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October 03, 2009

2QFY2010 Results Preview

TO PIT STOP BEFORE ANOTHER LAP

Research Team

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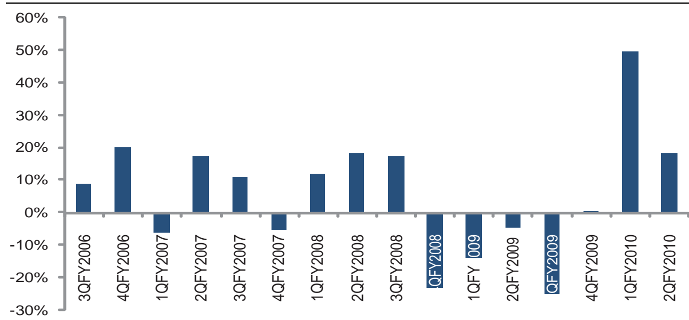
Note: Stock Prices as on September 30, 2009.

The rally continues; but the bulls go slow in 2QFY2010…

As expected at the end of 1QFY2010, the sprint witnessed by the Indian stockmarket turned into a much slower, but longer lasting version of the race, the marathon, as the Sensex gained another 18% during the September quarter. Continued strong domestic momentum, attributable in part to the stimulus packages announced by the government and on account of the strong domestic fundamentals of the Indian economy, apart from increasing global economic stability and strong liquidity, helped the Indian stockmarkets build on their 1QFY2010 gains.

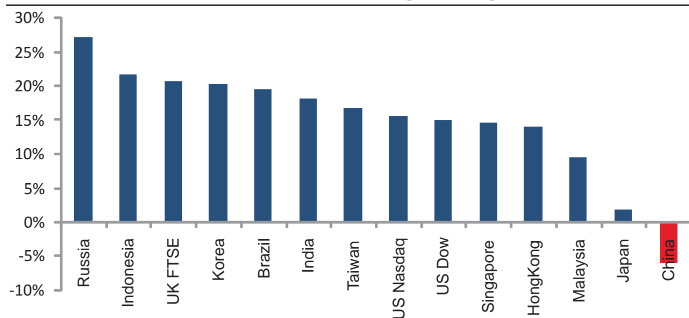
Exhibit 1: Sensex - On higher ground



Source: Bloomberg, Angel Research

However, the Sensex returns have lagged many of its developed and developing peers. The latter's out-performance was on account of the sharp underperformance by many of these markets in 1QFY2010 and building up of expectations of a sooner-than-expected recovery in their economies. While the Russian stockmarket (27%) led the quarterly gainers chart in the September quarter, thanks to the sustained firm global crude oil prices, the other leading percentage gainers for the quarter included the benchmark indices of Indonesia (22%), UK (21%) and South Korea (20%).

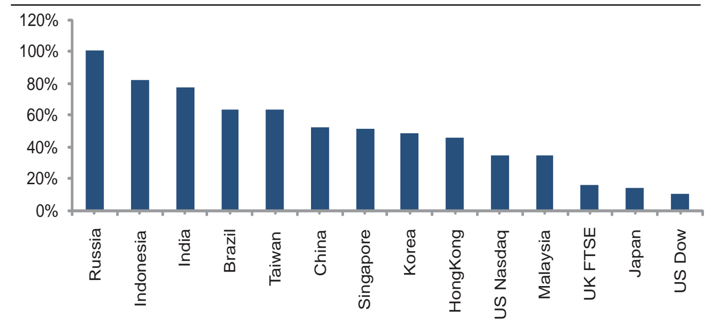
Exhibit 2: Russia tops; China springs a negative surprise



Source: Bloomberg, Angel Research

The big underperformer was however, the Chinese stockmarket, which lost 6% during 2QFY2010. There have been various issues that have affected investor sentiments towards the Chinese stockmarket. Firstly, launch of a new Nasdaq-style market called the "Growth Enterprise Market (GEM)" is leading to reallocation of capital by investors to new subscriptions causing a liquidity squeeze in the main Chinese market. GEM is a stockmarket set-up by the Hong Kong Stock Exchange for listing of growth companies that do not fulfill the requirements of profitability or track record. Secondly, a slew of IPOs that are in the pipeline led to liquidity getting sucked out from the secondary markets. Thirdly, fears that effects of the Chinese government's stimulus package might have peaked out have also kept investors on the back foot, as recently, the National Bureau of Statistics revealed that profits at China's major industrial companies were down 10.6% yoy during January-August 2009.

Exhibit 3: BRIC markets dominate



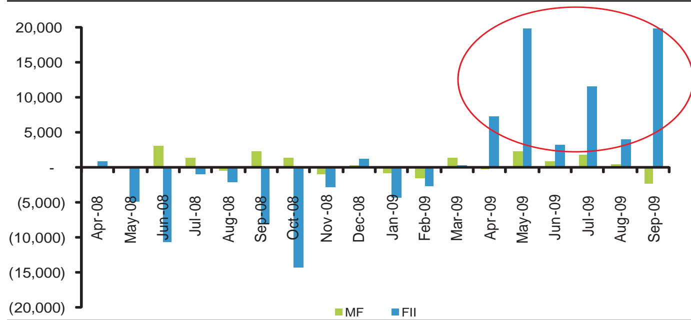
Source: Bloomberg, Angel Research

FII inflows sustain momentum; MFs take a backseat

The trend of strong FII inflows (Rs31,000cr or US $6.3bn) witnessed during 1QFY2010 gained further strength during the September quarter with FIIs pouring in Rs35,600cr (US $7.4bn) into Indian equities. With this, total cumulative FII inflows in 2009 crossed the US $10bn mark during September 2009 and stood at about Rs60,000cr (US $12.4bn) at the end of the month. Notably, close to half of the inflows by FIIs have come via qualified institutional placements (QIP) and IPOs combined.

Nonetheless, after a year of net outflow (US $12bn) in 2008 - the first such event this decade - FIIs are back again in the Indian markets in a big way, which is highly comforting. It must be noted that FIIs had invested about US $17.7bn in 2007. We believe this trend of inflows would broadly sustain over the long term considering the strong dynamics of the Indian economy.

Exhibit 4: FII inflows - Stronger by the day



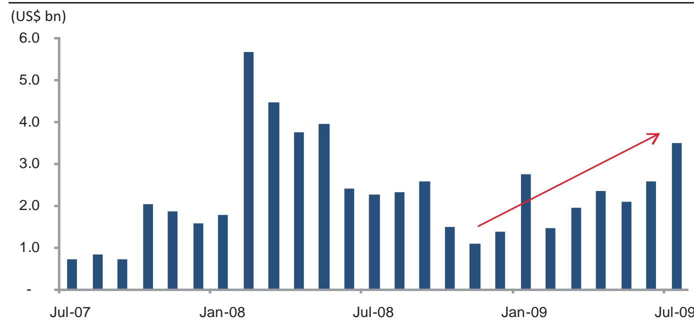
Source: SEBI, Angel Research

As far as the Domestic Mutual Funds industry was concerned, at the end of 2QFY2010, their net investments in the Indian stockmarkets stood at a paltry Rs177cr (US $33mn) as they resorted to considerable profit booking in the month of September 2009.

FDI - Investor confidence coming back…

While the FII inflows were once again strong during 2QFY2010, continued resurrection in FDI inflows was also heartening. Thus, from the lows of around US $1bn in November 2008, the FDI inflows into India have increased gradually and stood at US $3.5bn in July 2009. With global liquidity at comfortable levels and capital from the developed world scouting for avenues for optimal growth, money has started to flow into emerging economies like India.

Exhibit 5: FDI - Global confidence coming back



Source: Department of Industrial Policy & Promotion, Angel Research

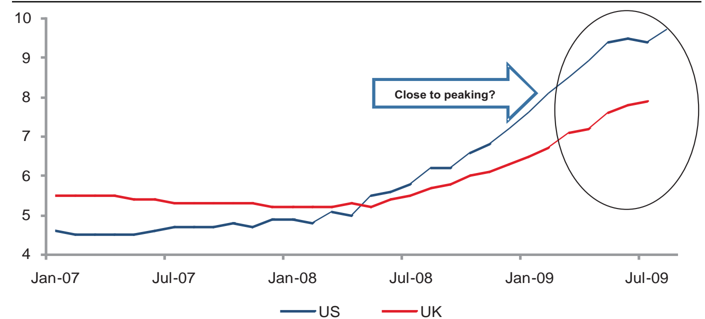
Notably, as per the UNCTAD World Investment Report 2009, while there would be some slowdown in global inflows in 2009 to US $1.2trillion (US $1.7trillion in 2008) before recovering marginally in 2010 to US $1.4trillion and to US $1.8trillion in 2011, the BRIC countries would be the most favoured recipients of the inflows increasingly for FDI. This is primarily because of the stronger resilience the developing economies displayed vis-à-vis their developed counterparts in the face of the global financial crises. In fact, as per the report, India ranks 3rd (China 1st) as the preferred locations for FDI inflows!

Our confidence with respect to continued strong FDI (and also FII) inflows also rests on the dynamics of the Indian economy, which boasts of favourable demographics, high savings rate, lower dependence on exports for growth thus portraying a strong domestic consumption theme, huge market potential across sectors and products in terms of penetration, lower credit-to-GDP ratio leaving ample scope for leveraging, etc. Thus, going forward, the recent political stability (UPA victory) and the proven economic stability in face of the global financial crises will lend immense confidence to global investors, which will help improve the flow of capital into the country.

Signals mixed on global economic recovery…

The world continues to remain divided over the sustainability of any economic recovery that is currently underway. While the continued high unemployment rates in the developed world and the consequent impact that it will have on the wages and the spending of consumers poses a significant threat to the feeble economic recovery signs, the consequences of the fading away of the effects of stimulus packages also raises questions. The latter is primarily considering the fact that most governments are already running high fiscal deficits and there is limited scope for them to maintain the spending momentum for a longer period of time.

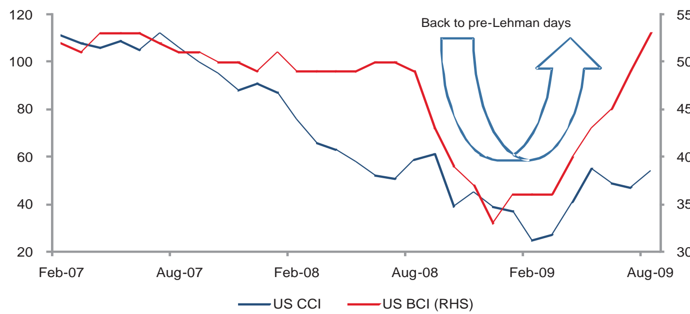
Exhibit 6: US/UK unemployment - No respite yet



Source: Angel Research

However, contrary to this, the Confidence Indices in the US - both consumer and business - either continued on their upward trajectory or remained firm with an upward bias, with the former index back to pre-Lehman crisis levels! Similar trends were witnessed in the UK confidence indicators as well. This improvement in confidence can be attributed to lesser deterioration in economic data, stability in the housing market and better liquidity in the system.

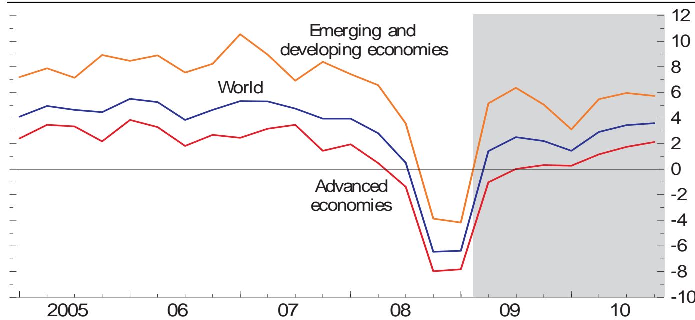
Exhibit 7: US - Strong rebound in Consumer Confidence



Source: Angel Research

Further, the IMF, in its World Economic Outlook Update (July 2009) has also talked about *'contractionary forces receding but weak recovery ahead'*. The update reads, *"The global economy is beginning to pull out of a recession unprecedented in the post-World War II era, but stabilization is uneven and the recovery is expected to be sluggish. Economic growth during 2009-10 is now projected to be about ½ percentage points higher than projected in the April 2009 World Economic Outlook (WEO), reaching 2.5 per cent in 2010. Financial conditions have improved more than expected, owing mainly to public intervention, and recent data suggest that the rate of decline in economic activity is moderating, although to varying degrees among regions."*

Exhibit 8: Global GDP Growth



Source: IMF Staff Estimates

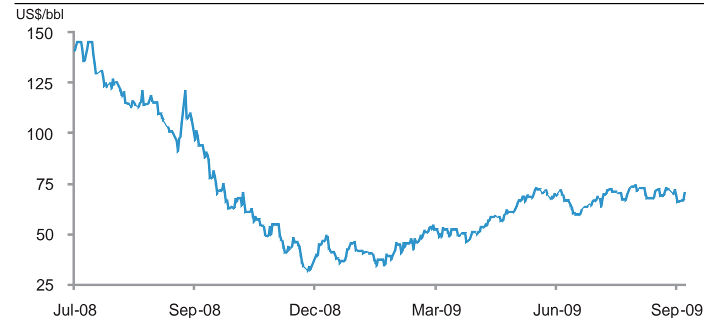
It also indicates/suggests that, *"Despite these positive signs, the global recession is not over, and the recovery is still expected to be slow, as financial systems remain impaired, support from public policies will gradually diminish, and households in countries that suffered asset price busts will rebuild savings. The main policy priority remains restoring financial sector health. Macroeconomic policies need to stay supportive, while preparing the ground for an orderly unwinding of extraordinary levels of public intervention. At the same time, given weak internal demand prospects in a number of current account deficit countries, including the United States, policies need to sustain stronger demand in key surplus countries."*

We believe that the signs of economic improvement are only getting stronger in India with the quarterly GDP having recovered from 5.3% yoy in 3QFY2009 to 5.8% yoy in 4QFY2009 and to a further 6.1% yoy in 1QFY2010. The strength in economic activity can also be judged from the fact that the Advance Tax paid by India Inc. has witnessed a 15% yoy increase in 2QFY2010 compared to a 4% yoy decline in 1QFY2010. We expect the economy to gain further strength, notwithstanding the short-term impact of deficient monsoons on GDP, as low interest rates help kick start another bout of corporate and consumer credit pick-up in the quarters to come.

Oil - Price movement restricted

Crude behaved on expected lines as the global crude oil prices remained within the US $60-80 per barrel range. For 2QFY2010, crude oil prices averaged 15% higher on a qoq basis, nonetheless, ending with gains of a mere 1% on a point-to-point basis to end the quarter at US $71 per barrel vis-à-vis the US $70 per barrel at the end of June 2009.

Exhibit 9: Oil - Consolidation time



Source: Bloomberg, Angel Research

While firmness in crude prices can be attributed to the expectations of an upturn in global economies, this coupled with disciplined supply by the oil producing nations will ensure a more balanced demand-supply situation going forward. However, in the near-to medium-term, considering that the possibility to increase supplies remains with excess capacity present to absorb the growth in demand, we do not expect a substantial increase in global crude oil prices from current levels.

Metals - The run continues…

The bounce in metal prices - both ferrous and non-ferrous, continued during the quarter on the back of several supporting factors. With global economies displaying signs of recovery (green shoots) and expectations of a pick-up in demand for commodities also helped the metal prices remain firm. Further, demand in emerging economies like China and India has also been quite firm,

aiding this recovery. End of the de-stocking period and disciplined increase in production have been the other factors supporting the revival. The continued weakness of the US$ against other currencies also helped push up metal prices.

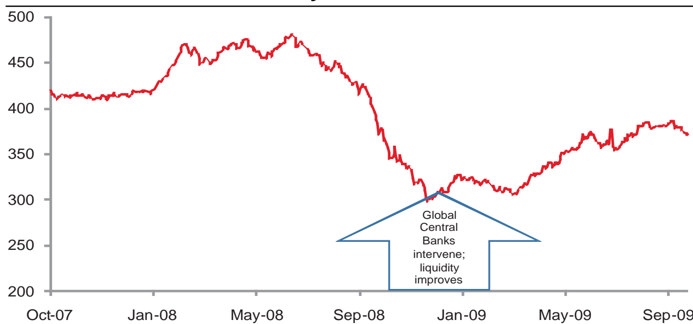
Exhibit 10: Metals - Gaining further ground

Spot US$/tonne	June 30, 09	Sept. 30, 2009	% chg qoq
Alumina	220	308	39.8
Lead	1,684	2,258	34.1
Zinc	1,534	1,943	26.7
Steel HR	446	542	21.5
Copper	5,083	6,147	20.9
Aluminium	1,607	1,856	15.5
Iron Ore	82	89	9.2
Tin	14,665	15,595	6.3

Source: LME, Bloomberg, Angel Research

The strong upmove in base metal prices was contrary to our expectations as we had expected a much tighter range for base metals in wake of the pending recovery in demand. However, the factors mentioned above coupled with the 'expectations of global recovery' helped in the firming up of the metal prices. Going forward, while heightened volatility cannot be ruled out, considering that the global economic recovery would continue here onwards, the possibility of a significant sustained correction in commodities is unlikely.

Exhibit 11: CRB Commodity Index Trend



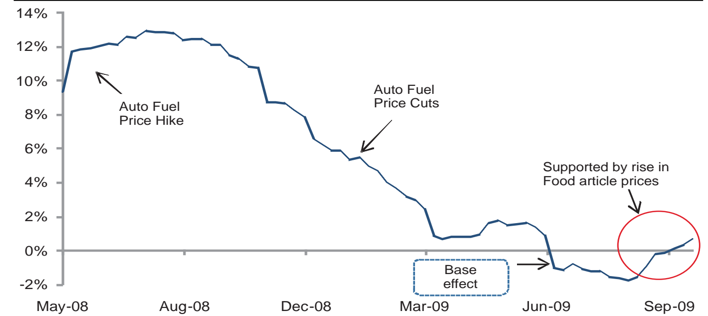
Source: Bloomberg, Angel Research

Inflation - Indian economy breaks out of deflation…

Even as many global economies continue to grapple with growth, which is also having an adverse impact on inflation, which continues to remain low or reflect a deflationary trend, this indicator charted back into positive territory towards early September 2009 for India.

Thus, for the week ended September 19, 2009, the Headline Inflation measured by the Wholesale Price Index (WPI) came in at 0.83% compared to 0.37% for the previous week and -0.12% for the week ended August 29, 2009. While this was largely on expected lines, at the same time, admittedly, the breakout into the inflationary territory came in a little early than anticipated (late September to early October).

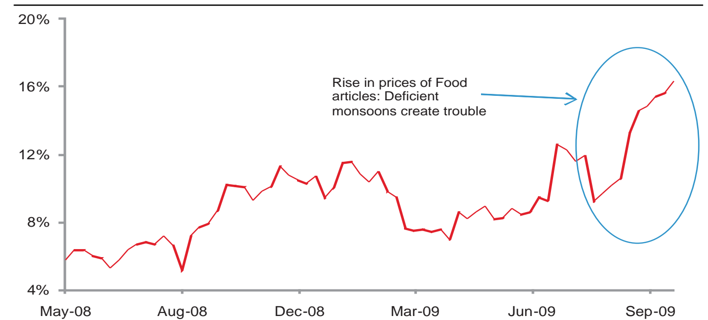
Exhibit 12: India Inflation - Raising its head



Source: Office of the Economic Advisor, Angel Research

Moreover, the Food Articles Index, which has a 15.4% weightage in the WPI, has witnessed a sharp rise (decade high of 16.3% yoy as on September 19, 2009) since March 2009 and particularly since August 2009 (*refer Exhibit 11*). This can be attributed to the failure of monsoons over several parts of the country that led to the drought/drought-like situation jeopardising plantations by farmers. This has put at risk the country's foodgrains production for the fiscal, which is expected to drop by around 15% yoy, leading to the spurt in prices in major food articles like cereals, pulses, fruits, spices, etc.

Exhibit 13: India Inflation - Food articles, the culprit



Source: Office of the Economic Advisor, Angel Research

Notably, the Reserve Bank of India had earlier in July 2009 forecasted inflation rate of around 5% by March 2010. However, going by the current rate along with the deficient monsoon this year (pushing food prices higher), and the expected gradual recovery in domestic demand, return of some pricing power amongst manufacturers, higher commodity prices and the disappearance of the high base effect, we believe that the inflation rate may settle between 6-7% by March 2010 even as we expect the WPI Inflation in FY2010 to average between 2.5-3%.

As far as the global inflationary pressures are concerned, with many economies still witnessing a deflationary trend, a section of the market continue to remain wary of the inflationary pressures that might develop over the next 12-18 months. This is considering the monetary and fiscal easing measures taken by the global central banks over the past one year, which in conjunction with the return in consumer demand going forward will lead to inflation.

Exhibit 14: Global Inflation (%) - Still at the lows

Country	Latest	Peak in 2008
India	(0.1)	12.9
Philippines	0.1	12.5
China	(1.2)	8.7
Malaysia	(2.4)	8.5
Singapore	(0.5)	7.5
Hong Kong	(1.5)	6.3
S. Korea	2.2	5.9
US	(2.1)	5.6
UK	1.6	5.2
Japan	(2.2)	2.3

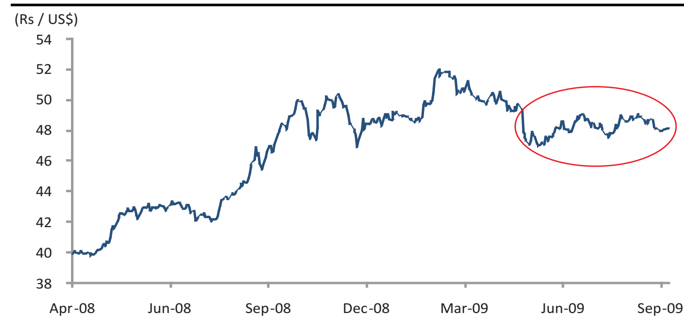
Source: Bloomberg, Angel Research, Note: Latest Inflation figures are either Aug/Sept. 2009, as available

We, however, continue to believe that the global economic recovery will be slow and staggered and the substantial existing capacities will ensure that prices do not rise in a hurry. Another point that would keep inflation subdued is the high unemployment rate in the developed economies and the high savings, which will prevent a sharp surge in consumption and rather allow it to increase only gradually over the next few quarters.

Currency - India in favour; capital inflows to lend support

On the currency front, the Indian Rupee behaved along expected lines as it remained broadly rangebound within the Rs47.5-49/US$ band. Notably, we had stated in our 1QFY2010 Preview, *"…over the next few quarters, we believe that the Rupee would remain largely range bound between the Rs45-50 levels to the USD. We believe a considerable appreciation of the Rupee against the USD is unlikely considering that India's exchange rate will be managed…"*

Exhibit 15: India currency - Rangebound for now



Source: Bloomberg, Angel Research

At this point in time, we have no reason to believe that the Rupee would trade outside the Rs45-50/US$ range over the next few quarters. We maintain that India's exchange rate will be managed to ensure export competitiveness rather than once again allowing volatile, short-term debt and FII inflows to cause the currency to appreciate without fundamental justification, only to depreciate even more rapidly subsequently - something that can have a highly destabilizing impact on the real economy. Based on our interpretations of the country's policy stance, this view is consistent with the evolving stance of our policy-makers.

We also believe that a significant depreciation of the Rupee against the US$ is unlikely, especially considering the changed (read positive) political outlook in the country with the UPA's convincing victory lending immense stability. This has raised expectations of structural reforms in the country, which will put India on a higher growth trajectory. This will ensure steady flow of capital into the country, thus preventing any significant depreciation of the Rupee against the US$.

Interest rates - Conducive to growth

Globally, Interest rates have continued to remain low in the post-Lehmann era as most economies are trying hard to chart back into the territory of some positive growth. This is despite increasing noises from several quarters of the globe that Central Banks will have to harden Interest rates soon to prevent runaway inflationary pressures.

Exhibit 16: Interest Rates (%) - Loose Monetary Policy continues

Country	Latest	Peak since 2006	+/- (bp)
Hong Kong	0.50	6.75	(625)
UK	0.50	5.75	(525)
US	0.25	5.25	(500)
Australia	3.00	7.25	(425)
India	4.75	9.00	(425)
Thailand	1.25	4.75	(350)
S. Korea	2.00	5.25	(325)
Germany	1.00	4.25	(325)
Singapore	0.06	3.00	(294)
China	5.31	7.47	(216)
Malaysia	2.00	3.50	(150)
Japan	0.10	0.50	(40)

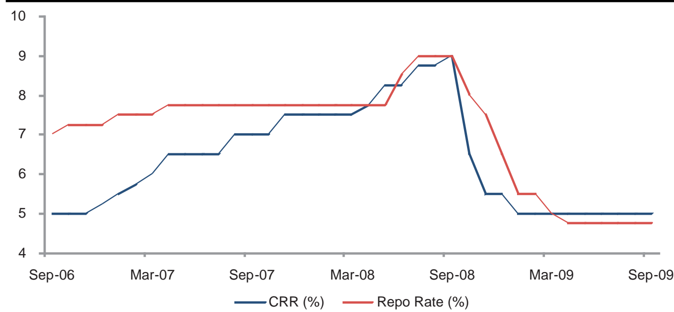
Source: Angel Research

The global Central Banks have however, been pretty clear and forthcoming at trying to put to rest the concerns arising from the possible effects of the tightening in monetary policy. For instance, a recent Federal Reserve statement read, *"…the Fed will continue*

to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

Even the OECD, in its release titled, 'What is the economic Outlook for OECD countries? An interim assessment' states, *"Regarding monetary policy, taking the first steps towards normalisation of policy interest rates from their current exceptionally low levels should in most cases and on current prospects wait until well into 2010 and in some cases even beyond. It is also important that central banks communicate their intentions explicitly, if conditionally, so as to affect interest rates at longer maturities more effectively."*

Exhibit 17: India - CRR, Repo Rate Trend



Source: Angel Research

Recently, on the domestic front also, due to the government's large borrowing programme and corresponding spurt in government bond yields, along with rising WPI inflation, there have been concerns about rising Interest rates. In our view, broader Interest rates will rise not in detriment to GDP growth, but consistent with it. At present, credit growth has dropped to 14%, there is huge amount of liquidity in the Banking System and it appears unlikely that the lending and deposit rates will start rising before early FY2011E. Even the RBI has clearly stated that exit policies will be implemented only when clear signs of growth momentum emerge. Nor do they wish to tighten monetary policy in response to supply-side inflation. Even if tightening begins somewhere towards early FY2011, we must keep in mind that in the last cycle, such tightening did not rein in credit growth for almost three years, simply because latent demand in India is so huge, which holds true just as much even today.

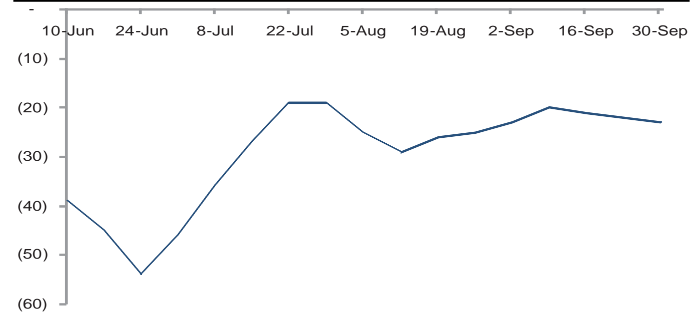
As regards bond yields, increase in longer maturity yields is a positive sign, indicating expectations of higher GDP growth. At the short-end, the rise in yields is more than expected, but this is due to short-term technicalities of the government borrowing programme. The RBI's committed Open Market Operations (OMC) limit not getting fully used is also not helping matters. But we see these as short-term fluctuations and overall do not expect a material increase in bond yields hereon, for the next few months.

To conclude, in our view, while Interest rates would consolidate at the current levels for a few quarters, we believe that the current Interest rate scenario should once again help unleash the huge latent domestic demand in India going forward.

Monsoon - Plays truant; but limited risk to economy

The worst fears for the sons of the soil (farmers) came true this fiscal with the monsoons being highly deficient this season. The cumulative seasonal rainfall for the country, as a whole, stood at 20% below the Long Period Average (LPA) as on September 23, 2009, one of the worst in this decade.

Exhibit 18: India Monsoons - Significant deficiency



Source: India Meteorological Department

Poor monsoons this year are being dreaded to have a significant impact on India's GDP. However, we believe there are various factors that would mitigate the impact of poor monsoons on India's GDP. Some of these factors include:

- Low dependence on Agriculture for GDP growth; Manufacturing and Services contribute to 83% of India's GDP
- Lower dependence on one season (monsoons) for crop production; winter crop also has an important role to play
- Increasing contribution from Irrigated Land; reduces dependence on monsoons for cultivation
- Various Government Schemes ie. NREGS and Bharat Nirman, estimated to collectively spend about Rs85,000cr in FY2010 would supplement rural India's income
- Low Interest rates and ample liquidity with Banks will ensure resurrection in consumption demand

Further, our analysis of the past trends and correlation between monsoons and the performance of various presumably-monsoon-dependent sectors (in terms of business and not stockmarket performance) indicates that the correlation has not been very strong

as is being feared. More so, the gradual and consistent transition of the Indian economy over the years from an agrarian economy to one being led by the services and the manufacturing sectors and emergence of various other sectors and factors influencing consumer decision making, has ensured that the impact of the monsoons on the Indian economy is reducing.

In fact, if we consider Corporate India's annual Net Sales and Net Profit growth over the last decade, it is apparent that the impact of poor monsoons on Corporate profitability is not prominent. Thus, we have arrived at the conclusion that any impact of deficient monsoons on the stockmarket is primarily a factor of nervous investor sentiments who prefer to exit/stay on the sidelines pending concrete evidence of the little impact on India Inc.'s profits.

Exhibit 19: Monsoon impact on India Inc.

Year	Monsoon	BSE - 30		BSE - 500	
	(+/- LPA)	Net Sales (% chg)	Net Profit (% chg)	Net Sales (% chg)	Net Profit (% chg)
FY2001	(12)	15.3	23.8	23.2	20.1
FY2002	(4)	22.2	23.0	8.4	10.0
FY2003	(20)	15.3	35.1	15.9	49.6
FY2004	5	16.1	23.3	14.6	34.9
FY2005	(9)	23.9	27.0	22.6	28.7
FY2006	(1)	23.3	25.6	19.9	8.2
FY2007	(5)	27.9	24.3	29.0	39.7
FY2008	(1)	18.8	19.2	30.4	31.2

Source: C-Line, CMIE, Angel Research, Note: Data pertains to 300 listed companies representing over 70% of India's stockmarket capitalisation

To get better understanding of the impact of monsoons on Agricultural GDP and the latter's impact on the Manufacturing and Services sectors and the Indian economy at large, we carried out a Regression Analysis of the same. This analysis indicates that the impact of a change in Agricultural GDP is minimal on the other two segments of the economy. Also, the impact on the GDP is largely restricted to that arising on account of the slowdown in Agricultural GDP, which does get impacted by the monsoons.

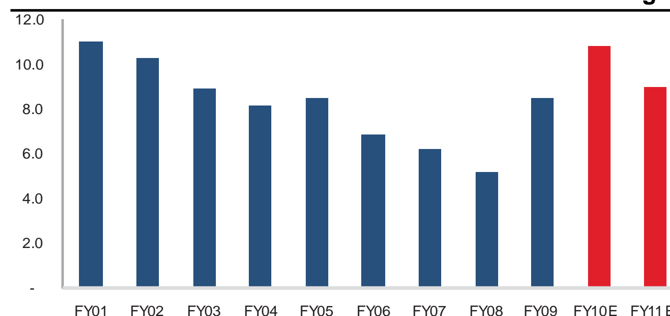
Our initial estimates had pegged India's GDP growth at 6-6.5% for FY2010. However, with the monsoon deficiency being significant, the impact of which will be inevitable on Agricultural GDP, we believe that though relatively cushioned compared to earlier years, the impact on India's GDP could still be about 1-1.5%.

Fiscal Deficit - To peak in FY2010; begin a gradual descent

A high Fiscal Deficit, despite the arguments in favour of it in the current scenario, is a situation that any economy would want to mend sooner than later, as it is not only detrimental from the country rating point of view by International Rating Agencies, but it could also exert pressure on domestic Interest rates on account of the high government borrowings.

After at around 8.5% in FY2009, India's Fiscal Deficit is expected to further balloon to around 11% in FY2010. This can be attributed in part to the lower tax receipts that the government will earn in FY2010 on account of the overall economic slowdown and the effects of stimulus measures through reduction in duty rates. Notably, while the country's indirect tax collections declined by 28% yoy in April-July 2009, direct tax collections registered a meagre increase of 4% yoy during April-August 2009. However, despite the pressure on government finances, the government is seized of the fact that the stimulus measures need to be sustained in the near term as the Indian economy has just started to re-gain strength.

Exhibit 20: Gross Fiscal Deficit as % of GDP - Peak in sight



Source: MoF, Angel Research

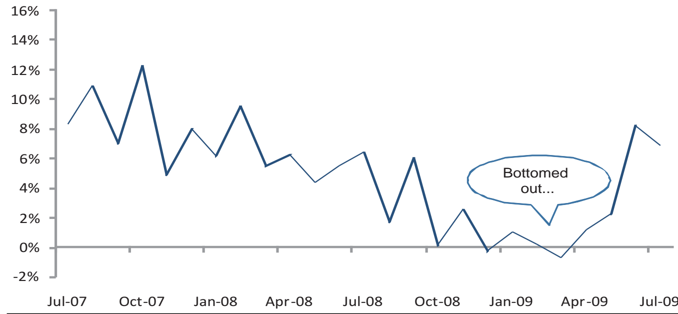
The government, however, is keen to revert back to its path of fiscal consolidation as soon as economic parameters stabilise. In fact, it has set for itself a target of about 1-2.5% reduction in central fiscal deficit by FY2012. We believe that this is possible as the economy goes into auto mode, reducing its dependence on stimulus measures which will then gradually be withdrawn. Tax collections will also improve in-line with the improvement in India's GDP, which will also aid government finances. Thus, in view of the above, we believe that India's Fiscal Deficit will peak out in FY2010 and reduce to around 9% in FY2011.

IIP - On path to a reasonably strong recovery

The Index of Industrial Production (IIP), which is a representative figure to measure the general level of industrial activity in the economy, points towards a reasonably strong recovery that is

underway for the Indian economy. Further, we expect this momentum to be largely sustained in the ensuing months and quarters of FY2010, notwithstanding the temporary hiccup that may arise on account of the lag effects of a deficient monsoon playing out on the Indian economy.

Exhibit 21: IIP - On recovery path



Source: MOSPI, Angel Research

Stability settling in global economies, domestic stimulus packages and strong domestic demand have been the primary reasons for the swift recovery that has been witnessed in the domestic economy. After recording a growth of -0.8% yoy in March 2009, the IIP has been improving ever since. For April-July 2009, the IIP is up by an average of 4.6% yoy. Going forward, expecting a further uptick in economic activity hereon, we expect the IIP growth in FY2010 to be in the range of 6.5-7%.

Considering the strength of the domestic fundamentals and assuming the impact of deficient monsoons, we believe that India's GDP growth in FY2010 would now be about 5-5.5% (6.7% in FY2009). However, it could accelerate to about 7-7.5% in FY2011 with a bias towards the upper range of the band depending on the government's pro-activeness on the reforms front.

Sensex Earnings - To continue to hold firm

2QFY2010 Earnings - Nothing to write home about; qoq and yoy performance to be flat

After a splendid performance witnessed during 1QFY2010, which had a positive surprise element in terms of Earnings upgrades, we expect 2QFY2010 to be a flat quarter on a yoy basis largely on account of the high base. Thus, for 2QFY2010, while we estimate Net Sales of Sensex companies to rise by about 6% yoy, we estimate Net Profit to register de-growth of about 1% yoy. Operating Margins are expected to be lower by about 40bp during the quarter on a yoy basis. Key features of the 2QFY2010 Earnings season are expected to be as follows:

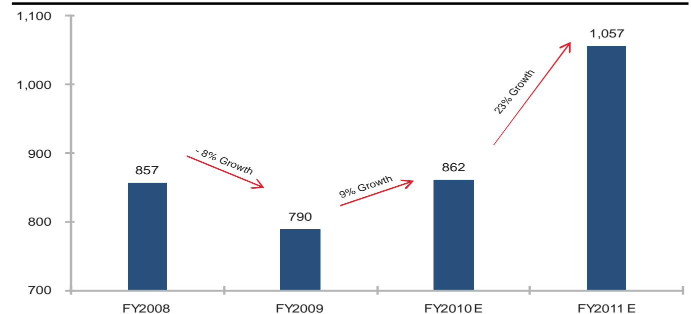
- Oil & Gas, Metals, Pharma and Real Estate are expected to be the key pressure points for Sensex Earnings during the quarter; sans these, the Sensex 2QFY2010 Net Sales would have been up 15% yoy and Net Profit up 18% yoy.
- Cement, Auto and IT are expected to be the positive contributors to Sensex Earnings.
- Earnings divergence is expected within sectors like Power, Banking and Telecom.

Post our 2QFY2010 Preview, our Earnings estimate for Sensex companies has broadly remained unchanged with a marginal upgrade of about 2% coming in. Thus, our FY2010E EPS stands upgraded to Rs862 from Rs842 at the end of 1QFY2010. Further, notably, along with some other minor changes, our FY2009 Sensex EPS has been adjusted from Rs800 to Rs790, which is primarily because of inclusion of Tata Motors' consolidated numbers (loss in FY2009) as against our earlier standalone numbers (profit in FY2009). Thus, in FY2010, we expect Sensex EPS to register a growth of 9% yoy. However, the market has already discounted the expected poor Earnings from Corporate India and is looking at FY2011 Earnings, which reflects a very robust scenario.

India Inc. Earnings - Slow and steady for now; much better times ahead

Aided in part by the stimulus packages and the low Interest rates, the Indian economy remained relatively resilient to the global slump. The playing out of the strong domestic consumption theme ensured that the Indian economy changes into higher gears faster than its peer economies, which also helped/will help Corporate India recover from the troughs. This trend will get all the more stronger in the coming quarters as the economy gets into auto-mode and the low Interest rates help unleash the huge latent domestic demand. Considering this, we expect India Inc. to deliver a considerably improved performance in FY2011. We estimate the Sensex EPS to come in at Rs1,057 for FY2011, an improvement of 6% over the Rs995 estimated at the end of 1QFY2010. Thus, for FY2011, we estimate the Sensex Earnings to register a growth of 23% yoy!!

Exhibit 22: Sensex EPS (Rs) and EPS Growth (%)



Source: Angel Research

The growth in FY2011E Earnings can primarily be attributed to:

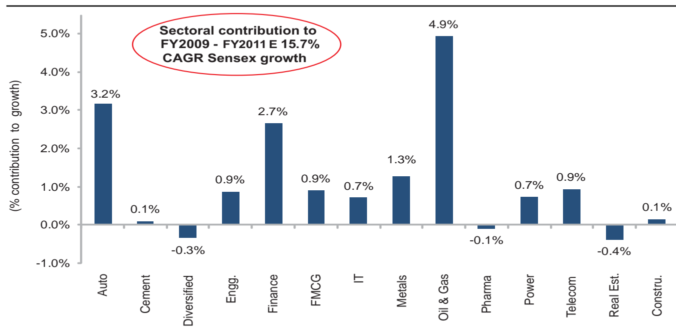
Exhibit 23: Net Profit growth (% yoy, adjusted for free-float)

Sector	Sensex representation	FY2010E	FY2011E
Automobiles	M&M, Maruti, Tata Motors, Hero Honda	- *	60
Banking & Financial	HDFC, HDFC Bank, ICICI Bank, SBI	6	19
FMCG	HUL, ITC	14	18
Metals	Hindalco, Tata Steel, Sterlite	(22)	65
Software	Infosys, TCS, Wipro	2	10

*Source: Angel Research; * Huge gain of 1,565% yoy because of the low base effect of FY2009*

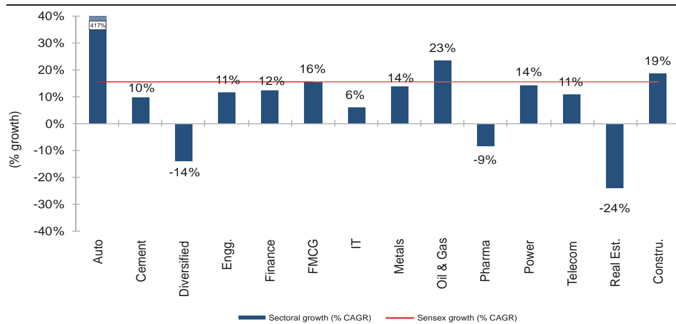
Thus, with the expected strong growth in EPS in FY2011, the Sensex Earnings is expected to register a CAGR of 15.7% over FY2009-11E.

Exhibit 24: Sector-wise contribution



Source: Angel Research

Exhibit 25: Sector-wise performance

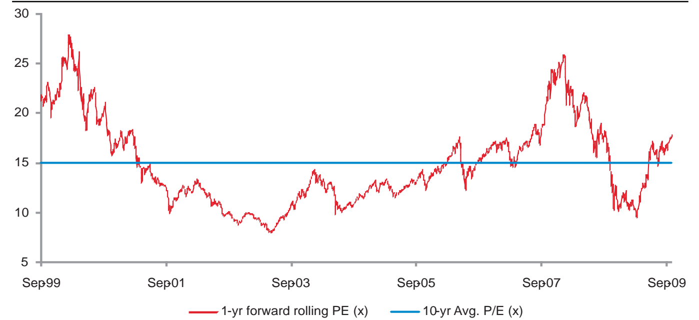


Source: Angel Research

India Market Strategy - To pit stop, before another lap (resumes)

The rally in the Indian stockmarkets has ensured that every investor, analyst and strategist reworks the numbers. To say the least, the rally on the bourses has been stupendous with the Sensex gaining 113% since the March lows. The optimism on the bourses clearly reflects recovery in investor sentiments on the back of the domestic economic recovery that is already underway. With the monsoon fear factor now behind us and positives like improvement in Corporate profitability and GDP growth creeping in, investor confidence has found some support.

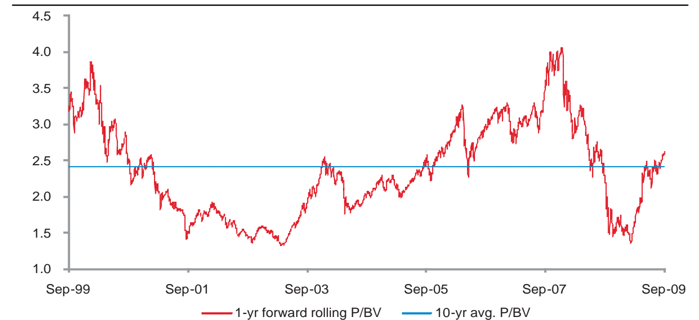
Exhibit 26: Sensex P/E



Source: Angel Research

Post another 18% rally during 2QFY2010, the Sensex at 17,125 levels now trades at 17.9x our 1-yr forward estimates (16.2 x our FY2011E EPS), which is at a marginal premium to the long-term (10-year) 1-yr forward average P/E of 15x. However, if one considers the last five years and the last three years 1-yr forward average P/E for the Sensex, which were the high growth years for India, the same work out to 15.5x and 17x, respectively.

Exhibit 27: Sensex P/BV



Source: Angel Research

Further, the Sensex trades at 2.6x our 1-yr forward estimates (2.4x our FY2011E BV), whereas the long-term (10-year) 1-yr forward average P/BV of the Sensex is 2.4x. However, if one considers the last five years and the last three years 1-yr forward average P/BV for the Sensex, the multiple arrived at are 2.8x and 2.6x, respectively.

Improving fundamentals, reflected in the Corporate performance, have been the cornerstone of the ongoing rally. With emerging markets continuing to be the cynosure of the global investing community, Indian markets are poised to march forward in the months and years to come ahead. Moreover, with the pick-up in economic activity, Earnings of India Inc., is set to further accelerate

and provide additional upsides. Thus, strong fundamentals, global investors' penchant for high growth markets and comfortable global liquidity would help drive and sustain potential re-rating of the Indian stockmarkets.

Taking cognizance of this and considering the two valuation parameters discussed above, we value the Sensex at 18,000 on FY2011E basis (including 750 points for embedded value in Sensex companies) at which level it would trade at 17x P/E and 2.6x P/BV. While the upside in the near term is limited (5%), upside risks to our Sensex target would arise from continued strong liquidity coupled with positive surprises on the Earnings front warranting an upgrade for Sensex Earnings.

In motor sports, a pit stop is where a racing vehicle stops during a rally for refueling, new tyres, repairs, mechanical adjustments, a driver change, or a combination of the above. This small pause ensures that the car that made that additional pit stop will run faster on the race track (on account of the improvement in operational mechanics) than cars that did not make the stop.

To conclude, considering all the factors (Earnings, Valuations, Liquidity, Fundamentals, etc.), we believe that 3QFY2010 may well turn out to be pit stop of sorts for the Indian stockmarkets as it consolidates and gets ready for another lap, as the race is by no means over…!!

Angel Research Model Portfolio

Angel Research Model Portfolio outperformed the Sensex by 8.9% during 2QFY2010 (October 1, 2009 over July 3, 2009), generating returns of 23.8% compared to Sensex returns of 14.9% during the period.

Outperformers: TCS (up 62%), Wipro (up 57%), IPCA Labs (up 57%), Madhucon Projects (up 56%), Bajaj Auto (up 54%), Godrej Consumers (up 51%), Ahmednagar Forging (up 45%), Jagran Prakashan (up 43%), Cadila Healthcare (up 41%) and Infosys (up 29%).

Stocks In: Tata Motors (2% weightage), Subros (2% weightage), Lupin (3%) and Deccan Chronicle (2% weightage).

Weightage Increased: ITC (increased from 3% to 4%).

Underperformers: TV18 (down 14%), Reliance Infrastructure (down 7%), L&T (up 4%), Bharti Airtel (up 7%), Reliance Industries (up 7%), HDFC Bank (up 8%), Rel. Communication (up 9%), Axis Bank (up 16%), Piramal Healthcare (up 20%), ITC (up 21%), M&M (up 21%) and ICICI Bank (up 23%).

Stocks Out: M&M (2% weightage), Ahmednagar Forging (2% weightage), Piramal Healthcare (3% weightage) and TV18 (2% weightage).

Weightage Reduced: Bharti Airtel (reduced from 6% to 5%).

Sector	Top Buys	Recommended Weightage (%)	Comments
Automobile	Tata Motors	2%	Tata Motors (TML) is gearing up for the next league of commercial vehicle (CVs) and passenger vehicle (PVs). It was sheer bad timing that TML's purchase of JLR in June 2008 coincided with the meltdown in the rich-world car markets. Domestic CV demand has started showing signs of recovery, and is expected to accelerate in 2HFY2010. This has received a boost from the incentives under the JNNURM Scheme provided to STUs, which are likely to drive bus demand in FY2010. Being the Segment leader, we expect TML to be a key beneficiary of the upturn in the CV cycle. We believe that volume recovery, coupled with aggressive cost-cutting initiatives, will lead to break-even at the consolidated level for TML by FY2011E.
	Bajaj Auto	2%	Bajaj Auto is perched to win back some of its lost market share over the next couple of years with multiple new launches in the fast growing Executive Segment. We expect its valuation multiple to expand on improved growth and Earnings visibility.
	Subros	2%	We expect the company to report robust Volume growth, on the back of new launches by its prime customers, such as Maruti and Tata Motors, its foray into manufacturing air-conditioning units for the CV Segment, and potential business opportunities from International players, who are setting up manufacturing hubs in India. In FY2008 and FY2009, the company had registered a dismal performance, following a major dip in volumes and supplemented by unutilised capacities. Going ahead, we expect the company to regain its momentum on the back of its improving core business fundamentals and the Auto industry witnessing a turnaround.

Continued...

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Comments
Banking	Axis Bank ICICI Bank HDCF Bank	10% 8% 6%	Concerns over Asset quality and slowing Credit growth, that were a major overhang over both the Private and PSU Bank stocks, are now receding as the GDP growth outlook continues to improve. We maintain our view that Monetary softening, strong Domestic Savings and low Interest rates will help revive domestic demand from late FY2010E and stimulus packages and bank bailouts will continue to stabilise developed economies over a similar timeframe. With capital markets reviving and equity issuances on the rise, aided further by internal generation, leverage levels should also decline over the next 9-12 months, even as domestic demand picks up. We retain our preference for Private Banks for several reasons. One, they are very well-positioned for the impending revival in GDP growth in terms of large capital adequacy and substantial network expansion - already done in the last couple of years and not fully leveraged as well as planned going forward. With their overall superior customer proposition, in our view, they are once again set to gain marketshare in key areas, viz., low-cost deposits as well as fee income. Moreover, on an average, they are exposed to lower interest rate risks than the PSU Banks (which also carry the risk of government interference). Thirdly, in terms of valuations as well, they are trading closer to mid-cycle valuations, while the PSU Banks appear relatively expensive at present. Moreover, PSU Bank valuations look even more stretched on adjusting their book values for the huge amount of restructuring that has been done by them in the last two quarters.
FMCG	ITC Godrej Consumer	4% 3%	A better regulatory environment (no Excise hike this Budget), higher Earnings growth and steady Cigarette Volumes (factoring in a 5% volume growth for FY2010E) indicate that the worst is over for ITC. Moreover, Profitability of its Agri-business, and pick up in the Paperboard Division and Hotel Business (2HFY2010E) will aid higher growth over FY2009-11E. Lower Earnings sensitivity to the monsoon vis-à-vis peers (ITC outperforms in deficient monsoon years), and modest valuations make ITC our Top Pick in the FMCG space. Steady growth in Soaps, revival in Hair Colours and acquisition of 49% in Godrej Sara Lee (GSL) give GCPL a formidable FMCG portfolio to sustain growth. Buyout of the remaining 51% Sara Lee stake in the GSL JV or a larger acquisition in the Hair Colour/Personal care space, supported by GCPL's strong Balance Sheet, can act as an upside trigger. Moreover, the fall in palm oil prices and GCPL's forward cover till December 2009 should aid significant Margin expansion during FY2010E.

Continued...

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Comments
Infrastructure	L&T	6%	Over the next few years, we expect the Infrastructure Sector to lend substantial boost to economic growth. Investment in the sector is expected to be much higher going ahead and the government is committed towards this. Thus, we believe that despite the near-term constraints, India's medium-to long-term growth story remains intact. Against this backdrop, L&T, which is amongst the largest E&C companies in India today, is expected to gain from its presence across various verticals and geographies. It is one of the major beneficiaries of current infrastructure capex in India. Further, infrastructure players like Reliance Infra having robust order book backlog and strong balance sheet are also in an advantageous position.
	Reliance Infra.	3%	
	Madhucon Projects	4%	Madhucon Projects (MPL) has a good mix of assets, which yield consistent cash flows and would facilitate future investments in high-growth areas. We prefer MPL to other Mid Cap Construction stocks on account of the following: 1) Cooling commodity prices, which we believe will benefit MPL (30% orders with fixed price contracts); 2) There exists a substantial valuation arbitrage between MPL and its peers; 3) Is one of the biggest beneficiaries of the improving liquidity scenario; and 4) Certain catalyst/triggers (Power and Coal business) are still not priced in.
Media	Deccan Chronicle	2%	Significant correction in newsprint prices (over 50% during the last six months) coupled with higher profitability in the IPL venture (due to revised media rights) are expected to drive strong Earnings growth for Deccan Chronicle Holdings (DCHL). Moreover, as Balance Sheet concerns fade (Debt and Receivable days both stand reduced), focus shifts to core properties (Print and IPL) and ongoing buy-back instills confidence, we believe that the DCHL stock warrants a re-rating. Any news flow on stake sale in the IPL venture *(Deccan Chargers)* or a win in the upcoming *Champions League T20* tournament holds additional upside to our estimates.
	Jagran Prakashan	2%	While slowdown in the economy and Ad-spend cuts remain concerns for Print Media companies, we expect Jagran to post steady growth (up-tick post 2HFY2010E) owing to its strong foothold in the Hindi belt (*Dainik Jagran*, India's No.1 daily), focus on local advertising and rising colour inventory. We expect Margins to improve significantly driven by lower newsprint costs (declined 50% from peak), lower losses in new initiatives and higher operating leverage (as ad-rate hikes get absorbed). 2QFY2010 and 3QFY2010 will register sharpest Gross Margin expansion due to low base.

Continued...

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Comments
Oil & Gas	Reliance Ind.	14%	We are maintaining our weightage on RIL in our Model Portfolio; this is despite the negative news flows pertaining to the KG gas litigation and recent underperformance by the stock. We continue to believe in the company's visible growth story. Recent monetisation of the treasury shares reflects RIL's ability to leverage its existing Balance Sheet. Execution of two major projects, viz. RPL refinery and KG basin gas output has phased out the execution risks and unleashed the company's future growth potential. Risks on account of volatility in external variables such as GRMs and Petrochemical Margins have also subsided to a considerable extent. Moreover, from the long-term perspective, the huge unexplored E&P acreage with the company could result in significant valuation upsides from current levels.
Pharmaceutical	Piramal Healthcare	3%	Cadila Healthcare is poised to achieve robust growth after consolidating its business across key geographies. Cadila's business in the US, France and Brazil is witnessing strong growth on the back of new launches, economy of scale and vertical consolidations. Further, the traction in the CRAMs Segment has emerged as a key catalyst for the company.
	Ipca Labs	3%	Ipca Laboratories (Ipca), a market leader in the Anti-Malarial and Rheumatoid Arthritis Segments, has grown at a steady pace in the past primarily driven by its Domestic Formulations Segment. Going forward, we expect the next leg of growth for the company to come from the Export Segment as it leverages its API capabilities to create a sturdy business in the Regulated and Emerging Formulations market. In the US, Ipca has filed 11 ANDAs of which 8 have been approved having a market size of US $800mn.
	Lupin	3%	Lupin is one of the best plays in the Generic space given its strong execution capabilities, improving financial performance and diversifying business model. Lupin registered stellar growth in Top-line and Bottom-line during FY2006-09. Going ahead, we expect Lupin to extend its robust growth despite the high base. Owing to the Mandideep issue, we believe that Lupin does not enjoy the deserved valuations. But, we are confident that Lupin has the potential to get re-rated once uncertainty over Mandideep gets cleared.

Angel Research Model Portfolio

Sector	Top Buys	Recommended Weightage (%)	Comments
Software	Infosys TCS Wipro	5% 5% 5%	We believe the long-term IT Off-shoring story remains intact, given that it is an irreversible trend and that it is increasingly assuming greater strategic value for global corporations. Initiatives like platform-based BPO and SaaS are likely to drive non-linear growth in future for Indian IT companies. The recent recovery in the global economy is expected to lead to resumption to higher growth path, particularly FY2011 onwards. Attrition rates have stabilised for the Sector, which is a positive. Considering the long-term opportunities available for Indian IT players plus the fact that these companies are focusing on expansion of their service lines to include higher value services like consulting and package implementation, we remain positive on the IT Sector.
Telecom	Bharti Airtel Reliance Comm.	5% 3%	There remains strong potential for mobile companies to increase mobile tele-density (under 40% currently), which will aid robust volume growth in terms of minutes of usage. With the Indian economy expected to grow at a healthy rate, there is strong growth potential in the Enterprise space also, apart from ILD and NLD services. Triggers like hiving off of the tower business to enable value unlocking are also a positive. However, owing to intensifying competition, slowing Subscriber and Revenue growth, ARPUs and Margin pressures, and Regulatory risks, we believe chances of an upward re-rating of stocks in the Sector are remote. We prefer companies with good scale, a strong execution track record and proven management capabilities like Bharti Airtel, which remains our Top Pick in the Sector. For Reliance Communications, the listing of Reliance Infratel could provide an upside trigger.

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Automobile	● The macro-economic scenario appeared optimistic in 1HFY2010 with Volumes registering a gradual up move across the Automobile Sector during the period. We had anticipated Volumes to improve sequentially from 1QFY2010 aided by an easing Monetary Policy and favourable business economy. Further, owing to a positive economic scenario and improving consumer sentiment, we retain our positive outlook on the Sector. ● Most Auto companies reported a sequential spurt in Volumes for 2QFY2010. Consumer discretionary Autos like two-wheelers and cars reacted fast to improving credit availability. Overall, most companies are expected to post good growth in 2QFY2010. ● Commodity prices fell significantly from their peak in FY2009, full benefits of which would be realised in 2QFY2010.	● Most domestic Auto majors are likely to register a better yoy performance. Post streamlining inventory levels and reduced input costs, Operating Profit is also expected to improve. ● Hero Honda, Maruti and M&M could deliver better numbers on better Volumes and launch of New Products during 1HFY2010.
Auto-Ancillaries	● The Auto Component Industry is expected to be on the path of recovery. Outlook for the industry is good on the domestic front, but slightly cautious on the export front. ● On the domestic front, momentum is expected to continue since recovery in the Passenger car, Two-wheeler and Light Commercial Vehicle Segments seem to be sustainable, aided by dropping Interest rates and better availability of finance. ● The yoy depreciation in the Rupee is expected to improve realisations of companies with high Exports exposure. However, these companies are expected to post slack exports volume following the decline in demand from most of the developed countries due to the overall global economic slowdown.	● Auto Ancillaries are expected to report a sequential Top-line growth in 2QFY2010- on the back of better domestic volume growth. ● Margin pressure is expected to reduce sequentially owing to improving operating leverage and reduced raw material cost. ● Broadly, the Sector is expected to deliver mixed bag Earnings owing to exaggerated Losses by ancillary companies for their exposure in overseas market.
Banking	● Core business growth for banks continued to be sedate in 2QFY2010 as well, with the Credit growth rate remaining low at 14% yoy at the end of August 2009. Banks continued to cut deposit rates, while leaving the lending rates largely unchanged sequentially. Towards end of the quarter, there were signs of moderating deposit growth. Overall, growth in Net Interest Income (NII) is likely to be sedate. ● During the quarter, Gsec yields increased by 50bp+ across the yield curve, subsequently cooling off on market expectations of an increase in the HTM limit by the RBI, though more so at the long end. Generally, 2QFY2010 is likely to be a relatively modest quarter in terms of treasury performance compared to the huge Profits registered in 1QFY2010. Overall, Profitability is expected to be moderate in 2QFY2010.	● Most banks expect NIMs to stabilise 3QFY2010 onwards as deposits increasingly re-price lower, especially Bulk deposits contracted at peak rates during September-October 2008. Over the next few quarters, banks with a larger component of wholesale deposits will benefit from the sharp downward re-pricing of the same. However, we believe these benefits are largely factored in the stock prices, and accordingly, retain our preference for the large private banks that offer superior visibility of growth in low-cost deposits and multiple Fee income streams, and are best placed to capitalise on the imminent revival in GDP growth.

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Capital Goods	● Visibility seems to be gradually improving, with foreign investments into the country gaining some momentum, the financial closure of projects stalled for several quarters beginning to happen, and quite a few large companies across sectors having successfully tapped the global financial markets. ● Cumulative IIP growth for the period April to July 2009-10 stands at 4.6% (5.6%), while the cumulative growth for Capital Goods components in the mentioned period fell sharply to 2.0% (10.4%). ● Top-line of the companies under our coverage universe is expected to post a growth of around 19.3% yoy. On the Operating front, we expect our universe to register 118bp Margin expansion. Consequently, Net Profit would also increase at a higher pace of around 23.9% yoy for our universe.	● Although the broader economic scenario is definitely showing some signs of improvement, we believe that growth pressures will persist in the near term and it will take a while for things start to picking up dramatically. ● Macro indicators are exhibiting a mixed trend. ● The growth would primarily be driven by BHEL, which is expected to continue its strong performance on the back of a healthy Order Book position and Margin expansion.
Cement	● For 2QFY2010, on a yoy basis, All-India cement consumption grew 12.3% to 45.8mn tonnes (40.7mn tonnes). However, on a sequential basis, consumption de-grew by 6.8% from 49.1mn tonnes in 1QFY2010. Notably, yoy cement consumption growth at 12.3% yoy during 2QFY2010 was higher than 7.5% yoy growth clocked during 2QFY2009. ● Cement consumption remained robust due to the extended construction activities owing to the delay in monsoon season over most part of the country, higher government spending on infrastructure projects and incremental demand coming from rural and semi-urban areas.	● We expect cement companies to deliver decent Topline growth on account of good volume growth , low base effect and higher prices yoy. ● Lower power & fuel cost and other operating expenses continue to improve. OPMs of companies during the quarter are expected to improve on account of the decline in costs like imported coal. ● We expect cement consumption growth in India to remain strong with the thrust on infrastructure and strong demand from Rural housing However, huge capacities that are expected to come on stream in H2 FY10 to exert pressure on the cement prices going ahead.
FMCG	● For 2QFY2010, we expect our FMCG universe to report slight moderation in Top-line growth to 13% yoy driven largely by Volume growth and improvement in Product mix. Earnings for the quarter are expected to grow at a robust pace of 17% yoy aided by Margin expansion in case of most companies (due to falling input cost).	● GCPL, Marico and Nestle are expected to report the strongest Earnings growth during the quarter. HUL, the segment leader, is expected to report muted Earnings growth owing to lower Other Income. We expect ITC to post 3-4% increase in Cigarette Volumes. ITC's Earnings are expected to grow by 10.9% aided by Margin expansion (driven by higher Margins in Cigarettes).

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Infrastructure	● For 2QFY2010, we expect all the companies in our universe to post a healthy 5-55% growth in Top-line on the back of a robust Order Book position and changing outlook towards infrastructure development in the country. On the Margin front as well, we expect some improvement due to cooling commodity prices. However, we expect companies under our coverage universe to report a mixed set of numbers on the Bottom-line front.	● Jaiprakash Associates is expected to post strongest earnings growth in our coverage universe primarily on account of extraordinary income on account of sale of five crore treasury shares during the quarter. We expect Punj Lloyd to second the Earnings growth during the quarter in our coverage universe followed by Sadbhav Engineering and Nagarjuna Construction.
Logistics	● The container traffic data released for FY2010 YTD (April-July 09) by the Indian Port Association (IPA) witnessed a 5.5% yoy decline. The JNPT port, which handles around 60% of the country's container volumes, registered a 6.3% yoy fall in volumes, while the Chennai port, which handles around 16% of the country's container volumes, witnessed a 7.9% yoy fall. This indicates that container traffic is stabilising at the current levels in absolute terms, after bottoming-out, in January and February 2009. Going ahead, we expect trade to revive post 2QFY2010, on the improving economy and on account of a low base. Nonetheless, we believe that the high base effect and lacklustre Exports during 1HFY2010 will result in moderate growth in Exim volumes for FY2010.	● For 2QFY2010, we expect our universe of stocks to report moderate growth on a sequential basis, on account of the improving visibility in trade, but to remain subdued yoy, on account of the high baseeffect. We expect Operating Margins to improve sequentially, owing to the improvement in Realisations (Concor) and a better Product-mix (GDL). We believe that the Domestic Segment will continue to do well in 2QFY2010, on the back of the strong domestic consumption. Consequently, we expect Concor, GDL and AGL to register a 2.8%, 21.6% and 13.6% yoy decline in PAT, respectively. Going ahead, we expect our universe of stocks to register robust growth in the ensuing quarters, on a low base and on increasing trade.
Metals	● Steel companies under our coverage are expected to post strong Sales volumes during 2QFY2010 on a yoy basis. However, lower steel realisation would impact Top-line growth. We expect Top-line of the Steel companies under our coverage to decline by 1-10% yoy. On the Margins front, we expect the companies to improve Margins sequentially on the back of improvement in Realisations, higher Sales volumes and easing Cost pressures on a qoq basis. ● We expect Base Metal players like Hindalco and Nalco to clock de-growth in Top-line owing to lower LME prices yoy. Rupee depreciation of around 11% yoy during the quarter has however acted as a saviour for these companies. We expect Margins of Nalco and Hindustan Zinc to decline by 800-2,000bp. However, we expect Hindalco to improve its Margins by 100bp yoy on higher copper Tc/Rc Margins.	● International steel prices have risen by 30-40% from recent lows on account of improvement in the global economic outlook. Steel demand has stabilised and de-stocking is over in the European and North American markets with prices moving up in those regions. Domestic steel producers also hiked steel prices during the quarter on the back of buoyant domestic demand and tracking the rise in global steel prices. We expect steel demand in India to grow by 6-7% in FY2010E and further pick up post FY2011E ● Prices of base metals like Copper, Aluminium, Zinc and Lead sequentially moved up by more than 20% during the September quarter. However, on a yoy basis, prices are still ruling lower by more than 20%.

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Oil & Gas	● Average crude oil prices during the quarter were higher by 14.9%. However, GRMs were subdued during the quarter with the benchmark Singapore Margins averaging at around US $2.7/bbl. Increase in crude oil prices during the quarter, could result in inventory gains for Refining companies. ● We expect the increase in oil prices to improve Cairn India's realisations. However, ONGC is not likely to benefit on account of the same due to a higher Subsidy burden. ● Petrochemical Margins were subdued during the quarter. While the Cracker and integrated PE Margins saw an improvement, non-Integrated PE Margins witnessed a contraction on account of higher Naphtha prices. Margins of the PVC Segment were largely flat during the quarter. ● On account of higher average crude oil prices, under-recoveries on subsidised petroleum products increased during the quarter.	● RIL is likely to report GRMs of US $7.4/bbl during the quarter. Similarly, Petrochem Margins are likely to be subdued on a qoq basis. ● Upstream major, ONGC, is expected to report reduction in Net Realisations on a qoq basis on account of the increase in Subsidy burden. We expect ONGC to register Net realisation of US $53.1/bbl (down US $5.2/bbl on a qoq basis). ● For IGL, we estimate CNG Volumes to increase by 7.6% yoy during 2QFY2010. The impact of the price hike made in the latter part of the pervious quarter will be visible in 2QFY2010 with OPMs expected to increase on a qoq basis to 41.5% (36.9%).
Pharmaceutical	● We expect our coverage universe to register flat yoy growth on the Top-line front mainly on account of Ranbaxy and Sun Pharma. We estimate our coverage universe to post 2.7% rise in Net Sales during 2QFY2010. Operating Margins (OPM) are expected to expand for most of the companies under our coverage except in case of Ranbaxy and Sun Pharma, which are likely to witness major Margin contraction. ● However, Net Profit is expected to increase by 19.8% on account of forex losses on foreign currency denominated debts reported in 2QFY2009. We expect 2QFY2010 to depict true operating performance for most of the companies under our coverage as the Rupee was flat on a qoq basis resulting in negligible MTM charges on foreign currency denominated working capital and debt.	● On the Top-line front, we expect large cap Cipla and mid caps Cadila Healthcare and PHL to post robust growth. ● We expect OPMs to marginally improve for Cipla, Cadila Healthcare and Piramal Healthcare.
Power	● For 2QFY2010 we expect the power companies to clock higher PLF's on account of the improvement in the fuel availability front. The coal stock situation in the power stations is looking a lot healthier as compared to the situation which prevailed a few quarters back. Similarly the availability of gas from KG basin is expected to result in assured fuel supply for gas based power plants. Higher PLF's inturn is expected to result in higher power generation and turnover for power companies.	● The power generation companies under our coverage, viz. NTPC, GIPCL and CESC, are expected to report a strong yoy growth in Top-line to 21.6% for 2QFY2010. ● Net Profit is expected to grow by 12.8% in 2QFY2010 on the back of increase in power generated, higher tariffs and improved PLF in gas-based plants.

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Power	● In addition to the improving fuel scenario, there has also been a considerable decline in the cost of fuel, which is expected to boost the operating margins of the power utilities during the quarter	● We expect Operating Margins to improve on account of better Operating performance.
Retail	● For 2QFY2010, we estimate consumer spending to speed up in Value Retailing as well as in the Lifestyle Retailing Segment on the back of increased footfalls and pick up in consumer confidence. ● We expect our universe of stocks to post Top-line growth of 10.9% on a yoy basis. We estimate major, Pantaloon Retail (PRIL), to lead the universe with 14% yoy growth in Top-line. ● We estimate OPM of our Retail Universe to increase by 140bp to 10.6% in 2QFY2010E from 9.2% in 2QFY2009 on the back of cost rationalisation measures and renegotiations on rent by the retailers. We estimate Net Profit Margins (NPM) to improve by 84bp to 3.5% in 2QFY2010E from 2.6% in 2QFY2009. ● We estimate PRIL to maintain its NPM, while Vishal Retail and Shoppers' Stop would see a significant yoy improvement in their NPM during the quarter. We expect Titan's NPM to decline during the quarter.	● Growth of the Retail Sector is co-related with the state of the economy. With the economic recovery gathering steam during the quarter, footfalls have started showing an upward trend, resulting in an increment in the SSS and the Sales Per Square Feet (SPSF) of the Retailers. We expect the trend to strengthen going ahead, thereby keeping the long-term growth prospects intact. The Value Retailing Segment is likely to lead the growth over the next few years, as more and more consumers are expected to go for value-for-money-goods. However, we expect growth of the Lifestyle Retailing Segment to pick up on the back of stable economic conditions. **We remain positive on the Retail Sector.**
Software	● Top-tier companies (excluding Satyam, including HCL Technologies) to report a 2-3% sequential increase in volumes along with stable billing rates ● Over the quarter, the Rupee saw marginal appreciation against the US Dollar of 0.6% qoq. Against the Euro, the Rupee lost over 4%, while against the British Pound, depreciation of nearly 5% was witnessed. Thus, on an overall basis, thecurrency movements have been slightly favourable for Indian software companies and could prove to be a tailwind ● IT Service revenues in Dollar terms are expected to de-grow by 1.7% yoy and grow by 3.1% qoq for the quarter, while in Rupee terms, these are expected to grow by 7.8% yoy and 3.7% qoq ● We believe from current levels, prospects of further Margin expansion are limited and expect this to trend downwards going forward. We expect Infosys to record a 96bp qoq decline in Margins, TCS a marginal 9bp qoq expansion,Wipro a 114bp qoq decline and HCL Technologies to record a flat margin profile this quarter.	● The benchmark BSE Sensex gained an impressive 18% over the quarter on the back of the strong 49% gains recorded in the previous quarter, as improved economic sentiment across the globe fired an increase in risk appetite and fund flows. The BSE IT Index, gained an outstanding 39%, out-performing the benchmark index. ● Australian telco Telstra retained Infosys as its IT vendor, while energy major British Petroleum (BP) cut its vendors from 40 to 5, with TCS, Infosys and Wipro all being retained, apart from IBM and Accenture in a five-year deal worth US $2bn. The BP deal we believe is a major positive signal and expectmore such vendor consolidation moves to happen going forward ● Announcement of extension of STPI scheme in Budget 2009-10 by one year till FY11 will extend tax benefitsto the sector.

Continued...

2QFY2010 Sectoral Outlook

Sector	Key Expectations	Comments
Software	● We expect the top-tier IT companies to post a decent 5% qoq growth in Net Profits for 2QFY2010 (14.5% yoy growth). This is expected to be led by the decent sales numbers posted by these companies. We expect Infosys to record a 3.1% qoq decrease in Bottom-line, TCS a 4.9% qoq growth, Wipro an impressive 13.3% qoq growth and HCL Tech to register a significant17.7% qoq increase in Bottom-line.	● Another positive indicator for the sector is the pay hikes and promotions given to their employees by Infosys and Wipro, which is a clear testimony to the improving business prospects
Telecom	● Topline growth is expected to come in at a decent 18.7% yoy on continued buoyancy in subscriber additions, even as ARPUs continue to witness downward pressure, while growth is expected to show improvement in other business segments like enterprise, broadband and long distance ● The impact of rapid network roll-outs is expected to continue this quarter, with a combined 117bp yoy fall in EBITDA margins expected overall. Intensifying competition is also expected to lead to further pressure on ARPUs, RPMs and Margins ● On account of the margin pressures, Net Profits are expected to grow by a combined 16.9% yoy; on a company-specific basis, Bharti to grow bottom-line by 23.8% yoy, RCOM to show a flat growth and Idea to show an outstanding 97.9% yoy growth, albeit on a low base	● Monthly mobile net adds remain strong and July and August 2009 saw the addition of 14-15mn subscribers in each month. This was faster than the additions recorded in the previous 3 months and was driven by the impressive performance of Tata Teleservices (TTSL) on the back of its GSM launch ● Mobile teledensity is still at relatively low levels of less than 40%, leaving good scope for growth ● However, the heightened competitive intensity in the sector with TTSL launching GSM services and other players like Aircel, Idea and SSTL also scheduled to launch across circles, apart from newer operators like Unitech, is likely to lead to continuing pressure on ARPUs and RPMs, lower returnson capital and a spectrum shortage ● Regulatory uncertainty remains a sectoral bug-bear and spectrum is perpetually an issue, with the release of spectrum from the Defense forces uncertain, which Could lead to a significant shortage of 3G spectrum for the upcoming auction scheduled to be held in December 2009 ● Thus, with intensifying competition, slowing subscriber growth and ARPU declines all leading to slowing top-line growth, margin pressures and regulatory risks, we believe chances of a re-rating for stocks in the sector are remote

Continued...

Automobile

Time to celebrate…

FY2010 has started on a positive note for the Indian Automobile Sector, with volumes improving every month. This has resulted in fresh buying and a sharp upturn in most Auto stocks on the bourses, in the last two quarters. The overall recovery in the Indian Auto Sector continues, due to a sustained improvement in demand, aided by the green shoots that continue to bloom in the domestic markets. This is due to improving macro-economic factors such as expanding liquidity, lower interest rates and rising consumer confidence. As a result, most Auto stocks have seen a sharp run up in recent times. Going ahead, we expect this economic recovery to help the Auto Sector, which includes passenger vehicles (PVs), commercial vehicles (CVs) and two-wheelers, in registering good growth in the Domestic market, and a decent growth in the Export markets, over FY2009-11E.

We estimate overall Auto Volumes to register a growth of around 7.5% yoy and 9.8% yoy in FY2010E and FY2011E, respectively. The growth in FY2010E would largely come due to a low base effect; this, however, should gradually pick up in FY2011E, aided by the improved economic environment for the sector. Over the longer term, comparatively low penetration levels, a healthy economic environment, and favourable demographics, supported by higher per-capita income levels, are likely to help the Auto companies in sustaining their Top-line growth.

Favourable Interest rates, Commodity prices: Finance has started returning to the Auto Sector, and to a larger extent in PVs, due to a larger ticket size and lower defaults. Banks and financial institutions have reduced their interest rates by almost 350-400bp in the last six months. CV disbursements are also improving, albeit at a slower pace. After a sharp fall in 3QFY2009, financiers have been cautious in lending to first-time users (who have the highest delinquency levels and contribute to 60-65% of the total lending). Financiers are optimistic that truck demand will recover by 4QFY2010, as freight volumes in the economy start improving. However, the two-wheeler auto finance market can continue to lag behind, owing to the rising proportion of sales from the rural markets, which are less dependent on finance as compared to the urban markets.

Another variable impacting the Margins of Auto companies is the movement of commodity prices, such as steel, aluminum, rubber and fuel. This proved to be a major headwind during FY2009, resulting in several percentage points being shaven-off from the Earnings growth of Auto companies. However, these commodities moved southward during 2HFY2009. Thus, average prices of inputs, which have shown an increase of 12-13% in FY2009, are expected to decline by around 15% in FY2010E and to remain low in the medium-term, which would help manufacturers in improving on the Margin front. As expected, margins have already bounced back with a lag effect, after a reduction in the auto industry's high-cost inventory in 1QFY2010.

Auto Index - impressive outperformance in 2QFY2010: The Auto Index registered a 43.2% jump during 2QFY2010 versus the 18.2% rise in the Sensex, outperforming it by an impressive 25%. The sentiment for Auto stocks had turned positive in 4QFY2009, on easing concerns of lower volume growth, following the various stimuli announced by the government and the RBI to cap the declining volumes of the industry. The positive upturn in volume continued in 1HFY2010, and further boosted the stock prices of most Auto and Auto-Component companies. The Valuation gap, however, started catching up in 2QFY2010. This was evident from the stock price of Bajaj Auto and Tata Motors, which registered a significant 50.8% and 103.1% jump, respectively, during the quarter. In 2QFY2010, Ancillary stocks like Bharat Forge, Amtek Auto and MRF also registered stunning performances on the bourses. However, front-runner stocks, like M&M and Hero Honda, underperformed the Auto Index (by 23.7% and 15.9%, respectively), while Maruti continued to move up, with an outperformance of 16.3% on the bourses during 2QFY2010.

Exhibit 1: BSE Sensex v/s Auto Index

Source: C-line

Commercial Vehicles: recovery on Board: During FY2009, the M&HCV space was a major disappointment and continued to decline, with transporters deferring purchases and with freight rates declining, indicating concerns over the sustainability of freight demand. However, volumes resumed a sequential recovery in 4QFY2009, and have continued this recovery in 1HFY2010. Tata Motors' CV sales registered a 25.7% qoq and a 13.9% yoy growth in volumes during 2QFY2010. We believe that CVs have a higher

Automobile

sensitivity to the economic and industrial slowdown; thus, we expect the M&HCV Segment to show a good recovery in 2HFY2010E, aided by the better IIP growth clocked in the last few months.

Exhibit 2: Tata Motors, Ashok Leyland - Quarterly volumes

Segment	2QFY2010	2QFY2009	%chg	1HFY2010	1HFY2009	%chg
Tata Motors	**150,377**	**133,952**	***12.3***	**273,490**	**265,685**	***2.9***
M&HCV	38,043	35,820	*6.2*	67,008	74,189	*(9.7)*
LCV	57,865	48,374	*19.6*	105,223	89,171	*18.0*
Utility Vehicles	7,856	9,569	*(17.9)*	15,973	22,132	*(27.8)*
Cars	46,613	40,189	*16.0*	85,286	80,193	*6.4*
Exports (Inc. Above)	8,002	9,159	*(12.6)*	13,222	22,040	*(40.0)*
Ashok Leyland	**14,301**	**17,207**	***(16.9)***	**21,999**	**35,695**	***(38.4)***
MDV Passenger	4,192	6,718	*(37.6)*	6,677	11,511	*(42.0)*
MDV Goods	9,855	10,261	*(4.0)*	14,837	23,711	*(37.4)*
LCV	254	228	*11.4*	485	473	*2.5*
Export (Inc. Above)	1,655	2,026	*(18.3)*	2,558	3,306	*(22.6)*

Source: Company; Angel Research

Passenger Vehicles: better-than-expected recovery: PV Sales volumes registered a good recovery in the last two to three quarters, largely aided by an increase in export volumes and a gradual recovery in domestic demand. This was supported by a rebound in Consumer sentiment after 3QFY2009, and was reflected in the improving volumes of the domestic PV market. Given its low penetration, the PV Segment has the potential to record double-digit growth over the next five years. The significant Export plans of manufacturers will further help in sustaining growth levels in FY2010. Maruti witnessed strong growth in 2QFY2010 - the company recorded a robust 29.9% and 23.8% yoy increase in volume during 2QFY2010 and 1HFY2010, respectively.

Exhibit 3: Maruti, M&M - Quarterly volumes

Segment	2QFY2010	2QFY2009	%chg	1HFY2010	1HFY2009	%chg
Maruti Suzuki	**246,188**	**189,451**	***29.9***	**472,917**	**382,035**	***23.8***
Total P. Cars	208,311	169,278	*23.1*	404,343	348,055	*16.2*
MUV Gypsy, Vitara	772	2,428	*(68.2)*	2,155	3,744	*(42.4)*
Domestic	209,083	171,706	*21.8*	406,498	351,799	*15.5*
Exports	37,105	17,745	*109.1*	66,419	30,236	*119.7*
M&M	**113,090**	**91,815**	***23.2***	**219,341**	**181,975**	***20.5***
Domestic Auto	70,798	60,104	*17.8*	132,521	116,971	*13.3*
Exports	1,862	2,941	*(36.7)*	3,007	6,128	*(50.9)*
Domestic Tractor	38,597	26,539	*45.4*	80,560	54,543	*47.7*
Exports	1,833	2,231	*(17.8)*	3,253	4,333	*(24.9)*

Source: Company; Angel Research

Two-wheelers: indicating strength of the market reach: In FY2009, the Two-wheeler Segment registered a 2.6% yoy growth, albeit on a low base. The growth story continued, with the top three Two-wheeler manufacturers registering a 14% yoy growth in 2QFY2010, aided by around a 13.1% yoy growth in the Motorcycle Segment. Hero Honda reported the best numbers among its peers in FY2009 and 1HFY2010, indicating the strength of its market reach and a better performance by the Rural Segment.

We believe that although the substantial ownership base of Two-wheelers results in reduced headroom for higher growth rates and increases the dependence on Replacement demand to sustain volumes, the rural markets will register better growth on account of the new demand arising from the relevant rural population. This is expected to help Two-wheeler companies in maintaining their growth momentum and in registering a 7-8% CAGR in Volumes over the next few years.

Exhibit 4: BAL, HH, TVS - Quarterly volumes

Segment	2QFY2010	2QFY2009	%chg	1HFY2010	1HFY2009	%chg
Bajaj Auto	**686,823**	**640,040**	***7.3***	**1,234,487**	**1,260,135**	***(2.0)***
Motorcycles	599,737	561,475	*6.8*	1,082,466	1,120,108	*(3.4)*
Scooters	1,840	3,621	*(49.2)*	3,533	6,965	*(49.3)*
Total 2 Wheelers	601,577	565,096	*6.5*	1,085,999	1,127,073	*(3.6)*
Three Wheelers	85,246	74,944	*13.7*	148,488	133,062	*11.6*
Exports (Inc. Above)	224,430	206,930	*8.5*	402,725	405,647	*(0.7)*
Hero Honda	**1,183,235**	**972,095**	***21.7***	**2,302,222**	**1,866,339**	***23.4***
TVS Motors	**390,389**	**370,112**	***5.5***	**737,570**	**701,901**	***5.1***
Motorcycles	154,843	177,624	*(12.8)*	307,621	341,952	*(10.0)*
Scooters	86,239	76,656	*12.5*	153,489	140,087	*9.6*
Mopeds	149,307	115,832	*28.9*	276,460	219,862	*25.7*

Source: Company; Angel Research

Auto-Ancillaries: to track the Auto Sector: The Auto Component Sector, which depends on the OEMs for its growth, was stuck in the midst of sluggish growth in the domestic market, and a recession-hit global export market in FY2009. The domestic market, which accounts for over 80% of the Rs90,000cr Indian Auto Component Sector, has experienced one of its worst phases, due to the dip in Auto sales. At the same time, exports, which acted as a cushion for any cyclical change in domestic demand (account for almost 20% of the total Auto Component Industry), have been dismal due to the global financial crisis. The US $18bn Sector saw its FY2009 Revenue going up by $1bn, but the slide has become significant, from their peak of a 27.2% CAGR over FY2003-08. Exports have also nose-dived from their 35% CAGR over FY2003-08, to 6.1% for FY2009. For the first time in a decade, the Sector clocked a single-digit growth in Revenues and registered a fall in Earnings. Global outsourcing from large traditional markets, like the US and Europe, has taken a stiff beating and has seen a reduction of up to 35% in many cases.

Automobile

Volume growth to continue, on a low base and on festive season buying: We believe that, going ahead, the success of new launches, rising income levels and the easy availability of finance, both in the Two and Four-wheeler Segments, will determine the sales fortunes of the auto players. With this backdrop, we expect Auto companies to report a sequential spurt in Revenue growth, on better volumes and stable pricing during the last couple of quarters.

OPM pressures to ease sequentially: Input costs have spiraled in the last two years, following a spurt in steel, rubber and aluminum prices. However, the cycle took a reverse turn in the recent past, following the softening of commodity prices, which will help manufacturers in improving their Margins, starting from 1QFY2010. Players are further expected to register an increase in their Net Profit in 2QY2010, on reduced Input costs and better operating leverage, followed by declining inventory volumes.

Auto Components Segment: At the end of FY2009, companies were finding it difficult to make future projections, as their two key markets, OEM and Replacement Segments, had been hit by poor demand and instability in final product prices, which were trending downwards. However, the industry is now on the path of recovery, aided by a better-than-expected revival in the domestic market, though exports remain discouraging. Companies in the sub-segment of the Auto Components Sector, such as Tyres, Bearings and Batteries, with a larger share of revenues from the Replacement and Domestic market, have been less affected than those that supply exclusively to the OEMs. Broadly, the Sector is expected to deliver a good yoy Earnings performance in 2QFY2010, aided by improved volumes and better operating leverage.

Outlook: The core business performance of Auto companies has changed for the better: visibility has been restored, with substantial yoy growth also being witnessed in the last two quarters. Consequently, while this quarter's performance is likely to be robust on a yoy basis, we also expect Auto companies to report a sequential spurt in their Revenues, due to better Volumes. Most of the stocks have shown a positive move in the last six to eight months, thanks to the better growth visibility for the Sector. We remain positive on the overall, long-term prospects of the Indian Auto Sector. We prefer stocks where strong and improving business fundamentals could continue to deliver positive earnings surprises.

Among the heavyweights, we prefer Bajaj Auto, Maruti and M&M. However, most of the Auto stocks have registered a sharp run up in the last six months, and we advise an Accumulate on the stocks at lower levels. Among the Ancillary stocks, we prefer Subros, FAG Bearing and Motherson Sumi, which are available at attractive valuations.

Exhibit 5: Quarterly Estimates - Automobile — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*%chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
Ashok Leyland	42	1,840.8	(1.4)	9.0	*75*	60.5	(10.0)	0.45	*(10.0)*	1.8	2.5	*41.3*	23.6	16.7	-	**Neutral**
Bajaj Auto@	1,494	2,842	*16.0*	19.4	*592*	352.5	*90.6*	24.4	*90.6*	91.8	105.0	*14.5*	16.3	14.2	1,575	**Accumulate**
Hero Honda	1,670	4,038	*26.6*	17.0	*375*	529.4	*72.8*	26.5	*72.8*	97.8	105.0	*7.3*	17.1	15.9	-	**Neutral**
Maruti	1,699	6,872	43.0	12.4	*208*	535.3	*80.8*	18.5	*80.8*	75.7	92.2	*21.8*	22.5	18.4	-	**Neutral**
M&M @	881	4,513	*45.5*	13.5	*545*	406.7	*60.6*	14.9	*57.4*	49.6	53.4	*7.6*	17.9	16.7	941	**Accumulate**
Tata Motors @*	591	7,898	*11.6*	12.0	*399*	479.5	*38.2*	9.3	*38.2*	(15.7)	25.4	-	-	23.2	-	**Neutral**
TVS Motors	63	1,093	*7.7*	5.6	*248*	27.6	*165.1*	1.2	*165.1*	3.6	4.7	*30.4*	17.6	13.5	-	**Neutral**

Source: Company, Angel Research; Price as on Sept. 30, 2009. Note: @Adjusted for extraordinary items; FY EPS on Consolidated basis*

Exhibit 6: Quarterly Estimates - Auto Ancillary — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*%chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
Amtek Auto*@ &	221	864	*(29.8)*	18.0	*156*	21.6	*(70.8)*	1.5	*(72.5)*	0.0	2.0	-	-	112.7	-	**Neutral**
Automotive Axle^	270	85	*(38.0)*	15.5	*203*	5.3	*(28.5)*	3.5	*(28.5)*	12.0	15.5	*29.8*	22.6	17.4	279	**Accumulate**
Bharat Forge* &	277	670	*(50.3)*	(1.0)	*(1,539)*	(38.7)	-	(1.7)	-	(4.3)	8.0	-	-	34.7	-	**Neutral**
Bosch India#	4,163	1,295	*2.1*	18.5	*(36)*	157.9	*(0.2)*	49.9	*1.0*	178	209	*17.2*	23.3	19.9	4,185	**Accumulate**
Exide Industries	92	894	*(0.7)*	20.4	*398*	106.0	*36.2*	1.3	*36.2*	5.5	6.0	*9.2*	16.8	15.4	95	**Accumulate**
FAG Bearing#	475	211	*(1.1)*	17.5	*(431)*	24.6	*(19.4)*	14.8	*(19.4)*	43.3	57.0	*31.6*	11.0	8.3	570	**Buy**
Motherson Sumi*	114	1,432	*130.7*	6.8	*(549)*	35.0	*(17.3)*	1.0	*(17.3)*	2.5	7.2	*184.0*	44.9	15.8	123	**Accumulate**
Rico Auto*	27	250	*2.4*	11.9	*8*	5.6	*44.9*	0.4	*44.9*	1.9	3.1	*63.2*	14.3	8.8	31	**Accumulate**
Sona Koyo	15	203	*13.4*	8.2	*11*	3.9	-	0.2	-	0.7	1.5	*107.4*	21.3	10.3	-	**Neutral**
Subros	41	222	*31.8*	9.2	*41*	4.9	*32.9*	0.8	*32.9*	3.4	5.0	*45.7*	12.0	8.3	50	**Buy**

*Source: Company, Angel Research; Price as on Sept. 30, 2009; Note: * Consolidated Results; # December Yearend; ^ September Yearend; @ Year-end June; & FY2010E and FY2011E EPS adjusted for FCCB interest after tax*

***Analyst* - Vaishali Jajoo / Shreya Gaunekar**

Banking

2QFY2010 - Marked by Interest rate volatility

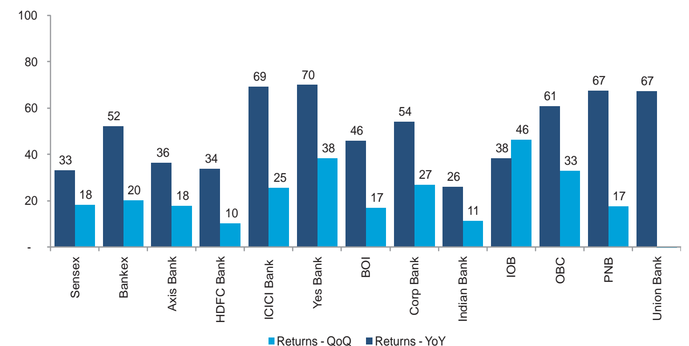
Core business growth for banks continued to be sedate in 2QFY2010 as well, with the Credit growth rate remaining low at 14% yoy at the end of August 2009. Banks continued to cut deposit rates, while leaving lending rates largely unchanged sequentially. Bulk deposit rates remained very low and money market liquidity remained excessive for a large part of the quarter. Towards the end of the quarter, however, there were signs of moderating deposit growth, matched by a reduction in LAF balances below Rs1 lakh cr for the first time in several months and lower deployment in Government bonds (Gsecs). Overall, growth in Net Interest Income (NII) is likely to be sedate, with improvement expected only 2HFY2010 onwards.

During the quarter, Gsec yields registered an increase of 50bp+ across the yield curve as banks became increasingly reluctant to increase their AFS exposure. Subsequently, yields cooled off on market expectations of an increase in the HTM limit by the RBI, though more so at the long end. Generally, 2QFY2010 is expected to be a relatively modest quarter in terms of treasury performance compared to the huge profits registered in 1QFY2010, as the rise in yields was not yet enough to trigger large MTM losses, though unrealised gains reduced and there were few opportunities to book profits. Overall, Profitability is expected to be moderate in 2QFY2010. Asset quality concerns, though receding, remain important metrics to monitor in the 2QFY2010 results.

Market Returns

The BSE Bankex performed in line with the Sensex in 2QFY2010, rising 20% sequentially. Within our coverage universe, mainly banks that had underperformed in the first leg of the rally such as Indian Overseas Bank and Oriental Bank of Commerce outperformed during the quarter. During 2QFY2010, the PSU Banks initially underperformed on account of rising Gsec yields. However, subsequent communication from policy-makers as well as expectations that the HTM limit would be enhanced, led to a sharp rally in the Bond markets and consequently in PSU Banks, with most of them now trading at fair to rich valuations, in our view. Smaller banks such as Yes Bank also continued to run up on account of the short-term catalyst of plummeting cost of wholesale funds. Axis Bank underperformed following its large equity dilution, though in our view, based on its post-dilution book value, the Bank is amongst the most attractively valued stocks in the Banking Sector at present.

Exhibit 1: Market returns (2QFY2010)



Source: BSE, Angel Research

Key Developments

Credit growth slows down further

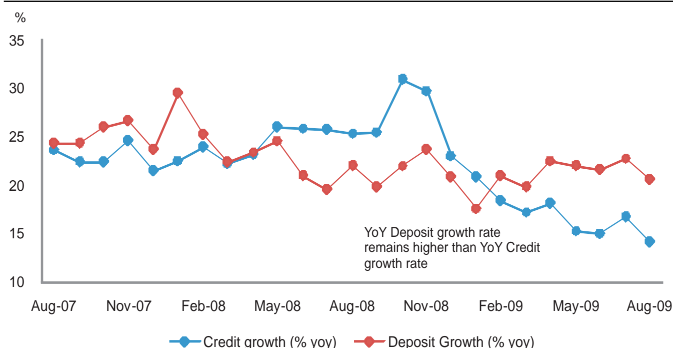
Following an exceedingly sedate first quarter, where Total Credit increased by a mere Rs8,287cr, 2QFY2010 witnessed a marginal improvement on a sequential basis with an absolute increase of Rs29,284cr by the end of August 2009. On a yoy basis though, the growth rate showed a further dip from 15% at the beginning of the quarter to 14% by the end of August 2009. While Deposit growth remained much above Credit growth, it started to show signs of moderation towards end August 2009. With banks continuing to cut FD rates (in most cases to at least 100bp lower than rates on Small Savings Schemes) and with Capital Market activity reviving, Deposits increased by Rs1 lakh cr, as against a substantial Rs1.5 lakh cr in 1QFY2010, with yoy growth at 20.5%, down from 24% in 1QFY2010.

Banks continued to deploy relatively large amount of funds in low-yielding government securities (as much as 54% of incremental deposits during July-August 2009), though this was decidedly better than the 100% incremental Investment-Deposit ratio registered in 1QFY2010. Excess liquidity in the money markets also showed signs of moderating, indicated by a reduction in LAF balances by the third week of September, below Rs1 lakh cr for the first time in several months.

On the Capital Market front, there was marked improvement in activity and notably, several large corporate bond issues from the financial as well as non-financial sectors were completed during 2QFY2010. Axis Bank maintained its market leadership in the Bond Underwriting Segment during the quarter (*Source: Bloomberg, September 28, 2009*).

Banking

Exhibit 2: Credit and Deposit growth



Source: RBI, Bloomberg, Angel Research

Deposit rates fall further

Most banks held on to their PLRs during 2QFY2010, with managements indicating a bottoming of interest rates. Deposit rates fell further during the quarter, with peak FD rates falling to 7-7.25% for most banks. On an average, PLRs were down 175bp and retail FD rates by 325bp from peak levels about a year ago at the height of the global crisis.

Most banks expect NIMs to stabilise 2HFY2010 onwards as deposits increasingly re-price lower, especially Bulk deposits contracted at peak rates during September-October 2008. Overall, we expect NII growth to remain moderate in 2QFY2010, with expectations of revival only 2HFY2010 onwards. Banks with a larger component of wholesale deposits will benefit more from the sharp downward re-pricing of the same. These include mainly the mid-caps like Yes Bank, OBC and Corporation Bank.

Exhibit 3: PLRs (%)

Bank	2QFY2010	1QFY2010	chg qoq	2QFY2009	chg yoy
BOI	12.00	12.00	-	14.00	*(2.00)*
PNB	11.00	11.00	-	14.00	*(3.00)*
UNBK	11.75	12.00	*(0.25)*	14.00	*(2.25)*
OBC	12.00	12.00	-	14.00	*(2.00)*
CRPBK	12.00	12.00	-	14.00	*(2.00)*
IOB	12.00	12.50	*(0.50)*	14.00	*(2.00)*
INDBK	12.00	12.50	*(0.50)*	14.00	*(2.00)*
ICICIBK	15.75	15.75	-	17.25	*(1.50)*
HDFCBK	15.75	16.00	*(0.25)*	16.50	*(0.75)*
AXSB	14.75	14.75	-	15.75	*(1.00)*
YESBK	16.50	16.50	-	17.00	*(0.50)*

Source: Company, Angel Research

Exhibit 4: Deposit Rates (%)

Peak Retail FD Rates					
Bank	2QFY2010	2QFY2010	chg qoq	2QFY2009	chg yoy
BOI	6.50	6.75	(0.25)	10.50	(4.00)
PNB	7.50	7.50	-	10.50	(3.00)
UNBK	6.75	8.00	(1.25)	10.50	(3.75)
OBC	7.75	7.75	-	10.50	(2.75)
CRPBK	7.25	8.00	(0.75)	10.50	(3.25)
IOB	7.25	7.75	(0.50)	10.50	(3.25)
INDBK	7.25	7.75	(0.50)	10.00	(2.75)
ICICIBK	7.75	8.25	(0.50)	10.50	(2.75)
HDFCBK	7.00	7.25	(0.25)	10.50	(3.50)
AXSB	7.30	7.60	(0.30)	10.00	(2.70)
YESBK	7.25	8.25	(1.00)	10.75	(3.50)

Source: Company, Angel Research

Gsec yields volatile

During the quarter, Gsec yields started to move up sharply across maturities, rising by 60bp at the long end of the yield curve (10-year benchmark Gsec) and by a much higher 80-110bp at the short end of the yield curve (1 to 3 years), as banks became increasingly reluctant to increase their AFS exposure. Subsequently, yields cooled off on market expectations of an increase in the HTM limit by the RBI, though more so at the long end, with the 3-year Gsec yield still up by almost 100bp sequentially.

In our view, the increase in longer maturity yields is consistent with an overall improving outlook on GDP growth and consequently, credit growth going forward. At the short-end, the rise in yields was more than expected, but this was partly due to short-term technicalities such as the increase in supply of paper from the government at the short end, with longer maturity Gsec issuances by the Central Government largely complete. The RBI's committed Open Market Operations (OMO) limit not getting fully used also did not help matters. Overall, we do not expect a material increase in Bond yields hereon for the next few months, as the immediate pressures of the Central Government borrowing programme start to wane. Generally, 2QFY2010 is likely to be a relatively modest quarter in terms of treasury performance compared to the huge profits registered in 1QFY2010, as the rise in yields was not yet enough to trigger large MTM losses, though unrealised gains reduced and there were few opportunities to book profits.

Eventually, Interest rates are set to increase consistent with the imminent revival in GDP and Credit growth. However, for the

Banking

Sector as a whole, rising Interest rates consistent with GDP growth and corresponding MTM losses would not be a negative as it would be outweighed by improving Credit growth, Fee Income and lower NPA losses. Rising Interest rates affect individual banks relatively. So, banks which have locked in more funds than the Sector average at low yields for a longer duration will experience lower profitability in terms of relatively higher MTM losses and pressure on NIMs. While this is usually the case with PSU Banks, they have especially been receiving large amount of deposits in the last few quarters and have parked a big chunk of this in Gsecs. Banks exposed to more Interest rate risks include Indian Bank and Union Bank of India.

Outlook

Concerns over Asset quality and slowing Credit growth, that were a major overhang over both the Private and PSU Bank stocks, are now receding as the GDP growth outlook continues to improve. We maintain our view that Monetary softening, strong Domestic Savings and low Interest rates will help revive domestic demand from late FY2010 and subscribe to the view that stimulus packages and bank bailouts will continue to stabilise developed economies over a similar timeframe. With capital markets reviving and equity issuances on the rise, aided further by internal generation, leverage levels should also decline over the next 9-12 months, even as domestic demand picks up. Overall, given the reasonable mid-cycle valuations, we believe a longer term investment perspective needs to be adopted to take advantage of the imminent upturn in GDP growth.

We retain our preference for Private Banks for several reasons. One, they are very well-positioned for the impending revival in GDP growth in terms of large capital adequacy and substantial network expansion - already done in the last couple of years and not fully leveraged as well as planned going forward. With their overall superior customer proposition, in our view, they are once again set to gain marketshare in key areas, viz., low-cost deposits as well as fee income. Moreover, on an average, they are exposed to lower interest rate risks than the PSU Banks (which also carry the risk of government interference). Thirdly, in terms of valuations as well, they are trading closer to mid-cycle valuations, while the PSU Banks appear relatively expensive at present. Moreover, PSU Bank valuations look even more stretched on adjusting their book values for the huge amount of restructuring that has been done by them in the last two quarters. At present, **Axis Bank is our Top Pick in the Banking Sector, which we believe offers a good combination of high growth and Earnings quality, A-list management and cheap valuations.**

Exhibit 5: Investment Mix Rs cr

As on June 2009	BOI		INDBK		IOB		OBC		PNB		AXSB	
	Rs cr	% of Total	Rs cr	% of Total	Rs cr	% of Total	Rs cr	% of Total	Rs cr	% of Total	Rs cr	% of Total
Investments	57,149		22,801		32,978		31,353		63,385		46,328	
SLR	46,679	82	18,858	83	27,681	84	27,904	89	54,511	86	26,859	58
HTM	36,643	64	12,754	56	24,003	73	21,633	69	46,880	74	24,442	53
AFS	10,036	18	6,104	27	3,678	11	6,271	20	7,632	12	2,417	5
Non SLR	10,470	18	3,388	15	4,348	13	3,449	11	8,874	14	19,469	42
AFS Dur. (yrs)	4.6		3.7		2.7		2.6		2.5		3.5	

Source: Company, Angel Research

Exhibit 6: Quarterly Estimates Rs cr

Company	CMP (Rs)	Op. Income 2QFY10E	Op. Income %chg	Net Profit 2QFY10E	Net Profit %chg	EPS (Rs) 2QFY10E	EPS (Rs) %chg	EPS (Rs) FY10E	EPS (Rs) FY11E	EPS (Rs) %chg	Adj. BVPS (Rs) FY10E	Adj. BVPS (Rs) FY11E	P/E (x) FY10E	P/E (x) FY11E	P/ABV (x) FY10E	P/ABV (x) FY11E	Target Price (Rs)	Reco
Axis Bank	982	1,886	*17.3*	506	*25.5*	14.1	*25.2*	59.0	69.1	*17.3*	385.4	438.3	16.6	14.2	2.5	2.2	1,151	Buy
HDFC Bank	1,642	3,087	*23.0*	683	*29.3*	16.0	*29.0*	64.6	77.8	*20.5*	446.6	505.3	25.4	21.1	3.7	3.2	1,769	Accumulate
ICICI Bank	905	3,824	*(5.0)*	992	*(2.1)*	8.9	*(2.1)*	32.4	41.1	*27.0*	435.1	458.7	27.9	22.0	2.1	2.0	1,047	Buy
Yes Bank	205	278	*29.5*	78	*22.5*	2.6	*22.4*	12.3	13.9	*13.2*	65.1	78.7	16.7	14.7	3.1	2.6	216	Accumulate
SIB	124	196	*18.8*	62	*20.2*	5.5	*(3.9)*	22.1	25.9	*17.3*	131.9	152.5	5.6	4.8	0.9	0.8	145	Buy
Bank of India	412	1,976	*(1.8)*	683	*(10.4)*	13.0	*(10.4)*	54.2	57.6	*6.3*	250.2	289.7	7.6	7.2	1.6	1.4	362	Reduce
Corp Bank	420	657	*13.1*	207	*7.9*	14.4	*7.9*	70.5	78.8	*11.8*	396.9	456.4	6.0	5.3	1.1	0.9	456	Accumulate
Indian Bank	163	979	*9.4*	301	*6.2*	3.6	*6.2*	32.0	34.8	*8.6*	154.1	181.2	5.1	4.7	1.1	0.9	181	Accumulate
IOB	127	1,060	*5.9*	322	*(10.3)*	5.9	*(10.3)*	21.5	24.4	*13.5*	109.1	128.2	5.9	5.2	1.2	1.0	115	Reduce
OBC	238	735	*0.6*	254	*7.1*	10.1	*7.1*	39.2	39.9	*1.9*	287.6	319.2	6.1	6.0	0.8	0.7	255	Accumulate
PNB	796	2,735	*15.2*	793	*12.2*	25.2	*12.2*	112.6	125.6	*11.5*	503.3	602.3	7.1	6.3	1.6	1.3	-	Neutral
Union Bank	240	1,342	*6.6*	372	*2.9*	7.4	*2.9*	38.6	42.7	*10.6*	169.6	203.1	6.2	5.6	1.4	1.2	264	Accumulate

Source: Company, Angel Research; Note: Price as on Sept. 30, 2009

Analyst **- Vaibhav Agrawal**

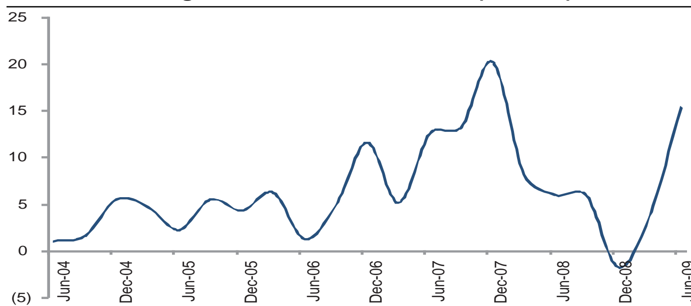
Capital Goods

Liquidity improves

The all-round rally in the Indian stock markets, ushered in after the strong election mandate in the last quarter, continued to strengthen during the current quarter as well. The risk appetite across the investor class has increased, with strong liquidity chasing stocks. Consequently, in line with the broader market trend, Capital Goods stocks have also garnered buying interest, in anticipation of the healthy order inflows. This is primarily on the back of the government's thrust on the Power Generation, Transmission and Distribution (T&D) Sectors, along with the broader Infrastructure development in the country.

The visibility also seems to be gradually improving, with foreign investments into India gaining some momentum, with the financial closure of projects stalled for several quarters now beginning to happen, and with quite a few large companies across sectors having successfully tapped the global financial markets.

Exhibit 1: Foreign Investments into India (US $bn)



Source: CMIE, Angel Research

However, Earnings will take time to catch up

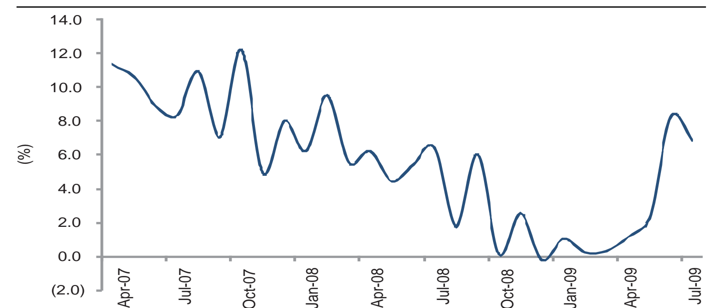
Although the broader economic scenario is definitely showing some signs of improvement, we believe that growth pressures will persist in the near term and it will take a while for things to pick up dramatically. Most of the companies will witness short-term growth challenges, with the macro-economic slowdown bound to adversely impact their FY2010E Earnings. Besides, though power-related capex is faring relatively better, industrial capex continues to reel under pressure, with certain segments of the industry still remaining negative. Additionally, the export business of companies will also continue to be a drag on their earnings, with no major signs of a revival occurring in the current year.

Macro Indicators

After a strong GDP growth of more than 9% recorded by India for three consecutive years, the country has shifted to a relatively lower growth trajectory. The growth for the year 2008-09 has been pegged at around 6.7%, which is likely to be followed by another year of relatively muted growth for the economy. Similarly, the Index of Industrial Production (IIP) has also cooled off, with growth falling from a high of 8.5% in FY2008 to a mere 2.6% in FY2009. For the current fiscal as well, the cumulative IIP growth for the period of April to July 2009-10 stands at 4.6% (5.6%).

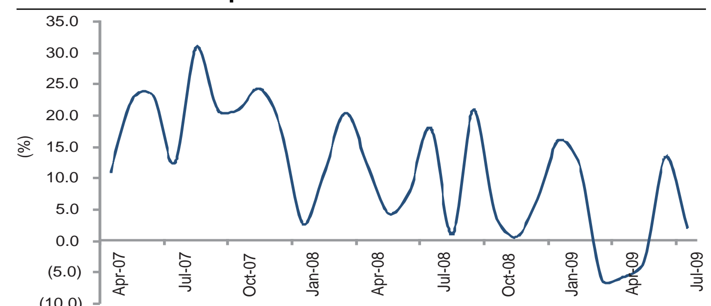
The Capital Goods component is not faring any better, with the cumulative growth for April-March FY2009 at 7.0% (18.0%). For the current fiscal, the cumulative growth for Capital Goods components during the period of April to July 2009-10 fell sharply to 2.0% (10.4%).

Exhibit 2: IIP Growth



Source: Bloomberg, Angel Research

Exhibit 3: CG Component Growth



Source: Bloomberg, Angel Research

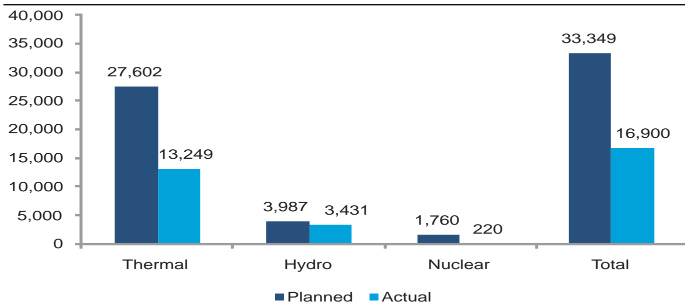
Power sector hurdled with Capacity addition delays

Most of the companies under our coverage in the Capital Goods space have their fortunes linked to the pace of Power sector growth in the country. Although Power Sector capex is relatively resilient, with a majority of the projects being planned by the Central and State sector utilities, a major cause of concern for companies is a capacity addition delay. Historically, India has a poor track record in this regard, with only 50-60% of the total planned capacity added during several of the previous five-year plans. As per Central Electricity Authority (CEA) data, we are faring no better even for the current plan period, with the execution rate being pretty dismal, and with around 50% of the projects already running behind

Capital Goods

schedule. This will adversely impact the growth prospects for all players involved in the entire power value-chain, albeit to varying extents.

Exhibit 4: Capacity addition (MW) for 11th Plan (till Aug '09)



Source: CEA, Angel Research

Capital Goods Index - An Underperformer

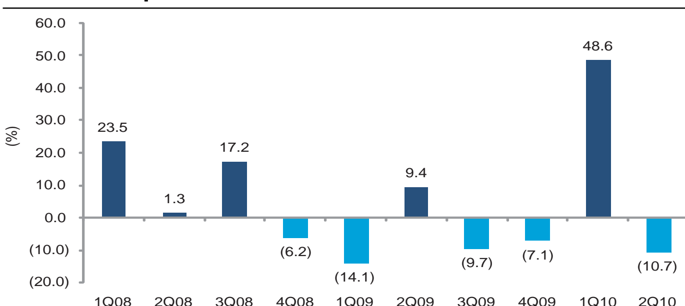
During 2QFY2010, the BSE Capital Goods (CG) Index had a muted quarter, gaining only 7.5% in absolute terms, and underperforming the benchmark BSE Sensex by 10.7%. Notably, during the preceding quarter, the CG index had a phenomenal run-up, primarily driven by the huge set of expectations emanating from the political stability emerging in the country after the election results. However, as most of the stocks had run-up way ahead of their fundamentals and were commanding premium valuations, the under-performance during the current quarter was not surprising.

Exhibit 5: Sensex v/s Capital Goods Stocks (2QFY2010)

	Abs. Returns (%)	Relative to Sensex (%)
BSE Sensex	18.2	-
BSE Capital Goods Index	7.5	(10.7)
ABB	0.9	(17.2)
Areva T&D	(6.3)	(24.4)
BHEL	5.5	(12.7)
Crompton Greaves	7.4	(10.8)
Thermax	35.5	17.3

Source: C-line, Angel Research

Exhibit 6: Capital Goods Index: Relative Returns to the Sensex



Source: C-line, Angel Research

On a stock-specific basis, most of the capital goods stocks underperformed the BSE Sensex - ABB by 17.2% and Crompton Greaves by 10.8%. However, the major loser was Areva T&D India, down 6.3% in absolute terms and underperforming the Sensex by a stupendous 24.4%. Despite a reasonably decent operational performance being exhibited by the company, the news of Areva T&D being up for sale continues to be a major overhang on the stock. BHEL also continued to underperform on the bourses, on the back of increasing concerns of competition (both Domestic and Chinese) denting the Market Share and the Margins of the company.

Interestingly, Thermax was the lone stock in our coverage universe that gained 35.5% in absolute terms and outperformed the broader benchmark indices by 17.3%. Pertinently, the improving revenue visibility from FY2011E onwards, coupled with the company's success in the utility boilers segment, were the key reasons driving a re-rating of the stock in the quarter.

Key Developments

ABB: During the quarter, ABB won several key orders, including a Rs128cr order from Power Grid Corporation of India Ltd (PGCIL), for a 400-kV gas insulated switchgear (GIS) substation, to strengthen the power transmission network in the country's western grid.

Areva T&D India: At the beginning of the quarter, Areva T&D India hogged the limelight, after news that Areva's global Power Transmission & Distribution (Areva T&D) unit was up for sale. Later, the Indian unit of the company officially released an update stating that the Areva Group's Supervisory Board has announced several steps to secure the Group's long-term financial requirements, and that it was deliberating various proposals, including the opening of its capital to new strategic partners and its employees. However, it stated that, "depending on the interest generated, the decision to dispose of the T&D activity or not and the choice of a potential buyer will be taken before the end of year".

BHEL: During 2QFY2010, BHEL continued to strengthen its position in private sector orders. Some of the key private sector orders won by it included the Rs640cr, Rs2,600cr and Rs2,630cr orders for the main plant package from Adhunik Power and Natural Resources, Jindal India Thermal Power and Monnet Power Company, respectively.

Continuing with its strategy of pursuing strategic alliances with state utilities for super-critical units, BHEL and Maharashtra State Power Generation Company signed an MoU for setting up a JV Company

Capital Goods

to Build, Own and Operate a 2x660MW thermal power plant, with supercritical parameters, at Latur in Maharashtra. The initial equity would be equally subscribed by both the partners, with a subsequent dilution at a later stage. Notably, BHEL has already set up two such JVs - a 2x800MW power plant at Udangudi in Tamil Nadu, and a 2x660/800MW and 1x660/800MW power plant at Yeramarus and Edlapur in Karnataka, respectively.

Additionally, the company also secured the largest-ever contract (valued at Rs990cr) in the transportation business segment. This order entails the manufacture and supply of 150 electric locomotives and has been placed by Indian Railways.

Crompton Greaves: Crompton Greaves, through its subsidiary Pauwels Trafo Belgium NV, entered into a Memorandum of Undertaking with the EIC Group, headquartered in Saudi Arabia, for establishing a JV company for the manufacture of medium power transformers in Saudi Arabia.

Thermax: During 2QFY2010, Thermax bagged its first turnkey IPP order worth Rs1,000cr, for the supply of a 270MW power plant being set up by a Hyderabad-based infrastructure company. The boilers for this project will be manufactured by Thermax, using the Circulating Fluidised Bed Combustion (CFBC) technology licensed from Babcock & Wilcox, US. The company will also supply the air-pollution control, water treatment and effluent treatment systems for the project.

Moreover, Thermax continued to enter into strategic alliances with various global leaders, including a JV with SPX Corporation to provide technology solutions for >300MW-range large power plants. Thermax also entered into an alliance with GE Water, USA, for advanced solutions in sewage treatment, and into a technology agreement with Wehrle Umwelt GmbH, Germany, for the treatment of hard-to-treat industrial effluents.

2QFY2010 Expectations

The Top-line of the companies under our coverage universe is expected to post a growth of around 19.3% yoy. This would primarily be driven by BHEL, which is expected to witness a strong revenue growth of 26.3%, on the back of a healthy order book. Thermax is expected to continue with a muted performance this time as well, with a slight de-growth in the Top-line for the quarter.

On the operating front, we expect our universe to register a 118bp margin expansion to 13.4%. Again, BHEL would be the key driver, as the company is expected to witness 151bp margin expansion to 14.8%, due to the falling employee cost. Areva T&D would witness a fall in its Margins, owing to the changing nature of its product-mix, coupled with increasing competitive pressures in the market.

Consequently, the Net Profit would also increase at a higher pace of around 23.9% yoy for our entire universe. While BHEL, Areva T&D and Crompton Greaves are expected to witness a strong increase in Net Profit, of 29.1%, 22.7% and 20.6% yoy, respectively, we estimate ABB and Thermax to have a muted growth in comparison.

Outlook

The scenario for the Indian Economy in general and that for the Capital Goods Industry in particular has undoubtedly improved to an extent, after the political stability in the country, along with the easing liquidity situation and the absence of major negative international news. However, we believe that most of the Capital Goods stocks are trading at premium valuations, factoring in an over-optimistic scenario in terms of demand and growth expectations, and consensus earnings need to be upgraded significantly to justify such valuations. Besides, although the capital goods companies catering to the Power Sector would continue to enjoy a degree of comfort, owing to the government's thrust on this core sector, the sector has its own set of problems, with around 50% of the planned power projects for the Eleventh Plan already running behind schedule. **With this backdrop of rich valuations, we prefer a very stock-specific approach, and broadly remain Neutral on the Capital Goods Sector.**

Exhibit 7: Quarterly Estimates Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
ABB*	784	1,736	*14.3*	10.0	*112*	113	*7.6*	5.3	*7.6*	21.6	27.7	*28.6*	36.4	28.3	554	**Sell**
Areva T&D*	316	818	*40.3*	14.9	*(83)*	63	*22.7*	2.6	*22.7*	11.1	13.1	*17.7*	28.3	24.1	262	**Sell**
BHEL	2,325	6,748	*26.3*	14.8	*151*	795	*29.1*	16.2	*29.1*	85.4	105.3	*23.4*	27.2	22.1	-	**Neutral**
Crompton Greaves	314	2,245	*7.3*	11.5	*42*	145	*20.6*	4.0	*20.6*	17.5	20.7	*18.6*	18.0	15.2	331	**Accumulate**
Thermax#	546	790	*(1.8)*	12.4	*76*	61	*6.8*	5.1	*6.8*	22.1	30.1	*36.1*	24.7	18.1	542	**Accumulate**

*Source: Company; Angel Research; Note: Price as on Sept. 30, 2009; Note: * Y/E December; # Estimates are standalone*

***Analyst* - Puneet Bambha**

Cement

In 2QFY2010, the Cement stocks gained on an absolute basis, with the Cement companies reporting a good set of dispatch numbers for the quarter. The numbers came in higher on the back of a spurt in demand from infrastructure projects from the rural and semi-urban areas. Moreover, a delayed monsoon season over most part of the country saw extension of the construction activities and resulting in incremental demand for cement. Besides, the higher growth rates came on a low base. Last year, there was a significant decline in demand from the Construction Sector on account of the economic slowdown. Overall, in 2QFY2010, the Cement Sector posted a double-digit growth in demand, up 12.3% yoy even as it posted a 6.8% sequential decline in demand. On the price front, the quarter witnessed the All-India average cement prices declining by Rs4-6/bag yoy, as the cement players resorted to prices cuts as prices remains typically lower during quarter. Going ahead, over the short to medium term, we expect cement stocks to underperform the broader markets on concerns of substantial over supply looming over the markets and lower prices. We believe that expectations of a decline in the spending pattern from the rural and semi-urban areas on account of poor monsoons could impact cement demand in the near term.

Exhibit 1: Sensex v/s Cement stocks (2QFY2010)

Cement majors	Abs. Returns (%)	Relative to Sensex (%)
Sensex	18.2	-
ACC	6.6	(11.6)
Ambuja	13.7	(4.5)
Grasim	19.8	1.7
Ultratech	15.7	(2.5)
India Cements	2.8	(15.4)
Madras Cements	18.2	0.0
JK Lakshmi	31.9	13.7

Source: BSE, Angel Research

All-India Cement Prices decline by Rs4-6/bag qoq - A seasonal adjustment

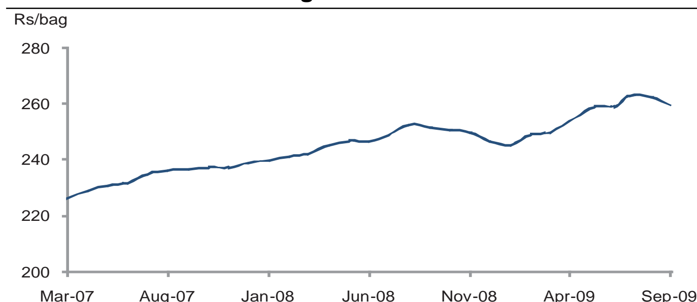
All-India average cement prices remained stable on a yoy basis increasing by a marginal 0.3% to Rs252/bag (Rs251/bag). However, on a sequential basis, All-India cement prices, on an average, fell by Rs4-6/bag. It may be noted here that the fall in cement prices was relatively lower in the Eastern and Northern regions, where it fell by Rs5-10/bag and Rs3-4/bag, respectively. In the Western and Southern parts of the country, prices fell by a substantial Rs10-15/bag on account of huge capacity addition and lower demand. We believe that in the absence of a significant recovery in demand, the cement prices will continue to witness downward pressure going ahead as well. Over the longer term, we expect prices to remain subdued as capacity to the tune of 70mn tonnes would be added over the next two years.

Exhibit 2: Average Cement prices in major cities (Rs/bag)

Market	2QFY2010	2QFY2009	*% yoy*	1QFY2009	*% qoq*
Mumbai	253	253	*(0.1)*	260	*(2.5)*
Delhi	231	229	*1.0*	234	*(1.1)*
Chennai	265	273	*(3.0)*	276	*(4.0)*
Kolkata	257	248	*3.5*	261	*(1.7)*
Average Price	**252**	**251**	***0.3***	**258**	***(2.4)***

Source: CMA, Angel Research

Exhibit 3: All-India average Cement Prices



Source: CMA, Angel Research

All-India Capacity Utilisation remains flat

All-India capacity utilisation during 2QFY2010 remained flat at 81.6% (81.7%) despite the huge capacity additions, mainly due to higher production yoy. During the quarter, All-India cement capacity addition is estimated at 7.7mn tonnes yoy to 57.7mn tonnes from 51.0mn tonnes in 2QFY2009. It may be noted here, in spite of large capacity additions during the last couple of quarters, capacity utilisation was strong due to higher dispatches and consumption that has been growing by more than 10% yoy. Cement production during 2QFY2010 grew by a healthy 12.9% yoy to 47.1mn tonnes. However, we expect capacity utilisation to decline to 78% in FY2010 from 89% in FY2009, due to capacity addition of almost 38mn tonnes during the year, which is higher than the incremental demand.

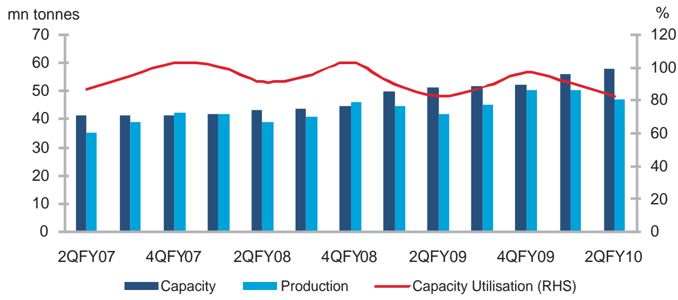
Exhibit 4: All-India Cement Scenario (mn tonnes)

	2QFY2010	2QFY2009	*% yoy*	1QFY2010	*% qoq*
Capacity	57.7	51.0	*13.1*	55.8	*3.5*
Production	47.1	41.7	*12.9*	50.1	*(6.0)*
Cap. Utilisation (%)	81.6	81.7		89.9	
Consumption	45.8	40.7	*12.3*	49.1	*(6.8)*

Source: CMA, Angel Research

Cement

Exhibit 5: Capacity Utilisation Trend

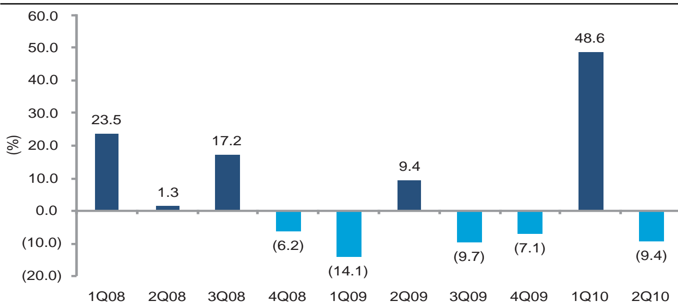


Source: CMA, Angel Research

Cement Consumption to remain strong

Cement consumption in India remained robust as construction activities have picked up since the beginning of 4QFY2009 and continued in 2QFY2010 on account of higher spending on infrastructure projects by the government, incremental demand coming from the rural and semi-urban areas and extended construction activities due to a delayed monsoon season over most part of the country. In 2QFY2010, All-India cement consumption grew by 12.3% yoy to 45.8mn tonnes (40.7mn tonnes). On a sequential basis, however, consumption de-grew by 6.8% from 49.1mn tonnes in 1QFY2010. Notably, cement consumption grew 12.3% (7.5%) yoy during 2QFY2010. We expect cement consumption to register 8% yoy growth to 192mn tonnes (178mn tonnes) in FY2010E. In FY2011E, we estimate cement consumption to increase by 8-9% yoy.

Exhibit 6: Cement Consumption and Growth Trends



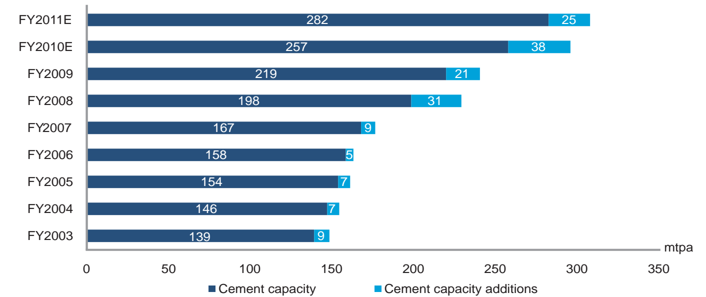
Source: CMA, Angel Research

Huge Capacity additions to lower Capacity Utilisation

All major players have announced large capacity addition plans in India to capitalise on the booming Real Estate and Infrastructure Sectors. Total cement capacity in India stood at around 219.2mtpa at the end of FY2009, a yoy increase of 21mtpa. In addition, during 1QFY2010 capacity was further augmented by around 14mn tonnes with another 8mn tonnes expected to have got added in 2QFY2010.

We expect these additional capacities to fully ramp up over the next 3-4 months and eventually exert pressure on cement prices. Overall, we expect the industry to add around 70mn tonnes of capacity through FY2010-11E. Such huge capacity additions would eventually result in an oversupply situation in the market while demand is not expected to keep pace with the supply.

Exhibit 7: Cement Capacity Additions



Source: CMA, Industry, Angel Research

Coal prices stablise

Coal is the main input for cement manufacturing and imported prices of coal skyrocketed during 1HFY2009. However, after peaking out in July 2008, coal prices collapsed by around 65% thereon. Average coal prices during 2QFY2010 were lower by 55% at US $73/tonne (US $163/tonne). Sequentially also, prices are expected to remain stable. We believe that the correction in coal prices would be Margin accretive for the cement companies in the quarter under review. The cement manufacturers use coal to generate power as well as in the kiln for cement production.

Exhibit 8: globalCOAL's NEWC FOB Coal Prices

Source: Bloomberg, Angel Research

Cement

Margins, Bottom-line to improve significantly yoy in 2QFY2010

The last couple of quarters have been strong for the cement companies in terms of dispatches and consumption. This came on the back of the significant capacity additions that took place in the mentioned period. Demand picked up owing to higher consumption from the semi-urban and rural areas and higher infrastructure spending by the government. As a result, cement players managed to post higher Sales and Realisations. Moreover, companies have been witnessing easing in cost pressure as prices of raw materials like coal and fly ash have declined significantly on a yoy basis. This was reflected in the last quarter performance of the companies wherein majors registered 100-1,000bp yoy increase in Margins. On a sequential basis also, Margins improved by a considerable 300-1,000bp owing to better Realisations and Volume growth. For 2QFY2010E, we expect the cement companies to continue to improve their Margins yoy primarily due the higher Sales Volumes and lower Input costs of raw materials like imported coal, freight, fly ash, etc. On a sequential basis, however, we expect the players to register a decline in Operating Margins owing to lower realisations during the quarter.

Exhibit 9: Margins to improve (%)

Company	2QFY2010E	2QFY2009	*yoy chg bp*	1QFY2010	*qoq chg bp*
ACC	33.2	27.9	*530*	38.0	*(475)*
Ambuja Cements	28.9	31.9	*(300)*	29.8	*(91)*
Grasim	29.4	23.0	*643*	31.1	*(167)*
Ultratech Cement	35.0	23.3	*1,166*	37.6	*(269)*
India Cements	29.3	28.5	*(79)*	30.0	*(74)*
Madras Cement	35.9	34.4	*154*	38.0	*(209)*
JK Lakshmi	29.8	19.3	*1,047*	34.0	*(421)*

Source: Companies, Angel Research

Cement Sector Outlook

Despite the slowdown in the Housing Sector, higher infrastructure spending by the government has kept cement demand at impressive levels. We believe that recovery in the Residential Real Estate market and low-cost and affordable housing projects would improve demand going ahead. On the supply front, with oversupply concerns expected to persist over FY2010-12E as we expect the Cement industry to add around 70mn tonnes during the next two years, capacity utilisation levels would be low. **Hence, we maintain our Neutral view on the Sector.**

Exhibit 10: Quarterly Estimates — Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			EV/Tonne (US $/t)		Target	Reco
	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*% chg*	FY10E	FY11E	Price (Rs)	
ACC^	820	1,889	*4.7*	33.2	*530*	387.0	*36.7*	21.7	*36.7*	73.3	73.8	*0.7*	117	105	743	**Reduce**
Ambuja Cements^	100	1,600	*15.4*	28.9	*(300)*	300.1	*20.1*	2.1	*20.1*	8.0	7.8	*(1.7)*	136	117	88	**Reduce**
Grasim*	2,768	4,968	*11.6*	29.4	*643.0*	711.1	*46.3*	77.6	*46.3*	226	200	*(11.2)*	117	109	-	**Neutral**
Ultratech Cement	798	1,536	*10.1*	35.0	*1,166*	293.7	*79.1*	23.6	*79.0*	89.4	73.6	*(17.6)*	108	100	-	**Neutral**
India Cements	135	1,095	*15.8*	29.3	*(79)*	151.3	*(1.7)*	5.4	*12.3*	18.5	17.0	*(7.9)*	77	73	-	**Neutral**
Madras Cement	121	921	*38.7*	35.9	*154*	162.3	*42.9*	6.8	*43.1*	19.2	19.5	*1.7*	84	77	-	**Neutral**
JK Lakshmi Cement	140	326	*11.3*	29.8	*1,047*	59.9	*122.7*	9.8	*123.2*	27.7	25.4	*(8.3)*	59	64	-	**Neutral**

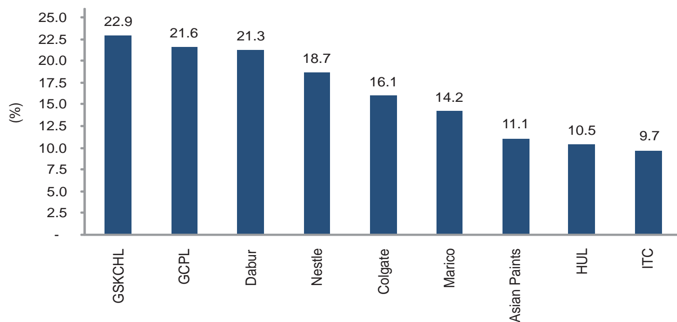
*Source: Company, Angel Research; Price as on Sept. 30, 2009; *Note - Full year EPS calculations based on fully diluted equity, ^ Y/E Dec.*

***Analyst* - Rupesh Sankhe / Laxmikant Waghmare**

FMCG

For 2QFY2010, we expect our FMCG universe to register a modest 13% growth in Revenues, as Price hikes take a backseat and focus shifts to sustaining Volume growth. Going ahead, better reach (significant investments in distribution infrastructure) and support from rural markets (higher MSPs, NREGS and rising food prices to drive rural incomes) are expected to be the key drivers aiding modest volume growth of our FMCG universe. The downside risks to our estimates include: 1) Lag effect of the economic slowdown on consumer spending (though less likely); 2) Impact of a drought on rural incomes (likely, though not as severe as in FY2003); and 3) Down-trading to a cheaper brand (likely).

Exhibit 1: Revenue Growth (yoy, 2QFY2010E)



Source: Company, Angel Research; Note: Nestle, GSKCHL figures - 3QCY2009E

Strategic focus shifts to Volume growth

Fearing inequitable monsoons, lower inflation, drop in Value growth and threat of losing market share to cheaper regional brands and private labels, FMCG majors are aggressively gunning for Volumes, ahead of Margins. Grammage correction, sharp uptick in promotions, pushing lower priced unit packs, and highlighting pricing in communication witnessed an unprecedented increase during 2QFY2010. Grammage correction was spearheaded by HUL in the Soap Segment and ITC in the Snack Food Segment. *Lux* and *Wheel* soaps are now being sold 10% more for the same price, while ITC's flagship brand, *Bingo*, is sold 50% more for the same price in the Western region.

FMCG companies are taking concerted measures to drive Volume growth and re-jig cost structures. While on one hand, HUL hiked retailer margins in some categories, the Godrej Group, on the other, is on a drive to consolidate its Consumer Goods business to prune costs and push efficiencies across its consumer product companies. Dabur India too followed suit by taking a relook at expanding its retail venture, *NewU*, and driving synergies from the recent Fem acquisition. Colgate, on the other hand, is offering freebies. ITC plans to invest close to Rs5,000cr in its Paper and Paperboards business to drive Volumes.

Keeping pace with our expectations, another step FMCG majors have undertaken to retain consumers and safeguard their volume growth is tweaking their pricing strategy. For instance, HUL has reduced the price of *Lifebuoy, Pepsodent, Wheel* and *Surf*, this quarter and is now focusing on salvaging its lost market share.

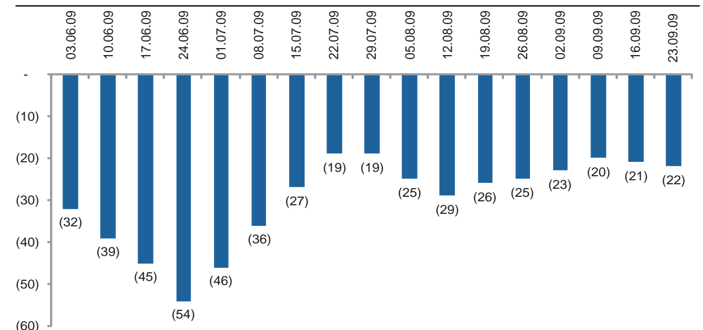
Positive Budget - ITC pleasantly surprised!

The Union Budget 2009-10 proved to be a positive for the FMCG Sector, on the whole, as it continued to build on the momentum to spur income levels particularly in rural areas driven by steps like higher allocation to NREGS and six-month extension of debt relief to farmers. In terms of specifics, abolishment of FBT, no reversal of Excise Duty cuts and confirmation of implementation of GST by April 2010 came as a major relief for the FMCG players. No change in the Excise Duty on cigarettes came as a welcome relief and a pleasant surprise for ITC.

Monsoon Impact - Yes, but less severe

The four-year spell of normal monsoons has finally ended, with this year drifting towards a major drought. Cumulative seasonal rainfall for the country, as a whole, stood at 22% below the LPA for the period June 1 - September 23.

Exhibit 2: Cumulative Rainfall during Jun-Sept 2009



Source: IMD; Company, Angel Research

Inequitable monsoons carry a downside risk to our estimates (both in terms of Volumes as well as Pricing) as rural consumption (a key incremental growth driver) takes a hit, albeit with a lag effect of three to six months. However, the severity will be lower than that in FY2003 (owing to better irrigation and government initiatives like higher MSPs, NREGS, Farm waiver and Sixth Pay Commission dues) and mixed for companies, depending on their sales mix and the exposure to rural markets.

FMCG

New product launches aid Volume growth

In a bid to garner higher market share and sustained growth, FMCG companies have been increasingly focusing on new launches and re-launches/variants of existing products. Category-wise, we expect the Personal care, Skin care, Homecare and Processed Foods Segments to drive growth for the FMCG Sector.

HUL led the FMCG pack in product launches during the quarter. It launched a cream-based surface cleaner, *CIF*, in two variants (cream and cream lemon); *Ponds White Beauty* and *Vaseline Healthy White body* lotion in Skin care. The company re-launched *Lifebuoy, Liril* and *Clinic All Clear* in the Soaps and Shampoo categories, *Pepsodent Germicheck* in Oral care and *Knorr* soups in the Processed Foods category.

ITC launched variants of *Sunfeast New Marie Light* in original and orange flavours. It also launched ballpoint and gel pens under *Classmate* and highlighters under its *PaperKraft* brand.

Marico launched its new product, *Revive Blue Plus*, in Kerala. The company also started prototyping two cooling oil variants - *Nihar Naturals Coconut Cooling Oil* in Bihar and *Parachute Advanced Coconut Cooling Oil* in Andhra Pradesh.

Dabur launched its much awaited premium Skin care brand - *Uveda* - in the Skin care Segment.

Gross Margin expansion to peak out

A low base of Gross Margins (2Q and 3QFY2009 were the worst hit on account of rising input costs) and softening commodity prices during 2HFY2009 are expected to aid significant Margin expansion for FMCG companies, on a yoy basis, during 2QFY2010E.

However, during 1QFY2010, commodities were on upward growth trajectory due to the sharp spike in broader markets across asset classes. As a result, input costs for FMCG companies increased by 30-40% on an average, from their bottoms. Going ahead too, agri-commodities, particularly those sourced domestically, are expected to remain firm. While wheat, barley, copra and safflower prices continue to remain benign, prices of other commodities like sugar, tea, coffee and milk are expected to further rise in the ensuing quarters largely due to poor monsoons in India.

Exhibit 3: Raw Material Cost Trend (%)

Commodity	CMP (Rs)	2QFY2010#	YTD	High
Tea (Rs/Kg)	111	(1.8)	25.3	(4.5)
Coffee (Rs/50kg)	10,125	6.5	61.0	(1.1)
Wheat (Rs/Quintal)	1,692	10.5	1.0	(1.8)
Barley (Rs/Quintal)	858	2.2	(3.3)	(34.6)
Sugar (Rs/ Quintal)	2,925	15.0	48.5	-
Milk Liquid (Rs/Ltr)	25	4.2	38.9	-
Palm Oil (MYR/Tonne)	2,410	6.6	47.9	(38.9)
Copra (Rs/Quintal)	3,100	(0.8)	(22.6)	(30.3)
Safflower (Rs/Quintal)	2,400	-	(25.0)	(27.3)
Soyabean Oil (Rs/10Kg)	453	(1.2)	(3.0)	(31.4)
Groundnt Oil (Rs/10Kg)	631	10.4	2.7	(14.4)
Coconut Oil (Rs/Quintal)	4,787	3.0	(19.2)	(26.6)
Caustic Soda (Rs/Kg)	20	(21.9)	(25.6)	(34.8)
Soda Ash (Rs/Kg)	18	(14.3)	(14.3)	(30.8)
LAB (Rs/Kg)	86	8.8	(13.9)	(29.5)
hdPE (Rs/Kg)	75	3.3	59.5	(29.4)
ldPE (Rs/Kg)	78	2.8	34.6	(21.5)

Source: Bloomberg, CMIE, Crisil, Angel Research ; # Note: Refers to July-August 2009 period

Re-investing gains in higher Ad-spends

With the focus back on Volume growth and sustaining market shares coupled with the room to spend more (due to higher Gross Margins), most FMCG companies have increased their Advertising spends (except Colgate) in recent times, and we expect this trend to continue.

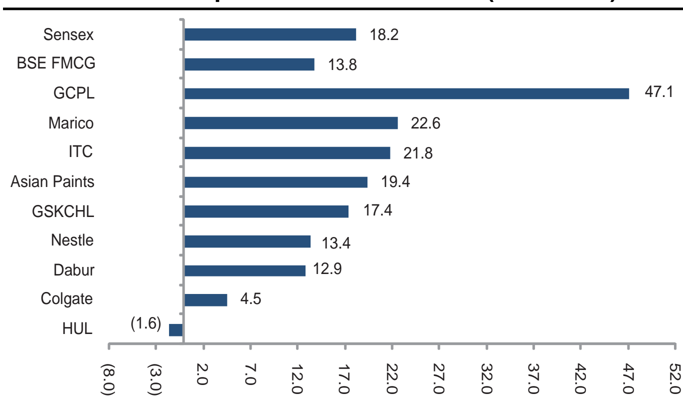
Leading the pack here are HUL, GCPL and GSKCHL, which continue to invest heavily in advertising to support new product launches. For instance, HUL recently tied up with Star to exclusively advertise its brands across all the 10 Star channels.

Monsoon woes hit stock performance

Concerns over weak monsoons have slammed the brakes on outperformance by FMCG stocks, as uncertainty over Top-line, fears of down-trading and down-pricing and intensifying competition have started impacting investor sentiment. The BSE FMCG Index registered an underperformance of 4.3% vis-à-vis Sensex during 2QFY2010 owing to weak performance by HUL (impacted by concerns about market share losses). However, GCPL, ITC and Marico (our Top Picks in 1QFY2010) emerged out-performers with GCPL delivering maximum returns.

FMCG

Exhibit 4: Relative performance to Sensex (2QFY2010)



Source: Company, Angel Research

Midcaps to outperform heavyweights

For 2QFY2010, we expect our FMCG universe to report a modest Top-line growth of 13% yoy. However, Earnings are expected to grow at a higher pace of 17% (Midcaps to post much higher growth of 25-30%) owing to Gross Margin expansion and better efficiencies. Sector leader, HUL, is expected to report a modest 10.5% Top-line growth driven by 3-5% Volume growth on the back of higher Ad-spends and Brand re-launches. However, Earnings (recurring) is expected grow at a muted pace of 8.3% owing to lower Other Income. ITC is expected to deliver a 9.7% Revenue growth impacted by slowdown in its Hotels Segment and rationalisation of Agri-business. However, a 3-4% Volume growth in Cigarette Segment and price hikes will support growth. Earnings for ITC is expected to grow by 10.9% largely driven by Top-line growth and Margin expansion (Cigarette Segment).

Valuations appear rich, Stay Selective

Most FMCG companies have witnessed a sharp rally in the recent past, and are currently trading at rich valuations that are being driven by a steady Earnings growth, significant Margin expansion and sustained Volume growth. In terms of their One-Year Forward P/Es, most companies are trading at their five-year averages, but at a 20-30% discount to their peak valuations (in FY2007). Thus, while the long-term consumption story for the FMCG Sector remains intact, further re-rating from current valuations seems less likely, owing to concerns over weak monsoons.

Hence, **we change our stance on the FMCG Sector to equal-weight from overweight, as we believe that both Earnings upgrades and P/E re-ratings are likely to take a breather from current levels.** However, a strong defensive appeal and steady Earnings growth are likely to cap the downside as well. Hence, we continue to emphasise on selective stock picking, and prefer companies which are leaders in their product categories, have a diverse product portfolio and stronger pricing power, and which are better placed to combat the vagaries of weak monsoons.

Among the heavyweights, we maintain an Accumulate on ITC (the worst is over for the company, Earnings are set to revive and the lowest risk is from the monsoon). **In Midcaps, we maintain an Accumulate on GCPL** (on account of the significant Margin expansion and the GSL consolidation will address portfolio concerns), **Marico** (a play on the valuation gap) **and Nestle** (due to its urban portfolio and its strong Earnings growth).

Exhibit 5: Quarterly Estimates Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
Asian Paints ^	1,406	1,640	*11.1*	16.8	*265*	171.5	*30.5*	17.9	*30.5*	62.2	72.9	*17.3*	22.6	19.3	1,492	Accumulate
Colgate Palmolive	633	479	*16.1*	16.6	*420*	80.7	*27.1*	5.9	*27.1*	26.4	28.7	*8.4*	24.0	22.1	-	Neutral
Dabur India ^	142	838	*21.3*	19.5	*139*	136.1	*26.2*	1.6	*26.2*	5.6	6.5	*17.0*	25.5	21.8	-	Neutral
GCPL ^	243	421	*21.6*	15.6	*410*	52.9	*52.2*	2.1	*52.9*	9.1	10.8	*18.4*	26.8	22.6	254	Accumulate
GSK Consumer *	1,156	519	*22.9*	16.8	*183*	70.1	*32.1*	16.6	*32.1*	59.2	66.6	*12.7*	19.9	17.7	-	Neutral
HUL	263	4,449	*10.5*	12.9	*107*	474.4	*8.3*	2.2	*8.3*	10.2	11.8	*15.8*	25.8	22.3	-	Neutral
ITC	232	4,129	*9.7*	31.5	*181*	890.6	*10.9*	2.4	*10.9*	10.2	12.0	*17.9*	23.1	19.6	255	Accumulate
Marico ^	89	689	*14.2*	14.3	*201*	65.3	*38.5*	1.1	*38.5*	4.0	4.8	*21.9*	23.1	19.0	97	Accumulate
Nestle *	2,270	1,315	*18.7*	20.8	*204*	174.5	*32.4*	18.1	*32.4*	69.7	81.8	*17.2*	31.7	27.1	2,400	Accumulate

*Source: Company, Angel Research; Note: Price as on Sept. 30, 2009; *Note: * Y/E December; ^ Consolidated*

***Analyst -* Anand Shah / Chitrangda Kapur**

Infrastructure

Work aplenty, Execution the key!

Infrastructure has been at the centre of government attention as it is expected to play a crucial role in sustaining the country's economic growth in the times to come, and due to the cascading multiplier effect that it has on the overall economy. Moreover, most pivotal factors including, Work on hand (Earnings growth), Capital, (Interest costs), Commodity prices (Operating Margins) and renewed intent by the Central Government are in place. Against this backdrop, it is the execution capability that would have a major bearing on growth of the Infra players. We believe that besides individual companies' intrinsic strengths, project mix (entailing higher Operating Margins and shorter execution periods) would also go a long way in determining their growth trajectory. Overall, companies with a judicious project mix would continue to be preferred over others in the fray.

Roads gaining momentum

In Infrastructure, the Roads Segment is one of the vital links of overall development. For instance, to expedite and develop power infrastructure (India is a power deficit country with an average power deficit of 10.9%), an adequate underlying transportation infrastructure is a necessity. Thus, we maintain that in the overall scheme of things, 'Roads' would be action field. This more than reflects the ambitious target set by the Minister for Roads, Transport and Highways (MoRTH), Kamal Nath of constructing 20km a day!! Till-date, of the planned 54,500km of National Highways to be developed under the NHDP, around 11,746km roads have been completed, 5,782km are at construction stage and road contracts to the extent of 36,972km are expected to be awarded over the next three-four years.

Nonetheless, we believe that the target of building 20km/day is ambitious considering NHAI's past track record. But, the Ministry/NHAI has proposed/ushered a number of changes at different levels to achieve the set target. For instance, the Model Concession Agreement (MCA) has been amended in terms of structure, procedural issues and technical criteria.

Issues concerning land acquisition, which have been a major road block, are also now being taken up. This is because, land acquisition issues have resulted in project cost overruns with NHAI having to compensate the developers for idle machinery, interest costs, etc. Hence, NHAI is in the process of setting up 150 land acquisition wings at the State-level and special arbitration cells to minimise inordinate delays due to land acquisition problems. Further, to expedite the road construction process, NHAI has decided to award the Letter of Award (LoA) only after it is in possession of 80% (as against 50% earlier) of the land required for the project.

All these developments highlight the serious intent of MoRTH in expediting highway development.

QIPs - The flavour of the day

In the capital-intensive Infrastructure Sector, execution of projects is dependent on timely and cheap availability of capital. But, a major part of FY2009 saw Infrastructure companies grappling with this prime problem of inadequate capital at competitive rates. As a result, the government has been addressing this problem through measures like hiking the ECB borrowing limit, reducing Interest rates, allowing bodies like IIFCL to raise money by issuing bonds to foreign institutions, etc.

In perspective, the quantum and timing of fund raising programs by companies point at their perception of the opportunity in the offing. Hence, QIPs have become the flavour of the day despite the equity dilution, and are a precursor to the robust growth lying ahead. In 2QFY2010, many Infra players resorted to QIPs to access capital due to the inherent advantages (to investors) of no lock-in period, minimum procedural and regulatory hassles and strengthening of Net Worth *(thereby improving the biding capability).*

Exhibit 1: Funds garnered through QIPs

Sr. No.	Company	Money raised (Rs cr)
1	Punj Lloyd	670
2	Hindustan Construction	480
3	Nagarjuna Construction	367
4	GVK Power and Infrastructure	717

Source: Company, Angel Research

Budget - a Dampener for Infra players

The Union Budget 2009-10 proved to be an overall negative for the Sector as the positives arising from increasing allocation to the Sector were eclipsed by the amendments and clarifications made on the Tax front. For instance, the revision in the Minimum Alternate Tax (MAT) is expected to have a major impact on the players. Most players owning infra assets had been claiming Section 80IA benefits along with paying 10% MAT. The Budget has however, increased MAT to 15% and done away the benefits arising from Section 80IA being availed by companies other than asset owners. However, it should be noted that there would not be a major impact on our Earnings estimate for FY2010E and FY2011E as we have not

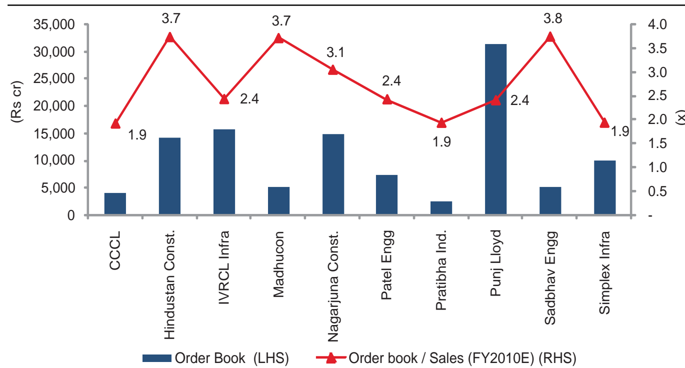
Infrastructure

factored in any tax benefits for the companies in our universe. We believe that it would also not significantly affect the stocks as it would reduce the Book Value by a mere 2-5%.

Order inflows to pick up in 2HFY2010

Order inflows, the lead indicator for infrastructure companies, are no longer a cause for concern. The Order Book-to-Sales ratio is comfortably ranging between 1.9 - 3.7x, and near-term plateauing (especially in the Roads Sector) is no longer a concern. In fact, we expect Order inflows to gain momentum in 2HFY2010 once the economy is back on growth trajectory, procedural and structural issues are addressed and execution plans get implemented. Post this, we expect a number of projects to be taken up on a priority basis, especially in the Roads, Irrigation, Power and Urban Infrastructure space.

Exhibit 2: Order Book, Order Book/Sales Ratio

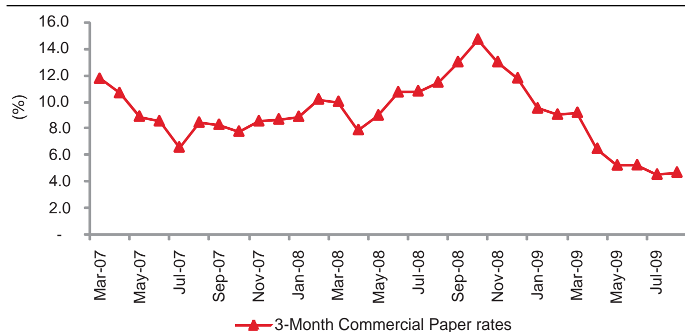


Source: Company, Angel Research

Benign short-term Interest rates - A possible fillip to Earnings

Our discussion with the Infra players indicates that the Interest rates are on a downward trend in the short term. We believe that such softening of Interest rates could serve as a near- term trigger for Earnings upgrade as well as lower the cost of working capital loans.

Exhibit 3: Short-term Interest Rate Trend

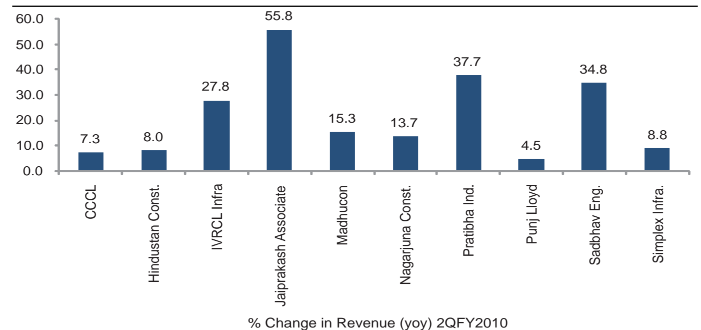


Source: Bloomberg

Earnings Outlook

With vital components (for infrastructure development) in place, viz. Capital, Commodity prices, Political will and strong Pipeline, we expect the Order Book/Sales Ratio to boost Top-line growth of the companies in our universe over the ensuing years. This is against the background of players vying for increasing proportion of the infrastructure opportunity pie. Accordingly, we expect the companies under our coverage to post a Top-line growth of 5-55% for 2QFY2010 on the back of strong Order Book and increased visibility particularly with the UPA government back in power. Earnings growth would, however, be a function of project mix.

Exhibit 4: Revenue Trend (2QFY2010E)



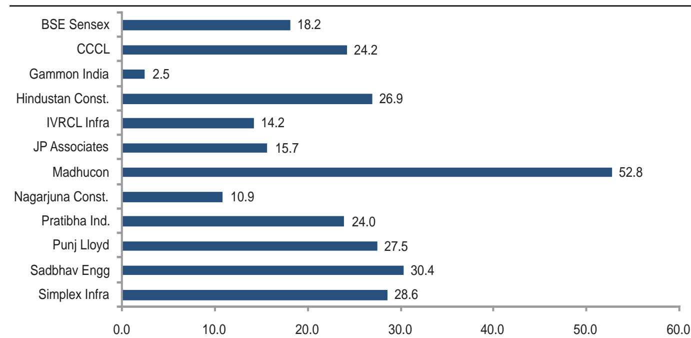
Source: Company, Angel Research

Sensex v/s Infrastructure stocks

On the bourses, 2QFY2010 was once again an outstanding quarter for the Infrastructure Sector with most Infra stocks out-performing the benchmark BSE Sensex. This outperformance could majorly be attributed to re-rating of the Infra Sector in terms of P/E expansion as a consequence of the UPA government getting re-elected (indicating continuation of stress on Infra development) and easing liquidity conditions. During 2QFY2010, stocks under our coverage universe yielded returns ranging between 3-60% as against the BSE Sensex returns of 18.2%.

Infrastructure

Exhibit 5: Relative outperformance to Sensex



Source: Company, Angel Research

Outlook

The Way ahead…

In light of the pivotal role that the Infrastructure Sector plays in enabling growth going ahead, we believe that the government will have to continue focusing on infrastructure development in the country. In fact, the traffic projections on most roads have been in sync with the economic cycle. Moreover, in the long term, with the economy on a roll (India has averaged 8-9% growth over the last 4-5 years), we expect the Infrastructure Sector to attract more and more funds not only from the domestic space, but also from the international arena.

Other factors including the political intent, liquidity position, commodity and crude prices, structural and procedural reforms at various government body levels (like NHAI) are also well positioned for the Indian infrastructure growth story to pan out.

Over the next few quarters, we expect healthy Order Backlogs of the companies in our universe to translate into Earnings growth. We also expect Order Inflows to start gaining momentum in 2HFY2010 as initiatives by the re-elected UPA government start yielding results. However, owing to the substantial liquidity inflows that we are currently witnessing, we do not rule out possibility of moderate monetary tightening by the Reserve Bank of India in turn resulting in slight hardening of Interest rates. However, this is unlikely to have a material impact on Earnings as a number of avenues of availing finance at competitive rates has now opened up, especially for infrastructure companies.

Valuation

The Infra Sector still offers tremendous 'Infusion-Dilution Opportunity', which will lead to companies trading at 2.0-2.5x P/BV in the longer run owing to higher growth opportunities. However, due to the sharp rally in these stocks YTD 2009, we recommend selective stock picking. We prefer companies that provide a decent blend of growth opportunities and attractive valuations. Also, we prefer Mid-caps to the large caps as there still exists some headroom for factoring in subsidiary valuations which is dependent on further improvement in the liquidity conditions and overall macro-economic scenario.

Overall, we remain bullish on the Infrastructure Sector. **Madhucon Projects continues to be our Top Pick in the Sector.**

Exhibit 6: Quarterly Estimates — **Rs cr**

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	**(Rs)**	**2QFY10E**	***% chg***	**2QFY10E**	***chg bp***	**2QFY10E**	***% chg***	**2QFY10E**	***% chg***	**FY10E**	**FY11E**	***%chg***	**FY10E**	**FY11E**	**Price (Rs)**	
CCCL^	326	501	*7.3*	9.3	*249.1*	19.2	0.4	5.2	*0.4*	28.3	32.1	*13.4*	11.6	10.2	-	**Neutral**
Hindustan Const.	131	701	*8.0*	13.1	*24.2*	7.9	(60.2)	0.3	*(60.2)*	2.8	3.1	*7.4*	46.2	43.0	-	**Neutral**
IVRCL Infra	392	1,481	*27.8*	8.4	*54.3*	50.0	(12.3)	3.6	*(12.3)*	20.9	24.1	*15.5*	18.8	16.2	-	**Neutral**
Jaiprakash Assoc.*	237	1,843	*55.8*	30.0	*57.7*	1,007.7	396.1	7.2	*396.1*	6.8	9.5	*39.7*	34.7	24.8	200	**Reduce**
Madhucon	268	280	*15.3*	11.3	*(525.9)*	11.8	(7.8)	3.2	*(7.8)*	20.9	24.7	*18.2*	12.8	10.9	305	**Buy**
Nagarjuna Const.	150	1,200	*13.7*	9.3	*(101.6)*	49.1	16.1	1.9	*16.1*	6.8	9.1	*34.6*	22.0	16.4	-	**Neutral**
Pratibha Indus.	207	268	*37.7*	9.9	*128.6*	10.4	(2.2)	6.2	*(2.2)*	38.4	44.3	*15.4*	5.4	4.7	266	**Buy**
Punj Lloyd	267	3,086	*4.5*	9.1	*(103.8)*	114.4	242.8	3.5	*242.8*	11.7	20.5	*74.8*	22.7	13.0	310	**Buy**
Sadbhav Engg.	871	167	*34.8*	12.1	*55.5*	8.2	62.7	6.6	*62.7*	52.2	62.1	*19.1*	16.7	14.0	-	**Neutral**
Simplex Infra	504	1,097	*8.8*	9.5	*74.1*	25.0	(16.1)	5.1	*(16.1)*	32.9	39.7	*20.5*	15.3	12.7	-	**Neutral**

*Source: Company, Angel Research; Price as on Sept. 30, 2009 ; Note: Target Prices are based on SOTP methodology, ^ standalone numbers; * Numbers include income from sale of treasury shares*

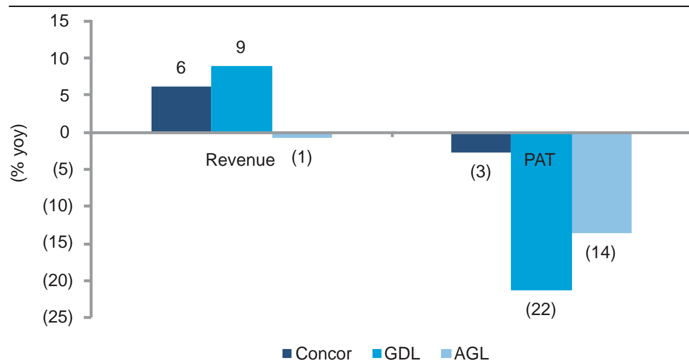
Analyst **- Shailesh Kanani / Aniruddha Mate**

Logistics

For 2QFY2010, we expect our universe of stocks to report moderate growth on a sequential basis, on account of the improving visibility in trade, but to remain subdued yoy, on account of the high base effect. We expect Operating Margins to improve sequentially, owing to the improvement in Realisations (Concor) and a better Product-mix (GDL). We believe that the Domestic Segment will continue to do well in 2QFY2010, on the back of the strong domestic consumption. Consequently, we expect Concor, GDL (Gateway Distriparks) and AGL (Allcargo Global Logistics) to register a 2.8%, 21.5% and 13.6% yoy decline in PAT, respectively.

Going ahead, we expect our universe of stocks to register robust growth in the ensuing quarters, on a low base and on increasing trade.

Exhibit 1: 2QFY2010 Revenue, PAT estimates

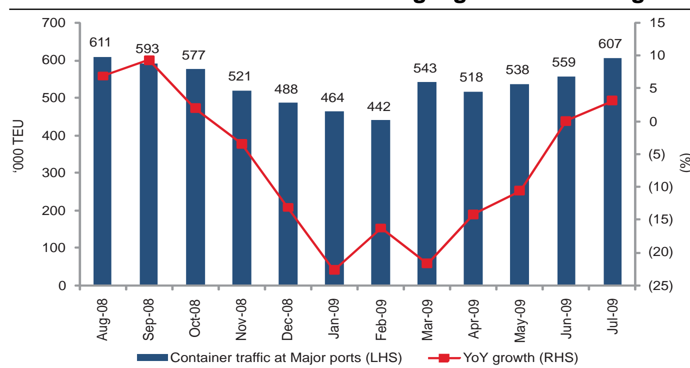


Source: Company, Angel Research

Improving Exim visibility

The container traffic data released for FY2010 YTD (April-July 09) by the Indian Port Association (IPA) witnessed a 5.5% yoy decline. The JNPT port, which handles around 60% of the country's container volumes, registered a 6.3% yoy fall in volumes, while the Chennai port, which handles around 16% of the country's container volumes, witnessed a 7.9% yoy fall. This indicates that container traffic is stabilising at the current levels in absolute terms, after bottoming-out, in January and February 2009. Going ahead, we expect trade to revive post 2QFY2010, on the improving economy and on account of a low base. Nonetheless, we believe that the high base effect and lacklustre Exports during 1HFY2010 will result in moderate growth in Exim volumes for FY2010. Company-wise, we estimate Concor to post a ~7.5% yoy decline in Exim volumes, and GDL to witness a 5% yoy decline in CFS volumes in 2QFY2010.

Exhibit 2: Container Traffic - Showing signs of bottoming out



Source: IPA, Angel Research

Key Developments

Removal of rebate and hike in Import Tariff to boost Concor's realisations

To combat higher empties due to lacklustre exports, Concor hiked the tariffs for import container traffic by 3%. On the other hand, Indian Railways (IR), which had extended the 10% rebate in domestic haulage charges to the rail operators in November 2008, withdrew the sop, effective from July 2009. As a result, we expect realisations to improve in 2QFY2010, as the company has indicated passing on the same. However, in light of the recent hike in diesel prices, which will impact the road operators, the effect of IR's move will only marginally depress the domestic volumes on rail. Overall, the Domestic Segment, which was the saving grace in 4QFY2009, will continue to do well in 2QFY2010.

Ongoing talks of a stake sale in GDL's rail subsidiary

For 1QFY2010, average utilisation levels for rakes increased to 86%, from 72.4% in 1QFY2009 and 83.3% in 4QFY2009. Also, in June 2009, GDL reported marginal gains at the PAT level, indicating that it should break-even at the PAT level earlier than market expectations. With Exim visibility improving, GDL's stake sale in its Rail business could fetch better valuations. As per media reports, GDL intends to dilute a 20-25% stake for Rs250-300cr. This, we believe, could unlock value for investors.

Blackstone converted warrants in AGL

Blackstone converted the warrants in AGL at a revised price of Rs934/share, instead of the earlier Rs1,284/share in CY2008, to fund its capex requirements; AGL had issued 1,081,081, 6%, fully-and-compulsorily convertible debentures (FCCDs), 1,513,514 warrants and 1,000 equity shares to Blackstone, which will result in a 10.4% dilution. As per the agreement, the warrants would be converted depending on AGL's Operating performance in CY2008.

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However, owing to the subdued prevailing market conditions, Blackstone converted the warrants at the lower band of the price, in spite of AGL meeting its Operating performance criteria. We believe that AGL is still adequately funded to meet its capex requirements over CY2008-10E, on account of its healthy Balance Sheet and comfortable Debt to Equity of 0.6x (pre-Warrant conversion).

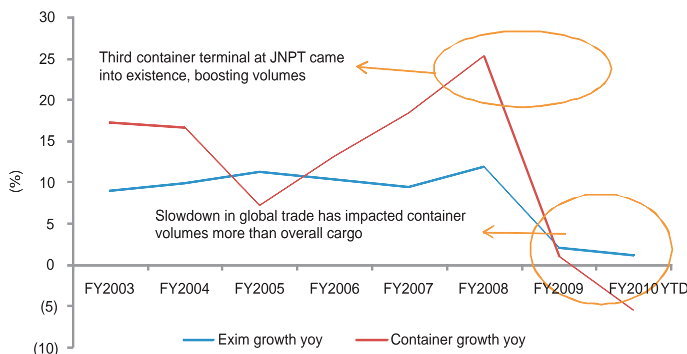
Increase in MAT to impact the sector

The Union Budget 2009-10 increased the MAT by 5%, from the current level of 10%. This would impact companies like Concor, GDL and AGL, which fall under the purview of MAT, due to their claiming of 80IA benefits on income earned from CFS and ICD. Moreover, a timely phase-out of CST will allow for the smooth functioning of VAT, which, in turn, will boost outsourcing to third-party logistics. Further, the Budget has extended interest subvention on pre-shipment credit up to March 31, 2010, from the current deadline of September 30, 2009, for the recession-hit export sectors such as handlooms, handicrafts, carpets, leather, gems and jewellery, marine products, and small and medium exporters. This should enhance exports and reduce the widening of trade, and, in turn, lower empties for Rail Container Operators, in the medium term.

Slowdown in economy impacted Container traffic more than overall Exim

Container traffic increased from 3.4mn TEU in FY2003 to 6.6mn TEU in FY2009, registering a CAGR of 12% during the period, whereas the Cargo at major ports posted a 9% CAGR in the mentioned period. As a result, the share of Container traffic in the current decade increased from 11.5% to 17.6% in FY2009, following an increase in the private participation in handling container terminals, and customer preference in transporting cargo in a containerised form, as it reduces handling costs. However, in FY2009, the slowdown in global trade impacted containerisation more than overall cargo. We expect this trend to continue during the better part of FY2010 as well.

Exhibit 3: Container Traffic likely to underperform in FY2010

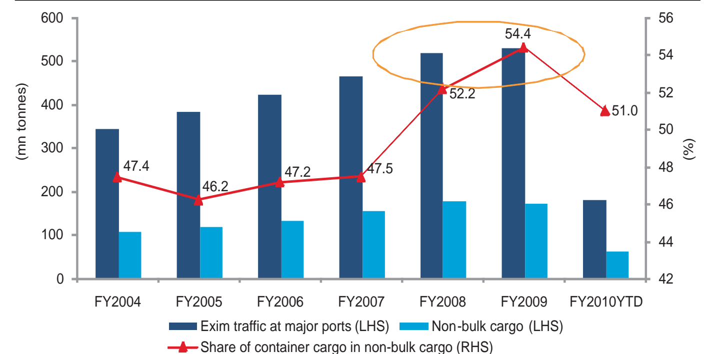


Source: IPA, Angel Research

Bullish on Container Industry, due to low penetration and customer preference

Non-bulk cargo, which constitutes around 35% of the total cargo at the major ports, has the potential to be transported in a containerised form. Previously, only basic goods were suitable for shipment in containers, but now most items can be shipped in a container. It is estimated that 75-80% of the total non-bulk cargo can be containerised. Currently, the containerisation level in India is at ~51%, compared to 80% globally, which shows that there still exists room for growth driven by an improvement in infrastructure. Notably, the trend towards containerisation registered substantial improvement in the last two years, increasing by 500-700bp despite the slowdown in trade in FY2009. This can be attributed to the customers' preference for containerisation, as it reduces handling costs. We expect the share of containerisation to increase to 62-65% over the next five years.

Exhibit 4: Improving level of Containerisation



Source: IPA, Angel Research

Dedicated freight corridor gets funding approval

Despite Railways being a cheaper mode of transportation as compared to Roadways, Railways' market share in freight declined from 65% in to 33% in 2007. This was mainly due to capacity and efficiency constraints in the Freight Segment, which led to a significant shift from Railways to Road. The Railway Budget 2006-07 has envisaged the construction of a dedicated multi-modal, high axle-load freight corridor, with computerised control, on the western and the eastern routes. The project, entailing an investment of Rs22,000cr, will be implemented in two phases. As per recent media reports, the Cabinet has approved a Rs17,700cr conditional

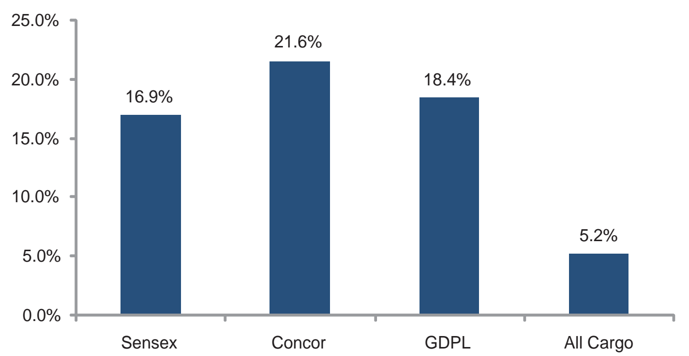
Logistics

loan from Japan to help build it. The Japanese overseas development assistance is going to be a soft loan, with an interest of only 0.2% per annum, with a long repayment period of over 30 years and a moratorium of 10 years. The project take-off will increase the rail market share in the longer-term, thereby benefiting rail container operators.

Sensex v/s Logistic stocks

During 2QFY2010, Concor and GDL outperformed the Sensex by around 5% and 2%, respectively. Concor's outperformance was largely driven by stellar Exim performance in 1QFY2010. The GDL stock's performance was largely driven by ongoing talks of a stake sale in its rail business and its breaking even at the PAT level (in the rail business in June).

Exhibit 5: Outperforming the Sensex in 2QFY10



Source: Bloomberg, Angel Research

Outlook

We believe that the sustained growth in the Indian economy, with GDP growth expected at 6-8% over the next few years, and India's emergence as a global outsourcing hub will facilitate Container trade in the country. In the current decade, container traffic registered a 12% CAGR, compared to the 9% CAGR posted by the total traffic at major ports. We expect this trend to continue and container traffic to register a 11% CAGR over the next five years, driven by the addition of new container terminals and by increased containerisation.

The improving trade visibility has seen a re-rating in the sector, thereby leading to a rally in the stocks. We prefer companies that provide a decent blend of growth opportunities and attractive valuations. On account of its stature as market leader, we are now assigning a 15x multiple to Concor, and, additionally, we are assigning a 13x multiple for GDL and AGL each, on their FY2011E EPS. Based on this, we maintain our Reduce and Neutral ratings on Concor and AGL, respectively. However, we expect GDL to register robust growth in FY2011E, on account of its being present at strategic locations, its ongoing expansion plans and its break-even in the Rail business at the PAT level. **Hence, we maintain an Accumulate on GDL, with a Target Price of Rs130.**

Exhibit 6: Quarterly Estimates — Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
	(Rs)	2QFY10E	% chg	2QFY10E	chg bp	2QFY10E	% chg	2QFY10E	% chg	FY10E	FY11E	%chg	FY10E	FY11E	Price (Rs)	
Gateway Distriparks	121	129	*9.0*	28.0	*(753)*	18	*(21.5)*	1.7	*(21.5)*	7.2	10.0	*39.3*	16.9	12.1	130	**Accumulate**
Concor	1,196	960	*6.3*	28.0	*(175)*	217	*(2.8)*	16.7	*(2.8)*	66.7	74.3	*11.4*	17.9	16.1	1,115	**Reduce**
Allcargo*	850	627	*(0.8)*	11.0	*(34)*	36	*(13.6)*	14.5	*(13.6)*	57.5	65.5	*14.1*	14.8	13.0	-	**Neutral**

*Source: Company, Angel Research; Price as on Sept. 30, 2009; *Note: December ending*

Analyst **- Param Desai**

Metals

Metal stocks continued their rally during 2QFY2010 with the BSE Metal Index outperforming the benchmark BSE Sensex by 10.7%, while returning 28.8% in absolute terms during 2QFY2010.

Better-than-expected June quarter results and expectations of a global recovery helped fuel the rally in most metals and metal stocks. Within this space, the ferrous pack was supported by strong demand in the domestic market coupled with improving realisations. Notably, steel companies have reported more than 20% yoy jump in salable steel volumes during the quarter. On the other hand, the non-ferrous pack was largely supported by the jump in base metal prices on the LME, which will be reflected in better realisations for the companies in the ensuing quarters. It must be noted that base metal prices continued to rally during the quarter and have recovered by 50-70% from their recent lows.

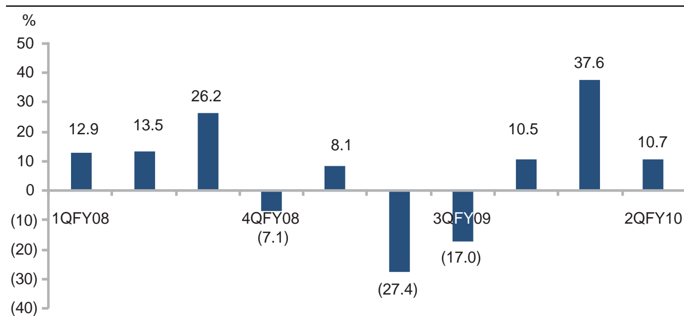
On the Indian bourses, Tata Steel, JSW Steel, Hindalco, Sterlite Industries, Hindustan Zinc and Sesa Goa outperformed the broader markets with gains of 20-50% in absolute terms, whereas SAIL and Nalco managed only 12-14% gains in absolute terms, thus underperforming the Sensex by 4-6%.

Exhibit 1: Sensex v/s Metal stocks (2QFY2010)

Metal Majors	Abs. Returns (%)	Relative to Sensex (%)
Sensex	18.2	-
BSE Metals	28.8	10.7
SAIL	13.0	(5.2)
Tata Steel	30.6	12.4
JSW Steel	34.8	16.6
Hindalco	49.0	30.9
Nalco	14.1	(4.0)
Sterlite Ind	27.6	9.4
Hindustan Zinc	37.5	19.3
Sesa Goa	45.1	26.9

Source: BSE, Angel Research

Exhibit 2: Metal Index - Relative Returns to Sensex



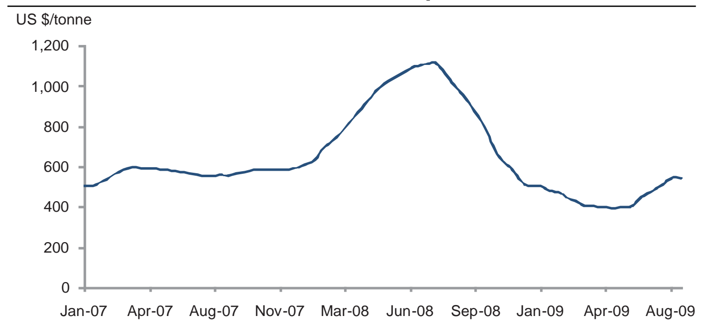
Source: BSE, Angel Research

Ferrous Sector - Steel prices remain firm

Steel prices, which started recovering during the last quarter, further strengthened during 2QFY2010. Stimulus packages announced by major economies and positive economic data trickling in from major consuming nations have resulted into incremental demand coming into the market. Thus, with demand emanating from the Infrastructure and Auto Sectors, prices inched up further during the quarter. Notably, the benchmark world export HRC prices have moved up to US $542/tonne. China's export prices have jumped from a low of US $445/tonne towards early April 2009 to US $600/tonne recently before receding back to around US $520/tonne. Steel prices in Europe have also moved up to around US $650/tonne from US $470/tonne in April 2009. However, prices are still ruling 50% below the peaks.

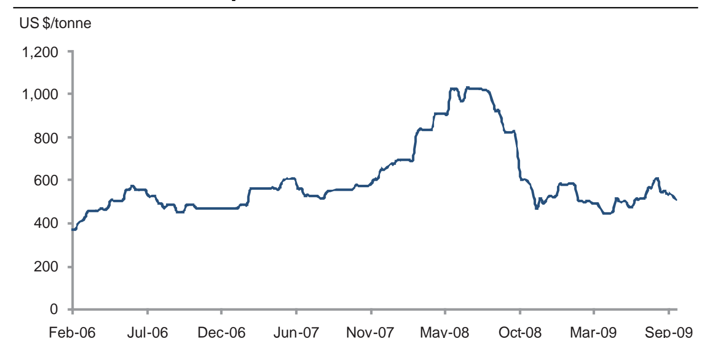
Due to improvement in steel demand and strong production by China, especially in July 2009, the Spot iron ore prices have also seen a sharp rally, with iron ore prices having moved up by 82% to US $115/tonne from the lows of US $63/tonne during April 2009 before settling down to around US $90/tonne recently. However, the Spot iron ore prices during the quarter have averaged US $93/tonne, lower by 41% yoy from US $161/tonne during the same period last year.

Exhibit 3: Benchmark HRC world Export Prices



Source: Bloomberg, Angel Research

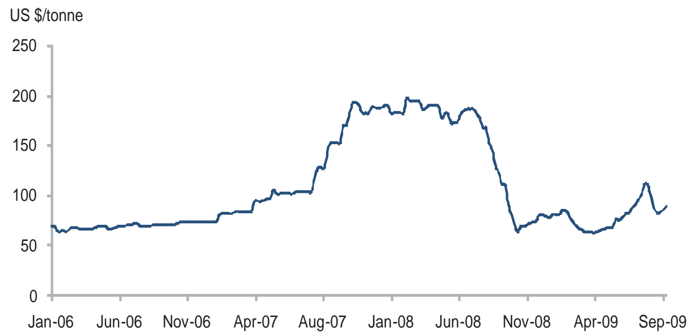
Exhibit 4: China Export FOB HRC Prices



Source: Bloomberg, Angel Research

Metals

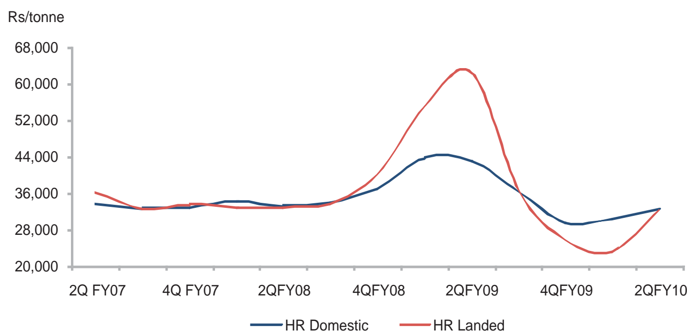
Exhibit 5: Indian Iron ore cfr China Spot Prices



Source: Bloomberg, Angel Research

Domestic steel producers also hiked steel prices during the quarter on the back of buoyant domestic demand and tracking the rise in global steel prices. Notably, average domestic HR prices during the quarter were higher by 8% qoq at Rs32,667/tonne (Rs30,333/tonne). However, prices are still lower by 24% yoy compared to Rs43,167/tonne last year.

Exhibit 6: Domestic HRC Prices



Source: Cris Infac, Angel Research

The domestic steel prices, which used to trade at a premium, are now at par with landed steel prices. This is mainly due to comparatively steeper rise in the global steel prices.

Ferrous Sector Outlook

International steel prices have risen by 30-40% from recent lows on account of improvement in global economic outlook. Steel demand has stabilised and de-stocking over in the European and North American markets with prices moving up in those regions. Global crude steel output has been on the rise on a month-on-month basis since the beginning of 2009 and is now higher by more than 12% compared to December 2008 levels. Steel consumption has witnessed some improvement due to incremental demand coming from Infrastructure and Automobile Sectors. However, even though steel demand appears to have improved, overall demand for steel globally is expected to remain weak in the near term compared to historical averages. Steel demand globally declined by 1.5% in 2008 and is expected to fall further by 10-12% in 2009. Demand for steel in India has been growing at a healthy rate of 12-13% per annum in the last 2-3 years (prior to FY2009) driven by strong GDP growth and Real Estate and Construction boom. However, in FY2009, steel consumption turned weak and increased by a meager 1% yoy. Moving into FY2010, during the April-August period, demand was stable and up by 6% yoy. We expect steel demand in India to grow at 6-7% in FY2010 and further pick up post FY2011. We expect domestic Steel prices to broadly remain firm at current levels and believe that significant upsides from current levels are capped in the medium term. Further, global coking coal and iron ore prices have been negotiated at lower prices, which will prevent steel prices from heading northwards. However, at the same time, the cost of production for domestic steel companies will come down significantly and will lead to Margin improvement.

During the quarter, major steel players in India operated at higher capacity utlilisations on improving demand. Companies under our coverage are expected to post strong Sales volumes during the quarter. However, lower steel realisation, on a yoy basis, would restrict Top-line growth. We expect Top-line of the steel companies under our coverage to decline by 1-15% yoy.

On the Margins front, we expect the companies to register an improvement on a qoq basis due to improvement in Realisations, higher Sales Volumes and easing Cost pressures. Companies have settled coking coal and iron ore contracts at lower levels. This will lower the raw material costs for these companies during 2QFY2010 and improve their Margins sequentially. However, on a yoy basis, due to the decline in realisations, we expect Margins of steel companies like Tata Steel, JSW Steel and SAIL to decline by around 200-1,200bp. Due to lower yoy spot iron ore prices, Sesa Goa's Margins are expected to dip by 440bp yoy. **We remain Neutral on the Ferrous Sector, while maintaining Neutral on SAIL, Tata Steel, JSW Steel and Sesa Goa.**

Non-Ferrous Sector

Base metals like copper, aluminium, zinc and lead also further strengthened during the September quarter. The prices have been moving up on improved global business outlook and Chinese demand. Speculative buying by traders further aided the rally in base metal prices. Notably, LME aluminium, alumina, copper, zinc and lead prices increased by 21.6%, 29.9%, 25.3%, 18.9% and 28% respectively, on a qoq basis. However, on a yoy basis, prices are still ruling lower by more than 20%.

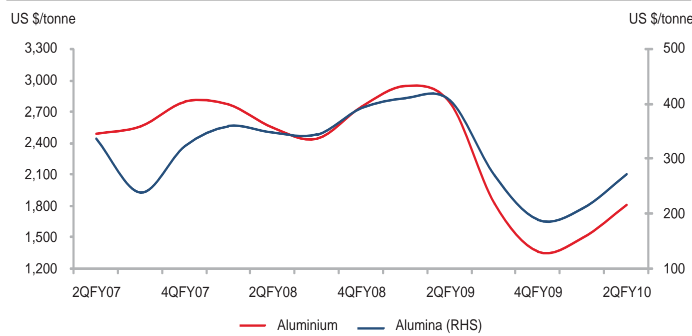
Metals

Exhibit 7: Average Base Metal Prices (US $/tonne)

	2QFY2010	2QFY2009	*yoy %*	1QFY2010	*qoq %*
Aluminium	1,816	2,785	*(34.8)*	1,493	*21.6*
Copper	5,867	7,672	*(23.5)*	4,681	*25.3*
Alumina	271	406	*(33.3)*	209	*29.9*
Zinc	1,759	1,779	*(1.1)*	1,479	*18.9*
Lead	1,924	1,912	*0.7*	1,503	*28.0*
Iron ore	93	161	*(42.4)*	69	*33.8*

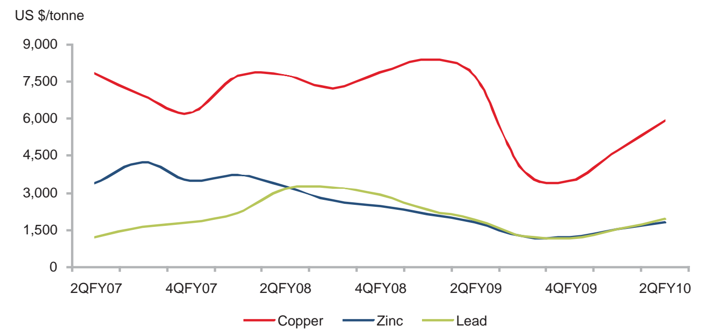
Source: LME, Angel Research

Exhibit 8: Average LME Aluminium and Alumina Prices



Source: LME, Angel Research

Exhibit 9: Quarterly LME Price Trend



Source: LME, Angel Research

Non-Ferrous Metals Sector Outlook

Base metal prices witnessed a strong rally during the quarter as industrial data emanating from major economies hinted towards a recovery in demand. Chinese stocking of commodities also helped in firming up of prices. We expect base metal prices to trade range bound from hereon. Also, the high inventory levels at the LME for most of the base metals would keep pressure on base metal prices.

On the domestic front, demand for Base metals has been growing at a decent rate compared to the growth globally due to strong domestic GDP growth. With long-term GDP growth remaining above 6% levels and per capita consumption of Base metals lower in India compared to China and the developed countries, long-term consumption story of Base metals is expected to remain intact. Last few months have seen an improvement in demand for base metals as demand is coming from user industries, viz. Automobile, Consumer Durables, Construction, Power and Packaging. Going forward, improved economic environment and stronger demand would lead to improvement in the volumes of the domestic players.

We expect Base Metal players like Hindalco and Nalco to clock de-growth in Top-line owing to lower LME prices yoy. Rupee depreciation of around 11% yoy during the quarter has however acted as a saviour for these companies. We expect Margins of Nalco and Hindustan Zinc to decline by 800-1,800bp. However, we estimate Hindalco's Margins to grow by 100bp yoy. Due to the decline in Topline and erosion in Margins, Bottom-line is expected to de-grow by an average 10-50% yoy during the quarter. **Due to the weak outlook on Base Metals prices, deceleration of demand for these metals, inventory hangover, we remain Neutral on the Base Metal Sector, while recommending Neutral on Hindalco, Nalco and Hindustan Zinc.**

Exhibit 10: Quarterly Estimates **Rs cr**

Company	CMP (Rs)	Net Sales 2QFY10E	Net Sales *% chg*	OPM (%) 2QFY10E	OPM *chg bp*	Net Profit 2QFY10E	Net Profit *% chg*	EPS (Rs) 2QFY10E	EPS (Rs) *% chg*	EPS (Rs) FY10E	EPS (Rs) FY11E	EPS (Rs) *% chg*	P/E (x) FY10E	P/E (x) FY11E	Target Price (Rs)	Reco
JSW Steel*	830	4,243	*(0.6)*	20.4	*(514)*	349.2	*10.0*	18.2	*10.2*	68.7	81.4	*18.5*	12.1	10.2	-	**Neutral**
SAIL	171	10,640	*(13.1)*	22.0	*(259)*	1,497	*(25.5)*	3.6	*(25.5)*	13.8	16.1	*16.7*	12.4	10.6	-	**Neutral**
Sesa Goa	265	1,169	*34.4*	43.3	*(436)*	445.8	*32.4*	5.7	*32.4*	21.1	26.1	*23.7*	12.6	10.2	-	**Neutral**
Tata Steel*	510	6,214	*(9.3)*	34.8	*(1,168)*	1,136	*(36.5)*	13.8	*(36.5)*	32.7	59.7	*82.6*	15.6	8.5	-	**Neutral**
Hindalco*	129	4,565	*(19.7)*	17.7	*97*	526.4	*(26.9)*	3.1	*(47.3)*	7.1	9.1	*28.2*	18.1	14.2	-	**Neutral**
Hind. Zinc	826	1,998	*14.6*	45.0	*(864)*	860.1	*(10.4)*	20.4	*(10.4)*	74.8	84.2	*12.6*	11.0	9.8	-	**Neutral**
Nalco	348	1,089	*(29.1)*	24.0	*(1,771)*	189.5	*(57.4)*	2.9	*(57.4)*	14.0	20.9	*49.3*	24.9	16.6	-	**Neutral**

*Source: Company, Angel Research; Price as on Sept. 30, 2009; *Note: FY2010 & FY2011 numbers are consolidated*

Analyst **- Hitesh Agrawal / Laxmikant Waghmare**

Oil & Gas

Mixed trend continues

Crude prices during the quarter were quite stable and traded in the range of US $60-74/bbl, whereas weakness in natural gas prices continued in 2QFY2010 as well. On the Petrochemical front, Margins strengthened during the quarter even though Refining Margins remained subdued.

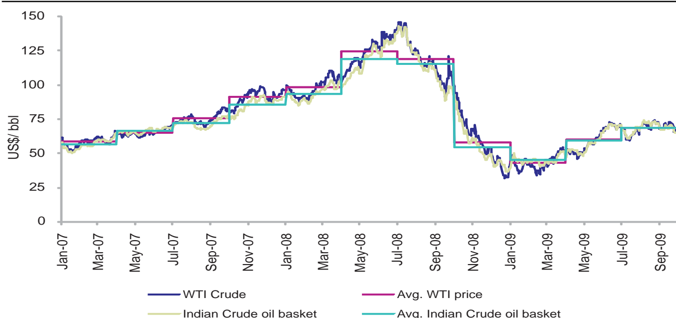
Crude showing strength; Natural Gas still subdued

During the quarter, crude prices remained range bound, while natural gas prices continued to rule weak. Crude traded at US $60-74/bbl levels. However, on an average, crude increased 14.9%. The decision taken by the OPEC in its September 9 meet to maintain current production targets provided support to markets. On a month-on-month basis, crude price increased in July and August, while the prices were in a range in September. Economic expectations, a weak Dollar and OPEC curbs have helped prop the crude prices amidst sluggish OECD demand, high inventories and widening spare capacity. The price-driving role of paper commodity markets also continues to be a hot topic. There have been recent views about CFTC and SEC oversight of over-the-counter (OTC) derivatives.

On the fundamental side, as per EIA, OECD commercial oil inventories stood at 2.74 billion barrels at the end of 2QFY2010. At 61 days forward cover, OECD commercial inventories were well above average levels for that time of the year. On account of economic recovery, world oil demand estimates of both IEA and EIA have witnessed an up-tick for 2009 and 2010.

The Indian basket of crude averaged at US $68.3/bbl during 2QFY2010 as against the 1QFY2010 average of US $59.4/bbl. We maintain our stance of subdued oil prices in the near term and expect crude to consolidate at current levels especially on account of the inventory overhang in the OECD countries. Thus, we expect crude prices to hover at around US $65-75/bbl in the visible future.

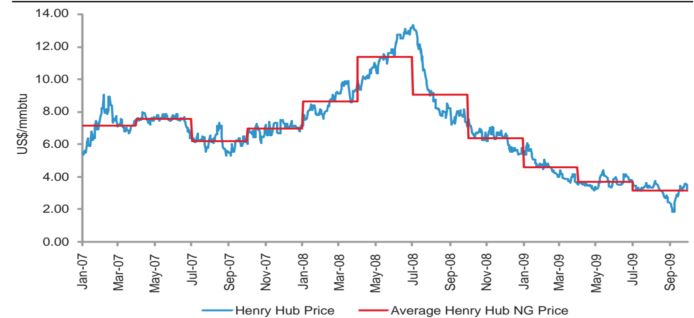
Exhibit 1: WTI Crude, Indian Basket of Crude Oil



Source: Bloomberg, Angel Research

Gas prices continued the downward journey during the quarter. Prices tumbled to an average of US $3.2/mmbtu as against the 1QFY2010 average price of US $3.7/mmbtu, thereby registering an average decline of 14.9%. However, some strength in prices was seen in September, with prices increasing by 36.7% from August end prices. Spot LNG prices for Asian delivery remained subdued during the quarter at around US $4.0-5.0/mmbtu levels. Going forward, prices are expected to remain weak as reflected from the rollover to November from October series. November contracts are reflecting prices of around US $5.0/mmbtu. Further, prices will depend on the timing of restart of the Japanese nuclear power plants. If the Japanese plants restart on schedule, spot LNG prices could come under pressure. Additional supplies from the Middle East and Sakhalin would also exert pressure on prices in such a scenario.

Exhibit 2: Natural Gas - Henry Hub prices



Source: Bloomberg, Angel Research

Petchem Margins witnessed uptick, Refining Margins hold on

Petrochemical Margins strengthened during the quarter with improvement in Cracker Margins and integrated Polyethylene (PE) Margins.However, non-Integrated PE Margins witnessed a contraction on account of higher naphtha prices. Margins of the PVC Segment were largely flat during the quarter.

On the Refining front, Margins seemed to be finding a trough and remained subdued on a qoq basis. We expect the Singapore benchmark Margins to average at US $2.7/bbl. On the Product front, spreads improved in Naphtha and Fuel oil, while spreads in key products such as Gasoline and Diesel were largely subdued during the quarter. The spread between light and heavy crude remained weak on a qoq basis, which in turn reflected the stable conversion margins during the quarter.

Oil & Gas

Key Developments

RIL raises Rs3,188cr from Treasury stock sale

Reliance Industries (RIL) raised Rs3,188cr by selling its treasury shares. RIL sold 15 million treasury shares held by Petroleum Trust at an average price Rs2,125, a 2.7% discount to its previous day's (September 16, 2009) close price of Rs2,184. Post the sale, the company's shares ended 4.5% lower at Rs2,086. The issuance led to a dilution of 1.0% on the pre-treasury number of shares. It is also speculated that the promoters might offload the entire stake held by the Petroleum Trust over the next 12-18 months. Thus, the treasury shares provide RIL the option to leverage its current Balance Sheet.

Oil India (OIL) IPO

OIL's IPO, which opened for subscription during September 7-10, 2009, raised Rs2,777cr at the upper price band of Rs1,050 per share. Around 2.64cr shares with face value of Rs10 were on offer in the price band of Rs950-1,050. This represented 11.0% of post issue paid-up share capital of the company. The Government of India (GoI) also offered 2.14cr shares to IOC, HPCL and BPCL in the ratio of 2:1:1. This represented 8.9% of post issue paid-up share capital of the company. As a result of the public issue and the government offloading its stake to OMCs, the GoI's stake in the company fell to 78.4% from 98.1% pre-IPO. OIL's shares saw a stellar listing on the bourses and closed at Rs1,041/share, registering a gain of 8.7% over the Issue price. We had recommended the IPO and assigned a Fair Value of Rs1,214/share.

NELP VIII launched - Government extends deadline to Oct 12

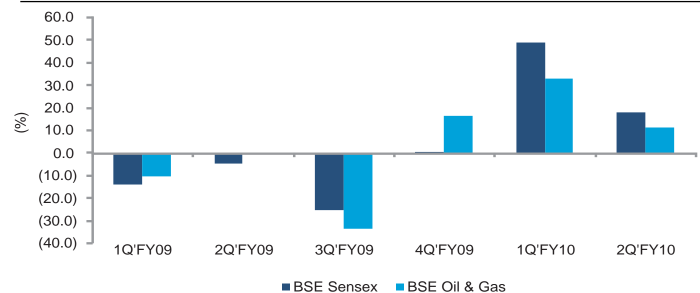
The first of the promotional road shows for 70 blocks offered under the Eighth round of New Exploration Licensing Policy (NELP) and 10 coal bed methane (CBM) areas was finally held in Mumbai on August 8 with October 12 being the last date for bidding i.e. an extension of two months over the previous deadline of August 10. On April 9, 2009, the government had launched the Eighth round of auction of blocks for exploration under the NELP. It was Hindalco deferred on account of ambiguity on the availability of tax holidays for natural gas. The round was re-launched after Finance Minister, Pranab Mukherjee, made mention in Budget 2009-10 of the seven-year holiday from payment of Income Tax on profits earned from production and sale of natural gas, which would be available for the blocks awarded under the NELP-VIII. Post Mumbai, road shows were held in Houston (Aug 20-21), Calgary (Aug 24-25), London (Sept 8-9), Perth (Sept 22) and Brisbane (Sept 24-25).

BSE OIL and GAS - 'underperformed Sensex'

On the bourses, the Oil & Gas Sector continued to under-perform in line with the previous quarter. It underperformed the benchmark Sensex by 6.6% during 2QFY2010. However, the OMCs outperformed both the Oil & Gas Sector Index as well as the Sensex by a huge margin. OMCs like IOC, BPCL and HPCL gained by around 28-34% on account of being exempted from sharing subsidy on the cooking fuel front.

RIL, RPL (which mirrors RIL on account of the merger) and RNRL were major laggards on account of the continuing court battle between the Ambani brothers. Thus, under performance by RIL (has weightage of 59.5% in the Oil & Gas index) capped gains in the Index. ONGC and Cairn India gained in line with gains in the Oil & Gas Index, but under-performed the Sensex as crude prices were in a range during the quarter.

Exhibit 3: Relative Performance to Sensex



Source: Bloomberg, Angel Research

Outlook

ONGC's performance, over the quarters, has largely been dependent on the subsidy sharing mechanism, and we believe the scenario is unlikely to change much going ahead. 1QFY2010 was one of the good quarters for the company on account of the lower subsidy burden due to low crude oil prices. However, things have one again changed following the increase in crude oil prices. Assuming, the government entirely bears the cooking fuel subsidy, the upstream players would have to share only the auto fuel subsidy. Accordingly, we have assumed that ONGC will bear the subsidy burden to the tune of Rs3,181cr during the quarter as against Rs429cr in 1QFY2010. Hence, for 2QFY2010, we expect ONGC's gross realisation at US $70/bbl while net realisation would be at US $53.1/bbl.

We expect **RIL** to report a marginally better performance for 2QFY2010 on a qoq basis. RIL's Refining Margins are expected to decline marginally to an average of US $7.4/bbl (US $7.5/bbl) qoq.

Oil & Gas

On the Petrochemical front, we expect Margins to decline marginally on account of decline in Polyproplyene (PP) spreads during the quarter. However, better integrated PE Margins offset the overall fall in Petchem Margins. In the Upstream Segment, we expect KG gas sales volumes to increase to 30mmscmd during 2QFY2010.

For 2QFY2010, OMCs **(IOC, HPCL and BPCL)** reported negative Marketing Margins on transport fuels (petrol and diesel) on account of higher crude oil prices. On the Refining side, weakness in middle distillate cracks is likely to drag down Refining Margins for these companies as the product slate of Indian PSU refineries is tilted towards middle distillates. As far profitability of the OMCs is concerned, it will depend on the extent of subsidy sharing on Auto fuels.

Gujarat Gas continues to be constrained by the lower gas supplies due to which volumes are expected to be stable at 2.75mmscmd during the quarter. For 26 days, 40% of PMT supply (major source) was hit during 3QCY2009 on account of Force Majeure event. However, volume loss, to an extent, will get offset due to higher LNG procurement on account of lower LNG prices. Thus, volume will be lower on a yoy basis (decline by 3.3%) and marginally higher on a qoq basis (increase by 1.7%). We estimate gas cost during the quarter to be marginally higher on a qoq basis on account of higher LNG procurement with the average exchange rate remaining flat qoq. Margins may take dip on a qoq basis as short supply from PMT has resulted in lower supply to the high-Margin Industrial customers. We expect Gross gas spread during 2QFY2010 to be lower on a qoq basis at Rs3.7/scm (Rs4.0/scm).

GSPL is expected to register an improvement in Volumes during the quarter owing to gas flows from the KG basin and higher LNG imports by Petronet LNG. We expect the company to transport 28mmscmd of volumes during the quarter. Our Earnings estimates for GSPL for the quarter does not factor in the 30% PBT sharing with the Government of Gujarat as the shareholders' approval is still awaited.

In case of **Petronet LNG,** expansion of the Dahej terminal at the beginning of the quarter is likely to result in Volume growth. Higher volumes coupled with depreciation of Rupee against the Dollar over the last one year, are likely to result in a strong 72.4% yoy Sales growth for the company. Volumes during the quarter are likely to increase to 110 Trillion British Thermal Units (TBTU), registering an increase of 46.7% yoy.

We estimate **GAIL** to register subdued Sales growth for the quarter. Subsidy burden during the quarter is expected to be at Rs256cr. Petchem Margins are expected to improve on account of the increase in crude oil prices and higher Base Margins. We expect transmission volumes to increase to 113mmscmd during 2QFY2010 owing to increased KG gas flow.

We expect **IGL** to continue to post strong Volumes growth driven by higher conversion of CNG vehicles during the trailing one year. CNG Volumes during the quarter are estimated to have registered an increase of 7.6% yoy. The impact of the price hike made in the latter part of the pervious quarter will be visible in 2QFY2010 with OPMs expected to increase on a qoq basis to 41.5% (36.9%).

Overall, 2QFY2010 is likely to be mixed for our universe of stocks.

Exhibit 4: Quarterly Estimates — Rs cr

Company	CMP	Net Sales		OPM (%)		Net Profit		FDEPS (Rs)		FDEPS (Rs)			P/E (x)		Target	Reco
	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
GAIL	359	6,589	*7.5*	19.6	*(375)*	755	*(26.3)*	5.9	*(26.3)*	25.3	27.4	*8.6*	14.2	13.1	325	**Reduce**
GSPL	84	224	*88.8*	94.0	*763*	86	*203.3*	1.5	*203.2*	4.3	4.8	*11.1*	19.4	17.5	75	**Reduce**
Gujarat Gas *	209	341	*5.1*	20.3	*204*	43	*9.7*	3.4	*9.7*	12.4	15.5	*24.7*	16.8	13.5	170	**Reduce**
IGL	163	264	*22.8*	41.5	*154*	59	*16.7*	4.2	*16.4*	15.9	17.1	*7.3*	10.2	9.5	-	**Neutral**
Petronet LNG	79	285	*72.4*	10.4	*(65)*	162	*56.7*	2.2	*56.7*	7.5	8.0	*5.9*	10.5	9.9	70	**Reduce**
ONGC ^	1,171	13,336	*(23.8)*	61.8	*1,322*	4,267	*(11.3)*	20.0	*(11.3)*	99	105	*5.6*	11.8	11.2	-	**Neutral**
RIL ^	2,201	50,353	*12.4*	14.7	*24*	4,178	*1.4*	25.4	*1.4*	117	163	*39.1*	18.8	13.5	2,340	**Buy**

*Source: Company, Angel Research, Price as on Sept. 30, 2009 ; Note - * - Calender year, ^ - Standalone numbers for quarter and consolidated numbers for full year; RIL's EPS does not include gain from Treasury stock sale.*

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

Pharmaceutical

Pharma Summit 2009 - Key Takeaways

The Pharma Summit 2009 focused on identifying, understanding and overcoming the key execution challenges being faced by the Indian Pharma companies as well as realising the untapped potential of the various business segments in the Pharma Sector. The forum was also used to discuss the various strategies that the Indian Pharmacos could adopt to tackle and overcome the challenges.

The Indian Pharmaceutical Sector has demonstrated the potential to emerge as one of the world's leading and fastest growing pharmaceutical markets and formed an integral part of the drug development, manufacturing and supply chain. India has proved its credentials by not only making a mark of being a supplier of high-quality low -cost generic drugs, but also consistently moving up the value chain to successfully foray into more challenging segments such as drug discovery and development and biopharmaceutical. In fact, India has already emerged as the preferred hub in the global pharmaceutical market.

Global generics are expected to post a CAGR of 10.5% over CY2007-12E. Generic sales, particularly to foreign markets, are expected to remain the largest business segment for the Indian pharmacos. However, the Indian players are facing challenges in terms of managing multiple regulatory systems, patent exclusivities, extensions and expiries, and this complexity increases with the number of foreign markets served. Thus, to succeed in the global generic markets would require building strong competencies across the value chain and developing robust relationship with trade associations.

The **Domestic Formulations** industry registered a CAGR of 14% during FY2003-08 from around US $3.9bn in FY2003 to US $7.7bn in FY2008 outpacing the Global Pharma Industry growth rate of 7%. Going ahead, the Domestic Formulations market is expected to report robust CAGR of 12.2% to US $13.7bn over FY2008-13E. By CY2015, India is expected to rank among the Top-10 global Pharmaceutical markets. In this space, the Indian companies face challenges by way of having a complex distribution model and diverse market. Hence, to have a profitable business model across a diversified domestic market, companies need to ensure optimal reach.

In the **CRAMS Segment**, managing quality and delivery timeliness are the key challenge faced by Indian companies. It is important for the Indian companies to focus on developing sustainable relationships with clients.

From the **Contract Research** perspective, though the Indian CROs are working on building scale, they appear to be in a dilemma regarding their expansion plans. The Summit identified that the Indian CROs need to develop a global footprint and broader range of service offerings, which can offer tremendous advantages to them.

On the **New Chemical Entity** (NCE) front, the Indian companies lack experience in developing their own molecules, especially the experience to take molecules through the advanced stages of development. The Collaborative Research model could mitigate the risks of failure, especially as the discovery program moves up the value chain.

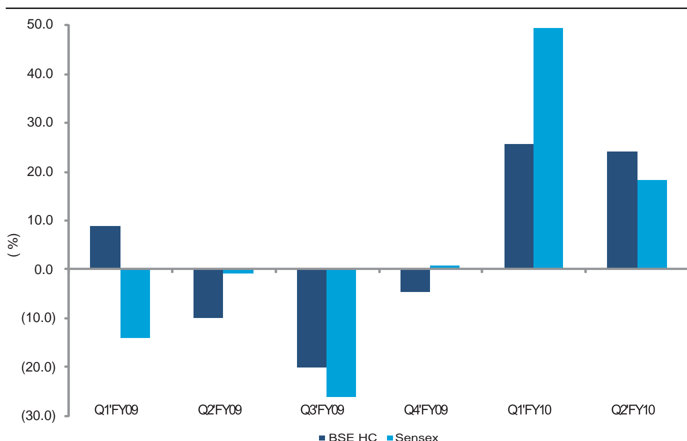
Biotechnology is a relatively new industry with a large number of start-ups. Given the high regulatory standards and overall market dynamics, penetration into highly regulated markets is challenging. Against this backdrop, it is important for the government, educational institutions and financial investors to collaborate closely with the industry players to address the afore-mentioned challenges and build a strong industry base

Overall, we expect US to remain the largest market for generics. Indian companies are looking at products with high technology barriers, which have limited competition to generate steady cash-flow. On the domestic front, we expect companies with higher proportion of Chronic and Lifestyle product sales, better supply chain management and higher Revenue per sales force to lead the pack. We continue to favour the CRAMS Segment. Currently, however, the Segment is witnessing near-term hiccups by way of inventory de-stocking at the Innovators' end, which is expected to last for few more quarters. Over the longer term, we expect this space to witness secular growth. CROs, with presence in multiple geographies and providing a full range of services, will be the key differentiators. We expect Out-licensing and Collaborative Research to be adopted by the Indian companies engaged in NCE Research given the substantial financial requirement and low success rate. In the Biopharma space, though EU, Japan and other developed markets have approved legislation for biosimilars, regulatory clarity in the US market would be a major catalyst for further investments in the Segment.

Pharmaceutical

BSE Healthcare Index outperforms the Sensex

Exhibit 1: BSE HC Index v/s Sensex



Source: C-Line, Angel Research

During 2QFY2010, the BSE Healthcare (BSE HC) Index surged 24.0% out performing the Sensex by 5.9%. The out performance of the Pharma sector comes after two consecutive quarter of under performance and was led by positive news flow across the sector.

From our coverage universe, among the large caps, Ranbaxy moved up a strong 64.5% during the quarter in anticipation of its Dewas facility getting the US FDA clearance, which would pave the way for launch of *Valtrex* during the exclusivity period (1QCY2010). Ranbaxy is also expected to announce its synergy plans with Daiichi by end of CY2009. GlaxoSmithKline Pharma added 30.4% during the quarter. DRL was up 27.0% driven by news that GSK Pharma is interested in taking minority stake in the company.

Among the mid caps, Cadila Healthcare gained 37.0% on the back of strong 1QFY2010 results and good show by its Contract Manufacturing Segment. Ipca Laboratories gained 53.5% during the quarter as the company reiterated its guidance of a Top-line growth of 18-20% and a steady OPM of 20-21% for FY2010. While Orchid Chemical spiked 88.6% on the back of approval of its much awaited product, Tazo+Pip, by the US FDA.

2QFY2010 Expectations

We expect our coverage universe to register flat yoy growth on the Top-line front mainly on account of Ranbaxy and Sun Pharma. Companies like Cipla would continue to benefit from Rupee depreciation. Cadila Healthcare would benefit from the strong show in the US and the Contract Manufacturing Segment, while Piramal Healthcare (PHL) is expected to post strong growth on the back of robust Domestic business. Operating Margins (OPM) are expected to expand for most of the companies under our coverage except in case of Ranbaxy and Sun Pharma, which are likely to witness major Margin contraction. However, Net Profit is expected to increase by 19.8% yoy primarily on account of the forex losses on foreign denominated debts reported in 2QFY2009. We expect 2QFY2010 to depict the true operating performance for most of the companies under our coverage as the Rupee has been flat on a qoq basis resulting in negligible MTM charges on foreign currency denominated working capital and debt.

Indian large cap, Cipla, to be an outperformer

Among our large cap coverage universe, during 2QFY2010E, we expect Cipla to post a Sales growth of 11.6% to Rs1,453.8cr driven by its Export business. We expect the company's Exports to grow 12.0% to Rs811.9cr while we expect Cipla's Domestic business to register 11.0% growth to Rs656.3cr. As a result, OPM is expected to expand by 148bp to 21.7%, while Net Profit would increase 69.6% to Rs257.0cr albeit on a low base. As per media reports, Cipla's Bangalore facility has received US FDA clearance.

For 2QFY2010E, we expect DRL to post 7.8% growth in Net Sales to Rs1,698.7cr on the back of growth in its US Formulation business. DRL expects to launch *Omeprazole* OTC with limited competition in 3QFY2010. During the quarter, the company launched *Starlix* with shared exclusivity. However, we believe that the company will continue to face competition in Germany. We expect Margins to expand by 256bp to 15.2%. Net Profit is expected to rise by 60.6% to Rs139.1cr driven by its US business.

We expect Ranbaxy to post a dismal 3QCY2009E performance. The company's Top-line is expected to de-grow by 12.6% with its US sales continuing to register subdued performance with the AIP getting invoked by the US FDA in February 2009. We expect Ranbaxy to report negative 2.5% Margin on account of high Operating leverage. We expect the company to post a Net Loss of Rs154.4cr.

Sun Pharma is expected to post a de-growth in Sales of 22.5% on account of high base effect. During 2QFY2009, the company enjoyed exclusivity sales pertaining to generic *Protonix*. As a result we expect OPM to contract by 21.67% to 24.0%. On the Bottom-line front, we expect the company to post a de-growth of 53.8% to Rs237.1cr

On the Mid-cap front, Cadila and PHL are expected to be outperformers

During 2QFY2010, we expect Lupin to post a robust 24.9% growth

Pharmaceutical

in Top-line to Rs939.9cr on the back of the strong growth registered in it's US and Domestic markets. On the Operating front, we expect OPMs to remain flat yoy, while Net Profit is expected to grow 10.3% to Rs145.5cr.

Cadila is also expected to post a strong 24.7% growth in Top-line on the back of strong Exports. Exports are expected to surge by 43.1% to Rs441.2cr driven by its US market and Contract Manufacturing Segment. We expect the company's OPM to remain flat yoy. Net Profit is expected to increase by a healthy 37.5% to Rs130.5cr driven by Top-line growth.

In case of PHL, we estimate the company to clock 10.7% yoy growth in Top-line to Rs978.6cr on the back of the continuous strong traction in its Domestic Formulation business and increasing contribution from the Inhalation Anaesthetic Segment post completion of the Minrad acquisition in March 2009. However, we expect PHL's CRAMS Segment to clock subdued growth for the quarter. We expect Margins to expand by 61bp to 20.7% on the back of the restructuring exercise undertaken in the CRAMS Segment. We expect Net Profit to register a significant 58.8% growth to Rs117.2cr albeit on a low base.

We estimate Ipca Laboratories to grow its Top-line by 14.4% to Rs397.8cr during 2QFY2010E. Exports are expected to increase by 13.0% on the back on higher penetration in the US and Semi-Regulated markets. We expect the company's Domestic Formulation business to grow at a notch higher than overall Industry growth. However, OPMs are expected to decline on account of lower Gross Margins. However, Net Profit is expected to increase by 40.0% to Rs51.1cr albeit on a low base.

Outlook and Valuation

During the quarter, the BSE HC Index rallied 24.0%. Going ahead, we recommend a bottom-up approach. **In Generics, we prefer companies with a strong, niche and visible product pipeline. In this space, we recommend Lupin and Cadila Healthcare.** We continue to favour CRAMS, though the Segment is witnessing near-term hiccups in terms of inventory de-stocking at the Innovators' end, which is expected to last for a couple of more quarters. However, we expect that this space to record secular growth over the longer term, which provides the players with immense opportunity on account of the challenges being faced by the Innovators and the cost reduction benefits provided by the Indian players. **In the CRAMS Segment, we recommend PHL, which provides investors exposure to the strategic CRAMS as well as the robust Domestic Formulations Segment. On the Small caps front, we recommend Ipca Laboratories given the steady nature of its business.**

Exhibit 2: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		FDEPS (Rs)		FDEPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
Alembic	52	313.4	*(9.1)*	12.0	*(518)*	17.8	*18.5*	1.3	*18.5*	4.5	5.9	*29.7*	11.5	8.9	47	Reduce
Aventis #	1,540	252.5	*1.8*	20.5	*118*	46.4	*5.4*	20.5	*5.4*	74.2	85.2	*14.9*	20.8	18.1	1,363	Reduce
Cadila Healthcare	519	920.1	*24.7*	20.8	*55*	130.5	*37.5*	10.4	*37.5*	32.5	36.1	*10.9*	16.0	14.4	541	Accumulate
Cipla	280	1,453.8	*11.6*	21.7	*148*	257.0	*69.6*	3.3	*69.6*	13.6	14.9	*9.8*	20.6	18.8	-	Neutral
Dr. Reddys	988	1,698.7	*7.8*	15.2	*256*	139.1	*60.6*	8.3	*60.6*	41.0	53.8	*31.2*	24.1	18.4	-	Neutral
Glaxo #	1,557	492.7	*7.6*	36.5	*(55)*	136.4	*3.4*	16.1	*3.4*	62.0	69.3	*11.8*	25.1	22.5	1,386	Reduce
Indoco Remedies	238	86.2	*9.7*	12.8	*539*	9.3	*328.7*	7.9	*328.7*	40.2	44.9	*11.7*	5.9	5.3	269	Accumulate
Ipca Laboratories	800	397.8	*14.4*	20.5	*(346)*	51.1	*40.0*	20.4	*40.0*	68.5	85.5	*24.8*	11.7	9.4	855	Accumulate
Lupin	1,137	939.9	*24.9*	21.5	*71*	145.5	*10.3*	17.5	*9.1*	76.5	86.0	*12.4*	14.9	13.2	1,290	Accumulate
Orchid Chemicals*	181	306.3	*(9.7)*	23.0	*(384)*	(22.0)	-	-	-	9.9	21.8	*120.7*	18.3	8.3	-	Neutral
Piramal Healthcare	383	978.6	*10.7*	20.7	*61*	117.2	*58.8*	5.6	*58.8*	22.5	26.5	*17.8*	17.0	14.5	397	Accumulate
Ranbaxy Lab #	403	1,645.4	*(12.6)*	(2.5)	*(1,168)*	(154.4)	-	-	-	-	4.1	-	-	98.6	251	Sell
Sun Pharma	1,399	913.0	*(22.5)*	24.0	*(2,167)*	237.1	*(53.8)*	11.4	*(53.8)*	62.2	73.8	*18.6*	22.5	19.0	1,181	Sell

Source: Company, Angel Research; Price as on Sept. 30, 2009; Note: Our numbers include MTM on Foreign Debt. # Q3'CY09 , The quaterly numbers are Standalone Financials*

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

Power

The Indian economy showed further signs of revival during the quarter, with various macro-economic data suggesting that the country is back on the growth path. The much awaited economic recovery augurs well for the power sector, which remained one of the least affected sectors, even during the worst phase of the slowdown. We believe that the increasing liquidity situation will result in a quicker financial closure of power projects, and in a smooth flow of funds into new projects. During the quarter, the Government of India reiterated its commitment towards developing the country's power sector, which it believes will drive India's economic growth in the future.

The Union Budget also had a few announcements favouring the Power Sector. Two such measures were the 160% and the 27% increases in the outlay for the Accelerated Power Development Reforms Programme (APDRP) and the Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), respectively, which are expected to be positive for the players in the power transmission EPC space. Another positive was the increase in the total outlay of financing by India Infrastructure Finance Company Limited (IIFCL) and commercial banks to Rs1,00,000cr for Public-Private Partnerships (PPPs).

This quarter witnessed two big-ticket Initial Public Offers (IPOs) from the power sector, from Adani Power and from NHPC. These two IPOs, which were over-subscribed multiple times, raised in excess of Rs9,000cr in the primary market, after their listing.

New Open Access Regulations to favour private power developers

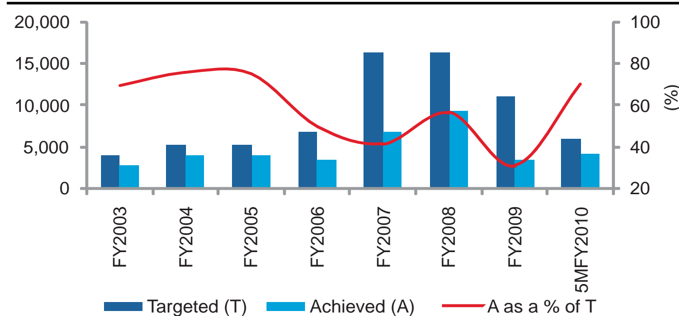
During the quarter, the CERC notified the long-awaited 'medium-term open access regulations and norms', to ensure grid connectivity for private power developers. The new guidelines were introduced to provide transmission corridors for transactions that fall in the category of three months to 25 years. As per the earlier regulations, the power generating companies had the option of booking power transmission corridors for up to three months (short-term open access), or for more than three years (long-term open access). The new regulations will ensure that all the grid-connected generators seek medium-term transmission usage for a period between three months to three years.

The new regulations also identify the Central Transmission Utility (CTU), the Power Grid Corporation of India Ltd (PGCIL), as the nodal agency for providing transmission linkages for the open access for transferring power through the grid. Traditionally, the setting-up of a power-generating station requires a finalised Power Purchase Agreement (PPA) right from the beginning. As per the new norms, however, power plants will get transmission facilities just by indicating the region in which the power is to be supplied, in case the beneficiaries are not clearly identified.

Capacity addition: a status check

The Ministry of Power has recently admitted that the Eleventh Plan generation capacity addition target of 78,700MW would not be met, and, at most, an addition of 62,000MW is feasible during this period. A total of 16,900MW of capacity has been added since the beginning of the Eleventh plan, till date, while the capacity addition during 5MFY2010 is at 4,183MW, as against the planned 5,953MW. The total installed Power Generation capacity in India stood at 152,148MW, as of August 31, 2009.

Exhibit 1: Generation Capacity Additions (MW): Targeted v/s Achieved



Source: CEA, Angel Research

The capacity addition of Transmission lines (500KV HVDC lines) also lagged during 5MFY2010, with the actual capacity added at 129 circuit km (ckm), as against the targeted 230ckm. The total addition to other categories of Transmission lines was 4,545ckm, as against the targeted 5,743ckm. During 5MFY2010, 5,065MW of sub-station capacity of 220kv was added, as against the targeted 4,655MW. The Total addition to 400KV sub-station capacity stood at 2,835MW, as against a target of 3,465MW.

Operational Highlights

India's total power generation rose 6.4% during 5MFY2010 to 319.3BU (300.0BU), primarily owing to a 10.6% yoy increase in Thermal power generation to 259.7BU (234.7BU). However, the Hydro power generation declined by 10.7% to 49.4BU (55.3BU), due to lesser water inflows on account of the poor rainfall. The plant load factor (PLF) for 5MFY2010 stood at 76.7%, which was in line with the target.

Power

Exhibit 2: Energy Generation (Bn Units)

	Aug-09	Aug-08	*chg (%)*	5MFY10	5MFY09	*chg (%)*
Thermal	50.6	43.7	15.8	259.7	234.7	10.6
Hydro	12.4	13.9	(10.8)	49.4	55.3	(10.7)
Nuclear	1.6	1.2	33.3	7.2	6.5	10.3
Total	**64.6**	**58.8**	**9.9**	**319.3**	**300.0**	**6.4**

Source: CEA, Angel Research

Coal Stock Position

As of August 31, 2009, 41 coal-based stations, out of the 78 monitored by the Central Electricity Authority (CEA), had coal stocks for more than 7 days, as against 47 at the end of May 2009.

Key Developments

NTPC

There were fresh developments in the row between NTPC and RIL over the supply of KG-basin gas for the Kawas and Gandhar expansion projects. NTPC filed a case in the Supreme Court of India against RIL not supplying 12mmscmd at the international competitive bid price of US $2.34/mmbtu. In a recent development, the company has decided to finally sign an agreement with RIL to buy 2.67 mmscmd of government-allotted natural gas at the officially approved price of $4.20/mmbtu.

NTPC has signed a Memorandum of Understanding (MOU) with the Government of Chhattisgarh for establishing a 4,000MW coal-based thermal power project, having 5 units of 800MW, all of which are at Lara in Raigarh District of Chattisgarh (subject to the establishment of techno-commercial feasibility).

During the quarter, the JV between NTPC, NHPC, Power Finance Corporation and TCS was granted in-principal approval to set up and operate a power exchange, named NPEX. Given the significant power shortages in India, there is significant scope for the growth of power exchanges, which can efficiently allocate power and supply from power-surplus areas to power-deficit ones.

CESC

During the quarter, CESC acquired a controlling stake in Dhariwal Infrastructure Private Limited (DIPL) for Rs200cr, with an option to increase this stake in the future. DIPL is currently engaged in setting up a 600MW thermal power generating station at Chandrapur in Maharashtra. The 2*300MW project has obtained a coal linkage from the South Eastern Coal Fields, and the water supply agreement has also been executed for the entire requirement. The Environment clearance for the project is at an advanced stage, and financial closure is expected to be achieved by December 2009. The project is expected to be commissioned in about 33 months, after financial closure is achieved. Fifty-percent of the power generated from the DIPL project will be sold to the Maharashtra State Electricity Board, while the rest will be sold in the open market. We believe that this acquisition is good for the long-term growth of the company, which is planning to add 4,150MW (excluding the 600MW DIPL project) by FY2013E. The company has built up a Rs1,000cr corpus to fund similar acquisitions in the future, in Maharashtra and in other locations outside West Bengal. We have still not factored the DIPL project in our model, as we do not have full details about this acquisition.

Spencer's Retail (Spencer's), the retail arm of CESC, is planning to invest Rs100cr in expansions in FY2010E, and to introduce some international apparel brands in the country. The company is also looking at expanding the US-based, Beverly Hills Polo Club (BHPC) brand, with which Spencer's had tied-up last year. Spencer's has also entered into an agreement with the French bakery chain, Au Bon Pan, and is planning to open the first India outlet at Bangalore in October 2009.

GIPCL

The company has commenced operations of the first phase of the new 125*2MW Surat Power Plant, during the quarter. The new plant is expected to be fully stabililised by the beginning of 3QFY2009, and is expected to contribute substantially to the company's Top-line, going ahead.

PTC

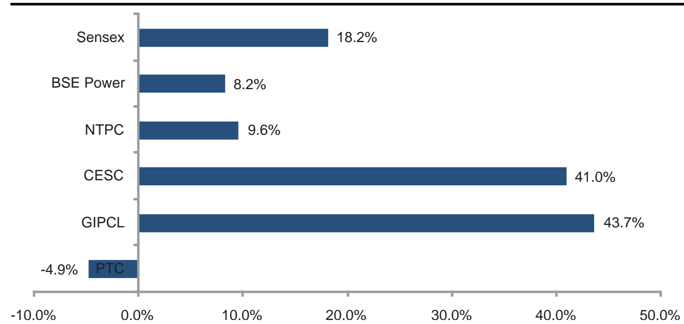
During the quarter, PTC indicated its plans to unlock the value of its investments in PTC Financial Services over the next one year, through an IPO or through private placement.

Performance of Power stocks during 2QFY2010

Out of all the power stocks under our coverage, GIPCL was the top performer during the quarter, with 43.7% gains. CESC rose by 41.0%, while NTPC gained 9.6%, as against the 18.2% gains made by the Sensex during the quarter. The BSE Power index also underperformed with respect to the Sensex, with quarterly gains of 8.2%. PTC was the lone loser in the power pack, with a negative return of 4.9% during the quarter.

Power

Exhibit 3: Performance on the Bourses



Source: BSE, Angel Research

Expected Financial Performance in 2QFY2010

The power generation companies under our coverage, NTPC, GIPCL and CESC, are expected to report a strong Top-line growth for 2QFY2010, to the tune of 21.6% yoy. Their net profit is expected to grow by 12.8% in the same period.

We expect NTPC's Sales to grow by 23.9% yoy to Rs11,966.5cr, due to a mix of capacity additions during the year, and a higher PLF of its gas plants, due to the easy availability of gas. The Company's generation during the quarter is expected to be 15% higher yoy. Its EBITDA is likely to grow by 37.7% yoy to Rs3,508.6cr, which is slightly higher than the sales growth, due to lower O&M expenses. We estimate NTPC to post a 13.9% growth in Net Profit to Rs2,404.3cr.

We expect GIPCL to register an 18% yoy decline in Sales in 2QFY2010, owing to a substantial decline in the fuel price, which is a pass-on. We expect the company to sell 1073 Million Units (MU) of power during the quarter. The realisation per unit is expected to remain flat at Rs2.2 per unit. The company's OPMs are expected to expand by 443bps to 23.5%. We expect the company's Bottom-line to grow by 6.3% yoy to Rs26.7cr.

We expect CESC to register an 8.6% yoy growth in its standalone Top-line to Rs829.5cr. The increase in the Top-line is expected to be on account of the higher tariff of Rs3.91/unit charged by the company in 2QFY2010 (Rs3.86/unit in 2QFY2009). The company did not add any capacity during FY2009 and in 2HFY2010. However, the company's OPMs are expected to contract by 51bps to 25.1%. We also expect CESC to witness a 4.8% yoy de-growth in its Bottom-line to Rs118cr.

We expect PTC to record a 76.2% yoy growth in its standalone Top-line to Rs3,579.8cr. We expect the company to trade 6,965MU of power during the quarter, resulting in a 35% increase yoy. The increase in volumes is on account of the commissioning of the 450MW Baglihar Hydro power Plant. We have assumed an average realisation of Rs5.14/unit. We expect PTC to post a 10.2% growth in Net Profit to Rs36.1cr.

Industry Outlook

The all-India requirement for power was 72,759MU, as against an availability of 64,991MU, which resulted in a shortage of 7,768MU, or a deficit of 10.7%, in August 2009.To meet this requirement, India needs to add massive capacities in the near term. The extension of the terminal date for tax benefits u/s 80 IB (4)(iv) of the IT Act for a further period of one year (up to March 31, 2011) for undertakings set up for power-generation units, transmission and distribution lines, or the renovation and modernisation of existing T&D lines, will help speed up capacity addition. We expect further improvements in the PLF of gas/liquid-based power stations, considering the likely increase in the natural gas from the Krishna Godavari D6 basin to power plants. Moreover, with global coal prices having come down significantly from a peak of US $180 per tonne in July 2008 to US $72 per tonne in Sep 2009, we expect thermal power generation to grow at a faster pace.

With progressive reforms happening in the power sector and an assured revenue stream on the back of PPAs, industry players with strong execution abilities are set to see strong growth in the long term. Hence, the outlook remains positive for the industry.

Exhibit 4: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	% chg	2QFY10E	chg bp	2QFY10E	% chg	2QFY10E	% chg	FY10E	FY11E	%chg	FY10E	FY11E	Price (Rs)	
CESC	389	830	8.6	25.1	(51)	118.0	(4.8)	9.4	(4.8)	33.7	36.0	6.9	11.6	10.8	449	**Buy**
GIPCL	114	238	(18.0)	23.5	443	26.7	6.3	1.8	6.3	8.4	10.3	21.4	13.5	11.1	-	**Neutral**
NTPC*	214	11,967	23.9	29.3	295	2404.3	13.9	2.9	13.9	10.8	11.8	9.3	19.8	18.1	-	**Neutral**
PTC	88	3,580	76.2	0.5	(15)	36.1	10.2	1.2	10.2	3.3	4.0	21.1	26.7	22.0	-	**Neutral**

*Source: Company; Angel Research; Note: Price as on Sept. 30, 2009; * Consolidated*

***Analyst* - Rupesh Sankhe / V. Srinivasan**

Retail

Indian Organised Retail - On the verge of a breakout

2QFY2010E was quite eventful as several players in the industry took strategic measures for better cost management, including the re-negotiation of rentals, store rationalisation and manpower resizing, to combat the slowdown and to stay afloat. Moreover, the organised segment exhibited signs of revival, as an increase in footfalls has been witnessed during 2QFY2010, which, in turn, will benefit the Same Store Sales (SSS) growth of key retailers. With an improvement in footfalls, coupled with the cost-rationalisation measures that have been undertaken, we expect the retail players to foresee better times in the future.

The Indian organised retail sector witnessed tough times in FY2009, due to the overall economic slowdown and weak consumer demand. Huge sales promotion and discount schemes were offered during the major part of the year to clear piled-up inventories. However, with economic growth indicators giving positive signals and with business confidence picking up, revival signals are visible in the Organised Retail Segment. The Organised Retail Segment witnessed a CAGR of 28% during FY2005-08 and, going ahead, we estimate it to post a CAGR of 30% over CY2008-13E.

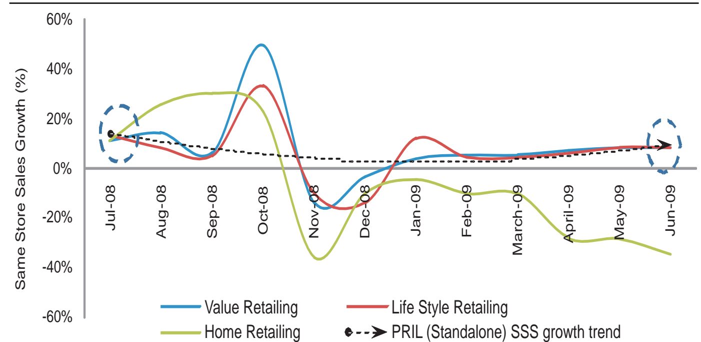
We believe that the Organised Retail Sector is currently at an inflexion point, and is ready to take the next leap of growth at a steady and stable pace. We maintain that the segment has a tremendous growth potential, and accordingly we expect it to capture a 10% share of the overall Retail Sector, albeit with a lag of five to seven quarters.

Value Retailing on a roll; Lifestyle Retailing catching up

On the back of the economic meltdown and the subdued consumer confidence, a paradigm shift was witnessed towards value retailing, during the past few quarters. We expect the Value Retailing Segment to continue to lead the revival being witnessed in the Indian Retail Sector. However, encouraging signals are also visible on the Lifestyle Retailing front, as stable economic conditions and a pick-up in consumer confidence has resulted in consumers opening up their wallets for purchasing lifestyle goods. The recovery in Lifestyle retailing is likely to gather further momentum, with the festive season kicking in from 3QFY2010E

Globally, the SSS growth trend has been favouring Value Retailers, and a similar trend has also been witnessed in India. During the past few months, the Value Retailing Segment registered positive growth, and the Lifestyle Retailing Segment also picked up earlier-than-expected, on the back of the high rate of economic revival in India. For instance, the market leader, Pantaloon Retail (PRIL), recorded positive SSS for six consecutive months since January 2009, with SSS growth of 8.1%yoy in June 2009. PRIL's Lifestyle Retailing Segment also picked up and registered SSS growth of 8.2% yoy in June 2009. The trend in SSS growth for the sector is likely to be strengthened in 2QFY2010, as PRIL witnessed a double digit SSS growth in 4QFY2009.

Exhibit 1: PRIL- SSS Growth Trend



Source: Company, Angel Research

Overall, we expect the Value Retailing Segment in India to post around a 30% growth in FY2010E, and to drive Retail Sector growth over the next few years. Hence, the major players in the Value Retailing Segment, including PRIL, Reliance Retail, Spencer's and More, stand to benefit from this ongoing trend.

Ban on FDI in multi-brand retail likely to persist

The proposed changes in the FDI policy that the Cabinet Committee on Economic Affairs (CCEA) cleared in February 2009 offered some glimmers of hope of allowing FDI in multi-brand retailing in India. However, the hope seems to be short-lived, as a recent parliamentary standing committee report strongly opposed FDI in retail, citing its ill effects on domestic businesses. Presently, 51% FDI is allowed in single-brand stores in India, and 100% in the wholesale cash-and-carry model. However, FDI has been completely kept out of multi-brand retail, owing to political opposition and opposition from mom-and-pop store operators. The retail industry, however, has been demanding the allowing of FDI into the multi-brand segment. Yet, the government maintains that big multinationals, if allowed into the multi-brand segment, may pose a substantial threat to domestic retailers, a factor that the government is not willing to concede. Yet, the Economic Survey

Retail

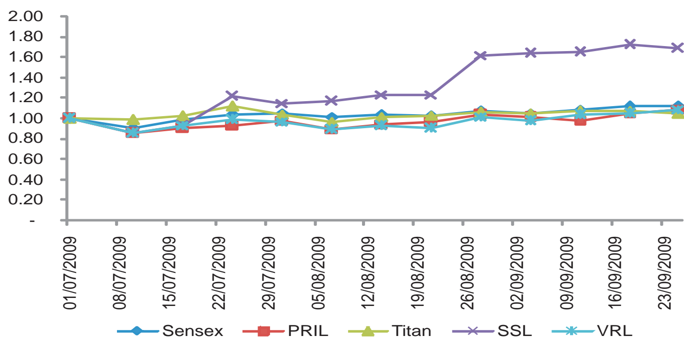
that the government presented before the Union Budget had great support to allow for a more liberal FDI regime in sectors like retail. International retailers are cautious on the Indian Retail Sector because of the ambiguous and stringent FDI norms in India.

We concur with industry experts that enabling FDI would be good for the Sector, as it will result in increased employment and a higher level of consumerism, on account of a substantial range of competitively-priced products. The government also stands to benefit from this, as the exchequer would receive increased collections, since the large organised trade players are tax-compliant, contribute robust tax revenues and are unable to avail of exemption limits. On the supply-chain front, we believe that wastage in farm-to-fork will reduce, with the transfer of technology of the best practices followed by the global players.

Retail stocks underperform the Sensex in 2QFY2010

The Retail Sector stocks, excluding Shoppers Stop, underperformed the Sensex in 2QFY2010. PRIL, Titan and Vishal Retail underperformed the benchmark BSE Sensex by 3%, 6%and 3%, respectively, while Shoppers Stop (SSL) emerged as a clear winner, outperforming the Sensex by a whopping 73%.

Exhibit 2: Retail Stocks vis-à-vis the Sensex



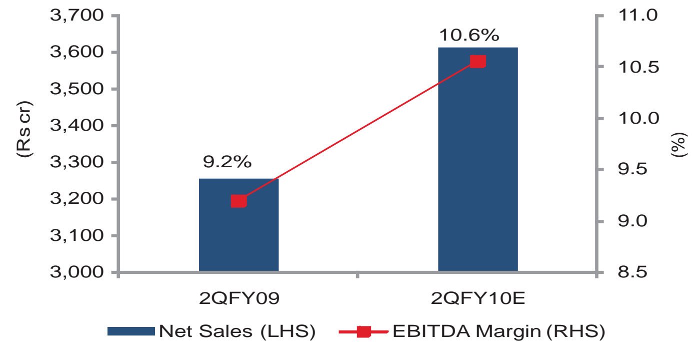
Source: Company, Angel Research

2QFY2010 Preview

Factors like cost-rationalisation measures undertaken during the quarter, coupled with increased footfalls leading to higher consumer spending, are likely to benefit retail players in 2QFY2009. We expect consumer spending to improve as the economy gains traction. We expect the Retail stocks under our coverage to report a Top-line growth of 10.9% yoy. We estimate PRIL to lead our universe, with a 13.8% yoy growth in its Top-line.

We expect the OPM of our Retail Universe to increase by 140bp to 10.6% in 2QFY2010E, from 9.2% in 2QFY2009, on the back of the hard-line cost-cutting measures implemented by the Retailers. We estimate the Net Profit Margin of our universe to increase by 84bp to 3.5% in 2QFY2010 from 2.6% in 2QFY2009.

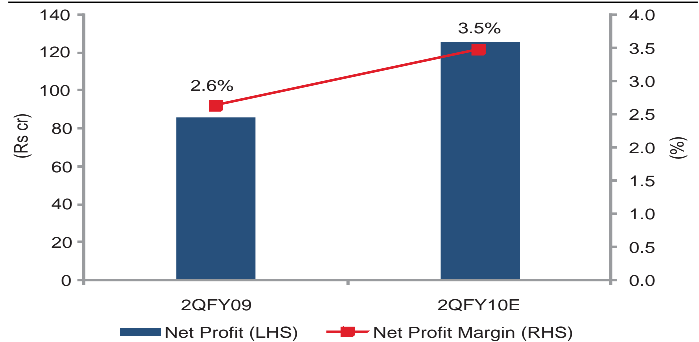
Exhibit 3: Retail Universe Sales and EBITDA margin estimates



Source: Company, Angel Research

Additionally, we expect PRIL to sustain its Net Profit Margin, while Titan is expected to witness a dip in its Net Profit Margin in 2QFY2010. Additionally, we estimate VRL's and Shoppers Stop's margins to improve during the quarter, thereby enabling the companies to post a marginal profit.

Exhibit 4: Retail Universe Net Profit estimates



Source: Company, Angel Research

Outlook and Valuation

The growth of the retail sector is positively co-related with the state of the economy. With the economic recovery gathering steam during the quarter under review, footfalls have started showing an upward trend, resulting in an increment in the SSS and the Sales Per Square Feet (SPSF) of the Retailers. We expect the trend to continue and to strengthen going ahead, thereby keeping the long-term growth prospects intact for the Organised Retail Segment

Retail

in India. We believe that Organised Retail will post a CAGR of 30% over the next five years, and will capture a 11.7% share of the total Indian retail market.

The Indian Retail Sector remains one of the fastest growing sectors in India, even amidst the economic slowdown, and we remain positive on its growth prospects. We expect the footfalls to continue improving in the coming quarters, thereby benefitting the retail players through increased consumer spending. The Value Retailing segment is likely to lead the growth over the next few years, as more and more consumers are expected to go for value-for-money goods. However, we expect the Lifestyle Retailing segment growth to pick-up on the back of stable economic conditions. We expect players like PRIL, who are straddled across price and product points, to benefit both in the short and in the long term.

PRIL continues to be our preferred pick in the Sector

We believe that PRIL is in a better position than its peers, on account of its presence across price points and categories, which make it a unique value proposition for Indian consumers. Moreover, the company has also taken cost-cutting measures and has re-negotiated its rent agreements. At Rs 339, the stock is trading at 21.7x its FY2011E Earnings and at 2.4x FY2011E P/BV. Our sum-of-the-parts Target for PRIL (Standalone) is Rs256, wherein we have valued its stake in FCH, HSRIL and Future Bazaar at Rs31, Rs12 and Rs18, respectively. **Although PRIL continues to be our Top Pick in the Retail Sector, we remain Neutral on the stock, on account of the recent run-up in the stock price.**

Titan has a stable and niche business model; however, the recent run-up in gold prices can negatively impact its earnings, due to a consequently lower demand. Although the company's watch segment is performing well, the jewellery segment of Titan is the major revenue and profit contributor. At Rs 1249, the stock is trading at 24.5x its FY2011E Earnings and at 6.4x FY2011E P/BV. **We remain Neutral on the stock, due to its rich valuations.**

We maintain our Neutral view on Vishal Retail, on account of the increased leverage on its Balance Sheet, resulting in increasing interest costs, thereby forcing the company to undertake several cost-cutting measures; this, in our view, can have a temporary positive impact. At Rs 71, the stock is trading at 5.2x its FY2011E Earnings and at 0.6x FY2011E P/BV.

We expect Shoppers Stop's performance to improve in the coming quarters, on the back of a pick-up in consumer demand for lifestyle retailing. At Rs 274, the stock is trading at 3.7x its FY2011E P/BV and at 0.7x FY2011E EV/Sales. Considering the recent run-up in the price, **we maintain our Neutral view on the stock.**

Exhibit 5: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*%chg*	FY10E	FY11E	Price (Rs)	
Pantaloon*	339	1,720	*14.0*	11.0	*75.0*	40.4	*11.7*	2.1	*(6.5)*	11.6	15.6	*34.8*	29.3	21.7	-	**Neutral**
Titan	1,249	923	*13.8*	7.6	*57.7*	37.1	*0.2*	8.4	*15.1*	42.4	51.0	*20.1*	29.5	24.5	-	**Neutral**
Vishal	71	324	*6.0*	12.0	-	3.5	-	1.5	-	9.2	13.5	*46.7*	7.7	5.2	-	**Neutral**
Shoppers Stop	274	382	9.3	4.9	*511.0*	3.8	-	1.0	-	4.6	8.0	*73.9*	59.5	34.2	-	**Neutral**

*Source: Company; Angel Research; Note: Price as on Sept 30, 2009; * Year Ended June; Estimates are 1QFY2010 for PRIL*

***Analyst* - Viraj Nadkarni**

Software

BSE IT Index - Expectations of a quick economic recovery and improved deal flows power gains

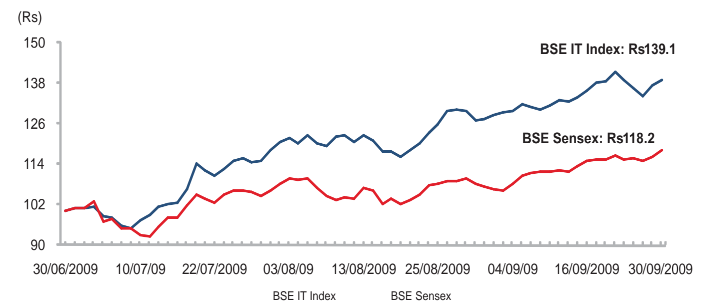
The just-concluded quarter saw the Indian equity markets post handsome gains even on a higher base, given that they had recorded superlative gains in 1QFY2010 as well, on the back of the handsome victory of the Congress-led UPA coalition and strong funds flows, allied with expectations of a faster-than-estimated economic recovery. The benchmark BSE Sensex gained an impressive 18% over the quarter, on the back of the strong 49% gains recorded in the previous quarter, as improved economic sentiment across the globe fired an increase in risk appetites and fund flows. As a matter of fact, FIIs pumped in significant sums of money into Indian equities over the quarter, investing an incredible sum of over US $7bn, the prime driver of the strong performance of Indian stocks.

Hence, these were the key factors driving the Sensex performance over 2QFY2010. The BSE IT Index, in line with the improved sentiment, had its fair share of buyers over the quarter, and gained an outstanding 39%, handsomely out-performing the benchmark index. In fact, this performance is even more impressive when we consider the fact that, in 1QFY2010, the IT Index gained an outstanding 44%. Thus, even on a high base, the index has performed admirably, netting superlative returns for investors over the past couple of quarters. With the global economy starting to see signs of a revival, after the recession stoked by the US sub-prime crisis last year, sentiment continues to improve for IT stocks, which are primarily dependent on export markets, particularly those in the US and in Europe, for growth. This is the case even as they have increased their focus on the fast-growing Indian IT market, which is expected to grow at a healthy rate, led by strong GDP growth over the next several years.

The quarter was characterised by a renewed strength in the deal flow for software majors. Vendor consolidation exercises have seen top-tier Indian IT companies like TCS, Infosys and Wipro all come out on top as the preferred vendors, leading to them not only retaining the customer, but also giving them the scope to increase their respective engagement sizes through a wider breadth of services offered. Two such examples include Telstra, where Infosys was retained in a vendor consolidation exercise that saw the Australian telco cut its vendors from four to two, and the energy major British Petroleum (BP), which, in a major exercise, cut its vendors from as many as 40 to just 5, with TCS, Infosys and Wipro all being retained, apart from IBM and Accenture, in a five-year deal worth US $2bn. The BP deal, we believe, is a major positive signal, and we expect more such vendor consolidation moves to happen, going forward, which are likely to throw up opportunities for those Indian IT vendors that have provided the best-in-class service. Another positive factor for the sector was the extension of the Software Technology Parks of India (STPI) scheme by one year, to March 31, 2011, announced in the Union Budget 2009-10.

With the global economy showing signs of a rebound, we expect Indian IT majors to benefit, given the sector's export-oriented nature. Deal flows have increased noticeably in recent times, with TCS, Infosys and Wipro all announcing strong wins of late, and with sectors like BFSI and Retail clearly showing signs of stabilising. Another positive indicator of the improving economic environment and the improving deal pipelines is the fact that companies like Infosys and Wipro are giving out pay hikes and promotions to their employees. Infosys, which had not raised salaries in April, is now going to do so in October, a clear testimony to the improved business prospects, while Wipro has also given out hikes, albeit more selectively, to top performers in the organisation. All these are positive indications of a better business environment, and we expect this to continue going forward, with top-line and bottom-line upgrades likely, particularly for FY2011.

Exhibit 1: BSE IT Index - Surging on improved sentiment



Source: C-line, Angel Research

Currency movements - Likely to act as a slight tailwind; cross-currency movements also favourable

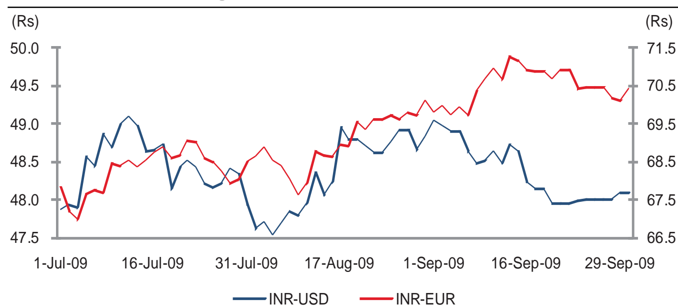
During the quarter, the Indian Rupee did not witness any dramatic movements against the US Dollar. Over the quarter, the Rupee saw a marginal appreciation against the US Dollar, of 0.6% qoq, based on the quarterly average rate. This appreciation, albeit marginal, is the second consecutive quarter of appreciation of the Rupee against the greenback, after five consecutive quarters of depreciation. On the other hand, the Rupee depreciated against other major currencies over the quarter, namely the Euro and British Pound. Against the Euro, the Rupee lost over 4% of its value, based on the quarterly average, while a depreciation of nearly 5% was witnessed against the British Pound. Thus, on an overall basis, the currency movements

Software

have been slightly favourable for Indian software companies, and could prove to be a tailwind.

This time around, cross-currency movements were in favour of software companies, the second consecutive quarter when this factor has proved to be a tailwind. The US Dollar depreciated against all major currencies, namely the Euro, British Pound and Australian Dollar. Thus, as was the case with the Indian Rupee, this is also the second consecutive quarter when cross-currency movements have been favourable, and comes after several quarters of consistent depreciation against the greenback. The Euro gained around close to 5%, the British Pound nearly 6%, and the Australian Dollar gained a significant 8.9% against the US Dollar. Hence, cross-currency movements are likely to play out in favour of software companies in this quarter, creating a decent tailwind for them. In fact, back-of-the-envelope calculations suggest that cross-currency tailwinds could add around 1-1.5% to the US Dollar revenues of top-tier IT companies this quarter.

Exhibit 2: Rupee against Dollar and Euro



Source: Bloomberg, Angel Research

2QFY2010 - Signs of economic recovery to start showing

We expect 2QFY2010 to see some recovery in core business volumes for top-tier software companies. Recent deal wins, favourable end-games in vendor consolidation exercises, and no further negative news flow and major events (such as the bankruptcy of a major client) are expected to enable IT companies to show resilience in their volume growth this quarter. The global economic environment has clearly witnessed a positive shift, with the gigantic stimulus packages doled out by major governments starting to have their desired effect. Nonetheless, we believe that the global economy is not yet totally out of the woods, and we would wait for a couple of quarters before passing a judgement on this. It is clear, however, that companies are starting to become more confident about their prospects and the order flow is starting to witness an improvement. We expect the situation to continue to gradually improve going forward, even as the possibility of a major negative event such as a bankruptcy cannot be ruled out.

For 2QFY2010, we expect the top-tier companies (excluding Satyam and including HCL Technologies) to report a 2-3% sequential increase in volumes, along with stable billing rates. Thus, the core business performance of these companies is expected to show an improvement over the previous few quarters, when sequential falls were seen. As regards FY2010 performance, we believe that there are chances of an upgrade, particularly in the event of 2HFY2010 performance being better-than-expected, even as we believe FY2011 will see a sustained recovery.

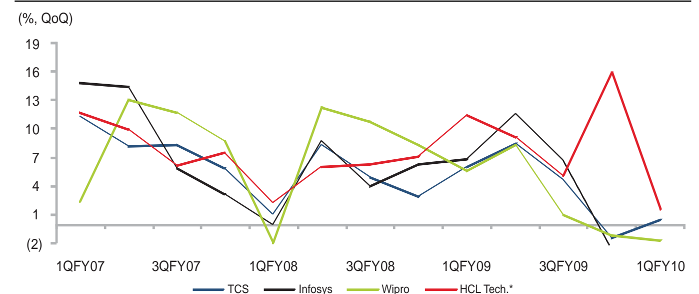
Overall, we expect the top-line to grow by 5.2% qoq (a growth of 8.8% yoy) for TCS, Infosys, Wipro and HCL Technologies, combined, this quarter. If we consider only IT Services for all the companies, the top-line over the quarter is estimated to grow by 3.7% qoq in Rupee terms (a growth of 7.8% yoy). It should be noted that in US Dollar terms, we expect de-growth of 1.7% yoy, with the growth in Rupee terms coming on account of a higher Rupee-Dollar rate (higher by nearly 10% yoy, at Rs48.38 v/s Rs44.16 in 2QFY2009), while, sequentially, Dollar revenues are estimated to grow by 3.1%. We expect favourable cross-currency movements to have a positive impact of 1-1.5% on sequential Dollar revenues, and in constant currency terms, expect revenues to grow by around 2% qoq.

Exhibit 3: Dollar v/s Rupee growth of top-tier IT companies*

Particulars	2QFY09	1QFY10	2QFY10E	*% chg qoq*	*% chg yoy*
Dollar revenues (mn)**	4,154	3,963	4,085	*3.1*	*(1.7)*
Rupee revenues (cr)**	18,341	19,066	19,765	*3.7*	*7.8*
Realised Rupee rate	44.16	48.11	48.38	*0.6*	*9.6*

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

Exhibit 4: Sales growth - Quarterly trends



*Source: Companies, Angel Research; * For HCL Technologies, since it has a June-ending fiscal year, 1QFY10=4QFY09 and so on*

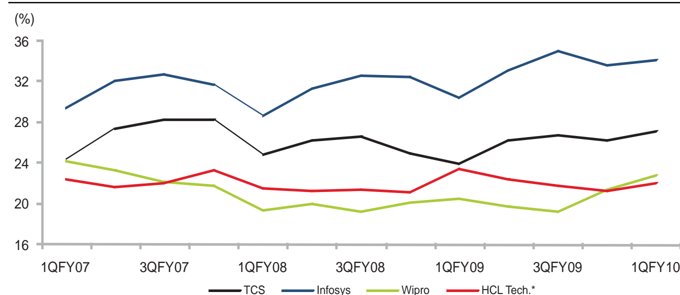
We expect pricing to stabilise, and have factored in a flattish performance on this front in 2QFY2010. With the global economy starting to witness a recovery and with companies starting to loosen their purse strings, pressure on pricing is expected to dissipate, and value creation and outcomes are expected to start to dictate pricing trends going forward.

Software

Margins to witness a downward trend

Software companies have, over the past few quarters, focused strongly on improving profitability amidst a difficult operating environment, to an admirable effect. For example, in 3QFY2009, Infosys recorded a multi-year high EBITDA Margin, crossing 35%; even in 1QFY2010, it crossed a 34% margin. These companies have utilised all major levers, such as higher utilisation rates, increasing the offshore proportion of revenues and raising the percentage of revenues earned from fixed price projects, apart from rationalising variable pay in line with their revenue growth. We believe that from current levels, the prospects of further Margin expansion are limited, and expect these to trend downwards. We expect Infosys to record a 96bp qoq decline in Margins, TCS a marginal 9bp qoq expansion, Wipro a 114bp qoq decline and HCL Technologies to record a flat margin profile this quarter.

Exhibit 5: EBITDA Margins - Quarterly trends

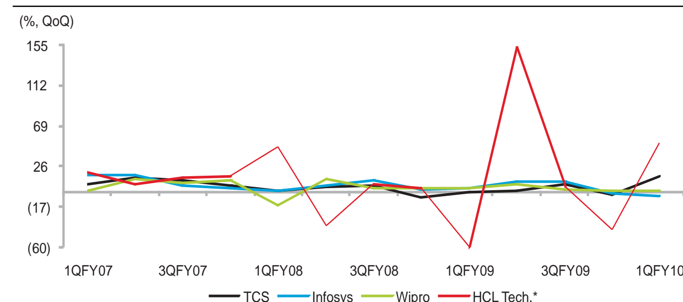


*Source: Companies, Angel Research; * For HCL Technologies, since it has a June-ending fiscal year, 1QFY10=4QFY09 and so on*

Net Profits to show decent growth

We expect the top-tier IT companies to post a decent 5% qoq growth in Net Profits for 2QFY2010 (14.5% yoy growth). This is expected to be led by the decent sales numbers posted by these companies. Among the companies, we expect Infosys to record a 3.1% qoq decrease in its Bottom-line, TCS a 4.9% qoq growth, Wipro an impressive 13.3% qoq growth and HCL Technologies to register a significant 17.7% qoq increase in its Bottom-line.

Exhibit 6: PAT growth - Quarterly trends



*Source: Companies, Angel Research; * For HCL Technologies, since it has a June-ending fiscal year, 1QFY10=4QFY09 and so on.*

Expect Infosys to upgrade its FY2010 EPS guidance

With the global economy emerging from the financial crisis that enveloped it in 2HCY2008, all eyes will be on an upgrade in Infosys' guidance for FY2010. While it may not yet upgrade its top-line guidance for the fiscal, in line with its stance of being conservative, we believe that an upgrade on the EPS front is a distinct possibility, given our expectations of a significant 7% beat on the upper end of its 2QFY2010 EPS guidance. This is likely to lead to upgrades for not just Infosys, but also for other top-tier IT firms, thus leading to these companies holding on to the premium valuations that they currently command. We are positive on the Indian IT Sector and believe an over-weight position on these stocks could lead to an out-performance vis-à-vis the benchmark indices. We have upgraded our FY2010-11 EPS estimates for all top-tier IT firms (TCS, Infosys and Wipro) and consequently, our target prices and P/E multiples, which are now in the range of 20-22x as compared with 15-16x earlier. We believe the premium valuations commanded by these companies wil sustain going forward. Hence, **we would recommend Accumulating these stocks on declines.**

Exhibit 7: Quarterly Estimates Rs cr

Company	CMP (Rs)	Net Sales 2QFY10E	Net Sales % chg (qoq)	OPM (%) 2QFY10E	OPM chg bp (qoq)	Net Profit 2QFY10E	Net Profit % chg (qoq)	EPS (Rs) 2QFY10E	EPS (Rs) % chg (qoq)	EPS (Rs) FY10E	EPS (Rs) FY11E	EPS %chg	P/E (x) FY10E	P/E (x) FY11E	Target Price (Rs)	Reco
Infosys	2,308	5,563	1.7	33.2	(96)	1,479.0	(3.1)	25.8	(3.1)	103.8	112.5	8.4	22.2	20.5	2,475	Accumulate
TCS	619	7,447	3.3	27.3	9	1,595.5	4.9	8.2	4.9	29.9	33.7	12.7	20.7	18.4	675	Accumulate
Wipro	602	7,103	10.7	21.7	(114)	1,150.6	13.3	7.9	13.1	27.8	31.2	12.0	21.6	19.3	-	Neutral
HCL Technologies	340	3,038	4.4	22.1	0	388.6	17.7	5.8	17.7	22.1	26.7	20.7	15.4	12.7	373	Accumulate

Source: Company, Angel Research; Note: Price as on Sept. 30, 2009;

***Analyst* - Harit Shah / Vibha Salvi**

Telecom

Positive overall market sentiment leads telecom stocks higher

During 2QFY2010, telecom stocks recorded a decent performance on the Indian bourses. With the overall market sentiment witnessing a significant improvement as global economic conditions continued to be on the mend, the general direction for Indian equities was positive in the past quarter. Owing to the improved macro-economic sentiment across the globe and an increased risk appetite, foreign investors pumped in significant amounts of money into Indian equities. As a matter of fact, in this quarter, Foreign Institutional Investors (FIIs) invested a massive sum of over US $7bn, on a net basis, into the Indian stock markets, which was the primary driver of the good performance of the benchmark indices.

By and large, Telecom stocks under-performed the benchmark BSE Sensex over the quarter. Given that there is no separate index for telecom stocks, if we take a basket of key telecom stocks, the basket gained 5.8% over the quarter, under-performing the Sensex, which registered a gain of over 18%. This comes after a strong performance in 1QFY2010, which saw the basket soar by 45%. In terms of stock-specific performances, it was the mid-sized enterprise telecom solutions provider, Tulip Telecom that gained the maximum, adding 10.2% over the quarter. Reliance Communications (RCOM) was the second-largest gainer, even as the stock gained only 6.2% over the quarter. The stocks of Idea Cellular and Bharti Airtel gained around 6% and 4%, respectively, while Tata Communications gained 2%. On the other hand, the stock of MTNL lost ground, falling by 6% over the quarter.

We believe that while mobile penetration at the current levels of under 40% still offers good scope for upside, the increasing headwinds being faced by the sector cannot be ignored. The intensifying competition within the sector and continuing regulatory risks remain its key features. Apart from RCOM, which launched pan-India GSM services in January, Aircel, Idea Cellular and Sistema-Shyam also launched their services in newer circles, signaling a further increase in competition. Tata Teleservices also launched its GSM-based cellular services in July, under the brand name 'Tata DoCoMo', which led to its monthly net additions shooting up to 2.2mn in July and as many as 3.4mn in August. This clearly indicates the heightened competitive intensity in the sector, with market leader Bharti Airtel's net-adds market share in August falling below 20% for the fourth time in the last eight months.

In a much-awaited move, the Department of Telecommunications (DoT) finally announced the date for the 3G spectrum auction, which has been scheduled for December 7, 2009, for W-CDMA (the GSM 3G standard). On the other hand, the auction for EVDO (the CDMA 3G standard) and Broadband Wireless Access (BWA, WiMAX) spectrum will be held two days after the close of the W-CDMA auction. The base price for 3G spectrum has finally been settled at Rs3,500cr. Apart from this, the DoT has also proposed to change the licence fee structure to a uniform level of 8.5% of adjusted gross revenues (AGR), as opposed to the current structure, which varies based on the type of licence held (UAS licence, NLD licence, ISP licence). Under the UAS licence, the licence fee is charged on a circle category basis, with the rate varying between 6-10%, depending upon whether the circle is a metro, or falls under the 'A', 'B' or 'C' categories.

A backdrop to this issue is the fact that, in the past, some operators have been alleged to have attempted to take advantage of the differential licensing structure for different licences, loading a greater proportion of their revenues on to the licence that carries a lower licence fee. For example, the licence fee on long distance services is 6%, as against 10% for Mumbai, Delhi and the 'A' category circles under the UAS licence, and a company could load more revenues on to its NLD licence, rather than on its UAS licence, to pay a lower revenue share to the Government. Thus, with a view to preventing such 'licence arbitrage', the DoT has mooted the idea of a uniform licence fee structure for all categories of licences. However, the sector regulator, the Telecommunications Regulatory Authority of India (TRAI) has said that all stakeholders need to be consulted before any such key decision can be taken on the licensing framework.

Key Sector Developments

3G base price fixed at Rs3,500cr, auction date set at December 7, 2009; four operators per circle allowed

The quarter finally saw the controversy over the fixing of the base price for the 3G spectrum auction being put to rest, with the DoT setting the base price at Rs3,500cr. It may be noted that the base price was earlier set at Rs2,020cr, but the Finance Ministry, with an eye on maximising the revenue potential from the auction, wanted the base price doubled to Rs4,040cr. This was staunchly opposed by telecom operators, who said that this would raise the cost of providing 3G services. Thus, it can be said that the Rs3,500cr base price is somewhat of a compromise between the figure set earlier by the DoT and the demands of the Finance Ministry. Apart from this, the date for the much-awaited 3G spectrum auction has also been set at December 7, 2009 (for W-CDMA spectrum), and the auctions for EVDO and BWA spectrum will be held two days

Telecom

after the close of the W-CDMA auction. The number of players per circle has now been set at four, as against the six earlier.

MNP implementation delayed again, deadline extended till December 31, 2009

The implementation of Mobile Number Portability (MNP), a system that enables subscribers to change their service providers without having to change their mobile numbers, has been delayed again, and the government has shifted the deadline, for the first phase in the Metro and 'A' circle categories to December 31, 2009, from the earlier deadline of September 20, 2009. The delay has been attributed to the operators' inability to upgrade their networks, as well as to the delay on the part of the regulator to come out with the tariff for the service; certain technical and commercial issues related to it are also being resolved. Thus, as per the new deadline, MNP services are likely to be available in the telecom circles of Delhi, Mumbai, Kolkata, Maharashtra, Gujarat, Andhra Pradesh and Tamil Nadu by the year-end. It may be noted that the DoT had issued guidelines for MNP implementation in the country in August last year. Thus, the constant delays are disappointing from the consumer point of view, as they would get considerably greater choice and convenience in using their mobile numbers and could also hope to get better QoS, as MNP implementation would force operators to upgrade their networks.

Newer operator launches continue unabated; TTSL launches GSM services

During the quarter, newer operators continued to launch operations across circles, as the competitive intensity in the Indian Telecom Sector, which is already the highest in the world, increases even further. The highlight of the quarter was the launch of GSM-based cellular services by Tata Teleservices (TTSL), in partnership with the Japan-based telecom major, NTT DoCoMo. The company launched these services under the brand name 'Tata DoCoMo' and received a tremendous response, adding 2.2mn subscribers in July and 3.4mn subscribers in August, as against a trailing 12-month average net-adds figure of less than 0.9mn from July 2008 to June 2009. TTSL launched GSM services in Mumbai, Chennai, Andhra Pradesh, Karnataka, Maharashtra, Tamil Nadu, Kerala, Madhya Pradesh and Orissa, and the significant traction witnessed in these launches gave the telco the honour of becoming the market leader in the month of August, in terms of subscriber net-adds - the first time that it has achieved this. Apart from TTSL, Sistema-Shyam Teleservices (SSTL) also continued its path towards becoming a pan-India operator, launching CDMA services in the Bihar telecom circle. Over the past few months, SSTL has launched operations in five new circles, apart from its erstwhile single circle, Rajasthan, where it has had a presence over the past few years. Idea Cellular and Aircel are also expected to continue their newer circle launches in their bids to become pan-India players, and newer players like Unitech Wireless, S Tel and Datacom are also in the process of launching their services, thus making India a 12-15 player market, shortly.

Etisalat, S Tel tower deals with RITL reflect traction in infrastructure-sharing space

During the quarter, two major deals were signed by Reliance Infratel (RITL), the telecom infrastructure arm of RCOM, with Etisalat DB Telecom (earlier Swan Telecom) and S Tel. The Etisalat deal is worth Rs10,000cr, spread over 10 years, and includes tower and transmission infrastructure, and the co-location of 30,000 cell sites across 15 telecom circles. On the other hand, the S Tel deal is worth Rs1,100cr. These deals signify increasing traction on the infrastructure-sharing front, with newer operators requiring a rapid roll-out of their services to gain competitive coverage, and this is expected to lead to improving tenancies of major towercos like RITL, Bharti Infratel and Indus Towers, over the next few years.

Bharti-MTN deal disconnected; long-term strategic negative

Bharti Airtel called off deal discussions with the MTN Group at the end of the exclusivity period on September 30, 2009. With the South African Government wanting to retain the national identity of MTN by insisting on a dual-listing structure, this was a key hurdle, given that India does not allow such a structure. We believe that the calling off of the deal is a disappointment, given the long-term strategic benefits that it would have provided Bharti, giving it access to 21 more emerging markets and a significant growth avenue. However, in the short-term it could be a positive, given that the significant debt burden that Bharti would have to take to finance the deal would have pressurised its Balance Sheet. The company can now focus on the upcoming 3G auction and is best-placed to bid for pan-India 3G spectrum, given its low leverage. Thus, as of now, it will be 'business as usual' for Bharti.

Subscriber growth to remain driver of Top-line growth

We expect the major telecom companies under our coverage - Bharti Airtel, RCOM and Idea Cellular - to report a decent Top-line growth to the tune of 18.7% yoy and 6.6% qoq during 2QFY2010. We expect Bharti Airtel, the market leader, to report an 18.7% yoy and 7.7% qoq increase in Net Revenues. This is expected to be

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driven by the key Mobile Services Business, which we estimate will grow by over 17.8% yoy and by 4.3% qoq. The key growth driver of this business is expected to be a strong accretion to the mobile subscriber base, which, we expect, will grow by 43% yoy and by 8.2% qoq, to touch 110.8mn, implying quarterly net additions of 8.4mn. As regards ARPUs this quarter, we expect a 4% qoq and nearly a 19% yoy contraction to Rs268 per user, per month. We expect the other business segments of the company to clock growth rates of 5-20% yoy. It should be noted that we expect a 29% yoy decline in the Passive Infrastructure Services Business, on account of the transfer of 35,066 towers to Indus from January 1, 2009.

RCOM, on the other hand, is expected to clock an 11.2% yoy and 5.4% qoq growth in Net Revenues. The key Wireless Business is estimated to grow by 17.8% yoy (6.6% qoq), in spite of the strong 54.9% yoy growth (9% qoq) in the mobile subscriber base of the company, which is expected to hit 86.8mn. This implies quarterly net-adds of 7.2mn. We expect ARPUs to fall by 24.4% yoy (2.5% qoq). As regards the other business segments of the company, we expect the Global Business to grow by 16.8% yoy (4.8% qoq) and the Broadband Business to grow by 12.1% yoy (fall of 1.3% qoq).

The third company under our coverage, Idea Cellular, is expected to record a strong 36.5% yoy and a 5.6% qoq growth in its 2QFY2010 Top-line. As is the case for Bharti and RCOM, we expect the strong growth to be driven chiefly by continuing strong subscriber numbers recorded by the company. We estimate the mobile subscriber base for Idea (ex-Spice) to grow by a robust 54.4% yoy and by 9.6% qoq to hit 46.9mn, implying quarterly net additions of 4.1mn. On the other hand, we estimate ARPUs to fall by 3% qoq and by 14.2% yoy to hit Rs229 per user, per month. Including Spice, the subscriber base is expected to touch 51.4mn, thus crossing the 50mn mark.

Margins to fall on network expansion, increased competitive intensity

We expect a combined 117bp yoy fall in EBITDA Margins in 2QFY2010 (an 80bp qoq fall). This is expected mainly on the back of higher network expansion costs and a secular decline in tariffs (revenues per minute), due to the ever-increasing competitive intensity in the sector. EBITDA in absolute terms is expected to grow by 17.3% yoy and by 4.5% qoq for Bharti, by just 2.2% yoy and 4.2% qoq for RCOM, and by a robust 48% yoy and 4.5% qoq for Idea Cellular.

Margin pressure to lead to the bottom-line growing at a slower rate than the top-line

We expect the Bottom-line of the telcos under our coverage to grow by a combined 16.9% yoy, as against an 18.7% yoy growth in the Top-line. However, the performance varies on a company-specific basis. We expect Bharti to grow its Bottom-line by 23.8% yoy (0.7% qoq), with the divergence in top-line and bottom-line growth coming on account of lower margins. The flattish qoq performance is owing to lower forex gains this quarter. RCOM is expected to show a flat yoy growth in the bottom-line (de-growth of 6.5% qoq), with margin pressures, higher depreciation charges and lower interest income all taking their toll. Idea Cellular, on the other hand, is expected to record an outstanding 97.9% yoy growth in the bottom-line. However, it should be noted that this is on a low base, as the company had reported a 35% yoy decline in its bottom-line in 2QFY2009, owing to lower margins, higher network operations costs, start-up EBITDA losses in the Mumbai circle, and higher advertising costs and access charges. On a qoq basis, we estimate a fall of 3.8%.

Stick with the market leader, Bharti Airtel

Going ahead, even as we expect robust growth in the Indian mobile subscriber base, given a more challenging business environment, a significant increase in competitive intensity, a further fall in tariffs and ARPUs, slowing subscriber growth, margin pressures and ever-present regulatory risks, we believe that the chances of a major valuation re-rating in the sector are remote. Consequently, in such a scenario, **we believe that it would be prudent to stick to the market leader with the best track record in the sector, Bharti Airtel, which remains our Top Pick.**

Exhibit 1: Quarterly Estimates — Rs cr

	CMP	Net Sales		OPM (%)		Net Profit		EPS (Rs)		EPS (Rs)			P/E (x)		Target	Reco
Company	(Rs)	2QFY10E	*% chg*	2QFY10E	*chg bp*	2QFY10E	*% chg*	2QFY10E	*% chg*	FY10E	FY11E	*% chg*	FY10E	FY11E	Price (Rs)	
Bharti Airtel	419	10,707	*18.7*	40.5	*(49)*	2,534.0	*23.8*	6.7	*23.7*	26.8	30.2	*12.8*	15.6	13.9	458	Accumulate
RCOM	308	6,157	*11.2*	36.4	*(320)*	1,530.1	*(0.0)*	7.1	*1.2*	27.6	29.6	*7.2*	11.2	10.4	329	Accumulate
Idea Cellular	75	3,144	*36.5*	28.6	*224*	285.7	*97.9*	0.9	*84.6*	3.8	4.4	*15.0*	19.6	17.1	66	Reduce

Source: Company, Angel Research; Note: Price as on Sept. 30, 2009

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