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# India Equity Strategy

## Strong Sep-07 Quarter Drives Earnings Upgrades

- Sensex ex-oil profits up 31% yoy vs. estimate of +21%** — The earnings outperformance was driven by upstream oil, petrochem, banks, capital goods and power sectors.
- 69% of profit surprise due to upstream oil and RIL** — Smaller retail marketing losses, better chemical margins, lower taxes and better upstream oil prices accounted for almost 69% of the profit surprise for Sensex companies.
- Key outperformers and underperformers** — Ex-oil profits for Sensex and Citi India universe companies were largely driven by the strong performances by private banks, capital goods, power, metals and, to a smaller extent, autos and hotels. Telecoms, cement, and downstream oil performed below expectations. Consumer, textiles, pharma, and IT services delivered in-line results.
- Margins expand, currency impact muted** — Unlike the previous quarter, the appreciating rupee accounted for fewer profit surprises. Margin expansions were overall slightly better than expected
- Strong results season has driven earning upgrades** — FY08E earnings growth for Sensex and Citi India universe has increased from 15.5% and 21.6% (pre-results season) to 22.1% and 26.7%, respectively. Although the pace of earning upgrades remains well below that in recent years, the positive momentum is a good sign.

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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
Sensex	30.5	27.2	42.6	31.4	30.8	28.9
Sensex - ex-Oil	32.3	35.6	49.1	37.6	35.7	30.6
Citi Universe	30.2	58.8	60.6	13.4	48.5	20.0
Citi Universe - ex-Oil	39.1	53.5	52.7	33.8	33.3	22.2

Source: Companies and Citi Investment Research

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

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## Strong Sep-07 Quarter

Sensex ex-oil profit growth of 31% yoy in the Sep-07 quarter was again higher than the forecast 21%, primarily driven by petrochemicals, banks, capital goods & power, and metals. The strong results have driven earnings upgrades. Our estimates for FY08 earnings growth for the Sensex and Citi India universe now stand at 22.1% and 26.7%, respectively vs. 15.5% and 21.6% earlier. While the pace of earning upgrades is markedly slower than what the market has been used to seeing in recent years, a positive momentum is welcome.

### Sensex ex-oil profits up 31% yoy vs. forecast of 21%

Profit growth for Sensex ex-oil companies grew 30.6% yoy vs. 20.8% forecast during the just completed Sep-07 quarter. Sep-07 quarter profits for the Citi India Universe ex-oil grew 22.2% vs. 14.5% forecast. The impact of the rupee's appreciation on overall results was much more muted than in the previous quarter, while margins came in ahead of expectations. Key sectors driving profit surprises were upstream oil, petrochemicals (mainly Reliance Industries), banks, metals, capital goods, and power.

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

Year to 31 Mar	FY07				FY08		
	1Q	2Q	3Q	4Q	1Q	2QE	2QA
Sensex	30.5	27.2	42.6	31.4	30.8	17.7	28.9
Sensex - ex-Oil	32.3	35.6	49.1	37.6	35.7	20.8	30.6
Citigroup Universe	30.2	58.8	60.6	13.4	48.5	17.0	20.0
Citigroup Universe - ex-Oil	39.1	53.5	52.7	33.8	33.3	14.5	22.2
Autos	50.5	35.6	24.9	14.8	-7.3	-8.1	-2.0
Banks/Fin	-2.2	18.0	20.8	21.3	40.0	15.7	30.7
Brokerages	85.9	38.7	36.0	53.3	86.1	91.3	74.3
Capital Goods	125.1	116.7	59.6	34.3	38.1	46.8	60.4
Cement	109.9	152.3	251.9	61.1	32.2	50.7	33.2
Consumer/FMCG	24.2	35.4	17.8	24.5	21.8	9.6	8.3
Hotels	63.2	67.8	74.0	83.5	42.4	54.3	67.3
IT Services	54.0	57.2	53.1	53.4	36.2	18.4	20.8
Media	-1.3	19.2	287.2	3.6	32.5	109.3	114.3
Metals	107.7	148.0	102.6	25.0	15.1	-14.3	-6.1
Oil & Gas	-16.2	74.6	103.0	-31.2	179.7	23.4	14.3
Petrochem/chemicals	-2.8	9.9	55.6	14.8	29.1	4.5	38.8
Pharma	38.8	91.6	72.6	116.2	28.5	-11.5	-10.7
Power	19.2	20.5	21.1	17.7	48.6	17.7	27.9
Sugar	39.1	118.4	-43.1	-83.6	-183.4	-110.9	-125.1
Telecom	237.9	171.8	138.0	95.3	120.3	114.2	94.3
Textiles	10.4	93.7	16.2	-13.5	16.3	-37.6	-33.6

Source: Citi Investment Research

### Key sectors driving profit surprises

In Figures 3 and 4 we detail the share of profits and profit surprises during the Sep-07 quarter for the Sensex and the Citi India universe of companies. Almost 69% of the Sensex profit surprise is accounted by the upstream oil and petrochem sectors. Banks, capital goods and power account for a further 28% of the Sensex profit surprise.

A similar analysis for the Citi India universe of companies provides further details on the pattern of profit surprises this quarter. Here too, the petrochem sector accounts for a large portion (44%) of the ex-oil profit surprise. Other significant contributors are banks, capital goods, power and metals. Smaller retail marketing losses, improving petrochem margins, and lower tax rates were

the main reasons behind the outperformance of Reliance this quarter. ONGC saw better net crude oil realizations.

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

Sector	Profit Share	Share of Profit Surprise
Autos, Ancillaries, Transportation	4.8%	3.3%
Engineering, Power, Construction	11.0%	10.0%
Metals, Mining	6.5%	7.5%
Building Materials	3.9%	-3.7%
Consumer, Retail	4.2%	-5.4%
Pharmaceuticals, Healthcare	1.6%	0.2%
IT Services	12.7%	4.3%
Telecom	10.5%	-2.9%
Oil & Gas, Chemicals	31.8%	68.6%
Banks, Financial Services	12.9%	18.0%
Sensex (Rs m)	280,615	24,803

Source: Citi Investment Research

**Figure 4. Citi India Universe — Share of Profits and Profit Surprises in Sep-07 Quarter (Percent)**

	Profit Share	Share of Profit Surprise	Profit Share (Ex-oil)	Share of Profit Surprise (Ex-oil)
Autos	4.0%	8.1%	5.5%	4.7%
Banks/Fin	13.9%	54.9%	18.9%	32.0%
Brokerages	0.5%	0.0%	0.6%	0.0%
Capital Goods	4.2%	12.3%	5.7%	7.2%
Cement	2.8%	-8.7%	3.9%	-5.1%
Consumer/FMCG	4.2%	-1.7%	5.8%	-1.0%
Hotels	0.3%	0.8%	0.4%	0.5%
IT Services	9.8%	11.4%	13.3%	6.7%
Media	0.3%	0.2%	0.4%	0.1%
Metals	8.9%	29.1%	12.1%	16.9%
Oil & Gas	26.4%	-71.8%		
Petrochem/chemicals	8.8%	74.8%	11.9%	43.6%
Pharma	3.0%	0.3%	4.1%	0.2%
Power	5.4%	14.8%	7.3%	8.6%
Sugar	-0.1%	0.0%	-0.1%	0.0%
Telecom	7.2%	-25.4%	9.8%	-14.8%
Textiles	0.5%	0.9%	0.6%	0.5%
Citi India Universe (Rsm)	452,839	13,138	333,446	22,569

Source: Citi Investment Research

Among other sectors, private banks' profits rose more than 50% yoy (19% for PSU banks), backed by margin expansion and growth in fee income. The lower charge on bad debts taken by SBI this quarter also boosted the bottom line for banks. Non-interest income for the sector grew almost 45% on a YoY basis, but margin trends (286bps for the sector) were divergent with private bank net interest margins rising 53bps yoy and government banks' margins falling 30bps. With the recent CRR cut, together with the SLR requirements putting away almost a third of bank deposits in the current environment of relatively easy liquidity, banks may resort to lowering deposit rates in order to arrest further deterioration in margins.

Margins in the power sector increased to 28.7% (vs. 22.2% expected, and 24.05% in 2Q FY07), giving a positive margin surprise of almost 650bps, primarily due to NTPC's profit growth of 31% yoy (vs. forecast of 17%).

Profit growth in the capital-goods sector remains robust and beat expectations. During this quarter, the sector delivered profit growth of 60% yoy (vs. 47% expected).

### Strong results drive earning upgrades; room for more

Estimates for FY08 earnings growth for Sensex ex-oil and Citi India universe ex oil now stands at 22.1% and 26.7%, respectively, vs. 15.5% and 21.6% before the results season started.

In the figure below, we have listed sectors that have seen most earnings upgrades and downgrades since end-Sep 07. Sectors that have seen significant earnings upgrades have been oil, petrochem, telecoms and cement. In the same table we have also highlighted that for the current FY08 forecasts to be met, companies have to deliver earnings growth of only 21.8% yoy in 2H, vs nearly 30% growth achieved in 1H. The built-in growth for 2H so far looks conservative compared with recent quarters' growth trends, and that may leave room for some more upgrades in coming quarters.

Although the scale of earnings revisions so far this year has been well below that seen at this time in previous years, a positive earnings revision momentum still bodes well for a market in need of strong fundamental news flow after a rapid liquidity-driven rally.

Figure 5. Required 2HFY08 Profit Growth, Recent Earnings Revisions by Sector

Company Name	Share of profits 1HFY07	Share of profits 2HFY07	Share of profits 1HFY08	Required profit share 2HFY08	FY08E Growth	1HFY08 Growth	Required Growth in 2HFY08	Sector Earnings Revisions- Last 1 month FY08	% Earnings Revision FY08	Sector Earnings Revisions- Last 1 month FY09	% Earnings Revision FY09
Autos	46.5%	53.5%	40.1%	59.9%	10.6%	-4.6%	23.8%	D	-1.44%	D	-1.71%
Banks/Fin	45.0%	55.0%	48.6%	51.4%	24.8%	34.7%	16.8%	U	1.04%	U	0.84%
Brokerages	41.7%	58.3%	51.9%	48.1%	44.7%	79.8%	19.5%	N	0.00%	N	0.00%
Capital Goods	31.2%	68.8%	32.2%	67.8%	45.9%	50.8%	43.7%	U	2.85%	U	5.50%
Cement	43.8%	56.2%	54.4%	45.6%	6.9%	32.6%	-13.2%	U	11.02%	U	9.76%
Consumer/FMCG	49.6%	50.4%	46.3%	53.7%	22.6%	14.4%	30.7%	U	3.99%	U	5.00%
Media	39.8%	60.2%	42.3%	57.7%	56.0%	65.9%	49.4%	N	0.00%	N	0.00%
Sugar	84.5%	15.5%	-2.4%	102.4%	nm	nm	nm	N	0.00%	N	0.00%
Metals	48.6%	51.4%	53.5%	46.5%	-6.1%	3.4%	-15.1%	D	-1.44%	D	-1.71%
Oil & Gas	47.0%	53.0%	61.4%	38.6%	13.0%	47.8%	-17.7%	U	16.41%	U	55.97%
Petrochem/chemicals	50.0%	50.0%	49.6%	50.4%	18.3%	17.4%	19.3%	U	20.82%	U	44.72%
Pharma	45.7%	54.3%	43.4%	56.6%	11.8%	6.1%	16.6%	D	-0.38%	D	-0.90%
Power	45.6%	54.4%	54.9%	45.1%	14.7%	38.3%	-5.1%	D	-0.15%	U	0.53%
IT Services	45.1%	54.9%	41.2%	58.8%	40.2%	27.9%	50.3%	U	1.18%	U	1.70%
Telecom	38.0%	62.0%	45.7%	54.3%	66.1%	99.6%	45.5%	U	15.83%	U	14.03%
Hotels	28.2%	71.8%	31.1%	68.9%	40.2%	54.6%	34.6%	N	0.00%	N	0.00%
Textiles	53.3%	46.7%	39.0%	61.0%	12.8%	-17.4%	47.2%	N	0.00%	N	0.00%
<b>Citi India Universe</b>	<b>45.6%</b>	<b>54.4%</b>	<b>47.1%</b>	<b>52.9%</b>	<b>25.4%</b>	<b>29.7%</b>	<b>21.8%</b>	<b>U</b>	<b>7.25%</b>	<b>U</b>	<b>14.27%</b>

Source: Citi Investment Research estimates

## Top-line growth modest, though better than expected

Top-line growth (ex-oil) for the Sensex (15% vs. forecast of 11.4%) and the Citi India universe increased marginally to 15.5% (vs. 13% forecast), but continued on the declining trend over the last four quarters. Sector trends were quite varied, as usual. Petrochem, capitals goods, brokerages, metals, and textiles outperformed, while banks, telecoms, media and hotels had lower-than-expected top-line growth.

**Figure 6. India Quarterly Sales Growth by Sector (Percent YoY)**

Year to 31 March	FY07				FY08		
	1Q	2Q	3Q	4Q	1Q	2QE	2QA
<b>Sensex</b>	<b>32.2</b>	<b>30.1</b>	<b>34.4</b>	<b>20.5</b>	<b>15.8</b>	<b>11.4</b>	<b>14.8</b>
<b>Sensex - ex-Oil</b>	<b>31.9</b>	<b>33.1</b>	<b>35.8</b>	<b>22.4</b>	<b>19.1</b>	<b>12.9</b>	<b>15.5</b>
<b>Citigroup Universe</b>	<b>36.0</b>	<b>41.5</b>	<b>30.4</b>	<b>18.6</b>	<b>13.5</b>	<b>6.7</b>	<b>6.1</b>
<b>Citigroup Universe - ex-Oil</b>	<b>38.9</b>	<b>42.4</b>	<b>36.3</b>	<b>27.2</b>	<b>20.4</b>	<b>12.6</b>	<b>15.4</b>
Autos	37.5	38.0	26.1	14.3	9.0	0.1	1.1
Banks/Fin	20.2	17.4	26.6	29.2	15.3	19.5	15.9
Brokerages	102.6	56.7	74.0	99.2	81.3	93.5	99.3
Capital Goods	76.0	92.3	39.1	42.2	36.9	34.6	41.4
Cement	36.3	33.5	49.2	38.0	22.3	26.7	25.1
Consumer/FMCG	59.1	31.5	24.0	34.1	19.7	19.6	18.1
Hotels	27.2	23.8	25.7	34.4	24.8	27.4	22.7
IT Services	56.6	60.8	52.2	51.5	28.8	23.0	24.2
Media	18.4	34.4	15.3	6.5	6.0	3.2	-10.6
Metals	72.2	73.1	49.8	23.4	13.6	-1.2	4.8
Oil & Gas	32.4	40.3	23.1	7.5	4.7	-0.6	-5.7
Petrochem/chemicals	20.9	34.3	43.0	5.5	13.6	-6.1	2.0
Pharma	21.5	50.9	38.5	54.1	22.6	8.4	10.8
Power	18.1	15.6	18.7	20.9	23.8	16.3	15.7
Sugar	46.3	62.4	8.7	23.9	0.5	-11.4	-20.3
Telecom	40.7	30.9	41.3	31.9	35.7	49.2	46.9
Textiles	26.9	34.8	15.6	18.0	17.9	13.3	23.1

Source: Companies and Citi Investment Research

**Figure 7. 2Q FY08 EBITDA Margins — Expected vs. Actual (bps)**

	Margins (%)		Change (bps)	
	Expected	Actual	Expected	Actual
Sensex	24.00	25.43	45	188
Sensex - ex-Oil	20.56	21.79	49	173
Citigroup Universe	17.67	16.15	168	17
Citigroup Universe - ex-Oil	19.35	20.58	-18	106

Source: Companies and Citi Investment Research

## Appendix A-1

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