2 July 2007 | 8 pages

India Equity Strategy

Jun-07 Quarter Results Preview

- Sensex ex-oil profit growth expected at 25% — Jun-07 quarter will mark the first quarter where significant INR appreciation, higher interest rates and credit moderation will show up in corporate results. Despite those challenges, we still expect overall margins to hold and a solid quarter with Sensex ex-oil profits expected to rise 25% yoy (Citi ex oil expected up 23.7%).
- INR appreciation and some top-line growth moderation — INR appreciated by 6.4% vs. US$ in Jun-07 quarter, which will weigh on margins of exporters. On the flipside, companies with forex debt will have significant gains. Base effect, higher interest rates and slowing credit will result in slightly slower sales growth.
- Expected sector leader and laggards — Profit growth leaders will be Telecoms (+100% yoy), Cement (+38%), Media (+32%) and Capital Goods (+31%). Key Banks and IT services sectors will also do well despite multiple challenges and should deliver the market average 25% profit growth. Key laggard sectors are likely to be Autos, Sugar, Metals and Textiles.
- Result season likely to be neutral or positive for earnings forecasts — We currently expect 15-16% ex-oil earnings growth for India in FY08 and FY09. A solid result season and near the end of rate hikes will either help keep those growth forecasts or help them higher. We do not see a risk of overall downward revisions.

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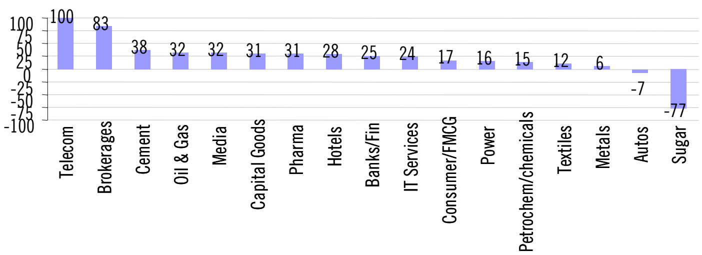
Figure 1. Sectoral Jun-07 Quarter Profit Growth (Percent YoY)



Source: Citigroup Investment Research

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

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Jun-07 Quarter Results Preview

Jun-07 quarter will be the first full quarter to feel the impact of a significant currency appreciation and higher interest rates. Notwithstanding these challenges and others (like wage inflation), we expect overall margins to hold and a solid 25% yoy rise in Jun-07 quarter profits for Sensex ex-oil.

Sensex ex-oil profit growth expected at 25% yoy

The soon to start Jun-2007 quarter results are expected to be solid per Citi analyst estimates. We expect Sensex ex-oil profits to rise 25% yoy. Growth expectations for the larger Citi India universe ex-oil are similar. Please refer to Figure-2 below.

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

	FY06				FY07				FY08
Year to 31 March	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1QE**
Sensex	**30.3**	**22.1**	**12.7**	**11.4**	**29.1**	**26.4**	**41.7**	**30.4**	**21.4**
Sensex - ex-Oil	**27.0**	**22.0**	**13.1**	**25.3**	**30.5**	**34.5**	**48.0**	**36.5**	**25.0**
Citigroup Universe (142 companies)	**8.5**	**13.5**	**4.7**	**42.6**	**24.4**	**51.9**	**55.0**	**11.9**	**24.7**
Citigroup Universe - ex-Oil	**23.3**	**18.3**	**21.7**	**31.0**	**32.4**	**44.1**	**45.8**	**32.8**	**23.7**
Autos	29.4	29.4	31.3	30.7	49.0	34.0	24.5	14.1	-7.2
Banks/Fin	1.5	13.3	24.2	17.4	-2.2	17.8	20.8	21.3	24.8
Brokerages	436.2	398.7	232.9	174.8	85.9	38.7	36.0	53.3	83.3
Capital Goods	85.2	37.1	107.9	94.1	122.4	118.3	59.8	33.7	31.3
Cement	23.2	4.3	2.4	76.0	104.3	152.3	251.9	61.1	37.9
Consumer/FMCG	21.0	18.1	27.8	23.5	24.2	35.4	17.8	24.5	17.3
Hotels	NA	NA	19.7	55.3	63.2	67.8	74.0	83.5	28.2
IT Services	18.8	24.1	27.9	47.4	47.2	48.2	44.2	43.8	24.5
Media	6.3	-38.5	-77.6	-30.7	-27.8	-21.6	459.6	3.5	31.8
Metals	32.5	14.9	31.7	60.4	62.1	72.7	52.0	22.3	5.9
Oil & Gas	-32.6	1.5	-39.3	74.5	-16.2	74.6	103.0	-31.2	32.1
Petrochem/chemicals	70.4	35.0	-20.3	-14.6	-2.8	9.9	55.6	14.8	14.7
Pharma	11.3	-16.6	9.8	51.5	38.8	91.6	72.6	116.2	30.7
Power	24.7	11.5	11.4	17.9	19.2	20.5	21.1	17.7	15.7
Sugar	318.9	68.3	15.9	85.3	39.1	118.4	-43.1	-83.6	-77.2
Telecom	22.4	27.2	34.7	43.2	237.9	171.8	138.0	95.3	100.5
Textiles	305.9	100.8	117.2	37.4	10.4	93.7	16.2	-13.5	11.5

Source: Citigroup Investment Research

Profit growth leading sectors during the quarter are likely to be Telecoms, Cement, Media and Capital Goods. Banks and IT services will also do well despite multiple challenges and both should deliver market-average 25% profit growth. Oil sector's profit growth will be as usual contingent on receipt/accrual of oil bonds.

Lagging behind this quarter will be Sugar, Autos and Metals.

Figure 3. India Quarterly Sales Growth by Sector (Percent YoY)

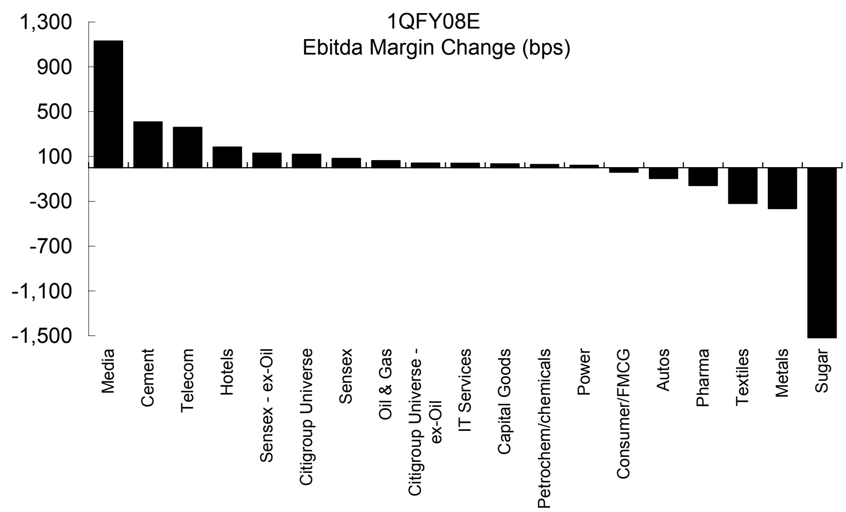
	FY06				FY07				FY08
Sales	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1QE**
Sensex	**23.2**	**22.5**	**16.0**	**24.3**	**30.6**	**29.4**	**34.6**	**21.1**	**17.2**
Sensex - ex-Oil	**26.2**	**25.2**	**18.2**	**28.4**	**30.1**	**32.2**	**36.0**	**23.1**	**18.9**
Citigroup Universe	**16.2**	**21.6**	**24.4**	**31.2**	**34.6**	**40.0**	**28.9**	**17.7**	**10.6**
Citigroup Universe - ex-Oil	**22.9**	**28.4**	**31.2**	**35.0**	**36.5**	**39.7**	**33.7**	**25.9**	**19.7**
Autos	14.4	19.1	20.5	30.7	36.6	37.1	26.0	13.9	3.1
Banks/Fin	27.8	15.9	16.5	14.3	20.2	26.2	26.6	29.2	21.0
Brokerages	527.5	304.0	194.8	144.6	102.6	56.7	74.0	99.2	78.7
Capital Goods	-12.3	27.2	79.6	57.0	77.3	93.9	39.0	41.3	33.5
Cement	39.8	29.8	33.3	47.8	28.2	30.4	49.2	38.0	27.7
Consumer/FMCG	16.8	49.0	60.4	52.2	59.1	31.5	24.0	34.1	18.8
Hotels	NA	NA	19.3	10.8	27.2	23.8	25.7	34.4	24.2
IT Services	40.1	37.5	46.0	48.6	45.0	47.4	40.8	39.6	28.1
Media	8.2	-3.5	11.4	2.3	11.9	38.1	10.6	na	Na
Metals	11.7	12.8	36.4	50.0	73.6	57.0	34.2	21.1	13.8
Oil & Gas	9.2	14.5	17.1	26.7	32.4	40.3	23.1	7.5	-0.3
Petrochem/chemicals	25.9	29.9	4.0	19.3	20.9	34.3	43.0	5.5	10.7
Pharma	23.2	7.8	18.2	26.0	21.5	50.9	38.5	54.1	29.0
Power	11.6	15.1	19.2	11.2	18.1	15.6	18.7	20.9	20.3
Sugar	132.4	48.6	48.7	134.5	46.3	62.4	8.7	23.9	21.7
Telecom	20.9	22.6	25.4	22.6	40.7	30.9	41.3	31.9	33.5
Textiles	25.3	34.0	57.0	37.7	26.9	34.8	15.6	18.0	24.3

Source: Citigroup Investment Research

We expect slight moderation in sales growth as base effect, higher interest rates, slower credit and INR appreciation kick in. Overall net sales growth will still be healthy around 18-19%.

Margin surprises can be one of the most significant drivers of profit surprises. Despite the headwinds of currency appreciation, slightly slower top-line growth and cost inflation (notably wages), we expect margins to hold overall.

Figure 4. Forecast 1QFY08E EBITDA Margin Changes (bps)

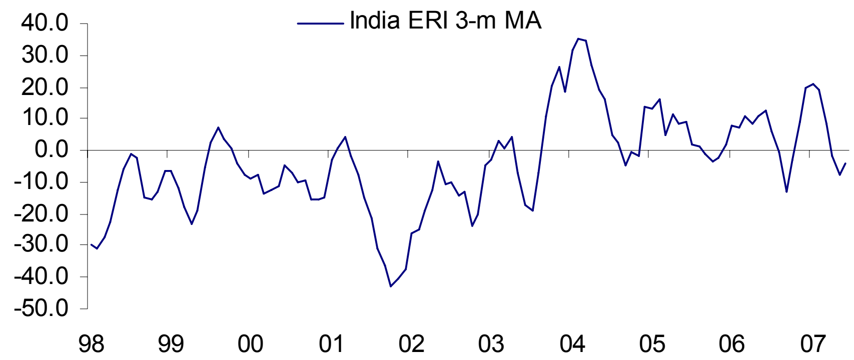


Source: Citigroup Investment Research

Sectors likely to see significant margin expansions yoy are Media, Cement, Telecom and Hotels. Those with big margin declines are likely to be Sugar, Metals and Textiles.

Earnings Revision Index for India took a significant dip down in 1Q and 2Q 2007 due to tightening liquidity, rate hikes and currency appreciation. We do believe the current 15-16% profit growth for FY08 and FY09 do already build in those factors and the upcoming quarterly results season's impact on longer-term earnings forecast will be neutral to positive.

Figure 5. India 3-month Earnings Revision Index



Source: IBES Note: Earnings Revisions Index = (Number of companies with earnings being revised up - Number of companies being revised down)/Total number of companies being revised

Select Sector Notes

Autos -- Expected to be one of the worst hit sectors from top-line deceleration due to base effect, higher interest rates and tighter liquidity. CV volumes have declined yoy, while car volume growth is also expected to be a moderate 5%. Motorcycles and LCVs steadier at around 10-11%. Despite INR appreciation, auto ancillary exporters expected to do well due to exposure to non-USD markets like Europe.

Banks – Loan growth slowed, but should still be healthy for the quarter at around 27%. Lending rate hikes will help keep margins steady. Low base effect will help profit growth of larger state-owned banks. Higher bond yields may throw some mark-to-market surprises.

Capital Goods – Continued strong order flow and order execution momentum to keep earnings growth robust here. Construction companies will be accounting for adverse 80-IA tax change and some of them may chose to restate earlier year's numbers as well for better comparisons.

Cement – Despite government intervention in pricing, average prices should still be up 10-11% yoy, driving better margins and strong profits.

Consumer – Steady top-line growth. Easing of margin pressure in food & beverages as agri input prices cooled off. Continued margin pressure in home and personal care segment due to higher palm oil and chemical prices. Cigarrette volumes could see significant tapering off due to VAT imposition by various state governments. Retailing profit growth expected to remain robust on volume expansion, although some cost pressures are building up in wages and property rentals.

IT Services – Currency appreciation of 6.4% during the quarter and wage hikes for many companies will weigh on margins. Visa costs will also come in during the quarter. Strong volume growth (7-9% qoq for large companies) will be the prime driver of 25% profit growth for the sector.

Metals – Aluminum saw lower domestic prices yoy due to currency appreciation. Steel profitability better this quarter due to 10-11% higher prices.

Oil & Gas/ Chemicals – We have assumed no accrual of oil bonds during the quarter, as was the case last year. Secular growth stories – i.e., upstream services and gas distributors – to do well. Refining margins bounced back significantly, to US$9/bbl during the quarter (vs. US$6.8/bbl in Mar-07 quarter).

Pharma – Sector to see positive impact of acquisitions and low base. Also, with many companies sitting with US$ debt/convertibles, pharma will be one of the few sectors to be a positive beneficiary of currency appreciation.

Telecom – Strong momentum on subscriber addition sustained at 6.1m/month. Margins will expand a bit further on scale economies and operating leverage. Another sector with significant foreign exchange gain on INR appreciation due to forex debt with companies.

Appendix A-1

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