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India Morning Meeting Notes

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- **Indian Telecom – May 2010 GSM net additions: overall net adds dip 10.8%; Bharti maintains its run rate**

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Asian Paints (APNT IN; Rs2296.25; Buy) – Price increase to support margin

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EBITDA growth should moderate after hitting 80% yoy in FY10, but structural earnings drivers are intact. AP remains very competitive and conscious about volume-led growth, in our view, and has successfully restructured its international business. We incorporate FY13F and roll forward our valuation. Buy.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	42,701	51,251	60,625	71,400	84,121
EBITDA (Rsm)	5,613	10,100	11,099	12,509 ▼	14,493
Reported net profit (Rsm)	3,624	7,745	8,067	9,241 ▼	10,750
Normalised net profit (Rsm)[1]	3,702	7,492	8,067	9,241	10,750
Normalised EPS (Rs)	38.6	78.1	84.1	96.3 ▼	112.1
Dividend per share (Rs)	17.5	27	30 ▲	30 ▲	40
Dividend yield (%)	0.76	1.18	1.31	1.31	1.74
Normalised PE (x)	59.5	29.4	27.3	23.8	20.5
EV/EBITDA (x)	39.1	21.8	19.9	17.7	15.3
Price/book value (x)	20.1	14.1	10.9	8.42	6.8
ROIC (%)	33	57.9	41.4	37.1	32.8

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

year to Mar, fully diluted

Strong paint demand and benign raw material prices boosted FY10 EBITDA

Asian Paints (AP) continued to register strong revenue growth – up 20% yoy in FY10, driven by buoyant demand for decorative and industrial paints. EBITDA margin came in at 19.7% (vs 13.1% in FY09) with peaks of 20-21% in 1Q-3QFY10. However, the margin shrank to 17.6% in 4Q10 due to the rise in excise duty and sequential hardening in raw material prices. FY10 EBITDA grew 80% yoy to Rs10.1bn, partly on a low base in FY09.

Recent paints price hike to partly offset the impact of hardening raw material prices

AP reported peak EBITDA margin of 19.7% in FY10, on low raw material prices and an appreciating rupee. However, a 6% rise in AP's raw material costs in 4Q has affected the margin. Besides, with the rupee starting to fall vs the dollar and with the recent excise duty cut being rolled back, we expect margins to moderate near term. AP's 4.15% price hike in decorative paints in May 2010 should partly offset the rise in raw material prices, in our view.

AP to gain traction post restructuring of international business

AP restructured its international operations by divesting stakes in Malaysia, Thailand, Hong

Kong (FY10) and China (1QFY11). These divestments, besides being earnings accretive, have also helped AP reduce its debt in international operations to US$33m in FY10 (US$40m in FY09). With improvement in the global economy (except Europe, where AP has no exposure), we expect strong growth in the company's international operations near term.

We incorporate FY13 forecasts; reiterate Buy

We cut our FY11-12F earnings by 3-8.5% to factor in the moderation in EBITDA margins. That said, our FY11-12F EBITDA margin of 17-18% would still be higher than the average of 15.9% over the last decade. We incorporate our FY13 forecasts, raise the value for the international business and roll forward our valuation model by a year, which raises our DCF-based target price to Rs2,550 (from Rs2,238). We reiterate Buy.

Tata Consultancy (TCS IN, Rs781.00, Buy) – Supply engine picking up steam

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TCS plans to scale back its freshers' training cycle to the earlier period of three months on rising demand for resources. Our interaction with its HR head also indicated a broad-basing of in-demand skills, a positive for realisations. However, the pick-up in attrition should keep pressure on quarterly pay-outs.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	278,129	300,289	336,152	396,912	468,290
EBITDA (Rsm)	71,781	86,799	94,453	108,757	125,300
Reported net profit (Rsm)	51,718	68,729	74,971	86,027	102,948
Normalised net profit (Rsm)[1]	51,718	68,729	74,971	86,027	102,948
Normalised EPS (Rs)	26.4	35.1	38.3	44	52.6
Dividend per share (Rs)	7	20	12	12	12
Dividend yield (%)	0.9	2.56	1.54	1.54	1.54
Normalised PE (x)	29.6	22.2	20.4	17.8	14.8
EV/EBITDA (x)	21.1	17.1	15.3	12.9	10.7
Price/book value (x)	9.7	7.27	5.93	4.83	3.9
ROIC (%)	46	45.5	41.4	43.8	47.6

1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: US GAAP
Source: Company data, RBS forecasts

year to Mar, fully diluted

FY11 gross addition could scale 30,000; skill demand is broad-basing

TCS plans to scale back its fresher training period to three months – from five months last year – effective from the first batch of trainees scheduled to join from the third week of June. This should add to the deployable bench. However, given the pick-up in resource demands from business units, gross hiring for FY11 is likely to scale the 30,000 guided earlier. TCS is seeing a pick-up in BU requirements for skill sets in Business Intelligence tools, ERP and Siebel CRM. Also, there is growing demand for software architects and Java professionals for application designing, a positive for blended realisation over medium term, in our view.

Attrition concerns remain

TCS expects attrition to grow to around 13% (TTM basis) in 1Q11. This implies a 250bp qoq rise in annualised attrition, on our analysis, which while partially seasonal, as employees leave for higher studies, we expect to continue over next two to three quarters as scale players rebuild benches. This could keep wage pressure high. TCS has ruled out a mid-term wage hike – it gave a 10% hike in April and roughly 3% promotion-led hikes in July that could cover around 15,000 employees. However, quarterly payouts could increase.

Reiterate positive sector outlook; Infosys, TCS and Patni are our preferred picks

We are positive on the mid- to long-range demand outlook given structural drivers in key verticals – new compliance/risk management norms in BFS and 4G-related capex spend in Telecom. We also expect continued traction in large deal wins (our earlier analysis indicated at-least 59 deals worth US$56bn due for renewal between 2010 and 2012). The 4.3% qtd INR depreciation should help 1Q11 margins. We believe tier-1 players benefit from two levels of defence in the current volatile market – INR depreciation protects downside earnings risk, while a global recovery could boost top-line growth. Infosys and TCS are our top picks. Play Patni for its low European exposure (13% of 2009 revenues) with INR weakness helping margins in the near-term; potential scale benefits over the mid-term.

Alert | India Inflation data – how scary?

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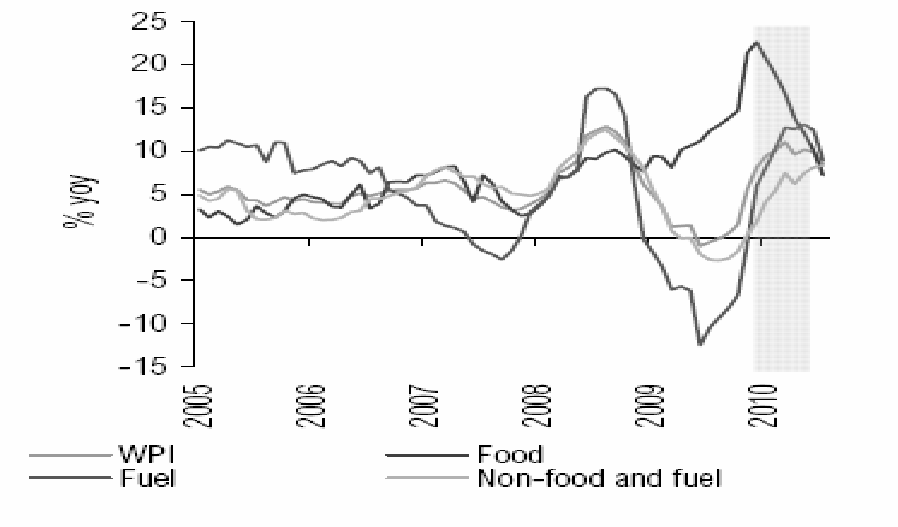
At 10.2% yoy (1.7% mom), headline WPI was shockingly higher than our and market estimates and has re-ignited fears of an inter-meeting policy rate hike. At the current pace of monthly expansion, it is unlikely that inflation will be reined into the 6%-6.5% range by July as we had previously anticipated.

Figure 1 : Trends and projected wholesale price inflation



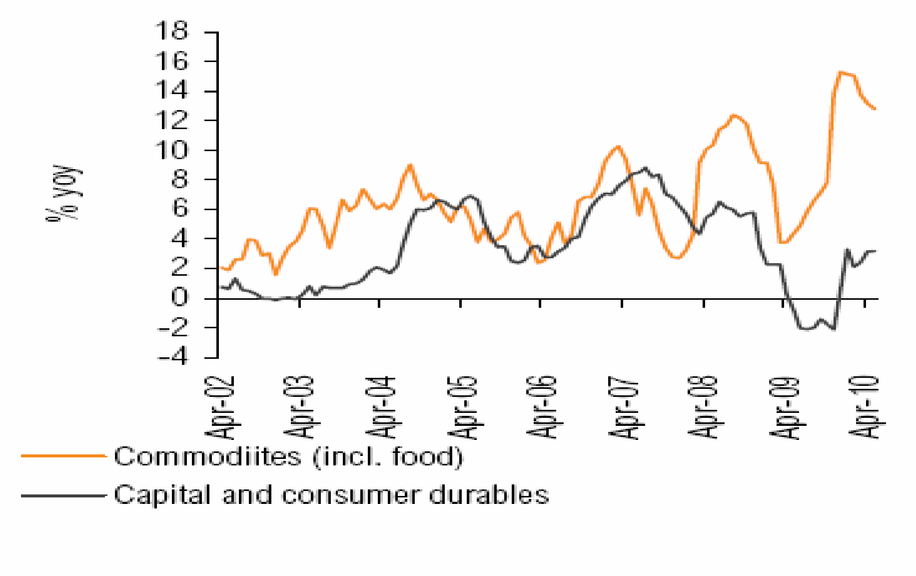
Source: CEIC, RBS

We, however, continue to assess the prospects of an inter-meeting rate hike as low – a view also echoed by the Finance Minister following the data release. Moreover, even if we are wrong in our assessment, the pressure on bond yields is likely to be limited due to a more supportive fiscal position as well as a boost from the revision in India's local currency rating outlook from 'negative' to 'stable'.

Details: May data revealed rising price pressures in all the major categories: food, fuel and manufactured productions. The three components rose 16.6% yoy, 13% yoy and 6.4% yoy, respectively. Nonetheless, within manufactured products, we note that price pressures were most pronounced in commodity related categories such as metals and after removing these items, the increase was a more moderate 3.2% yoy. We believe this is the appropriate way of gauging demand pull price pressures as well as the extent to which commodity prices are being passed on to end-users. Similarly, the rise in fuel prices is largely a response to increases in the tax structure rather than the underlying price.

Based on these prospects as well the fact, currently the banking system remains short of liquidity, we believe that rate hikes will remain confined to scheduled policy announcements. The system has been short on liquidity for almost three weeks now with yesterday's shortfall amounting to INR2.75bn. Though this is temporary, the authorities are likely to wait for a normalisation before tightening.

Figure 2 : Inflation by component

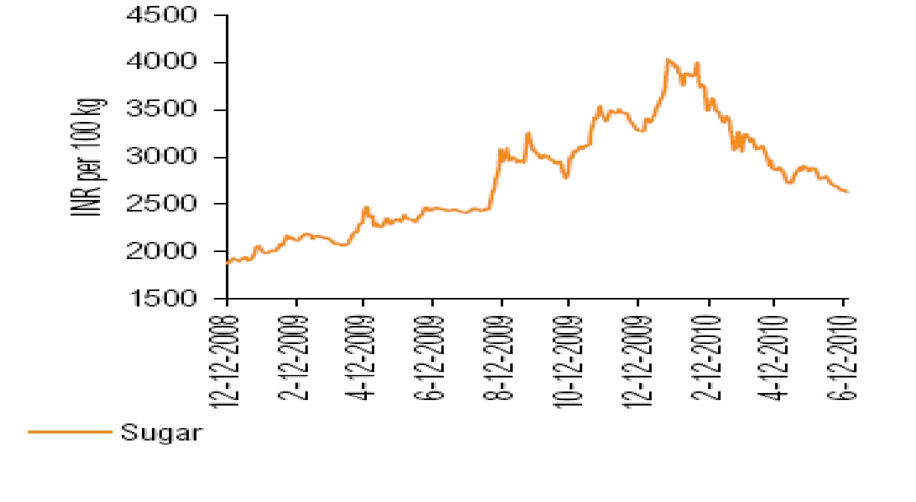


Source: RBS

In any case, we do not expect rates to significantly react even in the event of an inter-meeting hike as the fiscal position is becoming more supportive. The fiscal deficit for the current fiscal year is likely to be lower than the target of 5.5% of GDP following the better than expected revenues from sale of 3G and broadband spectrum. In an interview yesterday, the Finance Secretary alluded to the possibility of an undershoot amounting to 1% of GDP.

We also note that there is an inconsistency between actual prices and what is being reflected in the WPI data. Quite opposite to the WPI, market prices of major commodities/commodity related products including wheat, rice, sugar and steel have been softening. We expect that subsequent data to start reflecting these developments even though a 6% yoy print by July may still be difficult. Also agri prices should soften on the back of a more normal monsoon.

Figure 3 : Trends in sugar prices



Source: Bloomberg, RBS

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Indian Telecom – May 2010 GSM net additions: overall net adds dip 10.8%; Bharti maintains its run rate

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GSM net adds (ex-RCom/Tata) down 10.8% mom

The total GSM subscriber base (ex-RCom/Tata) rose 2.5% mom in May 2010 to 428m, with net adds of 10.6m, down 10.8% mom. Private players' net adds was 9.5m (10.5m in April), as declines were registered by Vodafone (down 10.6% mom), Idea (including Spice) (down 1.7% mom) and Uninor (down 101.2% mom). Bharti's net adds remained constant at 3m and Videocon net adds grew 7% mom. Net adds for Metros rose 0.7% mom, whereas for other circles they declined, with Circle A (including Chennai) down 19.7% mom, Circle B down 6.3% mom and Circle C down 10.4% mom.

Bharti monthly net adds constant at 3m

Bharti added 3m subs in May 2010 (he same as in April). The total subs base increased to 133.6m, implying 31.2% share of the GSM market (ex- RCom/Tata). Bharti's net adds in Metros was up 228.1% mom, primarily due to growth from Delhi (up 557% mom) and Mumbai (up 96.8% mom). Net adds in Circle A fell 16.6% mom, Circle B fell 4.6% mom and in Circle C fell 0.6% mom. Bharti's market share of net adds (ex-RCom/Tata) rose to 28.4% from 25.3% in April, due to increased net adds share across all circles, with Metros net adds share increasing to 25.8% (7.9% in April), Circle C net adds share increasing to 34% (30.6% in April), Circle B up 29.3% (28.8%) and Circle A up 24.8% (23.9%).

Idea's net adds (including Spice) down 1.8% mom

Idea (including Spice) added 1.4m subs, down 1.8% mom, as net adds declined in Kolkata (96.1% mom), Rajasthan (95.6%) and Gujarat (60.1%). An increase in net adds was reported in Karnataka (224.7%), Uttar Pradesh (E) (38.6%), Bihar (28.9%) and AP (24.1%) circles. Idea's share of net adds (including Spice) increased to 13.5% in May 2010 (vs 12.3% in April).

Vodafone loses pace; Uninor's subscriber base declines mom

Vodafone net adds were down 10.6% mom to 2.6m (down 20.1% in April), with a decline in Orissa (94.3%), Haryana (42.1%), Gujarat (31.8%), Rajasthan (29%), Bihar (24.4%), MP (24.1%) and AP (22.7%). Aircel net adds remained constant at 1.6m. New player Videocon's net adds were up 7% mom, STel was up 14.5% mom and Etisalat was up 10.7% mom. Uninor's subscriber base marginally declined mom, as its subscriber base declined in four out of its eight operating circles.

Table 1 : Wireless subscriber additions In May 2009 of pure-play GSM operators

	April 2010	May 2010	% change mom	% share
Aircel	1,608,367	1,609,990	0.1%	15.2%
Bharti Airtel	3,000,173	3,000,218	0.0%	28.4%
BPL Mobile	49,928	17,174	-65.6%	0.2%
BSNL	1,258,646	1,045,621	-16.9%	9.9%
Vodafone Essar	2,897,620	2,591,390	-10.6%	24.5%
IDEA	1,347,174	1,249,888	-7.2%	11.8%
MTNL	33,217	40,297	21.3%	0.4%
Spice	116,386	188,666	62.1%	1.8%
STel	105,564	120,856	14.5%	1.1%
Uninor	757,615	-8,722	-101.2%	-0.1%
Videocon	656,894	702,748	7.0%	6.7%
Etisalat	4,636	5,132	10.7%	0.0%
TOTAL	11,836,220	10,563,258	-10.8%	100.0%

Source: COAI

News headlines

Corporate

Oil & Gas

- Selling Rajasthan crude oil to RIL, Essar using heated pipeline: Cairn (Economic Times)
- PNGRB approves GAIL tariff for transporting natural gas (Economic Times)
- Reliance Industries restarts FCCU at new refinery: Sources (Economic Times)
- Reliance to invest US$3bn in petrochem units in Gujarat state : Sources (Business Standard)
- Reliance Inds pays Rs6.53bn as advance tax (Economic Times)

Banks

- Canara Bank arm launches Rs5bn venture fund (Economic Times)
- Bank of India raises Rs10bn through bonds (Business Standard)
- Pranab Mukherjee says central bank to decide on rate action (Business Standard)
- Govt, RBI discuss liquidity crunch (Business Standard)
- HDFC pays Rs2.15bn as advance tax: Source (Economic Times)
- SBI advance tax falls to Rs8.7bn; ICICI flat (Business Standard)

Pharma

- Cipla earmarks US$65m to buy stakes in 2 cos (Economic Times)

Commodity

- JK Lakshmi Cement to invest Rs1bn (Economic Times)
- Indian cos, Rio, BHP keen on developing Afghan mines (Business Standard)

Consumer

- Emami to seal Egyptian buy soon (Business Standard)

Retail/Real Estate

- Lodha Developers eyes PE for Mumbai project (Economic Times)
- Delhi raises property circle rates (Economic Times)

IT & Telecom

- Wipro allots 89,474 shares to employees (Economic Times)
- CII mulls promotion of BPOs in rural areas (Economic Times)
- Kronos and Wipro enter into strategic alliance (Business Standard)
- GSM operators add 11m new subscribers in April (Economic Times)
- Rel Infratel may combine its tower assets with GTL (Economic Times)

Power, engineering & infrastructure

- L&T says its bid for Rs250bn NTPC order error-free (Economic Times)

Automobiles

- Tata Motors May sales up 50% (Economic Times)
- Maruti, M&M, Ford, Toyota gear up for price hike (Economic Times)
- Ruias to form SPV for SsangYong bid (Economic Times)
- M&M to pay more to Renault to reform Logan platform (Business Standard)
- Nano may cost Rs5,000-15,000 more (Economic Times)
- Advance tax: Bajaj, M&M see massive jump; Tata Motors drops (Economic Times)
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