

Contents

Updates

Cement: October 2008: Demand remains subdued, prices stable

News Roundup

Corporate

- Japanese auto major **Toyota** has put the India launch of **Prius**, the world's first mass-produced hybrid vehicle, on the back burner. Infrastructure issues, a steep duty structure and inability to launch at a competitive price are some of the reasons cited by company officials. (ET)
- Kingfisher Airlines Ltd**, the country's second biggest airline by passengers flown, has paid the **Airports Authority of India (AAI)** Rs50 crore towards dues owed after the aviation ministry made it clear to the airline's chairman Vijay Mallya that he risked having the firm's bank guarantees encashed. Meanwhile, **Jet Airways (India) Ltd**, has paid **Indian Oil Corp. Ltd**, or IOC, Rs145 crore—the first payment of a six-installment plan. Jet's closest rivals, Kingfisher Airlines Ltd and state-owned **National Aviation Co. of India Ltd**, or Nacil, also paid part of their dues to IOC. In other news, Kingfisher Airlines has requested the government to allow foreign airlines to buy up to 25% in Indian carriers, and said foreign airlines have expressed interest in buying a stake in it. (Mint)
- Allaying fears of possible job cuts, global financial services giant **Citigroup** on Tuesday assured that about 52,000 layoffs over the world will have a 'limited' impact on India. The Citigroup has about 22,000 employees currently working in India. Of these, 12,000 work for **Citigroup Global Services Ltd (CGSL)** - which has been sold to **Tata Consultancy Services**. (Mint)
- In spite of a 28 per cent growth in the domestic car market for **Hyundai Motor India**, the company may consider production cuts if the current slowdown continues. The company is also evaluating price hike to absorb high input costs. (BL)
- The **Adani Group's Mundra Port and Special Economic Zone Ltd (MPSEZ)** has signed a memorandum of understanding (MoU) in Mumbai for setting up a dedicated automobile terminal with **Nippon Yusen Kaisha (NYK)** of Japan and **Wallenius Wilhelmsen Lines (WWL)** of Norway. (BL)
- ONGC Videsh Ltd (OVL)**, the wholly owned subsidiary of ONGC, has bagged two hydrocarbon exploration blocks in Colombia. In a statement issued here on Tuesday, OVL said CPO 5 and SSJN 7 are onshore blocks. (BL)
- Larsen & Toubro** has secured a Rs 700-crore order from **HPCL-Mittal Energy Ltd (HMEL)**, a joint venture of **Hindustan Petroleum Corporation Limited (HPCL)** and **Mittal Energy Investments**. The work involves setting up two 44,000-TPA capacity hydrogen generation units (HGU) for HMEL's grassroots refinery in Bathinda, Punjab. L&T has also been awarded a Rs 576-crore order for a 2-lakh-tonne per annum lube oil base stock plant by HPCL. (BL)

Economic and political

- The government has imposed a 5% import duty on some iron and steel products and a 20% duty on crude soyabean oil to make imports costlier and help the domestic industry hurt by a sharp slowdown in demand. (ET)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

| India | Change, % | | | |
|--------|-----------|-------|--------|--------|
| | 18-Nov | 1-day | 1-mo | 3-mo |
| Sensex | 8,937 | (3.8) | (10.4) | (39.0) |
| Nifty | 2,683 | (4.2) | (12.7) | (38.9) |

| Global/Regional indices | | | | |
|-------------------------|--------|-------|--------|--------|
| Dow Jones | 8,425 | 1.8 | (4.8) | (26.6) |
| FTSE | 4,209 | 1.8 | 3.6 | (22.8) |
| Nikkie | 8,211 | (1.4) | (5.6) | (36.2) |
| Hang Seng | 12,827 | (0.7) | (11.9) | (37.4) |
| KOSPI | 1,015 | (2.1) | (14.1) | (34.2) |

| Value traded - India | | | | |
|----------------------|-------------------|-------|-------|--|
| | Moving avg, Rs bn | | | |
| | 18-Nov | 1-mo | 3-mo | |
| Cash (NSE+BSE) | 113.2 | 137.7 | 153.9 | |
| Derivatives (NSE) | 432.6 | 437.7 | 397 | |
| Deri. open interest | 523.7 | 720 | 788 | |

Forex/money market

| | Change, basis points | | | |
|-------------------|----------------------|-------|------|-------|
| | 18-Nov | 1-day | 1-mo | 3-mo |
| Rs/US\$ | 49.7 | 0 | 68 | 602 |
| 6mo fwd prem, % | 0.7 | (25) | 71 | 24 |
| 10yr govt bond, % | 7.5 | 1 | (24) | (163) |

Commodity market

| | Change, % | | | |
|------------------|-----------|-------|--------|--------|
| | 18-Nov | 1-day | 1-mo | 3-mo |
| Gold (US\$/OZ) | 739.3 | 0.2 | (5.6) | (9.2) |
| Silver (US\$/OZ) | 9.7 | 0.2 | 3.1 | (27.0) |
| Crude (US\$/BBL) | 49.3 | 0.2 | (27.2) | (55.6) |

Net investment (US\$m)

| | 17-Nov | MTD | CYTD |
|-----|--------|-------|----------|
| FIs | (157) | (23) | (12,780) |
| MFs | (79) | (127) | 3,432 |

Top movers -3mo basis

| Best performers | Change, % | | | |
|----------------------|-----------|-------|--------|--------|
| | 18-Nov | 1-day | 1-mo | 3-mo |
| Hindustan Petroleum | 230 | 2.5 | (2.2) | 5.9 |
| Bharat Petroleum C | 318 | (2.1) | (10.2) | 1.2 |
| Bank Of Baroda | 263 | (2.8) | (13.5) | 1.8 |
| Financial Techn (Ind | 649 | (5.9) | (1.0) | (54.4) |
| Hindustan Unilever | 235 | (0.2) | (2.7) | (3.4) |

Worst performers

| | | | | |
|---------------------|-----|-------|--------|--------|
| Housing Developme | 108 | (3.7) | (14.1) | (65.5) |
| Suzlon Energy Limit | 51 | (7.0) | (41.3) | (78.7) |
| Unitech Limited | 39 | (8.0) | (50.6) | (76.2) |
| Bajaj Finserv Ltd | 124 | (4.9) | (21.7) | (77.0) |
| Tata Steel Limited | 165 | (0.9) | (33.5) | (72.5) |

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Cement

Sector coverage view

Cautious

| Company | Rating | Price, Rs | |
|---------------|--------|-----------|--------|
| | | 18-Nov | Target |
| Gujarat Ambuj | REDUCE | 54 | 60 |
| ACC | REDUCE | 406 | 550 |
| Grasim | ADD | 978 | 1,700 |
| India Cements | BUY | 86 | 145 |
| UltraTech Cem | BUY | 324 | 550 |
| Shree Cement | BUY | 434 | 850 |

October 2008: Demand remains subdued, prices stable

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- **Despatch growth of 4.5% yoy in October 2008 - compounded by base effect**
- **Cement prices stable at Rs240/bag—prices remain unchanged in key markets**
- **We retain our Cautious view on the sector**

Despatch growth of 4.5% yoy in October 2008—compounded by a base effect. Cement despatch growth rate deteriorated in October, recording 4.5% yoy (partially compounded by the base of 9% yoy growth in October 2007) worsening YTD growth for the sector to 6.7%. Our channel checks indicated that the credit crunch being faced by construction companies also contributed to lower-than-expected offtake of cement for infrastructure projects. We have factored 8.5% domestic demand growth in our estimates. Downside risks to our estimates for consumption growth stem from a further slowdown in real-estate related construction activity. We expect the slowdown in real estate construction in Middle East to impact export volumes as well as realizations in the next few months.

We note new capacities have started ramping up production, resulting in a decline in the industry utilization rates. Ultratech has begun commercial production from its newly commissioned clinker unit at Tadipatri (Andhra Pradesh) and the associated split-grinding unit at Ginigera (Karnataka). Grasim has begun commercial production from a clinker unit at Shambhupura and split-grinding unit at Dadri.

Cement prices stable at Rs240/bag—prices remain unchanged in key markets.

All India average cement prices during October 2008 remained flat at Rs240/bag (Rs240/bag in September 2008). Cement prices have been largely stable in all regions for the past three months, except South India where cement prices had moved up sharply during the last two months (from Rs245/bag in July to Rs263/bag in September). As demand growth continues to disappoint and capacity utilization drops, we expect cement prices to come under pressure. We currently factor a marginal decline in realizations during 4QFY09 followed by a 5-7% decline in prices during FY2010.

We retain our Cautious view on the sector. Valuations of cement companies have come off significantly and look reasonable both in terms of historical multiples and on a replacement cost basis. However, cement sector valuations typically remain below the replacement cost in a declining price (and profit margin) environment. We maintain our 'cautious' view on the sector prompted by risks to earnings from (1) slowing down demand and (2) decline in domestic realizations. While we estimate earnings decline for most cement companies led by decline in realizations, we have build in some cost-side relief to come from declining prices of imported coal and pet coke (partially offset by rupee depreciation) from 1QCY09. Our preferred picks in the cement sector remain Shree Cements, India Cements and Ultratech. We have a REDUCE rating on ACC and Ambuja Cement.

Exhibit 1: Despatch growth remains disappointing at 6.7% YTD

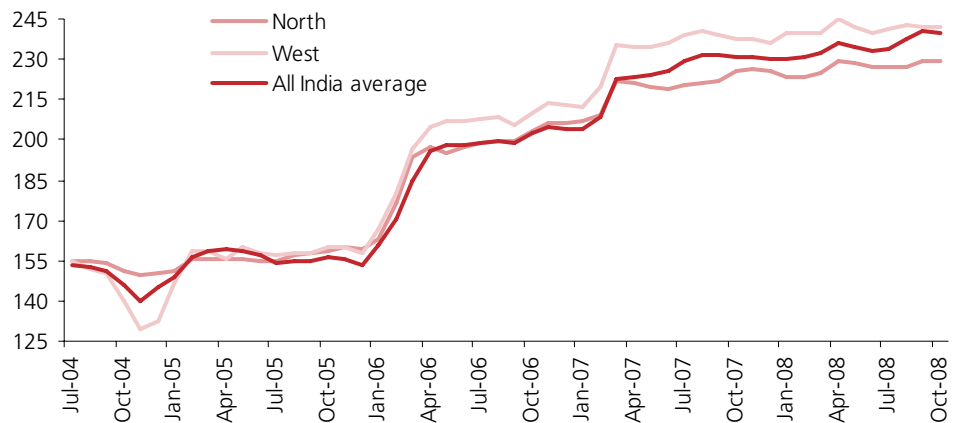
Cement despatch growth rates for major companies

| | Oct-08 | Growth (%) | |
|-------------------|-------------|------------|------------|
| | (mn tons) | y-o-y | YTD |
| ACC | 1.68 | (3.5) | 1.4 |
| Ambuja Cement | 1.42 | (3.9) | 1.8 |
| UltraTech | 1.25 | 5.5 | 1.8 |
| Grasim Industries | 1.27 | (6.4) | (3.0) |
| Shree Cement | 0.62 | 12.7 | 21.4 |
| India Cements | 0.62 | (12.3) | 1.9 |
| Madras Cements | 0.54 | 25.6 | 18.7 |
| Jaiprakash | 0.58 | (1.2) | 9.4 |
| Industry | 14.3 | 4.5 | 6.7 |

Source: CMA, Kotak Institutional Equities.

Exhibit 2: All India average at Rs240/bag

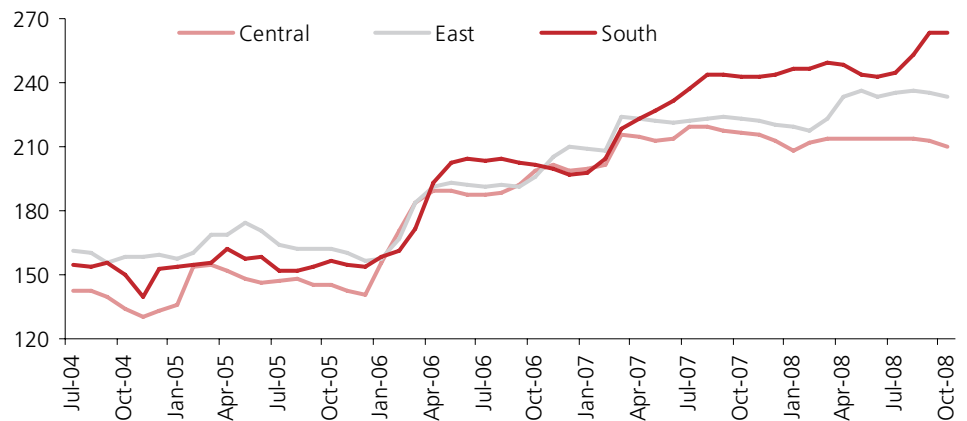
Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities.

Exhibit 3: Prices stable so far, we expect prices to start declining

Regional cement prices (Rs per 50 kg bag)



Source: CMA, Kotak Institutional Equities.

Exhibit 4: Cement comparative valuation

| Company | Market cap. (US\$ mn) | CMP (Rs) 18-Nov | Target price (Rs) | Rating | EPS (Rs) | | | | P/E (X) | | | |
|-----------------------|--------------------------|--------------------|----------------------|--------|----------|------|-------|-------|---------|------|-------|-------|
| | | | | | 2007 | 2008 | 2009E | 2010E | 2007 | 2008 | 2009E | 2010E |
| ACC | 1,539 | 406 | 550 | REDUCE | 56.7 | 64.1 | 56.2 | 44.5 | 7.2 | 6.3 | 7.2 | 9.1 |
| Ambuja Cement | 1,650 | 54 | 60 | REDUCE | 8.5 | 7.6 | 7.8 | 5.4 | 6.4 | 7.2 | 7.0 | 9.9 |
| Grasim Industries | 1,803 | 978 | 1,700 | ADD | 215 | 285 | 231 | 198 | 4.6 | 3.4 | 4.2 | 4.9 |
| India Cements | 451 | 86 | 145 | BUY | 26.1 | 24.5 | 22.7 | 20.2 | 3.3 | 3.5 | 3.8 | 4.3 |
| Jaiprakash Associates | 1,623 | 68 | 205 | BUY | 4.6 | 4.9 | 7.3 | 11.0 | 14.8 | 13.9 | 9.3 | 6.2 |
| Shree Cement | 304 | 434 | 850 | BUY | 45.2 | 90.2 | 109.1 | 71.3 | 9.6 | 4.8 | 4.0 | 6.1 |
| UltraTech Cement | 806 | 322 | 550 | BUY | 63.1 | 80.6 | 71.0 | 54.7 | 5.1 | 4.0 | 4.5 | 5.9 |

| Company | EV/EBITDA (X) | | | | EV/ton of production (US\$) | | | | EV/ton of capacity (US\$) | | |
|-----------------------|---------------|------|-------|-------|-----------------------------|------|-------|-------|---------------------------|-------|-------|
| | 2007 | 2008 | 2009E | 2010E | 2007 | 2008 | 2009E | 2010E | 2008 | 2009E | 2010E |
| ACC | 4.2 | 3.1 | 3.2 | 4.4 | 78 | 64 | 57 | 63 | 56 | 47 | 53 |
| Ambuja Cement | 4.7 | 3.6 | 3.6 | 4.6 | 119 | 95 | 81 | 78 | 88 | 73 | 68 |
| Grasim Industries | 2.9 | 2.4 | 2.6 | 2.6 | NA | NA | NA | NA | NA | NA | NA |
| India Cements | 5.4 | 3.2 | 2.7 | 2.9 | 97 | 79 | 67 | 60 | 68 | 51 | 47 |
| Jaiprakash Associates | 10.2 | 10.6 | 8.2 | 7.8 | NA | NA | NA | NA | NA | NA | NA |
| Shree Cement | 3.4 | 2.5 | 2.9 | 2.8 | 131 | 99 | 75 | 49 | 52 | 52 | 37 |
| UltraTech Cement | 3.7 | 3.1 | 2.9 | 3.3 | 62 | 66 | 53 | 47 | 51 | 44 | 42 |

Note:

(a) ACC - 2006 numbers for 12 months ending March 2006 (adjusted) and 2007 numbers for 12 months ending Dec 2006.

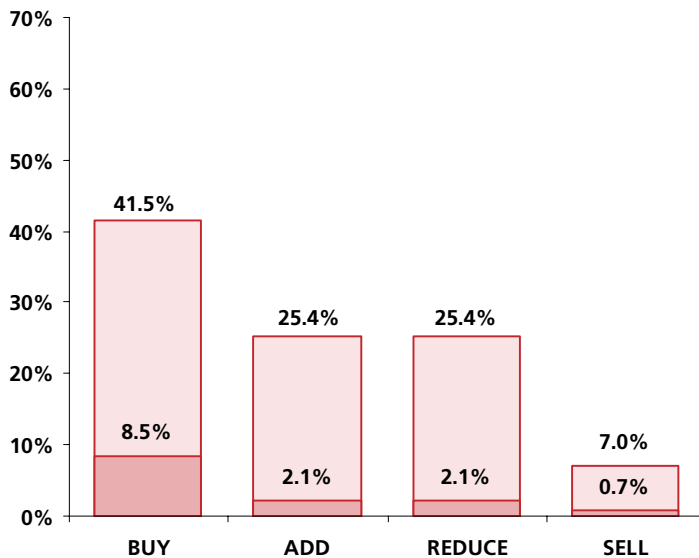
(b) Ambuja Cement- 2006 numbers for 12 months ending June 2006 and 2007 numbers for 12 months ending Dec 2006 (adjusted).

Source: Company reports, Kotak Institutional Equities estimates.

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Source: Kotak Institutional Equities

As of September 30, 2008

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BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL: We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

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