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RESULT PREVIEW: Q3FY09

Earnings decline likely; commodities play spoilsport

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Abhishek Singhal
+91-22-4040 7574
abhishek.singhal@edelcap.com

Siddhartha Sanyal
+91-22-4040 7505
siddhartha.sanyal@edelcap.com

Edelweiss Research Team

Earnings likely to decline led by commodities

Core earnings are likely to **decline 18% Y-o-Y** for the Sensex led primarily by strong earnings decline in commodities (oil & gas, metals, cement) in the quarter. Ex-commodities, earnings are likely to remain flat. PAT margin for the Sensex is expected to decline 393bps Y-o-Y to 17.5%. Considering translation losses on foreign currency loans (expected to be 3% of core earnings in Q3FY09 for the Sensex), reported earnings will be even lower. Revenue growth for the Sensex is expected to slow significantly to just 1% Y-o-Y in the quarter, led by lower realisations and volumes for the commodities sector. EBITDA margins are also expected to compress 74bps to 27.8% reflecting reverse operating leverage at play, particularly in commodities. The BFSI sector is expected to report strong core operating performance on the back of strong credit growth and stable to improving net interest margins.

Weak earnings growth outlook; consensus earnings downgrade likely

We currently expect just 3% earnings growth for the Sensex in FY10E. Contribution of the oil & gas sector will be highest to Sensex earnings growth in FY10 while metals sector will be the biggest drag. Slowing economic growth, weak demand, lower realisations, and reverse operating leverage are likely to keep earnings growth and profitability of domestic corporates under pressure in the near term. Consensus expectations have consistently been revised down in CY08; they are still, however, significantly above our estimates. We expect consensus earnings estimates to get revised down further, closer to our estimates.

Outlook for 2009: A year of risks and opportunities

Indian markets are offering good long term value at current valuations. Despite near-term macro-economic concerns, strong domestic liquidity will limit downside. Long-term investors should accumulate stocks for the next upcycle. In the near term, volatility will persist, though lower than in CY08. Make the best of the 8,000-12,000 range of the Sensex until elections. Election in mid-CY09 is the key event risk. We are **overweight on BFSI and consumer discretionary** and **underweight on IT and materials**.

Sector	Revenue growth		EBITDA margin		PAT growth	
	Y-o-Y (%)	Q-o-Q (%)	Y-o-Y (bps)	Q-o-Q (bps)	Y-o-Y (%)	Q-o-Q (%)
Auto	(19)	(17)	(546)	(316)	(65)	(54)
BFSI	12	3	603	(217)	19	16
Cement	6	(0)	(652)	(101)	(21)	(11)
Engg & Cap Goods	19	4	(152)	117	2	35
FMCG	18	3	(114)	157	9	15
IT	29	4	7	4	17	7
Media	15	5	(322)	305	(7)	(24)
Metals & Mining	2	(22)	(919)	(626)	(26)	(43)
Oil & Gas	(26)	(44)	(1,046)	(224)	(141)	(75)
Power	32	15	(77)	(247)	3	8
Real Estate	(45)	(45)	67	909	(61)	(55)
Telecom	28	5	(160)	(28)	14	(0)
Coverage	**(6)**	**(23)**	**(351)**	**134**	**(45)**	**(17)**
ex-commodities	**15**	**2**	**(36)**	**(73)**	**1**	**3**
Sensex	**1**	**(15)**	**(74)**	**110**	**(18)**	**(11)**
ex-commodities	**15**	**1**	**(97)**	**(5)**	**1**	**4**

Source: Edelweiss research
Note: Ex-commodities aggregate excludes companies in metals, cement and oil & gas sectors

Note: Q3 FY09 refers to the October-December 2008 quarter in this report, unless otherwise mentioned.

Contents

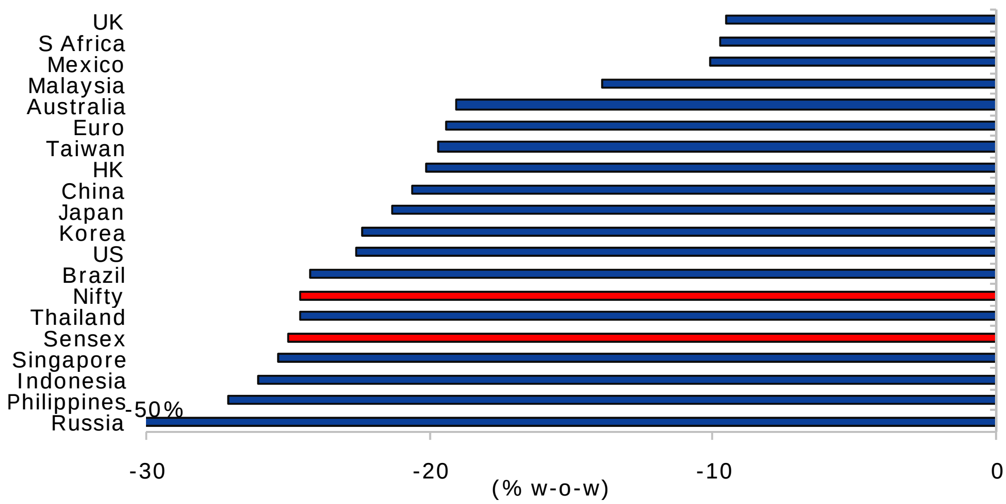
Markets recovered late after falling sharply in early Q3FY09

Global equities recovered late from the lows they touched in early Q3FY09. Early in Q3FY09, markets fell as the Lehman bankruptcy triggered a global financial market turmoil. FII selling due to redemption pressures led to underperformance of Indian equities. The recovery, which began in end October, may be attributed to government actions taken around the world to counter the slowdown in global growth. Apart from the spate of coordinated rate cuts taken across the world, governments have also tried to infuse liquidity into the system by pumping in capital. Many countries have also introduced packages to stimulate domestic industries and increase consumption.

The Indian economy has been relatively less impacted by slowing global growth due to low dependence on exports and resilience of domestic consumption. India growth drivers are improving at the margin (commodity prices, inflation, interest rates). Election in mid-CY09 is the key event risk.

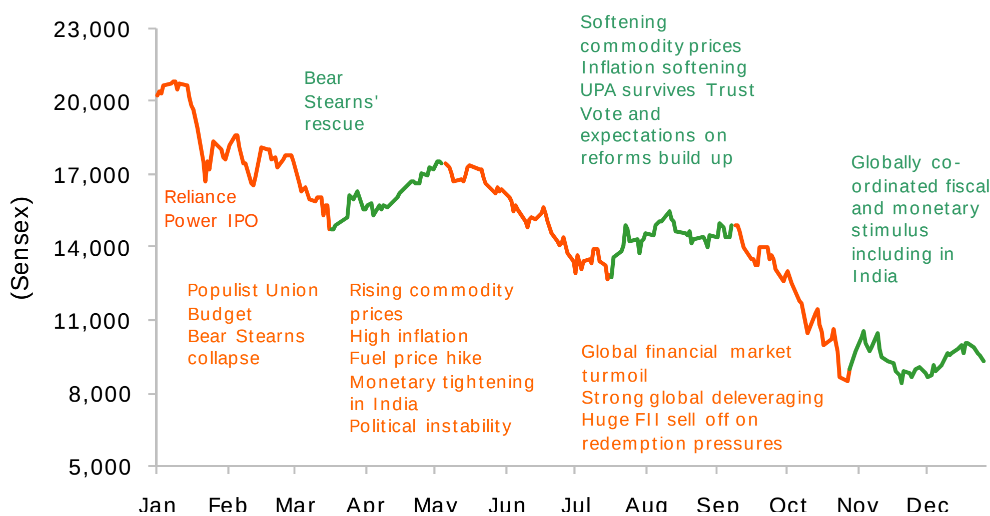
India underperformed global equity markets during the October-December 2008 quarter. The Sensex lost 25% during the period.

Chart 1: India underperformed global equity markets in Q3FY09



Source: Bloomberg, Edelweiss research

Chart 2: Sensex in CY08

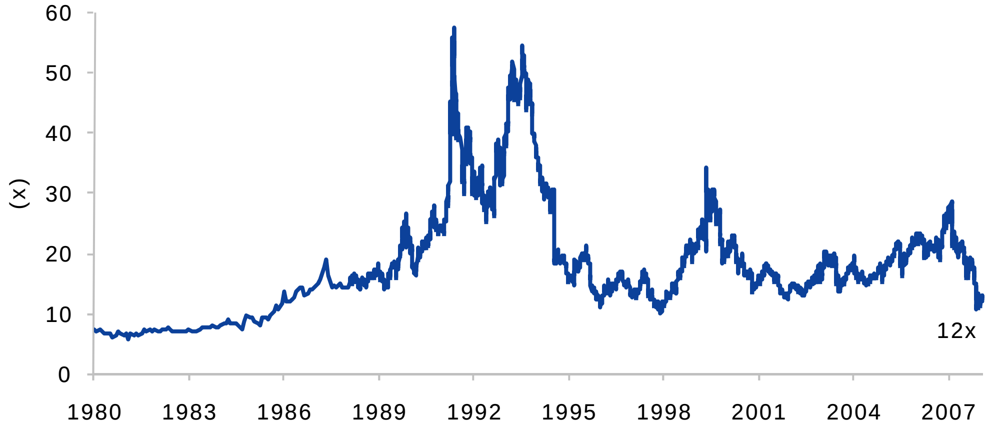


Source: Bloomberg, Edelweiss research

Valuations are near historic lows

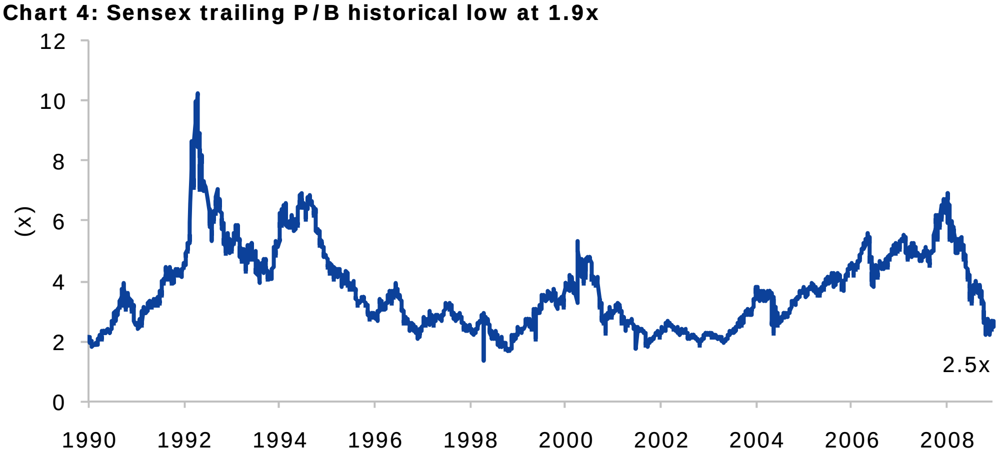
Market valuations are near all-time lows; though 15-20% downside cannot be ruled out. At 10335, the Sensex is currently trading at 12x FY08 earnings and 2.5x book value. The current dividend yield is 1.9%.

Chart 3: Sensex trailing P/E historical support at 10x



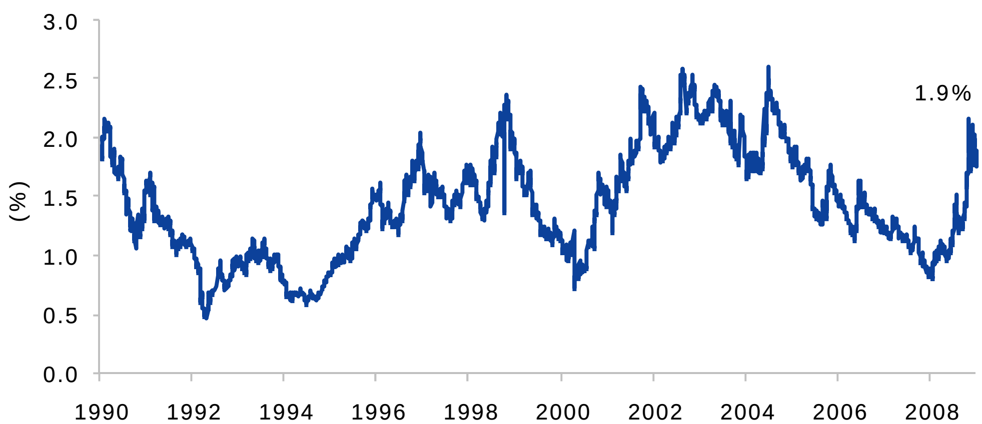
Source: Bloomberg, Edelweiss research

Chart 4: Sensex trailing P/B historical low at 1.9x



Source: Bloomberg, Edelweiss research

Chart 5: Sensex dividend yield historical high at 2.6%



Source: Bloomberg, Edelweiss research

FII outflows to be muted; strong DII inflows expected

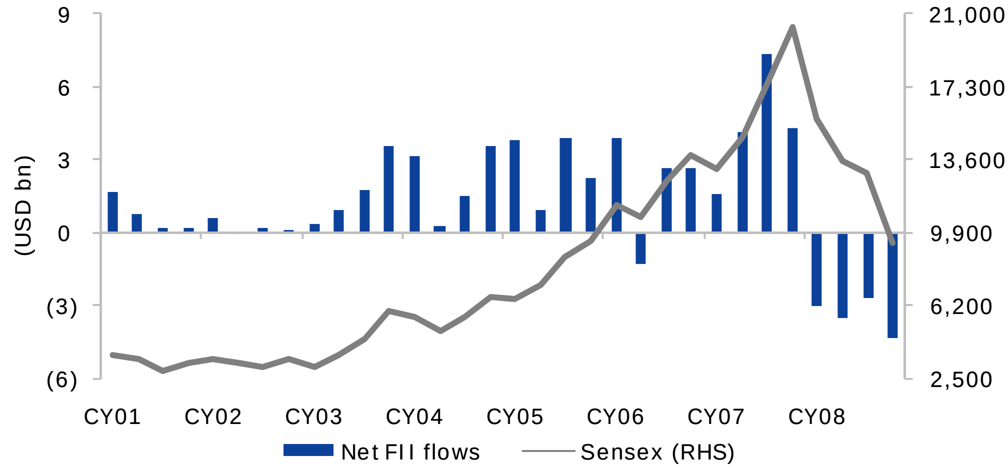
FII outflows have been strong as hedge funds face redemptions globally and there is a flight to safety to the USD-denominated assets. FIIs have sold USD 4.3 bn during Q3FY09 (USD 13 bn YTD) while domestic institutional investors have been net buyers of USD 2.9 bn (USD 16 bn YTD). In the near future we could potentially see a reduction in FII outflows as the USD 13 bn of equities they have sold YTD was on a much higher base than their current worth of USD 88 bn in Indian equities.

Insurance funds' subscriptions are likely to remain strong in the next quarter. We expect fresh inflows of USD 3.2 bn into the insurance funds in Q4FY09. This value is based on the conservative assumption of 13% premium growth over Q4FY09 (> 25% in each of the past five years) of which 15% is expected to get invested in equities (27% invested in FY08).

Mutual fund cash levels are also high. As of November 2008, large cap mutual funds had a total of USD 4.3 bn in cash, which amounts to 18% of the total corpus.

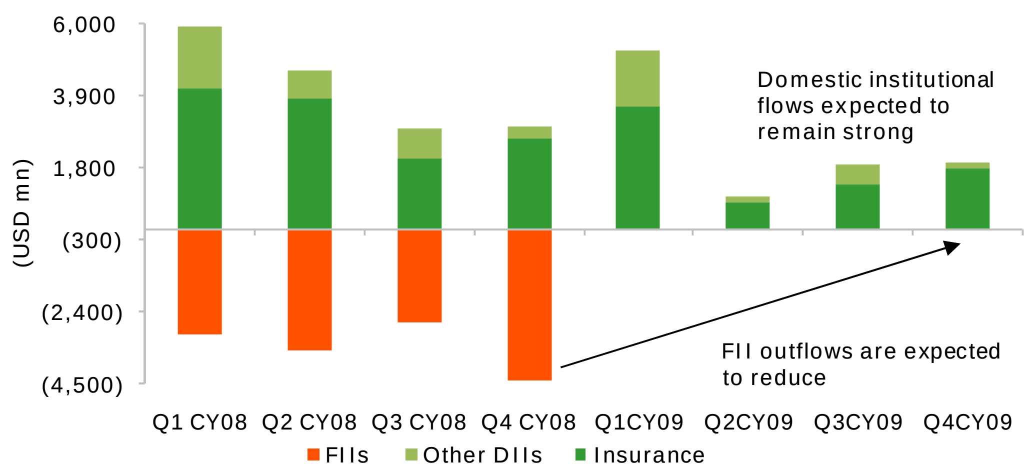
Hence, given the net inflow of institutional liquidity into Indian markets, we expect markets to react positively over the next quarter.

Chart 6: FII flows have been key driver of Indian market



Source: Bloomberg, Edelweiss research

Chart 7: Insurance flows will be key to liquidity in 2009; likely to remain strong



Source: Bloomberg, Edelweiss research

Revenue growth likely to slowdown significantly

Revenue for the Sensex is expected to marginally increase by 1% Y-o-Y in Q3FY09 and decline by 14% on a sequential basis. Commodities (oil & gas, metals, cement) are the biggest drag on revenue growth; ex-commodities, revenue is expected to grow at 15% Y-o-Y and remain flat sequentially. Automobiles and real estate are also expected to report a decline in revenues. Weak demand and lower realisations are likely to keep revenues under pressure over the next few quarters.

BFSI, capital goods, FMCG, IT, power, and telecom are expected to register healthy top line growth. Retail and construction sectors are expected to register strongest revenue growth.

Table 1: Revenue growth expected to remain flat Y-o-Y; decline sequentially

Sector	# of companies	Q3FY09E INR bn	Q3FY08 INR bn	Y-o-Y (%)	Q2FY09 INR bn	Q-o-Q (%)
Retail	2	22.1	15.5	42	19	18
Construction	4	22.2	15.7	41	20	12
Power	10	267	202	32	233	15
IT	12	274	213	29	262	4
Telecom	4	171	134	28	163	5
Logistics	8	26.6	21.9	22	26	1
Pipes	5	49.2	40.6	21	46	7
Engg & Cap Goods	19	294	247	19	283	4
FMCG	8	129	110	18	125	3
Urban Infra	3	24.0	20.4	17	23	7
Media	6	10.3	8.9	15	10	5
BFSI	23	298	266	12	288	3
Cement	7	119	112	6	119	(0)
Metals & Mining	11	341	333	2	439	(22)
Auto	7	186	229	(19)	225	(17)
Oil & Gas	10	1,316	1,787	(26)	2,341	(44)
Real Estate	2	21.1	38.2	(45)	38	(45)
Coverage	**141**	**3,569**	**3,793**	**(6)**	**4,659**	**(23)**
ex-commodities	**113**	**1,794**	**1,561**	**15**	**1,760**	**2**
Sensex	**30**	**1,656**	**1,647**	**1**	**1,952**	**(15)**
ex-commodities	**22**	**1,067**	**932**	**15**	**1,061**	**1**

Source: Edelweiss research

Note: (1) Ex-commodities aggregate excludes companies in metals, cement and oil & gas sectors

(2) Revenues for BFSI = Net Interest Income + Other Income

EBITDA margins likely to decline

EBITDA margins are expected to decline 74bps to 27.8% for the Sensex reflecting reverse operating leverage at play. Margin decline is expected to be most severe in commodities (oil & gas, metals, cement). Consumer sectors are also likely to face margin pressure.

We expect strong core operating performance from the BFSI sector on the back of strong credit growth and stable to improving net interest margins.

Table 2: EBITDA margins expected to decline in most sectors

Sector	# of companies	Q3FY09E (%)	Q3FY08 (%)	Y-o-Y (bps)	Q2FY09 (%)	Q-o-Q (bps)
BFSI	23	50.8	44.7	603	52.9	(217)
Logistics	8	23.7	20.8	287	25.4	(178)
Real Estate	2	68.1	67.4	67	59.0	909
IT	12	24.5	24.4	7	24.5	4
Retail	2	8.0	8.0	(3)	7.9	3
Urban Infra	3	10.0	10.8	(75)	9.0	98
Power	10	20.2	21.0	(77)	22.7	(247)
Construction	4	11.5	12.3	(83)	12.3	(74)
Pipes	5	12.3	13.4	(103)	13.6	(125)
FMCG	8	20.7	21.8	(114)	19.1	157
Engg & Cap Goods	19	12.9	14.4	(152)	11.7	117
Telecom	0	38.2	39.8	(160)	38.5	(28)
Media	6	26.9	30.1	(322)	23.8	305
Auto	7	6.8	12.2	(546)	9.9	(316)
Cement	7	24.0	30.6	(652)	25.0	(101)
Metals & Mining	11	24.4	33.5	(919)	30.6	(626)
Oil & Gas	10	(0.0)	10.4	(1,046)	2.2	(224)
Coverage	**141**	**15.7**	**19.2**	**(351)**	**14.4**	**134**
ex-commodities	**113**	**25.1**	**25.5**	**(36)**	**25.9**	**(73)**
Sensex	**30**	**27.8**	**28.5**	**(74)**	**26.7**	**110**
ex-commodities	**22**	**27.6**	**28.6**	**(97)**	**27.7**	**(5)**

Source: Edelweiss research

Note: (1) Ex-commodities aggregate excludes companies in metals, cement and oil & gas sectors
(2) EBITDA margins for BFSI = Pre-Provisioning Operating Profit / (Net Interest Income + Other Income)

Earnings decline likely this quarter; first time after the tech bust

We expect core earnings to decline 18% Y-o-Y for the Sensex led primarily by Reliance Industries (expected earnings decline of 61% Y-o-Y). Ex-commodities, earnings are likely to remain flat. PAT margin for the Sensex is expected to decline 393bps Y-o-Y to 17.5%.

Profits of commodities (oil & gas, metals, cement), auto, and real estate are expected to decline in Q3FY09, both on Y-o-Y and sequential basis. Core earnings are likely to grow in BFSI, logistics, IT, and telecom.

Table 3: Earnings decline likely; ex-commodities almost flat

Sector	# of companies	Q3FY09E INR bn	Q3FY08 INR bn	Y-o-Y (%)	Q2FY09 INR bn	Q-o-Q (%)
BFSI	23	94.7	79.7	19	82.0	16
Logistics	8	4.0	3.3	18	4.5	(12)
IT	12	49.8	42.7	17	46.4	7
Telecom	4	37.1	32.7	14	37.2	(0)
FMCG	8	20.2	18.4	9	17.6	15
Urban Infra	3	1.3	1.2	6	0.8	50
Power	10	32.3	31.4	3	29.8	8
Engg & Cap Goods	19	24.6	24.1	2	18.3	35
Media	6	1.6	1.7	(7)	2.1	(24)
Construction	4	0.94	1.02	(8)	1.1	(13)
Retail	2	0.30	0.33	(8)	0.2	67
Metals & Mining	11	50.1	67.7	(26)	88.0	(43)
Cement	7	14.5	18.5	(21)	16.4	(11)
Pipes	5	3.3	7.7	(57)	4.1	(19)
Real Estate	2	8.7	22.0	(61)	19.5	(55)
Auto	7	6.0	17.0	(65)	13.1	(54)
Oil & Gas	10	(62.3)	152.5	(141)	(35.6)	(75)
Coverage	**141**	**287**	**522**	**(45)**	**346**	**(17)**
ex-commodities	**113**	**285**	**283**	**1**	**277**	**3**
Sensex	**30**	**290**	**353**	**(18)**	**327**	**(11)**
ex-commodities	**22**	**196**	**193**	**1**	**189**	**4**

Source: Edelweiss research

Note: Ex-commodities aggregate excludes companies in metals, cement and oil & gas sectors

MTM losses on foreign currency loans to supress reported earnings outlook further

The INR depreciated ~4% against the USD in Q3FY09. Companies with foreign currency loans in their books need to report MTM/translation losses to the extent of increase in INR liability against such loans, in their quarterly results. We estimate the total translation losses on foreign currency loans could be 3% of core earnings in Q3FY09 for the Sensex (4% for our coverage universe), thereby suppressing reported earnings further, on top of a poor core earnings growth outlook.

Table 4: Stocks expected to report MTM losses on foreign currency loans

Stock	Q3FY09 Core PAT	Expected MTM loss on FX loans	
	INR mn	INR mn	% of core PAT
Reliance Communications	13,546	(3,457)	(26)
Tata Steel	14,690	(3,150)	(21)
Bharti Airtel	21,973	(1,438)	(7)
JSW Steel	3,137	(1,150)	(37)
Jindal Steel & Power	4,619	(1,000)	(22)
Tata Motors	(810)	(990)	NM
Power Finance	3,372	(450)	(13)
Mahindra & Mahindra	1,086	(390)	(36)
Usha Martin	250	(300)	(120)
Jindal Saw	819	(250)	(31)
Ashok Leyland	(511)	(234)	NM
India Cements	726	(139)	(19)
Tulip Telecom	615	(30)	(5)

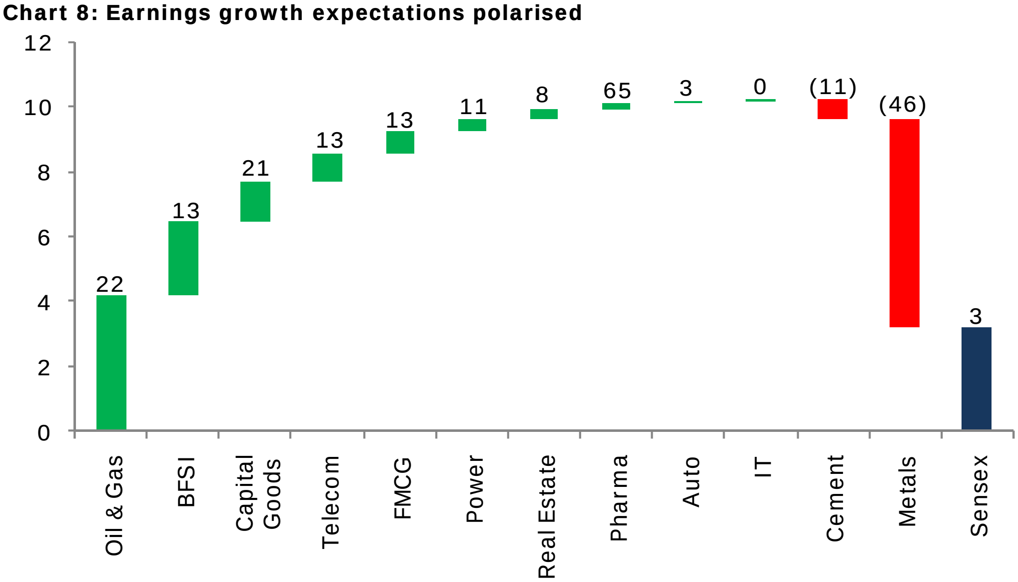
Source: Edelweiss research

Earnings growth outlook dismal for FY10

Earnings growth outlook over FY09 and FY10 has turned discouraging, particularly over the past three months. We currently expect just ~3% earnings growth for the Sensex in FY10E. Contribution of the oil & gas sector (esp. RIL) will be the highest to Sensex earnings growth in FY10E (ex-oil and gas, we expect earnings decline of 1%).

The metals sector will be the biggest drag on earnings growth, excluding which earnings growth is likely to be ~10% in FY10E. Ex-commodities (oil & gas, metals, cement) growth is likely to be 2%.

Chart 8: Earnings growth expectations polarised



Source: Edelweiss research

Note: (1) The bars represent the sector contribution to Sensex earnings growth of 3% in FY10E

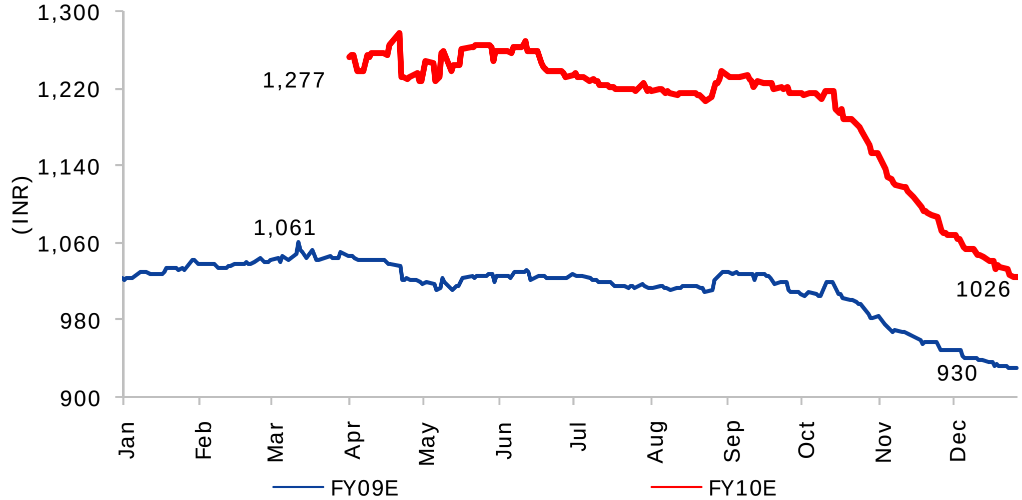
(2) The figures above the bars represent the expected earnings growth for the sector in FY10E

Risk of further earnings downgrade is high

Slowing economic growth, weak demand, and lower realisations will keep earnings growth and profitability of Indian corporates under pressure in the near term. Sales growth has been strong so far; however, it has been primarily due to better realisations as effects of high inflation were being passed on to end consumers. Now, with weak volumes and lower realisations, reverse operating leverage will play its part.

Consensus expectations have consistently been revised down in CY08. It is still, however, significantly above our estimates. We expect consensus earnings estimates to get revised down further, closer to our estimates.

Chart 9: Consensus Sensex EPS consistently revised down in CY08



Source: Edelweiss research

Table 5: Consensus expectations can further come down, closer to our estimates

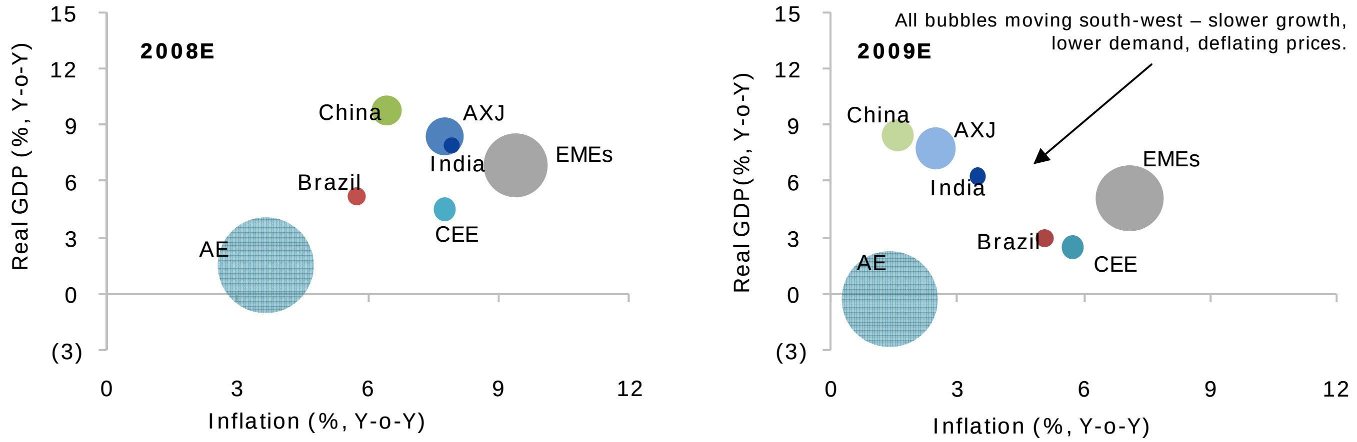
Sector	Sensex			
	FY09E (% Y-o-Y)		FY10E (% Y-o-Y)	
	Edelweiss	Consensus	Edelweiss	Consensus
Auto	(9)	24	3	10
BFSI	13	8	13	20
Capital Goods	25	25	21	27
Cement	(0)	(5)	(11)	(9)
FMCG	10	9	13	14
IT	25	24	(1)	8
Media	NA	NA	NA	NA
Metals	7	(4)	(42)	(27)
Oil & Gas	4	10	28	27
Pharma	(35)	(34)	65	60
Power	23	59	10	19
Real Estate	(28)	(7)	8	(6)
Telecom	9	18	13	16
Overall index	**7.8**	**10.3**	**4.4**	**10.3**
EPS (INR)	**909**	**930**	**949**	**1,026**

Source: Edelweiss research

Recession-deflation threats across the globe

Growth momentum has dipped significantly across most countries and threats of recession, deflation, and rising unemployment are creeping in, particularly in advanced economies. The November 2008 update of the World Economic Outlook (WEO) of the International Monetary Fund (IMF) projected world GDP growth to slow down from ~5% in CY07 to ~3.75% in CY08 and to just over 2% in CY09. As per IMF, activity in advanced economies is now expected to contract to ~0.25% in CY09; it will be the first annual contraction since World War II. Several other organizations have gloomier projections for global growth in CY09. The World Bank believes that global growth can be a mere 0.9% in CY09.

Chart 10: Global economy slipping into recession-deflation (Projections)



Source: IMF, Focus Economics, Edelweiss research

Note: AE: Advanced economies; AXJ: Asia ex-Japan; CEE: Central and Eastern Europe

Size of bubbles indicate relative size of the respective economy/ economic zone by nominal GDP

Threats of recession and deflation are inducing central banks to shift focus to boosting growth. The US Federal Reserve slashed its federal funds target to virtually zero from 4.25% at the start of the year. Bank of Japan has also reduced the policy rate to close to zero. Bank of England and ECB cut their benchmarks to 2% and 2.5%, respectively. Policy interest rates have been reduced sharply by several central banks across emerging markets as well since October.

Table 6: Growth, inflation and policy rates across globe

	Inflation (Y-o-Y, %)			GDP (Y-o-Y, %)			Policy interest rates (%)		
	Nov-07	**Oct-08**	**Nov-08**	**Q3-07**	**Q2-08**	**Q3-08**	**Dec-07**	**Dec-08**	**Current**
US	4.3	3.7	1.1	4.8	2.8	(0.5)	4.25	0.25	0.25
UK	2.1	4.5	4.1	3.4	1.5	2.5	5.50	2.00	2.00
Japan	0.6	1.7	1.0	1.9	0.7	(0.5)	0.50	0.10	0.10
Euro Zone	3.1	3.2	2.1	2.6	1.4	0.6	4.00	2.50	2.50
Brazil	4.2	6.4	6.4	5.4	6.2	6.8	11.25	13.75	13.75
China	6.9	4.0	2.4	11.5	10.1	9.0	14.50	15.50	15.50
Russia	11.5	14.2	13.8	7.3	7.5	6.2	10.00	13.00	13.00
India	5.5	9.8	10.5*	9.3	7.9	7.6	7.50#	6.50	5.50
							7.50 ##	5.50	5.50

Source: Bloomberg

*Note: * Oct-08 # Repo rate ## CRR*

Large stimulus packages across the globe to spur growth

Along with strong monetary easing by central banks, governments are also introducing stimulus packages to fight recession. The plans attempt to boost consumer demand by providing tax concessions and enhancing infrastructure investments to arrest the downside impact of global slowdown.

Table 7: Governments introducing large stimulus packages

Country	Amount	Details
U.S.	$ 168 bn	Tax refunds. The Obama Administration is likely to announce further large package taking the total to ~USD 1 tn. However, US has already disbursed over USD 3 tn for several bailout packages.
U.K.	£ 20 bn	Restoring prudence to the public finances, cut in VAT & other taxes, capex projects, higher pension and child benefit
E.U.	€ 200 bn	Clean technology projects, tax breaks, infrastructure spending, auto sector sops, employment creation, incentives for home-buyers
Japan	~$ 700 bn	Employment creation, financing for corporates & SMEs, liquidity support to banks, mortgage relief for home-owners, direct financial assistance to households
China	~$ 600 bn	Housing, infrastructure, support farmers, tax cuts for investment
S.Korea	$11bn	New spending and tax cuts
Malaysia	7 bn ringgit	Infrastructure and public services, low-cost housing
Thailand	$35.78bn	Lending to SMEs, small farms, stock market, govt expenditure, subsidy for transport, electricity, low-income groups
Australia	$7.4bn	Pensioners, middle and low-income groups, first-time home buyers, labor, training, infrastructure

Source: News sources

India: Real activity slows down; concerns aggravate for industry

Amidst the general trend of rapid slowdown of growth, the slowdown in India has been relatively modest. India's real GDP growth during Q2FY09 came in at 7.6% Y-o-Y. However, this is lower than the previous quarter's growth of 7.9% and, in fact, the lowest since Q4FY05. H1FY09 GDP growth recorded a growth of 7.8% against 9.3% in H1FY08.

Industrial Production (IP) for October 2008 declined by 0.4% Y-o-Y, in line with our expectations, but much below the consensus estimates (Edelweiss: -0.2%; consensus: 2.1%). IIP numbers have turned negative for the first time since the introduction of the new series in 1994. Growth and IIP are likely to remain subdued for the remaining part of FY09 as well.

Chart 11: IIP dips into negative zone

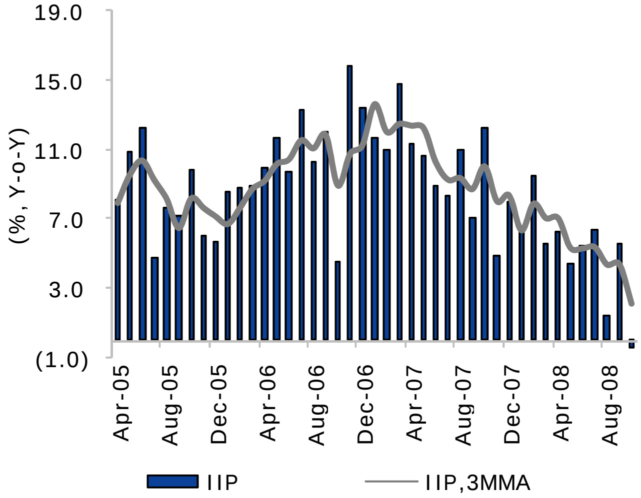


Chart 12: Core sector growth remains erratic

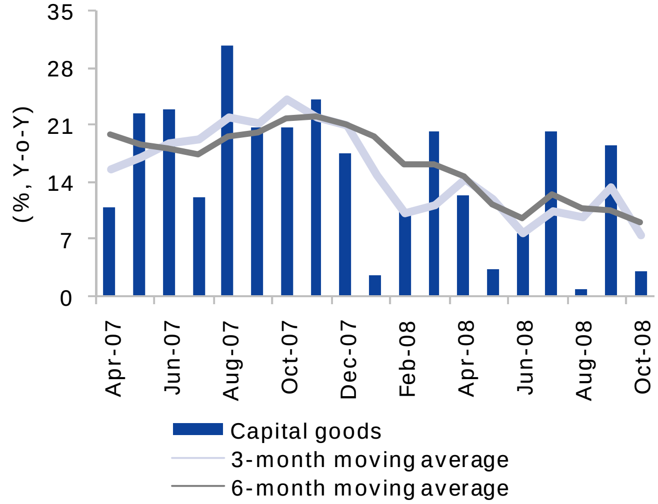


Chart 13: Intermediate goods production down

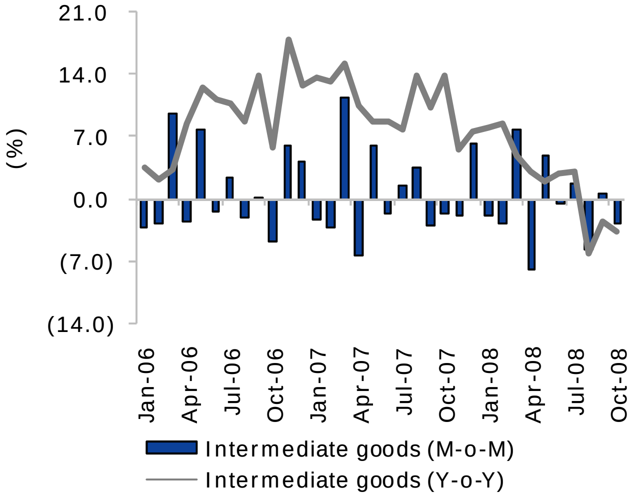
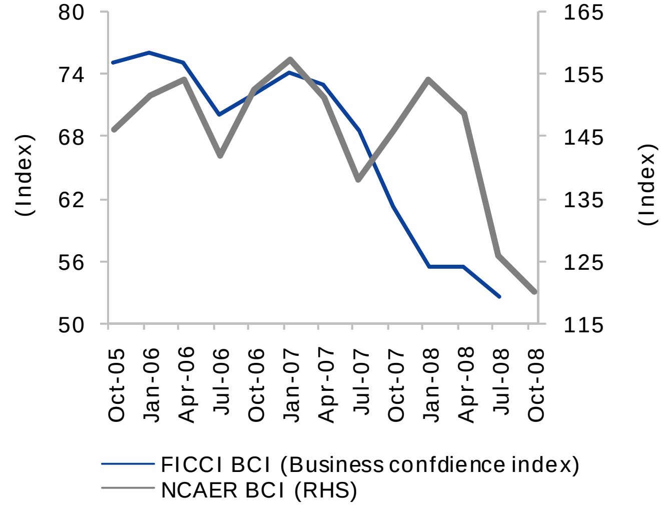


Chart 14: Business confidence is low



Source: CSO, NCAER, FICCI, Edelweiss research

Overall manufacturing activity numbers will display a sharp drop in Q3FY09, reflecting poor credit availability for industry (particularly SMEs), sharp drop in exports, and subdued business confidence. The construction sector too is likely to take a hit in Q3. However, agro-harvest and rural activities are likely to provide some resilience to the overall GDP numbers in Q3. Pay Commission-related disbursements during Q3 will also boost 'community and social services'. The subdued industrial sector is likely to be a drag on overall GDP in FY09. However, the share of activities covered under IIP constitutes only ~19% of overall real GDP and we believe that GDP growth for FY09 can be above 7%.

However, at 6%, FY10E GDP growth will be the lowest since FY03. Our projection of growth slowdown in FY10 is against the backdrop of a rapid deterioration of the global economic scenario and likely slowdown in discretionary consumption and corporate capex in India.

Stimulus package in India: Grappling to match expectations

In India also, the government and the Reserve Bank of India (RBI), in a co-ordinated move, announced two rounds of measures to stimulate the economy and to stem the slowdown, by slashing key rates, easing limits on foreign investments in corporate bonds, and rolling back some anti-inflationary measures**.** Equity markets appear to have priced in much of the measures already and the actual initiatives may not provide any significant upside for markets across the board. However, stock prices in certain sectors such as BFSI, construction, and export-oriented industries are likely to react positively. Further, it has now been indicated that the government does not envisage any further stimulus measures in the current fiscal year.

Some of the highlights of the first stimulus package include: (a) additional planned expenditure of up to INR 200 bn (~USD 4 bn) during the remaining months of FY09; (b) cut in Cenvat by 4% on several products other than petroleum for the remaining part of FY09; (c) cut in petrol and diesel prices by ~10% and 5%, respectively; (d) cut in repo and reverse repo rates further by 100bps to 6.5% and 5.0%, respectively, effective December 8; (e) reduction in ceiling for interest rate on export credit apart from providing a 2% interest subvention to exporters; (f) bank loans to housing finance companies (HFCs) for on-lending to individuals up to INR 2 mn per dwelling unit per family will now be classified under priority sector. To further boost the housing sector, public sector banks are likely to announce certain specific packages shortly; and (g) Small Industries Development Bank of India (SIDBI) provided with a refinance of INR 70 bn to enhance credit delivery to the employment-intensive micro and small enterprises (MSE) sector.

The second round of stimulus has taken special cognizance of the current problems of export-oriented sectors and has offered duty drawbacks, better DEPB benefits, etc. A line of credit of INR 50bn has been offered to the Exim Bank.

To help maintain the momentum of expenditure at the state government level, states has been allowed to raise additional market borrowings of ~INR 300 bn for capital expenditure. The government also plans to recapitalise public sector banks (of INR 200 bn) in the next year. This will help ensure that the banking system will not suffer from capital adequacy constraints to provide credit growth to support economic momentum in FY10.

On the monetary policy front, the RBI reduced the repo rate and reverse repo rate further by 100bps each (to 5.5% and 4%, respectively). Policy interest rates have now touched a new bottom. The cash reserve ratio (CRR) has also been slashed further by 50bps to 5%. We believe, the central bank is done with aggressive cuts in repo and reverse repo rates. However, we do not rule out the possibility of another up to 50bps cut in policy rates before the April round of monetary policy, primarily to boost sentiments.

To boost the corporate bond market, FII investment limit in INR-denominated corporate bonds in India has been increased from USD 6 bn to USD 15 bn. At the moment, AAA-rated corporate bonds are enjoying a huge spread over similar maturity government bonds (300-400bps for 10 year papers). With the current move of sharp hike in the ceiling there can be substantial inflows of foreign funds into the INR-denominated corporate bond market. Additionally, the policy on external commercial borrowings (ECBs) has been further liberalised by abolishing the ‘all-in-cost’ ceiling on such borrowings under the approval route. Such measures put together may be effective in improving the flow of forex into the country and may help strengthening the INR.

Fiscal situation remains a concern

Fiscal health will continue to be weak with likely dent in tax collections and high government spending. With the recent fiscal package, additional expenses following the agricultural debt waiver scheme, the Sixth Pay Commission recommendations, possible surge in pre-election spending, and off-balance sheet items like oil bonds, the fiscal deficit is set to slip sizeably during FY09. However, off-balance sheet items like oil and fertilizer bonds is likely to be reduced substantially in FY10 and will be beneficial at the margin.

Chart 15: Fiscal health is a chronic problem

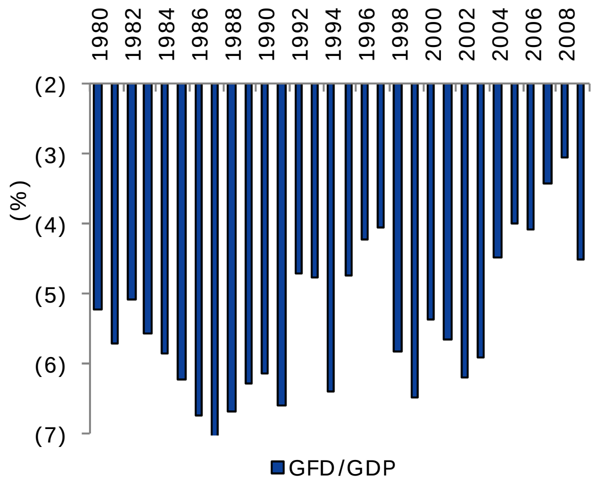


Table 8: Reduction in off-balance sheets burdens in FY10

(INR bn unless specified)

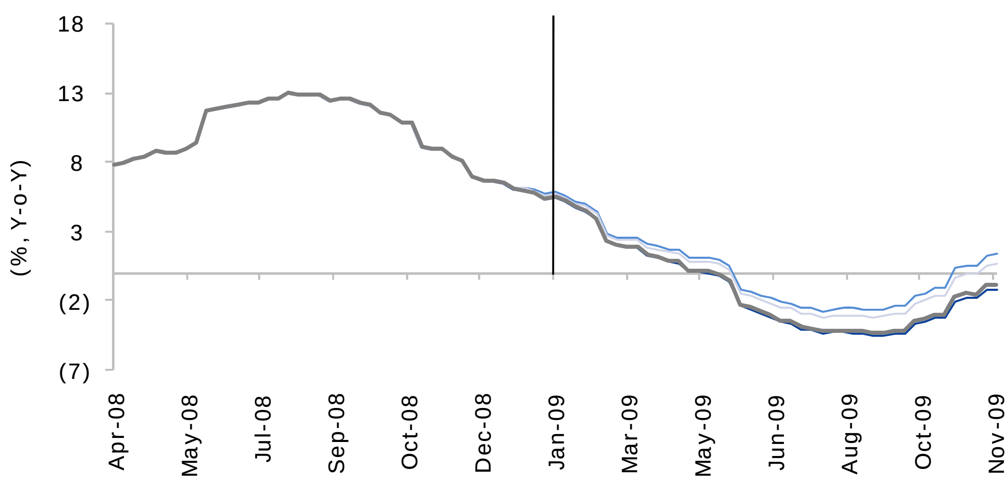
Bonds to be issued by	FY09E
Oil marketing companies (OMC's)	510
Fertiliser Companies	650
Food Corporation of India (FCI)	50
Total	1,210
Proportion of GDP (%)	2.3

Source: CGA, Edelweiss research

Inflation drops significantly

WPI inflation in India has halved from its peak in August at 12.93% to 6.38% for the week ending December 20. The pace of fall in commodity prices and overall price levels leads us to reiterate our view of a spell of negative Y-o-Y inflation in CY09. The visibility of the same has increased significantly since our first report on a possible near-zero inflation in India (refer our note *Inflation: From dizzying heights to ground zero,* dated November 4). We, however, prefer to refrain from calling it deflation as over a two-year period from 2007 overall prices will still show an annualised growth of ~4-5%. Nevertheless, the visibility of further strong softening of inflation has given RBI the leeway to reduce policy interest rates significantly.

Chart 16: WPI inflation in India—Projected trajectory



Source: Office of economic Adviser, Edelweiss research

Note: The various scenarios for the inflation projection are: (a) no change in prices from now on; (b) 8% annualised increase in primary products and manufactured food items; (c) 5% annualised reduction in fuel prices on top of scenario (b); and (d) 10% annualised reduction in metals, chemicals, machinery, and equipments prices on top of scenario (c).

Chart 17: Policy rates has hit new lows

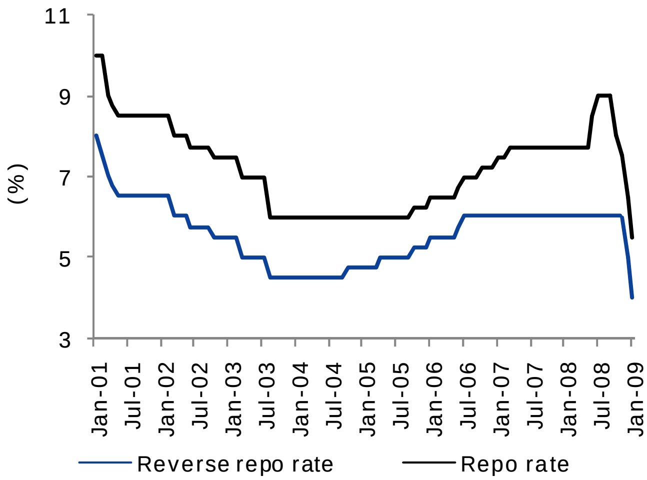


Chart 18: G-sec yields have halved

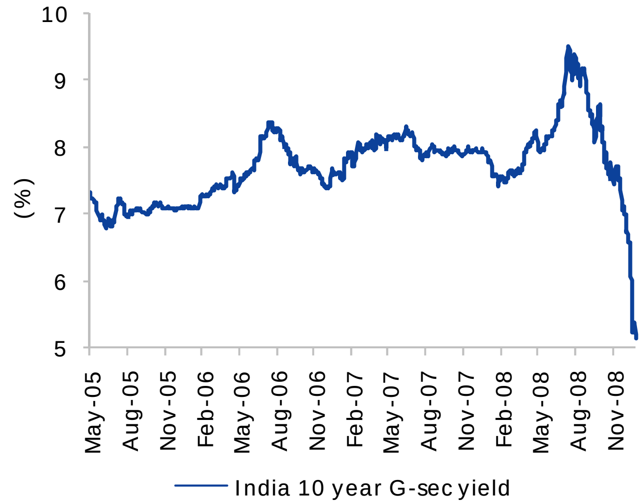


Chart 19: MSS unwinding—Big chunk of potential liquidity

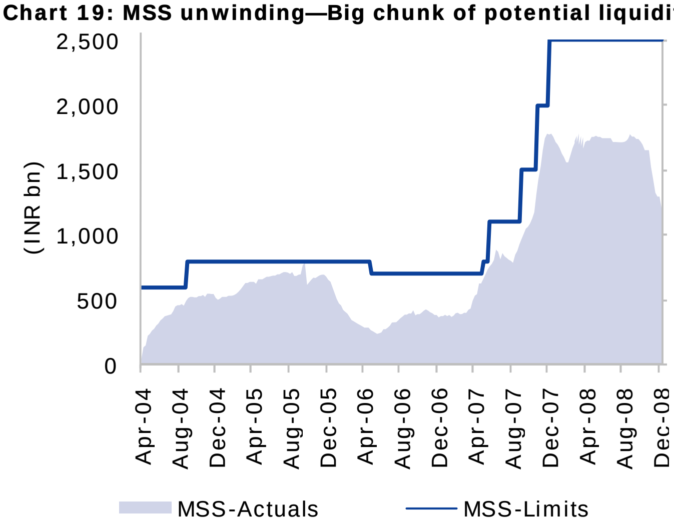
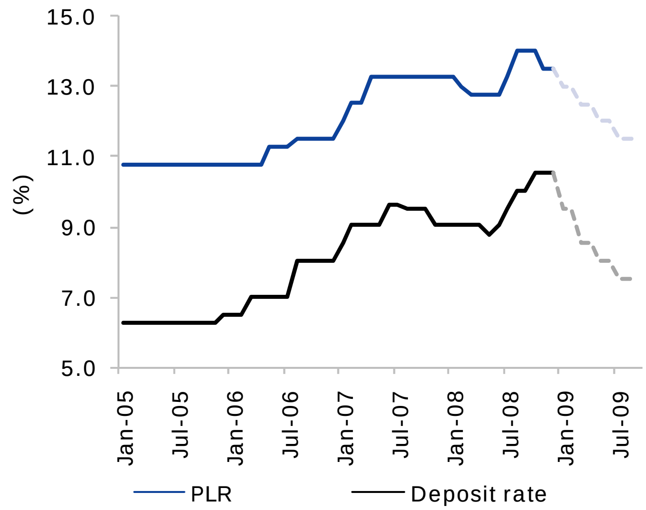


Chart 20: Bank lending rates to soften



Source: Bloomberg, RBI, Edelweiss research

Trade deficit remains high; decline in exports continues

Merchandise trade deficit during the quarter continued to rise, primarily reflecting slower exports and an expanding oil import bill. Exports growth declined for second consecutive month during October-November. The outlook for the merchandise trade account for remainder of the year will hinge critically on two inter-related factors: (a) softening in global commodity prices, particularly crude; and (b) deepening of global slowdown.

The sharp rise in commodity prices during the first four months of FY09 put considerable pressure on India's trade balance. Softening in global commodity prices thereafter is likely to have a significant positive impact on India's import bill. However, given the global slowdown and the recent financial market turmoil in some of India's major trading partners, including the US and Europe, exports may be under pressure in the coming months. Additionally, the volatility in USD-INR exchange rate may also influence demand for imports and export competitiveness of Indian products.

Balance of payments (BoP) turns into deficit

India's BoP turned negative for the first time since Q3FY06, at USD -4.7 bn.
BoP during Q2FY09 was characterised by:

- **Widening current account deficit:** Current account deficit widened further to USD 12.6 bn in Q2FY09 from USD 9.7 bn in the previous quarter. However, this widening was lower than market expectations of USD 17.65 bn.
    - Trade deficit rose to USD 38.6 bn in Q2FY09 against USD 31.6 bn in the previous quarter.
    - The surplus in the invisible account has, however, been more than expectation. Net invisibles surplus financed 67.5% of trade deficit in Q2FY09. The rise in invisible surplus was primarily due to increase in receipts under private transfers along with steady growth in software services exports.
- **Relatively lower capital account surplus:** Slowdown in the capital account is on expected lines, reflecting the global financial turmoil. The capital account surplus for Q2FY09 stood at USD 8 bn vis-à-vis USD 13 bn in the previous quarter and USD 34 bn in Q2FY08.
    - FDI stood at USD 5.6 bn in Q2FY09. This is markedly lower than the previous quarter while being still higher on a yearly basis.
    - FII recorded net outflows at USD 1.3 bn following the global trends of FIIs deleveraging their investments in most emerging markets. Net inflows under ADRs/GDRs are also softening, reflecting drying-up of liquidity in the overseas market.
    - ECBs are slowing down to USD 1.9 bn, down during Q2FY09 from USD 4.2 bn in the corresponding quarter of the previous year.

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AUTOMOBILES

Tough going

January 7, 2009

Deepak Jain
+91-22- 6623 3313
deepak.jain@edelcap.com

Amol Bhutada
+91-22-6620 3032
amol.bhutada@edelcap.com

Siddharth Bhatt
+91-22-4040 7451
siddharth.bhatt@edelcap.com

Key highlights of the sector during the quarter

All companies, with the exception of Hero Honda (HH), have registered disappointing sales so far (October and November) in Q3FY09E. Slowdown in industrial activities along with some overcapacity built in transportation fleet in Q1FY09 took its toll on commercial vehicle (CV) sales as both Tata Motors (TML) and Ashok Leyland (ALL) are expected to report more than 50% decline in their CV sales. Despite the festival season, passenger vehicle (PV) and two wheeler sales failed to pick up as some of the potential buyers postponed/cancelled their purchases in the light of the current gloomy scenario. Maruti Suzuki (MSIL), which launched its long awaited car *A Star* in November, failed to match last year's sales; its total volumes are expected to be down 16% Y-o-Y. Mahindra and Mahindra (M&M), which had so far shown reasonable growth from rural sales, also posted sagging volumes in October and November put together and is expected to post 24% Y-o-Y decline in total volumes.

Within two wheelers, Bajaj Auto (BAL) was the worst hit in the domestic market (down more than 50% Y-o-Y) with export growth expected to check the domestic slide partially. BAL's total volumes are expected to be down 30% Y-o-Y. TVS Motors' (TVS) domestic sales were also down substantially with exports cancelling some decline. The company is expected to post a volume decline of 10% Y-o-Y on a small base. HH is the clear outperformer in the auto pack and is expected to register a modest decline of 2% Y-o-Y in total volumes.

Result expectations for the sector and stocks under coverage

We expect aggregate revenues to be down 18.7% Y-o-Y for our coverage universe, with ALL's revenues expected to be hit the most, down 51.8% Y-o-Y. We estimate HH, the only company expected to have positive growth, to post a modest revenue growth of 3.8% Y-o-Y. Aggregate EBITDA margins are expected to take a severe beating on account of low volumes resulting in negative operating leverage. We estimate aggregate EBITDA margins to be down 540bps Y-o-Y and 300bps Q-o-Q. ALL is expected to post a loss at the EBITDA level, whereas HH's margins, amongst the coverage universe, will be the least impacted, down 160bps Y-o-Y and 90bps Q-o-Q. We estimate aggregate profits to be down 64.5% Y-o-Y with three companies viz., Tata Motors, Ashok Leyland, and TVS Motors, expected to report net losses. HH will again be the least impacted with profits down 3% Y-o-Y and 12.9% Q-o-Q.

Outlook over the next 12 months

In the past couple of weeks, auto stocks have rallied from their bottoms on expectations that: (a) the worst is in the price; and (b) with the recent fiscal and monetary stimulus, things will be back to normal soon. Though we agree the latter will bring back the lost consumer sentiment in the next two to three quarters, we differ slightly on the former. From the near term perspective, we recommend investors to reduce exposure to auto stocks at least till we have seen Q3FY09 numbers. We expect the numbers to be disappointing to alarming for nearly all the major companies and also expect stocks to react to the event despite modest expectations.

Recommendations

Top picks: Maruti Suzuki, Hero Honda

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Ashok Leyland	Revenues	8,675	18,001	(52)	17,459	(50)	Revenues to fall given the steep decline in volumes. The company had to resort to steep cuts in production to clear inventories. High negative operating leverage to play spoilsport. Higher interest costs.
	EBITDA	(130)	1,688	(108)	1,639	(108)	
	PAT	(511)	1,003	(151)	784	(165)	
Bajaj Auto	Revenues	20,976	25,017	(16)	25,484	(18)	Positives - sharp INR depreciation, export volumes growth, stable 3W volumes. Negatives - decline in domestic motorcycle volumes, reverse operating leverage, subvention paid to cutomers
	EBITDA	2,462	3,676	(33)	3,439	(28)	
	PAT	1,615	2,413	(33)	2,252	(28)	
Hero Honda Motors	Revenues	28,485	27,431	4	23,521	21	Marginal decline in volumes but couple of price hikes during the year. Marginal increase in all cost elements
	EBITDA	3,504	3,826	(8)	2,915	20	
	PAT	2,667	2,750	(3)	2,043	31	
Mahindra & Mahindra	Revenues	22,954	29,402	(22)	27,182	(16)	Steep decline in volumes resulting in negative operating leverage. Higher interest and depreciation costs.
	EBITDA	1,377	3,315	(58)	2,903	(53)	
	PAT	1,086	2,496	(56)	2,259	(52)	
Maruti Suzuki India	Revenues	45,443	47,748	(5)	49,936	(9)	Positives - price increases, product-mix change, INR/USD depreciation. Negatives: INR/JPY movement, JPY denominated royalty, volume decline resulting in negative operating leverage, dealer compensation for cut in excise duty
	EBITDA	3,999	7,139	(44)	5,158	(22)	
	PAT	2,190	4,138	(47)	2,962	(26)	
Tata Motors	Revenues	50,905	72,518	(30)	70,789	(28)	Positives: Insignificant forex losses on translation, stable sales on new *Indigo CS* and *Indica Vista* Negatives: decline in CV sales resulting in negative operating leverage
	EBITDA	1,273	8,197	(84)	5,754	(78)	
	PAT	(810)	4,139	(120)	2,732	(130)	
TVS Motor Company	Revenues	8,528	8,750	(3)	10,342	(18)	Positives: good moped volumes, motorcycle exports Negatives: decline in domestic motorcycle volumes, negative operating leverage, MTM loss on ECB ~INR 160 mn
	EBITDA	102	150	(32)	508	(80)	
	PAT	(223)	22	(1,108)	104	(315)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Ashok Leyland	Accumulate	446	16	(32)	(37)	6.9	11.0	3.9	5.5	1.0	8.0	14
Bajaj Auto	Buy	1,309	440	(9)	12	8.1	7.2	4.6	3.9	3.3	5.0	45
Hero Honda Motors	Accumulate	3,196	778	31	20	12.3	10.2	7.5	5.8	3.7	0.0	35
Mahindra & Mahindra	Buy	1,575	296	20	(1)	8.4	8.5	4.0	2.5	1.6	3.7	22
Maruti Suzuki India	Accumulate	3,309	557	(12)	25	10.5	8.4	4.9	3.5	1.6	0.8	17
Tata Motors	Buy	1,650	178	(29)	(14)	8.8	10.2	3.1	3.6	0.7	5.6	11
TVS Motor Company	Reduce	115	24	11	63	14.2	8.7	4.2	3.7	0.7	2.1	5

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

BANKING AND FINANCIAL SERVICES

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Ideas create, values protect

Quarter belongs to PSU banks

January 7, 2009

Vishal Goyal, CFA
+91-22-4040 7540
vishal.goyal@edelcap.com

Kunal Shah
+91-22-4040 7579
Kunal.shah@edelcap.com

Ajitesh Nair
+91-22-6623 3358
ajitesh.nair@edelcap.com

M B Mahesh
+91-22-6620 3027
mb.mahesh@edelcap.com

Key highlights of the sector during the quarter

MTM bond gains by banks has been the most discussed event in the quarter, and we also expect banks to post strong NII growth. In our view, PSU banks will grow at higher-than-industry loan growth rate of 26%, as private sector banks kept excess SLR. We believe banks will ration treasury profits and not book all the gains in this quarter; however, reversal of investment depreciation provisions will boost earnings. Weak real estate sentiments in anticipation of correction in property prices and decline in lending rates impacted real estate lending in Q3FY09. As a result, we believe specialised HFCs under coverage (HDFC and LIC Housing Finance) may witness some deceleration in disbursement growth in the near term. Earnings expectations for Q3FY09 appear weak for diversified NBFCs under coverage, viz., Reliance Capital and Kotak Mahindra Bank.

Result expectations for the sector and stocks under coverage

We expect our universe of banks to post 29% Y-o-Y and 4% Q-o-Q growth in NII due to 26% credit growth, CRR and SLR cuts effected in the past quarter. Most banks should show stable margins on the back of increasing CD ratios and liquidity crunch in October. Credit growth for the bigger PSU banks should be strong, however, we expect growth rates of private banks and mid sized PSU banks to moderate in Q3FY09. We expect NBFCs to witness deceleration in disbursement growth and pressure on margins due to high dependence on wholesale funding and sharp rise in corporate spreads.

We expect our coverage of companies to post PAT growth of 18% Y-o-Y with banks expected to grow earnings by 23% Y-o-Y however earnings of financial companies will see a decline of 3% Y-o-Y as per our estimate.

Outlook over the next 12 months

We are positive on the sector and recommend overweight considering the strong earnings in the next two quarters. In the next 1 month, SBI, PNB, Union Bank and Axis Bank are likely to outperform others due to strong bond gains, lowered NPA risks, strong operating performance. Among private banks we like Axis and HDFC Bank while we have a favorable view on SBI amongst PSU banks.

We remain underweight on Kotak Mahindra Bank considering non-conducive capital markets and pressure on its core banking profitability due to lower credit growth, increased investments in credit cards, lower capital market related fee income, and deterioration in asset quality.

Recommendations

Top picks: Axis Bank, HDFC Bank, State Bank of India.

Q3FY09 result expectations

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
Allahabad Bank	Revenues	6,340	8,182	(23)	6,248	1	First half has been tough for the bank in terms of profitability due to huge MTM provisions, particularly related to equity book. The investment gains could be significant and also there could be some amount of reversal of provisions on investment depreciation. Expect NII growth of 21%; however, PAT is expected to decline 53% Y-o-Y due to high base of Q3FY08 (strong treasury gains due to equity markets)
	EBITDA	2,492	2,197	13	3,065	(19)	
	PAT	1,723	3,649	(53)	417	313	
Axis Bank	Revenues	16,470	12,352	33	16,079	2	Credit growth should moderate from above 50% levels, while margins are expected to improve. Bond gains could be significant, specifically in the non-SLR book. Fee income will moderate; will, however, continue to grow by more than 50%. NPAs will be a key monitorable.
	EBITDA	8,395	5,413	55	8,384	0	
	PAT	4,758	3,068	55	4,029	18	
Federal Bank	Revenues	4,343	2,887	50	4,360	(0)	Credit growth will moderate, though margins should remain healthy. We do not expect significant deterioration in asset quality for the bank in this quarter, while reversal of provisioning will support profitability.
	EBITDA	2,816	1,506	87	3,049	(8)	
	PAT	1,662	1,029	62	1,143	45	
HDFC	Revenues	8,956	8,388	7	8,633	4	Disbursement growth to decelerate to ~20% levels; in Q3FY08 it booked INR 1.2 bn on sale of stake in HDFC Std Life and INR 1 bn on sale of investments in CAMS.
	EBITDA	7,859	7,602	3	7,600	3	
	PAT	5,698	6,489	(12)	5,342	7	
HDFC Bank	Revenues	27,200	21,165	29	25,096	8	Credit growth to moderate; however, margins to trend upwards. Credit costs to be in line with the trend. CASA could witness slippage in line with high interest on term deposits. Overall profitability trend should continue.
	EBITDA	12,101	9,349	29	11,385	6	
	PAT	6,158	4,294	43	5,280	17	
ICICI Bank	Revenues	41,471	43,863	(5)	40,250	3	We expect a weak quarter in terms of balance sheet growth and profitability. Margins could witness pressure in the quarter due to high cost of funds and slippage in CASA. Investment gains and lower DMA expenses should help profitability.
	EBITDA	21,446	19,767	8	24,379	(12)	
	PAT	11,374	12,302	(8)	10,142	12	
IDFC	Revenues	3,759	3,720	1	4,300	(13)	We expect very marginal growth in loan on a sequential basis. Gains from bond book will be reasonably higher compared with the previous quarter. NIMs adjusted for bond income to reduce sequentially. Fee income will be lower, considering lower investment banking activity and broking income. We have factored in higher provisions, considering the management outlook.
	EBITDA	2,721	2,450	11	2,510	8	
	PAT	2,001	2,170	(8)	2,320	(14)	
Indian Overseas Bank	Revenues	10,964	8,755	25	10,684	3	The investment gains could be significant. Expect NII growth of 28%; however, PAT is expected to grow 19% Y-o-Y due to high base of Q3FY08 (strong treasury gains due to equity markets).
	EBITDA	5,510	4,101	34	5,192	6	
	PAT	3,659	3,082	19	3,590	2	
ING Vysya Bank	Revenues	2,839	2,462	15	2,801	1	Expect a stable quarter for the bank. Margins are expected to be stable, while credit growth will be ~23% this quarter. Cost-to-income will see an uptick with expansion of branches.
	EBITDA	885	981	(10)	866	2	
	PAT	515	428	20	470	10	
Karnataka Bank	Revenues	1,855	1,897	(2)	1,734	7	Overall, we expect a much better quarter than the first half, with stable margins and bond gains. Asset growth will be muted.
	EBITDA	829	828	0	685	21	
	PAT	644	690	(7)	736	(13)	
Kotak Mahindra Bank	Revenues	8,025	16,675	(52)	9,499	(16)	Banking profitability to be impacted by increased investments in credit card/retail banking operations, lower fee income and deterioration in asset quality. Advance growth to decelerate to 20%; securtiies business revenues to decline significantly; subdued investment banking activities.
	EBITDA	2,690	6,670	(60)	3,113	(14)	
	PAT	1,404	3,637	(61)	1,559	(10)	
LIC Housing Finance	Revenues	2,089	1,701	23	2,127	(2)	Disbursements to grow at 16-18%; depedance on wholesale funding to put pressure on interest spreads; NPAs to be maintained.
	EBITDA	1,704	1,351	26	1,782	(4)	
	PAT	1,259	1,060	19	1,351	(7)	
Oriental Bank	Revenues	7,768	5,697	36	7,308	6	One of the most leveraged banks to bond yields could see good amount of reversal of provisions. Also, falling wholesale yields could help improve cost of funds.
	EBITDA	3,795	2,387	59	3,287	15	
	PAT	2,812	1,997	41	2,369	19	
Power Finance Corp	Revenues	5,786	4,760	22	5,721	1	Disbursements to grow at 30% plus; depedance on wholesale funding to put pressure on interest spreads; book MTM notional loss of INR 450 mn on unhedged forex borrowings.
	EBITDA	5,489	4,540	21	5,489	(0)	
	PAT	3,372	3,210	5	3,298	2	

Source: Edelweiss research

Q3FY09 result expectations (contd.)

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
Punjab National Bank	Revenues	24,743	19,078	30	23,750	4	Q3FY09 should be very strong in terms of credit growth, margin expansion, lower credit costs and NPAs. Upgradation of two of infrastructure projects should improve NPA situation, while bond gains would also be an added booster.
	EBITDA	13,449	8,573	57	12,955	4	
	PAT	8,107	5,414	50	7,071	15	
Reliance Capital	Revenues	12,711	11,556	10	13,225	(4)	Earning of consumer financing business to be weak as it has deliberately put on hold disbursements in October and November; current equity market conditions to slow down the pace of broking customer addition, but currency changing and distribution to support profits; investments made in newly launched businesses to impact earnings.
	EBITDA	1,771	1,565	13	3,007	(41)	
	PAT	1,203	1,181	2	2,291	(47)	
SBI	Revenues	84,135	69,535	21	77,985	8	One of the strongest results in the sector with all round performance expected. Expected profit from investments in oil bonds and reversal of provisioning on special bonds.
	EBITDA	42,941	30,166	42	40,316	7	
	PAT	29,348	18,085	62	22,597	30	
Shriram City union	Revenues	1,488	999	49	1,285	16	Disbursements expected to be INR 14 bn; interest spreads to come off marginally due to higher dependance on wholesale funds.
	EBITDA	806	542	49	690	17	
	PAT	335	253	32	319	5	
South Indian Bank	Revenues	1,709	1,335	28	1,651	4	Margins to expand on back of higher CD ratio. Credit growth will be muted.
	EBITDA	968	591	64	912	6	
	PAT	552	406	36	517	7	
SREI Infrastructure	Revenues	469	647	(27)	1,211	(61)	Disbursements to slow significantly as leveraging its balance sheet was critical to its growth; NPAs expected to go up; to book MTM notional loss on USD 60-65 mn unhedged forex borrowings.
	EBITDA	257	416	(38)	477	(46)	
	PAT	120	284	(58)	267	(55)	
Syndicate Bank	Revenues	8,489	7,446	14	9,046	(6)	Leveraged to bond yields, could see good amount of reversal of provisions. Also, falling wholesale yields could help improve cost of funds.
	EBITDA	3,460	2,103	65	4,698	(26)	
	PAT	2,758	2,732	1	2,619	5	
Union Bank	Revenues	13,705	11,355	21	12,586	9	Q3FY09 should be very strong in terms of credit growth, margin expansion, lower credit costs and NPAs. Bond gains and reversal of MTM provisions would also be an added booster.
	EBITDA	7,639	5,169	48	7,377	4	
	PAT	4,591	3,650	26	3,615	27	
Yes Bank	Revenues	2,189	1,899	15	2,144	2	Margins could be under pressure due to sharp increase in wholesale rates in October and November. Fee income would be under pressure.
	EBITDA	1,022	909	12	1,095	(7)	
	PAT	658	542	21	636	3	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Allahabad Bank	Accumulate	515	56	(42)	64	4.4	2.7	0.5	3.6	12
Axis Bank	Buy	4,134	560	44	21	13.1	10.8	2.0	1.1	16
Federal Bank	Buy	602	171	36	29	5.9	4.6	0.7	2.6	12
HDFC	Buy	9,532	1,630	6	27	18.2	14.3	3.2	1.7	19
HDFC Bank	Buy	9,127	1,044	43	41	19.5	14.7	3.0	1.0	17
ICICI Bank	Buy	11,440	500	(0)	30	13.4	10.3	1.1	2.2	9
IDFC	Accumulate	1,904	72	21	(1)	10.2	10.2	1.5	1.4	15
Indian Overseas Bank	Accumulate	872	78	(3)	14	3.6	3.2	0.7	3.9	22
Karnataka Bank	Accumulate	208	83	(17)	27	5.1	4.0	0.7	4.8	14
Kotak Mahindra Bank	Reduce	2,831	399	(31)	15	19.1	16.6	2.0	0.2	11
LIC Housing Finance	Buy	430	246	24	18	4.4	4.2	0.9	4.1	24
Oriental Bank	Accumulate	901	175	7	4	4.9	4.7	0.7	2.9	15
Punjab National Bank	Accumulate	3,473	536	22	9	6.8	6.2	1.3	2.6	21
Power Finance Corp	Accumulate	3,378	143	19	17	11.3	9.7	1.7	2.8	16
Reliance Capital	Accumulate	3,058	606	(14)	10	17.0	15.3	2.0	0.9	12
SBI	Buy	17,763	1,361	28	16	10.0	8.5	1.5	2.1	17
Shriram City union	Reduce	325	345	41	55	14.9	9.6	2.1	1.2	20
South Indian Bank	Buy	144	62	14	26	3.2	2.6	0.4	4.9	14
Syndicate Bank	Accumulate	712	66	(14)	15	4.7	4.1	0.8	3.0	18
SREI Infrastructure	Buy	128	54	(20)	56	6.8	4.4	0.5	2.8	10
Union Bank	Buy	1,752	169	(3)	19	6.4	5.3	1.3	2.1	22
ING Vysya Bank	Buy	317	151	35	30	7.3	5.6	1.0	1.3	14
Yes Bank	Buy	539	88	20	36	10.8	8.0	1.7	0.0	17

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

CEMENT

Edelweiss
Ideas create, values protect

Margin dip to continue

January 7, 2009

Revathi Myneni
+91-22-6623 3316
revathi.myneni@edelcap.com

Archana Khemka
+91-22-6623 3488
archana.khemka@edelcap.com

Key highlights of the sector during the quarter

In December 2008, excise duty on cement was cut by 4% (from earlier duty structure of 12% on bagged cement and 10% on bulk cement). The cut implied a benefit of ~INR 8-10/bag of cement. However, railway freight on cement also increased 8% (net impact of ~INR 1/bag). Accordingly, cement companies reduced prices by only ~INR 5-7/bag to pass on the excise duty benefit and retained the balance amount to account for freight cost increase and ~INR3-6/bag price correction that happened across regions, at the beginning of the month.

Cement prices in October and November 2008 remained largely flat. December price movements, adjusting for the impact of excise duty cut, also remained flat other than Andhra Pradesh, which witnessed additional correction of ~INR 2-3/bag. While all India demand for October-November grew 8.1% Y-o-Y, North and West continued to be laggards in demand growth.

Result expectations for the sector and stocks under coverage

We expect Q3FY09 to be uneventful with EBITDA margins expected to remain flat to slightly down Q-o-Q (despite Q2FY09 being a monsoon quarter for all companies except South). With a slowdown in overall demand (YTD demand growth of 8% for FY09 compared to 10.5% same period last year), Q3FY09E volumes are expected to be down 2% Y-o-Y. We expect realisations to be flat sequentially in the quarter. While imported coal costs have sharply come off (fob rates are 55% down from July peak, the Baltic Index is off 93% from its high), we gather that benefit of lower costs will accrue largely in Q4FY09. Hence, with flat realisations and no significant savings on costs in the quarter, we expect Q3FY09 to be unexciting.

Within our coverage universe, we expect companies with lower exposure to imported coal (ACC, Ambuja) to outperform. While we expect ACC's Y-o-Y performance to be strong (up 17%), Ambuja's expected 30% Y-o-Y growth in Q4CY08 will be largely led by one-time charges in Q4CY07. Also, we expect Grasim's muted performance on the back of weak performance of the VSF division (capacity utilisation of 54% and EBITDA margin at ~19%).

Outlook over the next 12 months

With available capacity addition of ~65 mn tonnes expected over FY09-10E (18% CAGR growth) compared to 8% domestic demand growth at best, we expect overall capacity utilisation for the industry to correct to 95% in FY09E and 85% in FY10E, compared to 102% in FY08. We expect sector downtrend to exacerbate in FY10, particularly towards the second half with price corrections straining margins. We maintain our negative view on the sector.

Recommendations

Top picks: UltraTech, Grasim, Ambuja.

Stocks to avoid: ACC, India Cements, Madras Cements.

Q3FY09 result expectations

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
ACC	Revenues	18,625	17,637	6	18,526	1	EBITDA margin expected to remain flat sequentially. Realisation is expected to be down 5% Q-o-Q, primarily due to one-time benefits in Q3CY08, which will not recur. Benefits of correction in imported coal rates to accrue from Q1CY09.
	EBITDA	4,840	4,173	16	4,861	(0)	
	PAT	2,839	2,419	17	2,834	0	
Ambuja Cements	Revenues	15,355	15,067	2	14,019	10	Margins are expected to be flat Q-o-Q. Y-o-Y performance is likely to show a strong growth on account of one-time items in Q4CY07. Benefit of correction in imported coal cost to accrue from Q1CY09. Also, we expect INR 100 mn impact on core profits due to exchange loss on repayment of USD 25 mn ECB.
	EBITDA	4,405	4,859	(9)	4,091	8	
	PAT	2,761	2,113	31	2,501	10	
Grasim Industries	Revenues	41,097	43,583	(6)	44,525	(8)	While cement division is expected to report sequential EBITDA growth (previous quarter was impacted by monsoons), we expect EBITDA to be flat Q-o-Q due to VSF and sponge iron divisions. We expect VSF profitability to be down due to lower volumes and prices in the quarter and sponge iron segment to report loss. While EBITDA will be maintained Q-o-Q, higher interest and depreciation charges are expected to pull down PAT.
	EBITDA	8,065	13,808	(42)	9,200	(12)	
	PAT	3,843	7,219	(47)	4,864	(21)	
India Cements	Revenues	7,243	7,379	(2)	9,455	(23)	EBITDA margin is likely to be down ~200bps Q-o-Q as the benefit of cost corrections is expected to flow Q4FY09E onwards.
	EBITDA	2,100	2,449	(14)	2,901	(28)	
	PAT	726	1,271	(43)	1,343	(46)	
Jaiprakash Associates	Revenues	14,780	9,000	64	11,826	25	PAT is likely to be down Q-o-Q as the impact of dividend from subsidiaries will not accrue over Q3FY09. Also, expect construction margins to be down as Q2FY09E reported high margin of 31%.
	EBITDA	3,364	2,230	51	3,478	(3)	
	PAT	1,375	1,560	(12)	2,031	(32)	
Madras Cements	Revenues	5,831	5,124	14	6,665	(13)	EBITDA margin is likely to be down ~100bps Q-o-Q as the benefit of cost corrections is expected to flow Q4FY09E onwards.
	EBITDA	1,951	1,906	2	2,304	(15)	
	PAT	891	1,107	(19)	1,136	(22)	
UltraTech Cement	Revenues	15,918	13,821	15	13,962	14	Estimate Q-o-Q volume growth of ~14% and flat realisations. Higher volumes will result in lower fixed cost per tonne, and hence, EBITDA margin will expand ~300bps Q-o-Q.
	EBITDA	3,845	4,685	(18)	2,967	30	
	PAT	2,095	2,795	(25)	1,642	28	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
ACC	Reduce	1,958	508	(4)	(38)	8.1	13.0	4.7	6.9	1.9	2.4	26
Ambuja Cements	Accumulate	2,194	70	2	(22)	8.9	11.4	4.7	5.8	1.9	3.4	23
Grasim Industries	Accumulate	2,327	1,235	(3)	(26)	4.5	6.1	3.3	3.5	1.0	1.9	29
India Cements	Sell	616	106	(1)	(22)	4.4	5.7	3.5	4.1	0.9	0.8	24
Jaiprakash Associates	Buy	2,287	94	18	15	18.4	16.0	7.6	6.3	1.9	1.2	12
Madras Cements	Sell	342	70	5	6	3.9	3.7	3.5	3.6	1.8	2.9	46
UltraTech Cement	Accumulate	985	385	1	(14)	4.7	5.5	3.7	3.7	1.3	1.5	32

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

CONSTRUCTION

Edelweiss
Ideas create, values protect

Braving it out

January 7, 2009

Revathi Myneni
+91-22-6623 3316
revathi.myneni@edelcap.com

Parvez Akhtar Qazi
+91-22-4063 5405
parvez.qazi@edelcap.com

Key highlights of the sector during the quarter

The construction sector is facing headwinds in the form of slowing economy, strained government finances, and slump in sectors like industrial production and real estate. This has led to a slowdown in order inflow from the private sector as well as some existing orders getting delayed or cancelled. Elections in various states meant that order award from the public sector also took a slight hit in the current quarter. This meant that companies which were heavily dependent on private sector orders like Simplex Infra and B L Kashyap witnessed a slower order accretion rate compared to those with exposure to the public sector like IVRCL and Patel Engineering which continued to have a healthy order intake. Cooling off of commodity prices, mainly steel, meant that companies (particularly Nagarjuna Constructions and Gammon with higher share of fixed price orders in order book) could atleast stop worrying about margins. Also, with interest rates declining (SBI PLR declining 100bps), there was one more reason to cheer for the funding intensive construction sector. However, overall liquidity crunch meant that achieving financial closure on projects became a herculean task which was as a serious blow for companies with large asset ownership portfolios. Already, some companies like Nagarjuna Constructions are deferring financial closure on some projects.

Result expectations for the sector and stocks under coverage

We believe that capital charges will continue to hurt profitability as in similar to H1FY09 and as a result, PAT margins will be impacted negatively Y-o-Y. We may see close to flat earnings growth in some companies. We expect Simplex and Patel Engineering to post strong turnover growth while for BLK, the same is expected to be muted. With increase in competitive intensity and business shift towards lower margin segments, EBITDA margins are expected to be under pressure. The benefits of interest rate cuts are likely to be felt only in the next quarter with the average interest rate level in the current quarter not substantially different from Q2FY09.

Outlook over the next 12 months

We expect order intake to remain a concern over the next year. While companies have enough orders in hand to provide revenue visibility for next year and a half, post that the picture is still hazy. With the approaching elections at the Center and some states, orders from the government sector may dip temporarily. With regulatory issues being solved, we expect project award from NHAI to resume soon, though we doubt that the proposed targets will be met. We expect corporate capex and real estate development projects to remain in a slumber for some time to come. Also, the slowdown and increase in competition may pressurise margins. Though fund crunch may ease over the next few months, funding concerns for BOT projects are not likely to ease both from the debt and equity point of view with lackluster capital markets and plenty of projects chasing good money. The outlook for the sector appears to be challenging over the next 12 months despite the long term fundamentals being strong.

Recommendations

Top picks: Patel Engineering.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
BL Kashyap & Sons Ltd	Revenues	4,242	4,058	5	4,044	5	Revenue growth is likely to be muted due to weakness in the real estate sector. Also, margins may come under pressure due to increase in competition.
	EBITDA	445	474	(6)	432	3	
	PAT	249	252	(1)	242	3	
C&C	Revenues	1,478	862	71	1,290	15	Topline growth is expected to be robust, aided by a strong order book. Margins will be decided by share of Afghanistan operations. These operations have higher margins in the overall execution for the quarter.
	EBITDA	266	174	53	246	8	
	PAT	34	73	(54)	50	(32)	
Patel Engg	Revenues	5,383	3,789	42	4,418	22	Patel Engg is expected to post strong top-line growth, backed by a robust oredr backlog, though increasing share of irrigation projects may mean that margins may come under a bit of pressure. High capital charges are likely to continue hurting net profits, similar to H1FY09.
	EBITDA	725	592	23	735	(1)	
	PAT	364	474	(23)	506	(28)	
Simplex Infra	Revenues	11,095	7,040	58	10,081	10	Simplex is expected to post strong topline growth though margins may come under a bit of pressure. High capital charges may mean that earnings growth may be more or less flat.
	EBITDA	1,121	705	59	1,019	10	
	PAT	290	220	32	281	3	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
C&C	Buy	41	109	(35)	28	7.4	5.8	5.3	5.1	0.6	2.2	8
BL Kashyap & Sons Ltd	Buy	134	317	35	46	4.2	2.9	2.2	1.5	1.2	1.4	33
Patel Engg	Buy	233	190	(24)	13	9.8	8.7	7.3	6.7	1.2	0.8	13
Simplex Infra	Buy	196	193	48	14	7.6	7.0	5.1	4.8	1.0	1.0	16

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

ENGINEERING AND CAPITAL GOODS

Edelweiss
Ideas create, values protect

Some pain before gain

January 7, 2009

Misal Singh
+91-22-4040 7414
misal.singh@edelcap.com

Hiral Desai
+91-22-6623 3480
hiral.desai@edelcap.com

Krishnakant Thakur
+91-22-6623 3314
krishnakant.thakur@edelcap.com

Key highlights of the sector during the quarter

Leading companies in the engineering and capital goods sector have not disappointed on the execution and order accretion fronts in H1FY09. However, the concerns we have been articulating in terms of weakening order accretion and lower execution are likely to come to the fore in H2FY09. We expect delays in projects across private and public sectors. In the private sector we expect significant strain in metals, petrochemicals, and real estate sectors. Hence, engineering and capital goods companies exposed to these sectors are likely to face project delays or cancellations. Government-driven infrastructure spending in the power and roads sector could continue, albeit at a substantially slower pace. We believe in the absence of significant incentives in second economic stimulus plan of the Government of India, capital expenditure in the private and public sectors is unlikely to rebound in a hurry.

Result expectations for the sector and stocks under coverage

We believe Y-o-Y margin decline is likely to be pervasive across the sector, due to lower execution in the quarter. Bharat Heavy Electricals is likely to report a 150bps Y-o-Y decline in margins due to likely delay at the sub-contractor's end. We estimate Larsen and Toubro's Q3FY09 revenues to grow 18% Y-o-Y and PAT to grow 16% Y-o-Y. Power transmission tower and EPC companies could see higher order accretion due to order flows from Power Grid Corporation of India in H2FY09. Thermax, due to its dependence on private corporate capex, could be impacted if orders are delayed or cancelled.

Outlook over the next 12 months

Even as interest rates fall, liquidity has been tight for contractors. Further, capacity expansion in core sectors has slowed down, as there is uncertainty on the demand side. Hence, in our view, key large scale projects in verticals such as metals and petrochemicals are unlikely to be announced over the medium term. Government-driven infrastructure spending in the power and roads sector is likely to continue, but at a much slower pace. We believe over the next two-three quarters things could get much bleaker for engineering and capital goods companies in terms of order accretion, project delays, and cancellations, before they improve. While the long-term structural story of infrastructure creation in India remains intact, we believe the current cyclical slowdown could last longer than expected, negatively impacting valuations.

Recommendations

Stocks to avoid: Larsen and Toubro, ABB, Siemens.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
ABB	Revenues	22,374	18,394	22	15,562	44	We have had three consecutive quarters of slipagges on projects side. We expect project execution to pick-up in December 2008 quarter, while margins will stay under pressure due to higher raw material costs (likely to ease from Q1FY10) and slower growth vis-a-vis last year, limiting operating leverage benefit
	EBITDA	2,770	2,602	6	1,719	61	
	PAT	1,881	1,808	4	1,048	79	
AIA Engineering	Revenues	2,693	1,888	43	2,865	(6)	We estimate realisation of ~INR 100/kg and margins of 23.5% for Q3FY09E
	EBITDA	633	525	21	673	(6)	
	PAT	422	405	4	444	(5)	
BHEL	Revenues	60,760	49,642	22	53,426	14	We expect execution to moderate in H2FY09, H1FY09 execution was exceptionally strong due to a few slippages from FY08. We expect EBITDA to drop 150bps on slower execution, fewer milestones and higher raw materials prices (we expect raw material costs benefit to flow from Q1FY10)
	EBITDA	11,317	9,976	13	7,107	59	
	PAT	8,431	7,719	9	6,157	37	
Crompton Greaves	Revenues	10,832	9,152	18	10,896	(1)	We are expecting 18-19% topline growth, in line with our full year growth estimates. However, we expect operating margins to drop ~80bps on lower operating leverage and higher materials costs due to lower product realisations
	EBITDA	1,286	1,160	11	1,469	(12)	
	PAT	759	679	12	925	(18)	
Cummins	Revenues	8,156	5,902	38	8,084	1	Watch out for updates on capacity expansion plans.
	EBITDA	1,088	867	25	1,232	(12)	
	PAT	835	746	12	939	(11)	
Emco	Revenues	2,751	2,434	13	2,306	19	Margin pressures likely, to watch out for update on the power project
	EBITDA	364	328	11	307	19	
	PAT	140	151	(7)	113	24	
JYS	Revenues	4,736	3,455	37	4,212	12	To watch out for order intake from PGCIL and interest cost.
	EBITDA	554	438	27	505	10	
	PAT	221	202	10	201	10	
KEC	Revenues	8,266	7,089	17	8,060	3	To watch out for negotiation of contracts, order intake from PGCIL and international geographies
	EBITDA	869	1,025	(15)	810	7	
	PAT	332	523	(37)	426	(22)	
Kirloskar	Revenues	6,122	5,371	14	6,142	(0)	Updates on capacity expansion plans
	EBITDA	656	487	35	723	(9)	
	PAT	281	218	29	217	30	
KPP	Revenues	5,424	3,519	54	4,326	25	To watch out for working capital and margin pressures, order intake from PGCIL and international geographies
	EBITDA	682	522	31	523	30	
	PAT	345	303	14	223	54	
L&T	Revenues	75,547	63,827	18	76,864	(2)	Expect topline growth to taper, as, execution in our view, would have slowed down through the credit crunch last quarter. Margins are likely to dip due to lower leverage
	EBITDA	7,969	7,407	8	6,768	18	
	PAT	5,606	4,818	16	4,603	22	
Sanghvi Movers	Revenues	835	573	46	956	(13)	Segmentwise break-up of revenues from various sectors. Any impact on yields on account of a slowdown and capex plans going forward.
	EBITDA	573	429	34	736	(22)	
	PAT	198	168	18	288	(31)	
Siemens	Revenues	22,203	19,144	16	24,911	(11)	Expect 16% growth in topline as first quarter tends to be soft, while we also expect SIEM's margins to stabilise at normal operating levels of 6.7% (last year due to provisioning and few writebacks, margins were very volatile throughout the year)
	EBITDA	1,484	1,497	(1)	3,716	(60)	
	PAT	933	725	29	2,251	(59)	
Suzlon	Revenues	40,867	36,413	12	41,818	(2)	15% Y-o-Y growth in volumes with stable realisations expected. Drop in EBITDA margin expected from 12.3% in Q309 on account of higher overheads. Hansen is expected to report strong numbers on account of robust order book
	EBITDA	5,108	5,870	(13)	4,126	24	
	PAT	2,453	3,983	(38)	(1,305)	288	
Techno Electric	Revenues	1,769	1,151	54	1,300	36	To watch out for order intake in H2FY09. Higher execution and margin improvement in H2FY09
	EBITDA	225	140	61	158	43	
	PAT	215	121	77	182	18	
Thermax	Revenues	9,741	9,335	4	8,399	16	Watch out for order book accretion, guidance on order execution
	EBITDA	1,150	1,095	5	NA	NA	
	PAT	772	797	(3)	543	42	

Source: Edelweiss research

Q3FY09 result expectations (contd.)

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
TRIL	Revenues	1,062	685	55	1,138	(7)	To watch out for commencement date of new facility. Impact of decline in copper prices
	EBITDA	155	125	24	198	(22)	
	PAT	88	74	19	127	(31)	
VAMP	Revenues	1,655	1,429	16	1,700	(3)	Margin pressure to come to the fore as the year progresses
	EBITDA	285	327	(13)	380	(25)	
	PAT	191	227	(16)	273	(30)	
Voltas	Revenues	7,904	7,127	11	10,067	(21)	Expect a slow topline growth as both UCL and EAS segments have slowed down dramatically, while margins are likely to remain stable in projects business
	EBITDA	598	636	(6)	776	(23)	
	PAT	478	431	11	619	(23)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
ABB	Reduce	2,232	512	7	14	20.7	18.1	12.8	11.0	5.2	0.6	28
AIA Engineering	Buy	270	140	22	28	8.1	6.3	5.2	3.8	1.8	1.2	25
BHEL	Accumulate	14,477	1,438	14	31	21.7	16.6	14.0	9.6	5.4	1.2	27
Crompton Greaves	Buy	1,105	147	29	15	10.3	8.9	6.3	5.5	3.6	2.3	37
Emco	Accumulate	49	44	(4)	15	4.8	4.1	2.1	0.7	0.5	1.5	12
JYS	Accumulate	128	76	35	12	6.9	5.9	4.5	4.1	1.5	1.0	25
KEC	Reduce	182	183	(34)	47	5.6	5.4	4.4	3.9	1.4	2.7	20
Cummins	Accumulate	933	229	20	7	11.7	10.9	8.2	7.3	3.0	2.0	28
Kirloskar	Accumulate	171	43	28	35	5.5	4.0	2.0	1.6	0.9	9.3	16
KPP	Accumulate	177	326	9	18	4.8	4.1	3.3	2.9	0.9	2.3	21
L&T	Reduce	10,317	857	31	17	16.5	14.2	13.8	10.8	3.8	1.1	25
Sanghvi Movers	Buy	72	80	25	38	3.9	2.8	3.3	2.4	0.9	5.4	27
Siemens	Reduce	2,105	304	9	14	17.5	15.3	8.6	7.3	3.6	1.5	22
Suzlon	Buy	2,084	68	(20)	20	10.7	8.9	7.4	5.2	1.1	3.1	15
Techno Electric	Buy	88	75	47	34	5.9	4.4	3.0	1.6	1.9	4.2	37
Thermax	Accumulate	484	198	7	24	7.6	6.1	3.4	2.5	2.6	6.1	37
TRIL	Buy	47	179	19	14	5.6	4.9	2.5	2.0	0.9	1.3	18
VAMP	Buy	86	412	11	(4)	4.7	4.9	2.6	2.4	1.7	3.0	44
Voltas	Accumulate	421	62	34	15	8.6	7.5	4.4	3.2	2.8	2.5	37

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

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FMCG

Good times to continue

January 7, 2009

Abneesh Roy
+91-22-6620 3141
abneesh.roy@edelcap.com

Ajay Thakur
+91-22-6620 3031
ajay.thakur@edelcap.com

Key highlights of the sector during the quarter

FMCG companies are expected to report strong top line growth on the back of steady volume growth and price hikes across product portfolios. Fairly well distributed monsoon and strong agri-commodity prices have raised prospects of continued strong rural demand for FMCG products. However, the winter has been relatively mild so far and could result in lower offtake of skin care products. Also, down trading/slowdown, though not evident so far, could have a bearing on value–for-money (VFM) categories such as soaps. We expect down trading with a lag, especially in mass categories like detergents and toothpastes. Depreciation of the INR by ~20% Y-o-Y could spell higher contribution from their international businesses. However, companies that import a chunk of their raw material could see cost inflation.

Result expectations for the sector and stocks under coverage

Top line growth for most companies would remain strong while EBITDA margins should remain under pressure. Gross margins are likely to be under pressure as most FMCG companies are yet to exhaust their high cost raw material inventory. However, correction in some agri-commodity, packaging material, and other key inputs is expected to provide some respite for FMCG companies. We estimate moderate margin decline for HUL, with price hike led strong top line. Strong copra prices are likely to dent Marico's margins and some translation losses on its foreign currency loans are also expected. Dabur could have relatively better gross margins on account of its diversified product portfolio and price hikes. Godrej Consumer and Nestle could witness some improvement in their margins on Q-O-Q basis on account of correction in input prices and price hikes. Post ban on smoking in public places and private offices, ITC could see marginally higher volume decline for the quarter, though we believe the impact to be temporary and with marginal impact. Losses from FMCG Others are expected to continue albeit with some moderation. Asian Paints' EBITDA margins are expected to remain subdued on lower volume off take, higher average crude prices, and rupee depreciation.

Outlook over the next 12 months

With exhaustion of most of the higher cost raw material inventory by the end of the current quarter, we expect gradual improvement in gross margins from the coming quarter for most FMCG companies. The benefit of correction in key input material such as palm oil (60%), edible oil (5-20%), and packaging material are likely to be reflected in the coming quarters. However, depreciating rupee could dilute some of the gains for imported inputs such as palm oil. A fairly well distributed monsoon is likely to boost demand from rural areas aiding steady growth in top line. New launches and price hikes taken over the past few months are also expected to boost the top line. In cigarettes, we expect ITC to take more staggered price hikes. Overall, we expect continued momentum in top line growth with stable margins, going forward. Fair valuations with high return ratios and healthy dividend yield, coupled with defensive nature of the business should limit downsides in uncertain market conditions. **Key risk**: Input cost inflation, down trading, and moderation in volume growth on account of price hikes across product categories remains a concern for the industry.

Recommendations

Top picks: Nestle India (large caps); Marico Industries, Godrej Consumer, and Colgate Palmolive India (mid caps).

Q3FY09 result expectations

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
Asian Paints	Revenues	13,966	11,776	19	14,753	(5)	Lower volumes offset by 12-13% average price hikes shall boost topline. International business could report better revenues, aided by depreciating rupee
	EBITDA	2,025	1,856	9	2,088	(3)	
	PAT	1,339	1,246	7	1,379	(3)	
Colgate	Revenues	4,198	3,675	14	4,125	2	Steady topline growth lead by continued strong volume growth. Other income which includes IT outsourcing services rendered to parent will continue to aid bottomline growth.
	EBITDA	672	611	10	512	31	
	PAT	683	605	13	635	8	
Dabur	Revenues	7,511	6,497	16	6,912	9	Revenues are expected to remain steady. International business could report better revenues aided by depreciating rupee
	EBITDA	1,299	1,163	12	1,248	4	
	PAT	1,038	925	12	1,074	(3)	
Godrej Consumer	Revenues	3,339	2,728	22	3,465	(4)	PAT is likely to be boosted by higher other income and interest income. International business could report better revenues aided by depreciating rupee
	EBITDA	581	568	2	397	46	
	PAT	481	430	12	347	38	
Hindustan lever	Revenues	43,364	36,874	18	40,279	8	Topline to be boosted by price hike across its portfolio. Moderation in Palm oil prices could benefit soaps margins albeit with lag effect.
	EBITDA	6,526	5,642	16	4,763	37	
	PAT	6,252	5,540	13	4,379	43	
ITC	Revenues	39,965	34,580	16	38,627	3	Price hike of 5-6% in cigarettes taken in Q2 shall be fully relfected this quarter. However, volumes could be slightly lower on account of ban on smoking in public and private offices. Hotels could see subdued performance due to global economy slowdown and recent mumbai terror stirkes.
	EBITDA	13,169	11,997	10	12,154	8	
	PAT	8,850	8,307	7	8,027	10	
Marico	Revenues	6,334	5,062	25	6,035	5	Topline likely to remain robust while bottomline could disappoint due to high base and some translation losses due to foreign currency loans. EBITDA margins could remain under pressure on account of high input prices.
	EBITDA	751	642	17	739	2	
	PAT	470	459	2	471	(0)	
Nestle India	Revenues	10,783	8,957	20	11,076	(3)	Gross margins likely to remain under pressure.Tax savings due to Uttaranchal plant shall aid in boosting bottom-line.
	EBITDA	1,779	1,576	13	2,072	(14)	
	PAT	1,080	936	15	1,318	(18)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Asian Paints	Accumulate	1,804	915	10	18	18.3	15.4	12.0	10.1	7.2	2.1	45
Colgate	Buy	1,134	405	19	16	20.0	17.2	19.5	16.7	29	3.9	157
Dabur	Accumulate	1,507	85	13	19	19.4	16.4	16.0	13.0	9.1	2.2	53
Godrej Consumer	Accumulate	742	140	9	19	20.8	17.5	15.6	12.4	5.8	2.8	44
Hindustan lever	Accumulate	10,889	243	14	16	26.3	22.6	23.8	20.4	33	3.0	132
ITC	Accumulate	13,411	173	6	15	19.4	16.8	12.6	10.7	4.7	2.2	26
Marico	Buy	732	59	17	22	19.2	15.7	12.2	9.8	8.1	1.5	49
Nestle India	Accumulate	2,925	1,475	25	23	26.3	21.3	16.8	14.0	30	2.9	121

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

IT

Edelweiss
Ideas create, values protect

Winds all over

January 7, 2009

Viju George
+91-22-4040 7414
viju.george@edelcap.com

Kunal Sangoi
+91-22-6623 3370
kunal.sangoi@edelcap.com

"We have revised our USD revenue guidance to reflect the current economic situation and drastic depreciation of major global currencies against the USD," said Mr. S. Gopalakrishnan, CEO and MD, Infosys, at the time of declaring the Q2FY09 results. The company is likely to repeat this in Q3FY09. We would be less concerned by a restatement of the annual guidance growth for FY09 (13-15% as of Q2FY09) on account of currency, noting that in the September-December 2008 quarter the USD appreciated (on an average) versus other currencies (notably, EUR and GBP). It is a possible second successive downgrade in the business outlook that concerns. Infosys had already provided a buffer of 3% in its Q2 revised growth outlook as a measure of caution and not because it felt business impact. The fact that the company, in just a quarter's time, not only draws down on that buffer completely, but also could take a further cut attests to the pace of deterioration in the environment that the company has not bargained for. If such a cut occurs, it is likely to lead to a somber mood among investors as a prelude to results of other IT companies.

Key highlights of the sector during the quarter

Increasing bargaining power of clients: When firms struggle to survive, outsourcing is less likely to be an immediate theme. During these testing times, along with cut down on discretionary spend, existing work with IT vendors also come under scanner for pricing cuts and contractual term renegotiation. M&As and restructuring will take centre stage as a result of the scramble for survival, but IT investments follow with a lag. Also, we believe that Indian IT players have not meaningfully directly participated in integration opportunities so far and may compete in solutions relating to risk measurement & management and compliance that financial institutions will be subject to a greater degree, going forward.

Rupee slide against USD to benefit top line, while strength against GBP to partly take away gains: The Indian Rupee lost 11.4% against USD based on quarter's average rate, while it gained 7.7% against GBP. Companies with lower hedge position (Infosys and Satyam) will continue to benefit while those that are over-hedged, Wipro and HCL Tech (HCLT) are unlikely to see major benefit of rupee depreciation. Further, companies like Mastek, HCLT, which have higher proportion of revenue billing in GBP, will see greater negative currency impact. Among the midcaps, high MTM loss provisions will be seen in Hexaware, Geometric, and Patni, as they are fully hedged. On the other hand, **Mphasis,** which used to keep its forex exposure (pertaining to P&L) open, has significantly increased its forward contracts in October (INR 48-49 /USD), locking in realisations at high rates.

Too early to turn positive on Indian IT; retain market underweight position

Caution is still warranted for the next three-six months and we believe a re-rating is some time away; yet, we will not wait for Indian companies to pronounce that the overall business health has improved, as they are often downstream in the tech food chain. As we had discussed in our December 31, 2008 report, ***"It's now all about the global macro, so do follow it!" -*** global indicators, (both within the tech macro food chain and also those that track the health of developed economies) - have to be monitored to capture reasonable upside in Indian IT stocks. Currently, our leading indicators point to an anemic state of affairs and do not display strength. We retain our market underweight position on the Indian IT sector.

Recommendations

Top pick: Infotech Enterprises.
Stocks to avoid: Wipro, Patni, Hexaware, Geometric.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Geometric	Revenues	1,604	1,240	29	1,526	5	Rupee depreciation to help post positve growth despite volume decline; Operating margins expected to improve with rupee benefit and efficiency improvement measures
	EBITDA	238	161	47	208	14	
	PAT	78	68	15	33	136	
HCL Tech	Revenues	25,828	18,166	42	23,693	9	USD 22mn consolidation of Axon revenues to push the revenue growth rate; BPO performance likely to deteriorate with currency and integration headwinds; Further accumulation in MTM losses due to rupee depreciation. Operating margin to decline with acquisition related costs and consolidation of low margin Axon revenue; Favourable currency movement (GBP-USD) for USD denominated debt (for Axon) benefitted by bringing down the cost of acquiring Axon
	EBITDA	5,269	3,885	36	5,311	(1)	
	PAT	3,784	3,105	22	3,375	12	
Hexaware	Revenues	2,845	2,592	10	2,946	(3)	To miss the full year and Q4 guidance; Significant impact on the bottom-line due to MTM losses on forward contracts; Demand outlook and order book expected to weaken further.
	EBITDA	365	181	102	393	(7)	
	PAT	185	(810)	123	115	61	
Infosys	Revenues	57,059	42,710	34	54,180	5	Stability of key accounts and early peak into the shape of FY10; Stand on pricing; amidst continued deterioration what will Infosys do?; Update on non-linear growth initiatives.
	EBITDA	19,108	13,920	37	17,940	7	
	PAT	15,460	12,310	26	14,320	8	
Infotech	Revenues	2,327	1,769	32	2,214	5	Cross currency headwinds likely to have impact on operating margins and top line growth; Losses on forward contracts maturing for the quarter expected to dampen the net profits.
	EBITDA	448	320	40	457	(2)	
	PAT	248	214	16	349	(29)	
Mastek	Revenues	2,604	2,117	23	2,578	1	Significant impact due to GBP depreciation against INR; guidance to be brought down in USD terms; Newer modules of SOA Elixir to be launched; NHS ramp-down slower than earlier anticipated providing revenue cushion.
	EBITDA	479	366	31	469	2	
	PAT	347	271	28	412	(16)	
Patni	Revenues	7,669	6,780	13	7,996	(4)	New CEO (Jeya Kumar - from Mphasis); roadmap and strategy to be seen; MTM losses to be meaningful with greater proportion of revenues hedged. USD 10mn factored in estimates; Normal tax provision this quarter (reversal last quarter) add to de-growth in net profits.
	EBITDA	1,212	1,238	(2)	1,425	(15)	
	PAT	1,010	1,024	(1)	1,802	(44)	
Rolta	Revenues	3,617	2,417	50	3,461	5	MTM to continue impacting the net profit for Q2 as well; New order accretion expected to slow down in the current enviornment; to be closely tracked; New acquisition of Pioncon to be consolidated since next quarter.
	EBITDA	1,228	928	32	1,185	4	
	PAT	439	602	(27)	136	223	
Sasken	Revenues	1,581	1,413	12	1,763	(10)	Services volumes to degrow; Visibility on the product reveneus remain low; Rupee to benefit OPM but other income to be negative due to MTM loss.
	EBITDA	310	159	94	411	(25)	
	PAT	134	39	248	104	30	
Satyam	Revenues	30,646	21,956	40	28,193	9	Guidance to be revised downward in USD terms due to cross currency movement. Margins to improve helped by USD appreciation; New contracts to be impacted due to recent corporate governance issue.
	EBITDA	7,243	4,712	54	6,509	11	
	PAT	5,993	4,336	38	5,809	3	
TCS	Revenues	71,377	59,241	20	69,534	3	Status on key BFSI accounts, especially those related to capital markets and commercial banking; "Pipeline continues to remain healthy" - this is likely to be the tone of management commentary; Assurance on margin stability in FY10 needed, given perception of TCS' propensity of lower pricing.
	EBITDA	18,141	15,788	15	17,324	5	
	PAT	13,376	13,308	1	11,742	14	
Wipro	Revenues	66,420	52,361	27	64,094	4	Likely to meet guidance in constant currency terms with modest upside to it, but management bandwidth to tide over FY10 seems strained, given recent key personnel departures; Outlook on Semiconductor/ telecom equipment vendor/ technology R&D remains a matter of concern.
	EBITDA	13,028	10,359	26	12,536	4	
	PAT	8,789	8,261	6	8,224	7	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Geometric	Sell	32	25	22	6	3.9	3.7	2.6	2.5	0.6	6.5	15
HCL Tech	Accumulate	1,736	126	45	22	5.7	4.7	3.9	2.9	1.4	7.9	27
Hexaware	Sell	68	23	1,215	81	5.5	3.1	2.6	1.7	0.4	3.5	8
Infosys	Accumulate	13,808	1,173	26	(3)	11.5	11.9	7.7	7.3	3.6	2.1	36
Infotech	Buy	115	106	33	17	5.1	4.4	2.5	2.2	0.8	2.4	16
Mastek	Accumulate	93	167	23	7	2.9	2.7	2.0	1.3	0.9	4.5	34
Patni	Sell	366	139	(4)	(10)	4.1	4.5	2.9	2.5	0.6	2.8	16
Rolta	Buy	418	126	4	53	8.7	5.7	5.0	3.7	1.5	3.2	19
Sasken	Accumulate	39	67	47	15	4.0	3.5	1.6	1.5	0.4	6.2	10
Satyam	Sell	2,316	167	37	(4)	5.0	5.2	1.7	1.2	1.2	2.4	28
TCS	Buy	10,367	515	6	15	9.5	8.2	6.9	6.0	3.5	5.2	39
Wipro	Accumulate	7,396	246	15	13	9.7	8.7	7.0	6.1	2.3	2.5	26

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

LOGISTICS

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Tough times

January 7, 2009

Krishnakant Thakur
+91-22-6623 3314
krishnakant.thakur@edelcap.com

Key highlights of the sector during the quarter

Global economic slowdown has taken a toll on EXIM trade, which has resulted in a slowdown in cargo traffic at ports, railway, and roadways logistics part of the business. Domestic and EXIM cargo traffic is driven by economic growth; along with macro economic factors, other factors affecting traffic slowdown are: (1) liquidity crisis faced by most importers resulting in stacking of cargo at ports; (2) high volatility of prices in the global commodity market which is impacting signing of long term cargo agreements; and (3) cooling of the Chinese economy, which is a major demand driver. In the short term, we believe such a gloomy environment will continue and domestic and EXIM trade will take a hit affecting companies in the logistics sector for atleast the next two quarters. Domestic cargo growth as reflected by softer IIP numbers and container traffic volumes are expected pressurise growth prospects of the sector.

Result expectations for the sector and stocks under coverage

India's export import performance has been dismal in October, with exports growth declining 12.1% Y-o-Y and imports growing by 10.6% Y-o-Y (non oil imports growth of 5.5% Y-o-Y), indicating a slowdown in cargo traffic at ports. On account of the dip in global trade, container traffic is expected to decline 5% Y-o-Y in H2FY09, resulting in a growth of 2-3% Y-o-Y in FY09E. This is likely to hurt CFS and container operators like Concor and Gateway Distriparks. Focus on domestic container volumes is also expected to keep margins under pressure. Allcargo Global Logistics is likely to report strong numbers as pure play CFS operators are earning higher realisations on account of higher ground rent charges. Conversion of full container load cargo (FCL) to less than container load (LCL) is also likely to happen over the short term. Port operators like Mundra Port are also expected to feel the heat of the slowdown in global trade (more on container volumes compared to bulk volumes) which will impact overall port traffic (expected growth rate of 16% Y-o-Y against an average of 30% in the past few quarters) and sale of SEZ land in H2FY09. On the domestic cargo front, Gati and Transport Corporation of India are likely to face margin pressures on account of lower volume growth in the automobile sector (services provided by logistics companies on outbound transportation).

Outlook over the next 12 months

With gloomy export import trade volumes in October on account of global uncertainty, volume growth in the logistics sector will be a major cause of concern for companies in H2FY09. Growth in container traffic is clearly a function of global trade and domestic cargo growth on which logistics segments like container terminals, CFS/ICD, and container train operators thrive. Apart from slackening demand other short term factors like inability of importers to take delivery resulting in stacking of cargo at ports, sharp drop in shipping freight rates impacting transportation of goods and competition from the road segment are likely to immediately impact sector players. Though CFS operators are likely to be compensated in higher ground rent in the short term, the going is likely to be tough for container train operators in the short term. We have downgraded our outlook on the container logistics sector on account of expectation of muted container volume growth.

Recommendations

Top picks: Container Corporation of India.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Allcargo	Revenues	3,853	4,039	(5)	5,443	(29)	Moderate growth in volumes in the CFS and MTO buisness. However, compensated by 10-12% imrovement in realisations on account of higher ground rent. Eculine volumes could see improvement on account of conversion of FCL cargo to LCL cargo
	EBITDA	361	283	27	716	(50)	
	PAT	142	194	(27)	471	(70)	
Container Corporation	Revenues	8,800	8,188	7	9,034	(3)	Expected decline in EXIM and domestic volumes. However, realisations improvement could happen on account of increase in haulage charges from IR. EBITDA margins expected to be stable due to tariff rationalisation
	EBITDA	2,322	2,123	9	2,688	(14)	
	PAT	1,815	1,742	4	2,239	(19)	
Dredging Corporation	Revenues	2,473	1,722	44	2,298	8	Contribution from Sethusamudram project to continue. However, on account of charter hire charges, margins are likely to be suppressed.
	EBITDA	174	381	(54)	157	11	
	PAT	209	359	(42)	81	158	
Gateway Distriparks	Revenues	1,045	640	63	1,184	(12)	10-15% drop in CFS volumes expected. However, this is expected to be compensated by higher ground rent. Margin in train buisness expected to deteriorate on account of lower fill factor on domestic volumes.
	EBITDA	302	255	18	421	(28)	
	PAT	129	188	(31)	234	(45)	
Gati	Revenues	1,859	1,345	38	1,584	17	Lower contribution from express business, however, compensated by contribution from air freight division. Margins expected to be under pressure on account of lower utilisation on air freight business.
	EBITDA	161	101	59	95	70	
	PAT	50	125	(60)	4	1,100	
Mundra Port & SEZ	Revenues	3,058	1,604	91	2,960	3	Cargo for the quarter expected at 9.0 mn tonnes, registering 18-20% Y-o-Y growth. Significant slowdown expected in container traffic and SEZ volumes.
	EBITDA	2,256	1,040	117	2,056	10	
	PAT	1,294	427	203	1,123	15	
Sical	Revenues	2,719	2,641	3	1,728	57	Earnings from logistics buisness expected to be stable. Infra assets contribution to take some time
	EBITDA	302	163	85	246	23	
	PAT	106	180	(41)	109	(2)	
Texmaco	Revenues	2,787	1,688	65	2,053	36	Slower order accretion on wagons expected from private parties. IR is expected to release order for 15000 wagons which is expected to provide big boost to the order book.
	EBITDA	416	201	107	309	35	
	PAT	210	128	64	217	(3)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Allcargo	Buy	300	653	71	22	12.3	10.0	6.5	5.8	1.9	1.0	19
Container Corporation	Accumulate	1,871	700	4	13	11.5	10.2	7.2	5.9	2.2	1.9	22
Dredging Corporation	Buy	147	255	(52)	34	9.6	7.2	6.5	3.4	0.6	2.6	6
Gateway Distriparks	Reduce	209	88	(4)	22	14.4	11.8	8.3	6.2	1.4	3.3	10
Gati	Buy	74	42	(23)	9	14.2	11.4	7.8	6.7	0.5	0.0	7
Mundra Port & SEZ	Buy	3,216	390	122	15	33.4	29.1	21.0	16.3	60	0.0	17
Sical	Buy	23	28	(18)	9	2.7	2.5	8.2	9.0	0.4	3.1	14
Texmaco	Buy	169	74	25	41	1.2	0.8	5.9	4.0	0.3	6.7	31

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

MEDIA

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On a roll

January 7, 2009

Abneesh Roy
+91-22-6620 3141
abneesh.roy@edelcap.com

Sharad Todi, CFA
+91-22-6623 3481
sharad.todi@edelcap.com

Key highlights of the sector during the quarter

Q3FY09 saw strong content and lineup of movies, which we expect will culminate in high footfalls at multiplexes. Movie releases such as *Golmaal Returns, Dostana, Rab Ne Bana Di Jodi,* and *Ghajini* did well as expected at the box office. There was a brief lull at multiplexes in Mumbai due to public security threats, which is likely to impact companies with strong concentration in Mumbai, such as Fame India. PVR recently opened its much awaited Phoenix Mills multiplex, which has seven screens. *Colors* ascended to the No. 2 spot within a few months of its launch, pushing *Zee TV* to the No. 3 slot. Hindi GEC content producers cornered broadcasters with a strike in which fresh content was off air for nearly 20 days. During this time *Colors* rose to the No.1 spot briefly, but *Star Plus* regained its leadership in December. *Aaj Tak* maintained its lead in the Hindi news genre. The DTH space remains buoyant with both Reliance and Bharti ramping up their operations and Dish TV and Tata Sky aggressively adding to their subscriber numbers. Newsprint prices came off their peak during the quarter, with domestic newsprint prices dropping significantly, followed by international newsprint. This is a significantly positive event for print media companies for whom newsprint costs amount to approximately half of their total revenues.

Result expectations for the sector and stocks under coverage

We expect multiplexes to report strong revenue growth in the quarter due to a robust content lineup. PVR is expected to report good revenue growth, also due to the opening of a seven screen multiplex. Inox's performance in terms of revenue and EBITDA is expected to be good since it opened a three screen multiplex in Burdhwan (West Bengal), but performance at the PAT level could be disappointing due to lower other income. Moving on to broadcasters, ad revenue may slowdown in Hindi GECs, indicating a challenging period ahead. ZEEL's flagship channel, *Zee TV,* conceding its spot to *Colors* will also impact the company's bargaining power with advertisers. TV-18 is expected to report a weak set of numbers due to a significant slowdown in ad-revenues, which was fuelled by spending from industries such as banking and financial services, autos, and real estate. TV Today is also expected to be impacted by the slowdown, but the festive season and continued leadership of *Aaj Tak* will enable it to report decent revenues. The company's profit margins could be dampened due to high carriage fees and employee retention costs. Zee News is expected to report robust revenue growth but dampened margins due to the cost incurred in launching *Zee Tamil.*

Outlook over the next 12 months

We maintain a positive outlook towards all companies under coverage. Performance of exhibition players is strongly dependent on the ability of players to roll out new multiplexes and strong content flow. On the broadcasting front, we are bullish on companies with a stronger regional presence such as ZNL. With advertising growth slowing down, we remain cautious towards ZEEL, TV Today, and TV-18. Since Reliance and Bharti have commenced their DTH operations, we believe this market will grow even faster, thereby benefitting broadcasters and providing some support against the slowdown in ad revenues. The recent decline in newsprint prices is a significant positive for print companies.

Recommendations

Top picks: Zee News, PVR, Zee Entertainment Enterprises.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Inox Leisure	Revenues	588	528	11	522	13	Footfalls could be lower than expected due to public security concerns; EBITDA could be dampened due to lower advertising revenues
	EBITDA	123	127	(4)	85	45	
	PAT	54	63	(15)	33	64	
PVR	Revenues	743	648	15	788	(6)	Footfalls could be lower than expected due to public security concerns; EBITDA could be dampened due to lower advertising revenues; Phoenix Mills property could contribute significantly to occupany and revenue growth
	EBITDA	120	130	(7)	150	(20)	
	PAT	35	61	(43)	79	(56)	
TV Today	Revenues	831	694	20	669	24	Impact on ad-rvenues due to slowdown; traction in subscription revenue growth after AajTak went pay; scalability of production expenses
	EBITDA	240	243	(1)	121	98	
	PAT	154	166	(7)	75	104	
TV-18	Revenues	950	914	4	808	18	Impact on ad-rvenues due to slowdown and strike in Hindi GEC; profitability of web and newswire businesses
	EBITDA	310	404	(23)	275	13	
	PAT	114	208	(45)	43	166	
Zee News	Revenues	1,360	983	38	1,277	7	Ad-revenue growth expected to slow down; margin could come under pressure through new channel launches and inability to scale down production costs.
	EBITDA	231	220	5	211	9	
	PAT	121	128	(5)	115	6	
ZEEL	Revenues	5,806	5,182	12	5,717	2	Impact on ad revenues due to slowdown and strike in Hindi GEC; traction in subscription revenue growth
	EBITDA	1,738	1,569	11	1,489	17	
	PAT	1,131	1,097	3	1,783	(37)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Inox Leisure	Reduce	49	38	(32)	27	13.2	10.4	6.6	5.8	0.9	2.6	7
PVR	Buy	51	109	2	26	12.0	9.4	4.0	3.5	1.0	1.2	10
TV-18	Accumulate	267	108	350	9	35.1	32.2	8.8	8.7	2.4	1.8	7
TV Today	Accumulate	97	81	7	18	10.0	8.5	3.8	2.8	1.4	2.2	15
ZEEL	Accumulate	1,339	150	7	22	15.8	12.9	10.1	8.4	2.0	1.3	13
Zee News	Buy	178	36	25	35	18.7	13.8	10.5	7.7	3.6	1.4	21

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009. TV 18 estimates of new business only.

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METALS AND MINING

Dismal quarter

January 7, 2009

Prasad Baji
+91-22-4040 7415
prasad.baji@edelcap.com

Amit Dixit
+91-22-6623 3475
amit.dixit@edelcap.com

Manan Tolat
+91-22-6620 3036
manan.tolat@edelcap.com

Key highlights of the sector during the quarter

In the ferrous space, demand contracted significantly in Q3FY09. As a result, steel makers world over have embarked on massive production cuts up to 35% in Europe, 40% in the US, and 50% in CIS. On the price front, after a phenomenal H1FY09, steel prices in India came off 23-25% from peak. Global steel prices, on the other hand, have cooled off 50% from peak for HR coil and 60-65% for rebars to USD 575/tonne and USD 560/tone, respectively. On the cost front, there was some respite in spot iron ore and coke prices, which is expected to benefit mid-cap players and JSW Steel. Overall, we expect EBITDA margin contraction (Q-o-Q) for all players. The deteriorating demand scenario had a severe impact on base metal prices as well. Copper, aluminium, and zinc prices declined 44%, 23%, and 55% Y-o-Y, respectively. Aluminium and zinc producers globally have also taken production cuts though on a relative basis production cuts have been more effective in zinc than in aluminium.

Result expectations for the sector and stocks under coverage

Among ferrous companies, we expect Jindal Steel and Power (JSPL) and JSW to suffer less owing to merchant power business and reduced raw material spot prices, respectively. We expect Corus to post PAT loss for the next two quarters and hence, on a consolidated basis, results are expected to be weak for Tata Steel. For SAIL, we expect a poor quarter as full impact of revised coking coal contracts (USD 300/tonne) comes to the fore, with no production cuts thus far and conversion costs, particularly staff cost, remaining the highest in the industry. We do expect positive surprise from Sesa Goa in form of strong iron ore volumes even in a weak demand scenario. However, its margins are expected to shrink on account of falling spot prices.

In the non-ferrous space, we expect companies to report a weak set of numbers on account of declining prices. Hindustan Zinc is expected to report strong volumes on the back of capacity ramp up, while Sterlite's copper production was impacted due to equipment breakdown. Hindustan Zinc and Sterlite are likely to lose out on by-product credits as its prices have dipped significantly. NALCO's margins are also expected to be under pressure as aluminium prices are near their production costs.

Outlook over the next 12 months

In the ferrous space, we expect demand to remain weak in the coming quarters. However, given the significant production discipline exercised so far, we expect prices to decline only slightly from current levels (by about USD 50-60/tonne). On the raw material front, we expect iron and coking coal contract prices for CY09 to be negotiated at 35% and 40% less, respectively, but these will be insufficient to compensate for the Y-o-Y steel price decline.

We expect base metal prices, especially aluminium and zinc, to rebound slightly from current levels due to ongoing production cuts and with prices close to average cost of production. Going forward, falling input costs are likely to provide some respite to producers.

Recommendations

Top picks: Hindustan Zinc, Sterlite Industries.

Stocks to avoid: We expect severe downside in SAIL from current levels due to relatively high inventory, high coking coal costs up to June 2008, and high staff/overhead costs.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Hindalco	Revenues	37,213	45,317	(18)	56,832	(35)	23% Y-o-Y decline in aluminium prices and falling alumina prices would impact margins
	EBITDA	6,162	8,006	(23)	9,934	(38)	
	PAT	4,234	5,427	(22)	7,200	(41)	
Hindustan Zinc	Revenues	11,887	16,580	(28)	17,905	(34)	55% and 60% Y-o-Y decline in zinc and lead prices will impact EBITDA margins adversely. Zinc cost of production expected to increase Q-o-Q due to reduced by-product credits.
	EBITDA	5,102	10,440	(51)	9,821	(48)	
	PAT	5,030	7,850	(36)	9,595	(48)	
Jindal Steel & Power	Revenues	20,314	13,956	46	22,161	(8)	Decline in sales volume and prices expected to reduce revenue Q-o-Q. The company is expected to fare relatively better than peers owing to less moderation in plates and longs in India.
	EBITDA	7,712	5,793	33	8,552	(10)	
	PAT	4,619	3,903	18	5,607	(18)	
JSW	Revenues	36,633	28,419	29	46,841	(22)	Decline in sales volume and prices to reduce revenues Q-o-Q. Company expected to gain from lower input costs and operating efficiencies.
	EBITDA	9,114	7,575	20	11,995	(24)	
	PAT	3,137	2,704	16	4,137	(24)	
Monnet Ispat	Revenues	3,964	2,882	38	3,997	(1)	Expect EBITDA to decline owing to lower realisations Q-o-Q. The effect is mitigated up to an extent by input cost also going down
	EBITDA	900	558	61	1,039	(13)	
	PAT	461	337	37	620	(26)	
Nalco	Revenues	11,746	11,093	6	15,715	(25)	23% Y-o-Y decline in aluminium prices and falling alumina prices likely to impact margins
	EBITDA	4,035	4,401	(8)	6,759	(40)	
	PAT	2,804	3,294	(15)	4,445	(37)	
SAIL	Revenues	101,579	95,333	7	122,386	(17)	Revenue impacted by reduced sales volume and steep price declines in flats. EBITDA impacted adversely due to full impact of higher coking coal contract prices.
	EBITDA	9,747	29,834	(67)	30,115	(68)	
	PAT	6,564	19,347	(66)	20,096	(67)	
Sesa Goa	Revenues	15,833	12,182	30	8,757	81	Expect iron ore sales volume of 5 mt. Margins will fall on account of lower spot prices. The company may book MTM loss up to INR 1-1.3 bn in P/L this quarter. In previous quarter, the same was booked in reserves. We have not considered this loss in our estimates.
	EBITDA	8,681	7,569	15	4,205	106	
	PAT	6,527	5,056	29	3,366	94	
Sterlite	Revenues	37,832	52,332	(28)	68,110	(44)	55% and 23% Y-o-Y decline in zinc and aluminium prices to adversely impact EBITDA. Shutdown of copper smelter in November likely to result in lower sales.
	EBITDA	8,135	15,717	(48)	18,523	(56)	
	PAT	5,865	8,553	(31)	12,770	(54)	
Tata Steel	Revenues	55,792	49,739	12	68,515	(19)	Revenue expected to decline on reduced realisations and lower volumes in steel division and lackluster performance of ferroalloys division, which is expected to tickle down to EBITDA and PAT
	EBITDA	22,476	20,966	7	31,838	(29)	
	PAT	10,614	10,802	(2)	19,332	(45)	
Usha Martin	Revenues	7,952	5,552	43	8,064	(1)	Revenue expected to decline Q-o-Q on lower volumes, however, the impact of reduced realisations is less for ropes. EBITDA decline (Q-o-Q) expected due to increased cost
	EBITDA	910	960	(5)	1,696	(46)	
	PAT	250	417	(40)	838	(70)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Hindalco	Reduce	2,033	58	(6)	(19)	4.5	5.6	3.2	3.7	0.4	3.2	11
Hindustan Zinc	Buy	3,338	384	(26)	(3)	5.0	5.1	1.7	1.3	1.1	1.3	24
Jindal Steel & Power	Reduce	3,171	997	61	(8)	7.6	8.2	5.0	5.5	2.1	0.5	31
JSW	Reduce	944	245	(27)	(11)	3.9	4.4	5.3	6.4	0.5	6.5	15
Monnet Ispat	Reduce	174	172	69	(25)	3.3	4.4	2.8	2.7	0.7	2.9	25
Nalco	Sell	2,747	207	10	(10)	7.4	8.2	4.0	4.1	1.3	2.9	19
SAIL	Reduce	7,630	90	(22)	(74)	6.3	24.7	3.0	12.1	1.3	3.2	23
Sesa Goa	Reduce	1,551	96	51	(32)	3.2	4.7	1.3	1.3	1.5	3.1	59
Sterlite	Buy	4,391	302	(4)	37	5.0	3.6	3.1	2.1	0.8	1.1	18
Tata Steel	Reduce	3,689	246	16	(70)	2.3	7.8	2.8	3.3	0.5	5.3	23
Usha Martin	Reduce	154	30	11	(6)	4.4	4.8	4.2	3.6	0.8	2.6	19

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

OIL AND GAS

Weak outlook

January 7, 2009

Niraj Mansingka
+91-22-6623 3315
niraj.mansingka@edelcap.com

Ruchi Vora
+91-22-6623 3365
ruchi.vora@edelcap.com

Abhishek Agarwal
+91-22-4063 5417
abhishek.agarwal@edelcap.com

Key highlights of the sector during the quarter

WTI crude averaged USD 57.3/bbl for Q3FY09, a decline of 51.7% Q-o-Q and 37.1% Y-o-Y. A steep decline in product demand (leading to much increased OPEC spare capacity, despite production cuts) resulting from the global slowdown and financial turmoil, the depreciation of the USD against global currencies (particularly the euro), have led to this drastic fall in prices. Refining margins also continued their steep decline since July 2008 (simple margins for December 2008 turned negative), and the simple-complex refining spread contracted as well. Indian complex refining margins during Q3FY09 were at USD 5.53/bbl (USD 14.12/bbl in Q2FY09, USD 15.44/bbl in Q3FY08). Decline in refining margins were primarily due to correction in naphtha prices which plummeted due to destocking in petrochemicals resulting from a freeze in global trade. Gasoline demand too was weak, leading to only diesel and jet/kerosene offering value-addition to refiners. In petrochemicals, cracker margins fell Q-o-Q due to fall in off take of petrochemicals forcing crackers to cut operating rates globally. Similarly, margins for polyester intermediates were also impacted. However, margins of polymers were high, due to less correction in prices of petrochemicals compared to olefins (ethylene, propylene) and petrochemical feedstock (naphtha). Marketing under-recoveries currently exist only for LPG and kerosene, with the much-lowered crude prices pushing up gasoline and diesel into over-recovery (despite the INR 5/lt and INR 2/lt price cuts for them, respectively). Oilfield services (jack-ups and offshore supply vessels) are expected to weaken as global E&P capital spending takes a hit. This, coupled with incremental new supply, is expected to weaken industry environment. Consequently, we expect 18-20% day rate correction and lower asset values in CY09.

Result expectations for the sector and stocks under coverage

Reliance Industries' (RIL) profit is expected to dip 24% Q-o-Q primarily due to lower refining margins. Petrochemical margins are expected to be higher due to higher polymer and polyester margins, partially offset by lower cracker margins and sales volumes. Positive trigger of the commissioning of RPL refinery and expectations of the impending production of gas from the KG-D6 basin strengthen the stock, limiting downsides. ONGC is expected to report further reduction in net crude realisation from USD 54.7/bbl in Q3FY08 and USD 46.7/bbl in Q2FY09 to USD 40.6/bbl in Q3FY09. Oil marketing companies (IOCL, BPCL, and HPCL) are expected to post poor results due to a combination of lowered GRMs, huge inventory losses marginally offset by lower under-recoveries (lower crude prices in the latter half of the quarter providing over-recoveries to recoup some of the losses). Pure-play refiners like Chennai petroleum will be the worst-hit due to dual impact of weakened margins and inventory losses.

Outlook over the next 12 months

Over the next year, we expect less volatility and a slow recovery in crude price due to overhang of OPEC's spare capacity and lagged effect of production cuts. While we continue with our bearish outlook on refining in medium and long term, in a short term we expect marginal improvement in refining margins due to improvement in naphtha cracks as a consequence of resumption in global trade and demand pick-up of petrochemicals.

Recommendations

Top picks: Reliance Industries, Cairn.

Stocks to avoid: Chennai Petroleum, Aban Offshore.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
	Revenues	9,321	NA	NA	8,243	13	Aban's results are likely to be weak, as higher interest costs offset any marginal increase in revenues. Overhang of three uncontracted rigs remains. Also, high revenue drillship and semi-submersible (under refurbishment) are yet to be operationalised.
Aban Offshore	EBITDA	5,121	NA	NA	4,605	11	
	PAT	1,366	NA	NA	2,678	(49)	
	Revenues	292,390	289,284	1	378,507	(23)	Large inventory losses due to steep decline in crude prices, low core GRMs, overall under-recoveries, despite over-recovery for gasoline and diesel last month, price cuts overhang stock, increased fraction of GoI bonds in under-recovery sharing
BPCL	EBITDA	(21,038)	4,371	(581)	(21,430)	2	
	PAT	(24,538)	2,913	(942)	(26,253)	7	
	Revenues	1,927	2,667	(28)	3,206	(40)	Sharp decline in crude prices in Q3FY09 is expected to significantly reduce Cairn's crude realisations. Consequently, weak quarterly results expected. Forex gains likely on account of depreciation of INR on foreign deposits.
Cairn India	EBITDA	838	1,439	(42)	2,279	(63)	
	PAT	247	137	81	2,060	(88)	
	Revenues	49,517	70,609	(30)	102,833	(52)	Huge inventory losses, and low core GRMs, partially offset by rupee depreciation; very poor results expected
CPCL	EBITDA	(6,216)	4,112	(251)	(534)	(1,064)	
	PAT	(4,819)	2,256	(314)	(1,027)	(369)	
	Revenues	4,048	4,089	(1)	2,830	43	Working capital pressures; production volumes to be watched
Finolex	EBITDA	688	453	52	(77)	993	
	PAT	246	216	14	(218)	213	
	Revenues	183,752	271,170	(32)	355,221	(48)	Large inventory losses due to steep decline in crude prices, exacerbated by FIFO inventory valuation, low core GRMs, overall under-recoveries, despite over-recovery for gasoline and diesel last month, price cuts overhang stock, increased fraction of GoI bonds in under-recovery sharing
HPCL	EBITDA	(25,099)	1,481	(1,795)	(25,438)	1	
	PAT	(29,999)	(157)	(18,971)	(32,189)	7	
	Revenues	2,221	1,827	22	2,152	3	Growth rate in PNG & CNG connections. We have assumed 21% Y-o-Y growth in CNG volumes
IGL	EBITDA	878	780	13	851	3	
	PAT	518	450	15	502	3	
	Revenues	389,995	640,585	(39)	864,663	(55)	Large inventory losses due to steep decline in crude prices and high relatively higher inventory levels, core GRMs, overall under-recoveries despite over-recovery for gasoline and diesel in last month, price cuts overhang stock, increased fraction of GoI bonds in under-recovery sharing, larger fraction of LPG and SKO sales in total sales vis-a-vis other players increases under-recoveries
IOCL	EBITDA	(68,339)	29,675	(330)	(58,890)	(16)	
	PAT	(71,039)	20,907	(440)	(70,471)	(1)	
	Revenues	142,822	151,208	(6)	174,996	(18)	Sharp decline in crude prices in Q3FY09 is expected to dent ONGC's net crude and VAP realisations. Some respite from lower subsidy burden. Consequently, weak quarterly results expected.
ONGC	EBITDA	59,339	80,318	(26)	85,054	(30)	
	PAT	34,544	43,665	(21)	48,084	(28)	
	Revenues	240,304	345,900	(31)	447,870	(46)	Lower expected GRMs due to global lower marings and inventory losses; lower production of petrochemical due to lower demand. Marginal positive impact of start of KG basin crude production. Overall, weak quarterly results
RIL	EBITDA	53,174	58,330	(9)	64,740	(18)	
	PAT	31,223	80,790	(61)	41,220	(24)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
BPCL	Buy	2,670	359	(58)	211	18.8	6.0	8.7	3.0	1.0	0.2	5
Cairn India	Buy	7,103	182	2,810	393	52.4	10.6	35.8	8.3	1.1	0.0	2
Finolex	Reduce	83	33	(73)	363	20.9	4.5	5.4	2.2	0.8	9.2	4
HPCL	Buy	1,840	264	(76)	644	32.9	4.4	41.4	5.9	0.8	0.3	3
IGL	Buy	321	112	11	7	8.0	7.5	4.3	3.8	2.2	3.6	30
IOCL	Accumulate	10,337	422	(71)	122	21.5	9.7	10.6	6.7	1.1	1.4	5
CPCL	Reduce	398	130	(34)	(50)	2.6	5.2	3.4	5.7	0.5	11.5	20
ONGC	Buy	31,893	725	19	5	6.5	6.2	2.7	2.6	1.7	4.4	29
RIL	Buy	44,196	1,366	(1)	33	15.0	11.3	10.7	6.7	1.9	1.0	15

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

Edelweiss
Ideas create, values protect

PIPES

Muted growth

January 7, 2009

Niraj Mansingka
+91-22-6623 3315
niraj.mansingka@edelcap.com

Ruchi Vora
+91-22-6623 3365
ruchi.vora@edelcap.com

Key highlights of the sector during the quarter

- The INR has depreciated 11.4% Q-o-Q and 23.6% Y-o-Y against the USD. As most of the revenues for the pipe sector are from exports and margins are based in USD terms, companies were positively impacted.
- Raw material prices (HR coil and billet) have corrected in the quarter.
- While plate prices have not corrected as much as HR coil prices, we believe the same is likely in the next quarter due to lag effect.
- The quarter has been peculiar by the absence of orders, which we believe is due to credit pressures. We are now turning cautious on the visibility of order book for global pipe companies.
- Due to global slowdown, shipping freight has corrected significantly. This has resulted in lower demand for ships and vessels, which in turn has reduced raw material—steel plate—demand and its margins.

Result expectations for the sector and stocks under coverage

We expect pipe sales volumes to moderate for most companies, as credit tightness continues to limit order execution. However, company order book adds some comfort on the quarter numbers.

We expect pipe company's top line and bottom line to be supported by realisation based on past orders (except for Maharashtra Seamless). Consequently, we expect a flattish to positive growth in revenues for companies.

Interest expenses are expected to be higher due to working capital pressures.

Outlook over the next 12 months

While Indian companies are well placed to take advantage of higher capacity share globally, we are currently turning cautious due to expectation of cut in spending by global oil & gas firms.

With a possible slowdown in global demand for pipelines, there may be some margin pressures in the industry. Further, with the collapse of shipping freight rates, the advantage of having a capacity in the high demand market like the US has been nullified. These could potentially ease margins in high demand markets like the US.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Jindal Saw	Revenues	14,744	16,116	(9)	14,855	(1)	Sales volumes are likely to be maintained on a Q-o-Q basis. However, EBITDA margins expected to be lower as yearly adjustments are made in Q4CY08 and ductile iron prices correct. Interest expenses likely to be higher, expenditure is capitalised.
	EBITDA	1,590	1,996	(20)	1,987	(20)	
	PAT	819	5,738	(86)	1,261	(35)	
Maharashtra Seamless	Revenues	5,607	3,770	49	6,022	(7)	Lower Q-o-Q sales volumes for seamless pipes (limited order book) and flat ERW sales. EBITDA margins are expected to decline due to pressure across the industry.
	EBITDA	839	686	22	886	(5)	
	PAT	830	512	62	899	(8)	
Man Inds	Revenues	4,583	4,137	11	3,766	22	Higher volumes likely in Q3FY09 (seasonality). However, EBITDA margins (USD/MT) are expected to moderate.
	EBITDA	511	482	6	438	17	
	PAT	210	207	1	197	6	
PSL	Revenues	9,377	6,207	51	6,438	46	We expect higher sales volumes in Q3FY09, as company executes its INR 60 bn order book. EBITDA margins are expected to be flat in terms of percentage due to large proportion of domestic orders.
	EBITDA	716	519	38	487	47	
	PAT	340	302	12	216	57	
Welspun Gujarat	Revenues	14,923	10,364	44	14,928	(0)	Expect flat sales volumes trend, as higher shipments in Q2FY09 are likely to be balanced by incremental plate production from HSAW plant October 2008 onwards. EBITDA margins (USD/MT) are likely to be lower. Potential for forex losses (net account payables/ECB).
	EBITDA	2,416	1,741	39	2,453	(2)	
	PAT	1,148	974	18	1,537	(25)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Jindal Saw	Buy	273	255	(24)	35	4.2	3.4	3.0	1.9	0.6	2.7	15
Man Inds	Buy	49	45	1	63	4.5	2.8	1.8	0.2	0.8	3.4	18
Maharashtra Seamless	Accumulate	243	168	6	4	5.2	5.0	3.7	3.4	0.9	3.0	19
PSL	Buy	81	92	60	61	3.0	1.8	3.5	3.4	0.6	5.4	21
Welspun Gujarat	Accumulate	454	119	28	23	5.1	4.2	4.0	3.0	1.1	1.7	24

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

Edelweiss

Ideas create, values protect

POWER

Business as usual

January 7, 2009

Shankar K
+91-22-4040 7412
shankar.k@edelcap.com

Shashikiran Rao
+91-22-4040 7581
shashikiran.rao@edelcap.com

Abhishek Bhandari
+91-22-4063 5496
abhishek.bhandari@edelcap.com

Key highlights of the sector during the quarter

The third quarter is important for power utilities with respect to achieving annual targets. During the three months (October–December) post the monsoons and annual maintenance, power plants run at maximum capacities. Of the total financial year earnings, Q3 contributes ~25%, while Q1 accounts for the maximum at 35-37%.

Result expectations for the sector and stocks under coverage

For Q3FY09, we expect all major players to report high revenue growth but flat earnings growth. As in Q2, revenues are likely to continue to grow on the back of rising fuel prices, but since it's a pass-through under the regulated scenario, their net profits are unlikely to be affected by rising fuel prices. NTPC is likely to report earnings growth primarily on the back of commercial capacity addition to the extent of 500 MW even though PLF will be marginally lower. Power Grid Corporation of India is expected to post decent Y-o-Y growth, but sequential growth is likely to be muted as there has not been any significant capacity addition in the current quarter. Companies with surplus cash are likely to report higher other income (NTPC, Reliance Infra).

Outlook over the next 12 months

New norms to be announced by CERC will be the key development which will guide the sentiment for the sector in the short to medium term. While we believe it could have some positives, but overall there will not be any significant gains from the new norms.

Historically, project delays, fuel linkages, and exigencies have been plaguing capacity addition programmes in the sector. Going forward, we believe in addition to these factors, companies have to strive to achieve higher PLF, financial closure for capacity additions, and project deadlines within cost and time stipulation.

Events to watch out for in each of the stocks over the next one year:

NTPC: Delay in project execution and lower PLFs to impact earnings growth.

Power Grid: In Q4, orders for capacity addition are expected to be placed; clarity on future capex programme and PWGR's equity contribution will emerge.

Tata Power: Trombay project commissioning in Q4FY09; how equity gap for future projects is funded in the event of non-subscription of warrants by Tata Sons.

Reliance Infrastructure: Roll out of EPC projects based on Reliance Power projects pipeline would be decided. A couple of road BOT projects will commence operations.

CESC: Sustaining momentum to accomplish Budge Budge commissioning by Sept 09.

GIPCL: Cost overrun and reimbursements will be the key to maintain earnings.

Lanco Infratech: Successful commissioning of 300 MW Amarkantak project and securing milestone receipts from existing real estate customers will be key.

GVK & GMR: Gas supplies and approval of airport capex are key milestones.

Recommendations

Non-consensus call: Most of the stocks have run up sharply in recent times. We believe the sector will continue to underperform the broader market as there are greater concerns in the form of new norms, funding issues, capacity delays along with fuel issues which are likely to dampen earnings growth going forward.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Adani Enterprises	Revenues	58,698	53,362	10	43,823	34	
	EBITDA	2,834	1,603	77	1,103	157	
	PAT	1,208	1,004	20	475	154	
CESC	Revenues	7,476	6,760	11	7,550	(1)	Revenues and PAT expected to remain flat sequentially.
	EBITDA	1,375	1,550	(11)	1,870	(26)	
	PAT	871	930	(6)	833	5	
GIPCL	Revenues	2,845	2,428	17	2,911	(2)	Extraordinary expense of ~INR 50 mn expected due to fire in Surat plant. The unit was closed down in November leading to lower power generation.
	EBITDA	511	661	(23)	558	(8)	
	PAT	210	371	(43)	248	(15)	
GMR Infrastructure	Revenues	8,228	5,631	46	8,468	(3)	Revenues higher than Q3FY08 on account of Hyderabad airport becoming operational. Q-o-Q a marginal improvement in the EBITDA and PAT as the Mangalore plant will be operational for part of the quarter, and UDF for the Hyderabad Airport being collected for the entire month. However, lower revenues expected on account of lower fuel costs for the Chennai plant, which is pass-through as per tariff norms.
	EBITDA	2,616	1,781	47	2,471	6	
	PAT	657	641	3	385	71	
GVK Power and Infra	Revenues	1,198	1,033	16	1,095	9	EBITDA to be lower Y-o-Y on account of lower profits in the JP-I power project, partially balanced by the lower minority interest from the same project
	EBITDA	485	624	(22)	468	4	
	PAT	439	404	9	444	(1)	
Lanco Infratech	Revenues	13,025	7,782	67	12,789	2	The company is likely to have a gain on sale of biogas-fired projects. The extraordinary loss would be in the range of ~INR 400 mn
	EBITDA	2,388	1,750	36	1,978	21	
	PAT	877	825	6	774	13	
NTPC	Revenues	106,089	85,774	24	96,614	10	No capacity addition this quarter. Kahlagon 500 MW which was commissioned in August 2008 was functional for full quarter.
	EBITDA	23,526	22,127	6	25,476	(8)	
	PAT	19,437	19,755	(2)	18,274	6	
Power Grid	Revenues	16,373	10,858	51	15,877	3	Capex of ~INR 25,000 mn done in this quarter. Profits to remain flat Q-o-Q.
	EBITDA	14,031	8,867	58	13,569	3	
	PAT	4,440	3,783	17	4,426	0	
Reliance Infra.	Revenues	31,635	13,983	126	24,316	30	Profits from power business to remain stable. EPC order book execution assumed around INR 800 mn.
	EBITDA	2,399	741	224	2,772	(13)	
	PAT	2,506	2,121	18	2,188	15	
Tata Power	Revenues	21,287	14,194	50	19,589	9	Revenues to rise due to the pass-through of higher costs of imported coal. PAT to remain flat as no new capacities have been commissioned in this quarter. Trombay 250 MW expansion expected in Q4FY09E.
	EBITDA	3,831	2,682	43	2,647	45	
	PAT	1,705	1,520	12	1,779	(4)	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Adani Enterprises	Buy	1,769	349	46	64	17.1	10.4	7.4	4.9	2.6	0.6	38
CESC	Buy	685	267	5	16	9.0	7.7	7.7	7.6	1.0	1.6	12
GIPCL	Accumulate	171	55	(40)	42	11.6	8.2	11.5	4.6	0.7	2.2	6
GMR Infrastructure	Accumulate	3,128	84	35	49	53.8	36.2	25.5	20.1	2.4	0.0	5
GVK Power and Infra	Accumulate	694	24	31	56	19.0	12.2	36.1	12.6	1.4	0.0	8
Lanco Infratech	Buy	793	173	27	52	8.5	5.6	7.9	6.9	1.7	0.0	22
NTPC	Accumulate	30,651	181	11	8	17.8	16.4	14.2	13.1	2.6	2.2	15
Power Grid	Accumulate	7,135	82	15	18	20.1	17.0	12.6	10.8	2.3	1.2	12
Reliance Infra.	Accumulate	3,179	667	52	14	13.2	11.5	12.8	10.6	1.3	1.2	10
Tata Power	Accumulate	3,791	833	13	8	30.0	27.7	17.0	17.6	2.2	1.4	8

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

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REAL ESTATE

Still in the woods

January 7, 2009

Aashiesh Agarwaal
+91-22-4063 5491
aashiesh.agarwaal@edelcap.com

Akshit Shah
+91-22-4063 5407
akshit.shah@edelcap.com

Key highlights of the sector during the quarter

During the last quarter, volumes dried up significantly on the back of a negative environment. While some developers announced the intention of launching mass housing projects, they appear to be reluctant to cut list prices to the extent required.

The government had introduced a stimulus package for the economy and for real estate. The package includes 100bps reduction in repo rate, allowing restructuring of real estate loans by banks, treating bank loans to HFC as priority sector loans (for ticket size not exceeding INR 2 mn), and reduction in excise duty across the board. Though the package is a positive step, it is unlikely to help players in the listed space.

Currently, developers are expecting a few more sops from the government. The demand list includes increasing cap on loans for interest rate subvention, restoration of tax benefits, introducing a debt moratorium of one year, and raising the ceiling on deductions allowed for interest payments on home loans.

Result expectations for the sector and stocks under coverage

Very few developers have managed to clock fresh sales. While we expect revenue generation in H2FY09 to be weaker than in H1, margins may improve due to reduction in cost of raw materials.

DLF: We expect DLF's revenue and net profit to be INR 19,932 mn and INR 8,330 mn, respectively, with EBIDTA margin of 69%.

Orbit: The high end property market has dried up completely and we do not expect any fresh bookings. Revenues will be reported based on the progress on properties already transacted. We expect Orbit's revenue and net profit for the quarter to be INR 1,187 mn and INR 357 mn, respectively.

Outlook over the next 12 months

Going ahead, we expect a clear shift of focus of developers from the high end segment to affordable housing. Government's initiatives will ease the repayment pressure on developers. However, general confidence in the economy will be a demand determinant over the next one year.

Recommendations

Top picks: Orbit

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
DLF	Revenues	19,932	35,984	(45)	37,444	(47)	Additional recovery from debtors and quantum of fresh transaction are key things to look for
	EBITDA	13,783	25,014	(45)	22,170	(38)	
	PAT	8,330	21,450	(61)	19,354	(57)	
Orbit Corporation	Revenues	1,187	2,236	(47)	738	61	Additional recovery from debtors and quantum of fresh transaction are key things to look for
	EBITDA	597	752	(21)	356	68	
	PAT	357	551	(35)	137	160	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
DLF	Reduce	10,374	296	(28)	8	8.9	8.3	8.5	7.7	1.7	1.3	23
Orbit Corporation	Buy	52	69	(64)	48	3.7	2.5	4.8	3.4	0.5	2.8	15

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

RETAIL

Fighting for footfalls

January 7, 2009

Priya Ayyar
+91-22-4063 5413
priya.ayyar@edelcap.com

Key highlights of the sector during the quarter

The quarter saw the first signs of consumers tightening their purse strings with the festive season sales falling below retailer expectations. The Dusserah-Diwali festive season that usually kicks off a fortnight in advance picked up only four to five days before the festivals. Though sales were good, most retailers believe there are signs of consumers getting cautious on big ticket and non essential spends. They have consciously been churning their merchandise mix to include fast moving goods and private labels. They have also been aggressive on promotional activities, discounting, and cross branding to reap maximum consumer spend. A combination of the global slowdown and the terror attacks kept many consumers away from stores in October and November. However, Xmas sales have been much better and many retailers have recorded a sharp pick up in sales and footfalls.

Result expectations for the sector and stocks under coverage

We expect value retailers with scale like Pantaloon Retail India (PRIL) to report better growth than lifestyle players like Shoppers Stop (SSL). Same store sales growth for all companies, especially life style retailers, has been under pressure and we expect this to impact revenues in the quarter. PRIL's same store sales growth has been in the 13-14% range, which, though lower than in FY08, is an improvement over the past few months. On the margin front, we expect PRIL's margins to improve on account of lower input costs and operational efficiencies. Interest costs, however, will impact net margins. We expect the pressure on SSL's margins to continue. The company had two large store openings towards the end of the quarter and this will impact profitability. Aggressive promotions are likely to impact gross margins. We expect PRIL to post revenue growth of 47% Y-o-Y and a PAT growth of 26% Y-o-Y. SS is likely to post revenue growth of 25%, primarily due to higher pricing and same store sales. Losses at the net level will continue. However, we expect profits at the EBITDA level due to softening of most input costs.

Outlook over the next 12 months

We believe the next twelve to eighteen months will be a challenge for retailers and this will test the resilience of their business model and operational efficiency. Retailers who can continue to attract consumers with attractive discounts and maintain efficiencies in the system will emerge winners. We expect value retailers like PRIL to fare better. With developers and retailers facing liquidity problems we expect store roll outs to slowdown and closures of unviable stores to gather pace. However, cost savings from cheaper inputs, lower rentals, cheaper procurement and higher share of private labels will emerge.

Recommendations

Top picks: Pantaloon Retail.

Q3FY09 result expectations

Stock		Q3FY09E	Q3FY08	Y-o-Y	Q2FY09	Q-o-Q	Key highlights and things to watch out for
		INR mn	INR mn	%	INR mn	%	
Pantaloon Retail	Revenues	18,059	12,268	47	15,112	20	Revenue growth will be helathy with good festive season sales and the shopping festival launched in December. Margin improvement will continue with lower salary hikes and softening of input costs. Interets costs to impact net margins.
	EBITDA	1,698	1,096	55	1,549	10	
	PAT	411	317	30	362	14	
Shoppers Stop	Revenues	4,069	3,266	25	3,601	13	Revenue growth likely to he healthy with good festive season sales and aggressive promotions. Addition of two large stores at the end of the quarter could impact margins. Lower employee and administrative costs could provide some margin buffer.
	EBITDA	65	146	(55)	(63)	203	
	PAT	(112)	8	(1,433)	(183)	39	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Pantaloon Retail	Buy	774	236	20	42	26.6	18.8	9.4	8.3	1.2	0.2	6
Shoppers Stop	Sell	120	168	(1,933)	23	NM	NM	23.3	15.5	2.6	0.9	(19)

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

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TELECOM

Robust growth

January 7, 2009

Devyani Javeri
+91-22-6623 3360
devyani.javeri@edelcap.com

Key highlights of the sector during the quarter

We expect robust wireless subscriber growth of ~30 mn in Q3FY09 and subscriber base at ~345 mn (up ~9% Q-o-Q). We expect ~2-3% Q-o-Q decline in mobility ARPUs primarily owing to lower tariffs as the competition intensifies with new circle launches by incumbents like Idea and Vodafone. Idea launched its services in Mumbai and Bihar and captured an impressive ~19% and ~11% share of wireless net adds, respectively, (Oct-Nov 2008). Vodafone Essar launched its services in Bihar and Madhya Pradesh and captured ~5.6% and ~3% of wireless net adds, respectively, (Oct-Nov 2008). The Department of Telecommunications (DoT) released its detailed information memorandum on 3G and BWA auction process in December. 3G auction is expected to commence January 2009-end. As per recent media reports, the auction reserve price for 3G and BWA spectrum may be doubled to INR 40.4 bn and INR 20.2 bn, respectively.

Result expectations for the sector and stocks under coverage

We expect revenue growth for telecos [Bharti Airtel (BHARTI) and Reliance Communications (RCOM)] to track robust subscriber growth; we estimate average ARPU decline of ~2.5% for BHARTI and ~3% for RCOM Q-o-Q. Consolidated operating margin for BHARTI and RCOM is expected to decline Q-o-Q owing to competitive pricing pressures in the mobility segment and full quarter impact of DTH services. Idea's operating margin is expected to dip Q-o-Q owing to its new circles launches in Mumbai and Bihar. Tata Communications is, however, expected to benefit from the INR depreciation versus the USD at the consolidated level, given that a significant portion of its revenue comes from its international subsidiaries. However, standalone numbers will depend on the accounting treatment for revenues/costs. For MTNL, we expect an EBIT loss during the quarter, though non-operating income will continue to aid the bottom line. Tulip Telecom's NI and IP VPN revenues are expected to grow at a robust pace Q-o-Q, given that Q3 is a seasonally strong quarter.

Outlook over the next 12 months

We expect accelerated subscriber growth over FY09-10, given the low telecom penetration level of ~31% in India and rising income levels. We estimate Indian wireless subscribers to grow at 33% CAGR over FY08-10 to 463 mn. Wireless operating metrics will, however, remain under pressure in the medium term with increasing competition, addition of marginal customers and likely introduction of MNP in H1FY10. Capex intensity will increase with 3G and WiMAX network rollouts in the latter half of the year (as per DoT, 3G auctions are expected to commence January 2009-end). We prefer integrated pan-India telecos over pure-play wireless operators given their wider presence, larger scale of operations, and non-mobility businesses providing stability to overall profitability.

Recommendations

Top picks: Bharti Airtel, Tulip Telecom

Q3FY09 result expectations

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
BHARTI	Revenues	96,135	69,639	38	90,203	7	Estimate mobility ARPU decline of 2.5%, primarily led by lower tariffs, though strong subscriber accretion will drive revenue growth. Launch of DTH services during the quarter may impact operating margin. Expect forex losses owing to rupee depreciation, though quantum is likely to be lower in Q3 verus Q2
	EBITDA	38,888	29,634	31	36,993	5	
	PAT	21,973	17,224	28	20,463	7	
MTNL	Revenues	12,238	11,897	3	12,362	(1)	Revenues to remain flat Q-o-Q, owing to continued attrition of wireline subscribers and decline in mobility ARPU. Expect an EBIT loss during the quarter, though non-operating income will continue to aid the bottom-line
	EBITDA	1,855	1,817	2	1,874	(1)	
	PAT	987	976	1	921	7	
RCOM	Revenues	58,366	48,742	20	56,450	3	Estimate mobility ARPU decline of 3%, primarily led by lower tariffs, though strong subscriber accretion will drive revenue growth. Full quarter impact of DTH segment may impact operating margin. Uncertainty in derivative income is a risk to our net-profit estimates.
	EBITDA	23,661	21,065	12	23,016	3	
	PAT	13,546	13,952	(3)	15,308	(12)	
TTSL	Revenues	4,217	3,331	27	3,785	11	Q3 is a seasonally strong quarter - expect strong traction in both IP/VPN and NI businesses.
	EBITDA	934	687	36	798	17	
	PAT	615	541	14	492	25	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
BHARTI	Buy	26,759	686	20	24	16.2	13.1	9.1	7.4	4.3	0.0	31
MTNL	BUY	1,074	83	5	13	12.9	11.4	1.5	0.9	0.4	4.8	3
RCOM	Accumulate	11,195	264	(1)	(1)	10.7	10.8	7.8	6.8	1.6	0.4	16
TTSL	Buy	305	511	27	21	7.4	6.1	5.9	4.8	2.9	0.4	46

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

URBAN INFRASTRUTURE

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Visibility concerns

January 7, 2009

Priya Ayyar
+91-22-4063 5413
priya.ayyar@edelcap.com

Key highlights of the sector during the quarter

The heightened global concerns have resulted in poor growth visibility for all the companies. Most companies in the space have used the acquisition route to increase their growth pace and expand reach in their respective areas of operations. Foreign entities are facing the brunt of slowdown in developed nations. On the domestic front, though the impact of the slowdown was much lower, delays in orders and impact of slowdown in real estate development and housing was visible. Sharp cooling off of metal prices coupled with slower volume growth has led to accumulation of high cost inventory which could impact margins in the quarter.

Result expectations for the sector and stocks under coverage

We expect Havells India (Havells) to report revenue growth of 8% and PAT decline of 59% Y-o-Y due to the poor performance of Sylvania and the slowdown in the domestic construction industry.

Sintex Industries (Sintex) is likely to post revenue growth of 40% and PAT growth of 43%. The monolithic division, with an order book of INR 15 bn, is well placed to post strong growth. Consolidated margins may see some impact of new acquisitions, which operate at lower margins.

We expect MIC Electronics to post an 8% Y-o-Y growth in revenues and a 57% growth in profits on the back of the rising share of LED revenues. The supply of screens to Delhi Metro, domestic Out Of Home players, and perimeter boards to South America will drive revenues in the quarter.

Outlook over the next 12 months

The next one year will bring in cost savings for all companies with softening of crude and commodities. However, revenue growth will be difficult. With the global slowdown affecting (to a lesser extent) almost all segments in the country revenue visibility is bleak. Additionally, the burden of high interest cost could impact net margins. However, the long term opportunity remains robust with the strong growth in infrastructure spend in the country, which will provide attractive growth opportunities.

Recommendations

Top picks: Sintex Industries, MIC Electronics.

Q3FY09 result expectations

Stock		Q3FY09E INR mn	Q3FY08 INR mn	Y-o-Y %	Q2FY09 INR mn	Q-o-Q %	Key highlights and things to watch out for
Havells India	Revenues	14,473	13,413	8	14,353	1	Growth in its dometsic and international business will see some impact of the global slowdown. High cost inventory in the cables and wires divison is likely to impact profitability in the standalone business. The key thing to watch for will be the impact on volumes as a result of slowdown in housing and construction sectors.
	EBITDA	724	990	(27)	529	37	
	PAT	188	458	(59)	(250)	175	
MIC Electronics	Revenues	975	905	8	988	(1)	Revenue growth driven by execution of orders from Delhi Metro and dometsic OOH players. High margin lead business to drive overall margin expansion. Key thing to watch out will be the order accretion and pipeline from railways.
	EBITDA	288	197	46	311	(7)	
	PAT	240	153	57	256	(6)	
Sintex Industries	Revenues	8,562	6,128	40	7,198	19	The domestic business is expected to deliver helathy growth based on orders from the government and the monolithic business. The BT shelter division and the foreign subsidiaries with exposure to the sectors like auto will likey see some growth trouble. However, the liquidity position with cash of INR 17 bn on books is a positive.
	EBITDA	1,396	1,016	37	1,199	16	
	PAT	842	587	43	838	0	

Source: Edelweiss research

Valuation snapshot

Company	Reco	Mkt Cap	Price	PAT growth		P/E		EV/EBITDA		P/B	DY	ROE
		USD mn	INR	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E	FY09E
Sintex Industries	Buy	554	197	37	55	10.3	6.6	6.5	5.1	1.4	1.1	16
Havells India	Reduce	164	138	(1)	0	5.0	5.0	5.6	5.1	1.0	2.0	21
MIC Electronics	Buy	85	41	52	22	4.6	3.7	1.7	1.2	0.9	1.0	26

Source: Bloomberg, Edelweiss research

Note: Price as of January 5, 2009

Edelweiss Securities Limited, 14th Floor, Express Towers, Nariman Point, Mumbai – 400 021,
Board: (91-22) 2286 4400, Email: research@edelcap.com

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Ideas create, values protect

Naresh Kothari	Co-Head Institutional Equities	naresh.kothari@edelcap.com	+91 22 2286 4246
Vikas Khemani	Co-Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Shriram Iyer	Head Research	shriram.iyer@edelcap.com	+91 22 2286 4256

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	86	58	31	9	187

* 2 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	70	56	61

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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