The Front Page

February 6, 2008

• What's Inside: India Cement Sector

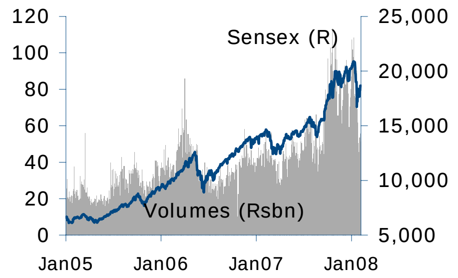
Market Front Page

Index Movements	Closing	% Chg	% YTD
Sensex	18,663	0.0	(8.0)
Nifty	5,484	0.4	(10.7)
BSE Smallcap	10,467	1.0	(21.6)
CNX Midcap	7,609	0.8	(17.3)
Nasdaq	2,310	(3.1)	(12.9)
DJIA	12,265	(2.9)	(7.5)
IBOV	61,080	2.7	(4.4)
FTSE	5,868	(2.6)	(9.1)
CAC	4,777	(4.0)	(14.9)
Turnover		US$m	% Chg
BSE		1,299	(7.6)
NSE		3,116	(10.5)
Derivatives (NSE)		7,893	(22.6)
FII F&O (US$m)		Index	Stocks
Net buying		105	(90)
Open interest		8,093	7,575
Chg in open int.		154	149
Equity Flows (US$m)	Latest	MTD	YTD
FII (4/2)	945	1,201	(3,070)
MF (4/2)	208	200	2,122

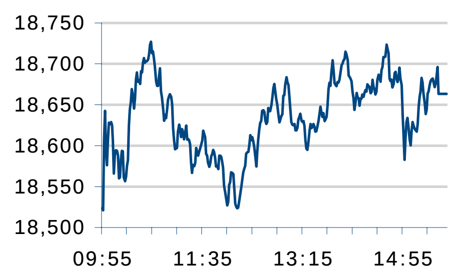
ADR/GDR (US$)	Latest	% Chg	% Prem
HDFC Bank	110.9	(5.5)	(3.5)
Reliance	130.8	(0.6)	(1.2)
Infosys	39.9	(6.7)	(2.2)
Satyam	24.3	(6.5)	9.9
Wipro	11.9	(6.2)	3.8
ICICI Bank	57.7	(4.5)	(4.0)
SBI	113.8	(1.9)	1.0
ITC	5.1	(2.1)	(1.4)
Commodities	Latest	%Chg	%YTD
Gold (US$/ounce)	887	0.1	6.4
Crude (US$/bl)	89	(0.2)	(5.3)
Aluminium (US$/MT)	2,598	(1.2)	10.5
Copper (US$/MT)	7,202	(1.3)	7.9
Forex Rates	Closing	% Chg	%YTD
Rs/US$	39.4	0.1	0.1
Rs/EUR	58.4	0.0	0.5
Rs/GBP	77.7	0.3	(1.3)
Bond Markets		Closing	bps Chg
10 yr bond		7.5	0.0
Interbank call		6.6	(8.0)

Charts Front Page

Sensex price volume trend



Sensex intraday



Corporate Front Page

- **HCL Tech** is close to clinching a US$1bn outsourcing contract from a European telecommunications company. **(BS)**
- **L&T** wins Rs18.1bn project to build Seawood station in Navi Mumbai. **(ET)**
- **TCS** has asked 500 people to leave the company on performance related issues. **(ET)**
- **Reliance Communications** to provide CDMA services in Assam and North-East India. **(FE)**
- **Hero Group** is in negotiations with French car major PSA Peugeot for a possible alliance for passenger cars. **(ET)**
- **Tata Power Company's** JV, Maithon power, has raised Rs31.2bn in debt to finance its 1,050MW power project. **(ET)**
- **JSW Steel's** steel production in January 2008 grew 13% to 0.29 mn tones. **(FE)**
- **Canara Bank**, **Corporation Bank** and **Allahabad Bank** have decided to lower interest rates on housing loans. **(BS)**
- **L&T** expects sales to reach US$2bn in the Gulf region in the next two years. **(BS)**
- **Reliance Communications** to test-launch its DTH services, Big TV, this week. **(BS)**
- **BPCL** owned Bharat Oman Refineries Ltd is likely to come with an IPO next financial year. **(DNA)**
- **Maruti Suzuki** denies low-cost small car plans. **(ET)**
- **BPCL**, Nandan Bio and Shapoorji Pallonji to form a JV for producing bio-diesel in Uttar Pradesh. **(FE)**
- **GMR Infra** to de-link its real estate project from the Delhi-airport upgrade plan. **(BS)**
- **GMR Infra** plans to bid for modernization of Prague airport. **(DNA)**
- **Indiabulls Real Estate** is planning a US$1.2bn IPO for its property trust on the Singapore stock exchange. **(BS)**

Market Front Page

Top Movers BSE 200

Top Gainers	Price (Rs)	Chg (%)	YTD (%)	Top Losers	Price (Rs)	Chg (%)	YTD (%)
Jindal Steel & Powe	2586	13.3	-15.8	Hero Honda	727	-5.6	4.2
Neyveli Lignite	167	12.1	-35.0	Indiabulls Real	650	-4.2	-12.9
Sobha Developers	869	8.7	-4.8	Gujarat Fluoro	270	-3.4	-22.4
IFCI	67	7.5	-28.5	Crompton Greave	315	-3.4	-20.4
CESC	565	7.0	-10.1	Bharat Elec.	1562	-3.1	-25.7

Volume spurts

Company	CMP	M.Cap	Vol. (in '000)	10D A.Vol (in '000)	% Chg
Glenmark Pharma	496	3,124	1,215	257	372
Neyveli Lignite	167	7,110	6,116	2,009	204
Reliance Comm	677	35,438	6,068	2,297	164
Rolta India	316	1,284	1,367	520	163
Torrent Power	184	2,203	779	303	157
Jindal Steel & Power	2586	10,099	749	296	153
Patni Computer	270	951	234	95	147
Ultratech Cement	899	2,838	80	34	136
Cipla	203	4,001	619	268	131
Sobha Developers	869	1,606	32	14	126

FII - FII trades

Scrip	2/4/2008			2/5/2008		
	Volume '000	Price	Prem %	Volume '000	Price	Prem %
Tata steel	626	841	3.0	1,599	822	3.0
Sbi	35	2,391	6.0	170	2,448	8.0
Sesa goa	-	-	-	98	3,454	5.0
Grasim inds	61	3,171	1.0	12	3,110	0.5
Canara bank	576	315	1.0	100	320	1.0
Andhra bank	-	-	-	200	97	1.0
Allahabad bank	-	-	-	500	122	2.0
Pantaloon	-	-	-	71	641	9.0

Corporate Front Page

- **Suzlon Energy's** Australian unit wins an order for supplying 27 wind turbines. **(DNA)**
- **Crisil**, Equifax and Tata Capital to set up a credit information company providing credit histories and checks on retail borrowers. **(BS)**
- **UB Group** is planning to foray into development of luxury retail stores. **(FE)**
- **Petronet LNG** awards US$250mn contract to a Japanese group for building two LNG gas storage tanks at Kochi. **(BS)**
- **Mercator Lines** is planning to expand its business portfolio with an investment of around Rs60bn over next few years. **(FE)**
- **Aurbindo Pharma** gets nod from US FDA for generic version of Fluoxetine. **(BS)**
- **Maytas Infra** sells minority equity to Infinite India Investments for Rs6bn. **(ET)**

Economy Front Page

- FM approves the proposed increase in the price of petrol and diesel by Rs2/litre and Re1/litre respectively. **(FE)**
- TRAI is set to allow FM radio channels to broadcast news and current affairs. **(ET)**
- Direct tax collections jump 40% to Rs2,185bn in the first ten months of the fiscal. **(ET)**
- FM likely to prod banks to lower interest rates in his February 12 meeting with banks chiefs. **(ET)**
- Steel imports rise 69% to about 5mn tons in the first nine months of the fiscal. **(BS)**
- Cement firms to appeal against MRTPC order of cartelization in Supreme Court. **(BS)**
- Government to soon finalize a plan for the proposed 1,000bn National Electricity Fund aimed at providing support to cash-strapped SEBs. **(BS)**

India Cement Sector

Capacity expansion to drive revenue growth | **6 Feb 2008** | **Industry Update**

With the pace of cement capacity additions expected to accelerate from 1QFY09, we expect a balanced demand-supply scenario to emerge in the next six months. We expect cement companies' realisations to remain firm for the next two quarters; any price fall thereafter on account of the supply tightness easing would be tempered by the rise in costs. We remain positive on cement companies adding substantial capacities, as we reckon their growing volumes will offset any price weakness. We are positive on Grasim Industries, Shree Cement, India Cements, Madras Cements and UltraTech Cement. We rate Kesoram Industries as Market Performer and recommend a Sell on ACC and Ambuja Cements.

Demand to pick up as busy construction season begins: Cement despatch growth has slowed down sharply in the past two months. The decline in November was confined largely to the eastern region, and was mainly due to the extended monsoon, frequent strikes, and the high-base effect of the previous year (when the busy festive season fell in October). As for the decline in December, we believe it was a blip due to a severe winter, and expect despatches to pick up from January-February as the busy construction season begins.

Supplies to increase, but we expect any price correction will be minimal: We expect about 35mtpa capacity to be added in the next 15 months despite delays in expansion projects, likely leading to an easing of the current supply tightness. Any price corrections in this period would likely be minimal, given rising production costs. Rising costs could result in losses for second-tier companies if prices fall more than 8-10%; hence, prices are unlikely to fall more sharply. The next three years could see a 52% increase in capacities (for comparison, production capacity increased 50% over the four years to FY97, but prices remained firm).

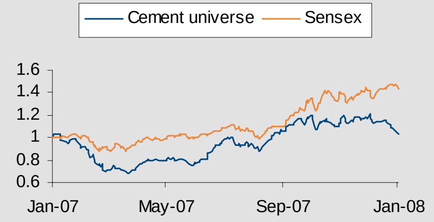
Imports pose no significant threat, given the firmness in prices across Asia: According to trade representatives of Pakistani cement companies, imports from Pakistan are unlikely to exceed 0.1m tonnes a month, given a shortage of rail wagons in that country and security restrictions at the Wagah border. Furthermore, sharp price increases in Russia make it an increasingly attractive market for Pakistani producers. Pakistani producers also have a cost advantage in the Middle East market, given the significantly higher transport costs of Indonesian and Thai producers.

Valuation matrix

	CMP (Rs)	Market cap (US$ m)	Rating	12 m Target (Rs)	Upside (%)	3m avg. liquidity (US$ m)	EV/EBIDTA (x) FY09ii	EV/EBIDTA (x) FY10ii	PER (x) FY09ii	PER (x) FY10ii
ACC	769	3,658	SELL	732	-5	2.9	7.7	8.4	12.1	13.7
Ambuja Cements	122	4,721	SELL	110	-10	1.2	7.9	8.8	13.7	14.1
Grasim Inds	2,979	6,922	BUY	3,492	17	1.7	4.8	4.6	9.2	9.8
India Cements	209	1,492	BUY	271	30	2.2	5.1	6.1	7.6	9.3
Kesoram Inds	479	555	MP	516	8	0.4	4.1	4.2	5.9	6.5
Madras Cements	3,900	1,194	BUY	4,649	19	0.4	5.6	5.5	8.6	8.4
Shree Cement	1,311	1,157	BUY	1,638	25	0.1	5.2	5.6	9.1	9.2
Ultratech Cement	899	2,837	BUY	1,014	13	1.0	6.9	6.7	10.6	10.9

Source: Bloomberg, IIFL Research

Performance of IIFL Cement universe vs Sensex



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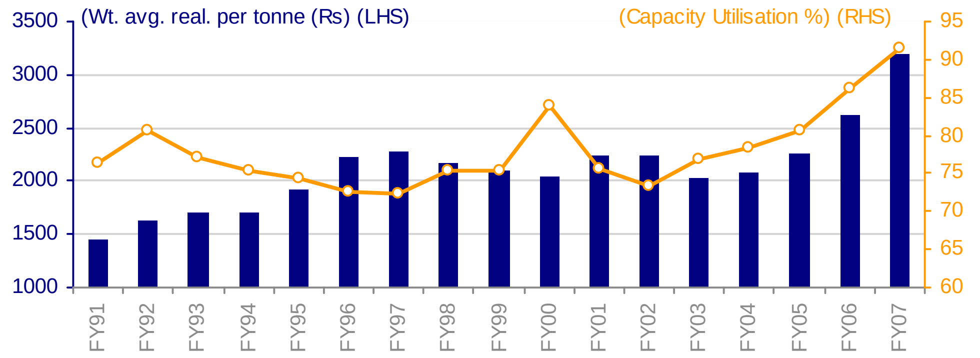
Supplies to increase, but realisations may not fall: Equipment suppliers have orders outstanding for capacities totalling about 90mtpa to be added by end-FY10. Equipment for about 70mtpa is to be delivered by March 2009. Of this 70mtpa, we reckon 26mtpa of capacity addition is likely to be delayed to FY10; 20mtpa is on schedule; 15mtpa is about 3-6 months behind schedule; and the remaining 9mtpa is likely to be delayed by more than 6 months. We expect about 35mtpa capacity to be added in the next 15 months, despite delays in expansion projects.

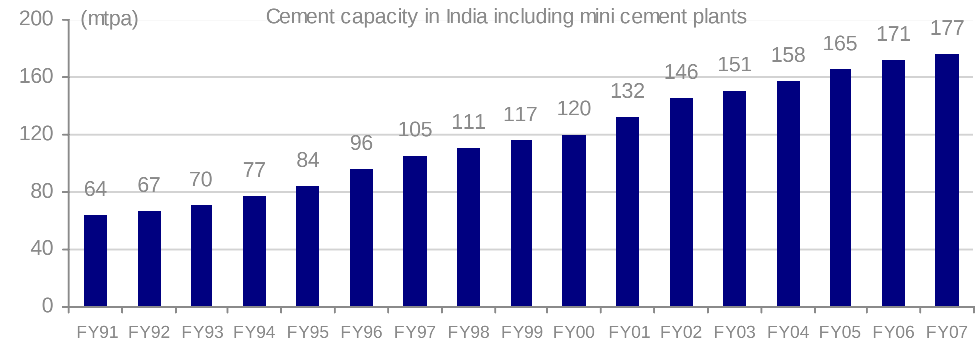
We expect these capacity additions to cause a shift from the current deficit to a balance by the second half of FY09. However, ramp-up of capacity utilisation is likely to be gradual. Firmness in international cement prices and a rise in power and freight costs would temper any price correction. Rising costs could result in losses for second-tier companies if prices fall more than 8-10%; hence, prices are unlikely to fall more sharply. The next three years could see a 52% increase in capacities (for comparison, production capacity increased 50% over the four years to FY97, but prices remained firm).

Figure 1: Cement realisations rose despite fall in capacity utilisation in last two cycles*



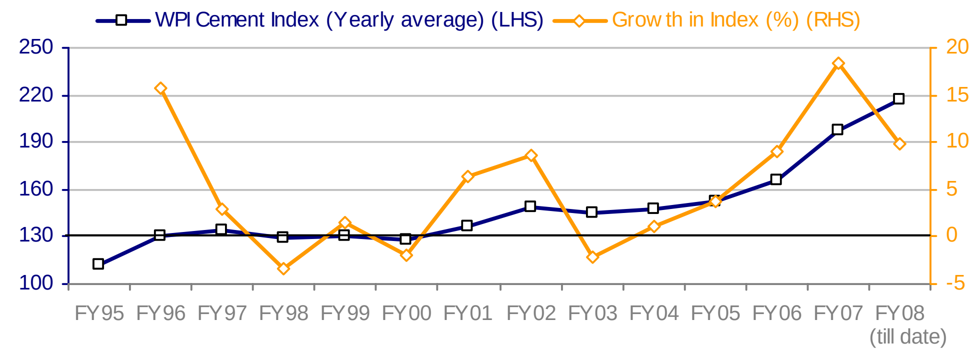
* Weighted average of 15 companies
Source: CMA, Companies, IIFL research

Figure 2: Cement capacity rose by 50% over FY92-97 and by 12% over FY04-07



Source: CMA

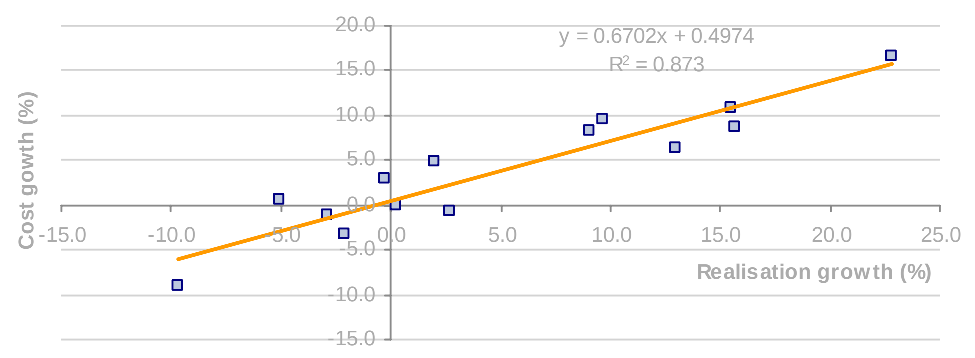
Figure 3: Steepest annual fall in cement price index (WPI) over the last 13 years is 3.5%



Source: Bloomberg, IIFL Research

Cement prices are influenced by cost trends: Historical data for the last 15 years shows that cost trends have a large bearing on Indian cement companies' realisations.

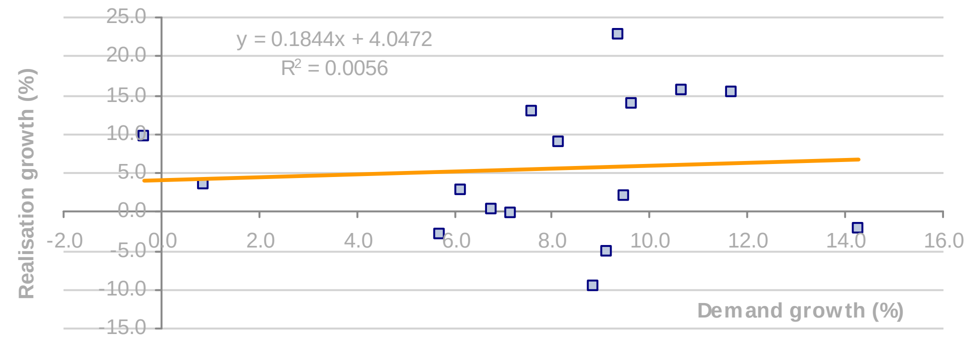
Figure 4: Strong correlation between cost of production and realisation*



*Data of companies dealing only in cement considered
Source: Industry, IIFL Research

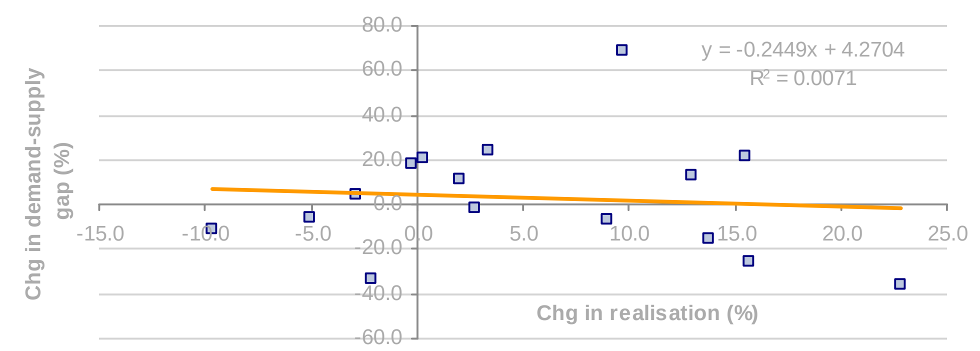
Realisations display no such correlation with demand growth or the demand-supply gap. Nor is there any inverse correlation between growth in capacity and rise in realisations; on the contrary, realisations fell sharply in FY03 despite demand growing faster than supply. Likewise, per-tonne EBITDA has also showed an inverse relation with changes in the demand-supply gap.

Figure 5: No correlation between demand growth and realisation increases



Source: Industry, IIFL Research

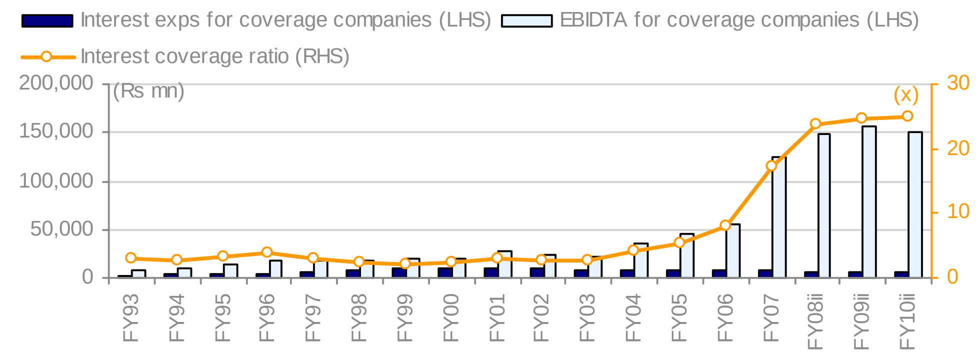
Figure 6: No inverse correlation between chg in supply-demand gap and chg in prices



Source: Industry, IIFL Research

Profitability in the last two cycles was depressed mainly because of high interest cost: In the last two cycles, most cement producers' capacity expansion projects were funded predominantly by debt. By contrast, most expansion projects at present are being funded by internal accruals (following two years of strong profit growth). This, in our view, would cushion cement producers' profitability. Companies with large expansion projects would remain relatively unaffected even if realisations were to ease.

Figure 7: Interest burden depressed profitability in the last two cycles



Source: Industry, IIFL research

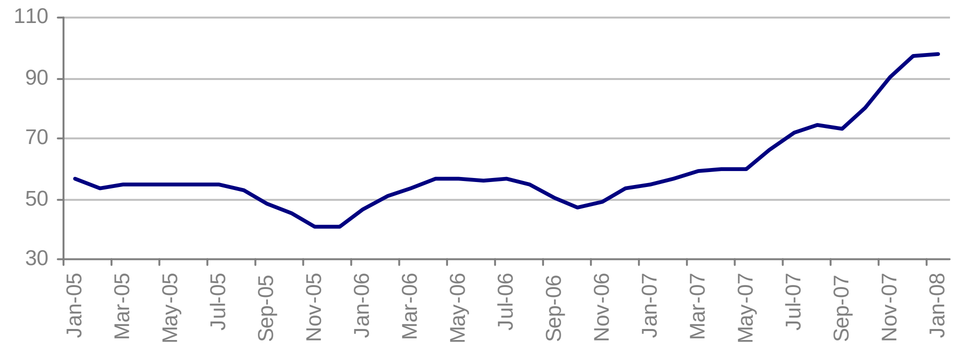
Imports pose no significant threat, given the firmness in prices across Asia: According to trade representatives of Pakistani cement companies, imports from Pakistan are unlikely to exceed 0.1m tonnes a month, given a shortage of rail wagons in that country and security restrictions at the Wagah border. Furthermore, sharp price increases in Russia make it an increasingly attractive market for Pakistani producers. Pakistani producers also have a cost advantage in the Middle East market, given the significantly higher transport costs of Indonesian and Thai producers.

FOB price of cement to India has remained steady at US$70/tonne despite four price hikes in the domestic Pakistan market since mid-November 2007. Prices in China, Indonesia and Thailand have also risen of late on account of cost increases. Pick-up in demand has induced leading Thai producers to increase their emphasis on domestic sales. However, the recent easing in international freight rates may induce an increase in imports by domestic consumers.

Dealer checks indicate higher price increase at retailer level in January: Cement producers raised prices in the southern region by Rs3-7/bag in the first week of January, after cutting them by Rs3-5/bag during the monsoon. Around mid-January, some producers partly rolled back price increases in Tamil Nadu. In the western region, producer prices rose by Rs3-5/bag since the beginning of January.
Retail prices rose by Rs5-10/bag in the southern and western regions since end-December. There were no price increases in the northern and eastern regions in the last two months. Dealers expect prices across regions to remain firm for the next 2-3 months, before easing around the monsoon.

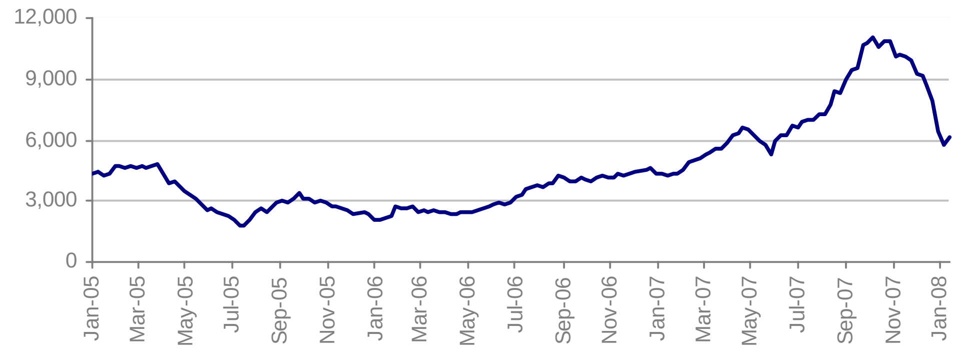
Cost pushes to dent margins: Coal India recently raised prices by 10%. On the positive side, the Coal Ministry increased linkages to cement producers to 21.4m tonnes, from 15.5m tonnes as at end-FY07. Coal prices in the international market have risen sharply in recent months. International freight costs have fallen 44% off their November 2007 peak. With the industry meeting nearly 40% of its coal requirement through imports or domestic spot-market purchases, we expect margins to fall, with pricing power likely to come down from 2HFY09. A rise in domestic freight rates also seems imminent, as the increase in international crude prices will have to be passed on some day. That said, we expect cement producers to pass on part of freight cost increases.

Figure 8: International coal price on the upswing (US$ per tonne FOB)



Source: Industry

Figure 9: Baltic dry Index



Source: Bloomberg

Figure 10: Company snapshots

Company	
Grasim (Buy)	• Cement capacity to increase by 50% in the next nine months; 70% of this addition would be in the next three months. • VSF capacity being expanded from 0.27mtpa to 0.34mtpa in the next three months. • High VSF prices expected to sustain going forward. • Captive power plant generating more than 350MW pa to be added in the next 12 months to control costs. • Robust volume growth and cost control to negate weakness in cement prices.
UltraTech Cement (Buy)	• Volume growth to pick up with cement capacity expansion in March 2008 (29% of existing capacity). • Costs to remain under control with 142MW CPP getting commissioned in phases from 4QFY08. • Cost control and improved volume growth to negate pricing weakness.
India Cements (Buy)	• Capacity being increased by 5mtpa (56% of present capacity) in the next 12 months • Present in supply deficit southern region. Pricing weakness not expected in the southern market till 3QFY09. • Buying two ships to reduce coal freight cost. • Improved volume growth with emphasis on cost control to negate pricing weakness expected from the end of FY09.
Madras Cements (Buy)	• Capacity being increased by 4mtpa (67% of present capacity) in the next 9 months. • Present in supply deficit southern region. • One of the low cost producers of cement in the country. • Robust volume growth to negate pricing weakness expected from the end of FY09.

Company	
Shree Cements (Buy)	• Increased cement capacity by 66% in the last 6 months and adding another 1.5mtpa capacity by 1QFY09 (20% of the present capacity). • One of the low cost cement producers in the country. • Robust volume growth to negate pricing weakness expected in the northern markets.
Kesoram Industries (MP)	• No cement capacity expansion in FY09. Tyre capacity to nearly double in FY09. • Stability in rubber prices coupled with improved outlook for auto industry to improve tyre segment margins. • Volume growth to be muted in FY09 in cement segment. No major cost reduction programme for the next two years. • Recent fall has made stock reasonable on valuation. Recommend Market Performer.
ACC (Sell)	• No major capacity addition in CY08. • 6mtpa capacity addition (20% of present capacity) to come through after 1QCY09. • Volume growth to be muted in CY08. No major cost reduction programme for the next two years.
Ambuja Cement (Sell)	• No major capacity addition in CY08 6mtpa capacity addition (35% of present capacity) to come through after 1QCY09. • Volume growth to be muted in CY08. Adding 150MW CPP in the next two years to control costs. • Exposure to northern markets and lack of presence in the southern markets a negative for the company in CY08.

Figure 11: Forthcoming cement plants

	Capacity (mtpa)	Expected date of commissioning	Location
North Zone			
Shree Cement	1.5	3QFY08	Ras
Ambuja Cement	1.0	3QFY08	Roorkee
Binani	3.1	3QFY08	Sirohi
Grasim	1.3	4QFY08	Dadri
Grasim	4.5	1QFY09	Shambupura
Grasim	4.4	2QFY09	Kotputli
Shree Cement	1.5	2QFY09	Ras
JP Associates	3.0	3QFY09	HP
JK Lakshmi	1.2	4QFY09	Sirohi
Ambuja Cement	1.5	2QFY10	Dadri
Ambuja Cement	1.5	3QFY10	Panipat
JP Associates	2.0	FY10	Chamba
North Sub-total	**26.5**		
West Zone			
Ambuja Cement	1.0	4QFY08	Surat
JP Associates	1.4	FY09	Kutch
Murli Agro	2.9	FY10	Chandrapur
Sanghi	4.0	FY10	Kutch
Century Textiles	2.0	FY10	Manikgarh
West Sub-Total	**11.3**		
Central Zone			
JP Associates	2.4	4QFY08	UP
Birla Corp	1.4	FY09	Satna
JP Associates	1.5	FY09	Rewa-Sidhi
Central Sub-total	**5.3**		
East Zone			
Lafarge	3.0	FY09	Sonadih
OCL	2.0	4QFY09	Orissa
ACC	1.2	1QFY10	Bargarh
Calcom Cement	1.3	FY10	Assam
East Sub-total	**7.5**		

	Capacity (mtpa)	Expected date of commissioning	Location
South zone			
Madras Cement	2.0	3QFY08	Jayanthipuram
India Cement	2.0	4QFY08	Multiple
Zuari	2.4	2QFY09	AP
Ultratech	4.9	1QFY09	Tadpatri
Madras Cements	2.0	2QFY09	Ariyalur
India Cements	1.0	2QFY09	Chennai
Penna Cement	1.6	3QFY09	AP
Rain Industries	1.1	3QFY09	AP
Dalmia Cement	2.3	3QFY09	Cuddapah
Sagar Cement	2.0	3QFY09	AP
India Cements	1.5	4QFY09	Malkapur
Deccan Cement	1.1	4QFY09	Andhra Pradesh
ACC	3.0	1QFY10	Wadi
JK Cement	3.5	1QFY10	Karnataka
Chettinad Cem	2.0	1QFY10	Tamilnadu
Kesoram Industries	1.5	1QFY10	Sedam
Dalmia Cement	2	1QFY10	TN
Orient Cement	1.8	1QFY10	Andhra Pradesh
Raghuram Cement	2	1QFY10	Andhra Pradesh
South Sub-Total	**39.7**		
All-India total	**90.2**		

Source: Industry, IIFL Research

Figure 12: All-India cement demand-supply scenario

	FY06	FY07	FY08ii	FY09ii	FY10ii
Effective cement capacity (mn ton)	150	157	168	208	245
Production (mn ton)	142	155	167	183	201
Capacity Utilisation (%)	94	99	99	88	82
Demand including exports(mn ton)	142	155	170	188	207
Demand growth (%)		9	10	10	10
Import	-	-	1	3	3
Possible production	150	157	165	194	232
As a % of demand	106	101	97	104	112
Surplus/(Deficit) over demand (mn ton)	9	2	-5	7	25

Source: CMA, Industry, IIFL Research

Key to IIFL recommendations:
BUY: Absolute return of > +10%
SELL: Absolute return of < -10%
Market Performer: Absolute return of -10% to +10%

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