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January 3, 2009
3QFY2009 Result Preview

"It pays to be aware of the dangers, but also recognise the opportunities."

Research Team

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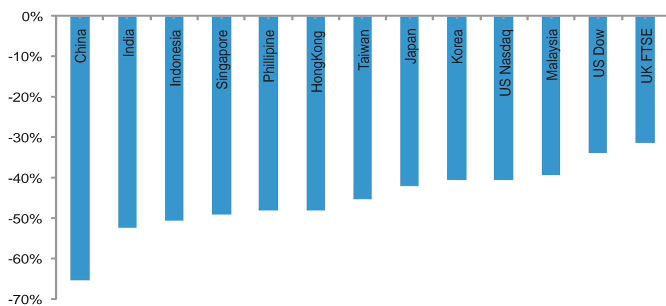
Note: Stock Prices as on December 31, 2008.

Subprime tremors felt, but the quake seems over...

What seemed a historic quarter (2QFY2009) for the world, and a probable end to the unearthing of further miseries, considering that huge damage had already been inflicted on the world economies, did not turn out quite the way as expected. History continued to get written in 3QFY2009 as well, as solvency of large global financial (and non-financial) institutions continued to get challenged, and the consequent push and pull between them and their governments took centre stage. This time around, the world was witnessing ripple effects of the event that has to its discredit not just the collapse of some of the world's oldest and most envied financial institutions, but which also seemingly threatened the sovereignty of a nation.

The impact of all of this continued to get reflected across asset classes, with equities, also the most liquid one, continuing to bear the brunt of past misdeeds of the financial world.

Exhibit 1: China and India - The underperformers in 2008



Source: Bloomberg, Angel Research

Meanwhile, on the domestic front, the scenario turned from bad in the previous quarter to a mixed one in the quarter under review, with some positives creeping back into the India story. However, the positives remained largely overshadowed for over half way through the quarter, as global deleveraging and unwinding of positions continued to take its toll on Indian equities, as developed economies continued to reel under the liquidity pressure.

Undoubtedly, the September 2008 quarter was the most disastrous in recent history as far as the events that panned out were concerned. However, tremors of the same continued well into 3QFY2009.

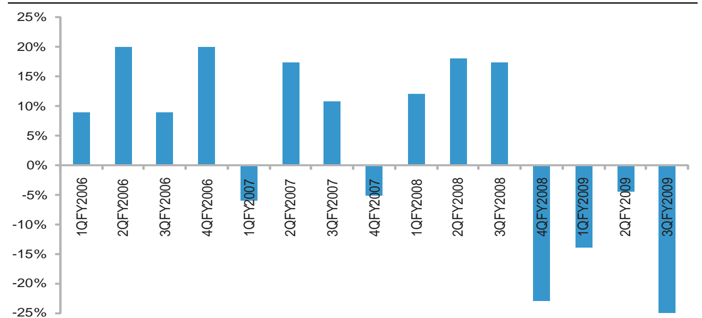
As far as the global events were concerned, while financial institutions continued to trip, governments across the globe stepped up their efforts to salvage the situation. In fact, in an unprecedented move during the quarter, as many as 7 global central banks including the US Fed, Bank of England, European Central Bank, Bank of Korea, Central Bank of China (Taiwan) and the Hong Kong Monetary Authority cut rates in a coordinated effort to curb risks of the credit crises sparking a global recession. Apart from this, governments continued to bail out financial institutions by providing lifelines to the likes of Citigroup, UBS, Royal Bank of Scotland, ABN AMRO, ING Bank, BNP Paribas and many more. In the non-financial segment, bail-out package was offered to the Big 3 automakers - General Motors, Chrysler and Ford. However, a bigger and an uncommon event that surfaced towards fag end of the September quarter was the Icelandic economic crisis, where capital fled the country pushing it to the brink of a collapse.

Fortunately, there has been no instance in India (or any other Emerging market) as yet that is a close resemblance of the ones being faced by the developed nations. We maintain that impact of the global liquidity crunch on Emerging markets in the medium term should be considerably less than that on the developed world. This is because of the strong growth prospects of the former, which will outpace the developed countries' economic growth by a wide margin. Also, huge forex reserves have and will continue to help Emerging economies withstand the shock of sudden and sharp capital outflows.

Sensex pain resurfaces

Effects of the global crises and the repercussions that are bound to follow in terms of a slower world economic growth in the near to medium-term, were clearly reflected in equities. In line with its global peers, the Indian stockmarkets too witnessed a massive exodus of capital in October 2008 as investors continued their shift away from riskier asset classes.

Exhibit 2: Sensex - Four consecutive quarters of -ve returns...



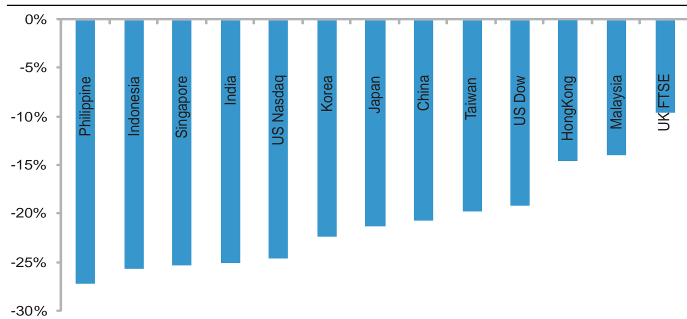
Source: Bloomberg, Angel Research

In perspective, while the September quarter witnessed 22% correction (intra-quarter high-low) in the Sensex, it corrected a massive 42% in October 2008 alone before finding some ground! However, markets witnessed some respite post this, helping limit the damage.

With the December quarter registering negative returns, the Sensex has now seen four consecutive quarters of losses. This is the first time since the Tech bubble that the Indian stockmarket has entered such a prolonged phase of correction. However, notably, during the 2000-2001 correction, while markets headed lower for seven consecutive quarters, the quantum of fall at about 44% was lower than what the Sensex has already undergone as yet, down over 50%.

Nonetheless, akin to 2QFY2009, the Indian stockmarkets outperformed many of its peers during the quarter under consideration. Consider, while the Philippines market shed maximum market capitalization after its significant outperformance during the September quarter when it ended with gains, other developing market indices like Indonesia and Singapore lost marginally greater ground compared to the Sensex. Other market indices too lost ground for another quarter as they settled with a loss of 10-25%. Further, some other markets like Brazil (down 24%) and Russia (down 48%) also continued their descent on account of the significant dependence of these economies on commodities (metals and oil), which have collapsed in the past few months.

Exhibit 3: Sensex - The outperformer in 3QFY2009…



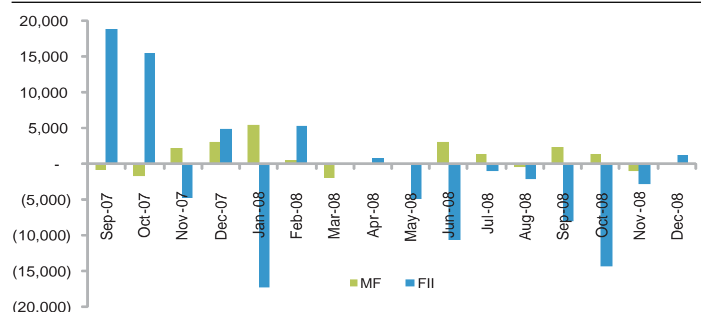
Source: Bloomberg, Angel Research

Liquidity crunch, low confidence and risk aversion takes toll on Capital flows...

FIIs continued their selling spree across Emerging markets, including in India. Continued pressure on global liquidity and redemption pressures across funds (Emerging markets' funds) led to FIIs continuing to pull out of Indian equities. Globally, no acts of government intervention in terms of bailout and/or stimulus packages and/or adoption of monetary tools to increase liquidity and make capital cheaply available helped soothe investor sentiments.

Thus, FII Net Sales during 3QFY2009 in Indian equities stood at Rs15,750cr (US $3.2bn) with their calendar 2008 Net Sales being Rs52,000cr (US $11.9bn). Even the Domestic Mutual Funds, which bought stocks worth nearly Rs11,000cr (US $2.6bn) until September 2008 (calendar year), opted to go into hibernation with their Net Purchase during the December quarter being a paltry Rs660cr (US $130mn) with the total for the calendar year being Rs11,660cr (US $2.7bn).

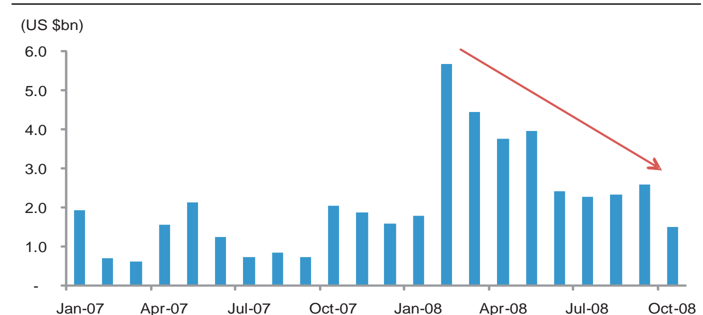
Exhibit 4: FIIs continue to dump; MFs adopt a wait-n-watch!



Source: Bloomberg, Angel Research

Apart from the pressure on FII flows, sustained scarcity of global liquidity continued to take its toll on foreign direct investment (FDI) inflows. There has been a sharp slowdown in FDI inflows into the country particularly from the second half of the calendar year (refer Exhibit 5). However, this trend was expected considering the evaporation of global liquidity and the risk-taking ability amongst the global investment community.

Exhibit 5: FDI under pressure



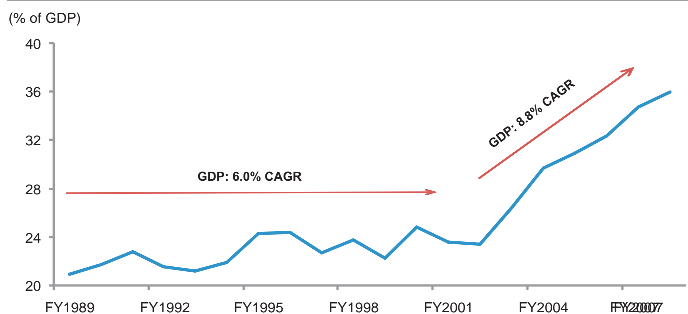
Source: Bloomberg, Angel Research

It must be noted that Merger & Acquisition (M&A) activities constitute almost 1/3rd of the global FDI flows and with capital becoming scarcer and dearer, companies globally are finding it difficult to

get access to the same. More so, even companies that have access to capital are opting to go slow on M&A activities and curtail their investment plans in view of the heightened global uncertainties and the global economic slowdown diluting the need for significant capital expenditure. All this has a direct bearing on the capital flows from and to a country.

Amidst all this, the much awaited hike in FDI in the Indian Insurance sector from 26% to 49% was passed. However, it must be noted that the Housing/Real Estate segment was amongst the largest recipients of FDI in FY2008. But now, with the domestic real estate scenario under pressure, it would affect the appetite of global investors. What could, however, mitigate the impact for India to some extent is continued reforms in the form of increase in FDI limits in certain key sectors like Telecom and Defence. Even the domestic Airline industry is asking the government to consider allowing international carriers to pick up stakes in the domestic airline companies.

Exhibit 6: Gross Domestic Savings (% of GDP) and GDP growth



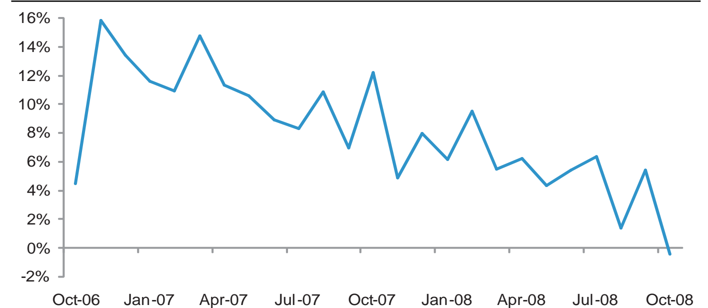
Source: RBI, Angel Research

Nonetheless, demography and fundamentals of the Indian economy indicate that our dependence on Capital Inflows has not been significant, thanks to the high savings rate of the country at 36% currently. Thus, despite the current and anticipated slowdown in FDI inflows into India for the medium term, even with limited foreign capital inflows, we can achieve high GDP growth rates. This has been demonstrated in the past as India received only US $20bn forex (FDI+FII) per annum (average) between 2002 and 2006, yet still managed 7-8% GDP growth. FDI would however be required to shore up and sustain India's GDP growth rate in the 9%+ range and we remain confident that once the global scenario stabilises, India's growth prospects and the investment opportunities that the country could offer would successfully attract flows back into the country. This belief is also supported by the fact that history suggests that capital will always get channelised towards relatively high yielding assets (or countries). Thus, when growth prospects within a country are limited (especially true for developed economies), capital would find opportunities for optimum growth in other markets and this is where India stands to gain.

Near-term contraction in GDP growth inevitable…

While for the first half of FY2009, India's GDP growth has been at about 7.8%, a considerable deceleration in the same is round the corner. This is evident from the poor IIP growth numbers for the month of October 2008, which came in at -0.4%, a number not witnessed in over a decade. Further, the way the domestic industrial activity has panned out in the months of November 2008 and December 2008, it seems unlikely that the current IIP numbers are the trough. The IIP growth numbers would also be weak in 4QFY2009 on account of the high base effect of last year, a period when the Indian economic engine was on full throttle, and absence of any substantial recovery in industrial activity until probably half way into 2009. This will take its toll on the country's GDP numbers, estimates for which now broadly range between 5-7% for FY2009 and FY2010.

Exhibit 7: Monthly IIP growth - Heading lower?



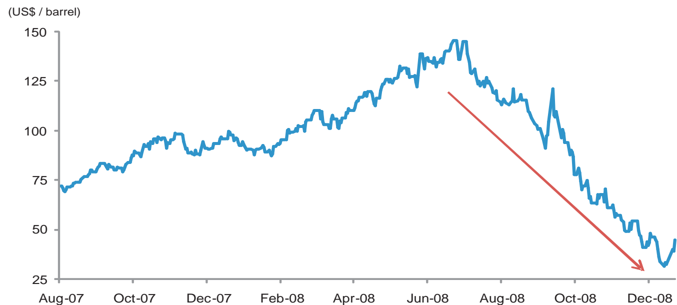
Source: RBI, Angel Research

…however, macro-economic positives creeping in

Oil - The Sultan dethroned

As expected, crude oil prices continued their downtrend during the quarter and are currently trading at multi-year lows of about US $40 per barrel, down by over 70% from its July 2008 peak. While we had argued on fundamental grounds that crude oil prices would have to settle at lower levels, we must admit that the pace and extent of the correction has been exacerbated by the blowout of the credit crisis and consequent collapse in global liquidity leading to significant contraction in global economic growth. While this reason for the sharp correction in crude oil prices may not sound appealing, the fact remains that India benefits tremendously from low oil prices.

Exhibit 8: Global Oil Prices (US $/barrel) - 'Black' Gold, indeed…



Source: Bloomberg, Angel Research

As stated above, other things remaining constant, lower crude oil prices in particular benefit the Indian economy considering its high dependency (70% of total requirement) on crude oil imports to meet its demand. We estimate that the near US $100 per barrel correction of the Indian crude basket could potentially save India (positive for fiscal deficit) around Rs1,50,000cr on an annualised basis by way of reduction in under-recoveries of oil marketing companies (OMCs), which equates to about 3% of India's GDP.

The government has however already negated the effect of some of this by reducing fuel prices during the quarter, with seemingly another round of cuts in the offing prior to the Lok Sabha elections. Further, in wake of the savings on the Oil Import Bill and the current economic slowdown, the government has taken some measures to support and pump-prime the economy by announcing two stimulus packages. The combined benefits doled out for the economy in these two packages is close to Rs60,000cr-70,000cr, which is about 1-1.5% of GDP. While this action by the government has indicated its intent to support the country's economic growth, the quantum of the measures announced are not very significant and will have only a limited impact on economic activity.

Exhibit 9: USD strength + INR weakness = INR Depreciation

Source: Bloomberg, Angel Research

What has also played a part in supporting the crash of the 'Sultan of commodities' is the steep appreciation of the US$ against most currencies, including the Indian Rupee. The Rupee has depreciated sharply against the US$ on account of the continued outflow of capital as investors exit the country to make good their global liquidity shortfall *(refer Exhibit 9)*. This would definitely negate some of the positive impact of the correction in crude oil prices. The Rupee depreciated by 5% (point-to-point) during the quarter and 14% (qoq average) against the US$.

However, going forward, we expect the Rupee to gain some ground as we expect not only the flight of capital to subside materially (and rather reverse) but also the US$ to lose some weight as it continues to grapple with its domestic challenges. Also, despite a slowdown in exports, we expect India's trade deficit to decline in the coming months on account of the substantial correction witnessed in commodity prices, chief among them being Oil, which would support Rupee's strength. Further, as risk aversion subsides and demand for the US Dollar (considered to be the safe heaven) reduces as investors consider investments in other markets, including India, this will also support the Rupee.

So, will the weakness in Oil sustain?

Broadly yes.

Apart from the credit crisis, what has aided the correction in crude oil prices is the 'oil demand destruction' that has set in globally. This was on account of the fact that the affordability and economic rationale of consuming oil at higher prices per barrel were increasingly getting adversely impacted. Globally, the fall in sea-borne trade, fall in passenger air travel, fall in demand for auto - both passenger and commercial, etc. all contributed to the slowdown in industrial and economic activity, consequently impacting the demand for oil. The damage has been such that even the periodic production cuts by the OPEC countries have failed to cushion the fall in oil prices as yet.

However, we believe that in the foreseeable future, a combination of factors would play a part in pushing oil prices higher from current levels of about US $40 per barrel to US $50-60 per barrel, which still would not be detrimental for India. These include some weakening of the US$ as the US continues to face challenges on the domestic front, the various monetary and non-monetary measures taken globally by the governments and their Central Banks to stabilise their economy and reduced oil supply by OPEC (and also some non-OPEC) countries, which in conjunction with a mild global economic recovery could potentially support higher

oil prices. Apart from this, for the OPEC countries, crude prices determine their economic health and considering that the break-even crude price for many of these countries is in the US $50-60 per barrel range, there is considerable likelihood that crude oil prices would retrace some of their lost ground.

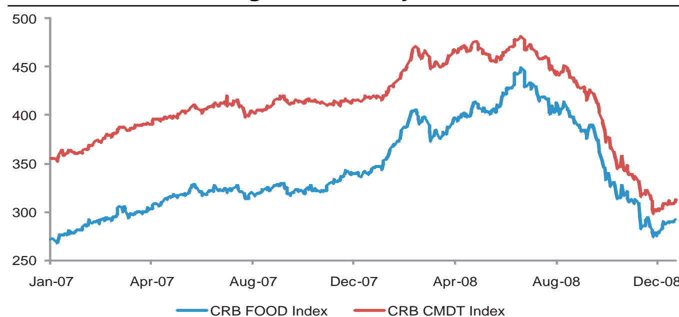
Exhibit 10: Metals - Collapse of the Titans…

Spot US$/tonne	Dec. 31, 07	Peak in 2008 (US$)	(Month)	Dec. 31, 08	% chg from 2007	% chg from peak
Lead	2,546	3,423	March	948	(62.8)	(72.3)
Copper	6,642	8,900	July	2,901	(56.3)	(67.4)
Iron Ore	190	210	March	81	(57.6)	(61.7)
Zinc	2,354	2,811	March	1,120	(52.4)	(60.2)
Tin	16,282	25,331	May	10,350	(36.4)	(59.1)
Aluminium	2,358	3,271	July	1,453	(38.4)	(55.6)
Alumina	360	435	June	225	(37.5)	(48.3)
Steel HR	601	1,113	July	595	(1.0)	(46.5)

Source: Bloomberg, Angel Research

With liquidity having vanished since the blow-off of the sub-prime crisis, capital became significantly dearer for investment managers across the globe. The monetary tightening resorted to by global central banks in the first half of 2008 to check the then runaway inflation also affected the capital borrowing abilities. This severely impacted the leveraging capabilities of investment managers aiding the meltdown across asset classes, including agri-commodities *(refer Exhibit 11).*

Exhibit 11: Metals & Agri Commodity Index



Source: Bloomberg, Angel Research

Global Inflation to continue to head lower…

Inflation rates in most countries had gone through the roof in the first half of 2008 as commodity prices hit multi-year highs. This coupled with higher interest rates, retarded global economic growth, leading to a sharp and complete reversal in commodity prices. The one big positive fallout of this is that global inflation has receded *(refer Exhibit 12)* and is expected to stabilise at lower levels in 2009. This can be considered as one silver lining for global economies as lower inflation would provide most Central Banks the scope to cut rates further.

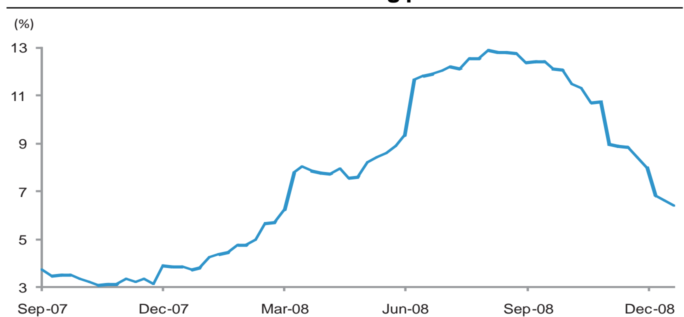
Exhibit 12: Global Inflation figures - Concerns deflated

Country	Latest	Peak in 2008
India	**6.4**	**12.9**
Philippine	9.9	12.5
China	2.4	8.7
Malaysia	7.6	8.5
Singapore	6.4	7.5
Hong Kong	1.8	6.3
S. Korea	4.5	5.9
US	1.1	5.6
UK	4.1	5.2
Taiwan	2.4	4.1
Japan	1.7	2.3

Source: Bloomberg, Note: Latest Inflation figures are either Oct/Nov 2008, as available

For similar reasons, in India too, inflation as measured by the wholesale price index (WPI) topped out in August 2008 and has since been on a steep downhill *(refer Exhibit 13)*. From a peak of 12.91%, inflation is currently at 6.4% levels. Moreover, compared to the previous quarter, if we consider the week-on-week annualised (4-week moving average) inflation, the same is now in the negative.

Exhibit 13: India Inflation - Catching pace downhill



Source: Bloomberg, Angel Research

Considering the current trend in terms of the weakness in oil, metals and other commodity prices, which we expect to sustain, inflation in India would settle at 3-4% levels by March 2009, even as the average for the full year would settle at 8.5-9% levels.

Interest Rates - Seeking lower ground

With the economic outlook weakening in 2008, global policy makers have resorted to various measures to support and re-fuel their economic growth. While bailout and stimulus packages have been the need of the hour, Monetary Policy tools have also played an important role in the entire scheme of things for global central banks, as they slash interest rates to make available cheaper credit, restore consumer confidence and rekindle demand. In fact, in many countries, the rates are close to zero now.

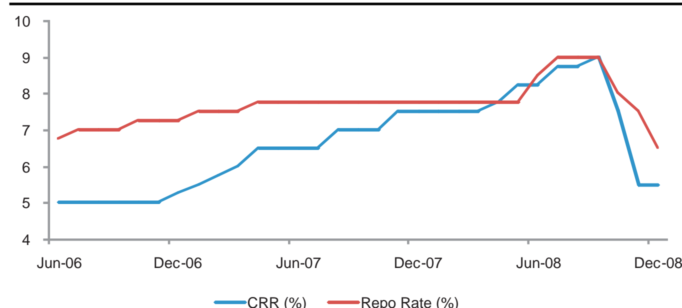
Exhibit 14: Global Interest Rates - Welcome lows

Country	Latest	Peak since 2006	+/- (bp)
Hong Kong	0.50	6.75	(625)
US	0.25	5.25	(500)
UK	2.00	5.75	(375)
India	**5.50**	**9.00**	**(350)**
Australia	4.25	7.25	(300)
Singapore	0.06	3.00	(294)
S. Korea	3.00	5.25	(225)
China	5.31	7.47	(216)
Thailand	2.75	4.75	(200)
Germany	2.50	4.25	(175)
Japan	0.10	0.50	(40)
Malaysia	3.25	3.50	(25)

Source: Bloomberg, Angel Research

The RBI has also cut the repo rate, the rate at which it lends to commercial banks, by 350bp to 5.5% since September 16, 2008. It has also reduced the cash reserve ratio (CRR) - the money banks keep with the RBI - by 400bp to 5%. Going forward, we expect the Monetary Policy to continue to play a mitigating role amidst the economic slowdown in the coming months, with softening measures to improve availability of capital to the private sector and also revive demand. We believe a conclusive reversal in the interest rate cycle is underway and the CRR and Repo rate cuts, though precipitated by the liquidity crunch, signal this reversal in consonance with the wider macro-economic developments. Further, large supply capacities across industries like cement, oil and gas, auto, infrastructure, etc. are set to come on-stream. At the same time, headwinds to growth have increased. As supply capacities progressively increase and demand continues to slow down, we believe that the RBI should increasingly be in a position to provide further necessary demand triggers by cutting rates.

Exhibit 15: India - Repo rate and CRR cuts



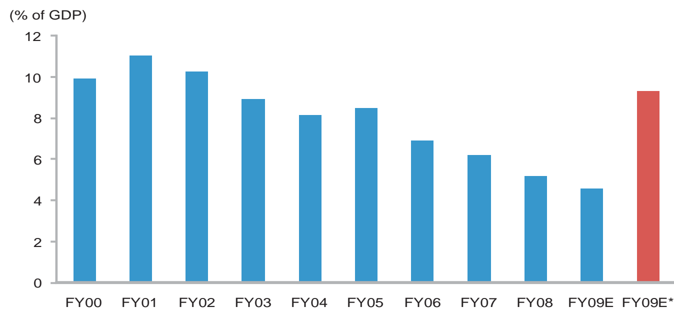
Source: RBI, Angel Research

Fiscal Deficit challenges to remain

Our estimates suggest that India's 'actual' fiscal deficit would be much higher at about 9-9.5% for FY2009 if we include the impact of off-balance sheet items also on India's fiscal position. However, collapse of crude oil prices was a favourable event for India's fiscal position during the quarter. We estimate that the near US $100 per barrel correction of the Indian crude basket could potentially save India (positive for fiscal deficit) about Rs1,50,000cr on an annualised basis in the form of reduction in under-recoveries of OMCs, which equates to about 3% of India's GDP.

Encouraged by this, while the government on the one hand has gone ahead and reduced fuel prices, thus partly offsetting the benefits, it has also initiated some measures to support and pump-prime the economy by announcing too stimulus packages. Combined benefits doled out for the economy through these two packages is estimated to be close to Rs60,000cr-70,000cr or about 1-1.5% of GDP. Apart from this, in wake of the slowing economic activity, the government's tax collections for FY2009 have also taken a hit, which would contribute to the pressure on fiscal deficit. We expect the government to miss its total tax revenue collection target by around Rs35,000-40,000cr, which would increase the pressure. Consequently, considering no significant change in the country's fiscal deficit position, we believe that the government's role henceforth in increasing expenditure could be limited.

Exhibit 16: Gross Fiscal Deficit as % of GDP



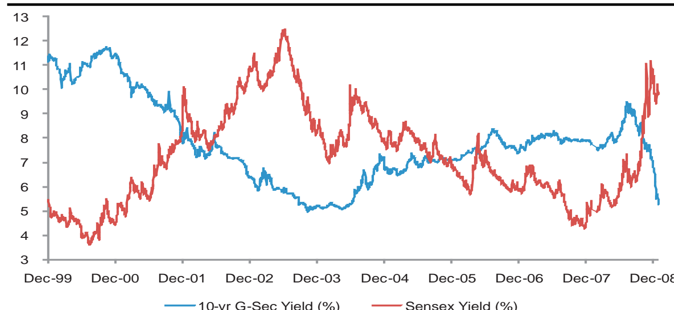
Source: RBI, Angel Research

Where is the bottom?

We acknowledge the fact that the current crisis has led to considerable financial and confidence damage amongst the investing community. However, this is not the first time. While the magnitude of the damage in the previous crises' was nowhere close to the current one, the rescue efforts resorted to then were also nowhere close to the ones being witnessed currently. The biggest comfort factor, which gives us hope that the situation will come under control soon, is the fact that the World is now One - or, at least the global Central Banks are, as they have taken (and may continue to take) coordinated steps to salvage the situation.

Further, we believe that the probability that a bottom may have already been formed is high as most of the dark clouds that hovered in 2QFY2009 have now convincingly passed away. The dark clouds being referred to here are the high commodity prices, high inflationary pressures and high interest rates. However, some may argue that even though the dark clouds may have almost passed over, we are still in the midst of the storm. While there may be only little truth in this, we believe that much of the storm has died down and it is the dust left behind that will take some time to settle, and it eventually will, signs of which are already visible.

Exhibit 17: 10-yr G-Sec yield v/s Sensex yield



Source: RBI, Angel Research

Notably, any asset class is favoured depending on the returns it can generate. At this point in time, if we consider the 10-year Government Bonds' yield and yield of the Sensex, returns from the former are considerably lower and are expected to remain so. Thus, going forward, as the global financial system adjusts to the new realities, the one thing that an investor can be sure of is that confidence will return. And this is when people will start living life to their fullest once again. This will mark reversal of trends and money will flow back into the system (also into Equities) and in the hands of the entrepreneurs who generate inflation-beating returns. We have seen this happen in the past, and it will be repeated this time around too.

Exhibit 18: Global Valuations v/s Growth

Country	2009E P/E (x)	2009E P/BV (x)	2009E GDP growth range (%)
China	12.4	2.1	8.5 - 9.0
India*	**9.9**	**1.6**	**6.0 - 7.0**
Indonesia	6.3	1.6	4.0 - 4.5
Malaysia	10.9	1.3	4.0 - 4.5
Hong Kong	10.4	1.3	3.0 - 3.5
Korea	9.9	1.0	3.0 - 3.5
Singapore	9.9	1.0	3.0 - 3.5
Taiwan	15.1	1.4	2.0 - 2.5
Japan	16.5	1.0	(0.5) - 0.0
US (Dow Jones)	14.1	2.5	(1.0) - (0.5)
US (Nasdaq)	14.8	2.0	(1.0) - (0.5)
UK	8.9	1.4	(1.5) - (1.0)

*Source: Bloomberg, Angel Research; *FY2010E*

It is important to note here that the valuation gap that existed between the Indian stockmarkets and its global peers has now narrowed, which could be attributed to the underperformance of the Indian indices v/s most other global markets. Thus, at the current juncture, considering India's growth prospects vis-a-vis its counterparts and keeping in view the valuations, abstinence by FIIs from Indian equities cannot sustain for long.

Ultimately, it is essential to recognise that, as markets mature over the years, so does the number of knowledgeable investors, making it difficult for the market to sustain its cheap valuations for long. Institutional and smart Fund Managers who have witnessed past market gyrations and mayhem - seeing the light at the end of the tunnel - will prevent further downfall by buying before the

positive news is trumpeted through the pink papers. This buying spree in hopes of a better future, but in the midst of current bad news, will restrict any prolonged corrections in the market. The only caveat in the near term, of course, is the heightened tension in the region owing to the India-Pakistan stand-off, which could affect flows into the country, if the situation is not resolved soon. Also, with elections due in mid-2009, uncertainty with respect to the probable combination at the Centre could keep foreign investors on the vigil.

India Inc. under pressure

The continued pressure on global liquidity and dismal economic outlook took a severe toll on consumer sentiments and businesses in 3QFY2009, impact of which will be visible over the next few quarters. While we acknowledge the fact that the deterioration in economic health will continue into 2009 as well, we believe that the fiscal and monetary measures announced in recent times will help cushion the slowdown to some extent, with stability expected to set in towards latter half of FY2010. Also, the possibility of a mild recovery cannot be ruled out.

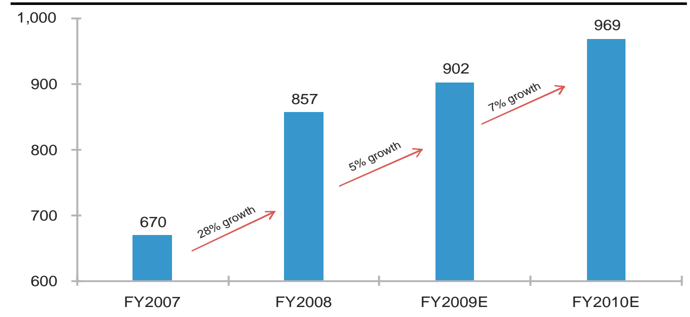
In wake of the new challenges that have emerged and the damage inflicted on world economies in recent months, we expect the Sensex to register 6.3% CAGR in Net Profit over FY2008-10E. Notably, this growth in Earnings is lower than our September quarter estimates. The downgrade in Sensex Earnings is primarily attributed to the following:

➢ The collapse in metal commodities by 40-60% during the quarter has led to complete reversal in the fortunes of metal companies, and consequently our estimates. In the midst of the new developments, we expect substantial de-growth in the Earnings of these companies. It must be noted that the downgrade in the Earnings of metal companies has alone contributed to 40% of our EPS downgrade for FY2010.

➢ Downgrade in the Earnings of Reliance Industries (RIL), the single-largest stock with a weightage of more than 14% in the Sensex, has also eroded Sensex FY2010E EPS. Pressure on GRMs and poor spreads in the Petrochemical business is the primary reason for the downgrade in RIL's Earnings, which has cost the Sensex almost 30% of the downgrade of our FY2010E estimates.

➢ Other sectors that have been responsible for the lowering of Sensex FY2010E EPS are Automobile and IT, both of which have a share of about 10% each in this. While the former is reeling under domestic pressures, challenges for IT are more global in nature.

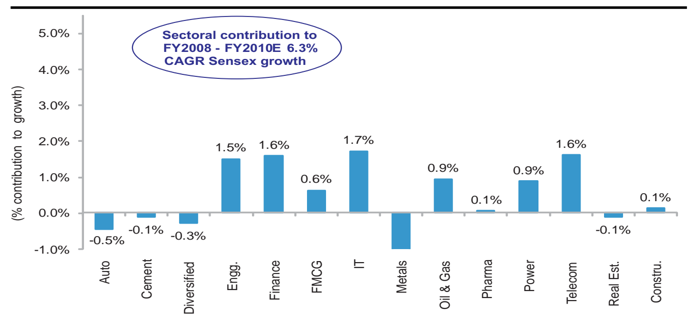
Exhibit 19: Sensex EPS and EPS growth



Source: Angel Research

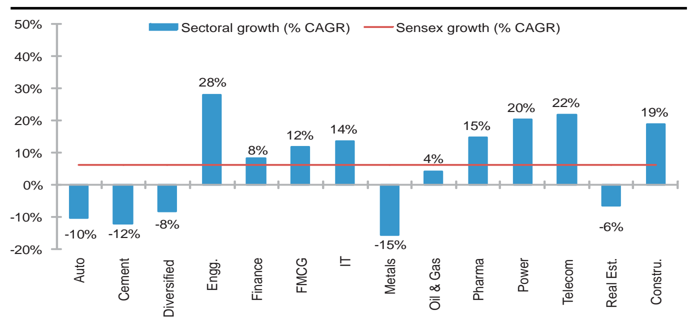
Thus, considering the impact of the changes mentioned above and factoring in the dilutions in the offing for Sensex companies over the next couple of years, we expect the Sensex EPS to log a CAGR of 6.3% over FY2008-10E to Rs969 from Rs857 in FY2008.

Exhibit 20: Sectoral contribution



Source: Angel Research

Exhibit 21: Sectoral Performance



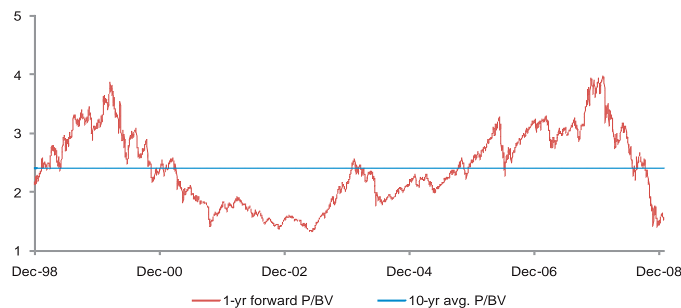
Source: Angel Research

Valuations at historic lows

Considering the current changed and challenging world scenario, investors have taken away the premium that was being accorded to Equities as an asset class for its growth. The prime reason for this is the relative safety in the (now erstwhile) high-yielding government bonds and uncertainties overshadowing the growth prospects of companies. Thus, on the valuation front, our markets are trading near their historical lows, which also limits the possibility of a downside, if any, for a sustained period of time.

The Sensex currently trades at 1.6x P/BV our FY2010E BV, whereas the long-term (10-year) 1-yr forward average P/BV of the Sensex is at 2.4x, which basically reflects the high RoEs and high growth enjoyed by Indian companies over the last decade. In line with this, we have arrived at a Fair Value of 13,000 for the Sensex on FY2009E BV and 15,500 on FY2010E BV.

Exhibit 22: Sensex P/BV Band (x)



Source: Angel Research

Further, the Sensex currently trades at 10x our FY2010E EPS. This low Earnings multiple reflects the lower growth in Earnings that India Inc. is expected to register over the next few quarters. However, it must be noted that the long-term (10-year) 1-yr forward average P/E of the Sensex is at 14.8x, which is basically a reflection of the Earnings CAGR registered by Sensex companies over the last decade. Keeping the above in mind, Fair Valuation of the Sensex can comfortably be pegged at 15x. Thus, we arrive at the Fair Value of 14,000 (including 500 points for embedded value in Sensex companies) for the Sensex on FY2009E diluted EPS of Rs902 and 15,000 (including 500 points for embedded value in Sensex companies) on FY2010E diluted EPS of Rs969.

Exhibit 23: Sensex P/E Band (x)

Source: Angel Research

Overall, taking an average of the two valuation parameters, we arrive at a Fair Value for the Sensex at 13,500 for FY2009 and 15,250 for FY2010.

The biggest hurdle for the Indian stock markets (akin to most of its peers across the globe) though is continued high risk aversion by investors towards Equities in general as an asset class. Global investors were in sell mode in 2008 on account of the various headwinds discussed earlier. However, we are confident that the domestic economic parameters would recover after a brief period of continued deterioration in 2009.

At this point in time, there are two options for an investor. Either buy into Equities or keep waiting on the sidelines for a better opportunity when the consensus says so. Note, there are lots of predictions floating around about the future course of our markets, but, again, as Warren Buffett advised recently, *"The market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, Spring will be over."*

It must be noted that a review of past recessionary phases confirms that stock market bottoms were made when "gloom and doom" was rampant, but these phases were succeeded by bull runs. Current market sentiments and valuations are similar to that. History demonstrates that economic resurgence follows recessions, but this reality is always doubted in troubled times.

In conclusion remember, 'it pays to be aware of the dangers, but also recognise the opportunities'.

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Sector Comment
Automobile	Maruti Amtek Auto	3% 4%	Revision in the Sixth Pay Commission, higher tax breaks and lower auto prices (on account of excise benefits provided by the government to automobile manufactures) all point at greater auto affordability for consumers in the medium term. Relatively, passenger vehicles (PVs) have low elasticity to movement in macro factors. Leader Maruti is expected to outperform the industry in view of lower penetration in domestic market and increasing thrust on exports. On the other hand, Amtek Auto's enhanced capacity at its Indian plants and added overseas capacities through multiple acquisitions will ensure that it is in an advantageous position to reap the opportunities available in the sector. It is the most attractive stock on valuation parameters in the Auto Ancillary space.
Banking	ICICI Bank HDFC Bank Axis Bank	12% 7% 6%	We expect domestic banks to continue to benefit from the Monetary Stimulus by the RBI to mitigate the GDP slowdown. We do not expect an increase in NPAs to materially impact Net Worth / Book Value of banks. We like ICICI Bank given its market-leading businesses across the financial services spectrum, it is available at extremely cheap valuations that factors in a challenging period ahead in terms of operating performance. Moreover, we believe that the Bank is decisively executing a strategy of consolidation that should result in an improved deposit and loan mix, and consequently improved operating metrics over the medium term. HDFC Bank and Axis Bank are also amongst our picks. Not only do these banks score high on all competitive parameters like CASA, Fee Income and Capital Adequacy, but also now trade at a significantly lower valuation premium to PSU Banks than in the past.
Infrastructure	L&T Reliance Infra. IVRCL	5% 5% 4%	In the past couple of years, the Infrastructure sector was a drag on overall economic growth. Over the next few years however, we believe that the sector can actually lend a boost to economic growth. Investment in the sector is expected to be much higher going ahead and the government seems to be very much committed towards this. Thus, we believe that despite the near-term constraints, India's medium-to-long-term growth story remains intact.In this backdrop, Larsen & Toubro is among the largest E&C companies in India today. With presence across various verticals and geographies, it is one of the major beneficiaries of current infrastructure capex in India. Further, infrastructure players like IVRCL and Reliance Infra have an order book backlog sufficient to take care of Revenue growth over the next few years.

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Sector Comment
Oil & Gas	Reliance Ind	7%	We are reducing weightage of RIL in our Model Portfolio, as its performance will now depend on volatile global variables such as GRMs and Petrochemical margins. We expect Margins to be under pressure in the near term for RIL, in turn adversely impacting its performance and risk perception. However, given the integrated nature of its operations in the Petrochemical segment along with complex refinery, its performance is likely to be better than industry. Similarly, RPL's upcoming refinery along with gas production from D-6 block and increase in crude oil production are likely to ensure decent Profitability growth for the company.
Pharmaceutical	Cadila Piramal Healthcare Ranbaxy	3% 3% 3%	Lower penetration of generic drugs in some Regulated markets along with US $100bn worth of drugs going off-patent over the next five years would drive growth. Further, the restructuring initiatives undertaken would add to the profitability. Apart from Generics, CRAMS provides another opportunity as lower penetration of Indian players (like Cadila Healthcare and Piramal Healthcare) along with the cost competitiveness would drive growth and profitability. While the Generic markets face challenging times, Ranbaxy is well placed on account of the strong growth visibility accruing on the back of settlement of key Para-IV FTF opportunities. However, the stock has corrected significantly after the USFDA banned 30 drugs from its two manufacturing facilities in India. While this will impact its near-term growth in the US market, positives on account of the settlements remain intact. Further, the company, after the takeover by Daiichi Sankyo, has strong cash on its books, which should protect downside in the stock.
Software	Infosys TCS Satyam	9% 6% 5%	We believe the long-term IT off-shoring story remains intact, given that it is an irreversible trend and that it is increasingly assuming greater strategic value for global corporations. Initiatives like platform-based BPO and SaaS are likely to drive non-linear growth in future for Indian IT companies. Wage inflation and Rupee appreciation are concerns of a lesser magnitude now than they were earlier though cross-currency fluctuations is a worrying trend. Attrition rates have also stabilised and for some companies, it is actually falling. Extension of STPI tax benefits by one year has been a welcome relief on the Tax front. Considering the opportunities available for Indian IT players, we maintain our long-term positive view on the IT sector.

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Sector Comment
Telecom	Bharti Airtel Reliance Comm	4% 4%	There remains strong potential for mobile companies to increase mobile tele-density (less than 30% currently), which will aid robust volume growth in terms of minutes of usage. With the Indian economy expected to grow at a healthy rate, there is strong growth potential in the Enterprise space also, apart from ILD and NLD services. Positive triggers like hiving off of the tower business to enable value unlocking are also likely to sustain stock price movements. Nonetheless, heightened competition, slowing subscriber growth, falling ARPUs and higher network roll out costs are likely to pressurise margins, even as regulatory risks continue to take their toll. In such a scenario, we believe Bharti Airtel is best placed to ride out the turbulence and the stock remains our top pick in the sector. We also like Reliance Communication on account of attractive valuations and are of the view that the significant fall in the stock price is not warranted. Nonetheless, we reduce our weightage marginally in the Telecom sector in view of the emerging opportunities across other sectors and stocks post their correction.
Mid-Cap	Bharati Shipyard	4%	India currently has a mere 1% share of the global ship-building order pie, which would increase on the back of labour cost competitiveness. Expanding capacities and robust order book position ensures good Revenue visibility for the company in the ensuing years.
	Pantaloon Retail	3%	Pantaloon Retail enjoys competitive advantage over other players on account of its presence across consumption and price points of Indian consumers, pan-India presence, lower execution risks in terms of store roll-outs and its eclectic mix of auxiliary support businesses, which help induce consumption. It has the right strategy in place, is driven by good management to expand and is growing in line with industry and is set to improve Margins.
	TV18	3%	The company has a dominant presence in Business News segment and a highly scalable business model spanning a spate of attractive properties across multiple platforms (TV, Internet, Print, Mobile and Newswire). This coupled with the group's proven execution capabilities, makes TV18 an attractive play in the Media space.

Note: L&T and TV18 are in the process of getting inducted under research coverage.

3QFY2009 Sectoral Outlook

Sector	Key Expectations	Comments
Automobile	● The third quarter is traditionally the most prosperous period (festival season) for the Auto sector. However, in 3QFY2009 volumes plunged across segments. While we had anticipated a volume decline post the 2QFY2009 Earnings season, the swiftness and extent of the decline caught us by surprise. Though the quarter was dogged by adverse macro-economic headwinds, positive announcements of the RBI-government stimulus package raised hopes of a recovery. However, these measures could help support demand, but it may not reverse near-term deceleration. ● The excise duty pass-on to end consumers is likely to be borne by OEMs as auto dealers are cash strapped and no longer in a position to share any additional burden. Further, December is usually a dull month for automobile sales. Hence, OEMs are now facing a double whammy of sales not picking up on the one hand and having to compensate dealers for inventory losses on the other.	● Most domestic auto majors (except Hero Honda) are likely to witness drastic profit erosion in 3QFY2009. Capacity utilisation has declined significantly owing to the sharp production cuts undertaken with a view to align production with demand and streamline inventory levels. ● Hero Honda could deliver better numbers on better volumes and start of its new Haridwar Plant in 2QFY2009.
Auto-Ancillaries	● Most of the Auto Ancillaries are expected to witness fall in Topline on the back of reduced Auto volumes. ● Margins are expected to be under pressure due to high input and inventory costs and no price hikes being passed on to most OEMs. ● A depreciating Rupee is expected to improve realisation of companies with high exports' exposure.	● Broadly, the sector is expected to deliver muted Earnings owing to exaggerated losses in some of the medium to small ancillary companies for 3QFY2009. ● Among the pack, Amtek Auto and Bharat Forge could surprise on declining side in 3QFY2009.
Banking	● Recognising the increasing headwinds to growth and with inflation no longer being a concern, the RBI changed its monetary stance in 3QFY2009 after four years of tight Monetary Policy. It cut the CRR and Policy rates with significant rapidity, sending a strong signal to banks to cut rates. PSU Banks took the lead in cutting rates, with cumulative reduction of up to 150-200bp in both PLR and deposit rates being announced by large PSU Banks like PNB. Banks increased their bond portfolios substantially, largely on account of risk aversion and increasingly to capitalise on opportunities for Treasury Profits. Credit growth remains strong this far driven by Replacement demand, though going forward, we expect it to trend downwards as private sector demand cools off.	● The steep fall in bond yields during 3QFY2009 will benefit banks, especially PSU Banks with larger AFS portfolios and provide additional buffer against increasing asset quality pressures. Profitability is expected to be strong in 3QFY2009E, especially for the larger PSU and Private Banks (ex-ICICI Bank), on account of strong credit growth, largely stable Margins and falling Bond yields.
Cement	● All-India cement consumption clocked dismal growth of 4.2% to 41.4mn tonnes during the quarter. So far this year, cement consumption grew by 6.8% yoy (9.8%) led by the slowdown in Housing and Construction. Capacity utilisation during the quarter	● We expect cement consumption growth in India to moderate to 7% over the next 2-3 years owing to GDP growth slowdown and expected slowdown in Housing. Due to the slowdown in demand and excess capacities, we expect

3QFY2009 Sectoral Outlook

Sector	Key Expectations	Comments
	declined to 85.4% (94.0%) due to huge capacity additions and lower demand for cement. Exports were marginally down yoy on account of lower demand. For nine months FY2009, Exports were lower by a substantial 26.1% because of the ban on cement exports in May 2008, which resulted in poor 1QFY2009 performance. On the other hand, all-India average cement prices were higher by around 5.2% yoy at Rs249/bag (Rs238/bag). Sequentially, prices were marginally lower on account of the Excise duty cut by 4%, lower demand due to slowing economy and dumping of Pakistani cements in the Northern markets.	cement prices to correct going forward. The cost relief on account of reduction in coal and fuel prices would help companies cushion margins but, fall in realisations would offset the fall in input costs. We expect cement companies to deliver flattish to marginal Topline growth for 3QFY2009 on account of marginally higher prices yoy and flat volumes. However, Margin pressures are expected to continue due to higher average raw material costs of coal, freight, etc.
FMCG	● For 3QFY2009, we expect our FMCG universe to report steady Topline growth of 15-18% largely driven by value growth (price hikes). However,, Earnings for the quarter are expected to be muted in the range of 8-10% owing to Margin contraction (due to higher advertising spends and input cost inflation). Nonetheless, significant fall in commodity prices hold upside risk to our Margin estimates.	● Nestle and Colgate are expected to report the strongest Earnings growth for the quarter. HUL, the segment leader, is expected to report modest Earnings growth driven largely by price hikes and savings from fall in palm oil prices (key input). We expect ITC to post marginal decline in cigarette volumes owing to its exit from non-filter cigarette segment. ITC is expected to deliver modest Earnings growth of 10% aided by Margin expansion in its core cigarette business (driven by price hikes). We remain bullish on the overall prospects of the FMCG sector but, prefer select set of stocks, which are better placed to combat the economic downturn and sustain Margins.
Infrastructure	● For 3QFY2009, we expect companies in our Universe to post healthy growth in Topline in the range of 20-30% on the back of robust order inflows and changing industry dynamics. On the Margin front the pressures are likely to continue and we expect most companies to post a red tick on the Margin front for 3QFY2009. However, Margins are expected to improve going ahead albeit with a lag effect (approximately six months) due to the recent crash in commodity prices.	● Despite constraints like high commodity prices and high interest rates, India's medium-to-long-term growth story remains intact. Further, all infrastructure players in our universe have an order book backlog sufficient to take care of Revenue growth for the next few quarters. Further, players with greater share of orders with price escalation clauses are relatively better placed. Overall, we expect the interplay of Revenue growth and Margin pressure to result in a dichotomy in performance of players in the Infrastructure sector players.

3QFY2009 Sectoral Outlook

Sector	Key Expectations	Comments
Metals	● Global steel prices have collapsed by more than 50% in the last couple of months. The domestic players also announced price cuts due to the slowdown in demand and inventory pile up during the quarter. Despite the sharp correction in steel prices, average steel realisation during the quarter is expected to be marginally higher yoy. Steel raw material prices like Iron ore also collapsed during the quarter owing to the demand slowdown. On the Non-Ferrous front, base metal prices crashed over the last couple of months. Aluminium, alumina, copper and zinc prices at the LME declined yoy by 25.2%, 21.6%, 45.7% and 54.7%, respectively. Prices fell qoq by more than 34.3%, 33.6%, 49.0% and 32.8% for aluminium, alumina, copper and zinc, respectively.	● We estimate higher steel realisations yoy during the quarter to contribute to the Topline growth of steel companies. However, due to raw material cost pressures of coking coal, Margins for non-integrated players would be impacted. On the Base Metals front, we expect Nalco, Hindalco and Hindustan Zinc to deliver de-growth in Topline due to the crash in aluminum, alumina and zinc prices. However, we estimate Rupee depreciation during the quarter to improve domestic realisations. Tc/Rc Margins, which were under pressure during the quarter, would impact profitability of Hindalco's copper business.
Oil & Gas	● GRMs softened significantly during 3QFY2009. The major variable, which is likely to impact clean GRMs, is the extent of inventory losses owing to sharp decline in crude oil prices during the quarter. ● We expect OMCs to see reprieve in marketing losses owing to the fall in crude prices. We expect under-recoveries in the Marketing segment to fully vanish in the next quarter. ● Fall in crude prices is expected to adversely impact performance of upstream oil companies like ONGC and Cairn. ● Due to the fall in naphtha prices, attractiveness of spot LNG has reduced significantly resulting in subdued volumes for Petronet LNG and GSPL. However, IGL is expected to continue to post strong volume growth driven by higher conversion to CNG in the last one year.	● RIL is estimated to report GRMs of US $9.0/bbl. Refining margins of OMCs are likely to be in range of US $1 to US $3/bbl during the quarter. ● Upstream major, ONGC, is expected to report weak performance for the quarter. Net realisations are estimated to decline to US $36.1/bbl on account of subsidy burden of US $20.9/bbl.
Pharmaceutical	● The Pharmaceutical sector is expected to post robust growth on the Sales front on the back of high depreciation of Rupee during the quarter. Apart from Rupee depreciation, companies like Dr Reddys and Orchid Chemicals would also benefit from product launches during the quarter. However, Rupee depreciation would also have negative impact on overall Profitability of companies like Ranbaxy, Wockhardt and Orchid Chemicals, which have FCCBs on their books. In the CRAMS space, we expect Piramal Healthcare to post robust performance aided by growth in sales from its Indian Assets. ● On the Operating front, we believe, except for some, Margins would remain stagnant or improve marginally as cost pressures ease.	● We expect Dr Reddys and Orchid Chemicals among the large-caps and Piramal Healthcare among Mid caps to post robust Top-line growth. On the OPM front, most companies are expected to report flat Margins. However, Piramal Healthcare and Cipla are estimated to report Margin expansion. Overall, we expect Dr Reddy and Piramal Healthcare to surprise positively on the upside.

3QFY2009 Sectoral Outlook

Sector	Key Expectations	Comments
Power	● We expect the power generation companies under our coverage, to report decent Topline growth during 3QFY2009 to the tune of 10% yoy, this would be on account of steep increase in fuel costs on a yoy basis. However, on the margins front we expect the companies to show de-growth due to higher employee and other costs. However in the short term on account of the industrial slowdown we need to take a close look at the way the volume growth shapes up. ● Also for some of the private power players achieving the financial closure is getting delayed on account of the high interest rate and the environmental clearance. ● Further, we expect the power companies in our universe to report similar 10% Bottom-line for 3QFY2009.	● Going ahead, we believe future growth in the Topline for the power companies would primarily come from capacity additions. Moreover; the Indian Power sector has tremendous potential for growth given that India has one of the lowest per capita consumption of power globally. ● Further, with substantial capacity likely to get added, we expect the, power companies to report healthy growth in Revenues. We estimate our universe of stocks to witness 12-15% Top-line growth over the next couple of years. Further, the huge correction in the broader index has resulted in the reduction of P/B multiple for these stocks. We remain positive on the sector.
Retail	● Although we estimate Retail companies in our Angel Retail Universe to register a below par yoy growth of 27% in 3QFY2009E, we estimate an expansion in the Operating Margins of our Retail Universe marginally by 30bp to touch 9.1% in 3QFY2009E from 8.8% in 3QFY2008. ● The current slowdown in the sector on due to global financial crisis is expected to be temporary as value-retailing would find favour with the consumers in both short as well long run. ● Retail property rentals have declined by a sharp 30-40% in key cities across the country and this trend is expected to continue over the next two quarters, bringing some relief to retailers grappling with high real estate costs. Retailers are also expected to increase their focus on Private Labels in current scenario.	● The below-par yoy Top-line growth is attributed to a relatively subdued Diwali resulting due to decline in consumer spending on back of the global financial crisis. ● This phenomenon has resulted in retailers focusing on cutting down costs by improving efficiencies in their retail operations in the quarter under preview. This has led to an expansion in the Operating Margins of our Angel Retail Universe on a yoy basis. ● Most Retailers have started re-negotiating their lease contacts for lower rentals in the quarter gone by. Retailers gradually plan shift to a revenue-sharing model with the mall developers to tackle the real estate costs in the long run. ● Retailers also shifted their focus on changing product mix in favour of high-Margin Private labels in 3QFY2009. This is step by Retailers towards not only improving their Bottom-lines but also to increase their bargaining power with the suppliers of Branded labels.

3QFY2009 Sectoral Outlook

Sector	Key Expectations	Comments
Software	● Volumes to record a quarterly dip of 3-5% qoq on account of the increasingly worsening global economic environment and poor health of major clients, leading to poor revenue visibility; pricing is also expected to decline by 0.5-1% qoq. ● Cross-currency fluctuations have also materialised as a major headwind for software, with the US Dollar's strength against the British Pound and Australian Dollar likely to stymie growth in US Dollar terms ● Dollar Revenues are thus expected de-grow by 4.5% qoq, even as Revenues in Rupee terms are expected to grow by 8.7% qoq (including only combined IT Services businesses for Wipro) entirely on account of the depreciating Rupee. ● In spite of Rupee depreciation, Margin performance is expected to be flattish due to lower billing days and poor volume growth are likely to take their toll. ● Infosys and Satyam expected to clock expansion of 20-40bp qoq, while TCS and Wipro could witness a flat trend; EBITDA, in absolute terms, for the 'Top-4' companies is expected to grow by 8% qoq. However, on account of forex losses, Net Profits are expected to grow by just 0.5% qoq.	● The previous quarter has been one of the most turbulent ones ever for IT companies, with the sub-prime contagion spreading to other sectors as well apart from BFSI, like Automotive and Retail and more companies going bust, getting taken over or bailed out. ● The business environment has worsened further and revenue visibility for FY2010 has become even poorer. ● The medium-term outlook for the sector remains cautious with clients themselves under strain, leading to further delays in budget allocations, delays in payment cycles, vendor consolidation, slowdown in volumes and even decline, apart from pricing pressures. ● Even Rupee depreciation, which was the only tailwind hitherto enjoyed by software companies, is starting to become a headwind due to cross-currency fluctuations. ● Consequently, we believe that in the medium term, growth will come to a halt and Margins will be under pressure leading to stock performance being muted. Nonetheless, we remain positive on the sector over the long term.
Telecom	● Topline growth is expected to remain strong in the region of 34.5% yoy on continued buoyancy in subscriber additions, even as ARPUs continue to witness downward pressure and growth in the other business segments namely enterprise, broadband and long distance expected to remain strong. ● Impact of rapid network roll out is expected to continue this quarter, with a combined 262bp yoy fall in EBITDA Margins expected.l ● On account of Margin pressures, Net Profits are expected to grow by around 15% yoy, slower than Topline growth; however, Idea is expected to clock nearly 30% yoy decline on account of EBITDA losses in its newer circles of operations like Mumbai and Bihar leading to Margin pressures and consequent impact on Bottom-line growth.	● Monthly mobile net adds continue to strengthen and have crossed the 10mn-mark for three months in succession (September, October and November). ● We expect telecom majors to continue to report healthy numbers. ● Mobile tele-density is still at low levels of under 30%, leaving strong scope for growth. ● The government is also progressing well on the Spectrum issue, having given Spectrum to existing and newer players in several circles. ● The 3G and BWA Spectrum auctions are scheduled to be held in January-February 2009, thus paving the way for high-speed data services in the country. However, amidst intensifying competition, slowing subscriber growth and ARPU declines, Topline growth would slow down and Margins would be under pressure. Besides, regulatory risks are also expected to persist. Thus, we believe chances of a re-rating of stocks are remote. ● Nonetheless, we believe downside risks are limited and towerco valuations also provide some cushion.

Automobile

In the slow lane

The Indian Automobile scenario turned harsher in FY2009. We believe the Auto sector will continue to witness near-term pressures with macro-economic growth expected to remain relatively dismal in the ensuing months. Overall, while rising input costs, interest rates and fuel costs were key concerns, our analysis suggests that the impact has been moderate till 1HFY2009. However, as expected, these snags have changed the near-term demand outlook for the industry. After registering overall positive growth of 12.1% yoy in 1HFY2009, Auto Sector volumes fell 9.3% yoy (including Exports) in October 2008 and further 10.4% in November 2008, dragging overall Industry sales growth YTD FY2009 to 5.8% yoy to 7.7mn units. Against this backdrop, it does not come as a surprise that the Auto makers have decided to cut back production. The credit period given to OEMs is usually 35-45 days. However, owing to the present crises facing the industry, this period has extended to 90-95 days in the last few months. Despite softening of interest rates, revival of consumer confidence and spending on Automobiles will take some time to revive.

Nonetheless, long-term key demand drivers remain intact, sub-optimal utilisation of new capacity and higher cost of operations are the major constraining factors in FY2009 and continue to be likely dampeners for Auto companies in the medium term.

Falling Interest rates, Commodity prices

Interest rates have been on an upward trajectory since beginning of 2008, which have increased to 15% (up 300bp yoy). The recent relaxation in CRR, SLR and Repo Rates by the RBI has provided some succor to the sagging financial markets and interest rates are expected to move southwards.

Commodity prices have also corrected in the last few months after hitting their peaks in the first half of 2008. The rise in commodity prices during the period was attributed to steady demand and cost push inflation. Raw material costs, which account for almost 70% of the total cost for Auto manufacturers, were on a continuous upward trend since the last two years and impacted their Margins. In FY2009 however, the cycle took a reverse turn following softening of commodity prices, which would help manufacturers improve Margins. However, Margins would bounce back with a lag effect post reduction in high-cost inventory.

Fuel cost accounts for almost 25%, 50% and 40% of the ownership cost for passenger vehicles (PVs), commercial vehicles (CV) and two-wheelers, respectively. Hence, an almost 15% hike in fuel prices in 2008 sent the industry into a tailspin. However, in December 2008, the government cut retail selling price of petrol by Rs5/litre and diesel by Rs2/litre. Though the price is still almost 6% higher than the average fuel price in 2007, this would certainly aid improve consumers' affordability in bad times.

Auto Index - Marginal underperformance in 3QFY2009: The Auto Index registered 33.5% decline during 3QFY2009 vis-a-vis the Sensex (declined 33.3%) having registered marginal underperformance. Sentiment for Auto stocks had turned negative in 1HFY2009 on concerns over lower volumes following increasing cost of ownership for consumers and low finance availability.

Exhibit 1: BSE Sensex v/s Auto Index

Source: C-line

Auto volumes plunged across the Auto sector in 3QFY2009, traditionally the most prosperous period (festival season) for the sector. While we had anticipated volume decline post the 2QFY2009 Earnings season, the swiftness and extent of the decline caught us by surprise, which resulted in further correction in Auto stocks during 3QFY2009. Two-wheelers registered subdued performance during 3QFY2009 with Bajaj Auto, Hero Honda and TVS combined witnessing a 15.6% yoy decline in total volumes. Hero Honda outperformed the Auto Index by 26.1% during the quarter on better than industry volumes. Passenger vehicle (PV) major, Maruti, declined sharply hitting its 52-week low during the 1HFY2009. However, the Maruti stock also witnessed modest long-term value buying during 3QFY2009 registering 9.2% outperformance vis-a-vis the Auto Index. Tata Motors hit its 52-week low in 3QFY2009. The stock has been getting impacted on uncertainties surrounding the Jaguar and Land Rover's (J&LR) financials and further on account of the domestic and global Auto outlook deteriorating significantly.

Commercial Vehicles - Uncertain scenario persists: The M&HCV Goods segment has been on a downtrend since the beginning of FY2009. During 3QFY2009, the M&HCV space was a major

Automobile

disappointment and continued to decline, with transporters deferring purchases and freight rates declining. This indicates concerns over sustainability of freight demand. Stocks of CV players, Tata Motors and Ashok Leyland, got battered down the most, with the two registering a steep fall of almost 54% and 43% respectively, in 3QFY2009. Moreover, given the unfavourable demand-supply scenario and aggressive investments incurred or announced by these players, we believe they could take longer time to break even.

Exhibit 2: Tata Motors - Quarterly volumes

Segment	3QFY09	3QFY08	%chg	9MFY09	9MFY08	%chg
Total Sales	**97,644**	**143,979**	***(32.2)***	**363,329**	**406,917**	***(10.7)***
M&HCV	19,803	47,042	*(57.9)*	93,992	122,783	*(23.4)*
LCV	34,928	45,347	*(23.0)*	124,099	121,281	*2.3*
Total CV	**54,731**	**92,389**	***(40.8)***	**218,091**	**244,064**	***(10.6)***
Utility Vehicles	6,271	11,767	*(46.7)*	28,403	33,207	*(14.5)*
Cars	36,642	39,823	*(8.0)*	116,835	129,646	*(9.9)*
Total PV	**42,913**	**51,590**	***(16.8)***	**145,238**	**162,853**	***(10.8)***
Exports (Inc Above)	**7,026**	**12,661**	***(44.5)***	**29,066**	**40,263**	***(27.8)***

Source: Company; Angel Research

We believe that CVs have higher sensitivity to the economic and industrial slowdown, which is impacting M&HCV demand. Meanwhile, we estimate the M&HCV segment to register a decline of 30% in FY2009E as the business fundamentals are negative. Further, we model around 3-4% growth in FY2010E as we expect some recovery to set in 2HFY2010 onwards. Majority of the factors that drive freight demand and consequently M&HCV demand are still negative even though waning interest rates is a positive for the segment.

Passenger Vehicles - Speed-breakers in growth: The domestic PV sales grew by around 7.5% in 1HFY2009. However, the situation began deteriorating thereafter following lag effect of increase in the interest rates and petrol prices in June 2008.

Exhibit 3: Maruti, M&M - Quarterly volumes

Segment	3QFY09	3QFY08	%chg	9MFY09	9MFY08	%chg
Maruti Udyog	**173,494**	**201,629**	***(14.0)***	**555,529**	**562,623**	***(1.3)***
Total PCar	157,230	186,816	*(15.8)*	505,285	521,841	*(3.2)*
MUV	1630	1,059	*53.9*	5374	2792	*92.5*
Domestic	158,860	187,875	*(15.4)*	510,659	524,633	*(2.7)*
Exports	14,634	13,754	*6.4*	44,870	37,990	*18.1*
M&M	**63,809**	**85,480**	***(25.4)***	**240,168**	**240,856**	***(0.3)***
Total Auto Sales	41,902	58,580	*(28.5)*	165,001	164,438	*0.3*
Exports	1,320	2,889	*(54.3)*	7,448	8,085	*(7.9)*
Tractor Sales	20,558	24,816	*(17.2)*	69,614	70,528	*(1.3)*
Exports	1,349	2,084	*(35.3)*	5,553	5,890	*(5.7)*

Source: Company; Angel Research

Consumer sentiment continued to rule weak in 3QFY2009 as reflected in the declining volumes of the domestic PV market. Due to lack of clarity on financing, consumers are either opting for cash transactions or are deferring purchases. Given the low penetration, the PV segment has immense potential for long-term growth. The significant export plans of manufacturers will further help sustain growth levels in FY2010. Maruti witnessed a halt in volume growth during 4QFY2008, which continued in 1HFY2009. The company recorded 14% yoy decline in volume in 3QFY2009. Tata Motors also reported a decline of 16.8% yoy in PV volumes during 3QFY2009.

Two-wheelers - Slowed down in 3QFY2008: For FY2008, the Two-wheeler segment reported 4.9% yoy decline due to high inflation, rising interest rates and contraction in availability of finance. However, FY2009 began with positive growth albeit on a low base. The growth story continued, with total two-wheeler sales registering 11.5% yoy growth in 1HFY2009 aided by 12.6% yoy motorcycle sales growth recorded in the segment. While tight availability of finance did impact purchases, cash purchases increased due to higher agricultural income in the northern states and return of customers who had deferred purchases in FY2008. However, the volume turned bad again in 3QFY2009.

Exhibit 4: BAL, HH, TVS - Quarterly volumes

Segment	3QFY09	3QFY08	%chg	9MFY09	9MFY08	%chg
Bajaj Auto	**493,750**	**713,443**	***(30.8)***	**1,753,885**	**1,898,649**	***(7.6)***
Motorcycles	414,041	634,624	*(34.8)*	1,534,149	1,659,705	*(7.6)*
Scooters	3,072	4,400	*(30.2)*	10,037	18,308	*(45.2)*
Total 2 Wheelers	**417,113**	**639,024**	***(34.7)***	**1,544,186**	**1,678,013**	***(8.0)***
Three Wheelers	**76,637**	**74,419**	***3.0***	**209,699**	**220,636**	***(5.0)***
Hero Honda	**857,806**	**893,581**	***(4.0)***	**2,724,145**	**2,452,500**	***11.1***
TVS Motors	**304,788**	**339,956**	***(10.3)***	**1,006,689**	**983,003**	***2.4***
Motorcycles	144,550	176,158	*(17.9)*	486,502	471,367	*3.2*
Scooters and Mopeds	160,238	163,798	*(2.2)*	520,187	511,636	*1.7*

Source: Company; Angel Research

Auto-Ancillaries to track Auto sector: At the beginning of FY2008, mood in the Indian Auto Component industry was buoyant. Every component maker clocked double-digit growth rate. But by end 2008, outlook turned bleak. The Auto Component sector, which depends on the OEMs for its growth, is stuck in the midst of a sluggish domestic sector and a recession-hit global export market. Component manufacturers are now knocking at the government's doors seeking a 2-3 years bridge policy to help survive the slowdown. The domestic market, which accounts for over 80% of the Rs90,000cr Indian auto component sector, is experiencing one of its worst phases due to the dip in auto sales. At the same

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time, exports, which acted as a cushion for any cyclical change in domestic demand (accounts for almost 20% of total Auto Component Industry), have been dismal due to global financial crises. Global outsourcing from large traditional markets like USA and Europe has taken a stiff beating and seen reduction of up to 35% in many cases. Overall export growth of the Auto Component industry has slumped to a meagre 6% in YTD FY2009 compared to 25% CAGR in the last five years.

Outlook

Volume growth to be tracked closely in the near term: Auto demand will continue to be driven by core drivers such as, rising household incomes and improvement in affordability. However, due to uncertain macro-economic factors, volumes will be tracked closely in the near term. We believe going ahead, success of the new launches, rising income levels and easy availability of finance both in the Two and Four-wheeler segments, will determine the sales fortune of the players therein. However, in 3QFY2009 players are unlikely to turn in a good performance.

OPM pressures to continue: Input costs have spiraled in the last two years following spurt in the steel, rubber and aluminum prices. Beginning of FY2009 was no different with players continuing to face pressure on account of high volatility in metal prices which continued during 1HFY2009 as well, exerting cost pressures on the companies. In 3QFY2009 however, the cycle has taken a reverse turn with the softening of commodity prices, which would help manufacturers improve Margins. Nonetheless, Margins would bounce back with a lag effect post reduction in high-cost inventory. Net Profit growth for most players would primarily depend on average realisations and cost-cutting measures adopted by them. Players are expected to register decline in Net Profit in 3QFY2009 on low operating leverage followed by low volumes.

No growth in Auto Component segment: Auto component makers have been hit by rising inventories amidst slowing demand, and are increasingly facing delays in getting paid. The companies are finding it difficult to make future projections as their two key markets, OEM and Replacement segments have been hit by poor demand and instability in final product prices, which are trending downwards. Companies in sub-segment of the Auto Component sector such as tyres, bearings and batteries with a larger share of revenues from the Replacement and Domestic market will be less affected than those that supply exclusively to OEMs. Broadly, the sector is expected to deliver muted Earnings performance in 3QFY2009 due to slowdown in overall Auto demand.

Our Top Picks in the Automobile sector are Maruti Suzuki, Amtek Auto and Exide Industries.

Exhibit 5: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	3QFY09E	*%chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*%chg*	FY09E	FY10E	Price (Rs)	
Ashok Leyland	15	981	*(45.5)*	0.5	*(869)*	(31)	*(126.0)*	(0.2)	*(126.0)*	1.4	2.0	*41.8*	10.3	7.3	-	Neutral
Bajaj Auto	391	1,847	*(26.2)*	9.0	*(509)*	98	*(73.3)*	6.8	*(81.3)*	38.1	50.1	*31.5*	10.3	7.8	451	Buy
Hero Honda	805	2,791	*1.8*	13.5	*(45)*	262	*(4.6)*	13.1	*(4.6)*	54.4	64.7	*18.9*	14.8	12.4	841	Accumulate
Maruti	507	4,292	*(7.8)*	6.9	*(618)*	214	*(54.1)*	7.4	*(54.1)*	43.5	52.3	*20.2*	11.7	9.7	627	Buy
M&M @	275	2,327	*(20.9)*	6.5	*(477)*	111	*(55.9)*	4.6	*(56.0)*	32.1	35.1	*9.4*	8.6	7.8	336	Buy
Tata Motors @	159	5,070	*(30.1)*	6.0	*(723)*	41	*(91.7)*	1.1	*(91.7)*	21.4	24.8	*16.0*	7.4	6.4	-	Neutral
TVS Motors	23	832	*(5.0)*	3.1	*138*	2	*(62.3)*	0.1	*(62.3)*	1.0	2.3	*131.0*	22.1	9.6	-	Neutral

Source: Company, Angel Research; Price as on December 31, 2008. Note: @Adjusted for extraordinary items.

Exhibit 6: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	3QFY09E	*%chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*%chg*	FY09E	FY10E	Price (Rs)	
Amtek Auto@	68	1,083	*(9.6)*	16.0	*(387)*	58	*(45.7)*	4.4	*(45.7)*	14.0	17.5	*25.0*	4.8	3.9	150	Buy
Automotive Axle^	109	122	*(30.3)*	13.5	*(210)*	7	*(51.9)*	4.7	*(51.9)*	26.7	31.2	*17.0*	4.1	3.5	-	Neutral
Bharat Forge*	84	1,077	*(0.3)*	13.5	*(270)*	46	*(35.4)*	2.1	*(35.4)*	12.4	13.1	*5.7*	6.8	6.4	137	Buy
Bosch India#	3,201	994	*(10.2)*	16.0	*584*	80	*(35.9)*	24.9	*(35.9)*	193.3	203.2	*5.1*	16.6	15.8	3,658	Accumulate
Exide Industries	48	795	*10.1*	16.0	*91*	67	*20.6*	0.8	*13.0*	3.8	4.4	*14.6*	12.5	10.9	70	Buy
FAG bearing#	225	169	*1.1*	14.3	*(129)*	12	*(13.0)*	7.5	*(13.0)*	52.9	57.0	*7.8*	4.3	3.9	342	Buy
Motherson Sumi*	60	546	*5.7*	13.0	*(107)*	36	*(4.3)*	1.0	*(4.3)*	4.7	6.2	*30.8*	12.7	9.7	80	Buy
Rico Auto*	11	217	*(9.6)*	7.0	*(749)*	(5)	*(16.7)*	(0.4)	*(16.7)*	0.4	1.7	*290.6*	26.7	6.8	-	Neutral
Sona Koyo	9	168	*(2.3)*	4.9	*(589)*	(2)	*(133.7)*	(0.1)	*(116.8)*	(1.2)	0.5	*-*	(7.3)	17.3	-	Neutral
Subros	19	158	*(1.2)*	8.5	*(437)*	3	*(65.5)*	0.4	*(65.5)*	3.1	4.6	*46.6*	6.0	4.1	27	Buy

*Source: Company, Angel Research; Price as on December 31, 2008; * Consolidated Results; # Y/E December ; ^ Y/E September; @ Y/E June*

***Analyst* - Vaishali Jajoo**

Banking

3QFY2009 marked by conclusive reversal of Interest rate cycle

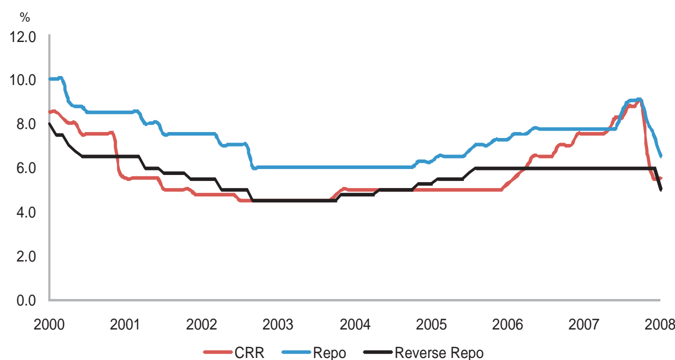
Recognising the increasing headwinds to growth and with inflation no longer being a concern, the RBI changed its monetary stance in 3QFY2009 after four years of tight Monetary Policy. It cut the CRR and policy rates with significant rapidity, sending a strong signal to banks to cut rates. PSU Banks took the lead in cutting rates, with cumulative reduction of up to 150-200bp in both PLRs and deposit rates being announced by large PSU Banks like PNB. Banks increased their bond portfolios substantially, largely on account of risk aversion and increasingly to capitalise on opportunities for Treasury Profits. The steep fall in bond yields during 3QFY2009 will benefit banks, especially PSU Banks with larger AFS portfolios and provide additional buffer against increasing asset quality pressures. Credit growth remains strong this far, driven by replacement demand, though going forward, we expect it to trend downwards as private sector demand cools off. That said, Profitability is expected to be strong in 3QFY2009E on account of strong credit growth, largely stable Margins and falling Bond yields.

Key Developments

Substantial monetary easing by the RBI

3QFY2009 was marked by a complete reversal in the RBI's monetary stance, with policy rates being cut with unprecedented swiftness. While the RBI's initial priority was to pump liquidity into the system to counter the outflow of foreign capital, once liquidity was restored, the RBI continued monetary easing to mitigate the increasingly evident headwinds to GDP growth.

Exhibit 1: CRR, Repo and Reverse Repo rate



Source: RBI, Angel Research

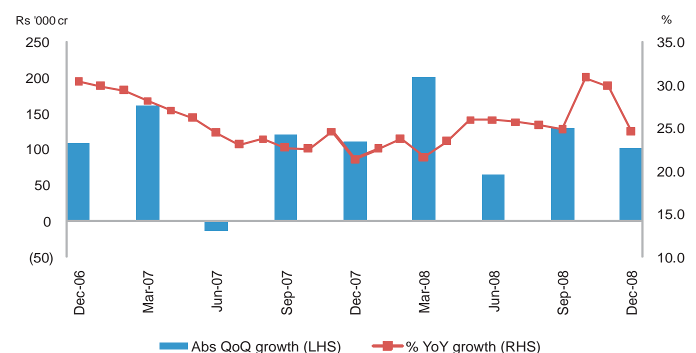
This far, the RBI has reduced CRR from a peak of 9% to 5%, Repo rate from 9% to 5.5%, Reverse Repo rate from 6% to 4% and SLR from 25% to 24%. As a result, liquidity has eased considerably, with banks on an average parking Rs15,000cr daily under the LAF window since November 2008, as against borrowing around Rs40,000cr daily in September-October 2008. Consequently, call rates have also remained within the LAF corridor of 5-6.5% in December 2008. Given the easy liquidity conditions, the Reverse Repo rate has become the operative rate, leading the RBI to cut the same by 200bp giving a clear signal to banks to cut broader interest rates.

Credit growth high, but expected to trend downwards

Trends for deposit, credit and investment growth were starkly different during September-October 2008 and November-December 2008. September-October 2008 was marked by sudden shortage in liquidity caused by the massive outflow of foreign capital. This triggered a substantial replacement demand for domestic credit during the period. As a result, there was an increase of Rs1,93,190cr in credit, while deposits increased by Rs1,23,978cr and investments in Bonds declined by 12,508cr. The credit-deposit ratio increased to 75.4% and credit growth to 29.4%.

While the swift RBI measures described above helped alleviate the liquidity situation during November-December 2008, banks evidently continue to remain risk-averse. Credit growth has already eased to 24.5% yoy on the back of a Rs6,996cr decline in absolute terms, even as investment in Bonds increased by Rs80,051cr during the period, also reflecting increased focus on Treasury as a profit centre going forward. Credit growth is expected to continue trending downwards, as demand from the private sector declines consistent with the slowdown in GDP growth.

Exhibit 2: Credit growth



Source: RBI, Angel Research. Note: Data up to December 19, 2008

Banking

Broader Interest rates falling with increasing momentum; NIMs expected to be largely stable

PSU Banks set the tone for cuts in both deposit and lending rates during the quarter. Virtually all PSU Banks cut their PLRs by 75bp (to 13.25% in most cases), which we believe would largely offset the margin benefits accruing from the steep CRR cuts. UNBK and PNB cut their PLR by 150bp to 12.5% in December 2008, while most other banks have announced similar cuts effective from January 2009. Recently, PNB announced further cut in its PLR to 12%, effective January 1, 2009, taking its PLR to the lowest in the industry.

At the same time, most large banks (including HDFC Bank amongst private banks) cut their peak fixed deposit card rates by 100bp on account of their competitive advantage in raising cheaper retail deposits, while smaller banks (at the other end of the competitive spectrum) such as IOB, CRPBK and OBC effected cuts ranging from 0-50bp. Recently, PNB announced a further sharp cut in its peak deposit rate by 100bp to 8.5% for deposits of one year to less than three years, a key factor in facilitating the PLR cut announced by the bank. Following some easing in bulk deposit and CD rates, ICICI Bank has recently indicated that it is looking at cutting interest rates in January 2009 for housing and other loan customers. The Bank continues to offer amongst the highest retail FD rates at 10.5%.

We believe that re-pricing gaps in deposits and advances result in only temporary margin changes (for instance, in a falling interest rate environment, loans get re-priced faster and can lead to temporary downward bias in NIMs). We believe factors such as competitive ability in garnering CASA marketshare are more dominant in determining the eventual direction of NIMs. In the current environment, we believe as credit growth continues to trend downwards and increasing portion of savings is allocated to deposits, competition for deposits will ease considerably as against the past few years. Hence, we believe that the performance gap between Private Banks with superior deposit mix such as HDFC Bank and Axis Bank on the one hand and PSU Banks on the other is likely to narrow, unlike in the past two years when PSU Banks experienced significant Margin compression while Private Banks experienced Margin expansion.

We expect Margins to be relatively stable in 3QFY2009E as well as going forward (though smaller, relatively less competitive PSU Banks such as Corp Bank and OBC are expected to continue to face Margin pressures). With credit growth registered in 3QFY2009 also being strong, overall growth in Net Interest Income is expected to be robust as well. However, over the next four quarters, a sharper-than-expected slowdown in credit growth and government pressure to reduce lending rates in case of PSU Banks constitute key downside risks.

Exhibit 3: Deposit rate and PLR cuts (%)

FY2009	Peak deposit rates		PLR	
	3QFY2009	Change	3QFY2009	Change
BOI	9.75	(0.75)	13.25	(0.75)
PNB	9.50	(1.00)	12.50	(1.50)
UNBK	9.50	(1.00)	12.50	(1.50)
OBC	10.50	-	13.25	(0.75)
CRPBK	10.00	(0.50)	13.25	(0.75)
IOB	10.00	(0.50)	13.25	(0.75)
INDBK	9.75	(0.25)	13.25	(0.75)
ICICIBK	10.50	-	17.25	-
HDFCBK	9.50	(1.00)	16.25	(0.25)
AXSB	9.75	(0.25)	15.75	-
YESBK	10.75	-	16.50	(0.50)

Source: RBI, Angel Research

Crashing Bond yields to aid Profitability

Driven by falling inflation, sharp monetary easing and increased risk aversion, Bond yields declined substantially during the quarter, falling by around 3% across maturities, though the fall was even higher at the shorter end of the yield curve. This fall in yields is expected to translate into substantial write-back of MTM provisions made in 1QFY2009 as well as Treasury gains (to the extent booked), especially for PSU Banks. Of the PSU Banks under our coverage, Union Bank of India, Indian Bank and Oriental Bank of Commerce have amongst the highest portion of their investment books in the AFS category.

We believe banks will take this opportunity to increase their NPA provision coverage, rather than taking the entire gains to Net Profits. Moreover, banks would have provisioning losses on their Equity portfolios that would have depreciated further in value in 3QFY2009E, with the benchmark Sensex down by around 35%.

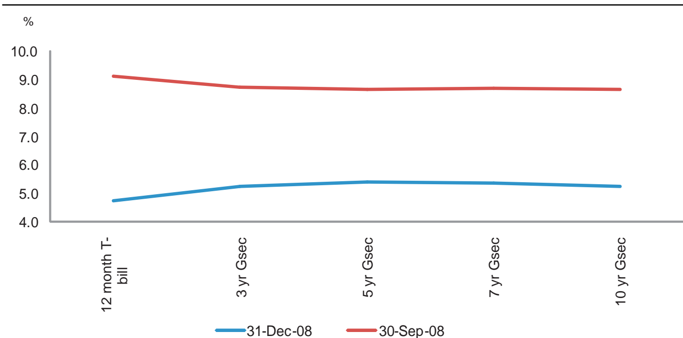
Banking

Exhibit 4: AFS Exposures

Bank	Investment Portfolio	SLR AFS Portfolio	Duration (yrs)
BOI	37,550	2,400	2.46
PNB	58,208	5,506	2.00
UNBK	34,674	6,268	2.25
OBC	22,658	5,612	1.54
CRPBK	15,000	1,200	1.60
IOB	31,000	4,700	2.00
INDBK	19,000	3,700	3.30

Source: RBI, Angel Research

Exhibit 5: Yield Curve



Source: RBI, Angel Research

Bond profits, restructuring to provide some buffer from NPAs

Asset quality trends continue to be a key element to monitor in the 3QFY2009E results. We have factored in asset quality deterioration into our estimates across the banks under our coverage, with NPA provisioning expenses expected to grow at a CAGR varying from 40 to 140% over FY2008-10E. Further, stress-testing analysis indicates that even a large 100bp increase in slippage ratios above our base case in FY2009E and FY2010E each for banks under our coverage, would result in a marginal average increase in FY2010E P/ABV of around 0.11x. The RBI has also relaxed restructuring norms allowing banks to restructure loans twice in a year (and once in case of Real Estate companies). These guidelines will be beneficial so long as the downturn does not stretch beyond 12-18 months otherwise it may have the effect of postponing and bunching up of NPAs beyond that period.

Operating Expenses of PSU Banks likely to be high going forward

Several PSU Banks have chalked up substantial branch expansion and staff recruitment plans including UNBK, BOI and IOB, amongst the banks under our coverage. Combined with wage revisions that are expected to result in an increase of at least 15% in wage bills, we believe that operating leverage benefits for several PSU banks will be relatively subdued over the ensuing quarters as opposed to the past few years.

Outlook

We expect domestic banks to continue benefiting from the RBI's Monetary Stimulus to mitigate the GDP slowdown. We do not expect an increase in NPAs to materially impact Net Worth / Book Value of banks. Our Top picks are HDFC Bank and Axis Bank. Not only do these banks score high on all competitive parameters such as CASA, Fee Income and Capital Adequacy, but also now trade at significantly lower valuation premium to PSU Banks than in the past. Amongst PSU Banks (which as a group are well placed from a cyclical point of view), we prefer large-caps and our top picks in this space are Punjab National Bank and Union Bank of India primarily on account of their strengths in CASA deposits. Falling Bond yields also create opportunities for short-term gains in PSU Banks.

Exhibit 6: Quarterly Estimates Rs cr

Company	CMP (Rs)	Total Income 3QFY09E	Total Income %chg	Net Profit 3QFY09E	Net Profit %chg	EPS (Rs) 3QFY09E	EPS (Rs) %chg	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) %chg	Adj. B/Value FY09E	Adj. B/Value FY10E	P/E (x) FY09E	P/E (x) FY10E	P/ABV FY09E	P/ABV FY10E	Target Price (Rs)	Reco
Axis Bank	505	1,701	*37.7*	415	*35.2*	11.6	*34.3*	44.8	57.3	*27.7*	272.3	311.9	11.3	8.8	1.9	1.6	748	Buy
HDFC Bank	998	2,732	*29.1*	601	*39.9*	14.1	*16.6*	52.8	66.0	*25.0*	349.6	453.4	18.9	15.1	2.9	2.2	1,360	Buy
ICICI Bank	448	4,474	*2.0*	1,249	*1.5*	11.2	*1.3*	36.7	43.4	*18.3*	417.2	432.7	12.2	10.3	1.1	1.0	707	Buy
Yes Bank	75	249	*31.1*	73	*34.6*	2.5	*33.7*	9.5	13.1	*38.5*	53.1	70.7	7.9	5.7	1.4	1.1	119	Buy
Bank of India	288	2,042	*25.0*	673	*31.5*	12.8	*22.0*	51.2	56.1	*9.5*	205.4	247.1	5.6	5.1	1.4	1.2	321	Accumulate
Corp Bank	189	615	*22.8*	212	*10.9*	14.7	*10.9*	54.5	61.8	*13.4*	336.5	383.8	3.5	3.1	0.6	0.5	307	Buy
Indian Bank	137	916	*6.3*	355	*15.5*	4.3	*15.5*	25.4	25.8	*1.7*	126.4	145.8	5.4	5.3	1.1	0.9	-	Neutral
IOB	72	1,056	*20.6*	337	*9.5*	6.2	*9.5*	23.0	24.6	*6.6*	99.3	113.3	3.1	2.9	0.7	0.6	96	Buy
OBC*	154	644	*12.9*	243	*75.7*	9.7	*75.7*	37.5	37.5	*(0.2)*	251.1	275.6	4.1	4.1	0.6	0.6	193	Buy
PNB	526	2,295	*20.3*	696	*28.5*	22.1	*28.5*	81.8	94.5	*15.5*	407.5	482.2	6.4	5.6	1.3	1.1	627	Buy
Union Bank	163	1,351	*18.9*	478	*30.8*	9.5	*30.8*	31.3	36.6	*16.7*	135.7	164.2	5.2	4.5	1.2	1.0	197	Buy

Source: Company, Angel Research; Note: Price as on December 31, 2008; OBC's 3QFY2008 PAT was suppressed due to extra-ordinary item; on an adjusted basis, we expect 22% yoy growth in PAT.

***Analyst* - Vaibhav Agrawal**

Cement

Cement Stocks - No relief yet

Cement stocks registered mixed performance during 3QFY2009. Post underperforming the broader markets over the past several quarters owing to fears of oversupply and rising input costs, major cement stocks like Ambuja and ACC out-performed the broader markets in 3QFY2009. Historical low valuations and hopes of a stimulus package by the government have led to some kind of value buying in these stocks. However, in absolute terms, major cement stocks declined 25-30% during the quarter. We believe that cement stocks will continue to under- perform and the industry is expected to face tough times going ahead due to the slowdown in demand coupled with excess capacity.

Exhibit 1: Sensex v/s Cement stocks (3QFY2009)

Cement majors	Abs. Returns (%)	Relative to Sensex (%)
Sensex	(25.0)	-
ACC	(21.9)	3.1
Ambuja Cements	(11.1)	13.9
Grasim	(27.8)	(2.8)
Ultratech Cement	(27.5)	(2.5)
India Cements	(21.1)	3.9
Madras Cements	(30.8)	(5.9)

Source: BSE, Angel Research

All-India Capacity utilisation declined

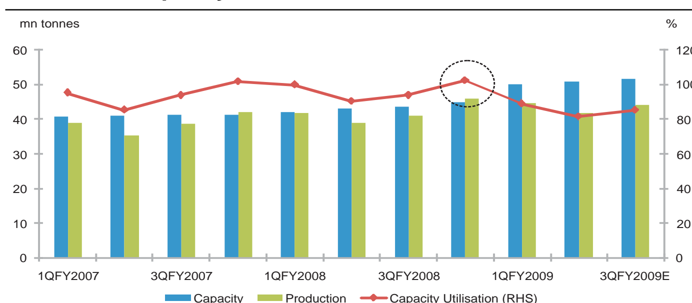
All-India capacity utilisation during 3QFY2009 declined to 85.4% from 94.0% in 3QFY2008, mainly due to fresh capacity addition and lower demand due to economic slowdown. All-India cement capacity addition was 8.0mn tonnes yoy to 51.6mn tonnes during the quarter from 43.6mn tonnes in 3QFY2008. It may be noted here, huge capacity additions coupled with lower cement demand growth had resulted in capacity utilisation peaking out in 4QFY2008 at 102.4% (refer Exhibit 3) and thereafter it has been showing a declining trend. Cement production grew by 7.6% during 3QFY2009 to 44.1mn tonnes as against consumption growth of just 4.2%.

Exhibit 2: All-India Cement Scenario (mtpa)

Particulars	3QFY09E	3QFY08	% yoy	9MFY09E	9MFY08	% yoy
Capacity	51.6	43.6	*18.4*	152.7	128.7	*18.7*
Production	44.1	41.0	*7.6*	130.4	122.0	*6.9*
Cap. Utilisation (%)	85.4	94.0	-	85.4	94.8	-
Consumption	41.4	39.7	*4.2*	126.1	118.1	*6.8*
Exports	1.0	1.0	*(5.3)*	2.08	2.81	*(26.1)*

Source: CMA, Angel Research

Exhibit 3: Capacity Utilisation trend

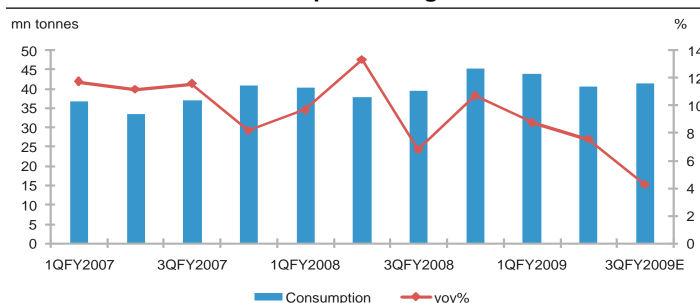


Source: CMA, Angel Research

Cement Consumption - Slowdown visible

Cement consumption in India fell substantially due to the slowdown in the Housing and Construction sectors led by slowdown in economy. For the quarter under review, all-India cement consumption grew a dismal 4.2% yoy to 41.4mn tonnes from 39.7mn tonnes in 3QFY2008. On a sequential basis too, consumption grew by a mere 1.5% to 41.4mn tones from 40.7mn tonnes in 2QFY2009. Cement consumption growth of 4.2% during 3QFY2009 yoy is much lower compared to growth of 6.8% yoy during 3QFY2008. So far this year, cement consumption grew by 6.8% yoy compared to the growth rate of 9.8% in the corresponding period of last year. This indicates the slowdown in cement demand in India due to overall slowdown in the economy and the Housing sector (accounts for highest 65% cement consumption in India).

Exhibit 4: Cement consumption and growth



Source: CMA, Angel Research

Exports decline yoy, higher qoq

Exports fell 5.3% yoy during the quarter though on a qoq basis were higher by 19.8% from 0.8mn tonnes in 2QFY2009 to1mn tonnes. So far this year, cement exports declined 26.1% yoy mainly due to the exports ban for six weeks by the government in May 2008. The government had lifted the cement export ban from all over India during December 2008 as cement demand in the domestic market has slowed down and prices have corrected.

Cement

Cement prices corrected qoq

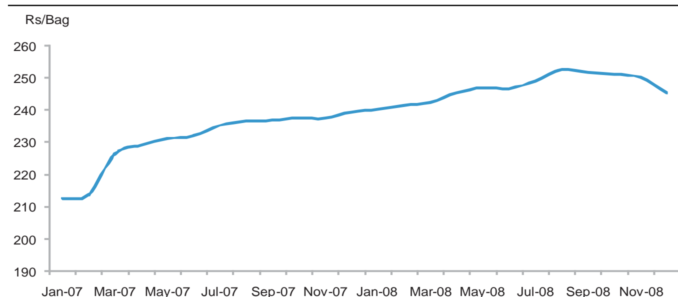
Exhibit 5: Cement Prices (Rs/barrel)

Particulars	3QFY09E	3QFY08	% yoy	9MFY09E	9MFY08	% yoy
Mumbai	251	241	*4.2*	252	238	*6.2*
Delhi	227	227	*0.3*	229	220	*3.8*
Chennai	276	253	*9.1*	270	246	*9.6*
Kolkata	239	230	*3.9*	244	229	*6.3*
Average Price	**249**	**238**	***4.5***	**249**	**233**	***6.6***

Source: CMA, Angel Research

All-India average cement prices had increased by 4.5% yoy from Rs238/bag in 3QFY2008 to Rs249/bag in 3QFY2009 mainly due to the strong demand on yoy basis and non-addition of significant capacity. During 3QFY2009, cement prices were marginally down on a qoq basis. Prices corrected more in the Northern markets due to lower demand and dumping of cement from Pakistan and reduction in excise duty by 4% to 8% on cement as players passed on the same to customers. We expect cement prices to continue to soften going ahead as impact of demand slowdown and excess capacity would exert pressure on prices.

Exhibit 6: All-India average Cement Prices



Source: CMA, Angel Research

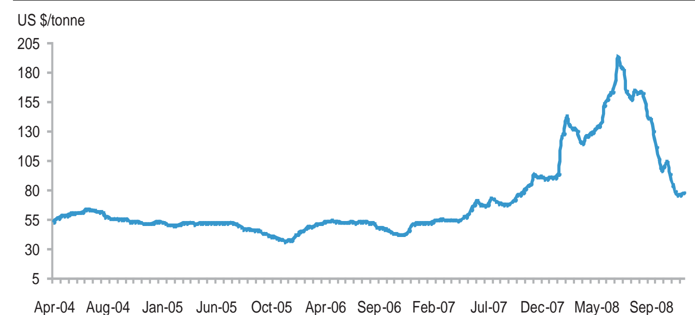
Capacity additions to exert pressure on prices

All major players have announced large capacity expansion plans in India to take advantage of the booming Real Estate and Infrastructure sectors. Total cement capacity in India was around 175.7mtpa at the end of FY2008, a yoy increase of 8.6mtpa. However, we believe capacity additions would be higher over the next two years. Current total cement capacity in India stands at 208mn tonnes, an increase of 32.3mtpa during the year. We had estimated capacity additions of 37.1mtpa in FY2009, and industry has already added 32.3mtpa so far. We expect industry to add another 32.1mtpa capacity in FY2010. Such huge capacity additions (69.2mtpa), almost 40% of FY2008 capacity and slowing demand would result in an oversupply kind of situation. Any delay in expansions would be offset by the lower demand. Overall, this is not favourable for the demand-supply equation.

Coal prices collapsed - To benefit going ahead

Coal is the main input for cement manufacturing and imported prices of coal had skyrocketed during 1HFY2009. However, after peaking out in July 2008, coal prices collapsed by around 60% thereon. However, despite the crash in imported coal prices, average coal prices during 3QFY2009 still ruled higher by 9.5% at US $92/tonne from US $84.2/tonne in 3QFY2008. However, prices were significantly down qoq by 43.5%. We believe that the correction in coal prices will help companies save costs. However, full impact would reflect in subsequent quarters. Manufacturers use coal to generate power and also in the cement production process in the kiln.

Exhibit 7: globalCOAL's NEWC FOB Coal Prices



Source: Bloomberg, Angel Research

Key developments

Stimulus package - Just a relief

The government announced its Rs20,000cr stimulus package on December 7, 2008 to boost overall economic activities in India and to maintain the country's GDP growth. The government announced the much-desired across-the-board cut in Excise duty. With this, cement that was being charged excise duty of 12% will now attract 8% duty. In response to this, Indian cement majors like ACC, Ambuja Cements and Shree Cement have decided to pass on the benefit to consumers and have reduced cement prices by Rs4-6/bag in December. However, we believe that the stimulus package announced by the government will only act as a cushion to falling cement demand rather than boosting it. With lower GDP growth estimates for FY2010, we expect cement demand to grow at 6-7% in FY2010.

Cement

Removal of Exports Ban

The government in December 2008 relaxed the ban on export of cement amidst the backdrop of waning demand for cement from the Housing sector. The ban was imposed on April 11, 2008 to curb the rapidly-rising inflation. We believe that this will have a marginal impact as the government had allowed cement exports from the ports in Gujarat on May 27, 2008. The government had also allowed export of cement to Nepal, which depends on India for its supplies. India's 85-90% of cement export takes place through Gujarat Ports.

Margins and Bottom-line to decline yoy in 3QFY2009

The Indian Cement industry, at this point in time, is experiencing challenging times, with huge capacity planned by several players, which is expected to exert pressure on prices. Margins of the cement players have been under pressure due to the firm prices and rising input costs of coal, freight, fly ash, etc. This was reflected in the last couple of quarterly performance, where Margins of all majors took a hit and declined by 400-500bp on a yoy basis.

We expect cement companies' margins to be under pressure in 3QFY2009 yoy, mainly due to correction in cement prices and lower volumes due to lower demand. However, sharp correction in the international coal prices during the quarter will help companies save costs sequentially. Also, reduction in diesel prices by Rs2/ltr during December would help players save Rs2-3/bag on sequential basis. The hike in diesel prices in May 2008 had increased operating costs for the cement manufacturers as freight costs constitute 20-25% of their operating costs.

Exhibit 8: Margins to decline in 3QFY2009

Market	3QFY2009E	3QFY2008	*yoy bp*	2QFY2009	*qoq bp*
ACC*	20.7	23.4	*(270)*	24.3	*(360)*
Ambuja*	28.1	33.3	*(520)*	29.2	*(110)*
Grasim	28.2	32.6	*(440)*	21.6	*660*
Ultratech	28.7	33.9	*(520)*	22.4	*630*
India Cements	30.1	33.2	*(310)*	31.3	*(120)*
Madras Cements	34.0	37.2	*(320)*	34.4	*(40)*

*Source: Companies, Angel Research; *Estimates are for 4QCY2008*

Cement Sector Outlook

On an average, cement demand grew at a rate of 8.8% during FY2003-2008 v/s India's GDP growth of around 8% during the same period. The rate of growth of cement consumption was much more at 8.8% in the last five years, mainly due to strong GDP growth driven by huge investments in Real Estate, construction activities led by urbanization, rising income levels and declining home loan rates. However, we believe that cement demand will grow at a slower rate compared to the last five years.

We had anticipated cement consumption growth to be at 8% in FY2009. However, with the slowdown in Housing and Real Estate due to the slowdown in the economy, the cement consumption grew by 6.8% yoy during 9MFY2009. We now expect cement consumption growth to moderate to 7% over the next 2 years with GDP growth rate slowing down. Also, slowdown in housing in India, which contributes around 65% to the cement consumption in India, will lead to a slowdown in cement demand growth in India.

The stimulus package announced by the government will only support falling cement demand rather than boosting it. Without the stimulus package provided by the government, cement consumption growth would have been much lower than our estimates of 7%. We believe that the slowdown in cement consumption growth and additional capacities planned by several players would exert pressure on cement prices going ahead. **We maintain our Neutral view on the Sector.**

Exhibit 9: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			EV/Tonne(US $/t)		Target	Reco
Company	(Rs)	3QFY09E	*% chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*%chg*	FY09E	FY10E	Price (Rs)	
ACC*	478	1,822	*2.1*	20.7	*(270)*	210	*(14.8)*	11.2	*(14.8)*	59.7	50.4	*(15.5)*	81	76	-	**Neutral**
Ambuja Cements*	70	1,566	*7.2*	28.1	*(520)*	273	*251.0*	1.8	*251.0*	9.4	7.3	*(22.2)*	111	106	60	**Reduce**
Grasim**	1,218	2,893	*10.0*	28.2	*(440)*	580	*4.7*	63.3	*4.7*	257.4	265.5	*3.2*	76	74	-	**Neutral**
India Cements	97	865	*17.2*	30.1	*(310)*	131	*3.1*	4.6	*0.0*	19.3	18.2	*(5.6)*	66	66	-	**Neutral**
Madras Cements	70	539	*5.1*	34.0	*(320)*	90	*(18.2)*	3.8	*(18.2)*	18.0	18.8	*4.6*	72	65	64	**Reduce**
Ultratech Cement	383	1,509	*9.2*	28.7	*(520)*	227	*(18.6)*	18.3	*(18.6)*	69.2	61.0	*(11.8)*	66	67	-	**Neutral**

*Source: Company, Angel Research; Note: Price as on December 31, 2008; * Y/E December, **FY2009 and FY2010 numbers are consolidated*

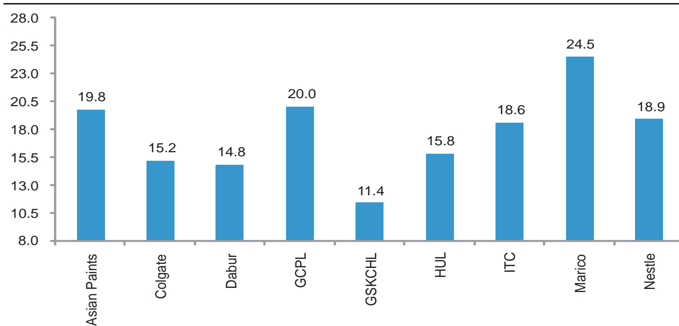
***Analyst* - Pawan Burde**

FMCG

For 3QFY2009, we expect the FMCG sector to clock yet another quarter of steady Top-line growth largely driven by value growth (via price hikes). Moreover, additional support in terms of higher advertising spends, new product launches and increased level of promotions is also expected to help FMCG companies sustain modest volume growth.

However, weakening macro-economic conditions coupled with falling income levels could lead to moderation in consumer spending in the ensuing quarters. For the quarter, we expect our universe of stocks to register robust 15-18% growth in Top-line led by companies like Nestle, Godrej Consumer and Marico.

Exhibit 1: Revenue Growth yoy % (3QFY2009E)



Source: Company; Angel Research; Note: HUL, Nestle, GSKCHL figures are for 4QCY2008E

Input costs soften - 'Margins to Improve'

Owing to sharp correction in global commodity prices, particularly crude oil, FMCG companies stand to benefit in terms of Margin expansion. Home-care products like detergents and soaps along with Personal care products like shampoos, toothpaste and skin-care are likely to benefit the most due to the dip in Palm oil, LAB prices and packaging costs. GCPL and HUL stand to benefit the most owing to high contribution of soaps/ detergents to their revenue. However, Agri-commodities, particularly those sourced domestically, are expected to remain firm. While milk, wheat and barley prices have witnessed certain moderation, sugar prices continue to hold firm.

Price hikes have been the most widely adopted strategy to combat input cost inflation. However, several companies have resorted to more innovative cost management strategies including tinkering with product size/weight, forward covers, change in product mix and better supply chain mechanics to tackle this challenge. We believe companies which have a diversified product portfolio are best placed to tackle this inflationary scenario.

M&A activity - 'Back on track'

Most Indian FMCG companies have been constantly looking at acquisitions to boost their growth. While nothing major has happened in the last several quarters, turmoil in financial markets seems to have had a favourable impact on M&A activity this quarter resulting in a series of transactions.

In a dramatic end to a hostile takeover, Emami bought the entire stake of the Parikh family in Zandu Pharmaceuticals for an estimated Rs243cr and gained majority holding in the company. The following open offer of 20% took Emami's holding in Zandu up to 70%.

After nearly four years of acquiring Balsara, Dabur acquired 72.2% stake in Fem Care Pharma at an all-cash deal of Rs204cr from existing promoters valuing Fem at Enterprise Value (EV) of Rs300cr. Dabur will also make an Open Offer for acquiring additional 20% stake in Fem. We believe though the acquisition will strengthen Dabur's position in the high-growth skin care market, at 3x FY2009E EV/Sales, it is expensive.

Godrej Consumer (GCPL) approved acquisition of the 50% stake by its joint venture (JV) partner SCA Hygiene Products' in Godrej SCA Hygiene. Post this transaction, the JV which owns the *Snuggy* brand of baby diapers, will become 100% subsidiary of GCPL.

Marico is open for acquisitions in the Beauty & Wellness space and is bullish on Emerging markets, especially Africa. After earlier brand acquisitions in Egypt and South Africa, the group is looking at a pan-Africa footprint. Kraft Foods, the world's largest food major, is learnt to be fine-tuning plans to make formal entry into India by acquiring stake in an Indian company.

Price Hikes - 'To take or not to take'

Over the past several quarters, most FMCG companies have resorted to judicious price hikes to protect their dwindling Margins. Despite softening of commodity prices this quarter, several companies initiated another round of price hikes. Leading from the front, Hindustan Unilever (HUL) hiked prices of products by 1-28% across categories such as tea, detergent, soap, shampoo and personal care since October. Among key price moves, HUL hiked prices of *Lux* 100gm soap bar by 6%, *Surf Excel* Quick Wash detergent by 5-6% and *Surf Excel Blue* by 12-13%. It also hiked prices of *Brooke Bond Red Label* tea and *Taj Mahal* tea by 8-14% between mid-October and early November. ITC Personal Care increased the price of its soap

FMCG

brand Vivel. Other FMCG majors Britannia and Tata Tea also hiked prices of select brands. Meanwhile, P&G reduced the pack size of its flagship detergent brand, Tide, while maintaining the price points.

Going ahead, as economic slowdown takes its toll on consumer spending, even as inflation declines, FMCG companies are likely to tweak their pricing strategy. Moreover, fears of losing out on marketshare and down-trading would make price hikes difficult. Most companies are likely to resort to three alternatives - enhance Margins by maintaining prices, increase promotional activity and advertising spends while maintaining the price levels or resort to price cuts. We believe companies like Nestle, HUL, ITC and Colgate are best placed to mitigate input cost inflation through price hikes owing to their dominant market position, diverse product portfolio and strong brand equity.

Excise cut by 4% - 'Benefits to be retained'

To boost economic growth, the government recently announced a stimulus package wherein it slashed Excise Duty by 4%. However, most FMCG companies are likely to retain the benefits of the same without introducing any price cuts. Moreover, reduction in Excise rates is not likely to be uniform across FMCG categories or players. Cigarettes (ITC), biscuits (Britannia Industries, ITC) or ready-to-eat foods (HUL, Nestle, Britannia, ITC) will not avail any benefits as these products are either subject to specific duty or are exempt from excise. Players with manufacturing facilities located in tax-free zones (GCPL, Marico and Dabur India) will also not see any significant Excise duty savings. Players like HUL, GSK Consumer, Colgate Palmolive India and Nestle India have the highest Excise duty outgo and stand to be key beneficiaries of the stimulus package.

Product launches - 'Key to long-term growth'

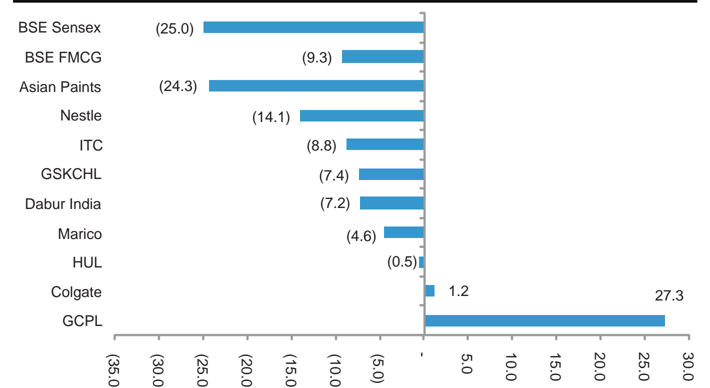
In a bid to garner higher marketshare and sustain long-term growth, most FMCG companies have launched new products largely in the form of variants/extensions of their existing brands. Rising income levels and growing aspirations coupled with lower penetration levels have fueled strong demand for lifestyle and value-added products. In terms of categories, we expect the Personal care, Household care and Processed Foods segments to drive growth in the FMCG sector.

Despite financial meltdown and rising inflationary trends, FMCG companies have retained their plans of new product launches. For instance, Dabur's acquisition of Fem Care is expected to give it immense synergies in promoting and developing its Skin care portfolio. Dabur could also use the *Fem* brand to enter new Skin care segments. Recently, Dabur also launched a new *Hajmola* variant, viz, *Hajmola Pudina.* Nestle India has plans to create a new image for its iconic noodle brand, *Maggi*. It is working on two options - either re-position the brand as a food for the entire family or heavily promote its dietary advantages to comply with the parent company's guidelines. The company has also launched a ready-made cooking aid called *Maggi Bhuna Masala* as well as a new variant of the *KitKat* brand. Tata Tea is gearing up to enter the Energy Drinks segment identifying fortified beverages as a growth area. CavinKare is launching new products variants in the *Fairever* fairness cream and *Chick Satin* shampoo range in the next quarter.

Market Returns-'Outperformance continues'

In terms of stock market performance, 3QFY2009 continued to be another steady quarter for the BSE FMCG Index, which once again delivered a significant outperformance of 15.7% vis-à-vis Sensex led by Godrej Consumer (GCPL). While only GCPL and Colgate delivered absolute positive returns, all FMCG stocks in our universe outperformed the Sensex. GCPL clocked significant outperformance of 52.2% as the street discounted the Margin benefit accruing from decline in palm oil prices. Heavyweights, HUL and ITC both outperformed the Sensex by 24.5% and 16.2% respectively. Among the Midcaps, all the stocks performed well except Asian Paints which performed in-line with the Sensex owing to heightened concerns over its Topline growth owing to slowdown in Housing sector.

Exhibit 2: Relative outperformance to Sensex (3QFY2009 Period)



Source: Company; Angel Research

FMCG

While we remain overweight on the FMCG sector, we maintain our stance of selective stock picking. We believe companies with leadership position in their product categories, diverse product portfolio and stronger pricing power are better placed to combat the economic slowdown.

Nonetheless, we believe FMCG continues to be a defensive sector owing to players' strong Balance Sheet, better Earnings visibility, high Cash flows and rich Dividend yield. Going ahead, we expect FMCG stocks to continue to command premium valuations though the overall P/E band could fall in line with Sensex valuations.

Outlook

According to a recent FICCI report, the Indian FMCG sector is poised to deliver 16% growth to Rs95,150cr in FY2009 aided by modest volume and higher value growth. However, going ahead, we believe Top-line growth is likely to moderate as price hikes take a backseat. Moreover, volume growth for select categories could come under pressure due to down-trading or shifting to smaller consumer packs.

For 3QFY2009, we expect our FMCG universe to report a robust Topline growth of 15-18% yoy. However, Earnings growth is expected to remain slightly muted at 8-10% owing to Margin contraction in case of most companies (mainly on account of rising input costs and media inflation). Sector leader, HUL, is expected to report a robust 15.8% Topline growth despite high base in personal care portfolio largely driven by price hikes. Earnings growth (recurring) is expected to be muted at 8.8% partially impacted by higher base. ITC is expected to witness a 2-3% volume decline during the quarter owing to its exit from non-filter cigarette segment. ITC is expected to deliver an 18.6% revenue growth during the quarter. However, earnings growth is expected to remain muted at 10% owing to exaggerated losses in its Non-cigarette FMCG business. We believe it will be a tough year for ITC and maintain Neutral view on the stock.

We remain bullish on overall prospects of the Indian FMCG sector. We prefer stocks, which are better placed to combat the economic slowdown and sustain Margins. While down-trading and softening of volume growth cannot be ruled out, our interaction with most FMCG companies indicates strong confidence and focus on sustaining volume growth.

Among the heavyweights, we prefer Nestle, a strong play on the Food Processing sector in India, compared to HUL and ITC owing to its premium-urban centric portfolio and strong growth performance. Among Midcaps, we prefer GSK Consumer and Marico, which are available at attractive valuations given their strong fundamentals, steady Earnings growth and superior growth levers.

Exhibit 3: Quarterly Estimates — Rs cr

Company	CMP (Rs)	Net Sales 3QFY09E	Net Sales % chg	OPM (%) 3QFY09E	OPM (%) chg bp	Net Profit 3QFY09E	Net Profit % chg	EPS (Rs) 3QFY09E	EPS (Rs) % chg	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) %chg	P/E (x) FY09E	P/E (x) FY10E	Target Price (Rs)	Reco
Asian Paints ^	895	1,410	*19.8*	14.7	*(106)*	128	*8.0*	13.4	*8.0*	48.1	58.2	*21.2*	18.6	15.4	1,048	Buy
Colgate Palmolive	408	423	*15.2*	15.0	*(163)*	71	*16.5*	5.2	*16.5*	19.5	22.8	*16.6*	20.9	17.9	455	Accumulate
Dabur India ^	84	746	*14.8*	17.1	*(82)*	103	*9.1*	1.2	*9.1*	4.3	5.0	*17.9*	19.7	16.7	-	Neutral
GCPL ^	139	327	*20.0*	16.8	*(409)*	47	*6.1*	1.8	*1.1*	6.7	8.3	*25.0*	20.8	16.6	-	Neutral
GSK Consumer *	573	316	*11.4*	13.2	*62*	30	*7.6*	7.0	*7.6*	44.1	52.3	*18.7*	13.0	11.0	733	Buy
HUL *	250	4,269	*15.8*	15.3	*(3)*	603	*8.8*	2.8	*8.8*	9.6	11.2	*16.6*	26.0	22.3	-	Neutral
ITC	171	4,101	*18.6*	32.8	*(187)*	913	*9.9*	2.4	*9.9*	8.8	10.3	*17.0*	19.5	16.7	-	Neutral
Marico ^	56	630	*24.5*	12.5	*(21)*	50	*8.3*	0.8	*8.3*	3.1	3.9	*26.2*	18.0	14.3	66	Buy
Nestle *	1,453	1,065	*18.9*	16.1	*(150)*	106	*13.3*	11.0	*13.3*	53.7	65.0	*21.1*	27.0	22.3	1,626	Accumulate

*Source: Company, Angel Research; Note: Price as on December 31, 2008; * Y/E December; ^ Consolidated*

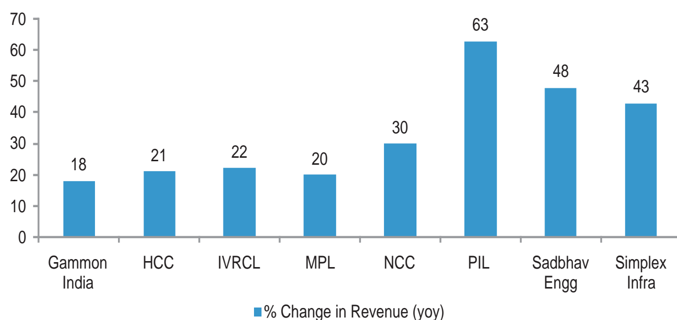
Analyst **- Anand Shah / Shweta Boob**

Infrastructure

Earnings Outlook

The Infrastructure sector has embarked on secular growth path led by strong investments by both the government and private sector players across segments including Roads, Ports, Power, Airports, Railways, Urban Planning, etc. We estimate infrastructure companies in our universe to post a CAGR of 20-30% in Revenues over the next couple of years. This optimism arises on account of the strong order book of these companies (2-5x FY2008 revenues), favourable macro environment leading to potential order inflow and changing industry dynamics.

Exhibit 1: Revenue Trend (3QFY2009E)



Source: Company, Angel Research

Robust Order Book position

Strong inflow of orders from sectors such as Power, Ports, Airports, Water and Sanitation Projects, etc., have helped the infra players to protect their Margins, to some extent, amidst the prevailing high commodity prices and interest rate regime as these segments fetch higher Margins compared to the Road projects. The industry has also evolved and changed from public investment driven to the strong private public partnership (PPP) mode. Growing number of complex jobs have also given way to the domestic construction companies joining hands with global leaders to better their pre-qualifications for bagging orders. Investment in the Infrastructure Sector is expected to be about US $500bn over the next 4-5 years, which would provide immense opportunity to all players in the segment. Moreover, overseas markets such as the Middle East continue to tick in strong order inflows for the domestic construction majors. In most cases, order inflow for the quarter was higher than the Revenues expected, which is positive for the sector per se.

IVRCL

- Bagged orders worth Rs2,169cr. Largest order bagged is worth Rs893cr relating to a lift irrigation project from the Government of Andhra Pradesh.
- IVRCL's Order book stands at Rs15,969cr or 4.1x FY2008 Revenues.

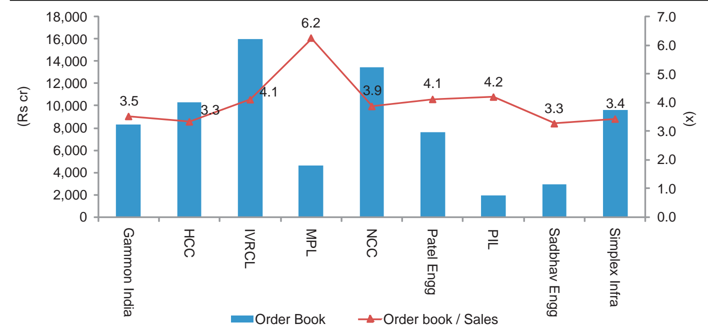
NCC

- Bagged orders worth Rs1,011cr. The largest order bagged was worth Rs484cr relating to construction of buildings.
- NCC's Order book stands at Rs13,440cr or 3.9x FY2008 Rev enues.

Patel Engineering

- Bagged the single largest order in the Irrigation segment worth Rs3,859cr (PE stake is 35%) in consortium with BHEL and Navyug Construction from the Government of Andhra Pradesh. Orders are expected to be completed over a period of 48 months.
- Order book stands at Rs7,652cr or 4.1x FY2008 Revenues.

Exhibit 2: Order Book, Order Book/ Sales Ratio



Source: Company, Angel Research

Special funding for Road, Port projects through IIFCL Bonds

The Government of India has cleared the proposal for issuance of tax-free bonds for an amount aggregating to Rs10,000cr at a coupon rate of 7.5%. The bonds would be issued by IIFCL in two tranches. These funds would be utilised in Road and Port projects. IIFCL would lend the money to banks at 8.5%. Further, the rate at which banks can lend this money to infrastructure companies has been capped at +2.5% over and above 8.5% in effect taking the cost of funds for infrastructure companies to 11%. We believe that in the current scenario of acute shortage of funds, this step by the government is in the right direction as these projects require huge funding. However, we believe that the initiative taken by the government is small considering the the quantum of funds required. We believe many more such

Infrastructure

measures need to be taken to meet the US $500bn infra spend target set by the government.

Liquidity - Sufficient, but not enough

Towards early CY2008, Capital, the back bone of the Infrastructure businesses (besides healthy Order inflows) seemed to have dried up. This was owing to RBI's monetary initiatives to curb soaring inflation. Access to capital markets also became difficult on account of the meltdown the world over, which resulted in growth stagnating in capital-intensive sectors like infrastructure.

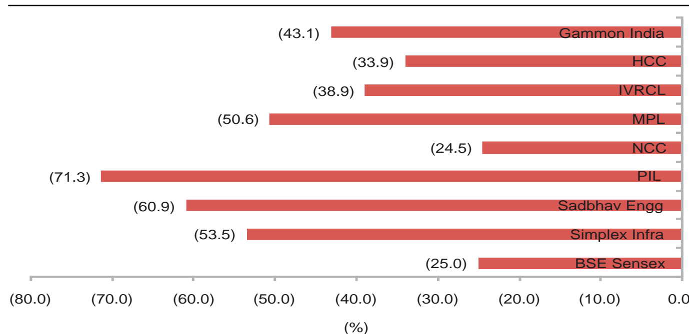
Infrastructure is the epicenter of economic growth, lack of which has a cascading effect on the economy. Hence, the RBI has taken constructive steps to ensure that there is abundant liquidity to fuel infra growth in the country. In line with this, the RBI has cut CRR in tranches. Currently, CRR is at 5.5% levels down from 9% levels in October 2008.

We believe this cut in benchmark rates has infused liquidity in the system, which will definitely help the Infrastructure sector. This positive impact was to an extent diluted due to money being pulled out by FIIs who were major sellers in the Equity markets. Nonetheless, we believe that the steps taken by RBI are in the right direction and will definitely have a positive impact on the economy and Infrastructure Sector per se.

Sensex v/s Infrastructure stocks

In terms of stock market performance, 3QFY2009 has been again one of the bad quarters for the Infrastructure space. None of the stocks have been able to outperform the Sensex. This can be majorly attributed to mayhem in markets in October 2008. However, after October some value buying has emerged and the stocks since the lows in October month have risen in the range of 50-80%. But all in all the quarter was painful as infrastructure

Exhibit 3: Relative 'Underperformance' to Sensex (3QFY2009)



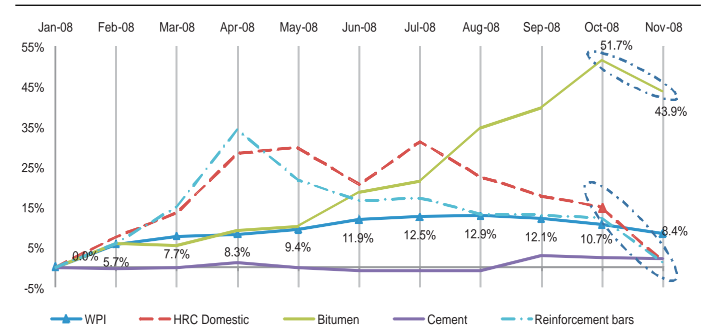
Source: C-Line, Angel Research

investors lost more as compared to Sensex. In this quarter there has been clear cut de-rating of the sector on the back of concerns like high interest rates and more than expected surge in commodity prices.

Why this Underperformance?

During 3QFY2009, infrastructure players once again continued to be a victim of high commodity prices (especially steel) and interest rate regime. These happen to be two pivotal points for EBITDA and Net Profit Margin determination respectively for infrastructure companies. We believe that the effect of these factors have impacted the stock prices resulting in underperformance vis-a-vis the broader indices. This was in spite of healthy order book to sales ratio for most of the companies in our universe. Any positive movement in these two pivotal is reflected in the margins but with a lag effect and these worries were related to Steel price prevalent about a quarter back. We expect the positives from recently witnessed cooling off in commodity prices along with softening in interest rates to be reflected in FY2010 and hence do not consider the recent hammering out effect to be a cause of concern but rather as an opportunity for long term investors.

Exhibit 4: Commodity Prices v/s WPI



Source: Bloomberg, Angel Research

What lies ahead?

We expect the infra companies to witness Margin pressure in 3QFY2009 as well as through FY2009. However, recently the commodity prices have witnessed a sharp correction. We expect infrastructure companies to benefit from this, though with lag effect (read six months). In this backdrop, we expect infra companies to bounce back in FY2010 and register better Margins.

Infrastructure

Outlook and Valuation

Passive Past

There have been visible and considerable changes in the infrastructure of the country in the past few years. Few years back, India witnessed a slowdown in the economy on account of growth in Infrastructure not keeping pace with growth in the economy. Power was short in supply, telecom was expensive, roads were congested, ports had become choke points, urban infrastructure was deteriorating. Instead of providing a fillip to growth, infrastructure had become the biggest bottleneck. The biggest reason for the poor state of infrastructure was the government policies or lack thereof. Investors were reluctant and financing was not easy.

Dynamic Present

The scenario has however changed tremendously in many ways even though on some fronts it continues to remain the same. Thus, though there has been an improvement in the state of affairs, we believe it is not adequate.

In Telecom, the quality of services has improved dramatically even as prices have fallen. Same is the case with Aviation, though most airports still require a lot of sprucing up in terms of infrastructure. The Power sector continues to suffer from shortages, even though investors' interest in the space has increased. The future looks promising, but development is delayed due to lack of clarity on the bidding process. Capacity augmentation and private participation have been slow , though non-majors have proliferated owing to which overall performance has improved. Urban infrastructure continues to be poor, though quite a few projects are being kick-started with the help of funding from the JNNURM.

Importantly, we believe that funding is no longer a constraint, even post the sub-prime crisis and resulting caution among the global investors. The private developers are willing and able to invest. We believe that the engulfing global financial crisis does not pose a threat to infrastructure funding in India, although risk-averse investors are likely to be more selective in the short to medium term. Moreover, the policy framework is also more or less in place in most sectors, though there is still considerable work to be done. But, infrastructure development is constrained by factors such as inadequate equipment manufacturing capacity, lack of project management expertise, slow clearances and local issues like land acquisition.

India's 11th FYP aims at drawing $500bn of investments to upgrade the country's infrastructure such as roads, ports, power and railways to achieve 9% average annual growth. While this will provide significant opportunities for the infrastructure service providers, builders and equipment suppliers, there are challenges from issues related to Policy, financing and project execution.

Resounding Future

In the past couple of years, Infrastructure has been a drag on overall economic growth. Over the next few years even as the economy threatens to slow down owing to global factors, we believe the Infrastructure sector will actually provide a boost to economic growth. The government is committed towards this and is most likely to ensure that expectations are met.

In sum, we believe despite constraints, India's medium-to-long-term growth story remains intact. All infrastructure players in our universe have an Order book backlog sufficient to take care of Revenue growth over the next few quarters. Players with a greater share of orders and with in-built price escalation clauses are relatively better placed. Overall, the interplay of Revenue growth and Margin pressures could lead to a dichotomy in performance among the infrastructure players. **Our Top Picks in the sector are IVRCL and Simplex Infrastructure.**

Exhibit 5: Quarterly Estimates — Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
	(Rs)	3QFY09E	*% chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*%chg*	FY09E	FY10E	Price (Rs)	
Gammon India	79	617	*18.0*	8.2	*(75.0)*	15	*(19.6)*	1.8	*(19.6)*	8.8	10.2	*16.2*	9.0	7.7	-	**Neutral**
HCC	51	907	*20.9*	12.1	*(79.7)*	20	*(19.2)*	0.8	*(19.2)*	2.6	5.9	*127.4*	19.7	8.7	70	**Buy**
IVRCL	144	1,201	*21.9*	9.6	*(170.6)*	51	*(19.9)*	3.7	*(19.9)*	16.6	22.7	*37.1*	8.7	6.3	204	**Buy**
MPL	86	241	*19.8*	12.6	*(94.1)*	9	*(27.9)*	2.4	*(27.9)*	16.1	19.6	*22.0*	5.4	4.4	151	**Buy**
NCC	72	1,017	*30.5*	9.8	*(126.2)*	40	*0.1*	1.7	*0.1*	7.5	9.5	*27.0*	9.6	7.5	96	**Buy**
PIL	67	243	*62.5*	11.0	*(167.4)*	13	*18.5*	7.9	*18.5*	19.6	26.3	*33.9*	3.4	2.6	-	**Neutral**
Sadbhav Engg	282	341	*48.2*	11.1	*(75.7)*	22	*58.2*	16.5	*58.2*	48.7	71.6	*46.9*	5.8	3.9	718	**Buy**
Simplex Infra	174	1,005	*42.8*	9.7	*(32.0)*	31	*41.4*	5.7	*41.4*	32.0	50.5	*57.9*	5.5	3.5	423	**Buy**

Source: Company, Angel Research; Price as on December 31, 2008 ; Note: Target Prices are based on SOTP

***Analyst -* Shailesh Kanani / Aniruddha Mate**

Metals

Metals 'Crash' with 'Crises'

During 3QFY2009, the BSE-Metal Index tumbled 42% in absolute terms and underperformed the BSE-Sensex by 17%. This came on the back of crash in Metal prices precipitated by the global economic crises. Metal stocks worldwide were victims of the global slowdown. The sub-prime imbroglio and the resulting financial turmoil has resulted in a liquidity crunch and impacted demand for metals globally. In line with this, Metal prices after peaking in July-August 2008 declined by more than 50% thereon, which impacted Metal equities globally.

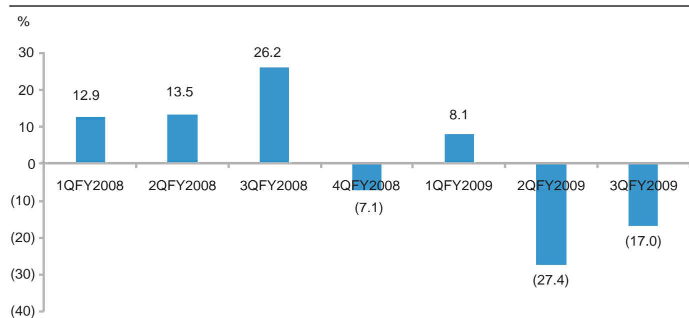
On the Indian bourses, bellwethers JSW Steel, Tata Steel, Hindalco, Nalco and Hindustan Zinc were major underperformers. Steel stocks underperformed despite some of positive measures announced by the government including removal of Export tax, restoration of Export benefits and reduction in the iron ore export duty. The recent stimulus package by the government also failed to cheer the Steel stocks. Base metal stocks also slipped on the back of the sharp correction in the LME Metal prices owing to the slow down in demand globally and inventory build up at the LME.

Exhibit 1: Sensex v/s Metal stocks (3QFY2009)

Metal Majors	Abs. Returns (%)	Relative to Sensex (%)
Sensex	(25.0)	0.0
BSE Metals	(42.0)	(17.0)
SAIL	(46.3)	(21.3)
Tata Steel	(56.1)	(31.1)
JSW Steel	(61.4)	(36.4)
Hindalco	(53.0)	(28.1)
Nalco	(50.9)	(26.0)
HZL	(58.4)	(33.4)

Source: BSE, Angel Research

Exhibit 2: Metal Index Relative Returns to Sensex

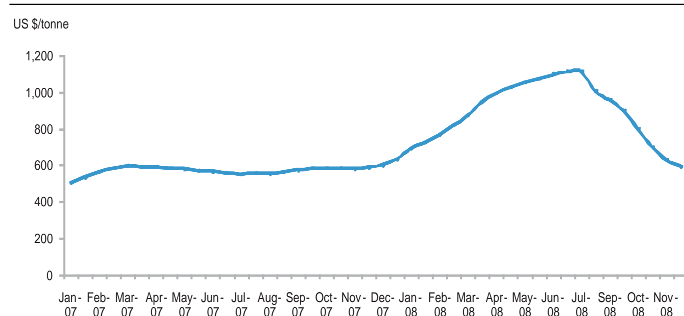


Source: BSE, Angel Research

Steel prices collapse globally

The Steel prices after peaking in July-August 2008, declined by more than 50% thereon. Overall slowdown in the global economy and liquidity crunch impacted end user sectors like Real Estate, Construction and Automobiles globally. As a result, demand for Steel declined sharply and consequently the Steel prices crashed in the last couple of months. In perspective, Benchmark World export HRC prices declined from US $1,100/tonne in July 2008 to $595/tonne currently. China's export prices have also collapsed from US $1,030/tonne to US $525/tonne in the mentioned period. Steel prices in Europe also declined to US $610/tonne from US $1,285/tonne in July 2008.

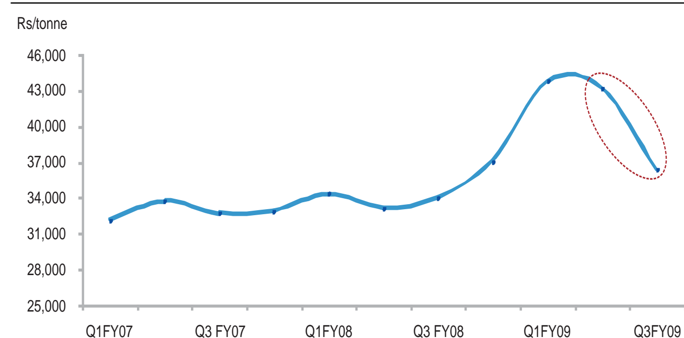
Exhibit 3: Benchmark HRC World Export prices



Source: Bloomberg

Correction in the global Steel prices also impacted the domestic prices, which fell by more than 25% from the peak of July 2008 till date. Notably, average domestic HR prices during the quarter were lower by 16% qoq at Rs36,333/tonne (Rs43,167/tonne). However, the prices were marginally higher 7% yoy from Rs33,998/tonne during 3QFY2008. We believe that the sharp fall in the Steel prices would impact realisations of the domestic steel companies during this quarter, which was otherwise high during 1HFY2009.

Exhibit 4: Domestic HRC Prices



Source: Cris Infac, Angel Research

Metals

After the sharp fall in the global Steel prices, the discount of domestic prices to landed cost has fallen significantly in the last few months compared to the huge discount that the Steel prices were quoting at during January-August 2008, when global Steel prices were ruling very high while the domestic prices were holding firm due to the government's intervention to hold prices to curb inflation. Currently, the Domestic HRC prices are higher than China's landed cost. Hence, to protect the domestic industry from cheap imports from China, the government restored the 5% import duty on Steel Products.

Key Developments during 3QFY2009

The quarter under review could be termed as a complete reversal quarter as far as the government measures are concerned. The government earlier in the year, when the Steel prices were skyrocketing, imposed several restrictive measures to control the prices in its bid to curb inflation. These measures included introduction of Export tax on Steel, removal of Export benefits, Export tax on iron ore, artificial cap on prices, etc. However, now government has initiated several steps to provide relief to the Sector. For a roundup of the major events in Steel sector during the quarter and their impact on the sector, refer Exhibit below.

Exhibit 5: Key events (3QFY2009)

Date	MajorSteel Events	Impact
01-Oct-08	Govt removes Export tax of 15% on steel, except scrap	Positive
01-Oct-08	Govt replaces iron ore Export tax of 15% to Rs200/tonne on fines. 15% Tax on lumps left unchanged	Neutral
22-Oct-08	NMDC hikes domestic iron ore prices by up to 40%	Negative
07-Nov-08	Govt impose an 8% ad valorem duty on the export of iron ore fines from Rs200/ tonne to protect the low grade iron ore producers	Neutral
15-Nov-08	The government restores Export incentives in the form of DEPB	Positive
19-Nov-08	Government imposes 5% import duty on steel products	Positive
04-Dec-08	NMDC reduces iron ore prices by 25%	Positive
08-Dec-08	Government reduces Excise Duty on Steel by 4% to 10%	Positive
08-Dec-08	Government cuts Export duty on iron ore to 0% on fines and to 5% from 15% on lumps	Positive

Source: Industry, Angel Research

Steel Sector Outlook

Steel prices have corrected by more than 50% globally and by more than 25% in the domestic markets on account of the global slowdown in the economy and end-user sectors such as Real Estate, Infrastructure and Automobiles. We do not expect the Steel prices to rebound significantly hereon due to the liquidity crunch globally and China (a major producer and consumer of Steel) also feeling the pinch of slowdown. Demand for Steel in India has been growing at a healthy 12-13% in the last 2-3 years driven by strong GDP growth and Real Estate and Construction boom. However, in FY2008, production lagged consumption and India for the first time, after almost a decade, became a net importer of steel. Going ahead, we expect demand for Steel to grow at a slower rate.

Major Steel players have announced production cuts due to the slowdown in Steel demand globally. We believe that with lower Steel prices going ahead, higher input costs (contracted coking coal) in the near term and lower volumes due to lower demand, profitability of the companies will be under pressure. We expect Top-line of Steel companies to be higher yoy due to marginally higher Steel prices during the quarter. In perspective, benchmark HRC prices were higher by 7% yoy at Rs36,333/tone. However, prices were significantly lower by 16% qoq.

However, on the Margins front, we expect the companies to turn in a subdued performance. In India, since the last couple of quarters Steel players have been witnessing pressure on Margins mainly due to the higher raw material costs. Players have not been able to pass on the cost burden to customers, due to the government intervention to control the steel prices and in turn control rising inflation. However, now with the sharp correction in the steel prices and input costs especially coking coal remaining same, we expect Margins of steel companies like JSW and SAIL to take a beating. However, Margins for Tata Steel (India) would improve marginally due to its high level of integration. Considering near-term Margin pressures, demand slowdown and uncertainty over the Steel prices, **we remain Neutral on the Sector.**

Metals

Non-ferrous Metals

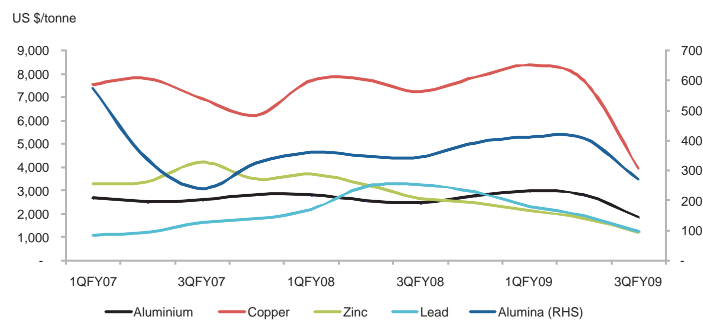
Base metal prices have also collapsed by more than 50% in the last couple of months owing to the global financial crisis. Notably the LME- Aluminium, Copper, Zinc and Lead prices have corrected by 56%, 68%, 63% and 75% from their peak, respectively. During the quarter, build up of inventories at the LME, adverse macro factors, expected slowdown in the global economy, etc. led to base metal prices at the LME averaging lower. The LME Aluminium, Alumina, Copper, Zinc and Lead prices fell substantially by 34.3%, 33.6%, 49.0%, 32.8% and 34.6% respectively, qoq. The LME prices were significantly down even on yoy basis.

Exhibit 6: Average Base Metals prices (US $/tonne)

	3QFY2009	3QFY2008	yoy %	2QFY2009	qoq %
Aluminium	1,828	2,445	(25.2)	2,785	(34.3)
Copper	3,910	7,203	(45.7)	7,672	(49.0)
Alumina	270	344	(21.6)	406	(33.6)
Zinc	1,195	2,638	(54.7)	1,779	(32.8)
Lead	1,249	3,220	(61.2)	1,912	(34.6)

Source: LME, Angel Research

Exhibit 7: LME Metal prices trend (US $/tonne)



Source: LME, Angel Research

Non-Ferrous Metals sector outlook

Base metal prices have corrected by more than 50% in the last couple of months. We expect global demand for base metals to moderate due to overall slowdown in the economy, sub-prime issues, tightening interest rates, etc. We expect average Base metal prices at the LME to decline in FY2009 and FY2010 from average FY2008 levels.

On the domestic front, demand for Base metals has been growing at a decent rate compared to growth globally due to strong GDP growth. With long-term GDP growth remaining above 5% levels and per capita consumption of Base metals lower in India compared to China and developed countries, long-term consumption story of Base metals is expected to remain intact. However, with slowdown in the domestic economy and user industries viz., Automobile, Consumer Durables, Construction, Power and Packaging, we expect demand to slow down in the short term. Over the next 1-2 years, economic slowdown, demand destruction, high inventory at the LME and hence lower average prices in FY2009 and FY2010, would impact profitability of companies in these sectors.

We expect Base Metal players like Hindalco, Nalco and Hindustan Zinc to clock de-growth in Topline owing to the sharp fall in LME prices. Their Margins are also expected to decline sharply following the slump in volumes and LME prices. **We remain Neutral on Base Metal Sector.**

Exhibit 8: Quarterly Estimates Rs cr

Company	CMP (Rs)	Net Sales 3QFY09E	Net Sales % chg	OPM (%) 3QFY09E	OPM (%) chg bp	Net Profit 3QFY09E	Net Profit % chg	EPS (Rs) 3QFY09E	EPS (Rs) % chg	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) %chg	P/E (x) FY09E	P/E (x) FY10E	Target Price (Rs)	Reco
JSW Steel*	230	3,006	17.3	26.5	(230)	303	(7.8)	15.7	(15.4)	71.5	76.1	6.4	3.2	3.0	200	Reduce
SAIL	77	11,603	21.7	22.6	(870)	1,714	(11.4)	4.1	(11.4)	16.0	12.2	(23.4)	4.8	6.3	-	Neutral
Tata Steel*	217	6,345	27.6	44.3	210	1,685	57.7	20.5	34.2	113.5	61.6	(45.7)	1.9	3.5	-	Neutral
Hindalco*	52	3,976	(12.3)	17.3	(30)	479	(11.8)	3.9	(11.8)	11.2	6.3	(43.6)	4.6	8.2	-	Neutral
Hind. Zinc	338	1,025	(38.2)	46.0	(1,700)	410	(47.8)	9.7	(47.8)	62.1	42.4	(31.7)	5.5	8.0	-	Neutral
Nalco	190	1,043	(5.9)	26.0	(1,370)	205	(37.8)	3.2	(37.8)	20.5	19.9	(3.3)	9.2	9.6	-	Neutral

*Source: Company, Angel Research; Note: Price as on December 31, 2008; * FY2009, FY2010 numbers are consolidated*

Analyst **- Pawan Burde**

Oil & Gas

Crude slumps, Refining Margins tumble

Crude has corrected significantly from its peak. So is the case with gas prices, refining and petrochemical margins. This in turn has affected performance of upstream, refining and petrochemical companies negatively but, benefited operations of oil marketing companies (OMCs), which have seen good days after a long time. Falling crude prices is also a welcome relief as India is a major importer of crude.

Crude - A victim of global slowdown

After hitting all-time highs of US $147/bbl in July 2008, oil prices have corrected ever since and recently hit a four-year low on the Nymex. The fall has been much severe than anticipated. It may be noted here that for the first time since 1983, crude oil demand is expected to witness contraction by 0.2mnbpd in 2008 (*Source: IEA Dec oil market report*). Weak demand in OECD (Organisation of Economic Co-operation and Development) countries is the prime reason for decline in oil consumption. Oil demand in the OECD countries is seen averaging 47.5million barrels per day (mnbpd) in 2008 (-3.3% or -1.6mnbpd versus 2007) and 46.9mnbpd in 2009 (-1.4% or -0.7mnbpd on a yearly basis). Declining demand of end products coupled with comfortable inventory position, increasing spare capacity and strengthening of the US Dollar against the Euro are the key reasons for the correction in oil prices.

OPEC grapples to stabilise prices

OPEC is currently pegging the fair price of oil at US $75/bbl. It is making desperate efforts to stem the fall in crude oil prices. At its September 2008 meet, OPEC had decided to maintain production. However, it agreed to cut production by 2mnbpd in its November meet. But, prices continued to fall and OPEC further cut production from 2mnbpd to 4.2mnbpd, from the actual September 2008 OPEC-11 production of 29.05mnbpd. The incremental production cut (2.2mnbpd) would be effective from January 1, 2009, with member countries strongly emphasising their firm commitment to ensure that their production is reduced by the individually agreed amounts. The cut, if implemented to the full extent by all member countries, would shave off 4.9% of daily global production of 86.5mnbpd (November 2008 production) (*Source: IEA Dec Oil Market Report*). OPEC is targeting forward cover of 52 days (normal inventory level during this period of the year) of inventory for maintaining prices at higher levels. Effectiveness of the OPEC as a cartel now lingers on the fact whether member nations adhere to production cuts or not. Initial reports suggest that compliance levels are close to 50% levels. However, off-late there is some improvement in the same.

Similarly, Refining margins have also significantly corrected impacted by the global economic slow down. Refining margins mostly fell in November, as gasoline and naphtha weakness continued to weigh on spreads. Gasoline cracks remained in negative territory during the quarter. The most pronounced fall was on the US West Coast, which was particularly hit hard by falling gasoline prices. Similarly, the weak petrochemical demand weighed heavily on the naphtha cracks. However, the distillate crack spread remained healthy during the quarter. Singapore hydro-skimming margins were US $-0.049/bbl and US $-2.74/bbl during the months of October and November (*Source: IEA Dec Oil Market Report*). However, some recovery has happened during December.

Auto fuels cheaper, cooking fuels unchanged

Much to the delight of Indian consumers, auto fuel prices have been slashed. Since February 2007, for the first time the country saw a cut in Auto fuel prices (Petrol - Rs5/litre, Diesel - Rs2/litre). However, cooking fuel (domestic LPG and PDS kerosene) prices were left unchanged. This in a way is part reversal of the fuel price hike effected in June 2008 (Petrol - Rs5/litre, Diesel - Rs3/litre, domestic LPG - Rs50/cylinder). We believe further cuts are in store.

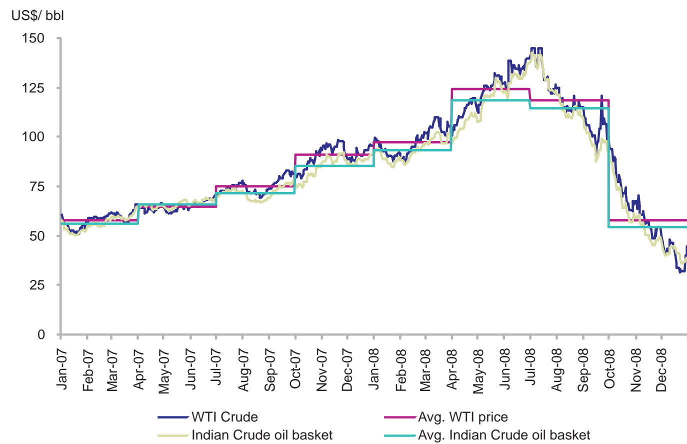
Reducing crude oil prices have come as a welcome relief for the Indian economy, which is largely dependent on crude oil imports (70% is imported). In FY2008, India had imported 121.67mn tonne of crude oil with the oil import bill touching US $68bn. In FY2009 this far, India has already shelled out US $60bn to import 76.20mn tonne of oil between April and October. The fall in prices is likely to ease the government's subsidy burden significantly. At the beginning of the fiscal, under-recoveries for the year was pegged at Rs2,05,000cr, which would now be lower at Rs1,10,000cr due to the steep correction in crude oil prices.

Retailing of petroleum products has also become economically viable now with the fall in crude prices. It has also attracted private retailers such as RIL, Essar Oil and Shell India once again towards this business. Currently, the break-even petrol prices hover at around US $80/bbl, and break even diesel prices are at around US $60/bbl. Domestic LPG's breakeven price is at around US $40/bbl and PDS kerosene is at US $20/bbl.

The Indian basket of crude tumbled to an average US $54.5/bbl during 3QFY2009 as against the 2QFY2009 average of US $115.0/bbl.

Oil & Gas

Exhibit 1: WTI Crude, Indian Basket of Crude Oil

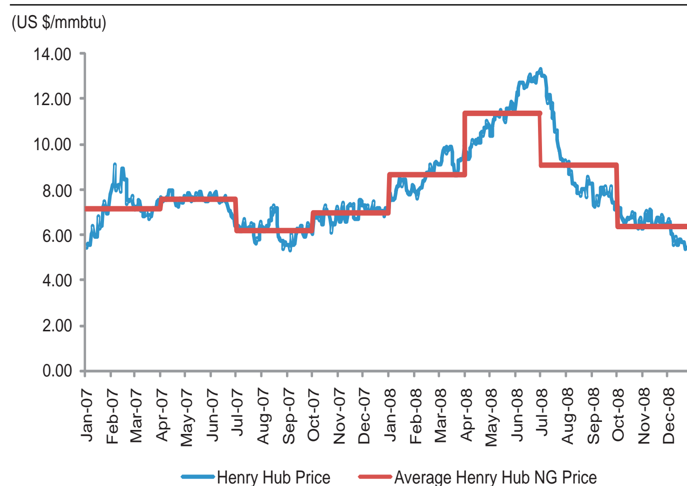


Source: Bloomberg, Angel Research

We expect crude to remain subdued in the near term amidst concerns of a slowing global economy coupled with time required for OPEC production cuts to have impact on inventory position and demand-supply equation. We believe oil prices are likely to hover around US $40 - 50/bbl in the visible future.

Gas prices also corrected significantly in line with crude oil prices and averaged at US $6.36/mmbtu in 3QFY2009 against the average price of US $9.06/mmbtu in 2QFY2009. Spot LNG prices have also reduced from US $18-20/ mmbtu to current levels of US $12-13/mmbtu. However, it is still higher than the naphtha prices. We believe that the spot LNG prices are likely to fall over the next 3-6 months.

Exhibit 2: Natural Gas - Henry Hub prices



Source: Bloomberg, Angel Research

Major developments

NELP VII winners awarded bocks, NELP VIII in Feb, 2009

Like bidding, awarding NELP blocks was also delayed. But, finally out of the 45 blocks for which bids were received (57 blocks were on offer), PSCs (Production Sharing Contract) were signed for 44 blocks and 1 block (Cairn Energy's bid for Mumbai basin deepwater block) was rejected. ONGC, along with its partners, bagged highest number of blocks (20). Total investments of US $1.5bn has been committed in these 44 blocks awarded in NELP VII. The next round, NELP VIII, is scheduled in February 2009 despite the fact that the global financial crises and low crude oil prices is expected to dampen participation of foreign companies. NELP VIII is expected to be the largest-ever auction in India covering an area of 4,00,000 sq. km. and more than 100 blocks will be on offer (v/s 1,50,000 sq. km. and 57 blocks on offer in NELP VII).

RPL's export refinery goes on stream

RPL (RIL's subsidiary) commissioned its refinery and commenced trial productions at the same. This 5,80,000bpd export-oriented refinery (sixth largest refinery in the world) makes Jamnagar a refinery hub with total refining capacity of 1.24mnbpd (largest capacity at a single location in world). The refinery comes at the time when refining margins have been impacted by the global slowdown and falling demand for petroleum products. However, due its superior configuration and high complexity, RPL's refinery is likely to report decent margins going ahead.

Guj Government's socio-economic directive to pay 30% of PBT - A dampener for GSPL

The Gujarat government has directed all Gujarat state-owned companies to contribute 30% of PBT for socio-economic causes. This is a severe blow for companies like GSPL, which have consented to contribute 30% of profits for socio-economic causes. In a separate event, the company has stated it could not invoke take or pay agreement in RIL's gas transportation volumes. This is again a major setback for its near-term Earnings estimates.

OVL closes Imperial deal

After much debate about the valuation of the deal, OVL has finally completed the Imperial acquisition towards end 3QFY2009. Declining crude prices had raised concerns over the valuations accorded to the deal with talks of OVL revisiting the valuations. However, the UK Take-over Code and reputation of the country prevented the fallout of the deal. The focus now shifts to the execution capabilities of the company to generate good returns

Oil & Gas

from the deal. The deal offers good long-term volume growth prospects for OVL along with providing energy security for the country.

Outlook

ONGC's performance over the last couple of years has largely been dependent on the subsidy sharing mechanism. 1QFY2009 was a good quarter for the company due to the relatively lower subsidy burden devised by the government. However, due to the high crude prices, the company's net realisation fell in 2QFY2009 to US $46.7/bbl (due to high subsidy burden of US $72.7/bbl). However, post 2QFY2008 the scenario has changed significantly following the steep correction in oil prices. In 3QFY2009, we expect some subsidy overhang to persist and estimate net realisations to fall to US $38.5/bbl due to subsidy share of US $20.9/bbl.

GRMs softened significantly in 3QFY2009. The major variable, which is likely to impact core GRMs, is the extent of inventory losses owing to sharp decline in crude prices during the quarter. RIL's performance is likely to come under pressure due to the margin squeeze in both the Refining and Petrochemical segments. RIL's Refining Margins had declined from US $15.7/bbl in 1QFY2009 to US $13.4/ bbl in 2QFY2009. We expect further decline in 3QFY2009 to US $9.0/bbl.

OMCs (IOC, HPCL and BPCL) are expected to benefit from declining crude prices with their Marketing Margins expected to be back in positive territory. However, inventory losses are likely to be witnessed on the refining side, which could drag down their refining margins. Moreover, beneficiaries of the correction in crude still needs to be ascertained given that more price cuts are likely to be witnessed in administered products such as, petrol and diesel.

Gujarat Gas continues to be constrained by the lower gas supplies on account of which volumes are expected to be subdued at 2.88mmscmd during the quarter. However, the same is marginally higher on both on qoq (increase of 1.0%) and yoy basis (increase of 0.6%). We estimate gas cost during the quarter to increase because of depreciation of the Rupee as the company has sourcing agreement priced in US Dollars. However, on account of the price hikes implemented in April and volume substitution from lower margin business (industrial bulk segment) to higher margin business (industrial retail and CNG segment) is likely to be cushioned to an extent.

GSPL is also expected to witness subdued volumes during the quarter owing to the fall in naphtha prices. Our Earnings estimates for the quarter for GSPL does not factor in 30% PBT sharing with the government of Gujarat as the shareholders' approval is still pending. We believe 30% PBT sharing for the full year will be provided in 4QFY2009, resulting in negative Earnings for that quarter.

In spite of a decline in volumes to the tune of 5.3% yoy, Petronet LNG is likely to witness strong sales growth of 27.0% driven primarily because of depreciation of Rupee against the Dollar over the last one year. However, as the company passes through the Rupee fluctuation to the off-takers, it's Margins are insulated from currency fluctuations.

We estimate GAIL to register robust Sales growth for the quarter driven by higher transmission volumes and lower subsidy burden. However, we estimate the company's Petchem margins to be marginally under pressure.

IGL is likely to continue to post strong volumes growth driven by increased conversion of CNG vehicles witnessed during trailing one year. CNG volumes during the quarter are estimated to have registered an increase of 19.3% yoy.

Overall, 3QFY2009 is likely to be mixed for our universe of stocks.

Exhibit 3: Quarterly Estimates — Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		FDEPS (Rs)		FDEPS (Rs)			P/E (x)		Target	Reco
	(Rs)	3QFY09E	% chg	3QFY09E	chg bp	3QFY09E	% chg	3QFY09E	% chg	FY09E	FY10E	%chg	FY09E	FY10E	Price (Rs)	
GAIL	206	6,364	*48.1*	15.7	*(460)*	728	*17.2*	5.7	*17.2*	23.1	26.8	*15.7*	8.9	7.7	298	**Buy**
GSPL	34	106	*(4.0)*	87.1	*(70)*	21	*(16.3)*	0.4	*(15.6)*	2.5	4.1	*64.0*	13.6	8.3	-	**Under Review**
Gujarat Gas*	233	341	*(1.5)*	14.9	*(360)*	33	*(16.6)*	5.1	*(16.4)*	25.9	28.4	*9.7*	9.0	8.2	340	**Buy**
IGL	102	219	*19.7*	40.7	*(200)*	50	*11.1*	3.6	*12.5*	14.5	14.6	*0.7*	7.0	7.0	-	**Neutral**
Petronet LNG	40	2,008	*27.0*	9.0	*(570)*	100	*(24.0)*	1.3	*(23.9)*	7.4	7.7	*4.1*	5.4	5.1	80	**Buy**
ONGC ^	668	11,745	*(22.3)*	43.7	*(942)*	2,782	*(36.3)*	13.0	*(36.3)*	101.0	108.1	*7.0*	6.6	6.2	948	**Buy**
RIL ^	1,230	28,354	*(18.0)*	19.0	*213*	3,079	*(20.7)*	19.6	*(26.7)*	102.5	130.9	*27.8*	12.0	9.4	1,440	**Buy**

*Source: Company, Angel Research, Price as on December 31, 2008; Note - *Calender year, ^ standalone numbers for the quarter and consolidated numbers for full year, RIL 3QFY2008 PAT excludes profits from sale of RPL's stake.*

***Analyst* - Deepak Pareek / Amit Vora**

Pharmaceutical

R&D suspension

Glenmark, which has successfully monetised its R&D pipeline through out-licensing the molecules, received a set-back when Eli Lilly decided to suspend clinical trials of its pain drug molecule GRC-6211. Eli Lilly decided to stop further development of the drug molecule post certain adverse findings. This is a second setback for the company. Earlier during the last year, the German drug company Merck KGaA ended a licensing deal with Glenmark for its diabetes drug, GRC 8200.

Eli Lilly's decision comes a year after it entered into a US $350mn licensing deal with Glenmark to take the molecule and a portfolio of other pain drugs through the final stages of clinical trials, in return for marketing rights in the US, Europe and Japan. The GRC 6211 molecule was then at mid-stage trials. Glenmark had received an upfront fee of US $45mn at the time of the deal and the balance sum was to be paid at different stages of drug development.

Exhibit1: R&D Pipeline - Snapshot

Compound	Status	Comments
GRC 3886 (Oglemilast)	Phase II	Out-licensed North American rights to Forest Labs.
GRC 8200 (Melogliptin)	Phase II	Last year Merck ended the licensing deal due to portfolio restructuring.
GRC 6211	Suspended	Eli Lilly suspended further development after adverse findings.
GRC 4039	Phase I	Completion of Phase I Trials, Phase II to be initiated.
GRC 10693	Phase I	Expected to enter Phase II before the end of FY'09.
GBR 500	Phase I	Filed an IND application with the US FDA for initiation of Phase I trials.
GRC 15300	Pre-Clinical	Expects to file a Phase 1 application by January '09
GBR 600	Pre-Clinical	Expects to file for Phase 1 by March '09.
GRC 9332	Pre-Clinical	Plans to file a Phase 1 application by the end of this financial year or early next year.

Source: Company

In terms of pipeline, Glenmark has thirteen new molecules under development with six in clinics and one NCE and three NBEs at discovery stage.

We believe such suspensions are part of, given low success ratio in the R&D business. Despite this setback, the company maintained its initial FY2009 out-licensing income guidance of US $69mn. Cumulatively, over the years Glenmark has received US $110mn cash from NCE out-licensing deals.

USFDA's scrutiny mounts

The USFDA is getting tougher on the Indian drug manufactures. After banning Ranbaxy's 30 drugs manufactured at two of its Indian facilities-Ponta Sahib and Dewas in September 2008, in November USFDA cracked its whip on Sun Pharmaceuticals and Lupin.

Sun Pharma was pulled up by the USFDA for "inadequate and untimely" quality checks at its Caraco facility. Caraco, a 76% subsidiary of Sun Pharma distributes Sun products apart from selling its own products in the US markets. However, unlike Ranbaxy, USFDA has not banned any product sales from the facility, but has frozen new drug approvals from the facility. The company has responded to the warning and does not expect the USFDA warning to have any impact on approval of application from Sun's other plant. The company has also decided to strengthen its internal process and mechanism to resolve the issue. As on 2QFY2009, the company had 96 ANDA pending approvals with the USFDA, of which around 19 ANDAs belong to Caraco.

In case of Lupin, the USFDA inspected its Mandideep facility and issued a report with 15 inspectional observations, following a routine GMP audit of the facility. Lupin alleged that outcome of this inspection does not affect supply of the products manufactured at this facility or the approvability of the pending applications with the USFDA. Lupin has also indicated that it responded to eight of the observations immediately and would be submitting a complete response to USFDA expeditiously. Any adverse result would impact the company's performance as Mandideep is its only USFDA approved plant to manufacture Cephalosporin and Prilis, which are significant contributors to its US Revenues.

The level of USFDA's scrutiny of Indian manufactures has definitely increased in the past few months, but we believe the issues raised can be resolved. However, we expect companies to be more cautious going forward.

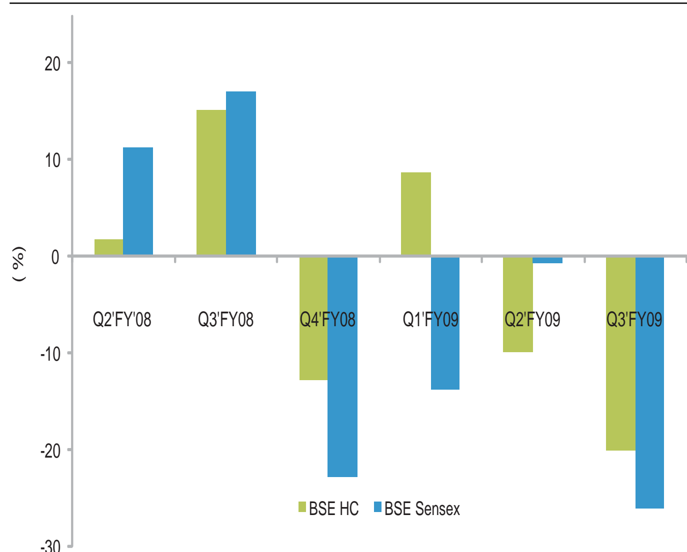
Pharmaceutical

Piramal Healthcare on Acquisition spree

During the quarter, Piramal Healthcare announced acquisition of Minrad International, a provider of generic inhalation anaesthetic, for a total consideration of US $40mn. Minrad, founded in 1996, has transformed itself into generic provider of Inhalation Anaesthetic products, which contributed 98% of Total Revenues in the first nine months of CY2008 with all four key products (Desflurane-ANDA filed, Sevoflurane, Enflurane and Isoflurane) under its portfolio. With the Minrad acquisition, Piramal will have all products of the Anaesthetic segment under its portfolio making it the third largest player after Abbott and Baxter in the US Inhalation Anaesthetic market. Management expects the acquisition to be marginally EPS accretive from FY2010.

BSE Healthcare Index outperforms the market

Exhbit2: BSE HC v/s BSE Sensex



Source: C-Line, Angel Research

During 3QFY2009, the BSE Healthcare Index (BSE HC) plunged by 20.1% in absolute terms but out performed the BSE Sensex by 6.0%. The out performance came on back of correction in prices in 2QFY2009 making the valuation attractive and defensive nature of the sector.

From the stock point of view, Ranbaxy relatively outperformed the BSE Sensex closing flat qoq on account of a sharp correction witnessed in 2QFY2009 and completion of the Daiichi deal during the quarter. Dr.Reddys (DRL) also out performed the Sensex on account of AOK tender win by Betapharm, its German subsidiary and launch of authorized generic version of GlaxoSmithKline Imitrex *(Sumatriptan Succinate)*. However, Orchid Chemicals and Wockhardt Pharma continued to under perform on concerns of high leverage and re-financing of FCCBs.

Rupee depreciation to play out

Indian pharma companies are set to benefit from a depreciating Rupee as they are primarily net exporters with exposure to the US Dollar and Euro. During the quarter, the US Dollar and Euro, on an average, yoy depreciated by 23.5% and 12.6%, respectively. However, overall impact of the deprecation on Profitability would be on the lower side as most of the companies 1) import significant portion of their raw material requirement, 2) have taken currency hedges by way of forward contracts, and 3) have foreign currency debt on their books. Therefore, extent of the gains would vary from company to company depending on the proportion of exports and extent of forward cover.

Exhibit3: Net Exports (FY2008)

Company	Net Export as a % of Sales
Alembic	22
Aventis*	1
Cadila Healthcare	32
Cipla	35
Dishman Pharma	75
Dr.Reddys	63
Indoco Remedies	17
Jubilant Organosys	46
Piramal Healthcare	44
Orchid Chemical	64
Ranbaxy*	65
Sun Pharma	48
Wockhardt*	67

*Source: Company, Angel Research; Note: * YE CY2007*

3QFY2009 expectations

The Indian Pharmaceutical sector is expected to post robust growth on the Sales front aided by high deprecation of the Rupee during the period. For the stocks in our universe, we expect them to post 24.6% rise in Sales mainly on the back of higher growth on the exports front. Apart from Rupee deprecation, companies like DRL and Orchid Chemicals would also benefit from big drug launches during the period. During the quarter, DRL and Orchid are expected to reflect benefits of launch of the generic version of *Sumatriptan Succinate* and *Piperacillin Tazobactum*, respectively.

On the Operating front, baring a few, Operating Margins are expected to remain stagnant or inch slightly upwards.

Pharmaceutical

Rupee deprecation would also impact the results in mark-to-mark losses for the companies with the foreign currency loans and FCCBs on the books. The companies would be impacted by translational losses due to FCCBs include Ranbaxy, Wockhardt and Orchid Chemicals.

Indian large-cap DRL to be an outperformer: Among the Indian large caps, most are likely to post double-digit growth on the sales front, aided by robust growth on the exports front and rupee depreciation. Notable performance amongst the large caps is expected from DRL and Sun Pharmaceuticals. DRL launched its *Sumatriptan Succinate* during the quarter, which would aid increase its Sales and Net Profit growth during the period. We estimate the company to post 76.1% rise in Net Profit. Sun Pharmaceuticals, on the other hand, is expected to post 39.7% and 41.2% rise in Sales and Net Profit.

Other large caps like Ranbaxy and Cipla are also expected to post robust double-digit growth for the period. Ranbaxy's performance during the quarter would be aided by exports and Rupee deprecation. The recent ban on import of 30 drugs into the US markets would start reflecting in its US performance. On the Operating front, Margins are expected to contract by 40bp owing to higher SG&A and R&D expenditure during the period. This, along with translational losses during the period would have its impact on the company's Net Profits. Cipla, on the other hand, is expected to post robust performance on the Sales and Operating fronts. We expect the company to post a 22.7% rise in Sales and a 270bp expansion on the Operating front. However, lower Other Income during the period would restrict overall Net Profit growth to around 7.7%.

Mid-cap Piramal Healthcare to ride higher growth in Indian CRAMS Business: Amongst the Mid-caps, Piramal Healthcare is expected to post robust performance on the back of robust Sales growth in the CRAMS segment mainly aided by robust growth in Sales from Indian Assets. This along with reduced R&D expenditure would aid improvement on the Operating front. Overall, we have factored in 560bp improvement in the company's Operating performance. This improvement in OPM would aid a 69.6% increase in Net Profits.

Among other Mid-cap companies, we expect Cadila Healthcare to post robust performance for the quarter under review. The company is expected to post 23.7% rise in Sales mainly aided by the 34% growth on the Exports front. On the Operating front, Margins are expected to expand by 100bp. Overall, the company is expected to post 30.2% rise in Net Profit.

Outlook and Valuation

During the quarter, the Pharma Sector continued to be bogged down by slew of negative news flow. In the last one year the sector outperformed the Sensex even though stocks in the space witnessed significant battering down. We this has improved the risk-reward equation for the investors. However, given the challenges in the sector, we advocate stock specific investments in the space. Segment-wise, we continue to favour CRAMS. This space is expected to witness secular growth and provide the players immense opportunity on account of the challenges being faced by Innovators and cost reduction benefits. **We maintain a Buy on Ranbaxy, DRL, Cadila Healthcare, Piramal Healthcare, Orchid Chemicals, Wockhardt, Alembic and Indoco Remedies.**

Exhibit 4: Quarterly Estimates **Rs cr**

	CMP	Net Sales		OPM (%)		Net Profit		FDEPS (Rs)		FDEPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	3QFY09E	*% chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*%chg*	FY09E	FY10E	Price (Rs)	
Alembic	31	299	*16.7*	12.1	*60*	15	*(63.3)*	1.1	*(63.3)*	3.3	6.3	*90.9*	9.5	5.0	44	Buy
Aventis#	953	232	*13.6*	15.6	*140*	32	*16.7*	13.7	*16.7*	68.1	71.7	*5.3*	14.0	13.3	1,209	Buy
Cadila Healthcare	268	695	*23.7*	16.2	*100*	67	*30.2*	5.4	*30.2*	25.4	31.5	*24.0*	10.5	8.5	450	Buy
Cipla	187	1,235	*22.7*	19.0	*270*	227	*7.7*	2.9	*7.7*	10.0	11.5	*15.0*	18.7	16.3	-	Neutral
Dr.Reddys	470	1,612	*35.5*	14.4	*190*	110	*76.1*	6.5	*76.1*	28.6	32.2	*12.6*	16.4	14.6	581	Buy
Glaxo#	1,147	356	*5.0*	29.8	*(40)*	69	*(14.6)*	7.9	*(14.6)*	51.6	57.9	*12.2*	22.2	19.8	1,250	Accumulate
Indoco Remedies	128	79	*(12.9)*	12.1	*(590)*	5	*(57.0)*	4.2	*(57.5)*	33.2	40.7	*22.6*	3.8	3.1	204	Buy
Orchid Chemicals*$	92	319	*33.5*	32.8	*20*	4	*(85.0)*	0.6	*(85.0)*	22.5	30.4	*35.1*	4.1	3.0	210	Buy
Piramal Healthcare	239	823	*12.4*	22.1	*560*	123	*69.6*	5.9	*69.6*	21.2	22.4	*5.7*	11.3	10.6	340	Buy
Ranbaxy Lab#	252	2,321	*30.1*	9.7	*(40)*	74	*(60.4)*	1.7	*(65.6)*	14.7	19.3	*31.3*	17.2	13.1	316	Buy
Sun Pharma	1,065	1,104	*39.7*	43.0	*(190)*	450	*41.2*	25.6	*41.2*	84.6	70.7	*(16.4)*	12.6	15.1	1,273	Buy
Wockhardt#	108	820	*7.6*	22.1	*(280)*	78	*(26.8)*	7.2	*(26.8)*	32.7	40.4	*23.5*	3.3	2.7	230	Buy

Source: Company, Angel Research; Price as on December 31, 2008; Note # -Q4CY2008 , Note- The quaterly numbers are Standalone Financials, $-18 Month Target*

Analyst **- Sarabjit Kour Nangra / Sushant Dalmia**

Power

Power sector in times of financial crisis - A status check

The third quarter of FY2009 saw the global financial scenario worsening. Almost all sectors in the economy faced the brunt of credit crunch with the Power sector being no exception. The sector witnessed deferral of bidding for a number of power projects. Although we believe that the crisis would not affect the projects for which financial closures have been completed, possibility of delays in awarding new projects or delays in commencement of new projects cannot be ruled out. With financing of the Power sector following the 70:30 debt-equity route, projects of some of the financially weak state electricity boards (SEBs), seem to have already hit road blocks. The Union government though, seems unfazed with its argument that the sector is largely unaffected by the current crisis as most of the funding had been tied up and many large projects have achieved financial closure.

In fact some recent government measures to ease liquidity coupled with lowering of interest rates are expected to provide relief to the Power sector. Falling commodity prices are also expected to bring down the overall cost of projects.

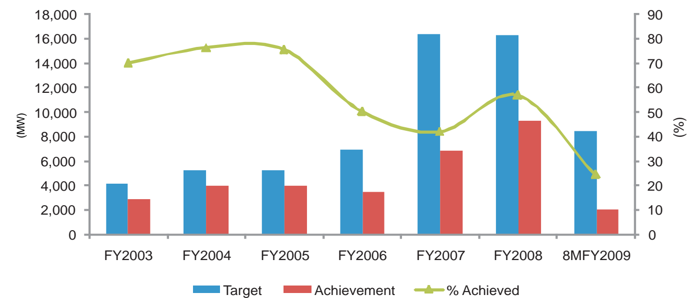
Capacity Addition - 'A tall order'

Actual capacity addition during the first 8 months of the current fiscal was less than 25% of the targeted capacity addition. As against the targeted capacity addition of 8,471MW, only 2,059MW was added. Delays in the supply of critical BTG and BOP equipment were the primary reasons for slippages in capacity addition. Total installed power generation capacity in India stood at 1,46,902MW as of November 30, 2008.

Power generation targets too have not been met during 8MFY2009, partly due to the failure in achieving capacity addition targets and lower utilisation of existing plants. PLF for 8MFY2009 stood at 74.65% as against the targeted PLF of 77.95%. Power deficit for the period of April - November 2008 stood at 10.6%.

Capacity addition targets for transmission lines too have not been met with actual capacity addition being, 156 circuit km (ckm) as against the target of 670ckm in the case of 500KV HVDC lines during 8MFY2009. The total addition to other categories of transmission has been 6,812ckm as against target of 9,919ckm. During 8MFY2009, 5,238MW of sub-station capacity was added as against the targeted 7,275MW.

Exhibit 1: Generation Capacity Addition - Target v/s Achievement



Source: CEA, Angel Research

CERC guidelines

During the quarter, the Central Electricity Regulatory Commission (CERC) issued its order restricting prices of electricity in the short-term market. As per the new order, CERC is empowered to fix price caps for inter-state sale of electricity to an electricity trader and sale by one licensee to another licensee, whether distribution licensee or electricity trader.

The final order is yet to be passed on the CERC's proposal on rationalisation of tariff terms for generation and transmission companies. The proposal, if passed, is not expected to impact CESC, which has secured its multi-year tariff order for FY2008-11 from the West Bengal Electricity Regulatory Commission (WBERC).

Fuel shortage persists

Thermal plants continued to face fuel shortages during the quarter. As of November 27, 2008 51 coal-based stations out of the 79 monitored by the Central Electricity Authority (CEA), had coal stocks of less than seven days while 33 stations had stock of less than four days. According to CEA's report, this far, 5.6 billion units of generation have been lost by power stations till October 2008 due to unavailability of adequate coal.

The CEA report cited non-receipt of coal, inadequate linkage and law and order problems as reasons for the current situation. Fuel shortage is attributed to the fact that the Coal sector is growing at a much slower pace than the Power sector. Moreover, the supply crisis is expected to majorly impact future power projects, especially the private power developers who have been assigned projects but have not yet received fuel supply linkages.

To tackle the coal shortage, the Coal Ministry has asked Coal India (CIL) and its subsidiaries to scale up production to 405MMT

Power

from 381MMT planned earlier. The Power Ministry intends to import 20MMT of coal in FY2009 while NTPC and CIL plan to import 8MMT and 4MMT of coal, respectively. The Power Ministry has also asked generation utilities to import 25MMT in FY2010 and accordingly place the necessary orders in January 2009. Railways and Shipping authorities have been requested to make necessary arrangements for coal movement to coal-based power plants. The situation is no better in gas based plants too, with capacities capable of generating 5,000MW of power lying idle on account of gas shortage in the country. The gas supply position in the country is expected to improve once supply from the K-G basin commences.

On the part of the Indian companies, they are either looking at acquiring stakes in Indonesian coal mines or are entering into long-term contracts for the supply of coal from Indonesia. For instance, Tata Power owns 30% stake in PT Bumi Resources Tbk's mines in Indonesia to meet the requirements of the Mundra UMPP. Reliance Power, GMR Energy, JSW Energy and Emco are some other companies, who own stakes in Indonesian coal mines.

Key Developments

NTPC: The company in joint venture (JV) with NHPC, Power Finance Corporation and Tata Consultancy Services has set up a power exchange at the national level called, 'National Power Exchange Limited'. NTPC's stake in the JV would be 16.67%. The company is also looking at finalising a JV partner for venturing into cement manufacture.

During the quarter, not much headway was made in some of the longstanding disputes involving NTPC such as hiving off of the LNG terminal of the Ratnagiri power project in which the company holds 28.33% stake, legal tangle over pricing of gas to be supplied by RIL from the KG-basin and the issue with Technoprom over the supply of boiler for the coal-based plant in Barh. NTPC didn't commission any new power plants during the quarter but asserted that its capacity addition plans are on track.

CESC: During the quarter, CESC got its tariff order for FY2009 from the West Bengal Electricity regulatory commission (WBERC). The commission fixed the average tariff at Rs3.91/unit (old tariff of Rs3.86/unit) with effect from April 1, 2008. This change in tariff is expected to provide additional revenues to the company.

During 3QFY2009, CESC entered into a contract with SP Global Solutions (SPGS), a subsidiary of Singapore Power, for providing consultancy support aimed at improving the standard of distribution in the CESC licensed area. CESC is expected to invest Rs 2,000cr over the next three to five years for technology upgradation to revamp its distribution network.

CESC's retail arm, Spencer's Retail, targets to turn profitable in the next 12 months. As part of its strategy, Spencer's has decided to shut 56 unviable stores - 40 have already been closed and another 16 are expected to be shut in the next 3 months.

GIPCL: At the company's 2X125MW Surat Lignite Power Project, fire broke out in the main lignite feeding conveyer system. Hence, the company stopped power generation at the unit. The conveyer system now has been repaired and the generation loss has been limited to 20-25 days.

PTC: The 450MW Baglihar HEP (BHEP) commenced operations in October 2008 and is expected to contribute substantially to PTC's total traded volumes FY2010E onwards. PTC has tied up for trading 50% of the power generated by BHEP. Recently, the company formed a subsidiary, PTC Energy to make asset-based investments. PTC proposes to invest in green-field power projects, group captives, wind power and the distribution segment through this subsidiary.

PTC is setting up a joint venture (JV) with Singapore-based firm Asian Infratech for identifying and acquiring companies overseas. PTC will have 50% stake in the JV. The company said it will be bidding for acquiring entire operations of coal mines on sale and will also look at picking up minority stake in coal and power companies.

Performance of Power stocks during 3QFY2009

3QFY2009 was mixed bag in terms of the performance of power stocks under our coverage. PTC was the best performer amongst all the stock under our coverage and gained a handsome 7.1% and NTPC continued to outperform the index and gained 5.4%. While CESC fell by 15%, GIPCL was the worst hit power stock declining by a whopping 24% though in relative terms it fared slightly better than Sensex which shed 25%. The BSE power index too declined by 19.1% during the quarter, in line with the fall in Sensex. While concerns continued to prevail over the valuation of the power companies, the sector was also impacted by the overall poor performance of the stock markets.

Power

Exhibit 3: Performance on the Bourses

Power majors	Absolute Returns (%)	Relative to Sensex (%)
Sensex	(25.0)	
BSE Power	(19.1)	5.9
CESC	(14.8)	10.2
GIPCL	(23.7)	1.3
NTPC	5.4	30.4
PTC	7.1	32.1

Source: BSE, Angel Research

Top-line growth powered by Capacity addition

The major power generation companies under our coverage, NTPC, GIPCL and CESC are expected to report strong Top-line growth in 3QFY2009 to the tune of 9.8% yoy.

We estimate market leader NTPC to report 10% yoy growth in Net Revenues during 3QFY2009. We estimate NTPC to augment capacity by 3,000MW this fiscal. Capacity addition and improvement in tariff realisations are expected to be the key growth drivers of this business.

For 3QFY2009, we estimate GIPCL to clock 9.9% yoy growth in Revenues on the back of increase in fuel costs. GIPCL's capacity expansion has been delayed by six months and we expect first phase to get commercially operational by end 1QFY2009. We estimate the company's PAT to de-grow by 17.7% yoy in 3QFY2009.

For 3QFY2009, we expect CESC to record 6% yoy growth in Top-line. As in the case of NTPC and GIPCL, we expect the strong growth to be driven chiefly by continued strong increase in fuel costs. Moreover the new tariff order issued by the WBERC increasing the average tariff to Rs3.91/unit for FY2009 is expected to result in incremental revenue.

For 3QFY2009, we expect PTC to record 38.8% yoy growth in Top-line. Volumes would increase primarily on account of commissioning of the 450MW Baglihar HEP.

Bottom-line estimated to post marginal growth

We expect the power companies in our universe to report marginal growth in Bottom-line for 3QFY2009. We estimate NTPC to record Bottom-line of around 11% yoy while GIPCL is expected to register de-growth of 17.7% in Net Profits yoy. However, we expect CESC to report 12.1% yoy increase in Net Profits mainly on account of higher realisations. We expect PTC to post a phenomenal 238% rise in Net Profits to Rs21cr. This performance is expected to be driven by the significant contribution by the high-Margin LTT segment to Top-line and Other Income.

We remain Positive on the Power sector

The Indian Power Sector is still evolving, but it is expected to be the principal driver of the Indian Economy, which notwithstanding the current economic slowdown, is expected to grow at a rate higher than most other economies of the world. India's power deficit is increasing even though the country's per capita power consumption is amongst the lowest globally. With India's demand for power set to almost double over the next 10 years, capacity addition in the sector is the need of the hour. With the country expected to witness substantial capacity addition in the future, we expect Revenues of power companies to grow at a healthy pace.

Also the stimulus package that was announced by the central government in December 2008, which contained a duty cut on Naphtha for power generation is expected to lower the cost of generation for the units that run on Naphtha. We estimate our universe of stocks to witness 12-15% Top-line growth over the next couple of years.

We remain positive on the sector at lower valuation multiples which is on account of the recent steep correction in the broader indices and the Power stocks, the sector has also witnessed a multiple de-rating. CESC and GIPCL remain our Top Picks in the Power space.

Exhibit 4: Quarterly Estimates **Rs cr**

Company	CMP (Rs)	Net Sales 3QFY09E	Net Sales % chg	OPM (%) 3QFY09E	OPM (%) chg bp	Net Profit 3QFY09E	Net Profit % chg	EPS (Rs) 3QFY09E	EPS (Rs) % chg	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) %chg	P/E (x) FY09E	P/E (x) FY10E	Target Price (Rs)	Reco
CESC	238	717	*6.0*	23.4	*44*	104	*12.1*	8.3	*12.1*	31.8	34.2	*7.5*	7.5	7.0	449	**Buy**
GIPCL	46	267	*9.9*	23.8	*(342)*	31	*(17.7)*	2.0	*(17.7)*	6.0	7.8	*31.2*	7.6	5.8	60	**Buy**
NTPC*	181	10,271	*10.1*	27.9	*(392)*	1976	*11.0*	2.4	*11.0*	9.6	10.4	*8.8*	18.8	17.3		**Neutral**
PTC	69	1,013	*38.0*	0.4	*0.2*	21	*238*	0.9	*123.0*	3.7	3.9	*5.3*	18.4	17.5		**Neutral**

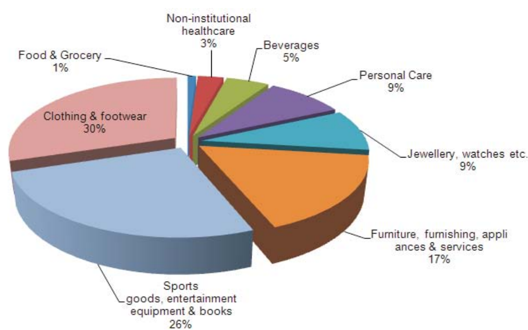
*Source: Company; Angel Research; Note: Price as on December 31, 2008; * Consolidated*

***Analyst* - Girish Solanki / V. Srinivasan**

Retail

Ushering in Organised Retail has seen the Indian consumers come a long way from shopping at local traditional grocery stores to now demanding more choice in terms of products and categories to shop from in an ambiance of a modern store. Changing lifestyles, increasing per capita income and change in consumer preferences has seen a gradual shift in focus of Indian consumers towards modern retail.

Exhibit 1: Share of Organised sector in Total Retail by category (%)



Source: Angel Research

Global meltdown affects Indian Retail

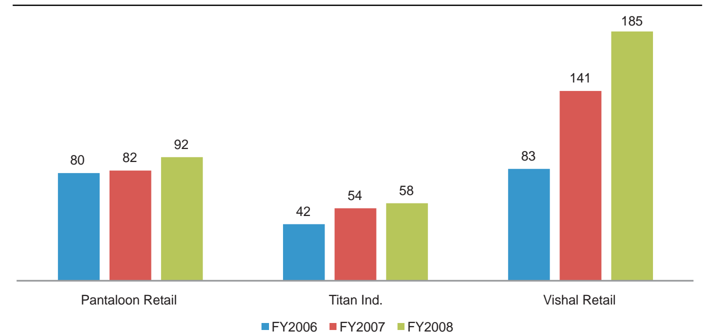
During 3QFY2009, growth of Organised Retail is expected to have slowed down impacted by the cascading effect of the prevailing global financial crises. Decreasing consumption and spending of Indian consumers is expected to have resulted in sluggish growth in the Indian Retail sector in the quarter under review. Indian consumers have suddenly become magpies from munificent spenders. However, we do not expect staple goods and basic essentials to be impacted to a great extent. The Lifestyle segment, which constitutes discretionary items, is expected to have witnessed a slowdown as consumers have or are likely to postpone buying such items. On the other hand, we expect Value Retailing to benefit from the crises as consumers will now seek more value for money.

Credit crunch hits Retailers...

Economic slowdown, tight credit cycles of major FMCG companies and suppliers and rising inventories due to subdued off-take have impacted few retailers, who are witnessing a stretch in their working capital cycles and cash cycles, leading to defaults in payments. Hence, modern retailers are re-negotiating for favourable payment terms with the FMCG companies to tide over the liquidity crunch.

For instance, Vishal Retail is negotiating for credit lines of around 90 days from its suppliers as it has the highest number of cash cycle days. Vishal Retail has cash cycle days of around six months compared to 2-3 months for its peers in the industry.

Exhibit 2: Cash Conversion Cycle (no. of days)



Source: Company, Angel Research

However, we do not expect the FMCG companies to adjust the payment terms by a long stretch. Hence, Retailers have explored other avenues like Private Labels in their endeavour to improve their Bottom-line.

...high-Margin Private Labels aid Retailers

Retailers are exploring new avenues for growth like Private Labels, which fetch higher Margins compared to Branded Labels and provides them bargaining power with their suppliers. Margins range from 15-20% in FMCG labels, around 20% in consumer durables and 30-70% in apparels. Retailers are now looking at setting up manufacturing facilities to develop various Private Labels in-house to meet consumers' value for money requirement and save costs through vertical integration.

The Future Group proposes to invest Rs200cr in developing Private Labels with target revenues of Rs10,000cr by FY2012. Currently, some of the group's consumer brands include *John Miller, Indigo Nation, DJ&C in apparel* and FMCG brands include *Tasty Treat, Care Mate, Fresh 'n Pure,* and in the consumer durable category it has brands such as *Koryo* and *Sensei.*

Vishal Megamart registered a surge in Private Label sales from 5-6% of Total Turnover to 17-18% in 2QFY2009, and the company expects to clock similar performance in 3QFY2009 as well.

We expect other key retailers also to increase their focus on Private Labels to improve their Bottom-line apart from increasing their bargaining power with the suppliers of Branded labels.

Retail

Retailers continue expansion on falling Rentals

Retail property rentals have declined by a sharp 30-40% in key cities across the country. More specifically, Tier-I cities have witnessed a correction of 15-20% and this trend is expected to continue over the next six months. Most Retailers are now re-negotiating for lower rent with the mall owners and are looking to shift to a revenue-sharing model with the mall developers. As a result, key retailers are not only planning to roll out their bigger format stores but have also stepped up their expansion plans. Pantaloon Retail (PRIL), for instance, expects to reach 16mn sq. ft. by end FY2009.

Exhibit 3: Retail Expansion

Retailer	No. of new stores	Timeframe (months)
Big Bazaar (PRIL)	40	8-10
Subhiksha	600	12-14
Spencer's	100	6-8
Koutons	50	2-3

Source: Company, Angel Research

Retailers woo consumers through discounts

To combat the ongoing economic slowdown and woo consumers back to the stores, many retailers are offering aggressive and attractive discounts. In this manner, retailers are trying to move the piling inventories and maintain Top-line growth.

From its 23-day offer period (gifts worth Rs15cr would be on offer) starting December 13, 2008, Future Group expects to garner Revenues of around Rs700cr. The company also plans to offer discounts as high as 58% on electronics and furniture products during festivals at all its 1,000 stores across the country.

Even the Luxury retailers like *Gucci*, *Jimmy Choo*, *Bottega Venetta*, *Salvatore Ferragamo*, *Ermenegildo Zegna*, *Moschino* and *Charriol* are offering discounts in the range of 30-50% to combat dropping sales.

Strategic alliances of convenience and compromise

Various key retailers in the country are entering into strategic alliances with specialist global retailers to leverage the latter's experience and bring more width to product categories. 3QFY2009 witnessed few joint ventures (JV) and alliances been formed to aid growth of Specialty segments in Indian Retail.

Future Group entered into a strategic partnership with Middle East-based Axiom Telecom - Future Axiom Telecom. This entity will retail Axiom's products in India through 500 new stores in 58 cities under the brand name *Mobile Bazaar* and *Mport.*

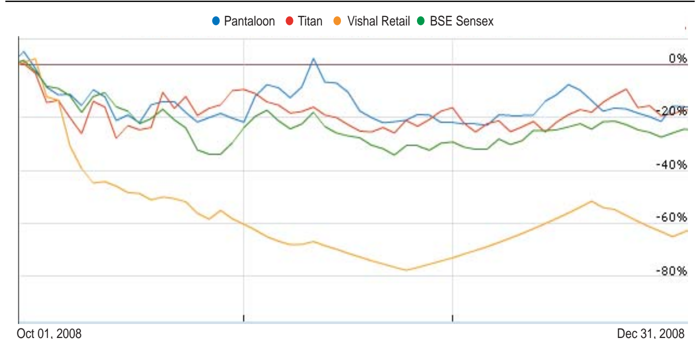
PRIL also divested its holding in the 50:50 JV, Alpha Future Retail Pvt, with British airport retailer, Alpha Group Plc. in favour of Alpha Overseas Holdings Ltd.

Reliance Brands, a part of Reliance Retail, announced a JV with Italian lifestyle brand *Diesel* to introduce the brand in India. *Diese*l will hold majority stake in the 51:49 JV. Another newly formed JV between Reliance Retail and Pearle opened its first outlet in Bengaluru. Branded as *Vision Express*, it offers a wide variety of fashionable and trendy optical products.

PRIL, Titan Outperform Sensex in 3QFY2009

The Retail sector has been underperforming on the bourses since the last two years owing to concerns on the Margin front due to high Rentals, escalating HR expenses and inefficient Supply Chains. After witnessing such an underperformance, PRIL and Titan outperformed the Sensex during 3QFY2009. Towards end 3QFY2009, Vishal Retail also showed signs of recovery after losing around 94% of value and hitting a 52-week low of Rs56 from 52-week high of Rs1,001.

Exhibit 4: Angel Retail Universe v/s Sensex (3QFY2009)



Source: Google Finance, Angel Research

3QFY2009 Expectations

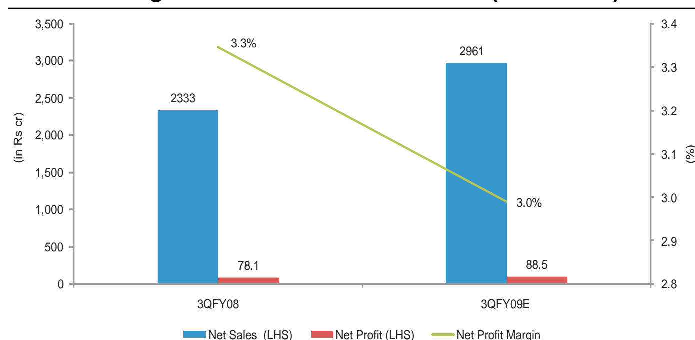
For 3QFY2009, we estimate consumer spending to have slowed down, which is expected to result in below-par Top-line growth. Overall, we estimate Top-line growth of our Universe to register yoy growth of 27% in 3QFY2009E on the back of a relatively subdued *Diwali* due to a decline in consumer spending. We estimate PRIL to lead our universe with 32% yoy growth in Top-line.

Retail

We estimate OPM of our Retail Universe to increase marginally by 30bp to touch 9.1% in 3QFY2009E from 8.8% in 3QFY2008 on the back of increasing operational efficiencies.

We estimate Net Profit Margins of our Universe to decline marginally by 30bp yoy to 3% in 3QFY2009E from 3.3% in 3QFY2008 due to inventory buildup at the Retailers' end in times of slowdown and sluggish consumer spending.

Exhibit 5: Angel Retail Universe v/s Sensex (3QFY2009)



Source: Angel Research

However, we estimate PRIL to sustain its Net Profit Margin (NPM) at 2.6% in 2QFY2009E (June ending). Titan Industries is also estimated to sustain its NPMs at around 4% in 3QFY2009E compared to 3.8% in 3QFY2008. We estimate Vishal Retail to register sharp decline in NPM from 5.1% in 3QFY2008 to 2.3% in 3QFY2009E due to increasing Interest costs on account of high debt.

Outlook and Valuation

We are positive on the Retail sector as it is still one of the fastest growing sectors in India even amidst the economic slowdown. Industry experts expect current slowdown to be temporary as value-retailing would find favour with the consumers in both the short and long run.We expect falling rentals to bring some relief to Retailers grappling with high Real Estate costs.

Overall, we believe that future prospects of the Indian Retail sector are bright, with Organised Retail expected to be primarily driven by Value Retailing. Hypermarkets and Big-Box store formats would drive Value Retailing as consumers are expected to go for value-for-money goods over the next couple of years. Players like PRIL, who are present across consumption and price points and provide "Value-for-Money" products to the Indian consumers, are likely to benefit in the near term, and cascading impact of the same would be witnessed only over the long term.

PRIL continues to be our Top-pick in the Sector

We believe that PRIL has competitive advantages over its peers on account of its presence across consumption and price points of Indian consumers apart from having a pan-India presence and lower execution risks. We maintain our **Buy** recommendation on PRIL.

Titan has a stable and niche business model and we expect it to continue delivering robust Return Ratios. We, however, remain **Neutral** on the stock due to its rich valuations.

We maintain our **Neutral** view on Vishal Retail on account of its increasing leverage on its Balance Sheet and its inability to raise equity in the current market scenario.

Exhibit 6: Quarterly Estimates — Rs cr

Company	CMP (Rs)	Net Sales 3QFY09E	Net Sales % chg	OPM (%) 3QFY09E	OPM (%) chg bp	Net Profit 3QFY09E	Net Profit % chg	EPS (Rs) 3QFY09E	EPS (Rs) % chg	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) %chg	P/E (x) FY09E	P/E (x) FY10E	Target Price (Rs)	Reco
Pantaloon*	218	1,622	*32.2*	9.2	*20*	42	*31.9*	2.4	*13.6*	10.0	14.8	*47.9*	21.8	14.8	284	**Buy**
Titan	927	937	*16.7*	7.8	*150*	37	*20.9*	8.4	*20.9*	41.0	52.7	*28.6*	22.6	17.6	-	**Neutral**
Vishal	96	403	*32.5*	12.0	*(230)*	10	*(39.2)*	4.2	*(39.2)*	15.4	21.0	*36.4*	6.3	4.6	-	**Neutral**

*Source: Company; Angel Research; Note: Price as on December 31, 2008; * Year Ending in June; Estimates are 2QFY2009 for PRIL*

Software

BSE IT Index - Worsening times

The just-concluded quarter witnessed another shocker of a performance by the BSE IT Index, which lost 28% during the period under review. The third quarter of FY2009 proved to be a poor one for the market as a whole, with the benchmark BSE Sensex collapsing by as much as 25% on account of the worsening global economic environment, the impact of which is being felt, to some extent, by the Indian economy as well as reflected by slowing GDP growth, significant FII outflows and lacklustre sentiment. The quarter was one of the most turbulent in recent memory for the Indian stock markets and the economic slowdown is expected to continue for another 12-18 months.

The US economy continued to crumble with the sub-prime contagion spreading to other sectors of the economy like Automotive and Retail. Major corporations like General Motors are facing a liquidity crisis with falling demand for their products and are on the brink of bankruptcy. In fact, the entire US Automotive Industry is in dire need of a bail-out package from the government and the latter has obliged with a US $17.4bn handout for the ailing industry. On the other hand, the US Fed has cut the Federal Funds Rate to an unprecedented range of 0-0.25% and will keep it at this level for some time in its bid to ward off a recession.

These developments point to a not-too-encouraging scenario for Indian IT companies. Major clients of Indian software majors have either gone bankrupt/got merged/taken over or received a bail-out package from the government, with notable names in this list being hitherto-reputed firms like Lehman Brothers, AIG, Wachovia, Merrill Lynch, General Motors and Ford Motor. Thus, rheir major market, the US, is in the throes of a recession and their clients themselves are in trouble. Apart from this, companies like Telstra are resorting to vendor consolidation as well, which will lead to some IT vendors losing business (in the case of Telstra, Infosys and Satyam are the key Indian IT vendors). Thus, the business environment for the sector is worsening and, as of now, seems likely to turn around only by 2HFY2010. Thus, the "expected recovery period" has effectively been pushed back by a year, given that earlier, managements of Indian IT majors were expecting a recovery in 2HFY2009.

While we maintain that over the long-term, off-shoring will remain a mega trend, in the medium-term, the significant headwinds being faced by IT companies are unlikely to subside in a hurry. The EPS CAGR over FY2009-11E is unlikely to be very enthusing, especially if the tax benefits available to software companies under the Software Technology Parks of India (STPI) scheme are not extended, leading to stock performance being muted.

Currency movements - The sole tailwind, now starting to become a headwind

This far, Rupee depreciation has been the sole tailwind that has helped software companies clock better financial performances in Rupee terms (their reporting currency). In the fiscal year-to-date (YTD), the Indian Rupee has depreciated by over 20% against the US Dollar and by over 10% against the Euro (point-to-point). Thus, even as Dollar growth recorded by software companies has not been enthusing, favourable currency movements have cushioned the blow. In fact, recently the Rupee actually crossed the 50-mark against the Dollar, hitting a lifetime low.

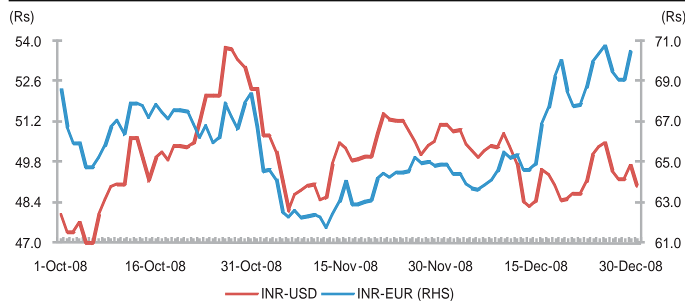
However, in recent times, even this tailwind is beginning to recede. After crossing Rs50 to a Dollar, the Rupee fell below the 47-mark at one stage, before again losing some ground. Apart from becoming less of a tailwind, it is the significant volatility that is of concern for IT companies, who could report greater hedging losses. Therefore, the Rupee movement is now starting to become a headwind.

Another variable impacting revenue of software companies, in Dollar terms, is the movement of currencies like the Euro, British Pound and Australian Dollar against the US Dollar. This has materialised as a major headwind this fiscal, leading to several percentage points being shaved off Dollar revenue growth of these companies. This is because the US Dollar has appreciated significantly against these currencies, leading to their value in Dollar terms eroding to that extent. This fiscal YTD, the US Dollar has appreciated by 12% against the Euro, by 27% against the British Pound and by as much as 33% against the Australian Dollar (point-to-point).

During 3QFY2009, the Rupee further depreciated against the US Dollar, even as it gained ground towards the end of the quarter. During the quarter, depreciation was to the tune of 14% on a quarterly average basis. On a point-to-point basis, at the end of the quarter, the Rupee ended lower by 3.4% against the Dollar sequentially. However, this tailwind was countered by cross-currency movements, with the Australian Dollar collapsing by over 32% against the US Dollar, the British Pound by 17% and the Euro by 14% (quarterly average).

Software

Exhibit 1: Rupee v/s Dollar, Euro



Source: oanda.com, Angel Research

Rupee depreciation to be the only saviour in 3QFY2009; volumes to fall sequentially

We expect this quarter to be one of the worst on record for Indian IT companies. The December quarter traditionally has been a slower quarter for Indian IT, with the holiday season leading to a lesser number of billing days. This time around, anecdotal evidence suggests that due to the global slowdown, tight budgets and pressing need to cut costs, IT vendors have been asked to take an extended holiday to ensure an even lesser number of billing days than usual. Infosys has clearly stated that in recent times, the demand situation has only worsened.

Amidst this backdrop, we expect the Top-4 Indian IT companies to report a sequential decline in volume growth, along with a fall in pricing. Thus, core business performance is set to change for the worse. Visibility for FY2010 is becoming poorer, and with vendor consolidation also being witnessed, uncertainty only increases. Consequently, while this quarter's performance is likely to be poor, we believe this may be just the beginning of a painful period for Indian IT companies.

Overall, we expect Top-line growth to come in at 7.5% qoq (32.2% yoy) for TCS, Infosys, Wipro and Satyam this quarter, led by Rupee depreciation. If we consider only combined IT Services for Wipro, Top-line growth estimated over the quarter stands at 8.7% qoq in Rupee terms (33.1% yoy), with the Rupee rate being higher by nearly 14% qoq (26.6% yoy). However, Dollar revenues (core business) are expected to witness de-growth of 4.5% qoq (growth of just 5.2% yoy). Another headwind seen this quarter, as was the case in 2QFY2009 as well, was cross-currency fluctuations The US Dollar has seen a major rally against two currencies - the British Pound and Australian Dollar - which accounted for over 19% of Infosys' billing in 2QFY2009. This factor will adversely impact Dollar revenue growth of these companies.

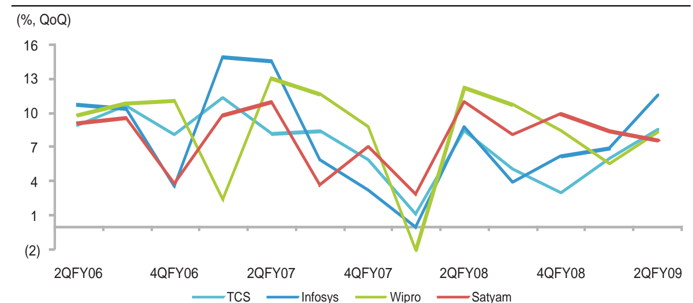
Exhibit 2: Dollar v/s Rupee growth of Top-tier IT companies*

Particulars	3QFY08	2QFY09	3QFY09E	*% chg qoq*	*% chg yoy*
Dollar revenues (mn)**	4,124	4,545	4,339	*(4.5)*	*5.2*
Rupee revenues (cr)**	16,281	19,941	21,677	*8.7*	*33.1*
Realised Rupee rate	39.48	43.88	49.96	*13.9*	*26.6*

*Source: Company, Angel Research; * Companies include TCS, Infosys, Wipro and Satyam; ** For Wipro, only combined IT Services Revenues are included.*

Pricing has emerged as a major headwind with the slowdown. Till recently, IT companies denied any impact of the slowdown on pricing and management commentary has revolved around statements to the effect of "pricing is stable", "newer contracts are coming in at higher rates" and "we see no fall in pricing". However, of late, these comments have moderated, reflecting a more bearish stance and commentary has started revolving around statements like "some clients have asked for renegotiations", "billing rates are beginning to soften" and "pricing is likely to be stable-to-negative". We interpret these as indicative of a worsening pricing environment and expect a 0.5-1% qoq decline in pricing for IT companies this quarter. We do not foresee any improvement going forward rather we expect pricing pressure to become even more acute in the days to come.

Exhibit 3: Quarterly trends in Sales growth



Source: Companies, Angel Research

Margins to see flattish trend

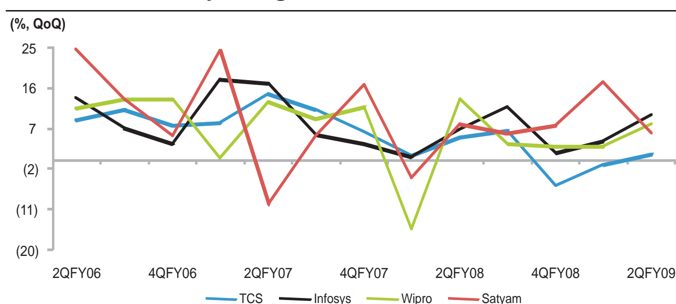
With the quarter under review having a significant number of holidays and lesser billing days, apart from pricing pressure, we expect a flat trend in margins this quarter, helped by the Rupee depreciation. We expect a 24bp qoq rise for Infosys, 2bp qoq rise for TCS and 41bp qoq rise for Satyam, while Wipro is expected to see just a 1bp qoq fall. The margin position is expected to be salvaged to a large extent due to the Rupee depreciation over the quarter. We remain cautious on the margin prospects of Indian IT companies on account of the poor global business climate and do not expect meaningful improvement until a recovery is witnessed.

Software

Net Profit growth to remain subdued

We expect just 0.5% qoq growth in Net Profits for the Top-4 IT companies in 3QFY2009. Losses on account of hedging are likely to impact growth, given that these companies have hedged their receivables at rates considerably below current levels. In fact, this quarter some IT companies could actually register negative Other Income, as was the case with TCS in 2QFY2009.

Exhibit 4: Quarterly PAT growth trends



Source: Companies, Angel Research

'Maytas-gate' - A shocker of an episode

A stand-out development during the quarter, and unfortunately one that "stands out" for all the wrong reasons, is the Satyam Computer Services imbroglio wherein it proposed to acquire stakes in Maytas Infrastructure and Maytas Properties, companies controlled and run by the Satyam Promoter Group (relatives and friends). The blatant conflict of interest, apart from the absolutely baseless business logic of the deal, was truly shocking. The company proposed to spend a substantial US $1.6bn (Rs7,680cr, at Rs48 to a Dollar) on these acquisitions to diversify its business into the Infrastructure and Real Estate sectors with a view to "de-risk its core business by bootstrapping a new business vertical in infrastructure". The deal would have completely eroded Satyam's cash reserves of well over Rs5,300cr and resulted in the company taking on significant debt to the tune of US $400mn. After strenuous objections from irate shareholders, Satyam called off the deal. This is a very poor example of corporate governance and has led to significant erosion in the credibility of the company's management. It also raises questions about the "independence" of Satyam's independent directors on its Board, given that they are supposed to represent the interests of minority shareholders and act as the first level of "self-regulation" for a company. We believe the company will learn from this episode and in future will take measured and considered decisions of a transformational nature. Four high-profile independent directors have already resigned from the company and a meeting is scheduled on January 10, 2009 to decide on the best course of action to regain the lost confidence of major stakeholders in the company.

Key points to watch - Further guidance downgrades, commentary on worsening demand environment

The quarter gone by has proved to be extremely difficult for Indian IT companies. More companies are in trouble, budgets are becoming tighter, pricing pressure is worsening and vendor consolidation is also leading to increased uncertainty. Cross-currency movements have also emerged as a headwind for the sector. Against this backdrop, we expect further downgrades in guidance by IT companies.

Commentary on the demand environment will also be keenly tracked. The quarter will give a clearer picture about how the slowdown is impacting the sector, in terms of volume growth, pricing trends, client spending patterns, budgetary tightening, vendor rationalisation, project delays or cuts, and hiring targets. We expect Dollar revenues to remain under pressure, even as the Rupee guidance may not be materially impacted on account of the fall in value of the domestic currency. However, as mentioned, even this tailwind is beginning to recede. Overall, while we remain positive on the IT Sector from a longer-term perspective, medium-term stock performance is unlikely to be enthusing. **Our Top Pick in the sector remains Infosys.**

Exhibit 5: Quarterly Estimates Rs cr

Company	CMP (Rs)	Net Sales 3QFY09E	Net Sales *% chg (QoQ)*	OPM (%) 3QFY09E	OPM (%) *Chg bps (QoQ)*	Net Profit 3QFY09E	Net Profit *% chg (QoQ)*	EPS (Rs) 3QFY09E	EPS (Rs) *% chg (QoQ)*	EPS (Rs) FY09E	EPS (Rs) FY10E	EPS (Rs) *% chg*	P/E (x) FY09E	P/E (x) FY10E	Target Price (Rs)	Reco
Infosys	1,118	5,832	*7.6*	33.4	*24*	1,491	*4.1*	26.0	*4.2*	100.9	107.6	*6.7*	11.1	10.4	1,292	**Buy**
TCS	478	7,471	*7.4*	26.2	*2*	1,227	*(2.7)*	12.5	*(2.7)*	54.1	57.5	*6.2*	8.8	8.3	575	**Buy**
Wipro	234	6,970	*6.7*	19.7	*(1)*	994	*1.6*	6.8	*1.4*	27.3	29.1	*6.4*	8.5	8.0	291	**Buy**
Satyam	170	3,074	*9.0*	23.5	*41*	564	*(3.0)*	8.2	*(3.0)*	32.3	33.0	*2.3*	5.3	5.1	231	**Buy**

Source: Company, Angel Research; Note: Price as on December 31, 2008

***Analyst* - Harit Shah**

Telecom

Telecom stocks record mixed performance in 3QFY2009

During the December 2008 quarter, telecom stocks recorded a mixed performance versus the benchmark index, the BSE Sensex. There is currently no separate index of telecom stocks. If we take a basket of major telecom stocks, the basket marginally "out-performed" the Sensex, giving negative returns of 21.2% (negative 25.0% for the Sensex). However, on a stock-specific basis, the performance is varied. Mobile market leader, Bharti Airtel managed to lose just 8.9% over the quarter, while RCOM, the second-largest player, lost a significant 31.9%. Idea Cellular's stock price also witnessed over 30% erosion in value. The stock of Tata Communications was the key out-performer, clocking positive returns of 7%, while Tulip Telecom proved to be the major under-performer, with its stock price crashing by nearly 44%.

Key developments - 3G auction to take place on January 30, 2009

The quarter saw further progress made on the 3G and Broadband Wireless Access (BWA) spectrum auctions, with the Department of Telecommunications (DoT) finalising the 3G auction process in January 2009, which will be followed by the auction process for BWA spectrum. There was a delay, with the auction originally scheduled on January 16, but due to the requirement to take Cabinet approval for some key proposals of the Policy, the process has been postponed by a couple of weeks to January 30. The government initially expected to garner around Rs40,000cr from the auction process. However, as is known, the quarter was one of unprecedented global turmoil, with the financial contagion in the US spreading to other sectors of the economy like Automotive and Retail. Europe is also in the firing line and the world is in the midst of a prolonged economic slowdown. Major reputed banks and financial institutions went bust or received a bail-out package from the government for survival. The US Automotive Industry is on the verge of collapse and if this does happen, the impact on the economy would be perilous given that millions of jobs would be lost. This industry has received a bail-out package of over US $17bn. However, a globally reputed company like Toyota is expected to report its first-ever operating loss in seventy-one years, truly unbelievable. This is a clear reflection of the extent of the global economic slowdown.

The economic turmoil has also led to a liquidity crisis, with credit - the lifeline of the global economy - in extremely short supply. All these factors have led to a toning down of expectations of the possible receipts from the spectrum auction. Given the current scenario, the government's expectations to raise Rs40,000cr from the auction process are unlikely to materialise. It should be noted that a significant number of global companies were also expected to bid for 3G spectrum, given India's attractiveness as a market and that getting 3G spectrum is likely to be the only way to get a foothold into the market due to lack of suitable acquisition targets. However, the current crisis seems to have significantly tempered down expectations on the receipts from the auction and the government is now hopeful that the final auction price will be "a few times higher than the reserve price of Rs2,020cr".

In the 3G pre-bid conference held on December 23, 2008, apart from "the usual suspects" like Bharti Airtel, RCOM and Vodafone-Essar, representation of foreign players was fairly disappointing. Even though the DoT has said that this may not be an indication of low foreign interest in the process, we believe the business case is not favourable for a standalone 3G operator, given that firstly, there is not enough spectrum in all circles to accommodate more players leading to the likelihood of bids being aggressive in circles like Delhi and secondly, just 5 MHz of spectrum will be given to the winning bidders in each circle, which is not enough for a start-up 3G operation.

It may be noted that in a bid to placate potential foreign bidders to get greater foreign participation in the 3G spectrum auction, the DoT has said that new players who win 3G spectrum will also be eligible for getting 2G spectrum without any additional entry fee, which comes bundled with the Universal Access Service Licence (UASL) that companies pay for to offer telecom services in India. However, we believe this is just an 'eyewash' and these players will have to wait in the queue to get 2G spectrum. In fact, it is questionable whether, in the event of winning 3G spectrum, these players will get any 2G spectrum at all, given that newer as well as existing operators are in the queue in many circles. This raises serious questions on the quantity of spectrum available for allotment and increases uncertainty. Thus, we believe this step is just a means to get greater foreign participation in the 3G auction process and thereby raise more money, and consequently do not expect much by way of foreign participation.

3G auction - Spectrum availability for 5 players in only 15 circles

While the government had said that there are likely to be around 5 3G operators per circle, there is enough spectrum to accommodate that many players in only 15 of the 22 telecom circles in the country. MTNL and BSNL have been allotted 3G

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spectrum ahead of other operators and MTNL has done a soft-launch of its 3G services in Delhi. These PSU telecom majors will have to match the price paid by the highest bidder in each circle. Excluding these players, only 15 circles have enough spectrum to be auctioned for the remaining four slots. In Rajasthan and the North East, there will be no auction at all due to lack of spectrum. In Delhi, a key circle for 3G services, there will be just 2 slots up for grabs, also the case in Gujarat, which is likely to lead to aggressive bidding for these circles. In West Bengal, there is just one slot available, while in UP (West) and Himachal Pradesh, there are three slots available. Thus, while the 15 circles that will accommodate five 3G operators are unlikely to witness aggressive bidding, circles like Delhi are likely to see bids going much higher than the reserve price of Rs160cr for the circle.

Exhibit 1: Circle-wise 3G spectrum available for auction

Telecom Circle	Number of blocks of spectrum available for auction	Reserve Price (Rs cr)
Delhi (Metro)	2	160
Mumbai (Metro)	4	160
Kolkata (Metro)	4	80
Maharashtra	4	160
Gujarat	2	160
Andhra Pradesh	4	160
Karnataka	4	160
Tamil Nadu (incl. Chennai)	4	160
Kerala	4	80
Punjab	4	80
Haryana	4	80
Uttar Pradesh (E)	4	80
Uttar Pradesh (W)	3	80
Rajasthan	0	80
Madhya Pradesh	4	80
West Bengal	1	80
Himachal Pradesh	3	30
Bihar	4	30
Orissa	4	30
Assam	4	30
North East	0	30
Jammu & Kashmir	4	30

Source: Press Information Bureau, Angel Research

2G battle to continue to hot up - Start-up spectrum allotted in more circles to newer operators

The battle for marketshare in the 2G market is expected to get fiercer, as newer operators like Unitech Wireless, Datacom, Swan Telecom, Loop Telecom and Tata Teleservices (cross-over technology) have received start-up spectrum in more circles like Haryana, Himachal Pradesh, Kolkata, Bihar, Assam, Rajasthan, the North East and Jammu & Kashmir. Unitech now has spectrum in 20 of the 22 telecom circles in the country, Tata Teleservices in 12, Datacom in 11, Loop Telecom in 8 and Swan Telecom in 5. Apart from this, existing operators like Vodafone-Essar, Idea Cellular and Tata Teleservices (CDMA) have also commenced operations recently in circles like Madhya Pradesh, Assam, Bihar, the North East and Jammu & Kashmir, leading to intensifying competition in these circles. Thus, the business environment is set to become even more challenging for telecom operators, with falling average revenues per user (ARPUs), slowing subscriber growth, margin pressure and regulatory risks all likely to take their toll.

Subscriber growth to remain key driver of Top-line growth

We expect the major telecom companies under our coverage - Bharti Airtel, RCOM and Idea Cellular - to report strong Top-line growth to the tune of 34.5% yoy and 7.3% qoq during 3QFY2009. We expect market leader, Bharti Airtel to report a 40.5% yoy and 8.5% qoq increase in Net Revenues. This is expected to be driven by the key Mobile Services Business, which we estimate will grow by 38.4% yoy and 6.6% qoq. Key growth driver of this business is expected to be strong accretion to the mobile subscriber base, which we expect will grow by over 55% yoy and by 10.5% qoq to 85.6mn, implying quarterly net additions of 8.2mn,the company's highest-ever. On a yearly basis, net additions are expected to cross 30mn, the first time ever, implying average net adds of over 2.5mn a month.

On the other hand, we expect ARPUs to decline by 4% qoq and by nearly 12% yoy to Rs317 per user per month. We expect the company's other business segments to also clock robust growth rates of 20-60% yoy. We estimate the Passive Infrastructure Services segment to grow by 9.1% qoq and the transfer of 30,000 towers to Indus is likely to happen in 4QFY2009.

RCOM, on the other hand, is expected to clock a 22.2% yoy and 5.4% qoq growth in Net Revenues. The key Wireless Business is estimated to grow at a disappointing 15.6% yoy (5.5% qoq) in spite of the strong 49.8% yoy growth (9.5% qoq) in the mobile subscriber base of the company, which is expected to touch 61.3mn. This is on account of the steep 23.9% yoy fall (4% qoq)

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in ARPUs, which are expected to hit Rs260 per user per month. As regards its other businesses, we expect the Global Business to grow by 32.2% yoy and the Broadband Business by 45% yoy.

Idea Cellular, the third telecom company under our coverage, is expected to record a robust 44.2% yoy and 7% qoq growth in 3QFY2009 Top-line. As is the case for Bharti and RCOM, we expect strong growth to be chiefly driven by continued strong subscriber numbers recorded by the company. We estimate Idea's mobile subscriber base to grow by a robust 61.7% yoy and by 12% qoq to touch 34.0mn, implying quarterly net additions of 3.7mn. On a yearly basis, net additions are estimated at 13.0mn. On the other hand, we estimate ARPUs to fall by 4% qoq and by 8.4% yoy to hit Rs256 per user per month.

Margins to fall on network expansion

We expect the three telcos under our coverage to record a combined 262bp yoy fall in EBITDA Margins in 3QFY2009. This is expected mainly on the back of higher network expansion costs, given the large capex undertaken by these companies to expand their networks into the interiors of the country. Apart from this, we expect the secular decline in tariffs (revenues per minute) to also impact the margin profile. On a company-specific basis, we expect Bharti Airtel to record a 101bp yoy margin decline (53bp qoq expansion), RCOM a 299bp yoy decline (54bp qoq fall) and Idea Cellular a massive 759bp yoy decline (72bp qoq decline). EBITDA in absolute terms is expected to grow by 37.2% yoy and by 9.9% qoq for Bharti, by 13.5% yoy and 4% qoq for RCOM and by just 11.7% yoy and 4.5% qoq for Idea Cellular. The disappointing performance by Idea is on account of the company's roll outs in newer circles, which are expected to incur losses at the EBITDA level. The company has recently rolled out in Mumbai in August and in Bihar in October.

Margin pressure to lead to Bottom-line growing at a slower rate than Top-line

We expect the Bottom-line of the telcos under our coverage to grow by a combined 15% yoy, as against a 34.5% yoy growth in Top-line. However, the performance varies on a company-specific basis. We expect Bharti to grow its Bottom-line by 24.1% yoy and by 4.4% qoq, with the divergence in top-line and bottom-line growth coming on account of the margin pressure and forex losses. RCOM is expected to grow Bottom-line by just 11.4% yoy and record a fall of 0.1% qoq on account of similar factors. Idea Cellular, on the other hand, is expected to record a significant fall of 29.5% yoy in Bottom-line on account of the poor performance at the EBITDA level due to the newer circle launches. On a qoq basis, even though healthy growth of 15.8% is expected, it should be noted that this comes on a low base, with the performance in 2QFY2009 being fairly disappointing.

Stick with market leader, Bharti Airtel

Going ahead, even as we expect robust growth in the Indian mobile subscriber base, given a more challenging business environment, a secular fall in ARPUs and slowing subscriber growth, thus leading to slowing Top-line growth, increasing competition, which could further queer the pitch for tariffs, higher network expansion costs, all leading to margin pressure and regulatory risks, we believe chances of a major valuation re-rating in the sector are remote. Consequently, in such a scenario, **we believe it would be prudent to stick to the market leader in the sector with the best track record, Bharti Airtel, which remains our Top Pick.**

Exhibit 2: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	3QFY09E	*% chg*	3QFY09E	*chg bp*	3QFY09E	*% chg*	3QFY09E	*% chg*	FY09E	FY10E	*% chg*	FY09E	FY10E	Price (Rs)	
Bharti Airtel	715	9,786	*40.5*	41.5	*(101)*	2,138	*24.1*	11.3	*24.1*	45.9	57.8	*26.0*	15.6	12.4	957	**Buy**
RCOM	227	5,835	*22.2*	39.1	*(299)*	1,529	*11.4*	7.0	*10.3*	29.2	32.4	*10.8*	7.8	7.0	389	**Buy**
Idea Cellular	53	2,474	*44.6*	25.6	*(759)*	167	*(29.5)*	0.6	*(35.7)*	2.3	2.6	*15.1*	23.0	20.0	-	**Reduce**

Source: Company, Angel Research; Note: Price as on December 31, 2008

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