kotak® Institutional Equities

# INDIA DAILY

## August 22, 2007

## Contents

### Updates



## News Roundup

### Corporate

- JSW Steel announced the acquisition of three companies — Jindal United Steel Corporation, Saw Pipes USA and Jindal Enterprises LLC — in the US for US$940 mn from Jindal Saw in a leveraged buy out (LBO) deal. (BS)
- Bharat Heavy Electricals (BHEL) has won two turnkey contracts, valued at US$1.6 bn, for setting up power projects of 1,000 MW each for Damodar Valley Corporation (DVC). (BS)
- NYSE listed India's largest BPO Genpact has reported a 1% rise in net income to US$7.1 mn in 2QFY07 from US$7 mn in 2QFY06; revenues at US$200.5 mn were higher 42% from the corresponding period in the previous year. (BS)
- Broadband and telecom service provider MTNL, having a broadband user base of over 0.5 mn in Delhi and Mumbai, has entered into a strategic partnership with AOL, America's leading web service provider, to bring the latter's products and content to India. (BL)
- SBI Life, the insurance and asset management arm of India's largest commercial bank, has recorded a net profit of Rs48 mn during 1QFY08 versus Rs39 mn for the whole of FY2007. (ET)

### Economic and political

- The government announced a 44.39% jump in collection of direct taxes, including corporate and income tax, to Rs592.1 bn in the financial year till August 15, 2007 versus Rs410.1 bn over the same period a year ago. (BL)
- The CPI(M) again made its opposition to the India-US nuclear deal clear when it conveyed its willingness to let India's representative to attend the IAEA annual general conference on the condition that no talks on the said nuclear deal would be held during the conference. (BS)
- The central government on Tuesday approved 20 foreign direct investment (FDI) proposals worth Rs10.8 bn, including ICICI Bank's plan to offload up to 24% stake in ICICI financial services through the FDI route. (FE)

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

## EQUITY MARKETS

| | | Change, % | | |
|---|---|---|---|---|
| **India** | **21-Aug** | **1-day** | **1-mo** | **3-mo** |
| Sensex | 13,989 | (3.0) | (10.1) | (3.2) |
| Nifty | 4,075 | (3.2) | (10.8) | (4.8) |
| **Global/Regional indices** | | | | |
| Dow Jones | 13,091 | (0.2) | (5.5) | (3.3) |
| Nasdaq Composite | 2,521 | 0.5 | (6.2) | (2.6) |
| FTSE | 6,086 | 0.1 | (7.6) | (7.9) |
| Nikkie | 15,872 | (0.2) | (12.6) | (10.2) |
| Hang Seng | 21,865 | 0.6 | (6.1) | 4.9 |
| KOSPI | 1,758 | 1.2 | (11.4) | 7.0 |

**Value traded - India**

| | | | Moving avg, Rs bn | |
|---|---|---|---|---|
| | **21-Aug** | | **1-mo** | **3-mo** |
| Cash (NSE+BSE) | 154.8 | | 162.6 | 154.7 |
| Derivatives (NSE) | 454.9 | | 480.7 | 311.0 |
| Deri. open interest | 835.8 | | 906.3 | 608.4 |

**Forex/money market**

| | | Change, basis points | | |
|---|---|---|---|---|
| | **21-Aug** | **1-day** | **1-mo** | **3-mo** |
| Rs/US$ | 41.1 | - | 84 | 54 |
| 6mo fwd prem, % | 0.7 | (25) | 71 | 24 |
| 10yr govt bond, % | 8.0 | (3) | 15 | (16) |

**Net investment (US$mn)**

| | **17-Aug** | | **MTD** | **CYTD** |
|---|---|---|---|---|
| FIIs | (789) | | 1,759 | 8,004 |
| MFs | 58 | | 111 | (24) |

**Top movers -3mo basis**

| | | Change, % | | |
|---|---|---|---|---|
| **Best performers** | **21-Aug** | **1-day** | **1-mo** | **3-mo** |
| Thermax | 608 | (3.1) | (1.7) | 35.5 |
| Chambal Fert | 43 | (4.3) | 19.8 | 25.8 |
| Reliance Energy | 692 | (4.6) | 0.5 | 25.6 |
| Crompton Greaves | 272 | (3.2) | 3.3 | 24.7 |
| BHEL | 1,590 | (1.2) | (3.5) | 18.9 |
| **Worst performers** | | | | |
| Polaris | 109 | (5.7) | (17.3) | (36.7) |
| Escorts | 82 | (6.3) | (26.6) | (35.4) |
| Balrampur Chini | 53 | (3.6) | (24.2) | (32.7) |
| HPCL | 226 | (1.1) | (10.7) | (24.5) |
| IOC | 377 | (1.7) | (12.4) | (24.9) |


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## Media

| SUTV.BO, Rs298 | |
|---|---|
| Rating | U |
| Sector coverage view | Cautious |
| Target Price (Rs) | 310 |
| 52W High -Low (Rs) | 462 - 264 |
| Market Cap (Rs bn) | 117.4 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 6.8 | 9.5 | 12.2 |
| Net Profit (Rs bn) | 2.5 | 3.9 | 5.3 |
| EPS (Rs) | 6.3 | 10.0 | 13.4 |
| *EPS gth* | *20.8* | *57.4* | *34.6* |
| P/E (x) | 47.0 | 29.9 | 22.2 |
| EV/EBITDA (x) | 26.1 | 16.4 | 12.0 |
| Div yield (%) | 0.5 | 0.8 | 1.3 |

**Shareholding, June 2007**

| | Pattern | % of Portfolio | Over/(under) weight |
|---|---|---|---|
| Promoters | 93.0 | - | - |
| FIIs | 4.4 | 0.0 | (0.1) |
| MFs | 0.9 | 0.0 | (0.1) |
| UTI | - | - | (0.1) |
| LIC | - | - | (0.1) |

# Sun TV Network: Wait for more clarity on emerging competitive environment; Retain U

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- **We would recommend holding off without more clarity on emerging competitive environment**
- **Our assumptions are fairly aggressive; hence, downside risks to earnings exist**
- **Retain U despite stock having collapsed to below our 12-month target price**

We retain our U rating on Sun TV stock despite the stock having collapsed over the past few weeks and the stock now trading below our 12-month DCF-based target price of Rs310. We would like to see more clarity on the emerging competitive environment especially the performance of Kalaignar TV, the channel promoted by the family of the chief minister of Tamil Nadu. Also, our model builds in fairly aggressive assumptions on Sun TV's revenues and profitability, which may be at risk from increased competition. Key risk to our (still) negative stock view is higher-than-expected revenues.

**Media stocks have come off more sharply in the recent market correction.** Exhibits 1 and 2 show that media stocks have in general under-performed the broader market in the recent market correction and some of them are significantly off their recent highs. Nonetheless, we are not changing our cautious view of the Indian media stocks, in particular of the TV broadcasting stocks. We assume the recent correction simply reflects a more judicious view of the street regarding the earnings potential and valuations of media stocks. However, we still see a lot of risks to the street's (and our) assumptions of the TV media stocks. We look at some of the risks faced by Sun TV in more detail.

**More competition on the anvil; impact too early to gauge.** We see potential risks to Sun's high market shares in all its markets from entry of new channels. In particular, in the crucial Tamil market, Kalaignar TV may emerge as a strong competitor to Sun TV. It is presumably well funded (it has purchased the telecast rights of two of the biggest recent Tamil hits) and may benefit from start of a proposed cable TV network by state government. Sun TV has very high market share in the Tamil market, which increases the risk of erosion of market share from new competition particularly from a potentially strong one such as Kalaignar TV or rejuvenated extant players.

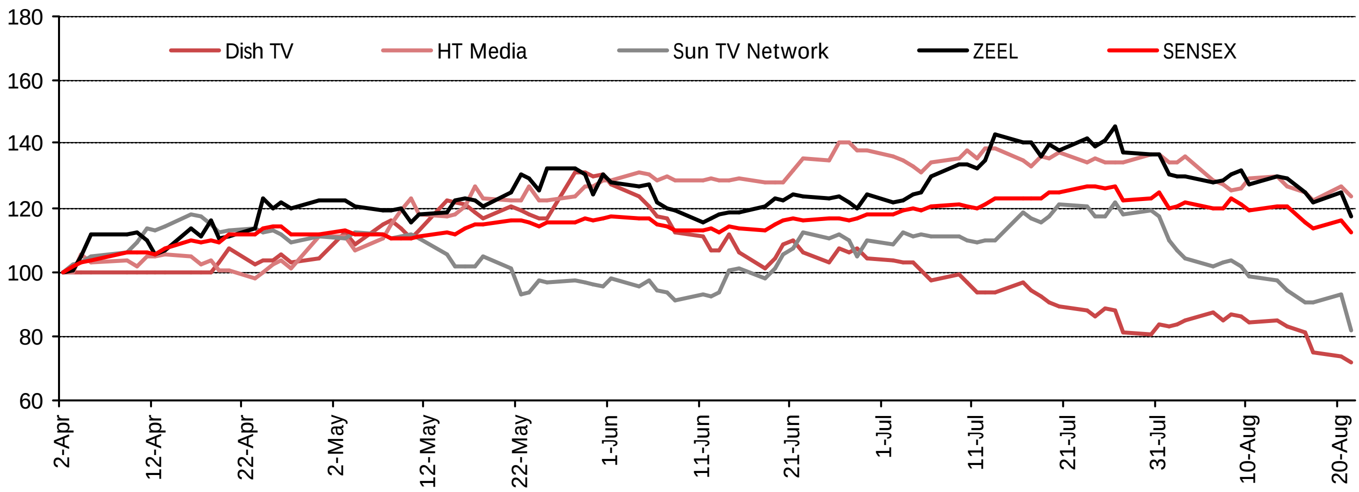
**Our assumptions may be at risk if competition turns out to be worse versus our expectations.** We see risks to our assumptions on Sun's revenues (in particular, ad revenues) and high profitability.

1. **Strong assumed growth in ad revenues implies continued high market shares.** We model Sun's TV ad revenues to grow at or above the growth rate for the Indian ad market, which implies Sun TV will be able to retain its current high market shares in all its key markets. However, this remains to be seen in light of emerging competition, particularly in Sun's key Tamil market where Sun has a dominant market share. Exhibit 3 gives our assumptions for Sun's revenues. We expect Sun's TV ad revenues to grow at 32%, 18%, 15% and 15% for FY2008E, FY2009E, FY2010E and FY2011E, respectively.

2. **High assumed profitability may also be at risk.** We model Sun's EBITDA margin (amortized programming costs taken above EBITDA) to rise to 70% in FY2011E from 57.1% in FY2007 and 63.1% in FY2008E and remain above 70% throughout our forecast period (up to FY2018E) and in perpetuity. Our assumptions imply that Sun continues to have very high market shares with relatively low programming costs. However, this remains to be seen especially if the competitive environment were to deteriorate with the entry of several players and start of new channels by extant players in all Sun's markets. We would clarify that Sun's EBITDA margins would be high versus other broadcasters given that it follows the 'broadcast' model for a significant portion of its programming; the cost of programs 'broadcast' by production houses does not reflect in Sun's programming costs.

**Media stocks have declined sharply in the recent market correction**

Relative performance of media stocks since April 1, 2007




Source: Bloomberg, Kotak Institutional Equities.

**Media sector stocks have seen a sharp decline from their peak levels**

Correction in the prices of media sector stocks from 52-week high prices

| | 52-week high (Rs) | Current price (Rs) | Correction (%) |
|---|---|---|---|
| Balaji Telefilms | 271 | 229 | 15.6 |
| Deccan Chronicle | 241 | 217 | 9.8 |
| Dish TV India | 134 | 73 | 45.4 |
| HT Media | 241 | 213 | 11.9 |
| Jagran Prakshan | 594 | 560 | 5.7 |
| NDTV India | 447 | 311 | 30.6 |
| Sun TV Network | 456 | 298 | 34.7 |
| Television 18 | 926 | 777 | 16.1 |
| TV Today Network | 166 | 141 | 15.5 |
| UTV Software | 572 | 441 | 22.8 |
| Wire and Wireless | 129 | 53 | 58.8 |
| ZEEL | 349 | 282 | 19.2 |
| Zee News | 73 | 59 | 19.0 |
| **BSE SENSEX** | **15,975** | **13,989** | **12.4** |

Source: Bloomberg, Kotak Institutional Equities.

**We model Sun's revenues to grow strongly led by growth in pay-TV and FM radio revenues**

Derivation of revenues of Sun TV/Sun TV Network, March fiscal year-ends, 2005-2013E (Rs mn)

| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E | 2011E | 2012E | 2013E |
|---|---|---|---|---|---|---|---|---|---|
| **Advertisement revenues** | | | | | | | | | |
| Sun TV | 1,038 | 1,085 | 1,491 | 1,858 | 2,130 | 2,442 | 2,799 | 3,147 | 3,538 |
| K TV | 100 | 123 | 141 | 162 | 182 | 205 | 226 | 248 | 273 |
| Sun News | 28 | 39 | 47 | 55 | 62 | 70 | 78 | 86 | 95 |
| Sun Music | 2 | 94 | 122 | 163 | 183 | 206 | 232 | 255 | 281 |
| Sun Kids | — | — | — | 151 | 209 | 249 | 297 | 345 | 399 |
| Sun Documentary | — | — | — | 64 | 164 | 196 | 233 | 271 | 313 |
| Sun Sports | — | — | 9 | 58 | 65 | 73 | 82 | 91 | 100 |
| Surya TV | 226 | 386 | 476 | 574 | 663 | 764 | 881 | 1,003 | 1,142 |
| Kiran TV | 3 | 28 | 40 | 59 | 82 | 92 | 104 | 114 | 125 |
| Gemini TV | — | — | 467 | 596 | 686 | 789 | 907 | 1,032 | 1,173 |
| Teja TV | — | — | 44 | 51 | 57 | 64 | 70 | 77 | 85 |
| Gemini News | — | — | 35 | 41 | 46 | 52 | 58 | 64 | 70 |
| Gemini Music | — | — | 75 | 100 | 113 | 127 | 142 | 157 | 172 |
| Udaya TV | — | — | 428 | 535 | 615 | 708 | 814 | 926 | 1,053 |
| Udaya Movies | — | — | 43 | 49 | 55 | 62 | 68 | 75 | 82 |
| Udaya Varthegulu (News) | — | — | 25 | 29 | 33 | 37 | 42 | 46 | 50 |
| Udaya TV 2 | — | — | 30 | 40 | 45 | 51 | 57 | 63 | 69 |
| **Total TV ad revenues** | **1,397** | **1,755** | **3,472** | **4,584** | **5,389** | **6,187** | **7,091** | **7,999** | **9,022** |
| Radio | 144 | 158 | 168 | 658 | 1,375 | 1,862 | 2,304 | 2,816 | 3,027 |
| **Total advertisement revenues** | **1,542** | **1,913** | **3,640** | **5,242** | **6,764** | **8,048** | **9,395** | **10,815** | **12,050** |
| **Broadcast revenues (or slot sales)** | | | | | | | | | |
| Sun TV | 455 | 531 | 607 | 698 | 768 | 845 | 930 | 1,023 | 1,125 |
| Surya TV | 38 | 60 | 60 | 69 | 75 | 83 | 91 | 100 | 111 |
| Gemini TV | — | — | 332 | 381 | 419 | 461 | 507 | 558 | 614 |
| Udaya TV | — | — | 86 | 101 | 111 | 123 | 135 | 148 | 163 |
| **Total broadcast revenues** | **493** | **591** | **1,085** | **1,250** | **1,375** | **1,512** | **1,663** | **1,830** | **2,012** |
| **Total ad and broadcast revenues** | **2,034** | **2,504** | **4,725** | **6,491** | **8,139** | **9,560** | **11,058** | **12,644** | **14,062** |
| **Pay-TV revenues** | | | | | | | | | |
| Sun TV | 398 | 447 | 659 | 1,335 | 2,016 | 2,473 | 2,874 | 3,196 | 3,509 |
| Surya TV | — | — | — | — | 162 | 208 | 249 | 284 | 319 |
| Gemini TV | — | — | 643 | 767 | 911 | 1,113 | 1,328 | 1,555 | 1,735 |
| Udaya TV | — | — | 373 | 447 | 535 | 656 | 785 | 920 | 1,029 |
| **Total pay-TV revenues** | **398** | **447** | **1,675** | **2,549** | **3,624** | **4,449** | **5,235** | **5,956** | **6,592** |
| International revenues | 88 | 183 | 339 | 355 | 371 | 386 | 399 | 409 | 416 |
| Others | 10 | 18 | 42 | 70 | 100 | 130 | 154 | 178 | 203 |
| Sumangali Cable Vision (SCV) | 356 | — | — | — | — | — | — | — | — |
| **Total revenues** | **2,886** | **3,152** | **6,781** | **9,465** | **12,234** | **14,525** | **16,847** | **19,188** | **21,274** |
| **Growth (%)** | **7** | **9** | **115** | **40** | **29** | **19** | **16** | **14** | **11** |

Source: Company, Kotak Institutional Equities estimates.

**Consolidated profit model, balance sheet, cash model of Sun TV for 2006 and SunTV Network for 2007-2012E, March fiscal year-ends (Rs mn)**

| | 2006 | 2007 | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|---|
| **Profit model (Rs mn)** | | | | | | | |
| Net sales | 3,219 | 6,780 | 9,465 | 12,234 | 14,525 | 16,847 | 19,188 |
| **EBITDA** | **2,035** | **3,874** | **5,977** | **8,073** | **9,951** | **11,795** | **13,617** |
| Other income | 172 | 411 | 789 | 910 | 1,196 | 1,550 | 1,974 |
| Interest (expense)/income | (65) | (64) | (18) | — | — | — | — |
| Depreciation | (147) | (294) | (525) | (630) | (515) | (436) | (381) |
| Amortization | — | (56) | (235) | (235) | (235) | (235) | (195) |
| **Pretax profits** | **1,995** | **3,871** | **5,989** | **8,118** | **10,398** | **12,675** | **15,015** |
| Tax-cash | (709) | (1,509) | (2,059) | (2,852) | (3,614) | (4,377) | (5,163) |
| Tax-deferred | 16 | 108 | (18) | 51 | 38 | 27 | 17 |
| Minority interest | — | (9) | 21 | (25) | (50) | (72) | (96) |
| **Net profits after minority interests** | **1,302** | **2,461** | **3,932** | **5,292** | **6,771** | **8,253** | **9,773** |
| **Earnings per share (Rs)** | **5.3** | **6.3** | **10.0** | **13.4** | **17.2** | **20.9** | **24.8** |
| | | | | | | | |
| **Balance sheet (Rs mn)** | | | | | | | |
| Total equity | 3,071 | 11,932 | 14,714 | 18,277 | 22,628 | 27,930 | 34,210 |
| Deferred Tax | 32 | (56) | (38) | (88) | (127) | (153) | (170) |
| Total borrowings | 2,333 | 867 | — | — | — | — | — |
| Currrent liabilities | 741 | 1,693 | 1,633 | 1,766 | 1,845 | 1,930 | 2,023 |
| **Total capital** | **6,209** | **14,478** | **16,329** | **19,999** | **24,441** | **29,874** | **36,325** |
| Cash | 732 | 6,494 | 6,348 | 9,522 | 13,507 | 18,355 | 24,121 |
| Current assets | 2,440 | 3,221 | 5,143 | 6,338 | 7,356 | 8,397 | 9,458 |
| Total fixed assets | 2,830 | 3,543 | 2,910 | 2,405 | 2,040 | 1,779 | 1,599 |
| Intangible assets | 206 | 1,220 | 1,927 | 1,732 | 1,537 | 1,342 | 1,146 |
| **Total assets** | **6,209** | **14,478** | **16,329** | **19,999** | **24,441** | **29,874** | **36,325** |
| | | | | | | | |
| **Free cash flow (Rs mn)** | | | | | | | |
| Operating cash flow, excl. working capital | 1,722 | 3,239 | 4,721 | 6,350 | 7,579 | 8,784 | 9,956 |
| Working capital | (251) | (1,992) | (1,982) | (1,063) | (938) | (956) | (968) |
| Capital expenditure | (2,091) | (433) | (793) | (125) | (150) | (175) | (200) |
| Investments | (326) | (849) | (821) | (1,129) | (1,242) | (1,366) | (1,503) |
| Other income | 80 | 402 | 789 | 910 | 1,196 | 1,550 | 1,974 |
| **Free cash flow** | **(619)** | **814** | **1,946** | **5,161** | **6,490** | **7,654** | **8,788** |
| | | | | | | | |
| **Ratios (%)** | | | | | | | |
| Debt/equity | 76.0 | 7.3 | — | — | — | — | — |
| Net debt/equity | 52.1 | (47.2) | (43.1) | (52.1) | (59.7) | (65.7) | (70.5) |
| RoAE | 36.1 | 32.9 | 29.6 | 32.2 | 33.3 | 32.8 | 31.6 |
| **RoACE** | **26.6** | **26.8** | **29.9** | **33.0** | **34.1** | **33.6** | **32.3** |

Source: Kotak Institutional Equities estimates.

**Metals**

| JSTL.BO, Rs539 | |
|---|---|
| Rating | IL |
| Sector coverage view | Neutral |
| Target Price (Rs) | 580 |
| 52W High -Low (Rs) | 771 - 261 |
| Market Cap (Rs bn) | 92.6 |

**Financials**

| March y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 85.9 | 100.2 | 110.8 |
| Net Profit (Rs bn) | 12.9 | 14.5 | 15.7 |
| EPS (Rs) | 73.3 | 82.6 | 89.4 |
| *EPS gth* | *51.3* | *12.8* | *8.1* |
| P/E (x) | 7.4 | 6.5 | 6.0 |
| EV/EBITDA (x) | 4.7 | 5.1 | 6.0 |
| Div yield (%) | 2.5 | 3.7 | 3.7 |

## JSW Steel: Acquisition of US Mill - execution is critical to value-accretion

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- **JSW Steel acquired US facilities (plate and pipe mill) of group company Jindal Saw for a total consideration of US$940 mn (including working capital payments)**
- **Separate accounts for US-mills are not available, which precludes a thorough analysis. Our preliminary estimates point that stellar execution is critical for value-accretion to JSW Steel shareholders from this acquisition**
- **Key positives: (a) No equity-dilution announced, acquisition fully-funded with debt, (b) Potential to unlock inefficiencies in existing Jindal Saw set-up and (c) Strong ruling demand for plates and prices can provide upsides**
- **Key negatives: (a) Probable plate-capacity buy-out at the peak-of-cycle, (b) Forward integration in pipes makes little sense to us and (c) Value-accretion difficult unless utilization rates improve drastically**
- **We await more details on the acquired company; until which, we value the investment in US mill at acquisition cost. We reduce our target price on JSW steel to Rs580 (from Rs700 earlier) following lower global valuation. Retain In-Line rating on the stock**

JSW Steel acquired the US facilities (plate and pipe mill) of group company Jindal Saw for a total consideration of US$940 mn (including working capital payments). Our preliminary estimates point that stellar execution is critical for value-accretion to JSW Steel shareholders from the acquisition. As we await more details on the acquired company we value the investment in US mill at acquisition cost. We reduce our target price on JSW steel to Rs580 (from Rs700 earlier) following lower global valuations. We maintain our estimates and retain our In-Line rating on the stock.

### JSW Steel acquired 90% for plate/pipe mill in US

JSW Steel acquired 90% in US facilities (plate and pipe mill) from a group company, Jindal Saw for a total consideration of US$940 mn, which includes working capital payment of US$130 mn. Exhibit 1 gives details of break-up of total investments. The facilities were originally created by US Steel in 1980 at Baytown, Houston, Texas. The facilities have capacity to produce 1.2mnt of plates, 0.5mnt of L-Saw pipes and 0.35mnt of coated pipes and have access to captive jetties and railway sidings.

### Probable synergies from slab-exports…

Since slabs have an independent market, we will not ascribe synergies to sale of slab per-se, but the company appeared confident of reducing operating costs from (a) supplying appropriately sized slabs and thereby reduce cost of re-sizing at US and (b) lower scrap generation and improvement in yields. JSW also indicated that it can improve utilization rates drastically by incurring nominal capital-expenditure of US$61 mn.

### …but growth in utilization rates is critical to value-accretion…

For year ended June 2007, US mills clocked 40% utilization on plate mill and 45% on pipe mill registering a normalized EBITDA of US$144 mn; and valuing the transaction at 6.3X EV/EBITDA. In our opinion, higher utilization is critical for value accretion going forward. Exhibit 2 gives sensitivity of plate and pipe utilization to EBITDA.

### …and stable product pricing is relevant too

We note that historically, API-grade HR coils and plates have traded in close-bands (difference of US$50/ton). However recently, the spread has widened over US$300/ton following strong demand from the Oil & Gas sector and limited availability of plates/slabs. However, a lot of plate capacity is expected over the next couple of years that might pressurize plate pricing going forward. Exhibit 3 gives details.

### No equity-dilution; entire acquisition funded from debt

JSW plans to fund the entire acquisition from debt proceeds and does not plan to raise equity. The debt will be arranged through banks at a cost of 250bps over LIBOR structured into various instruments. Exhibit 4 gives details of funding structure. Exhibit 5 gives details of organization structure involved in funding the transaction. The operating structure at US-mills will likely undergo drastic change after the acquisition. Exhibit 6 gives details.

### Consolidated DER will likely cross 1:1; pro-forma consolidation shows

We have consolidated the latest available balance sheet (March 2007) of JSW Steel with the recently announced transaction. We note that the acquisition might get operational from October 2007, subject to all clearances. Exhibit 7 gives details.

### Reduce target price; Retain In-Line

Following reduction in global steel stock valuations, we reduce our EV/EBITDA-based target price of JSW steel to Rs580 from Rs700 earlier. With little details on the financials of acquired company at our disposal, we have no reason to believe that the acquisition is value-accretive or not, and consequently, we value it at acquired cost. We maintain our In-Line rating on the stock.

**Exhibit 1: JSW acquired plate and pipe facilities in US from a group company, Jindal Saw**

Details of payment-breakup, March fiscal year-ends (US$ mn)

| Type of asset acquired | Capacity (tpa) | Cost (US$ mn) |
|---|---|---|
| Plate mill | 1,200,000 | 320 |
| Pipe mill (excluding coating facility) | 500,000 | 530 |
| Coating and double-jointing facility | 350,000 | 50 |
| **Total acquisition cost** | | **900** |
| Stake acquired (%) | | 90.0 |
| **Total consideration for assets (US$ mn)** | | **810** |
| Working capital investments (US$ mn) | | 130 |
| **Total investment from JSW (US$ mn)** | | **940** |

Source: Company data, Kotak Institutional Equities

**Exhibit 2: EBITDA of US mill is very sensitive to pricing and utilization**

Sensitivity of US mill to pricing and utilization, March fiscal year-ends, Proforma numbers (US$ mn)

| | | Plate utilization (%) (c) | | | |
|---|---|---|---|---|---|
| | | **35.0** | **45.0** | **55.0** | **65.0** |
| Pipe utilization (% | **50.0** | 118 | 133 | 148 | 163 |
| | **60.0** | 131 | 146 | 161 | 176 |
| | **70.0** | 144 | 159 | **174** | 189 |
| | **80.0** | 157 | 172 | 187 | 202 |

| | | Plate prices (US$/ton) | | | |
|---|---|---|---|---|---|
| | | **850** | **900** | **950** | **1,000** |
| Pipe prices (US$/t | **1,250** | 119 | 131 | 143 | 155 |
| | **1,300** | 134 | 146 | 158 | 170 |
| | **1,350** | 149 | 161 | **173** | 185 |
| | **1,400** | 164 | 176 | 188 | 200 |

Note:

(a) Output is 2008 EBITDA in US$ mn terms

(b) For year-ended June 2007, US mills estimated utilization was 40% for plate mill and 45% for pipe mill

(c) Utilization-based EBITDA estimates are based on base plate prices of US$900/ ton and pipe price of US$1300/ton

Source: Kotak Institutional Equities estimates

**Exhibit 3: Large plate capacities planned over next two years**

Announced API grade plate mill capacities

| Producer | Country | Max width (mm) | Start Date | Capacity mn tons |
|---|---|---|---|---|
| OMK | Russia | 5,000 | 2010 | 1.20 |
| MMK | Russia | 4,800 | mid-2009 | 1.50 |
| Severstal | Russia | 5,000 | 2008 | 1.00 |
| | **Russia total** | | | **3.70** |
| Welspun | India | 4,500 | 2008 | 1.50 |
| Essar Steel | India | 5,000 | Q4 2007 | 1.50 |
| Jindal Steel & Power(1) | India | 3,800 | April 2007 | 1.00 |
| Jindal Steel & Power | India | 5,000 | 2008/9 | 1.20 |
| | **India total** | | | **5.20** |
| Yingkou | China | 5,000 | Q4 2009 | 2.30 |
| Baotou | China | 3,700 | Q4 2007 | 1.40 |
| | **China Total** | | | **3.70** |
| | **Grand Total** | | | **12.60** |

Note: (1) Started in April 2007

Source: Hatch Beadows, Kotak Institutional Equities

**Exhibit 4: JSW Steel to fund the acquisition entirely out of debt**
Details of funding, March fiscal year-ends (US$ mn)

| Details | US$ mn | Remarks |
|---|---|---|
| **Cost of acquisition** | **940** | |
| Cost of business acquired | 810 | Paid for 90% of US$900 mn of Enterprise value |
| Working capital funded | 130 | |
| | | |
| **Funding** | **940** | |
| Bridge debt at International Holding level | 150 | 18 month bridge with 6 quarterly instalments |
| Recourse debt at US Holing level | 230 | 30 month bullet payment |
| Non-recourse debt at SPV-2 level | 430 | 7 year loan, non recourse to JSW assets |
| Working capital funding | 130 | Bank borrowing |

Source: Company data, Kotak Institutional Equities

**Exhibit 5: Total acquisition cost of US$940 mn to be funded entirely by debt**
Details of fund flow structure through various companies, US$ mn

| Companies | US$ mn | Structure |
|---|---|---|
| **International Holding Company** | | 100% held by JSW Steel |
| Borrow 18 month bridge | 150 | |
| Invest in US Holing Company | 150 | |
| | | |
| **US Holding Company** | **470** | 100% held by International Holding Company |
| Investments from International Holding | 150 | |
| Borrow recourse debt, bullet payment | 230 | |
| Receive investments from seller | 90 | Jindal Saw and Jindal-affiliates to invest for balance 10% stake in Target company |
| Invest in SPV-2 | 470 | |
| | | |
| **SPV-2** | **1,030** | 90% owned by JSW Steel, 10% by Jindal Saw and Jindal-affiliates |
| Investments from US Holding Co. | 470 | |
| Borrow non-recourse 7-year debt | 430 | |
| Borrow for working capital | 130 | |
| Payment for acquiring facilities | 1,030 | |
| | | |
| **Summary** | | |
| Payment to acquire facilities | 1,030 | Includes working-capital |
| Payment by Jindal Saw and Jindal-affiliates | 90 | |
| Payment by JSW Steel | 940 | |
| o/w payment for assets | 810 | |
| o/w payment for working capital | 130 | |

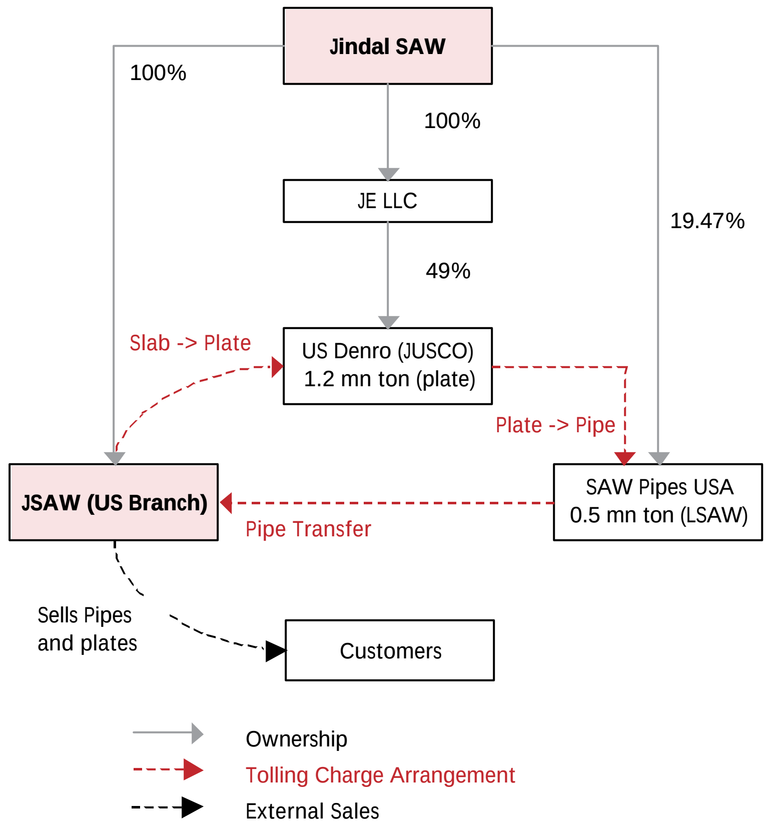
**Notes:**
(a) All companies to be merged post acquisition and SPV-2 to be the operating company

Source: Company data, Kotak Institutional Equities

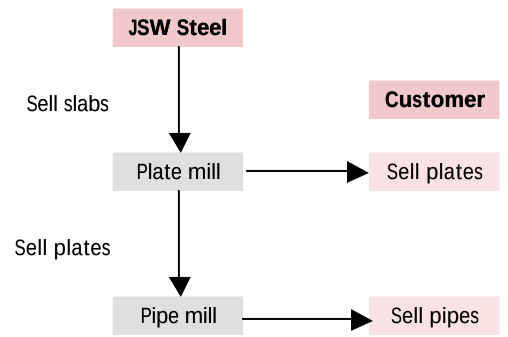
**Exhibit 6: Acquistion will simplify the organisation set-up drastically**

Previous and present operating structure of Jindal Saw and JSW Steel's US facility

**Jindal Saw present operating structure**




**Structure after JSW acquisition**




Source: Company data, Kotak Institutional Equities

**Exhibit 7: Post acquisition consolidated net gearing might increase to 1.3X**

Proforma consolidation of March 2007 annual accounts (Rs mn)

| | Standalone | | | Consolidated |
|---|---|---|---|---|
| | JSW Steel Acquiring company | SPV-2 Target company | Acquisition Borrowings | |
| **Total liabilities** | **105,849** | **42,312** | **38,615** | **148,161** |
| Net worth | 64,118 | 42,312 | - | 64,118 |
| Borrowings | 41,730 | - | 38,615 | 80,345 |
| Minority interest | - | - | | 3,697 |
| | | | | |
| **Total assets** | **105,849** | **42,312** | **-** | **148,161** |
| Net fixed assets | 101,920 | 36,972 | - | 138,892 |
| Investments | 1,929 | - | - | 1,929 |
| Net working capital | 1,999 | 5,340 | - | 7,339 |
| | | | | |
| **Ratios** | | | | |
| Debt to Equity (X) | 0.7 | | | 1.3 |
| Debt to capitalization (X) | 0.4 | | | 0.6 |

Notes:
(a) Net worth includes deferred taxes
(b) Minority interest is treated as debt for ratio calculations

Source: Company data, Kotak Institutional Equities estimates

**Exhibit 8: JSW Steel, Valuation, 2008E basis (Rs mn)**

| | EBITDA (Rs mn) | Multiple (X) | Value (Rs mn) | Value (Rs/share) | Comment |
|---|---|---|---|---|---|
| Fiscal 2008E basis | 33,369 | 5.4 | 180,192 | 1,048 | Valued at global average |
| Less: Net debt | | | (80,172) | (466) | FY2008E net debt, adjusted for cash and marketable securities |
| **Arrived market capitalization** | | | **100,020** | **582** | |
| **Target price** | | | | **580** | Reduced from Rs700 earlier |

Note:
(a) We value investments in the US mill at acquisition cost, as we do not have adequate basis to determine whether the acquisition is value accretive or not.

Source: Kotak Institutional Equities estimates

**Exhibit 9: JSW Steel, Profit model, March fiscal year-ends, 2005-10E (Rs mn)**

| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| Gross sales | 70,359 | 67,661 | 93,373 | 108,855 | 120,385 | 147,317 |
| Less: excise duty | 3,565 | 5,860 | 7,429 | 8,661 | 9,578 | 11,721 |
| **Net sales** | **66,794** | **61,801** | **85,944** | **100,194** | **110,807** | **135,596** |
| **Expenditure** | **(43,325)** | **(44,340)** | **(57,776)** | **(66,825)** | **(76,170)** | **(92,043)** |
| Inc/ decrease in stock | 433 | 1,393 | (665) | 345 | 287 | 695 |
| Raw materials | (28,880) | (31,121) | (39,640) | (45,488) | (50,342) | (62,100) |
| Employee costs | (1,072) | (1,270) | (1,755) | (2,305) | (2,559) | (2,929) |
| Power & fuel | (5,417) | (4,158) | (3,931) | (4,900) | (6,013) | (7,015) |
| Other manufacturing costs | (5,407) | (5,563) | (7,097) | (8,573) | (10,228) | (11,990) |
| Other costs | (2,983) | (3,622) | (4,688) | (5,903) | (7,316) | (8,703) |
| | | | | | | |
| **EBITDA** | **23,469** | **17,461** | **28,168** | **33,369** | **34,637** | **43,554** |
| Non-operational other income | 190 | 3,830 | 1,052 | 196 | 196 | 196 |
| Interest | (4,699) | (3,603) | (3,995) | (3,916) | (4,384) | (6,536) |
| Depreciation | (3,595) | (4,058) | (4,982) | (5,491) | (6,492) | (7,278) |
| Miscellaneous expenditure written off | (605) | (618) | (1,090) | (1,960) | - | - |
| Profit before exceptional items and taxation | 14,759 | 13,011 | 19,152 | 22,198 | 23,958 | 29,936 |
| Extraordinary items | 33 | - | - | - | - | - |
| PBT | 14,793 | 13,011 | 19,152 | 22,198 | 23,958 | 29,936 |
| Current tax | (745) | (32) | (3,526) | (4,440) | (5,271) | (6,885) |
| Deferred tax | (5,280) | (4,336) | (2,706) | (3,219) | (2,995) | (3,443) |
| **PAT** | **8,768** | **8,643** | **12,920** | **14,539** | **15,692** | **19,608** |
| **Adjusted PAT** | **8,589** | **6,099** | **12,210** | **14,411** | **15,564** | **19,480** |

Source: Company data, Kotak Institutional Equities estimates

**Exhibit 10: JSW Steel, Balance sheet, March fiscal year-ends, 2005-10E (Rs mn)**

| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| **Sources of funds** | | | | | | |
| Share capital | 4,691 | 4,971 | 5,258 | 5,120 | 5,120 | 5,120 |
| Reserves & surplus | 26,806 | 38,592 | 50,683 | 63,584 | 75,542 | 91,416 |
| Deferred tax liability | 3,055 | 7,420 | 10,127 | 13,345 | 16,340 | 19,783 |
| **Total equity** | **34,552** | **50,983** | **66,067** | **82,050** | **97,003** | **116,319** |
| | | | | | | |
| Secured loans | 35,684 | 40,587 | 36,325 | 72,901 | 110,621 | 117,873 |
| Unsecured loans | - | 373 | 5,405 | 5,405 | 5,405 | 5,405 |
| **Total loan funds** | **35,684** | **40,961** | **41,730** | **78,306** | **116,026** | **123,278** |
| | | | | | | |
| Current liabilities | 16,083 | 23,201 | 22,857 | 26,883 | 29,650 | 34,705 |
| Other liabilities | 2,680 | - | - | - | - | - |
| | | | | | | |
| **Total sources of funds** | **88,999** | **115,144** | **130,655** | **187,238** | **242,679** | **274,303** |
| | | | | | | |
| **Uses of funds** | | | | | | |
| Gross block | 75,203 | 83,684 | 105,128 | 123,222 | 188,195 | 196,367 |
| Less: accumulated depreciation | 14,439 | 18,505 | 23,237 | 28,728 | 35,219 | 42,497 |
| Net fixed assets | 60,764 | 65,180 | 81,891 | 94,494 | 152,976 | 153,870 |
| Capital work in progress | 3,493 | 18,619 | 20,029 | 56,779 | 51,279 | 75,779 |
| **Total fixed assets** | **64,257** | **83,799** | **101,920** | **151,273** | **204,255** | **229,649** |
| | | | | | | |
| Investments | 2,296 | 851 | 1,929 | 4,142 | 4,142 | 4,142 |
| Current assets | 18,940 | 27,454 | 24,856 | 31,834 | 34,293 | 40,523 |
| Inventory | 7,434 | 9,242 | 10,114 | 11,606 | 12,844 | 15,844 |
| Sundry debtors | 2,666 | 2,292 | 2,452 | 2,858 | 3,161 | 3,868 |
| Cash | 1,225 | 989 | 3,378 | 925 | 1,018 | 1,119 |
| Other current assets | 7,615 | 14,931 | 8,913 | 16,446 | 17,271 | 19,692 |
| Miscellaneous expenditure | 3,506 | 3,040 | 1,949 | (11) | (11) | (11) |
| | | | | | | |
| **Total uses of funds** | **88,999** | **115,144** | **130,655** | **187,239** | **242,679** | **274,303** |
| | | | | | | |
| **Ratios** | | | | | | |
| Debt/ Equity | 1.1 | 0.9 | 0.7 | 1.0 | 1.2 | 1.1 |
| RoAE (%) | 25 | 20 | 22 | 20 | 18 | 18 |
| RoACE (%) | 16 | 9 | 14 | 11 | 9 | 10 |
| Asset turnover ratio (x) | 0.9 | 0.8 | 0.9 | 0.9 | 0.7 | 0.7 |
| Book value (Rs per share) | 246 | 307 | 386 | 461 | 548 | 660 |
| Net debt | 34,460 | 39,972 | 38,352 | 77,381 | 115,009 | 122,159 |

Source: Company data, Kotak Institutional Equities estimates

**Exhibit 11: JSW Steel, Cash flow model, March fiscla year-ends (Rs mn)**

| | 2005 | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| **Cash Flow from operating Activites** | | | | | | |
| PBT | 14,726 | 13,011 | 19,152 | 22,198 | 23,958 | 29,936 |
| Add: depreciation | 3,595 | 4,058 | 4,982 | 5,491 | 6,492 | 7,278 |
| Add: non cash expenses | - | - | 920 | - | - | - |
| Less: expenses capitalised | - | - | (379) | - | - | - |
| Less: taxes paid | 1,046 | 875 | (2,848) | (4,440) | (5,271) | (6,885) |
| Add: working capital changes | (3,470) | (3,205) | 3,134 | (8,709) | 401 | (1,073) |
| **Total operating cash flow** | **15,898** | **14,739** | **24,961** | **14,540** | **25,580** | **29,256** |
| | | | | | | |
| **Cash flow from investing activities** | | | | - | - | - |
| Capital expenditure | (15,916) | (23,607) | (22,485) | (54,844) | (59,473) | (32,672) |
| Investments | - | 1,445 | 39 | (2,213) | - | - |
| Misc expenditure not written off | 587 | 466 | - | 1,960 | - | - |
| **Total investing cash flow** | **(15,329)** | **(21,697)** | **(22,446)** | **(55,097)** | **(59,473)** | **(32,672)** |
| | | | | | | |
| **Cash flow from financing activities** | | | | | | |
| Share issuances | 7,991 | 5,944 | 2,122 | 1,958 | - | - |
| Loans | (12,186) | 5,276 | 2,337 | 36,576 | 37,720 | 7,252 |
| Less: dividends paid (including dividend tax) | (463) | (1,045) | (4,087) | (431) | (3,734) | (3,734) |
| Other long term liabilities | 4,533 | (3,454) | - | - | - | - |
| **Total financing cash flow** | **(125)** | **6,722** | **372** | **38,104** | **33,986** | **3,518** |
| | | | | | | |
| **Net change in cash** | **443** | **(236)** | **2,887** | **(2,453)** | **93** | **102** |
| Opening cash | 782 | 1,225 | 491 | 3,378 | 925 | 1,018 |
| **Closing cash** | **1,225** | **989** | **3,378** | **925** | **1,018** | **1,119** |
| | | | | | | |
| **Changes in net working capital** | **(3,470)** | **(3,205)** | **7,783** | **(8,709)** | **401** | **(1,073)** |
| Decr/(incr) in accounts receivable | 1,401 | 374 | (160) | (406) | (303) | (707) |
| Decr/(incr) in inventories | (4,555) | (1,808) | (871) | (1,492) | (1,238) | (3,000) |
| Decr/(incr) in other current assets | (5,295) | (7,316) | 6,018 | (7,532) | (826) | (2,421) |
| Incr/(decr) in accounts payable | 4,434 | 4,821 | 3,473 | 722 | 2,768 | 5,055 |
| Incr/(decr) in other current liabilities | 536 | 688 | (637) | - | - | - |
| Incr/(decr) in other provisions | 9 | 36 | (41) | - | - | - |

Source: Company data, Kotak Institutional Equities estimates

**Pipes**

| JIND.BO, Rs606 | |
|---|---|
| Rating | OP |
| Sector coverage view | Attractive |
| Target Price (Rs) | 790 |
| 52W High -Low (Rs) | 728 - 285 |
| Market Cap (Rs bn) | 34.0 |

**Financials**

| September y/e | 2007 | 2008E | 2009E |
|---|---|---|---|
| Sales (Rs bn) | 49.6 | 61.1 | 81.9 |
| Net Profit (Rs bn) | 2.8 | 3.9 | 5.8 |
| EPS (Rs) | 51.4 | 67.4 | 101.9 |
| *EPS gth* | *67.1* | *31.1* | *51.2* |
| P/E (x) | 11.8 | 9.0 | 6.0 |
| EV/EBITDA (x) | 7.2 | 5.4 | 3.5 |
| Div yield (%) | 1.0 | 1.1 | 1.1 |

## Jindal Saw: Sells stake in US operations to JSW; cash inflow just compensates the loss of business

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- **We estimate post tax US$206 mn cash inflow to JSAW for its stake sale apart from the US$130 mn for working capital liquidation**
- **We find acquisition consideration break up between JSAW's plate and pipe affiliates to be puzzling**
- **Maintain target and rating; will revisit estimates and target price post conference call**

JSAW through sale of its stake in its US affiliates is expected to realize US$336 mn. We estimate that of the total EV valuation of US$0.9 bn for JSAW's affiliates' in US, JSAW will receive a post tax cash inflow of US$206 mn. Apart from this JSAW will also receive US$130 mn from JSW for its working capital investment in the US operations. We believe cash inflow from the sale just compensates for the loss of the business value in US. However, we note that the acquisition consideration break up between JSAW's plate and pipe affiliates to be puzzling; plate mill receiving a very low valuation versus our expectations. We maintain our target price and rating on the stock and will revisit our estimates post the conference call.

**Exhibit 1: Net earnings to decline marginally in FY2008E**

Effect of US operations on earnings estimates, September fiscal year-ends, 2006-09E, (Rs mn)

| | Current estimates (incl. USA) | | | | Proforma estimates (excl. USA) | | | | Change (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007E | 2008E | 2009E | 2006P | 2007E | 2008E | 2009E | 2006P | 2007E | 2008E | 2009E |
| Revenue | 38,731 | 49,620 | 61,107 | 81,897 | 24,331 | 27,869 | 36,261 | 51,250 | (37.2) | (43.8) | (40.7) | (37.4) |
| Growth (%) | | 28.1 | 23.1 | 34.0 | | 14.5 | 30.1 | 41.3 | | (13.6) | 7.0 | 7.3 |
| EBITDA | 4,066 | 5,953 | 7,757 | 10,671 | 4,449 | 4,077 | 5,982 | 9,126 | 9.4 | (31.5) | (22.9) | (14.5) |
| EBITDA margin (%) | 10.5 | 12.0 | 12.7 | 13.0 | 18.3 | 14.6 | 16.5 | 17.8 | 7.8 | 2.6 | 3.8 | 4.8 |
| Net profit | 1,563 | 2,761 | 3,852 | 5,783 | 1,813 | 1,537 | 2,698 | 4,784 | 16.0 | (44.3) | (30.0) | (17.3) |
| EPS (Rs) | 27.9 | 49.3 | 68.8 | 103.3 | 32.4 | 27.5 | 48.2 | 85.4 | 16.0 | (44.3) | (30.0) | (17.3) |

Source: Kotak Institutional Equities estimates.

**Exhibit 2: Allocation of deal value to various USA units (US$ mn)**

| | Ent. Value (1) | Net debt (2) | Equity value |
|---|---|---|---|
| **Total deal value** | **900** | **125** | **775** |
| Value for pipe mill | 530 | 74 | 456 |
| Value for plate mill | 320 | 44 | 276 |
| Value for double joint mill | 50 | 7 | 43 |

Note: (1) Enterprise value allocated as per company information
(2) Estimated net debt allocated in the ratio of enterprise value

Source: Company, Kotak Institutional Equities estimates.

**Exhibit 3: Cash proceeds to JSAW from sale of USA plants (US$ mn)**

| | Equity Value | JSAW's stake (%) | Cash flow |
|---|---|---|---|
| Pipe mill | 456 | 19.4 | 89 |
| Plate mill | 276 | 49.0 | 135 |
| Double joint mill | 43 | 100.0 | 43 |
| **Total cash flows** | **775** | | **267** |
| Tax on capital gains (22.6%) | | | 60 |
| **Post tax realisation** | | | **206** |
| Working capital realisation | | | 130 |
| **Total cash flow to JSAW (US$ mn)** | | | **336** |
| **Total cash flow to JSAW (Rs mn)** | | | **13,784** |

Source: Kotak Institutional Equities estimates.

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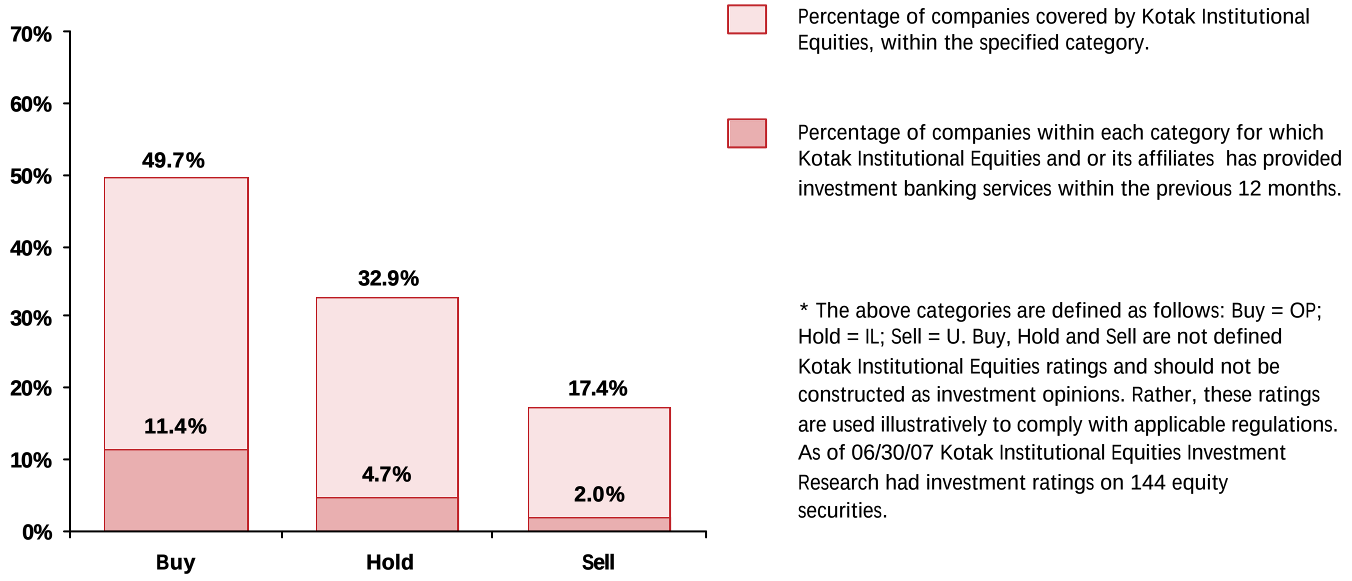
**Kotak Institutional Equities Research coverage universe**

Distribution of ratings/investment banking relationships




* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 06/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities. As of June 30, 2007

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**OP = Outperform**. We expect this stock to outperform the BSE Sensex over the next 12 months.
**IL = In-Line.** We expect this stock to perform in line with the BSE Sensex over the next 12 months.
**U = Underperform.** We expect this stock to underperform the BSE Sensex over the next 12 months.

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

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