

## FIRST CALL

India Equity Research

November 4, 2011

## CONTENTS

## Latest Research

- **Jubilant Foodworks** - Slowest growth in last seven quarters; Reduce
- **Karnataka Bank** - Profitability set to improve; Buy
- **Manappuram Finance** - Strong trajectory but return ratios vulnerable; Hold
- **Steel Authority of India** - Positive surprise on costs; Hold
- **Taj GVK Hotels & Resorts** - A mixed bag; Buy
- **Metals and Mining** - Aluminium: Strong demand to drive up prices
- **EdelFlash: Ashok Leyland** - Mixed bag performance
- **EdelFlash: Consumer Goods** - Pakistan: The new growth frontier?
- **EdelFlash: Telecom** - TRAI Recommendations – More liberal M&A policy
- **hEDGE** - The alternative insights monthly

## Analyst comments

**Sun TV Network:** Result update; Under review

## Regular Features

- Sales Trader's Commentary
- Insider Trades & Bulk Deals
- Technical Updates
- Eye Catchers

## Sectoral Movements

Ticker	% Change				
	3-Nov-11	1 D	1 M	3 M	1 Y
Banking	11,233	(0.1)	9.9	(6.7)	(24.9)
IT	6,170	(0.8)	11.4	0.2	(9.5)
Pharmaceuticals	6,138	(0.0)	6.4	(2.8)	(7.4)
Oil	9,055	1.1	9.3	3.3	(18.8)
Power	2,220	1.6	6.7	(8.2)	(30.3)
Auto	9,212	(0.4)	11.0	8.7	(10.0)
Metals	11,652	(0.3)	12.0	(13.0)	(33.3)
Real Estate	1,909	1.6	14.4	(2.1)	(48.7)
FMCG	4,173	(0.2)	9.8	4.9	12.8
Capital Goods	10,890	0.7	3.4	(12.7)	(34.7)

India	Change in %			
	3-Nov-11	1-d	1-mo	3-mo
Nifty	5,266	0.1	10.3	(1.2)
Sensex	17,482	0.1	10.2	(1.2)
CNX 500	4,180	0.2	8.7	(3.1)

Global Indices				
	3-Nov-11	1-d	1-mo	3-mo
DJIA	12,044	1.8	11.4	5.8
NASDAQ	2,698	2.2	12.2	5.5
Hang Seng	19,865	3.2	22.2	(9.2)
Nikkei 225	8,751	1.3	2.4	(9.2)

Net Inv (INR Bn)			
1-Nov-11	Buy	Sell	Net
FII Cash	16.4	14.5	1.9
FII F&O	189.5	194.1	(4.5)
MF Cash	3.4	3.9	(0.5)

Value Traded - India (INR Bn)		Change in %		
	3-Nov-11	1-d	1-mo	3-mo
BSE Cash	22.0	(0.8)	2.4	(14.5)
NSE Cash	98.8	8.8	13.9	(6.8)
NSE F&O	1,034.1	(30.5)		

Forex/Money Market		Change in %		
	3-Nov-11	1-d	1-mo	3-mo
INR/USD	49.1	0.1	0.0	(9.8)
USD/EUR	1.4	(0.1)	3.4	(2.0)
USD/YEN	0.0	(0.1)	1.6	(1.1)
10 Yr G-Sec	8.9	0.2	4.5	5.8

Commodities (USD/Mt ton)		Change in %		
	3-Nov-11	1-d	1-mo	3-mo
Copper	7,901.8	0.4	13.4	(16.9)
Aluminium	2,124.5	0.9	(2.0)	(14.9)
*Gold	1,757.9	(0.3)	8.2	6.8
*Silver	34.3	(0.7)	14.1	(11.8)
**NYMEX	94	1.7	21.2	2.3
*USD/Troy Ounce		**USD/bbl		

Agri Commodities (INR/QT)		Change in %		
	3-Nov-11	1-d	1-mo	3-mo
Sugar	3,072.0	0.4	3.0	3.4
^INR/Maund		^^INR/KG		

Open Interest (INR mn)			
Volume	3-Nov-11	2-Nov-11	% Change
Futures	509,377	504,366	1.0
Call	301,710	295,445	2.1
Put	391,026	385,214	1.5
Total	1,202,113	1,185,025	1.4

Put Call Ratios			
Volume	3-Nov-11	2-Nov-11	% Change
PCR	0.88	1.16	(24.1)
WPCR	0.91	0.97	(5.9)
OI PCR	1.29	1.30	(0.6)
Total OI/ Volur	1.16	1.20	(2.9)

Nifty IVs at 21 - 25% levels.

FII Activity\* (INR Mn) (2-Nov)



## STOCKS IN NEWS

**ICICI** bank may recast corporate debt. (ET)

Trai proposes easier M&A norms for telcos. (ET)

**Ackruti city** in talks with PE firms to raise INR 150 crore. (ET)

**Kingfisher** inks flies pact with American airlines. (ET)

**SKS** fund-raising plan faces valuation hurdles. (BS)

Relief for **Tatas** in Singur land case. (BS)

**Ranbaxy's** plan for Lipitor fuels speculation. (BS)

**Sesa Goa** to buy Videocon arm. (BS)

**Glaxo** to pay USD 3 bn to US over charges of misselling. (DNA)

**NMDC** may drop plan to buy stake in **Vincy Coal**. (DNA)

**Dhanlaxmi bank** eyes fresh capital infusion. (MINT)

Suspended workers at **Maruti** resign. (MINT)

**Welspun** plans unit in US, raising capacity. (MINT)

## RESULTS FOR THE DAY

Name of company	Q2FY12E	Q2FY11	PAT		
			Y-o-Y	Q1FY12	Q-o-Q
TV18 IN EQUITY	(150)	(129)	16.3	211	(171.1)
BHARTI	8,745	16,612	(47.4)	12,152	(28.0)
ONGC	53,856	53,888	(0.1)	40,949	31.5
Nagarjuna Construction	260	460	(43.5)	233	11.6
Marico	754	716	5.3	850	(11.3)
PSL	152	187	(18.6)	145	5.1
TTSL	845	780	8.3	772	9.4

## SALES TRADERS COMMENTARY

On Thursday, Indian equity markets recovered in late trade to close with moderate gains on back of short covering. The Sensex and Nifty marginally gained more than 0.10% each. Sustained buying was seen in power, realty, oil&gas, capital goods and PSU stocks.

The Sensex closed at 17481, up 17 points, while the Nifty jumped 07 points to end the day at 5365.

Major gainers were Bharat Heavy Electricals (4.18%), D L F (3.92%), Tata Power Company (3.23%), Bharti Airtel (2.15%), Jaiprakash Associates (2.09%), and Reliance Industries (1.51%).

Major losers were Hindustan Unilever (2.08%), Tata Motors (1.74%), Sterlite Industries (India) (1.70%), Tata Steel (1.23%), I C I C I Bank (0.98%), and Wipro (0.95%).

The Power index jumped 1.64%. Major gainers were Bharat Heavy Electricals (4.18%), Reliance Infrastructure (1.72%), Crompton Greaves (1.28%), NTPC (1.11%) and GVK Power & Infrastructure (0.6%).

The IT index slipped 0.73%. Major losers were Oracle Financial Services Software (1.97%), Mphasis (0.97%), Infosys (0.94%), H C L Technologies (0.91%) and CORE Education and Technologies (0.57%).

The Consumer Durables index was down 0.58%. Major losers were Whirlpool of India (6.54%), Rajesh Exports (1.58%), Bajaj Electricals (0.88%), Gitanjali Gems (0.6%) and T T K Prestige (0.24%).

Major losers in the mid-cap space were Alok Industries (1.46%), A2Z Maintenance & Engineering Services (0.96%), CORE Education and Technologies (0.57%), Amtek Auto (0.47%) and Alfa-Laval (India) (0.36%).

Major losers among small caps were Adhunik Metaliks (3.46%), Action Construction Equipment (2.01%), A B G Infralogistics (1.29%), Provogue (India) (0.52%) and INEOS ABS (India) (0.01%).

## CONFERENCE CALLS

Conference call details company	Date	Time
Ashok Leyland	4-Nov-11	10.30 AM IST
Bharti Airtel Limited	4-Nov-11	2.30 PM IST
Manappuram Finance Ltd.	4-Nov-11	4.00 PM IST
Prestige Estates Projects Ltd.	4-Nov-11	4.00 PM IST
Marico Limited	4-Nov-11	6.00 PM IST

# JUBILANT FOODWORKS

## Slowest growth in last several quarters

India Equity Research | Hotels

Jubilant Foodworks (JFL) reported a Q2FY12 PAT of INR237mn (up 28% Y-o-Y), below ours and Street estimates. This was driven by same store sales (SSS) growth of 27% which was the slowest in last seven quarters. We believe SSS growth could slow down further on the back of slackening discretionary expenditure, especially in urban India. We cut our EPS estimates by 4%-5% over FY12-13 and target price to INR 626 (INR 643 earlier) to factor this. We continue to find valuations expensive and maintain 'REDUCE' recommendation.

### Slowest SSS growth in last seven quarters; risk of further slowdown

JFL reported system sales growth of 47% y-o-y, one of the slowest in its listing history, driven by SSS growth of 27% (versus avg ~37% in last 6 qtrs). This was aided by nearly 10% price hike undertaken by JFL over last one year, again highest in its history, to counter food inflation. JFL has added 33 stores in H1 versus target of 80 store additions in the year. We believe SSS growth could slow down further as anecdotal evidence from other sectors indicates that the discretionary spending is already slackening. We note that JFL's SSS growth had dipped to 6% during the previous downturn (FY09).

### EBIDTA margin may peak on inflation, higher ad spend

EBIDTA margins remained flat at 18% in Q2, driven by high food inflation and a rise in staff costs. We believe margins could be peaking with food inflation not showing any signs of cooling off. Moreover, the management plans to increase advertising expenses to tide over any slowdown in demand. Also, pre-operative expenses (INR 9 mn in 2Q) on Dunkin Donut could further put pressure on near term profitability.

### Outlook and valuations: Expensive; maintain 'REDUCE'

With negative working capital, positive free cash flows, high growth and operating leverage, we continue to like JFL's business model. However, at CMP of INR 815, it is trading at FY12E and FY13E PE of 52.4x and INR 37.1x respectively. We believe JFL's current premium valuation to leading consumer discretionary names like Nestle and Titan is unjustified given their strong parentage, ownership of industry leading brands and superior return ratios. We continue to value JFL on DCF and reduce our target price to INR626. We continue with our 'REDUCE' recommendation.

#### Financials

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E
Revenue (INR mn)	2,404	1,634	47.1	2,169	10.8	6,781	10,194
EBIDTA (INR mn)	436	297	46.8	414	5.4	1,196	1,869
Net profit (INR mn)	237	184	28.4	232	2.2	717	988
Diluted EPS (INR)	3.7	2.9	27.5	3.6	1.9	11.0	15.6
Diluted P/E (x)						74.3	52.4
ROAE (%)						46.9	43.5

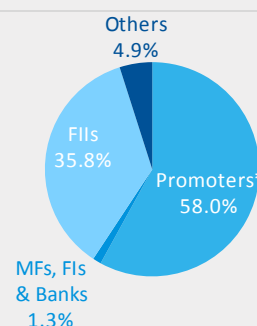
#### EDELWEISS RATINGS

Absolute Rating	REDUCE
Investment Characteristics	None

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

CMP	: INR 815
Target Price	: INR 626
52-week range (INR)	: 1,021 / 461
Share in issue (mn)	: 64.7
M cap (INR bn/USD mn)	: 53 / 1,070
Avg. Daily Vol. BSE/NSE ('000)	: 1,497.6

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	4.0	9.4	5.4
3 months	(7.9)	(0.9)	7.0
12 months	(26.7)	50.0	76.7

#### Manav Vijay

+91 22 4063 5413  
manav.vijay@edelcap.com

#### Manish Sarawagi

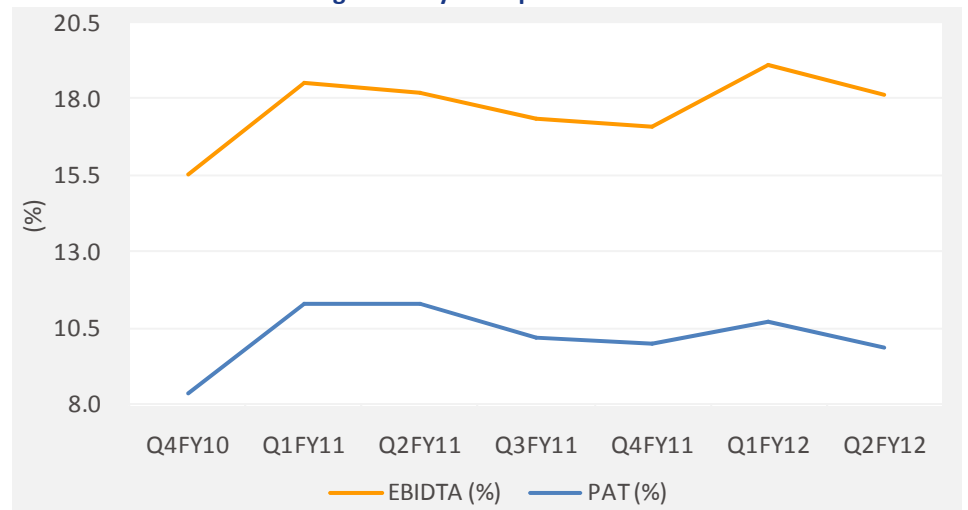
+91 22 4040 7575  
manish.sarawagi@edelcap.com

November 3, 2011

### Other highlights of the concall

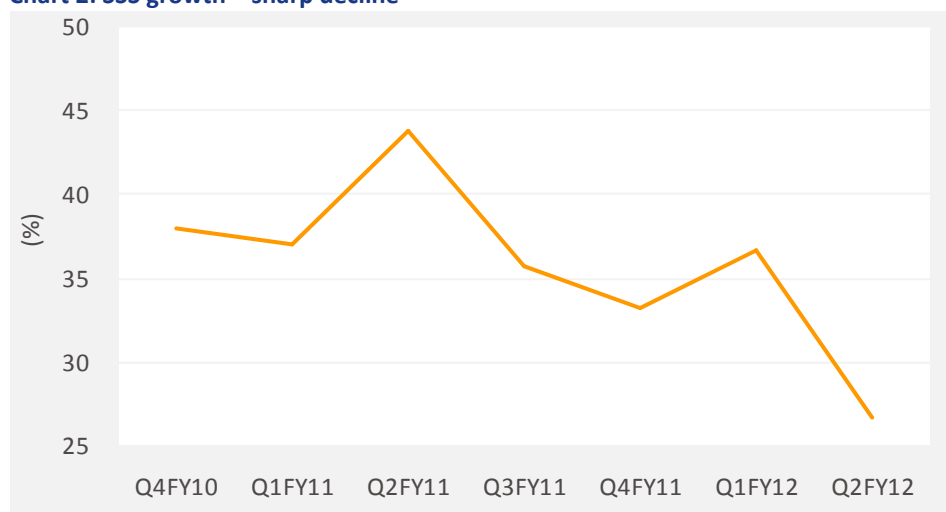
- JFL management mentioned that it is witnessing initial signs of slowdown in the external environment. Although internally everything is going fine.
- In terms of food inflation, the company believes that the worst is behind.
- JFL opened 19 new stores during the quarter, ending Q2FY12 with 411 stores.
- The company has already signed 29 new stores during Q3FY12 and is on track to open 80 Dominos stores in FY12.
- Post the 5% price hike in April 2011 and 2.5% price rise in August 2011, the company is looking for another price hike in Nov 2011, although the extent is still to get decided.
- In Sri Lanka, the company opened its first store and is looking to open 25-30 stores over 5-6 years. Operations in Sri Lanka, managed by JFL, are not sub-franchised.
- First Dunkin Donut store is expected by H2FY12 and in the first phase the company will restrict to metros only.

**Chart 1: EBITDA and PAT margins – may be at peak**



Source: Company, Edelweiss research

Chart 2: SSS growth – sharp decline



Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E	FY13E
Net sales	2,403	1,633	47.2	2,169	10.8	6,781	10,194	14,088
Other operating income	1	1	0.0	1	0.0	-	-	-
Total income	2,404	1,634	47.1	2,169	10.8	6,781	10,194	14,088
Consumption of raw material	504	346	45.8	462	9.1	1,443	2,151	2,973
Purchase of traded goods	131	59	121.4	90	45.2	263	347	479
Staff costs	475	325	46.1	421	12.9	1,356	2,039	2,803
Rent	185	127	45.5	164	12.7	536	765	1,057
Other expenses	673	480	40.3	618	8.8	1,986	3,024	4,188
EBIDTA	436	297	46.8	414	5.4	1,196	1,869	2,589
Depreciation	93	69	34.1	87	7.2	293	388	497
EBIT	343	228	50.6	327	4.9	903	1,480	2,091
Interest	-	1	NM	-	NM	3	-	-
Other income	14	3	NM	12	13.7	22	24	34
PBT and extraordinary items	357	229	55.6	339	5.2	922	1,505	2,126
Extraordinary items	(9)	-		-		-	(30)	(40)
PBT	348	229	51.6	339	2.5	922	1,475	2,086
Taxes	111	45	NM	108	NM	204	487	688
PAT	237	184	28.4	232	2.2	717	988	1,397
EPS	3.66	2.87	27.5	3.59	1.9	11.2	15.8	22.4

## As % of net revenue

Consumption of raw material	21.0	21.2		21.3		21.3	21.1	21.1
Staff costs	19.8	19.9		19.4		20.0	20.0	19.9
Rent	7.7	7.8		7.5		7.9	7.5	7.5
Other expenses	28.0	29.4		28.5		29.3	29.7	29.7
Total expenditure	81.9	81.8		80.9		82.4	81.7	81.6
EBIDTA	18.1	18.2		19.1		17.6	18.3	18.4
Net profit	9.8	11.3		10.7		10.6	9.7	9.9
Tax rate	32.0	19.7		31.7		22.2	33.0	33.0

### Company Description

JFL is the largest pizza chain in India and is also one of the fastest growing multi-national fast food chains. The company, part of the Jubilant Bhartia Group, was founded in 1995 and opened its first store in January 1996. Since then it has expanded to gain leadership position with 392 stores across 93 cities located in 25 states and more than 10,000 employees. The company offers both dine-in and delivery options. JFL commands 50% market share in the Indian pizza market and 65% in the home delivery segment. The master franchise agreement with Dominos International is till 2024 and is renewable for another 10 years.

### Investment Theme

JFL is currently trading at 52.4x PE FY12. We believe that the company is in a sweet spot due to its business model. As the Indian consumer is developing taste for fast food products especially pizza, the company with its dominant strategy of opening stores in Tier 2 and 3 towns is clearly paying off in terms of above average growth rate. But we believe that at current valuations where margins are close to its peak, there is hardly any cyclicity risk factored in the model.

### Key Risks

Faster than expected roll out of stores, better than estimated SSS growth along with continuous roll out of new products are some of the risks on the upside.

## Financial Statements (Consolidated)

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Income from operations	2,808	4,239	6,781	10,194	14,088
Total operating expenses	2,471	3,573	5,584	8,325	11,499
Raw material	718	1,050	1,706	2,497	3,452
Employee costs	556	805	1,355	2,039	2,803
Manufacturing and other expenses	1,196	1,719	2,523	3,789	5,244
EBITDA	338	666	1,196	1,869	2,589
Depreciation and amortisation	169	243	293	388	497
EBIT	168	423	903	1,480	2,091
Interest	89	91	3	-	-
Total other income	2	4	22	24	34
Profit before tax	81	335	922	1,505	2,126
Provision for tax	8	1	204	487	688
Core Profit	73	334	717	1,018	1,437
Extraordinary income/(loss)	-	(4)	-	(30)	(40)
Profit after tax	73	330	717	988	1,397
Profit After Minority Interest	73	330	717	988	1,397
Shares outstanding (mn)	58	64	64	64	64
EPS (INR) basic	1.3	5.3	11.2	15.8	22.4
Diluted shares (mn)	58	64	65	65	65
EPS (INR) diluted	1.3	5.3	11.0	15.6	22.0
Dividend per share (INR)	-	-	-	1.00	2.00
Dividend payout (%)	-	-	-	7.6	10.8

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

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	88.0	84.3	82.4	81.7	81.6
Raw materials	25.6	24.8	25.2	24.5	24.5
Employee costs	19.8	19.0	20.0	20.0	19.9
Manufacturing and other expenses	42.6	40.5	37.2	37.2	37.2
Depreciation and amortisation	6.0	5.7	4.3	3.8	3.5
Interest expenditure	3.2	2.2	0.1	0.0	-
EBITDA margins	12.0	15.7	17.6	18.3	18.4
Net profit margins	2.6	7.9	10.6	10.0	10.2

### Growth metrics (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	33.0	51.0	59.9	50.3	38.2
EBITDA	25.7	97.3	79.6	56.2	38.5
PBT	(11.3)	314.3	175.2	63.3	41.2
Core net profit	(13.7)	358.7	114.7	41.9	41.2
EPS	(13.7)	320.0	108.4	41.9	41.2



Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
Equity capital	582	648	645	645	645
Reserves & surplus	(353)	526	1,269	2,181	3,428
Shareholders funds	228	1,174	1,914	2,827	4,073
Secured loans	824	86	-	-	-
<b>Sources of funds</b>	<b>1,053</b>	<b>1,260</b>	<b>1,914</b>	<b>2,827</b>	<b>4,073</b>
Gross block	1,710	2,276	2,904	3,880	4,974
Depreciation	651	872	1,103	1,491	1,988
Net block	1,059	1,403	1,801	2,390	2,986
Capital work In progress	89	26	44	44	44
Investments	-	0	205	305	605
Inventories	55	71	142	160	221
Sundry debtors	12	29	45	70	96
Cash and bank balances	30	70	90	427	879
Loans and advances	239	362	698	826	1,001
Total current assets	336	533	984	1,491	2,205
Current liabilities	431	702	1,150	1,433	1,797
Total current liabilities & provisions	431	702	1,150	1,433	1,797
Net current assets	(95)	(169)	(167)	58	408
Deferred tax (net)	-	-	31	31	31
<b>Uses of funds</b>	<b>1,053</b>	<b>1,260</b>	<b>1,914</b>	<b>2,827</b>	<b>4,073</b>
Book value per share (BV) (INR)	4	18	29	44	63

Free cash flow					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net profit	73	330	717	988	1,397
Depreciation	169	243	293	388	497
Others	88	59	14	(24)	(34)
Gross cash flow	330	632	1,025	1,352	1,860
Less: Changes in working capital	12	(157)	(262)	(112)	(101)
Operating cash flow	319	789	1,288	1,464	1,962
Less: Capex	541	521	716	976	1,094
<b>Free cash flow</b>	<b>(222)</b>	<b>269</b>	<b>571</b>	<b>488</b>	<b>868</b>

Cash flow metrics					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating cash flow	319	789	1,288	1,464	1,962
Financing cash flow	232	(229)	(67)	(75)	(151)
Investing cash flow	(542)	(523)	(1,199)	(1,052)	(1,359)
Net cash flow	9	37	22	337	452
Capex	(541)	(521)	(716)	(976)	(1,094)

**Ratios**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
ROAE (%)	37.5	47.6	46.9	43.5	42.0
ROACE (%)	19.4	36.6	60.8	70.0	69.8
Inventory (days)	7	6	7	7	6
Debtors (days)	2	2	2	2	2
Payable (days)	57	58	61	57	51
Cash conversion cycle	(49)	(50)	(52)	(48)	(43)
Current ratio	0.8	0.8	0.9	1.0	1.2
Debt/EBITDA	2.4	0.1	-	-	-
Interest cover (x)	1.9	4.6	264.0		
Fixed assets turnover (x)	3.2	3.4	4.2	4.9	5.2
Total asset turnover (x)	3.2	3.7	4.3	4.3	4.1
Equity turnover(x)	14.4	6.0	4.4	4.3	4.1
Debt/Equity (x)	3.6	0.1	-	-	-
Adjusted debt/Equity	3.6	0.1	-	-	-

**Du pont analysis**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
NP margin (%)	2.6	7.9	10.6	10.0	10.2
Total assets turnover	3.2	3.7	4.3	4.3	4.1
Leverage multiplier	4.4	1.6	1.0	1.0	1.0
ROAE (%)	37.5	47.6	46.9	43.5	42.0

**Valuation parameters**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Diluted EPS (INR)	1.3	5.3	11.0	15.6	22.0
Y-o-Y growth (%)	(13.7)	320.0	108.4	41.9	41.2
CEPS (INR)	4.2	9.1	15.7	21.9	30.1
Diluted P/E (x)	650.7	154.9	74.3	52.4	37.1
Price/BV(x)	207.7	44.1	27.8	18.7	13.0
EV/Sales (x)	17.2	12.2	7.7	5.1	3.6
EV/EBITDA (x)	142.8	77.7	43.5	27.6	19.7
EV/EBITDA (x)+1 yr forward	72.4	43.3	27.9	20.0	14.6
Dividend yield (%)	-	-	-	0.1	0.2

# KARNATAKA BANK

## Profitability set to improve

India Equity Research | Banking and Financial Services

Karnataka Bank's (KBL) Q2FY12 PAT at INR 411 mn jumped 43% Y-o-Y. Though margin expanded in line with expectation (27bps Q-o-Q to 2.2%), slippages were higher at 4%. Investment depreciation of INR 220 mn and tax rate of 40% further dented earnings. Building in NIM expansion and ~300bps increase in CD ratio, we factor in 21.7% CAGR in NII over FY11-13, translating into 18.6% spurt in PAT. We maintain 'BUY' with TP of INR 115.

### Margin expansion drives 31% NII growth

Net interest margin improved 27bps to 2.2%, led by ~40bps expansion each in yields on advances and investments, offset by just ~20bps expansion in cost of deposits. We are building in 2.3-2.4% margin over FY11-13 coupled with ~300bps CD ratio expansion. KBL's advances came in steady with 22% Y-o-Y/ 5% Q-o-Q growth to INR 190 bn, primarily led by SME, retail and farm credit. Management is targeting credit growth of 20-25% for the next two-three years with focus on NIM expansion.

### Slippages inch up to 4%; recovery efforts to keep GNPA in check

KBL's gross NPLs inched up from 3.68% in Q1FY12 to 4.1% in Q2FY12 on account of higher slippages of INR 1.79 bn (4% annualized). While recoveries were lower at INR 794 mn, there were no write-offs during the quarter. Credit cost was lower at ~50bps as provisioning coverage came off 5 percentage points. We are building in LLP at 80bps for FY11-13.

### Outlook and valuations: Profitability set to improve; maintain 'BUY'

Having reinforced its equity base with an INR 4.57 bn rights issue in March 2011, KBL is geared to improve its growth trajectory along with focus on enhancing productivity (currently cost-income ratio stands at 55%, higher than industry average). Key concern for the bank has been asset quality with a headline GNPA ratio of 3.5-4.0%. While performance on this front will drive the stock, which is trading at 0.6x FY13E P/B for RoE of ~10-11% as the KBL is yet to fully leverage the recently raised capital. We maintain 'Buy/Sector Outperformer' recommendation/rating with a target price of INR 115, valuing the stock at 0.9x one year rolling adjusted P/B.

#### Financials

Year to March	Q2FY12	Q2FY11	Growth %	Q1FY12	Growth %	FY11	FY12E
Net Interest Income	1,816	1,391	30.6	1,537	18.2	6,125	7,622
Net profit	411	287	43.0	498	(17.5)	2,046	2,294
Book Value per share						129.1	137.8
EPS	2.2	2.1	1.7	2.6	(17.4)	11	12
Price/ adj Book						0.8	0.7
Price/ PPOP						5.3	3.9
Price/ Earnings						8.2	7.3

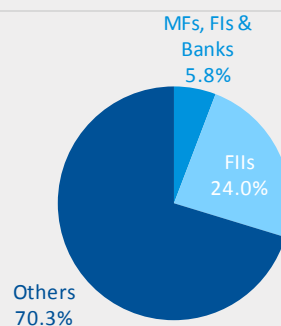
#### EDELWEISS 4D RATINGS

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

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

CMP	: INR 88
Target Price	: INR 115
52-week range (INR)	: 193 / 79
Share in issue (mn)	: 188.2
M cap (INR bn/USD mn)	: 17 / 338
Avg. Daily Vol.BSE/NSE('000)	: 1,149.0

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW BFSI Index
1 month	2.2	8.4	3.4
3 months	(25.2)	(2.3)	(8.1)
12 months	(47.4)	(10.5)	(18.0)

#### Nilesh Parikh

+91 22 4063 5470  
nilesh.parikh@edelcap.com

#### Kunal Shah

+91 22 4040 7579  
kunal.shah@edelcap.com

#### Suruchi Chaudhary

+91 22 6623 3316  
suruchi.chaudhary@edelcap.com

November 2, 2011

## Financials snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	Growth (%)	Q1FY12	Growth (%)	FY11	FY12E	FY13E
Interest on advances	5,777	3,966	45.6	5,169	11.7	17,077	22,826	26,988
Interest on investments	1,783	1,670	6.8	1,696	5.1	6,422	8,257	9,481
Interest on other resources	4	1	245.5	1	280.0	210	439	479
Other interest income	38	81	(53.4)	2	NA			
Interest income	7,602	5,719	32.9	6,868	10.7	23,709	31,522	36,948
Interest expenses	5,785	4,328	33.7	5,331	8.5	17,584	23,900	27,870
Net interest income	1,816	1,391	30.6	1,537	18.2	6,125	7,622	9,078
Other income	802	636	26.1	821	(2.4)	2,918	3,691	4,314
Fee income	802	636	26.1	821	(2.4)	2,517	2,991	3,564
Operating expenses	1,451	1,271	14.2	1,287	12.7	5,490	6,318	7,267
Staff expense	779	717	8.6	778	0.1	3,451	3,846	4,267
Other opex	672	554	21.4	509	32.1	2,039	2,472	2,999
Pre prov op profit (PPP)	1,167	756	54.4	1,071	9.0	3,152	4,294	5,376
Provisions	479	577	(16.9)	596	(19.6)	1,204	2,051	2,016
Profit before tax	688	179	284.0	475	44.8	2,349	2,944	4,110
Provision for tax	277	(108)	NA	(23)	NA	303	649	1,234
Profit after tax	411	287	43.0	498	(17.5)	2,046	2,294	2,876
EPS (INR)	2.2	2.1	1.7	2.6	(17.4)	10.9	12.2	15.3

## Ratios

NII / GII	23.9	24.3		22.4		25.8	24.2	24.6
Cost - income	55.4	62.7		54.6		60.7	55.9	54.3
Provisions / PPOP	41.1	76.3		55.6		38.2	47.8	37.5
Tax rate	40.3	(60.4)		(4.8)		12.9	22.1	30.0
Net interest margin	2.3	2.0		2.0		2.1	2.2	2.3

## Balance sheet (INR bn)

Advances	190.7	156.8	21.6	180.9	5.4	173.5	206.4	245.7
Deposits	288.5	250.5	15.2	275.5	4.7	273.4	317.1	371.1

## Asset quality (INR mn)

Gross NPA	7,771	5,874	32.3	6,773	14.7	7,022	8,799	9,747
Gross NPA (%)	4.0	3.7		3.7		4.0	4.2	3.9
Net NPA	4,217	1,727	144.1	3,380	24.8	2,803	3,613	3,500
Net NPA (%)	2.2	1.1		1.9		1.6	1.8	1.4
Provision coverage (%)	45.7	70.6		50.1		60.1	58.9	64.1

## Company Description

KBL was incorporated in 1924 at Mangalore (Karnataka) as a private bank. Over the years, it has merged with Sringeri Sharada Bank, Chitladurg Bank, and Bank of Karnataka. Karnataka continues to remain its major business area. Indian public holds around 50% of the equity, institutional investors about 5%, and FIIs around 30%. Its balance sheet size is ~INR 330 bn as on Q2FY12 and it has market cap of INR 17 bn. The bank's staff strength is at over ~5,000 and it is present in 21 states and two Union territories. It has entered in to a joint venture agreement and holds equity investments to the extent of 15% in Universal Sompo General Insurance Company.

## Investment Theme

Karnataka Bank is one of the best regional-based private banks in the country with all branches under CBS. We like the bank for its strong regional presence, good technology network, and possible M&A play. It offers an attractive play on robust loan growth average 20% FY11-13E, improving asset quality, and consolidation in the Indian banking space. Current valuations look attractive; also possible M&A opportunity can provide an upside.

## Key Risks

Undue delay in credit growth can result in slower-than-expected margin improvement.

Higher-than-expected slippage in restructured assets can result in deterioration in asset quality.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Interest income	19,174	20,434	23,709	31,522	36,948
Interest expenses	14,438	17,078	17,584	23,900	27,870
Net interest income	4,736	3,356	6,125	7,622	9,078
Non interest income	3,532	3,295	2,918	3,691	4,314
- Fee & forex income	1,363	1,735	1,948	2,377	2,852
- Misc. income	304	455	569	614	712
- Investment profits	1,865	1,106	401	700	750
Net revenues	8,267	6,651	9,042	11,313	13,393
Operating expense	3,465	3,861	5,490	6,318	7,267
- Employee exp	1,904	2,068	3,451	3,846	4,267
- Other opex	1,561	1,793	2,039	2,472	2,999
Preprovision profit	4,802	2,791	3,553	4,994	6,126
Provisions	806	894	1,204	2,051	2,016
- Loan loss provisions	470	810	675	1,376	1,741
- Investment depreciation	334	(182)	389	650	250
- Other provisions	2	267	139	25	25
PBT	3,996	1,897	2,349	2,944	4,110
Taxes	1,329	225	303	649	1,234
PAT	2,667	1,671	2,046	2,294	2,876
Reported PAT	2,667	1,671	2,046	2,294	2,876
EPS (INR)	21.9	12.5	10.9	12.2	15.3
DPS (INR)	6.0	4.0	3.0	3.0	4.0
Payout ratio (%)	32.0	37.5	32.0	28.7	30.5

Growth ratios (%)					
Year to March	FY09	FY10	FY11	FY12E	FY13E
NII growth	1.0	(29.1)	82.5	24.4	19.1
Fees growth	(3.6)	27.2	12.3	22.0	20.0
Opex growth	13.4	11.4	42.2	15.1	15.0
PPOP growth	(11.7)	(42.6)	87.1	36.2	25.2
PPP growth	18.0	(41.9)	27.3	40.6	22.7
Provisions growth	18.3	10.9	34.6	70.4	(1.7)
PAT growth	10.3	(37.3)	22.4	12.1	25.3

Operating ratios (%)					
Year to March	FY09	FY10	FY11	FY12E	FY13E
Yield on advances	12.3	10.6	10.7	12.0	11.9
Yield on investments	7.0	6.8	6.8	6.9	7.1
Yield on assets	9.3	8.4	8.3	9.5	9.6
Net interest margins	2.3	1.4	2.1	2.3	2.4
Cost of funds	7.3	7.3	6.4	7.6	7.6
Cost of deposits	7.5	7.5	6.6	7.8	7.8
Cost of borrowings	11.4	8.8	8.3	8.6	8.6
Spread	2.0	1.1	1.9	1.9	2.0
Cost-income	41.9	58.0	60.7	55.9	54.3
Tax rate	33.3	11.9	12.9	22.1	30.0

Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
<b>Liabilities</b>					
Equity capital	1,216	1,340	1,882	1,882	1,882
Reserves	14,454	16,988	22,409	24,057	26,066
Net worth	15,670	18,328	24,291	25,939	27,948
Sub bonds/pref cap	3,500	3,500	3,500	3,500	3,500
Deposits	203,333	237,307	273,365	317,091	371,055
Borrowings	39	3,416	7,363	7,672	7,981
Other liabilities	6,285	8,268	8,792	9,791	11,651
<b>Total</b>	<b>228,828</b>	<b>270,818</b>	<b>317,311</b>	<b>363,993</b>	<b>422,136</b>
<b>Assets</b>					
Loans	118,100	144,357	173,481	206,442	245,666
Investments					
Gilts	59,362	64,060	66,989	77,976	91,002
Others	30,253	35,861	48,075	49,387	50,949
Cash & equi	14,607	18,056	19,861	20,728	24,240
Fixed assets	1,385	1,481	1,455	1,564	1,458
Other assets	5,121	7,004	7,451	7,895	8,820
<b>Total</b>	<b>228,828</b>	<b>270,818</b>	<b>317,311</b>	<b>363,993</b>	<b>422,136</b>
<b>Balance sheet ratios (%)</b>					
Credit growth	10.7	15.0	18.3	19.0	19.0
Deposit growth	19.5	16.7	15.2	16.0	17.0
EA growth	18.3	18.0	17.6	15.0	16.2
SLR ratio	29.2	28.0	25.0	24.0	24.0
C-D ratio	65.2	64.3	66.1	67.8	68.9
Low-cost deposits	19.9	23.3	24.9	23.6	23.4
Gross NPA ratio	3.7	3.7	4.0	4.2	3.9
Net NPA ratio	1.0	1.3	1.6	1.8	1.4
Provision coverage	73.8	65.7	60.1	58.9	64.1
Incremental slippage	1.5	2.5	2.2	3.3	2.6
Net NPA / Equity	7.4	10.3	11.5	13.9	12.5

<b>Ratios</b>					
Year to March	FY09	FY10	FY11	FY12E	FY13E
<b>ROA decomposition (%)</b>					
Net interest income/Assets	2.3	1.4	2.1	2.3	2.4
Fees/Assets	0.8	0.9	0.9	0.9	0.9
Investment profits/Assets	0.9	0.5	0.1	0.2	0.2
Net revenues/Assets	4.0	2.7	3.2	3.4	3.5
Operating expense/Assets	(1.7)	(1.6)	(1.9)	(1.9)	(1.9)
Provisions/Assets	(0.4)	(0.4)	(0.4)	(0.6)	(0.5)
Taxes/Assets	(0.6)	(0.1)	(0.1)	(0.2)	(0.3)
Total costs/Assets	(2.7)	(2.1)	(2.5)	(2.7)	(2.7)
ROA	1.3	0.7	0.7	0.7	0.8
Equity/Assets	7.2	7.0	7.5	7.6	7.0
ROAE	18.1	9.8	9.6	9.1	10.7

### Valuation metrics

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	21.9	12.5	10.9	12.2	15.3
EPS growth (%)	10.1	(43.1)	(12.8)	12.1	25.3
Book value per share (INR)	128.9	136.8	129.1	137.8	148.5
Adjusted book value/share (INR)	122.2	126.9	118.6	124.4	135.5
Diluted P/E (x)	4.1	7.2	8.2	7.3	5.8
Price/ BV (x)	0.7	0.7	0.7	0.6	0.6
Price/ ABV (x)	0.7	0.7	0.8	0.7	0.7
Dividend yield (%)	6.7	4.5	3.4	3.4	4.5
Price to income (x)	3.4	3.0	3.7	3.1	2.6
Price to PPOP (x)	3.7	7.1	5.3	3.9	3.1



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

## ABSOLUTE RATING

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

## RELATIVE RETURNS RATING

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

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

## RELATIVE RISK RATING

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

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

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

# MANAPPURAM FINANCE

## Strong trajectory but return ratios vulnerable

India Equity Research | Banking and Financial Services

Manappuram Finance (Manappuram) reported A PAT of INR1.35bn – up 125% YoY and 25% QoQ (ahead of ours and Street's expectations). Disbursement growth was robust at 30% QoQ and gold loan AUMs too kept pace with 17% QoQ increase to INR105bn. Interest spreads as anticipated came off 60bps due to funding cost pressure, but this was partially due to a ~25bps decline in opex/assets ratio to 6.6%. Considering the recent spike in gold prices and regulatory overhang, we maintain 'HOLD' with target price of INR67.

### Disbursements, AUMs sustain strong growth momentum

Disbursement growth was robust – almost doubling YoY (up 30% QoQ) to INR90bn. Gold loan AUMs too kept pace and grew by 17% QoQ (113% YoY) to INR105bn. Gold stock has gone up 8% QoQ to 65 tonnes, suggesting that the 8%-10% increase in AUMs can be accounted to spurt in gold prices/average ticket size. The management has revised its guidance upwards to INR135bn AUM by FY12. Outlook on growth *per se* is buoyant given that the company added half of the current number of branches (2,503) in the last one year. Currently, disbursements per branch stand at INR36mn and can be ramped up to INR60mn as branches mature, boosting the loan book growth.

### Spreads under pressure as expected

As was anticipated, interest spreads came off 60 bps to 13.46% as cost of funds increased ~115 bps. The company hiked lending rates by 150bps in July 2011 though it faced additional pressure from increasing proportion of low LTV-low yield products in incremental disbursements while the increase in lending yields was capped at ~55 bps to 25.7%. With bilateral assignment virtually coming to an end given the new securitization guidelines (requiring minimum retention period), we expect cost of funds to go up. We are building in spreads of 11%-13% for FY12-13E.

### Outlook and valuations: Return ratios vulnerable; maintain 'HOLD'

Based on the current disbursement run rate and ongoing network expansion, we estimate INR 170 bn AUMs by FY13E. While we remain positive on its niche business model of collateralised lending, generating RoEs of 20% plus, we believe RoEs will be vulnerable to increased competition, margin pressure, volatility in gold prices and most importantly regulatory risk. The stock trades at 1.8x FY13E book and we maintain our 'HOLD/Sector Performer' recommendation/rating on the stock.

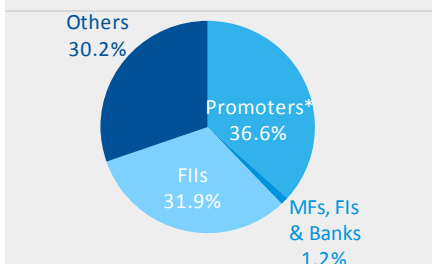
#### EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

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

CMP	: INR 59
Target Price	: INR 67
52-week range (INR)	: 95 / 42
Share in issue (mn)	: 833.7
M cap (INR bn/USD mn)	: 49 / 994
Avg. Daily Vol.BSE/NSE('000)	: 2,339.8

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	26.3	8.4	3.4
3 months	14.0	(2.3)	(8.1)
12 months	(13.6)	(10.5)	(18.0)

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

**Nilesh Parikh**  
+91 22 4063 5470  
nilesh.parikh@edelcap.com

**Suruchi Chaudhary**  
+91 22 6623 3316  
suruchi.chaudhary@edelcap.com

November 3, 2011

#### Financials

Year to March	Q2FY12	Q2FY11	Growth (%)	Q3FY11	Growth (%)	FY11	FY12E
Net oper. Inc. (INR mn)	3,713	1,792	107.2	3,145	18.1	8,335	13,837
PAT (INR mn)	1,353	602	124.8	1,078	25.5	2,827	4,726
BV per share (INR)						23.1	27.7
Diluted EPS (INR)						3.4	5.7
Price/ Book (x)						2.5	2.1
Diluted P/E (x)						17.3	10.4

### Benefits of expansion likely; 223 branches added

The company added 223 branches in Q2FY12 (over and above 216 new branches added during Q1FY12 and 1,059 in FY11) taking the total tally to 2503 branches. The company continues to guide that it may moderate the pace of branch addition to 150 branches per quarter in H2FY12. Average loan outstanding/branch stands at INR 42 mn and we are building in continued traction in AUM growth as new branches reach their optimum operational limits.

### Opex, assets decline as economies of scale kick in

With an increase in outstanding gold loan per branch in Q2FY12 to INR 42 mn (from an average of INR 35 mn in FY11), Manappuram reported a dip in opex/average assets to 6.6% from 7.4% in Q4FY11. We believe opex/assets will trend further down as AUM accretion happens given the aggressive branch expansion and headcount addition in recent times. Since majority (~INR 170k out of INR 225k per month per branch) of expenses is fixed in nature, there is a scope for further productivity improvement which will enable it offset margin pressures to some extent.

### Asset quality in comfort zone

Gross NPLs in gold loan was capped at 0.4% and provisioning was minimal at INR 78 mn for the quarter. The default rate on gold loans is low due to strong sentimental value attached and physical custody of pledged jewellery.

Chart 1: Robust disbursement growth

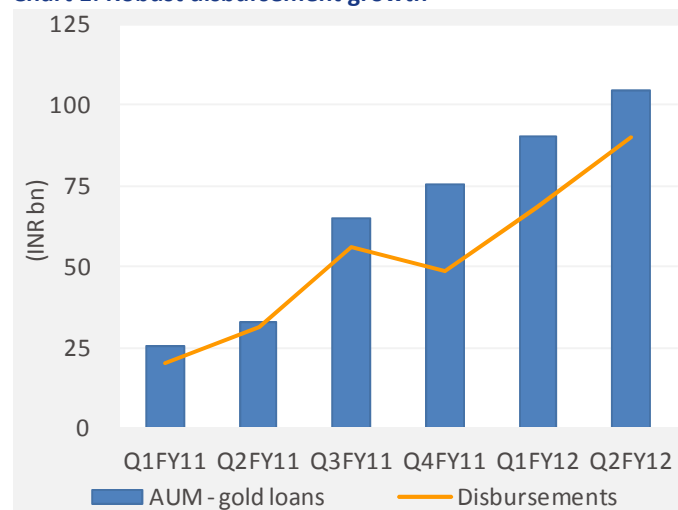
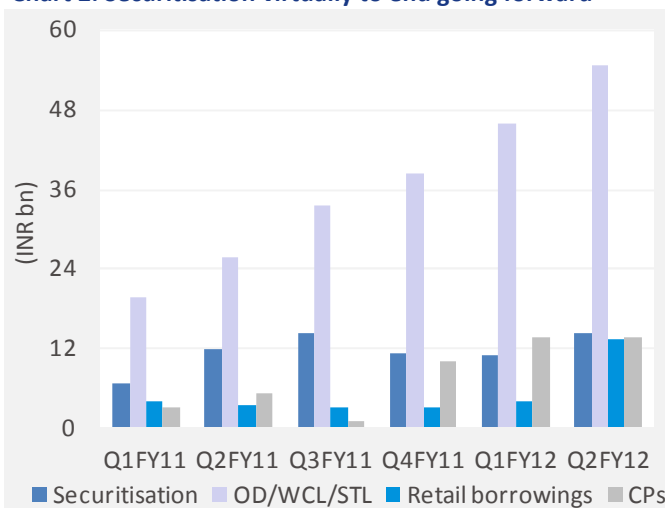
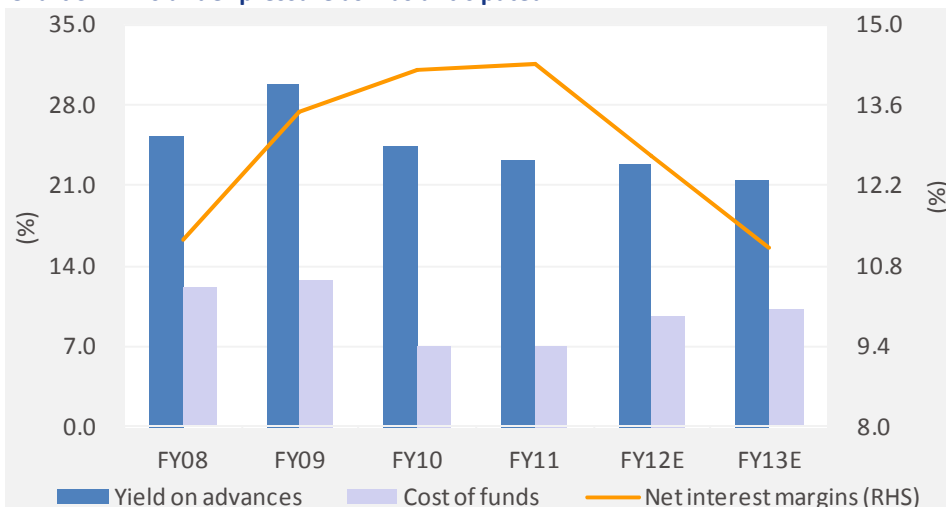
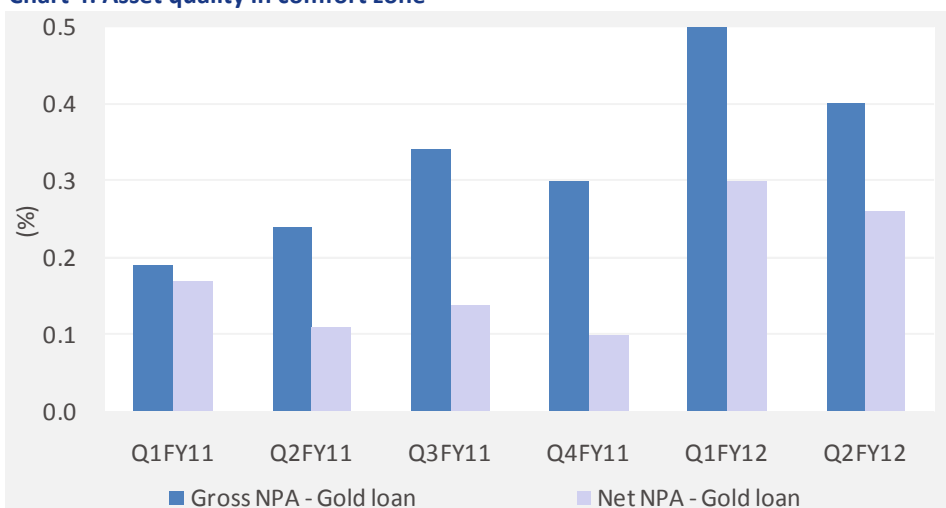


Chart 2: Securitisation virtually to end going forward



Source: Company

**Chart 3: NIMs under pressure as was anticipated**

**Chart 4: Asset quality in comfort zone**


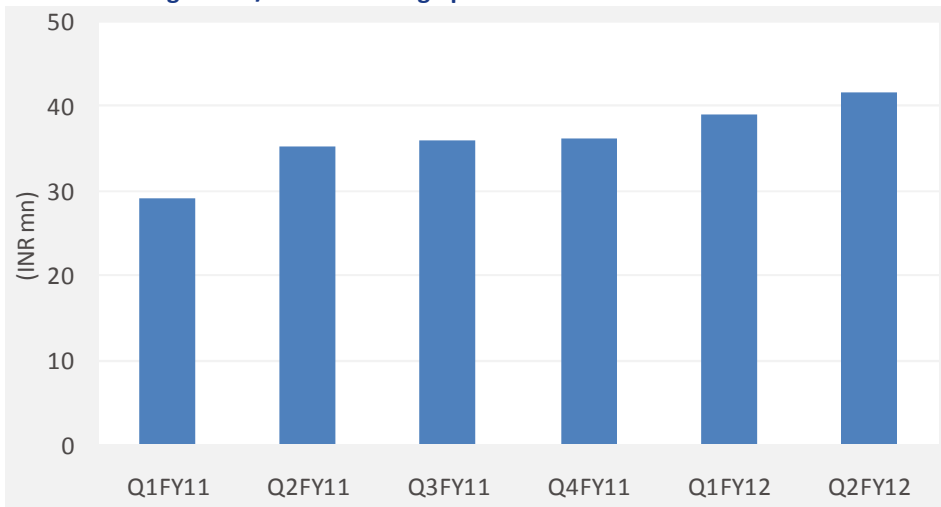
Source: Company

**Table 1: Branch addition largely in Southern region**

State	As on date									
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	Q1FY12	Q2FY12
Kerala	15	26	30	89	143	244	275	405	418	424
Tamil Nadu	5	13	25	86	107	119	201	391	441	492
Karnataka	3	6	12	35	50	96	188	374	421	465
Andhra Pradesh		3	10	40	78	115	185	386	432	481
Maharashtra		3	8	23	25	27	53	102	111	123
Delhi			5	9	10	10	35	51	60	61
Gujarat					7	7	18	61	63	70
Others				9	16	26	50	294	334	387
Grand Total	23	51	93	291	436	644	1,005	2,064	2,280	2,503

Source: Company

Chart 5: Average AUM/branch inching up with better branch utilisation



Source: Company

## Financials snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	Growth (%)	Q1FY12	Growth (%)	FY11	FY12E	FY13E
Operating income	6,199	2,432	154.9	4,929	25.8	11,654	22,442	31,876
Interest expended	2,486	640	288.6	1,784	39.3	3,320	8,605	13,947
Net operating income	3,713	1,792	107.2	3,145	18.1	8,335	13,837	17,929
Other income	56	6	817.4	6	850.5	161	293	397
Total income	3,769	1,798	109.6	3,151	19.6	8,496	14,130	18,327
Operating expenses	1,573	788	99.7	1,321	19.1	3,819	6,026	7,834
Pre-provision profit	2,195	1,010	117.3	1,829	20.0	4,676	8,104	10,492
Provisions and write off	39	79	(50.7)	158	(75.4)	224	826	1,508
Operating profit	2,156	931	131.5	1,671	29.0	4,452	7,278	8,984
Depreciation	153	31	396.2	75	104.3	213	224	282
Profit before tax	2,003	900	122.5	1,596	25.5	4,239	7,054	8,702
Tax	650	299	117.7	518	25.5	1,412	2,328	2,872
Profit after tax	1,353	602	124.8	1,078	25.5	2,827	4,726	5,830

## Ratios (%)

Gross NPA - Gold loan	0.5	0.7	0.9
Net NPA - Gold loan	0.1	0.2	0.2
Tax rate	33.3	33.0	33.0

## Company Description

The Manappuram Group was started in 1949 by Late Mr. V. C. Padmanabhan, with focus primarily on money lending activities. The group has come a long way in 60 years operating five companies under its fold, spread over 15 states with ~2300 branches, an employee base over 17,000, and a live customer base of over 1,360 k.

Manappuram General Finance, Manappuram Group's flagship company, is the leading gold loan providing NBFC based out of Kerala, with INR 90 bn (market share estimated at ~5%) assets under management. It is present in the (collateralised) micro-finance space (average ticket size of INR 35 k), with the main line of business being 'lending against household jewellery'. It does not provide loans to jewellers, banks, or against bullion. It has transitioned from a hire purchase company to a gold loan company in view of the market fallout.

## Investment Theme

Manappuram has created a niche by providing quick liquidity to low/irregular income households to meet their urgent personal/business needs, by offering loans against jewellery. Growth potential is huge, considering the significantly untapped organised gold loan market in India (~0.12% of gold stock value). The organized market is expected to grow exponentially, owing to: (1) changing psychology; (2) shift from unorganised lenders; (3) and growing presence beyond South. Despite increasing competition, specialised financiers may continue to hold their own, given scale, expertise, brand equity, and niche servicing. We like Manappuram for its niche business model of collateralised 'lending against jewellery'. It generates NIMs of ~15% plus, RoEs of 20% plus (25% plus pre dilution via QIP in November, 2010), with huge growth potential and low default risk. Highly experienced and quality management provides comfort on the ability to lever on emerging gold loan opportunity to build a scalable and profitable business. While we are positive on its growth potential, we believe RoEs will be vulnerable to increased competition, margin pressure, fluctuations in gold prices, and regulatory risk.

## Key Risks

- We believe competition intensity in gold loan financing is bound to rise in the next few years, posing a risk to NIMs enjoyed by specialised gold loan financiers like Manappuram.
- Like any other financial asset, demand and asset quality of gold loans is susceptible to price fluctuations of underlying collateral (gold).
- The company runs the risk of providing easy access to liquidity for stolen jewellery. It also runs the key man risks at the branch level and possibility of collusion between borrowers and loan approvers.
- Scalability of business will be limited beyond a particular level of productivity and growth in AUMs will have to be driven by rapid expansion in branches. Any slowdown in targeted expansion of branch network may lead to downward revision in growth and earnings estimates.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Interest income	2,999	4,675	11,634	22,418	31,848
Interest charges	1,348	1,369	3,320	8,605	13,947
Net interest income	1,651	3,306	8,314	13,813	17,901
Fee & other income	83	107	181	317	425
Net revenues	1,734	3,413	8,496	14,130	18,327
Operating expense	825	1,453	4,032	6,250	8,116
- Employee exp	367	536	1,605	2,819	3,620
- Depreciation /amortisation	38	57	213	224	282
- Other opex	420	859	2,214	3,207	4,214
Preprovision profit	909	1,960	4,463	7,880	10,210
Provisions	181	142	224	826	1,508
PBT	729	1,818	4,239	7,054	8,702
Taxes	251	621	1,412	2,328	2,872
PAT	478	1,197	2,827	4,726	5,830
Reported PAT	478	1,197	2,827	4,726	5,830
Basic number of shares (mn)	458.7	585.3	833.8	833.8	833.8
Basic EPS (INR)	1.0	2.0	3.4	5.7	7.0
Diluted number of shares (mn)	948.8	589.0	833.8	833.8	833.8
Diluted EPS (INR)	0.5	2.0	3.4	5.7	7.0
DPS (INR)	2.5	0.5	0.5	0.9	1.0
Payout ratio (%)	11.1	16.1	20.6	15.0	15.0

### Growth ratios (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating income growth	95.1	100.3	151.5	66.1	29.6
Net revenues growth	97.1	96.8	148.9	66.3	29.7
Opex growth	98.2	76.1	177.6	55.0	29.9
PPP growth	96.1	115.6	127.7	76.6	29.6
Provisions growth	363.9	(21.4)	57.9	268.4	82.5
PAT growth	71.2	150.5	136.1	67.2	23.4

### Operating ratios (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Yield on advances	29.8	24.5	23.1	22.9	21.4
Cost of funds	12.7	7.1	7.1	9.6	10.1
Spread	17.0	17.4	16.0	13.3	11.3
Net interest margins	13.5	14.2	14.3	12.7	11.1
Cost-income	47.6	42.6	47.5	44.2	44.3
Tax rate	34.4	34.2	33.3	33.0	33.0

Balance sheet					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
<b>Liabilities</b>					
Equity capital	228	340	834	834	834
Reserves	2,290	5,765	18,406	22,279	27,062
<b>Net worth</b>	<b>2,518</b>	<b>6,106</b>	<b>19,240</b>	<b>23,113</b>	<b>27,895</b>
Preference capital	40	0	0	0	0
Subordinate debt	687	1,165	2,779	3,279	3,279
Secured loans	4,711	16,501	43,723	95,635	143,405
Unsecured loans	209	691	10,038	32	34
Deferred tax liability	(14)	(33)	(87)	(176)	(285)
Assignments	7,765	7,077	11,183	12,094	17,680
<b>Total liabilities</b>	<b>15,916</b>	<b>31,506</b>	<b>86,876</b>	<b>133,977</b>	<b>192,008</b>
<b>Assets</b>					
Loans	4,670	18,694	63,671	108,848	159,120
Investments	11	1,407	403	404	404
<i>Current assets</i>	<i>3,696</i>	<i>4,774</i>	<i>12,082</i>	<i>14,666</i>	<i>17,886</i>
<i>Current liabilities</i>	<i>561</i>	<i>1,015</i>	<i>1,911</i>	<i>4,104</i>	<i>5,431</i>
Net current assets	3,135	3,759	10,171	10,563	12,455
Fixed assets (net block)	336	569	1,448	2,069	2,349
Assignments	7,765	7,077	11,183	12,094	17,680
<b>Total assets</b>	<b>15,916</b>	<b>31,506</b>	<b>86,876</b>	<b>133,977</b>	<b>192,008</b>
<b>Balance sheet ratios (%)</b>					
Loan growth	60.9	107.3	190.5	61.6	46.2
Deposit growth	161.6	249.5	212.7	77.9	49.9
EA growth	74.6	98.6	176.1	54.4	43.8
Gross NPA ratio	0.3	0.4	0.5	0.7	0.9
Net NPA ratio	0.1	0.1	0.1	0.2	0.2
Provision coverage	70.0	70.0	70.0	70.0	75.0

**RoE decomposition (%)**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Net interest income/Assets	13.5	14.2	14.3	12.7	11.1
Non-interest income/Assets	0.7	0.5	0.3	0.3	0.3
Net revenues/Assets	14.2	14.7	14.6	13.0	11.4
Operating expense/Assets	(6.7)	(6.2)	(6.9)	(5.8)	(5.0)
Provisions/Assets	(1.5)	(0.6)	(0.4)	(0.8)	(0.9)
Taxes/Assets	(2.0)	(2.7)	(2.4)	(2.1)	(1.8)
Total costs/Assets	(10.3)	(9.5)	(9.7)	(8.7)	(7.8)
ROA	3.9	5.1	4.9	4.3	3.6
Equity/Assets	12.6	18.5	21.8	19.5	15.9
ROAE	30.9	27.8	22.3	22.3	22.9



### Valuation metrics

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	0.5	2.0	3.4	5.7	7.0
EPS growth (%)	(64.8)	306.1	66.8	67.2	23.4
Book value per share (INR)	4.4	9.0	23.1	27.7	33.5
Adjusted book value per share (INR)	4.3	8.9	23.0	27.5	33.1
Diluted P/E (x)	117.3	28.9	17.3	10.4	8.4
Price/ BV (x)	13.5	6.5	2.5	2.1	1.8
Price/ Adj. BV (x)	13.5	6.6	2.6	2.1	1.8
Dividend yield (%)	4.3	0.9	0.8	1.4	1.8

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

## ABSOLUTE RATING

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

## RELATIVE RETURNS RATING

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

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

## RELATIVE RISK RATING

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

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

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

# STEEL AUTHORITY OF INDIA

## Positive surprise on costs

India Equity Research | Metals and Mining

Steel Authority of India (SAIL) reported an EBITDA above estimates, led by positive surprise on costs while volume and realisations were broadly in-line. Forex translation loss of INR5bn dented the bottom-line. SAIL's expansion projects are tracking to revised schedules. We maintain 'HOLD/SU' on SAIL with a target price of INR107.

### EBITDA above estimates led by positive surprise on costs

SAIL's blended realisations for Q2FY12 at INR38.5k/t were down ~2% QoQ, but in-line with estimates. Volumes at 2.81mt were only slightly below estimates of 2.9mt. However, with raw material per tonne coming in at ~7% below estimates, EBITDA at INR11.8bn was ~20% above estimates. EBITDA/t at USD92/t was virtually flat QoQ.

### Forex loss of ~INR5bn mars bottom-line

SAIL reported notional forex loss of INR5bn on short term forex loans (we believe these are loans of USD500mn taken in Q2FY12).

### Projects on track, extra steps to improve raw material security

We understand SAIL's expansion projects are on track as per revised schedules. Projects at IISCO (2 mtpa) and Bokaro (net 0.2 mtpa) are on schedule for completion by June 2012 and March 2012 respectively. SAIL has been awarded iron ore exploration licence in Bellary, Karnataka. It has also floated a global tender for setting up 10mtpa iron ore beneficiation and 4mtpa pellet plants (SAIL has ~35mt of iron ore fines inventory). Additionally, SAIL's board has approved the revival of Sindri unit of FCI involving a 5.6mtpa greenfield steel plant and 1.15mtpa fertilizer plant with a total investment of INR300bn.

### Outlook and Valuations: No positive trigger, maintain 'HOLD/SU'

Capex guidance for FY12 has been cut from INR 140 bn earlier to INR 126 bn, reflecting partly slower project execution. In spite of Q2FY12 EBITDA being above estimates, we maintain our FY12 and FY13 estimates, considering a potential period of weak margins due to falling international steel prices. We maintain 'HOLD/SU' on SAIL with a target price of INR 107.

#### Financials

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E
Revenues (INR mn)	108,367	106,029	2.2	108,109	0.2	427,187	477,342
EBITDA (INR mn)	11,842	14,915	(20.6)	11,964	(1.0)	61,068	48,833
Net profit (INR mn)	4,946	10,900	(54.6)	8,381	(41.0)	49,047	31,087
Diluted EPS (INR)	1.2	2.6	(54.6)	2.0	(41.0)	11.9	7.5
Diluted P/E (x)						9.2	14.5
EV/EBITDA(x)						7.7	11.8
ROCE (%)						13.9	8.2

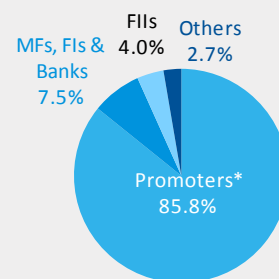
#### EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

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

CMP	: INR 109
Target Price	: INR 107
52-week range (INR)	: 202 / 98
Share in issue (mn)	: 4,130.4
M cap (INR bn/USD mn)	: 466 / 9,460
Avg. Daily Vol.BSE/NSE('000)	: 3,101.6

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Metals and Mining Index
1 month	8.1	8.4	1.5
3 months	(8.6)	(2.3)	(13.7)
12 months	(42.1)	(10.5)	(13.6)

#### Prasad Baji

+91 22 4040 7415  
prasad.baji@edelcap.com

#### Navin Sahadeo

+91 22 6623 3473  
navin.sahadeo@edelcap.com

November 3, 2011

## Other key highlights

- Capex incurred in Q2FY12 is INR 27.5 bn.
- The debt and cash as end of Q2FY12 are INR235bn and INR157bn respectively

**Table 1: Sequential realisation, volume and EBITDA/t remain stable**

	Q2FY12	Q2FY11	% change	Q1FY12	% change
Production volume (mn tonne)	3.0	3.1	(2.6)	3.0	(1.4)
Sales volume (mn tonne)	2.8	3.0	(6.3)	2.8	2.2
Net blended realisation	38,565	35,343	9.1	39,313	(1.9)
Raw material	18,340	17,220	6.5	17,996	1.9
Staff costs	7,049	5,668	24.4	8,186	(13.9)
Stores & spares	2,321	2,025	14.6	2,246	3.3
Power & fuel	3,999	2,922	36.9	3,698	8.1
Other expenses per tonne	2,641	2,532	4.3	2,832	(6.7)
Total costs per tonne	34,350	30,367	13.1	34,959	(1.7)
EBITDA per tonne	4,214	4,972	(15.2)	4,350	(3.1)
EBITDA per tonne - USD	92	107	(13.7)	97	(5.2)

Source: Company, Edelweiss research

**Chart 1: Sales volume drop YoY to 2.8 mt**

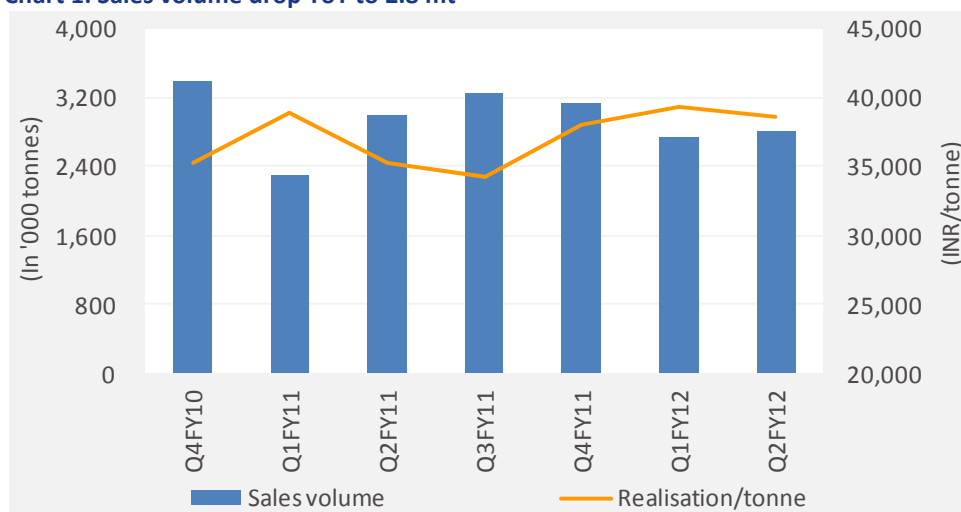
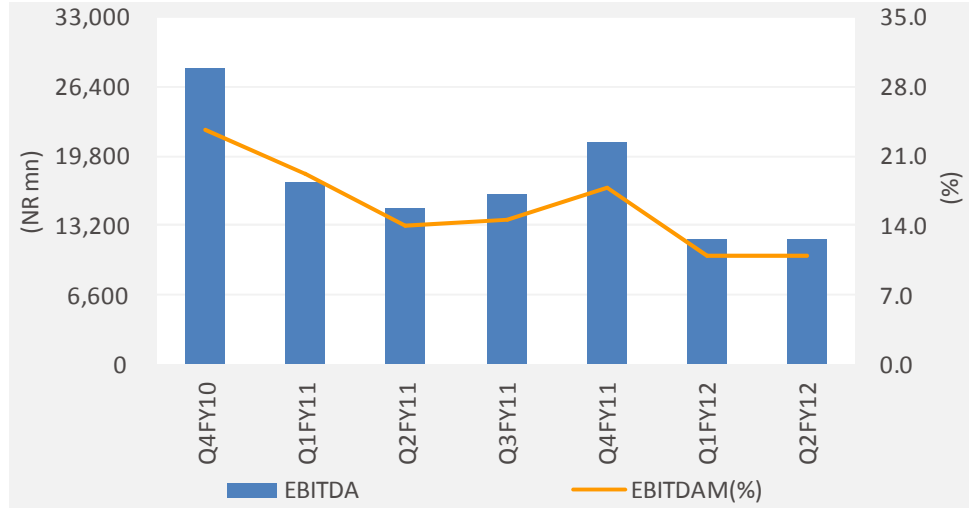
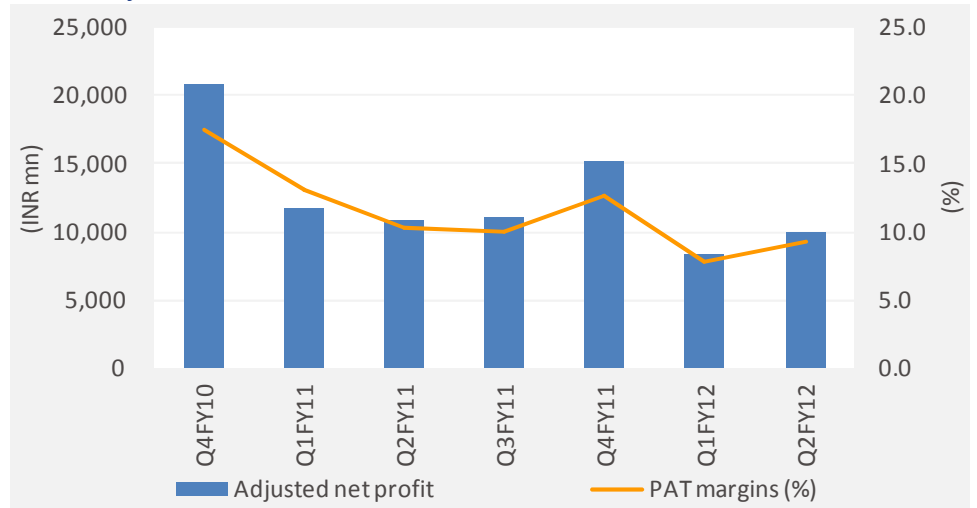


Chart 2: EBITDA remains stable Q-o-Q



Source: Company, Edelweiss research

Chart 3: Adjusted PAT increases ~ 20% Q-o-Q



Source: Company, Edelweiss research

## Financials snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E	FY13E
Total net revenues	108,367	106,029	2.2	108,109	0.2	427,187	477,342	534,487
Dec/(inc) in stock	(4,548)	2,865	(258.7)	(2,799)	62.5	(13,527)	0	0
Raw material	56,085	48,794	14.9	52,290	7.3	202,479	234,670	244,004
Staff costs	19,808	17,004	16.5	22,512	(12.0)	76,233	89,000	93,450
Stores & spares	6,521	6,076	7.3	6,178	5.6	23,951	23,135	26,474
Power & fuel	11,237	8,766	28.2	10,171	10.5	35,876	46,321	53,005
Purchase of traded goods/Materials/Items	19	12	N/M	9	N/M	0	0	0
Other expenses	7,403	7,597	(2.6)	7,787	(4.9)	41,106	35,382	39,693
Total expenditure	96,525	91,114	5.9	96,146	0.4	366,119	428,508	456,625
EBITDA	11,842	14,915	(20.6)	11,964	(1.0)	61,068	48,833	77,862
Exceptional items	0	0		0		1,037	0	0
Interest	2,000	1,090	83.4	1,710	17.0	4,750	6,770	9,420
Depreciation	3,938	3,688	6.8	3,742	5.2	14,858	14,559	16,745
Other income	6,332	5,787	9.4	5,781	9.5	29,446	20,022	13,494
PBT	12,236	15,923	(23.2)	12,293	(0.5)	71,943	47,526	65,190
Tax	2,203	5,023	(56.2)	3,913	(43.7)	22,896	16,439	22,549
Adjusted net profit	10,034	10,900	(7.9)	8,381	19.7	49,047	31,087	42,640
Extraordinary items	(5,087)	0		0			0	0
Reported net profit	4,946	10,900	(54.6)	8,381	(41.0)	49,047	31,087	42,640
Equity capital (FV INR 10)	41,305	41,304		41,304		41,304	41,304	41,304
# of shares (mn)	4,130	4,130		4,130		4,130	4,130	4,130
EPS (INR)	1.2	2.6	(54.6)	2.0	(41.0)	11.9	7.5	10.3

## as % of net revenues

Raw material	47.6	48.7		45.8		44.2	49.2	45.7
Staff costs	18.3	18.6		20.4		17.8	18.6	17.5
Stores & spares	6.0	6.6		5.6		5.6	4.8	5.0
Power & fuel	10.4	8.3		9.4		8.4	9.7	9.9
Other expenses	6.8	7.2		7.2		9.6	7.4	7.4
EBITDA	10.9	14.1		11.1		14.3	10.2	14.6
Adjusted net profit	9.3	10.3		7.8		11.5	6.5	8.0
Tax rate	18.0	31.5		31.8		31.8	34.6	34.6

### Company Description

Steel Authority of India (SAIL) is the largest steel-maker in India (fifteenth-largest in the world), and is one of the Government of India's 'Navratna' companies with saleable steel capacity of 13 mt. The company has the distinction of being India's largest producer of iron ore and of having the country's second largest mines network.

Ranked amongst the top ten public sector companies in India in terms of turnover, it produces both carbon and special steel for the construction, engineering, power, railway, automotive, and defense industries and benefits from 100% self-sufficiency in iron ore. The company enjoys a near-monopoly position in the lucrative market for rails and heavy plates in India.

Its units are located near iron ore and non-coking coal reserves, primarily in the eastern and central parts of the country. SAIL has merged Indian Iron and Steel Company, an ailing subsidiary, with itself and is awaiting the allocation of Chiria iron ore mines, which is currently being opposed by the Jharkhand government.

### Investment Theme

SAIL's product mix has been improving gradually with reduction in semis and some improvement in production of value-added products. SAIL's costs such as employee, stores & spares and power costs have been consistently reducing since Q2FY09. This, coupled with the healthy balance sheet, mitigates the issue of lower volume growth.

### Key Risks

Higher than anticipated increase in staff, raw material and other operating costs

Deterioration in product mix

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net revenue	431,501	405,514	427,187	477,342	534,487
Accretion to stock	(19,345)	11,610	(13,527)	0	0
Raw material costs	217,577	186,083	226,430	257,806	270,477
Employee expenses	84,015	54,168	76,233	89,000	93,450
Power & freight	31,146	33,646	35,876	46,321	53,005
SGA & other expenses	40,408	35,105	41,106	35,382	39,693
Total operating expenses	353,801	320,612	366,119	428,508	456,625
EBITDA	77,700	84,902	61,068	48,833	77,862
Depreciation and amortisation	12,851	13,372	14,858	14,559	16,745
EBIT	64,849	71,529	46,210	34,274	61,117
Interest expenses	2,532	4,020	4,750	6,770	9,420
Other income	30,985	33,577	29,446	20,022	13,494
VRS & other expenses	38	232	1,037	0	0
Profit before tax	93,339	101,318	71,943	47,526	65,190
Provision for tax	32,286	33,777	22,896	16,439	22,549
Core profit	61,053	67,541	49,047	31,087	42,640
Profit after tax	61,053	67,541	49,047	31,087	42,640
Profit after minority interest	61,053	67,541	49,047	31,087	42,640
Basic shares outstanding (mn)	4,130	4,130	4,130	4,130	4,130
Basic EPS	14.8	16.4	11.9	7.5	10.3
Diluted shares (mn)	4,130	4,130	4,130	4,130	4,130
Diluted EPS	14.8	16.4	11.9	7.5	10.3
Dividend per share (INR)	2.6	3.3	2.4	3.5	3.5
Dividend payout (%)	17.4	20.2	20.2	20.2	20.2

## Common size metrics- as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	82.0	79.1	85.7	89.8	85.4
Depreciation	3.0	3.3	3.5	3.1	3.1
Interest expenditure	0.6	1.0	1.1	1.4	1.8
EBITDA margins	18.0	20.9	14.3	10.2	14.6
Net profit margins	14.1	16.7	11.5	6.5	8.0

## Growth metrics (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	9.2	(6.0)	5.3	11.7	12.0
EBITDA.	(26.2)	9.3	(28.1)	(20.0)	59.4
PBT	(18.3)	8.5	(29.0)	(33.9)	37.2
Net profit	(18.5)	10.6	(27.4)	(36.6)	37.2
EPS	(18.5)	10.6	(27.4)	(36.6)	37.2



Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
Equity capital	41,304	41,304	41,304	41,304	41,304
Reserves & surplus	238,537	291,863	329,391	343,993	370,150
Shareholders funds	279,841	333,167	370,695	385,297	411,454
Secured loans	14,736	77,559	118,139	148,139	223,139
Unsecured loans	60,652	87,554	83,516	83,516	83,516
Borrowings	75,388	165,113	201,655	231,655	306,655
Deferred tax liability	13,322	14,149	14,911	14,911	14,911
<b>Sources of funds</b>	<b>368,550</b>	<b>512,429</b>	<b>587,260</b>	<b>631,863</b>	<b>733,019</b>
Gross block	327,287	353,962	382,632	449,309	565,542
Depreciation	204,599	217,809	231,805	246,364	263,109
Net block	122,688	136,153	150,827	202,945	302,432
CWIP	65,442	150,261	222,258	290,581	344,348
Total fixed assets	188,131	286,414	373,085	493,526	646,781
Investments	6,527	6,688	6,841	6,841	6,841
Loans and advances	21,221	33,431	46,579	46,579	46,579
Inventories	101,215	90,275	113,028	126,298	141,418
Sundry debtors	30,244	34,939	41,613	46,499	52,065
Cash and equivalents	182,285	224,364	174,789	100,598	50,376
Total current assets	345,109	390,812	380,904	325,443	296,564
Sundry creditors and others	77,134	109,369	114,749	128,221	143,571
Provisions	94,082	62,117	58,821	65,727	73,596
Total CL & provisions	171,216	171,485	173,570	193,948	217,166
Net current assets	173,893	219,326	207,334	131,496	79,397
<b>Uses of funds</b>	<b>368,550</b>	<b>512,429</b>	<b>587,260</b>	<b>631,863</b>	<b>733,019</b>
Book value per share (BV) (INR)	68	81	90	93	100

## Free cash flow metrics

Year to March	FY09	FY10	FY11	FY12E	FY13E
Net profit	61,053	67,541	49,047	31,087	42,640
Add: Non cash charge	10,487	(31,649)	4,402	14,559	16,745
Gross cash flow	71,540	35,892	53,450	45,646	59,386
Less: Changes in W. C.	10,992	(14,925)	32,639	(1,648)	(1,877)
Operating cash flow	60,547	50,817	20,811	47,293	61,263
Less: Capex	54,864	101,763	106,715	135,000	170,000
<b>Free cash flow</b>	<b>5,683</b>	<b>(50,946)</b>	<b>(85,904)</b>	<b>(87,707)</b>	<b>(108,737)</b>

## Cash flow statement

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating cash flow	61,243	48,005	21,560	47,293	61,263
Financing cash flow	27,513	73,950	18,175	13,516	58,516
Investing cash flow	(44,065)	(80,212)	(89,333)	(135,000)	(170,000)
Net cash flow	44,691	41,743	(49,597)	(74,191)	(50,221)
Capex	54,864	101,763	106,715	135,000	170,000
Dividends paid	(14,960)	(11,978)	(11,978)	(16,484)	(16,484)

## Ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	23.9	22.0	13.9	8.2	10.7
ROACE (%)	20.5	16.5	8.5	5.7	9.0
Inventory (days)	156	177	174	169	181
Debtors (days)	26	29	33	34	34
Payable (days)	130	172	192	172	183
Cash conversion cycle (days)	52	34	15	31	31
Debt/EBITDA	1.0	1.9	3.3	4.7	3.9
Current ratio	2.0	2.3	2.2	1.7	1.4
Debt/ Equity	0.3	0.5	0.5	0.6	0.7
Adjusted debt/Equity	0.3	0.5	0.5	0.6	0.7

## Turnover

Year to March	FY09	FY10	FY11	FY12E	FY13E
Fixed assets t/o (x)	3.6	3.1	3.0	2.7	2.1
Total asset turnover (x)	1.3	0.9	0.8	0.8	0.8
Equity turnover (x)	1.7	1.3	1.2	1.3	1.3

## Valuation parameters

Year to March	FY09	FY10	FY11	FY12E	FY13E
EPS (INR)	14.8	16.4	11.9	7.5	10.3
Y-o-Y growth (%)	(18.5)	10.6	(27.4)	(36.6)	37.2
CEPS (INR)	17.3	19.6	15.5	11.1	14.4
P/E (x)	7.4	6.7	9.2	14.5	10.6
Price/BV(x)	1.6	1.4	1.2	1.2	1.1
EV/Sales (x)	0.8	0.9	1.1	1.2	1.3
EV/EBITDA (x)	4.3	4.5	7.7	11.8	9.0
Dividend yield (%)	2.4	3.0	2.2	3.2	3.2

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bhushan Steel	HOLD	SP	M	Coal India	BUY	SO	M
Hindalco Industries	BUY	SO	M	Hindustan Zinc	BUY	SO	L
Jindal Steel & Power	BUY	SO	M	JSW Steel	BUY	SO	M
National Aluminium Company	HOLD	SU	M	Sesa Goa	HOLD	SP	M
Steel Authority of India	HOLD	SU	L	Sterlite Industries (India)	BUY	SP	M
Tata Steel	BUY	SO	M	Usha Martin	HOLD	SP	M

## ABSOLUTE RATING

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

## RELATIVE RETURNS RATING

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

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

## RELATIVE RISK RATING

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

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

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

# TAJ GVK HOTELS & RESORTS

## A mixed bag

India Equity Research | Hotels

Taj GVK Hotels & Resorts (Taj GVK) posted better-than-expected Q2FY12 operational numbers. Sales, at INR592mn (flat YoY), EBITDA margin of 33% and 19% PAT margin (adjusted for deferred tax) were above our estimates. However, political uncertainty in Hyderabad, increased competition, upsurge in hotel business in the hi-tech city (away from CBD where Taj GVK dominates) and economic slowdown are expected to keep ARR and ORs under pressure in the near term. Taj GVK remains one of the most attractive hotel stocks despite superior operational parameters. We maintain 'BUY' with a reduced TP of INR 130.

### Steady performance in Q2FY12; mixed ARR and ORs trend

Taj GVK's reported PAT of INR43mn was down 40% YoY due to the creation of deferred tax liability of INR70mn. Sales and EBITDA were flat YoY. Hyderabad properties reported mixed ARR and ORs trend—while Taj Krishna posted YoY improvement, the other two properties posted a decline. ARR and ORs of Chandigarh property dipped due to increased competition. Expansion plans are on track as the new hotel at Begumpet is likely to start operations by Q3FY12 end.

### Revising down estimates as outlook for busy H2FY12 subdued

Outlook for H2FY12, which is peak season for the hospitality industry, is subdued for Taj GVK with management expecting only 3-5% hike in ARR over H1, primarily driven by increased competition and additional supplies. We are revising down our OR estimates for FY12 to 62% (earlier 67%) and for FY13 to 68% (earlier 72%). We have also revised down our ARR assumptions 4-5% over the same period. As a result, our sales estimates are down ~10-12% and EBITDA 15-16% over FY12-13.

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

Taj GVK is strengthening its leadership in Hyderabad's CBD area by adding new facilities. At CMP of INR 93, the stock is currently trading at EV/EBITDA of 7.5x and 6.1x FY12E and FY13E, respectively. The company continues to trade at ~40% discount to replacement costs despite having one of the best operational parameters. We value it at 8x (30% discount to other large players) FY13E EV/EBITDA (rolling over from FY12) and reduce our TP to INR 130 (INR 165 earlier). We maintain 'BUY' recommendation.

#### Financials

Year to March	Q2FY12	Q2FY11	Growth %	Q1FY12	Growth %	FY11	FY12E
Net rev (INR mn)	592	598	(0.9)	589	0.6	2,595	2,804
EBITDA (INR mn)	195	193	1.2	204	(4.5)	965	986
Net profit (INR mn)	43	74	(41.9)	120	(64.1)	433	414
Diluted EPS (INR)	0.7	1.2	(41.9)	1.9	(64.1)	6.9	6.6
Diluted P/E (x)						13.6	14.2
EV/EBITDA (x)						7.5	7.5
RoAE (%)						14.2	12.6

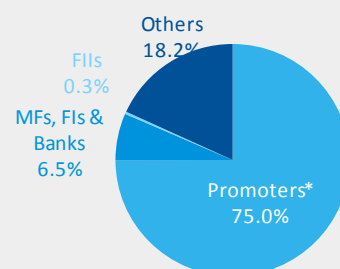
#### EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	None

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

CMP	: INR 93
Target Price	: INR 130
52-week range (INR)	: 155 / 84
Share in issue (mn)	: 62.7
M cap (INR bn/USD mn)	: 6 / 119
Avg. Daily Vol. BSE/NSE ('000)	: 61.6

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	2.0	4.5	2.5
3 months	(8.2)	(2.3)	5.9
12 months	(26.3)	(34.7)	(8.4)

#### Manav Vijay

+91 22 4063 5413  
manav.vijay@edelcap.com

#### Manish Sarawagi

+91 22 4040 7575  
manish.sarawagi@edelcap.com

November 2, 2011

### Expansions on track to boost F&B sales

The new 181 rooms hotel at Begumpet is expected to be operational during November 2011. Expansion of car parking at Taj Krishna and Ginger, Hyderabad, is on track in terms of time as well as capex involved. With the opening of the car parking facility at Krishna, Hyderabad, we believe the proportion of F&B in overall sales will rise to more than 50% in FY13E.

**Table 1: Property wise ORs** (%)

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Taj Krishna	60.0	56.0	63.0	64.0	53.0	58.0
Taj Banjara	66.0	71.0	73.0	79.0	52.0	57.0
Taj Chandigarh	74.0	65.0	77.0	74.0	75.0	63.0
Taj Mount Road	50.0	57.0	65.0	75.0	63.0	63.0
Deccan Hyderabad	67.0	72.0	69.0	74.0	63.0	67.0

Source: Company, Edelweiss research

**Table 2: Property wise ARRs** (INR)

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Taj Krishna	7,500	7,200	7,500	8,000	7,500	7,700
Taj Banjara	5,300	5,000	5,500	5,500	5,200	5,000
Taj Chandigarh	7,300	7,500	8,000	7,800	7,000	7,000
Taj Mount Road	5,300	5,500	5,200	5,300	5,200	4,700
Deccan Hyderabad	5,300	5,000	5,500	5,500	5,200	5,000

Source: Company, Edelweiss research

## Financials snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	Growth %	Q1FY12	Growth %	FY11	FY12E	FY13E
Income from operations	592	598	(0.9)	589	0.6	2,595	2,804	3,270
Total income	592	598	(0.9)	589	0.6	2,595	2,804	3,270
Expenditure	397	405	(1.9)	384	3.4	1,630	1,817	2,137
F&B	57	60	(4.8)	56	2.3	252	266	311
Employee costs	124	123	0.6	119	4.2	468	533	621
Fuel, power & light	56	53	6.6	53	5.4	210	266	311
Other expenditure	160	169	(5.4)	156	2.3	701	752	895
EBIDTA	195	193	1.2	204	(4.5)	965	986	1,132
Depreciation	50	50	(0.3)	50	(0.5)	206	236	277
EBIT	145	143	1.7	154	(5.9)	759	750	855
Interest expenses	32	30	6.3	29	9.0	113	151	131
Other income	-	-	NA	1	(100.0)	11	10	10
Profit before tax & extraord. item	113	113	0.5	126	(9.9)	657	609	734
PBT	113	113	0.5	126	(9.9)	657	609	734
Provision for taxes	70	39	81.9	6	1,130.1	224	195	242
PAT	43	74	(41.9)	120	(64.1)	433	414	491
Diluted EPS	0.7	1.2	(41.9)	1.9	(64.1)	6.9	6.6	7.8
as % of net revenue								
F&B	9.7	10.1		9.5		9.7	9.5	9.5
Employee costs	20.9	20.6		20.2		18.0	19.0	19.0
Fuel, power & light	9.5	8.8		9.1		8.1	9.5	9.5
Other expenses	27.0	28.2		26.5		27.0	26.8	27.4
EBIDTA	33.0	32.3		34.7		37.2	35.2	34.6
PAT	7.3	12.4		20.4		16.7	14.8	15.0

### Company Description

Incorporated in 1999, Taj GVK Hotels & Resorts (Taj GVK) is a joint venture of the Taj and GVK group. The Tata group company, Indian Hotels Company (IHCL), holds 25.52% of the JV, and other promoters 49.47%. IHCL is a strategic investor in the company. All major decisions including on investments are taken by the board including the representatives from IHCL. IHCL also manages all the properties and receives management contract fees as part of the operating agreement.

Taj GVK currently operates five premium properties, totaling 900 rooms in cities like Hyderabad, Chennai and Chandigarh. Hyderabad accounts for more than 50% of the total rooms and revenues. To diversify the operations and reduce its dependence on the Hyderabad market, the company opened hotels in Chandigarh (149 rooms) and Chennai (220 rooms).

### Investment Theme

With its leadership position at the CBD area of Hyderabad, no other major hotel group has its presence in the entire Banjara Hills area. With its current 3 properties in Hyderabad, the company is adding another property at a relatively lower category to have presence across all the required segments. Strategic expansion of car parking facility at Taj Krishna to attract higher MICE and banqueting business is expected to help the company in the long term. To diversify, the company has opened hotels in Chandigarh and Chennai. With one of the best operating and return ratios in the industry, the company is one of the best managed operations in the country.

### Key Risks

Heavy reliance on Hyderabad, execution delays in the expansion plans and general economic slowdown are some of the risks for the company.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Income from operations	2,375	2,283	2,593	2,804	3,270
Total operating expenses	1,492	1,422	1,631	1,817	2,137
Employee cost	453	410	468	533	621
Selling, general & admin expenses	241	223	249	266	311
Other expenditure	798	789	913	1,018	1,206
EBITDA	1,037	861	962	986	1,132
Depreciation and amortisation	137	196	206	236	277
EBIT	900	665	756	750	855
Interest	84	122	113	151	131
Total other income	12	10	14	10	10
Profit before tax	828	553	657	609	734
Provision for tax	289	187	224	195	242
Core profit	539	366	433	414	491
Extraordinary income/(loss)	(11)	(3)	-	-	-
Profit after tax	527	363	433	414	491
Profit after minority interest	527	363	433	414	491
Shares outstanding (mn)	62.7	62.7	62.7	62.7	62.7
EPS (INR) basic	8.6	5.8	6.9	6.6	7.8
Diluted shares (mn)	62.7	62.7	62.7	62.7	62.7
EPS (INR) diluted	8.6	5.8	6.9	6.6	7.8
Dividend per share (INR)	2.0	2.0	2.0	3.0	3.0
Dividend payout (%)	27.9	40.5	33.9	53.3	44.9

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

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	62.8	62.3	62.9	64.8	65.4
Employee cost	19.1	18.0	18.0	19.0	19.0
Selling, general & admin expenses	10.2	9.7	9.6	9.5	9.5
Other expenditure	33.6	34.6	35.2	36.3	36.9
Depreciation and amortisation	5.7	8.6	7.9	8.4	8.5
Interest expenditure	3.5	5.4	4.4	5.4	4.0
EBITDA margins	43.6	37.7	37.1	35.2	34.6
Net profit margins	22.7	16.0	16.7	14.8	15.0

### Growth metrics (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	(7.8)	(3.9)	13.6	8.1	16.6
EBITDA	(14.5)	(17.0)	11.8	2.5	14.8
PBT	(23.7)	(33.2)	18.8	(7.3)	20.5
Core net profit	(23.7)	(32.1)	18.3	(4.4)	18.7
EPS	(23.7)	(32.1)	18.3	(4.4)	18.7



<b>Balance sheet</b>					(INR mn)
<b>As on 31st March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Equity capital	125	125	125	125	125
Reserves & surplus	2,585	2,801	3,089	3,283	3,554
Shareholders funds	2,710	2,927	3,214	3,408	3,679
Secured loans	1,090	1,203	1,311	1,511	911
Unsecured loans	300	50	100	100	100
Borrowings	1,390	1,253	1,411	1,611	1,011
Minority interest	10	9	20	20	20
Deferred tax (net)	122	161	193	266	361
<b>Sources of funds</b>	<b>4,233</b>	<b>4,350</b>	<b>4,838</b>	<b>5,305</b>	<b>5,071</b>
Gross block	4,631	4,830	4,937	6,887	6,987
Depreciation	891	1,075	1,255	1,491	1,769
Net block	3,740	3,755	3,682	5,395	5,218
Capital work in progress	694	843	1,204	104	104
Inventories	45	44	47	54	63
Sundry debtors	64	68	97	69	81
Cash and bank balances	21	29	50	115	50
Loans and advances	197	217	264	250	250
Total current assets	327	358	458	488	444
Sundry creditors and others	395	452	339	496	488
Provisions	149	170	181	201	221
Total current liabilities & provisions	544	622	520	697	708
Net current assets	(217)	(263)	(62)	(208)	(264)
Miscellaneous expenditure	17	15	13	13	13
<b>Uses of funds</b>	<b>4,233</b>	<b>4,350</b>	<b>4,838</b>	<b>5,305</b>	<b>5,071</b>
Book value per share (INR)	43	46	51	54	58

<b>Free cash flow</b>					(INR mn)
<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Net profit	527	363	433	414	491
Depreciation	137	196	206	236	277
Deferred tax	33	38	32	-	-
Others	41	148	109	224	226
Gross cash flow	738	745	780	875	995
Less: Changes in working capital	(177)	(34)	173	(212)	9
Operating cash flow	916	779	606	1,087	987
Less: Capex	1,258	362	497	850	100
<b>Free cash flow</b>	<b>(342)</b>	<b>417</b>	<b>109</b>	<b>237</b>	<b>887</b>

<b>Cash flow metrics</b>					
<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Operating cash flow	916	779	606	1,087	987
Financing cash flow	250	(410)	(89)	(172)	(952)
Investing cash flow	(1,258)	(362)	(497)	(850)	(100)
Net cash flow	(92)	8	21	66	(65)
Capex	(1,258)	(362)	(497)	(850)	(100)
Dividend paid	(200)	(126)	(126)	(188)	(188)

**Ratios**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
ROAE (%)	21.5	13.1	14.2	12.6	13.9
ROACE (%)	24.0	15.5	16.5	14.8	16.5
Inventory (days)	6	7	6	7	7
Debtors (days)	9	11	12	11	8
Payable (days)	85	116	88	84	84
Cash conversion cycle	(69)	(98)	(70)	(66)	(69)
Current ratio	0.6	0.6	0.9	0.7	0.6
Debt/EBITDA	1.3	1.5	1.5	1.6	0.9
Interest cover (x)	10.7	5.4	6.7	5.0	6.5
Fixed assets turnover (x)	0.6	0.6	0.7	0.5	0.6
Total asset turnover (x)	0.6	0.5	0.5	0.5	0.6
Equity turnover(x)	1.0	0.8	0.9	0.9	1.0
Debt/Equity (x)	0.5	0.4	0.4	0.5	0.3
Adjusted debt/Equity	0.5	0.4	0.4	0.5	0.3

**Du pont analysis**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
NP margin (%)	22.7	16.0	16.7	14.8	15.0
Total assets turnover	0.6	0.5	0.6	0.6	0.6
Leverage multiplier	1.5	1.5	1.5	1.5	1.5
ROAE (%)	21.5	13.1	14.2	12.6	13.9

**Valuation parameters**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Diluted EPS (INR)	8.6	5.8	6.9	6.6	7.8
Y-o-Y growth (%)	(23.7)	(32.1)	18.3	(4.4)	18.7
CEPS (INR)	11.3	9.6	10.7	11.5	13.8
Diluted P/E (x)	10.9	16.1	13.6	14.2	12.0
Price/BV(x)	2.2	2.0	1.8	1.7	1.6
EV/Sales (x)	3.1	3.1	2.8	2.6	2.1
EV/EBITDA (x)	7.0	8.3	7.5	7.5	6.1
EV/EBITDA (x)+1 yr forward	6.8	6.1	6.0	5.2	
Dividend yield (%)	2.1	2.1	2.1	3.2	3.2

# ALUMINIUM

## Strong demand to drive up prices

India Equity Research | Metals and Mining

China to continue to drive the global aluminium market which we estimate to surge by a robust 11% in 2011 and 7% in 2012 despite the fragile demand from the US and Europe. The current price of ~USD 2,200/t is significantly below the marginal cost of USD 2,590/t which is unsustainable, in our view. Though we expect prices to recover, we are lowering our FY13 estimate by ~6% to USD 2,550/t. We also see a similar trend in zinc but prefer aluminium over zinc. Stocks, however, are factoring in a far severe scenario. Despite the earnings cut, we maintain 'BUY' on Hindalco, Sterlite (our top picks), and Hindustan Zinc (HZL) and 'HOLD' on National Aluminium (NALCO).

### Global market better than in 2008, but prices below marginal cost

For 9mCY11, the global as well as Chinese aluminium demand is growing at a pace of 11.4% and 16.7% respectively while in 9mCY08, it was much weaker at 1% and 3.5% respectively. Aluminium prices were relatively overvalued in 9mCY08 considering the weak demand being ~USD 100/t above the marginal cost whereas average prices in 9mCY11 are already ~USD 50/t below marginal cost in spite of better demand.

### Demand to ride high on emerging markets as developed world toils

We factor in the CY12 demand to decline 5.0% Y-o-Y and 5.8% Y-o-Y for US and Europe respectively. However, given the strong growth in China (13.5% Y-o-Y in CY12) and emerging markets, global aluminium demand is not expected to recede. Even as we lower our global growth estimate, it remains fairly strong at 7.0% Y-o-Y for CY12E, carrying on from the 11% Y-o-Y growth in CY11.

### Shadow indicators allude to higher prices ahead

The ratio of aluminium prices (energy proxy) and Brent crude is at an all-time low. The price for incentivising new supply is USD 3,230/t while our long-term price is USD 2,700/t, both significantly higher than current prices.

### Outlook: Prices to rebound; buying opportunity now

For **Hindalco**, revised price assumptions and a cut in estimates of Novelis and the copper business lead to a 14.5% downward revision in FY13E EBITDA. We maintain '**BUY/Sector Outperformer**' but reduce our price target from INR 266 to INR 197, incorporating a ~55% discount to CWIP against our earlier assumption of 15%. For **Sterlite**, we cut FY13E EBITDA by ~20%, led by 12.5% cut in zinc prices and reduced power generation. We maintain '**BUY/Sector Performer**', but trim our TP from INR 195 to INR 166, excluding Talwandi Saboo project in our valuation. For **HZL**, the cut in FY13E EBITDA is ~14%; maintain '**BUY/ Sector Outperformer**' with revised price target of INR 150 (earlier INR 166). For **NALCO**, the cut in FY13E EBITDA is ~21%; maintain '**HOLD/Sector Performer**' with revised price target of INR 64 (earlier INR 73).

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

**Navin Sahadeo**  
 +91 22 6623 3473  
 navin.sahadeo@edelcap.com

November 3, 2011



# ASHOK LEYLAND

## Mixed bag performance

India Equity Research | Automobiles

Ashok Leyland (AL) Q2FY12 was a mixed bag with PAT at INR1.5bn (down 8% Y-o-Y) were 17%/9% ahead of ours and consensus estimates. However, the quality of earnings was not very encouraging. Despite an improvement in product mix and ramp up at Pantnagar plant, gross margins declined by 140bps Q-o-Q to 26.5%. Improvement in EBITDA margin by 130bps Q-o-Q to 10.7% was entirely driven by operating leverage. It brings sustainability of margins under doubt given the expectations of sales slow-down and an increase in discounts in H2FY12. Management call is scheduled for 4th Nov 2011 at 10:30 am IST. We maintain Reduce with TP of INR22

### Operating leverage benefit pulled down by gross margin pressure

AL's sales and margins were ahead of ours and street expectations. The Q2 sales volume was 4% above our estimate due to strong numbers in September after weak performance for two months. Operating leverage led to higher deviation from our expectation at EBITDA level (11% and 2% above ours and street estimates).

Despite an improvement in product mix (3% less bus Q-o-Q) and higher production from Pantnagar (7,000 units vs 5,900 units in Q1), gross margins declined by 140bps sequentially. Benefit of operating leverage helped it post an improvement in EBITDA margins to 10.7% vs 9.4% in Q1FY12

### Debt increase and so does interest ; Lower taxes provides relief

Despite an improvement in inventory situation, gross debt has increased by 31% to INR33.6bn in last two quarters. As a result, interest cost has gone up to INR627mn vs INR533mn in Q1FY12 and INR451mn in Q4FY11. Relief has come from lower tax rate at 20% vs our expectations of 22%.

### Outlook and valuations: Challenging; maintain 'REDUCE'

Outlook for H2FY12 stays challenging as the full impact of rising interest rate is being felt on freight availability and discount increases. We maintain 'REDUCE/ Sector Underperformer' recommendation/rating on AL with a target price of INR 22.

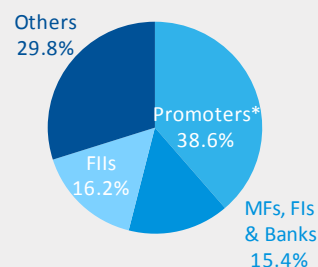
#### EDELWEISS 4D RATING

Absolute Rating	REDUCE
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	Low
Sector Relative to market	Equalweight

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

CMP	: INR 27
Target Price	: INR 22
52-week range (INR)	: 40 / 22
Share in issue (mn)	: 2,660.7
M cap (INR bn/USD mn)	: 71 / 1,451
Avg. Daily Vol. BSE/NSE ('000)	: 9,836.7

#### SHARE HOLDING PATTERN (%)



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

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Auto Index
1 month	(0.4)	8.4	13.8
3 months	4.1	(2.3)	10.5
12 months	(26.8)	(10.5)	(0.2)

#### Sachin Gupta

+91-22-6623 3472  
sachin.gupta@edelcap.com

#### Chetan Vora

+91-22-6620 3101  
chetan.vora@edelcap.com

November 03, 2011

#### Financials

Year to March	FY10	FY11	FY12E	FY13E
Revenues (INR mn)	72,813	111,692	124,878	142,590
Rev. growth (%)	20.9	53.4	11.8	14.2
EBITDA (INR mn)	8,008	12,436	12,806	14,647
Net profit (INR mn)	4,237	6,312	6,449	7,649
Shares outstanding (mn)	2,661	2,661	2,661	2,661
Diluted EPS (INR)	1.6	2.5	2.4	2.9
EPS growth (%)	193.6	58.2	(1.9)	18.6
Diluted P/E (x)	17.3	10.9	11.1	9.4
EV/EBITDA (x)	10.7	6.7	6.7	5.4
ROAE (%)	11.7	17.2	15.5	16.6



# CONSUMER GOODS

## Pakistan: The new growth frontier?

India Equity Research | Consumer Goods

The Pakistan government has granted India the Most Favoured Nation (MFN) status. The move is expected to raise legal trade between the two fractious neighbours manifold, benefitting Indian consumer companies (Dabur, Marico, Godrej Consumer, Emami, Pidilite). At a time when domestic growth is slackening for some domestic consumer companies like Dabur, Pakistan can provide the much needed shot in the arm. This opportunity, in our view, over the long term can be as huge as Bangladesh (contributes 50% to Marico's international business; 16% to overall revenue). A few domestic consumer companies already have a small presence (through informal trade and via Dubai) and good brand recognition in Pakistan due to widespread viewership of Indian television. We see this as a structural positive for domestic consumer firms.

### MFN status: Much needed shot in the arm

Dabur, GCPL and Marico told us that they have a limited presence in Pakistan currently and view this development positively. Dabur is witnessing muted growth and breakeven level in Pakistan and will benefit from this move. Mr. P Ganesh, CFO, GCPL, believes this is a big opportunity and Mr. Vijay Subramaniam, CEO (international business), Marico, said the company will look at Pakistan market in a far more strategic manner. We expect GCPL to evaluate Pakistan's hair colour and household insecticide categories. At a time when some consumer firms' growth is slowing in the domestic market (Dabur: 4.5% volume growth, Marico issued growth warning, Emami expected to report slowdown in volume growth largely due to seasonality), Pakistan can provide the much needed boost with an opportunity as big as Bangladesh. Pakistan's population is bigger than Bangladesh's and consumer habits are similar to India.

### Direct link holds USD 6 bn trade potential

The informal trade between Indian and Pakistan (exports via Dubai, Nepal and Mauritius and smuggling) is humungous and pegged at USD 3.5 bn. Pakistan granting MFN status to India is likely to lead to direct trade doubling to ~USD 6 bn in three years.

### Volatile political relations a major risk

We expect execution to be a major challenge. The India-Pakistan relationship is not based on sound economic decisions, but is more political. In spite of India granting Pakistan MFN status in 1996, the latter has permitted import of just 852 items from India. Terror threats from and internal civil war in Pakistan will prove to be a challenge for Indian consumer goods companies (case in point: during the recent Arab uprising, major consumer goods companies faced a setback).

**Likely beneficiaries:** Dabur, Marico, GCPL, Emami, Pidilite.

**Abneesh Roy**

+91 22 6620 3141

abneesh.roy@edelcap.com

**Harsh Mehta**

+91 22 4063 5543

harsh.mehta@edelcap.com

November 3, 2011



# TELECOM

## TRAI Recommendations – More liberal M&A policy

India Equity Research | Telecom

The TRAI published its response to the Department of Telecom's views on its recommendations made in May 2010. It has recommended more liberal M&A norms with a market share criterion of 35% for the combined entity and permitting merger between players who hold spectrum beyond 4.4 MHz as well. All the other responses are a reiteration of its previous recommendations. The net negative impact on Bharti's DCF of INR 475 per share would be INR 30 and for Idea's DCF of INR 103 would be INR 21 in case these recommendations are accepted.

### The key recommendations made by the TRAI are:

- **M&A** – Allow operators holding more than 4.4 MHz spectrum each to merge. It had earlier recommended that only players with 4.4 MHz be allowed to merge. The combined market share (subscriber based on VLR and revenue) of the merged entity should not exceed 35%. But in case it exceeds 35% but up to 60%, TRAI would evaluate and make a recommendation to the government on a case to case basis. *Bharti has 31% market share, Vodafone 22%, Idea 14%, RCOM 9%, Docomo 9% and rest of them have less than 5%. This means even a merger as significant as one between Vodafone and Idea is possible.*
- **Spectrum cap** – TRAI had earlier prescribed a cap of 10 MHz spectrum in Delhi and Mumbai and 8 MHz in all other circles. It is now permitting operators to acquire spectrum beyond this limit through auction or merger.
- **Spectrum pricing** – It reiterated its stance that recommendations made by the group of experts in February 2011 be applicable. The price of spectrum in the 900 MHz band should be 1.5x that of the price of the spectrum in the 1800 MHz band. But if auction is conducted, then auction prices would be applicable. *We had estimated that the impact of excess spectrum based on this pricing methodology on Bharti would be INR 11 per share and on Idea INR 5 per share. On license renewal, the impact is INR 34 per share for Bharti and INR 28 per share for Idea.*
- **Spectrum re-farming** – While it reiterated that re-farming of 800/900 MHz band of spectrum should be done, it would come up with specific recommendations including considering restricting auction of 700 MHz band of spectrum to players who do not possess spectrum in the 800/900 MHz band in due course. *Bharti can acquire more 3G and BWA spectrum between 2014 and 2021 and tune its network to operate in multiple bands. But the recommendation to restrict holders of 800/900 MHz band from participating in the auction of 700 MHz is unfair but negative for Bharti and Idea as it would impact their competitiveness.*
- **Uniform license fee** – It reiterated its recommendation of reducing the license fee across circles to 6% over the next four years i.e. by FY16. It also reiterated that IP-1 and ISPs should pay license fee of 3% starting in FY13 and increase to 6% by FY16. *The benefit from lower license fee of 6% but fee on towercos would provide a net benefit of INR 15 per share for Bharti and INR 12 per share for Idea.*
- **Exit policy** – It would come up with recommendations in due course.

**Ganesh Duvvuri**  
 +91 22 4040 7586  
 ganesh.duvvuri@edelcap.com

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

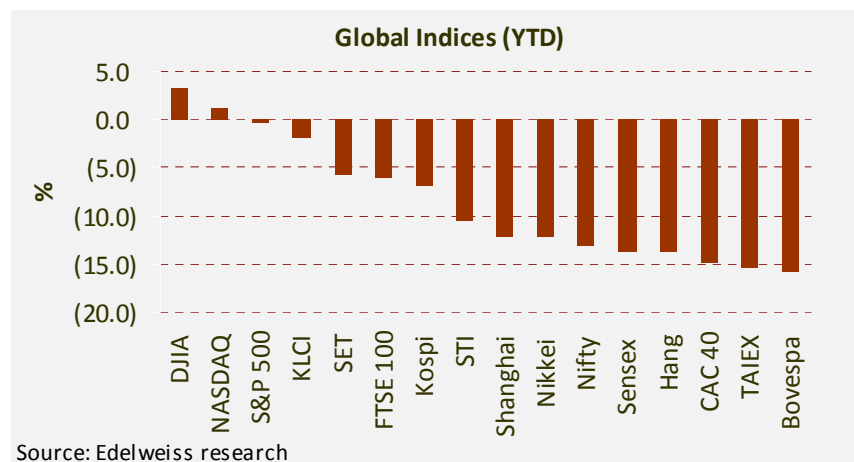
November 3, 2011

### November view: Still some pain before gain

- Headwinds galore before respite
- Season of downgrades
- Indian mutual fund industry: Subtle change on the horizon
- Results so far
- Banking: Multiple headwinds
- Auto: Robust auto sales numbers

### Headwinds galore before respite

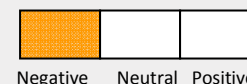
October soothed nervous minds as the European Union (EU) finally appeared to be taking strong steps to tackle debt concerns in the region. Markets started sensing that a solution this time would be a conclusive one. The rally triggered by these expectations led to the covering of shorts. However, the downgrade saga continued with Fitch downing Italy and Spain. S&P also downgraded Spain on the back of a weak economic outlook. Finally, the EU had been successful in enticing lenders to a 50% cut in Greece debt holdings besides extending the limit of the bailout fund to USD 1.4 tn. The US also reported an economic expansion to the tune of ~2.5% in July-September quarter thereby laying fears of a recession to rest. Meanwhile, country default rates in EU also came down remarkably. On one hand, euro rallied while on the other DXY witnessed a brief correction phase. The US treasury yields have risen by ~20 bps in October even as CRY Index gained ~7.3% alone the month, affirming the argument that inclination towards risk was returning gradually.



Note: Performance till 31-Oct-2011

Though things appeared to be settling down, the twist in the tale came with Greece deciding to seek vote of citizens on the proposed rescue plan for debt concerns. Now, the prospects of a split in the European Union appear strong as Greece's December referendum for bail out will also decide whether it stays in the Union or not. These developments have certainly accentuated the risks on the downside. Market sentiments over the medium term will be shaped by the incoming macro data and emerging clarity on specific details of the package. Nifty has its resistance and supports placed at 5300/5475 and 5200/5000 respectively.

### November – Market View

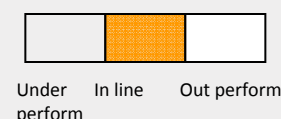


### November – Sectors to watch

- Out-performers
  - Auto
  - FMCG
- Under-performers
  - Banking

### October Retrospect

### India vs. Global Markets



### Fund Flows

- FII
- MF

### October- Sector performance

- Outperformers – Auto, IT
- Underperformers – Consumer durables, Capital Goods

**Yogesh Radke**  
+91-22-6620 3199  
yogesh.radke@edelcap.com

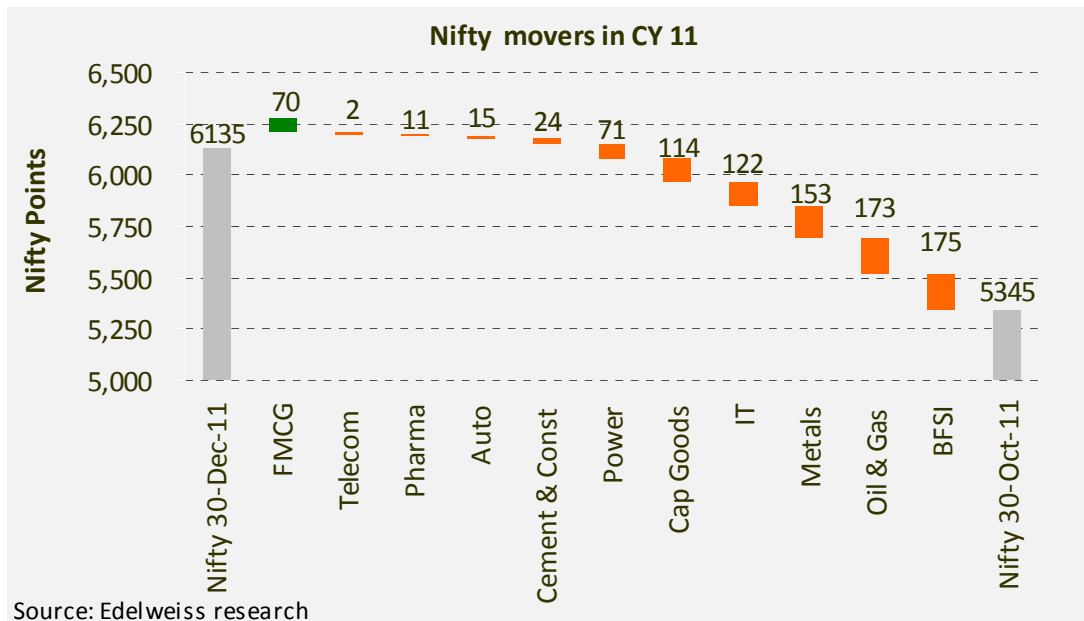
**Sriram Velayudhan**  
+91-22-6620 3100  
sriram.velayudhan@edelcap.com

**Gaurav S Mehta**  
+91-22-6623 3312  
gauravs.mehta@edelcap.com

November 3, 2011



Even if the European Union arrives at some sort of consensus to rescue the ailing economies, for countries like India, the situation from CY12 will only get more challenging. Though inflation is expected to taper off from the first half of CY12, improving situation in the Western world certainly increases the possibility of a liquidity glut in emerging countries like India (as cheap money chasing growth in the developing world). Till date CY11 has not been that exciting for equities. Nifty is down by ~13.20% in CY11 (YTD). Barring FMCG, all other sectors are in the red. BFSI and oil & gas have been dragging the Nifty movement.



#### Yet an action packed October:

The Q2FY12 results so far indicate a strong revenue and earnings growth with margin compression. The monetary policy saw the central bank raising key rates by 25 bps which was broadly in line with the expectations. Finally coming to terms with the reality, the growth estimate for FY12 was downgraded to 7.6% from 8.0%. Unlike the earlier reviews, the Reserve Bank hinted at a breather from tightening from the next review onwards. At the same time, the inflation forecast for March 2012 was maintained at 7%. In a surprise move, the RBI deregulated the rate for savings deposits which entails having a uniform rate for deposits up to INR 0.1 mn.

For deposits above INR 0.1 mn, banks may provide differential interest rates if they choose so. Sensing margin pressures, most banks (barring few like Yes Bank, Kotak Mahindra and Federal Bank) corrected sharply that day. The boon of high saving deposits has now become a bane in a flash. In the current scenario of depleting profits and deteriorating asset quality, shelling out more interest on saving deposits will only add to the margin squeeze. The October derivative settlement saw roll cost levels (cost to long rollers) in Nifty expanding to ~55-60bps which was mainly on the back of soaring costs in NDF market.



### Season of downgrades

Sell-side analysts have downgraded EPS estimates across sectors with downward revisions almost double the number of upward ones. For our universe of BSE-200 stocks, we have witnessed ~65% revisions on the down side. Among the important valuation parameters, consensus estimate of forward earnings (EPS) is the strongest determinant of future stock performance of the company. Analysts revising their earnings from time to time act as catalyst for the stock performance. Historically, we have found that stock prices react most strongly and adjust most quickly to revision clusters that accompany corporate information events which pertain to financial statement information. In our endeavor to screen out top-bottom deciles stocks based upon EPS revisions, Price Target and stock rating revisions, every month we run our proprietary stock selection model. In our last monthly report **Factor Analysis Oct-11-EDEL**, we have highlighted stocks based on this methodology.

#### Top deciles

Company name	IBES EPS Revision(%)	
	1M Chg	3M Chg
Ranbaxy Laboratories	36	33
Manappuram Finance	7	3
MRPL	6	6
P T C India	6	13
Infosys	3	2
Shree Renuka Sugars	3	-5
Indusind Bank	2	2
Mahindra & Mahindra	2	-2
Bharat Electronics	2	1
C E S C	2	-8
Indraprastha Gas	2	11
Oil India	1	2
Canara Bank	1	-10
Grasim Industries	1	0
Engineers India	1	8

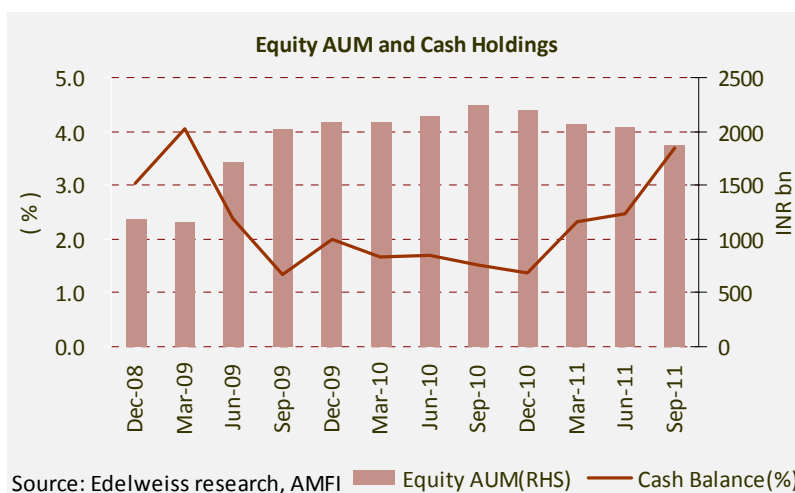
Source: Edelweiss research, IBES

#### Bottom deciles

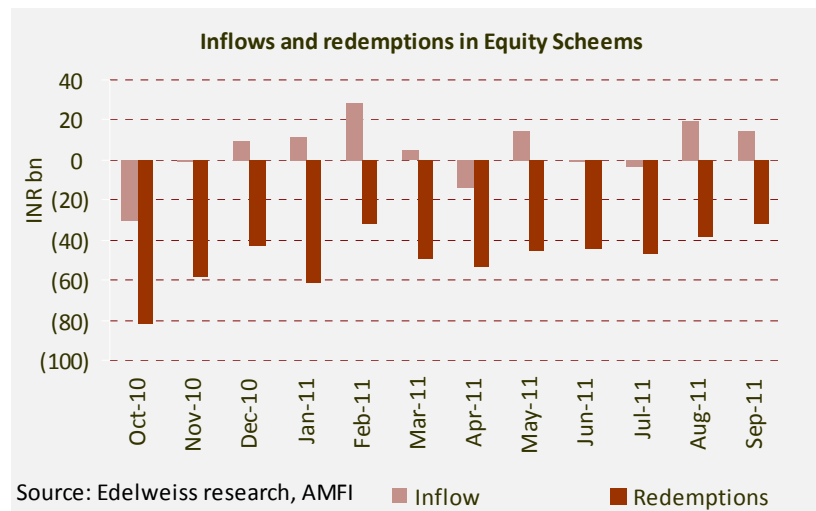
Company name	IBES EPS Revision(%)	
	1M Chg	3M Chg
Bhushan Steel	-14	-15
Lanco Infratech	-14	-49
Gujarat N R E Coke	-13	-33
Jaiprakash Power Ventures	-10	-13
Punj Lloyd	-8	-31
J S W Energy	-8	-34
Reliance Communications	-8	-21
Piramal Healthcare	-7	-6
Pantaloon Retail (India)	-7	-11
Unitech	-7	-20
Voltas	-7	-15
Sintex Industries	-7	-7
Maruti Suzuki India	-7	-13
I N G Vysya Bank	-7	-7
J S W Steel	-5	-23

### Indian mutual fund industry: Subtle changes on the horizon

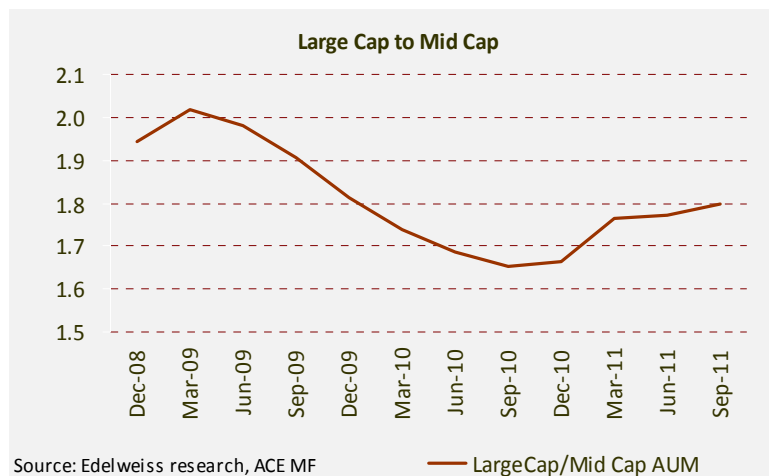
At the end of the Jul-Sep quarter, the total AUM (equity + debt) of the Indian mutual fund industry stands at ~INR 6.42 tn. Out of this, the equity AUM accounts for ~INR 1.87 tn (~29% of the total AUM). The equity AUM between July and September quarter has come down by ~INR 172 bn. Market uncertainty coupled with redemptions have compelled mutual funds to hike percentage of cash in the portfolio. During the aforesaid period debt AUM stands at ~INR 4.55 tn. Factors like rate hike, government borrowing plans and advance tax payments impacted the debt AUM during the quarter.



Cash balances account for ~3.70% of equity funds. As we see from the chart, cash holdings have been rising continuously since December, 2010. However, comfort for equity funds stems from the slowing pace of redemptions; from ~INR 132.5 bn during September 2010, the amount has now come down to ~INR 32.17 bn at the end of September 2011. This we believe should be a huge respite for equity schemes which have been reeling under redemption pressures for some time now. Also the standout feature during the quarter was inflows (net of new offerings, sale of existing schemes and redemptions) into equity schemes. All these observations point towards a gradual revival of investment interest in equity schemes. In CY11, the equity AUM has come down by ~15% (from ~INR 2.20 tn in Dec-2010 to ~INR 1.87 tn in Sep-2011).



Mid-cap funds appear to be still out of favour with investors. The ratio of large cap to mid cap AUM has been increasing consistently during CY11. The ratio now stands at 1.8 as compared to 1.65 on Dec-2010. The fate of mid cap funds to an extent depends on market conditions which if stay bleak, there would be few takers for mid cap schemes.

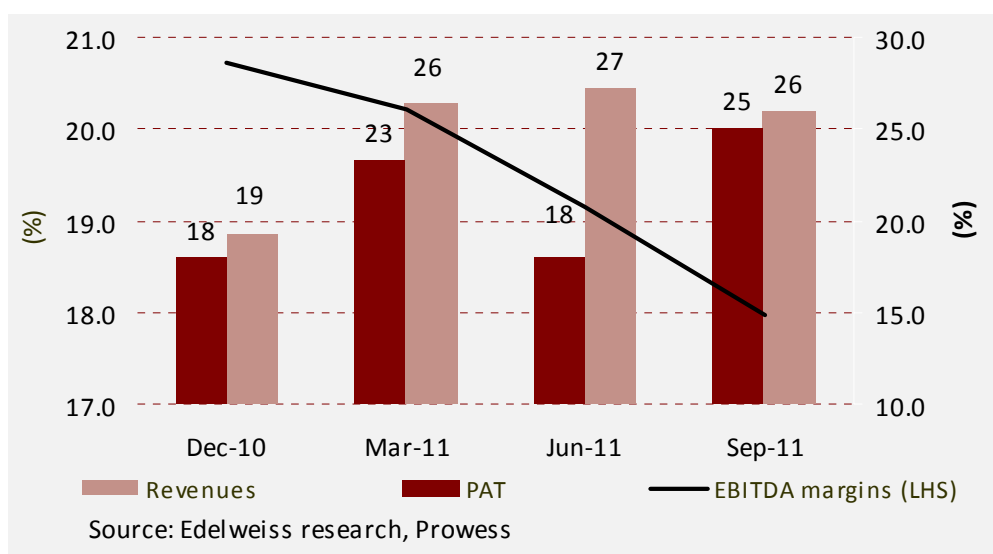


### Results so far:

Having grown in the last few quarters, top-line has slowed down considerably this quarter. Operating profits of Indian companies grew at the slowest pace in six quarters while growth in input costs growth outpaced sales significantly. Guidance from managements also weakened further as companies could not pass on price hikes in line with growth in operating expenses.

While inflation continues to remain firm, interest rates are already high resulting in Industrials and interest rate sensitive sectors to witness indecisiveness and procedural delays. This has dried out order announcements and slowed down execution and decision-making. Big 3 in IT sector have reported results with mixed revenue growth performance. IT bellwether Infosys surprised the street by its guidance revision. The currency movement during the quarter certainly worked in its favour. However, TCS and HCL Tech could not match the street expectations. While the domestic business and muted growth from its top clients let down TCS, for HCL Tech, the party spoiler was the emphasis on building the order book which took a toll on operational performance during the quarter.

Mixed performance from the banking sector where PSU banks have shown a significant deterioration in asset quality with increasing gross NPLs and slippages coming higher than expected. On the other hand, private sector kept its asset quality intact, maintaining stable margins. Most of the private banks have reported higher growth in retail advances as compared to corporate or wholesale advances as retail loans offer higher yields vis-a-vis corporate loans. Consumer sector saw excellent results with the behemoth HUL reporting impressive numbers across all segments. All segments have delivered double digit growth for the third consecutive quarter while the overall domestic sales grew 18.5% Y-o-Y. Management body language was also very positive with focus being on leverage from consumer insights to deliver winning innovations and maintaining relentless focus on execution, cost management and building organizational capabilities for competitive advantage.



*Note: Universe includes 34 companies from the BSE100 (excluding BFSI and OMCs)*

For the set of 34 companies (excluding banks and OMCs) that form the BSE100 universe, revenue and reported profit have increased by 26% and 25% respectively over the previous year. As stated above, the pace of top-line growth has definitely decelerated over the last few quarters. However, the major drag has been the operating profit margins which stand at ~18%. Escalating costs have pulled down the operating profit margins in the last few quarters.

## Banking: Multiple headwinds for BFSI (our Banking analyst, Nilesh Parikh)

### Savings deposit rate deregulation:

In a recent credit policy announcement, the RBI deregulated the savings bank deposit rate with two important caveats: 1) Each bank will have to offer a uniform interest rate on saving bank deposit up to INR 0.1 mn and 2) For accounts above INR 0.1 mn, the bank may provide differential interest rates if it chooses so. If we assume that saving rates settles at 5%, the impact on NII for banks would be in the range of 4%-7%. However, the impact on earnings would be higher for state owned banks (19% for SBI) given the higher dependence on interest income in the revenue pie as against private sector counterparts (9% for HDFC Bank) for whom the fee income is a support hand.

### System based NPL recognition:

An emerging trend coming out of PSU bank results is the significant deterioration in asset quality with increasing gross NPLs and slippages coming at higher levels than expected. Consequently, coverage ratios are also going down. On the other hand, private banks have once again steered clear of the trend with asset quality remaining intact.

### Housing finance companies face regulatory headwinds

National Housing Bank (NHB) has issued a circular whereby housing finance companies (HFCs) will not be allowed to charge prepayment penalty on pre-closure of floating rate loans. Also, they will have to bring uniformity in lending rates for old and new customers with a similar risk profile. This seems to be a structural negative for pure-play HFCs vis-à-vis banks as it levels the competitive field with respect to existing loans. Our banking analyst Nilesh Parikh believes that HFCs make (at best) ~5-6 bps of outstanding individual loan book as prepayment fee income currently but prepayments can shoot up if restrictions/charges are removed altogether. The increase in refinancing demand will increase churn and impact stability of the loan book and ALM profile of HFCs.

## Auto: Robust auto sales numbers (Our auto analyst, Sachin Gupta)

Festive season did bring cheers with a good set of monthly sales numbers though Maruti Suzuki was an exception. Market leader Maruti numbers were down 53% Y-o-Y; 35% Q-o-Q at 55,595 units largely on account of the unrest at its Manesar plant which severely affected production.

Volume (units)	Oct-11	Oct-10	% Change	Sep-11	% Change	YTD FY12	YTD FY11	% Change
Hero Honda sales	512,238	505,553	1.3	549,625	(6.8)	3,586,130	3,022,467	18.6
Maruti Suzuki	55,595	118,908	(53.2)	85,565	(35.0)	589,428	715,886	(17.7)
Mahindra & Mahindra	73,344	58,776	24.8	68,810	6.6	414,341	326,658	26.8
Ssangyong sales	9,125	7,445	22.6	9,504	(4.0)	95,395	64,775	47.3
Tata Motors	68,009	64,757	5.0	78,786	(13.7)	467,671	444,874	5.1

The simultaneous strike at Suzuki Powertrain which makes engines and transmissions in support of MSI's Manesar plant's workers affected production at Gurgaon facility also. Although adjusting for production loss of over 40,000 units, Y-o-Y decline is around 20%. Mahindra & Mahindra reported stellar numbers with tractor sales of 31,838 units (up 31% Y-o-Y; 29% M-o-M). Seasonally, October is sequentially a strong month implying continuing buoyant demand from Southern states and a revival in Northern states due to the festive season. Hero MotoCorp sales, hit due to capacity constraints, were marginally up 1% Y-o-Y though overall sales fell 7% M-o-M to 512,238 units. To achieve a volume of 6.2mn units in FY12, the asking growth rate for the balance five months stands at 9% Y-o-Y. Total sales of Tata Motors came in at 68,009 (up 5% Y-o-Y; down 14% Y-o-Y), largely subdued due to a below par performance by LCV sales. Though LCV sales were up by 6% Y-o-Y, it declined by 22% M-o-M to 21,892 units after a strong first half growth, suggesting inventory build up at the dealers' end.

## Technical view: Bulls return, ready to rumble or tumble? (Our technical analyst, Tejas J. Shah)

After the choppy and sideways trend in September, the traditionally horrid October turned out to be the best month in recent times with a smart 7.6% up move. The move was highly unexpected in the face of lingering debt problems in the Euro zone. Index rallied every week of the month making higher tops and bottoms, and the final days saw a sharp spike near Diwali holidays. Now whether it was a bear market rally or a start of a new cyclical uptrend is what we will dissect in the following analysis.

We had spoken about the positive divergence developing in our previous months note and indeed the market respected the internal readings and a bullish trend emerged at the end. There have been certain key technical developments that need to be pointed out. A double bottom (4720) breakout has been confirmed above 5170 that carries a target of 5620. We have also managed to close the bearish gap formed in early August, negating the crisis seen at that time. Nifty has been maintaining strength above the key 50 daily EMA providing support to short-term bulls.

On the momentum oscillator front, the setup has drastically improved from the start of October. Upward momentum has picked up strength in the previous week with the ADX trending up and a bullish crossover of +DI and -DI lines being achieved. RSI and MACD on the daily charts have moved into positive territory signaling a bullish trend while the weekly MACD (medium-term) has given a buy crossover from deep oversold conditions.

We expect Nifty to trade in a stiff range of 5200 (earlier breakout zone) and 5400 (200 DMA) for the month of November which seasonally has a sideways trend before a rally in December. Thus we remain in a 'bear market rally' as long as we trade below the 200 DMA and the 12-month falling trend line between 5400 and 5475 with the caution that improving momentum conditions have the potential to lead a breakout. Weakness below 5200 / 5170 will signal a return to the downtrend with an immediate target of 4720 (test of the previous low) though the probability of that playing out this month is low.

### Monthly Nifty Chart

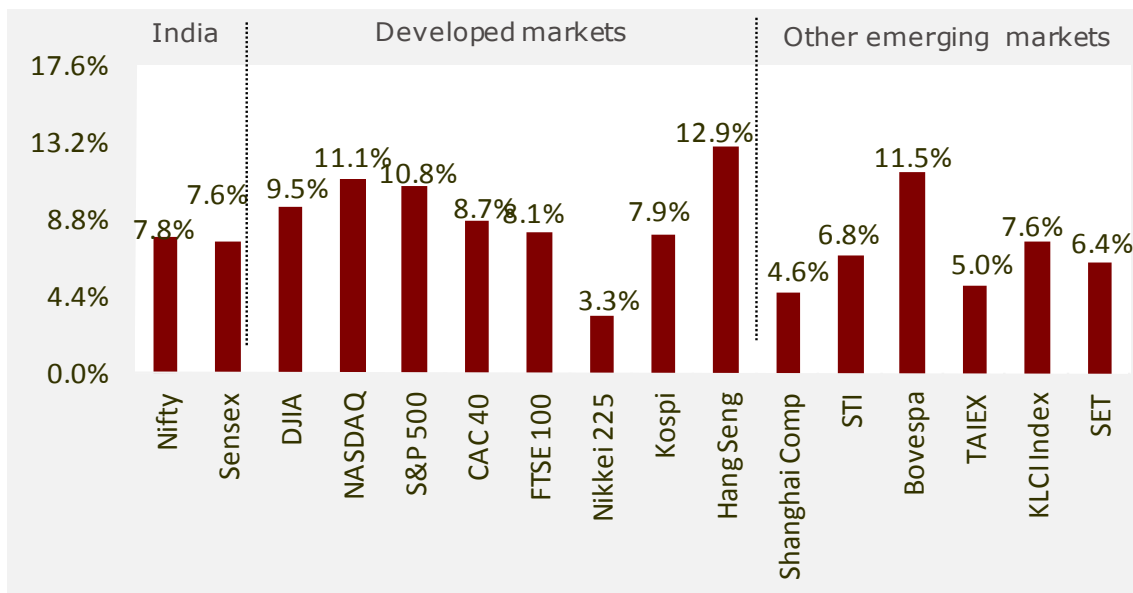


### Weekly Nifty Chart



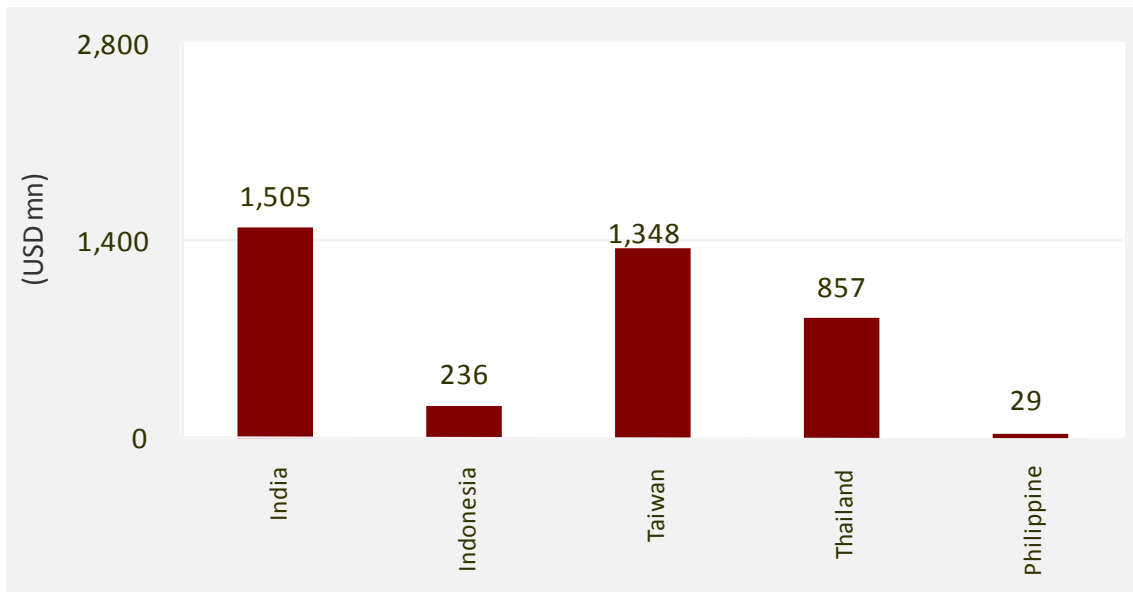
### Global meltdown

- EU summit during diwali week turned out to be a precursor for a sharp rally in risk assets globally. EU meeting outcome importantly underlines the resolve and commitment of leaders to keep the Eurozone intact.
- **Key pointers are:**
  - 1) Private investors have voluntarily agreed to take a 50% haircut in the value of Greek debt.
  - 2) Banks are required to strengthen their capital positions such that the core Tier 1 capital ratio reaches 9% by June 2012.
  - 3) Resources of EFSF (European Financial Stability Facility) have also been strengthened by leveraging it to EUR 1 tn without extending guarantees.
- Moody's Investors Service has reduced Spain's credit rating by two levels to A1 from Aa2, with the outlook remaining negative. Spain's rating was cut for the third time in 13 months.
- Emerging markets' performances were in line with other markets; Bovespa being the biggest gainer (up ~11.5%) followed by KLCI (up ~7.6%).
- In contrast to the September trend, Indian benchmark indices gave positive returns in October. Although RBI once again hiked base rates by 25bps, it continues to maintain its anti-inflationary stance.
- Nikkei (up 3.3%) underperformed every major market.
- Among developed markets, Hang Seng (up ~12.9%) was the leading gainer followed by Nasdaq (up ~11.1%) and S&P 500 (up ~10.8%) respectively.



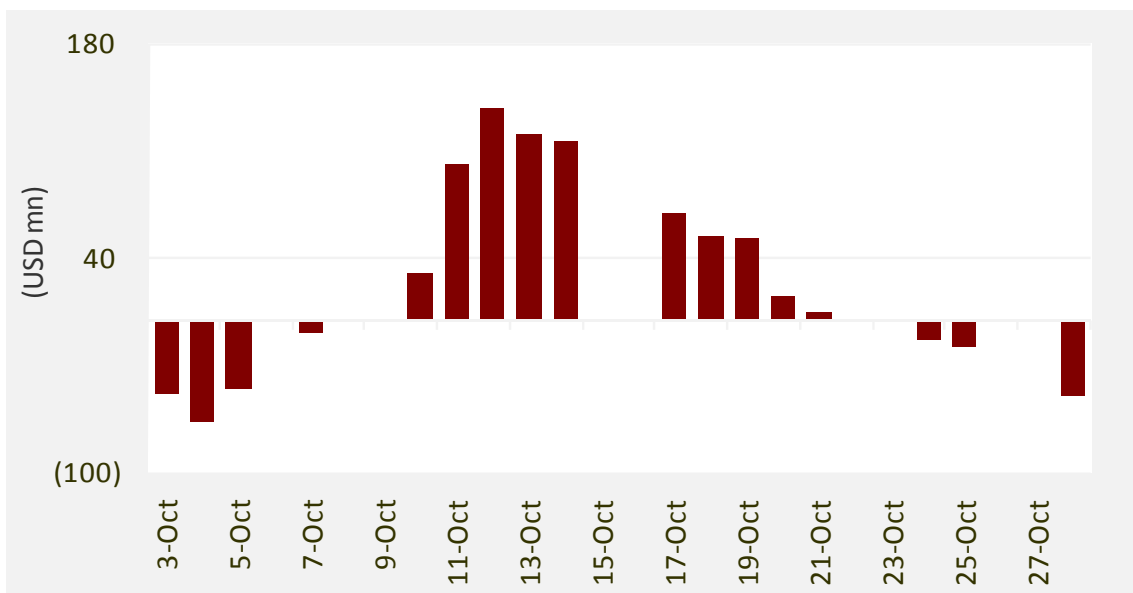
### FII flows positive in India; Philippines the odd one out

- FII were net buyers in India (cash + futures). Taiwan, among emerging markets, posted FII inflows of ~USD 1.34 bn.
- In India, FIIs were net buyers of ~USD 1.5 bn (cash + futures) in October. In the cash segment, FIIs bought ~USD 409 mn while in futures, they were net buyers of ~USD 1.1 bn.



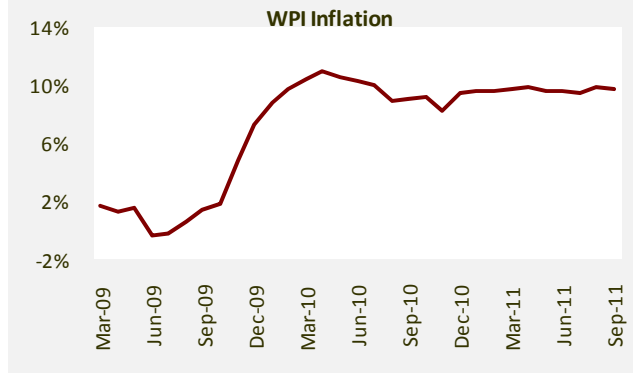
### Domestic funds net sellers

- In continuation with the September month trend, domestic mutual funds were net sellers in October.
- They were net sellers of ~USD 49.5 mn of Indian equities in October.

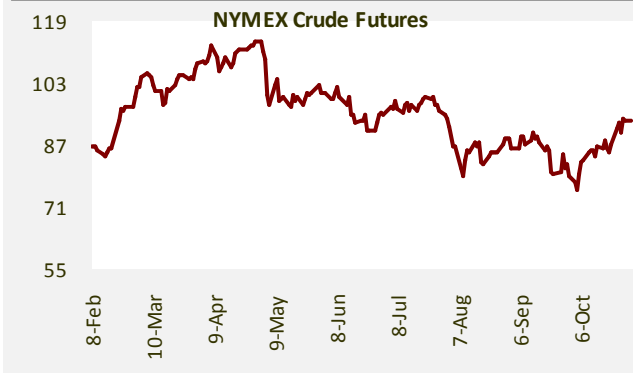


## Macro-environment

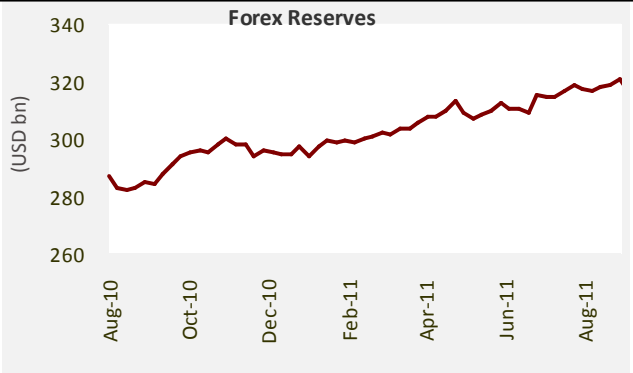
### Inflation sustaining at 9.7%



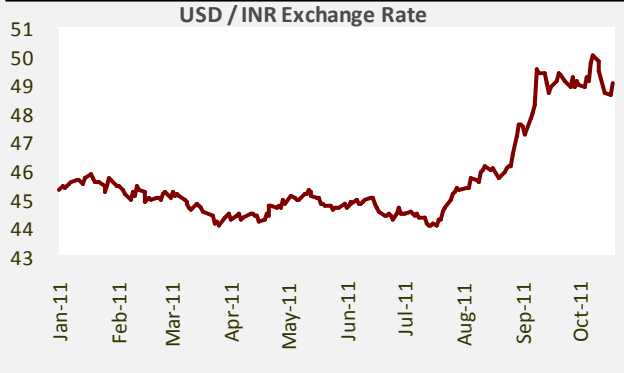
### Crude oil at ~USD 93.2 per barrel



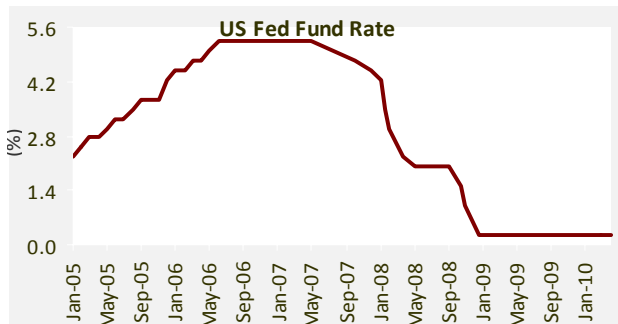
### Forex reserves at USD 320.8 bn



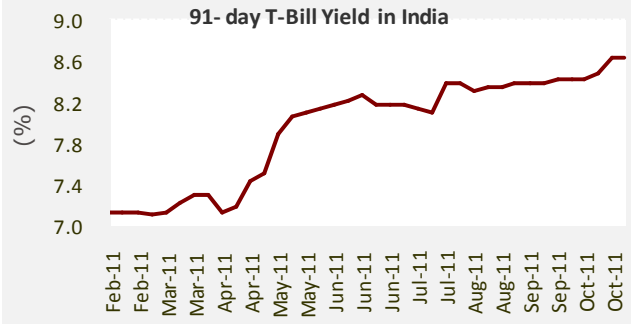
### Rupee ends August at ~48.7



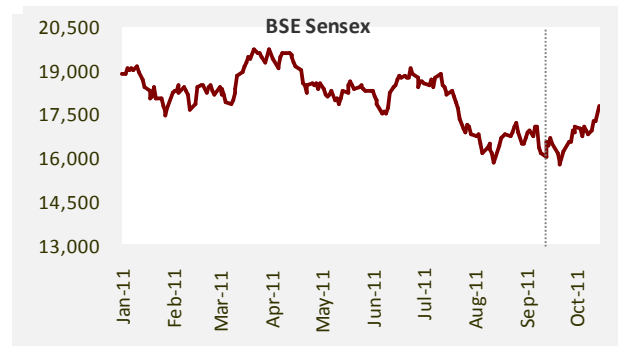
### Fed target rate at 0.25%



### Indian short-term yields at ~8.65%



### Sensex rose ~ 7.60 % M-o-M



### Zinc and lead hit hard

Commodities	(% Chg)	Price	1Mth	3Mth	1 Year
Steel	USD/ton	705	2.5	(7.5)	39.6
Tin	USD/ton	22,000	8.1	(21.7)	(14.1)
Zinc	USD/ton	2,000	7.5	(19.7)	(17.5)
Copper	USD/ton	7,990	13.8	(18.7)	(2.6)
Aluminium	USD/ton	2,155	(0.2)	(10.0)	(1.6)
Nickel	USD/ton	19,575	11.2	(21.7)	(14.9)
Lead	USD/ton	2,082	4.9	(20.3)	(15.0)
Gold	USD/Oz.	1,718	5.8	6.1	26.9
Silver	USD/Oz.	34.48	15.2	(12.2)	39.7



## RESULT UPDATE

### Sun TV Network (SUNTV IN, INR 274, UNDER REVIEW)

Sun TV Network (Sun TV) reported a ~6% Y-o-Y rise in revenues and ~8% Y-o-Y increase in PAT in Q2FY12, ahead of our expectations, amidst concerns over the ad slowdown and the impact on the subscription revenue of the relaunch of Arasu Cable in Tamil Nadu. The ad environment remained weak with a ~2% Y-o-Y growth in ad revenues. In spite of the good operational performance in adverse macro environment, there remains an overhang of regulatory and judicial impact on the stock. Hence we maintain the stock 'UNDER REVIEW'.

#### Declining costs help post robust EBITDA margin of ~81%

Sun TV Network posted a ~6.2% growth in revenues from INR 4248 mn in Q2FY11 to INR 4513 mn in Q2FY12. Sun TV adopted a cost conscious approach and managed to reduce the operational expense by ~7.2% Y-o-Y and ~2.5% on a Q-o-Q basis. The cost of revenues declined by ~10% Y-o-Y from INR 250 mn in Q2FY11 to INR 225 mn in Q2FY12. Due to this, the EBITDA margin remained healthy at ~81%.

#### Ad environment continues to remain weak

The ad scenario continues to remain soft and hence the growth in the ad revenue was just ~2.1% Y-o-Y (INR 2350 mn in Q2FY12 vis-a-vis INR 2300 mn in Q2FY11). Broadcast revenue declined by 2.5% Y-o-Y from INR 400 mn in Q2FY11 to INR 390 mn in Q2FY12. Movies/Others segment saw a huge jump of ~123% Y-o-Y from INR 148 mn in Q2FY11 to INR 330 mn in Q2FY12.

#### Arasu impact: Subscription revenue falls ~10% Q-o-Q

Analog cable subscription revenue saw decline in revenue by ~13% Y-o-Y because deal with Arasu was not signed. Lack of signing has impacted the month of October also. Though, DTH subscription revenue grew by ~13% Y-o-Y from INR 700 mn in Q2FY11 to INR 790 mn in Q2FY12, it declined by 6% on a Q-o-Q basis. However, the impact of the relaunch of Arasu cable was felt only in the first week. The viewership has returned back to normal.

#### Outlook and valuations: Seeking Clarity; UNDER REVIEW

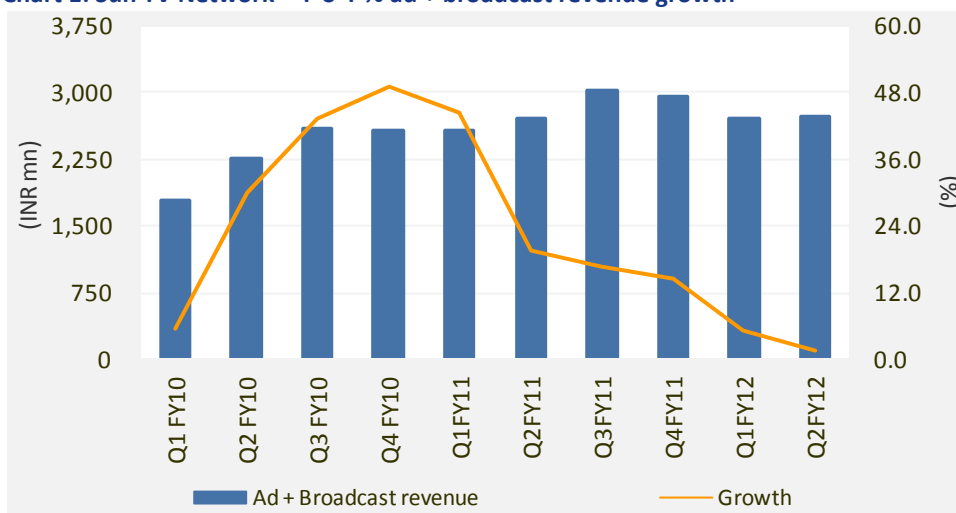
We continue to like Sun TV's near monopolistic market standing and presence in high growth regional markets. However, we would keep a close watch on the regulatory action by the Tamil Nadu government. The conference call is scheduled on Friday – 4th November, 2011 at 11am posts which, we will release a detailed report.

Table 1: Revenue break-up

	Q1 FY11	Q2FY11	Q3FY11	Q4FY11	FY11	Q1FY12	Q2FY12	Y-o-Y % change	Q-o-Q % change
Ad	2,220	2,300	2,610	2,580	9,710	2,310	2,350	2.2	1.7
Broadcast	350	400	420	370	1,540	390	390	(2.5)	0.0
<b>Ad+Broadcast</b>	<b>2,570</b>	<b>2,700</b>	<b>3,030</b>	<b>2,950</b>	<b>11,250</b>	<b>2,700</b>	<b>2,740</b>	1.5	1.5
DTH	670	700	700	820	2,890	840	790	12.9	(6.0)
Cable	510	540	530	560	2,140	560	470	(13.0)	(16.1)
<b>Total Subscription</b>	<b>1,180</b>	<b>1,240</b>	<b>1,230</b>	<b>1,380</b>	<b>5,030</b>	<b>1,400</b>	<b>1,260</b>	1.6	(10.0)
International	160	160	200	170	690	200	180	12.5	(10.0)
Movies/Others	494	148	1,520	105	2,267	220	330	123.3	50.0
<b>Total</b>	<b>4,404</b>	<b>4,248</b>	<b>5,980</b>	<b>4,605</b>	<b>19,237</b>	<b>4,540</b>	<b>4,510</b>	6.2	(0.7)

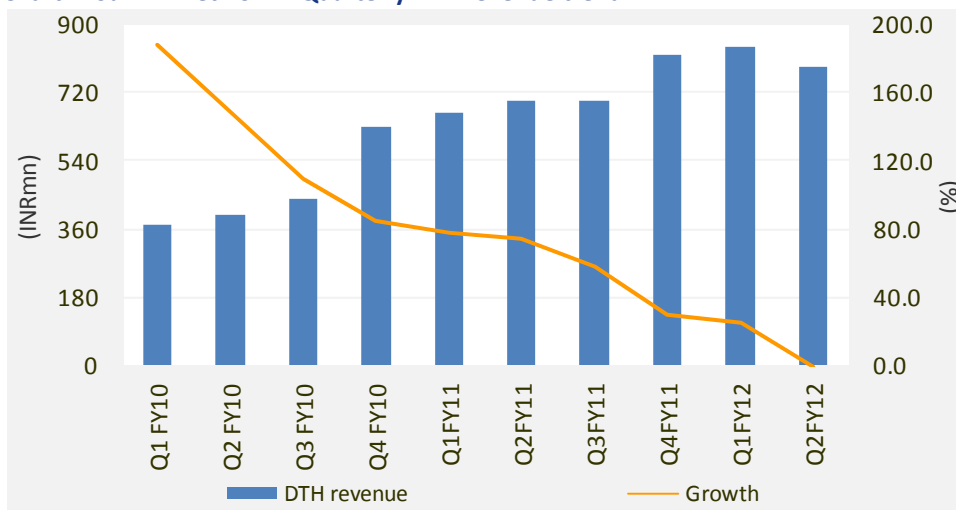
Source: Company, Edelweiss research

Chart 1: Sun TV Network – Y-o-Y % ad + broadcast revenue growth



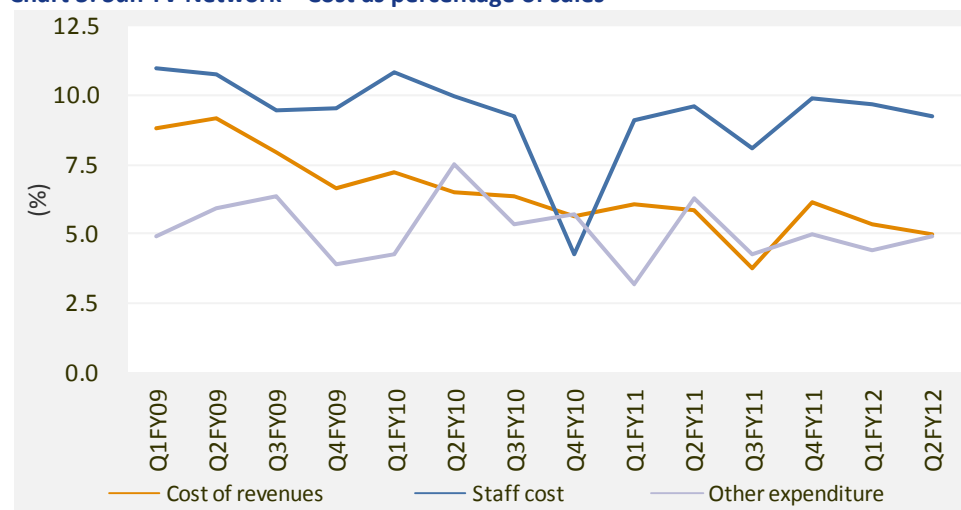
Source: Company, Edelweiss research

Chart 2: Sun TV Network – Quarterly DTH revenue trend



Source: Company, Edelweiss research

Chart 3: Sun TV Network – Cost as percentage of sales



Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q2FY12	Q2FY11	% change	Q1FY12	% change	FY11	FY12E	FY13E
<b>Revenues</b>	4,513	4,248	6.2	4,540	(0.6)	20,135	21,021	23,700
Cost of revenues	225	250	(10.0)	242	(7.1)	1,373	1,331	1,803
Staff cost	414	407	1.8	440	(5.9)	1,919	1,896	2,160
Other expenditure	219	268	(18.2)	199	10.4	1,063	1,307	1,602
<b>Total expenditure</b>	858	925	(7.2)	881	(2.5)	4,356	4,534	5,565
<b>EBITDA</b>	3,654	3,323	10.0	3,659	(0.1)	15,779	16,487	18,135
Interest	8	3	153.3	2	230.4	23	21	17
Depreciation/Amortization	1,176	908	29.6	1,061	10.8	4,805	5,445	6,350
Other income	186	93	101.3	173	7.7	487	534	592
<b>PBT</b>	2,657	2,505	6.1	2,769	(4.0)	11,439	11,554	12,360
Provision for tax	856	830	3.0	892	(4.1)	3,831	4,084	4,386
<b>Adjusted net profit</b>	1,801	1,674	7.6	1,876	(4.0)	7,608	7,471	7,973
<b>Reported net profit</b>	1,801	1,674	7.6	1,876	(4.0)	7,698	7,561	8,063
No. of shares (mn)	394	394		394		394	394	394
EPS (INR)	4.6	4.2		4.8		19.3	18.9	20.2
Tax Rate (%)	32.2	33.1		32.2		33.5	35.3	35.5

## As % of net revenues

Cost of revenues	5.0	5.9		5.3		6.8	6.3	7.6
Staff cost	9.2	9.6		9.7		9.5	9.0	9.1
Other expenditure	4.9	6.3		4.4		5.3	6.2	6.8
EBITDA	81.0	78.2		80.6		78.4	78.4	76.5
Net Profit	39.9	39.4		41.3		38.1	35.8	33.9



## PLEDGE SHARES

Reporting Date	Company Name	Name of the Entity	Pledged Quantity	Pledged % of the total capital
3-Nov-11	Strides Arcolab	Agnus Holdings	35,000	0.06%
3-Nov-11	Strides Arcolab	Chayadeep Properties	100,000	0.17%
3-Nov-11	Strides Arcolab	Pronomz Ventures LLP	7,685,000	13.24%
3-Nov-11	Hero Honda Motors	Hero Investments	80,000	0.04%
3-Nov-11	Granules India	C Krishna Prasad	5,011,800	24.99%
3-Nov-11	Sharon Bio-Medicine	Mohan Prasad Kala	1,300,800	12.32%
3-Nov-11	Refex Refrigerants	T Anil Jain	1,350,000	8.72%



## INSIDER TRADES

Company Name	Acquirer/Seller	B/S	Qty Traded
Bhansali Engineering Polymers	Jayesh Bhansali	Buy	21940
Indiabulls Financial Services	Priapus Properties Private	Buy	700000
Indiabulls Financial Services	Hespera Real Estate Private	Buy	1000000
Indiabulls Financial Services	Orthia Land Development	Buy	2500000
Innovative Industries	Standard Chartered Equity	Buy	1499954
Kirloskar Oil Engines	Kirloskar Brothers Investments .	Buy	682685
LT FOODS	Raghuvesh Holdings Private	Buy	46218
Maithan Alloys	Dhruva Agarwalla (Minor)	Buy	100000
Maithan Alloys	Anshuman Agarwalla	Buy	100000
Parabolic Drugs	PNG Trading Private	Buy	16048
Rallis India	Tata AIG Life Insurance Company	Buy	100000
Rallis India	Tata AIG Life Insurance Company	Buy	200000
Raymond	J.K. Investo Trade (India) .	Buy	45000
Religare Enterprises	Sunil Kumar Garg	Buy	21000
Vakrangee Softwares	Vakrangee Capital Private	Buy	150000
Vardhman Polytex	ALMA Assets Consultanc	Buy	45000
Viceroy Hotels	K. Narasimha Rao	Buy	35579
Andhra Cements	ISG Traders	Sell	508648
India Infoline	Mukesh Singh	Sell	80567
IndusInd Bank	Anish Bhel	Sell	17000
IndusInd Bank	S V Parthasarathy	Sell	20000
IndusInd Bank	Sanjeet Anand	Sell	50000
IndusInd Bank	V K Iyer	Sell	39932
Natraj Financial & Services	Mrs. Lata Manoj Jain	Sell	82700
Stone India	ISG Traders	Sell	21733
Vakrangee Softwares	Mr. Dinesh Nandwana	Sell	150000

## BULK DEALS

Date	Company Name	Acquirer/Seller	B/S	Qty Traded	Price
3-Nov-11	Aadi Industries	Rakesh Sahu	Sell	198129	16.27
3-Nov-11	Action Financial Services (I)	Moonstar Securities Trading & Finance Co P	Buy	49989	26.28
3-Nov-11	Ashutosh Paper Mills	Arvinder Singh Pasricha	Buy	40000	174
3-Nov-11	Birla Pacific Medspa	Rupak Trading	Sell	1167818	17.9
3-Nov-11	ECE Industries	Ece Industries	Buy	403300	138.06
3-Nov-11	ECE Industries	Minal Patel	Sell	200000	138
3-Nov-11	Exelon Infrastructure	Manish Ratilal Shah	Buy	100996	34.92
3-Nov-11	Krishnadeep Trade & Investments	Carnet Elias Fernandes	Sell	29000	167.48
3-Nov-11	Krishnadeep Trade & Investments	Hotel Polo Towers	Buy	36000	167.46
3-Nov-11	Madhur Industries	Niravbhai Payal	Sell	21400	54.1
3-Nov-11	McDowell Holdings	Sbi Mutual Fund - Gifts Plan B	Buy	317624	53
3-Nov-11	McDowell Holdings	Sbi Mutual Fund - Mef (Mms-90)	Sell	317624	53
3-Nov-11	Nikki Global Finance	Scope Vyapar	Sell	22000	341.5
3-Nov-11	Nu Tek India	Alfa Fiscal Services	Buy	1739000	1.27
3-Nov-11	Nu Tek India	Chetan Laxmikant Dave	Buy	2391624	1.26
3-Nov-11	Onelife Capital Advisors	Jayantkumar & Co	Sell	75000	190
3-Nov-11	Onelife Capital Advisors	Prakashbhai Ishwarbhai Rana	Sell	39000	191.28
3-Nov-11	Orchid Chemicals & Pharmaceuticals	R Vijayalakshmi	Buy	801044	182.88
3-Nov-11	Passari Cellulose	Manisha Vikas Shinde	Sell	33900	104.06
3-Nov-11	Passari Cellulose	Varun Prem Budhrani	Buy	25888	103.83
3-Nov-11	Pitti Laminations	Jagartius Universal	Buy	126000	63.34
3-Nov-11	Polytex India	Jatin Shantilal Shah	Buy	80000	125
3-Nov-11	R Systems International	Bhavook Tripathi	Buy	229900	110
3-Nov-11	R Systems International	Ge Capital Mauritius Equity Investment	Sell	230,000	110
3-Nov-11	S V Electricals	Poonam Agrawal	Sell	140,000	12
3-Nov-11	Unimers India	Choice International	Sell	445,400	11
3-Nov-11	Unimers India	Sangeeta Rathi	Buy	450,000	11
3-Nov-11	VMS Industries	Madhuvan Vincom	Sell	255,286	25

Edelweiss

Ideas create, values protect



## TECHNICAL UPDATES

Nifty ended yet another volatile session with marginal gains of 0.14% on continued events out of the Euro zone. After a soft opening the index slid lower to make a new lower low for the week at 5202, however presence of demand at the crucial level helped the index rally higher above the opening level turning the trend positive. Broadly Nifty has been constricted to a small trading band between 5300 and 5200 and a break of this range is likely to get some directional move in the market. Trading volumes improved marginally however the breadth continues to be in favour of declines suggesting broader market underperformance. Momentum oscillators have completed the corrective cycle on hourly charts, whereas the daily oscillators setup maintains the bullish trend. *We expect trade to remain choppy on the final day of the week with range of 5350-5230. We continue to maintain our short-term bullish bias for a test of 5400 with key pivot at 5170.*

Sectoral performances were mixed in a mostly volatile yet sideways session. Power stocks led the up move with gains of 1.64% followed by Realty (+1.55%) and Oil & Gas (+1.08%) shares. On the losing side were IT (-0.73%), Autos (-0.58%) and Metals (-0.39%) stocks. Broader market indices ended the day with almost unchanged and with negligible underperformance to the frontline peers.

**Bullish Setups:** CNXBANK, ABGS, HUVR, POWF, TPWR

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



### Nifty Index

Bloomberg Code	NIFTY Index
Spot Price	5,265
Resistance 1	5,300
Resistance 2	5,356
Support 1	5,230
Support 2	5,200
Nifty 20 SDMA	5,115
Nifty 50 SDMA	5,029
Nifty 200 SDMA	5,398
Adv : Dec [NSE]	680 : 751
Turnover Rs Crs.	12,083
BSE+NSE cash	

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



## EYE CATCHERS

### Futures Snapshot

#### Top OI Rises

Scrip	% OI Chg	OI	% Price Chg	% Future Vol Chg
Jubilant Foodworks Ltd	41	994	(2.1)	357
Idea Cellular	23	12,212	3.0	227
Bajaj Hindustan	17	21,371	(6.3)	231
Bank of Baroda	15	2,888	2.7	(17)
Welspun Guj	14	6,768	1.7	437
REC	12	4,411	4.5	71
Canara Bank	11	2,178	1.2	(23)
Rolta India	9	2,306	(3.1)	(28)

#### Top OI Falls

Scrip	% OI Chg	OI	% Price Chg	% Future Vol Chg
CNX IT	(16)	20	(0.8)	61
Oriental Bank	(12)	643	3.9	50
TVS Motors	(11)	5,508	0.2	515
On Mobile	(9)	2,264	13.5	998
Exide Industries	(8)	2,314	2.4	200
BHEL	(7)	11,458	4.3	195
PTC	(7)	3,436	4.7	589
Arvind Limited	(6)	4,696	-	(55)



**Edelweiss Securities Limited**, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.  
Board: (91-22) 4009 4400, Email: [research@edelcap.com](mailto:research@edelcap.com)

Vikas Khemani	Head Institutional Equities	<a href="mailto:vikas.khemani@edelcap.com">vikas.khemani@edelcap.com</a>	+91 22 2286 4206
Nischal Maheshwari	Head Research	<a href="mailto:nischal.maheshwari@edelcap.com">nischal.maheshwari@edelcap.com</a>	+91 22 6623 3411

## Access the entire repository of Edelweiss Research on [www.edelresearch.com](http://www.edelresearch.com)

This document has been prepared by Edelweiss Securities Limited (Edelweiss). Edelweiss, its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates/ group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, group companies, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender/borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates/ group companies to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. Past performance is not necessarily a guide to future performance. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. Edelweiss Securities Limited generally prohibits its analysts, persons reporting to analysts and their family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

For recipients in the United States: This report was prepared by Edelweiss Securities, which is not a FINRA member nor a broker-dealer registered with the SEC. US persons receiving this research and wishing to effect any transactions in any security discussed in the report should contact an SEC-registered broker-dealer. In order to conduct business with Institutional Investors based in the U.S., Edelweiss Securities has entered into a chaperoning agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

Copyright 2009 Edelweiss Research (Edelweiss Securities Ltd). All rights reserved