



Sensex: 15939

India Strategy

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Preserving Capital: Best Risk-Reward Bets

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Investment Summary

- ❖ **H1CY12 is a period to preserve capital. Hence stable businesses are over-owned, leaving them most vulnerable to major FII sell-offs. Thus in this report, we sift through beaten down large caps to find safety in Price vs. Business**
- ❖ **Expect 2012 to be guided by: (a) government action and (b) global macro. Rate cuts, the fisc, capex, and capital inflows depend on them**
- ❖ **Q1CY12 – a period of disappointments: With UP elections before Budget, expect no major govt action; macro data and earnings to disappoint; US\$ 200 bn of debt rollovers in eurozone; valuations not cheap enough; liquidity inflows at risk. Steep INR depreciation among biggest risks in case of eurozone freeze, vitiating the cycle further**
- ❖ **Most vulnerable: In the event of an FII-led sell-off, the top 10 Index heavyweights would be most under pressure. Of these, RIL, HDFC*, ICICI*, L&T, SBI, Bharti* (*FIIs OW) are already in the lowest quartile of their historical valuations and all ex-HDFC (ref our exercise) have favorable risk-return at CMP. Hence the remaining 4 are vulnerable: Infosys, ITC, HDFC Bank, and TCS*. In Nifty cos, Ambuja, ACC, BHEL, Siemens, HUL, Wipro, ONGC, & Cipla are overvalued**
- ❖ **H2CY12 may bring cheer, with a reversal of current vicious cycle as RBI's rate cuts and Reforms traction stabilize growth and INR. Hence the year-end Sensex could touch 18K (14x FY13E EPS of ~Rs 1,300)**
- ❖ **Best Risk-Reward: Accordingly, we undertook an exercise to sift out the best risk-reward ideas among severely beaten down large caps, using tests such as their 3-year upside, stress-case downside using multiple valuation methodologies, and manageability of their risks**
- ❖ **Stocks which passed these tests were: BPCL, RIL, PNB, PGCIL, ICICI, Bharti, SBI. Unsurprisingly, banks dominate: a) as interest rates reduce, asset quality concerns reduce and credit demand improves, apart from MTM bond gains; b) bulk of provisioning on existing NPAs over, and c) slippages manageable (ref sensitivity exercise)**
- ❖ **Key Sector OWs in Model Portfolio: Banking, Oil & Gas, Pharma, and Telecom**

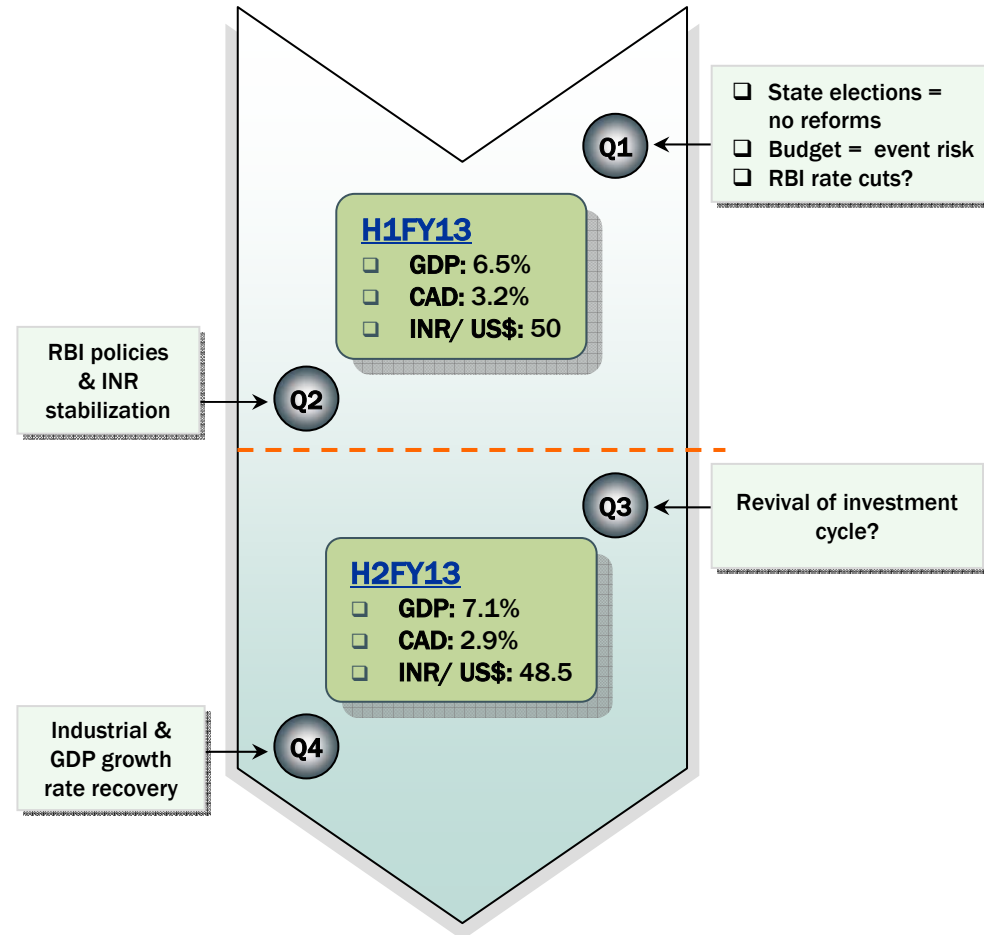
India Macro: Will be a story of 2 halves

❖ **Macro: Clouds to darken in next 3 months before it starts getting any better towards H2FY13 (ref chart) ----->**

- ❑ **Reforms:** Given impending state elections, no major reforms expected till March 2012
- ❑ **Growth:** GDP growth likely to slip to 6.6% in Q3 (vs. 6.9% in Q2 & 7.7% in Q1). IIP growth will hit sub 1% avg. growth rate in Q3 (vs. 3% in Q2 & 7% in Q1) before recovering in Q4
- ❑ **Twin deficits to worsen near term:** Though much of the deterioration is factored in, headlines will continue to disappoint
 - ▶ **Fiscal woes to continue:** Higher slippage on divestment and tax revenue front. We expect FY12 deficit to rise to 5.6% of GDP (vs. budgeted 4.6%) and avg. 5.1-6% in FY13 (ref Appendix for scenarios)
 - ▶ **CAD:** Will rise to 3.6% in Q3 before correcting to 2.7% in Q4 due to seasonality
 - ▶ **INR:** Given negative headlines and muddling policy, INR will remain under pressure and avg. ~Rs 52 in Q4 before showing a bounce thereafter

❖ **Interest rate cuts – the only silver lining:** The onus of rescuing growth will be squarely upon RBI. We expect post-Budget, the RBI to cut Repo rates by 125-150 bps through FY13, with a bulk of it being front ended

Macro environment



Reforms take off and policy clarity hold the key to curing growth & INR woes

Earnings growth concerns

❖ **FY13E Sensex EPS growth** (ref Appendix for sectoral & Top-10 co breakup) **shows some improvement because:**

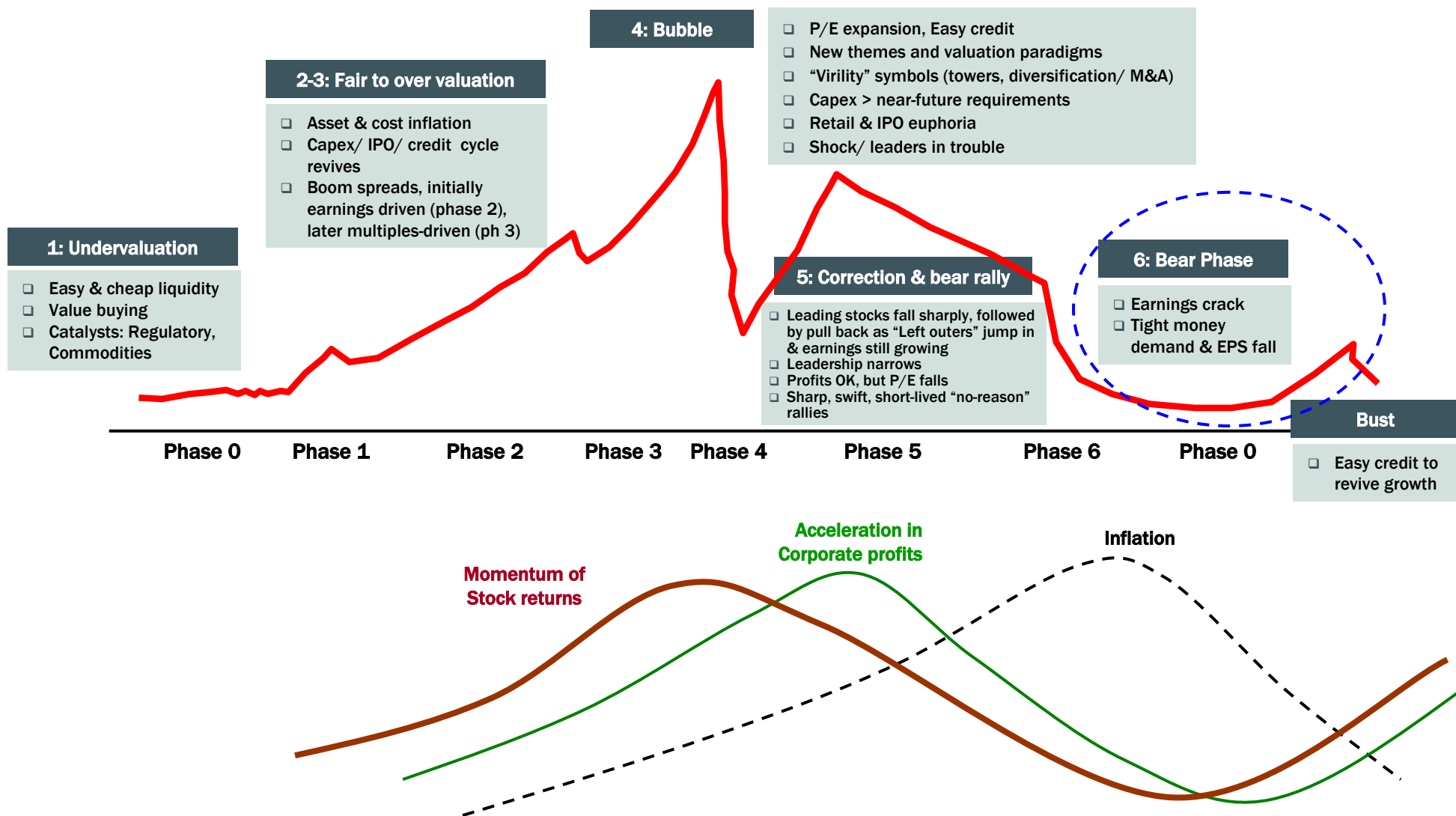
- ❑ ONGC's subsidy share is assumed to fall in FY13 as crude price reduces
- ❑ SBI had huge provisions in FY12 & we assume capital infusion in FY13
- ❑ Bharti had major Africa & 3G investments in FY12 & we assume tariff hikes in FY13
- ❑ ICICI will have lower provisions and higher growth in FY13

Sensex EPS	FY12E	FY13E
EPS (Rs)	1,148	1,304
Growth YoY (%)	12	14

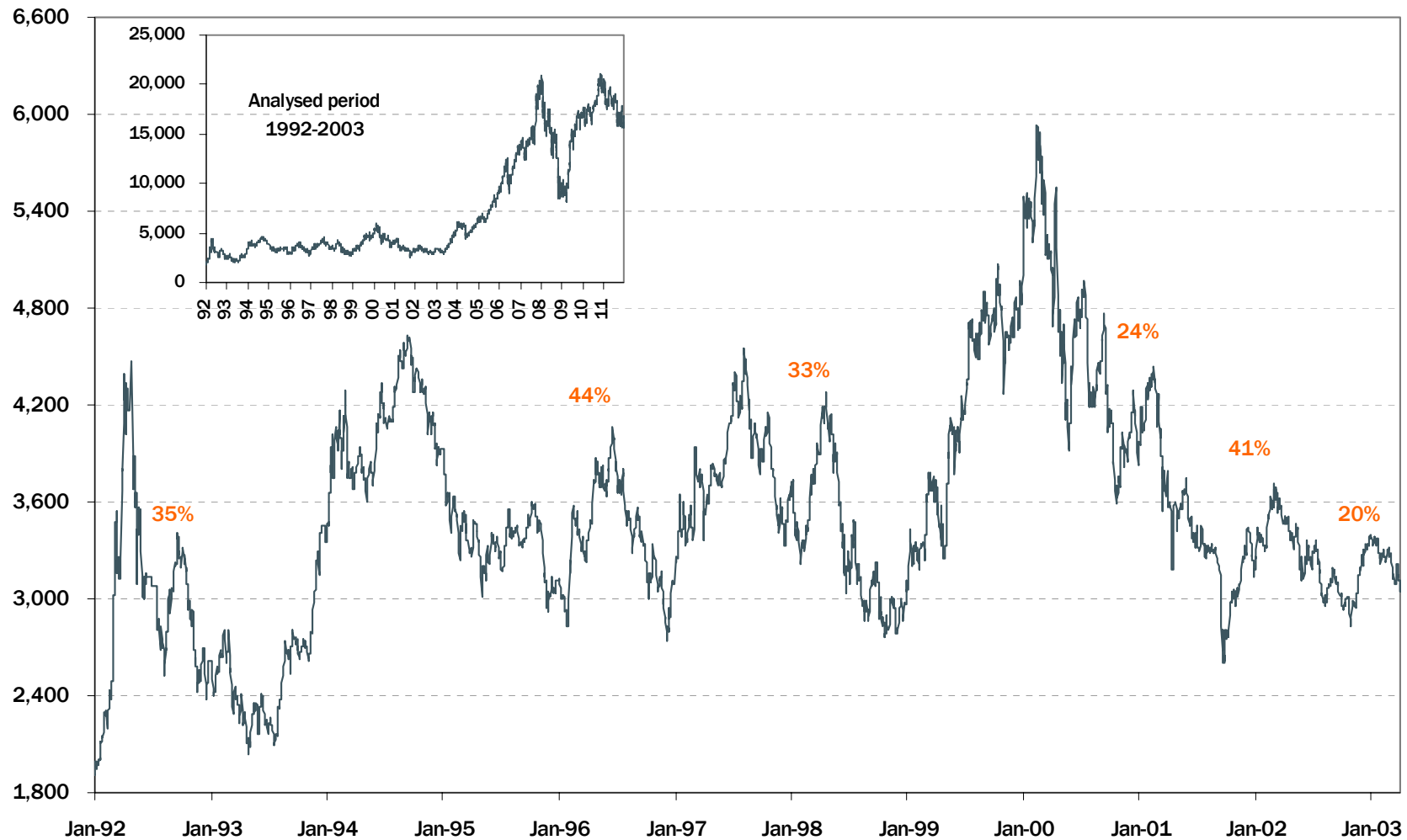
❖ **However, threats that are worrying for India Inc earnings include:**

- ❑ **Investment:** Capex slowdown continues
- ❑ **Consumption:** With rural steroids stagnating and the urban slowdown, **rural deceleration inevitable**
- ❑ **Entry of international players** in Indian industry due to compression in home markets, e.g. in capital goods, auto, etc.
- ❑ **Rapid INR depreciation** could lead to vicious cycle of further INR depreciation and imported inflation if capital flows suffer (India may have to resort to US\$20-25 bn special NRI bonds like the IMD issue in worst case scenario, ref Appendix on BoP)
- ❑ **Availability of coal** to fuel manufacturing remains an issue. **SEB losses** would continue to pile up as tariff revisions inadequate
- ❑ **Banking:** Any large scale restructurings resulting in major provisions could affect individual banks, though the system can withstand them
- ❑ **Clarity on global IT budgets only by Feb**
- ❑ **7 state elections in 2012:** UP (biggest electorate) will finish polling on March 3. Hence, expect little govt action before Budget (mid-March), and if the Cong does not make any headway, it may turn even more populist thereafter. In Opposition-ruled Punjab (ends March 3) and Gujarat (polling in H2CY12), any headway by the Cong can lead to reforms momentum
- **Note:** Our assumptions for 2012 do **NOT include any major govt reforms** (except FDI in retail), **INR to remain weak in FY13** (avg. 49.1 and 48.5 by end FY13) and a **125-150 bps cut in interest rates** (falling crude prices and domestic growth)

We are now at the long and painful rounded-bottom period of market cycle



Bear mkts have swift & sharp misleading rallies



However, there's no discernible pattern in sector/ type of stocks in these bear-rallies – Ref Appendix

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Buys

- ❖ **Closing prices as of 3 Jan 2012 taken as CMP**

Sifting through to shortlist Buys: BPCL, RIL, PNB, PGCIL, ICICI, Bharti, SBI

- ❖ **Candidates considered:** a) Stocks at PEs equivalent to that at 8-14K Sensex AND in their lowest quartile of historical valuations, b) PGCIL which only satisfies the 2nd condition but has high upside potential, and c) BPCL and IOC which are in lowest quartile of their own P/ABV, which is the apt metric for them

Stocks	CMP (Rs)	3-yr TP (Rs/sh)	3-yr stock CAGR (%)	Valuation			Stress case TP (Rs/sh)	Stress case downside (%)	Reco	
				Method	Current	5-yr median				5-yr hist. low
BPCL	474	800	19	P/ABV	0.4x	0.9x	0.3x	460	3	Buy
Reliance Inds	724	1,850	37	EV/EBITDA	5.4x	10.0x	5.3x	660	9	Buy
PNB	803	1,719	29	P/ABV	1.1x	1.4x	0.6x	672	16	Buy
PGCIL \$	101	155	15	P/BV	2.0x	2.4x	1.7x	92	9	Buy
ICICI Bank	725	1,370	24	P/ABV(c)	1.2x	1.8x	0.6x	614	15	Buy
PFC \$	143	286	26	P/ABV	0.9x	1.7x	0.8x	114	20	
Bharti Airtel	358	600	19	EV/EBITDA	7.4x	8.7x	6.3x	308	14	Buy
State Bank	1,707	3,026	21	P/ABV(c)	1.4x	1.6x	0.8x	1409	17	Buy
IDFC \$	97	176	22	P/ABV(c)	1.0x	2.2x	0.9x	78	19	
HDFC	665	1,097	18	P/ABV(c)	4.5x	5.2x	2.0x	554	17	
Tata Power*	93	125	10	SOTP	1.4x	1.9x	1.1x	84	9	
IOC	251	355	12	P/ABV	0.9x	1.0x	0.7x	222	11	
L&T^	1,060	1,586	14	SOTP	10.9x	15.0x	10.0x	916	14	
DLF	191	280	14	P/BV	1.2x	1.0x	0.9x	166	13	
Tata Steel#	361	701	25	EV/EBITDA	5.1x	6.1x	3.0x	231	36	
BHEL \$	248	355	13	P/E	9.7x	21.0x	9.0x	156	37	
Sterlite Inds	95	NA	-	SOTP-EV/EBITDA	2.1x	4.8x	0.0x	77	19	

^ SOTP is core business PE+value of investments. * Power business at PB & coal business at EV/ EBITDA. C: Consolidated

Tata Steel shows high stock 3-yr CAGR, but also has high near-term risk due to potential for global steel price collapse if the Chinese economy hard-lands
For IDFC and PFC, performance is contingent on power sector reforms

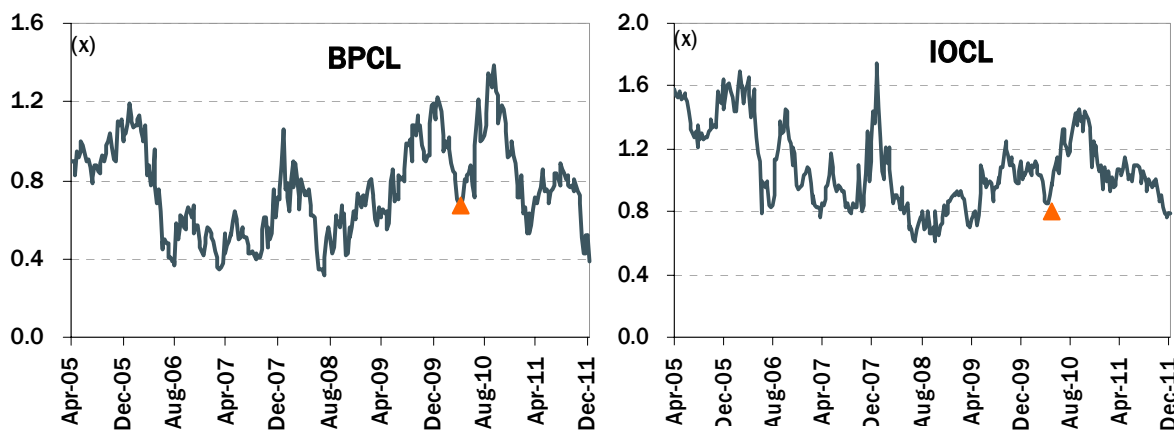
\$ For 3-yr upsides, 5-yr median valuations taken except for BHEL (10 year median of 15x), PGCIL (2.0x), PFC (1.4x), IDFC (1.7x)

To gauge risk-reward note: Downside is a 1-time near-term (FY13) stress-case computation, whereas Upside is THREE-year CAGR

Buys chosen based on: Absolute upside > 15% pa, Up/ Downside Ratio, Absolute immediate downside not high

- ❖ **3-year stock CAGR of 19% and 12% respectively for BPCL (TP: Rs 800) and IOC (TP: Rs 355)**
 - ❑ P/ABV^[1] at 0.85x and 1x for BPCL & IOC respectively (5-year avg.)
- ❖ **Government will continue to protect oil marketing companies**
 - ❑ Historically, government has never allowed OMCs to make losses on an annual basis despite administered fuel prices
 - ❑ OMCs Navratna tag could be at risk if operating conditions deteriorate further: need to make profits in FY12 itself
 - ❑ Upstream RoCEs (30-40%) significantly higher than OMC RoCEs (~10%) making Upstream prime candidate for higher burden
- ❖ **Valuation near CY08 lows on P/ABV – little room for downside**
 - ❑ **BPCL:** No E&P portfolio in CY08; strong E&P portfolio currently, hence valuation near CY08 lows unjustified
 - ❑ **IOC:** Earnings to expand going forward on petchem capacity expansion and likely higher polymer margins

Historical P/ABV for OMCs



▲ Petrol price deregulation and significant hike in other fuel prices.

Stress case TPs with P/ABV at CY08 lows

		BPCL	IOC
FY13 Reported BV	(Rs mn)	161,917	567,703
Less: Treasury stock & current invt.	(Rs mn)	(31,788)	(46,522)
Adjusted Book Value (ABV)	(Rs mn)	130,129	521,181
Adjusted number of shares	(mn)	328	2,370
Implied stress TPs	(Rs/sh)	460	222
Less: Mkt value of inv. in listed cos	(Rs/sh)	342	79
Core CMP	(Rs/sh)	118	143
Book Values			
Adjusted Book Value	(Rs/sh)	397	220
Reported Book Value	(Rs/sh)	448	234
P/ABV on stress TPs (x)	(Rs/sh)	0.30	0.65

❖ 3-year stock CAGR of 37%

- ❑ TP of Rs 1,850 based on EV/EBITDA of 10x (5-year historical median)*
- ❑ FY15 assumptions: GRMs at US\$9/bl, KG-D6 production at 45 mmscmd; gas price at US\$ 5.75/mmbtu
- ❑ Earnings CAGR of 25% through FY12E-15E backed by doubling of petrochemical capacity and GRMs rising from \$6.5 to 9 / bl as simple refiners exit as fuel oil spreads reduce
- ❑ Further upside not considered, from broadband venture to be launched in 2HCY12

❖ “Net cash” by end of FY12

- ❑ Annual operating cash flow of US\$ 7 bn over next 2-3 years along with US\$7.2 bn proceeds from BP
- ❑ RIL mgmt conservative in exploring inorganic growth avenues; would not destroy cash hoard (did not pursue Lyondell-Basell)

❖ CMP (Rs 724) near replacement cost (Rs 705/sh) and 10% above stress case value (Rs 660/ sh)

Method	Assumptions	Rs/Share
Replacement Cost	<ul style="list-style-type: none"> ❑ Refining (Rs 212/sh): 33MMT at US\$900/cpldx bpd, 29MMT at US\$1,000/cplx bpd ❑ Petchem (Rs 171/sh): Polymer US\$1,250/tn; Derivatives US\$800/tn ❑ E&P (Rs 122/sh): D6/Sat/R-series at US\$10/boe; D3/D4/D9/NEC-25 at US\$5/boe ❑ Shale gas (Rs 28/sh): 11.8 tcf at US\$5/boe 	705
P/BV (x)	<ul style="list-style-type: none"> ❑ P/BV at 1.0x; 5-year historic average at 1.7x 	660
Stress DCF	<ul style="list-style-type: none"> ❑ Refining: FY13E EV/EBITDA of 5x;GRM at US\$8.5/bl ❑ Petchem:FY13E EV/EBITDA of 5x; Margin at 2008 levels ❑ KG-D6: 9.3 tcf; Peak production at 60 mmscmd; Other blocks: 50% discount 	784
EV/EBITDA (x)	<ul style="list-style-type: none"> ❑ EV/EBITDA at 7x; 25% discount to historical average 	913

Source: ENAM Research

* Adjusting for non-earning assets in CY 07- 09 (ie ignoring E&P), implied EV/ E then= ~7.5x, implying 3 yr TP of ~Rs 1475, ie stock CAGR of 20%

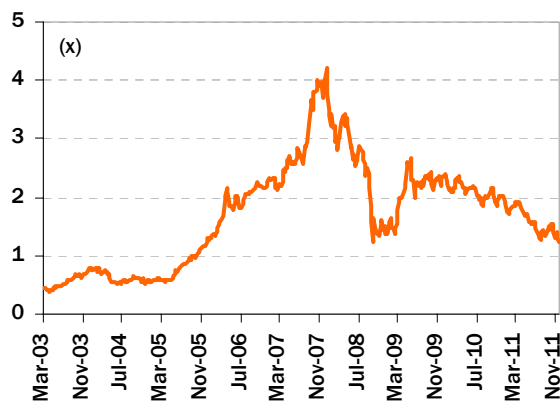
CMP prices in the extant cyclical biz & cash only; E&P biz available for free!

	(USD bn)	(Rs/ Shr)	Comments
Refining, petchem	38.9	554	FY13E EV/E of 6.5x
PMT, Yemen, Shale gas	4.0	57	DCF
Treasury shares (at CMP)	4.4	63	Conversion at CMP
Total enterprise value	47.3	674	
FY12 Net Debt	(8.5)	(121)	Net of cash from BP
Total Equity value	55.7	795	
CMP	50.7	724	
Valuation ascribed to E&P	(5.0)	(71)	E&P avlbl for free
E&P business valuation	14.4	206	
KG D6	8.1	116	
NEC-25, D4, D3, D9	4.2	60	
Contingent resources	2.1	30	

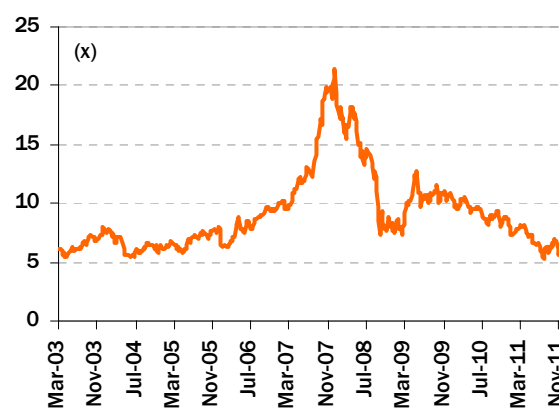
Source: Company, ENAM Research * the above valuations are not our SOTP

Valuation - pessimism overdone

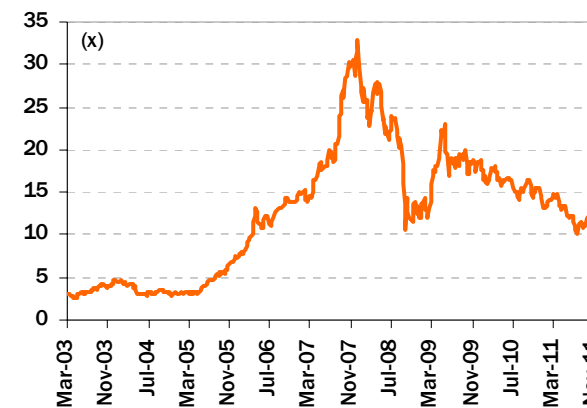
P/BV (1-yr fwd)



EV/EBITDA (1-yr fwd)



P/E (1-yr fwd)



❖ 3-yr stock CAGR of 15%

- ❑ Based on 2x FY16E BVPS (vs. 5 yr median of 2.4x) as post FY15, book accretion would slow vs. FY07-15E CAGR of 14%. Higher growth in FY07-15 is due to expansion of mkt share to ~85% of incremental capacities vs. ~33% earlier. Stable 17%+ RoE business
- ❑ 20% earnings CAGR over FY12E-15E driven by: gross block (Rs 500 bn) + CWIP (Rs 260 bn) + FY12 capex (Rs 180 bn)

❖ Large proportion of medium-term asset growth linked to NTPC; significant delays unlikely

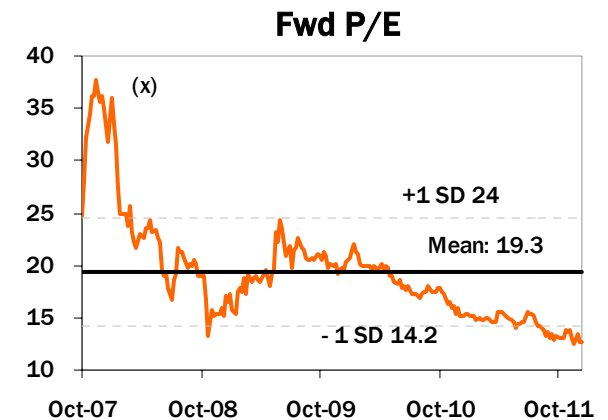
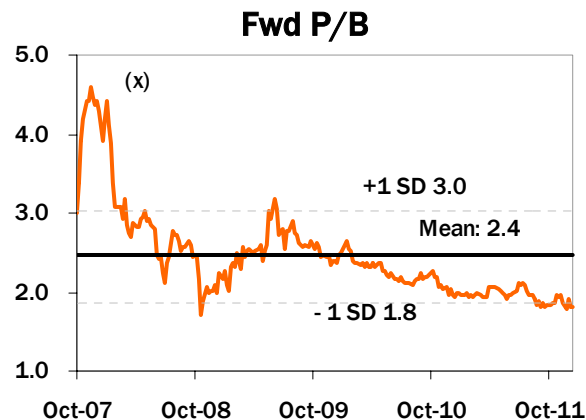
- ❑ Capacity build-out (thus profits) of 1.5x over next 3 yrs is largely dependant projects nearing completion for NTPC/ Mundra UMPPs
- ❑ For private power projects, which may see some delay, PGCIL has tied up investment with a cluster of projects. Hence, commissioning and returns not dependent on any one project.

❖ Stress case value of Rs 92 (9% downside from CMP Rs 101/sh)

- ❑ Stress valuation of Rs 92 implies P/B of 1.6x for core biz derived from Gordon growth model assuming MT growth of 8% (v/s current 11%), conversion cycle of CWIP at 3 yrs (current 2 yrs) and RoE of 16% (v/s. current 17%).

CMP implies significant slowdown in earnings

Implied Growth model	(Rs)
EPS FY12E	7
PE expected FY14	15
Hurdle rate	20%
Reqd stock price	120
Implied EPS FY14	8
EPS growth FY12-14E	9%



- ❖ **Upside potential - multiple earnings drivers, stock CAGR of ~19% over FY12E-15E (TP: Rs 600)**
 - ❑ **India:** Return of pricing power to improve realisation from 2HFY12E (FY12-15E RPM CAGR of 1% v/s 15% CAGR decline over FY08-11). Upside from 3G (FY12-15E Rev CAGR: >80%; contribution to grow to 4-5%)
 - ❑ **Africa:** Volume growth to accelerate (FY12-15E: ~30% CAGR) driven by market penetration and minutes elasticity
 - ❑ **Tower co:** Increasing tenancy ratio (2.7x in FY15E v/s 1.9x in FY12E) to drive operating leverage

- ❖ **Huge regulatory levies unlikely; Bharti cushioned by healthy BS**
 - ❑ **Upcoming National Telecom Policy / Spectrum Enactment Act** to allay concerns on huge regulatory levies (aggregating ~US\$ 6-7 bn) by facilitating industry consolidation, right basing pricing for 2G spectrum/ renewal fees (vs. 3G currently), Spectrum Re-farming etc
 - ❑ **Mitigants: (1) Strong BS:** Comfortable Net Debt/ Equity (Q2FY12: 1.3x; FY15E: ~0.25x) and Net Debt/ EBITDA (Q2FY12: 2.9x; FY15E: 0.4x) (2) **Free Cash Flows** (~US\$3 bn in FY14E and growing)

- ❖ **Current valuation (on EV/E) at multi-year lows:** Our worst case value per share at Rs 308 assumes lower multiple for tower co, regulatory and forex impact

Method	Assumptions	Rs/Share
Stress case valuation (SoTP)	<ul style="list-style-type: none"> ❑ Tower Co: FY13E EV/EBITDA of 8x (same as wireless multiple) v/s our base case of 12x ❑ Regulatory Impact: Rs 91/ share in the worst case which includes (a) TRAI Feb 2011 Recos; (b) DoT recos in Oct/Nov 2011 & (c) End of roaming & 3G ICR, MTR cut ❑ Forex: Rs 40/share impact (both INR & African currencies depreciate 20% v/s US\$) 	308

Source: ENAM Research

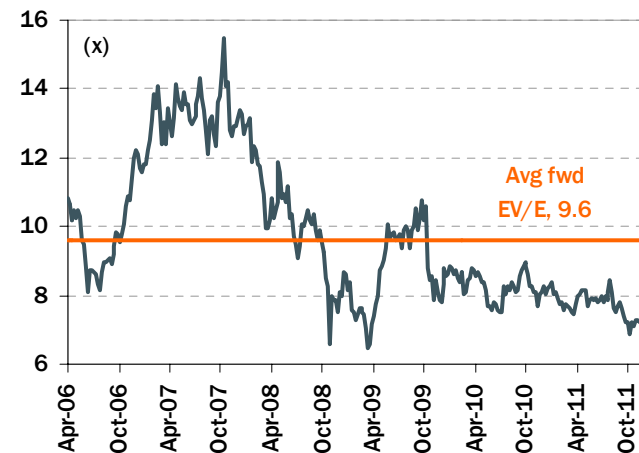
FY13E: Market (implied EPS) factoring in ~25% lower than expected EPS; unlikely to come about, in our view

Implied Growth Model	(Rs)
CMP	358
Avg 5 yr fwd P/E	19
Implied FY13E EPS	19
Expected FY13E EPS	25
Variance	(25)

Forward PE: At ~20% discount to long term average



Forward EV/EBITDA: At all-time low ...



Sensitivity of SBI/ ICICI/ PNB to slippages: Worst case impact of 9-17% on PBT

Exposure to vulnerable sectors in Mar 11

Bank	GNPA % (Sep-11)	Prov coverage% (Sep-11)	Slippage% In FY 11	Restr. Loan% (Sep-11)	Infra (ex-power)	Power	Construction	Textiles	Gems & Jewellery	Iron and Steel
ICICI Bank	4.1	78.2	1.5	1.0	5.1	5.0	1.8	0.8	0.8	3.7
SBI	4.2	63.5	2.4	4.4	6.4	2.8	1.3	5.2	1.2	4.9
PNB	2.1	75.1	2.3	6.0	7.9	6.7	0.8	3.2	0.5	4.1

Source: ENAM Research; Note – Exposures based on FY11 Company Annual Reports

We have assumed default ratio of 2-6%/ sector, with max provisioning requirement in 1st year of slippage, ie 25%. Worst case PBT impact (RoE also drops by similar magnitude for that year):

SBI – 17%

Assumed slippage	2%	4%	6%
Sensitive sectors	% Impact on FY13E PBT		
Construction	0.3	0.7	1.0
Textiles	1.4	2.7	4.1
Gems & Jewellery	0.3	0.6	0.9
Iron and Steel	1.3	2.5	3.8
Infrastructure (ex power)	1.7	3.3	5.0
Power	0.7	1.5	2.2
Total % Impact on PBT	6	11	17

PNB – 9%

Assumed slippage	2%	4%	6%
Sensitive sectors	% Impact on FY13E PBT		
Construction	0.1	0.2	0.3
Textiles	0.4	0.9	1.3
Gems & Jewellery	0.1	0.1	0.2
Iron and Steel	0.5	1.1	1.6
Infrastructure (ex power)	1.1	2.1	3.2
Power	0.9	1.8	2.7
Total % Impact on PBT	3	6	9

ICICI Bank – 10%

Assumed slippage	2%	4%	6%
Sensitive sectors	% Impact on FY13E PBT		
Construction	0.3	0.7	1.0
Textiles	0.2	0.3	0.5
Gems & Jewellery	0.1	0.3	0.4
Iron and Steel	0.7	1.4	2.0
Infrastructure (ex power)	1.0	1.9	2.9
Power	0.9	1.8	2.8
Total % Impact on PBT	3	6	10

Source: ENAM Research; Note – Exposures based on FY11 Company Annual Reports

❖ 29% stock CAGR over FY12E-15E

- ❑ 21% earnings CAGR over FY12E-15E driven by (a) loan CAGR of ~18% (v/s 26% growth over last 3 yrs) (b) stable margin (~350 bps) and (c) consistent growth in fee income ~10%. TP of Rs 1,719 based on 5-yr median multiple of 1.4x FY15E ABV
- ❑ Return ratios expected to remain stable with RoA of 1.2% and RoE of ~22% supported by strong CASA (~37%) franchise

❖ Despite near term asset quality concerns, high provision coverage provides cushion to earnings

- ❑ Restructured advances at ~6% amongst the highest in industry due to proactive restructuring of loans including SEBs. However it maintains high PCR of ~75% which cushions earnings from asset quality shocks
- ❑ We expect credit costs at ~0.8% over FY12E-15E (v/s 0.4% in FY11) due to higher expected slippages from restructured loans

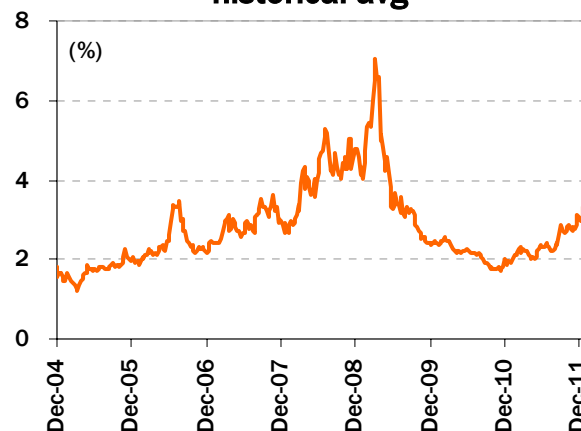
❖ We believe current valuation factors in most asset quality concerns; Stress valuation of Rs 672 implies P/ABV of 0.9x assuming 14% credit growth and 6% slippages

Gordon growth – Higher Justified P/BV

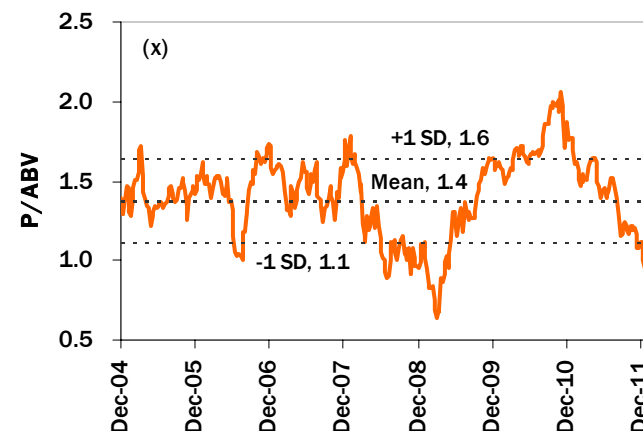
	(%)
Sustainable ROE	20
Sustainable growth	6
Cost of equity	14
P/B (Gordon) (x)	1.7

Stress Case TP	Rs 672
Downside from CMP	16%
0.9x FY13E ABV	
Assumed 6% slippages and 14% credit growth	

Dividend yield in line with historical avg



Trades below -1 S.D. P/ABV

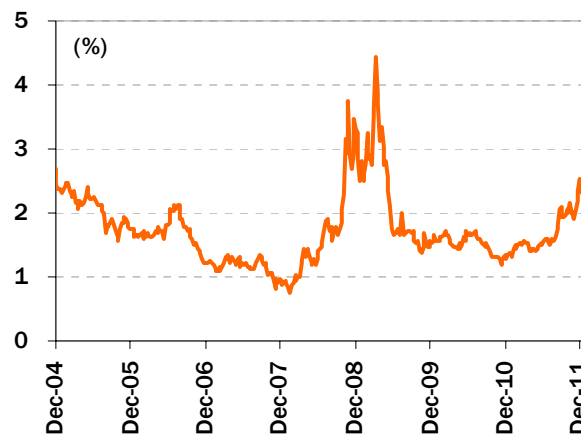


- ❖ **24% 3-yr stock CAGR – underleveraged balance sheet with strong growth drivers in place**
 - ❑ Earnings CAGR over FY12E-15E at ~20% driven by (a) loan CAGR of ~17% (v/s flat growth over last 3 yrs), margin improvement (by ~15 bps from current 2.6%) and (c) avg credit costs expected to be low at ~0.7% over FY12-15E (v/s 1.3% in FY11). TP of Rs 1,370 based on 1.8x FY15E core ABV + investments
 - ❑ Well capitalized (Tier 1 ~13%), standalone RoEs to improve from current ~12% to ~15% over next two years
- ❖ **Asset quality concerns remain but not as stark as in 2009**
 - ❑ Overseas book well protected with majority being India-centric exposure (>80%). Investments in bonds of European banks is less than US\$35 mn
 - ❑ Pace of NPA accretion has consistently slowed down, ICICI has seen negligible net addition to NPAs in last six months along with a high coverage ratio of 78%. Current focus is on secured asset classes (unsecured retail loans ~5%)
- ❖ **Valuation: Stress valuation of Rs 614 implies P/ABV of 0.9x for core biz assuming 14% credit growth, 2.7% slippages and lower value of investments**

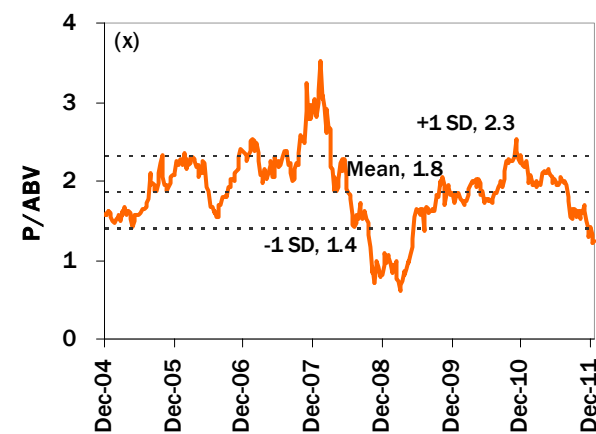
Gordon growth – Higher justified P/BV

	(%)
Sustainable core ROE	15
Sustainable growth	5
Cost of equity	14.3
P/B (Gordon) (x)	1.1
Stress Case TP Rs 614	
Downside from CMP	15%
0.9x FY13E ABV + investments	
Assumed 2.7% slippages, 14% credit growth and lower VOI	

Dividend yield above historical avg



Pessimism overdone: Near -1 S.D. P/ABV



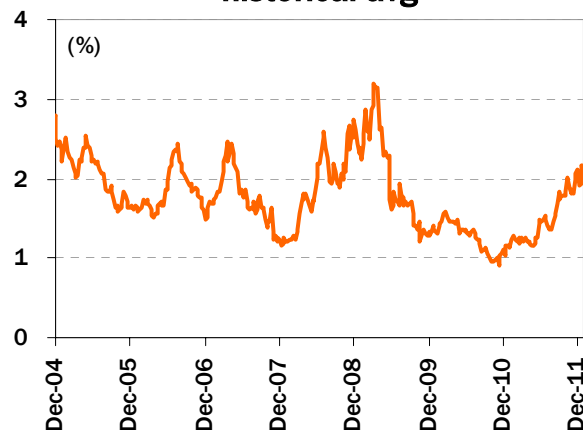
- ❖ **21% 3-yr stock CAGR – capital infusion by government to support business growth**
 - ❑ PAT is expected to post CAGR of ~22% over FY12E-15E (factoring in slippage ratio of 2.4%), driven by higher NIM (3.3%) and moderate loan growth (~15%). TP of Rs 3,026 based on 1.6x FY15E core ABV + value of investments
 - ❑ Capital infusion by the govt would support business growth and is likely to be book accretive
- ❖ **Initiatives on asset quality and capital conservation to support balance sheet**
 - ❑ Mgmt targets net NPA ratio at 1.8% for FY12E (v/s ~2% in Sep-11) driven by (1) higher focus on recoveries and (2) business process re-engineering (creating special recovery teams)
 - ❑ Tier-1 CAR to be shored up to ~8% without any capital infusion through (a) transfer of export credit to ECGC and (b) cancelling unutilised limits to infra sector
- ❖ **Stress case implies ~17% downside from current level: Our stress case assumes FY13E credit growth of ~14% v/s base case of ~16%. Our stress case TP of Rs 1,409 is based on 0.9x FY13E ABV**

Gordon growth – Justified P/BV higher than trading P/BV

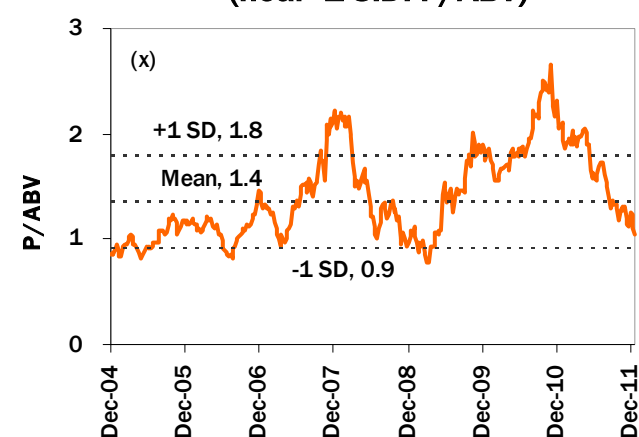
	(%)
Sustainable core ROE	15
Sustainable growth	5.0
Cost of equity	14
P/B (gordon) (x)	1.1

Stress Case TP	Rs 1409
Downside from CMP	17%
0.9x FY13E ABV + investments	
Assumed 4.5% slippages, 14% credit growth and lower VOI	

Dividend yield in line with historical avg



Trades near historical lows (near -1 S.D. P/ABV)





Model Portfolio

Model Portfolio

❖ **Key Sector OWs: Banking, Oil & Gas, Pharma, and Telecom**

❖ **Key Nifty-OW positions and non-Nifty inclusions:**

BFSI	Oil & Gas	Engg/ Infra	Exporters	Resources	Domestic Conspn, etc
<input type="checkbox"/> SBI <input type="checkbox"/> ICICI <input type="checkbox"/> Axis Bk <input type="checkbox"/> BOB <input type="checkbox"/> PNB <input type="checkbox"/> PFC	<input type="checkbox"/> RIL <input type="checkbox"/> Cairn <input type="checkbox"/> BPCL <input type="checkbox"/> HPCL	<input type="checkbox"/> PGCIL	<input type="checkbox"/> Sun Pharma <input type="checkbox"/> HCL Tech <input type="checkbox"/> Dr Reddy's <input type="checkbox"/> Lupin <input type="checkbox"/> Ranbaxy	<input type="checkbox"/> Coal India <input type="checkbox"/> Hindustan Zinc <input type="checkbox"/> Sterlite Inds	<input type="checkbox"/> Bharti <input type="checkbox"/> Bajaj Auto <input type="checkbox"/> Coromandel Intl <input type="checkbox"/> Jain Irrigation <input type="checkbox"/> Pantaloon

Nifty-benchmarked ENAM Model Portfolio...

Notes: a) Nil-cash portfolio, b) Non-Nifty stocks highlighted in blue & usually capped at 2%, c) Allocations capped at 10% (eg RIL, ICICI), d) Stks of mcap < \$ 1bn excluded irrespective of analyst's upside, e) Tgt pr upsides are based on 1yr analyst-outlook while Model portfolio may be at variance to reflect nearer term concerns/ triggers, allocative Imperatives, impending changes in multiples for factors not yet quantifiable into forecasts, f) Highlighted wtgs are those that are changed from previous wtgs, underlined = major OW vs Nifty

Sector/ Company name	Mcap (USD mn)	CMP (INR)	Weightages (%)		Target Pr. (INR)	Upside (%)	21-Sep-11 Price (INR)	21-Sep-11 Weights (%)	OW/ UW wrt Nifty
			Nifty Current	ENAM 3-Jan-12					
Auto	38,506		8.3	5.5				3.5	▼
Mah & Mah	7,880	687	2.2	2.0	763	11	814	1.0	▼
Tata Motors	9,824	179	2.4	0.0	216	21	165	0.0	▼
Bajaj Auto	8,660	1,602	1.5	<u>2.5</u>	UR	-	1,603	2.5	▲
Hero Honda	7,148	1,904	1.3	1.0	UR	-	2,138	0.0	▼
Maruti Suzuki	4,994	921	0.9	0.0	1,020	11	1,124	0.0	▼
Banks & Financial Services	98,627		24.3	27.0				29.5	▲
State Bank	19,322	1,627	3.0	<u>6.0</u>	2,158	33	2,007	4.0	▲
HDFC Bank	18,780	431	5.5	4.0	505	17	493	6.0	▼
ICICI Bank	14,825	686	5.6	<u>8.0</u>	907	32	901	7.5	▲
HDFC	17,980	655	6.1	4.0	672	3	674	6.0	▼
Axis Bank	6,254	817	1.5	<u>2.0</u>	NR	-	1,154	2.0	▲
Kotak Mah Bank	6,003	446	1.1	0.0	-	-	480	0.0	▼
PNB	4,667	781	0.7	<u>1.5</u>	1,175	51	1,001	1.5	▲
IDFC	2,523	95	0.8	0.0	128	35	115	0.0	▼
BoB	4,862	682	-	0.5	915	34	790	0.5	-
Power Finance	3,411	132	-	1.0	200	51	164	2.0	-
Cement	14,902		3.1	1.0				2.0	▼
Ambuja Cement	4,478	158	0.8	0.0	135	(14)	149	0.0	▼
Grasim Inds	4,322	2,517	1.1	1.0	2,833	13	2,357	2.0	▼
ACC	4,009	1,150	0.8	0.0	962	(16)	1,073	0.0	▼
JP Associates	2,094	53	0.4	0.0	78	47	74	0.0	▼

...Nifty-benchmarked ENAM Model Portfolio...

Sector/ Company name	Mcap (USD mn)	CMP (INR)	Weightages (%)		Target Pr. (INR)	Upside (%)	21-Sep-11 Price (INR)	21-Sep-11 Weights (%)	OW/ UW wrt Nifty
			Nifty Current	ENAM 3-Jan-12					
Engineering & Infra	28,248		5.9	5.0				5.0	▼
Larsen & Toubro	11,440	1,001	3.8	4.0	1,464	46	1,562	4.0	◀▶
BHEL	10,991	237	1.3	1.0	207	(13)	328	1.0	▼
Siemens	4,107	641	0.4	0.0	538	(16)	896	0.0	▼
Reliance Infra	1,711	346	0.3	0.0	-	-	459	0.0	▼
FMCG, Media, Retail, etc	48,668		10.7	9.0				11.5	▼
ITC	29,487	201	7.7	6.0	-	-	198	7.5	▼
Hindustan Unilever	16,558	413	3.0	0.0	350	(15)	339	1.0	▼
Coromandel International	1,466	275	-	1.0	400	46	310	1.0	-
Jain Irrigation	629	89	-	1.0	172	94	170	1.0	-
Pantaloon Retail	527	129	-	1.0	312	143	257	1.0	-
IT - Services	95,994		15.8	10.5				10.5	▼
Tata Consultancy	42,704	1,165	4.2	4.0	1,204	3	1,043	5.5	◀▶
Infosys Tech	29,832	2,744	9.5	5.5	2,786	2	2,433	5.0	▼
Wipro	18,419	398	1.4	0.0	368	(8)	355	0.0	▼
HCL Tech	5,039	388	0.7	1.0	490	26	406	0.0	▲
Resources	69,968		5.7	7.0				6.0	▲
SAIL	6,294	80	0.3	0.0	UR	-	114	0.0	▼
Sterlite Inds	5,658	90	0.9	1.5	135	49	134	1.5	▲
Tata Steel	6,042	342	1.6	1.0	481	41	458	0.0	▼
Hindalco Inds	4,164	117	1.1	0.0	122	4	146	0.0	▼
Sesa Goa	2,655	160	0.5	0.0	-	-	220	0.0	▼
Coal India	35,704	299	1.3	3.5	419	40	384	3.5	▲
Hindustan Zinc	9,451	118	-	1.0	145	22	132	1.0	-

...Nifty-benchmarked ENAM Model Portfolio

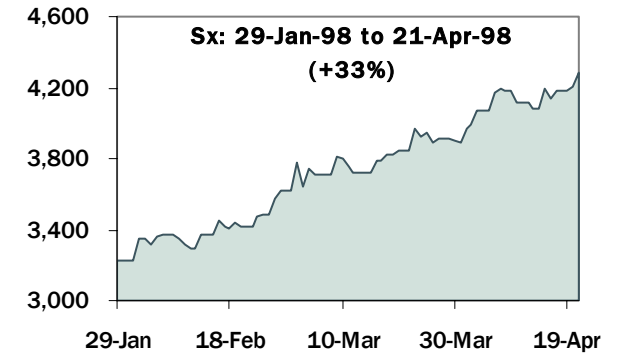
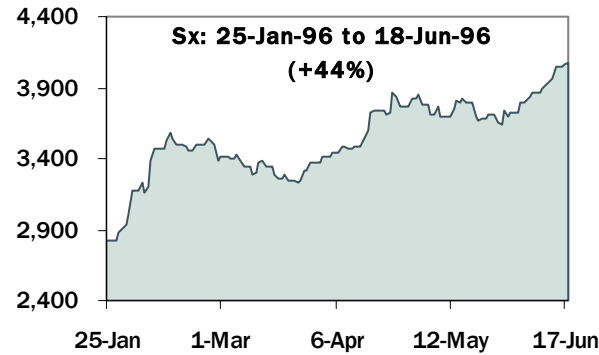
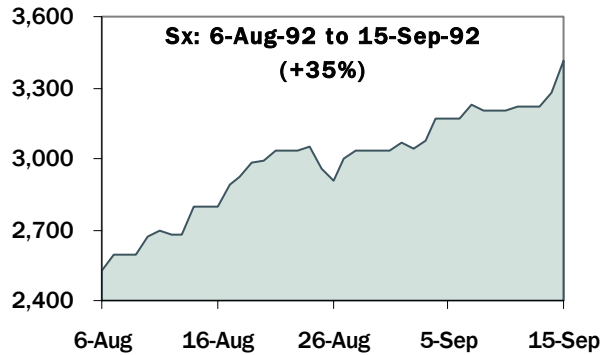
Sector/ Company name	Mcap (USD mn)	CMP (INR)	Weightages (%)		Target Pr. (INR)	Upside (%)	21-Sep-11 Price (INR)	21-Sep-11 Weights (%)	OW/ UW wrt Nifty
			Nifty Current	ENAM 3-Jan-12					
Oil & Gas	109,155		13.2	17.0				12.5	▲
Reliance Inds	42,632	713	8.3	<u>10.0</u>	1,025	44	838	8.0	▲
ONGC	41,305	258	2.5	1.5	250	(3)	261	1.5	▼
Cairn	11,207	305	0.8	<u>1.0</u>	355	16	298	0.0	▲
GAIL	9,154	383	1.2	0.0	420	10	431	0.0	▼
BPCL	3,255	479	0.4	<u>3.0</u>	620	30	662	1.5	▲
HPCL	1,601	248	-	1.5	300	21	370	1.5	-
Pharmaceuticals	26,425		4.3	7.0				5.5	▲
Sun Pharma	9,615	497	1.3	<u>2.0</u>	570	15	484	2.0	▲
Dr Reddy	5,024	1,568	1.4	<u>2.0</u>	1,789	14	1,528	2.0	▲
Cipla	4,821	321	1.2	0.0	310	(4)	284	0.0	▼
Ranbaxy Lab	3,213	404	0.4	<u>1.0</u>	468	16	490	0.0	▲
Lupin Ltd	3,752	440	-	<u>2.0</u>	540	23	486	1.5	-
Power Utilities	49,162		5.0	4.0				7.0	▼
NTPC	24,881	161	1.5	0.0	171	6	173	0.0	▼
Jindal Steel & Power	7,959	463	1.2	<u>1.0</u>	620	34	557	2.0	▼
Power Grid	8,690	100	1.0	<u>3.0</u>	120	20	99	3.0	▲
Tata Power	3,890	89	1.0	<u>0.0</u>	100	13	100	2.0	▼
Reliance Power	3,742	72	0.3	0.0	UR	-	83	0.0	▼
Real Estate	5,841		0.5	0.0				0.0	▼
DLF	5,841	187	0.5	0.0	225	20	213	0.0	▼
Telecommunications	28,748		3.3	7.0				7.0	▲
Bharti Airtel	24,467	341	2.9	<u>6.0</u>	485	42	393	6.0	▲
Reliance Com	2,709	68	0.3	0.0	UR	-	85	0.0	▼
Aditya Birla Nuvo	1,573	750	-	1.0	1,410	88	956	1.0	-
Nifty Index			100.0	100.0				100.0	
Nifty Index performance					From Inception 7-Jan-10	(9.5)			
ENAM Model Portfolio performance					From Inception 7-Jan-10	(9.6)			

Source: Bloomberg; ENAM Research



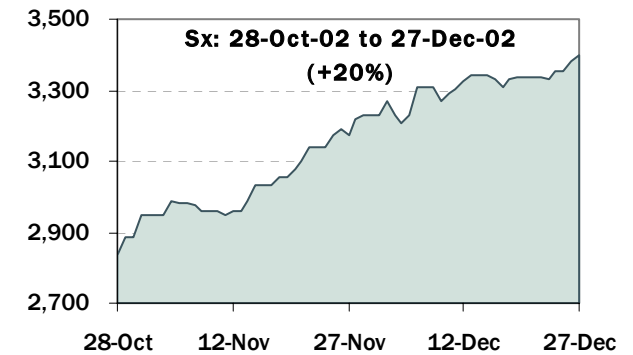
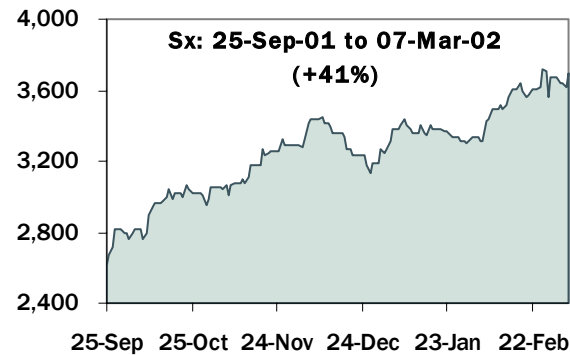
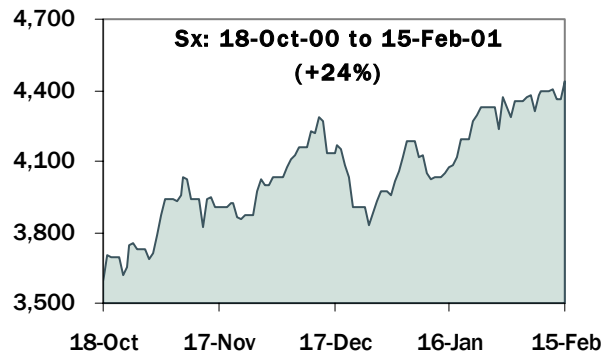
Appendix

Bear rallies have no sectoral or stock patterns...



Sector	Start PE (x)	End PE (x)	Perf (%)	Sector	Start PE (x)	End PE (x)	Perf (%)	Sector	Start PE (x)	End PE (x)	Perf (%)
Oil	9	15	74	Infra	7	14	109	Chem & Fert	8	13	60
Pharma	33	56	70	Power	12	20	73	Engg	14	20	49
Engg	31	46	49	Chem & Fert	13	22	72	Metals	16	24	48
Textiles	41	60	46	Telecom	11	18	69	FMCG	34	49	42
Misc	18	26	44	Engg	10	16	62	Textiles	7	10	36
FMCG	36	51	43	Auto	11	17	58	BFSI	8	11	35
Power	3	5	40	Textiles	7	11	56	Infra	8	11	33
				BFSI	5	8	55				
				Metals	15	23	54				
				Misc	19	27	46				
				Oil	7	10	46				
Top 10 Cos In Sensex				Top 10 Cos In Sensex				Top 10 Cos In Sensex			
Indian Hotels Co. Ltd.	14	26	85	Bharat Heavy Electricals Ltd.	6	13	124	Steel Authority Of India Ltd.	NM	NM	74
Reliance Industries Ltd.	9	15	74	Reliance Infrastructure Ltd.	7	14	109	Nestle India Ltd.	29	48	65
Glaxosmithkline Pharmaceuti	33	56	70	Tata Steel Ltd.	11	21	82	Tata Chemicals Ltd.	8	13	60
I T C Ltd.	29	48	68	Mahindra & Mahindra Ltd.	10	18	77	Bharat Heavy Electricals Ltd.	17	26	57
Futura Polyesters Ltd.	NM	NM	67	Tata Power Co. Ltd.	12	20	73	I C I C I Ltd. [Merged]	7	11	56
Larsen & Toubro Ltd.	28	46	62	Tata Chemicals Ltd.	13	22	72	I D B I Bank Ltd.	4	5	48
Mahindra & Mahindra Ltd.	15	23	52	Mahanagar Telephone Nigam	11	18	69	Indian Petrochemicals Corpn.	6	9	46
Hindustan Motors Ltd.	NM	NM	48	Bajaj Holdings & Invst. Ltd.	11	19	68	Hindalco Industries Ltd.	9	13	44
Premier Ltd.	NM	NM	47	Ambuja Cements Ltd.	12	19	62	Hindustan Unilever Ltd.	44	62	42
Bombay Dyeing & Mfg. Co. Li	25	36	44	I T C Ltd.	11	18	60	I T C Ltd.	24	34	42

...Bear rallies this decade

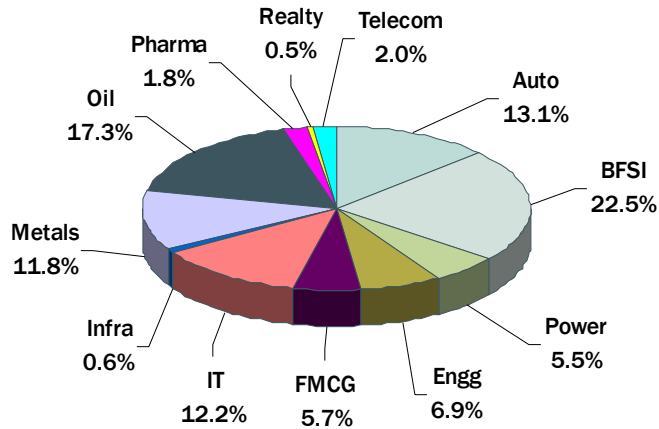


Sector	Start PE (x)	End PE (x)	Perf (%)	Sector	Start PE (x)	End PE (x)	Perf (%)	Sector	Start PE (x)	End PE (x)	Perf (%)
Engg	11	20	78	Auto	19	38	97	Oil	7	9	36
Cement	6	11	76	IT	14	26	88	IT	22	28	27
BFSI	9	12	42	Media	38	66	74	Metals	5	7	25
Oil	11	16	40	BFSI	5	8	58	Media	35	42	20
Telecom	5	7	38	Metals	8	12	52				
Metals	7	9	31	Cement	12	17	45				
Auto	NM	NM	29	Oil	10	15	43				

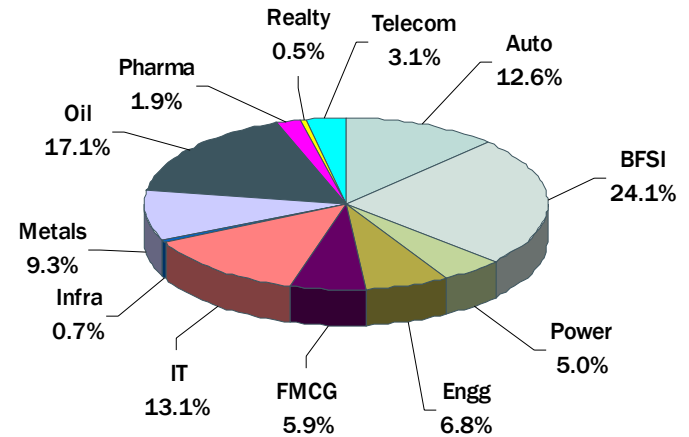
Top 10 Cos in Sensex				Top 10 Cos in Sensex				Top 10 Cos in Sensex			
A C C Ltd.	51	110	119	Hindustan Petroleum Corpn. I	5	14	173	Hindustan Petroleum Corpn. I	5	7	47
Grasim Industries Ltd.	5	9	82	H C L Technologies Ltd.	8	20	135	Reliance Industries Ltd.	7	10	36
Bharat Heavy Electricals Ltd.	8	15	81	Satyam Computer Services Li	8	19	135	Dr. Reddy'S Laboratories Ltd.	14	18	33
Larsen & Toubro Ltd.	15	26	76	Hero Motocorp Ltd.	8	16	105	Satyam Computer Services Li	22	29	33
Tata Steel Ltd.	5	9	75	Bajaj Holdings & Invst. Ltd.	7	15	100	Tata Steel Ltd.	5	6	29
Hindustan Petroleum Corpn. I	3	6	71	Glaxosmithkline Pharmaceuti	NM	NM	95	Infosys Ltd.	26	34	27
Castrol India Ltd.	16	25	55	Tata Motors Ltd.	NM	NM	82	A C C Ltd.	26	32	24
State Bank Of India	5	8	54	Zee Entertainment Enterprise	38	66	74	Bajaj Holdings & Invst. Ltd.	8	10	24
Cipla Ltd.	27	40	49	Infosys Ltd.	20	34	67	State Bank Of India	4	5	23
I C I C I Ltd. [Merged]	38	56	45	Hindalco Industries Ltd.	5	9	57	Tata Motors Ltd.	15	19	23

Stock-wise contribution to Sensex profits

Sensex: PAT contribution FY12E



Sensex: PAT contribution FY13E



Top 10 Contribute 64% of PAT

Company name	FY12e (%)
Reliance Inds	13.4
Infosys	7.4
Tata Motors	7.3
ICICI Bank	7.0
State Bank	6.2
HDFC	5.1
Larsen & Toubro	4.6
ITC	4.4
HDFC Bank	4.2
Tata Steel	4.0

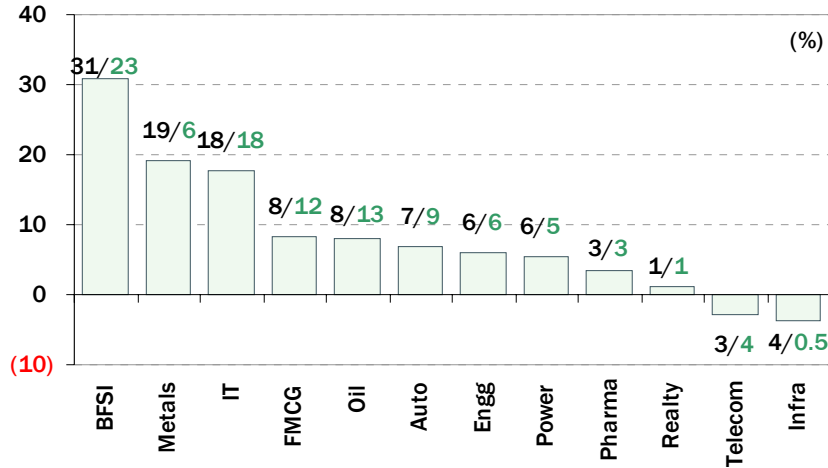
Top 10 Contribute 64% of PAT

Company name	FY13e (%)
Reliance Inds	12.3
Infosys	7.9
ICICI Bank	7.4
State Bank	7.1
Tata Motors	6.1
HDFC	5.2
ONGC	4.7
Larsen & Toubro	4.6
ITC	4.5
HDFC Bank	4.3

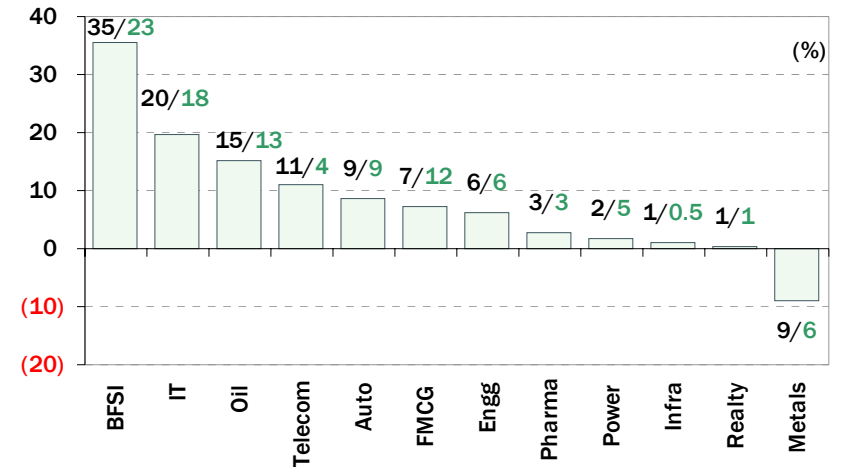
Source: ENAM Research

Sector-wise contribution to Sensex PAT growth

Sector contribution to Sensex PAT growth* FY12E



Sector contribution to Sensex PAT growth* FY13E



* Nos (ff adj) in black are growth nos, whereas green after the slash indicates index weights. While there is no direct relation, it provides a perspective of where growth is v/s its weightage, e.g. Metals with 6% weightage contributes 19% of earnings growth in FY12 v/s high-weightage low-contribution sectors like IT/FMCG/Oil.

Top 10 Contribute 85% of Sensex PAT growth

Company name	FY12e (%)
Reliance Inds	15.3
Infosys	11.8
State Bank	10.3
Sterlite	9.2
HDFC Bank	8.0
HDFC	7.1
ITC	6.4
Tata Motors	5.6
Coal India	5.5
ICICI Bank	5.4

Top 10 Contribute 85% of Sensex PAT growth

Company name	FY13e (%)
State Bank	14.0
Infosys	11.4
Bharti Airtel	10.9
ONGC	10.8
ICICI Bank	10.2
Tata Consultancy	6.2
HDFC	5.7
HDFC Bank	5.5
ITC	5.5
Larsen & Toubro	5.0

Source: ENAM Research

2012: Global backdrop and tentative forecasts

- ❖ **Elections:** in US (Nov), Russia (Mar), China (Oct-Nov), France (Apr-May), S Korea, Greece, etc.
- ❖ **Europe:** Focus on fiscal tightening v/s growth: Recession likely, Expect continued easing, Banking crisis possible, affecting global trade. Euro to weaken with easing & need to support exports
- ❖ **US:** More flexibility, as reserve currency. US\$ to not weaken, given the problems in euro & yen (high real rates, bad fisc). Markets will wait for 2 yrs after new President takes over for LT reforms; else US\$ plunge inevitable then
- ❖ **Inflation:**
 - ❑ Deflation (deleveraging cycle & high unemployment) likely before Govts get away with inflating away problems
 - ❑ Monetary policy to continue to be easy, with anti-inflationary tightening in EMs also ending. But QE unlikely in US (growth has recovered, & easing is incrementally not useful)
- ❖ **China:** Soft-landing likely: Govt well aware of issues and has fiscal & monetary resources to respond to global slowdown; Banks quite liquid (LTD 0.7) & as SoEs, can be recapitalized. Housing remains key concern. RMB/ US\$ appreciation to slow, to support exports
- ❖ **Commodities:** Weak Metals possible as slowing Chinese growth+ no QE+ stronger US\$. But, Alu now below marginal production costs. But Crude may not abate as much as Western recession demands as Strong Asian demand+ strong US\$+ Mid East uncertainty+ futures already discounting a decrease

BoP: Scenarios and funding gap

External Sector	FY12E	FY13 base case	FY13 worst case
Current Account			
Exports (US\$ bn)	291	346	346
Imports (US\$ bn)	440	515	528
- of which oil	130	110	120
- & non oil	310	405	408
Total Trade Bal (DGCIS)	(149)	(169)	(182)
- as a % of GDP	(7.2)	(8.0)	(8.6)
Invisibles, net (US\$ bn)	91.0	103.7	103.7
~Software	45.0	51.3	51.3
~Remittances	53.0	60.4	60.4
Current A/c Bal (US\$ bn)	(58.2)	(65.0)	(78.3)

Funded by

External Sector	FY12E	FY13 base case	FY13 worst case
Capital Account			
FDI	20	25	15
Portfolio Invst	2	5	0
Capital Inflows - % of GDP	1.1	1.2	0.5
Loans (ECBs)	11	20	15
ST (suppliers credit ect)	11	11	7
Banking capital	8	15	13
~of which NRI	5.0	7.5	10
other capital	4.5	6.0	5.0
Cap account balance	56.0	81.5	54.5
% of GDP	2.7	3.9	2.2
Overall balance (US\$ bn)	(2.2)	16.5	(23.8)

Source: RBI; ENAM Research

In our worst case, we have assumed crude avg. of US\$115/bbl

In our worst case, we have assumed lower FDI YoY, zero FII inflows & lower supplier's credit. In such case, INR could overshoot to Rs 56-58 levels

In the worse case, India will have to fund a gap of US\$20-25 bn if it fails to attract capital inflows (FDI/FII) by resorting to debt flows (Special NRI bonds on the lines of IMD etc)

Fiscal deficit concerns to remain

Fiscal deficit will swing on crude price average & food security bill quantum

(Rs bn)	FY11RE	FY12BE	Enam FY12	FY13E base case	FY13E worse case
Net revenue receipts	7,838	7,899	7,581	8,111	8,034
Non-debt capital receipts	317	550	200	300	300
- Divestment	227	400	?	200	
TOTAL REVENUES		8,449	7,781	8,411	8,334
Non Plan Expenditure:					
- Revenue expenditure	10,537	10,972	11,155	12,159	13,253
- Interest	2,408	2,680	2,680	2,975	2,975
- Defense	907	952	952	1,000	1,000
- Subsidies	1,642	1,436	2,246	2,358	2,658
- Capital expenditure	1,629	1,606	1,626	1,627	1,627
TOTAL EXPENDITURE	12,166	12,577	12,781	13,786	14,880
Fiscal deficit	4,010	(4,128)	(5,000)	(5,375)	(6,546)
% to GDP	(5.1)	(4.6)	(5.5)	(5.1)	(6.0)

In our worse case, crude at US\$115/bbl and food security impact of ~Rs 300 bn considered

Govt share of under recoveries (assuming 50% share)

(Rs bn)		Exchange rate (Rs/USD)				
		46	48	50	52	54
Crude oil prices (\$/bbl)	90	342	360	380	487	522
	100	413	486	559	596	666
	110	589	672	755	806	886
	120	765	858	952	1,016	1,107

Source: GoI, ENAM Research

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