India Market Strategy

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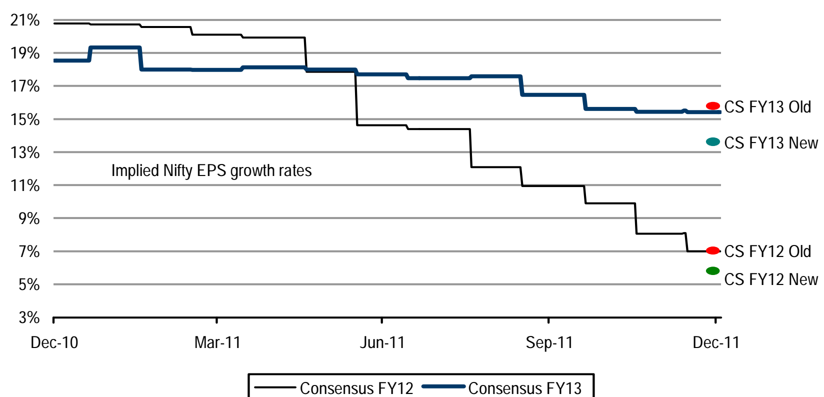
STRATEGY

Nifty FY13 earnings cut by 300 bp, but downside risks ahead

Figure 1: **Nifty FY13 earnings growth seen at 13%, FY12 at 5%**



Source: Thomson Reuters, Company data, Credit Suisse estimates

- **Economic prospects remain grim; expect multiple compression.** The Indian economy continues to slow, and the fiscal situation continues to worsen: in the first eight months, government revenues are only 45% of FY12 targets, versus the 14-year average of 54%. Annualising 8M FY12 performance would yield a fiscal deficit of 6.5%. The correlation between bond yields and repo rates seen over the past several years could break. Higher bond yields and low GDP growth have historically meant low P/E multiples.
- **Earnings continue to grind down.** CS' bottom-up forecasts have been cut sharply, driving down FY13 Nifty EPS integer by 300 bp to 398: the cuts over the past year have thus been 13%. The sharpest cuts have been in materials and industrials. However, at +13% YoY growth (consensus +15%), they still have meaningful downside, as sales growth peters out, and the multi-year low in margins persists. Will FY13 Nifty EPS settle at 370 as top-down analysts predict, or be down YoY and below 350?
- **Can markets fall when everyone is bearish?** Most market participants seem to be bearish, as would be logical when the momentum is obviously so weak. However, in our mind that is not a bullish sign yet because we are unsure if they are bearish enough in their talk: (1) Will fiscal deficit be 6.5% of GDP or 5.7%? (2) Will participants adjust to 11–12x as the fair-value P/E vs the 14x currently in vogue? In fact, we haven't even seen large-scale redemptions yet (FII outflows US$700 mn in CY11; MF inflows US$1.2 bn). We continue to like exporters (TCS, Sun Pharma) and remain sellers of rate sensitives (ICICI Bank, L&T).

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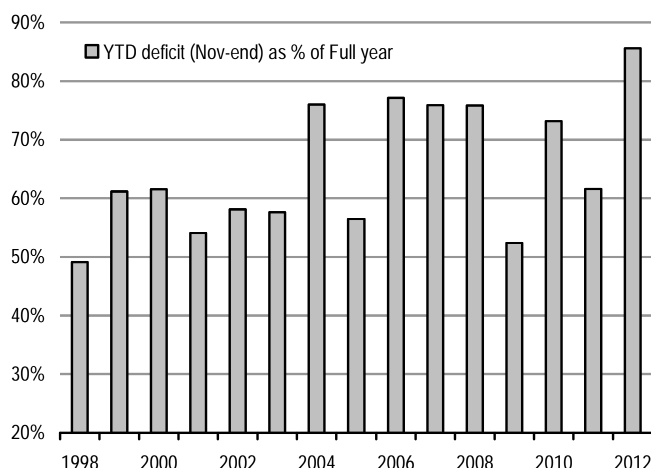
Deteriorating macro to hurt returns

Fiscal situation to remain grim

The April-November fiscal deficit run-rate was one of the highest ever, with 8M fiscal deficit at 84% of budget estimates, the highest in 14 years (Figure 2). Though expenditure has been growing higher than budgeted estimates (+11% vs +9% revised budget estimate), there has been a marked slowdown in momentum in taxes and non-tax revenues (Figure 3). In fact, 8M revenues at 45% of FY targets are significantly lower than the 54% average seen in the last 14 years for which data is available.

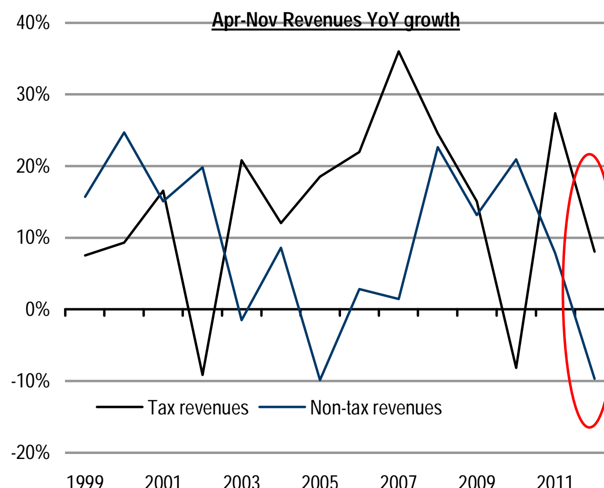
8M FY12 fiscal deficit was 84% of FY targets, the highest ever; revenues at 45% of FY targets were the lowest ever

Figure 2: **8M fiscal deficit as a % of full year GDP**



Source: CMIE, Credit Suisse estimates

Figure 3: **Both tax and non-tax revenues slowing**



Source: Ministry of Finance, CMIE

Given this scenario, tax rate increases are now widely expected in the FY13 budget, mainly excise duties to start with. The Prime Minister has also hinted at subsidy cuts, and timing the budget post the state elections indicates the government may be serious. However, the government's political determination will be tested. Further, food subsidies, which the PM does not want to touch, are likely to increase substantially due to the food subsidy bill; we fear FY13 may be no better. The economy is now visibly slowing down, with gross tax revenues down YoY in October 2011—this creates stress on FY12 no doubt, but poses substantial challenges to the government in managing fiscal issues.

Slowing economy creates obvious pressures on FY12; the big worry would be how to consolidate the fiscal side in FY13

Weakness in rupee to persist

The rupee has been one of the weakest currencies globally in 2011. We think the rupee will likely continue to be weak because of three reasons:

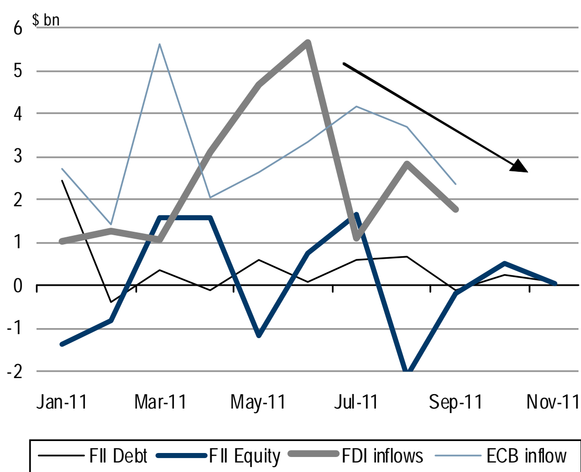
Rupee weakness is likely to continue

(1) India's trade deficit would not narrow since exports are linked to world GDP growth, and the current global slowdown would cause a bigger slowdown in India's exports.

(2) The already-low FII inflows into debt and equities would remain muted (Figure 4). We haven't seen any outflows yet on this front, but the fact is we need strong inflows to counter the widening trade deficit. There could be a surge in FII inflows into government securities when the new limits are auctioned, but it would be temporary.

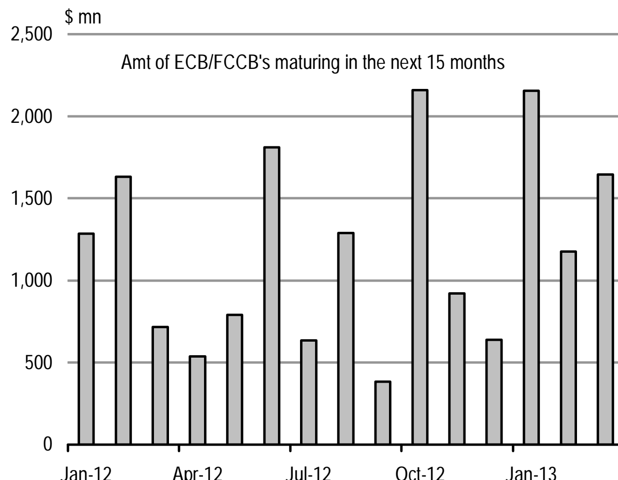
(3) With the bleak outlook on equities, only debt flows can potentially support the rupee. But the stress on European banks and depletion of risk appetite could keep dollar access for Indian corporates restricted. In fact, the dollar debt could increasingly be rolled over using domestic borrowing: US$20 bn of these (ECBs, including FCCBs) are maturing in the next 12 months (Figure 5).

Figure 4: Capital flows have been muted (monthly)



Source: Bloomberg

Figure 5: ECB/FCCB rollover stresses would surface



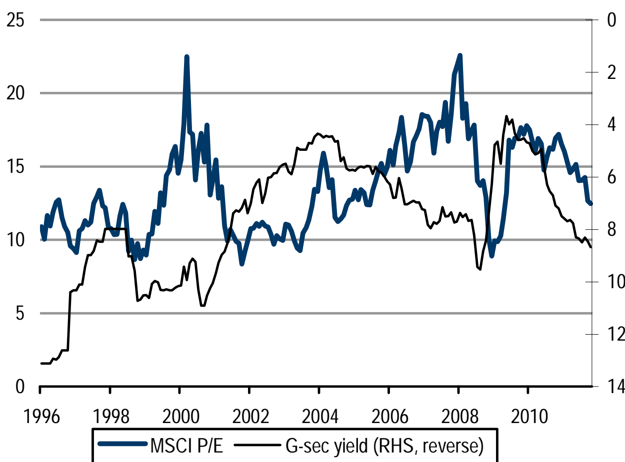
Source: RBI, Credit Suisse Research

Multiples as well as earnings under pressure

While there is significant attention paid to movements in consensus earnings estimates, estimates for market multiples are taken as "five-year average" or "ten-year average". We note that historically multiples have been driven by G-Sec yields (Figure 6) as well as GDP growth (Figure 7): the former affects the discount rate while the latter the forward demand outlook. Given the current fiscal scenario, we expect continuous upward pressure on G-sec yields: with the exception of the 2000 internet boom, current bond yields imply a 9–13x P/E range. Further, CS economists expect GDP growth to be sub-7% in the remaining quarters of FY12. Therefore, P/E multiples are likely to fall to 11–12x levels.

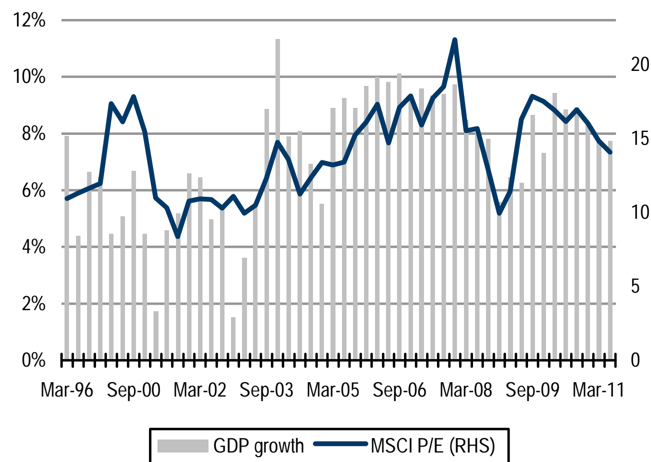
P/E multiples for the market usually do not get much attention: we find they are driven by government bond yields as well as expected GDP growth; we see downside on both fronts

Figure 6: Ten-year yields to remain high



Source: Bloomberg, MSCI

Figure 7: Slowdown in GDP could pressurise multiples

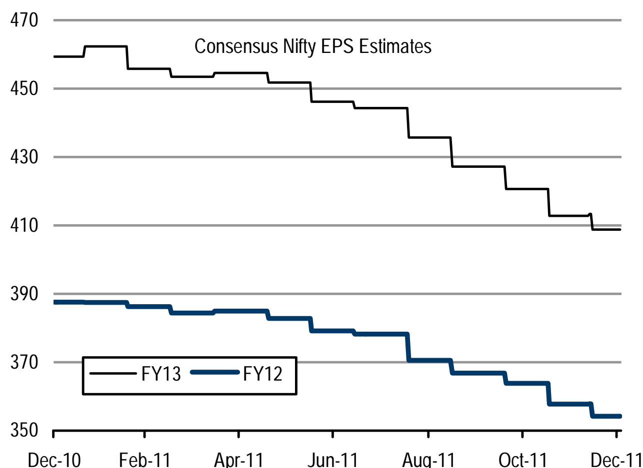


Source: MSCI, CMIE

Earnings estimates also have meaningful downside: FY12 EPS has been consistently cut through the year (down 9% in 2011, Figure 8), and growth is now expected to be 7% compared to 21% at the beginning of 2011 (Figure 9). However, the consensus FY13 estimates have only seen similar cuts (~11%) and still show 15% YoY growth. We believe this number faces a significant downside risk.

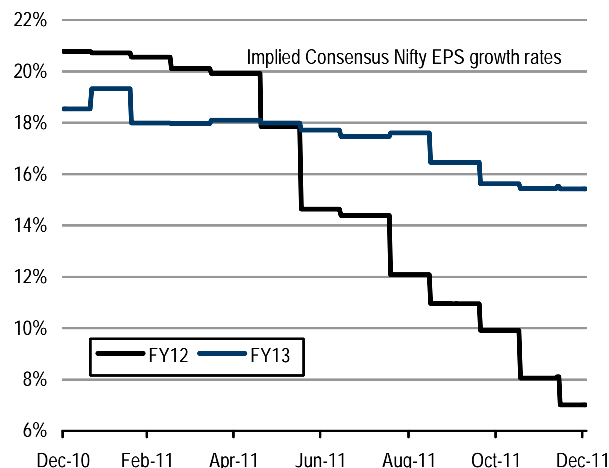
While consensus FY12 Nifty EPS growth is now a mere 7% versus 21% at the beginning of 2011, FY13 growth is still 15%: this has downside

Figure 8: **EPS estimates cut consistently in 2011**



Source: Thomson Reuters, Credit Suisse estimates

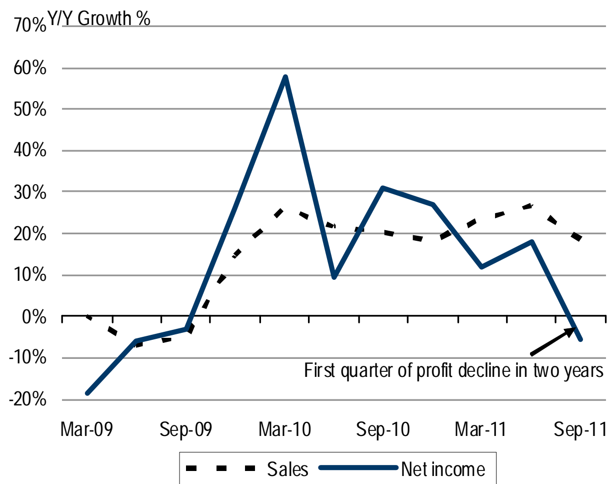
Figure 9: **Downside to consensus' 15% growth in FY13**



Source: Thomson Reuters, Credit Suisse estimates

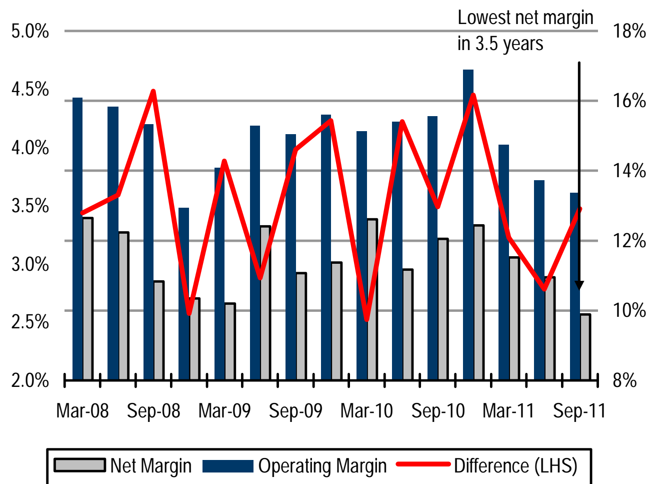
The trend is already clear: 2Q FY12 was the first quarter in two years to see a YoY decline in profits for companies in the Nifty index (Figure 10). Worryingly, this happened despite a 20% YoY sales growth, indicating the continuing margin depletion, which is already at three-year lows (Figure 11). We fear that a potential slowdown could impact sales and put further pressure on operating profit growth due to negative operating leverage.

Figure 10: **Nifty saw the first profit decline in two years**



Source: Bloomberg, Company data, Credit Suisse estimates

Figure 11: **Margins at three-year lows**



Source: Thomson Reuters, Company data, Credit Suisse estimates

CS Nifty FY13 EPS cut by 300 bp

In this backdrop, CS's bottom-up estimates have been revised downwards (listed in Figure 12). Pharma and IT see upgrades with change in the INR rate assumption, while metals and banks see large cuts due to the slowdown in the macro environment. A detailed explanation of these changes follows in the following section.

Figure 12: **Summary of changes in earnings estimates in our coverage**

Rs mn, year-end Mar	FY12 PAT			FY13 PAT			Target price		
	Old	New	Change	Old	New	Change	Old	New	Change
IT services									
TCS	106,031	106,243	0%	128,075	131,582	3%	1375	1375	0%
Infosys	79,321	81,863	3%	93,978	96,847	3%	3050	3050	0%
Wipro	55,738	55,492	0%	63,867	64,678	1%	390	390	0%
HCLT	21,446	22,907	7%	25,022	27,658	11%	485	485	0%
Metals and mining									
SAIL	40,687	25,171	-38%	46,706	33,637	-28%	87	66	-24%
JSW Steel	5,455	182	-97%	16,006	15,409	-4%	465	465	0%
Tata Steel	87,599	78,904	-10%	67,725	50,381	-26%	400	340	-15%
Private banks									
ICICI Bank	66,010	65,715	0%	76,538	73,828	-4%	872	711	-18%
HDFC Bank	52,675	51,118	-3%	66,244	63,875	-4%	548	514	-6%
Axis Bank	38,261	39,620	4%	42,167	41,500	-2%	1,368	997	-27%
Yes Bank	8,509	8,920	5%	10,725	10,796	1%	280	225	-20%
IndusInd Bank	7,543	7,653	1%	9,367	9,117	-3%	300	265	-12%
Public sector banks									
SBI	110,057	111,978	2%	150,865	129,714	-14%	1,750	1,537	-12%
PNB	46,004	47,675	4%	53,286	53,476	0%	1,236	768	-38%
Bank of Baroda	42,690	47,864	12%	49,246	51,632	5%	1,035	778	-25%
Bank of India	27,843	23,124	-17%	37,455	32,102	-14%	353	228	-34%
Union Bank of India	23,722	20,551	-13%	28,683	25,878	-10%	342	182	-47%
Oil & gas									
Reliance Industries	226,736	210,384	-7%	264,576	246,788	-7%	1,022	910	-11%
ONGC	244,653	254,097	4%	258,415	262,754	2%	337	315	-7%
OIL India	32,246	30,816	-4%	32,896	30,384	-8%	1,540	1411	-8%
Cairn India	84,817	93,959	11%	92,179	105,384	14%	337	372	10%
Pharma									
Sun Pharma	22,058	22,800	3%	25,931	26,834	3%	576	595	3%
Cipla	11,722	12,366	5%	13,248	14,471	9%	330	360	9%
Glenmark	5,433	5,492	1%	6,109	6,291	3%	340	350	3%
Autos									
Hero Motocorp	23,989	23,360	-3%	29,623	27,930	-6%	2,522	2,238	-11%
Bajaj Auto	29,655	30,948	4%	32,717	33,291	2%	1,641	1,670	2%
Maruti	15,698	14,733	-6%	21,577	20,125	-7%	1,010	944	-7%
Tata Motors	93,820	95,668	2%	104,863	100,415	-4%	190	190	0%
Mahindra	29,324	28,694	-2%	36,442	32,696	-10%	910	812	-11%
Utilities									
Adani Power	11,678	11,060	-5%	22,289	20,578	-8%	73	71	-3%
Jaip. Power Ventures	4,421	4,417	0%	3,681	3,659	-1%	41	41	0%
KSK Energy	1,616	1,616	0%	1,580	1,580	0%	136	135	-1%
Lanco	2,152	2,061	-4%	2,702	2,451	-9%	14	14	0%
NHPC	21,491	21,491	0%	23,803	23,803	0%	26	26	0%
NTPC	95,860	95,907	0%	101,764	101,809	0%	181	181	0%
Reliance Power	6,371	6,219	-2%	9,947	9,610	-3%	70	69	-1%
Tata Power	15,914	15,465	-3%	18,732	19,536	4%	102	101	-1%
Capital goods									
L&T	39,199	37,942	-3%	43,976	41,491	-6%	1019	976	-4%

Source: Company data, Credit Suisse estimates

These changes in individual company estimates lead to a drop in our bottom-up Nifty FY12/FY13 EPS estimate from 354/410 to 351/398 implying 5%/13% growth (Figure 13).

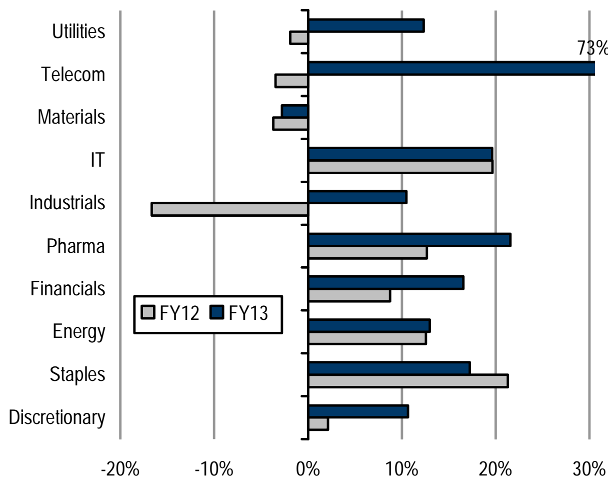
Figure 13: Nifty to grow at 5% in FY12, 13% in FY13

	EPS estimates		Implied growth rates	
Nifty	**FY12**	**FY13**	**FY12**	**FY13**
Consensus	354	409	6.4%	15.4%
CS old	354	410	6.3%	15.7%
CS new	351	398	5.4%	13.4%

Source: Thomson Reuters, Company data, Credit Suisse estimates

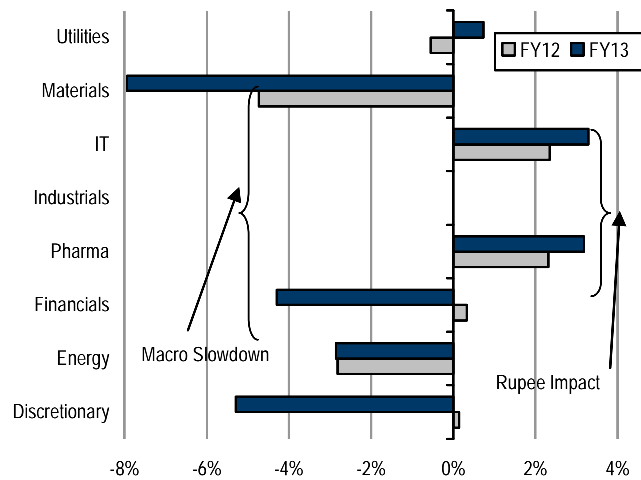
Not surprisingly, a breakdown of FY12/FY13 growth in Nifty EPS (Figure 14) shows that the sectors related to the investment cycle—industrials, materials and utilities—are expected to be the laggards in terms of corporate performance within the Nifty Index. This is in line with the sharp slowdown seen in the investment component of the GDP (gross capital formation), which grew at a dismal 1.2% in the Jul-Sep 2011 quarter.

Figure 14: Industrials, materials dragging down Nifty EPS



Source: Company data, Credit Suisse estimates

Figure 15: Changes—macro slowdown vs weak rupee



Source: CMIE, Credit Suisse estimates

Exporting sectors (IT and pharma) with dollar revenues and rupee costs have seen earnings upgrades to incorporate the change in INR assumption, while all other sectors see downgrades incorporating the impact of the prevailing economic slowdown on demand and profits (Figure 15).

Are we done yet? Unlikely

We believe even the low 13% growth expected in FY13 has downside risk. Hence, we continue to remain bearish on the overall market, with downside risks to both multiples as well as earnings. We also fear the rupee is likely to continue to remain weak over the next 3-6 months. The prevailing investment slowdown should continue till RBI cuts rates materially to make an impact on the investment cycle, and reforms start again.

We prefer companies with dollar-linked revenues and rupee costs, such as IT, pharma and some of the energy names. We remain UNDERWEIGHT on banks, industrials, materials and real estate.

Rationale for earnings and target price changes

Banks and Financials

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'Fee'ling the pinch

As we build in lower loan growth and fees (lower estimates by 5–9%), we cut earnings estimates for Indian banks by 5-15%. Bank of India, SBI and IOB are banks with the sharpest cuts in estimates. With domestic bond yields also on an upward trajectory as the government continues to slip on its fiscal deficit targets, the potential of an upward spike in yields presents an additional 3-11% risk to our earnings estimates.

We have lowered our loan and fee estimates for FY12 to FY14, and raised our credit cost estimates for SBI, Axis and Union for FY13. We have also built in equity issuances at SBI, BOB, BOI, Axis and Yes Bank.

We increase our credit cost estimate to factor in deteriorating financials and higher pipeline of restructured assets. Our credit cost estimates are still conservative at 1.0–1.3% of loans as regulatory requirements on restructured asset provisions is low (2% GP).

Oil & gas

Sanjay Mookim (sanjay.mookim@credit-suisse.com, 91 22 6777 3806)

A weaker rupee—a boon and a bane

Theoretically, the oil, gas and petrochemical business is almost completely 'dollarised'. Oil prices are denominated in US dollars; refining and petrochemical margins in India generally track dollar margins in the region. The sharp depreciation of the rupee should therefore lead to a concomitant increase in top line for oil/gas producing and refining companies in India.

The impact is cleanest for Cairn India, where higher revenues should lead to higher rupee profits. RIL will also see similar top line support, but the inflation of its large dollar borrowings (for which the impact is accounted outside the P&L) limits upside to rupee stock valuations (through a higher net debt number).

Subsidy mechanisms cloud the impact on government-owned oil companies, namely ONGC and OIL India. While their rupee revenues benefit due to a weaker rupee, their subsidy payments are likely to be higher as well. Given ONGC's crude sales volumes and volumes of controlled product sales in India, we estimate that ONGC's reported domestic net realisations have negative leverage to rupee crude prices for upstream subsidy shares of greater than 31%. ONGC's consolidated EPS begins to have negative leverage to rupee crude prices for upstream subsidy shares of greater than 40%. With a tight fiscal and ballooning under-recoveries, upstream shares of greater than 40% seem very likely in FY12. The weaker rupee may not be a net benefit to either ONGC or OIL India.

Changes to company models

Cairn India: We update FY12 rupee-dollar rate to 49 and FY13 to 51, and continue to assume a 1.5% currency depreciation for our earnings forecasts.

Reliance Industries: We update rupee dollar forecasts in line with those used for Cairn, and update for: (1) lower KG oil and gas production volumes and (2) lower refining margins. We reduce FY13 KG gas production estimate to 36 mmscmd. Given the weakness in refining margins in 3Q continues, we mark to market FY12 GRM estimate to US$8.7, and reduce FY13 GRM estimate to US$10.1 (from US$11.6/bbl). We continue to

see relatively low levels of net refining capacity additions in CY12; with downside risks to refining margins dependant on demand disappointments. We also estimate a Rs90 bn forex loss for FY13 which though not reflected in the P&L will increase FY12 net debt estimate and therefore the aggregate NAV. We also increase our risk-free rate estimate 70 bp to 8.7%.

ONGC: Besides updating for the weaker rupee, we mark to market capex run rates, and for the strong performance at OVL (essentially through lower than forecast royalty payments) and a higher risk-free rate. Our FY12 ONGC subsidy estimate of Rs510 bn implies a $45/bbl net realisation for the domestic business.

OIL India: We update our model for the weaker rupee and estimate that OIL India pays 11% of total FY12/FY13 under-recoveries. Given the government's current mechanism of linking these proportions to historical delivered PAT ratios, OILI is at a disadvantage, having delivered relatively strong earnings growth, and could theoretically see its subsidy shares increase.

Pharmaceuticals

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Weak rupee to act as second wind

Cipla, Sun and Glenmark benefit the most from INR depreciation in the pharma sector as they have the least hedged USD exposure. Lupin and Dr. Reddy's on the other hand are mostly hedged around 47. Target price for Sun and Glenmark increase by 3% as we increase USD/INR assumption from 48 to 51. Increase in target price for Cipla is higher at 9% as in addition to the currency benefits we increase margin expectation from Indore SEZ plant for FY13 (given the margin improvement in 1H FY12).

Automobiles

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Lower volume growth in a weak economy

Given our expectation of the economic growth remaining weak in FY13, we revise our volume growth expectations for all segments of the industry downwards. Given the low base for the passenger car industry in FY12, we expect FY13 to be a better year and have 15% growth next year. In all the other segments, we expect FY13 to be weaker compared to FY12. On the two-wheelers we now expect only 8% growth in industry volumes in FY13 compared to 13% growth in volumes in FY12. We also lower our M&HCV industry volume growth assumption from 10% to 5%.

Two-wheelers: Our channel checks indicate that retail has significantly slowed. While the marriage season in January will likely give more clarity about the demand on the ground, we have moderated our two-wheeler industry growth assumption from 12% to 7% for FY13.

Hero Motocorp: Other than adjusting for industry volume growth, we have slightly moderated our margin assumptions. The rupee depreciation hurts the company in the form of higher royalty payments to Honda, Japan (since they are Yen-denominated). Thus, we have revised our FY13 EPS estimates for Hero Motocorp from Rs147 to Rs140 and reduced our target price from Rs2,522 to Rs.2,238.

Bajaj Auto: We have revised downwards Bajaj Auto's domestic motorcycle volumes but increased its export volumes leading to a ~3% decline to our FY13 volume estimates. Given its higher share of exports (roughly a third of revenue), Bajaj is a beneficiary of the rupee depreciation. Hence, we have revised upwards our margin estimates for FY13 from 19.2% to 20.6%, leading to a 2% increase in our FY13 estimates; target price increases from Rs1,641 to Rs1,670.

Maruti Suzuki: The passenger car industry continues to be impacted by the adverse macro environment. Maruti with a higher share of petrol models at the entry level, which has been most impacted during the current slowdown, has lost a bit of market share as well. We bring down our volume assumptions for Maruti further and are now building n a 13% decline in its overall volumes in FY12 to 1.1 mn units. We retain our slightly optimistic industry growth target of ~15% in FY13. However, on account of the low base, Maruti's market share should improve and expect its volumes to grow at ~20% to 1.34 mn units. The sharp depreciation of the rupee will put further pressure on already thin margins. Though 3Q should mark the worst quarter for the company and things should look better thereon, we believe it is still early to be buying Maruti. Our EPS estimates are revised down to Rs51 and Rs70 from Rs54 and Rs75 for FY12 and FY13 respectively; target price falls to Rs944 from Rs1,010.

Tata Motors: We have revised down our M&HCV volume growth assumption for FY13 from 10% to 5%. JLR's volume traction remains strong; however, with the bulk of the incremental volumes likely to come from Evoque, which is a lower-margin product, we have tweaked our margin estimates, but the decline is compensated for by the translation gains on account of the depreciation of the rupee. While FY12 earnings increase by 2%, FY13E earnings drop by 4% on lower M&HCV growth. There are no changes to our target price.

Mahindra & Mahindra: We remain convinced about the volume traction in both UVs and SCVs. Mahindra will continue to grow faster than the industry in UVs on account of the new launches. With the company ramping up production of the XUV 5OO and mini–Xylo having the potential to be a large volume model (given its price point of ~Rs600,000 at which 0.5 mn cars are sold) , we build in 80,000 extra units from just these two models. In SCVs, the company should grow in line with industry growth at 15%. However, after nearly three years of bumper growth, we expect tractor volumes to start slowing down slightly and have downgraded our FY13 industry volume growth assumptions to 5%. On account of higher production from Chakan (where part of profit is kept by subsidiary) along with INR depreciation, we have downgraded our FY13 margin estimates by ~130 bp. Our FY12 and FY13 earnings drop by 2% and 10%, respectively, and target price falls from Rs910 to Rs812.

Metals and Mining

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Weak steel market expected to continue at least till 1H13

Liquidity-driven supply-chain unwind continues in Europe. Stress on banks is slowing their lending, causing a classic supply-chain bull-whip. The revival from this is likely to be as sharp as the current unwind, but that depends on the banks becoming comfortable with lending again. In a few weeks, it should be clear if the LTRO funds are really being deployed in the sovereign debt markets. If they are not, we could see renewed stress. If they are, it can be expected that banks will start lending again in a few months.

Continued uncertainty on China. While a restock is inevitable some time, it is difficult to take a 12–18 month view on the sector without confidence on Chinese growth—it directly affects steelmaking costs prices and prices. Weak steel demand growth in China (2–3% YoY) is expected to continue for the next 2–3 years, according to our Chinese steel analyst.

India demand slow; and classic problems of over-leverage. Domestic prices have remained unchanged despite a 20% fall in the rupee, demonstrating the weak demand. Capital investments in the Indian economy continue to deteriorate, and so are some consumer demand segments. Further, most large Indian manufacturers now have weak balance sheets, preventing them from cutting production in response to the weakening demand.

Tata Steel: FY13 should be an eventful year for Tata—its domestic expansion is now just 1Q away, iron ore/coal output from its Canadian/Mozambique mines should also start, and its EU business should release working capital. These can materially change its cash generation potential. While a US$6 bn market cap on US$15 bn EV makes an EV/EBITDA-driven fair value extremely volatile, we believe short of a global crisis, it is difficult to justify a fair value below Rs340. Therefore, we upgrade to NEUTRAL. Fear of a sharper slowdown in Europe/China prevents us from recommending a buy. Potential further book value erosion due to the UK pension fund is another risk.

SAIL: FY07-11 iron ore prices rose $98/t, adding $165/t to SAIL's EBITDA, masking the structural change in staff costs as well as the industry-wide squeeze in smelting margins. With industry fundamentals weakening, we expect the weakness to continue well into FY13, and reduce our EBITDA/T estimates by 18%. Our FY13-14E EPS falls by 38–28%. We remain concerned about delays in commissioning of SAIL's steel plants and therefore still believe CWIP does not need to be valued. Further, even the currently operational coke ovens at its only profitable plants at Bhilai and Bokaro continue to operate below capacity, hurting costs. We roll forward to FY13 and reduce our TP to Rs66. With 19% downside to current market price, we maintain our UNDERPERFORM rating.

JSW Steel: JSW's production cost is undergoing structural changes—access to cheap ore mined near its steel plant is now difficult. Thus, while we have been of the view that its utilisation is likely to pick up in FY13, the price at which it gets iron ore is now likely to be materially higher. Some of this change in fundamentals is now already reflected in the stock price, but we believe there is further downside. We cut our FY13–14 estimates by 4% and 8%, respectively. Our FY12 estimate cut is higher as we incorporate Ispat's reported numbers due to a massive one-time hit again. We maintain our TP of Rs465. With 13% downside to the current market price, we maintain our UNDERPERFORM rating.

IT services

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Weak demand to offset weak rupee

We have revised our FY12E, FY13E and FY14E numbers to reflect further weakening of the macro environment (resulting in lower volume assumptions) and also a weaker rupee (resulting in higher INR-denominated revenue and margins). Thus, our assumptions for revenue, EBIT margins and EPS move up. We now assume an exchange rate of Rs51/USD in our models, versus our previous assumption of Rs47/USD. We leave our target price unchanged at this stage; however, higher EPS numbers will also get negated by potentially lower multiples in this environment. Our FY13E EPS numbers go up by 1–11% for our coverage universe.

In our view, our numbers are reasonably conservative at this point. We have assumed 12–14% volume growth in FY13 for larger companies, assuming further deterioration in the macro. Based on current conditions, we believe the companies can record higher growth. We have assumed that the entire benefits of the currency on margins will not be passed on and the companies may use some of these benefits to make operational investments. Finally, we have modelled in a currency assumption of INR51/USD versus the current level of 53.3.

Capital goods

Amish Shah (amish.shah@credit-suisse.com, 91 22 6777 3743)

Expect further disappointment to L&T's order inflow growth guidance

L&T has already revised down its FY12 order inflow growth guidance twice during the year from 15–20% to 5% now. We believe L&T will miss even this guidance, expect a 9% YoY decline in its FY12 order inflows and see a downside risk to our 11% YoY order inflow growth estimates for FY13.

We believe L&T will be forced to enter into low-margin orders to bolster its order book growth, as its RoEs are more sensitive to asset-turns than margins. Besides, with one-sixth of its order book represented by slow-moving orders, we see downside risk to even our FY12–14 revenue growth estimates.

Rapid investments in strategic ventures and our estimate of initial losses from these entities should result in L&T's RoE to compress to 15–16% over FY12-14 (vs over 25% in the past), which remains one of our key concerns. We cut EPS by 3–6% over FY12–14 and target price by 4% to Rs976, but maintain our UNDERPERFORM rating for L&T.

Utilities

Amish Shah (amish.shah@credit-suisse.com, 91 22 6777 3743)

We update our rupee dollar forecasts to Rs49 (FY12) and Rs51 (FY13 onwards) in our models, resulting in an increase in imported coal costs (in INR terms). However, international spot coal prices have corrected by around 10% over the past four months, limiting the impact of rupee depreciation. Our FY12–13 EPS estimates for Adani Power decline by 5–8%, whereas Lanco's EPS estimates decline by 4–9% for FY12–13. NTPC's earnings remain largely unaffected as the company is currently able to pass-through any increase in fuel costs under its regulated (cost-plus-assured RoE) model. Tata Power's FY13–14 earnings increase by 4–2% on higher revenues (in INR terms) from its Indonesian coal mining business.

Companies Mentioned *(Price as of 05 Jan 12)*
Adani Power Ltd (ADAN.BO, Rs64.30, NEUTRAL, TP Rs71)
Axis Bank Limited (AXBK.BO, Rs869.30, OUTPERFORM, TP Rs997.00)
Bajaj Auto Limited (BAJA.BO, Rs1,464.80, NEUTRAL, TP Rs1,670.00)
Bank of Baroda (BOB.BO, Rs693.95, OUTPERFORM, TP Rs778.00)
Bank of India (BOI.BO, Rs286.05, UNDERPERFORM, TP Rs228.00)
Cairn India Ltd (CAIL.BO, Rs338.75, NEUTRAL, TP Rs372)
Cipla Limited (CIPL.BO, Rs334.95, OUTPERFORM, TP Rs360.45)
Glenmark Pharmaceuticals (GLEN.BO, Rs289.05, OUTPERFORM, TP Rs349.59)
HCL Technologies (HCLT.BO, Rs414.70, OUTPERFORM, TP Rs485.00)
HDFC Bank (HDBK.BO, Rs442.55, OUTPERFORM, TP Rs514.00)
Hero Motocorp Ltd (HROM.BO, Rs1,828.55, OUTPERFORM, TP Rs2,238.00)
ICICI Bank (ICBK.BO, Rs747.25, NEUTRAL, TP Rs711.00)
IndusInd Bank (INBK.BO, Rs246.90, NEUTRAL, TP Rs265.00)
Infosys Limited (INFY.BO, Rs2,838.90, OUTPERFORM, TP Rs3,050.00)
Jaiprakash Power Ventures Ltd (JAPR.BO, Rs34.10, NEUTRAL, TP Rs41.00)
JSW Steel Ltd (JSTL.BO, Rs582.15, UNDERPERFORM [V], TP Rs465.00)
KSK Energy Ventures Ltd (KSKE.BO, Rs36.50, OUTPERFORM, TP Rs135)
Lanco Infratech Ltd. (LAIN.BO, Rs10.37, NEUTRAL [V], TP Rs14.00)
Larsen & Toubro (LART.BO, Rs1,087.40, UNDERPERFORM, TP Rs976.00)
Mahindra & Mahindra (MAHM.BO, Rs649.85, OUTPERFORM, TP Rs812.00)
Maruti Suzuki India Ltd (MRTI.BO, Rs932.70, UNDERPERFORM, TP Rs944.00)
National Hydroelectric Power Corporation Ltd (NHPC.NS, Rs18.65, NEUTRAL, TP Rs26.00)
NTPC Ltd (NTPC.BO, Rs156.85, NEUTRAL, TP Rs181.00)
Oil & Natural Gas Corporation Limited (ONGC.BO, Rs262.30, NEUTRAL, TP Rs315)
Oil India Ltd. (OILI.BO, Rs1,127.95, OUTPERFORM, TP Rs1411)
Punjab National Bank Ltd (PNBK.BO, Rs826.30, NEUTRAL, TP Rs768.00)
Reliance Industries (RELI.BO, Rs699.25, OUTPERFORM, TP Rs910.00)
Reliance Power Ltd (RPOL.BO, Rs70.95, UNDERPERFORM, TP Rs69)
State Bank Of India (SBI.BO, Rs1,691.70, NEUTRAL, TP Rs1,537.00)
Steel Authority of India Ltd (SAIL.BO, Rs83.70, UNDERPERFORM, TP Rs66.00)
Sun Pharmaceuticals Industries Limited (SUN.BO, Rs499.25, OUTPERFORM, TP Rs595.00)
Tata Consultancy Services (TCS.BO, Rs1,172.45, OUTPERFORM, TP Rs1,375.00)
Tata Motors Ltd. (TAMO.BO, Rs201.55, NEUTRAL, TP Rs190.00)
Tata Power Company Ltd (TTPW.BO, Rs93.60, NEUTRAL, TP Rs101)
Tata Steel Ltd (TISC.BO, Rs362.30, NEUTRAL, TP Rs340.00)
United Bank of India (UBOI.BO, Rs46.80, OUTPERFORM, TP Rs134.00)
Wipro Ltd. (WIPR.BO, Rs414.35, NEUTRAL, TP Rs390.00)
Yes Bank Ltd (YESB.BO, Rs247.45, UNDERPERFORM, TP Rs225.00)

Disclosure Appendix

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