

# Positive 2Q; challenges lie ahead

## Trim PO; Maintain Neutral

We have trimmed our sum-of-the-parts based PO for ABNL by 6% to Rs965/sh to factor in our revised PO of Idea and lower growth in the insurance business. Despite valuation upside potential, we remain Neutral as growth visibility for ins. biz. is poor and bal sheet also appears weak with standalone net debt/EBITDA at ~5x FY10E.

## Revenue and margins up in 2Q

In 2Q, ABNL reported a profit of Rs14mn after 6 qtr; results were better than our expectations. The turnaround was led by improvement in the garments & fertilizers biz. and strong carbon black profits due to one-time input price advantage. Healthy topline growth (ex insurance income on policy holder fund) and cost rationalization across businesses (except rayon and telecom business) were key profit drivers.

## ABNL life business continues to gain mkt. share

We have cut our insurance value by 8% to factor in moderation in growth (6% contraction in H1). However, this was better than private sector, which contracted 15% YoY leading to ABNL gaining market share (up 20bps QoQ to 8.9%). We have lowered our growth estimates (APE new biz.) to 30% for FY10 from 37% earlier to factor in the moderation in H1. Furthermore, ABNL's AMC business also grew 65% YoY, but, we have cut our AMC value estimate by 4-5% to factor in margin pressure due to entry load ban.

## EV disclosure - EV at Rs30.6bn

ABNL separately disclosed EV of Rs30.6bn (FY09), which at our target multiple (FY09) trades at 3.2x and potentially could trade at similar multiples by FY11. However, we continue to value insurers on growth based metric (NBAP). Hence, we think there could be upsides as market moves to EV based disclosures (market may assign higher multiples to improving profitability vs. growth) and more clarity on regulatory issues.

## Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	1,149	(4,283)	(1,179)	(357)	2,272
EPS	12.32	(45.84)	(8.34)	(1.10)	22.06
EPS Change (YoY)	-59.1%	NM	81.8%	86.9%	NM
Dividend / Share	6.73	4.47	4.47	4.47	4.47
Free Cash Flow / Share	(199.26)	(116.31)	(202.91)	(27.78)	6.85

## Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	66.36x	NM	NM	NM	37.04x
Dividend Yield	0.823%	0.546%	0.546%	0.546%	0.546%
EV / EBITDA*	13.93x	23.63x	12.13x	10.55x	7.46x
Free Cash Flow Yield*	-22.12%	-13.13%	-23.86%	-3.40%	0.838%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 5.

## Bank of America Merrill Lynch

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## Stock Data

Price	Rs817.30
Price Objective	Rs965.00
Date Established	4-Nov-2009
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs330.25-Rs1,054
Mrkt Val / Shares Out (mn)	US\$1,789 / 103.0
Average Daily Volume	316,557
BofAML Ticker / Exchange	ADYAF / BSE
Bloomberg / Reuters	ABNL IN / ABRL.BO
ROE (2010E)	-0.7%
Net Dbt to Eqty (Mar-2009A)	38.5%
Est. 5-Yr EPS / DPS Growth	10.0% / 1.0%
Free Float	55.0%

## Key Changes

(Rs)	Previous	Current
Price Obj.	1,025.00	965.00
2010E Rev (m)	170,675.5	164,874.4
2011E Rev (m)	198,215.3	188,020.0
2012E Rev (m)	226,173.8	212,207.5
2010E EPS	-13.65	-8.34
2011E EPS	-0.89	-1.10
2012E EPS	21.89	22.06

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4.

## iQprofile<sup>SM</sup> Aditya Birla Nuvo Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
<b>(Rs Millions)</b>					
Sales	118,611	136,432	164,874	188,020	212,208
Gross Profit	10,270	6,051	11,789	13,551	19,173
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	5,020	(908)	3,250	4,206	8,484
Net Interest & Other Income	(3,507)	(4,568)	(4,620)	(4,819)	(4,804)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,513	(5,476)	(1,369)	(613)	3,679
Tax (expense) / Benefit	(1,610)	(753)	(1,093)	(757)	(1,490)
Net Income (Adjusted)	1,149	(4,283)	(1,179)	(357)	2,272
Average Fully Diluted Shares Outstanding	93	93	114	114	114

### Key Cash Flow Statement Data

Net Income	1,149	(4,283)	(1,179)	(357)	2,272
Depreciation & Amortization	5,249	6,959	8,538	9,345	10,689
Change in Working Capital	(4,779)	3,566	43	(623)	(433)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1,712	1,846	1,283	1,013	83
Cash Flow from Operations	3,331	8,088	8,685	9,379	12,611
Capital Expenditure	(21,952)	(19,139)	(28,775)	(12,240)	(11,906)
(Acquisition) / Disposal of Investments	(28,236)	(21,694)	(44,943)	(53,793)	(61,818)
Other Cash Inflow / (Outflow)	239	(8,515)	0	0	0
Cash Flow from Investing	(49,950)	(49,349)	(73,718)	(66,034)	(73,723)
Shares Issue / (Repurchase)	7,511	0	5,750	0	0
Cost of Dividends Paid	(639)	(424)	(460)	(460)	(460)
Cash Flow from Financing	19,671	44,249	20,091	2,863	(704)
Free Cash Flow	(18,621)	(11,051)	(20,090)	(2,861)	705
Net Debt	59,039	56,900	71,700	75,022	74,777
Change in Net Debt	12,083	(1,894)	14,799	3,320	(246)

### Key Balance Sheet Data

Property, Plant & Equipment	54,478	66,658	86,894	89,790	91,007
Other Non-Current Assets	99,381	129,590	174,533	228,327	290,144
Trade Receivables	12,034	13,436	13,382	14,174	14,726
Cash & Equivalents	7,940	32,295	32,295	32,295	32,295
Other Current Assets	26,593	27,621	27,510	29,139	30,273
Total Assets	200,425	269,600	334,613	393,724	458,443
Long-Term Debt	51,814	76,824	88,829	92,151	91,906
Other Non-Current Liabilities	2,262	2,162	2,162	2,162	2,162
Short-Term Debt	15,165	12,371	15,165	15,165	15,165
Other Current Liabilities	24,507	30,503	30,380	32,179	33,431
Total Liabilities	93,747	121,860	136,536	141,657	142,664
Total Equity	106,678	147,740	198,077	252,067	315,779
Total Equity & Liabilities	200,425	269,600	334,613	393,724	458,444

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	1.8%	0.2%	1.8%	1.7%	1.6%
Return On Equity	1.3%	-3.4%	-0.7%	-0.2%	0.8%
Operating Margin	4.2%	-0.7%	2.0%	2.2%	4.0%
EBITDA Margin	8.7%	4.4%	7.2%	7.2%	9.0%

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	2.9x	NM	NM	NM	5.5x
Asset Replacement Ratio	4.2x	2.8x	3.4x	1.3x	1.1x
Tax Rate (Reported)	106.4%	NM	NM	NM	40.5%
Net Debt-to-Equity Ratio	55.3%	38.5%	36.2%	29.8%	23.7%
Interest Cover	1.1x	-0.1x	0.4x	0.4x	0.9x

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

### Company Description

ABNL is a conglomerate with exposure to 10 diverse businesses. ABNL is the largest (27% stake) shareholder of Idea Cellular that is separately listed. ABNL also owns 74% of the unlisted life-insurance biz namely, Birla Sun Life. Other key businesses include carbon black, garment-retailing, BPO services, rayon, fertilizers, textiles, insulators, and financial services.

### Investment Thesis

We have a Neutral rating on ABNL as we think the Co's strategic initiatives will help long-term competitiveness but exert pressure on short-term financials. Telecom & financial services remain the largest value drivers for the Co. The remaining businesses, viz carbon black, fertilizers, garments, BPO, rayon etc, are highly unrelated and hence we apply around 30% conglomerate discount on sum-of-parts.

### Stock Data

Price to Book Value 0.4x

04 November 2009

**Table 1: Target valuation of ABNL on FY11E sum-of-parts**

Business	Stake held	Valuation Benchmark	ABNL (Rs/sh)
Telecom/Idea	27%	PO for Idea (Rs75/sh)	553
Insurance	74%	15x FY11 NBAP	605
AMC	50%	4% of current AUM	102
Carbon Black	100%	7x EV/EBITDA; local market valuation	131
Fertilizers	100%	7x EV/EBITDA; local market valuation	106
Garments & Textile	100%	0.6x EV/sales; discount to Raymond	86
BPO & IT	88%	7x EV/EBITDA; discount to First source	40
Rayon	100%	7x EV/EBITDA; local market valuation	111
Misc. businesses	100%	5x EV/EBITDA; local market valuation	26
less Net Debt (excl. Idea)			418
Add potential cash from exercise of share warrants			38
<b>Total equity value of ABNL</b>			<b>1381</b>
(less) Conglomerate discount		(-30%)	-416
<b>Target share price of ABNL</b>			<b>965</b>

Source: BofA Merrill Lynch Research

**Table 2: Trend in EBIT for key business segments**

Yr-ending 31st March (Rs mn)	2QFY09	1QFY10	2QFY10	YoY change	QoQ Change
Garments	(305)	(451)	(122)	na	na
Rayon Yarn	187	385	328	75%	-15%
Carbon Black	233	250	782	235%	213%
Insulators	285	171	172	-40%	0%
Other Textiles	126	45	99	-22%	117%
Fertilizers	567	113	335	-41%	196%
Financial Services	161	168	155	-4%	-8%
Life Insurance	(1,943)	(1,085)	(1,249)	na	na
BPO & IT	(84)	72	97	na	35%
Telecom	1,028	1,224	1,022	-1%	-17%

Source: Company data

**Table 3: 2Q FY10 results summary- Standalone**

Yr to 31 Mar (Rs mn)	2Q		1Q		2Q	
	FY09	FY10	FY10	YoY	QoQ	
<b>Turnover</b>	<b>13,366</b>	<b>9,968</b>	<b>12,279</b>	<b>-8%</b>	<b>23%</b>	
Operating costs	11,489	8,858	10,141	-12%	14%	
<b>EBITDA</b>	<b>1,877</b>	<b>1,110</b>	<b>2,139</b>	<b>14%</b>	<b>93%</b>	
EBITDA Margin	14.0%	11.1%	17.4%			
Depreciation	405	442	449	11%	2%	
<b>Operating profit</b>	<b>1,473</b>	<b>668</b>	<b>1,690</b>	<b>15%</b>	<b>153%</b>	
Recurring other income	137	162	212	56%	31%	
<b>EBIT</b>	<b>1,609</b>	<b>830</b>	<b>1,902</b>	<b>18%</b>	<b>129%</b>	
Interest	593	947	861	45%	-9%	
<b>Profit before tax</b>	<b>1,016</b>	<b>(117)</b>	<b>1,041</b>	<b>2%</b>	<b>na</b>	
Taxes	363	(95)	448	24%	na	
<b>Recurring net profit</b>	<b>653</b>	<b>(22)</b>	<b>592</b>	<b>-9%</b>	<b>na</b>	
Extra-ordinary Inc/(exp)	0	0	0			
<b>Reported net profit</b>	<b>653</b>	<b>(22)</b>	<b>592</b>	<b>-9%</b>	<b>na</b>	

Source: Company data

**Table 4: 2Q FY10 results summary- Consolidated**

Yr to 31 Mar (Rs mn)	2Q		1Q		2Q	
	FY09	FY10	FY10	YoY	QoQ	
<b>Turnover</b>	<b>36,096</b>	<b>53,694</b>	<b>48,826</b>	<b>35%</b>	<b>-9%</b>	
Operating costs	34,380	51,009	45,399	32%	-11%	
<b>EBITDA</b>	<b>1,716</b>	<b>2,685</b>	<b>3,427</b>	<b>100%</b>	<b>28%</b>	
EBITDA Margin	4.8%	5.0%	7.0%			
Depreciation	1,604	2,027	2,126	33%	5%	
<b>Operating profit</b>	<b>111</b>	<b>658</b>	<b>1301</b>	<b>1069%</b>	<b>98%</b>	
Recurring other income	602	673	703	17%	4%	
<b>EBIT</b>	<b>713</b>	<b>1,331</b>	<b>2,004</b>	<b>181%</b>	<b>na</b>	
Interest	1,786	1,898	1,669	-7%	-12%	
<b>Profit before tax</b>	<b>-1073</b>	<b>-567</b>	<b>335</b>	<b>na</b>	<b>na</b>	
Taxes	514	65	655	27%	913%	
<b>Recurring net profit before minority</b>	<b>-1588</b>	<b>-631</b>	<b>-320</b>	<b>na</b>	<b>na</b>	
Minority interests	-542	-278	-334	na	na	
<b>Recurring net profit</b>	<b>-1046</b>	<b>-353</b>	<b>14</b>	<b>na</b>	<b>na</b>	
Extra-ordinary Inc/(exp)	0	0	0	na	na	
<b>Reported net profit</b>	<b>(1,046)</b>	<b>(353)</b>	<b>14</b>	<b>na</b>	<b>na</b>	

Source: Company data

## Price objective basis & risk

### Aditya Birla Nu (ADYAF)

We have a price objective of Rs965/share for AB Nuvo based on sum-of-parts using 30% conglomerate discount. Valuation for most businesses is linked to earnings outlook for FY11E, except insurance (15x FY11E NBAP) & financial services (4% of current-AUM), which are linked to NBAP & assets under management, respectively. Our target valuation for Idea Cellular is around Rs75/sh.

Upside to our ABNL PO could stem from stronger-than-expected scale economies in telecom and/or acceleration of market growth in insurance. Risks are possible unexpected slowdown in market growth for telecom or a sharper-than-expected slowdown in financial services.

## Analyst Certification

I, Reena Verma Bhasin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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### India - General Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
	Balrampur Chini	BMPRF	BRCM IN	Sanjaya Satapathy
	Chambal Fertilisers & Chemicals	CHBZF	CHMB IN	Prasad Deshmukh
	Cummins India	CUIDF	KKC IN	Sanjaya Satapathy
	Exide Indus Ltd	XEDRF	EXID IN	Sanjaya Satapathy
	Jain Irrigation Systems Ltd	JNIDF	JI IN	Prasad Deshmukh

**India - General Coverage Cluster**

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	Triveni Engg	TVIEF	TRE IN	Sanjaya Satapathy
	Voltas	VTSJF	VOLT IN	Sanjaya Satapathy
<b>NEUTRAL</b>				
	Aditya Birla Nu	ADYAF	ABNL IN	Reena Verma Bhasin, CFA
	Shree Cements	SREEF	SRCM IN	Reena Verma Bhasin, CFA
	UltraTech Cemen	XDJNF	UTCEN IN	Reena Verma Bhasin, CFA
<b>UNDERPERFORM</b>				
	Ambuja Cements	AMBUF	ACEM IN	Reena Verma Bhasin, CFA
	Assoc. Cement	ADCLF	ACC IN	Reena Verma Bhasin, CFA
	DLF Limited	XVDUF	DLFU IN	Gagan Agarwal
	India Cements	INIAF	ICEM IN	Reena Verma Bhasin, CFA
	India Cements -G	IAMZY	ICEM LX	Reena Verma Bhasin, CFA
	Nagarjuna Fertilizers & Chemicals Ltd	NFACF	NFCL IN	Prasad Deshmukh
	Tata Chemicals Ltd	TTCXF	TTCH IN	Prasad Deshmukh
<b>RSTR</b>				
	Grasim	GRSJF	GRASIM IN	Reena Verma Bhasin, CFA
	Grasim -G	GRSJY	GRAS LX	Reena Verma Bhasin, CFA
<b>RVW</b>				
	APIL	ANSFF	APIL IN	Gagan Agarwal
	HDIL	XGHSF	HDIL IN	Gagan Agarwal
	Indiabulls Real Estate Ltd	IBELF	IBREL IN	Gagan Agarwal
	Omaxe Limited	XOMXF	OAXE IN	Gagan Agarwal
	Puravankara Projects Ltd	XPJVF	PVKP IN	Gagan Agarwal
	Unitech Ltd	UTKIF	UT IN	Gagan Agarwal

**iQmethod<sup>SM</sup> Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

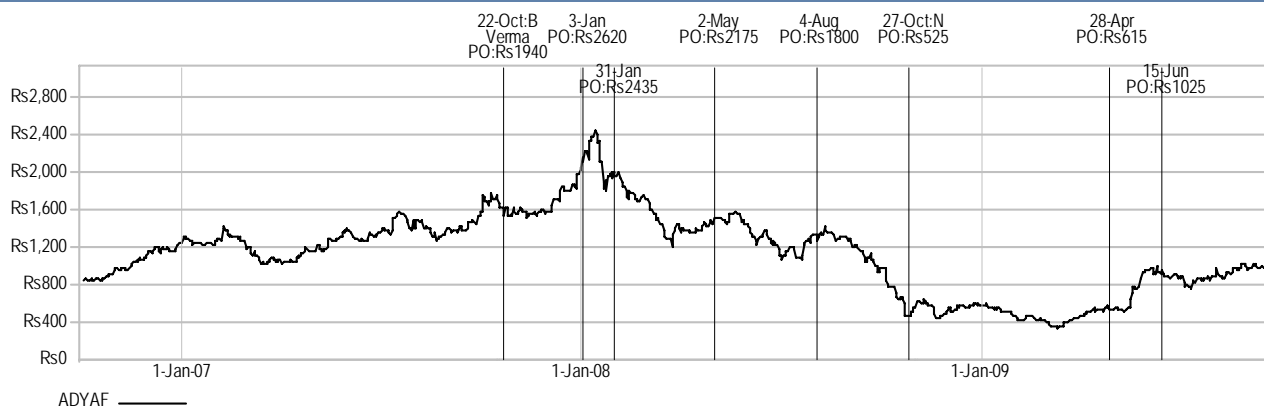
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## Important Disclosures

### ADYAF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of September 30, 2009 or such later date as indicated.

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### Investment Rating Distribution: Industrials/Multi-Industry Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	45	51.14%	Buy	19	48.72%
Neutral	20	22.73%	Neutral	11	64.71%
Sell	23	26.14%	Sell	7	38.89%

### Investment Rating Distribution: Global Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1528	47.19%	Buy	740	53.86%
Neutral	815	25.17%	Neutral	436	60.39%
Sell	895	27.64%	Sell	378	45.99%

\* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofAML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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