Q1FY2007 earnings preview

The domestic demand continues to drive the growth

Key points

- The domestic demand driven story is likely to continue with the growth in the Sensex earnings led by the automobile, cement, capital goods and fast moving consumer goods (FMCG) companies. We expect the pharmaceuticals sector to report a strong growth on the back of the latest acquisitions done by the companies (Dr Reddy's acquired Betapharm) and new product approvals.
- We also expect the information technology sector companies to report a strong earnings growth on the back of a robust volume growth and the depreciation of the rupee vis-à-vis the dollar.
- We expect the earnings of the Sensex companies to grow by a strong 19.1% year on year (yoy) led by a strong growth in the above-mentioned sectors.

Sensex earnings growth (%)

Sector	Contribution to Sensex earnings for Q1FY2007E	% y-o-y change in Q1FY2007E	% y-o-y growth in FY2007E earnings
Auto	6.7	36.8	25.6
Bank	12.4	6.6	16.4
Capital goods	1.8	45.0	38.8
Cement	2.9	96.0	37.0
FMCG	5.5	22.8	24.2
IT	17.0	39.6	34.9
Metals	7.3	10.0	19.3
Oil	34.0	13.1	14.3
Pharma	2.0	49.2	68.7
Power	8.9	1.2	9.1
Diversified	1.4	25.2	36.2
Total	100.0	19.1	21.0
Total excl ONGC		21.4	22.6

Note: We have not included Tata Power Company as Reliance Communication Ventures Ltd (RCVL) has replaced it in the Sensex. We have also not included RCVL in our numbers, as the comparable figures for the last year are not available.

- For FY2007 the earnings of the Sensex companies are expected to grow at 21.0% and excluding Oil and Natural Gas Corporation the growth is likely to be 22.6%. The earnings growth for the banking sector for Q1FY2007 is likely to be much lower than the full year growth as a major portion of the mark-to-market losses on the bond portfolios will be booked in Q1FY2007.

Automobiles—to report strong growth

- We expect the two-wheeler as well as four-wheeler segments to report a strong growth in the earnings on the back of robust sales volumes.
- The two-wheeler volumes have continued their secular growth with Bajaj Auto leading the pack with a 28.1% year-on-year (y-o-y) growth in the volumes.
- The four-wheeler majors reported a strong growth in passenger vehicles as well as commercial vehicles due to the lower base of last year.
- The volume growth in the quarter should lead to margin expansion, thereby mitigating the impact of the rising costs to some extent. Most of the vehicle companies are planning to raise the prices from Q2FY2007 onwards to offset the impact of the cost increases.

Automobile majors' volume growth

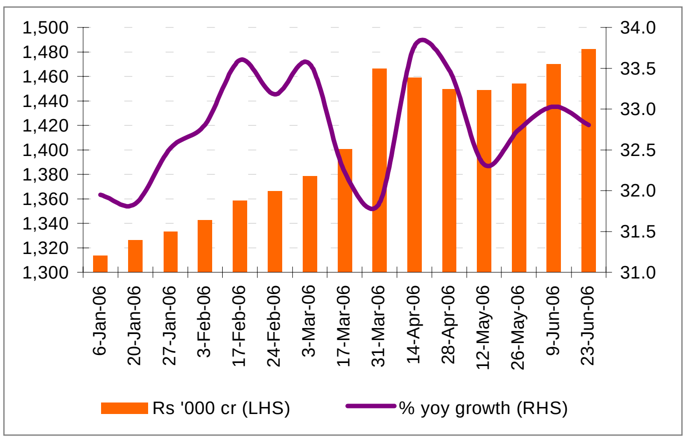
	Q1FY2007	Q1FY2006	% yoy chg
Two-wheelers			
Bajaj Auto	647,094	505,000	28.1
Hero Honda	788,357	658,026	19.8
TVS Motors	376,274	307,425	22.4
Four-wheelers			
Tata Motors	126,154	87,499	44.2
Maruti Udyog	144,948	121,866	18.9
Ashok Leyland	17,067	13,320	28.1
M&M	61,894	52,190	18.6

(Rs crore)	Net sales			Profit after tax		
	Q1 FY07E	Q1 FY06	% yoy chg	Q1 FY07E	Q1 FY06	% yoy chg
Bajaj Auto	2,135.4	1,634.2	30.7	314.5	209.0	50.5
Maruti Udyog	3,116.4	2,612.9	19.3	315.7	226.5	39.4
Tata Motors	5,725.1	3,878.1	47.6	327.8	272.7	20.2

Banking—rising interest rates to hurt

- The loan book of scheduled commercial banks has grown by 32.8% during the period up to the week ended June 23, 2006. However, the growth in the net interest income is likely to be much lower as the deposit costs have risen, but the full impact of the increase in the lending rates is yet to come in.

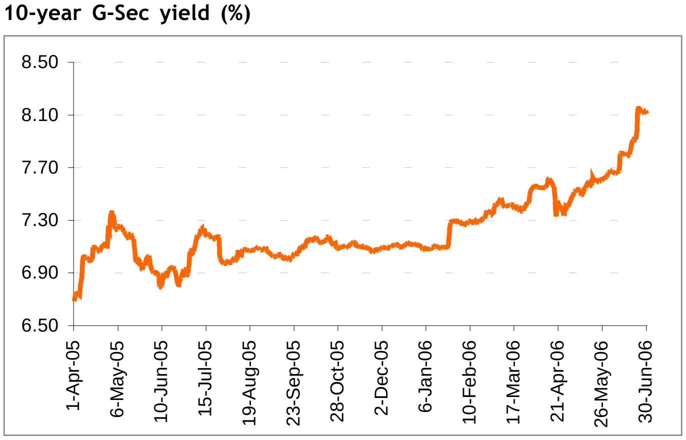
Loan growth of scheduled commercial banks



Source: RBI

- The mark-to-market losses of the banks are also expected to go up as the government bond yields have shot up substantially over the last quarter.

10-year G-Sec yield (%)



Source: Bloomberg

- We expect the private sector banks to outperform their peers in the public sector. We expect the earnings of UTI Bank and HDFC Bank to report a strong growth while that of the public sector banks are likely to decline or remain flat.

Capital goods and engineering

- We expect a strong growth in the revenues of the capital goods and engineering companies on the back of a strong order book carried forward at the end of FY2006.
- Driven by the operating leverage, the earnings of the capital goods and engineering companies are likely to see continued growth momentum.

Cement

- We expect the cement sector as a whole to report an impressive performance in the April-June quarter of 2006, on the back of a decent 7-8% volume growth and a 19-20% realisation growth.
- Amongst the cement companies in our coverage, JK Cement is expected to top the chart of earnings growth with a 273% growth in its net earnings followed by Shree Cement with a net earnings growth of 182%.
- We expect UltaTech and ACC's operating margins to expand, driven by the cost savings and higher leverage to the firm cement prices.
- We expect Madras Cements to register a healthy volume growth of 23.9% yoy in Q1FY2007 on the back of the strong demand in south India. This coupled with the firm cement prices and the lower sales tax rate would result in a substantial 77% growth in its earnings.
- Shree Cement is likely to report a healthy volume growth driven by the commissioning of its new 1.2 million tonne cement plant. This coupled with the firm cement prices in the northern region is likely to lead to a staggering 182% growth in its earnings.
- We maintain our positive view on the sector with ACC, UltraTech and Madras Cement as our top picks.

(Rs crore)	Net sales			Profit after tax		
	Q1 FY07E	Q1 FY06	% yoy chg	Q1 FY07E	Q1 FY06	% yoy chg
ACC	1,276.0	1,107.6	15.2	213.2	130.8	63.0
Grasim	1,776.9	1,553.2	14.4	250.3	205.5	21.8
UltraTech	978.0	815.0	20.0	90.0	59.2	52.0
JAL	908.5	817.0	11.2	104.2	83.8	24.3
Madras Cement	288.0	218.8	31.6	32.0	18.3	77.0
Shree Cement	303.0	143.1	112.0	73.0	26.0	182.0
JK Cement	254.0	200.3	26.8	19.0	5.1	273.3

Fast moving consumer goods (FMCG)

- Backed by a pick-up in the rural demand, the FMCG sector has seen the volume growth getting better every quarter. The revenue growth for the current quarter is likely to be in the higher double-digit range.
- We expect the market leader in the segment, Hindustan Lever Ltd's (HLL) earnings to grow by 24.4% yoy backed by the strong volume growth and price increases in its key product segments. Also the faster growth in the higher margin personal care segment should help expand margins.
- We expect ITC's profits to grow by 18.7% yoy driven by the growth in cigarettes, hotels and paper businesses.
- We expect Godrej Consumer Products to report a 19.4% y-o-y growth in its earnings with the continuing strong growth in the personal care segment.

Information technology

- The revenue growth of the information technology (IT) companies for Q1FY2007 would be in the range of 6-10% quarter on quarter driven by a 4-8% growth in the volumes and 2-2.2% depreciation in the rupee against the US dollar.
- The favourable forex movement would boost the operating profit margins and cushion against the adverse impact of the cost pressures. However, the mark-to-market losses against the forward cover would result in a much lower other income. Thereby, leading to a lower growth in the earnings.
- Infosys with its front-ended growth would be the best performer among the front-line IT services companies. Satyam would also positively surprise by better than guided earnings growth of 1.2% (as against the guidance of a sequential decline of 1.7%). On the other hand, Wipro is likely to disappoint with a flattish performance both in terms of the revenue and earnings growth.

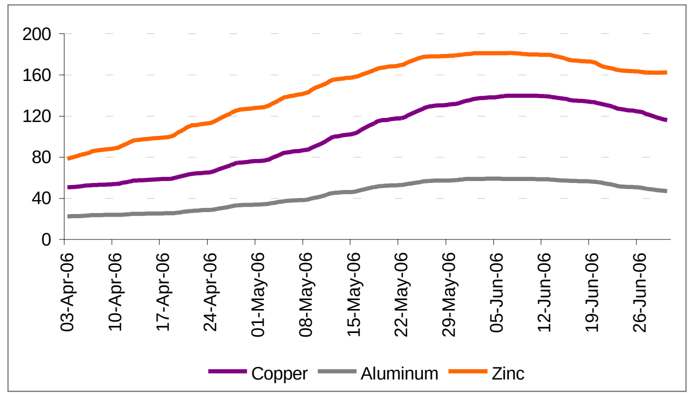
(Rs crore)	Net sales			Profit after tax		
	Q1 FY07E	% qoq chg	% yoy chg	Q1 FY07E	% qoq chg	% yoy chg
Infosys Tech	2,873.0	9.5	38.7	702.4	4.4	32.0
Satyam Comp	1,395.0	6.2	31.8	288.0	1.2	51.4
HCL Tech	1,215.3	8.3	31.0	222.5	15.4	37.4
Wipro (cons)	3,060.0	0.2	33.8	596.5	-0.2	39.8
TCS	4,020.0	7.7	38.0	854.0	5.5	32.0

Metals

Non-ferrous

- Despite correcting from their highs, the aluminium, copper and zinc prices are still sharply higher over the last year.

% y-o-y growth in non-ferrous metal prices



Source: LME

- We expect the non-ferrous metal majors like Hindalco, National Alumunium, Hindustan Zinc and Sterlite Industries (India) to report a strong growth in earnings backed by the firm metal prices.

Ferrous

- Tata Steel has reported a strong growth in its production as well as sales volumes for Q1FY2007. The production volumes have grown by 17% yoy and the sales volumes have grown by 28% yoy.
- However, with the prices having fallen 15-20% in the hot rolled and cold rolled segments, Tata Steel is likely to see a drop in its earnings of 11-14%.

Tata Steel volume numbers

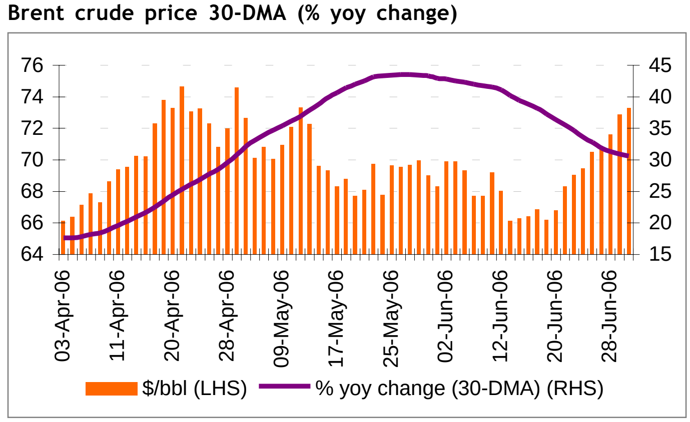
Million tonne	Q1FY2007	Q1FY2006	% yoy chg
Crude steel production	1.21	1.1	9.4
Saleable steel production	1.11	0.9	17.0
Sales volumes	1.12	0.87	28.0

Source: Company

Oil and gas

- ONGC is likely to report a 9-11% growth in the profits, as the benefits of higher realisation on crude and higher production are likely to be offset by the higher subsidy burden under the new subsidy sharing formula.

Brent crude price 30-DMA (% yoy change)



Source: Bloomberg

Note: 30-DMA: 30-day moving average

- The downstream players like HPCL, BPCL and Indian Oil Corporation are likely to report profits compared to the losses that they reported in Q1FY2006, on account of the stronger refining margins and the issue of oil bonds.

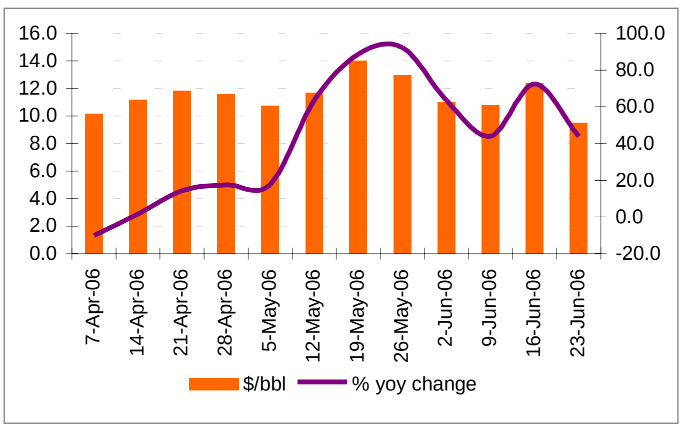
- RIL is expected to show a strong growth in its earnings due to the following reasons.

  - The refining business is likely to remain strong as the gross refining margins (GRMs) for Q1FY2007 are likely to remain strong and the company has expanded capacities through de-bottlenecking.

  - The petrochemicals business is also likely to show a strong traction led by the price increases. The prices of polypropylene and polyethylene have gone up by 12% yoy and 17% yoy respectively over the last year. However, in the polyester segment the prices have declined by 1-8%.

  - The oil exploration and production business is likely to report a good growth on the back of increased volumes and higher price realisation on both crude oil as well as gas.

Singapore GRMs ($/bbl)



Source: Bloomberg

Pharmaceuticals

- Cipla is expected to report a very high double-digit growth in its revenues as well as profits on the back of supplies of Finasteride (generic version of "Proscar", a Merck product) to Teva Pharma of Israel (see our note 'Cipla receives (Pr)oscar" dated June 21, 2006).

- Dr Reddy's Laboratories is expected to report a strong growth backed by the consolidation of the numbers of Betapharm.

- Ranbaxy is likely to continue its dismal performance due to the pricing pressure faced in the US markets.

Telecom

- Bharti Telecom is expected to report a strong 45% y-o-y growth in its earnings backed by the robust addition in the net subscriber base and the strong growth in the non-mobile revenues.

- The growth for Reliance Communication Ventures Ltd is likely to be in the range of 6-7% on a q-o-q basis with the company expected to report a profit of Rs450-470 crore as compared to a loss of Rs391 crore in the same quarter last year.

Annexure - I

Stocks to watch out for in Sensex

Stocks where the earnings growth is expected to be high

Company	Q1FY2007E	Q1FY2006	% yoy chg
ACC	262.1	130.7	100.5
Gujarat Ambuja Cements	278.6	145.2	91.9
Hindalco Industries	585.1	324.9	80.1
Cipla	191.9	111.4	72.3
Satyam Computer Services	294.9	193.1	52.7
BHEL	195.0	127.9	52.5
Bajaj Auto	315.1	208.0	51.5
Bharti Televentures	735.3	504.2	45.8
Wipro	598.0	422.6	41.5
Maruti Udyog	316.7	226.5	39.8

Stocks where lower earnings growth/decline is likely

Company	Q1FY2007E	Q1FY2006	% yoy chg
Reliance Energy	176.3	156.6	12.6
ICICI Bank	591.0	530.0	11.5
Oil & Natural Gas Corp	3,663.1	3,318.6	10.4
NTPC	1,482.3	1,482.4	-
TISCO	788.4	924.1	-14.7

Annexure II - Non Sensex companies where high growth is expected

Company	Q1FY2007E	Q1FY2006	% yoy chg
I Flex	56.1	5.9	850.8
Hindustan Zinc	1,100.0	145.0	659.4
Shree Cement	75.0	26.0	188.0
I Gate	3.8	1.3	203.8
UltraTech	142.0	60.0	136.5
Welspun India	24.5	10.8	126.9
Nalco	617.5	281.0	120.1
ZEE Telefilms	65.0	31.0	111.5
Tata Tea	64.1	32.6	96.6
Thermax	24.4	13.3	83.1

The author doesn't hold any investment in any of the companies mentioned in the article.