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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
♦ Deepak Fertilisers	17-Mar-05	50	84	126
♦ HLL	24-Nov-05	172	198	280
♦ ICICI Bank	23-Dec-03	284	821	1,240
♦ IndoTech Trans	28-Nov-06	199	266	335
♦ Infosys	30-Dec-03	689	1,993	2,670

Sharekhan Special

Q4FY2007 IT earnings preview

The steep appreciation of the rupee has further added to the seasonal weakness in the fourth quarter which would limit the revenue growth of the information technology (IT) companies to 5-6.6% on a sequential basis. The margins would be under pressure, especially in case of Wipro (because of a relatively lower forward cover and the impact of annual salary hikes to its onsite employees in Q4) and Satyam Computer Services (Satyam; due to an incremental cost of \$4.5 million related to stock-based compensation). The earnings growth is expected to vary substantially for the various companies with a wide range of 1.3% to 6% sequentially.

Rupee rage

The average exchange rate of Rs44.2 against the dollar is quite close to the assumption of Rs44.1-44.3 made by the domestic companies (Infosys Technologies [Infosys]: Rs44.1; Satyam: Rs44.3) in their Q4 guidance. The other major currencies such as the euro and pound sterling were more or less flat on an average basis.

However, the steep appreciation of the rupee at the fag end of the quarter has resulted in a weighted average appreciation of around 1.2% in the rupee in terms of the end-of-period rates. This is likely to adversely affect the non-operating income (or the other income component) in

the fourth quarter results of companies like Infosys and Satyam that use the fair value method of accounting for the currencies hedges.

On the other hand, the other income component of Tata Consultancy Services (TCS) and Wipro would not be affected by the appreciation of the rupee as they use the cash flow hedging method of accounting for the bulk of the exchange rate cover. However, in the cash flow hedging method, the impact would be more pronounced on the revenue growth as the end-of-period exchange rates are used for the conversion.

Exchange rate movement

INR vs	End of period rates		Average rates	
	31-Dec-06	31-Mar-07	31-Dec-06	31-Mar-07
US Dollar	44.3	43.5	45.0	44.2
% qoq chg		-1.6		-1.7
Euro	58.3	58.2	58.0	57.9
% qoq chg		-0.2		-0.2
Pound sterling	86.9	85.5	86.2	86.3
% qoq chg		-1.6		0.1

In terms of the forward cover, TCS and HCL Tech are more comfortably placed with hedged positions for the next three to four months of revenues. On the other hand, Wipro had

Quarterly estimates

(Rs crore)	Net sales			Net profit			EPS (Rs)	OPM (%)
	Q4FY07	% qoq	% yoy	Q4FY07	% qoq	% yoy		
Infosys Tech	3877.0	6.1	47.8	1031.3	4.9	53.2	18.5	32.6
Guidance	3789-3798			977-978			17.9	
Satyam Computer	1751.5	5.4	33.3	353.1	4.7	23.9	5.4	24.6
Guidance	1728-1736			355.0			5.4	
HCL Tech#	1552.6	6.0	38.4	290.0	1.3	50.2	4.5	21.7
Wipro (cons)	4181.7	5.5	36.9	775.4	4.1	29.8	5.5	19.4
Wipro (global IT)	3044.8	5.5	33.0					
Guidance (global IT)	\$685 mn							
TCS	5183.7	6.6	39.2	1170.6	6.0	46.3	12.0	26.3

Please note HCL Tech is a June ending company.

considerably reduced its forward cover to around one month revenues as on December 2006 and runs the risk of getting caught on the wrong foot if timely actions have not been initiated during the quarter.

Forex cover

(\$ million)	Sep-06	Dec-06	FY2007E revenues	% forex hedge
Infosys Tech	373	360	3102	11.6
Satyam Computer	158	254	1448	17.5
HCL Tech	451	515	1336	38.5
Wipro (Global IT)	377	188	2461	7.6
TCS	1100	1250	4165	30.0

Ahead of consensus in case of Infosys

Our estimates are slightly ahead of consensus in case of Infosys and behind consensus estimates for Satyam. The consensus estimates already factor in a much sober performance in Q4 and the same is also reflected in the recent underperformance of the BSE IT Index as compared to the benchmark indices.

Consensus vs our estimates

(Sequential growth in %)	Net sales		Net profit	
	Consensus	Our estimates	Consensus	Our estimates
Infosys Tech	5.3	6.1	3.7	4.9
Satyam Computer	5.7	5.4	6.3	4.7
HCL Tech	6.0	6.0	2.4	1.3
Wipro (Cons)	7.2	5.5	3.2	4.1
TCS	5.5	6.6	6.7	6.0

Scope for positive surprise in FY2008 guidance

In terms of the FY2008 guidance also, the street expectations are a lot more conservative now. Most analysts expect Infosys to give an earnings guidance of 23-24% in rupee terms. It is much lower than the 26.5-28.5% earnings growth guidance given at the beginning of FY2007 and implies a less than 5% sequential growth in the earnings over the four quarters.

We believe that the street expectations are over conservative and leave enough room for positive surprises.

Notwithstanding the obvious concerns related to rupee appreciation, a possible slowdown in the USA and wage inflation, the recent surveys don't indicate any slowdown in IT spending of US companies but hint at further momentum in offshore outsourcing by major global corporations and increasing penetration in newer markets (especially in parts of Europe). Moreover, the annual growth guidance given by Cognizant Solutions (a Nasdaq-listed Indian offshore vendor) for CY2007 is quite robust (more or less similar to the one given by the company in February 2006) and doesn't indicate any serious concerns related to growth in the current year.

Cognizant—robust guidance for CY2007

	CY2006G	CY2006A	CY2007G
Revenues	42%	61%	43%
PAT	36%	48%	35%

Valuation

The street expectations have toned down considerably in terms of both Q4 performance and the annual guidance for FY2008, and the recent underperformance of the tech stocks indicates that the same has already been factored in the valuations. This essentially means that the negatives have been priced in, leaving limited scope for downside. But positive surprises, especially in terms of higher than expected annual guidance by Infosys, are not ruled out. However, the continued strengthening of the rupee and seasonal weakness in Q1 (due to wage hikes and additional visa related cost) would continue to influence sentiments on tech counters in the short run. We believe that any further weakness would be an opportunity to accumulate the front-line tech stocks and prefer Infosys and TCS.

Valuation matrix

	EPS (Rs)		P/E	
	FY07	FY08	FY07	FY08
Infosys	67.8	89.8	29.0	21.9
TCS	42.1	53.6	28.5	22.4
Wipro	20.1	24.9	26.6	21.4
Satyam	21.0	25.0	21.9	18.4
HCL Tech	16.8	20.5	17.3	14.1

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

Mahindra & Mahindra

Apple Green

Stock Update

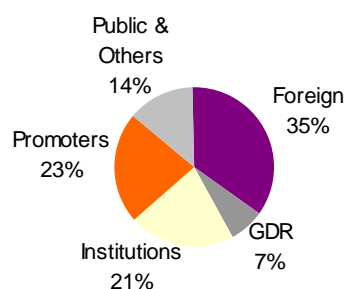
Logan unveiled

Buy; CMP: Rs711

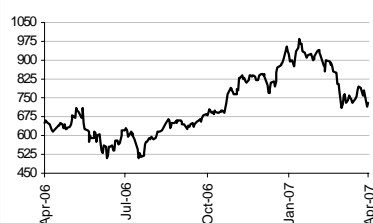
Company details

Price target:	Rs1,050
Market cap:	Rs17,348 cr
52 week high/low:	Rs1,002/488
NSE volume: (No of shares)	7.9 lakh
BSE code:	500520
NSE code:	M&M
Sharekhan code:	M&M
Free float: (No of shares)	17.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.7	-21.3	7.3	16.5
Relative to Sensex	-2.9	-12.9	4.7	5.0

Key points

- ♦ Mahindra Renault has made the much-awaited launch of its passenger car *Logan*. Three variants of the car have been launched—two in the petrol segment and one in the diesel segment.
- ♦ The vehicle has been priced aggressively as its petrol version is priced between 4.28 lakh and 5.69 lakh, and its diesel version is priced between Rs5.47 lakh and Rs6.44 lakh.
- ♦ Currently, the vehicle is being manufactured at the company's Nasik plant. With the setting up of a new greenfield plant near Chennai by mid-2009, the capacity would be scaled up by 300,000 units. Also, the localisation content would improve from 50% currently to about 80-90%.
- ♦ We expect the car to do well in the Indian markets, mainly on account of its pricing. We expect the launch of *Logan* to have a negative impact on models like Maruti's *Esteem*, Tata Motors' *Indigo*, and Hyundai's *Getz*. The launch of the passenger cars also further diversifies M&M's business model.
- ♦ At the current market price of Rs711, the stock discounts its FY2008E consolidated earnings by 10.4x. We maintain our Buy recommendation on the stock with a price target of Rs1,050.

Mahindra Renault, a 51:49 joint venture between Mahindra & Mahindra (M&M) and Renault SA, has made its Indian debut with the launch of its passenger car *Logan*. *Logan* has been widely successful worldwide as a no-frills car, with about 450,000 vehicles sold in 51 countries so far.



Valuation table

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Stand-alone					
Net sales (Rs cr)	4873.0	6509.3	7945.8	10272.5	11805.4
%y-o-y change		33.6	22.1	29.3	14.9
Net profit (Rs cr)	322.2	507.6	663.3	866.7	1012.7
EPS (Rs)	13.6	21.4	28.0	36.5	42.7
%y-o-y change		57.6	30.7	30.7	16.8
PER (x)	52.3	33.2	25.4	19.5	16.6
Consolidated					
Net profit (Rs cr)	426.5	675.2	1121.6	1359.5	1588.9
EPS (Rs)	18.3	28.9	48.1	58.2	68.1
%y-o-y change		58.3	66.1	21.2	16.9
PER (x)	109.7	69.3	41.8	34.5	10.4

Variants

	1.4 litre petrol	1.6 litre Petrol	1.5 litre Diesel
Type	4 cylinder, 8 valve	4 cylinder, 8 valve	4 cylinder, 8 valve
Power (hp/rpm)	75/5500	90/5500	65/4000
Torque (Nm/rpm)	112/3000	128/3000	160/2000
Price (ex-showroom, Mumbai)	4.28-4.72 lakh	5.69 lakh	5.47-6.44 lakh

In India, three variants of the car have been launched—two in the petrol segment and one in the diesel segment. The pricing is the most impressive part of the model as its petrol version is priced between 4.28 lakh and 5.69 lakh, and its diesel version is priced between Rs5.47 lakh and Rs6.44 lakh.

Compares extremely well on pricing front

As expected, *Logan* has been aggressively priced by M&M and is available at a lesser price compared with all the other cars available in the same segment. However, the car loses out on the power front, which is lower than that of most of its peers. *Logan* is targeted at the B-segment and the entry-level C-segment; it will be pitted against models like Tata *Indigo*, Ford *Ikon*, *Esteem* and *Swift*.

It can be seen from the tables below that *Logan* compares very well on the price front across segments and this shall be its scoring point. The base model of *Logan* may also have an impact on the B-segment, as the customers can now own a sedan at a price that is just a little higher than that of a hatchback. However, since the base model doesn't have a power steering, the demand may mainly come from tourist taxis. On the other hand, it may also give

competition to the higher-level C-segment cars like *Chevrolet Aveo*, *Ford Fiesta* and *Hyundai Verna* as it offers near-about features (sans expensive interiors) at a lower price.

The company has claimed that the vehicle would return an average of 14-18km per litre in the diesel version and about 10-14km per litre in the petrol version. Emission levels of the diesel car have also been drastically reduced to 125g/km of CO₂.

Capacity expansion next year

Currently, *Logan* is being manufactured at the company's Nasik plant, which has a capacity to produce 50,000 cars per annum. The company is going for a phased launch of *Logan*. In the first phase, it would be launched in ten cities, including all metropolitan cities, while in the second phase it shall be launched in another 15 cities.

In collaboration with Renault and Nissan, M&M is also setting up a greenfield plant near Chennai, which shall have a capacity of 300,000 vehicles. Moreover, the facility would also manufacture powertrain, leading to an increase in the local content from the current 50% to about 80-90%. The

B-segment and entry-level C-segment

	Swift	Getz 1.3l	Ford Ikon	Indigo	Esteem	Logan 1.4l
Engine capacity	1298cc	1341cc	1299cc	1396cc	1298cc	1390cc
Prices (ex-showroom, Mumbai/ in lakh)	4.13-4.64	5.13-5.5	5.6-6.3	4.6-5.7	4.63-5.31	4.28-4.71
Power (hp/rpm)	87/6000	82.9/5,500	70/5500	85/5500	85/6000	75/5500
Torque (Nm/rpm)	113/4500	115/3200	105/2500	117/3500	110/4500	112/3000

Higher-level C-segment

	Aveo	Verna	Accent	Fiesta 1.6	Logan 1.6l
Engine capacity	1399cc	1599cc	1599cc	1596cc	1598cc
Prices (ex-showroom, Mumbai/ in lakh)	7.2	6.6-7.3	6.25-7.2	7.5	5.69
Power (hp/rpm)	102/5600	103/5500	102.6/5800	101/6500	90/5500
Torque (Nm/rpm)	147/3000	146/3000	141/4500	146/3400	128/3000

Diesel segment

	Swift	Indigo	Ford Fiesta	Logan 1.5l
Engine capacity	1248cc	1396cc	1399cc	1461cc
Prices (ex-showroom, Mumbai / in lakh)	4.88-5.24	5-6	7.3-8.4	5.47-6.44
Power (hp/rpm)	75/4000	70/4500	68/4000	65/4000
Torque (Nm/rpm)	190/2000	132/2500	160/2000	160/2000

company has already stated that it has been able to produce the car in India at a 10% lesser price in comparison to Romania. A higher level of localisation would lead to a margin improvement going forward.

Valuations

The launch of *Logan* marks M&M's entry into the passenger car segment and hence further strengthens M&M's business model. We expect *Logan* to do well in the Indian market mainly on account of its attractive pricing. We expect the launch of *Logan* to have a negative impact on models like

Maruti's *Esteem*, Tata Motors' *Indigo*, and Hyundai's *Getz*. However, the passenger car market in India is expected to show a slowdown, due to the impact of the rising interest rates and a high growth base. Also, an aggressive pricing by M&M may trigger a round of price war in the passenger car space, which shall hurt the auto industry.

At the current market price of Rs711, the stock discounts its FY2008E consolidated earnings by 10.4x. We maintain our Buy recommendation on the stock with a price target of Rs1,050.

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Cement

Sector Update

Government cuts CVD on cement imports

Key point

- ♦ The government on Tuesday scrapped the 16% countervailing duty (CVD) as well as the 4% additional duty on cement imports into the country, which is a sequel to the import duty cut in January (refer to our note dated January 23, 2007).
- ♦ With this move, the import parity price, which acts as a pricing benchmark for the domestic prices, will come down from Rs245-255 per bag to Rs210-215 per bag.
- ♦ The government has also expressed a possibility of a roll-back of the excise duty hike affected in the budget. If that happens, then the retail prices will come down to Rs210-215 per bag in line with the import prices.

Import parity price to drop below national average price...

After the customs duty was slashed to nil in January, the landed cost of imported cement stood at Rs245-255 per bag (now it will be cheaper on account of the rupee appreciation). At that time the national average price was hovering in the range of Rs205-210 per bag leaving ample scope for appreciation in the domestic prices.

However after the excise duty hike in the budget, the cement manufacturers passed on the hike to the consumers effectively taking the national average price to Rs220-225 per bag. Now with the CVD being cut, the cost of imported cement will come down by Rs40-45 per bag to Rs210-215 per bag, and would slip below the national average price.

Working of the costing of imported cement

Landed cost of imported cement	Pre-duty cut	Post-import duty cut	Post-CVD cut
CIF	75	75	75
USD	43	43	43
In Rs	3225	3225	3225
Clearing charges	125	125	125
C&F per tonne	3350	3350	3350
Customs duty @ 12.5%	418.75	0	0
CVD per tonne	408	408	0
Landed Cost per tonne	4176.75	3758.00	3350
VAT @ 12.5%	522.09	469.75	418.8
Secondary freight	500	500	500
Total	5198.84	4727.75	4268.75
Price per bag	259.94	236.39	213.44

Source : ShareKhan * exchange rate assumed in our previous report 1 USD= Rs45,CIF = USD80

...but no major impact in the near future

Theoretically the government has given a green signal to the cement consumers to go ahead and import cement for their consumption. But on speaking to the cement manufacturers and dealers, we understand that the infrastructure bottlenecks at the ports will make it difficult for cement to be imported on a large scale. Yes, we do agree that some large contractors will be able to import cement directly for their consumption (direct imports would be cheaper as the value-added tax [VAT] is not applicable), but to be imported regularly on a large scale, the ports would need handling equipments like silos for storing, packing units for bagging et al.

Also for importing cement, one would need a Bureau of Indian Standards (BIS) approval for quality, which would take at least three months to obtain. This coupled with the arrival of the monsoons in June will push the scope of importing cement to November. Thus in the near future we believe that this event will not have a significant impact on the industry.

Coastal-based players to be impacted if at all imports take place

Out of the five ports capable of handling bulk cement in India, cement imports seem feasible only from Mumbai and Chennai, as the domestic prices in these regions are high at Rs255 per bag and Rs225 per bag respectively. Thus even if cement imports do happen in the near future, the players having significant presence in the coastal areas (mainly Maharashtra and Tamil Nadu) will be the first to be affected. We do not foresee players in the hinterland to be affected due to the infrastructure bottlenecks in transporting cement.

Impact--more sentimental than practical

This has been one of the desperate measures taken by the government to discipline the cement manufacturers and in turn moderate the prices of cement. Going ahead if the excise duty is rolled back, then the cement prices would come down to the earlier levels of Rs210-215 per bag aligning it with the import parity price.

But as things stand currently, we do not expect this event to have any practical impact on the cement industry in the near future. Thus this move will only have a sentimental impact on the cement manufacturers and would not impact the earnings of these companies in the near future.

Evergreen

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 Infosys Technologies
 Reliance Industries
 Tata Consultancy Services

Apple Green

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 ACC
 Apollo Tyres
 Bajaj Auto
 Balrampur Chini Mills
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 Crompton Greaves
 Elder Pharmaceuticals
 Grasim Industries
 Hindustan Lever
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 ICI India
 India Cements
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 JM Financial
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 Selan Exploration Technology
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Vulture's Pick

Esab India
 Orient Paper and Industries
 WS Industries India

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