IIFL

The Front Page

October 7, 2008

- **What's Inside: India Coal, Strategy (2QFY09 preview), Life Insurance, India Cements, Events calendar**

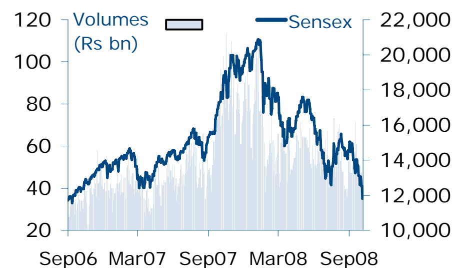
Market Front Page

Index Movements	Closing	% Chg	% YTD
Sensex	11,802	(5.8)	(41.8)
Nifty	3,602	(5.7)	(41.3)
BSE Smallcap	5,087	(6.9)	(61.9)
CNX Midcap	4,515	(5.8)	(50.9)
Nasdaq	1,863	(4.3)	(29.8)
DJIA	9,956	(3.6)	(24.9)
IBOV	42,101	(5.4)	(34.1)
FTSE	4,589	(7.9)	(28.9)
CAC	3,712	(9.0)	(33.9)
Turnover		US$m	% Chg
BSE		819	(17.0)
NSE		2,168	(12.8)
Derivatives (NSE)		9,872	2.9
FII F&O (US$m)		Index	Stocks
Net buying		(201)	(53)
Open interest		5,955	3,039
Chg in open int.		(238)	(218)
Equity Flows (US$m)	Latest	MTD	YTD
FII (3/10)	(259)	(330)	(9,555)
DII (6/10)	139	163	13,649
MF (3/10)	(72)	(41)	2,970

ADR/GDR (US$)	Latest	% Chg	% Prem
HDFC Bank	75.0	(12.8)	(0.6)
Reliance	66.9	(14.6)	(2.6)
Infosys	27.8	(5.9)	0.9
Satyam	14.1	(6.1)	14.7
Wipro	8.9	(1.9)	34.0
ICICI Bank	20.7	(9.3)	0.8
SBI	56.1	(10.5)	(6.4)
ITC	4.0	NA	NA
Tata Motors	6.6	(7.9)	0.0
Commodities	Latest	%Chg	%YTD
Gold (US$/ounce)	864	0.5	3.6
Crude (US$/bl)	88	(6.5)	(8.5)
Aluminium (US$/MT)	2,250	(3.8)	(6.6)
Copper (US$/MT)	5,560	(7.5)	(16.7)
Forex Rates	Closing	% Chg	%YTD
Rs/US$	47.5	0.6	20.4
Rs/EUR	64.5	(0.5)	10.9
Rs/GBP	83.4	0.4	5.9
Bond Markets		Closing	bps Chg
10 yr bond		8.1	(20.0)
Interbank call		11.5	(225.0)

Charts Front Page

Sensex price volume



Sensex intraday

Corporate Front Page

- **ONGC Videsh Ltd** is in talks with the Iranian government for exploring an oil block in the northern part of the country (BS)
- **Reliance Industries** and **NTPC** are willing to go for an out-of-court settlement to resolve their KG Basin gas dispute (BS)
- **Reliance Power** has sought another coal block near its Sasan UMPP in Madhya Pradesh (ET)
- **ACC** plans to set up hydropower plants (BS)
- **ONGC** to sign a MoU with State-owned Uranium Corporation of India for exploration and mining of uranium (BL)
- Gujarat is emerging as the favourite location to replace Singur for setting up of mother plant for **Tata Motors's** *Nano* (ET)
- Andhra Pradesh government offers Rs3bn to **Tata Motors** for relocating *Nano* plant from Singur and setting up the integrated plant (ET)
- **Dr Reddy's Labs** promoters may hike holding in the company further to enhance value for shareholders (ET)
- **SpiceJet** plans to send two-three aircraft from its fleet back to plane lessors by the end of this year before the leasing period comes to an end (BS)
- Rio Tinto and **Orissa Mining Corporation** are in talks to settle mining dispute (BS)
- **Vizag** port to invest Rs30bn for capacity expansion (BS)
- **SRM Energy**, a Spice Energy group, is planning to set up an 1,800-2,000MW coal-based thermal power plant in Cuddalore district of Tamil Nadu (BS)
- **D-Link India**, the listed arm of Taiwan-based D-Link Corporation, has approved the demerger of its Indian business (BS)
- **HCL Tech** seeks shareholder nod to borrow up to Rs40bn (BL)
- **PSL Ltd** commissioned its new facility set up by the company's subsidiary PSL North America LLC (PSL NA) at Port Bienville Industrial Park in the State of Mississippi (BL)

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Market Front Page

Top Movers BSE 200

Top Gainers	Price (Rs)	Chg (%)	YTD (%)	Top Losers	Price (Rs)	Chg (%)	YTD (%)
BPCL	380	1.9	-27.5	Praj Industries	93	-18.8	-61.3
Aurobindo Pharma	271	0.4	-50.1	Great Offshore	393	-17.9	-58.0
EIH	125	0.4	-32.4	Aban Offshore	1456	-16.5	-70.6
Vijaya Bank	35	0.0	-58.8	Sterlite Ind.	336	-15.4	-67.6
Colgate-Palmolive	394	-0.2	-3.0	JSW Steel	348	-15.4	-73.7

Volume spurts

Company	CMP	M.Cap	Vol. (in '000)	10D A.Vol (in '000)	% Chg
Container Corp	845	2,315	989	110	797
Glaxosmithkline	1155	2,062	214	32	573
Colgate-Palmolive	394	1,129	435	125	248
GTL	149	298	2,045	635	222
Praj Industries	93	360	3,798	1,313	189
Jindal Stainless	101	344	280	100	178
Glenmark Pharma	436	2,300	1,721	683	152
BEML	584	512	115	46	149
Thermax	367	923	92	38	141
Dr Reddy's Labs	476	1,686	865	361	140

FII - FII trades

Scrip	3/10/2008			4/10/2008		
	Volume '000	Price	Prem %	Volume '000	Price	Prem %
Tata steel	1,527	403	-	1,239	364	0.1
Sbi	353	1,510	0.7	236	1,462	0.7
Union bank	133	152	3.5	156	150	3.5
Obc	878	156	3.0	-	-	-
Grasim	42	1,760	0.5	2	1,625	0.5
Iob	-	-	-	19	88	3.0
Andhra bank	-	-	-	263	55	0.5

Corporate Front Page

- **Dish TV** to raise Rs11.39bn through allotment of shares on rights basis to the existing shareholders (FE)
- **Mudra Group** has launched a new event solutions unit, Celsius, which will focus on providing brand-related event management services (ET)
- **Sical Logistics** to rope in **MMTC India** as a 26% equity partner for its 12m-tonne iron ore terminal at Ennore (ET)
- **Larsen & Toubro Infotech** signs an agreement with Astea International Inc, which provides service lifecycle management and mobility solutions (FE)
- Quippo Telecom Infrastructure is set to strike a partnership with the hived-off tower arm of **Tata Teleservices** (ET)

Economy Front Page

- RBI cuts CRR by 50 basis points to ease liquidity (BS)
- Sebi rolls back P-Note curbs (BS)
- Net direct tax collections grew 32.5% in the first six months of FY09, slower than the 40% growth in the same period last year (BS)
- The National Pharmaceutical Pricing Authority (NPPA) has fixed ceiling prices of 79 medicines (BL)
- Government may soon allow 100% FDI in commodity broking business (ET)
- Government may consider special window to bring 49% FDI in defence sector (FE)

Insider Trading

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)	Shares Transaction (%)	Holding after Transaction (%)
Gujarat NRE Coke Ltd.	Marley Foods Pvt Ltd	1/10/2008	Buy	516,071	58.9	30	0.2	7.3
Gujarat NRE Coke Ltd.	Marley Foods Pvt Ltd	29/09/2008	Buy	433,740	59.0	26	0.1	7.1
Gujarat NRE Coke Ltd.	Mona Jagatramka	30/09/2008	Buy	200,000	61.1	12	0.1	1.2
Motherson Sumi Systems Ltd.,	Samvardhana Motherson Finance Ltd.	18/09/2008 - 26/09/2008	Buy	8,874,890	89.2	791	2.5	23.9
Reliance Industries Ltd	Bhumika Trading Private Ltd	3/10/2008	Buy	17,200,000	1,401.0	30,288	0.8	8.3
Reliance Industries Ltd	Anumati Mercantile Private Ltd	3/10/2008	Buy	34,700,000	1,401.0	61,105	2.1	5.3
Reliance Industries Ltd	Eklavya Mercantile Pvt Ltd.	3/10/2008	Buy	17,300,000	1,401.0	30,464	0.8	5.3
Reliance Industries Ltd	Bahar Trading Pvt. Ltd	3/10/2008	Buy	34,500,000	1,401.0	60,753	2.1	5.3
Reliance Industries Ltd	Ekansha Enterprises Pvt Ltd.	3/10/2008	Buy	16,300,000	1,401.0	28,703	0.7	5.3
S.Kumars Nationwide Ltd.	S. Kumars Enterprises (Synfabs) Ltd.	30/09/2008	Buy	6,376,195	43.4	276	2.9	6.7
Today's Writing Products Ltd.	Mr. Rajesh Kumar Drolia (HUF)	24/09/2008	Buy	504,000	52.5	26	3.9	12.0
Today's Writing Products Ltd.	Mr. Chirag Drolia	24/09/2008	Buy	300,000	52.5	16	2.3	3.4
Today's Writing Products Ltd.	Ms. Akriti Drolia	24/09/2008	Buy	300,000	52.5	16	2.3	2.9

Deal Size worth more than Rs10m considered

BSE/ NSE - Bulk Deals

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)
Raymond Ltd.	Citigroup Global Mkts Mauritius Pvt Ltd- Sell Code	6/10/2008	Sell	313,534	116.0	36
Strides Arcolab Limited	Dobliss Holdings Limited	6/10/2008	Sell	850,000	180.0	153
20 Microns Limited	Taib Sec Mauritius Ltd	6/10/2008	Sell	110,791	37.1	4
20 Microns	Taib Sec Mauritius Ltd	6/10/2008	Sell	71,267	37.6	3
Gwalior Chem	Morgan Stanley Mauritius Company Limited	6/10/2008	Buy	1,440,977	59.0	85
Gwalior Chem	Merrill Lynch Capital Markets Espana S.A. S.V.	6/10/2008	Sell	1,440,977	59.0	85
Pantal Retai	Fid Fund Mauritius Limited	6/10/2008	Buy	1,737,704	306.7	533
Pantal Retai	Deutsche Securities Mauritius Limited	6/10/2008	Sell	1,827,820	306.7	561

India Coal

Coal 'block' could weigh on growth

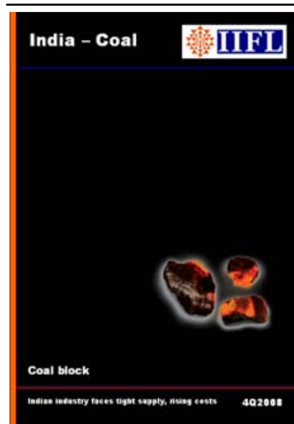
7 October 2008

Our new coal report, *Coal 'block'* highlights supply constraints to industries and power plants despite ample reserves of coal. The increasingly tight supply is evident from the increasing number of power stations with critically low levels of coal stocks, loss of production at Nalco, the country's second-largest aluminium refiner, and declining supply of coal under long-term supply agreement to cement companies. Miners are finding it difficult to accelerate production growth. A widened demand-supply gap would necessitate an increase in costly imports, putting industries' margins under pressure. Among non-utilities, the key sectors to be affected would be aluminium (Nalco, Hindalco) and cement (ACC, Ambuja, UltraTech). We have a reduce rating on all these stocks. In addition, coal-based power plants aggregating 46GW under construction will likely witness sub-optimal utilisation.

Production constraints point to bleaker supply outlook: Constraints in stepping up coal production are reflecting in ever tighter supply to multiple industries. The outlook is unlikely to improve in the medium term, as 95% of the incremental supply from Coal India Ltd has to be contributed by new mines (CIL contributes 83% of domestic supply). New mine projects are prone to delays associated with a plethora of clearances required and prickly relief & rehabilitation (R&R) issues. Nor does private mines' record so far inspire much confidence: of the 39 captive coal blocks allocated during FY93-03, only 14 had commenced operations by end-FY08. CIL's focus on increasing mechanisation is the only bright spot in an otherwise-dull supply outlook.

While demand growth accelerates: On the other hand, demand for thermal coal will rise at an annualised 9.6% over FY08-12, as compared to 7% over FY03-07. This growth in demand would be driven primarily by thermal-power capacity addition. Even after factoring in possible delays, we expect thermal power capacity addition in the 11th Five-Year Plan period (FY08-12) to be 44GW which is almost four-fold the 12GW thermal capacity added during the 10th plan. The entire capacity to be added during the period is under construction, with 42 months still left in the Plan period.

User industries face shrinking margins, sub-optimal utilisation: In the event of shortfall in domestic production, supplies to large non-utility coal consumers like aluminium, copper and cement companies would be cut before the utilities and SMEs are affected. The government plans to lower the threshold that triggers penalties for non-performance of supply contracts for such players from 90% of the assured quantity to 60%. Replacement of cheap linkage coal with costly imports would have a significant impact on margins of these companies. However, decline in international prices of coal could help soften the margin impact for these companies.

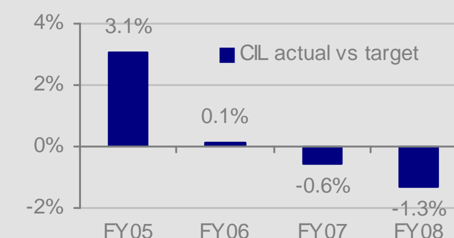


Potential EBITDA hit entailed by replacement of linkage coal by imports

(Rs/tonne)	Aluminum*	Cement
Coal India average prices	736	1,505
Imported coal average price (adjusted for calorific value)	4,300	4,300
Specific consumption of coal (x)	13.6	0.125
EBITDA per tonne	51,600	1,000
Incremental cost if 15% domestic coal replaced by imported coal	7,270	52.41
% decline in EBITDA per tonne	14.0%	5.2%

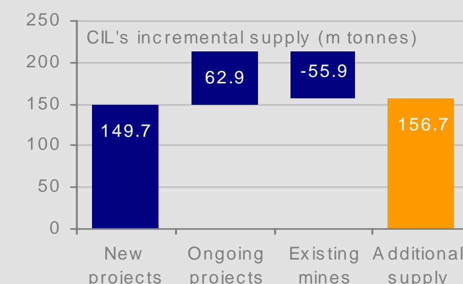
Source: IIFL Research, *based on Nalco numbers

CIL missing production targets



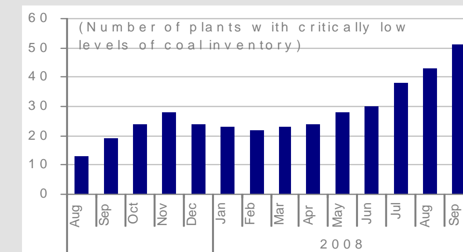
Source: CIL, IIFL Research

Supply targets look daunting



Source: Ministry of Coal, IIFL Research

Shortages already evident



Source: CEA, IIFL Research

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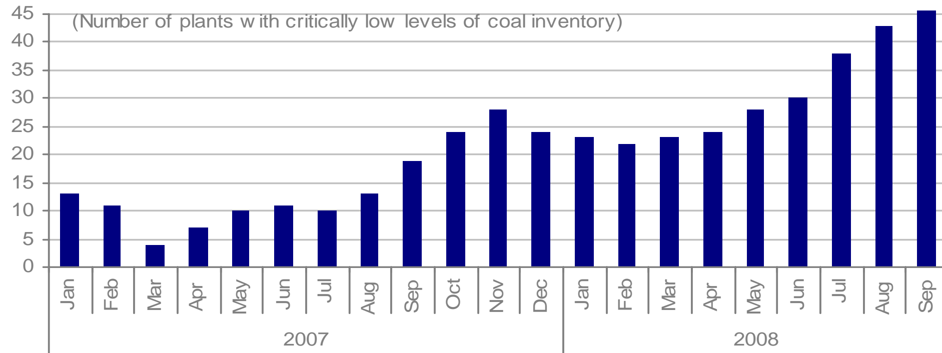
Supply tightness already visible

The number of thermal power stations with coal supplies at critically low levels (less than seven days' needs) rose sharply over the last 12 months, to 51 as at end-September 2008 from 19 a year ago.

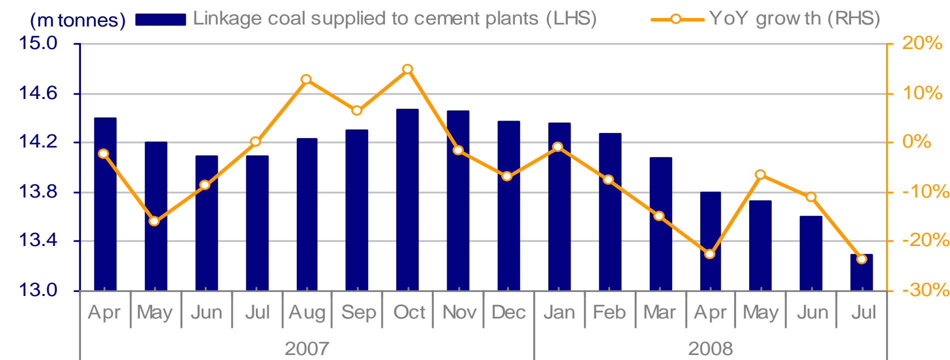
Figure 1: Number of power stations with critical coal supply is increasing



Source: Central Electricity Authority, IIFL Research

This is a good indicator of supply constraints faced by other user industries, considering that utilities enjoy preferential allocation of coal supplies. For instance, supply of linkage coal to Indian cement plants has declined over the last nine months.

Figure 2: Supply of linkage to cement plants has gone down



Source: Central Electricity Authority, IIFL Research

Government supply growth estimates are optimistic

The Planning Commission expects domestic coal production to increase from 430.8m tonnes in FY07 to 680m tonnes in FY12, based on estimated commencement of new mines.

Figure 3: Supply projections by FY12 (m tonnes)

	FY02	FY07	% increase	FY12E	% increase
CIL	279.7	360.9	29.1%	520.5	44.2
SCCL	30.8	36.1	17.2%	40.8	13.0
Others	17.3	33.8	95.0%	118.7	251.2
Total	**327.8**	**430.8**	**31.4%**	**680**	**57.8**

Source: Ministry of Coal, IIFL Research

When compared to our demand estimates, PCWG's (Planning Commission Working Group on Coal) projection of supplies by FY12 implies a shortfall of 114.2m tonnes, which would have to be met through imports. Metallurgical coking coal and non-metallurgical coal would account for 40.9m tonnes and 73.4m tonnes respectively of the imports. This is at variance to Planning Commission documents, which estimate the demand-supply gap for non-coking coal at a modest 10.3m tonnes.

Figure 4: 14.4% of India's coal requirement in FY12 would have to be imported

	Domestic production	Demand	Imports	Imports as % of demand
Metallurgical coking	27.7	68.5	40.9	59.6%
Non-coking + non-metallurgical	652.4	725.7	73.4	10.1%
Total	680.0	794.2	114.2	14.4%

Source: Ministry of Coal, IIFL Research

The actual demand-supply gap could be wider than our estimate; we are not sanguine about domestic production projections stated in the Plan documents. Government projections rely on:

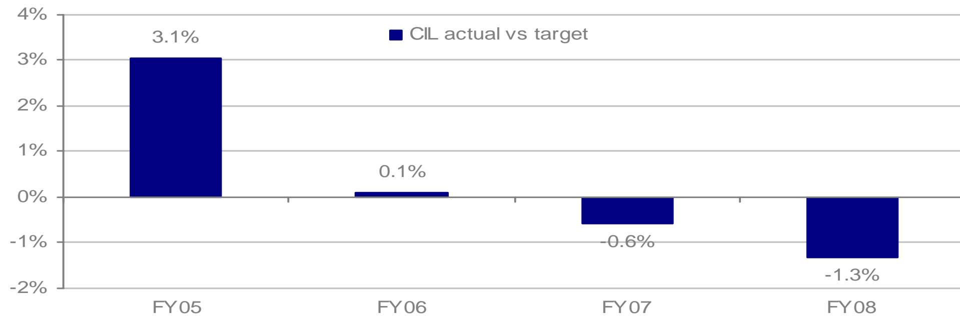
- significant acceleration in production growth from CIL (contributing almost four-fifths of domestic production)
- jump-start in production from captive mines

We have concerns on both assumptions.

The 10th Plan period initially set a production target of 405m tonnes for the terminal year of the 10th Plan period (FY07). This target was subsequently revised to 432.5m tonnes, as operational efficiency gains in existing mines enabled CIL to accelerate production growth in the earlier half of the Plan period. Actual production in FY07, however, was marginally below this target, at 430.8m tonnes, as it became tougher to extract further efficiency gains in the second half of the Plan period. This slippage is evident in the downtrend in achievement vis-à-vis the target over the last four years.

The key point to note is not the quantum of slippage in FY08, which is small (1.3%), but the fact that the target could not be achieved even after constant monitoring from the highest echelons of policy-making (the Prime Minister holds the Coal portfolio).

Figure 5: CIL's performance has slipped in recent years



Source: Ministry of Coal, IIFL Research

Given the downtrend in actual production vis-à-vis targets, prospects of acceleration in growth look dim. Plan documents factor in 7.6% CAGR in production in CIL over the 11th Plan period as compared to 5.2% CAGR achieved in the 10th Plan period. Actual production growth is trailing the targeted rate; in the first year of the 11th Plan period (FY08-12), CIL's production increased by 5.1% YoY. Production growth accelerated to 6.4% YoY in the first four months of the current fiscal (FY09)—faster than the 5.1% achieved in FY08, but still 6.7% short of the budgeted production of 120.8m tonnes in the first four months of FY09.

Large contribution of new mines decreases growth visibility

The fact that new projects are to contribute almost all of the incremental production over FY08-12 make these targets particularly onerous. Our conversations with industry sources and analysis of government documents suggest that pre-production stages of relief and rehabilitation (R&R) and forest clearances are increasingly hard.

Figure 6: 11th Plan incremental supply leveraged to new mines

CIL	FY07	FY120E*	Incremental	FY12RE*	Incremental
Existing mines and completed projects	241.8	186.0	-55.9	191.3	-50.5
Ongoing projects	102.4	165.3	43.3	186.7	64.7
New projects	19.6	169.2	169.2	142.5	142.5
Total	363.8	520.5	156.7	520.5	156.7

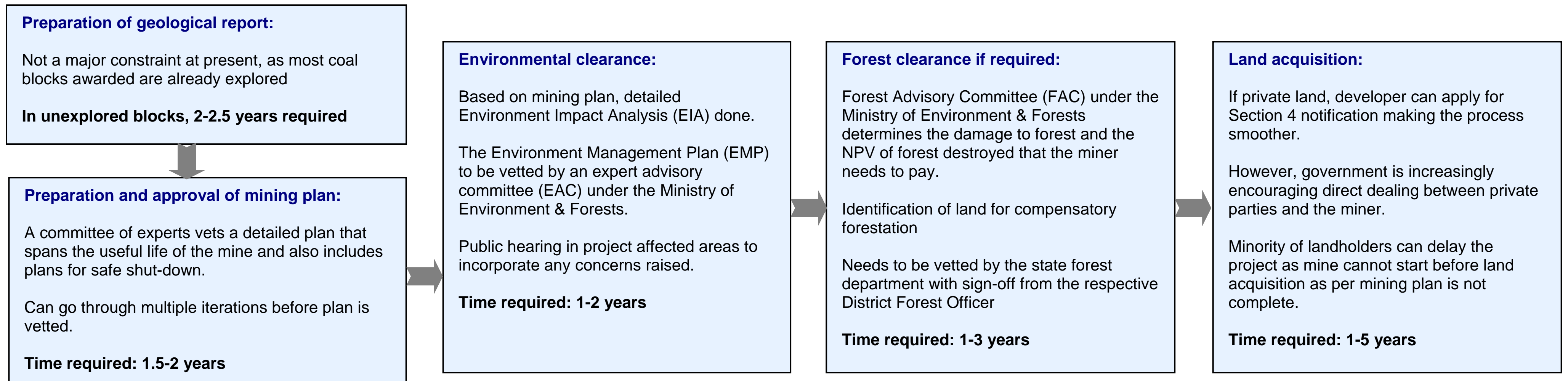
Source: Ministry of Coal, IIFL Research *E denotes original estimates, *RE revised estimates

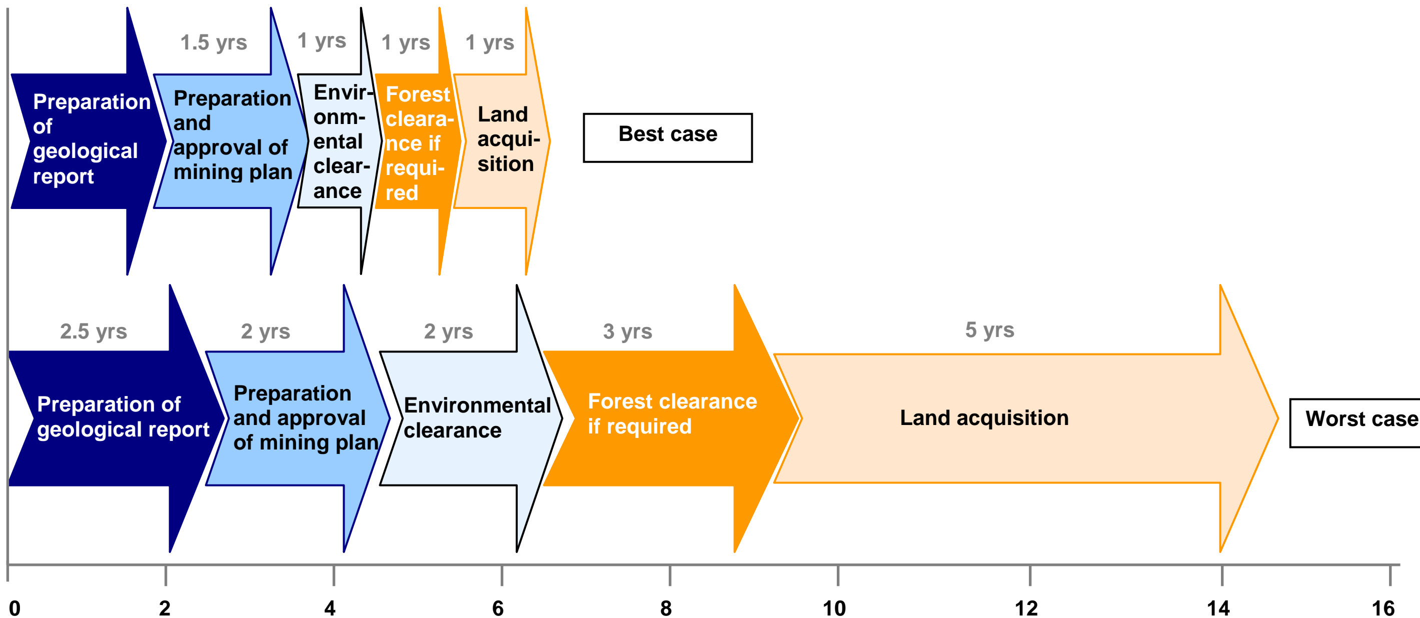
In the above table, note that CIL has trimmed its estimate of new projects' contribution to incremental production. This clearly indicates that the company is not sanguine about the new mines getting commissioned on time. CIL expects to bridge the shortfall through enhanced production from mature mines and faster ramp-ups in projects that are yet to achieve full production.

Obtaining approvals for a greenfield industrial site in India is cumbersome. Obtaining mining approvals is especially vexatious. An expert committee under the Ministry of Coal first vets a detailed mining plan before the process for other regulatory approvals can even start. The expert committee not only assesses the viability of the overall plan but also goes into finer details of the production plan. The process for obtaining environment clearance is similar to other industries. However, given forest cover in India's coal-bearing areas, most coal-mining projects require additional forest clearance. After all clearances, a developer has to grapple with land acquisition issues.

The key reason for delays in regulatory approvals is that approvals have to be obtained in a series; processes for the various approvals required cannot run concurrently. Based on discussions with industry experts, we reckon that obtaining the requisite approvals can take as long as five years. Time lines for land acquisition can vary significantly, depending on local issues.

Figure 7: Preparatory stages for opening new mines are time-consuming





Source: Ministry of Coal, IIFL Research

Environment and forest clearance is a huge challenge

There have been cases where new mine clearances have been pending with the Ministry of Environment & Forests for 3-4 years. Environment clearances at multiple levels—central, state and local—only delay the process. Even if a project is vetted by the Central Environment Ministry, the District Forest Officer has the final say.

Several PSUs and Ministry of Coal have made multiple representations to the Environment Ministry to clearly demarcate "no-go" zones so that plans are developed only for mines that have clear prospects of receiving the requisite proposals. For the allowed zones, coal officials have proposed a plan for standard compensation to be paid for afforestation initiatives. None of these initiatives has borne fruit yet; the Environment Ministry insists on case-by-case approvals. As such approvals are typically tardy, commissioning of new mines can be delayed by 2-3 years.

Most of India's coal reserves are situated in tribal areas. Until relatively recently, tribals seldom bothered to scrutinise R&R policies of coal companies and compensation paid was not linked to economic potential of the land acquired. Now, there is increasing political mobilisation among locals striving to link R&R compensation to economic potential of the mines. Higher compensation received by tribals in Meghalaya coal mines has had a demonstration impact. This could result in significant increase in start-up costs. A more vexatious issue is that locals want employment in the mines in addition to monetary compensation. Companies are ill-equipped to employ large numbers of locals, especially those with suspect job fit. Protracted negotiations over employment guarantee translate into further delays. Successful agitation against global majors like POSCO in Orissa has provided a fillip to grassroots political mobilisation in the neighbouring states of Jharkhand and Chattisgarh. The three states are the topmost coal producers in India.

India does not have a unified R&R policy; each state formulates its own policy. Delay in formulating R&R policy acts as another roadblock. For example, Jharkhand, the state with the largest coal deposits in India, has only recently finalised its R&R policy—but is yet to form the administrative machinery to implement the policy. Policy-making in the state had been paralysed in the absence of a stable government over the past couple of years.

Also, most PSUs and railways have their own internal guidelines on rehabilitation packages. Any incompatibility between these policies would need to be resolved before the R&R package is actually rolled out. The state governments might not share the Central government's urgency in accelerating growth in coal production. There are cases where delays have not been resolved even after direct intervention by the highest authorities.

Further area-wise analysis of incremental coal production in the 11th Plan period suggests significant challenges. Six areas under the PSUs would contribute almost half of the incremental capacity over the 11th Plan period. Of the six areas, the two in Orissa could face significant R&R issues, given the state's higher population density and mobilisation of tribals against land alienation. The two areas in Jharkhand could see significant law & order problems, as both areas are at the epicentre of Maoist insurgency currently affecting large parts of eastern, south-eastern and central India.

Figure 8: Incremental supply to be contributed by areas with significant local issues

Area	State	Incremental production in 11th Plan	Remarks
Singrauli	Madhya Pradesh	36.71	
North Karanpura	Jharkhand	23.8	Law & order problems
Talcher	Orissa	20.0	R&R can be an issue
Korba	Chattisgarh	18.0	
IB Valley	Orissa	11.4	R&R can be an issue
Rajmahal	Jharkhand	8.5	Law & order problems
Total		**118.4**	

Source: Ministry of Coal, IIFL Research

CIL has to acquire 67,000 hectares of land for the new projects to be commissioned during the 11th Plan period. Given the issues involved in acquisition of such large areas of land, there are grounds for concern on

potential slippages in planned capacity addition. Recent politicisation of land acquisition for other projects in coal-bearing states (such as the *Nano* car and Nandigram project in West Bengal and Posco steel project in Orissa) does not bode well for large land acquisition programmes. There have even been some violent agitations against land acquisition by large corporations.

Performance of captive units does not inspire confidence

To accelerate production growth, the government started allocating coal blocks to PSUs and private companies for captive consumption since the 1990s. After nationalisation of coal mines in 1972, only Coal India Ltd (CIL) and its subsidiaries were allowed to mine and sell coal in India. Later, a joint venture between the Central government and the Andhra Pradesh state government, Singareni Coal Company Ltd (SCCL) was allowed to commercially mine coal in the state. (See Annexure I for a detailed background of coal mining in India.)

11th Plan documents envisage 86.5m tonnes (35% of incremental capacity over FY08-12) to be contributed by new captive coal mines. However, performance of captive mines allocated till now does not inspire confidence. Of the 39 captive coal blocks allocated over FY93-03, only 14 had commenced operations by end-FY08.

Figure 9: Development of captive coal mines has been slow off the block

Coal blocks awarded during FY93-03	
No. of companies	27
Coal blocks allocated	39
Blocks where production had commenced by FY08	14
Blocks for which opening permission was granted	9
Commissioning expected by FY09-10	16

Source: Ministry of Coal, IIFL Research

Case studies of some captive blocks allocated

Case Study 1: CESC – private sector utility

CESC, the first private utility to be allocated captive coal in CY93, started coal production at Sarshatali coal mine in Burdwan district in West Bengal during CY02—nine years after the block was allocated. However, because of non-acquisition of total land requirement, it has not been able to reach peak-rated capacity of 3.1mtpa after eight years of operation. FY08 production stood at 2.75m tonnes. The company expects production to reach peak capacity by FY10 once forest land is handed over.

Case Study 2: NTPC – public sector utility

NTPC was allocated a mine at Pakri Barwadih in Hazaribagh district in Jharkhand in CY04. Land acquisition is currently under progress under the Coal Bearing Areas Act. The project has recently received forest clearance at the district level. Railway connectivity is still pending as Indian Railways has indicated that it might not be possible to evacuate coal till an important section, the Tori-Shivpur line is connected. Most likely, the Ministry of Coal would intervene to expedite railway connectivity.

Case Study 3: SAIL/IISCO – public sector steel producer

IISCO (subsequently acquired by SAIL) was allocated a mine at Tasra in Dhanbad district in Jharkhand in CY96 has not been able to start production after 12 years of coal block allocation. Mining Plan and Environment Management Plan have still not been approved and the entire land is still not acquired. This would be among the worst examples of project delays in the sector.

Case Study 4: IMFA group – ferro alloy and captive power producer

IMFA group through an SPV, Utkal Coal Ltd was awarded the Utkal-C coal mine in Angul district in Orissa in CY98. The end use projects, 108 MW coal fired power plant and ferro-alloy industries are operational. The project has been delayed due to forest clearance and land acquisition problems. Coal ministry is contemplating review of coal linkages to the end-use projects.

Case Study 5: Monnet Ispat & Energy Ltd

Monnet was awarded the Utkal-B coal mine in Angul district in Orissa in CY99. Land acquisition has still not been completed after nine years because of pending R&R issues.

Surge in coal block awards does not mean production is a given
There has been a significant acceleration in coal block awards in the last three years, increasing expectations that private initiative could infuse more vibrancy in the sector.

Figure 10: Coal block awards have surged in recent years

	Number of companies	Coal blocks allocated
1993-2003	27	39
2004	3	5
2005	16	24
2006	64	51
2007	57	55
2008	NA	31

Source: Ministry of Coal, IIFL Research

However, the five case studies involving companies across market cap, end-use and ownership spectrum indicate that performance on the ground is at odds with expectations. The results should not come as a surprise to policy planners; no regulatory changes have been enacted to solve the teething troubles faced by new mines. The same set of R&R and environment-clearance issues plague private coal blocks as well.

Productivity improvements could ease supply shortfalls

Given significant concerns on timelines for commissioning of new mines, enhanced production from CIL's existing mines is the key to meeting production targets. CIL has raised production targets for existing mines and reduced those for new mines. The company is betting on enhanced efficiency, increased mechanisation and outsourcing to help accelerate production growth in the existing mines.

Figure 11: Significant headroom to improve equipment productivity

(m cu m /year)	FY03	FY04	FY05	FY06	MoC benchmark	Intl benchmark
Shovel (10 cu. m)	1.48	1.63	1.72	1.73	2.08	4.14
Dragline (24/96)	4.16	3.11	3.3	3.16	3.45	N/A
Dragline (30/88)	4.23	4.21	4.12	4.75	4.38	N/A

*Excavator productivity data from SCCL mines
Source: Planning Commission, IIFL Research

Production data of excavators used in SCCL suggests there is significant room for efficiency gains in equipment used in Indian mines. More importantly, the level of mechanisation in Indian mines is much lower than global averages. Investments in heavy earth-moving machinery (HEMM) can help accelerate production growth in existing mines.

CIL is looking to introduce higher-rating 42cu m shovels and 270-tonne dumpers to increase productivity of mining operations. It is also investing in improved truck despatch systems to increase efficiencies. It has announced global tenders for operation of seven underground mines and plans to increase outsourcing of overburden removal. These steps could help accelerate production in existing mines.

CIL, together with its subsidiaries, currently has a cash balance of ~Rs240bn (US$5.3bn) with annual net profit run rate of ~Rs50bn (FY08 net profit stood at Rs52.4bn or US$1.2bn). The annual capex run rate is lower at ~Rs20bn (FY08 capex stood at Rs20.3bn or US$450m).

Figure 12: CIL has the financial wherewithal to step up capex

(Rs bn)	FY03	FY04	FY05	FY06	FY07	FY08
Production (m tonnes)	290.7	306.4	323.6	343.4	360.9	379.5
Gross sales	242.3	262.3	306.6	340.0	351.3	388.7
Net sales	204.0	219.0	258.6	287.0	296.0	326.3
Cost of production	163.9	171.8	190.8	203.3	221.9	251.0
Cost of production (Rs/tonne)	564.0	560.8	589.8	592.0	614.9	661.4
EBITDA	40.0	47.2	67.8	83.7	74.1	75.4
PBT	31.3	51.0	48.9	87.9	86.0	87.4

Source: Coal India Ltd, IIFL Research

CIL and five of its operating subsidiaries were Category I 'Mini Ratna' companies in CY07. PSUs of this category are free to incur capex up to Rs5bn a year without government approval, and can thus firm up investment plans relatively quickly. CIL has applied for Navratna status, the highest ranking that can be accorded to a PSU. Approval of the Navratna status would further increase the independence of CIL's board and increase its capacity to undertake much larger investment decisions.

In contrast to our concerns on CIL achieving its 520.5mtpa production target by FY12, the company's management remains confident it can significantly surpass its target to reach 575mtpa by FY12. This would translate to incremental production of 214m tonnes over five years, as compared to incremental production of 81m tonnes over the last Plan period and 18.6m tonnes in FY08.

In our view, it would be difficult to bridge the shortfall in production due to delay in commissioning of new mines through accelerated production in existing mines.

Figure 13: New projects face serious slippages

Company	Number of projects	Total capex outlay (Rs bn)	Ultimate capacity (m tonnes)	Projects on schedule	Projects delayed	% delayed
CIL	107	159.4	230.5	85	22	20.6
SCCL	28	24.0	39.4	25	3	10.7
Total	**139**	**183.4**	**269.8**	**110**	**25**	**18.0**

Source: Industry, IIFL Research

Demand growth to accelerate

We estimate demand for coal will rise by 60% over FY08-12, from 497m tonnes in FY07 to 794m tonnes in FY12, primarily driven by thermal-power capacity addition. Prospects of power capacity targets being met are much brighter in the 11th Five-Year Plan period (FY08-12) as compared to previous Plan periods. Almost the entire capacity to be added during the period is under construction, with 42 months still left in the Plan period. India's ample coal reserves would suggest that imports play only a marginal role in meeting domestic demand, but the increasing proportion of imports in the country's coal usage indicates that the supply response is lagging.

Figure 14: Coal demand growth to accelerate over FY08-12

(m tonnes)	FY02	FY07	Increase over FY03-07 (%)	FY12E	Increase over FY08-12 (%)
Power	240.0	326.5	36.1	542.9	66.3
Cement	17.0	20.4	20.2	32.3	58.1
Others	63.2	111.2	75.9	150.6	35.5
Thermal coal demand	**320.2**	**458.1**	**43.1**	**725.8**	**58.4**
Steel	34.1	38.8	13.7	68.5	76.5
Total coal demand	**354.3**	**496.9**	**40.3**	**794.3**	**59.9**

Source: CIL, IIFL Research

Coal demand from utilities to increase 66% over FY08-12

Utilities are the main consumers of coal in India, with offtake from the sector accounting for 71% of domestic production in FY08. As per government plans, India is likely to add 78.7GW power capacity during the 11th Plan period (FY08-12) and projects based on domestic coal account for 49.7GW of this proposed capacity.

Figure 15: Domestic coal accounts for 63% of FY08-12 proposed power capacity addition

Proposed source of fuel	Capacity addition (MW)
Domestic coal	**49,654**
Coastal projects (Imported coal)	4,300
Gas	4,289
Lignite	1,450
Total thermal	**59,693**
Hydro	15,627
Nuclear	3,380
Total addition in 11th Plan	**78,700**

Source: Ministry of Power, IIFL Research

Equipment ordering for the planned capacities is complete, with 42 months still left in the current Five-Year Plan period (FY08-12). This has raised expectations that there should be a step jump in achievement vis-à-vis targets as compared to the last Plan period, when less than 50% of the targeted generation capacity addition was attained. During the 11th Plan period, we expect 85% of coal-based capacity addition targets to be achieved, with ~8GW of capacities to be delayed by 6-12 months.

Figure 16: Ordering for 11th Plan capacity is complete

(MW)	Thermal	Hydro	Nuclear	Total
Central	21,430	8,654	3,380	33,464
State	23,201	3,482	-	26,683
Private	14,946	3,491	-	18,437
Total	**59,577**	**15,627**	**3,380**	**78,584**

Source: CEA, IIFL Research

Based on our calculations, the proposed increase in power generation capacity would require an additional 216m tonnes of coal supply per year.

Figure 17: Coal requirement for additional power capacity

	Unit	Value
Station heat rate	kcal per kwh	2,400
Calorific value of coal	kcal per kg	4,100
PLF	%	85
Coal requirement per MW	('000 tonnes / year)	4.4
Incremental coal requirement by FY12	**million tonnes/year**	**216.4**

Source: Ministry of Coal, IIFL Research

Coal consumption in captive power units registered a CAGR of 10.6% during the 10th Plan period (FY03-07). Government plans continue to lay emphasis on captive power capacity addition. Planning Commission estimates that coal consumption in captive power plants will grow at an annualised rate of 14% over FY08-12. Our estimate is more modest, a CAGR of 10.7% over the period, in line with our expectation of utilities' coal consumption. This would translate into incremental demand of 19.2m tonnes by FY12, representing ~4,000MW capacity addition during the period, as compared to coal-based captive power capacity of 9,081MW as at end-FY06.

The steel sector's total coal requirement works out to 68.5m tonnes/year by FY12, based on hot-metal production plan of 70.3m tonnes by FY12, according to various policy documents. That translates to incremental demand of 33.5m tonnes of coal by FY12 over FY07 demand of 35m tonnes. Domestic production of coking coal has declined from 13.3mtpa (million tonnes per annum) in FY99 to 7.6mtpa in FY08. Hence, most of the incremental demand would be met through increased imports. However, demand-supply balance in the steel sector is not important for our analysis, as the focus of this report is on thermal coal.

The cement sector is another important consumer of coal. As per Plan documents, annual cement production during the 11th Plan period should increase 61%, from 156m tonnes during FY07 to 251m tonnes during FY12. Driven by substantial technological improvements, average specific consumption of coal in cement plants has decreased from 0.154 in FY02 to 0.127 in FY07. We estimate coal requirement for incremental cement production at 11.9m tonnes by FY12.

Figure 18: Coal requirement for additional cement capacity

Cement production in FY07 (m tonnes)	156
Cement production in FY12 (m tonnes)	251
Incremental production (m tonnes)	95
Production CAGR	10.0%
Specific consumption of coal	0.125
Coal requirement (mtpa)	**11.9**

Source: Ministry of Coal, IIFL Research

Total thermal coal demand to increase 58% over FY08-12

We estimate other coal-consuming industries will drive incremental demand of 20.2m tonnes by FY12, as compared to 102.6m tonnes consumed in FY07 (assuming GDP growth of 7.5% and coal elasticity to GDP of 0.6).

Our bottom-up analysis for major consumers and top-down estimate for smaller consumers gives an estimate of 9.6% CAGR in demand for thermal coal and 9.8% CAGR in overall coal and coke demand.

User industries to face rising costs; lower utilisation

In the event of a shortfall in domestic production, supplies to large coal consumers such as metals and cement plants would be cut before supplies to SMEs are affected. The policy is based on the rationale that domestic production shortfall has to be met through imports and large players would have the wherewithal to procure foreign coal in economic

quantities, unlike SMEs, who might not be able to manage the logistics of coal imports. Supplies to large utilities would also be affected, but major non-utilities would be the first ones to bear the brunt.

The government plans to lower the threshold for penalty payment by PSU coal companies to cement companies from 90% of assured supply earlier to 60% now. Large coal users except utilities might not have sufficient headroom to pass on input price increases. This could potentially translate into margin headwinds for cement and metal companies. In the following sections, we detail impact of a potential coal shortage on specific companies.

Nalco gets linkage coal from Bharatpur coal block of Mahanadi Coal-fields. Nalco's coal stock has reached critically low levels thrice in the past year. In a recent call, management said it plans to import ~10% of its coal requirement, as supplies of linkage coal are faltering. According to our metals team, a 20% reduction in linkage coal would translate to a 12% hit to our FY09ii earnings estimate.

Figure 19: Nalco - impact on earnings in case of 20% reduction in coal linkages

NALCO	Amount
Coal consumption (tonne)	6,080,122
Cost per tonne (Rs/tonne)	666
Linkage coal (%)	90
Linkage coal (tonne)	5,472,110
Imports required, assuming 20% cut in linkages (tonne)	1,094,422
Landed cost of imported coal (Rs/tonne)	7,500
Adjustment for calorific value (x)	1.7
Adjusted coal price (Rs/tonne)	4,412
Increase in cost (Rs/tonne)	3,745
Increase in cost (Rs m)	4,099
Tax (Rs m)	1,353
Impact on PAT (Rs m)	2,746
PAT estimate FY09ii	22,852
Impact on PAT (%)	12

Source: Company, IIFL Research

Hindalco sources coal for its aluminium smelting operation from: 1) captive coal mines for the 143,000tpa Hirakud smelter; 2) coal linkages (75%) and e-auction (25%) for its Renukoot smelter and Alupuram smelters (total capacity: 400,000tpa). According to our metals team, a 20% cut in linkage coal would translate to an 8% hit on FY09ii earnings. Additionally, price of e-auction coal has been on an uptrend. Over the past six months, e-auction coal price has increased from Rs1,200/tonne to Rs2,200/tonne. This will put pressure on power cost, irrespective of linkage coal availability.

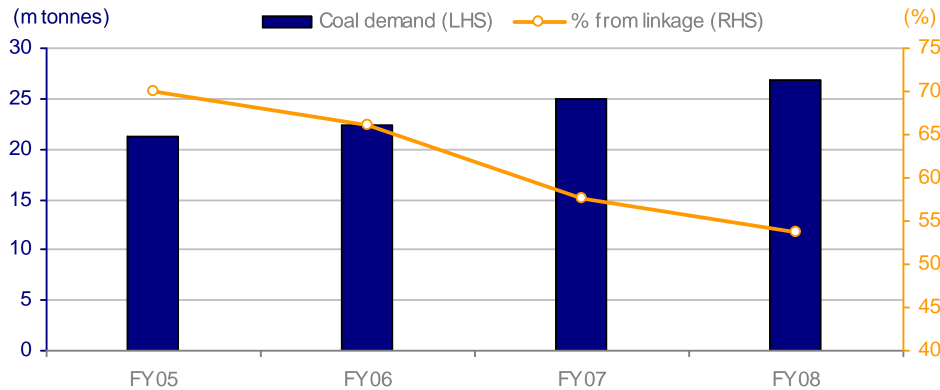
Figure 20: 20% reduction in Hindalco's coal linkages would take 8% off earnings

HINDALCO	Amount
Coal consumption (tonne)	7,241,660
Cost per tonne (Rs/tonne)	1,242
Linkage coal (%)	65
Linkage coal (tonne)	4,707,079
Imports required assuming 20% cut in linkages (tonne)	941,416
Landed cost of imported coal (Rs/tonne)	7,500
Adjustment for calorific value (x)	1.7
Adjusted coal price (Rs/tonne)	4,412
Increase in cost (Rs/tonne)	3,170
Increase in cost (Rs m)	2,984
Tax (Rs m)	985
Impact on PAT (Rs m)	1,999
Consolidated PAT estimate (Rs m)	24,067
Impact on PAT (%)	8

Source: Company, IIFL Research

Power and fuel form a major cost item in cement production (25-35% of cost of sales). Indian cement producers primarily use coal as fuel for firing the kiln. Cement companies are given linkage coal to the extent of 75% of the normative requirement to fire kilns. However, the contribution of cheaper linkage coal has decreased over the last four years.

Figure 21: Contribution of cheap linkage coal is going down for cement producers

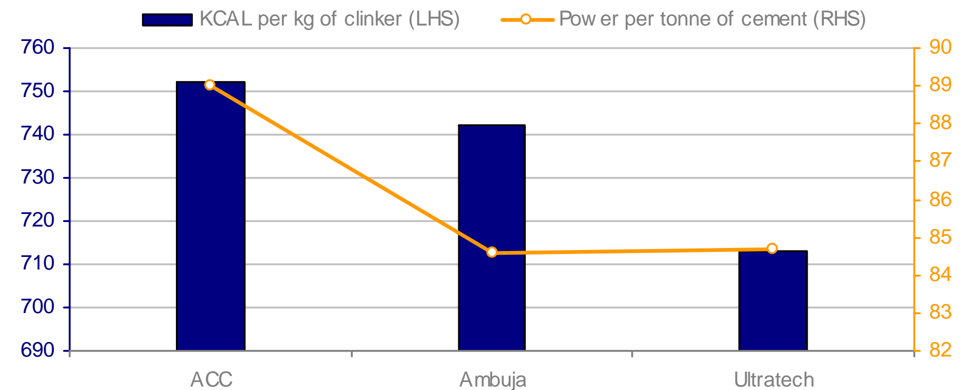


Source: Company, IIFL Research

We expect the proportion of linkage coal to drop further as CIL has reduced the cut-off limit for penalty clause from 90% of the agreed supplies to 60% of the agreed supplies in the model fuel supply agreement with cement producers. This effectively reduces the receipts from Coal India to 45% of cement companies' total coal requirement to fire their kilns.

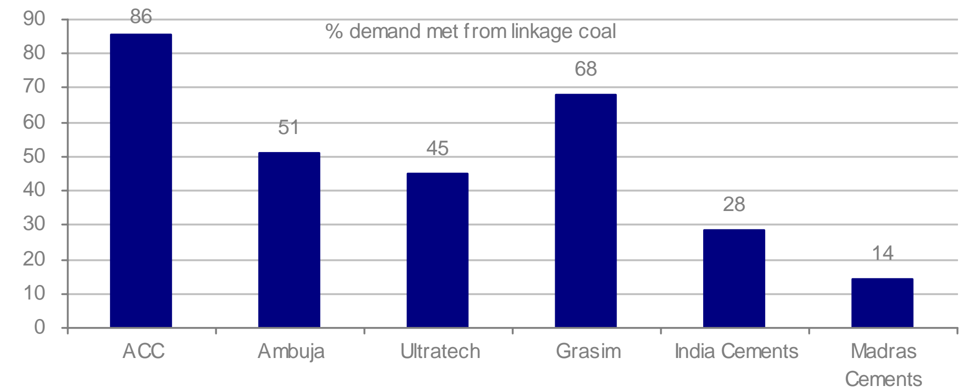
Replacement of cheaper linkage coal with costlier spot purchases from CIL (through e-auctions) or even more expensive imports would translate into increased cost per tonne for cement producers. Besides, potential government intervention/oversupply is likely to impair companies' ability to increase prices, putting pressure on margins. Risk of margin compression would be highest for players that have high contribution from linkage coal and high specific energy requirement.

Figure 22: ACC has the highest specific energy consumption…



Source: Company, IIFL Research

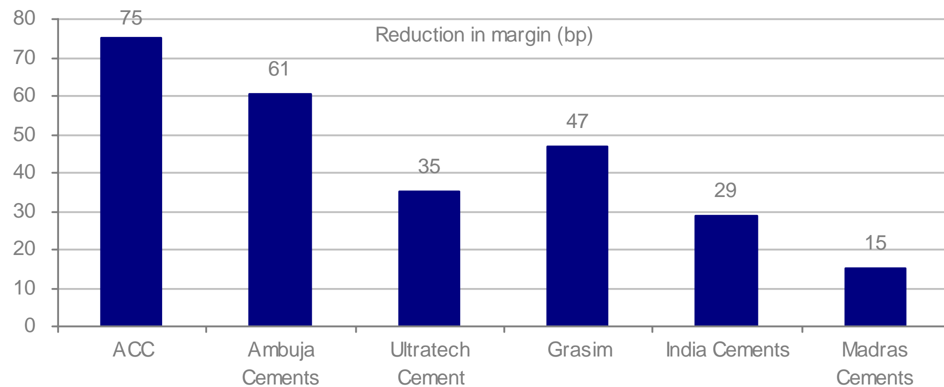
Figure 23: …and the highest contribution from linkage coal



Source: Company, IIFL Research

Based on contribution from linkage coal and specific energy requirement for different companies and our assumptions on replacement of linkage coal with costlier spot purchases, our analysis suggests that ACC's margins are the most vulnerable, with Madras Cements the least affected.

Figure 24: ACC's EBITDA margins to be hardest hit if linkage coal is replaced by spot



Source: Company, IIFL Research

The impact on margins could be much higher if linkage coal has to be replaced with imported coal.

Utilities to take a hit as well

Non-utilities would be the first to get impacted. But large shortfalls in production targets would mean that utilities also would have bear the burnt of insufficient fuel. As highlighted earlier in this report, the number of power stations with critical coal stock has witnessed a sharp increase recently (51 as end-September 2008 as compared to 19 a year ago). According to the power secretary, ~2% of India's installed power generation capacity remains unutilised due to coal shortages. We analyse the impact on utilities under different regulatory regimes below:

- **Public utilities under fixed-return regime:** As ROEs are fixed, decrease in PLFs would be compensated by higher tariffs. However, if coal linkages for new capacities are not available, then Commercial Operations Date (COD) might not be formally declared. There are existing examples of gas power plants that are fully constructed but awaiting COD due to unavailability of gas. The same situation obtains in nuclear power projects. Despite existing nuclear power plants running at 46.4% PLF, projects totalling 3GW are currently under execution. It is only after COD, that a power project is entitled for the guaranteed return.

Figure 25: Gas power plants have suffered because of fuel shortage

Sector	Capacity (MW)	Generation (MU)	PLF (%)
Central	5,899	31,285	65.2
Private	4,183	20,967	55.6
State	3,899	16,526	49.2

Source: CEA, IIFL Research

Figure 26: Similarly, nuclear stations have low PLFs but new capacity is coming up

	Capacity	Generation	PLF
Kaiga APS	660	2,495	42.9
Kakrapar APS	440	2,040	52.8
Madras APS	440	1,749	45.2
Narora APS	440	670	17.3
Rajasthan APS	740	2,480	38.2
TARAPUR APS	1400	7,342	59.7
Total nuclear	4120	16,776	46.4

Source: CEA, IIFL Research

- The above is a pessimistic scenario. A more likely outcome is decrease in PLFs. This would affect the incentive payments and user interchange (UI) charges earned by these utilities. Hence, it could limit the public utilities' ability to earn higher-than-guaranteed ROEs. For example, NTPC's FY08 ROE on existing assets stood at 23% vs the guaranteed 14%.
- **Private utilities under fixed-return regime:** Private utilities with projects under implementation under the fixed-ROE regime would be at higher risk than state utilities. In a supply crunch, state utilities such as NTPC would get preferential treatment over private companies. Projects that have begun implementation without requisite coal linkages are most at risk. For example, Sterlite Energy has received firm coal linkages for only one of the four units for its power plant under execution at Jharsuguda. Hence, 1,800MW out of 2,400MW capacity is at risk.
- **Private utilities with captive mine allocation:** Merchant power plants based on captive coal mines could witness delays, as these units find it difficult to procure linkage coal. Financial closure of some of the projects under implementation could get harder. Lenders are already hesitant to fund projects without firm take-or-pay arrangements. Lack of visibility on fuel availability would impair lenders' appetite further.

India Strategy

2QFY09 Earnings preview

7 October 2008

2QFY09 earnings season will kick off this week. For the IIFL universe of 125 companies, we estimate aggregate reported profit growth of 12% YoY, much lower than the estimated revenue growth of 27% YoY. Earnings breadth would be weak, with 60% of incremental profits for our universe coming from the Oil & Gas sector. While EBITDA growth would be reasonably strong, FX losses and other below-EBITDA line items will drag down profit growth to 12%. Autos, Cement, Non-ferrous Metals, Pharma and Utilities would likely report YoY decline in profit. Oil & Gas, Telecom and Steel are likely to report the strongest headline profit growth of over 20%.

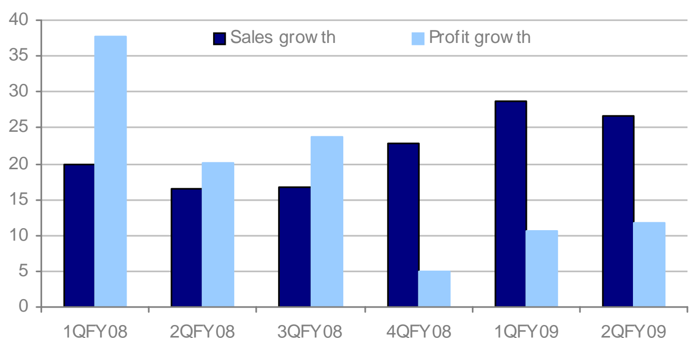
Strong (value-led) revenue growth to continue: We estimate aggregate sales growth for our universe by 27% YoY, making 2QFY09 the second consecutive quarter of above-25% sales growth. However, the robust topline growth largely reflects higher value rather than volume, with Steel and Oil & Gas showing the strongest sales growth. The two sectors would account for 43% of the estimated sales growth for our universe.

Strong headline EBITDA growth, but margins likely to contract further: Headline EBITDA growth would likely be a strong 22%, but dominated by Oil & Gas and Steel. Margins (ex-Financials), however, would continue to contract further by 130bps YoY, on account of rising operating costs. Cement and Utilities would likely see the biggest margin contraction of over 500bps YoY, while Pharma would likely be the only sector to report YoY expansion in EBITDA margin.

Non-operating items to continue to drag earnings: With ~10% QoQ depreciation in the rupee, large FX losses would recur in 2QFY09 as well, depressing reported profits. Interest costs, which we estimate at 30% YoY higher (ex-Financials and Oil & Gas), as against sales and EBITDA growth of 24% and 17% respectively, would also be a drag on reported profits. Drag from higher interest expenses would only increase over the next few quarters, in our view.

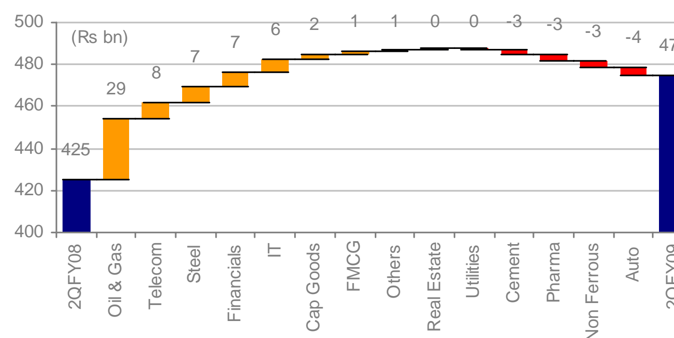
Companies that could positively surprise are — Hindustan Unilever, Cipla
Companies that could negatively surprise are — TCS, Grasim, ICICI, HCC

IIFL Universe — profits to lag sales growth for fourth consecutive quarter



Source: IIFL Research

Sectoral contribution to incremental 2QFY09 profits



Source: IIFL Research

IIFL Universe Quarterly profit growth

	1QFY09	2QFY09
Auto	-7.7	-22.9
Banks & Financials	11.7	9.5
Capital Goods	36.4	10.6
Cement	-15.4	-14.1
FMCG	5.8	8.4
IT Services	8.3	17.1
Non Ferrous	-4.6	-9.3
Oil & Gas	29.4	33.0
Pharmaceuticals	-4.6	-23.5
Real Estate	17.1	1.3
Steel	11.4	20.8
Telecom	27.7	23.6
Utilities	-20.3	-1.8
Others	57.5	30.9
IIFL Universe	10.5	11.8
IIFL Universe ex Financials	10.3	12.3
IIFL Universe ex Oil & Gas	5.6	6.3
IIFL Universe ex Financials and Oil & Gas	4.3	5.5

Source: IIFL Research. Reported PAT basis. Oil & Gas includes RIL and ONGC only

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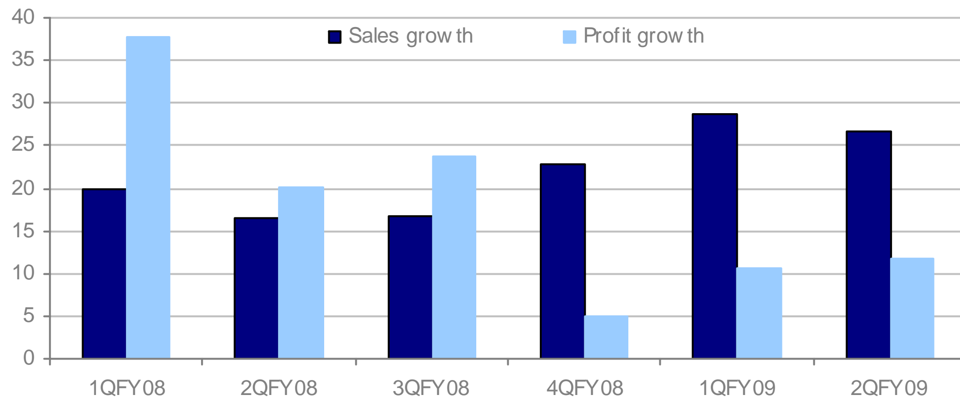
We expect our coverage universe (125 companies) to report profit growth of 12% YoY for 2QFY09—a modest acceleration from 10% YoY profit growth in 1QFY09 (reported-profit basis). Sales growth is also likely to decelerate modestly, but would still remain a robust 27% (as against 29% in 1QFY09). Continued EBITDA margin compression due to faster growth in operating costs and sharply lower other income would depress reported profit growth. Profit growth is thus likely to lag sales growth for the fourth consecutive quarter.

Figure 1: IIFL Universe — profits to lag sales growth for fourth consecutive quarter



Source: IIFL Research

Five sectors—Autos, Cement, Non-ferrous metals, Pharmaceuticals and Utilities—are likely to report an outright decline in profits (second consecutive quarter of YoY decline in profits), with Non-ferrous Metals also likely to show outright contraction, even in sales.

Rising input costs would hurt Autos and Cement; lower LME prices (primarily Lead and Zinc) would hurt Non-ferrous Metals and FX items would drag down earnings for the Pharma sector.

Profit growth is likely to accelerate for Financials (lower MTM losses) and IT Services (absence of large FX losses at HCL Technologies, Hexaware and Mindtree).

Oil & Gas (RIL and ONGC) is likely to be the best-performing sector, with both sales and profits rising by over 30%. Telecom and Steel would be the other sectors likely to show 20% profit growth for 2QFY09.

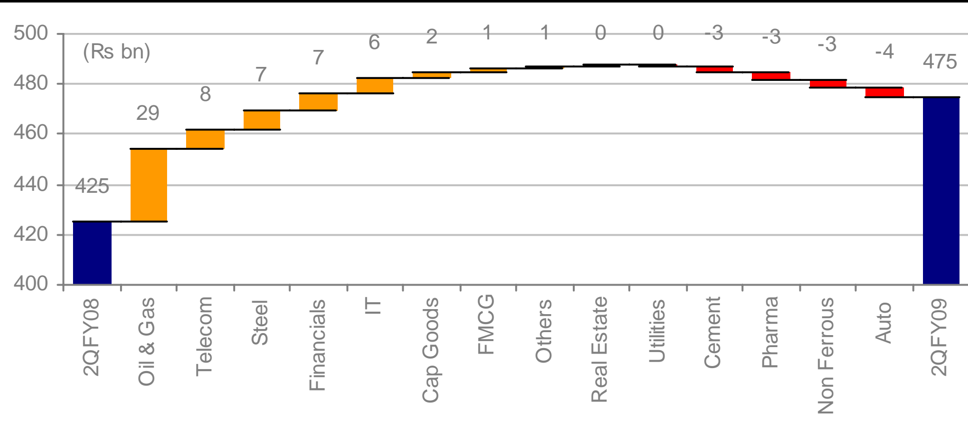
Figure 2: IIFL Universe — quarterly profit growth

	Profit growth (YoY%)					
	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09ii
Auto	16.5	7.7	24.4	-4.4	-7.7	-22.9
Banks & Financials	43.0	31.9	50.4	42.1	11.7	9.5
Capital Goods	46.1	74.1	16.0	7.1	36.4	10.6
Cement	52.9	32.6	-27.5	-7.2	-15.4	-14.1
FMCG	24.5	8.0	22.5	12.9	5.8	8.4
IT Services	30.5	23.8	23.2	4.5	5.7	17.1
Non Ferrous	13.5	-7.0	-34.6	20.4	-4.6	-9.3
Oil & Gas	23.6	3.0	51.8	-27.8	29.4	33.0
Pharmaceuticals	40.8	25.5	61.1	3.6	-4.6	-23.5
Real Estate	202.3	122.2	42.8	-41.7	17.1	1.3
Steel	80.3	19.2	16.5	10.8	11.4	20.8
Telecom	124.3	81.4	48.8	40.9	27.7	23.6
Utilities	48.3	32.5	-9.7	22.8	-20.3	-1.8
Others	-53.2	-47.7	-36.5	-48.7	57.5	39.6
IIFL Universe	37.7	20.1	23.8	5.0	10.3	11.8
IIFL Universe ex Financials	36.8	17.9	19.3	-0.9	10.0	12.3
IIFL Universe ex Oil & Gas	41.8	25.5	16.2	13.6	5.3	6.3
IIFL Universe ex Financials and Oil & Gas	41.6	23.8	8.6	7.7	3.8	5.5

Source: IIFL Research. On reported PAT basis. Real Estate excludes DLF, IBREL and ARIL due to lack of comparable quarterly history

Breadth of profit growth, however, is likely to be weak, with Oil & Gas expected to contribute ~60% of the incremental profit growth; ex-Oil & Gas, we estimate that the IIFL Universe's profit would grow just 6% YoY. Oil & Gas, Telecom and Steel are likely to account for almost 90% of incremental profit growth during 2QFY09.

Figure 3: Sectoral contribution to incremental 2QFY09 profits



Source: IIFL Research

Core earnings growth to be strong, notwithstanding continued EBITDA margin compression

We estimate 20% YoY growth in our Universe's EBITDA (ex Financials). This would be the second consecutive quarter of above-20% growth, largely driven by Steel (42% YoY), Oil & Gas (33%, largely ONGC) which contribute 63% of incremental EBITDA growth. Excluding these two sectors (Oil & Gas, dominated by RIL and ONGC; and Steel) EBITDA growth drops to just 13%.

Further, EBITDA growth of 22% (ex-Financials) would continue to trail sales growth of 28% (ex-Financials), resulting in YoY EBITDA margin compression of 120bps—making 2QFY09 the fourth straight quarter of over-100bps margin compression. Every sector barring Pharma is likely to show margin compression in varying degrees, with Utilities and Cement likely to see the largest margin decline (500bps YoY).

Figure 4: EBITDA growth strong, though margin compression would continue

	YoY EBITDA growth		YoY EBITDA Margin change (bps)	
	1QFY09	2QFY09	1QFY09	2QFY09
Auto	4.4	1.7	-150	-1.3
Capital Goods	53.6	24.4	1.1	-0.7
Cement	-3.0	-5.1	-4.1	-5.0
FMCG	4.8	10.0	-2.7	-1.5
IT Services	32.8	29.5	0.1	-0.5
Non Ferrous	-11.8	-15.3	-3.3	-3.0
Oil & Gas	31.5	33.3	-2.4	-1.2
Pharmaceuticals	49.6	29.1	3.4	1.4
Real Estate	22.4	15.0	-0.3	0.0
Steel	41.9	42.3	-0.5	-0.9
Telecom	36.3	32.7	-0.2	-1.2
Utilities	7.9	0.1	-1.6	-5.0
Others	40.6	46.5	1.7	5.4
IIFL Universe ex Financials	23.8	21.8	-1.1	-1.2
IIFL Universe ex Financials and Oil & Gas	20.8	17.4	-0.9	-1.3

Source: IIFL Research

Watch out for Other Income/FX losses

With the rupee having depreciated by ~10% sequentially, we expect significant FX losses in 2QFY09 as well. For our universe, we expect other income to drop 27% YoY (ex-Financials) and thus drag down profitability. We expect RCom and Ranbaxy to report the biggest FX losses in our coverage universe, but the bulk of the losses would be in the balance sheet, rather than reflecting on the income statement.

Figure 5: Movement of key drivers of other income

	Level as of End			Change QoQ	
	March	June	Sept	June	Sept
INR/USD	40.12	43.04	46.96	7.3%	9.1%
10yr bond yield	7.96	8.70	8.64	74bps	6bps
Sensex	15644.4	13461.6	12860.4	-14.0%	-4.5%

Source: Bloomberg

However, Banks would get relief from MTM losses on their bond portfolios, as QoQ bond yields have appreciated modestly.

Figure 6: Large FX losses expected

	1QFY09		2QFY09	
Amounts in Rs m	P&L	Balance sheet / Not provided	P&L	Balance sheet / Not provided
Ashok Leyland	339		485	
Bajaj Auto		980		1,400
Mahindra & Mahindra Ltd.	779		1,260	
Maruti Suzuki India Ltd.	179	1,346	269	1,924
Tata Motors Ltd.	1,999	1,312	3,600	2,362
India Cements	218		290	
Biocon Limited	319		427	
Cipla Limited	747		1,001	
Dishman Pharmaceuticals	165			
Jubilant Organosys Ltd	1,076		1,441	
Ranbaxy Laboratories Limited	1,931	9,086	2,587	12,219
Bharti Airtel*	1,840		2,500	
Idea Cellular	152		250	
Reliance Communications		14,600		15,000
HCL Technologies	2,644		170	
Infosys Technologies	800		600	
Satyam Computers	363		300	
TCS	746	4,000	1,500	
Wipro	697	9,344	700	
Suzlon	1,640		1,800	

Source: IIFL Research. *US GAAP basis

Interest expense to continue to rise

Ex financials and Oil & gas, we expect interest costs to rise 30% YoY—higher than Sales and EBITDA growth of 24% and 17% respectively continuing to drag profit growth. Drag on profitability from higher interest costs would only increase over the next few quarters in our view.

Agri-commodities

Agricultural input companies should continue to see very strong growth in volumes as well as pricing, driven by strong soft-commodities prices. Despite raw-material prices rising significantly (sulphur prices up 75% YoY and petrochemical derivative prices up 25% YoY during Q2FY09), we believe most companies will be able to pass on costs fully, as evindenced by the strong margins reported during Q1FY09. However, interest costs will remain a headwind, since most of these companies are heavily dependent on working capital (which amounts to 3-6 months of revenues). We remain positive on revenue and earnings growth in this sector over the next couple of quarters.

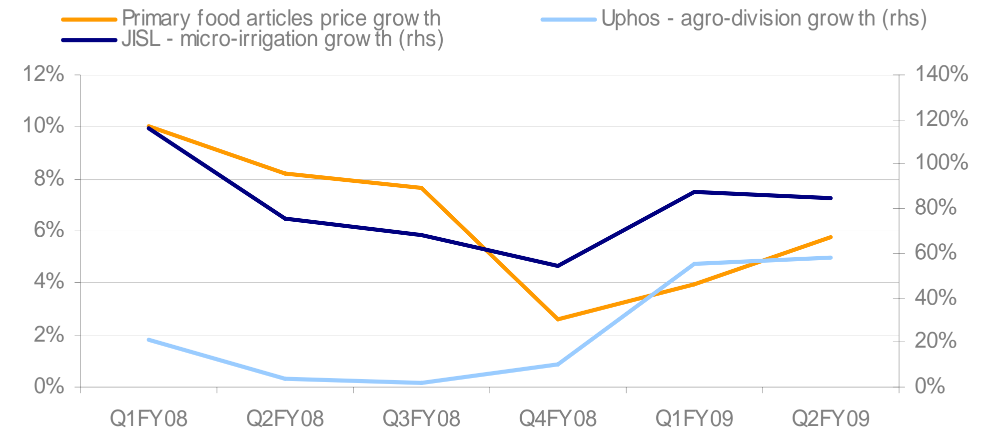
- We remain optimistic about Jain Irrigation's strong revenue growth prospects in the micro-irrigation space, where government spend remains strong. Interest costs could be higher by ~20% YoY, driven by higher interest rates and 10%+ rupee depreciation vs the US$.
- Lakshmi Energy and Foods should continue to see strong growth in volumes (driven by recent capacity expansion) as well as prices. The company has no FC debt in its books and thus remains unaffected by exchange-rate movements. Excluding deferred tax provision during the quarter (which the company has started providing for, beginning Q1FY09), PAT growth is 29% YoY.
- United Phosphorus should continue to see very strong revenue growth (driven mostly by pricing), though EBITDA margins will remain subdued on account of the lower margins following its Cerexagri acquisition. Also, interest costs will be affected by the rupee's depreciation vs the US dollar, since 80%+ of debt is in US$.
- Bajaj Hindusthan's earnings growth will be driven mostly by strong pricing, though interest costs will remain a headwind due to its heavy working capital requirements (inventory will remain high in the hands of most sugar companies).

Figure 7: IIFL estimates for QE September 2008

Rs mn	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Bajaj Hindusthan	8,475	-34%	16.6%	NA	-157	NA
Jain Irrigation Systems Limited	3,978	21%	17.1%	11%	156	-48%
Lakshmi Energy and Foods	2,793	36%	24.0%	34%	461	31%
United Phosphorus Ltd.	12,479	41%	19.4%	40%	1,591	80%

Source: IIFL Research

Figure 8: Revenues for Jain Irrigation and UPhos strongly correlated to higher Agricultural prices



Source: CMIE, IIFL Research

Automobile & Auto Ancillaries

Volume growth for the sector remained muted on account of the significant rise in cost of financing, stiffer financing norms and increase in fuel prices. Two-wheeler volumes were the only silver lining in the quarter. However, we reckon margins for most firms would improve QoQ on account of the price increases undertaken in 1QFY09 and 2QFY09. YoY, margins would remain weak because of lower volumes and higher raw-material costs. Mark-to-market losses on foreign currency exposure would have a significant impact on reported PAT. Benefits from the recent decline in commodity prices would be visible from 3QFY09 onwards.

- Maruti: Realisations were better in 2QFY09, on account of product mix shifting towards the *Swift*. We estimate margins would remain constrained, as the company was not able to pass on price increases.
- Hero Honda: We estimate a 100bps margin expansion on account of superior volume growth (up 28% YoY) and price increases.
- Bajaj Auto: With the product mix shifting towards high-margin three wheelers, we expect margins to improve 100bps QoQ.
- Tata Motors: We expect the company to report mark-to-market losses of Rs3.6bn on its US$900m forex exposure. However, higher other income on sale of stake in Tata Steel will result in a positive PAT of Rs3.4bn.

Figure 9: IIFL estimates for QE September 2008

Rs mn	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Apollo Tyres	10,818	28%	6.4%	-36%	265	-48%
Ashok Leyland	17,409	0%	8.0%	-17%	310	-61%
Bajaj Auto	24,646	NA	12.5%	NA	2,100	NA
Balkrishna Industries	3,485	31%	20.3%	19%	81	-70%
Everest Kanto Cylinders	2,182	71%	30.2%	66%	325	15%
Exide Industries	6,755	1%	19.4%	13%	716	16%
Hero Honda Ltd.	32,517	38%	13.4%	50%	3,345	64%
Mahindra & Mahindra Ltd.	31,454	16%	10.1%	9%	1,256	-56%
Maruti Suzuki India Ltd.	48,633	7%	9.8%	-20%	3,651	-22%
Tata Motors Ltd.	72,213	12%	8.3%	1%	3,402	-35%

Source: IIFL Research

Figure 10: Except for two-wheelers volumes were weak during the quarter

	Q2FY08	Q1FY09	Q2FY09	%QoQ	%YoY	1HFY08	1HFY09	%YoY
Maruti	191,325	192,584	189,451	(1.6)	(1.0)	360,994	382,035	5.8
Hero Honda	756,633	894,244	972,095	8.7	28.5	1,559,486	1,866,339	19.7
Bajaj Auto	614,093	620,095	640,040	3.2	4.2	1,185,206	1,260,135	6.3
Two Wheelers	539,212	561,977	565,096	0.6	4.8	1,038,989	1,127,073	8.5
Three Wheelers	74,881	58,118	74,944	29.0	0.1	146,217	133,062	(9.0)
Mahindra & Mahindra	69,456	82,608	78,894	(4.5)	13.6	137,645	161,502	17.3
Auto	47,184	52,502	55,738	6.2	18.1	88,127	108,240	22.8
Tractors	22,272	30,106	23,156	(23.1)	4.0	49,518	53,262	7.6
Tata Motors	135,589	131,733	133,952	1.7	(1.2)	262,950	265,685	1.0
Commercial Vehicles	80,396	79,166	84,194	6.4	4.7	151,687	163,360	7.7
Cars and Uvs	55,193	52,567	49,758	(5.3)	(9.8)	111,263	102,325	(8.0)
Ashok Leyland	18,870	18,425	17,106	(7.2)	(9.3)	37,033	35,531	(4.1)

Source: Company data, IIFL Research

Banks & Financials

We expect 13% YoY earnings growth (after considering HDFC operating PAT for 2QFY08) for our coverage universe in 2QFY09, as compared to 12% YoY growth in the previous quarter. Indian banks and financials are likely to report strong sequential improvement in earnings. Lending rates have got revised across the board, but would not result in margin expansion for banks and financials, as funding costs have also risen. Long-term bond yields declined marginally and thus write-back of provisions would not be material for government banks. We expect government banks to report high loan loss provisions for 2QFY09, unlike in 1QFY09, when they recorded low provisions/write-backs on account of farm-loan waivers. Axis Bank, HDFC (pre-exceptional basis) and HDFC Bank would be frontrunners, with +40% earnings growth. ICICI Bank would probably disappoint (with 9% YoY earnings decline) on account of higher NPL provisions and MTM losses on its US$1.4bn CDO book. Among government banks, BOI and BOB are likely to report strong numbers.

- Loan growth has remained strong at 26% YoY, far ahead of deposit growth of 22.5%. Incremental investment-deposit ratio has slumped to 11% (from its peak of 36% in February 2008) as banks have had to delve into their investment portfolios to fund loan growth.
- Lending rates have been revised upwards across the board by 50-150bps. However, margin expansion is unlikely on account of commensurate rise in funding costs. We expect net interest income growth for our coverage universe to remain broadly stable at 1QFY09 levels of 24% YoY.
- 10-yr bond yields were down marginally (6bps) QoQ, so a write-back of MTM provisions would not be material in case of government banks. However, the benefit of lower MTM provisions in 2QFY09 would be negated by a rise in loan loss provisions, to some extent.
- We expect 13% YoY earnings growth for our coverage universe in 2QFY09 as compared to 12% YoY growth in 1QFY09.
- New private sector banks (ex-ICICI Bank) are likely to report +40% YoY earnings growth, compared to 11% for Government banks and 8% for old private sector banks. Among financials, we expect +40% growth for HDFC and a modest 20% for IDFC.

Figure 11: IIFL estimates for QE September 2008

Rs m	Sales*	YoY chg	PAT	YoY chg
Axis Bank	14,628	51%	3,400	49%
Bank of Baroda	16,173	13%	3,851	18%
Bank of India	17,203	14%	5,336	26%
Canara Bank	15,018	11%	4,174	4%
Corporation Bank	5,767	7%	1,766	9%
Development Credit Bank	1,126	26%	181	24%
Federal Bank	3,580	26%	1,123	18%
HDFC*	8,960	34%	5,751	-11%
HDFC Bank	23,897	45%	5,188	41%
ICICI Bank	40,209	4%	9,162	-9%
IDFC	3,966	22%	2,330	20%
Indian Overseas Bank	9,574	19%	3,364	5%
ING Vysya Bank	2,699	29%	465	1%
Jammu & Kashmir Bank	2,990	18%	1,222	13%
Karnataka Bank	1,965	17%	537	-11%
Karur Vysya Bank	1,557	31%	456	5%
Oriental Bank of Commerce	6,186	14%	2,161	-8%
Punjab National Bank	20,570	17%	6,158	14%
South Indian Bank	1,499	19%	398	11%
State Bank of India	69,588	20%	18,096	12%
Union Bank	10,629	13%	3,152	14%
Vijaya Bank	3,651	19%	955	-9%
YES Bank	2,042	29%	581	28%

Source: IIFL Research
*Exceptional gain in 2QFY08, adjusted for which profit growth comes to 42% YoY
All figures are on standalone basis, except for IDFC

Capital Goods

We expect most companies in our Capital Goods universe to register strong revenue growth, driven by the robust order books. However EBITDA growth would lag revenue growth as impact of higher raw-material cost combined with higher employee cost in some cases translates to lower margins. Higher interest expenses, primarily for construction contractors, should result in much slower growth in net profit.

- BHEL's revenue growth will be driven by improved execution capabilities due to enhanced production capacity, both at the company's and vendors' plants. However, EBITDA margin would be lower, on account of higher provisioning for 6th Pay Commission recommendations.
- Larsen & Toubro's net profit growth is higher than EBITDA growth as other income in 2QFY08 was much lower compared to its quarterly trend. We build in other income in line with the last few quarters', resulting in higher net profit growth.
- Nagarjuna Construction's EBITDA margin, we reckon, should decline on account of a rise in raw-material prices translating into a YoY decline in net profit.
- HCC's net profit growth would lag EBITDA growth significantly, because of a sharp increase in interest costs. We also assume full tax rate vs the 2QFY08 rate of 16.6%.
- IVRCL's net profit growth lags EBITDA growth on account of a sharp increase in interest costs. A higher assumed tax rate of 25% vs 15.3% in 2QFY08 also affects the company's net profit growth.
- Patel Engineering's net profit growth would be hurt by a significantly higher interest expenses and tax at full rate vs 14.2% in 2QFY08.
- Gammon's net profit growth is lower because of a sharp increase in interest expenses.
- Net profit decline for Sadbhav is driven by a sharp increase in interest costs and tax at full rate vs 18.6% in 2QFY08.

Figure 12: IIFL estimates for QE September 2008

Rs m	Sales	YoY	Ebitda margin	Ebitda YoY	PAT	YoY
ABB India	16,531	20%	12.8%	23%	1,469	27%
Alstom Projects India Ltd	5,175	30%	8.7%	39%	319	32%
B L Kashyap	5,027	35%	11.9%	36%	337	24%
Bharat Heavy Electrical Ltd*	50,757	28%	16.2%	19%	6,129	-11%
Consolidated Construction Consortium Ltd	5,363	40%	8.7%	40%	273	13%
Crompton Greaves	19,694	25%	10.2%	26%	1,145	26%
Gammon India Ltd.	5,754	25%	8.5%	19%	113	-34%
Hindustan Construction Co.	6,584	20%	12.5%	37%	98	-16%
IVRCL Infrastructure	8,950	30%	8.0%	29%	297	-16%
Jyoti Structures Ltd.	4,136	30%	11.5%	20%	198	17%
Kalpataru Power Transmission	4,622	20%	12.0%	4%	275	-14%
KEC International	7,487	33%	11.0%	11%	358	6%
Larsen & Toubro	75,997	38%	10.8%	40%	5,417	56%
Maytas Infra Ltd	3,449	NA	11.1%	NA	23	NA
Nagarjuna Construction	8,464	25%	10.0%	0%	297	-12%
Patel Engineering	4,374	29%	15.4%	21%	182	-49%
Punj Llyod	28,227	49%	9.0%	53%	1,334	49%
Sadbhav Engineering Ltd	1,425	40%	11.0%	28%	44	-20%
Siemens India	29,259	33%	13.3%	9%	3,172	24%
Simplex Infrastructures Ltd	7,996	40%	10.0%	40%	252	32%
Thermax Ltd.	8,625	12%	12.7%	8%	725	5%

* Excluding Rs2.5bn extraordinary item in 2QFY08, BHEL's 2QFY09ii PAT growth is 40% YoY.
Source: IIFL Research

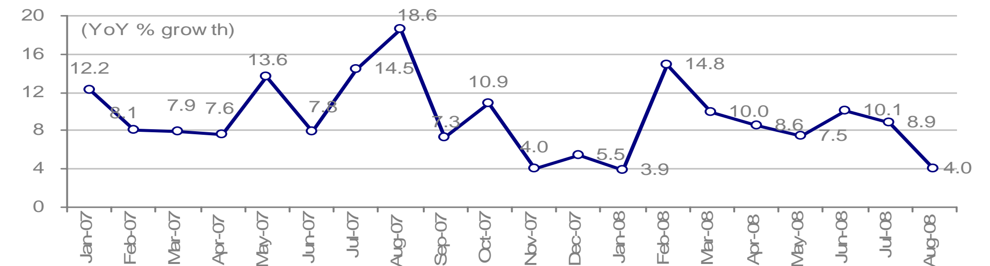
Cement

We expect most cement companies to report earnings declines for QE September 2008 on account of cost increases not being matched by increases in cement prices. Domestic cement demand growth declined to 6.5% YoY for the five months ended August 2008 from 16% in the year-ago period. Cement capacity grew 18.5% YoY and reduced the pricing power of cement producers. However, we expect south-based producers to report improved performances as cement prices in the region have rallied with strong demand growth, and new capacities started in the last two quarters are yet to ramp up production.

- We believe ACC's capacity constraints resulted in muted volume growth. Hence, we expect the company to report a profit decline—which would have been steeper, but for an Rs553m sales-tax benefit in Uttar Pradesh deferred for the first two quarters of 2008 and later reversed in mid-July.
- A slowdown in VSF demand coupled with sharp increases in cost of raw materials (sulphur and pulp) is likely to weigh on Grasim's profit. Sulphur prices started falling from mid–August; this, we believe, would reflect in gains for Grasim from QE December 2008. We expect flat cement volumes for QE September 2008 because of a lack of cement capacity. Growth would resume from QE December 2008, with Shambupura cement capacity to commence production shortly.
- We expect India Cements to post the largest fall in profit in our universe, primarily due to higher tax outgo and forex translation losses on account of rupee depreciation.
- Madras Cements (MC) would post the highest core profit (EBITDA) growth in profit in our universe, as its plant at Jayanthipuram stabilised. This would have boosted dispatch growth to 21% YoY in our view. Coal costs were also under control, as MC has booked coal at a lower cost and the inventory is expected to last till mid-3QFY09.

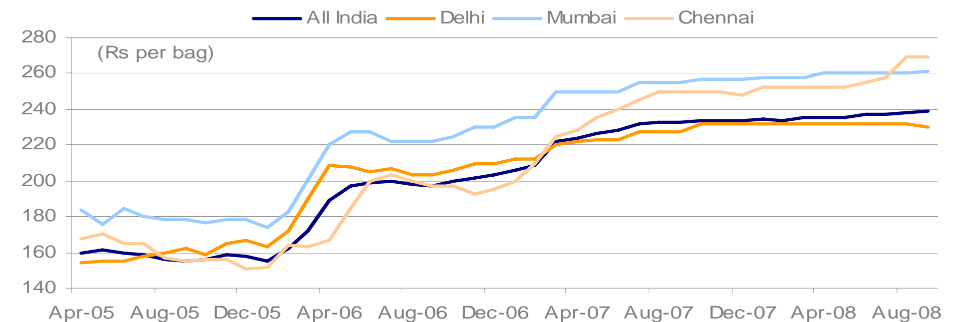
We maintain our cautious view on the sector as we expect supply to outpace demand in all regions from 4QFY09. We believe that the downside in cement stocks is limited, as stocks are available at substantial discounts to their replacement costs. That said, we see no near-term positive trigger either.

Figure 13: Domestic demand growth declines on account of monsoon and slowdown in housing



Source: CMA

Figure 14: All-India average cement price continues to rule high, with strong uptick in the south



Source: Industry

Figure 15: IIFL estimates for QE September 2008

Rs m	Sales	YoY chg	Ebitda margin	Ebitda YoY	PAT	YoY chg
ACC	17,238	5%	23.3%	-11%	2,366	-18%
Ambuja Cements	14,283	10%	27.1%	-5%	2,429	-22%
Grasim Industries	24,632	-2%	25.8%	-21%	3,992	-20%
IndiaCements	9,092	19%	35.2%	4%	1,511	-32%
Kesoram Industries	8,976	34%	16.2%	-7%	824	-8%
Madras Cement	6,749	35%	40.0%	26%	1,411	17%
Shree Cement	6,211	33%	31.1%	-4%	1,138	20%
Ultratech Cement	14,548	24%	25.4%	12%	1,936	4%

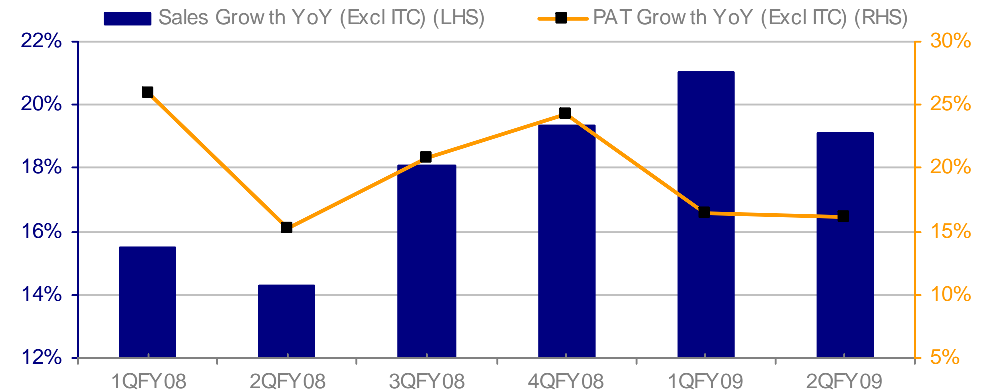
Source: IIFL Research

FMCG

We expect IIFL FMCG universe to report 18.5% sales growth, continuing the momentum of 1QFY09 (19.7% growth). Consumer demand remains robust despite numerous price increases taken by companies, with no evidence so far of volume growth slowdown, apart from some instances of downtrading to lower SKUs in high-priced consumables. Respite on cost pressures seems to be on the horizon for many consumer-goods companies, as prices of some raw materials such as palm oil and edible oils have started trending downward. Depending on the raw-material stock held, however, it might take a quarter or two for the positive impact to kick in.

- **Sales momentum to sustain:** Sales growth will be particularly strong for HUL, Nestle and Marico as these companies benefit from their dominant leadership positions in high-growth categories like personal products, processed foods and hair oils. HUL will also benefit from price-led growth in detergents, where its key competitor Procter & Gamble also raised prices, with the overall price increase working out to 10% on a blended basis. Marico, Nestle and Colgate are likely to report double-digit volume growth despite inflationary conditions.
- **Raw-material decline not likely to benefit margins this quarter:** Though prices of key raw materials like palm oil (down 40%) and edible oils (down 5-25%) have corrected from their peaks, positive impact on profitability could be seen only after one or two quarters, as companies typically hold 1-2 months of raw-material inventory. Marico's margins are likely to be under pressure despite the price hikes, as prices of copra (key raw material) remain high.
- **ITC: Profit impact due to one-time expenses in cigarettes:** We expect ITC's profit to reflect the effect of subdued EBIT in the cigarettes business on account of trade activities undertaken to encourage conversion from non-filters to filters. ITC has taken a blended price increase of 5-6% in its filter portfolio; this, along with robust sales growth in the other FMCG business (c50%) will boost topline growth. Also, losses in the personal care business will remain high, though we expect them to start declining from 3QFY09 onwards.

Figure 16: Sales growth will remain strong, while PAT growth will be over 15%



Source: Company, IIFL Research

Figure 17: IIFL estimates for QE September 2008

Rs m	Sales	YoY	Ebitda margin	Ebitda YoY	PAT	YoY
Britannia	7,770	18%	9.7%	10%	600	24%
Colgate	4,185	15%	15.4%	14%	638	17%
Dabur India	6,708	15%	19.1%	10%	1,078	12%
Glaxo Smithkline Consumer	4,100	17%	17.6%	9%	563	12%
Hindustan Unilever Limited	40,240	20%	12.2%	10%	4,768	17%
ITC	38,600	18%	29.0%	9%	7,645	-1%
Marico	5,700	23%	12.7%	12%	460	9%
Nestle	11,000	21%	20.5%	18%	1,460	26%

Source: IIFL Research

IT Services

Excessive pessimism going into the results season—fears of IT companies missing their US$ revenue guidance on account of the US$'s appreciation against GBP/Euro and clients' bankruptcies/sales hitting vendors' business—imply that negative surprises are unlikely in the QE September 2008 results. We expect Infosys and Satyam to raise their yearly rupee EPS guidance by ~5% on the back of a stronger US$. On the other hand US$ revenue guidance will likely be revised downwards by 2ppt+ (this, in our view, is in the price). We also believe that business rampdowns from affected clients (Lehman, Merrill, AIG, Washington Mutual, etc) were minimal in QE September 2008, and would intensify during 4Q. On the rupee front, the average 4.9% depreciation against the US$ in 2QFY09 is the highest in a decade and could add 150bps to EBITDA margins.

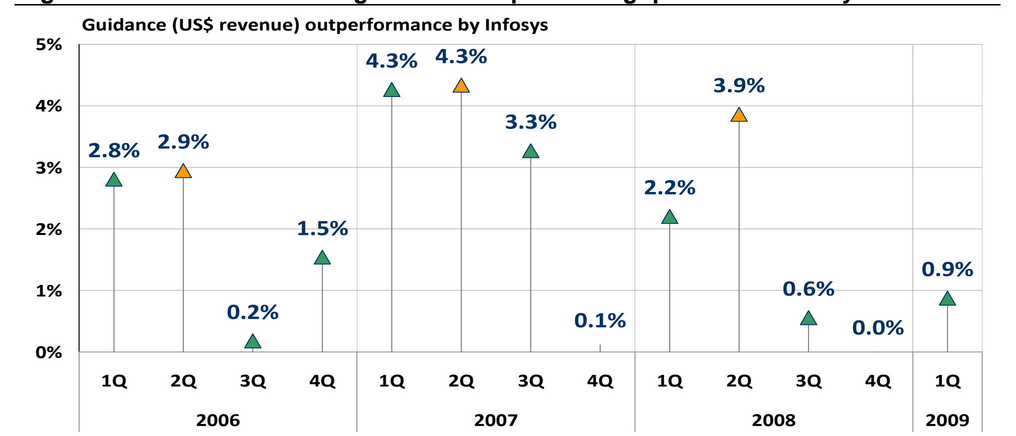
- As the financial crisis worsened only towards the fag end of the quarter, we do not think it had a material impact on IT companies' 2QFY09 performance.
- Even from Lehman, which filed for Chapter 11 bankruptcy, only a small amount of receivables for TCS, Wipro and Satyam would be uncollectible (after the cure amount from Barclays).
- However, we expect managements' commentary to be very negative and hiring to be low during the quarter.
- Our conversations with management of Indian vendors indicate that rampdowns from affected clients haven't started so far. Given their preliminary focus on larger integration issues and initial 'indecision', we expect loss of business only from 4QFY09 onwards.
- For FY10, we reckon BFSI business would decrease by 10% YoY. Rampdowns could, however be severe in certain accounts like AIG for TCS, Washington Mutual for Infosys etc.
- During 1QFY09, INR's depreciation (vs US$) was the highest in a decade. This is likely to have prompted some firms to enter into hedging contracts during July, that only on hindsight seems hasty.
- We reckon TCS' had frontloaded its quarterly hedging transactions towards July. These being non cash-flow in nature, we estimate the net P&L impact due to forex gains/losses to be –Rs1500m (vs -Rs746 in 1QFY09).
- We expect Infosys to give a ~15% QoQ EBITDA growth in 2QFY09 – driven by margin recovery from one-time visa expenses in 1Q and expansion due to INR depreciation.

Figure 18: IIFL estimates for QE September 2008

Rs mn	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
3i Infotech	6,125	120%	18.5%	93%	721	80%
HCL Technologies	23,307	36%	22.2%	42%	3,605	17%
Hexaware	3,044	20%	10.8%	8%	236	-12%
Infosys Technologies	53,268	30%	32.1%	33%	14,009	27%
Infotech Enterprises	2,254	40%	19.4%	49%	293	16%
KPIT Cummins	1,891	27%	15.9%	28%	169	20%
Mindtree	2,469	36%	22.0%	82%	194	-29%
Patni	8,621	28%	17.9%	26%	1,087	-15%
Satyam Computers	28,527	40%	22.7%	61%	5,561	36%
Tata Consultancy Services	68,591	22%	24.3%	12%	12,801	3%
Tech Mahindra	12,169	36%	24.5%	51%	2,662	47%
Wipro	65,801	38%	18.4%	24%	9,332	13%

Source: IIFL Research

Figure 19: 2Q has been among the best outperforming quarters for Infosys



Source: IIFL Research

Metals

Steel: Strong realisation growth

Steel prices were ~35% higher in 2QFY09 as compared to the year-ago period. On a QoQ basis, we expect steel companies to report a 3-7% rise in realisations. The rise in realisations would translate into a strong rise in EBIDTA for the quarter.

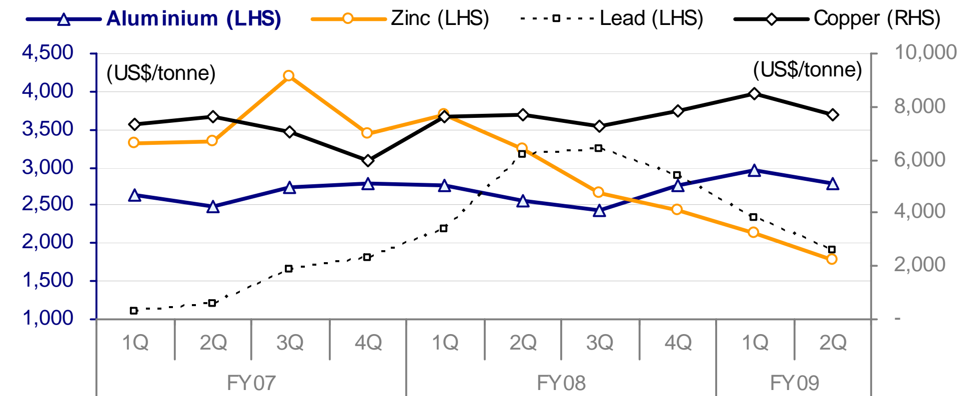
- **Increasing coking-coal prices:** Tata Steel and SAIL's new coking coal contracts came into effect from July 2008 (coking coal prices are up 205% YoY). This will significantly offset the benefit of higher realisations. JSW Steel will see a marginal increase in raw-material cost as the bulk of the impact of higher coking-coal prices came in 1QFY09.
- **Forex losses to hit reported earnings:** Tata Steel and JSW Steel have a large amount of foreign currency debt on their books. A 9.3% depreciation in the rupee against the US dollar QoQ will impact Tata Steel's and JSW Steel's reported earnings negatively.

Non Ferrous: Lower prices but partly offset by rupee depreciation

Prices of non-ferrous metals declined by 5-15% QoQ in QE September 2008. While aluminium prices rose 9% YoY, zinc and lead prices declined by ~40% YoY. The impact of lower LME prices will be partly offset by an average 5% sequential depreciation in the rupee (8% YoY).

- **Aluminium producers to report YoY growth**: Driven by higher prices and depreciation in the rupee, we expect aluminium producers to report an improvement in earnings during the year (Hindalco and Nalco).
- **Hindustan Zinc and Sterlite to report a drop:** A sharp decline in zinc and lead prices will drive down earnings of Hindustan Zinc and Sterlite. The impact of lower prices will be partly offset by higher volumes and weaker rupee.

Figure 20: Non-ferrous metal price movement (LME Spot prices)



Source: Bloomberg, IIFL Research

Figure 21: IIFL estimates for QE September 2008

Rs m	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Hindalco	49,190	-1%	19.9%	6%	7,219	12%
Hindustan Zinc Limited	14,725	-26%	54.5%	-43%	7,146	-38%
National Aluminium Company	14,919	14%	50.0%	31%	5,493	25%
Sterlite Industries	59,367	-10%	27.0%	-18%	10,186	-6%
JSW Steel	38,852	63%	26.0%	49%	2,253	-56%
Steel Authority of India	133,674	46%	25.6%	30%	22,949	35%
Tata Steel	65,949	38%	47.5%	55%	15,856	33%
Welspun Gujarat Stahl Rohren	14,175	53%	16.5%	53%	1,036	26%

Source: IIFL Research

Pharma

We expect the secular growth story in the pharma sector to continue in 2QFY09, though growth will be masked by significant forex losses in several companies including Ranbaxy, Jubilant, Cipla and Biocon. The depreciation of the rupee should benefit pharma companies in general, though the hedging at Rs41-42 to the US$ will prevent the benefit from flowing down to the net-profit line. Operationally, we expect Cipla and Biocon to benefit the most from rupee depreciation.

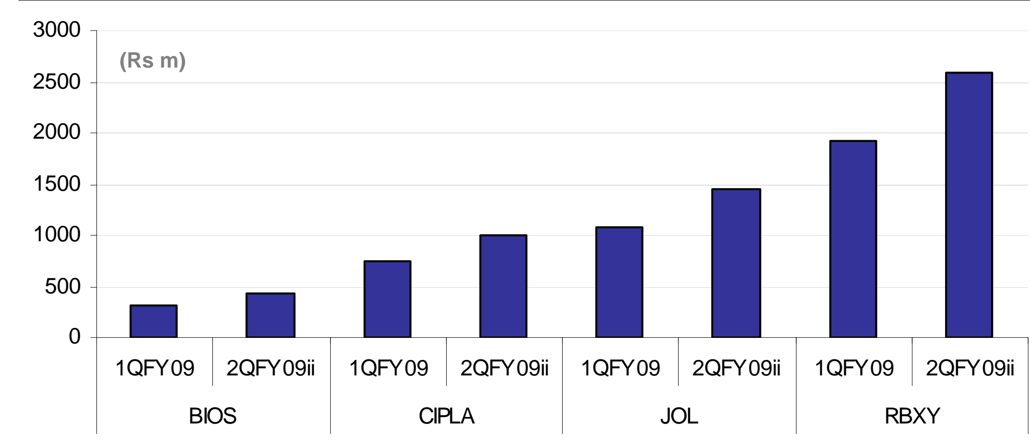
- Sun and Glenmark would report the highest YoY growth rates in 2QFY09, thanks to specific product revenues that made no contribution in the previous quarter. Sun will continue to benefit from the continued exclusivity of generic Protonix and Glenmark from generic Trileptal, though the contribution from both the products may show a decline QoQ.

- We expect Cipla and Dr Reddy's to report continued stable performance in 2QFY09, with 16-17% EBITDA growth YoY. However, PAT figures may show YoY declines, due to: forex hedging losses for Cipla; and high other income and significant tax write-backs for Dr Reddy's in 2QFY08.

- Among small-caps, Dishman and Opto Circuits would report continued strong performances, with EBITDA growth of ~50% YoY. Dishman continues to improve utilisation rates in its newly added capacity and Opto Circuits continues to penetrate global markets in interventional cardiology and patient monitoring systems.

- We expect continued dull performance from Ranbaxy and Biocon in 2QFY09. Ranbaxy's international business has not been doing well of late and will be further compounded by the US FDA's import alert on 29 drugs during part of the quarter. Biocon may benefit from the rupee's depreciation and show some growth due to consolidation of the newly-acquired Axicorp in Germany; but we do not expect any significant improvement in the base business, which has been stagnating for quite some time.

Figure 22: Large forex losses expected for pharma companies



Source: IIFL Research

Figure 23: IIFL estimates for QE September 2008

Rs mn	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Biocon Limited	4,075	46%	22.6%	13%	187	-63%
Cipla Limited	12,300	12%	21.2%	17%	1,025	-46%
Dishman Pharmaceuticals & Chemicals Ltd	2,418	30%	24.8%	48%	301	7%
Dr Reddy's Laboratories	14,708	16%	11.5%	16%	1,493	-52%
Glaxo Smithkline Pharma Ltd	4,292	2%	34.4%	8%	1,145	NM
Glenmark Pharmaceuticals	5,577	49%	33.7%	59%	1,356	81%
Jubilant Organosys Ltd	8,481	37%	18.6%	39%	-739	NM
Opto Circuits India Limited	2,121	71%	26.0%	51%	411	21%
Ranbaxy Laboratories Limited	18,339	3%	13.4%	-13%	-651	NM
Sun Pharmaceutical Industries Ltd	10,084	51%	45.4%	90%	4,241	94%

Source: IIFL Research

Real Estate

Revenue growth in 2QFY09 will be driven by unrecognised sales and private-equity deals. We expect further deceleration in revenue and earnings growth in FY09 on account of high interest rates and tight liquidity.

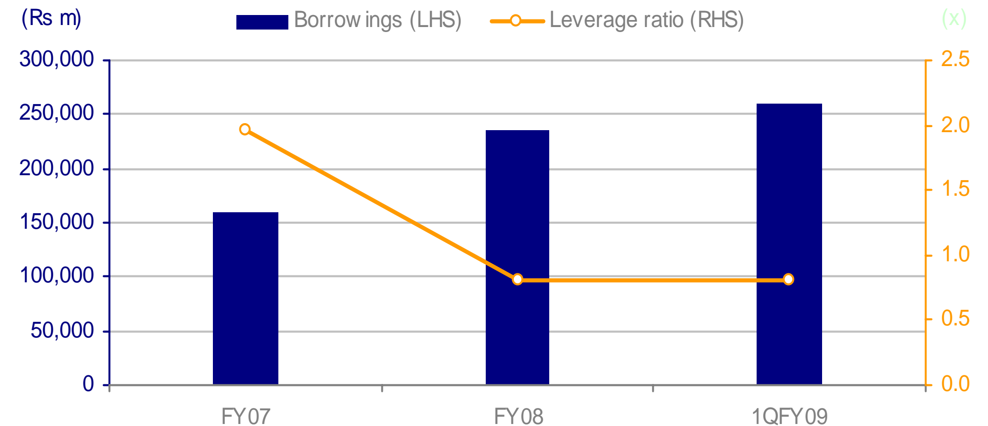
- Seasonally, 2QFY09 is a subdued quarter for new launches in the residential segment. Developers are hoping volumes will pick up in October (the Hindu period of *shradh*, which is considered inauspicious, has just ended, and the festival season is about to start). In our view, only discounts can boost end–user affordability, given the firmness in mortgage rates and tight liquidity.
- Cushman Wakefield, in its latest report, has indicated a marginal fall in lease rentals on IT Park/SEZ space in Gurgaon, and larger corrections in Chennai and Noida. Our channel checks suggest that IT SEZ space is registering pre-leases 6-12 months ahead of delivery, indicating healthy demand. However, rentals in IT Parks have seen corrections across most major IT/ITES hubs.
- As discussed in our note dated 23 September 2008 (*Retailers indicate sharp correction in rentals*), developers have been signing up anchor tenants at discounts to going rates, as retailers indicate a 10-30% correction in new rental contracts. Upfront deposits have dwindled to 15-30 days of rent against 6 months earlier, further drying up a source of funding for developers.
- DLF's pricing strategy continues to be on track; the company intends to price its products at discounts to secondary prices of ready-to-move-in properties. It has priced its residential offering at Kochi at Rs2,350p sq ft, in line with its pricing strategy in New Gurgaon, and should see relatively stronger volumes compared to its peers. It is also offering weighted-average rentals of Rs175-200/sq ft at its Mumbai NTC mill property, which is likely to be delivered in the next two-three years.
- Real-estate players' borrowing costs have increased significantly in the past six months. We expect debt levels to increase in 2QFY09, and this will likely affect execution pipelines.

Figure 24: IIFL estimates for QE September 2008

Rs m	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Anant Raj Limited	1,817	16%	90.1%	10%	1,293	24%
DLF LTD	42,258	30%	65.7%	23%	22,074	9%
Indiabulls Real Estate Limited	813	222%	30.0%	733%	448	37%
Peninsula Land Limited	1,637	39%	50.5%	35%	647	92%
Puvankara Projects Limited	1,573	12%	37.5%	2%	599	-1%
Sobha Developers Ltd	3,645	12%	27.1%	20%	513	-9%
Unitech Limited	11,516	14%	49.9%	13%	3,916	-5%

Source: IIFL Research

Figure 25: Debt has increased significantly, increasing refinance risk



Source: IIFL Research. Includes our entire coverage but excludes IBREL

Telecom

Telecom stocks are expected to continue their growth momentum for the present. Increasing affordability of services from subscribers' perspective drives this, especially the availability of cheaper and better handsets. Most companies are at a high point in their capex cycle, and the capex is import-intensive, and the sharp depreciation of the rupee against the US during 2Q (US$/INR fell from 42.8 to 46.9) would, we believe, cause dents in this quarter's numbers.

- Sequential revenue growth is expected to be strong for Bharti and Idea, at 8% and 7% respectively. We expect a slightly muted rate of revenue growth for RCOM, as the impact on RCOM's PCO business of long-distance rate cuts during the previous quarter plays out. We expect that relative to 1QFY09, both rate-per-minute drops and minutes of usage increases will be less sharp.
- We estimate that Bharti's capital-goods supplier's credit varies between US$500m and US$750m at any time, and is chiefly responsible for forex losses of Rs1.26bn and Rs1.84bn in 4QFY08 and 1QFY09. Under US Gaap reporting, we expert the corresponding loss in 2QFY09 to be around Rs2.5bn.
- For RCOM, the exposure will stem not only from capital credits, but also the unhedged US$3.2bn exposure, thanks to FCY loans and FCCBs. We rate the likelihood of FCCB conversion as low for the present, but under Schedule 6 of the companies, Act, RCOM is likely to continue to exclude losses due to these FX exposures from its P&L. These losses, we estimate would be upward of Rs15bn.
- Idea Cellular does not have outstanding FCY loans, and its exposure to capital credit on imports is relatively smaller than for RCOM and Bharti. Furthermore, this quarter's performance should rather feature a jump in other income, thanks to approximately a month's lag between TM's US$1.7bn investment, and the outflows due to the open offer for Spice Communication shares, which ends today.
- Onmobile's recent results have featured FCY deferred payments related to acquisitions of Vox Mobili and Telisma, and these should wind down now, and we do not expect FX losses. On the other hand, the depreciation of the Rupee would boost Onmobile's income from international operations relative to previous estimates, thanks to translation gains.
- Tanla Solutions would not be a beneficiary of the collapse of the Rupee as the GBP/INR rate has held constant at Rs85, right through 2Q. Nevertheless, we expect strong operational performance from Tanla at least from its UK operations.
- GTLI is exposed to FX risk too, thanks to FCCBs (US$300m convertible at Rs53/share, 50% higher than where the stock trades now). More relevant is the tightening of liquidity, which makes credit incrementally difficult, and hence a slowing down of capacity addition is likely.
- MTNL's problems relate to FX losses, its weak operational performance, bloated wage bill and 3G, where despite getting 3G spectrum, MTNL faces the challenge of constructing a viable business plan around an unknown cost of spectrum (MTNL will need to match the highest bidder when the 3G & BWA auctions happen later this year).

Figure 26: IIFL estimates for QE September 2008

Rs mn	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY
Bharti Airtel	91,542	44%	41.5%	40%	20,821	29%
GTL Infrastructure	626	130%	49.6%	124%	-447	72%
Idea Cellular	23,301	49%	30.9%	41%	2,901	32%
MTNL	12,343	3%	4.2%	-71%	277	-71%
Onmobile	989	69%	42.0%	57%	229	32%
Reliance Communications	54,909	21%	41.8%	19%	15,255	15%
Tanla Solutions	1,775	65%	48.0%	73%	571	56%

Source: IIFL Research

Utilities

- **Capacity additions remain muted during the quarter**: As per CEA, India's generation capacity was 145.6GW as at end-August 2008. During the first five months of the year (April-August), generation capacity increased by 2,566MW, mainly as some projects scheduled to be commissioned earlier were delayed. In 2QFY09 (till August 2008), addition in installed capacity was modest, at 714MW. Lower capacity additions were partly due to the monsoon rainfall, among other issues. NTPC is the only company under our utilities coverage universe that has added capacity of 500MW during the quarter.

- **Healthy PLFs for utilities**: Given the mounting peak deficit (~15% during 1HFY09) and limited capacity additions, all utilities' PLFs have been well above the benchmark. The ongoing coal shortage is likely to reflect in a marginal impact on NTPC's 2QFY09 results. We expect other utilities—Reliance Infrastructure, Tata Power, GIPCL and CESC—to report flat generation both YoY and QoQ.

- **Core earnings of utilities to remain flat:** In the absence of any meaningful capacity addition during the quarter, core earnings of utilities under our coverage would likely remain flat. In case of Reliance Infrastructure, we forecast PAT growth of 19% due to higher treasury income. In case of Tata Power, the YoY comparison may not be relevant, given changes in accounting practices adopted from 1QFY09. We forecast a flat PAT for NTPC on a YoY basis as we build in higher wage costs (which NTPC would recover with a lag). GIPCL is likely to report booking maintenance-related expenditure of Rs55m-60m in 2QFY09, which it would recover later in the year; this would affect PAT in QE September 2008.

- **PTC's earnings growth due to treasury income:** We forecast QoQ growth in PTC's trading volumes (seasonal trend), but do not build in any significant YoY growth; hence, PAT growth would be largely due to an increase in treasury income.

- **Suzlon - 25% YoY growth in EBIDTA:** We build in: 1) WTG sales of 717MW (5% YoY growth); and 2) sales growth of 50% from gearbox business in 2QFY09. We forecast EBIDTA growth of 25% YoY. Building in losses from regional subsidiaries and excluding MTM losses arising on FCCBs, we expect Suzlon to report PAT of Rs4.08bn (up 3% YoY).

- **Build in margin contraction for smaller transformer manufacturers**: Overcapacity and escalation in input costs, in our view, would weigh high on operating margins for food-chain companies such as Bharat Bijlee, Voltamp and Apar, where we build in lower operating margins, and subsequently forecast EBIDTA and PAT will grow slower than sales.

Figure 27: IIFL estimates for QE September 2008

Rs m	Sales	YoY chg	Ebitda margin	Ebitda YoY	PAT	YoY chg
Apar Industries Ltd*	5,937	42%	5.5%	21%	201	-52%
Bharat Bijlee Ltd	1,859	37%	17.1%	23%	197	21%
CESC Ltd	8,654	19%	18.0%	10%	960	3%
Gujarat Industries Power Company Ltd	2,549	32%	18.5%	-12%	142	-33%
National Thermal Power Corporation	99,249	24%	26.8%	-3%	19,436	1%
Power Grid Corporation of India	13,975	35%	81.5%	33%	5,334	44%
PTC India	19,192	31%	0.4%	-19%	200	73%
Reliance Infra	21,122	37%	9.5%	11%	2,968	19%
Suzlon Energy Ltd	45,570	25%	16.1%	25%	4,080	3%
Tata Power Company Ltd	15,672	NA	20.0%	NA	1,573	NA
Voltamp Transformers Ltd	1,630	10%	18.5%	9%	201	9%

*In 2QFY08, there was an exceptional income of Rs298.7m from profit on sale of development rights (Rs303.7m), VRS amortisation (Rs4m) and loss on sale of fixed asset (Rs1m). Excluding these items, PAT growth is 65% in 2QFY09ii

Source: IIFL Research

Others

Figure 28: IIFL estimates for QE September 2008

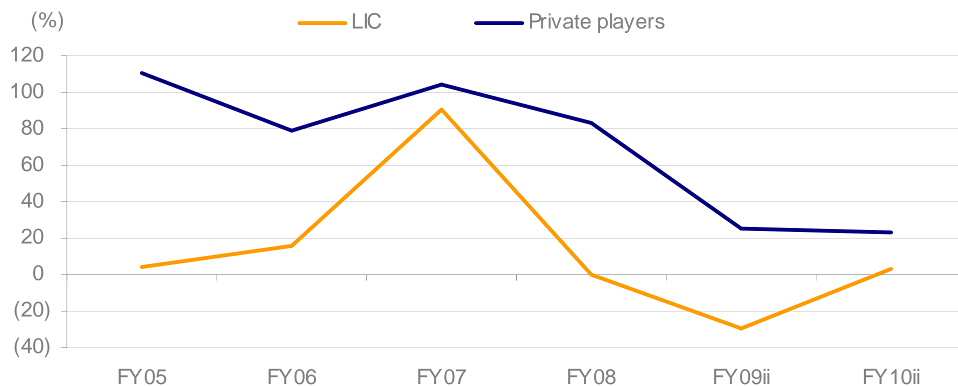
Rs m	Sector	Sales	YoY	Ebitda Margin	Ebitda YoY	PAT	YoY	Remarks
Bombay Rayon Fashions Ltd.	Textile	3,257	45%	23.2%	53%	432	41%	• Revenue and earnings growth should remain strong driven mainly by volume growth due to recent capacity expansion. BRFL is one of the few companies whose earnings are not significantly impacted by interest rate volatility, since most of the company's loans are under the TUFS scheme where the company receives interest subsidy upto 9%, leaving the net interest exposure at ~2%.
Concor	Logistics	8,990	10%	27.0%	14%	2,008	15%	• Container volumes grew by modest 7.1% in July-August 08 at major ports owing to saturation of capacity at JNPT. Concor is unlikely to meet its guidance of 15% volume growth in FY09. We have assumed 12% volume growth in FY09, which is also at risk in our opinion. • However, Concor's balance sheet with Rs15bn in cash and zero-debt offers the financial flexibility to undertake capex and grow the business in the present liquidity-tightened environment.
ONGC	Oil & Gas	207,995	35%	60.0%	48%	74,753	51%	• We build in: gross realisation (before the subsidies) of US$121/bbl, and a net realisation of US$70/bbl- flat QoQ, but up 23% YoY • Net Profit to grow sequentially due to INR depreciation, as the volumes expected to remain flat. YoY growth is driven by higher realization and INR depreciation.
Phillips Carbon Black	Chemicals	3,836	54%	15.2%	71%	388	62%	• Sharp growth in realisation to lead to earnings growth, Core EBIDTA margin to increase 160bps on account of sharp realisation growth • Waste heat recovery power plant commissioned at the end of September in Durgapur to start contributing from 3QFY09
Reliance Industries Limited	Oil & Gas	451,578	41%	14.3%	12%	41,966	9%	• In line with the regional trends, the refining margins are likely to weaken QoQ. We build in GRM of US$12/bbl in 2QFY09 • In petrochemicals, we build in 5% lower volumes due to de-stocking by the consumers. However, the average delta is likely to strengthen due to 8.5% INR depreciation QoQ(RIL)
Zee Entertainment	Media	5,336	34%	25.4%	3%	937	1%	• Zee Entertainment is expected to register strong topline growth on the back of advertising revenue growth. The PAT growth however will be muted on account of increased programming cost and forex loss.

Source: IIFL Research

Sharp slowdown

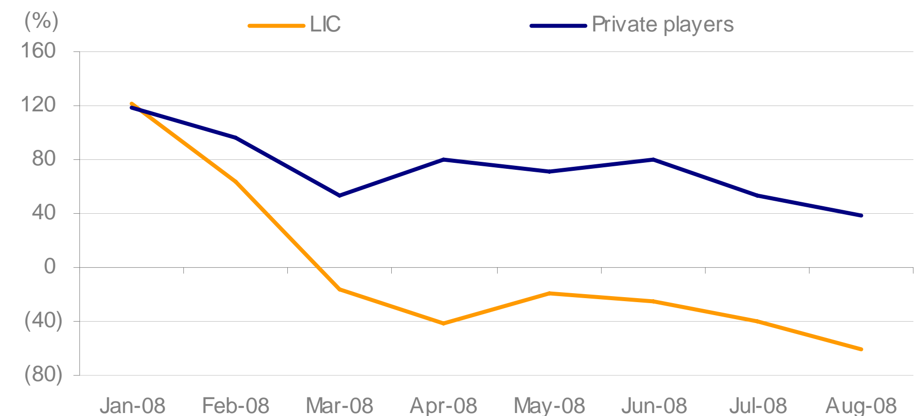
Life insurance premium growth slowed down significantly in the month of August, with annual premium equivalent (APE) for the sector declining by 30% YoY. APE for LIC dropped by 61% YoY and grew by 'only' 39% YoY for private insurers, a sharp decline from 84% growth in FY08. The insurance business is seasonal, and over 60% of premium collections in a year come in the second half. Growth is unlikely to pick up in the near term, given low investor interest in equities. We are lowering our current year's APE growth assumption to 25% for private players (from 45% earlier) and -30% for LIC (from 16% earlier). Furthermore, we are lowering the NBAP multiple to 12x (from 16x) on account of the sharp deceleration in premium growth. As a result, valuation of Indian life insurance companies would drop by 25-35%.

Figure 1: APE registered CAGR of 94% for pvt cos and 23% for LIC during FY04-08



Source: IRDA, IIFL Research

Figure 2: APE growth (YoY) has decelerated over the last few months

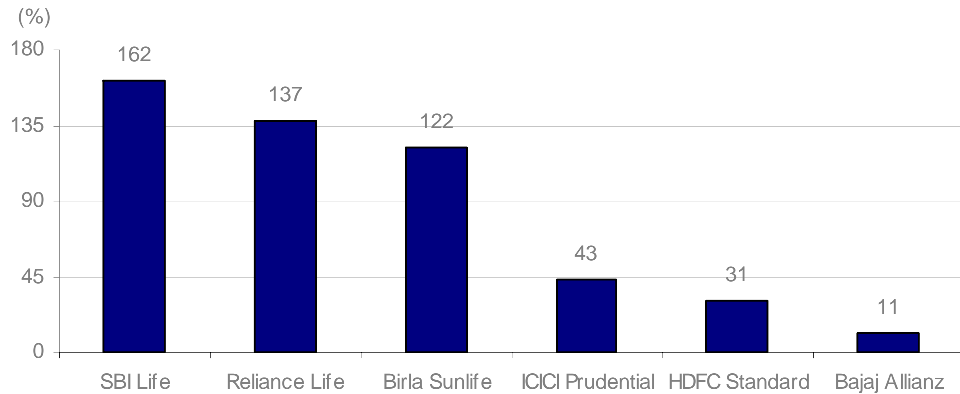


Source: IRDA, IIFL Research

Deceleration in APE growth: After a CAGR of 42% over the last four years (FY04-08), APE growth for the sector is estimated to slump to (-) 1% in the current year. Private players recorded 94% CAGR during this period (versus LIC's growth of 23%), but we expect them to grow by only 25% in the current year.

LIC's APE has declined since March 2008. It dropped by 61% YoY in August 2008, the sharpest fall since October 2007. Private players's APE continues to grow, but at a significantly slower rate. Private-sector insurers' APE growth has dropped from 123% YoY in December 2007 to 39% in August 2008—the lowest growth rate witnessed since June 2007.

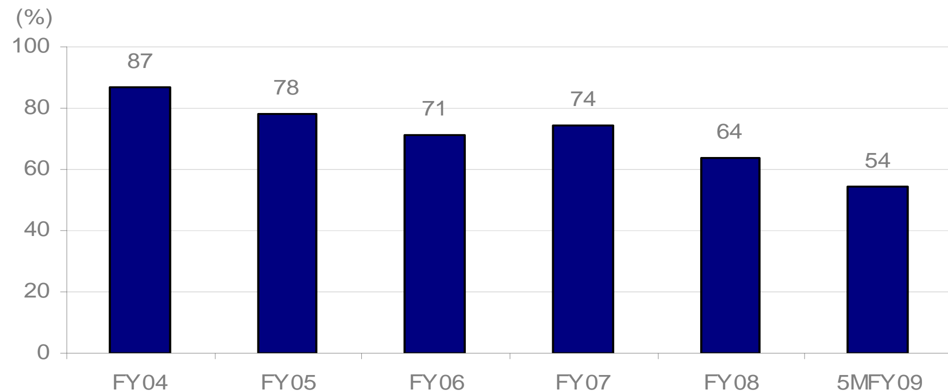
Figure 3: 5MFY09 YoY APE growth for top six players



Source: IRDA, IIFL Research

LIC is losing out: LIC's market share in first-year premium (FYP) has gone down from 87% in FY04 to 54% YTD FY09. Its business mix has also been changing, with an increasingly large share coming from single-premium policies. For example, YTD FY08, single premiums have accounted for 60% of total FYP for LIC, as compared to 12% for private-sector players. This shows LIC's inability to generate business from regular premiums, which are more stable and profitable.

Figure 4: LIC's market share in FYP terms – down by 10% in 5MFY09



Source: IRDA, IIFL Research

We reduce our forecasts: We are reducing our FY09ii APE forecasts for private players to 25% YoY growth (down from 45% earlier) and for LIC to -30% (down from 25% earlier). We estimate the sector's APE will decline by 1% in FY09.

Figure 5: APE - new business growth assumption (old)

(%)	FY08A	FY09ii		FY10ii	
		Old	New	Old	New
HDFC Standard	72	45	25	35	22
ICICI Prudential	67	40	25	30	22
Reliance Life	167	74	56	50	39
SBI Life	93	40	40	35	30
Private players	84	45	25	35	23
Industry	17	31	-1	30	17

Source: IRDA, IIFL Research

Furthermore, we are lowering our target NBAP multiple to 12x (from 16x) in view of sharp deceleration in premium growth. We are maintaining our NBAP margin assumptions, though. As a result, valuation of private insurance companies would drop by 25-35%. Consequently, we are reducing our SOTP values for HDFC by 4%, ICICI Bank by 9%, Reliance Capital by 11% and SBI by 3%.

Figure 6: NBAP - margin assumptions maintained as of now

(%)	FY08A	FY09ii	FY10ii
Bajaj Allianz	21.0	20.0	19.0
HDFC Standard	19.5	19.0	18.5
ICICI Prudential	19.2	17.0	16.0
Reliance Life	18.0	17.5	17.0
SBI Life	19.0	18.5	18.0

Source: IIFL Research

Figure 7: IIFL estimated value of life-insurance businesses

(Rs m)	Old	New	% chg
HDFC Standard Life	101,997	66,053	(35)
ICICI Prudential Life	282,617	189,472	(33)
Reliance Life	94,165	63,355	(33)
SBI Life	143,831	108,197	(25)

Source: IIFL Research

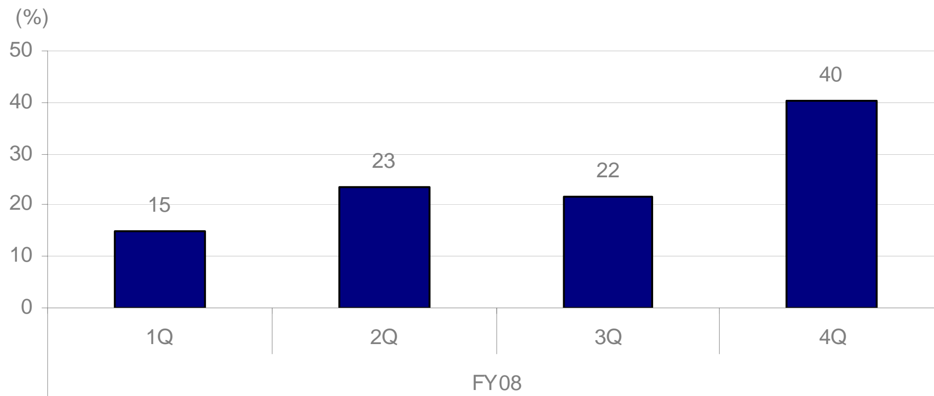
Figure 8: % change in SOTP

(%)	Old SOTP	New SOTP	% chg
HDFC	2,325	2,231	(4)
ICICI Bank	679	617	(9)
Reliance Capital	1,118	993	(11)
SBI	1,591	1,549	(3)

Source: IIFL Research

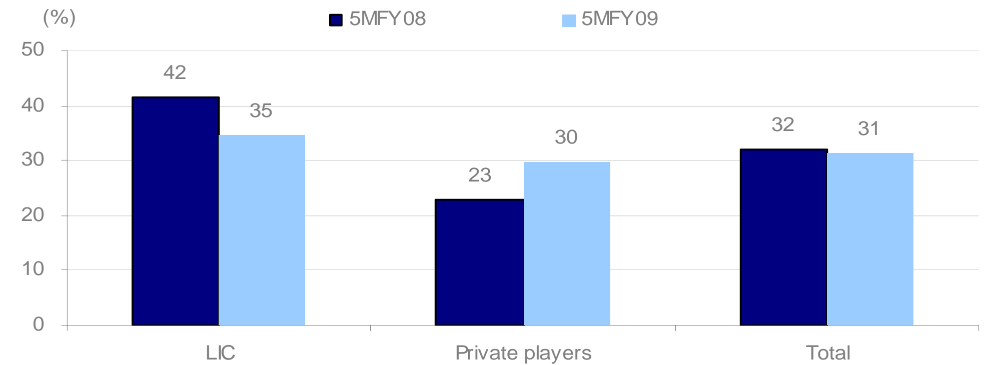
Back-ended business: Premium collected is very seasonal, with the bulk of business done in the last quarter of the fiscal. For example, in FY08, the second half (October 2007-March 2008) accounted for 62% of the industry's APE and the last quarter (January-March 2008) for 40%. As compared to that, the first five months of FY09 have accounted for 31% of our revised FY09ii FYP forecasts for the industry. As such, if the present slowdown continues for the next six months, it will have a significant adverse implications for the industry's resource mobilisation, and in turn, its ability to invest in equity markets.

Figure 9: APE business quarterly share for FY08



Source: IRDA, IIFL Research

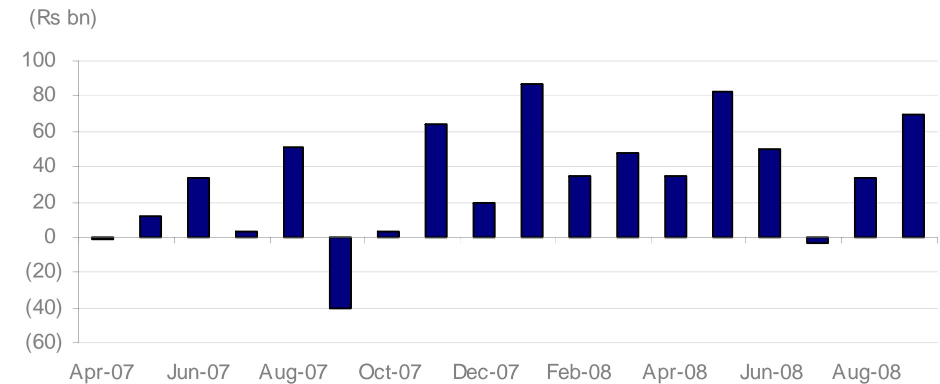
Figure 10: Business achieved in the first five months



Source: IRDA, IIFL Research

Waning investment in equity markets: Deceleration in insurance premium is showing up in reduced flows of domestic institutional investors (DII) ex-mutual funds (DII ex MF). DII ex-MF flows have declined from Rs87bn in January 2008 to Rs69bn in September 2008.

Figure 11: DII ex – MF flow



Source: Bloomberg, IIFL Research

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India Cements - REDUCE

Cement

7 Oct 2008

Positive triggers missing

We are raising our FY09 earnings estimate for India Cements (ICL) marginally (by 3%) after our recent management visit. Cement prices in the southern region have rallied on continued strong demand. This, we believe, will lead to faster growth in realisations than we had earlier factored in. For volumes, on the other hand, we cut our estimates for FY09 and FY10, in view of delays in de-bottlenecking capacities. ICL is trading at US$56/tonne (based on FY10ii capacity), near its previous down-cycle valuation. We maintain our REDUCE rating and target at Rs122. Our cautious view stems from our expectation of a sharp decline in cement prices in the southern markets in FY10, with new capacities commissioned in the last six months to stabilise in the next 3-6 months. Nevertheless, any sharp correction in ICL's stock from here on would provide long-term value, in our view.

- **Cement price rallies in the southern markets**: For the five months ended August 2008, cement demand in the southern region has grown by 11.7% YoY, against all-India growth of 7.8%. Recent capacity additions from Penna Cement and Rain Commodities are yet to stabilise. Same-plant (for plants more than a year old) capacity utilisation has increased 670bps YoY to 107.4% in the southern region. The demand-supply mismatch has caused average cement price in the southern region to increase sharply in recent months. We expect ICL's realisations to rise higher than our earlier expectation.

- **We expect realisation to dip in FY10:** We believe that cement prices are in for a sharp correction from 4QFY09, as recent major capacity expansions of UltraTech Cement, Penna Cement, Rain Commodities and Sagar Cement totalling 11mtpa (15% of existing capacity) would stabilise by 4QFY09. In addition to this, capacities to the tune of 11mtpa would be added in the next six months, which we expect will ease supply tightness in the southern markets. We expect average cement realisation for ICL to decline by 11% in FY10 after an increase of 11% in FY09.

CMP	**Rs108**
12-mth Target price (Rs)	***122 (13%)***
Market cap (US$ m)	**637**
Bloomberg	**ICEM IN**

52Wk High/Low (Rs)	333/105
Diluted o/s shares (m)	282
Daily volume (US$ m)	2.2
Dividend yield FY08ii (%)	1.6
Free float (%)	71.9

Shareholding pattern (%)

Promoters	28.1
FIIs	34.5
Domestic MFs/Insurance cos	17.8
Others	19.6

Price performance (%)

	1M	3M	1Y
India Cements	-24.7	-17.4	-61.6
Rel. to Sensex	-6.1	-5.2	-28.0
Madras Cements	-18.8	-24.6	-51.0
UltraTech	-19.2	-11.5	-56.2
ACC	2.5	25.6	-49.1

Stock movement

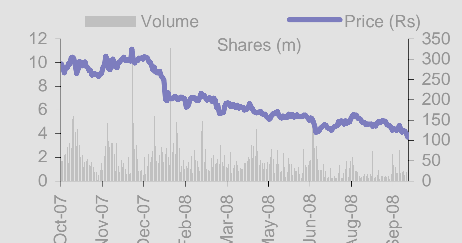

Figure 1: Financial snapshot

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenues (Rs m)	22,553	30,443	35,707	35,109	37,458
EBIDTA	7,343	10,313	12,694	9,966	8,535
EBITDA margins (%)	32.6	33.9	35.6	28.4	22.8
Reported PAT (Rs m)	4,788	6,375	6,202	4,469	3,416
EPS (Rs)	18.4	22.5	21.9	15.8	12.1
Growth (%)	1078.7	22.3	-2.7	-27.9	-23.6
PER (x)	**5.9**	**4.8**	**4.9**	**6.8**	**9.0**
ROE (%)	35.4	25.9	20.6	13.2	9.4
EV/EBITDA (x)	**6.1**	**3.8**	**3.0**	**3.1**	**2.9**
Price/Book (x)	1.3	0.9	0.8	0.7	0.7

Source: Bloomberg, IIFL Research

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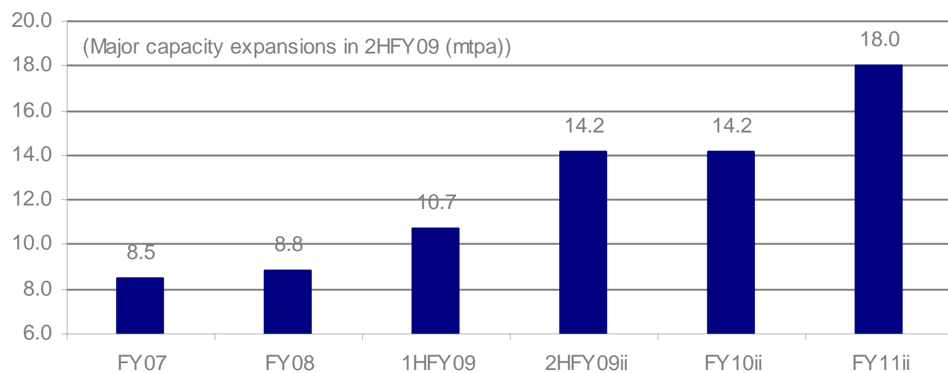
We reduce volume growth expectation as capacity expansions are delayed: ICL is expanding its cement capacity from the current 10.7mtpa to 14mtpa by end-FY09. These capacities are being added in a phased manner, through de-bottlenecking at various plants. Upgradation of ICL's Kiln-1 in Vishnupuram, which would increase its capacity by 1300tpd, is delayed, and is now expected to be completed in 4QFY09. Capacity de-bottlenecking at Yerraguntla and Malkapur are slightly behind schedule. We cut our volume growth expectation to 7% (9.8m tonnes) from 14% (10.5m tonnes) on account of delays in capacity expansion. We reduce volume expectation for FY10 from 10% growth to 7% growth.

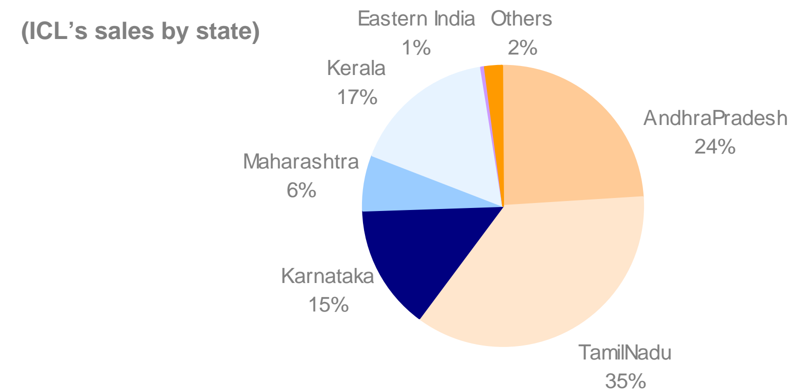
Indonesian coal price yet to decline: ICL imports ~65% of its coal requirement from Indonesia. Indonesian coal prices are yet to decline, as floods in the mines had recently caused a shortage. The current FOB price is US$105/tonne and CIF price is US$125/tonne. We expect full impact of coal price rise to reflect in 3QFY09 and coal costs to decline from 4QFY09. Out of the domestic purchases, nearly 90% is procured from linkages, while the rest is purchased at e-auctions, where prices are at a 30% premium to linkage prices.

Figure 2: ICL - volume growth to remain muted, with capacity constraints in FY09 and supply tightness easing in FY10



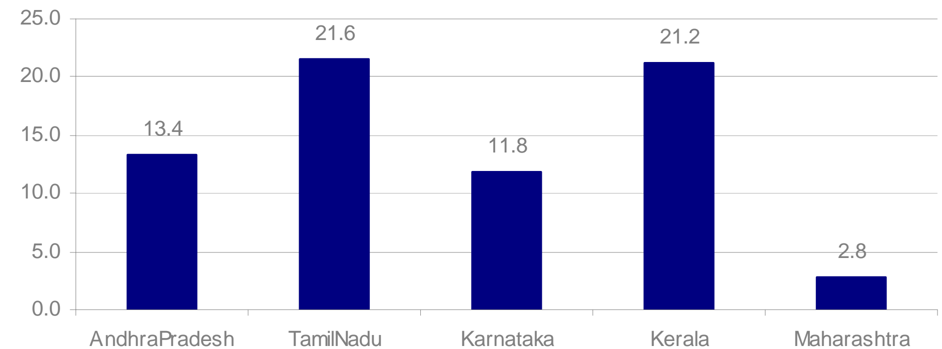
Source: Company

Figure 3: The southern region accounts for over 90% of ICL's current cement sales



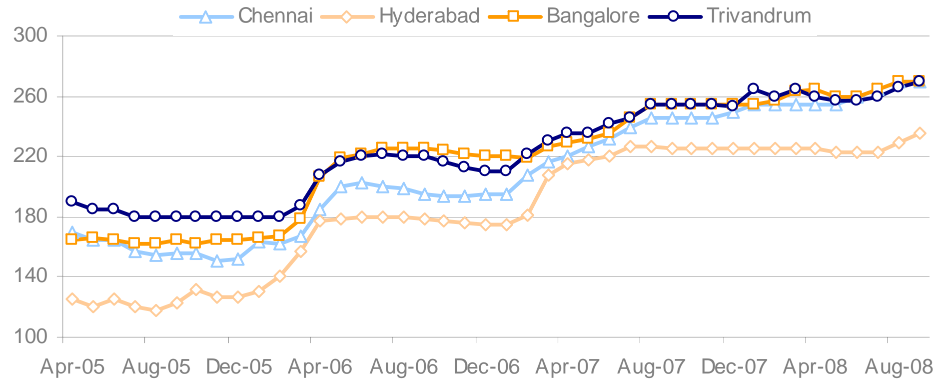
Source: Industry, IIFL Research

Figure 4: State-wise market share of ICL (major states)



Source: Industry, IIFL Research

Figure 5: Cement prices in the South have risen sharply in the past three months

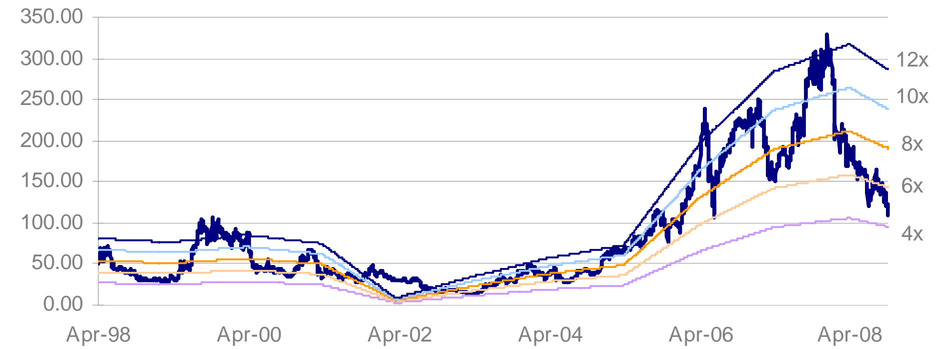


Source: Industry, IIFL Research

Figure 6: 1-year forward rolling EV/tonne - nearing trough valuation

Source: Bloomberg, IIFL Research

Figure 7: 1-year forward rolling EV/EBIDTA



Source: Bloomberg, IIFL Research

Figure 8: 1-year forward rolling P/BV

Source: Bloomberg, IIFL Research

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IIFL

Events calendar – October 2008

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
		1 Export-Import data - Aug	2	3 WPI for 20 Sep	4
6	7	8 Indiabulls Real Estate	9 WPI for 27 Sep	10 Infosys, Mastek IIP - Aug	11
13 Axis Bank	14	15 Concor, HCL Tech, L&T,	16 HDFC Bank Mphasis WPI for 4 Oct	17 HDFC, Satyam Comp,	18 Balkrishna Inds.,
20 Mindtree Rural CPI - Sep	21 Power Fin.,	22 3i Infotech, Max India	23 ACC, Bajaj Auto Bajaj holding, Exide WPI for 11 Oct	24 Dishman, GSK Cons, HCC, Monetary Policy	25
27 ICICI Bank, Tata Power	28	29 Mahindra & Mahindra,	30 Dabur India WPI for 18 Oct	31 India cement	

Black: Quarterly results, Blue: Economic data

Events

Period	Events
Oct-08	• **HSM** modernization – 2.5mtpa to 3.2mtpa • Bar and Rod mill 1.5mtpa • **Concor** - Container traffic data for month of September at major ports • **Tata Motors** - Launch of the eagerly awaited Nano. • **Tata Motors** - Rights issue of Rs52bn in two tranches 1) Rights issue in ratio of 1:6 at Rs340 per share 2) Rights issue in ratio of 1:6 at Rs305 per share, differential shares with lower voting rights and higher dividend • **Maruti** - A-star launch
Nov-08	• US Presidential elections • **JSW** – Capacity expansion to 6.8mtpa
Dec 08	• **Sun Pharma** - Israeli supreme court decision on enforceability of special tender offer rule in Taro acquisition • **Nalco** – Phased commissioning of 2nd phase expansion • Increase alumina capacity from 1.57mtpa to 2.1mtpa • Increase aluminium capacity from 345ktpa to 460ktpa • Increase power capacity from 960MW to 1200MW • **Lakshmi Energy** and Foods 2nd 15MW power plant to begin commercial production.
Oct-Dec 08	• **Jubilant Organosys** - generic sestamibi approval by US FDA
Nov-Dec 08	• **Dr Reddy's Labs** - Imitrex authorized generic launch in US
Oct-Dec 08	• Indus Tower expected to get towers from three shareholders **Bharti, Vodafone and Idea** • 3G auctions expected to be held • **Grasim's** Shambupura 4.5mtpa cement plant to start commercial prod. • Commercial production from **RIL** KG D-6 starts • Commercialisation of **RPL** refinery • **Unitech** - Dilution of stake in its telecom subsidiary • **Madras Cements** 2mtpa cement plant at Ariyalur to start Prod.

Period	Events
Jan-Mar 09	• **RCOM** expected to launch GSM services nationwide • **Grasim's** Kotputli 4.4 mtpa expansion to commence prod.
Apr-Jun 09	• India's national elections
Oct-Mar 09	• **DLF** - Buy back of shares- upto Rs 11bn & cap price at Rs600/share • **DLF** - Capital raising by DAL • **Sobha** - Right issue upto Rs3.5bn • **Sintex** - Announcement of new international acquisition in composite segment • **Arshiya International** - Capital raising to fund its FTWZ & Rail business • **Puravankara Projects** - Capital raising by its subsidiary Provident Housing & Infrastructure Ltd to fund its mass housing project
Oct-Dec 09	• **BHEL** Capacity goes up from 10 GW to 15 GW

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%

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