Kotak Institutional Equities

INDIA DAILY

May 14, 2008

EQUITY MARKETS

		Change, %		
India	**13-May**	**1-day**	**1-mo**	**3-mo**
Sensex	16,753	(0.6)	6.0	(5.7)
Nifty	4,958	(1.1)	3.8	(4.7)
Global/Regional indices				
Dow Jones	12,832	(0.3)	4.3	3.7
Nasdaq Composite	2,495	0.3	9.6	7.0
FTSE	6,212	(0.1)	6.5	5.7
Nikkie	13,952	(0.0)	8.0	2.4
Hang Seng	25,355	(0.8)	6.5	5.6
KOSPI	1,840	(0.2)	5.3	8.4

Value traded - India

		Moving avg, Rs bn		
	13-May		**1-mo**	**3-mo**
Cash (NSE+BSE)	206.9		199.8	193.6
Derivatives (NSE)	381.1		410.0	376
Deri. open interest	742.1		610	679

Contents

Results

GAIL (India): 4QFY08 results—'low' provisional subsidy loss a positive surprise

Updates

Dish TV: Robust subscriber addition in April 2008; new schemes to entice users

Energy: Oil bonds at 50% of gross under-recoveries, short of petroleum ministry's proposed 57%

Forex/money market

		Change, basis points		
	13-May	**1-day**	**1-mo**	**3-mo**
Rs/US$	42.2	0	220	260
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	(2)	(11)	44

Net investment (US$mn)

	12-May		**MTD**	**CYTD**
FIIs	(92)		(78)	(2,792)
MFs	(15)		9	1,611

Top movers -3mo basis

		Change, %		
Best performers	**13-May**	**1-day**	**1-mo**	**3-mo**
Thomas Cook	102	1.6	4.5	54.0
NALCO	481	6.6	14.1	37.2
Nestle India	1,872	1.4	23.6	41.3
i-Flex	1,326	8.0	21.8	29.6
Ranbaxy	487	(1.6)	9.4	28.0
Worst performers				
Reliance Cap	1,287	(1.3)	0.4	(35.3)
Thermax	456	(0.8)	(10.6)	(30.4)
BoB	295	1.6	0.1	(26.0)
Siemens India	566	(0.5)	(8.7)	(27.1)
Essel Propack	35	(1.8)	(12.0)	(24.3)

News Roundup

Corporate

- A statement from India's Bharti Airtel highlighting discussions with South Africa's MTN on synergies has led bankers to infer that a merger might be on the cards (rather than a 'bid') under which MTN shareholders could get a combination of cash and equity in Bharti Airtel in return for the Indian company acquiring control in MTN. (Media reports)
- Hewlett-Packard (HP) has agreed to buy Electronic Data Systems (EDS) for US$13.9 bn. Bangalore-based MphasiS, in which EDS holds 60.9% of equity, is expected to be delisted in Indian bourses.

Economic and political

- Terrorists struck Jaipur, triggering eight serial blasts in 12 minutes last evening in crowded market areas and near a temple leaving at least 60 killed and 200 injured. (BS)
- A new proposal has been approved by the Securities and Exchange Board by which retail investors in IPOs will not have to pay the entire application money upfront but will be permitted to retain the funds in their own accounts until the allotment is finalised. The finer details of this mechanism are being worked out. (Media reports)
- The US is keenly looking at introducing a 50-50 law, under which Indian IT companies will have to employ 50% Americans in their US operations. (FE)

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

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Energy

GAIL.BO, Rs409	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	440
52W High -Low (Rs)	556 - 281
Market Cap (Rs bn)	345.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	197.0	222.9	278.4
Net Profit (Rs bn)	26.0	27.6	30.2
EPS (Rs)	30.8	32.6	35.7
EPS gth	*21.7*	*6.0*	*9.4*
P/E (x)	13	12.5	11.5
EV/EBITDA (x)	7.6	7.1	6.3
Div yield (%)	2.4	2.7	2.9

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.3	-	-
FIIs	20.0	0.8	(0.1)
MFs	3.3	0.8	(0.1)
UTI	-	-	(0.9)
LIC	6.0	1.4	0.5

GAIL (India): 4QFY08 results—'low' provisional subsidy loss a positive surprise

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- **4QFY08 results helped by 'low' provisional subsidy burden**
- **Significant risk due to high subsidy burden and imminent regulations**
- **Revised earnings and 12-month SOTP-based target price to Rs440 (Rs425 previously)**

GAIL (India) reported 4QFY08 net income at Rs7.2 bn versus our expected Rs6.9 bn and Rs6.8 bn in 4QFY07. GAIL's 4QFY08 EBITDA was Rs11.6 bn versus our expected Rs9.3 bn and Rs6.0 bn in 4QFY07. The variance was due to (1) lower-than-expected subsidy loss (provisional) at Rs3.8 bn versus our expected Rs5.5 bn, (2) surprisingly lower raw material costs at Rs3.6 bn (-23.7% qoq) and (3) lower other expenditure; this was partially compensated by higher-than-expected employee costs at Rs2.2 bn due to a provision for pending pay revision. The management has not given any clarification regarding the sharp decline in raw material costs despite significantly higher volumes qoq. We have revised our FY2009E and FY2010E EPS estimates to Rs32.6 and Rs35.7, respectively, from Rs32.0 and Rs34.9, respectively, to reflect (1) higher subsidy losses (-ve impact), (2) higher petrochemical and LPG prices (+ve) and (3) weaker rupee (+ve). We have revised our 12-month SOTP-based target price to Rs440 from Rs425 previously to reflect higher EBITDA for LPG production and petrochemical segments (see Exhibit 1). Key downside risks stem from higher-than-expected subsidy losses, weaker-than-expected commodity prices and imminent regulations.

4QFY08 results helped by lower-than expected 'provisional' subsidy burden. Exhibit 2 gives details of GAIL's 4QFY08 and FY2008 results.

1. **Subsidy loss on provisional basis seems very low.** GAIL's 4QFY08 subsidy amount increased 5.4% qoq and declined 22.9% yoy to Rs3.87 bn. However, the amount is significantly lower versus our expectations of Rs5.5 bn in the context of increased industry gross under-recoveries on higher crude prices. Based on GAIL's share of gross under-recoveries in 9MFY08 at 5.8%, the gross under-recoveries for 4QFY08 works out to Rs200 bn, which is significantly lower versus our estimate of Rs280 bn. GAIL's FY2008 subsidy amount decreased 11.7% to Rs 13.1 bn versus Rs14.9 bn in FY2007. The provisional subsidy amount seems low given that gross under-recoveries have jumped 51% in FY2008 although the share of upstream companies was higher at 42.7% of gross under-recoveries in FY2007 versus 33.33% assumed currently.

2. **Employee costs.** Employee costs rose to Rs2.2 bn (+124%qoq and +170% yoy) due to a one-off provision for the pending pay revision. GAIL provided Rs1.3 bn in 4QFY08 for the pending pay revision on an estimated basis for the period January 1, 2007-March 31, 2008. The company has also adopted AS-15 (Accounting Standard for retirement benefits), which resulted in an additional charge of Rs204 mn in 4QFY08.

3. **Raw material costs.** Raw material costs declined significantly to Rs3.7 bn (-23.7% qoq and -20.3% yoy). The management has not given any clarification regarding the sharp decline in raw material costs; the decline is surprising given significantly higher volumes qoq.

4. P**etrochemicals segment's EBIT increased 59% qoq (Rs1.3 bn)** to Rs3.6 bn led by higher sales volumes (+34.6% qoq) and higher sales (+38.8%). On a yoy basis, EBIT increased significantly 20.6% yoy (Rs620 mn), which is surprising given flat sales and increase in sales volume by 10.1%. The steep increase in sales volumes qoq is due to a shutdown at GAIL's plant at Auraiya in 3QFY08 (in the month of October). This also explains the increase in LPG volumes, whose sales volumes increased 7.2% and 5.5% qoq, respectively.

Key downside risks to earnings

1. **Subsidy burden issue seems to be going out of 'control'.** We believe that high crude prices will continue to create uncertainty about GAIL's subsidy burden and earnings without a proper subsidy-sharing system. The government has still not decided the scheme for FY2008E and the finance ministry has reportedly refused to give oil bonds pertaining to 57% of gross under-recoveries as requested by the petroleum ministry. The ad hoc approach creates uncertainty regarding the earnings of upstream companies. GAIL has provided for Rs13 bn as subsidy burden for FY2008; however, this seems to be very low as discussed above.

   We fear that FY2009E will only be worse for the industry given the likely high under-recoveries at current level of crude price. Exhibit 3 shows that gross under-recoveries may be significantly higher in FY2009E versus FY2008E; we compute gross under-recoveries at Rs1.7 tn at US$110/bbl compared to Rs0.75 tn in FY2008E (US$79/bbl crude price). We apprehend that the government may increase the subsidy burden to be borne by upstream companies from 33.33% currently.

2. **Risks from imminent regulations.** We believe that the key to stock price will be the likely strong volume growth in gas transportation volumes beyond FY2010E and the likely impact of regulations which may result in declining tariffs, profits from extant pipelines. We expect GAIL's gas transportation volumes to increase significantly beyond FY2010E propelled by a steep increase in domestic gas volumes. GAIL has proposed to build 5,052 kms of pipelines (seven new ones) at a cost of Rs246 bn (see Exhibit 4).

   However, GAIL's future profits from its key gas transmission business will likely be determined by regulations for gas transmission networks to be notified by the Petroleum and Natural Gas Regulatory Board (PNGRB). The regulator has already notified city gas distribution regulations capping returns at 14% (post tax) ROCE. We expect the regulations for a gas transportation sector network to be similar to the regulations applicable for a single bid in a CLGD network

   Exhibit 5 gives our computation of GAIL's ROCE for its various segments based on FY2008 and FY2007 data. The pipeline segment shows a ROCE of 18.8% for FY2008 and 25.7% for FY2007. The decline in FY2008 reflects addition of new assets but limited revenues and profits on those assets. We clarify that the computed ROCE is on the current capital employed (end-FY2008), which may or may not be the base for computation of regulated tariffs. The regulator may decide to use a different capital employed (total investment in pipeline and associated infrastructure since inception of a pipeline [GCI] or replacement value).

Earnings revisions. We have made minor revisions to our earnings model—(1) higher subsidy losses, (2) higher LPG prices based on higher crude prices, (3) weaker rupee and (4) other minor changes. Exhibit 6 gives our key assumptions and Exhibit 7 gives key financials.

FY2009. We have revised FY2009E EPS to Rs32.6 from Rs32 previously to reflect (1) higher LPG prices based on higher crude prices (US$100/bbl versus US$90/bbl previously) and (2) higher subsidy burden at Rs25 bn compared to Rs20 bn previously. Subsidy loss was Rs13.1 bn for FY2008 with crude prices at US$79/bbl. We assume the share of upstream companies at 33.33% of the gross under-recoveries for FY2009E.

FY2010. We have revised FY2010E EPS to Rs35.7 from Rs34.9 based on a rationale similar to that discussed above for FY2009E. Our revised subsidy loss assumption is Rs22 bn versus Rs18 bn previously.

We value GAIL stock at Rs440 per share

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

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		
	Replacement cost	EBITDA	EV/RC	EV/EBITDA	Replacement cost basis	EBITDA basis	EV (Rs/share)
Natural gas/LPG transportation		15		6.0		93	110
LPG production		37		4.0		147	174
Petrochemicals		10		4.0		39	46
Oil and gas upstream	17		1.00		17		21
Subsidy sharing scheme		(25)		1.0		(25)	(30)
Investments	94		0.80		75		88
ONGC shares	68		0.80		54		64
Others	25		0.80		20		24
Total		**37**				**254**	**410**
Net debt/(cash)					(20)	(20)	(23)
Implied value of share (Rs/share)							**433**

Source: Kotak Institutional Equities estimates.

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

	qoq			yoy			yoy		
	4Q 2008	**3Q 2008**	***% chg***	**4Q 2008**	**4Q 2007**	***% chg***	**FY2008**	**FY2007**	***% chg***
Sales	49,353	42,983	*14.8*	49,353	38,834		180,082	160,472	
Total expenditure	37,753	34,261	*10.2*	37,753	32,810	*15.1*	140,590	130,499	*7.7*
(Inc)/dec in stock	(821)	547		(821)	(284)		(299)	(753)	
Purchase	28,890	24,190	*19.4*	28,890	23,368	*23.6*	102,007	94,290	*8.2*
Raw material	3,607	4,725	*(23.7)*	3,607	4,527	*(20.3)*	17,148	17,851	*(3.9)*
Staff cost	2,203	985	*123.6*	2,203	816	*169.9*	4,700	2,923	*60.8*
Other expenditure	3,874	3,814	*1.6*	3,874	4,383	*(11.6)*	17,033	16,187	*5.2*
EBITDA	**11,600**	**8,723**	***33.0***	**11,600**	**6,024**	***92.6***	**39,492**	**29,973**	***31.8***
Other income	997	1,848	*(46.1)*	997	1,129	*(11.7)*	5,564	5,450	*2.1*
Interest	195	196	*(0.1)*	195	221	*(11.7)*	796	1,071	*(25.7)*
Depreciation	1,425	1,387	*2.7*	1,425	1,471	*(3.2)*	5,710	5,754	*(0.8)*
Pretax profits	**10,976**	**8,988**	*22.1*	**10,976**	**5,461**	*101.0*	**38,550**	**28,598**	*34.8*
Tax	4,328	2,429	*78.2*	4,328	1,779	*143.3*	12,525	7,941	*57.7*
Deferred	(576)	346	*(266.3)*	(576)	274	*(310.4)*	10	190	*(94.6)*
Prior period adjust.	—	—		—	3,399		—	3,399	
Net income	**7,224**	**6,213**	*16.3*	**7,224**	**6,807**	*6.1*	**26,015**	**23,867**	*9.0*
Tax rate (%)	34.2	30.9		34.2	37.6		32.5	28.4	
Volume data									
Gas sales (mcm/d)	68.8	69.1	*(0.4)*	68.8	68.9	*(0.2)*	69.4	67.8	*2.3*
Gas transmission (mcm/d)	82.2	85.3	*(3.7)*	82.2	79.7	*3.0*	82.5	77.3	*6.8*
LPG transported ('000 tons)	783	710	*10.3*	783	659	*18.8*	2,754	2,491	*10.6*
LPG production ('000 tons)	254	237	*7.2*	254	258	*(1.6)*	1,044	1,026	*1.8*
LPG sales ('000 tons)	250	237	*5.5*	250	260	*(3.8)*	1,039	1,038	*0.1*
Other liquids prodn ('000 tons)	78	70	*11.4*	78	83	*(6.0)*	305	317	*(3.8)*
Other liquids sales ('000 tons)	73	72	*1.4*	73	81	*(9.9)*	304	314	*(3.2)*
Polymers ('000 tons)-prodn	109	77	*41.6*	109	99	*10.1*	386	354	*9.0*
Polymers ('000 tons)-sales	109	81	*34.6*	109	99	*10.1*	391	347	*12.7*
Subsidy payment	(3,872)	(3,675)	*5.4*	(3,872)	(5,020)	*(22.9)*	(13,137)	(14,880)	*(11.7)*
Segment revenue (Sales/Income)									
Transmission services									
(1) Natural gas	5,762	6,022	*(4.3)*	5,762	4,762	*21.0*	22,865	22,144	*3.3*
(2) LPG	1,079	996	*8.4*	1,079	915	*17.9*	3,893	3,440	*13.2*
Natural gas trading	33,802	31,120	*8.6*	33,802	29,701	*13.8*	126,577	120,208	*5.3*
Petrochemicals	7,467	5,378	*38.8*	7,467	7,437	*0.4*	25,912	25,702	*0.8*
LPG and liquid hydrocarbons	7,898	5,278	*49.6*	7,898	4,332	*82.3*	26,614	21,219	*25.4*
Telecom	72	70	*2.0*	72	69	*3.3*	286	254	*12.6*
Unallocated	1,055	1,571	*(32.9)*	1,055	984	*7.2*	5,064	5,097	*(0.7)*
Total	57,133	50,435	*13.3*	57,133	48,200	*18.5*	211,210	198,063	*6.6*
Less: Inter-segment revenue	6,784	5,604	*21.1*	6,784	6,844	*(0.9)*	25,564	27,155	*(5.9)*
Sales/Income from operations	**50,350**	**44,832**	***12.3***	**50,350**	**41,356**	***21.7***	**185,646**	**170,908**	***8.6***
Segment results (Profit before tax and interest)									
Transmission services									
(1) Natural gas	3,755	4,141	*(9.3)*	3,755	2,767	*35.7*	15,535	15,154	*2.5*
(2) LPG	688	565	*21.8*	688	487	*41.3*	2,318	1,906	*21.6*
Natural gas trading	692	402	*0.0*	692	492	*40.4*	2,044	1,943	*5.2*
Petrochemicals	**3,628**	**2,288**	*58.6*	**3,628**	**3,008**	*20.6*	12,542	9,545	*31.4*
LPG and liquid hydrocarbons	3,533	1,252	*182.2*	3,533	(732)	*(582.7)*	9,004	1,022	*781.5*
Telecom	4	8	*(51.2)*	4	5	*(25.9)*	31	10	*220.6*
Total	12,300	8,656	*42.1*	12,300	6,028	*104.1*	41,475	29,579	*40.2*
Less: Interest	195	196	*(0.1)*	195	221	*(11.7)*	796	1,071	*(25.7)*
Less: Other unallocable exp (net)	1,128	(528)	*(313.8)*	1,128	346	*226.4*	2,129	(90)	*(2,473.7)*
Total PBT	**10,976**	**8,988**	***22.1***	**10,976**	**5,461**	***101.0***	**38,550**	**28,598**	***34.8***
Capital employed									
Transmission services									
(1) Natural gas	54,162	52,395		54,162	37,011		54,162	37,011	
(2) LPG	9,883	9,967		9,883	10,510		9,883	10,510	
Petrochemicals	20,021	20,331		20,021	19,128		20,021	19,128	
LPG and liquid hydrocarbons	10,352	9,357		10,352	8,970		10,352	8,970	
Telecom	373	407		373	475		373	475	
Total	**94,791**	**92,456**		**94,791**	**76,094**		**94,791**	**76,094**	

Source: Kotak Institutional Equities estimates, company reports.

Gross under-recoveries will likely be significantly higher in FY2009E
Share of various participants of under-recoveries, March fiscal year-ends, 2006-2009E (Rs bn)

	2006	2007	2008E	2009E			yoy 9M 2008	9M 2007	% chg
Dated Brent crude oil price (US$/bbl)	57	65	79	80	95	110	74	67	*11*
Subsidy loss	**400**	**494**	**706**	**639**	**1,159**	**1,732**	**479**	**405**	***18***
Payment by government (oil bonds)	**115**	**241**	**350**	**317**	**575**	**859**	**203**	**192**	***6***
Share of BPCL	22	53	79	72	72	195	46	43	*6*
Share of HPCL	23	49	73	66	66	180	43	39	*8*
Share of IOCL	70	138	197	179	179	484	115	109	*5*
Net under-recovery of oil companies	**285**	**253**	**356**	**322**	**584**	**873**	**275**	**214**	***29***
Share of refining companies	27	—	—	—	—	—	—	3	—
Share of upstream companies	**140**	**205**	**235**	**213**	**386**	**577**	**160**	**149**	***7***
Share of ONGC	120	170	199	181	327	489	135	124	*9*
Share of GAIL (b)	11	15	14	12	22	34	9.3	9.9	*(6)*
Share of Oil India	10	20	22	20	36	54	15	16	*(5)*
Net under-recovery of R&M companies	**118**	**48**	**121**	**109**	**198**	**296**	**116**	**64**	***80***
Pre-tax profits of R&M companies	**74**	**96**					**139**	**66**	

Note:
(a) Share of oil bonds assumed at 57%.
(b) GAIL gas provided for Rs 13 bn as subsidy loss on provisonal basis for FY2008.

Source: Kotak Institutional Equities estimates.

GAIL's proposed augmentation of pipeline network will take time to develop
Proposed capital expenditure plan, March fiscal year-ends, 2008E-2012E (Rs mn)

Natural gas pipelines	Project cost (Rs mn)	Length (Kms)	Comments
Vijaipur-Dadri-Bawana-Nangal pipeline	54,920	1,181	Completion targeted for June 2010
Chainsa-Gurgaon-Jhajar-Hissar	5,360	310	Completion targeted for September 2009
Jagdishpur-Haldia	65,000	876	Unlikely before CY2011; contingent on Reliance group's Kakinada-Haldia pipeline
Dabhol-Bangalore	35,680	730	Contingent on development of Dabhol LNG terminal and availability of surplus LNG
Kochi-Kanjirrkod-Bangalore/Mangalore	35,000	840	Unlikely before CY2011; contingent on start of Petronet LNG's Kochi terminal
Dahej-Vijapur expansion	25,000	610	
Vijaipur-Auraiya-Jagdishpur	25,000	505	
Total	**245,960**	**5,052**	

Source: Kotak Institutional Equities estimates.

GAIL's earnings may be at risk if impending regulations are less favorable versus street expectations
Return on capital employed for various segments of GAIL

	Transmission	Petrochemicals	LPG and liquid HCs
FY2007			
EBIT (Rs mn)	17,060	9,545	1,022
EBIT * (1-t)	12,215	6,834	731
Capital employed (Rs mn)	47,521	19,128	8,970
ROCE (%)	**25.7**	**35.7**	**8.2**
FY2008			
EBIT (Rs mn)	17,853	12,542	9,004
EBIT * (1-t)	12,051	8,466	6,078
Capital employed (Rs mn)	64,045	20,021	10,352
ROCE (%)	**18.8**	**42.3**	**58.7**

Source: Company, Kotak Institutional Equities.

We model strong increase in gas volumes between FY2007 and FY2010

Key assumptions behind GAIL model, March fiscal year-ends, 2004-2010E

	2004	2005	2006	2007	2008E	2009E	2010E
Volumes							
Natural gas transportation, gross (mcm/day)							
HBJ pipeline	32	32	32	32	32	32	32
Other pipelines	31	36	36	39	40	42	48
Regassified LNG							
Dahej-Vijaipur pipeline (transmitted and sold)		2	7	6	9	9	15
Dahej-Vijaipur pipeline (transmitted)		1	4	4	6	6	10
Dahej-Uran pipeline					6	12	12
Panvel-Dabhol pipeline					4	6	8
Elimination of double-counted volumes (a)			(1)	(3)	(15)	(18)	(20)
Total gas transmission	**63**	**72**	**79**	**77**	**82**	**89**	**105**
LPG (000 tons)							
Sold	1,089	1,089	1,039	1,037	1,039	1,100	1,100
Transported	1,841	2,138	2,228	2,490	2,700	2,800	2,800
Petrochemicals (000 tons)							
Polyethylene							
Domestic sales	225	279	271	337	375	420	420
Exports	40	40	40	10	10	—	—
Total petrochemicals	**265**	**319**	**311**	**347**	**385**	**420**	**420**
Prices							
Natural gas (Rs/cubic meter)							
Natural gas ceiling price	2.85	2.85	3.52	4.21	5.24	5.83	6.42
Regassified LNG including transportation	6.61	6.50	6.47	6.93	6.44	6.35	7.79
Transmission plus marketing charges							
HBJ pipeline, Dahej-Vijaipur pipeline (from FY2007)	1.15	1.15	1.15	0.99	0.96	0.96	0.97
Dahej-Vijaipur, Dahej-Uran, Panvel-Dabhol pipeline	0.69	0.67	0.69	0.99	1.03	1.04	1.04
Other pipelines	0.40	0.41	0.42	0.40	0.42	0.44	0.46
LPG							
LPG (US$/ton)	319	399	510	531	702	855	814
Transmission charges (Rs/ton)							
Jamnagar-Loni	1,436	1,522	1,522	1,522	1,522	1,522	1,522
Vizag-Secunderabad	1,450	1,450	1,450	1,450	1,450	1,450	1,450
Other assumptions							
Polyethylene, HDPE (US$/ton)	680	990	1,055	1,315	1,500	1,635	1,535
Import tariff, Polyethylene	28%	17%	10%	5%	5%	5%	5%
Import tariff, LPG	10%	7%	0%	0%	0%	0%	0%
Exchange rate (Rs/US$)	46.0	45.0	44.3	45.3	40.3	39.5	38.5
Subsidy losses	4,280	11,380	10,640	14,880	13,137	25,000	22,500

Note:

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

Source: Company, Kotak Institutional Equities estimates.

Media

DSTV.BO, Rs52	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	65
52W High -Low (Rs)	143 - 34
Market Cap (Rs bn)	22.3

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	4.2	7.7	12.1
Net Profit (Rs bn)	(4.1)	(4.1)	(2.7)
EPS (Rs)	(9.5)	(9.5)	(6.4)
EPS gth	-	-	-
P/E (x)	(5.5)	(5)	(8.2)
EV/EBITDA (x)	(13.3)	(29.3)	35.4
Div yield (%)	-	-	-

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	57.9	-	-
FIIs	15.3	0.1	(0.0)
MFs	4.3	0.1	0.0
UTI	-	-	(0.1)
LIC	2.7	0.1	(0.0)

Dish TV: Robust subscriber addition in April 2008; new schemes to entice users

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- **Robust gross subscriber addition of 99,500 for the month of April 2008**
- **New schemes announced to increase volumes before competition starts operations**
- **Rights issue for raising capital to sustain aggressive subscriber addition and capex**
- **Retain ADD with 12-month DCF-based target price of Rs65**

Dish TV announced robust gross subscriber addition of 99,500 subscribers for the month of April 2008; we model Dish TV to add 91,667 gross subscribers and 73,333 net subscribers (adjusted for churn) every month in FY2009E. Dish TV also announced new schemes to ramp up its monthly subscriber addition and to lock in a captive set of subscribers, given the mechanics of the scheme, before strong competition in the form of Big TV (Reliance ADAG) and Bharti start commercial operations. Dish TV is offering 12 months of premium service and set-top box (STB) for an upfront payment of Rs3,990; this is at a discount of Rs1,000 to its previous offering. Dish TV also announced its rights issue in order to raise capital to sustain its aggressive subscriber acquisition strategy. We retain our ADD rating on Dish TV with a 12-month DCF-based target price of Rs65, pending 4QFY08 results. Key risks stem from lower-than-expected ARPUs and stronger-than-expected emerging competition.

Robust subscriber addition in April 2008. Dish TV reported gross subscriber addition of 99,500 for the month of April 2008, moderately ahead of our expectation. We model gross subscriber addition of 1.1 mn in each of FY2009E, FY2010E and FY2011E and Dish TV would need to add 91,667 subscribers every month to achieve our numbers. We model a churn rate of 7% on average subscriber base of Dish TV for FY2009E, FY2010E and FY2011E; we expect Dish TV to add 0.88 mn, 0.82 mn and 0.76 mn net paying subscribers in FY2009E, FY2010E and FY2011E. The company has not disclosed the net subscriber addition for the month and is likely to report the net paying subscriber base figures on a quarterly basis.

New schemes to accelerate subscriber addition. Dish TV announced some new schemes (see Exhibit 1) to accelerate its subscriber volume before new competition in the form of Big TV and Bharti start commercial services in the coming months. Moreover, the schemes are structured to (1) lock in consumers for long periods and (2) let consumers try the premium packages of Dish TV at substantial discount, which will likely (a) increases subscriber stickiness and (b) persuade a majority of the subscribers to stick with the premium packages once the discount period is over. We believe such schemes will be instrumental in maintaining the subscriber addition momentum Dish TV has gained in the past few months.

Higher subsidy a cause for concern given weak balance sheet. We have previously highlighted the inherent risk in the weak balance sheet of Dish TV versus strong well-capitalized competition. Dish TV has been aggressive in acquiring new subscribers and funding its capex plans through high-cost debt; we believe this is not sustainable since the DTH is a loss-making emerging business and Dish TV will need equity infusion at some point to sustain its aggressive consumer acquisition strategy. We note that the higher subsidy element inherent in the new schemes (see Exhibit 2) while supportive of subscriber addition, will be a strain on the financials of Dish TV in the near term; we model Dish TV's capital requirement at Rs8.6 bn over FY2009-11E though higher-than-expected subscriber addition will necessitate higher spending. Dish TV has announced a rights issue to raise equity capital (up to Rs12 bn).

Comparison of new Dish TV schemes with schemes running previously

	Scheme 1	Scheme 2	Scheme 3	Scheme 4
Revised schemes				
Set-top box	yes	yes	yes	NA
# of free premium months of service	12	6	3	NA
# of free movies-on-demand	53	40	33	NA
Initial payment (Rs)	3,990	2,990	2,490	NA
Previous schemes				
Set-top box	yes	yes	yes	yes
# of free premium months of service	12	6	3	—
# of free movies-on-demand	12	6	3	—
Initial payment (Rs)	4,990	3,590	3,150	990

Source: Company, Kotak Institutional Equities estimates.

The value of subscriber subsidy on new schemes depends on the value of free movies-on-demand
Economics of various DTH service schemes offered by Dish TV

	New 12-month scheme	Old 12-month scheme	Old STB-only scheme
Initial upfront payment (Rs)	3,990	4,990	990
Average price of service package (Rs)	300	300	250
# of months of service	12	12	12
# of free premium months of service	12	12	—
Total realization over 12 months (Rs)	**3,990**	**4,990**	**3,990**
Average cost of service package (Rs)	180	180	150
Total cost of content over 12 months (Rs)	2,160	2,160	1,800
Total other variable expenses over 12 months (Rs)	360	360	330
Total cost of equipment (STB+antenna+VC) (Rs)	3,000	3,000	3,000
Total cost of installation (Rs)	300	300	300
Total subs cost over 12 months (Rs)	**5,820**	**5,820**	**5,430**
Value of subscriber subsidy (Rs)	**1,830**	**830**	**1,440**
# of free movies-on-demand	**53**	**12**	**—**

Source: Kotak Institutional Equities estimates.

Pricing has a more significant impact on valuation of Dish TV than volume
Sensitivity of Dish TV's valuation to number of subscribers and subscription fees

	DCF value (Rs/share)	Change from base case (%)
Change in # of paying subscribers (%)		
20%	79	23
10%	72	12
Base case	**64**	
-10%	57	(12)
-20%	49	(23)
Change in monthly subscription fees (%)		
20%	146	128
10%	105	64
Base case	**64**	
-10%	33	(49)

Source: Kotak Institutional Equities estimates.

Dish's subscribers will likely increase to 4.3 mn by FY2010E and to 7.0 mn by FY2015E

Key financial and operating data of Dish TV, March fiscal year-ends, 2007E-2017E

	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues (Rs bn)	1.9	4.2	7.7	12.1	17.3	21.5	25.0	28.6	31.9	35.2	38.3	41.3	44.2
EBITDA (Rs bn)	(1.9)	(2.1)	(1.1)	1.0	3.5	5.0	6.0	7.1	8.0	8.9	9.7	10.5	11.3
EBITDA margin (%)	**(97.0)**	**(49.7)**	**(14.7)**	**8.4**	**20.1**	**23.3**	**23.9**	**24.7**	**24.9**	**25.2**	**25.2**	**25.5**	**25.5**
Year-end # of paying subscribers (mn)	**1.7**	**2.6**	**3.4**	**4.3**	**5.0**	**5.6**	**6.2**	**6.6**	**7.0**	**7.3**	**7.6**	**7.7**	**7.9**
Increase/(decrease) in # of paying subs (mn)	0.9	0.9	0.9	0.8	0.8	0.6	0.6	0.4	0.4	0.3	0.3	0.1	0.1
Average # of paying subscribers (mn)	1.2	2.1	3.0	3.8	4.6	5.3	5.9	6.4	6.8	7.2	7.4	7.7	7.8
Subscription fees per month (Rs/sub/month)	98	133	183	229	276	302	322	343	362	383	405	428	452
ARPU (Rs/sub/month)	**113**	**156**	**210**	**259**	**307**	**333**	**350**	**369**	**387**	**406**	**426**	**448**	**470**

Source: Kotak Institutional Equities estimates.

Our DCF-based target price for Dish TV is Rs65

Discounted cash flow analysis of Dish TV (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	**(1,131)**	**1,019**	**3,475**	**5,008**	**5,987**	**7,056**	**7,954**	**8,882**	**9,667**
Tax expense	—	—	—	(220)	(350)	(467)	(566)	(670)	(2,292)
Working capital changes	72	933	539	843	798	589	615	315	347
Cash flow from operations	**(1,059)**	**1,952**	**4,013**	**5,631**	**6,435**	**7,177**	**8,003**	**8,526**	**7,723**
Capital expenditure	(3,277)	(3,118)	(2,967)	(3,588)	(3,548)	(3,270)	(3,219)	(2,952)	(2,883)
Free cash flow to the firm	**(4,336)**	**(1,166)**	**1,046**	**2,043**	**2,887**	**3,908**	**4,784**	**5,574**	**4,840**

	Now	+ 1-year	+ 2-years
Total PV of free cash flow (a)	**9,539**	**16,699**	**21,709**
FCF one-year forward	5,695	6,036	6,399
Terminal value	81,353	86,234	91,409
PV of terminal value (b)	**21,230**	**22,504**	**23,854**
Total PV (a) + (b)	**30,769**	**39,202**	**45,563**
Net debt	6,396	11,774	14,727
Equity value	24,373	27,429	30,836
Equity value (US$ mn)	**539**	**686**	**801**
Shares outstanding (mn)	428	428	428
Equity value/per share (Rs)	**57**	**64**	**72**

Discount rate (%)	13.0
Growth from 2017 to perpetuity (%)	6.0
Exit free cash multiple (X)	14.3
Exit EBITDA multiple (X)	7.7

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Dish TV, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008E	2009E	2010E	2011E	2012E
Profit model							
Net revenues	315	1,909	4,193	7,698	12,105	17,294	21,476
EBITDA	**(830)**	**(1,852)**	**(2,082)**	**(1,131)**	**1,019**	**3,475**	**5,008**
Other income	—	34	36	40	45	38	40
Interest (expense)/income	(17)	(118)	(491)	(825)	(1,129)	(1,259)	(1,164)
Depreciation	(18)	(565)	(1,466)	(2,171)	(2,797)	(3,304)	(3,096)
Amortization	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Pretax profits	**(875)**	**(2,511)**	**(4,013)**	**(4,098)**	**(2,874)**	**(1,061)**	**778**
Extraordinary items	(1,203)	(5)	—	—	—	—	—
Tax	—	(3)	—	—	—	—	(88)
Deferred taxation	—	—	(61)	10	142	267	134
Net income	**(2,078)**	**(2,519)**	**(4,074)**	**(4,087)**	**(2,731)**	**(794)**	**823**
Earnings per share (Rs)	**—**	**(5.9)**	**(9.5)**	**(9.5)**	**(6.4)**	**(1.9)**	**1.9**
Balance sheet							
Total equity	1,915	(395)	(4,344)	(8,432)	(11,288)	(12,081)	(11,258)
Deferred taxation liability	—	—	61	51	(91)	(358)	(492)
Total borrowings	84	1,751	6,494	11,994	14,994	14,994	13,994
Current liabilities	1,820	8,596	8,493	8,137	8,896	9,838	11,322
Total liabilities and equity	**3,819**	**9,952**	**10,704**	**11,751**	**12,511**	**12,392**	**13,566**
Cash	59	113	98	220	267	15	309
Other current assets	1,528	2,271	1,253	1,082	1,485	1,965	2,362
Total fixed assets	1,067	6,107	7,902	9,008	9,328	8,991	9,484
Intangible assets	75	516	506	496	486	476	466
Investments	1,089	945	945	945	945	945	945
Total assets	**3,819**	**9,952**	**10,704**	**11,751**	**12,511**	**12,392**	**13,566**
Free cash flow							
Operating cash flow, excl. working capital	(850)	(1,814)	(2,574)	(1,956)	(111)	2,215	3,755
Working capital changes	599	3,507	915	(184)	356	461	1,087
Capital expenditure	(1,025)	(2,921)	(3,262)	(3,277)	(3,118)	(2,967)	(3,588)
Investments	185	(451)	—	—	—	—	—
Other income	3	5	36	40	45	38	40
Free cash flow	**(1,088)**	**(1,674)**	**(4,884)**	**(5,377)**	**(2,828)**	**(253)**	**1,294**
Ratios (%)							
Debt/equity	4.4	(443.6)	(149.5)	(142.2)	(132.8)	(124.1)	(124.3)
Net debt/equity	1.3	(414.9)	(147.2)	(139.6)	(130.5)	(124.0)	(121.6)
ROAE (%)	(217.0)	(331.3)	174.2	64.6	27.6	6.7	(6.8)
ROACE (%)	**(89.6)**	**(283.2)**	**(200.5)**	**(112.1)**	**(45.9)**	**4.8**	**85.7**

Source: Kotak Institutional Equities estimates.

Energy

Sector coverage view	Cautious

Company	Rating	Price, Rs 13-May	Target
IOC	REDUCE	418	450
BPCL	REDUCE	349	400
HPCL	BUY	236	400

Oil bonds at 50% of gross under-recoveries, short of petroleum ministry's proposed 57%

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- **Oil bonds likely at 50% of under-recoveries (versus 57% as proposed by petroleum ministry)**
- **Situation still manageable for FY2008 but likely to worsen significantly in FY2009E given significantly higher under-recoveries**
- **Retain estimates for downstream companies pending confirmation of development**

As per reports in electronic media, the finance ministry has rejected the petroleum ministry's proposal for issue of oil bonds amounting to 57% of gross under-recoveries to the downstream companies but has agreed to issue oil bonds worth 50% of the under-recoveries. The earnings of BPCL, HPCL and IOCL will be lower by 30%, 39% and 17%, respectively, if the development is confirmed. We expect the earnings of downstream companies to be reasonable in FY2008E despite lower oil bonds (at 50% of under-recoveries); however, the situation looks fairly grim for FY2009E with likely significantly higher under-recoveries for the industry. We retain our earnings estimates and 12-month fair valuations for BPCL, HPCL and IOCL stocks at Rs400 (REDUCE), Rs400 (BUY) and Rs450 (REDUCE), respectively based on 1X FY2009E book value pending confirmation of the news reports. However, ratings and earnings have lost meaning in the current environment of (1) likely high gross under-recoveries, (2) low possibility of favorable government action given fiscal and political compulsions and (3) uncertainty regarding the subsidy-sharing scheme.

Oil bonds at 50% of under-recoveries for FY2008E. As per media reports, the finance ministry has consented to issue oil bonds for 50% of the gross under-recoveries versus the 57% requested by the petroleum ministry. Also, the finance ministry has computed gross under-recoveries at Rs706 bn compared to the petroleum ministry's estimated Rs773 bn. This development, if confirmed, will impact the earnings of downstream companies; earnings of BPCL, HPCL and IOCL will be lower by 30%, 39% and 17%, respectively, if the government issues oil bonds worth 50% of the gross under-recoveries as against 57% announced previously (Exhibit 1). The earnings of downstream companies for FY2008E will still be 'reasonable' given (1) strong refining margins, (2) good inventory gains and (3) relatively moderate crude prices at US$79/ bbl for FY2008; which should help protect earnings. However, the situation looks gloomy for FY2009E as discussed below.

Gross under-recoveries will be significantly higher in FY2009E. We see significant risks to the earnings of downstream oil companies in FY2009E given the likely high gross under-recoveries at current level of crude price. Exhibit 2 shows that gross under-recoveries may be significantly higher in FY2009E versus FY2008E; we compute gross under-recoveries at Rs1.7 tn at US$110/bbl compared to Rs0.75 tn in FY2008E (US$79/bbl crude price).

However, government's reluctance to give oil bonds at 57% (as requested by the petroleum ministry), only raises concerns about protection of earning (if any) of downstream companies in FY2009E. At current levels of crude prices and 50% oil bonds to be issued by the government, the net under-recoveries to be borne by downstream companies for FY2009E would be Rs418 bn against Rs171 bn in FY2008E. This compares with pre-tax earnings of Rs96 bn for the PSU R&M companies in FY2007 and Rs139 bn in 9M2008.

The lack of clarity on the subsidy sharing scheme makes the earnings of downstream oil stocks very difficult to estimate; this also creates uncertainty regarding the earnings of upstream companies. We had previously highlighted this in our note *'Ratings and earnings have lost meaning in the current environment'* released on May 6, 2008. At present, we assume that upstream companies will bear 33.33% of the under-recoveries. However, we apprehend that the government may increase the subsidy burden to be borne by upstream companies (as it had done in FY2007 when it was increased to 41.5%) in the current environment of (1) likely high gross under-recoveries and (2) low possibility of favorable government action given fiscal and political compulsions.

Earnings of downstream companies will be lower if oil bonds worth 50% of gross under-recoveries are issued

Earnings of downstream companies, March fiscal year-ends 2008E (Rs mn)

	BPCL	HPCL	IOCL
Net profits			
Net profits with 57% oil bonds	26,806	18,636	114,220
Net profits with 50% oil bonds (a)	18,992	11,437	94,806
Change	**(7,814)**	**(7,199)**	**(19,414)**
Net profits			
EPS with 57% oil bonds	71.6	55.0	95.8
EPS with 50% oil bonds (a)	49.9	33.7	79.5
Change (%)	**(30)**	**(39)**	**(17)**

Note:

(a) As per media reports, government will issue oil bonds amounting to 50% of under-recoveries for FY2008.

Source: Kotak Institutional Equities estimates.

Gross under-recoveries will likely be significantly higher in FY2009E

Share of various participants of under-recoveries, March fiscal year-ends, 2006-2009E (Rs bn)

								yoy	
	2006	**2007**	**2008E**	**2009E**			**9M 2008**	**9M 2007**	***% chg***
Dated Brent crude oil price (US$/bbl)	57	65	79	80	95	110	74	67	*11*
Subsidy loss	**400**	**494**	**706**	**639**	**1,159**	**1,732**	**479**	**405**	***18***
Payment by government (oil bonds)	**115**	**241**	**350**	**317**	**575**	**859**	**203**	**192**	***6***
Share of BPCL	22	53	79	72	72	195	46	43	*6*
Share of HPCL	23	49	73	66	66	180	43	39	*8*
Share of IOCL	70	138	197	179	179	484	115	109	*5*
Net under-recovery of oil companies	**285**	**253**	**356**	**322**	**584**	**873**	**275**	**214**	***29***
Share of refining companies	27	—	—	—	—	—	—	3	—
Share of upstream companies	**140**	**205**	**235**	**213**	**386**	**577**	**160**	**149**	***7***
Share of ONGC	120	170	199	181	327	489	135	124	*9*
Share of GAIL	11	15	14	12	22	34	9.3	9.9	*(6)*
Share of Oil India	10	20	22	20	36	54	15	16	*(5)*
Net under-recovery of R&M companies	**118**	**48**	**121**	**109**	**198**	**296**	**116**	**64**	***80***
Pre-tax profits of R&M companies	**74**	**96**					**139**	**66**	

Note:

(a) Share of oil bonds assumed at 50% and share of upstream companies at 33.33%.

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of BPCL, March fiscal year-ends, 2004-2011E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)								
Net sales	479,840	578,774	755,333	965,569	1,161,871	1,145,628	1,160,324	1,195,182
EBITDA	**38,686**	**26,231**	**9,407**	**35,362**	**41,556**	**32,008**	**35,673**	**39,907**
Other income	4,348	4,015	4,653	7,332	11,892	8,849	7,419	5,792
Interest	(1,447)	(1,748)	(2,474)	(4,774)	(5,520)	(5,638)	(4,658)	(2,872)
Depreciation	(6,754)	(7,130)	(7,680)	(9,041)	(10,287)	(9,400)	(10,356)	(11,305)
Pretax profits	34,833	21,368	3,906	28,879	37,641	25,819	28,079	31,522
Extraordinary items	(420)	810	176	(68)	1,279	—	—	—
Tax	(12,026)	(7,250)	(140)	(9,286)	(10,880)	(7,613)	(6,964)	(9,408)
Deferred taxation	(805)	(1,230)	(1,025)	(268)	(1,234)	(1,163)	(2,580)	(1,306)
Net profits	21,582	13,698	2,916	18,055	26,806	17,043	18,535	20,808
Net profits after minority interests	**19,086**	**11,334**	**2,916**	**18,055**	**26,806**	**17,043**	**18,535**	**20,808**
Earnings per share (Rs)	**64.6**	**37.2**	**7.6**	**50.1**	**71.6**	**47.1**	**51.3**	**57.6**
Balance sheet (Rs mn)								
Total equity	69,960	82,887	91,394	102,735	117,698	127,211	137,556	149,170
Deferred taxation liability	11,304	12,533	13,558	13,826	15,060	16,224	18,803	20,110
Total borrowings	32,701	46,589	83,736	108,292	78,325	63,325	53,396	18,396
Currrent liabilities	95,495	104,462	94,070	112,767	100,571	100,002	101,880	106,722
Total liabilities and equity	**209,459**	**246,472**	**282,758**	**337,620**	**311,653**	**306,761**	**311,636**	**294,398**
Cash	9,319	6,644	4,921	8,640	4,414	3,938	3,155	3,314
Current assets	97,729	130,393	128,208	127,698	119,074	117,344	118,249	121,885
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	88,484	98,542	110,855	118,334	127,564	139,878	154,630	153,596
Investments	13,927	10,893	38,774	82,949	60,602	45,602	35,602	15,602
Total assets	**209,459**	**246,472**	**282,758**	**337,621**	**311,653**	**306,761**	**311,636**	**294,398**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	30,727	21,118	9,275	29,920	24,498	18,757	24,051	27,627
Working capital	1,025	(18,393)	1,577	11,451	(566)	2,964	1,933	1,205
Capital expenditure	(17,001)	(17,120)	(19,945)	(17,908)	(17,579)	(21,714)	(25,109)	(10,271)
Investments	1,278	2,992	(28,146)	(45,481)	22,347	15,000	10,000	20,000
Other income	1,985	2,445	1,785	4,337	8,885	7,046	6,460	5,792
Free cash flow	**18,015**	**(8,957)**	**(35,455)**	**(17,682)**	**37,585**	**22,054**	**17,335**	**44,353**
Ratios (%)								
Debt/equity	40.2	48.8	91.6	105.4	66.5	49.8	38.8	12.3
Net debt/equity	28.8	41.9	86.2	97.0	62.8	46.7	36.5	10.1
RoAE	28.8	14.4	3.3	16.3	21.5	12.3	12.4	12.8
RoACE	**21.2**	**12.0**	**4.1**	**11.0**	**14.3**	**10.6**	**11.8**	**12.1**
Key assumptions (standalone until FY2005)								
Crude throughput (mn tons)	8.8	9.1	17.2	19.8	21.0	21.0	21.5	23.0
Effective tariff protection (%)	7.2	4.8	2.9	1.6	1.4	1.4	1.4	1.3
Net refining margin (US$/bbl)	4.2	3.8	2.1	3.2	4.7	3.7	3.1	3.5
Sales volume (mn tons)	20.9	21.5	23.3	24.2	25.4	26.4	27.4	28.4
Marketing margin (Rs/ton)	1,893	1,732	(671)	(1,140)	(2,884)	(2,118)	395	1,438
Subsidy under-recoveries (Rs mn)	(13,518)	(25,821)	(31,847)	(20,159)	(18,347)	(16,888)	(8,833)	(3,814)

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of HPCL, March fiscal year-ends, 2004-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Profit model (Rs mn)							
Net sales	597,020	708,609	889,959	1,034,993	1,019,515	1,024,096	1,040,529
EBITDA	**20,511**	**8,056**	**24,036**	**32,507**	**31,729**	**34,815**	**44,592**
Other income	3,295	3,285	6,845	11,088	10,216	8,814	6,625
Interest	(816)	(1,587)	(4,230)	(7,145)	(8,044)	(7,332)	(5,976)
Depreciation	(6,584)	(6,902)	(7,040)	(8,218)	(10,245)	(9,826)	(10,555)
Pretax profits	16,406	2,851	19,611	28,232	23,657	26,471	34,687
Extraordinary items	1,471	2,201	3,030	—	—	—	—
Tax	(5,897)	(898)	(6,625)	(7,462)	(4,108)	(7,547)	(10,196)
Deferred taxation	793	(97)	(365)	(2,134)	(3,933)	(1,450)	(1,594)
Prior period adjustment	—	—	61	—	—	—	—
Net profits	**12,773**	**4,056**	**15,712**	**18,636**	**15,616**	**17,474**	**22,897**
Earnings per share (Rs)	**34.8**	**6.6**	**40.0**	**55.0**	**46.1**	**51.6**	**67.6**
Balance sheet (Rs mn)							
Total equity	84,409	87,357	95,987	105,898	114,376	123,863	136,294
Deferred tax liability	13,748	13,844	14,209	16,343	20,276	21,726	23,320
Total borrowings	21,854	66,638	105,175	146,675	125,175	105,175	80,675
Current liabilities	69,887	79,549	101,195	91,733	95,704	98,661	99,092
Total liabilities and equity	**189,896**	**247,389**	**316,566**	**360,649**	**355,531**	**349,425**	**339,381**
Cash	2,016	426	868	508	789	405	431
Current assets	93,007	109,674	113,779	129,716	130,403	131,476	131,387
Total fixed assets	77,305	97,013	130,644	145,127	154,041	162,247	167,266
Investments	17,568	40,276	71,275	85,298	70,298	55,298	40,298
Total assets	**189,896**	**247,389**	**316,566**	**360,649**	**355,532**	**349,425**	**339,382**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	15,977	10,126	23,966	15,508	17,815	19,313	28,421
Working capital changes	(3,614)	(5,351)	8,936	(22,791)	5,061	2,863	520
Capital expenditure	(12,849)	(25,298)	(38,510)	(20,309)	(17,397)	(17,409)	(15,574)
Investments	2,995	(22,884)	(31,704)	(14,023)	15,000	15,000	15,000
Other income	800	941	2,067	8,480	8,439	7,836	6,625
Free cash flow	**3,310**	**(42,466)**	**(35,246)**	**(33,136)**	**28,919**	**27,603**	**34,992**
Ratios (%)							
Debt/equity	22.3	65.8	95.4	120.0	93.0	72.2	50.5
Net debt/equity	20.2	65.4	94.7	119.6	92.4	72.0	50.3
RoAE	13.4	4.1	14.9	16.0	12.2	12.5	15.0
RoACE	**10.1**	**2.5**	**8.8**	**10.7**	**9.9**	**9.5**	**11.7**
Key assumptions							
Crude throughput (mn tons)	13.9	14.0	16.7	16.5	18.3	19.3	19.3
Effective tariff protection (%)	5.6	3.1	1.4	1.2	1.2	1.2	1.1
Net refining margin (US$/bbl)	4.5	3.9	4.3	4.4	4.0	3.3	3.8
Sales volume (mn tons)	20.6	20.1	23.4	24.2	25.0	25.8	26.6
Marketing margin (Rs/ton)	1,688	(463)	(710)	(2,306)	(1,650)	527	1,397
Subsidy under-recoveries (Rs mn)	(26,708)	(29,671)	(18,899)	(16,199)	(15,547)	(11,518)	(7,203)

Source: Kotak Institutional Equities estimates.

Consolidated profit model, balance sheet, cash model of IOCL, March fiscal year-ends, 2004-2010E (Rs mn)

	2004	2005	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	1,173,450	1,379,018	1,729,474	2,149,428	2,614,895	2,554,551	2,587,310
EBITDA	**114,303**	**86,765**	**82,044**	**110,451**	**169,548**	**126,917**	**134,007**
Other income	17,565	16,138	21,310	27,451	51,396	37,422	28,718
Interest	(5,043)	(7,433)	(12,101)	(17,058)	(15,577)	(13,070)	(7,258)
Depreciation	(20,626)	(23,140)	(24,711)	(28,686)	(30,706)	(32,152)	(33,947)
Pretax profits	106,199	72,330	66,542	92,157	174,661	119,117	121,519
Extraordinary items	3,553	4,283	5,590	24,757	5,588	5,504	5,428
Tax	(25,966)	(13,658)	(19,975)	(25,834)	(55,947)	(39,209)	(38,064)
Deferred taxation	(5,157)	(2,335)	(1,282)	(8,040)	(2,391)	(405)	(2,450)
Net profits	79,052	59,475	51,125	82,729	121,910	85,006	86,433
Net profits after minority interests	**73,298**	**52,666**	**45,362**	**62,469**	**114,220**	**78,649**	**81,205**
Earnings per share (Rs)	**62.8**	**45.1**	**38.8**	**52.4**	**95.8**	**66.0**	**68.1**
Balance sheet (Rs mn)							
Total equity	233,386	271,302	317,977	378,117	442,900	490,789	537,095
Deferred tax liability	47,934	50,367	50,602	59,859	62,250	62,655	65,105
Total borrowings	146,147	197,809	292,395	290,215	276,903	195,864	118,264
Currrent liabilities	219,522	266,430	286,716	330,791	386,596	389,225	396,860
Total liabilities and equity	**646,988**	**785,907**	**947,691**	**1,058,981**	**1,168,650**	**1,138,534**	**1,117,323**
Cash	13,777	13,356	8,080	9,385	5,537	5,798	6,041
Current assets	278,550	368,158	413,904	437,178	576,287	567,966	571,728
Total fixed assets	320,647	370,003	383,717	415,014	420,717	438,662	453,446
Investments	34,013	34,391	141,990	197,403	166,108	126,108	86,108
Total assets	**646,988**	**785,907**	**947,691**	**1,058,981**	**1,168,649**	**1,138,534**	**1,117,323**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	93,713	71,765	(10,334)	(44,660)	95,685	74,598	96,805
Working capital changes	1,710	(33,421)	(8,136)	2,237	(64,812)	19,680	444
Capital expenditure	(47,179)	(73,626)	(49,042)	(50,969)	(38,117)	(51,096)	(44,236)
Investments	(509)	(1,172)	(17,778)	99,768	31,295	40,115	40,000
Other Income	5,826	7,814	10,317	13,582	27,519	24,700	23,433
Free cash flow	**53,560**	**(28,641)**	**(74,973)**	**19,958**	**51,571**	**107,997**	**116,447**
Ratios (%)							
Debt/equity	52.0	61.5	79.3	66.3	54.8	35.4	19.6
Net debt/equity	47.1	57.3	77.1	64.1	53.7	34.3	18.6
RoAE	30.0	18.3	13.7	16.1	25.1	15.4	14.6
RoACE	**20.4**	**13.7**	**9.3**	**11.3**	**17.1**	**11.6**	**12.0**
Key assumptions (IOC standalone)							
Crude throughput (mn tons)	37.7	36.6	38.5	44.0	47.2	48.2	49.7
Effective tariff protection (%)	7.9	5.8	3.3	1.9	1.7	1.7	1.7
Net refining margin (US$/bbl)	5.4	6.2	4.8	4.9	6.8	5.9	5.4
Sales volume (mn tons)	47.1	48.2	50.4	53.4	55.7	57.8	59.7
Marketing margin (Rs/ton)	2,092	1,982	26	(633)	(1,598)	(1,297)	996
Subsidy under-recoveries (Rs mn)	(28,078)	(64,309)	(95,361)	(34,041)	(15,039)	(20,088)	(15,994)

Source: Kotak Institutional Equities estimates.

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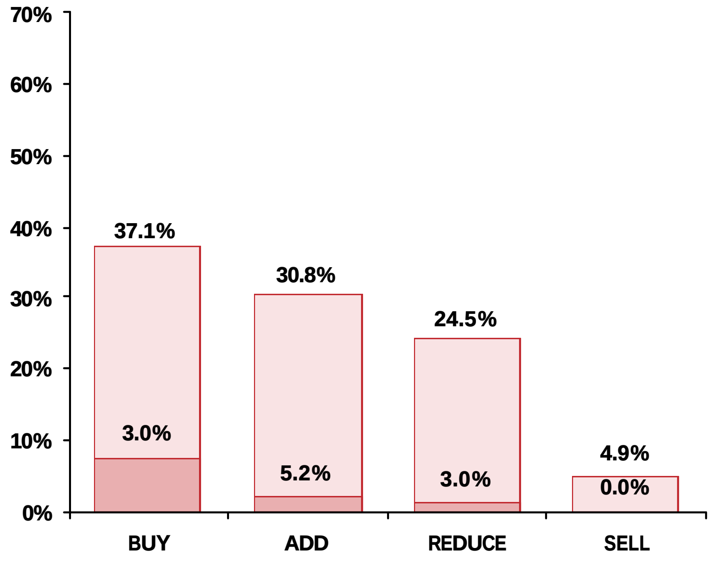

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Source: Kotak Institutional Equities. As of March 31, 2008

Ratings and other definitions/identifiers

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Definitions of ratings

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