

## FIRST CALL

India Equity Research

November 3, 2011

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- **Essar Oil** - Full complexity throttle from FY13; Buy
- **Hindustan Unilever** – Blockbuster quarter; Buy
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- **EdelFlash:** Ranbaxy Laboratories - Pfizer and Watson confirm Lipitor launch by Ranbaxy

## Regular Features

- Sales Trader's Commentary
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- Technical Updates
- Eye Catchers

## Sectoral Movements

## % Change

Ticker	2-Nov-11	1 D	1 M	3 M	1 Y
Banking	11,238	(0.4)	6.6	(7.6)	(23.3)
IT	6,220	0.1	11.3	0.0	(7.5)
Pharmaceuticals	6,138	0.4	5.2	(4.1)	(6.9)
Oil	8,958	0.8	6.3	1.3	(17.4)
Power	2,184	(0.0)	4.4	(11.1)	(30.7)
Auto	9,249	(0.4)	9.3	6.9	(8.2)
Metals	11,693	(0.3)	10.8	(14.2)	(31.5)
Real Estate	1,880	(0.2)	11.8	(5.7)	(48.7)
FMCG	4,181	0.2	8.6	3.2	14.2
Capital Goods	10,816	(0.3)	3.3	(14.1)	(34.4)

India	Change in %			
	2-Nov-11	1-d	1-mo	3-mo
Nifty	5,258	0.0	8.4	(2.7)
Sensex	17,465	(0.1)	8.1	(2.7)
CNX 500	4,171	0.0	6.9	(4.3)

Global Indices	2-Nov-11	1-d	1-mo	3-mo
DJIA	11,836	1.5	11.1	(0.5)
NASDAQ	2,640	1.3	13.0	(2.0)
Hang Seng	19,297	(2.2)	14.7	(12.3)
Nikkei 225	8,640	(2.2)	1.1	(10.3)

Net Inv (INR Bn)	Buy	Sell	Net
31-Oct-11			
FII Cash	19.1	18.8	0.3
FII F&O	181.0	187.4	(6.5)
MF Cash	3.4	7.4	(3.9)

Value Traded - India (INR Bn)	Change in %			
	2-Nov-11	1-d	1-mo	3-mo
BSE Cash	22.2	(0.8)	(10.8)	(9.4)
NSE Cash	90.8	(7.1)	(19.4)	(5.1)
NSE F&O	989.8	(30.5)		

Forex/Money Market	Change in %			
	2-Nov-11	1-d	1-mo	3-mo
INR/USD	49.2	0.2	(0.1)	(10.0)
USD/EUR	1.4	(0.5)	3.9	(4.5)
USD/YEN	0.0	(0.0)	1.8	1.3
10 Yr G-Sec	8.9	(0.6)	4.6	5.3

Commodities (USD/Mt ton)	Change in %			
	2-Nov-11	1-d	1-mo	3-mo
Copper	7,870.0	2.0	12.5	(18.5)
Aluminium	2,105.0	0.9	(0.9)	(17.6)
*Gold	1,726.3	(0.7)	4.1	3.9
*Silver	33.7	(1.6)	10.9	(19.1)
**NYMEX	93	0.4	16.8	(1.4)
*USD/Troy Ounce		**USD/bbl		

Agri Commodities (INR/QT)	Change in %			
	2-Nov-11	1-d	1-mo	3-mo
Sugar	3,060.0	(0.4)	3.3	2.7
^INR/Maund		^^INR/KG		

Open Interest (INR mn)	2-Nov-11	1-Nov-11	% Change
Volume			
Futures	504,366	501,672	0.5
Call	295,445	285,113	3.6
Put	385,214	366,136	5.2
Total	1,185,025	1,152,921	2.8

Put Call Ratios	2-Nov-11	1-Nov-11	% Change
Volume			
PCR	1.16	1.16	0.1
WPCR	0.97	1.07	(10.1)
OI PCR	1.30	1.28	1.5
Total OI/ Volur	1.20	1.24	(3.7)

Nifty IVs at 21 - 25% levels.

FII Activity\* (INR Mn) (1-Nov)



## STOCKS IN NEWS

**AV Birla Group** weigh USD 5-b bid for Australia's new hope. (ET)

**VF** buys out Arvind in JV for INR 257 cr. (ET)

**CIL**, gets finmin nod for buying unlisted foreign cos. (ET)

**J&K bank** gets to offer interest subvention plans. (ET)

**SAIL**, Posco settle differences over Bokaro plant. (ET)

**GAIL India** likely to spend USD 1 bn on acquiring shale gas asset in North America assets. (DNA)

**SKS** to raise INR 900 cr via share sale. (MINT)

**PowerGrid** eyes firms in South America. (MINT)

**Kingfisher Airlines** seeks aid from banks. (MINT)

**SBI** to get INR 3000 cr capital infusion. (MINT)

**Tata Singur** hearing begins today. (BS)

**RIL's** satellite fields' plan hits hurdle. (BS)

## RESULTS FOR THE DAY

Name of company	Q2FY12E	Q2FY11	PAT		
			Y-o-Y	Q1FY12	Q-o-Q
Manappuram General Finance	1,103	602	83.2	1,078	2.3
Sun TV	1,590	1,674	(5.0)	1,876	(15.2)
SAIL	6,536	10,900	(40.0)	8,381	(22.0)
Jubilant	270	184	46.7	232	16.4
Ashok Leyland	1,320	1,671	(21.0)	768	71.9

## SALES TRADERS COMMENTARY

The Nifty closed flat amid extreme volatility in the last half an hour of trade on Wednesday. The market was moderately lower in the morning trade due to weak Asian cues before turning higher in the afternoon trade heeding to positive European cues. At the close of trade, it erased all gains post the weak manufacturing data from the Euro zone.

The Sensex closed at 17,464.85, down 0.09% whereas Nifty ended up 0.01% at 5,258.45.

Gainers were Reliance Communication (4.97%), Reliance Power (3.10%), Reliance Infrastructure (2.16%), HCL Tech (1.90%) and Dr Reddy's (1.68%).

Losers were Punjab National Bank (3.37%), Bharti Airtel (2.72%), Hero MotoCorp (2.45%), ICICI Bank (1.39%) and Tata Steel (1.04%)

The IPO index was at 1,576.41, down 6.43 points or by 0.41%. Major losers were Aster Silicates (4.86%), ARSS Infrastructure Projects (1.36%), Aqua Logistics (1.15%), Ashoka Buildcon (0.42%) and Bajaj Corp (0.4%).

The Bankex index was at 11,232.30, down 45.65 points or 0.4%. Major losers were Punjab National Bank (3.73%), I CICI Bank (1.23%), Bank Of India (1.04%), Federal Bank (0.78%) and Kotak Mahindra Bank (0.72%).

The Auto index was at 9,252.77, down 36.57 points or 0.39%. Major losers were Cummins India (2.45%), Hero MotoCorp (2.35%), Apollo Tyres (1.86%), Exide Industries (0.53%) and Maruti Suzuki India (0.5%).

On the other hand, the Oil & Gas index was at 8,955.32, up 65.45 points or 0.74%. Major gainers were Essar Oil (2.45%), Oil India (1.32%), Hindustan Petroleum Corporation (0.82%), Cairn India (0.6%) and Indian Oil Corporation (0.51%).

Globally, Asia ended flat while Europe was trading mixed.

## CONFERENCE CALLS

Conference call details company	Date	Time
TIL Limited	3-Nov-11	11.00 AM IST
OnMobile Global Limited	3-Nov-11	11.00 AM IST
TAJGVK Hotels & Resorts Ltd.	3-Nov-11	11.00 AM IST
Globus Spirits Limited	3-Nov-11	11.30 AM IST
TRF Limited	3-Nov-11	3.00 PM IST
Jubilant FoodWorks Limited.	3-Nov-11	4.00 PM IST
Welspun Corp.	3-Nov-11	4.30 PM IST

# ANALYSIS BEYOND CONSENSUS

## ...THE NEW ABC OF RESEARCH

Reliance Infrastructure | Annual Report Analysis

**Reliance Infrastructure (RInfra) annual report analysis highlights increase in core working capital requirement on the back of higher debtors. EPC revenue has dipped despite the company migrating to BOT accounting under IFRS. Investments in group companies continue to remain high.**

### Core w/cap requirement increases on the back of debtors

Core working capital requirement (excluding financial assets and liabilities) increased from INR 10.6 bn in FY10 to INR 18.6 bn in FY11 primarily due to debtors jumping from INR 22.5 bn in FY10 to INR 52.4 bn in FY11 with increase in average receivable days from 52 to 90. Assuming 2 months average debtors for power business, the imputed debtor days for EPC business have jumped up from 36 in FY10 to 386 in FY11.

Creditors also jumped from INR 25.3 bn in FY10 to INR 37.9 bn in FY11 with average payable days increasing from 72 to 94. Assuming 2 months average creditor for power business, the creditor days for EPC business have increased significantly from 115 in FY10 to 270 in FY11.

### IFRS based accounting opted for BOT; EPC revenue however declines

During FY11, RInfra migrated to IFRS based accounting, under which the EPC revenue /profits earned on BOT projects undertaken by the SPV are treated as realised and hence not eliminated.

Despite the above, EPC's revenue decreased from INR 33.0 bn in FY10 to INR 29.9 bn in FY11 and EBIT margins increased from 7.3% in FY10 to 8.1% in FY11. The company has not provided details for the EPC amount executed for BOT contracts for subsidiaries/associates.

### Investment in group companies remains high

RInfra's group investments (excluding investment in Reliance Power) stood at INR 27.0 bn (FY10: INR 34.3 bn), of which INR 11.0 bn (FY10: INR 11.0 bn) was invested in Sonata Investments and INR 16.0 bn (FY10: INR 23.3 bn) in Reliance Infra Projects International.

### Higher yield on ICDs due to repayments at year end

Inter-corporate deposits (ICDs) dipped from INR 27.7 bn in FY10 to INR 8.0 bn in FY11 with average yield at 17.5% during FY11 (FY10: 9.9%). The higher yield should be on account of repayments at the year end.

*\* - All figures are based on consolidated financial statements, unless otherwise stated*

#### Market Data

52-week range (INR)	: 1,075 / 366
Share in issue (mn)	: 263.7
M cap (INR bn/USD mn)	: 121 / 2,455
Avg. Daily Vol. BSE/NSE ('000)	: 1,867.9

#### Market Data

Promoters	: 48.4
MFs, FIs & Banks	: 21.0
FIIIs	: 15.0
Others	: 15.5
*Promoters pledged shares (% of share in issue)	: Nil

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Analysis beyond Consensus (ABC) is our initiative to provide a differentiated perspective to our clients on various non-routine and intricate issues. This unit of research works independent of the sector/stock research team and views expressed in this report may vary with that of respective sector/stock analyst.

# ALLAHABAD BANK

## A tidy quarter, all eyes on asset quality

India Equity Research | Banking and Financial Services

Allahabad Bank (ALBK) once again surpassed Street's expectation reporting a PAT of INR 4.8 bn in Q2FY12, up 21% Y-o-Y and 17% Q-o-Q on the strength of margin expansion, controlled delinquencies and lower tax provision (9%). Despite migrating 100% to system based NPL recognition, no negative surprise was seen in slippages. Even NIMs expanded 28bps Q-o-Q to 3.7% as it shed low yielding agri loans and short term loans. We expect NIMs to come under pressure due to savings rate deregulation and build up of agri loans. Better core performance will get offset by investment depreciation hit (with rise in bond yields). Considering relatively higher power sector exposure and underweight stance on state owned banks, we maintain 'REDUCE' rating on the stock.

### NIMs expand as bank discards low yielding agri, short term loans

NIMs expanded by 28bps, crossing the 3.5% threshold for the first time, led by a 100bps increase in yield on advances as the bank cast off low yielding agri loans (INR 8-10 bn) and short term loans (INR 30 bn). Hike in cost of funds was capped at 14bps - CASA ratio was maintained at 31% and it shed bulk deposits (down 8% Q-o-Q). The management maintained its NIM guidance at 3%, being skeptical about the impact of savings rate deregulation. We are building in margins (calc) of 2.9-3.1% for FY12-12E.

### No negative surprise in slippage despite 100% migration

During the quarter, ALBK's slippages were capped at INR 5.2 bn (2.1% annualised) – as was expected it picked up from low level of 60bps in Q1FY12 due to 100% migration to system based NPL recognition. The management indicated that 50% of slippages have accrued from migration of small ticket loans (less than INR 2.5 mn). Recoveries/upgradation momentum was sustained while aggressive write-offs of INR 2.5 bn led to a mere 7% Q-o-Q increase in GNPA to 1.77%. Restructured asset pool at INR 29.4 bn, 3.07% of advances, has shown a marginal decline.

### Outlook and valuations: Eyes on asset quality; maintain 'REDUCE'

ALBK has been surprising on the margin front since past few quarters while the asset quality performance was also better. However, loan growth has moderated to 17% and margins may come under pressure due to savings rate deregulation. The stock is currently trading at 0.8x FY13 book and considering our underweight stance on SOE banks, we maintain 'REDUCE/Underperformer' recommendation/rating on the stock.

#### Financials

Year to March	Q2FY12	Q2FY11	Growth %	Q1FY12	Growth %	FY11	FY12E
Net int. inc. (INR mn)	13,182	9,692	36.0	11,756	12.1	40,225	50,445
Net profit (INR mn)	4,880	4,026	21.2	4,181	16.7	14,231	17,902
B/V per share (INR)						160.5	191.7
Diluted EPS (INR)	10.3	9.0	13.8	8.8	16.7	29.9	37.6
Price/ Adj book (x)						1.1	0.9
Price/ Earnings (x)						5.4	4.3

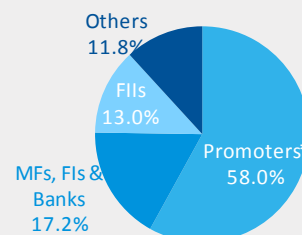
#### EDELWEISS 4D RATINGS

Absolute Rating	REDUCE
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Equalweight

#### MARKET DATA (R: ALBK.BO, B: ALBK IN)

CMP	: INR 161
Target Price	: INR 157
52-week range (INR)	: 272 / 139
Share in issue (mn)	: 476.2
M cap (INR bn/USD mn)	: 77 / 1,556
Avg. Daily Vol.BSE/NSE('000)	: 869.6

#### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : NIL  
(% of share in issue)

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	(10.3)	8.4	3.4
3 months	(29.6)	(2.3)	(8.1)
12 months	(42.3)	(10.5)	(18.0)

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### Loan growth moderates; conservative in lending to power sector

Loan growth momentum moderated to 17% Y-o-Y (from >30% in the past four quarters) due to unwinding of agri loans (to the tune INR 8-10 bn) and deliberate shedding of short term loans (by INR 30 bn). Considering the concentrated exposure of more than 20% to the infrastructure segment (of which power is 14%), ALBK is extremely conservative in lending to the power sector. Unlike peers, momentum in retail loan growth had been strong at 20% Y-o-Y and 5% Q-o-Q. We are building in loan growth of 19% CAGR over FY11-13E.

### Core fee income strong

During the quarter, the bank's core fee income grew 21% Y-o-Y, led by processing fees and exchange income. Treasury profits were limited at INR 70 mn (against INR 1.6 bn in FY11).

### Other highlights

- ALBK has amortised INR 374 mn in Q2FY12 towards retirement benefits.
- AFS constitutes 35% of the investment book where duration is three years. It booked investment depreciation of INR 824 mn in Q2FY12.
- Provisioning coverage, including technical write offs, was maintained at 80%.

**Table 1: Loan growth moderated to 17%**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Advances (INR bn)	657	724	757	821	868	946	987	957
Advances growth Q-o-Q (%)	8.0	10.3	4.5	8.4	5.8	8.9	4.4	(3.1)
Advances growth Y-o-Y (%)	25.9	21.9	24.1	35.0	32.2	30.6	30.4	16.6
Deposits (INR bn)	942	1,061	1,083	1,136	1,209	1,319	1,338	1,420
Deposit growth Q-o-Q (%)	7.9	12.6	2.1	4.9	6.4	9.0	1.5	6.1
Deposit growth Y-o-Y (%)	25.4	24.8	21.2	30.2	28.4	24.4	23.5	25.0
CD ratio (%)	69.8	68.3	69.9	72.2	71.8	71.7	73.8	67.4

**Table 2: Margins expand due to shedding of low yielding agri/short term loans**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Cost of deposit	6.0	5.6	5.6	5.7	6.0	6.0	7.0	7.1
Cost of borrowing	6.3	6.0	6.6	6.4	5.7	5.9	6.9	6.9
Cost of fund	6.0	5.6	5.7	5.8	5.9	6.0	6.9	7.1
Yield on advances	10.5	10.1	10.3	10.4	10.6	10.7	11.6	12.6
Yield on investments	6.8	6.8	6.8	6.9	7.1	7.2	7.6	7.6
Yield on fund	8.7	8.4	8.8	9.0	9.3	9.5	10.3	10.9
Net Interest margin	3.0	3.0	3.1	3.3	3.4	3.5	3.4	3.7

**Table 3: CASA maintained at 31%; reliance on bulk deposits coming off**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
CASA	35.1	34.5	34.2	34.7	33.3	33.5	32.0	30.6
SA	27.8	26.7	27.1	27.3	26.7	26.5	26.0	25.3
CA	7.3	7.8	7.1	7.4	6.6	6.9	6.0	5.4
Term deposits	64.9	65.5	65.8	65.3	66.7	66.5	68.0	69.4
DRI	1.2	0.6	0.4	0.3	0.2	0.2	0.2	0.1
CD	11.4	13.8	15.7	15.2	15.7	13.4	13.9	12.0
Others	52.3	51.2	49.7	49.9	50.8	53.0	54.0	57.2

Source: Company

**Table 4: Fee income grew 20% led by processing fee and exchange income**

	Q2FY12	Q2FY11	Growth (%)	Q1FY12	Growth (%)
Commision & exchange	2,560	2,130	20.2	2,060	24.3
Processing fees	980	710	38.0	430	127.9
LC/BG and Bills	650	570	14.0	760	(14.5)
Exchange	420	190	121.1	170	147.1
Others	480	620	(22.6)	520	(7.7)
Investment profits	70	380	(81.6)	260	(73.1)
Other	462	940	(50.9)	539	(14.3)
<b>Total</b>	<b>3,092</b>	<b>3,450</b>	<b>(10.4)</b>	<b>2,859</b>	<b>8.1</b>

**Table 5: Slippages at 2.1% - 50% due to migration to system based NPL recognition**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Incremental slippage*	1.3	3.9	0.7	2.4	1.8	3.7	0.6	2.1
Gross NPA	11,605	12,218	11,393	14,703	15,405	16,479	16,044	17,152
Growth Q-o-Q (%)	7.2	5.3	(6.8)	29.0	4.8	7.0	(2.6)	6.9
Net NPA	2,275	4,702	3,084	4,565	5,067	7,364	5885.9	6641.2
Growth Q-o-Q (%)	9.2	106.6	(34.4)	48.0	11.0	45.3	(20.1)	12.8
Gross NPA (%)	1.8	1.7	1.5	1.8	1.8	1.7	1.6	1.8
Net NPA (%)	0.4	0.7	0.4	0.6	0.6	0.8	0.6	0.7
Provison coverage (%)	80.4	61.5	72.9	69.0	67.1	55.3	63.3	61.3

\*one quarter lag

**Table 6: Aggressive write-offs caps increase in gross NPLs**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q1FY12
Opening gross NPA	10,821	11,605	12,218	11,393	14,703	15,405	16,479	16,044
Add: Additions during the year	1,928	6,440	1,182	4,539	3,623	8,126	1,518	5,208
Less:	1,144	5,827	2,007	1,230	2,921	7,052	1,954	4,100
Closing gross NPA	11,605	12,218	11,393	14,703	15,405	16,479	16,044	17,152

Source: Company

## Banking and Financial Services

Financials snapshot								(INR mn)
Year to March	Q2FY12	Q2FY11	Growth (%)	Q1FY12	Growth (%)	FY11	FY12E	FY13E
Interest on advances	29,614	19,840	49.3	26,994	9.7	82,742	112,669	133,390
Interest on investments	9,072	6,308	43.8	8,342	8.8	26,703	34,907	43,120
Interest on other resources	201	143	40.7	161	24.9	702	680	836
Interest income	38,933	26,369	47.6	35,498	9.7	110,147	148,256	177,346
Interest expenses	25,751	16,677	54.4	23,743	8.5	69,922	97,811	121,102
Net interest income	13,182	9,692	36.0	11,756	12.1	40,225	50,445	56,244
Other income	3,092	3,447	(10.3)	2,859	8.1	13,704	14,811	18,373
Fee income	3,092	3,067	0.8	2,599	19.0	12,089	14,111	16,673
Operating expenses	6,781	5,324	27.4	5,719	18.6	23,383	25,658	29,599
Staff expense	4,675	3,503	33.4	3,822	22.3	15,576	16,563	19,038
Other opex	2,107	1,821	15.7	1,897	11.1	7,807	9,095	10,561
Pre prov op profit (PPP)	9,493	7,435	27.7	8,636	9.9	30,546	39,598	45,017
Provisions	4,117	2,714	51.7	3,197	28.8	11,239	16,043	16,536
Loan loss provisions	3,016	2,250	34.0	1,656	82.2	8,942	12,043	14,336
Profit before tax	5,376	5,101	5.4	5,699	(5.7)	19,307	23,555	28,482
Provision for tax	496	1,075	(53.9)	1,518	(67.3)	5,076	5,653	8,117
Profit after tax	4,880	4,026	21.2	4,181	16.7	14,231	17,902	20,364
EPS (INR)	10.3	9.0	13.8	8.8	16.7	30	38	43
<b>Ratios</b>								
NII / GII	33.9	36.8		33.1		36.5	34.0	31.7
Cost - income	41.7	40.5		39.1		43.4	39.3	39.7
Provisions / PPOP	43.4	36.5		37.0		36.8	40.5	36.7
Tax rate	9.2	21.1		26.6		26.3	24.0	28.5
Capital adequacy (%)	13.0	13.5		12.8		13.6	12.9	13.0
<b>Balance sheet data</b>								
Advances (INR bn)	957	821	16.6	987	(3.1)	936,249	1,114,136	1,325,822
Deposits (INR bn)	1,420	1,136	25.0	1,338	6.1	1,318,872	1,567,112	1,858,210
CD Ratio (%)	67.4	72.2		73.8		71.0	71.1	71.3
<b>Asset quality (INR bn)</b>								
Gross NPA (%)	1.8	1.8		1.6		1.7	1.8	1.9
Gross NPA	17.2	14.7		16.0		16	20	25
Net NPA (%)	0.7	0.6		0.6		0.8	0.8	0.7
Net NPA	6.6	4.6		5.9		7	9	10
Provision coverage (%)	61.3	69.0		63.3		55.3	57.4	60.6



## Company Description

Allahabad Bank has a pan-India presence with the sixth largest network of 2,441 branches across India as on Q2FY12, and a strong presence in the eastern region. Nearly 70% of the bank's branches are in Uttar Pradesh and eastern India. Its market share in advances and deposits was at 2.30% and 2.34%, respectively; as on Sep 2011 its balance sheet stood at ~INR 1.5tn. Incorporated in 1865 by European businessmen and nationalized in 1969, Allahabad Bank is India's oldest public sector bank. The government of India (GoI) has a 55% stake in the bank, whereas, the foreign share holding is a little above 18%.

## Investment Thesis

Despite 17-18% plus RoE and reasonable CASA of 30.6% as on Q2FY12, the bank trades at significant discount to its peers, mainly due to technological backwardness and poor perception of its asset quality. In our view, the stock could continue to trade in a range considering its concentration in eastern states which are economically backward as compared to rest of the country and thus carry higher delinquency risk.

## Key Risks

**Asset quality:** In this current scenario, there is a greater risk of NPA accretion for Allahabad Bank than its peers, given its geographical spread and relatively weaker risk management systems.

Maintaining Capital adequacy in this environment is a challenge.

Bank's cost to income ratio is one of the highest in the PSU space.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Interest income	72,592	83,692	110,147	148,256	177,346
Interest expenses	52,061	57,187	69,922	97,811	121,102
Net Interest income	20,531	26,505	40,225	50,445	56,244
Non interest income	13,447	15,159	13,704	14,811	18,373
- Fee & forex income	6,210	6,974	8,568	10,161	12,239
- Misc. income	1,510	2,425	3,522	3,951	4,434
- Investment profits	5,727	5,760	1,615	700	1,700
Net revenues	33,978	41,664	53,929	65,256	74,616
Operating expense	13,994	16,178	23,383	25,658	29,599
- Employee exp	8,739	10,114	15,576	16,563	19,038
- Other opex	5,255	6,065	7,807	9,095	10,561
Preprovision profit	19,983	25,486	30,546	39,598	45,017
Provisions	8,253	7,769	11,239	16,043	16,536
- Loan loss provisions	3,332	8,331	8,942	12,043	14,336
- Investment depreciation	3,575	(1,024)	1,308	3,000	1,500
- Other provisions	1,346	463	989	1,000	700
PBT	11,730	17,716	19,307	23,555	28,482
Taxes	3,072	5,653	5,076	5,653	8,117
PAT	8,659	12,063	14,231	17,902	20,364
EPS	19.4	27.0	29.9	37.6	42.8
DPS	2.5	5.5	5.5	5.5	5.5
Payout ratio (%)	12.9	20.4	18.4	14.6	12.9

Growth ratios (%)					
Year to March	FY09	FY10	FY11	FY12E	FY13E
NII growth	31.0	29.1	51.8	25.4	11.5
Fees growth	41.8	12.3	22.8	18.6	20.4
Opex growth	20.9	15.6	44.5	9.7	15.4
PPOP growth	41.4	38.4	46.7	34.5	11.4
PPP growth	35.1	27.5	19.9	29.6	13.7
Provisions growth	130.9	150.0	44.7	42.7	3.1
PAT growth	(11.2)	39.3	18.0	25.8	13.8

Operating ratios (%)					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Yield on advances	10.1	9.8	10.0	11.0	10.9
Yield on investments	6.7	5.7	6.5	7.5	8.0
Yield on assets	8.3	7.8	8.2	9.2	9.3
Net interest margins	2.3	2.5	3.0	3.1	2.9
Cost of funds	6.1	5.5	5.4	6.3	6.6
Cost of deposits	6.2	5.6	5.5	6.4	6.7
Cost of borrowings	8.5	8.1	7.8	8.5	8.5
Spread	2.1	2.3	2.8	2.9	2.7
Cost-income	41.2	38.8	43.4	39.3	39.7
Tax rate	26.2	31.9	26.3	24.0	28.5

Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
<b>Liabilities</b>					
Equity capital	4,467	4,467	4,762	4,762	4,762
Reserves	45,323	54,376	71,669	86,517	103,827
<b>Net worth</b>	<b>49,790</b>	<b>58,843</b>	<b>76,432</b>	<b>91,279</b>	<b>108,589</b>
Sub bonds/pref cap	29,119	40,119	39,119	47,119	55,119
Deposits	849,718	1,060,558	1,318,872	1,567,112	1,858,210
Borrowings	9,366	14,236	30,063	31,294	36,398
Other liabilities	29,754	34,550	39,736	42,511	46,417
<b>Total</b>	<b>967,747</b>	<b>1,208,305</b>	<b>1,504,221</b>	<b>1,779,315</b>	<b>2,104,733</b>
<b>Assets</b>					
Loans	588,019	716,049	936,249	1,114,136	1,325,822
<b>Investments</b>					
<i>Gilts</i>	<i>216,764</i>	<i>311,212</i>	<i>352,224</i>	<i>408,638</i>	<i>484,323</i>
<i>Others</i>	<i>79,747</i>	<i>73,074</i>	<i>80,247</i>	<i>86,344</i>	<i>93,100</i>
Cash & equi	66,368	91,682	110,274	144,616	171,479
Fixed Assets	2,364	2,496	2,840	3,138	3,396
Other Assets	14,487	13,792	22,388	22,444	26,613
<b>Total</b>	<b>967,747</b>	<b>1,208,305</b>	<b>1,504,221</b>	<b>1,779,315</b>	<b>2,104,733</b>
<b>Balance sheet ratios (%)</b>					
Credit growth	15.9	19.9	31.1	18.9	18.9
Deposit growth	18.6	24.8	24.4	18.8	18.6
EA growth	18.6	25.4	24.1	18.6	18.3
SLR ratio	25.2	29.3	26.7	26.0	26.0
C-D ratio	71.8	69.2	72.9	72.9	73.1
Low-cost deposits	34.6	34.5	33.5	32.5	32.0
Gross NPA ratio	1.8	1.7	1.7	1.8	1.9
Net NPA ratio	0.7	0.7	0.8	0.8	0.7
Provision coverage	60.9	61.5	55.3	57.4	60.6
Incremental Slippage	1.7	2.1	2.4	2.1	2.2
Net NPA / Equity	8.5	8.0	9.6	9.5	9.0
Capital Adequacy	13.1	13.6	12.9	13.0	13.1
- Tier 1	8.0	8.1	8.3	8.4	8.5
Book Value	111.5	131.7	160.5	191.7	228.0

**ROA decomposition (%)**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Net Interest Income/Assets	2.3	2.5	3.0	3.1	2.9
Fees/Assets	0.9	0.9	0.9	0.9	0.9
Investment profits/Assets	0.7	0.5	0.1	0.0	0.1
Net revenues/Assets	3.9	3.9	4.0	4.0	3.9
Operating Expense/Assets	(1.6)	(1.5)	(1.8)	(1.6)	(1.5)
Provisions/Assets	(0.9)	(0.7)	(0.8)	(1.0)	(0.9)
Taxes/Assets	(0.4)	(0.5)	(0.4)	(0.3)	(0.4)
Total Costs/Assets	(2.9)	(2.8)	(3.0)	(2.9)	(2.8)
ROA	1.0	1.1	1.1	1.1	1.1
Equity/Assets	5.3	5.1	5.1	5.2	5.2
ROAE	18.5	22.2	21.0	21.3	20.4

### Valuation metrics

Year to March	FY09	FY10	FY11	FY12E	FY13E
EPS (INR)	19.4	27.0	29.9	37.6	42.8
EPS growth (%)	(11.2)	39.3	10.7	25.8	13.8
Book value per share (INR)	111.5	131.7	160.5	191.7	228.0
Adjusted Book Value/share (INR)	104.8	124.4	149.7	179.0	213.7
Price/Earnings (x)	8.3	6.0	5.4	4.3	3.8
Price/ BV (x)	1.4	1.2	1.0	0.8	0.7
Price/ ABV (x)	1.5	1.3	1.1	0.9	0.8
Dividend yield (%)	1.6	3.4	3.4	3.4	3.4
Price to income (x)	5.5	4.7	3.9	3.3	2.8
Price to PPOP (x)	5.0	3.6	2.7	2.0	1.8

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	REDUCE	SO	H	Axis Bank	BUY	SO	M
Bank of Baroda	HOLD	SO	L	Federal Bank	BUY	SO	M
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	H
Infrastructure Development Finance	HOLD	SU	M	ING Vysya	HOLD	SP	H
Karnataka Bank	BUY	SO	L	Kotak Mahindra Bank	REDUCE	SP	L
LIC Housing Finance	HOLD	SP	M	Manappuram General Finance	HOLD	SU	M
Oriental Bank Of Commerce	REDUCE	SU	H	Power Finance Corp	BUY	SO	L
Punjab National Bank	REDUCE	SU	L	Reliance Capital	BUY	SP	M
Rural Electrification Corporation	BUY	SO	L	Shriram City Union Finance	BUY	SO	H
South Indian Bank	HOLD	SP	H	State Bank of India	HOLD	SP	L
Union Bank Of India	HOLD	SO	L	Yes Bank	BUY	SO	M
Mahindra & Mahindra Financial Services	HOLD	SP	M				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

# BAJAJ ELECTRICALS

## Tripped on consumer margins

India Equity Research | Engineering and Capital Goods

Bajaj Electricals (BJE) Q2FY12 earnings were marginally below ours and consensus estimates. Revenue, however, grew 19% on the back of a strong growth in lighting and consumer durables which grew by 25% and 21% respectively. E&P growth was lower at 10%. Earnings grew slower at 7% as interest costs jumped up significantly. We believe that the cleansing activity is broadly over and benefits of the same should accrue from now on. We expect the balance sheet quality to improve as BJE works towards reducing capital employed through the cleansing. We maintain 'BUY' on the stock with target price of INR 240.

### E&P show signs of pick-up, lighting, consumer divisions shine

BJE reported a robust growth in its lighting division, growing at 25%. Fans disappointed with ~4% growth dragging the overall consumer durable growth to 21% even as consumer durables and Morphy Richards clocked ~30% growth. After a muted sales growth, E&P saw a pick-up in execution, posting a 10% growth in Q2FY12. EBITDA grew 18% to INR 525 mn as BJE reported a flat margin of 7.5%. While the company seemed to be on track to achieve the promised E&P EBIT margin by the end of the year, the concern during the quarter stemmed from the 200bps dip seen in consumer durables. BJE indicated that this dip was due to a combination of higher RM costs, lower fans sales and increased cost of imports from China owing to an adverse currency movement. Higher interest cost (as inventory piled up in fans and coolers) and lower other income cut PAT growth to 7% (INR 250 mn) in the quarter. Current order book stands at INR 74.2bn.

### Outlook and valuations: Structurally positive; maintain 'BUY'

The cleansing of E&P order book is broadly over hence we consider BJE is on track to achieve its targeted profitability. We believe BJE's consumer businesses will continue to report strong growth as it launches new products and enters newer segments amid increased competition. We are concerned with shrinking order book in E&P though. We marginally cut our earnings by 6% and 4% for FY12E and FY13E respectively. The stock is currently trading at P/E of 12.5x and 9.6x FY12E and FY13E respectively. We maintain 'BUY / Sector Outperformer' with a target price of INR 240.

#### Financials

(INR mn)

Year to March	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	FY11	FY12E
Net revenues	7,008	5,878	19.2	5,443	28.8	27,408	32,853
EBITDA	525	446	17.9	302	74.0	2,598	2,963
Net profit	250	234	7.0	111	125.0	1,488	1,583
Diluted EPS (INR)	2.5	2.4	7.0	1.1	125.0	15.0	16.0
Diluted P/E (x)						13.3	12.5
EV/EBITDA (x)						7.7	7.1
ROAE (%)						26.9	23.5

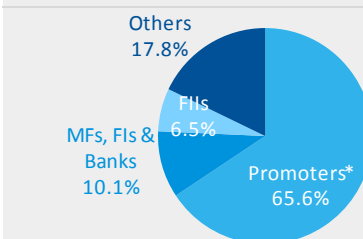
#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

#### MARKET DATA (R: BJEL.BO, B: BJE IN)

CMP	: INR 200
Target Price	: INR 240
52-week range (INR)	: 297 / 160
Share in issue (mn)	: 99.6
M cap (INR bn/USD mn)	: 20 / 404
Avg. Daily Vol.BSE/NSE('000)	: 139.4

#### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : 1.7  
(% of share in issue)

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	7.3	8.4	(1.2)
3 months	(10.4)	(2.3)	(10.8)
12 months	(29.9)	(10.5)	(25.9)

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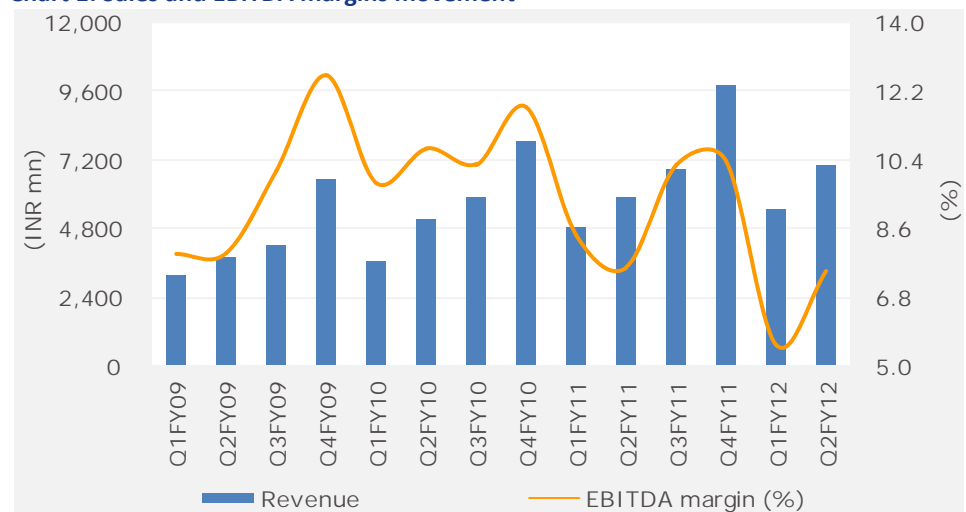
November 2, 2011

**Table 1: Segmental performance**

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	H1FY12	H2FY12	% change
<b>Revenues (INR mn)</b>								
Lighting	1,892	1,514	25.0	1,274	48.5	3,166	2,613	21.2
Consumer durables	3,394	2,798	21.3	3,031	12.0	6,425	5,427	18.4
Engineering & Projects	1,712	1,560	9.7	1,136	50.7	2,848	2,670	6.7
<b>Total</b>	<b>6,998</b>	<b>5,872</b>	<b>19.2</b>	<b>5,441</b>	<b>28.6</b>	<b>12,439</b>	<b>10,711</b>	<b>16.1</b>
<b>Segment rev. mix (%)</b>								
Lighting	27.0	25.8		21.7		25.5	24.4	
Consumer durables	48.5	47.6		51.6		51.6	50.7	
Engineering & Projects	24.5	26.6		19.3		22.9	24.9	
<b>EBIT (INR mn)</b>								
Lighting	113	68	67.4	62	82.3	175	89	95.7
Consumer durables	315	317	(0.9)	291	8.0	606	568	6.6
Engineering & Projects	65	48	35.0	(76)	NM	(12)	162	NM
<b>Total</b>	<b>492</b>	<b>433</b>	<b>13.7</b>	<b>277</b>	<b>77.8</b>	<b>769</b>	<b>819</b>	<b>(6.1)</b>
<b>Segment EBIT mix (%)</b>								
Lighting	22.9	15.6		12.6		22.7	10.9	
Consumer durables	63.9	73.3		59.1		78.8	69.4	
Engineering & Projects	13.2	11.1		(15.5)		(1.5)	19.7	
<b>Segment EBIT margin (%)</b>								
Lighting	6.0	4.5		4.9		5.5	3.4	
Consumer durables	9.3	11.3		9.6		9.4	10.5	
Engineering & Projects	3.8	3.1		(6.7)		(0.4)	6.0	
<b>Total EBIT margins</b>	<b>7.0</b>	<b>7.4</b>		<b>5.1</b>		<b>6.2</b>	<b>7.6</b>	

Source: Company, Edelweiss research

**Chart 1: Sales and EBITDA margins movement**



Source: Company, Edelweiss research

Chart 2: Segmental margin - Lighting

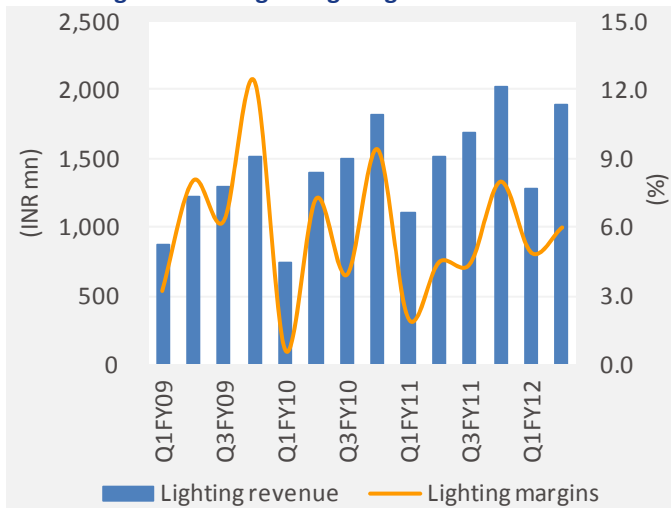


Chart 3: Segmental margin – Consumer durables

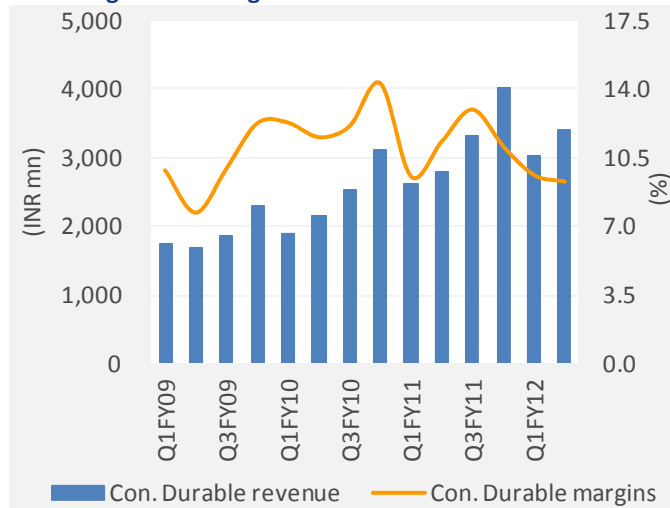
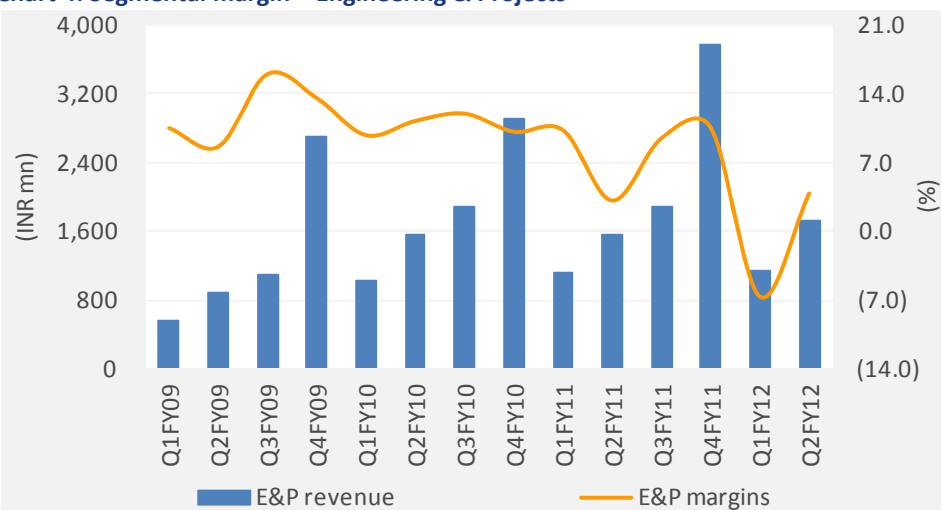
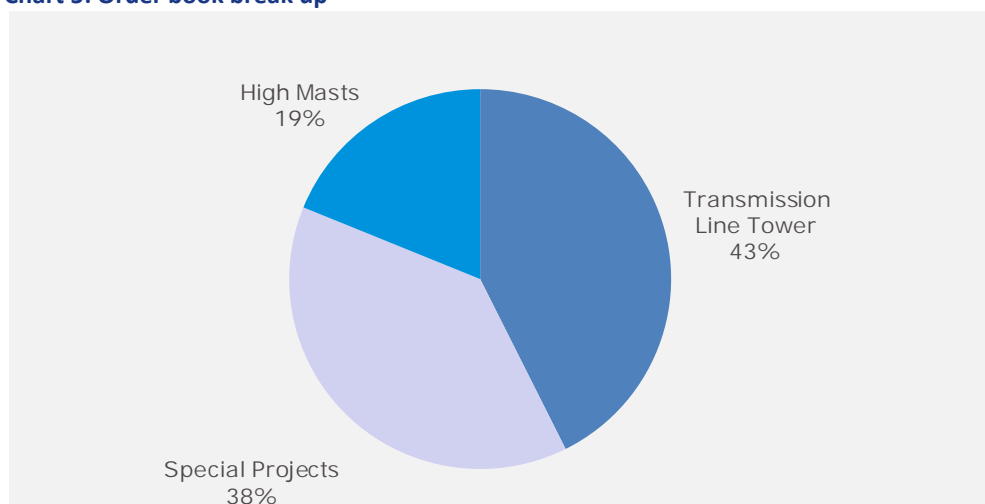


Chart 4: Segmental margin – Engineering & Projects



Source: Company, Edelweiss research

Chart 5: Order book break up



Source: Company, Edelweiss research



## Financial snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% Change	Q1FY12	% Change	FY11	FY12E	FY13E
Net revenues	7,008	5,878	19.2	5,443	28.8	27,408	32,853	38,848
Raw material	5,209	4,444	17.2	4,111	26.7	20,729	24,806	29,063
Staff costs	463	375	23.5	315	47.1	1,224	1,438	1,660
Other expenses	811	613	32.2	715	13.4	2,856	3,646	4,349
Total expenditure	6,483	5,432	19.3	5,141	26.1	24,810	29,891	35,072
EBITDA	525	446	17.9	302	74.0	2,598	2,963	3,776
Depreciation	29	23	24.8	31	(4.9)	126	135	149
EBIT	496	422	17.5	271	82.9	2,472	2,828	3,627
Other income	7	15	(53.0)	7	6.0	57	55	54
Interest	128	76	68.7	107	20.3	291	466	521
Profit before tax	375	361	3.7	171	118.9	2,239	2,416	3,161
Tax	125	128	(2.2)	60	107.8	751	834	1,106
Core profit	250	234	7.0	111	125.0	1,488	1,583	2,055
Extraordinary items						(50)		
Reported net profit	250	234	7.0	111	125.0	1,438	1,583	2,055
Adjusted net profit	250	234	7.0	111	125.0	1,488	1,583	2,055
Equity capital (FV INR 2)	198	198		198		198	198	198
No. of shares (mn)	99	99		99		99	99	99
Diluted EPS (INR)	2.5	2.4	7.0	1.1	125.0	15.0	16.0	20.8
<b>As % of net revenues</b>								
Direct costs	74.3	75.6		75.5		75.6	75.5	74.8
Employee cost	6.6	6.4		5.8		4.5	4.4	4.3
Other operating expenses	11.6	10.4		13.1		10.4	11.1	11.2
EBITDA	7.5	7.6		5.5		9.5	9.0	9.7
Adjusted net profit	3.6	4.0		2.0		5.4	4.8	5.3
Tax rate	33.3	35.3		35.0		33.5	34.5	35.0

## Company Description

Incorporated as Radio Lamp Works in July 1938, the company changed its name to Bajaj Electricals in October 1960. The 71-year old Bajaj Group company operates through five strategic business units—home appliances, fans, lighting, luminaries, and engineering & projects.

The company has two manufacturing facilities, one at Chakan for fans, and another at Ranjangaon for galvanised material. The company sources the manufacture of CFL bulbs through its associate company where BJE has acquired equity interest. It outsources all other home appliances products like steam irons and toasters through its dedicated manufacturers located across the country.

## Investment Theme

With its consumer facing business growing steadily, the company is now focused more on growing its E&P division. BJE is the largest small appliances company in India and the leader in the small domestic appliances market. By virtue of tie ups with global majors like Morphy Richards (UK) and Nardi (Italy), the company competes with premium players like Philips and Kenstar, and has been able to create a niche in the premium segment. Its products like mixers, irons, OTG, water heaters and room coolers are leading products in their respective products ranges.

The company's distribution reach is far wider than its competitors, and is efficiently managed in terms of logistics and supply chain. BJE outsources most of its manufacturing. It has long-term relations with its vendors, dating back several decades, and has exclusive arrangements with 70% vendors. With such a set up in place, the company is able to focus on its core competencies, i.e., marketing and distribution.

## Key Risks

The market in which BJE primarily operates consists of large unorganised players with a number of small and medium sized players. Over dependence on vendors or vendor buy out by competition is a key risk. Further, intense competition in the consumer durable segment can squeeze margins.

Increase in prices of key raw materials such as steel and zinc can hamper margins of the E&P division. Greater contribution of E&P business is likely to increase the debt levels in the form of higher working capital that this business demands. Excess competition can put pressure on margin. This could go against the company's forecasts of margin improvement.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Income from operations	17,658	22,286	27,408	32,853	38,848
Materials costs	13,149	16,524	20,729	24,806	29,063
Employee costs	771	972	1,224	1,438	1,660
Other manufacturing expenses	1,901	2,292	2,856	3,646	4,349
Total operating expenses	15,821	19,787	24,810	29,891	35,072
EBITDA	1,836	2,499	2,598	2,963	3,776
Depreciation & Amortization	123	157	126	135	149
EBIT	1,714	2,342	2,472	2,828	3,627
Other income	57	29	57	55	54
Interest expenses	370	314	291	466	521
Profit before tax	1,401	2,057	2,239	2,416	3,161
Provision for tax	507	835	751	834	1,106
Core profit	894	1,221	1,488	1,583	2,055
Extraordinary income/ (loss)	(2)	(50)	(50)	-	-
Profit After Tax	892	1,171	1,438	1,583	2,055
Profit after minority interest	894	1,221	1,488	1,583	2,055
Basic shares outstanding (mn)	86	98	99	99	99
Basic EPS (INR)	10.3	12.5	15.1	16.0	20.8
Diluted equity shares (mn)	101	98	99	99	99
Diluted EPS (INR)	8.9	12.4	15.0	16.0	20.8
CEPS (INR)	11.7	13.8	16.2	17.4	22.3
Dividend per share (INR)	2.3	2.8	3.3	3.3	3.3
Dividend payout (%)	22.6	22.4	21.8	20.5	15.8

Common size metrics - as % of net revenues					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	89.6	88.8	90.5	91.0	90.3
Employee expenses	4.4	4.4	4.5	4.4	4.3
S G & A expenses	10.8	10.3	10.4	11.1	11.2
Direct Cost	74.5	74.1	75.6	75.5	74.8
Depreciation	0.7	0.7	0.5	0.4	0.4
Interest expenditure	2.1	1.4	1.1	1.4	1.3
EBITDA margins	10.4	11.2	9.5	9.0	9.7
Net profit margins	5.1	5.5	5.4	4.8	5.3

Growth ratios (%)					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	28.5	26.2	23.0	19.9	18.2
EBITDA	28.2	36.1	3.9	14.1	27.4
PBT	25.7	46.8	8.9	7.9	30.8
Net profit	22.3	36.6	21.8	6.4	29.8
EPS	22.3	21.0	20.2	6.4	29.8

Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
Equity capital	173	195	198	198	198
Reserves & surplus	2,277	4,749	5,913	7,172	8,902
Shareholders funds	2,450	4,944	6,111	7,370	9,100
Secured loans	1,480	684	483	1,483	1,683
Unsecured loans	658	834	682	682	682
Borrowings	2,139	1,518	1,165	2,165	2,365
Deferred tax (net)	31	(5)	(20)	(20)	(20)
<b>Sources of funds</b>	<b>4,619</b>	<b>6,457</b>	<b>7,255</b>	<b>9,514</b>	<b>11,445</b>
Gross block	1,545	1,700	2,302	2,502	2,752
Depreciation	599	683	769	904	1,052
Net block	946	1,016	1,533	1,598	1,699
Capital work in progress	25	1	-	-	-
Investments	316	366	366	366	366
Inventories	1,777	2,094	2,946	3,874	4,419
Sundry debtors	5,592	7,507	10,654	13,290	15,705
Cash and equivalents	538	612	481	438	541
Loans and advances	1,130	1,777	1,668	1,834	2,018
Other current assets	-	-	-	-	-
Total current assets	9,037	11,990	15,749	19,435	22,682
Sundry creditors and others	5,191	6,273	9,661	11,561	12,979
Provisions	513	643	731	324	324
Total current liabilities & provisions	5,703	6,916	10,392	11,885	13,303
Net current assets	3,334	5,074	5,357	7,550	9,379
<b>Uses of funds</b>	<b>4,619</b>	<b>6,457</b>	<b>7,255</b>	<b>9,514</b>	<b>11,445</b>
Book value per share (INR)	14.2	25.3	30.9	37.3	46.0

Free cash flow					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net profit	894	1,221	1,488	1,583	2,055
Depreciation	123	157	126	135	149
Deferred tax	31	(5)	(20)	-	-
Others	211	243	260	466	521
Gross cash flow	1,259	1,616	1,853	2,184	2,724
Less: Changes in WC	(55)	1,564	828	2,237	1,726
Operating cash flow	1,314	52	1,025	(53)	998
Less: Capex	134	395	627	200	250
<b>Free cash flow</b>	<b>1,181</b>	<b>(343)</b>	<b>398</b>	<b>(253)</b>	<b>748</b>

Cash flow metrics					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating cash flow	1,314	52	1,025	(53)	998
Investing cash flow	(288)	(387)	(207)	(200)	(250)
Financing cash flow	(808)	409	(949)	210	(645)
Net cash flow	218	74	(131)	(43)	103
Capex	(134)	(395)	(627)	(200)	(250)
Dividends paid	(161)	(201)	(274)	(324)	(324)
Share issuance/(buyback)	-	1,599	55	-	-

### Profitability & efficiency ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	42.6	33.0	26.9	23.5	25.0
ROACE (%)	41.6	45.1	38.1	35.3	35.9
Inventory day	47	43	44	50	52
Debtors days	102	107	121	133	136
Payable days	123	127	140	156	154
Cash conversion cycle (days)	26	23	25	27	34
Current ratio	1.6	1.7	1.5	1.6	1.7
Debt/EBITDA	1.2	0.6	0.4	0.7	0.6
Debt/Equity	0.9	0.3	0.2	0.3	0.3
Adjusted debt/equity	0.9	0.3	0.2	0.3	0.3
Interest coverage	4.6	7.4	8.5	6.1	7.0

### Operating ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
Total asset turnover	4.0	4.0	4.0	3.9	3.7
Fixed asset turnover	19.0	22.7	21.5	21.0	23.6
Equity turnover	8.4	6.0	5.0	4.9	4.7

### Du pont analysis

Year to March	FY09	FY10	FY11	FY12E	FY13E
NP margin (%)	5.1	5.5	5.4	4.8	5.3
Total assets turnover	4.0	4.0	4.0	3.9	3.7
Leverage multiplier	2.1	1.5	1.2	1.2	1.3
ROAE (%)	42.6	33.0	26.9	23.5	25.0

### Valuation parameters

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	8.9	12.4	15.0	16.0	20.8
Y-o-Y growth (%)	5.0	39.8	21.1	6.4	29.8
CEPS (INR)	11.7	13.8	16.2	17.4	22.3
Diluted PE (x)	22.5	16.1	13.3	12.5	9.6
Price/BV (x)	14.1	7.9	6.5	5.4	4.3
EV/Sales (x)	1.1	0.9	0.7	0.6	0.5
EV/EBITDA (x)	10.1	8.0	7.7	7.1	5.6
Dividend yield (%)	1.2	1.4	1.6	1.6	1.6

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	REDUCE	SU	L	AIA Engineering	HOLD	SU	M
Bajaj Electricals	BUY	SO	M	BGR Energy Systems	HOLD	SP	M
Bharat Heavy Electricals	HOLD	SP	L	Crompton Greaves	REDUCE	SU	M
Cummins India	BUY	SO	L	Havell's India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power Transmission	HOLD	SP	M
KEC International	BUY	SO	M	Larsen & Toubro	BUY	SO	M
Siemens	BUY	SO	L	Techno Electric & Engineering	BUY	None	None
Thermax	BUY	SO	L	Voltamp Transformers	HOLD	SU	M
Voltas	HOLD	SP	L				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

# ESSAR OIL

## Full complexity throttle from FY13

India Equity Research | Oil, Gas and Services

Essar Oil (ESOIL) reported Q2FY12 EBITDA of INR 1.37 bn and a PAT of INR -1.66 bn (loss), lower than the estimated INR 4.75 bn and INR 0.23 bn (profit) due to forex losses of INR 4.1 bn (INR 2.7 bn to be reversed in Q3FY12). Post the adjustment of forex losses, numbers were better than estimates due to higher than expected refining margins (Reported USD 7.2/bbl versus expected USD 6.7/bbl). The company has successfully completed 35 day (13 days in Q2FY12) shutdown at its Vadinar refinery to tie in new units for expanding the capacity to 18 mmtpa. Full impact of the complex refinery will be visible in FY13. Maintain Buy.

### Higher operational GRMs at USD 5.1/bbl, throughput at 3.03 mmt

ESOIL's clean GRM of USD 7.2/bbl (down USD 0.2/bbl Q-o-Q) was higher than our estimates (USD 6.7/bbl) due to better product price management by the company. Adjusted for sales tax deferral, operating GRMs were at USD 5.1/bbl versus USD 4.2/bbl during Q1FY12. Refining throughput at 3.03 mmt was down 16.3% Q-o-Q due to the shutdown in refinery for 13 days during Q2FY12.

### Phase 1 expansion benefits to accrue from Q1FY13 onwards

During the recent shut-down of the refinery, ESOIL tied in new units to the existing refinery besides revamping existing units (CDU and FCCU). During Q3FY12, mechanical completion for other units (Coker, VGOHT, etc.) is expected to be completed. The revamped CDU is currently (October last week) processing at a run-rate of 16 mmtpa and is expected to gradually scale up to 18 mmtpa once secondary units become operational. We expect the refinery phase I expansion to go commercial by end March 2012 and report healthy GRMs from Q1FY13 onwards. The refinery optimization project, which is expected to expand the capacity to 20.0 mmtpa is on schedule for completion by Sep-12.

### Outlook and Valuation: GRMs to improve in FY13; maintain 'BUY'

We maintain our SOTP at INR 153/share. We value ESOIL using 6.5x EV-EBIDTA for its refining business and INR 44/share for its upstream business. Key driver for the stock will be earnings growth post commercialization of phase I expansion. We maintain our 'BUY' and 'Sector Outperformer' rating on the stock.

#### Financials

(INR mn)

Year to March	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	FY11	FY12E
Net revenues	130,260	109,420	19.0	150,240	(13.3)	469,882	568,322
EBITDA	1,370	6,120	(77.6)	8,660	(84.2)	24,255	33,524
PAT	(1,660)	1,300	NA	4,690	NA	6,539	10,291
Diluted EPS (INR)	(1.2)	1.0	NA	3.4	NA	4.8	7.5
Diluted P/E (x)	(17.6)	22.5		6.2		17.9	11.4
ROAE (%)						11.7	14.6

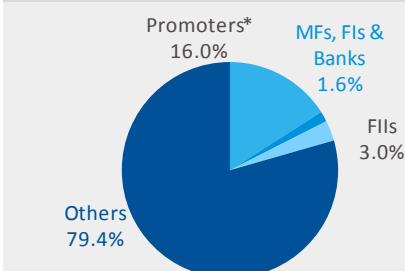
#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

#### MARKET DATA (R: ESRO.BO, B: ESOIL IN)

CMP	: INR 86
Target Price	: INR 153
52-week range (INR)	: 161 / 73
Share in issue (mn)	: 1,365.7
M cap (INR bn/USD mn)	: 117 / 2,379
Avg. Daily Vol.BSE/NSE('000)	: 1,846.9

#### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : 32.9  
(% of share in issue)

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW O & G Index
1 month	1.0	8.4	8.1
3 months	(27.9)	(2.3)	2.6
12 months	(40.0)	(10.5)	(14.1)

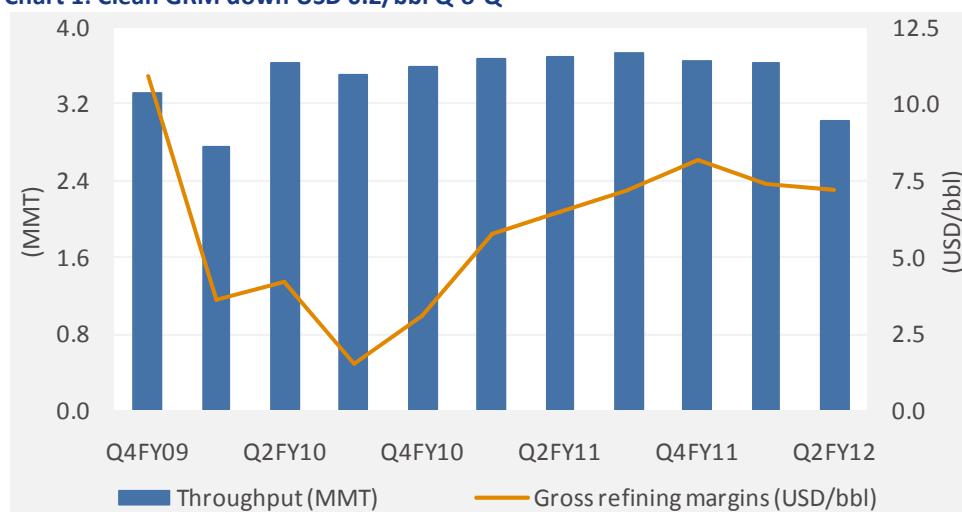
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November 2, 2011

## Other highlights

- Gas production at Raniganj was 22,000 scm/day compared to 33,000 scm/day during Q1FY12
- Capex in E&P segment during Q2FY12 was INR 790 mn
- Raniganj CBM project received Environmental Clearance for Phase-1 during Q2FY12
- CBM supplies through the Raniganj-Durgapur pipeline has started
- Other income for the quarter was high at INR 1.22 bn against average of INR 400 mn in last 4 quarters and our estimate of INR 350 mn due to high interest income earned on Iran payables. However, there were no losses on the same due to hedging.
- Forex loss of INR 4.07 bn included realized losses of INR 2.68 bn and unrealized losses of INR 1.39 bn. As per the management, INR 2.68 bn will be reversed in Q3FY12 during the sale of products.

**Chart 1: Clean GRM down USD 0.2/bbl Q-o-Q**



Source: Company, Edelweiss research

**Table 1: Maintain SOTP at INR 153/share**

	Value as on Mar-12 (INR mn)	Value per share as on Mar-12 (INR/share)	Notes
1-yr forward operational EBITDA	35,842	25	non-including sales tax deferral
EV of operational assets	232,976	161	at industry multiple of 6.5x
NPV of income tax benefit	10,894	8	7 year tax holiday
NPV of E&P assets	63,968	44	risk-weighted estimate
NPV of sales tax deferral	11,940	8	NPV of deferral yet to be booked
EV of firm	319,778	221	sum of parts above
FY12 net debt (net of investments/WIP/FCCB)	98,469	68	Debt net of cash, FCCB, WIP, investments
Equity value of firm at year end	221,309	153	EV - Net debt
Equity value of firm (Mar-2012)	221,309	153	Value as on Mar-2012

Source: Company, Edelweiss research



**Table 2: Revising upwards our FY12/13E revenues**

	Revised estimates		Previous estimates		(% Change)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Revenues (INR mn)	568,322	642,758	524,278	606,839	8.4%	5.9%
EBITDA (INR mn)	33,524	46,721	34,526	44,646	-2.9%	4.6%
PAT after minority interest (INR mn)	10,291	15,310	10,070	15,304	2.2%	0.0%
Diluted EPS (INR)	7.5	11.2	7.4	11.2	2.2%	0.1%

Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% Change	Q1FY12	% Change	FY11	FY12E	FY13E
Net revenues	130,260	109,420	19.0	150,240	(13.3)	469,882	568,322	642,758
Raw material costs	120,960	101,400	19.3	136,910	(11.6)	429,358	517,596	577,959
Gross profit	9,300	8,020	16.0	13,330	(30.2)	40,524	50,726	64,799
Employee expenses	360	330	9.1	300	20.0	1,197	1,257	1,319
Other expenses	7,570	1,570	382.2	4,370	73.2	15,072	15,945	16,759
Operating expenses	7,930	1,900	317.4	4,670	69.8	16,269	17,202	18,078
Total expenditure	128,890	103,300	24.8	141,580	(9.0)	445,627	534,798	596,037
EBITDA	1,370	6,120	(77.6)	8,660	(84.2)	24,255	33,524	46,721
Depreciation & amortization	1,830	1,840	(0.5)	1,810	1.1	7,309	8,216	12,283
Other income	1,220	220	454.5	470	159.6	3,540	3,809	5,333
Interest	3,170	3,060	3.6	2,840	11.6	12,202	13,983	17,255
Profit before tax	(2,410)	1,440	NA	4,480	NA	8,284	15,134	22,515
Tax	(750)	140	NA	(210)	NA	1,745	4,843	7,205
Core profit	(1,660)	1,300	NA	4,690	NA	6,539	10,291	15,310
PAT	(1,660)	1,300	NA	4,690	NA	6,539	10,291	15,310
Equity capital	13,660	13,660		13,660		13,823	13,657	13,657
Diluted shares (mn)	1,366	1,366		1,366		1,366	1,366	1,366
Diluted EPS (INR)	(1.2)	1.0	NA	3.4	NA	4.8	7.5	11.2

## as % of Net revenues

Direct costs	92.9	92.7		91.1		91.4	91.1	89.9
Gross profit	7.1	7.3		8.9		8.6	8.9	10.1
Other expenses	5.8	1.4		2.9		3.2	2.8	2.6
EBITDA	1.1	5.6		5.8		5.2	5.9	7.3
PBT	(1.9)	1.3		3.0		1.8	2.7	3.5
Adjusted net profit	(1.3)	1.2		3.1		1.4	1.8	2.4
Tax rate	31.1	9.7		(4.7)		21.1	32.0	32.0

## Company Description

ESOIL is one of the major arms of the Essar Group, and currently has operations primarily in refining and marketing of petro products. Historically, the company had a business of oil exploration rigs, which it has exited. ESOIL aims to be a vertically integrated entity, and has therefore embarked on acquisition of upstream assets. However, its core business remains refinery-centric, for which the company has ambitious expansion plans.

ESOIL has a 18.0 MMTPA, 11.1 NCI (Nelson Complexity Index) refinery at Vadinar, near Jamnagar in Gujarat. The refinery started trial production in mid-FY08, and FY09 was its first full year of operations. ESOIL has interests in the upstream sector as well, and aims to transform into a true integrated oil and gas entity through forays into the E&P segment. It has interests in blocks in India (both E&P and CBM), and some assets lying with other group companies of ESOIL are pending approval for transfer to ESOIL.

## Investment Theme

- Mega expansion in refining to complete as industry recovers from overcapacity
- Twin fiscal benefits increase attractiveness of returns for investors
- Expanded high-complexity refinery to outperform peers on multiple fronts
- Robust demand despite global economic slowdown provides comfort on offtake
- Resilient marketing model to benefit further from auto fuel pricing deregulation
- Exploratory upsides and CBM monetisation to add value

## Key Risks

- Project execution risk for refinery 2
- Recessionary demand attenuation leading to overcapacity and muted GRMs
- Rupee appreciation may harm refining realisations
- Marketing segment's growth may be constrained due to regulatory disparity
- Signing of PSC for Ratna E&P block

## Financial Statements (Standalone)

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net revenue	375,164	365,046	469,882	568,322	642,758
Materials costs	342,030	342,509	429,358	517,596	577,959
Gross profit	33,135	22,537	40,524	50,726	64,799
Employee costs	969	975	1,197	1,257	1,319
Other Expenses	21,977	10,903	15,072	15,945	16,759
Operating expenses	22,946	11,878	16,269	17,202	18,078
Total operating expenses	364,975	354,387	445,627	534,798	596,037
EBITDA	10,189	10,659	24,255	33,524	46,721
Depreciation & Amortization	6,549	7,283	7,309	8,216	12,283
EBIT	3,640	3,376	16,946	25,308	34,438
Other income	1,837	8,719	3,540	3,809	5,333
Interest expenses	10,915	11,809	12,202	13,983	17,255
Profit before tax	(5,437)	286	8,284	15,134	22,515
Provision for tax	(302)	(9)	1,745	4,843	7,205
Current taxes	-	(9)	1,625	3,027	4,503
Deferred taxes	(321)	-	120	1,816	2,702
Core profit	(5,135)	295	6,539	10,291	15,310
Profit After Tax	(5,135)	295	6,539	10,291	15,310
Basic shares outstanding (mn)	1,202	1,202	1,366	1,366	1,366
Basic EPS (INR)	(4.3)	0.2	4.8	7.5	11.2
Diluted equity shares (mn)	1,202	1,202	1,366	1,366	1,366
Diluted EPS (INR)	(4.3)	0.2	4.8	7.5	11.2
CEPS (INR)	0.9	6.3	10.2	14.9	22.2
Dividend per share (INR)	-	-	-	0.3	0.5
Dividend payout (%)	-	-	-	3.9	5.2

### Common size metrics - as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	6.1	3.3	3.5	3.0	2.8
Materials costs	91.2	93.8	91.4	91.1	89.9
Depreciation	1.7	2.0	1.6	1.4	1.9
Interest expenditure	2.9	3.2	2.6	2.5	2.7
EBITDA margins	2.7	2.9	5.2	5.9	7.3
Net profit margins	(1.4)	0.1	1.4	1.8	2.4

### Growth ratios (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	6,572.1	(2.7)	28.7	20.9	13.1
EBITDA	(2,139.0)	4.6	127.6	38.2	39.4
PBT	1,133.8	(105.3)	2,798.5	82.7	48.8
Net profit	1,147.0	(105.7)	2,119.6	57.4	48.8
EPS	1,147.0	(105.7)	1,852.8	57.4	48.8

**Balance sheet****(INR mn)**

<b>As on 31st March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Equity capital	13,092	23,713	13,823	13,657	13,657
Reserves & surplus	22,729	23,023	51,556	61,615	76,130
Shareholders funds	35,820	46,737	65,379	75,272	89,786
Secured loans	94,192	94,706	122,744	140,073	140,188
Unsecured loans	6,126	8,831	22,725	38,986	36,087
Borrowings	100,317	103,537	145,469	179,059	176,275
Deferred tax liability	(6)	(6)	115	1,931	4,632
<b>Sources of funds</b>	<b>136,132</b>	<b>150,268</b>	<b>210,963</b>	<b>256,262</b>	<b>270,694</b>
Gross block	133,647	138,025	139,746	233,697	257,617
Depreciation	7,589	14,932	22,305	30,521	42,804
Net block	126,058	123,094	117,441	203,176	214,813
Capital work in progress	19,139	43,188	84,230	28,650	23,776
Total fixed assets	145,197	166,281	201,671	231,826	238,589
Investments	1,031	2,030	1,030	1,030	1,030
Inventories	22,509	39,694	57,491	63,813	71,255
Sundry debtors	11,654	20,333	23,673	28,632	32,383
Cash and equivalents	11,746	13,508	29,587	52,989	63,455
Loans and advances	9,123	6,947	7,379	8,525	9,641
Other current assets	4,199	3,307	4,978	6,021	6,810
Total current assets	59,231	83,789	123,108	159,981	183,544
Sundry creditors and others	69,074	101,603	112,877	134,575	150,269
Others current liabilities	253	228	1,970	2,000	2,200
Total current liabilities & provisions	69,327	101,832	114,847	136,575	152,469
Net current assets	(10,096)	(18,043)	8,262	23,406	31,075
<b>Uses of funds</b>	<b>136,132</b>	<b>150,268</b>	<b>210,963</b>	<b>256,262</b>	<b>270,694</b>
Book value per share (INR)	29.8	38.9	47.9	55.1	65.7

**Free cash flow****(INR mn)**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Net profit	(5,135)	295	6,539	10,291	15,310
Depreciation	6,549	7,283	7,309	8,216	12,283
Deferred tax	(321)	-	120	1,816	2,702
Others	9,077	3,090	8,662	10,174	11,922
Gross cash flow	10,170	10,668	22,630	30,497	42,217
Less: Changes in WC	(8,055)	(9,708)	10,225	(8,258)	(2,797)
Operating cash flow	18,225	20,375	12,405	38,755	45,014
Less: Capex	14,367	28,426	42,764	38,370	19,046
<b>Free cash flow</b>	<b>3,858</b>	<b>(8,051)</b>	<b>(30,359)</b>	<b>385</b>	<b>25,968</b>

**Cash flow metrics**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Operating cash flow	18,225	20,375	12,405	38,755	45,014
Investing cash flow	(12,529)	(20,706)	(38,224)	(34,561)	(13,714)
Financing cash flow	(9,079)	2,033	19,839	19,209	(20,835)
Net cash flow	(3,383)	1,702	(5,980)	23,403	10,466
Capex	(14,367)	(28,426)	(42,764)	(38,370)	(19,046)
Dividends paid	-	-	-	(398)	(796)

## Profitability & efficiency ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
Gross profit margin (%)	8.8	6.2	8.6	8.9	10.1
EBITDA margin (%)	2.7	2.9	5.2	5.9	7.3
ROAE (%)	(14.3)	0.7	11.7	14.6	18.6
ROACE (%)	2.7	2.4	9.5	10.9	13.1
ROA	(3.8)	0.2	3.6	4.4	5.8
Receivable turnover (x)	38.1	22.8	21.4	21.7	21.1
Inventory turnover (x)	9.6	11.0	8.8	8.5	8.6
Payables turnover (x)	4.6	4.0	4.0	4.2	4.1
Inventory day	38	33	41	43	43
Debtors days	10	16	17	17	17
Payable days	79	91	91	87	90
Cash conversion cycle (days)	(31)	(42)	(33)	(28)	(30)
Current ratio	0.9	0.8	1.1	1.2	1.2
Quick ratio	0.5	0.4	0.6	0.7	0.7
Cash ratio	0.2	0.1	0.3	0.4	0.4
Debt/EBITDA	9.8	9.7	6.0	5.3	3.8
Debt/Equity	2.8	2.2	2.2	2.4	2.0
Adjusted debt/equity	2.8	2.2	2.2	2.4	2.0
Interest coverage	0.3	0.3	1.4	1.8	2.0
Long term debt / Capital employed (%)	73.7	68.9	69.0	69.9	65.1
Total debt / Capital employed (%)	124.6	136.7	123.4	123.9	123.2

## Operating ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
Total asset turnover	2.8	2.5	2.6	2.4	2.4
Fixed asset turnover	5.8	2.9	3.9	3.5	3.1
Equity turnover	10.4	8.8	8.4	8.1	7.8

## Du pont analysis

Year to March	FY09	FY10	FY11	FY12E	FY13E
NP margin (%)	(1.4)	0.1	1.4	1.8	2.4
Total assets turnover	2.8	2.5	2.6	2.4	2.4
Leverage multiplier	3.8	3.5	3.2	3.3	3.2
ROAE (%)	(14.3)	0.7	11.7	14.6	18.6

## Valuation parameters

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	(4.3)	0.2	4.8	7.5	11.2
Y-o-Y growth (%)	1,147.0	(105.7)	1,852.8	57.4	48.8
CEPS (INR)	0.9	6.3	10.2	14.9	22.2
Diluted PE (x)	(20.1)	349.7	17.9	11.4	7.6
Price/BV (x)	2.9	2.2	1.8	1.6	1.3
EV/Sales (x)	0.5	0.5	0.5	0.4	0.4
EV/EBITDA (x)	18.7	17.9	9.6	7.2	4.9
EV/EBITDA (x)+1 yr forward	17.9	7.9	6.9	5.2	5.4
Dividend yield (%)	-	-	-	0.3	0.6
Basic P/E (x)	(20.1)	349.7	17.9	11.4	7.6

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Aban Offshore	HOLD	SU	H	Bharat Petroleum Corporation	BUY	SO	M
Cairn India	HOLD	SO	M	Chennai Petroleum Corporation	HOLD	SP	H
Essar Oil	BUY	SO	H	GAIL (INDIA)	REDUCE	SU	L
Gujarat State Petronet	REDUCE	SU	M	Hindustan Petroleum Corporation	BUY	SO	L
Indian Oil Corporation	BUY	SO	M	Indraprastha Gas	BUY	SO	L
ONGC	BUY	SO	L	Petronet LNG	BUY	SO	L
Reliance Industries	BUY	SO	M	Shiv Vani Oil & Gas Exploration Service	BUY	SO	M

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

# HINDUSTAN UNILEVER

## Blockbuster quarter

India Equity Research | Consumer Goods

The Hindustan Unilever (HUL) stock has jumped 68% and outperformed the Sensex ~63%, vindicating our report, *Go Contra; turnaround signals getting louder*, dated May 26, 2010. Moreover, the company's Q2FY12 numbers beat our estimates on all fronts with all segments posting double digit growth with stable/increasing market share. In Q3FY12, we would keep a vigil for adverse currency impact on raw materials and an early festive season denting volumes. HUL remains our top pick in the large cap consumer goods space as ITC is likely to underperform since we strongly expect a sharp excise hike in Union Budget 2012. Maintain 'BUY'.

### Numbers ahead on all fronts; margin pressure well managed

HUL's Q2FY12 revenue jumped ~18% Y-o-Y to ~INR 56.1 bn. Overall, ~9.8% volume growth was ahead of our 7-8% estimate partly aided by an early festive season and restocking due to price hikes, in our view. All segments delivered double digit growth for the third consecutive quarter and EBITDA margin expanded 116bps. Ad spending was ahead of competition in personal products, beverages and packaged foods while in soaps & detergents it was recalibrated in line with the industry trend.

### Strong segmental surge: Soaps & detergents surprise

Soaps & detergents (S&D) growth accelerated to 21.8% Y-o-Y and margin expanded 64.5bps Y-o-Y to 12.4% (315bps Q-o-Q) led by double digit growth in *Rin*, *Surf*, *Wheel*, *Lux*, and *Lifebuoy*. Personal products grew 18.2% Y-o-Y, primarily led by volume, with *Fair & Lovely*, *Vaseline*, *Ponds*, and hair and oral care delivering double-digit growth. While packaged foods business grew 20.9%, beverages surged 14.6%.

### Outlook and valuations: Positive; maintain 'BUY'

Despite cut in ad spending, HUL's volume grew robustly, indicating brand salience, aggression, innovation, and a strong product pipeline. We are revising up our EPS 5% each for FY12E and FY13E and expect PE re-rating to continue. At CMP, the stock is trading at 33.8x and 28.8x FY12E and FY13E, respectively. We maintain 'BUY/SO' recommendation/rating on the stock.

### Financials

(INR mn)

Year to March	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	FY11	FY12E
Net revenues	56,105	47,647	17.8	55,794	0.6	196,910	226,246
EBITDA	8,267	6,469	27.8	7,543	9.6	23,771	28,672
Core profit	6,445	5,257	22.6	5,819	10.8	21,442	24,835
Adj. EPS (INR)	3.2	2.6	22.8	2.9	9.9	9.8	11.5
Diluted P/E (x)						39.5	33.8
EV/EBITDA (x)						34.8	28.3
ROAE (%)						79.8	80.4

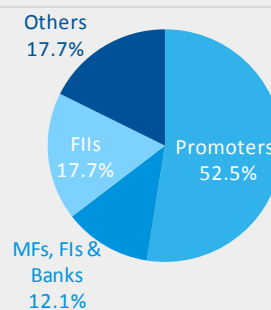
### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Equalweight

### MARKET DATA (R: HLL.BO, B: HUVV IN)

CMP	: INR 388
Target Price	: INR 415
52-week range (INR)	: 393 / 264
Share in issue (mn)	: 2,161.0
M cap (INR bn/USD mn)	: 839 / 17,024
Avg. Daily Vol.BSE/NSE('000)	: 2,466.7

### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : NIL  
(% of share in issue)

### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Consumer Goods Index
1 month	4.3	8.4	4.8
3 months	8.1	(2.3)	2.4
12 months	22.1	(10.5)	19.0

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November 1, 2011



## Results a testimony to our thesis

HUL's Q2FY12 numbers are a testimony to our conviction as its smart product mix, positioning and reasonable pricing have helped boost profitability and gain market share. We will do a quick post mortem of our thesis to see how this has played out in the past 18 months.

**Table 1: Our Thesis**

What did we say?	When?	What proof do we have in Q2FY12?
HUL has shifted from home-to-home sale to retail sales in water purifier.. Can impact volumes in near term	September 19th, 2011	Others category (includes water) disappointed with 24% de-growth
Signs of slowdown in ad spend get louder... HUL to be the biggest beneficiary	July 22nd, 2011	HUL maintaining market share despite A&P expenses down 196bps Y-o-Y.
Right pricing is the key... can lead to margin slippages in the short term	January 28th, 2011	HUL has taken judicious price increases without any negative impact on volume growth momentum; similar gross margin dips were seen in all FMCG companies
Current margins in Soaps & Detergents (S&D) are unsustainable	January 28th, 2011	HUL is indicating that future growth will be a combination of price increases as well volume growth; S&D margins surge on a sequential q-o-q basis
A&P expenses to moderate going forward following high base, lower pace of innovation and ~50% of recent re-launches	January 28th, 2011	A&P expenses down 196bps Y-o-Y despite several new product launches.
Momentum will continue in the coming quarters with increased focus on new product launches and market share gain in existing categories	October 27th, 2010	Market share gain across many categories and consistent double digit volume growth achieved
HUL will not do a <i>Me too</i> product	October 27th, 2010	HUL entered 3 new segments in Foods in Q4FY11: Juice in 4 differentiated variants; Creamy spread in 3 differentiated variants; Nutrismart in 2 differentiated variants. Currently, HUL is test marketing soya based juice
Premiumization trend continues...	June 23rd, 2010	Premiumization trend in personal products leading to 6th quarter to double digit volume growth and margin expansion
Soaps & Detergents – volumes will come back...	June 23rd, 2010	Strong double digit growth seen in soaps and detergents. HUL growing faster than the market
Gap in distribution will increase from smaller players	June 23rd, 2010	Rural distribution 3x from early 2010; focus on perfect stores to improve consumer visibility
Focus on new categories...will focus on Foods	February 4th, 2010	Soupy noodles a success; initial feedback from consumers is positive for other food categories. Test marketing Kissan Juice
HUL is investing heavily in its brands to build brand equity	February 4th, 2010	No volume demand destruction seen despite cut in A&P
Aggressive stance is the right way to go (with respect to price cuts in mass segments)...	February 4th, 2010	Regional competitors running out of steam and losing market share; consolidation in the industry taking place. Share of regional players in detergents has significantly reduced in last 1 year

Source: Edelweiss research

### Key conference call highlights

- **Cost effectiveness:** Expansion of EBITDA margin (116bps Y-o-Y) despite significant pressure on gross margin (down 348bps Y-o-Y) reflects prudent management of other expenses. The company's investment in IT technology to enhance distribution seems to be reaping supply chain scalability benefits. Operating leverage due to company's sheer size and reach augurs well for margin play.

Chart 1: Indexed overheads (as % of TO)

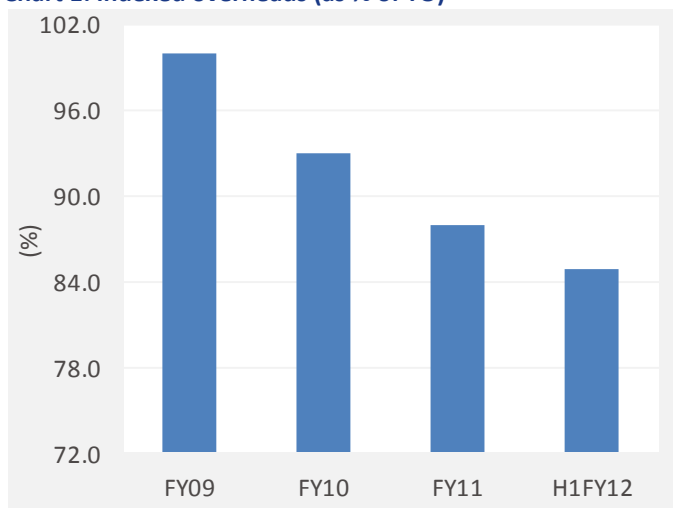
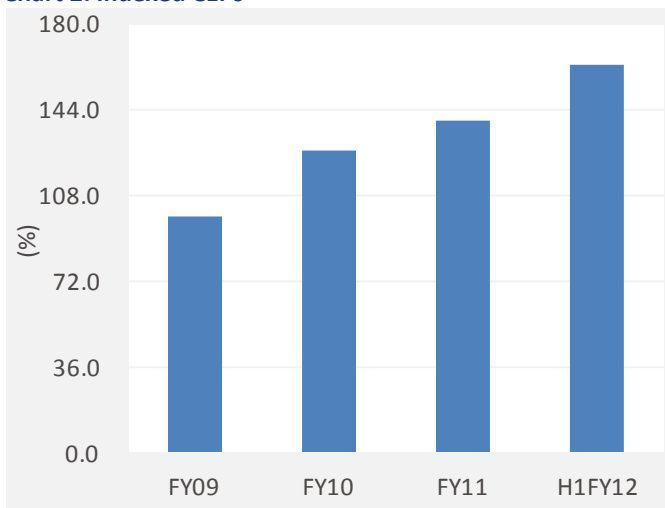
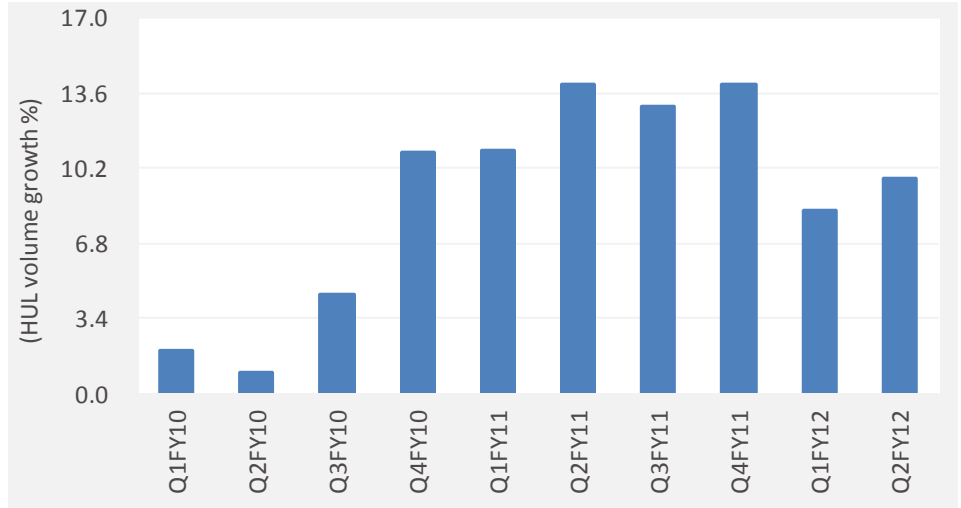


Chart 2: Indexed CEPs



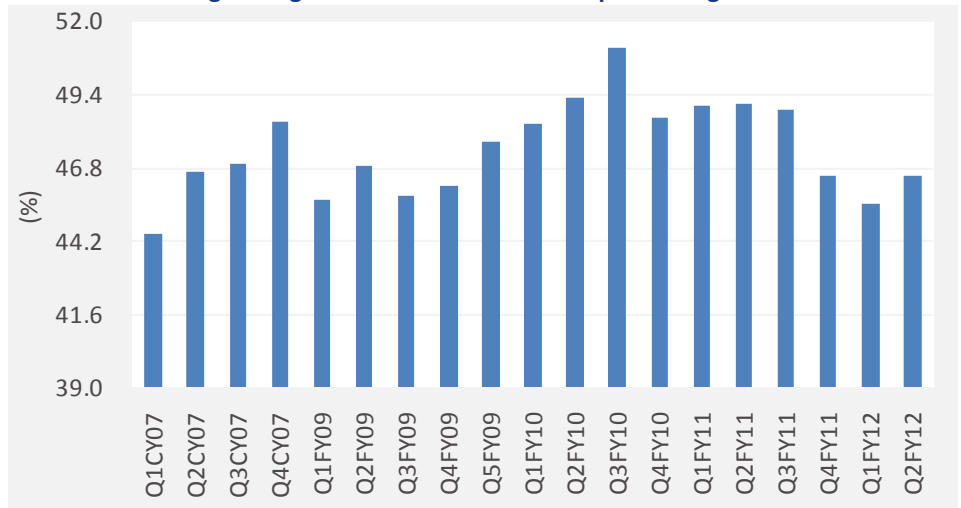
Source: Company, Edelweiss research

- **Rural scene:** HUL believes rural growth has been a tad ahead of urban growth unlike suggested by Neilson data and competitors (Dabur), well supported by its additional reach to 500,000 rural outlets. The company has launched innovative accessible INR 1 (Dove shampoo) and INR 5 (Knorr soupy noodles) packs to further fuel rural growth.
- **Modern trade channel for tomorrow:** HUL's share in modern retail has been higher than that of other FMCG players; at the same time, it is growing at a faster pace than peers. Modern retail contributing significantly to sales (early double digit) also plays a vital role in aiding volume growth.
- **Jack of all trades:** All categories have outperformed the market, except shampoos, where growth has marginally lagged market, though the category has also grown in double digits, especially led by *Dove* and other new launches.
- **Volume play:** Due to advancement of festive season and restocking, volumes posted a good show. Innovative launches and offerings at lower price points further added to the momentum. However, we expect volume growth to taper a bit in Q3FY12 due to restocking by wholesalers in Q2FY12 and as purchases were brought ahead in Q2FY12 due to an early festive season compared to last year.

**Chart 3: Robust volume growth—Rebalancing between volume and price led growth**


Source: Company, Edelweiss research

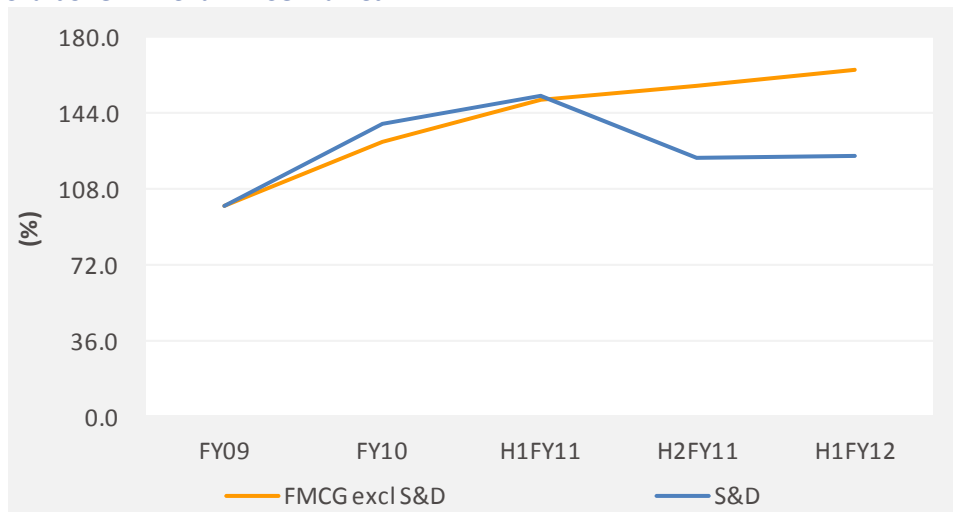
- Price hikes:** HUL had effected price hike in various categories like laundry (5%), Pears (6%), breads (8%) and coffee (10%) in Q2FY12. These hikes have driven overall growth, especially in the S&D segment. These hikes had been initiated despite high competitive intensity, reflecting pricing power and established brand equity.

**Chart 4: Gross margin—High raw material inflation impacts margin**


Source: Company, Edelweiss research

- Water business:** *Puriet's* performance has been on track. HUL moved from the mass to premium market with the launch of *Marvella*—working on reverse osmosis technology. The go-to-market model is progressing as per schedule and expected to reflect benefits in the near term.
- Ad spends:** Like in previous quarters, ad spends have been recalibrated in commodity sensitive categories (in line with industry). Spends were stepped up in three out of four categories (barring S&D where spending has been kept in line with industry trend).

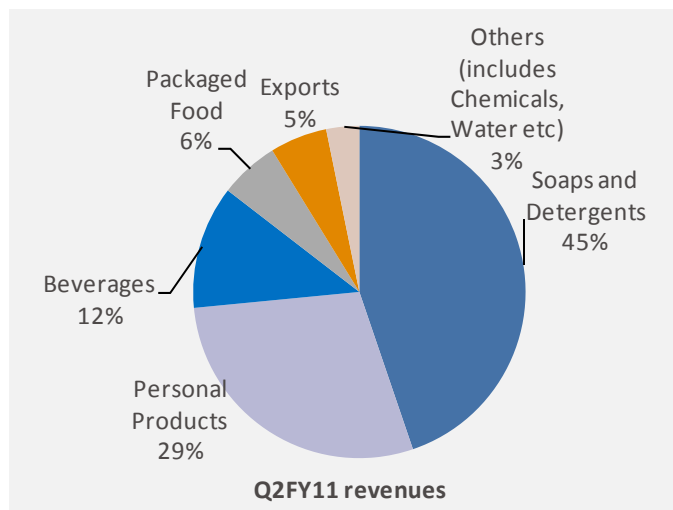
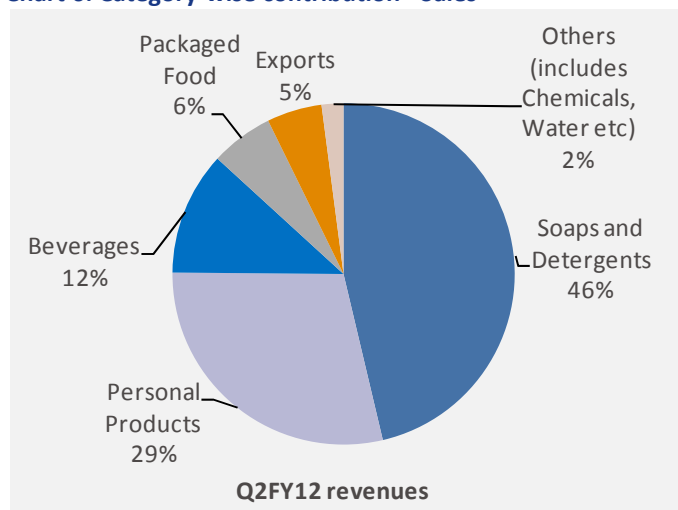
Chart 5: GRP Trend- FMCG Market



Source: Company, Edelweiss research

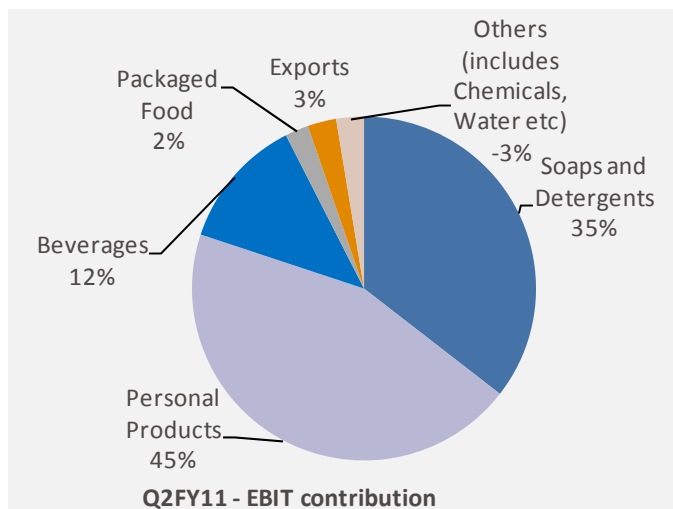
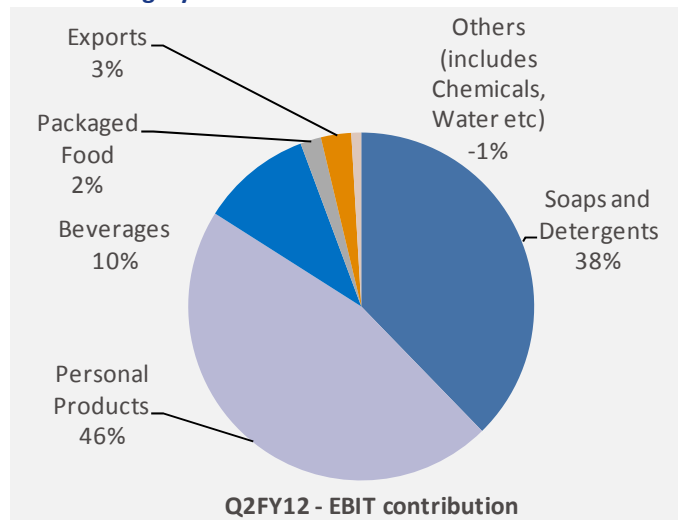
- New products dazzle; constant focus on innovation:** Q2FY12 has been an innovation intensive quarter—*Fair & Lovely* unique tube, *Lakme* Fruit Moisture Range, *Ponds* face wash range, unique green tea with three flavours, *Taj Mahal* tea bags (7 flavours for 7 days), *Pureit Marvella RO*, *Comfort* new variant with anti-bacterial action, *Vaseline* lip therapy with four new variants, *Axe Provokem* (premium deo) and accessible packs of INR 1 *Dove* sachet and INR 5 pack of *Knorr Soupy Noodles*. To add flavour to existing products some were relaunched with new twists—*Vaseline* moisturiser, *Kissan* range, *Lux* with silk protein extract, *Vim* with “100 Nimbuon ki Shakti”. We believe HUL’s focus on keeping the consumer enthused with new and improved offerings will keep it a step ahead in the midst of intense competition.

Chart 6: Category-wise contribution - Sales



Source: Company, Edelweiss research

Chart 7: Category-wise contribution - EBIT



Source: Company, Edelweiss research

### Soaps & detergents

Soaps & detergents grew at an impressive rate of ~22% Y-o-Y primarily led by price growth (growth was broad-based across categories). Margins expanded 64.5bps Y-o-Y to 12.4% despite softening in ad spends (in line with industry). The laundry portfolio grew ahead of market with *Rin* delivering double-digit volume growth for seventh consecutive quarter. *Comfort* has gained a strong foothold in the fabric conditioner market, which was further strengthened with the launch of new *Comfort* fabric care with anti-bacterial action. In household care, *Vim* continues to post strong double-digit growth backed by relaunch with a stronger proposition of '100 Nimbuon Ki Shakti'. *Lux* and *Lifebuoy* featuring in top 5 most trusted brands in Brand Equity survey 2011 is a sign of HUL's superior brand positioning.

Chart 8: Y-o-Y revenue growth

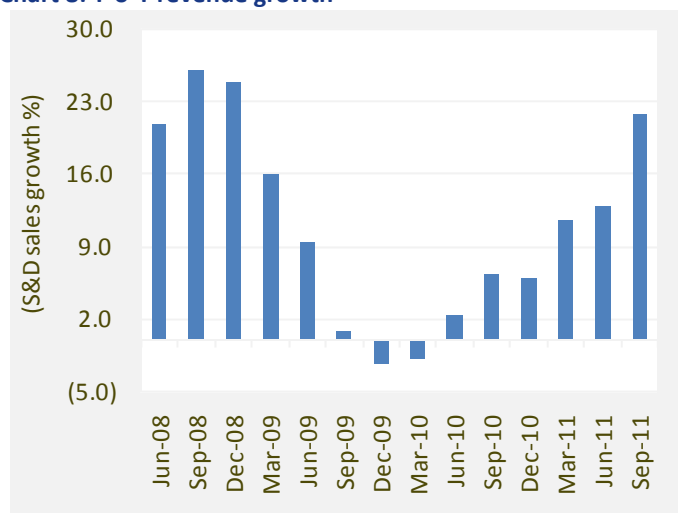
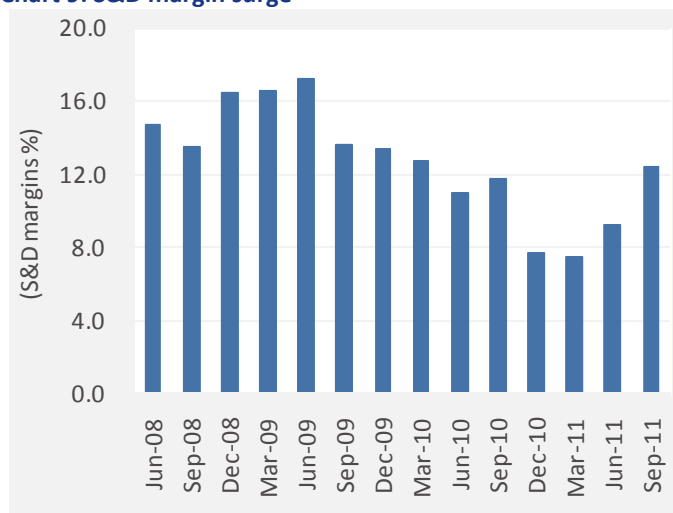


Chart 9: S&D margin surge



Source: Company, Edelweiss research

### Personal products buoyant, aided by skin care

Personal products grew ahead of markets at 18.2% Y-o-Y with skin care delivering particularly strong performance (*Fair & Lovely*, *Pond's* and *Vaseline* posted double digit growth backed by launches of new variants). Skin care growth was driven by focus on premium products; face wash business doubled and *Vaseline* delivered strong double digit growth for eighth consecutive quarter. Both hair and oral portfolios performed well across key brands; though shampoo was a laggard with growth slightly behind market. Margins expanded 143bps Y-o-Y to 24.4%.

Chart 10: Y-o-Y revenue growth

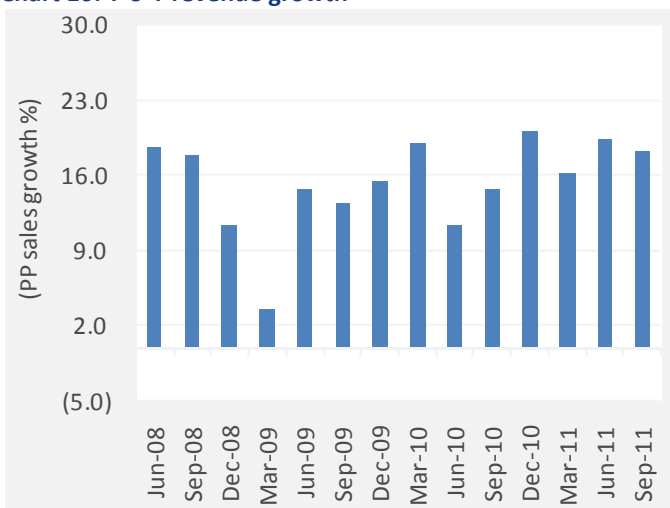
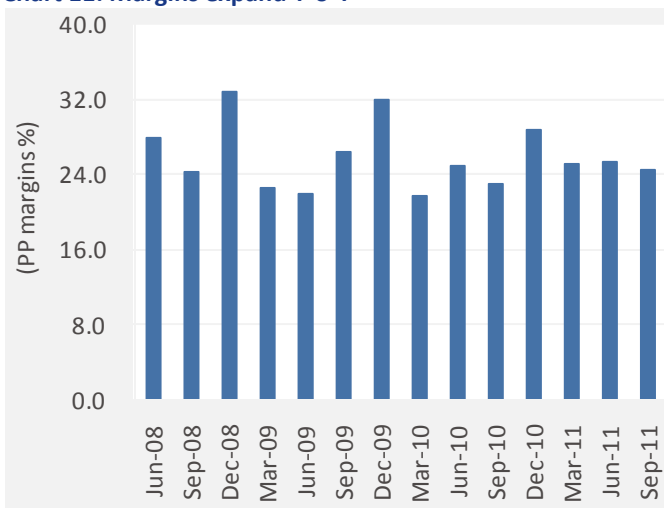


Chart 11: Margins expand Y-o-Y

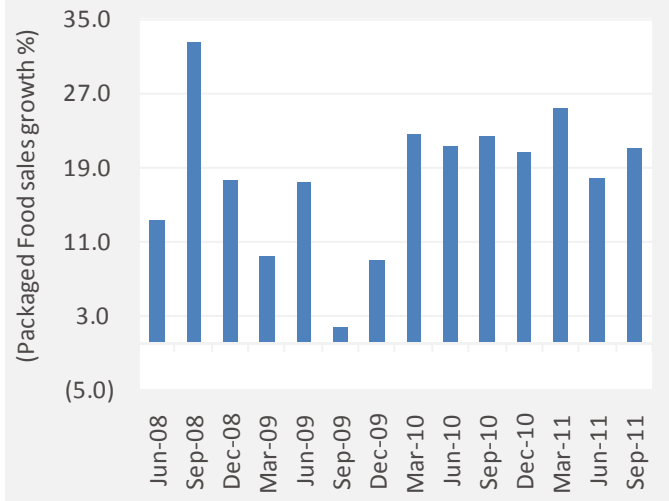


Source: Company, Edelweiss research

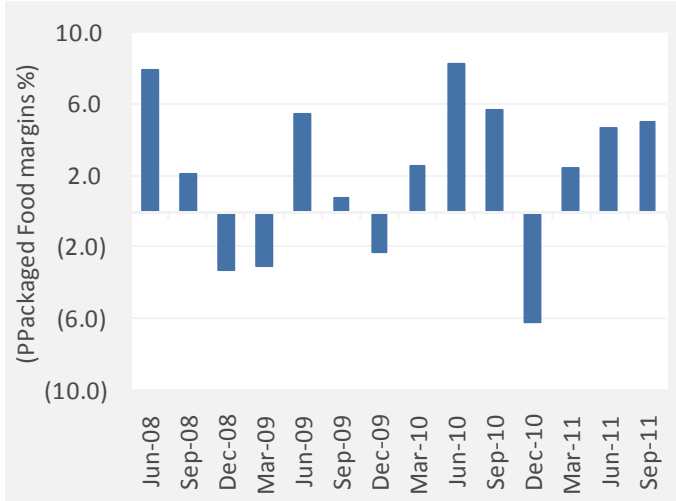
### Processed foods

Packaged foods business grew 21% Y-o-Y with margin at 5%; *Knorr* (new accessible INR 5 packs introduced) and *Kissan* (relaunched with "100% Real" proposition) performed exceedingly well, with double-digit growth. The company plans to launch soupy noodles in multi packs (4 in 1) to complete presence across the noodle segment. Soft launched products 'Soya juice' (launched only in Delhi, Mumbai and Chennai) and *Kissan creamy spread* (mayo-based bread spread launched in 20 cities) in initial phases of launch.

**Chart 12: Robust sales growth**



**Chart 13: Margins continuous with its upward movement**

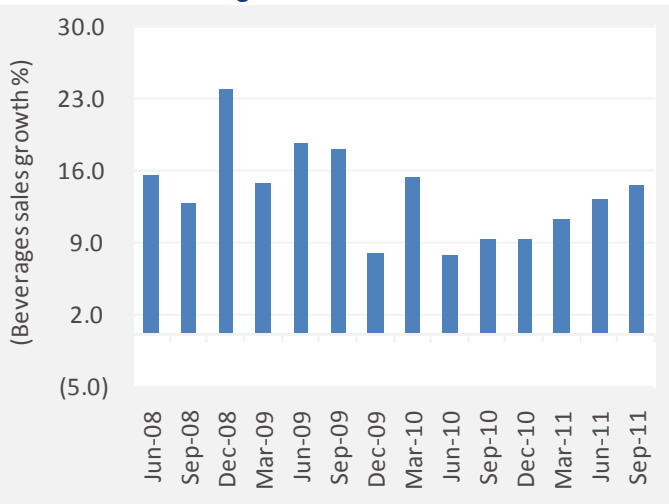


Source: Company, Edelweiss research

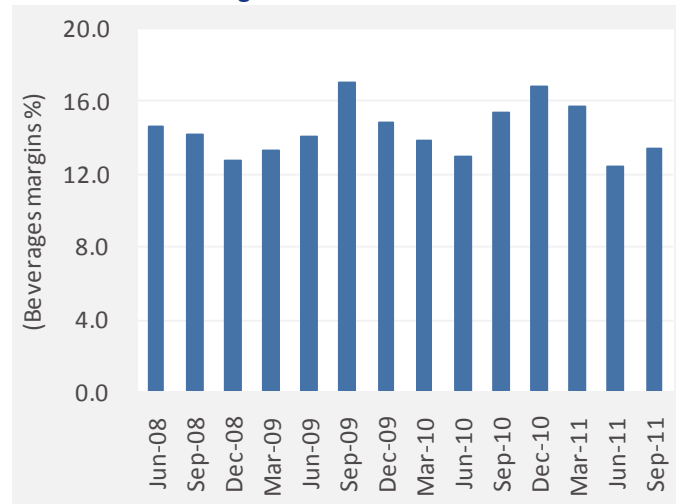
### Beverages

Beverages posted healthy broad-based growth of 14.6% Y-o-Y (margin at 13.4%) with double digit growth across premium and popular segments in tea and coffee. To add to the buzz in the beverage market with new launches and innovative propositions—unique green tea with 3 flavours and *Taj Mahal* tea bags (7 flavours for 7 days). HUL's performance in the premium segment of coffee (two player market) has been good with *Bru Exotica* (premium offering), *Bru Cappuccino* and newly launched *Bru Lite* specially targeted towards mild coffee drinkers of North India performing well.

**Chart 14: Stable sales growth**



**Chart 15: Robust margins**



Source: Company, Edelweiss research

## Export sales

Chart 16: Sales growth robust

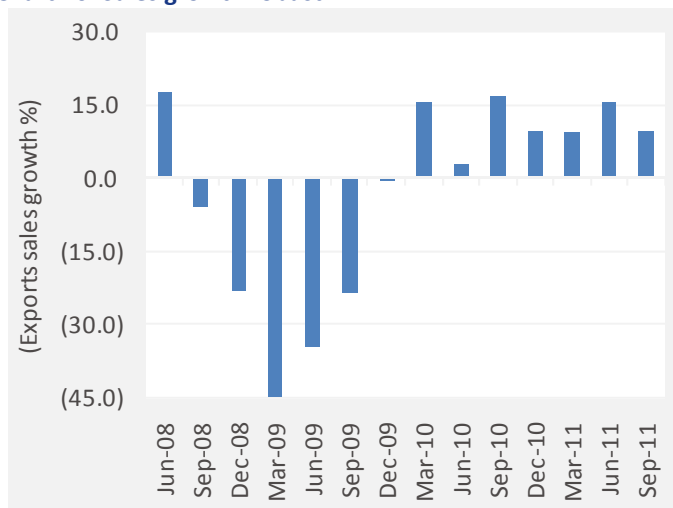
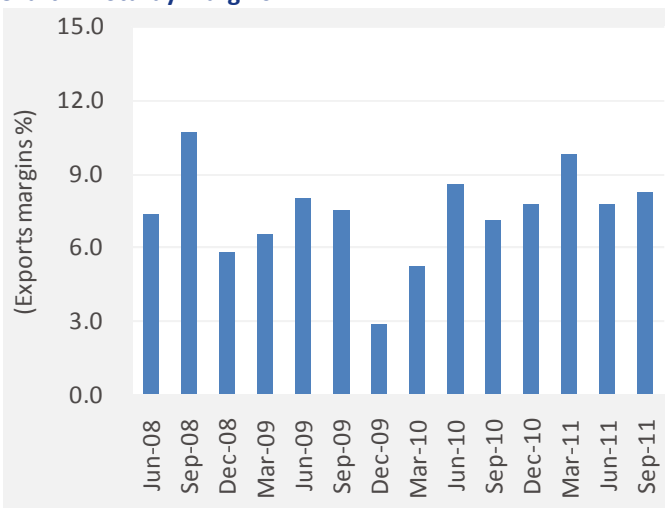


Chart 17: Sturdy margins



Source: Company, Edelweiss research

Table 2: Segment net revenue (Sales and Income from Services)

Year to March - Revenues (INR mn)	Q2FY12A	Q2FY11	Y-o-Y growth (%)	Q1FY12	Q-o-Q growth (%)
Soaps and Detergents	25,926	21,294	21.8	25,550	1.5
Personal products	16,126	13,649	18.2	16,307	(1.1)
Beverages	6,533	5,700	14.6	6,086	7.3
Packaged food	3,318	2,744	20.9	3,721	(10.8)
Exports	2,909	2,647	9.9	3,063	(5.0)
Others (includes chemicals, water etc)	1,161	1,527	(24.0)	1,066	8.9
<b>Segment results (Profit/(Loss) before tax and interest)</b>					
Soaps and Detergents	3,212	2,501	28.4	2,361	36.1
Personal products	3,940	3,140	25.5	4,133	(4.7)
Beverages	877	876	0.2	754	16.4
Packaged food	165	155	(6.2)	174	(5.2)
Exports	240	189	(27.0)	237	1.4
Others (includes chemicals, water etc)	(78)	(183)	57.4	(26)	(204.7)
<b>Segment margins</b>					
Year to March - Margin (%)	Q2FY12A	Q2FY11	Y-o-Y growth (bps)	Q1FY12	Q-o-Q growth (bps)
Soaps and Detergents	12.4	11.7	64.5	9.2	315.2
Personal products	24.4	23.0	142.9	25.3	(90.8)
Beverages	13.4	15.4	(193.4)	12.4	104.0
Packaged food	5.0	5.7	(68.9)	4.7	29.2
Exports	8.3	7.1	110.9	7.7	52.6
Others (includes chemicals, water etc)	(6.7)	(12.0)	(239.4)	(2.4)	(2,304.1)

Source: Source: Company, Edelweiss research



**Table 3: Balance sheet - Snapshot**

As on 30th September 2011	Q2FY12	Q2FY11	% change Y-o-Y
<b>Sources of funds</b>			
Share capital	2,161	2,182	(1.0)
Reserves and surplus	37,607	34,702	8.4
Loan funds	1,979	-	N.A.
<b>Total sources of funds</b>	<b>41,747</b>	<b>36,884</b>	<b>13.2</b>
<b>Uses of funds</b>			
			-
Fixed assets (inc CWIP)	24,290	24,465	(0.7)
Investments	26,557	21,867	21.4
Deferred tax asset (net)	2,038	2,352	(13.4)
Inventories	25,108	23,845	5.3
Sundry debtors	7,588	6,283	20.8
Cash and bank balances	15,645	21,156	(26.1)
Other current assets	439	487	(9.8)
Loans and advances	8,150	6,742	20.9
Total current assets	56,931	58,513	(2.7)
Current liabilities	60,232	63,052	(4.5)
Provisions	7,837	7,261	7.9
Total current liabilities and provisions	68,068	70,313	(3.2)
Net current assets	(11,138)	(11,800)	(5.6)
<b>Total uses of funds</b>	<b>41,747</b>	<b>36,884</b>	<b>13.2</b>

Source: Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E	FY13E
Net sales	55,222	46,809	18.0	55,039	0.3	196,910	226,246	258,264
Other income-operational	883	838	5.4	755	17.0			
Net revenues	56,105	47,647	17.8	55,794	0.6	196,910	226,246	258,264
Cost of goods sold	30,010	23,830	25.9	30,741	(2.4)	102,386	120,990	135,748
Gross profit	26,095	23,817	9.6	25,052	4.2	94,524	105,256	122,516
Staff cost	2,873	2,450	17.3	2,862	0.4	10,102	11,991	14,205
Advertising & promotions	6,514	6,465	0.8	6,330	2.9	27,965	27,828	32,283
Other expenditure	8,441	8,433	0.1	8,318	1.5	32,687	36,765	41,968
Total expenditure	17,828	17,348	2.8	17,509	1.8	70,753	76,584	88,455
EBITDA	8,267	6,469	27.8	7,543	9.6	23,771	28,672	34,060
Depreciation/Amortisation	571	554	3.1	562	1.6	2,293	2,366	2,627
EBIT	7,696	5,915	30.1	6,981	10.2	21,478	26,306	31,433
Net interest (incl. financial other income)	771	768	0.5	506	52.5	5,883	5,947	6,379
PBT	8,467	6,683	26.7	7,486	13.1	27,361	32,253	37,813
Provision for taxation	2,022	1,426	41.8	1,667	21.3	5,919	7,418	8,697
Core PAT	6,445	5,257	22.6	5,819	10.8	21,442	24,835	29,116
Exceptionals (net of tax)	444	404	9.8	453	NM	1,624	897	0
Reported net profit	6,889	5,661	21.7	6,272	9.8	22,961	25,732	29,116
EPS (INR)	3.2	2.6	22.8	2.9	9.9	9.8	11.5	13.5
Diluted P/E (x)						39.5	33.8	28.8
EV/EBITDA (x)						34.8	28.3	23.5
ROAE (%)						79.8	80.4	75.2

## as % of net sales

COGS	53.5	50.0		55.1		52.0	53.5	52.6
Staff costs	5.1	5.1		5.1		5.1	5.3	5.5
Advertising & sales	11.6	13.6		11.3		14.2	12.3	12.5
Other expenditure	15.0	17.7		14.9		16.6	16.3	16.3
EBITDA	14.7	13.6		13.5		12.1	12.7	13.2
EBIT	13.7	12.4		12.5		10.9	11.6	12.2
PBT	15.1	14.0		13.4		13.9	14.3	14.6
Net profit	11.5	11.0		10.4		10.9	11.0	11.3
Tax rate	23.9	21.3		22.3		21.6	23.0	23.0

### Company Description

HUL, the largest FMCG Company in India, was formed by merging three subsidiaries of Unilever in 1956. At present, Unilever Plc holds a 52.5% stake in the company. HUL's portfolio of products covers a wide spectrum including soaps, detergents, skin creams, shampoos, toothpastes, tea, coffee, packaged foods and branded atta.

Powerful brands and an enviable distribution network are HUL's primary strengths. The company operates through segments—soaps & detergents, personal products, beverages, foods,—exports, and other operations.

### Investment Theme

HUL is a play on consumption growth in India. The company has displayed its ability to effect price hikes and avoid impact of inflation in vegetable oils, which, combined with improved outlook for fabric wash and strong growth in processed foods and beverages, boosts our positive outlook on the stock. The recent moves by the company to dispose of its non core assets including few properties give it a near term upside. We believe the price war in the detergent segment with rival P&G has ended and this is likely to add to the profitability from the segment going forward.

### Key Risks

A rise in crude oil prices can result in biodiesel demand resurfacing, which in turn could lead to increase in vegetable oil price inflation; in turn deteriorating the company's operating margins.

The price war in HUL's popular segments with new entrants entering the fray could hit the company hard.

Further risks arise from down trading by consumers in response to recent price hikes, which could hurt the company's top line.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net revenue	205,011	177,643	196,910	226,246	258,264
Materials costs	109,660	90,115	102,386	120,990	135,748
Gross profit	95,351	87,528	94,524	105,256	122,516
Employee costs	11,890	9,709	10,102	11,991	14,205
Other Expenses	35,114	27,829	32,687	36,765	41,968
Advertisement & sales costs	21,538	24,230	27,965	27,828	32,283
EBITDA	26,810	25,759	23,771	28,672	34,060
Depreciation & Amortization	2,000	1,919	2,293	2,366	2,627
EBIT	24,810	23,840	21,478	26,306	31,433
Other income	5,801	3,440	5,893	5,951	6,383
EBIT incl. other income	30,611	27,279	27,371	32,257	37,817
Interest expenses	265	75	10	4	4
Profit before tax	30,346	27,205	27,361	32,253	37,813
Provision for tax	5,392	6,153	5,919	7,418	8,697
Core profit	24,954	21,052	21,442	24,835	29,116
Prior period adjustments (net)	145	594	1,624	897	-
Minority interest	(54)	(80)	(106)	-	-
Profit after minority interest	25,045	21,566	22,961	25,732	29,116
Basic shares outstanding (mn)	2,180	2,180	2,180	2,160	2,160
Basic EPS (INR)	11.4	9.7	9.8	11.5	13.5
Diluted equity shares (mn)	2,180	2,180	2,183	2,160	2,160
Diluted EPS (INR)	11.4	9.7	9.8	11.5	13.5
CEPS (INR)	12.4	10.5	10.9	12.6	14.7
Dividend per share (INR)	7.5	6.5	6.5	7.3	8.3
Dividend payout (%)	65.3	65.7	61.4	61.4	61.4

## Common size metrics - as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Materials costs	53.5	50.7	52.0	53.5	52.6
Employee expenses	5.8	5.5	5.1	5.3	5.5
Advertising & sales costs	10.5	13.6	14.2	12.3	12.5
Other expenses	17.1	15.7	16.6	16.3	16.3
Depreciation	1.0	1.1	1.2	1.0	1.0
Interest expenditure	0.1	-	-	-	-
EBITDA margins	13.1	14.5	12.1	12.7	13.2
EBIT margins	12.1	13.4	10.9	11.6	12.2
Net profit margins	12.2	11.9	10.9	11.0	11.3

## Growth ratios (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	48.0	(13.3)	10.8	14.9	14.2
EBITDA	41.4	(3.9)	(7.7)	20.6	18.8
PBT	40.9	(10.4)	0.6	17.9	17.2
Net profit	40.8	(15.6)	1.9	15.8	17.2
EPS	40.7	(15.6)	1.7	17.1	17.2

## Balance sheet

(INR mn)

As on 31st March	FY09	FY10	FY11	FY12E	FY13E
Equity capital	2,180	2,182	2,160	2,160	2,160
Reserves & surplus	19,195	24,508	24,934	32,264	40,559
Shareholders funds	21,453	26,794	27,239	34,570	42,864
Minority interest (BS)	78	105	146	146	146
Secured loans	1,563	105	-	25	25
Unsecured loans	2,778	4	27	1	1
Borrowings	4,341	108	27	27	27
<b>Sources of funds</b>	<b>25,794</b>	<b>26,902</b>	<b>27,266</b>	<b>34,596</b>	<b>42,891</b>
Gross block	29,591	36,672	38,541	43,041	47,541
Depreciation	13,012	14,529	16,307	18,673	21,300
Net block	16,580	22,144	22,235	24,369	26,242
Capital work in progress	4,779	2,800	2,997	2,997	2,997
Investments	2,876	12,244	11,885	11,885	11,885
Inventories	25,805	22,264	28,738	29,238	33,305
Sundry debtors	5,606	6,917	9,549	9,397	10,656
Cash and equivalents	18,641	20,124	17,873	26,803	36,830
Loans and advances	7,453	5,895	6,632	6,632	6,632
Total current assets	57,702	55,393	63,169	72,448	87,801
Sundry creditors and others	43,325	53,522	61,730	65,813	74,744
Provisions	15,349	14,638	13,359	13,359	13,359
Total current liabilities & provisions	58,674	68,160	75,089	79,172	88,104
Net current assets	(972)	(12,767)	(11,920)	(6,724)	(303)
<b>Uses of funds</b>	<b>25,794</b>	<b>26,902</b>	<b>27,266</b>	<b>34,596</b>	<b>42,891</b>
Book value per share (INR)	9.8	12.3	12.5	16.0	19.8

## Free cash flow

(INR mn)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Net profit	25,045	21,566	22,961	25,732	29,116
Add : Non cash charge	2,173	1,480	785	1,473	2,631
Depreciation	2,000	1,919	2,293	2,366	2,627
Others	174	(440)	(1,508)	(893)	4
Gross cash flow	27,218	23,046	23,745	27,205	31,747
Less: Changes in WC	(11,914)	(12,428)	898	(3,734)	(3,606)
Operating cash flow	39,132	35,474	22,848	30,939	35,352
Less: Capex	2,901	7,081	1,869	4,500	4,500
<b>Free cash flow</b>	<b>36,231</b>	<b>28,393</b>	<b>20,979</b>	<b>26,439</b>	<b>30,852</b>

## Cash flow metrics

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating cash flow	39,132	35,474	22,848	30,939	35,352
Investing cash flow	(5,777)	(16,449)	(1,509)	(4,500)	(4,500)
Financing cash flow	(15,056)	(20,872)	(16,512)	(17,508)	(20,825)
Net cash flow	18,298	(1,847)	4,827	8,930	10,027
Capex	(2,901)	(7,081)	(1,869)	(4,500)	(4,500)
Dividends paid	(19,133)	(16,564)	(16,420)	(18,401)	(20,821)
Share issuance/(buyback)	2,180	2	(22)	-	-

**Profitability & efficiency ratios**

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	140.1	87.6	79.8	80.4	75.2
ROACE (%)	219.9	126.9	143.0	138.1	117.0
Inventory day	46	49	47	47	47
Debtors days	10	13	15	15	15
Payable days	89	116	121	122	122
Cash conversion cycle (days)	(33)	(54)	(59)	(59)	(60)
Current ratio	1.0	0.8	0.8	0.9	1.0
Interest coverage	93.8	319.1	2,126.5	6,592.9	7,878.0

**Operating ratios**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Total asset turnover	10.1	6.7	7.3	7.3	6.7
Fixed asset turnover	12.9	9.2	8.9	9.7	10.2
Equity turnover	11.6	7.4	7.3	7.3	6.7

**Du pont analysis**

Year to March	FY09	FY10	FY11	FY12E	FY13E
NP margin (%)	12.2	11.9	10.9	11.0	11.3
Total assets turnover	10.1	6.7	7.3	7.3	6.7
Leverage multiplier	1.1	1.1	1.0	1.0	1.0
ROAE (%)	140.1	87.6	79.8	80.4	75.2

**Valuation parameters**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	11.4	9.7	9.8	11.5	13.5
Y-o-Y growth (%)	40.0	(15.6)	1.7	17.1	17.2
CEPS (INR)	12.4	10.5	10.9	12.6	14.7
Diluted PE (x)	33.9	40.2	39.5	33.8	28.8
Price/BV (x)	39.4	31.6	31.1	24.2	19.6
EV/Sales (x)	4.1	4.7	4.2	3.6	3.1
EV/EBITDA (x)	30.9	32.1	34.8	28.3	23.5
Dividend yield (%)	1.9	1.7	1.7	1.9	2.1

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Asian Paints	BUY	SP	M	Colgate	HOLD	SU	M
Dabur	BUY	SP	M	Emami	BUY	SO	H
Godrej Consumer	BUY	SO	H	Hindustan Unilever	BUY	SO	L
ITC	BUY	SO	L	Marico	BUY	SP	M
Nestle Ltd	HOLD	SU	L	United Spirits	BUY	SP	H

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

# ROLTA INDIA

## Poor free cash generation a key concern

India Equity Research | IT

Rolta India's (Rolta) Q1FY12 revenues were a tad below our estimates while EBITDA margins (excl. MTM losses) stood at 39.5% in line with ours and consensus estimates. While the management is seeing traction in its GIS segments (for IP based solutions) and order book remaining fairly healthy at INR 20.8 bn, the key concern for us continues to be the free cash generating ability of the business. Though the company's debt-equity ratio at 0.8 is at comfortable level, we see its high capex and acquisition led model continuing to impact the FCF generation. While the EV/EBITDA at 3.2x/2.6x FY12E/13E remains undemanding, we believe stock returns will only follow as the visibility of FCF generation improves. We cut our target price to INR 97 and maintain 'BUY'.

### Profitability takes a hit due to MTM losses

Revenue at INR 4.9 bn grew 2.0% Q-o-Q versus our estimate of 3.2%. The EBITDA margin nosedived 380bps to 36.8% due to MTM losses. However, excluding MTM losses, margin at 39.5% was in line with our estimates. Net profit at INR 554 mn saw a sharp decline of 32.4% Q-o-Q largely on account of MTM losses on FCCBs and other foreign currency borrowings as well as wage hikes given during the quarter. Excluding the impact of MTM losses, net profit stood at INR 813 mn.

### FCCB repayment to be refinanced through ECB

About USD 135mn of FCCB repayment is due in June 2012, which is likely to be refinanced through ECB. Thus, higher interest costs will impact not only the profitability but the FCFE as well.

### Outlook and valuations: Focus on cash flow; maintain 'BUY'

While we believe the company will be able to achieve its revenue guidance of 13-15% growth for FY12, we remain cautious on the free cash generation in FY12 as it has guided for a capex of INR 2.5 bn –INR 3.0 bn (from INR 2.5bn in Q4FY11) and has a debt of INR 14.6 bn. However, at CMP of INR 82, we see the concerns being factored in. Currently the stock trades at EV/EBITDA of 3.2x and P/E of 4.4x for FY12E. We have a 'BUY /Sector Performer' rating on the stock.

### Financials

(INR mn)

Year to June	Q1FY12	Q4FY11	% Chg	Q1FY11	% Chg	FY11	FY12E
Net revenues	4,858	4,766	2.0	4,276	13.6	18,056	20,455
EBITDA	1,790	1,934	(7.5)	1,697	5.4	7,203	7,885
Net profit	543	808	(32.8)	679	(20.1)	3,724	2,991
Diluted EPS (INR)	3.4	5.0	(32.8)	4.2	(19.6)	22.9	18.5
Diluted P/E (x)						4.9	4.4
EV/EBITDA (x)						3.7	3.2
EV/Revenues (x)						1.5	1.2

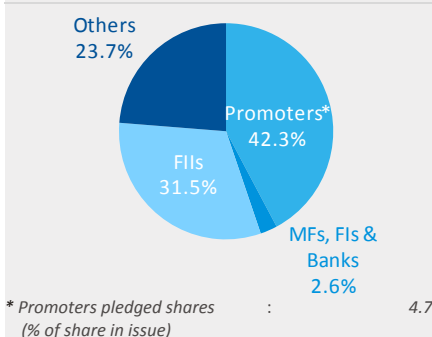
### EDELWEISS 4D RATINGS

<b>Absolute Rating</b>	<b>BUY</b>
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Equalweight

### MARKET DATA (R: ROLT.BO, B: RLTA IN)

CMP	: INR 82
Target Price	: INR 97
52-week range (INR)	: 189 / 70
Share in issue (mn)	: 161.3
M cap (INR bn/USD mn)	: 13 / 267
Avg. Daily Vol.BSE/NSE('000)	: 711.2

### SHARE HOLDING PATTERN (%)



### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	(12.4)	8.4	8.3
3 months	(33.6)	(2.3)	(1.9)
12 months	(52.5)	(10.5)	3.9

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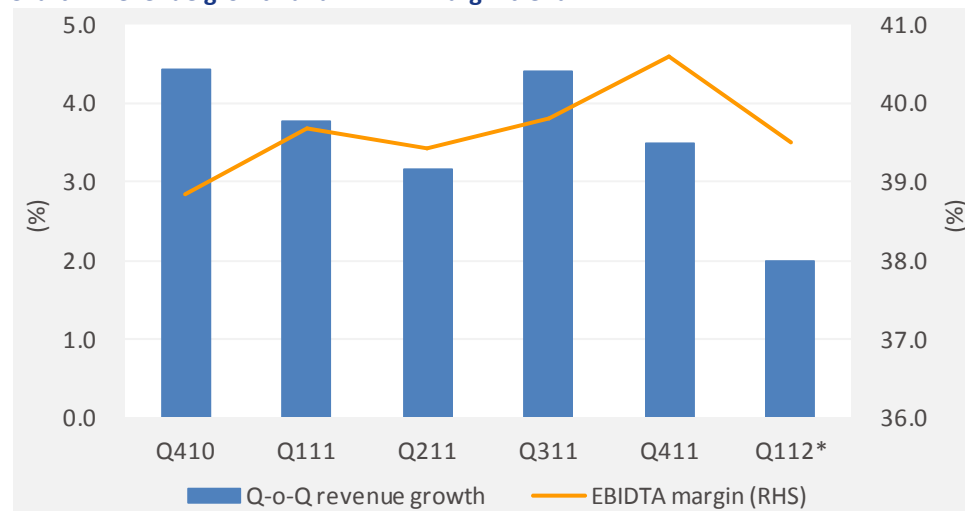
November 1, 2011



## Key highlights

- Consolidated revenue at INR 4.9 bn was marginally below our estimates and surged 2.0% Q-o-Q and 13.6% Y-o-Y. Gross profit at INR 2.4 bn declined 3.0% Q-o-Q. Gross margin dipped 250bps to 49.6%.
- EBITDA at INR 1.8 bn declined 7.5% Q-o-Q and up 5.4% Y-o-Y. EBITDA margin crashed 380bps Q-o-Q to 36.8% predominantly on account of mark-to-market losses on FCCBs and other foreign currency borrowings and wage hikes effected during the quarter. Excluding the MTM losses, EBITA margin stood at 39.5% in line with ours and consensus estimates.

**Chart 1: Revenue growth and EBITDA margin trend**



Note: \*Q2FY11 EBITDA margin is excluding MTM losses

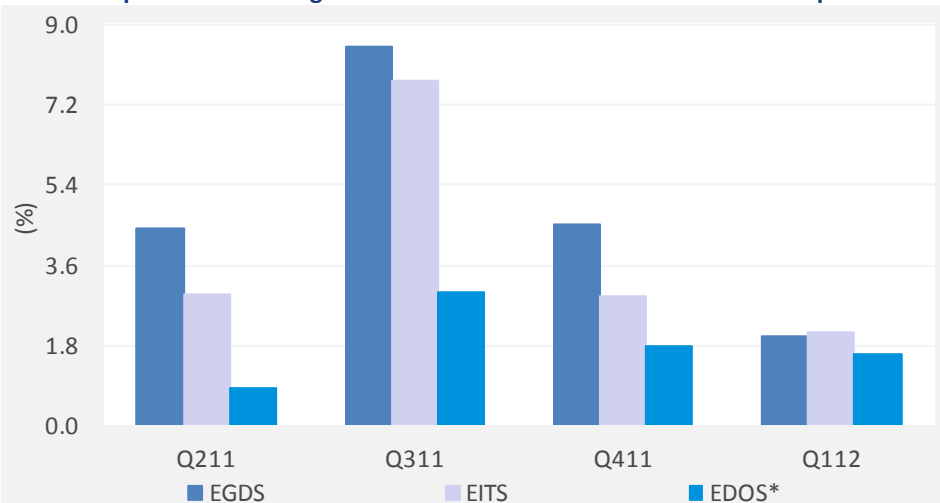
Source: Company, Edelweiss research

- Reported net profit at INR 554 mn was down 32.4% Q-o-Q and 18.4% Y-o-Y. The decline was on account of lower operating profits. Net margin for the quarter stood at 11.4% (17.2% in Q4FY11). Mark-to-market loss of INR 259 mn on FCCBs and other foreign currency borrowings were charged to the P&L. Without considering this charge, the net profit for the quarter stood at INR 813 mn.

## Segmental performance

- Enterprise Geospatial and Defense Solutions (EGDS):** Consolidated revenue at INR 2.6 bn was up 2.0% Q-o-Q and 20.8% Y-o-Y. While the gross profit stood at INR 1.6 bn, gross margin surged 220bps sequentially to 60.3%. EBITDA margin took a breather declining sequentially by 460bps to stand at 49.1%. Utilisation for the quarter crashed sequentially by 380bps to 74.8%. Order book showed a sequential decline of 0.4%. On the reported basis, realisation fell 3.1% Q-o-Q.
- Enterprise Design and Operation Solutions (EDOS):** While the consolidated revenue came in at INR 1.0 bn, EBITDA margin at 36.2% crashed by 490bps over the previous quarter. Order book grew by just 2.4% from the previous quarter.
- Enterprise IT Solutions (EITS):** The EITS segment revenue at INR 1.2 bn grew 2.1% Q-o-Q. EBITDA margin at 11.1% dipped by 100bps from the previous quarter. Order book jumped up by 4.7% from the previous quarter.

**Chart 2: Sequential revenue growth for all businesses declines over last 3 quarters**

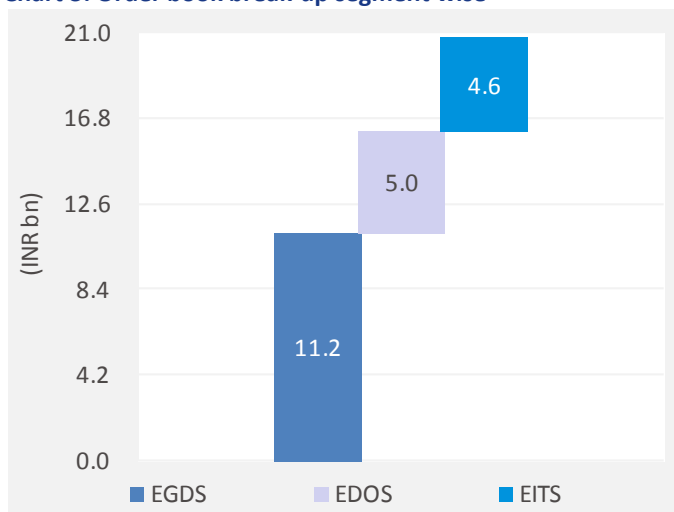


\* Note: Q311 revenue growth post adjustment of share from Shaw Rolta JV

Source: Company, Edelweiss research

- **Order book accretion disappoints:** Rolta's order book grew by just 1.4% sequentially. Current order book stands at INR 20.8 bn. The book to bill ratio stood at 1.06x during the quarter.

**Chart 3: Order book break-up segment wise**



**Chart 4: New order booking sees marginal uptick**



Source: Company, Edelweiss research

- The management has guided for a capex of INR 2500-INR 3000 mn in FY12.
- Tax rate: Management expects FY12 tax rate to be in the 16%-17% range.

## Financial snapshot

(INR mn)

Year to June	Q1FY12	Q4FY11	% Change	Q1FY11	% Change	FY11	FY12E	FY13E
Net revenues	4,858	4,766	2.0	4,276	13.6	18,056	20,455	23,032
Cost of revenue	2,448	2,282	7.3	2,087	17.3	8,931	10,302	11,585
Gross profit	2,410	2,484	(3.0)	2,189	10.1	9,126	10,153	11,447
SG&A	621	549	13.0	492	26.2	1,923	2,268	2,764
EBITDA	1,790	1,934	(7.5)	1,697	5.4	7,203	7,885	8,683
Depreciation	948	886	6.9	763	24.1	3,300	3,551	4,000
EBIT	842	1,048	(19.7)	934	(9.8)	3,903	4,334	4,683
Other income	82	124	(33.9)	55	48.0	308	217	220
Interest	271	254	6.6	194	39.5	899	912	921
Profit before tax	653	918	(28.9)	795	(17.9)	3,312	3,639	3,981
Tax	110	110	0.0	115	(4.3)	625	647	717
Core profit	543	808	(32.8)	680	(20.2)	2,687	2,991	3,265
Minority interest	-	-	150.0	1	(80.0)	-	-	-
Extra ordinary item						1,036	-	-
Reported net profit	543	808	(32.8)	679	(20.1)	3,724	2,991	3,265
Diluted EPS (INR)	3.4	5.0	(32.8)	4.2	(19.6)	22.9	18.5	20.2

## As % of net revenues

Gross profit	49.6	52.1		51.2		50.5	49.6	49.7
SG&A	12.8	11.5		11.5		10.6	11.1	12.0
EBITDA	36.8	40.6		39.7		39.9	38.5	37.7
Adjusted net profit	11.2	17.0		15.9		14.9	14.6	14.2
Reported net profit	11.2	17.0		15.9		20.6	14.6	14.2
Tax rate	16.8	12.0		14.5		18.9	17.8	18.0

## Company Description

Rolta is one of the leading providers of GIS and engineering design and automation (EDOS) services. In GIS, the company provides and develops digital map-based solutions, servicing customers in segments like defence, environmental protection, utilities, emergency services, and public planning. In EDOS, it focuses on computer-aided plant design and mechanical engineering solutions. The company provides a combination of software skills and component manufacturing services through its EDA group. It also provides security and IT infrastructure, software development, testing, and gaming services through its EITS group. The company's past 12 months (TTM) revenue stood at INR 18.7 bn and it employs over 3,994 people.

## Investment Theme

Outsourcing of engineering services is expected to touch USD 38-50 bn by 2020 against USD 2 bn currently, as per a Nasscom-Booz Allen Hamilton study. As one of the leading offshore engineering services firms for the manufacturing industry, Rolta is poised to grab the rising opportunities. Nevertheless, in the current environment, as capex spending has eased, the company has seen uptick in new orders. Moreover, with increased emphasis and spending plans on upgrading defence technologies, opportunity for Rolta is significant. In addition, visibility for the JV with the Thales Group is also looking up. We perceive Rolta to be in a strong position to explore the high opportunity segments of GIS and engineering along with its focus on transitioning towards solutions approach.

## Key Risks

- (a) Substantial proportion of revenue from non-annuity sources.
- (b) Slow down in GIS segment.
- (c) Inability to monetise Fusion solutions could impact profitability.
- (d) Inadequate free cash generation to repay FCCB and ECB debt.

## Financial Statements

Income statement					(INR mn)
Year to June	FY09	FY10	FY11	FY12E	FY13E
Net revenue	13,728	15,327	18,056	20,455	23,032
Cost of revenues	7,455	7,914	8,931	10,302	11,585
Gross profit	6,274	7,413	9,126	10,153	11,447
Total SG&A expenses	1,588	1,643	1,923	2,268	2,764
EBITDA	4,685	5,770	7,203	7,885	8,683
Depreciation & Amortization	1,867	2,679	3,300	3,551	4,000
EBIT	2,818	3,091	3,903	4,334	4,683
Other income	903	409	308	217	220
Interest expenses	409	697	899	912	921
Profit before tax	3,312	2,803	3,312	3,639	3,981
Provision for tax	402	406	625	647	717
Core profit	2,910	2,398	2,687	2,991	3,265
Extra ordinary item	-	-	1,036	-	-
Profit after tax	2,910	2,398	3,723	2,991	3,265
Minority int. and others - paid/(recd.)	7	5	-	-	-
Profit after minority interest	2,917	2,403	3,724	2,991	3,265
Basic shares outstanding (mn)	161	161	161	161	161
Basic EPS (INR)	18.1	14.9	16.7	18.5	20.2
Diluted equity shares (mn)	161	162	161	161	161
Diluted EPS (INR)	18.1	14.8	16.7	18.5	20.2
CEPS (INR)	29.6	31.5	37.1	40.6	45.0
Dividend per share (INR)	3.0	3.2	3.5	4.0	4.0
Dividend (%)	30.0	32.5	35.0	40.0	40.0
Dividend payout (%)	19.5	25.5	17.7	25.2	23.0

Common size metrics - as % of net revenues					
Year to June	FY09	FY10	FY11	FY12E	FY13E
Cost of revenues	54.3	51.6	49.5	50.4	50.3
Gross margin	45.7	48.4	50.5	49.6	49.7
SG&A expenses	11.6	10.7	10.6	11.1	12.0
EBITDA margins	34.1	37.6	39.9	38.5	37.7
EBIT margins	20.5	20.2	21.6	21.2	20.3
Net profit margins	21.2	15.6	14.9	14.6	14.2

Growth ratios (%)					
Year to June	FY09	FY10	FY11	FY12E	FY13E
Revenues	28.0	11.6	17.8	13.3	12.6
EBITDA	20.2	23.2	24.8	9.5	10.1
EBIT	12.1	9.7	26.3	11.1	8.0
PBT	23.4	(15.4)	18.1	9.9	9.4
Net profit	26.7	(17.6)	12.1	11.3	9.1
EPS	28.8	(18.3)	12.5	11.3	9.2

**Balance sheet**

(INR mn)

As on 30th June	FY09	FY10	FY11	FY12E	FY13E
Equity capital	1,610	1,612	1,613	1,613	1,613
Share premium account	2,577	2,355	2,403	2,403	2,403
Reserves & surplus	10,054	12,080	14,969	17,273	19,785
Shareholders funds	14,242	16,047	18,985	21,289	23,802
Minority interest (BS)	8	3	2	2	2
Borrowings	9,967	12,588	14,636	12,725	10,421
Deferred tax liability	479	424	446	520	520
<b>Sources of funds</b>	<b>24,696</b>	<b>29,061</b>	<b>34,069</b>	<b>34,536</b>	<b>34,745</b>
Gross block	16,518	21,594	29,985	32,985	35,985
Accumulated depreciation	4,047	5,014	8,314	11,865	15,865
Net block	12,471	16,580	21,670	21,119	20,119
Capital work in progress	2,793	2,428	1,800	1,350	1,200
Deferred tax asset	72	71	67	67	67
Goodwill	3,010	2,961	2,849	2,849	2,849
Investments	354	551	961	400	500
Inventories	105	39	-	-	-
Sundry debtors	5,951	6,248	6,926	8,294	9,150
Cash and equivalents	1,376	504	451	705	871
Loans and advances	1,305	2,031	1,758	2,286	2,971
Total current assets	8,736	8,821	9,135	11,285	12,992
Sundry creditors and others	1,794	1,246	1,308	1,373	1,648
Provisions	946	1,105	1,105	1,161	1,335
Total current liabilities & provisions	2,740	2,351	2,413	2,533	2,982
Net current assets	5,996	6,470	6,722	8,751	10,010
<b>Uses of funds</b>	<b>24,696</b>	<b>29,061</b>	<b>34,069</b>	<b>34,536</b>	<b>34,745</b>
Book value per share (INR)	88.5	99.6	117.7	132.0	147.5

**Free cash flow**

(INR mn)

Year to June	FY09	FY10	FY11E	FY12E	FY13E
Net profit	2,917	2,403	3,724	2,991	3,265
Depreciation	1,867	2,679	3,300	3,551	4,000
Others	(30)	673	617	769	701
Gross cash flow	4,754	5,755	7,641	7,311	7,966
Less: Changes in WC	1,151	1,706	304	1,775	1,092
Operating cash flow	3,603	4,049	7,337	5,536	6,874
Less: Capex	7,635	4,684	7,762	2,550	2,850
<b>Free cash flow</b>	<b>(4,032)</b>	<b>(635)</b>	<b>(425)</b>	<b>2,986</b>	<b>4,024</b>

**Cash flow metrics**

<b>Year to June</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11E</b>	<b>FY12E</b>	<b>FY13E</b>
Cash flow from operations	3,515	5,168	7,703	7,432	8,415
Cash for working capital	(1,151)	(1,706)	(304)	(1,775)	(1,092)
Operating cash flow	3,603	4,049	7,337	5,536	6,874
Net purchase of fixed assets	(7,635)	(4,684)	(7,762)	(2,550)	(2,850)
Net purchase of investments	2,467	(196)	(410)	561	(100)
Others in Cash Flow Metrics	(1,234)	(1,746)	308	217	220
Investing cash flow	(6,402)	(6,626)	(7,864)	(1,772)	(2,730)
Dividends	(576)	(573)	(658)	(752)	(752)
Proceeds from issue of equity	8	13	49	-	-
Proceeds from LTB/STB	3,846	3,317	1,149	(2,823)	(3,225)
Financing cash flow	1,577	1,705	540	(3,575)	(3,978)
Net cash flow	(1,223)	(872)	13	188	166

**Profitability & efficiency ratios**

<b>Year to June</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
ROAE (%)	22.3	15.8	15.3	14.9	14.5
ROACE (%)	13.8	11.7	12.7	12.9	13.7
Debtors days	146	145	133	136	138
Payable days	50	36	26	24	24
Cash conversion cycle (days)	95	109	107	112	114
Current ratio	3.2	3.8	3.8	4.5	4.4
Debt/EBITDA	2.1	2.2	2.0	1.6	1.2
Debt/Equity	0.7	0.8	0.8	0.6	0.4
Adjusted debt/equity	0.7	0.8	0.8	0.6	0.4
Interest coverage	6.9	4.4	4.3	4.8	5.1

**Operating ratios**

<b>Year to June</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Total asset turnover	0.6	0.6	0.6	0.6	0.7
Fixed asset turnover	1.4	1.1	0.9	1.0	1.1
Equity turnover	1.1	1.0	1.0	1.0	1.0

**Valuation parameters**

<b>Year to June</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Diluted EPS (INR)	18.1	14.8	16.7	18.5	20.2
Y-o-Y growth (%)	28.8	(18.3)	12.5	11.3	9.2
CEPS (INR)	29.6	31.5	37.1	40.6	45.0
Diluted PE (x)	4.5	5.5	4.9	4.4	4.0
Price/BV (x)	0.9	0.8	0.7	0.6	0.6
EV/Sales (x)	1.6	1.6	1.5	1.2	1.0
EV/EBITDA (x)	4.6	4.3	3.7	3.2	2.6
EV/EBITDA (x)+1 yr forward	3.7	3.4	3.4	2.9	-
Dividend yield (%)	3.7	4.0	4.3	4.9	4.9

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ECLERX SERVICES	BUY	SO	M	HCL Technologies	BUY	SO	H
Hexaware Technologies	BUY	SO	M	Info Edge	REDUCE	SU	M
Infosys	HOLD	SP	L	Infotech Enterprises	BUY	SO	H
Mphasis	REDUCE	SU	M	Patni Computer Systems	HOLD	SU	M
Rollta India	BUY	SP	H	Tata Consultancy Services	BUY	SO	L
Wipro	HOLD	SU	L				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



**IT****Cognizant results - Q4CY11 guidance disappointing**

India Equity Research | IT

Cognizant's Q3CY11 revenue at USD 1.6bn, up 7.3% Q-o-Q in organic terms, was higher by 2% over its guidance. It stated that there is no slowdown in decision making and that clients are shifting most cost containment initiatives towards global delivery (read offshore/low cost destinations) and deploying the consequent cost savings on discretionary projects (consulting/data analytics). It expects 2012 budgets to remain stable with an upward bias and is confident that clients will take up more offshoring initiatives. Despite the bullish commentary it guided to organic revenue growth of just 2.8% Q-o-Q for Q4CY11. The tier-1 Indian IT companies provided similar commentaries with TCS indicating that 2012 budgets would remain stable. Overall, Cognizant is seeing a robust growth in Infrastructure Management Services, BPO and CRM/Analytics. We prefer TCS due to its diversified portfolio and positioning as a primary offshore vendor and HCLT due to its strong IMS and restructured platform BPO offering.

- Revenue at USD 1.6 bn grew 32% Y-o-Y with EBITDA margins stable at 20.2% and net income at USD 227mn, ahead of Street expectations and growing at 12% Y-o-Y.
- Revenue growth of 11% Q-o-Q in its Healthcare business which contributes 26% to revenue. BFSI grew 7% Q-o-Q contributing 41% to revenue and Manufacturing and Retail grew 5% Q-o-Q, contributing 20%.
- North America business, accounting for 78% of revenue, grew 8% Q-o-Q while Europe grew 5% Q-o-Q, contributing 18% to revenue.
- It saw a slowdown in Europe but stated that most CIOs in European client organizations indicated that they would defend their 2012 budgets and continue to take up discretionary projects out of savings from shifting routine work offshore.
- Seeing a good demand for Infrastructure Management Services, high-end BPO, Analytics and Customer relationship management.
- The guidance indicates 2.8% Q-o-Q growth in organic revenues which is the lowest Q-o-Q growth in the last seven quarters.
- It saw price increase of 4%-5% Y-o-Y mainly due to successful price re-negotiations in 2010. It expects pricing to remain stable in CY12.
- It derives only 31% revenues from fixed price projects compared to at least 40% for the tier-1 Indian IT companies. This is surprising as we believe clients are compelling vendors to improve efficiency by shifting to fixed price models.

**Relative valuation snapshot**

Company	P/E (x)		EV/EBITDA(x)		Mcap/Revenue		EPS CAGR (%)
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY11-13E
HCL Tech	14.2	12.0	8.1	6.6	1.5	1.3	25.9
Infosys	20.0	17.7	13.6	11.9	4.9	4.2	15.9
TCS	20.8	18.1	14.9	12.8	4.5	3.8	17.0
Wipro	16.3	14.4	11.8	10.2	2.5	2.1	9.6
Cognizant*	22.8	19.1	15.3	12.6	3.5	2.9	22.3

\*Bloomberg estimates

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November 2, 2011



# RANBAXY LABORATORIES

## Pfizer and Watson confirm Lipitor launch by Ranbaxy

India Equity Research | Pharmaceuticals

As we enter November, the clock has started ticking for the expected launch of generic Lipitor by Ranbaxy on Nov 30, 2011. Pfizer and Watson during their earnings call have indicated Ranbaxy launch on scheduled date which reaffirms our expectations (*Refer note dated Sept 13, 2011*). Our TP of INR 541 per share includes INR 64 per share from Lipitor.

We highlight key takeaways from Pfizer and Watson over the likely scenario on the expiry of Lipitor patent on Nov 30, 2011.

On Nov 30, 2011 Watson expects to launch Lipitor generic as an authorized generic (AG) under settlement with Pfizer. Ranbaxy has exclusivity for 180 days post which other players who have settled with Pfizer can enter the market.

Watson expects the atorvastatin launch to contribute between USD 60mn–USD 67 mn to its earnings in the fourth quarter albeit at lower gross margins due to higher profitability share by Pfizer. This is based on the assumption that Ranbaxy will launch along with Watson and Pfizer will compete aggressively in retaining approximately 40% brand share for Lipitor. The earnings guidance considers 10 weeks of inventory at the time of the launch which indicates potential sales of USD 400 mn–USD 500 mn during 180 days of exclusivity in line with our estimates for Ranbaxy.

Watson management has indicated that its market intelligence suggests full launch by Ranbaxy with sufficient capacity and inventory to meet demand and gain market share. Also Ranbaxy is actively talking to customers for the launch which rules out the possibility of out licensing exclusivity to third party.

Pfizer in its conference call has also affirmed that it expects Ranbaxy to launch generic Lipitor by end Nov 2011 and has made efforts to maintain brand share by promoting it aggressively over the last three to four months. Lipitor franchise in US grew 13% Y-o-Y (USD 1.47 bn sales during Q3CY11) for Pfizer due to its efforts to retain the brand share post the genericization. Pfizer had also taken some price cuts ahead of the generic entry.

### Financials

Year to December	CY09	CY10	CY11E	CY12E
Revenues (INR mn)	74,529	87,106	102,230	117,892
Rev growth (%)	0.4	16.9	17.4	15.3
EBITDA (INR mn)	6,106	16,802	21,775	25,826
Adjusted net profit (INR mn)	3,586	12,929	15,155	17,491
Shares outstanding (mn)	420	421	421	421
Adj. Diluted EPS (INR)	8.5	30.7	36.0	41.5
EPS growth (%)	60.5	260.6	17.2	15.4
P/E (x)	58.8	16.3	13.9	12.1
EV/EBITDA (x)	37.6	12.9	9.8	7.8
ROAE (%)	(4.7)	19.2	24.2	22.7

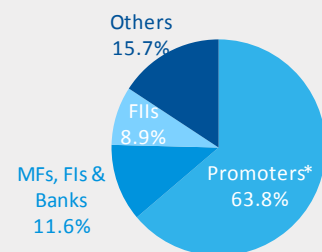
### EDELWEISS 4D RATING

<b>Absolute Rating</b>	<b>HOLD</b>
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to market	Equalweight

### MARKET DATA (R: RANB. BO, B: RBXY IN)

CMP	: INR 501
Target Price	: INR 541
52-week range (INR)	: 624 / 414
Share in issue (mn)	: 421.5
M cap (INR bn/USD mn)	: 211 / 4,322
Avg. Daily Vol. BSE/NSE ('000)	: 905.6

### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : Nil  
(% of share in issue)

### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Pharma Index
1 month	3.1	8.4	4.1
3 months	(6.7)	(2.3)	(3.7)
12 months	(11.6)	(10.5)	1.6

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November 1, 2011

We highlight a few tactics employed by Pfizer to retain higher brand share which could have a potential impact on market share of generics

- **Paying discounts to PBMs to block generics:** PBM or Pharmacy benefit managers supply drugs to target patients depending on their prescription usage. Pfizer is offering higher discounts to these PBMs to block generics, an effective way to ensure that generics do not get dispensed, thereby helping it maintain the market share.
- **Protecting market share in the mail order segment:** Pfizer has been undertaking strong measures to protect its brand share in the mail order segment. Lipitor being a chronic cure medication has high mail order utilization and Pfizer has built aggressive inventory to maintain a large position in the mail order segment.
- Aggressive brand promotion and discounts: Pfizer is offering higher discounts under co-pay card thereby making generics less attractive to the patient. Pfizer is aggressively promoting the brand through the doctor channel in order to retain and generate higher prescriptions.

### **Lipitor launch adds option value of INR 64 per share**

We have built in USD 350 mn revenue for Ranbaxy during six months exclusivity (assuming 50% price erosion and 30% market share). Further, post the exclusivity, we estimate incremental earnings of INR 1.6 per share to CY12 core EPS. Overall, the option value of Lipitor would be INR 64 per share (inc. recurring earnings).

### **Outlook and valuations: Lipitor launch a potential trigger in short term**

We expect Lipitor launch to act as a positive catalyst in the short term, but core business performance will drive the long term value. Lower than expected ramp-up in emerging markets and lack of traction in core margins will cap the upside for the stock. We thus maintain '**HOLD**' rating with price target of INR 541.



## PLEDGE SHARES

Reporting Date	Company Name	Name of the Entity	Pledged Quantity	Pledged % of the total capital
2-Nov-11	Edserv Softsystems	G Gita	838,500	3.53%
2-Nov-11	Indoco Remedies	Ramanth G Kare	0	0.00%
2-Nov-11	Asian Paints	Geetanjali Trading & Investments	10,736,779	11.19%
2-Nov-11	Marg	Akshya Infrastructure	1,440,000	3.78%

## INSIDER TRADES

Company Name	Acquirer/Seller	B/S	Qty Traded
AIA Engineering	Nalanda India Equity Fund .	Buy	152700
Asian Paints	Rhea M Choksi	Buy	21565
Avon Corporation	Pankaj Saraiya	Buy	38279
Geodesic	Kiran Kulkarni	Buy	474839
Geodesic	Pankaj Kumar	Buy	875000
Microsec Financial Services	Topview Enclaves LLP	Buy	24701
Monnet Industries	Cecil Webber Engineering	Buy	530827
Monnet Ispat Energy	Cecil Webber Engineering	Buy	2238007
Monnet Ispat Energy	Kamdhenu Enterprises	Buy	6738721
Monnet Ispat Energy	Udhyam Merchandise (P)	Buy	950500
Monnet Sugar	Cecil Webber Engineering	Buy	1061681
Monnet Sugar	Kamdhenu Enterprises	Buy	2683706
Network 18 Media & Investments	RB Holdings	Buy	28065239 off market
Strides Arcolab	Pronomz Ventures LLP	Buy	12040000 inter se transfer
Wim Plast	Ghisulal Rathod	Buy	25410
Woo Yang Electronics (India)	Abheek Properties	Buy	650000 Pref. Allotment
Woo Yang Electronics (India)	Bright Hills Infra Projects	Buy	799000 Pref. Allotment
Woo Yang Electronics (India)	High Ground Productions	Buy	1175525 Pref. Allotment
Apollo Tyres	Merrill Lynch Capital Markets	Sell	5189000
Arvind	Aeon Investments .	Sell	45000
Asian Paints	Manish M Choksi	Sell	21565
ITC	Mr. P V Dhobale	Sell	40000
ITC	K Vaidyanath	Sell	30000
Monnet Industries	Bhagyashali Holdings	Sell	530827
Monnet Industries	Chaturanan Industries	Sell	1335438
Monnet Ispat Energy	Bhagyashali Holdings	Sell	1888007
Monnet Ispat Energy	Chaturanan Industries	Sell	6450853
Monnet Ispat Energy	Mili Marketing	Sell	87500
Monnet Ispat Energy	Monnet Finance	Sell	350000
Monnet Ispat Energy	Nayan Traders	Sell	863000
Monnet Ispat Energy	Neon Properties	Sell	287868
Monnet Sugar	Bhagyashali Holdings	Sell	1061654
Monnet Sugar	Chaturanan Industries	Sell	2671076
Network 18 Media & Investments	Raghav Bahl	Sell	6704725 off market
Network 18 Media & Investments	RB Investments	Sell	21360514 off market
Pennar Industries	Capthall Mauritius Investment Limited	Sell	1840000
Strides Arcolab	Agnus Holdings	Sell	11610000 inter se transfer
Strides Arcolab	Chayadeep Properties	Sell	1075000 inter se transfer

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## BULK DEALS

Date	Company Name	Acquirer/Seller	B/S	Qty Traded	Price
2-Nov-11	Coral Laboratories	Chetan Doshi	Buy	19870	73
2-Nov-11	Coral Laboratories	Ela Anil Sheth	Sell	20000	73
2-Nov-11	Diamant Infrastructure	Jatin Shantilal Shah	Sell	190000	16
2-Nov-11	Exelon Infrastructure	Anitha Yarlagadda	Sell	70000	33.65
2-Nov-11	GFL Financials India	Neha Bipin Patel	Buy	15000	73.25
2-Nov-11	GFL Financials India	Vijaykumar J Jha	Sell	32000	73.25
2-Nov-11	Gitanjali Gems	Macquarie Bank	Sell	748000	352.84
2-Nov-11	Indo Thai Securities Limited	Cetka Consultancy Bureau (Tulsidas Laxman Nakrani)	Buy	80000	89.2
2-Nov-11	Indo Thai Securities Limited	P S Sheth	Buy	62073	23.67
2-Nov-11	Jindal Drilling & Industries	Stable Trading Co..	Buy	320000	321
2-Nov-11	Jindal Drilling & Industries	Sudha Apparels	Sell	320000	321
2-Nov-11	Kesar Enterprises	Mitesh Narendrakumar Mehta	Buy	50000	60
2-Nov-11	Kesar Enterprises	National Insurance Co	Sell	50000	60
2-Nov-11	Madhur Industries	Palak Nileshbhai Karia	Sell	70880	55.13
2-Nov-11	Monotype India	Everlink Dealer	Sell	53750	20.45
2-Nov-11	Nu Tek India	Butterfly Commotrade	Buy	3945433	1.36
2-Nov-11	Nu Tek India	Chetan Laxmikant Dave	Sell	1090766	1.3
2-Nov-11	Onelife Capital Advisors Limited	Bmd Exports	Sell	106165	208.48
2-Nov-11	Onelife Capital Advisors Limited	Prakashbhai Ishwarbhai Rana	Sell	158011	217.34
2-Nov-11	Passari Cellulose	Manisha Vikas Shinde	Buy	34000	103.56
2-Nov-11	Passari Cellulose	Ruby Amin Merchant	Buy	39000	102.38
2-Nov-11	Passari Cellulose	Varun Prem Budhrani	Sell	24400	103.74
2-Nov-11	Prakash Constrowell	Alfa Fiscal Services	Buy	42316	239.09
2-Nov-11	Regency Trust	Shilpa Jain	Buy	62450	77.6
2-Nov-11	Technofab Engineering	M Power Trading	Sell	200000	136
2-Nov-11	Technofab Engineering	Pragmatic Traders	Buy	198913	136
2-Nov-11	Tutis Technologies	Mandvi Dyes & Chemicals	Sell	85000	18.93

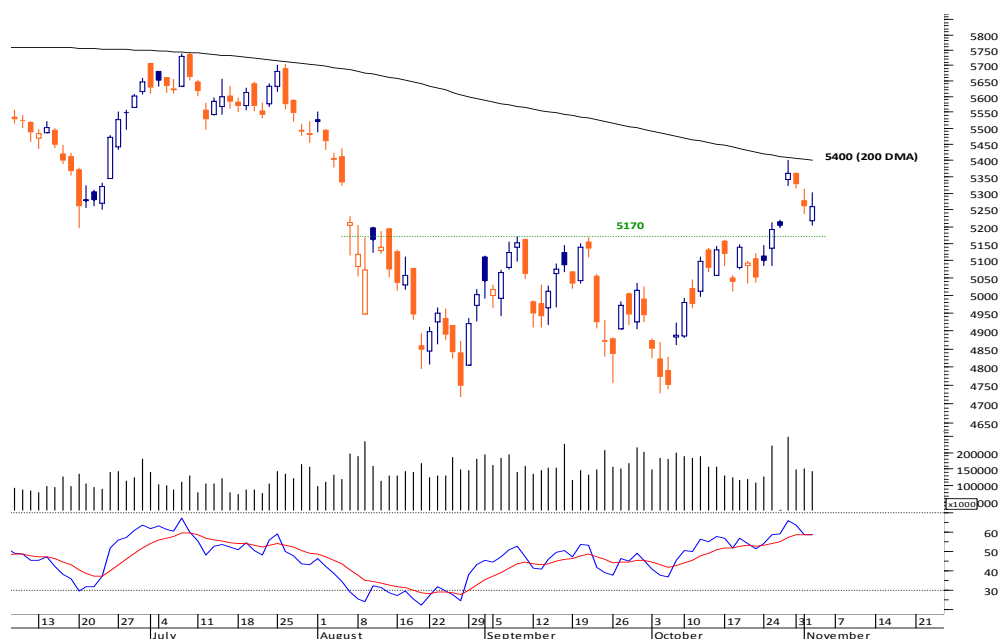
## TECHNICAL UPDATES

Nifty ended a very volatile day almost unchanged as traders look for clarity on the events clouding the Euro Zone. For the third consecutive session the index has made a lower top and lower bottom raising alarm bells on the downside risks. Nifty opened lower on the back of weak cues from global markets but surprised participants here as it started to make up the losses on opening. Intraday the index recovered 95 points off the lows, however in the final hour gave up the gains and ended unchanged. This suggests a stiff tussle between the bulls and the bears as they fight it out for control. Trading volumes continue to decline whereas the market breadth ended neutral. *The 'bullish island gap' has been closed and focus shifts to the key pivot for Nifty at 5170 where the 'double bottom' breakout was confirmed. A breakdown of that level will shift the balance in favour of bears. We continue to maintain our constructive view risking 5170 and look for a test of the 200 DMA at 5400 once again*

Most sectoral indices ended the day in the red with the exception of Oil & Gas (+0.76%), Healthcare (+0.44%) and FMCG (+0.24%). Among the prominent losers were Auots (-0.44%), Banking (-0.35%) and Cap Goods (-0.30%) stocks. Mid-cap and Small-cap ended mixed with 0.02% and -0.06% returns.

**Bullish Setups:** CNXBANK, ABGS, NMDC, HUVR

**Bearish Setups:** RBXY, LPC, BPCL, INFY



### Nifty Index

Bloomberg Code	NIFTY Index
Bloomberg Code	NIFTY Index
Spot Price	5,258
Resistance 1	5,300
Resistance 2	5,356
Support 1	5,230
Support 2	5,170
Nifty 20 SDMA	5,090
Nifty 50 SDMA	5,021
Nifty 200 SDMA	5,401
Adv : Dec [NSE]	702 : 753
Turnover Rs Crs.	11299

Indicator	Outlook	Points*
Candlestick	Positive	1
Stochastic	Positive	1
Moving Avg	Negative	(1)
RSI	Neutral	0
ADX	Neutral	0
MACD	Neutral	0
<b>Aggregate</b>	<b>Positive</b>	<b>1</b>

## EYE CATCHERS

### Futures Snapshot

#### Top OI Rises

Scrip	% OI Chg	OI	% Price Chg	% Future Vol Chg
Allahabad Bank	21	2,529	8.0	1,013
GVK Pow. & Infra Ltd.	14	68,932	(4.3)	23
Arvind Limited	12	4,988	(0.2)	50
Andhra Bank	12	2,384	(1.9)	686
Bank of Baroda	11	2,504	0.2	(12)
Power Finance Corp	11	8,872	0.9	70
Colgate Palmolive	11	281	1.5	(57)
Chambal Fertilizers	10	3,768	2.6	426

#### Top OI Falls

Scrip	% OI Chg	OI	% Price Chg	% Future Vol Chg
Gujarat Minerals De	(16)	402	0.2	(18)
Tata Chemicals	(8)	363	2.0	4
Escorts India	(7)	4,568	4.6	242
Divi's Lab	(7)	619	0.3	98
Bombay Dyeing	(5)	456	(1.9)	(12)
HPCL	(4)	3,737	1.2	(45)
Bajaj Holdings	(4)	57	0.4	(75)
Havells India	(4)	640	0.4	(50)



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