ECB/FCCB Accounting

Research Analysts

Sanjay Mookim
9122 6777 3806
sanjay.mookim@credit-suisse.com

Nilesh Jasani
9122 6777 3720
nilesh.jasani@credit-suisse.com

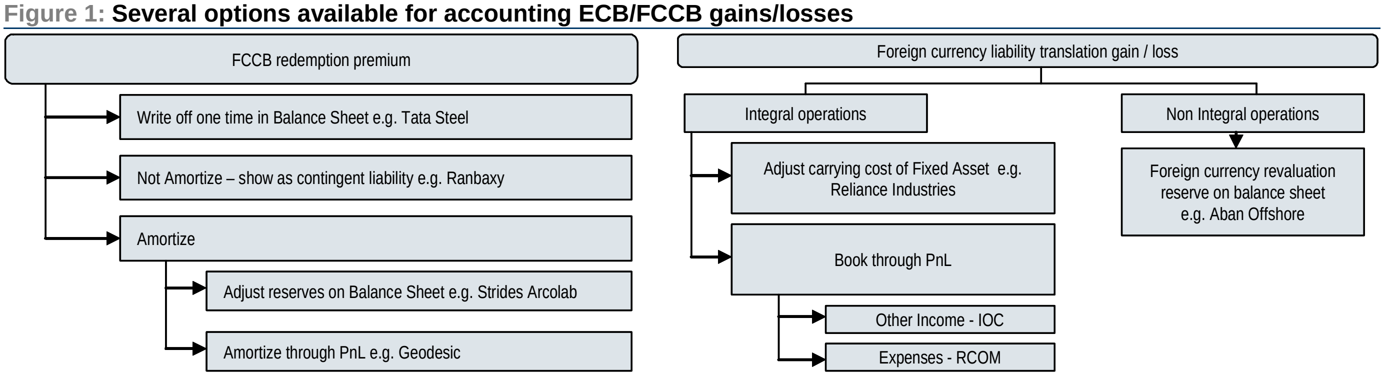
Rajasa K
91 22 6777 3932
rajasa.k@credit-suisse.com

STRATEGY

FY09 – look for losses in the balance sheet

- **With the rapid depreciation of the rupee, Indian companies with external liabilities (external commercial borrowing and foreign currency convertible bonds) face translation losses which on average are 12% of FY08 PBT. Stock price falls also mean that many FCCBs may not be converted, giving rise to a redemption premium debit. Some companies have not yet reported either of these. Risks of large one-time hits exist, although there is a higher chance of most not making it to the P&L.**
- **Indian accounting rules do not force companies to book translation losses/redemption premiums to the P&L. While many booked translation gains in FY08, quite a few are likely to switch policy to post losses straight in the balance sheet in FY09. FCCB redemption premiums can go straight to reserves. Detailed disclosure on loss amounts is also not mandated. This can cloud reported earnings and make comparisons tricky. In FY09, investors in companies with foreign debt should take a deeper look into balance sheets.**
- **Companies such as RCOM and HCC have already switched accounting policies for YTD FY09E and booked translation losses in the balance sheet. Aban, Essar Oil and Ispat Industries have large foreign debts compared to their PBT. Companies such as RCOM, NTPC, Reliance Infra and JPA have large foreign borrowings and rupee earnings.**
- **We believe concerns on the rollover of this external debt are low. Available rupee funding should keep Indian companies going. One-time losses generated need to be properly accounted for and disclosed, limiting valuation impact. Despite potential favourable regulations and improved availability, appetite for foreign debt is expected to be curbed by rupee depreciation. The future cost of capital is likely to increase.**

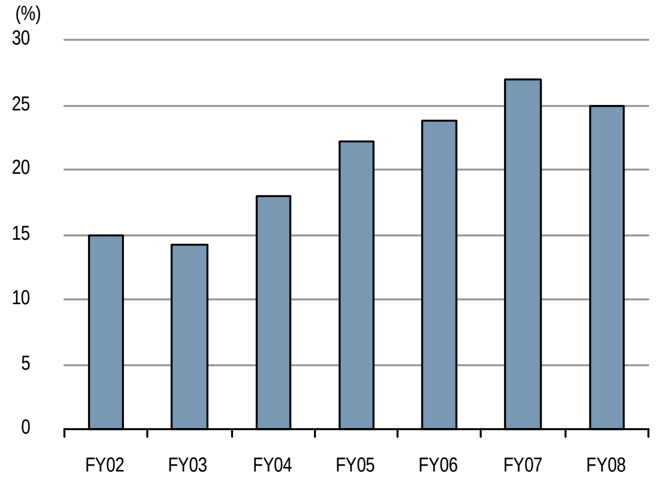
Figure 1: **Several options available for accounting ECB/FCCB gains/losses**



Source: Credit Suisse estimates

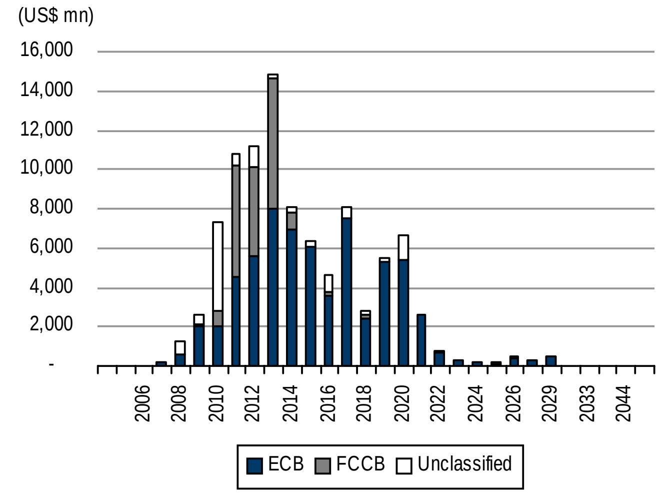
Focus charts and table

Figure 2: **Foreign currency debt has become an increasing source of finance for Indian companies**



Source: RBI, Credit Suisse estimates

Figure 3: **Repayment of foreign currency liabilities for Indian companies peaks in 2013E**



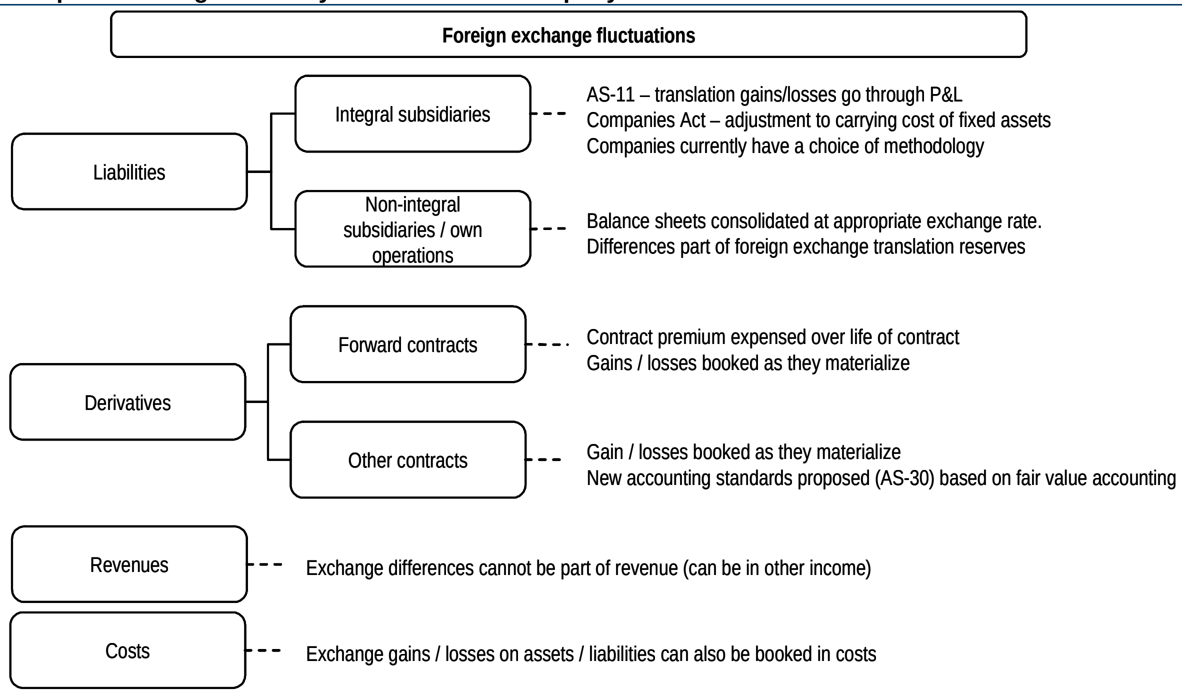
Source: RBI, Credit Suisse estimates

Figure 4: **Summary of companies surveyed**

	Number of companies	Not all translation gains in FY08 P&L	Average currency movement (%)	Potential translation impact % FY08 PBT
ECB	44	11	24.30	12
	Number of companies	**Redemption premium in P&L**	**Redemption premium in Contingent liability**	**CMP – Average discount to FCCB conversion**
FCCB	26	1	6	78

Source: Credit Suisse estimates

Figure 5: **Impact of foreign currency movements on company accounts**



Source: Credit Suisse estimates

FY09 – look for losses in the balance sheet

The rupee has depreciated 25% against the USD and 30% against the yen since March 2008. Foreign currency debt constitutes about 25% of total corporate India borrowings (up from 15% in 2002). Translation losses can be large – at current rates, about 12% of FY08 PBT. Some firms have also not accounted for FCCB redemption premiums. Indian firms with foreign debt now face large one-time losses. Ideally, these should be one-time deductions from valuations. However, the way companies disclose and account for these losses will determine valuation impact, in our view. Most translation gains were booked in the P&L in FY08 and received full multiples in a bull market. Firms may try to insulate P&L in FY09 and Indian accounting allows them to do this. ECB/FCCB translation losses can be booked to fixed assets and redemption premiums to reserves. Detailed disclosure is also not mandated, making comparisons/analysis difficult. Firms with large foreign debt and limited disclosure may consequently see some discount to valuations. In FY09, investors in companies with foreign debt should take a deeper look into balance sheets.

Rollover of foreign debt is not the issue

Indian corporate foreign currency debt as a proportion has risen from 15% in 2002 to 25% now. Repayment of the current stock of foreign debt peaks in 2013. Rollover, though, is unlikely to be an issue – available rupee debt should keep most companies going – with perhaps some implications for India's foreign reserves. Top-rated Indian companies should continue to get dollar funding. Yet, the appetite for foreign currency debt has been curbed by the recent rupee depreciation. Even with potential regulatory stimulus and lower global risk aversion, Indian companies may prefer rupee debt in future. As a result, the cost of funds is expected to increase.

Availability of foreign debt is limited now – repayment of old stock should not be an issue

Accounting of one-time losses is an issue

Large rupee depreciation and sharp stock price falls have created large losses on corporate India's ECBs/FCCBs. We estimate that total translation losses on current rates could be as high as 12% of FY08 PBT. Without currency and stock reversal, these are one-time cash losses. FCCB-related losses could also surprise. Of 26 companies we surveyed, only one has amortised FCCB redemption through its P&L; six have not even accounted for this in the balance sheet (and remain contingent liabilities). Most stock prices are now below conversion rates. This increases the chances of a large one-time hit on earnings (or book values).

Large one-time losses have been generated on foreign debt. Disclosure/accounting of these is an issue

International accounting standards require such losses go through the P&L. Indian rules, though, have more flexibility. How companies disclose and account for these losses can then determine valuation impact, in our view.

Indian rules can save the P&L

Ideally, these should be one-time deductions from valuations. Many companies, though, booked translation gains in the P&L in FY08; which have received full multiples in the bull market. Companies may now try to insulate P&L from these losses.

Lack of details on the currency impact can become a reason for a valuation discount

Indian accounting provides the means to do this. Translation gains/losses can be booked straight to the carrying costs of fixed assets (companies such as RCOM (RCOM IN, TP Rs260, CMP Rs187, U) and HCC (HCC IN, CMP 35, Not rated) have already changed policies in FY09). FCCB redemption premiums can be debited from securities premium accounts. Detailed disclosure of amounts is also not mandated. This can cloud reported earnings, make comparisons tricky and may become a reason for a valuation discount. In FY09, investors in firms with foreign debt should take a deeper look into balance sheets.

Companies with large foreign debt

Figure 6: **Companies with large foreign currency debt**

Company name	Revenue linked to dollar	Debt % of PBT (FY08)	FY08 translation gain (loss) % of PBT	Translation gains/losses in PNL (FY08)	Estimated FY09E loss % of FY08 PBT*	Translation gains/losses identifiable in 1Q-2Q FY09E
Asahi India Glass Ltd	N	5,786		N	1406	N
G H C L Ltd.	N	819		Y	199	Y
Moser Baer India Ltd	N	519	-11	Y/N	126	N
Havells India Ltd	N	435		Y	106	N
Sintex Industries Ltd	N	365		Y	89	N
Reliance Communications Ltd	N	301		Y	73	N
Jaiprakash Associates Ltd	N	295	9	Y	72	N
Adani Enterprises Ltd	N	277	171	N	67	N
Chambal Fertilisers & Chemicals Ltd	N	276	307	N	67	Y
Alok Industries Ltd	N	274	10	N	67	N
Reliance Infrastructure Ltd	N	273	9	Y	66	N
United Phosphorus Ltd	N	233		Y	57	N
Tata Motors Ltd	N	128		Y	31	Y
Jet Airways (India) Ltd	N	90	-1	N	-22	Y
N T P C Ltd	N	74	1	Y	18	Y
Mahindra & Mahindra Ltd	N	54		Y	13	Y
Grasim Industries Ltd	N	34		Y/N	8	N
Aban Offshore Ltd	Y	5,180		Y/N	1259	N
Essar Oil Ltd	Y	4,978		Y	1210	N
Ispat Industries Ltd	Y	2,585	-34	Y	628	Y
Reliance Natural Resources Ltd	Y	1,404		Y	341	N
Matrix Laboratories Ltd	Y	1,258		Y	306	N
Subex Ltd	Y	1,167	-63	Y	284	Y
Firstsource Solutions Ltd	Y	772	-78	Y	188	N
Hotel Leelaventure Ltd	Y	602		Y	146	Y
Hindalco Industries Ltd	Y	427		Y	104	N
Jubilant Organosys Ltd	Y	420		Y	102	Y
Bhushan Steel Ltd	Y	410	3	N	100	Y
Orchid Chemicals & Pharmaceuticals Ltd	Y	409		Y	99	Y
Mercator Lines Ltd	Y	385	0	Y	94	Y
Aurobindo Pharma Ltd	Y	351		Y	85	Y
Dr. Reddy's Laboratories Ltd	Y	339	13	Y	82	N
3I Infotech Ltd	Y	338		Y	82	N
J S L Ltd	Y	332	9	Y	81	Y
J S W Steel Ltd	Y	284		Y	69	Y
Bharat Forge Ltd	Y	216		Y	52	Y
Lupin Ltd	Y	174		Y	42	N
Bharat Petroleum Corp. Ltd	Y	129		Y	31	Y/N
Hindustan Petroleum Corp. Ltd	Y	118	7	Y/N	29	N
Jindal Steel & Power Ltd	Y	107	0	Y	26	Y
Indian Oil Corp. Ltd	Y	101	2	Y	25	Y/N
Tata Steel Ltd	Y	75		Y	18	Y
Reliance Industries Ltd	Y	52	0	N	13	Y
Wipro Ltd	Y	38		Y	9	N

** without factoring hedging activities*

Source: Company data, CMIE, Credit Suisse estimates

Rollover of foreign debt is not the issue

Indian corporate foreign currency debt as a proportion has risen from 15% in 2002 to 25% now. Repayment of the current stock of debt peaks in 2013. Rollover though is unlikely to be an issue – available rupee debt should keep most companies going – with implications for India's foreign reserves. Top-rated Indian firms should continue to get dollar funding.

Yet, appetite for foreign currency debt has been curbed by recent rupee depreciation. Even with potential regulatory stimulus and lower global risk aversion, Indian companies may prefer rupee debt in future. The cost of funds is therefore likely to increase.

Significant increase in foreign currency liabilities

Indian companies have been increasingly borrowing in foreign currencies. This has been facilitated by: 1) easing regulations, 2) an increasing risk appetite among foreign banks for Indian company exposure, 3) low headline foreign currency interest rates, 4) a stable currency and 5) increasing capex plans by Indian companies. As a consequence of all these, the proportion of foreign currency debt on corporate India balance sheet has risen from 15% in FY02 to about 25% now – on an increasing quantum of debt.

Most foreign currency debt is likely to be USD denominated

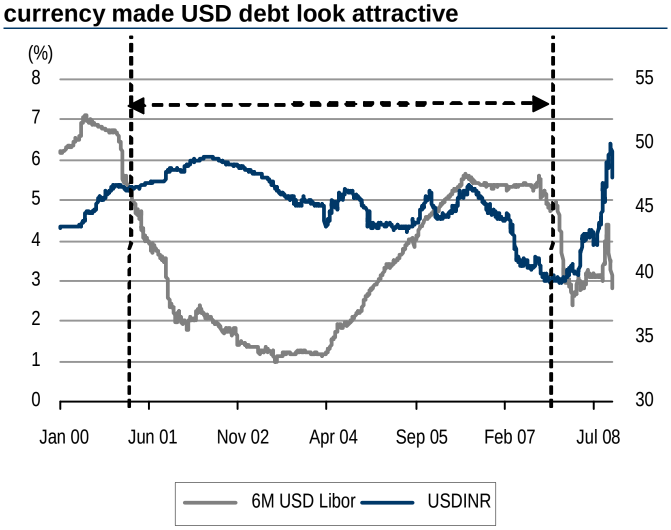
While exact data is difficult to obtain, most debt is likely to be denominated in the USD and JPY. Indian companies pay withholding tax on the absolute amount of interest remitted abroad. Low coupon rates for JPY loans encourage companies to maximise JPY borrowings – the low interest payments imply low withholding tax payments and reduce overall borrowing costs. The capacity of banks to lend, though, is highest for dollar-denominated debt, so most borrowing is actually likely to be USD denominated.

Most foreign debt likely to be floating-interest-rate based

Most of the debt is also likely to be in the form of syndicated bank lending or foreign currency convertible bonds (FCCB). Bank lending is typically floating rate, while the coupon on FCCB can be fixed. Due to stringent reporting requirements and tax disadvantages, few Indian companies have issued fixed rate bonds in foreign currencies.

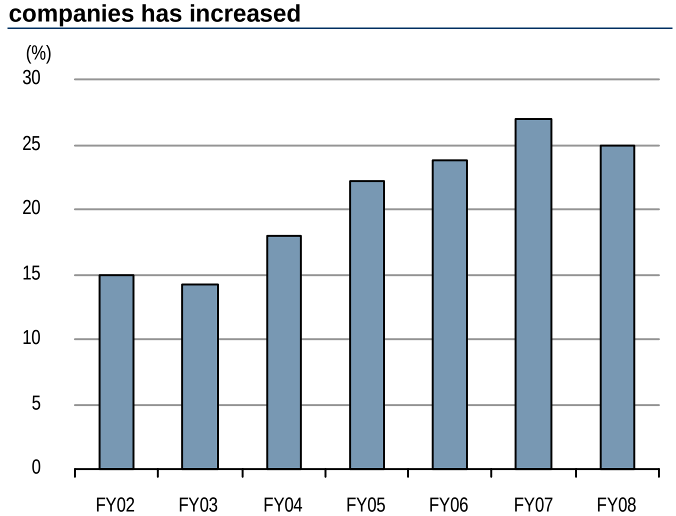
While regulation may remain favourable, other factors driving foreign currency borrowing have changed. The rupee has become more volatile and global risk appetites have increased. Capex could also slow into the downturn.

Figure 7: **Low absolute interest rates and an appreciating currency made USD debt look attractive**



Source: Bloomberg, Credit Suisse estimates

Figure 8: **Proportion of foreign currency debt for Indian companies has increased**

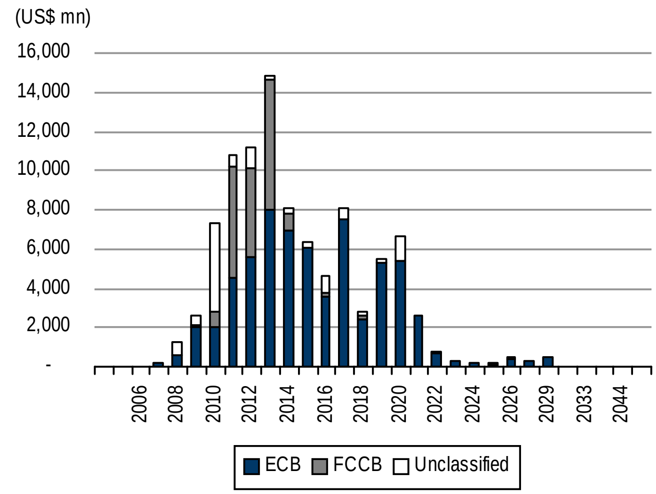


Source: CMIE, Credit Suisse estimates

Repayment peaks 2 to 4 years from now

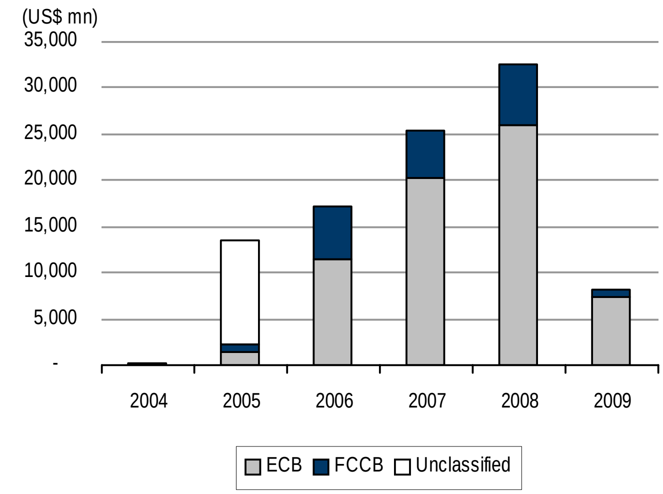
Corporate India foreign debt repayment peaks two to four years from now. The data available from the RBI is gross (and does not factor in re-financing or early repayments). We believe that is likely to be small – not much original repayment was due before FY10 and the RBI does not typically allow early repayment. Some longer dated borrowings (extending into 2030) are likely to be import credits (ECA financing), leases or lending between affiliates. Bank lines for such extended tenures are typically not available.

Figure 9: **Foreign currency repayment to peak in 2013**



Source: RBI, Credit Suisse estimates

Figure 10: **FY09 has seen significantly reduced foreign currency liability issuances**



Source: RBI, Credit Suisse estimates

Appetite for foreign borrowing may be low in future

In FY09 YTD, external borrowings have slowed sharply. From close to US$33 bn (ECB+FCCB) issued in FY08, only about US$8 bn has been issued to date. Issuance of FCCB has slowed more than for debt – understandable, given the equity market correction in early CY08.

Indian companies may no longer aggressively pursue foreign debt

Even if market conditions improve, Indian company appetite for foreign debt is likely to be lower in future. A stable currency is essential to estimate total borrowing costs but this may now be difficult to make. There may not be any rate advantage on a fully hedged basis. Over the past couple of years, Indian companies with foreign currency debt have reported low interest costs but this is likely to increase in future.

Rollover of this debt unlikely to be an issue

While there is a large amount of repayment due upfront, rollover is unlikely to be an issue. Top-tier Indian companies can continue to get foreign currency debt. Available rupee debt should also keep most companies going.

Accounting of one-time losses is an issue

Large rupee depreciation and sharp stock price falls have created large losses on corporate India ECBs/FCCBs. We estimate that total translation losses on current rates could be as high as 12% of FY08 PBT. Without currency and stock reversal, these are one-time cash losses. FCCB-related losses could also surprise. Of 26 companies, we surveyed, only one has amortised FCCB redemption through its P&L; six have not even accounted for this in their balance sheets (and remain contingent liabilities). Most stock prices are now below conversion rates. This increases the chances of a large one-time hit on earnings (or book values).

International accounting standards require such losses go through the P&L. Indian rules though have more flexibility. How companies disclose and account for these losses can then determine valuation impact, in our view

ECB/FCCB translation losses – large potential hit

Without currency appreciation, translation losses will be crystallised and represent an increase in borrowing costs

Depreciation of the rupee will have created large translation losses on the foreign currency debts of Indian companies. Without an exchange rate reversal, these are cash losses and increase borrowing costs for companies. We estimate below, the potential impact of rupee depreciation on the stock of foreign debt.

Most foreign currency borrowing by Indian companies is likely to be denominated in USD and JPY. To estimate the gross impact of the rupee depreciation, we construct a dollar-heavy theoretical basket of currencies.

Figure 11: **Composition of a theoretical basket**

	Weight (%)
USD	75
JPY	20
EUR	5
CHF	0

Source: Credit Suisse estimates

On current exchange rates, the rupee has depreciated 25% against the dollar since 31 March 2008 and 30% against JPY. With the Euro and the CHF also depreciating against the dollar, the EUR: INR and CHF: INR are almost flat.

Figure 12: **The rupee has so far depreciated most against the USD and JPY**

	FY07 - end	FY08 - end	FY09-current	FY08 vs FY07 (%)	FY09 vs FY08 (%)
USD: INR	43.48	40.12	49.99	8	-25
JPY: INR	0.37	0.40	0.52	-9	-30
EUR: INR	58.06	63.34	62.44	-9	1
CHF: INR	35.77	40.40	41.16	-13	-2
Theoretical basket				3.5	-24.3

Source: Bloomberg, Credit Suisse estimates

Assuming the 24.3% weighted average depreciation of the rupee to date, the Rs1.4 tn non-banking foreign currency debts with Indian companies would be worth Rs1.79 tn now. The consequent Rs349 bn increase in rupee liabilities represent about 12% of FY08 corporate India (non-banking) PBT.

Figure 13: Translation losses on the debt can be 12% of FY08 PBT

	End-FY08	Current (adjusted for rupee depreciation)	Difference
Total debt * (Rp mn)	1,438,365	1,787,792	349,427
Total debt (US$ mn)	35,853.81		
Total FY08 PBT * (Rp mn)			3,014,116
Percentage (%)			12

** Non-banking industries*

Source: CMIE, Credit Suisse estimates

FCCB redemption premiums another source of worry

Several Indian companies have also issued FCCBs. Redemption premiums for these bonds are interest expense and should appear in P&L – both IFRS and US GAAP require that they do. Indian accounting rules, though, do not specify a treatment. Almost all Indian firms have kept these costs out of P&L and consequently reported lower interest costs.

Redemption premiums are interest costs, but do not show up in Indian company P&L – inflating earnings

On average, stock prices are 78% below FCCB conversion prices. With redemption now more likely, these premiums should appear in P&L as interest expense. However, of 26 companies we surveyed, only one has amortised FCCB redemption through P&L; six have not even accounted for this in the balance sheet (and they remain contingent liabilities). For these, there is a risk of a one-time hit on earnings/net worth on redemption.

Figure 14: Most companies have not yet accounted for FCCB redemption premiums

Company	Redemption premium accounting policy
Reliance Communications Ltd	Amortise to securities premium
Ranbaxy Laboratories Ltd	Amortise to securities premium
JSW Steel Ltd	Amortise to securities premium
Jubilant Organosys Ltd	Amortise to securities premium
3i Infotech Ltd	Amortise to securities premium
Strides Arcolab Ltd	Amortise to securities premium
Jindal Saw Ltd	Amortise to securities premium
Hotel Leela venture	Amortise to securities premium
Moser Baer	Amortise to securities premium
Rolta India	Amortise to securities premium
Jaiprakash Associates Ltd	Appropriate profit to reserve
Aban Offshore	Appropriate profit to reserve
GTL Infrastructure Ltd	Contingent liability
Aurobindo Pharma Ltd	Contingent liability
Suzlon Energy Ltd	Contingent liability
Bharat Forge Ltd	Contingent liability
Educomp Solutions Ltd	Contingent liability
Amtek Auto	Contingent liability
Adani Enterprises	n.a.
Tata Steel Ltd	One time write-off to securities premium
Tata Motors Ltd	One time write-off to securities premium
Sintex Industries Ltd	One time write-off to securities premium
Firstsource Solutions Ltd	One time write-off to securities premium
Orchid Chemicals & Pharmaceuticals Ltd	One time write-off to securities premium
Mahindra & Mahindra Ltd	One time write-off to securities premium
Geodesic Information Systems Ltd	Through P & L

Source: Company data, Credit Suisse estimates

Figure 15: Most FCCB significantly out of money

	Issue currency	Issue amount (mn)	Current amount (Rs mn)	Maturity	Conversion price (Rs)	Redemption premium (%)	Effective conversion price (Rs)	Current market price (Rs)	Difference (%)
Reliance Communications Ltd	USD	500	297	May-11	480.68	125.84	605	192	315
	USD	1,000	990	Feb-12	661.23	127.69	844	192	440
Tata Steel Ltd.	USD	875	875	Sep-12	758.10	123.35	935	148.8	628
Jaiprakash Associates Ltd	USD	100	2	Feb-10	47.26	131.96	62	57.85	108
	EUR	165	9	Mar-13	111.75	132.07	148	57.85	255
	USD	400	396	Sep-12	247.76	147.70	366	57.85	633
Tata Motors Ltd	USD	100	0	Jul-08	250.75	116.82	293	128.6	228
	USD	100	4	Apr-09	573.11	95.11	545	128.6	424
	USD	300	300	Apr-11	780.40	121.78	950	128.6	739
	JPY	11,760	11,760	Mar-11	1,001.39	99.25	994	128.6	773
	USD	490	490	Jul-12	960.96	131.82	1,267	128.6	985
Ranbaxy Laboratories Ltd	USD	440	440	Mar-11	716.32	126.77	908	202.4	449
Sintex Industries Ltd	USD	225	223	Mar-13	580.00	129.28	750	168.7	444
JSW Steel Ltd	USD	325	324	Jun-12	953.40	142.80	1,361	175.25	777
GTL Infrastructure Ltd	USD	300	269	Nov-12	53.04	140.41	74	37.95	196
Jubilant Organosys Ltd	USD	200	200	May-11	413.45	142.43	589	117	503
	USD	75	61	May-10	273.06	138.38	378	117	323
	USD	35	0	Apr-09	163.65	113.70	186	117	159
Firstsource Solutions Ltd	USD	275	275	Nov-12	92.29	138.62	128	10.95	1,168
Aurobindo Pharma Ltd	USD	60	56	Aug-10	522.04	139.95	731	114.4	639
	USD	150	150	May-11	1,014.06	146.29	1,483	114.4	1,297
	USD	50	50	May-11	1,014.06	146.99	1,491	114.4	1,303
3i Infotech Ltd	USD	50	20	Mar-11	115.00	138.95	160	32.45	492
	EUR	15	-	Oct-11	95.00	138.95	132	32.45	407
	EUR	30	30	Apr-12	154.32	138.95	214	32.45	661
	USD	100	100	Jul-12	165.94	138.95	231	32.45	711
Suzlon Energy Ltd	USD	300	300	Jun-12	359.68	145.23	522	36.9	1,416
	USD	200	200	Oct-12	371.55	144.88	538	36.9	1,459
Orchid Chemicals & Pharmaceuticals	USD	175	175	Feb-12	348.34	142.77	497	82.4	604
	USD	43	20	Nov-10	243.80	147.77	360	82.4	437
Mahindra & Mahindra Ltd	USD	200	200	Mar-11	922.04	128.03	1,180	248.9	474
Bharat Forge Ltd	USD	60	44	Apr-10	336.11	126.12	424	83.9	505
	USD	60	60	Apr-10	384.12	129.15	496	83.9	591
	USD	40	40	Apr-12	604.03	133.82	808	83.9	963
	USD	40	40	Apr-13	690.32	137.01	946	83.9	1,127
Strides Arcolab Ltd	USD	40	40	Apr-10	358.70	136.78	491	98.25	499
	USD	100	100	Jun-12	461.55	145.06	670	98.25	681
Geodesic Information Systems Ltd	USD	125	125	Jan-13	302.27	138.38	418	59.5	703
Educomp Solutions Ltd	USD	80	80	Jul-12	2,949.83	141.09	4,162	2088.95	199
Jindal Saw Ltd	JPY	9,090	8,465	Jun-11	675.00	117.93	796	234.9	339
Aban Offshore	JPY	11,610	5,410	Apr-11	2,789.04	121.81	3,397	640.35	531
Adani Enterprises	USD	250	250	Jan-12	645.00	n.a.	n.a.	273	
Amtek Auto	USD	250	250	Jun-11	458.64	133.82	614	48	1,279
	USD	150	20	Jun-10	209.83	129.15	271	48	565
Hotel Leela venture	USD	100	100	Apr-12	72.00	146.61	106	17.8	593
	EUR	60	51	Aug-10	47.31	125.50	59	17.8	334
Moser Baer	USD	75	75	Jun-12	545.94	135.07	737	52.9	1,394
	USD	75	75	Jun-12	611.45	139.39	852	52.9	1,611
Rolta India	USD	150	150	Jun-12	368.70	139.39	514	156.9	328

Source: Company data, Credit Suisse estimates

How companies treat these one-time losses is important

Most companies booked translation gains in their P&L in FY08, which were accorded full multiples in a bull market. For some companies, the large one-time losses can erode a significant portion of FY09 reported EPS. There is then some incentive for companies to try to insulate P&L in FY09 and book translation losses/FCCB redemption premiums to the balance sheet. A detailed disclosure of the impact of exchange movements is also not mandated.

Indian firms are likely to continue with earlier disclosure (lack of) practices – which may become a reason for a valuation discount

We believe the issue of knowing the impact is perhaps as important as the size of the impact. Unfortunately, the disclosure track record of most Indian companies is not great, i.e. those who may continue to try to hide the impact in their balance sheets. As a result, the uncertainty around foreign currency impact on company accounts could become a reason for a valuation discount.

Indian rules can save the P&L

Ideally, these losses should be one-time deductions from valuations. Many companies though, have booked translation gains in their P&L in FY08, which received full multiples in the bull market. Companies may now try to insulate their P&L from these losses.

Indian accounting provides the means to do this. Translation gains/losses can be booked straight to the carrying costs of fixed assets (Companies, such as RCOM and HCC, have already changed policies in FY09). FCCB redemption premiums can be debited from securities premium accounts. Detailed disclosure of amounts is also not mandated. This can cloud reported earnings, make comparisons tricky and may become a reason for a valuation discount. In FY09, investors in companies with foreign debt should take a deeper look into balance sheets.

Accounting for impact on stock – liabilities

Exchange rate movements increase/decrease the amount of rupees needed to repay foreign currency liabilities on company balance sheets. Longer term liabilities in large amounts are also difficult to hedge (the costs of hedging may be significant).

Accounting for changes in the rupee value of foreign debt is also not uniform across companies. The accounting standard AS-11 defines treatment of translation losses in two categories:

> *"Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise"*

> *"Non-integral foreign operation is a foreign operation that is not an integral foreign operation"*

For example, a foreign operation whose majority sales are from the reporting entity/remits proceeds to the reporting entity would be considered an integral foreign operation.

Translation losses on non-integral subsidiaries don't go through P&L

In consolidating the foreign assets and liabilities of non-integral operations, the assets and liabilities are translated at the closing exchange rate. Resulting exchange differences are accumulated in a foreign currency translation reserve on the balance sheet of the consolidated accounts until the disposal of the investment in the operations. For example, Aban Offshore (ABAN IN, TP Rs1,261, CMP Rs645, O) when consolidating its foreign operations (Aban Singapore) follows this method (It booked some translation loss in the P&L due to consolidation among subsidiaries of Aban Singapore (not listed)

AS-11 requires companies to account for translation gains/losses on integral operations in the Profit and Loss account. (It is not necessary for companies though to individually report the exact translation amount booked.)

The Indian Companies Act allows companies to book translation losses in the balance sheet

Schedule VI of the Companies Act, however, is at variance -

> *"…In consequence of a change in the rate of exchange at any time after the acquisition of such asset, there has been an increase or reduction in the liability of the company, as expressed in Indian currency, for making payment towards the whole or a part of the cost of the asset or for repayment of the whole or a part of moneys borrowed by the company from any person, directly or indirectly in any foreign currency specifically for the purpose of acquiring the asset (being in either case the liability existing immediately before the date on which the change in the rate of exchange takes effect), the amount by which the liability is so increased or reduced during the year, shall be added to, or, as the case may be deducted from the cost, and the amount arrived at after such addition or deduction shall be taken to be the cost of the fixed asset."*

Companies can, in accordance with the Companies Act, then, account for translation gains /losses in the carrying cost of fixed assets; without any immediate impact on the P&L. At this moment, companies following the Schedule VI interpretation are assumed to be in compliance with the Accounting Standards.

Most companies in India tend to take translation gains/losses through the P&L. We sampled companies that account for 85% of the total foreign currency debt outstanding). Of these only 11 indicated they book some or all translation gains/losses in the carrying costs of fixed assets – Reliance Industries (RIL IN, TP Rs1,969, CMP Rs1,069, N) being the largest.

FCCB redemption premiums can also go through balance sheet

While AS-16 (standard on borrowing costs) classifies amortisation of discounts/premiums as part of borrowings, the Companies Act allows redemption premiums to be directly written off against securities premium accounts in the balance sheet.

The Indian Companies Act also allows redemption premiums to be booked in the securities premium account on the balance sheet

> *"Application of premiums received on issue of shares*
>
> *(1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the securities premium account"; and the provisions of this Act relating to the reduction of the securities capital of a company shall, except as provided in this section, apply as if the securities premium account were paid-up securities capital of the company.*
>
> *(2) The securities premium account may, notwithstanding anything in sub-section (1), be applied by the company-*
>
> *…*
>
> *(d) In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company".*

Accounting for impact on flows

The export and import components of company operations are exposed to exchange rates when they report revenue and expenses in Indian rupees. The Indian Accounting Standard – AS-11 states –

> *"A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction"*

This means revenue from exports and costs of imports reported in company accounts is booked at the spot rates. Export-oriented companies will therefore see increase in reported top line numbers with a depreciating rupee even if they are completely hedged.

Most companies with significant currency exposure are likely to hedge their sales and costs forward. The impact of these hedges is recorded separately in the books and may or may not be separately disclosed. AS-11 also states that for forward exchange contracts that are not speculative in nature,

The impact of currency hedging typically appears below the EBITDA line for companies

> *"The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract."*
>
> *"Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change."*
>
> *"Any profit or loss on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period."*

These gains/losses on forward contracts are mostly booked as a part of Interest Costs, Other Income or as Other Expenses.

Of the 44 companies we sampled only seven accounted for exchange rate impact as part of expenses (the others put this in other income/finance charges/split between income and expenses) Details were not available for two companies.

Exporting companies are likely to see EBITDA benefit with depreciating rupee

The impact of revenue/cost ("flow") currency hedging is then below the EBITDA line for most companies. Exporting companies are then likely to report high EBITDA margins in FY09 due to the depreciating currency – meeting market expectations. Other than for IT companies, the market does not focus much on hedging policies of companies – those that have hedged forward are likely to report disappointing "other income" in FY09.

Only net impact seen in P&L

AS-11 requires companies to disclose the amount of exchange differences included in the net profit and loss for a period. Most companies though stop at that and do not provide a break-up of how much was due to translation of liabilities and how much was on forward contracts.

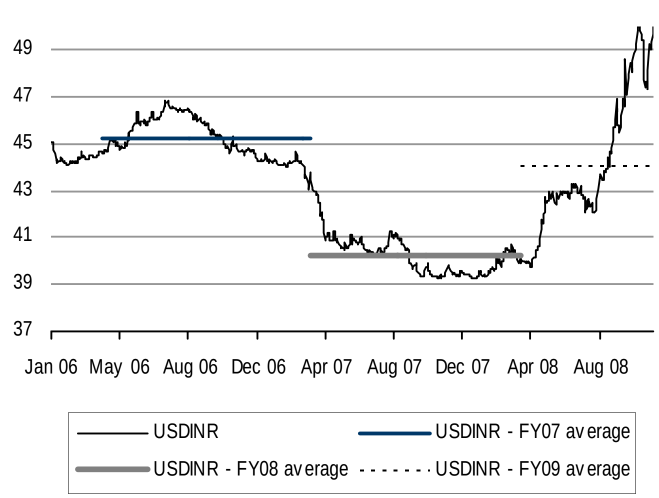
Detailed disclosure of currency impact not mandated – break-up of hedging and one-time losses may not be clear

One may argue that exchange rate entries due to hedging activities are part of a company's business operations and should be part of the operating profit while translation gains/losses are not. The lack of detail in most cases makes this difficult to segregate. Examining cash flow statements can provide a clue. Most companies deduct an amount from reported earnings to estimate operating profit for cash flow statements – essentially the amount of currency gains/losses they do not consider part of operating income. In our sample of 44 companies, this represented 4.2% of reported FY08 PBT.

Currency movements very sharp

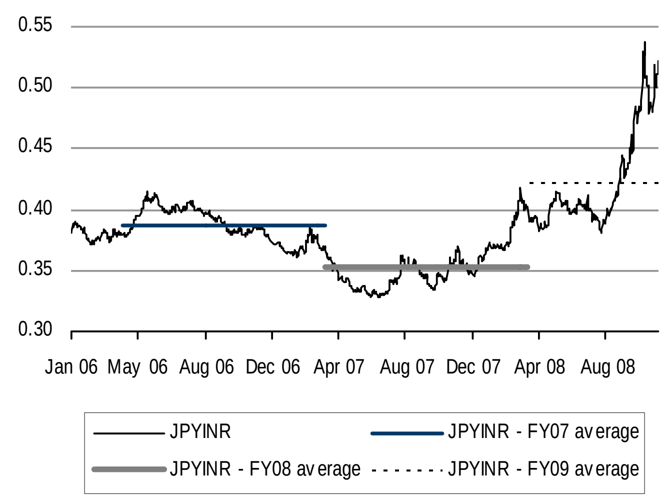
The Indian rupee has depreciated sharply against both the USD and JPY. While flow transactions are dependant on average rates, balance sheet entries depend on the closing currency rates. Both the USD and JPY have strengthened sharper than the averages imply – the percentage loss on liabilities is likely then to be more than the average currency gain on flows.

Figure 16: **While the dollar has not reversed all losses yet, the sharp current rise means it might do so**



Source: Bloomberg, Credit Suisse estimates

Figure 17: **Movement of the JPY YTD in FY09 has already eroded all gains made by the INR in FY08**



Source: Bloomberg, Credit Suisse estimates

Companies likely to switch policies and account for losses in the balance sheet

Most companies have, for the first three quarters of FY09, continued with their earlier policy of booking translation gains/losses in the P&L. Some companies – such as Reliance

Communications (RCOM IN, TP Rs260, CMP Rs187, U) and HCC (HCC IN, CMP Rs35, Not rated) – have switched and are now booking in the balance sheet. Pressure on full-year reported numbers may force more companies to follow suit.

Figure 18: Most companies have continued with their earlier accounting policy for translation gains/losses so far

	Booked in P&L? (Y/N)		
Company	**Mar-08**	**Jun-08**	**Sep-08**
Infosys Technologies	Y	Y	Y
JSW Steel	Y	Y	Y
Tata Steel	Y	Y	Y
Bharti Airtel	Y	Y	Y
Reliance Communication	Y	N	N
Idea Cellular	Y	Y	Y
Crompton Greaves	Y	Y	Y
Suzlon Energy	Y	Y	Y
Punj Lloyd		Y	Y
Mahindra & Mahindra		Y	Y
Tata Motors	Y	Y	Y
Bharat Forge Ltd	Y	Y	Y
Reliance Industries	N	N	N
Bharat Petroleum	Y	Y	Y
Cairn India	Y	Y	Y
IVRCL Infrastructures and Projects Ltd		Y	Y
Gammon India Ltd	Y	Y	Y
Simplex Infrastructures Ltd		Y	Y
India Cements	Y	Y	Y
Ranbaxy Laboratories	Y	Y	Y
Aurobindo Pharma	Y	Y	Y

Source: Company data, Credit Suisse estimates

Companies mentioned

Name of company	Bloomberg code	Mkt cap	Price as of 3 Dec 08	Rating	Target price
Asahi India Glass Ltd	AISG IN Equity	6,397	40	Not Rated	n.a.
G H C L Ltd.	GHCL IN Equity	2,405	24	Not Rated	n.a.
Moser Baer India Ltd	MBI IN Equity	8,908	53	Not Rated	n.a.
Havells India Ltd	HAVL IN Equity	6,200	107	Not Rated	n.a.
Sintex Industries Ltd	BVML IN Equity	22,488	165	Not Rated	n.a.
Reliance Communications Ltd	RCOM IN Equity	386,799	187	Underperform	260
Jaiprakash Associates Ltd	JPA IN Equity	73,925	62	Outperform	99
Adani Enterprises Ltd	ADE IN Equity	66,276	269	Not Rated	n.a.
Chambal Fertilisers & Chemicals Ltd	CHMB IN Equity	14,025	34	Not Rated	n.a.
Alok Industries Ltd	ALOK IN Equity	2,915	15	Not Rated	n.a.
Reliance Infrastructure Ltd	RELI IN Equity	117,586	507	Outperform	967
United Phosphorus Ltd	UNTP IN Equity	36,671	84	Not Rated	n.a.
Tata Motors Ltd	TTMT IN Equity	59,938	133	Outperform	746
Jet Airways (India) Ltd	JETIN IN Equity	11,064	128	Not Rated	n.a.
N T P C Ltd.	NATP IN Equity	1,310,617	159	Neutral	160
Mahindra & Mahindra Ltd.	MM IN Equity	62,885	243	Neutral	540
Grasim Industries Ltd	GRASIM IN Equity	83,254	908	Outperform	2,213
Aban Offshore Ltd	ABAN IN Equity	24,376	646	Outperform	1,261
Essar Oil Ltd	ESOIL IN Equity	90,237	75	Not Rated	n.a.
Ispat Industries Ltd	NDEN IN Equity	12,286	10	Not Rated	n.a.
Reliance Natural Resources Ltd	RNR IN Equity	66,877	41	Not Rated	n.a.
Matrix Laboratories Ltd	HDPH IN Equity	8,115	53	Not Rated	n.a.
Subex Ltd	SUBX IN Equity	1,040	30	Not Rated	n.a.
Firstsource Solutions Ltd	FSOL IN Equity	4,753	11	Not Rated	n.a.
Hotel Leelaventure Ltd	LELA IN Equity	6,801	18	Not Rated	n.a.
Hindalco Industries Ltd	HNDL IN Equity	86,629	51	Neutral	105
Jubilant Organosys Ltd	JOL IN Equity	17,056	116	Not Rated	n.a.
Bhushan Steel Ltd	BHUS IN Equity	15,186	358	Not Rated	n.a.
Orchid Chemicals & Pharmaceuticals Ltd	OCP IN Equity	5,713	81	Not Rated	n.a.
Mercator Lines Ltd	MRLN IN Equity	5,558	24	Not Rated	n.a.
Aurobindo Pharma Ltd	ARBP IN Equity	5,965	111	Outperform	550
Dr. Reddy's Laboratories Ltd	DRRD IN Equity	80,009	475	Outperform	810
3I Infotech Ltd	III IN Equity	4,439	34	Not Rated	n.a.
J S L Ltd	JDSL IN Equity	4,361	27	Not Rated	n.a.
J S W Steel Ltd	JSTL IN Equity	34,352	184	Outperform	350
Bharat Forge Ltd	BHFC IN Equity	18,302	82	Outperform	193
Lupin Ltd	LPC IN Equity	48,503	586	Neutral	620
Bharat Petroleum Corpn. Ltd	BPCL IN Equity	129,502	358	Outperform	408
Hindustan Petroleum Corpn. Ltd	HPCL IN Equity	80,610	238	Neutral	259
Jindal Steel & Power Ltd	JSP IN Equity	120,320	778	Not Rated	n.a.
Indian Oil Corpn. Ltd	IOCL IN Equity	472,359	396	Not Rated	n.a.
Tata Steel Ltd	TATA IN Equity	120,327	165	Outperform	320
Reliance Industries Ltd	RIL IN Equity	1,682,537	1,069	Neutral	1,969
Wipro Ltd	WPRO IN Equity	325,696	223	Underperform	330
Ranbaxy Laboratories Ltd	RBXY IN Equity	85,650	204	Outperform	220
GTL Infrastructure Ltd	GTLI IN Equity	28,329	37	Not Rated	n.a.
Tata Power Co.Ltd	TPWR IN Equity	143,470	648	Neutral	936
Suzlon Energy Ltd	SUEL IN Equity	56,411	38	Outperform	149
Bajaj Hindusthan Ltd	BJH IN Equity	5,791	41	Neutral	67
Strides Arcolab Limited	STR IN Equity	3,925	98	Not Rated	n.a.
Punj Lloyd Ltd	PUNJ IN Equity	43,413	143	Neutral	222
Geodesic Information Systems Ltd	BVH IN Equity	-	-	Not Rated	n.a.
Educomp Solutions Ltd	EDSL IN Equity	35,778	2,070	Outperform	2,700
Jindal Saw Ltd.	JSAW IN Equity	12,283	236	Neutral	470
Glenmark Pharmaceuticals Ltd	GNP IN Equity	79,634	318	Outperform	350
Infosys Technologies	INFO IN Equity	662,125	1,157	Neutral	1,400
Bharti Airtel	BHARTI IN Equity	1,260,408	664	Outperform	950
Idea Cellular	IDEA IN Equity	143,534	46	Outperform	60

Companies mentioned (continued)

Name of company	Bloomberg code	Mkt cap	Price as of 3 Dec 08	Rating	Target price
Crompton Greaves	CRG IN Equity	40,927	112	Neutral	208
Cairn India	CAIR IN Equity	255,464	135	Neutral	161
IVRCL Infrastructures and Projects Ltd	IVRC IN Equity	18,349	137	Outperform	265
Gammon India Ltd	GMON IN Equity	4,513	52	Neutral	128
Simplex Infrastructures Ltd	SINF IN Equity	6,310	128	Outperform	395
India Cements	ICEM IN Equity	23,861	85	Outperform	168
Hindustan Construction Company	HCC IN Equity	9,004	35	Not Rated	n.a.

Note: As on Dec 03, 2008

Source: Company data, Credit Suisse estimates

Disclosure Appendix

Important Global Disclosures

Sanjay Mookim & Nilesh Jasani each certify, with respect to the companies or securities that he or she analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities.

Analysts' stock ratings are defined as follows***:

Outperform (O): The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral (N): The stock's total return is expected to be in line with the industry average* (range of ±10%) over the next 12 months.

Underperform (U):** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

**The industry average refers to the average total return of the relevant country or regional index (except with respect to Europe, where stock ratings are relative to the analyst's industry coverage universe).*

***In an effort to achieve a more balanced distribution of stock ratings, the Firm has requested that analysts maintain at least 15% of their rated coverage universe as Underperform. This guideline is subject to change depending on several factors, including general market conditions.*

****For Australian and New Zealand stocks a 7.5% threshold replaces the 10% level in all three rating definitions, with a required equity return overlay applied.*

Restricted (R): In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

Volatility Indicator [V]: A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward.

Analysts' coverage universe weightings are distinct from analysts' stock ratings and are based on the expected performance of an analyst's coverage universe* versus the relevant broad market benchmark**:

Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

**An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

Credit Suisse's distribution of stock ratings (and banking clients) is:

	Global Ratings Distribution	
Outperform/Buy*	39%	(60% banking clients)
Neutral/Hold*	44%	(57% banking clients)
Underperform/Sell*	14%	(50% banking clients)
Restricted	2%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

Credit Suisse's policy is to update research reports as it deems appropriate, based on developments with the subject company, the sector or the market that may have a material impact on the research views or opinions stated herein.

Credit Suisse's policy is only to publish investment research that is impartial, independent, clear, fair and not misleading. For more detail please refer to Credit Suisse's Policies for Managing Conflicts of Interest in connection with Investment Research: http://www.csfb.com/research-and-analytics/disclaimer/managing_conflicts_disclaimer.html

Credit Suisse does not provide any tax advice. Any statement herein regarding any US federal tax is not intended or written to be used, and cannot be used, by any taxpayer for the purposes of avoiding any penalties.

Important Regional Disclosures

Restrictions on certain Canadian securities are indicated by the following abbreviations: NVS--Non-Voting shares; RVS--Restricted Voting Shares; SVS--Subordinate Voting Shares.

Individuals receiving this report from a Canadian investment dealer that is not affiliated with Credit Suisse should be advised that this report may not contain regulatory disclosures the non-affiliated Canadian investment dealer would be required to make if this were its own report.

For Credit Suisse Securities (Canada), Inc.'s policies and procedures regarding the dissemination of equity research, please visit http://www.csfb.com/legal_terms/canada_research_policy.shtml.

As of the date of this report, Credit Suisse acts as a market maker or liquidity provider in the equities securities that are the subject of this report.

Principal is not guaranteed in the case of equities because equity prices are variable.

Commission is the commission rate or the amount agreed with a customer when setting up an account or at anytime after that.

To the extent this is a report authored in whole or in part by a non-U.S. analyst and is made available in the U.S., the following are important disclosures regarding any non-U.S. analyst contributors:

The non-U.S. research analysts listed below (if any) are not registered/qualified as research analysts with FINRA. The non-U.S. research analysts listed below may not be associated persons of CSSU and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

- Sanjay Mookim, non-U.S. analyst, is a research analyst employed by Credit Suisse Securities (India) Private Limited.
- Nilesh Jasani, non-U.S. analyst, is a research analyst employed by Credit Suisse Securities (India) Private Limited.

Important MSCI Disclosures

The MSCI sourced information is the exclusive property of Morgan Stanley Capital International Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, re-disseminated or used to create any financial products, including any indices. This information is provided on an “as is” basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI, Morgan Stanley Capital International and the MSCI indexes are services marks of MSCI and its affiliates.

The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of Morgan Stanley Capital International Inc. and Standard & Poor’s. GICS is a service mark of MSCI and S&P and has been licensed for use by Credit Suisse.

For Credit Suisse disclosure information on other companies mentioned in this report, please visit the website at www.credit-suisse.com/researchdisclosures or call +1 (877) 291-2683.

Disclaimers continue on next page.

CREDIT SUISSE

CREDIT SUISSE (Hong Kong) Limited
Asia/Pacific: +852 2101-6000