Aditya Birla Money

Top 5 DEEPAVALI Picks

24th October 2011

Business brief and strength:

Bharti Airtel is the largest telecom operator in India and the 5th largest in the world with a presence in over 19 countries across Asia and Africa. Bharti is the best positioned telecom operator to benefit from the changes in the current telecom regulatory environment, improving domestic market and significant opportunities in Africa.

- **Structural changes – end of tariff war:** Recently, Tata Docomo increased the tariffs for STD calls and SMS for new subscribers. Two years prior, the same company had initiated a price war by introducing per-seconds billing, which led to a crash in call rates. The recent move indicates that the environment is more challenging for new entrants to survive at the prevailing cheap call rates and is likely to trigger industry consolidation and upward movement in pricing. Soon after, the market leader Bharti Airtel has also increased its tariff rates by 20% from 1p/sec to 1.2p/sec in 4 circles today. We believe this is a sign of a major fundamental change happening in the domestic telecom sector. It most likely signals an end to fall in call rates and an upward trend in pricing over the long term for incumbents.
- **3G and BWA – next wave of growth area:** Currently, Bharti derives ~12-14% of the revenues from VAS services and is expected to go up significantly once the 3G and BWA usage picks up in the next 1-2 yrs. Bharti expects 3G revenue to contribute ~3-4% of wireless revenues by FY13E. Globally for telecom companies, ~30-40% of the telecom revenues are derived from the non-voice segment as against only ~12% in India and that too the bulk comes from SMS. Data margins are far healthier than the commoditised mobile voice business. Established players like Bharti are well placed to capture the data revolution ahead through its across the segment presence.
- **India vs Africa – long term opportunities in African business:** Africa provides enormous opportunities with a) low mobile penetration (just 40% vs 70% in India), b) average no. of competitors (3-5 vs 10-12), c) Minutes of Usage (MoU) (~115 vs ~449 minutes) and d) ARPU ($7 vs $4). This depicts the headroom for improvement and Africa now works in ***"Low usage, high price model", which India was in during the 2001-2004 period.*** During Q1FY12, African business grew by 5.9% QoQ, EBITDA margin improved 30 bps to 26.7%. However, the current expansion plans of network restructuring for better quality and coverage would yield better results after 4-5 quarters down the line.

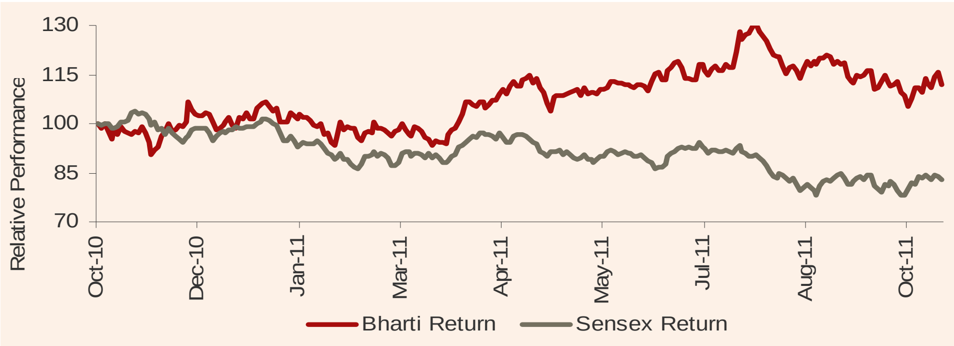
Outlook & Valuation: The stock currently trades at a consolidated P/E of 20.8x and 14x on its FY12E and FY13E earnings of ₹18.4 and ₹27.3 respectively (Bloomberg Consensus). The stabilised operating performance in the domestic market, initial signs of tariff hikes, improving African business, upbeat 3G prospects and strong presence in the under penetrated telemedia business is likely to lead to an out-performance in the medium to long term.

Financial Snapshot

(In ₹ bn)	2011	2012E	2013E
Sales	592.7	717.5	823.9
EBITDA	200.8	250.7	304.2
PAT	65.0	69.7	103.6
EPS	17.2	18.4	27.3

Source: Bloomberg Consensus, ABML Research

Chart: Bharti vs. Sensex



Source: Capitaline, ABML Research

Business brief and strength:

HDFC Bank is amongst the leading private sector banks with one of the best CASA ratios, operational proficiency and superior asset quality. It has a strong distribution network with 2111 branches and 5998 ATMs in 1111 cities. The bank is planning to add another 100-150 branches in FY12, particularly in Tier IV and Tier V centers.

- **Strong CASA ratio, high NIM's and healthy capital adequacy:** HDFC's deposit profile is one of the best among its peers with a 47.3% CASA mix. The bank's access to low cost deposit is the key differentiating factor which gives it a competitive edge over its peers. It also enables the bank to enjoy best in class NIMs of 4.0%+. The management expects the NIM to be in range of 3.9-4.3% in FY12, despite rising cost pressures. The Bank's total CAR as at Sep 30, 2011 was at 16.5% (Tier-I CAR of 11.4%), which bodes well for its future growth.
- **Higher than Industry growth with superior return ratios:** HDFC Bank's best-in-class liability profile, strong growth momentum and enviable asset quality has translated into a commendable return profile. The bank has maintained average RoAA of over 1.4% and average RoAE of ~19% for over a decade. HDFC Bank has a track record of consistent performance across various operating parameters while maintaining the asset quality. The bank's total business registered a CAGR growth of 33.7% over FY07-11
- **Comfortable asset quality:** HDFC Bank continues to see improvement in asset quality (contrary to the industry trend of deteriorating asset quality). Portfolio quality as of Sep 30, 2011 remained healthy with gross NPA at 1.0% and net NPA at 0.2%. The NPA provision coverage ratio (excluding write-offs, technical or otherwise) was at 81.3% as of Sep 30, 2011, thereby making it largely insulated from taking any hits on its profitability.

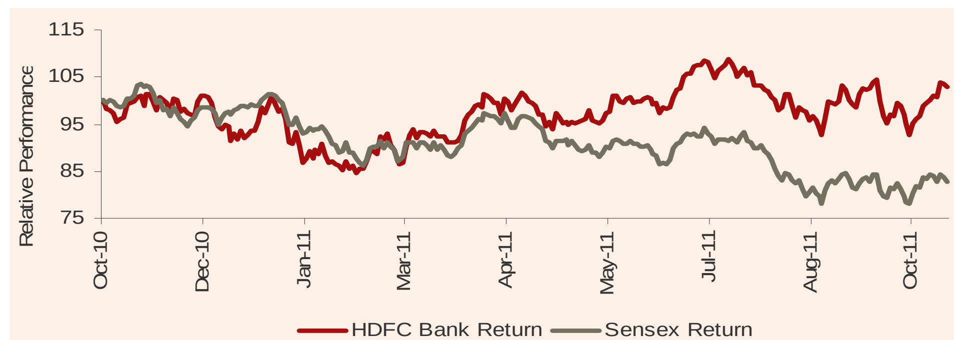
Outlook & Valuation: HDFC Bank has always commanded premium valuations vis-à-vis its peers due to its track record of consistent growth in earnings and assets. Despite macro headwinds, the bank has continued to deliver +30% earnings growth and maintained its asset quality. The stock currently trades at 3.3x FY13E BV and 17.8x FY13E EPS (Bloomberg Consensus). In a scenario of elevated interest rates and a tough macro situation, we believe the bank's controlled aggression strategy will help it to continue to outperform its peers and hence command higher valuations.

Financial Snapshot

(In ₹ bn)	2011	2012E	2013E
Net Income	149.9	179.3	215.6
Operating Profit	59.2	75.4	91.8
Net Profit	39.9	51.2	63.6
EPS	17.2	21.9	27.2
Book Value	110.4	126.1	146.5

Source: Bloomberg Consensus, ABML Research

Chart: HDFC Bank vs. Sensex



Source: Capitaline, ABML Research

ITC

CMP ₹ 207.0

Aditya Birla Money

Business brief and strength:

ITC is a conglomerate with businesses spanning across cigarettes, FMCG, hotels, paper, paperboard and agri commodities. The company is a market leader in the cigarette business and in the non-cigarette FMCG business, the company has a presence in packaged foods (Sunfeast Yippee noodles, Sunfeast biscuits etc), personal care (soaps and shampoo with brands like Vivels, Fiama Di Wills etc), lifestyle retailing (stores like Wills Lifestyle and John Player) and the stationery business (brand like Classmate). The company also has a presence in rural retailing through its network of stores under "E-choupal". Company operates 105 hotels under the banner of ITC Hotel, Welcom, Fortune and Welcom Heritage.

- **Cigarette business….strong pricing power; healthy revenues:** ITC being a market leader in cigarette business(~75% volume share) coupled with relatively inelastic demand has strong pricing power in this business. This has led to the cigarette division consistently posting strong EBIT margin of ~54% over the last three years. On volume front, due to differential VAT (12.5% - 40%) across states, illicit trade accounts for 16% of the industry volumes. Hence, there is humungous scope of volume expansion due to changing lifestyles and potential of converting illicit trade into a legal one. In FY11, cigarette division accounted for 44% of the sales mix and 83% of the EBIT mix.
- **Investments in other businesses to start reaping benefits:** ITC has created multiple businesses through the cash generated from its cigarette business. ITC's FMCG revenues have grown phenomenally (~2.5x) over the past five years from FY07 to FY11. ITC has not only entered newer segments but also built powerful brands in the foods (Aashirvaad, Sunfeast, and Bingo) and personal care (Vivel, Fiama Di Wills, Superia) segment within a short span of time. The FMCG business has grown by 23.1% in FY11 to ₹ 44.7 bn and its EBIT loss has declined by 14.9% to ₹ 2.9 bn. Going forward, we believe the other FMCG divisions will gradually become EBIT positive led by ramp-up in volumes and rise in profitability.
- **Stable business healthy returns:** The company's top-line and profits have grown at a CAGR of 12.5% and 15.9% respectively over 2007-2011. It has delivered a healthy five year average ROE of 28.5% which is commendable.

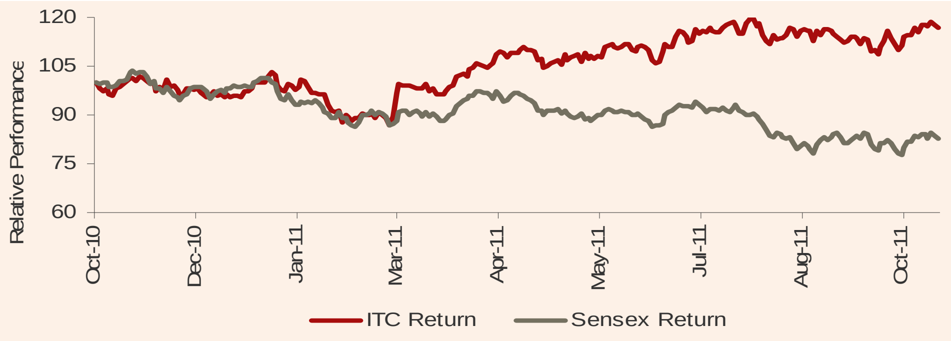
Outlook & Valuation: The stock currently trades at a consolidated P/E of 26.8x and 22.5x on its FY12E and FY13E earnings of ₹7.7 and ₹9.2 respectively (Bloomberg Consensus). The ability to create scalable businesses, categories and strong brands has been the forte of the company. ITC is also through with the investing phase(major) for its FMCG businesses and is likely to be throwing more FCF as this business turns EBIT positive.

Financial Snapshot

(In ₹ bn)	2011	2012E	2013E
Sales	217.5	258.4	296.1
EBITDA	75.5	90.3	105.4
PAT	50.1	60.0	70.2
EPS	6.5	7.7	9.2

Source: Bloomberg Consensus, ABML Research

Chart: ITC vs. Sensex



Source: Capitaline, ABML Research

Business brief and strength:

Mahindra & Mahindra is the pioneer and leading UV (~57% market share) and Tractor (~40% market share) manufacturer in India. The company has spread its wings across all segments such as 2w, 3w, 4w (PV, UV, Electric car - Reva), LCV and HCV (through JV with Navistar). It also has subsidiaries in various businesses like IT, Auto ancillary, Hospitality, Infrastructure, etc., Acquisition of South Korean based Ssangyong Motors in FY11 has led the global foray for M&M

- **Undisputed leader in core business (UV & Tractors):** M&M has remained the undisputed market leader in both its core businesses (UV – with ~57% market share & Tractors – with~40% market share). Since FY12, the company's UV segment has regained 460 bps market share to 57.3% vs 52.7% in FY11 and regained more than 100 bps in the tractors segment. a) Expected new product launches & Ssangyong product launches in the UV segment and b) stable growth prospects for tractors business (increased mechanisation in Agriculture) would help to main the revenue momentum. Recently, M&M launched XUV-500, which got an overwhelming response and demonstrated its superior position in the UV market. To set a new trend, M&M is working vigorously on ***"Nano-SUV" (with less than 1 tonne weight),*** which is likely to be ready in 2 years.
- **Ssangyong – turnaround on the cards:** In FY11, M&M acquired 70% stake in a South Korean based SUV manufacturer Ssangyong Motors, which has a distribution network of over 130 dealers in Korea and ~1200 dealers in more than 90 countries. This gives mutual benefit, product portfolio, wide distribution and sales network. The management has guided for ~50% volume growth to 1.2 lac units for CY11 and operations to breakeven in CY12.
- **Developing stronger non-core segments:** ***LCV* -** M&M is the second largest LCV manufacturer with ~30% market share (including Navistar JV). We expect this segment to grow faster than the industry average on the back of a) faster rural growth, b) stretching city limits c) increasing organised retail and d) preferred mode for goods carrier as against 3 wheeler carriers**.** ***MHCV* –** Mahindra-Navistar has increased its market share to 0.6% in less than a year's time. Both ***passenger cars*** and **2w** are in restructuring mode.

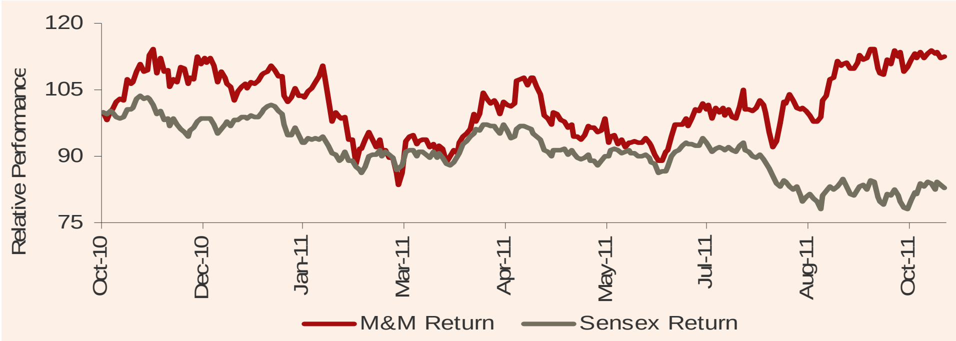
Outlook & Valuation: The stock currently trades at a consolidated P/E of 15.3x and 13x on its FY12E and FY13E earnings of ₹52.9 and ₹61.7 respectively (Bloomberg Consensus). We believe a) sustained market leadership in core segment, b) aggressive product launches in LCVs c) Ssangyong turnaround d) brand value and e) subsidiaries' performance would help M&M to outperform the market in the OEM space.

Financial Snapshot

(In ₹ bn)	2011	2012E	2013E
Sales	339.6	417.9	478.4
EBITDA	56.5	59.4	69.7
PAT	27.6	32.2	37.7
EPS	50.2	52.9	61.7

Source: Bloomberg Consensus, ABML Research

Chart: M&M vs. Sensex



Source: Capitaline, ABML Research

Titan

CMP ₹ 226.6

Aditya Birla Money

Business brief and strength:

Titan Industries (TI) with a 65% market share in the organised watch segment is the largest player in the Indian branded watch market, with well-established popular brands like TITAN, Fastrack, Sonata and Xylys. The company is also India's largest organised jewellery player with its Tanishq brand. The company also has the largest eyewear retail chain in India with stores under the name of "Titan Eye". In the B2B segment, the company has a presence in the precision engineering.

- **India is the largest consumer of gold…..Tanishq has championed organised jewellery retailing in India:** India is the largest consumer of gold with estimated consumption of ~800 tonnes of gold every year, out of which 600 tonnes is used for making jewellery. Thus, the market opportunity in jewellery is estimated to be of ₹ 1000 bn. The company is the largest jewellery retailer in India and the opportunity from unorganised to organised is humungous. Tanishq expects to close this current financial year with about 150 stores in all including 10 large format stores.
- **Underpenetrated watch market throws good growth opportunity:** The Indian watch market is estimated to be of ~46 mn pieces worth ₹ 31 bn and has grown at CAGR of 8% during the last 5 years. Out of the total market, the organised market comprises only ~36% and the rest is catered to by the unorganised segment. Hence, the market offers huge growth opportunity due to lower penetration of ~27% and consumer conversion from unbranded to branded watches. The company is expanding its presence in the premium watch segment by further expanding the HELIOS stores by adding ~30,000 sq ft (up 10% YoY) in FY12E. The watch division is expected to report a growth of ~22% in FY12E.
- **Ability to identify categories, create brands and scale:** The ability to create scalable businesses (jewellery, eye care), categories and strong brands has been the hallmark of the company. The company is now looking to enter the luxury lifestyle category with new product lines. It expects to touch a turnover of $3bn by 2014-15 after diversifying. The company's revenues and profits over the last five years (2007-2011) has grown at a CAGR of 32.9 % & 44.3% respectively. The company has delivered a healthy five year average ROE of 38.7%.

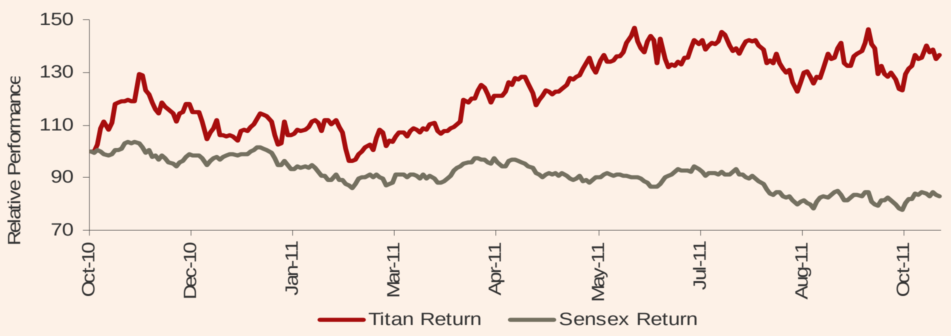
Outlook & Valuation: Tanishq has build the right customer perception and enjoys the trust of the customers with the pedigree of the TATA brand. The stock currently trades at a consolidated P/E of 34.3x and 27.6x on its FY12E and FY13E earnings of ₹6.6 and ₹8.2 respectively (Bloomberg Consensus).

Financial Snapshot

(In ₹ bn)	2011	2012E	2013E
Sales	63.9	84.1	101.0
EBITDA	6.3	8.0	9.9
PAT	4.6	5.9	7.3
EPS	5.2	6.6	8.2

Source: Bloomberg Consensus, ABML Research

Chart: Titan vs. Sensex



Source: Capitaline, ABML Research

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