J.P.Morgan

India Ahead of the Pack

Bharat Iyer[AC]
(91-22) 6639-3005
bharat.x.iyer@jpmorgan.com

J.P. Morgan Daily Valuations

Top Stories

Banks

Rural Banking: The next frontier? *(Adarsh Parasrampuria)*
We attended HDFC Bank's latest rural loan mela held at Bhimavaram in Coastal Andhra Pradesh to understand rural initiatives taken by banks. We were positively surprised by the awareness level of rural borrowers about banks/NBFCs operating. Though reach of the PSU banks is better, rural customers preferred Private Banks over PSUs for the service quality, promptness, and Push factor, despite lower rates from the PSUs.

Borrower profile: More than 50% of the borrowers did have bank accounts and credit histories, but some part of the population set were availing a loan for the first time. Borrowers revealed that crop loans were covered by PSU banks but certain categories of consumer loans were not well distributed. Overall, we were positively surprised by the awareness level of borrowers about private banks and NBFCs active in that area.

India Mining

India Coal Industry: Demand-supply mismatch positive for miners; domestic pricing trends key to watch *(Pinakin Parekh, CFA)*
While coal production to increase, so would the deficit. Some key themes likely to evolve in India's coal market include…: lower supply of coal against linkages to smaller segments like cement. Coking coal deficit is likely to worsen in sync with increasing blast furnace capacity. We estimate India's coking coal imports to increase to 50MT in FY14E from 23MT in FY10. We expect India's thermal coal production to increase by a CAGR of 7.7% over FY10-14E, but consumption is likely to increase by a CAGR of 10.1% over the same time, implying thermal coal imports to increase to 93MT in FY14E from 44MT in FY10. With the captive mining blocks not ramping up as expected and the recent GO/NO GO issues regarding new mining block development, it means domestic supply is unlikely to see meaningful increase (at least in sync with consumption). Logistics infrastructure would need to keep pace with increasing coal production. **Pithead coal inventories have increased 3x over FY01-10 even as some of the non utilities buyers have had to resort to market purchase of coal, due to logistics issues.**

Indian Coal- Demand not a constraint, can pricing become more market driven?: Whether India’s coal suppliers can achieve a more market driven pricing mechanism for their coal would have implications not only for its profitability but also for the user industries. As of now other than the hikes in the notified prices (where the user are mainly utilities), quasi market pricing is there only for e-auction coal sales, (10% of volumes), higher grade thermal and coking coal and beneficiated coal sales. A large part of Indian coal is currently at a steep discount to landed imported coal (admittedly it has higher ash content and lower calorific value). We do not expect any sudden move towards full market pricing. Beneficiation of coal has so far not taken off in India on a large scale (even as Indian coal has high ash and relatively low calorific value)

India Equity Research Team

Automobiles and Auto Parts
Aditya Makharia, Bharat Iyer

Banks, Financial Institutions and Insurance
Seshadri Sen, Adarsh Parasrampuria

Consumer Goods & Media
Latika Chopra

Economics
Jahangir Aziz, Sajid Chinoy

Engineering, Construction, Infrastructure and Utilities
Shilpa Krishnan, Sumit Kishore, Deepika Belani

IT Services
Viju George, Nishit Jasani

Metals, Mining and Materials
Pinakin Parekh, Neha Manpuria

Oil & Gas
Pradeep Mirchandani, Neil Gupte

Real Estate
Saurabh Kumar, Gunjan Prithyani

Small and Mid Caps
Princy Singh, Dinesh Harchandani

Strategy
Bharat Iyer, Bijay Kumar, Gunjan Prithyani

Telecom
Malvika Gupta

Lanco Infratech (Overweight)

Healthy growth, ambitious pipeline: Reiterate OW *(Shilpa Krishnan)*

Good tidings in store. Lanco has an operating capacity of 2.08GW currently. We expect a ramp up to 4.85GW by end of FY12 and implementation of the entire portfolio of 9.3GW before FY15. **Our estimates imply 40% EBITDA growth CAGR FY10-FY15**. We expect good tidings on commissioning of Udupi-II (600MW), and financial closure of Amarkantak-III&IV (2x660MW) & Vidharbha (2x660MW), in the nearterm, followed by CoD of Anpara (2x600MW) around end of FY11.

High on risk--> high on return. (a) Risk#1: Lanco has high exposure to merchant rates; ~38% of capacity has not yet been tied up in PPAs; **provision in est.**: conservative merchant assumption of Rs4 in FY12, declining to Rs3.26 by FY16. Downside of Rs16/share if merchant price is 50p below est., **(b) Risk#2**: 4.74GW relies on coal linkage, 1GW on captive coal and 1.2GW on imported coal; **provision in est.:** 75-80% PLF est. for under implementation projects. LoA for linkage available for entire 4.74GW, imported coal cost is pass thru in tariff. Downside of Rs6/share if PLF for linkage projects is 500bps below estimates.

Sterlite Industries (Overweight)

Contrary to our expectations, negative news flow for the company continues; Indian Court orders shut down of copper smelter - ALERT *(Pinakin Parekh, CFA)*

Madras High Court orders closure of copper smelter unit in Southern India state of Tamil Nadu: According to various media reports (CNBC, India Today), the Madras High Court ordered the closure of Sterlite Industries' (STLT) copper smelter unit at Tuticorin, Tamil Nadu, in relation to ongoing litigation in which certain petitioners were seeking closure of the smelter on environmental issues. The original petition was filed in 1996. **While we expect STLT to contest the judgment in a higher court, we are not clear on whether the company will need to shut down the unit until a stay order is available**.

Likely profit and stock price impact: We expect the share price to react negatively to yet another negative piece of news on the regulatory front. Copper smelting contributes a relatively small part of STLT's profits (12% of FY10 EBITDA, 20% of FY11E and 14% of FY12E of attributable EBITDA) and accounts for ~ Rs21/share in our Rs200 price target (~10% of PT). **We estimate, in the unlikely scenario of a complete shutdown of the smelting operations, the EPS risk at 19%/12% for FY11/12.** However we would like to highlight that current zinc prices are 5% higher than our full year assumptions and hence there is upside risk to our zinc estimates. In our view the shutdown/ re-start expenses in copper smelting are not as high as in aluminum smelting (where pots can freeze), although some costs are likely.

Tata Consultancy Services (Overweight)

Enterprise Solutions - On the continued revival path *(Viju K George)*

Reason for the note: Enterprise Solutions (SAP/Oracle) which includes business intelligence has been a relative laggard in the TCS portfolio over the past two years (15% of revenues in Jun-10, down 23% from peak in Mar-08 in absolute terms). But that is soon likely to reverse and growth is likely to be strongly back, Mr. Krishnan Ramanujam (head, Enterprise Solutions & Technology Excellence) said in an investor conference call.

Legacy reasons for recent underperformance no longer hold. One reason for TCS' underperformance in this relatively discretionary but high value-add, highmargin segment is that earlier enterprise solutions within TCS was wedged inside the respective verticals (such as manufacturing, retail etc.). This limited scale and growth. It was only recently that the division has been carved out and treated as an independent horizontal. Mr. Ramanujam took charge of this restructured, reconfigured unit in Jan 2010 and since then the going has been good, which we believe should continue to reflect in financials.

Coverage Changes

We are transferring the coverage of the following stocks to Viju K George, viju.k.george@jpmorgan.com, (91-22) 6157-3597. Viju will publish on the names in the next couple of days.

- Mahindra Satyam, SATY.BO
- Tech Mahindra, TEML.BO