investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
BASF India	18-Sep-06	220	**238**	300
BEL	26-Sep-06	1,108	**1,168**	1,525
ICICI Bank	23-Dec-03	284	**703**	770
Orient Paper	30-Aug-05	214	**595**	800
UltraTech	10-Aug-05	384	**882**	1,000

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Market Outlook

Earnings upgrades required

Key points

- In our last Market Outlook report dated August 02, 2006, we had said that going ahead there would be two key positive triggers for the Indian equity market, viz a pause in the rate hikes by the US Federal Reserve (Fed) and better-than-expected earnings for Q1FY2007.
- The two triggers have played out as per our expectations and at the current level of 12,404 the Sensex has swiftly discounted both these positives, leaving very marginal upside.
- The Fed futures are indicating that any rate cut by the Fed can come in the first quarter of CY2007 at the earliest. This leaves us exposed to global economic risks in the interim six months.
- Corporate earnings haven't seen any significant upgrades over the last few months. Any upside from hereon would depend on the upgrades in the index' earnings driven by the better-than-expected Q2FY2007 earnings, especially in the banking and oil sectors.
- However, upgrades in the Sensex' earnings will have to be significant—in the range of 10%—to bring the market's valuations back to attractive levels. The Sensex is currently trading at 16.1x its one-year forward earnings, which is towards the higher end of the band in which it has usually traded, ie 12-16x.
- We continue to prefer domestic demand-driven stories like automobiles, banking, capital goods and cement.

US economy—some more time for clear signals

Our view during the recent volatile summer months was positive as we expected strong earnings and a likely pause by the Fed to restore market sentiment and flows. That scenario has played out. The earnings of the Sensex companies grew by 22.6% year on year (yoy) compared with expectations of a 19.1% growth. With the Fed taking a breather after its two-year journey of rate hikes coupled with lower oil prices, many of the market's concerns have eased.

As always, the question is what next?

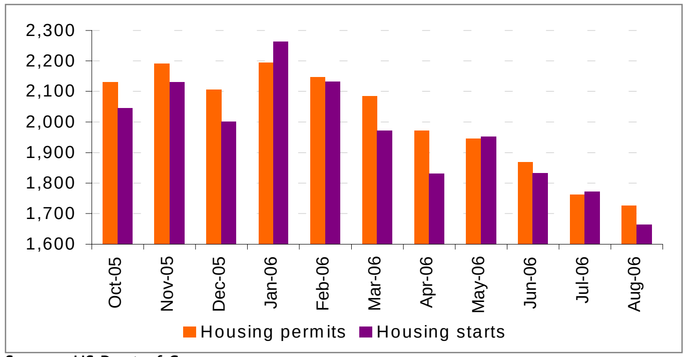
The scenario on the US economy front remains ambiguous. Economic indicators exhibit a mixed trend. Some such as the gross domestic product (GDP) growth, manufacturing and housing are slowing while others such as retail sales, employment and consumer confidence are showing resilience. Surprisingly the average US consumer still looks upbeat, at least in the short term, as the indicators like the retail sales and the Consumer Confidence Index have both shown signs of a revival for September 2006. A steady decline in the gasoline and heating oil prices may have prompted a spurt in the consumer spending. Further, US mortgage rates have begun declining and this coupled with the lower gas prices could definitely help the US economy reach the much desired "soft landing". This is definitely a scenario to be hoped for. However, historically soft landings have happened only 50% of the time and our concern is in the global markets too much complacency is now building up that the best-case scenario will definitely happen. Any disappointment on this count could eventually have repercussions on flows and performance here.

Further, inflation in the US economy continues to remain high and well above the 1-2% comfort level of the Fed. Declining labour productivity could make taming inflation a long drawn affair. The underlying assumption in the markets is that the gradual cooling down of the housing market followed by a slowdown in the economy will help cool off the inflation. Historical experiences suggest that it normally takes six to nine months before the weakness in the housing market starts to cool inflation. In this six to nine month period if the incoming data on inflation is not as per expectations, it would again be a negative surprise for the markets.

Hence we believe that it will take still some more time before the full impact of the Fed's rate hike exercise is felt and the inventories in the pipeline get cleared (like in case of housing). The Fed futures are indicating that any Fed rate cut can be expected at the earliest only in the first quarter of CY2007.

New housing permits slowing down (in thousands)

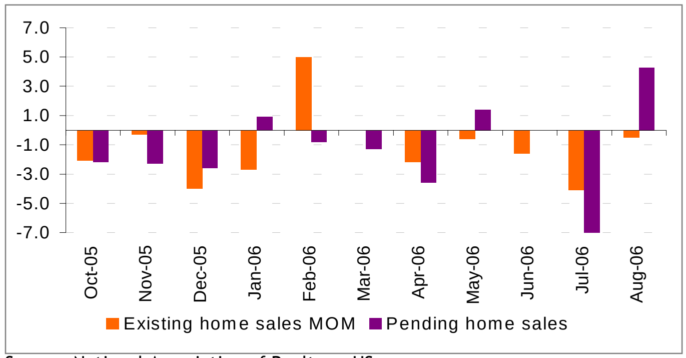
- New housing permits and new housing starts slowing down.
- Both declined for the seventh month in a row, reflecting the impact of rising interest rates in the USA.
- Optimists argue that this indicates a clearing of inventory by builders, after which the housing market would pick up.



Source: US Dept of Commerce

Pending home sales on rise—people expecting Fed to cut rates

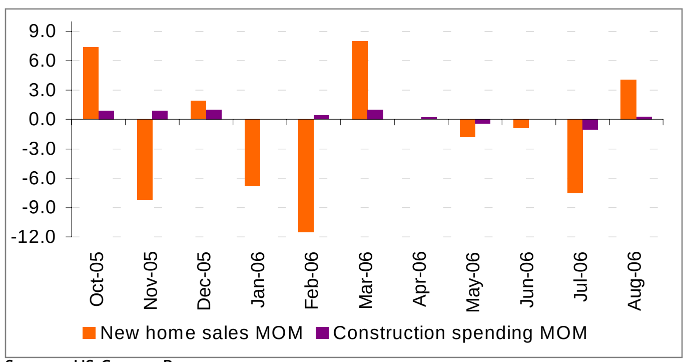
- The existing home sales still on the decline, however the pending home sales show a smart growth of 4.3% which means that the existing home sales may grow for the coming month.



Source: National Association of Realtors, US

New home sales and construction spending rises

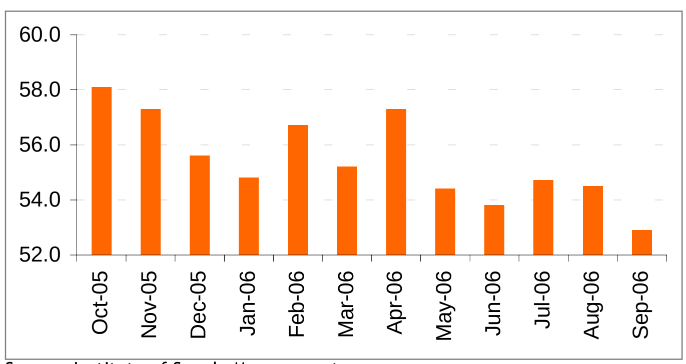
- The new home sales as well as construction spending again on the rise.
- This might be just an inventory effect. It may take a while for the pending inventory in the housing sector to clear.



Source: US Census Bureau

ISM Manufacturing Index on decline

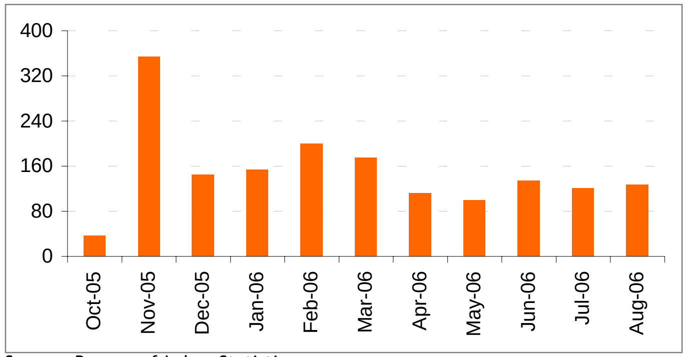
- Growth in manufacturing slowed in September 2006 as indicated by the ISM Manufacturing Index.
- The ISM Manufacturing Index at 52.9 was lower than 54.5 recorded in August 2006 and also lower than the estimated level of 53.5.



Source: Institute of Supply Management

Change in non-farm pay-roll

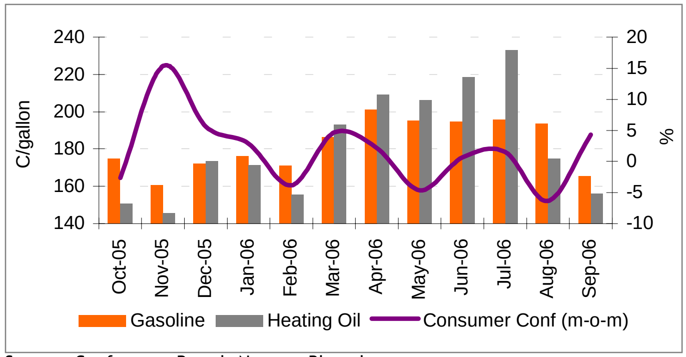
- Addition to non-farm pay-roll is slowing down. It remains sluggish for August 2006, indicating less pressure on inflation.



Source: Bureau of Labor Statistics

Consumer Confidence Index shows revival

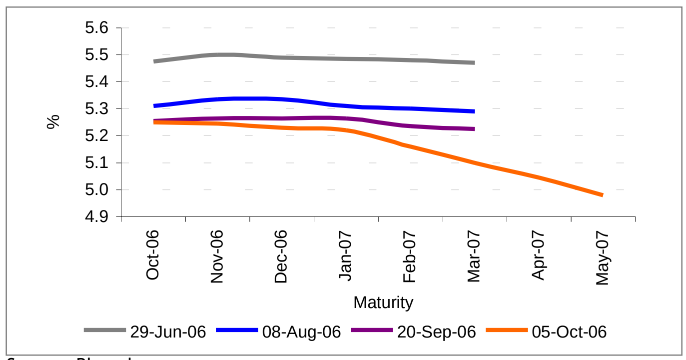
- The Consumer Confidence Index is witnessing a revival as it is inching up by 4.3% month on month.
- Retail sales for August 2006 grew for the second consecutive month, by 0.2% over the previous month.
- One of the reasons for the increased consumer confidence could be falling gasoline and heating oil prices which may have left more income at the US consumer's disposal.



Source: Conference Board, Nymex, Bloomberg

Markets also expecting a cut only next year

- Markets are also expecting a rate cut only in CY2007. The Fed futures maturing in January 2007 and March 2007 are trading at 5.22% and 5.1% respectively.



Source: Bloomberg

Sensex' earnings may get revised post-Q2FY2007

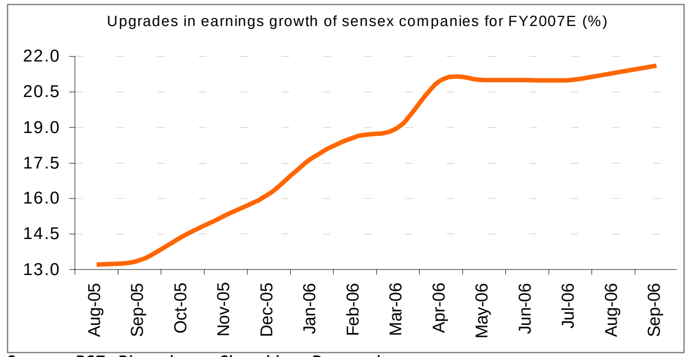
The earnings growth estimates for the Sensex have remained stagnant at 21% and 11% for FY2007 and FY2008 respectively for a long time. There are various reasons for the same: 1) Rising interest rates, which started tightening from December 2005 and continued to do so till September 2006; 2) volatility in global commodity markets, especially oil, in the last few months; and 3) heavy rains and floods in the western and northern parts of India in August 2006.

However, we believe that H2FY2007 will see an upgrade in the Sensex' earnings with the easing of the above-mentioned concerns. The interest rates have already softened over the past few weeks. Oil has also started to cool down. We believe that the earnings upgrade will be led by the banking sector. That is because the front-end losses on the bond portfolio of banks have already been provided for. Also with interest rates expected to remain benign, the banks will have much lower or negligible mark-to-market losses on their bond portfolio and may even see some treasury gains.

However, upgrades in the Sensex' earnings will have to be in the range of a minimum 10-15% to justify the valuations as the Sensex is currently trading at 16.1x its one-year forward earnings, which is towards the higher end of the band in which it has usually traded, ie 12-16x.

Sensex' earnings may see revision after Q2FY2007

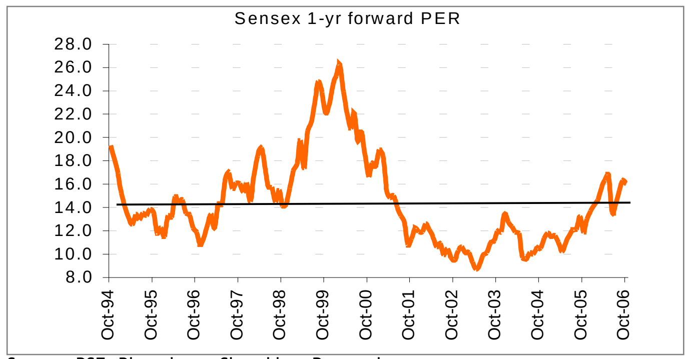
- The estimated growth in the Sensex' earnings has remained stagnant at 21% for long.
- It may see substantial upgrade in earnings if Q2FY2007 results are better than expected.
- Banking sector may lead the upgrade on the back of strong earnings for Q2FY2007 and easing interest rate scenario.



Source: BSE, Bloomberg, Sharekhan Research

Sensex' valuations

- The Sensex has usually traded between 12x and 16x one-year forward PER over the last ten years.
- Sensex' valuations are ripe at 16x one-year forward earnings (Sensex = 12,404)
- Overall earnings need to be upgraded by at least 10-15% for the valuations to be reasonable.



Source: BSE, Bloomberg, Sharekhan Research

H2FY2007 implied growth at 21%—further upgrades necessary

- Sensex' earnings expected to grow at 22.6% yoy and 8.4% sequentially for Q2FY2007.
- Implied growth for H2FY2007 works out to 21% yoy which looks fairly discounted in the Sensex.
- Upgrade necessary for further upside.

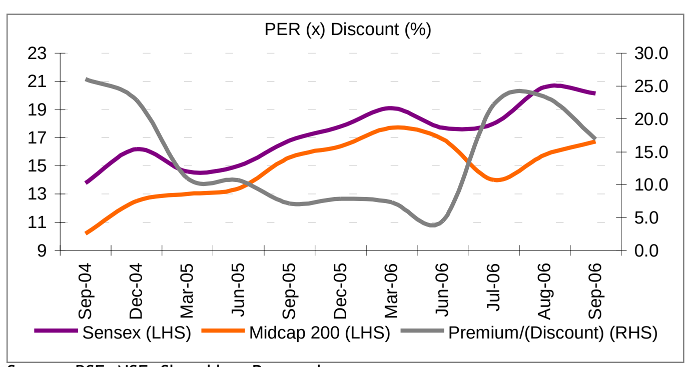
Sensex earnings growth

	Q2FY2007E		Implied growth
	% yoy chg	% qoq chg	for H2FY2007
Auto	18.6	6.6	22.3
Bank	10.7	30.0	29.2
Capital goods	27.5	30.5	38.5
Cement	241.3	-15.0	40.1
FMCG	23.5	8.1	19.3
IT	41.2	5.0	37.5
Metals	29.6	9.3	43.2
Oil	8.9	7.9	(0.1)
Pharma	136.4	29.0	101.8
Power	20.6	-5.6	0.2
Total	22.6	8.4	21.0

Source: Sharekhan Research

Discount between large-caps and mid-caps narrows as mid-caps rally

- The Sensex has gone up by nearly 12% since our last Market Outlook report dated August 02, 2006.
- The CNX Midcap Index has gone up by around 19.5% over the same period.
- This has narrowed the valuation gap between the two to 17% on a trailing twelve-month basis compared with 22% in August 2006.



Source: BSE, NSE, Sharekhan Research

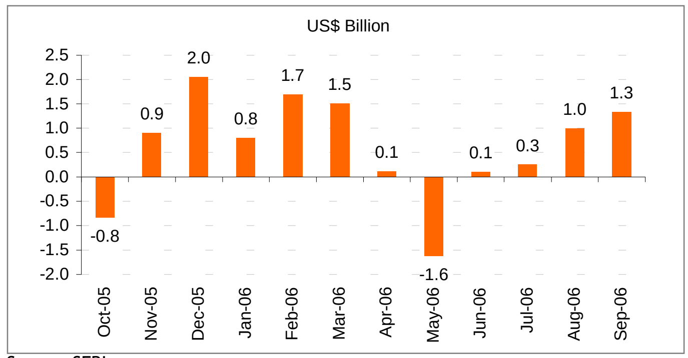
Liquidity—eased a lot after May 2006

May 2006 saw one of the biggest crashes in the Indian stock market with the Sensex crashing by more than 2,000 points during the month. The crash was led by the sell-off by the foreign institutional investors (FIIs) who sold Indian equities worth $1.6 billion in the month. However, over the following four months the whole trend was reversed and the FIIs bought Indian equities worth $2.7 billion over June-September 2006.

Domestic mutual funds have not lagged behind. After mobilising more than Rs27,000 crore during CY2006, they have invested more than Rs13,700 crore in the Indian equities. We believe that they with their cash coffers of Rs10,000 crore will continue to provide liquidity and cushion to the equity markets.

FIIs resume their buying spree

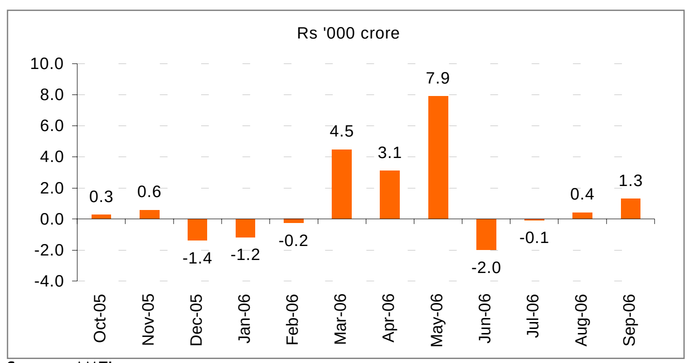
- FIIs have poured in $5.2 billion (net) in CY2006.
- FII investments are again on the rise after a sharp sell-off in May 2006.
- FIIs have regained confidence following better-than-expected Q1FY2007 earnings growth and easing of pressure on interest rates.



Source: SEBI

Domestic funds play in line with expectation

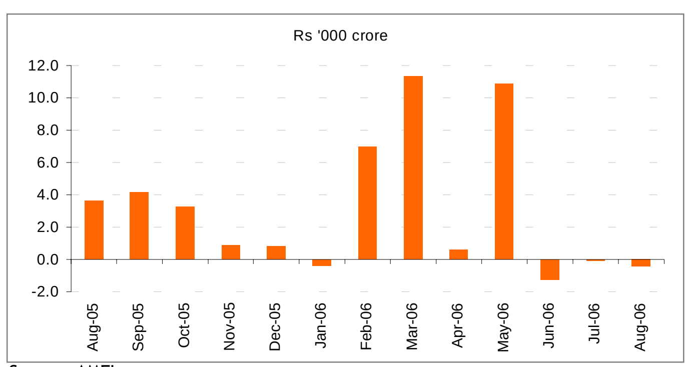
- Domestic mutual funds have also been steady players in the market, having bought Rs13,747 crore of Indian equities (net) during CY2006.



Source: AMFI

Flows to equity-based mutual funds

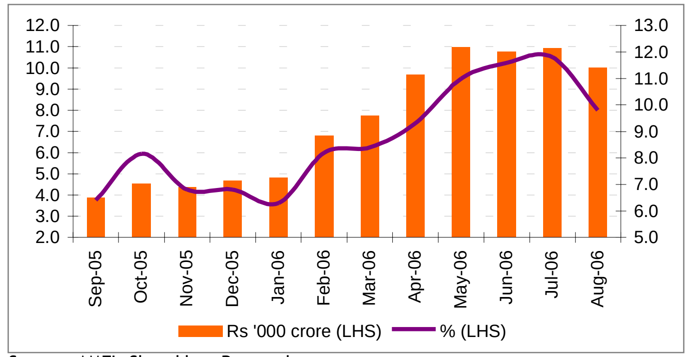
- Last three months have seen net redemption of money from the equity-based mutual funds as very limited new fund offerings were floated during the period.
- However, equity-based mutual fund schemes have garnered a staggering Rs27,000 crore during CY2006.



Source: AMFI

Cash levels with mutual funds to act as cushion

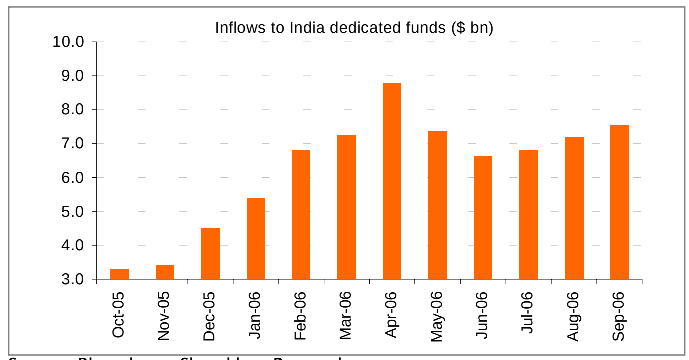
- Domestic liquidity for equity markets still looks buoyant with the mutual funds sitting on Rs10,000 crore of cash which should be invested in the market over the next couple of months.



Source: AMFI, Sharekhan Research

Money raised by India dedicated funds on rise

- Emerging markets are still fancied by asset managers across the globe.
- The BRIC economy dedicated funds make more than 25% of the funds raised globally.
- India dedicated funds on the rise with more than $7 billion to be invested in Indian equities.



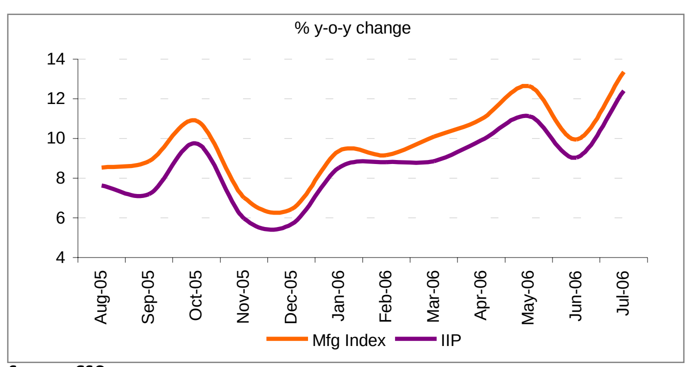
Source: Bloomberg, Sharekhan Research

India—strong on domestic front as has ever been

After the brief pause that the economy took during November-December 2006, it seems it never looked back. The Index of Industrial Production has grown by 10.6% in the year till date. The Manufacturing Index has grown by 11.7% in the year till date. We expect the growth to continue, as is indicated by the leading indicators like electricity production and sales of motorcycles, commercial vehicles and cement dispatches.

IIP sparkles with manufacturing sector's strong growth

- Index of Industrial Production and Manufacturing Index report strong growth in July 2006.
- The Index of Industrial Production grew by a strong 12.4% yoy for July 2006. The growth was the highest in the last ten years.
- The manufacturing sector grew by 13.3%.



Source: CSO

Leading indicators show strong growth would continue

- The strong growth is expected to continue as is indicated by the upswing in consumption of commercial vehicles, motorcycles, cement and production of coal and electricity.
- Small aberration may come in August 2006 as the month was marred with floods in the states of Gujarat, Maharashtra, Madhya Pradesh and Uttar Pradesh.

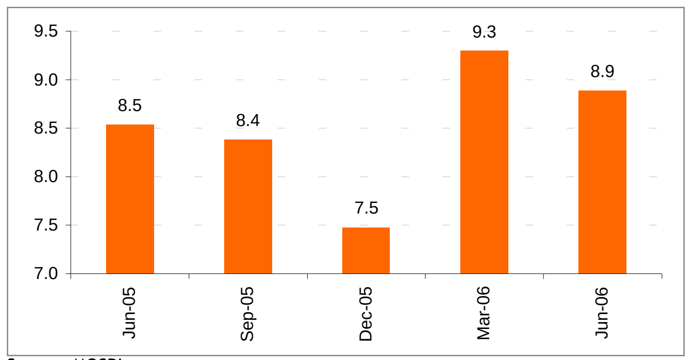
Indicator% y-o-y change

	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Trend
Steel	8.6	6.4	5.6	8.0	6.3	Up
Coal	3.4	8.1	11.9	10.6	0.2	Up
Electricity	5.9	5.1	4.9	8.6	3.7	Up
Cement dispatches*	10.2	8.3	9.5	10.3	8.9	Up
Commercial vehicles*	63.6	50.3	46.2	39.8	36.9	Up
Passenger vehicles*	19.9	23.0	23.8	22.9	20.9	Up
Motorcycles*	18.3	22.2	24.3	23.1	19.4	Up

Source: CMIE, * YTD

The GDP keeps growing at scorching pace

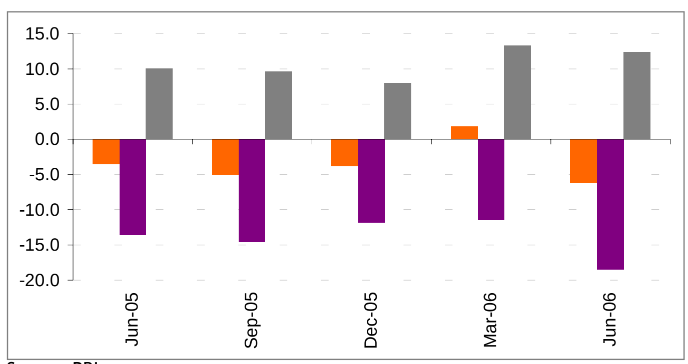
- India's gross domestic product (GDP) for Q1FY2007 grew by 8.9% yoy, slightly above expectation.
- The growth was achieved on the back of a 9.7% y-o-y growth in the industrial sector.
- Agriculture also grew by a handsome 3.4%.



Source: MOSPI

Current account deficit worsens—however falling crude would provide relief later

- Current account deficit worsened for Q1FY2007 probably due to currency fluctuations and higher imports of defence items.
- The same should correct over coming quarters.
- Remarkably, the invisible earnings maintained the momentum, growing at 23.5%.
- Loans and foreign direct investment have kept overall balance of payment healthy despite outflow on account of portfolio investments in Q1FY2007.



Source: RBI

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

Sharekhan Special

Q2FY2007 earnings preview

Key points

- The domestic demand-driven story is likely to continue, as is evident from the growth in the Sensex' earnings led by automobile, cement, capital goods and fast moving consumer goods (FMCG) companies.
- We also expect the information technology (IT) companies to report a strong earnings growth on the back of a robust volume growth and the depreciation of the rupee vis-à-vis the dollar.
- We expect the earnings of the Sensex companies to grow by a strong 22.6% year on year (yoy) led by a strong growth in the above-mentioned sectors.

Sensex' earnings growth (%)

Sector	% y-o-y change in Q2FY2007E	% q-o-q change in Q2FY2007E	Implied growth for H2FY2007
Auto	18.6	6.6	22.3
Bank	10.7	30.0	29.2
Capital goods	27.5	30.5	38.5
Cement	241.3	-15.0	40.1
FMCG	23.5	8.1	19.3
IT	41.2	5.0	37.5
Metals	29.6	9.3	43.2
Oil	8.9	7.9	(0.1)
Pharma	136.4	29.0	101.8
Power	20.6	-5.6	0.2
Diversified	68.7	1.5	22.3
Total	22.6	8.4	21.0

Note: We have not included Tata Power Company as Reliance Communication Ventures Ltd (RCVL) has replaced it in the Sensex. We have also not included RCVL in our numbers, as the comparable figures for the last year are not available.

- The implied growth for H2FY2007 works out 21% yoy. Further upmove in the Sensex could come only from further upgrades in the Sensex' earnings.

Automobiles—to report strong growth

- Q2FY2007 has been a good quarter for the automobile sector despite being a lean season due to the monsoons and the inauspicious *Shradh Paksha*. Though floods and heavy rains in some parts of the country affected automobile sales, the two-wheeler segment (except the market leader) has grown well.
- The commercial vehicle segment has also grown albeit at a lower rate as compared to Q1FY2007 and ditto for the passenger car segment.
- The softening of the raw material prices, especially steel and copper, coupled with the strong volume growth in the quarter should lead to margin expansion, as against margin contraction in Q1FY2007. The product prices increased by 2-3% across categories during the quarter, which should further cushion the margins.
- We expect Tata Motors, Maruti Udyog and Bajaj Auto to be among the key performers in the sector for this quarter.

Automobile majors' volume growth

	Q1FY2007	Q1FY2006	% y-o-y growth
Two-wheelers			
Bajaj Auto	708,125	555,552	27.5
Hero Honda	751967	742425	1.3
TVS Motors	419,195	325,530	28.8
Four-wheelers			
Tata Motors	139,894	107,062	30.7
Maruti Udyog	157,683	140,540	12.2
Ashok Leyland	19,869	14,895	33.4
M&M	66,708	53,746	24.1

Quarterly estimates

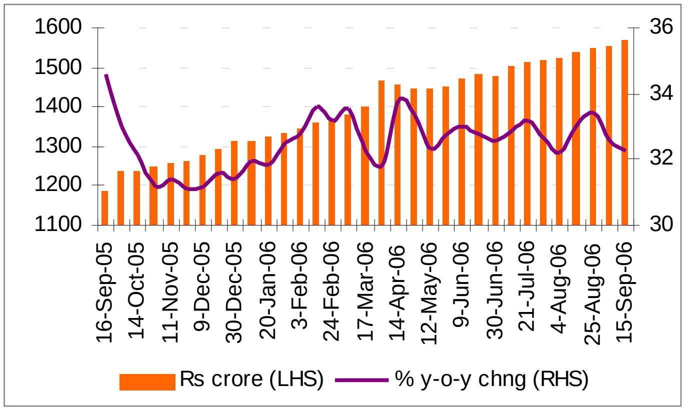
(Rs crore)	Net sales			Profit after tax		
	Q2FY07E	Q2FY06	% yoy change	Q2FY07E	Q2FY06	% yoy change
Bajaj Auto	2,478.4	1,867.0	32.8	337.7	290.8	16.1
TVS Motor Company	1,047.5	789.2	32.7	37.3	31.9	16.8
Maruti Udyog	3,417.5	3,039.9	12.4	346.2	262.7	31.8
Mahindra & Mahindra	2,393.5	1,914.8	25.0	194.9	157.2	24.0
Tata Motors	6,575.0	4,781.3	37.5	456.5	337.9	35.1
Ashok Leyland*	1,649.1	1250.1	31.9	91.8	76.8	19.6
Omax Auto	166.7	150.4	10.8	5.6	4.8	17.9
Sundaram Clayton	196.5	151.7	29.5	25.9	14.6	77.6
Subros	151.3	130.8	15.7	6.0	4.0	48.6

* Does not include income from sale of stake in IndusInd Bank

Banking—a joyful quarter at last

- The loan book of the scheduled commercial banks has grown by 32.3% during the period up to the week ended September 15, 2006. The growth in the net interest income is likely to be commensurate with that in the loan book, as the margins continue to be stable on the back of the increase in the lending rates.

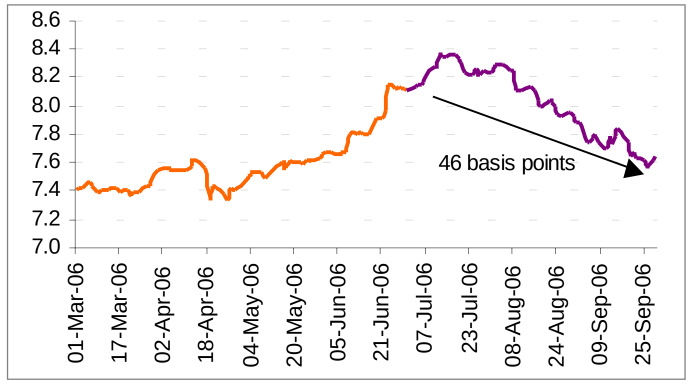
Stupendous loan growth continues unabated



Source: RBI, Sharekhan Research

- With the 10-year government bond settling at approximately 46 basis points lower than its June 2006 level, we believe that the mark-to-market losses will be much lower for the banks or may not be there at all.

10-year G-Sec yield declining (%)



Source: Bloomberg, Sharekhan Research

- Among the public sector banks we expect Corporation Bank and Punjab National Bank to report strong growth in earnings. HDFC Bank is likely to lead the pack of the private sector banks.

Quarterly estimates

	NII				Core operating profit				Net profit			
	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq
Allahabad Bank	429.8	367.6	16.9	9.9	235.5	193.8	21.5	6.5	190.5	168.3	13.2	48.6
Andhra Bank	357.2	288.6	23.8	6.5	224.4	171.5	30.8	13.0	153.5	132.9	15.5	31.9
BOB	1,015.2	781.8	29.9	15.1	574.1	380.7	50.8	4.6	290.5	259.1	12.1	77.9
BOI	734.8	578.6	27.0	-3.9	382.8	330.1	16.0	-18.1	201.6	132.2	52.5	-3.4
Canara Bank	940.2	806.7	16.6	-0.8	652.3	573.1	13.8	10.7	368.3	306.5	20.2	92.9
Corporation Bank	338.8	306.5	10.5	4.3	270.6	232.2	16.6	10.4	154.5	105.6	46.3	7.1
PNB	1,434.9	1,190.7	20.5	11.0	894.6	609.1	46.9	-0.5	532.0	422.0	26.1	44.7
UBI	662.4	602.3	10.0	4.4	375.6	324.8	15.7	-5.7	212.5	61.1	247.8	27.4
Total-PSBs excl SBI	**5,913.3**	**4,922.8**	**20.1**	**6.1**	**3,609.9**	**2,815.3**	**28.2**	**1.2**	**2,103.4**	**1,587.7**	**32.5**	**41.5**
State Bank of India	3,855.3	3,608.0	6.9	-0.7	2,135.0	1,736.2	23.0	-18.7	1,077.2	1,215.4	-11.4	34.7
HDFC Bank	837.5	612.1	36.8	2.4	569.1	458.7	24.1	-7.9	264.4	199.6	32.4	10.5
ICICI Bank	1,443.3	953.5	51.4	-2.2	1,240.0	804.1	54.2	8.5	723.6	580.1	24.7	16.8
UTI Bank	381.4	255.5	49.3	18.5	269.6	159.0	69.6	0.9	142.2	109.0	30.4	18.0
Total-private banks	**2,662.2**	**1,821.1**	**46.2**	**1.8**	**2,078.7**	**1,421.8**	**46.2**	**2.5**	**1,130.2**	**888.7**	**27.2**	**15.4**

Quarterly estimates (July-September 2006)

(Rs crore)	Net sales			Profit after tax		
	Q2FY07E	Q2FY06	% change	Q2FY07E	Q2FY06	% change
ACC	1300	1005	29	212	74	185
Orient Paper	232	170	36	25	3	672
UltraTech	922	635	45	144	0	143900
Madras Cement	400	246	63	90	18	400
Shree Cement	304	155	96	83	37	122
JK Cement	248	206	20	20	7	190
India Cements	498	391	27	95	6	1524

Capital goods and engineering

- We expect a strong growth in the revenues of the capital goods and engineering companies on the back of a strong order book carried forward at the end of FY2006.
- Due to operating leverage, the growth momentum in the earnings of these companies is likely to be maintained.

Cement

- The performance of the cement sector is expected to pick up from where it was left in Q1FY2007. We expect the sector as a whole to report an impressive performance for Q2FY2007 due to a 9-10% growth in the cement volume and a huge 29-30% rise in their cement realisation. Hence this sets a benchmark of 38-40% growth in the top line.
- Cement consumption in the southern region has remained very healthy, growing by 20% during the quarter. Further, the sales tax rate in Tamil Nadu has been reduced from the average rate of 23.5% to 14.5% and cement players have not passed on this benefit to the consumers. The same was clearly visible in Q1FY2007. Hence we expect the south-based cement manufacturers to deliver a superlative performance.
- Amongst the companies in our coverage, we expect Madras Cement and Shree Cement to top the charts in terms of the top line growth.
- On the earnings front, we rate UltraTech Cement and India Cements as our best picks. On account of their huge leverage to cement price, both these players are expected to report a manifold jump in their earnings.

Fast moving consumer goods

- Backed by a pick-up in the rural demand, the fast moving consumer goods (FMCG) sector has seen improving volume growth every quarter. The revenue growth for the current quarter is likely to be in the higher double-digit range.
- We expect the earnings of the market leader in the segment, Hindustan Lever Ltd, to grow by 17.4% yoy backed by the strong volume growth and price increases in its key product segments.
- We expect ITC's profits to grow by 21.1% yoy driven by the growth in its cigarette, hotel and paper businesses.

Information technology

- Given the robust demand environment, the front-line information technology service companies are expected to maintain the growth momentum in Q2 also. We expect the volumes to grow in the range of 6.5-10% sequentially for the quarter.
- The depreciation of the rupee would further aid the overall growth in the revenues (based on the average exchange rate during the quarter). However, the impact of the exchange rate fluctuation is likely to be lower in Q2. Especially in terms of the translation gains (that means lower other income), as the end of the period exchange rate was more or less stable as compared with Q1.
- Based on the implied compounded sequential quarterly growth rate (CQGR) for the next two quarters, we believe that there is scope for a possible earnings upgrade in the case of HCL Technologies and Wipro.

Earning estimates

Rs crore	Net sales			Net profit		
	Q2FY07	% q-o-q growth	%y-o-y growth	Q2FY07	% q-o-q growth	%y-o-y growth
Infosys Tech	3343.2	10.9	45.7	863.8	8.8	45.8
Satyam Computer	1558.3	8.0	34.9	304.0	-14.1	28.1
HCL Tech#	1341.4	7.0	38.2	239.5	2.8	43.0
Wipro (cons)	3391.1	8.3	35.8	655.5	6.7	39.3
TCS	4462.3	7.7	41.4	932.4	8.1	35.1

HCL Technologies is a June ending company

Oil and gas

- Oil and Natural Gas Corporation is likely to report a sedate 8.5% growth in profits, as the benefits of higher realisation on crude and higher production are likely to be offset by the higher subsidy burden under the new subsidy sharing formula.
- Reliance Industries is likely to show a sedate 10% y-o-y growth in profits for the following reasons:
- The gross refining margins have come down by nearly 14-15% yoy which will have a negative impact on the profit before interest and tax (PBIT) from the refining business;
- The petrochemical plant at Hazira was shut for a few days because of floods in the region; this may have an impact on the PBIT from the petrochemical business. We expect these losses to be compensated by the higher realisations on the polymer products; and
- The other income is likely to be lower due to lower investible surplus.

Metals

Non-ferrous

- Despite correcting from their highs, the aluminium, copper and zinc prices are still sharply higher over the last year. Aluminum prices have seen a jump of 37% in Q2FY2007 over the same period last year whereas copper and aluminum have seen a sharp jump of more than 100% in their prices.
- We expect the non-ferrous metal majors like Hindalco Industries, National Aluminium Company, Hindustan Zinc and Sterlite Industries (India) to report a strong growth in earnings backed by the firm metal prices.

Ferrous

- The growth in Tata Steel's earnings will remain limited to 6.5% yoy due to a sedate growth in volumes. However, the price realisation is expected to have improved as Q2FY2006 had seen a sharp dip in the realisations.
- A shut-down at a blast furnace at the Jamshedpur plant has led to a flat growth in the production of saleable steel and hence the volume growth was limited to just 4.5%.

Tata Steel volume numbers

Million tonne	Q2FY2007	Q2FY2006	% y-o-y growth
Crude steel production	1.33	1.33	0.2
Saleable steel production	1.25	1.23	1.1
Sales volumes	1.26	1.20	4.5

Source: Company

Pharmaceuticals

- Due to increasing focus on the high-growth lifestyle segments and aggressive new product launches (either from in-house or in-licencing base) the domestic pharmaceutical industry is likely to deliver an impressive growth in Q2FY2007. Companies with wider domestic presence and higher market share, like Ranbaxy Laboratories, Cipla, Sun Pharmaceuticals and Cadila Healthcare are likely to benefit from this.
- In the international business front, the new generic launches in the regulated markets of the USA and Europe, and the increasing global penetration have maintained the growth for the domestic industry. Also with the increase in product filings, Indian companies are increasing their contribution of revenues from the regulated markets as more and more drugs are becoming generic. For example, Ranbaxy Laboratories is expected to derive strong sales from the launch of generic "Zocor"

under 180-day exclusivity. Similarly, Dr. Reddy's Laboratories may witness revenue upside from "Zocor" supplies, as it is the authorised generic for the product.

- Strong pricing pressures in the generic industry is forcing the Indian companies to acquire global companies in order to build up their scale of operations, increase their global presence, and derive manufacturing and cost synergies.
- India, with its low-cost skilled labour and international regulatory compliance, is attracting foreign companies to outsource their research and manufacturing. As a result, Indian players like Nicholas Piramal and Dishman Pharma are getting a large number of CRAMS orders.
- A strong domestic market scenario and increasing contribution from exports are likely to result in strong top line and margin growth for the Indian pharma players.

Quarterly estimates

	Net sales			Net profit		
	Q2FY07E	Q2FY06	% y-o-y chng	Q2FY07E	Q2FY06	% y-o-y chng
Ranbaxy Labs	1,543.9	1,283.4	20.3	193.2	18.4	950.0
Cipla	867.5	672.0	29.1	171.6	122.6	40.0
Sun Pharma	514.2	422.2	21.8	177.9	145.6	22.2
Wockhardt	420.9	359.4	17.1	68.9	65.0	6.0
Orchid Chemicals	244.9	239.4	2.3	26.3	27.3	-3.5
Elder Pharma	109.6	84.4	29.9	14.2	7.3	94.9

Telecom

- Bharti Telecom is likely to see a strong 66.7% y-o-y growth in earnings backed by a steady addition to the subscriber base and stable margins.
- During Q2FY2007, Bharti Telecom is expected to have added 3.8 million subscribers, nearly 0.3 million higher than 3.5 million subscribers added in Q1FY2007.
- The stable margins in the wireless business segment due to the growing economies of scale will help it keep the overall margins stable.

Annexure—I

Stocks to watch out for in Sensex

Stocks where the earnings growth is expected to be high

Company	Q2FY07E	Q2FY06	% y-o-y change
Gujarat Ambuja Cements	243.9	75.3	223.9
Associated Cement Co	212.0	74.0	185.0
Hindalco Industries	588.3	276.5	112.8
Grasim Industries	313.0	187.7	66.8
Bharti Airtel	834.0	500.4	66.7
Dr Reddy's Laboratories	163.0	107.5	51.5
BHEL	374.7	260.2	44.0
Cipla	174.4	122.6	42.3
Maruti Udyog	346.2	262.7	31.8

Stocks where lower earnings growth/decline is likely

	Q2FY07E	Q2FY06	% y-o-y change
Reliance Industries	2677.8	2481.0	7.9
Oil & Natural Gas Corp	4389.5	4138.3	6.1
TISCO	1098.1	1045.4	5.0
Tata Power Co	127.6	125.7	1.5
Hero Honda Motors	213.8	237.9	-10.1
State Bank of India	1,077.2	1,215.4	-11.4

Stocks where there is low implied growth—upgrades likely

	H2FY07	H2FY06	Implied % y-o-y change
ONGC	6,103.6	6,333.0	-3.6
Reliance Energy	342.2	334.1	2.4
NTPC	3,500.8	3,348.0	4.6
Reliance Industries	4,635.4	4,278.0	8.4
Maruti Udyog	774.3	699.9	10.6
Hero Honda Motors	600.0	529.0	13.4
Satyam Computer	647.4	562.7	15.1
Cipla	404.9	346.4	16.9

Annexure II—Non-Sensex companies where high growth is expected

Company	Q2FY07E	Q2FY06	% y-o-y change
UltraTech Cement	144.0	0.1	143,900.0
Orient Paper	25.0	3.0	672.0
Hindustan Zinc	902.2	196.0	360.3
JSW Steel	247.7	106.3	136.9
Shree Cement	83.0	37.0	122.0
Nalco	531.1	283.0	87.6
Thermax	40.3	25.3	59.0
ABB	79.8	52.9	50.7
HCL Tech	239.5	202.3	43.0
Alstom Projects	16.4	11.5	42.6
Siemens	146.4	104.5	40.1

Sharekhan Special

Auto earnings preview

Q2FY2007 has been a good quarter for the automobile sector despite being a lean season due to the monsoons and the *Shradh Paksha*. Though the floods and heavy rains in some parts of the country affected automobile sales, the two-wheeler segment (except the market leader Hero Honda) has grown well; the commercial vehicle segment has also grown albeit at a lower rate as compared to Q1FY2007 and ditto for the passenger car segment. Bajaj Auto's sales grew by 27%, while Hero Honda reported a marginal rise of 1.3% in its motorcycle sales. Maruti's car sales grew by 12%, M&M's tractor sales were up by 29.7% and Tata Motors' commercial vehicle sales (including exports) grew by 39%.

With the softening of the raw material prices, especially steel and copper, coupled with the strong volume growth in the quarter should lead to margin expansion, as compared to the fall in the margins in Q1FY2007. The product prices have been increased by around 2-3% across categories during the quarter, which should further cushion the margins.

We expect Tata Motors, Maruti Udyog and Bajaj Auto to be among the leaders in performance in the sector for Q2FY2007.

Bajaj Auto

The company has reported a strong growth in sales for Q2FY2007. The motorcycle sales were up 40% and the three-wheeler sales witnessed a strong growth of 18%. Its new 100cc bike *Platina* was well received by the market and posted good numbers. At the start of the quarter, Bajaj hiked the prices of *Platina*, *Discover* and some of its three-wheeler brands by 1-3%. However, in order to promote sales, it later slashed the prices of *Platina* by Rs2,000 in mid-September. The sales for the quarter are projected to grow by 32.8%, the earnings before interest, tax, depreciation and amortisation (EBITDA) margins are likely to increase by 30 basis points and the profit after tax (PAT) is projected to grow by 16.1%.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
Motorcycles	623,062	445,557	39.8
Geared scooters	697	18,793	-96.3
Un-geared scooters	3,683	22,717	-83.8
Total two-wheelers	627,442	487,067	28.8
Three-wheelers	80,683	68,485	17.8
Grand total	708,125	555,552	27.5

Quarterly estimates

(Rs crore)	Net sales			Profit after tax		
	Q2FY07E	Q2FY06	% change	Q2FY07E	Q2FY06	% change
Bajaj Auto	2,478.4	1,867.0	32.8	337.7	290.8	16.1
TVS Motor Company	1,047.5	789.2	32.7	37.3	31.9	16.8
Maruti Udyog	3,417.5	3,039.9	12.4	346.2	262.7	31.8
Mahindra & Mahindra	2,393.5	1,914.8	25.0	194.9	157.2	24.0
Tata Motors	6,575.0	4,781.3	37.5	456.5	337.9	35.1
Ashok Leyland*	1,649.1	1250.1	31.9	91.8	76.8	19.6
Omax Auto	166.7	150.4	10.8	5.6	4.8	17.9
Sundaram Clayton	196.5	151.7	29.5	25.9	14.6	77.6
Subros	151.3	130.8	15.7	6.0	4.0	48.6

* Does not include income from sale of stake in IndusInd Bank

TVS Motors

TVS Motors continued on its strong growth path recording an overall volume growth of 28.8% following a good 22.4% growth in Q1FY2007. The motorcycle sales growth during the quarter stood at 37.3% backed by the strong performances of *Star City* and *Apache*. *Apache* became the number 2 brand in the premium bike category while the sales of *Star City* crossed 75,000 units towards the end of the quarter. The company's exports reached the highest ever level with volumes of 31,729 vehicles. Backed by strong volume growth, we expect TVS to report a top line growth of 32.7%. The margins are expected to improve due to the reduction in the raw material prices and a price hike of about 1.5% effected towards the end of the last quarter.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
Motorcycle	258,321	188,200	37.3
Scooters	73,364	68,814	6.6
Mopeds	87,510	68,516	27.7
TOTAL	419,195	325,530	28.8

Mahindra & Mahindra (M&M)

Scorpio sales continued to do well since its new launch. During the quarter the company introduced the all-new *Scorpio* in some of the export markets such as Sri Lanka and Kenya. The three-wheeler segment has been performing brilliantly for the company and the quarter marked a growth of 68.7% year on year (yoy). The tractor sales remained buoyant with a sales growth of 29.7%.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
Utility vehicles	29,505	26,601	10.9
Scorpio	9,893	8,248	19.9
UVs w/o Scorpio	19,612	18,353	6.9
LCVs	1,991	1,883	5.7
Three-wheelers	8,887	5,269	68.7
Total automotive	40,383	33,753	19.6
Exports	2,761	1,822	51.5
Tractors	23,564	18,171	29.7
Total	66,708	53,746	24.1

Maruti Udyog

Despite the seasonal hitch, Maruti Udyog delivered a good performance in Q2FY2007. During the quarter, the company launched the *WagonR Duo*, a new version with better looks and dual fueling. Consequently, the A2 segment comprising of *Alto*, *Zen*, *Wagon R* and *Swift* marked a growth of 22.4% in the quarter. The sales of *Baleno* and *Esteem* also received a boost towards the end of the quarter due to various schemes and discounts initiated by the company. During the quarter the company recorded a volume growth of 12.2%. The exports have been down in the quarter, and are expected to remain flat for the rest of the year as Suzuki has started sourcing *Alto* from its Hungarian unit. We expect the realisations to rise marginally, due to the better product-mix, as the sales of *Swift* and *Wagon R Duo* were higher during the period. The company also resorted to a marginal price hike in the month of August of 0.17-1.47%.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
M-800	20,145	20,801	-3.2
Omni, Versa	20,523	17,467	17.5
Alto, Zen, Wagon-R, Swift	99,747	81,491	22.4
Baleno, Esteem	8,389	8,177	2.6
Total passenger cars	148,804	127,936	16.3
MUV	714	727	-1.8
Domestic	149,518	128,663	16.2
Export	8,165	11,877	-31.3
Total sales	157,683	140,540	12.2

Tata Motors

Tata Motors delivered a good performance in Q2FY2007 with an overall growth of 31%. The light commercial vehicle (LCV) segment continued on its high growth path recording a growth of 44.5% as *Ace* continued to do well. The utility vehicle (UV) segment has recovered due to the successful re-launch of *Safari* and the reduction in its price. The car segment too performed well with the good performance of *Indica Xeta* and the launch of the facelifted versions of the *Indigo* family. The commercial vehicle (CV) segment has also witnessed growth albeit at a lower rate.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
M&HCV	40,787	29,052	40.4
LCV	30,443	21,063	44.5
Total CV	71,230	50,115	42.1
Utility vehicles	11,506	8,242	39.6
Cars	42,882	34,711	23.5
Total domestic	125,618	93,068	34.9
Exports	14,276	13,994	2.0
TOTAL	139,894	107,062	30.7

Ashok Leyland

Ashok Leyland marked a strong growth of 33.4% in Q2FY2007. The goods carrier segment, contributing about 81% of the total sales, led the growth with a 62% increase yoy. However, the sales of the passenger carrier segment declined by 21.8% to 3,771 units. We expect Ashok Leyland to post a strong sales growth of 32.4% and the net profits are projected to grow by 24.4% to Rs95.5 crore. During the quarter, the company sold its 2.89% stake in IndusInd Bank at a price of Rs46 per share. This is expected to add an extraordinary income of about Rs38 crore during the quarter.

Sales performance

Particulars	Q2FY07	Q2FY06	% growth
MDV passenger	3,771	4,822	-21.8
MDV goods	16,010	9,838	62.7
LCV	88	235	-62.6
Total sales	19,869	14,895	33.4

Omax Auto

We expect the revenues of Omax Auto to mark a rise of 10.8% year on year during the quarter. The operating margins are expected to improve to 9.4% due to increasing operating efficiencies, and the cooling off of the raw material prices. The net profits for the quarter are expected to mark a growth of 17.9% to Rs5.6 crore. Exports are expected to pick up from the second half of the fiscal. The commencement of commercial operations of Omax Steel should further help in improving the margins.

Sundaram Clayton

With buoyancy in the CV segment we expect Sundaram Clayton to post strong Q2FY2007 results. The dividend income, which wasn't accounted for in the last quarter, would be reflected in the present quarter, making the yoy comparison look spectacular. We expect both the die-casting and the brakes divisions to perform well during the quarter and expect a sales growth of 30% for Q2 and the net profits to rise by 82.5%.

Subros

The passenger car segment has witnessed a strong volume growth despite the monsoons and the seasonal flip, which should translate into strong growth numbers for Subros. The sales for the quarter are projected to grow by 15.7%. The EBITDA margins are expected to expand to 10.5% from 8.7% in the corresponding quarter last year. The PAT is projected to rise by 48.6% to Rs6 crore.

Valuation table-Sharekhan auto universe

Particulars	CMP	EPS		PER		EV/EBIDTA	
	(RS)	FY07	FY08	FY07	FY08	FY07	FY08
Bajaj Auto	3,099	138.0	166.7	22.5	18.6	15.6	12.0
TVS Motor	122	8.2	13.8	14.9	8.8	8.4	5.0
Maruti Udyog	942	50.2	61.7	18.8	15.3	12.7	9.4
M&M	703	55.7	64.1	12.6	11.0	8.7	7.2
Tata Motors	894	58.0	70.6	15.4	12.7	9.2	7.8
Ashok Leyland	49	3.1	3.8	16.0	12.9	8.9	7.3
Omax Auto	102	14.9	20.8	6.8	4.9	4.8	3.6
Sundaram Clayton	1,228	58.2	79.1	16.7	12.3	14.1	10.0

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

Sharekhan Special

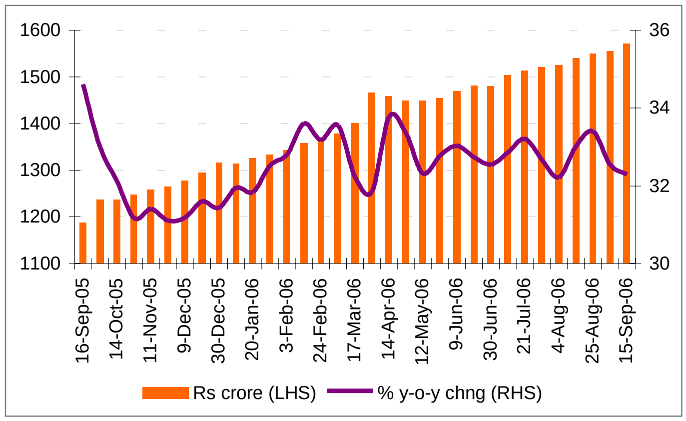
Banking earnings preview

- We expect Indian public sector banks (PSBs) excluding State Bank of India (SBI), to report a healthy year-on-year (y-o-y) growth of 20% in their net interest income (NII) and a strong growth of 32.5% in their earnings for Q2FY2007. SBI, an exception, is likely to report a decline in its earnings due to high loan recoveries in the same quarter last year.
- The private sector banks are likely to continue their strong performance, as their earnings are likely to grow at 27.4% year on year (yoy) for the same period.
- We expect the loan book of the PSBs to grow at a healthy rate of 18-20% and that of the private sector banks at 40-50%.
- The net interest margins (NIMs) are expected to remain stable as most of the banks have raised their prime lending rates over the last two quarters. The same should help them to mitigate the loss of income on account off non-payment of interest on cash reserve ratio (CRR) balances with the Reserve Bank of India.
- The strong performance at the operating level is likely to be aided by the declining 10-year government bond yield, which should help the PSBs to reduce their mark-to-market losses to nil or a negligible level.

Loan book continues to grow strongly...

Despite an increase in the prime lending rates effected by most of the banks during the quarter, the loan book of the scheduled commercial banks continued the robust growth during Q2FY2007, growing by 32.3% yoy.

Stupendous loan growth continues unabated



Source: RBI, Sharekhan research

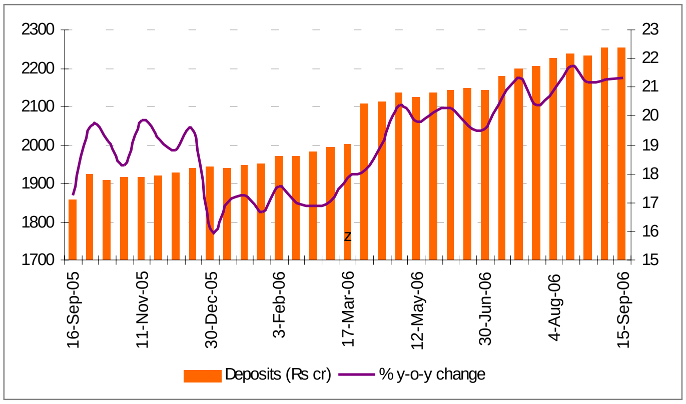
Quarterly estimates

	NII				Core operating profit				Net profit			
	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq
Allahabad Bank	429.8	367.6	16.9	9.9	235.5	193.8	21.5	6.5	190.5	168.3	13.2	48.6
Andhra Bank	357.2	288.6	23.8	6.5	224.4	171.5	30.8	13.0	153.5	132.9	15.5	31.9
BOB	1,015.2	781.8	29.9	15.1	574.1	380.7	50.8	4.6	290.5	259.1	12.1	77.9
BOI	734.8	578.6	27.0	-3.9	382.8	330.1	16.0	-18.1	201.6	132.2	52.5	-3.4
Canara Bank	940.2	806.7	16.6	-0.8	652.3	573.1	13.8	10.7	368.3	306.5	20.2	92.9
Corporation Bank	338.8	306.5	10.5	4.3	270.6	232.2	16.6	10.4	154.5	105.6	46.3	7.1
PNB	1,434.9	1,190.7	20.5	11.0	894.6	609.1	46.9	-0.5	532.0	422.0	26.1	44.7
UBI	662.4	602.3	10.0	4.4	375.6	324.8	15.7	-5.7	212.5	61.1	247.8	27.4
Total-PSBs excl SBI	**5,913.3**	**4,922.8**	**20.1**	**6.1**	**3,609.9**	**2,815.3**	**28.2**	**1.2**	**2,103.4**	**1,587.7**	**32.5**	**41.5**
State Bank of India	3,855.3	3,608.0	6.9	-0.7	2,135.0	1,736.2	23.0	-18.7	1,077.2	1,215.4	-11.4	34.7
HDFC Bank	837.5	612.1	36.8	2.4	569.1	458.7	24.1	-7.9	264.4	199.6	32.4	10.5
ICICI Bank	1,443.3	953.5	51.4	-2.2	1,240.0	804.1	54.2	8.5	723.6	580.1	24.7	16.8
UTI Bank	381.4	255.5	49.3	18.5	269.6	159.0	69.6	0.9	142.2	109.0	30.4	18.0
Total-private banks	**2,662.2**	**1,821.1**	**46.2**	**1.8**	**2,078.7**	**1,421.8**	**46.2**	**2.5**	**1,130.2**	**888.7**	**27.2**	**15.4**

...and so do the deposits

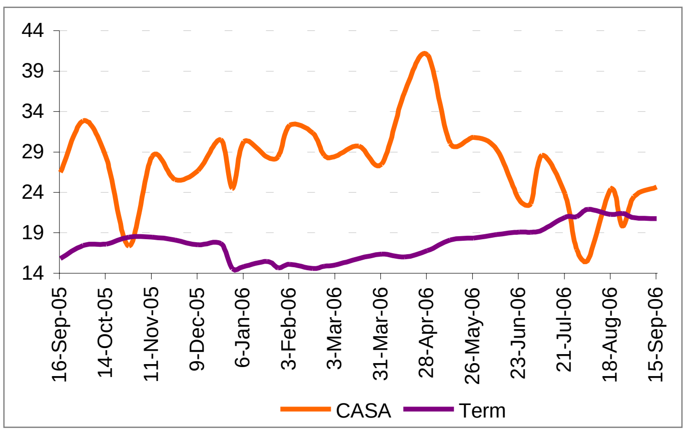
The deposits of the scheduled commercial banks also grew by a strong 21.3% yoy during Q2FY2007 with the demand deposits growing at 24.7% yoy and the term deposits growing at 20.8% yoy.

Strong growth in deposit mobiliastion



Source: RBI, Sharekhan research

CASA deposits growing faster (% y-o-y change)



Source: RBI, Sharekhan research

NIM to remain stable

Over Q4FY2006 and Q1FY2007, the banks have substantially upped their deposit rates with the hike ranging between 25 basis points and 50 basis points across various maturities. Although the banks had commensurately raised the lending rates too, yet the same had not been able to mitigate the rising borrowing costs. Consequently, the pressure on the NIMs was clearly visible in these quarters.

With no significant increase in the interest rate visible going forward, we expect the pressure on the NIMs to ease a little going forward. With the full impact of the increase in the prime lending rates (of 25-50 basis points, that too despite a strong opposition from the finance ministry) to be felt in Q2FY2007, we expect the NIMs to improve in Q2FY2007 over Q1FY2007.

The strong growth in loan book and stable NIMs will also help the banks to mitigate loss of income on account of non-payment of interest on the CRR balances with the RBI.

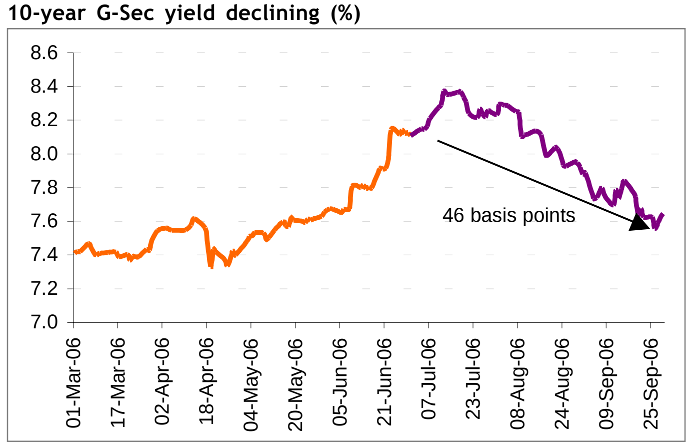
Strong NII growth backed by stable NIM and growing loan book

We expect the NII of the PSBs excluding SBI to grow by 20.1% and that of the private sector banks by 46.2% backed by the stable NIMs and the strong loan growth.

Mark-to-market losses to be lower or absent

With the 10-year government bond settling at approximately 46 basis points lower than its June 2006 level, we believe that the mark-to-market losses will be much lower for banks or may not be there at all.

10-year G-Sec yield declining (%)



Source: Bloomberg, Sharekhan research

Earnings to grow by 32.5% for PSBs and 27.2% for private banks

We expect the PSBs excluding SBI to report a healthy y-o-y growth of 20.1% in their NII and a strong growth of 32.5% in their earnings for Q2FY2007.

The growth is likely to be the highest for Bank of India at 52.4%, followed by Corporation Bank, in the range of 46%. Union Bank of India is likely to report a 247.8% growth in its earnings but primarily due to the low base effect. During the same quarter last year the bank had provided Rs235 crore for amortisation of its bond portfolio and the same was a one-time expense.

The only exception amongst the whole banking sector is the State Bank of India, which is likely to report a decline in its earnings due to a higher income from loan recoveries in Q2FY2006.

Amongst the private sector banks, HDFC Bank is likely to lead the pack with a 32% yoy earnings growth followed by UTI Bank, whose earnings are expected to grow by 30.4% yoy.

Valuation table

	Price (Rs)	PER (x) FY06	FY07E	FY08E	P/BV (x) FY06	FY07E	FY08E	P/PPP FY06	FY07E	FY08E
Allahabad Bank	89.9	5.7	6.1	4.1	1.1	1.0	0.8	4.6	5.0	3.3
Andhra Bank	93.7	9.4	8.8	7.1	1.6	1.4	1.3	5.4	4.6	3.8
BOB	289.4	12.8	10.8	7.6	1.3	1.2	1.1	4.1	3.6	3.0
BOI	166.7	11.6	10.8	9.3	1.6	1.5	1.3	3.9	3.3	2.9
Canara Bank	289.5	10.7	9.5	7.4	1.7	1.5	1.3	3.2	2.8	2.5
Corporation Bank	413.4	13.3	11.8	9.6	1.8	1.6	1.4	4.1	3.8	3.2
Punjab National Bank	539.1	11.8	10.4	8.3	1.9	1.6	1.4	5.2	5.1	4.3
State Bank of India#	1,039.1	12.4	11.6	9.1	2.0	1.7	1.5	4.3	4.1	3.8
Union Bank of India	136.0	10.2	7.5	6.1	1.5	1.3	1.1	3.6	3.1	2.7
HDFC Bank	930.6	33.2	25.8	19.8	5.5	4.7	3.9	12.9	9.9	7.7
ICIC Bank#	705.5	24.7	20.1	15.2	2.8	2.6	2.2	15.9	11.9	9.7
UTI Bank	388.0	22.2	18.4	14.5	3.8	3.2	2.7	9.6	8.1	6.3

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

Sharekhan Special

Cement earnings preview

Key points

- The cement sector is expected to pick up from where its impressive Q1FY2007 performance ended. We expect the cement sector as a whole to report an impressive performance during Q2FY2007 due to a 9-10% growth in the cement volumes and a huge 29-30% rise in the cement realisations. Hence this sets a benchmark of 38-40% growth in the top line.
- The cement consumption in the southern region has maintained a very healthy 20% growth. Further the sales tax rate in Tamil Nadu has been reduced from an average rate of 23.5% to 14.5% and the cement players have not passed on this benefit to the consumer, which was clearly visible in Q1FY2007. Hence we expect south-based cement manufacturers to deliver a superlative performance.
- Amongst the companies in our coverage we expect Madras Cement and Shree Cement to top the charts in terms of the top line growth.
- On the earnings front we rate UltraTech Cement and India Cements as our top picks. On account of their huge leverage to the prices of cement, both these players are expected to report a multifold jump in their earnings.
- We also like JK Cement and Orient Paper and expect them to report a 190% and a 672% growth respectively in their earnings.

Maintain positive view on the sector—rate UltraTech, ACC and India Cements as top picks

After a healthy growth in Q1 of the current fiscal, we expect the buoyancy to continue in the current quarter on account of the hectic activity in the industrial, construction and housing segments in the country. This can be substantiated by the fact that capacity utilisation levels have been hovering around 95%. The tightening demand-supply situation coupled with a ban on the overloading of trucks has led to the cement realisations rising by 29% year on year (yoy) and by 5% quarter on quarter (qoq) in the July to September quarter of 2006. The cumulative effect of these two factors will see the companies witnessing a bumper performance. We maintain our positive view on the sector with UltraTech Cement, ACC and India Cements as our top picks. We also like Orient Paper and JK Cement on account of their compelling valuations, which are much lower than the sector average.

Valuation table

Companies	PER		EV/EBIDTA		EV/Ton ($ US/Tonne)	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
ACC	20.2	17.4	11.9	10.0	196.0	177.9
UTCL	16.1	14.1	8.3	7.5	154.9	150.5
Shree Cement	12.9	9.9	8.5	6.2	198.9	138.6
Madras Cement	16.2	13.0	9.3	7.7	153.7	140.8
JK Cement	14.8	9.5	7.9	5.3	93.2	87.7
Orient Paper	8.4	6.1	5.5	4.1	86.4	66.4
India Cements	13.2	8.8	12.7	9.0	196.9	161.5

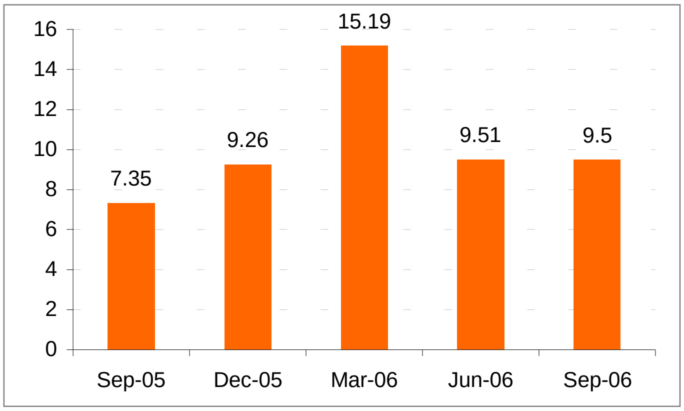
Quarterly estimates (July-September 2006)

(Rs crore)	Net sales			Profit after tax		
	Q2FY07E	Q2FY06	% change	Q2FY07E	Q2FY06	% change
ACC	1300	1005	29	212	74	185
Orient paper	232	170	36	25	3	672
UltraTech	922	635	45	144	0	143900
Madras Cement	400	246	63	90	18	400
Shree Cement	304	155	96	83	37	122
JK Cement	248	206	20	20	7	190
India Cements	498	391	27	95	6	1524

Cement dispatches maintain a healthy growth rate

Cement dispatches have maintained a healthy pace by recording a growth of 9.5% yoy in the July-September quarter of 2006. The growth rate is very healthy considering the fact that August witnessed a subdued growth of 3% in the cement dispatches on account of the heavy rainfall in most parts of the country. The hectic activity in the housing, construction and industrial segments led to a sharp bounce back in the month of September leading to an overall dispatch growth of a massive 15%.

July-September quarterly dispatches growth-industry



July-September quarter dispatches - cement manufacturers

Companies	Lakh tonne	%yoy chg
ACC	41.5	7.50
UltraTech	35.9	18
Shree Cement	11.09	44.00
JK Cement	8.24	-6.00
Madras Cement	14.2	20.00
India Cements	22.45	5.00
Orient Paper	5.14	25

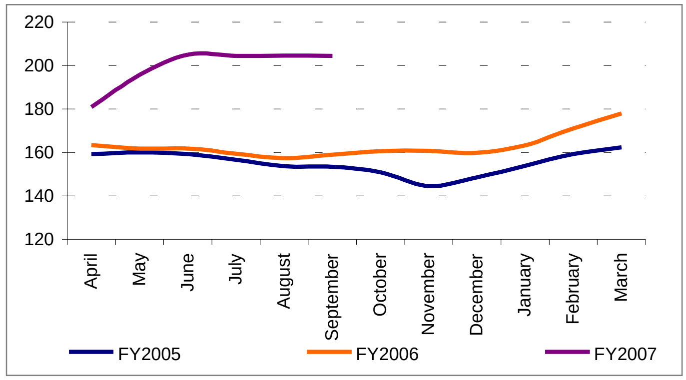
Source: CMA

On the back of the strong cement consumption growth of 10.5% for the first two months of the July-September quarter, the cement manufacturers have recorded a decent growth in the cement volumes. This is clearly reflected in the cement dispatches. Shree Cement with a 44% dispatches growth has topped the volume growth chart followed by Madras Cement, which has recorded a 20% growth.

Prices maintain upward trajectory

With a tight demand-supply situation prevailing in the country, the prices of cement have been rising over the last one-year. Factors like the ban on the overloading of trucks by the Supreme Court has added fuel to the tightening demand-supply situation. Despite the severe rainfall and floods in the country, the average cement price remained firm at Rs205 per 50kg bag, which has resulted in a whopping 29% year-on-year (y-o-y) rise and a 5% quarter-on-quarter (q-o-q) rise in the cement prices in the current quarter.

Cement prices remain firm



South-based cement manufacturers to benefit from the reduced sales tax rates and high cement consumption growth

The cement consumption in the southern region has maintained its scorching pace with the region recording a very healthy 20% growth for the first five months of the current fiscal. This is on the back of a 25% growth in the cement consumption recorded in FY2006. Further the sales tax rate in Tamil Nadu has been reduced from an average rate of 23.5% to 14.5% and the cement players have not passed on this benefit to the consumer, which was clearly visible in Q1FY2007 (the rise in the cement realisation was much more than the rise in the cement prices in the southern region). Hence with the double whammy of rising volumes and the higher growth in cement realisations, we expect south-based cement manufacturers to deliver a superlative performance.

Cost factors face slight upward pressure

On the cost front, the power and fuel cost should largely remain stable on a y-o-y basis or could even come down for some players on account of the continuous slide in the thermal coal prices. However the freight cost even though stable on a q-o-q basis will be up around 20-25% because of the Supreme Court ban on the overloading of trucks and a rise in the prices of diesel. Hence on the cost front we expect a slight upward pressure to continue on account of the freight rates.

Ultratech, India Cement and Orient Paper to top the earnings chart

Amongst the companies in our coverage we expect Madras Cement and Shree Cement to top the charts in terms of the top line growth. On the earnings front we rate UltraTech Cement and India Cements as our top picks. On account of their huge leverage to the prices of cement both the players are expected to report a multifold jump in their earnings. We also like JK Cement and Orient Paper and expect them to report a 190% and a 672% growth respectively in their earnings on account of the cumulative effect of higher capacity utilisation as well as higher prices.

Outlook

Going forward we expect the prices of cement to remain stable for 30-45 days till the construction activity in the country regains full steam. The prices are expected to rise by Rs5-8 per 50kg bag during November 2006. The cement consumption for the period April to August 2006 at 10.4% is very encouraging. If the cement consumption continues at this rate during the months ahead, the capacity utilisation would surely cross the 98% level at the end of FY2007. This in effect would mean that the prices could see another round of uptrend. This will be extremely positive for the cement stocks as the earnings would receive a tremendous fillip by the double impact of the rising volumes and higher cement realisations. This also means that there could be another round of earnings upgrades for the cement stocks which in turn would mean that the sector would continue to outperform the overall market.

On the supply front, even though the cement producers have announced big capacity addition plans, the high gestation period for these projects coupled with the continued buoyancy in the cement consumption would mean that the capacity utilisation levels will be comfortably placed (96% even at the end of FY2008) at least till the end of FY2008. This in turn is likely to maintain the firm trend of cement prices. Hence the cement companies are expected to post an impressive performance both operationally and financially at least for the next 6-7 quarters. We maintain our positive view on the sector and rate ACC, UltraTech and India Cements 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.

Quarterly estimates (July-September 2006)

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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 Electronics
- Bharat Heavy Electricals
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- Allahabad Bank
- Andhra Bank
- Cipla
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- JK Cement
- Madras Cement
- Shree Cement
- Transport Corporation of India

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- Subros
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