Kotak Institutional Equities

INDIA DAILY

June 02, 2008

EQUITY MARKETS

India	30-May	Change, % 1-day	1-mo	3-mo
Sensex	16,416	0.6	(6.7)	(6.6)
Nifty	4,870	0.7	(6.8)	(6.8)
Global/Regional indices				
Dow Jones	12,638	(0.1)	(3.2)	3.0
Nasdaq Composite	2,523	0.6	1.8	11.1
FTSE	6,054	(0.2)	(2.6)	2.9
Nikkie	14,346	0.1	2.1	5.5
Hang Seng	24,589	0.2	(6.3)	1.1
KOSPI	1,841	(0.6)	(0.4)	7.6

Value traded - India

	30-May		Moving avg, Rs bn 1-mo	3-mo
Cash (NSE+BSE)	203.1		198.9	194.5
Derivatives (NSE)	647.6		418.2	491
Deri. open interest	960.7		617	637

Forex/money market

	30-May	Change, basis points 1-day	1-mo	3-mo
Rs/US$	42.2	0	149	177
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	-	15	56

Net investment (US$mn)

	29-May		MTD	CYTD
FIIs	(269)		-	(3,485)
MFs	0		-	1,367

Top movers -3mo basis

Best performers	30-May	Change, % 1-day	1-mo	3-mo
Chambal Fert	84	(3.3)	18.9	43.1
Shipping Corp	281	(2.4)	11.4	30.5
Nestle India	1,767	(1.4)	1.3	28.8
Thomas Cook	103	(0.2)	2.3	28.2
i-Flex	1,376	0.3	(3.3)	27.5
Worst performers				
SAIL	162	0.7	(11.6)	(36.3)
Thermax	427	(1.3)	(14.5)	(35.4)
Reliance Cap	1,200	(2.6)	(22.2)	(34.2)
SBI	1,445	(1.1)	(20.7)	(31.6)
Siemens India	560	(0.5)	(3.2)	(31.5)

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Corporate

- Copper miner Grupo Mexico says it will do “absolutely everything” in its power to block the sale of its bankrupt subsidiary Asarco to Sterlite Industries, including a court fight. (ET)
- WNS Holdings appears to have emerged as the highest bidder for insurance giant Aviva’s BPO operations—Aviva Global Services (AGS)—with an offer of over US$200 mn. (ET)
- The market value of Bajaj Auto (market cap: Rs8,311 crore) has been overtaken by its insurance business, Bajaj Finserve (market cap: Rs9,340 crore). (ET).

Economic and political

- During the quarter ended March 2008, India Inc reported the lowest net profit growth in the last nine quarters, after the state-owned oil marketing and power companies declared poor results. (BS)
- The second central public sector units (PSU) pay revision committee report has suggested a new classification of state-owned companies linking salaries and remuneration to productivity and performance. (BS)

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

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Utilities

LAIN.BO, Rs488	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	650
52W High -Low (Rs)	888 - 159
Market Cap (Rs bn)	108

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	32.5	75.9	126.9
Net Profit (Rs bn)	3.5	7.1	15.5
EPS (Rs)	15.9	31.8	69.8
EPS gth	*103.1*	*116.4*	*139.6*
P/E (x)	30.6	15.3	7.0
EV/EBITDA (x)	20.4	14.2	8.1
Div yield (%)	(1.2)	(0.0)	-

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	73.7	-	-
FIIs	13.2	0.2	(0.1)
MFs	1.2	0.1	(0.2)
UTI	-	-	(0.2)
LIC	1.5	0.1	(0.1)

Lanco Infratech: 4QFY08: Continues with sharp ramp-up across segments

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- **Power—remains on track, await commissioning of Lanco Amarkantak**
- **Construction division—revenues double to Rs15.7 bn**
- **LITL starts booking revenues from real estate**
- **Retain BUY rating with SOTP-based target price of Rs650/share**

Lanco Infratech (LITL) reported consolidated sales of Rs12.2 bn (our est. Rs13.1 bn), EBITDA of Rs2.8 bn (our est. Rs2.8 bn) and net profit of Rs1.6 bn (our est. Rs1.9 bn) during 4QFY08. For the full year FY2008, LITL reported consolidated sales of Rs32 bn, EBITDA of Rs6.9 bn and net profit of Rs3.5 bn. The strong revenue growth for the quarter (+150%) and full year (+102%) was on account of increased sales contribution from construction and power and recognition of revenue from the real estate development at Lanco Hills. Higher construction revenue can be attributed to Lanco Amarkantak nearing completion and good progress in Nagarjuna power. We have revised our EPS estimates for FY2009 to Rs31.8 (Rs33.8 previously) and FY2010 to Rs69.8 (Rs69 previously). Our revised EPS estimates factor in marginal delays in completing Lanco Amarkantak and phasing Lanco Hills—as indicated by the management. LITL has changed accounting policies and reduced inter-segment sales and profits during consolidation. Our estimates do not factor in this elimination as management is likely to use structures like preference shares etc. to avoid elimination of inter-segment revenues. We retain our BUY rating and reduce our target price to Rs650/share (Rs670/share previously).

Power—remains on track, await commissioning of Lanco Amarkantak. LITL reported consolidated net sales of Rs6.1 bn for 4QFY08 and Rs17.5 bn for the full year, an increase of 127% yoy and 65%, respectively. The increase in revenues can be attributed to higher trading revenue (Rs6.6 bn for FY2008) and use of high-cost naphtha fuel at the Kondapalli power plant. Operational performance of the plant at Kondapalli improved (69% PLF for FY2008 versus 53% PLF in FY2007) due to the increased use of naphtha. We have revised our estimates for the power business to factor in marginal delays in implementation of power projects. We expect a step improvement in revenues from the power business as the 300 MW first unit at Amarkantak is expected to commission by August/September 2008 (as against earlier stated commissioning date of June 2008). We note that LITL will be able to generate significantly higher RoEs if Lanco Amarkantak Phase 1 operates as a merchant power plant. The High Court has put a stay on the termination of the PPA with PTC (back-to back arrangement with Madhya Pradesh) for the time being. Lanco Amarkantak-Phase 1 is entitled to regulated returns (14% RoE + efficiency gains) under the PPA.

Management confirmed that the two projects in Uttar Pradesh aggregating 3,300 MW where LITL was declared the L1 bidder will likely go in for re-bids as in the opinion of the state regulator the bid price for both the projects was higher than expected.

Construction division—revenues double to Rs15.7 bn. Income from construction contracts doubled for the quarter and full year to Rs6.5 bn and Rs15.7 bn, respectively. The higher revenues for the quarter can be attributed to near completion of the first phase (300 MW) power project at Amarkantak and pick up of work at Nagarjuna Power. Management remains confident of achieving strong EBITDA margins upwards of 18% on internal power projects (85% of current order book) and has indicated that the 39% EBIT margin for 4QFY08 is due to a misallocation of construction expenses in the segment results.

Management indicated that its Chinese equipment supplier – Dong Fang will deliver on time and at agreed fixed costs contracted power equipment supplies despite the recent earthquake in China and rising prices of steel respectively. LITL's order book now stands at Rs130 bn at end-March 2008 (Rs114 bn at end-3QFY08). The increase in order book was mainly on account of addition of the Kondapalli Extension project (370 MW). We note that LITL along with its consortium partners have emerged as the lowest bidder for the Rs80 bn Vizinkham transshipment port for a concession period of 33 years.

LITL starts booking revenues from real estate. LITL reported real estate revenues of Rs1.3 bn for FY2008 compared to our estimates of Rs2.5 bn. LITL has adopted a policy for recognition revenues from residential real estate only after (1) at least 25% of the total project costs have been incurred, and (2) 25% of the amount payable from the customer has been received and a formal sale agreement has been signed. LITL started booking revenues from 4QFY08 and were below our expectations because of delays in construction and slower sales. We adjust our model for the same and now take a construction period of 36 months compared to 30 months earlier. We take 80% sales in FY2008 for Hill County Phase-I and II compared to 100% earlier. As a result of the changes, our residential revenue estimates are revised to Rs6.5 bn in FY2009E (earlier Rs7 bn) and Rs18.8 bn in FY2010E (earlier Rs18.3 bn).

We currently assume a sale model for the commercial properties of LITL and have not made any changes to our earlier assumptions. We estimate revenues of Rs7.4 bn in FY2009E and EBITDA of Rs3.5 bn (see Exhibit). However, if LITL goes in for a lease model, the financials will change but we do not expect any impact on the valuation.

Post our changes to the model, our Mar '09 based NAV for Lanco's property business reduces to Rs88/share from Rs91/share previously.

Retain BUY rating with SOTP-based target price of Rs650/share. Our SOTP-based value of Rs650 includes—(1) power project portfolio (Rs310/share), (2) value of construction business (Rs241/share), (3) value of real estate business (Rs88/share), (4) BOT road projects (Rs5/share) and (5) value from sale of carbon credits (Rs9/share).

Lanco Infratech (Consolidated), Quarterly performance, March year-ends (Rs mn)

	FY2008	FY2007	yoy (% chg)	4QFY08	4QFY07	yoy (% chg)
Net sales	**32,413**	**16,058**	***102***	**12,249**	**4,895**	***150***
Construction Generation and Operating Expenses	(23,708)	(11,220)	*111*	(8,794)	(3,276)	*168*
Personnel costs	(874)	(235)	*272*	(337)	(77)	*335*
Other expenses and provisions	(926)	(404)	*129*	(319)	(231)	*38*
Total expenses	(25,507)	(11,860)	*115*	(9,451)	(3,584)	*164*
EBITDA	**6,905**	**4,198**	***64***	**2,799**	**1,311**	***113***
Depreciation	(776)	(656)		(228)	(180)	
EBIT	6,129	3,542		2,571	1,131	
Other income	953	416		428	111	
Net interest	(832)	(829)		(187)	(224)	
PBT	**6,250**	**3,130**	***100***	**2,812**	**1,018**	***176***
Tax	(1,405)	(468)		(762)	(215)	
Profit before Minority Interest	**4,846**	**2,662**	***82***	**2,050**	**803**	***155***
Minority Interest	(1,304)	(778)		(456)	(234)	
Net Profit	**3,542**	**1,884**	***88***	**1,595**	**569**	***180***
EBITDA margin (%)	21.3	26.1		22.8	26.8	
Effective tax rate (%)	22.5	14.9		27.1	21.1	
Segment Revenues						
Construction	15,560	5,143	*203*	6,584	2,168	*204*
Power	17,631	10,794	*63*	6,180	2,718	*127*
Property development	1,288	-		1,288	-	
Infrastructure development	112	-		112	-	
Others	(56)	151		(94)	9	
Total	**34,535**	**16,087**		**14,070**	**4,895**	
less inter -segment revenues	(2,123)	(29)		(1,820)	-	
Net revenues	**32,413**	**16,058**		**12,249**	**4,895**	
EBIT						
Construction	3,815	978		2,594	441	
Power	3,518	2,472		1,075	518	
Property Development	501	(25)		606	(10)	
Infrastructure development	12	-		12	-	
Others	-	114		-	(1)	
less interest expenses	(425)	(410)		220	70	
less unallocable expenses	(1,171)			(1,695)	-	
Total	**6,250**	**3,130**		**2,812**	**1,018**	
EBIT Margin (%)						
Construction	24.5	19.0		39.4	20.3	
Power	20.0	22.9		17.4	19.1	
Property Development	38.9			47.0		
Infrastructure development	10.8			10.8	-	

Source: Company data, Kotak Institutional Equities.

Lanco Infratech (Standalone), Quarterly performance, March year-ends (Rs mn)

	FY2008	FY2007	yoy (% chg)	4QFY08	4QFY07	yoy (% chg)
Net sales	**15,745**	**5,320**	***196***	**6,619**	**2,172**	***205***
Construction Generation and Operating Expenses	(11,470)	(3,983)	*188*	(4,433)	(1,568)	*183*
Personnel costs	(594)	(139)	*327*	(224)	(38)	*491*
Other expenses and provisions	(541)	(154)	*252*	(181)	(127)	*43*
Total expenses	(12,605)	(4,276)	*195*	(4,838)	(1,733)	*179*
EBITDA	**3,141**	**1,044**	***201***	**1,780**	**440**	***305***
Depreciation	(116)	(37)		(51)	(15)	
EBIT	3,025	1,007		1,730	425	
Other income	291	214		71	30	
Net interest	(345)	(212)		(148)	(59)	
PBT	**2,971**	**1,009**	***194***	**1,653**	**396**	***317***
Tax	(933)	(279)		(553)	(94)	
Deferred tax	-	-		-	(60)	
Net Profit	**2,038**	**731**	***179***	**1,100**	**243**	***353***
EBITDA margin (%)	19.9	19.6		26.9	20.2	
Effective tax rate (%)	31.4	27.6		33.5	38.7	

Source: Company data, Kotak Institutional Equities.

Breakup of revenues and EBITDA for residential and commercial segment

	FY2009E	FY2010E	FY2011E
Residential			
Revenues	6,459	18,837	13,556
EBITDA	3,200	8,372	5,909
Commercial			
Revenues	7,350	10,868	9,096
EBITDA	3,469	5,059	4,100

Source: Kotak Institutional Equities estimates.

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

	2006	2007	2008	2009E	2010E
Profit model (Rs mn)					
Net sales	1,471	16,058	32,468	75,888	126,885
EBITDA	**167**	**4,198**	**6,910**	***15,343***	**33,445**
Other income	13	416	953	852	792
Interest	(36)	(829)	(832)	(1,814)	(3,767)
Depreciation	(19)	(656)	(775)	(2,581)	(3,698)
Extraordinary items	(0)	(1)	0	0	0
Pretax profits	125	3,128	6,256	11,801	26,773
Tax	(33)	(468)	(1,406)	(2,517)	(6,605)
Minority Interest	79	(778)	(1,305)	(2,213)	(4,658)
Net profits	**171**	**1,883**	**3,545**	***7,071***	**15,510**
Earnings per share (Rs)	**5.6**	**8.5**	**15.9**	***31.8***	**69.8**
Balance sheet (Rs mn)					
Total equity	954	15,105	19,978	27,051	42,562
Deferred taxation liability	31	92	5	6	5
Total borrowings	1,495	20,821	47,380	129,526	189,889
Currrent liabilities	1,581	11,424	12,671	27,828	35,750
Minority Interest	41	41	41	41	41
Total liabilities and equity	**4,101**	**47,482**	**80,075**	***184,453***	**268,247**
Cash	414	5,050	8,001	14,365	25,171
Current assets (excl cash)	2,264	12,013	17,671	33,096	44,371
Total fixed assets	409	24,390	54,263	136,852	198,564
Investments	1,015	6,029	135	135	135
Deferred Expenditure	0	0	5	5	5
Total assets	**4,101**	**47,482**	**80,075**	***184,453***	**268,247**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	128	3,669	5,797	12,957	26,290
Working capital	(230)	95	(4,411)	(268)	(3,354)
Capital expenditure	(211)	(24,637)	(30,649)	(85,169)	(65,411)
Investments	(419)	(5,014)	5,894	0	0
Free cash flow	**(732)**	**(25,888)**	**(23,369)**	***(72,480)***	**(42,474)**

Source: Kotak Institutional Equities estimates.

SOTP value of Rs650/share

	Equity value	Equity Inv.		Capacity		Attributable value		
	(Rs mn)	(Rs mn)	P/BV (X)	Gross	Attributable	(%)	(Rs mn)	(Rs/share)
Operating power plants								
Lanco Kondapalli	8,131	3,400	2.4	368	217	59	6,465	
Aban Power	2,399	1,318	1.8	120	61	51	1,841	
Clarion Power	718	224	3.2	12	12	97	775	
Rithwik Power	394	90	4.4	6	5	89	402	
Lanco Electric Utility (Power trading)	622	212	2.9			100	620	
Power plants under construction								
Lanco Amarkantak	9,755	5,135	1.9	600	456	76	7,414	
Lanco Green	1,403	838	1.7	70	63	90	1,262	
Vamshi Hydro	426	139	3.1	10	9	91	388	
Vamshi Industrial	389	145	2.7	10	9	91	354	
Nagarjuna Power	11,705	8,708	1.3	1,015	751	74	8,662	
Lanco Energy - Teesta VI	12,528	5,900	2.1	500	370	74	9,271	
Anpara 'C'	13,476	8,230	1.6	1,200	1,200	100	13,476	
Power plants yet to achieve financial closure								
Lanco Hydro (Uttaranchal)	3,634	1,900	1.9	150	137	91	3,309	
Lanco Amarkantak extn.	7,176	3,840	1.9	600	456	76	5,454	
Orissa power project	33,106	16,632	2.0	1,980	1,980	100	33,106	
Sub total	**105,861**	**56,712**	**1.9**	**6,641**	**5,726**		**92,798**	**417**
Net equity funding requirement							(23,890)	(107)
Power (A)							**68,908**	**310**
Construction (B)							**53,579**	**241**
Property development (C)							**19,512**	**88**
Road projects (D)							**1,006**	**5**
Carbon credits (E)							**1,981**	**9**
Grand total (A+B+C+D+E)							**144,985**	**652**

Source: Kotak Institutional Equities estimates.

Construction

PUJL.BO, Rs321	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	420
52W High -Low (Rs)	656 - 214
Market Cap (Rs bn)	102.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	81.4	114.2	152.9
Net Profit (Rs bn)	3.3	5.4	7.9
EPS (Rs)	10.4	16.9	24.7
EPS gth	*98.7*	*63.4*	*46.0*
P/E (x)	30.9	18.9	13.0
EV/EBITDA (x)	17.6	11.4	8.3
Div yield (%)	0.2	0.5	0.7

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	44.7	-	-
FIIs	24.4	0.3	0.1
MFs	12.6	0.8	0.6
UTI	-	-	(0.2)
LIC	-	-	(0.2)

Punj Lloyd: Continuation of contract specific losses in Sembawang mask very strong operational performance of the standalone entity

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- **Results broadly in line with expectations led by higher-than-expected margins and lower-than-expected other income**
- **Margin expansion led by standalone entity; legacy impact on margins of Sembawang likely continues**
- **Contract variations in Simon Carves may result in a potential loss of Rs1.8 bn though management believes amount is recoverable**
- **Large order backlog of Rs196 bn, mix shifts away from India and towards process segment**
- **Maintain target price of Rs420 and BUY rating**

Punj Lloyd has reported 4QFY08 consolidated revenues of Rs23.5 bn (up 38% yoy) and PAT of Rs1.2 bn (up 33% yoy). Revenue growth is led by 88% growth in revenues of the standalone entity to Rs15 bn. EBITDA margin expansion is also led by the standalone entity, which has seen margins expand by 710 bps to 16.1% in 4QFY08 (versus 9% a year ago). On the other hand, subsidiary margins have likely contracted significantly, to 0.8% in 4QFY08 from 10.9% a year ago. The effect of legacy orders on Sembawang's margins likely continues. Order backlog at the end of FY2008 increased by 23% to Rs196 bn. Auditor qualifications to Simon Carves' (UK) account highlight that it has a potential loss of Rs3.1 bn on its books, for extra work on a long-term contract in progress. However, the management believes that the money can be recovered as it is attributable to changes in contract scope and design and negotiations are currently being undertaken with the client. We believe that about Rs1.3 bn may have already been recovered post the accounts of FY2008. Net current assets at Rs22.5 bn (excluding cash of Rs77 mn) have increased to 101 days of sales at the end of FY2008, from 37 days of sales in FY2007 on a consolidated basis. We maintain our FY2009E DCF-based target price of Rs420 and our BUY rating. We will revisit our estimates post the management conference call.

Results broadly in line with expectations led by higher-than-expected margins and lower-than-expected other income

Punj Lloyd reported 4QFY08 consolidated revenues of Rs23.5 bn (up 38% yoy) and PAT of Rs1.2 bn (up 33% yoy) versus our expectation of Rs24.4 bn and PAT of Rs1.3 bn respectively (Exhibit 1). Revenue growth is led by 88% growth in revenues of the standalone entity to Rs15 bn. Subsidiary revenues have reduced by 6% yoy. Consolidated EBITDA margins in 4QFY08 expanded by 60 bps yoy to 10.6% versus 10% a year ago and our expectation of 9.8%. Interest and depreciation in 4QFY08 increased 26% and 24% (yoy), respectively, led by the increased capex. Other income is a negative of Rs183 mn (versus our expectation of Rs407 mn), possibly due to a reversal of derivative gains recognized in earlier quarters of Rs218 mn (such a reversal was necessitated by a change in accounting policy whereby derivative gains are not to be recognized). Net current assets at Rs22.5 bn (excluding cash of Rs77 mn) have increased to 101 days of sales at the end of FY2008, from 37 days of sales in FY2007 on a consolidated basis. Punj has likely undertaken a capex of greater than Rs3 bn during the year on a consolidated basis, as its net block has increased to Rs16.2 bn at the end of FY2008 from Rs13.6 bn at the end of FY2007.

Sharp margin expansion for standalone entity led by operating leverage. The EBITDA margin expansion is led by the standalone entity, which has seen margins expand by 710 bps to 16.1% in 4QFY08 (versus 9% a year ago). The margin expansion at the standalone entity (and hence consolidated) is led by operating leverage as the other expenditure cost ratio has significantly decreased by 450 bps yoy.

Exceptionally low margins at subsidiary level highlight potential loss-booking in legacy orders. On the other hand, subsidiary margins have likely contracted significantly to 0.8% in 4QFY08 from 10.9% a year ago. The effect of legacy orders on Sembawang's margins likely continues and some order may have been executed at a loss or marginal contribution in this quarter also.

EPC risk to the fore – auditor's qualifications suggest that over half of the full-year profitability may be wiped out because of specific contract; management believes amount is recoverable. Auditor qualifications to Simon Carves' (UK) account highlight that it has a potential loss of Rs3.1 bn on its books for extra work on a long-term contract currently in progress (which would result in decrease of work in progress by Rs2.6 bn and increase provision for foreseeable losses by Rs465 mn). Management however believes that the money can be recovered as it is attributable to changes in contract scope and design and negotiations are currently being undertaken with the client. We believe that about Rs1.3 bn may have already been recovered post the accounts of FY2008. We highlight that if the balance amount is not recovered, it will likely cause a loss of Rs1.8 bn—50% of Punj's consolidated profits of Rs3.6 bn in FY2008.

Strong growth in FY2008 highlights organization capability to scale-up. Punj's (consolidated) revenues have grown 51% yoy in FY2008 and standalone revenues have grown 100%. Consolidated revenues have grown at a slower pace as getting SEC back on track (acquired early last year) and integrating it with Punj will likely take some time. We highlight that SEC has received strong order inflows in FY2008 and hence will potentially achieve strong growth in FY2009. We also highlight that doubling of Punj's (standalone) revenues (all of ahead peer companies being covered by KIE), indicates organization's capabilities to rapidly scale-up its business. We also highlight that 59% of the consolidated revenues were derived from international operations in FY2008, indicating the increasing global nature of its operations.

Large order backlog likely comprises of higher-margin process orders. Order backlog at the end of FY2008 increased by 23% to Rs196 bn. We highlight that Punj had strong order inflows in FY2008 (Exhibit 3). Contribution of likely higher-margin process-related orders in the order book has increased from Rs27 bn in FY2007 (though sectoral break-up of SEC orders is not available) to Rs77bn in FY2008 (Exhibit 4). Contribution of the Indian geography in the order book has declined from 40% at the end of FY2007 to 30% at the end of FY2008 (Exhibit 5). This is likely led by strong execution in the standalone entity in FY2008 and strong order inflows in Sembawang during the year.

Maintain target price of Rs420 and BUY rating. We maintain our FY2009E DCF-based target price of Rs420 (Exhibit 6) and our BUY rating. We will revisit our estimates post the management conference call on Tuesday, June 3, 2008, in which we expect to receive details on (1) audit qualifications, (2) business plans, (3) components of other income and (4) working capital levels.

Exhibit 1. Punj Lloyd (standalone) - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			12 months		
	4QFY08	4QFY07	*(% chg)*	4QFY08	3QFY08	*(% chg)*	FY2008	FY2007	*(% chg)*
Net sales	**14,994**	**7,983**	***87.8***	**14,994**	**12,438**	***20.6***	**44,886**	**22,397**	***100.4***
Operating costs	**(12,574)**	**(7,264)**	***73.1***	**(12,574)**	**(11,380)**	***10.5***	**(39,741)**	**(20,544)**	***93.4***
Material consumed and cost of goods sold	(4,953)	(2,607)	*90.0*	(4,953)	(4,355)	*13.7*	(16,254)	(5,902)	*175.4*
Contractor charges	(2,839)	(1,667)	*70.3*	(2,839)	(3,509)	*(19.1)*	(9,963)	(4,960)	*100.9*
Staff Cost	(1,210)	(734)	*64.7*	(1,210)	(928)	*30.4*	(3,585)	(2,366)	*51.6*
Other Expenditure	(3,572)	(2,256)	*58.3*	(3,572)	(2,588)	*38.0*	(9,939)	(7,317)	*35.8*
EBITDA	**2,421**	**719**	***236.8***	**2,421**	**1,058**	***128.8***	**5,144**	**1,853**	***177.7***
Other income	72	210	*(65.9)*	72	145	*(50.4)*	532	658	*(19.2)*
Interest costs	(301)	(261)	*15.4*	(301)	(239)	*25.8*	(1,133)	(692)	*63.6*
Depreciation	(318)	(242)	*31.4*	(318)	(294)	*7.9*	(1,134)	(845)	*34.2*
PBT	**1,874**	**427**	***339.1***	**1,874**	**669**	***180.1***	**3,409**	**973**	***250.3***
Taxes	(577)	(195)	*195.9*	(577)	(277)	*107.9*	(1,195)	(357)	*234.4*
PAT	**1,297**	**232**	***459.6***	**1,297**	**392**	***231.2***	**2,214**	**616**	***259.5***
Key ratios									
Material consumed and cost of goods sold	33.0	32.7		33.0	35.0		36.2	26.4	
Contractor charges	18.9	20.9		18.9	28.2		22.2	22.1	
Staff Cost	8.1	9.2		8.1	7.5		8.0	10.6	
Other Expenditure	23.8	28.3		23.8	20.8		22.1	32.7	
EBITDA margin (%)	**16.1**	**9.0**		**16.1**	**8.5**		**11.5**	**8.3**	
PAT margin (%)	8.7	2.9		8.7	3.1		4.9	2.8	
Effective tax rate (%)	30.8	45.7		30.8	41.5		35.1	36.7	

Source: Company data, Kotak Institutional Equities.

Exhibit 2. Punj Lloyd (consolidated) - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			12 months		
(in Rs mn)	4QFY08	4QFY07	*(% chg)*	4QFY08	3QFY08	*(% chg)*	FY2008	FY2007	*(% chg)*
Net sales	**23,467**	**17,036**	***37.8***	**23,467**	**21,170**	***10.8***	**77,529**	**51,266**	***51.2***
Operating costs	**(20,981)**	**(15,329)**	***36.9***	**(20,981)**	**(20,126)**	***4.2***	**(71,122)**	**(47,523)**	***49.7***
Material consumed and cost of goods sold	(7,478)	(2,989)	*150.2*	(7,478)	(7,614)	*(1.8)*	(28,285)	(16,370)	*72.8*
Contractor charges	(5,966)	(6,461)	*(7.7)*	(5,966)	(6,747)	*(11.6)*	(21,339)	(14,181)	*50.5*
Staff Cost	(2,889)	(2,019)	*43.1*	(2,889)	(2,392)	*20.8*	(8,924)	(6,369)	*40.1*
Other Expenditure	(4,648)	(3,860)	*20.4*	(4,648)	(3,373)	*37.8*	(12,575)	(10,602)	*18.6*
EBITDA	**2,486**	**1,707**	***45.7***	**2,486**	**1,045**	***138.0***	**6,407**	**3,743**	***71.2***
Other income	(183)	164	*(211.9)*	(183)	459	*(139.9)*	811	794	*2.1*
Interest costs	(326)	(258)	*26.3*	(326)	(284)	*14.5*	(1,292)	(825)	*56.5*
Depreciation	(409)	(329)	*24.3*	(409)	(365)	*12.0*	(1,462)	(1,062)	*37.8*
PBT	**1,568**	**1,283**	***22.2***	**1,568**	**854**	***83.7***	**4,464**	**2,650**	***68.4***
Taxes	(374)	(398)	*(6.0)*	(374)	(308)	*21.4*	(1,235)	(690)	*79.1*
PAT	**1,194**	**885**	***34.9***	**1,194**	**546**	***118.8***	**3,229**	**1,960**	***64.7***
Minority interest/Exceptional items	(17)	-		(17)	-		356	-	
Reported PAT	**1,177**	**885**	***33.1***	**1,177**	**546**	***115.8***	**3,584**	**1,960**	***82.8***
Key ratios									
Material consumed and cost of goods sold	31.9	17.5		31.9	36.0		36.5	31.9	
Contractor charges	25.4	37.9		25.4	31.9		27.5	27.7	
Staff Cost	12.3	11.8		12.3	11.3		11.5	12.4	
Other Expenditure	19.8	22.7		19.8	15.9		16.2	20.7	
EBITDA margin (%)	**10.6**	**10.0**		**10.6**	**4.9**		**8.3**	**7.3**	
PAT margin (%)	5.1	5.2		5.1	2.6		4.2	3.8	
Effective tax rate (%)	23.9	31.0		23.9	36.1		27.7	26.0	

Source: Company data, Kotak Institutional Equities estimates.

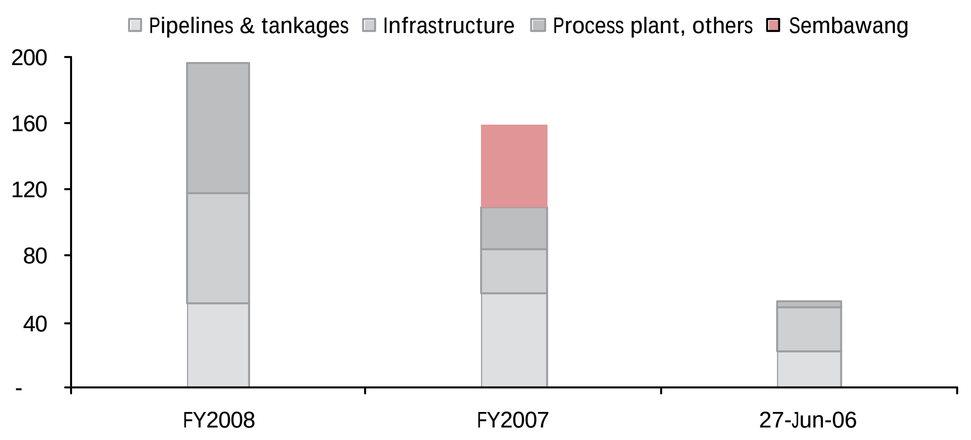
Exhibit 3: Strong order inflows continue for Punj Lloyd so far in this financial year
Key orders won by Punj Lloyd in FY2008 so far (Rs mn)

Date	Segment	Area	Client	Value (Rs mn)	Group entity	Description
7-Mar-08	Oil and Gas	Pipeline	Petronas, Malaysia	20,000	Punj Lloyd	EPC of a 512 km, 36" diameter onshore natural gas pipeline in Malaysia with support from local partners
14-Feb-08	Civil, Infrastructure and Power	Buildings	Marina Bay Sands Pte Ltd, Singapore	11,192	Sembawang Engineers and Constructors	Construction of the North Podium in the integrated resort comprising casino, theatres and retail arcade
12-Dec-07	Process	Process	Indian Oil Corporation	5,900	Punj Lloyd	Construction of coker unit & block for the Vadodara refinery in Gujarat
30-Nov-07	Civil, Infrastructure and Power	Infrastructure	Land Transport Authority, Singapore	12,720	Sembawang Engineers and Constructors	Construction of the MRT station in Marina Bay in Singapore
5-Nov-07	Process	Process	Jurong Aromatics Corporation Pte Ltd, Singapore	17,700	Sembawang Engineers and Constructors	EPC work for a new mega aromatics plant at Jurong island
12-Oct-07	Oil and Gas	Pipeline	Qatar Petroleum	3,890	Punj Lloyd	EPC on LSTK basis of 46 km of 18" multi-product pipeline
6-Aug-07	Process	Process	Bharat Oman Refineries Limited	5,900	Punj Lloyd	Lump-sum turnkey contract for building a sulphur block at Bina Refinery
2-Aug-07	Civil, Infrastructure and Power	Buildings	Sentosa Pte Ltd, subsidiary of Genting Group	6,660	Sembawang Engineers and Constructors	Sub-structural works at Sentosa Integrated Resort Development
27-Jul-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	3,180	Punj Lloyd	Laying of pipeline & associated facilities for East-West Pipeline project
23-Jul-07	Oil and Gas	Tankage	Saudi Kayan Petrochemical Company (SABIC)	1587(a)	Dayim Punj Lloyd Construction Contracting Company Ltd	EPC of tanks at Jubail Industrial city, Saudi Arabia
20-Jul-07	Process	Process	Gulf Fluor	500(b)	Simon Carves Ltd.	Fluorides plant incorporating a new Sulphuric Acid plant
14-May-07	Oil and Gas	Pipeline	GAIL (India) Ltd	1,227	Punj Lloyd	Phase II of Panvel — Dabhol Pipeline
16-Apr-07	Oil and Gas	Pipeline	Oman Gas Company	5,300	Punj Lloyd	24", 40 Km pipeline
19-Apr-07	Oil and Gas	Pipeline	Ras Laffan Olefins Company Ltd, USA	1,935	Punj Lloyd	Ethylene pipeline
23-Apr-07	Oil and Gas	Pipeline	Reliance Gas Transportation Infrastructure Ltd	1,802	Punj Lloyd	48", 122 Km pipeline
Total				**99,492**		

(a) Estimated share of Punj Llyod
(b) Estimated order value

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 4. Order backlog has increased substantially with the inclusion of Sembawang
Order backlog position of Punj Lloyd group, (Rs bn)

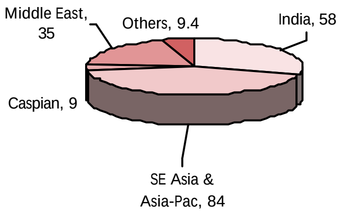


Source: Company, Kotak Institutional Equities

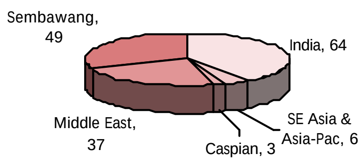
Exhibit 5: Proportion of order backlog contributed by Indian gepgraphy has declined to 30% at the end of FY2008 from 40% at the end of FY2007

Geographical mix of order backlog of Punj Lloyd group (Rs bn)

FY2008



FY2007



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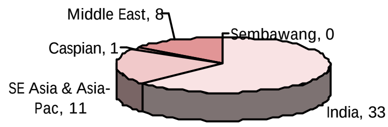

Note:
Orderbacklog of SEC was about Rs69 bn at the end of FY2008

Source: Company data, Kotak Institutional Equities.

Exhibit 6. Punj Lloyd Consolidated- DCF model, March fiscal year-ends (Rs mn)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E
Revenues	**81,426**	**114,205**	**152,888**	**197,957**	**243,199**	**296,975**	**359,237**	**427,298**	**491,393**	**565,102**	**621,612**
Revenue growth (%)	58.8	40.3	33.9	29.5	22.9	22.1	21.0	18.9	15.0	15.0	10.0
EBITDA	**6,254**	**10,169**	**14,442**	**18,777**	**23,017**	**28,110**	**34,005**	**40,449**	**46,682**	**53,685**	**59,053**
EBITDA (%)	7.7	8.9	9.4	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
Depreciation	(1,394)	(1,596)	(1,832)	(2,094)	(2,392)	(2,707)	(3,022)	(3,337)	(3,504)	(3,679)	(3,863)
EBIT	4,860	8,574	12,611	16,683	20,625	25,403	30,983	37,112	43,179	50,006	55,190
Tax	(1,456)	(2,412)	(3,546)	(4,703)	(5,803)	(7,149)	(8,722)	(10,449)	(14,249)	(16,502)	(18,213)
Change in net working capital	**(10,105)**	**(9,420)**	**(9,558)**	**(8,524)**	**(8,837)**	**(11,941)**	**(13,940)**	**(15,738)**	**(13,170)**	**(15,146)**	**(11,612)**
Capex	(1,786)	(3,250)	(3,500)	(4,000)	(4,500)	(4,500)	(4,500)	(4,500)	(4,914)	(5,651)	(6,216)
Free cash flow	**(7,092.6)**	**(4,913.5)**	**(2,162.3)**	**1,550.8**	**3,876.9**	**4,519.9**	**6,843.6**	**9,762.5**	**14,349.3**	**16,386.1**	**23,012.5**
PV of each cash flow	(7,092.6)	(4,913.5)	(1,922.0)	1,225.3	2,722.9	2,821.7	3,797.7	4,815.5	6,291.6	6,386.4	7,972.4

PV of cash flows	22,106	17%
PV of terminal value	108,859	83%
EV	130,965	100%
Debt	5,267	
Equity value	125,698	
Equity value (Rs/share)	**418**	

FCF in terminal year (Rs mn)	25,250
Exit FCF multiple: (1+g)/(WACC-g)	14.0
Terminal value of FCF (Rs mn)	353,501
Exit EBITDA multiple	5.4

Weighted average cost of capital-WACC	
Terminal growth - g (%)	5.0
Risk free rate-Rf (%)	7.5
Market risk premium—(Rm-Rf) (%)	5.5
Beta (x)	1.1
Cost of equity-Ke (%)	13.6
Cost of debt-Kd (%)	12.0
Tax rate (%)	33.9
Debt/Capital (%)	41.9
Equity/Capital (%)	58.1
WACC (%)	11.2
Used WACC (%)	12.5

Sensitivity of DCF value to WACC, Terminal Growth rate

		WACC (%)				
		11.5	**12.0**	**12.5**	**13.0**	**13.5**
Terminal growth rate (%)	**3.0**	406	369	336	307	282
	4.0	455	411	373	339	309
	5.0	520	465	**418**	377	342
	6.0	608	537	478	427	384
	7.0	736	638	559	494	439

Source: Company data, Kotak Institutional Equities estimates

Consumer products

COLG.BO, Rs416	
Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	455
52W High -Low (Rs)	525 - 324
Market Cap (Rs bn)	56.6

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	15	17	18
Net Profit (Rs bn)	2.4	2.6	3.1
EPS (Rs)	17.3	19.2	22.4
EPS gth	*18.4*	*10.6*	*17.0*
P/E (x)	24.0	22	18.6
EV/EBITDA (x)	19.0	16.1	13.5
Div yield (%)	3.1	3.5	4.0

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.0	-	-
FIIs	7.8	0.1	(0.1)
MFs	5.2	0.2	0.1
UTI	-	-	(0.1)
LIC	6.1	0.2	0.1

Colgate-Palmolive (India): 4QFY08—Stable business and steady market shares; an excellent stock for volatile times

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- **Robust volume growth, steady market shares**
- **Street overly concerned on sorbitol prices**
- **Market share gains by 'Cibaca' and 'Babool' indicates mix of new consumer recruitment and likely category downtrading**
- **Performance of 'Pepsodent Mahapack' is a key trigger to watch out for**
- **Retain ADD rating and target price of Rs455/share, stock offers 4% dividend yield**

Colgate reported yoy sales growth of 14.0%, EBITDA decline of 5.9% and net profit growth of 11.1% for 4QFY08. Higher other expenses (up 27.7% yoy), employee costs (up 22.5% yoy) and certain one-off provisions (in base and current quarter) dented EBITDA growth for the quarter. Full benefit of increased sourcing from the production facility in Himachal Pradesh was visible as the effective tax rate for FY2008 reduced by 450 bps to 18.8%. We forecast a 200 bps higher effective tax rate for FY2009E as the company ramps up production at the Goa and Hyderabad units for logistical reasons. Market leadership in toothpaste and toothbrushes was maintained with shares of 48.2% and 37.2%, respectively. HUL has recently launched Pepsodent Mahapack (Rs6 for 30 gms, a flow wrap product) at the LUP (low unit pack) segment. We expect HUL to up the ante in the oral category as their market share has fallen below the 30% mark for the first time in 10 years. We believe street concerns on sorbitol prices impacting Colgate's margins are unfounded—Calcium carbonate is the key raw material in white toothpaste (Colgate Dental cream) and over 85% of Colgate's portfolio is white toothpaste. Sorbitol is a key raw material in silica-based toothpaste (Close Up, Colgate Gel). We continue to believe that Colgate is well positioned to capitalize on penetration driven growth opportunity in India. We have marginally revised our estimates for FY2009E to Rs19.2 (Rs19.1 previously) and FY2010E EPS to Rs21.9 (Rs22.5 previously). Our DCF-based fair value of Rs455/share (23XFY09E) offers a 10% upside to CMP, we retain ADD rating. Dividend yield of 4% provides downside support as well.

Robust volume growth, steady market shares. Colgate achieved overall volume growth of 10% yoy in toothpaste and 20% in toothbrush categories for 4QFY08. New launches by the company in the toothpaste category in CY2007 have done well—'Colgate Active Salt' and 'Colgate Max Fresh' have achieved market share of about 5%. Increasing volumes and further consolidation of market shares through product innovation and re-launch have helped the company retain its growth momentum. Market share gains by 'Cibaca' (Colgate) and 'Babool' (Dabur) suggest two possible trends—(1) higher consumer recruitment into toothpaste category as these two are entry-level brands, (2) potential down trading within the toothpaste category to lower-value products (these brands are positioned as 'value for money'). We believe the new consumer recruitment driven growth is the likely scenario as the category penetration improvement of 8% suggests (53% for 2007 compared to 45% in 2004). However, we highlight the task ahead for market leaders—both Colgate and HUL with a combined market share of 80%—to develop and expand the franchise for top-end and specialty products (eg., 'Colgate Total', 'Pepsodent Gumcare'). Our discussions with marketers indicate that both the companies are yet to invest significantly in communicating to the consumer the value proposition for the top-end brands.

Street concerns on sorbitol prices unfounded. We highlight that calcium carbonate is the key raw material in white toothpaste (like Colgate Dental cream, Pepsodent) while sorbitol is a key ingredient in silica-based toothpastes (Close Up of HUL, Colgate Gel). We estimate that over 85% of Colgate's toothpaste portfolio is white toothpaste (Colgate Dental cream and variants, Cibaca). Hence, the street concerns on higher prices of sorbitol and hence Colgate's raw material costs are unfounded.

Colgate structurally needs to have higher brand spends. Colgate has one of the highest advertising & promotion (A&P) spends in the FMCG industry (at 17% of sales). We believe that HUL spends about 13% of sales on A&P in oral category and has significant media buying benefits (we est. about 20%) because of the leadership position as India's no.1 spender on media. Hence, to maintain the relative share of voice/share of market (SOV/SOM), Colgate needs to structurally have a higher A&P to sales ratio.

Performance of 'Pepsodent Mahapack' is a key trigger to watch out. HUL's current market share at <30% in toothpaste is the lowest in ten years. Though oral care is a non-focus category for parent Unilever, it contributes significantly to HUL. We estimate HUL's oral care business at about Rs8 bn with gross margins of about 45%. We had highlighted in our note dated 3rd January 2008 that HUL will be uncomfortable to allow its market share to dip below 30% and is expected to look at various options to prevent further market share loss. The company has recently launched Pepsodent 'Mahapack'—flow wrapped toothpaste of 30 gms priced at Rs6. The product was initially launched in select geographies, currently it is extended pan India. We believe that this SKU (stock keeping unit) could be a success for HUL given the value proposition. Colgate has retaliated by reducing the retail price of its 20gm pack of Colgate Dental Cream to Rs5 from Rs6.

HUL gaining market shares from low cost competition (Anchor, Ajanta) and Babool (Dabur) is the best-case scenario for Colgate—which we believe is the most likely case. Additionally, considering the resource prioritization which HUL will likely have—higher resources for categories with hyper-competition like shampoo, skin and investment requirements of foods and water business—we believe that the possibility of a price based competition is unlikely.

Supply chain streamlined—all incremental volumes may not come from Himachal Pradesh. We believe the acquisition of three contract manufacturers in Hyderabad and Goa by Colgate is to streamline its supply chain and highlight that all incremental growth may not come from Himachal. We believe that Colgate is trying to improve the stock availability at point of sale as possibly the company have found it difficult to service the entire country from Himachal. We like the company's choice of improving the stock availability index at point of sale over fiscal benefits. During November 2007, Colgate acquired 75% stake in three companies—Advanced Oral Care Products Pvt Ltd, Professional Oral Care Products Pvt Ltd and SS Oral Hygiene Products Pvt Ltd—for a purchase consideration of Rs63 mn. These companies have been manufacturing and supplying oral care products for the company for several years.

Retain ADD rating with a target price of Rs455. Colgate has maintained an average dividend payout ratio of 75% over the last five years (even after investing over Rs1 bn in the new Himachal facility). We expect the payout ratio to be maintained. We have marginally revised our estimates for FY2009E to Rs19.2 (Rs19.1 previously) and FY2010E EPS at Rs21.9 (Rs22.5 previously). At the current market price of Rs416/share, the stock is quoting at 4% yield for FY2009E. Our DCF-based fair value of Rs455/share (23X FY09E) offers a 10% upside to CMP, we retain ADD rating. Stability of earnings, good dividend yield and market leadership position makes Colgate an excellent defensive stock to own in volatile times. The key risk to our rating is any unprecedented competitive activity by HUL for aggressive market share gains and higher-than-expected down trading in the category.

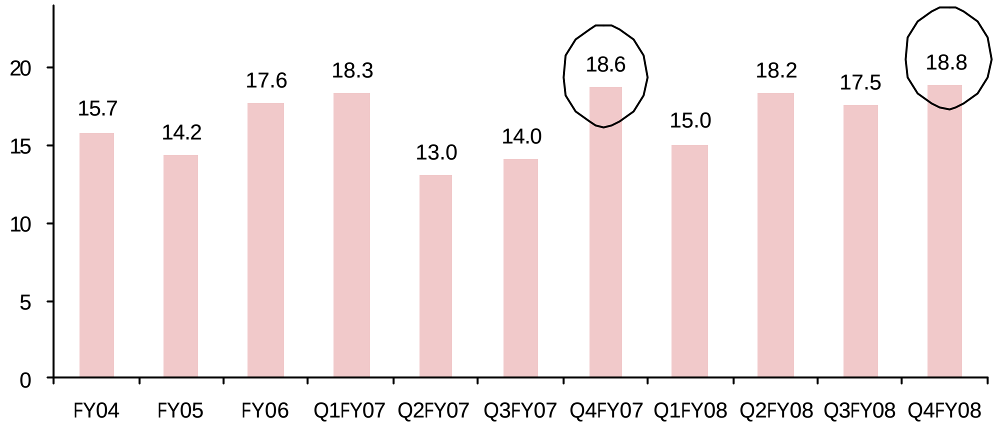
Colgate Palmolive (India)-Quarterly summary, March yearends (Rs mn)

	yoy			Our est.	yoy
	4QFY08	4QFY07	% chg	4QFY08	% chg
Net sales	**3,913**	**3,433**	**14.0**	**3,870**	**12.8**
Material cost	(1,768)	(1,539)		(1,610)	
Employee cost	(307)	(251)		(388)	
Other expenditure	(598)	(468)		(545)	
Advertising & promotions	(735)	(639)		(708)	
Total expense	(3,408)	(2,897)		(3,251)	
EBITDA	**506**	**535**	**(5.6)**	**620**	**15.7**
Depreciation	(55)	(37)		(53)	
EBIT	451	499		566	
Other income	214	174		196	
Net interest	(4)	(3)		(2)	
PBT	**662**	**670**	**(1.3)**	**760**	**13.5**
Tax	(105)	(169)		(175)	
PAT	**556**	**501**	**11.1**	**586**	**17.0**
Extraordinary income (loss)	-	5		-	
Reported net profit	**556**	**506**	**9.9**	**586**	**15.8**
EBITDA margin (%)	12.9	15.6		16.0	
Effective tax rate (%)	15.9	25.3		23.0	
Costs as % of net sales					
Material cost	45.2	44.8		41.6	
Employee cost	7.9	7.3		10.0	
Other expenditure	15.3	13.6		14.1	
Advertising & promotions	18.8	18.6		18.3	

Source: Company data, Kotak Institutional Equities.

Colgate will have to spend higher on A&P to match HUL

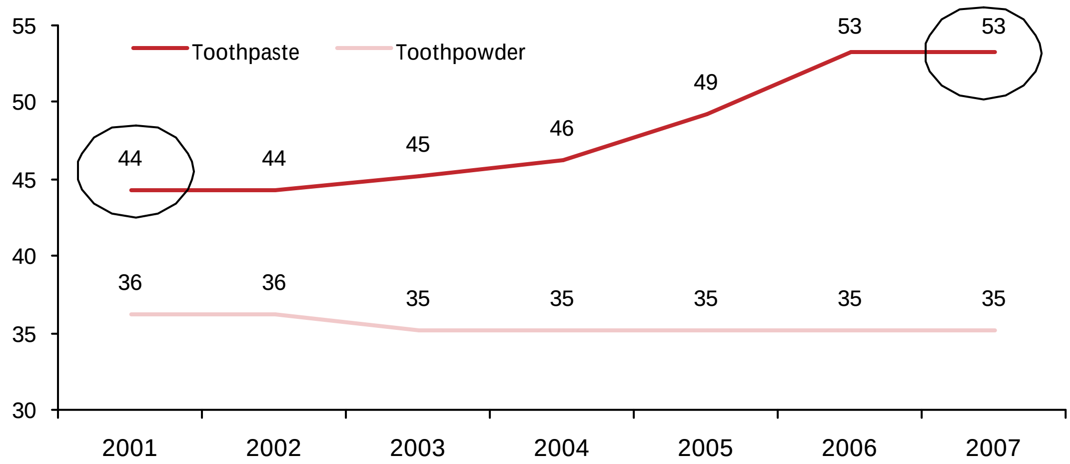
Advertising and promotion as a % of sales



Source: Company data, Kotak Institutional Equities.

Faster growth in market shares of Cibaca and Babool indicates improvement in category penetration

Toothpaste and toothpowder penetration (%)



Source: Company data, Kotak Institutional Equities.

Colgate, change in estimates, March fiscal year-ends (Rs mn)

	FY2009E			FY2010E		
	New	**Old**	**Change (%)**	**New**	**Old**	**Change (%)**
Sales	16,883	16,583	1.8	19,111	18,366	4.1
EBIDTA	2,821	2,959	(4.7)	3,320	3,574	(7.1)
Net profit	2,615	2,598	0.6	2,975	3,056	(2.7)
EPS (Rs)	19.2	19.1	0.6	21.9	22.5	(2.7)
Sales growth (%)	15.1	13.1		13.2	10.8	
EPS growth (%)	12.4	11.0		13.8	17.6	

Source: Kotak Institutional Equities estimates.

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

	2006	2007	2008	2009E	2010E
Profit model (Rs mn)					
Net sales	**11,239**	**12,892**	**14,665**	**16,883**	**19,111**
EBITDA	**2,018**	**2,089**	**2,301**	**2,821**	**3,320**
Other income	196	670	773	729	735
Interest	(6)	(10)	(13)	(10)	(10)
Depreciation	(149)	(153)	(197)	(197)	(217)
Extraordinary items	(125)	(389)	(10)	0	0
Pretax profits	1,934	2,208	2,854	3,344	3,828
Tax	(558)	(606)	(538)	(729)	(853)
Net profits	**1,376**	**1,602**	**2,316**	**2,615**	**2,975**
Earnings per share (Rs)	**11.0**	**14.6**	**17.1**	**19.2**	**21.9**
Dividend per share (Rs)	**7.5**	**9.5**	**13.0**	**16.3**	**18.6**
Balance sheet (Rs mn)					
Total equity	2,711	2,805	1,832	1,851	1,873
Total borrowings	44	43	44	44	44
Currrent liabilities	3,511	4,226	4,718	5,405	5,957
Total liabilities and equity	**6,265**	**7,074**	**6,593**	**7,300**	**7,874**
Cash	880	1,117	227	230	189
Current assets	2,135	2,447	2,740	3,283	3,713
Total fixed assets	1,691	1,920	2,036	2,196	2,381
Investments	1,559	1,590	1,590	1,590	1,590
Total assets	**6,265**	**7,074**	**6,593**	**7,300**	**7,874**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	1,348	1,411	2,211	2,449	2,774
Working capital	427	71	75	19	38
Capital expenditure	(332)	(600)	(312)	(357)	(402)
Investments	124	150	0	0	0
Free cash flow	**1,567**	**1,033**	**1,974**	**2,111**	**2,410**
Key assumptions					
Revenue growth (%)	17.0%	14.7%	13.8%	15.1%	13.2%
EBITDA margin(%)	18.0%	16.2%	15.7%	16.7%	17.4%

Source: Kotak Institutional Equities estimates.

Consumer Products

TTTE.BO, Rs863	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	1,100
52W High -Low (Rs)	1015 - 545
Market Cap (Rs bn)	53.3

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	45.3	46.7	48.7
Net Profit (Rs bn)	3.3	3.9	4.2
EPS (Rs)	54.1	63.3	67.3
EPS gth	*3.6*	*17.2*	*6.2*
P/E (x)	16.0	13.6	12.8
EV/EBITDA (x)	6.2	5.6	5.0
Div yield (%)	1.7	2.0	2.2

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	35.3	-	-
FIIs	12.9	0.1	(0.0)
MFs	9.8	0.4	0.2
UTI	-	-	(0.1)
LIC	11.0	0.4	0.2

Tata Tea: 4QFY08—Domestic business continues to grow strongly

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- **Domestic tea business benefiting from uptrading**
- **Restructuring complete with separation of North Indian tea plantations**
- **Adverse forex movement impacts consolidation of Tetley and Eight O'Clock coffee**
- **Focus on integration of operations and drive growth**
- **Reiterate BUY, target price of Rs1,100/share**

Tata Tea reported 9.5% growth in standalone revenues at Rs2.75 bn and a 73% increase in EBITDA to Rs259 mn during 4QFY08. We note the reported financials exclude those of North Indian Plantations which have now been transferred to a separate company for a consideration of Rs3.66 bn and profit booked of Rs1.62 bn. Adjusting for the loss of sale from plantations, domestic sales grew by 17% yoy. Tata Tea continues to gain market share in the domestic market and domestic branded tea volume sales grew by 15%. While all major brands grew in single digits, Agni portfolio grew strongly by 46% yoy. We have been highlighting that Agni would be the natural uptrade from the unorganized tea segment and will be the main beneficiary of the high tea prices. Consolidated sales grew by 1.5% and EBITDA declined by 16.5% during 4QFY08 as Tetley spent more on promotions. Management highlighted pushing through higher prices to retailers (in response to higher commodity prices) from end-March, which would aid in recovering margins. For FY2008, consolidated sales grew 8.6% and EBITDA declined by 2.9% as the appreciation of the Rupee against GBP and US$ diluted sales growth and profits. We maintain our EPS estimates of Rs63.3 for FY2009E and Rs67.3 for FY2010E. We reiterate BUY with a target price of Rs1,100/ share. Our valuation captures the DCF value of the core business plus 50% value of the investment portfolio (Rs91/share). Our target price implies a P/E of 17X on FY2009E and offers an upside of 27% over the current market price.

Domestic tea business benefiting from uptrading. Tata Tea continues to be the volume market leader in Indian tea market, posting 15% volumes growth during the quarter. While most brands grew at a moderate 5-8% yoy, 'Agni' grew by a whopping 46% yoy benefiting from higher tea prices and capturing the natural uptrade from the unorganized sales. Adjusting for the sale of the North Indian plantations business, which have been hived off into a different company (Tata Tea holds 49% stake), Tata Tea continued its strong performance in Indian operations with estimated sales growth of 17%. The reported financials are not comparable to previous years due to a reorganization of cost heads. A bulk of employee expenses and other expenditure is now in the form of direct variable costs—purchase of tea from the plantations.

Restructuring complete with separation of North Indian tea plantations. The separation of tea plantations has now been completed and in our view the company now has a healthier balance sheet—having reduced asset intensive businesses (and used cash generated to retire debt) and better financial flexibility—without the burden of a large workforce. The North India Plantations Division (NIPD) has been transferred to Amalgamated Plantations Private Limited (APPL) with effect from April 1, 2007. Tata Tea has booked a gain of Rs1.62 bn on a sale consideration of Rs3.66 bn. The financials of APPL have been consolidated into Tata Tea on a proportionate basis.

Adverse forex movement impacts consolidation of Tetley and Eight O'Clock coffee. Appreciation of Indian Rupee against the GBP and US$ during FY2008 resulted in the reported numbers capturing lower sales growth and profits for Tata Tea's overseas operations—Tetley and Eight O'Clock coffee. Tetley reported flat sales growth at Rs23 bn for FY2008. In constant currency terms, sales grew by 6% yoy (organic + inorganic). We believe that the company's strategy of focusing on new markets and new initiatives in tea (aggressive push of herbal and green tea) is paying off well.

Focus on integration of operations and drive growth. We believe growth in Tata Tea would be a function of successful integration of operations—both for domestic as well as international operations. Management highlighted the recent launch of 'Himalaya' in Mumbai with the Mount Everest team working with Tata Tea's sales and marketing team. We believe that Tata Tea can significantly scale up the water business using the distribution reach of Tata Tea. During FY2008, Mount Everest Mineral Water achieved a turnover of Rs250 mn (Rs240 mn in FY2007). Eight O'Clock coffee has launched and started selling organic coffee under the Goodearth brand in US. With the entry of Dunkin Donuts, all the coffee marketing companies were losing sales. The launch of Goodearth in the premium segment helped Eight O'Clock arrest the decline in sales. Eight O'Clock achieved sales of Rs6.8 bn during FY2008.

Reiterate BUY, target price of Rs1,100/share

We believe that the strong performance by the company in the Indian market, coupled with signs of turnaround in international portfolio, augurs very well. We estimate EPS of Rs63.3 for FY2009E and Rs67.3 for FY2010E. We reiterate BUY with a target price of Rs1,100/share. Our valuation captures the DCF value of the core business plus 50% value of the investment portfolio (Rs91/share). Tata Tea has investments in group companies like Rallis, Tata Consultancy Services, Tata Chemicals, Tata Sons. Our target price implies a P/E of 17X on FY2009E and offers an upside of 27% over the current market price.

Tata Tea (unconsolidated) quarterly summary, March yearends (Rs mn)

		yoy			yoy	
	4QFY08	4QFY07	% chg	2008	2007	% chg
Net sales	**2,750**	**2,512**	**9.5**	**11,534**	**10,701**	**7.8**
Total operating expenses	(2,491)	(2,363)		(9,771)	(8,728)	
EBITDA	**259**	**150**	**73.2**	**1,763**	**1,973**	**(10.7)**
Depreciation	(24)	(47)		(102)	(185)	
EBIT	235	103		1,661	1,788	
Other income	210	78		1,099	702	
Net interest	(47)	(164)		(464)	(324)	
PBT	**398**	**17**	**2,285.6**	**2,297**	**2,166**	**6.0**
Tax	(220)	(31)		(752)	(432)	
Deferred tax	15	(8)		22	-	
PAT	**194**	**(21)**	**(1,004.7)**	**1,567**	**1,734**	**(9.7)**
Extraordinary income (loss)	1,595	60		1,562	1,332	
Net profit	**1,789**	**39**	**4,497.9**	**3,129**	**3,066**	**2.1**
EBITDA margin (%)	9.4	6.0		15.3	18.4	
Effective tax rate (%)	51.4	228.1		31.8	19.9	

Source: Company data, Kotak Institutional Equities.

Tata Tea (Consolidated) quarterly summary, March yearends (Rs mn)

	4QFY08	4QFY07	yoy % chg	2008	2007	yoy % chg
Net sales	**11,768**	**11,591**	**1.5**	**43,923**	**40,444**	**8.6**
Total operating expenses	(10,153)	(9,658)		(36,821)	(33,128)	
EBITDA	**1,615**	**1,933**	**(16.5)**	**7,102**	**7,316**	**(2.9)**
Depreciation	(235)	(245)		(916)	(967)	
EBIT	1,381	1,689		6,186	6,349	
Other income	59	382		397	664	
Net interest	(159)	(1,074)		(1,652)	(2,807)	
PBT	**1,281**	**997**	**28.5**	**4,931**	**4,207**	**17.2**
Tax	(594)	(93)		(1,534)	(1,076)	
PAT	**687**	**903**	**(24.0)**	**3,397**	**3,132**	**8.4**
Extraordinary Income (loss)	489	(304)		15,662	1,406	
Minority interest & share of profit in associates	(46)	(206)		(3,633)	(147)	
Net profit	**1,130**	**394**	**187.1**	**15,426**	**4,391**	**251.3**
EBITDA margin (%)	13.7	16.7		16.2	18.1	
Effective tax rate (%)	46.4	9.3		31.1	25.6	

Source: Company data, Kotak Institutional Equities.

Construction

NGCN.BO, Rs197	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	285
52W High -Low (Rs)	388 - 156
Market Cap (Rs bn)	47.5

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	34.7	47.6	60.7
Net Profit (Rs bn)	1.6	2.4	3.3
EPS (Rs)	7.0	10.0	13.6
EPS gth	*7.3*	*43.1*	*36.3*
P/E (x)	28.2	19.7	14.5
EV/EBITDA (x)	16.3	11.7	9.5
Div yield (%)	0.6	0.8	0.8

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	22.5	-	-
FIIs	34.8	0.2	0.1
MFs	22.4	0.8	0.6
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Nagarjuna Construction: Ramp-up of industrial and Middle-East business bode well, increase in working capital a concern, Reiterate BUY

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- **Revenue growth as expected, however, operating margins below expectations**
- **Continued diversification in order book; provides visibility of about 2.3 years**
- **Ramp-up of Middle-East business as well as industrial segments bode well**
- **Reiterate BUY based on strong growth visibility, diversification of business segments and attractive valuations**

Nagarjuna Construction reported 4QFY08 revenues of Rs12.5 bn (44% growth yoy) ahead of our expectations of Rs12 bn. The operating profit grew at 50% yoy to Rs1.1 bn as compared to Rs0.7 bn in 4QFY07. EBITDA margins of 8.7% was below our expectations, partly contributed by Nagarjuna specific phenomenon of having lower 4Q margins versus nine month as well as full-year margins. Other key highlights of the results and conference call are (a) sustained visibility of 2.3 years based on order backlog of Rs110 bn, (b) ramp-up of Middle-East business with >20% contribution to order backlog from that geography, (c) enlarging presence in power, oil and gas and metals area with incremental order inflows, (d) substantial business being conducted by subsidiaries in Middle-East also apart from parent entity and (e) increase in working capital in terms of number of days of sales. We have revised our FY2009E and FY2010E earnings estimates to Rs10 (from Rs11.3 earlier) and Rs13.6 (from Rs14.8 earlier) based on lower margin expectations versus earlier in an environment of rising commodity prices. We have also revised our DCF-based target price to Rs285 from Rs310 earlier based on lower core construction business valuation of Rs221 (versus Rs245 earlier), in line with reduction in earnings estimates. Reiterate BUY based on (a) likely strong growth, (b) ramp-up of business segments such as metals, power, oil and gas and international, and (c) attractive valuations—P/E multiple of about 13.5X adjusted for BOT and real estate assets.

Revenue growth as expected, however, operating margins below expectations

Nagarjuna Construction reported 4QFY08 revenues of Rs12.5 bn (44% growth yoy) ahead of our expectation of Rs12 bn. The operating profit grew at 50% yoy to Rs1.1 bn as compared to Rs0.7 bn in 4QFY07. The EBITDA margin at 8.7%, however, was lower than our expectations of 10.8%. A key reason for margin disappointment is that unlike other construction and engineering companies, Nagarjuna has been reporting lower margins versus nine months as well as full-year numbers in the fourth quarter. This is counter intuitive and the management was unable explain it adequately, leading us to surmise that the gap possibly relates to accounting peculiarities. The management suggested that 4Q margins were lower because of pressure from rising commodity prices, an observation that is not in line with what has been reported by peer companies (Exhibit 1).

Significant business ramp-up in Middle-East bodes well for the future in terms of achieving geographical diversification

Nagarjuna has reported a substantial ramp-up in Middle-East business—21% of order backlog in the parent entity comes from the international segment. Several international subsidiaries such as NCC, Dubai and NCC international have reported substantial independent turnover in the Middle East, amounting to about Rs1.6 bn with average profitability at PAT level, in line with the parent business or slightly ahead of it (Exhibit 2).

Large proportion of order backlog allows for escalation related to commodity price escalation

About 65% of the orders have price escalation clauses built into it either as star rated or linked to certain specific indices relevant to a particular commodity. Some of the other contracts particularly in metals segment do not allow for escalation however management seemed confident of achieving about 8% margin in these particular contracts as most of the components have been ordered to the subcontractors. Typically buildings, water and transportation related contracts allow them escalation based on star rates. Thus we believe that impact of commodity price movement on Nagarjuna Construction would be muted.

Order inflow remain strong with extended visibility; continued diversification in order book highlights build-up of potential

The order book of Nagarjuna Construction has diversified over the last year with ramp up of newer segments like power, oil and gas and metals (Exhibit 2). Although buildings, transportation and water & environment continue to be major contributors to the orders (amounting together to 50% of total order backlog) the distribution across sectors is more balanced compared to the previous year. The number of international projects has also grown significantly over the year to Rs24.2 bn accounting for 21% of the total order backlogs. The order inflow continues to remain strong, growing at 67% yoy to Rs113.8 bn which provides a visibility of 2.3 years versus 2.1 at the end of FY2007 (Exhibits 3 and 4).

Prima facie working capital situation in terms of no of days of sales seem to have worsened

We highlight that prima facie working capital as no of days of sales (adjusted for cash, mobilization advance and loans to subsidiaries) has worsened from about 65 days of sales at the end of FY2007 to about 90 days of sales at the end of FY2008. High working capital limits fresh cash flow generation and limits the growth prospects of the company without resorting to raising fresh equity at periodical intervals.

Revise earnings estimates, Reiterate BUY with a target price of Rs285 versus Rs310 earlier

We have revised our FY2009E and FY2010E earnings estimates to Rs10 (from Rs11.3 earlier) and Rs13.6 (from Rs14.8 earlier) based on lower margin expectation versus earlier in an environment of rising commodity prices. We have also revised our DCF based target price to Rs285 from Rs310 earlier based on lower core construction business valuation to Rs221 (versus Rs245 earlier) versus earlier, in line with reduction in earnings estimates. We reiterate BUY based on (a) strong growth visibility based on order backlog, (b) ramp up of business segments in areas like metals, power, oil and gas and international – areas that hold immense potential, and (c) attractive valuations - P/E multiple of about 13.5X adjusted for BOT and real estate assets (Exhibits 5, 6 and 7).

Exhibit 1. Nagarjuna Construction - 4QFY08 - key numbers (Rs mn)

	yoy			qoq			yoy		
(in Rs mn)	4QFY08	4QFY07	% chg	4QFY08	3QFY08	% chg	FY2008	FY2007	% chg
Net sales	**12,541**	**8,679**	***44.5***	**12,541**	**7,795**	***60.9***	**34,729**	**28,710**	***21.0***
Operating costs	**(11,447)**	**(7,951)**	***44.0***	**(11,447)**	**(6,933)**	***65.1***	**(31,131)**	**(26,013)**	***19.7***
Raw materials	(4,295)	(2,434)	*76.4*	(4,295)	(1,952)	*120.0*	(10,944)	(9,544)	*14.7*
Other construction expenses	(5,390)	(4,295)	*25.5*	(5,390)	(3,646)	*47.8*	(14,780)	(12,129)	*21.9*
Labour	(1,140)	(825)	*38.2*	(1,140)	(369)	*208.7*	(3,228)	(2,899)	*11.3*
Staff cost	(387)	(259)	*49.3*	(387)	(767)	*(49.6)*	(1,402)	(844)	*66.1*
Other expenditure	(235)	(139)	*69.4*	(235)	(199)	*18.5*	(777)	(597)	*30.2*
Operating profit	**1,094**	**727**	***50.4***	**1,094**	**862**	***26.9***	**3,598**	**2,697**	***33.4***
Other income	37	270	*(86.2)*	37	11	*244.4*	56	292	*(81.0)*
Interest cost	(174)	(166)	*4.9*	(174)	(167)	*4.3*	(719)	(504)	*42.8*
Depreciation	(138)	(96)	*43.5*	(138)	(123)	*12.3*	(482)	(299)	*61.3*
Profit before tax	**819**	**735**	***11.5***	**819**	**584**	***40.4***	**2,452**	**2,187**	***12.1***
Tax	(293)	(236)	*24.3*	(293)	(187)	*56.6*	(833)	(667)	*24.8*
Profit after tax	**526**	**499**	***5.4***	**526**	**396**	***32.8***	**1,620**	**1,519**	***6.6***
Key ratios									
Raw material, labour and other const. expenses	86.3	87.0		86.3	76.6		83.4	85.6	
Staff cost	3.1	3.0		3.1	9.8		4.0	2.9	
Other expenditure	1.9	1.6		1.9	2.5		2.2	2.1	
Operating profit margin (%)	**8.7**	**8.4**		**8.7**	**11.1**		**10.4**	**9.4**	
PAT margin (%)	4.2	5.8		4.2	5.1		4.7	5.3	
Effective tax rate (%)	35.8	32.1		35.8	32.1		34.0	30.5	

Source: Company data, Kotak Institutional Equities.

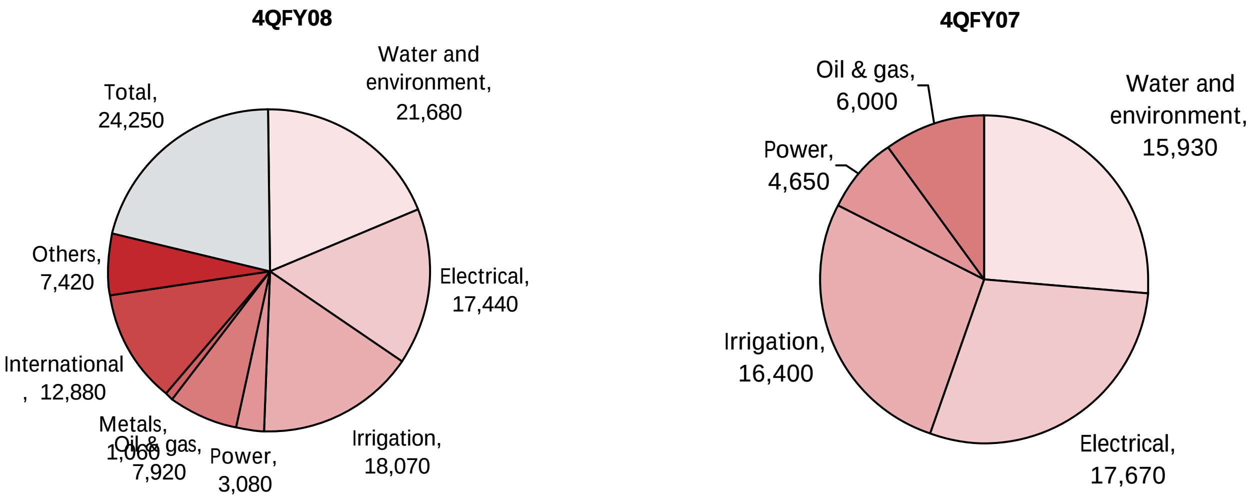
Exhibit 2. Consolidated results of Nagarjuna Construction, March fiscal year-ends FY2007-08, (Rs mn)

	yoy		
(in Rs mn)	FY2008	FY2007	% chg
Net sales	**36,354**	**29,486**	***23.3***
Operating costs	**(32,377)**	**(26,558)**	***21.9***
Operating profit	**3,977**	**2,928**	***35.8***
Other income	236	35	*581.5*
Interest cost	(1,063)	(579)	*83.6*
Depreciation	(607)	(381)	*59.3*
Profit before tax	**2,543**	**2,003**	***27.0***
Tax	(854)	(1,038)	*(17.7)*
Profit after tax	**1,689**	**965**	***75.0***
Key ratios			
Operating profit margin (%)	**10.9**	**9.9**	
PAT margin (%)	4.6	3.3	
Effective tax rate (%)	33.6	51.8	

Source: Company data, Kotak Institutional Equities.

Exhibit 3. Nagarjuna Construction's order book has diversified with the addition of new segments

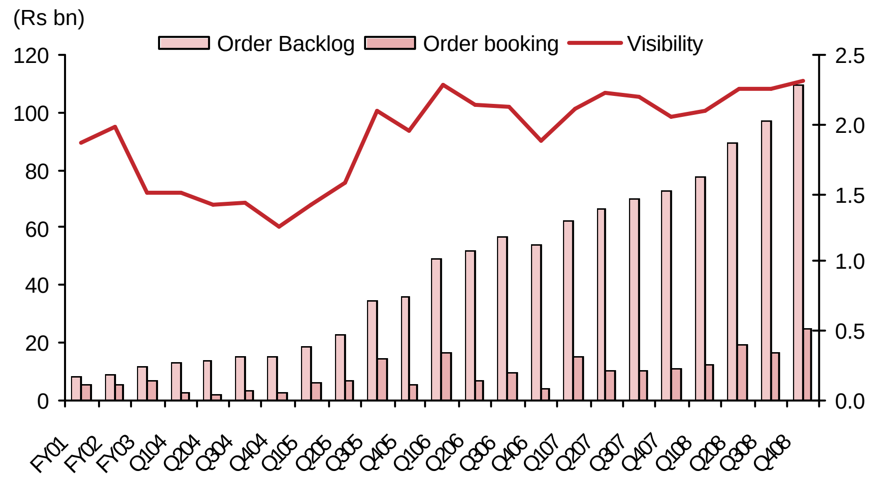
Nagarjuna Construction's order backlog at the end of FY2007 and FY2008 (Rs mn)



Source: Company data.

Exhibit 4. Nagarjuna Construction's order visibility has improved to 2.5 years based on forward four quarter revenues

Order backlog, order booking and visibility (X) of Nagarjuna Construction



Source: Kotak Institutional Equities.

Exhibit 5. Nagarjuna Construction - DCF model, March fiscal year-ends 2009E-2019E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**47,602**	**60,718**	**74,825**	**92,163**	**114,548**	**141,653**	**172,037**	**197,843**	**221,584**	**243,742**	**268,116**
Revenue growth rate (%)	37	28	23	23	24	24	21	15	12	10	10
Cost of revenues	(42,596)	(54,293)	(66,908)	(82,641)	(102,714)	(127,019)	(154,263)	(177,069)	(198,317)	(218,149)	(239,964)
EBITDA	**5,006**	**6,425**	**7,917**	**9,522**	**11,834**	**14,635**	**17,774**	**20,773**	**23,266**	**25,593**	**28,152**
EBITDA margin (%)	10.5	10.6	10.6	10.3	10.5	10.5	10.5	10.5	10.5	10.5	10.5
Depreciation	(581)	(700)	(830)	(980)	(1,158)	(1,375)	(1,612)	(1,719)	(2,139)	(2,581)	(3,271)
EBIT	**4,435**	**5,736**	**7,098**	**8,552**	**10,687**	**13,270**	**16,172**	**19,065**	**21,138**	**23,023**	**24,892**
Tax	(1,353)	(1,792)	(2,217)	(2,642)	(3,312)	(4,132)	(5,069)	(5,975)	(6,625)	(7,216)	(7,802)
Change in net working capital	(622)	(1,971)	(3,134)	(3,631)	(4,784)	(5,884)	(6,748)	(5,303)	(4,553)	(4,250)	(4,675)
Capex	(1,500)	(1,500)	(1,800)	(2,000)	(2,500)	(3,000)	(3,000)	(4,946)	(5,540)	(6,094)	(6,703)
Free cash flow	**1,530**	**1,162**	**767**	**1,248**	**1,239**	**1,618**	**2,957**	**4,549**	**6,548**	**8,034**	**8,973**
PV of each cash flow	1,530	1,033	606	877	773	898	1,458	1,995	2,552	2,783	2,763

PV of cash flows	17,268	FCF in terminal year (Rs mn)	8,973
PV of terminal value	38,685	Exit FCF multiple: (1+g)/(WACC-g)	14.0
EV	55,953	Terminal value of FCF (Rs mn)	125,622
Debt	2,848	Exit EBITDA multiple	4.5
Equity value	53,106		
Fully diluted shares outstanding (mn)	241		
Equity value (Rs/share)	**220.7**		

Exit FCF multiple (X)	14.0
Exit EBITDA multiple (X)	4.5

Terminal growth - g (%)	5.0
Risk free rate-Rf (%)	8.0
Market risk premium—(Rm-Rf) (%)	5.5
Beta (x)	1.1
Cost of equity-Ke (%)	14.1
Cost of debt-Kd (%)	12.0
Tax rate (%)	33.6
Debt/Capital (%)	44.3
Equity/Capital (%)	55.7
WACC (%)	11.4
Used WACC (%)	12.5

Sensitivity of target price to WACC and terminal growth rate

		11.5	12.0	12.5	13.0	14.0
Growth	**4.0**	238	218	200	185	159
rate (%)	**5.0**	267	242	**221**	202	172
-	**6.0**	306	274	247	224	188
	7.0	363	319	283	254	208
	9.0	612	498	418	357	274

Source: Kotak Institutional Equities estimates.

Exhibit 6. Derivation of SOTP based target price for NCCL

	Equity commitment (Rs mn)	Incremental P/B multiple (X)	Valuation (Rs mn)	Per share Rs
BOT Projects	**3,148**	**0.4**	**1,555**	**6.5**
Roads				
Brindavan Infrastructure Co. Ltd.	150	0	60	0.2
Bangalore elevated Corridor Project	637	1	637	2.6
Western UP Tollway Ltd.	239	1	239	1.0
Orai - Bhognipur	832	0	333	1.4
Pondicherry Tindivanam Tollway Limited	375	1	188	0.8
Power				
Gautami Power	420	0	0	-
Hydropower project in Himachal Pradesh	495	0	99	0.4
ICICI Ventures/Tishman/ Nagarjuna project			2,666	11
Book value of investments	4,142			17
Value of core construction business			**53,106**	**221**
Value of land bank			6,734	28
Total				**283**

Source: Kotak Institutional Equities estimates.

Exhibit 7: Construction stocks are trading at an average P/E of 15.5X and EV/EBITDA of 10X based on FY2009E earnings

Comparison of valuation of various construction companies in India, March fiscal year-ends 2008-2010E (Rs bn)

	Revenues (Rs bn)			EBITDA (Rs bn)			EPS (Rs)			P/E (X)			EV/EBITDA (X)			EV/SALES (X)		
Company	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Consolidated Construciton Company	15.1	21.1	28.1	1.3	2.0	2.8	27.5	40.7	56.5	22.6	15.3	11.0	16.2	10.5	7.4	1.4	1.0	0.7
IVRCL Infrastructure	36.6	50.4	69.5	3.6	5.0	6.9	15.6	19.6	26.7	19.4	15.4	11.3	12.0	9.2	7.1	1.2	0.9	0.7
Larsen & Toubro standalone	248.8	335.6	450.9	28.1	40.0	53.8	71.5	94.9	123.1	31.9	24.1	18.5	24.9	17.8	13.4	2.8	2.1	1.6
Nagarjuna Construction Company	34.7	47.6	60.7	3.6	5.0	6.4	7.0	10.0	13.6	18.9	13.2	9.7	11.6	8.3	6.5	1.2	0.9	0.7
Punj Lloyd Ltd	82.7	111.1	141.4	6.2	10.3	13.9	10.4	17.8	24.5	31.0	18.0	13.1	17.6	11.2	8.3	1.3	1.0	0.8
Sadbhav Engineering	8.5	13.4	15.4	1.0	1.7	1.9	44.7	73.5	82.4	12.7	7.7	6.9	8.0	4.6	3.7	1.0	0.6	0.5
Average										**22.7**	**15.6**	**11.8**	**15.1**	**10.3**	**7.7**	**1.5**	**1.1**	**0.8**

Note:

(1) For Nagarjuna, we have adjusted value of land bank (about Rs39/share), other BOT projects (Rs6.5/share) and investments (Rs20/share) for a total of Rs65/share.

(2) For Punj Lloyd & CCCL, estimates are based on consolidated estimates as they do not have any BOT projects.

(3) For IVRCL we have adjusted value of IVR Prime (Rs60/share corresponding to IVR Prime price of Rs200/share) and other BOT projects for a total adjustment of Rs115/share.

(4) For L&T, we have deducted Rs700 per share as the value of subsdiaries/associates/JVs.

(5) For Sadbhav Engineering, we have deducted Rs385 per share (the value of BOT projects).

Source: Bloomberg, Kotak Institutional Equities estimates.

Property

SOBH.BO, Rs499	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	610
52W High -Low (Rs)	1060 - 480
Market Cap (Rs bn)	36.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	14.6	20.4	28.4
Net Profit (Rs bn)	2.1	2.8	3.5
EPS (Rs)	28.2	38.2	48.5
EPS gth	*26.8*	*35.4*	*26.9*
P/E (x)	17.7	13.1	10.3
EV/EBITDA (x)	14.3	11.4	8.7
Div yield (%)	0.6	0.8	0.8

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	87.0	-	-
FIIs	8.1	0.0	(0.1)
MFs	0.5	0.0	(0.1)
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Sobha Developers: Upgrade rating to ADD from REDUCE as the stock price is already factoring in difficult conditions

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- **4QFY08 revenues below estimates; we revise downwards our revenue estimates to factor in delays in residential launches**
- **Land bank quantity as well as quality improving; targets new launches in Kochi, Mysore and Chennai this year**
- **Upgrade rating to ADD from REDUCE with a revised target price of Rs610/share; we believe the stock price is already factoring in delays and correction in prices**

Sobha Developers (Sobha) reported operating revenues of Rs4.7bn (v/s our expectation of Rs5.3 bn) and PAT of Rs702 mn (v/s our expectation of Rs759 mn) for 4QFY2008. We note that new launches have been low and therefore we lower our sales expectations for FY2009-10E. Currently, Sobha has 10.4 mn sq. ft of real estate under construction as of end-FY2008. As a result of delayed launches we revise our revenue estimates to Rs20.5 bn for FY2009E (Rs22.2 bn earlier) and Rs28.3 bn for FY2010E (Rs32.9 bn earlier). Our PAT estimate is revised to Rs2.8 bn in FY2009E (Rs2.9 bn earlier) and Rs3.5 bn in FY2010E (Rs3.9 bn earlier). Based on delay in launches our NAV is revised to Rs680/share (Rs714/share earlier). Our NAV already factors in pricing correction of 10% in FY2009 and we have reduced sales expectations. Also, we note that progress continues on the quality as well as quantity of land bank. We base our revised target price at 10% discount to NAV (parity to NAV earlier) to factor in high leverage position of Sobha. As a result our target price is revised to Rs610/share (Rs710 earlier). Our revised target price provides an upside of 22% and we upgrade our rating to ADD from REDUCE earlier.

Sobha intends to launch large number of projects over the next 12 months

Sobha has been able to launch very few projects in the Bangalore markets in the last twelve months. Sobha launched 2 projects in Bangalore in the last quarter—Sobha Celsia (0.68 mn sq. ft) and Sobha Petunia (0.45 mn sq. ft). Other launches in FY2008 were in Trissur (1.7 mn sq. ft), Pune (0.3 mn sq. ft), Coimbatore (0.2 mn sq. ft) and Bangalore (0.5 mn sq. ft). We also observe that area under ongoing projects has remained stagnant over the past two quarters (Exhibit 3). Other key highlights of residential business are as below

- Management indicated that at an overall portfolio level, the average selling prices have increased from Rs2,700/sq. ft in FY2007 to Rs3,200/sq. ft in FY2008.
- Sobha intends to increase its presence to 8 cities in the near future—plans to add Chennai, Kochi, Mysore and Gurgaon.
- Has large development plans ahead of 24.5 mn sq. ft—Bangalore (12), Gurgaon (7), Kochi (1.9), Trissur (1.6), Mysore (1.3) and Coimbatore (0.7).
- Open land bank, excluding land for planned development is 196 mn sq. ft, with Bangalore contributing 80.4 mn sq. ft (approximately 40%).

Sobha sold 2.4 mn sq. ft in FY2008 compared to our estimate of 2.5 mn sq. ft. We believe that revenue booking was below our expectations for 4QFY08 on account of, (1) lower sales of existing projects, (2) delay in projects reaching threshold level of 25% (management indicated that there are 7 such projects in Bangalore and one project in Coimbatore). Going forward, to factor in delayed launches, we lower our sales expectations and estimate Sobha to sell 4.4 mn sq. ft of real estate in FY2009E compared to 6.9 mn sq. ft earlier and also factor in delay in some of its projects. Going forward, expansion of geographical footprint will likely increase addressable market for Sobha enabling higher sale volumes. As a result we revise our revenue estimates from residential business to Rs12.6 bn for FY2009E (Rs14.5 bn earlier) and Rs16.6 bn for FY20010E (Rs21.1 bn earlier).

Contractual order book has remained stagnant indicating higher focus on real estate business

Exhibit 4 highlights that order book of contractual business has remained stagnant over the past two quarters. Management has indicated that Sobha intends to lower its focus on contractual business in the future as it expands its real estate business on a more aggressive manner. We maintain our revenue estimates of Rs7.0 bn for FY2009E and Rs8.9 bn for FY2010E.

Land reserves quality of Sobha continues to improve

Exhibit 5 highlights improvement in land reserves quality of Sobha. Sobha has got access to 4,024 acres of land reserves, of which it has paid Rs19.4 bn, which leaves an amount outstanding of Rs6.6 bn. We highlight that the amount outstanding has been continuously declining, indicating an improvement in the ownership status of the land bank. The amount paid as a percentage of total payments has risen to 74.6% compared to 63.5% at the end of 3QFY08 and 42% at end-FY2007. This was a key area to be monitored and we believe that the land quality risk has abated significantly. The management has highlighted that already, 3,350 acres of land reserves have been registered.

The land acquisition process for Sobha continues to be strong. Sobha has added close to 875 acres in FY2008. We note that the land acquired is in the recent past has not been factored into our NAV, hence the upside potential to our NAV. We have modeled 140 mn sq. ft to our NAV calculations. We have factored in 60 mn sq. ft into our NAV estimates at cost price of Rs150/sq. ft.

Our Mar'09 based target price is revised to Rs610/share; upgrade rating to ADD from REDUCE

Our target price is revised to Rs610/share based on a 10% discount to our Mar'09 based NAV of Rs681/share (earlier Rs714/share). We note that the discount of 10% is warranted on account of deteriorating financial condition (leverage of 1.7X as of Mar '08 compared to 0.7X as of Mar '07) in a tight liquidity environment. We believe that the current stock price of Rs499/share (correction of 20% in the last one month) already factors in the—(1) delays in launches, (2) possible correction in real estate prices, and (3) deteriorating financial condition. Our target price results in an upside of 20% from current levels and hence we upgrade our rating to ADD from REDUCE.

Sobha Developers :4QFY2008 results

				% change		Kotak estimates					% change	
(in Rs mn)	4QFY2007	3QFY2008	4QFY2008	qoq	yoy	4QFY08	deviation	FY07	FY08A	FY09E	FY08/FY07	FY09/FY08
Net sales	**3,573**	**3,553**	**4,741**	**33.4**	**32.7**	**5,300**	**(10.5)**	**11,865**	**14,226**	**20,358**	**19.9**	**43.1**
Operating costs	**(2,673)**	**(2,592)**	**(3,661)**	**41.2**	**37.0**	**(3,983)**	**(8.1)**	**(9,303)**	**(10,689)**	**(15,773)**	**14.9**	**47.6**
(Increase)/Decrease intock in inventories	380	1,085	874	(19.4)				1,017	4,063			
Land cost expenses	(754)	(1,119)	(1,089)	(2.7)				(1,832)	(3,900)	(1,715)		
Construction expenses	(1,433)							(4,952)	(7,887)	(10,778)		
Raw material consumption	(178)	(1,872)	(2,529)	35.1				(1,051)				
Production expenses	(52)							(236)				
Staff cost	(261)	(247)	(302)	22.3				(707)	(1,025)	(1,243)		
Other administrative expenses	(375)	(439)	(615)	40.1				(1,542)	(1,940)	(2,036)		
EBITDA	**900**	**961**	**1,080**	**12.4**	**20.0**	**1,317**	**(18.0)**	**2,562**	**3,537**	**4,585**	**38.1**	**29.6**
Other income	16	4	24	500.0	50.0	10		29	119	41	310.3	-65.3
Interest costs	(87)	(171)	(192)	12.3		(236)		(481)	(597)	(528)	24.1	-11.6
Depreciation	(67)	(87)	(92)	5.7		(139)		(244)	(350)	(522)	43.4	49.1
PBT	**762**	**707**	**820**	**16.0**	**7.6**	**952**		**1,866**	**2,709**	**3,577**	**45.2**	**32.0**
Taxes	(143)	(96)	(118)	22.9	(17.5)	(193)		(251)	(426)	(794)	69.7	86.4
PAT	**619**	**611**	**702**	**14.9**	**13.4**	**759**	**(7.5)**	**1,615**	**2,283**	**2,783**	**41.4**	**21.9**
Key ratios												
EBITDA margin (%)	25.2	27.0	22.8			24.9		21.6	24.9	22.5		
PAT margin (%)	17.3	17.2	14.8			14.3		13.6	16.0	13.7		
Effective tax rate (%)	18.8	13.6	14.4			20.2		13.5	15.7	22.2		

Source: Company data, Kotak Institutional Equities estimates.

Revenue growth for Sobha is showing a declining trend

Key operating characterstics of Sobha Developers

	Q1FY07	Q2FY07	Q3FY07	Q4 FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08
Real estate business including charges collected	1,039	1,912	1,989	2,598	1,533	1,725	2,114	3,194
Contractual income	1,015	1,349	987	976	1,144	1,529	1,436	1,560
Other income	3	1	9		15	76	7	0
Total income	2,057	3,262	2,985	3,561	2,692	3,330	3,557	4,754
Cost of Sales	1,612	2,517	2,180	2,502	1,787	2,294	2,450	3,460
Cost of sales (%)	*78*	*77*	*73*	*70*	*66*	*69*	*69*	*73*
GP	445	745	805	1,059	905	1,036	1,107	1,294
GP (%)	*22*	*23*	*27*	*30*	*34*	*31*	*31*	*27*
Unallocable expenses (%)	4	3	4	4	1	4	4	4
PBDIT	355	636	683	917	870	901	965	1,104
PBDIT (%)	*17*	*19*	*23*	*26*	*32*	*27*	*27*	*23*
PBT	176	436	491	763	501	680	707	820
PBT (%)	*9*	*13*	*16*	*21*	*19*	*20*	*20*	*17*
PAT	169	371	456	619	408	562	611	702
PAT (%)	*8*	*11*	*15*	*17*	*15*	*17*	*17*	*15*
Comaprison to corresponding period of previous years (Growth in %)								
Total income		105	77		31	2	19	34
GP		121	68		103	39	37	22
PBDIT		120	62		145	42	41	20
PBT		105	45		185	56	44	7
PAT		118	49		141	51	34	13
Real estate GP	248	482	641	894	705	776	867	1,034
Contractual GP	197	264	165	166	200	260	240	261
Real estate GP %	24	25	32	34	46	45	41	32
Contractual GP%	19	20	17	17	17	17	17	17
% to total revenue								
Real estate business including charges collected %	51	59	67	73	57	52	59	67
Contractual income %	49	41	33	27	42	46	40	33
Other income %	0	0	0	0	1	2	0	0
Cost of sales %	78	77	73	70	66	69	69	73
GP %	22	23	27	30	34	31	31	27
PBT %	9	13	16	21	19	20	20	17
PAT %	8	11	15	17	15	17	17	15

Source: Company, Kotak Institutional Equities.

More residential projects are getting launched in new cities

Details of ongoing residential projects (mn sq. ft)

	Jun-07	Sep-07	Dec-07	Mar-08
Completed at beginning of the quarter		5.1	5.8	5.9
Ongoing at the beginning of the quarter		10.8	10.7	11.1
Launched during the quarter	1.8	0.6	0.5	1.1
Handed over during the quarter	-	0.7	0.1	1.9
Completed at end of the quarter	5.1	5.8	5.9	7.8
Ongoing at the end of the quarter	**10.8**	**10.7**	**11.1**	**10.3**

Ongoing projects citywise

	Jun-07	Sep-07	Dec-07	Mar-08
Bangalore	9.04	8.62	8.84	7.98
Trissur	1.76	1.76	1.76	1.76
Pune		0.31	0.31	0.30
Coimbatore			0.20	0.28
Total	**10.80**	**10.69**	**11.11**	**10.32**

Source: Company data, Kotak Institutional Equities.

Contractual order book has remained stagnant

Contractual projects as of Jun-07, Sep-07, Dec-07 and Mar-08

	Jun-07	Sep-07	Dec-07	Mar-08
Number of contracts in progress	34	31	34	32
Total SBA (mn sq. ft)	8.69	8.47	8.32	8.34
Total Billing value (in Rs mn)	8,209	7,684	7,691	8,186

Source: Kotak Institutional Equities.

Land bank expanding beyond Bangalore; payables decreasing

Land bank details as on Mar-07, Jun- 07, Sep- 07 and Dec- 07

	Jun-07			Sep-07			Dec-07			Mar-08		
Location	**Land (acres)**	**Paid (in mn)**	**Payable (in mn)**	**Land (acres)**	**Paid (in mn)**	**Payable (in mn)**	**Land (acres)**	**Paid (in mn)**	**Payable (in mn)**	**Land (acres)**	**Paid (in mn)**	**Payable (in mn)**
Bangalore	1,625	6,465	8,359	1,643	6,676	7,060	1,638	6,329	6,905	1,600	7,704	4,269
Mysore	156	201	1,675	156	221	1,635	156	364	1,460	66	375	480
Pune	117	669	285	153	1,004	167	164	1,089	165	171	1,476	181
Chennai	527	1,000	—	540	1,048	4	540	1,200	—	540	1,434	4
Kochi	498	2,405	—	504	2,511	—	506	2,569	—	514	2,954	—
Trissur	15	86	—	15	43	—	48	280	—	49	276	—
Coimbatore	12	3	—	12	3	—	36	262	—	66	56	361
Hosur	623	969	—	719	1,425	—	719	1,468	—	719	1,839	—
Hyderabad	—	—	—	78	—	116	78	—	116	78	—	116
Gurgaon	—	—	—	192	1,365	415	192	1,668	112	220	3,237	1,192
Total	**3,574**	**11,798**	**10,319**	**4,012**	**14,294**	**9,397**	**4,077**	**15,228**	**8,758**	**4,024**	**19,351**	**6,603**
% of total cost		**53.3**	**46.7**		**60.3**	**39.7**		**63.5**	**36.5**		**74.6**	**25.4**

Note:
This does not include land allocated to on-going projects.

Source: Company, Kotak Institutional Equities.

We estimate March 2009 based NAV at Rs681/share

	March '09 based NAV Growth rate in selling prices			
	0%	3%	5%	10%
Valuation of land reserves	**36**	**47**	**58**	**79**
Residential projects	31.0	34.8	37.5	44.8
Commercial projects	3.4	8.3	11.9	22.2
Retail projects	5.0	7.1	8.6	12.7
Less: Land cost to be paid	(7)	(7)	(7)	(7)
Less: Net debt	(17)	(17)	(17)	(17)
Add: Contractual business	6	6	6	6
Add: Balance 60 mn sq. ft (at avg. cost of Rs150/sq. ft)	9	9	9	9
NAV	**27**	**39**	**50**	**70**
Total no. of shares (mn)				73
NAV/share				**681**

Source: Kotak Institutional Equities estimates.

Profit model of Sobha Developers, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007	2008E	2009E	2010E	2011E
Total revenues	**4,629**	**6,277**	**11,865**	**14,226**	**20,358**	**28,369**	**38,591**
Land costs	(1,054)	(781)	(1,832)	(3,900)	(1,715)	(2,128)	(2,817)
Construction costs	(2,344)	(2,975)	(5,222)	(3,824)	(10,778)	(15,584)	(21,063)
Employee costs	(221)	(286)	(707)	(1,025)	(1,243)	(1,567)	(2,265)
SG&A costs	(376)	(829)	(1,542)	(1,940)	(2,036)	(2,553)	(3,087)
EBITDA	**634**	**1,407**	**2,563**	**3,537**	**4,585**	**6,537**	**9,359**
Other income	23	8	29	119	41	53	70
Interest	(109)	(219)	(481)	(597)	(528)	(1,064)	(1,139)
Depreciation	(74)	(112)	(244)	(350)	(522)	(682)	(834)
Pretax profits	**473**	**1,083**	**1,866**	**2,709**	**3,577**	**4,843**	**7,457**
Extraordinary items	—	—	—	—	—	—	—
Current tax	(123)	(188)	(251)	(430)	(812)	(1,338)	(2,363)
Deferred tax	(11)	(0)		(8)	18	27	40
Net income	**339**	**892**	**1,615**	**2,271**	**2,783**	**3,532**	**5,134**
Adjusted net income	**339**	**892**	**1,615**	**2,271**	**2,783**	**3,532**	**5,134**
EPS (Rs)							
Primary	5.3	14.0	24.5	31.2	38	48	70
Fully diluted	5.3	14.0	24.5	31.2	38	48	70
Shares outstanding (mn)							
Year end	63	63	73	73	73	73	73
Primary	63	63	66	73	73	73	73
Fully diluted	63	63	66	73	73	73	73
Cash flow per share (Rs)							
Primary	7	15	34	27	28	42	65
Fully diluted	7	15	34	27	28	42	65
Growth (%)							
Net income (adjusted)	281	163	82	40	23	27	45
EPS (adjusted)	281	161	76	27	23	27	45
DCF/share	277	114	133	(21)	1	53	54
Cash tax rate (%)	26	17	13	16	23	28	32
Effective tax rate (%)	28	17	13	16	22	27	31

Source: Kotak Institutional Equities estimates.

Energy

ONGC.BO, Rs865	
Rating	BUY
Sector coverage view	Cautious
Target Price (Rs)	1,150
52W High -Low (Rs)	1387 - 768
Market Cap (Rs bn)	1,851

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	1,105	1,281	1,298
Net Profit (Rs bn)	223.4	281.7	317.5
EPS (Rs)	104.4	131.7	148.4
EPS gth	*22.8*	*26.1*	*12.7*
P/E (x)	8.3	6.6	5.8
EV/EBITDA (x)	3.4	2.8	2.3
Div yield (%)	4.2	4.6	4.9

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.1	-	-
FIIs	7.6	2.1	(3.4)
MFs	1.6	2.4	(3.1)
UTI	-	-	(5.5)
LIC	2.4	3.1	(2.4)

ONGC: Buy when there is little to lose

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- **Stock appears to be discounting around US$45/bbl in perpetuity**
- **Most scenarios suggest limited downside to stock price**
- **Fair value at Rs1,150/share at US$50/bbl long-term crude price**

We do not see meaningful downside risk to ONGC stock unless (1) crude oil prices increase to over US$140/bbl in which case we see significant downside risk to the Indian stock market in general and (2) the government's action turns out to be completely irrational. Our reverse valuation exercise shows that ONGC stock price is discounting about US$45/bbl in perpetuity; we do not believe the situation is that desperate over the long term. Our 12-month target price of ONGC stocks is Rs1,150 based on a normalized crude oil price of US$50/bbl, equivalent to ONGC's net realization over the past few years versus our otherwise normalized crude price assumption of US$75/bbl (Dated Brent basis). Key downside risk stems from higher-than-expected subsidy losses.

ONGC stock price seems to be discounting fairly bleak scenarios

We look at various scenarios of crude oil price to understand the implications for ONGC's earnings and valuation. We conclude that the stock appears to be discounting fairly bleak scenarios.

1. **FY2009E base-case scenario of crude price of US$100/bbl and subsidy-sharing at 33.33% for upstream companies.** We model FY2009E consolidated EPS of Rs132, which results in the stock being available at 6.6X FY2009E EPS and 4.2X FY2009E DACF. In a 'normal' scenario, we believe ONGC's stock is currently very attractively valued.

2. **FY2009E crude price of US$124/bbl and share of under-recoveries at 33.33% for upstream companies.** In this case, we compute ONGC's FY2009E consolidated EPS at Rs160, which results in the stock being available at 5.4X FY2009E EPS. We note that ONGC has moderate leverage to higher crude prices under the extant subsidy-sharing formula with its share of subsidy burden practically nullifying the impact of higher crude prices, both measured in crude oil equivalent terms. We expect ONGC to sell 34 mn tons of crude oil on a consolidated basis, in addition to 4 mn tons of products in FY2009E. Adjusted for a blended royalty rate of about 12.5% on crude oil (10% on offshore crude, 20% on onshore crude) for domestic crude and higher rates for overseas crude, ONGC's net sales would work out to about 26 mn tons of crude oil plus 4 mn tons of products. Against this, ONGC's subsidy share of the total consumption of the four controlled products in crude equivalent terms works out to about 23.5 mn tons (83 mn tons of consumption of four controlled products in FY2009E X 33.33% share for upstream companies X 84.8% share of ONGC of upstream companies).

3. **FY2009E crude price of US$124/bbl and share of under-recoveries at more than 33.33% for upstream companies (or 28.3% for ONGC).** We compute that ONGC's FY2009E consolidated EPS would be still higher than its FY2008E of Rs105 until ONGC's share of total gross under-recoveries remains below 36%. At Rs105 consolidated EPS, ONGC stock is available at 8.2X. We do not see much downside risk to the stock in this scenario (so long as the government does not drastically increase the share of upstream companies).

4. **Crude price declines to less than US$100/bbl but stays above US$80/bbl.** We see ONGC's FY2009E consolidated EPS above Rs100 in all these cases, which means the stock is available at 8.6X FY2009E EPS or lower. Exhibit 4 shows sensitivity of ONGC's EPS to various levels of crude price and related subsidy losses.

5. **Crude price averages US$150/bbl or higher; say goodbye to India, let alone ONGC.** We believe the Indian market will likely collapse in this scenario (probably 15-20% lower from current levels) given acute BOP and fiscal pressures, which in turn will result in (1) sharp rupee depreciation (positive for ONGC ironically but negative for global investors) and (2) steep increase in interest rates (negative for market in general). ONGC stock will also decline in that case but we do not think it would matter much in the likely capitulation of the Indian market. Even at a net price of US$40/bbl, ONGC's EPS would come to around Rs75, which should result in ONGC stock finding support at about Rs700, in our view.

More downside to crude price than upside from current levels

We continue to be quite perplexed by the strength in crude oil prices, but we should not be, given that there is no real basis for pricing of products controlled by cartels or 'perverse' economics. The market has ascribed all sorts of reasons to explain the current high prices (1) rising cost of production, (2) tight supply, (3) weakness in dollar versus other currencies, (4) speculative action and (5) rising acceptance of 'peak oil' theory. We see more downside risks to crude oil prices than upside risks currently.

1. **High inventories and weak demand and provide downside risks to earnings in the near term unless supply disruptions become more acute.** We note that US and OECD stocks of products and crude oil are at above their long-term averages (see Exhibits 6 and 7). Also, we note that OECD demand has declined over the past few years with the IEA projecting CY2008E OECD demand at 48.8 mn b/d versus 49.4 mn b/d in CY2004, 49.7 mn b/d in CY2005, 49.3 mn b/d in CY2006 and 49.1 mn b/d in CY2007.

   We do not see any issues about supply of crude oil to match demand for incremental demand of crude in CY2008E or in CY2009E despite significant supply disruptions in Nigeria and other places. Against the IEA's projected global demand growth of 1.03 mn b/d in CY2008E, the IEA projects supply growth of 0.68 mn b/d of non-OPEC oil (including bio-fuels of 0.43 mn b/d) and NGLs of 0.38 mnb/d, which should be sufficient to meet incremental growth (see Exhibit 9).

2. **Cost of production including taxation is still not above US$75/bbl for the least-efficient producers.** We compute that the marginal cost of production, including taxation, is about US$75/bbl. Thus, we find it hard to attribute the current high crude oil prices and the steep increase in the past few months solely to the increase in cost of production.

3. **New energy sources look increasingly viable at current crude prices; hard to bet on a US$100/bbl long-term crude price.** We see high oil prices leading to increased investment in new forms of energy and more efficient usage of energy (should be fairly simple to replicate in less-efficient vehicles given that technology already exists in several parts of the world). Also, we have large faith in human ingenuity to develop the requisite technology; it's only a matter of time, in our view. Even though we do not think bio-fuels are real alternatives to crude oil, we do see significant progress in solar (photovoltaic), nuclear and CTL/GTL over the next few years capping the long-term or normalized price of crude.

   In particular, we would look at CTL/GTL as a viable alternative especially as coal and gas reserves are more equitably distributed globally. For example, QAPCO-Shell's US$20 bn 'Pearl' GTL project in Qatar looks extremely viable at current levels of crude price. The project's annual revenues from middle distillates alone would be around US$5 bn (140,000 b/d of middle distillates at US$100/bbl). In addition, it will produce 120,000 b/d of condensates. The payback period and IRR of the project are very attractive at current levels given very low operating costs (primarily, cost of gas).

We value ONGC stock at Rs1,150 on US$50/bbl normalized crude price

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

	2009E	2010E	2011E
A. Core business valuation			
Normalized crude price assumption (US$/bbl)	50.0	50.0	50.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	20,308	66,576	113,859
Add: OCF after normalizing natural gas price	31,735	27,076	23,723
Add: OCF after removing subsidies	290,852	252,554	210,957
Recurring OCF	342,895	346,206	348,539
Recurring capex			
Production per annum (mn bbls)	397	390	392
Replacement or F&D costs (US$/bbl)	9.0	9.0	9.0
Recurring capex	142,934	138,606	137,688
Free cash flow	**199,961**	**207,601**	**210,851**
Free cash flow multiple (X)	9	9	9
Enterprise value	1,799,646	1,868,405	1,897,657
(Net debt)/cash	380,878	530,713	716,876
Investments	90,514	95,457	100,398
Equity value	2,271,037	2,494,575	2,714,931
Equity value of core business (Rs/share)	**1,062**	**1,166**	**1,269**
B. New discoveries valuation			
KG-DWN-98/2 block (Rs/share)	49	55	62
MN-DWN-98/3 block (Rs/share)	15	16	18
Equity value of new discoveries (Rs/share)	**64**	**71**	**80**
Total equity value per share (Rs/share)	**1,125**	**1,238**	**1,349**

Source: Kotak Institutional Equities estimates.

Including catalysts, ONGC is attractively valued

Valuations of ONGC with and without catalysts (X)

	2009E	2010E	2011E
Market capitalization (Rs bn)	1,851	1,851	1,851
Net debt (Rs bn)	(418)	(573)	(764)
EV (Rs bn)	1,433	1,278	1,087
1. Base case			
DACF (Rs bn)	339	358	389
EPS (Rs)	132	148	162
EV/DACF	4.2	3.6	2.8
P/E	6.6	5.8	5.3
2. Assuming gas price increase and no subsidy losses			
DACF (Rs bn)	587	551	556
EPS (Rs)	246	239	242
EV/DACF	2.4	2.3	2.0
P/E	3.5	3.6	3.6

Source: Kotak Institutional Equities estimates.

ONGC's valuation is highly leveraged to normalised crude prices

Valuation sensitivity of ONGC to normalised crude price (Rs/share)

	Equity value (Rs/share)	Change from base case (%)
Normalized crude prices		
US$90/bbl	2,208	96
US$80/bbl	1,948	73
US$70/bbl	1,685	50
US$60/bbl	1,416	26
US$50/bbl	**1,125**	
US$45/bbl	952	(15)
US$40/bbl	738	(34)

Source: Kotak Institutional Equities estimates.

Sensitivity of earnings for ONGC at various levels of crude price and subsidy loss (Rs bn)

	Crude price (US$/bbl)						
	70	**80**	**90**	**100**	**110**	**120**	**130**
Gross under-recoveries	970	1,219	1,468	1,717	1,966	2,215	2,464
Share of upstream companies	323	406	489	572	655	738	821
Share of ONGC in under-recoveries	**274**	**344**	**415**	**485**	**556**	**626**	**696**
Net profit for ONGC (Rs bn)	189	209	228	248	268	287	307
EPS	**89**	**98**	**107**	**116**	**125**	**134**	**144**

Note:
(a) Share of upstream companies has been assumed to be at 33.33%.

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)

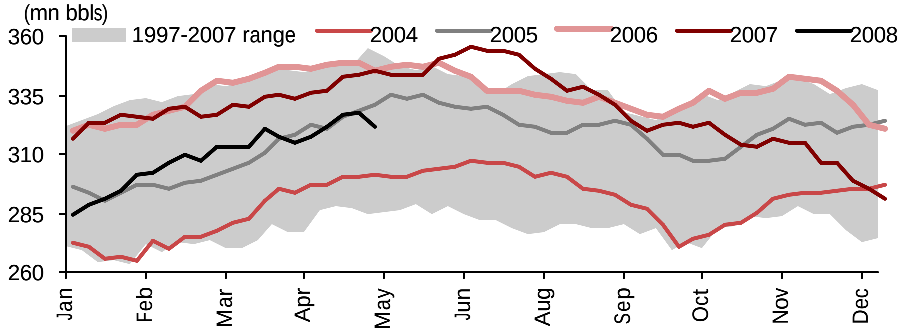
	2006	2007	2008E	2009E				yoy		
								9M 2008	9M 2007	*% chg*
Dated Brent crude oil price (US$/bbl)	57	65	79	80	95	110	124	74	67	*11*
Subsidy loss	**400**	**494**	**771**	**639**	**1,159**	**2,008**	**2,535**	**479**	**405**	***18***
Payment by government (oil bonds)	**115**	**241**	**353**	**292**	**530**	**919**	**1,160**	**203**	**192**	***6***
Share of BPCL	22	53	86	71	129	224	283	46	43	*6*
Share of HPCL	23	49	77	64	116	201	253	43	39	*8*
Share of IOCL	70	138	190	157	285	495	624	115	109	*5*
Net under-recovery of oil companies	**285**	**253**	**418**	**347**	**628**	**1,089**	**1,375**	**275**	**214**	***29***
Share of refining companies	27	—	—	—	—	—	—	—	3	—
Share of upstream companies	**140**	**205**	**257**	**213**	**386**	**669**	**845**	**160**	**149**	***7***
Share of ONGC	120	170	218	181	327	568	716	135	124	*9*
Share of GAIL (b)	11	15	13	12	22	39	49	9.3	9.9	*(6)*
Share of Oil India	10	20	24	20	36	63	80	15	16	*(5)*
Net under-recovery of R&M companies	**118**	**48**	**161**	**134**	**242**	**420**	**530**	**116**	**64**	***80***
Pre-tax profits of R&M companies (d)	**74**	**96**	**162**					**139**	**66**	

Note:
(a) Share of upstream companies assumed at 33.33% and share of oil bonds based on oil bonds announced for FY2008.
(b) Share of GAIL for FY2008 is based on the provisional subsidy burden reported by the company.
(c) Our official crude forecast for FY2009E is US$100/bbl.
(d) Pre-tax profits include actual reported profits of HPCL and IOCL and estimated profits for BPCL.

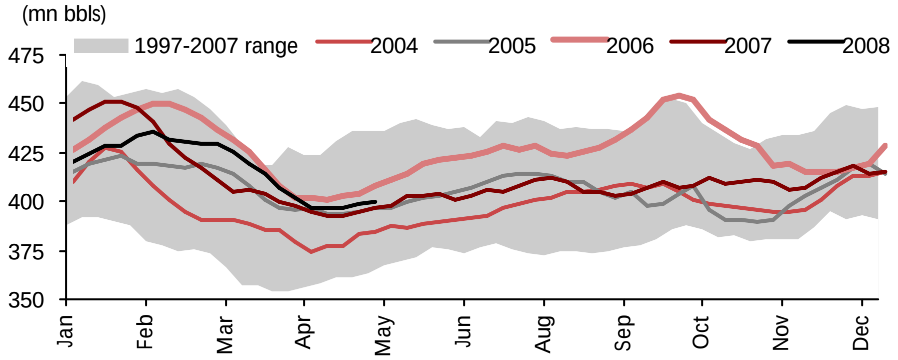
Source: Kotak Institutional Equities estimates.

U.S. (DOE) crude oil and refined product statistics

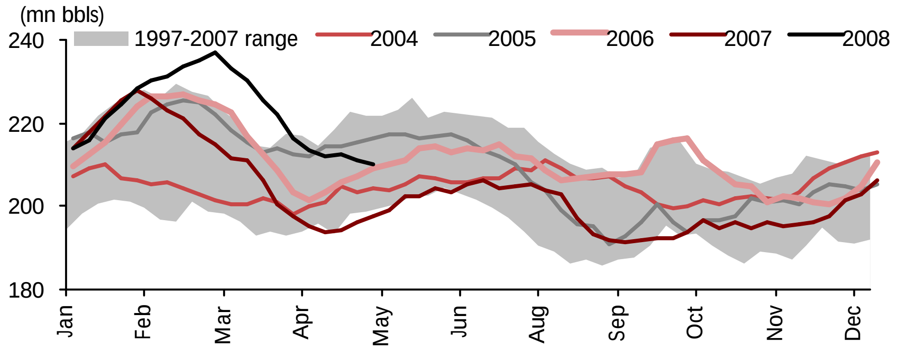
Crude oil



Key products



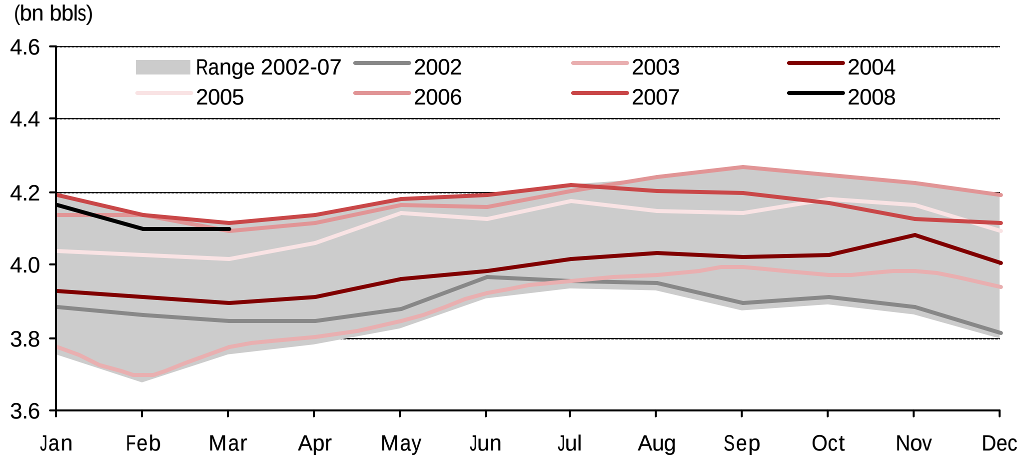
Gasoline



Source: Department of Energy, USA.

OECD stocks is comfortable currently

Total industry and government-controlled crude and product stocks in OECD countries (bn bbls)



Source: IEA.

OECD demand has declined in recent years

Summary of global oil demand (mn bbls/day)

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
OECD demand									
North America	25.4	25.5	25.3	25.5	25.1	25.3	25.4	25.5	25.7
Europe	15.5	15.6	15.6	15.3	15.3	15.5	15.6	15.6	15.6
Pacific	8.5	8.6	8.4	8.3	8.4	8.5	8.5	8.5	8.5
Total OECD	**49.3**	**49.7**	**49.3**	**49.1**	**48.8**	**49.2**	**49.4**	**49.6**	**49.7**
FSU	3.8	3.9	4.1	4.1	4.2	4.2	4.3	4.4	4.5
Europe	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.9	0.9
China	6.4	6.7	7.2	7.5	7.9	8.3	8.7	9.0	9.4
Other Asia	8.6	8.8	8.9	9.2	9.5	9.6	9.9	10.2	10.4
Latin America	5.0	5.1	5.3	5.6	5.9	5.8	5.9	6.0	6.1
Middle East	5.7	6.0	6.2	6.5	6.8	7.1	7.3	7.6	7.9
Africa	2.8	2.9	2.9	3.0	3.1	3.1	3.2	3.3	3.5
Total Non-OECD	**33.0**	**34.1**	**35.3**	**36.7**	**38.1**	**38.9**	**40.0**	**41.1**	**42.4**
Total demand	**82.3**	**83.8**	**84.7**	**85.8**	**86.8**	**88.0**	**89.3**	**90.6**	**92.0**

Source: International Energy Agency Medium-term oil report.

Expect crude prices to soften led by weakness in demand
Estimated global crude demand, supply and prices, Calendar year-ends

	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Demand (mb/d)									
Total demand	82.5	83.8	84.7	85.8	86.8	88.0	89.3	90.6	92.0
Yoy growth	3.3	1.3	0.9	1.1	1.0	1.2	1.3	1.3	1.4
Supply (mb/d)									
Non-OPEC	48.8	48.6	49.1	49.7	50.4	51.5	51.8	52.1	52.5
Yoy growth	0.6	(0.2)	0.5	0.6	0.7	1.1	0.3	0.3	0.4
OPEC									
Crude	29.5	30.7	30.9	31.3	31.2	30.5	30.9	31.8	32.4
NGLs	4.2	4.5	4.6	4.8	5.2	6.0	6.6	6.7	7.1
Total OPEC	**33.7**	**35.2**	**35.5**	**36.1**	**36.4**	**36.5**	**37.5**	**38.5**	**39.5**
Total supply	**83.4**	**84.6**	**85.4**	**85.8**	**86.8**	**88.0**	**89.3**	**90.6**	**92.0**
Total stock change	1.0	0.7	0.8						
OPEC crude capacity				**34.4**	**35.5**	**36.1**	**37.1**	**37.9**	**38.4**
Implied OPEC spare capacity				**3.1**	**4.3**	**5.6**	**6.2**	**6.1**	**5.9**
Demand growth (yoy, %)	**4.2**	**1.6**	**1.1**	**1.3**	**1.2**	**1.4**	**1.5**	**1.5**	**1.5**
Supply growth (yoy, %)									
Non-OPEC	**1.2**	**(0.4)**	**1.0**	**1.2**	**1.4**	**2.2**	**0.6**	**0.6**	**0.8**
OPEC	**8.4**	**4.5**	**0.9**	**1.7**	**0.8**	**0.3**	**2.7**	**2.7**	**2.6**
Total	**4.4**	**1.4**	**0.9**	**0.5**	**1.1**	**1.4**	**1.5**	**1.5**	**1.5**
Dated Brent (US$/bbl)	**38.3**	**54.4**	**65.8**	**72.7**	**100.0**	**95.0**	**90.0**	**90.0**	**90.0**

Source: IEA, BP Statistical Review of World Energy, and various government and industry sources.

ONGC's earnings are highly leveraged to crude prices
Earnings sensitivity of ONGC to key variables

	2009E			2010E			2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rs/US$	39.0	40.0	41.0	38.5	39.5	40.5	38.0	39.0	40.0
Net profits (Rs mn)	265,903	281,682	297,451	301,406	317,501	333,586	330,898	347,060	363,215
Earnings per share (Rs)	124.3	131.7	139.1	140.9	148.4	156.0	154.7	162.3	169.8
% upside/(downside)	**(5.6)**		**5.6**	**(5.1)**		**5.1**	**(4.7)**		**4.7**
Average crude prices									
Crude price (US$/bbl)	98.0	100.0	102.0	93.0	95.0	97.0	88.0	90.0	92.0
Net profits (Rs mn)	269,436	281,682	293,919	304,513	317,501	330,480	333,464	347,060	360,649
Earnings per share (Rs)	126.0	131.7	137.4	142.4	148.4	154.5	155.9	162.3	168.6
% upside/(downside)	**(4.3)**		**4.3**	**(4.1)**		**4.1**	**(3.9)**		**3.9**
Cess									
Cess on domestic crude (Rs/ton)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	273,297	281,682	290,067	308,914	317,501	326,087	338,360	347,060	355,760
Earnings per share (Rs)	127.8	131.7	135.6	144.4	148.4	152.5	158.2	162.3	166.3
% upside/(downside)	**(3.0)**		**3.0**	**(2.7)**		**2.7**	**(2.5)**		**2.5**
Natural gas prices									
Natural gas price ceiling (Rs/'000 cum)	4,000	4,500	5,000	4,250	4,750	5,250	4,500	5,000	5,500
Net profits (Rs mn)	276,078	281,682	287,280	312,171	317,501	322,825	341,836	347,060	352,279
Earnings per share (Rs)	129.1	131.7	134.3	146.0	148.4	150.9	159.8	162.3	164.7
% upside/(downside)	**(2.0)**		**2.0**	**(1.7)**		**1.7**	**(1.5)**		**1.5**

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	2007	2008E	2009E	2010E	2011E	2012E
Profit model (Rs mn)									
Net sales	467,124	707,083	807,603	968,227	1,105,143	1,281,396	1,297,858	1,352,281	1,385,450
EBITDA	**196,494**	**281,195**	**310,054**	**358,001**	**426,546**	**463,589**	**492,367**	**523,258**	**509,322**
Other income	23,752	17,595	27,350	45,377	38,683	46,897	57,772	57,772	58,272
Interest	(5,028)	(2,512)	(537)	394	(1,261)	(1,476)	(2,226)	(5,423)	(9,560)
Depreciation and depletion	(65,525)	(73,465)	(97,726)	(119,550)	(113,791)	(110,357)	(104,087)	(96,683)	(94,423)
Pretax profits	149,693	222,813	239,141	284,222	350,176	398,654	443,827	478,924	463,611
Tax	(46,101)	(74,690)	(71,196)	(88,987)	(114,560)	(124,319)	(133,689)	(132,566)	(129,017)
Deferred tax	(7,779)	(4,744)	(13,612)	(9,264)	(9,548)	11,960	10,120	2,030	3,795
Net profits	95,523	143,175	154,596	178,412	228,744	286,295	320,257	348,388	338,389
Net profits after minority interests	**94,219**	**140,670**	**153,542**	**176,921**	**225,134**	**281,682**	**317,501**	**347,060**	**338,203**
Earnings per share (Rs)	**44.1**	**65.8**	**71.8**	**82.7**	**105.3**	**131.7**	**148.4**	**162.3**	**158.1**
Balance sheet (Rs mn)									
Total equity	415,582	488,912	578,830	670,137	805,863	988,260	1,199,008	1,425,152	1,641,198
Deferred tax liability	54,250	57,911	71,557	80,976	90,524	78,564	68,445	66,415	62,620
Liability for abandonment cost	80,292	80,941	128,675	151,857	151,857	151,857	151,857	151,857	151,857
Total borrowings	60,961	39,028	28,767	21,826	34,254	41,427	77,054	117,454	157,854
Currrent liabilities	85,376	128,346	142,435	187,051	108,530	117,960	118,015	120,445	125,615
Total liabilities and equity	**696,461**	**795,138**	**950,264**	**1,111,847**	**1,191,028**	**1,378,068**	**1,614,378**	**1,881,323**	**2,139,145**
Cash	95,721	101,843	90,743	206,262	269,491	422,305	607,768	834,331	1,109,892
Current assets	133,039	178,421	240,210	192,652	210,647	223,147	224,083	234,502	241,253
Total fixed assets	419,213	471,543	565,722	643,219	641,177	662,902	707,874	732,897	708,406
Goodwill	11,661	10,753	14,172	27,686	27,686	27,686	27,686	27,686	27,686
Investments	30,811	26,961	35,753	36,888	36,888	36,888	41,828	46,769	46,770
Deferred expenditure	6,017	5,617	3,663	5,141	5,141	5,141	5,141	5,141	5,141
Total assets	**696,461**	**795,138**	**950,264**	**1,111,848**	**1,191,029**	**1,378,068**	**1,614,379**	**1,881,324**	**2,139,147**
Free cash flow (Rs mn)									
Operating cash flow, excl. working capital	133,261	187,001	216,736	252,772	252,988	285,076	309,133	347,656	336,455
Working capital changes	25,630	18,787	46,461	(4,990)	(91,516)	(48,739)	37,346	(4,547)	(1,580)
Capital expenditure	(56,301)	(103,418)	(113,738)	(135,049)	(52,874)	(81,491)	(104,098)	(87,288)	(38,938)
Investments	(10,608)	(9,887)	(28,912)	53,822	—	—	(4,940)	—	—
Other income	9,767	13,049	14,537	20,422	39,338	47,272	57,772	57,772	58,272
Free cash flow	**101,749**	**105,532**	**135,083**	**186,976**	**147,937**	**202,119**	**295,213**	**313,593**	**354,208**
Ratios (%)									
Debt/equity	14.7	8.0	5.0	3.3	4.3	4.2	6.4	8.2	9.6
Net debt/equity	(8.4)	(12.8)	(10.7)	(27.5)	(29.2)	(38.5)	(44.3)	(50.3)	(58.0)
RoAE	21.6	28.0	25.9	25.5	27.6	29.1	27.6	25.5	21.4
RoACE	**20.6**	**24.6**	**22.0**	**22.1**	**23.3**	**25.4**	**24.4**	**23.0**	**19.7**
Key assumptions									
Rs/dollar rate	46.0	45.0	44.3	45.3	40.3	40.0	39.5	39.0	39.0
Crude fob price (US$/bbl)	28.7	40.6	57.2	64.8	78.9	100.0	95.0	90.0	90.0
Ceiling/actual natural gas price (Rs/'000 cm)	2,850	2,850	3,515	4,211	4,250	4,500	4,750	5,000	4,750
Subsidy loss (Rs bn)	26.9	41.0	119.6	170.2	200.0	405.0	350.0	290.0	290.0

Source: Kotak Institutional Equities estimates.

Industrials

BGRE.BO, Rs345	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	390
52W High -Low (Rs)	989 - 265
Market Cap (Rs bn)	24.8

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	14.5	20.9	28.1
Net Profit (Rs bn)	0.9	1.2	1.7
EPS (Rs)	11.9	16.6	23.0
EPS gth	*(67.9)*	*38.9*	*38.6*
P/E (x)	28.9	20.8	15.0
EV/EBITDA (x)	16.5	12.0	9.3
Div yield (%)	0.3	0.5	0.7

BGR Energy Systems: Sharp correction post recent initiation prompts rating upgrade to ADD from REDUCE earlier

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- **Highlight sharp correction in the stock post the recent initiation**
- **Cut target price to Rs390 (from Rs460 earlier) imply lower P/E multiple versus earlier**
- **Upgrade rating to ADD from REDUCE earlier based on based on significant correction, sectoral prospects and likely strong execution**

We highlight steep correction in the stock - 24% in absolute terms and 18% relative to the market since our initiation with REDUCE rating on May 6, 2008. We had stated in our report that BGR Energy's (1) high working capital levels (115 days) and (2) low-margin profile (10.6%), imply lower return on capital and free cash flow generation, that are characteristics of construction rather than engineering business (and thus would likely cap trading multiples as well). We upgrade our rating to ADD (from REDUCE earlier) with a revised target price of Rs390 (versus Rs460 earlier) based on (1) significant correction, (2) investment momentum in power generation, (3) limited competition in turnkey BOP (4) strong design and engineering skills, (5) BGR Energy's ability to scale up its business quickly. Key risks arise from (1) margin pressures due to commodity price increase, (2) dependence on further order wins to meet earnings projections, (3) potential delays, litigation in large-sized projects, (4) execution management given the strong growth across multiple divisions, and (5) dependence on technological partners.

Highlight sharp correction in the stock post the recent initiation

We highlight steep correction in BGR Energy's stock price - 24% in absolute terms and 18% relative to the market since our initiation with REDUCE rating on May 6, 2008. BGR Energy is now trading at a P/E of 21X FY2009E and 15X FY2010E earnings, far more reasonable versus 27X FY2009E and 20X FY2010E that was prevailing at the time of initiation. We had highlighted in our initiating coverage report that high valuation multiples for BGR Energy precludes optimism on the stock, in-spite of its likely strong growth over the next few years. We had also stated that BGR Energy's (1) high working capital levels (115 days) and (2) low-margin profile (10.6%), imply lower return on capital and free cash flow generation, that are characteristics of construction rather than engineering business (and thus would likely cap trading multiples as well).

Cut target price to Rs390 (from Rs460 earlier), upgrade to ADD based on significant correction in valuation, sectoral prospects and likely strong execution

We cut our DCF-based target price to Rs390 from Rs460 earlier (Exhibit 1). Our implied target P/E multiple for BGR Energy is now 23.5X based on FY2009E, which is at about 20% discount to our implied target valuation multiple for the industrial sector coverage universe (Exhibit 2). We highlight that our industrial sector coverage universe is currently trading at a P/E multiple of 24X FY2009E EPS versus P/E multiple of 21X FY2009E for BGR Energy (Exhibits 3 and 4). We upgrade our rating to ADD from REDUCE earlier based on (1) significant correction in valuations, (2) visible investment momentum in power generation sector with several projects coming up for bidding (likely to be commissioned during FY2010E-12E), (3) limited competition in the provision of turnkey BOP services for large power plants (up to 500 MW) that may potentially ensure strong order inflows (4) BGR Energy's strong design and engineering skills that differentiate it from its competitors, (5) BGR Energy's ability to scale up its business quickly (CAGR revenue growth (annualized) of about 88% during FY2005-08E), lending confidence to our revenue growth assumptions during FY2008E-10E (CAGR of 39%) and (6) BGR Energy's presence across several diverse businesses such as process equipment for the oil & gas industry and for water and environmental solutions, that provide several sources of consistent long-term growth.

Key risks arise from (1) margin pressures due to commodity price increase and foreign exchange fluctuations, (2) dependence on further order wins to meet strong growth in earnings (as estimated by us), (3) delays, litigation in large-sized projects that contribute bulk of revenues, (4) execution management given the strong growth across multiple divisions, and (5) dependence on technological partners.

We will revisit our assumptions and target price post the declaration of 4QFY08 results (our expectation of revenues of Rs5.2 bn and PAT of Rs337 mn, with operating margins of 11.7%).

Exhibit 1: Our DCF-based target price of Rs390 per share
DCF valuation of BGR Energy System, March fiscal year-ends, 2009E-2019E (Rs mn)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	**20,933**	**28,113**	**33,654**	**39,526**	**45,455**	**52,274**	**60,115**	**69,132**	**79,502**	**89,042**	**97,946**
Revenue growth (%)	*44.3*	*34.3*	*19.7*	*17.4*	*15.0*	*15.0*	*15.0*	*15.0*	*15.0*	*12.0*	*10.0*
EBITDA	**2,224**	**2,990**	**3,575**	**4,171**	**4,773**	**5,489**	**6,312**	**7,259**	**8,348**	**9,349**	**10,284**
EBITDA margin (%)	*10.6*	*10.6*	*10.6*	*10.6*	*10.5*	*10.5*	*10.5*	*10.5*	*10.5*	*10.5*	*10.5*
Depreciation	(168)	(212)	(235)	(255)	(272)	(294)	(316)	(339)	(363)	(386)	(410)
EBIT	2,057	2,778	3,341	3,916	4,501	5,195	5,996	6,919	7,985	8,963	9,875
Tax	(686)	(934)	(1,122)	(1,316)	(1,512)	(1,745)	(2,014)	(2,325)	(2,682)	(3,011)	(3,317)
Change in net working capital	(1,068)	(2,232)	(354)	(1,583)	(1,462)	(1,681)	(1,933)	(2,223)	(2,557)	(2,352)	(2,196)
Capex	(650)	(400)	(400)	(400)	(450)	(450)	(500)	(500)	(550)	(550)	(600)
Free cash flow	**(179)**	**(576)**	**1,699**	**872**	**1,349**	**1,612**	**1,864**	**2,211**	**2,558**	**3,436**	**4,171**
PV of each cash flow	(179)	(576)	1,510	689	947	1,007	1,035	1,091	1,122	1,339	1,445
PV of cash flows	9,429	*32%*						FCF in termi	0%	0%	4,171
PV of terminal value	20,232	*68%*						Exit FCF mu	0.0	0.0	14.0
EV	29,661	*100%*						Terminal val	0.0	0.0	58,401
Debt	1,490							Exit EBITDA	0.0	0.0	5.7
Equity value	28,171										
Shares outstanding (mn)	72.0										
Equity value (Rs/share)	**391**										

Weighted average cost of capital-WACC								
Terminal growth - g (%)	5.0	**Sensitivity of DCF value to WACC, Terminal Growth rate**						
Risk free rate-Rf (%)	8.0					WACC (%)		
Market risk premium—(Rm-Rf) (%)	5.5		391	11.5	12.0	12.5	13.0	13.5
Beta (x)	1.1	Terminal	4.0	419	385	356	330	307
Cost of equity-Ke (%)	14.1	growth	4.5	442	405	372	344	319
Cost of debt-Kd (%)	12.0	rate (%)	5.0	468	427	**391**	360	333
Tax rate (%)	34.0		5.5	499	453	413	378	348
Debt/Capital (%)	60.7		6.0	536	483	438	399	366
Equity/Capital (%)	39.3							
WACC (%)	10.3							
Used WACC (%)	12.5						Base case	

Source: Kotak Institutional Equities estimates.

Exhibit 2: Target prices and implied valuation for Kotak Institutional Equities industrial sector coverage universe, March fiscal year-end 2009E

						Implied target multiple		
	Rating	Price (Rs)	Shares o/s (mn)	Mkt cap (Rs bn)	Target price (Rs)	P/E (X)	EV/EBIDTA (X)	P/B (X)
Electrical equipment								
BHEL	REDUCE	1,663	490	814	1,875	26	19	8
ABB	REDUCE	1,024	212	217	1,125	37	24	15
Suzlon	ADD	277	1,496	415	350	30	19	7
Siemens	REDUCE	560	331	185	600	34	19	11
Electrical equip. aggregate				**1,631**		**29**	**20**	**9**
Engineering & construction								
L&T	BUY	2,983	292	870	3,600	31	20	9
Dredging Corp	REDUCE	607	28	17	775	12	4	2
Engg. & const. aggregate				**919**		**32**	**21**	**6**
Defense								
Bharat Electronics	ADD	1,200	80	96	1,475	14	8	6
KIE sector aggregate				**2,615**		**28.8**	**19.5**	**6.5**
BGR Energy Systems	REDUCE	390	72	28	380	23	13	4

Source: Kotak Institutional Equities estimates..

Exhibit 3: As expected, valuation multiples of BGR Energy have corrected and become lower than our industrial sector coverage universe
Valuation multiples of industrial sector coverage unvierse, March fiscal year-ends, FY2007-10E

	EV/EBIDTA (X)				P/E (X)				EV/sales (X)				P/B (X)			
	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E
Electrical equipment																
BHEL	24.1	21.4	16.1	12.2	70.0	28.5	23.4	18.7	4.4	3.7	2.9	2.2	9.3	7.4	6.0	4.8
ABB	44.2	29.0	21.6	15.6	63.7	44.1	33.6	25.2	4.9	3.5	2.7	2.0	18.4	13.5	10.0	7.4
Suzlon	34.1	27.6	17.0	12.3	46.2	54.4	24.1	16.3	5.6	3.6	2.4	1.9	11.8	5.6	4.6	3.6
Siemens	24.5	16.7	17.4	11.7	47.5	27.2	32.1	21.7	2.9	1.9	1.7	1.4	15.0	10.1	8.0	6.1
Electrical equipment aggregate	**28.2**	**23.0**	**17.1**	**12.5**	**41.5**	**33.7**	**25.0**	**18.6**	**4.5**	**3.3**	**2.5**	**1.9**	**11.1**	**7.5**	**6.0**	**4.8**
Engineering & construction																
L&T	35.6	23.2	16.7	12.8	47.5	36.6	25.6	20.0	4.5	3.2	2.4	1.8	11.5	7.4	5.0	3.9
Dredging Corp	2.2	1.5	9.0	8.8	10.1	11.7	9.6	9.1	0.7	0.3	2.1	1.8	1.5	1.4	1.3	1.1
Engineering & const. aggregate	**34.6**	**23.1**	**17.0**	**13.1**	**47.2**	**36.4**	**25.3**	**19.8**	**4.5**	**3.2**	**2.5**	**1.9**	**10.6**	**7.1**	**4.9**	**3.9**
Defense																
Bharat Electronics	7.7	7.4	6.0	5.4	13.1	12.4	11.1	10.4	1.9	1.6	1.4	1.2	5.8	4.5	3.6	3.0
KIE sector aggregate	**27.6**	**21.6**	**16.1**	**12.2**	**39.6**	**32.1**	**23.7**	**18.2**	**4.3**	**3.1**	**2.4**	**1.9**	**10.4**	**7.1**	**5.4**	**4.3**
BGR Energy Systems	**50.3**	**18.5**	**13.5**	**10.4**	**97.4**	**32.7**	**23.5**	**17.0**	**3.7**	**2.0**	**1.4**	**1.1**	**5.1**	**5.6**	**4.6**	**3.7**

Source: Kotak Institutional Equities estimates.

Exhibit 4: BGR Energy stil trades at a significant premium to the construction sector
Comparison of valuation of various construction companies in India, March fiscal year-ends 2008E-10E (Rs bn)

	Revenues (Rs bn)			EBITDA (Rs bn)			EPS (Rs)			P/E (X)			EV/EBITDA (X)			EV/SALES (X)		
Company	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
Consolidated Construciton Company	15.1	21.1	28.1	1.3	2.0	2.8	27.5	40.7	56.5	22.4	15.1	10.9	16.1	10.4	7.4	1.4	1.0	0.7
IVRCL Infrastructure	36.6	50.4	69.5	3.6	5.0	6.9	15.6	19.6	26.7	19.4	15.4	11.3	12.0	9.2	7.1	1.2	0.9	0.7
Larsen & Toubro standalone	248.8	335.6	450.9	28.1	40.0	53.8	71.5	94.9	123.1	31.9	24.1	18.5	24.9	17.8	13.4	2.8	2.1	1.6
Nagarjuna Construction Company	34.7	47.6	60.7	3.6	5.0	6.4	7.0	10.0	13.6	18.9	13.2	9.7	11.6	8.3	6.5	1.2	0.9	0.7
Punj Lloyd Ltd	81.4	114.2	152.9	6.3	10.2	14.4	10.4	16.9	24.7	30.9	18.9	13.0	17.6	11.4	8.1	1.4	1.0	0.8
Sadbhav Engineering	8.5	13.4	15.4	1.0	1.7	1.9	44.7	73.5	82.4	12.7	7.7	6.9	8.0	4.6	3.7	1.0	0.6	0.5
Average										**22.7**	**15.7**	**11.7**	**15.0**	**10.3**	**7.7**	**1.5**	**1.1**	**0.8**
BGR Energy Systems	14.5	20.9	28.1	1.6	2.2	3.0	11.9	16.6	23.0	32.7	23.5	17.0	18.5	13.5	10.4	2.0	1.4	1.1

Note:
(1) For Nagarjuna, we have adjusted value of land bank (about Rs39/share), other BOT projects (Rs6.5/share) and investments (Rs20/share) for a total of Rs65/share.
(2) For Punj Lloyd & CCCL, estimates are based on consolidated estimates as they do not have any BOT projects.
(3) For IVRCL we have adjusted value of IVR Prime (Rs60/share corresponding to IVR Prime price of Rs200/share) and other BOT projects for a total adjustment of Rs115/share.
(4) For L&T, we have deducted Rs700 per share as the value of subsdiaries/associates/JVs.
(5) For Sadbhav Engineering, we have deducted Rs385 per share (the value of BOT projects).

Source: Bloomberg, Kotak Institutional Equities estimates.

Strategy

Sector coverage view	N/A

Closing trade—gaining from volatility

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- **Closing long DLF and short Unitech'gross return +8.3%**
- **Closed all trades with net positive return of over 8%**

Closing long DLF, short Unitech

We had initiated long DLF, short Unitech trade on April 16, 2008 to capture the valuation differential arising from (1) higher confidence in DLF's execution capability (we highlighted large delays in commercial and residential projects for Unitech), (2) lower leverage for DLF versus UT's and (3) a higher portion of DLF's NAV being front-ended versus that of UT. Furthermore, DLF stock was trading at a discount to NAV versus premium to NAV for Unitech. Since the initiation of the trade, DLF stock has decreased by 4.9% and Unitech stock has fallen by 13.2% generating gross positive return of 8.3%.

Alpha-Bet trades

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

	Stock	Close price (Rs)	Initiation price (Rs)	Return (%)
Closed trade (15 April-7 May 2008)				
Long	L&T	2,993	2,807	6.6
Short	BHEL	1,785	1,833	(2.6)
Return (%)				**9.2**
Closed trade (15 April-14 May 2008)				
Long	ITC	226	208	8.8
Short	HUL	243	246	(1.3)
Return (%)				**10.1**
Closed trade (15 April-15 May 2008)				
Long	Tata Power	1,401	1,274	10.0
Short	NTPC	191	191	0.2
Return (%)				**9.8**
Closed trade (15 April-30 May 2008)				
Long	DLF	587	617	(4.9)
Short	Unitech	233	268	(13.2)
Return (%)				**8.3**

Source: Bloomberg, Kotak Institutional Equities estimates.

History of Alpha-Bet trades

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

	Stock	Close price (Rs)	Initiation price (Rs)	Return (%)
Closed trade (18 July-30 July 2007)				
Long	Bajaj Auto	2,293	2,282	0.5
Short	ABNL	1,375	1,576	(12.8)
Return (%)				**13.2**
Closed trade (18 July-23 August 2007)				
Long	Ambuja Cement	133	129	3.1
Short	ACC	963	1,023	(5.9)
Return (%)				**9.0**
Closed trade (18 July-23 August 2007)				
Long	HPCL	251	259	(3.1)
Short	Cairn (50%)	161	158	1.9
	GAIL (50%)	312	331	(5.7)
Return (%)				**(1.2)**
Closed trade (14 September-21 September 2007)				
Long	JSPL	5,371	4,619	16.3
Short	Tata Steel	741	704	5.3
Return (%)				**11.0**
Closed trade (14 September-24 September 2007)				
Long	ICICI Bank	996	907	9.8
Short	Infosys Technologies	1,763	1,830	(3.7)
Return (%)				**13.5**
Closed trade (18 July-3 October 2007)				
Long	RCOM	643	567	13.4
Short	Idea Cellular	128	130	(1.2)
Return (%)				**14.6**
Closed trade (14 September-5 October 2007)				
Long	Suzlon	1,652	1,372	20.4
Short	GMR (50%)	174	153	13.7
	MTNL (50%)	154	145	5.9
Return (%)				**10.6**
Closed trade (14 November-29 November 2007)				
Long	Bharti Airtel	916	860	6.5
Short	RCOM	665	725	(8.3)
Return (%)				**14.8**
Closed trade (14 November-29 November 2007)				
Long	HCL Technologies	313	302	3.8
Short	ZEEL	282	313	(9.9)
Return (%)				**13.7**
Closed trade (14 September-31 December 2007)				
Long	IVRCL (50%)	554	511	8.5
	Nagarjuna Construction (50%)	353	292	21.1
Short	Siemens	1,893	1,881	0.6
Return (%)				**14.2**
Closed trade (10 January-24 January 2008)				
Long	HPCL	256	333	(23.1)
Short	IOCL	452	684	(33.9)
Return (%)				**10.8**
Closed trade (10 January-11 February 2008)				
Long	Ranbaxy	366	398	(8.0)
Short	Glenmark	449	538	(16.5)
Return (%)				**8.5**
Closed trade (10 January-11 February 2008)				
Long	Sterlite	700	1,015	(31.0)
Short	Nalco	354	479	(26.1)
Return (%)				**(4.9)**
Closed trade (10 January-11 February 2008)				
Long	Hindalco (50%)	153	218	(29.8)
	Sesa Goa (50%)	2,849	3,636	(21.6)
Short	Tata Steel	726	858	(15.4)
Return (%)				**(10.3)**
Closed trade (15 April-7 May 2008)				
Long	L&T	2,993	2,807	6.6
Short	BHEL	1,785	1,833	(2.6)
Return (%)				**9.2**
Closed trade (15 April-14 May 2008)				
Long	ITC	226	208	8.8
Short	HUL	243	246	(1.3)
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Return (%)				**8.3**

Source: Bloomberg, Kotak Institutional Equities estimates.

Economy

Sector coverage view N/A

RBI unlikely to pull in reins immediately though growth and inflation numbers may have increased headroom

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- **Real GDP growth in 4QFY08 at 8.8% confirms economy still buoyant**
- **Headline inflation crosses 8.0, but still remains supply-side**
- **Liquidity may tighten in near term of its own accord**
- **In our view, RBI is unlikely to further tighten monetary policy in near term**

Two surprises; would a third follow? The first, a big positive surprise in real GDP for 4QFY08 turning out to be 8.8%, nearly 1 ppt higher than street expectations. The second, headline inflation increased to 8.1% against street expectation of 7.9%. Consequently, the market began preparing for a third surprise in the form of possible further imminent tightening of monetary policy by raising the repo rate or CRR. In our view, liquidity conditions are likely to tighten on their own in the near term and RBI is unlikely to tighten monetary policy in haste.

High real GDP growth in 4QFY08 reaffirms confidence in 8.0%+ growth in FY2009E

Real GDP growth of 8.8% in 4QFY08 has reinforced our real GDP growth projection of 8.2% for FY2009E (see Exhibits 1 and 2). There have been no signs of non-manufacturing growth slowing down as yet. The 4QFY08 real GDP growth of 8.8% was about 1 ppt above our expectations and those of the market. Growth was the same as in 3QFY08, implying that economic activity slowed down only in the manufacturing sector and that this slowdown was compensated by the services sector which remained buoyant.

Highlights of 4QFY08 real GDP growth

- Real GDP growth in 4QFY08 at 8.8% (same as in 3QFY08) dispels the fear that economy has already slowed down.
- High 8.8% growth achieved in spite of manufacturing activity slowing down to 5.8% from 9.6% in 3QFY08. IIP manufacturing had dropped to 5.8% in 4QFY08 from 8.9% in 3QFY08 and the GDP for manufacturing reflected this trend.
- Services sector continued to record double digit growth for the 14th successive quarter and its buoyancy compensated for the manufacturing slow down. Construction activity and 'trade, hotels, transport and communication' recorded 12%+ growth.
- 'Community, social & personal services' growth jumped to 9.5% from 6.2% in the previous quarter; but this may just reflect higher government expenditure.

High real GDP growth in FY2008 supported by investment boom

Upward revision in FY2008 growth to 9.0% (Revised Estimates [RE]) from 8.7% (Quick Estimates [QE]) is on account of higher agriculture and mining output. The high growth was supported by a sustained investment boom in the economy

Highlights of the data release on revised estimates (RE) for real GDP growth for FY2008

- 9.0% growth in FY2008 RE means that the Indian economy recorded a growth rate of 9.0% or more for the third year in succession.
- The upward revision in growth was mainly on account of agriculture (4.5%RE from 2.6% in QE) and mining (4.7% RE in place of 3.4% QE).

- Per capita income recorded an impressive growth of 7.8% in FY2008.
- Investment rate has reached an all-time high of 37.5% of GDP in FY2008.

In our base case projection of 8.2% for 2009E, we had any way taken agricultural growth for FY2008E at 4.3% in place of then CSO's estimate of 2.6%. We had expected this upward revision because the crop output numbers were higher. This was also explained in our Economy report of May 9, "*Bulwarks against headwinds firmly in place.*" As such, we retain our agricultural growth projection of 3.0% and real GDP growth projection of 8.2% for FY2009E.

Food and energy prices push headline inflation to above 8.0%

Headline inflation rate (yoy % change in WPI) for the week-ended March 17, 2008 increased to 8.1% from 7.8% in the preceding week (see Exhibit 3). The increase in prices over the week came mainly from fruits, vegetables and mineral oils (comprising crude oil based fuels.

Headline inflation rate crossed 8.0%, confirming our rather vocal fears since early April that headline inflation in FY2009E could average around 8.0%. Our earlier analysis was that inflation remains a supply-side phenomenon and demand-side pressures may come only in 2HFY08. This week's WPI numbers reaffirm this view. Highlights of the inflation data are:

- Food price inflation jumped to 5.43% from 4.56% in the preceding week mainly due to a 2.8% increase in prices of fruits and 2.1% in prices of vegetables over the week.
- Increase in prices of some fuels whose prices are not controlled also added to inflationary pressures.
- Inflation for manufactured products increased only marginally. The steel price roll back was far less than anticipated with its WPI falling by mere 0.6% over the week.

RBI unlikely to further tighten monetary policy in near term

We do not expect RBI to tighten its reins in the near term despite buoyant growth and still-rising inflation

Key factors in our rationale

- We continue to believe that RBI has concerns that growth and investment might slow down ahead and with moderation of capital flows, liquidity may decrease on its own
- Real GDP growth has remained high, but there is a clear slowdown in manufacturing growth. The Finance Minister in his post data press conference clearly acknowledged that this was a problem and that the government would be addressing it soon.
- RBI's daily LAF window requires small liquidity injections after the third CRR hike of 25 bps. Advance tax collection during second and third week of June may take about Rs450 bn out of the system leading to liquidity tightening and interest rate hike on its own.
- Inflation remains supply-side phenomenon and cannot be addressed by monetary policy tightening.

We believe RBI may take a decision on further tightening only after there is clarity on the mounting fiscal deficit and how it may be funded. It may, in fact, have to cut SLR to avoid an interest rate shock from high oil and fertilizer bond issuance.

Exhibit 1: Growth maintained at 8.8% in 4QFY08; no slowdown evident as yet

Sector-wise quarterly real GDP growth rates

		Sector	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
I	**1**	**Agriculture and allied activities**	**2.7**	**3.2**	**4.0**	**4.9**	**4.4**	**4.7**	**6.0**	**2.9**
II		**Industry (2+3+4)**	**10.0**	**10.7**	**10.3**	**11.5**	**9.6**	**8.6**	**8.6**	**5.8**
	2	Mining and quarrying	4.1	3.9	6.0	8.2	1.7	5.5	5.7	5.9
	3	Manufacturing	11.7	12.2	11.3	12.8	10.9	9.2	9.6	5.8
	4	Electricity, gas and water supply	4.3	6.6	7.6	5.4	7.9	6.9	4.8	5.6
III		**Services (5+6+7+8)**	**11.7**	**11.6**	**11.1**	**10.5**	**10.6**	**10.7**	**10.0**	**11.4**
	5	Construction	13.1	12.0	10.8	12.2	7.7	11.8	7.1	12.6
	6	Trade, hotels, transport, storage and communication	10.9	12.7	12.1	11.6	13.1	11.0	11.5	12.4
	7	Financing, insurance, real estate and business services	13.6	13.9	14.7	13.4	12.6	12.4	11.9	10.5
	8	Community, social and personal services	10.3	7.2	5.6	5.1	5.2	7.7	6.2	9.5
IV		**Real GDP at factor cost (I+II+III)**	**9.6**	**10.1**	**9.3**	**9.7**	**9.2**	**9.3**	**8.8**	**8.8**

Source: Central Statistical Organization

Exhibit 2: FY2009 Likely to see 8.0% plus growth

Real GDP at factor cost and components (growth rates in %), March fiscal year-ends

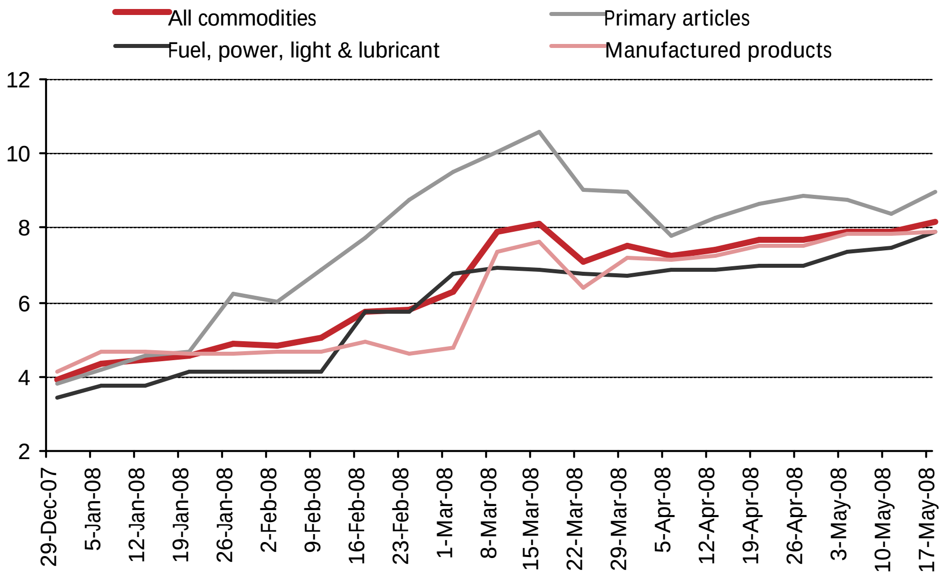
		Sector	2007	CSO 2008AE	CSO 2008RE	KIE 2009E
I	**1**	**Agriculture and allied activities**	**3.8**	**2.6**	**4.5**	**3.0**
II		**Industry (2+3+4)**	**10.6**	**8.6**	**8.1**	**7.6**
	2	Mining and quarrying	5.7	3.4	4.7	7.1
	3	Manufacturing	12.0	9.4	8.8	7.7
	4	Electricity, gas and water supply	6.0	7.8	6.3	7.6
III		**Services (5+6+7+8)**	**11.2**	**10.6**	**10.7**	**9.8**
	5	Construction	12.0	9.6	9.8	8.5
	6	Trade, hotels, transport, storage and communication	11.8	12.1	12.0	9.7
	7	Financing, insurance, real estate and business services	13.9	11.7	11.8	9.3
	8	Community, social and personal services	6.9	7.0	7.3	11.0
IV		**Real GDP at factor cost (I+II+III)**	**9.6**	**8.7**	**9.0**	**8.2**

Note:
(1) AE: Advance Estimates
(2) RE: Revised Estimates
(3) KIE: Kotak Institutional Equities estimates

Source: Central Statistical Organisation, Government of India, Kotak Institutional Equities

Exhibit 3: Inflation crosses 8.0%, expect it to stay elevated with further upside risks

WPI inflation rate for major groups (yoy %)



Source: Office of the Economic Advisor, Ministry of Commerce & Industry, Government of India

Energy

Sector coverage view			Cautious

		Price, Rs	
Company	**Rating**	**30-May**	**Target**
IOC	REDUCE	426	460
BPCL	REDUCE	357	350
HPCL	REDUCE	245	260

Government considering options to address a problem which seems to be going out of control

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- **A retail price increase, cut in duties or/and higher amount of oil bonds may not be sufficient to address the issue**
- **Significant risks to earnings of downstream R&M oil companies**
- **A significant increase in retail prices will result in higher inflation; negative impact on automobile companies as well**

We believe that the recent surge in crude oil prices and corresponding increase in gross under-recoveries for the industry has increased risks to earnings of downstream R&M oil companies. Although the government is considering several options to address the issue including an increase in retail prices of auto fuels, cut in duties or/and issue of higher oil bonds, we believe that these steps will only partly alleviate the problem given the high level of under-recoveries. The current marketing losses incurred on the controlled products have reached perilous levels and will likely remain high even after the proposed hike in retail prices being considered by the government. Also, any significant rise in retail price of auto fuels will not only push inflation higher (which already is a concern for the government at present), but will also likely impact the earnings of automobile companies as higher running costs of automobiles will dampen demand. We believe that softening of crude prices from the current high levels seems to be the only way through which the under-recoveries can be brought to manageable levels.

Several options being considered to tackle the problem; however, might be a case of too little too late. As per media reports, the government is considering several options to tackle the problem of significantly higher gross under-recovery for the industry, which has risen sharply due to the recent surge in crude prices and unchanged domestic retail prices. The options considered are hike in retail prices of auto fuels, reduction in custom duty on crude oil (5.15% currently), reduction in import duty on diesel and gasoline and issue of higher oil bonds. However, we believe that an increase in retail prices of auto fuels or/and cut in duties will only partly alleviate the problem given the high level of under-recoveries. Exhibit 1 shows that gross under-recoveries will likely be significantly higher in FY2009E versus FY2008; we compute gross under-recoveries at Rs2 tn at US$110/bbl and compared to Rs0.77 tn in FY2008 (US$79/bbl crude price).

At current levels of crude prices and 45.7% oil bonds to be issued by the government (based on oil bonds issued for FY2008), the net under-recoveries to be borne by downstream companies for FY2009E would be Rs420 bn against Rs161 bn in FY2008E. This compares with pre-tax earnings of Rs96 bn for the PSU R&M companies in FY2007 and Rs162 bn in FY2008E.The government may have to issue of oil bonds of Rs1.1 tn in FY2009E versus Rs353 bn in FY2008E to maintain the FY2009E profits of the downstream oil companies at FY2008E levels. However, if the government decides to freeze the subsidy sharing in percentage terms, it will virtually wipe out the profits of the downstream companies.

Increase in retail price might not be sufficient given high marketing losses. We believe that the increase in retail prices of auto fuels might not be sufficient to tackle the problem given the high marketing losses at current levels of crude price. As per media reports, the government is considering a hike of Rs5/liter for gasoline and Rs2/liter for diesel, which is significantly lower than the current losses on gasoline and diesel at Rs16.2/liter and Rs22.8/liter, respectively (computed using international product prices in May 2008 and domestic retail prices for June 2008). The current losses on LPG and kerosene are at Rs389/cylinder and Rs36/liter, respectively (Exhibit 2). Thus, even after the proposed hike, the marketing losses will be significant.

Significant rise in retail price of auto fuels will only push inflation higher; automobile companies to be impacted negatively. An increase in the price of diesel will increase the operating cost for a freight operator significantly, given that diesel costs constitutes around 70% of a freight operator's operating cost. Given the current slowdown in economic activity, we believe that freight operators will not be able to pass on the hike and this will impact the sale of commercial vehicles significantly. An increase in the price of petrol will increase the cost of ownership for two wheeler owners and passenger car owners. However, the impact will be more on sale of small cars versus two wheeler owners.

Reduction in duty will be positive for refiners but concerns remain over strength of refining cycle and possibility of sharing subsidy burden. The proposed reduction in import duty on crude oil as well as diesel and gasoline will have positive impact on refining margins through higher tariff protection. While the proposed reduction in import duty on crude oil (2.5%) will be matched by reduction in import duty on gasoline and diesel; however, no reduction in import duty on other products would result in increase in overall higher tariff protection (See exhibit 3). This would be positive for earnings of standalone refiners such as CPCL and MRPL. However, we maintain our cautious view regarding the strength of the refining cycle, which could come under pressure led by (1) weakness in demand in CY2008E and CY2009E and (2) significant new refining capacity being completed on or ahead of time from 2HCY08. In addition, we do not rule out the possibility of standalone refiners being included in the subsidy-sharing scheme (as was the case in FY2006).

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	124	74	67	*11*
Subsidy loss	**400**	**494**	**771**	**639**	**1,159**	**2,008**	**2,535**	**479**	**405**	***18***
Payment by government (oil bonds)	**115**	**241**	**353**	**292**	**530**	**919**	**1,160**	**203**	**192**	***6***
Share of BPCL	22	53	86	71	129	224	283	46	43	*6*
Share of HPCL	23	49	77	64	116	201	253	43	39	*8*
Share of IOCL	70	138	190	157	285	495	624	115	109	*5*
Net under-recovery of oil companies	**285**	**253**	**418**	**347**	**628**	**1,089**	**1,375**	**275**	**214**	***29***
Share of refining companies	27	—	—	—	—	—	—	—	3	—
Share of upstream companies	**140**	**205**	**257**	**213**	**386**	**669**	**845**	**160**	**149**	***7***
Share of ONGC	120	170	218	181	327	568	716	135	124	*9*
Share of GAIL (b)	11	15	13	12	22	39	49	9.3	9.9	*(6)*
Share of Oil India	10	20	24	20	36	63	80	15	16	*(5)*
Net under-recovery of R&M companies	**118**	**48**	**161**	**134**	**242**	**420**	**530**	**116**	**64**	***80***
Pre-tax profits of R&M companies (d)	**74**	**96**	**162**					**139**	**66**	

Note:

(a) Share of upstream companies assumed at 33.33% and share of oil bonds based on oil bonds announced for FY2008.

(b) Share of GAIL for FY2008 is based on the provisional subsidy burden reported by the company.

(c) Our official crude forecast for FY2009E is US$100/bbl.

(d) Pre-tax profits include actual reported profits of HPCL and IOCL and estimated profits for BPCL.

Source: Kotak Institutional Equities estimates.

Marketing losses have increased considerably due to surge in crude prices
Calculation of marketing margins/subsidy of key products

	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Average (Fiscal years) 2005	2006	2007	2008	2009
International price (US$/ton)															
LPG	580	614	710	821	849	821	794	804	804	871	364	475	496	625	826
Gasoline	628	672	723	821	805	826	865	908	975	1,086	385	520	625	678	990
Kerosene	646	697	750	880	823	810	861	968	1,070	1,236	362	544	617	678	1,092
Diesel	602	661	693	782	770	770	810	924	1,017	1,172	325	482	560	626	1,038
India IPP price (incl. transport) (a)															
LPG (Rs/cylinder)	431	443	496	559	573	562	554	556	580	621	350	401	420	480	586
Gasoline (Rs/liter)	21.7	22.7	24.3	27.3	26.8	27.7	29.3	30.5	34.2	37.9	16.7	20.5	23.4	24.9	34.2
Kerosene (Rs/liter)	22.9	24.1	25.8	29.9	28.0	27.9	29.9	33.2	38.3	44.0	15.9	21.3	24.5	25.1	38.5
Diesel (Rs/liter)	23.1	24.7	25.8	28.9	28.4	28.7	30.5	34.3	39.5	45.3	15.7	21.1	24.2	25.3	39.7
India retail price without taxes															
LPG (Rs/cylinder)	232	232	232	232	232	232	232	232	232	232	201	234	234	232	232
Gasoline (Rs/liter)	20.2	20.2	20.2	20.2	20.2	21.0	21.7	21.7	21.7	21.7	17.1	18.6	21.8	20.4	21.7
Kerosene (Rs/liter)	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	7.1	8.0	8.0	8.0	8.0
Diesel (Rs/liter)	21.6	21.6	21.6	21.6	21.6	22.0	22.5	22.5	22.5	22.5	17.4	19.9	22.2	21.7	22.5
Marketing margin or (subsidy) (b)															
LPG (Rs/cylinder)	**(199)**	**(212)**	**(265)**	**(327)**	**(342)**	**(331)**	**(322)**	**(324)**	**(349)**	**(389)**	**(149)**	**(167)**	**(187)**	**(248)**	**(354)**
Gasoline (Rs/liter)	**(1.5)**	**(2.5)**	**(4.1)**	**(7.2)**	**(6.6)**	**(6.7)**	**(7.6)**	**(8.7)**	**(12.5)**	**(16.2)**	**0.3**	**(1.9)**	**(1.6)**	**(4.6)**	**(12.5)**
Kerosene (Rs/liter)	**(14.9)**	**(16.1)**	**(17.8)**	**(21.9)**	**(20.0)**	**(19.9)**	**(21.9)**	**(25.2)**	**(30.3)**	**(36.0)**	**(8.8)**	**(13.4)**	**(16.5)**	**(17.1)**	**(30.5)**
Diesel (Rs/liter)	**(1.5)**	**(3.1)**	**(4.2)**	**(7.3)**	**(6.8)**	**(6.6)**	**(8.0)**	**(11.9)**	**(17.0)**	**(22.8)**	**1.7**	**(1.2)**	**(2.0)**	**(3.6)**	**(17.2)**

Source: Industry data, Kotak Securities estimates.

Reduction in duty on crude as well as diesel and gasoline to result in higher overall tariff prote
Import tariffs on oil products, March fiscal year-ends, 2005-2010E (%)

	2005	2006	Mar-07	2007	2008E	2009E	2010E
LPG	6.6	—	—	—	—	—	—
Gasoline	16.7	10.2	7.7	8.1	7.7	7.7	7.7
Naphtha	7.6	4.7	—	—	—	—	—
Kerosene	6.6	—	—	—	—	—	—
ATF	19.4	10.2	10.3	10.2	10.3	10.3	10.3
Diesel	16.7	10.2	7.7	8.1	7.7	7.7	7.7
FO	19.4	10.2	10.3	10.2	10.3	10.3	10.3
Bitumen	19.4	10.2	10.3	10.2	10.3	10.3	10.3
Weighted average import duty	**14.5**	**7.9**	**6.1**	**6.2**	**6.1**	**6.1**	**6.1**
Duty on crude	10.2	5.1	5.2	5.1	5.2	5.2	5.2
Tariff differential	**4.4**	**2.8**	**0.9**	**1.1**	**0.9**	**0.9**	**0.9**

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	1,194,887	1,540,611	1,572,209	1,623,795
EBITDA	**38,686**	**26,231**	**9,407**	**35,362**	**38,308**	**29,717**	**33,266**	**41,530**
Other income	4,348	4,015	4,653	7,332	11,775	10,582	16,656	20,576
Interest	(1,447)	(1,748)	(2,474)	(4,774)	(5,658)	(9,188)	(18,053)	(30,002)
Depreciation	(6,754)	(7,130)	(7,680)	(9,041)	(10,437)	(9,672)	(10,636)	(11,596)
Pretax profits	34,833	21,368	3,906	28,879	33,989	21,439	21,233	20,509
Extraordinary items	(420)	810	176	(68)	1,279	—	—	—
Tax	(12,026)	(7,250)	(140)	(9,286)	(9,402)	(5,996)	(4,533)	(5,583)
Deferred taxation	(805)	(1,230)	(1,025)	(268)	(1,471)	(1,291)	(2,684)	(1,388)
Net profits	21,582	13,698	2,916	18,055	24,395	14,152	14,016	13,538
Net profits after minority interests	**19,086**	**11,334**	**2,916**	**18,055**	**24,395**	**14,152**	**14,016**	**13,538**
Earnings per share (Rs)	**64.6**	**37.2**	**7.6**	**50.1**	**64.9**	**39.1**	**38.8**	**37.4**
Balance sheet (Rs mn)								
Total equity	69,960	82,887	91,394	102,735	115,286	122,568	129,779	136,744
Deferred taxation liability	11,304	12,533	13,558	13,826	15,297	16,588	19,273	20,661
Total borrowings	32,701	46,589	83,736	108,292	84,666	156,166	335,666	475,666
Currrent liabilities	95,495	104,462	94,070	112,767	100,667	118,408	121,234	127,202
Total liabilities and equity	**209,459**	**246,472**	**282,758**	**337,620**	**315,917**	**413,730**	**605,951**	**760,273**
Cash	9,319	6,644	4,921	8,640	1,299	876	933	1,279
Current assets	97,729	130,393	128,208	127,698	121,300	152,398	154,877	159,953
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	88,484	98,542	110,855	118,334	132,716	144,854	159,540	158,438
Investments	13,927	10,893	38,774	82,949	60,602	115,602	290,602	440,602
Total assets	**209,459**	**246,472**	**282,758**	**337,621**	**315,917**	**413,730**	**605,951**	**760,273**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	30,727	21,118	9,275	29,920	22,537	14,533	10,680	5,945
Working capital	1,025	(18,393)	1,577	11,451	(2,719)	(13,356)	1,592	892
Capital expenditure	(17,001)	(17,120)	(19,945)	(17,908)	(22,828)	(21,810)	(25,322)	(10,494)
Investments	1,278	2,992	(28,146)	(45,481)	22,347	(55,000)	(175,000)	(150,000)
Other income	1,985	2,445	1,785	4,337	8,792	10,582	15,410	20,576
Free cash flow	**18,015**	**(8,957)**	**(35,455)**	**(17,682)**	**28,129**	**(65,052)**	**(172,639)**	**(133,081)**
Ratios (%)								
Debt/equity	40.2	48.8	91.6	105.4	73.4	127.4	258.6	347.9
Net debt/equity	28.8	41.9	86.2	97.0	72.3	126.7	257.9	346.9
RoAE	28.8	14.4	3.3	16.3	19.7	10.5	9.7	8.8
RoACE	**21.2**	**12.0**	**4.1**	**11.0**	**13.2**	**8.6**	**7.9**	**6.6**
Key assumptions (standalone until FY2005)								
Crude throughput (mn tons)	8.8	9.1	17.2	19.8	20.9	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	5.2	4.0	3.2	3.7
Sales volume (mn tons)	20.9	21.5	23.3	24.2	26.4	27.4	28.5	29.6
Marketing margin (Rs/ton)	1,893	1,732	(671)	(1,140)	(2,983)	(9,659)	(7,607)	(3,691)
Subsidy under-recoveries (Rs mn)	(13,518)	(25,821)	(31,847)	(20,159)	(33,961)	(24,884)	(14,284)	(9,568)

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	1,067,743	1,370,872	1,392,172	1,413,988
EBITDA	**20,511**	**8,056**	**24,036**	**15,540**	**33,847**	**41,238**	**47,755**
Other income	3,295	3,285	6,845	11,980	16,217	22,874	25,599
Interest	(816)	(1,587)	(4,230)	(7,925)	(21,956)	(37,524)	(45,870)
Depreciation	(6,584)	(6,902)	(7,040)	(8,508)	(10,438)	(10,023)	(10,758)
Pretax profits	16,406	2,851	19,611	11,087	17,670	16,565	16,726
Extraordinary items	1,471	2,201	3,030	—	—	—	—
Tax	(5,897)	(898)	(6,625)	(1,799)	(2,002)	(4,105)	(4,033)
Deferred taxation	793	(97)	(365)	(2,025)	(4,029)	(1,526)	(1,653)
Prior period adjustment	—	—	61	4,086	—	—	—
Net profits	**12,773**	**4,056**	**15,712**	**11,349**	**11,639**	**10,935**	**11,041**
Earnings per share (Rs)	**34.8**	**6.6**	**40.0**	**33.5**	**34.3**	**32.3**	**32.6**
Balance sheet (Rs mn)							
Total equity	84,409	87,357	95,987	106,146	110,647	114,875	119,145
Deferred tax liability	13,748	13,844	14,209	16,234	20,263	21,789	23,442
Total borrowings	21,854	66,638	105,175	189,175	366,425	478,925	539,425
Currrent liabilities	69,887	79,549	101,195	92,812	111,666	115,979	116,211
Total liabilities and equity	**189,896**	**247,389**	**316,566**	**404,368**	**609,001**	**731,568**	**798,224**
Cash	2,016	426	868	1,224	998	1,341	1,971
Current assets	93,007	109,674	113,779	134,210	170,283	174,384	175,475
Total fixed assets	77,305	97,013	130,644	148,636	157,421	165,545	170,480
Investments	17,568	40,276	71,275	120,298	280,298	390,298	450,298
Total assets	**189,896**	**247,389**	**316,566**	**404,368**	**609,001**	**731,569**	**798,224**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	15,977	10,126	23,966	6,334	8,127	(1,015)	(2,147)
Working capital changes	(3,614)	(5,351)	8,936	(26,138)	(17,220)	1,483	(858)
Capital expenditure	(12,849)	(25,298)	(38,510)	(22,932)	(17,461)	(17,523)	(15,693)
Investments	2,995	(22,884)	(31,704)	(49,023)	(160,000)	(110,000)	(60,000)
Other income	800	941	2,067	9,304	16,217	21,604	25,599
Free cash flow	**3,310**	**(42,466)**	**(35,246)**	**(82,454)**	**(170,338)**	**(105,451)**	**(53,099)**
Ratios (%)							
Debt/equity	22.3	65.8	95.4	154.6	279.9	350.4	378.3
Net debt/equity	20.2	65.4	94.7	153.6	279.1	349.5	376.9
RoAE	13.4	4.1	14.9	9.8	9.2	8.2	7.9
RoACE	**10.1**	**2.5**	**8.8**	**6.0**	**8.7**	**7.3**	**7.3**
Key assumptions							
Crude throughput (mn tons)	13.9	14.0	16.7	16.8	18.3	19.3	19.3
Effective tariff protection (%)	5.6	3.1	1.4	1.2	1.2	1.2	1.2
Net refining margin (US$/bbl)	4.5	3.9	4.3	6.2	4.6	4.3	4.3
Sales volume (mn tons)	20.6	20.1	23.4	24.8	25.6	26.5	27.4
Marketing margin (Rs/ton)	1,688	(463)	(710)	(2,476)	(8,415)	(6,663)	(3,206)
Subsidy under-recoveries (Rs mn)	(26,708)	(29,671)	(18,899)	(25,359)	(17,540)	(8,876)	(8,564)

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	2,732,553	3,441,760	3,537,339
EBITDA	**114,303**	**86,765**	**82,044**	**110,451**	**121,076**	**113,150**	**131,213**
Other income	17,565	16,138	21,310	27,451	43,025	48,626	98,626
Interest	(5,043)	(7,433)	(12,101)	(17,058)	(17,555)	(47,390)	(86,398)
Depreciation	(20,626)	(23,140)	(24,711)	(28,686)	(29,918)	(32,467)	(34,550)
Pretax profits	106,199	72,330	66,542	92,157	116,628	81,919	108,891
Extraordinary items	3,553	4,283	5,590	24,757	5,374	6,359	6,304
Tax	(25,966)	(13,658)	(19,975)	(25,834)	(38,236)	(26,674)	(33,707)
Deferred taxation	(5,157)	(2,335)	(1,282)	(8,040)	(473)	(587)	(2,703)
Net profits	79,052	59,475	51,125	82,729	83,412	61,017	78,785
Net profits after minority interests	**73,298**	**52,666**	**45,362**	**62,469**	**74,563**	**53,505**	**72,477**
Earnings per share (Rs)	**62.8**	**45.1**	**38.8**	**52.4**			
Balance sheet (Rs mn)							
Total equity	233,386	271,302	317,977	378,117	450,110	501,288	570,184
Deferred tax liability	47,934	50,367	50,602	59,859	60,331	60,919	63,622
Total borrowings	146,147	197,809	292,395	290,215	418,813	948,600	1,298,181
Currrent liabilities	219,522	266,430	286,716	330,791	390,802	471,540	484,536
Total liabilities and equity	**646,988**	**785,907**	**947,691**	**1,058,981**	**1,320,057**	**1,982,347**	**2,416,523**
Cash	13,777	13,356	8,080	9,385	5,157	4,686	4,982
Current assets	278,550	368,158	413,904	437,178	605,766	749,597	768,627
Total fixed assets	320,647	370,003	383,717	415,014	428,025	446,956	461,806
Investments	34,013	34,391	141,990	197,403	281,108	781,108	1,181,108
Total assets	**646,988**	**785,907**	**947,691**	**1,058,981**	**1,320,056**	**1,982,347**	**2,416,523**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	93,713	71,765	(10,334)	(44,660)	56,767	36,011	17,196
Working capital changes	1,710	(33,421)	(8,136)	2,237	(84,561)	(54,492)	(3,601)
Capital expenditure	(47,179)	(73,626)	(49,042)	(50,969)	(41,972)	(51,148)	(44,373)
Investments	(509)	(1,172)	(17,778)	99,768	(83,705)	(499,885)	(400,000)
Other Income	5,826	7,814	10,317	13,582	13,451	48,575	88,558
Free cash flow	**53,560**	**(28,641)**	**(74,973)**	**19,958**	**(140,019)**	**(520,940)**	**(342,221)**
Ratios (%)							
Debt/equity	52.0	61.5	79.3	66.3	82.0	168.7	204.8
Net debt/equity	47.1	57.3	77.1	64.1	81.0	167.9	204.0
RoAE	30.0	18.3	13.7	16.1	16.3	10.4	12.6
RoACE	**20.4**	**13.7**	**9.3**	**11.3**	**10.9**	**7.1**	**7.8**
Key assumptions (IOC standalone)							
Crude throughput (mn tons)	37.7	36.6	38.5	44.0	47.4	48.4	49.9
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	8.9	6.9	6.2
Sales volume (mn tons)	47.1	48.2	50.4	53.4	57.4	59.6	61.5
Marketing margin (Rs/ton)	2,092	1,982	26	(633)	(1,690)	(8,172)	(6,269)
Subsidy under-recoveries (Rs mn)	(28,078)	(64,309)	(95,361)	(34,041)	(40,937)	(57,040)	(21,276)

Source: Kotak Institutional Equities estimates.

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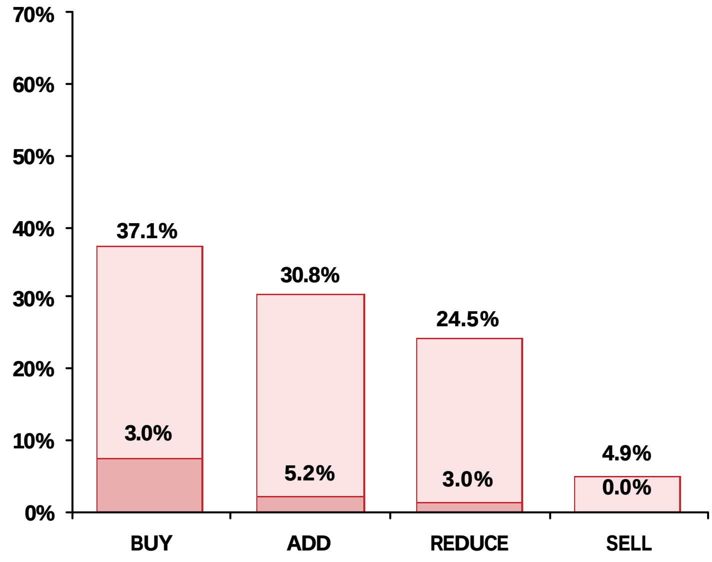

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Source: Kotak Institutional Equities. As of March 31, 2008

Ratings and other definitions/identifiers

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