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India Morning Meeting Notes

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TODAY'S STORIES

Bank of India – Earning momentum continues
India Cement – Yoy EBITDA growth of 184%, but qoq decline of 23%
Voltas Ltd – 3QFY07 results
Hero Honda Motors – Hiccups in the short haul
HCL Technologies – Cautious optimism
Castrol India – Strength tested, let's test the speed

Company news

Bank of India (BOI IN; Buy; Rs204.40) – Earning momentum continues

Business growth accelerates

Loans grew 28% yoy and deposits grew 21.4% yoy. The proportion of low-cost deposits was stable at 41% of domestic deposits. Loan growth has accelerated in 3Q, from 20% in 1Q and 23% in 2Q.

Net interest margin increases to 3.18%, from 3.02% a year ago

Net interest margins increased 16bp yoy to 3.18% in 3QFY07. This is on the back of a 27.6% increase in interest costs and a 35% increase in yield on advances. Yield on loans improved to 8.43%, from 7.65% in December 2005, with domestic yield improving from 8.45% to 9.20%.

Other income (including fees and treasury gains) is higher by 23% yoy

Fee income increased by 22.6% yoy and treasury gains accounted for 6.3% of the total income compared to 3.2% a year ago.

Operating expenses up 15% yoy, largely due to other than staff costs

Staff costs increased 7.8% yoy and other operating expenses 29.6%. Note that BOI accounts for computerisation costs in the profit and loss account, and hence the increase in operating costs is higher than for peers.

Strong growth in operating income; net profit up 78% yoy to Rs2.55bn

Net profit increased 78% yoy, led by a 47.6% increase in pre-provision operating income. However, there has been a slippage in three large accounts, leading to an increase in provisioning; hence, the improvement in asset quality is not significant compared to the recent past. Tax rate was lower at 21.5% in 3QFY07, vs 26.4% a year ago.

Recommendations

We maintain our Buy rating. BOI trades at 9.5x FY08F earnings and 1.5x FY08F adjusted book, after writing off 100% pre-tax net NPAs. Our estimates include equity dilution of 100m shares in FY08.

Important disclosures and analyst certifications regarding companies can be found in the Disclosure Appendix.

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Table 1 : Bank of India financials

(Rs mn)	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
Net interest income	**5,590**	**5,786**	**6,566**	**7,528**	**7,644**	**8,494**	**8,588**
% growth	3.8	-2.9	6.1	55.6	36.8	46.8	30.8
Treasury gains	310	476	220	135	510	503	550
% of Total Income (excld portfolio income)	5.3	7.8	3.2	1.2	6.5	5.7	6.3
Other Income	2,634	2,556	2,405	3,959	2,597	3,030	2,673
% growth	-87.0	-86.5	-84.9	18.0	-25.0	10.4	-48.2
Total Income	**8,533**	**8,818**	**9,191**	**11,622**	**10,751**	**12,026**	**11,811**
Total operating expenses	**4,867**	**5,517**	**5,444**	**5,324**	**6,075**	**7,236**	**6,279**
% growth	7.5	18.8	15.4	-2.1	24.8	31.2	15.3
Operating Income before prov	**3,666**	**3,301**	**3,747**	**6,298**	**4,676**	**4,791**	**5,532**
% growth	1.6	-15.6	-1.6	92.2	27.6	45.1	47.6
Provisions & Contingencies	1,392	1,521	1,804	3,140	1,685	1,587	2,286
% Operating income	38.0	46.1	48.1	49.9	36.0	33.1	41.3
Provision for Taxes	557	459	512	614	904	1,083	697
% of PBT	24.5	25.8	26.4	19.4	30.2	33.8	21.5
Net Profit	**1,717**	**1,322**	**1,431**	**2,544**	**2,087**	**2,121**	**2,549**
% growth	5.6	166.8	90.7	381.9	21.5	60.5	78.1
Equity	**4881**	**4881**	**4881**	**4881**	**4881**	**4881**	**4881**
EPS	**3.5**	**2.7**	**2.9**	**5.2**	**4.3**	**4.3**	**5.2**
Loans (Rs bn)	579.9	611.4	623.0	666.6	698.1	751.0	798.2
Deposits (Rs bn)	804.9	858.6	877.9	939.3	958.1	1032.9	1066.1
Loans / Deposits (%)	72.0	71.2	71.0	71.0	72.9	72.7	74.9
Gross NPLs (Rs bn)	30.9	28.1	28.1	24.8	25.2	22.2	21.9
Gross NPLs (%)	5.3	4.6	4.5	3.7	3.6	3.0	2.7
Net NPLs (Rs bn)	14.5	13.3	12.1	9.7	9.8	7.9	7.5
Net NPLs (%)	2.5	2.2	1.9	1.5	1.4	1.0	0.9
CAR - Tier I (%)	0.0	0.0	6.8	6.8	0.0	6.9	6.2

Source: Company data

India Cement (ICEM In; Buy; Rs241.75) – Strong yoy EBITDA growth of 184%, but qoq decline of 23%

IC's results were exactly in line with our expectations. The macro environment for the cement business in India (and South India) remains positive on volumes and pricing, and the real threat (if any) to pricing seems clearly from 2HFY09. IC will be extracting the benefit of low-cost expansion (through de-bottlenecking) over the next two years to drive incremental volumes, which would be return-accretive. IC is contemplating a greenfield capacity in North India to address growth beyond FY09. It remains the cheapest stock on all key parameters in the top-five cement companies. We continue to like the stock and re-iterate Buy.

- Sales growth of 36% driven by 28% realisation growth and 7% volume growth.

Prices. IC's sales realisation/mt of Rs2,709 in 3QFY07, while 28% higher yoy, was 1% lower than in 2QFY07. The qoq weakness in realisation was due to monsoon in Tamil Nadu in 3Q. Prices in the southern region have started rising, with a Rs100/mt (Rs5/bag) price increase in Andhra Pradesh since the end of the quarter.

EBITDA. EBITDA growth was strong yoy at 184%, but saw a qoq decline of 23%. Margin at 28.2% was down from 33.4% in 2QFY07, largely due to the impact of lower prices, and lower volumes qoq. EBITDA/mt moderated to Rs763/mt, from Rs914/mt in 2QFY07.

- Management is working on increasing the current capacity of 7.69mmt by 2mmt by upgradations/modernisations at its various plants. We believe this will be fully reflected in FY09.
- IC has achieved a PAT of Rs3.09bn in FY07 so far (leading to EPS of Rs14). Our full-year profit estimate is Rs4.32bn with EPS of Rs19.7/share. We believe the company is on track to deliver these numbers. We maintain our FY08 EPS estimate of Rs23.9.

Stock trades at 6.7x EV/EBITDA on FY08F, and US$145 EV/Capacity. We maintain our Buy recommendation.

Table 2 : India Cements financials

Rs m	2Q07	2Q06	Growth	3Q07	3Q06	Growth
Sales	**5163.5**	**3914.1**	**32%**	**4724**	**3466**	**36%**
EBITDA	**1725.7**	**679.6**	**154%**	**1330.5**	**467.8**	**184%**
Margin	33.4%	17.4%		28.2%	13.5%	**109%**
Interest	364.2	427.1		346.6	295.7	**17%**
Depreciation	192.6	197.2		198.2	196.8	**1%**
Other income	8.3	9.1		17.1	36.5	**-53%**
PBT	1177.20	64.4		802.8	11.8	**6703%**
Extraordinary					66.5	
Tax	4.000	5.9		5.0	6	
PAT	1173.20	58.5		797.8	72.3	**1003%**
Cement sales (mmt)	1.888	1.9	-1%	1.744	1.63	**7%**
Average realisation (Rs)	2734.905	2060.1	33%	2709	2123	**28%**
Total cost/mt (Rs)	1820.869	1762		1945.9	1836.3	
EBITDA/mt (Rs)	914.04	298.0526		762.9	286.5	

Source: Company data

Voltas (VOLT IN; Buy; Rs110.25) – 3QFY07 results

Key highlights

- The company reported 31% top-line growth to Rs5.7bn. Segment-wise, electromechanical saw 23% growth to Rs3.6bn, driven by 50% growth in the domestic business.
- Strong trend in the engineering business continued, with 76% growth, while the cooling business grew 26% despite 3Q being its weak season.
- EBIDTA was up only 8% to Rs275m. This was due to three reasons, in our view

  1. International billing has yet to pick up as the overall EMP business has grown only 23% despite 50% growth in the domestic business. We expect this to be overcome in 4Q, when billing should improve substantially.
  2. Despite 23% growth in top line, electromechanical saw a 10% yoy decline in EBIT. We believe this was due to higher provisioning, which happens at initial stages of any project. This also includes a cost element, which may not be commensurately reflected in the top line, especially staff costs. This is also seen in the increase in staff costs in the last three quarters, since hiring costs kick in much before billing starts. We expect this trend to reverse once billing picks up in 4Q.
  3. Despite 76% growth in the engineering services business, textile machinery has grown only 23.7%. This also dampened the EBIT margin. LMW, the key principal, is expected to have a strong 4Q. This should be

reflected in this segment for Voltas, and should also lead to better EBIT margins.

- The company has Rs13.6m as EOI. PBT at Rs330m is largely in line with our expectations.
- Voltas's order book of Rs24bn is at an all-time high, indicating strong momentum going forward. The macro scenario continues to be strong and we expect momentum to strengthen from hereon.

The stock is trading at 19x FY08F PE and we maintain our Buy rating.

Table 3 : Voltas financials

Rs m (Non-Annualised)	Dec-05	Sep-06	Dec-06
Gross Sales	4,471	5,407	5,809
Excise	118	108	119
Excise rate	2.6	2.0	2.1
Net sales	**4353**	**5298.8**	**5689.2**
Change	50.9%	13.4%	30.7%
International projects		1,400	
Adjusted sales		**3,899**	
Expenditure	**4099**	**5098**	**5414**
Consumption of raw materials	3,222	3,973	4,219
Personnel cost	461	580	638
Other expenses	415	545	557
PBDIT	**254**	**201**	**275**
Change	*371%*	*-25%*	*8%*
OPM	*5.8*	*3.8*	*4.8*
Other income	48	153	85
Non-recurring income	375	9	31
Non-recurring expenses	**488**	**0**	**18**
Interest	15	16	14
PBDT	172	348	359
Depreciation	22	28	29
PBT	150	319	330
Tax	37	69	136
PAT	**113.6**	**250.0**	**194.3**

Source: Company data

Hero Honda Motors (HH IN; Hold; Rs729.55) – Hiccups in the short haul

We cut our FY07-08 sales volume forecasts for Hero Honda 3-4% after a poor market response to its portfolio overhaul. We expect margin pressure to increase and so lower our EPS forecasts by 10%. Hold (from Buy), with a target price of Rs661.70 (from Rs872).

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	74216.5	87139.8	100364	114535	128834
EBITDA (Rsm)	11645.1	13644.5	12589.9▼	13620.6▼	15111.6▼
Reported net profit (Rsm)	8104.7	9677.9	9319.1▼	10464.2▼	12063.6▼
Normalised net profit (Rsm)[1]	8104.7	9677.9	9319.1	10464.2	12063.6
Normalised EPS (Rs)	40.6	48.5	46.7▼	52.4▼	60.4▼
Dividend per share (Rs)	20.0	20.0	21.0	22.0	24.0
Dividend yield (%)	2.74	2.74	2.88	3.01	3.29
Normalised PE (x)	18.0	15.1	15.6▲	13.9▲	12.1▲
EV/EBITDA (x)	12.7	10.7	11.6	10.8	9.69
Price/book value (x)	9.76	7.25	5.92	4.84	3.97
ROIC (%)	49.8	46.6	34.5	29.5	26.8

1. Post-goodwill amortisation and pre-exceptional items
Source: Company data, ABN AMRO forecasts
Accounting Standard: Local GAAP
year to Mar, fully diluted

Product overhaul fails to sustain excitement; sales estimate lowered
During April-December 2006, Hero Honda launched six new models in an attempt to improve its product offering. Our excitement on short-term gains from the improved technology was short-lived, as the launches failed to attract new customers to the Hero Honda brand, leading to below-industry growth during the period. Also, the recently upgraded entry-level bikes (CD series) are eating into its most profitable offering in the executive segment, Splendor. As a result, we reduce our sales volume estimates for the company by 3% to 3.4m for FY07 (March year-ending) and by 4% to 3.83m for FY08.

EBITDA margins set to fall further
EBITDA margins, which started to decline from 1QFY07, slid a steep 268bp yoy to 12.7% in 2QFY07, due to rising commodity prices and a tough motorcycle pricing scenario. We expect Hero Honda's margins to slide below 12% over 3Q-4QFY07 because of the impact from promotional offers during the festival season and the likely rise in advertisement costs due to the upcoming Cricket World Cup, before settling at a medium-term level of 11.5%. As a result, we cut our EPS forecasts by around 10%, to Rs46.7 for FY07 and Rs52.4 for FY08.

Underperformance in the short term, but Hold for medium-term outlook
On FY07-09F EBIT CAGR of just 8.4% and adjusting for cash and investment (Rs118 per share), we find the core auto business fairly valued at 14.7x FY08F PE and 12.7x FY09F PE, given its high ROE, dividend yield and technology edge. We lower our DCF-based target price to Rs661.7 (from Rs872) to reflect our revised earnings forecasts, which are 9-12% below Bloomberg consensus. We believe the stock's underperformance in recent quarters already captures to a large extent the weakness in EPS, which may reverse after another two quarters as margin stabilises after the one-time step-down. At our DCF-based target, the stock would trade at 13x FY08F P/E, representing 9% downside potential from current levels. Hold.

HCL Technologies (HCLT IN; Buy; Rs660.50) – Cautious optimism

Better than expected margin expansion and well-spread top-line growth suggest large deal wins are beginning to have an impact. We see margin levers that could offset the rising manpower costs. However, quarterly performance volatility remains the key risk.

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	33694.0	44007.0	60340.6	76716.6	96905.9
EBITDA (Rsm)	7722.3	9848.0	13530.8▲	16892.5▲	21032.4▲
Reported net profit (Rsm)	6104.1	7747.0	11102.0▲	13235.7▲	16136.1▲
Normalised net profit (Rsm)[1]	6104.1	7747.0	11102.0	13235.7	16136.1
Normalised EPS (Rs)	19.5	24.1	34.2▲	40.8▲	49.7▲
Dividend per share (Rs)	16.0	16.0	16.0	16.0	16.0
Dividend yield (%)	2.42	2.42	2.42	2.42	2.42
Normalised PE (x)	33.8	27.4	19.3▼	16.2▼	13.3▼
EV/EBITDA (x)	25.3	19.9	14.4	11.4	9.01
Price/book value (x)	5.57	5.27	4.66	4.02	3.37
ROIC (%)	53.6	37.3	46.2	47.2	47.5

1. Post-goodwill amortisation and pre-exceptional items
Source: Company data, ABN AMRO forecasts
Accounting Standard: US GAAP

year to Jun, fully diluted

2Q07 results - Large deal wins beginning to have an impact

Revenue grew to US$331m in 2QFY07, 10.2% qoq growth (Rs14.65bn, 6.2% qoq growth). It was well spread: software services grew 9.2% qoq; infrastructure services 16.7% while BPO services grew 9.4%, all in US$. Volumes increased 7% and the average blended realisation in software services rose 2.1% qoq. A 5.1% addition to the manpower base in 2Q and 17% in 1H is comparable with larger players. Six large deal wins announced over the last 12 months contributed 12.5% to 2Q07 revenues (16.7% qoq growth to US$41m). Management indicated that on a consolidated basis, these deals had margins higher than the corporate average.

We see levers to offset rising manpower costs

The sharp 1.6% qoq increase in attrition in IT services, despite the RSU payout scheme, kept utilisation low (offshore ex-trainees down 3.1% qoq) and indicates continued pressure for wage hikes in FY08. However, management downplayed cost pressures and any possibility of mid-term salary hikes. Note lateral constituted 83% of hires in 2Q07. We see three potential margin levers: decline in support manpower share; continued growth in services share in IMS and higher fresher intake.

Key risk remains the quarterly volatility in 'delivery vs promise'

While 2Q07 was the second consecutive quarter of 10%+ US$ revenue growth and margins remained in a narrow band in 1H07, we remain cautious on the volatility in quarterly performance. SG&A expenses' share of revenues remains high (up 51bp qoq) and while this could be a margin lever in the medium term, near term this could affect margins. Also, of the six large deal wins, two have reached steady state, while two are in the ramp-up mode and two are transitioning.

Upgrade to Buy. Relative underperformance implies an entry point

The stock is trading at 16.2x FY08F (June year-end) EPS. It has been a relative underperformer over the last six months – up only 23% against a 42% increase in the BSE IT Index. We expect upgrades to consensus earning forecasts post higher than expected 2Q07 numbers and a marginal rerating to close the gap with peers.

Castrol India (CSTRL IN; Buy; Rs231.80) – Strength tested, let's test the speed

Castrol has maintained its bottom line despite large spikes in base oil prices. This proves the strength of brand and raises earning growth potential as base oil prices weaken and volumes grow. We stay at Buy and raise our target price to Rs300.

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	14303.8	17524.0	18353.7	18040.8	18586.3
EBITDA (Rsm)	2107.4	2201.0	3020.3	3521.5	4654.2
Reported net profit (Rsm)	1411.8	1546.0	2006.7	2351.1	3121.5
Normalised net profit (Rsm)[1]	1411.8	1392.0	2006.7	2351.1	3121.5
Normalised EPS (Rs)	11.4	11.3	16.2	19.0	25.3
Dividend per share (Rs)	8.25	9.00	11.0	14.0	16.0
Dividend yield (%)	3.51	3.83	4.68	5.96	6.81
Normalised PE (x)	20.5	20.8	14.5	12.3	9.29
EV/EBITDA (x)	13.1	12.2	8.87	7.46	5.48
Price/book value (x)	7.44	6.94	6.26	5.78	4.93
ROIC (%)	56.5	52.2	84.5	87.1	123.2

1. Post-goodwill amortisation and pre-exceptional items
Source: Company data, ABN AMRO forecasts
Accounting Standard: Local GAAP

year to Dec, fully diluted

2006 results

Castrol reported EBITDA of Rs2,201m in 2006, an increase of 4% yoy. Although volumes were flat, the company managed to raise prices to match the unprecedented spike in input base oil prices (now 53% of operating costs), thereby maintaining profitability. Net profit at Rs1.4bn has remained virtually static over the last four years, despite base oil prices nearly trebling over this period.

The worst base oil price scenario should be over

Average lube base oil prices in 2006 increased 60% yoy with base oil margins over crude oil touching unprecedented highs. We can't see this being sustained, given new capacities, the decline in crude prices and new regulations in the EU. Crude oil prices have already corrected 30% since August 2006 and base oil prices always follow crude, albeit with a lag of up to six months. We expect the base oil price cycle to come off its peak and settle down, albeit at a somewhat higher equilibrium. We are already beginning to see easing pricing pressure in the LOBS market.

Strong earnings growth potential

Castrol has managed to increase the prices of its products roughly in line with the increase in base oil prices, thus protecting its bottom line. These price hikes have been possible only due to the strength of its brands and this should also prevent any sudden fall. We see considerable earnings potential resulting from lower base oil prices pushing up margins. Higher margins are also likely to support volume growth.

Maintain Buy; DCF-based target price raised to Rs300

We estimate Castrol's 2007 EPS will grow 40% to Rs16.20, giving a return on equity of 46%. We forecast earnings will grow 64% over 2007-09 on the back of lower base oil prices and volume growth. We believe a potential share price trigger is a decline in LOBS prices, which we expect to come through by 2Q07. Meanwhile, the 2007F dividend yield of 4.7% should provide downside support.

News headlines

Economic & Politics

- Government slashes customs duty on 11 items (Business Standard)
- Government puts the brakes on SEZ approvals, notifications (Business Standard)
- Interim NPS plan allows 5% equity investment (Financial Express)

Corporate

Banks

- IDBI net slips 9.6% (Business Standard)
- Kotak Bank net up 39% (Business Standard)
- UTI Bank to sell US$250m bond to meet loan growth overseas (Financial Express)

Pharma

- Paswan moots pharma fund to monitor prices (Economic Times)

Media

- Zee PAT zooms 132% (Financial Express)
- Radio City to tune into Ahmedabad in March (Business Standard)

Retail

- 11 retailers readying Rs20bn IPOs (Business Standard)

Commodity

- JSW Steel's 3Q net more than doubles to Rs3.62bn (Economic Times)

Auto

- Nissan to team up with Mahindra-Renault (Economic Times)
- Maruti 3Q net profit rises 11%; merger costs take a toll (Economic Times)

Information Technology

- Polaris back in black with Rs32.29 crore net profit (Business Standard)

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