

India Update

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Highlights

Sector/event	Impact
AUTO: Hero Honda Motors (HHML) – Recommendation change	HHML reported 27% YoY decline in Q4FY07 net profits to Rs1.95bn on the back of 590bps YoY EBITDA margin contraction to 10.2%, which in turn was due to higher raw material costs, aggressive pricing and increased sales promotions. We expect slowdown in HHML's sales growth momentum from 13% volume CAGR in FY05-07 to 10.2% CAGR in FY07-09E. Further, HHML would face margin pressure due to increased advertisement & promotional spends, intense competition for market share, commoditisation of the 100cc motorcycle segment and the accelerating trend of offering more value to the customer at the same price point. This would translate into lacklustre 10.3% earnings CAGR in FY07-09E. However, cash per share of Rs154 and 2.6% dividend yield in FY08E would limit the downside to the stock price. We downgrade HHML to HOLD and maintain Bajaj Auto as our preferred pick in the two-wheeler space.

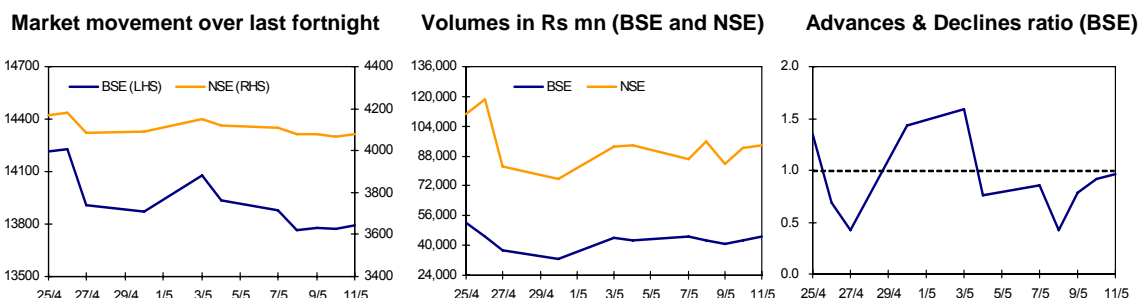
News Snippets

Sectoral

- Department of Telecommunications has recommended that extra spectrum be allowed only for the technology that the mobile operators have chosen to use initially, implying that Reliance Communications may get additional spectrum only for CDMA operations. (The Financial Express)
- The Telecommunications Regulatory Authority of India has proposed increasing the FDI cap for cable television operators to 74% from the existing 49%. (Business Line)

Corporate

- Jet Airways is mulling a US\$400mn rights issue for its expansion plans as well as starting a fully fledged dedicated cargo service by year end. (The Financial Express)
- Gujarat State Corporation will invest Rs6bn through its subsidiary GSPC Gas Company over the next four years for CNG and PNG network. (The Economic Times)
- ONGC Videsh and Reliance Industries are likely to strike a strategic relationship for overseas oil and gas projects. (Business Line)



Market data as on May 11, 2007

INDICES		
		% chg (DoD)
BSE Sensex	13796	0.18
S&P CNX Nifty	4077	0.24
BSE 100	7040	0.25
BSE 200	1668	0.25
Instanex Skindia DR	2442	(1.28)
Mindex	5792	0.48

OVERSEAS MARKETS		
		% chg (DoD)
Dow Jones	13326	0.84
Nasdaq Comp.	2562	1.12
S&P 500	1506	0.96
Hang Seng	20468	(1.34)
Nikkei	17554	(1.03)

ADVANCES/DECLINES (BSE)			
Group	A	B1	B2
Advances	112	326	394
Declines	89	373	396
Unchanged	4	9	38

FII TURNOVER (BSE+NSE)* (Rs mn)			
Bought	Sold	Net	
20,471	18,556	1,915	

NEW HIGHS AND LOWS (BSE)			
Group	A	B1	B2
Highs	8	14	11
Low	-	16	10

CURRENCY	
US\$1 =	Rs41.27

* FII turnover (BSE + NSE) as on May 10, 2007

Hero Honda Motors (Downgrade to Hold)

AUTO

RECOMMENDATION CHANGE

Long and winding road...

Rs705

Shilpa Gupta

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Earnings revision

(%)	FY07E	FY08E
Sales	↓ 0.5	↑ 2.5
EBITDA	↓ 24.8	↓ 24.4
EPS	↓ 23.6	↓ 23.2

Hero Honda Motors (HHML) reported 27% YoY decline in Q4FY07 net profits to Rs1.95bn (i-SEC: Rs1.83bn) on the back of 590bps YoY EBITDA margin contraction to 10.2%, which in turn was due to higher raw material costs, aggressive pricing and increased sales promotions. We expect a slowdown in HHML's sales growth momentum from 13% volume CAGR in FY05-07 to 10.2% CAGR in FY07-09E. Further, HHML would face margin pressure due to increased advertisement & promotional (A&P) spends, intense competition for market share, commoditisation of the 100cc motorcycle segment and the accelerating trend of offering more value to the customer at the same price point. This would translate into lacklustre 10.3% earnings CAGR in FY07-09E. However, cash per share of Rs154 and dividend yield of 2.6% in FY08E would limit the downside to the stock price. We downgrade HHML to HOLD from BUY and maintain Bajaj Auto (BAL) as our preferred pick in the two-wheeler space.

Table 1: Valuation summary

		Y/E March	EPS (Rs)	P/E (x)	EV/E (x)		
Price (11/05/07) (Rs)	705	2005	40.6	17.4	10.6	BSE Sensex	13796
52 wk Range (Rs)	890/629	2006	48.6	14.5	8.9	M.Cap (Rs bn)	141
DPS FY08E (Rs)	18.5	2007P	43.0	16.4	10.1	M.Cap (US\$ bn)	3.4
Dividend yield (%)	2.6	2008E	47.2	14.9	8.8	Shares Out (mn)	200
Face value (Rs)	2.0	2009E	52.2	13.5	7.5	Float (%)	45.1

Source: Company data, i-SEC Research

- Q4FY07 results – Unprecedented margin pressure.** HHML's revenues grew 17% YoY in Q4FY07 on the back of 12.1% YoY volume growth led by strong demand for variants of *CD Dawn* and *CD Deluxe* launched in December '06 (390bps YoY market share gain to 52%). However, EBITDA margin dipped 590bps YoY to 10.2%, resulting in net profits declining 27% YoY to Rs1.95bn. In FY07, the company's revenues grew 13.6% YoY led by 11.5% volume growth, though it lost 190bps market share to 47.8%. EBITDA margin contracted 390bps YoY to 11.8%, resulting in net profits declining 11.7% to Rs8.6bn.
- Lowering earnings estimates.** We downgrade our EBITDA margin assumptions 380bps to 11.6% in FY08E and 410bps to 11.4% in FY09E on account of competitive pressures and HHML's aggressive pricing strategy. Consequently, we lower our net profit estimates 23-24% for FY08E and FY09E.
- Downgrade to HOLD.** On account of lacklustre 10.3% earnings CAGR through FY07-09E, we downgrade HHML to HOLD from BUY. However, cash per share of Rs154 and dividend yield of 2.6% in FY08E would limit the downside to the stock. We maintain BAL as our preferred pick in the two-wheeler space and the overall third top pick in the sector.

Table 2: Q4FY07 Results review*(Rs mn, year ending March 31)*

	Q4FY07	Q4FY06	% chg (YoY)	Q3FY07	% chg (QoQ)	FY07	FY06	% chg (YoY)
Gross Sales	31,353	26,096	20.1	30,659	2.3	115,421	100,862	14.4
Less: Excise duty	4,958	3,538	40.1	3,998	24.0	16,421	13,722	19.7
Net Sales	26,396	22,559	17.0	26,661	(1.0)	99,000	87,140	13.6
(Inc)/Dec in Stock	113	87	29.9	873	(87.1)	23	(150)	(115.2)
Raw Materials	19,177	15,307	25.3	18,756	2.2	71,765	60,673	18.3
Staff Cost	905	821	10.1	917	(1.4)	3,538	3,206	10.4
Other Expenditure	3,514	2,711	29.6	3,095	13.6	11,944	9,731	22.7
Total Expenses	23,709	18,927	25.3	23,641	0.3	87,270	73,460	18.8
EBITDA	2,687	3,632	(26.0)	3,019	(11.0)	11,730	13,680	(14.3)
Interest	(77)	(39)	95.7	(55)	39.6	(230)	(61)	275.4
Depreciation	355	305	16.5	376	(5.5)	1,398	1,146	22.0
Other Income	445	430	3.4	336	32.5	1,899	1,527	24.3
Recurring pre-tax income	2,854	3,797	(24.8)	3,034	(6.0)	12,461	14,122	(11.8)
Taxation	904	1,125	(19.7)	943	(4.1)	3,883	4,409	(11.9)
- current	859	1,096	(21.6)	909	(5.5)	3,788	4,230	(10.4)
- deferred	44	29	55.1	34	31.5	94	179	(47.3)
Reported Net Income	1,950	2,672	(27.0)	2,092	(6.8)	8,579	9,713	(11.7)
Recurring Net Income	1,950	2,672	(27.0)	2,092	(6.8)	8,579	9,713	(11.7)
Ratios (%)								
RM/Sales	73.1	68.2		73.6		72.5	69.5	
Staff Cost/Sales	3.4	3.6		3.4		3.6	3.7	
Other Expenses/Sales	13.3	12.0		11.6		12.1	11.2	
EBIDTA Margins	10.2	16.1		11.3		11.8	15.7	
Net profit margins	7.4	11.8		7.8		8.7	11.1	
Effective Tax Rate	31.7	29.6		31.1		31.2	31.2	

Source: i-SEC Research

Details in our report '*Long and winding road...*' dated April 14, '07.

Chennai Petroleum (Unrated) Oil&Gas and Petrochemicals

Q4FY07 RESULTS REVIEW

Riding the refining upswing

Rs216

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Chennai Petroleum (CPCL) has reported an impressive recurring profit of Rs1.9bn in Q4FY07 on the back of a sustained uptrend in refining margins, which improved significantly to US\$6.42/bl. We believe that global refining margins could sustain at current levels on the back higher capacity utilisations. We expect CPCL to enjoy net income of Rs7.2bn in FY08E assuming GRM at US\$6/bl based on quick estimates. The stock currently trades at FY08E P/E of 4.5x with 6.8% yield (quick estimates) expected in FY08E. CPCL offers one of the best exposures to pure refining, which can take advantage of the positive refining margin outlook over the next one year.

Table 1: Valuation summary

		Y/E March	EPS (Rs)	P/E (x)	EV/E (x)		
Price (11/05/07) (Rs)	216	2004	27.4	7.9	7.8	BSE Sensex	13796
52 Week Range	260/143	2005	40.2	5.4	4.6	Market Cap. (Rs bn)	31.6
Dividend FY08E (Rs/sh.)	17.2	2006	31.7	6.8	5.5	Market Cap. (US\$ mn)	694
Dividend yield (%)	7.98	2007E	38.0	5.7	4.6	Shares Out. (mn)	148.9
Face value (Rs)	10	2008E	48.1	4.5	3.4	Free float (%)	32.7

Source: Company data, i-SEC Research

- **Improving GRMs led to flaring EBITDA margin**, which improved 454bps YoY to 7% in Q4FY07 versus 2.5% in Q4FY06. This was despite 92.3% hike in personnel cost, which increased because of higher payout of performance-related bonuses. Net sales rose 3.9% YoY to Rs57.3bn, while EBITDA improved 194.3% YoY to Rs4bn.
- **Impressive 434% YoY improvement in net income** despite 12% YoY increase in depreciation and 20.3% YoY rise in interest costs, which however, were offset by 87% YoY increase in other income.
- **CPCL, a pure refining play, set to ride a potential flyer in GRMs in the next two years.** With 10.5mntpa refining capacity associated with secondary processing capability (one hydrocracker), CPCL's margins would be driven by: i) sustained upswing in industry prospects based on global capacity constraints ii) likely increase in light heavy differential, which can help CPCL enjoy savings in crude cost by increasing heavier crude in its crude basket and iii) improved yields based on operational efficiency gains and secondary processing capacity. We estimate 26.7% YoY growth in FY08E recurring net income (assuming US\$6/bl GRM).
- **Attractive valuations at US\$108.7/te of annual capacity and FY08E P/E of 4.5x**, based on quick estimates (FY08E EPS-Rs48.1/share), assuming GRMs at US\$6/bl. Factoring in 36% payout, we estimate CPCL to hike dividend to Rs14.7/share, which implies FY08E yield of 6.8%. The stock is also attractive at FY08E EV/annual capacity of US\$108.7/te (US\$14.9/bl). There is potential for 41% upside in earnings for US\$1/bl increase in our base case GRM assumption.

Table 2: Q4FY07 results review*(Rs mn, year ending March 31)*

	Q4FY07	Q4FY06	% Ch (YoY)	% Ch (QoQ)	FY07	FY06	% Ch (YoY)
Net sales	57,252	55,082	3.9	(0.9)	246,948	211,288	16.9
(Increase)/Decrease in stocks	(2,538)	(1,044)	143.1	(566.9)	(3,884)	(4,000)	(2.9)
Raw materials consumed	54,513	52,887	3.1	(2.2)	232,372	197,780	17.5
Staff cost	607	316	92.3	100.6	1,506	968	55.6
Other expenditure	652	1,558	(58.2)	(45.9)	4,547	5,625	(19.2)
Total expenses	53,233	53,716	(0.9)	(7.8)	234,542	200,374	17.1
EBITDA	4,019	1,366	194.3	NA	12,407	10,914	13.7
Interest	577	480	20.3	40.0	1,883	1,741	8.2
Depreciation	662	591	12.0	12.9	2,419	2,358	2.6
Other Income	338	180	87.2	121.5	705	418	68.6
Recurring Pre-tax Income	3,118	475	555.9	NA	8,809	7,233	21.8
Extraordinary income/(expense)		0			-	-	
Taxation							
Current	1,203	145	729.8	1,235.4	3,089	2,264	36.4
Deferred	24	(24)	(201.3)	(106.6)	67	160	(57.9)
Recurring Net Income	1,891	354	434.0	NA	5,653	4,809	17.5
Reported Net Income	1,891	354	434.0	676.6	5,653	4,809	17.5
Margins (%)			(bps)	(bps)			(bps)
EBITDA margin	7.0	2.5	454.1	697.6	5.0	2.5	254.5
Net Income margins	3.3	0.6	266.0	472.2	2.3	0.6	164.6
Operating details							
GRM (US\$/bl)	6.4	3.0	117.6	142.3	5.0	4.4	14.4

Source: Company data, i-SEC Research

Table 3: CPCL attractive on EV/capacity

	FY07E	FY08E
EV/refining capacity (Rs/te)	5,395.5	4,455.8
EV/refining capacity (US\$/te)	131.6	108.7
EV/refining capacity (US\$/bl)	18.0	14.9

Source: Company data, i-SEC Research

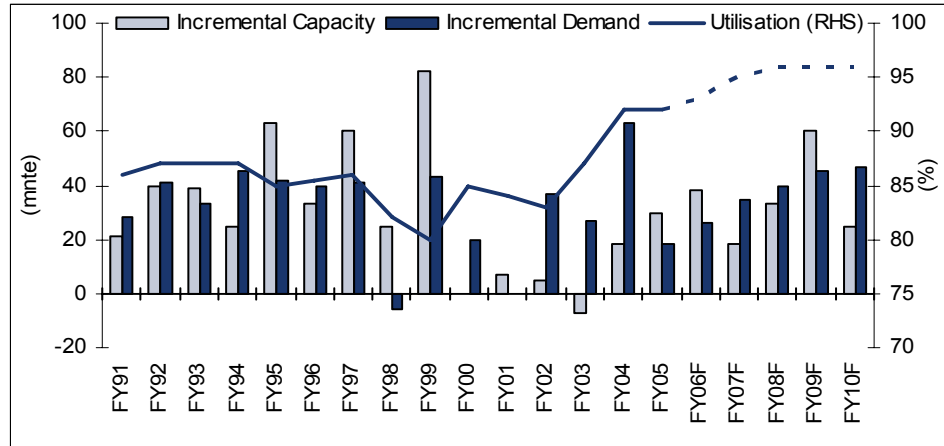
Table 4: Peer group valuation

Company	Country	Market Cap (US\$mn)	Price Perf. (1 yr % ch)	1 yr fwd EPS CAGR (%)	EBIDTA Margin (%)	Current EV/E (x)	1 yr fwd (x)	Price/BV (x)	RoCE (%)	RoE (%)
Bharat Petroleum	India	2,710	(16.6)	(1.7)	2.2	10.1	6.5	1.2	4.1	6.1
Chennai Petroleum	India	784	(16.9)	24.1	6.8	4.6	3.4	1.0	13.8	20.8
Hindustan Petroleum	India	2,140	(17.2)	(0.6)	1.2	15.3	7.0	1.1	2.0	2.2
Indian Oil Corp	India	12,949	0.2	18.5	5.6	8.5	11.4	1.7	10.7	17.0
SK Corp	South Korea	15,585	64.9	(5.7)	15.4	2.6	10.0	1.8	13.5	22.6
S-Oil Corp	South Korea	8,582	(2.1)	(1.7)	8.9	7.2	7.7	2.2	18.4	25.5
Sunoco Inc	USA	9,042	1.2	(6.2)	5.7	5.5	9.9	4.2	23.5	47.5
Average		7,399	1.9	3.8	6.5	7.7	8.0	1.9	12.3	20.2

Source: Bloomberg, i-SEC Research

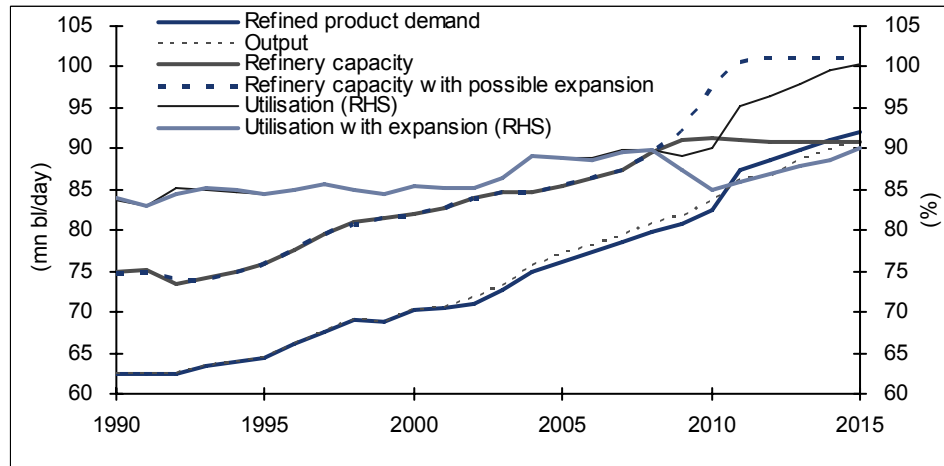
- **Refining margins to ride the current boom.** At present, the global refining capacity utilisation is above 90% due to robust demand and closure of refineries in the US (tighter emission norms) and China (old refineries). Further, there are few new refinery projects visible in the next two years due to constraints in availability of EPC contractors and capacity with fabrication shops for refinery equipment. Robust demand and limited increase in supply would sustain higher capacity utilisation, which in turn is expected to sustain the current upswing in refinery margins over the next two years (Chart 1 & Chart 2).

Chart 1: Asian refineries to run at higher than 90% operating rates



Source: Industry data, Wood Mackenzie, i-SEC Research

Chart 2: Global refining utilisation expected to remain tight



Source: i-SEC Research, Oil and Gas journal

Recent reports/updates		
Analyst	Company/Sector	Date
Shilpa Gupta	Hero Honda Motors: Long and winding road...	May 14
Anand / Shilpa Yadav	Britannia Industries: When going gets tough...	May 7
S. Ramesh / Amit	Indraprastha Gas: Refuelling for growth	May 3
S. Ramesh / Amit	Gujarat Gas: In the fast lane	May 3
Anand / Shilpa Yadav	Hindustan Lever: Muted tempo	May 3
Anand / Shilpa Yadav	GSK Consumer: Surprise packet	Apr 30
S. Ramesh/Amit	Reliance Industries: Growth plans on track	Apr 27
Rajesh Vora	Cipla: Sluggish gait	Apr 27
Anand /Shilpa Yadav	Godrej Consumer Products: Of waning hue	Apr 26
S Ramesh	BPCL: Piping hot	Apr 26
Rajesh Vora	Pharma: Theme note on Sun Pharma & Glenmark	Apr 24
Anand / Shilpa Yadav	Kansai Nerolac: Radiant hues	Apr 24
Anand / Shilpa Yadav	Colgate-Palmolive: Tranquil tone	Apr 23
S. Ramesh / Amit	Netback: Refining on a winning streak	Apr 19
Shilpa Gupta	Speedometer: Subdued pace	Apr 16
S. Ramesh / Amit	GAIL (India): Stepping up the gas	Apr 16
Shilpa Gupta	Automobiles Quarterly results preview: Mixed bag	Apr 12
Rajesh Vora	Pharma Quarterly results preview: In full bloom	Apr 11
S. Ramesh / Amit	Oil&Gas Quarterly results preview: Full blast ahead	Apr 9
Anand / Shilpa Yadav	FMCG Quarterly results preview: On a promising note	Apr 9
Rajesh Vora	Wockhardt: On come-back trail	Apr 5
Poonam Nishal	Utilities Quarterly results preview: Waiting for Godot	Apr 5
Amar Kedia	Aviation Quarterly results preview: Mixed bag	Apr 3
Rajesh Vora	Glenmark Pharma: Raising the bar	Apr 3
Amar Kedia	SpiceJet: Tempest to blow past	Apr 3
Poonam Nishal	Telecom Quarterly results preview: Swelling volumes to script success	Apr 2
S. Ramesh	Gujarat Gas: Set for new highs	Mar 30
Rajesh Vora	Cadila Healthcare: Run to form	Mar 26
Amar Kedia	Balmer Lawrie: Stirring up	Mar 23
Anand Shah	Nestle: On an accelerated growth path	Mar 22
S. Ramesh	Netback margin monthly: Refining, the lone star shining	Mar 19
Rajesh Vora	Sun Pharma: The Sun SPARCles	Mar 16
Vikash Mantri	Jagran Prakashan (Unrated): Augmenting clout	Mar 15
Shilpa Gupta	Speedometer (Mar '07) – Balanced manoeuvre	Mar 14
Eq. Research Team	Union Budget Review 2007-08	Mar 1

Quarterly results date reckoner

No.	Nifty companies	Date of result	No.	Other companies	Date of result
1	ABB India	April 26	1	Adlabs Films	April 26
2	ACC	April 19	2	Alembic Limited	-
3	Bajaj Auto	May 17	3	Apollo Hospitals Enterprise	-
4	Bharat Heavy Electricals	-	4	Arvind Mills	May 12
5	Bharat Petroleum Corporation	-	5	Ashok Leyland	May 4
6	Bharti Airtel	April 27	6	Asian Paints	May 10
7	Cipla	April 26	7	Aventis Pharma	April 16
8	Dabur India	May 8	8	Balaji Telefilms	May 16
9	Dr. Reddy's Laboratories	May 18	9	Bank of Baroda	April 28
10	GAIL (India)	May 8	10	Bharat Forge	-
11	GlaxoSmithKline Pharmaceuticals	April 27	11	Britannia Industries	-
12	Grasim Industries	April 25	12	Cadila Healthcare	April 26
13	Gujarat Ambuja Cements	April 20	13	Canara Bank	May 2
14	HCL Technologies	April 17	14	Colgate-Palmolive	May 3
15	HDFC Bank	April 24	15	Corporation Bank	April 28
16	Hero Honda Motors	May 11	16	GlaxoSmithKline Consumer	-
17	Hindalco Industries	May 4	17	Glenmark Pharma	April 25
18	Hindustan Lever	April 30	18	Godrej Consumer Products	April 25
19	Hindustan Petroleum Corporation	-	19	Gujarat Gas Company	April 30
20	Housing Development Finance Corporation	May 3	20	IDBI	April 20
21	ITC	-	21	Indian Hotels Co.	-
22	ICICI Bank	April 28	22	Indraprastha Gas	-
23	Indian Petrochemicals Corporation	-	23	Info Edge (India)	May 3
24	Infosys Technologies	April 13	24	Infotech Enterprises	-
25	Larsen & Toubro	-	25	Jammu & Kashmir Bank	May 7
26	Mahanagar Telephone Nigam	April 24	26	Jet Airways	-
27	Mahindra & Mahindra	May 28	27	JSW Steel	April 30
28	Maruti Udyog	April 24	28	Kansai Nerolac Paints	May 3
29	National Aluminium Company	April 25	29	Madras Cements	May 30
30	Oil & Natural Gas Corporation	-	30	Marico	April 26
31	Punjab National Bank	May 23	31	Mphasis	April 30
32	Ranbaxy Laboratories	April 27	32	National Thermal Power Corp.	-
33	Reliance Communications	April 30	33	Nestle India	April 30
34	Reliance Energy	April 25	34	Oriental Bank of Commerce	April 28
35	Reliance Industries	April 26	35	Patni Computer Systems	April 25
36	Reliance Petroleum	April 25	36	Polaris Software Lab	April 27
37	Satyam Computer Services	April 20	37	Procter & Gamble	April 30
38	Siemens	April 23	38	Punjab Tractors	-
39	State Bank of India	May 12	39	Raymond	April 26
40	Steel Authority of India	May 21	40	Sasken Communication Technologies	-
41	Sterlite Industries (India)	May 3	41	SpiceJet	-
42	Sun Pharmaceutical Industries	May 15	42	Tata Tea	-
43	Suzlon Energy	May 14	43	TVS Motor Company	-
44	Tata Consultancy Services	April 16	44	Union Bank of India	May 7
45	Tata Motors	May 18	45	UTI Bank	April 17
46	Tata Power Co.	May 30	46	Wockhardt	April 26
47	Tata Steel	May 17			
48	Videsh Sanchar Nigam	-			
49	Wipro	-			
50	Zee Entertainment	April 21			

Note: Result dates in calendar format on Page 9

Quarterly results date reckoner

MAY 2007

Sun	Mon	Tue	Wed	Thu	Fri	Sat
	.	1 .	2 .	3 Kansai Nerolac, Info Edge, Colgate-Palmolive	4 Ashok Leyland	5 .
6 .	7 Union Bank of India, J&K	8 GAIL	9 .	10 Asian Paints	11 Hero Honda	12 SBI
13	14 .	15 Sun Pharma	16 Balaji Telefilms	17 Bajaj Auto	18 Tata Motors, DRL	19 .
20	21 .	22 .	23 PNB	24 .	25 .	26 .
27	28 M&M	29 .	30 Madras Cement, Tata Power	31 .		

ANALYST CERTIFICATION

We I, *Shilpa Gupta, PGDM, BTech; S. Ramesh, PGDM, BTech; Amit Mishra, PGDM, BE* research analyst(s) and the author(s) of this report, hereby certify that all of the views expressed in this research report accurately reflect my/our personal views about any and all of the subject issuer(s) or securities. We/I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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