PPFAS

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BEYOND
BOTTOM FISHING

6th November 2008

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Preamble

The synchronous carnage in the financial markets the world over is reflective of not just the extent of globalization that we have achieved, but also the price we pay for having the US currency as a standard benchmark for world trade. While the global & local regulators have done well with their rescue efforts in averting a Japan-like depression, things do not change automatically for the good. We perceive that every bear market, while the extent of fall gets steeper, the timeline is also reducing. There is so much of Instant Gratification in everything. You have one of the biggest & the most wide-spread slow-down and it would be surprising if the revival happens anytime soon. Infact, the money pumped in by the governments may go towards adding to the surpluses. Many bottom fishers have gone active on even cyclicals, justifying bottomed out valuations and more importantly the case that the markets move ahead of the business cycles. But how much ahead, when most of these companies (like real estate, cement, steel, etc.) are still to report a meaningful drop in the earnings as the cycle turns. Clearly the easy come – easy go(instant gratification) syndrome is visible not just in the sharp price movements, but also in the timeline.

One wonders if research makes any sense, more particularly after such an extent of damage. You have companies who have seen their market capitalization erode to levels even, below the cash on the books or their annual earnings. Still investors in these scrips loose money by every passing day. Just as a friend from another broking firm says, 'from these levels, anything & everything will go up in the longer run. Research is futile. Just track the liquidity movement.' We beg to dissent. Afterall, choice is empowering.

To give some idea of what we have to say in this report..

- Why investment in select FMCG at higher multiples makes sense over many cheap alternatives (cigar butts) and more so after the markets have already been battered down, & the sector has played its part well, as a defensive bet?
- Why a number of sectors with seemingly high growth prospects and cheap valuations are Big AVOIDs ? Plus the behavioral biases attached to these BlackJacks.
- Options to play on the theme of Business Cycles & Sector Rotations including some positive bias businesses with a policy/political acceleration
- Our perspectives on the IT & Banking sectors in the post turmoil scenario
- Impressions on the Blue Oceans forming up in Telecom space

Plus we have included some useful screeners, which may help into filter, select and abstain from some more propositions.

We have tried to bring in some different perspectives to both investing & industries. Something, more than Just Bottom Fishing ! Trust you find this useful & worth of your time.

Sector Surmises

Buffett Meal

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FMCG Sector

Munger's Three Great Lessons of Investing.

1. "A great business at a fair price is superior to a fair business at a great price."
2. "A great business at a fair price is superior to a fair business at a great price."
3. "A great business at a fair price is superior to a fair business at a great price."

We know that FMCG & Pharma make the best defensive investments and is aptly reflected in the share price performance in the current downfall.

Index	Jan 08	Oct 08	Change	% Chg
Auto	5204.73	3099.38	-2105.35	-40.45
Bankex	11557.13	5578.15	-5978.98	-51.73
BSE Realty Index	12093.27	2545.64	-9547.63	-78.95
Capital Goods	18474.53	7975.5	-10499.03	-56.83
Consumer Durables	5933.77	2266.13	-3667.64	-61.81
FMCG Sector	**2294.65**	**1922.07**	**-372.58**	**-16.24**
Healthcare Sector	4005.76	3195.16	-810.6	-20.24
Metal	17553.09	6230.34	-11322.75	-64.51
Oil & Gas	12533.06	6877.5	-5655.56	-45.13
Power Index	4344.41	1812.67	-2531.74	-58.28
S&P CNX NIFTY	**5756.35**	**3210.22**	**-2546.13**	**-44.23**
Sensitive Index	**19325.65**	**10549.65**	**-8776**	**-45.41**
Tech	3582.73	2209.16	-1373.57	-38.34

Source: PPFAS Research

Wonder why investing in the relatively less impacted FMCG companies versus the many highly-battered high-growth stocks-trading at cheap valuations makes sense ?

Some businesses are inherently better than the others. An easy way to identify these..:

Low Capital Intensity x High Margin = Fantastic Returns on Capital

A number of industries fit the bill on the above profiling. Engineering, Capital Goods, FMCG, IT are some of the examples. But many of these like engineering & capital goods are cyclical in nature. Even IT is slightly cyclical, except for India, thanks to the outsourcing story. So to find whats better than the above..

Low Capital Intensity x High Margin x Sustainability = Fantastic Businesses.

Many FMCG companies make it to the list. Consumer monopolies with brand assets and sustained growth, when available at attractive valuations make great investments.

Particulars	GCPL	Marico	Pidilite
CMP	101.45	49.70	97.80
Dividend Yield	3.94%	1.32%	1.79%
P/E	14.29	17.89	14.40
Initial Rate of Return (EPS/Price)	7.00%	5.59%	6.94%

Source: PPFAS Research

"The secret that Warren has figured out is that excellent businesses that benefit from a consumer monopoly, that can consistently earn high rates of returns on shareholders' equity, are often bargain buys even at what seem to be very high price-to-earnings ratios."

- Buffettology

Summary Financials

GCPL	2002	2003	2004	2005	2006	2007	2008	CAGR
Net Sales	458.6	470.1	489.6	562.7	699.7	953.2	1102.6	15.7%
Operating Profit	71.1	81.8	88.4	106.9	150	182.3	218.5	20.6%
OPM	15.5%	17.4%	18.1%	19.0%	21.4%	19.1%	19.8%	
PAT	42	53.3	54.9	89.6	121.3	144	159.24	24.9%
NPM	9.2%	11.3%	11.2%	15.9%	17.3%	15.1%	14.4%	
EPS	1.9	2.4	2.9	4	5.4	6.4	7.1	24.6%
Networth	53.2	45.5	42.4	49.9	78.7	122	171.6	21.6%
Capital Employed	78.3	68	74.2	63.9	154	303.6	367.6	29.4%
Dividend	1.38	2.00	2.25	3.00	3.50	3.75	4.00	19.5%
Payout	72.4%	83.3%	77.6%	75.0%	64.8%	58.6%	56.3%	
ROE	78.9%	117.1%	129.5%	179.6%	154.1%	118.0%	92.8%	
ROE (1-Payout)	21.8%	19.5%	29.0%	44.9%	54.2%	48.9%	40.5%	

Marico	2002	2003	2004	2005	2006	2007	2008	CAGR
Net Sales	695.7	774.4	888.5	1007.0	1143.9	1556.9	1906.7	18.3%
Operating Profit	74.8	75.8	74.4	85.9	139.7	198.6	246.2	22.0%
OPM	10.8%	9.8%	8.4%	8.5%	12.2%	12.8%	12.9%	
PAT	50.1	56.2	59.0	69.3	86.9	112.9	169.2	22.5%
NPM	7.2%	7.3%	6.6%	6.9%	7.6%	7.3%	8.9%	
EPS	0.9	1.9	1.0	1.2	1.4	1.9	2.8	21.5%
Networth	197.2	193.0	184.2	216.9	261.5	192.4	314.6	8.1%
Capital Employed	202.2	208.1	197.2	282.6	501.1	443.4	672.7	22.2%
Dividend	0.1	0.6	0.9	0.5	0.6	0.7	0.7	29.3%
Payout	16.2%	28.4%	86.2%	44.8%	43.5%	35.3%	23.6%	
ROE	25.4%	29.1%	32.0%	32.0%	33.2%	58.7%	53.8%	
ROE (1-Payout)	21.3%	20.9%	4.4%	17.7%	18.8%	37.9%	41.1%	

Pidilite	2002	2003	2004	2005	2006	2007	2008	CAGR
Net Sales	491.7	574.3	653.8	772.3	917.0	1248.2	1708.2	23.1%
Operating Profit	94.5	110.0	110.0	124.3	140.4	166.2	241.1	16.9%
OPM	19.2%	19.2%	16.8%	16.1%	15.3%	13.3%	14.1%	
PAT	54.0	56.9	61.0	75.4	87.8	111.8	173.0	21.4%
NPM	11.0%	9.9%	9.3%	9.8%	9.6%	9.0%	10.1%	
EPS	2.1	2.3	2.4	3.0	3.5	4.4	6.8	21.2%
Networth	233.1	306.0	314.9	361.5	413.3	480.6	619.8	17.7%
Capital Employed	305.3	346.2	401.2	453.5	501.6	660.6	1189.0	25.4%
Dividend	0.7	0.8	0.8	1.0	1.3	1.5	1.8	16.5%
Payout	32.7%	31.9%	32.9%	33.2%	35.8%	33.9%	25.8%	
ROE	23.2%	18.6%	19.4%	20.9%	21.2%	23.3%	27.9%	
ROE (1-Payout)	15.6%	12.7%	13.0%	13.9%	13.6%	15.4%	20.7%	

Source: PPFAS Research

Observe that all the three companies have had an EPS CAGR of over 21-25% over the past 6 years. Now for whether such a growth rate is sustainable, one may consider the following facets :

- Past performance – The near, medium & longer term past performance of all these companies all indicate a robust and somewhat consistent growth trend.
- Take a guess on normalized inflation rate plus some population growth and maybe even some per capita increase in consumption.
- These reputed branded companies with strong distribution networks tend to grow at a faster pace as compared to competition.
- All these 3 companies are mid-size companies with an awesome market standing. Marico & Pidilite are pure consumer monopolies with their brands 'Parachute' & 'Fevicol' respectively. GCPL is a fraction of the size of HUL, but a close No 2 player, with a track record of gradually increasing market share.
- GCPL, Marico & Pidilite have generated RoEs of 93%, 54% & 21% respectively. Dividend payout ratios have been 56%, 23% & 26%. Even the retained portion of the ROE is as high as 41%, 41% & 21%, which basically goes back into the company to generate future growth. This is actually what goes into compounding the year-on-year growth for the companies.

So there are reasonable basis for these companies to maintain their healthy growth rates in the coming years. We hypothetically estimate that these companies will moderate their growth rates to 18% for the next 5 years & thereafter further moderate at 15% for the next 5 years. Also along with the growth rates, we expect the P/E ratios to correct correspondingly.

Godrej Consumer

Year	EPS	Target P/E	Target Price	FY13	5 Yr. Payoff	FY18	10 Yr. Payoff
FY08	7.10	14.29	101.45	1-Apr-2008	(101.45)	1-Apr-2008	(101.45)
FY13	16.24	13.50	219.28	1-Apr-2013	219.28	1-Apr-2018	408.38
FY18	32.67	12.50	408.38	Return	16.66%	Return	14.93%

Marico Industries

Year	EPS	Target P/E	Target Price	FY13	5 Yr. Payoff	FY18	10 Yr. Payoff
FY08	2.78	17.89	49.70	1-Apr-2008	(49.70)	1-Apr-2008	(49.70)
FY13	6.36	16.50	104.86	1-Apr-2013	104.86	1-Apr-2018	191.73
FY18	12.78	15.00	191.73	Return	16.09%	Return	14.45%

Pidilite Industries

Year	EPS	Target P/E	Target Price	FY13	5 Yr. Payoff	FY18	10 Yr. Payoff
FY08	6.79	14.40	97.80	1-Apr-2008	(97.80)	1-Apr-2008	(97.80)
FY13	15.54	13.50	209.77	1-Apr-2013	209.77	1-Apr-2018	390.67
FY18	31.25	12.50	390.67	Return	16.48%	Return	14.85%

Source: PPFAS Research

So even if the growth rates moderate to 18% & 15% for next 2 five-year periods and also assuming some correction in the target multiples, we see that each of these investments provide over 15%+ five year CAGR TAX FREE returns. Plus some regular dividends, which we have not factored in the payoffs. All this is despite the initial rate of return of just 6.7%.

How best to apply this strategy ?

This strategy works best only from a long term perspective and that too when applied to Excellent Businesses. The magic lies in the compounding.

"Understanding both the power of compounding and the difficulty of getting it is the heart and soul of understanding a lot of things."

- Charles Munger

Advantage over investing into Value Stocks

So how does the above investment strategy compare over another value investing proposition with say a much higher 40-50% return. One, the effective return for most re-rating candidates, depends on the period over which the re-rating is effected (if at all for some). Second important aspect to consider is that of re-investing. In the relatively longer run, your investment returns are governed not just by the returns on the re-rating propositions, but also on the successes/failures of the future re-investment endeavours.

This is where the Excellent businesses win over the mediocre. The power of compounding works for them as they are saved from the re-investment efforts & outcomes. Also, these are really not dependent on any re-ratings. **So even at 15-20 P/E, select FMCGs are better value & growth play – the value being in the growth.**

Companies

Godrej Consumer Products Limited

Godrej Consumer Products Ltd. (GCPL) is a major player in the Indian FMCG market with leadership in personal, hair, household and fabric care segments. Their centre of attention is in providing customers with value goods required for meeting their daily needs. They are among the largest marketer of toilet soaps in the country with leading brands such as Cinthol , Evita, Crowning Glory, Vigil, Shikakai, Fairglow , Godrej No.1. They are the leader in the hair colour category in India and have a vast product range. At the market price of Rs. 101.45, the stock trades at 14x of FY09E earnings (on expanded equities post rights). GCPL has higher margins versus many peers in the FMCG industry and it is trading at a lower PE ratio when compared to other players. We recommend buy at current levels with a long term visibility, to participate into the expanding horizons of the Indian conglomerate.

Marico Industries Limited

Marico Industries has established itself as one of the leading consumer products and services company in India. They focus on branded products and most of Marico's brands dominate their categories with significant marketshare. Their key brands and brand extensions include Parachute, Saffola, Kaya, Hair & Care, Mediker, Sundari ,Fiancee etc which have significant market shares in their product categories. The company has demonstrated steady growth on both the topline and bottomline, over the last 5 years they grew to a CAGR of 21% and 30% respectively. At the current market price of Rs. 49.7, the stock trades cheap at 16x of FY09 earnings.

Pidilite Industries Limited

Pidilite Industries is a prime example of a consumer monopoly in the Indian listed space. It is a leader in the field of consumer adhesives and sealants. Its flagship brand – Fevicol – is a prime example of branding an adhesive. The aspect that works in Pidilite's favour is that its portfolio is stacked with a formidable array of brands. Pidilite has achieved consistent sales and earnings growth for the last 10 years, with ROCE in excess of 20%. In the last 4 years total income has grown at a CAGR of 30.29%, operating profit has grown at a CAGR of 25% and bottomline has grown at a CAGR of 32%. At the market price of Rs. 97.80, the stock is a strong value pick at 14x FY9E earnings.

Each of the above companies, are either near monopolies or market leaders or in the top2 rankings. Yet there are all very moderately sized companies, suggesting, room for growth through market size and/or market share over many further years to come.

With the scrip prices having corrected recently, the 3 scrips fits the 3 golden rules perfectly.

Earnings Statement

Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Total Revenues	6,997.2	9,532.3	11,025.7	13,045.9
- Growth (%)	24.4%	36.2%	15.7%	18.3%
Total Expenditure	5,570.0	7,735.4	8,880.7	10516.3
Operating Profit	1,427.2	1,796.9	2,145.0	2,529.6
Other Income	73.1	26.5	40.3	54.4
EBITDA	1,500.3	1,823.4	2,185.3	2,584.0
- Growth (%)	40.4%	21.5%	19.8%	18.2%
Depreciation	114.7	142.1	181.7	307.0
EBIT	1,385.6	1,681.3	2,003.6	2,276.9
Interest	64.7	96.3	128.7	148.4
PBT	1,320.8	1,585.0	1,874.9	2,128.5
Tax	107.8	195.4	282.5	319.3
PAT Before EI	1,213.0	1,389.7	1,592.4	1,809.3
- Growth (%)	35.4%	14.6%	14.6%	13.6%
Extra-ordinary Items	0.0	50.6	0.0	0.0
Reported PAT	1,213.0	1,440.3	1,592.4	1,809.3

Ratio Analysis

Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
OPM (%)	20.4%	18.9%	19.5%	19.4%
EBITDA (%)	21.4%	19.1%	19.8%	19.8%
PBIT (%)	19.8%	17.6%	18.2%	17.5%
PAT (%)	17.3%	14.6%	14.4%	13.9%
Interest Cover (x)	21.4	17.5	15.6	15.3
EPS (Rs.)	5.4	6.2	7.1	7.0
P/E (x)	18.9	16.5	14.4	14.5
P/BV (x)	29.1	18.8	13.6	4.2
BVPS (Rs.)	3.5	5.4	7.5	24.1
Market Cap (Rs. Mn.)	22,911.9	22,911.9	22,911.9	26,185.0
M Cap/Sales (x)	3.3	2.4	2.1	2.0
EV (Rs. Mn.)	23,325.6	24,173.0	24,356.9	23,588.6
EV/EBITDA (x)	15.5	13.3	11.1	9.1
EV/Sales (x)	3.3	2.5	2.2	1.8
ROCE (%)	94.0%	56.9%	56.3%	33.9%
RONW (%)	154.2%	113.9%	94.4%	29.1%
Debt/Equity Ratio (x)	0.9	1.4	1.1	0.1
Inventory T/o Days	52.4	51.8	63.4	63.0
Debtors T/o Days	15.8	18.5	16.9	20.0
Advances T/o Days	7.4	17.8	22.1	22.1
Creditors T/o Days	93.2	96.5	96.2	90.0
Working Cap T/o Days	(8.9)	6.1	9.7	74.0
Fixed Assets T/o (Gross)	4.0	3.5	3.8	3.5
DPS (Rs.)	3.5	3.8	4.2	4.2
Dividend Payout (%)	65.2%	60.9%	60.0%	60.0%
Dividend Yield (%)	3.4%	3.7%	4.2%	4.1%

Balance Sheet

Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	225.8	225.8	225.8	258.1
Reserves	561.0	994.1	1,489.8	5,986.8
Shareholders Funds	786.8	1,220.0	1,715.6	6,244.9
Borrowed Funds	687.2	1,736.1	1,871.0	500.0
Deferred Tax Liability	65.7	79.8	89.1	89.1
Total Liabilities	1,539.7	3,035.9	3,675.7	6,834.0
Fixed Assets	849.6	1,992.1	2,399.1	2,536.3
Goodwill	851.4	885.7	956.0	956.0
Investments	10.1	0.1	0.1	669.1
Current Assets				
Inventory	1,004.7	1,352.3	1,915.6	2,251.8
Sundry Debtors	303.3	483.2	509.6	714.8
Loans & Advances	142.8	464.8	667.7	789.3
Cash & Bank Balance	263.4	474.9	425.9	2,427.2
Current Liabilities				
Sundry Creditors	1,787.3	2,520.0	2,904.5	3,216.8
Provisions	98.1	97.3	322.4	322.4
Net Current Assets	(171.3)	158.1	291.8	2,644.0
Miscellaneous Expenditure	0.0	0.0	28.7	28.7
Total Assets	1,539.7	3,035.9	3,675.7	6,834.0

Cash Flow

Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	89.7	263.4	474.9	425.9
Profit After Tax	1,213.0	1,440.3	1,592.4	1,809.3
Invt Income	(73.1)	(26.5)	(40.3)	(54.4)
Interest Paid	64.7	96.3	128.7	148.4
Misc. Exp W/Off	0.0	0.0	(28.7)	0.0
Depreciation	114.7	142.1	181.7	307.0
Deferred Taxation	(13.8)	13.1	9.2	0.0
Others	85.9	(27.7)	(33.3)	0.1
Change in Working Cap	(29.8)	(117.8)	(182.8)	(350.8)
CF - Operating Activities	1,361.8	1,519.7	1,626.9	1,859.6
Change in Fixed Assets	(36.0)	(1,255.9)	(555.4)	(444.2)
Change in Goodwill	(851.4)	(34.3)	(70.3)	0.0
Change in Investments	(10.1)	10.0	0.0	(669.0)
Investment Income	73.1	26.5	40.3	54.4
CF - Investing Activities	(824.4)	(1,253.7)	(585.4)	(1,058.8)
Increase in Equity	(23.5)	(33.0)	2.0	3,968.4
Changes in Borrowings	625.9	1,048.9	134.9	(1,371.0)
Interest Paid	(64.7)	(96.3)	(128.7)	(148.4)
Dividend Paid	(901.3)	(974.1)	(1,098.8)	(1,248.4)
CF - Financing Activities	(363.6)	(54.5)	(1,090.5)	1,200.6
Net Change in Cash	173.8	211.5	(49.1)	2,001.3
Closing Cash & Bank	263.4	474.9	425.9	2,427.2

Marico : BUY

Earnings Statement

Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Total Revenues	11,439.4	15,569.2	19,066.9	21,929.5
- Growth (%)	13.0%	36.1%	22.5%	15.0%
Total Expenditure	9,997.6	13,443.3	16,603.4	19,240.9
Operating Profit	1,441.8	2,125.9	2,463.5	2,688.6
Other Income	35.4	101.6	66.8	232.0
EBITDA	1,477.2	2,227.5	2,530.3	2,920.5
- Growth (%)	64.5%	50.8%	13.6%	15.4%
Depreciation	446.7	520.6	308.6	288.7
EBIT	1,030.5	1,706.9	2,221.7	2,631.9
Interest	50.5	206.1	276.6	276.6
PBT	980.0	1,500.8	1,945.1	2,355.3
Tax	111.2	371.9	359.5	339.8
PAT Before MI	868.8	1,128.9	1,585.6	2,015.5
Minority Interest	0.0	0.0	1.0	1.3
PAT After MI	868.8	1,128.9	1,584.6	2,014.2
- Growth (%)	24.7%	29.9%	40.4%	27.1%
Extra-ordinary Items	0.0	0.0	106.1	0.0
Reported PAT	868.8	1,128.9	1,478.5	2,014.2

Ratio Analysis

Particulars	FY06	FY07	FY08	FY09E
OPM (%)	12.6%	13.7%	12.9%	12.3%
EBITDA (%)	12.9%	14.3%	13.3%	13.3%
PBIT (%)	9.0%	11.0%	11.7%	12.0%
PAT (%)	7.6%	7.3%	8.3%	9.2%
Interest Cover (x)	20.4	8.3	8.0	9.5
EPS (Rs.)	1.5	1.9	2.6	3.3
P/E (x)	33.2	26.8	19.1	15.0
P/BV (x)	11.0	15.7	9.6	6.8
BVPS (Rs.)	4.5	3.2	5.2	7.3
Mcap (Rs. Mn.)	28,826.0	30,267.3	30,267.3	30,267.3
M Cap/Sales (x)	2.5	1.9	1.6	1.4
EV (Rs. Mn.)	30,623.2	32,349.6	33,093.8	32,050.4
EV/EBITDA (x)	20.7	14.5	13.1	11.0
EV/Sales (x)	2.7	2.1	1.7	1.5
ROCE (%)	20.6%	38.5%	33.0%	32.7%
RONW (%)	33.3%	58.7%	50.4%	45.1%
Debt/Equity Ratio (x)	0.9	1.3	1.1	0.8
Inventory T/o Days	42.2	51.9	49.9	49.0
Debtors T/o Days	16.4	15.1	16.5	17.0
Advances T/o Days	16.9	16.8	20.3	17.7
Creditors T/o Days	47.8	62.8	49.0	49.0
Working Cap T/o Days	34.4	27.6	44.6	59.2
Fixed Assets T/o (Gross)	2.4	5.6	5.4	4.8
DPS (Rs.)	0.6	0.6	0.7	1.0
Dividend Payout (%)	41.4%	34.6%	25.2%	30.0%
Dividend Yield (%)	1.2%	1.3%	1.3%	2.0%

Balance Sheet

Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	580.0	609.0	609.0	609.0
Reserves	2,034.8	1,314.7	2,537.2	3,856.5
Shareholders Funds	2,614.8	1,923.7	3,146.2	4,465.5
Minority Interest	-	-	1.2	2.5
Borrowed Funds	2,396.5	2,509.7	3,579.4	3,579.4
Deferred Tax Liability	82.8	- 1,151.5	- 981.7	- 981.7
Total Liabilities	5,094.1	3,281.9	5,745.1	7,065.7
Fixed Assets	3,813.0	1,654.4	2,573.1	2,667.1
Goodwill	16.7	449.5	842.4	842.4
Investments	184.7	0.1	0.1	0.1
Current Assets				
Inventory	1,322.9	2,214.7	2,604.6	2,944.0
Sundry Debtors	515.3	642.6	862.7	1,021.4
Loans & Advances	528.8	716.6	1,060.9	1,060.9
Cash & Bank Balance	414.6	427.3	752.8	1,796.2
Current Liabilities				
Sundry Creditors	1,498.3	2,677.2	2,559.6	2,944.0
Provisions	206.1	147.2	391.9	322.4
Net Current Assets	1,077.2	1,176.8	2,329.5	3,556.1
Misc. Expenditure	2.5	1.2	-	-
Total Assets	5,094.1	3,282.0	5,745.1	7,065.7

Cash Flow

Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	338.1	414.6	427.3	752.8
Profit After Tax	868.8	1,128.9	1,478.5	2,014.2
Invt Income	(35.4)	(101.6)	(66.8)	(232.0)
Interest Paid	50.5	206.1	276.6	276.6
Misc. Exp W/Off	1.3	1.3	1.2	0.0
Depreciation	446.7	520.6	308.6	288.7
Deferred Taxation	31.9	158.1	202.1	0.0
Others	(44.7)	(4,677.7)	110.4	(0.0)
Change in Working Cap	169.5	(86.9)	(827.2)	(183.2)
CF - Operating Activities	1,488.6	(2,851.2)	1,483.4	2,164.3
Change in Fixed Assets	(2,778.7)	2,053.7	(1,159.4)	(382.7)
Change in Goodwill	0.0	(432.8)	(392.9)	0.0
Change in Investments	(60.5)	184.6	0.0	0.0
Investment Income	35.4	101.6	66.8	232.0
CF - Investing Activities	(2,803.8)	1,907.1	(1,485.5)	(150.7)
Increase in Equity	0.0	1,513.9	0.0	0.0
Changes in Borrowings	1,852.2	113.2	1,069.7	0.0
Change In Minority	0.0	0.0	1.2	1.3
Interest Paid	(50.5)	(206.1)	(276.6)	(276.6)
Dividend Paid	(410.0)	(464.2)	(466.7)	(694.9)
CF - Financing Activities	1,391.7	956.8	327.6	(970.2)
Net Change in Cash	76.5	12.7	325.5	1,043.4
Closing Cash & Bank Bal	414.6	427.3	752.8	1,796.2

Pidilite : BUY

Earnings Statement				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Total Revenues	9,170.0	12,481.7	17,082.0	21,619.9
- Growth (%)	18.7%	36.1%	36.9%	26.6%
Total Expenditure	7,766.1	10,820.2	14,670.8	18,549.8
Operating Profit	1,403.8	1,661.5	2,411.2	3,070.0
Other Income	176.2	188.7	314.6	398.1
EBITDA	1,580.1	1,850.2	2,725.8	3,468.2
- Growth (%)	17.6%	17.1%	47.3%	27.2%
Depreciation	277.8	327.7	459.0	674.8
EBIT	1,302.3	1,522.6	2,266.8	2,793.3
Interest	15.4	66.4	190.0	190.0
PBT	1,286.9	1,456.2	2,076.8	2,603.3
Tax	405.9	340.4	358.0	650.8
PAT Before MI	881.0	1,115.8	1,718.8	1,952.5
Share of P/L in Asso.	(6.3)	1.0	9.0	10.2
Minority Interest	2.8	0.7	2.0	2.3
Profit after MI	877.6	1,117.5	1,729.8	1,965.0
- Growth (%)	16.3%	27.3%	54.8%	13.6%

Ratio Analysis				
Particulars	FY06	FY07	FY08	FY09E
OPM (%)	15.3%	13.3%	14.1%	14.2%
EBITDA (%)	17.2%	14.8%	16.0%	16.0%
PBIT (%)	14.2%	12.2%	13.3%	12.9%
PAT (%)	9.6%	8.9%	10.1%	9.0%
Interest Cover (x)	84.5	22.9	11.9	14.7
EPS (Rs.)	3.5	4.4	6.1	6.9
P/E (x)	28.0	22.1	16.0	14.1
P/BV (x)	6.0	5.1	4.4	3.6
BVPS (Rs.)	16.4	19.0	22.0	27.4
Market Cap (Rs. Mn.)	24,684.7	24,684.7	27,561.8	27,560.8
M Cap/Sales (x)	2.7	2.0	1.6	1.3
EV (Rs. Mn.)	24,927.2	25,593.2	31,074.6	29,365.4
EV/EBITDA (x)	15.8	13.8	11.4	8.5
EV/Sales (x)	2.7	2.1	1.8	1.4
ROCE (%)	27.8%	24.4%	19.8%	21.5%
RONW (%)	21.3%	23.2%	27.7%	25.3%
Debt/Equity Ratio (x)	0.1	0.3	0.8	0.7
Inventory T/o Days	62.0	64.7	63.9	64.0
Debtors T/o Days	45.1	46.2	50.8	46.0
Advances T/o Days	6.4	14.9	19.8	15.7
Creditors T/o Days	41.0	47.9	47.3	48.0
Working Cap T/o Days	70.8	75.3	110.9	128.1
Fixed Assets T/o (Gross)	1.9	2.2	2.1	2.2
DPS (Rs.)	1.3	1.5	1.6	1.3
Dividend Payout (%)	35.8%	33.9%	25.8%	19.4%
Dividend Yield (%)	1.3%	1.5%	1.6%	1.4%

Balance Sheet				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	252.4	252.4	281.8	281.8
Reserves	3,880.5	4,553.5	5,915.8	7,436.7
Shareholders Funds	4,132.9	4,805.9	6,197.6	7,718.5
Borrowed Funds	563.2	1,449.1	5,263.6	5,263.6
Deferred Tax Liability	304.9	335.4	416.1	416.1
Minority Interest	14.7	15.2	12.7	15.0
Total Liabilities	5,015.6	6,605.6	11,890.0	13,413.1
Fixed Assets	3,072.4	3,868.8	6,668.1	5,795.8
Investments	159.6	159.2	32.4	32.4
Current Assets				
Inventory	1,558.1	2,213.7	2,988.3	3,790.9
Sundry Debtors	1,133.4	1,579.9	2,377.4	2,724.7
Loans & Advances	330.0	509.5	928.0	930.0
Cash & Bank Balance	161.2	381.4	1,718.4	3,426.6
Other Current Assets	23.1	21.7	-	-
Current Liabilities				
Sundry Creditors	1,028.8	1,637.9	2,212.1	2,843.2
Provisions	398.5	493.4	610.7	444.1
Net Current Assets	1,778.3	2,574.9	5,189.3	7,584.9
Misc. Expenditure	5.2	2.7	0.3	-
Total Assets	5,015.6	6,605.6	11,890.0	13,413.1

Cash Flow				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	141.6	161.2	381.4	1,718.4
Profit After Tax	877.6	1,117.5	1,729.8	1,965.0
Invt Income	(176.2)	(188.7)	(314.6)	(398.1)
Interest Paid	15.4	66.4	190.0	190.0
Misc. Exp W/Off	2.3	2.5	2.4	0.0
Depreciation	277.8	327.7	459.0	674.8
Deferred Taxation	17.0	30.5	0.0	0.0
Others	(150.7)	141.7	686.2	0.0
Change in Working Cap	153.3	(745.2)	(1,405.5)	(687.4)
CF - Operating Activities	1,016.4	752.3	1,347.4	1,744.3
Change in Fixed Assets	(769.6)	(1,098.4)	(3,735.6)	197.6
Change in Investments	26.5	0.4	126.9	0.0
Investment Income	176.2	188.7	314.6	398.1
CF - Investing Activities	(566.8)	(909.3)	(3,294.2)	595.8
Increase in Equity	0.0	0.0	180.1	0.0
Changes in Borrowings	(64.0)	885.9	3,814.4	0.0
Interest Paid	(15.4)	(66.4)	(190.0)	(190.0)
Chng In Minority Interest	9.2	0.6	(2.5)	2.3
Dividend Paid	(359.8)	(442.9)	(518.1)	(444.1)
CF - Financing Activities	(430.0)	377.2	3,283.9	(631.8)
Net Change in Cash	19.6	220.2	1,337.0	1,708.2
Closing Cash & Bank Bal	161.2	381.4	1,718.4	3,426.6

Think about IT

Information Technology

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From sunrise to sunset and beyond, is it darkest before dawn?

- Please Read PPFAS Blog-post dated 08 Sept. '08 | www.ppfas.net/blog

Just an eclipse

The IT industry as been weathering a severe storm following the Sub-prime crisis and possibly is the worst hit industry next only to the large global banks & i-banks. Punished like as if they caused it.

"..there are no provable absolutes, and that, with the absence of provable certainty, all decisions are about probabilities - that is, all decisions are about the respective probabilities..." - Robert Rubin | Former Secretary of the Treasury of the United States

'Price is what you pay; value is what you get.' So the exercise to weigh the pros & cons. **First the negatives. 2 key negatives are : A – The Industry Scenario & B – The Business Model itself.**

- The industry scenario for the IT industry is certainly gloomy with concerns over receivables, loss of clients and most importantly the declining growth rates; as the developed world averts a depression to settle for a recession. And this developed world is 80-100% of what most IT companies cater to.
- On the business model, it is primarily outsourcing – getting it done cheaply at low cost English skilled countries like India. Now, the realizations grow at moderate growth rates somewhat in line with the overall GDP growth rates for the developed nations. On the other hand, the cost increase is steeper on account of salary hikes, withering tax benefits and a generally appreciating currency (a reverse trend currently on account of severe USD-liquidity crunch). So a part of the growth is going towards maintaining profits.

The Positives. 2 key positives are : A – the Visibility & B – the Value.

- The Visibility is in its Necessity. The world cant do without IT. In crisis, you need some of IT even more. The labour arbitrage theory still holds. Offshore salaries are still just ~ 1/3rd of Onsite. The visibility sustains until India maintains its edge on two fronts – (1) ability (educated & english speaking employees...increasing by the years & (2) the relative labour-cost arbitrage continues.
- Value. It Is the excellent margins & ROEs. Most companies are cash rich & debt free and many have delivered fantastic growth over the years. Read Below : A Cyclical morphed into Growth Industry. Most attractively, it is the cheap throw away prices at which many able IT companies are available for investment. For many companies, even if the earnings drop by 35%-75%, the consequent P/E would still be higher than the corresponding ROE.

Particulars	CMP	FY09E			If earnings drop by	Then		
		EPS	P/E	ROE		EPS	P/E	ROE
Infosys	1,378.5	102.5	13.5	32.3%	35.50%	66.1	20.9	20.8%
Mphasis	163.1	15.8	10.3	24.3%	34.50%	10.3	15.8	15.9%
NIIT Technologies	68.0	23.3	2.9	26.0%	69.70%	7.1	9.6	9.6%
Sonata Software	17.0	7.2	2.3	26.1%	70.00%	2.2	7.8	7.8%
HTMT Global ^	149.9	46.3	3.2	35.6%	74.00%	12.0	12.5	12.6%

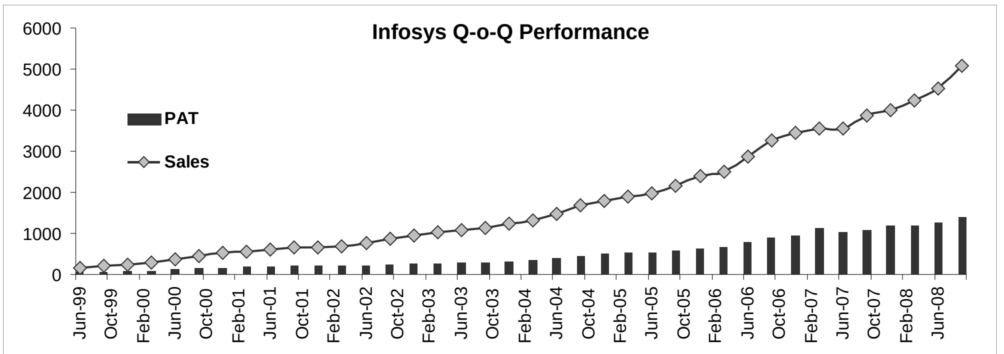
^ ROE - Excl Cash for HTMT Global

Source: PPFAS Research

" When the gap between perception and reality is the maximum, price is the best."

A Cyclical morphed into Growth Industry

The kind of growth that a number of IT companies have delivered in the past has been excellent. We have been trained to look at & expect for a Q-Q growth for the IT companies.



Source: Capitaline, PPFAS Research

While most of the IT companies demonstrate a positive quarter-on-quarter growth for the past many years, ever thought of any of the Indian IT companies as being Cyclical ? But in essence they are. The businesses of the clients go through business cycles and there is a corresponding effect to their IT spending. But India story has been a little different. Because of the outsourcing – our ability & cost advantage – India has been gaining a greater share of the pie. We may safely bet that this trend of increasing share will continue for some reasonable time.

..But not a Commodity (yet)

Most if not all commodities are cyclical; but not vice versa. You can change your vendors for grains & steel anytime. But it is not so easy to change your IT vendor. For a decent size organization, think of all the data gone into the old system and all the employees who have been used to the softwares. Atleast it is relatively sticky & it needs support. What we comprehend is that 'Applications' is still a very subjective affair. Most companies use softwares customized to their requirements. But this may change in the coming times as companies shift to packaged (read branded) softwares. This leaves us with a cogitative point –**'In IT, it is different; you build Brands to Commoditize'.**

IT is a lot much about HR

In the past few months, issues like realizations, growth prospects & currency fluctuations have garnered all the focus. But we think there is something else, that is much more important, i.e. HR. Personally, we believe that in IT, you need you best guy to manage HR. There is still a lot more linearity in the IT business. It is no easy challenge to manage thousands of educated people. This is the most important weapon available to the Indian IT companies in the current crisis-like situation. There are surely some tailwinds here. With supply side comfortable, you can rationalize your costs and retain the better talent that enhances productivity.

Real time to get scared

We are totally convinced on the long term prospects for the IT industry. There are concerns for sure, but we think these are overdone. We would be more apprehensive:

- when India's edge – in terms of ability & more importantly, the labour arbitrage is significantly compromised;
- if there is a slowdown which is coupled with supply side headwiinds.

But now the outlook is comforting on both the issues.

Viewpoint on Acquisitions

The cash rich IT companies have on many occasions resorted to acquisitions for many reasons–scale, domain expertize, strengthening geographical presence, diversification, clientele, integration benefits, etc. 3 key points here :

- Reasons for acquisition – Strategic and/or Growth;
- Valuations are rich relative to the acquiring entity, especially in the recent times
- Most acquisitions are done internationally;

Growing organically is the best way. But it is difficult & time consuming. Therefore acquisitions. What most acquisitions have to offer to the buyer is either strategic (domain, geography, clientele, diversification, integration savings, etc.) or pure growth (scale). Its best when it is done both selectively and opportunistically. For companies, which easily resort to this option, it generally ends up being a portfolio approach. Some work, many don't.

The second thing is why not Buyback own shares when these acquisitions are expensive relative to the acquiring company, especially in the recent times ? One reason could be that the investment horizon of the management & the external investors are very different. The former have a much longer horizon & are interested in seeing their creation grow. Even otherwise, in a time when the IT companies are valued purely on the growth front and are valued nothing for the static & inherent business value, such acquisition led growth do bring in some respite to the shrinking market cap.

Why are most acquisitions done internationally, even when the small domestic companies are available at obscene/liquidation valuations ? We have a number of smaller IT companies with positive growth, generating 25% returns and trading at even < 3x current year earnings. Also the large & small caps seem to have complementing characteristics. One has lower offshoring with difficulty in executing good organic growth; the large caps have higher growth rates with very high offshoring component. How much more can one improve & vice-versa ? What we fathom about this is that there is a case size misfit. We have a few very big companies employing even upwards of 50,000 people and growing at double digits. And there are dozens of smaller companies employing a few (lower single digit) thousands. From a growth perspective, these do not even add a very small fraction to the large cap companies. For example, it makes no sense for Infosys who adds 25,000 people every quarter, to acquire a small company employing a 2000-4000 people even after factoring the valuations and/or other positives. We do not have many mid-size companies, who could very effectively play the part of both buyer & seller in the Indian arena.

What we like

We think that the large caps are the most efficient but in the current times, they have a higher de-rating risk on account the relatively higher exposure to BFSI segment & USA (both biggest pieces in the pie in terms of vertical & geography). While there has already been a severe de-rating in valuations despite the improving profitability, the risk of further de-rating remains, should the market continue to give large importance to PEG ratios.

On the other hand, small cap IT companies are available at liquidation valuations. Sure the market is expecting some de-growth in earnings, but the current valuations suggest of these companies for going out of business. Say for companies like NIIT Tech, even if the current year earnings drop by 70%, the consequent P/E would still be higher than the corresponding ROE. We think these are still Growth (Cyclicals morphed into Growths) stocks and are definitely here to stay. We look for some critical factors like

- Domain Expertize (which is critical to protect in case of vendor consolidation)
- Visibility in terms of assured business from long term contracts
- Lower BFSI & US focus

Basically, niche & technically sound companies available at 'cigar-butt' valuations. What more, should they gain size & scale, or India fills the void in the midcap space, these investments double up as future takeover (read re-rating) targets.

Companies

Infosys

Big Fish in the Big Pond. More importantly, this IT bellwether has the most impeccable track record and has set new standards for management credibility. It has clinched some transformational deals amidst the global BFSI turmoil. Its decision of not to go in for the price-war for Axon bid, speaks highly of the management & investment culture of country's most admired company. There are some risks to its share price on account of the high exposure to BFSI (clear slow down in growth rates) and the markets fascination for PEG. But still for Infosys, it is still 'Test of faith' v/s. 'Leap of faith' for many others. Infosys trades at 12.x FY09E earnings of Rs. 102.50 per share.

Mphasis

High visibility for offshoring from EDS-HP parent. Mphasis offers the highest visibility in terms of offshoring from its EDS-HP parentage. It is a decent size company with over 28,000 employees, over Half a Billion dollar revenues, both poised & capable of high growth in the coming times. Relatively lower forex hedging enables maximizing the forex gains. The possibility of HP-EDS increasing its stake in this company through integration with HP India and the consequent buyback & maybe de-listing remain a distant possibility. Mphasis trades at 10.3x FY09E earnings of Rs. 15.75 per share.

NIIT Technologies

This extremely vertical & cost focused company avoids going for every other opportunity available. Strong domain competence, especially in Travel & Insurance would shield it from any vendor consolidation threat and may possible even turn it to its advantage. NIIT Tech & IBM were the only 2 out of the 23 vendors that were retained by British Airways as a part of their restructuring in 2001. NIIT Technologies has recently received a multi-billion long term contract from British Airways, which will have a higher offshore element. By offering integrated & SOA/ Platform based offerings, it is further strengthening its vertical command. Also, the company is an early mover towards Non-Linear offerings including SaaS, Managed Services, which provide for value addition & cost effectiveness to clients and higher margins for NIIT Technologies. Over Rs. 9,000 Mn. run-rate company is available at a 50% market cap of Rs. 4,500 Mn. Consistent 25%+ ROEs and a P/E of 2.9x its FY09E EPS. Not to forget the dividend yield of ~10%.

Sonata Software

Small but a steady company with high medium-term visibility for all the 3 business segments. The standalone IT business has delivered a steady Q-Q growth for the past 6 quarters. Business from TUI Infotech JV, which constitutes ~45% of the business has a contractual guarantee. TUI group has committed a Euro 670 mn of revenue to TUI Infotec over 5 years during 2006-2011 which includes a 40% cash penalty compensation clause for non fulfillment. The domestic software licensing business too has a track record of a steady performance. 25% ROE (on low debt) company available at 2.3x FY09E earnings & 6.50% dividend yield.

HTMT Global

An ITES company with a low BFSI exposure (<10%) and an impressive track of 47% CAGR over FY04-08 period. It has successfully turnaround its overseas acquisition. A diversified client mix and its opportune utilization from low cost centres like Durgapur, reflect positively on the management. HTMT Global has a market cap of Rs. 3 Bn. and holds free net cash of ~ Rs.5 Bn. This means it is available at ~65% of the free cash on books. In terms of P/E it is 3.2x FY09E earnings. While reported ROEs are ~11%, excluding the free cash the ROEs are in 30-40% range. Dividend yield is 5.7%.

Its not sunset; just an eclipse. Think about IT.

Infosys Tech : BUY

Earnings Statement				
YE March (Rs. Crs.)	**FY06**	**FY07**	**FY08**	**FY09E**
Net Sales	9,521.0	13,893.0	16,692.0	21,835.2
Software Dvlp. Expenses	5,066.0	7,458.0	9,207.0	11,938.4
Gross Profit	4,455.0	6,435.0	7,485.0	9,896.9
Total Expenditure	6,431.0	9,502.0	11,454.0	14,806.9
Operating Profit	3,090.0	4,391.0	5,238.0	7,028.3
Other Income	139.0	370.0	704.0	632.0
EBITDA	3,229.0	4,761.0	5,942.0	7,660.3
Depreciation	437.0	514.0	598.0	763.3
EBIT	2,792.0	4,247.0	5,344.0	6,897.0
Interest	-	-	-	-
PBT	2,792.0	4,247.0	5,344.0	6,897.0
Tax	313.0	386.0	685.0	1,034.5
PAT	2,458.0	3,856.0	4,659.0	5,862.4

Ratio Analysis				
YE March (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
OPM (%)	32.5%	31.6%	31.4%	32.2%
EBITDA (%)	33.9%	34.3%	35.6%	35.1%
PBIT (%)	29.3%	30.6%	32.0%	31.6%
PAT (%)	25.8%	27.7%	27.9%	26.8%
EPS (Rs.)	44.5	67.3	81.5	102.5
P/E (x)	31.0	20.5	16.9	13.5
P/BV (x)	5.5	7.0	5.7	4.3
BVPS (Rs.)	252.4	196.8	241.2	317.4
Market Cap (Rs. Mn.)	38,046.6	78,850.2	78,850.2	78,850.2
M Cap/Sales (x)	4.0	5.7	4.7	3.6
EV (Rs. Mn.)	38,046.6	78,850.2	78,850.2	78,850.2
EV/EBITDA (x)	11.8	16.6	13.3	10.3
EV/Sales (x)	4.0	5.7	4.7	3.6
ROCE (%)	39.7%	37.7%	38.7%	38.0%
RONW (%)	35.3%	34.2%	33.8%	32.3%
Debtors T/o Days	61.6	64.0	72.1	75.0
Advances T/o Days	49.7	31.9	60.6	60.0
Creditors T/o Days	35.8	38.6	41.8	37.0
Working Cap T/o Days	152.9	193.7	193.0	213.0
Fixed Assets T/o (Gross)	3.2	3.0	3.1	3.1
DPS (Rs.)	44.9	11.4	33.3	22.5
Dividend Payout (%)	100.7%	17.0%	40.8%	22.0%
Dividend Yield (%)	3.3%	0.8%	2.4%	1.6%

Balance Sheet				
YE March (Rs. Crs.)	**FY06**	**FY07**	**FY08**	**FY09E**
Equity Capital	138.0	286.0	286.0	286.0
Reserves	6,828.0	10,969.0	13,509.0	17,867.8
Shareholders Funds	6,966.0	11,255.0	13,795.0	18,153.8
Pref Shares by Subsidiary	-	-	-	-
Minority Interest	68.0	4.0	-	-
Total Liabilities	**7,034.0**	**11,259.0**	**13,795.0**	**18,153.8**
Fixed Assets	2,226.0	3,771.0	4,777.0	5,189.7
Investments	755.0	25.0	72.0	72.0
Current Assets				
Sundry Debtors	1,608.0	2,436.0	3,297.0	4,486.7
Loans & Advances	1,297.0	1,214.0	2,771.0	3,589.4
Cash & Bank Balance	3,429.0	5,871.0	6,950.0	9,415.4
Current Liabilities				
Sundry Creditors	934.0	1,469.0	1,912.0	2,213.4
Provisions	1,412.0	681.0	2,279.0	2,538.1
Net Current Assets	3,988.0	7,371.0	8,827.0	12,739.9
Deferred Tax Assets	65.0	92.0	119.0	152.2
Total Assets	**7,034.0**	**11,259.0**	**13,795.0**	**18,153.8**

Cash Flow				
Particulars (Rs. Crs.)	**FY06**	**FY07**	**FY08**	**FY09E**
Opening Cash & Bank	1789.0	3429.0	5871.0	6950.0
Profit After Tax	2458.0	3856.0	4659.0	5862.4
Less : Invt Income	(139.0)	(370.0)	(704.0)	(632.0)
Depreciation	437.0	514.0	598.0	763.3
Deferred Taxation	(22.0)	(27.0)	(22.0)	(33.2)
Others	(302.0)	(6.0)	(453.0)	0.0
Change in Working Cap	354.0	(941.0)	(377.0)	(1447.5)
CF - Operating Activities	2786.0	3026.0	3701.0	4513.0
Change in Fixed Assets	(949.0)	(2053.0)	(1156.0)	(1176.0)
Change in Investments	456.0	730.0	(47.0)	0.0
Investment Income	139.0	370.0	704.0	632.0
CF - Investing Activities	(354.0)	(953.0)	(499.0)	(544.0)
Increase in Equity	646.0	1189.0	106.0	0.0
Changes in Borrowings	(94.0)	0.0	0.0	0.0
Dividend Paid	(1412.0)	(756.0)	(2225.0)	(1503.6)
CF - Financing Activities	(792.0)	369.0	(2123.0)	(1503.6)
Net Change in Cash	1640.0	2442.0	1079.0	2465.4
Closing Cash & Bank Bal	3429.0	5871.0	6950.0	9415.4

Mphasis : BUY

Earnings Statement

YE March (Rs. Mn.)	FY06	FY07	FY08	FY09E
Net Sales	9,401.1	17,606.2	24,230.7	31,984.6
Cost of Revenues	6,485.6	13,187.7	18,735.7	24,854.8
Selling Expenses	584.6	918.4	952.7	1,226.1
Genaral & Admin Expenses	868.1	1,456.7	1,750.5	2,223.1
Total Expenditure	7,938.3	15,562.8	21,438.9	28,304.0
Operating Profit	1,462.8	2,043.4	2,791.8	3,680.5
Other Income/Forex Gain	76.5	(135.4)	(215.1)	-
EBIT	1,539.3	1,908.1	2,576.7	3,680.5
Interest	(17.5)	(75.1)	(84.9)	(76.2)
PBT	1,556.8	1,983.2	2,661.6	3,756.7
Tax	58.2	182.5	108.7	370.9
PAT	1,498.6	1,800.7	2,552.9	3,385.8

Ratio Analysis

YE March (Rs. Mn.)	FY06	FY07	FY08	FY09E
OPM (%)	15.6%	11.6%	11.5%	11.5%
EBITDA (%)	16.4%	10.8%	10.6%	11.5%
PBIT (%)	16.4%	10.8%	10.6%	11.5%
PAT (%)	15.9%	10.2%	10.5%	10.6%
EPS (Rs.)	8.9	8.4	11.9	15.8
P/E (x)	18.3	19.5	13.7	10.3
P/BV (x)	4.2	3.5	3.0	2.5
BVPS (Rs.)	39.2	46.9	53.9	64.9
Market Cap (Rs. Mn.)	27,465.9	35,051.3	35,034.3	35,034.3
M Cap/Sales (x)	2.9	2.0	1.4	1.1
EV (Rs. Mn.)	27,502.8	35,079.7	35,091.1	35,091.1
EV/EBITDA (x)	17.9	18.4	13.6	9.5
EV/Sales (x)	2.9	2.0	1.4	1.1
ROCE (%)	23.2%	18.9%	22.2%	26.3%
RONW (%)	22.7%	17.9%	22.1%	24.3%
Debtors T/o Days	82.3	87.5	87.4	80.0
Advances T/o Days	27.6	31.3	44.5	33.0
Creditors T/o Days	32.5	41.0	45.6	33.0
Working Cap T/o Days	91.0	97.6	79.6	77.0
Fixed Assets T/o (Gross)	3.0	3.1	3.1	3.0
DPS (Rs.)	2.9	2.3	3.3	4.0
Dividend Payout (%)	32.5%	27.5%	27.8%	25.4%
Dividend Yield (%)	1.8%	1.4%	2.0%	2.5%

Balance Sheet

YE March (Rs. Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	1,684.0	2,149.1	2,148.0	2,148.0
Reserves	4,921.9	7,935.9	9,420.7	11,801.3
Shareholders Funds	6,605.9	10,085.0	11,568.8	13,949.3
Borrowed Funds	36.9	28.4	56.8	56.8
Total Liabilities	**6,642.8**	**10,113.4**	**11,625.5**	**14,006.1**
Fixed Assets	1,455.3	2,518.3	3,632.8	4,579.5
Goodwill	2,676.5	2,710.5	2,710.5	2,710.5
Current Assets				
Sundry Debtors	2,119.3	4,221.6	5,804.4	7,010.3
Loans & Advances	711.2	1,508.3	2,955.6	2,891.8
Cash & Bank Balance	988.5	1,892.6	952.5	1,081.8
Current Liabilities				
Sundry Creditors	836.2	1,975.3	3,025.9	2,891.8
Provisions	638.3	939.9	1,403.0	1,340.8
Net Current Assets	2,344.5	4,707.1	5,283.6	6,751.2
Deferred Tax Assets	166.5	177.4	260.1	226.4
Total Assets	**6,642.8**	**10,113.4**	**11,625.5**	**14,006.1**

Cash Flow

YE March (Rs. Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	954.7	988.5	1892.6	952.5
Profit After Tax	1498.6	1800.7	2552.9	3385.8
Less : Invt Income	8.7	1.8	(4.0)	0.0
Depreciation	518.2	1692.6	1329.2	1598.5
Deferred Taxation	(18.2)	9.2	(87.0)	33.7
Others	(22.8)	196.9	4.3	0.0
Change in Working Cap	(301.6)	(857.7)	(1516.5)	(1338.4)
CF - Operating Activities	1682.9	2843.4	2278.8	3679.6
Change in Fixed Assets	(785.4)	(1706.9)	(2443.7)	(2545.1)
Change in Investments	(791.7)	(5.3)	261.5	0.0
Investment Income	(8.7)	(1.8)	4.0	0.0
CF - Investing Activities	(1585.8)	(1714.0)	(2178.2)	(2545.1)
Increase in Equity	219.0	337.1	(239.7)	(0.0)
Changes in Borrowings	(9.4)	(8.5)	28.4	0.0
Dividend Paid	(272.9)	(553.9)	(829.3)	(1005.2)
CF - Financing Activities	(63.3)	(225.3)	(1040.7)	(1005.2)
Net Change in Cash	33.8	904.1	(940.1)	129.3
Closing Cash & Bank Bal	988.5	1892.6	952.5	1081.8

Earnings Statement				
Particulars (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
Total Revenues	6,075.3	8,858.6	9,415.1	9,885.9
- Growth (%)	*11.8%*	*45.8%*	*6.3%*	*5.0%*
Total Expenditure	4,919.5	7,056.0	7,652.4	7,903.9
Operating Profit	1,155.8	1,802.6	1,762.7	1,982.0
- Growth (%)	*20.8%*	*56.0%*	*-2.2%*	*12.4%*
Other Income	36.9	148.6	146.1	147.9
EBITDA	1,192.7	1,951.2	1,908.8	2,129.9
- Growth (%)	*15.9%*	*63.6%*	*-2.2%*	*11.6%*
Depreciation	389.5	434.7	388.8	485.9
EBIT	803.2	1,516.6	1,520.0	1,644.0
Interest	13.5	1.0	10.8	44.7
PBT	789.7	1,515.6	1,509.2	1,599.3
Tax	114.8	185.3	137.7	196.4
PAT Before MI	674.9	1,330.2	1,371.5	1,402.9
Minority Interest	12.0	37.8	18.9	19.3
PAT	662.90	1292.44	1352.61	1383.58
- Growth (%)	*13.2%*	*95.0%*	*4.7%*	*2.3%*

Ratio Analysis				
Particulars	**FY06**	**FY07**	**FY08**	**FY09E**
OPM (%)	19.0%	20%	19%	20%
EBITDA (%)	19.6%	22%	20%	22%
PAT (%)	10.9%	15%	14%	14%
Interest Cover (x)	59.5	1,512.9	140.8	36.8
EPS (Rs.)	11.4	22.0	23.0	23.3
P/E (x)	5.9	3.1	2.9	2.9
P/BV (x)	1.5	1.1	0.9	0.8
BVPS (Rs.)	46.7	63.1	75.2	89.7
Market Cap (Rs. Mn.)	3,939.3	3,985.3	3,988.6	4,028.4
M Cap/Sales (x)	0.6	0.4	0.4	0.4
EV (Rs. Mn.)	3,435.7	3,835.0	3,975.1	3,546.7
EV/EBITDA (x)	2.9	2.0	2.1	1.7
EV/Sales (x)	0.6	0.4	0.4	0.4
ROCE (%)	24.7%	32.6%	29.5%	27.2%
RONW (%)	24.5%	34.9%	30.6%	26.0%
Debt/Equity Ratio (x)	0.2	0.2	0.1	0.1
Inventory T/o Days	0.4	0.1	0.2	0.2
Debtors T/o Days	71.1	75.6	83.3	80.0
Advances T/o Days	25.2	17.4	27.1	27.0
Creditors T/o Days	52.6	51.6	59.9	60.0
Working Cap T/o Days	91.8	64.6	51.7	60.2
Fixed Assets T/o (Gross)	2.3	2.3	2.2	2.0
DPS (Rs.)	6.0	6.5	6.5	7.0
Dividend Payout (%)	35.0%	19.7%	28.2%	30.0%
Dividend Yield (%)	8.8%	9.6%	9.6%	10.3%

Balance Sheet				
Particulars (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
Equity Capital	386.5	391.0	587.0	592.9
ESOP & Share Application	13.9	3.9	2.4	2.4
Reserves	2,309.4	3,307.5	3,823.7	4,721.8
Shareholders Funds	2,709.9	3,702.5	4,413.1	5,317.1
Minority Interest	63.3	149.3	49.5	68.8
Borrowed Funds	420.2	793.2	646.8	496.8
Total Liabilities	**3,193.4**	**4,645.0**	**5,109.5**	**5,882.7**
Fixed Assets	949.1	1,530.2	2,377.5	2,873.3
Investments	649.4	1,444.3	1,311.4	1,311.4
Current Assets				
Inventory	6.1	2.9	5.6	5.0
Sundry Debtors	1,200.7	1,860.6	2,178.3	2,196.9
Loans & Advances	425.9	427.7	710.0	741.4
Cash & Bank Balance	923.8	943.5	660.3	978.6
Other Current Assets	171.3	146.5	93.4	98.1
Current Liabilities				
Liabilities	888.0	1,269.5	1,565.9	1,647.6
Provisions	290.9	521.4	728.7	718.4
Net Current Assets	1,549.0	1,590.3	1,353.2	1,653.9
Net Deferred Tax	45.9	80.1	67.4	44.1
Total Assets	**3,193.4**	**4,645.0**	**5,109.5**	**5,882.7**

Cash Flow				
Particulars (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
Opening Cash & Bank	927.9	923.8	943.5	660.3
Profit After Tax	662.9	1,292.4	1,352.6	1,383.6
Invt Income	(36.9)	(148.6)	(146.1)	(147.9)
Interest Paid	13.5	1.0	10.8	44.7
Depreciation	389.5	434.7	388.8	485.9
Deferred Taxation	(27.2)	(6.9)	22.5	23.3
Others	(78.4)	(8.8)	(241.0)	(70.5)
Change in Working Cap	(74.6)	(21.6)	(46.1)	17.6
CF - Operating Activities	850.9	1,542.2	1,341.6	1,736.6
Change in Fixed Assets	(338.4)	(1,077.6)	(1,069.6)	(981.7)
Change in Investments	(211.2)	(794.9)	132.8	0.0
Investment Income	36.9	148.6	146.1	147.9
CF - Investing Activities	(512.6)	(1,723.8)	(790.8)	(833.8)
Increase in Equity	10.4	(2.5)	(195.6)	5.9
Changes in Minority Interest	12.0	86.0	(99.8)	19.3
Changes in Borrowings	(119.5)	373.0	(146.4)	(150.0)
Interest Paid	(13.5)	(1.0)	(10.8)	(44.7)
Dividend Paid	(231.9)	(254.2)	(381.5)	(415.0)
CF - Financing Activities	(342.4)	201.4	(834.1)	(584.5)
Net Change in Cash	(4.2)	19.8	(283.3)	318.3
Closing Cash & Bank Bal	923.8	943.5	660.3	978.6

Earnings Statement				
YE March (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
Sales & Services	5,070.3	8,977.2	14,283.7	16,569.1
Total Expenditure	4,668.2	8,189.2	13,169.0	14,918.4
- Purchase of traded goods	2,960.9	3,764.0	5,422.2	6,289.7
- Operating expenses	1,707.3	4,425.2	7,746.8	8,628.6
Operating Profit	402.1	788.0	1,114.7	1,650.7
Other Income	38.7	198.6	310.6	57.3
EBITDA	440.8	986.6	1,425.3	1,708.0
Depreciation	107.7	297.4	433.5	448.2
EBIT	333.1	689.2	991.8	1,259.8
Interest	6.6	27.7	49.6	70.0
PBT	326.5	661.5	942.2	1,189.8
Tax	51.1	83.5	125.2	267.7
PAT before MI	275.4	578.0	817.0	922.1
Minority Interest	-	107.3	237.8	160.0
Profit from Affiliates	-	9.6	6.0	-
PAT before EI	275.4	480.3	585.2	762.1
Extraordinary Items	(161.8)	-	-	-
Reported PAT	113.6	480.3	585.2	762.1

Ratio Analysis				
YE March (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
OPM (%)	7.9%	8.8%	7.8%	10.0%
EBITDA (%)	8.7%	11.0%	10.0%	10.3%
PBIT (%)	6.6%	7.7%	6.9%	7.6%
PAT (%)	5.4%	5.3%	4.1%	4.6%
EPS (Rs.)	2.6	4.6	5.6	7.2
P/E (x)	6.5	3.7	3.1	2.3
P/BV (x)	1.2	1.0	0.8	0.6
BVPS (Rs.)	14.5	17.8	21.8	27.7
Market Cap (Rs. Mn.)	1,787.7	1,787.7	1,787.7	1,787.7
M Cap/Sales (x)	0.4	0.2	0.1	0.1
EV (Rs. Mn.)	1,787.7	2,368.9	2,071.1	1,787.7
EV/EBITDA (x)	4.1	2.4	1.5	1.0
EV/Sales (x)	0.4	0.3	0.1	0.1
ROCE (%)	21.9%	26.2%	34.9%	37.7%
RONW (%)	18.1%	25.7%	25.6%	26.1%
Inventory T/o Days	5.4	2.3	3.7	4.0
Debtors T/o Days	94.1	79.0	61.0	60.7
Advances T/o Days	29.8	17.6	10.8	13.7
Creditors T/o Days	93.5	127.7	79.1	49.0
Working Cap T/o Days	71.8	17.2	13.8	23.1
Fixed Assets T/o (Gross)	6.9	1.3	2.0	2.2
DPS (Rs.)	1.0	1.1	1.1	1.1
Dividend Payout (%)	38.2%	24.1%	19.8%	15.2%
Dividend Yield (%)	5.9%	6.5%	6.5%	6.5%

Balance Sheet				
YE March (Rs. Mn.)	**FY06**	**FY07**	**FY08**	**FY09E**
Equity Capital	105.2	105.2	105.2	105.2
Reserves	1,416.4	1,762.4	2,183.4	2,810.2
Shareholders Funds	1,521.6	1,867.6	2,288.5	2,915.3
Minority Interest	-	184.9	269.1	429.1
Borrowed Funds	-	581.2	283.4	-
Deferred Tax Liabilities	0.9	0.6	1.1	1.1
Total Liabilities	**1,522.5**	**2,634.2**	**2,842.2**	**3,345.5**
Fixed Assets				
Gross Block	736.7	6,922.4	7,173.7	7,416.9
Accumulated Depn.	418.6	5,074.8	5,410.5	5,666.6
Net Block	318.2	1,847.7	1,763.2	1,750.3
Capital WIP	15.9	49.5	74.1	80.9
Investments	75.7	143.1	238.7	238.4
Current Assets				
Inventory	75.5	56.1	144.7	182.7
Sundry Debtors	1,307.4	1,941.9	2,386.9	2,754.1
Loans & Advances	414.2	432.1	424.5	620.7
Cash & Bank Balance	571.1	1,212.5	764.4	857.5
Current Liabilities				
Sundry Creditors	1,298.8	3,141.7	3,096.2	2,222.5
Provisions	71.9	77.9	85.4	1,143.8
Net Current Assets	997.5	423.0	539.0	1,048.7
Deferred Tax Assets	115.3	171.0	227.2	227.2
Total Assets	**1,522.5**	**2,634.2**	**2,842.2**	**3,345.5**

Cash Flow				
Particulars	**FY06**	**FY07**	**FY08**	**FY09E**
Opening Cash & Bank	166.9	571.1	1212.5	764.4
Profit After Tax	113.6	480.3	585.2	762.1
Investment Income	(38.7)	(198.6)	(310.6)	(57.3)
Depreciation	107.7	297.4	335.8	256.1
Others	192.5	175.6	(55.6)	0.0
Change in Working Cap	239.8	1081.5	(564.1)	(416.7)
CF - Operating Activities	614.9	1836.1	(9.3)	544.2
Change in Fixed Assets	(140.1)	(1860.6)	(275.9)	(250.0)
Change in Investments	61.7	(67.3)	(95.6)	0.3
Investment Income	38.7	198.6	310.6	57.3
CF - Investing Activities	(39.7)	(1729.3)	(60.9)	(192.4)
Increase in Equity	0.0	0.0	(28.9)	(0.0)
Changes in Borrowings	(51.1)	581.2	(297.8)	(283.4)
Changes in Minority Hldg	0.0	87.1	84.2	160.0
Dividend Paid	(119.9)	(133.8)	(135.3)	(135.3)
CF - Financing Activities	(171.0)	534.6	(377.8)	(258.8)
Net Change in Cash	404.2	641.4	(448.1)	93.0
Closing Cash & Bank Bal	571.1	1212.5	764.4	857.5

Earnings Statement				
Particulars (Rs Mn.)	**FY07**	**FY08**	**Q1FY09**	**FY09E**
Total Revenues	2,654.8	6,370.5	1,703.2	7,371.0
- Growth (%)		140.0%	N.A.	15.7%
Total Expenditure	2,388.0	5,432.0	1,434.9	6,142.7
Operating Profit	266.7	938.5	268.3	1,228.3
Other Income	161.1	363.6	76.0	296.2
EBITDA	427.9	1,302.1	344.4	1,524.5
Depreciation	143.6	279.5	74.4	286.9
EBIT	284.3	1,022.6	270.0	1,237.6
Interest	0.5	14.5	17.8	78.6
PBT	283.7	1,008.1	252.2	1,159.0
Tax	(9.1)	133.9	51.7	208.6
PAT Before MI	292.9	874.1	200.5	950.4
Share in Associates	0.0	0.0	0.2	0.6
Minority Interest	0.0	0.0	0.0	0.0
PAT after MI	292.9	874.2	200.7	951.0
- Growth (%)		198.5%	N.A.	8.8%
Extraordinary Items	0.0	0.0	0.0	0.0
Reported PAT	292.9	874.2	200.7	951.0

Ratio Analysis				
Particulars	**FY07**	**FY08**	**Q1FY09**	**FY09E**
OPM (%)	10.0%	14.7%	15.8%	16.7%
EBITDA (%)	16.1%	20.4%	20.2%	20.7%
PBIT (%)	10.7%	15.8%	14.8%	15.7%
PAT (%)	11.0%	13.7%	11.8%	12.9%
Interest Cover (x)	534.3	70.5	60.8	15.7
EPS (Rs.)	14.3	42.6	39.1	46.3
P/E (x)	10.5	3.5	3.8	3.2
P/BV (x)	0.4	0.4	0.4	0.4
BVPS (Rs.)	334.7	367.2	388.7	401.9
Market Cap (Rs. Mn.)	3,078.6	3,078.6	3,078.6	3,078.6
M Cap/Sales (x)	1.2	0.5	1.8	0.4
EV (Rs. Mn.)	(2,434.7)	(2,130.8)	(1,644.8)	(1,788.0)
EV/EBITDA (x)	n.a.	n.a.	n.a.	n.a.
EV/Sales (x)	n.a.	n.a.	n.a.	n.a.
ROCE (%)	4.1%	13.0%	12.3%	13.5%
RONW (%)	4.3%	11.6%	10.1%	11.5%
Debt/Equity Ratio (x)	0.0	0.0	0.1	0.1
Inventory T/o Days	0.0	0.0	0.0	0.0
Debtors T/o Days	137.1	60.0	44.2	65.0
Advances T/o Days	213.1	70.0	22.3	75.0
Creditors T/o Days	370.1	90.0	32.2	75.0
W Cap(ExCash)T/o Days	(89.7)	33.8	42.4	72.4
Fixed Assets T/o (Gross)	0.9	2.1	2.0	2.1
DPS (Rs.)	5.0	8.5	0.0	10.0
Dividend Payout (%)	35.1%	20.1%	0.0%	21.6%
Dividend Yield (%)	3.3%	5.7%	0.0%	6.7%

Balance Sheet				
Particulars (Rs Mn.)	**FY07**	**FY08**	**Q1FY09**	**FY09E**
Equity Capital	205.4	205.4	205.4	205.4
Share Application Money	0.0	0.0	0.0	0.0
Reserves	6,668.4	7,337.2	7,776.9	8,047.9
Shareholders Funds	6,873.8	7,542.6	7,982.3	8,253.3
Borrowed Funds	4.3	276.1	714.5	714.5
Deferred Tax Liability	9.0	72.5	111.2	203.9
Minority Interest	0.0	0.0	0.0	0.0
Total Liabilities	**6,887.2**	**7,891.2**	**8,808.0**	**9,171.7**
Goodwill	0.0	0.0	0.0	0.0
Fixed Assets	2,022.2	1,816.1	2,567.4	2,129.2
Investments	421.3	100.0	22.6	0.0
Current Assets				
Inventory	0.0	0.0	0.0	0.0
Sundry Debtors	997.2	1,047.2	837.1	1,312.6
Loans & Advances	1,549.8	1,221.7	422.7	1,514.6
Cash & Bank Balance	5,096.4	5,385.6	5,415.3	5,581.2
Other C.A. (Deposits)	126.8	261.8	449.5	504.9
Current Liabilities				
Sundry Creditors	2,691.7	1,570.8	608.8	1,514.6
Provisions	634.7	370.4	297.8	356.2
Net Current Assets	4,443.7	5,975.1	6,218.0	7,042.5
Miscellaneous Expenditure	0.0	0.0	0.0	0.0
Total Assets	**6,887.2**	**7,891.2**	**8,808.0**	**9,171.7**

Cash Flow				
Particulars (Rs Mn.)	**FY07**	**FY08**	**Q1FY09**	**FY09E**
Opening Cash & Bank	6,236.6	5,096.4	5,385.6	5,385.6
Profit After Tax	292.9	874.2	200.7	951.0
Invt Income	(161.1)	(363.6)	(76.0)	(296.2)
Interest Paid	0.5	14.5	17.8	78.6
Miscellaneous Exp W/Off	0.0	0.0	0.0	0.0
Depreciation	143.6	279.5	74.4	286.9
Deferred Taxation	(18.2)	63.5	25.2	92.7
Others	(110.8)	0.0	(361.5)	38.7
Change in Working Cap	(171.7)	(1,242.3)	(213.2)	(871.8)
CF - Operating Activities	(24.9)	(374.2)	(332.7)	279.9
Change in Fixed Assets	(1,004.4)	(73.4)	(450.6)	(600.0)
Change in Investments	(134.4)	321.3	77.4	100.0
Investment Income	161.1	363.6	76.0	296.2
CF - Investing Activities	(977.6)	611.5	(297.2)	(203.8)
Increase in Equity	0.0	0.0	239.0	(0.0)
Changes in Borrowings	(16.9)	271.8	438.4	438.4
Interest Paid	(0.5)	(14.5)	(17.8)	(78.6)
Dividend Paid	(120.1)	(205.4)	0.0	(240.3)
CF - Financing Activities	(137.6)	51.9	659.6	119.5
Net Change in Cash	(1,140.1)	289.2	29.7	195.6
Closing Cash & Bank Bal	5,096.4	5,385.6	5,415.3	5,581.2

Ferris Wheels

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Offshore, Ship Building, et.al.

"Cyclicals are like blackjack: Stay in the game too long,
and it's bound to take back all your profit."
- Peter Lynch

Don't blame the market

All the stocks have been battered by the ongoing liquidity-crunch. One should realize that the commodity down-cycle have coincided with the crisis.

When doing our coverage on Aban, we thought we have been conservative in factoring replacement costs, higher WACC rate and also a terminal drop in realization. We had our arguments for preference for DCF based valuation versus the usual P/E methodology, as the near term earnings would not reflect the normalized sustainable earnings due to asset movement & dry-dockingand would not be able to capture the long term performance of the company. Few others have went with the relative parameters like P/E, P/BV, EV/EBITDA etc. for their recommendations, for it is difficult to predict the longer term profitability for these cyclical companies and so focus near-term. How naive- All !

So something went wrong. Like many others, we were not able to foresee the macro financial turmoil emerging and consequently its implications on the oil prices. Aban has had some new contracts recently at rates even better than what we had anticipated. The company appears to be extremely cheap on near term & medium term expected profitability. But the current drop in the oil prices certainly puts a big question on the sustainability of the rate in the longer run, which are now more likely to deteriorate.

But our Bigger wrong was to get carried away by the seemingly cheap valuations. We misjudged these cyclicals as growth stocks. This is a cyclical industry which identifying the trend would be more important than the valuation. In fact these make good investments with a 'Buy high P/E, Sell low P/E' strategy.

Back to Basics

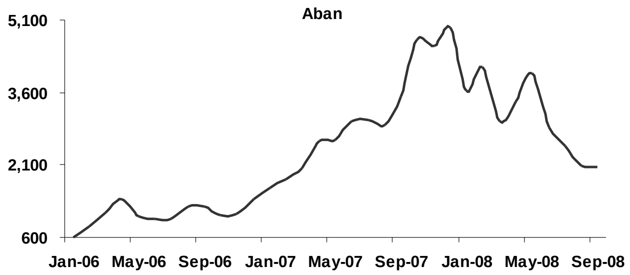
A cyclical company would see its sales and profits rise and fall in a regular manner, as the industry moves from expansionary & recessionary cycles. Examples would be - metals, automobiles, paper, chemicals, airlines, shipping, offshore, ship-building, etc..

Example: Company ABC is cheap or expensive? How should one value this stock?

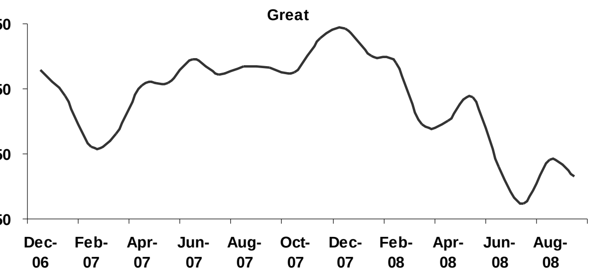
Year	Phase	EPS (Rs)	Price	PE	Price/Avg EPS
2004	Bottom	30.0	600.0	20.0	2.7
2008	Peak	500.0	3000.0	6.0	13.7
2012	Bottom	125.0	1250.0	10.0	5.7
2004-2012	Average	218.3			

It is generally understood that low PE is cheap stock, and high PE is expensive stock. But for a cyclical, one may wrongly end up NOT buying in 2004 at Rs. 600, when its PE is HIGH at 20 and NOT sell in 2008 at Rs. 3000 when its PE is LOW at 6. Clearly a long-term but a faulty value strategy would prove disastrous. So re-iterating again, identifying the trend would be more important than the valuation. Here is a graphical representation of the above philosophy for some of our coverage scrips.

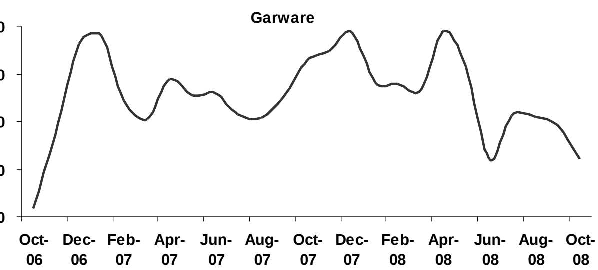
As Peter Lynch says, "Polygraphs of liars and the Maps of the Alps."



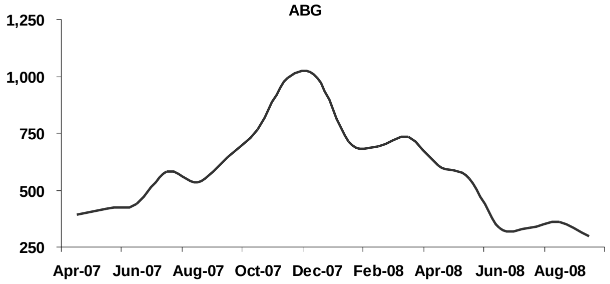
FY09	Aban
EPS	357.0
BVPS	591.6
P/E	2.5
P/BV	1.5



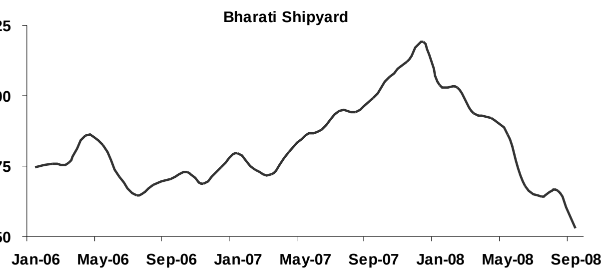
FY09	Great
EPS	60.0
BVPS	265.8
P/E	5.7
P/BV	1.3



FY09	Garware
EPS	22.9
BVPS	103.4
P/E	4.4
P/BV	1.0



FY09	ABG
EPS	41.9
BVPS	305.1
P/E	3.0
P/BV	0.4



FY09	Bharati
EPS	46.5
BVPS	291.9
P/E	1.5
P/BV	0.2

Source: Bloomberg, PPFAS Research

Offshoring Outlook

Charter rates for any type of a vessel have on an average increased to 3 times in the current cycle. For example, rates for Jack-ups increased from $50,000/ day to $1,50,000/ day. The deep water rigs saw a sharper rise as the oil prices surged to unprecedented levels.

Lets look at the earnings. Aban earns a Rs. 20 Bn. net profit on a topline of Rs. 60 Bn. in FY10E from its long term contracts. Offshore companies have fixed cost – variable revenue model. Like every rise in the day rates has a direct impact on the bottomline, the vice-versa is also true. Imagine, if the day rates for new contracts correct by 33% on account of the lower oil prices (still ~$1,00,000/day for a Jack-up) and there is a near similar impact on the bottomline as well. There is case of a near complete wipe-off in profits. The company is highly leveraged and an early change in cycle would bring a lot of trouble to the company. It would be helpful to remind oneself, that just before the Sinvest consolidation, Aban achieved a PAT of just Rs. 1.2 Bn. on a turnover of Rs. 20 Bn and a loss in FY07 on a turnover of Rs. 7 Bn.

Deepwater rigs have a higher delta. Drilling deep involves higher cost and makes economical sense, when the oil prices are above a certain threshold. Generally these larger & more complex vessels have seen the highest surge in the day rates. These may now see the highest fall, followed by the Jackups and then the other OSVs. The actual change may not be in the same order as the demand & supply scenario would play its own role as well. But for once assuming the DD-SS scenario constant, the larger companies like Aban may feel the highest pain.

Can the prices go lower from the already battered levels ? Generally one may resort to other methods like P/BV or NAV, etc. to determine a base case valuation. However, for offshore industry, one should realize that the book values & NAV are as cyclical as the the day rates. As the day rates go down the market value of these generally easily traded assets will move correspondingly. Even the payback period methodology goes for toss, if the company does not realize the expected realizations from these assets. Estimated Payback time and DCF based valuations suffer from a very high risk of assumptions going wrong.

What we think for Aban is also what we perceive for the other plays in the offshore segment. True that Aban has done well to secure a few long dated contracts for its working assets. But to hold on with the hope of cycle improving would tantamount to getting trapped in an 'Aversion to a Sure Loss' framework, which a critical part of the 'Prospect Theory' by Kahneman & Tversky.

Also read : Creative Destruction (or) Destruction of Creativity?

www.ppfas.net/blog

Ship Building – This time its (NOT) different !

Different - is what we thought, when we first became cognizant of some order cancellations in China and an initial drop in the shipping rates. Coz unlike earlier & other companies abroad, the Indian Ship Building companies had been clever to book orders for extended period and that to on their future expanded capacities. Plus they have in place back-to-back arrangements for the raw materials & bought out components. Therefore, we have a case where there is a strong visibility for a sharp uptrend in both revenues & earnings. And 3.5 years is lot reasonable a time to secure more orders the period beyond. It has been a mistake to play the extended cycles and again here we see the share price performance in contrast to the earnings trend.

Shipyard Outlook

At Rs. 71, Bharati Shipyard is trading at just 1.5 times its FY09E earnings and a P/BV of just 0.2 times. As on March 08 it had Rs. 42 per share as cash on hand, which is ~45% of its current market cap. It has secured long term orders on good margins. The P/BV parameter for a shipyard is a much more realistic figure as compared for an offshore company. But the company may be in for some trouble in the near to medium term. The cash on hand is not free. The represent some of the money raised through $100 Mn. FCCB in December 2005. The first tranche of $20 Mn worth of bonds have got converted, but the balance $80 Mn. are due in December 2010. With conversion rate at Rs. 498 per share, these will be called for redemption. With the company still in a big capex mode and also the working capital blockage on account of subsidy, the company does not have any free cash flows. The likely fallout of this could be postponement/shelving of future plans, raise new debt to repay old one, alternatively much higher dilution to same/other investors at much lower rates, etc. Whatever, the fallout, it will be detrimental to the interest of the common stockholder.

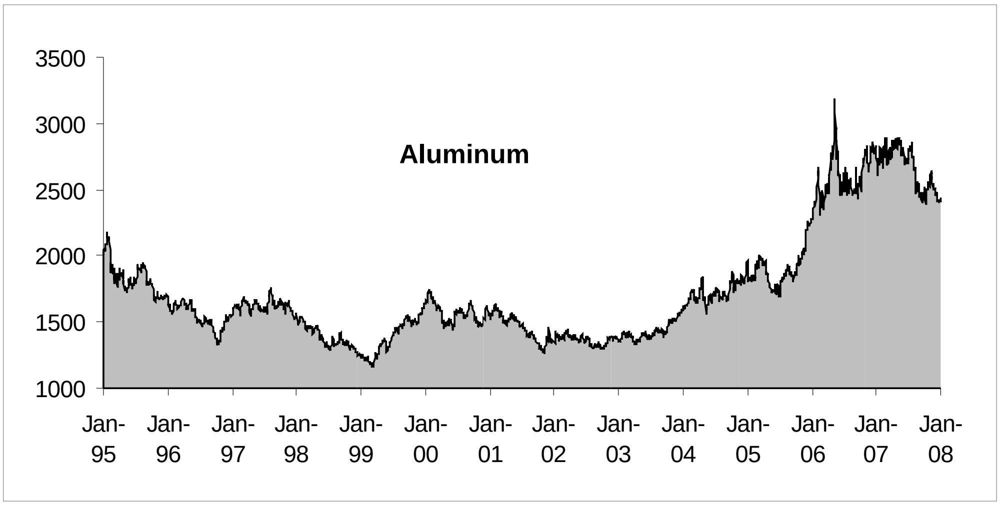
At 126, ABG Shipyard is trading at 3x its FY09E earnings and a P/BV of 0.4x. Though overall cheap, but it seems much expensive as compared to Bharati. We see that ABG has been lucky versus Bharati in terms of its strategy for a pro equity funding and relatively lower back-to-back bookings of raw materials for the future contracts. ABGs QIP plans goes for a toss, but still has room for securing debt on account of its relatively under-leveraged status. Plus it can nor cover-up some pending inputs at lower costs.

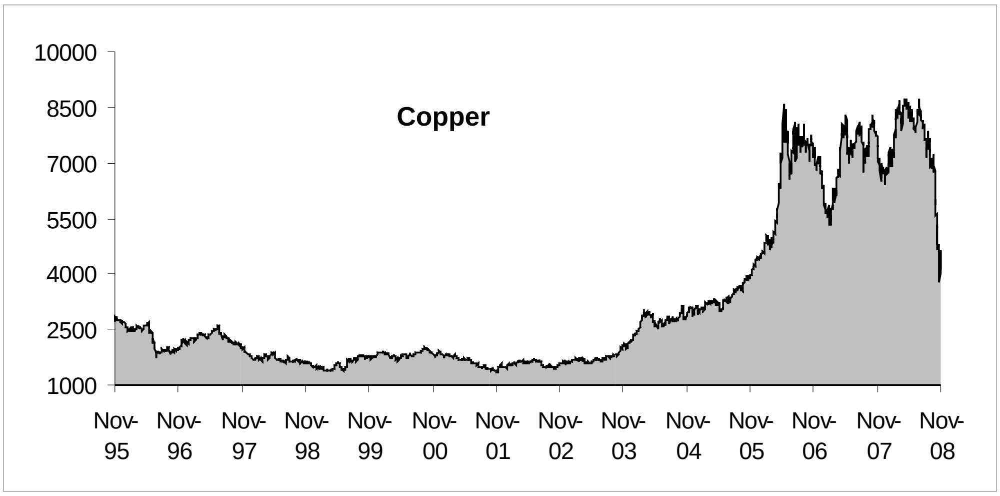
We appreciate that the company has taken orders from genuine users & not ship traders, who are used to ride the trade cycles. Plus also the loss of stage-wise & advance payments in case of any cancellations. However, the extent of liquidity crunch globally, can put on strain on the buyers to service the capex installments. The news of any cancellations for any shipyard company will not be taken well by the markets. What we sense that the world's largest consumers, USA & Europe going in for a recession, will have the biggest hit on the global trade. A weakening currency will make consumption of imported goods even more expensive. While the shipping indices have come down substantially, there is little case of any revival in the foreseeable future. We fear that this coupled with the liquidity crunch could test the patience of the genuine ship-owners, who have placed orders with the shipyards. Tighter credit & poor cash-flows would add more strain to the general functioning of the Indian Shipyard companies. We recommend to consider these risks and avoid falling in for these seemingly cheap & bottomed-out scrips.

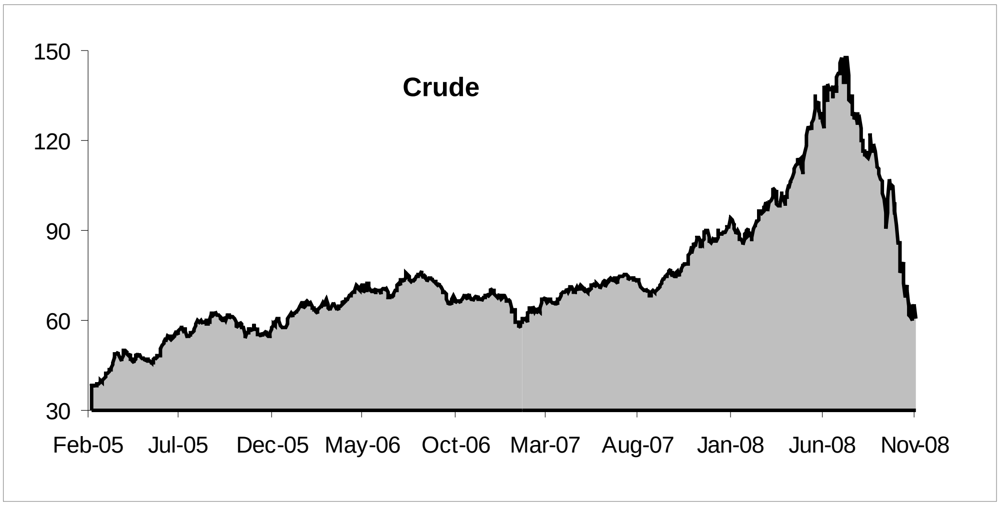
Aluminium, Copper, Crude

True, most of these commodities have corrected a lot. But maybe not enough. These prices are still higher than the long term averages. Plus almost the entire the world & not a nation is headed for a slowdown/recession. These commodities are global commodities and should be looked from a global perspective and not on a country-specific perspective.

We again re-iterrate our opinion : 'The commodity cycles have coincided with the liquidity-crunch.' Please discern this and avoid catching a falling knife.







Source: Bloomberg, PPFAS Research

Long term?

After so much mayhem, do these make attractive long term bets ?

Predicting an upturn is an arduous task in itself. It seems that the bad news have now been factored in. Hopefully. But even this would not be enough. There needs to be some positive news-flow before we see a reversal of trend. Given the global financial turmoil and the ensuing slowdown or recession, we may witness a notable drop in consumption, oil prices & global trade. The wait doesn’t end here. Still would need a resurrection / re-constructing news-flow.

What Now – when the damage has already been done ?

Don't go for mistake no 2. A natural behavioral tendency or fallacy would be to cling to these stocks. Should the economic scenario worsen, investors saddled with cyclicals may have to wait for long periods, before the stocks return to their recent highs. Cyclicals make terrible buy & hold investments. Also you don't have to make it back the same way you lost it. Time to shift to better alternatives. Look for blue-chip banks, FMCG, etc..

Lamentably, we find it difficult to do a detailed forecast in a downturn versus earlier. So we shamefully & discreetly shift our allegiance to Keynes - “Better roughly right than precisely wrong.”

Companies

Aban Offshore Ltd.

Aban Offshore Ltd. (AOL) is the largest private sector offshore drilling entity in India, providing world class drilling & oil-field services to the offshore oil & gas industry. With the acquisition of Sinvest ASA, AOL now has a total fleet of 21 drilling assets, placing it among the top ten drilling asset owners in the world. Almost all its revenues come from the charter day rates for its drilling rigs, besides which it also very small revenue share coming from its wind power generation unit.

A few months back, where crude oil prices had sky-rocketed to US$ 145 levels, the day rates for all the offshore drilling & support vessels had also zoomed to their all-time high levels. Companies like AOL had seen a corresponding jump (two-fold & three-fold in some cases) in the charter day rates for their drilling vessels.

But now the tide seems to have changed. With the financial turmoil across the world & developed countries like US & Europe on the brink of a recession, the crude oil prices have retrenched a great deal to sub US$ 65 levels. Can this steep fall in crude oil prices lead to a dip in investments by the Oil & Gas majors, thereby leading to a drop in charter day rates for the drilling vessels ? The answer to this is anyone's guess.

For AOL, who has majority of its drilling assets entered into long-term contracts, ranging from 3 – 5 year periods, this might not be of much impact. But if the recent contracts are any indication of the times to come, there definitely seems some tough times ahead. Aban has recently contracted two rigs, 'Deep Driller 5' & 'Deep Venture' at day rates about 15% higher than their previous contracts. On the other hand, as per the last announcement, it contracted another rig 'Deep Driller 3' at day rates about 28% lower than its previous contract. So it remains to be seen whether AOL is able to contract its other vessels that come up for renewal, at same day rates as their current contracts, or may be higher or lower. However, we believe that even a 15-20% drop in future day rates for Aban's vessels will have a significant impact on the company's earnings going forward.

At CMP of Rs. 882.6, the scrip trades at 2.5x FY09E earnings. We recommend a SELL.

Garware Offshore Services Ltd.

Garware Offshore Services Ltd. (GOSL) is a company engaged in providing offshore support services to the offshore oil & gas industry. It currently owns & operates a fleet of seven offshore support vessels (OSV), catering to oil & gas companies, largely in India. It earns majority of its revenues from the chartering of its OSV's, the charter rates for which had risen in conjunction with those of the drilling rigs. The company also gets revenues from its agreement with a Norway shipbuilding company, to sell ships & ship designs. However, with the steep retracement in crude prices over the past two months, we believe that it might be difficult for companies to fetch similar chartering rates as have been in the recent past.

At Rs. 101.35, GOSL trades at 4.4x FY09E earnings. We recommend a SELL on rise.

Great Offshore Ltd.

Great Offshore Ltd. (GOFF) is an integrated offshore oilfield services provider, offering a wide range of services from drilling to marine & air logistics, from marine construction to port / terminal services. It currently owns & operates a massive fleet of 41 offshore assets, comprising of drilling rigs & support vessels. GOFF came into being after the demerger of the offshore division of The Great Eastern Shipping Co. Ltd. GOFF earns its revenues from diversified operations of chartering of drilling rigs & offshore support vessels, marine construction contracts & operating of harbour tugs at major ports in India.

Although GOFF has diversified business operations, reducing its dependence on any one business segment, majority of its revenues come from the chartering of offshore assets. With the slump in crude oil prices & the current financial crisis all over the world, the outlook does not seem clear for GOFF to be able to garner similar day rates for its offshore vessels.

Even if the charter rates dip by 20%, there could be a significant impact on the company's earnings.

At CMP of Rs. 341.6, the scrip trades at 4.7x FY09E earnings. We recommend a SELL on rise.

ABG Shipyard Ltd.

ABG Shipyard Ltd. (ABG) is presently the largest private sector shipyard in India, manufacturing a variety of ships like bulk carriers, interceptor boats, diving support vessels, offshore support vessels, etc. ABG is one of the major shipbuilding companies worldwide in the niche area of offshore vessels. The company has already built & delivered over 100 vessels successfully since its inception. ABG had its primary yard located at Magdalla, Surat & has recently expanded its shipbuilding capacity at Surat & Dahej, in Gujarat. ABG Shipyard Ltd. currently has an order book of Rs. 114,000 Mn. including orders two Jack up rigs.

ABG has largely been using the equity route to raise funds for its expansion. The company has already done a private placement previously & further has plans to raise funds through QIB placements. It has also issued Convertible Warrants to its promoter during the last financial year. This policy of raising funds through the equity route leads to dilution of earnings for the existing shareholders.

We still believe that the shipbuilding era for India remains positive for the shipbuilding companies. However, in the current financial scenario, it may be difficult for ABG to raise funds through debt. Also the subscribers to convertibles already issued, would not want to convert these into equity shares, since the price of the scrip has been hammered & hence, these convertibles would come up for redemptions. Therefore, we believe that the company's expansion plans may get derailed or postponed. Also, in case of any order cancellations from the shipping companies that have placed orders with ABG, the company would suffer to much extent. The issue on the subsidy front still remains a gray area.

In the current market scenario of financial turmoil, bankruptcies & falling commodities, the impact has been clearly visible on the shipping sector, where the Baltic has corrected more than 75 – 80 percent from its peak. In such a scenario, it might be difficult for shipbuilding companies to report sustained growth going forward.

At CMP of Rs. 125.7, the scrip trades at 3x FY09E earnings. We recommend a SELL on rise.

Bharati Shipyard Ltd.

Bharati Shipyard Ltd. (BSL) is India's second largest private sector shipyard engaged in design & construction of various types of sea-going, coastal harbour, inland crafts & vessels. BSL has also developed itself as successful builder of the complex offshore support vessels. The companies main yard is located at Ratnagiri, besides which it has other scattered shipbuilding facilities at Ghodbunder, Goa & Kolkata. The company is also expansing its yard capacities at Mangalore & Dabhol. As of the last reported numbers, BSL has an order book of Rs. 48,750 Mn. (approx).

BSL has mostly taken the debt route for financing its expansion plans, although it has used the equity route as well – through the issue of FCCB. The company had issued FCCBs worth US$ 100 Mn. of which US$ 20 Mn. have already been converted into equity shares. Our view is that, the balance FCCBs would not get converted & would come up for redemptions, since the conversion price of Rs. 498 is way too high as compared to scrips CMP. This would lead to the company leveraging further, probably at higher cost to redeem these bonds, eventually leading to higher interest burden & decrease in earnings. Also this would have a negative impact on the companies expansion plans.

At CMP of Rs. 70.85, the scrip trades at 1.5x FY09E earnings. We recommend a SELL on rise.

Aban Offshore : SELL

Earnings Statement				
Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Total Revenues	4,901.6	7,186.8	20,210.6	46,573.2
- Growth (%)	69.3%	46.6%	181.2%	130.4%
Total Expenditure	2,089.6	3,712.6	7,794.0	14,584.8
Operating Profit	2,812.0	3,474.1	12,416.6	31,988.4
Share in Asso./JVs	0.0	203.6	853.1	0.0
Forex Gain/(Loss)	(8.4)	163.1	(1,943.8)	0.0
Other Income	147.8	717.9	1,069.9	322.7
EBITDA	2,951.4	4,558.6	12,395.8	32,311.1
Depreciation	1,014.0	1,265.6	3,077.5	5,542.1
EBIT	1,937.4	3,293.0	9,318.4	26,769.0
Interest	436.3	2,686.4	6,658.5	8,632.3
PBT	1,501.1	606.6	2,659.9	18,136.7
Tax	678.4	746.6	1,430.1	3,169.8
PAT Before EI & MI	822.6	(140.0)	1,229.8	14,966.9
Minority Interest (MI)	0.0	0.0	(0.1)	1,129.5
PAT Before EI	822.6	(140.0)	1,229.9	13,837.3
- Growth (%)	59.3%	-117.0%	-978.4%	1025.1%
Extraordinary Items (EI)	0.0	0.0	0.0	0.0
PAT	822.6	(140.0)	1,229.9	13,837.3

Ratio Analysis				
Particulars	FY06	FY07	FY08	FY09E
OPM (%)	57.4%	48.3%	61.4%	68.7%
EBITDA (%)	60.2%	63.4%	61.3%	69.4%
PBIT (%)	39.5%	45.8%	46.1%	57.5%
PAT (%)	16.8%	-1.9%	6.1%	29.7%
Interest Cover (x)	4.4	1.2	1.4	3.1
EPS (Rs.)	22.3	(3.8)	32.5	357.0
P/E (x)	39.5	(232.5)	27.1	2.5
P/BV (x)	7.6	6.1	4.1	1.5
BVPS (Rs.)	116.8	143.9	215.0	591.6
Market Cap (Rs. Mn.)	32,526.8	32,554.8	33,349.0	34,208.7
M Cap/Sales (x)	6.6	4.5	1.7	0.7
EV (Rs. Mn.)	43,489.5	127,816.2	157,329.9	147,955.5
EV/EBITDA (x)	14.7	28.0	12.7	4.6
EV/Sales (x)	8.9	17.8	7.8	3.2
ROCE (%)	12.6%	2.9%	6.7%	19.4%
RONW (%)	19.1%	-2.6%	15.1%	65.3%
Debt/Equity Ratio (x)	2.6	20.4	16.1	5.0
Inventory T/o Days	36.4	51.9	29.7	40.0
Debtors T/o Days	52.1	103.3	85.1	70.0
Advances T/o Days	13.5	145.8	23.1	20.0
Creditors T/o Days	62.2	336.4	118.6	75.0
Working Cap T/o Days	29.8	621.7	118.7	50.6
Fixed Assets T/o (Gross)	0.4	0.1	0.2	0.3
DPS (Rs.)	2.6	3.0	3.6	36.0
Dividend Payout (%)	11.7%	-79.2%	11.1%	10.1%
Dividend Yield (%)	0.3%	0.3%	0.4%	4.1%

Balance Sheet				
Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	73.7	73.8	75.6	77.5
Preference Capital	1,500.0	3,060.0	3,060.0	3,260.0
Reserves	2,730.5	2,174.4	4,987.7	19,591.7
Shareholders Funds	4,304.2	5,308.2	8,123.3	22,929.2
Minority Interest	0.0	0.0	0.0	1,129.5
Borrowed Funds	11,098.1	108,525.3	130,434.0	115,097.9
Deferred Tax Liability	655.9	737.5	653.6	1,379.1
Total Liabilities	**16,058.1**	**114,571.0**	**139,210.9**	**140,535.7**
Fixed Assets	15,466.3	97,647.5	126,246.9	127,689.9
Investments	192.1	4,682.5	6,390.9	6,390.9
Trade Investments	52.9	1,464.4	1,464.4	1,464.4
Current Assets				
Inventory	488.8	1,022.3	1,646.8	5,103.9
Sundry Debtors	699.0	2,033.1	4,712.1	8,931.8
Loans & Advances	181.4	2,870.8	1,277.7	2,552.0
Cash & Bank Balance	135.4	13,264.0	6,453.1	1,351.0
Current Liabilities				
Sundry Creditors	835.3	6,624.5	6,568.0	9,569.8
Provisions	269.7	324.7	948.6	1,914.0
Net Current Assets	399.7	12,241.0	6,573.1	6,454.9
Total Assets	**16,058.1**	**114,571.0**	**139,210.9**	**140,535.7**

Cash Flow				
Particulars (Rs Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	982.8	135.4	13,264.0	6,453.1
Profit After Tax	822.6	(140.0)	1,229.9	13,837.3
Investment Income	(147.8)	(717.9)	(1,069.9)	(322.7)
Interest Paid	436.3	2,686.4	6,658.5	8,632.3
Misc. Exp W/Off	0.0	0.0	0.0	0.0
Depreciation	1,014.0	1,265.6	3,077.5	5,542.1
Deferred Taxation	91.4	81.3	(83.8)	725.5
Others	(64.4)	205.1	(48.6)	0.0
Change in Working Cap	391.6	1,287.3	(1,143.0)	(4,983.9)
CF - Operating Activities	2,543.9	4,667.8	8,620.5	23,430.7
Change in Fixed Assets	(8,339.9)	(83,651.6)	(31,628.3)	(6,985.0)
Change in Investments	39.5	(4,490.4)	(1,708.3)	0.0
Investment Income	147.8	717.9	1,069.9	322.7
CF - Investing Activities	(8,152.6)	(87,424.1)	(32,266.7)	(6,662.3)
Increase in Equity	(4.1)	(127.6)	2,049.1	2,716.4
Changes in Pref. Capital	1,500.0	1,560.0	0.0	200.0
Changes in Borrowings	3,919.0	97,427.3	21,908.6	(15,336.1)
Chng in Minority Interest	0.0	0.0	0.0	1,129.5
Interest Paid	(436.3)	(2,686.4)	(6,658.5)	(8,632.3)
Dividend Paid – Equity	(109.3)	(129.7)	(159.2)	(1,632.4)
Dividend Paid – Preference	(108.0)	(158.7)	(304.7)	(315.5)
CF - Financing Activities	4,761.4	95,884.9	16,835.4	(21,870.4)
Net Change in Cash	(847.4)	13,128.5	(6,810.8)	(5,102.1)
Closing Cash & Bank	135.4	13,264.0	6,453.1	1,351.0

Garware Offshore : SELL

Earnings Statement				
Particulars (Rs Mn.)	CY05	CY06	FY08 (15mths)	FY09E
Total Revenues	308.6	523.8	1,136.7	1,459.6
- Growth (%)	-3.2%	69.7%	117.0%	28.4%
Total Expenditure	172.0	229.2	441.6	450.7
Operating Profit	136.6	294.6	695.1	1,009.0
Forex Gain/(Loss)	0.0	0.0	160.6	0.0
Other Income	3.1	10.7	11.8	4.3
EBITDA	139.7	305.2	867.5	1,013.2
Depreciation	35.7	76.2	160.3	212.3
EBIT	104.0	229.0	707.2	800.9
Interest	5.4	67.6	218.9	269.7
PBT	98.6	161.4	488.2	531.2
Tax	8.2	8.5	13.2	19.6
PAT Before EI	90.4	152.8	475.0	511.6
- Growth (%)	-26.9%	69.1%	210.8%	7.7%
Extra-ordinary Items	15.4	3.0	0.0	35.0
PAT	105.8	155.8	475.0	546.6

Ratio Analysis				
Particulars	CY05	CY06	FY08 (15mths)	FY09E
OPM (%)	44.3%	56.2%	61.2%	69.1%
EBITDA (%)	45.3%	58.3%	76.3%	69.4%
PBIT (%)	33.7%	43.7%	62.2%	54.9%
PAT (%)	29.3%	29.2%	41.8%	35.1%
Interest Cover (x)	19.4	3.4	3.2	3.0
EPS (Rs.)	7.3	8.3	19.9	22.9
P/E (x)	13.8	12.2	5.1	4.4
P/BV (x)	2.0	1.7	1.2	1.0
BVPS (Rs.)	51.7	60.5	82.8	103.4
Market Cap (Rs. Mn.)	1,461.6	1,908.2	2,414.1	2,414.1
M Cap/Sales (x)	4.7	3.6	2.1	1.7
EV (Rs. Mn.)	2,243.2	3,646.9	4,981.3	6,126.5
EV/EBITDA (x)	16.1	11.9	5.7	6.0
EV/Sales (x)	7.3	7.0	4.4	4.2
ROCE (%)	6.7%	7.7%	15.3%	12.7%
RONW (%)	12.1%	13.4%	24.1%	20.8%
Debt/Equity Ratio (x)	1.1	1.6	1.3	1.6
Inventory T/o Days	36.8	41.9	41.1	40.0
Debtors T/o Days	172.7	78.1	53.4	65.0
Advances T/o Days	153.7	87.0	43.0	87.5
Creditors T/o Days	40.2	36.5	30.7	40.0
Working Cap T/o Days	317.5	219.2	107.3	161.4
Fixed Assets T/o (Gross)	0.2	0.2	0.3	0.2
DPS (Rs.)	1.2	1.8	1.8	2.0
Dividend Payout (%)	16.4%	21.8%	9.0%	8.7%
Dividend Yield (%)	1.2%	1.8%	1.8%	2.0%

Balance Sheet				
Particulars (Rs Mn.)	CY05	CY06	FY08 (15mths)	FY09E
Equity Capital	144.2	188.3	238.2	238.2
Share Warrant – App. Money	13.7	32.7	0.0	0.0
Reserves	587.9	918.5	1,733.9	2,224.7
Shareholders Funds	745.8	1,139.5	1,972.0	2,462.9
Minority Interest	0.0	0.0	0.0	0.0
Borrowed Funds	810.8	1,847.2	2,653.0	3,853.0
Deferred Tax Liability	0.0	0.0	0.0	0.0
Total Liabilities	**1,556.7**	**2,986.7**	**4,625.0**	**6,315.9**
Fixed Assets	1,283.6	2,666.5	4,285.1	5,664.7
Investments	4.6	5.6	5.6	5.6
Current Assets				
Inventory	31.1	60.1	127.9	160.0
Sundry Debtors	146.0	112.1	166.2	259.9
Loans & Advances	130.0	124.8	133.9	350.0
Cash & Bank Balance	29.2	108.6	85.7	140.6
Current Liabilities				
Sundry Creditors	34.0	52.4	95.5	160.0
Provisions	33.9	38.7	84.0	105.0
Net Current Assets	268.4	314.5	334.3	645.5
Total Assets	**1,556.7**	**2,986.7**	**4,625.0**	**6,315.9**

Cash Flow				
Particulars (Rs Mn.)	CY05	CY06	FY08 (15mths)	FY09E
Opening Cash & Bank	19.0	29.2	108.6	85.7
Profit After Tax	105.8	155.8	475.0	546.6
Investment Income	(3.1)	(10.7)	(11.8)	(4.3)
Interest Paid	5.4	67.6	218.9	269.7
Misc. Exp W/Off	0.0	0.0	0.0	0.0
Depreciation	35.7	76.2	160.3	127.3
Deferred Taxation	0.0	0.0	0.0	0.0
Others	(94.8)	(3.9)	0.0	0.0
Change in Working Cap	(10.7)	33.2	(42.6)	(256.4)
CF - Operating Activities	38.3	318.4	799.9	682.9
Change in Fixed Assets	(869.3)	(1,455.3)	(1,780.8)	(1,506.9)
Change in Investments	(0.3)	(1.0)	0.0	0.0
Investment Income	3.1	10.7	11.8	4.3
CF - Investing Activities	(866.5)	(1,445.7)	(1,769.1)	(1,502.7)
Increase in Equity	72.3	257.8	440.4	0.0
Changes in Share Warrants	13.7	19.1	(32.7)	0.0
Changes in Borrowings	777.5	1,036.4	805.8	1,200.0
Interest Paid	(5.4)	(67.6)	(218.9)	(269.7)
Dividend Paid	(19.8)	(39.1)	(50.2)	(55.7)
CF - Financing Activities	838.4	1,206.6	944.4	874.6
Net Change in Cash	10.2	79.3	(24.8)	54.8
Closing Cash & Bank	29.2	108.6	85.7	140.6

Great Offshore : SELL

Earnings Statement

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Total Revenues	5,821.9	7,459.0	7,942.5	9,639.8
- Growth (%)		28.1%	6.5%	21.4%
Total Expenditure	3,193.5	4,334.6	3,853.4	4,787.1
Operating Profit	2,628.4	3,124.4	4,089.1	4,852.7
- Growth (%)		18.9%	30.9%	18.7%
Other Income	42.6	113.9	159.7	193.4
Forex Gain/(Loss)	36.2	386.0	0.0	0.0
EBITDA	2,707.2	3,624.3	4,248.8	5,046.1
- Growth (%)		33.9%	17.2%	18.8%
Depreciation	709.0	985.5	1,038.3	1,176.9
EBIT	1,998.2	2,638.8	3,210.4	3,869.2
Interest	360.6	683.9	620.8	380.8
PBT	1,637.6	1,954.9	2,589.7	3,488.4
Tax	185.8	173.4	293.0	467.6
PAT Before EI	1,451.8	1,781.5	2,296.7	3,020.8
- Growth (%)		22.7%	28.9%	31.5%
Extra-ordinary Items	0.0	234.8	0.0	0.0
PAT	1,451.8	2,016.3	2,296.7	3,020.8

Ratio Analysis

Particulars	FY07	FY08	FY09E	FY10E
OPM (%)	45.1%	41.9%	51.5%	50.3%
EBITDA (%)	46.5%	48.6%	53.5%	52.3%
PBIT (%)	34.3%	35.4%	40.4%	40.1%
PAT (%)	24.9%	27.0%	28.9%	31.3%
Interest Cover (x)	5.5	3.9	5.2	10.2
EPS (Rs.)	38.1	52.9	60.2	72.3
P/E (x)	9.0	6.5	5.7	4.7
P/BV (x)	2.1	1.5	1.3	1.0
BVPS (Rs.)	162.0	231.3	265.8	329.5
Market Cap (Rs. Mn.)	13,021.8	13,021.8	13,021.8	14,263.3
M Cap/Sales (x)	2.2	1.7	1.6	1.5
EV (Rs. Mn.)	19,911.0	19,289.1	18,598.2	15,816.8
EV/EBITDA (x)	7.4	5.3	4.4	3.1
EV/Sales (x)	3.4	2.6	2.3	1.6
ROCE (%)	14.6%	14.4%	16.4%	20.9%
RONW (%)	23.5%	22.9%	22.7%	22.0%
Debt/Equity Ratio (x)	1.2	1.1	0.9	0.3
Inventory T/o Days	4.0	3.8	4.5	4.5
Debtors T/o Days	77.7	85.5	72.0	72.0
Advances T/o Days	25.5	76.5	22.0	22.0
Creditors T/o Days	96.9	96.4	90.0	90.0
Working Cap T/o Days	45.0	201.8	184.3	127.9
Fixed Assets T/o (Gross)	0.4	0.5	0.4	0.5
DPS (Rs.)	8.0	16.0	18.0	22.0
Dividend Payout (%)	21.0%	30.2%	29.9%	30.4%
Dividend Yield (%)	2.3%	4.7%	5.3%	6.4%

Balance Sheet

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Equity Capital	381.2	381.2	381.2	417.5
10% OCR Pref. Capital		1,500.0	1,500.0	0.0
Reserves	5,794.6	6,934.1	8,252.6	13,342.4
Shareholders Funds	6,175.8	8,815.3	10,133.8	13,759.9
Borrowed Funds	7,465.6	9,461.3	9,445.1	4,759.6
Deferred Tax Liability	(32.9)	(65.7)	0.0	0.0
Total Liabilities	**13,608.5**	**18,210.9**	**19,578.9**	**18,519.5**
Fixed Assets	12,889.5	13,904.7	15,386.4	14,959.4
Goodwill on Consolidation	0.5	0.5	0.5	0.5
Investments	0.0	181.9	181.9	181.9
Current Assets				
Inventory	63.1	78.3	97.9	118.8
Sundry Debtors	1,239.6	1,748.2	1,566.7	1,901.6
Loans & Advances	406.4	1,562.9	478.7	581.0
Other Current Assets	5.5	0.0	0.0	0.0
Cash & Bank Balance	576.4	3,194.0	3,868.7	3,206.0
Current Liabilities				
Sundry Creditors	1,545.7	1,971.0	1,958.4	2,376.9
Provisions	27.2	488.6	43.5	52.8
Net Current Assets	718.1	4,123.8	4,010.1	3,377.7
Total Assets	**13,608.5**	**18,210.9**	**19,578.9**	**18,519.5**

Cash Flow

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Opening Cash & Bank	1,024.0	576.4	3,325.3	4,000.0
Profit After Tax	1,451.8	2,016.3	2,296.7	3,020.8
Investment Income	(42.6)	(113.9)	(159.7)	(193.4)
Interest Paid	360.6	683.9	620.8	380.8
Miscellaneous Exp W/Off	2.1	0.4	0.0	0.0
Depreciation	709.0	985.5	1,038.3	1,176.9
Deferred Taxation	(61.5)	(32.8)	65.7	0.0
Others	(3.2)	0.0	0.0	0.0
Change in Working Cap	(146.4)	(788.1)	788.4	(30.2)
CF - Operating Activities	2,269.8	2,751.3	4,650.1	4,354.9
Change in Fixed Assets	(5,778.2)	(1,869.4)	(2,520.0)	(750.0)
Change in Investments	0.0	(181.9)	0.0	0.0
Investment Income	42.6	113.9	159.7	193.4
CF - Investing Activities	(5,735.6)	(1,937.4)	(2,360.3)	(556.6)
Increase in Equity	72.5	(63.9)	0.0	3,180.0
Changes in Pref.Capital	0.0	1,500.0	0.0	(1,500.0)
Changes in Borrowings	3,654.0	1,995.7	(16.2)	(4,685.5)
Interest Paid	(360.6)	(683.9)	(620.8)	(380.8)
Dividend Paid – Equity	(347.7)	(728.1)	(802.7)	(1,074.7)
Dividend Paid – Preference	0.0	(84.8)	(175.5)	0.0
CF - Financing Activities	3,018.2	1,935.0	(1,615.2)	(4,460.9)
Net Change in Cash	(447.6)	2,748.9	674.7	(662.6)
Closing Cash & Bank Bal.	576.4	3,325.3	4,000.0	3,337.3

ABG Shipyard : SELL

Earnings Statement

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Revenues (Excl Subsidy)	6,242.2	8,851.4	13,837.4	20,732.7
- Growth (%)	33.2%	41.8%	56.3%	49.8%
Total Expenditure	5,107.9	6,751.7	10,857.6	16,300.6
Operating Profit	1,134.3	2,099.7	2,979.8	4,432.1
Other Income	52.7	74.0	62.3	82.3
Subsidy	819.4	817.0	1,651.1	2,476.7
EBITDA	2,006.4	2,990.7	4,693.3	6,991.1
EBITDA (Excl. Subsidy)	*1,187.0*	*2,173.7*	*3,042.2*	*4,514.4*
Depreciation	59.6	74.0	225.4	374.2
EBIT	1,946.8	2,916.7	4,467.8	6,616.9
Interest	266.8	457.1	470.0	785.0
PBT	1,679.9	2,459.6	3,997.8	5,831.9
Tax	518.4	852.8	1,359.3	1,982.8
PAT Before EI	1,161.5	1,606.8	2,638.6	3,849.1
- Growth (%)	38.7%	38.3%	64.2%	45.9%
Extra-ordinary Items	1.6	-0.3	0.0	0.0
PAT	1,163.1	1,606.5	2,638.6	3,849.1

Ratio Analysis

Particulars	FY07	FY08	FY09E	FY10E
OPM (%)	18.2%	23.7%	21.5%	21.4%
EBITDA (%)	32.1%	33.8%	33.9%	33.7%
EBITDA % (Excl. Subsidy)	19.0%	24.6%	22.0%	21.8%
PBIT (%)	31.2%	33.0%	32.3%	31.9%
PAT (%)	18.6%	18.1%	19.1%	18.6%
Interest Cover (x)	7.3	6.4	9.5	8.4
EPS (Rs.)	22.8	31.5	41.9	56.7
P/E (x)	5.5	4.0	3.0	2.2
P/BV (x)	1.1	0.8	0.4	0.3
BVPS (Rs.)	115.4	150.5	305.1	397.2
Market Cap (Rs. Mn.)	6,400.9	6,400.9	7,909.3	8,537.8
M Cap/Sales (x)	1.0	0.7	0.6	0.4
EV (Rs. Mn.)	9,095.1	10,755.2	11,700.2	15,667.7
EV/EBITDA (x)	4.5	3.6	2.5	2.2
EV/Sales (x)	1.5	1.2	0.8	0.8
ROCE (%)	19.5%	22.6%	18.3%	18.5%
RONW (%)	19.8%	21.0%	13.7%	14.3%
Debt/Equity Ratio (x)	0.7	0.7	0.3	0.3
Inventory T/o Days	311.1	512.5	300.0	300.0
Debtors T/o Days	4.7	3.5	5.0	5.0
Advances T/o Days	387.4	454.9	325.0	325.0
Creditors T/o Days	303.2	641.4	250.0	250.0
Working Cap T/o Days	473.1	356.6	409.7	400.0
Fixed Assets T/o (Gross)	3.5	3.4	2.1	1.9
DPS (Rs.)	1.5	2.0	3.0	4.0
Dividend Payout (%)	6.6%	6.3%	7.2%	7.1%
Dividend Yield (%)	1.2%	1.6%	2.4%	3.2%

Balance Sheet

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Equity Capital	509.2	509.2	629.2	679.2
Convertible Warrants		318.7		
Reserves	5,369.2	6,835.3	18,566.4	26,297.6
Shareholders Funds	5,878.4	7,663.2	19,195.6	26,976.8
Minority Interest	0.0	0.0	0.0	0.0
Borrowed Funds	4,095.8	5,222.0	5,222.0	8,722.0
Deferred Tax Liability	1,080.3	1,675.3	2,554.9	3,837.9
Total Liabilities	**11,054.5**	**14,560.6**	**26,972.5**	**39,536.7**
Fixed Assets	2,962.8	5,855.8	9,880.4	14,756.2
Investments	0.0	58.2	1,558.2	2,058.2
Current Assets				
Inventory	5,320.4	12,428.0	11,373.2	17,040.5
Sundry Debtors	81.2	84.0	189.6	284.0
Loans & Advances	6,624.6	11,030.4	12,321.0	18,460.6
Cash & Bank Balance	1,401.5	867.7	1,431.1	1,592.1
Current Liabilities				
Sundry Creditors	5,185.8	15,555.0	9,477.7	14,200.5
Provisions	150.1	208.4	303.3	454.4
Net Current Assets	8,091.7	8,646.6	15,533.9	22,722.3
Miscellaneous Expenditure	0.0	0.0	0.0	0.0
Total Assets	**11,054.5**	**14,560.6**	**26,972.5**	**39,536.7**

Cash Flow

Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Opening Cash & Bank	4,052.8	1,401.5	513.2	1,395.3
Profit After Tax	1,163.1	1,606.5	2,638.6	3,849.1
Investment Income	(52.7)	(74.0)	(62.3)	(82.3)
Interest Paid	266.8	457.1	470.0	785.0
Miscellaneous Exp W/Off	0.0	0.0	0.0	0.0
Depreciation	59.6	74.0	225.4	374.2
Deferred Taxation	413.1	595.0	879.5	1,283.0
Others	19.3	0.0	0.0	0.0
Change in Working Cap	(5,814.8)	(1,088.7)	(6,323.9)	(7,027.5)
CF - Operating Activities	(3,945.5)	1,569.9	(2,172.7)	(818.6)
Change in Fixed Assets	(1,481.2)	(3,002.9)	(4,250.0)	(5,250.0)
Change in Investments	0.0	(58.2)	(1,500.0)	(500.0)
Investment Income	52.7	74.0	62.3	82.3
CF - Investing Activities	(1,428.6)	(2,987.0)	(5,687.7)	(5,667.7)
Increase in Equity	(19.7)	(21.2)	9,433.3	4,250.0
Changes in Borrowings	3,098.8	1,126.3	0.0	3,500.0
Interest Paid	(266.8)	(457.1)	(470.0)	(785.0)
Dividend Paid	(89.4)	(119.2)	(220.8)	(317.8)
CF - Financing Activities	2,722.8	528.8	8,742.5	6,647.2
Net Change in Cash	(2,651.3)	(888.3)	882.1	160.9
Closing Cash & Bank Balance	1,401.5	513.2	1,395.3	1,556.2

Bharati Shipyard : SELL

Earnings Statement				
Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Total Revenues	3,610.2	6,451.4	9,555.4	13,055.4
- Growth (%)	38.4%	78.7%	48.1%	36.6%
Total Expenditure	2,955.0	5,142.0	7,743.0	10,582.1
Operating Profit	655.2	1,309.5	1,812.4	2,473.2
Forex Gain/(Loss)	(1.4)	(16.1)	0.0	0.0
Other Income	32.1	33.6	20.2	20.2
Subsidy	617.5	597.1	1,140.0	1,560.0
EBITDA	1,303.5	1,924.1	2,972.7	4,053.5
EBITDA (Excl. Subsidy)	*686.0*	*1,327.0*	*1,832.7*	*2,493.5*
Depreciation	51.1	81.5	215.9	372.5
EBIT	1,252.3	1,842.6	2,756.7	3,680.9
Interest	143.8	215.8	497.4	1,075.7
PBT	1,108.5	1,626.9	2,259.3	2,605.3
Tax	376.2	548.5	768.2	885.8
PAT	732.3	1,078.3	1,491.1	1,719.5
Minority Interest (MI)	0.2	0.0	0.0	0.0
PAT after MI	732.0	1,078.3	1,491.1	1,719.5
- Growth (%)	43.5%	47.3%	38.3%	15.3%

Ratio Analysis				
Particulars	FY07	FY08	FY09E	FY10E
OPM (%)	18.1%	20.3%	19.0%	18.9%
EBITDA (%)	36.1%	29.8%	31.1%	31.0%
EBITDA % (Excl. Subsidy)	19.0%	20.6%	19.2%	19.1%
PBIT (%)	34.7%	28.6%	28.9%	28.2%
PAT (%)	20.3%	16.7%	15.6%	13.2%
Interest Cover (x)	8.7	8.5	5.5	3.4
EPS (Rs.)	32.5	39.1	46.5	53.7
P/E (x)	2.2	1.8	1.5	1.3
P/BV (x)	0.7	0.3	0.2	0.2
BVPS (Rs.)	107.1	208.9	291.9	342.0
Market Cap (Rs. Mn.)	1,594.1	1,953.3	2,270.1	2,270.1
M Cap/Sales (x)	0.4	0.3	0.2	0.2
EV (Rs. Mn.)	3,133.1	4,000.0	7,563.7	13,873.2
EV/EBITDA (x)	2.4	2.1	2.5	3.4
EV/Sales (x)	0.9	0.6	0.8	1.1
ROCE (%)	15.7%	18.3%	18.5%	16.1%
RONW (%)	30.4%	18.7%	15.9%	15.7%
Debt/Equity Ratio (x)	2.3	0.7	0.6	1.1
Inventory T/o Days	257.4	340.4	300.0	300.0
Debtors T/o Days	139.0	105.5	140.0	140.0
Advances T/o Days	159.9	165.1	160.0	160.0
Creditors T/o Days	321.8	341.3	250.0	250.0
Working Cap T/o Days	584.6	340.7	308.9	309.8
Fixed Assets T/o (Gross)	2.2	3.3	1.5	1.2
DPS (Rs.)	3.0	3.0	3.0	3.0
Dividend Payout (%)	9.2%	7.7%	6.4%	5.6%
Dividend Yield (%)	3.5%	4.2%	4.2%	4.2%

Balance Sheet				
Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Equity Capital	225.0	275.7	320.4	320.4
Reserves	2,222.8	5,512.3	9,060.8	10,667.8
Shareholders Funds	2,447.8	5,788.0	9,381.2	10,988.2
Minority Interest	10.9	12.8	12.8	12.8
Borrowed Funds	5,555.3	4,316.5	5,527.0	11,952.0
Deferred Tax Liability	287.4	304.2	575.3	887.9
Total Liabilities	**8,301.4**	**10,421.5**	**15,496.3**	**23,840.9**
Fixed Assets	2,457.4	4,332.6	7,341.7	12,694.2
Goodwill on Consolidation	3.0	3.0	3.0	3.0
Investments	20.0	34.5	34.5	34.5
Current Assets				
Inventory	2,546.3	6,016.0	7,853.7	10,730.4
Sundry Debtors	1,375.2	1,865.1	3,665.1	5,007.5
Loans & Advances	1,582.0	2,918.5	4,188.7	5,722.9
Cash & Bank Balance	4,016.3	2,269.8	233.4	348.8
Current Liabilities				
Sundry Creditors	3,183.2	6,032.9	6,544.8	8,942.0
Provisions	554.9	1,015.1	1,309.0	1,788.4
Net Current Assets	5,781.8	6,021.4	8,087.1	11,079.3
Miscellaneous Expenditure	39.1	30.0	30.0	30.0
Total Assets	**8,301.4**	**10,421.5**	**15,496.3**	**23,840.9**

Cash Flow				
Particulars (Rs Mn.)	FY07	FY08	FY09E	FY10E
Opening Cash & Bank	4,721.5	4,016.3	2,269.8	233.4
Profit After Tax	732.0	1,078.3	1,491.1	1,719.5
Investment Income	(32.1)	(33.6)	(20.2)	(20.2)
Interest Paid	143.8	215.8	497.4	1,075.7
Miscellaneous Exp W/Off	9.8	9.2	0.0	0.0
Depreciation	51.1	81.5	215.9	372.5
Deferred Taxation	139.7	16.8	271.1	312.6
Others	1.0	6.2	0.0	0.0
Change in Working Cap	(194.4)	(1,986.2)	(4,102.1)	(2,876.7)
CF - Operating Activities	850.9	(611.9)	(1,646.8)	583.4
Change in Fixed Assets	(1,419.3)	(1,962.9)	(3,225.0)	(5,725.0)
Change in Investments	(9.9)	(14.5)	0.0	0.0
Investment Income	32.1	33.6	20.2	20.2
CF - Investing Activities	(1,397.1)	(1,943.8)	(3,204.8)	(5,704.8)
Increase in Equity	(16.6)	2,358.6	2,214.6	0.0
Changes in Minority	0.2	1.9	0.0	0.0
Changes in Borrowings	80.1	(1,238.8)	1,210.4	6,425.0
Interest Paid	(143.8)	(215.8)	(497.4)	(1,075.7)
Dividend Paid	(79.0)	(96.8)	(112.5)	(112.5)
CF - Financing Activities	(159.0)	809.2	2,815.1	5,236.9
Net Change in Cash	(705.2)	(1,746.6)	(2,036.4)	115.5
Closing Cash & Bank Balance	4,721.5	4,016.3	2,269.8	233.4

Migration from “splurging to savings”

Two-Wheeler Industry

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Drop in input prices, Shift from 4-wheeler (splurging) to 2-wheeler (savings) and possible petrol price cut on account of lower crude prices and upcoming Centre and State elections are the key triggers for a smooth ride ahead.

India's two-wheeler industry, which was going through a lean phase in line with the global trend, has bounced back, posting higher sales for Sept'08. Despite the aforesaid concerns to overcome the impact of high interest rates, rising fuel costs and slackening in availability of finance, two-wheeler sales numbers have surprisingly witnessed a recovery. The two-wheeler industry volumes grew by 12.4% YTD in FY09 led by factors like the excise duty cut, low base of production cutbacks made last year.

Rising interest rates during the year pushed the industry into de-growth, against all expectations and projections. The overall two-wheeler pie (Domestic + Exports) reported a decrease of 2% with domestic numbers shrinking by almost 12% for the first time in the decade. Maintaining liquidity, which went stretched affects the credit availability, is the key priority for policy makers that is implemented by the frequent CRR cut (currently @ 6.5%). This in turn is providing respite on working capital financing for the corporates.

With rising credit spreads, the effect of monetary easing on actual credit offtake is likely to come only with a lag. Hence, the capex plans of corporates will be taking a sharp hit. Greenfield expansions are expected to suffer more than brownfield ones, as sanctions for new projects will dry up significantly.

For most of the two-wheeler industry therefore, managing FY07-08 and H1FY09 was like trying to grow on a rocky terrain, of which the sub-soil was far from nourishing and the business climate was harsh. Yet, strong companies, like strong trees, learnt to adapt and adjust. They grew tough roots along the ROCKS.

Currently Hero Honda and Bajaj Auto have negative working capital. In terms of capex plans, both these companies are nearing the end of their major capex programmes and also have sufficient cash on balance sheets to fund future capex. Thus we do not see any funding issues for future expansions for any of these companies.

Luckily, the market leaders like Hero Honda, Bajaj Auto and TVS Motors have considerably weathered the storm and surpassed the tally of previous years volume numbers marginally. The companies have also resisted the temptation to bump up sales artificially through comprehensive festival-related discounts and investing more in new models and upgrades. Also the government's initiative of farm-loan waiver and revision in the Sixth Pay Commission seems to have given a boost to rural demand.

Companies

Hero Honda Motors Ltd. (HHML)

Hero Honda Motors Limited (HHML) is the largest two-wheeler company in the world with an overall market share of 44% in domestic markets. HHML's motorcycle product mix in FY08 consisted ~28% of entry level motorcycles, ~66% of executive models and remaining ~6% of premium segment bikes. The company currently has an overall production capacity of 3.9 million units from its two facilities at Manesar and Dharuhera in Haryana. The company's Uttaranchal plant has begun its operations in the first week of April-2008 with the initial capacity to produce 750,000 units per annum.

Hero Honda trades at 15x FY08 earnings of Rs. 48.5 per share.

Bajaj Auto Ltd. (BAL)

Bajaj Auto Limited (BAL) is the second largest player in the domestic two-wheeler industry. The company's market share in the 125 cc plus segment is close to 50%. Growth in the 125cc plus segment was attributable to its new launches (XCD 125 DTS-Fi, Discover 135 DTS-i, Pulsar 200 DTS-i, and Pulsar 220 DTS – Fi). BAL also continued to be a dominant player in the domestic three-wheeler market. In the passenger three-wheeler segment BAL enjoyed market share of 71.5% in FY08. Over 47% of its three-wheelers were exported during the year. The company has also started its new manufacturing facility at Pantnagar (Uttarakhand) which has the capacity to produce 1 million bikes annually. BAL already has four manufacturing units in Maharashtra, including a modern plant at Chakan where Pulsar is manufactured and one at Waluj near Aurangabad where it manufactures three-wheelers, its smaller motorcycles and the newly launched 125cc XCD. Bajaj Auto has planned to launch four new 125cc bikes in FY09.

Bajaj Auto trades at 9.5x FY08 earnings of Rs. 52.2 per share.

TVS Motors Ltd. (TML)

TVS motor is the third largest player in the two-wheeler industry. TVS enjoy strong market share in south India and has a network of around 600 dealers and 2,000 authorized service centers across India. TVS operates through its manufacturing plants based in Hosur and Mysore with an installed capacity of 2 million vehicles per annum. The company has recently set up a new plant in Himachal Pradesh for manufacturing two wheelers with an installed capacity of 4 lakh vehicles. It has also marked its entery into the three wheeler segment with the launch of first two-stroke 200cc auto rickshaws under the brand name “King”. These auto rickshaws will also be available in LPG and Petrol versions. The company is likely to benefit from lower comparable base and strong sales growth will drive the profits.

TVS Motors trades at 22.5x FY08 earnings of Rs. 1.3 per share.

Outlook

With the Indian middle class earning higher per capita income, more people are ready to own private vehicles. But, the spike in the interest rate and rising input costs has been adversely impacting the domestic demand for both the two and three wheeler segments. The domestic price of CR coil has increased 18.5% in FY08 over last year; while the aluminum price has increased 12.4% in FY08 over last year. The persistent volatility of metal prices would continue to exert cost pressure on the companies. Further with the rising interest rate and non-availability of finance, the short term outlook in the two-wheeler industry remains bleak.

But on comparative basis we expect two-wheelers to perform better than four-wheelers on account of lower sensitivity to commodity prices going with less competition and good margins. This can be further attributed by the recent developments in the commodities markets as well as the political scenario of the Indian markets. World over, the drop in input prices viz., crude, aluminium, rubber, lead have fallen, which have marginally aided the margins of the Indian two-wheeler companies. This has also seen a shift from the 4-wheeler market and more focus on two-wheelers as its results in a lot of savings for the end consumers. Also with the substantial fall in crude prices from a high of $147/barrel to a recent low of $61/barrel is a positive trigger for the Indian two-wheeler market. The forthcoming state elections in December 2008 and central elections between February-May 2009 could result in the petrol prices falling thereby aiding the customers and ramping up two-wheelers sales .

We recommend a BUY on Bajaj Auto and ACCUMULATE on Hero Honda and TVS Motors as the valuations could turnaround in terms of cost cutting and improvement in productivity, which would further cushion margins.

Earnings Statement				
Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Two Wheelers Sold (Nos)	2,621,400	3,000,751	3,336,756	3,337,142
- Growth (%)	26.6%	14.5%	11.2%	0.01%
Total Revenues	74,216.5	87,139.8	98,999.6	103,318.0
- Growth (%)	27.2%	17.4%	13.6%	4.4%
Total Expenditure	62,530.1	73,495.3	87,269.2	89,824.3
Operating Profit	11,686.4	13,644.5	11,730.4	13,493.7
Other Income	1,369.0	1,562.8	1,898.5	1,854.2
EBITDA	13,055.4	15,207.3	13,628.9	15,347.9
- Growth (%)	14.1%	16.5%	-10.4%	12.6%
Depreciation	893.8	1,146.2	1,397.8	1,603.2
EBIT	12,161.6	14,061.1	12,231.1	13,744.7
Interest	(10.9)	(61.3)	(229.9)	(358.1)
PBT	12,172.5	14,122.4	12,461.0	14,102.8
Tax	4,067.8	4,409.0	3,882.1	4,424.0
PAT	8,104.7	9,713.4	8,578.9	9,678.8
- Growth (%)	11.3%	19.8%	-11.7%	12.8%

Ratio Analysis				
Particulars	FY05	FY06	FY07	FY08
OPM (%)	15.7%	15.7%	11.8%	13.1%
EBITDA (%)	17.6%	17.5%	13.8%	14.9%
PBIT (%)	16.4%	16.1%	12.4%	13.3%
PAT (%)	10.9%	11.1%	8.7%	9.4%
Interest Cover (x)	(1,115.7)	(229.4)	(53.2)	(38.4)
EBITDA per share (Rs.)	65.4	76.2	68.2	76.9
EPS (Rs.)	40.6	48.6	43.0	48.5
P/E (x)	17.9	14.9	16.9	15.0
P/BV (x)	9.7	7.2	5.9	4.9
BVPS (Rs.)	74.8	100.6	123.7	149.5
Market Cap (Rs. Mn.)	144,862.4	144,862.4	144,862.4	144,862.4
M Cap/Sales (x)	2.0	1.7	1.5	1.4
EV (Rs. Mn.)	126,437.5	124,514.1	126,417.6	119,203.3
EV/EBITDA (x)	9.7	8.2	9.3	7.8
EV/Sales (x)	1.7	1.4	1.3	1.2
ROCE (%)	71.7%	64.1%	46.4%	44.1%
RONW (%)	54.3%	48.3%	34.7%	32.4%
Debt/Equity Ratio (x)	0.1	0.1	0.1	0.0
Inventory T/o Days	10.0	9.5	10.2	11.2
Debtors T/o Days	4.4	6.6	12.4	10.5
Advances T/o Days	11.8	11.5	9.7	6.6
Creditors T/o Days	50.0	44.9	38.4	46.8
Working Cap T/o Days	(46.5)	(31.1)	(20.9)	(31.4)
Fixed Assets T/o (Gross)	6.721	5.920	5.498	5.329
DPS (Rs.)	20.0	20.0	17.0	19.0
Dividend Payout (%)	49.3%	41.1%	39.6%	39.2%
Dividend Yield (%)	2.8%	2.8%	2.3%	2.6%

Balance Sheet				
Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Equity Capital	399.4	399.4	399.4	399.4
Reserves	14,534.4	19,693.9	24,301.2	29,463.0
Shareholders Funds	14,933.8	20,093.3	24,700.6	29,862.4
Borrowed Funds	2,017.6	1,857.8	1,651.7	1,320.0
Deferred Tax Liability	1,015.3	1,201.0	1,295.8	1,305.9
Total Liabilities	**17,966.7**	**23,152.1**	**27,648.1**	**32,488.3**
Fixed Assets	7,153.3	9,935.6	13,554.5	15,487.0
Investments	20,266.5	20,618.9	19,738.7	25,668.2
Pre-operative Expenses	0.0	0.0	0.0	160.5
Deferred Tax Asset	6.3	13.2	13.8	52.2
Current Assets				
Inventory	2,042.6	2,265.5	2,755.8	3,171.0
Sundry Debtors	895.5	1,586.6	3,352.5	2,974.4
Loans & Advances	2,396.1	2,737.8	2,630.6	1,854.6
Cash & Bank Balance	176.0	1,587.2	357.8	1,310.9
Other Current Assets	35.1	35.3	36.0	56.9
Current Liabilities				
Sundry Creditors	10,157.6	10,728.8	10,419.2	13,249.8
Provisions	4,847.1	4,899.2	4,372.4	4,997.6
Net Current Assets	(9,459.4)	(7,415.6)	(5,658.9)	(8,879.6)
Total Assets	**17,966.7**	**23,152.1**	**27,648.1**	**32,488.3**

Cash Flow				
Particulars	FY05	FY06	FY07	FY08
Opening Cash & Bank	371.2	4,720.4	1,587.2	357.8
Profit after Tax	8,104.7	9,713.4	8,578.9	9,678.8
Less: Investment Income	(1,369.0)	(1,562.8)	(1,898.5)	(1,854.2)
Interest Paid	(10.9)	(61.3)	(229.9)	(358.1)
Depreciation	893.8	1,146.2	1,397.8	1,603.2
Deferred Taxation	115.6	178.8	94.2	12.0
Others	(55.1)	(4,754.8)	(272.2)	(130.9)
Change in Working Cap	1,753.6	(632.6)	(2,986.1)	4,173.8
CF - Operating Activities	9,432.7	4,026.9	4,684.2	13,124.6
Change in Fixed Assets	(2,104.4)	(3,711.2)	(4,743.9)	(3,406.7)
Change in Investments	(4,615.5)	(352.4)	880.2	(5,929.5)
Change in Pre-operative Exp	0.0	0.0	0.0	(160.5)
Change in Deferred Tax Asset	0.5	(6.9)	(0.6)	(38.4)
Investment Income	1,369.0	1,562.8	1,898.5	1,854.2
CF - Investing Activities	(5,350.4)	(2,507.7)	(1,965.8)	(7,680.9)
Increase in Equity	(0.0)	0.0	(0.0)	(78.1)
Changes in Borrowings	270.6	(159.8)	(206.1)	(331.7)
Interest Paid	10.9	61.3	229.9	358.1
Dividend Paid	(4,559.0)	(4,553.9)	(3,971.6)	(4,438.9)
CF - Financing Activities	(4,277.5)	(4,652.4)	(3,947.8)	(4,490.6)
Net Change in Cash	(195.2)	(3,133.2)	(1,229.4)	953.1
Closing Cash & Bank Bal	176.0	1,587.2	357.8	1,310.9

Bajaj Auto : BUY

Earnings Statement				
Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Sales in Numbers	1,824,699	2,281,230	2,721,824	2,451,407
- Growth (%)	-	25.0%	19.3%	-9.9%
Net Revenues	59,270.5	76,679.0	95,204.1	90,461.5
- Growth (%)	-	29.4%	24.2%	-5.0%
Total Expenditure	50,136.9	63,116.3	81,034.4	77,526.3
Operating Profit	9,133.6	13,562.7	14,169.7	12,935.2
Other Income	4,081.3	4,384.5	5,556.4	1,226.9
EBITDA	13,214.9	17,947.2	19,726.1	14,162.1
Depreciation	1,853.6	1,910.0	1,902.6	1,739.6
EBIT	11,361.3	16,037.2	17,823.5	12,422.5
Interest	6.7	3.4	53.4	51.6
Compensation under VRS	490.2	226.4	385.7	1,023.6
Exceptional Items	0.0	0.0	103.9	0.0
PBT	10,864.4	15,807.4	17,280.5	11,347.3
Tax	3,196.3	4,791.1	4,900.9	3,787.8
PAT Before EOI	7,668.1	11,016.3	12,379.6	7,559.5
EOI / PPA	376.5	216.4	(8.6)	1.7
Reported PAT	7,291.6	11,232.7	12,388.2	7,557.8
- Growth (%)	-	54.1%	10.3%	-39.0%

Ratio Analysis				
Particulars	FY05	FY06	FY07	FY08
OPM (%)	15.4%	17.7%	14.9%	14.3%
EBITDA (%)	22.3%	23.4%	20.7%	15.7%
PBIT (%)	19.2%	20.9%	18.7%	13.7%
PAT (%)	12.3%	14.6%	13.0%	8.4%
Interest Cover (x)	1,695.7	4,716.8	333.8	240.7
EPS (Rs.)	72.1	111.0	122.4	52.2
P/E (x)	6.9	4.5	4.1	9.5
P/BV (x)	1.2	1.1	0.9	4.5
BVPS (Rs.)	408.6	471.5	547.0	109.7
Market Cap (Rs. Mn.)	50,418.0	50,418.0	50,418.0	72,094.0
M Cap/Sales (x)	0.9	0.7	0.5	0.8
EV (Rs. Mn.)	15,995.2	5,698.9	1,362.2	66,305.3
EV/EBITDA (x)	1.2	0.3	0.1	4.7
EV/Sales (x)	0.3	0.1	0.0	0.7
ROCE (%)	21.2%	25.7%	24.9%	42.5%
RONW (%)	17.6%	23.5%	22.4%	47.6%
Debt/Equity Ratio (x)	0.3	0.3	0.3	0.8
Inventory T/o Days	13.8	13.0	11.9	14.1
Debtors T/o Days	10.9	14.4	20.3	11.1
Advances T/o Days	123.9	101.3	109.6	35.9
Creditors T/o Days	48.3	58.5	57.5	42.1
Working Cap T/o Days	(12.6)	(32.8)	(19.7)	(9.2)
Fixed Assets T/o (Gross)	2.2	2.7	3.0	3.0
DPS (Rs.)	25.0	40.0	40.0	20.0
Dividend Payout (%)	34.7%	36.0%	32.7%	38.3%
Dividend Yield (%)	5.0%	8.0%	8.0%	4.0%

Balance Sheet				
Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Equity Capital	1,011.8	1,011.8	1,011.8	1,446.8
Reserves	40,331.7	46,695.5	54,331.4	14,429.1
Share Warrants Issue	0.0	0.0	0.0	0.0
Shareholders Funds	41,343.5	47,707.3	55,343.2	15,875.9
Minority Interest	0.0	0.0	0.0	0.0
Borrowed Funds	12,269.9	14,671.5	16,254.3	13,343.4
Deferred Tax Liability	1,399.0	875.8	741.7	109.8
Total Liabilities	**55,012.4**	**63,254.6**	**72,339.2**	**29,329.1**
Fixed Assets	11,408.3	11,558.4	12,963.9	12,928.2
Technical Know-how	40.6	13.4	41.3	105.3
Investments	45,605.8	58,569.7	64,475.3	18,571.4
Current Assets				
Inventory	2,241.7	2,729.3	3,097.0	3,496.1
Sundry Debtors	1,763.5	3,015.5	5,298.3	2,753.1
Loans & Advances	20,120.0	21,273.7	28,594.0	8,887.7
Cash & Bank Balance	1,086.9	820.9	834.8	560.7
Other Current Assets	685.3	721.3	362.2	799.5
Current Liabilities				
Sundry Creditors	7,850.7	12,288.7	14,989.7	10,432.5
Provisions	20,089.0	23,158.9	28,337.9	8,340.4
Net Current Assets	(2,042.3)	(6,886.9)	(5,141.3)	(2,275.8)
Miscellaneous Expenditure	0.0	0.0	0.0	0.0
Total Assets	**55,012.4**	**63,254.6**	**72,339.2**	**29,329.1**

Cash Flow				
Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Opening Cash & Bank	793.7	1,086.9	820.9	834.8
Profit after Tax	7,668.1	11,016.3	12,379.6	7,559.5
Less: Investment Income	(4,081.3)	(4,384.5)	(5,556.4)	(1,226.9)
Interest Paid	6.7	3.4	53.4	51.6
Depreciation	1,853.6	1,910.0	1,902.6	1,739.6
Deferred Taxation	(187.3)	(394.4)	(134.1)	(173.2)
Others	(552.5)	(321.6)	(456.8)	(3,988.7)
Change in Working Cap	(394.7)	4,578.6	(1,731.7)	(3,139.6)
CF - Operating Activities	4,312.6	12,407.8	6,456.6	822.3
Change in Fixed Assets	(407.1)	(1,650.9)	(2,842.7)	1,824.4
Change in Investments	(7,051.4)	(12,963.9)	(5,905.6)	45,903.9
Change in Tech. Know-how	36.1	27.2	(27.9)	(64.0)
Investment Income	4,081.3	4,384.5	5,556.4	1,226.9
CF - Investing Activities	(3,341.1)	(10,203.1)	(3,219.8)	48,891.2
Increase in Equity	0.1	(253.9)	(17.2)	(43,639.6)
Share Warrants Issue	0.0	0.0	0.0	0.0
Changes in Borrowings	2,212.7	2,401.6	1,582.8	(2,910.9)
Interest Paid	(6.7)	(3.4)	(53.4)	(51.6)
Dividend Paid	(2,884.4)	(4,615.0)	(4,735.1)	(3,385.5)
CF - Financing Activities	(678.3)	(2,470.7)	(3,222.9)	(49,987.6)
Net Change in Cash	293.2	(266.0)	13.9	(274.1)
Closing Cash & Bank Bal	1,086.9	820.9	834.8	560.7

TVS : ACCUMULATE

Earnings Statement

Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Total Sales (Nos)	1,167,000	1,340,000	1,526,000	1,277,000
- Growth (%)	1.7%	14.8%	13.9%	-16.32%
Total Revenues	28,759.1	32,349.6	38,549.6	32,195.0
- Growth (%)	2.0%	12.5%	19.2%	-16.5%
Total Expenditure	26,643.4	30,304.8	37,176.6	31,782.0
Operating Profit	2,115.7	2,044.8	1,373.0	413.0
Other Income	793.0	710.0	659.3	908.5
EBITDA	2,908.7	2,754.8	2,032.3	1,321.5
- Growth (%)	-1.6%	-5.3%	-26.2%	-35.0%
Depreciation	896.3	939.1	876.0	945.9
EBIT	2,012.4	1,815.7	1,156.3	375.6
Interest	7.9	131.2	247.8	21.9
PBT	2,004.5	1,684.5	908.5	353.7
Tax	628.8	514.5	242.5	36.0
PAT	1,375.7	1,170.0	666.0	317.7
- Growth (%)	-0.7%	-15.0%	-43.1%	-52.3%

Ratio Analysis

Particulars	FY05	FY06	FY07	FY08
OPM (%)	7.4%	6.3%	3.6%	1.3%
EBITDA (%)	10.1%	8.5%	5.3%	4.1%
PBIT (%)	7.0%	5.6%	3.0%	1.2%
PAT (%)	4.8%	3.6%	1.7%	1.0%
Interest Cover (x)	254.7	13.8	4.7	17.2
EBITDA per share (Rs.)	12.2	11.6	8.6	5.6
EPS (Rs.)	5.8	4.9	2.8	1.3
P/E (x)	5.2	6.1	10.7	22.5
P/BV (x)	1.1	0.9	0.9	0.9
BVPS (Rs.)	28.6	32.3	34.1	34.6
Market Cap (Rs. Mn.)	7,136.9	7,136.9	7,136.9	7,136.9
M Cap/Sales (x)	0.2	0.2	0.2	0.2
EV (Rs. Mn.)	6,512.7	7,301.9	9,159.5	10,373.4
EV/EBITDA (x)	2.2	2.7	4.5	7.8
EV/Sales (x)	0.2	0.2	0.2	0.3
ROCE (%)	23.2%	15.8%	8.0%	2.5%
RONW (%)	20.3%	15.3%	8.2%	3.9%
Debt/Equity Ratio (x)	0.3	0.5	0.8	0.8
Inventory T/o Days	29.6	40.4	37.5	46.0
Debtors T/o Days	5.0	6.6	10.5	10.0
Advances T/o Days	20.9	24.2	21.5	31.5
Creditors T/o Days	57.4	59.2	54.6	57.3
Working Cap T/o Days	0.5	7.8	18.5	23.6
Fixed Assets T/o (Gross)	2.234	2.347	2.599	1.798
DPS (Rs.)	1.3	1.3	0.9	0.7
Dividend Payout (%)	22.5%	26.4%	30.3%	52.3%
Dividend Yield (%)	4.3%	4.3%	2.8%	2.3%

Balance Sheet

Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Equity Capital	237.5	237.5	237.5	237.5
Reserves	6,550.8	7,423.7	7,855.2	7,978.3
Shareholders Funds	6,788.3	7,661.2	8,092.7	8,215.8
Borrowed Funds	1,868.4	3,850.4	6,335.6	6,663.4
Deferred Tax Liability	1,485.1	1,490.1	1,590.1	1,549.0
Total Liabilities	**10,141.8**	**13,001.7**	**16,018.4**	**16,428.2**
Fixed Assets	7,704.8	8,214.6	10,029.1	10,430.5
Investments	1,753.9	3,441.9	3,447.4	3,389.6
Current Assets				
Inventory	2,332.3	3,579.0	3,965.6	4,053.8
Sundry Debtors	395.6	581.9	1,114.0	878.6
Loans & Advances	1,647.0	2,148.8	2,275.8	2,775.2
Cash & Bank Balance	738.7	243.5	865.6	37.3
Other Current Assets	2.9	3.0	3.0	3.0
Current Liabilities				
Sundry Creditors	4,521.9	5,244.6	5,770.2	5,057.6
Provisions	556.1	624.4	497.3	609.9
Net Current Assets	38.5	687.2	1,956.5	2,080.4
Total Assets	**10,141.8**	**13,001.7**	**16,018.4**	**16,428.2**

Cash Flow

Particulars (Rs. Mn)	FY05	FY06	FY07	FY08
Opening Cash & Bank	180.0	4,720.4	243.5	865.6
Profit after Tax	1,375.7	1,170.0	666.0	317.7
Less: Investment Income	(793.0)	(710.0)	(659.3)	(908.5)
Interest Paid	7.9	131.2	247.8	21.9
Miscellaneous Exp W/Off	(515.6)	(13.4)	72.6	57.7
Depreciation	896.3	939.1	876.0	945.9
Deferred Taxation	254.6	5.0	100.0	(41.1)
Others	(39.0)	(4,040.9)	(133.0)	(60.3)
Change in Working Cap	239.3	(1,143.9)	(647.2)	(952.2)
CF - Operating Activities	1,426.2	(3,662.9)	522.9	(618.9)
Change in Fixed Assets	(1,520.3)	(1,389.7)	(2,557.5)	(1,287.0)
Change in Investments	(473.7)	(1,688.0)	(5.5)	57.8
Investment Income	793.0	710.0	659.3	908.5
CF - Investing Activities	(1,201.0)	(2,367.7)	(1,903.7)	(320.7)
Increase in Equity	14.2	55.0	(26.5)	(0.0)
Changes in Borrowings	678.3	1,982.0	2,485.2	327.8
Interest Paid	(7.9)	(131.2)	(247.8)	(21.9)
Dividend Paid	(351.1)	(352.1)	(208.0)	(194.6)
CF - Financing Activities	333.5	1,553.7	2,002.9	111.3
Net Change in Cash	558.7	(4,476.9)	622.1	(828.3)
Closing Cash & Bank Bal	738.7	243.5	865.6	37.3

Other people’s money

Banking Industry

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Mr. Garfield in the movie Other People's Money says - “I love money; & whats better than money is other people's money.”

This statement cant be more true for a Banker. Even the best capitalized banks are leveraged for 6-8x. There are other people who also leverage, like the consumers in US. Then we have these banks buy this leverage and start playing the Greater Fool game. So what these banks then have is a LOT of other people's money.

When you are on a treadmill and running really fast, you can't stop suddenly. You fall on your face. That’s what happened to Lehman. Merill & AIG were lucky to get some support that helped slowdown the speed. The sub-prime crisis fear has not spared the Indian banks as well, which we can say have just hopped on a manual one. For our dear PSUs, derivatives is far; they just manage to do the basic lending in the first place.

So, we are bullish on the banking sector as a whole. India is still a Savings economy & we are far from having got used to credit cards. Our Banking & Capital Market mechanisms are the most robust in the world and is justly being acknowledged & appreciated globally. In general, we like the Private sector banks, for they are more dutiful towards their karma, in the sense they lend what they borrow. Plus their 'no pain no gain' mantra to focus on cost control & efficiency. The PSU counterparts on the other hand have specific expertize. Their Deposits & Investments divisions are far more efficient, relatively. They appear to be more risk averse & conservative, thanks to their 'no pain' mantra.

Some of the recent developments (sub-prime which turned into a credit-crunch) in the banking industry put the Indian Banks & more particularly the PSUs in a very sweet spot. The spiraling interest rates and more importantly the liquidity crunch has virtually closed the international window for corporates, who depended on low cost ECBs, FCCBs, libor based & other forex loans. The Indian Banks are a straight beneficiary of those accounts. Equity is just not an option. Even the few rights issues are unlikely to get the support of their own shareholders. All ways go to the Indian Banks.

What more, is that the Indian Banks have become more discreet. Plus they have the pricing power to compensate for the tight liquidity scenario. But the best times are for our PSU banks.

The recent scare-run to the ATMs & branches of ICICI Bank and the FMP-selling Mutual Funds, have done a more than a serious damage to the repute of the aggressive private players. Our common man is a very simple guy. It took him four years of a big bull run to shift his savings from post office & bank deposits to the stock markets & equity mutual funds. Then after more than a reasonable thrashing on the stock exchanges, he gets jolted by the FMPs (sold as an assured returns scheme) pegged to go sub-prime and most importantly, even his money in India's 2nd largest bank being unsafe. Certainly the Credibility Crisis is as Big as the liquidity crisis for the private banks.

So more if not all roads go to the PSU Banks. Both for the depositors and also the borrowers. Borrowers, because the PSUs have the deposits & so the liquidity. The CRR cuts further strengthens the banks capacity to lend. We are on the higher side of the interest rate cycle, and ergo the likelihood of most PSUs making more money on their investment portfolios. The frontline PSUs all have now moved to Core-Banking, which makes them more efficient plus also requires the CASA holders to maintain an increased minimum balance. There have been some VRS initiatives & other staff rationalizations done. 8-to-8 & Sunday Banking have helped improve its 'Service' image and close some gap with the private players.

This time they have an opportunity to channelize their current & the new CASA & deposits money plus their surplus investments to the increased lending opportunities to India Inc. with an improved cost structure. In other words, they can have the cake & it it too. We hope the PSU banks get their act together, to their karma.

So we like the more conservative private sector banks like HDFC Bank & Axis Bank. Amongst the PSUs, we prefer the larger & the more aggressive players like State Bank of India. We prefer a cautious approach & prefer to keep away from the aggressive private players & smaller PSU banks available at really cheap valuations. While these may pay off to an aggressive investor, we prefer to stay-put.

We remain perturbed over the medium term prospects of the many NBFCs who have borrowed internationally and lent domestically for longer term horizons, as this may head them for a serious margin & liquidity squeeze which may affect their profitability & new business respectively. NBFCs without a strong & credible retail franchise may find it more difficult to source fundings.

Some perspectives on why we generally like Private Banks, from our blog-post dated 16th Sept. '08.

Oligopolies, Regulations and Profits

by Rajeev Thakkar

The financial sector has been on top of my mind (and that of many others) for some time now. My thoughts have been on a different plane and not related to the woes of Lehman, Merrill etc. More specifically I have been pondering over the banking sector in India.

The following are the characteristics of the banking sector in India.

Uninterested competition

Uninterested competition in the presence of a large number of Public Sector banks. These banks are run for the employees and for the government and its political constituency. Sometimes they think about customers and rarely if ever about shareholders.Witness the spectacle where State Bank of India is wanting to merge with a small 100% owned subsidiary State Bank of Saurashtra. Despite assurances of no employee retrenchment and no job losses there have been numerous strikes and demonstrations opposing this. We have a situation of employees holding the government, customers and shareholders to ransom without any rhyme or reason. Just imagine what would happen if some enterprising bank Chariman or Managing Director was to try and close unviable branches or outsource some work to third parties. (To digress slightly, try opening a PPF account with any SBI branch in South Mumbai. You will be told that the branch has a lot of workload and cannot cope up and hence you should open the account in some suburban branch. The account opening form will not be given to you unless you plead, cajole, threaten and / or get some personal connections.) Witness the government directives to write off farmer loans / lower interest rates / not increase interest rates / give loans to specific sectors / geographies etc. without any indication of how the banks are to be compensated.

Lack of alternatives

The Reserve Bank has effectively killed of the Non-Bank Financial Companies (NBFC) sector by repeatedly choking off access to funds and the way they can run their business.

Restrictive licencing

The Reserve Bank want to keep the money of the depositors' safe. It also wants to avoid systemic risks. Towards this end the Reserve Bank has selected to restrict the banking business to a chosen few. The 'chosen' ones are either government owned banks or banks promoted by government owned institutions in partnership with multilateral agencies or some large NBFCs which were allowed to convert to banks when NBFCs were being phased out. New bank licences are effectively not on offer. It does not matter to the Reserve Bank that such actions have severely limited competition in the banking sector and reduced customer choice.

Effective Oligopoly

Hence we have ICICI Bank (earlier a government promoted institution), HDFC Bank and Axis Bank (erstwhile UTI Bank) as the flag bearers of new age private banks being run for customers and shareholders apart from employees and the government. A lot of others folded up and merged with other banks. HDFC Bank acquired (directly/indirectly) Times Bank, Centurion Bank, Bank of Punjab and Lord Krishna Bank. Global Trust Bank merged with Oriental Bank of Commerce in a shot gun merger. Sangli Bank merged with ICICI Bank. The others like Indusind Bank or the old private banks (the ones which escaped nationalisation on account of small scale of operations) or the very new banks like Yes Bank are too small to make a difference. Kotak Bank is more a stock broker and an investment bank rather than a commercial bank.

Regulated profits'

Regulated profits' for whose benefit? For most industries where competition is limited, the regulators step in for the benefit of the consumers. For example in the case of Power utilities, there is a cap on tariffs and on the returns that utilities can make or for example TRAI sets maximum charges for cable television, channels or mobile phone charges. In banking we have a unique situation where the regulator regulates charges to favour the oligopolistic service providers !!! Thus we have a surprising situation that current accounts pay zero interest and savings accounts pay a low interest (which is capped as per regulations) and calculated as per the minimum balance held during a month. On the other hand when it come to lending rates for the consumer, banks recently went to the Supreme Court to waive off a cap on interest rates @ 30% p.a.!!!!

Guaranteed growth

In no other industry is growth virtually guaranteed. In a situation where money supply grows 15% to 20% each year, a growth in deposits and lending is given. Further you have uninterested competitors (see point 1) who will cede market share each year and a growth in excess of 20% is assured.

Under penetration and cherry picking of assets

I read an article on Bloomberg today which mentioned that banks in the US have become really stringent in lending for mortgages. Really? US banks have now moved to a situation where borrowers are required to put up 3% to 5% of the house value upfront to avail of mortgage loans!!! In India 25% to 30% upfront payment is the norm. That too on the 'white' component if you know what I mean. This is again because there is no effective competition in the market place. Hence banks can cherry pick people to whom they will lend. The others simply have to do without credit.

If we cannot get a banking licence, we can surely buy stocks of some of these Oligopolistic businesses.

Banking : Financials

Company Name	Axis Bank	Canara Bank	HDFC Bank	ICICI Bank	PNB
Year	200803	200803	200803	200803	200803
Int Earned (Rs. Crs.)	7,005.3	14,200.7	10,115.0	30,788.3	14,265.0
Int expended (Rs. Crs.)	4,420.0	10,662.9	4,887.1	23,484.2	8,730.9
NIM (%)	3.5	2.4	4.4	2.2	3.6
Credit-Deposit (%)	65.9	69.4	65.3	88.7	70.6
Investment / Deposit (%)	41.4	32.1	47.3	42.7	32.4
Cash / Deposit (%)	8.2	7.6	10.4	10.1	9.0
Op Exps / Total Inc (%)	24.6	17.5	30.2	20.7	21.8
Int Income / Total Funds (%)	7.7	8.3	9.0	8.3	7.9
Net Int Inc / Total Funds (%)	2.8	2.1	4.7	2.0	3.1
Non Int Inc / Total Funds (%)	2.0	1.4	2.0	2.4	1.1
Op Exps / Total Funds (%)	2.4	1.7	3.3	2.2	2.0
Net Profit / Total funds (%)	1.2	0.9	1.4	1.1	1.1
RONW (%)	17.6	19.1	17.7	11.8	19.6
Net Non Perf. Assets (Rs. Crs.)	248.3	899.0	298.5	3,490.6	753.8
Net Non Perf. Assets (%)	0.42	0.84	0.47	1.55	0.64
Capital Adequacy Ratio (%)	13.7	13.3	13.6	14.0	13.0
Tier I Capital (%)	10.2	7.0	10.3	11.8	8.5
Tier II Capital (%)	3.6	6.2	3.3	2.2	4.4
Return on Assets (%)	1.2	0.9	1.3	1.1	1.2
Business Per Employee (Rs. Crs.)	11.2	6.1	5.1	10.1	5.1
Profit Per Employee (Rs. Crs.)	0.1	0.0	0.1	0.1	0.0
Equity (Rs. Crs.)	358.9	410.0	425.1	1,113.3	315.3
Reserves (Rs. Crs.)	8,410.8	10,090.5	11,142.8	45,357.5	12,003.0
Networth (Rs. Crs.)	8,768.5	8,295.6	11,497.2	46,470.2	10,782.7
Capital Employed (Rs. Crs.)	109,625.7	178,491.2	133,251.0	400,417.1	197,513.1
EPS (Rs.)	28.9	36.8	43.4	36.0	62.8
BV (Rs.)	244.3	202.3	272.1	417.4	342.0
CMP – 03 Nov (Rs.)	602.3	167.5	1,070.8	431.0	452.5
P/BV	2.6	0.9	4.1	1.1	1.4
Mcap (Rs. Crs.)	23,000.9	7,293.9	47,219.1	51,109.8	15,323.6
Dividend -%	60.0	80.0	85.0	110.0	130.0
Payout -%	20.8	21.7	19.6	30.6	20.7
Div Yield -%	0.9	4.5	0.8	2.4	2.7
Deposits (Rs. Crs.)	87,626.2	154,072.4	100,768.6	244,431.0	166,457.2
Borrowings (Rs. Crs.)	5,624.0	2,517.2	4,478.9	65,648.4	5,446.6
Total Liabilities (Rs. Crs.)	109,625.7	180,696.0	133,251.0	400,417.1	199,048.8
Advances (Rs. Crs.)	59,661.1	107,238.0	63,426.9	225,616.1	119,501.6
Total Assets (Rs. Crs.)	109,625.7	180,696.0	133,251.0	400,417.1	199,048.8

Source: Capitaline

Banking : Financials

Company Name	Andhra Bank	Bank of Baroda	Bank of India	St Bk of India	Union Bank
Year	200803	200803	200803	200803	200803
Int Earned (Rs. Crs.)	4,289.9	11,813.5	12,355.2	48,950.3	9,447.3
Int expended (Rs. Crs.)	2,870.0	7,901.7	8,126.0	31,929.1	6,361.0
NIM (%)	2.9	2.9	3.1	3.1	2.8
Credit-Deposit (%)	68.4	68.7	73.6	77.5	72.3
Investment / Deposit (%)	32.1	28.5	28.6	34.8	32.7
Cash / Deposit (%)	8.6	5.7	7.0	8.3	8.1
Op Exps / Total Inc (%)	20.7	21.3	18.3	22.8	19.8
Int Income / Total Funds (%)	8.2	7.3	7.8	7.6	8.4
Net Int Inc / Total Funds (%)	2.7	2.4	2.7	2.6	2.7
Non Int Inc / Total Funds (%)	1.3	1.3	1.3	1.5	1.6
Op Exps / Total Funds (%)	2.0	1.8	1.7	2.1	2.0
Net Profit / Total funds (%)	1.1	0.9	1.3	1.0	1.2
RONW (%)	18.0	14.6	27.6	16.8	26.8
Net Non Perf. Assets (Rs. Crs.)	53.7	493.6	592.0	7,424.3	127.6
Net Non Perf. Assets (%)	0.15	0.47	0.52	1.78	0.17
Capital Adequacy Ratio (%)	11.6	12.9	13.0	13.5	12.5
Tier I Capital (%)	8.5	7.6	8.2	9.1	7.5
Tier II Capital (%)	3.1	5.3	4.8	4.3	5.1
Return on Assets (%)	1.2	0.9	1.3	1.0	1.3
Business Per Employee (Rs. Crs.)	6.3	7.1	6.5	4.6	7.0
Profit Per Employee (Rs. Crs.)	0.0	0.0	0.1	0.0	0.1
Equity (Rs. Crs.)	485.0	367.0	525.2	634.9	505.1
Reserves (Rs. Crs.)	2,764.3	10,678.4	10,063.5	48,401.2	6,842.6
Networth (Rs. Crs.)	3,249.3	11,043.9	8,826.3	49,032.7	5,623.3
Capital Employed (Rs. Crs.)	56,624.3	179,599.5	177,097.5	722,125.1	122,643.7
EPS (Rs.)	11.2	37.9	37.5	103.9	26.8
BV (Rs.)	67.0	301.0	168.1	772.4	111.3
CMP – 03 Nov (Rs.)	46.2	248.2	247.6	1,240.6	136.3
P/BV	0.7	1.0	1.6	1.7	1.3
Mcap (Rs. Crs.)	2,374.1	10,520.1	14,510.4	83,877.2	7,506.1
Dividend -%	40.0	80.0	40.0	215.0	40.0
Payout -%	35.8	21.0	10.7	20.7	14.9
Div Yield -%	8.2	2.8	1.4	1.6	2.7
Deposits (Rs. Crs.)	49,436.6	152,034.1	150,012.0	537,403.9	103,858.6
Borrowings (Rs. Crs.)	590.5	3,927.1	7,172.5	51,727.4	4,760.5
Total Liabilities (Rs. Crs.)	56,624.3	179,599.5	178,860.6	722,125.1	124,368.1
Advances (Rs. Crs.)	34,238.4	106,701.3	113,476.3	416,768.2	74,348.3
Total Assets (Rs. Crs.)	56,624.3	179,599.5	178,860.6	722,125.1	124,368.1

Source: Capitaline

Blue Ocean Formation

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Telecom Industry

Blue ocean is forming in the Red ocean of telecommunication industry. There is a new technology which makes the competition irrelevant by providing the same service at fraction of the cost. VoIP is proving to be the blue ocean which is forming in the bloody red ocean formed due to price wars of the telecom giants. We had seen this happening in the case of Bharti, Reliance Communication and other giants creating blue ocean and changing the face of the telecommunication industry. In a similar stance now we expect VoIP to change the telecommunication industry.

The telecommunication Industry

The worlds second largest Cell phone market is about to see a major change. The Telecom Giants are expected to show a down turn with every passing quarter. The new recommendation by TRAI (Telecom Regulatory Authority of India) severely causes threats to the Telecom giants. The strong recommendation to provide net telephony would reduce the ARPU (Average Revenue Per User) significantly. The Telecom companies have no other option but to continue to reduce their calling rates and fall back on VAS(Value Added Services).

Constructive Oligopoly & Destructive Oligopoly

According to Charlie Munger there are two kinds of Oligopoly. The constructive Oligopoly which allows all the companies to enjoy their respective share of the market without hurting each others margins. The destructive Oligopoly is the one which we can see now prevailing in the Indian Telecommunication market. In such a market the companies fight against each other for a larger market share but the ultimate winner is the consumer. Since the Telecom business is more or less commodity kind of business where in the only differentiating factor is the call rates, its difficult to retain subscribers and cost becomes the major deciding factor. The early mover advantage plays a significant advantage but after the start of destructive oligopoly it is difficult to have sustained high return on Investment.

Charlie Munger “when we were in the textile business, which is a terrible commodity business, we were making low-end textiles - which are a real commodity product. And one day, the people came to Warren and said, "They've invented a new loom that we think will do twice as much work as our old ones.”

And Warren said, "Gee, I hope this doesn't work because if it does, I'm going to close the mill.”

And he meant it.” Mr. Warren Buffett realized if newer technology prevails then it was very difficult for the business to take advantage of it as the advantage would have to passed on the consumers to remain competitive in the business. These are businesses which are capital intensive in nature which restrict any real income.

Charles Mungers Mountain Theory

A man standing on a mountain peak can see a fundamental shift happening and another mountain developing right in front of him yet cannot go all the way down and climb up that mountain. Many times it happens that due to fundamental change in the industry some changes arise which causes another mountain to rise and over shadow the existing one. It is highly unlikely that a man can go down all the way from one peak and climb up the new mountain in time to take the advantage of the new better larger mountain.

In case of Telecommunication industry, wire line was the first mountain. MTNL and BSNL are the ones sitting at the peak. Then this was followed by the fundamental shift which completely overshadowed wire line, new mountain was wireless communication. Companies like Bharti, Reliance Communication, Vodafone etc were the first to go on top of the second mountain. They were the first ones to ride the change. The existing leaders like BSNL and MTNL could not compete with them because of the change in landscape. It was difficult for them to climb down one and climb up another bigger mountain in time. MTNL has now tried to go to the next big mountain which we believe is VoIP. This new mountain would overshadow the wireless mountain and become the next even bigger mountain. VoIP is a step ahead in the wireless communication, it uses the existing infrastructure to provide a much cheaper and better service.

Only Low ARPU(Average Revenue Per User) users left

All the major cities in India have already been covered, these cities would be have the high ARPU users. The cream subscribers have already been added and from now on as the companies continue to progress inward into the rural areas, the ARPU per user would fall significantly. Since now the cities have been covered the only way to expand the user base is by entering the rural areas. Every new subscriber from the rural area would reduce the current ARPU for the telecom service providers. The companies have no other alternative then to bank on VAS(Value Added Services) to maintain their ARPU.

High End Users

We expect the highest ARPU users to shift to net telephony first. These would be the users with the required handset and technological know how to shift to net telephony. This would hit the Telecom Operators severly as these would be subscribers generating the highest revenue. Net Telephony would be able to provide the same services as the telecom giants but at a fraction of the cost. Since the Telecom giants have already spent the Capital to set up the infrastructure, they would not be willing to provide net telephony over night to avoid a drastic fall in revenue. The Telecom giants have already started shifting their focus on VAS to sustain their ARPU.

2G – 3G – 4G

As we progress from 2G to 3G the ability to transfer and receive data along with voice improves dramatically. We are getting better connectivity to the Internet with every new handset and a shift in technology. Since the VoIP companies can provide the same services as the telecom operator without requiring huge infrastructure, it posses as a huge potential threat to the existing Giants.

Call Drops

The problems of Call drops at the ground level has been increasing significantly. The voice clarity as well as connectivity has seen a decline in recent times. This problem is prevailing in almost all the services providers and is increasing day by the day. The existing infrastructure does not seem to be able to cope with the additional subscribers or call minutes.

We believe that the companies have on purpose avoided to spend on the infrastructure. The companies are aware of the change and shift in technology and do not wish to spend money where they do not see any return on investment. The companies are well aware of the call drops and reducing voice quality but are still not interested to spend further on out dated technology. The companies would like to milk the existing infrastructure as much as possible. This is another positive sign for VoIP providers who are next in line to take advantage of the situation.

Morph into Internet Service Providers

We believe the next step of all the telecom service providers would be to morph into some sort of ISP(Internet Service Provider). The Voice, Data, SMS, MMS, etc services provided by the telecom companies can be provided over the internet and at a fractional cost. The cost advantage would force the telecom companies to move to become some sort of Internet providers.

Shifting to the new Technology

We now expect the technological shift to happen with the easing of rules and regulations. The already available VoIP technology looks to be the next step in telecom industry. There could be other technologies waiting to take over VoIP as well but as of now we believe VoIP looks like the next logical step. The smaller communication companies like Geodesic, Tulip Telecom maybe in a sweet spot to ride the next technological wave.

Conclusion

We believe that the Telecom Giants are about to peak out on their revenue. The only way to sustain is to bank significantly on the VAS. The new emerging smaller companies in the Telecom space could be the next in line to see significant growth.

Company

Geodesic Limited

Geodesic is well placed to ride the next wave in shift in Telecommunication industry with its VoIP venture. We expect a sea change in the telecom industry and VoIP to become the next technology. It has had a phenomenal growth rate of 94% topline & 102% bottomline CAGR over FY05-08 period. This growth has come from its various products which continue to do well and contribute to the growth. The future triggers include plans to acquire 3 companies and capex plans of $10Mn to globally launch its new VoIP product across the globe. Its performance has remained robust in the current global slowdown with revenue growth of 125.1% & 126.5% growth in PAT. The stock is available at cheap valuations of 6.9x FY 08 earnings. We believe VoIP to be the Blue Ocean forming in the Red sea of telecom industry & Geodesic to be the key beneficiary.

Geodesic : Financials

Earnings Statement

Particulars (Rs Mn)	FY05	FY06	FY07	FY08
Total Revenues	432.2	967.8	1,680.5	3,164.3
- Growth (%)	147.4%	123.9%	73.6%	88.3%
Total Expenditure	195.7	429.1	644.3	1,249.2
Operational Exp	165.6	283.7	396.3	833.0
Staff Cost	0.0	72.1	106.3	184.2
Other Admin Exp	30.0	67.7	136.0	220.0
Exp W/O	0.1	5.6	5.7	11.9
Operating Profit	236.4	538.7	1,036.3	1,915.2
Other Income	7.3	36.3	76.1	138.4
EBITDA	243.7	575.1	1,112.4	2,053.6
Depreciation	55.1	138.1	207.5	336.2
EBIT	188.6	437.0	904.9	1,717.4
Interest	0.2	1.5	1.2	74.3
PBT	188.4	435.5	903.7	1,643.1
Tax	7.8	23.0	(8.0)	157.1
PAT Before MI	180.6	412.6	911.6	1,486.1
Minority Interest	0.0	0.0	0.0	0.0
PAT after MI	180.6	412.6	911.6	1,486.1
- Growth (%)	129.4%	128.5%	121.0%	63.0%
Extraordinary Items	(1.4)	(10.1)	(13.4)	(0.6)
Reported PAT	179.1	402.5	898.2	1,485.5

Ratio Analysis

Particulars	FY05	FY06	FY07	FY08
OPM (%)	54.7%	55.7%	61.7%	60.5%
EBITDA (%)	56.4%	59.4%	66.2%	64.9%
PBIT (%)	43.6%	45.0%	53.8%	51.9%
PAT (%)	41.8%	42.6%	54.2%	47.0%
Interest Cover (x)	1,047.6	296.7	772.1	23.1
EPS (Rs.)	3.5	7.0	15.4	16.1
P/E (x)	26.9	13.3	6.1	5.8
P/BV (x)	9.1	2.7	1.8	1.9
BVPS (Rs.)	10.4	34.6	52.9	50.0
Market Cap (Rs. Mn.)	4,858.9	5,507.5	5,561.6	8,662.4
M Cap/Sales (x)	11.2	5.7	3.3	2.7
EV (Rs. Mn.)	4,500.1	4,608.0	4,375.3	7,136.8
EV/EBITDA (x)	18.5	8.0	3.9	3.5
EV/Sales (x)	10.4	4.8	2.6	2.3
ROCE (%)	31.3%	20.9%	28.6%	17.5%
RONW (%)	33.7%	20.4%	29.1%	32.2%
Debt/Equity Ratio (x)	0.1	0.0	0.0	1.1
Debtors T/o Days	132.1	88.1	134.0	120.3
Advances T/o Days	29.1	76.8	59.6	108.9
Creditors T/o Days	140.2	6.6	20.4	40.3
WCap(Ex Cash)T/o Days	28.1	153.0	164.1	160.4
Fixed Assets T/o (Gross)	1.7	1.4	1.7	1.9
DPS (Rs.)	0.3	0.4	0.4	0.6
Dividend Payout (%)	8.5%	5.7%	2.6%	3.7%
Dividend Yield (%)	0.3%	0.4%	0.4%	0.6%

Balance Sheet

Particulars (Rs Mn)	FY05	FY06	FY07	FY08
Equity Capital	103.4	117.2	118.3	184.3
5% Redeemable Pref. Sh.	16.5	16.5	16.5	0.0
Share Application Money	19.3	39.9	193.1	18.4
Reserves	398.1	1,875.3	2,821.7	4,556.9
Shareholders Funds	537.3	2,048.8	3,149.6	4,759.6
Borrowed Funds	52.8	21.6	15.2	5,067.9
Deferred Tax Liability	12.8	25.2	1.5	(17.9)
Minority Interest	0.0	0.1	0.2	2.8
Total Liabilities	602.8	2,095.8	3,166.5	9,812.4
Goodwill	0.0	247.8	247.8	134.1
Fixed Assets	157.0	498.7	944.2	1,546.0
Investments	46.7	522.6	138.6	232.8
Current Assets				
Inventory	2.9	1.0	0.1	0.3
Sundry Debtors	156.5	233.6	616.7	1,042.8
Loans & Advances	34.5	203.7	274.2	943.8
Cash & Bank Balance	364.9	398.5	1,062.9	6,360.7
Other C.A. (Deposits)	5.5	0.0	0.0	0.0
Current Liabilities				
Sundry Creditors	166.0	17.5	94.0	349.2
Provisions	0.0	15.2	41.2	247.2
Net Current Assets	398.2	804.2	1,818.6	7,751.2
Miscellaneous Exp	1.0	22.6	17.3	148.2
Total Assets	602.8	2,095.8	3,166.5	9,812.4

Cash Flow

Particulars (Rs Mn)	FY05	FY06	FY07	FY08
Opening Cash & Bank	81.6	364.9	398.5	1,062.9
Profit After Tax	179.1	402.5	898.2	1,485.5
Invt Income	(7.3)	(36.3)	(76.1)	(138.4)
Interest Paid	0.2	1.5	1.2	74.3
Miscellaneous Exp W/Off	0.0	0.0	0.0	0.0
Depreciation	55.1	138.1	207.5	336.2
Deferred Taxation	2.2	12.1	(23.7)	(19.2)
Others	(4.9)	(303.9)	(17.9)	(18.3)
Change in Working Cap	79.2	(372.4)	(350.1)	(634.8)
CF - Operating Activities	303.7	(158.5)	639.2	1,085.2
Change in Fixed Assets	(112.5)	(444.8)	(629.8)	(934.6)
Change in Investments	72.9	(475.9)	384.0	(94.2)
Investment Income	7.3	36.3	76.1	138.4
CF - Investing Activities	(32.4)	(884.4)	(169.8)	(890.4)
Increase in Equity	(22.8)	1,135.8	230.0	205.8
Changes in Pref Cap	0.0	0.0	0.0	(16.5)
Changes in Borrowings	52.4	(31.1)	(6.4)	5,052.7
Interest Paid	(0.2)	(1.5)	(1.2)	(74.3)
Dividend Paid	(17.4)	(26.7)	(27.5)	(64.8)
CF - Financing Activities	11.9	1,076.4	194.9	5,103.0
Net Change in Cash	283.3	33.6	664.4	5,297.8
Closing Cash & Bank Bal	364.9	398.5	1,062.9	6,360.7

The Convenient Shift

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Sectoral Rotation – Opportunities in distress for related industries

"If you are in the right sector, at the right time, you can make a lot of money very fast."
- Peter Lynch

There has been a positive fallout of the commodity slump to certain industries. An easy-way to look out for these are all commodity consumers. Engineering, Appliances, Cars and so many others are all consumers of base commodity. But not many have been able to gain much out of the input price declines, which may be on account of either or both of the undermentioned reasons.

i. Their volumes have been affected correspondingly depriving the input price gains. These too are cyclicals mostly.

ii. Business with no pricing power end up passing it on to the consumers. Poor businesses with high competition.

We zoom into 3 companies, the best within their industry, which do not suffer from the above negatives and are more likely than not to be a positive beneficiary. He key differentiator for these companies versus the rest is that they have some pricing power & their businesses are not so cyclical. Plus we have included GIPCL, which is likely to benefit from the softening gas prices and is trading at 0.6x FY08 book value, certainly cheap for a utility.

Companies

Castrol

Castrol is a key beneficiary of the correction in the oil prices. Their sales depend on the overall number of vehicles and not the number of vehicles sold in a particular year. Castrol is more focused on 2 wheelers and is a near monopoly play. While the volume game may take a backseat, the margin gains are a near- surety. So it is a non-cyclical play with a good pricing power on account of its monopolistic positioning. In term of financials, the company is trading at ~12.5x FY09E earnings of Rs. 24 per share. This is certainly cheap, if one factors in the exceptionally high ROEs 50.8% despite a moderate leverage and a very high dividend payout ratio of 79.2%. The dividend yield works out to 4.9%. Castrol is our stock-pick on this theme.

At CMP of Rs. 299.5 the stock is trading at 17x CY07 earnings.

Apollo Tyres

Apollo Tyres is India's largest tyre company, with a strong focus on Heavy vehicles. The company is a key beneficiary of the sharp correction in rubber prices. The company is relatively the best in terms of size, growth consistency, lower leverage & tight working capital management. Infact the company is twice as better than competition in terms of its fixed asset turnover & working capital management, which further helps in controlling leverage & generate better returns. Now for a tyre company, the replacement market is somewhat non-cyclical. But the OEM business is cyclical & is negatively impacted. Also other key negative is the serious dumping of radial tyres from China, which is now suffering on its exports to America. Though Apollo has managed an anti-dumping restriction, the industry remains slightly competitive. We sense that there is some medium-term gain for this industry. However, in the longer run, we do not prefer this business from an investment perspective, on account of the high capital intensity (both fixed & working), competition & the sharp fluctuations in key input.

Amara Raja Batteries

Car Battery is again a segment which caters to OEM & replacement markets, the former being a cyclical element. These companies are benefiting from the falling lead prices. During the times of spiraling lead prices, these companies have shown some ability to pass it on the clients.

Amara Raja Batteries Limited (ARBL), an Amara Raja - Johnson Controls company with 26% equity from Johnson Controls, is the technology leader and is one of the largest manufacturers of lead acid batteries for both industrial and automotive applications in the Indian storage battery industry.

In India, Amara Raja is the preferred supplier to major telecom service providers, telecom equipment manufacturers, UPS Segments (OEM & Replacement) and also to Indian railways, Power, Oil & Gas among other industry segments. ARBL manufactures and sells automotive batteries under the Brand Name AMARON, which is distributed through a large pan-India sale-service retail network.

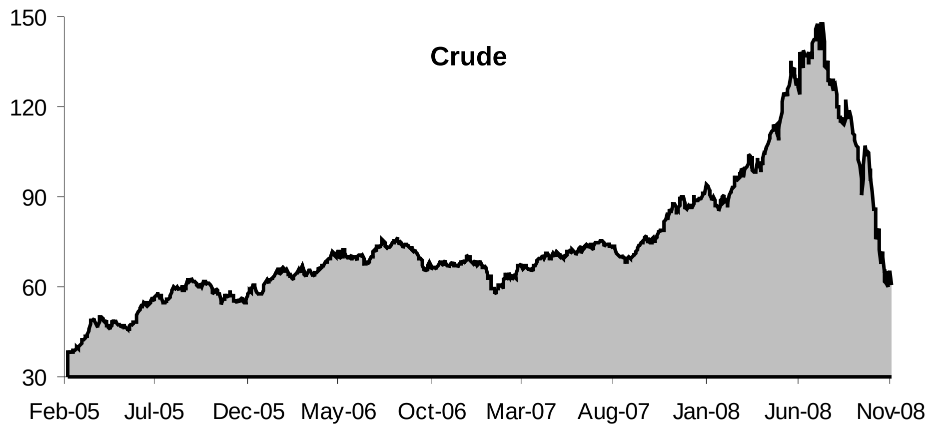
Gujarat Industries Power Company

A substantial fall in gas prices in recent times following cheap availability of naphta (competing fuel) and going ahead a boost from new gas finds is likely to help GIPCL for its Gas fired Power Plants at Vadodara. These plants operate on a MOU arrangement with the Government of Gujarat. The other power plant is lignite based wherein the raw material procurement is not an issue as the company has its own captive mines which would cater them over a period of 30 years support 1000 MW capacity. The company has massive expansion plans to increase its current installed capacity of 555 MW increasing to 805 MW by FY2009 and further to 1305 MW by FY2012 .

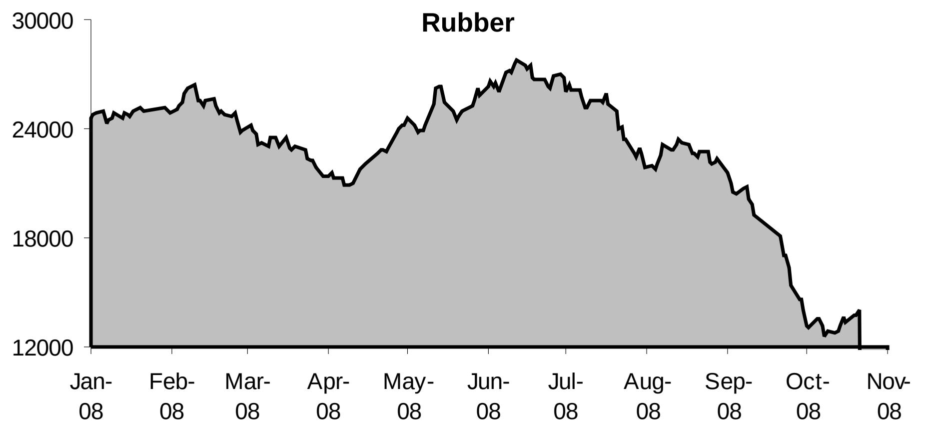
On the valuation front, scrip is trading cheap at just 0.6x FY08 book value of Rs. 75/-.

Beneficiaries

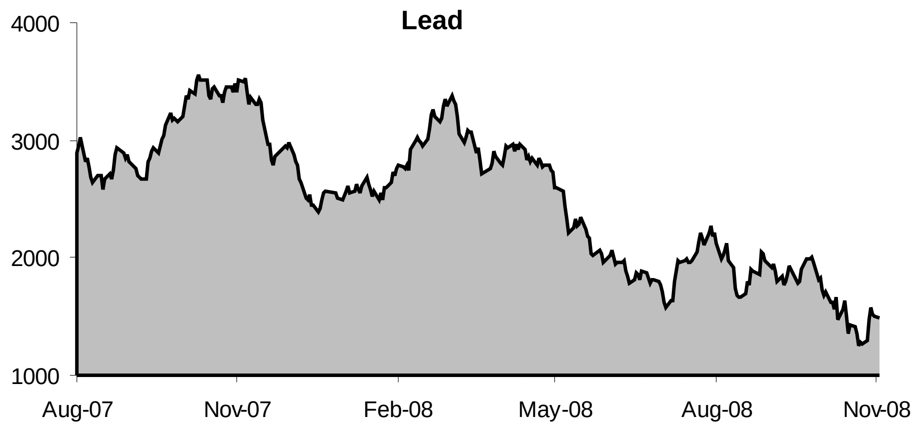
Castrol



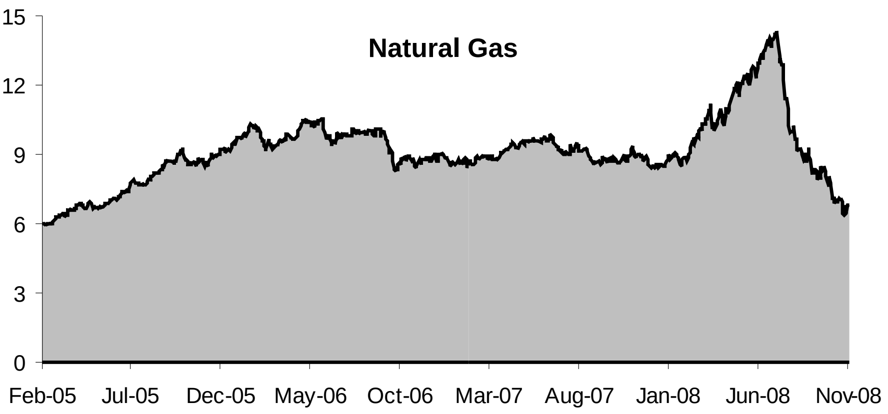
Apollo Tyres



Amara Raja



GIPCL



Source: Bloomberg

Castrol : BUY

Earnings Statement

Particulars (Rs. Mn)	CY04	CY05	CY06	CY07
Total Revenues	13,051.2	14,303.8	17,524.1	18,882.6
- Growth (%)	-	9.6%	22.5%	7.8%
Total Expenditure	10,969.0	12,187.0	15,324.3	15,586.9
Operating Profit	2,082.2	2,116.8	2,199.8	3,295.7
Other Income	220.9	200.7	343.8	348.4
EBITDA	2,303.1	2,317.5	2,543.6	3,644.1
- Growth (%)	-	0.6%	9.8%	43.3%
Depreciation	248.8	189.3	180.1	207.8
EBIT	2,054.3	2,128.2	2,363.5	3,436.3
Interest	28.7	30.1	41.1	37.9
PBT	2,025.6	2,098.1	2,322.4	3,398.4
Tax	678.3	638.2	777.5	1,214.1
PAT	1,274.6	1,468.1	1,544.9	2,184.3
- Growth (%)	-	15.2%	5.2%	41.4%

Ratio Analysis

Particulars	CY04	CY05	CY06	CY07
OPM (%)	16.0%	14.8%	12.6%	17.5%
EBITDA (%)	17.6%	16.2%	14.5%	19.3%
PBIT (%)	15.7%	14.9%	13.5%	18.2%
PAT (%)	9.8%	10.3%	8.8%	11.6%
Interest Cover (x)	71.6	70.7	57.5	90.7
EBITDA per share (Rs.)	18.6	18.7	20.6	29.5
EPS (Rs.)	10.3	11.9	12.5	17.7
P/E (x)	29.1	25.2	24.0	17.0
P/BV (x)	10.3	9.5	8.9	8.6
BVPS (Rs.)	29.1	31.5	33.8	34.8
Market Cap (Rs. Mn.)	37,030.2	37,030.2	37,030.2	37,030.2
M Cap/Sales (x)	2.8	2.6	2.1	2.0
EV (Rs. Mn.)	35,481.4	35,578.2	35,740.7	33,673.2
EV/EBITDA (x)	15.4	15.4	14.1	9.2
EV/Sales (x)	2.7	2.5	2.0	1.8
ROCE (%)	56.5%	54.2%	56.2%	79.4%
RONW (%)	35.4%	37.6%	37.0%	50.8%
Debt/Equity Ratio (x)	0.01	0.01	0.01	0.01
Inventory T/o Days	46.5	54.6	53.2	43.5
Debtors T/o Days	36.7	38.7	39.4	28.6
Advances T/o Days	16.3	19.5	17.2	15.4
Creditors T/o Days	55.1	61.2	56.3	66.1
Working Cap T/o Days	28.7	40.4	53.0	50.4
Fixed Assets T/o (Gross)	5.2	5.8	7.1	7.6
DPS (Rs.)	8.3	8.3	9.0	14.0
Dividend Payout (%)	80.0%	69.5%	72.0%	79.2%
Dividend Yield (%)	2.8%	2.8%	3.0%	4.7%

Balance Sheet

Particulars (Rs. Mn)	CY04	CY05	CY06	CY07
Equity Capital	1,236.4	1,236.4	1,236.4	1,236.4
Reserves	2,364.3	2,664.2	2,940.2	3,065.4
Shareholders Funds	3,600.7	3,900.6	4,176.6	4,301.8
Borrowed Funds	37.2	27.9	27.9	27.9
Deferred Tax Liability	174.1	118.5	61.3	0.0
Total Liabilities	**3,812.0**	**4,047.0**	**4,265.8**	**4,329.7**
Fixed Assets	1,497.7	1,383.3	1,296.8	1,332.6
Investments	1,289.1	1,081.4	425.2	205.8
Deferred Tax Asset	0.0	0.0	0.0	182.2
Current Assets				
Inventory	1,662.4	2,139.0	2,555.2	2,249.8
Sundry Debtors	1,312.6	1,516.4	1,889.9	1,479.5
Loans & Advances	583.2	766.0	825.1	798.2
Cash & Bank Balance	296.9	398.5	892.2	3,179.1
Other Current Assets	0.1	0.1	0.4	18.6
Current Liabilities				
Sundry Creditors	1,970.2	2,398.4	2,703.6	3,418.3
Provisions	859.8	839.3	915.4	1,697.8
Net Current Assets	1,025.2	1,582.3	2,543.8	2,609.1
Total Assets	**3,812.0**	**4,047.0**	**4,265.8**	**4,329.7**

Cash Flow

Particulars (Rs. Mn)	CY04	CY05	CY06	CY07
Opening Cash & Bank	277.8	296.9	4,720.4	892.2
Profit after Tax	1,274.6	1,468.1	1,544.9	2,184.3
Less: Investment Income	(220.9)	(200.7)	(343.8)	(348.4)
Interest Paid	28.7	30.1	41.1	37.9
Depreciation	248.8	189.3	180.1	207.8
Deferred Taxation	0.0	(38.7)	(53.9)	(5.3)
Others	(9.2)	(90.5)	(4,448.4)	(175.9)
Change in Working Cap	141.8	(455.5)	(467.8)	2,221.6
CF - Operating Activities	1,463.8	902.1	(3,547.8)	4,122.0
Change in Fixed Assets	(36.2)	(1.3)	29.6	(123.7)
Change in Investments	(441.2)	207.7	656.2	219.4
Change in Def. Tax Asset	0.0	0.0	0.0	(182.2)
Investment Income	220.9	200.7	343.8	348.4
CF - Investing Activities	(256.5)	407.1	1,029.6	261.9
Increase in Equity	(0.0)	(0.0)	(0.0)	(15.5)
Changes in Borrowings	(4.8)	(9.3)	0.0	0.0
Interest Paid	(28.7)	(30.1)	(41.1)	(37.9)
Dividend Paid	(1,154.7)	(1,168.2)	(1,268.9)	(2,043.6)
CF - Financing Activities	(1,188.2)	(1,207.6)	(1,310.0)	(2,097.0)
Net Change in Cash	19.1	101.6	(3,828.2)	2,286.9
Closing Cash & Bank Bal	296.9	398.5	892.2	3,179.1

Resurrection Weapon

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Defense Industry

"The more we sweat in peace the less we bleed in war."

The dilution of USA & USD dominion on the world is capable of unsettling a lot of things, not just economically but also from a political parlance. While the world feels some respite from the Saddam's & the Kim Jong II's, we still have a hysterical-fears with Iran-Israel. With our neighbour brother becoming the next Afghanistan or Iraq for the US warplanes, its internal political confrontations and finally with its nuclear deal with China, it is imperative for India to take heed.

The security spending is rarely a function of economics. The change in India's global standing post the signing of the nuclear deal with USA and the New Offset policy are important events. The Offset Policy is particularly important in sense that it can bring in a lot of traction to the Indian companies in the defense space.

Bharat Electronics Limited (BEL) is a leading Indian defense electronics company with around 95 per cent of the market share for strategic electronics in India. BEL manufactures a wide range of cutting-edge Military Communication Systems, Radars and Sonars, Naval Systems, Telecom & Broadcast Systems, Electronic Warfare Systems, Tank Electronics, Opto Electronics, Professional Electronic Components and Solar Powered Systems. The Company has been using the technologies and skills acquired over the years to design a number of civilian products such as Electronic Voting Machines, Set Top Boxes, etc.

Key Investment arguments

- Excellent relationship based strategic position and a Quasi Monopoly business
- A Non cyclical and Low Capital intensiveness business
- Excellent return ratios
- Good revenue visibility due to high indigenisation level targets for defense expenditure
- Key Beneficiary of Offset Policy
- Sharp rise in the Order book to be reflected in the revenues of the coming years

Rise in Order Book

Particulars	FY05	FY06	FY07	FY08
Sales (Rs Mn.)	33,401.2	36,549.7	40,485.0	42,067.4
Order Book (Rs Mn.)	61,080.0	66,330.0	91,000.0	95,860.0
Order Book/Sales (x)	1.8	1.8	2.2	2.3

Source: PPFAS Research

Opinion

We believe that the increasing share of civilian contracts, cost reduction through indigenisation (BEL saved Rs. 163 Crs through cost savings initiatives in FY08), improving exports (33% increase in FY08), continuous innovation (20 new products introduced in FY08), all auger well for BEL. The impact is clearly visible as BEL has been able to expand margins, despite a sharp 50% increase in DA as per the new wage revision norms.

The share of BEL is coming down with the sector being opened up for private players. The opening up of the FDI window upto 49% in select parts is likely to benefit both BEL & private players equally.

While FY09 may be a muted year for BEL, the company is likely to see a very good traction in the coming year, as a larger portion of its pending order-book gets executed. Moreso the Offset policy has been effected only from September 2008. The coming years will see the positive fallout of this policy. Financially the company's performance has been commendable. BEL trades at 6.5x its FY09E earnings of Rs. 98.2 per share.

We see BEL as being relatively less cyclical than the other engineering companies, albeit with a lower growth rate. But the extremely cheap valuations & the positive future outlook does put BEL as a key defensive bet.

Earnings Statement				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Total Revenues	36,593.1	40,532.4	42,119.3	42,958.7
Total Expenditure	27,786.1	30,808.7	31,852.2	32,489.2
Operating Profit	8,807.1	9,723.7	10,267.2	10,469.5
Other Income	1,135.0	1,945.5	2,403.6	2,461.6
EBITDA	9,942.0	11,669.1	12,670.8	12,931.1
Depreciation	895.0	933.3	1,007.2	1,018.9
EBIT	9,047.0	10,735.9	11,663.6	11,912.1
Interest	270.2	8.4	3.0	2.5
PBT	8,776.8	10,727.5	11,660.6	11,909.6
Tax	2,759.4	3,397.5	3,503.4	4,048.1
PAT before MI	6,017.4	7,330.0	8,157.2	7,861.6
Minority Interest	4.3	5.9	0.8	5.0
PAT before EI	6,013.1	7,324.1	8,156.4	7,856.6
Extraordinary Items	(28.2)	(8.6)	216.3	0.0
Reported PAT	5,984.9	7,315.5	8,372.7	7,856.6

Ratio Analysis				
Pariculars	FY06	FY07	FY08	FY09E
OPM (%)	24.1%	24.0%	24.4%	24.4%
EBITDA (%)	27.2%	28.8%	30.1%	30.1%
PBIT (%)	24.8%	26.5%	27.7%	27.8%
PAT (%)	16.5%	18.1%	19.4%	18.3%
Interest Cover Ratio	33.5	1,281.0	3,871.1	4,764.2
EPS	75.2	91.6	102.0	98.2
Book Value per share	264.0	333.6	415.2	490.4
Market Cap	50,872.0	50,872.0	50,872.0	50,872.0
Enterprise Value	50,964.7	50,895.4	50,892.8	50,892.8
P/E	8.5	6.9	6.2	6.5
P/BV	2.4	1.9	1.5	1.3
M Cap/Sales	1.4	1.3	1.2	1.2
EV/EBITDA	5.1	4.4	4.0	3.9
EV/Sales	1.4	1.3	1.2	1.2
ROCE (%)	42.3%	39.8%	34.9%	30.2%
RONW (%)	28.5%	27.4%	24.6%	20.0%
Debt/Equity Ratio	0.0	0.0	0.0	0.0
Inventory T/o Days	106.0	114.8	118.8	120.0
Debtors T/o Days	103.6	153.5	180.6	180.0
Advances T/o Days	80.5	28.1	48.9	50.0
Creditors T/o Days	230.0	257.7	287.5	280.0
Net Wrkg Cap T/o Days	158.5	188.9	237.0	285.1
Fixed Assets T/o (Gross)	2.8	2.9	2.8	2.7
DPS	14.6	18.0	20.7	19.6
Dividend Payout (%)	19.4%	19.7%	20.3%	20.0%
Dividend Yield (%)	2.3%	2.8%	3.3%	3.1%

Balance Sheet				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Equity Capital	800.0	800.0	800.0	800.0
Reserves	20,343.2	25,898.5	32,412.2	38,432.0
Shareholders Funds	21,143.2	26,698.5	33,212.2	39,232.0
Minority Interest	16.5	22.3	23.2	28.2
Government Grants	142.5	206.6	208.5	208.5
Borrowed Funds	92.7	23.4	20.8	20.8
Total Liabilities	21,394.8	26,950.8	33,464.8	39,489.5
Fixed Assets	4,255.4	4,490.6	4,724.3	4,701.4
Investments	0.0	0.0	0.0	0.0
Inventory	10,611.1	12,736.8	13,688.2	14,107.0
Sundry Debtors	10,377.8	17,030.7	20,818.7	21,160.5
Loans & Advances	8,064.4	3,111.4	5,635.3	5,877.9
Cash & Bank Balance	18,577.1	20,930.6	24,615.5	29,560.0
Sundry Creditors	23,033.9	28,589.1	33,138.8	32,916.3
Provisions	8,725.5	4,271.3	4,303.3	4,274.5
Net Current Assets	15,870.9	20,949.1	27,315.5	33,514.7
Deferred Tax Assets	1,246.2	1,501.4	1,424.9	1,424.9
Miscellaneous Expenditure	22.3	9.6	0.0	0.0
Total Assets	21,394.8	26,950.8	33,464.8	39,641.0

Cash Flow				
Particulars (Rs. Mn.)	FY06	FY07	FY08	FY09E
Opening Cash & Bank	13,487.1	18,577.1	20,930.6	24,615.5
Profit After Tax	5,984.9	7,315.5	8,372.7	7,856.6
Less : Invest. Income	(1,135.0)	(1,945.5)	(2,403.6)	(2,461.6)
Add. Interest Expense	270.2	8.4	3.0	2.5
Depreciation	895.0	933.3	1,007.2	1,018.9
Deferred Taxation	(59.2)	(216.5)	37.0	0.0
Others	4,307.0	(263.2)	(19.3)	0.0
Govt.Grant Adjustment	4.5	64.1	1.9	0.0
Net Change in W Capital	779.1	(2,724.7)	(2,681.5)	(1,254.6)
CF - Operating Activities	11,046.6	3,171.4	4,317.3	5,161.8
Change in Fixed Assets	(888.3)	(1,012.6)	(1,094.0)	(996.0)
Change in Investments	(4,538.4)	0.0	0.0	0.0
Investment Income	1,135.0	1,945.5	2,403.6	2,461.6
CF - Investing Activities	(4,291.7)	932.8	1,309.7	1,465.6
Increase in Equity	0.0	0.0	0.0	(0.0)
Changes in Borrowings	(65.4)	(69.2)	(2.6)	0.0
Changes in Minority Int.	2.5	5.8	0.9	5.0
Interest Paid	(270.2)	(8.4)	(3.0)	(2.5)
Dividend Paid	(1,331.8)	(1,678.9)	(1,937.4)	(1,836.8)
CF - Financing Activities	(1,664.9)	(1,750.7)	(1,942.1)	(1,834.3)
Net Change in Cash	5,090.0	2,353.6	3,684.9	4,793.1
Closing Cash & Bank	18,577.1	20,930.6	24,615.5	29,408.6

For the Inquisitionists

Dividend Yield Plays

NIIT Tech, HTMT Global. VST Industries, Wyeth are some of our picks. Bongaigaon, Chennai Petro & Tata Chem are the traditional bets based on the Dividend Yield plays.

Name	M Cap	Div %	EPS	ROCE (%)	RONW (%)	P/E	Div Yield -%	Payout
Bongaigaon Ref	763.3	50.0	13.9	36.1	27.7	3.5	13.1	36.0%
C P C L	1,952.6	170.0	72.5	36.9	36.8	3.9	13.0	23.5%
NIIT Tech.	399.1	65.0	24.4	41.4	41.8	4.2	9.6	26.7%
HCL Infosystems	1,488.1	400.0	16.5	40.4	33.0	8.4	9.2	48.6%
VST Inds.	346.6	200.0	34.4	39.8	26.9	9.0	8.9	58.2%
Finolex Inds	418.0	30.0	5.2	11.7	13.2	12.6	8.9	57.4%
Andhra Bank	2,240.7	40.0	11.2	0.0	18.0	6.6	8.7	35.8%
West Coast Paper	226.2	150.0	13.8	16.4	25.9	4.7	7.6	21.8%
Bank of Maha	1,138.7	20.0	7.3	0.0	18.9	6.9	7.6	27.4%
Vijaya Bank	1,155.3	20.0	8.0	0.0	18.3	6.2	7.5	25.0%
Solvay Pharma	269.9	400.0	49.4	50.8	33.3	14.3	7.5	81.0%
Graphite India	605.9	150.0	8.3	20.7	20.7	6.2	7.5	36.0%
Vardhman Textile	315.7	40.0	20.5	7.4	10.8	5.1	7.3	19.5%
Ashok Leyland	2,760.4	150.0	3.3	26.1	23.5	10.8	7.2	45.9%
Lak. Mach. Works	781.5	450.0	188.2	56.0	36.2	8.5	7.1	23.9%
Wyeth	962.0	300.0	30.8	45.4	31.6	14.8	7.1	97.5%
Merck	488.2	200.0	37.7	24.5	16.9	11.9	6.9	53.0%
Alok Inds	342.7	12.0	10.4	9.4	16.9	5.5	6.9	11.5%
Tata Elxsi	316.5	70.0	15.7	47.9	49.8	10.0	6.9	44.5%
Deccan Chronicle	1,070.2	150.0	10.6	30.2	28.7	15.5	6.9	28.3%
Allahabad Bank	2,300.5	35.0	21.2	0.0	24.6	3.6	6.8	16.5%
HTMT Global	307.9	100.0	26.9	12.3	11.5	11.9	6.7	37.1%
Tata Tea	3,253.1	350.0	44.6	12.0	11.0	18.5	6.7	78.4%
IL&FS Inv Manage	330.8	55.0	9.6	87.1	57.6	25.7	6.6	57.1%
T N Newsprint	472.4	45.0	15.9	16.0	18.3	6.3	6.6	28.3%
Dredging Corpn	644.6	150.0	52.7	12.6	13.1	12.3	6.5	28.4%
Supreme Inds.	339.3	80.0	17.2	22.9	21.7	10.2	6.5	46.7%
Balmer Lawrie	428.5	170.0	50.5	44.2	29.2	7.4	6.5	33.7%
SRF	525.5	50.0	19.3	19.3	17.8	5.2	6.5	25.9%
Finolex Cables	376.3	75.0	5.6	15.9	14.6	12.8	6.1	27.0%
Apar Inds.	301.3	55.0	25.5	35.9	24.0	8.1	5.9	21.6%
Balkrishna Inds	353.2	105.0	52.8	22.4	27.8	10.3	5.8	19.9%
Pfizer	1,452.8	275.0	108.9	37.2	27.3	5.9	5.7	25.3%
Greaves Cotton	526.3	60.0	21.5	42.7	33.1	8.2	5.6	27.9%
Syndicate Bank	2,698.6	28.0	15.8	0.0	24.1	4.8	5.4	17.8%
Tata Chemicals	3,915.6	90.0	39.0	14.7	18.0	7.2	5.4	23.1%
Guj Inds Power	704.1	25.0	6.3	11.3	9.2	14.2	5.4	39.4%
JK Tyre & Indust	209.2	27.0	21.2	14.7	17.4	6.0	5.3	12.7%
Opto Circuits(I)	1,531.3	50.0	11.7	38.6	45.1	28.2	5.2	42.6%
Navneet Publicat	438.9	120.0	5.2	27.4	24.7	18.5	5.2	45.9%
Alembic	400.1	75.0	7.9	16.6	23.2	7.2	5.2	19.1%
HCL Technologies	11,675.1	450.0	10.2	23.5	20.7	24.6	5.2	88.3%
JBF Inds.	285.2	22.5	14.5	18.1	23.5	6.9	4.9	15.6%
Esab India	488.6	155.0	32.2	90.6	59.2	14.3	4.9	48.1%
Castrol India	3,703.0	140.0	15.1	80.5	51.5	23.8	4.7	92.5%
Rallis India	423.2	160.0	95.3	23.7	27.3	3.5	4.5	16.8%

Source: Prowess

Cigar Butts

These are stocks available at seemingly cheap valuations. However one should not fall for these blindly, for there could be certain negative facets attached to these which may gradually surface over a period of time, denying a long term investor its true potential. As Buffett said, “There is rarely just one cockroach in the kitchen”. As a part of our basic filtering, we have eliminated the more vulnerable small cap companies. Also we recommend to avoid selecting any cyclical company in industry like Cement, Steel, Shipping, etc. based on this approach. We feel that NIIT Tech, Zensar & Apar are some of the interesting bets from this query.

Name	M Cap	DER	PBIDTM (%)	ROCE (%)	RONW (%)	P/E	P/BV	Div Yield -%
Ingersoll-Rand	832.2	0.0	18.9	16.7	13.0	3.1	1.2	2.3
JK Lakshmi	246.9	1.4	28.2	24.8	43.7	3.2	1.1	6.2
Uttam Galva	390.3	1.6	11.9	19.9	19.7	3.3	0.6	0.0
Bongaigaon Ref	763.3	0.2	7.4	36.1	27.7	3.5	0.9	13.1
Rallis India	423.2	0.2	12.3	23.7	27.3	3.5	1.8	4.5
Oswal Chem & Fer	285.1	0.0	44.5	12.7	11.5	3.6	0.5	0.0
Ankur Drugs	257.8	3.1	16.0	15.6	40.2	3.7	1.1	1.6
Nectar Lifescn.	276.9	1.9	17.9	17.1	34.1	3.7	1.1	2.2
C P C L	1,952.6	0.7	6.6	36.9	36.8	3.9	1.2	13.0
Birla Corpn	709.3	0.3	30.8	51.8	47.6	3.9	1.5	4.3
India Glycols	223.9	1.4	23.0	29.9	44.7	3.9	1.4	5.0
Tata Sponge Iron	223.0	0.6	34.1	46.9	47.6	4.1	1.6	4.8
NIIT Tech.	399.1	0.1	39.1	41.4	41.8	4.2	1.6	9.6
Jindal Poly Film	370.1	0.2	19.2	19.7	15.6	4.2	0.6	1.5
Prism Cement	499.6	0.0	34.5	62.2	47.0	4.2	1.6	6.0
GE Shipping Co	3,219.2	0.7	61.1	20.9	29.3	4.3	1.4	7.1
Orient Paper	443.4	0.8	23.7	59.6	65.2	4.4	1.8	5.2
J K Cements	383.9	0.8	30.1	34.0	41.5	4.4	1.5	9.1
Kesoram Inds.	683.1	1.3	20.2	32.7	47.2	4.7	1.8	3.7
West Coast Paper	226.2	0.9	18.4	16.4	25.9	4.7	0.9	7.6
Guj Alkalies	530.2	0.5	26.6	25.6	23.2	5.0	1.0	4.9
Godawari Power&I	223.3	1.0	17.0	24.1	32.2	5.0	1.2	5.0
Hind.Zinc	13,430.1	0.0	71.3	61.7	45.2	5.1	1.9	1.6
SRF	525.5	0.6	20.0	19.3	17.8	5.2	0.8	6.5
Tata Metaliks	233.9	0.6	11.9	47.3	41.6	5.3	1.8	7.6
Alok Inds	342.7	3.9	32.1	9.4	16.9	5.5	0.8	6.9
Nava Bharat Vent	958.2	0.7	44.3	37.3	51.6	5.5	2.1	4.9
Kolte Patil Deve	231.0	0.2	46.8	37.4	34.3	5.7	1.3	5.7
G N F C	951.9	0.2	18.8	28.3	21.8	5.8	1.1	6.9
G S F C	653.2	0.5	14.8	18.7	16.8	5.9	0.9	5.5
Pfizer	1,452.8	0.0	26.2	37.2	27.3	5.9	3.0	5.7
JK Tyre & Indust	209.2	2.4	8.4	14.7	17.4	6.0	1.1	5.3
Zensar Technolgs	252.8	0.0	19.5	25.5	24.2	6.1	1.3	3.6
Graphite India	605.9	0.8	24.6	20.7	20.7	6.2	1.1	7.5
T N Newsprint	472.4	0.9	24.9	16.0	18.3	6.3	1.1	6.6
Unichem Labs.	594.8	0.1	19.0	22.8	19.4	6.3	1.1	3.0
Savita Chemicals	237.1	0.2	10.0	31.8	27.1	6.5	1.5	7.1
IVR-Prime Urban	286.8	0.6	42.1	29.0	33.3	6.6	1.2	9.0
Bhushan Steel	2,916.4	3.2	18.5	11.0	29.8	6.7	1.7	0.4
Dalmia Cement	701.8	1.5	29.5	19.0	27.4	6.7	2.1	4.6
Guj Flourochem	972.1	0.6	57.3	31.1	32.6	6.8	2.2	4.2

Source: Prowess

Cash Rich Companies

These companies are at advantage over others in managing their overall profits through higher cash discounts/higher other income/lower interest expense. We have looked at Net Cash as a percentage of Market Cap & the Total Balance Sheet size and have sorted the results based on the combined rankings. Here again we have excluded the banking companies for the query. HTMT Global, Bharat Electronics, Lakshmi Machine Works, Engineers India, Ingersoll are the key picks.

Name	M Cap	Net Cash	Total Liab	Cash/Total Liab	Cash/M Cap	ROCE (%)	RONW (%)	P/E
Apar Inds.	301.3	396.4	364.9	108.6%	131.6%	35.9	24.0	8.1
HTMT Global	307.9	510.9	983.2	52.0%	166.0%	13.0	11.6	3.5
Engineers India	2329.2	1,252.6	1,152.1	108.7%	53.8%	29.8	19.6	20.3
Lak. Mach. Works	781.5	568.3	757.5	75.0%	72.7%	56.0	36.2	8.5
Ingersoll-Rand	832.2	516.2	702.4	73.5%	62.0%	16.7	13.0	3.1
Alstom Projects	1650.4	393.0	353.8	111.1%	23.8%	35.0	21.7	60.7
Mysore Cement	213.3	180.7	364.6	49.6%	84.7%	27.2	27.2	10.0
Bharat Electron	5086.8	2,452.1	3,234.5	75.8%	48.2%	40.3	28.4	10.6
Hinduja Ventures	242.3	203.4	665.8	30.6%	84.0%	8.4	6.4	17.7
Wyeth	962	227.1	260.9	87.1%	23.6%	45.4	31.6	14.8
Pfizer	1452.8	479.8	648.6	74.0%	33.0%	37.2	27.3	5.9
M T N L	4340.7	3,369.4	11,921.4	28.3%	77.6%	7.0	5.0	11.2
NMDC Ltd	59867	7,198.8	8,289.7	86.8%	12.0%	70.5	46.1	43.6
B H E L	65652	8,290.8	10,869.4	76.3%	12.6%	45.2	29.2	36.8
Colgate Palmoliv	5264.6	139.6	166.9	83.6%	2.7%	130.0	104.7	28.8
Oswal Chem & Fer	285.1	203.1	1,859.3	10.9%	71.2%	12.7	11.5	3.6
Satyam Computer	20216.2	4,438.0	7,379.5	60.1%	22.0%	29.6	26.1	15.8
Apollo Sindhoori	272	53.3	85.5	62.3%	19.6%	55.0	60.0	7.1
Castrol India	3703	315.1	433.0	72.8%	8.5%	80.5	51.5	23.8
Titagarh Wagons	739.5	164.9	280.9	58.7%	22.3%	48.0	37.5	0.0
Astrazeneca Phar	1170.9	111.0	159.3	69.7%	9.5%	63.3	40.8	29.7
Geojit Fin Serv	503.8	126.0	232.7	54.2%	25.0%	33.2	22.2	20.9
Aventis Pharma	1719.9	390.6	706.9	55.3%	22.7%	34.7	22.5	19.4
Natl. Aluminium	9493.9	3,516.5	8,874.4	39.6%	37.0%	30.5	19.7	18.6
Madras Aluminium	524.3	159.0	395.8	40.2%	30.3%	27.3	24.8	18.8
S A I L	37235.6	10,714.2	26,108.8	41.0%	28.8%	49.4	37.3	10.5
SKF India	903.3	236.2	545.3	43.3%	26.2%	51.2	33.2	15.6
Container Corpn	8282.3	1,521.5	3,183.9	47.8%	18.4%	32.6	25.9	15.5
Dredging Corpn	644.6	256.9	1,255.3	20.5%	39.9%	12.6	13.1	12.3
Sulzer India	214.3	22.5	45.2	49.8%	10.5%	65.1	39.0	18.4
Punjab Tractors	727.9	194.8	668.9	29.1%	26.8%	14.9	9.9	22.9
Infosys Tech.	78919.1	6,429.0	13,490.0	47.7%	8.2%	41.5	36.3	19.7
Anant Raj Inds	1441.6	539.1	2,951.2	18.3%	37.4%	24.5	22.5	15.1
Jyothy Labor.	360.5	95.3	329.4	28.9%	26.4%	22.4	16.8	14.4
P & G Hygiene	2451.1	166.5	346.6	48.0%	6.8%	56.6	41.2	20.4
Balmer Lawrie	428.5	100.5	331.3	30.3%	23.5%	44.2	29.2	7.4
Merck	488.2	116.9	422.9	27.6%	24.0%	24.5	16.9	11.9
Tanla Solutions	995.5	183.8	700.5	26.2%	18.5%	30.1	23.8	3.0
IL & FS Invsmart	603.8	126.8	682.4	18.6%	21.0%	4.0	2.3	69.5
Solvay Pharma	269.9	24.4	86.8	28.1%	9.0%	50.8	33.3	14.3
Neyveli Lignite	9982.4	1,958.9	11,831.0	16.6%	19.6%	13.2	12.7	19.3
Oracle Financial	5036.1	640.1	2,812.6	22.8%	12.7%	16.7	15.9	19.2
GAIL (India)	28230	3,207.1	14,270.8	22.5%	11.4%	29.1	21.3	14.6
IL&FS Inv Manage	330.8	16.7	58.5	28.5%	5.0%	87.1	57.6	25.7
Kirl. Ferrous	203.6	39.5	304.1	13.0%	19.4%	25.6	17.4	11.9
Fag Bearings	523.3	63.9	318.1	20.1%	12.2%	44.5	28.4	14.8
Indraprastha Gas	1476.3	133.1	583.3	22.8%	9.0%	49.6	33.4	11.2
T.V. Today	383.1	48.6	293.1	16.6%	12.7%	24.2	15.9	13.4

Source: Prowess

High Leverage Companies

We recommend caution dealing with any of the below highly leveraged companies. Many of these companies are paying a price for their under-estimation of the risks in their aggressiveness. Even some of the good companies may be constrained in executing their plans in the current tough liquidity scenario, which may call for compromise from both the company & the investors. We have excluded banking companies for this query.

Name	Year End	M Cap	Debt	Networth	Debt/Eq	ROCE (%)	RONW (%)	P/E
Asahi India Glas	200803	720.3	1,391.4	294.5	4.7	6.8	4.6	80.6
Alok Inds	200803	342.7	5,767.3	1,321.2	4.4	9.4	16.9	5.5
Strides Arcolab	200712	560.9	1,062.8	244.5	4.3	0.0	0.0	0.0
Vipul Ltd	200703	206.7	229.1	56.0	4.1	39.7	114.2	28.0
Jai Balaji Inds	200803	239.7	1,429.8	352.5	4.1	18.3	41.2	11.5
Unitech	200803	7,954.7	8,119.5	2,143.8	3.8	23.4	62.4	43.8
Bombay Dyeing	200803	780.7	1,415.8	395.9	3.6	3.6	-4.5	165.1
Bhushan Steel	200803	2,916.4	5,718.1	1,625.3	3.5	11.0	29.8	6.7
Chemplast Sanmar	200803	215.9	847.5	253.2	3.3	5.1	0.8	58.7
Kohinoor Foods	200703	308.1	460.2	141.6	3.2	9.4	16.8	6.2
Zenith Infotech	200803	339.4	331.8	105.6	3.1	14.5	45.9	9.3
MMTC	200803	70,319.3	3,201.6	1,030.0	3.1	16.1	23.8	565.1
Era Infra Engg	200803	870.9	1,447.1	466.2	3.1	20.4	32.1	11.4
Bombay Burmah	200803	237.4	270.0	88.3	3.1	12.8	24.8	52.9
GTL Infrastruc	200803	2,975.9	2,475.7	838.2	3.0	0.0	0.0	0.0
Ankur Drugs	200803	257.8	618.1	210.7	2.9	15.6	40.2	3.7
Shrenuj & Co.	200803	209.6	638.2	218.4	2.9	12.3	16.0	8.8
Adhunik Metal	200803	423.8	889.7	309.9	2.9	15.9	28.1	15.9
Omaxe Ltd	200703	1,052.7	914.1	321.2	2.8	23.5	47.0	9.2
Orchid Chemicals	200803	760.4	1,953.4	688.1	2.8	13.4	31.0	5.9
REI Agro	200703	2,760.0	1,291.3	462.2	2.8	13.0	25.3	10.0
Essar Oil	200803	11,465.8	10,015.6	3,600.7	2.8	0.0	0.0	0.0
Swan Mills	200803	406.1	151.3	55.2	2.7	18.2	20.4	24.3
Jet Airways	200803	1,654.9	12,015.0	4,551.6	2.6	-2.2	-28.9	0.0
Ispat Inds.	200803	1,507.3	7,225.0	2,901.6	2.5	12.2	3.0	112.0
HEG	200703	639.5	887.8	358.2	2.5	13.0	21.8	8.5
Kingfisher Air	200706	898.8	916.7	373.7	2.5	0.0	0.0	0.0
Satra Properties	200803	387.6	191.0	78.2	2.4	34.4	75.7	36.8
JSL Ltd	200803	636.4	4,306.1	1,788.1	2.4	12.6	16.6	9.3
Varun Ship. Co.	200803	679.5	2,200.8	914.8	2.4	13.1	27.6	5.1
Jaybharat Text	200803	5,735.6	216.1	91.7	2.4	19.2	41.7	181.5
SpiceJet	200703	309.0	432.2	184.6	2.3	0.0	0.0	0.0
GHCL	200803	345.6	1,163.6	502.5	2.3	13.4	22.0	10.5
Adani Enterprise	200803	9,917.0	3,062.5	1,337.7	2.3	16.5	22.0	47.8
Radico Khaitan	200803	621.9	540.0	239.6	2.3	9.4	10.3	40.1
Hotel Leela Ven.	200803	1,057.8	2,035.7	930.2	2.2	11.9	21.4	10.4
Kajaria Ceramics	200803	219.7	337.3	154.9	2.2	12.8	10.1	14.2
Marksans Pharma	200803	218.5	303.1	141.5	2.1	6.9	12.4	44.2
Uflex	200803	435.3	1,359.9	637.4	2.1	8.0	11.0	15.4
S T C	200803	711.3	1,098.7	524.9	2.1	16.6	26.0	16.3
Jaiprakash Assoc	200803	9,641.6	8,305.6	4,199.5	2.0	12.1	18.9	45.0
Binani Cement	200803	649.9	792.2	417.6	1.9	26.3	48.9	7.5
Shristi Infra	200803	859.6	50.8	28.6	1.8	19.9	48.2	225.2
JK Tyre & Indust	200709	209.2	915.0	533.9	1.7	14.7	17.4	6.0
Federal-Mogul Go	200712	208.3	292.4	176.3	1.7	0.0	0.0	0.0
Sanwaria Agro	200803	523.7	193.3	125.3	1.5	38.9	77.6	14.8
Spice Comm	200712	2,369.9	1,285.5	857.9	1.5	6.7	-10.2	11.4

Source: Prowess

Annexure

Company (FY08)	Reco	M Cap (Rs. Mn.)	Revenues (Rs. Mn.)	OPM (%)	NPM (%)	Debt/Eq (x)	ROCE (%)	RONW (%)	P/E (x)	P/BV (x)	Div Yield (%)
Godrej Consumer	Buy	22,911.9	11,025.7	19.5%	14.4%	1.1	56.3%	94.4%	14.4	13.6	4.2%
Marico Industries	Buy	30,267.3	19,066.9	12.9%	8.3%	1.1	33.0%	50.4%	19.1	9.6	1.3%
Pidilite Industries	Buy	27,561.8	17,082.0	14.1%	10.1%	0.8	19.8%	27.7%	16.0	4.4	1.6%
Infosys Technologies	Buy	788,502.0	166,920.0	31.4%	27.9%	-	38.7%	33.8%	16.9	5.7	2.4%
Mphasis	Buy	35,034.3	24,230.7	11.5%	10.5%	-	22.2%	22.1%	13.7	3.0	2.0%
NIIT Technologies	Buy	3,988.6	9,415.1	18.7%	14.4%	0.1	29.5%	30.6%	2.9	0.9	9.6%
Sonata Software	Buy	1,787.7	14,283.7	7.8%	4.1%	-	34.9%	25.6%	3.1	0.8	6.5%
HTMT Global Sol.	Buy	3,078.6	6,370.5	14.7%	13.7%	0.0	13.0%	11.6%	3.5	0.4	5.7%
Aban Offshore	Sell	33,349.0	20,210.6	61.4%	6.1%	16.1	6.7%	15.1%	27.1	4.1	0.4%
Garware Offshore ^	Sell	2,414.1	1,136.7	61.2%	41.8%	1.3	15.3%	24.1%	5.1	1.2	1.8%
Great Offshore	Sell	13,021.8	7,459.0	41.9%	27.0%	1.1	14.4%	22.9%	6.5	1.5	4.7%
ABG Shipyard	Sell	6,400.9	8,851.4	23.7%	33.0%	0.7	22.6%	21.0%	4.0	0.8	1.6%
Bharati Shipyard	Sell	1,953.3	6,451.4	20.3%	28.6%	0.7	18.3%	18.7%	1.8	0.3	4.2%
Hero Honda	Accumulate	144,862.4	103,318.0	13.1%	9.4%	-	44.1%	32.4%	15.0	4.9	2.6%
Bajaj Auto	Buy	72,094.0	90,461.5	14.3%	8.4%	0.8	42.5%	47.6%	9.5	4.5	4.0%
TVS Motors	Accumulate	7,136.9	32,195.0	1.3%	1.0%	0.8	2.5%	3.9%	22.5	0.9	2.3%
Geodesic	Buy	8,662.4	3,164.3	60.5%	47.0%	1.1	17.5%	32.2%	5.8	1.9	0.6%
Castrol India #	Buy	37,030.2	22,374.1	19.4%	12.8%	0.0	93.2%	59.5%	12.9	7.7	5.5%
Apollo Tyres	Unrated	12,751.2	36,970.5	12.6%	5.9%	0.5	24.1%	20.0%	7.2	1.0	2.0%
Amara Raja Batteries	Unrated	4,607.3	10,833.3	14.6%	8.7%	0.8	31.0%	32.7%	4.7	1.4	1.3%
Guj. Ind. Power Corp.	Buy	6,745.8	9,355.5	27.1%	10.9%	0.6	11.3%	9.2%	7.4	0.6	5.6%
Bharat Electronics	Buy	50,872.0	42,119.3	24.4%	19.4%	0.0	34.9%	24.6%	6.2	1.5	3.3%

Banking Cos. (FY08)	Reco	M Cap (Rs. Crs.)	Revenues (Rs. Crs.)	NNPA (Rs. Crs.)	NNPA (%)	NIM (%)	CAR (%)	RONW (%)	ROA (%)	P/BV (x)	Div Yield (%)
Axis Bank	Buy	23,000.9	7,005.3	248.3	0.4	3.5	13.7	17.6	1.2	2.6	0.9
HDFC Bank	Buy	47,219.1	10,115.0	298.5	0.5	4.4	13.6	17.7	1.3	4.1	0.8
State Bank of India	Buy	83,877.2	48,950.0	7,424.3	1.8	3.1	13.5	16.8	1.0	1.7	1.6

^ 15 Months
 # CY07

Notes

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