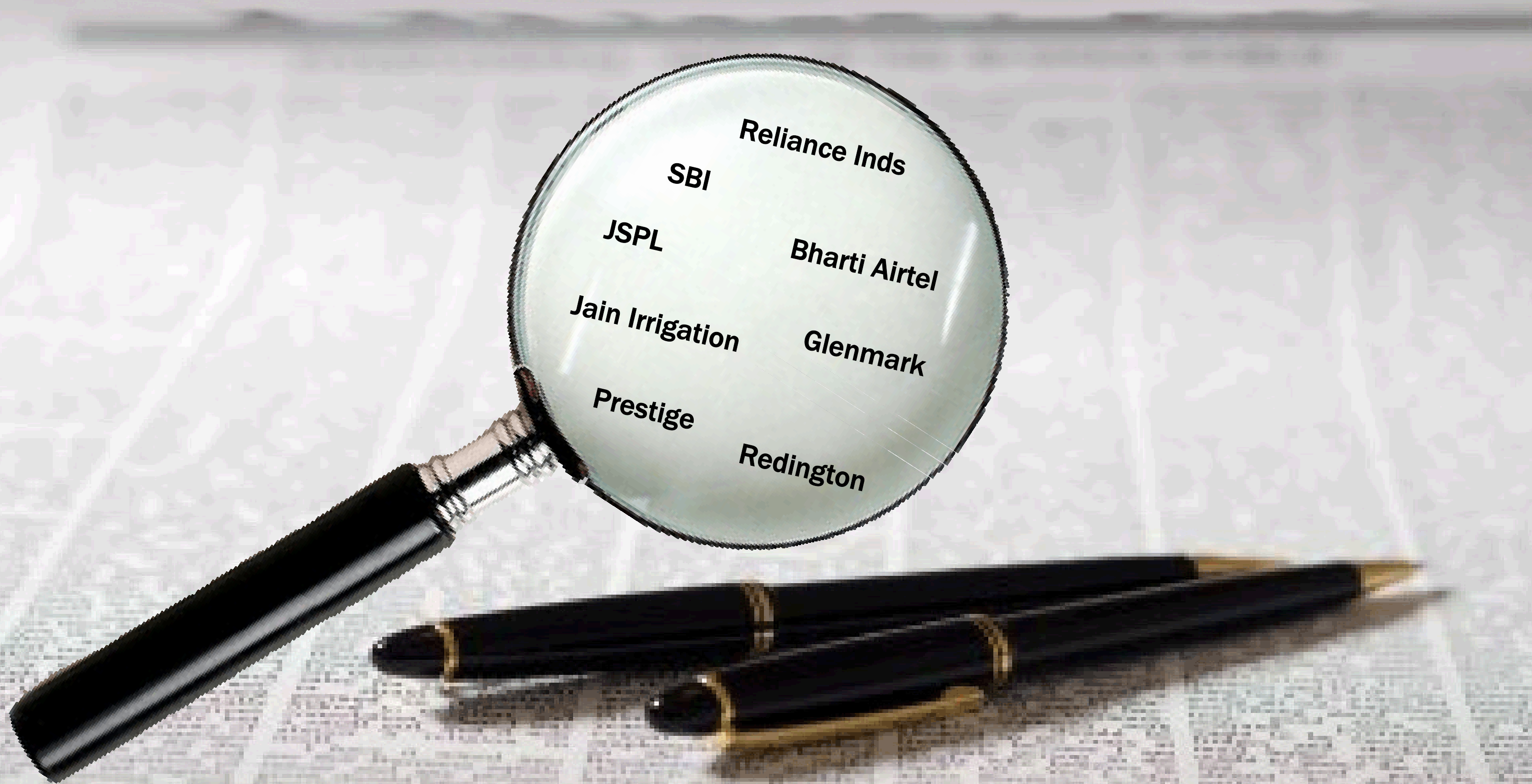
India Strategy

Sensex: 17059



High Conviction Bets

Source: http://www.123rf.com

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Summary

- **Market Outlook:** We are today in a sweet-spot rally, based on the combination of weak global growth + measures to avoid liquidity collapse. This will last till the next QE – which can again jerk markets down, till policy action by the Indian Govt or the relative growth/ fisc/ valuation of India again stand out

- Till then, select picks in interest-rate sensitives (Banks) and domestic consumption to outperform v/s expensive defensives (FMCG) and global-vulnerables (Metals). Policy cues to drive other sectors

- What has prompted this change in outlook?
  - **Developed world:** The FOMC has signaled a focus on growth and employment generation by committing to low interest rates and a preparedness to bring in QE3 as may be required in future. A tiny QE may be good for global liquidity and growth (and hence India), but anything more could buoy commodities, hurting India the most. Expect non-tariff barriers. Trade off between deratings in core Europe v/s defaults in periphery could increase overall risk aversion
  - **RBI policy:** With little leeway left on hiking interest rates to control inflation, monetary policy moves to be muted. However, it may again get into war-mode IF there is a QE program unleashed in a few months in US or Europe
  - **Govt reforms:** Refer our comprehensive report **"Indian Reforms: Can the govt seize this opportunity?"** dt Aug 8, 2011: Items requiring approval by regulatory bodies or just Cabinet approval may move forward in the next 3 months. However, game-changing Acts requiring Parliamentary approval may take time

Recommendations

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- **High conviction bets:** It is in context of this uncertain background, that we recommend our key low downside/ high absolute upside bets: **RIL, Bharti, SBI, JSPL, Glenmark, Jain Irrigation, Redington, Prestige**

- Additionally, we provide some other names for portfolio allocators and risk-takers respectively:

  a) **Defensive hideouts** (low beta) with valuation comfort: **Coal India, Sun Pharma, PGCIL, Bajaj Auto, Hero MotoCorp, BoB, Grasim, Cadila, Oracle, Godrej Cons, Coromandel, GSPL**

  b) **Very high risk-reward bets** – Very high upside, with above normal risk: **PFC, REC, JSW Energy, Crompton, JP Power, Suzlon, Pantaloon, Aurobindo**

Note: Current TP upsides may not fully reflect the potential upside/ downside due to possible events. The write-ups for each stock clearly lay out the growth drivers, downside-protection, as well as the possible upsides/ risks which are beyond our current assumptions for TP.

In an uncertain world, where events keep unfolding, and stock selection is paramount, diving into the key upside/ downside factors has been the focus of this report – rather than being driven by TP upsides alone, which are after all, probabilistic forecasts based on today's state of things

Happy Independence Day and Raksha Bandhan!

High Conviction bets

Company	Mkt Cap (USD bn)	CMP (Rs)	Target Price (Rs)	Upside (%)	P/E (x) FY12e	P/E (x) FY13e
Reliance Inds	55.9	773	1,155	49	10	10
Bharti Airtel	33.3	397	490	23	23	15
SBI	31.5	2,250	2,650	18	1.3	1.2
Jindal Steel & Power	10.5	512	701	37	10	9
Glenmark Pharma	2.0	331	391	18	13	14
Jain Irrigation	1.4	169	222	31	17	12
Redington India	0.8	94	128	36	13	11
Prestige Estates	0.8	114	186	63	14	11

Source: Bloomberg, ENAM Research; Note: For Banks P/E = P/B

Yes, there would be some risk in these too, as detailed in the individual stock write-ups; and hence they are not in the Defensive group – it's their ratio of upside/ downside at CMP which has secured their entry in this class

Defensives

Company	Mkt Cap (USD bn)	CMP (Rs)	Target Price (Rs)	Upside (%)	P/E (x) FY12e	P/E (x) FY13e
Coal India	53.8	386	372	(4)	14	13
Sun Pharma	10.9	481	570	18	22	17
Power Grid	10.5	103	120	16	15	13
Bajaj Auto	9.3	1,460	1,640	12	14	13
Hero MotoCorp	8.2	1,858	1,941	4	16	14
Bank of Baroda	7.3	840	1,000	19	1.4	1.2
Grasim Inds	4.2	2,098	2,758	31	7	6
Cadila Healthcare	3.9	860	1,124	31	21	17
Oracle Financials	3.6	1,962	2,608	33	15	14
Godrej Consumer	3.0	416	475	14	24	19
Coromandel Intl	2.0	324	400	24	14	12
GSPL	1.3	101	120	19	10	10

Source: Bloomberg, ENAM Research; Note: For Banks P/E = P/B

With most defensives superbly priced, these reasonably valued stocks offer low downside, with some upside

… And for Risk-takers

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Company	Mkt Cap (USD bn)	CMP (Rs)	Target Price (Rs)	Upside (%)	P/E (x) FY12e	P/E (x) FY13e
Power Finance	5.0	173	245	42	1.1	1.0
Rural Electrification	4.1	189	240	27	1.3	1.2
JSW Energy	2.2	62	74	19	9	8
Crompton Greaves	2.0	145	224	55	12	9
JP Power Ventures	1.8	38	60	57	10	8
Suzlon Energy	1.7	42	64	52	12	8
Pantaloon Retail	1.4	312	377	21	25	18
Aurobindo Pharma	1.0	155	232	50	8	7

Source: Bloomberg, ENAM Research; Note: For Financials P/E = P/B

Note: TP upsides may not factor in and reflect the entire potential

Outstanding return potential for identified above-normal risk

Table of contents

High Conviction bets

RIL

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- CMP ignores E&P business completely
- RIL to be net cash by FY12
  - Led by huge operating cash flow of US$ 7bn and US$ 7.2bn proceeds from BP, limited capex plans in near term
- Doubling of petchem capacity in the next 2-3 years would be a huge boost to earnings
- CAG audit risk offset by BP's entry
  - BP has already done due-diligence of the accounts of KG D6, other blocks
  - RIL's capex competitive versus global deep-water assets
- Cash allocation a risk, but management conservative enough not to destroy valuations through acquisitions
- Among most under-owned megacaps

RIL – Break-up of current market price*

	(USD bn)	(Rs/ Shr)	Comments
Refining, petchem	45.7	605	FY12e EV/E of 6.5x
PMT, Yemen, Shale gas	4.2	55	DCF
Cash proceeds from BP	7.2	99	Does not include bonus payments of US$ 1.8bn
Treasury shares (at CMP)	5.0	66	Conversion at CMP
Total enterprise value	**62.0**	**825**	
FY12 Net Debt	2.5	33	net of cash from BP
Total Equity value	**59.5**	**792**	
CMP	58.2	770	
Valuation ascribed to E&P	(1.4)	(22)	E&P avlbl for free
No of shares	3,270		
E&P business valuation	**20.5**	**272**	
KG D6	9.6	127	
NEC-25, D4, D3, D9	7.4	98	
CBM	1.7	23	
Contingent resources	1.8	24	

Source: Company, ENAM Research * the above valuations are not our SOTP

Financial summary

(CMP: Rs 773)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
2010	2,037,397	158,976	-	48.6	2.2	-	12.1	11.0	-	6.3
2011	2,658,110	202,110	-	61.8	27.1	-	13.5	13.2	-	7.0
2012E	2,196,604	241,720	71.8	73.9	19.6	10.5	12.7	15.3	5.1	7.0
2013E	2,158,515	251,986	80.4	77.1	4.2	10.0	10.8	13.8	4.6	7.0

Source: Company, ENAM estimates; *Consensus broker estimates

Bharti Airtel

India Business

- **2G:** Declining competitive intensity and recent tariff hikes to improve price realisations (RPM: Revenue Per Minute), after 3 yrs of >15% decline YoY leading to higher EBITDA margins (FY13E: ~36% vs. ~35% in FY11), cash flow generation (FY14E onwards: >USD 3 bn)
- **3G/ BWA:** 3G revs to constitute ~4% of wireless revs by FY15E and grow at >100% for next 3 yrs. Data margins higher vs. voice
- **Embedded value in tower subs:** Largest tower assets in the industry at ~79K towers in Q1FY12 & rising tenancy ratios. Value unlocking in tower company a key positive trigger (~25% value to target EV). Value unlocking in tower assets to enable repayment of debt undertaken for 3G/BWA/ Zain acquisition **Upside** if proceeds> our asspn of 12x EV/ EBITDA of FY13
- **Risk:** Regulatory risks with respect to Spectrum charges, Spectrum Re-farming, Towerco under licencing (**total worst case TRAI-based impact at Rs 26/ share, net of licence fee reduction**)

Africa Business

- **Growth drivers:** Completion of KYC compliance to stem fall in subs addns, wider network coverage to result in higher net sub adds (vs ~2 mn/ qtr currently). Margin expansion observed in past 2 qtrs (+160 bps)
- **Upsides:** a) possible reduction in Interconnect charges, b) improvement in operating cost/ min (our asspns of only ~150 bps/year margin expansion in next 2 years) and capex per min through outsourcing IT ops/ network, c) unlocking of African towercos
- **Risk:** Lower subs additions, low minutes elasticity, delay in achievement of higher margins/ operational efficiencies, **interest rate risk on hi floating-rate foreign borrwgs** (impact 5-7% on PBT)

Financial summary

(CMP: Rs 397)

Y/E Mar	Sales (Rs mn)	EBITDA (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)
2010	418,472	167,633	91,638	-	24.2	8	-	24.1	23.5	-
2011	594,672	203,002	63,110	-	15.7	(35)	-	13.1	12.9	-
2012E	721,233	246,136	64,984	19.3	17.1	9	23.2	11.8	10.7	8.3
2013E	857,881	304,301	101,620	27.9	26.8	56	14.8	16.1	14.3	6.4

*Source: *Consensus broker estimates, Company, ENAM estimates*

SBI

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- **The new management team has strategically shifted from market share acquisition to incrementally focus on profitable growth. Consolidation of subsidiary banks has taken a backseat with focus on more core issues like margin expansion and recoveries**
  - **Clean up:** A bold one shot step by providing for pending liabilities (pension, gratuity and NPA provisions) and cleaning up the book
  - **Profitability:** Management's commitment evident from withdrawal of certain low priced products (teaser rate loans) and aggressive increase in base rates (175 bps in last 6 months)
  - **NPAs:** Aggressive provisioning, focus on recoveries (recovery teams, tracking centers, stressed assets management group) and better risk management practices. Any large PSU exposure is more likely to be restructured

- **Re-rating:** Management guidance of impact on H1FY12 performance due to higher provisions already factored in, whereas the positive surprise on margins are yet be captured. Margin expansion (high 49% CASA and low 11% bulk deposits) and improving asset quality to be key re-rating triggers

- **Risks:** Delay in capital raising due to need for Govt' s allocation to Rights may force slowdown. Rights price may be an overhang. Infra exposure ~9%, of which power is 1/3: assuming 30% of SBI's power loans go for restructuring, impact: ~4% on FY12E PBT, to factor in a 5% interest forego and 2% restructured asset provisioning

Financial summary (Standalone) **(CMP: Rs 2250)**

Y/E Mar	PAT (Rs mn)	FDEPS (Rs)	EPS Chg (%)	P/E (x)	P/E (x)*	Adj. BV (Rs.)	P/Adj. BV (x)	P/Adj. BV (x)*	RoE (%)	RoA (%)	Net NPA (%)
2010	91,661	144	0.5	15.6	10.1	929	2.4	1.7	14.8	0.9	1.7
2011	82,645	130	(9.9)	17.3	11.2	899	2.5	1.8	12.6	0.7	1.6
2012E	118,025	163	24.9	13.8	8.9	1,209	1.9	1.3	14.8	0.9	1.4
2013E	147,069	203	24.6	11.1	7.2	1,339	1.7	1.2	14.8	1.0	1.2

Source: Company, ENAM Research.*P/Adj. BV and P/E calculated after deducting value of investment from price and cost of investment from BV. We have assumed dilution of Rs 200 bn in FY12

JSPL ...

- **Margin of Safety is implicit,** given that JSPL's current market cap is accounted for by only operational power and steel assets. Hence, power expansion (4.4 GW), foreign coal assets (1.7 bn t), and foreign iron ore assets (20 bn t) are not in the price:

JSPL – What is the current market price factoring in*?

Segment	Value (Rs bn)	Comments
Jindal Power	184	Valued at 10x FY12 PAT + FY11 cash of Rs 22 bn
CPP - 1,350 MW	70	Valued at 10x FY13 PAT (First full yr. of operations)
Steel	219	at 5.5x FY12 EBIDTA; 1.5 MTPA expansion (vs. current 4.5 MTPA) from FY13 not considered
S. African Mine	9	Operational 50 mnt resources ; Valued at EV / reserves of USD 4/MT; with avg. GCV 6,800 Kcal/Kg & CoP USD 60/MT
Total	**482**	
Total (Rs/ sh)	**516**	
CMP (Rs/ sh)	**524**	

Source: Company, ENAM Research * the above valuations are not our Sum of Parts

Potential upsides: Valuation of International resources

Mine	Reserves (MT)	EV/Reserves (USD/t)	Valuation (Rs bn)	Comments
Indonesia (Coal)	500	2.0	45	Mining to commence from end FY12; ~5,000 GCV coal
Mozambique (Coal)	1,200	2.0	108	Mining to commence from FY13; ~25% coking & 75% thermal coal
Bolivia (iron ore)	20,000	-	-	Not ascribing any value as logistics challenging; co. claims to start prodn. in FY12
Total upside			**153**	-
Total upside (Rs/sh)			**164**	**31% upside from CMP**

Source: Company, ENAM Research

... JSPL

- **JSPL's cost of production for both power & steel are in the lowest quartile of industry; hence low earnings volatility**
  - **Power:** Fuel cost at Rs 0.5/ kWh vs. NTPC's (sector leader) fuel cost at ~Rs1.8/kWh in Q4FY11
  - **Steel:** COP of at ~USD 450/t vs. SAIL's (sector leader) at ~USD 560/t
- **Driven by volume expansion, earnings to increase by ~22% CAGR over FY11-13**
  - **Power**: Notwithstanding an expected fall in profits from existing 1 GW capacity (due to est. fall in merchant), incremental volumes from 1,350 MW CPP (largely commercial sales initially) to drive earnings expansion, Our merchant assumptions at Rs 4.2 for FY 12 (Q1 actuals at 4.3)/ Rs 4 for FY 13 – note 80% of his merchant sales are sold 12 m fwd
  - **Steel**: Profitability for FY12E to be driven by growth in iron ore pellet volumes (up by 2.4x to 2.2 mn MT) and the recently acquired Oman plant. In FY13E, earnings growth would be driven by 50% rise in steel capacity to 4.5 mn MT
- **Risks**: a) Draft mining Bill provisions taken in our assumptions, but could vary depending on final outcome, b) Global commodity shocks, as incremental profits in FY 12 largely from iron ore pellet sales and half of cons profits from steel where is relatively more vulnerable as an integrated player

Financial summary (CMP: Rs 512)

Y/E Mar	Sales (Rs bn)	PAT (Rs bn)	Consensus EPS* (Rs)	EPS (Rs)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
2010	111	36	-	38.4	-	-	40.5	28.6	-	1.3
2011	131	38	-	40.2	-	-	30.1	22.4	-	1.5
2012E	167	47	49.0	50.3	4.7	10.2	28.2	20.5	8.0	1.9
2013E	227	53	56.7	57.0	25.2	9.0	24.8	18.7	7.4	2.5

Source: Company, ENAM estimates; *Consensus broker estimates

Glenmark

- **Niche product launches to drive growth in US:** Has a strong portfolio of 72 products (35 ANDAs pending approval including 4 FTFs and 10-12 hormonal products). We estimate US business to grow at 18% CAGR over FY11-13E
- **Robust domestic franchise:** We expect domestic biz. to grow at 16% CAGR over FY11-13E led by increase in market share in derma, CVS, respiratory & diabetic segments
- **Crofelemer launch** (first ever novel launch by any Indian company) in semi-regulated markets by 2HFY12 (expected to generate USD 80 mn of sales annually)
- **Base business** EPS of Rs 18 (FY 12)/ 21.5 (FY13) translates to a base-biz PE of 18/ 15, which is lower than peers
- **Upside:** 6 NCEs (new chemical entity) and 2 NBEs (new biological entity) products in the R&D pipeline, with a decent track record of generating revenues from out-licensing deals
- **Key risks:** a) Glenmark has lost a summary judgment against Abbott and Sanofi for generic Tarka and would be liable to pay USD 16 mn (~Rs 3/ share), however would be appealing in higher court. b) Pricing pressure in US markets

Financial summary (CMP: Rs 331)

Y/E March	Sales (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change (YoY %)	P/E (x)	RoE# (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
2010	24,124	3,491	-	12.9	116	-	17.6	14.5	-	0.4
2011	29,491	3,278	-	12.1	(6)	-	14.8	12.1	-	1.8
2012E	36,825	6,625	22.2	24.6	102	13.5	28.0	21.4	11.7	1.8
2013E	40,445	6,515	22.4	24.1	(2)	13.7	21.9	20.2	11.2	1.8

Source: Company, ENAM estimates; *Consensus broker estimates

Jain Irrigation

- **Underpenetrated MIS (50% of sales, 64% of EBITDA) segment to grow at 30%+ CAGR over the next 5 years:**
  - <u>Expanding revenue avenues</u>: Newer states (20% of revenues in FY11) like Raj, Guj, MP and HP gaining traction
  - <u>Structural rise in farm income & cropping diversification</u> from MSP driven crops will stimulate demand for micro irrigation
  - <u>Govt initiatives in 2010:</u> (1) Recognized MIS subsidy program as a National Mission to expand addressable market & (2) Implementation of CWBP scheme; govt has made it obligatory to implement MIS in min 10% of canal command areas
  - <u>Sustained growth despite rising competitive intensity</u>: MIS revenue grew by 31% in FY11 and 30% in Q1FY12
- **Improvement in capital efficiency as the government subsidy program kicks into Mission mode**
  - FY 11 saw states' budgets unprepared for the immediate govt thrust, and political changes, delaying subsidy payments to farmers in TN & Mah – now resolved; AP (15% of MIS revenues) still a concern
  - Reduced gross receivable days in the MIS segment from 373 days in FY11 to 350 days in Q1FY12 on account of better collections. Mgmt has guided towards a further reduction in receivables to 310 days by the end of Q2FY12
- **Trading below 6 yr median level: The 1-yr fw EV/EBITDA of 8x, the stock is at 25% discount to its 6 year median.**
- **Key Risk: Capital allocation to non MIS segments, delay in government subsidy and slower turnaround of intl. subs.**

Financial summary (CMP: Rs 169)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
2010	33,755	1,652	-	4.3	(18)	-	14.7	15.6	-	1.4
2011E	40,691	2,759	-	7.2	65	-	19.4	16.5		1.0
2012E	50,169	3,864	9.5	10.0	40	16.9	22.2	18.3	9.4	1.2
2013E	61,181	5,424	12.1	14.1	40	12.0	25.0	20.6	7.5	1.3

Source: Company, ENAM estimates; *Consensus broker estimates

Redington India

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- **India (~47% of sales, 61% of PBIT): High growth (27% YoY) to continue in FY12E:**
  - **Smart phones:** We estimate higher growth in smart phones at ~37% in FY12E and ~20% in FY13E
  - **iPad:** We build-in revenues for iPad at ~Rs 3.5 bn in FY12E/ Rs 10 bn in FY13E. The management places market potential at ~500K units/ Rs 20 bn opportunity (current waiting period is ~ 3 weeks), of which we assume 50% mkt share

- **Upsides beyond our assumptions:**
  - **Strategic initiatives to improve working capital cycle:** Higher growth in non-IT segment (Q1FY12 rev share: ~19%) and improving creditor days to improve working capital cycle. This is a long-term biz transformation (high RoE and cash flow generation). Profit sensitivity high to increasing iPad mkt share
  - **Value unlocking in key ventures:** (**1**) NBFC (Q1FY12 book size: Rs 6.7 bn), grew ~30% YoY with zero NPAs (**2**) 3D PL (i.e. ADC)
  - GST Implementation

- **Key Risks:** Further interest rate hikes, currency fluctuations for international operations

Financial summary (CMP: Rs 94)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)
2010	137,578	1,843	-	4.7	13.5	-	17.7	14.6	-
2011	174,585	2,260	-	5.7	22.6	-	20.0	16.0	-
2012E	215,114	2,840	7.3	7.2	25.7	13.1	21.9	18.0	9.0
2013E	256,563	3,390	8.8	8.6	19.4	11.0	22.2	19.0	8.1

Source: Company, ENAM estimates; *Consensus broker estimates

Prestige

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- **Current valuations factor in value of a) OPERATIONAL rental assets (Rs 1.76 bn of annualized rental income) and b) Net cash flows from ONGOING development projects (Rs 43 bn over next ~3 yrs)**
- **Bangalore realty (~80% of portfolio): Best placed among metros**
  - New launches from several Bangalore developers over the last quarter seeing significant absorption
  - Recently launched PEPL's projects saw ~1 msf being sold in the last 2 months
- **Key triggers:**
  - **Slew of new launches:** With approvals starting to come in, Prestige is expected to launch +10 msf of projects in remainder of FY12, (PEPL has maintained its sales guidance of ~Rs 15 bn for FY12 vs Rs 2.1 bn achieved in Q1FY12)
  - Revenue recognition boost from Q3/ Q4 as accounting thresholds being crossed
- **Risks: a) Any IT slowdown, b) Cash-burn** on rental and hospitality projects (but, on-going development projects and manageable incremental debt to adequately fund this)

Financial summary (CMP: Rs 114)

Y/E March	Sales (Rs mn)	PAT (Rs mn)	EPS (Rs.)	RoE (%)	RoCE (%)
2010	10,244	1,294	3.9	13.7	10.3
2011	15,431	1,667	5.1	9.7	11.5
2012E	16,313	2,763	8.4	10.9	11.6
2013E	22,702	3,519	10.7	12.3	13.3

Valuation	(Rs)
Target price	186
Upside (%)	63

Source: Company, ENAM estimates; *Consensus broker estimates

Defensives

Defensive, with valuation comfort and some upside

Stock	Rationale
Coal India	❑ Domestic coal prices at half of international prices, thus no downside if global coal prices fall. Only merchant coal miner in India and strong balance sheet (cash of ~USD 10 bn). Draft mining bill provisions already imputed in TP ❑ **Upside** if form of Bill changed to royalty-format ❑ **Risk:** wage revision above expectations
Sun Pharma	❑ Domestic (~40% of business): 75% from robust chronic franchise ❑ Internatnl: Taro (27% of Sun's FY 12) boosting already strong US biz, with strong pipeline of 24 pending ANDAs ❑ Strong balance sheet with USD 1 bn of cash, adds scope for inorganic growth ❑ **Upside:** Caraco & Cranbury facilities getting US FDA clearance ❑ **Risk:** Pricing pressure in US mkts, any more US FDA warning letters, any liability for Protonix sales
Power Grid	❑ A quasi monopoly where ALL costs are pass-through. Tariff structure insulated from lower PLFs due to coal shortage (take-or-pay) or stranded assets (project cluster approach) ❑ **Risk:** execution delays due to land acquisition

Defensive, with valuation comfort and some upside

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Stock	Rationale
Bajaj Auto	❑ 2W defensive: high cash purchases (~65%), rural (~50%), demonstrated pricing power, not crude-sensitive ❑ Volume growth> industry at ~17% (sector: 12-14%) backed by new launches (Boxer, new Pulsar), strong exports ❑ Consistent pricing actions and higher margin 3W (new state permits) volumes to cushion margins. Mgmt guidance of 20% to be maintained ❑ Risk: Govt to review DEPB (9% benefit) on 30th Sept. –ve impact on exports (33% of volumes). Mgmt expects duty drawback scheme (replaces DEPB) to be at 4-5% and expects pricing/ absorption for the balance
Hero MotoCorp	❑ Co's target of 6 mn units for FY12E seems intact ❑ Margins pressures incrementally easing, with regular price hikes ❑ High dividend payouts v/s competition, to continue
Bank of Baroda	❑ Earnings growth, cost efficiencies, technological platform, asset quality consistently better than PSU peers ❑ 100% system-based NPA recognition ensures low slippages in Q2 unlike peers ❑ Risk: CMD retiring in end-2012

Defensive with valuation comfort and some upside

Stock	Rationale
Grasim Inds	❑ VSF prices have stopped falling (45% of TP). Implied valuation of cement assets (60% stake in UltraTech) at USD 70/t vs Ultratech's current valuation at USD 120/t ❑ Strong net-cash balance sheet ❑ **Upside** if promoter holding increased and subsequently FII cap raised ❑ **Risk** in commodity price moves
Cadila Healthcare	❑ Domestic (~50% of business): 50% from chronic segment ❑ International (~50% of business): Strong pipeline of 67 products approved by US FDA and 64 pending ANDAs ❑ **Upside:** Launch of products from Abbott JV (26 products under JV) and faster resolution of warning letter for Moraiya facility ❑ **Risk:** Pricing pressure in US mkts
Oracle Financials	❑ Products (~70% of revs; ~85% of operating profit): Increased signings with Tier 1 banks ❑ Revenue stability: AMC revs (17% of revenues, and growing), Implementation revs (~35% of revenues) which are dependent on license fee signings (recur over ~1.5-2 yrs from date of signing; FY11 saw ~25% YoY growth in license fees) ❑ Potential stake sale of services biz (~Rs 270/ share), strong cash reserves (~Rs 360/ share) ❑ **Upsides:** Delisting, Core banking signings, beneficiary of Dodd Frank Act implementation in FY13 ❑ **Risks:** Europe exposure (~24% of products in Q1FY12), and 100% BFSI exposure

Defensive with valuation comfort and some upside

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It's possible!

Stock	Rationale
Godrej Consumer	❑ 64% of revenues is still India-centric, showing firm growth in all 3 categories ❑ Softening commodity costs and calibrated price hikes will aid margins in 2HFY12 ❑ **Upside:** Earnings surprise from Darling acquisition, cost rationalization due to integration
Coromandel Intl	❑ 25% fertilizer volume growth by 2HFY13, increase in profitability from non-subsidy business (20% of PBIT, to grow to 40% in ~3 yrs) ❑ **Upside:** Increase in complex fertilizer consumption, post urea de-regulation in Oct ❑ **Risk:** As DAP prices rise, if Govt maintains NBS subsidy rates (based on $612/ t vs spot of 670), margins may reduce – Govt has kept increasing subsidies to avoid shortage
GSPL	❑ Current pipelines valued at 1.8x FY12 P/BV reasonable, given fixed 12% post-tax RoCE return ❑ New pipelines to generate value in long term as absence of domestic gas finds necessitates significant LNG capacity to come online in next 5-6 years ❑ **Upside:** Improved visibility in gas supplies through announcements of LNG terminal or huge domestic gas finds ❑ **Risk:** Reduction in tariffs on existing Gujarat pipelines, cost over-runs in new pipelines

Very high risk-reward bets!

SEB Reforms

- **The SEB situation is alarming, with losses mounting to ~USD 15 bn.** Five states (UP, MP, TN, Raj and Har) contribute ~65-70% of losses. Financial health of SEBs has caused collateral damage to gencos through off-take risk (questioning SEBs' ability to pay its dues and procure relatively expensive merchant/imported coal power). This impacts lenders such as REC & PFC (deferrals expected from SEBs and gencos). **A bailout package by central government or default by the SEBs seems highly unlikely**

- Key provisions:
  - The state governments may consider converting loans due from the state governments to the distribution utilities as government equity to ensure capital infusion and improve the net worth of the utility
  - Allow SEBs to increase tariff annually and State governments to ensure that distribution utilities file their Annual Tariff Revision Petition every year and also get their account audited periodically. **Watch-out for tariff increases by TN during H2FY12.**
  - Introduction of rating mechanism for SEBs in the next 6 months to enforce greater financial discipline amongst SEBs
  - Timely disbursement of subsidies to state electricity boards by the respective state governments.
  - Appointing distribution franchises in urban areas through competitive bidding i.e. privatization of distribution circles.

- Beneficiaries:
  - If the above recommendations are implemented, it would improve SEB financials structurally, thereby improving outlook on Power financiers – REC and PFC.

Very high risk-reward bets! : Power Financing

Stock	Rationale/ Upside	Risks/ Downside
PFC	❑ Strong growth visibility: outstanding sanctions at ~1.7x total loan assets ❑ Maintains healthy asset quality with Net NPA ratio at 0.20%. Expected SEB reforms to abate asset quality concerns, a key re-rating trigger ❑ Maintains margins at healthy level (~3.9%). With assets getting re-priced in coming quarters, margins are expected to remain stable ❑ Maintains adequate safeguards such as escrow mechanism, sufficient government guarantee and asset charge to protect its asset quality	❑ Any significant delay in implementation of SEB reforms may lead to increased uncertainty on asset quality ❑ Significant increase in interest rate may impact its growth rates with few projects becoming unviable ❑ Exposure to imported coal UMPPs where tariffs inadequate
REC	❑ Improvement in lending mix, with increase in share of generation segment (to ~43%) will strengthen its balance sheet ❑ Private sector contribution is expected to increase to ~13.5% by FY12E (currently at 11%) which will support margins ❑ Maintains healthy return ratios with expected ROE of ~22% and ROA of ~3% in FY12E and strong growth visibility ❑ Maintains 0.26% Net NPA ratio. SEB reforms which are expected in some time will abate the asset quality risks	❑ Significant increase in interest rate may impact its growth rates with few projects becoming unviable ❑ Currently maintains ~50% of its loan book in T&D segment which is more susceptible to asset quality risk ❑ Un-hedged foreign borrowing may lead to some MTM losses due to Fx variation. ~11% of its borrowing is in form of foreign currency borrowing of which >70% is hedged

Very high risk-reward bets! : Power Utilities

Stock	Rationale/ Upside	Risks/ Downside
JP Power	❑ Limited downside as CMP= 3 operational hydro assets of 1.7 GW ❑ Current upside of 60% is largely derived from the under-construction 1.3 GW on domestic captive mines (no forest & land issues) with expected CoD in Q1FY14 ❑ Further upside if the on-going tariff negotiation for the recently commissioned 1 GW hydro is favorable, with higher proportion of merchant vs. current at 20%	❑ High leverage at D:E of 2.6x ❑ Equity dilution required for projects beyond 3.5 GW ❑ High leverage at the parent level (JP Associates)
JSW Energy	❑ Limited downside: CMP= operational assets of 3.1 GW at current replacement cost of Rs 55 mn/MW. CMP also implies coal prices at USD 130 for perpetuity and merchant at Rs 3.5/kWh ❑ Sustainability: NOT in question due to low leverage (D:E) of 1.4x and positive cash-flows considering above assumptions ❑ Current upside of 30%+ could improve: a) Forthcoming projects (2.9 GW) on domestic captive blocks: land acquisition and eqpt ordering process is on, b) SEB reforms could improve merchant outlook (current asspns @ Rs 4)	❑ Higher imported coal spot prices ❑ High sensitivity to merchant prices and continued distress in SEBs financials may impact merchant realization as well as the receivable cycle negatively

Very high risk-reward bets! : Power Equipment…

Stock	Rationale/ Upside	Risks/ Downside
Suzlon Energy	❑ With 100% of REpower a mere formality, Suzlon now has access to its cash flows and superior technology ❑ **REpower** is one of the global leaders in 2 MW on-shore products, which is the dominant volume segment in on-shore. Also a global leader in 5/6 MW high-margin hyper-growth offshore segment. However, European manufacturing base were high cost, restricting its volumes to only Europe ❑ **On-shore**: Can compete better in India and Europe, with tech+ cost advantage due to manufacturing REpower now in India ❑ **Offshore**: Germany (world's 2nd largest mkt) has closed further nuclear plants – REpower gets home-mkt advantage ❑ Indian wind mkt (Suzlon has 50% mkt share) doubled to ~3GW, as cost of power thru wind now= imported coal based plants. Suzlon's PBT break-even is at 1.7 GW, which is now near-guaranteed from India alone ❑ **FCCB repayment** of Rs 25 bn in FY13 now manageable: cash of ~Rs 20 bn (REpower), Rs 7 bn (Hansen sale) & ~Rs 10 bn (overdue receivables)	❑ Recently, global majors such as Siemens & Emerson have issued order-inflow growth warning. REpower (~60% of FY13E PAT) derives majority of its sales from Europe and may face deferrals, as witnessed during 2008 ❑ Above impact on REpower can be more as it is expanding capacities & manpower ❑ Any collapse in oil/ coal prices to affect relative economics of wind power

Very high risk-reward bets! : ...Power Equipment

Stock	Rationale/ Upside	Risks/ Downside
Crompton Greaves	❑ **International Subs:** In Q1, loss at EBITDA level was circumstantial due to deferral of revenue of ~20% of Q1FY12 sales. Expect sustainable sales growth of 6-7% & margins of 6-8% ❑ **Domestic T&D and Industrial biz:** ABB & Siemens' domestic T&D and industrial biz are 2.5x larger than CG, largely due to technology advantage in automation. CG has now bridged this through acquisitions. In FY 13, PGCIL to bring in compulsory domestic sourcing ❑ **Risk/ reward:** Considering normalized international subs margins of ~8% and pick-up in domestic T&D, expect EPS of Rs 16 in FY13 & RoE of 20%+. Favorable risk-reward at P/E of 9xFY13	❑ International biz (30% of EBITDA) could face risk of project deferral due to European debt crisis. Further, global majors such as Siemens, Emerson, etc have issued order inflow growth warning ❑ T&D Order flows from PGCIL and state transmission Cos. do not pick-up in FY12

Very high risk-reward bets! : Others

Stock	Rationale/ Upside	Risks/ Downside
Pantaloon	❑ FDI for multi-brand retailing could entail strategic tie-up with MNC retailers, with additional funds: Will improve balance sheet, enhance supply chain efficiency & accelerate growth plans for hypermarket food & grocery retailing ❑ Our sensitivity analysis for 25 to 45% stake sale in FVRL indicates a potential 57% to 114% upside to FY13E earnings (assuming stake sale at 1x EV/S to enter growth mkt)	❑ Rising interest cost and a stretched balance sheet (D/E at 1.4x) could strain operating cash flow and thereby growth in FY12 ❑ Same-store sales impacted by increase in apparel prices and decline in consumer sentiments
Aurobindo	❑ **US biz.** (27% of FY11 sales) **to lead growth @ 15%+ CAGR over FY11-13E**: Strong product pipeline (215 cumulative and 77 ANDAs pending approval) in US ❑ **EU/RoW** biz. (12% of FY11 sales) growth at **24% CAGR over FY11-13E**, to be led by product launches, geographic expansion and supply to Pfizer/ AstraZeneca ❑ Thus formulations' contribution to sales would rise from 54% in FY11 to 65%+ in FY13E. EBITDA margin (ex-dossier income) expansion from 17% in FY11 to 19% in FY13E	❑ **Unit-VI (~3% contribution to FY11 sales)** is currently under Import Alert and **Unit-III (8-10% contribution to FY11 sales)** is under Warning Letter from US FDA. Delay in resolution could slow down approval process and hamper future growth. Also, corrective action cost may impact margins ❑ **High dependency on Pfizer** – Change of focus by Pfizer/ inability to launch products/ garner market share would impact revenues

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