



STRATEGY  
EQUITIES RESEARCH

# INDIA MARKET OUTLOOK

## WATCH OUT FOR THE FCCB



### SUMMARY

FCCBs offer opportunities for capital appreciation

Some foreign currency convertible bonds (FCCBs) are pricing in significant financial distress. We believe these FCCBs may offer good capital appreciation opportunities along with principal protection.



### CATALYST

Potential for capital appreciation when risk appetite recovers

As risk aversion wanes, we believe FCCBs may no longer price a 'bankruptcy' or significant principal haircuts, providing significant capital appreciation opportunities for investors.



### IMPLICATIONS

Stock selection is key

We highlight Reliance Comm, Suzlon, JP Associates, Videocon, Evrest Canto, Rolta, Great Offshore, Shiv Vani as 'safe' FCCBs trading at high YTM.

### BNPP TOP RECOMMENDATION

	BBG	Rating	Price	TP	P/E		P/BV
			(INR)	(INR)	FY12E	FY13E	FY12E
					(x)	(x)	(x)
Hindalco	HNDL IN	BUY	134	186	7.0	5.9	0.8
Bharti Airtel	BHARTI IN	BUY	375	470	21.3	13.0	2.6
GAIL India	GAIL IN	BUY	426	573	13.5	12.7	2.5
ONGC	ONGC IN	BUY	269	322	7.9	7.7	1.7
Larsen & Toubro	LT IN	BUY	1,370	1850	20.3	17.8	3.3

Source: BNP Paribas



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3 OCTOBER 2011

## Watch out for these FCCBs

In an earlier note (*Till debt do us part 18 July 2011*) we pointed out that non-conversion of Foreign Currency Convertible Bonds (FCCB) issued by Indian companies could lead to significant stress on the balance sheets of some of those companies. In this note we look at those FCCBs themselves – in particular, the yields they are trading at. This may sound surprising – we are, after all, equity analysts – but some of these FCCBs seem significantly undervalued, and hence, could generate significant capital appreciation going forward.

### EXHIBIT 1: FCCB

	Issue Date	Maturity Date	Yield to maturity	Conversion Price	CMP	Premium (Discount) to Conversion price
AKSH OPTIFIBRE	Jan-08	1/8/2013	295.7	67.9	6.05	-91%
ASSAM CO INDIA	Nov-06	Nov-11	217.4	28.6	10.8	-62%
GTL INFRASTRUCTRE	Nov-07	11/29/2012	94.4	60.2	12.45	-79%
STERLING BIOTECH	May-07	5/16/2012	81.6	173.2	71	-59%
SUBEX	Nov-09	3/9/2012	67.8	74.3	43.6	-41%
SUBEX AZURE	Mar-07	3/9/2012	56.5	663.7	43.6	-93%
PRIME FOCUS	Dec-07	12/13/2012	32.2	125.6	58.8	-53%
RELIANCE COMM	Feb-07	3/1/2012	26.1	668.3	73.2	-89%
ORCHID CHEM	Feb-07	2/28/2012	23.4	353.5	169.9	-52%
SUZLON ENERGY	Jun-07	10/11/2012	23.2	97.2	37.8	-61%
SUZLON ENERGY	Jun-07	6/12/2012	23.1	97.2	37.8	-61%
JAIPRAKASH ASSOCIATES	Sep-07	9/12/2012	22.4	182.5	75.7	-59%
GEODESIC	Jan-08	1/18/2013	22.5	344.4	52.1	-85%
SUZLON ENERGY	Jun-07	10/11/2012	21.6	68.6	37.8	-45%
SUZLON ENERGY	Jun-07	6/12/2012	20.8	68.6	37.8	-45%
VIDEOCON	Jul-06	12/16/2015	18.6	236.0	168.95	-28%
EVEREST KANTO	Oct-07	10/10/2012	17.9	303.6	72.4	-76%
GITANJALI GEMS	Nov-06	11/25/2011	16.9	218.6	346.15	58%
ROLTA INDIA	Jun-07	6/29/2012	16.5	403.4	82.9	-79%
GREAT OFFSHORE	Oct-07	10/12/2012	16.2	559.8	124.45	-78%
MAN INDUSTRIES	May-07	5/23/2012	14.1	124.6	130.75	5%
SUZLON ENERGY	Jun-07	7/25/2014	15.4	83.6	37.8	-55%
FIRSTSOURCE	Dec-07	12/4/2012	14.9	104.8	11.6	-89%
SHIV-VANI OIL	Jul-10	8/17/2015	14.5	488.2	195.9	-60%
SUZLON ENERGY	Jun-07	4/13/2016	14.0	54.0	37.8	-30%
JAIPRAKASH POWER	Feb-10	2/13/2015	13.0	82.9	35.1	-58%
TULIP IT SRVCS	Jul-07	8/26/2012	12.9	247.7	159.9	-35%
3I INFOTECH	Apr-07	7/27/2012	13.1	181.3	26.9	-85%
STRIDES ARCOLAB	Jun-07	6/27/2012	12.5	505.6	357.8	-29%
JSW STEEL	Jun-07	6/28/2012	12.5	1,055.2	612.05	-42%
PRAKASH INDUSTRIES	Oct-09	4/30/2015	11.5	236.3	52.7	-78%
CORE PROJECTS	May-07	5/7/2015	11.6	272.7	289.55	6%
WELSPUN GUJARAT	Oct-09	10/17/2014	11.1	278.5	41	-85%
FINANCIAL TECH	Dec-06	12/21/2011	10.1	2,357.9	842.95	-64%
SESA GOA	Oct-09	10/31/2014	8.9	322.2	196.35	-39%
FLEX INDUSTRIES	Mar-07	3/9/2012	8.6	145.2	144.45	0%
TATA POWER	Nov-09	11/21/2014	8.4	1,386.8	100	-93%
TATA MOTORS	Jul-07	7/12/2012	8.3	199.3	162.1	-19%
SINTEX	Mar-08	3/13/2013	8.0	271.1	134.85	-50%
BHARAT FORGE	Apr-06	4/28/2012	7.0	598.8	273.5	-54%
TATA STEEL	Sep-07	11/21/2014	6.8	581.1	431.6	-26%
BHARAT FORGE	Apr-06	4/28/2013	6.5	684.4	273.5	-60%
AMTEK AUTO	Sep-09	Sep-14	4.9	136.0	130.45	-4%
REI AGRO	Nov-09	11/13/2014	5.2	44.3	24.8	-44%
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TATA STEEL	Sep-07	9/5/2012	4.6	812.0	431.6	-47%
PIDILITE	Dec-07	12/7/2012	4.8	116.0	167	44%
LARSEN & TOUBRO	Oct-09	10/22/2014	2.8	1,817.0	1392.65	-23%
TATA MOTORS	Jul-07	10/16/2014	(0.7)	118.3	162.1	37%

Source: Bloomberg

We would particularly draw attention to the FCCB's of Reliance Comm, Suzlon Energy, JP Associates, Videocon Industries, Rolta India, Great Offshore. The bond market seems to be discounting a situation where these companies would default on their FCCB repayment commitments or force bondholders to

accept significant principal haircut. While such possibilities could arise for some companies, we believe that a majority of these companies are not potential defaulters.

### The safe FCCBs

The advantage of investing in a convertible bond (CB) is the principle protection it offers – only exception of course, is in case of bankruptcy. However, a defaulting company loses access to international capital markets. Most companies therefore, foresee liquidity problems and restructure their CBs in return for more favourable terms to bondholders, such as higher coupon payments. For example - Tata Steel rolled over its CB maturing in Sep 2012 to Nov 2014 and increased its coupon rate from 1% to 4.5%.

However, other companies may prefer to default either as a negotiating tactic - to get bondholders to accept haircuts – or because they do not intend to access international capital markets. In such instance, the only recourse for investors is through the slow and unpredictable Indian legal system. There are two such 'winding up' petitions against Wockhardt Pharmaceuticals and Cranes Software currently. This underscores the need to select appropriate FCCB's for investment.

From among the list, we have shortlisted companies that offer a good YTM - >15% - and may need to access the capital markets in the near future.

### EXHIBIT 2: CB

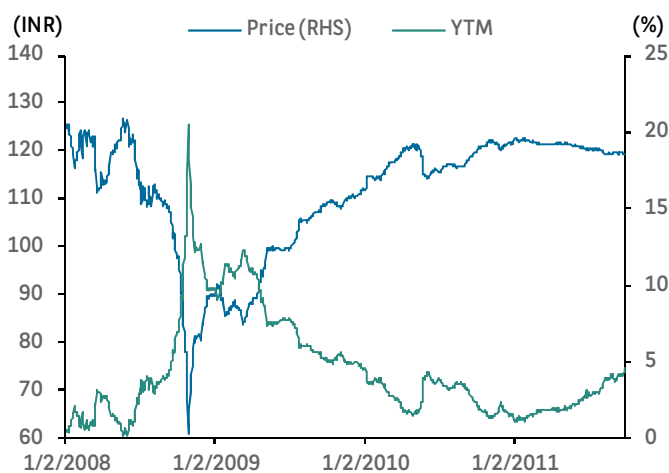
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Source: Bloomberg

### Does this strategy work?

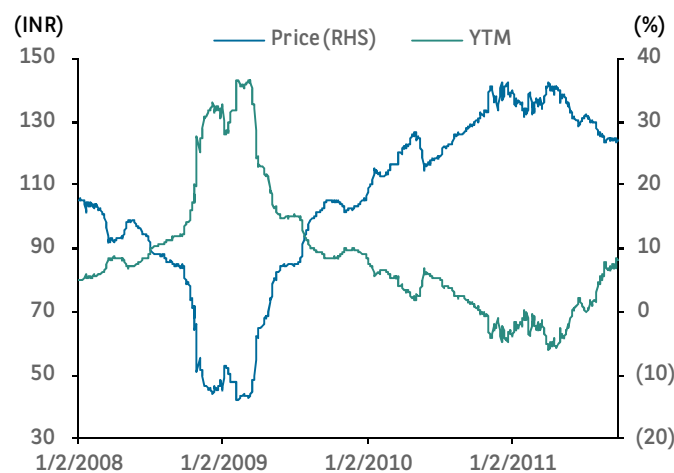
A similar situation arose in 2008 post the Lehman crisis. FCCBs of companies like Tata Motors and Tata Steel were trading at yields of 30% and 20% respectively. As the following charts show, an investor who bought those FCCB's would have made returns ranging from 100% to 150% over the past 3 year period. While these returns are lower than that of the common stock, it must be noted that convertible bonds are 'safer' than common stock as they occupy a more privileged position in a company's capital structure.

### EXHIBIT 3: Tata Steel CB



Source: Bloomberg

### EXHIBIT 4: Tata Motors CB



Source: Bloomberg

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-	-

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