

India Equity Strategy

 Equity

1QFY11 Earnings Review: Feels Foreign

- Indian growth, foreign earnings** — India's headline 1Q11 profit growth is a robust 34%yoy, but with almost 80% of this growth being generated by its foreign subsidiaries (swinging from losses to large profits), it is actually a fairly disappointing show. 'Domestic only' earnings growth at 7.5% is weak, short of expectations, and in line with trends observed midway through the results season. The negative bias in the quarter is apparent in the upside/downside surprise ratio (37/53, with 34 in line); Citi's own earnings upgrade/downgrade ratio at 23/19, and FY11 earnings growth expectation coming back to 28%, suggest aggregates remain relatively unchanged.
- It's commodities, banks and swings** — Commodities and banks make up almost 80% of earnings growth – commodities with help from abroad and banks due to more fundamental reasons. The telecom and energy sectors are the laggards, with median earnings growth for companies at around 20%. The quarters' results do also stand out in the level of earnings concentration (sectors/stocks) and volatility, suggesting less predictability up ahead.
- Sales and operating margins relatively balanced** — While overall sales and margins have been boosted by the foreign business turnarounds, domestic margins have largely held, with sales too growing as per expectations. This suggests pressures are below EBIDTA levels, which could exacerbate given rising rates.
- Earnings growth back to the starting line?** — Does the rally in earnings in the latter half of the season, and FY11 earnings growth back at 28% (after dipping to 22% in early Aug), leave India where it started the earnings season? We think not. This is because domestic businesses seem to be driving top-line growth, while bottom-line momentum is fuelled by commodity biased/ cyclical foreign subsidiaries. This could well challenge India's domestic growth/valuation premium.

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Figure 1. 1QFY11 Growth Share of International Earnings for Sensex ex-oil Companies



Source: Company data, CIRA

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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India Equity Strategy

Feels Foreign

Consolidated PAT growth is impressive for both Sensex and the broader CIRA universe (ex-oil basis)...though not hugely out of expectation range (this includes offshore subsidiary profits, not always cleanly reported)...the big swing is from offshore subsidiaries wildly swinging from losses to profits

Figure 2. 1QFY11 Results (Growth in percent YoY)

	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Sensex (30/30)	26.6%	27.7%	21.7%	27.6%	23.9%	24.4%	↔
Sensex ex-oil (29/30)	30.3%	30.5%	33.5%	37.4%	36.5%	34.4%	↔
Sensex ex-Energy	18.9%	20.5%	28.6%	34.0%	36.5%	34.6%	↔
Sensex ex-fin	26.5%	27.5%	23.1%	27.2%	25.0%	24.4%	↔
Sensex ex-oil, ex-fin	30.4%	30.4%	38.2%	39.3%	40.7%	36.6%	↔
Citi Universe	23.8%	25.5%	8.7%	12.1%	1.4%	-1.8%	↔
Citi Universe Ex-oil	20.0%	21.0%	28.6%	31.9%	34.0%	32.6%	↔
Citi Universe ex-fin	23.4%	24.8%	6.0%	6.7%	-3.0%	-9.5%	↓
Citi Universe ex-oil, ex-fin	19.0%	19.4%	32.6%	31.8%	39.6%	33.6%	↓
Citi Universe ex-Metals	23.5%	26.2%	-0.7%	3.9%	-12.1%	-15.4%	↔
Citi Univ. ex-oil, ex-Metals	18.3%	21.0%	17.6%	22.7%	16.0%	14.5%	↔

Source: Company data, CIRA

The numbers, however, lose sheen if we strip out foreign subsidiaries...profits are both low and short of expectations.

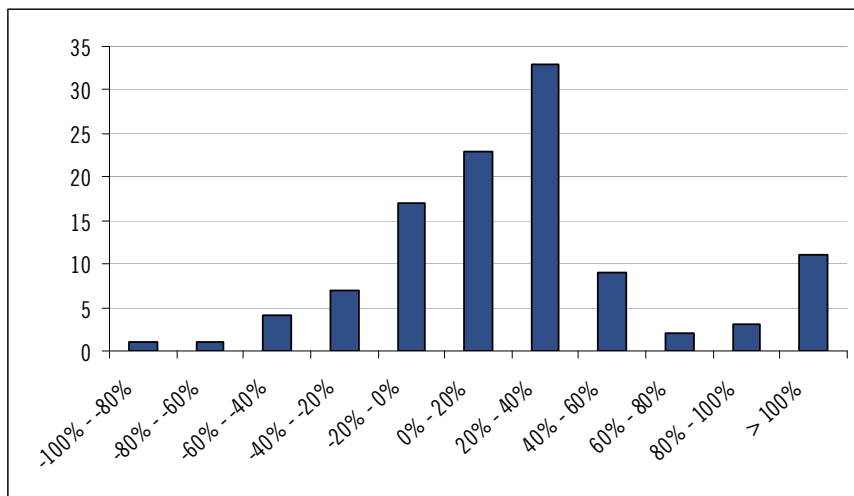
Figure 3. 1QFY11 Standalone Results (Growth in percent YoY)

	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Sensex (30/30)	26.9%	26.7%	10.5%	14.0%	5.4%	2.7%	↔
Sensex ex-oil (29/30)	31.4%	30.0%	19.5%	20.5%	13.0%	7.5%	↓
Sensex ex-Energy	17.0%	16.9%	12.6%	14.6%	9.4%	3.5%	↓
Sensex ex-fin	26.8%	26.4%	9.7%	11.0%	3.5%	-0.7%	↔
Sensex ex-oil, ex-fin	31.6%	29.8%	20.6%	18.2%	12.1%	4.3%	↓
Citi Universe	23.5%	24.1%	1.9%	3.3%	-8.3%	-13.4%	↓
Citi Universe Ex-oil	18.9%	17.9%	18.8%	19.4%	17.5%	13.2%	↔
Citi Universe ex-fin	23.1%	23.2%	-2.4%	-4.2%	-14.4%	-23.0%	↓
Citi Universe ex-oil, ex-fin	17.6%	15.7%	18.8%	14.4%	16.8%	7.7%	↓
Citi Universe ex-Metals	22.6%	24.3%	-3.1%	-0.6%	-14.7%	-19.9%	↓
Citi Univ. ex-oil, ex-Metals	16.5%	17.4%	13.9%	16.1%	11.7%	7.6%	↔

Source: Company data, CIRA

Earnings growth of CIRA universe companies is most concentrated in the 0-40% band

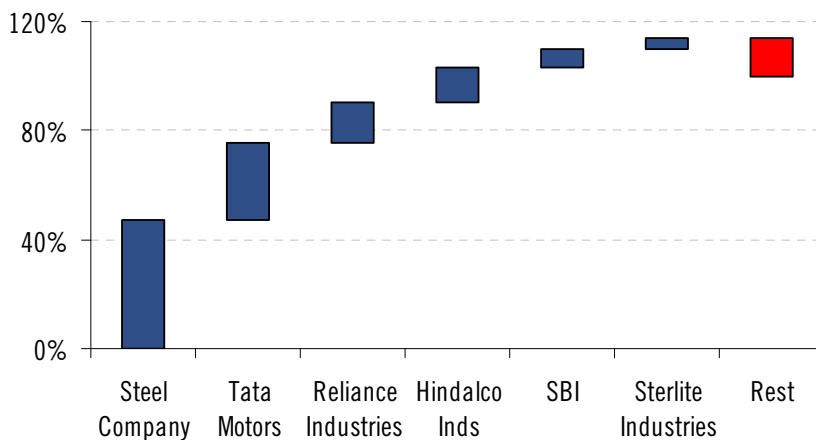
Figure 4. 1QFY11 Earnings Growth Distribution for CIRA Universe



Source: Company data, CIRA

However, on index level, only a handful of companies drove aggregate earnings growth...suggesting a high level of concentration

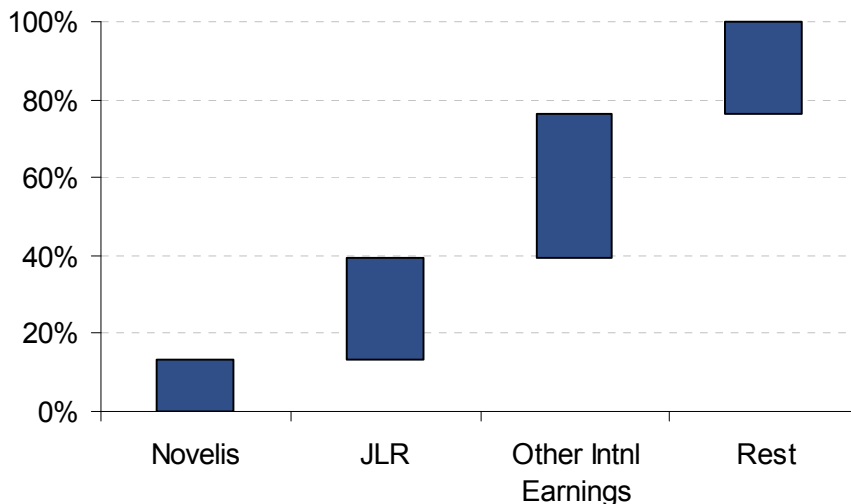
Figure 5. 1QFY11 Earnings Growth Share for Sensex ex-oil Companies



Source: Company data, CIRA

... further digging reveals most of this growth is attributable to foreign subsidiaries. Do, however, note that despite being large contributors to growth, foreign earnings only form about 7.5% of Sensex ex-oil earnings for the quarter...so this is an extreme quarter

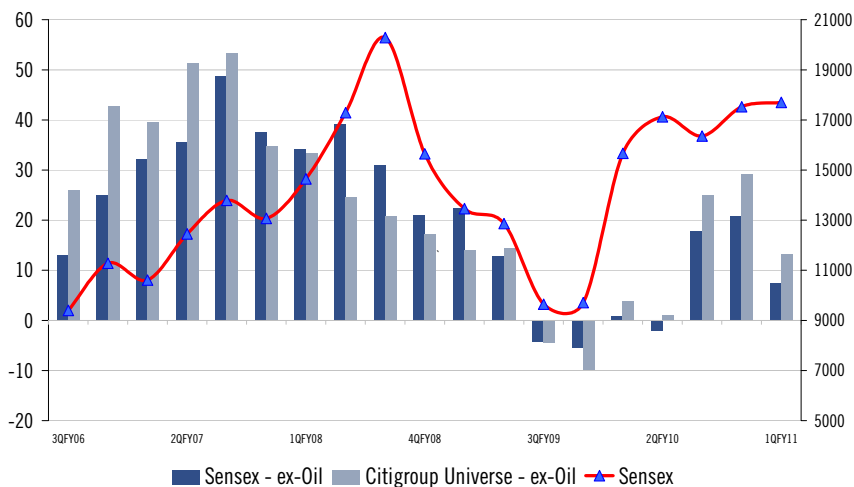
Figure 6. 1QFY11 Growth Share of International Earnings for Sensex ex-oil Companies



Source: Company data, CIRA

But the pace of earnings growth has slackened off, notwithstanding less but still some base effect support

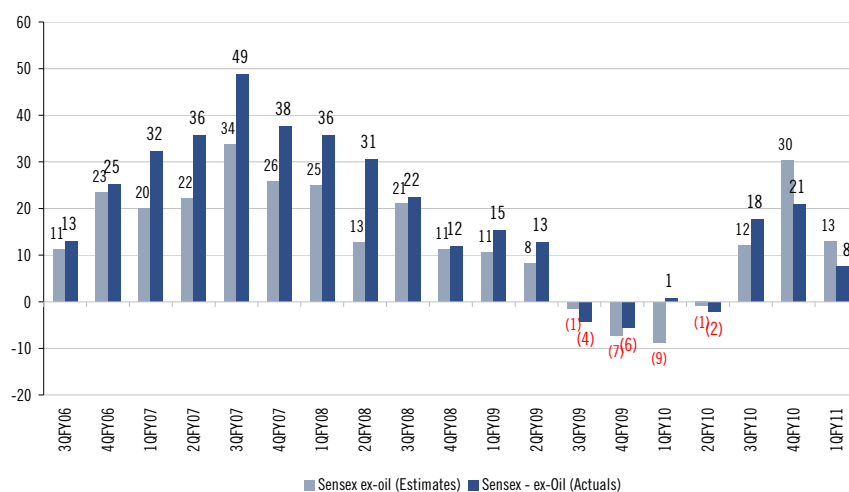
Figure 7. Sensex ex-oil and CIRA Universe (Standalone) Profit Growth and the Market



Source: : Company data, CIRA

This is the second quarter running when Citi/market has over-estimated earnings...which has historically not been a problem with India

Figure 8. Sensex ex-oil (Standalone) Profit Growth vs. Estimates



Source: Company data, CIRA

Overall margins meaningfully boosted by swings from losses to profits for a few foreign subsidiaries

Figure 9. Sensex and CIRA Universe 1QFY11 Margins (Change in bps)

	EBITDA Margin		PAT Margin		EBITDAM% Change		PATM% Change	
	Expected	Actual	Expected	Actual	Last Qtr	Last Year	Last Qtr	Last Year
Sensex (30/30)	23.5%	24.4%	13.3%	13.2%	340	(2)	173	(36)
Sensex ex-oil (29/30)	22.0%	22.6%	12.7%	12.5%	308	113	164	36
Sensex ex-Energy	23.9%	24.5%	14.1%	13.7%	424	248	230	143
Sensex ex-fin	20.8%	21.3%	11.9%	11.7%	268	(6)	123	(30)
Sensex ex-oil, ex-fin	19.1%	19.2%	11.2%	10.9%	226	123	108	50
Citi Universe	18.3%	18.6%	9.9%	9.4%	(126)	(222)	(179)	(262)
Citi Universe Ex-oil	26.6%	27.1%	15.6%	15.3%	315	224	176	133
Citi Universe ex-fin	14.9%	14.8%	8.0%	7.4%	(197)	(251)	(249)	(281)
Citi Universe ex-oil, ex-fin	21.5%	21.3%	12.9%	12.3%	204	200	78	131
Citi Universe ex-Metals	18.0%	18.4%	9.7%	9.1%	(111)	(395)	(182)	(449)
Citi Univ. ex-oil, ex-Metals	28.7%	29.2%	17.0%	16.4%	487	40	279	(93)

Source: Company data, CIRA

However, it's a meaningfully weaker margin show for domestic businesses

Figure 10. Sensex and CIRA Universe Standalone 1QFY11 Margins (Change in bps)

	EBITDA Margin		PAT Margin		EBITDAM% Change		PATM% Change	
	Expected	Actual	Expected	Actual	Last Qtr	Last Year	Last Qtr	Last Year
Sensex (30/30)	26.5%	27.4%	15.4%	15.1%	57	(304)	(49)	(353)
Sensex ex-oil (29/30)	24.8%	25.3%	14.9%	14.3%	39	(199)	(59)	(299)
Sensex ex-Energy	28.4%	28.9%	17.6%	16.6%	82	(59)	(62)	(216)
Sensex ex-fin	23.4%	23.7%	13.9%	13.4%	18	(329)	(97)	(365)
Sensex ex-oil, ex-fin	21.4%	21.2%	13.2%	12.4%	(4)	(209)	(111)	(304)
Citi Universe	19.2%	19.4%	10.6%	9.9%	(292)	(390)	(313)	(429)
Citi Universe Ex-oil	29.7%	30.1%	17.8%	17.3%	14	37	(47)	(71)
Citi Universe ex-fin	15.5%	15.2%	8.6%	7.7%	(344)	(437)	(383)	(463)
Citi Universe ex-oil, ex-fin	24.0%	23.5%	14.9%	13.9%	(45)	(27)	(144)	(103)
Citi Universe ex-Metals	18.3%	18.5%	9.8%	9.1%	(287)	(464)	(321)	(503)
Citi Univ. ex-oil, ex-Metals	29.9%	30.2%	17.7%	16.9%	60	(33)	(27)	(154)

Source: Company data, CIRA

Sectoral Skews

Metals and banks are the stand-outs on the upside...telecom bringing up the rear

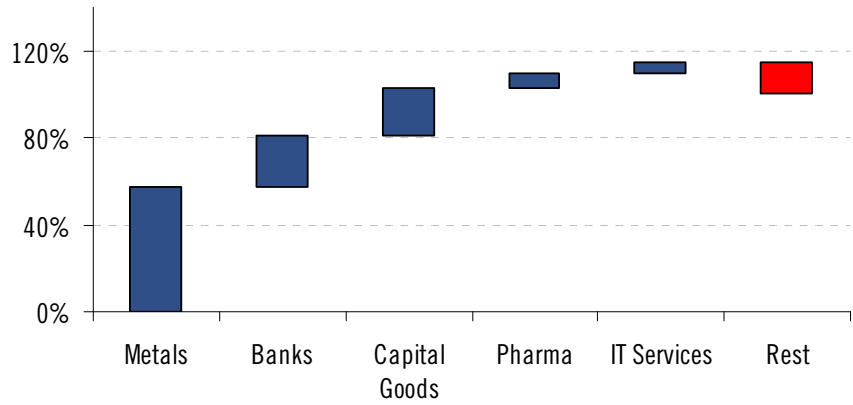
Figure 11. CIRA Universe 1QFY11 Results by Sector

Sector	Sales		EBITDA		PAT		Act. Vs. Est.
	Expected	Actual	Expected	Actual	Expected	Actual	
Auto & Components	29.4%	27.7%	34.0%	19.7%	29.7%	20.2%	↓
Banks	33.4%	43.1%	19.3%	33.9%	19.5%	30.8%	↑
Capital Goods	33.3%	32.8%	93.0%	110.6%	157.7%	188.5%	↑
Div. Financials	14.8%	11.0%	13.3%	16.2%	20.9%	21.2%	↔
Energy	29.8%	32.5%	-45.3%	-41.8%	-77.7%	-85.2%	↓
Food, Bev, Tobacco	16.8%	17.5%	16.8%	19.8%	16.4%	19.6%	↔
Hhold, Personal Prods	9.3%	12.6%	9.5%	7.9%	11.6%	6.0%	↓
Metals	25.8%	21.0%	126.7%	114.6%	475.7%	475.5%	↔
Cement	1.9%	22.3%	-10.9%	2.8%	-14.7%	-4.6%	↑
Media	36.4%	41.6%	63.6%	78.9%	103.4%	111.5%	↑
Pharma	14.1%	11.4%	35.7%	30.2%	41.9%	50.1%	↑
Real Estate	32.1%	41.5%	13.5%	33.0%	19.7%	30.0%	↑
IT Services	12.1%	13.4%	12.9%	13.3%	12.0%	11.0%	↔
Telecom	0.8%	3.7%	-10.2%	-10.2%	-23.8%	-60.2%	↓
Rest	25.2%	15.4%	39.5%	-10.9%	-31.9%	-103.7%	↓
Utilities	5.7%	10.3%	10.9%	6.6%	6.8%	-0.5%	↓

Source: Company data, CIRA

Is India's earnings-mix really that broad-based and stable?

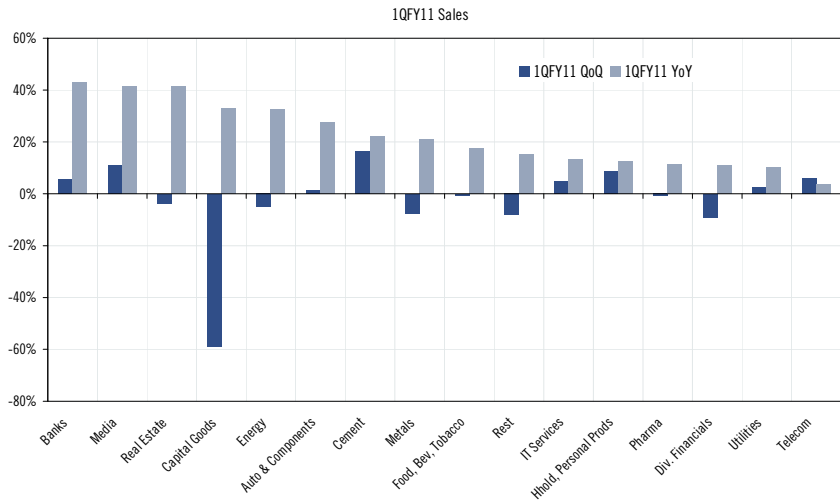
Figure 12. CIRA Universe ex-Energy Profit Growth Break-up



Source: Company data, CIRA

Sales growth relatively well spread and a positive sign...qoq stand-outs; more to do with seasonality than growth shifts

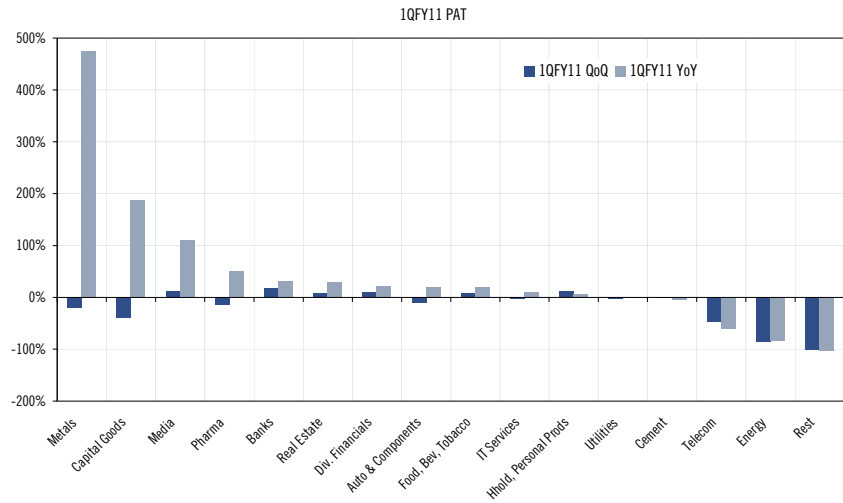
Figure 13. CIRA Universe 1QFY11 Sales Growth by Sector (QoQ and YoY)



Source: Company data, CIRA

Profit divergence is fairly extreme....

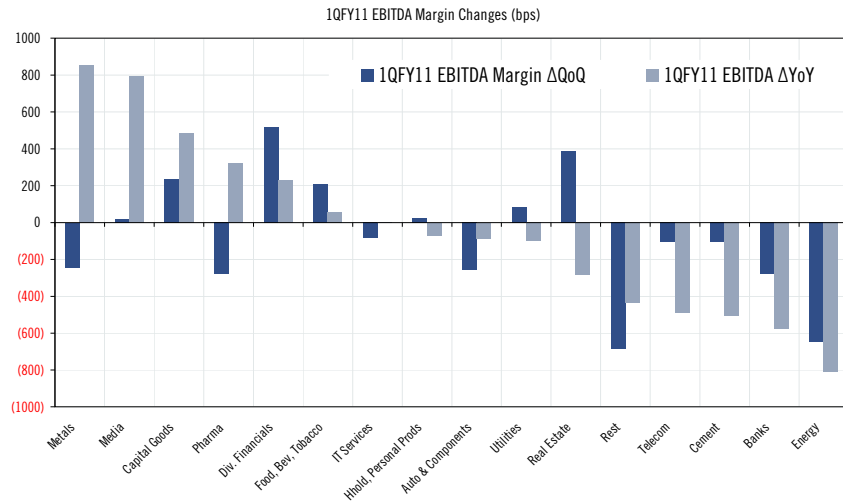
Figure 14. CIRA Universe 1QFY11 Profit Growth by Sector (QoQ and YoY)



Source: Company data, CIRA

.. similar skew is also visible in EBITDA margins

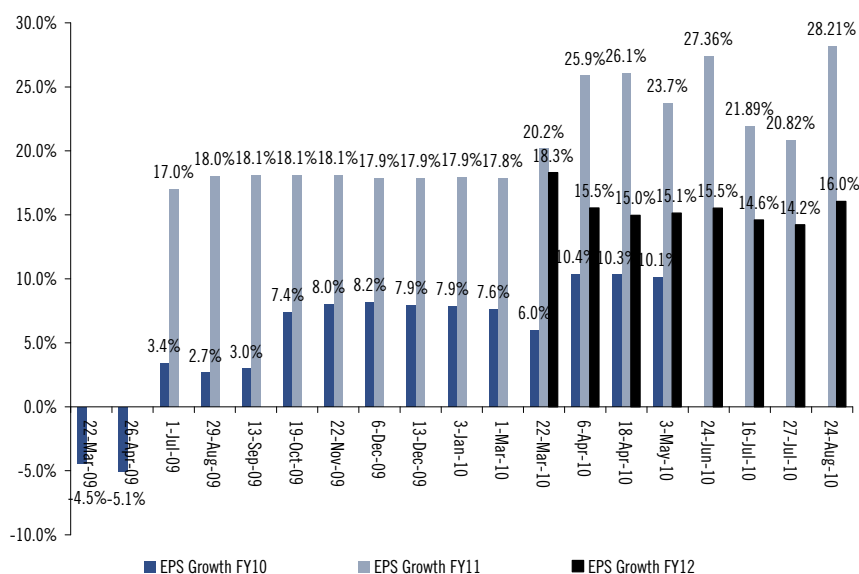
Figure 15. CIRA Universe 1QFY11 sector-wise EBITDA Margins (bps, YoY vs. QoQ)



Source: Company data, CIRA

Back to the start of season...earnings growth at 28% for FY11, after dipping to 22% mid season

Figure 16. Evolution of Sensex Earnings Growth Estimates



Source: CIRA

Lots of upgrades and downgrades...more up than down for Citi (23/19), but a lot of big ones

Figure 17. CIRA FY11 PAT Estimates Changes

Top Upgrades

Company	RIC	PAT Estimates (Rs mn) as on		
		24-Aug-10	13-Jul-10	% chg
Tata Motors	TAMO.BO	74,766	48,865	53.0%
Kotak Mahindra Bank	KTKM.BO	17,533	12,324	42.3%
Educomp Solutions	EDSO.BO	3,886	3,054	27.2%
Adani Power	ADAN.BO	11,472	9,139	25.5%
Voltas	VOLT.BO	3,847	3,190	20.6%
Colgate Palmolive (India)	COLG.BO	4,675	3,894	20.1%
LIC Housing Finance	LICH.BO	8,504	7,317	16.2%
Hindalco Industries	HALC.BO	33,519	29,229	14.7%
State Bank of India	SBI.BO	126,215	110,765	13.9%
Bank of Baroda	BOB.BO	33,140	29,636	11.8%

Top Downgrades

Company	RIC	PAT Estimates (Rs mn) as on		
		24-Aug-10	13-Jul-10	% chg
Tech Mahindra	TEML.BO	6,499	7,640	-14.9%
Maruti Suzuki India	MRTI.BO	22,699	28,948	-21.6%
Federal Bank	FED.BO	4,971	6,536	-23.9%
Jaiprakash	JAIA.BO	9,062	12,120	-25.2%
Edelweiss Capital	EDEL.BO	2,505	3,441	-27.2%
DLF	DLF.BO	17,268	24,208	-28.7%
Lanco Infratech	LAIN.BO	8,974	14,315	-37.3%
MindTree	MINT.BO	1,239	2,081	-40.5%
OnMobile Global	ONMO.BO	721	1,268	-43.2%
Suzlon Energy	SUZL.BO	-5,376	1,846	-391.2%

Source: CIRA

Companies Mentioned

Adani Power (ADAN.BO; Rs137.15; 1L)
Bank of Baroda (BOB.BO; Rs815.95; 3M)
Colgate Palmolive (India) (COLG.BO; Rs831.85; 3L)
Educomp Solutions (EDSO.BO; Rs567.15; 3M)
Hindalco Industries (HALC.BO; Rs163.45; 1M)
Kotak Mahindra Bank (KTKM.BO; Rs838.95; 1M)
LIC Housing Finance (LICH.BO; Rs1,218.05; 3M)
State Bank of India (SBI.BO; Rs2,823.70; 1L)
Tata Motors (TAMO.BO; Rs991.80; 1M)
Voltas (VOLT.BO; Rs203.60; 2M)
DLF (DLF.BO; Rs311.45; 1L)
Edelweiss Capital (EDEL.BO; Rs53.15; 3M)
Federal Bank (FED.BO; Rs343.15; 1M)
Jaiprakash (JAIA.BO; Rs115.70; 1M)
Lanco Infratech (LAIN.BO; Rs70.50; 1M)
MindTree (MINT.BO; Rs519.60; 3M)
Maruti Suzuki India (MRTI.BO; Rs1,220.00; 2L)
OnMobile Global (ONMO.BO; Rs328.40; 1M)
Suzlon Energy (SUZL.BO; Rs49.60; 2M)
Tech Mahindra (TEML.BO; Rs695.50; 3M)

Appendix A-1

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