

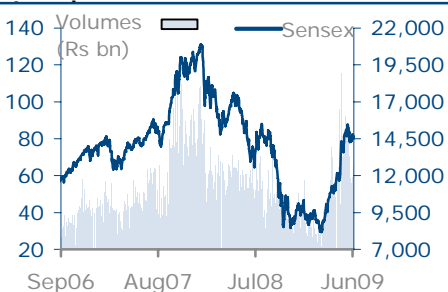
• What's Inside: Strategy (1QFY10 Earnings preview); Bharti Airtel (BUY); Strategema; Events calendar

Market Front Page

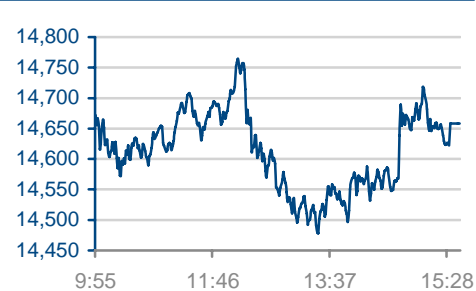
Index Movements	Closing	% Chg	% YTD	ADR/GDR (US\$)	Latest	% Chg	% Prem
Sensex	14,658	0.1	51.9	HDFC Bank	102.0	(2.1)	8.6
Nifty	4,349	0.2	47.0	Reliance	83.9	(2.6)	0.0
BSE Smallcap	5,800	0.7	57.5	Infosys	36.2	(3.0)	(3.4)
CNX Midcap	5,496	0.4	47.1	Satyam	3.3	2.8	4.1
Nasdaq	1,797	(2.7)	13.9	Wipro	11.8	0.4	47.6
DJIA	8,281	(2.6)	(5.6)	ICICI Bank	29.9	(2.9)	(2.4)
IBOV	51,025	(1.0)	35.9	SBI	72.2	(2.0)	(1.6)
FTSE	4,234	(2.5)	(4.5)	Sterlite	12.7	0.5	(3.8)
CAC	3,116	(3.1)	(3.2)	Tata Motors	8.6	(2.8)	40.1
Turnover	US\$m	% Chg	Commodities	Latest	%Chg	%YTD	
BSE	1,229	3.7	Gold (US\$/ounce)	933	0.4	5.8	
NSE	3,702	6.5	Crude (US\$/bl)	67	(3.7)	49.6	
Derivatives (NSE)	11,073	(4.2)	Aluminium (US\$/MT)	1,640	(1.4)	6.5	
FII F&O (US\$m)	Index	Stocks	Copper (US\$/MT)	5,035	(1.0)	64.0	
Net buying	(20)	40	Forex Rates	Closing	% Chg	%YTD	
Open interest	5,607	3,928	Rs/US\$	47.8	(0.3)	(1.4)	
Chg in open int.	265	19	Rs/EUR	67.5	(0.0)	(1.1)	
Equity Flows (US\$m)	Latest	MTD	YTD	Rs/GBP	78.6	(0.4)	12.2
FII (1/7)	34	34	5,004	Bond Markets	Closing	bps Chg	
DII (2/7)	44	28	2,469	10 yr bond		6.9	(9.0)
MF (1/7)	(35)	(35)	450	Interbank call		3.3	0.0

Charts Front Page

Sensex price volume



Sensex intraday



Corporate Front Page

- **Reliance Industries** will partially shut its old Jamnagar refinery for 2-3 weeks to carry out maintenance work. (FE)
- **Hindalco** has received approval from lenders to amend terms of US\$982m loan it obtained to part finance the acquisition of Novelis. (BL)
- Areva France announced that it was disposing all its transmission and distribution businesses globally, including **Areva T&D India Ltd.** (FE)
- **Hindalco** plans to raise US\$500m via QIP to fund its capex plans and retire debt. (ET)
- **NTPC** is in talks with JBIC to raise US\$500m for green energy. (ET)
- **Tech M** plans a second preference allotment of shares to increase its stake in **Satyam**. (FE)
- **L&T** and **Tata Projects** have submitted offers for a Rs15bn project of Coastal Energen. (BL)
- **Shaw Wallace** has sold its entire 10.27% stake in **United Spirits** for Rs9bn. (FE)
- **Punj Lloyd** bagged 3 contracts worth Rs18.7bn from the Housing and Infrastructure Board of Libya. (FE)
- **Yes Bank** plans to raise US\$200m tier-I equity capital either through a follow-on public issue or through a QIP. (BL)
- US drug regulator has approved **Ranbaxy Laboratories** oral solution Oxcarbazepine. (BS)
- **Future Capital Holdings** is setting up a mall development company to manage, develop and own retail properties in the country. (ET)

Market Front Page

Top Movers BSE 200

Top Gainers	Price (Rs)	Chg (%)	YTD (%)	Top Losers	Price (Rs)	Chg (%)	YTD (%)
Torrent Power Ltd	192	11.0	158.6	Bank of Baroda	432	-4.3	54.3
Gujarat Mineral Dev	92	10.0	117.3	India Infoline Ltd	128	-3.2	151.2
GAIL India Ltd	310	7.8	50.5	Television Eightee	109	-3.1	22.7
Sintex Industries Lt	241	7.7	27.4	Bajaj Auto Ltd	978	-3.1	150.1
Oil & Natural Gas C	1127	7.1	68.9	Mundra Port and S	589	-3.1	81.1

Volume spurts

Company	CMP	M.Cap	Vol. (in '000)	10D A.Vol (in '000)	% Chg
GAIL India Ltd	310	8,239	13,583	2,743	395
Bharat Electronics Ltd	1375	2,302	277	77	261
Jain Irrigation Systems Ltc	650	1,019	569	176	223
MAX India Ltd	211	978	1,576	500	215
GlaxoSmithKline Pharmaci	1265	2,243	177	57	209
Torrent Power Ltd	192	1,896	6,372	2,172	193
Indian Oil Corp Ltd	550	13,959	1,692	600	182
Oil & Natural Gas Corp Ltc	1127	50,422	10,288	3,865	166
NIIT Ltd	70	241	37,945	14,962	154
Hindustan Petroleum Corp	320	2,267	5,358	2,228	141

FII - FII trades

Scrip	1/7/2009			2/7/2009		
	Volume '000	Price	Prem %	Volume '000	Price	Prem %
Grasim	27	2,334	0.8	13	2,383	2.0
Pnb	-	-	-	106	700	4.5
Bank of baroda	316	451	0.8	66	440	2.2

Corporate Front Page

- **Coal India** will float tenders for development and operation of high capacity underground mines in 7 blocks on a long term basis within the next 2 weeks. (BL)
- **Max India** approved issuance of shares for Rs4.5bn in one or more tranches. (BL)
- **Ashok Leyland** bagged a Rs3bn order for 1500 buses from Tamil Nadu State Transport Corporation. (BL)
- **Emami** raised Rs3.1bn through QIP. (BL)
- **Strides Arcolab** bought back US\$18.5m of its FCCBs at a 12% discount. (BL)
- Jubilant Pharmaceuticals NV, a subsidiary of **Jubilant Organosys**, recalled its hypertension drug from the UK market on an order issued by the UK regulator. (BL)
- Auditors say that **Wockhardt** will have to repay Rs14bn debt before end of 2009 if it fails to reschedule its debt through CDR program. (BS)
- **HDIL** has raised Rs16.8bn through QIP placement to KKR, Blackstone and fidelity. (BS)
- **Webel-SL Energy** plans to raise Rs600m by private placement of shares with QIB. (BL)
- **Maytas Infrastructure** announced that its lenders have agreed to infuse Rs1bn capital along with restructuring of Rs16bn debt. (BS)
- **S Kumars Nationwide** plans to raise Rs10bn through issue of shares on QIP basis to fund its expansion plans. (FE)
- Drug price regulator, NPPA, issued notices to recover around Rs13bn from pharmaceutical companies for allegedly overcharging consumers. (ET)

Economy Front Page

- Inflation remained in the negative territory for the 3rd week at -1.3% for the week ended June 20. (FE)
- Economic survey 2008-09 reported a GDP growth of 6.7% after stimulus measures. (FE)
- Economic survey has suggested allowing FDI in multi brand retailing. (FE)
- Economic Survey re-iterated at divestment in profit making PSU's and consequently raising Rs250bn. (FE)
- Economic survey suggested deregulation of petrol prices. (FE)
- Economic survey advocated bringing all regulators including commodities, FMC under SEBI. (FE)
- Economic survey also indicated to phasing out of surcharges, cess and transaction tax and lift ban on farm futures, free sugar and fertilizer sectors. (FE)
- Economic survey suggested major reforms in the telecom sector including auctioning spectrum for mobile services. (BL)
- Economic Survey has recommended deregulation of coal sector by introducing 49% FDI. (ET)
- Economic Survey has recommended implementing the GST throughout the country and also favors dual GST structure levied on both center and state. (BS)
- MET department stated that the monsoon for the week ended July 1 was 29% below normal, improving from a 68% shortfall in the previous 7 days. (FE)
- Ministry of road transport seeks fast track clearance for 30 public-private road projects. (BL)
- The centre is planning to open the nuclear sector to private and foreign players. (BL)

Insider Trading

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)	Shares Transaction (%)	Holding after Transaction (%)
Ambika Cotton Mills Ltd	P V Chandran	30/06/2009	Buy	60,000	77.0	5	1.0	1.1
Kamadgiri Synthetics Ltd	Abhay Kumat	16/06/2009	Sell	331,000	32.0	11	11.0	0.7
Kamadgiri Synthetics Ltd	Blessings Mercantile Pvt Ltd	16/06/2009	Buy	200,000	32.0	6	6.7	6.7
Kingfisher Airlines Ltd	G R Gopinath	17/06/2009	Sell	207,917	54.4	11	0.1	3.4
Ruchi Infrastructure Ltd	Dinesh Shahra	26/06/2009	Sell	1,100,000	30.0	33	0.5	2.9
United Spirits Ltd	Shaw Wallace & Co Ltd	30/06/2009	Sell	10,282,553	872.0	8,966	10.3	-
Vippy Industries Ltd	Starshine Enterprises Pvt Ltd	30/06/2009	Buy	17,000,000	7.0	119	6.9	18.7
Vippy Industries Ltd	Sunline India Enterprises Pvt Ltd	30/06/2009	Buy	17,000,000	7.0	119	6.9	18.7
Vippy Industries Ltd	Moon Nutrients Pvt Ltd	30/06/2009	Buy	16,000,000	7.0	112	6.0	18.7

Deal size worth more than Rs5m considered. The exchange does not report transaction prices, so we have assumed them to be closing prices for the respective days. Hence, actual deal sizes may vary from the figures above.

BSE/ NSE - Bulk Deals

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)
Aurobindo Pharma Ltd.	Hsbc Invest (Hk) Ltd A/C Hgif India Equity Fund	2/7/2009	Buy	1,417,000	460.0	652
Aurobindo Pharma Ltd.	Standard Chartered Private Equity (Mauritius) Ltd	2/7/2009	Sell	643,745	460.2	296
Aurobindo Pharma Ltd.	Standard Chartered Private Equity(Mauritius)Ltd-Fdi A/C	2/7/2009	Sell	801,839	460.0	369
Zylog Systems Ltd	Sundaram Small Cap Fund	2/7/2009	Buy	350,000	195.0	68
Zylog Systems Ltd	Sundaram Smile Fund	2/7/2009	Buy	150,000	195.0	29
Zylog Systems Ltd	Aditicon Services India Pvt Ltd	2/7/2009	Sell	201,400	195.0	39
Radico Khait	Citigroup Global Markets Mauritius Private Ltd	2/7/2009	Buy	1,225,000	80.0	98
Radico Khait	Hsbc Global Investment Funds Mauritius Ltd	2/7/2009	Sell	1,211,485	80.0	97

The 1Q earnings season will likely be the third consecutive quarter of YoY profit declines. We estimate an 8.5% YoY profit decline for our universe of 130 companies (10% decline for Sensex), compared with the 4% decline in the previous quarter. However, excluding commodity companies, profits are likely to have increased 3% (2% for Sensex), though this would still be lower than the 7% growth in 4QFY09 (ex commodities). Five sectors—Ferrous and non ferrous metals, Oil & Gas, Real Estate and Telecom—are likely to report outright decline in profits. We expect the Auto sector to report the strongest earnings growth in our universe, while Real Estate will probably show the sharpest profit decline. FMCG, IT Services are likely to report an improvement in profit growth vis-à-vis 4QFY09, while Banks and Capital Goods are likely to report significant deceleration in profit growth from the previous quarter.

Headline revenue growth will continue to decelerate: Overall revenue growth for our universe has likely been a modest 1%—sharply slower than 7% in 4QFY09 and 11% in 3QFY09. Even excluding the commodity sectors, reported sales growth is likely to show a deceleration to 13% in 1QFY10 from 19% in 4QFY09 and 21% in 3QFY09. Four sectors—Ferrous and non ferrous metals, Real Estate and Oil & Gas—are likely to report an outright decline in sales, while Autos will likely show a turnaround, with 8% growth in sales after two consecutive quarters of decline.

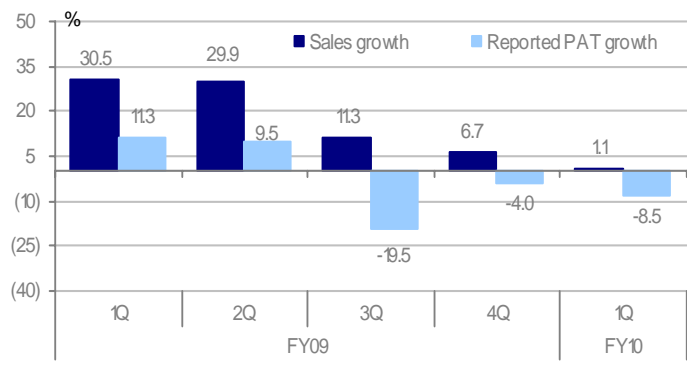
EBITDA margins would be down YoY but up QoQ: For the IIFL Universe, we estimate EBITDA margins would be down 180bps YoY but up 260bps QoQ. EBITDA margins in this quarter are likely to be the highest since 1QFY09. Even excluding commodity sectors, margins are likely to have improved 130bps QoQ, to a three-quarter high. Margin expansion would be especially strong for Autos and Cement, where we reckon they would be the highest since 2HFY08.

Rupee appreciates QoQ after five consecutive quarters of depreciation: The rupee has appreciated ~6% during 1QFY10 after five consecutive quarters of depreciation. Companies that had booked significant MTM losses in the preceding quarters could see a reversal (especially if they have not adopted revised AS-11). Bond yields too have been flat QoQ after rising in 4QFY09, implying no MTM losses for banks on their bond portfolio.

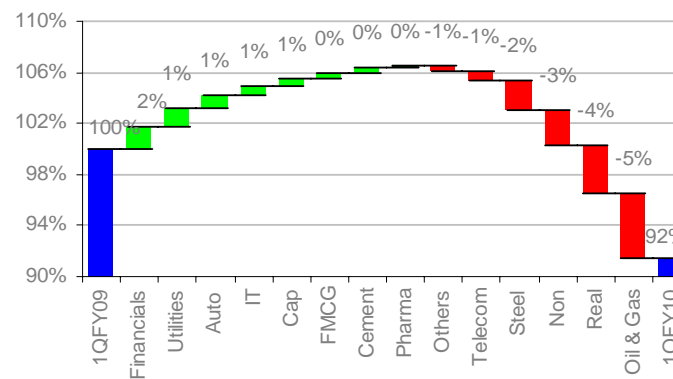
IIFL Universe Quarterly profit growth

On Reported PAT basis	4QFY09	1QFY10
Auto	6.6	28.7
Banks & Financials	26.7	11.8
Capital Goods	23.0	13.8
Cement	6.4	9.1
FMCG	11.5	13.5
IT Services	4.3	7.9
Non Ferrous	-66.9	-39.9
Oil & Gas	-12.0	-22.0
Pharmaceuticals	15.6	9.1
Real Estate	-75.2	-73.2
Steel	-20.1	-31.3
Telecom	4.0	-7.8
Utilities	29.4	26.4
Others	-48.6	-23.7
IIFL Universe	-4.0	-8.5
IIFL Universe ex Financials	-10.5	-12.0
IIFL Universe ex Commodities	7.0	2.6

Source: IIFL Research. Reported PAT basis. Oil & Gas includes RIL and ONGC only

IIFL Universe — profits to lag sales growth for fifth consecutive quarter


Source: IIFL Research

Sectoral contribution to incremental 1QFY10 profits


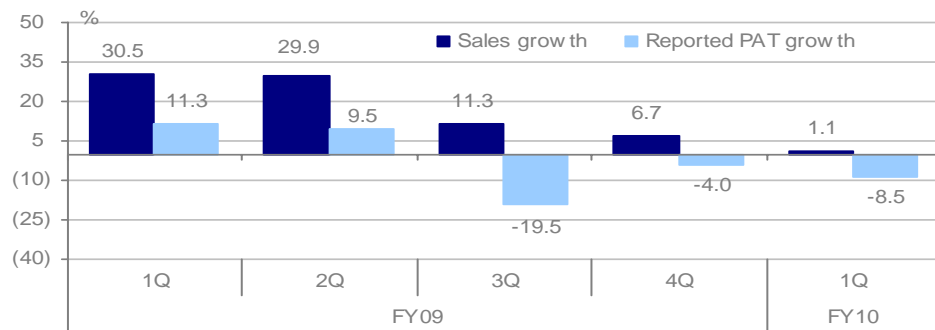
Source: IIFL Research

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We expect an 8.5% decline in profits for our universe of 133 companies—the third straight quarter of YoY decline in reported profits—compared with the 4% decline in profits in 4QFY09. For the widely tracked Sensex, we expect reported profits (non-free-float-weighted) to decline by 10% YoY. Sales are likely to be flattish YoY, with 1% growth—as against the 7% growth in 4QFY09. (For the Sensex, we estimate a 4% YoY sales decline in 1QFY10). Commodities would continue to be the major drag, with a 27% YoY decline in profits for IIFL universe as well as Sensex. Excluding commodity sectors, profit growth would be positive, though still weak at 3% for IIFL universe (2% for Sensex). This will likely be the fifth consecutive quarter when profit growth will lag sales growth for IIFL universe.

Figure 1: Profit growth to lag sales growth for fifth straight quarter for IIFL Universe



Source: Bloomberg, IIFL Research

Apart from the commodity sectors of Metals and Oil & Gas, which we believe will report sharp decline in profits, Real Estate and Telecom will likely report outright decline in profits. We expect Financials and Capital Goods to report a sharp deceleration in profit growth, while FMCG and IT will likely report modest acceleration. Autos will likely be the standout sector in our coverage with the strongest profit growth and a significant turnaround from the previous 2-3 quarters, when the sector witnessed flat/sharply lower profits.

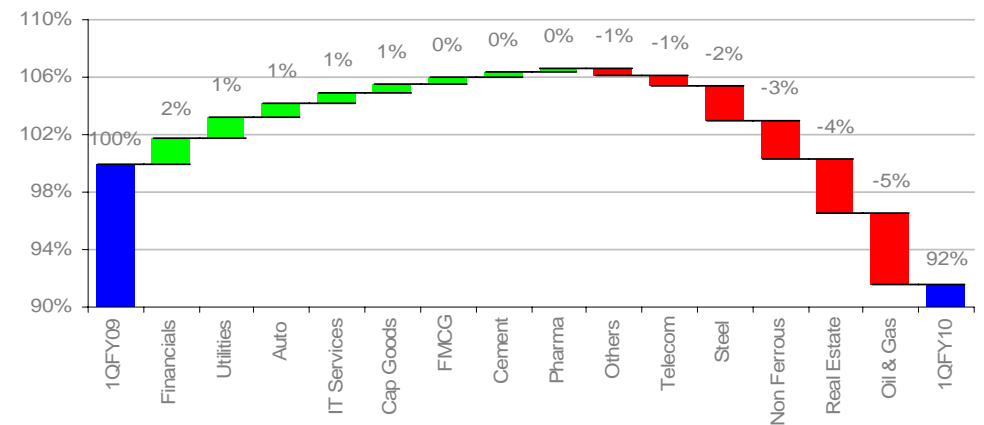
Overall, of the 13 sectors in our universe, we expect four sectors to report outright decline in profits, six sectors to show a deceleration in profit growth from 4QFY09, and seven sectors to show an acceleration in profit growth from 4QFY09.

Figure 2: IIFL Universe sectoral reported PAT growth

For IIFL Universe	Reported PAT growth YoY				1QFY10
	1QFY09	2QFY09	3QFY09	4QFY09	
Auto	0.8	-22.1	-76.4	6.6	28.7
Banks & Financials	17.0	30.9	38.0	26.7	11.8
Capital Goods	37.2	5.7	48.8	23.0	13.8
Cement	-16.1	-14.5	-17.3	6.4	9.1
FMCG	5.8	13.8	6.8	11.5	13.5
IT Services	4.6	17.7	15.3	4.3	7.9
Non Ferrous	-4.6	3.0	-34.5	-66.9	-39.9
Oil & Gas	29.4	1.8	-51.1	-12.0	-22.0
Pharmaceuticals	-4.6	8.6	-80.3	15.6	9.1
Real Estate	21.8	-9.0	-70.3	-75.2	-73.2
Steel	11.6	20.9	-64.6	-20.1	-31.3
Telecom	25.3	17.4	14.5	4.0	-7.8
Utilities	-22.3	6.6	3.1	29.4	26.4
Others	41.9	22.8	-30.5	-48.6	-23.7
IIFL Universe	11.3	9.5	-19.5	-4.0	-8.5
IIFL Universe ex Financials	10.4	5.6	-30.4	-10.5	-12.0
IIFL Universe ex Commodities	7.8	11.3	-1.8	7.0	2.6

Source: Bloomberg, IIFL Research

Figure 3: Sectoral contributors to expected 1Q profit de-growth



Source: IIFL Research

We expect reported EBITDA margins to be down 180bps YoY but up 265bps QoQ in 1QFY10—a bigger QoQ improvement than in the 130bps QoQ expansion in 1QFY09. Excluding commodity companies, we expect margins would be down 170bps YoY but up 270bps QoQ (in 1QFY09, by contrast, margins excluding commodity companies had actually dropped 80bps). Overall EBITDA, we reckon, would be down 7% YoY in 1Q, but up 9% excluding commodity companies.

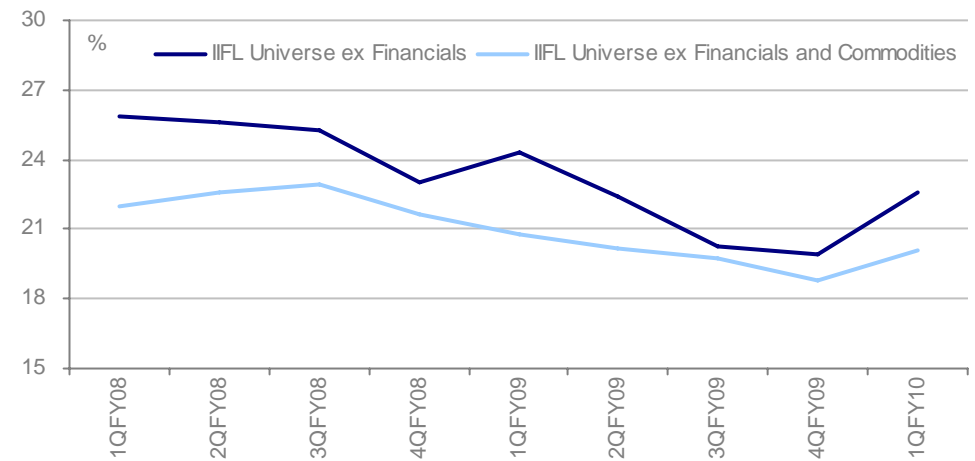
Figure 4: Sectoral EBITDA margins

For IIFL Universe	EBITDA Margin			Change in EBITDA margin (bps)	
	1QFY09	4QFY09	1QFY10	YoY	QoQ
Auto	10.0	9.4	11.9	191	251
Capital Goods	10.2	12.1	9.9	-34	-222
Cement	28.3	26.9	30.7	238	376
FMCG	18.7	21.2	19.9	121	-129
IT Services	23.5	25.2	23.4	-18	-187
Non Ferrous	33.2	17.3	23.1	-1011	580
Oil & Gas	29.0	26.7	33.1	408	643
Pharmaceuticals	25.0	20.7	26.9	189	622
Real Estate	59.0	42.3	40.9	-1807	-137
Steel	32.6	17.9	22.8	-976	489
Telecom	35.6	32.5	32.0	-355	-50
Utilities	21.4	19.9	22.5	112	262
Others	15.1	9.0	13.3	-178	431
IIFL Universe (ex Financials)	22.1	17.6	20.2	-183	265
IIFL Universe ex Commodities	24.3	19.9	22.6	-173	272

Source: IIFL Research

We expect Oil & Gas and Cement companies to report the biggest YoY expansion in margins. Metals will likely report a sharp margin YoY compression in margins, but on a QoQ basis, we expect a significant expansion (580bps for Non-Ferrous Metals and 489bps for Steel).

Auto and Cement sectors would report margin expansion in both YoY and QoQ terms. Auto sector margins in 1QFY10 will likely be the highest since 4QFY08, while for Cement, margins would be the highest since 3QFY08.

Figure 5: EBITDA margins to rise QoQ for IIFL Universe


Source: IIFL Research

We expect other income to show a big turnaround in 1QFY10. After depreciating for five consecutive quarters, the rupee has appreciated by ~6% against US\$ in 1QFY10. Many companies which had booked huge FX losses throughout these previous five quarters could see a reversal of MTM losses (unless they had adopted revised AS-11, which allowed them to take FX gains and losses to balance-sheet). For banks, bond yields have remained almost flat QoQ and thus there should be no MTM gains or losses on bond portfolios. Equity markets have rallied almost 50%, so there could be some gains on equity portfolios.

Figure 6: Movements in key other income drivers

Q/E numbers	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
INR/USD	43.0	47.0	48.8	50.7	47.9
QoQ Chg (%)		9.1	3.9	3.9	(5.6)
Bond Yields	8.7	8.6	5.3	7.0	7.0
QoQ Chg (bps)		(6.4)	(337.3)	174.8	0.2
Sensex	13,462	12,860	9,647	9,709	14,494
QoQ Chg (%)		(4.5)	(25.0)	0.6	49.3

Source: Bloomberg, IIFL Research

Agri-related companies

Despite a lull in the onset of monsoons, demand for agricultural inputs has remained stable over the past quarter. A further delay or a poor spatial distribution in the rainfall will begin to reflect in lower demand for agricultural inputs, beginning with QE September. Agricultural processing companies, on the other hand, will continue to benefit from strong crop output during the rabi season (harvest ends in June) and any strain on account of poor rainfall will begin to be visible from QE December (when the kharif harvest begins).

- Strong rabi output supports stable demand for June quarter:** Following stable crop output growth (agricultural GDP grew 2.7% YoY in QE March 2009), demand for agricultural inputs has remained healthy over the past quarter. Also, prices of agricultural commodities have remained stable (prices of primary food articles during the June-ending quarter rose 7-9% YoY), boosting already strong farm incomes.

Companies such as Jain Irrigation and United Phosphorus should also benefit from falling raw-material prices (these companies' RM costs have declined 40-80%), making investment in farm inputs more attractive to farmers. Additionally, as a result of declining RM costs and since not all cost benefits have been fully passed on during the June-ending quarter, EBITDA margins should witness expansion.

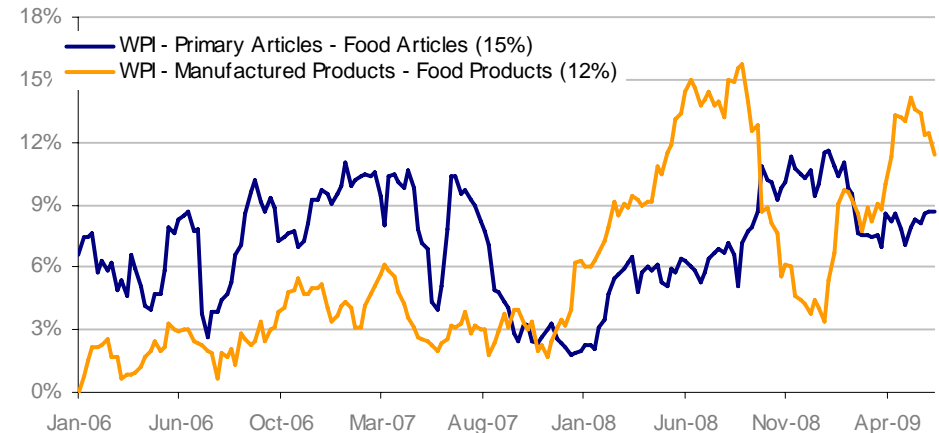
- Soft commodity processing to benefit from strong prices:** In addition to the availability of soft commodities remaining unaffected, pricing growth continues to offer a strong tailwind to food processing companies.

We expect sugar companies to report significant growth in revenues and earnings, owing entirely to the 15%+ QoQ increase in prices of sugar. A worse-than-expected monsoon is likely to support a further rally in sugar prices, as sugarcane output will likely fall short of the industry's forecast of 17.5-18.5m tonnes for SS09-10 (sugar season 2009-10).

For paddy processing companies such as Lakshmi Energy and Foods, the June-ending quarter would show an improvement over the March-ending quarter, owing to an export order for the PUSA 1121 variety of

rice. Meaningful improvement in the company's topline, however, will likely come only from the December quarter, when sales to FCI (Food Corporation of India) are likely to pick up.

Figure 7: Pricing growth in primary food articles support healthy farm incomes



Source: CSO, IIFL Research

Figure 8: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Bajaj Hindusthan	7,412	61.5	28.2	852.4	436	NA
Jain Irrigation Systems Limited	5,664	19.4	22.5	23.7	620	109.9
Lakshmi Energy and Foods	1,513	(51.2)	25.5	(16.5)	183	(54.5)
United Phosphorus Ltd.	14,292	10.0	21.1	11.7	1,767	19.7

Source: IIFL Research

Automobile & Auto Ancillaries

Auto companies were able to sustain the momentum generated in 4QFY09. All segments, save M&HCV, registered decent volume growth as availability of finance improved. The rural segment continues to be strong, with both Hero Honda and Mahindra & Mahindra delivering 20%+ growth. Maruti's volumes also witnessed strong growth in both domestic and export markets, led by the launch of the *Ritz* and the success of the *A-star* in European markets. M&HCV volumes continue to be weak, and any sustainable recovery would hinge on an improvement in the overall economy. We expect most companies in our universe to report double-digit profit growth for 1QFY10, with Mahindra & Mahindra and Hero Honda leading the way. Ashok Leyland, on the other hand, is likely to report a loss, with volumes declining by more than 60% during the quarter.

Commodity price gains to continue: Benefits from decline in commodities, primarily steel and aluminum, but also precious metals like nickel and rhodium, started accruing from 4QFY09. The full impact of this benefit would be visible in 1QFY10 results. The major beneficiaries would be Maruti, Tata Motors and Ashok Leyland, where benefits were not visible in 4QFY09 because of inventories and longer-duration contracts.

Product mix the other key variable: For most manufacturers, the product mix during the quarter also shifted towards higher-margin products. For Mahindra & Mahindra, the proportion of tractors sold increased from 36% in 1QFY09 to 41% in 1QFY10, for Bajaj the % of three-wheelers increased from 9.4% to 11.6%, and for TAMO the % of LCVs (Ace) increased from 31% to 39%. For both Hero Honda and Bajaj Auto, the increase in % of vehicles assembled in Uttaranchal, where tax incentives are available, will contribute to further margin improvement.

Figure 9: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Ashok Leyland	8,120	(56.9)	7.5	(83.0)	(418)	NA
Apollo Tyres	11,414	6.1	10.1	16.0	547	12.4
Balkrishna Industries	3,361	13.1	18.2	8.5	351	144.4
Bajaj Auto	24,065	4.1	16.1	57.9	2,295	31.0
Exide Industries	8,612	(5.0)	16.8	16.4	988	20.2
Everest Kanto Cylinders	2,081	10.0	21.8	(8.9)	256	(27.0)
Hero Honda Ltd.	38,380	35.0	16.0	87.0	4,703	72.4
Mahindra & Mahindra Ltd.	41,072	24.7	10.9	44.8	3,060	92.1
Maruti Suzuki India Ltd.	60,691	27.7	5.5	16.5	5,023	7.8
Tata Motors Ltd.	66,780	(3.6)	5.4	22.4	4,180	28.2

Source: IIFL Research. *Numbers for TAMO include gains from stake sale in Tata Steel

Figure 10: Most auto companies were able to build on the volume revival witnessed in the previous quarter

	1QFY09	4QFY09	1QFY10	%QoQ	%YoY	YTD-09	YTD-10	%YoY
Maruti	192,584	236,628	226,729	(4.2)	17.7	192,584	226,729	17.7
Hero Honda	894,244	997,855	1,118,996	12.1	25.1	894,244	1,118,996	25.1
Bajaj Auto	620,095	439,615	547,662	24.6	(11.7)	620,095	547,662	(11.7)
Two Wheelers	561,977	374,788	484,420	29.3	(13.8)	561,977	484,420	(13.8)
Three Wheelers	58,118	64,827	63,242	(2.4)	8.8	58,118	63,242	8.8
Mahindra & Mahindra	82,625	81,693	102,280	25.2	23.8	82,625	102,280	23.8
Auto	52,502	52,512	58,897	12.2	12.2	52,502	58,897	12.2
Tractors	30,123	29,181	43,383	48.7	44.0	30,123	43,383	44.0
Tata Motors	131,733	134,184	123,113	(8.3)	(6.5)	131,733	123,113	(6.5)
Commercial Vehicles	79,166	73,280	76,323	4.2	(3.6)	79,166	76,323	(3.6)
Cars and Uvs	52,567	60,904	46,790	(23.2)	(11.0)	52,567	46,790	(11.0)
Ashok Leyland	18,425	10,788	7,061	(34.5)	(61.7)	18,425	7,061	(61.7)

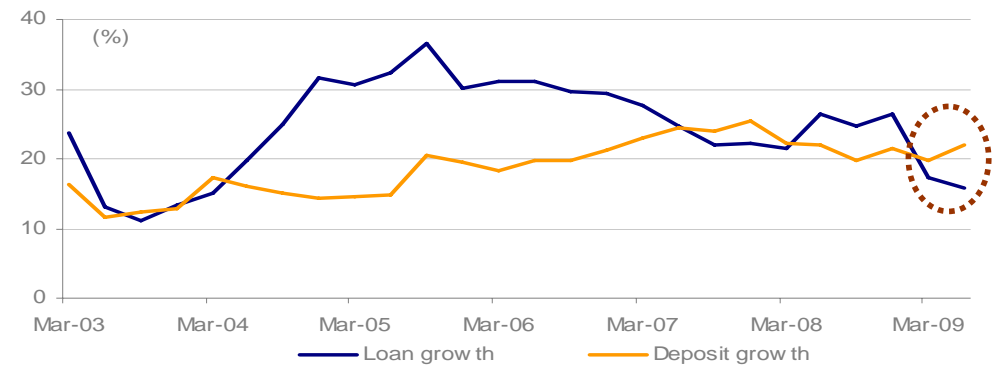
Source: Companies, IIFL Research

Banks & Financials

We expect banks and financials to report modest earnings growth in 1QFY10, owing to margin pressure and lower loan growth. Banking system loan growth in June was 15.8% YoY, the slowest in five years. LDR has declined to five year low and the lending mix is changing in favour of higher rated corporates. Also, the share of high yielding retail loans is falling. Banks are investing most of the incremental deposits in government securities. These factors together are likely to put pressure on margins.

- Falling LDR to keep margins under pressure:** Bank loan growth slowed down to the lowest level in the last five years, to 15.7% YoY in June 2009, compared to the 26.3% YoY rise a year ago. However, deposits continue to grow at a rapid clip, up 22% YoY. Consequently, the incremental loan/deposit ratio (LDR) fell to a five-year low of 52.8%. Falling LDR, combined with the PLR cuts implemented by banks, is likely to have kept NIMs under pressure.
- Provision on investment depreciation to be lower:** During 1QFY09, 10-year G-sec yields had hardened by 74bps, forcing banks to make provisions for investment depreciation. However, during 1QFY10, 10-year G-sec yields remained flat at 7.01%. Consequently, banks are likely to make very low provisions for investment depreciation.
- Further restructuring of loans likely:** The five largest government banks and four private banks restructured Rs300bn or 1.8% of their outstanding loans in FY09. Most of them also reported significant number of pending restructuring cases. RBI has permitted banks to restructure loans till 30 June 2009. Banks are likely to have restructured the pending cases during 1QFY10. Hence, the reported NPA and provision for NPA may not rise much during 1QFY10.
- Among private banks, we expect HDFC Bank to report profit growth of 20% YoY and Axis Bank of 10% YoY. Among government banks, we expect Bank of Baroda to report 19% YoY growth and PNB 16%.

Figure 11: System deposit growth continues to outpace loan growth



Source: RBI, IIFL Research.

Figure 12: IIFL estimates

Rs m	Total Income	YoY chg (%)	PAT	YoY chg (%)
Axis Bank	16,193	12.8	3,642	10.3
Bank of Baroda	19,362	23.4	4,416	19.1
Bank of India	20,637	18.1	5,602	(0.3)
HDFC	8,460	14.5	5,225	14.3
HDFC Bank	28,892	24.7	5,550	19.6
ICICI Bank	33,159	(8.6)	6,638	(8.8)
IDFC	3,819	(0.5)	1,953	(10.3)
LIC Housing Finance	2,803	56.7	1,704	62.8
Punjab National Bank	24,198	27.3	5,953	16.2
Power Finance Corporation	5,680	8.8	3,710	25.1
State Bank of India	78,207	8.3	17,804	8.5
Shriram Transport Finance	4,764	17.1	1,644	14.5
Union Bank	12,242	18.6	2,633	15.1
YES Bank	2,274	9.9	593	9.1

Source: IIFL Research. All figures are on standalone basis, except for IDFC.

Capital Goods

We expect most companies in our Capital Goods universe—except those levered to real-estate projects or short-gestation industrial projects—to report stable revenue growth, driven by healthy order books. Among large caps, BHEL and Larsen & Toubro would report ~20% revenue growth, while growth likely remained subdued for ABB, Thermax and Siemens.

We reckon the effect of lower commodity prices aided EBITDA margin expansion for most construction and capital good companies in this 1QFY10. Sharp YoY increases in interest expenses, primarily for construction contractors, would continue to hurt 1QFY10 profitability. However, QoQ, we should see some improvement on this front, as interest rates have come off their highs.

- We expect BHEL to report 20% YoY revenue growth in 1QFY10. EBITDA margins should expand ~140bps YoY as the company benefits from lower raw-material prices and slower growth in employee expenses. The increase in employee expenses would be lower, as the company has already provided for pay revisions under the Sixth Pay Commission.
- Larsen & Toubro, we believe, will report 1QFY10 revenue growth of ~19%. EBITDA margins would remain flat. Net profit growth would be marginally slower than EBITDA growth on account of higher interest costs.
- ABB's revenue growth would remain subdued, owing to delays/deferrals in existing industrial orders. Strong order inflow in 1QCY09 should start reflecting in revenues from next quarter onwards. Slowdown in industrial capex would also hurt product segment margins for the company.
- Crompton Greaves will likely report another quarter of robust revenue growth, driven by strong order inflows for the T&D business. Margins likely remained stable in the quarter.
- Net profit growth for construction contractors including IVRCL, Nagarjuna, Gammon, HCC and Simplex would be hit by the sharp

YoY increase in interest costs, driven by higher borrowings and elevated interest rates. QoQ, interest costs would ease off for these companies.

Figure 13: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
ABB India	16,971	5.0	9.1	(3.6)	1,247	(5.4)
Alstom Projects India Ltd	4,374	20.0	5.0	57.8	263	43.6
Bharat Heavy Electrical Ltd.	51,951	20.0	16.1	39.0	4,670	21.5
CCCL	4,251	12.0	7.1	7.9	168	(7.7)
Crompton Greaves	23,196	14.0	13.4	13.6	1,309	6.8
Gammon India Ltd.	6,321	8.0	8.2	8.0	143	(72.8)
Hindustan Construction Co.	10,477	21.0	15.4	26.5	139	(55.1)
IVRCL Infrastructure	11,606	25.0	7.7	26.1	419	(3.6)
Jyoti Structures Ltd.	4,820	20.0	10.4	10.4	204	(0.6)
B L Kashyap	3,520	(15.0)	10.0	(91.5)	166	(54.0)
KEC International	6,721	12.0	9.7	(1.5)	150	(41.3)
Kalpataru Power Transmission	5,462	15.0	12.7	3.5	211	(27.1)
Larsen & Toubro	82,394	19.3	13.9	19.0	5,968	18.8
Nagarjuna Construction	10,680	10.0	7.6	7.3	437	17.9
Patel Engineering	6,993	25.2	15.4	20.7	282	(19.3)
Punj Llyod	30,164	13.9	(2.4)	8.3	855	(12.3)
Sadbhav Engineering Ltd	2,945	12.0	9.0	10.2	155	4.0
Siemens India*	20,025	10.0	14.6	(21.5)	1358	(20.1)
Simplex Infrastructures Ltd	11,692	15.0	10.5	11.5	369	(19.4)
Thermax Ltd.	7,232	0.9	14.1	(5.1)	573	(10.1)

Source: IIFL Research. Note: *PAT for Siemens is adjusted for exceptional items.

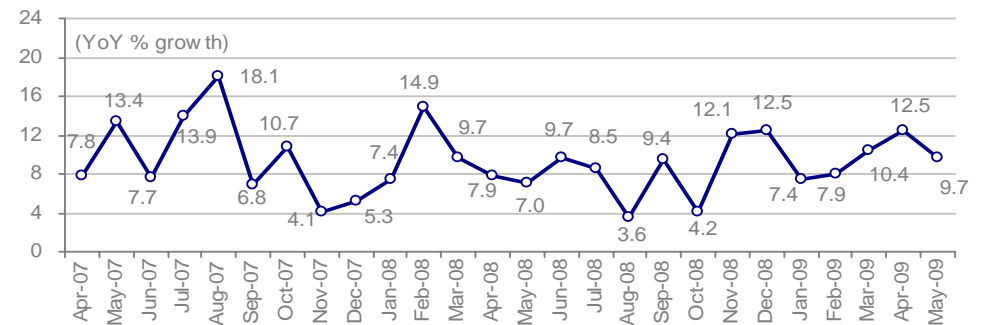
Cement

Cement price continued to rise in QE June 2009, on account of strong growth in demand—particularly in the northern and central regions—from infrastructure, metro rail construction, rural housing, and government sponsored housing projects. Pricing discipline in other regions is strong at present and this has kept prices firm, despite moderate demand growth and declining utilisation rates. We expect all companies to report growth in pre-exceptional PAT, except Grasim Industries (primarily on account of higher effective tax rate).

- We expect cement companies based in the northern and central regions to outperform south-based companies, owing to higher volume growth and an increase in realisations. We expect south-based companies to benefit from the decline in coal costs.
- We expect companies based in the northern and central regions to report 2-8% YoY and 3-4% QoQ increase in realisation and south-based companies to report 4-10% YoY and 1-2% QoQ growth in realisation.
- We expect Grasim to report YoY decline in pre-exceptional PAT on account of higher effective tax rate and profit fall in the hived-off sponge iron division. We also expect Grasim to report sale of the sponge iron division. Our estimate for the quarter does not factor in any EO income from sale of sponge iron division.
- We expect India Cements to benefit from rupee appreciation in QE June 2009 against rupee depreciation in QE June 2008.

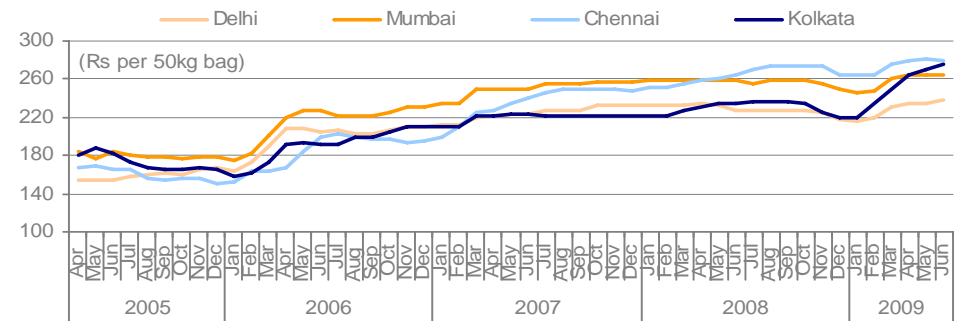
We expect a stable pricing scenario in monsoon, as supplies from new players are yet to start. We expect high growth rate in cement despatches to continue till 2QFY10, primarily on account of the low base. Growth in despatches will likely start tapering off from 3QFY10, unless the government gives a further push to infrastructure. We continue to be positive on cement companies based in the northern and central regions and negative on companies based in the southern and western regions, as we expect pricing discipline to crack from 2HFY10, when new players increase cement supplies.

Figure 14: Domestic consumption growth continues to be robust



Source: CMA

Figure 15: Uptrend in prices continued in north and east markets for QE June 2009



Source: Industry

Figure 16: IIFL estimates for QE June 2009

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
ACC	21,170	10.3	29.7	66.4	4,151	62.8
Ambuja Cements	17,984	14.6	28.4	20.4	3,635	(37.0)
Grasim Industries	29,156	12.5	23.6	6.3	4,861	(5.4)
IndiaCements	9,609	14.7	25.4	7.8	1,818	27.9
Kesoram Industries	11,006	23.7	15.9	22.1	1,124	15.8
Madras Cement	7,428	20.8	26.7	11.5	1,204	5.7
Shree Cement	8,511	38.5	41.0	67.8	2,340	97.5
Ultratech Cement	18,751	25.3	28.7	38.0	3,591	35.5

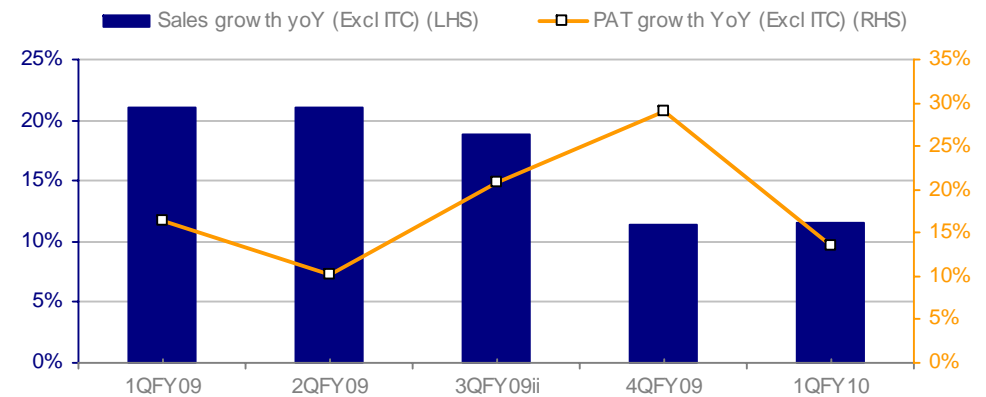
Source: IIFL Research

FMCG

- **Moderate sales growth momentum on low price growth:** With the impact of YoY price increases tapering off in many categories, most companies are likely to report a moderation in revenue growth in 1QFY10.
- **Robust volume growth in personal care and foods:** We expect reported volume growth in most personal-care categories such as toothpaste, hair oil, shampoo and skin-care, to remain in double-digit levels. We also expect robust volume growth in processed-foods categories like malted beverages, noodles and baby food.
- **Signs of recovery in soaps and detergents volume growth:** We expect companies to report a recovery in volume growth in soaps and detergents, albeit a gradual one. Grammage increases and price cuts taken by HUL in soaps and detergents, we reckon, have likely stemmed the decline in volumes seen during the previous quarter.
- **Home and personal care (HPC) – raw-material pressure to abate:** Raw-material costs are likely to have declined for most HPC companies (HUL, Colgate, Dabur, and Marico), in line with the trend seen during 4QFY09. However, foods companies are unlikely to report a fall in raw-material costs as prices of sugar, wheat and milk have remained elevated through the quarter.
- **HUL likely to report a recovery in FMCG volume growth, but decline in exports likely to have dragged down overall sales growth:** HUL is likely to report a recovery in volume growth after a 4% decline in 4QFY09. Price cuts in soaps and detergents, we reckon, have likely revived volumes in 1QFY10. Overall reported sales growth, however, will be sluggish, as the company continues to exit non-core exports, resulting in an estimated 15-20% decline in exports revenues.
- **ITC cigarette volumes likely to have grown; hotels business weak:** We expect ITC to report growth in cigarettes’ volume sales after over seven quarters of decline, owing to a favourable base and absence of a YoY excise hike this year (due to a delayed budget).

Hotels business, we believe, remained under pressure, given the weakness in domestic and foreign travel (because of the economic slowdown) coupled with an unfavorable base as hotel revenues were strong in the year-ago quarter since occupancy was propped up by the IPL tournament, for which ITC was the official hospitality partner. The paper business is likely to report a good performance, as capacity utilisation and operational stability likely improved in newly commissioned machines.

Figure 17: Sales growth momentum is moderating



Source: IIFL Research

Figure 18: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Britannia	7,765	12.0	9.0	10.5	469	16.4
Colgate	4,687	15.0	16.7	22.0	827	14.9
Dabur India	6,945	15.0	17.7	27.6	853	20.8
Hindustan Unilever Limited*	46,034	9.2	13.8	21.0	5,967	6.9
ITC	43,798	12.3	32.4	17.4	8,631	15.3
Marico	6,730	12.0	13.1	20.1	548	18.2
Nestle	11,910	15.0	24.5	16.6	1,469	21.3
Glaxo Smithkline Consumer	4,366	16.0	22.0	29.5	563	22.0

Source: IIFL Research. Note: * For HUVR pre-exceptional PAT growth is 10.3% YoY

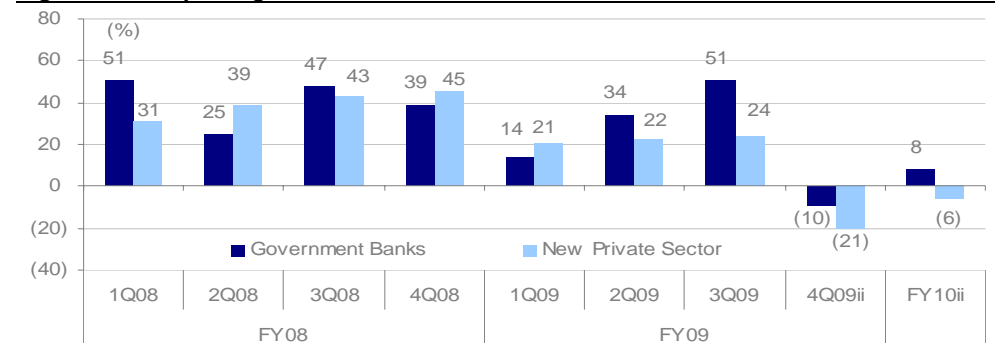
IT Services

After 1QFY10, which has likely been the third straight quarter of sequential US\$ revenue decline, tier 1 vendors could be eyeing sequential growth by 2QFY10. This, we reckon, will be reflected in the guidance and management commentary during the upcoming 1QFY10 results. Also, despite the currency headwinds (INR appreciation of ~5.5% vs US\$ assumed rate in 1QFY10), we reckon Infosys's rupee EPS guidance for FY10 will be maintained as an indication of improvement in the business environment. For 1QFY10, we expect marginal outperformance vs guidance (~1ppt constant currency revenues) at tier 1 vendors and cross-currency tailwinds would add another ~1.5ppt of growth. Cost-cutting continues to reign supreme, with seasonal salary hikes and even promotions being kept on hold at most vendors. While the rich valuations at tier 1 vendors may rule out any upsides due to the undercurrent of stable environment, mid-cap peers like Infotech Enterprises, Patni and Tech Mahindra remain cheap.

- Our recent conversations with company managements indicate that the pace of project renewals has picked up. New client wins have been modest and deal flow has improved, suggesting a return to growth by as early as 2QFY10.
- Though a recovery is still some time away and we expect tier 1 vendors to register a ~5% YoY degrowth (US\$ revenue) in FY10, the sequential growth rates could pick up to ~3% by 2HFY10.
- While TCS has been the most vocal about its expectation of a return to sequential growth by 2QFY10, we believe Infosys and Wipro's guidance ranges would imply growth at the top-end.
- INR has appreciated by 5.5% vs US\$ during 1QFY10 (compared to Infosys' assumed rate in the guidance). Though this necessitates a downward revision of ~6-7% in Infosys's FY10 EPS guidance, we believe it will be negligible, reflecting an improvement in the demand environment.
- Also, for 1QFY10, we believe Infosys's guidance was conservative, and could well be beaten by ~1ppt (in the last 16 quarters, Infosys has outperformed the top-end of its guidance by ~2%, compared with Wipro's ~1%).

- The seasonal impact on margins for IT services firms is also likely to be minimal, given the near absence of salary hikes and fewer H1B visa applications.
- While rich valuations at larger vendors run against the odds of re-rating, mid-caps in our coverage are cheap and could be the largest beneficiaries of the improving environment.
- Infotech Enterprises, for example, has ~30% of its market cap in cash and we expect its 1QFY10 revenues to remain flat QoQ, as against a decline at large-cap vendors. Likely ramp-up in BTGS contracts (Andes deal) is a key positive for Tech Mahindra, which we believe, will also benefit from a successful restructuring at Satyam.

Figure 19: Net profit growth trend



Source: IIFL Research

Figure 20: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
3i Infotech	5,974	27.5	19.6	17.9	467	(20.7)
HCL Technologies	26,458	22.0	21.3	3.3	2,75	(36.4)
Hexaware	2,564	(9.9)	14.8	301.4	126	32.7
Infosys Technologies	54,033	11.3	33.6	15.0	14,641	12.5
Infotech Enterprises	2,285	13.9	21.7	23.9	284	(29.1)
KPIT Cummins	2,014	14.4	29.4	13.0	264	103.0
Mindtree	3,221	45.2	22.8	58.3	753	NA
Patni	7,746	(1.2)	16.8	(11.1)	929	(24.4)
Tata Consultancy Services	69,181	7.9	26.2	10.2	12,286	(1.2)
Tech Mahindra	10,513	(5.8)	24.7	(6.6)	1,569	(39.4)
Wipro	64,205	7.6	20.7	2.4	9,432	3.6

Source: IIFL Research

Metals

Steel volume gains to continue: We expect steel companies to report continued uptick in earnings, driven by 20% growth in volumes for companies under coverage to 6m tonnes.

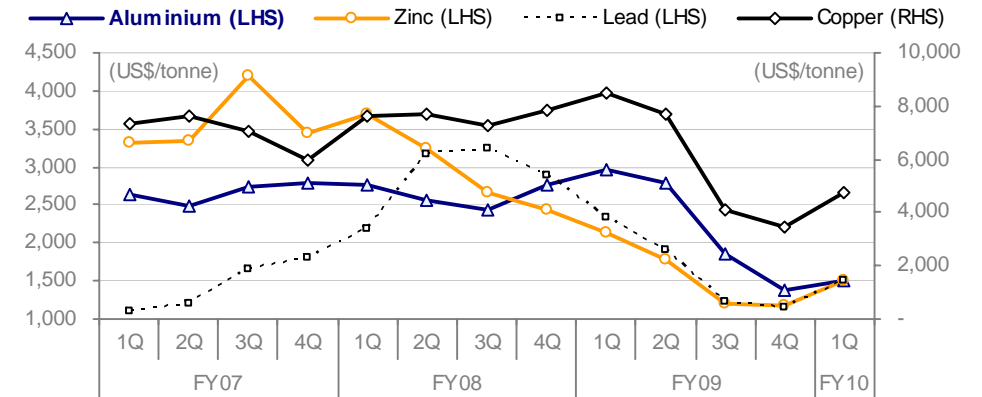
- **Realisation flat:** 4QFY09 saw the full impact of price cuts taken in 3QFY09. With the demand situation improving marginally in 1QFY10, there were no significant price cuts. We expect companies to report flat realisations QoQ.
- **Divergent cost trends:** Benefits from lower coking coal prices, we reckon, have accrued to varying extents for companies in the sector. We expect Tata Steel to report a marginal QoQ fall in production cost on the back of the lower coking coal prices. SAIL, on the other hand, is unlikely to report a significant change in production cost, given the company's large coking coal inventory. JSW has likely been the biggest beneficiary of the fall in coking-coal prices, as its low inventory position enabled it to enter into new coking coal contracts at lower prices.

Non-ferrous – strong quarter, barring aluminium: Although prices saw an increase QoQ, the extent of increase varied across. Average aluminium prices increased by 10% QoQ; prices of copper and zinc rallied much more, with increases of 36% and 26% respectively.

- **Aluminium producers to report depressed profitability:** We expect Hindalco to report a slight uptick in profits on higher aluminium prices. NALCO will likely report a QoQ improvement in profitability, mainly as 4QFY09 profits were affected by significant inventory re-stocking. However, in the absence of any significant improvement in aluminium prices, recovery in profitability is likely to be protracted for these companies.
- **Sterlite earnings to be up:** We expect Sterlite to report a 25% QoQ increase in profits. Profits from the zinc business are likely higher, thanks to: 1) the sharp increase in zinc prices during the quarter; and 2) decline in costs on the back of a fall in prices of coke. We expect stable results for the copper smelting business,

while profits from the Australian mines likely dropped in 1QFY10. The aluminium business is unlikely to report any significant improvement in profitability, but this would be partly mitigated by sale of power.

Figure 21: Non-ferrous metal prices have increased QoQ



Source: IIFL Research

Figure 22: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Hindalco	46,111	(0.8)	8.3	(43.2)	2,873	(58.8)
Hindustan Zinc Limited	14,486	(11.9)	45.1	(21.8)	6,985	(17.6)
JSW Steel	42,959	17.0	10.8	(13.2)	3,000	36.7
National Aluminium Company	10,690	(27.2)	8.5	(64.3)	1,993	(62.1)
Steel Authority of India	95,146	(13.7)	17.5	(37.9)	12,509	(31.8)
Sterlite Industries	51,189	(11.3)	19.0	(30.9)	7,504	(34.8)
Tata Steel	51,193	(17.0)	22.3	(42.8)	8,814	(40.8)

Source: IIFL Research

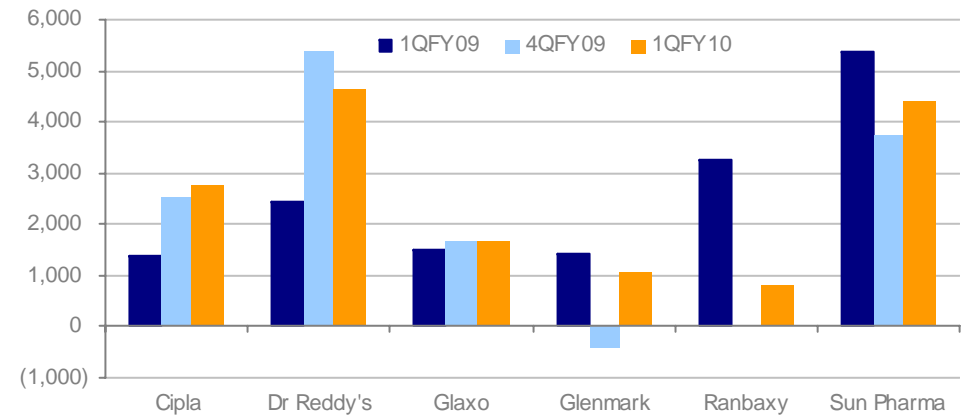
Pharmaceuticals

We look forward to a mixed performance by the pharma companies in 1QFY10. Among the larger ones, we expect the best growth numbers from Dr Reddy's and Cipla. Sun Pharma is also likely to report good numbers, as the impact of recent FDA action on its US facilities will be felt only from 2QFY10 onwards. The rupee's appreciation over the previous quarter will likely lead to some margin pressure on a sequential basis, but we expect the impact to be relatively muted. Our preferred picks ahead of the quarterly result season: Dr Reddy's, Cipla and Jubilant Organosys.

- Rupee appreciation will likely have a minor impact on margins:** The average INR/USD exchange rate was about 2.3% lower in 1QFY10 than in 4QFY09. There could be minor sequential margin pressure arising out of this. However, both the highly sensitive companies—Cipla and Biocon—had relatively muted margin in 4QFY09, and hence we see no significant contraction from those levels.
- US and Russia to remain key growth markets:** We expect the US and Russian markets to continue leading the growth story for Indian pharma. We expect good performance in the US market by Dr Reddy's and Sun Pharma, while Ranbaxy and Glenmark will likely report significant business erosion. We expect Dr Reddy's to report continued growth in the Russian market, aided by the rouble's appreciation. However, the numbers from the German market are key directional indicators for Dr Reddy's in that market. Domestic market growth should remain stable and CRAMS should show signs of stabilisation and growth.
- Relief from forex losses:** Many companies are likely to report benefits on their forex hedges from the 5% higher INR/USD at end-1QFY10 than at end-4QFY09. Ranbaxy could report a significant reversal of mark-to-market losses, though it forms only a small portion of the total. Biocon and Cipla should also benefit.
- Exclusivity impact on Sun, Dr Reddy's:** Sun Pharma and Dr Reddy's numbers will likely show some weakness on YoY and QoQ

basis respectively, due to the waning of exclusivity upsides in prior periods.

Figure 23: Net profit growth trend



Source: IIFL Research

Figure 24: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Biocon Limited	4,624	75.2	27.4	622.5	(896)	NA
Cipla Limited	14,843	23.0	26.3	36.2	2,758	97.0
Dr Reddy's Laboratories	19,032	26.6	27.2	89.0	2,711	83.7
Glaxo Smithkline Pharma Ltd	4,544	9.0	36.0	9.0	1,280	11.5
Glenmark Pharmaceuticals	5,115	11.0	(8.8)	(23.8)	314	(72.8)
Jubilant Organosys Ltd	8,693	5.2	19.9	(2.7)	700	448.5
Opto Circuits India Limited	2,304	29.9	33.1	24.6	541	20.8
Ranbaxy Laboratories Limited	17,469	(9.4)	0.1	(75.9)	(166)	NA
Sun Pharmaceutical Industries Ltd	11,741	12.7	33.0	(6.7)	4,922	(1.9)

Source: IIFL Research

Real Estate

The uptick in residential demand witnessed in 4QFY09 strengthened in 1QFY10, with developers reporting sharply higher sales figures. While apartment prices remained more or less flat after the 25-30% correction in 3QFY09 across most metros, Mumbai saw developers increasing prices by up to 20% from the bottom, as the feeling of improved economic performance buoyed the stock market. While most large developers admit that the revival in volumes is a result of the sharp price cuts, we see residential prices starting to trend upwards as risk-capital became abundantly available during the quarter. Real-estate developers raised a total of US\$2.7bn via private placements, among them DLF (US\$760m), Unitech (US\$900m), HDIL (US\$350m), Indiabulls Real Estate (US\$550m) and Sobha Developers (US\$130m). This, coupled with significant asset sales by the likes of DLF and Unitech, is likely to considerably de-lever their respective balance sheets. Improved liquidity should help developers in improving execution; however, the impact is likely to be visible 2QFY10 onwards.

- We expect DLF to report QoQ growth in non-DAL revenues, driven by strong sales at the Shivaji Road project in Delhi. Indiabulls Real Estate is also likely to report QoQ growth in topline on the back of sales in Gurgaon and Chennai. For other developers, we expect revenues to be broadly flat QoQ.
- We expect reported margins to trend down as share of mid-income project revenues in the overall pie continues to increase going forward.
- A word of caution is probably warranted for the large volume of mid-income residential sales that have been reported by many developers. In most cases, developers have been able to execute annually only a fraction of the volumes that they have managed to sell over the past six months. Ramping up construction will not be easy in our opinion, and the linkage of cash flows to construction instead of time-period as was prevalent earlier could impact operating cash flows in the future.
- Commercial leasing activity continues to be lacklustre, as most IT players have toned down growth plans and now have adequate space locked in for the next 2-3 years.

- DLF, in our opinion, may well need to reverse more than Rs2bn of revenues booked earlier, owing to discounts that it offered on pre-sold apartments in Chennai and Gurgaon and cancellations across both these projects.

Figure 25: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Anant Raj Limited	256	-	93.1	-	259	-
DLF LTD	11,583	(69.6)	48.4	(79.3)	3,943	(78.8)
Indiabulls Real Estate Limited	735	60.3	NA	NA	326	148.6
Peninsula Land Limited	1,382	11.5	33.5	56.0	488	56.2
Puvankara Projects Limited	631	(60.0)	15.1	(66.5)	199	(67.9)
Unitech Limited	4,763	(53.8)	32.9	(65.9)	1,263	(70.2)

Source: IIFL Research

Telecom

- Speculation has raged in the past quarter, on Bharti-MTN, capital-raising through the induction of a strategic partner by RCOM, open offer by Axiata for Idea (we now know that this is not happening), and finally 3G and (possibly) 2G spectrum auctions.
- Given improved conditions, we are less worried than we once were, on ARPU declines caused by cautious spending. That said, any optimism has to be tempered by the launch of free-minutes-based schemes by players like MTS (Sistema, who launched a scheme with 1m free on-net minutes for an upfront fee of Rs499 and valid for 19 years), though such schemes launched in 4QFY09 by RCOM have been unwound.
- The enterprise businesses for Bharti and RCOM will likely report weak revenues, based on tepid order flow a few months ago, which will likely curb reported revenue growth in 1QFY10 (correspondingly, since companies hurry through their budgets in 4Q and this will spur enterprise revenues in 2QFY10).
- Also during this quarter, the rupee has appreciated by ~4% against the US dollar; the US dollar has appreciated by ~3% against the yen. On the forex front, this should give a breather to Bharti and (especially) RCOM, who have been making losses for the last few quarters.
- Bharti is likely to emerge unscathed from the IUC cuts (Rs0.3 to Rs0.2/minute for domestic termination). In our conversations with the company during the middle of this quarter, we understood that Bharti was EBITDA-neutral. However, the gains will be tempered by lukewarm performance in its enterprise business. Revenue growth in aggregate should be 3.1% QoQ, with stable EBITDA margins.
- RCOM has now withdrawn free minutes and has stepped up conventional advertising. RCOM will also sport some wireless revenues from the brisk sale of its data cards. Its GSM distribution has also gained traction from the strategy of enlisting franchisees, rather than exclusively through its *Web World* stores. Franchisees are reported to be more eager to take up GSM than CDMA, plus Bharti and Vodafone, the other two hot franchises, are supposed to be saturated in the major cities. RCOM may show forex gains in its

P&L, though our numbers do not show any. We expect revenue growth of 7% in 1QFY10, but a decline in PAT, driven by capitalization.

- Idea Cellular has not had an impressive quarter, in our view, with regard to subscriber additions. After averaging more than 1.6m per month in 4Q, Idea averaged only 1.2m in April and May, a level which has remained constant despite adding Spice and a few circles organically. The brand reinforcement managed by Bharti through its advertising of Airtel Digital is not an option available to Idea (which is a single-product business) and can affect relative ARPU expansion performance in stable circles. We expect revenue growth of 8.2%, lower than in the last few quarters, and pressure on ARPU to begin showing from here on.
- Onmobile had faced possible disruption of revenue from India from CRBT, consequent to a TRAI order, which threatened to make viral marketing of this product impossible. This was to happen w.e.f. 10 June. But the implementation has been deferred, and Onmobile gets a breather. A revised order is expected in July, with a better balance between consumer protection and revenue growth.

Figure 26: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Bharti Airtel	101,286	19.4	40.7	16.8	24,761	22.3
GTL Infrastructure	705	54.0	56.3	73.7	(62)	NA
Idea Cellular	32,418	49.2	27.1	13.2	2,725	3.6
MTNL	10,525	(6.2)	(7.0)	NA	(1,102)	NA
Onmobile	1,264	62.4	33.5	104.8	282	85.8
Reliance Communications	62,036	18.6	35.8	1.4	10,042	(33.6)
Tanla Solutions	1,423	(14.7)	31.3	(48.1)	147	(73.9)
Tata Communications	27,135	19.3	16.4	56.7	272	(26.5)

Source: IIFL Research

Utilities

- Capacity additions remained muted during the quarter:** As per CEA, India's generation capacity was 149.4GW as at end-May 2009. Addition in installed capacity in the first two months of 1QFY10 was muted, at 1,427MW. Among utilities under our coverage, NTPC is the only one to have commissioned capacity in the period—500MW at Kahalgaon, towards the end of the quarter. Please note that this has not been accounted for by CEA in the 1.4GW addition. Also, spot prices of power fluctuated widely during the quarter, from a peak of Rs13/unit to a low of Rs0.8/unit, before settling at current levels of Rs5.5-6/unit.
- NTPC, PGCIL - earnings boost due to new tariff norms:** We expect NTPC and PGCIL to report earnings growth of 25% YoY and 37% YoY respectively in 1QFY10, largely due to new CERC tariff norms, and capitalisation associated with project completion. The new tariff norms allow CPSUs to earn higher benchmark RoE (15.5%, vs 14%) and also retain benefits from efficient tax planning. Operationally, we expect NTPC to report firm PLFs for coal as well as gas-based stations.
- CESC tariff revision leading to profit growth:** CERC's new tariff guidelines are not applicable to CESC and GIPCL, as they are governed by the respective state regulators. Nonetheless, as CESC's tariff was revised from 2QFY09, it would report a ~23% YoY increase in PAT in 1QFY10. GIPCL has operated all its plants well above the benchmark PLFs, and we expect it to report profit growth of 14% YoY.
- Flat trading volumes for PTC:** We reckon PTC's trading volumes remained almost flat YoY, in turn resulting in flat operating profits YoY. However, sharp increase in the treasury book (it raised Rs5bn during the quarter and has Rs8bn unutilised cash on books) in 1QFY10ii would lead to a 54% YoY increase in reported earnings.

- Tata Power – benefits from merchant sale of power:** Tata Power has commissioned a 250MW unit at Trombay and a 120MW unit at Haldia, and has been selling power generated from these units on short-term PPAs. While its Mumbai licence area operations continue to be a cash cow, we believe that such opportune sale of power would lead to 23% YoY growth in PAT. We estimate Reliance Infra's adjusted PAT to grow 7% YoY.
- Smaller equipment manufacturers face margin pressure:** Sales growth of smaller companies in the power food chain—Bharat Bijlee, Apar, Voltamp—is likely to be healthy, as order flow remains robust. However, given the overcapacity leading to intense competition, we reckon operating profits have remained flat, at best. For instance, we expect Voltamp to report a decline in operating profit, due to sharp erosion in EBITDA margins.

Figure 27: IIFL estimates

Rs m	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)
Apar Industries Ltd	5,116	(5.2)	(3.8)	(15.4)	158	(17.5)
Bharat Bijlee Ltd	1,245	17.4	15.7	1.0	77	1.1
CESC Ltd	9,540	21.8	22.7	65.8	1,038	8.1
Gujarat Industries Power	3,025	15.3	23.0	29.7	256	14.0
National Thermal Power Corp	114,726	20.3	19.4	37.8	21,534	24.7
PTC India	15,746	30.9	0.2	(1.1)	292	54.1
Power Grid Corporation of India	15,159	17.1	84.6	17.7	4,198	37.3
Reliance Infrastructure	27,393	24.6	13.9	NA	2,382	(5.7)
Suzlon Energy Ltd	60,035	117.5	8.0	52.9	1,197	8,769.3
Tata Power Company Ltd	21,472	6.0	19.9	38.3	2,352	23.4
Voltamp Transformers Ltd	1,858	9.2	21.7	(17.5)	177	(23.5)

Source: IIFL Research

Others

Figure 28: IIFL estimates (others)

Rs m	Sector	Sales	YoY (%)	Ebitda margin (%)	Ebitda YoY (%)	PAT	YoY (%)	Remarks
Aditya Birla Novo	Divesified	34,278	6.2	(0.2)	(53.3)	(1,996)	NA	<ul style="list-style-type: none"> Smallest quarter for the financials business.
Bombay Rayon Fashions Ltd.	Textiles	3,709	34.8	15.7	26.1	223	(36.1)	<ul style="list-style-type: none"> Revenue growth of 25% YoY to be almost entirely driven by volume growth in garment sales, as the new 15m pieces facility begins to stabilise during 1HFY10. Margins have likely remained under stress, owing to the 8-10% appreciation of the rupee vs the US\$ during the quarter.
Concor	Logistics	8,181	(0.6)	26.8	(5.2)	1,886	(6.5)	<ul style="list-style-type: none"> We expect Concor to report a QoQ decline in revenues, as dwell times fell from mid-teens to single-digit levels, reducing handling charges. Margins have likely remained flat as domestic business continues to contribute substantially.
Jindal Steel and Power	Diversified	18,898	(0.3)	9.4	(26.6)	3,008	(25.2)	<ul style="list-style-type: none"> We expect a 24% YoY increase in steel volumes to partially offset the drop in per tonne PBIT margins. Also, continued strong performance at JPL in 1QFY10 (we build in a Rs5.5/unit realization – down 6% QoQ) would allow the company to report a consol PAT of Rs9.1bn.
ONGC	Oil & Gas	175,000	(12.7)	41.8	(26.9)	44,194	(32.6)	<ul style="list-style-type: none"> Decline in profit due to sharp drop in the net realizations (1QFY10 at US\$56/bbl v/s US\$ 69/bbl in 1QFY09)
Pantaloon Retail	Retail	16,715	21.0	10.5	26.4	379	16.6	<ul style="list-style-type: none"> Sales growth to stabilize as same store sales has seen a marginal pickup during the past 2 months. EBITDA margin expansion (YoY) would be lower than in previous quarters as the YoY employee cost reduction benefits are tapering off. Interest cost could see a sharp YoY increase
Phillips Carbon Black	Chemicals	2,773	(7.3)	(30.7)	1.2	107	(53.1)	<ul style="list-style-type: none"> We expect QoQ revival in volumes and with decline in high cost raw material inventory, we expect the company to post profit against loss in QE March 2009.
Redington Inida	IT Products	32,260	10.2	3.0	41.0	509	49.6	<ul style="list-style-type: none"> India business growth should be less than in the Middle East.
Reliance Industries Limited	Oil & Gas	257,540	(38.1)	19.2	(6.6)	38,984	(5.1)	<ul style="list-style-type: none"> The profit erosion contained due to -1) gas business and 2) higher treasury income. Core business – refining and petrochem remains under pressure.
Sintex Industries	Divesified	7,258	(0.4)	19.7	21.9	681	20.6	<ul style="list-style-type: none"> We expect flat YoY revenues on account of expected weakness in overseas businesses. We expect EBITDA margin to decline, on a fall in average realisations.
Zee Entertainment	Media	4,755	(12.3)	23.4	(23.1)	668	(58.3)	<ul style="list-style-type: none"> Revenues are likely to have suffered from a decline in advertising revenues due to shift in viewership away from GECs to the IPL and the election. Growth from DTH revenues would have had a marginal impact on overall topline, as DTH accounts for only 8-10% of total revenues. Cost reduction through lower carriage charges and programming cost is likely to have mitigated some of the pressure on the topline.

Source: IIFL Research

Bharti Airtel - BUY



BHARTI IN

Rs804

Telecom

03 Jul 2009

Company Update

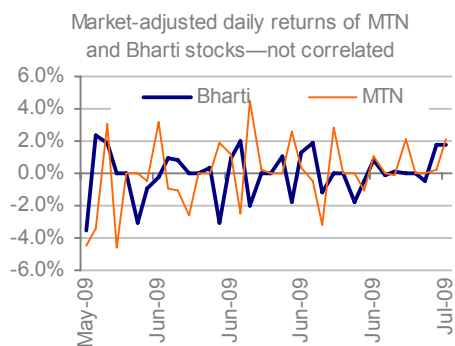
Size will matter

In our view, the Bharti-MTN deal is driven more by strategic considerations than by synergies. In a world where giants such as Apple and Google are invading the telco space, size will be key. Nevertheless, an analysis of savings / synergy opportunities in the proposed Bharti-MTN deal suggests that Bharti can have a gain of almost US\$3bn. Our key assumptions are based on measures attributable to Bharti's involvement, over and above MTN's own cost reduction measures. These include estimates of opex and capex savings in MTN and capex savings in Bharti. We consider opex savings in Bharti attributable to this deal unlikely. The proposed deal (as the terms stand now) is not significantly earnings dilutive for Bharti even without considering synergies. Hence, we are in no hurry to reduce our TP (Rs 866); we retain BUY.

Scale will assume increasing importance; the proposed deal comes not too soon: We consider a recent move by Vodafone to open its network to third-party application developers worldwide (not yet in India though) as an acknowledgement that giants such as Apple and Google pose a serious threat in the telco space. In this context, we feel that despite the attendant risks and challenges in a merger, companies like Bharti are correct in looking to expand inorganically and gun for scale, besides driving synergies.

US\$3.0bn of gains for Bharti possible from synergies: From this deal, we consider plausible: 1) a 10% reduction in the addressable elements in MTN's opex (these elements, chiefly network opex, staff costs and G&A form 35% of MTN's opex); 2) a 15% reduction in MTN's unit equipment purchase costs (our survey of vendors and major operators indicates that though applying India equipment prices in African markets may suggest a bigger reduction, this is not likely at all); and 3) a 5% reduction in Bharti's equipment procurement costs. Taken together with a holding-company discount of 20% for Bharti's stake in MTN, these estimates total to ~US\$3.0bn of present value gains for Bharti. These estimates may seem conservative, but one must note that MTN has initiated several cost reduction measures, including infrastructure sharing, and induction of Chinese vendors (Huawei supplies GSM and optical transmission equipment in Nigeria for MTN) and the publicly announced measures are likely already priced in. Further, equipment prices around the world are not falling at the rate seen in recent years. Hence, we consider our estimates fair.

Will the deal go through?



Source: Bloomberg; IIFL Research

Financial summary

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenues (Rs m)	270,249	369,615	429,638	506,674	578,011
EBITDA Margins (%)	42.0	41.0	40.4	40.5	41.2
Reported PAT (Rs m)	67,009	84,699	100,203	120,122	145,478
EPS (Rs)	35.3	44.6	52.8	63.3	76.6
Growth (%)	57.2	26.4	18.3	19.9	21.1
PER (x)	22.7	18.0	15.2	12.7	10.5
ROE (%)	37.4	32.2	28.5	26.4	25.4
Debt/Equity (x)	0.2	0.3	0.3	0.0	-0.1
EV/EBITDA (x)	13.8	10.5	9.2	7.7	6.7
Price/Book (x)	6.5	4.8	3.6	2.9	2.3

Price as at close of business on 2 Jul 2009

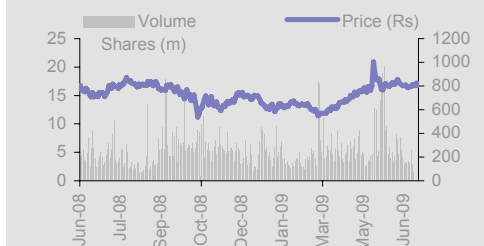
12-mth Target price (Rs) 866 (8%)

Market cap (US\$ m)	31,789
52Wk High/Low (Rs)	1036/483
Diluted o/s shares (m)	1898
Daily volume (US\$ m)	95.3
Dividend yield FY010ii (%)	0.2
Free float (%)	32.9

Shareholding pattern (%)	
Promoters	67.2
FII's	20.7
Domestic MFs/Insurance cos	7.4
Others	4.7

Price performance (%)			
	1M	3M	1Y
Bharti	0.6	25.7	13.5
Rel. to Sensex	2.0	-15.9	6.2
RCOM	-11.9	48.7	-24.7
IDEA	-8.4	45.6	-14.8
MTNL	-3.4	50.8	25.9

Stock movement



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Synergies can yield US\$3bn of value for Bharti

We examine the synergies in this deal on both sides—MTN’s operations as well as Bharti’s. Our conclusion is that there can be US\$3bn worth of gains for Bharti, chiefly driven by a 10% reduction in addressable elements in MTN’s opex, a 15% reduction in MTN’s unit equipment prices and a 5% reduction in Bharti’s unit equipment costs.

To recap, the two legs of the proposed Bharti MTN deal were:

- Bharti to issue 0.5 shares (as GDRs) and ZAR86 to MTN shareholders in return for each MTN share, for 36% of MTN’s current share capital; and
- MTN to acquire 25% post-transaction economic interest in Bharti for: 1) cash consideration of ~US\$2.9 billion; and 2) fresh issuance of MTN shares equal to ~25% of the currently-issued share capital of MTN.

At the end of this, Bharti Airtel (and not a mix of Bharti Telecom¹ and Airtel) would own 48.8% of MTN; MTN would own 25% of Bharti; and MTN’s original shareholders would own 11.2% of Bharti.

From Bharti’s perspective, net upfront outflow of US\$4.5bn, but no significant earnings dilution: We presume that in the second leg, the US\$2.9bn is a US\$ amount, whereas the cash component in leg 1 is in ZAR. The US\$/ZAR rate has moved during this period (24 May 2009 till date) from R8.3 to R7.76. Hence from Bharti’s perspective, the net cash outflow is $672m \times 86 / 7.76 - US\$2.9bn = US\$4.5bn$. Similarly, the outflow for MTN is US\$2.9bn, in leg 2. While prima facie the terms seem to suggest an earnings dilution for Bharti, on adding back Bharti’s share of MTN’s consolidation PAT gains from ownership of Bharti, the implied earnings dilution is negligible.

¹ MTN will not invest into Bharti at the level of Bharti Telecom since that would not raise Bharti Airtel’s stake in MTN.

Defining a scale—100bps savings in MTN ~US\$460m value for Bharti

How much PV gain to Bharti would a 100bps improvement in MTN’s costs imply? MTN trades at 10.5x 1-yr-fwd consensus earnings. Our assumption of steady-state tax rate for MTN is 30%. A 100bps savings in cost would mean a 70bps post-tax saving, which on 1-yr-fwd consensus revenue of ZAR125bn means ZAR0.87bn PAT improvement. Multiplying this by a PER of 10.5x and a holding-company discount of 20% yields ZAR7.3bn ~US\$0.95bn.

Since Bharti will own 48.8% of MTN, this implies a PV gain to Bharti of US\$460m, from a 100bps reduction in MTN’s costs.

Some of the possible opex savings could be:

- ⇒ Network cost reduction from managed services (MTN is not in managed services mode);
- ⇒ call centre, IT outsourcing (as being done by IBM for Bharti), back-office relocation to India, overheads rationalisation;
- ⇒ better utilisation of submarine cable assets;
- ⇒ improved terms owing to scale in international roaming agreements and termination agreements;
- ⇒ infrastructure sharing—it is catching on in Africa also, but may get accelerated if Bharti gets involved.

Figure 1: The opex heads which can be attacked form 20% of sales for MTN

MTN Cost Breakdown (% of sales)	Dec-07	Dec-08
Regulatory revenue share – A	4.7%	6.2%
Cellphones and accessories –B	8.6%	6.2%
Interconnect and roaming – C	12.5%	12.3%
M&S – D	13.5%	13.0%
Network opex – E	8.4%	9.0%
Employee – F	4.9%	5.2%
G&A – G	6.5%	5.9%

Source: MTN; IIFL Research

The costs that can be targeted were 20% for sales (and 35% of costs) in FY08; if one assumes a 10% reduction, this would amount to 200bps.

10% reduction in the relevant costs possible; can yield 200bps: As can be seen from figure 1, items A, B, C and D will not lend themselves to cost reduction efforts. The available heads E, F and G, constitute 20% of sales.

We assume a 10% potential reduction in these costs. While this may seem conservative—and it is finally a judgement call—it must be remembered that:

- 1) MTN has been working on several cost reduction measures, including infrastructure sharing, and to the extent that this has been articulated, we believe it will be in the price already; and
- 2) we are interested only in unanticipated savings, ie, those directly attributable to Bharti's involvement.

Bharti should be able to effect network cost reductions: Network cost reduction from managed services can be considered attributable to Bharti for the following reasons:

- (a) outsourcing network operations does yield network cost savings, because efficiency gains are pursued by the vendor in a focussed manner and with explicit cost reduction targets;
- (b) Bharti has developed a considerable body of expertise in managing the managed-services model and extracting efficiency gains, and it cannot be assumed that MTN independently opting for a managed services model can yield the same gains.

Hence, considering a 10% saving on costs that amount to 20% of revenue, we get 200bps of savings. Note that we don't assume any reduction in interconnect and roaming costs (D in figure 2). This is because though this item was 12.3% of sales in FY08, the largest item—the split between the regulated and negotiated costs—is not available. Nevertheless, this is an upside to our assumptions.

235bps can come from capex savings: MTN's capex-to-sales ratio was 22.9% in the last three years. We assume a decline to 17.5% (mid point of a 15%-20% range). Based on this, a 15% reduction would be equal to 235bps of savings.

Figure 2: A 15% improvement in capex MTN unit rates equals 235bps of sales

MTN capex (ZAR bn)	Capex	Sales	% capex /sales	%
FY06	9.8	51.6	19.0%	
FY07	15.3	73.1	20.9%	
FY08	26.9	102.5	26.2%	
Aggregate	52.0	227.2	22.9%	
Assumed steady state capex to sales				17.50%
Assumed capitalised expenses				10%
Achievable reduction in unit prices				15.0%
Savings reduction as % of MTN sales				2.35%

Source: Companies, IIFL Research

15% reduction in unit capex rates possible— => margin improvement of 235bps: We think a reduction of not more than 15% in unit rates in capex is possible for the following reasons:

- 1) as before, we are interested only in the incremental impact of Bharti's involvement, and it must be remembered that MTN has initiated aggressive cost reduction programmes on its own;
- 2) MTN's capex reduction measures include the introduction of Chinese vendors; for instance, in Nigeria, one of MTN's biggest markets, the principal vendor is Huawei, for both 900/1800MHz GSM as well as nationwide optic fibre backbone; and
- 3) we have surveyed several vendors and all major operators, and the simplistic assumption of capex unit rate reduction on the basis of India unit rates applying to Africa is not considered realistic even by one respondent.

Nevertheless, for reasons of superior scale and the opportunity to harmonise procurement, our judgemental call is that a 15% reduction in capex unit rates is not out of the question. We must also remember that Bharti's high usage (~5x of MTN) model calls for a deployment expertise which can result in a more optimal rollout for MTN, should MTN adopt that model.

Other possible savings avenues are:

- savings in Bharti itself, attributable to gains from the MTN deal;
- gains from cross-selling opportunities (Bharti's non-wireless products in MTN territories and vice versa); and
- market share gains.

Opex savings in Bharti unlikely; 5% savings in Bharti's capex possible—equivalent to 200bps margin improvement in MTN:

- We don't believe any significant saving in opex is possible, since the operations have little geographical overlap, and India is a low-cost market—with Bharti already setting the benchmark.
- Based on purchasing volume gains, we are certain that a 5% improvement in unit rates is possible.
- If this is applied on Bharti's projected 3-yr capex/sales ratio of 15% (ex-3G), this amounts to 80bps saving in Bharti's capex/sales ratio, which translates to 160bps savings in MTN.

Figure 3: A 5% reduction in Bharti's capex rates is equivalent to 200bps margin improvement in MTN

Item	Bharti	MTN
Pre-tax savings in Bharti (bps)	80	
Tax rate (Bharti)	15%	
Post-tax savings in Bharti (bps)	68	
Bharti 1yr fwd Sales (Rs bn)	448.5	
1yr FWD PER (Bharti)	14.8	
Implied market cap gain (INR bn)	45.1	
Implied market cap gain (ZARbn)		7.3
Bharti post deal shareholding in MTN		48.8%
Required MTN Market cap gain		14.9
MTN 1yr FWD PER		10.5
Required MTN PAT improvement		1.4
Equivalent pre-tax margin improvement in MTN (bps) – A		160
A above, adjusted for assumption of holding company discount (bps)		200

Source: IIFL Research

Figure 4: Total saving is 755bps of MTN sales – a gain of US\$3.5m to Bharti

Item (% of MTN sales)	bps	Assumption
Savings form MTN opex	200	10% reduction in addressable items
Savings form MTN capex	235	15% reduction in unit prices
Savings from Bharti capex	200	5% reduction in unit prices
Total savings	635	

=> PV gain to Bharti = \$2.9bn

20% holding company discount

Source: IIFL Research

Hence, we can see that all these measures (savings in both Bharti and MTN) put together are equivalent to 635bps of margin improvement in MTN. Recall that we had defined a scale earlier which showed that 100bps of margin improvement in MTN would produce a present value gain to Bharti, net of holding company discount of 20%, of US\$460m.

Applying that scale, we see that Bharti should have a value gain from the proposed MTN transaction of US\$2.9bn, which is ~10% of its market cap. However, keeping in mind that the deal terms are not necessarily frozen yet, we don't change our earnings estimates yet. However, this is sufficient to obviate the need to revise our target price downwards.

Significant gains and risks beyond savings

We look at each of these—strategic gains and risks—in turn, briefly.

Strategic gains: size does matter, especially when technology gains are invading the telco space:

- Reports in the media suggest that Deutsche Telekom is contemplating selling T-Mobile, and popular valuation estimates are €3bn-4bn. While T-Mobile may not be the emerging markets quarry that either Bharti or MTN is looking for, digesting acquisitions of this size will become easier for a combined Bharti–MTN.
- On another plane, Vodafone has opened up its network for third-party applications. This is in response, presumably, to the threat posed/potential opportunity loss emanating from the success Apple

has had in building an army of developers, who are generating revenue for Apple through application downloads and sales.

- Google is another company that has made inroads into the telco space with its mobile OS Android, and its dominant internet presence.

What Vodafone has done by opening its APIs for outside developers is to promote the superior convenience for end-subscribers. End subscribers who download applications from an iPhone or Android phone would have to make separate payments, but with Vodafone, the same application can be paid for through the monthly phone bill, a much more convenient option.

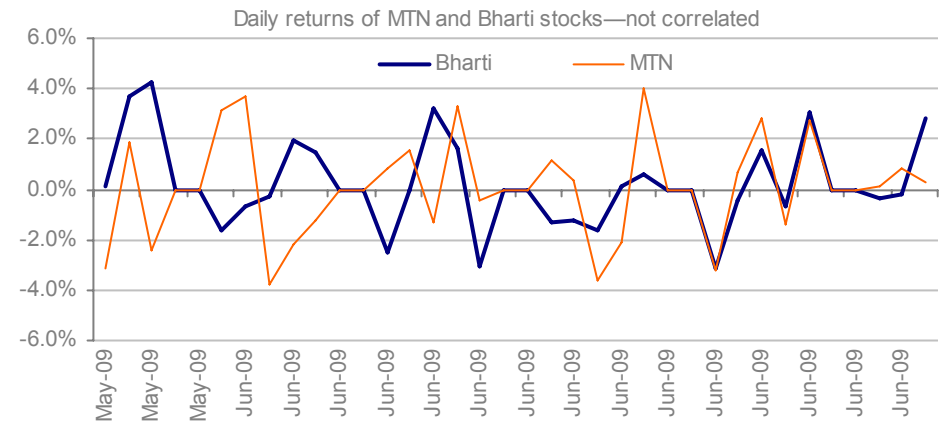
In this context, it can be seen that the battleground is shifting, and size and financial might will have increasing importance.

Risks that temper optimism around strategic gains:

- **Regulatory risks: incrementally, the MTN is rolling out in less friendly terrain.** The average penetration in the countries that contribute the bottom 20% of revenues for MTN is 25%, and include countries such as Afghanistan. Bharti has had a somewhat rough time in India in the last two years in tackling volatile regulation, and in the countries MTN is incrementally emphasising presence in, involvement of MTN management in constructive engagement with regulators in each country will be crucial.
- **Risk of diluted management involvement from MTN’s side:** The proposed deal envisages a proportional sale of 36% of MTN shares to Bharti by all MTN shareholders. Hence, there is no risk that MTN’s management stops having its skin in the game.

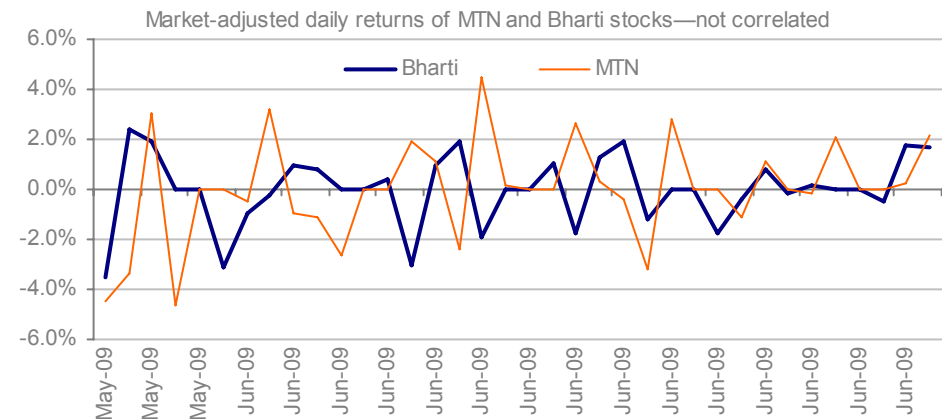
However, since it will be Bharti that will be taking control of MTN (as the largest single shareholder by far with 48.8%) and will be pressed to drive synergies, it would be naive to expect that it will be a pain-free process.

Figure 5: Daily stock price returns do not suggest any correlation...



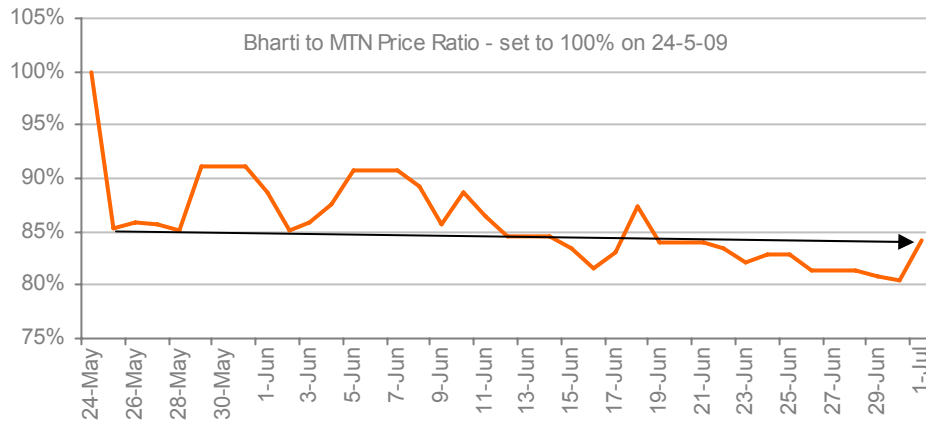
Source: Bloomberg, IIFL Research

Figure 6: ...nor do market-adjusted stock price returns



Source: IIFL Research daily prices adjusted for currency and index movements. Top40 Index taken for MTN, Sensex taken for Bharti

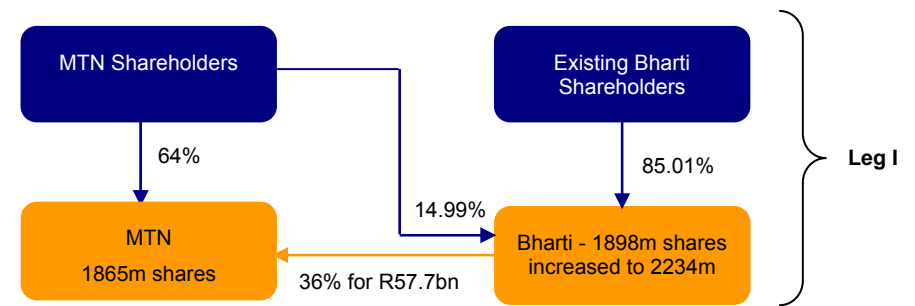
Figure 7: MTN has marginally gained against Bharti, net of market



Source: IIFL Research; daily prices adjusted for currency and index movements. Top40 Index taken for MTN, Sensex taken for Bharti

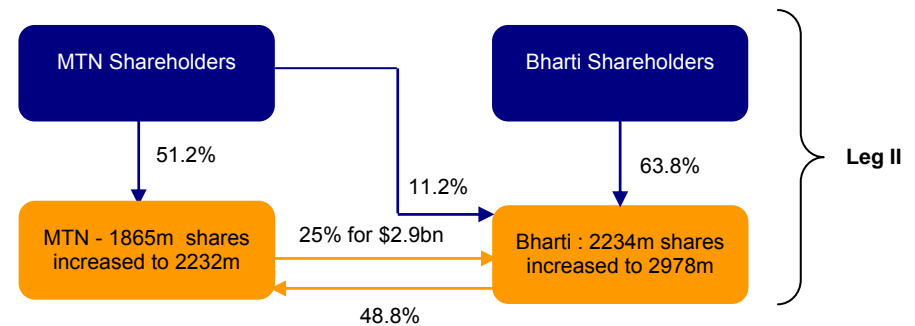
Appendix: Structure of proposed deal

Figure 8: Bharti purchases 36% of MTN from shareholders...



Source: Companies, IIFL Research

Figure 9: ...and finally gets 48.8% of MTN



Source: Companies, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenue	270,249	369,615	429,638	506,674	578,011
EBITDA	113,398	151,677	173,498	205,279	238,007
EBIT	76,137	104,097	116,113	139,600	163,997
Interest income	737	4,844	4,570	6,997	14,211
Interest expense	-3,873	-4,352	-5,489	-5,642	-5,347
Others	3,536	-11,516	2,183	8,122	14,137
Profit before tax	76,537	93,073	117,378	149,077	186,998
Taxes	-8,378	-6,615	-15,124	-25,583	-36,554
Minorities and other	-1,151	-1,759	-2,050	-3,371	-4,966
Net profit	67,009	84,699	100,203	120,122	145,478

No significant erosion in earnings under currently proposed terms

Cashflow summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Profit Before Tax	76,537	93,073	117,378	149,077	186,998
Depr. & amortization	37,261	47,581	57,385	65,679	74,010
Tax Paid	-8,378	-10,400	-13,961	-22,741	-31,332
Working capital Δ	-2,919	-19,789	3,937	4,057	3,082
Other operating items	-1,474	4,898	-397	-401	-405
Operating cashflow	101,028	115,363	164,342	195,671	232,353
Capital expenditure	-142,061	-141,320	-169,030	-98,293	-89,388
Free cash flow	-41,033	-25,957	-4,688	97,379	142,966
Equity Raised	21,132	-3,648	0	0	0
Investments	-45,509	10,141	-1,416	-7,330	-13,319
Debt financing/disposal	64,535	23,831	13,488	-29,941	-2,644
Dividends paid	0	0	-4,468	-9,976	-17,580
Other items	188	0	120	0	0
Net change in cash	-687	4,367	3,036	50,132	109,422

Capex savings in Bharti could be up to 5% on unit prices, based on procurement synergies

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Cash & cash equivalents	54,863	49,070	52,485	103,000	212,810
Sundry debtors	28,062	28,528	33,161	39,107	44,613
Trade Inventories	1,142	963	1,119	1,320	1,505
Other current assets	29,715	65,518	70,738	77,341	83,485
Fixed assets	313,407	409,136	445,968	478,582	493,960
Intangible assets	40,247	40,364	40,364	40,364	40,364
Other assets	5,207	10,370	86,201	93,251	106,288
Total assets	472,643	603,947	730,035	832,965	983,025
Short-term debt	19,348	64,808	65,456	66,110	66,772
Sundry creditors	18,749	18,771	22,061	25,959	29,284
Other current liabilities	116,038	133,606	156,490	138,185	145,849
Long-term debt/Convertibles	77,715	53,993	54,533	55,078	55,629
Other long-term liabilities	15,195	18,120	19,062	21,680	26,675
Minorities/other Equity	3,013	10,704	12,755	16,126	21,092
Networth	222,585	303,945	399,679	509,826	637,724
Total liabilities & equity	472,643	603,947	730,035	832,965	983,025

Minority includes 11.9% of Bharti Infratel, which in turn includes the income stream from Indus. Bharti Infratel will likely have a role to play in accelerating opex savings from the MTN deal, should it happen

Ratio analysis

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Sales growth (%)	45.9	36.8	16.2	17.9	14.1
Core EBITDA growth (%)	52.8	33.8	14.4	18.3	15.9
Core EBIT growth (%)	54.6	36.7	11.5	20.2	17.5
Core EBITDA margin (%)	42.0	41.0	40.4	40.5	41.2
Core EBIT margin (%)	28.2	28.2	27.0	27.6	28.4
Net profit margin (%)	24.8	22.9	23.3	23.7	25.2
Dividend payout ratio (%)	0.0	0.0	3.8	7.1	10.3
Tax rate (%)	-10.9	-7.1	-12.9	-17.2	-19.5
Net Debt/Equity (%)	24.8	31.0	26.0	4.5	-14.1
Return on Equity (%)	48.7	62.1	59.8	11.1	-37.8
Return on Assets (%)	37.4	32.2	28.5	26.4	25.4

Source: Company data, IIFL Research



From our sales desk



The Strategema

3 July 2009

Expect Big Splash Infrastructure Spending in FY2010 Union Budget

We attended a lunch meeting organised by the Indian embassy in New York, and got a foretaste of a big treat for the country. Montek Singh Ahluwalia, Deputy Chairman of India's Planning Commission, hinted at a massive thrust on infrastructure development in the forthcoming Budget. While urban infrastructure will continue to see the policy thrust, the incremental initiatives would be on rural development. This year's India Budget is important—this government has the strongest political mandate since India embarked on economic reforms in FY1992. Expectations are running high—the NIFTY has risen 22% since the May general elections. The Big Push on infrastructure may extend the rally.

We were at a lunch meeting organised by the Indian Embassy in New York, where the Deputy Chairman of the Planning Commission, Montek Singh Ahluwalia, addressed a select crowd on India's economic and policy outlook. Infrastructure has been a key policy focus over the past several years. However, **this year's budget may provide a BIG push on infrastructure investments**—bigger than what the market may already be expecting. India's previous Finance Minister PC Chidambaram, at his annual Union Budget presentations, had drawn direct comparisons between India and China on infrastructure, and had stressed on the need to step up infrastructure spending in India. We all know that this coming budget will also put a renewed thrust on the Infrastructure theme. However, Mr Ahluwalia's speech hinted on a scale of public and public-private planned initiative *like never before*.

The Eleventh Five Year Plan (2007-12) has estimated an investment requirement of US\$500bn in infrastructure for broad-based and inclusive growth. Mr Ahluwalia stressed that **US\$100bn infrastructure spending in FY2010** is quite feasible, with 30% participation from the private sector. The numbers are ambitious, but not impossible, in our view.

Strategema is an ancient Greek word, meaning war strategies or schemes to outwit opponents. Today's video game generation is more familiar with "Strategema" as a game central to the episode "Peak Performance" of Star Trek: The Next Generation.

The incremental focus would be on rural infrastructure to ensure “inclusive growth”. Mr Ahluwalia mentioned that **irrigation and water bodies, rural roads, and rural housing** would be the key focus ahead. The undertone was that the new government’s strong election mandate was to promote inclusive growth. Thus, while urban infrastructure will continue to see the policy thrust, the incremental initiatives would be on rural development.

Infrastructure spending has significant multiplier. On a low base, the multiplier effect would be more pronounced in rural areas—job creations and related and associated industrial and manufacturing activities, and private consumption. Thus, unless the monsoon damages prospects, the **rural consumption stories** would remain fundamentally supported ahead.

Mr Ahluwalia did not sound unduly worried on inflation, fiscal deficit and the current account deficit front, and expects 6.5-7.5% GDP growth in FY2010. We are likely to see sticky deficit figures ahead, with the government’s robust infrastructure spending plans. The Planning Commission is comfortable with a current account deficit of 2.5-3.5% of GDP.

This year’s India Budget is important—this government has the strongest political mandate since India embarked on economic reforms in FY1992. Expectations are running high—the NIFTY has risen 22% since the May General elections. The Big Push on infrastructure may extend the rally.

From the Sales Desk, our pre-Budget Top Picks have been:

IRB (IRB IN)

- Company has recently bagged close to \$1bn worth of highway (NHAI) projects: Budget may facilitate faster project implementation
- IRB has underperformed peers (IVRCL, or L&T etc.) over the past three months: possibility of a catch-up run

Shree Cement (SRCM IN)

- Forward P/E multiple of 9.4x, EV/Ton: INR62/- (the stock price has run up, but still it is cheap)
- Present in the North where prices have been rising fastest

Everest Kanto (EKCL IN)

- Stock trading at 9.7x FY11 earnings
- Expect lumpy orders ahead with Reliance KG Basin gas distribution falling in place, and the government's policy framework for city gas distribution licenses likely to result in demand for more than 100,000 cylinders in current fiscal itself

Infosys (INFO IN)

- possible STPI tax exemption (in Budget)
- possible earnings upgrade by analysts following INR weakness
- possible post-budget fund reallocation towards IT as sector seems to be fundamentally bottoming out

Bajaj FinServ (BJFIN IN)

- Possible beneficiary, if Budget relaxes foreign partner's stake limit
- A sweet turnaround story with focus on productivity and profitability (also, company's economic interest in Life Insur. can grow substantially in coming years)

LIC Housing Finance (LICHF IN)

- Turnaround Story: Gross NPLs, at 1.07%, have seen a transformational 330bps improvement since FY05, thanks to a holistic business restructuring exercise.
- With 8% share of the Indian housing mortgage pie, LIC Housing Finance (LIC HF) looks poised for a market outperforming 17-18% growth in loan book.
- Valuations, at 1.7x FY10ii P/B, are fair rather than expensive, given 24% RoE and stable NIM of 2.5%-2.9%. Price has run up a lot, but further upside possible with market segment re-rating
- Average loan size of less than INR1.4mn is the right segment where a spurt in housing loan demand is expected ahead

Bank of Baroda (BOB IN)

- P/B multiple if 1.2x, 14% CAR, 0.3% Net NPL, track record of robust growth

Among others, include **Jain Irrigation, Lakshmi Energy & Food (LKEF), Jubilant Organosys, Opto Circuits, ITC, Infotech Enterprises, Patni and Tech Mahindra**. Stock prices of several of the companies mentioned above have run up in recent sessions. However, a pro-growth and pro-infrastructure budget may not prompt early profit booking – may in turn extend the rally, we maintain. Mr. Ahluwalia’s speech inspires us to focus further on **Jain Irrigation**. At current market price of INR650, Jain Irrigation’s stock price is well above our target price set in May. However, the Budget may brighten the prospects of earnings upgrades.

Figure 1: Indian ADRs

Company Name	CMP (US\$)	Chg (%)				Avg. Volume ('000)			Mkt Cap (US\$ m)	Sales Gwth (%)	EPS Growth (%)	RoE (%)
		1D	5D	YTD	1YR	1D	5D	1M				
DR REDDY'S-ADR	16.9	(1.2)	3.5	72.8	11.5	888	689	410	2,851	38.2	NA	-22.9
HDFC BANK-ADR	102.0	(2.1)	2.0	42.8	43.1	383	361	510	14,485	58.1	14.2	16.9
ICICI BANK-ADR	29.9	(2.9)	0.9	55.1	10.0	2,119	2,441	2,993	16,616	7.1	-0.2	7.8
INFOSYS TECH-ADR	36.2	(3.0)	(1.3)	47.4	(15.0)	2,884	2,107	2,348	20,750	30.0	28.3	37.4
MAHANAGAR-ADR	4.3	(2.0)	6.1	24.9	(0.7)	102	232	149	1,361	-3.5	-17.0	4.8
PATNI COMPUT-ADR	10.8	(3.1)	(1.3)	82.5	4.9	68	64	84	689	15.9	-7.4	15.7
REDIFF.COM INDIA	2.7	(6.0)	8.1	32.3	(59.8)	78	59	116	78	-21.1	NA	5.9
SATYAM COMP-ADR	3.3	2.8	-	(63.1)	(86.4)	2,930	2,820	8,641	1,631	30.7	17.7	26.0
SIFY TECHNOL-ADR	1.6	(5.9)	0.6	4.6	(49.7)	95	48	164	68	-19.0	NA	0.6
STERLITE IND-ADR	12.7	0.5	5.7	130.6	(13.4)	800	961	1,320	9,018	-14.4	-47.0	39.4
TATA COMMUNI-ADR	19.7	(2.8)	6.0	(8.0)	21.5	95	181	238	2,803	20.6	29974.4	0.0
TATA MOTORS-ADR	8.6	(2.8)	(11.4)	93.3	(3.4)	1,168	1,634	1,595	3,868	9.1	-0.3	26.4
WIPRO LTD-ADR	11.8	0.4	2.5	44.5	0.9	211	334	392	17,219	28.6	18.5	30.8

Source: Bloomberg

Events calendar – July 2009

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
		1	2	3	4
		May Exports ↓ 29.0% May Imports ↓ 39.2%	WPI for 20 Jun ↓ 1.31%	Educomp Rail Budget	
6	7	8	9	10	11
Union Budget		Moser Baer	Praj Inda WPI for 27 Jun	Infosys, UTV Soft IIP for May	
13	14	15	16	17	18
Axis Bank	HDFC Bank, Power Fin	Bajaj FinServ, CMC	Bajaj Auto, Bajaj Holdings, Exide WPI for 4 Jul	Colgate, Dabur India	
20	21	22	23	24	25
IDFC		HDFC	ACC, Maruti Suzuki WPI for 11 Jul	Mah Lifespace, Phillips Carbon Black	
27	28	29	30	31	
	3i Infotech, BPCL Monetary Policy		Mahindra & Mah WPI for 18 Jul		

Black: Quarterly results, Blue: Economic data

Events

	Jul-Sep 09	Oct-Dec 09	Jan-Mar 10	Apr-Jun 10	Jul-Sep 10
Economics / Politics	<ul style="list-style-type: none"> Revised Budget for 2009-10 (July) RBI's Monetary policy meeting (end July) 	<ul style="list-style-type: none"> RBI's Monetary policy meeting (end October) State elections in Maharashtra and Arunachal Pradesh 	<ul style="list-style-type: none"> State Elections in Bihar, Haryana and Jharkhand 		
Auto	<ul style="list-style-type: none"> 18 Jul – launch of Bajaj new fuel efficient commuted bike 	<ul style="list-style-type: none"> Tata Motor's Nano plant at Sanand to start operations 	<ul style="list-style-type: none"> M&M's Chakan plant with a capacity of 320,000 vehicles to start operations. 		
Cement	<ul style="list-style-type: none"> Ambuja Cement's 1.5 mtpa Dadri plant to start ACC's 1.2 mtpa Bargarh plant to start Grasim's 4.4 mtpa Kotputli expansion to commence prod. Orient Cement 1.6 mtpa Devapur, AP plant to start JP Associates 1.2 mtpa Gujarat plant to start JK Cement 3.5 mtpa Karnataka plant to start 	<ul style="list-style-type: none"> NCL Industries 1.5 mtpa AP plant to start Andhra Cement 1 mtpa AP plant to start Ambuja Cement 1.5 mtpa Panipat plant to start ACC 3 mtpa Wadi, Kar plant to start Zuari Cements 2.4 AP mtpa plant to start Raghuram Cement AP 2 mtpa plant to start Dalmia Cements 2.3 mtpa Ariyalur plant to start 	<ul style="list-style-type: none"> JP Associates 3.0 mtpa HP plant to start 		

Events

	Jul-Sep 09	Oct-Dec 09	Jan-Mar 10	Apr-Jun 10	Jul-Sep 10
Infrastructure		<ul style="list-style-type: none"> • BHEL Capacity goes up from 10 GW to 15 GW 			
Metals		<ul style="list-style-type: none"> • Sterlite: First phase of 2,400MW power plant will commence operation 	<ul style="list-style-type: none"> • JSW Steel: Commissioning of 3.5mntpa hot strip mill 		
Pharma	<ul style="list-style-type: none"> • Lupin: Clarity on FDA issue resolution at Mandideep facility. 	<ul style="list-style-type: none"> • Max Healthcare: Opening of 270 bed Max Balaji tertiary care centre, Pratapganj, New Delhi • Sun Pharma: Clarity on FDA issue resolution at Caraco facility in Detroit • Biocon: Initiation of insulin studies for US market • Glenmark: Initiation of phase III trial for melogliptin 	<ul style="list-style-type: none"> • Dr Reddy's: Potential USFDA approval for fondaparinux • Biocon: data from oral insulin study in India. 		
Real Estate	<ul style="list-style-type: none"> • DLF to acquire stake in DAL. • DLF to sell wind energy business • DLF to sell multiplex business, DT Cinemas • Puravankara Projects – Capital raising by its subsidiary Provident Housing & Infrastructure Ltd to fund its mass housing project • Anant Raj - QIP fund raising 				

Events

	Jul-Sep 09	Oct-Dec 09	Jan-Mar 10	Apr-Jun 10	Jul-Sep 10
Telecom	<ul style="list-style-type: none"> • Indus Towers expected to receive towers from Bharti, Vodafone and Idea and thus merger of tower subsidiaries into Indus completed • 3G auctions announcement expected, followed by clarifications • MNP in metros expected to be implemented as per DoT order • Idea Spice merger expected to receive court approval, and get completed • RCOM may raise capital through QIP placement • TRAI may come out with revised recommendations on enhancement of transparency in VAS offerings 	<ul style="list-style-type: none"> • 3G auctions expected to be held • Idea cellular expected to become pan-India operator • Bharti MTN Deal expected to be concluded. 			
Utilities	<ul style="list-style-type: none"> • CESC Budge Budge (250MW) unit operational • Suzlon to start production from new facilities • Lanco's Amarkantak Unit-1 (300MW) to commission 	<ul style="list-style-type: none"> • Lanco's Kondapalli-II to commission (366MW) • GIPCL's SLPP-II unit 3 (250MW to commission) 	<ul style="list-style-type: none"> • NTPC's Dadri unit (980MW) to commission 	<ul style="list-style-type: none"> • NTPC's Sipat-I Unit 1 (660MW), Korba-III (500MW) to commission • GIPCL's SLPP-II unit 4 (250MW to commission) 	
Others		<ul style="list-style-type: none"> • EKC's Kandla SEZ plant to manufacture 300,000 steel plate cylinders for exports to Europe to start operations. 			



Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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