317,977	378,117	450,449	470,654	547,803	588,835	648,323	709,719	772,846
Deferred tax liability	50,602	59,859	60,331	58,876	54,072	63,598	70,019	73,224	74,210
Total borrowings	292,395	290,215	382,818	465,250	497,523	502,859	427,813	368,168	288,273
Current liabilities	286,716	330,791	386,724	376,107	472,991	503,799	518,662	546,294	556,187
<b>Total liabilities and equity</b>	<b>947,691</b>	<b>1,058,981</b>	<b>1,280,322</b>	<b>1,370,888</b>	<b>1,572,389</b>	<b>1,659,091</b>	<b>1,664,817</b>	<b>1,697,405</b>	<b>1,691,517</b>
Cash	8,080	9,385	8,413	8,076	13,501	10,176	10,212	10,288	9,454
Current assets	413,904	437,178	599,256	473,965	648,895	739,624	764,794	825,787	849,029
Total fixed assets	383,717	415,014	460,307	565,545	690,165	705,381	710,901	682,420	654,125
Investments	141,990	197,403	212,345	323,301	219,828	203,910	178,910	178,910	178,910
<b>Total assets</b>	<b>947,691</b>	<b>1,058,981</b>	<b>1,280,322</b>	<b>1,370,888</b>	<b>1,572,389</b>	<b>1,659,091</b>	<b>1,664,817</b>	<b>1,697,405</b>	<b>1,691,517</b>
<b>Free cash flow (Rs mn)</b>									
Operating cash flow, excl. working capital	(10,334)	(44,660)	(107,263)	(345,677)	95,357	97,307	112,864	122,426	104,055
Working capital changes	(8,136)	2,237	(1,414)	76,881	(36,589)	(68,428)	(6,210)	(46,854)	7,919
Capital expenditure	(49,042)	(50,969)	(79,586)	(135,923)	(126,405)	(55,429)	(51,507)	(24,262)	(26,853)
Investments	(17,778)	99,768	92,665	299,410	98,991	14,188	25,015	14	849
Other Income	10,317	13,582	18,253	16,413	7,950	31,166	30,649	31,871	30,875
<b>Free cash flow</b>	<b>(74,973)</b>	<b>19,958</b>	<b>(77,346)</b>	<b>(88,896)</b>	<b>39,303</b>	<b>18,805</b>	<b>110,811</b>	<b>83,195</b>	<b>116,845</b>
<b>Ratios (%)</b>									
Debt/equity	79.3	66.3	74.9	87.9	82.7	77.1	59.6	47.0	34.0
Net debt/equity	77.1	64.1	73.3	86.3	80.4	75.5	58.1	45.7	32.9
RoAE	13.7	16.1	16.3	5.5	21.5	13.6	13.6	12.7	12.0
<b>RoACE</b>	<b>9.3</b>	<b>11.3</b>	<b>11.2</b>	<b>4.8</b>	<b>12.4</b>	<b>9.0</b>	<b>9.8</b>	<b>9.8</b>	<b>9.7</b>
<b>Key assumptions (IOC standalone)</b>									
Crude throughput (mn tons)	38.5	44.0	47.4	51.3	50.7	51.8	51.8	51.8	51.8
Effective tariff protection (%)	3.1	1.6	1.3	2.8	2.2	0.8	0.8	0.8	0.8
Net refining margin (US\$/bbl)	4.8	4.2	8.2	3.6	4.5	4.9	5.9	6.4	6.4
Sales volume (mn tons)	50.4	53.4	57.4	61.0	63.6	67.2	71.0	75.1	79.5
Marketing margin (Rs/ton)	26	(633)	(2,203)	(5,253)	850	357	1,509	1,471	1,463
Subsidy under-recoveries (Rs mn)	(47,740)	(21,900)	(97,738)	—	(31,588)	(27,056)	(21,917)	(21,997)	(21,221)

Source: Company, Kotak Institutional Equities estimates

## Profit model, balance sheet, cash model of GAIL, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>									
Net sales	163,513	160,472	180,082	237,760	250,404	421,536	606,813	745,270	788,122
<b>EBITDA</b>	<b>35,981</b>	<b>30,649</b>	<b>39,275</b>	<b>40,647</b>	<b>47,761</b>	<b>49,660</b>	<b>75,121</b>	<b>89,655</b>	<b>95,066</b>
Other income	4,555	5,450	5,564	7,966	4,343	5,369	4,975	5,327	5,573
Interest	(1,174)	(1,071)	(796)	(870)	(700)	(1,150)	(5,049)	(7,213)	(5,866)
Depreciation	(5,595)	(5,754)	(5,710)	(5,599)	(5,618)	(6,607)	(9,628)	(12,866)	(14,864)
<b>Pretax profits</b>	<b>33,767</b>	<b>29,274</b>	<b>38,333</b>	<b>42,144</b>	<b>45,785</b>	<b>47,272</b>	<b>65,419</b>	<b>74,904</b>	<b>79,908</b>
Tax	(9,221)	(7,941)	(12,525)	(13,941)	(13,750)	(13,148)	(11,799)	(11,920)	(13,065)
Deferred taxation	(445)	(190)	(10)	(62)	(636)	(900)	(4,445)	(7,294)	(6,340)
<b>Net profits</b>	<b>23,350</b>	<b>24,619</b>	<b>26,015</b>	<b>28,037</b>	<b>31,399</b>	<b>33,225</b>	<b>49,175</b>	<b>55,690</b>	<b>60,504</b>
<b>Earnings per share (Rs)</b>	<b>18.4</b>	<b>19.4</b>	<b>20.5</b>	<b>22.1</b>	<b>24.8</b>	<b>26.2</b>	<b>38.8</b>	<b>43.9</b>	<b>47.7</b>
<b>Balance sheet (Rs mn)</b>									
Total equity	99,733	113,929	130,049	147,696	167,991	188,643	219,329	253,571	291,148
Deferred taxation liability	12,997	13,187	13,197	13,259	13,896	14,795	19,240	26,534	32,874
Total borrowings	19,166	13,379	12,659	12,001	14,804	53,253	131,053	133,853	81,653
Current liabilities	37,522	45,512	60,604	81,548	103,784	116,199	100,427	115,928	120,553
<b>Total liabilities and equity</b>	<b>169,418</b>	<b>186,007</b>	<b>216,509</b>	<b>254,505</b>	<b>300,475</b>	<b>372,891</b>	<b>470,049</b>	<b>529,885</b>	<b>526,228</b>
Cash	44,959	26,604	44,730	34,562	41,720	26,100	20,298	21,212	24,776
Other current assets	28,309	50,851	59,370	87,804	95,408	122,577	148,828	165,979	168,043
Total fixed assets	81,716	93,913	97,500	114,767	142,617	203,484	280,193	321,965	312,679
Investments	14,434	14,638	14,909	17,373	20,730	20,730	20,730	20,730	20,730
<b>Total assets</b>	<b>169,418</b>	<b>186,007</b>	<b>216,509</b>	<b>254,505</b>	<b>300,475</b>	<b>372,891</b>	<b>470,050</b>	<b>529,886</b>	<b>526,228</b>
<b>Free cash flow (Rs mn)</b>									
Operating cash flow, excl. working capital	25,165	23,920	33,692	30,456	33,152	33,699	55,226	65,945	72,368
Working capital changes	5,950	(10,151)	(388)	(5,573)	14,632	(14,754)	(42,023)	(1,651)	2,561
Capital expenditure	(5,811)	(20,449)	(12,419)	(25,535)	(33,310)	(65,810)	(83,290)	(50,060)	(1,810)
Investments	(6,462)	(205)	(270)	(2,464)	(3,358)	—	—	—	—
Other income	3,995	3,884	4,042	5,243	4,343	5,369	4,975	5,327	5,573
<b>Free cash flow</b>	<b>22,837</b>	<b>(3,002)</b>	<b>24,658</b>	<b>2,127</b>	<b>15,459</b>	<b>(41,496)</b>	<b>(65,112)</b>	<b>19,561</b>	<b>78,691</b>
<b>Ratios (%)</b>									
Debt/equity	17.0	10.5	8.8	7.5	8.1	26.2	54.9	47.8	25.2
Net debt/equity	(22.9)	(10.4)	(22.4)	(14.0)	(14.8)	13.3	46.4	40.2	17.6
ROAE (%)	22.1	20.5	19.2	18.4	18.3	17.2	22.3	21.5	20.0
<b>ROACE (%)</b>	<b>19.9</b>	<b>16.1</b>	<b>17.8</b>	<b>17.5</b>	<b>17.2</b>	<b>15.0</b>	<b>16.9</b>	<b>15.6</b>	<b>15.8</b>

Source: Company, Kotak Institutional Equities estimates



## Profit model, balance sheet, cash model of OIL, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>									
Net sales	55,502	53,892	60,819	72,414	80,728	89,526	102,379	108,778	110,424
<b>EBITDA</b>	<b>26,554</b>	<b>22,292</b>	<b>23,852</b>	<b>28,339</b>	<b>38,756</b>	<b>46,967</b>	<b>56,295</b>	<b>60,558</b>	<b>60,779</b>
Other income	3,639	5,335	6,770	9,372	7,869	9,223	9,906	10,931	12,135
Interest	(152)	(151)	(383)	(26)	(37)	(24)	(9)	—	—
Depreciation and depletion	(3,314)	(2,595)	(3,093)	(3,768)	(7,638)	(9,110)	(11,455)	(12,641)	(13,975)
Pretax profits	26,728	24,881	27,145	33,916	38,951	47,056	54,737	58,848	58,939
Tax	(9,347)	(7,406)	(8,538)	(11,910)	(11,598)	(15,505)	(18,204)	(19,565)	(19,591)
Deferred tax	(498)	(1,020)	(707)	(343)	(1,211)	(125)	22	17	13
<b>Net profits</b>	<b>16,883</b>	<b>16,454</b>	<b>17,901</b>	<b>21,663</b>	<b>26,142</b>	<b>31,425</b>	<b>36,555</b>	<b>39,300</b>	<b>39,361</b>
<b>Earnings per share (Rs)</b>	<b>78.9</b>	<b>76.9</b>	<b>83.6</b>	<b>101.2</b>	<b>115.0</b>	<b>130.7</b>	<b>152.0</b>	<b>163.4</b>	<b>163.7</b>
<b>Balance sheet (Rs mn)</b>									
Total equity	58,483	68,491	79,330	93,310	137,697	156,785	179,320	203,198	227,138
Deferred tax liability	7,013	8,033	8,655	8,998	10,209	10,334	10,312	10,296	10,283
Liability for abandonment cost	10	11	11	15	19	19	19	19	19
Total borrowings	3,341	8,140	1,749	565	375	213	—	—	—
Current liabilities	11,668	10,320	17,541	30,914	32,693	32,496	33,437	34,106	34,165
<b>Total liabilities and equity</b>	<b>80,515</b>	<b>94,995</b>	<b>107,286</b>	<b>133,801</b>	<b>180,992</b>	<b>199,846</b>	<b>223,088</b>	<b>247,619</b>	<b>271,605</b>
Cash	31,015	32,757	42,808	60,700	85,487	92,205	105,047	121,547	139,206
Current assets	14,540	22,350	18,957	22,853	37,266	40,015	42,370	43,542	43,843
Total fixed assets	30,658	35,813	40,633	45,361	49,460	58,848	66,893	73,752	79,777
Investments	4,302	4,075	4,887	4,887	8,594	8,594	8,594	8,594	8,594
Deferred expenditure	—	—	—	—	184	184	184	184	184
<b>Total assets</b>	<b>80,515</b>	<b>94,995</b>	<b>107,286</b>	<b>133,801</b>	<b>180,992</b>	<b>199,846</b>	<b>223,088</b>	<b>247,619</b>	<b>271,605</b>
<b>Free cash flow (Rs mn)</b>									
Operating cash flow, excl. working capital	19,843	18,357	20,104	27,246	24,645	27,938	34,082	36,994	37,188
Working capital changes	5,884	(8,696)	7,435	2,368	(12,813)	(2,946)	(1,413)	(503)	(242)
Capital expenditure	(6,108)	(9,370)	(9,492)	(8,496)	(9,224)	(14,998)	(15,500)	(15,500)	(16,000)
Investments	(2,482)	226	(811)	—	(3,708)	—	—	—	—
Other income	1,670	2,892	4,214	5,470	7,869	9,223	9,906	10,931	12,135
<b>Free cash flow</b>	<b>18,807</b>	<b>3,409</b>	<b>21,450</b>	<b>26,587</b>	<b>6,769</b>	<b>19,217</b>	<b>27,074</b>	<b>31,921</b>	<b>33,081</b>
<b>Ratios (%)</b>									
Debt/equity	5.7	11.9	2.2	0.6	0.3	0.1	—	—	—
Net debt/equity	(33.1)	(32.8)	(31.9)	(31.9)	(38.3)	(38.1)	(39.9)	(43.0)	(46.2)
RoAE	28.1	23.2	21.8	22.8	20.9	20.0	20.5	19.5	17.5
<b>RoACE</b>	<b>28.0</b>	<b>23.0</b>	<b>21.5</b>	<b>22.7</b>	<b>20.9</b>	<b>19.9</b>	<b>20.5</b>	<b>19.5</b>	<b>17.5</b>
<b>Key assumptions</b>									
Rs/dollar rate	44.3	45.3	40.3	45.8	47.4	45.0	45.3	45.3	45.3
Crude fob price (US\$/bbl)	57.2	64.8	78.9	83.0	67.1	75.0	75.0	80.0	80.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,200	6,783	7,500	7,500	7,500
Subsidy loss (Rs bn)	9.8	19.9	23.1	30.2	15.5	19.8	14.7	17.0	17.6

Source: Company, Kotak Institutional Equities estimates

## Consolidated profit model, balance sheet, cash model of ONGC, March fiscal year-ends, 2006-2014E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
<b>Profit model (Rs mn)</b>									
Net sales	807,603	966,542	1,091,644	1,200,176	1,090,473	1,216,504	1,342,039	1,502,009	1,500,352
<b>EBITDA</b>	<b>310,054</b>	<b>357,707</b>	<b>407,481</b>	<b>418,299</b>	<b>468,954</b>	<b>529,826</b>	<b>595,843</b>	<b>650,822</b>	<b>643,377</b>
Other income	27,350	45,378	53,565	56,197	29,934	33,332	48,601	65,255	80,598
Interest	(537)	394	(12,027)	(11,442)	(6,212)	(1,454)	(1,382)	(6,860)	(6,140)
Depreciation and depletion	(97,726)	(119,550)	(138,624)	(153,985)	(186,996)	(167,845)	(200,524)	(195,662)	(188,121)
Pretax profits	239,141	283,928	310,395	309,069	305,680	393,858	442,538	513,555	529,713
Tax	(71,196)	(88,986)	(102,908)	(111,333)	(94,961)	(122,189)	(137,424)	(153,040)	(155,432)
Deferred tax	(13,612)	(9,264)	(6,471)	(3,495)	(12,077)	(2,149)	(953)	(4,094)	(5,548)
Net profits	154,596	178,119	202,767	200,063	198,832	269,520	304,160	356,421	368,733
<b>Net profits after minority interests</b>	<b>153,542</b>	<b>176,627</b>	<b>199,156</b>	<b>196,679</b>	<b>195,675</b>	<b>267,240</b>	<b>301,814</b>	<b>355,219</b>	<b>366,937</b>
<b>Earnings per share (Rs)</b>	<b>71.8</b>	<b>82.6</b>	<b>93.1</b>	<b>92.0</b>	<b>91.5</b>	<b>124.9</b>	<b>141.1</b>	<b>166.1</b>	<b>171.6</b>
<b>Balance sheet (Rs mn)</b>									
Total equity	578,830	670,137	786,657	929,353	1,045,186	1,207,091	1,388,672	1,598,389	1,814,000
Deferred tax liability	71,557	80,976	87,227	92,076	104,153	106,302	107,255	111,349	116,897
Liability for abandonment cost	128,675	151,857	129,325	171,451	175,368	175,368	175,368	175,368	175,368
Total borrowings	28,767	21,826	22,039	73,633	57,256	39,724	119,124	111,274	96,674
Current liabilities	142,435	187,051	251,797	293,480	237,041	243,772	258,662	284,445	293,919
<b>Total liabilities and equity</b>	<b>950,264</b>	<b>1,111,847</b>	<b>1,277,045</b>	<b>1,559,994</b>	<b>1,619,004</b>	<b>1,772,257</b>	<b>2,049,081</b>	<b>2,280,826</b>	<b>2,496,858</b>
Cash	90,743	206,262	249,807	224,671	212,010	339,207	572,045	834,646	1,094,768
Current assets	240,210	192,652	257,384	309,494	295,048	329,942	346,390	371,749	376,334
Total fixed assets	565,722	643,219	695,227	871,287	950,589	936,809	964,348	908,133	859,458
Goodwill	14,172	27,686	22,847	111,108	111,108	111,108	111,108	111,108	111,108
Investments	35,753	36,888	45,041	36,926	43,744	48,684	48,684	48,684	48,684
Deferred expenditure	3,663	5,141	6,739	6,506	6,506	6,506	6,506	6,506	6,506
<b>Total assets</b>	<b>950,264</b>	<b>1,111,848</b>	<b>1,277,045</b>	<b>1,559,994</b>	<b>1,619,005</b>	<b>1,772,257</b>	<b>2,049,081</b>	<b>2,280,826</b>	<b>2,496,859</b>
<b>Free cash flow (Rs mn)</b>									
Operating cash flow, excl. working capital	216,736	252,772	284,517	274,321	262,045	327,885	382,382	417,414	408,297
Working capital changes	46,461	(4,990)	(24,929)	(109,306)	(41,073)	21,836	58,443	33,489	4,888
Capital expenditure	(113,738)	(135,049)	(166,427)	(208,137)	(154,415)	(75,767)	(153,409)	(65,938)	(65,938)
Investments	(28,912)	53,822	(7,348)	(92,159)	(6,817)	—	—	—	—
Other income	14,537	20,422	22,822	31,612	29,934	33,332	48,601	65,255	80,598
<b>Free cash flow</b>	<b>135,083</b>	<b>186,976</b>	<b>108,636</b>	<b>(103,668)</b>	<b>89,674</b>	<b>307,285</b>	<b>336,017</b>	<b>450,219</b>	<b>427,844</b>
<b>Ratios (%)</b>									
Debt/equity	5.0	3.3	2.8	7.9	5.5	3.3	8.6	7.0	5.3
Net debt/equity	(10.7)	(27.5)	(29.0)	(16.3)	(14.8)	(24.8)	(32.6)	(45.3)	(55.0)
RoAE	25.9	25.5	24.8	21.0	18.3	22.0	21.8	22.4	20.4
<b>RoACE</b>	<b>22.0</b>	<b>22.0</b>	<b>21.9</b>	<b>18.3</b>	<b>16.1</b>	<b>19.2</b>	<b>19.3</b>	<b>20.3</b>	<b>18.7</b>
<b>Key assumptions</b>									
Rs/dollar rate	44.3	45.3	40.3	45.8	47.4	45.0	45.3	45.3	45.3
Crude fob price (US\$/bbl)	57.2	64.8	78.9	83.0	67.1	75.0	75.0	80.0	80.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,200	6,783	7,500	7,500	7,500
Subsidy loss (Rs bn)	119.6	170.2	220.0	282.3	115.5	143.7	106.7	124.0	128.0

Source: Company, Kotak Institutional Equities estimates

JUNE 28, 2010

UPDATE

BSE-30: 17,575

### Competition, delays, traffic disappointments mar otherwise large opportunity.

Award activity has picked up significantly (6,500 km since end-FY2009); however, competition among more than 30 developers leads to aggressive bids and limited asset returns. Traffic disappointment vs developer's estimates, and COD delays argue for caution. Construction firms would be key beneficiaries of estimated road construction revenues of Rs1-1.2 tn over next 3 years; asset value remains to be tested in long-term.

### Pick-up in award activity, 6,500 km since end-FY2009; high competition may limit asset returns

NHAI award activity has picked up significantly under the new leadership with about 6,500 km awarded during last one year since end-FY2009 versus about 850 km during FY2009. However, immense competition among more than 30 developers actively participating in tenders leads to aggressive bids and potentially limited asset returns. We note aggressive bidding in recent rounds such as (1) wide divergence of winning bid from L2 bid, (2) fewer projects asking for VGF and actually offering high annual escalating premiums, (3) entry of new players – Transstroy (Russia) and Essel-CR18 and scale up of smaller ones such as B Seenaiiah, Ramky, Gayatri etc.

### Traffic disappointment vs developer's original base estimates, and delays in COD argue for caution

Actual toll collection across nine projects, commissioned in the last 18 months, has been about 30-35% below developer's original base estimates. For instance, GMR's Ambala-Chandigarh project average daily toll in FY2010 was about 25% below company's estimate. Nagarjuna mentioned in 4QFY10 concall that toll collection on Bangalore tollway has been about 35% below original estimates. Annualised toll collection on several of the recently commissioned projects (such as Bharuch-Surat, Panipat Elevated etc.) may have barely met interest service requirement for the first year. Based on detailed analysis of about 4,000 km of completed BOT projects, we observe that projects have seen an average delay of about 8 months in achieving COD as per NHAI.

### Current execution of 9-10 km/day versus target of 20 km/day; likely to inch up post more awards

With about 9,000 km of projects under implementation and average construction period of about 2.5-3 years, the country is possibly constructing about 9-10 km/day, far below the target of 20 km/day set by the authority. We expect additional awards of about 3,000-3,500 km on BOT basis in remaining part of FY2011E which could take the execution to about 12-14 km/day. NHAI continues its aggressive tendering activity with 2,700 km of projects to be bid in Jun-Jul 2010; about 1,700 km of 4/6 lane projects including (1) 195 km Ahmedabad-Vadodra, (2) 164 km Jhansi-Khajuraho, and (3) 135 km Eastern Peripheral Expy. We also find a higher number of two-laning (about 1,000 km) and annuity (about 1,100 km) projects in the bidding schedule.

### Positive on near-term constr'n; asset value is tested in long-term; market not valuing project wins

We estimate road construction revenues of about Rs1-1.2 tn over FY2011E-13E based on (1) about 9,000 km under implementation, (2) about 3,000-3,500 km of new awards in FY2011E, and (3) revenue of about Rs100 mn/km. Key beneficiaries would be construction companies based on (1) order book accretion (2) likely upside to near-term earning, and (3) potential upside from asset ownership. A road project provides – (1) revenue visibility which is realized over two-three years from the start of construction, and (2) a road asset whose value would be tested in the longer-term – both held by the same entity. Hence, the overall value accretion from a road project remains doubtful and would be realized in the long-term. Based on price movement we believe that market is not ascribing value on a project win but later on visible execution and toll trends.

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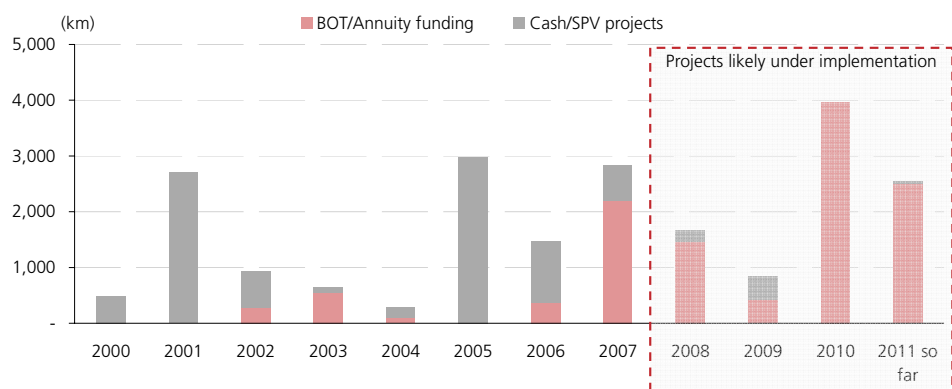
## Significant pick-up in award activity but competition could limit asset returns

### Pick-up in award activity; about 6,500 km awarded since beginning of FY2010

NHAI road project award activity has picked up significantly under the new leadership. The authority awarded about 6,500 km since beginning of FY2010 compared to about 850 km in FY2009 and 1,650 km in FY2008. Recent awards include several large ticket projects – (1) Rs31 bn Mah/Goa border to Goa/Kar border stretch to IVRCL, (2) Rs30 bn Delhi-Agra highway to Reliance Infra, (3) Rs17 bn Bareilly-Sitapur project to Era-OJSC consortium, and (4) Rs17 bn Hungund-Hospet to GMR. Several players have tied up to bid for the high-valued NHDP Phase-V projects, for instance – (1) IRB and Reliance Infrastructure have formed a consortium, and (2) HCC has signed MOU with Orascom Construction of Egypt.

### BOT projects activity shows significant revival under new NHAI leadership

BOT and Cash/SPV funded NHDP projects based on start dates, March fiscal year-ends, 2001-11 (km)



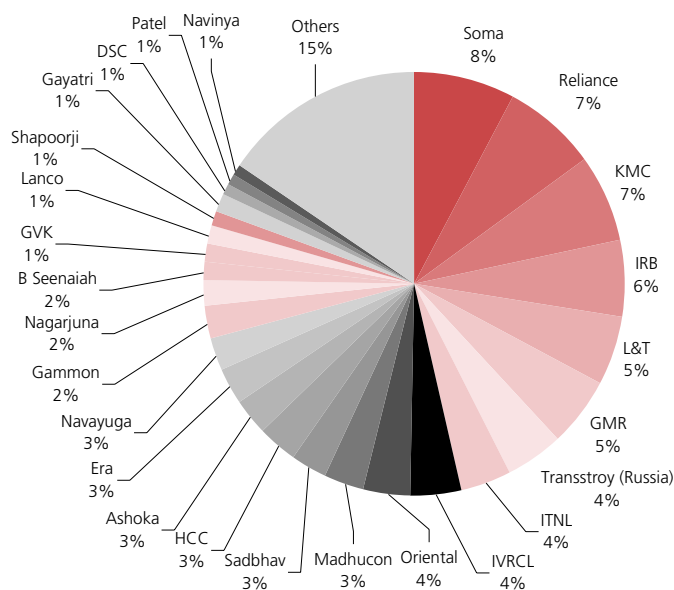
Source: NHAI, Kotak Institutional Equities

### But high competition leads to aggressive bids and potentially limited returns

NHAI road development is a highly fragmented market with more than 30 developers actively vying for projects. Most players, including the established names such as ITNL, IVRCL, Sadbhav and HCC, have market share of less than 5% in about 12,600 km of BOT projects awarded so far. Such high level of competition has led to aggressive bidding behavior and potentially limited returns from the road assets. We note instances of aggressive bidding in recent rounds such as (1) wide divergence of winning bid from L2 bid in some cases, (2) fewer projects asking for viability gap funding and in smaller amounts versus the earlier round, (3) entry of new players such as Transstroy (Russia) and Essel-CR18, and (4) some players quoting aggressive bids versus the regionally dominant players who presumably would have better understanding of traffic and other project-specific conditions.

### Fragmented market of NHAI road project developers

Share of developers in about 12,600 km of NHAI BOT projects announced till date



Source: NHAI, Kotak Institutional Equities

### Traffic disappointments and delays in achieving COD argue for some caution

#### Significant traffic disappointment versus developer's original base estimates

We highlight that most road projects commissioned in the last 18 months have shown significant traffic disappointment compared to company's original estimates for base traffic. Actual toll collection across nine projects analyzed was about 35% below the estimates of the developers. For instance, GMR's Ambala-Chandigarh project which has been in operation for more than a year (achieved COD in Nov-08) collected average daily toll of about Rs0.5 mn in FY2010, about 25% below company's estimate of Rs0.7 mn. Nagarjuna mentioned in its 4QFY10 concall that daily toll collections on Bangalore elevated tollway (COD in Apr-2010) has been about 35% below original estimates of the company.

#### Toll collection has been about 30-40% below estimates on recently commissioned BOT projects

Toll collection data for key BOT projects commissioned during the last 18 months

Company	Project	FY2010 Toll collection (Rs mn/day)			COD			Source of original estimates
		Actual	Estimated	(%)	Actual	Estimated	Delay (mths)	
GMR	Ambala-Chandigarh Expy	0.5	0.7	(25.4)	Nov-08	Nov-08	—	Company investor toolkit May09, NHAI
	Jadcherla Expressway	1.2	1.7	(27.3)	Feb-09	Feb-09	—	Company investor toolkit May09, NHAI
	Ulunderpet Expressway	1.6	2.7	(42.5)	Jul-09	Mar-09	4	Company investor toolkit May09, NHAI
IRB	Surat-Dahisar	9.1	15.3	(40.2)	Feb-09	Apr-09	(1)	Kotak coverage reoport
	Bharuch-Surat	3.5	6.1	(42.2)	Sep-09	Jun-09	4	Kotak IPO and coverage reoport
Nagarjuna	Bangalore elevated tollway	1.1	1.7	(35.0)	Apr-10	Mar-09	13	4Q concall, Company pp Nov-08
IVRCL	Jallandar-Amritsar	0.8	1.2	(33.3)	May-10	Dec-08	17	4Q concall, Annual reports
	Kumarapalyam-Chengapalli	1.2	1.3	(11.5)	Sep-09	Jan-09	8	4Q concall, Company ppt
Sadbhav	Aurangabad-Jalna	0.7	0.7	(4.1)	Jul-09	Jul-09	—	4Q concall, Company guidance, CARE rating Oct-08
<b>Total</b>		<b>19.7</b>	<b>31.5</b>	<b>(37.2)</b>			<b>7</b>	

Source: Company, NHAI, , Kotak Institutional Equities estimates

### Toll revenue on several recent projects may have been insufficient to service interest

We estimate that a road project would require first year annualized toll collection of about 10% of the total project cost to be able to meet its interest servicing requirement. The estimate is based on (1) 70:30 debt:equity, (2) 80% EBITDA margin in the first year, and (3) 11% as the cost of debt. Toll collection on several of the recently commissioned projects may have been insufficient to meet interest service requirement for the year. For example, L&T reported toll collection of Rs256 mn on Panipat elevated project in FY2009 which implies annualized revenue of Rs363 mn i.e. less than 5% of the project cost. Annualized collection of Rs644 mn on Krishnagiri-Thopur project in FY2009 was about 7.4% of the total project cost. IRB's Bharuch-Surat reported toll revenue of Rs663 mn in FY2010, which implies annualized toll of about Rs1.3 bn. The toll collection would have barely met the interest requirement on a project level debt of Rs11 bn at the end-FY2009 (there may have been a repayment of debt since end-FY2009 as IRB reported debt of Rs8 bn at end-FY2010).

Several recently commissioned projects may have found tough to even service interest service cost in the first year  
Toll collection revenues of recently commissioned projects by L&T and IRB (Rs mn)

Company	Project	COD	Revenue (Rs mn)			Project cost (Rs mn)	Annualized revenue/project cost (%)
			FY	Reported	Annualized		
L&T	Panipat Elevated	17-Jul-08	2009	256	363	7,746	4.7
	Krishnagiri - Thopur	6-Feb-09	2009	94	644	8,719	7.4
	Western Andhra Tollway	14-Mar-09	2009	15	322	3,732	8.6
IRB	Bharuch - Surat	20-Sep-09	2010	663	1,294	14,091	9.2
<b>Total</b>				<b>2,623</b>	<b>2,623</b>		

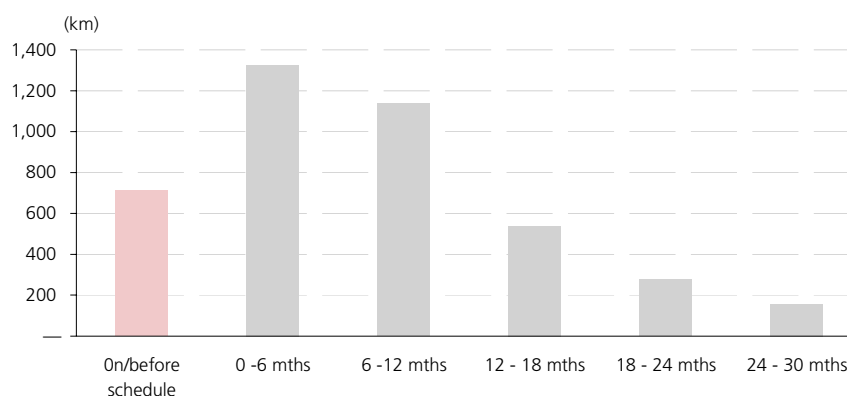
Source: Company, Kotak Institutional Equities

### BOT projects have seen average delay of 8 months in achieving COD

Based on detailed project-wise analysis of about 4,000 km of BOT/SPV projects commissioned so far, we observe that road projects have seen an average delay of about 8 months in achieving COD. The delays have been led by issues such as land acquisition, ROB clearances and partially due to execution issues on part of the developers. The analysis is based on NHAI provided data of original estimate of completion and actual completion dates and may not include delays before the start of projects, such as in early stages of land acquisition and awarding. Furthermore, the data may be conservative as it only includes completed projects and would include delay on projects still under implementation.

### NHAI projects have seen an average execution delay of about 8 months

Delay in actual COD vs. original published estimate of BOT projects commissioned before June-2010



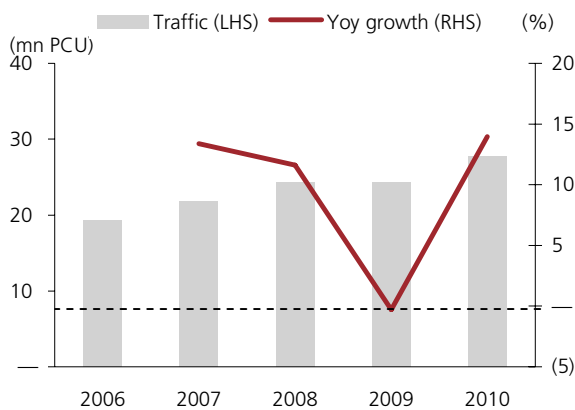
Source: NHAI, Kotak Institutional Equities

### Lack of historical data on traffic growth; vehicle stock and diesel sales possible indicators

#### Lack of historical data on toll collection as only 800 km was completed by FY2009

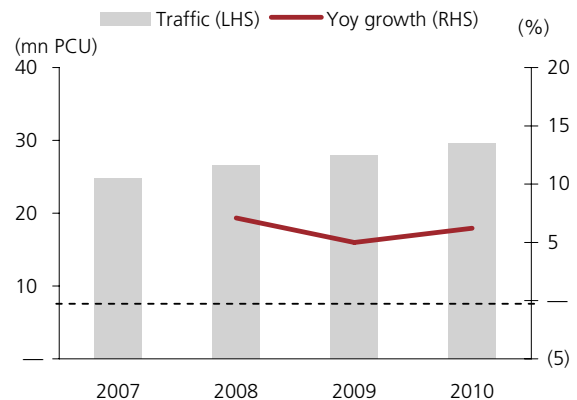
We highlight that the road sector suffers from lack of historical data on toll collection as only about 800 km of BOT-toll road project had been completed before end-FY2009. Lack of historical track record makes traffic growth assumption, a key driver for the value of a road asset, more subjective. Jaipur-Kishangarh and Mumbai-Pune, possibly the only two road projects with more than three years of historical data, have shown materially different growth rates. While Jaipur-Kishangarh has reported traffic CAGR of 9.5% over FY2006-10; Mumbai-Pune has lagged behind at about 5.6% over FY2008-10. Slow growth in commercial traffic on Mumbai-Pune led by over capacity at port near Mumbai could be a potential reason for visibly slow traffic growth. Nevertheless, further track record of traffic growth on road assets needs to be ascertained over time.

**Traffic on Jaipur-Kishangarh grew at 9.5% CAGR over FY06-10**  
Annual traffic and yoy growth for Jaipur-Kishangarh, FY2006-10



Source: Company, Kotak Institutional Equities

**Traffic on Mumbai-Pune has grown at 5.6% CAGR over FY08-10**  
Annual traffic and yoy growth for Mumbai-Pune, FY2007-10

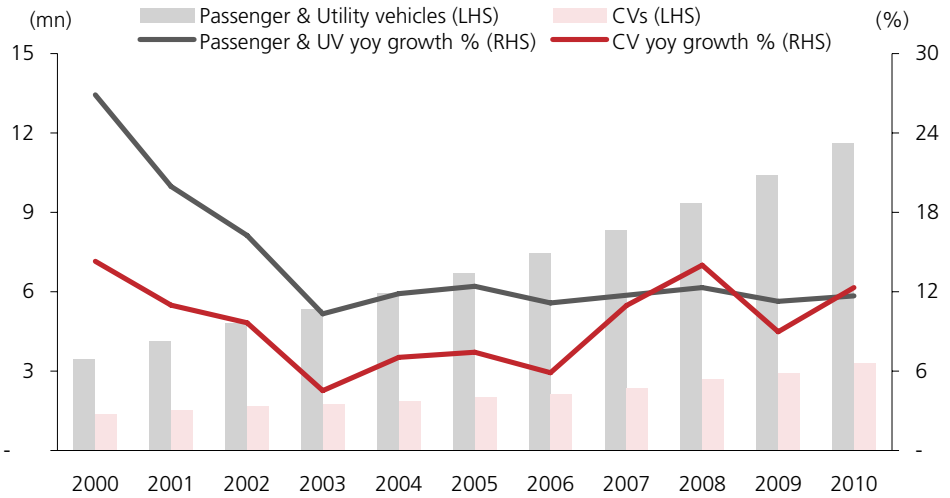


Source: Company, Kotak Institutional Equities

### Historical trend in CV sales growth would imply about 7% commercial traffic growth

Commercial vehicle sales in India has grown at about 8% CAGR over FY2000-10. Assuming a similar long-term growth in CV sales going forward and ten years as average life of a commercial vehicle, we estimate that the stock of commercial vehicles in India would grow at about 7-8% CAGR over the next ten years. Passenger and utility vehicles sales have grown at a CAGR of about 10% over FY2000-10. A similar long-term growth rate would imply about 11-12% CAGR in stock of passenger and utility vehicles over the next ten years. As the traffic in PCU terms is primarily driven by commercial vehicles, we believe PCU traffic growth is likely to be about 7% over the long-term.

Stock of vehicles in India, March fiscal year-ends, 2000-10 (mn)



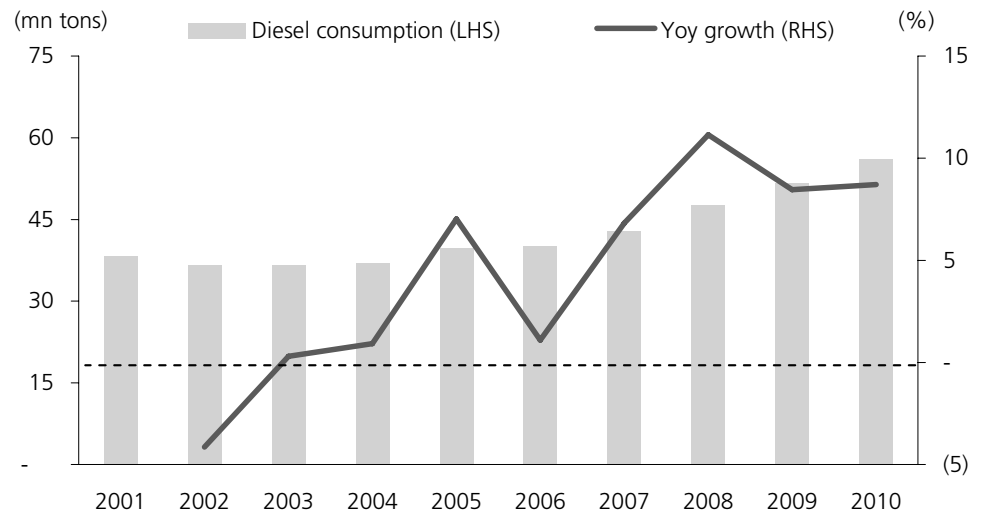
Source: SIAM, Kotak Institutional Equities

**Diesel consumption has grown at about 7% CAGR over FY2005-10**

Diesel consumption in the country, likely to be a good indicator of total commercial traffic in the country, has grown at about 7% CAGR over FY2005-10.

Diesel consumption in the country has grown at about 7% CAGR over FY2005-10

Diesel consumption in India, March fiscal year-ends, 2000-10 (mn tons)



Source: Ministry of Oil & Gas, Kotak Institutional Equities

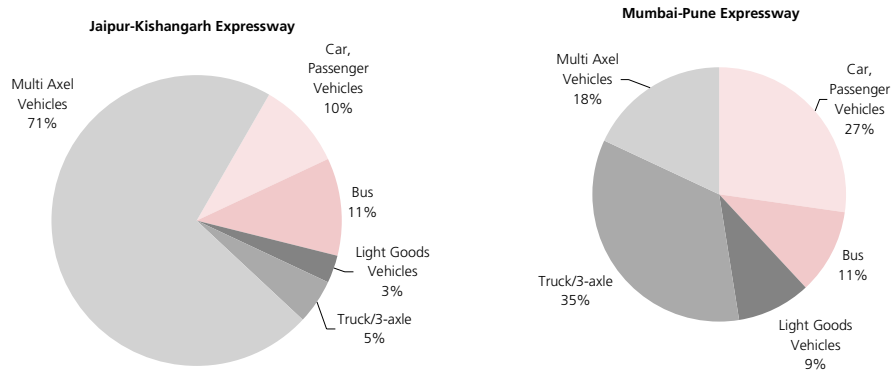
**Economics of toll roads are primarily driven by commercial vehicles**

Toll from commercial vehicles (trucks, multi-axle vehicles and light goods vehicles) primarily drive the economics of a road as the segment contribute to majority of the toll revenues. Commercial vehicles contribute about 80% of the total toll collection on Jaipur-Kishangarh highway and about 60% on the Mumbai-Pune Expressway. Hence, expected growth rate in commercial traffic is key to the value of road assets.



### Commercial vehicles contribute to majority of toll revenues

Vehicle-wise origin of toll collection on Jaipur-Kishangarh and Mumbai-Pune Expressway



Source: Company, Kotak Institutional Equities

### About 9-10 km/day execution based on 9,000 km under implementation

Expect 3,000–3,500 km additional award in FY2011E, implies 12-14 km/day execution

With about 9,000 km of projects under implementation and average construction period of about 2.5-3 years, the country is possibly constructing about 9-10 km/day. Although the execution is below the target of 20 km/day set by the authority, we believe that the authority has demonstrated significant pick-up in awarding activity by enhancing projects viability and bidding participation. NHAI has proposed an aggressive work plan which aims to award about 75% of the planned 4/6 lane project by end-FY2011. We estimate that the authority may have awarded about 6,000 of 4/6 lane projects since beginning of FY2010 so far. We expect additional awards of about 3,000–3,500 km on BOT basis in remaining part of FY2011E which could take the execution to about 12-14 km/day.

Proposed work plan aims to award about 75% of 4/6 lane highway length by end-FY2011  
 NHAI proposed work plan as on Nov-2009, March fiscal year-ends, 2010-14E (km)

	2010	2011	2012	2013	2014	Total
<b>Four and six lane BOT projects</b>						
<b>BOT (toll)</b>						
4 lane - Phase III	4,373	—	—	—	—	4,373
4 lane - Phase II	55	—	—	—	—	55
6 lane - Phase V	2,403	1,200	—	—	1,477	5,080
Expressways - Phase VI	—	—	436	604	—	1,040
4 lane - Phase VII	—	—	681	—	—	681
<b>BOT (toll) total</b>	<b>6,831</b>	<b>1,200</b>	<b>1,117</b>	<b>604</b>	<b>1,477</b>	<b>11,229</b>
<b>BOT (annuity)</b>						
4 lane - Phase III	524	—	—	—	—	524
4 lane - Phase II	380	—	—	—	—	380
J&K - Phase II	239	—	—	—	—	239
4 lane - SARDP-NE	394	—	—	—	—	394
<b>BOT (annuity) total</b>	<b>1,537</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,537</b>
<b>BOT total (4/6 lane projects)</b>	<b>8,368</b>	<b>1,200</b>	<b>1,117</b>	<b>604</b>	<b>1,477</b>	<b>12,766</b>
<b>Two lane BOT projects</b>						
<b>BOT (toll)</b>						
2 lane with paved shoulders - Phase III	1,977	—	—	—	—	1,977
2 lane - Phase IV	—	4,086	3,075	339	—	7,500
<b>BOT (annuity)</b>						
2 lane with paved shoulders - Phase III	1,477	—	—	—	—	1,477
2 lane - Phase IV	—	4,645	4,000	1,355	—	10,000
<b>BOT total (2 lane projects)</b>	<b>3,454</b>	<b>8,731</b>	<b>7,075</b>	<b>1,694</b>	<b>—</b>	<b>20,954</b>
<b>EPC</b>						
4 lane - SARDP-NE	330	—	—	—	—	330
2 lane - Phase IV	—	1,161	1,000	339	—	2,500
2 lane with paved shoulders - Phase III	500	—	—	—	—	500
<b>EPC total)</b>	<b>830</b>	<b>1,161</b>	<b>1,000</b>	<b>339</b>	<b>—</b>	<b>3,330</b>
<b>Total over all projects</b>	<b>12,652</b>	<b>11,092</b>	<b>9,192</b>	<b>2,637</b>	<b>1,477</b>	<b>37,050</b>

Source: NHAI, Kotak Institutional Equities

### Bids in near-term for 1,700 km of 4/6 lane projects; two-lane projects start to appear

NHAI continue on its aggressive tendering activity with about 2,700 km of projects to be bid (RFP/RFQ) in Jun-Jul 2010. The projects include about 1,700 km of 4/6 lane projects including (1) 195 km Ahemdabad – Vadodra in Gujarat, (2) 164 km Jhansi – Khajuraho in Madhya Pradesh, and (3) 135 km Eastern Peripheral Expressway in Haryana and UP. We also find a higher number of two-laning (about 1,000 km) and annuity (about 1,100 km) projects in the bidding schedule.

Bids planned for Jun-Jul 2010 include 1,700 km of 4/6 lane projects; 1,000 km of two-lane projects  
List of projects for which RFQ/ Bids are likely to be invited in the next 2 months

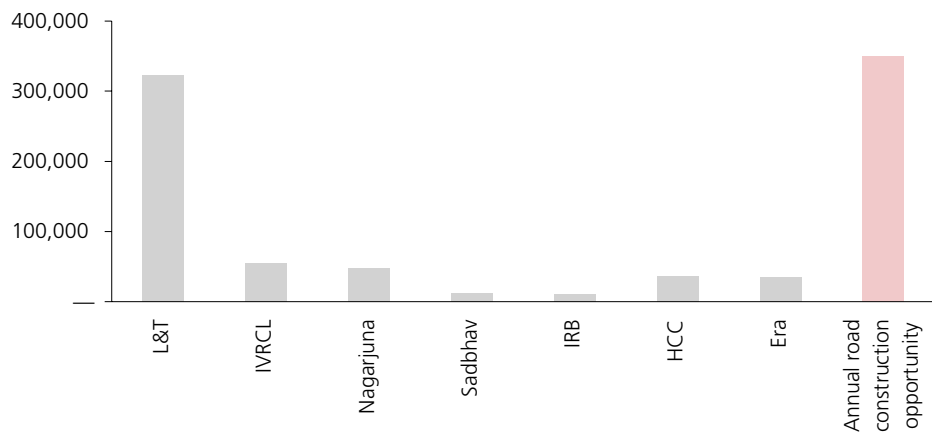
Project	Length (km)	State	NH	Lane	Type	Bid Date
Ahemdabad - Vadodra	195	Gujarat	8	6	Toll	8-Jul-10
Jhansi - Khajuraho	164	Madhya Pradesh	75	2	Toll	29-Jun-10
Eastern Peripheral Expressway	135	Haryana, UP	NE-II	6	Toll	15-Jul-10
Jetpur - Somnath	128	Gujarat	8D	4	Toll	30-Jul-10
Kanpur-Kabrai	123	Uttar Pradesh	86	2	Toll	21-Jun-10
Barwa Adda -Panagarh	122	Jharkhand	2	6	Toll	17-Jul-10
Jowai to Meghalaya /Assam Border	104	Meghalaya/Assam	44	2	Toll	28-Jun-10
Panvel - Indapur	84	Maharashtra	17	4	Toll	20-Jun-10
Agra-Aligarh	79	Uttar Pradesh	93	2	Toll	21-Jun-10
Nagapattinam - Thanjavur	77	Tamil Nadu	67	2	Toll	24-Jun-10
Vijayawada - Machilipatnam	65	Andhra Pradesh	9	2	Toll	28-Jun-10
Walayar - Vadakkancherry	58	Kerala	47	4	Toll	30-Jun-10
Patna - Bakhtiyar	51	Bihar	30	4	Toll	30-Jun-10
Jabalpur- Bhopal	189	Madhya Pradesh	12	4	Annuity	30-Jul-10
Panikoili-Rimuli	163	Orissa	215	4	Annuity	25-Jul-10
Ghoshpukur - Salsalabari	163	West Bengal	31	4	Annuity	8-Jul-10
Khagaria-Purnea	144	Bihar	3	2	Annuity	25-Jun-10
Chhapra-Gopalganj	95	Bihar	85	2	Annuity	25-Jun-10
Barasat - Krishnagar	84	West Bengal	34	4	Annuity	28-Jun-10
Jorhat - Demow	82	Assam	37	4	Annuity	8-Jul-10
Krishnagar - Bahrapore	78	West Bengal	34	4	Annuity	30-Jun-10
Srinagar - Banihal	67	Jammu & Kashmir	1A	4	Annuity	23-Jul-10
Udhampur - Ramban	43	Jammu & Kashmir	1A	4	Annuity	2-Jul-10
Ramban - Banihal	36	Jammu & Kashmir	1A	4	Annuity	2-Jul-10
Sanchi-Sagar	98	Madhya Pradesh	86	2	NA	29-Jun-10
Indore - Betul Pkg I	44	Madhya Pradesh	59A	2	NA	5-Jul-10
Indore - Betul Pkg II	37	Madhya Pradesh	59A	2	NA	12-Jul-10
<b>Total</b>	<b>2,708</b>					

Source: NHAI, Kotak Institutional Equities

### Positive on near-term potential; asset value remains to be tested in long term

We estimate that road sector could generate total construction revenues of the order of Rs1-1.2 tn over the next three years. The estimate is based on (1) about 9,000 km of projects currently under implementation, (2) about 3,000-3,500 km of addition award activity in FY2011E, and (3) average construction revenue of about Rs100 mn/km. Key beneficiaries of the road development opportunity would be construction companies based on (1) order book accretion for the sector as a whole plus (2) likely upside to near-term earning visibility, and (3) potential upside of infra development opportunity. A road project win provides (1) near-term revenue and earning visibility which is realized over two-three years from the start of construction, and (2) a road asset where the value would be tested in the longer-term. In the case of road projects the asset would be held by the same entity (directly or indirectly) and to that the extent the total benefit of a road project remains doubtful and would only be realized in the long-term.

**Road construction could generate total revenues of about Rs1-1.2 tn over the next three years**  
 Construction segment revenues of E&C companies and infra developers, March fiscal year-end, 2010 (Rs mn)

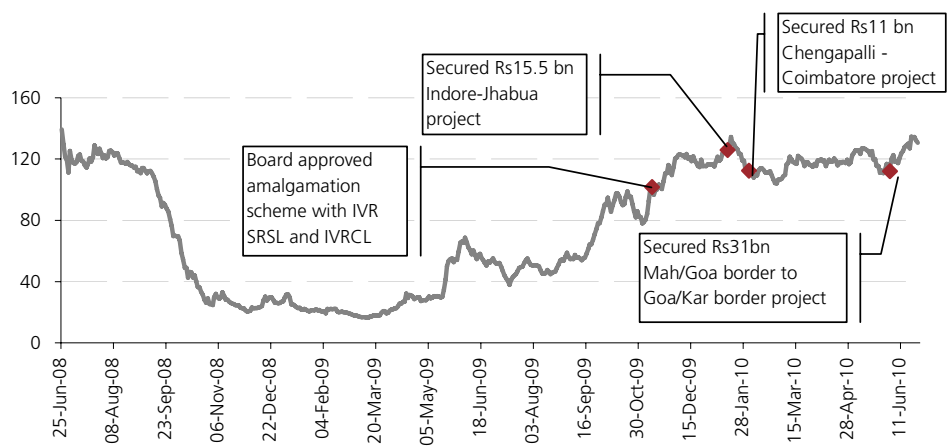


Source: Company, Kotak Institutional Equities estimates

**Market seems to not immediately reward for asset value from road project wins**

IVRCL Assets and Holding stock price, which is likely to indicate the value of the assets in the portfolio excluding the value from construction, fails to show material uptick on announcements of road project wins by the company. The trend possibly indicates that the market does not ascribe value of a road asset to the company immediately on a project win. The value of the asset is potentially ascribed on visible execution and toll collection trends.

**Investors seem to not immediately reward companies for asset value from road project wins**  
 IVRCL Assets & Holding share price chart for the period 25-Jun-2008 to 25-Jun-2010



Source: NSE, Kotak Institutional Equities

### Concession agreement reduces developer's risk from variations in traffic growth

Concession agreement provides for some reduction in developer's risk, as well as upside, due to variation in traffic growth. We notice that the agreement also tilts the balance slightly in favor of the concessionaire by a larger increasing in the concession period for traffic shortfall versus a reduction in the concession period for excess.

#### Concession agreement reduces developer's risk, as well as upside, due to variations in traffic growth Impact of traffic growth variation to concession agreement

Item	Details	Examples	
		Amritsar-Pathankot	Rohtak-Panipat
Target traffic (PCU)	Used for determining the modifications to the concession period	34,498	23,800
Target date	Base date for determining actual traffic	1-Jan-19	1-Sep-19
Actual traffic (PCU)	Average of the traffic sampled on (1) one year prior to the Target Date, (2) on the Target Date and (3) on the first anniversary of the Target Date		
Design capacity (PCU)	Maximum stated capacity for the highway	66,000	6,000
<b>Effect of variations in traffic growth</b>			
If actual traffic falls short of target traffic by more than 2.5%	For every 1% excess vs. Target Traffic, Concession Period is reduced by 0.75% up to a maximum reduction of 10% of the Concession Period.		
If actual traffic exceed target traffic by more than 2.5%	For every 1% shortfall vs. Target Traffic, Concession Period is increased by 1.5% up to a maximum increase of 20% of the Concession Period		
If traffic exceeds design capacity in any year	Concessionaire may have the reduction in Concession Period waived by paying premium of 25% of the Realisable Fee in the respective years Toll collected from traffic exceeding the design capacity would be payable to NHAI		
If traffic exceeds design capacity for 4 consecutive years	NHAI may terminate the concession agreement by making a Termination Payment after granting 180 days period for the concessionaire to make a representation for capacity augmentation		

Source: NHAI, Kotak Institutional Equities

#### Award activity has picked up with about 4,100 km awarded in Dec09-May10 Phase-wise status of NHDP Phases III to VII (as of May 31, 2010)

	Length (Kms)			
	Total	Completed	Under impl- ementation	To be awarded
I Golden Quadilateral (GQ) - 4-laning of Mumbai-Delhi-Kolkata-Chennai	5,846	5,791	55	—
II NSEW Corridor - 4-Laning of Silchar-Porbandar and Kashmir Kanyakumari	7,300	5,117	1,644	539
<b>III Stretches connecting tourist and religious places with urban centres</b>	<b>12,109</b>	<b>1,712</b>	<b>5,126</b>	<b>5,271</b>
IV 2-laning of less important national highways	14,799	—	176	14,623
<b>V 6-laning of high density corridors in GQ, NSEW</b>	<b>6,500</b>	<b>275</b>	<b>2,025</b>	<b>4,200</b>
VI New expressway construction	1,000	—	—	1,000
VII Urban areas - ring roads etc.	700	—	41	659
<b>Total</b>	<b>48,254</b>	<b>12,895</b>	<b>9,266</b>	<b>26,093</b>

	To be awarded	Total awarded as on					Awarded during			
		May-10	Dec-09	Apr-08	Feb-07	Mar-06	Dec09- May10	Apr08- Dec09	Feb07- Apr08	Mar06- Feb07
I Golden Quadilateral (GQ) - 4-laning of Mumbai-Delhi-Kolkata-Chennai	—	5,846	5,846	5,846	5,846	5,846	—	—	—	—
II NSEW Corridor - 4-Laning of Silchar-Porbandar and Kashmir Kanyakumari	539	6,761	6,618	6,321	6,230	3,285	143	297	91	2,945
<b>III Stretches connecting tourist and religious places with urban centres</b>	<b>5,271</b>	<b>6,838</b>	<b>4,360</b>	<b>1,809</b>	—	—	<b>2,478</b>	<b>2,551</b>	<b>1,809</b>	—
IV 2-laning of less important national highways	14,623	176	—	—	—	—	176	—	—	—
<b>V 6-laning of high density corridors in GQ, NSEW</b>	<b>4,200</b>	<b>2,300</b>	<b>1,034</b>	<b>1,030</b>	—	—	<b>1,266</b>	<b>4</b>	<b>1,030</b>	—
VI New expressway construction	1,000	—	—	—	—	—	—	—	—	—
VII Urban areas - ring roads etc.	659	41	19	—	—	—	22	19	—	—
<b>Total</b>	<b>26,298</b>	<b>22,336</b>	<b>18,251</b>	<b>15,380</b>	<b>12,435</b>	<b>9,131</b>	<b>4,085</b>	<b>2,871</b>	<b>2,945</b>	<b>3,304</b>

Source: NHAI, Kotak Institutional Equities

## Details of projects recently awarded by NHAI on a PPP basis

Company	Projects awarded	Length (km)	TPC (Rs mn)
IVRCL	Four/six laning of NH-17 Mah/Goa border to Goa/Kar border	122	31,000
Reliance Infra	Six laning of Delhi-Agra highway	180	29,600
Era & OJSC	Four laning of Bareilly-Sitapur on NH-24, UP	151	17,230
GMR	Hungund-Hospet	97	17,000
L&T	Six laning of Krishnagiri-Walajahpet on NH 46, Tamil Nadu.	148	14,500
L&T	Six laning of Samakhiali Ghandhidham, Gujarat	56	14,000
Sadbhav	Bijapur-Hungund	97	12,500
IRB	Six laning of Tumkur -Chitradurga on NH-, Karnataka	114	12,000
Reliance Infra	Six laning of Hosur-Krishnagiri on NH-7, Tamil Nadu	60	9,250
Ashoka Buildcon	Four-laning of Sambalpur-Baragarh on NH-6, Orissa	88	9,090
GVK	Fur laning on the Deoli-Kota on NH-12, Rajasthan	83	8,500
Madhucon	Four laning of Chappra-Hajipur on NH-19, Bihar	64	8,300
Gayatri	Six laning of Indore-Dewas	45	6,020
ITNL & Ramky	Four Laning of Jorabat-Shillong on NH-40, Assam & Meghalaya	62	5,360
Ashoka Buildcon	Six-laning of Belgaum-Dharwad section of NH-4 , Karnataka	79	4,800
ITNL	Four laning of Chenani-Nashri of NH-1A, Jammu & Kashmir	41	NA
<b>Total</b>		<b>1,487</b>	<b>199,150</b>

Source: NHAI, News Runs, Kotak Institutional Equities

JUNE 28, 2010

UPDATE

BSE-30: 17,575

**South revisiting 3QFY10?** Cement prices in South came off by Rs20-25/bag in the latter half of May, as stabilization of newly commissioned capacities coupled with lackluster demand growth has failed to contain the deteriorating competitive forces, especially in the key state of Andhra Pradesh. In our view, ramp-up of production from newly commissioned capacities coupled with lean demand in the monsoon will likely keep cement prices under check.

#### Prices fall sharply in South, hold up in rest of India

All-India cement prices declined to Rs240/bag (Rs250/bag in April 2010) primarily driven by weakness in South India where cement prices fell by ~20-25/bag in the second half of the month. Cement prices in West also softened by ~Rs10/bag after 3 consecutive months of price increase while prices in rest of India remained largely unchanged in May 2010.

The weak pricing environment in South could be attributed to large capacity additions in the first 4 months of CY2010, especially in South India which added ~11mn tpa out of total addition of ~27 mn tpa. In our view, ramp-up of newly commissioned capacities will continue to keep cement prices under check over the next few months.

#### Dispatches remain sedate for second consecutive month

Cement dispatches in May 2010 continued to remain sedate with 8% yoy growth compared to 8.9% yoy growth in April 2010, after having completed FY2010 with a healthy 10.2% yoy growth in despatches. We are encouraged by higher despatch growth reported by Jaiprakash (53.6% yoy), India Cement (+11% yoy) and Shree Cements (15% yoy) though continue to remain concerned by ACC's (-2.2% yoy) negative growth in despatches on back of a moderate growth of 1.2% yoy in April 2010. We highlight that the timely onset of monsoons will likely bring an early halt to construction activity compared to the delayed and sparse monsoon during the same period last year.

#### Stocks continue to underperform

Cement stocks have corrected by 2.2% over the past one month and 16.2% in past 3 months, on the back of weak results in 4QFY10 and lower-than-expected price increases. We acknowledge that absolute downside from current levels is limited and valuations less demanding. However, the risks to earnings from (1) further deterioration in pricing environment as seen in South in May 2010, and (2) higher input costs, may lead to downward revision of earning and corresponding expansion of trading multiples. We maintain a BUY rating on Jaiprakash Associates and Shree Cement on account of (1) reasonable valuations, (2) strong volume growth and (3) cushion to earnings from non-cement business. We also have an ADD rating on Grasim Industries as the CMP implies a large 'holding company' discount for its ownership in the cement business, which in our view is unwarranted.

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**Exhibit 1: Despatch growth in May has been sedate**  
Cement despatch growth rate for major companies

	May-10	Growth (%)	
	(mn tons)	y-o-y	YTD
ACC	1.75	(2.2)	(0.5)
Ambuja Cements	1.80	9.9	12.9
Ultratech Cement	1.55	1.3	4.2
Grasim Industries	1.78	10.1	7.8
Shree Cement	0.85	15.1	4.9
India Cements	0.89	11.4	14.2
Madras Cements	0.63	4.5	6.9
Jaiprakash	1.24	53.6	52.5
<b>Industry</b>	<b>17.8</b>	<b>8.0</b>	<b>8.4</b>

Source: CMA, Kotak Institutional Equities

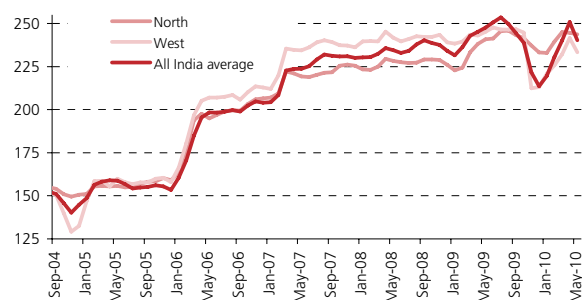
**Exhibit 2: Cement prices in South were weak in later half of May 2010**

Region-wise cement prices (Rs/bag)

	4QFY10	Jan-10	Feb-10	Mar-10	Apr-10	May-10
North	239	233	239	245	245	244
Central	249	230	254	262	252	248
East	254	246	254	261	265	263
West	226	221	226	232	242	233
South	207	195	206	220	252	228
<b>All India</b>	<b>230</b>	<b>220</b>	<b>231</b>	<b>240</b>	<b>251</b>	<b>240</b>

Source: CMA, Kotak Institutional Equities

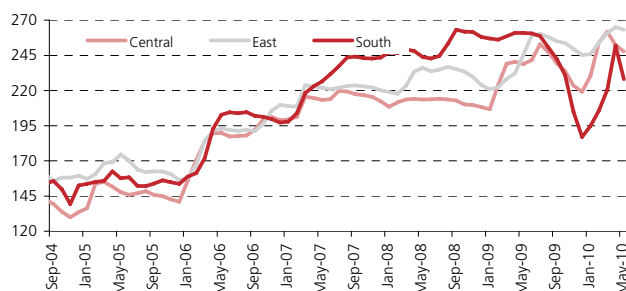
**Exhibit 3: All India average cement prices at Rs240/bag**  
Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities

**Exhibit 4: Volatility in cement prices have increased over the last few months**

Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities

**Exhibit 5: Cement stocks have under performed the Sensex in the last 1 month**  
Relative performance on cement stocks

	Change (%)					Relative change (%)			
	1-mo	3-mo	6-mo	1-year	CYTD	1-mo	3-mo	6-mo	1-year
Ambuja Cements	11.2	19.8	17.8	68.8	11.8	3.9	17.8	12.9	(13.9)
ACC	11.9	15.2	26.6	74.3	12.4	4.6	13.3	21.4	(11.1)
Grasim Industries	7.0	19.4	10.2	92.1	16.3	(0.0)	17.4	5.7	(2.0)
UltraTch Cement	11.3	25.4	52.4	18.4	21.8	4.0	23.3	46.1	(39.6)
India Cements	(0.7)	5.3	(2.8)	19.9	(1.1)	(7.2)	3.5	(6.8)	(38.8)
Shree Cement	15.8	25.0	54.7	277.3	19.7	8.2	22.9	48.3	92.5
<b>Cement</b>	<b>10.0</b>	<b>19.3</b>	<b>23.1</b>	<b>86.0</b>	<b>14.8</b>	<b>2.7</b>	<b>17.3</b>	<b>18.0</b>	<b>(5.1)</b>

Source: Kotak Institutional Equities



Exhibit 6: Cement comparative valuation

Company	Market cap. (US\$ mn)	CMP (Rs) 25-Jun	Target price (Rs)	Rating	EPS (Rs)				P/E (X)			
					2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
ACC	3,495	891	830	SELL	56	83	62	63	15	10	14	14
Ambuja Cements	3,850	117	98	SELL	7.2	8.0	7.9	8.1	16	15	15	15
Grasim Industries	3,561	1,799	2,150	ADD	239	301	240	282	8	6	7	6
India Cements	718	108	110	SELL	18	10	10	11	6	11	10	10
Shree Cement	1,523	2,025	2,550	BUY	175	208	221	242	12	10	9	8
UltraTech Cement	2,513	935	940	SELL	79	88	67	77	12	11	14	12

Company	EV/EBITDA (X)				EV/ton of production (US\$)				EV/ton of capacity (US\$)			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
ACC	7.7	5.6	6.5	5.7	154	151	139	118	151	142	120	106
Ambuja Cements	8.7	8.1	8.4	7.6	209	198	184	161	189	183	171	147
Grasim Industries	5.0	4.1	4.1	3.2	NA	NA	NA	NA	NA	NA	NA	NA
India Cements	4.8	5.7	5.6	5.4	118	95	88	85	108	80	83	75
Shree Cement	7.0	4.5	4.1	3.3	186	149	122	101	172	153	113	98
UltraTech Cement	7.0	5.5	6.2	5.1	150	123	108	90	143	106	102	86

Source: Kotak Institutional Equities estimates



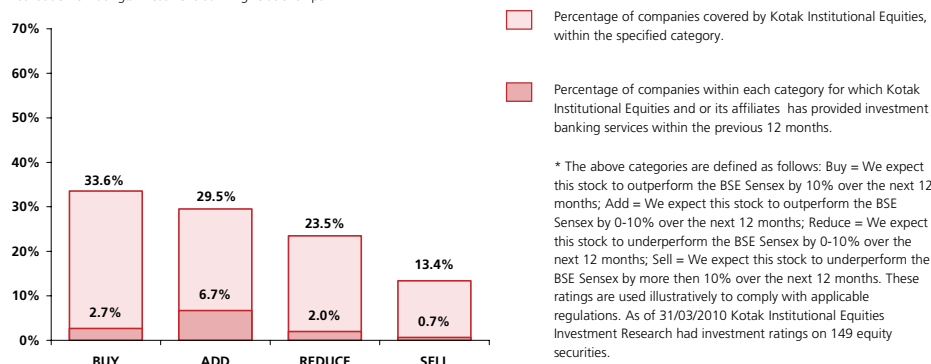




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Source: Kotak Institutional Equities

As of March 31, 2010

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**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.

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

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