INDIA DAILY

March 13, 2008

Contents

Updates

Tata Steel: 3QFY08 consolidated net earnings below estimates; retain REDUCE

Economy: IIP growth drops further in January; signals investment cycle may be past its peak

News Roundup

Corporate

- Bharti Airtel Lanka, a subsidiary of Indian telecom giant Bharti Airtel, has signed a US$100-mn investment agreement with the Board of Investment of Sri Lanka to begin Lankan operations by this year. (ET)
- Citigroup, Merrill Lynch and DE Shaw are likely to invest US$500 mn in the DLF Assets/ real estate investment trust (REIT). (ET)
- The Benetton Group has unveiled five priority growth markets—India, Turkey, East European and ex-Soviet Union countries, Mexico and China—apart from chasing new growth drivers in established areas. (ET)
- Suven Life has signed an agreement with Eli Lilly to collaborate on the pre-clinical research of molecules used in the treatment on Central Nervous Sustem (CNS) disorders. (ET) In other news, Eli Lilly has sued Krka Group in a patent dispute aimed at preventing the Slovenian company from selling copies of the antipsychotic treatment Zyprexa. (BS)
- Hikal, a Mumbai-based contract research and manufacturing player for pharmaceutical and crop protection companies, is investing Rs200 crore to set up four new manufacturing facilities in Bangalore and Mumbai and a research and development cenre in Pune.

Economic and political

- Industrial output growth in January registered a 10-month low of 5.3% against 11.6% in the same month last year and a revised 7.7% in December. (BS, see our comment inside)

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

EQUITY MARKETS

		Change, %		
India	**12-Mar**	**1-day**	**1-mo**	**3-mo**
Sensex	16,128	0.0	(4.8)	(19.8)
Nifty	4,872	0.1	(1.2)	(19.6)
Global/Regional indices				
Dow Jones	12,110	(0.4)	(3.5)	(10.4)
Nasdaq Composite	2,244	(0.5)	(5.5)	(15.9)
FTSE	5,776	1.5	(1.8)	(9.2)
Nikkie	12,600	(2.0)	(3.6)	(18.9)
Hang Seng	22,841	(2.5)	(1.4)	(17.7)
KOSPI	1,638	(1.3)	0.4	(14.5)

Value traded - India

			Moving avg, Rs bn	
	12-Mar		**1-mo**	**3-mo**
Cash (NSE+BSE)	226.5		189.4	189.5
Derivatives (NSE)	446.3		362.2	714
Deri. open interest	680.3		674	1,108

Forex/money market

		Change, basis points		
	12-Mar	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.3	0	58	92
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.6	(3)	10	(29)

Net investment (US$mn)

	11-Mar		**MTD**	**CYTD**
FIIs	(43)		317	(4,271)
MFs	79		(410)	1,954

Top movers -3mo basis

		Change, %		
Best performers	**12-Mar**	**1-day**	**1-mo**	**3-mo**
Thomas Cook	97	(0.6)	52.6	27.1
Asian Paints	1,154	(0.6)	1.0	17.0
Ranbaxy	464	2.4	25.3	12.9
Sun Pharma	1,268	2.6	16.3	12.8
NALCO	494	4.0	50.5	11.7
Worst performers				
Arvind Mills	41	(2.7)	(6.4)	(47.6)
Tata Tele	32	0.2	(3.7)	(47.1)
Neyveli Lignite	135	(2.3)	(0.1)	(46.7)
MRF	4,259	(2.7)	0.7	(46.3)
Balaji Telefilms	193	1.8	(9.8)	(45.2)

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Metals

TISC.BO, Rs766	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	800
52W High -Low (Rs)	970 - 372
Market Cap (Rs bn)	659.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	175.5	199.2	220.1
Net Profit (Rs bn)	43.7	46.1	50.4
EPS (Rs)	50.9	53.6	58.6
EPS gth	*(20.9)*	*5.4*	*9.3*
P/E (x)	15.1	14.3	13.1
EV/EBITDA (x)	9.2	8.1	8.0
Div yield (%)	1.4	1.5	1.5

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	33.7	-	-
FIIs	20.5	1.1	(0.0)
MFs	4.2	1.3	0.2
UTI	-	-	(1.1)
LIC	9.8	2.8	1.7

Tata Steel: 3QFY08 consolidated net earnings below estimates; retain REDUCE

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- **Consolidated EBITDA at Rs39 bn fell 17% qoq despite 4% improvement in standalone EBITDA; reported numbers were lower than our estimates**
- **Implied Corus Group EBITDA fell over 30% qoq following lower revenues—probably on lower realization, or on lower sales volumes**
- **We change our assumptions for steel prices and raw material price increase for the next two years, but largely maintain FY2009E EBITDA estimates**
- **Fine-tune our target price to Rs800 (Rs775 earlier). Retain REDUCE following our assertion that the Corus Group will not be able to pass on the raw material price increase, which will therefore constrain operating margins**

Tata Steel, in its 3QFY08 consolidated results, reported an EBITDA of Rs39 bn, down 17% on qoq basis and lower than our estimates. Implied Corus Group EBITDA fell over 30% qoq amidst lower revenues but stable costs. We change our assumptions for steel prices and raw materials, but continue to believe that the hike in steel prices is unlikely to cover for much higher increase in costs. We fine-tune our target price to Rs800 and retain our REDUCE rating on the stock.

Consolidated EBITDA at Rs39 bn fell 17% qoq despite 4% improvement in standalone EBITDA. The reported EBITDA was lower than our implied estimates for the quarter. We note that consolidated EBITDA over the past three quarters has fallen 20% despite a 23% improvement in the EBITDA of Tata Steel's standalone business.

Implied Corus Group EBITDA fell over 30% follower lower revenues amidst stable costs. The implied revenue of the Corus Group shows a 3% drop in sequential revenues, which could have been caused by (a) lower realizations or (b) lower volumes. We believe the probability of the former is higher as volumes have been reasonably constant over all four quarters in a year. Implied operating cost appears to have increased just under a percentage on a sequential basis.

We change our assumptions on operating matrix of the consolidated entity. We now expect Corus Group's operating costs to increase much higher than anticipated following (a) higher iron ore prices (by 65%) since Corus Group has recently signed agreement with CVRD for supply of ore fines and lumps and (b) much higher coking coal prices (see our report dated Feb 28, 2008), which we now expect would increase by 100% for supplies in CY2008 versus 30% expected earlier. Consequently, we now expect steel prices in FY2009E will increase by 25% versus 4% expected earlier. However, this increase will not compensate for the increase in the cost of iron ore and coal to Corus Group, such that consolidated margins will still reduce, albeit higher EBITDA (than expected earlier) for the standalone entity and lower EBITDA than expected for the Corus Group.

We have not yet built in the proposed GBP 300 mn performance improvement that the management spoke about during the 2Q analyst meet. We have argued earlier (see our report dated Feb 12, 2008) that the benefits of such performance improvement programs have not been visible in the consolidated results for FY2008 and we present our inability to build such improvements in our model unless we have more clarifications.

We fine-tune our target price to Rs800/ share (from Rs775 earlier). As noted above, the mix of consolidated EBITDA in our recent estimate will shift in favor of the standalone entity (which we value at a higher multiple), which results in a marginally higher target price despite constant EBITDA. We maintain our view that consolidated EBITDA will likely reduce in FY2009E, following the inability of the Corus Group to pass on the increase in raw material prices. Retain REDUCE on the stock.

Continuing net earnings have sequentially fallen over the last 3Qs
Consolidated net earnings of Tata Steel, March fiscal year-ends (Rs mn)

	1Q FY08	2Q FY08	3Q FY08
Net revenues	**311,546**	**324,249**	**318,985**
Expenditure	262,502	277,022	279,558
Consumption of RM	137,113	146,271	144,459
Staff Cost	39,803	39,494	41,667
Other Expenditure	85,587	91,257	93,431
EBITDA	**49,043**	**47,227**	**39,428**
Other Income	1,742	1,102	1,975
Interest (net)	8,921	13,847	10,809
Depreciation	10,298	11,014	10,113
Profit Before Extra-ord Items	**31,566**	**23,468**	**20,481**
Extra-ord items	44,339	18,996	1,248
Profit Before Tax	**75,906**	**42,465**	**21,729**
Tax	12,526	9,389	7,707
Reported net earnings	**63,380**	**33,076**	**14,023**
Add: Share of associates	392	393	520
Less: Minority interest	(168)	(45)	(387)
Reported consolidated net income	63,604	33,424	14,155
Adjusted continuing net income	**19,041**	**14,079**	**12,775**
Adjusted continuing EPS	22.1	16.4	14.9

Note a: Adjusted continuing net income is calculated assuming all taxes as operating taxes

Source: Company data, Kotak Institutional Equities estimates

Drop in Corus Group's revenues lead to sequential drop in consol. EBITDA
Calculation of implied EBITDA of Corus Group, March fiscal year-ends (Rs mn)

	1QFY08	2QFY08	3QFY08
Implied Corus Group EBITDA			
Consolidated EBITDA	49,043	47,277	39,428
Tata Steel standalone EBITDA	16,992	20,254	20,966
Assumed other subsidaries EBITDA	1,112	1,112	1,112
Implied Corus Group EBITDA	**30,939**	**25,910**	**17,349**
Sequential change in EBITDA		(5,029)	(8,561)
Sequential change in EBITDA (%)		**(16.3)**	**(33.0)**
Implied Corus Group revenues			
Consolidated revenues	311,546	324,249	318,985
Tata Steel standalone revenues	41,976	47,851	49,739
Assumed other subsidaries revenues	26,000	26,000	26,000
Implied Corus Group revenues	**243,570**	**250,398**	**243,246**
Sequential change in revenues		6,829	(7,152)
Sequential change in revenues (%)		**2.8**	**(2.9)**
Implied Corus Group revenues			
Implied Corus Group costs	**212,630**	**224,488**	**225,897**
Sequential change in revenues		11,858	1,409
Sequential change in revenues (%)		**5.6**	**0.6**

Source: Company data, Kotak Institutional Equities

We largely retain our EBITDA estimates for FY2009 amidst changed assumption

Summary of changes in assumptions and its impacts, March fiscal year-ends (Rs mn)

	FY2008E		FY2009E		FY2010E	
	Old	New	Old	New	Old	New
Gross steel selling prices (US$/ton)	715	715	746	896	687	837
Iron ore price increase (%)	20	20	40	65	-	20
Coking coal price increase (%)	(20)	(20)	30	100	-	(10)
Net revenues (Rs bn)	1,227	1,289	1,307	1,423	1,361	1,520
EBITDA (Rs bn)	**200**	**179**	**163**	**161**	**157**	**167**

Source: Kotak Institutional Equities estimates

We maintain that Consolidated net earnings will likley reduce in FY2009E

Summary consolidated statement of Tata Steel, March fiscal year-ends (Rs mn)

	2008E	2009E	2010E
Summary income statement			
Net revenues	1,289,715	1,422,639	1,519,797
EBITDA	178,500	161,299	167,374
Pre-tax profits	101,041	86,800	93,905
Continuing recurring net earnings	62,041	54,208	58,002
Continuing recurring EPS (Rs)	72.1	63.0	67.4
Summary balance sheet statement			
Liabilities	**779,811**	**870,101**	**904,183**
Share capital	8,600	8,600	8,600
Reserves	309,846	426,541	469,571
Net borrowings	461,364	434,959	426,012
Assets	**779,811**	**870,101**	**904,183**
Net fixed assets	597,303	662,607	751,990
Investments	75,638	75,638	50,000
Net working capital	106,870	131,855	102,193

Source: Kotak Institutional Equities

Tata Steel, SOTP valuation, March fiscal year-ends, 2009E basis (Rs mn)

	EBITDA		Multiple	Enterprise value		EV	Vauation basis
	(Rs mn)	(£ mn)	(X)	(Rs mn)	(USD mn)	(Rs/share) (a)	
Tata Steel standalone	106,183	-	7.0	722,041	18,051	840	Valued on FY2009E EBITDA
Corus Group standalone (b)	52,640	658	6.5	342,160	8,554	398	Valued on CY2008E EBITDA
Present value of synergies				41,326	1,033	48	Probability adjusted
Total Enterprise Value				**1,105,527**	**27,638**	**1,286**	
Tata Steel standalone net debt				43,495	-		FY2009E, adjusted for cash and marketable securities
Corus Group standalone net debt				52,820	-		December 2008E, adjusted for cash and marketable securities
Borrowings in Tata Steel Asia Holdings' account				44,000	-		
Borrowings in Tulip UK's account				24,000	-		
Senior debt at Tata Steel UK's account (d)				160,000	-		
Mezannine debt at Tata Steel UK's account (d)				124,000	-		
Total borrowings				**448,316**	**11,208**	**521**	
Arrived market capitalization				**657,211**	**16,430**	**764**	
Value of investments				**36,114**	**903**	**42**	
Market capitalization (including Investments)						**806**	
Target price (Rs)						**800**	Increased from Rs775

Notes:
(a) Based on fully diluted number of shares.
(b) Based on 2007 December-ended forecasted EBITDA.
(c) Currency conversion from GBP and USD into INR is based on current exchange rates.
(d) Refinanced by US$6.2 bn by way of non-recourse debt, of which US$3.3 bn is five year amortizing loan and balance is 7 year amortizing loan.

Source: Company, Kotak Institutional Equities estimates.

Economy

Sector coverage view	N/A

IIP growth drops further in January; signals investment cycle may be past its peak

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- **January 2008 IIP growth at 5.3%—down from 7.7% a month ago and 11.6% a year ago**
- **Slowdown evident, but magnified by strong base effects in 3QFY08**
- **Steep drop in capital goods output indicates an investment cycle turnaround**
- **We expect IIP growth to rebound into double digits in February 2008**

Industrial growth proved to be even slower than expected in January. It has clearly decelerated this year and the slowdown has been magnified by base effects in 3QFY2008. In January, capital goods production dropped nearly 19% from the preceding month. It clocked a growth of 2.1% yoy, the lowest since April 2002, after which the current investment cycle began. We believe this signals that the investment cycle may be beginning to turn. With signs of decelaration in output and investment, the monetary policy has yet to respond with a rate cut. It is still unclear if we would see one in April as headline inflation has now risen to 5.0% from 3.0% in October 2007.

Industrial slowdown appears magnified

IIP growth dipped across sectors in January 2008 (Exhibits 1 & 2). We believe that industrial growth has slowed down in FY2008. On a 3-month moving average (3mMA) basis, IIP growth dropped to 6.0% in January 2008 from 13.6% a year ago (Exhibit 3). Even on a 12-month moving average basis, IIP growth is at 9.4%, perceptibly lower than 11.6% in April 2007.

However, the slowdown in the industrial growth over the past three months has been magnified by the strong base effect. We expected January IIP growth to drop to around 7.0%, while the market expected 8.0% (Reuters poll). In any case, we had anticipated that IIP growth would be low during Nov'07-Jan'08 (see our Economy Report of *November 5, 2007: India story to continue*). The January data is, therefore, not a shocker so much as a matter of some concern.

Expect about double-digit growth in February 2008

Due to the strong base effect, we expect IIP growth to rebound to double digits in February 2008, the data for which would be released on April 11, 2008. On a more sustainable basis, IIP growth could average about 8-10% in the next few months.

Manufacturing output drops mom

January IIP confirms deceleration in manufacturing output, which is visible from 2QFY08 on a 3mMA basis (Exhibit 4). Salient aspects of the January IIP numbers are:

- Manufacturing output decelerates to 5.9% yoy; drop by 1.9% mom
- Mining growth drops to mere 1.8% yoy in spite of marginal improvement mom
- Due to base effects electricity output decelerates to 3.3% yoy in spite of 1.5% increase mom

Capital goods slowdown now visible

Growth in capital goods production dropped to 2.1% in January. The growth in capital goods production in the first 10 months of FY2008, at 18.3%, is the same as in the corresponding period of the previous year. On a 3mMA basis, growth in capital goods output has decelerated to 14.4% in January 2008 from 24.2% in October 2007. This deceleration has been led by the falling/stagnating output of tractors, diesel engines, diamond tools, machine tools, switchgear circuit breakers, turbines and commercial vehicles.

Investment cycle may have begun to descent, but plenty of investment still in the pipeline

We believe the January IIP signals a change in direction for the investment cycle, which appears to be descending from its peak. However, in our view, this does not indicate that the investment boom has but merely that it is slowing down from here. Capital goods imports remained robust in January. There is far too much investment in pipeline to herald an abrupt end to the investment boom in the near term. We understand that the top 1,000-odd Indian firms have envisaged fixed investments of about Rs3,000 bn (US$75 bn) which have reached financial closure in FY2008. Even if a quarter of this investment gets deferred, we believe there is enough in investment the pipeline to drive growth, nevertheless, some softening in the pace is inevitable.

Consumer durables register negative growth in spite of the marked jump in output

Consumer durables output recorded negative growth of 3.1% yoy. Growth in this segment has contracted in seven out of the 10 months in FY2008. On a 3mMA basis, growth in this segment has completely stagnated in FY2008 in comparison with an average growth of around 16% in the period 2HFY06-1HFY07 (Exhibit 6). However, negative growth in January 2008 has been largely due to base effects—on a mom basis, growth has jumped by 7.2%.

Other salient features of growth in use-based classification sectors are:

- Consumer non-durables recording a double digit growth yoy for the second successive month
- Intermediate goods contracting 2.6% mom
- Basic goods growth decelerating to 3.5% largely on base effects

Odds for RBI cutting policy rates still finely balanced

We do not expect the RBI to respond immediately with an unscheduled policy change. The January IIP numbers have clearly strengthened the case for a rate cut. However, this has been counterbalanced by a surge in the inflation rate to 5.0%. Of late, the RBI appears to have intervened in the FX markets to provide liquidity with an eye on the expected March spike associated with tax collections. The government also increased its expenditure. As a result, liquidity has turned into surplus, with absorption in excess of Rs300 bn in its daily window.

In our assessment, the odds for RBI cutting rates in its scheduled April policy are finely balanced. We expect inflation to moderate to 4.7% by then. We also expect a significant built up in political and business lobby pressures for a rate cut after the January IIP. However, the rate cut may hinge on capital flows drying up till then, as the central bank would also factor in the liquidity likely to be generated from the fiscal stimulus provided in the Union budget presented at end-February 2008.

Exhibit 1: Manufacturing activity jumps in December, balks expectations of slowdown
Industrial Growth (based on IIP)

	Mining (104.73)		Manufacturing (793.58)		Electricity (101.69)		General (1000.00)	
Month	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**
Growth over the (								
Dec	7.7	1.8	12.3	5.9	8.3	3.3	11.6	5.3
Apr-Jan	4.8	4.6	12.1	9.2	7.6	6.3	11.2	8.7

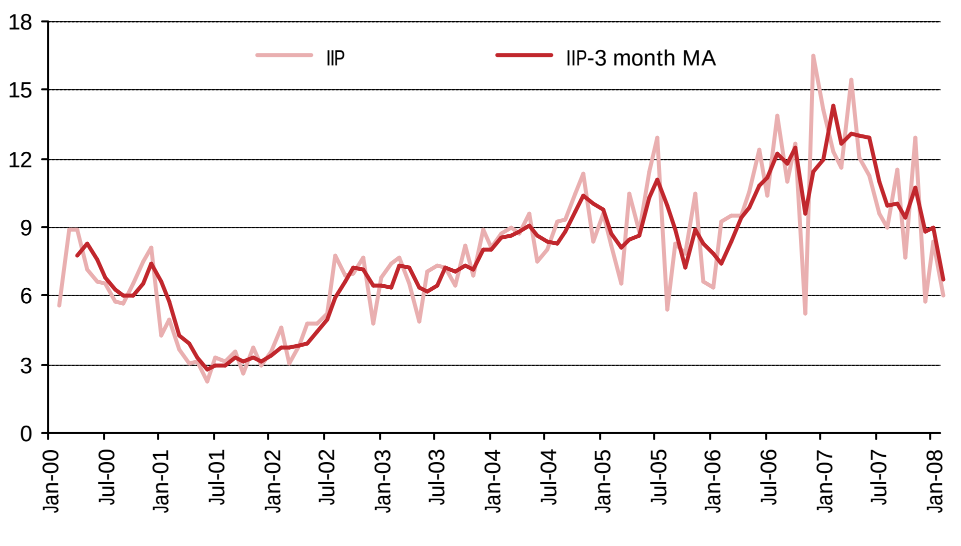
Source: Central Statistical Organisation.

Exhibit 2: Double digit growth in consumer non-durables lead December IIP's positive surprise
Industrial Growth (based on use-based IIPs)

Month	Basic goods (35.57)		Capital goods (9.26)		Intermediate goods (26.51)		Consumer goods (28.66)		Consumer durables (5.37)		Consumer non-durables (23.30)	
	2006-2007	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**	**2006-2007**	**2007-2008**
Growth over the (												
Dec	12.0	3.5	16.3	2.1	13.7	7.0	8.2	7.0	5.3	-3.1	9.1	10.1
Apr-Dec	10.0	7.4	18.3	18.3	11.6	9.3	9.7	5.9	10.6	-1.7	9.4	8.6

Source: Central Statistical Organisation.

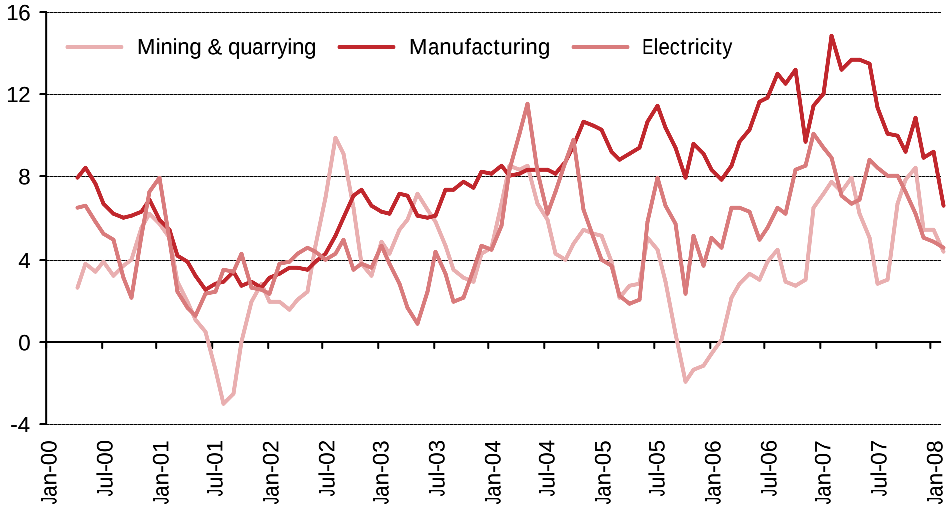
Exhibit 3: Industrial growth decelerates over last one year
Index of Industrial Production (IIP): yoy growth & its 3-month Moving Average(MA)



Source: CSO, Kotak Institutional Equities.

Exhibit 4: Deceleration sets in across all major sectors

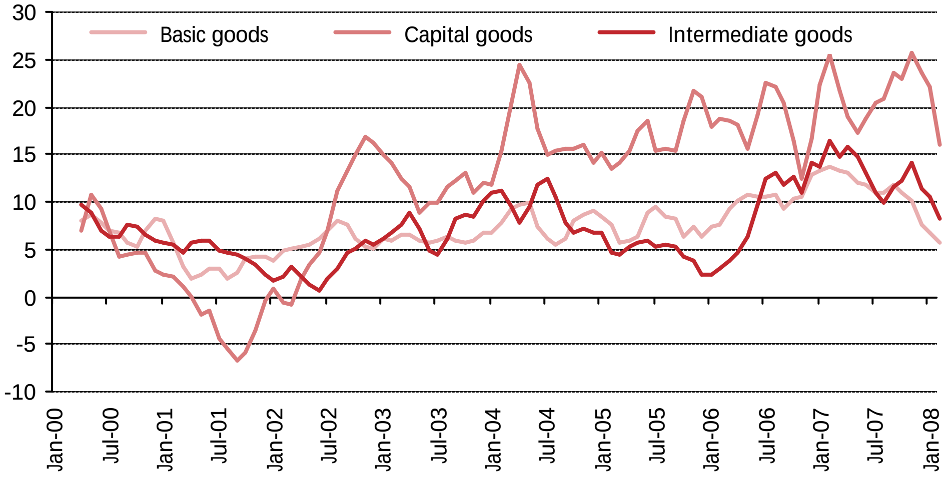
3-month moving average of yoy growth in sector-wise IIP



Source: CSO, Kotak Institutional Equities.

Exhibit 5: Deceleration across use-based sectors but growth in capital goods still high

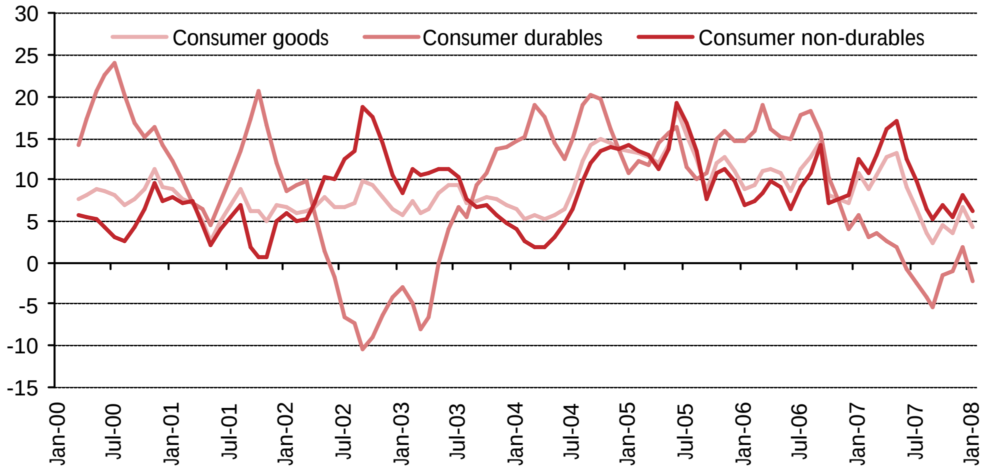
3-month moving average of yoy growth in major use-based sectors



Source: CSO, Kotak Institutional Equities.

Exhibit 6: Consumer goods output face recessionary conditions in FY2008

3-month moving average of yoy growth in consumer goods and its durables and non-durables components



Source: CSO, Kotak Institutional Equities.

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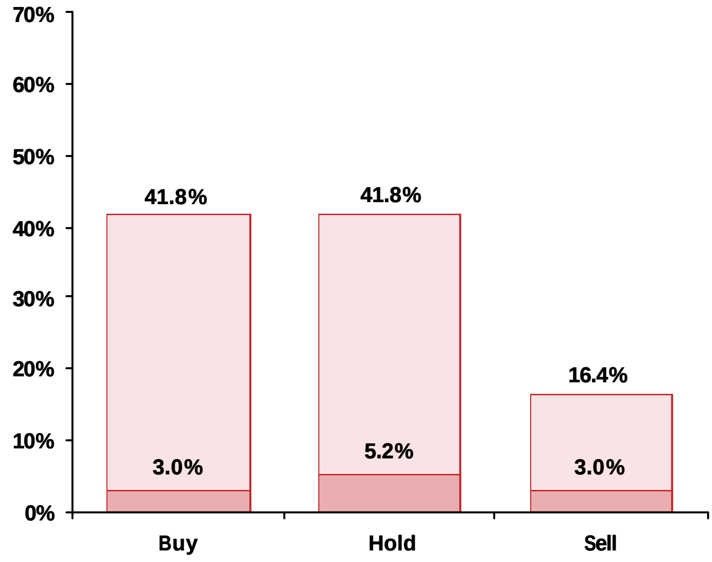
Distribution of ratings/investment banking relationships



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* 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 09/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

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

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
SELL: We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

Old rating system

Definitions of ratings

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.

Other definitions

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