10 April 2007 │ 9 pages

India Equity Strategy

Mar-07 Quarter Results Preview

- **Last quarter of the year, lesser surprises** — Being the last quarter of the year for most of the market, Mar-07 quarter results should hold lesser surprises. The focus will clearly be on the year ahead, starting with guidance from IT services companies and a close watch on how companies view growth prospects in the face of higher interest rates, tighter liquidity and likely slower credit growth.

- **Sensex ex-oil profit growth expected at 26%** — While not high as the last couple of quarters, we expect ex-oil profit growth to still be strong at 26% for Sensex as well as Citigroup India Universe. FY07 is likely to end as the 5th consecutive year of 25-30% earnings growth in India. The quarter should also mark the end of this high-growth phase, as earnings growth in coming years is expected at around 15%.

- **Robust topline growth, steady margins** — Although top line growth will likely moderate from +30% seen in the last couple of quarters, it is steady expected to remain robust at 23-24%. EBITDA margins should be stable overall, albeit with wide variation across sectors. Impact of higher interest rates and tighter liquidity would be felt mainly in banks and autos.

- **Leaders & laggards** — Sectors to lead profit growth should be Cement, Hotels, IT Services, Pharma and Telecoms. Laggards should be Autos, Chemical, Oil & Gas, Power and Sugar sectors.

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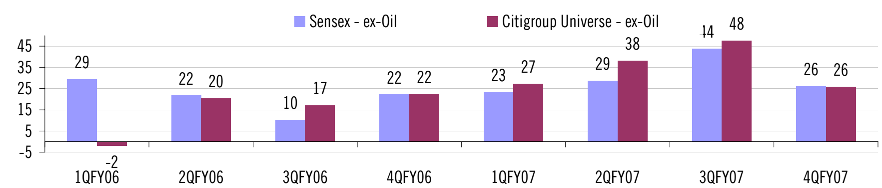
Figure 1. India Ex-oil Earnings Growth (Percent YoY)



Source: Citigroup Investment Research

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

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Mar-07 Quarter Results Preview

Being the last quarter of FY07, Mar-07 quarter results will likely carry lesser surprises and the focus will be clearly on the year ahead. Guidance by IT services companies will as usual set the tone. Key to watch will be whether higher interest rates and tightening liquidity have started to bite into growth.

For the Mar-07 quarter, we expect 26% profit growth for Sensex ex-oil as well as Citigroup ex oil universe. Though slower than the last couple of quarters, it should help FY07 to end as the 5th consecutive year of 25-30% earnings growth. It should also mark the end of such high earnings growth, as we expect overall earnings growth to moderate to around 15-16% over FY08 and FY09.

Sensex ex-oil profit growth expected at 26% yoy

Ex-oil profit growth for Mar-07 quarter is expected at 26% for the Sensex, and the Citigroup India Universe. Significantly higher subsidy losses for downstream oil majors implies that earnings growth would drop to 3.4% for the Citigroup Universe. However, Sensex including oil should see a higher numbers at 30%, primarily due to ONGC which is likely to see a 58% jump in earnings on a yoy basis.

We expect profit growth will be led by Cement, Hotels, IT Services, Pharma and Telecom sectors (40-80% growth expected in these sectors). Capital Goods, Consumer, Textiles and Metals likely to see steady growth. Key underperformers will likely be Autos, Chemicals, Oil & Gas, Power and Sugar sectors.

Figure 2. India Quarterly Profit Growth (Percent YoY)

	FY06 - Y/Y Growth				FY07E – Y/Y Growth			
Year to 31 March	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4QE**
Sensex	**32.2**	**21.9**	**10.5**	**9.1**	**23.5**	**22.1**	**38.4**	**30.4**
Sensex - ex-Oil	**29.4**	**21.8**	**10.3**	**22.2**	**23.3**	**28.7**	**43.8**	**26.0**
Citigroup Universe	**-8.8**	**15.0**	**1.4**	**36.1**	**19.9**	**47.3**	**56.7**	**3.4**
Citigroup Universe - ex-Oil	**-1.9**	**20.5**	**17.1**	**22.4**	**27.2**	**38.1**	**47.5**	**25.8**
Autos	29.4	29.4	26.1	25.9	43.5	27.6	23.2	4.6
Banks/Fin	1.5	13.3	24.2	17.4	-2.2	15.7	20.8	15.2
Brokerages	436.2	398.7	232.9	174.8	85.9	38.7	36.0	30.2
Capital Goods	-89.3	37.1	53.0	44.0	59.0	38.1	62.3	24.9
Cement	9.8	7.2	-4.2	46.3	80.1	93.0	197.6	73.8
Consumer/FMCG	21.0	18.1	22.7	17.0	18.5	31.0	14.4	22.6
Hotels	NA	NA	19.7	55.3	63.2	67.8	74.0	52.5
IT Services	18.8	24.1	24.7	45.6	46.2	47.5	40.7	39.9
Media	6.3	-38.5	-77.6	-30.7	-27.8	-21.6	459.6	17.0
Metals	32.5	14.9	-2.3	11.4	13.4	72.7	104.8	22.7
Oil & Gas	-32.6	1.5	-39.4	74.1	-17.1	74.4	102.9	-39.9
Petrochem/chemicals	70.4	51.6	-10.6	-14.6	13.3	9.9	58.0	8.4
Pharma	11.6	-16.3	8.9	55.7	42.6	95.7	78.2	65.2
Power	24.7	11.5	11.4	17.9	18.0	18.2	21.1	9.3
Sugar	318.9	68.3	15.9	85.3	39.1	118.4	-43.1	-75.2
Telecom	22.4	27.2	34.7	43.2	218.4	171.8	138.0	81.4
Textiles	290.5	59.5	54.9	10.6	-5.9	62.0	16.5	17.4

Source: Citigroup Investment Research

Top line growth should moderate from +30% in the last two quarters, but stay robust at around 23% for the Sensex, and 24% for the Citigroup universe. Given that overall trend, acceleration in topline growth will be hard to come by, notable exceptions being Banks / Financials, Capital goods, IT Services, Sugar and Telecom. Sharpest deceleration in topline growth will likely be seen in Autos, Hotels and Petrochemicals.

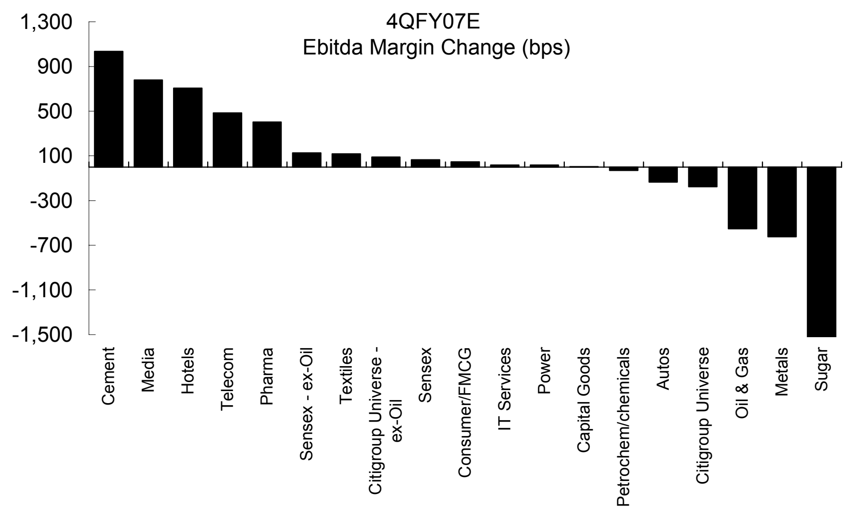
Figure 3. India Quarterly Sales Growth by Sector (Percent YoY)

	FY06 Y/Y growth				FY07E Y/Y growth			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE
Sensex	**19.4**	**18.9**	**12.7**	**21.1**	**31.7**	**29.2**	**33.6**	**22.4**
Sensex - ex-Oil	**21.6**	**20.9**	**14.2**	**24.6**	**31.3**	**32.1**	**35.0**	**22.5**
Citigroup Universe	**15.6**	**20.2**	**19.5**	**26.4**	**30.8**	**36.0**	**28.2**	**17.1**
Citigroup Universe - ex-Oil	**21.7**	**25.5**	**21.7**	**26.3**	**29.6**	**32.5**	**32.9**	**22.3**
Autos	14.4	19.1	15.8	26.2	37.9	31.6	25.4	12.0
Banks/Fin	27.8	15.9	16.5	8.3	14.0	26.2	26.6	27.9
Brokerages	527.5	304.0	194.8	144.6	102.6	56.7	74.0	106.4
Capital Goods	-12.3	27.2	35.7	20.7	27.3	26.9	23.8	30.3
Cement	13.9	9.0	11.4	18.8	23.5	25.4	43.8	32.0
Consumer/FMCG	16.5	18.9	20.1	12.2	19.5	22.9	23.6	16.8
Hotels	NA	NA	19.3	10.8	27.2	23.8	25.7	37.1
IT Services	40.1	37.5	41.2	44.0	40.4	42.8	35.5	39.6
Media	8.2	-3.5	11.4	2.3	11.9	38.1	10.6	12.6
Metals	11.7	12.8	13.5	25.2	47.4	57.0	61.3	36.2
Oil & Gas	9.2	14.5	17.0	26.6	32.2	40.1	23.0	10.8
Petrochem/chemicals	25.9	29.9	4.0	30.1	35.3	34.3	43.0	3.7
Pharma	23.2	13.4	22.5	31.3	24.8	45.9	36.1	31.8
Power	11.6	15.1	19.2	11.2	18.1	15.6	18.7	18.6
Sugar	132.4	48.6	48.7	134.5	46.3	62.4	8.7	16.8
Telecom	20.9	22.6	25.4	22.6	28.6	30.9	41.3	45.1
Textiles	15.6	15.8	21.0	8.1	12.4	16.1	15.5	14.3

Source: Citigroup Investment Research

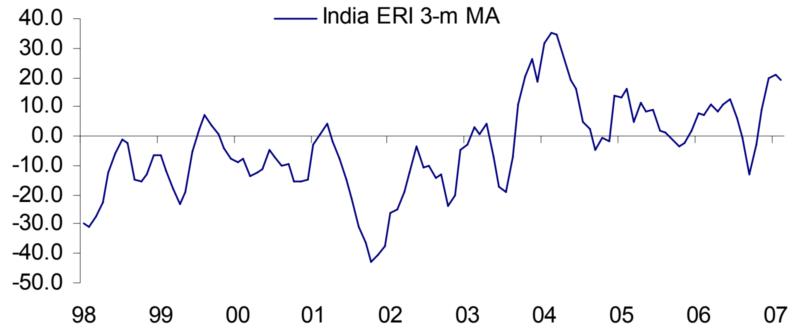
Overall margins are expected to be flat. Largest margin improvements are likely in Cement, Media, Hotels, Telecom and Pharma sectors. Sectors likely to see significant margin erosion are Sugar, Metals and Oil & Gas.

Figure 4. Forecast 4QFY07E EBITDA Margin Changes (bps)



Source: Citigroup Investment Research

Figure 5. India 3-month Earnings Revision Index



Source: IBES, Citigroup Investment Research. Note: Earnings Revisions Index = (Number of companies with earnings being revised up - Number of companies being revised down)/Total number of companies being revised.

Sectoral Comments

Autos — Over the quarter, margins expected to compress 200-400bps on a yoy basis across passenger cars and 2-wheelers, due to a combination of a stiff base effect, as also rising input cost pressures. Overall volume trends have been divergent – 2-wheeler sales for the quarter have been a sedate 6% (compounding margin pressures), whilst for 4-wheelers, sales growth has been more robust – CV sales are up 22% yoy (Ashok Leyland (ASOK.BO - Rs36.25; 3L), Tata Motors (TAMO.BO - Rs698.00; 1L), whilst car majors like Maruti (MRTI.BO - Rs783.25; 1L) have reported 27% y/y growth in domestic volumes.

Banks — Earnings growth likely to be in line with expectations at 15%. Margins should hold contrary to some market expectations. Downside risks are provisioning requirements for private banks for loans, and mark-to-market losses on bonds and corporate debt portfolios with rising interest rates. No definite trends expected in asset quality.

Capital Goods — Earnings growth expected at 25%. Construction sector might see decline in earnings on account of tax payments for the entire year at one go. L&T (LART.BO - Rs1,573.50; 2L) should see healthy sales growth but margin compression. Earnings are expected to be steady for the power sector reflecting growth in generation capacities.

Cement — Expect relatively flat or lower volumes. Prices up ~30% across the sector, hence margins should improve significantly. Grasim's (GRAS.BO - Rs2,156.00; 1L) VSF margins are expected to be lower due to lower volumes, and higher pulp prices, and cement margins higher on the back of increased prices.

Consumer — Expect profit growth to look up, on the back of strong top-line growth and margin expansion driven by softening in raw materials prices. Our top picks are HLL (HLL.BO - Rs203.75; 1L) and United Spirits (UNSP.BO - Rs813.00; 1L). Likely laggard — ITC (ITC.BO - Rs153.00; 3L).

Hotels — Expect strong profitability to continue - sales growth at 37% and earnings growth at 52% driven by rise in average room rates, and higher occupancy rates across metro markets and tourist destinations. Our top picks are Indian Hotels (IHTL.BO - Rs145.00; 1L), and EIH (EIHO.BO - Rs95.50; 1L).

IT Services — Expect 4QFY07 to be a solid quarter, although currency appreciation should impact reported numbers. Expect 7.5% qoq revenue growth (US$-terms) and 6.7% qoq profit growth for our coverage universe. Revenue growth should be driven by volumes with a marginal uptick in pricing. Q4 historically not a great quarter for hiring – volume growth driven by improved utilization. Currency impact on reported profits should be significant, with the rupee appreciating 1.8% against the $ both on an average as well as period-end basis. TCS (TCS.BO - Rs1,217.00; 1L), HCL Tech (HCLT.BO - Rs291.10; 1M) appear best hedged against currency movements. We reiterate our view that Tier-I players are best placed in the present environment. TCS and Infosys (INFY.BO - Rs2,037.00; 1L) remain our top picks in the large-cap segment while Hexaware (HEXT.BO - Rs169.10; 1M) and KPIT (KPIT.BO - Rs132.80; 1M) look best placed in the mid-tier space.

Metals — Aluminium pricing should be better on the back of a supply side crunch due to smelter constraints and the entry of hedge funds. Alumina prices higher on a sequential basis but lower YoY. Relatively flat margins overall, with Copper margins likely to decline due to expected TC/RC decline. Steel expected to do better than non-ferrous metals on the back of higher volumes, and better pricing.

Oil & Gas / Chemicals — Gross under-recoveries were higher compared to the previous quarter. Besides, the oil marketing companies would receive oil-bonds on a quarterly basis, rather than a full-year basis like last year. So while oil bonds issued were flat on a qoq basis at about Rs50bn, they are significantly lower than the one-time tranche issued last year of 140bn. Sales growth of ~10% is basically due to higher prices but expected to have little impact on margins. Singapore refining margins are up by US$3, which would help Reliance Industries' (RELI.BO - Rs1,383.80; 2L) earnings. Our top picks — ONGC (ONGC.BO - Rs862.80; 1M), GSPL (GSPT.BO - Rs49.75; 1M) and ABAN (ABAN.BO - Rs2,240.00; 1H). We see laggards being — HPCL (HPCL.BO - Rs256.00; 3M), BPCL (BPCL.BO - Rs312.00; 3M), and IOC (IOC.BO - Rs393.75; 3M).

Pharma — Sector is expected to witness robust revenue growth of 31% YoY driven primarily by the Indian, Russian, and EU markets, as wells as inorganic initiatives by some of the leading companies. The consequent operating leverage along with improving product/geographical mix should lead to continued improvement in EBITDA margins (up 400 bps), and profits will likely be up 65% YoY. Our top pick is Nicholas Piramal (NICH.BO - Rs251.00; 1M). Likely laggard — Cipla (CIPL.BO - Rs235.10; 3L).

Telecom — Subscriber addition momentum has continued to accelerate during the quarter. We expect stable ARPUs and moderate EBITDA margin gains would continue to drive strong earnings growth ~80%. Bharti's net-add should be more stable than its peers. Our top pick — Bharti (BRTI.BO - Rs760.55; 1L). Likely laggard — MTNL (MTNL.BO - Rs153.90; 3L).

Textiles — Results expected to be a mixed bag, due to continued pressure on domestic business, and pressure on yarn prices (down by 4–5%). Players on the garmenting side, branded apparel and home textiles are likely to benefit. Our top picks are Raymond (RYMD.BO - Rs332.05; 1L) and Gokaldas (GOKL.BO - Rs229.00; 1M). Likely laggard — Arvind (ARMI.BO - Rs43.90; 2M).

Appendix A-1

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