

Equities

10 February 2012 | 11 pages

India Equity Strategy

3QFY12 Earnings Tracker: So Far, So So

Equities

- **So far, so so** — 2/3rds through the 3QFY12 earnings season (93/135), earnings growth is flat and largely in line with expectations – neither justifying the top-down gloom leading into the results, nor supporting the market's more recent boom. The upside/downside surprise ratio is at a relatively neutral 38/30, Citi and managements' guidance revisions (up – 6%, down – 13%, unchanged – 33%, no guidance – 47%) suggests that the underlying corporate reality rests somewhere between the contrasting Dec 11/Feb12 moods.
- **Subtle shift from growth to profitability focus** — The results do reflect the economy's challenges, and managements' orientation; growth is coming off as sales growth (Ex-Reliance Ind.) moderates to 17% from 20%+ levels, while margins (ex-energy) actually rise at aggregate. While there are variations in trends across sectors, the numbers do reflect a greater cost and caution bias than previously. The recent market mood notwithstanding, we expect this trend to sustain over next two quarters.
- **Swinging sectorally** — Aggregates suppress more pronounced underlying trends: Consumers and Pharma performed strongly, while Telecom was the big disappointment, along with Utilities. Banks are also ahead of expectations (on asset quality), though earnings themselves are in-line. While there are sectoral divergences, overall flat earnings growth and slower sales growth are reflective of a more overall challenging environment, rather than a sectorally split / divergent economic trend.
- **Earnings, and the market, from here** — Citi's own earnings revisions appear to be bottoming (32/35 up/down in this season); the broader consensus earnings chart seems to have turned; and we believe our FY12/FY13 earnings estimates (9.7%/14.5%) should stay relatively stable for at least a quarter. We have a largely similar view on the market: we maintain our 18,400 Sensex target (for Dec-12), and believe the market should stay robust, but will wait for economy/earnings to catch up.

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Figure 1. Sensex and CIRA Universe 3QFY12 Results (Growth in percent YoY)

	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Aggregate							
Sensex (23/30)	8.4%	21.8%	3.4%	0.8%	-1.3%	-0.4%	↔
Sensex ex-Oil (22/30)	8.6%	23.7%	3.9%	2.3%	3.6%	0.7%	↔
Citi Universe	12.1%	21.5%	6.0%	4.7%	0.3%	-0.4%	↔
Citi Univ Ex-Energy	16.4%	18.1%	11.1%	10.4%	5.1%	1.1%	↔
Sensex ex-Energy	14.0%	17.5%	10.0%	8.4%	7.3%	3.8%	↔
Citi Univ ex-Energy, ex-Metals	20.1%	20.5%	15.7%	15.6%	10.7%	6.5%	↔
Citi Univ ex-Reliance	16.1%	17.3%	9.2%	7.9%	1.8%	1.0%	↔

Source: Company data, CIRA

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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India Equity Strategy

3QFY12 Earnings Tracker: So Far, So So

Figure 2. Sensex and CIRA Universe 3QFY12 Estimates - Aggregates

Sector	QoQ Growth—Expected			YoY Growth—Expected		
	Sales	EBITDA	PAT	Sales	EBITDA	PAT
Sensex (30/30)	-2.9%	1.7%	-0.8%	12.4%	6.5%	2.9%
Sensex ex-Oil (29/30)	-2.3%	6.1%	7.2%	12.8%	7.4%	7.4%
Citi Universe	1.7%	14.2%	23.0%	15.2%	4.2%	-5.5%
Citi Univ ex-Fin	1.0%	14.2%	20.3%	14.7%	0.2%	-12.9%
Citi Univ Ex-Energy	7.1%	13.2%	17.1%	18.3%	14.6%	11.4%
Citi Univ ex-Fin, Energy	6.4%	12.7%	12.1%	17.6%	12.5%	6.3%
Sensex ex-Energy	6.0%	11.2%	12.4%	18.0%	12.3%	10.7%
Sensex ex-fin	-3.3%	1.0%	-2.6%	12.0%	5.3%	1.1%
Sensex ex-fin, energy	6.0%	13.1%	13.1%	17.9%	12.2%	10.0%
Citi Universe ex-Metals	2.0%	15.1%	26.5%	16.2%	5.7%	-5.1%
Citi Univ ex-Energy, ex-Metals	9.6%	14.0%	19.7%	21.2%	19.2%	16.1%

Source: Company data, CIRA estimates

The quarter so far (93/135) is largely in line with modest expectations....

Aggregates should inch up a little after Coal India inclusion (expected growth of 50%) ...

Figure 3. Sensex and CIRA Universe 3QFY12 Results (Growth in percent YoY)

Aggregate	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Sensex (23/30)	8.4%	21.8%	3.4%	0.8%	-1.3%	-0.4%	⇔
Sensex ex-Oil (22/30)	8.6%	23.7%	3.9%	2.3%	3.6%	0.7%	⇔
Citi Universe	12.1%	21.5%	6.0%	4.7%	0.3%	-0.4%	⇔
Citi Univ ex-Fin	11.8%	22.2%	5.6%	3.1%	-1.1%	-0.9%	⇔
Citi Univ Ex-Energy	16.4%	18.1%	11.1%	10.4%	5.1%	1.1%	⇔
Citi Univ ex-Fin, Energy	16.4%	18.8%	12.1%	10.0%	4.5%	0.9%	⇔
Sensex ex-Energy	14.0%	17.5%	10.0%	8.4%	7.3%	3.8%	⇔
Sensex ex-fin	8.2%	22.0%	2.5%	-0.5%	-3.2%	-2.6%	⇔
Citi Universe ex-Metals	13.8%	23.9%	8.6%	7.6%	3.7%	3.2%	⇔
Citi Univ ex-Energy, ex-Metals	20.1%	20.5%	15.7%	15.6%	10.7%	6.5%	⇔
Citi Univ ex-Reliance	16.1%	17.3%	9.2%	7.9%	1.8%	1.0%	⇔

Source: Company data, CIRA estimates

Figure 4. Results Relative to CIRA Expectations

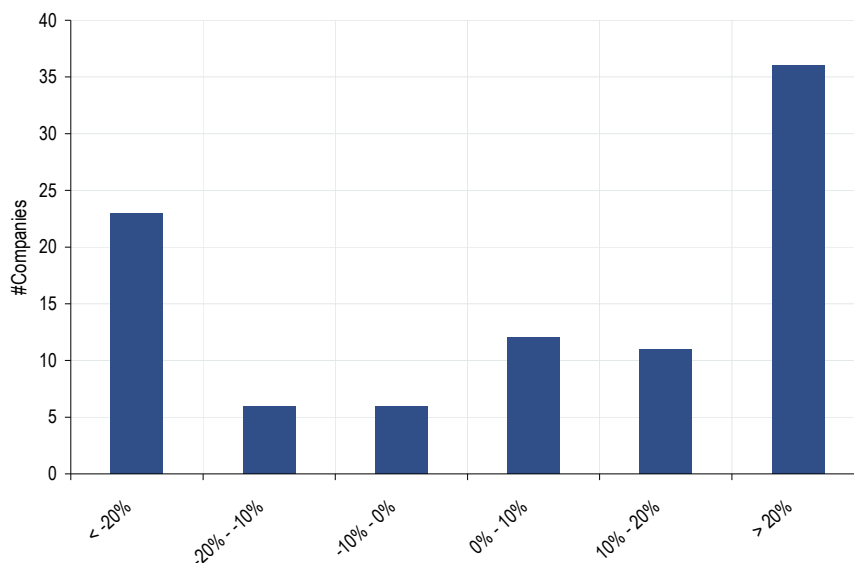
Headline Profits		Operational Profits		Guidance		Analyst View	
Above	46%	Above	41%	Maintained	33%	More Positive	17%
Inline	20%	Inline	27%	Raised	6%	More Negative	15%
Below	34%	Below	33%	Lowered	13%	Unchanged	68%
				No Guidance	47%		

Source: Citi Investment Research and Analysis estimates

At aggregate, just a little better than expectations; operating trends largely in line with headline ones; managements largely neutral on guidance (more downs than ups though); and our analysts' mood largely unchanged

Wide dispersion in earnings growth..

Figure 5. 3Q Earnings Growth Profile for CIRA Universe



Source: Citi Investment Research and Analysis estimates

Sales momentum is beginning to slacken as demand and pricing soften.. but finally margins (ex-Energy) expand – this is not consistent across sectors and is a little skewed (like all aggregates), but slowing growth and an across-the-economy focus on costs (apart from some commodity relief) is supporting profitability....we expect this trend to continue

Figure 6. Sensex and CIRA Universe 3QFY12 Margins (Growth in percent, Chg in bps)

Aggregate	EBITDA Margin		PAT Margin		EBITDAM% Chg		PATM% Chg	
	Exp	Actual	Exp	Actual	Last Qtr	Last Year	Last Qtr	Last Year
Sensex (23/30)	22.4%	19.5%	12.6%	11.3%	(193)	(406)	(124)	(251)
Sensex ex-Oil (22/30)	19.8%	17.1%	11.4%	9.7%	(100)	(357)	(75)	(222)
Citi Universe	24.7%	22.5%	13.6%	12.4%	(98)	(362)	(82)	(273)
Citi Univ ex-Fin	21.4%	19.1%	11.7%	10.7%	(124)	(355)	(96)	(250)
Citi Univ Ex-Energy	24.2%	23.7%	13.2%	12.5%	68	(167)	2	(211)
Citi Univ ex-Fin, Energy	20.0%	19.2%	10.7%	10.2%	49	(154)	(10)	(181)
Sensex ex-Energy	21.4%	20.5%	12.3%	11.5%	24	(172)	(20)	(152)
Sensex ex-fin	20.7%	17.8%	11.4%	10.2%	(208)	(404)	(137)	(258)
Citi Universe ex-Metals	26.7%	24.3%	15.0%	13.7%	(102)	(368)	(77)	(275)
Citi Univ ex-Energy, Metals	26.9%	26.8%	15.0%	14.4%	106	(112)	30	(189)
Citi Univ ex-Reliance	26.4%	25.9%	14.4%	14.2%	(15)	(226)	(46)	(229)

Source: Company data, CIRA estimates

There are sector swings...with Pharma gaining from the generic cycle and a weak currency , along with Consumer stables leading the show...Telecom is the key laggard disappointing in both momentum and profitability....the underlying environmental story though is one of slower demand, modest pricing...and an aggressive corporate sector focus on costs...this trend should not reverse as quickly as the market has in this year

Figure 7. CIRA Universe 3QFY12 Results by Sector (Growth in percent YoY)

Sector	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Auto & Components	8.4%	11.6%	1.6%	-0.4%	1.7%	-1.5%	↔
Banks	14.4%	11.5%	8.8%	13.3%	8.3%	6.4%	↔
Capital Goods	24.1%	24.2%	16.0%	15.5%	9.2%	4.8%	↔
Div. Financials	34.2%	-4.9%	-4.8%	-11.2%	-8.0%	-61.4%	↓
Energy	-1.6%	32.2%	-8.5%	-11.5%	-12.8%	-4.5%	↑
Food, Bev, Tob.	13.7%	10.0%	12.7%	12.2%	17.4%	17.0%	↔
Hhold, Prnsl Prods	21.2%	21.0%	16.8%	26.4%	13.9%	26.3%	↑
Metals	4.0%	10.3%	-14.4%	-18.8%	-29.0%	-31.8%	↔
Cement	23.1%	22.7%	36.1%	31.6%	36.8%	35.5%	↔
Media	11.1%	10.0%	21.7%	25.6%	5.7%	19.7%	↑
Pharma	17.5%	23.6%	33.8%	45.0%	26.1%	32.9%	↑
Real Estate	-38.6%	-36.9%	-38.1%	-38.7%	-44.6%	-44.9%	↔
IT Services	30.9%	31.0%	35.2%	33.9%	22.7%	21.7%	↔
Telecom	17.6%	13.1%	29.8%	17.7%	-15.2%	-29.4%	↓
Utilities	21.0%	28.0%	2.5%	4.0%	7.1%	-4.3%	↓

Source: Company data, CIRA estimates

At aggregate (ex-energy) margins have bounced back qoq...with more sectors than not showing similar trends.....we were expecting this for two to three quarters, but better late than never

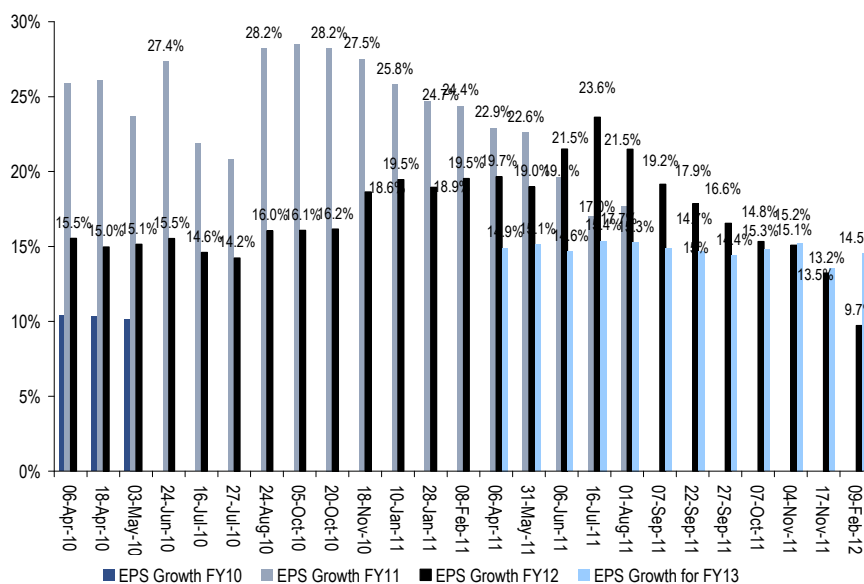
Figure 8. CIRA Universe 3QFY12 Margins by Sector (Growth in percent, Chg in bps)

Sector	EBITDA Margin		PAT Margin		EBITDAM% Chg		PATM% Chg	
	Exp	Actual	Exp	Actual	Last Qtr	Last Yr	Last Qtr	Last Yr
Auto & Components	11.9%	11.3%	8.6%	8.1%	(23)	(137)	(71)	(107)
Banks	81.9%	87.5%	46.5%	46.9%	447	138	220	(225)
Capital Goods	14.6%	14.6%	8.9%	8.6%	121	(110)	25	(159)
Div. Financials	37.9%	49.9%	20.5%	12.2%	(3)	(351)	(52)	(1780)
Energy	26.3%	18.9%	14.9%	12.2%	(564)	(935)	(312)	(468)
Food, Bev, Tob.	30.1%	31.0%	20.8%	21.4%	45	61	57	129
Hhold, Prnsl Prods	14.8%	16.0%	10.9%	12.1%	77	69	64	51
Metals	13.9%	12.4%	6.1%	5.5%	(129)	(446)	(137)	(343)
Cement	20.8%	20.2%	10.5%	10.4%	452	136	303	98
Media	24.9%	25.9%	8.4%	9.6%	22	321	(22)	78
Pharma	21.5%	22.2%	13.7%	13.7%	247	328	72	96
Real Estate	41.5%	40.0%	27.1%	26.2%	69	(119)	(126)	(383)
IT Services	26.6%	26.3%	18.9%	18.7%	188	56	72	(143)
Telecom	29.6%	27.9%	4.1%	3.5%	(85)	108	16	(212)
Utilities	27.1%	26.0%	16.1%	13.6%	9	(601)	(166)	(458)

Source: Company data, CIRA estimates

Citi's earnings have moved down a little over the last quarter...9.7% for FY12E and 14.5% for FY13E now ... the results season thus far has been evenly poised as far as upward/downward revisions are concerned

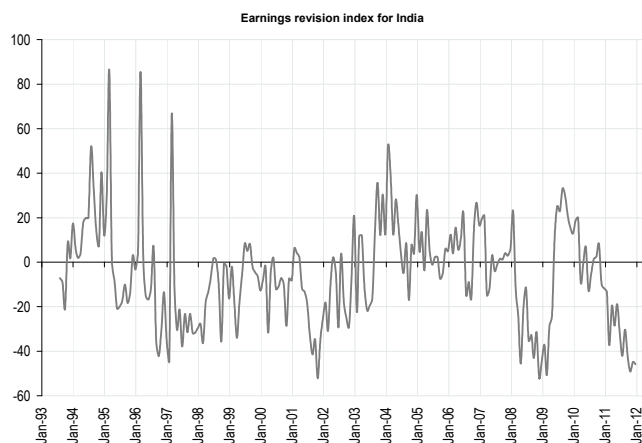
Figure 9. Evolution of Sensex Earnings Growth Estimates



Source: Citi Investment Research and Analysis estimates

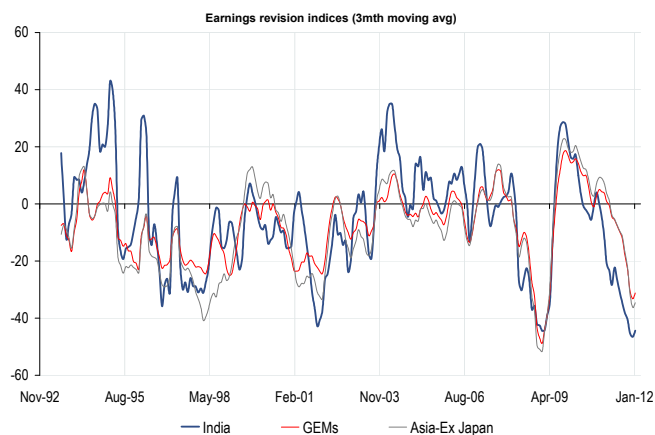
At the market consensus level, Indian earnings appear to have bottomed out, having reached March 2009 level and fallen sharper than GEM's and Asia Ex earnings revisions

Figure 10. Earnings Revision Index for India



Source: IBES, Factset

Figure 11. Earnings Revision Index (3m MA): India vs. Asia Ex vs. GEMs



Source: IBES, Factset

Valuations and Risks

Coal India

(COAL.BO; Rs330.00; 1)

Valuation

Our target price incorporates a 25% wage hike per employee in FY12, 20% hike in FY13 and 2% raw coal price hike in FY13. We believe the proposed 26% profit-sharing burden is likely to be lower but unlikely to be zero. Hence our TP is derived using a combination of two scenarios: #1 assumes no profit sharing - derived price Rs393; #2 assumes 26% profit sharing in FY14 and beyond (based on our interactions with the Secretary, Ministry of Mines) - derived price Rs367; with a 50:50 weighting. CIL does not have a long valuation history since it listed in Nov 2010. We arrive at our TP of Rs380 using: (1) a valuation based on DCF+30% premium (Rs491) and (2) 9x FY13 PE based valuation (Rs213); with a 60/40 weighting. The 9x multiple lies within the current trading range (7-10x) of the Indonesian and Chinese coal producers.

Risks

Key downside risks to our investment thesis on CIL are: risks of restrictions imposed by regulators related to forest clearance and environmental safeguards; difficulties in obtaining reserves/resources; a proposed 26% profit-sharing requirement contained in the New Mining Bill; land acquisition; ban on e-auction coal; logistical constraints including rail transport bottlenecks; restricted ability to raise coal prices; higher wages than anticipated; unrelated investments; disruption of operations in politically unstable areas; auction for future reserves; and non-availability of critical equipment. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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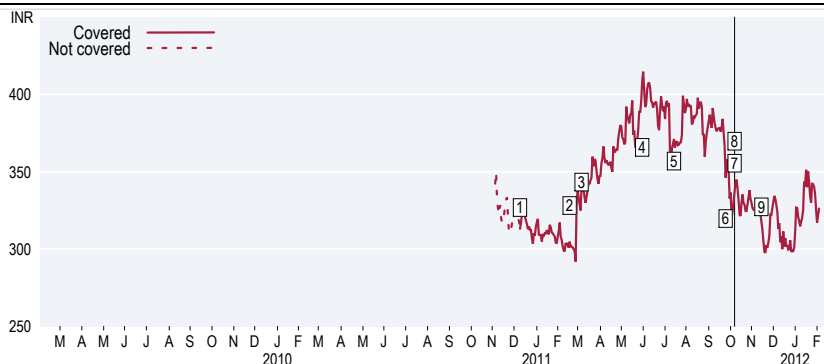
Coal India (COAL.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Raashi Chopra, CFA

Covered since December 9 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Coal India (COAL.BO)

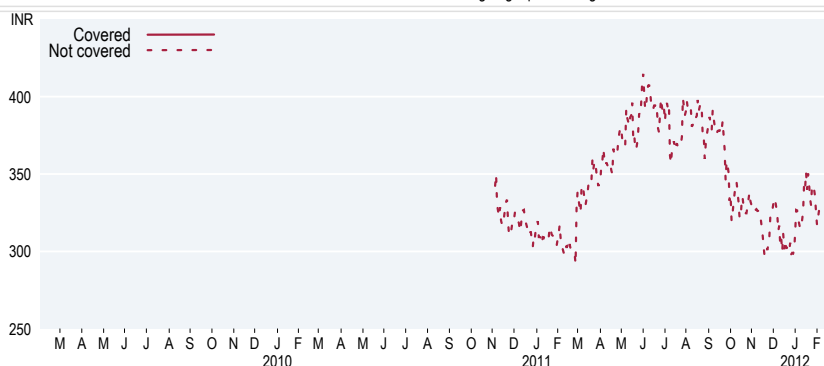
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Raashi Chopra, CFA

Covered since December 9 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 31 Dec 2011</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
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