India

Across the Board: 3QFY11E preview

3QFY11E earnings preview: India coverage

In this note, we aggregate data for our coverage in India (121 stocks across 15 sectors) to quantify expectations for 3QFY11E.

Further deceleration in growth in 3QFY11E – 19% sales growth; 14% EBIT growth

While we expect a modest deceleration in revenue growth (ex. Energy) in 3QFY11E at 19% vs. 20% in 2Q, escalating input cost pressures coupled with higher interest expense, would lead to net income growth of 16% (vs. 23%/26% in 2Q/1Q). We estimate EBIT margins to contract 100 bp yoy and EBIT growth to moderate to 14% (vs. 18%/36% in 2Q/1Q). On a qoq basis, we estimate sales/EBIT to rise by 6%/11%, largely driven by Cement, Metals, Infra.

Cost pressures hit margins across sectors

We expect 11 out of 15 sectors to witness yoy margin contraction in 3Q, led by Cement, Telecom and Autos. While most sectors would witness an EBIT growth in 3Q led by topline growth, we expect Cement and Telecom to report a yoy EBIT decline as cost pressures weigh on profits.

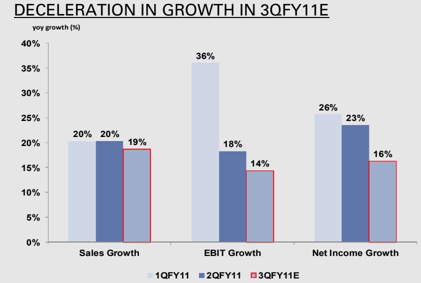
Indian valuations reflect robust growth expectations; focus to shift to FY12 outlook

Despite the recent pullback, India continues to be the second most expensive market in Asia (25% prem to AEJ), reflecting robust growth expectations. Against the backdrop of inflationary and policy headwinds, we believe India Inc's FY12 earnings outlook would be in focus—key risk being rising input /interest costs. GS Global ECS Research team is underweight India on stretched valuations, inflation pressures and earnings downgrades. For our coverage, we forecast 17%/25% growth in sales/EBIT in FY12E.

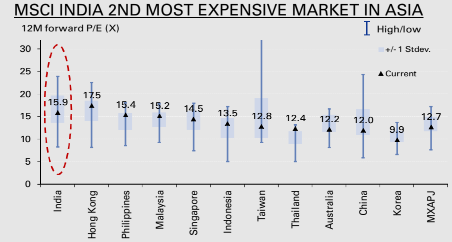
Our top Buys to deliver 32% sales growth and 37% net income growth this quarter

In our *India Handbook*, dated Dec 3, 2010, we highlighted our best ideas for superior growth, improving returns, compelling relative valuations. We believe our top 'Buys' will outperform our broader coverage in FY11E and deliver aggregate 23% topline growth and 47% growth in EBIT. For 3QFY11E, we expect our top picks to deliver an avg. 32% sales growth and 27% EBIT growth. Our top picks which offer an avg. 3-yr EBITDA CAGR of 28% are at a 15% disc to MSCI India's 12-m fwd P/E.

DECELERATION IN GROWTH IN 3QFY11E



MSCI INDIA 2ND MOST EXPENSIVE MARKET IN ASIA



Source: Company data, Goldman Sachs Research estimates.

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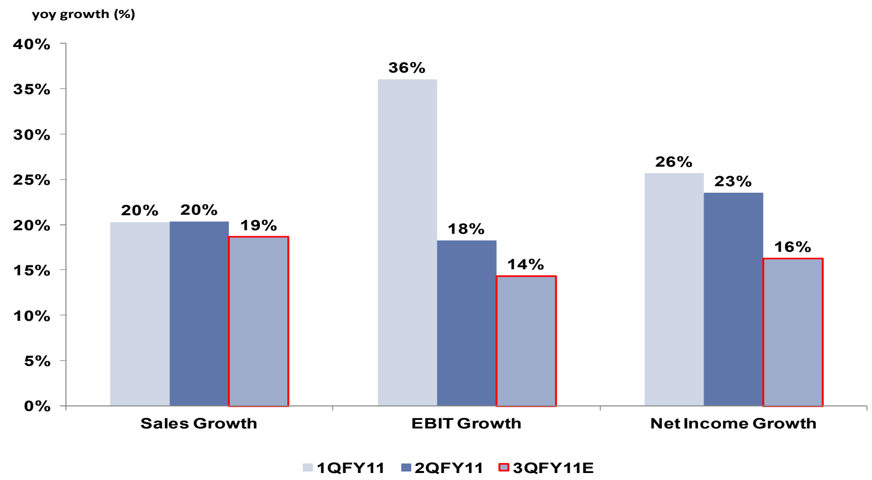
Exhibit 1: We expect 3QFY11E EBIT growth to decelerate to 14% vs. 18% in 2QFY11 for GS India coverage (ex. Energy)

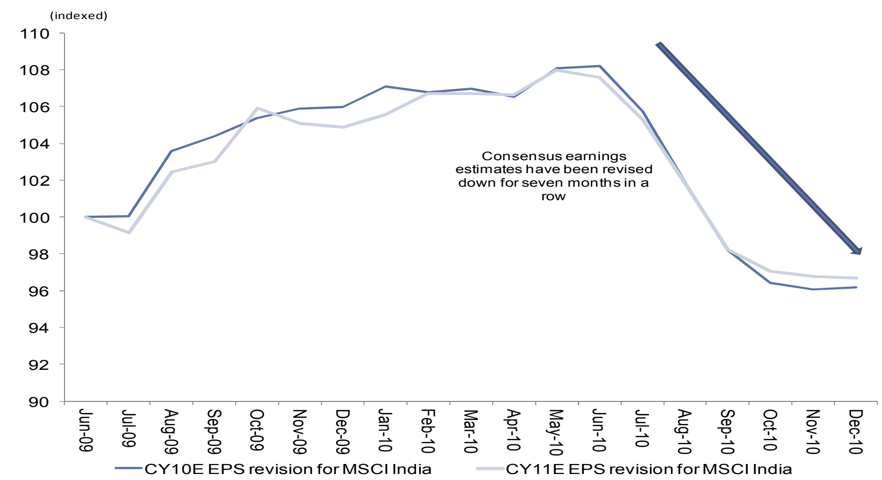
Yoy growth in sales, EBIT and net income for GS India coverage (ex. Energy)



Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Slowdown in growth partially reflected in estimates; consensus estimates have been revised downwards for seven months in a row

Consensus earnings revisions for MSCI India stocks



Source: Company data, MSCI, I/B/E/S, Goldman Sachs Research estimates.

Exhibit 3: Sales, EBIT and net income by sector—high yoy growth led by Real Estate, Oil&Gas, Infra, Industrials & Financials, while Cement, Telecom lag

Yoy growth in Sales, EBIT and Net Income by sectors

Sectors	YoY 3QFY11E GROWTH		
	Sales	EBIT	Net Income
Autos	26%	1%	20%
Consumer Staples	11%	6%	4%
Fertilizers	13%	-2%	-22%
Financials	23%	25%	28%
Healthcare	14%	11%	19%
Industrials	32%	28%	24%
Infrastructure	30%	25%	78%
IT Services	23%	18%	15%
Materials: Cement	2%	-26%	-25%
Materials: Metals	17%	2%	15%
Media	35%	46%	55%
Oil & Gas	14%	53%	64%
Real Estate	33%	65%	44%
Telecom	29%	-16%	-53%
Utilities	22%	17%	2%
Aggregate	**18%**	**21%**	**25%**
Aggregate (ex. Oil & Gas)	**19%**	**14%**	**16%**

Source: Company data, Goldman Sachs Research estimates.

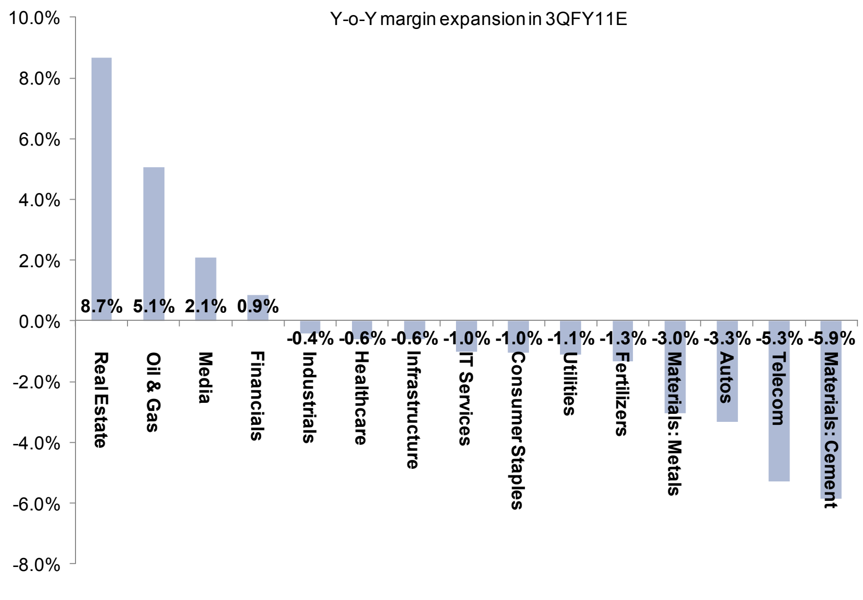
Exhibit 4: We expect most sectors (ex. Autos & Fertilizers) to see a sequential growth led by cement, metals, infra as execution picks up, post seasonal slowdown in 2Q

Qoq growth in sales, EBIT and net income by sectors

Sectors	QoQ 3QFY11E GROWTH		
	Sales	EBIT	Net Income
Autos	3%	-3%	-1%
Consumer Staples	2%	7%	6%
Fertilizers	2%	-8%	-11%
Financials	3%	3%	15%
Healthcare	10%	44%	1%
Industrials	16%	15%	13%
Infrastructure	26%	40%	84%
IT Services	5%	5%	4%
Materials: Cement	13%	97%	92%
Materials: Metals	14%	47%	39%
Media	11%	15%	16%
Oil & Gas	4%	9%	9%
Real Estate	4%	9%	9%
Telecom	3%	-1%	-5%
Utilities	11%	39%	3%
Aggregate	**5%**	**11%**	**10%**
Aggregate (ex. Oil & Gas)	**6%**	**11%**	**10%**

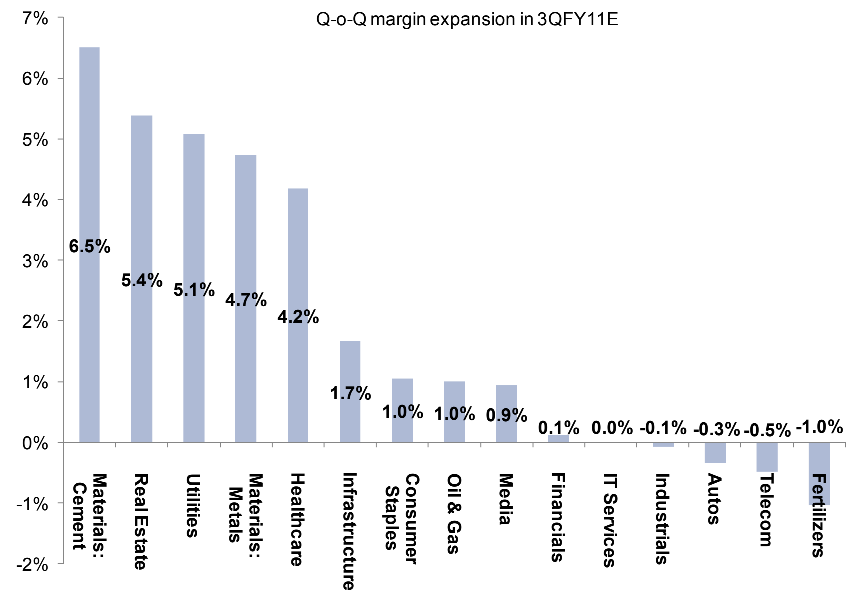
Source: Company data, Goldman Sachs Research estimates.

Exhibit 5: Yoy margin compression across most sectors, as cost pressures weigh on profits
Yoy margin expansion in 3QFY11E



Source: Company data, Goldman Sachs Research estimates.

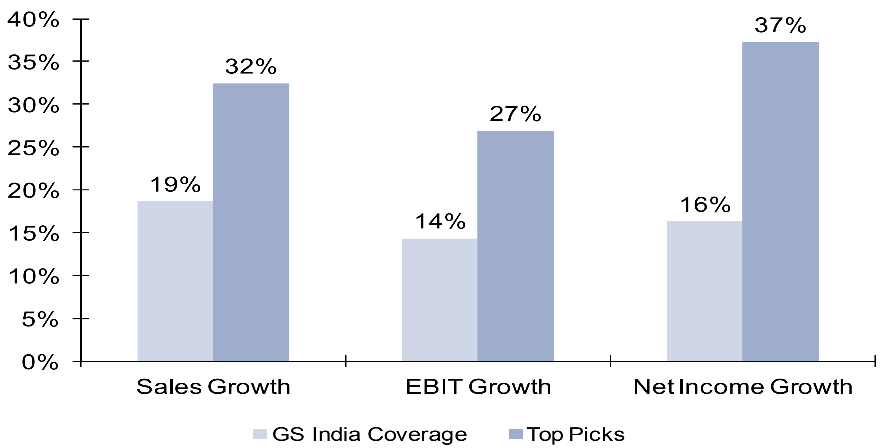
Exhibit 6: Sequential margin expansion across sectors, led by Cement, Real Estate, Utilities and Metals
Qoq margin expansion in 3QFY11E



Source: Company data, Goldman Sachs Research estimates.

Note: We have excluded Apollo Tyres, IL&FS, Ultratech Cements, Orient Green, Reliance Power from our coverage universe, as there are no comparables for last quarter.

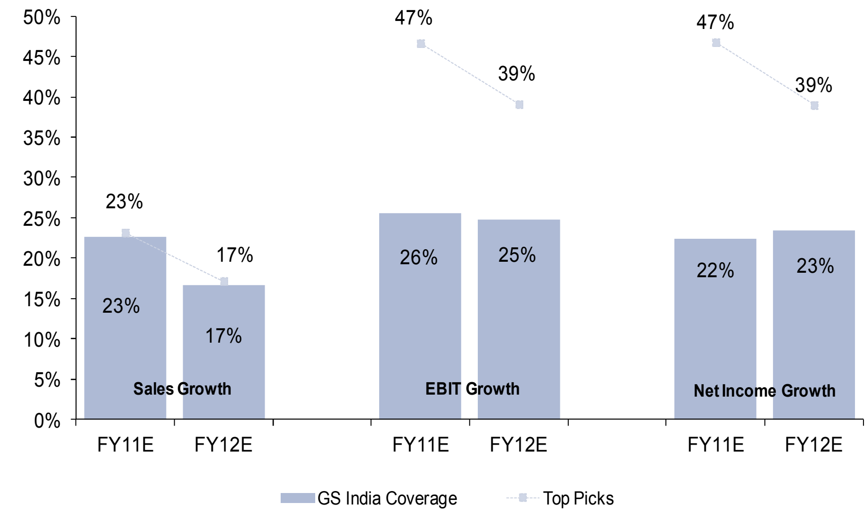
Exhibit 7: We expect our top picks to outperform the broader coverage in 3QFY11E...
Sales, EBIT and net income growth for GS coverage (ex. Oil & Gas) vs. top picks



Note: For top picks, we use an equal weighted average of growth rates, to avoid misrepresentation.

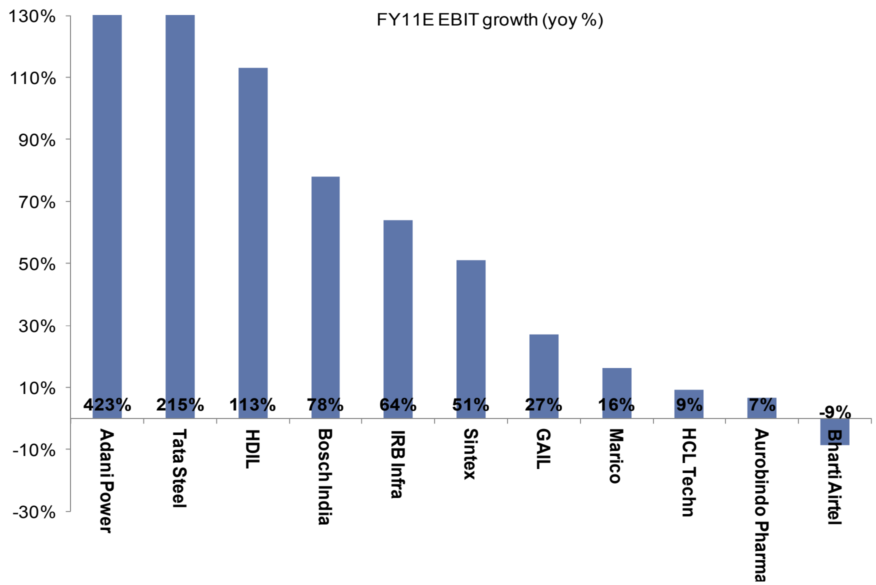
Source: Company data, Goldman Sachs Research estimates.

Exhibit 8: ...and deliver superior growth for FY11E/FY12E
Sales, EBIT and net income growth for GS coverage vs. top picks



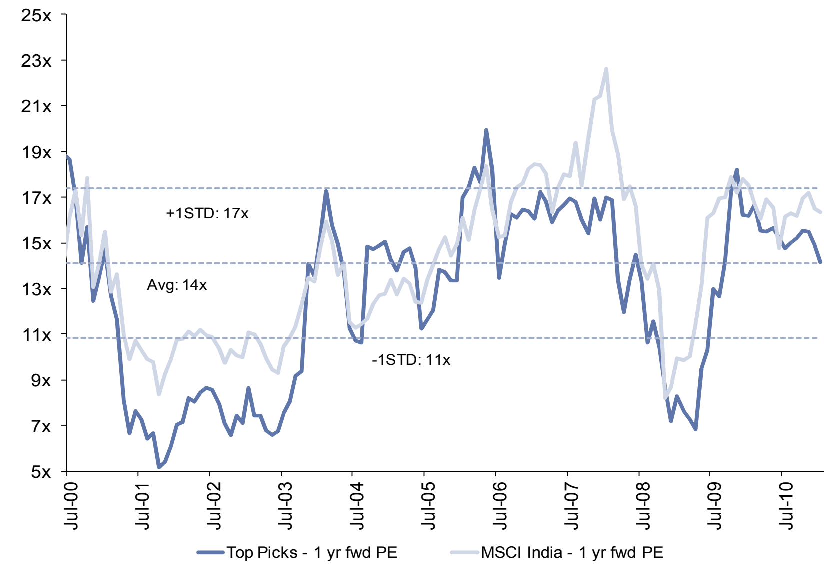
Source: Company data, Goldman Sachs Research estimates.

Exhibit 9: Strong growth across all top picks in FY11E
FY11E yoy EBIT growth for top picks



Source: Company data, Goldman Sachs Research estimates.

Exhibit 10: Our top picks trading at a 15% discount to MSCI India, in spite of higher earnings growth



Source: Datastream, Company data, Goldman Sachs Research estimates.

Exhibit 11: 3QFY11 expectations for sectors under coverage

Sector	3QFY11 expectations
Automobiles	**>** We expect margins and EPS to be sequentially flat on average for the sector. Stocks likely to be under focus include: - 1) Hero Honda – expect sequential earnings growth due to robust sales volumes reported for the quarter. 2) Ashok Leyland - likely to see sequential and yoy earnings decline due to seasonal demand weakness, particularly post the expiry of Sept 30 2010 new emission norms deadline. **>** We also believe that the market is likely to focus on FY2012E outlook, amid concerns on the macro front, mainly inflation and potential monetary tightening
Consumer Staples	**>** We are looking for improvement in sector gross margins following 1. Reduction in raw material prices following a robust monsoon; 2. Relative easing of price war, particularly in HPC, allowing companies to increase prices. **>** More updates on consolidation in the industry following news articles of acquisitions in India and abroad.
Fertilizers	**>** We expect weaker volumes due to unseasonal rainfall in 3Q. **>** We expect Soda ash margins to narrow due to higher costs.
Financials	**>** We expect another strong set of operating numbers for the quarter with 30% PAT growth for the sector driven by strong NII growth (20% yoy growth) **>** Margins to remain stable/improve for the retail borrowers, and a peak in NPL cycle implying improving asset quality going forward.
Healthcare	**>** We expect average revenue growth of 16% yoy in 3QFY11 for our coverage universe. Revenue growth is normalized in this quarter due to lack of major one-off opportunities (except Ranbaxy). **>** We expect margins to remain stable, however, grow at a lower pace than the revenue growth as high margin one-off revenues are replaced by core revenues from base products.
Industrials	**>** The heavy equipment supply space in India is reaching a critical mass and various domestic companies will now compete to grow market share and presence. This, coupled with the continuing competitive pressure from China ($15bn worth power equipment orders announced on Chinese players in the last 3 m) will likely affect order inflows for incumbents, margins and returns in the interim **>** We expect execution to pick up post monsoons, in-line with the stronger execution seen in 2H historically for these companies. However, margins are likely to decline from 1HFY11 levels as the impact of increase in raw material costs kicks in
Infrastructure	**>** We expect execution to pick up in the seasonally strong 2H. However, margins could be under pressure due to increase in raw material costs. **>** We expect order inflows to be stronger for these companies in Q4, given that roads segment is a key driver of order inflow growth for these companies - 14,000 Kms of road projects are in various stages of award, which we expect to be awarded in 4QFY11E

Source: Company data, Goldman Sachs Research estimates.

Exhibit 12: 3QFY11 expectations for sectors under coverage

Sector	3QFY11 expectations
IT Services	> We expect another strong quarter, primarily led by the large cap names. We expect 4.8% sequential revenue growth despite this quarter being seasonally weak. A 3.5% appreciation in INR should be mitigated by supportive cross currency movements and robust volume growth. > We would look out for the indications of attrition easing out as we believe that it has peaked out in the previous quarter. Hence, we do not see significant downside risks to the margins as most of the wage hikes for the year are behind us. We would also watch out for the outlook on 2011 budgets and pipeline and initial indications of the size of budgets finalized by the corporates.
Materials: Cement	> While Cement companies will witness a sequential growth in EBIT, led by higher realizations, cost pressures continue to weigh on profits. As highlighted earlier, the recovery in cement companies' profits would be gradual, amid competitive pressures. > On a YoY basis, we expect EBIT to decline by 26%, with a 600bps contraction in EBIT margin for our coverage group.
Materials: Metals	> For steel companies, we expect a modest improvement in margins on a qoq basis, amid flat realizations and lower coking coal costs. Volume growth would be muted on a qoq basis. > Inspite of increase in base metal prices (up 10%-20% qoq), we expect profitability to remain muted, on higher input costs.
Media	> We foresee strong advertising growth for the broadcasting companies to continue in 3QFY11E, as seen in 1HFY11. > The DTH companies have seen extremely strong subscriber additions over Q3FY11 – the impact of this on ARPUs and profitability would be the key thing to watch out for
Oil & Gas	> Losses will continue for oil marketing companies as government subsidy sharing regime remains unclear, in our view > We expect ONGC, OIL earnings to be boosted by high other income but should remain below the required FY11E run rate. GAIL is likely to report strong numbers again on improved petchem performance. RIL 3QFY11 earnings will remain sluggish but 4QFY11 is likely to be better from higher refining and petchem margins, in our view.
Real Estate	> We are expecting a healthy topline growth of 33% yoy as area under execution increases for various developers and revenue booking for Indiabulls real estate becomes significant. We look for improvement in operating cash flows on a qoq basis. > DLF will likely show a sharp jump in margins on a qoq basis on account of higher proportion of revenues from plot sales.
Telecom	> We expect the cellular revenue growth in 3QFY11 for Bharti/Idea to be strong led by steady net adds, growth in MOU and stable tariffs. EBITDA margins, however are likely to decline qoq for Bharti (partially driven by higher operating costs from African operations) and RCOM (due to higher opex), while we expect Idea to report a slight improvement in 3QFY11 driven by scale benefits. > As the procurement issues were resolved, we expect capex spending for the operators to pick-up after couple of quarters of weak spending.
Utilities	> We expect the companies to report short term rates in the range of Rs3.50/kwh for this quarter, much below the consensus expectations. Further, companies are likely to guide the short term rates of Rs4/kwh for FY12E due to 1) supply exceeding the demand 2) Weak finances of SEBs, versus the consensus estimates of Rs5/kwh. > Though the commissioning of new capacities will result in volume growth, we expect the utilization levels to be lower in 3QFY11 than the street estimates due to low offtake by states on account of better than expected monsoons and the weak finances of state SEB's.

Source: Company data, Goldman Sachs Research estimates.

Exhibit 13: Snapshot of our top picks

Top picks	Ticker	Current price (Rs/ Share)	12-month target price (Rs.)	Covering Analyst	Methodology	Key catalysts	Key risks
Adani Power	ADAN.BO	124	167	Durga Dath	SOTP (DCF)	Commissioning of the first unit of Mundra Phase III in 1Q2011; Receipt of coal linkages for its Kawai and Tiroda Phase II power projects in 2011; Allocation of coal block for its Tiroda power project	Equipment issues leading to further delay in the projects.
Aurobindo Pharma	ARBN.BO	1,289	1,545	Balaji V. Prasad	Director's Cut	Licensing agreements with large pharma; Redemption of FCCBs in May 2011	Failure to redeem FCCBs.
Bosch India	BOSH.BO	6,401	7,846	Sandeep Pandya	P/E	Ongoing signs of strong demand in the domestic auto industry; Relative easing of vendor capacity constraints through 2011	Higher raw material costs, lower consumer confidence, high volatility in quarterly earnings.
Bharti Airtel	BRTI.BO	339	430	Sachin Salgaonkar	SOTP	Incremental newsflow related to potential cancellation of licenses of new operators; Additional revenue growth led by 3G uptake; Data points providing visibility on turnaround of Bharti's African asset.	Re-emergence of price wars in India led by MNP rollout; Weaker than expected African revenues and EBITDA margins
Gas Authority of India	GAIL.BO	503	570	Nilesh Banerjee	DCF	New pipeline capacity coming on stream by Apr '11; Rise in gas volumes through imported LNG	Delay in pipeline projects leading to delay in volume ramp-up; Weak petrochemical prices; Higher subsidy burden
HCL Technologies Ltd.	HCLT.BO	464	492	Balaji V. Prasad	Director's Cut	Continued visibility on the realization of cross-selling opportunities through HCL Axon over the medium term; Any large total outsourcing orders could trigger a re-rating	The failure to leverage the Axon acquisition to secure new orders in both SAP and non-SAP services; Industry trend moving away from infrastructure and application outsourcing
HDIL	HDIL.BO	169	360	Puneet Jain	RNAV	Upcoming project launches in Mumbai suburbs Goregaon and Santa Cruz in 2HFY11E; Revenue recognition for projects beginning 4QFY11E;Shifting of families for the airport slum project	Execution delays of inherently difficult slum rehabilitation projects, Sharp correction in TDR prices and a fall in Mumbai residential property demand.
IndusInd Bank	INBK.BO	223	320	Tabassum Inamdar, CFA	P/B	Strong earnings growth – 36% CAGR in profits FY10-FY13E; Network expansion	High dependence on bulk deposits/ borrowings (at 52.7% of assets); Frequent capital raising
IRBI	IRBI.BO	209	315	Ishan Sethi	SOTP	Strong pick up in execution in the construction segment in 2HFY11; Strong growth in traffic and increase in toll rates at the BOT projects that are currently operational.	Lower than expected traffic growth, higher than expected increase in interest rates, volatile construction material costs, lower than expected spending by the Indian government on core infra projects
Marico	MRCO.BO	124	151	Aditya Soman	P/E	Improvement in op margins for the international business; Any reduction in the inflation in India should ease margins and result in value growth	Sustained inflationary pressure in India; An unfavorable outcome in the Parachute litigation; Sustained losses at Kaya
Sintex Industries	SNTX.BO	166	269	Ishan Sethi	P/E	New orders and continued execution in monolithic business; India's continued spending on social infrastructure; Stronger than expected recovery in growth and margins of overseas subsidiaries	Prolonged slowdown in the telecom infrastructure, international auto and textiles; Execution delays in the monolithic segment, Volatile raw material prices
Tata Steel	TISC.BO	651	764	Pritesh Vinay	P/B	Resilient quarterly earnings, leading to consensus upgrades; Rising spot steel prices	Slower-than-expected demand recovery in Europe.

Note: (1) Prices as of the market close of January 10, 2011; (2) All stocks are Buy rated, with Adani Power, Bosch India, Bharti Airtel, GAIL, HDIL, Tata Steel, IndusInd Bank on our Conviction Buy list; (3) For important disclosures, please go to http://www.gs.com/research/hedge.html.

Source: Company data, Goldman Sachs Research estimates.

Other disclosures

Reg AC

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