

Indices

	Last close	% Chg	% YTD
Sensex	12,366	(0.7)	31.6
Nifty	3,570	(0.5)	25.8
CNX Midcap	4,693	0.0	16.4
Nasdaq	2,244	0.3	1.7
DJIA	11,727	0.5	9.4

Volumes

	US\$m	% Chg
BSE	634	(16.0)
NSE	1,311	(15.7)
Derivatives (NSE)	4,378	6.9

ADR/GDR (US\$)

	Latest	% Chg	% Prem
Dr Reddy's Lab	15.5	(0.3)	(2.6)
HDFC Bank	60.1	(1.3)	(0.6)
ICICI Bank	30.4	0.8	(0.3)
ITC	4.0	0.8	(2.0)
Infosys	47.7	0.5	19.9
Satyam	39.2	0.9	8.8
Ranbaxy	9.3	(0.3)	(1.1)
Reliance	50.5	(1.9)	(0.6)
Wipro	13.2	0.4	16.3
SBI	55.7	1.6	23.2
Tata Motors	18.9	1.8	(0.6)

Net Inflows/Outflows (US\$m)

	3-Oct	MTD	YTD
FII's	277.9	306	5,248
Dom MF's	26.5	(19)	3,069

Currencies

	Closing	Chg
Rs/US\$	45.70	(0.54)
US\$/EUR	1.27	(0.0)

Bond Markets

	Closing	Chg
10 yr bond	7.62	(0.03)
Interbank call	6.55	(0.83)

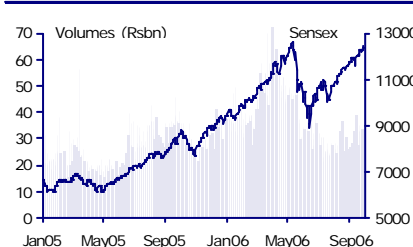
Commodities

	Latest	% Chg	% Chg 1 m
Brent (US\$/bbl)	57.1	(1.1)	(15.2)
Gold (US\$/oz)	578	3.3	(7.8)
Cu (US\$/MT)	7,391	(2.8)	(2.6)
Steel (US\$/MT)	600	-	(3.2)

FII activity in derivatives 03-Oct

	Index	Stocks
Net buying	(59.7)	(18.0)
Open interest	2,137.9	2,466.0
Chg in open int. (DoD)	65.3	26.7

Sensex



What's inside

Tech Results Preview

News headlines: Corporate

- **Indian Hotels (IHCL)**, which runs hotels and resorts under the Taj brand, is buying the Boston-based Ritz-Carlton hotel for US\$170m (ET)
- **The Tata group** would invest up to Rs4bn as equity in Infiniti Retail, Tata's new retail venture for consumer and electronic goods. The group has tied up with Australia's largest retailer, Woolworths (ET)
- **Pantaloen Retail** is entering travel retail and food and beverage catering businesses at leading airports in a 50:50 JV with Alpha Airports Group (BS)
- **Carrefour** is in talks with Dubai's Landmark group for opening up to 200 stores in India (BS)
- **Wockhardt** has acquired Pinewood Laboratories, one of the largest and fastest growing branded generic pharmaceutical companies in Ireland in an all-cash deal worth US\$150m (ET)
- **GHCL** is in negotiations to take over a large US-based retailer of home textiles, which could translate into a deal size of c.US\$200m (ET)
- **Fortis Healthcare Ltd** has filed the draft prospectus for raising funds through an IPO (BS)
- **Cipla** is in talks with the developers of Goa's first pharma SEZ to acquire 80 acres of land for setting up its largest formulation plant (BS)

News headlines: Economic and Political

- Two-wheeler sales rose 26% YoY in September '06. Bajaj Auto reported a 50% increase in sales with 35% increase in domestic market (ET)
- Domestic ATF prices could come down sharply as the government is likely to provide infrastructure to private companies to sell it in domestic

Turnover highlights

	Price (Rs)	Chg (%)	Vol (\$m)	YTD chg (%)
NTPC	133	2.3	7.2	18.8
IOC	530	1.2	3.0	(4.9)
Bajaj Auto	3,031	1.1	28.7	51.5
Tata Motors	870	0.9	36.6	33.2
SBI	1,033	0.5	30.9	13.9
Satyam	822	0.4	55.7	11.4
Hindalco	172	0.4	14.8	19.9
SAIL	78	0.3	25.3	44.8
ITC	188	0.2	15.9	32.4
Grasim	2,520	0.0	115	81.2
Sun Pharma	930	0.0	3.1	36.4
Tata Steel	535	(0.2)	38.3	40.5
Gail	262	(0.3)	3.0	(1.3)
Hero Honda	772	(0.4)	8.8	(10.2)
ICICI Bank	696	(0.4)	14.7	19.1
Bharti	466	(0.5)	3.7	34.9
HDFC Bank	921	(0.6)	5.3	30.2
Dr.Reddy's	727	(0.6)	9.7	48.6
TCS	1,015	(0.7)	116	19.2
Reliance	1,161	(0.8)	39.8	69.7
Zee	303	(0.9)	16.0	93.0
ONGC	1,159	(1.0)	31.6	(1.4)
BHEL	2,369	(1.0)	21.1	70.9
Wipro	520	(1.0)	5.6	12.1
Maruti	968	(1.3)	29.1	52.1
L&T	1,252	(1.6)	20.2	35.8
Infosys	1,818	(1.6)	56.1	21.3
Ranbaxy	428	(2.6)	9.3	18.2
HLL	249	(2.7)	22.9	26.4
HDFC	1,477.3	(3.7)	27.8	22.6

BSE 200 Movers and Shakers

	Price (Rs)	Chg (%)	YTD chg (%)
Top Gainers			
Sesa Goa	1,061	9.1	4.8
Dredging Corp.	599	5.6	0.8
Lupin Ltd	482	4.5	25.8
Asahi India	120	4.3	32.7
Monsanto	1710	4.1	(10.9)
J&K Bank	467	4.1	(3.9)
Neyveli Lignite	67	4.1	(15.5)
Hexaware	168	4.0	28.3
Mphasis BFL	192	3.4	28.6
Jindal Stainless	112	3.1	14.8
Polaris Software	121	2.9	(8.2)
Volta India	224	2.5	9.8
LIC Housing	173	2.4	(12.3)
Escorts	129	2.4	76.6
Top Losers			
Glenmark	301	(4.0)	(4.1)
HDFC	1,477	(3.7)	22.6
Finolex Ind.	93	(3.6)	188
Kotak Mahindra	320	(3.6)	43.0
Hinduja TMT	531	(2.8)	45.6
Pfizer Ltd	901	(2.8)	(11.0)
HLL	249	(2.7)	26.4
Ranbaxy	428	(2.6)	18.2
Cipla	256	(2.5)	44.1
Amtek Auto	323	(2.5)	8.5
Crompton Greaves	240	(2.5)	55.6
Volta	101	(2.4)	68.5
Bombay Dyeing	737	(2.3)	97.7
Sterling Biotech	142	(2.3)	15.9

airports (ET)

- ❑ THE Maharashtra Electricity Regulatory Commission has increased electricity tariffs in the Reliance Energy licence area by an average 7.5%. (ET)

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Note: In the interests of timeliness, this document has not been edited.

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19/07/2006

2QFY07 Results Preview

Focus on margins

Strong volume growth expected, aided further by currency

Wide variations in margin movements

Infosys and Wipro our only preferred bets

Margin expectations

TCS +167bps
 Infosys +175bps
 Patni +138bps

 Satyam -156bps
 Wipro -134bps

- The Sep quarter is seasonally the strongest for Indian techs, and we expect our coverage universe to show 9%QQ/39.7%YY revenue growth in 2Q.
 - Currency continues to be a favourable tailwind. The Rupee, on a quarter average basis, has depreciated 2%QQ against the US\$, 3.5% against €, and 4.7% against the £. On an end-of period basis, Rupee has been flattish against the US\$, down 1% against £ and up 1.2% against €.
- Focus shifts to margin management as 1Q's margin collapse needs to be reversed by several vendors while others are entering wage hike season.
 - TCS and Infosys both expected to show 160-175bps QQ margin expansion. 2Q start crucial for TCS given management's guidance of flat YY margins for FY07. Infosys could gain 100bps from visa costs alone.
 - Satyam and Wipro likely to show declines as wage hikes kick in.
- We expect Infosys to report a strong quarter on topline & margins while Wipro is expected to guide for an improved 2H performance. Both remain our preferred bets within Indian techs for market relative outperformance. All other stocks rated Underperform currently.

Figure 1

Jul-Sep 2006 result expectations

	Revenues			Ebitda %			Pre-exceptional net		
	Rs m	%QoQ	%YoY	%	bpsQoQ	bpsYoY	Rs m	%QoQ	%YoY
Aztec	663	11.5	38.1	22.5	167	(56)	117	25.9	29.6
Mphasis	2,878	10.4	26.5	16.0	393	(578)	304	100.8	(24.2)
HCL Technologies	13,539	8.0	39.5	22.2	(30)	(8)	2,557	9.7	52.7
Hexaware	2,276	10.0	29.6	16.5	148	(50)	342	14.8	42.0
Hexaware guidance ¹	\$48m or Rs2,225m						\$7.2m or Rs333m		
I-GATE	1,998	10.0	28.3	9.0	190	(58)	58	454.8	3.6
Infosys	33,687	11.7	46.8	31.2	175	(76)	8,619	8.1	46.8
Infosys guidance ²	Rs32,570-32,800m						EPS Rs29.78 or Rs8,231m		
I-flex Solutions	4,409	8.2	22.7	22.8	1,158	749	717	72.9	77.5
Infotech Enterprises	1,252	7.0	52.0	18.7	(5)	(76)	184	(6.9)	69.1
Mastek	2,004	6.0	33.0	16.0	(55)	(158)	215	4.7	43.5
Patni Comp	6,987	7.5	35.2	16.5	138	(190)	878	15.7	23.8
Patni guidance ³	4.5-5.0%QQ \$ growth						\$18.2m or Rs844m		
Polaris	2,553	10.0	19.5	16.5	99	335	244	20.5	74.5
Satyam	15,694	8.8	35.9	23.0	(156)	(89)	3,068	(13.4)	29.3
Satyam guidance ⁴	Rs15,210-15,290m						EPS Rs8.87 or Rs2,890m		
TCS	44,647	7.7	41.4	25.8	167	(188)	9,116	5.7	30.7
Wipro Global IT	26,668	8.8	40.7	26.5	(134)	(147)	5,667	4.6	36.2
Wipro guidance ⁵	US\$577m								
Wipro (full co.)	34,268	nm	36.7	23.3	nm	(59)	6,486	nm	35.7
Universe	159,253	9.0	39.7	25.1	98	(80)	32,088	6.2	37.4
Top-6 vendors	141,222	9.0	41.4	26.1	60	(117)	29,906	4.4	37.4
HCL Infosystems	30,239	nm	32.7	3.1	nm	(26)	741	Nm	19.5

Source: CLSA Asia-Pacific Markets **Notes:** (1) Hexaware guidance in US\$ converted to INR at Rs46.37/\$ (average for the quarter), (2) Infosys guidance in INR at Rs45.87/\$, (3) Patni guidance at Rs45.48/\$ currency rate, (4) Satyam guidance assumes Rs45.84/\$, (5) Wipro's hedges for 2Q between Rs44.90-46.00 so unlikely to gain materially from quarter average of Rs46.37

Figure 2

Result dates

Mphasis*	3 rd week	Mastek	11 th Oct	Polaris*	17/18/19 th Oct
Infosys	11 th Oct	Hexaware*	17/18/19 th Oct	Moser Baer*	Last week
TCS	16 th Oct	Patni Comp*	27 th Oct	HCL Info	18 th Oct
Wipro	18 th Oct	I-GATE*	3 rd week	Aztec	12 th Oct
Satyam	20 th Oct	I-Flex	20 th Oct	Educomp*	Last week
Infotech Ent.	18 th Oct	HCL Tech	16 th Oct		

Note: Those marked with "*" represent tentative dates.

Margins need to reverse strongly to keep pace with FY07 expectations

Currency remains favorable for 2Q

Expect Infosys, Wipro and Patni to deliver on margins

TCS' margin move will be directionally up but will get compared against management's full year guidance requirement

Focus on margins

With the Sep quarter usually strong in volume terms, the focus on tech results this month will be on operating margins. Margin movements have been a negative surprise in the industry for two quarters now. Our coverage universe saw a 194bpsQQ margin erosion at Ebitda level in the June quarter, despite (1) strong favourable movement from currency (Rupee depreciated across the board in June quarter), (2) not all vendors underwent wage hikes last quarter (Wipro, HCLT, Satyam are entering wage hike season only from Sep quarter).

Looking at 2Q dynamics, the first thing that is apparent is that currency continues to remain favourable, at least on an average basis. The Rupee weakened on an average basis against all major currencies – US\$, € and £. Relatively mixed end-of-period moves may, however, remove the big translation gains that ensued in 1Q from end of period re-statements of net monetary assets. At revenue and Ebitda level, currency will remain a major tailwind.

Figure 3

% moves in currency – INR versus €, £, Yen and US\$				
Average %	Re/€	Re/£	Re/100 yen	Re/\$
June quarter	6.9	6.7	4.5	2.3
Sep quarter	3.5	4.7	0.5	2.0
End of period %	Re/€	Re/£	Re/100 yen	Re/\$
June quarter	8.9	9.8	6.2	3.2
Sep quarter	(1.2)	1.0	(3.4)	(0.2)

Source: Bloomberg data

On a vendor level, margins will however be a function of several other factors, some of which are summarized below. Overall, we expect margins to decide the relative movement of stocks in the month ahead. Our confidence on margins is relatively higher for **Infosys** (visa costs alone provide more than half the predicted upside), **Wipro** (scale of pay hikes is as yet selective and Dec quarter will see more of the wage impact), and **Patni** (again, visa costs go away in the quarter).

At **TCS**, expectation of +200bpsQQ move in each of 2Q-3Q-4Q are up for a test, especially given management's assertion of its YY flat margin guidance for FY07 all through last 3 months. A start as close to +200bps will be positive though we expect the range of margin expansion to be in the 150-170bps range.

Figure 4

Margin dynamics

	Headwinds	Tailwinds
TCS +167bps	<ul style="list-style-type: none"> <input type="checkbox"/> Promotion related impact of 40-60bps <input type="checkbox"/> Pending wage re-alignments (selective) – about Rs150m impact from here <input type="checkbox"/> Offshore shift may temporarily stall in 2Q 	<ul style="list-style-type: none"> <input type="checkbox"/> Slight improvement in utilization <input type="checkbox"/> Lower loss in Diligenta (Pearl BPO) <input type="checkbox"/> Reduced use of shadow resources in large deals
Infosys +175bps	<ul style="list-style-type: none"> <input type="checkbox"/> Lower utilization as 2Q sees strongest recruitment 	<ul style="list-style-type: none"> <input type="checkbox"/> Visa costs expected to fall from \$11m in 1Q to \$3m in 2Q <input type="checkbox"/> Fresher hiring <input type="checkbox"/> Better performance from subsidiaries – net margins of subs fell to 0.7% in 1Q c.f. 7% in Mar06 quarter
Wipro -134bps	<ul style="list-style-type: none"> <input type="checkbox"/> Wage hikes for younger manpower kick in from 1st Sep <input type="checkbox"/> Margin impact from integration of acquisitions – Saraware, Quantech and Enabler 	<ul style="list-style-type: none"> <input type="checkbox"/> More license revenue in New Logic? <input type="checkbox"/> Higher utilization <input type="checkbox"/> Offshore shift <input type="checkbox"/> Better BPO margins
Satyam -156bps	<ul style="list-style-type: none"> <input type="checkbox"/> Wage hikes kick in for both onsite and offshore <input type="checkbox"/> Slightly lower utilization post strong hiring season 	<ul style="list-style-type: none"> <input type="checkbox"/> Improving profitability of Nipuna and other subs <input type="checkbox"/> Offshore shift <input type="checkbox"/> Fresher hiring <input type="checkbox"/> Slightly better average realization (management comments)
HCLT -30bps	<ul style="list-style-type: none"> <input type="checkbox"/> Partial wage hikes (others from 1st October or on completion of 1 year) 	<ul style="list-style-type: none"> <input type="checkbox"/> Continued profitability expansion in Comnet business as export share rises <input type="checkbox"/> Better margins in ERP segment of IT services business
Patni +138bps	<ul style="list-style-type: none"> <input type="checkbox"/> Utilization amidst hiring, overhead costs 	<ul style="list-style-type: none"> <input type="checkbox"/> Reduced visa costs (80-100bps from here alone?)

Source: CLSA Asia-Pacific Markets

Net margins for Infosys subs fell to 0.7% in 1QFY07 from 7% in 4QFY06

Fig.5 shows profitability trends for Infosys' subsidiaries. Net margins for the four subsidiaries fell sharply in the Jun06 quarter, to 0.7% c.f. 7.0% in the Mar06 quarter. We think Infosys has substantial margin levers simply from a mean reversion of profit margins in subsidiaries to the FY06 range of ~7%.

Figure 5

Infosys has substantial margin leverage in subsidiary accounts

Revenues, \$m	Q1 05	Q2 05	Q3 05	Q4 05	FY 05	Q1 06	Q2 06	Q3 06	Q4 06	FY 06	Q1 07
Progeon	7.2	9.1	12.0	14.6	42.9	18.0	20.6	22.5	24.4	85.6	28.4
Infy Australia	16.1	17.2	17.6	16.6	67.6	18.7	19.3	17.2	17.6	72.7	18.4
Infy Consulting	0.0	0.3	1.7	2.8	4.8	5.5	8.9	8.3	9.6	32.3	10.2
Infy China	0.0	0.0	0.6	1.2	1.9	0.8	1.3	2.0	1.8	5.9	2.1
TOTAL	23.3	26.7	31.9	35.2	117.1	43.1	50.0	50.0	53.4	196.5	59.1
Net profits, \$m											
Progeon	(0.9)	1.1	2.8	3.7	6.6	4.4	5.3	5.5	5.9	21.1	6.0
Infy Australia	0.4	0.8	0.3	(1.8)	(0.4)	0.2	1.1	1.4	1.5	4.2	0.8
Infy Consulting	(0.8)	(3.0)	(1.9)	(1.7)	(7.3)	(2.1)	(1.2)	(2.7)	(2.2)	(8.2)	(4.1)
Infy China	(0.2)	(0.5)	(0.8)	(0.3)	(1.9)	(0.6)	(0.7)	(1.0)	(1.5)	(3.7)	(2.3)
TOTAL	(1.5)	(1.6)	0.3	(0.1)	(2.9)	1.9	4.5	3.1	3.7	13.3	0.4
Net margins, %	-6.6%	-6.0%	1.0%	-0.3%	-2.5%	4.4%	9.0%	6.3%	7.0%	6.8%	0.7%

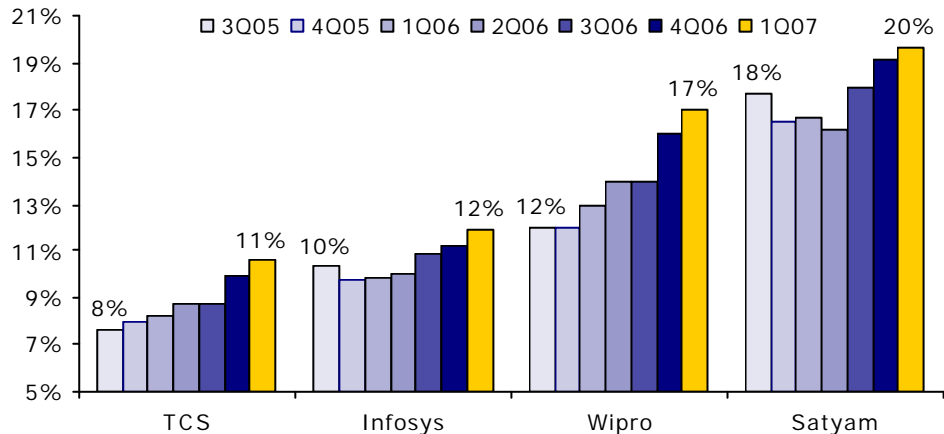
Source: CLSA Asia-Pacific Markets

Manpower attrition is the other operational data point. Attrition numbers have been inching for almost all vendors for several quarters now and some decline is due post wage hikes (employees defer resignations for a while?) and seasonally as well. Among the vendors, Satyam has already guided for a QoQ decline in attrition numbers.

Satyam has guided for lower QQ attrition in 2Q

Figure 6

Some respite expected in manpower attrition, seasonally and post wage hikes



Source: CLSA Asia-Pacific Markets

Fig. 7 shows effective dates of wage hikes. The wide variation in effective dates is causing substantial difference in margin movements on a QQ basis.

Figure 7

Wage hike dates for key vendors

	Offshore wage hikes	Onsite wage hikes	Promotion dates, wherever known	Other issues
TCS	1 st April	1 st July	1 st July	
Infosys	1 st April	1 st April		
Wipro	1 st Sep for younger manpower; 1 st Oct/1 st Nov for others	1 st Jan		RSU grants in Sep06 quarter
Satyam	1 st July	1 st July		RSU grants in Dec06 quarter
HCL Tech	1 st July mostly 1 st Oct. for some	1 st July mostly 1 st Oct. for some	1 st July mostly	
Patni	1 st April	1 st April		

Source: CLSA Asia-Pacific Markets

Wage hikes begin for Satyam, HCLT and Wipro

Figure 8

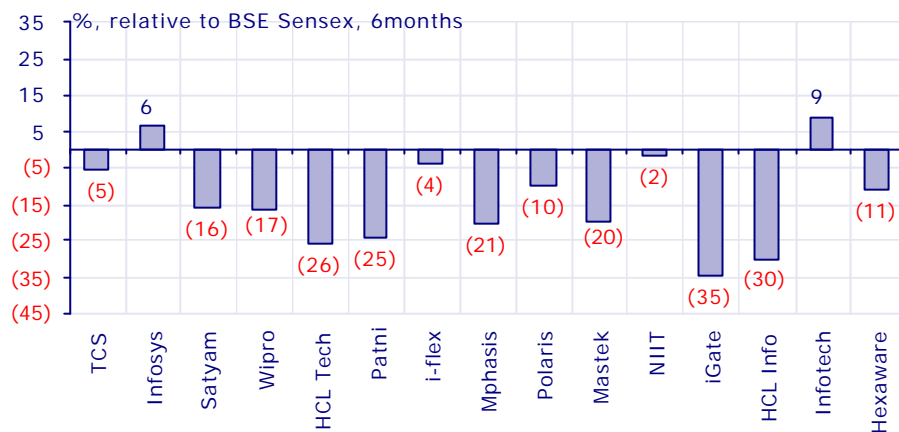
Tech Valuations - Summary

	Price (Rs)	Mcap (\$m)	FY07CL Pex	FY08CL Pex	FY06-08 Cagr %	EV/ Ebitda FY07	M Cap/ rev FY07	PEG	Div Y, FY07,%	P/BV, FY06
TCS	1,015	21,676	25.4	21.3	26.3	19.9	5.4	1.0	1.2	17.0
Infosys	1,818	22,028	27.9	22.7	34.9	21.7	7.3	0.8	1.4	14.4
Wipro	520	16,260	27.2	22.1	27.8	20.7	5.2	1.0	1.3	11.2
Satyam	822	5,873	20.2	17.4	26.0	15.4	4.2	0.8	1.0	6.2
HCL Tech	553	3,912	18.9	15.7	25.3	13.6	3.3	0.7	2.9	5.5
I-flex	1,433	2,395	32.0	26.1	38.6	20.9	5.5	0.8	0.6	8.1
Patni	386	1,162	15.1	11.8	27.0	9.5	1.9	0.6	0.5	2.9
Mphasis BFL	192	675	17.8	14.9	15.1	11.6	2.6	1.2	1.6	4.8
Hexaware	168	484	17.1	12.9	35.5	11.6	2.4	0.5	1.3	4.7
Mastek	346	213	11.5	9.8	23.6	5.7	1.2	0.5	2.1	3.7
Polaris	121	259	11.8	10.0	54.9	6.0	1.1	0.2	1.7	2.2
Infotech	210	211	12.8	10.7	33.4	8.7	1.9	0.4	1.2	4.5
i-GATE	182	124	18.2	6.9	121.4	4.7	0.7	0.2	3.3	1.8
Aztec	129	124	11.5	9.2	30.9	7.8	2.0	0.4	0.5	3.6
HCL Info	144	531	7.9	7.1	12.9	4.1	0.2	0.6	5.5	3.4
Educomp	714	249	45.4	28.0	70.6	25.1	11.4	0.6	-	11.1

Source: CLSA Asia-Pacific Markets

Figure 9

Techs relative to BSE Sensex – 6 month performance



Source: CLSA Asia-Pacific Markets

Figure 10

Performance over varying periods of time

% Relative to Sensex	YTD	1m	3m	6m	12m
TCS	(12.3)	(3.3)	(3.7)	(5.3)	(7.5)
Infosys	(10.1)	(4.5)	(1.1)	6.2	(0.7)
Satyam	(20.0)	(2.1)	(2.1)	(16.3)	(0.0)
Wipro	(19.3)	(4.4)	(12.8)	(16.7)	(6.5)
HCL Tech	(28.8)	(9.3)	(7.6)	(26.0)	(25.4)
Patni	(53.6)	(0.1)	(1.2)	(24.5)	(61.9)
i-flex	1.9	(4.3)	12.5	(3.7)	2.0

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: BUY = Expected total return greater than 10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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Note: In the interests of timeliness, this document has not been edited.

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