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Market Outlook

India Research
October 19, 2010

Dealer's Diary

The key benchmark indices saw immense volatility as bargain hunting emerged after a two-day steep slide. The pre-open session that began on the bourses on October 18, 2010, saw a wide difference in Sensex and Nifty values. The market breadth was weak, compared to a positive breadth in the opening trade. However, smart recovery in European stocks and US index futures aided an intraday rebound on the domestic bourses. The Sensex and Nifty closed the trade flat in green, gaining 0.2% each. BSE mid-cap and small-cap indices, however, closed down by 0.5% and 0.2%, respectively. Among the front liners, TCS, NTPC, Tata Steel, ONGC and L&T gained 1–3%, while ACC, Bharti Airtel, JP Associates, Tata Power and Cipla lost 2–3%. Among mid caps, Petronet LNG, Shree Ashtavinayak Cine Vision, Indiabulls Real Estate, Nagarjuna Construction and Jindal Saw gained 3–8%, while Chambal Fertilizers, Gujarat State Fertilizers, Unichem Labs, Rashtriya Chemicals & Fertilizers and Manappuram General Finance & Leasing lost 4–8%.

Markets Today

The trend deciding level for the day is 20090 / 6083 levels. If NIFTY trades above this level during the first half-an-hour of trade then we may witness a further rally up to 20309 – 20448 / 6181 - 6285 levels. However, if NIFTY trades below 20090 / 6083 levels for the first half-an-hour of trade then it may correct up to 19950 – 19731 / 5978 - 5880 levels.

Indices	S2	S1	R1	R2
SENSEX	19,731	19,950	20,309	20,448
NIFTY	5,880	5,978	6,181	6,285

News Analysis

- Aurobindo Pharma- Initiating Coverage
- SC extends stay on Sterlite's plant closure till December
- Surya Roshni's promoters propose warrant conversion triggering an open offer
- 2QFY2011 Result Review: L&T, Sesa Goa, Rallis India
- 2QFY2011 Result Previews: HDFC Bank, Bajaj Auto, Container Corp, Cadila Healthcare

Refer detailed news analysis on the following page.

Net Inflows (October 15, 2010)

₹ cr	Purch	Sales	Net	MTD	YTD
FII	2,922	2,268	654	18,107	1,06,429
MFs	344	1,429	(1,085)	(4,746)	(27,775)

FII Derivatives (October 18, 2010)

₹ cr	Purch	Sales	Net	Open Interest
Index Futures	2,098	2,272	(174)	16,246
Stock Futures	1,648	2,518	(870)	44,869

Gainers / Losers

Gainers			Losers		
Company	Price (₹)	*chg (%)*	Company	Price (₹)	*chg (%)*
Petronet LNG	125	*8.3*	Chambal Fert	86	*(7.5)*
IB Real Estate	206	*5.4*	Apollo Hosp	518	*(3.1)*
Nagarjuna Cons	154	*4.1*	Engineers Ind	350	*(2.9)*
Piramal Health	531	*3.6*	Anant Raj Inds	139	*(2.9)*
HCL Tech	446	*3.5*	Grasim Inds	2,252	*(2.1)*

Domestic Indices	Chg (%)	(Pts)	(Close)
BSE Sensex	0.2%	43.8	20,169
Nifty	0.2%	13.3	6,076
MID CAP	-0.5%	(39.4)	8,272
SMALL CAP	-0.1%	(15.8)	10,614
BSE HC	-0.2%	(10.5)	6,291
BSE PSU	0.3%	30.8	10,363
BANKEX	-0.2%	(22.4)	14,026
AUTO	-0.1%	(13.8)	9,738
METAL	0.0%	0.7	17,494
OIL & GAS	0.8%	89.3	10,782
BSE IT	1.3%	77.6	6,153
Global Indices	**Chg (%)**	**(Pts)**	**(Close)**
Dow Jones	0.7%	80.9	11,144
NASDAQ	0.5%	11.9	2,481
FTSE	-0.3%	(19.3)	5,743
Nikkei	0.0%	(1.8)	9,498
Hang Seng	-1.2%	(288.3)	23,469
Straits Times	-0.7%	(23.0)	3,181
Shanghai Com	-0.5%	(15.9)	2,955

Indian ADRs	Chg (%)	(Pts)	(Close)
Infosys	0.2%	0.1	$68.7
Wipro	-0.4%	(0.1)	$16.5
ICICI Bank	-0.3%	(0.1)	$51.2
HDFC Bank	0.9%	1.7	$186.6

Advances / Declines	BSE	NSE
Advances	1,205	488
Declines	1,792	888
Unchanged	90	48

Volumes (₹ cr)	
BSE	4,579
NSE	16,254

Aurobindo Pharma- Initiating Coverage

Aurobindo Pharma (APL), over the years, has transformed itself from being a low-margin API player to a high-margin formulation player. Consequently, APL's FY2012 OPM and RoE are at par with top Indian generic peers. Concerns on the debt front are also receding and the company's net debt/equity ratio is expected to improve to 0.6x in FY2012 from 1.1x in FY2010. We expect net sales and recurring profit (excluding other operating income) to post CAGR of 15.6% and 29.1%, respectively, over FY2010–12. The stock is currently trading at 13.6x FY2011E and 10.3x FY2012E earnings, which is at 50% discount to the top Indian generic peers, and is unwarranted due to the improving business mix, owing to which we believe that the stock is poised for re-rating. **We Initiate Coverage on the stock with a Buy recommendation and an SOTP Target Price of ₹1,330.**

Supply agreements to drive growth: To leverage on its cost efficiency and strong product filings, APL entered into supply agreements with Pfizer and AstraZeneca, which provide significant revenue visibility. APL is also in talks with other MNCs for more supply agreements. Revenue from the supply agreements is set to rise 3x over FY2010–12 from ₹227cr to ₹644cr.

US and ARV formulation segments to be the key drivers for base business: APL's US base business (ex-Pfizer) is expected to post a CAGR of 36.0% over FY2010–12 to US $268mn, with revenue per product increasing to US $2.6mn from US $2.3mn. On the ARV front, we expect revenue to log a CAGR of 11.1% to ₹612cr over FY2010–12, as APL would continue to be the largest supplier under the PEPFAR contract with a market share of 35%.
Valuation: Based on the SOTP methodology, the core business (ex-other operating income) is valued at 14x FY2012E EPS (₹1,263/share), while other operating income has been valued at 7x 50% of FY2012E income (₹9.5/share) and ascribed ₹67/share.

SC extends stay on Sterlite's plant closure till December

The Supreme Court (SC) has extended the stay on the closure of Sterlite Industries' copper smelting unit at Tuticorin in Tamil Nadu till the second week of December. Last month, the High Court (HC) had ordered the unit's closure for violations of ecological norms over a period of time.

The SC also ordered the company to explain within a month what steps it had taken to comply with the HC's various interim orders over the years. It has also asked the Tamil Nadu Pollution Control Board to state at the next hearing the latest position of the company's activities and their environmental impact. We maintain our Accumulate rating on the stock with a Target Price of `196.

Surya Roshni's promoters propose warrant conversion triggering an open offer

The promoters of Surya Roshni Ltd. plan to convert 1.6cr optionally convertible warrants held by them into an equal number of equity shares. Most of these warrants were allotted in July 2010. This move has triggered an open offer by the promoters to acquire up to 20% of the expanded capital. The calculated open offer price is ₹111/share. The offer would remain open from December 8, 2010, to December 27, 2010, with the specified date of November 12, 2010. Post the conversion of the warrants, the promoters' stake would increase to 55.0% from 29.1% currently. In case the open offer is fully subscribed, the stake would rise further to about 75.0%. However, we are not factoring in any increase in promoters' stake on the back of this open offer, as the current market price is much higher than the open offer price of ₹111/share. On the other hand, this large infusion of promoters' funds is a positive signal about the prospects of the company. **We maintain a Buy rating on the stock with a Target Price of ₹143.**

Result Review – 2QFY2011

L&T

L&T reported decent top-line growth of 17.8% yoy to ₹9,331cr (₹7,919cr), above our estimates of ~11.5% growth, mainly on account of pick-up in the E&C segment, which recorded 16.9 top-line growth to ₹8,015cr. On the EBITDA front, the performance was below our expectations mainly because of higher-than-anticipated staff cost – owing to an increase in employee base and annual salary revision. Therefore, the company reported EBITDAM of 10.8% against our expectation of 11.4%. Adjusting for extraordinary income (₹70.8cr – Satyam share sale) and dividend from subsidiaries, the company reported bottom line of ₹650.2cr, marginally above our estimate of ₹637.4cr.

L&T has always traded at a premium to Sensex valuations and has outperformed the Sensex on a consistent basis, given its strong operating cash flows, superior return ratios (in excess of 20%) and excellent capital efficiency. **At the CMP of ₹2,013, the stock is trading at P/E multiple of 28.7 on FY2012E standalone earnings of ₹70.1/share and offers limited upside to our SOTP Target Price of ₹2,024. Hence, we recommend Neutral on the stock.** Further, it should be noted that our target price factors in ₹1,542/share value at 22x FY2012E EPS (~22% earnings CAGR over FY2010–12E) for L&T parent and values its subsidiaries at ₹482/share. Therefore, at the current juncture, we believe most of the positives are factored in and the near term catalyst can come from value unlocking at the subsidiary level.

Sesa Goa

Sesa Goa's top line increased by 70.5% yoy to ₹918cr. Iron ore sales volume at 2.0mn tonnes were up by 23.7% yoy. Volumes were severely affected by the state-wide temporary export restriction imposed by the Karnataka government at the end of July. Despite benchmark iron ore prices increasing by ~30% qoq, the company's realisations were lower by 19.1% qoq (an increase of 48% yoy) at US $73/tonne. Pig iron sales volume increased by 25.4% yoy to 84,000 tonnes. Average realisation also increased by 35.6% yoy to ₹25,326/tonne, flat on a qoq basis. EBITDA margin declined by 2,349bp qoq to 37% on account of lower-than-expected realisations, higher export duty, increased royalty rates and higher freight cost per tonne. Other income decreased by 37.6% qoq to ₹100.4cr (up 12.5% yoy). Lower tax rate at 4.6% v/s 22.9% in 2QFY2010 led to bottom line increasing by 131.3% yoy to ₹385cr, down 70.4% qoq, during the quarter.

At the CMP of ₹369, the stock is trading at 4.0x and 3.2x FY2011E and FY2012E EV/EBITDA, respectively. **We currently have a Neutral rating on the stock and will review our numbers/rating post the conference call.**

Rallis India

Rallis India's 2QFY2011 results were broadly in line with our estimates. Although total sales grew 14.7% to ₹368cr, it was 10% below our estimate of ₹407.1cr. For 2QFY2011, RAIL reported lower gross margin of 41.9% (43.4%) owing to price erosion in key products. The company however, reported EBITDA margin of 24.3% for the quarter, which was ahead of our estimate by 190bp and came on the back of high operating leverage. Given that monsoons have been normal, industry is expected to continue to register healthy growth in FY2011. As a result, with RAIL being a major player in the domestic market, we expect it to grow at a higher pace than industry. We maintain our estimates and expect the company to register a CAGR of 21% and 36% in net sales and profit over FY2010-12, respectively. Post out-performing the Sensex by 104% over the last one year, at current levels, the stock is trading at fair valuations of 15x FY2012E EPS. **Hence, we remain Neutral on the stock.**

Result Previews – 2QFY2011

HDFC Bank

HDFC Bank is scheduled to announce its 2QFY2011 results. We expect the bank to report a healthy NII growth of 31.8% yoy. However, the bank's NIM is expected to be flattish sequentially. Other income is expected to register moderate growth of 5.7% yoy. The bank's pre-provision profit is expected to register moderate growth of 15.1% yoy, while net profit is expected to increase by 32.1% on a yoy basis to `909cr on account of lower provisioning expenses. At the CMP, the stock is trading at valuations of 3.83x FY2012E ABV, which is closer to our target multiple of 4.0x. Hence, we maintain a Neutral rating on the stock.

Bajaj Auto

Bajaj Auto is slated to announce its 2QFY2011 results. We expect the company's top line to grow by 41% yoy to ₹3,940cr on account of 45.7% yoy growth in volumes. On the operating front, EBITDA margin is expected to decline by 243bp yoy to 19.6% due to an increase in raw-material cost. However, the bottom line is expected to grow by 51% yoy to ₹608.4cr. The stock rating is under review.

Container Corporation of India

Concor is scheduled to announce its 2QFY2011 results. The rail container operator is expected to report a 7.2% yoy decline in the top line to ₹891cr on account of a hit in volumes from the Exim segment after the JNPT port was completely shut for five days post an accident between two sea-faring vessels and prolonged monsoon. We expect Concor's OPM to decline by 50bp yoy to 26.9%. Consequently, net profit is expected to decline by 8.7% yoy to ₹186.5cr. At the CMP, the stock is trading at 17.9x its FY2012E EPS of ₹72.5. We maintain our Reduce rating on the stock with a Target Price of ₹1,194.

Cadila Healthcare

Cadila is expected to post strong 16.9% growth in net sales to ₹1,067cr on the back of robust growth on the export and domestic formulation fronts. The company continues to enjoy over 25% market share in generic *Flomax* in the US, which is a near-term key driver. We expect the company's OPM to expand by 159bp to 20.5% on the back of favourable product mix. Net profit is expected to increase by 17.9% to ₹156cr, driven by top-line growth and OPM expansion. We maintain our Neutral rating on the stock.

Economic and Political News

- Biocon in US $200mn pact with Pfizer
- Emami’s board approves ₹5,000cr acquisitions set to raise up to ₹2,000cr
- RIL's 4 trans-country gas lines with an investment of ₹20,000cr are well behind schedule

Corporate News

- Ministry's Posco panel fails to reach consensus
- K'taka begins acquiring land for ArcelorMittal steel project
- UP to take call on commercial viability of international airport in Kushinagar
- Govt comfortable with rupee at 43-45 a dollar

Source: Economic Times, Business Standard, Business Line, Financial Express, Mint

Events for the day	
Bajaj Auto	Results
Cadila Health	Results
Container Corp	Results
HCL Tech	Results
HDFC Bank	Results
Ingersoll Rand	Results
Polaris Soft	Results

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Ratings (Returns) :	Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
	Reduce (-5% to -15%)	Sell (< -15%)	

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