The Front Page

August 26, 2008

- What's Inside: Infosys (REDUCE), Steel Sector, Telecom, Grasim (ADD), Events calendar

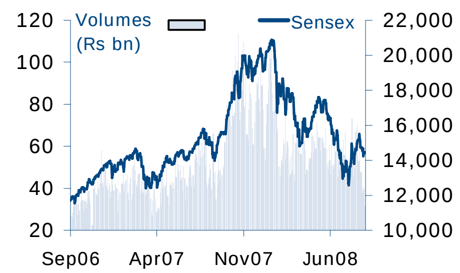
Market Front Page

Index Movements	Closing	% Chg	% YTD
Sensex	14,450	0.3	(28.8)
Nifty	4,335	0.2	(29.4)
BSE Smallcap	6,922	(0.1)	(48.1)
CNX Midcap	5,668	0.4	(38.4)
Nasdaq	2,366	(2.0)	(10.8)
DJIA	11,386	(2.1)	(14.2)
IBOV	54,477	(2.5)	(14.7)
FTSE	5,506	2.5	(14.7)
CAC	4,356	(1.0)	(22.4)
Turnover		US$m	% Chg
BSE		716	(21.3)
NSE		1,712	(20.1)
Derivatives (NSE)		10,551	3.2
FII F&O (US$m)		Index	Stocks
Net buying		294	46
Open interest		8,809	4,365
Chg in open int.		144	8
Equity Flows (US$m)	Latest	MTD	YTD
FII (22/8)	(28)	(451)	(7,197)
MF (22/8)	42	(187)	2,421

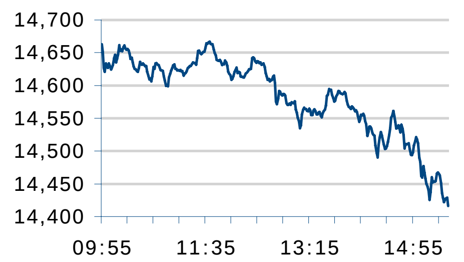
ADR/GDR (US$)	Latest	% Chg	% Prem
HDFC Bank	84.8	(0.8)	2.5
Reliance	103.8	1.0	1.8
Infosys	39.9	(4.0)	2.4
Satyam	21.4	(1.8)	18.9
Wipro	11.3	(3.0)	17.7
ICICI Bank	29.5	(2.4)	(1.7)
SBI	64.0	0.8	3.2
ITC	4.2	(0.9)	0.4
Commodities	Latest	%Chg	%YTD
Gold (US$/ounce)	821	(0.1)	(1.5)
Crude (US$/bl)	115	0.4	19.5
Aluminium (US$/MT)	2,790	(2.1)	15.8
Copper (US$/MT)	7,660	(2.5)	14.8
Forex Rates	Closing	% Chg	%YTD
Rs/US$	43.6	0.2	10.6
Rs/EUR	64.2	(0.4)	10.4
Rs/GBP	80.3	(1.0)	2.0
Bond Markets		Closing	bps Chg
10 yr bond		9.0	(9.0)
Interbank call		9.0	(60.0)

Charts Front Page

Sensex price volume



Sensex intraday



Corporate Front Page

- **Infosys** to acquire UK-based Axon Group for US$753m in an all-cash deal (ET)
- **RIL** may transfer 80% in KG D6 to its four unlisted subsidiaries (ET)
- **Tata Motors** to pull out of Singur, if the situation does not improve within the next fortnight (ET)
- **NTPC** seeks government nod to raise ECBs worth US$25bn (BL)
- **SAIL** has expressed concerns over likely delays in its expansion projects due to problems in equipment supply (BL)
- Norway's StatoilHydro is keen to treble its stake to 30% in a gas block operated by **ONGC** in KG basin (BS)
- **ONGC** notifies four new discoveries and plans Rs4.5bn to enhance its E&P capabilities (BL)
- BSNL, **Bharti, Tata Comm** and Saudi Telecom to invest around US$400m in an undersea cable link (FE)
- **NALCO** has floated a tender to export 30,000 tonnes of alumina (BL)
- **Wipro** to launch Unza's personal-care portfolio in India this month (ET)
- **HCL Tech** has signed an agreement to acquire US-based Control Point Solutions (ET)
- **Bharti Airtel** ties up with IBM for sharing technology and services (ET)
- **BHEL** and Heavy Engineering Corp plan to join hands to manufacture forging equipment for nuclear power plants (DNA)
- **IOC**, **HPCL** and **BPCL** have asked the government for US$4bn forex loan from the RBI (FE)
- TRAI data reveals that **Airtel** and **RCom** tops the list of most congested networks (BS)
- **Britannia Industries** to increase prices if input cost continue to spiral (BS)

Market Front Page

Top Movers BSE 200

Top Gainers	Price (Rs)	Chg (%)	YTD (%)	Top Losers	Price (Rs)	Chg (%)	YTD (%)
Great Offshore	470	8.1	-49.8	Suzlon Energy	216	-4.4	-44.1
Indiabulls Real	302	6.6	-59.4	BF Utilities	2161	-4.2	-3.4
Zee Ent	221	4.5	-32.4	Adani Enterprise	617	-3.6	-46.4
Television 18	248	4.2	-53.6	EIH	150	-3.1	-18.8
Yes Bank	133	3.9	-46.6	Hindustan Zinc	558	-2.9	-32.5

Volume spurts

Company	CMP	M.Cap	Vol. (in '000)	10D A.Vol (in '000)	% Chg
Adani Enterprise	617	3,489	816	129	533
Gujarat Fluoro	198	526	234	45	426
Great Offshore	470	411	513	147	250
Patni Computer	228	728	1,057	324	227
Exide Industries	69	1,269	786	307	156
Corporation Bank	272	895	125	50	149
Ultratech Cement	593	1,693	181	76	138
Ranbaxy Labs Ltd	512	4,391	7,762	3,440	126
NDTV	320	459	201	91	121
Zee Ent	221	2,201	2,114	1,106	91

FII - FII trades

Scrip	22/8/2008			25/8/2008		
	Volume '000	Price	Prem %	Volume '000	Price	Prem %
Tata steel	465	592	-	994	601	-
Sbi	189	1,351	0.2	10	1,386	0.5
Grasim inds	5	2,025	4.0	30	2,017	2.5
Pantaloon	109	410	20.0	-	-	-
Allahabad bank	-	-	-	34	64	1.5
Obc	-	-	-	110	161	2.0

Corporate Front Page

- Government is taking a tough stance against oil majors **ONGC**, **RIL** and **Cairn** for delaying payment of royalties (ET)
- **Essar Oil's** arm to bid for more oil & gas blocks in Australia (BL)
- **Jet** and Kingfisher to spend about Rs1bn each towards global brand campaigns (DNA)
- **Dr Reddy's** has renamed its US subsidiary Reddy Pharmaceuticals as Promius Pharma (ET)
- **GHCL** has decided to undertake a restructuring program involving a hive-off of the home textile business (ET)
- **PTC** is planning to import coal and buy stakes in overseas coal mines to diversify its business (BS)
- **Fortis Healthcare** is undertaking a restructuring exercise and expects to achieve 16% operating margin in the current fiscal (ET)
- **Emami** plans overseas buy to drive growth (BS)
- **Eicher Motors** to increase price of three models of its Royal Enfield motorcycle with effect from 1 September 2008 (BS)
- **Tata Metaliks** gets prospective licence for iron ore in Maharashtra (BS)
- **HOV Services** to mull restructuring of its subsidiary companies (BS)
- **Purvankara** arm in talks with four PE funds to raise about Rs7.5bn (BS)
- **Royal Orchid** to invest Rs5bn to add eight new hotels by 2010 (ET)
- **Emco** is looking for coastal sites for setting up a power plant that will use imported coal (DNA)
- **Visa Steel** to invest Rs20bn over next 2-3 years (DNA)

Economy Front Page

- Telecom Commission has decided to auction 3G spectrum for CDMA players in the 800MHz band (ET)
- Steel exports dip 25% in April-July 2008 to 2.75m tonnes (BS)
- India adds a record 9.22m wireless subscribers in July 2008 (ET)
- Fiscal deficit target of 2.5% for 2008-09 is likely to be exceeded by a significant margin, says Planning Commission Deputy Chairman, Montek Singh (ET)
- State-run oil companies have proposed a Rs57/litre price for diesel they sell to industrial users (ET)
- India may attract US$40bn FDI in 2008-09 (ET)
- Three-year lock-in period to remain for FDI in real estate in 'mixed' projects that include hotel and tourism activities (ET)
- The Department of Pharmaceuticals has asked NPPA to clear price revision applications received from drug companies within a period of 30 days (ET)
- Cement firms may cap prices on fear of glut (BS)

Insider Trades

Company	Name of Acquirer / Seller	Transaction Date	Buy / Sale	Quantity	Price (Rs)	Deal Size (Rs m)	Shares Transaction (%)	Holding after Transaction (%)
ACC Ltd	Life Insurance Corporation Of India	14/03/2008 - 14/08/2008	Sell	3,815,504	670.0	2,556	2.0	16.9
Arshiya International Ltd	Mrs. Archana A Mittal	21/08/2008	Buy	750,000	164.0	123	1.3	36.5
Asian Oilfield Services Ltd.	VSB Investments Pvt Ltd.	12/08/2008	Buy	300,000	146.0	44	2.9	5.5
Eicher Motors Ltd.	Aktiebolaget Volvo (Publ)	--	Buy	2,275,610	272.0	619	8.1	8.1
K.P.R. Mill Ltd.	Kotak Mahindra Bank Ltd	--	Sell	1,746,000	95.6	167	4.6	1.5
Mahindra Composites Ltd.	Mahindra & Mahindra Ltd.	18/08/2008	Buy	1,341,203	41.0	55	30.6	30.6
Man Industries (India) Ltd	Priyal Mansukhani	20/08/2008	Buy	315,000	69.0	22	0.6	0.7
Sharp Industries ltd.	Lalit Polyester Pvt Ltd.	19/08/2008	Buy	900,000	25.6	23	4.5	12.7
Sharp Industries ltd.	Asset Reconstruction Company India Ltd.	19/08/2008	Sell	9,687,733	25.6	248	48.6	6.2
Sharp Industries ltd.	Ridhi Petrochem Pvt. Ltd	19/08/2008	Buy	1,600,000	25.6	41	8.0	8.0
Sharp Industries ltd.	Cat Cosmetics & Health Care P Ltd	19/08/2008	Buy	1,600,000	25.6	41	8.0	8.0
Sharp Industries ltd.	Swastik Bio-Agro Tech Limited	19/08/2008	Buy	1,620,000	25.6	41	8.1	8.1
Sharp Industries ltd.	Paras Leasings Limited	19/08/2008	Buy	997,733	25.6	26	5.0	5.0
Sharp Industries ltd.	Sabrang Polymers Pvt Ltd.	19/08/2008	Buy	2,970,000	25.6	76	14.9	14.9

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)
Anjani Synthetics	Gulf Investment Services Co SAOG Proprietary Investments	25/08/2008	Sell	100,000	53.9	5
Dhanus Tech	Melchior Indian Opportunities Fund	25/08/2008	Buy	158,519	148.0	23
Madhucon Projects	Mirae Asset Investment Management Co. Ltd.	25/08/2008	Sell	351,879	286.0	101
Madhucon Projects	Mirae Asset India Discovery Equity Investment Trust 1	25/08/2008	Buy	188,704	286.0	54
Madhucon Projects	Mirae Asset Mgt Inv Co Ltd Ac Mirae Asset India Eq Mst Inv Tr	25/08/2008	Sell	353,262	286.0	101
Modipon Ltd	Lotus Global Investments Limited	25/08/2008	Buy	120,000	34.0	4
Modipon Ltd	India Man Fund Mauritius Ltd	25/08/2008	Sell	120,000	34.0	4

Infosys – REDUCE

INFO IN	Rs 1706	IT Services	26 Aug 2008	Company Update

Axonify

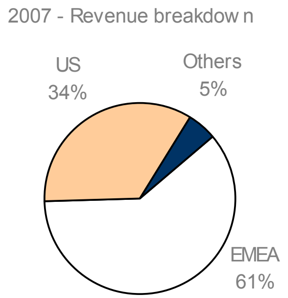
Infosys's acquisition of Axon highlights its need to introduce non-linearity to counter the slowdown in organic growth. It is also an attempt at giving a boost to its small consulting business to compete with MNCs (Accenture, Cap Gemini, IBM, etc). In our view, the proposed purchase price of US$753m (~2x revenues/~17xCY2008E) is reasonable for acquiring a credible SAP presence and broadening its geography/vertical spread. Now, the key challenge for Infosys will be to manage any conflicts arising out of differences in compensation, ideologies and work culture of employees. Given the discretionary nature of ERP implementations, these risks might be amplified by global headwinds. For FY09-10, we expect the acquisition to be earnings-neutral.

Credible presence in SAP implementation: We reckon Infosys has been trailing peers in SAP-related services. It was among the last of sector leaders to gain entry into SAP's Global Services Partner programme (Wipro, TCS and HCL Tech had achieved the status during 2004-2007). Axon's focus on high-end SAP consulting (~2,000 employees, mostly SAP consultants with high billing rates of ~US$200/hr) enhances Infosys's SAP presence. Management expects the acquisition to improve its prospects of winning transformational deals, among other things. Moreover, Axon's client roster includes public sector enterprises and the Energy & Utilities vertical (in which Infosys has traditionally had low exposure).

Yet another attempt at achieving scale in Consulting? Infosys Consulting was among the company's most ambitious attempts to introduce non-linearity, but the business has failed to live up to expectations. It slipped on its headcount target (management targeted 500 employees by 2007, but was able to scale up to only ~250 employees) and is yet to break even. Axon's acquisition is an attempt to reinvigorate the Consulting unit. While the acquisition adds front-end (onsite) consulting capabilities, taking the battle onsite (IBM, Accenture, CapGemini, CSC, EDS etc are leveraging their credible offshore presence) would imply lower margins.

Earnings-neutral: According to Infosys's management, it would be November 2008 before the acquisition is completed. As such, its financial contribution during FY09 would be minimal. We maintain our bearish view on the sector and Infosys on account of poor revenue visibility for the near term. Our negative stance is also influenced by client-specific concerns (Europe: BFSI) and fears of the slowdown spreading beyond the BFSI sector in the US.

Axon – CY07 revenue breakdown



Source: IIFL Research

Financial Summary

Y/e 31 Mar	FY06A	FY07A	FY08ii	FY09ii	FY10ii
Revenues (Rs m)	138,930	166,920	217,518	253,202	303,546
YoY (%)	45.9	20.1	30.3	16.4	19.9
EBITDA Margins (%)	31.6	31.4	32.4	30.8	31.2
Reported PAT (Rs m)	38,560	46,590	59,992	65,723	75,382
EPS (Rs)	67.4	81.5	104.6	114.6	131.5
YoY (%)	51.1	20.9	28.3	9.6	14.7
PER (x)	25.3	20.9	16.3	14.9	13.0
ROE (%)	34.3	33.8	33.3	29.1	27.0
EV/EBITDA (x)	20.8	17.0	12.2	10.5	8.2
Price/Book (x)	8.7	7.1	5.4	4.3	3.5

Price as at close of business on 25 August 2008

12-mth Target price (Rs) 1710 (0%)

Market cap (US$ m)	**22,306**
52Wk High/Low (Rs)	2142/1212
Diluted o/s shares (m)	572
Daily volume (US$ m)	85.6
Dividend yield FY08ii (%)	2.0
Free float (%)	83.5

Shareholding pattern (%)

Promoters	16.5
FIIs	33.6
Domestic MFs/Insurance cos	7.9
Others	42.0

Price performance (%)

	1M	3M	1Y
Infosys	10.0	-9.5	-6.5
Rel. to Sensex	8.8	2.1	-6.7
TCS	2.4	-14.4	-19.7
Wipro	3.1	-12.3	-8.2
Satyam	5.1	-18.4	-9.9

Stock movement

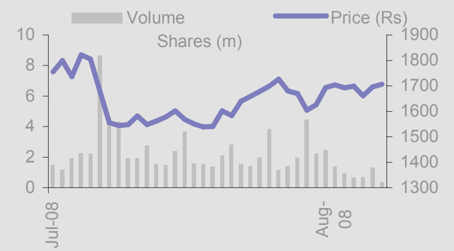


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Figure 1: Summary financials of Axon

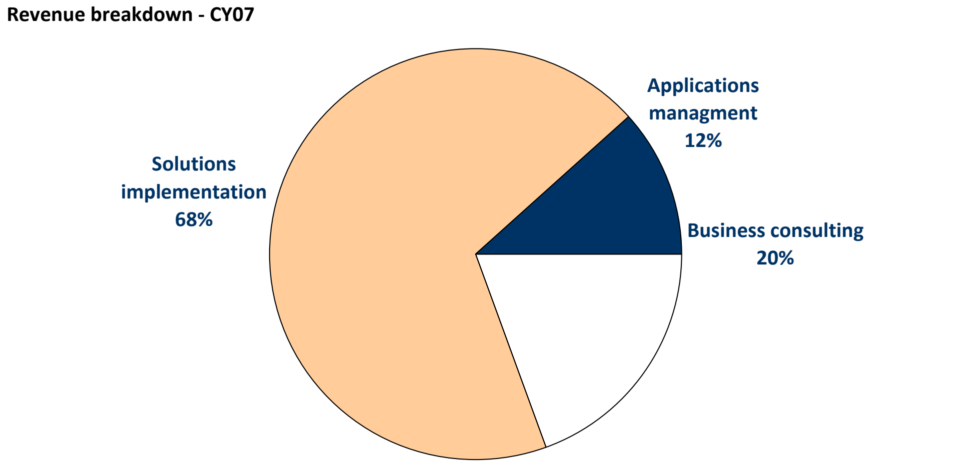
US$ m	FY05	FY06	FY07
Key income statement data			
Revenues	170	254	378
YoY	52.3%	49.8%	48.7%
Gross profit	42	74	104
Gross profit margin	24.9%	29.1%	27.5%
Operating profit	14	33	57
YoY	30.4%	138.5%	69.4%
Operating margin	8.2%	13.1%	15.0%
Other income	1	-1	-2
PBT	15	33	55
Tax rate	23.1%	29.9%	31.6%
PAT	12	21	37
PAT margin	6.8%	8.2%	9.9%
Key balance sheet data			
Cash and equivalents	24	23	47
Other current assets	63	80	86
Total current assets	88	103	133
Goodwill and intangibles	55	98	109
Property, plant and equipment	2	3	4
Other non-current	5	14	13
Total assets	**150**	**218**	**260**
Current liabilities	41	81	100
Loans	-	-	-
Other non-current liabilities	20	32	11
Called up share capital+premium	44	54	57
Reserves	0	-28	-29
Retained earnings	45	80	122
Total equity	89	105	149
Total liabilities	**150**	**218**	**260**

Source: IIFL Research; GBP/US$ - 1.85

Better vertical presence/higher offshore activities: Among the critical wins for Infosys would be Axon's roster of public sector clients. In addition to presence in public sector ERP implementations in the UK, Axon has presence in US public-sector enterprises, partly by way of its acquisition of TUI consulting in 2005. Some of its public sector clients include Birmingham City Council, Transport for London and the city of San Diego.

Credible SAP presence: Among Indian IT vendors, Infosys has been late to gain entry into SAP's Global Services Partner programme. However, given Axon's deep expertise in SAP-related services, we believe Infosys could gain a foothold in the SAP implementation market. Also, management expects to leverage Axon's skills to target transformational deals.

Figure 2: Axon – CY07 revenue breakdown



Source: IIFL Research

Margin divergence - impending decline? Axon earns ~20% operating margins from the EMEA geography, but only 10% from others. The high margins in EMEA are likely to be unsustainable for consulting services and might fall. While margins from US could increase, it would need a 1.8% increase in US margins to compensate for a 1% decline in EMEA margins. A higher tax rate in the US further hampers profitability.

Figure 3: High exposure to EMEA

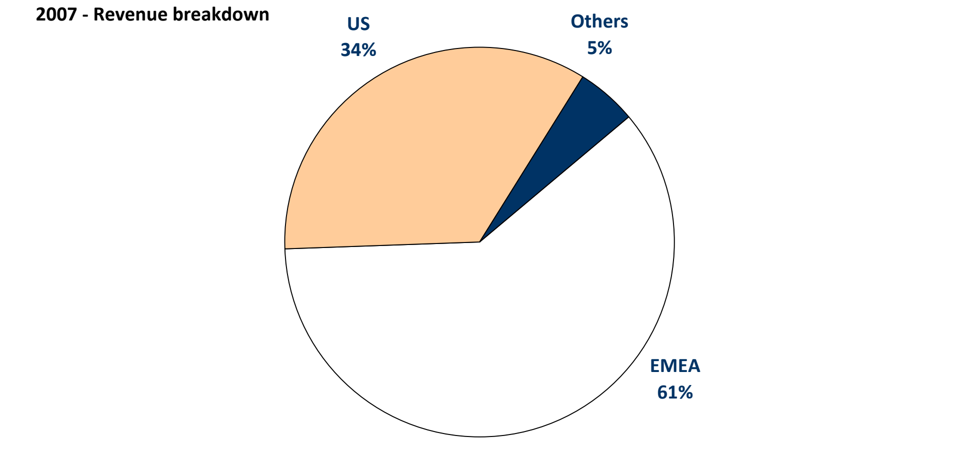
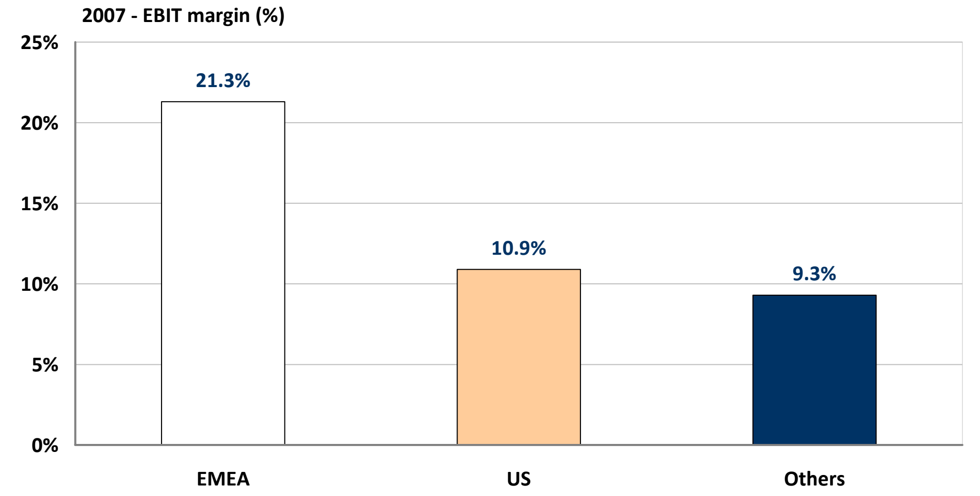


Figure 4: Margins from EMEA are difficult to sustain



Source: IIFL Research

An acquisitive strategy of Axon vs Infosys: In its 27-year history, Infosys has preferred organic growth. As such, Axon is its largest acquisition by far. Also, its travails with scaling high-end people-driven businesses (Infosys Consulting has slipped on employee growth targets) could impinge upon management's intention to leverage Axon. Also, Axon has been active on the acquisitions front. As such, Infosys's traditional preference to organic growth could constrain its growth.

Figure 5: A few key acquisitions of Axon

Date	Name	Location	Services offered	Revenues	Purchase value	Units	Comments
8-Apr-05	Feanix corporation	USA	SAP consulting services for the US Aerospace and Defence Industry	17.6*	23.5	US$ m	
21-Dec-05	TUI consulting	USA	SAP consulting services for US Utilities and Public Sector				
11-Jan-06	Premier H R Solutions	USA			14.5	US$ m	3.6 is contingent on business performance
1-Dec-06	Zytalis	USA	SAP consulting services High-Technology and Discrete Manufacturing sectors.	7.5	29.6	US$ m	14.6 is deferred over 2008-10
26-Mar-07	JSPC i-Solutions Berhad	Malaysia	SAP Consultancy for the Malaysian, Singapore and Chinese markets	3.9	9.3	GBP m	
2-May-08	EnterSys Group L.P.	USA	SAP consulting services to the oil, gas & chemical sector	25	25	US$ m	7.5 in deferred cash payments/10 contingent on future biz. performance
1-Jul-08	SCM solutions	USA	Supply Chain Management Services				
17-Jul-08	Consulting Principles Pty Ltd	Australia	Specialist supply chain and logistics SAP consulting services	7	3.5	AUS$ m	3 in deferred cash payments over the next 2 years

Source: IIFL Research; * - 1Q annualised

Could Axon's earn-outs affect the deal size? The deal lacks clarity on probable earn-outs to Axon's management/employees. In addition, Axon could be indebted to earn-outs on its own acquisitions. However, we estimate the impact of these secondary earnouts will be minimal (~US$35m for the above acquisitions).

Still, non-UK Europe is a tough nut to crack: The Continental Europe market is 6x the size of Europe (source: Axon Annual Report), but Axon has a minimal presence in that market. As such, the acquisition may not give Infosys the crucial language/cultural skills necessary for success in Continental Europe market.

Figure 6: Axon vs Infosys

US$ m	Axon - CY07	Infosys - FY08
Revenues	378	4,142
Cost of sales	-274	-2,285
Gross profit	104	1,857
Gross profit margin	27.5%	44.8%
Administrative expenses	-47	-706
Operating profit	57	1,151
Operating profit margin	15.1%	27.8%
Non-operating income	-2	200
PBT	55	1,351
ETR	32.5%	14.4%
PAT	37	1,156
PAT margin	9.9%	27.9%

Source: IIFL Research; US$/GBP: 1.85; Rs/US$: 40.3

Figure 7: Infosys + Axon

Infosys (after Axon acquisition)	FY08	FY09ii*	FY10ii
Revenues	3,882	5,171	6,389
Operating profit	1,103	1,482	1,679
Op profit margin (%)	28.4%	28.7%	26.3%
PBT	1,266	1,623	1,815
ETR	14.4%	14.2%	16.2%
PAT	1,083	1,392	1,521
PAT margins	27.9%	26.9%	23.8%
% change			
Revenues	0.0%	2.2%	8.5%
Operating profit	0.0%	1.1%	4.4%
Op profit margin (%)	0 bps	-30 bps	-102 bps
PBT	0.0%	-0.2%	-0.2%
ETR	0 bps	4 bps	21 bps
PAT	0.0%	-0.2%	-0.5%
PAT margins	0 bps	-65 bps	-215 bps

Source: IIFL Research; * - 3 month consolidation of Axon; GBP/US$ - 1.85;

Figure 8: Shareholding pattern of major holders

Shareholder	Stake
Promoters + employees *	18.1%
BlackRock Investment Management	6.6%
Aegon Asset Management UK plc	6.1%
Standard Life Investments	6.1%
JP Morgan Asset Management	4.9%
Renovo (EBT)	4.7%
Don Kirkwood (held in nominees account)*	3.8%
Globflex Capital	3.7%
Scottish Widows	3.4%
Legal & General Investments	3.0%
	60.6%

Source: IIFL Research; * - Infosys press release; Shareholding patter of other major holders is on 31 Dec 2007.

Figure 9: Deal specifics

Purchase value	GBP 407.1m
Purchase price	Pence 600
Estimated completion date	Nov-08
Offer price premium to	
Closing price	19.4%
3 months average closing price	31.7%
6 months average closing price	33.1%

Source: IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY06A	FY07A	FY08ii	FY09ii	FY10ii
Revenue	138,930	166,920	217,518	253,202	303,546
EBITDA	43,910	52,380	70,471	78,082	94,627
EBIT	38,770	46,400	62,996	69,112	83,863
Other income	3,720	7,040	6,884	9,130	10,365
Exceptional items	40	1,010	0	0	0
Adj. Profit before tax	**42,530**	**54,450**	**69,881**	**78,242**	**94,228**
Taxes	3,860	7,860	9,888	12,519	18,846
Minorities and other	-110	0	0	0	0
Net profit	**38,560**	**46,590**	**59,992**	**65,723**	**75,382**
Revenue	138,930	166,920	217,518	253,202	303,546

Cashflow summary (Rs m)

Y/e 31 Mar	FY06A	FY07A	FY08ii	FY09ii	FY10ii
Profit before tax	38,770	46,400	62,996	69,112	83,863
Depr. & amortization	5,140	5,980	7,475	8,970	10,764
Tax paid	-3,860	-7,860	-9,888	-12,519	-18,846
Working capital Δ	-12,660	7,330	-3,243	-4,442	-2,387
Other items	3,720	2,749	6,884	9,130	10,365
Operating cashflow	31,110	54,599	64,224	70,252	83,760
Capital expenditure	-20,530	-11,560	-12,000	-13,200	-14,520
Free cash flow	**10,580**	**43,039**	**52,224**	**57,052**	**69,240**
Equity raised	12,354	830	0	0	0
Investments	20	0	0	0	0
Dividends paid	-7,510	-19,019	-17,955	-19,671	-22,562
Other items	-1,284	1,010	0	0	0
Net change in cash	**14,160**	**25,860**	**34,269**	**37,381**	**46,678**

Source: Company data, IIFL Research

Financial summary

Balance sheet summary (Rs m)

Y/e 31 Mar	FY06A	FY07A	FY08ii	FY09ii	FY10ii
Cash & equivalents	62,050	84,680	118,949	156,330	203,008
Sundry debtors	33,410	46,220	56,730	69,363	85,597
Other current assets	920	1,190	0	0	0
Fixed assets	**28,060**	**34,530**	**47,495**	**51,245**	**54,473**
Intangible assets	-40	0	0	0	0
Other term assets	9,650	13,240	4,800	5,280	5,808
Total assets	**134,050**	**179,860**	**227,974**	**282,218**	**348,886**
Sundry creditors	14,690	19,120	20,143	23,989	28,619
Other current liabs	6,810	22,790	27,844	32,189	41,407
Net worth	**112,550**	**137,950**	**179,987**	**226,039**	**278,860**
Total liabs & equity	**134,050**	**179,860**	**227,974**	**282,218**	**348,886**

Ratio analysis

Y/e 31 Mar	FY06A	FY07A	FY08ii	FY09ii	FY10ii
Revenue growth (%)	45.9	20.1	30.3	16.4	19.9
Op Ebitda growth (%)	42.1	19.3	34.5	10.8	21.2
Op Ebit growth (%)	46.1	19.7	35.8	9.7	21.3
Op Ebitda margin (%)	31.6	31.4	32.4	30.8	31.2
Op Ebit margin (%)	27.9	27.8	29.0	27.3	27.6
Net profit margin (%)	27.8	27.9	27.6	26.0	24.8
Dividend payout (%)	19.5	40.8	30.0	30.0	30.0
Tax rate (%)	9.1	14.4	14.2	16.0	20.0
Net debt/equity (%)	-55.1	-61.4	-66.1	-69.2	-72.8
Net debt/op Ebitda (x)	-1.4	-1.6	-1.7	-2.0	-2.1
Return on equity (%)	34.3	33.8	33.3	29.1	27.0

Source: Company data, IIFL Research

Steel

Cooling down

26 August 2008

After rising by 50-75% in the year to date, steel prices have started easing. A fall in scrap and iron-ore prices and weakness in demand portend further softening. Indian steel stocks, trading at PERs of 5-7x, look attractively valued in relation to global peers as well as to historical multiple bands. However, falling steel prices and worsening macro headwinds for commodities are likely to keep multiples under pressure. We maintain our positive stance on Indian steel stocks from a 12-month perspective but expect no outperformance in the near term. We retain ADD on Tata Steel, JSW Steel and SAIL, with JSW being our top pick in the sector.

International prices softening and more to come: Steel price globally have corrected by US$60-100/tonne from their peaks. The fall in prices is across geographies and product categories. Our industry sources suggest that in European markets, volumes remain sluggish volumes even though mills have started offering US$100-150/tonne discounts on list prices. Similar weakness is evident in input prices, which are leading indicators of steel prices. Scrap prices have dropped by over 24% to US$435/tonne (HMS 2 Rotterdam) over the past month and spot prices of iron ore are down 5% to US$115/tonne.

Discount to international steel prices vanishing fast: A government directive had kept Indian domestic steel prices at a ~US$300-350/tonne (for HRC) discount to import parity price, giving comfort that Indian prices will not be fall in the near term. A fall in international prices and cheaper imports from South East Asian countries has reduced this discount to US$100/tonne. Imports into India have been concluded at ~US$1,000/tonne CNF as compared to world export FOB price of US$1,100/tonne (from *Steelbenchmarker),* which is at a marginal premium to realisation in the spot market. In the contract segment, steel prices may be higher than import parity prices. Domestic steel prices can come under pressure if international prices soften by US$100-150/tonne.

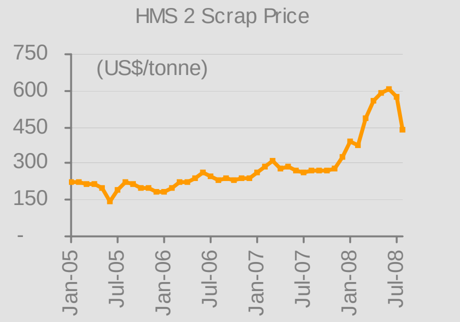
Valuations attractive, but uncertain steel environment to keep multiples under pressure: We were already building in a decline in steel prices in our earnings model for 2HFY09. Hence, we see no downside risk to our earnings estimates even if prices fall by US$100/tonne. Indian steel stocks are trading at 5-7x FY09ii, which are close to the low end of these companies' trading band. Despite these attractive valuations, we do not expect steel stocks to outperform in the near term, as 1) steel stocks' performance is closely linked to steel prices; 2) falling steel prices impede earnings visibility of steel companies; and 3) demand is weakening in Europe, USA and China and there are growing concerns on the global growth outlook. We do not expect steel prices to start recovering before December 2008, so multiples would likely remain under pressure.

Valuation summary

	Price	Market cap	Reco.	EPS (Rs)		PER (x)		EV/EBIDTA (x)	
	Rs	Rs m		FY09ii	FY10ii	FY09ii	FY10ii	FY09ii	FY10ii
JSW Steel	756	141,433	Add	106.0	129.1	7.1	5.9	5.0	4.7
SAIL	149	616,668	Add	21.0	20.4	7.1	7.3	3.7	4.1
Tata Steel	580	424,067	Add	108.8	101.6	5.3	5.7	5.0	4.7

Source: IIFL Research

Scrap prices - sharp downturn



Source: Bloomberg, IIFL Research

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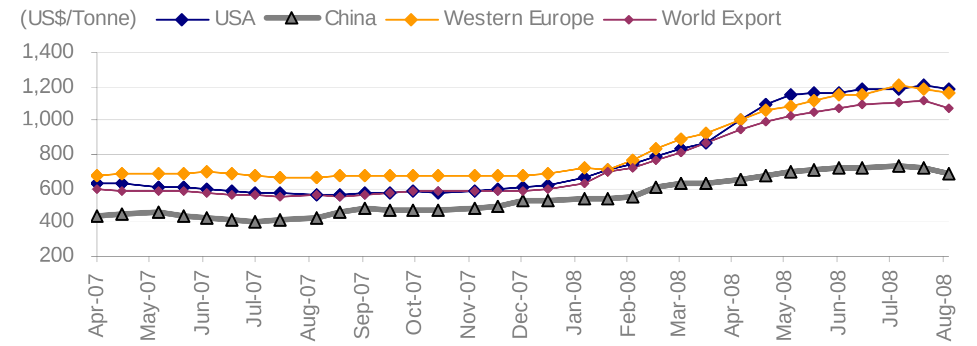
Prices cooling down across regions

The past one month has seen moderation in prices across regions. Across geographies, major steel producers have been unable to fully realise price hikes they had announced earlier for shipments scheduled in August. Our sources indicate that unofficial discounts in the European market have reached US$100-150/tonne, and producers are finding it hard to sell even at these prices.

Figure 1: Prices coming off highs across regions



Source: Steel Benchmarker, IIFL research

Demand stagnation across geographies

The slowdown in global economic growth has started telling on steel demand. According to CRU, global apparent consumption of finished steel grew by 5.2% YoY in 2QCY08, which is the slowest rise in the last 10 quarters. North America and Europe, two major steel-consuming regions that accounting for 10% and 16% of total consumption in CY07, have seen a decline in demand in 2QCY08 after moderate growth in 1QCY08. While Chinese demand is still holding up, demand growth has slowed down considerably from the highs of 2007. Steel consumption in the first half of CY08 grew 5.6% YoY. IISI forecasts consumption will grow 6.8% in the full year.

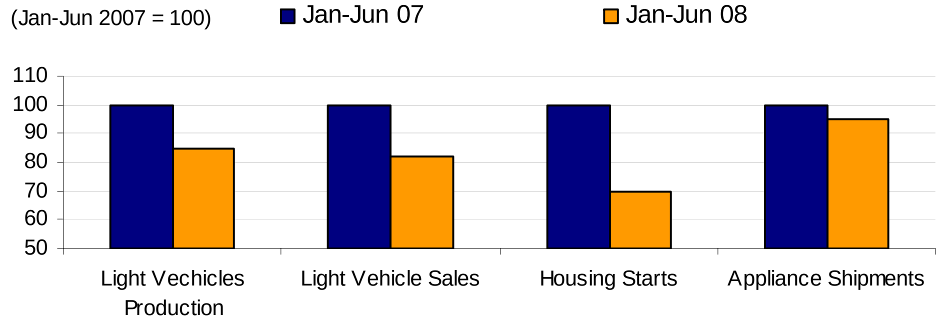
Figure 2: Consumption growth slowdown across geographies

	2005	2006	YoY%	2007	YoY%	1HCY07	1HCY08	YoY%
USA	89,082	100,578	12.9	90,710	-9.8	46,692	45,635	-2.3
Canada	15,936	17,326	8.7	15,079	-13.0	7,784	7,597	-2.4
North America	118,997	133,815	12.5	121,184	-9.4	61,921	61,758	-0.3
Germany	31,809	35,412	11.3	38,360	8.3	19,866	19,956	0.5
France	15,949	15,974	0.2	16,649	4.2	9,336	8,995	-3.6
Italy	29,522	33,455	13.3	33,722	0.8	17,056	17,035	-0.1
Spain	21,215	24,543	15.7	24,430	-0.5	13,312	12,411	-6.8
UK	8,771	9,639	9.9	10,357	7.4	5,297	4,824	-8.9
Other Europe	55,352	66,010	19.3	70,843	7.3	35,678	36,909	3.5
Europe	162,618	185,033	13.8	194,361	5.0	100,544	100,129	-0.4
Japan	74,307	74,614	0.4	76,744	2.9	38,890	38,154	-1.9
China	316,175	357,939	13.2	411,075	14.8	197,447	221,979	12.4
South Korea	38,698	42,183	9.0	46,975	11.4	23,901	25,730	7.7
Taiwan	19,191	18,303	-4.6	17,030	-7.0	8,700	9,010	3.6
Asia	483,961	528,991	9.3	594,891	12.5	290,618	317,885	9.4
CIS	40,348	45,400	12.5	52,965	16.7	25,692	27,508	7.1
Brazil	8,303	8,847	6.6	10,340	16.9	5,131	5,949	16.0
Rest of world	140,377	160,694	14.5	184,692	14.9	91,524	94,509	3.3
Total world	954,604	1,062,780	11.3	1,158,434	9.0	575,429	607,739	5.6

Source: CRU, IIFL Research

Weakness in construction-segment demand in the US and continued sluggish demand from automotive segments in Europe are major contributors to the growth slowdown. We expect no significant improvement in these regions in the coming months. Recovery of Chinese demand post Olympics will be the key to steel prices in 2HFY09.

Figure 3: Slowdown in steel end-user segments

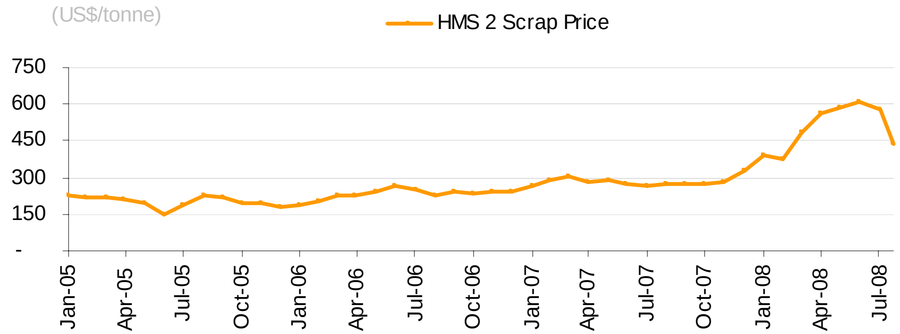


Source: CRU, IIFL research

Fall in raw-material prices indicates further weakness

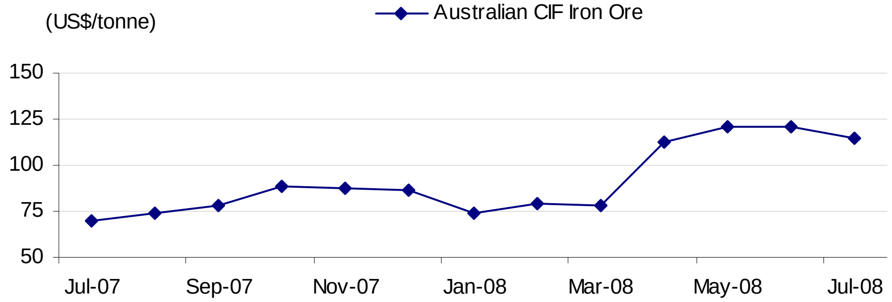
Scrap prices have historically been a leading indicator of steel prices. Scrap prices, after maintaining an uptrend for almost a year, have started declining and are down ~26% in the past month. Additionally, spot prices of iron ore have dropped by 5-10% in the past month. On the other hand, coking coal and LAM coke prices remain strong.

Figure 4: Scrap prices trading down sharply



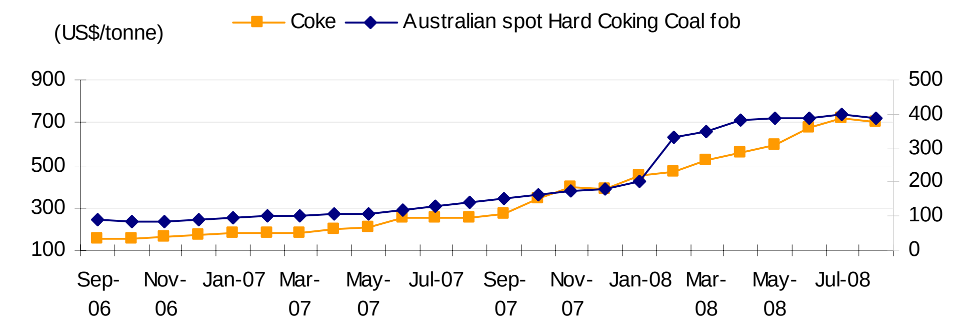
Source: Bloomberg, IIFL Research

Figure 5: Iron-ore prices trading down



Source: CRU, IIFL Research

Figure 6: Coke and coking coal prices down marginally



Source: CRU, IIFL Research

Domestic price discount to international price narrowing

Indian steel producers have refrained from increasing domestic steel price in a bid to contain inflation. A government directive had kept Indian domestic steel prices at a ~US$300-350/tonne (for HRC) discount to international export prices. This huge discount represented downside protection to Indian steel prices. Recent cheap imports from South East Asian countries have reduced the gap between the domestic price and import-parity price to US$100/tonne. According to industry sources, in many cases, contract prices are currently higher than import parity prices. Should international prices fall by another US$100/tonne in the months ahead, domestic prices would come under pressure.

Figure 7: Discount to import parity price at ~US$100/tonne

Particulars	Amount
FOB price for re-rolling grade (US$/tonne)	980
Freight (US$/tonne)	40
CNF price (US$/tonne)	1,020
Exchange rate (Rs/US$)	42
Landed cost (Rs/tonne)	42,840
Internal transportation	1,500
Import parity price (Rs/tonne)	44,340
Domestic price (Rs/tonne)	39,500
Discount (Rs/tonne)	4,840
Discount (US$/tonne)	115

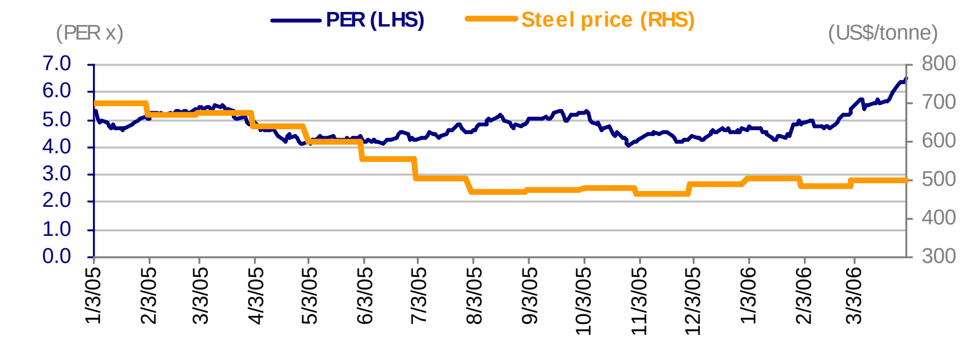
Source: Industry, IIFL Research

Steel prices are key to stock performance

In our view, direction of steel prices is key to stock performance. In CY05, for instance, Tata Steel had underperformed the market by 30%. This was despite being the world's most cost-efficient steelmaker, with among the highest EBITDA margins in the world (Tata Steel had not yet acquired Corus). Tata Steel was then trading at a PER of 4-6x, at a discount to most global steel majors. Although the stock was cheap, it underperformed the broader market on account of persistent negative news flow on regional prices. Uncertainty over steel prices reduced Tata Steel's earnings visibility, hampering stock price performance.

This is also evident from the fact that TATA traded at Rs420 when steel prices were at US$600/tonne in March 2005 (steel prices were falling). However as steel prices started recovering, the stock rose to Rs600 in January 2006; at this point, steel prices were US$420-440/tonne, and were rising. Near-term performance of commodity stocks tends to follow the commodity cycle, irrespective of valuations.

Figure 8: Tata PE band in 2004-2006 vs steel prices



Falling steel price to keep multiple under pressure

As in 2005, the attractive valuation notwithstanding, we expect no near-term outperformance, as steel prices are unlikely to recover before December 2008, in our view. Falling steel prices impede earnings visibility of steel companies, which reduces investors' confidence in earnings estimates. We retain our positive stance on Indian steel stocks from a 12-month perspective, but expect no outperformance in the near term. We retain ADD on Tata Steel, JSW Steel and SAIL, with JSW Steel being our top pick in the sector.

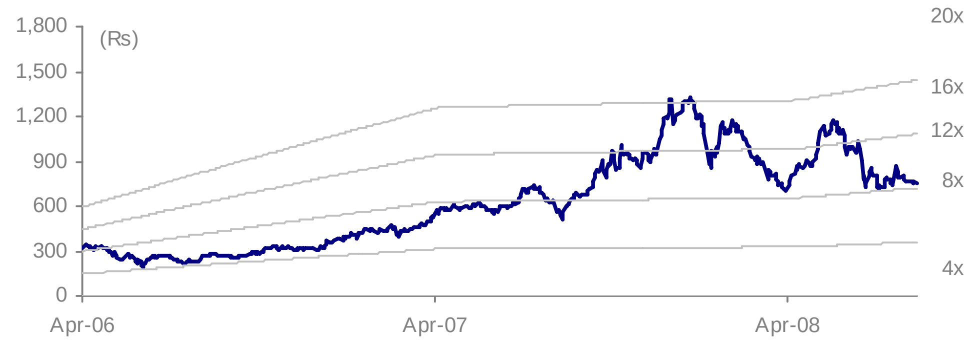
Figure 9: SAIL - significantly below historical highs

Source: IIFL Research

Figure 10: TATA Steel - off highs

Source: IIFL Research

Figure 11: JSW Steel - below historical highs



Source: IIFL Research

Figure 12: Global Valuation

	P/E		EV/EBITDA	
	FY09	FY10	FY09	FY10
Global Peers				
Nippon Steel	9.9	9.5	6.3	6.3
Arcelor Mittal	5.7	5.9	5.0	5.5
POSCO	7.7	7.3	5.3	4.8
JFE	8.1	9.9	5.5	5.3
CIA Sideurgica	8.3	6.9	7.2	5.2
Evraz Group	5.6	5.2	4.2	3.9
China Steel	9.0	8.3	8.6	8.5
Median	8.1	7.3	5.5	5.3
India				
SAIL	7.1	7.3	3.7	4.1
Tata Steel	5.3	5.7	5.0	4.7
JSW Steel	7.1	5.9	5.0	4.7

Source: Bloomberg, IIFL Research

BWA Guidelines – Broadly misguiding

26 August 2008

The DoT guidelines for BWA (broadband wireless access) auctions promise more than can be delivered. We understand that after the formality of allocating 20MHz to BSNL and MTNL is through, not much spectrum will be left in the coveted 2.5GHz band. Though in theory 80MHz in four blocks (including the BSNL and MTNL allocations) would be available, we understand that the bands are neither contiguous nor free from interference, and are thus of limited economic value. Spectrum charges may apply to existing broadband revenues too, worsening the case, and making even the reserve price seem steep. The high backhaul needed to be provisioned for broadband would impede rural applications. Given all this, we think the BWA auctions may not be held along with 3G auctions; even if they are, there may not be sufficient gains for ISPs to worry mainstream telcos.

Availability still not clear: TRAI's recommendations had stated that spectrum in the 2.3-2.4GHz and 2.5-2.6GHz bands would be auctioned, and the guidelines are consistent here. However, WPC's (Wireless Planning & Coordination) website carries documents suggesting that Defence forces and Department of Space are still using the spectrum. Opinions in the industry are divided over whether the spectrum mentioned in the guidelines is going to be easily available and free from interference. This is an important issue, as the high sensitivity of satellite receivers to interference may well impair telcos' ability to operate Wimax services. As such, the process is likely to run into objections.

Unclear spectrum usage charges and high reserve price: As per DoT's guidelines, there seems to be adequate spectrum to accommodate four 20MHz blocks in all. However, TRAI's earlier recommendations raise doubts on availability of contiguous spectrum except for one 25MHz block in 2.5GHz, which may go to BSNL/MTNL. Annual spectrum charges, if levied on adjusted gross revenues inclusive of broadband revenues would make the spectrum unjustifiably expensive. These factors suggest there is a strong possibility of the BWA allocation not being held in the near future. Operators that we spoke to are guarded on committing themselves to Wimax, and consider the reserve price too steep.

Delay in Wimax will marginally benefit 2G/3G operators at the expense of ISPs and TCOM: Based on these issues, we think there is a possibility that the auctions may not happen along with the 3G auctions, or may get delayed. Such a delay will make 3G a more sought-after technology, with ISPs losing out on an opportunity to expand their broadband operations. Among frontline companies, Tata Communications will likely be the most affected by this.

Key highlights of BWA guidelines

- Spectrum will be auctioned in blocks of **20MHz,** with two **blocks each** in 2.3GHz and 2.5GHz
- UASL holders or operators who fulfil criteria for UASL or Category A and B ISP are eligible for bidding
- R**eserve price** per MHz in 2.3GHz and 2.5GHz bands shall be 25% of the 3G reserve price
- A multi-stage, ascending **e-auction** will be conducted. At each stage, the lowest bidder will be eliminated After the final stage, all bidders will have to match the bid of the highest bidder
- One block of 20MHz would be allocated to MTNL and BSNL in their circles at a price equal to the highest bid in the respective circles
- **Rollout obligation** requires 90% coverage of metro area in all metros in five years, while for other circles, 25% and 50% rural SDCA coverage is required at the end of two and five years, respectively
- BWA spectrum will attract annual spectrum charge of 1% after the first year

Source: DoT

Wireline and broadband subs: July '08

in '000	Subscribers
Wire line subscribers	38,760
Internet Subscribers	11,500
Broadband	4,570
Bharti	852
TCOM	219
RCOM	1,031

Source: TRAI, IIFL Research

Data rate comparison

Technology	Minimum spectrum reqd	Peak data rate - Downlink
GSM / EDGE	4.4 MHz	0.474Mbps in 4.4MHz
CDMA	1.25MHz	0.153Mbps in 1.25MHz
HSPA	5MHz	14.4Mbps in 5MHz
EVDO	1.25MHz	3.1Mbps in 1.25MHz
Wimax E	10MHz	23Mbps in 75% of 10MHz

Source: Industry, IIFL Research

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Spectrum availability not clear

Department of Telecommunications (DoT) released on 1 August 2008 the detailed set of guidelines for auction and allotment of BWA services. Some of the clauses are not aligned to the earlier recommendations suggested by TRAI in July 2008. This has resulted in some ambiguity on the actual availability of spectrum in the 2.3GHz and the 2.5GHz bands.

Three blocks available, after one allotted to BSNL/MTNL

In its guidelines, DoT states that spectrum would be auctioned in the 2.3GHz and 2.5GHz bands for data services. Each winning bidder would be likely to get 20MHz in each of the two bands. There would be two such 20MHz blocks each in 2.3GHz and 2.5GHz bands. UAS licensees, operators fulfilling eligibility criteria for obtaining UASL and A and B class ISPs are eligible for the auction process.

Of the available blocks, one block of 20MHz will be allotted to BSNL/MTNL, which in turn will have to match the price offered by the highest bidder for that particular circle.

Spectrum in 700MHz and 3.3-3.6MHz would be auctioned as and when it becomes available.

Concerns on availability and contiguity

TRAI, in its July 2008 paper, recommended allocation and pricing for contiguous spectrum, as it facilitates efficient utilisation of spectrum and scalability for future expansions. According to TRAI's paper, 40MHz spectrum is available in the 2.3-2.4GHz band, but this spectrum is scattered and not contiguous. That is because it has been vacated at different points in time by state electricity boards, power utilities, oil companies and the Railways.

Contiguous spectrum allows more cost-efficient hardware combinations to be deployed, by promoting scalability.

In the 2.5GHz band, contiguous blocks of 15MHz and 25MHz are available, but we understand that even in this band, satellite receivers belonging to AIR are operational, and will face interference problems. We also understand that the Department of Space has plans in this frequency band. Secondly, the guard band recommended to eliminate interference problems can be upward of 5MHz on each side.

All these issues may make the usable size significantly lower than the 20MHz being mentioned by DoT. Moreover, BSNL is to be allotted 20MHz spectrum in the 2.5GHz band in three circles (Gujarat, Maharashtra and Andhra Pradesh) and is expected to get similar quantum in the remaining circles. This will almost certainly raise concerns on quality and quantum of the remaining spectrum, as BSNL's share is expected to come out of the coveted 2630-2655MHz chunk. BSNL intends to start its own operations in two circles and outsource the rest on a revenue-share basis to Soma Networks.

However, postings on WPC's website related to NFAP 2008 plan indicate that there are unresolved issues even in the 2.3 and 2.5GHz bands. One note by JCES (Joint Communications Electronic Staff) indicates that Defence operations are in 2300-2400MHZ, while another note states that INSAT system is using 2535-2655MHz for its applications.

Holders of 3.3-3.6GHz spectrum faced with a dilemma

TRAI had recommended migration of players already present in the 3.3-3.4GHz band from city level to circles. This would involve either surrender of the city-wise 3.3GHz allocation and bidding for BWA spectrum circle-wise; or matching the auction price for 3.3GHz, were the 3.3GHz spectrum already held was not surrendered. However, the current DoT guidelines are silent in this respect.

Current allocations

- TCOM has 12MHz spectrum in 3.3GHz and has rolled out Wimax Rev D in 50 cities.
- RCOM has 12MHz in 3.3GHz and has rolled out Wimax Rev D in four cities. Plans to expand to 10 cities by year-end.

High backhaul needs would limit rural BWA

Among the various BWA technologies, Wimax 802.16 Rev E seems to be the most likely choice. In rural areas, where line-of-sight access is more easily available, a larger cell radius may be possible, which means more subscribers and greater traffic through each base station.

Even at modest capacity utilisation levels, the backhaul requirement from a Wimax tower could be multiples of the level of a typical GSM base station.

Such backhaul capacity is more economical by fibre than by microwave, and connecting rural Wimax towers through fibre will be sufficiently challenging (especially for ISPs), and create enough opportunity for 3G to make inroads, especially since 3G would be done by operators already having sufficient scale.

In sum, the window of opportunity for sustaining interest in BWA auctions is fast closing. They may not be held with 3G auctions after all, what with so many issues around Wimax, besides the well-known shortage in variety, volume and cost of devices, cloudy availability of spectrum, and absence of sufficient clarity on guidelines on pricing as well as options for holders BWA spectrum in 3.3GHz frequencies.

Figure 1: Comparison of mobile technologies

Technology	GSM / EDGE	CDMA	HSPA	EVDO (Rev A)	Wimax Rev (E)
Duplexing Mode	**FDD**	**FDD**	**FDD**	**FDD**	**TDD**
Minimum spectrum required (MHz)	4.4	1.25MHz	5MHz	1.25MHz	10MHz
Spectral efficiency (bits/Hz/sector/s)	0.33	0.51	0.8 downlink and 0.2 uplink	0.8 downlink and 0.2 uplink	0.8 downlink and 0.3 uplink
Peak data rate - Downlink	0.474Mbps in 4.4MHz	0.153Mbps in 1.25MHz	14.4Mbps in 5MHz	3.1Mbps in 1.25MHz	23Mbps in 75% of 10MHz
Peak data rate - Uplink	0.474Mbps in 4.4MHz	0.153Mbps in 1.25MHz	5.76Mbps in 5MHz	1.8Mbps in 1.25MHz	4Mbps in 25% of 10MHz

Source: Industry, IIFL Research

Appendix: Guidelines for Auction and allotment of spectrum for BWA services

1. **Frequency bands**
   a. Spectrum in 2.5GHz band shall be allocated for BWA services through bidding / auction;
2. **Eligibility for bidding for BWA spectrum**
   b. Any person who holds a UASL or
   c. Who fulfils the eligibility criteria for obtaining UASL as per DoT guidelines or
   d. Who holds a ISP license category A or B
3. **Amount of spectrum and reserve price**
   a. Spectrum shall be auctioned in 2.5GHz and 2.3 GHz bands for data services. Each successful bidder can get 20MHz in 2.3 and 2.5GHz bands in a telecom service area. The number of blocks shall be two in 2.3GHz bands and two in 2.5GHz band. The reserve price per MHz in 2.3 GHz and 2.5GHz bands shall be 25% of the 3G reserve price.
   b. Spectrum in 700MHz and 3.3-3.6GHz bands shall be auctioned as and when it becomes available.

Figure 2: Reserve price

Service area	Reserve price (Rs m)
Mumbai, Delhi and Category A	400
Kolkata and Category B	200
Category C	75
Total	5,050

Source: IIFL Research, DoT

4. **Mergers and Acquisitions**
   a. M&A shall be as per guidelines on the subject issued by DoT earlier or any subsequent revision thereof.
5. **Auction process**
   A controlled, simultaneous, ascending e-auction shall be conducted as per details to be notified separately. The broad stipulation shall be as follows:
   a. The bidding shall be service area-wise
   b. The bid shall be submitted in rupees for each block of spectrum
   c. Successful bidder shall deposit 25 % of the successful bid amount within 5 days of the close of the auction, failing which the earnest money shall stand forfeited.
   d. Successful bidder shall deposit the balance amount (bid amount-bid deposit) within fifteen calendar days of the bid, failing which the earnest money shall stand forfeited.
   e. Neither a bidder can withdraw a bid after placing, nor can it reduce a bid in subsequent rounds. If a bidder withdraws a bid at any point of time, the earnest money shall be forfeited.
   f. GoI (Government of India) reserves right to disqualify any bidder violating these rules
   g. If the number of bids is less than or equal to the number of spectrum blocks available in the service area, the spectrum shall be allocated to all the bidders at the highest price. If the number of bids is greater than the number of spectrum blocks available, the auction shall proceed as per e-auction rules
   h. When the number of bidders left is equal to the number of blocks of spectrum being auctioned in any service area, the auction shall be closed. All the bidders shall have to match the bid of the highest bidder (H1). In case they do not match, then that block would be offered to the next highest bidder at the highest bid price (H1). If any block is left vacant then that block shall be re-auctioned.
   i. The top bidder shall be called in decreasing order of their bids to choose which block of spectrum they wish to be allocated
   j. If there is a tie between a bidder who is a UAS licensee and another who is an ISP licensee, then preference will be given to UAS licensee. If there is a tie between two UAS licensee or two ISP licensees, then preference would be given to the bidder with the higher subscriber base.
   k. One block of 20MHz shall be allocated to MTNL in Delhi and Mumbai and BSNL in other service areas at a price equal to the highest bid in the respective service area.

6. Grant of licence

a. The successful bidder shall get spectrum allotment for BWA service for a period of 15 years duration.
b. The successful bidder shall obtain SACFA clearance and a separate wireless operating license from the WPC wing as per prescribed procedure.
c. In case UAS or ISP license for BWA service is cancelled / terminated for any reason, the spectrum allocated shall stand withdrawn forthwith
d. If the period of the UAS or ISP license is expiring before the extended spectrum allotment for BWA services, its existing UAS or ISP license shall be extended in the 19th or 14th year of its validity as applicable, to a date 15 years from the date of BWA spectrum allotment at a price. This price would be determined by the GoI at the time of extension of license. This automatic extension of the UAS or ISP license shall be done for the period required to make it co-terminus with the BWA spectrum allocation period by amending license conditions, if required.
e. A separate entry fee shall be payable for grant of UAS/ISP license for BWA services in addition to BWA spectrum auction price. This shall be equal to the entry fee of the UAS/ISP license issued by the DoT

7. Rollout obligations

Figure 3: Rollout obligations

Category of Circle	At the end of 2 years from date of BWA spectrum allocation	At the end of 5 years from date of BWA spectrum allocation
Metros	-	90% of metro area
A,B & C	25% rural SDCAs area coverage	50% ruralSDCAs area coverage

Source: DoT

8. Penalty for non-fulfilment of rollout obligations

a. If the licensee does not achieve the two years rollout obligations stated above its PBG shall be encashed. If it fails the 5 year rollout obligation, its spectrum assignments shall be cancelled.

9. Annual Spectrum usage charges

a. No spectrum charges will be payable for BWA services in the first year from the date of allocation of spectrum
b. Operator shall pay an annual spectrum charge of 1% of AGR after a period of one year.

10. Other issues

a. GoI (Government of India) reserves the right to amend or modify these terms and conditions before the commencement of auction process, The final conditions shall be indicated in the bidding document
b. GoI reserves right to disqualify a bidder or cancel bidding process
c. Transferring / sharing spectrum , if any, shall be governed by policy as may be determined by GoI
d. Auction shall be conducted by an independent expert agency to be appointed for this purpose by the GoI

Quick Take

Grasim Industries - ADD

Cement **25 Aug 2008**

North in focus

During our recent meeting, Grasim's management said it expects a rise in the northern market's share of its volumes from the current 30% to 40% by end-FY09, after capacity expansion at Shambupura is complete. The ongoing expansions would increase Grasim's consolidated cement production capacity to nearly 50mtpa (including subsidiaries). Besides, we expect pricing power erosion in the northern power to be modest compared to that in the south. In our view, the stock's current valuation—a 25% discount to replacement cost of US$140/tonne—does not do justice to its strength in the business. We retain ADD.

- Grasim expects cement volume growth of ~12% in FY09, with production from 4.4mtpa Shambupura unit to start in early October 2008. Grasim expects volume growth for UltraTech Cement (a subsidiary of Grasim) at 6% for FY09, as 1QFY09 volumes were adversely affected by an export ban that lasted for nearly six weeks. Cement production from UltraTech's 4.9mtpa Tadpatri unit is expected from end-September 2008.
- Grasim, like other cement companies, has seen a decline in receipts from coal linkages—they have dropped from 50% for the 12-month period to March 2007, to 40% at present. Grasim purchases about 40-45% of its coal requirement from the open market, where prices are twice as much as on linkage coal. About 15% of coal requirement is imported. According to Grasim, producers are unable to pass on cost increases because of government restrictions.
- Demand for VSF continues to be lukewarm at present, but we expect demand to recover from 2HFY09. Prices of VSF have stabilised. Raw-material cost continues to be higher, with no respite seen from high sulphur prices. Pulp prices have stabilised in recent months. As VSF volumes continue to decline, capacity expansion at Harihar is likely to get delayed.

CMP	**Rs1,929**
12-mth Target price (Rs)	***1,944 (1%)***
Market cap (US$ m)	**4,077**
Bloomberg	**GRASIM IN**

52Wk High/Low (Rs)	4074/1625
Diluted o/s shares (m)	92
Daily volume (US$ m)	5.4
Dividend yield FY08ii (%)	1.5
Free float (%)	74.8

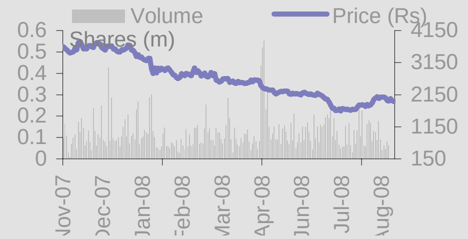
Shareholding pattern (%)

Promoters	25.2
FIIs	37.4
Domestic MFs/Insurance cos	25.0
Others	12.4

Price performance (%)

	1M	3M	1Y
Grasim Inds	9.5	-16.1	-29.2
Rel. to Sensex	7.3	-1.3	-30.3
ACC	-1.2	-17.8	-41.2
Ambuja Cements	-1.2	-23.2	-38.6
UltraTech	8.5	-13.9	-31.2

Stock movement



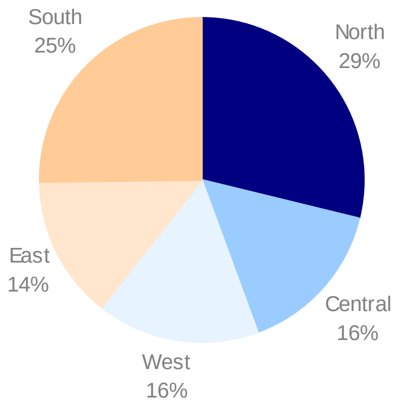
Financial summary (Consolidated)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenues (Rs m)	140,952	169,739	177,451	183,840	196,761
EBIDTA	39,723	49,598	44,493	39,780	37,546
EBITDA margins (%)	28.2	29.2	25.1	21.6	19.1
Reported PAT (Rs m)	19,675	28,914	28,278	18,993	18,013
EPS (Rs)	214.6	284.6	251.5	207.1	196.5
Growth (%)	89.1	32.6	-11.6	-17.6	-5.2
PER (x)	9.0	6.8	7.7	9.3	9.8
ROE (%)	34.3	36.6	27.3	15.6	13.4
EV/EBITDA (x)	**4.9**	**4.1**	**4.6**	**4.9**	**4.6**
Price/Book (x)	2.7	1.9	1.5	1.4	1.2

Source: Company, IIFL Research
Price as at close of business on 22 August 2008

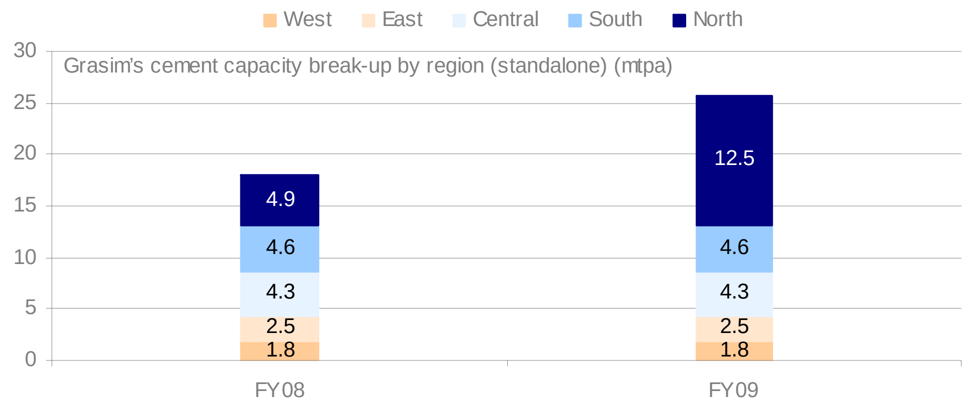
radhakrishnan@iiflcap.com

Figure 1: Grasim's cement sales break-up by region (standalone)



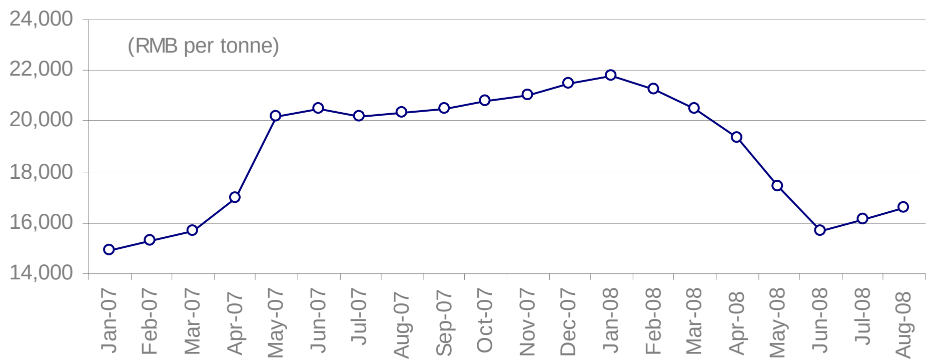
Source: Industry

Figure 2: Aggressive capacity expansion in the North



Source: Industry

Figure 3: VSF prices in China seem to have bottomed out of late



Source: Industry, IIFL Research

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Events calendar – August 2008

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
				1 June Foreign Trade	2
4	5 Hind Motor	6	7 Welspun Guj WPI for 26 Jul	8	9
11 June IIP	12 UTV Soft	13 Peninsula Land	14 WPI for 2 Aug	15	16 Divi's Lab
18 SIB	19	20	21 WPI for 9 Aug	22	23
25	26	27 Sun TV	28 WPI for 16 Aug	29 1QFY09 GDP	30 **AGM** SAIL–10 Sept

Blue: Economic data, Orange: AGM

We have moved to a new recommendation structure. The key objective of the change is to provide an unequivocal view on each stock, either positive or negative.

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, we introduce **Add** and **Reduce** recommendations 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%.
