kotak® Institutional Equities

INDIA DAILY

May 10, 2007

EQUITY MARKETS

		Change, %		
India	**9-May**	**1-day**	**1-mo**	**3-mo**
Sensex	13,782	0.1	4.5	(5.2)
Nifty	4,079	0.1	6.0	(2.6)
Global/Regional indices				
Dow Jones	13,363	0.4	6.3	6.2
Nasdaq Composite	2,576	0.2	4.0	4.7
FTSE	6,550	(0.0)	2.1	2.6
Nikkie	17,749	0.0	0.5	1.4
Hang Seng	20,793	(0.2)	2.2	0.6
KOSPI	1,603	0.6	7.0	12.3

Value traded - India

			Moving avg, Rs bn	
	9-May		**1-mo**	**3-mo**
Cash (NSE+BSE)	123.5		128.1	125.2
Derivatives (NSE)	310.0		235.8	322.2
Deri. open interest	510.9		465.3	603.6

Forex/money market

		Change, basis points		
	9-May	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.9	-	(198)	(329)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.1	(3)	(5)	28

Net investment (US$mn)

	8-May		**MTD**	**CYTD**
FIIs	(53)		1,257	40
MFs	(5)		234	(303)

Top movers -3mo basis

		Change, %		
Best performers	**9-May**	**1-day**	**1-mo**	**3-mo**
Balaji Telefilms	164	1.5	15.7	27.6
Britannia	1,485	7.6	20.3	25.4
GESCO	257	0.4	23.5	22.6
Castrol India	273	1.5	25.4	21.1
i-Flex	2,331	2.4	7.3	19.7
Worst performers				
Polaris	166	2.3	(3.6)	(24.6)
Ashok Leyland	37	(1.8)	1.2	(21.2)
Ingersoll Rand	286	(1.7)	5.8	(21.2)
Tata Motors	723	(0.3)	0.4	(20.1)
Arvind Mills	45	(0.1)	(2.8)	(19.6)

Contents

News Roundup

Corporate

- The government is likely to rake in more than Rs22.5 bn for its 10.27% stake in the countries largest carmakers Maruti Udyog Ltd (MUL). As many as 36 banks, financial institutions and mutual funds bid for the stake sale and offered between Rs765 and Rs850 a share against a floor price of Rs760 set ny the government.(FE)
- Union de Credit pour le Batiment SA(UCB), a subsidiary of Paris based bank BNP Paribas SA, will pay Rs1.96 bn for a 49.9% stake in Sundaram Home Finance Ltd, a subsidiary of Sunadaram Finance Ltd.(BL)
- Vodafone group has completed the takeover of Hutchison Essar by paying US$10.9 bn in cash, which is US$180 mn less than the intially agreed amount of US$11.08 bn (FE)

Economic and political

- The board of approval of SEZs deferred a decission on giving formal clearance to the Reliance promoted Navi Mumbai SEZ Pvt. Ltd, while granting formal approval to 16 proposals out of 23 cases it considered.(BL)
- The Finance mnistry has clarified that fringe benefit tax(FBT) will be appilcable on all ESOPs, where the physical transfer of shares have taken place beyond March 31, even though the option may have been excercised by the employee in March itself. Several companies had offered Esops in March itself to escape the tax. (ET)

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

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Pharmaceuticals

LUPN.BO, Rs709	
Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	730
52W High -Low (Rs)	755 - 406
Market Cap (Rs bn)	57.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	20.1	25.0	28.3
Net Profit (Rs bn)	3.1	3.1	3.4
EPS (Rs)	35.0	35.0	38.9
EPS gth	*78.3*	*0.0*	*11.2*
P/E (x)	20.3	20.3	18.2
EV/EBITDA (x)	13.9	14.0	12.1
Div yield (%)	0.7	0.7	0.8

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	52.3	-	-
FIIs	13.8	0.1	(0.1)
MFs	7.2	0.4	0.2
UTI	2.3	0.9	0.7
LIC	1.8	0.1	(0.1)

Lupin: Stock is near fair value; cut weight on every rise

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- **Net profit for FY2007 is Rs3.09 bn; about a quarter is non-recurring operating income**
- **For FY2008, we estimate 24% topline growth, 31% growth in EBITDA and flat earnings growth.**
- **Stock seems near fair value; lowering rating to IL with revised target price of Rs730. We recommend trimming weight on every rise.**

On a consolidated basis, net profit for FY2007 is Rs3.09 bn; about a quarter of which is non-recurring operating income. In March 2007, Lupin received Euro20 mn (Rs0.75 bn net of tax) from Servier, for sale of intellectual property related to Perindopril (an anti hypertensive). We have fine-tuned our modeled and expect flat earnings in FY2008 and 11% earnings growth in FY2009. Excluding Perindopril, we estimate earnings growth of 32% in FY2008. Generic Cefdinir constitutes about a quarter of our FY2008 earnings estimate. This product will likely shrink sharply in FY2009, as competition intensifies and will be an important overhang on the stock. Another important overhang will be the strong rupee, as about half of the company's revenues are from exports. We have now assumed rupee dollar rate of Rs43 in FY2008 and Rs42 in FY2008. Stock seems fairly valued, after strong 40% returns in the last six months. We are lowering our rating to IL (OP earlier), with revised target price of Rs730 (DCF rolled over to March 2009; Rs650 earlier). Our implied target PE is 19X FY2009 earnings. We would recommend trimming exposure on every rise.

19% topline growth for FY2007 was driven by a strong 39% growth in the formulations business (61% of sales versus 52% in the previous year). API sales were down 3%, owing to a sharp dip in advanced markets. Customers of an important product (Lisinopril) have been switched from the API to the formulation, largely explaining the dip. The company has a 33% share of the generic in the US market.

EBITDA margin (excluding other operating income) for the year is up 60bps to 14.5%. Material cost was down 240 bps to 46.3%; however sharp rise in overheads and research cost has impacted margin expansion. The drop in material cost seems to be a result of increasing contribution from formulations business. We are particularly impressed by the strong growth in the domestic formulations business (24% for the year; albeit slow in the last quarter). This quarter also benefited from sharp increase in branded Suprax (antibiotic for kids) sales in the US market.

For FY2008, we estimate 24% topline growth, 31% growth in EBITDA and flat earnings growth. Excluding the income from Perindopril, we estimate earnings growth of 32% in FY2008. We have assumed a tax rate of 24% versus 20% in FY2007, as more earnings come from tax-free plants.

Advanced market formulation sales (generics) is likely to rise from US$75 mn in FY2007 to US$135 mn in FY2008 (up from 16% of sales to 24%). In total, we expect nine launches in the US market; generic Cefdinir (recently launched) is the most important. This is a $750 mn brand (Omnicef) in the US. We have assumed that Lupin will sell about $45 mn worth of the generic, based on 75% discount and 25% market share. At this moment, only three companies (Sandoz, Lupin and authorized generic) have launched the product. The other companies expecting approval are Teva, Wockhardt, Orchid, Aurobindo and Ranbaxy. We note that Lupin is currently short of stock, and this might impact its market share. Other products which are important to Lupin's US business are i) branded Suprax ($25 mn sales), ii) generic Ceftriaxone, iii) Lisinopril.

In India (37% of total sales), the company has added new therapies and has become aggressive on new product launches. In the short-term, this is resulting in higher marketing spend, but is expected to yield positive results over the medium term. For instance, the filed force size has been increased to 1800 people, up from 800 two years back. The company has already become the second largest player in the asthma segment. The other segments that it is eyeing include women healthcare and gyanecology. Traditionally, Lupin has been strong in anti-tb, cephalosporins and cardiovascular categories.

APIs and Intermediates constitute 39% of total sales; key categories include cephalosporin intermediates, anti-tb products and Lisinopril. The company has added two new categories (optically active compounds and steroids) that will add to the growth momentum. External API sales were down 3% in the year, owing to sharp increase in captive consumption. The company has said that it will not be adversely impacted by the rise in Pen-G prices ($15 per BoU from $6 in the previous year), atleast in the short-term. It has largely inventory of Pen-G, including contracts at lower prices.

Lupin - results table (Rs mn)

	Standalone numbers			Consolidated numbers							
	Q4FY06	4QFY07	yoy growth %	1QFY07	2QFY07	3QFY07	4QFY07	FY2006	FY2007	FY2008E	FY2009E
Gross sales	4,344	5,303		5,125	4,995	5,156	5,441	17,503	20,717	25,561	28,973
Excise	124	123		162	156	139	123	549	579	592	681
Net Sales	**4,220**	**5,181**	23	**4,963**	**4,839**	**5,017**	**5,318**	**16,954**	**20,137**	**24,969**	**28,293**
Total Exp	**3,804**	**4,431**	16	**4,395**	**4,123**	**4,154**	**4,542**	**14,603**	**17,215**	**21,131**	**24,060**
- Inc/Dec Stock	(48)	(73)		98	(277)	(184)	(146)				
- Consp of RM	2,034	2,484		2,444	2,470	2,372	2,545	8,259	9,321	11,765	13,713
- Staff Cost	406	463	14	462	517	531	691	1,690	2,200	2,684	3,041
- Other Exp	1,413	1,558	10	1,393	1,413	1,436	1,453	4,654	5,694	6,683	7,306
EBITDA	**416**	**750**	80	**568**	**716**	**863**	**776**	**2,352**	**2,922**	**3,838**	**4,232**
Other operating income		1,283		81	47	38	1,288	503	1,453	495	561
Depreciation	114	125		107	112	121	126	409	466	521	649
Interest	95	98		92	93	89	98	313	372	310	234
Other Income	410			217	171	99	50	122	538	356	381
PBT	**618**	**1,810**	193	**667**	**728**	**789**	**1,890**	**2,255**	**4,075**	**3,858**	**4,291**
Current Tax	106	388		108	226	112	413	493	860	617	515
Deferred Tax	10	51		23	(16)	57	65	28	129	154	343
Extraordinary charges								0	0	0	0
Minority Interest								4	0	0	0
PAT	502	1,371		536	518	620	1,411	1,730	3,086	3,087	3,432
Adj. PAT	**502**	**1,371**	173	**536**	**518**	**620**	**1,411**	**1,730**	**3,086**	**3,087**	**3,432**
Diluted EPS (Rs)								**19.6**	**35.0**	**35.0**	**38.9**
Operating ratios (% of net sales)											
Materials	47.0	46.5		51.2	45.3	43.6	45.1	48.7	46.3	47.1	48.5
R&D	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Staff	9.6	8.9		9.3	10.7	10.6	13.0	10.0	10.9	10.7	10.7
Others	33.5	30.1		28.1	29.2	28.6	27.3	27.4	28.3	26.8	25.8
EBITDA Margin	9.9	14.5		11.4	14.8	17.2	14.6	13.9	14.5	15.4	15.0
EBITDA Margin (including other operating income)	9.9	31.5		12.9	15.6	17.8	31.2	16.4	20.3	17.0	16.6
Tax rate (%)	18.7	24.3		19.6	28.8	21.4	25.3	23.1	24.3	20.0	20.0
PAT margin	11.9	26.5		10.8	10.7	12.4	26.5	10.2	15.3	12.4	12.1
Revenue breakup (Rs mn)											
Domestic				**2,842**	**2,884**	**2,589**	**2,222**	**8,786**	**10,537**	**11,967**	**13,762**
Formulations				2,066	2,130	1,939	1,396	6,069	7,531	8,661	9,960
APIs				776	754	650	826	2,717	3,006	3,307	3,803
Developing mkts				**1,269**	**1,116**	**1,223**	**1,474**	**3,858**	**5,082**	**5,742**	**6,700**
Formulations				396	220	330	532	802	1,478	1,921	2,498
APIs				873	896	893	942	3,056	3,604	3,820	4,202
Developed mkts				**717**	**966**	**1,259**	**1,576**	**4,327**	**4,518**	**7,260**	**7,830**
Formulations				527	766	851	1,174	1,997	3,318	6,060	6,510
APIs				190	200	408	402	2,330	1,200	1,200	1,320
Others (balancing number)				135	(127)	(54)	46	(17)	0	0	0
Total				**4,963**	**4,839**	**5,017**	**5,318**	**16,954**	**20,137**	**24,969**	**28,293**

Energy

ONGC.BO, Rs909	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	1,075
52W High -Low (Rs)	1009 - 620
Market Cap (Rs bn)	1,945

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	953.1	996.0	984.0
Net Profit (Rs bn)	185.6	211.8	212.2
EPS (Rs)	86.8	99.0	99.2
EPS gth	*18.2*	*14.1*	*0.2*
P/E (x)	10.5	9.2	9.2
EV/EBITDA (x)	4.5	3.9	3.6
Div yield (%)	3.3	3.6	3.6

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	8.7	2.7	(3.9)
MFs	1.3	2.5	(4.2)
UTI	-	-	(6.7)
LIC	2.3	3.9	(2.7)

Oil & Natural Gas Corporation: Revision to earnings; higher subsidy and stronger rupee to offset higher crude price

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- **Subsidy burden for 4QFY07 will be likely significantly higher versus 3QFY07**
- **Reduced EPS 6-9% for FY2007E-FY2009E to factor likely higher subsidy losses**
- **Revised 12-month target price to Rs1,075 from Rs1,100 previously**

We assume high subsidy loss for ONGC in 4QFY07 based on with GAIL's reported provisional amount will likely result in weak results. We are perplexed by the large subsidy loss reported by GAIL for 4QFY07 as industry gross under-recoveries on sale of subsidized products was likely lower in 4QFY07 versus 3QFY07 as per our computations. We can only conclude that the government has increased the share of gross under-recoveries of the upstream companies. We have made changes to our earnings model to reflect (1) higher subsidy losses, (2) higher crude price assumption and (3) stronger rupee. We have revised FY2007-FY2010E EPS to Rs87, Rs99, Rs99 and Rs112, respectively from Rs94, Rs106, Rs106 and Rs115, respectively previously. Our revised 12-month 9X normalized FCF-based target price is Rs1,075 versus Rs1,100 previously. Key downside risk stems from higher-than-expected subsidy losses.

Higher subsidy loss to likely erode 4QFY07 earnings. GAIL (India) reported 4QFY07 subsidy loss of Rs5 bn which was significantly higher versus our estimate of Rs2.64 bn and 3QFY07's Rs3.15 bn despite similar gross under-recoveries in 4QFY07 versus 3QFY07. However, we note that GAIL has provided the amount on a provisional basis in the absence of communication from the government. Assuming the government applies the same formula for ONGC, we expect ONGC's FY2007 subsidy burden to increase to Rs170 bn from Rs145 bn previously assumed by us. This will result in likely weak results for ONGC for 4QFY07 at around Rs30 bn compared to our previously estimated Rs47.7 bn and Rs46.7 bn in 3QFY07. More important, it will hurt sentiment for ONGC stock as it will create further uncertainty regarding the methodology followed by the government for the subsidy sharing scheme. We have now factored a higher subsidy loss for ONGC for subsequent years also. However, we note that the subsidy figure is difficult to factor noting the influence of several key variables—(1) global crude price, (2) domestic selling price of four controlled products, which depends on the government of India, (3) share of upstream companies and (4) amount of oil bonds given by the government to downstream oil companies, which will influence the share of ONGC.

The government may have revised the subsidy-sharing formula or may review the figures later. We highlight that the government is yet to communicate the official subsidy figures to the upstream companies. However, it looks like the government has inexplicably raised the share of gross under-recoveries of upstream companies to around 40% from the normal 33%; total subsidy loss of the upstream companies will likely be Rs205 bn in FY2007 versus a total under-recovery of Rs540 bn. The government may yet review the subsidy amount later.

Earnings revisions

We have made several revisions to our earnings model, which include (1) higher crude prices, (2) higher subsidy losses and (3) stronger rupee.

FY2008. We have reduced FY2008E EPS to Rs99 from Rs106 previously. The downward revision primarily reflects (1) higher assumed subsidy loss of Rs150 bn compared to Rs120 bn previously, (2) lower gas price of Rs4/cu m from Rs4.75/cu m assumed previously and (3) a stronger rupee (Rs43/US$ versus Rs45/US$ previously) which offset increased crude price (US$65/bbl versus US$60/bbl previously).

We have raised our crude price (all with reference to Dated Brent) estimates by US$5/bbl for FY2008E to factor in (1) continued problems in certain key oil producing countries such as Nigeria; increased militant activity in Niger Delta has now shut 844,000 b/d of output which constitutes around 28% of the total output in Nigeria and (2) continued low OPEC production; March 2007 OPEC production at 30.1 mb/d is about 1.2 mb/d lower than September 2006 production.

FY2009. We have reduced FY2009E EPS to Rs99 from Rs106 previously to reflect higher subsidy loss (Rs120 bn compared to Rs90 bn previously) and a stronger rupee (Rs43/US$ versus Rs45/US$ previously). We have also revised our crude price assumption to US$60/bbl compared to US$55/bbl assumed previously to factor in Angola's entry into the OPEC. Although Angola is outside OPEC's quota system currently, its loss as a key contributor to increased non-OPEC crude supply over the next 2-3 years will likely be bullish for crude prices.

FY2010. We have reduced FY2010E EPS to Rs112 from Rs115 previously. The yoy earnings growth reflects an increase in our expected gas price to Rs5/cu m from Rs4.5/cu m in FY2009E. We have reduced earnings due to (1) higher subsidy loss of Rs90 bn compared to Rs60 bn previously, (2) lower gas price and (3) a stronger rupee (Rs43/US$ versus Rs45/US$ previously). We have also revised our crude price assumption to US$60/bbl compared to US$55/bbl previously, which partly offsets the impact of the three negative factors discussed above.

We believe ONGC stock is attractively valued at current price

Estimation of fair value of ONGC stock based on normalized free cash flow (Rs mn)

	2008E	2009E	2010E
Crude price assumption (US$/bbl)	50.0	50.0	50.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	197,863	225,080	247,303
Add: OCF after normalizing natural gas price	34,977	29,592	22,161
Add: OCF after removing subsidies	101,383	82,343	60,438
Recurring OCF	334,223	337,014	329,902
Recurring capex			
Production per annum (mn bbls)	380	388	380
Replacement or F&D costs (US$/bbl)	8.0	8.0	8.0
Recurring capex	130,798	133,588	130,650
Free cash flow	**203,424**	**203,426**	**199,252**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,830,818	1,830,837	1,793,266
(Net debt)/cash	252,651	395,631	491,663
Investments	88,236	88,236	88,512
Equity value	2,171,706	2,314,705	2,373,441
Equity value per share (Rs)	**1,015**	**1,082**	**1,110**

Source: Kotak Institutional Equities estimates.

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

	2004	2005	2006	2007E	2008E	2009E	2010E
Profit model (Rs mn)							
Net sales	433,264	635,956	742,532	953,141	996,048	984,050	1,027,690
EBITDA	**192,480**	**269,526**	**318,069**	**379,374**	**400,875**	**394,939**	**438,201**
Other income	18,220	21,811	28,446	21,848	21,335	21,965	23,127
Interest	(6,964)	(3,950)	(955)	(1,417)	(941)	(777)	(555)
Depreciation and depletion	(65,480)	(73,466)	(98,007)	(110,238)	(104,941)	(104,331)	(101,834)
Pretax profits	138,255	213,921	247,553	289,567	316,329	311,796	358,939
Tax	(46,101)	(74,003)	(71,523)	(106,205)	(109,239)	(105,901)	(128,490)
Deferred tax	(4,218)	(770)	(16,585)	3,299	6,713	8,056	10,591
Net profits	86,811	138,943	159,706	186,661	213,802	213,951	241,040
Net profits after minority interests	**87,979**	**137,639**	**157,201**	**185,607**	**211,907**	**212,495**	**238,694**
Earnings per share (Rs)	**41.1**	**64.4**	**73.5**	**86.8**	**99.1**	**99.3**	**111.6**
Balance sheet (Rs mn)							
Total equity	415,582	488,912	578,830	692,277	819,015	949,639	1,080,511
Deferred tax liability	54,250	57,911	71,557	70,184	62,528	51,632	41,535
Liability for abandonment cost	80,292	80,941	128,675	128,675	128,675	128,675	128,675
Total borrowings	60,961	39,028	22,259	18,584	16,484	7,192	45,491
Currrent liabilities	85,376	128,346	152,162	88,040	88,061	88,472	87,116
Total liabilities and equity	**696,461**	**795,138**	**953,483**	**997,760**	**1,114,762**	**1,225,610**	**1,383,329**
Cash	95,721	101,843	91,132	135,991	269,135	402,823	537,154
Current assets	133,039	178,421	240,479	198,807	172,660	163,528	167,456
Total fixed assets	419,213	471,543	568,252	609,340	619,345	605,637	625,129
Goodwill	11,661	10,753	14,172	14,172	14,172	14,172	14,172
Investments	30,811	26,961	35,480	35,480	35,480	35,480	35,753
Deferred expenditure	6,017	5,617	3,969	3,969	3,969	3,969	3,663
Total assets	**696,461**	**795,138**	**953,484**	**997,759**	**1,114,761**	**1,225,609**	**1,383,327**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	120,499	178,158	225,995	217,179	239,998	236,903	258,173
Working capital changes	24,950	18,839	44,082	(7,825)	23,324	(52,601)	35,067
Capital expenditure	(56,366)	(102,727)	(110,836)	(103,311)	(65,780)	(41,550)	(32,550)
Investments	(10,608)	(9,887)	(28,640)	—	—	—	—
Other income	9,765	12,964	14,539	22,573	21,990	22,340	23,127
Free cash flow	**88,240**	**97,347**	**145,141**	**128,615**	**219,532**	**165,092**	**283,817**
Ratios (%)							
Debt/equity	14.7	8.0	3.8	2.7	2.0	0.8	4.2
Net debt/equity	(8.4)	(12.8)	(11.9)	(17.0)	(30.8)	(41.7)	(45.5)
RoAE	20.2	27.4	26.5	26.6	26.1	22.8	22.7
RoACE	**19.2**	**24.1**	**22.8**	**22.5**	**22.6**	**20.0**	**20.3**
Key assumptions							
Rs/dollar rate	46.0	45.0	44.3	45.3	43.0	43.0	43.0
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	65.0	60.0	60.0
Ceiling natural gas price (Rs/'000 cm)	2,850	2,850	3,515	3,750	4,000	4,500	5,000
Subsidy loss (Rs bn)	26.9	41.0	119.6	170.3	150.0	120.0	90.0

Source: Kotak Institutional Equities estimates.

Natural gas price increase and moderate volume growth are key earnings drivers

Key assumptions, March fiscal year-ends, 2003-2010E

	2003	2004	2005	2006	2007E	2008E	2009E	2010E
Rs/US$ rate	48.4	46.0	45.0	44.3	45.3	43.0	43.0	43.0
Subsidy share scheme loss (Rs bn)	—	26.9	41.0	119.6	170.3	150.0	120.0	90.0
Import tariff on crude oil (%)	10	10	10	5	5	5	3	3
Crude/natural gas prices								
Crude price								
Crude price, WTI (US$/bbl)					66.8	67.0	62.0	62.0
Crude price, Dated Brent (US$/bbl)	27.0	28.7	40.6	57.2	64.8	65.0	60.0	60.0
Net crude price, ONGC-India (Rs/tonne)	7,284	6,255	9,196	10,390	10,444	10,289	9,855	10,977
Net crude price, ONGC-India (US$/bbl)	20.6	18.6	28.0	32.1	31.6	32.8	31.4	35.0
Natural gas price								
Ceiling natural gas price, India (Rs/cu m)	2.85	2.85	2.85	3.52	3.75	4.00	4.50	5.00
Ceiling natural gas price, India (US$/mn BTU)	1.57	1.66	1.69	2.12	2.21	2.49	2.80	3.11
Net natural gas price, ONGC-India (Rs/cu m)	2.24	2.18	2.18	3.11	3.33	3.56	4.02	4.49
Net natural gas price, ONGC-India (US$/mn BTU)	1.24	1.27	1.29	1.88	1.97	2.21	2.50	2.79
International operations								
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.4	3.2	3.2	3.1	3.2	3.0	3.0	3.0
Net crude price, OVL-Sudan (Rs/tonne)	4,253	4,285	5,893	8,118	9,384	8,943	8,264	8,264
Net crude price, OVL-Russia (Rs/tonne)	—	—	—	8,320	9,633	9,182	8,475	8,475
Sales volumes—Domestic fields (a)								
Crude oil (mn tonnes)	23.9	23.9	24.1	22.5	23.5	23.4	23.4	23.4
Natural gas (bcm)	21.1	21.1	20.6	20.5	20.8	20.2	20.2	19.4
Sales volumes—Overseas fields								
Crude oil (mn tonnes)	0.2	3.3	3.7	4.5	6.5	7.8	7.6	7.1
Natural gas (bcm)	0.0	0.5	1.3	1.8	2.0	2.1	2.4	2.4
Total sales								
Crude oil (mn tonnes)	24.1	27.3	27.8	27.0	30.0	31.2	31.0	30.5
Natural gas (bcm)	21.1	21.6	22.0	22.3	22.7	22.3	22.6	21.8
Total sales (mn toe)	**42.9**	**46.6**	**47.4**	**46.9**	**50.3**	**51.1**	**51.2**	**50.0**
Total sales (mn boe)	**313**	**340**	**346**	**342**	**367**	**373**	**373**	**365**
Crude oil (%)	56	59	59	58	60	61	61	61
Natural gas (%)	44	41	41	42	40	39	39	39

(a) Includes ONGC's share of production from joint venture fields.

Source: Company data, Kotak Institutional Equities estimates.

ONGC's earnings are highly leveraged to crude prices

Earnings sensitivity of ONGC to key variables

	2008E			2009E			2010E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rs/US$	42.0	43.0	44.0	42.0	43.0	44.0	42.0	43.0	44.0
Net profits (Rs mn)	202,154	211,907	221,659	203,216	212,495	221,773	229,265	238,694	248,124
Earnings per share (Rs)	94.5	99.1	103.6	95.0	99.3	103.7	107.2	111.6	116.0
% upside/(downside)	**(4.6)**		**4.6**	**(4.4)**		**4.4**	**(4.0)**		**4.0**
Average crude prices									
Crude price (US$/bbl)	63.0	65.0	67.0	58.0	60.0	62.0	58.0	60.0	62.0
Net profits (Rs mn)	199,481	211,907	224,326	199,772	212,495	225,211	225,741	238,694	251,643
Earnings per share (Rs)	93.3	99.1	104.9	93.4	99.3	105.3	105.5	111.6	117.7
% upside/(downside)	**(5.9)**		**5.9**	**(6.0)**		**6.0**	**(5.4)**		**5.4**
Cess									
Cess on domestic crude (Rs/tonne)	3,060	2,550	2,040	3,060	2,550	2,040	3,060	2,550	2,040
Net profits (Rs mn)	204,143	211,907	219,671	204,745	212,495	220,245	230,855	238,694	246,534
Earnings per share (Rs)	95.4	99.1	102.7	95.7	99.3	103.0	107.9	111.6	115.3
% upside/(downside)	**(3.7)**		**3.7**	**(3.6)**		**3.6**	**(3.3)**		**3.3**
Natural gas prices									
Natural gas price ceiling (Rs/'000 cum)	3,500	4,000	4,500	4,000	4,500	5,000	4,500	5,000	5,500
Net profits (Rs mn)	206,504	211,907	217,306	207,097	212,495	217,889	233,510	238,694	243,876
Earnings per share (Rs)	96.5	99.1	101.6	96.8	99.3	101.9	109.2	111.6	114.0
% upside/(downside)	**(2.5)**		**2.5**	**(2.5)**		**2.5**	**(2.2)**		**2.2**

Source: Kotak Institutional Equities estimates.

Economy

Sector coverage view N/A

India's Rupee: On a slippery slope

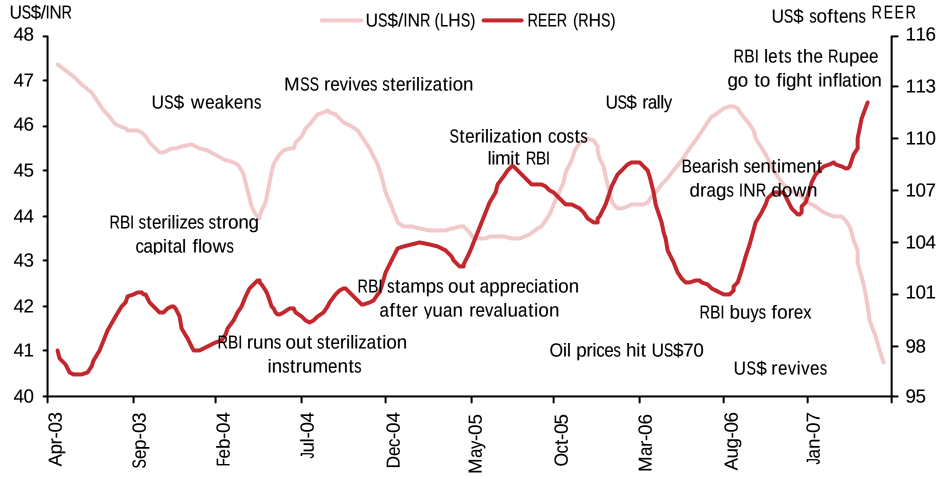
Indranil Sen Gupta : indranil.sengupta@kotak.com, +91-22-6634-1216

- **Rupee running ahead of fundamentals: 112+ REER**
- **Higher crude prices raise current account deficit: FY2008E US$65/bbl Dated Brent**
- **Little upside: BoP barely consistent with RBI's forex intervention requirements**
- **Retain Rupee forecast: Rs41/USD near-term, Rs43/USD FY2008E (1.37 Euro/USD)**

We continue to believe that the Indian Rupee is running ahead of fundamentals (Exhibit 1). Sanjeev Prasad and Gundeep Singh, our oil analysts, have increased their FY2008E Dated Brent forecast to US$65/bbl (from US$60/bbl). This pushes up our current account deficit to 1.4% of FY2008E GDP (Exhibit 2). As a result, the BoP yields an RBI forex intervention of US$21.5 bn. This is just about the US$21.5 bn the RBI will likely need to buy to fund domestic liquidity at the current CRR (Exhibit 3). The demand and supply of Rupee are thus likely reasonably balanced suggesting us a sure correction at the point of RBI forex intervention. We note that the Rupee has appreciated to Rs41/USD essentially on the back of the government's anti-inflationary strong Rupee policy. We nevertheless expect a reversion to the policy preference for export promotion with our expected inflation peak off in 1QFY2008. The government has, after all, hiked the Market Stabilization Scheme limit to Rs1100 bn to empower the RBI's sterilization. Besides, the recent sell off in the US Dollar may be overdone given that we do not expect the US Fed to ease monetary policy before 2HFY08.

Exhibit 1: The Rupee REER is up 112, well past 108 levels which typically set off forex intervention

US$/INR, REER of the Rupee



Source: RBI, x-rates.com

Exhibit 2: BoP yields US$ 21.5 bn of forex intervention

India's balance of payments (US$bn)

Item	FY2005	9MFY06	FY2006	9MFY07	FY2007E	FY2008E
Current Account	**-5.4**	**-9.5**	**-9.2**	**-11.8**	**(14.0)**	**(14.0)**
% of GDP	-0.4		-1.1		(1.6)	(1.4)
Trade balance	-36.6	-40.1	-51.8	-52.3	(68.0)	(78.0)
- Exports	82.2	74.6	105.5	91.3	125.0	148.0
- Imports	118.8	114.7	157.0	143.6	193.0	226.0
o/w Oil imports	29.8	31.5	43.9	43.8	56.0	61.0
Invisibles	31.2	30.6	42.7	40.5	54.0	64.0
o/w income from forex reserves	3.9		5.5		7.5	10.0
Capital Account	**31.5**	**7.7**	**24.2**	**28.0**	**47.0**	**46.5**
Foreign investment	12.1	11.5	17.2	11.0	18.0	22.0
- FDI	3.2	3.3	4.7	5.8	10.0	10.0
- FII+	8.9	8.2	12.5	5.2	8.0	12.0
Banking capital	3.9	1.8	1.4	1.1	8.0	6.0
- NRI deposits	3.0	1.1	2.8	3.2	5.0	3.5
Short term credit	3.8	1.7	1.7	1.3	3.0	3.0
ECBs	5.0	-1.2	2.7	9.1	12.5	12.5
Others	6.7	-6.1	1.2	5.5	5.5	3.0
Overall balance	**26.2**	**-1.8**	**15.1**	**16.2**	**33.0**	**32.5**
Memo						
RBI's net forex purchases	**20.8**	**-2.6**	**8.1**	**9.8**	**24.5**	**21.5**

Source: RBI, Kotak Institutional Equities.

Exhibit 3: US$21.5 bn RBI forex intervention necessary to fund FY2008E 8.2% real GDP growth rate

Monetary projections (Rsbn)

- The demand for overall liquidity is arrived by a broad money (M3) demand function:

  M3 growth rate = 1.4 x real GDP growth rate + inflation rate …(1)

  where the income elasticity of money demand is estimated at 1.4
- Estimated 8.2% real GDP growth rate and 5% inflation rate in FY2008 requires an M3 growth rate of 16.5%.
- In absolute terms, this works out to Rs5433 bn (US$126 bn).
- The supply of liquidity is arrived by a money supply function:

  M3 growth = 4.9 x Reserve money growth …(2)

  where the money multiplier is taken at 4.9 (assuming constant 6.5% CRR).

  Reserve money = RBI's net domestic assets + RBI's net foreign assets …(3)
- Primary liquidity of Rs1264 bn/US$29.4 bn (= 5433/4.9 + 155 bn, of 50bp CRR hike) is needed to support our FY2008 scenario.
- FY2008 likely begins with a domestic liquidity overhang of about Rs338 bn (US$8.0 bn)
- These include: balances in the Market Stabilization Scheme, adjusted for RBI's LAF repos.
- This implies that the RBI will need to buy about Rs926 bn / US$21.5 bn of foreign currency to produce the necessary primary liquidity.

Source: RBI, Kotak Institutional Equities.

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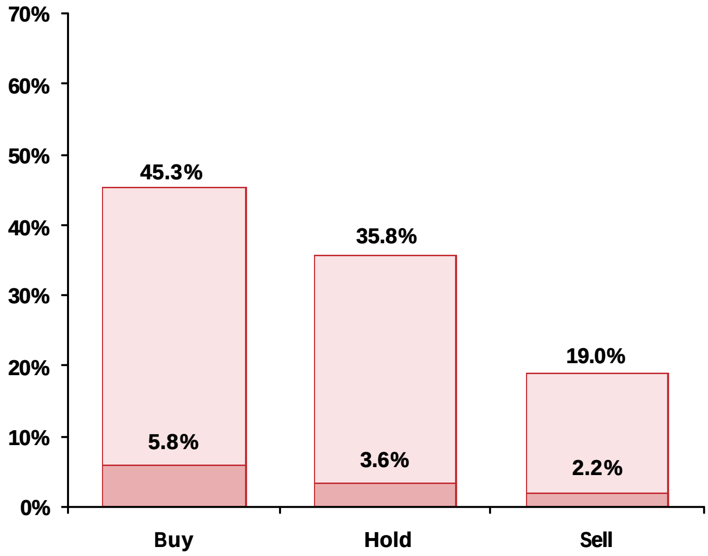

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Source: Kotak Institutional Equities. As of March 31, 2007

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