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India Equity Strategy

Transfer of Coverage: In-line Dec-07 Quarter

- Sensex ex-oil profits at 22.5% vs. 21% est.** — Sensex ex-oil profits for the last quarter were largely in-line with estimates, unlike the significant outperformance in the last two quarters. Earnings for our universe (159 companies) were better at 17% (vs. 9% forecast), mainly due to oil-bond issuance. Ex-oil profits for our universe were more in-line, at 20.4% vs. forecast of 17.2%.
- Key outperformers and underperformers** — Ex-oil profit surprises were largely driven by banks, brokerages, media, pharmaceuticals and hotels. Key underperformers were capital goods, metals, power, and textiles. IT services, cement, consumer, telecom and the auto sectors delivered in-line results.
- Top-line growth muted, margins flat** — Ex-oil revenues for the Sensex were below expectations at 15% vs. 19% forecast, continuing the declining trend of the last five quarters, and margins are flat.
- Overall, no surprises this time** — Earnings this quarter were largely in-line with expectations, with outperformance by banks providing the main positive surprise. Unlike the previous quarter, results this season are unlikely to drive earnings upgrades. Our estimates of FY09E earnings growth for Sensex and the Citi India universe currently stand at 19.5% and 25%, respectively.
- Model Portfolio** — We are overweight on financials, telecom, IT services, and consumers, neutral on capital goods, auto and pharmaceuticals, and underweight on materials, energy and utilities. With this note we are transferring Strategy responsibilities to Aditya Narain from Ratnesh Kumar, who has left the firm.

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Figure 1. India Quarterly Profit Growth Trend (Percent YoY)

Year to 31 March	FY07				FY08		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Sensex	30.5	27.2	42.4	31.4	30.8	28.9	17.0
Sensex - ex-Oil	32.3	35.6	48.8	37.6	35.7	30.6	22.5
Citigroup Universe	32.3	59.4	55.5	13.5	48.3	19.8	17.3
Citigroup Universe - ex-Oil	41.9	54.3	46.8	33.9	33.0	21.9	19.8

Source: Citi Investment Research

 See Appendix A-1 for Analyst Certification and important disclosures.

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¹Citigroup Global Markets India Private Limited

Dec-07 Quarter Results Review

Earnings for the quarter-ended Dec-07 were largely in-line with expectations, with strong performance by banks, public and private, offering the only positive surprise to Sensex profits. A rare negative surprise by capital goods, and in-line performance by IT services, telecom and petrochemicals contributed to the muted profit growth numbers. Our estimates of FY09 overall profit growth for Sensex, and the Citi India universe of companies currently stand at 19.5% and 25.1%, respectively. Unlike the Sep-07 quarter, results this time are unlikely to drive positive earnings revisions.

Sensex ex-oil profits up 22% vs.21% forecast

Ex-oil profits for Sensex companies grew 22.5% vs. 21% forecast for the quarter ended Dec-07.¹ Unlike the previous two quarters in fiscal year FY08, earnings this quarter were largely in-line with expectations. Overall profit growth for the Sensex came in marginally lower than expectations at 17% vs. 19.4% forecast. Profits for the larger Citi India universe were slightly better at 17% vs. 9% forecast, primarily due to oil-bond issuance to downstream oil majors. Ex-oil profits were more in-line at 20% vs. 17.2% forecast.

Figure 2. India Quarterly Profit Growth by Sector (Percent YoY)

Year to 31 March	FY07				FY08			
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	3QA
Sensex	30.5	27.2	42.4	31.4	30.8	28.9	19.4	17.0
Sensex - ex-Oil	32.3	35.6	48.8	37.6	35.7	30.6	21.0	22.5
Citigroup Universe	32.3	59.4	55.5	13.5	48.3	19.8	8.9	17.3
Citigroup Universe - ex-Oil	41.9	54.3	46.8	33.9	33.0	21.9	17.2	19.8
Autos	50.5	35.6	18.8	14.8	-7.3	-2.0	-0.3	2.4
Banks/Fin	-2.0	18.1	21.0	21.6	40.4	31.1	22.7	47.3
Brokerages	41.0	43.5	-25.6	-49.4	-15.6	-20.7	40.3	73.4
Capital Goods	132.2	119.7	47.0	34.0	35.2	57.6	40.5	22.6
Cement	109.9	152.3	69.2	61.1	32.2	33.2	14.9	12.9
Consumer/FMCG	24.2	35.4	16.8	24.5	21.8	8.3	16.9	19.8
Hotels	63.2	67.8	74.0	83.5	42.4	67.3	36.0	44.0
IT Services	54.0	57.2	46.0	53.4	36.2	20.8	16.9	21.3
Media	44.6	147.3	230.8	49.9	78.1	76.0	34.4	53.0
Metals	107.7	148.0	100.8	25.0	15.1	-6.1	-14.4	-22.9
Oil & Gas	-16.8	74.6	102.2	-31.1	181.7	14.3	-24.7	7.4
Petrochem/chemicals	10.3	9.2	57.6	14.0	28.2	41.6	40.3	38.7
Pharma	36.4	83.1	61.2	94.9	29.7	-9.4	10.9	17.9
Power	19.2	20.5	21.1	17.7	48.6	27.9	15.8	2.3
Sugar	39.1	118.4	-43.1	-83.6	-183.4	-73.9	-378.3	-18.8
Telecom	237.9	189.1	149.7	109.8	120.3	82.7	41.4	41.2
Textiles	-18.8	91.5	14.1	-0.9	58.2	-36.6	15.4	7.0

Source: Citi Investment Research

Key sectors driving profit surprises

Earnings this quarter were largely in-line with expectations overall, and outperformance was restricted to banks and hotels in the ex-oil universe. Overall profits for the Citi India universe were boosted by oil-bond issuance to the tune of Rs91bn, and improvement in refining margins for downstream oil companies. Most other sectors' performance was either in-line or below expectations. Telecom, consumer, auto, cement, petrochemicals and IT services delivered in-line results. Key underperformers this quarter were capital goods, metals, textiles and power. In Figure 3 we detail the share of

¹ Our numbers here do not include DLF for relevant yoy comparison of profits.

profits, and profit surprise for the Sensex universe of companies. Profits for the banking sector in the Citi India Universe grew 47% this quarter on a yoy basis, vs. 23% expected. The outperformance was broad-based across private and public sector banks, primarily on overall margin improvement, strong fee income growth and declining gross NPLs. Profits for public sector banks grew 41% (vs. 16% estimate) and 56% for private banks (vs. 32% estimate.). Fee income growth for most private banks was higher than 30%, and asset quality looks stable. Pre-provision profits were up 44% (33% ex-trading gains) on a yoy basis.

Lower-than-expected sales, margin compression, and loss of legacy orders were some of the key reasons behind a disappointing quarter for capital goods, with earnings growth at 22.6% vs. 40.5% forecast. Among other key sectors driving Sensex profits, telecom and IT services were largely in-line. Despite relatively modest sales growth, telecom earnings were well supported with price elasticity kicking in as lower tariffs in Sep-07 led to higher MoUs in the third quarter, resulting in strong margin expansion. IT services also saw muted sales growth, but earnings were in-line on lower depreciation charges this quarter.

Figure 3. Sensex—Share of Profits and Profit Surprises in Dec-07 Quarter (Percent)²

Sector	Dec-07 Quarter Profits Vs Expectations	Profit Share In Sensex	Share of Profit Surprise
Autos, Ancillaries, Transportation	2.2%	5.2%	4.9%
Engineering, Power, Construction	-13.4%	11.6%	-80.2%
Metals, Mining	-8.1%	5.5%	-21.8%
Building Materials	-4.7%	4.1%	-10.3%
Consumer, Retail	-0.2%	4.8%	-0.5%
Pharmaceuticals, Healthcare	-0.1%	1.7%	-0.1%
IT Services	2.5%	13.3%	14.3%
Telecom	-0.8%	10.8%	-3.7%
Oil & Gas, Chemicals	-10.2%	28.7%	-146.0%
Banks, Financial Services	28.8%	14.3%	143.4%
Sensex (Rs m)		287,801	(6,341)

Source: Citi Investment Research

² Excluding DLF.

Top-line growth muted, margins flat

Sales growth for the Citi India universe of companies (ex-oil) came in marginally lower than expectations at 17.4% vs. 19.5% forecast, continuing the trend of the last five quarters. Banks, brokerages, hotels and sugar outperformed, while metals, capital goods and telecom disappointed. Most other sectors had top-line growth in-line with expectations. Margins overall remained flat on a sequential basis.

Figure 4. India Quarterly Sales Growth by Sector (Percent YoY)

	FY07				FY08			
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	3QA
Sales								
Sensex	32.2	30.1	34.4	20.5	15.8	14.8	17.6	13.8
Sensex - ex-Oil	31.9	33.1	35.8	22.4	19.1	15.5	19.5	16.1
Citigroup Universe	37.4	41.5	27.7	18.5	13.5	6.9	10.1	14.6
Citigroup Universe - ex-Oil	41.7	42.5	32.1	27.1	20.5	17.3	19.5	17.4
Autos	37.5	38.0	20.6	14.3	9.0	1.1	10.2	8.8
Banks/Fin	20.4	17.5	26.7	29.3	15.4	16.2	11.1	14.9
Brokerages	41.9	24.6	5.1	31.7	24.8	107.4	110.0	121.1
Capital Goods	77.0	95.3	38.7	42.7	37.1	39.9	35.2	26.8
Cement	36.3	33.5	49.2	38.0	22.3	25.1	16.4	17.1
Consumer/FMCG	59.1	31.5	-16.3	34.1	19.7	18.1	18.3	17.0
Hotels	27.2	23.8	25.7	34.4	24.8	22.7	22.3	26.0
IT Services	56.6	60.8	40.9	51.5	28.8	24.2	25.4	25.6
Media	31.3	49.7	16.0	21.4	22.5	8.3	47.5	55.9
Metals	72.2	73.1	49.8	23.4	13.6	4.8	-0.2	-10.6
Oil & Gas	32.4	40.3	22.4	7.5	4.7	-5.7	-2.3	11.0
Petrochem/chemicals	37.9	37.4	45.7	5.5	14.4	12.5	27.1	30.7
Pharma	16.2	41.8	33.9	47.9	22.8	10.4	16.7	17.4
Power	18.1	15.6	18.7	20.9	23.8	15.7	11.8	12.7
Sugar	46.3	62.4	8.7	23.9	0.5	-23.5	15.7	23.7
Telecom	40.7	30.9	54.7	31.9	35.7	46.9	36.3	22.6
Textiles	7.5	8.5	15.9	27.1	20.6	39.6	19.5	21.7

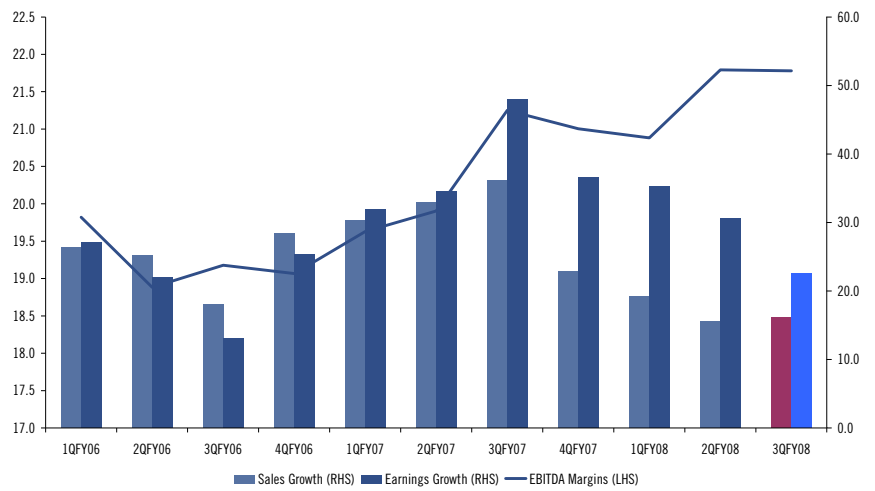
Source: Citi Investment Research

Figure 5. 3QFY08 EBITDA Margins—Expected vs. Actual (bps)

	Margins (%)		Change (bps)	
	Expected	Actual	Expected	Actual
Sensex	25.60	25.09	-6	-58
Sensex - ex-Oil	21.96	21.78	69	52
Citigroup Universe	15.89	14.21	-29	-185
Citigroup Universe - ex-Oil	20.58	20.39	-22	-29

Source: Citi Investment Research

Figure 6. Sensex Ex-oil—Sales, Earnings Growth, and EBITDA Margins



Source: Citi Investment Research

Appendix A-1

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