Equity Research

November 6, 2008

BSE Sensex: 10120

INDIA

Sept Qtr 2008 Results Review

Confirms slowing earnings trajectory

Reason for report: Q2FY09 results review

I-Sec universe reported Sept Quarter 2008 YoY growth in revenue, EBITDA and net profit of 32%, 17% and 9% respectively. Revenue growth was led by sectors like Fertiliser (78%), Construction (48%), Steel (44%), Oil & Gas (34%), Banking (41)% and Technology (33%). The decline in EBITDA margins of 357 bps was sharper than our estimate of 136 bps and was aggravated in sectors like Oil & Gas (due to subsidies, lower GRMs and lower Petchem margins), Cement (high coal costs), Real estate (change in product mix) and Media (high newsprint prices, higher programming costs). There was growth YoY in EBITDA margin in Technology (Rupee impact), Steel (higher product prices) and textiles (focus on high-margin segments). Net margin came off by 327 bps against our estimate of 159 bps. Only the Steel sector showed improvement YoY in net margins (550bps). Steel, fertiliser and banking sectors led in net profit growth. Sensex companies delivered sales, EBITDA and net profit growth of 26.6%, 13.9% and 5.5% respectively in Q2 (on a standalone basis as consolidated numbers are yet to come through for a few companies). We are currently expecting Sensex profit growth of 6% in FY09 (consolidated), which we believe will likely be revised downwards in the days ahead. Quality of earnings is an issue. Losses on account of forex loans have been routed through the Balance Sheet in some companies. Isec Universe and the Sensex earnings would have been worse otherwise.

- **Aggregate EBITDA margin to likely drift down further.** Looking out into H2FY09, we see pressure on earnings growth coming from those sectors that are global growth sensitives (Oil & Gas, Metals and IT services). Among the domestic sectors Auto sector will likely face pressure near term from both poor demand (credit availability and credit cost driven) as well as from raw materials. Real estate is likely to face pressure from poor demand conditions.
- **Sensex target implies tepid earnings growth:** Due to marked deterioration in earnings outlook consequent to the credit crisis in OECD countries and impact on the real economies globally, on 12 Oct 2008 we lowered our Sensex target to 16050 (from 19300). This was based on a target PE multiple of 11.8x (one Standard deviation below the 8 year mean of 15.9x) against 15.2x (8 year median) used previously to take into account the earnings uncertainty (which we believe is difficult to quantify so early in the cycle). We had also pushed back the investment horizon to March 2010 from Sept 2009 to price in a more prolonged phase of risk aversion. If one were to use the median PE on the Sensex target it implies a modest growth of 4% in Sensex earnings over FY09-FY11 (vs. our current expectation of 18%).
- **I-Sec Market View: Overweight stance on domestic, capital efficient and interest rate sensitive sectors.** Our UW stance on Oil & gas driven by risk to refining and petrochemical margins, UW on IT Services driven by likely reversal in rupee, volume, pricing and margin pressures from deeper-than-expected OECD slowdown. UW on Capital Goods driven by valuations, risk to P/E and EPS from lower order inflow growth from Infrastructure and Commodities sectors due to poor capital and debt market conditions. Positive view on Indian Financials underpinned by relative insulation from global problems, valuations, a peaking inflation and interest rate cycle and healthy corporate sector. Expect earnings upgrade from higher demand (due to lower interest rates in the next 12-18 months) in Autos and lower pressure from raw materials. Overweight on Consumer sector driven by steady earnings prospects and possibility of surprises from lower soft commodity prices.

Sector stance	
Auto	OW
Banking	OW
Engineering	UW
FMCG	OW
Metals	UW
Oil&Gas and Petro	UW
Pharma	OW
Real Estate	N
Technology	UW
Telecom	OW
Utilities	N

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Table 1: Summary of Q2FY09 sales

(Rs mn)

Sector	Estimates	Actual	Variance %	Sales Q2FY08	Change YoY %
Technology	270,255	272,779	0.9	205,030	33.0
Oil &gas	1,013,402	979,488	-3.3	729,973	34.2
Automobiles	173,776	175,837	1.2	154,051	14.1
Media	10,337	10,400	0.6	8,044	29.3
Real estate	72,031	70,654	-1.9	59,566	18.6
Metals	246,345	255,746	3.8	178,007	43.7
Pharmaceuticals	88,327	93,398	5.7	74,326	25.7
Power T&D	18,041	19,421	7.6	14,894	30.4
Textiles	12,087	11,959	-1.1	9,693	23.4
Construction	23,134	27,056	17.0	18,259	48.2
FMCG	139,980	141,846	1.3	116,591	21.7
Fertiliser	57,166	69,348	21.3	39,048	77.6
Cement	88,945	92,087	3.5	82,048	12.2
Aggregate	**2,213,826**	**2,220,019**	**0.3**	**1,689,529**	**31.4**
Banking NII	141,715	155,549	10	110,308	41
Aggregate incl. Banking	**2,355,541**	**2,375,568**	**1**	**1,799,837**	**32**

Source: Company data, I-Sec Research

Table 2: Summary of Q2FY09 EBITDA

(Rs mn)

	Estimates	Actual	Variance %	EBITDA Q2FY08	Change YoY %
Technology	63,539	66,981	5.4	49,199	36.1
Oil &gas	196,894	143,030	-27.4	156,624	-8.7
Automobiles	18,466	17,134	-7.2	19,751	-13.2
Media	1,913	1,468	-23.3	1,507	-2.6
Real estate	38,251	34,282	-10.4	33,419	2.6
Steel	79,173	88,079	11.2	54,300	62.2
Pharmaceuticals	22,163	20,613	-7.0	16,314	26.4
Power T&D	2,361	2,400	1.7	2,034	18.0
Textiles	1,633	2,034	24.6	1,393	46.1
Construction	2,047	2,363	15.4	1,814	30.3
FMCG	28,006	27,474	-1.9	24,497	12.1
Fertiliser	4,713	6,359	34.9	4,006	58.8
Cement	23,011	22,318	-3.0	26,109	-14.5
Aggregate	**482,169**	**434,536**	**-9.9**	**390,967**	**11.1**
Banking PPP	104,339	118,693	13.8	81,122	46.3
Aggregate incl. Banking	**586,508**	**553,229**	**(5.7)**	**472,089**	**17.2**

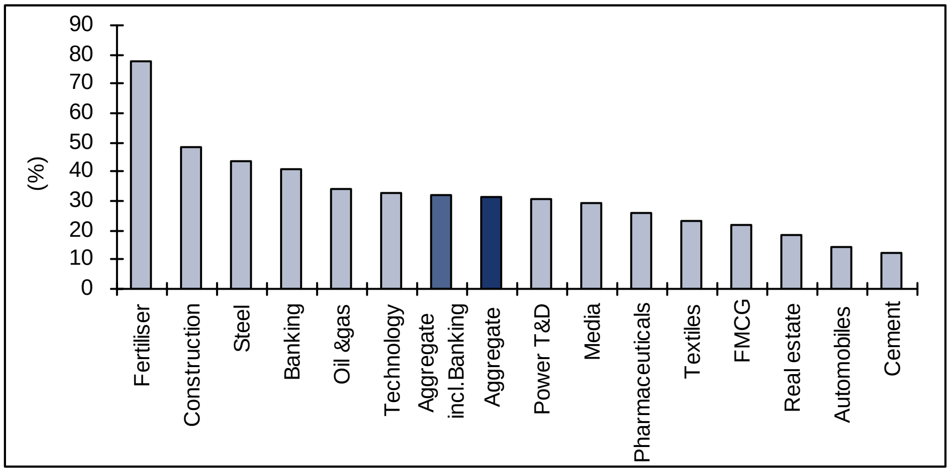
Source: Company data, I-Sec Research

Table 2: Summary of Q2FY09 PAT

Sector	PAT Estimates	Actual	Variance %	PAT Q2FY08	Change YoY %
Technology	49,292	50,228	1.9	41,091	22.2
Oil &gas	114,268	71,390	-37.5	97,792	-27.0
Automobiles	13,676	12,147	-11.2	13,552	-10.4
Media	1,013	636	-37.2	836	-23.9
Real estate	27,719	27,303	-1.5	28,301	-3.5
Steel	48,776	58,208	19.3	30,722	89.5
Pharmaceuticals	15,298	12,678	-17.1	11,157	13.6
Power T&D	1,227	1,241	1.2	1,024	21.3
Textiles	276	658	138.6	646	1.9
Construction	776	874	12.6	847	3.2
FMCG	20,086	19,032	-5.2	17,698	7.5
Fertiliser	1,966	2,990	52.1	1,706	75.2
Cement	13,603	14,160	4.1	16,593	-14.7
Aggregate	**307,975**	**271,545**	**-11.8**	**261,964**	**3.7**
Banking PAT	54,759	63,761	16	45,881	39
Aggregate incl. Banking	**362,734**	**335,306**	**(8)**	**307,844**	**9**

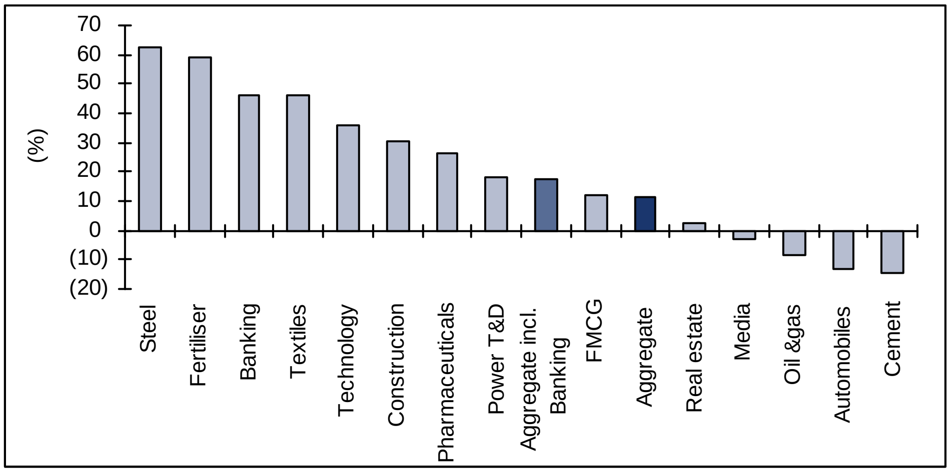
Source: Company data, I-Sec Research

Chart 1: Sales growth



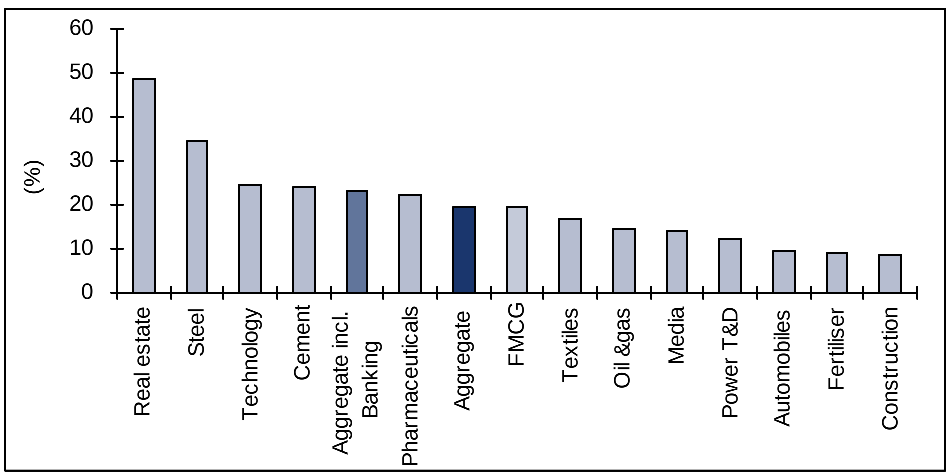
Source: Company data, I-Sec Research

Chart 2: EBITDA growth



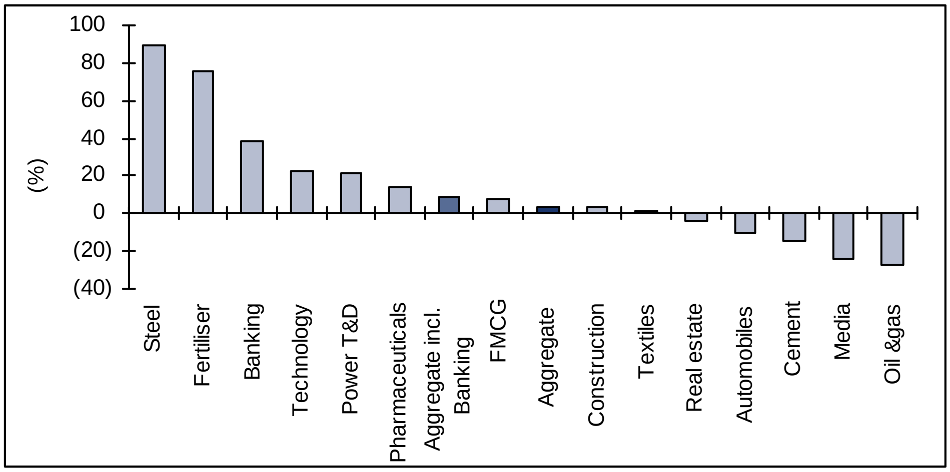
Source: Company data, I-Sec Research

Chart 3: EBITDA margin



Source: Company data, I-Sec Research

Chart 4: PAT growth



Source: Company data, I-Sec Research

Equity Research

November 5, 2008

INDIA

Automobiles

Mixed bag

Reason for report: Q2FY09 results review

The I-Sec auto universe posted aggregate revenue growth of 14.1% YoY to Rs174bn in Q2FY09, mainly on price hikes and volume growth in various segments. As regards volumes, two-wheelers seized leadership posting 17.8% YoY volume rise (motorcycles up 19.4% YoY; mopeds up 12.6% YoY and scooters up 3.4% YoY). The growth in two-wheelers was followed by three-wheelers posting volume growth of 6.3% YoY and CVs registering 5.1% overall volume increase (M/HCVs down 9.9% YoY; LCVs up 26.6% YoY). However, PVs declined 2.5% YoY (passenger cars down 2.8% YoY; UVs & MPVs up 2.1% YoY). Among companies, revenue growth was led by Punjab Tractors (PTL up 48.9% YoY on a low base), Hero Honda Motors (HHML up 36.1% YoY on strong volume growth) and TVS Motor (TVSM up 23% YoY on a low base). Our top picks in the sector are Mahindra & Mahindra (M&M), HHML and Maruti Suzuki (MSIL).

- **Margin pressure.** In Q2FY09, most of the impact of high raw material cost (up 220bps YoY to 73.2% for I-Sec auto Universe) was seen, leading to 310bps YoY decline in EBITDA margin to 9.7%, lower than our estimates. This was largely driven by Bharat Forge (BFL, 710bps margin decline to 17.5%), M&M (570bps margin decline to 7.9%) and MSIL (540bps YoY dip to 7.3%). Only Hero Honda (HHML, up 120bps YoY), PTL (up 240bps YoY) and TVSM (up 50bps YoY) posted EBITDA margin expansion – the latter two on lower base. This coupled with higher interest cost and depreciation led to recurring net profits declining 10.4% YoY to Rs13.6bn.

- **Top picks outperform.** We prefer: i) secular (two-wheelers, PVs) vis-à-vis cyclical (CVs) segments, ii) segments with low exposure to financing (two-wheelers) and iii) domestic plays with significant and increasing exposure to rural markets (two-wheelers, tractors, small cars) versus exports plays, especially to the US/UK. These factors combined with excellent management and attractive valuations have guided our choice of top picks in the sector, which are M&M, HHML and MSIL. Our top picks have outperformed the Sensex in Q2FY09.

- **We have downgraded Bharat Forge & Ashok Leyland to HOLD from Buy.** Bharat Forge's (BFL) earnings have been lowered 19-25% in FY09-11E on: i) severe slowdown in key geographies of US & Europe, ii) key subsidiaries affected on slowdown in US/Europe and iii) lesser traction from non-auto business (refer *Calm before the storm* dated October 7, '08). Given the deterioration in macroeconomic fundamentals, slowdown in IIP growth, pruning of corporate capex plans, softening of freight rates and CV financing related issues, we have lowered Ashok Leyland's (ALL) FY09E-10E earnings estimates 33-42% and believe there is downside risk to FY09E volume guidance (ALL guidance 86,000 units, 3.4% growth; I-Sec: 82,617 units, 0.7% decline) and EBITDA margin (ALL guidance flat; I-Sec: 180bps dip) (refer *Slackening speed* dated October 23, '08).

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Table 1: Q2FY09 results review

Company	Sales					EBITDA					Rec PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
	Estimate	**Actual**	**Var**	**Actual**	**YoY**	**Estimate**	**Actual**	**Var**	**Actual**	**YoY**	**Estimate**	**Actual**	**Var**	**Actual**	**YoY**
Ashok Leyland	17,889	18,664	4.3	17,459	6.9	1,228	1,539	25.4	1,685	(8.6)	541	606	12.0	798	(24.0)
Bajaj Auto	26,011	25,484	(2.0)	23,618	7.9	3,840	3,439	(10.5)	3,827	(10.2)	2,877	2,274	(21.0)	2,386	(4.7)
Bharat Forge	6,285	6,756	7.5	5,632	19.9	1,421	1,185	(16.6)	1,383	(14.3)	717	415	(42.2)	677	(38.8)
Hero Honda	31,107	32,021	2.9	23,521	36.1	3,918	4,349	11.0	2,915	49.2	3,071	3,063	(0.3)	2,043	49.9
M&M	31,928	31,380	(1.7)	28,024	12.0	2,937	2,476	(15.7)	3,805	(34.9)	2,196	2,452	11.7	2,837	(13.6)
MSIL	47,729	48,303	1.2	45,474	6.2	4,482	3,524	(21.4)	5,763	(38.9)	3,947	2,961	(25.0)	4,665	(36.5)
Punjab Tractors	2,893	3,080	6.4	2,069	48.9	206	306	48.1	155	97.2	180	273	51.5	98	178.5
TVS Motor	9,934	10,151	2.2	8,254	23.0	434	317	(27.0)	218	45.1	147	104	(29.2)	47	119.2
Total	**173,776**	**175,837**	**1.2**	**154,051**	**14.1**	**18,466**	**17,134**	**(7.2)**	**19,751**	**(13.3)**	**13,676**	**12,147**	**(11.2)**	**13,552**	**(10.4)**
EBIDTA Margin (%)						10.6	9.7		12.8		7.9	6.9		8.8	

* Tata Motors have not been included as ICICI Securities is the lead manager to the rights issue
Source: Company data, I-Sec Research

BFL – Downgrade to HOLD and earnings revision

Table 2: Earnings revision (Standalone)

(Rs mn)

	FY09E			FY10E		
	Old	**Revised**	**% Chg**	**Old**	**Revised**	**% Chg**
Operating income	26,530	25,902	(2.4)	31,450	30,198	(4.0)
EBITDA	6,102	5,880	(3.6)	7,391	7,036	(4.8)
PAT	3,241	2,851	(12.0)	4,172	3,485	(16.5)
EPS (Rs)	13.4	11.8	(12.0)	17.3	14.5	(16.5)

Source: I-Sec Research

Table 3: Earnings revision (Consolidated)

(Rs mn)

	FY09E			FY10E		
	Old	**Revised**	**% Chg**	**Old**	**Revised**	**% chg**
Operating income	54,236	54,903	1.2	62,305	62,322	0.0
EBITDA	8,457	7,564	(10.6)	10,086	8,875	(12.0)
PAT	4,020	3,267	(18.7)	5,116	3,981	(22.2)
EPS (Rs)	16.6	13.6	(18.7)	21.2	16.5	(22.2)

Source: I-Sec Research

ALL – Downgrade to HOLD and earnings revision

Table 4: Earnings downgrade

(Nos)

	FY09E			FY10E		
	Old	**Revised**	**% Change**	**Old**	**Revised**	**% Change**
Sales Volumes (nos.)						
M/HCV Goods	81,662	59,567	(27.1)	97,876	64,332	(34.3)
M/HCV Passenger	20,021	21,896	9.4	23,024	24,086	4.6
LCV	491	1,154	135.1	613	1,500	144.5
Total Volumes	**102,173**	**82,617**	**(19.1)**	**121,513**	**89,918**	**(26.0)**
Operating Income	94,900	82,486	(13.1)	118,850	92,483	(22.2)
EBITDA	9,942	6,861	(31.0)	13,340	8,491	(36.3)
PAT	5,501	3,672	(33.3)	7,311	4,269	(41.6)
EPS (Rs)	4.2	2.8	(33.3)	5.5	3.2	(41.6)

Source: I-Sec Research

Table 5: Mixed results –I-Sec Auto universe

Company	Results snapshot
Maruti Suzuki	• Recurring net profits dipped 36.5% YoY to Rs2.96bn, below our estimates of Rs3.95bn • Lower-than-estimated EBITDA margin of 7.3% (I-Sec: 9.4%). EBITDA margin contracted a sharp 540bps YoY (280bps QoQ) on: i) full impact of raw material price hike, ii) increase in royalty, power & employee costs and iii) unfavourable currency movement. • MSIL is likely to benefit from launch of *A-Star* (domestic launch in November, exports to commence in Q4FY09) and *Splash* (FY10), special initiatives targetting rural markets & corporates, implementation of pay commission recommendations, softening trend in commodities and yield improvement plans. • Maintain MSIL as our third top pick in the sector. BUY.
Bharat Forge	• Below I-Sec and Street expectations with standalone recurring net profits sharply declining 38.8% YoY to Rs415mn (I-Sec: Rs717mn) • Sharp 710bps YoY dip in EBITDA margin to 17.5%, mainly on account of 230bps YoY increase in raw material-to-sales percentage and adverse currency movement. • We have recently downgraded BFL from BUY to Hold and have lowered earnings 19-25% for FY09-11E on the back of: i) severe slowdown in key geographies of US & Europe, ii) key subsidiaries affected on account of slowdown in US/Europe and iii) lesser traction from non-auto business. Downgrade to HOLD
TVS Motor	• Recurring net profits rose 2.2x to Rs104mn (I-Sec: Rs147mn) on a low base • Lower-than-estimated EBITDA margin of 3.1% (I-Sec: 4.4%) led by deteriorating product mix (premium segment's market share dipped 500bps YoY to 17.6%) against the benefits of price hikes and operating leverage • Total revenues rose 23% YoY to Rs10.2bn on 14.5% YoY volume rise (motorcycles & mopeds up 22.9% YoY & 12.6% YoY, scooters flat) and price hikes. • We expect market share losses to continue (weak resale price, a reason) with the only respite from strong export growth. Maintain SELL
Ashok Leyland	• Recurring net profits declined 24% YoY to Rs606mn (I-Sec: Rs541mn) on account of 8.9% YoY dip in volumes, 150bps YoY contraction in EBITDA margin and rise in interest & depreciation expenses due to ongoing capex • We have lowered FY09E-10E earnings estimates 33-42% led by deterioration in macroeconomic fundamentals, slowdown in IIP growth, pruning of corporate capex plans, softening of freight rates and CV financing related issues, and believe there is downside risk to ALL's FY09E volume guidance (ALL guidance 86,000 units, 3.4% growth; I-Sec: 82,617 units, 0.7% decline) and EBITDA margin (ALL guidance flat; I-Sec: 180bps dip. Downgrade to HOLD
Hero Honda	• Strong 49.9% YoY recurring net profit growth to Rs3.06bn (I-Sec: Rs3.07bn) – 28.5% YoY volume growth, 6% YoY increase in blended realisations and 120bps YoY EBITDA margin expansion to 13.6% (I-Sec: 12.6%). • Launched four variants in mid-October to capitalise on the festive season demand and further consolidate its market leadership • We maintain HHML as the second top-pick; the company is: i) set to further increase its lead in the domestic market, leveraging significant competitive advantage, ii) most insulated from financing issues, with least dependence on financing and, iii) likely to post robust earnings CAGR of 21.4% over FY08-FY11E.
Bajaj Auto	• 4.7% YoY decline in recurring net profit to Rs2.27bn (I-Sec: Rs2.88bn) on the back of lower-than-estimated EBITDA margin of 13.5% (I-Sec: 14.8%). • 4.2% YoY volume growth (motorcycles: up 5.6% YoY; three-wheelers: flat) led by a strong 30.8% YoY exports growth • Based on lower-than-estimated recurring net profit (down 4.7% in H1FY09), production cuts November onwards and sharply deteriorating financials of KTM, we will shortly revisit our recommendation and earnings estimates. Maintain HOLD
Mahindra & Mahindra	• Results were better than expected, with recurring net profits declining 13.6% YoY to Rs2.45bn (I-Sec: Rs2.2bn) • Revenues rose 12% YoY to Rs31.4bn – 13% YoY volume growth (automotive up 16.9% YoY and farm equipment up 4.2% YoY) • Operational performance subdued (EBITDA margin dipped 670bps YoY to 7.9%) on: i) increase in input price, which led to raw material-to-sales rising 670bps YoY to 70.4% and ii) forex losses of Rs1.18bn (including Rs967mn on revaluation of foreign currency liabilities) • Other income rose a sharp 53.2% YoY on higher dividend income and on account of amalgamation of Mahindra Holdings & Finance (MHFL), which also resulted in Rs430mn exceptional profit for the company. • M&M's group companies posted mixed results – consolidated revenue growth of 20.4% YoY to Rs71bn even as reported profits declined 4.9% YoY to Rs3.7bn. • M&M would benefit owing to launch of its MPV *Ingenio* in Q3FY09, improvement in liquidity, decline in commodity prices and buoyant rural sector due to Government spending; we maintain M&M as the top pick in the sector.
Punjab Tractors	• Recurring net profits growing ~2.8x YoY to Rs273mn (I-Sec: Rs180mn) on a low base (Q2FY08 was affected post the acquisition by M&M due to restructuring, including sharp reduction in inventory & debtors). • Revenues rose 48.9% YoY to Rs3.1bn on 40.5% YoY volume growth. EBITDA margin expanded 240bps YoY and 80bps QoQ to 9.9%, driving 97% YoY growth in EBITDA. • PTL has benefitted from restructuring and integration with M&M and enjoys healthy cash & cash equivalent of ~Rs3.5bn as of end-FY08 (versus Rs0.5bn as of end-FY07). Maintain HOLD on rich valuations.

Source: I-Sec Research

Equity Research
November 5, 2008

INDIA

Banking

Respite indeed

Reason for report: Q2FY09 results review

Q2FY09 was a robust quarter for the banking sector, with the I-Sec banking universe posting strong net profit growth of 39%. Growth in advances and deposits was robust at 36% YoY and 31% YoY respectively. Operating numbers were above I-Sec and Street estimates with strong NII growth of 41% YoY, other income growth of 17% YoY and moderate 20% YoY increase in operating expenses, fuelling a robust operating profit growth of 46% YoY. Provisions were high, rising 106% in Q2FY09. Movement in NIM for I-Sec banking universe was mixed on a YoY basis, while NIMs expanded ~4-51bps sequentially. Although asset quality was stable sequentially with GNPAs falling in 1-45bps range, on an absolute basis, GNPAs increased Rs12.9bn or 5% QoQ (with State Bank of India alone recording Rs11.4bn or 10% QoQ rise). At the current price, PSU banks in our universe trade within 0.5-1.1x FY10E BV and 3.5-5.3x FY10E EPS. Private banks' valuations are at 0.6-2.6x FY10E BV and 5-17.1x FY10E EPS. State Bank of India (SBI), Punjab National Bank (PNB), Bank of Baroda (BoB) and Bank of India (BoI) are our top picks in the PSU space; we prefer IDFC in the private space.

- **Business growth momentum maintained; margins expand.** Advances and deposits growth in Q2FY09 was robust at 36% YoY and 31% YoY respectively for the I-Sec Banking universe. Advances growth for PSU banks was at 33.2% YoY, while deposits for PSU banks increased 28% YoY. CASA for most banks was down 1-2.2% QoQ. NIMs increased ~4-51bps QoQ for all banks under our coverage. NII growth was robust at 41% YoY for I-Sec Banking universe.
- **Other income growth strong; overall moderation in costs.** Non interest income increased 17% YoY for our universe (10% for PSU banks), while treasury profits were muted in Q2FY09. Other income (ex-treasury) increased an impressive 65.5%, 57% and 56% YoY for PNB, BoI and Union Bank of India (UBI) respectively. Overall, operating cost increase was moderate at 20% YoY. Cost-to-income ratio for I-Sec Banking universe declined to 46.2% in Q2FY09 from 51.1% in Q2FY08.
- **Asset quality concerns linger, provisions increased to reflect the same.** Asset quality remained stable with GNPAs falling ~1-45bps QoQ (exceptions being HDFC Bank with 7bps QoQ increase & DCB with 8bps) & NNPAs decreasing ~1-21bps QoQ (NNPAs increased 4bps QoQ each for Canara Bank & Corporation Bank and 7bps QoQ for HDFC Bank). On an absolute basis, GNPAs increased ~5% QoQ or Rs12.9bn for our universe (SBI's GNPAs increased 10% QoQ or Rs11.4bn). Provisioning increased 106% YoY for I-Sec Banking universe and 135% YoY for PSU banks (despite write-backs on investment depreciation for most banks).
- **Earnings momentum strong; maintain positive stance on the sector.** In Q2FY09, net profits grew a robust 39% driven by 46% growth in operating profits. We maintain our positive stance on the sector on the back of likely margin support from recent RBI measures and softening interest rate, which is likely to arrest significant slippages in asset quality. At current prices, PSU banks in our universe trade within 0.5-1.1x FY10E BV and 3.5-5.3x FY10E EPS. Private banks' valuations are at 0.6-2.6x FY10E BV and 5-17.1x FY10E EPS. Our top picks in the PSU space are SBI, BoB, BoI and PNB. In the private space, we prefer IDFC.

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Table 1: Q2FY09 results review

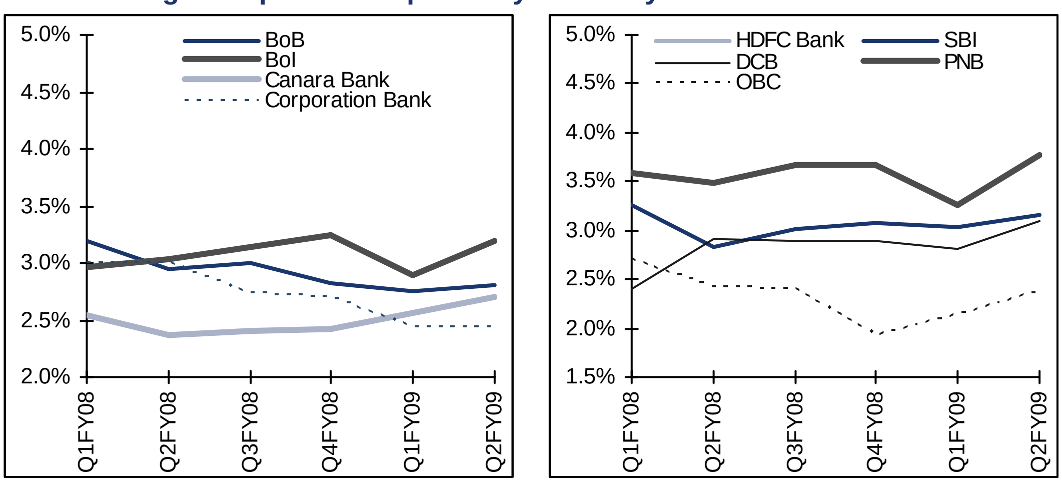
Company	NII			PPP			PAT		
(Rs mn)	**JAS09**	**YoY (%)**	**QoQ (%)**	**JAS09**	**YoY (%)**	**QoQ (%)**	**JAS09**	**YoY (%)**	**QoQ (%)**
BoB	11,338	15.5	7.3	8,456	32.7	(1.7)	3,953	20.8	6.6
BoI	13,631	38.3	15.4	12,147	44.6	13.3	7,629	79.4	35.8
Canara Bank	11,490	46.0	12.7	7,735	18.9	9.9	5,294	31.8	331.6
Corporation Bank	4,067	10.3	7.6	3,515	19.3	9.5	1,915	18.7	3.9
HDFC Bank	18,665	60.5	8.3	11,229	35.8	9.3	5,280	43.3	13.7
OBC	5,217	30.6	16.8	4,067	49.4	15.0	2,369	0.3	7.4
PNB	17,122	32.6	18.5	13,678	60.0	39.2	7,071	31.3	38.0
SBI	54,554	45.0	13.2	41,932	54.6	5.8	22,597	40.2	37.7
DCB	579	24.6	18.9	191	(40.4)	(23.8)	10	(93.1)	(81.6)
UBI	9,753	48.6	20.4	6,997	32.4	13.6	3,615	31.1	58.3
Sector aggregate	**155,549**	**41.0**	**13.2**	**118,693**	**46.3**	**10.7**	**63,761**	**39.0**	**37.4**

Source: I-Sec Research

Business growth momentum maintained; margins expand

Business growth remained strong at 33% during Q2FY09 with advances and deposits growing 36% YoY and 31% YoY respectively for the I-Sec Banking universe. Advances growth for PSU banks at 33.2% YoY was robust with higher growth in SBI and BoI at 37.8% and 35% YoY respectively, while deposits for PSU banks increased 28% YoY. Rising term deposits rates during the quarter pressurised CASA - for most banks, CASA dipped 1-2.2% QoQ (OBC being a notable outlier, with CASA increasing 30bps QoQ to 24%). Movement in NIMs was mixed with an increase of ~16-34bps YoY in some banks (BoI, Canara Bank, HDFC Bank, PNB, SBI, UBI, DCB), while there was a decline of ~4-57bps for others (OBC, Corporation, BoB). On a QoQ basis though, NIMs increased ~4-51bps for all banks under our coverage. NII growth was robust at 41% YoY for the I-Sec Banking universe. We expect margins to sustain at current levels with an upward bias, despite a surge in deposit rates and likely BPLR cuts given the recent CRR cuts from 9% to 5.5% (this releases 3.5% of the banks' net demand and time liabilities for lending).

Chart 1: Margins expanded sequentially driven by BPLR hikes



Source: I-Sec Research, Company data

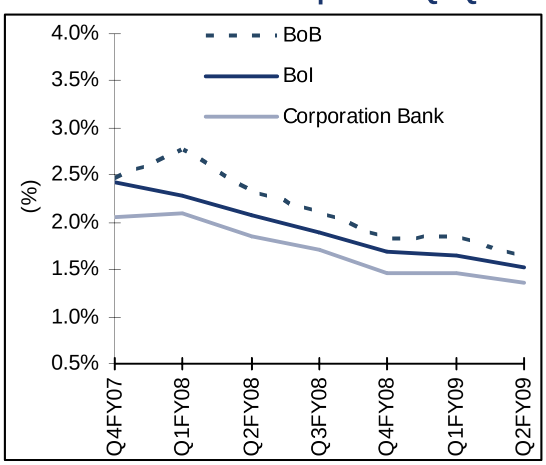
Other income growth strong, overall moderation in costs

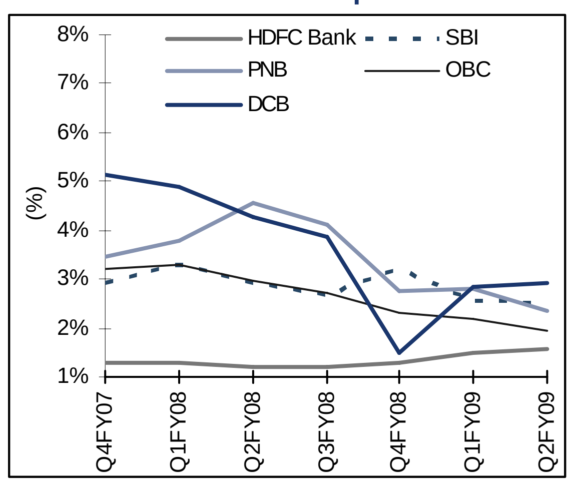
Non interest income increased 17% YoY for our universe (10% for PSU banks), while treasury profits were muted in Q2FY09. Other income (ex-treasury) increased a strong 65.5%, 57% and 56% YoY for PNB, BoI and UBI respectively. Overall, operating costs increased a moderate 20% YoY, while that for PSU banks increased 13% YoY. The low growth in PSU banks was driven primarily by moderate increase in staff costs and as implementation of core banking solution neared completion for most banks. Low growth in staff costs was largely on account of lower AS-15 related provisions during Q2FY09 vis-à-vis Q2FY08. As a result, cost-to-income ratio for the I-Sec Banking universe declined to 46.2% in Q2FY09 from 51.1% in Q2FY08. PSU banks witnessed higher decline with the ratio at 44.8% in Q2FY09 (down 6.3% YoY).

Asset quality concerns linger; provisions increased to reflect the same

Asset quality was stable with GNPAs improving ~1-45bps (exceptions being HDFC Bank with 7bps QoQ increase and DCB with 8bps) and NNPAs decreasing ~1-21bps QoQ (NNPAs increased 4bps QoQ each for Canara Bank & Corporation Bank and 7bps QoQ for HDFC Bank). However, on an absolute basis, GNPAs increased ~5% QoQ to Rs271.5bn in Q2FY09 from Rs258.6bn in Q2FY08 (SBI alone increased its GNPAs Rs11.4bn or 10% QoQ). Banks also provided higher in the quarter, with provisioning increasing 106% YoY for the Banking universe and 135% YoY for PSU banks (despite write-backs on investment depreciation for most banks in Q2FY09). In the PSU space, provisions increased aggressively for SBI, PNB and BoB by 612%, 308% and 147% YoY. We have increased loan loss provisions for all banks in our coverage to reflect rising concerns on asset quality in the system.

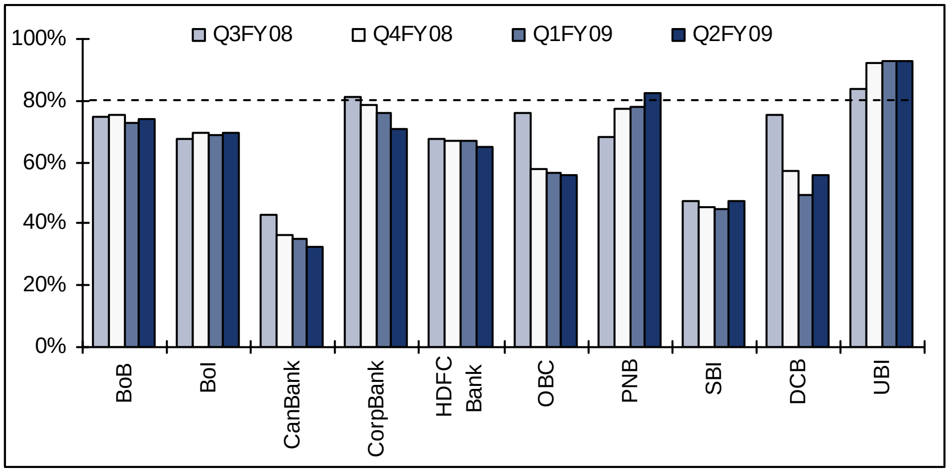
Chart 2: Gross NPAs improved QoQ with HDFC Bank and DCB as exceptions





Source: I-Sec Research, Company data

Chart 3: Provision coverage ratios increased QoQ



Source: I-Sec Research

Earnings momentum strong; maintain positive stance on the sector

The quarter saw a robust 39% growth in net profit, driven by 46% growth in operating profits. Operating costs increased a moderate 20% YoY, while provisioning remained high at Rs26.7bn for I-Sec Banking universe (versus Rs13bn in Q2FY08), as banks build up for possible deterioration in asset quality going forward. We maintain our positive stance on the sector on the back of likely margin support from recent RBI measures and on softening interest rate scenario, which in our view will arrest significant slippages in asset quality. At current prices, PSU banks in our universe trade within 0.5-1.1x FY10E BV and 3.5-5.3x FY10E EPS. Private banks' valuations are at 0.6-2.6x FY10E BV and 5-17.1x FY10E EPS. In the PSU space, SBI, BoB, BoI and PNB are our top picks. In the private space, we prefer IDFC.

Table 2: I-Sec estimates versus actuals

Company	NII			PPP			PAT		
(Rs mn)	**JAS09E**	**JAS09**	**Var (%)**	**JAS09E**	**JAS09**	**Var (%)**	**JAS09E**	**JAS09**	**Var (%)**
BoB	11,171	11,338	1.5	7,481	8,456	13.0	4,107.5	3,953	(3.8)
BoI	12,099	13,631	12.7	10,656	12,147	14.0	5,359.4	7,629	42.3
Canara Bank	9,677	11,490	18.7	6,967	7,735	11.0	3,874.6	5,294	36.6
Corporation Bank	4,006	4,067	1.5	3,247	3,515	8.3	1,922.9	1,915	(0.4)
HDFC Bank	18,461	18,665	1.1	11,487	11,229	(2.3)	5,066.1	5,280	4.2
OBC	4,625	5,217	12.8	3,375	4,067	20.5	1,817.7	2,369	30.3
PNB	15,351	17,122	11.5	10,614	13,678	28.9	6,299.7	7,071	12.2
SBI	48,867	54,554	11.6	36,779	41,932	14.0	19,786.0	22,597	14.2
DCB	572	579	1.3	337	191	(43.3)	152.1	10	(93.4)
UBI	8,576	9,753	13.7	6,655	6,997	5.1	3,029.4	3,615	19.3
Sector aggregate	**141,715**	**155,549**	**9.8**	**104,339**	**118,693**	**13.8**	**54,759.0**	**63,761**	**16.4**

Source: I-Sec Research

Table 3: Valuations

Company	Price (Rs)	Rating	Earlier target price (Rs)	Revised target Price (Rs)	Revision (%)	Upside (%)	P/E (x) FY09E	P/E (x) FY10E	P/B (x) FY09E	P/B (x) FY10E
BOB	286	BUY	405	363	(10.4)	26.8	6.5	5.2	1.0	0.9
BoI	276	BUY	425	375	(11.8)	36.0	5.5	4.9	1.3	1.1
Canara Bank	177	HOLD	200	202	1.0	13.8	4.6	3.9	0.8	0.7
Corp Bank	219	BUY	478	420	(12.1)	91.7	4.0	3.5	0.6	0.6
HDFC Bank	1113	HOLD	1,355	1,134	(16.3)	1.9	20.0	17.1	3.0	2.6
OBC	141	BUY	245	220	(10.2)	56.1	4.5	3.6	0.5	0.5
PNB	485	BUY	740	631	(14.7)	30.0	6.1	5.3	1.2	1.0
SBI	1321	BUY	1,863	1,668	(10.5)	26.3	5.9	5.2	0.8	0.8
IDFC	70	BUY	160	93	(41.9)	33.5	10.4	8.2	1.4	1.3
DCB	27	BUY	118	78	(33.9)	186.8	7.7	5.0	0.7	0.6
UBI	149	BUY	197	197	-	32.6	5.3	4.4	1.1	0.9

*Valuations for IDFC/SBI arrived at after stripping off the value of subsidiaries and associates from the price
Prices as on November 4, '08
Source: I-Sec Research

Table 4: Earnings revisions for banks with material changes

(Rs bn)

	FY09E			FY10E		
	New	**Old**	**% chg**	**New**	**Old**	**% chg**
Bank of India						
NII	52.7	50.7	4.0	62.6	61.2	2.4
PPP	47.4	44.5	6.4	56.4	53.8	4.8
Net profit	26.2	23.3	12.5	29.9	27.2	9.8
Canara Bank						
NII	42.5	40.7	4.6	49.3	47.3	4.2
PPP	34.1	33.0	3.3	39.9	39.2	1.7
Net profit	15.9	14.9	6.8	18.7	18.2	2.3
IDFC						
NII	7.5	8.1	(7.2)	9.2	10.2	(10.0)
PPP	12.6	12.9	(2.1)	15.8	16.3	(2.9)
Net profit	8.5	8.8	(3.1)	10.8	11.3	(4.1)
PNB						
NII	65.1	62.1	4.8	75.5	71.3	5.9
PPP	48.8	44.1	10.7	57.3	52.4	9.3
Net profit	25.1	23.7	6.1	28.7	27.5	4.3
SBI						
NII	205.9	193.9	6.2	234.0	224.4	4.3
PPP	164.6	149.4	10.2	188.2	179.2	5.0
Net profit	80.0	73.9	8.2	90.9	87.3	4.1
UBI						
NII	35.7	33.6	6.3	41.3	39.5	4.7
PPP	29.6	27.7	6.7	34.8	32.9	5.8
Net profit	14.2	12.8	11.1	17.1	16.2	5.3

Source: Company data, I-Sec Research

INDIA

Cement

Cost pressure unabated

Reason for report: Q2FY09 results review

I-Sec Cement universe's Q2FY09 results were largely in line with expectations. While Q2FY09 demand grew 7.5% despite political unrest, incessant rains and floods, cement prices rose 2.3% YoY, largely led by price increases in South and East. Weak demand and fear of Government intervention prevented northern players from raising prices. Cement companies also bore the brunt of lower volumes owing to capacity constraints and sharp rise in fuel prices, which peaked during Q2FY09. Unable to pass on cost escalations, all cement companies faced margin pressure, which declined 244-1418bps during Q2FY09. We believe current valuations at US$35-85/te more than factor in the impact of an impending oversupply in FY10. We remain bullish on companies likely to post impressive volume growth and achieve cost savings. Grasim and Shree Cement (SCL) are our top picks in the sector.

- **Volumes unimpressive.** While cement despatches grew 7.5% YoY in Q2FY09, most cement companies, excluding SCL, posted lower-than-industry volume growth, mainly on account of capacity constraints. SCL's volumes were aided by timely capacity additions in September '07 and March '08. Going forward, we expect UltraTech Cement (UTCL) and Grasim to post impressive volumes with cement supplies commencing from 9mnte tonne expansion in November '08.
- **Limited pricing upside.** Cement prices rose just 2.3% YoY, mainly led by South and East. Consequently, south-based companies posted higher YoY average realisation growth versus those with exposure to the northern markets. While lower demand owing to heavy rains and floods, political unrest in Jammu & Kashmir and fear of Government intervention prevented Northern players from undertaking price hike, strong demand in South and East aided price increase in two regions.
- **Cost pressures.** Cement companies faced unprecedented escalation in fuel costs in Q2FY09. Prices of imported coal peaked at ~US$190/te, which affected companies such as India Cements, UTCL, Grasim and Ambuja Cement. Even pet coke prices moved up in line with coal prices, thereby affecting SCL and JK Cements. Also, shortage in domestic linkage coal forced players to purchase coal from open markets at significant higher rates, affecting margins. North-based companies posted higher EBITDA margin contraction versus south-based peers, mainly due to limited pricing upside in the North.
- **ACC's results were better than expectations** due to one-time reversal of sales tax provision of ~Rs554mn after the Government of Uttar Pradesh (UP) passed an ordinance restoring sales tax exemption for company's Tikaria plant in UP. JK Cements' results were significantly below expectations due to lower-than-expected net realisations (with 40% of cement sales being in bulk wherein excise is higher) and significant increase in pet coke prices.
- **Valuations.** Cement companies are currently valued at EV/te in US$35-85 range, at substantial discount to replacement cost of ~US$ 125-130/te. While fundamentals seem week with oversupply likely in beginning- FY10, we see value in stocks which are likely to post volume growth and cost savings. Grasim and SCL are out top picks in the sector.

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Table 1: Q2FY09 results – Actuals versus estimates

Company	Sales					EBITDA					Rec PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
(Rs mn)	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	%Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY
ACC	17,192	18,046	5	16,788	7	3,771	4,382	16	4,486	-2	2,272	2,834	25	2,797	1
Ambuja Cement	14,161	13,873	-2	12,871	8	3,893	3,945	1	4,376	-10	2,462	2,501	2	2,971	-16
Grasim	25,519	26,853	5	24,776	8	6,261	5,792	-8	7,848	-26	3,921	4,195	7	4,998	-16
India Cements	8,768	9,455	8	7,612	24	3,063	2,901	-5	3,074	-6	1,675	1,638	-2	2,179	-25
JK Cement	3,647	3,607	-1	3,564	1	833	505	-39	1,004	-50	432	178	-59	727	-76
Shree Cement	6,055	6,292	4	4,760	32	2,089	1,828	-13	2,011	-9	1,150	1,172	2	1,062	10
UltraTech Cement	13,603	13,962	3	11,676	20	3,101	2,967	-4	3,310	-10	1,691	1,642	-3	1,859	-12
Total	**49,822**	**51,272**	**3**	**46,664**	**10**	**13,648**	**13,559**	**-1**	**14,638**	**-7**	**7,991**	**8,323**	**4**	**9,842**	**-15**

Source: Company data, I-Sec Research

Equity Research
November 5, 2008

INDIA

Construction

Marching despite interest cost ache

Reason for report: Q2FY09 results review

Top pick

IVRCL Infrastructure& Projects

The I-Sec Construction universe's Q2FY09 revenues grew a strong 48%, ahead of I-Sec and Street estimates, owing to strong topline growth for IVRCL Infrastructure & Projects and Nagarjuna Construction (NCC) at 65% and 56% respectively, despite subdued topline growth for Gammon India (GIL) at 11%. Strong H1FY09 revenue growth by IVRCL and NCC did not motivate them to change their FY09 revenue guidance of 35-40% and 30% respectively, suggesting lower growth in H2FY09. At present, the companies have strong orderbook-to-sales ratio at 3.8x-2.6x (FY08 turnover), which will largely protect the expected topline growth of FY09. The order inflows were robust at Rs40bn, Rs30bn and Rs17bn (net of suspended orders of Rs15bn) for IVRCL, NCC and GIL respectively. However, the expected tight credit availability in H2FY09 & FY10, forthcoming central and state elections, and deteriorating investments in end segments (such as buildings, metals) will lead to sluggish order inflow growth through H2FY09-FY10 and likely affect FY10-11 revenue growth. Further, we have factored in the expected expansion in working capital cycle and ~200-300bps increase in average interest cost, which will likely affect interest costs and net margins in FY09-10. During the past one year, stock prices have dipped 76-84%, versus 62% decline in BSE Cap Goods. This decline, we believe, more than factors in the expectation of weaker order inflows in FY09-10. On the contrary, there exists an upside to our estimates if there is a spurt in pre-election awards of infrastructure projects by the current Government. Our sum-of-the-parts (SOTP) valuations, without any value assigned to realty ventures, suggest a target price of Rs164, Rs70 & Rs86 for IVRCL, NCC & GIL respectively. IVRCL, with an upside of 25%, is our top pick with strong orderbook of Rs138bn and the least stress on its balance sheet owing to limited exposure to BOT projects.

- **Revenue growth to slow down in H2FY09.** IVRCL and NCC have delivered strong H1 topline growth of 51% and 41%, but have maintained FY09 guidance of 35-40% and 30% respectively. The current credit crunch is likely to impact the time taken to execute the orderbook. Accounting for higher execution time, we believe IVRCL, NCC and GIL will deliver 28%, 21% and 21% topline growth in H2FY09 (full year FY09 topline growth of 37%, 29% and 17% respectively).
- **Impact of higher interest cost will slow down PAT growth in H2FY09 and FY10.** The working capital cycle is elongating as increasingly, advances from customers are either priced higher or are unavailable. The credit crunch is likely to extend the debtor days as well. Average interest rates have increased 200-300bps, which is likely to put downward pressure on net margins of the companies. On account of lower exposure to capital-intensive BOT projects, IVRCL is best placed to deliver 18% EPS growth through FY08-11E versus 14% for NCC and 9% for GIL.
- **Valuations.** We have excluded the embedded value of the real estate venture and have given conservative multiple of 1-1.1x for the BOT infrastructure projects. Our SOTP valuations suggest a target price of Rs164, Rs70 & Rs86 for IVRCL, NCC & GIL respectively. IVRCL, with an upside of 25%, is our top pick with strong orderbook of Rs138bn and the least stress on its balance sheet owing to limited exposure to BOT projects.

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Table 1: Quarterly summary

Company (Rs mn)	Sales					EBITDA					PAT				
	Q2FY09				%	Q2FY09				%	Q2FY09				%
	Expected	Actual	% Var	Q2FY08	YoY	Expected	Actual	% Var	Q2FY08	YoY	Expected	Actual	% Var	Q2FY08	YoY
IVRCL	8,901	11,366	28	6,885	65	694	913	31	553	65	293	424	45	339	25
NCC	8,560	10,558	23	6,772	56	950	1,085	14	848	28	348	423	21	336	26
Gammon	5,674	5,132	(10)	4,603	11	403	366	(9)	412	(11)	135	27	(80)	171	(84)
Total	**23,134**	**27,056**	**17**	**18,259**	**48**	**2,047**	**2,363**	**15%**	**1,814**	**30**	**776**	**874**	**13**	**847**	**3**
Margin						9	9	-0.1	10	-1.2	3	3	-0.1	5	-1.4

Source: i-SEC Research

Table 2: Earnings change

(Rs mn)

Earnings Change	Before the Earnings Season			Post the Earnings Season		
IVRCL	**FY09**	**FY10**	**FY11**	**FY09**	**FY10**	**FY11**
Sales	49,958	64,402	85,424	50,054	59,615	68,466
EBITDA	4,645	5,993	8,121	4,759	5,665	6,574
Recurring PAT	2,214	2,868	3,912	2,224	2,572	3,069
EPS (Rs)	16.4	21.2	29.0	16.5	19.1	22.7
				0	(10)	(22)
NCC						
Sales	42,812	51,649	65,180	43,797	48,437	57,245
EBITDA	4,188	4,981	6,552	4,296	4,749	5,610
Recurring PAT	1,686	2,009	2,777	1,671	1,721	2,407
EPS (Rs)	7.4	8.8	12.1	7.3	7.5	10.5
				(1)	(14)	(13)
Gammon						
Sales	27,688	33,862	40,597	26,609	30,604	34,960
EBITDA	2,294	3,058	3,941	2,221	2,720	3,114
Recurring PAT	669	1,085	1,587	564	903	1,167
EPS (Rs)	7.7	12.5	18.3	6.5	10.4	13.4
				(15.6)	(16.8)	(26.5)

Source: I-Sec Research

Table 3: Valuation change/recommendation change

IVRCL

Date	FY10 EPS	FY10 P/E*	Rating Buy	Construction business	Investment value	Target price	Market price	Upside %
25-Sep-08*	21.2	12	BUY	255	61	316	256	24
10-Oct-08**	21.2	12	BUY	255	49	304	196	56
31-Oct-08	19.1	7.5	BUY	143	22	165	85	94

Source: I-Sec Research

NCC

Date	FY10 EPS	FY10 P/E*	Rating Buy	Construction business	Investment value	Target price	Market price	Upside %
25-Sep-08*	8.8	11	BUY	96.8	50	147	113	30
10-Oct-08**	8.8	11	BUY	96.8	50	147	83.7	76
28-Oct-08	7.52	6	BUY	53	17	70	48.8	43

Source: I-Sec Research

GIL

Date	FY10 EPS	FY10 P/E	Rating Buy	Construction business	Investment value	Target price	Market price	Upside %
25-Sep-08*	15.8	10	HOLD	157	23	180	166	8
10-Oct-08**	15.8	10	BUY	158	22	180	127	42
3-Nov-08	14.1	6	HOLD	84	2	86	74	16

Source: I-Sec Research

Equity Research
November 5, 2008

INDIA

Fertilisers

Excellent quarter, but gloomy prospects

Reason for report: Q2FY09 results review

Q2FY09 was an excellent quarter for the Fertiliser sector with I-Sec fertiliser universe posting strong net profit growth of 75.2%. Growth in total business was robust at 77.6%, driven by high trading volumes and increased input cost of DAP and urea. However, in Q2FY09, international fertiliser prices dropped significantly. Urea prices have fallen from US$800/te to below US$300/te, offsetting the benefits of the newly announced Urea Policy. We have lowered the benefits from the Urea Policy to reflect the most conservative realisations provided in the policy. DAP prices have started softening from US$1,200/te+ to US$800/te. In H1FY09, companies such as Rashtriya Chemicals Fertilizers (RCF) and Gujarat State Fertiliser gained owing to rising phosphoric acid prices; this will likely reverse going forward. We have reduced our target prices 39-50% for Chambal Fertilisers, Nagarjuna Fertilisers and RCF. The benefits from the policy changes will accrue in the long term versus expectations of immediate benefits. Further, payment in the form of bonds worth Rs140bn has created pain for fertiliser companies as these bonds generally trade at 10-12% discount to the face value.

- **Strong quarter.** Q2FY09 was a strong quarter for Fertilisers with impressive net profit growth at 75.2% and sales growing at 77.6%. Increased profitability could be attributed to inventory gain in DAP & complex fertiliser business and strong volumes in urea business. Robust rise in revenues was on account of high raw material costs (a pass through in fertilizers) and high trading volumes.

- **Policy benefits losing sheen due to falling international fertiliser prices.** International fertiliser prices have dropped significantly. Urea prices have fallen from US$800/te to below US$300/te, offsetting the benefits from the newly announced Urea Policy. We have cut down the benefits from the policy to reflect the most conservative realisation provided in the policy. DAP prices have started softening from US$1,200/te+ to US$800/te. In H1FY09, companies such as RCF and GSFC gained on account of rising phosphoric acid prices, which will likely reverse going forward.

- **Bonds play havoc.** The Government has approved supplementary budget of Rs520bn for the fertiliser subsidy, taking to the total to Rs840bn for FY09. Out of the supplementary approval, Rs140bn will be paid as bonds. Payment in bonds is a clear negative as bonds trade at 10-12% discount, which would lead to a total loss of ~Rs14bn (53% of reported industry profits in FY08, excluding unlisted companies). Assuming 10% loss on fertiliser bonds, this is clear negative for the sector.

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Table 1: I-Sec estimates versus actuals

Company (Rs mn)	Sales					EBITDA					Recurring PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY
Chambal Fertilisers	8,818	17,290	96.1	7,207	139.9	1,337	1,491	11.5	1,173	27.2	555	475	(14.4)	428	11.0
GSFC	19,493	17,357	(11.0)	10,898	59.3	1,728	2,517	45.7	1,371	83.5	890	1,589	78.6	816	94.7
RCF	21,601	26,142	21.0	14,142	84.9	826	1,541	86.6	700	120.2	418	844	101.8	390	116.2
Nagarjuna Fertilisers	7,253	8,559	18.0	6,801	25.9	823	810	(1.5)	762	6.4	103	82	(20.8)	71	14.0
Total	**57,166**	**69,348**	21.3	**39,048**	77.6	**4,713**	**6,359**	34.9	**4,006**	58.8	**1,966**	**2,990**	52.1	**1,706**	75.2

Source: I-Sec Research, Company data

Table 2: Earnings change

Earnings Change	Before the Earnings Season			Post the Earnings Season		
	FY09	FY10	FY11	FY09	FY10	FY11
Chambal Fertilisers						
Sales	44,223	43,961	44,949	42,617	37,793	38,780
EBITDA	9,804	11,892	11,741	8,478	8,713	8,596
Recurring PAT	4,150	5,792	6,008	3,156	3,253	3,331
EPS (Rs)	10.0	13.9	14.4	7.6	7.8	8.0
				(24)	*(44)*	*(45)*
RCF						
Sales	54,295	58,763	62,732	71,246	69,434	72,906
EBITDA	3,160	4,205	4,705	3,635	3,729	3,734
Recurring PAT	1,661	2,102	2,435	1,742	1,550	1,592
EPS (Rs)	3.0	3.8	4.4	3.2	2.8	2.9
				5	*(26)*	*(35)*
Nagarjuna Fertilisers						
Sales	24,158	24,930	25,787	23,395	23,927	24,926
EBITDA	3,189	3,903	4,241	3,248	3,738	4,321
Recurring PAT	232	637	946	342	483	950
EPS (Rs)	0.5	1.5	2.2	0.8	1.1	2.2
				47.4	*(24.1)*	*0.5*

Source: I-Sec Research, Company data

Table 3: Valuation table

Company	Price (Rs)	Rating	Earlier target price (Rs)	Revised target Price (Rs)	Revision (%)	Upside (%)	P/E (x)	
							FY09E	FY10E
Chambal Fertilisers	48	BUY	115	70	(39.13)	45.83	6.3	6.1
GSFC	81	BUY	163	163	-	102.23	3.1	3.2
RCF	32	HOLD	61	30	(50.82)	(7.41)	10.3	11.5
Nagarjuna Fertilisers	19	SELL	28	15	(46.43)	(20.42)	23.6	16.7

Source: I-Sec Research

Equity Research

November 5, 2008

FMCG

Well played

Reason for report: Q2FY09 results review

I-Sec FMCG universe displayed great resilience registering robust sales growth of 21.7% YoY to Rs141.9bn in Q2FY09. This was on the back of strong volume growth (except Hindustan Unilever, ITC & Godrej Consumer Products) and increased realisations. Sharp increase in raw material costs resulted in operating margins declining 164bps YoY to 19.4% in Q2FY09. Operating profits grew 12.1% YoY to Rs27.5bn in Q2FY09. Going forward, with slowdown in GDP, we believe that discretionary categories such as Paints, Jewellery, top-end skin creams and even categories such as Health Food Drinks could be under pressure. While we believe that commodity prices cooling down will be a relief to the sector, significant margin expansion may not be a reality for all categories/companies.

- **Robust volume growth (for some) & increased realisations (for most) led to strong sales growth of 21.7% YoY…** I-Sec FMCG universe registered robust growth with sales growing 21.7% YoY to Rs141.9bn. Volume growth was strong for companies such as Britannia, GSK Consumer, Asian Paints, United Spirits, Colgate Palmolive and P&G Health & Hygiene, but muted for Hindustan Unilever, ITC and Godrej Consumer Products. High sales growth in inflation environment indicates resilience of consumer spend on FMCG and is unlike to that witnessed earlier. This is primarily due to: i) robust agricultural growth and ii) decreasing share of wallet for FMCG (thus any cut down in consumer spending will be more towards discretionary products).
- **…however, OPM declined 164bps YoY due to higher raw material costs.** In spite of softening of commodity prices, most companies faced input cost pressure with sharp increase in raw material costs. This is because of inventory levels of raw materials. Operating margins for the universe declined 164bps YoY to 19.4% in Q2FY09. Operating profit increased 12.1% YoY to Rs27.5bn. Lower other income (mainly for ITC & HUL) resulted in recurring profits growing a muted 7.5% YoY to Rs19bn in Q2FY09.
- **Going forward, discretionary categories could be under stress.** With expected slowdown in GDP growth (especially in manufacturing & services) in FY09 and FY10, we expect significant negative consumer sentiment and as a result discretionary categories such as Paints, Jewellery, top-end skin creams and even categories such as Health Food Drinks could be under pressure.
- **FMCG prices have gone up, raw material prices are coming down and hence margins will increase. Not really, as we believe there are some caveats.** While we believe that cooling down of commodity prices will be a relief to the sector, significant margin expansion may not be a reality. Categories facing intense competition (Toilet Soaps, Biscuits, & Shampoo etc) will resort to higher sales promotion & advertising expenses. Categories such as Paints & Edible oil may resort to price reductions. Highly brand loyal categories (Coconut Oil, Oral Care, Tobacco, Alcohol, Skin Creams, Baby Foods etc) with little competition may benefit with the reversal of commodity prices. Our preferred picks are ITC, Marico & Nestle. Given the expected muted performance of HUL from Q4CY08E (due to high base), we do not expect any significant upside for the stock in the medium term.

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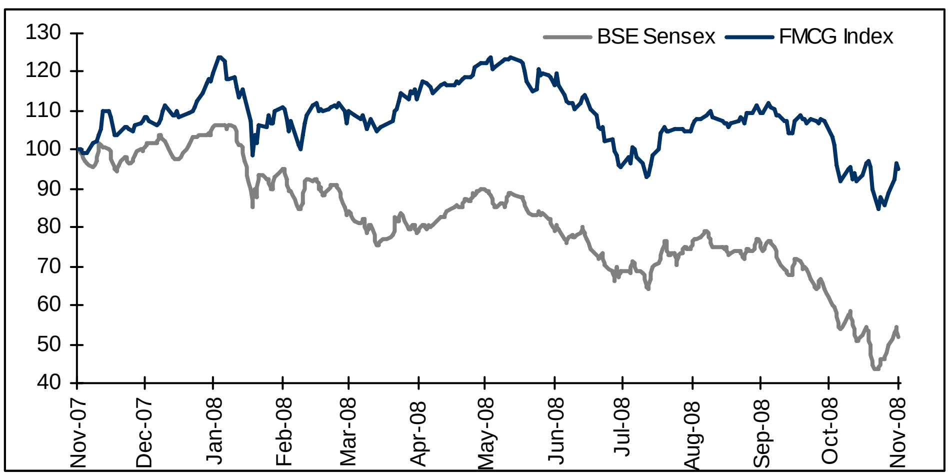
Table 1: Quarterly summary

Company	Sales					EBITDA					Recurring PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
(Rs mn)	Estimate	Actual	Var (%)	Actual	YoY	Estimate	Actual	Var (%)	Actual	YoY	Estimate	Actual	Var (%)	Actual	YoY
Asian Paints (Consolidated)	13,695	14,753	7.7	11,332	30.2	2,275	2,088	-8.2	1,816	15.0	1,435	1,324	-7.7	1,225	8.1
Britannia (Standalone)	7,971	8,385	5.2	6,588	27.3	802	755	-5.9	695	8.6	630	584	-7.3	510	14.5
Colgate Palmolive	4,239	4,125	-2.7	3,639	13.4	676	688	1.8	690	(0.3)	650	635	-2.3	547	16.1
GSK Consumer	4,184	4,225	1.0	3,516	20.2	762	664	-12.9	694	(4.3)	574	530	-7.7	505	5.0
GCPL (Standalone)	2,460	2,607	6.0	2,103	24.0	399	321	-19.5	434	(26.0)	373	323	-13.4	337	(4.2)
HUL	40,401	41,109	1.8	33,952	21.1	5,748	5,594	-2.7	4,802	16.5	4,768	4,379	-8.2	4,098	6.9
ITC	39,832	38,627	-3.0	32,701	18.1	12,174	12,154	-0.2	10,802	12.5	8,487	8,027	-5.4	7,709	4.1
Marico (Consolidated)	5,844	6,035	3.3	4,638	30.1	771	739	-4.2	648	14.0	493	471	-4.5	423	11.3
Nestle	10,444	11,076	6.1	9,088	21.9	2,030	2,100	3.4	1,959	7.2	1,273	1,323	3.9	1,197	10.5
PGHH	1,785	1,883	5.5	1,508	24.9	564	581	2.9	478	21.4	458	492	7.3	345	42.5
United Spirits	9,125	9,020	-1.2	7,526	19.9	1,805	1,790	-0.8	1,479	21.0	945	939	-0.6	802	17.1
Total	**139,980**	**141,846**	**1.3**	**116,591**	**21.7**	**28,006**	**27,474**	**-1.9**	**24,497**	**12.1**	**20,086**	**19,027**	**-5.3**	**17,698**	**7.5**

Source: I-Sec Research

Chart 2: FMCG index outperformed the BSE Sensex 50% in past 12 months



Source: Bloomberg, I-Sec Research

Media

Margins slide, though revenue growth strong

Reason for report: Q2FY09 result review

Top picks

Zee News
TV Today

Q2FY09 results for the Media sector were disappointing owing to significant escalation in costs. Revenue growth for the I-Sec Media universe was strong at 29%, while EBITDA and PAT dipped 3% YoY and 24% YoY respectively. The decline in profitability was owing to higher-than-anticipated costs escalation in programming. Revenue growth momentum was driven by advertisement and subscription, but most companies are circumspect with macroeconomic scenario deteriorating rapidly. Surprisingly, companies have not indicated any cost cutting as they continue to deny significant slow down in advertising. Realty and financial segments dragged down ad growth in Q2FY09. Print players are likely to benefit from the decline in newsprint prices as crude eases. Zee News (ZNL) and TV Today (TVTN) posted the best results with PAT growing 101% and 47% respectively. Our top buys in the sector are ZNL and TVTN.

- **Programming costs a drag for broadcasting companies.** Strong revenue growth was reported by broadcasting companies such as TVTN and ZNL. Ad revenues for Zee Entertainment (ZEEL), ex-sports, grew only a marginal 13%. While TVTN and ZNL reported healthy EBITDA margin, high programming and sports business related costs pulled down margins for ZEEL.
- **Correction in ad growth resulting in earnings revision.** We have lowered FY10E estimates for ad growth to 12% owing to the current macro environment, which largely led to earnings revision in print and broadcasting companies. In case of Balaji Telefilms (BTL) and Prime Focus (PFL), company specific issues let to steep revision in earnings.
- **Overall, current valuations reflect macro concerns.** Correction in media stocks have been in line with the dismal ad growth outlook. We continue to favour companies with strong balance sheet and market standing vis-à-vis upcoming business models in distribution or challengers in broadcasting space. Our top buys in the sector are ZNL and TVTN.

Company name	Market cap (Rs mn)	P/E (x) FY08	FY09E	FY10E	FY11E	EV/EBITDA (x) FY08	FY09E	FY10E	FY11E
Balaji Telefilms	4,629.9	4.8	5.8	5.6	5.1	1.7	2.1	2.0	1.8
HT Media	17,332.9	18.5	22.1	14.1	11.4	10.7	9.8	7.0	5.7
ENIL	7,137.7	(172.4)	(361.7)	40.3	10.7	20.1	16.1	10.8	5.0
TV Today	3,886.0	8.9	7.7	7.1	6.4	3.7	2.8	2.6	2.4
Zee News	9,350.8	25.2	16.5	13.5	9.5	13.9	10.0	8.0	5.6
Prime Focus	2,773.5	9.2	9.3	8.5	6.8	3.3	2.5	2.2	1.9

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Table 1: Q2FY09 results review

Company (Rs mn)	Sales					EBITDA					Recurring PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY
Balaji Telefilms	947	1,034	9	779	33	318	231	-27	330	-30	212	181	-15	263	-31
HT Media	3,287	3,342	2	2,810	19	513	399	-22	485	-18	284	163	-43	319	-49
ENIL	1,275	1,099	-14	858	28	130	-60	-146	-70	-15	-24	-182	658	-172	6
TV Today	580	669	15	464	44	95	122	28	78	55	63	79	24	54	47
Zee News	1,185	1,277	8	776	65	244	212	-13	105	102	146	115	-21	57	101
Prime Focus	930	892	-4	584	53	242	185	-24	189	-2	119	53	-56	95	-44
Isec Set	**10,337**	**10,400**	**1**	**8,044**	**29**	**1,913**	**1,468**	**-23**	**1,507**	**-3**	**1,013**	**636**	**-37**	**836**	**-24**

Source: Company data, I-Sec Research

Table 2: Earnings changes

(Rs mn)

Balaji Telefilms *	Pre		Post		% change	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	4,390	5,284	4,390	4,955	0.0	-6.2
EBITDA	1,073	1,543	1,123	1,157	4.7	-25.0
Recurring PAT	759	1,086	793	821	4.5	-24.4
EPS (Rs)	11.6	16.7	12.2	12.6	4.5	-24.4
HT Media	**Pre**		**Post**		**% change**	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	14,749	17,242	14,506	16,551	-1.6	-4.0
EBITDA	1,824	2,781	1,864	2,586	2.2	-7.0
Recurring PAT	954	1,566	847	1,332	-11.2	-15.0
EPS (Rs)	4.1	6.7	3.6	5.7	-11.2	-15.0
ENIL	**Pre**		**Post**		**% change**	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	6,676	8,650	5,642	6,616	-15.5	-23.5
EBITDA	1,420	2,502	553	824	-61.1	-67.1
Recurring PAT	651	1,304	(20)	177	-103.0	-86.4
EPS (Rs)	13.7	27.4	(0.4)	3.7	-103.0	-86.4
TV Today	**Pre**		**Post**		**% change**	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	3,009	3,583	2,849	3,224	-5.3	-10.0
EBITDA	804	1,063	820	894	2.0	-15.9
Recurring PAT	502	670	512	560	2.1	-16.4
EPS (Rs)	8.6	11.5	8.8	9.7	2.1	-16.4
Zee News	**Pre**		**Post**		**% change**	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	5,017	6,699	5,252	6,814	4.7	1.7
EBITDA	884	1,327	946	1,181	7.0	-10.9
Recurring PAT	533	792	566	691	6.2	-12.7
EPS (Rs)	2.2	3.3	2.3	2.9	6.4	-12.7
Prime Focus	**Pre**		**Post**		**% change**	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Sales	2,832	3,343	3,731	4,040	31.8	20.8
EBITDA	995	1,236	937	1,063	-5.8	-14.0
Recurring PAT	413	514	298	328	-28.0	-36.2
EPS (Rs)	32.5	40.4	23.4	25.8	-28.0	-36.2

* For Balaji Telefilms, the earnings change was done before Q2FY09 results on announcement of suing of Star Group

Source: Company data, I-Sec Research

Table 3: Recommendation changes

	Recommendation		Price Target		
	Pre	**Post**	**Pre**	**Post**	**Comments**
Balaji Telefilms *	Buy	Hold	209	107	Acrimony with Star Group to lead to lower realisations and margins
HT Media	Buy	Buy	141	100	Factoring in slowdown and management's inability to contain costs
ENIL	Buy	Buy	652	211	Slowdown with high fixed costs to lead to extended losses in OOH
TV Today	Buy	Buy	95	91	Corrections in valuation owing to overall market condition
Zee News	Strong Buy	Strong Buy	67	58	Corrections in valuation owing to overall market condition
Prime Focus	Buy	Hold	1107	217	US and UK operations to bleed given slowdown and risks of FCCB non-conversion

* For Balaji Telefilms, the recommendation change was done before Q2FY09 results on announcement of suing of Star Group

Source: Company data, I-Sec Research

Equity Research

November 5, 2008

INDIA

Metals

Farewell to a robust H1; H2 subdued

Reason for report: Q2FY09 results review

In Q2FY09, I-Sec metals universe witnessed robust topline and EBITDA growth of 47.3% YoY and 65.4% YoY respectively, despite volumes dipping 7.2% YoY due to realisations rising 36-60% YoY & 0.3-13% QoQ across products and delayed impact of surging coking coal price (on high Q1 inventories). As Q2 progressed, higher Chinese exports at ~5mnte and ~6mnte in July and September respectively on lower domestic demand (from Olympics) and robust HRC export realisations at US$1,200/te was replaced by global slowdown with credit crisis affecting the US and EU, leading to ~40% fall in global steel prices by October. We believe current valuations of global and domestic steel stocks more than discount the weakness in steel price and demand uncertainty. With high net cash at Rs31/share (Rs130bn) and intrinsic value (share price at FY10E BV), Steel Authority of India (SAIL) is clearly the top pick in the sector.

- **Last quarter of sequential price growth.** Q2FY09 spot realisations surprised positively as domestic manufacturers passed on probably the last of price hikes in June at ~US$110/te, despite stringent Government control (with export duties on semi-finished products being imposed in June). Price hike was rolled back in end-July. Also, with global steel prices dipping in mid September, domestic billets and long product prices declined 40% from peaks. With increased possibility of imports, domestic producers finally resorted to Rs4,000-6,000/te cut in steel price, effective November, across product categories. While spot-contract mix will determine the extent of drop in blended net sales realisation, any prolonged weakness in spot market will reflect in contract realisations.
- **Raw material, the key to margin stability.** While contract price hike in coking coal was muted in Q2 owing to increased inventories of either coal or finished steel (JSWS, SAIL), Q3FY09 will reflect the full impact. As September witnessed building up of ~73mnte iron ore inventory at Chinese ports (equivalent to 50days of consumption versus normal 5-10days), spot market pricing dipped 60% from peak, resulting in margin relief for unintegrated producers such as JSW Steel, which purchases 56% of its iron ore requirements in spot. Also, as US scrap prices touch US$150/te in November (highs of US$700/te) players can replace hot metal with scrap as charge in blast furnace, resulting in reduced cost pressure. Key beneficiary from subdued input cycle will be JSW Steel.
- **Increased liquidity to aid inventory restocking in supply chain.** Q2, a period of interest rate resets for most domestic steelmakers, witnessed 4-5% point increase in working capital borrowing due to tight inter-bank liquidity. With dealers struggling with liquidity and sedate order inflows, inventory build-up for most steelmakers was significant. With the current CRR, SLR and repo rate cut, and infusion of ~Rs400bn in inter-bank system, we expect better supply chain response November onwards.
- **Possible reimposition of import duties to curtail low-priced Chinese imports.** As domestic Chinese coke price reduced to ~US$350/te (high of US$650-700/te), China's domestic cost curve also shifted downwards. With subsidised energy prices, delay in new Chinese export taxes (previously scheduled in August), and low domestic prices, exports will likely increase to India. While current flat rolled products do not attract any import duty, the Government will have to act expediently in increasing duties to at least 10% with reimposition of excise CVD on longs. The Government has been supportive of the industry with recent removal of export taxes (from 15% to nil for semi finished and longs) to help domestic prices stay competitive with falling global prices.

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Price outlook and valuations

Since US and EU steel prices have declined sharply and US scrap prices have touched lows of US$125/te, an 82% retracement in two months, further downside will be limited. Supply-side response has been quick, with varying degrees of production cut-backs being announced by global producers, removing ~100mnte of annualised capacity from the system. European producers (operating flexible EAF mills) are currently working at 70% utilisation. Domestic prices, which are linked to import parity of international prices, have been supported by a strong dollar. While short-term visibility remains weak, the recent sharp correction in steel prices would limit further downside. We believe that the current valuations of global and domestic steel stocks more than discount the steel price weakness and demand uncertainty.

We prefer stocks with lower leverage and comfortable cash reserves. With current net cash of Rs31/share (130bn) and intrinsic value (share price equal to FY10E BV), SAIL is clearly the top pick in the sector.

Table 1: Quarterly steel volumes

(mnte)

Volumes	Q2FY09	Q1FY09	% Chg QoQ	Q2FY08	% Chg YoY
SAIL	2.65	2.65	-	3.16	(16.1)
JSW Steel	0.84	0.82	2.4	0.81	3.7
Jindal Steel (Metallics* +Steel products)	0.55	0.47	17.7	0.49	12.5
Total **	5.26	5.09	3.2	5.67	(7.2)

* Pig iron and sponge iron
** Including all steel stocks under I-Sec coverage
Source: Company data, I-Sec Research

Table 2: Quarterly realisations

(Rs/te)

	Q2FY09	Q1FY09	% Chg QoQ	Q2FY08	% Chg YoY
SAIL	41,742	41,620	0.3	28,980	44.0
JSW Steel	46,569	41,211	13.0	29,390	58.5

Source: Company data, I-Sec Research

Table 3: Realisations – Actuals versus assumptions

(Rs/te)

	Net Sales Realisation (H1FY09)	Post Revision Prices (H2FY09E)	Full year Realisations (FY09E)	I-Sec FY09 estimates	Discount in assumptions from current prices (%)
JSW Steel	43,890	38,890	41,390	39,870	3.7
SAIL	41,681	36,681	39,181	38,463	1.8

Source: Company data, I-Sec Research

Table 4: Quarterly results – Estimates versus actuals

Company	Sales					EBITDA					Rec PAT				
	Q2FY09			Q2FY08	%	Q2FY09			Q2FY08	%	Q2FY09			Q2FY08	%
(Rs mn)	Expected	Actual	% Var	Actual	YoY	Expected	Actual	% Var	Actual	YoY	Expected	Actual	% Var	Actual	YoY
SAIL	123,830	122,386	-1	91,635	34	32,783	36,794	12	21,103	74	21,928	26,775	22	11,815	127
JSW	38,577	42,692	11	25,831	65	8,524	10,904	28	7,359	48	4,248	5,858	38	4,387	34
JSPL Standalone	18,024	22,161	23	12,690	75	7,173	8,551	19	5,584	53	4,512	5,606	24	2,952	90
JSPL Consolidated	22,481	28,699	28	NA		9,963	10,272	3	NA		5,584	8,752	57	NA	
Total*	**250,802**	**262,284**	**4.6**	**178,007**	**47.3**	**81,963**	**89,800**	**9.6**	**54,300**	**65.4**	**49,848**	**61,354**	**23.1**	**30,722**	**99.7**

*Including all steel stocks under I-Sec coverage
Source: Company data, I-Sec Research

Equity Research
November 5, 2008

Top pick

Cairn

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INDIA

Oil&Gas and Petrochemicals

Gas to drive growth

Reason for report: Q2FY09 results review

The I-Sec oil & gas universe posted 27% YoY earnings decline with 34.2% YoY revenue growth in Q2FY09, primarily due to Rs32.2bn net loss in Hindustan Petroleum (HPCL). Excluding HPCL, earnings for I-Sec oil & gas universe grew 7.6% YoY. Higher subsidy burden for Oil & Natural Gas Corporation (ONGC) led to lower earnings. Higher profitability from LPG on lower subsidy burden and increased realisations propped GAIL's earnings growth to an impressive 79% YoY. Higher refining sales and improved oil & gas profitability led to 7.4% YoY growth in Reliance Industries' (RIL) earnings. Inventory losses, lower refining margins and higher interest costs resulted in net losses for HPCL. Earnings for gas distribution companies such as Gujarat Gas Company (GGCL) and Indraprastha Gas (IGL) grew an impressive 36.4% & 17.1% respectively. Cairn's recurring net income was at Rs3.1bn (I-Sec: Rs1.6bn) on higher other income at Rs1.2bn income from investments and forex gains of Rs873mn.

- **Higher crude prices dented oil marketing companies' profitability.** High crude prices led to severe liquidity crunch and dented oil marketing companies' (OMCs) profits as bonds are difficult to sell and OMCs were forced to sell petro-products at discount. Also, delay in bond allotment led to cash crunch with OMCs, implying significantly higher borrowings and interest rates.
- **Upstream subsidy sharing concerns slightly ameliorated.** Though the overhang of unallocated Rs400bn subsidy burden on upstream companies (ONGC, GAIL) receded, we are sceptical on ONGC's earnings and valuations due to *ad hoc* Government policy.
- **GRMs under strain on higher inventory losses.** With greenfield refining capacities in India, China and Saudi Arabia, and continued demand concerns, refining margins will likely be pressurised (but unlikely if the winter is not severe in the US).
- **GAIL & GGCL to maintain earnings growth** on increasing gas supplies in India and possible upside to earnings. GAIL will benefit from lower under-recoveries in FY09, and increased gas transportation and sales volumes from H2FY10 through phase 1 gas pipelines of National Gas Grid (NGG). GGCL may be the key beneficiary of the proposed gas allocation policy and initial supplies from the KG Basin, though uncertainty prevails regarding gas supplies.
- **RIL's complexity to prop profits.** RIL's earnings and valuations are expected to be strained on global demand slowdown, leading to lower petchem and refining profits. However, higher complexity, delays/cancellation of future expansions and shutdowns of simple refiners and crackers will support complex margins. We will revisit our estimates shortly to factor in changed global scenario, and marginal delays in KG D6 and Reliance Petroleum (RPL) production versus earlier estimates.
- **Cairn, our top pick.** Cairn is currently trading at long-term implied crude price of US$41/bl. The stock offers 15% upside to our bear-case valuation of Rs163/share and 84% upside to our fair value at Rs261/share.

Table 1: Quarterly summary

(Rs mn)

Company	Sales					EBITDA					PAT				
	JAS'08			JAS'07		JAS'08			JAS'07		JAS'08			JAS'07	
	Expected	Actual	% Var	Actual	% chg YoY	Expected	Actual	% Var	Actual	% chg YoY	Expected	Actual	% Var	Actual	% chg YoY
Cairn #	3,745	3,206	(14.4)	2,658	20.6	2,629	2,483	(5.6)	1,865	33.1	1,575	3,145	99.7	1,253	150.9
GAIL	58,938	61,726	4.7	45,289	36.3	14,276	14,748	3.3	8,783	67.9	9,058	10,235	13.0	5,725	78.8
GUJGAS#	3,310	3,246	(1.9)	2,686	20.8	654	593	(9.3)	491	20.7	402	393	(2.1)	288	36.4
HPCL	347,735	313,011	(10.0)	218,794	43.1	1,326	(25,438)	NA	2,771	NA	(4,112)	(32,189)	NA	1,559	NA
IGL	2,022	2,152	6.4	1,741	23.6	865	851	(1.7)	750	13.4	495	502	1.4	429	17.1
ONGC #	176,527	148,277	(16.0)	138,374	7.2	115,180	85,054	(26.2)	84,153	1.1	65,073	48,084	(26.1)	50,167	(4.2)
RIL #	421,124	447,870	6.4	320,430	39.8	61,964	64,740	4.5	57,810	12.0	41,778	41,220	(1.3)	38,370	7.4
Sector Total	1,013,402	979,488	(3.3)	729,973	34.2	196,894	143,030	(27.4)	156,624	(8.7)	114,268	71,390	(37.5)	97,792	(27.0)

#-consolidated numbers; NM – Not meaningful as numbers are negative; JAS – July, August & September quarter
Source: I-Sec Research

Table 2: H1FY09 industry under-recoveries

(Rs bn)

	H1FY09	Sharing (%)	% chg (YoY)	H1FY08	Sharing (%)
Gross under-recoveries	929.2			262.3	
Sharing of under-recoveries					
Upstream	259.3	27.9	196.8	87.4	33.3
Oil bonds issued by Govt. of India	449.7	48.4	299.5	112.6	42.9
Downstream marketing companies	220.2	23.7	253.4	62.3	23.8
Total	929.2	100	254.3	262.3	100

Source: I-Sec Research

Table 3: Margin summary

(% change)

	Q2FY09 Margin/Price	% chg (YoY)	% chg (QoQ)	Key companies
PP - Naphtha spread (Rs/tonne)	45,758	13.1	25.6	RIL, Bloomberg
PE - Naphtha spread (Rs/tonne)	40,798	1.0	9.8	RIL, Bloomberg
MEG - Naphtha spread (Rs/tonne)	2,491	(86.7)	(74.1)	RIL, Bloomberg
PET - Naphtha spread (Rs/tonne)	35,283	2.6	7.6	RIL, Bloomberg
PTA - Naphtha spread (Rs/tonne)	7,224	(51.7)	26.7	RIL, Bloomberg
HSD retail margins (Rs/litre)	(13.7)	NM	NM	HPCL, BPCL, RIL
MS retail margins (Rs/litre)	(7.0)	NM	NM	HPCL, BPCL, RIL
Gross refining margins (US$/bl)	6.5	80.6	2.5	HPCL, BPCL, RIL
Oil price (IPE Brent) (US$/bl)	116.2	54.0	(5.9)	ONGC

NM – Not meaningful as the base period numbers are negative
Source: RIL, Bloomberg, I-Sec Research

Table 4: Earnings change

(% change)

Cairn India	Before Earnings season				Post Earnings season			
	CY08E	CY09E	CY10E	CY11E	CY08E	CY09E	CY10E	CY11E
Sales	28,531	45,101	129,466	126,673	22,576	32,055	124,896	129,601
EBITDA	8,651	28,974	107,112	105,636	6,476	19,869	103,224	108,840
Net Income	4,193	21,039	89,097	90,207	2,726	13,059	85,082	92,384
EPS (Rs)	2.2	11.1	47.1	47.7	1.4	6.9	45.0	48.8

Source: I-Sec Research

Equity Research

November 5, 2008

Top picks

Glenmark Pharma
Sun Pharma

Pharmaceuticals

Standing tall

Reason for report: Q2FY09 results review

The aggregate recurring net profit for I-Sec Pharma universe climbed 33% YoY, excluding the loss from Ranbaxy. This was broadly in line with our estimates. Powered by strong growth in Sun Pharma (SPIL) and Glenmark (top two BUYs), I-Sec Pharma universe achieved 14% YoY rise in consolidated recurring net profit to Rs11.2bn on the back of 26% rise in sales and 26% surge in EBITDA. However, this performance was significantly dented by Ranbaxy's shocking results with Rs49mn loss (I-Sec & Street expectations at Rs1.5-1.7bn PAT). EBITDA margin expanded 240bps to 25.7% versus only 12bps to 22.07% including Ranbaxy. Rising interest cost and forex translation loss have partly offset the gains at EBITDA level.

- **As expected, our top BUYs delivered the highest PAT growth.** Our top two BUYs, Glenmark and SPIL's Q2FY09 results were in line with estimates. Glenmark's recurring consolidated net profit climbed 43% to Rs1.1bn. SPIL recorded a stellar 135% jump in consolidated recurring net profit to Rs5.1bn and contributed a whopping 40% to I-Sec's aggregate PAT, powered by lumpy profits from exclusivity for its generic *Protonix* in the US. Cadila, Aventis and GSK Pharma reported better-than-expected results, while Cipla, Dr. Reddy's Laboratories (DRL) and Alembic reported below-expected results.

- **Glenmark & SPIL offer better risk-return profile.** Until October 7, '08 (when we released our Q2FY09 results preview note, '*Unruffled amidst turbulence*'), our top BUYs, Glenmark and SPIL were holding up well (up 15% and 61% versus Sensex's 42% decline YTD until then). However, their stock prices have come down since then amidst accelerated meltdown in global equities (including India) and fundamental negative news (Eli Lilly stopping clinical trials on Glenmark's GRC6211 and SPIL's 72% US-based subsidiary Caraco receiving a warning letter from the US FDA). With expected slowdown in global economic growth, pharma business will likely be least affected. Our top BUYs, Glenmark and SPIL (the best in the business) have consistently delivered market-beating RoI in the past, and are likely to deliver strong RoI of 25-40% in the coming 6-9 months. We expect 25-35% annualised RoI in the next 3-4 years.

Company	Results vs. expectations	Earnings
Alembic	Below expectations	Likely to be cut
Aventis	Above expectations	Maintain or marginal cut
Cadila	Above expectations	Upgrade likely
Cipla	Below expectations	Likely to be cut
Dr. Reddy's	Below expectations	Potential to cut, wait for AOK tender in Germany
Glenmark	In line	Maintain
GSK Pharma	Above expectations	Upgrade likely
Ranbaxy	Below expectations	Sharp cut likely
Sun Pharma	In line	Likely upward revision
Wockhardt	Below expectations	Already cut 6-9%; Downgraded to HOLD from BUY

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Table 1: Q2FY09 results – Actuals versus estimates

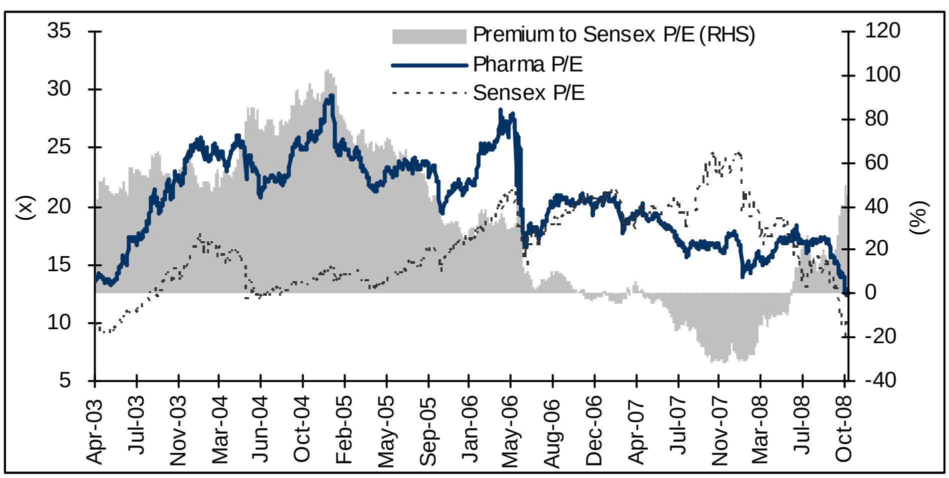
Company	Sales				EBITDA				Rec PAT			
	Q2FY09				Q2FY09				Q2FY09			
(Rs mn)	Expected	Actual	% Var	% YoY	Expected	Actual	% Var	% YoY	Expected	Actual	% Var	% YoY
Alembic	3,394	3,492	3	11	643	605	-6	-1	430	375	-13	-18
Aventis	2,561	2,649	3	10	452	479	6	7	379	446	18	21
Cadila	7,161	7,586	6	22	1,585	1,525	-4	16	946	1,068	13	31
Cipla	12,103	13,176	9	25	2,838	3,155	11	41	2,194	1,514	-31	-21
Dr. Reddy's	15,084	15,904	5	25	2,601	2,436	-6	27	1,261	1,113	-12	31
Glenmark	5,112	5,597	9	46	1,678	1,694	1	40	1,207	1,113	-8	43
GSK Pharma	4,483	4,788	7	5	1,590	1,791	13	17	1,157	1,320	14	20
Ranbaxy	19,295	18,884	-2	14	3,118	1,440	-54	-49	1,783	-49	-103	-103
Sun Pharma	9,991	12,086	21	74	5,308	5,380	1	123	4,953	5,128	4	135
Wockhardt	9,143	9,235	1	25	2,351	2,108	-10	16	988	650	-34	-40
Total	**88,327**	**93,398**	**6**	**26**	**22,163**	**20,613**	**-7**	**26**	**15,298**	**12,678**	**-17**	**14**
Excluding Ranbaxy	**69,032**	**74,514**	**8**	**29**	**19,045**	**19,173**	**1**	**42**	**13,515**	**12,727**	**-6**	**33**

Source: I-Sec Research

Pharma trades at premium in sluggish environment

Historically, Indian pharma stocks, in general, have performed better compared with the broader market (such as the Sensex) during bad times (Chart 1). The I-Sec Pharma universe's one-year forward P/E commanded a premium of 25-50% over Sensex P/E during April '03 (when equities started moving up) to mid-'06. During the scorching bull-run (mid-'06 to December '08), Pharma traded mostly at discount. Again following the historic trend, Pharma sector is trading at a premium (currently at 20%), concurrent with the financial tsunami in '08. With consensus expectations of slowdown in the economic growth globally, it will be fair to assume that the Indian pharma sector will command a premium as seen in the past.

Chart 1: I-Sec Pharma P/E versus Sensex P/E



Source: Company data, I-Sec Research

Until October 7, '08 (when we released our Q2FY09 results preview note, *Unruffled amidst turbulence*), our top BUYs, Glenmark and SPIL were holding up well (up 15% and 61% versus Sensex's 42% decline YTD until then). However, their stock prices have dipped a sharp 25-30% MoM, amidst accelerated meltdown in global equities (including India) and fundamental negative news (Eli Lilly stopping clinical trials on Glenmark's GRC6211 and SPIL's 72% US-based subsidiary Caraco receiving a warning letter from the US FDA). With expected slowdown in global economic growth, pharma business will likely be least affected. However, our investment *mantra* remains pick & choose and, hence, we reiterate Glenmark and SPIL as our top two BUYs on the back of the companies having consistently delivered market-beating RoI in the past. We expect the companies to deliver strong RoI of 25-40% in the coming 6-9 months. We estimate annualised RoI of 25-35% in the next 3-4 years.

New US president favours generics

With Democrat candidate, Barack Obama, becoming the forty fourth President of the US, his promise of reducing healthcare costs up to US$2,500 for a typical American family will come by way of:

- Lower drug costs by allowing imports of safe medicines from other developed countries, **increasing the use of generic drugs** in public funded programmes and **taking on drug companies that block cheaper generic medicines in the market**
- Hospitals collecting and reporting health care cost and quality data
- Reducing the costs of catastrophic illnesses for employers and employees
- Reforming the insurance market to increase competition by taking on anticompetitive activity that drives up prices without improving quality of care

Equity Research
November 5, 2008

INDIA

Power Transmission/Equipment

On track

Reason for report: Q2FY09 results review

Q2FY09 results were in line with our expectations with aggregate PAT for I-Sec transmission & distribution (T&D) universe rising 21% YoY to Rs1.24bn, mainly owing to strong 30% surge in net revenues to Rs19.4bn (due to robust orderbook). We expect strong order rebound from utilities, mainly Power Grid Corporation (PGCIL) from H2FY09 – Q2FY09 witnessed order ramp-up including tenders from Sasan and Mundra ultra mega power plants. Continued economic slowdown (implying postponement of capex by corporates) could affect order inflow for transformer companies. EBITDA margin contracted 130bps to 12.4% due to rise in commodity prices. However, the recent fall in commodity prices & oil, if sustained, will be margin-accretive for T&D companies. Higher interest cost capped overall profitability, mainly for transmission companies.

- **Strong orderbook boosted growth** KEC International (KECI) and Jyoti Structures (JSL) reported strong sales on the back of robust orderbook and higher execution, but margin pressure and increased interest cost capped the profit growth. KECI and JSL reported profit growth of 60% (excluding the translation loss of Rs248mn) and 19% respectively. Kalpataru Transmission (KPTL) was the laggard in the transmission space with net profits declining 31% YoY to Rs223mn owing to margin pressure and higher interest cost. Voltamp Transformers (VTL) and Transformers & Rectifiers (T&R) reported strong profit growth of 48% and 45% respectively owing to robust sales for the latter and margin expansion for the former. Pricing pressure owing to new supply and order inflow for transformer companies will be the key factors to watch for in the rest of FY09.
- **High revenue visibility in H2FY09.** We expect strong order rebound from utilities, mainly Power Grid Corporation (PGCIL) from H2FY09 – Q2FY09 witnessed order ramp-up, including tenders from Sasan and Mundra ultra mega power plants. Further, PGCIL is confident of incurring Rs80bn capex in FY09E, in line with estimates. We believe robust orderbook and high visibility of order inflow will ensure strong revenue growth for the top three transmission companies until FY10. While order enquiries remain robust for transformer companies, concerns on oversupply will remain for the next few quarters. Besides, the recent fall in prices of commodities and oil has come as a breather for T&D companies; prices easing further, if sustained, will be margin-accretive in H2FY09.
- **Inexpensive valuations.** The I-Sec T&D universe has underperformed the BSE Capital Goods a significant 18%, offering value at current levels. In transmission, we prefer companies with a judicious balance of domestic & export markets and diversified business model with low risk profile. However, based on superior earnings growth and higher upside potential, JSL remains our top pick in transmission; in transformers, margin-driven earnings growth will drive valuations.

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Table 1: I-Sec estimates versus actuals

Company (Rs mn)	Sales					EBITDA					Rec PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY	Expected	Actual	% Var	Actual	% YoY
KEC international	6,481	8,065	24	5,630	43	810	814	0	673	21	364	426	17	266	60
Kalpataru Power	4,931	4,326	-12	3,876	12	614	523	-15	529	-1	347	223	-36	322	-31
Jyoti Structures	4,097	4,208	3	3,182	32	488	501	3	398	26	214	201	-6	170	19
Voltamp Trans.	1,689	1,700	1	1,481	15	319	380	19	277	37	214	273	28	185	48
Transformers & Rectifiers	844	1,123	33	726	55	129	183	42	157	16	89	118	33	81	45
Total	**18,041**	**19,421**	**7.6**	**14,894**	**30**	**2,361**	**2,400**	**1.7**	**2,034**	**18**	**1,227**	**1,241**	**1.2**	**1,024**	**21**
EBIDTA Margin (%)						13.1	12.4	-0.7	14	-1.30	7	6	-0.4	7	-0.5

Source: I-Sec Research

Equity Research

November 5, 2008

Real Estate

Lacklustre earnings

Reason for report: Q2FY09 results review

I-Sec Real Estate universe posted negative growth in Q2FY09. Revenues dipped 16% YoY & 1% QoQ. However, PAT grew a benign 4% YoY and was flat QoQ. Realty companies struggled in Q2FY09 given the difficult operating macro environment of rising home loan rates, tight liquidity and reduced transaction volumes. Higher financing costs also affected margins. Historically, second half has been the peak season; however, we expect incremental sales to be sluggish in H2FY09. Though valuations have corrected significantly, we believe downside risk to earnings is still high. We have lowered earnings estimates for Housing Development Infrastructure (HDIL), Lanco Infratech, Sobha Developers & Peninsula Land post Q2FY09 results. We have significantly lowered NAV estimates for I-Sec Realty universe. Our top picks in the sector are HDIL & Lanco.

- **Continued negative trend in transaction volumes and prices.** Realty witnessed tepid transactions and drop in selling prices (or discounts as freebees and stamp duty exemptions). High interest rate scenario has further moderated demand from home buyers, who are deferring purchase plans. Interest rate tightening has dried up liquidity for developers, leading to additional downward pressure. Private equity deals have also slowed down considerably due to valuation concerns. Q2FY09 saw moderation in demand across segments. We believe that additional supply expected in the next few quarters may further soften prices.

- **Revenues & margins declined.** Real estate companies posted muted revenue and PAT growth owing to lower transaction volume and margins. On a sequential basis, the companies posted an overall 1% and 2% decline in revenue and EBITDA respectively. Realty companies reported drop in margins owing to higher input and financing cost. PAT margins declined ~10% YoY (39% in Q2FY09 against 48% in Q2FY08) due to higher interest cost and higher debt levels. We have significantly lowered our earnings estimates to address macro economic changes.

- **Significant execution risk.** Q2FY09 witnessed few project launches as developers deferred launches and extended timelines for current projects under execution. Higher costs and sluggish sales have dented working capital requirements for ongoing projects. We expect this to lead to further stress on cashflows.

- **Change in valuations assumptions.** We have lowered our NAV estimates for I-Sec Realty universe. We have assumed ~100-200bps increase in cost of equity and cost of debt, ~100-150bps increase in cap rates for larger companies, rationalised selling prices/lease rentals, delayed development pipelines and factored in execution delays. Our top picks in the sector are HDIL and Lanco Infratech.

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Table 1: Quarterly summary

Company	Sales					EBITDA					PAT				
	Q2FY09					Q2FY09					Q2FY09				
	Expected	Actual	% Var	Q2FY08	% YoY	Expected	Actual	% Var	Q2FY08	% YoY	Expected	Actual	% Var	Q2FY08	% YoY
DLF	39,239	37,444	-5	32,500	15	24,658	22,170	-10	22,640	-2	19,510	19,354	-1	20,180	-4
Unitech	11,130	9,831	-12	10,135	-3	5,814	6,092	5	5,276	15	3,768	3,589	-5	4,101	-12
HDIL	6,317	4,776	-24	4,649	3	4,532	2,706	-40	2,561	6	2,834	2,657	-6	2,294	16
Lanco	9,166	12,790	40	6,467	98	1,413	1,590	13	1,209	31	557	516	-7	609	-15
Sobha	3,273	2,934	-10	3,254	-10	917	936	2	825.11	13	460	490	7	561.81	-13
Peninsula	1,018	1,105	9	1,174	-6	594	515	-13	614	-16	408	546	34	337	62
Marg	874	909	4	491	85	221	212	-4	130	64	114	106	-7	66	61
DSK	1,014	866	-15	897	-3	102	60	-41	164	-63	69	46	-34	153	-70
Total	72,031	70,654	-2	59,566	-16	38,251	34,282	-10	33,419	-3	27,719	27,303	-2	28,301	4

Source: i-SEC Research

Table 2: Earnings revision

	Pre Results			Post Results		
(Rs mn)	**FY09E**	**FY10E**	**FY11E**	**FY09E**	**FY10E**	**FY11E**
Lanco						
Sales	65,470	100,692	176,067	46,150	63,718	98,814
EBITDA	14,489	22,864	41,075	9,075	13,643	25,226
Net Income	6,297	8,776	16,918	3,510	4,251	5,779
EPS (Rs)	28.7	39.9	77.0	16.0	19.3	26.3
HDIL						
Sales	35,097	46,425	61,336	29,499	35,904	43,797
EBITDA	24,862	31,355	39,871	19,773	23,039	27,575
Net Income	18,013	21,313	25,784	13,554	15,028	16,547
EPS (Rs)	65.4	77.4	93.6	49.0	54.3	59.8
Peninsula Land						
Sales	7,830	9,972	12,118	5,011	6,648	8,265
EBITDA	4,661	5,857	6,720	2,595	3,397	3,815
Net Income	3,200	3,923	4,425	2,063	2,436	2,596
EPS (Rs)	11.5	14.1	15.8	7.4	8.7	9.3
Sobha						
Sales	28,609	40,061	43,434	14,407	15,314	18,964
EBITDA	6,035	8,501	9,093	3,727	3,700	4,393
Net Income	3,488	5,003	5,121	1,712	1,444	1,653
EPS (Rs)	47.8	68.6	77.3	23.5	19.8	22.7

Source: I-Sec research

Table 3: Target price revision

	Earlier	Latest	% change	Recommendation
DLF	518	327	-37	Maintained Hold
Unitech	117	57	-51	Upgraded to Hold
HDIL	689	392	-43	Maintained Buy
Lanco	564	296	-48	Maintained Buy
Sobha	1,324	169	-87	Maintained Buy
Peninsula	66	35	-47	Maintained Hold
Marg	407	291	-29	Maintained Buy

Source: I-Sec research

ICICI Securities

Technology

Circumspect stance

Reason for report: Q2FY09 results review

Q2FY09 results corroborated our cautious stance on IT. Though current sectoral valuations are at historic lows, we believe demand uncertainty will prevail over low valuations and result in sectoral underperformance. However, the sector enjoys high free cashflow generation, higher RoIC and transparency, but decision making delays, in an increasingly deteriorating macro environment, will act as a drag and valuation upside will be capped with EPS CAGR for large-caps declining to less than 10% through FY09E-11E (depreciating rupee, the risk to our estimates). We do not recommend BUY on any large-cap in the I-Sec IT universe, but still expect Infosys and Satyam to outperform peers. We reiterate Sell on HCL Tech given lower earnings visibility due to higher hedging (more than 90% forwards) at significant lower rate than spot and high discretionary nature of Axon revenues (88% comes from consulting and package implementations services).

- **Lowest volume growth YoY despite Q2 being the best quarter seasonally.** Despite decent QoQ volume growth (combined volume growth for Infosys, Satyam, Wipro and HCL Tech at 3.9%) in Q2FY09, YoY volume growth for most large-caps was lower in Q2FY09 versus that in the past three years – the combined volume growth for Infosys, Satyam and Wipro declined to 22% in Q2FY09 versus 35-40% in each of the past three years.
- **SAP results reassure slowdown beyond BFSI.** Besides sluggish growth in BFSI across large-cap IT companies in the past few quarters, other major verticals such as Telecom, Manufacturing and Retail are also showing signs of weakness for Indian IT vendors. We expect further weakness in coming quarters. With challenging macro environment, SAP has stopped giving non-GAAP guidance for full year from Q3CY08. The SAP management is witnessing decision delays in software licence demand from the US, UK, France and Russia. We believe this softening is likely to affect Indian IT vendors with some lag (as is evident from Satyam's comment during Q2FY09 results that enterprise application will grow in line with the company average in H2FY09; however, demand visibility will be lower for FY10).
- **Pricing guidance not subdued despite most managements being cautious on demand.** Q3FY09 & Q4FY09 revenue growth guidance of marginal growth-to-negative growth indicates that the managements are cautious on demand. FY09 guidance was lowered owing to volatile currency movements and challenging macro environment in coming quarters. Despite the companies expecting stable pricing, we expect client and vendor consolidation to lead to pricing pressure.
- **Reiterate cautious outlook on IT.** Q2FY09 results corroborated our cautious stance on IT (refer our sector report '*In Doldrums*' dated September 24, '08). We believe demand uncertainty will prevail over low valuations and result in sectoral underperformance. Delays in decision making will act as a drag and valuation upside would be capped with EPS CAGR for large-caps declining to less than 10% through FY09E-11E. Despite our cautious stance, we expect Infosys and Satyam to outperform peers.

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Table 1: Q2FY09 results review

Company	Sales			EBITDA			Recurring PAT		
	Q2FY09	Q2FY08	YoY	Q2FY09	Q2FY08	YoY	Q2FY09	Q2FY08	YoY
HCL Technologies	23,693	17,094	38.6	5,311	3,642	45.8	3,376	2,859	18.1
Infosys Technologies	54,180	41,060	32.0	17,940	12,840	39.7	14,320	11,000	30.2
Infotech Enterprises	2,214	1,611	37.5	457	293	55.7	349	253	38.0
MphasiS	8,361	6,017	39.0	1,770	1,079	64.1	1,412	663	112.9
Patni Computer Systems	8,523	6,736	26.5	1,399	1,115	25.4	1,129	1,098	2.8
Satyam Computer Services	28,193	20,317	38.8	6,509	4,027	61.6	5,809	4,091	42.0
Tata Consultancy Services	69,534	56,398	23.3	18,197	14,821	22.8	12,615	12,474	1.1
Wipro	64,095	47,281	35.6	12,527	9,419	33.0	9,465	7,269	30.2
3i Infotech	6,016	2,779	116.5	1,142	588	94.2	684	401	70.5
Nucleus Software Exports	755	704	7.2	84	179	(53.2)	41	162	(74.8)
NIIT	3,095	2,702	14.5	405	358	13.1	198	211	(6.3)
Educomp Solutions	981	449	118.3	507	229	121.6	254	136	87.0
Info Edge India	653	526	24.1	154	162	(4.9)	155	151	2.1
Allied Digital Services	1,513	708	113.7	305	154	97.5	241	101	137.5
Onmobile Global	975	649	50.3	274	292	(6.2)	184	189	(3.0)
Total - Big 5	**239,695**	**182,151**	**31.6**	**60,484**	**44,749**	**35.2**	**45,584**	**37,693**	**20.9**
Total	**272,779**	**205,030**	**33.0**	**66,981**	**49,199**	**36.1**	**50,228**	**41,058**	**22.3**

Source: Company data, I-Sec Research

Table 2: I-Sec estimates versus actuals

(Rs mn)

Company	Sales			EBITDA			Rec PAT		
	Actuals	Estimates	Var %	Actuals	Estimates	Var %	Actuals	Estimates	Var %
HCL Technologies	23,693	24,692	(4.0)	5,311	5,637	(5.8)	3,376	3,565	(5.3)
Infosys Technologies	54,180	53,072	2.1	17,940	16,708	7.4	14,320	14,166	1.1
Infotech Enterprises /India	2,214	2,147	3.1	457	399	14.4	349	250	39.6
MphasiS	8,361	8,155	2.5	1,770	1,391	27.3	1,412	848	66.5
Patni Computer Systems	8,523	8,621	(1.1)	1,399	1,385	1.0	1,129	892	26.5
Satyam Computer Services	28,193	28,061	0.5	6,509	6,022	8.1	5,809	5,483	5.9
Tata Consultancy Services	69,534	69,003	0.8	18,197	16,835	8.1	12,615	13,421	(6.0)
Wipro	64,095	62,489	2.6	12,527	12,152	3.1	9,465	8,818	7.3
3i Infotech	6,016	5,900	2.0	1,142	1,075	6.3	684	646	5.8
Nucleus Software Exports	755	863	(12.6)	84	191	(56.0)	41	121	(66.3)
NIIT	3,095	3,153	(1.8)	405	387	4.7	198	261	(24.2)
Educomp Solutions	981	919	6.7	507	506	0.2	254	249	2.0
Info Edge India	653	666	(2.0)	154	183	(15.9)	155	146	5.9
Allied Digital Services	1,513	1,520	(0.4)	305	319	(4.4)	241	220	9.4
Onmobile Global	975	994	(2.0)	274	349	(21.6)	184	206	(10.9)
Total - Big 5	**239,695**	**237,317**	**1.0**	**60,484**	**57,354**	**5.5**	**45,584**	**45,453**	**0.3**
Total	**272,779**	**270,255**	**0.9**	**66,981**	**63,539**	**5.4**	**50,228**	**49,292**	**1.9**

Source: Company data, I-Sec Research

Table 3: Valuations

		Price	EPS (Rs)			P/E (x)			EV/EBITDA (x)		
Company	Rating	(Rs)	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E
HCL Technologies*	SELL	156	21.3	21.4	25.3	7.3	7.3	6.2	3.7	3.4	2.6
Infosys Technologies	HOLD	1,322	102.1	108.6	118.5	13.0	12.2	11.2	9.2	8.5	6.9
Infotech Enterprises	BUY	144	22.8	23.3	26.0	6.3	6.2	5.5	3.0	2.3	1.7
MphasiS	BUY	161	20.9	22.0	22.5	7.7	7.3	7.2	4.9	4.2	3.4
Patni Computer Systems**	HOLD	137	26.9	29.5	31.1	5.1	4.6	4.4	1.3	1.5	0.7
Satyam Computer	HOLD	277	33.7	34.9	37.0	8.2	7.9	7.5	4.6	4.0	3.1
Tata Consultancy Services$	HOLD	506	58.9	62.9	68.6	8.6	8.0	7.4	6.0	5.4	4.5
Wipro	HOLD	272	26.2	29.1	32.1	10.4	9.3	8.5	6.9	5.9	4.8
3i Infotech#	U.R.	45	14.4	15.5	17.0	3.2	2.9	2.7	5.8	4.8	4.0
Nucleus Software	HOLD	55	9.5	11.9	11.4	5.7	4.6	4.8	1.1	1.0	1.0
NIIT	HOLD	40	4.1	4.6	5.8	9.8	8.7	6.9	0.6	0.6	0.5
Educomp Solutions	BUY	2,690	76.9	136.3	214.3	35.0	19.7	12.5	16.9	9.2	6.6
InfoEdge	BUY	404	21.8	27.2	33.7	18.5	14.8	12.0	10.2	7.1	4.8
OnMobile	BUY	214	14.1	21.2	26.6	15.2	10.1	8.1	9.9	6.7	5.3
Allied Digital India##	BUY	289	56.5	88.6	121.9	5.1	3.3	2.4	3.5	1.8	0.6

U.R.=Under Review,*PAT after ESOP charges, ** Figures for CY08E, CY09E and CY10E,#Fully diluted EPS, ##Estimates before Q2FY09 results, $ excluding CGSL acquisition

Source: Company data, I-Sec Research

Table 4: Sales revision

Sales Revision	Before Results		After Results		Chg %	
Company	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
HCL Technologies	102,492	103,325	100,116	101,843	(2.3)	(1.4)
Infosys Technologies	216,878	239,623	220,039	230,494	1.5	(3.8)
Infotech Enterprises /India	9,111	11,229	9,605	11,143	5.4	(0.8)
MphasiS	33,360	39,542	34,362	38,099	3.0	(3.6)
Patni Computer Systems	31,611	33,782	31,962	32,787	1.1	(2.9)
Satyam Computer Services	114,486	119,598	115,275	120,907	0.7	1.1
Tata Consultancy Services	286,982	300,139	287,348	301,888	0.1	0.6
Wipro	261,346	287,762	261,364	291,072	0.0	1.2
3i Infotech	23,137	28,975	23,010	26,804	(0.5)	(7.5)
Nucleus Software Exports	3,928	5,203	3,239	3,750	(17.5)	(27.9)
NIIT	12,020	14,227	11,570	12,931	(3.7)	(9.1)
Educomp Solutions	5,297	9,118	5,245	8,456	(1.0)	(7.3)
Info Edge India	2,814	3,651	2,750	3,381	(2.3)	(7.4)
Allied Digital Services	6,290	9,356	6,290	9,356	0.0	0.0
Onmobile Global	4,304	6,265	4,013	5,821	(6.8)	(7.1)
Total - Big 5	**982,183**	**1,050,448**	**984,142**	**1,046,205**	**0.2**	**(0.4)**
Total	**1,113,661**	**1,210,953**	**1,116,187**	**1,198,733**	**0.2**	**(1.0)**

Source: Company data, I-Sec Research

Table 5: EBITDA revision

(Rs mn)

EBITDA Revision	Before Results		After Results		Chg %	
Company	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
HCL Technologies	22,284	21,863	21,176	21,425	(5.0)	(2.0)
Infosys Technologies	69,105	75,826	70,498	71,737	2.0	(5.4)
Infotech Enterprises /India	1,660	2,017	1,865	2,049	12.4	1.6
MphasiS	5,775	6,921	6,421	7,140	11.2	3.2
Patni Computer Systems	4,957	5,144	5,080	5,022	2.5	(2.4)
Satyam Computer Services	25,120	25,220	26,467	26,646	5.4	5.7
Tata Consultancy Services	71,294	72,027	74,200	75,079	4.1	4.2
Wipro	51,874	55,597	51,695	55,947	(0.3)	0.6
3i Infotech	4,281	5,353	4,370	4,966	2.1	(7.2)
Nucleus Software Exports	777	986	487	550	(37.3)	(44.2)
NIIT	1,332	1,777	1,178	1,381	(11.6)	(22.2)
Educomp Solutions	3,045	5,752	2,904	5,379	(4.6)	(6.5)
Info Edge India	856	1,129	741	960	(13.4)	(15.0)
Allied Digital Services	1,478	2,389	1,478	2,389	0.0	0.0
Onmobile Global	1,615	2,482	1,335	2,150	(17.4)	(13.4)
Total - Big 5	**239,677**	**250,532**	**244,036**	**250,834**	**1.8**	**0.1**
Total	**265,453**	**284,481**	**269,894**	**282,820**	**1.7**	**(0.6)**

Source: Company data, I-Sec Research

Table 6: Recurring PAT revision

(Rs mn)

RPAT Revision	Before Results		After Results		Chg %	
Company	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
HCL Technologies	14,733	15,024	14,646	14,920	(0.6)	(0.7)
Infosys Technologies	59,380	65,402	58,425	62,289	(1.6)	(4.8)
Infotech Enterprises /India	1,026	1,203	1,198	1,225	16.7	1.8
MphasiS	3,507	4,117	4,374	4,605	24.7	11.8
Patni Computer Systems	3,627	3,987	3,641	3,777	0.4	(5.3)
Satyam Computer Services	21,934	23,248	22,779	23,689	3.9	1.9
Tata Consultancy Services	57,507	60,293	57,598	61,592	0.2	2.2
Wipro	37,755	42,695	38,321	42,801	1.5	0.2
3i Infotech	2,614	3,222	2,573	2,769	(1.6)	(14.0)
Nucleus Software Exports	559	789	307	384	(45.0)	(51.3)
NIIT	896	1,206	676	766	(24.6)	(36.5)
Educomp Solutions	1,486	2,656	1,408	2,495	(5.3)	(6.1)
Info Edge India	663	847	595	742	(10.3)	(12.4)
Allied Digital Services	1,047	1,650	1,047	1,650	0.0	0.0
Onmobile Global	944	1,445	817	1,228	(13.5)	(15.0)
Total - Big 5	**191,309**	**206,662**	**191,769**	**205,291**	**0.2**	**(0.7)**
Total	**207,679**	**227,784**	**208,403**	**224,931**	**0.3**	**(1.3)**

Source: Company data, I-Sec Research

Table 7: EPS revision

(Rs mn)

EPS Revision	Before Results		After Results		Chg %	
Company	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
HCL Technologies	21.5	21.5	21.3	21.4	(0.6)	(0.7)
Infosys Technologies	103.7	114.0	102.1	108.6	(1.6)	(4.7)
Infotech Enterprises	19.8	23.3	22.8	23.3	15.1	0.4
MphasiS	16.8	19.7	20.9	22.0	24.7	11.8
Patni Computer Systems	26.8	30.8	26.9	29.5	0.3	(4.4)
Satyam Computer Services	32.4	34.1	33.7	34.9	4.3	2.5
Tata Consultancy Services	59.2	61.6	58.9	62.9	(0.6)	2.2
Wipro	26.1	29.0	26.2	29.1	0.3	0.4
3i Infotech	14.6	18.1	14.4	15.5	(1.6)	(14.4)
Nucleus Software Exports	16.7	23.6	9.5	11.9	(43.1)	(49.6)
NIIT	5.4	7.3	4.1	4.6	(24.6)	(36.5)
Educomp Solutions	81.3	145.2	76.9	136.3	(5.4)	(6.1)
Info Edge India	24.3	31.0	21.8	27.2	(10.3)	(12.4)
Allied Digital Services	56.5	88.6	56.5	88.6	0.0	0.0
Onmobile Global	16.3	25.0	14.1	21.2	(13.5)	(15.0)

Source: Company data, I-Sec Research

Table 8: Recommendation change

Company	Pre Results Reco	Post Results Reco	Rationale
HCL Technologies	SELL	SELL	Refer our report dated October 13, '08 *Overcast Horizons*
Infosys Technologies	BUY	HOLD	Macro challenges impacting growth in FY10, P/E re-rating unlikely
Infotech Enterprises /India	BUY	BUY	-
MphasiS	BUY	BUY	-
Patni Computer Systems	HOLD	HOLD	-
Satyam Computer Services	HOLD	HOLD	Refer our report dated October 13, 2008 *Overcast Horizons*
Tata Consultancy Services	HOLD	HOLD	Refer our report dated September 24, 2008 *In Doldrums*
Wipro	HOLD	HOLD	Refer our report dated September 24, 2008 *In Doldrums*
3i Infotech	BUY	Under Review	
Nucleus Software Exports	BUY	HOLD	Projects starts delays continuing
NIIT	BUY	HOLD	Expected slower growth in individual IT training and NIIT IFBI
Educomp Solutions	BUY	BUY	
Info Edge India	BUY	BUY	
Allied Digital Services	BUY	BUY	
Onmobile Global	BUY	BUY	

Source: Company data, I-Sec Research

Table 9: Target price revision

Company	Old TP	Revised TP	Chg %
HCL Technologies	170	165	(2.9)
Infosys Technologies	1875	1410	(24.8)
Infotech Enterprises /India	250	190	(24.0)
Mphasis	240	210	(12.5)
Patni Computer Systems	NA	NA	NA
Satyam Computer Services	290	305	5.2
Tata Consultancy Services	600	615	2.5
Wipro	305	315	3.3
3i Infotech	175	Under review	NA
Nucleus Software Exports	236	NA	NA
NIIT	123	39	(68.3)
Educomp Solutions	5256	3990	(24.1)
Info Edge India	775	582	(24.9)
Allied Digital Services*	1050	1050	-
Onmobile Global	660	425	(35.6)

Source: Company data, I-Sec Research,*before Q2FY09 results review

Table 10: Guidance

Company	Revenue growth Guidance			Comments
	OND08 - Q/Q %	JFM09 - Q/Q %	FY09 - Y/Y%	
Infosys	0.3% - (3.4)%	(0.1)	13%-15.1%	FY09 sales growth lowered 6% with 3% impact from cross currency and 3% from macro challenges
Wipro	1%	NA	NA	Marginal growth guidance against earlier guidance of bounce back in H2FY09
Satyam	0% - (2.8)%	(0.0)/(0.6)	19%-21%	FY09 sales growth rate revised downwards 5% with 3% impact from cross currency and 2% from macro challenges
Patni	(3.5)% - (4.1)%	NA	8.4%-8.5%	We believe that Patni would be the worst hit due to vendor consolidation
HCL Tech		NA		Stopped giving any forecast of full year growth due to lower organic visibility
TCS		NA		Delayed project ramp-up in H1FY09 for TCS is likely to lead to better growth visibility in H2FY09

Source: Company data, I-Sec Research

Table 11: Pricing Outlook

Pricing Commentary	Comments
Infosys	Pricing continues to be stable; there can be one or two sporadic instances of pricing pressure
Satyam	Outlook on pricing for the year continues to be stable. There is a possibility that there will be some pressure on pricing if the current economic environment prevails for few months longer.
Wipro	Pricing continues to stable; there can be one or two sporadic instances of pricing pressure
TCS	Stable pricing
HCL Technologies	Pressure on blended pricing; though no major change in price competition

Source: Company data, I-Sec Research

Table 12: Employee addition plans

Employee additions	Comments
Infosys	The management reiterated its FY09E gross employee addition at 25,000 including 17,299 in H1FY09.
Satyam	FY09E guidance for gross employee addition (Standalone) reduced to 8,000-10,000 from the earlier 14,000-15,000. H1FY09 gross addition at 5241
Wipro	Wipro reiterating its FY09E guidance of 14,000 gross fresher additions, with most of it in H2FY09 as H1FY09 fresher addition of just +3,000.
TCS	TCS' FY10E campus offers at ~24,500 (versus +20,000 in FY08) surprised positively. Reiterated gross addition target of 30,000-35,000 for FY09E
HCL Technologies	Higher freshers are expected to join in OND '08, JAS '08 freshers addition of just 240

Source: Company data, I-Sec Research

Table 13: Big-5* revenue operating metrices (dollar revenue growth)

Q/Q %	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
BIG 5 Revenues	10.9	8.4	4.3	2.1	3.4
BIG 5 Revenues BFSI	11.8	8.5	1.3	0.8	2.4
BIG 5 Revenues Telecom	10.1	8.6	3.8	-3.6	1.8
BIG 5 Revenues Retail	13.6	8.1	6.9	6.8	4.3
BIG 5 Revenues Manufacturing	11.2	9.6	10.3	0.8	6.6
BIG 5 Revenues US	9.8	8.0	4.3	3.8	2.3
BIG 5 Revenues Europe	11.2	8.4	4.7	0.5	5.2

Big-5 includes Infosys, Satyam, Wipro, TCS and HCL Tech

Source: Company data, I-Sec Research

Equity Research
November 5, 2008

INDIA

Textiles

Uncertain outlook

Reason for report: Q2FY09 results review

Q2FY09 results were better than our expectations with I-Sec textiles universe witnessing healthy revenue growth of 23% on the back of expanded capacities. Aggregate PAT grew a meagre 2% (excluding Himatsingka Seide, PAT growth was at 17%) on account of margin improvement. EBITDA margin expanded 264bps to 17% owing to focus on high-margin, value-added segments and benefits from integrated manufacturing facilities. The ongoing capex has resulted in higher interest and depreciation cost, which capped the overall PAT growth in Q2FY09. However, global economic slowdown (which could lead to lower orders and capacity utilisation) will be the key factor to watch for in the rest of FY09.

- **Mixed bag.** Bombay Rayon Fashions (BRFL) reported the highest recurring net profit growth of 65% to Rs367mn on the back of higher-than-estimated EBITDA margin (which rose 200bps to touch a high of 23.9%). The decline in Vardhman Textiles' (VTL) net profit was much lower than our estimates due to higher-than-estimated EBITDA margin, which grew 190bps to 17.5% on account of better operating leverage on scale-up of integrated processed fabric capacities and 24MW captive power plants (CPP) getting operational. Himatsingka Seide was the worst performer with reported consolidated net losses at Rs205mn, mainly due to Rs256mn forex-related losses and lower sales from global subsidiaries (including retail).

- **H2FY09 challenging.** The ongoing global economic slowdown in the US could result in lower orders that, in turn, may lead to lower capacity utilisation of textile companies in India. This combined with significant increase in cotton prices will affect profitability of textile companies, mainly upstream companies such as VTL that are still unable to pass on the significant increase in cotton prices in the past year (YoY prices still high after the recent fall). Based on this and increasing competition from low-cost manufacturing countries such as Vietnam and Bangladesh, we do not foresee any benefit to earnings from rupee depreciation for the remaining part of FY09.

- **Stay selective.** We believe that companies that are integrated, operating in niche segments and focussed on growing domestic markets are likely to absorb unfavourable, short-term external factors. Based on this, higher earnings growth visibility and recent meltdown in the stock market, we recommend selective investment in the sector.

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Table 1: I-Sec estimates versus actuals

	Sales					EBITDA					Rec PAT				
	Q2FY09			Q2FY08		Q2FY09			Q2FY08		Q2FY09			Q2FY08	
Company (Rs mn)	**Expected**	**Actual**	**% Var**	**Actual**	**% YoY**	**Expected**	**Actual**	**% Var**	**Actual**	**% YoY**	**Expected**	**Actual**	**% Var**	**Actual**	**% YoY**
Bombay Rayon	2,894	2,870	-1	2,246	28	641	687	7	492	39	287	367	28	222	65
Vardhman Textiles#	6,507	6,540	0	4,926	33	911	1,144	26	736	55	81	260	222	315	-18
Himatsingka Seide	2,686	2,549	-5	2,521	1	81	204	153	164	24	-92	32	-134	109	-71
Total	**12,087**	**11,959**	**-1.1**	**9,693**	**23**	**1,633**	**2,034**	**24.6**	**1,393**	**46**	**276**	**658**	**138.6**	**646**	**2**
EBIDTA Margin (%)						13.5	17.0	3.5	14	2.6	2	6	3.2	7	-1.2

YoY is adjusted for de-merger of thread business

Source: I-Sec Research

ANALYST CERTIFICATION

We /I, *Girish Pai, MBM, BTech; Shilpa Gupta, PGDM, BTech; Hemant Joshi, PGDM, B. Tech; Sumeet Budhraja PGDM, BE; Sunil Tuleja, MBA (Finance); Swarit Dakalia, CA; Siddharth Teli, MBA (Finance); Abhishek Murarka, PGDM, MBA (Finance); Sanjay Singh, BE, PGDM; Novonil Guha, CA; Sandeep Shah, CA; Krupal Maniar, CA, CFA; Sagar Thakkar, CA; Pallav Agarwal, PGDM, CA, CS, CWA; Abhijit Mitra, MBA (Finance), BE; Vikash Mantri, PGDM, CFA; Suchitra W L, PGDM, BE; Rajesh Vora, Grad. CWA, CFA; Amit Mishra, PGDM, BE; Gagan Dixit, PGDM, BTech; Gaurav Pathak, PGDM, BTech; Shaleen Silori, MBA (Finance); Prakash Gaurav Goel, CA; Nishant Bhargava, MBA (Finance)* research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

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