investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**1,231**	1,760
HLL	24-Nov-05	172	**243**	300
ICICI Bank	23-Dec-03	284	**621**	750
Orient Paper	30-Aug-05	214	**502**	675
UltraTech	10-Aug-05	384	**771**	1,000

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Tata Tea

Apple Green

Stock Update

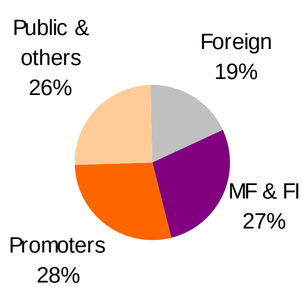
Analyst meet takeaways

Buy; CMP: Rs798

Company details

Price target:	Rs1,040
Market cap:	Rs4,469 cr
52 week high/low:	Rs1,047/560
NSE volume: (No of shares)	2.6 lakh
BSE code:	500800
NSE code:	TATATEA
Sharekhan code:	TATATEA
Free float: (No of shares)	4.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-0.9	20.6	-10.3	1.5
Relative to Sensex	-9.7	2.4	-20.4	-33.1

We attended the analyst meet organised by Tata Tea Ltd (TTL) last week after the acquisition of Energy Brands Inc (EBI) by the company. Even though the recent acquisitions of TTL have helped the company transform itself into a splendid branded beverage play, we believe that the funding issues with regard to the latest acquisition (EBI) will act as an overhang on the stock in the short term.

Valuation of EBI revised at 12.4x sales

In the analyst meet, the management of TTL indicated that EBI's revenues for CY2005 were at $175 million instead of $350 million as was stated earlier. This puts the valuation of EBI at 12.4x its CY2005 revenues against the earlier valuation of 6.2x.

TTL may go for equity dilution

The various options available to TTL for raising Rs864 crore required to invest in EBI are as follows:

- it could unlock the value of its investments in various other Tata group companies;
- it could restructure/sell partially its north Indian plantation operations;
- it could take debt as its stand-alone debt/equity ratio is very low at 0.2x; or
- it could go for equity dilution, which may be in any form including a rights issue. The dilution may be to the extent of 8-10%.

TTL's stake in TTGL to go down

TTL and Tata Sons Ltd (TSL) will invest $192 million and $58 million respectively in Tata Tea GB Ltd (TTGL; a vehicle for the EBI acquisition) in the form of equity. TSL will subscribe to convertible bonds of TTGL which will increase its stake in the latter to 23% (current holding = 1.4%). TTL's stake in TTGL will come down to 77% from 98.5% pre-acquisition.

Short-term overhang on the stock

We expect the EBI acquisition to act as an overhang on the stock price in the short term because of the following reasons.

1. *Near-term earnings to reduce by 20-25%*
   - To fund the acquisition, TTL will either raise debt or dilute equity or reduce investment which will affect its earnings negatively
   - TTL's stake in TTGL will reduce to 77% from 98.5% pre-acquisition
   - TTGL will have to take $427 million of debt to fund the acquisition which will increase TTGL's interest cost
2. *Reduce appetite for further acquisitions*

   TTL's consolidated debt/equity ratio of nearly 3-4x will reduce its appetite for further acquisitions in tea space

3. *EBI to contribute to earnings from FY2009*

   EBI is expected to start paying dividend from FY2009 onwards and hence will contribute to TTL's profitability only after three years

Long-term potential is immense

The management of EBI has indicated that the revenues of the company are likely to quadruple over CY2005-07 to $700 million with the potential to reach even $1 billion in the same period. It is also expecting the enterprise value of the company to nearly go up to $10 billion from the current $2.2 billion (appreciate almost five times). Thus, the investment in EBI holds immense long-term potential for TTL looking at the fact that TTL holds the right to increase its stake in the company to 40%.

Valuation and view

We will revise our earnings for the stock once the funding pattern for the EBI acquisition becomes clear. We maintain our Buy recommendation on the stock with price target of Rs1,040.

Valuation table (consolidated)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	245.8	296.7	320.5	360.7
Shares in issue (cr)	5.6	5.6	5.6	5.6
EPS (Rs)	43.9	53.0	57.2	64.4
% yoy growth	*29.6*	*20.7*	*8.0*	*12.6*
PER (x)	18.2	15.1	13.9	12.4
Book value (Rs)	271.1	280.1	325.9	378.9
P/BV (x)	2.9	2.8	2.4	2.1
EV/EBIDTA (x)	10.6	10.2	8.8	7.6
EV/Sales (x)	1.9	1.8	1.6	1.4
RoCE (%)	14.0	13.9	15.3	16.9
RoNW (%)	17.2	19.2	18.9	18.3

The author doesn't hold any investment in any of the companies mentioned in the article.

Cement

Sector Update

Subdued growth numbers

Cement majors report subdued dispatch numbers for the month of August 2006

For the month of August 2006 the cement majors have registered a subdued growth in cement dispatches, primarily because of the incessant floods in the states of Maharashtra, Gujarat, Rajasthan, Andhra Pradesh and Madhya Pradesh. For example, ACC's cement dispatches for the month of August 2006 grew by 3.8% to 13.5 lakh tonne. Gujarat Ambuja, the most affected player, has reported a 4% decline in its dispatches to 9.39 lakh tonne. This is because its primary markets like Maharashtra, Gujarat and Rajasthan, witnessed heavy floods. However, the AV Birla group, which includes UltraTech Cement and Grasim Industries, reported a 4.9% growth in the cement dispatches. This is primarily because the group as a whole is dominant in the central, southern and eastern regions, where the rainfall was pretty normal.

Company	Aug'2006 (lakh tonne)	% yoy chg
ACC	13.5	3.8
GACL	9.39	-4
Grasim	23.3	4.9

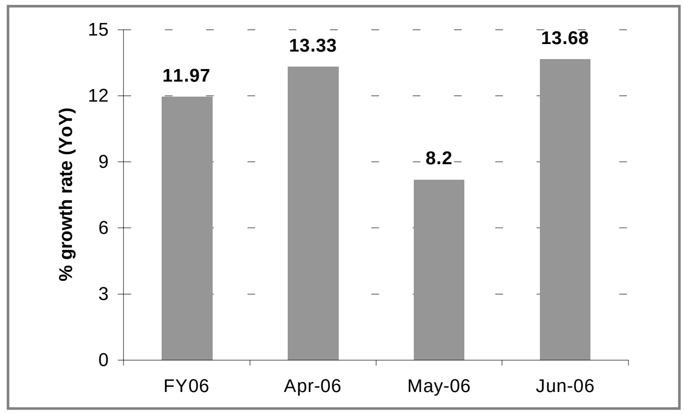
Higher base of August 2005 also subdues growth figures

Last year the floods impacted the dispatch figures of cement majors during the month of July 2005. As you will remember the July 26, 2005 floods virtually paralysed Mumbai and other prominent districts of Maharashtra and Gujarat. Consequently the dispatches that had lagged in the month of July 2005 picked up significantly in the month of August 2005. Hence the higher base of last year also resulted in the numbers being subdued.

Cement consumption maintains momentum along with cement prices

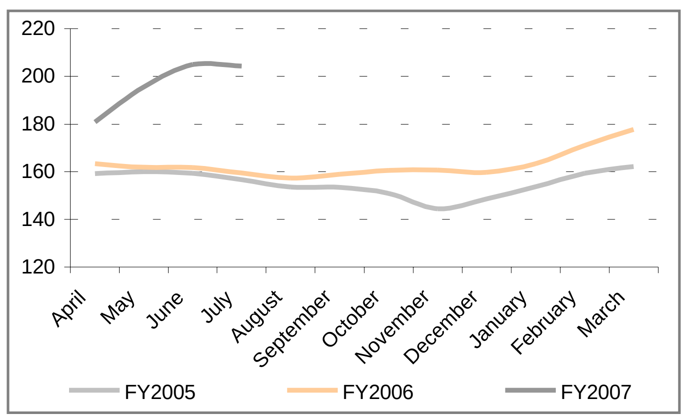
Tracking the hectic housing, industrial and infrastructure activities in the country, the consumption of cement has also kept its scorching pace, with a growth of 11.7% for the first three months of FY2007. This compares favourably with the 11.5% growth registered in the first three months of FY2006. The healthy trend in the consumption is clearly reflected in the cement dispatches that have grown by 9.5% for the first three months of the current fiscal. Keeping its pace, the prices of cement have also stayed firm across the country, with the same rising by 21.6% on a year-on-year basis and by 13.5% on a quarter-on-quarter basis.

Consumption growth



(Source: CMA)

Average cement prices



(Source: CMA)

August cement dispatches an aberration—growth momentum to resume going forward

Overall we believe that the August dispatch numbers are an aberration, largely affected by the incessant rainfall and the flood situation across the country. This in turn has affected the construction activity. We believe the underlying theme of a strong cement consumption growth driven by a pick-up in the housing activity, industrial capital expenditure (capex) and infrastructure projects is still intact and expect the dispatches to pick up in the coming months. The strong cement consumption growth can be gauged by the number of projects that developers like DLF, Unitech and Ansal have lined up, the continued growth in home loans despite rising interest rates and the soaring order books of construction majors like larsen & Toubro, HCC, IVRCL, Simplex, NCC etc.

Outlook remains positive

As mentioned earlier the muted growth as depicted by the August cement dispatches is an aberration and we expect the dispatches to resume the growth momentum once the heavy rainfall lessens and the construction activity regains normalcy. We remain positive on the sector and rate ACC, UltraTech and Madras Cement as our top picks in the sector. We also like Orient Paper and JK Cement on account of their compelling valuations, which are much less than the sector average.

Earnings table

Companies	PER		EV/EBIDTA		EV/Ton ($ US/Ton)	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Under Ccoverage						
ACC	18.8	16.3	11.2	9.4	184.6	167.2
Grasim Industries	13.4	11.2	6.7	5.2		
UltraTech Cement	14.5	12.7	7.6	7.2	137.3	117.0
JP Associates	19.3	13.4	8.2	6.6		
Shree Cements	11.7	9.1	7.9	5.7	183.8	127.3
Madras Cement	14.0	11.3	8.1	6.7	132.5	119.6
JK Cement	13.0	8.3	7.1	4.7	83.9	78.4
Orient Paper & Industries	9.3	6.9	6.8	5.3		
Not under coverage						
Gujarat Ambuja	19.7	14.6			182.0	
Birla Corporation	13.2				85.0	
India Cement	13.2	15.4	10.0	8.0	160.0	128.0

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Media

Sector Update

Rate ceiling negative in short term

We believe that the ceiling rate of Rs5 per channel per subscriber per month fixed by the Telecom Regulatory Authority of India (TRAI) is negative for the broadcasters, especially the niche channels like the sports and news channels.

However, we believe that in the longer term, the implementation of the conditional access system (CAS) itself would be a big positive for the broadcasters. TRAI has put the implementation of CAS on fast track after an order by the Delhi High Court. With its initiatives on clearing the operational glitches in the way of the implementation of the system, the government's strong commitment towards the same is becoming apparent. This will definitely help the broadcasters as the current practice of under-declaration of subscribers will be a thing of past under the CAS regime.

We expect the broadcasters to renegotiate the prices with TRAI as the current price ceiling of Rs5 seems too low especially for the niche channels where the differentiation in the content and channel positioning is most important.

Ceiling fixed at Rs5 per subscriber for pay channels

TRAI, via its order dated August 31, 2006, has come out with the guidelines for pay as well as free-to-air (FTA) channels. The salient features of the same are as follows:

- TRAI has fixed the maximum retail price of any pay channel at Rs5 per channel per subscriber per month (excluding taxes);
- all pay channels will have to be offered compulsorily on a la carte basis;
- in addition, the channels can be offered with discounts as bouquets in addition to the a la carte offer;
- broadcasters are free to fix prices of individual pay channels within this ceiling;
- a multi-system operator will have to provide a minimum of 30 FTA channels at a maximum total price of Rs77 per subscriber per month; and
- the above rules will come into effect from December 31, 2006.

Negative for niche channels in short term

We believe that the TRAI order is negative for the niche channels like the news channels (eg NDTV or CNBC TV18) as well as sports channels (eg ESPN, Star Sports) in the short term. These channels are able to charge higher rates compared to the general entertainment channels. However, we expect the broadcasters to renegotiate the price with TRAI.

Speedy implementation of CAS is a sure positive

We see the recent activities of TRAI as a positive for the broadcasters because of the following reasons.

- The issuance of guidelines by TRAI over the last couple of weeks to clear operational glitches in the way of the speedy implementation of CAS shows strong commitment on part of the government to implement CAS.
- The guidelines will also encourage active participation of the subscribers, as with a clear set of guidelines they will be better placed to take advantage of CAS. The under-reporting of subscribers which is very high currently will become a thing of past post-CAS.

Impact on companies

In our note "CASe hearing progresses" dated August 29, 2006, we had mentioned that the smooth implementation of CAS could result in an incremental upside of 19% and 15.6% to our estimates for NDTV and TV18 respectively. However, the implementation of the above-mentioned ceiling limit can take away the potential upside, as the same would mean that these channels will have to virtually triple their subscriber base in such a scenario to benefit from the increased reporting of the subscribers.

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Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Associated Cement Companies
Bajaj Auto
Balrampur Chini Mills
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Heavy Electricals
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Godrej Consumer Products
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico Industries
Maruti Udyog
MRO-TEK
Lupin
Nicholas Piramal India
Omax Auto
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

3i Infotech
Aban Loyd Chiles Offshore
Cadila Healthcare
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Solectron Centum Electronics
Television Eighteen India
Thermax
TVS Motor Company
UTI Bank
Welspun Gujarat Stahl Rohren

Ugly Duckling

Ashok Leyland
Deepak Fertilisers & Petrochemicals Corporation
Genus Overseas Electronics
HCL Technologies
ICI India
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India

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