9 January 2008

Alchemy themes for 2008

Alchemy Sales
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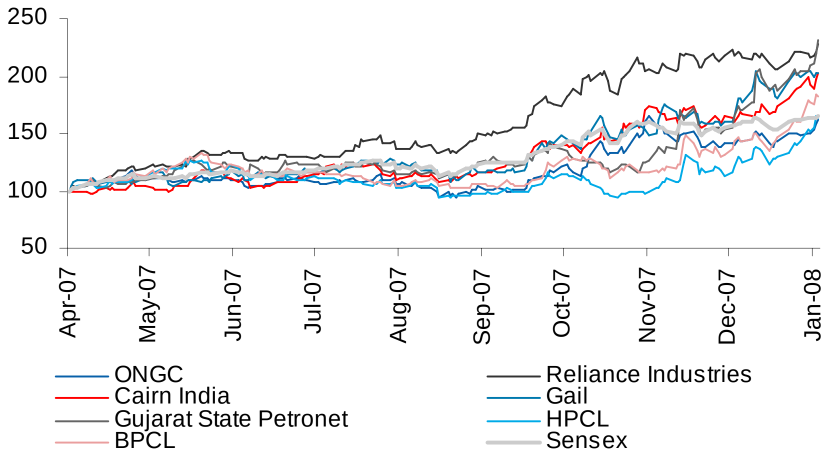
Themes for 2008

- **Energy** – ONGC (ONGC IN, Mkt Cap: Rs2,827bn), Reliance Industries (RIL IN, Mkt Cap: Rs4,434bn), Cairn India (CAIR IN, Mkt Cap: Rs447bn), Gail India (GAIL IN, Mkt Cap: Rs443bn), Gujarat State Petronet Ltd (GUJS IN, Mkt Cap: Rs56bn), HPCL (HPCL IN, Mkt Cap: Rs124bn), BPCL (BPCL IN, Mkt Cap: Rs177)

  Strong growth in energy demand – India is witnessing strong growth in energy demand and along with China is responsible for substantial portion of world's incremental demand growth. *High energy prices* – This will encourage and benefit exploration activity in India. This will be positive for ONGC, RIL and Cairns India. Increase in gas volumes due to higher domestic gas production and higher LNG imports to benefit incumbent gas pipeline companies like GAIL and GSPL. The healthy refining margins will benefit refining companies as refining margins are expected to remain strong on the back of demand growth for petroleum products and delays in setting up new refining capacities. The OMCs are probably witnessing the worst phase now (with crude oil quoting at historical highs) and we believe it can only get better from here. We believe HPCL and BPCL are quoting at a substantial discount to peers, and are grossly under valued with a limited downside. Any decision by the government to increase prices of auto fuels would be a welcome sign and will improve visibility of OMCs' cash flows.

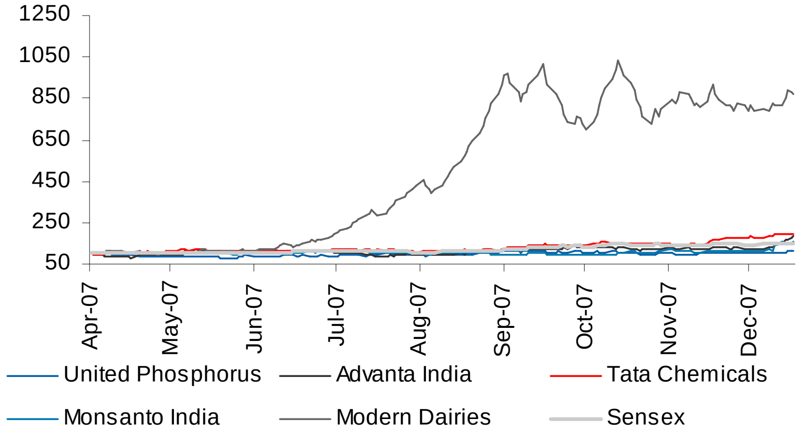


Source: Bloomberg, Alchemy

- **Food Securities** – United Phosphorus (UNTP IN, Mkt Cap: Rs80bn), Advanta (ADV IN, Mkt Cap: Rs25bn), Tata Chemicals (TTCH IN, Mkt Cap: Rs89bn), Monsanto (MCHM IN, Mkt Cap: Rs19bn), Modern Dairies (MRD IN, Mkt Cap: Rs1.4bn)

  Food security is a dominant concern world over. We believe ancillary companies will outperform. United Phosphorus is the largest Indian agrochemical play in the global crop protection space. Advanta is one of the leading seeds companies, globally, operating in Australia, Thailand, Argentina and India. Tata Chemicals will benefit from its presence in the fertilizer space. Monsanto is a global leader in corn seeds and have close to a 30% share in India. Rising consumption of Corn in India; and usage of corn in ethanol production in the driving the demand for corn and Monsanto has a big winner in this category - 'Dekalb' (corn hybrid seeds).

  The dairy industry in India is growing at a rapid pace – Due to the growing demand of nutritional products from milk in the world market. Modern dairy has diversified in the production of value added products like edible grade casein, WPC, edible grade lactose. Indian milk industry has tremendous edge by way of export to world market. Globally there is a shortage of milk solids and milk is diversified away from Casein manufacturing towards the manufacture of other dairy products. Modern Dairies will be one of the key beneficiaries of this growth.



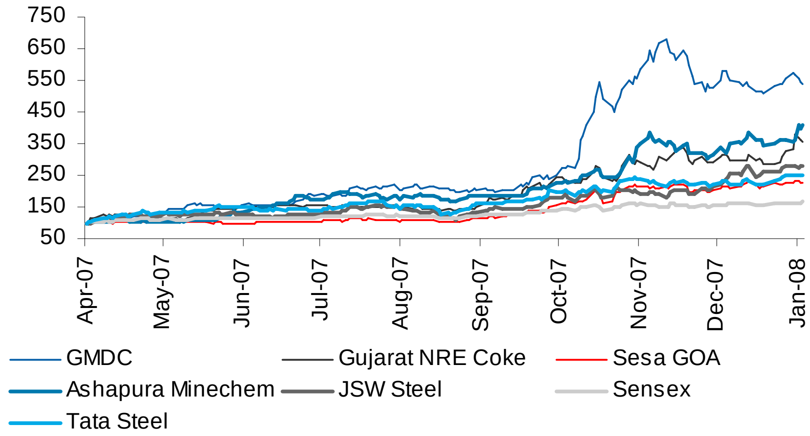
Source: Bloomberg, Alchemy

- **Resources** – GMDC (GMDC IN, Mkt Cap: Rs79bn), Gujarat NRE Coke (GNC IN, Mkt Cap: Rs43bn), Sesa Goa (SESA IN, Mkt Cap: Rs146bn), Ashapura Minechem (ASMN IN, Mkt Cap: Rs31bn), JSW Steel (JSTL IN, Mkt Cap: Rs207bn), and Tata Steel (TATA IN, Mkt Cap: Rs652bn),

  We believe mining companies are going to be the key beneficiaries of rising demand of minerals including coal. The capacity constraints and governmental controls (for instance Indonesian government's quota on export of coal) will lead to repricing of assets. Gujarat Mineral Development Corporation (GMDC) with its lignite mining, Sesa Goa with its iron–ore mining and Ashapura with its bentonite and bauxite (non-captive) reserves in India would be the direct beneficiaries of rising prices of minerals and will enjoy a scarcity premium

  Gujarat NRE Coke is the key beneficiary of improved coke realization. The coke prices have moved from $160/ton in Q2FY07 to $270/ton in Q2FY08. Going forward the company is expecting the coke realizations to range from $300 to $340 per tonne for remaining two quarters. The Company will also benefit from the capacity expansion from current 1mtpa to 4mtpa by 2011-12.

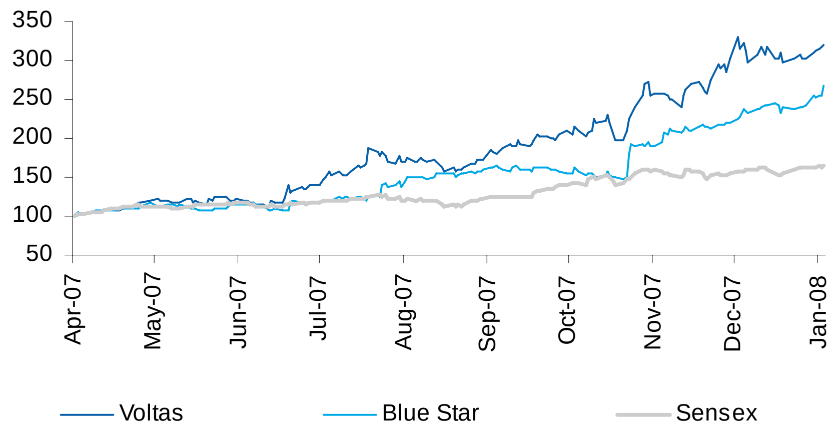
Tata Steel has taken various initiatives on the raw materials front for sourcing iron ore and coal and is likely to benefit in a rising price scenario. It has also embarked on an expansion plan to increase its capacity to 100MT by 2015 through the organic and inorganic route. JSW Steel is also expanding capacity to 10MT and has plans to acquire 500MT iron ore mine in Latin America. Long-term contracts for iron ore are scheduled to be renewed in the next quarter and could result in steel price hikes.



Source: Bloomberg, Alchemy

- **Domestic Consumption** – Blue Star (BLSTR IN, Mkt Cap: Rs46bn), Voltas (VOLT IN, Mkt Cap: Rs79bn)

  The current boom in retail, entertainment, and IT/IT enabled services is going to drive strong demand for central and commercial air-conditioning systems in India. The combined capex of these three sectors alone is expected to generate potential demand of around Rs50bn over next three-four years, which is almost double the current market size of the industry. Blue Star and Voltas, being leaders in this industry, are expected to garner significant share of this demand.



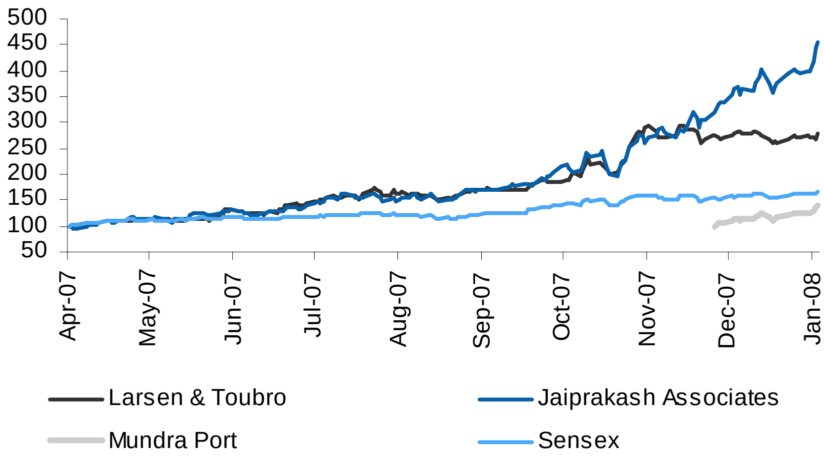
Source: Bloomberg, Alchemy

- **Infrastructure** – L&T (LT IN, Mkt Cap : Rs1,261bn), JP Associate (JPA IN, Mkt Cap : Rs536bn), Mundra Port (MSEZ IN, Mkt Cap : Rs481bn)

  We continue to remain bullish on the infrastructure sector. JP Associate will be a direct play on the sector due to its presence in cement, construction and real estate. JPA will benefit from growth driven by cement capacity expansion and the Taj Expressway project (expected to cost Rs60bn). JPA has been assured 6,250 acres alongside the expressway.

  Mundra port and special economic zone (MPSEZ) is one of the leading non-captive private sector ports in India, providing services for bulk cargo, container cargo, crude oil cargo, value-added port services, including rail services. Along with diversifying its service offerings, MPSEZ has developed access to rail, road, and pipeline network across India, which has helped it tie up strategic arrangements with customers.

  L&T is likely to benefit from strong order inflow and revenue growth in FY08 (30%). Healthy margins of Engineering & Construction (E&C) (accounting for 75% of revenues & 67% of EBIDTA) will be at 11-11.5% primarily because of higher pricing power and healthy order book. Pricing Power to continue due to higher capacity utilization resulting in better spread of fixed overheads. Listing of L&T Infotech and listing of Pipava Shipyard (L&T owns shipyard in Hazira and South India) will act as trigger for the stock.

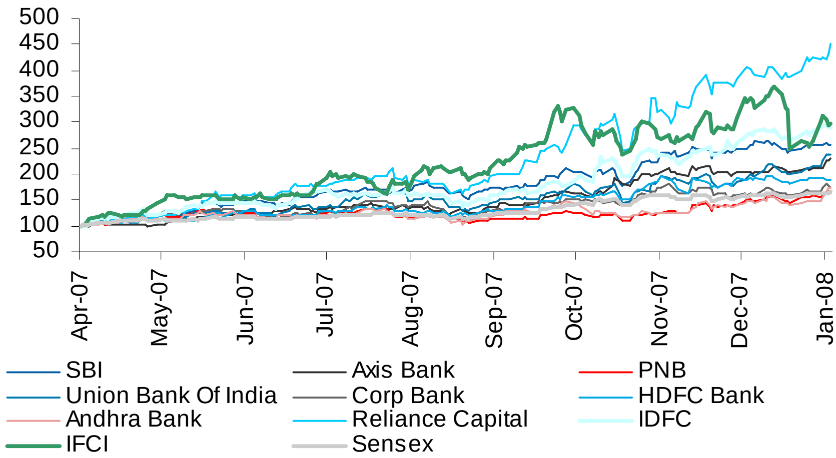


Source: Bloomberg, Alchem

- **Banking and NBFC** – SBI (SBIN IN, Mkt Cap: Rs1,297bn), Punjab National Bank (PNB IN, Mkt Cap: Rs215bn), Union Bank of India (UNBK IN, Mkt Cap: Rs113bn), Corporation Bank (CRPBK IN, Mkt Cap: Rs62bn), Andhra Bank (ANDB IN, Mkt Cap: Rs57bn), HDFC Bank (HDFCB IN, Mkt Cap: Rs608bn), Axis Bank (AXSB IN, Mkt Cap: Rs382bn), Reliance Capital (RCFT IN, Mkt Cap: Rs662bn), IDFC (IDFC IN, Mkt Cap: Rs291bn) and IFCI (IFCI IN, Mkt Cap: Rs58bn)

  The year 2009 presents opportunities for inorganic growth in the banking space and despite the challenges facing state-owned banks, we remain positive on potential consolidation driving growth in the sector. Some consolidation in operations of PSU banks has already been witnessed and we expect this to continue over 2008. Private sector banks are expected to continue to grow ahead of system-wide growth. However, from a valuation perspective, PSU banks appear undervalued as compared to private banks. NBFC are well placed to capitalize the growth in business due to stable interest rate with a downward bias and less competition from banks, which have seen rise in effective cost due to hike in CRR. This will further aid the margins. On account of strong traction in various business segments like equity broking, distribution of third party products and asset management, revenues for the companies present in the segment are likely to be boosted.

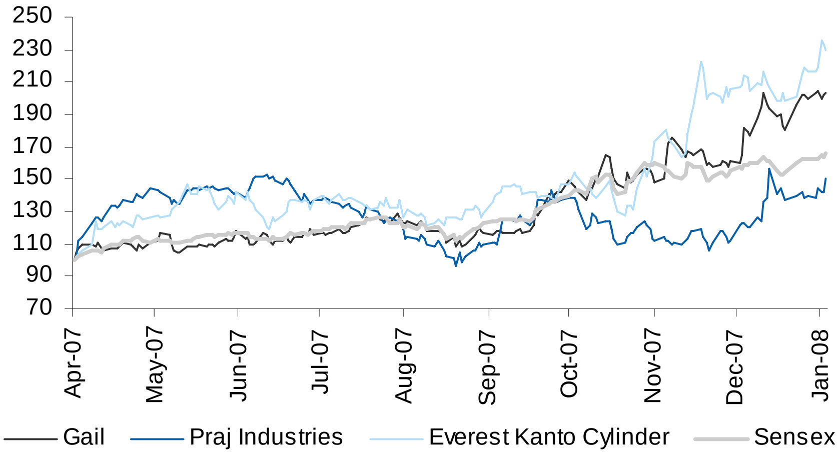
On account of high ambiguities, the planned strategic placement of IFCI got stalled. However revenues of IFCI have shown strong traction on account of aggressive recoveries and continued momentum in the same will guard its performance in near future. Media has also been quoting authorities in government to restart the process of scouting for strategic partner in the near future, with clarity on the issues such as Government's convertible warrants and grants to IFCI. Restarting of the strategic divestment process, coupled with maintaining aggressive momentum in recoveries will aid IFCI in near future.



Source: Bloomberg, Alchemy

- **Alternate fuels –** Praj Industries (PRJ IN, Mkt Cap: Rs45bn), GAIL (GAIL IN, Mkt Cap: Rs443bn), Everest Kanto Cylinders (EKCL IN, Mkt Cap: Rs34bn)

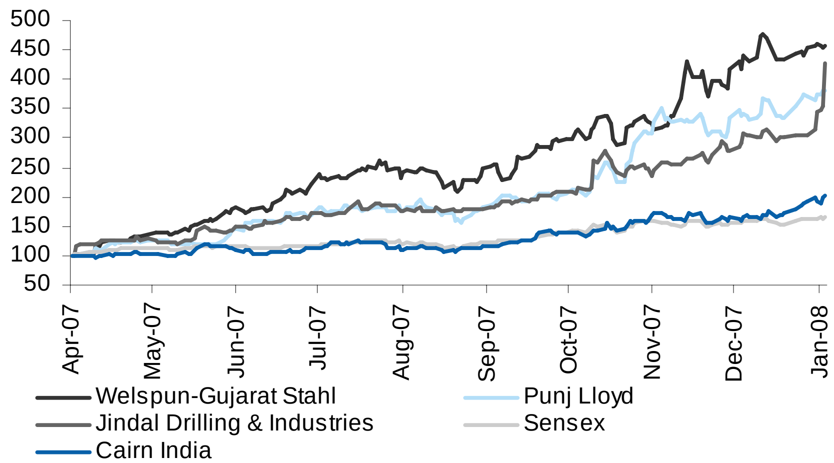
  The high crude oil prices and the possible clearance of the Energy bill by the US senate have once again brought into focus the importance of shifting to alternate fuels. This is expected to benefit companies in this space like Praj (ethanol technology supplier), GAIL (from setting up infrastructure to supply natural gas for use as CNG and increase in usage of gas in proportion to total energy consumption) and Everest Kanto Cylinders (manufacturer of CNG cylinders).



Source: Bloomberg, Alchemy

- **Investments in E&P and downstream infrastructure –** Cairn India (CAIR IN, Mkt Cap: Rs447bn), Jindal Drilling (JDDL IN, Mkt Cap: Rs8bn), Punj Llyod (PUNJ IN, Mkt Cap: Rs165bn), Welspun Gujarat Stahl (WGS IN, Mkt Cap: Rs78bn)

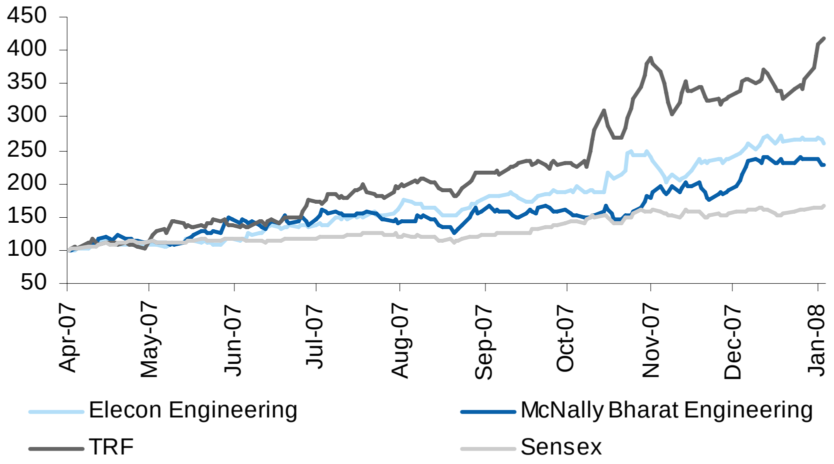
  Cairns India (E&P player), Jindal Drilling (offshore drilling contractor), Punj Llyod (an EPC contractor) and Welspun Gujarat (a manufacturer of pipes) are three other companies slated to benefit from higher investments in E&P and downstream infrastructure – fallout of high crude prices.



Source: Bloomberg, Alchemy

- **Material Handling** – TRF (TRF IN, Mkt Cap: Rs10bn), Elecon Engineering(ELCN IN, Mkt Cap: Rs30bn, McNally Bharat Engineering (MCNA IN, Mkt Cap: Rs7.9bn)

  Elecon, McNally and TRF Ltd (manufacturers of material handling equipment) are expected to benefit from higher investments in mining due to rising demand of minerals including coal.



Source: Bloomberg, Alchemy

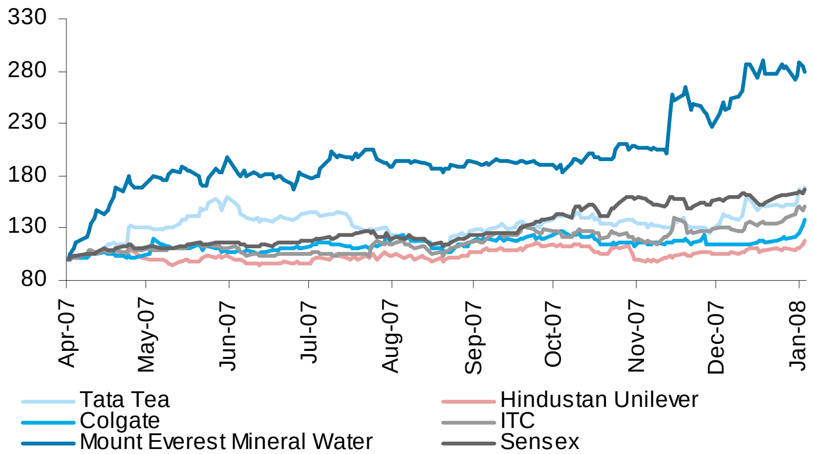
- **FMCG** – Hindustan Unilever (HUVR IN, Mkt Cap: Rs518bn), Tata Tea (TT IN, Mkt Cap: Rs58bn), Colgate (CLGT IN, Mkt Cap: Rs64bn), ITC (ITC IN, Mkt Cap: Rs869bn), Mount Everest Mineral Water (MEM IN, Mkt Cap: Rs5.5bn)

The Indian FMCG sector is expected to witnesses a robust growth in earnings led by strong demand not only from the urban Indian but from rural economy as well. Rural incomes one of the biggest driver of demand has been boosted by strong farm incomes (helped by higher MSP's) and strong infrastructure development (higher land valuation). We would bet on HLL as its derives larger portion of its sales from the rural India. While in terms of valuations Tata Tea is the most compelling given its strong balance sheet post the cash infusion from the Glaceau stake sale.

Colgate is a strong play on the under penetrated indian oral care market. The company has witnessed s steady growth of 9-10% in volumes despite price hikes. Further HUL has not been able to do well in its portfolio. The expansion at the Baddi unit would entail more excise and income tax benefits.

ITC has witnessed a mere two decline in cigarette volumes after such steep price hikes post VAT. The decline is lower than our estimates of 4%. It is building a strong portfolio in foods and FMCG which would drive future growth. A turnaround in the other FMCG business would be the next trigger in the stock.

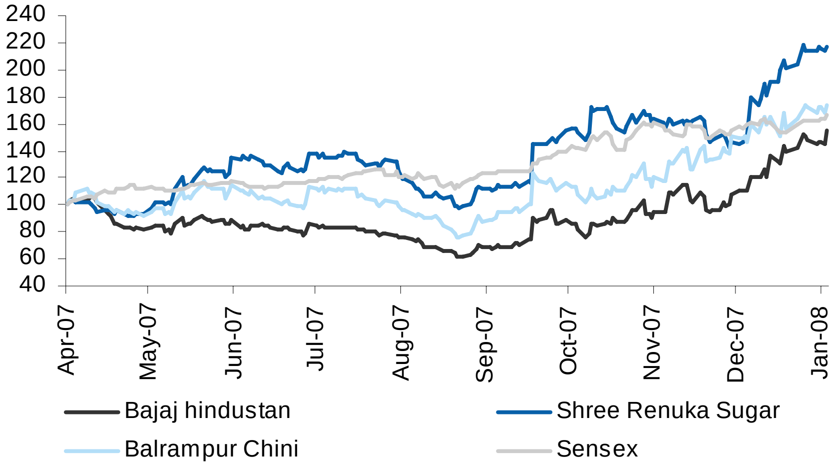
Mount Everest: post the take over by tata tea's management - the company has plans to take the brand global- leveraging on tetley's network. Also in the Indian shores there are plans to increase availability of the same and increase the marketing spend behind.



Source: Bloomberg, Alchemy

- **Sugar** – Balrampur Chini (BRCM IN, Mkt Cap: Rs30bn), Shree Renuka Sugar (SHRS IN, Mkt Cap: Rs30bn), Bajaj Hindustan (BJH IN, Mkt Cap: Rs53bn)

  We believe its time to accumulate sugar stocks. Sugar production in the current crushing season is expected to be much lower than anticipated due to delayed crushing and lower recovery rate, especially in UP. Further, production in the next year is expected to decline due to reduced cane planting and diversion to other crops. Sugar consumption on the other hand is expected to be much higher driving the inventory levels lower; hence, there is a case for revival of sugar prices and the sugar stocks. Balrampur Chini and Shree Renuka Sugar would be the primary beneficiaries of this before the other sugar companies.

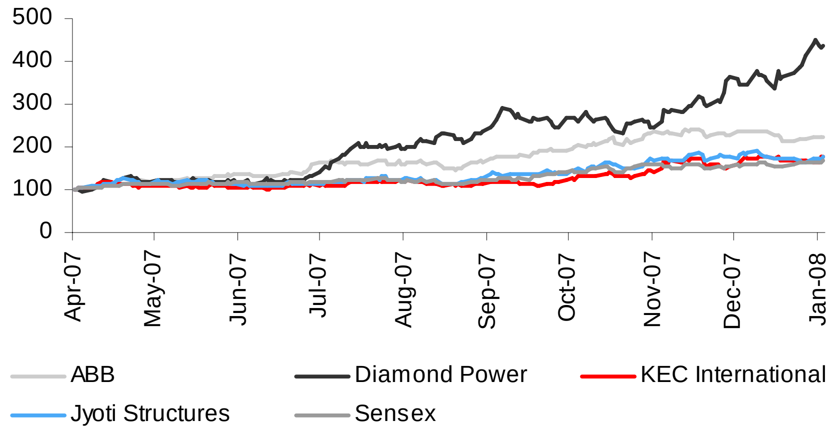


Source: Bloomberg, Alchemy

- **Power** – ABB (ABB IN, Mkt Cap: Rs317bn), Diamond Power (DIPI IN, Mkt Cap: Rs8.8bn), KEC (KECI IN, Mkt Cap: Rs32bn), Jyoti Structures (JYS IN, Mkt Cap: Rs24bn)

  The Government of India has an ambitious mission of 'POWER FOR ALL BY 2012'. This mission would require our installed generation capacity to be at least 2, 00,000MW by 2012 from the present level of 1,28,000MW. To be able to reach this power to the entire country, an expansion of the regional transmission network and inter regional capacity to transmit power would be essential. This presents huge opportunity for players involved in manufacturing of cables & conductors, transformers, transmission towers and EPC projects. KEC and Jyoti Structures with strong pre-qualification status, well-diversified geographical presence, and unparalleled execution capabilities for cross country projects are in ideal position to benefit from current boom in T&D projects

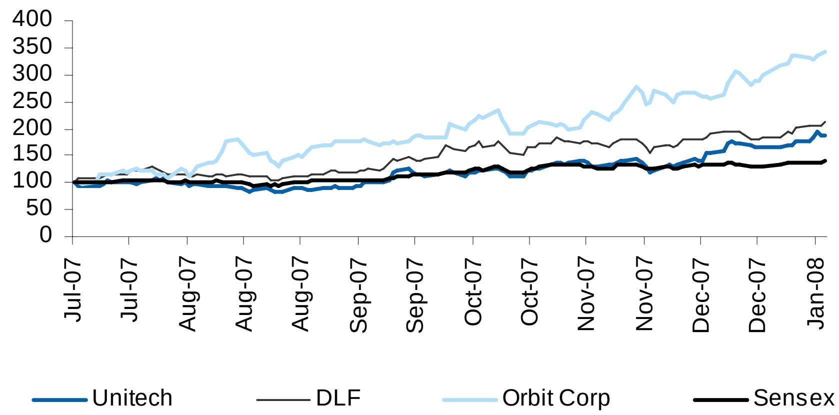
  Diamond Power Infrastructure, with three critical businesses under its fold - Cables (5500km) and conductors (50,500MT), Transformers (12,500MVA) and EPC (with order book 1.3xFY07 sales), has become integrated player in power infrastructure with inherent cost competitiveness led by in-house manufacturing of vital components. This is expected to help company to move up the value chain from sub-contractor to main contractor and significantly improve company's profitability.



Source: Bloomberg, Alchemy

- **Real Estate –** Unitech (UT IN, Mkt Cap: Rs851bn), DLF (DLFU IN, Mkt Cap: Rs1,962bn) and Orbit (ORB IN, Mkt Cap: Rs35bn)

  Capital raising will continue to remain key driver for real estate companies in 2008. Having raised substantial money through IPO in 2007, real estate companies will continue to monetize their projects. Introduction (though at draft stage) of REIT will enable small real estate companies to raise funds. Larger companies will raise money outside India through REIT due to scale advantage and lower capitalization rates. Stable Interest rates will keep real estate demand buoyant. We believe Unitech will benefit because of its Diversified Set of Portfolio, Ability to monetize projects (United Corporate Parks) and Land acquisition from government ensures clear title. DLF is largest Real Estate Company in India and has an ability to raise money at project development stage. Orbit is a Niche Player with huge market opportunity (redevelopment in Mumbai)



Source: Bloomberg, Alchemy

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