Equity Research
August 27, 2009
BSE Sensex: 15770

INDIA

Market strategy

Well-poised companies with market capitalisation <US$2bn

This note identifies well-poised mid-caps (market capitalisation of up to ~US$2bn) in the I-Sec coverage universe. The key criteria used are: i) significant capex spent in the past three years, relative to the size of the companies, ii) comfortable current D/E and iii) absence of significant equity dilution in the past two years. Our rationale is that companies that have invested in expanding their businesses over the past few years without aggressively resorting to significant external funding will be well placed to capitalise on the improving economic situation in the next few years (Table 1).

- **Key criteria for selection.** This list consists of companies that have made significant investments, relative to their size, in the recent years. While we anticipate overall economic recovery in the next few years, we have been conscious of debt-equity level while picking companies from our coverage universe, in case the recovery gets deferred. We prefer companies that have been able to fund such expansion without resorting to external funding as much as possible. In our view, such expansion is sustainable.

- **Well-poised companies.** Table 1 lists our preferred mid-cap picks. We favour Gujarat State Petronet (GSPL, it has incurred significant capital expenditure in the past three years through internal accruals and debt, and has comfortable debt-equity ratios) for its likely impressive gas volume and potentially higher tariffs. Sun TV is further strengthening its leadership in South India, is best positioned to monetise its distribution control and has attractive valuations, relative to its history. We prefer CESC for its robust business, expansion plans and attractive valuations. A significant proportion of dilution in CESC over the past two years has been due to the merger of the promoter's retail business.

Table 1: Well-poised companies with market capitalisation under US$2bn

Company	Price (Rs)	Mkt cap (US$mn)	3-Yr cumulative capex as % of cum revenues	Net D/E (%)	FY07-09 equity dilution (%)	EBITDA margin (%)	I-Sec Rating	Rel. perf to Sensex (%)	
								3m	12m
GSPL	76	856	111	94	4	87	BUY	20.2	12.6
Educomp Solutions	4,288	1430	89	170	8[a]	48	BUY	40.2	13.2
Lanco Infratech	422	1876	58	220	29[b]	13	BUY	9.9	34.3
Sun TV	275	2133	47	(8)	0	71	HOLD	(6.4)	2.5
OnMobile Solutions	524	617	27	(41)	35	31	BUY	14.0	(2.1)
Glenmark	218	1059	26	104	4	27	BUY	(23.1)	(76.8)
Dishman Pharma	215	333	26	121	10	18	BUY	4.2	(37.7)
CESC	359	854	26	43	48	20	BUY	(9.2)	(0.7)

Note: [a] Further 9% equity dilution in FY10 & additional 8% due to outstanding FCCBs; D/E will correspondingly fall to 80% and 50% respectively; [b] includes equity dilution at the time of IPO; there has been further 8% dilution in FY10
Source: I-Sec Research

Anantha Narayan
+91 22 6637 7311
anantha.narayan@icicisecurities.com

CESC

- CESC's valuations are among the most attractive in the sector – at present, on standalone basis, it is trading below 1.2x FY10E BV and at P/E of 10x
- The Budge-Budge expansion will provide 250MW additional capacity Q3FY10 onwards
- We believe the market is ascribing negative value to its retail business; considering the improvement in the Indian retail sector as well as CESC's own business, we value that business at Rs35/share
- We believe equity dilution can provide capital for future projects such as Haldia, thereby reducing execution risk

Dishman

- Immediate outlook is challenging – we expect lower-than-normal growth in the next 2-3 quarters due to inventory tightening by customers and demand slowdown
- The long-term opportunity, however, is quite attractive. Dishman would benefit from the outsourcing opportunity from India, which could rise 4x to ~US$5bn in the next five years
- Dishman is among the best CRAMS player in the API segment and the preferred partner for many of the top 20 global pharma companies – for example Solvay, Astra Zeneca, GSK plc and some Japanese players
- Dishman' stake in Dishman SEZ Pvt (which was an investor concern) has been reduced to 1% from 100%

Educomp

- Educomp has a first mover advantage in high-growth 'smart class' education, which is an annuity-based business model
- Its K-12 schools initiatives are on track providing consistency in revenue streams
- Educomp has a presence across the education value chain (pre-schools, vocational training, e-learning, etc.) through various acquisitions and joint ventures
- Its recent QIP of Rs6bn allays funding concerns for the next two years
- We expect 54% CAGR in fully diluted EPS over FY09-11E

Glenmark

- The recent failure of Oglemilast in clinical trials (for treating chronic obstructive pulmonary disease) has led to a correction in Glenmark's stock price
- We remain confident about Glenmark's robust business model and R&D pipeline. Improvement in base-business performance, likely approval of 1-2 key ANDAs and a R&D licensing deal in FY10 are key stock triggers
- The stock trades at an attractive FY11E P/E of 12x (generics business earnings) and the downside risk is limited

Gujarat State Petronet

- We expect favourable Petroleum & Natural Gas Regulatory Board policy on gas pipelines
- GSPL's capex plans are aggressive and the company will likely record an impressive gas volume CAGR of 35% over FY09-12E
- Book value is understated; FY09 adjusted BV is at Rs29/share versus Rs22/share reported BV
- We expect strong FY10 performance owing to a jump in gas volumes and higher unregulated tariffs

Lanco Infratech

- Capacity of operational plants is being significantly ramped up to 2,000MW from 500MW; 4,000MW capacity will witness financial closure in FY10
- The EPC segment is going strong – the current orderbook is at US$2.5bn, with potential addition of US$5bn in the next 12 months
- Conversion of 150MW into merchant power is likely and new merchant power projects will be added
- EBITDA margin declined to 13% in FY09 (versus average EBITDA margin of 18% through FY07-09) and we expect average EBITDA margin to be 26% between FY10 and FY12
- Valuations are attractive – NAV is Rs463 versus the current stock price of Rs422 and the stock trades at FY11E earnings of 13.9x

OnMobile

- Recent international deal wins from Vodafone and Telefonica will de-risk business
- International revenue will form ~50% of consolidated revenues in the next 5-6 years and the revenue share from VAS providers is higher in the international market
- We are positive on OnMobile in the long term considering the non-linearity in business, clear leadership in high-growth VAS market and recent strong traction in international markets; revenue and earnings growth will likely pick up from FY12

Sun TV

- Sun is further strengthening its leadership in key South Indian markets by launching channels in niche genres such as comedy and kids, which will help it garner a larger share of the advertising pie – Sun owns 18 channels in South India with a market share of more than 50%
- Sun is best positioned to monetise its considerable distribution control through promoter companies such as Sun Direct (DTH player) and Sumangali Cablevision (Chennai-based MSO) over the distribution network. Sun's subscription revenues are expected to grow 31% in FY09-12E driven by increase in DTH revenues
- The radio and movies businesses are key concerns though. Sun's radio business with 44 licences has been bleeding and the company expects Rs600mn loss from radio in FY10. While Sun's entry into the movie production business is justified since the company annually purchases TV distribution rights for more than 75% of the movies produced in South India, the venture is likely to increase volatility in profitability
- Sun currently trades at a 20% premium to the Sensex versus a historical range of 50-60%. We believe the strength of the business model justifies a 30-40% premium range

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10 outperformance; **HOLD**: -10 to +10 relative performance; **SELL**: +10 underperformance

ANALYST CERTIFICATION

We /I, Anantha Narayan, PGDM, B.E. research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Anantha Narayan, PGDM, B.E.* research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its affiliates collectively do not own 1 or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that *Anantha Narayan, PGDM, B.E.* research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.