India Strategy

Ground view

"You need chaos in your soul to give birth to a dancing star"…. - Nietzsche

The sovereign debt crisis, growth moderation and fears of recession seem to have heightened the sense of confusion prevailing in the global markets. The state of chaos is evident in the exodus from equity markets – developed markets saw value erosion of 12%, while Indian markets tanked 10% in 3 months! While the domestic economy appears to be in better shape than those of the developed geographies, stubbornly high inflation and the consequent aggressive stance of the RBI have raised the spectre of sub-7% GDP growth. With the macro environment being extremely uncertain, we sense the need to take stock of what is happening on the ground. We have put together trends, concerns and triggers across various sectors in this consolidated product, which highlights the actual "Ground Feel" in Corporate India.

Trends: The demand scenario continues to be strong, with sectors like Consumers and Retail clocking strong volume growth in the past three months. While some moderation is visible in certain segments of automobiles (interest-rate sensitive categories), demand for 2-wheelers and LCVs remains healthy. In Financials, an effective transmission of policy rate hikes has led to a sharp increase in deposit and lending rates, resulting in robust deposit mobilization albeit at the cost of credit growth. Deceleration in order inflows in the capital goods and infrastructure spaces has kept investment momentum subdued, which in turn is dragging down cement volumes. Meanwhile, the weak global demand environment has moderated volumes in metals, but doesn't seem to have prodded any roll-back in technology spending, keeping Indian IT Services companies unscathed (so far).

Concerns: Persistently high commodity prices have dented margins across sectors. While cost optimization (lower A&P spends) has offset decline in EBITDA margins of Consumers, the impact has been more pronounced for sectors like Cement, Automobiles, Real estate, etc. Further, the tight monetary policy adopted by the apex bank (~325bp hike in policy rates since March 2010) to counter high inflation has increased cost of funds (SBI PLR is at an all-time high of 14.75%!), impacting credit growth and discretionary spending in the economy. On the fiscal front, lack of positive policy triggers from the government has slowed down investment spends. While the domestic economy appears to be insulated from the global turmoil, worsening of the sovereign debt crisis in the Euro zone or a recession in the US would be negative for global plays like IT Services and Metals.

Triggers: Emerging economies have been grappling with inflationary pressure (thanks to lax monetary policies adopted by the developed world!). This has resulted in repeated policy rate hikes by central banks in most emerging economies. Moderation in commodity prices (likely on weak global demand outlook) and clarity on the interest rate cycle would be key triggers for Indian corporates. While lower commodity prices are expected to boost earnings growth across sectors, lower interest rates are likely to benefit leveraged plays like infrastructure and in turn kick-start the capex cycle. Meanwhile, India Inc. seems to be awaiting policy triggers from the government, which, though no silver bullet, could go a long way in reviving sentiment and investment momentum.

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SEBI Registration Nos.: INB23 12914 37, INF23 12914 37, INB01 12914 33, INF01 12914 33.

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Auto

Hopes on 'festive season sales'

After clocking over 25% growth in FY11, the auto industry has started feeling the pinch of rising interest rates and slowing growth. But the impact has not been observed across segments – passenger vehicle and 3-wheeler sales have started declining, but 2-wheelers and LCVs have been growing at a brisk pace (15% and 20%+ respectively). The MHCV category, which is most susceptible to the macro-economic environment, has been resilient so far with growth only moderating to 7-8%. We recently interacted with corporates, channel partners and dealers across geographies for an on-ground update. While the passenger car segment is pinning its hopes on the festive season, MHCV dealers are becoming cautious in the wake of negative global news flow. LCVs and 2-wheelers are expected to grow at a healthy pace backed by a normal monsoon. We are not too optimistic about sales picking up in the festive season. Also, we believe MHCVs will be most vulnerable hereon. Further, recent segmental performances suggest that the growth slowdown in metros and larger cities has not yet trickled down to smaller towns.

Passenger cars – 'festive' hopes: Footfalls have fallen marginally, but conversion rates have dropped sharply. This implies consumers have put purchase decisions on hold. The key reasons for the purchase deferrals are the sharp rise in petrol prices and higher interest rates. Dealers are optimistic about a pick-up in passenger car bookings in the next 15 days as consumers aim to get deliveries during the festive season. However, OEMs are not too optimistic. Most players have increased discounts on their models (2-3%) except on new launches.

MHCVs – resilient so far, but challenges ahead: MHCV growth, though having slowed to mid-single-digit levels, is showing greater resilience (or lag effect) than anticipated. While dealers in metros are indicating a sharper deceleration, opening up of new pockets of economic activity has been providing a growth cushion. However, dealers say that the increasingly negative news flow on the economy, India and globally, has made buyers more cautious. We expect the slowdown in sales to become sharper hereon, particularly after the festive season, as IIP growth worsens, the capex cycle remains weak and export sales moderate.

LCVs and 2-wheelers remain firm; post-monsoon demand holds the key: As the rural and semi-urban markets have been largely insulated from the macro slowdown so far, 2-wheelers and LCVs have been growing at a healthy clip of 15% and 20%+ respectively. While the normal monsoon could provide a cushion, the LCV category should see some moderation in growth as economic fallout trickles down to smaller towns and villages.

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Capital Goods

Capex remains a drag

Macro headwinds like inflation and monetary tightening, coupled with government inertia on reforms, have stifled the investment cycle. New project announcements have been declining in the past four quarters (-55% yoy in June 2011) and the number of projects being stalled is at peak levels (total value: Rs3.5trn). In 1QFY12, order inflows fell sharply by 24% yoy, resulting in muted order backlog (-4% yoy). Companies point out that investments have especially slowed down in infrastructure (power, roads, etc) as rising interest rates have increased funding costs and pressured project IRRs. We believe order inflows are likely to be dull in the next few quarters, which will impact earnings visibility in FY13 and drive an earnings downgrade cycle. However, after the recent stock price correction, valuations are becoming attractive and risk-reward is turning favorable. We prefer companies with strong order backlogs and consumer-led stories and with valuations at the lower end of the historical trading band. We remain neutral on the sector, with Havells and Kalpataru being our top picks.

Economic slowdown affecting capex: Rising interest rates and policy inertia have been slowing down India's macro-economic environment. Auto and port volumes have slowed and so has business confidence. These factors have been dragging down India's investment cycle since mid-2010. While the domestic market is struggling to cope with the macro headwinds (high inflation and continued monetary tightening), aggravation of the debt crisis in Europe and fears of a recession in the US have caused further damage. Accordingly, growth of new project announcements have been negative in the past four quarters (-55% yoy in June 2011) and the number of projects being stalled is at peak levels (cumulative value of Rs3.5trn). The slowdown in investments is across sectors, with infrastructure segments like power and roads bearing the maximum brunt.

Muted order inflows and backlog hit earnings visibility: Order inflows fell by 24% yoy in 1QFY12, leading to a lower order backlog (-4% yoy) due to the slowdown in investment activity. In our interactions, some companies highlighted that with another rate hike expected new projects and order inflows would remain muted over the next few quarters due to pressure on project IRRs. We believe this would impact order backlog and earnings visibility for FY13. There seems to be some movement on policy reform with the government introducing the draft land acquisition bill. However, we need to see material progress on reforms to enable speedier and cost-effective implementation of projects and boost investments. Any relaxation in monetary policy led by a potential easing of inflation would drive investments as the cost of funding projects would fall and IRRs would improve.

Valuations turning favorable; maintain neutral view on sector: With the recent price correction across stocks, valuations have become attractive and risk-reward is turning favorable. However, the earnings downgrade cycle is yet to play out completely as weak order inflows over the next 1-2 quarters will impact earnings visibility for FY13. So, we prefer companies with the following attributes: 1) order backlogs which provide visibility, 2) growth led by consumer demand, and 3) valuations at the lower end of their historical trading band. We remain neutral on the sector, with our top picks being Havells and Kalpataru.

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Consumer goods

No slowdown yet

We spoke to various companies like HUL, Dabur, Colgate and GCPL for an update on the demand scenario in the context of inflationary pressure and rising prices. Our checks indicate that demand remains strong. Categories like shampoo, skincare, homecare and toothpaste continue to see volume growth in the mid-teens, with no slowdown in rural or urban segments. Mature categories like soaps have slowed down to low single digits; but HUL and GCPL are still registering mid to high single-digit volume growth despite raising prices by high single digit levels. While input prices have not come off, they have stabilized. The current practice of optimizing A&P instead of increasing prices to manage EBITDA margins should continue, especially due to the popular perception that commodities will cool off. As a result, while revenue growth would sustain, margins would remain under pressure in the near term.

High input costs pressuring gross margins: Input costs remain elevated, with most commodities being at record highs. Prices of commodities such as Brent crude, liquid paraffin, coffee, copra, etc, are at least 50% higher yoy, while those of safflower oil, palm oil, etc, are up 20% yoy. Given that commodities have held on to their high levels in the past few months and price increases are still not offsetting the impact, gross margins will remain under pressure.

Prices up, but no slowdown yet: Despite an average pricing increase of over 5% (price increases as high as 32% for a few brands including Parachute), volume growth has remained fairly robust and most categories are still recording double-digit growth. Our interactions with companies indicate that categories like shampoo, skincare, toothpaste, juices and homecare continue to report volume growth in the mid-teens, with no slowdown seen in urban or rural growth. In certain mature categories like soaps, while category volume growth has slowed down to low single digits, companies like GCPL and HUL have still grown ahead of the market at mid to high single-digit levels despite high single-digit price increases and expect to maintain their growth trajectory (HUL is posting growth on the back of ~20% tonnage growth in detergents and 9% in soaps last year)

Moderate pricing activity from current levels: Companies continued to raise prices in the last few months, with prices of several products like Rin, Pears, Clear, Godrej No.1, Dabur Amla and Vatika hair oil rising by 3% to 10%. However, with input prices stabilizing, the pace of price increases is expected to slow down except for a few categories like soaps and detergents whose margins are still under pressure. Also, given that significant price increases have been executed, companies are wary of increasing prices too aggressively too soon and risk demand destruction. Lastly, given the general perception that commodity prices will eventually correct, companies, smarting from the 2008 experience, are wary of giving unorganized players any room to gain market share. As a result, they are adopting a wait-and-watch approach on price increases. So, the current trend of optimizing A&P rather than increasing prices to improve EBITDA margins should continue and margins are expected to stay under pressure in the near term.

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Cement

Volume growth normalizes; prices hold

Cement demand has been sluggish in the past four months, clocking just 3% yoy growth in April-July 2011. Our channel checks indicate limited demand improvement on the ground. And, with macro factors (interest rates and government action on infrastructure investments) remaining unfavorable, we expect volumes to be sluggish in the near term. Hence, while capacity additions in the sector are slowing down, we believe pick-up in demand has now emerged as the key to improve capacity utilization and subsequently drive a return of pricing power to cement companies. Meanwhile, cost pressures continue, with all key elements, including raw material, coal and freight, showing a rising trend. As a result, we see no marked improvement in profits of cement companies in the medium term. We believe valuations of US$140-160 EV/tonne and 16-17x FY12E earnings are expensive. We maintain our bearish stance on the sector and reiterate Underperformer on Ambuja Cements, ACC and UltraTech. We maintain Outperformer on Grasim mainly because its earnings are cushioned by the VSF business.

Muted volumes – key concern: Cement volume growth has been muted in the past 8-10 months, led by lower housing demand (higher interest rates) and slowdown in infrastructure investments (due to government inaction on large projects). Trailing 12-month demand growth has been just 4%, with YTD volume growth in April-July 2011 at 3%. Macro factors like interest rates and government decision-making remain unfavorable, while dealer and user industry feedback indicates limited improvement on the ground. Though volumes could sequentially improve by end-September 2011 as the monsoon recedes, material growth yoy is unlikely. Demand is especially weak in large consumption centers like metros and the non-trade (projects) segment. Dealers indicate a marginal improvement in retail demand in the past 1-2 months and expect the trend to continue. However, unless demand picks up from large housing and infrastructure projects over the next few months, overall volume growth is likely to remain muted.

Pricing stabilized in August 2011, but pressures remain: After a decline of Rs15-20/bag in June-July 2011, cement prices have been largely stable across regions (except in the South) in August. In the South, prices declined by a lower Rs5-7/bag in the past two months and were stable through August. The widening gap between trade and non-trade prices has emerged as a key trend across regions. The differential has increased to almost Rs30/bag in some markets, indicating weak demand and the resultant price pressure in large user segments.

No respite from cost pressure: While cement realizations in July-September 2011 declined sequentially across regions (except in the South), cost pressures continue to escalate. The full impact of the Rs3/litre hike in diesel price from end-June 2011 will be seen from Q2FY12 earnings. Coal costs are likely to remain high, led by ~30% increase in linkage coal prices since March 2011 as also higher e-auction coal prices (100% premium over notified prices in Q1FY12, vs 90% in Q4FY11). Moreover, quantities supplied under linkage are reducing, leading to higher dependence on the relatively more expensive e-auction/ imported coal. Going forward, we expect strain on EBITDA/ tonne.

Our view: Cement firms have raised prices to historical highs across regions over the past 6-8 months, but cost pressures and lower volumes have restricted the net gains to EBITDA/ tonne. A pick-up in demand remains critical to improvement in capacity utilization and return of pricing power, especially in the inflationary environment. But given high interest rates (a further 25bp hike by RBI likely) and its impact on housing demand, coupled with government inaction on pushing large infrastructure projects, we believe any material improvement in demand is unlikely in the medium term. So we expect capacity utilization of 72.8% in FY12, marginally higher than 71.9% in FY11. In view of the sluggish volume growth and concerns on profitability, we believe cement stocks are richly valued (EV of US$140-160/ tonne; PER of ~16x) and do not reflect the weak business fundamentals.

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Financials

Risk-reward turning favorable

Reeling under the impact of a long trail of negative news of sticky inflation, a series of policy rate hikes and global economic weakness, financial stocks have corrected sharply (down 20% YTD), with banking stocks (ex HDFC Bank) underperforming the Sensex by 12% YTD. The underperformance has been starker for PSU banks (down 11% YTD) as against an outperformance of 6.5% by private banks (in line with our view) owing to better asset quality and earnings visibility. Most financial stocks are now trading at a discount to their long-term averages. We believe current valuations factor in the risks of higher interest rates (lower credit growth and contraction in NIMs) as also slower economic growth (asset quality deterioration). Worsening of the global economy is still a risk; but we believe any downside due to that would be short-lived and financial stocks would rapidly recover. Our picks are SBI (1.3x FY12E book), ICICI Bank (1.7x), IndusInd Bank (2.6x) and ING Vysya Bank (1.1x). We believe these offer high earnings visibility and improving profitability coupled with attractive valuations.

Macro concerns on the mend; interest rates have almost peaked: Increasing worries on domestic growth moderation and global uncertainties are likely to soften RBI's policy stance. We believe interest rates are close to peaking and expect the RBI to take a breather after another 25bp hike in policy rates. In light of this, we believe lending rates in the economy have likely peaked. We expect most banks in our coverage universe to see a compression in margins (~15bp in FY12), with private banks (~10bp) being better placed than PSU banks (~19bp) owing to more aggressive rate hikes as also better ALM.

Asset quality risk not a crisis; FY12 earnings growth to remain robust at 27% yoy: Higher interest rates and slower economic growth are straining India Inc's debt servicing capacity. Delay in infrastructure projects and the 'moral hazard' plaguing agricultural loans are further accentuating asset quality risk for lenders. However, strong corporate balance sheets (gearing at a mere 0.54x) should assuage the extent of stress. Also, retail credit is benefiting from a structural improvement in credit discipline and higher incomes. We deduce that ~17% of banks' outstanding credit is 'stressed' and expect a large part of it to get restructured. In our base case, we expect NPAs + restructured assets to peak at 7.8% in FY13, as against 5.8% now. As a bulk of the stress is likely to be recognized in the form of restructuring, associated credit costs are likely to be minimal. On the back of contained credit costs and healthy traction in loan disbursal (see system credit growth at ~18% for FY12), we see earnings of our coverage universe expanding at ~27% CAGR over FY11-13E. We expect PSU banks to see ~25% earnings growth in FY12, while private banks are expected to see a higher ~30% yoy rise.

Valuations below long-term averages: We believe concerns on asset quality and compression of NIMs are largely priced in and risk-reward is extremely favorable. However, valuations are still much ahead of the trough levels of FY09 and the threat of a worsening global crisis remains an overhang on stock performance in the near term. Our long-term outlook for the sector remains positive and we see a rebound in banking stocks ahead as interest rates peak and the global economy stabilizes. Our picks are SBI, ICICI Bank, IndusInd Bank and ING Vysya Bank. We believe these banks offer higher earnings visibility, improving profitability and also attractive valuations.

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Infrastructure

All eyes on deleveraging

Order flows to construction companies have been muted in the past few months mainly due to a slowdown in power sector orders. Working capital levels remain high due to delayed payments and increased support to subsidiaries and vendors. While competitive intensity has driven down threshold IRRs of road projects, we see higher toll rate hikes (linked to WPI) offsetting at least the impact of higher interest rates. We see divestments/ value-unlocking of BOT/ real estate investments as key triggers for infra companies as it will ease the stress on balance sheets. A decisive stance on key policy overhangs, besides providing the much desired clarity, could also restore confidence among investors and developers in the sector. Also, peaking of interest rates could provide a significant earnings boost for construction players given the high leverage on their books.

New order flows slowing down: Order flows have slowed in the past two quarters, with announced order flows falling ~30% each in July and August. A slowdown in power sector order flow (generation as well as T&D) due to uncertainties on availability and pricing of fuel has been the main reason for the decline. NHAI ordering has been strong at ~3100km of roads (YTD FY12). Buildings segment orders have also been fairly robust.

Working capital cycles remain stubbornly high: Working capital cycles for EPC players remain stretched, led by delayed payments from government agencies and increased support to subsidiaries/ vendors/ sub-contractors. Leverage of construction players at 1.1-1.5x (debt/ EBITDA of 4-5x) clearly remains stretched, driving concerns on their ability to service debt and fund future projects. This is also reflected in valuations, with most infra stocks trading at 0.5-1x P/B.

Competition, execution challenges driving down IRRs: Intense competition for new orders has driven threshold IRRs down to ~15% from 18-20% a few years back. We estimate IRRs for some of the recently awarded road projects to be well below the ~15% threshold. Also, most developers that commissioned road projects in the past 12-15 months have missed traffic projections by 10-15%. This would mandate further equity support from parent in the initial years.

Higher interest rates not a very big risk to IRRs for road projects: The sustained rise in WPI has led to an average ~250bp rise in borrowing costs for infrastructure players. However, NHAI toll projects, in particular, have a well-defined mechanism for pass-through for inflation (linked to WPI), albeit with a lag. We estimate that higher toll rates would largely offset any negative impact of higher interest rates on the IRRs of these projects.

Lower interest rates and deleveraging to be key triggers: Construction companies have 25-35% of their capital employed invested in BOT/ real estate projects. As some of these projects have been commissioned, they have become ideal divestment candidates. Most construction companies plan to deleverage their balance sheets through stake divestment in these assets. Such deleveraging, we believe, can re-rate the stocks significantly. Further, peaking of interest rates can also drive up earnings, with an earnings sensitivity of 15-30% for every 100bp change in interest rates. A steep and sustained rise in interest rates can materially increase stress on the balance sheet.

Clarity on policy direction can help restore confidence: Policy decisions on key issues like forest clearances for coal mines in "NoGo Areas", 12th Plan gas allocation, fixing of revenue model (Single Till/ Double Till) for non-metro private airports, collection of ADF at Delhi and Mumbai airports, etc, have been substantially delayed, driving uncertainties on the returns from and viability of projects in these sectors. Decisive policy actions on these fronts could help address the aforementioned uncertainties and restore the confidence of investors and developers.

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IT Services

Pain in the offing

The global economy is in turmoil and most macro-economic indicators are pointing to either a recession or very slow growth for a couple of years in the developed world. We see muted growth in tech spending, which is cyclical in nature, with the possibility of a decline in 2012. This could result in a business slowdown for Indian IT services companies. Our interactions with various players indicate that the companies are currently not witnessing any major pressure on business but sporadic slower decision-making. However, we believe the impact will be visible from the December or March quarter as IT spending usually lags economic growth/ contraction by 3-4 quarters. In the challenging environment, we take a cautious view on the sector and recommend sticking to the top few names.

IT services companies not seeing any major impact…: We recently interacted with the managements of various Indian IT services companies for their view on the impact of the economic slowdown in developed markets on tech spending and business in general. Most companies highlighted that they are cautious and are closely watching global events. However, there has not been any pressure on the business so far. A few companies, notably Infosys, Mahindra Satyam and Persistent Systems, did speak of slower decision-making in a few cases. Yet most of these companies mentioned that it is too early to call it a trend. Indian IT companies have not made any major changes to their hiring/ investment plans. We believe global corporates as also Indian IT companies are better prepared for any downturn this time than during the beginning of the previous global financial crisis.

…but there may be more pain: IT spend typically reacts to any contraction or recovery in economic activity with a lag of 3-4 quarters. Revenues of the top4 Indian IT services companies show a strong correlation with S&P operating earnings with a three quarter lag. We believe this is because of the lag between the annual IT budgeting process and actual spend. While global corporates are largely spending in line with 2011 IT budgets, we believe 2012 budgets might build further caution, which could impact IT spend and thereby revenues of Indian IT companies. We believe the impact on revenue growth will likely be visible in the December or March quarter.

Tier1 players better placed in the challenging times: We see revenue growth of IT services companies slowing in FY12 and FY13. Aggregate revenue growth of the top4 companies could fall from ~26% in FY11 to ~22/19% in FY12/13E and industry growth should decline by 3-4% from 19% in FY11. While companies would take longer to feel the heat of the macro-economic turmoil due to the aforementioned lag effect, we take a cautious view on the sector. We believe larger players like Infosys and TCS are better placed to sail through the challenging times. We rate Infosys and TCS as Outperformer and Wipro, HCL Tech and Mphasis as Neutral. Most other stocks in our universe are rated Underperformer.

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Media – TV Distribution

Regulatory 'saviour' awaited!

Our investment call on the cable distribution space was clearly off the mark. We had initiated coverage on the sector in July 2010 with a bullish stance. Our positive bias was solely based on the 'voluntary digitization' scenario prevailing at the time. With nationalized MSOs having acquired a "critical mass" of 9-10m subscribers, DTH pressure mounting on LCOs, and players well capitalized (Hathway and DEN raised Rs4bn+ in IPO), voluntary digitization in cable was well nigh. With DTH adding 11-12m subscribers annually (on a base of 30m+) and digital cable having a subscriber base of ~3m, the delta change for cable companies was far superior to DTH. However, the perceived 'regulatory trigger' (mandatory digitization to be enforced by the government) played spoilsport! Herein we undertake an analysis on the divide between 'perception' and what was happening on the ground.

The TRIGGER…: In August 2010, the TRAI recommended mandatory digitization across the country, with a sunset clause for analog cable. This was undoubtedly a game changing idea for the cable industry. Unlike the failed CAS mandate in 2006, the TRAI recommendations had the consent of nearly all industry participants. Broadcasters were backing it given the visible income stream from DTH operators (unlike in CAS where a price cap of Rs5 per channel kept them away) and MSOs were funded to seed STBs (unlike earlier). With respect to LCOs, there was lower retaliation given the subscriber loss to DTH. In essence, the regulatory trigger was perceived to change the industry dynamics and hasten the process of digitization (especially for cable companies). In the wake of this, all distribution stocks, especially DEN and Hathway, registered a strong upmove.

…and the DELAY: The TRAI recommendations received a final go-ahead from the I&B Ministry only in April 2011. The long wait of nine months changed the industry landscape for cable operators, while momentum in DTH remained strong. The reason for the "lack of action" among MSOs such as DEN and Hathway was apparent – players had limited access to capital; so even if they went ahead and aggressively digitized (at say 100% subsidy), they were unlikely to get any returns on that capital (as digitization without addressability would not lead imminent monetization). Players had limited 'incentive' to ramp up aggressively. Thus cable players pulled back their aggressive expansion plans, and the regulatory mandate has now become imperative to transform the industry. Meanwhile, the delay from the government has only been stretching.

What's happening on the ground? The bill is expected to be taken up for discussion in the winter session of Parliament. As it requires a change in the Cable Act, Parliament approval is mandatory. So the bill will first be reviewed by the Cabinet and then taken up for discussion in the Lok Sabha. There seems to be an overall consensus by all participants – government, broadcasters, MSOs – for mandatory digitization. However, LCOs continue to be against it for obvious reasons. Timelines for the regulatory mandate are uncertain at this point. Though DEN and Hathway stocks have corrected materially and are currently trading at an EV less than the capital employed in the business, we see near-term operational challenges restricting upside in the stock in the near term. Our sense is that the government trigger is the only saviour for the industry now; else we may see a wave of consolidation among the bigger players to make the model viable.

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Metals

Glass is half empty

Weakening macroeconomic indicators and muted construction and automotive demand in developed countries highlight concerns over demand growth in the steel sector. Prices have corrected by US$40-80 per tonne in the past two months and we see the likelihood that a bottom is near. A combination of cost support, supply flexibility and China's relative strength are set to arrest the sharp fall in steel prices. Therefore, while the risk of a financial collapse persists, we believe prices in all regions are now at levels that have strong support.

Macroeconomic indicators remain weak: Over the past few months, economic uncertainty in the developed world, political crises and, more importantly, rising inflation in the emerging economies, particularly India and China, have led to slack demand for commodities. Notably, global PMI has been sliding sharply for the past three months and fell to 50.1 in August 2011 from 55 in April 2011. Also, regional PMIs (Eurozone, China and the US) are down below 50 for two consecutive months, indicating a slowdown in economic growth. With steel being a lynchpin of economic development, the recent concerns over economic growth and the sovereign turmoil have driven widespread concerns over the near-term future of the steel industry and steel prices.

Chinese consumption underpins global steel demand: While the economic momentum in the developed world has slowed, demand growth in China has been strong despite a string of monetary measures by the government to marginally decelerate the growth rate to rein in rising inflation. While PMIs over several months have dropped and are hovering at 50, steel production remains elevated. Construction demand has been strong despite severe controls on the private real estate market. We expect production to maintain levels close to 700m tpa, supporting prices which are already showing signs of an uptrend.

Supply constraints continue to aid strong raw material prices: Spot prices of iron ore and coking coal remain strong due to rising supply constraints. The recent strength in iron ore prices comes on the back of tight supply from India following Karnataka state's decision to ban iron ore exports. The state accounts for about a quarter of India's annual exports of ~120m tonnes. Coking coal prices have cooled off from highs in the early part of year, but are still significantly higher than the historical average. While production at Australian mines is improving gradually, it is yet to reach optimal capacity, helping maintain the imbalance for the rest of CY11. Raw material for steel production, thus, continues to be the bottleneck in the chain and is helping keep prices high.

Inventories on the rise, but not to alarming levels: There has been a sea change in terms of maintaining inventory levels since the previous economic crisis. Mills and traders, hit hard by the need to liquidate inventory during the downturn, have been taking a conservative approach. Muted demand growth saw steel players maintaining idle capacity, which also highlights flexibility on the supply side. In fact, easing of concerns over demand growth would lead to destocking and assuage fears of an inventory pile-up.

Prices to hold up, but with a downward bias: After a US$60/ tonne correction in US and European steel prices over the past two months, we believe prices have bottomed. While weaker demand in developed countries arrests the possibility of a hike in steel prices, an unprecedented rise in raw material prices has led to an increase in marginal CoP, which will cushion prices from further downside. We expect prices to hold up due to cost-push inflation but with a downward bias on account of muted end-user demand. Meanwhile, all major players have announced price hikes in the range of US$30-50 per tonne effective from September 2011.

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Oil & Gas

Tread with caution

Roaring crude prices seem to have dampened spirits across our coverage universe, with India being the only country where rising crude prices are a worry even for upstream companies (Cairn India being the honorable exception). This, coupled with rising gas scarcity and increasing demand, implies that the fortunes of natural gas T&D players are also looking a little frayed though their long-term prospects remain solid. We would venture, however, that all is not lost. The dissipating Libyan crisis and the uncertain economic environment across Europe and the US bode well for global crude prices in H2FY12E. Additionally, refining margins are likely to deliver strong yoy growth, primarily due to strength seen in the first half of the year. In the natural gas space, our conversations with CGD players suggest that pricing power is intact and hence rising cost of gas sourced via LNG is unlikely to hurt margins in the near term. This should sustain growth in profits over the next 12-18 months.

Whither the crude decline? The increase in uncertainty around the Eurozone, the definite move towards a regime change in Libya, and continued uncertainty around the US economy have failed to provide any respite to Brent crude prices, which have stubbornly stayed at ~US$110/bbl levels. We remain optimistic, however, of some weakness coming through in Brent prices, with more indications of demand weakness coming through in every successive forecast of the IEA, Libya rapidly moving towards a complete overthrow of Gaddafi's regime, and clear indications that European demand may stay subdued for some time. This will have a moderating impact on runaway GRMs as well, with Singapore GRMs clearly unsustainable at current levels of ~US$9/bbl. Having said that, even with some moderation, refining margins for Indian players would be at least ~25% higher yoy.

Petrochemical margins to remain flat: The demand-supply mismatch for petrochemical products, particularly for the ethylene chain, and moderating cotton prices imply that spreads and margins for petchem will be muted in FY12. The balance is set to improve from FY13. We build in a 10-14% decrease in petchem margins for RIL, GAIL and IOC.

Natural gas – output slump continues to hurt T&D players: The continued decline in KG D6 output, coupled with tight surplus capacity at India's LNG terminals, implies difficult times will continue for Indian T&D players GAIL and GSPL. Both the players are expanding capacity substantially through FY12E and therefore capacity utilization will remain a concern. However, the largest terminal owner, PLNG, and CGD players IGL and GGCL are in better shape as price acceptability for higher priced gas has increased with the slump in domestic gas supply.

Our view: Most players in our coverage universe (ex OMCs) have seen a strong quarter, with 47% growth in PAT and 28% growth in EBITDA in Q1FY12. However, the next may not be as exciting as the subsidy burden will be substantially higher in Q2FY12, resulting in relatively muted earnings for PSU upstream players (OIL, ONGC). Also, earnings for natural gas T&D companies will be dull as growth in gas volumes will be minimal over the next 12 months. The companies that will keep growing are: a) Cairn India – rising output and strong crude; b) IGL/GGCL – gross spreads remain strong; c) RIL – strong refining margins and stabilizing KG D6 output; and d) PLNG – strong terminal utilization and higher marketing margins due to the domestic gas scarcity. Our top picks at current prices are: 1) RIL – too much pessimism factored in the price, a milder-than-expected CAG report, and strong fundamentals; 2) ONGC/OIL – despite the subsidy overhang, production growth will come though over FY12-13E even as net realizations moderate over the next two quarters; and c) PLNG – the best bet to play the natural gas space.

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Real Estate

Price correction a key monitorable

We spoke to various companies, brokers and property consultants in the MMR, NCR and Bangalore markets to get a ground update on the residential demand/ absorption environment. Our channel checks indicate that despite significantly lower absorption in Mumbai, prices have not corrected enough to entice demand. However, developers are willing to negotiate with genuine buyers though they are not reducing prices officially. Absorptions in NCR are also witnessing a slowdown, largely led by land acquisition issues in Noida/ Greater Noida and sharp price appreciation in Gurgaon. While end-users are adopting a wait-and-watch strategy, investor interest is low due to limited upside potential in the value of properties. Meanwhile, demand in Bangalore is steady, with moderate price appreciation. However, the trend is gradually shifting to high-end residential projects.

MMR – Absorptions low, but developers willing to negotiate: Our channel checks suggest that increasing unaffordability and developers' reluctance to cut prices have led to a sharp fall in demand in the past few quarters. While consumers have been holding purchase decisions anticipating a price correction, limited new supply due to slowdown in approvals has enthused developers to keep prices high. However, with developers now willing to negotiate lower prices with genuine buyers, the deadlock seems to be breaking. However, official prices remain at historical high levels.

NCR – Falling investor demand and land acquisition troubles: The Noida and Greater Noida markets have witnessed a sharp decline in demand, with minimal price appreciation as land acquisition troubles in the region have turned buyers cautious. This, in turn, has resulted in demand shifting to the other markets of NCR like Ghaziabad, Faridabad, Dadri, New Gurgaon, etc. Gurgaon, after a sharp price rise last year, is witnessing demand slowdown as investor interest has started sinking. Also, lower affordability is pressuring end-user demand. However, projects on the proposed Dwarka Expressway are witnessing strong traction due to low prices and favorable location.

Bangalore – Steady demand and stable pricing: Bangalore has remained the sanest market, with a steady increase in demand and property prices in the past year. Our channel checks suggest that demand for mid-income projects has remained fairly robust and adequate supply has restricted any sharp price appreciation. However, the past few quarters saw an increase in developer interest for luxury residential launches. The takeoff, however, has not been very encouraging due to the premium pricing and substantially large ticket sizes.

Our view: We do not expect prices to appreciate in the near term and believe a 15-30% correction is required to drive absorptions in markets like Mumbai and Gurgaon. Bangalore remains our preferred market, where both demand and prices are expected to remain steady.

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Retail

'Sale' peps up sales

Retail sales slowed down in Q1FY12, with same-store volumes declining in some segments. This was prompted by multiple factors, but mainly led by sharp price increases taken in the apparel category and slowing discretionary spend. Our recent interactions with managements suggest that sales improved in July and August though largely led by an 'extended sale period'. We expect the momentum to remain strong in the festive season. Sales after the festival period will be the key monitorable. Also, we believe Indian customers are increasingly adjusting their purchases to the 'sale period calendar' rather than the 'festive calendar'.

A sluggish Q1FY12: Retail sales slowed down materially in Q1FY12. Shoppers Stop's same-store-sales growth dropped from 14% in the previous quarter to 7% (volume declining), Pantaloon Retail witnessed a material slowdown in the fashion and home solutions segments, and Provogue saw a decline in same-store volumes. This was mainly due to slower discretionary spend, a longer IPL calendar, and a sharp increase in prices in the apparel segment (over 15%).

Extended sale period drives July/ August sales: July and August saw some improvement in sales compared with the preceding quarter. The biggest driver of the uptick was the 'extended sale period'. The period was extended by 3-7 days by most retailers and came as a relief for consumers after the sharp price increases in the previous quarter. We believe the momentum will sustain this month too as the festive season begins 15 days earlier than in 2010.

Sales after the festive season hold the key: While value retail would continue to witness strong growth, we remain cautious on the fashion and home categories (discretionary segments). We believe sales will start slowing after the festive season as increasingly negative economic news from various regions hurts consumer sentiment.

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Telecom

Evolutionary phase

The Indian telecom industry is passing though an evolutionary phase characterized by: i) the advent of data-centric technologies like 3G and BWA, 2) near saturation in subscriber growth, with net additions declining to as low as 6.7m in July 2011 compared to ~20m early this year, 3) expectations of sweeping regulatory reforms in the National Telecom Policy 2011. In this backdrop, we spoke to various operators and dealers across metros and top-tier cities and took a closer look at TRAI financial data to analyze the road ahead. We believe the sector will see a marked slowdown in volume growth in the near term (Q1FY12 is a case in point). However, a modest hike in headline tariffs and higher data mix would start reflecting in financials over the next 2-3 quarters notwithstanding circle-specific promotions. Our assumptions of 3G revenues remain conservative in view of cautious commentary by stakeholders. Announcement of NTP 2011 remains the key trigger. Bharti Airtel offers better risk-reward at current valuations.

Subscriber additions unlikely to rise: TRAI subscriber data for July 2011 indicates a 42% mom drop in subscriber additions to 6.7m. Subscriber additions have witnessed a double-digit decline over the last four months from ~20m in March 2011. Our interactions with operators and dealers indicate that this was driven by: i) unavailability of adequate numbering plans, ii) lower intensity of newer operators, iii) incumbents' focus on only revenue-earning subscribers, and iv) near saturation in subscriber growth, with urban penetration at over 150% and limited network rollout in low-income rural areas (rural penetration 34%). The total Indian wireless subscriber base is 858m, which implies that penetration is ~72% (active penetration 50%).

Action shifting towards 3G plans and Tablets: We believe the hike in headline 2G voice tariffs will trickle down the system over the next 2-3 quarters. However, the action is shifting towards 3G plans. Recently, Idea and RCOM lowered their 3G data plans by 50-70%. Dealers and handset manufacturers reckon that 3G tariffs are still too high to evoke mass response and believe other operators would follow, which would help drive usage and develop the ecosystem. After high-speed dongles failed to attract strong response in the early stages of the 3G launch, operators rushed in with tablet PCs to drive up data usage among urban youth. Currently, RCOM's ZTE-manufactured tablet, priced at Rs12,999, is attracting more eyeballs. We learn that circle-specific festive promotions have started kicking in, with Vodafone, Uninor and Idea being more aggressive in Kolkata, Maharashtra (including Mumbai) and Andhra Pradesh. Also, a few dealers highlighted that the Anna Hazare movement and KBC5 (in the initial weeks) drove significant non-voice usage and are expected to more than offset seasonal weakness in Q2FY12.

Two-pronged strategy at work: TRAI financial data clearly reflects that ARPU pressure in metros and category 'A' circles has wilted (almost flat ARPUs, vs. 4-5% decline earlier), with operators realizing no additional benefits from a tariff war at penetration levels of over 150%. However, other circles continue to witness calibrated promotions (ARPU decline at ~3% qoq) as operators look to gain market share in the rural areas. We believe operators will adopt a two-pronged strategy of driving data revenue in urban areas via high-speed dongles and tablets, and higher voice usage in rural areas as the subscriber base matures and economic growth trickles down to the lowest-income household. We believe Bharti Airtel, which is an entrenched player in most urban markets and has the largest market share in rural areas, is best placed to reap the benefits of the changing Indian telecom landscape.

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Valuations

Companies	Price (Rs)	Mcap (Rs bn)	TP (Rs)	Reco	EPS (Rs/share)	Earnings CAGR FY11-13E	FY12E P/E (x)	FY12E EV/EBITDA (x)	FY12E P/BV (x)	FY12E RoE (%)	FY12E RoCE (%)
Alcoholic Beverages											
Radico Khaitan	123	16.3	165	OP	6.8	31.2	18.0	10.3	2.2	13.1	13.5
United Breweries	403	96.8	425	UP	7.6	26.0	53.2	26.6	8.3	16.7	13.1
United Spirits	842	110.1	950	N	41.8	37.4	20.1	11.7	2.3	12.0	11.7
Auto Components											
Bharat Forge	286	66.6	300	UP	17.1	29.2	16.7	8.7	2.8	18.1	16.3
BOSCH	7,120	223.6	7,660	OP	326.6	18.3	21.8	16.2	17.5	22.7	21.2
Automobiles											
Ashok Leyland	26	69.6	23	UP	2.4	12.1	10.9	7.5	1.6	15.5	13.1
Bajaj Auto	1,626	470.5	1,502	N	100.1	13.6	16.2	12.4	7.7	52.4	58.1
Escorts	72	6.7	110	OP	9.2	1.3	7.9	4.5	0.4	5.5	6.5
Hero MotoCorp	2,200	439.4	1,663	UP	113.8	15.0	19.3	13.1	11.3	66.3	49.0
M & M	797	489.0	762	N	45.2	14.0	17.6	13.4	4.0	24.8	23.6
Maruti Suzuki	1,109	320.9	1,141	UP	87.8	14.4	12.6	7.4	2.0	17.0	18.7
Tata Motors	162	516.1	200	N	28.9	8.9	5.6	3.9	1.9	40.1	22.0
TVS Motor	64	30.2	50	UP	5.1	30.6	12.3	7.9	2.7	23.6	18.1
Cement											
ACC	1,038	194.9	850	UP	57.5	8.1	18.0	9.0	2.8	16.0	17.5
Ambuja Cement	144	219.4	105	UP	8.1	5.3	17.7	9.8	2.7	16.1	18.9
Grasim Industries	2,309	211.7	2,600	OP	244.4	7.3	9.4	4.2	0.9	10.4	13.1
UltraTech Cement	1,126	308.5	850	UP	67.2	17.4	16.8	8.5	2.5	16.0	15.3
Construction											
Gammon India *	81	12.8	125	OP	5.2	390.4	(4.9)	3.2	(0.2)	3.7	8.3
HCC *	30	17.8	44	OP	0.6	(13.3)	(11.8)	3.4	(0.3)	2.4	8.1
IVRCL Infrastructures *	43	13.1	73	OP	4.1	(4.8)	(10.0)	0.4	(0.5)	5.4	9.4
Jaiprakash Associates	69	146.5	126	OP	7.1	7.9	9.7	9.0	0.7	7.1	7.7
Larsen & Toubro	1,609	979.5	2,010	OP	82.3	20.3	19.5	13.4	4.0	21.7	18.3
Madhucon Project *	74	5.6	160	OP	6.6	9.0	(5.1)	(0.8)	(0.4)	7.5	10.4
Nagarjuna Construction *	70	18.9	106	OP	6.6	(0.4)	5.0	3.8	0.3	6.6	9.2
Simplex Infrastructures	245	12.1	265	N	21.9	5.2	11.2	4.7	1.0	9.5	11.6
Consumer goods											
Colgate-Palmolive	990	134.6	975	UP	31.8	10.0	31.1	21.3	30.9	107.7	137.2
Dabur India	103	178.8	110	N	4.3	23.5	24.1	17.1	10.5	50.1	54.7
Godrej Consumer	426	137.8	450	N	19.5	25.9	21.9	14.1	8.2	37.2	23.3
Hindustan Unilever	339	740.4	340	OP	11.6	19.8	29.4	24.8	17.0	65.5	68.7
ITC	198	1,533.0	225	OP	7.7	18.9	25.8	16.5	8.5	35.3	47.2
Marico Industries	141	85.9	155	N	5.5	19.1	25.8	16.4	7.0	31.0	34.7
Nestle India	4,180	403.0	4,500	OP	103.7	21.2	40.3	26.2	31.7	94.8	128.4
Education											
Educomp Solution	237	22.7	400	OP	41.7	17.6	5.7	4.7	0.9	16.9	16.3
Everonn Systems	333	6.3	UR	UR	50.7	32.8	6.6	2.8	1.6	27.0	27.3
NIIT	46	7.6	55	N	6.3	30.0	7.3	5.6	1.5	21.0	12.9

Source: IDFC Securities Research   Note: OP - Outperformer; UP - Underperformer; N - Neutral; UR - Under Review

*Note: * Valuations adjusted for BOT values*

Valuations

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Engineering											
AIAE	310	29.2	370	OP	19.7	8.6	15.7	11.7	2.4	16.3	18.0
Bharat Electronics	1,559	124.7	2,045	OP	113.9	12.5	13.7	8.2	2.1	16.6	14.7
Carborundum Universal	314	29.3	350	OP	19.6	21.7	16.0	10.3	3.0	20.7	19.3
Elecon Engineering	74	6.9	100	OP	8.2	13.9	9.0	6.0	1.5	18.1	16.0
Engineers India	257	86.7	325	OP	18.0	14.9	14.3	7.8	4.8	37.2	43.6
Havell India	359	44.8	452	OP	27.2	14.6	13.2	8.3	4.8	43.2	28.3
Thermax India	485	57.8	525	N	37.6	13.2	12.9	8.1	3.5	30.3	40.2
Voltas	123	40.8	127	N	9.8	5.6	12.6	8.0	2.6	21.8	25.0
Exchanges											
Financial Technologies	862	39.5	900	N	32.0	21.7	26.9	31.4	1.8	6.9	3.4
Hospitals											
Apollo Hospitals	527	65.7	644	OP	16.9	19.6	31.3	15.4	3.4	11.2	11.4
Fotis Healthcare	147	59.7	153	UP	2.3	14.4	63.6	17.6	1.8	2.8	4.8
Infra Developers											
Adani Enterprise	600	659.4	633	OP	32.8	29.7	18.3	13.5	2.5	15.1	10.4
Gammon Infrastructure	14	10.4	24	OP	0.2	11.3	93.7	19.7	1.2	1.4	3.7
Gujarat Pipavav	68	28.6	77	OP	0.8	n/a	85.6	20.9	3.7	4.4	7.3
GMR Infrastructure	29	111.5	40	OP	(0.4)	n/a	n/a	17.2	1.2	(1.7)	2.1
GVK Power	17	26.8	32	N	1.3	19.8	13.3	10.9	0.4	3.6	4.4
Lanco Infratech	18	43.2	42	OP	1.8	20.0	10.1	11.4	0.7	7.7	6.9
Mundra Port & SEZ	151	302.1	154	OP	6.1	38.7	24.7	18.5	5.7	25.6	17.0
IT Services											
HCL Technologies	386	260.0	440	N	30.9	25.9	12.5	7.6	2.7	23.5	23.7
Hexaware Technologies	72	20.9	70	UP	6.3	56.8	11.3	8.5	2.0	18.6	15.2
Infinite Computer	94	4.1	135	OP	27.1	15.1	3.5	1.5	0.8	25.0	28.7
Infosys Technologies	2,395	1,368.4	2,800	OP	133.0	13.9	18.0	12.0	4.3	25.7	29.1
KPIT Cummins	142	11.4	160	UP	15.0	22.0	9.5	6.3	1.7	19.7	20.5
Mahindra Satyam	71	83.2	67	UP	5.3	27.7	13.3	8.0	1.8	11.9	10.9
Mindtree	356	14.2	320	UP	32.5	25.2	11.0	6.5	1.6	15.8	15.6
MphasiS	347	73.1	430	N	39.2	(8.7)	8.9	5.6	1.8	22.7	22.9
Patni Computer	300	39.0	280	UP	29.3	(14.1)	10.2	4.3	1.2	12.1	10.1
Persistent Systems	302	12.1	290	UP	29.1	0.7	10.4	6.5	1.4	14.6	13.8
Tata Consultancy	1,028	2,011.7	1,180	OP	53.2	17.9	19.3	14.4	6.1	35.7	40.7
Tech Mahindra	650	80.2	670	UP	60.2	12.9	10.8	8.3	1.9	19.0	17.1
Wipro	339	825.4	365	N	23.6	9.4	14.4	10.3	2.9	22.1	19.7
Logistics											
Allcargo	149	19.5	182	N	14.5	14.1	10.3	5.6	1.4	14.5	16.2
Container Corporation	884	114.9	1,000	N	75.6	15.2	11.7	7.8	2.0	18.5	16.8
Gateway Distripark	138	14.9	155	OP	10.7	12.2	12.9	6.8	2.1	16.5	14.1

Source: IDFC Securities Research *Note: OP - Outperformer; UP - Underperformer; N - Neutral; UR - Under Review*

Valuations

Companies	Price (Rs)	Mcap (Rs bn)	TP (Rs)	Reco	EPS (Rs/share)	Earnings CAGR FY11-13E	FY12E P/E (x)	EV/EBITDA (x)	P/BV (x)	RoE (%)	RoCE (%)
Media											
Dish TV India	76	81.3	85	N	0.4	n/a	212.3	14.9	95.8	58.3	10.6
DEN Network	49	6.3	91	OP	3.4	31.6	14.5	5.3	0.7	5.3	8.0
Entertainment Network	247	11.8	280	N	12.1	53.9	20.4	10.3	2.9	15.3	15.1
Hathway Cables	86	12.3	153	OP	2.8	n/a	30.5	6.6	1.4	4.9	8.4
HT Media	142	33.5	170	N	9.9	24.2	14.4	8.0	2.2	16.7	19.6
TV18 Broadcast	42	9.9	55	N	2.1	n/a	19.6	6.9	1.2	6.1	9.2
Jagran Prakashan	105	33.0	125	N	7.1	14.0	14.7	8.8	4.4	31.4	34.0
PVR	120	3.3	140	OP	11.0	115.0	10.9	6.1	1.1	10.5	9.9
Sun TV Network	296	116.5	UR	UR	19.8	7.3	14.9	8.7	4.0	29.1	39.6
Zee Entertainment	115	112.1	135	N	6.7	18.0	17.0	12.0	2.4	14.5	18.3
Metals											
Coal India	379	2,394.7	487	OP	22.8	25.1	16.6	10.2	5.3	36.5	39.2
Hindalco Industries	145	276.8	199	OP	14.8	10.3	9.8	6.3	0.9	10.0	8.1
Hindustan Zinc	133	563.7	157	OP	15.6	19.3	8.5	5.0	2.0	25.7	24.2
Jindal Steel & Power	545	507.7	601	N	43.3	6.8	12.6	9.4	2.8	24.4	16.5
JSW Steel	686	156.1	848	OP	80.9	44.0	8.5	5.4	0.8	11.1	11.4
Monnet Ispat	490	31.5	604	OP	53.0	4.9	9.3	9.4	1.3	14.8	10.2
NMDC	250	992.0	230	UP	16.6	2.8	15.1	9.1	4.0	29.8	37.5
SAIL	109	451.2	110	UP	11.3	9.0	9.7	7.2	1.1	12.2	11.3
Sesa Goa	224	199.2	310	N	56.7	9.0	4.0	1.8	1.2	33.0	25.1
Sterlite Industries	135	465.5	213	OP	20.2	20.4	6.7	3.8	0.8	12.5	15.2
Tata Steel	461	442.1	747	OP	71.5	14.2	6.4	4.9	1.0	17.0	11.3
Mid-cap & Others											
Advanta	395	6.7	n/a	OP	15.3	n/a	25.9	10.7	1.3	5.2	8.1
Great Eastern Shipping	253	38.5	300	OP	41.6	27.7	6.1	7.7	0.6	10.1	5.2
Jain Irrigation	172	66.2	225	OP	9.6	35.3	17.9	8.9	3.6	21.8	17.9
Jet Airways	273	23.5	375	OP	28.9	n/a	9.4	7.1	0.7	7.4	7.0
Sintex	146	39.4	240	OP	21.1	18.9	6.9	5.9	1.3	21.3	14.2
United Phosphorus	150	69.1	242	OP	17.3	29.4	8.7	6.0	1.6	19.5	17.2
Oil & Gas											
BPCL	660	238.5	617	UP	65.4	20.7	10.1	9.7	1.3	13.6	7.6
Cairn India	292	555.2	366	OP	48.1	40.3	6.1	4.1	1.1	20.4	22.0
Essar Oil	96	132.3	178	OP	6.4	54.8	14.9	7.9	1.8	12.7	11.5
GAIL (India)	424	537.5	481	N	34.6	10.3	12.2	7.3	2.2	18.9	20.6
Gujarat Gas Company	449	57.6	450	OP	23.5	8.6	19.1	12.0	5.6	32.0	33.8
Gujarat State Petronet	106	59.4	105	N	10.1	6.7	10.5	6.8	2.4	25.2	23.3
HPCL	375	127.2	363	UP	62.7	10.7	6.0	9.1	0.8	15.0	5.7
IOC	309	751.3	305	UP	38.9	12.0	8.0	7.3	1.1	15.0	9.9
Indraprastha Gas	430	60.3	446	OP	21.2	11.0	20.3	10.3	4.9	26.7	31.8
Oil India	1,373	330.2	1,497	OP	169.7	24.6	8.1	4.0	1.7	23.3	25.6
ONGC	275	2,350.2	324	OP	32.5	15.2	8.5	3.7	1.7	22.0	22.9
Petronet LNG	178	133.2	181	OP	10.0	21.5	17.7	11.7	4.0	25.0	17.2
Reliance Industries	826	2,699.9	1,160	OP	67.6	12.2	12.2	6.9	1.3	12.4	11.1

Source: IDFC Securities Research *Note: OP - Outperformer; UP - Underperformer; N - Neutral; UR - Under Review*

Valuations

Companies	Price (Rs)	Mcap (Rs bn)	TP (Rs)	Reco	EPS (Rs/share)	Earnings CAGR FY11-13E	FY12E P/E (x)	EV/EBITDA (x)	P/BV (x)	RoE (%)	RoCE (%)
Pipes											
Jindal Saw	127	34.7	152	OP	19.6	28.6	6.5	3.0	0.8	13.6	14.8
Maharashtra Seamless	370	26.1	403	N	44.9	7.4	8.2	4.5	0.9	11.7	14.2
Pharmaceuticals											
Aventis Pharma	2,210	50.8	2,192	N	80.0	16.4	27.6	18.4	4.5	17.2	17.3
Biocon	333	66.6	391	N	19.9	12.6	16.7	10.4	2.8	17.9	15.9
Cipla	283	227.3	365	OP	15.3	21.7	18.5	13.5	3.0	17.2	16.4
Dishman Pharma	63	5.1	108	UP	9.8	9.3	6.4	6.1	0.5	8.7	8.2
Dr Reddys Lab	1,527	258.4	1,803	OP	82.4	19.0	18.5	12.5	4.6	27.3	21.5
Glaxosmithkline Pharma	2,053	173.9	2,355	N	79.8	14.9	25.7	18.3	8.2	33.3	32.2
Glenmark Pharma	328	88.9	401	OP	25.4	14.8	12.9	10.5	3.2	28.7	20.1
IPCA Laboratories	278	34.8	395	OP	24.0	16.1	11.6	9.1	2.6	25.0	21.7
Lupin	479	213.6	498	N	22.1	13.4	21.7	15.5	5.1	26.2	22.8
Ranbaxy Lab	489	206.1	594	OP	40.8	27.3	12.0	9.9	2.9	26.9	17.6
Strides Arcolab	299	17.3	544	OP	33.4	51.9	9.0	8.4	1.0	11.8	10.1
SUN Pharma	486	503.2	543	OP	20.7	12.8	23.5	18.4	4.4	20.5	19.9
Torrent Pharma	598	50.6	718	OP	41.2	22.5	14.5	12.4	3.9	29.8	19.5
Power Equipment											
ABB	833	176.5	500	UP	11.2	53.7	74.1	45.1	6.7	9.4	11.4
BHEL	1,681	823.1	2,103	N	141.7	15.6	11.9	7.3	3.3	30.7	37.5
Crompton Greaves	162	103.8	165	UP	11.1	(5.0)	14.5	8.8	2.6	19.5	20.3
EMCO	52	3.6	60	N	1.3	n/a	41.6	6.5	0.6	1.6	6.6
Jyoti Structures	69	5.7	114	OP	14.3	10.8	4.8	3.0	0.8	17.9	25.0
Kalpataru Power	112	17.1	162	OP	14.7	13.6	7.6	4.1	0.9	12.1	15.2
KEC International	59	15.1	98	OP	8.9	10.3	6.6	5.5	1.3	22.0	18.1
Power Utilities											
Adani Power	86	188.2	124	OP	7.0	61.8	12.3	14.6	2.5	22.4	8.8
CESC	284	35.5	445	OP	41.0	5.6	6.9	3.7	0.8	11.4	10.2
Jaiprakash Power	33	88.2	61	OP	1.5	117.9	21.7	18.2	1.2	5.9	5.2
KSK Energy	104	38.9	176	OP	6.0	60.6	17.3	14.8	0.9	6.1	5.6
NTPC	172	1,421.9	199	N	11.8	12.2	14.6	11.4	1.9	13.5	9.7
Nava Bharat Ventures	204	15.6	278	OP	31.0	(24.7)	6.6	9.0	0.8	12.8	9.0
PTC	72	21.3	85	N	5.3	10.6	13.7	0.3	0.9	6.8	6.7
Reliance Infrastructure	464	124.1	953	OP	38.1	(2.2)	12.2	(1.7)	0.7	5.7	2.7
Tata Power	985	233.8	1,186	N	35.5	10.4	27.7	16.0	2.2	8.0	4.1
Real Estate											
Ansal Properties & Infra	32	5.0	104	OP	9.4	47.6	3.4	5.9	0.2	7.6	9.8
DLF	209	355.2	256	OP	11.3	15.2	18.5	12.5	1.3	6.9	7.3
Godrej Properties	686	47.9	683	N	21.0	38.2	32.7	34.2	4.6	15.0	8.1
Jaypee Infratech	50	69.5	85	OP	7.6	(24.3)	6.6	9.5	1.2	19.9	10.9
Sunteck Realty	272	17.1	434	OP	0.6	1,288.5	464.3	460.0	2.5	0.5	0.3
HDIL	110	45.5	144	N	24.4	9.9	4.5	5.2	0.4	10.7	9.4
Unitech	28	73.5	UR	UR	2.3	16.0	12.1	12.9	0.6	5.1	4.4
Retail											
Pantaloon Retail	260	55.6	308	OP	11.6	34.2	22.4	8.5	1.7	7.9	11.4
Provogue India	31	3.6	83	OP	3.9	10.9	8.0	6.8	0.5	5.9	7.5
Shoppers' Stop	391	32.0	388	N	7.3	51.2	53.3	21.5	5.1	9.9	11.7
Titan Industries	220	195.4	250	OP	6.8	29.4	32.6	24.3	13.7	48.6	58.3

Source: IDFC Securities Research *Note: OP - Outperformer; UP - Underperformer; N - Neutral; UR - Under Review*

Valuations

Companies	Price	Mcap	TP	Reco	EPS	Earnings CAGR	FY12E P/E	FY12E EV/EBITDA	FY12E P/BV	FY12E RoE	FY12E RoCE
	(Rs)	(Rs bn)	(Rs)		(Rs/share)	FY11-13E	(x)	(x)	(x)	(%)	(%)
Telecoms											
Bharti Airtel	386	1,465.1	447	OP	17.1	24.6	22.6	8.3	2.6	11.9	9.5
IDEA Cellular	96	316.3	76	UP	3.2	60.0	30.0	7.9	2.4	8.2	9.9
OnMobile Global	62	7.3	105	OP	6.0	9.8	10.4	4.3	0.8	8.5	6.1
Reliance Communication	82	168.5	99	UP	5.6	9.0	14.6	6.8	0.5	3.1	3.6
Tyre											
Apollo Tyres	59	29.6	71	OP	8.9	13.8	6.6	4.6	1.1	17.2	14.9
Balkrishna Industries	170	16.5	190	OP	23.4	18.6	7.3	6.2	1.6	24.3	19.4

Companies	Price	Mcap	TP	Reco	EPS	Earnings CAGR	FY12E P/E	FY12E P/Adj. BV	FY12E P/BV	FY12E RoE	FY12E RoA
	(Rs)	(Rs bn)	(Rs)		(Rs/share)	FY11-13E	(x)	(x)	(x)	(%)	(%)
Financials											
Allahabad Bank	164	78.2	275	OP	38.6	24.9	4.3	0.9	0.8	22.0	1.1
Axis Bank	1,133	465.3	1,700	OP	104.4	25.6	10.9	2.1	2.1	20.7	1.6
Bajaj Auto Finance	630	23.1	970	OP	93.2	32.5	6.8	1.4	1.4	22.9	3.2
Bank of Baroda	774	303.2	1,220	OP	126.5	18.2	6.1	1.3	1.2	22.8	1.3
Bank of India	324	177.4	500	OP	52.8	24.6	6.1	1.0	0.9	17.3	0.8
Canara Bank	434	192.1	650	OP	102.7	18.4	4.2	0.9	0.8	22.8	1.2
Corporation Bank	449	66.5	590	N	101.0	13.3	4.4	0.8	0.8	19.4	0.9
HDFC	662	971.6	800	OP	28.5	18.0	23.2	4.9	4.9	22.6	2.8
HDFC Bank	484	1,125.1	600	OP	21.9	29.0	22.1	3.8	3.8	18.6	1.6
ICICI Bank	884	1,018.1	1,450	OP	58.1	26.2	15.2	1.7	1.7	11.7	1.5
Indian Bank	208	89.4	330	OP	47.7	22.7	4.4	0.9	0.8	22.4	1.5
Indusind Bank	266	124.0	375	OP	16.8	33.6	15.9	2.8	2.7	18.9	1.5
ING Vysya Bank	290	34.8	480	OP	35.5	32.9	8.2	1.2	1.2	15.8	1.0
LIC Housing Finance	212	100.6	250	OP	24.4	24.6	8.7	1.9	2.0	24.9	1.9
Magma Fincorp	73	9.4	130	OP	7.6	16.8	9.5	1.2	1.2	16.9	1.9
M & M Finance	672	69.7	840	OP	57.3	27.5	11.7	2.2	2.3	21.8	3.8
OBC	292	85.3	470	OP	59.9	22.0	4.9	0.7	0.7	14.8	1.0
Power Finance	161	185.0	250	OP	24.1	11.5	6.7	1.0	1.0	17.6	2.8
Punjab National Bank	981	310.7	1,350	OP	167.5	21.0	5.9	1.3	1.2	23.8	1.3
Rural Electrification	188	185.6	260	OP	29.7	16.3	6.3	1.3	1.3	21.3	3.1
Shri Ram Transport	675	152.7	950	OP	67.8	25.6	10.0	2.4	2.5	27.6	4.2
Shriram City Union	530	26.3	880	OP	65.0	31.8	8.1	1.7	1.8	23.9	3.0
State Bank of India	1,946	1,235.5	3,000	OP	189.9	39.3	10.2	1.3	1.7	17.3	0.9
Union Bank of India	238	124.8	415	OP	51.2	26.5	4.6	1.0	0.8	22.2	1.0
Yes Bank	281	97.4	440	OP	28.3	33.0	9.9	2.1	2.1	23.3	1.4

Source: IDFC Securities Research *Note: OP - Outperformer; UP - Underperformer; N - Neutral; UR - Under Review*

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