Equity Research

August 6, 2009

BSE Sensex: 15903

INDIA

Market Earnings Review

Margin revival but no earnings upgrade yet

Strategy

Aggregate EBITDA and net income for the I-Sec universe in April-May-June '09 (AMJ) quarter surprised positively. However, this was largely driven by significant cost control and higher other income/forex gains, with revenues being slightly lower than expectations. Thus, the sustainability of these positive surprises is not assured. Earnings upgrade can be a key positive trigger for the markets, but we continue to doubt that it will ensue in the short term – our Sensex earnings estimates remain broadly unchanged. We continue to reiterate our defensive stance on the market in the short term, given rich valuations (FY10E & FY11E P/E of 18x & 15x), uncertainty in the global macro-economic environment and potential risk still on the monsoon front.

- **Cost control, raw material benefits and other income led to positive surprise.** EBITDA margin for the I-Sec universe expanded 150bps YoY (I-Sec: 160bps compression) and net income rose marginally (I-Sec: 10% decline). This was largely driven by cost control, raw material benefits and high-than-expected other income. Aggregate revenues declined 7% YoY (as against our estimates of a 3% decline).
- **Auto, IT, real estate surprise positively; banks & telecom negatively.** Volume growth and raw material cost benefits aided the first YoY net income growth for auto in four quarters. IT surprised positively on volumes and margins. Real estate revenues were significantly higher than expected, but they tend to be lumpy. Banks' margins were under pressure and asset quality was mixed. Telecom stocks faced pressure on ARPUs and MoUs. Based on AMJ '09 results and our bottom-up view on stocks, we maintain BUY on Axis Bank, Bajaj Auto, Bharti Airtel, Glenmark, GSK Consumer, Gujarat State Petronet, HDFC, Lanco, Marico, Tata Steel, Tata Consultancy Services (TCS) and Texmaco and reiterate SELL on Bharat Petroleum Corporation (BPCL), Chambal Fertilizer, Colgate, Divi's, DLF, Entertainment Network India, Idea and Unitech.
- **Earnings upgrade insignificant.** AMJ '09 results have not triggered any significant revision in our Sensex EPS estimates – FY10E & FY11E estimates (unadjusted for free float) are Rs893 and Rs1,075 respectively, not even 1% higher than our estimates a month ago.

I-Sec universe – Quarterly review for AMJ '09

	Revenue			EBITDA margin (%)			PAT		
	AMJ-09	% YoY	versus est (%)	AMJ-09	YoY (bps)	versus est (bps)	AMJ-09	% YoY	versus est (%)
Automobile	254,196	7.9	3.7	12.7	354	139	20,282	30.2	13.7
Banks	160,066	11.8	(2.4)	-	-	-	76,814	50.5	19.5
Fertilisers	30,850	(24.7)	6.7	11.0	54	(197)	1,322	(25.8)	(23.2)
FMCG	140,316	9.9	(1.2)	22.1	270	70	21,053	19.3	(1.6)
Media	18,535	1.1	(2.5)	25.1	397	382	2,346	26.8	53.9
Metals	333,937	(13.6)	(0.4)	24.0	(1,065)	216	48,335	(44.0)	4.5
Oil & Gas	1,039,811	(19.5)	(7.5)	20.3	556	493	121,042	18.2	19.1
Pharma	83,071	3.6	1.0	21.0	(444)	40	11,851	(15.6)	6.3
Real estate	49,201	(28.1)	48.2	29.8	(2,450)	(1,017)	8,184	(72.0)	9.2
Technology	214,110	10.8	2.3	27.1	321	172	43,656	18.9	12.0
Telecom	190,627	19.3	(5.2)	39.2	(145)	94	44,614	15.4	18.1
Utilities	145,949	18.2	0.8	26.2	308	240	25,304	26.6	8.6
I-Sec Universe (ex-banks)	2,500,601	(8.3)	(2.5)	22.6	149	287	347,991	(4.5)	12.6
I-Sec Universe	2,660,667	(7.3)	(2.5)	-	-	-	424,805	2.3	13.8

Source: I-Sec Research

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I-Sec Equity Research

Cost control, raw material benefit led to some margin revival in AMJ '09, but no revenue surprises

While aggregate revenues for the I-Sec universe came in slightly below our expectations for AMJ '09, margins and net income surprised positively.

Revenues declined 7% YoY (Chart 5) as against our expectations of a 3% decrease (refer our note *No major uptrend* yet dated July 10, '09). The marginal negative surprise was mainly driven by banks (high balance sheet liquidity led to compression in NIMs), telecom (decline in ARPU and MoU) and oil & gas (which tends to be slightly unpredictable from one quarter to the next). Real estate companies surprised positively with lower-than-expected revenue decline.

EBITDA margin for the I-Sec universe (excluding banks) expanded 150bps YoY as against our expectations of a 160bps compression. Metal companies' margins declined less than expected due to cost efficiencies. IT companies' margins expanded on the back of higher volumes. Cost control helped media companies and raw material benefits aided the auto sector.

Net income rose marginally YoY versus our expectations of a 10% decline. However, most of this positive surprise has been on account of higher other income (or lower net interest costs), trading profits and forex gains. This was especially the case with banking, media, telecom and oil & gas.

As we have noted before, earnings revival and upgrades can be a key positive trigger for the markets; however, we do not believe that AMJ '09 quarter has provided that. There were no revenue surprise and the positive surprise on the earnings front has largely been driven by cost control and higher other income.

Auto, IT, real estate surprise positively; banks & telecom negatively

As expected (refer our note *No major uptrend* yet dated July 10, '09), most sectors continued with the January-February-March trend in AMJ '09 as well, with the exception of automobiles and fertilisers. The auto sector reported its first YoY net income growth in four quarters and fertilisers reported its first net income decline in five quarters. A combination of volume growth and raw material cost benefits aided the auto sector, while decline in prices and trading revenues hurt the fertilisers sector.

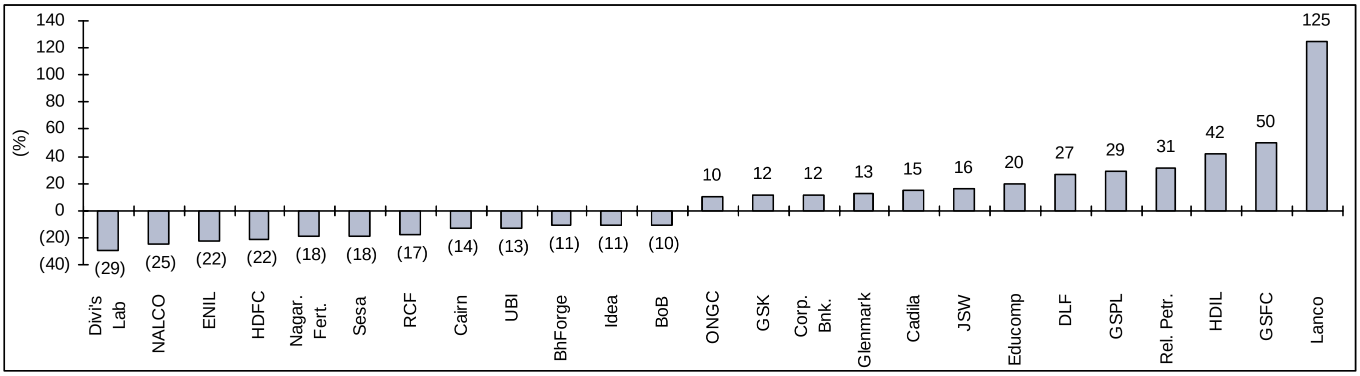
Revenues and EBITDA for the auto sector were 4% and 17% ahead of expectations. Tata Motors was the key outperformer – while revenue still declined YoY, EBITDA rose over 50%. Ashok Leyland was a notable exception in the sector – EBITDA was one-tenth of Q1FY09 levels due to operational deleverage and high-cost inventory. IT surprised positively on volumes and margins. While the magnitude of surprise was small, stocks in the sector react disproportionately to surprises. TCS, Wipro and Patni were the standout performers. Real estate stocks posted revenues significantly higher than our expectations. However, real estate revenues can be lumpy. Banks were hit by compression of NIMs due to high balance sheet liquidity, but strong trading profits helped earnings. In Telecom, the extent of decline in ARPU and MoU was higher than anticipated for wireless operators, though strong other income/lower net interest costs helped shore earnings.

Results were mixed in other sectors. In the consumer sector, Asian Paints witnessed sharp margin expansion, while Britannia's market share slipped. In media, Jagran Prakashan and TV Today gained due to strong ad/circulation growth and cost control respectively. Among the metal stocks, Hindalco and Tata Steel surprised positively on cost savings in aluminium/copper and price increase respectively; Sesa Goa disappointed due to lower iron ore realisations. BPCL, Hindustan Petroleum Corporation and Cairn's net income surprised positively in the oil & gas sector due to forex gains/inventory gains/high other income. Lower GRMs hurt Reliance Petroleum. In pharmaceuticals, forex gains aided Ranbaxy's net income, while Sun Pharma disappointed on account of the negative impact of US FDA issues for Caraco, pipeline filling in the domestic market in Q4FY09 and likely sharp decline in revenues from the high-margin generic *Protonix*.

No significant earnings change post AMJ '09

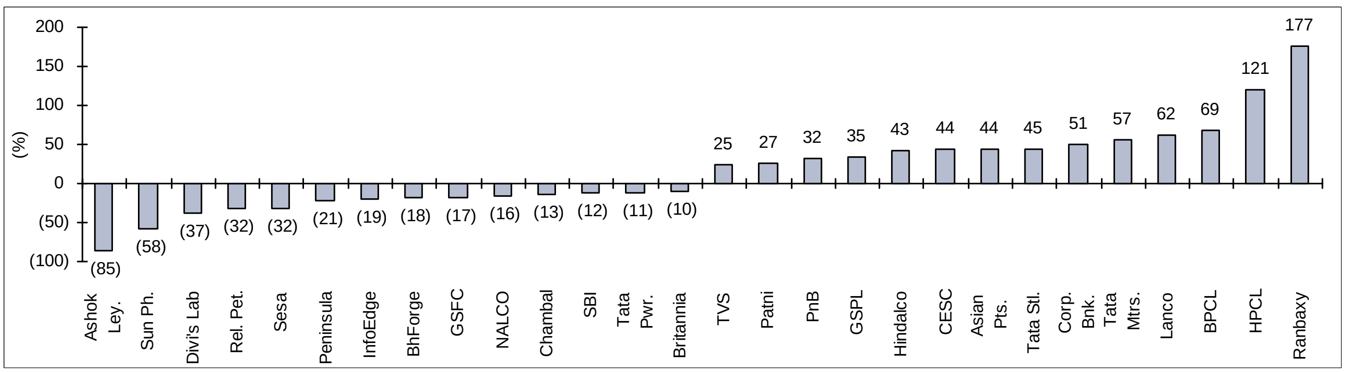
Our FY10 and FY11 earnings estimates for the BSE Sensex have not changed significantly (less than 1%) post AMJ '09 (Table 1). While estimates for auto stocks, some metal companies, cement stocks and TCS have been raised significantly, those for Reliance Industries have been lowered.

Chart 1: Surprises in AMJ '09 – Actual revenues versus estimated (%)



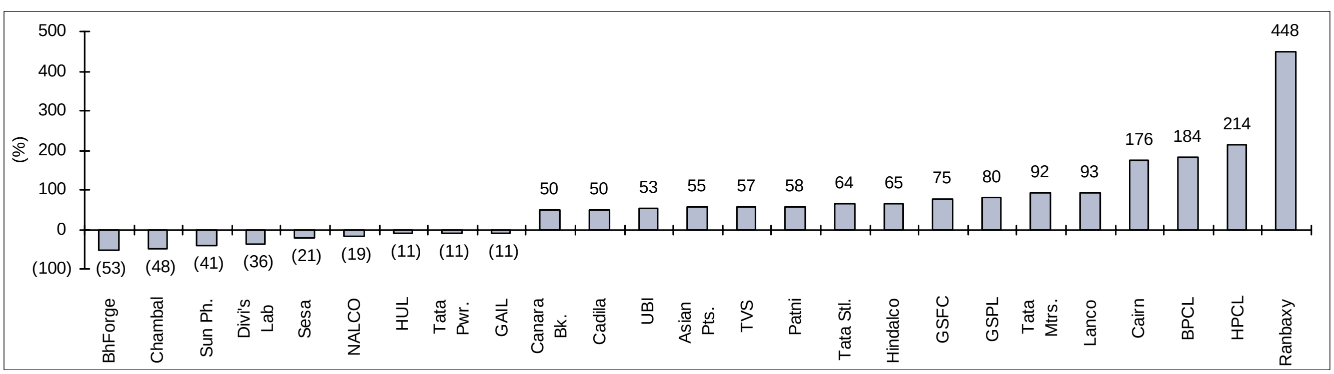
Source: I-Sec Research

Chart 2: Surprises in AMJ '09 – Actual EBITDA versus estimated (%)



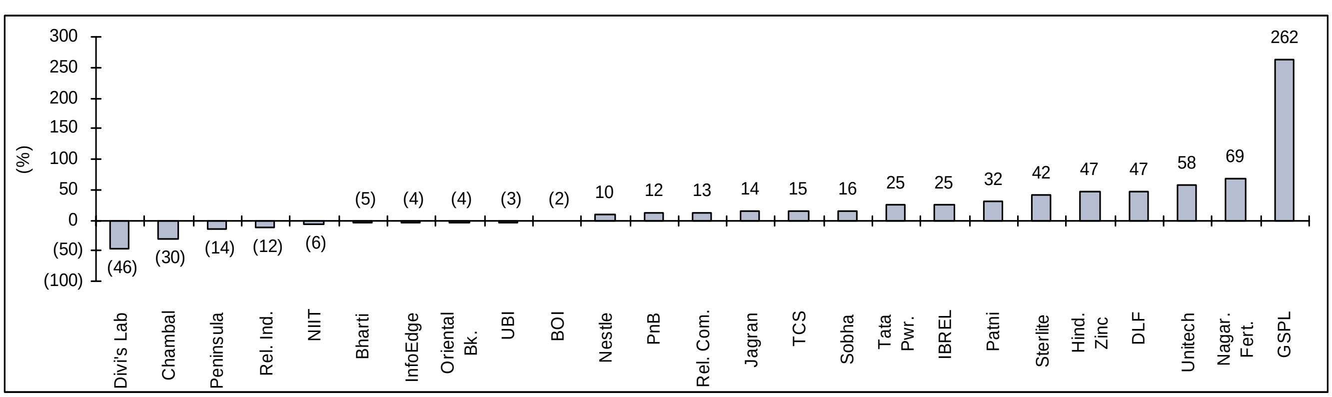
Source: I-Sec Research

Chart 3: Surprises in AMJ '09 – Actual PAT versus estimated (%)



Source: I-Sec Research

Chart 4: Significant FY10 earnings revisions



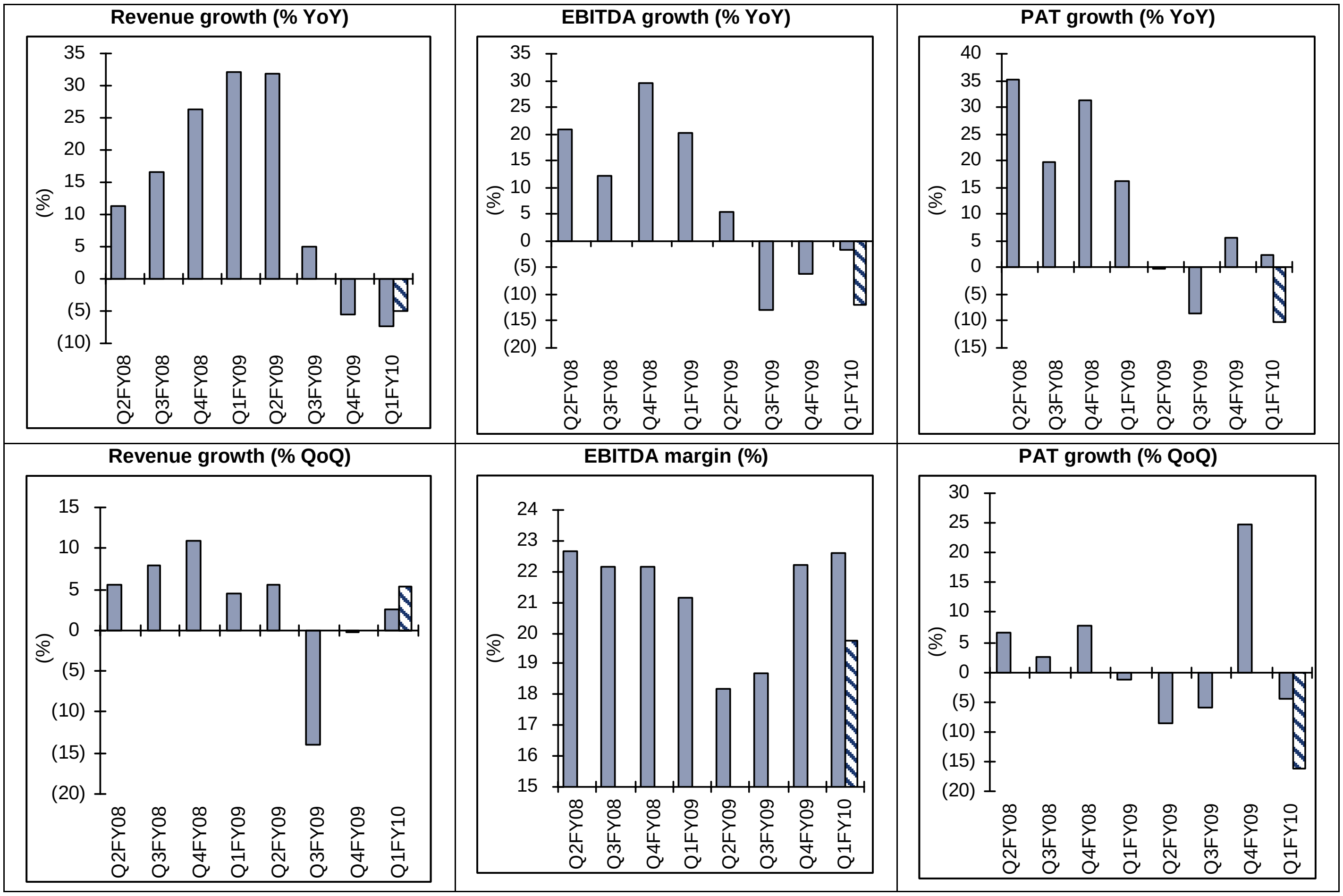
Source: I-Sec Research

Table 1: Change in Sensex earnings

	Old EPS (Rs)		Old Growth (%)		New EPS (Rs)		New Growth (%)	
	FY10	**FY11**	**FY10**	**FY11**	**FY10**	**FY11**	**FY10**	**FY11**
Free Float Adjusted	827	1019	(1)	23	831	1022	1	23
Non-Free Float Adjusted	890	1069	1	20	893	1075	3	20

Source: I-Sec Research

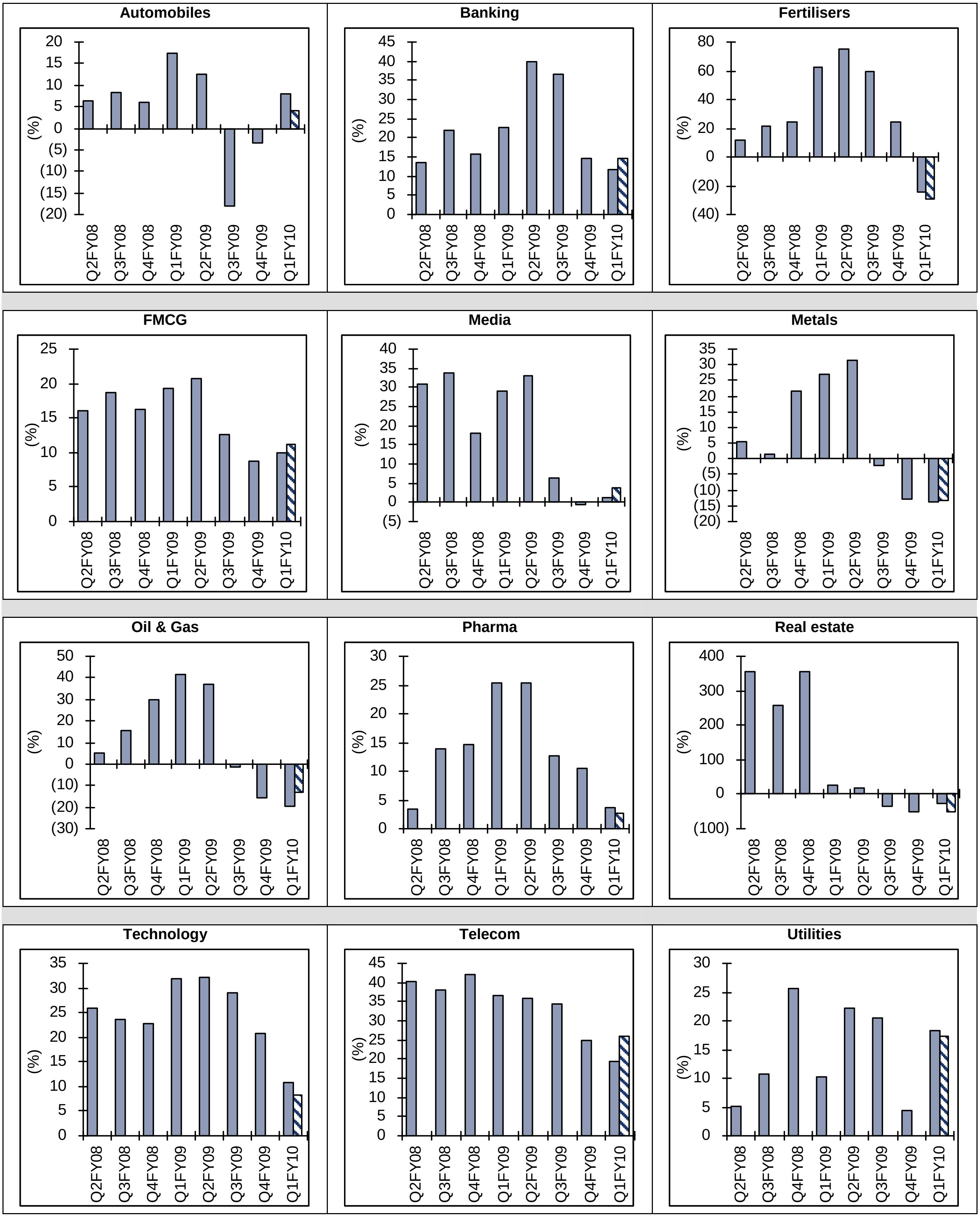
Chart 5: Quarterly trends in the past eight quarters



Note: I-Sec estimates; Actuals; EBITDA and EBITDA margins do not include Banks

Source: I-Sec Research

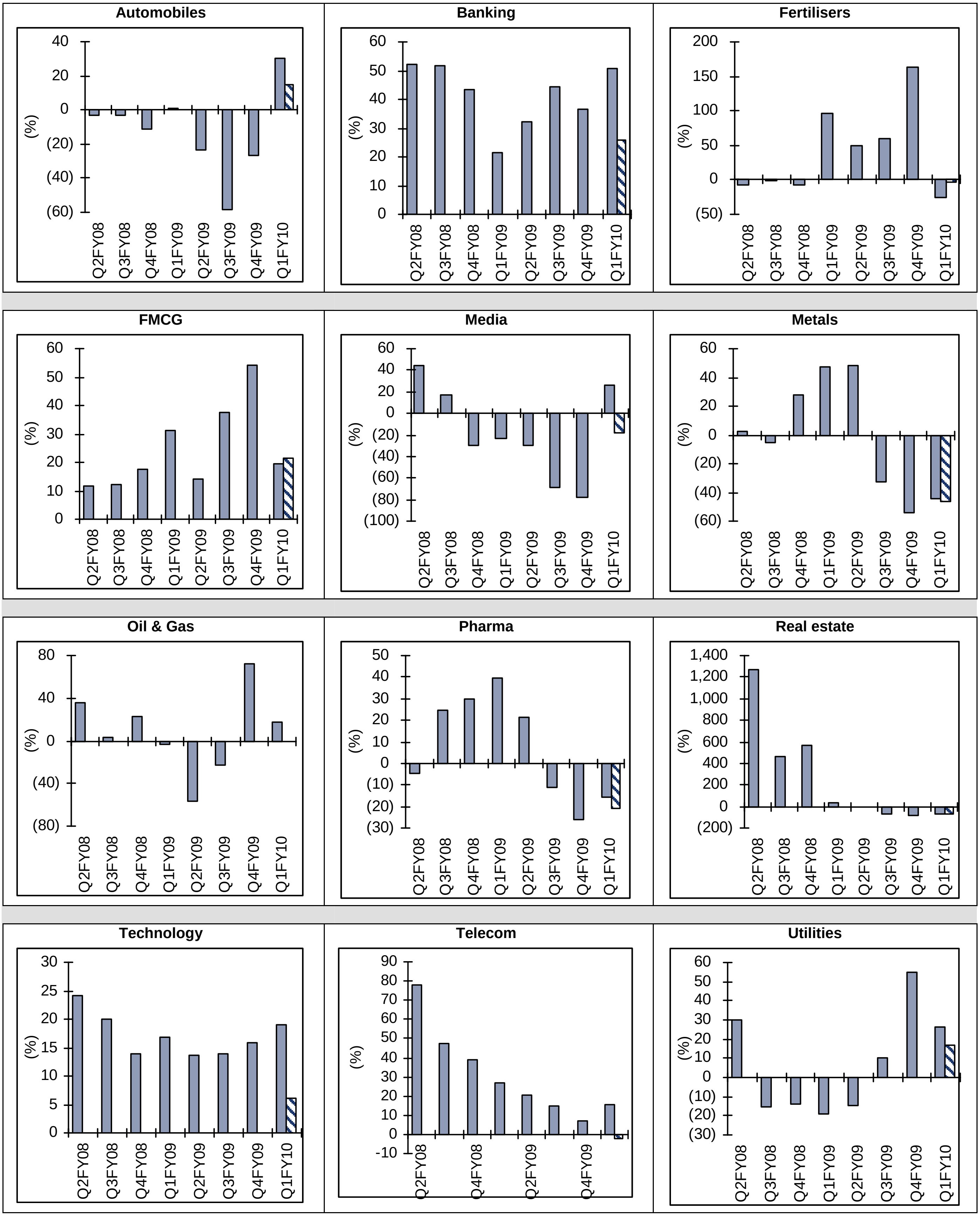
Chart 6: Sector-wise revenue growth (% YoY)



Note: I-Sec estimates; Actuals

Source: I-Sec Research

Chart 7: Sector-wise PAT growth (% YoY)



Note: I-Sec estimates; Actuals
Source: I-Sec Research

Table 2: Sector summary of AMJ '09 results

	Revenues (Rs mn)				EBITDA Margin (%)				PAT (Rs mn)				Key surprises
	AMJ09	% YoY	% QoQ	Vs. Est (%)	AMJ09	(bps) YoY	(bps) QoQ	Vs. Est (bps)	AMJ09	% YoY	% QoQ	Vs. Est (%)	
Ashok Leyland	9,125	(52)	(25)	1	1	(624)	(809)	(750)	30	(96)	(91)	(60)	Margin contraction due to deleverage, high cost inventory
Bajaj Auto	23,385	1	24	0	19	806	430	338	3,105	80	66	24	Exports helped margin, lower tax rate due to Uttaranchal plant
Bharat Forge	3,586	(44)	23	(11)	21	(87)	624	(182)	108	(82)	(744)	(53)	Standalone margin expansion due to higher volumes
Hero Honda	38,224	34	12	(0)	17	501	96	83	5,001	83	24	7	Slightly better margins, lower tax rate
Mahindra & Mahindra	42,426	29	16	2	14	553	235	184	4,009	109	38	8	Better margins in farm equipment, lower raw material prices
Maruti Suzuki	63,647	34	0	7	10	32	300	51	5,835	22	78	6	Higher exports realisation
TVS Motor	9,756	7	9	2	5	161	141	95	181	158	153	57	QoQ margin improvement due to raw material benefits
Tata Motors	64,046	(8)	(7)	8	11	437	322	352	2,014	(34)	155	92	Higher margins due to raw material benefits
Automobile	254,196	8	3	4	13	354	261	139	20,282	30	53	14	
Chambal Fertiliser	7,699	(4)	(7)	9	18	(27)	639	(454)	509	(33)	(9)	(48)	Problems in the shipping business, decline in fertiliser trading
GSFC	11,431	(12)	35	50	5	(637)	(1,654)	(375)	266	(62)	(73)	75	Improvement in Caprolactum; fall in DAP prices
Nagarjuna Fertiliser	3,290	(24)	(39)	(18)	29	964	1,128	440	231	82	(13)	(8)	Decline in fertiliser trading & fuel costs
RCF	8,430	(46)	(56)	(17)	7	294	(26)	118	316	65	(69)	(8)	Poor core business, fertiliser trading, exchange gain
Fertilizer	30,850	(25)	(25)	7	11	54	(113)	(197)	1,322	(26)	(53)	(23)	
Asian Paints	14,602	18	2	1	19	498	632	562	1,761	65	72	55	Sharp expansion in margins
Britannia	7,312	5	(4)	(4)	9	(3)	(79)	(64)	530	18	26	4	Lower sales growth due to loss of market share
Colgate-Palmolive	4,680	15	3	(1)	26	309	475	179	1,028	43	33	14	Lower advertising spends
GSK Consumer	4,687	25	(13)	2	20	114	(454)	51	552	19	(34)	(9)	Lower other income
Godrej Consumer	4,389	21	28	5	20	535	57	235	697	78	19	16	-
Hindustan Unilever	44,757	8	12	(0)	16	67	102	28	5,367	(2)	18	(11)	-
ITC	40,827	5	4	(4)	34	508	92	(6)	8,787	17	9	(5)	-
Marico	6,967	17	24	(3)	14	116	79	(55)	600	30	42	(9)	-
Nestle India	12,095	17	(4)	(0)	22	326	(276)	76	1,731	51	(15)	4	Overall margin expansion
FMCG	140,316	10	6	(1)	22	270	83	70	21,053	19	12	(2)	
Balaji	398	(57)	(25)	1	8	(2,636)	3,431	481	90	(60)	(276)	1,333	High other income, increase in sponsored programme realisations
ENIL	871	(19)	(13)	(22)	-8	(1,034)	369	(1,039)	(194)	143	(17)	51	Low revenue growth, higher costs
HT Media	3,351	3	(1)	(0)	21	20	762	145	324	(14)	38	19	Strong Hindi ad revenue growth, cost rationalisation
IBN18	567	36	18	(1)	4	3,620	4,253	1,225	(64)	(69)	(82)	(34)	Cost control in news business, lower losses in Viacom18
Jagran Prakashan	2,319	12	15	2	30	637	1,103	160	495	56	127	29	Strong ad & circulation revenue growth, forex gains
NDTV	1,309	10	6	(0)	-44	3,289	8,788	4,095	(807)	(21)	(51)	(31)	Cost control, entertainment revenue ramp-up, low news revenue
Sun TV	2,877	29	4	2	78	247	(407)	(137)	1,198	17	5	(0)	High subscription revenue growth
TV Today	710	11	32	(1)	27	711	1,786	536	167	82	104	42	Lower costs, high other income
Zee Entertainment	4,759	(12)	(7)	(5)	25	(202)	120	(48)	1,019	(1)	11	24	Low interest costs, high subscription revenue, low operating costs
Zee News	1,374	22	(1)	(4)	18	271	310	168	119	28	36	(3)	Operating costs control, high interest costs & increasing debt
Media	18,535	1	0	(3)	25	397	1,167	382	2,346	27	467	54	
Hindalco (Standalone)	38,904	(16)	3	1	16	(444)	782	479	3,472	(50)	31	65	Cost savings in aluminium, copper
Hindustan Zinc	15,122	(8)	17	6	51	(870)	568	(82)	7,188	(15)	30	5	Earnings change due to change in zinc realisations
JSW Steel -Standalone	39,902	(10)	12	16	17	(673)	1,142	(106)	(19)	(100)	(101)	(103)	Higher-than-expected loss in US subsidiary
Jindal Steel & Power	27,486	27	(6)	(7)	58	1,114	297	627	9,885	90	23	(9)	Lower steel realisations, higher merchant spot rates in power
NALCO	9,353	(36)	(17)	(25)	18	(3,231)	941	194	1,264	(76)	52	(19)	Higher aluminium business loss, lower alumina margins
Sesa Goa	10,115	(21)	(30)	(18)	45	(1,810)	(734)	(925)	4,293	(32)	(22)	(21)	Lower-than-expected iron ore realisations
SAIL	91,528	(17)	(22)	(1)	11	(1,608)	71	36	7,627	(62)	29	(1)	No key surprise, lower wage provisioning (one-time)
Sterlite	45,371	(21)	3	(5)	22	(1,008)	253	186	6,727	(42)	12	7	Net income change due to ADR issue
Tata Steel	56,156	(9)	(14)	6	31	(1,804)	874	838	7,898	(56)	16	64	Rs3,000/te QoQ price increase, higher cost savings of US$30/te
Metals	333,937	(14)	(9)	(0)	24	(1,065)	484	216	48,335	(44)	12	5	
BPCL	255,143	(23)	4	(5)	7	893	(1,045)	291	12,318	(215)	(66)	184	Forex gains, inventory gains, lower other expenses
Cairn India	2,050	(49)	13	(14)	64	(298)	2,076	401	1,739	4	114	176	Higher other income
GAIL	60,413	(3)	(3)	(9)	19	(1,112)	169	25	7,260	(40)	15	(11)	LPG, petrochem profitability decline
GSPL	2,108	76	60	29	0	0	0	0	805	147	132	80	Higher transmission volumes
Gujarat Gas	3,392	9	11	(0)	22	395	404	268	474	28	30	10	Better product mix
HPCL	244,362	(18)	5	(7)	9	1,087	(1,473)	551	13,124	(248)	(74)	214	Higher-than-expected inventory gain of Rs10.8bn
Indraprastha Gas	2,339	22	2	(1)	37	(299)	(105)	116	483	11	(3)	3	Higher PNG sales volumes
ONGC	149,454	(15)	23	10	64	(303)	1,276	449	48,479	(26)	125	6	Lower subsidy sharing
Reliance Industries	320,550	(23)	13	(16)	18	375	(70)	393	36,360	(12)	(6)	(3)	Higher effective tax rate
Reliance Petroleum	76,390	N.A.	108	31	6	N.A.	(10)	(569)	1,050	N.A.	25	(602)	Lower GRMs, lower interest & depreciation expenses
Oil & Gas	1,039,811	(20)	9	(8)	20	556	(369)	493	121,042	18	(22)	19	

	Revenues (Rs mn)				EBITDA Margin (%)				PAT (Rs mn)				Key surprises
	AMJ09	% YoY	% QoQ	Vs. Est (%)	AMJ09	(bps) YoY	(bps) QoQ	Vs. Est (bps)	AMJ09	% YoY	% QoQ	Vs. Est (%)	
Aventis	2,499	1	9	1	21	89	413	283	471	13	25	21	Higher margin
Cadila	8,896	25	23	15	23	25	228	103	1,268	25	94	50	Revenue growth boosted by the US market
Cipla	13,395	11	(2)	(5)	28	514	123	594	2,417	73	(4)	16	Higher margin
Dishman Pharma	2,277	(3)	(22)	(3)	23	(321)	(578)	323	241	(41)	(46)	16	Better than expectations despite Solvay problem
Divi's Lab	2,058	(23)	(34)	(29)	32	(886)	(324)	(396)	588	(39)	(45)	(36)	Lower demand from the West and inventory destocking
Dr. Reddy's	17,788	19	(8)	(7)	24	999	(121)	448	2,389	160	15	34	Beats expectations on better revenue mix, margins
GSK Pharma	4,754	14	4	12	35	(409)	(270)	(218)	1,317	15	5	12	Higher revenues, margin and other income
Glenmark	5,437	18	11	13	26	(477)	1,223	(76)	725	(37)	882	25	Ahead of expectations due to higher revenues
Ranbaxy	17,953	(7)	20	6	7	(975)	1,266	442	633	(61)	(340)	448	Forex gains
Sun Pharma	8,014	(23)	(29)	6	16	(3,559)	(1,697)	(2,475)	1,802	(64)	(54)	(41)	US FDA trouble and inventory pipeline filling in Q4FY09
Pharma	83,071	4	(1)	1	21	(444)	(1)	40	11,851	(16)	(3)	6	
DLF	16,499	(57)	47	27	45	(1,642)	3,132	(988)	3,960	(79)	149	2	-
Unitech	4,848	(53)	26	0	50	(889)	1,748	(0)	1,476	(65)	(47)	(0)	Higher other income due to asset sales, reduction in overall debt
HDIL	2,954	(48)	(17)	42	39	(4,235)	1,235	(728)	1,075	(77)	74	34	Higher TDR sales and realisations and pick-up in volumes
IBREL	46	(90)	(89)	(92)	-69	(4,834)	(1,905)	(7,002)	60	(55)	(299)	(79)	Absence of core earnings & higher interest cost
Sobha	1,771	(49)	20	0	24	(541)	1,227	115	127	(75)	370	41	-
Peninsula Land	1,154	(7)	(41)	2	39	(223)	2,520	(1,178)	329	(40)	(9)	(8)	-
Lanco Infratech	21,929	140	21	125	13	(394)	(143)	(496)	1,159	96	29	93	Higher power trading, higher contribution from EPC segment
Real estate	49,201	(28)	21	48	30	(2,450)	1,364	(1,017)	8,184	(72)	31	9	
Infosys Technologies	54,720	13	(3)	1	34	367	58	175	15,270	20	(4)	9	Dollar revenue & margins higher than expectations
TCS	72,070	12	0	3	27	333	101	144	15,159	22	15	16	Volume and margins ahead of expectations
Wipro	63,188	6	(3)	3	23	248	188	211	9,797	11	2	8	Decline in billing rates and better performance on margins
Patni	7,729	(1)	(3)	1	21	596	334	435	1,368	32	80	58	Dollar revenue and margins higher than expectations
Infotech Enterprises	2,326	16	(1)	(0)	23	413	85	238	462	88	149	21	Lower dollar revenue, better margins
3i Infotech	5,978	28	(1)	(1)	20	46	30	70	589	0	(9)	4	Announcement of QIP
Info Edge (India)	529	(16)	(8)	(5)	24	(216)	(697)	(394)	133	3	(4)	(6)	-
Nucleus Software	805	(3)	(6)	(8)	20	417	249	250	101	26	6	10	Cancellation of a large deal
Educomp Solutions	1,480	113	(20)	20	50	(1,404)	544	(1,412)	363	126	(33)	22	Robust growth in Smart_Class
NIIT	2,625	1	(13)	(6)	11	369	(121)	235	99	(41)	(44)	8	Margins surprised positively
Allied Digital Services	1,588	74	9	(1)	19	(586)	91	16	228	45	3	2	-
OnMobile Solutions	1,072	38	(7)	(3)	23	(408)	(1,070)	(410)	87	(43)	(64)	(45)	Higher-than-expected investment relating to new deal wins
Technology	214,110	11	(2)	2	27	321	114	172	43,656	19	4	12	
Bharti Airtel	99,416	17	1	(4)	42	24	103	34	25,167	24	12	7	Decline in ARPUs & MoUs, forex gains, high tax rate
Reliance Comm	61,452	15	0	(5)	40	(237)	99	51	16,477	5	27	42	High other income, growth in wireless minutes, low capex
Idea Cellular	29,759	37	1	(11)	29	(403)	129	290	2,971	13	8	8	Increase in churn, decline in ARPUs & MoUs, forex gains
Telecom	190,627	19	1	(5)	39	(145)	105	94	44,614	15	17	18	
CESC	8,090	3	9	(2)	23	790	297	740	1,050	12	12	29	One-time adjustment in costs; some may not be a pass through
NTPC	120,027	26	5	2	26	107	706	263	21,936	28	4	10	Control on O&M
Tata Power	17,832	(12)	29	(7)	25	1,024	402	(125)	2,318	22	(35)	(11)	Lower merchant realisation, power purchase reduced significantly
Utilities	145,949	18	8	1	26	308	650	240	25,304	27	(1)	9	
Axis Bank	10,456	29	1	1	-	-	-	-	5,620	70	(3)	31	Incremental restructured assets higher, high trading gains
Bank of Baroda	12,047	14	(18)	(10)	-	-	-	-	6,854	85	(17)	37	Higher-than-expected contraction in NIMs to 2.37%
Bank of India	13,006	10	(9)	(2)	-	-	-	-	5,843	4	(28)	(1)	56bps QOQ contraction in margins to 2.42%
Canara Bank	12,915	27	(1)	3	-	-	-	-	5,553	353	(23)	50	Strong NII growth of 27%; NIMs up 13bps YoY to 2.17%
Corporation Bank	4,675	24	9	12	-	-	-	-	2,612	42	0	32	Strong NII growth, write-back of investment depreciation
HDFC Bank	18,556	8	0	(7)	-	-	-	-	6,061	31	(4)	7	Strong trading profits (Rs2.56bn)
Oriental Bank	4,842	9	5	3	-	-	-	-	2,574	17	31	12	Sharp rise in restructured assets
Punjab National Bank	18,618	29	(2)	7	-	-	-	-	8,321	62	(4)	30	Higher restructured assets of Rs90bn
State Bank of India	50,249	4	4	(1)	-	-	-	-	23,304	42	(15)	15	Dabhol upgraded to standard restructured assets, trading gains
Union Bank of India	8,016	2	(13)	(13)	-	-	-	-	4,422	94	(5)	53	Stress on NIMs, surge in restructured asset to 5.8%
HDFC	6,686	3	(23)	(22)	-	-	-	-	5,649	21	(23)	(5)	Trading gains versus no profit on sale of investments in Q1FY09
Banks	160,066	12	(3)	(2)	-	-	-	-	76,814	50	(13)	19	
Total ex banks	2,500,601	(8)	3	(3)	23	149	40	287	347,991	(4)	(2)	13	

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10% outperformance; **HOLD**: -10% to +10% relative performance; **SELL**: +10% underperformance

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