kotak® Institutional Equities

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News Roundup

Corporate

- In its largest investment in the Indian property business Citigroup Property Investors, the real estate arm of Citigroup, has invested Rs640 crore in four special economic zones of Delhi-based property developer BPTP. In other property news, the US$16 bn Sistema, the Russian conglomerate with interests in telecom, real estate and banking, will develop a mixed-use real estate project in Gurgaon to cater to rising demand for office space, homes and hotels in the National Capital Region. (BS)
- The government has started the process of selling a substantial holding of shares in a few blue chip companies, now vested with the Specified Undertaking of UTI (SUUTI). The list of attractive assets the undertaking inherited after the split of UTI Mutual Fund in 2002-03 are Axis Bank (27%), ITC>12%) and L&T (10%). (ET)

Economic and political

- Under a new Duty Free Tariff Preference Scheme, India will unilterally provide preferential market access for exports from all 50 Least Developed Countries (LCDs), a majority of which were in Africa. (BL)
- The Reserve Bank of India has told banks that they can no longer consider stocks as collateral against loans for calculating capital adequacy ratio (CAR). (ET)

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

EQUITY MARKETS

	Change, %			
India	**8-Apr**	**1-day**	**1-mo**	**3-mo**
Sensex	15,588	(1.1)	(2.4)	(25.3)
Nifty	4,710	(1.1)	(1.3)	(24.9)
Global/Regional indices				
Dow Jones	12,576	(0.3)	5.7	(1.2)
Nasdaq Composite	2,349	(0.7)	6.2	(5.1)
FTSE	5,990	(0.4)	5.1	(4.5)
Nikkie	13,245	(0.0)	3.6	(9.3)
Hang Seng	24,312	(1.1)	8.0	(12.0)
KOSPI	1,755	(1.1)	5.5	(4.9)

Value traded - India

		Moving avg, Rs bn		
	8-Apr		**1-mo**	**3-mo**
Cash (NSE+BSE)	172.2		196.2	214.8
Derivatives (NSE)	331.4		387.1	844
Deri. open interest	557.7		655	1,286

Forex/money market

	Change, basis points			
	8-Apr	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.8	(17)	(66)	56
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	1	37	33

Net investment (US$mn)

	7-Apr		**MTD**	**CYTD**
FIIs	93		(96)	(3,160)
MFs	(10)		(160)	1,407

Top movers -3mo basis

	Change, %			
Best performers	**8-Apr**	**1-day**	**1-mo**	**3-mo**
Sun Pharma	1,270	(0.5)	(2.9)	15.6
Ranbaxy	471	(2.7)	8.2	14.4
Hero Honda	742	(1.0)	(3.2)	7.9
Cipla	212	(1.2)	6.3	1.7
Nestle India	1,558	1.3	3.9	1.4
Worst performers				
Rashtriya Chem	51	1.9	(25.6)	(60.0)
Reliance Cap	1,226	0.6	(11.4)	(57.1)
Reliance Energy	1,150	(1.1)	(9.4)	(55.2)
Tvs Motor	33	(2.8)	(18.0)	(54.2)
Tata Tele	28	(0.4)	(10.8)	(52.8)

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Utilities

TTPW.BO, Rs1134	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	1,540
52W High -Low (Rs)	1641 - 505
Market Cap (Rs bn)	264.2

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	64.8	73.4	80.4
Net Profit (Rs bn)	5.7	6.9	8.9
EPS (Rs)	26.6	29.7	38.1
EPS gth	*(0.1)*	*12.0*	*29.3*
P/E (x)	42.7	38.2	29.7
EV/EBITDA (x)	24.7	25.7	23.0
Div yield (%)	0.7	0.8	0.8

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	33.9	-	-
FIIs	18.6	0.6	(0.1)
MFs	7.1	1.2	0.6
UTI	-	-	(0.6)
LIC	9.5	1.5	0.9

Tata Power: Bumi guiding 59% yoy increase in coal prices, growth from mining business intact

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- **Bumi reports 94% yoy increase in net income, guides 59% yoy increase in selling prices**
- **Tata Power's exposure to imported coal hedged**
- **Implementation of 5,660 MW on schedule**
- **SOTP-based target price of Rs1,540/share**

Bumi Resources conducted an analyst conference call to discuss the results for the quarter and year-ended December 2007. Bumi reported a 94% yoy growth in net income for the quarter-ended December 2007 and 67% yoy increase in net income for the full year-ended December 2007. Media reports on probable losses of Bumi for the current quarter were based on previous estimates of extraordinary income—growth from the mining business remains intact. Bumi has guided for an average selling price of US$70/ton (+59% yoy) and sales of 62 mn tons (+13% yoy) for CY2008. We believe that the equity stake in Bumi along with firm off-take agreement hedges Tata Power (TPC) against the risk of increase in imported coal prices. TPC's investment in the coal mines is expected to start yielding returns from FY2010. We reiterate our conviction on the long-term growth prospects of the company and retain our earning estimates and 'ADD' rating with a target price of Rs1,540/share.

Bumi reports a 94% increase in core operating income, upward revision in estimates of coal reserves. Bumi reported a 94% yoy increase in net income against a 22% yoy increase in sales and 63% yoy increase in operating income for the quarter ended December 2007. Media reports on a quarterly loss were based on earlier estimates (which have subsequently been revised) of extraordinary income from the sale of 30% stake in coal mines to Tata Power. Bumi has guided sales of 62 mn tons (+13% yoy) with an average selling price of US$70/ton (+59% yoy) in CY2008. Bumi expects to contain cash cost for mining to remain at US$26/ton through increased operational efficiencies — despite increasing fuel costs and a higher stripping ratio. We note that Bumi has revised estimates for coal reserves by 13% from 7.2 bn tons to 8.1 bn tons (see Exhibit-2). TPC has indicated that investment in the coal mines will likely start yielding returns from FY2010.

TPC's exposure to imported coal prices largely hedged. TPC is largely hedged against rising imported coal prices due to its firm off-take agreement (10.5 mn tpa ± 20%) with the coal mines in Indonesia. TPC requires about 18 mn tpa for its two projects based on imported coal (4,000 MW Mundra UMPP and another project of 2,400 MW capacity in coastal Maharashtra). The tariff-bid of Mundra for fuel reimbursement contains a non-escalable portion and an escalable portion linked to movement of imported coal prices. TPC's exposure to higher fuel cost is restricted to the non-escalable portion of fuel reimbursement. However, due to the firm off-take agreement at a price comparable to the non-escalable tariff bid, TPC is exposed to ~2.5 mn tpa of fuel risk as indicated by TPC management and explained in Exhibit 3.

We note that Bumi management has in its response to investor queries indicated that most of the off-take for TPC will be at market driven prices. TPC is pursuing additional acquisitions/fuel-supply agreements to meet the balance requirement of imported coal. We note that the equity interest in Bumi acts as an additional hedge against rising prices of imported coal.

Tremendous value creation from Bumi (Rs490/share). We value TPC's 30% stake in the coal business of PT Bumi Resources TBK (Bumi) at US$2.8 bn—11X P/B of its equity investment of US$250 mn. With a targeted production level of 100 mn tons in five years, a 30% stake in Bumi Resources gives TPC an economic benefit of 30 mn tons. Out of this, 12 mn tons of coal acts as a natural hedge for coal required for the Mundra UMPP. TPC thus will enjoy economic benefit of ~18% (18 mn tons out of 100 mn tons) in the coal mines in Indonesia. We subtract the debt taken for acquisition (US$1.05 bn) of these coal mines to arrive at a value of US$2.8 bn (Rs490/share). We have factored a price of IDR7,300 for Bumi to value TPC's stake in the coal mines against a consensus target price of IDR8,300.

Implementation of 5,660 MW on schedule. TPC is in the process of commissioning 5,660 MW of projects by FY2012-13, requiring a total capex of Rs240 bn—Rs180 bn debt and Rs60 bn equity. Financial closure for Mundra (4,000 MW) will likely be completed by April 2008 while debt funding for Maithon (1,050 MW) has been completed. Exhibit 2 details the progress on various projects currently under implementation. Equity funding of Rs60 bn is to be met through (1) internal accruals of ~Rs29 bn, (2) preferential allotment of ~Rs19 bn and (3) sale of investments in group companies. We note that TPC has recently commissioned Unit 1 (45 MW out of 90 MW) at Haldia.

SOTP based target price of Rs1,540/share. We value TPC's 30% stake in coal mines in Indonesia at Rs490/share based on its 18% net economic benefit derived from the consensus target price of Bumi Resources. The operating businesses of TPC contribute Rs234/share to our target price. This comprises Rs154/share for the Mumbai licence area valued using DCF (implying 2X P/B), Rs39/share for generation assets at Jojobera (P/B of 2X), Rs14/share for 51% stake in Tala transmission project (P/B of 1.4X) and Rs26/share for the 51% stake in Delhi distribution business of NDPL (implied P/B of 1.5X). We value TPC's 49% stake in Tata BP Solar at Rs66/share. We use DCF-to-equity to assign Rs144/share, Rs28/share and Rs26/share as the likely value enhancement from Mundra UMPP (4,000 MW), Maithon JV (1,050 MW) and merchant power (500 MW), respectively. Value enhancement from new projects (50% likelihood scenario) contributes additional Rs159/share.

Exhibit 1: Financial results for Bumi Resources, December year-ends

(US$ mn)

	2008E	2007	2006	(% chg)	4QCY2007	4QCY2006	(% chg)
Sales	**3,779**	**2,265**	**1,852**	***22***	**620**	**508**	***22***
Cost of sales	(1,612)	(1,511)	(1,322)		(414)	(395)	
Gross profit	2,167	754	530		206	113	
Operating expenses	(354)	(348)	(202)		(82)	(37)	
Operating income	**1,813**	**406**	**328**	***24***	**124**	**76**	***63***
Other income	(20)	(23)	(135)		1	(67)	
Profit before tax	1,793	383	193		125	9	
Tax	(540)	(15)	(3)		(29)	25	
Minority interest	(376)	(51)			(26)	2	
Net income	**877**	**317**	**190**	***67***	**70**	**36**	***94***
Operating assumptions							
Selling price (US$/ton)	70	44	41	*8*			
Sales (ton)	62	55	50	*11*			
Cash cost (US$/ton)	26	26	26	*(1)*			

Source: Company data, Kotak Institutional Equities.

Exhibit 2: Bumi has revised estimates of coal reserves
(Coal reserves bn tons)

	2007	2005	(% chg)
Proven reserves	1.40	1.09	*29*
Coal resources	6.73	6.12	*10*
Total	**8.13**	**7.21**	***13***

Source: Company data.

Exhibit 3: Tata Power is largely hedged against rising prices of imported coal
(mn tpa)

Availability of coal	
Supply of Imported coal from Bumi (a)	12.6
Coal to be utilised for other projects (b)	5.5
Coal available for Mundra (c=a-b)	7.1
50% at market price (d)	3.6
Balance at fixed price (e=c-d)	3.6
Demand for coal	
Coal requirement for Mundra (f)	12.0
Escalable portion for Mundra (g)	6.0
Non-escalable portion for Mundra (h=f-g)	6.0
Unhedged coal requirement (f=h-e)	**2.5**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 4: Valuation of TPC's stake in coal mines in Indonesia

At discount to consensus target price (IDR)	**7,300**
Market cap of Bumi Resources-USD bn (a)	**15.19**
Full value of coal resources- Arutmin and Kalimantan (b)= (a)/70%	21.70
FY2012 est. coal production at Arutmin and Kalimantan (mn tonnes)	100
TPC's economic share (30%)	30
TPC's requirement of imported coal (for Mundra UMPP)	12
TPC's net economic benefit from coal (mn tonnes)	18
TPC's net economic benefit from coal (%) (f)	**18**
Value of TPC stake (g) = (b)X(f)	3.91
Debt taken for acquisition of coal mines (US$ bn) (h)	1.05
Attributable equity value of coal mines for TPC (US$ bn) = (g) - (h)	2.86
Per share value (Rs)	**490.4**

Source: Bloomberg, Kotak Institutional Equities estimates.

Exhibit 5: Tata Power Sum-of-the-parts valuation

	Methodology	Key assumptions/comments	Per share value (Rs)
Mumbai (Generation, transmission & distribution business)	**DCFe** Disc. Rate: 11% Term. Yr. Grth: 2%	The business enjoys very high predictability of cash flows. We have not built in (1) likely incremental capacity creation in Mumbai (beyond the 250 MW already under construction).	154
Jojobera generation business	**DCFe** Disc. Rate: 11% Term. Yr. Grth: 0%	The project enjoys pretty lucrative terms in its PPA: Assured RoE of 16% plus incentive on PLF higher than 75%. We assign a value of 2X book as FCFE likely to be 20% Capacity (MW) 428; Equity (Rs bn) 4.5 Assumed cost/MW 35; Attributable debt (Rs bn) 6.0 Total Cost (Rs bn) 15.0	39
Powerlinks Transmission Ltd.	**Price/Book (X)**	We value the equity investment at 1.4X book: The project earns a regulated RoE of 14% as per the Central Electricity Regulatory Commission (CERC) tariff guideline for inter-state transmission project.	14
Delhi Distcom (NDPL)	**DCF** Disc. Rate: 11% Term. Yr. Grth: 4%	NDPL earns 16% RoE provided it meets cetain A,T&C loss reduction benchmarks. It is also incentivized by way of higher returns in the event of bettering the benchmarks Equity invested in NDPL Rs bn 1.8 NDPL reserves (attr.) Rs bn 1.9	26
Tata BP Solar	**EV/Sales (X)**	8X EV/Sales on FY07 as compared to 17X for comparable standalone PV manufacturers; an additional 40% group company discount built in	66
Investments	**Various**	Total value (Rs bn) / Per share value (Rs): Telecom 52.6 / 226 TCS/Tata Sons 17.1 / 73 Others 2.2 / 9	308
Investible surplus on books	**Market value**	Marketable securities & cash on books (Rs bn)	64
Bumi Resources	**Market value**	Economic interest - based on market cap of PT Bumi Resources	490
Mundra UMPP	**DCF-equity**	Levelized tariff of Rs2.26/unit for 25 years	144
Maithon	**DCF-equity**	1,050 MW project; 14% RoE + efficiency gains	28
Merchant power plant	**DCF-equity**	500 MW; P/B of 2.5X with a levelized tariff of Rs2.26/unit	26
Value enhancement from future projects -assuming 50% probability			159
Total			1,519

Source: Kotak Institutional Equities estimates.

Exhibit 6: Tata Power: Profit model, balance sheet, cash model 2006-2010E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	56,955	64,756	73,389	80,435	88,322
EBITDA	**9,986**	**10,786**	**11,487**	**13,772**	**15,210**
Other income	1,758	2,671	2,578	3,023	2,504
Interest	(1,807)	(2,833)	(2,214)	(2,215)	(2,534)
Depreciation	(3,457)	(4,148)	(3,568)	(4,080)	(4,560)
Extraordinary items	1,571	1,877	0	0	0
Pretax profits	8,052	8,353	8,284	10,500	10,621
Tax	(1,625)	(816)	(1,368)	(1,615)	(1,328)
Minority interest	1,104	6	0	0	0
Net profits	**7,532**	**7,544**	**6,915**	**8,886**	**9,293**
Earnings per share (Rs)	**23**	**27**	**29.7**	**38.1**	**39.9**
Balance sheet (Rs mn)					
Total equity	54,183	59,479	70,516	88,261	97,674
Deferred taxation liability	336	458	1,315	1,858	1,808
Total borrowings	42,285	51,784	79,806	96,959	135,335
Currrent liabilities	17,100	22,238	21,007	22,881	24,893
Capital contribution from consumers	636	758	758	758	758
Minority interest	2,068	2,496	2,496	2,496	2,496
Total liabilities and equity	**116,607**	**137,214**	**175,898**	**213,214**	**262,963**
Cash	10,793	14,024	6,057	3,062	(1,795)
Current assets	22,105	29,293	30,093	32,781	35,760
Total fixed assets	54,788	63,001	64,664	70,286	73,914
Investments	28,632	30,833	75,022	107,022	155,022
Deferred expenditure	289	62	62	62	62
Total assets	**116,607**	**137,214**	**175,898**	**213,214**	**262,964**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	8,635	10,255	10,378	13,002	13,145
Working capital	(4,683)	(2,849)	(719)	(949)	(905)
Capital expenditure	(9,487)	(11,054)	(4,924)	(9,394)	(7,783)
Investments	1,401	(2,010)	(44,387)	(32,000)	(48,000)
Free cash flow	**(4,135)**	**(5,659)**	**(39,653)**	**(29,342)**	**(43,542)**

Source: Company data, Kotak Institutional Equities estimates.

Telecom

TATA.BO, Rs479	
Rating	REDUCE
Sector coverage view	Cautious
Target Price (Rs)	530
52W High -Low (Rs)	783 - 361
Market Cap (Rs bn)	136.6

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	40.4	41.0	44.4
Net Profit (Rs bn)	4.9	2.6	4.1
EPS (Rs)	17.2	9.2	14.4
EPS gth	*(7.8)*	*(46.2)*	*55.6*
P/E (x)	27.9	52	33.3
EV/EBITDA (x)	11.4	17.8	13.3
Div yield (%)	0.9	0.9	1.0

Shareholding, December 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	76.2	-	-
FIIs	8.4	0.2	(0.3)
MFs	2.4	0.3	(0.1)
UTI	-	-	(0.4)
LIC	7.3	0.8	0.4

Tata Communications: Reliance Globalcom (FLAG) wins arbitration against Tata Communications (VSNL) on access rights case; final verdict on damages expected in a few months

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- **Final verdict on the damages sought by RCOM (approx US$400 mn) expected in a few months**
- **A verdict against TCOM (assuming charges equal RCOM's claim) reduces our target price on TCOM by 11% to Rs470/share from Rs530/share currently**

A Netherlands-based district court in Hague has upheld an order by the arbitration tribunal of the International Chamber of Commerce (ICC) in 2006 directing VSNL (now Tata Communications) to permit Reliance Globalcom (formerly FLAG Telecom) to upgrade its bandwidth capacity at TCOM's cable landing station in Mumbai. We note that this case relates to FLAG Telecom's FLAG Europe-Asia cable for which VSNL was a signatory as a landing station party in India. We highlight that in February 2007, FLAG had also filed a claim seeking monetary relief of Rs177 bn (later reduced to Rs168 bn), plus interest, to compensate for the business opportunity loss due to VSNL's refusal to allow FLAG to upgrade the capacity of its Europe-Asia cable at the India landing station. A district court hearing on this case is expected in the next two months. We compute the impact of TCOM's target price to be Rs59/share (excluding interest component of the claim) or 11% of our current target price of Rs530/share, if the verdict were in RCOM's favor and assuming that the court upholds RCOM's computation of the claim. We await the final verdict before making any changes to our earnings models and target prices for TCOM/ RCOM.

Substantial negative impact on TCOM if the verdict on compensatory charges is in favor of RCOM. We believe that a negative verdict (for TCOM) in the FLAG Europe-Asia landing station access rights case could mean a payout of US$400 mn (ex-interest, based on press reports and the latest TCOM filings with the SEC) provided (1) the verdict is in RCOM's favor, (2) RCOM's computation on the claim amount is accepted, and (3) the case does not go into further appeals. The case is due for hearing in the next two months. Exhibit 1 depicts the impact on our SOTP-based target price for TCOM in the event of a verdict against the company. Our target price for the company reduces by 11% (Rs59/share) to Rs470/share in such an event.

No financial impact as of now; TCOM exploring options of appealing in higher courts. Our discussion with TCOM management indicates that (1) there is no financial implication of the recent hearing; it simply upholds the previous landing station access right awards to RCOM, (2) the case on RCOM's financial claims is due for hearing in a district court in the next two months, (3) TCOM is exploring options of appealing in higher courts in case the district court issues a verdict in favor of RCOM, (4) the damage claim amount of approx US$400 mn (plus interest) is based on RCOM's computation and none of the lower courts have made a comment on the same; interestingly, we highlight that RCOM acquired FLAG Telecom for a total consideration of US$207 mn.

A brief history of the case. The case relates to FLAG Telecom's FLAG Europe-Asia submarine cable system, which became operational in 1997. We note that TCOM (VSNL) was one of the initial investors in the cable system as well as one of the landing signatories in the consortium. In December 2004, RCOM filed a case against TCOM for restricting access to its cable landing station in Mumbai, thus hampering RCOM's ability to augment capacity on the Europe-Asia cable system and meet market demand. Subsequently, the Arbitration Tribunal of the ICC International Court of Arbitration issued three partial awards in favor of RCOM asking TCOM to grant FLAG access to the Mumbai cable landing station of the FEA cable system. Subsequent to the second award (in Dec 2006), RCOM also filed a claim seeking monetary relief of relief of Rs177 bn (later reduced to Rs168 bn), plus interest, to compensate for the business opportunity loss due to VSNL's refusal to allow FLAG to upgrade the capacity of its Europe-Asia cable at the India landing station.

An unfavorable verdict in the RCOM damage claim case could have a negative impact of Rs59/share on TCOM's SOTP value

	Estimated value		Value in SOTP		
	(Rs bn)	(Rs/share)	(Rs bn)	(Rs/share)	Comments
1. Core business					
Enterprise value (EV)	49	172	49	172	12-month forward DCF (discounting FY2008 onwards)
Net cash/(debt)	8	29	8	29	As of end-March 2008
Total	**57**	**201**	**57**	**201**	
2. Investments					
TATA Teleservices (TTSL)	32	112	32	112	Valuation based on US$5 bn equity value for TTSL
Tyco Global Network (TGN)	6	20	5.7	20	Valued at book value (100% taken in SOTP)
Teleglobe (TG)	8	28	8.1	28	Valued at book value (100% taken in SOTP)
SNO (South Africa)	0	0	0	0	No NPV ascribed (i.e. neither capex nor revenues modeled)
Total	**46**	**160**	**46**	**160**	
3. Others					
Surplus real estate	69	242	48	170	70% of estimated market value of surplus land
Total	**69**	**242**	**48**	**170**	
Grand total [1]+[2]+[3]	**172**	**604**	**151**	**531**	**12-month forward target price is Rs530**
Impact if the verdict on RCOM's damage claim case is against TCOM					
Damages paid (ex-interest)	**(17)**	**(59)**	**(17)**	**(59)**	
Target price post-impact			**135**	**472**	**Target price gets reduced by Rs59/share**

Source: Company filings, Kotak Institutional Equities estimates.

Metals

Sector coverage view	Cautious

		Price, Rs	
Company	**Rating**	**8-Apr**	**Target**
Hindalco	ADD	170	225
NALCO	REDUCE	432	400
Tata Steel	REDUCE	656	800
Hindustan Zinc	ADD	532	1,000
JSPL	ADD	1,813	2,900
Sterlite	ADD	777	1,000
Sesa	ADD	2,862	3,700
JSW	ADD	738	1,040

Coking coal price contracts—negotiations

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- **Arcelor-Mittal agrees to a 220% increase in contract prices of coking coal with BHP; much higher than our estimate of a 100% increase**
- **JSPL least impacted by cost escalation following (a) captive supply of iron ore, (b) 40% of production through secondary steel-making route using captive non-coking coal and (c) extant steel business valuations forms just 37% of SOTP-based valuations. Tata Steel and JSW Steel to be hit more.**
- **Too many moving variables—sector plagued by global and domestic issues**
- **Retain estimates and ratings for steel companies in India; reiterate JSP as our top-pick in the sector**

Arcelor Mittal has agreed to a 220% increase in coking coal price contracts for CY2008—higher than our expectations of 100%. We expect contracts for soft coking coal to be fixed on similar lines. We believe that JSP will be the least impacted as 40% of its total production is through secondary steel-making route using non-coking coal—Tata Steel and JSW will be hit hard. The many variables such as volatile steel prices and unpredictable government action (to curb inflation) make assessment difficult. We retain our earnings estimates and ratings for steel companies in India—JSP remains our top pick on account of its relative immunity to raw material price hikes.

Arcelor-Mittal has agreed to pay 220% increase in contract rates of hard coking coal to BHP, which is much higher than our estimates of 100% increase. We expect contracts for soft coking coal to follow a similar percentage increase. We had pointed out upside risk to our estimates in our report on coking coal dated Feb 26, 2008. We expect the contact settlement between Arcelor-Mittal and BHP to be accepted as a benchmark for all coking coal negotiations for the current year.

We estimate JSP to be the least impacted stock (on account of the dramatic increase in costs) following

- 100% access to captive iron ore for existing operations as well as for all future expansions
- 40% of its production being through DRI-EAF route of steel making, which allows JSP to use captive non-coking coal to convert into sponge iron and eventually into steel, and
- Valuation of its extant steel business in our SOTP-based valuation framework comprises just 37% of the target price

Our illustrative exercise on three steel companies under our coverage shows that Tata Steel and JSW Steel will have to increase realizations over US$180/ton to maintain operating margins (calculated per ton of steel produced), while JSPL will have to increase prices by just US$136/ton to retain operating margins.

Too many moving variables make assessment of earnings for steel companies extremely difficult (if not impossible). We list some of them below:

- **Highly volatile global steel prices; will likely correct in the second half of CY2008E.** At a price increase of US$200/ton and 1.3 bn tons of estimated production in CY2008E, global steel price increase will amount to US$260 bn. This is a huge increase, which consumers across the world may not be able to absorb considering already weak end-user markets in the NAFTA region, expectation of weakening market in European region and increasing exports from China in second half (following higher production as furnaces return to production in summers).
- **Unpredictable government action to curb inflation in India.** Rising inflation concerns have led to steel companies cutting domestic prices at a time when domestic prices stood at 15% discount to landed costs. Our expectations of the government cutting excise duty on steel (currently 14%) and recovering part of the loss to exchequer from taxing the export of iron ore, hasn't materialized as yet. Such 'nationalistic' considerations are yet another vagary in analysing the economics of India's steel businesses.

We retain our earnings estimates for the time being till we have more clarity on issues highlighted above. Amidst rising confusion, we reiterate JSP as our top steel pick and also believe that Sesa Goa (see our note dated April 8, 2008) provides attractive risk-reward proposition.

We believe the global situation (question over sustained increase in steel prices) is not any less severe than the domestic situation (government not allowing to raise prices) and do not assume (or model) that large global steel price increases can be passed on to final consumers for the full year. As a result, we do not recommend buying into Tata Steel's stock at this juncture, despite a 23% upside to our target price. In addition, we believe the consensus estimate of EBITDA growth for FY09E may be come under question with the new developments.

We retain our cautious view on the sector.

Illustrative increase in price required for FY2009E operating margins to be maintained

Cost push and price increase required to maintain margins for Indian steel companies, March fiscal year-ends

	Tata Steel (C)	JSW Steel	JSPL	Remarks
Total increase in costs ($ mn)	**4,567**	**739**	**286**	
FY09E coking coal purchase (mn tons)	14	2	1	
Increase in coking coal prices ($/ton)	202	190	202	
Pre-tax profit impact of coking coal ($ mn)	**2,788**	**420**	**186**	
FY09E iron ore purchase (mn tons)	28	6	-	
Increase in iron ore prices ($/ton)	34	27	-	
Pre-tax profit impact of iron ore ($ mn)	**930**	**169**	**-**	
Increase in other costs ($ mn)	850	150	100	Purchased coke, freight and other expenses
Combined tonnage sold (mn tons)	25	4	2	
Price increase required to offset cost push ($/ton)	**183**	**187**	**136**	

JSP's steel valuation forms just 37% of SOTP-based valuation, and requires lowest price increase to improve margins.

Note:

1. Tata Steel (C) stands for Consolidated numbers of Tata Steel
2. Break-up of usage of hard, soft and semi-soft coal not available for Corus Group
3. Lower increase in avg. per ton ore price following supplies from NMDC at lower rates

	Tata Steel (C)	JSW Steel	JSPL
SOTP-valuation (%)	**100**	**100**	**100**
Valuation of extant steel business	100	86	37
Valuation of other businesses	-	14	63

Note:

1. Valuation of other businesses in JSW Steel is conversion business in US and SISCOL value accretion
2. Valuation of other businesses in JSP is for its power business (33%) and value accretion in El-Mutun mine

Source: Company data, Kotak Institutional Equities estimates

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

	EBITDA		Multiple	Enterprise value	Enterprise value	EV	Vauation basis
	(Rs mn)	(£ mn)	(X)	(Rs mn) (e)	(USD mn) (e)	(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				-			December 2008E, adjusted for cash and marketable securities
Borrowings in Tata Steel Asia Holdings' account				-			
Borrowings in Tulip UK's account				-			
Senior debt at Tata Steel UK's account (d)				-			
Mezannine debt at Tata Steel UK's account (d)				-			
Total borrowings				**43,495**	**11,208**	**521**	
Arrived market capitalization				**1,062,031**	**16,430**	**764**	
Value of investments				**36,114**	**903**	**42**	
Market capitalization (including Investments)						**806**	
Target price (Rs)						**800**	

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: Kotak Institutional Equities estimates

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

	EBITDA (Rs mn)	Multiple (X)	Enterprise value (Rs mn)	Enterprise value (US$ mn)	Enterprise value (Rs/share)	Comment
FY2009E standalone EBITDA	38,264	7.0	267,846	6,696	1,333	
Less: standalone net debt of JSW Steel			(98,735)	(2,468)	(491)	FY2009E net debt, adjusted for cash and marketable securities
Standalone equity valuation (a)			**169,111**	**4,228**	**841**	
Add: US subsidiary FY2009E EBITDA	6,940	7.0	48,580	1,215	242	
Less: cost of acquisition of US subsidiary			(37,600)	(940)	(187)	
Value accretion on acquisition (b)			**10,980**	**275**	**55**	
FY2009E SISCOL EBITDA	3,703	7.0	25,918	648	129	Non-integrated plant; similar multiple of JSW assumed
Less: SISCOL net debt			(8,000)	(200)	(40)	Post expansion debt assumed
Value accretion on SISCOL acquisition (c)			**17,918**	**448**	**89**	
Arrived market capitalization (a+b+c)			180,091	4,950	985	
Target price (Rs/share)					**1,040**	

Source: Kotak Institutional Equities estimates

Jindal Steel and Power, SOTP-based valuation, March 2009E (Rs mn)

	EBITDA (Rs mn)	Multiple (X)	Enterprise value (Rs mn)	Enterprise value (US$ mn)	Enterprise value (Rs/share)	Comments
Existing steel business			**166,424**	**4,161**	**1,081**	
Steel business (extant business)	27,788	7.2	200,075		1,300	
Less: Net debt of steel business			(33,651)		(219)	FY2009E net debt, adjusted for cash
Stake in Jindal Power (100% holding)			**148,542**	**3,714**	**965**	
First 1000 MWs (250 MWs already commissioned)					694	1-yr forward DCF-to-firm basis, including 800 MWs sale on spot basis for 7 years
Incremental 1320 MWs on existing mine					154	1-yr forward DCF-to-firm basis. Levelized tariff of Rs2.25/unit assumed on commissioning
Additional 1500 MWs on coal mine allocated in Jharkhand					117	Assuming JSP can set-up incremental 1500 MWs new mines allocated in Jharkkhand
Value accretion from development of El Mutun, Bolivia (note 1, 2)			**133,801**	**3,345**	**869**	DCF-to-firm basis, assuming 50% probability of investments fructifying
Arrived market capitalization			**448,766**	**11,219**	**2,915**	
Target price (Rs/share)					**2,900**	

Notes:

1. Based on our assumption of extraction of 15 bn tons of iron ore extraction over FY2026 and based on long term iron ore prices of US$35/ton.
2. We apply a factor of 20% to discount cash flows and assume just 50% probability of completion of commissioning of the project.

Source: Kotak Institutional Equities estimates

Consumer products

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**8-Apr**	**Target**
Hindustan Unil	ADD	248	230
ITC	BUY	208	250
Nestle India	ADD	1,558	1,560
Colgate-Palmo	ADD	428	455
SmithKilne Cor	ADD	597	650
Asian Paints	ADD	1,185	1,110
Jyothy Laborat	BUY	651	900
Lakshmi	OP	198	338
Tata Tea	BUY	889	1,100
Godrej Consun	ADD	126	140

Palm oil prices correct over 25%—potential respite for HUL and Godrej Consumer

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- **Palm oil prices and variants have corrected about 25% in the past month**
- **Companies use palm variants of crude palm oil, palm stearin, palm fatty distillate acid and palm kernel oil for soap manufacture**
- **Likely respite for HUL & Godrej Consumer while rolling over forward commodity contracts**
- **Competitive activity likely to increase as ITC goes national with the soap portfolio launch**

Palm oil prices have corrected by about 25% in the past month. However, the prices are up about 50% and 110% in the past year and two years, respectively. It is likely that HUL and GCPL took forward covers in 2007 (effective till March 2008) which helped them maintain margins. We estimate palm oil commodity contract roll-overs at 25-30% higher prices yoy. The lower palm prices will help companies to hold the price line as the category was facing flat volumes over the past year. This will likely aid companies to retain margins, bring back volumes and prevent downtrading. Competitive activity is likely to increase as ITC goes national with the soap portfolio. We like ITC's strategy of launching a portfolio of soaps covering the entire pyramid. We believe that soaps category falls under the 'portfolio purchase' consumer behavior and it is imperative for any player with long-term ambitions in the category to have product offerings covering the whole spectrum of consumers. We reiterate our BUY rating on ITC and ADD on HUL and GCPL.

Palm oil prices have corrected about 25% in the past month, still up 50% yoy

We believe the recent softening of palm prices is a positive development for Hindustan Unilever (HUL) and Godrej Consumer (GCPL). Prices of palm oil and variants have corrected by about 25% from the peak touched on March 4, fuelled by speculation that China may impose price controls on edible oil and that the regulatory risk in Indonesia is rising. However, the prices are up about 50% and 110% in the past one year and two years, respectively. We believe the key palm variants used by HUL and GCPL are crude palm oil, palm stearin, palm fatty distillate acid and palm kernel oil. Typically, companies use a combination of palm oil variants for manufacturing distilled fatty acid which is in turn used for soap manufacture. The prices of these variants have corrected by about 25% in the past month.

We estimate palm oil commodity contract roll-overs at 25-30% higher prices yoy

The lower palm prices will help companies hold the price line as the category was facing flat volumes over the past year. This will likely aid companies to retain margins, bring back volumes and prevent downtrading. We estimate soap sales to contribute about one-fifth and two-thirds to HUL and GCPL FY2009E sales, respectively. We estimate palm oil to constitute 35-40% of soap sales and about 70% to total cost. Significant price increases, possible formulation adjustments and cost efficiencies have likely helped the players maintain margins when faced with hyper-inflation in the key input. The benchmark retail price of Lux 100g SKU has gone up over 20% in the last 1.5 years to Rs17 from Rs14. Anticipating further cost escalations, HUL has increased the prices of all soap brands except Breeze (we estimate Breeze to contribute less than 10% of HUL soap sales) in February 2008. We believe HUL and GCPL likely had forward covers taken in 2007 (effective till March 2008) which helped them maintain margins.

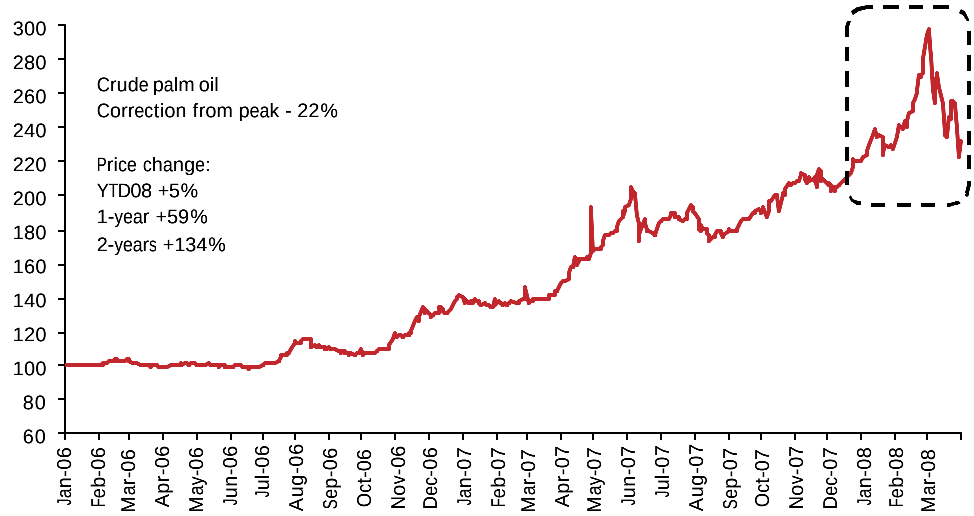
Competitive activity likely to increase as ITC goes national with the soap portfolio, reiterate BUY on ITC, ADD on HUL and GCPL

ITC has recently entered the soap category with a portfolio offering covering each price segment. It has launched 'Superia' at the low end (<Rs10/100g), 'Vivel' and 'Vivel Di Wills' at the mid-segment (Rs16-20/100g) and 'Essenza Di Wills' at the top end (>Rs25/100g). We like ITC's strategy of launching a portfolio of soaps covering the entire pyramid. We believe that its soaps category falls under the 'portfolio purchase' consumer behavior and it is imperative for any player with long-term ambitions in the category to have product offerings covering the whole spectrum of consumers.

We believe ITC is well placed to make a strong entry into HUL's soap citadel with its soap portfolio offerings. We reiterate BUY on ITC (+17% upside), ADD on GCPL (+11% upside) and HUL (8% downside).

Palm oil and variants - prices have corrected significantly in March and April 2008

Crude palm oil prices (indexed to base)



Source: Bloomberg, Kotak Institutional Equities.

Prices of most palm oil variants have corrected in March/April 2008

	Price change (%)			
Palm oil variant	**Correction from peak**	**YTD 08**	**1-year**	**2-years**
Crude palm oil	(22)	+5	+59	+134
Palm stearin	(24)	+1	+49	+111
Palm fatty distillate acid	(26)	(21)	+26	+64
Palm kernel oil	(15)	+1	+62	+106

Note: Correction from peak prices touched on 4th March 2008

Source: Bloomberg, Kotak Institutional Equities.

HUL effected signifant price hikes in all major soap brands in 2008

Price increases in YTD CY08

Soap brand	Price increase (%)	Contribution to CY2008E revenues (%)
Lifebuoy	10	
Liril	13	
Lux	10	
Rexona	11	
Hamam	9	
Dove	12	
Total soaps	**11**	**18**

Source: Kotak Institutional Equities.

HUL: Profit model, balance sheet, 2005-2009E, December year-ends (Rs mn)

	2005	2006	2007	2008E	2009E
Profit model (Rs mn)					
Net sales	110,605	121,034	137,178	154,745	174,811
EBITDA	**14,433**	**16621**	**18857**	**22239**	**26278**
Other income	3,048	3,545	4,627	4,417	4,767
Interest	(192)	(107)	(255)	(208)	(58)
Depreciation	(1,245)	(1,302)	(1,384)	(1,528)	(1,697)
Extraordinary items	976	3,155	1,581	-	-
Pretax profits	17,021	21,912	23,426	24,920	29,290
Tax	(2,530)	(2,950)	(3,812)	(4,531)	(5,850)
Deferred taxation	(410)	(268)	(359)	(364)	(385)
Net profits	**14,081**	**18,694**	**19,255**	**20,026**	**23,055**
Earnings per share (Rs)	**6.0**	**7.0**	**8.0**	**9.2**	**10.6**
Balance sheet (Rs mn)					
Total equity	23,056	27,235	17,193	18,276	19,524
Total borrowings	569	726	726	726	726
Currrent liabilities	41,183	45,231	54,205	57,338	64,609
Total liabilities and equity	**64,809**	**73,191**	**72,124**	**76,341**	**84,858**
Cash	3,550	4,169	4,682	4,299	7,396
Current assets	24,080	27,527	31,309	34,961	39,259
Total fixed assets	14,835	15,110	16,248	17,559	19,068
Investments	20,142	24,139	17,999	17,999	17,999
Deferred tax asset	2,201	2,245	1,886	1,523	1,137
Total assets	**64,809**	**73,191**	**72,124**	**76,341**	**84,858**

Source: Kotak Institutional Equities estimates.

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

	2006	2007	2008E	2009E	2010E
Profit model (Rs mn)					
Net sales	6,997	9,532	11,033	12,313	13,746
EBITDA	**1,412**	**1,797**	**2,122**	**2,316**	**2,577**
Other income	72	66	81	350	322
Interest	(65)	(135)	(94)	(67)	(46)
Depreciation	(115)	(142)	(185)	(204)	(254)
Extraordinary items	20	99	0	0	0
Pretax profits	1,325	1,684	1,923	2,394	2,600
Tax	(113)	(243)	(274)	(340)	(404)
Net profits (reported)	**1,212**	**1,440**	**1,649**	**2,054**	**2,196**
Earnings per share (Rs)	**5.3**	**5.9**	**7.3**	**8.0**	**8.5**
Balance sheet (Rs mn)					
Total equity	787	1,220	2,049	6,863	7,851
Total borrowings	687	1,736	1,147	335	335
Currrent liabilities	1,885	2,617	2,774	3,108	3,431
Deferred tax liability	66	80	86	101	101
Total liabilities and equity	**3,426**	**5,653**	**6,056**	**10,407**	**11,718**
Cash	263	475	1,098	1,743	2,584
Current assets	1,451	2,300	2,212	2,514	2,919
Total fixed assets	850	1,992	1,985	2,229	3,144
Investments	10	0	727	3,887	3,037
Goodwill	851	886	35	35	35
Total assets	**3,426**	**5,653**	**6,056**	**10,407**	**11,718**

Source: Kotak Institutional Equities estimates.

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Kotak Institutional Equities Research coverage universe

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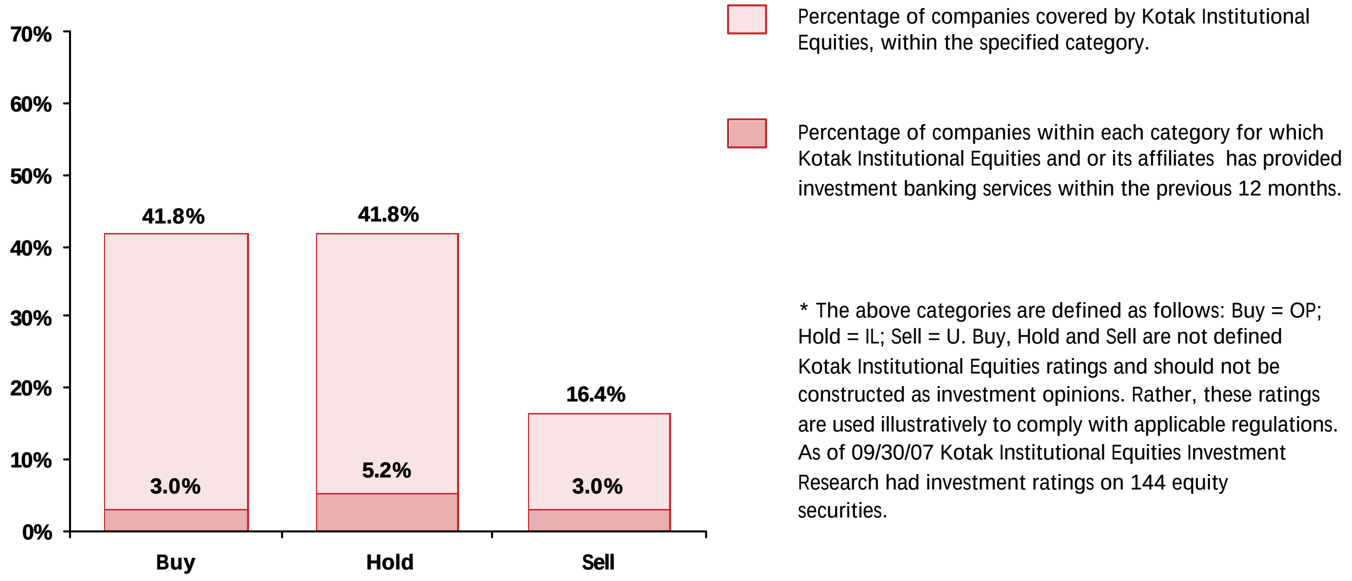

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 09/30/07 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

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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

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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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