

India Investment Strategy

Strong earnings growth continues

February – 2007

Key Themes

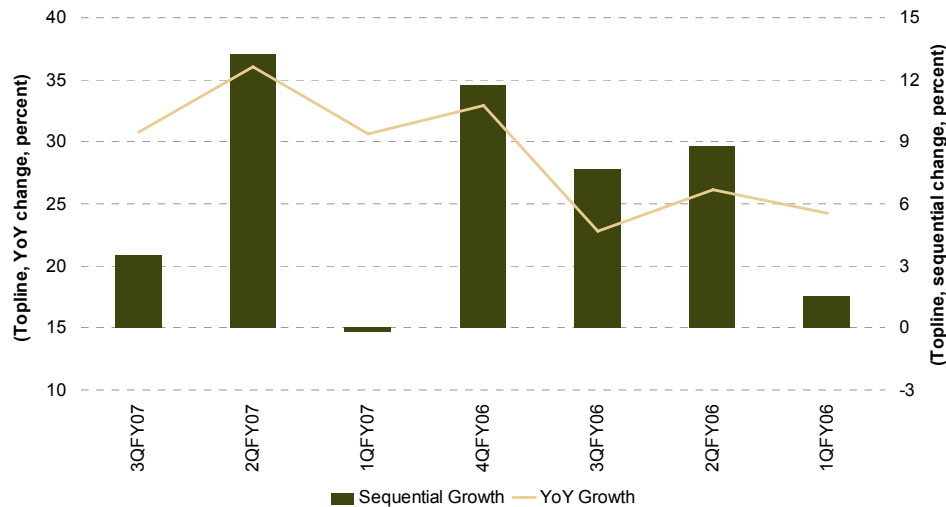
- **Growth once again surpasses expectations**
 - Top line, EBIDTA and PAT grew by 30.7%, 51.1% and 69.3%, respectively
 - 24 of 29 sectors at 20% + growth
 - EBIDTA margins up by 286 bps YoY
- **A quick survey of our analysts indicate earnings upgrade in 30% companies**
 - Upgrades mostly in construction, financial services, healthcare, hospitality, metals, textile
- **Top down call remains bullish**
 - Positive: Auto, building material, communication, construction, engineering, financial services, healthcare, hospitality, technology, textile
 - Neutral: Agro chem, auto ancillary, FMCG, logistic, metals, oil & gas
 - Cautious: Agro-pdt, airline, shipping
- **Our call of “mid /small caps outperforming large cap” made in Nov’06 is being maintained**
- **Mid- small caps price performance @ 7.2 % was better than large caps @ 5.5 % (Sep’06 – Dec’06)**
- **Introducing FY09 target**
 - FY07, FY08 and FY09 target at 14,500, 16,500 and 19,000, respectively

Top line

3QFY07 results remains impressive

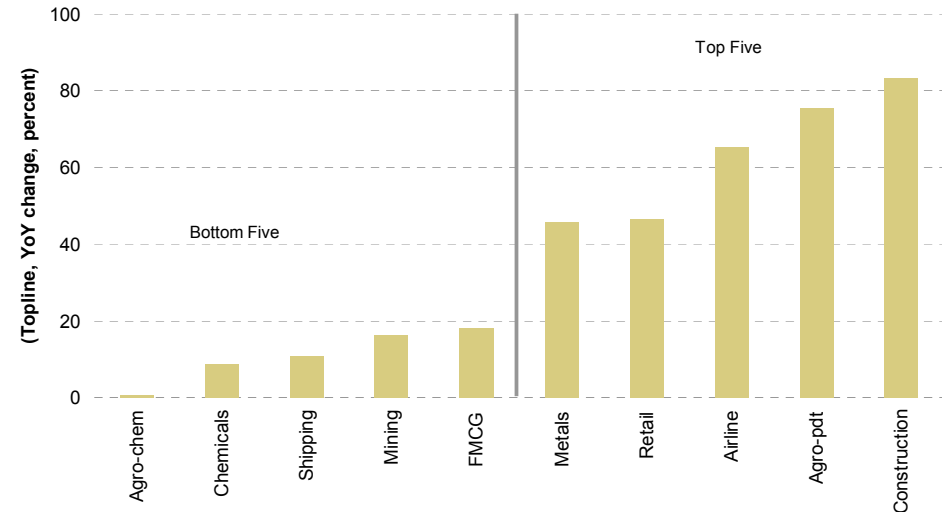
▪ Top line on a roll

- 30.7 % YoY growth, 30% + growth in last 4 quarters
- 24 out of 29 sectors clock 20% + growth
- QoQ slide mainly seasonal
- 30%+ growth in last 4 quarters



▪ Some turnaround among the laggards

- Airlines due to rise in fare and occupancy in busy season
- Agro products due to higher realization
- Top line for agro-chem, chemicals, shipping, mining and FMCG continue to lag



(The analysis in this report is based on 671 listed companies for which the results were published till 2nd Feb'06. Out of 671 companies 179 are large (market cap over Rs 25 bn cr), 294 are mid (Rs 25bn-5bn), 198 small cap (less than Rs 5bn) companies)

Operating Performance

EBIDTA growth improves significantly

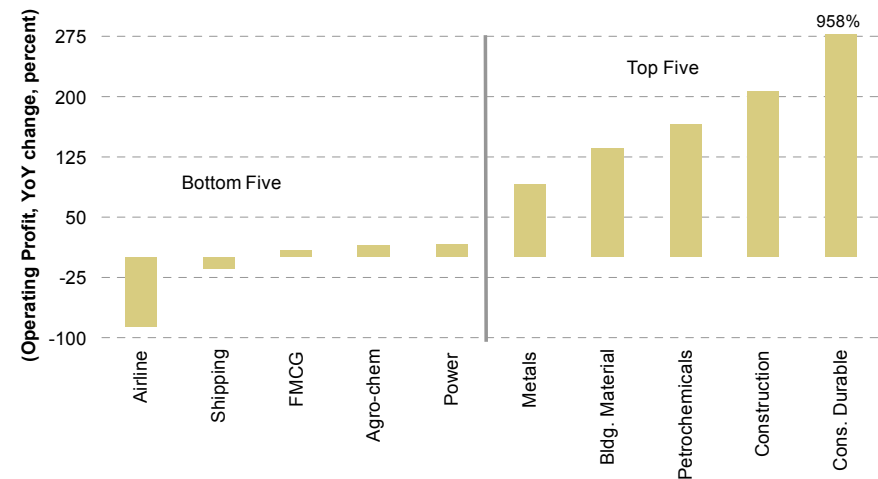
- High growth at operating level (YoY)

- Due to moderation of metal and oil prices
- 50%+ growth on the highest in recent years



- Significant margin improvement

- Reflecting growth in industrial production, capital goods showed an impressive EBIDTA growth (YoY)
- Transportation, consumers and power continue to lag



Bottom line

Growth momentum in bottom line continues

- **Another bottom line surprise**

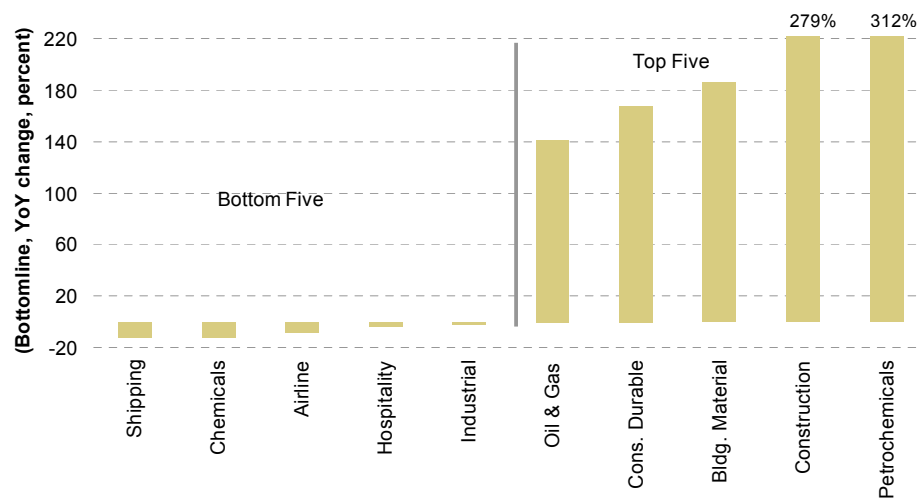
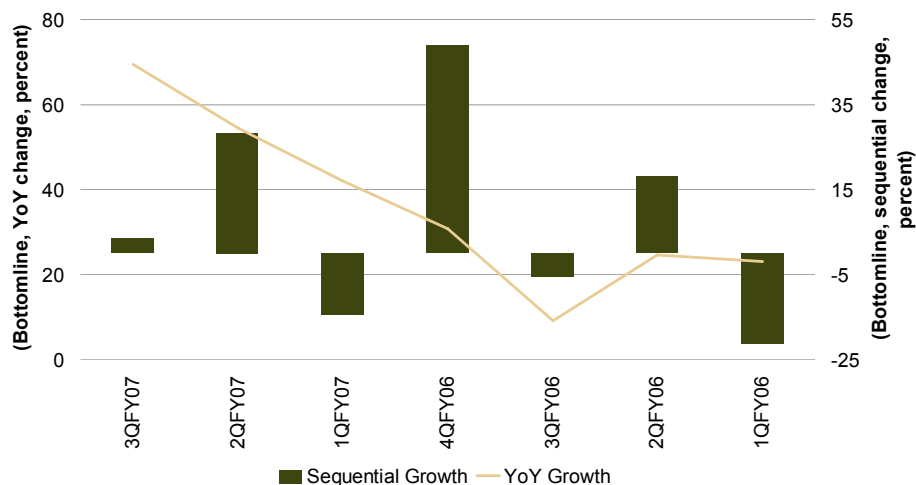
- ~70% YoY growth
- 250 bps increase in margins (YoY)

- **Strong bottom line growth for**

- Infrastructure
- Other core sectors

- **Bottom line squeeze for**

- Transportation
- Intermediate products



Result Update

3QFY07 Financial Performance

Sector	SALES (%)		EBIDTA Margins (%)		PAT (%)	
	TTM	Qtr YoY	TTM	TTM-1	TTM	Qtr YoY
Total	32.6	30.7	20.7	19.5	48.7	69.3
Agro-chem	11.1	0.6	10.6	11.2	94.1	42.0
Agro-pdt	34.4	75.4	10.5	11.4	74.0	85.5
Airline	44.5	65.5	(2.0)	14.8	(87.4)	(8.6)
Auto	37.7	26.5	12.1	11.9	26.4	10.4
Auto Anc.	29.2	26.9	11.3	11.4	53.5	46.3
Bldg. Material	33.4	42.6	24.7	16.8	133.7	185.4
Chemicals	13.9	9.0	16.2	16.4	10.6	(12.8)
Communication	42.5	30.1	26.4	22.2	99.8	129.1
Cons. Durable	28.7	30.9	9.5	4.2	70.5	167.4
Construction	68.1	80.6	19.0	14.4	108.3	273.3
Engineering	33.2	31.6	12.8	10.3	47.1	53.6
Fin. Services	34.1	28.0	60.2	59.6	30.9	26.5
FMCG	19.0	18.2	19.7	21.5	15.7	13.0
Healthcare	44.5	38.1	18.5	16.3	58.8	37.7
Hospitality	30.1	27.3	35.2	31.1	48.5	(4.1)
Industrial	30.0	30.2	17.6	17.3	48.5	(2.5)
Logistics	26.2	31.3	17.3	18.9	(19.3)	23.6

continued

Result Update

3QFY07 Financial Performance (Concluded)

Sector	SALES (%)		EBIDTA Margins (%)		PAT (%)	
	TTM	Qtr YoY	TTM	TTM-1	TTM	Qtr YoY
Media	34.6	26.5	23.3	23.0	40.5	106.4
Metals	38.3	45.7	24.2	20.9	62.6	127.7
Mining	11.8	16.3	59.7	58.9	20.6	31.7
Miscellaneous	29.7	33.1	8.3	7.1	59.3	96.8
Oil & Gas	30.0	23.6	11.3	9.7	64.6	141.2
Packaging	29.6	24.2	15.3	15.9	38.4	48.7
Petrochemicals	18.8	25.0	10.2	6.3	83.1	312.7
Power	22.1	21.7	20.6	23.6	0.0	19.7
Retail	52.4	46.7	7.9	7.9	82.5	89.1
Shipping	30.5	10.8	31.4	36.5	-11.7	-12.8
Technology	46.5	44.6	21.1	21.4	58.0	45.7
Textile	36.1	41.6	15.5	14.2	60.5	87.8
Total	32.6	30.7	20.7	19.5	48.7	69.3
-Oil & Gas						
Sub Total 1	34.0	34.5	25.6	24.7	44.6	58.8
-Fin Services						
Sub Total 2	33.9	35.8	18.4	16.8	48.2	68.1

Source: ARG Research

Valuation

Valuation of mid and small-cap companies remains attractive

(amount in Rs. Bn, PER in x)

Sector	TTM Financials (ALL)				TTM Financials (Large Cap)				TTM Financials (Mid Cap)				TTM Financials (Small Cap)			
	SALES	EBIDTA	PAT	PER	SALES	EBIDTA	PAT	PER	SALES	EBIDTA	PAT	PER	SALES	EBIDTA	PAT	PER
Agro-chem	310.8	33.0	30.1	7.1	39.4	6.1	4.1	11.2	246.8	25.5	24.9	6.5	24.6	1.3	1.1	5.7
Agro-pdt	542.0	56.9	41.1	11.7	76.4	13.7	11.3	17.2	238.5	29.1	22.3	10.1	227.1	14.0	7.5	8.5
Airline	81.2	(1.6)	0.4	227.5	68.2	2.6	1.7	31.8	12.3	(4.6)	(1.4)	loss	0.7	0.3	0.1	57.0
Auto	907.4	109.8	74.0	19.2	799.4	105.8	71.5	18.9	102.0	3.8	2.2	29.5	6.1	0.2	0.3	23.6
Auto Anc.	299.6	33.8	18.8	23.0	72.0	11.1	7.0	33.7	147.4	15.2	7.7	18.2	80.2	7.5	4.0	13.8
Bldg. Material	560.1	138.6	91.4	15.5	421.7	111.6	72.1	15.9	112.6	23.4	16.5	14.0	25.9	3.6	2.8	13.9
Chemicals	162.3	26.3	16.5	22.8	48.3	9.8	7.0	35.3	59.9	11.3	6.3	14.0	54.1	5.1	3.2	13.0
Communication	465.5	122.7	51.9	47.8	407.2	130.7	64.8	37.1	47.6	(9.3)	(13.6)	loss	10.7	1.3	0.7	11.3
Cons. Durable	225.5	21.5	12.3	17.9	96.8	16.2	9.7	14.4	90.6	3.6	2.1	20.4	38.1	1.7	0.5	80.2
Construction	251.8	47.9	29.2	48.8	166.9	32.3	19.3	61.5	58.7	10.3	6.8	29.4	26.3	5.3	3.2	12.8
Engineering	781.0	99.9	74.6	30.6	600.4	77.8	61.4	31.8	105.5	14.7	9.0	29.6	75.1	7.3	4.1	16.0
Fin. Services	2,130.1	1,281.9	293.7	14.4	1,764.5	1,056.3	251.3	15.0	341.7	209.1	38.7	10.7	23.9	16.4	3.8	10.0
FMCG	380.6	74.9	62.0	27.0	348.2	69.5	57.2	27.3	25.0	4.3	3.2	28.3	7.5	1.2	1.6	11.2
Healthcare	411.7	76.0	55.9	26.9	292.3	54.8	40.0	30.6	101.0	18.3	13.6	17.9	18.5	3.0	2.3	16.5
Hospitality	37.8	13.3	8.4	25.9	21.6	6.6	4.0	32.7	12.6	5.4	3.7	20.3	3.5	1.3	0.7	16.5
Industrial	42.5	7.5	5.0	24.4	-	-	-	-	32.0	5.8	3.9	25.2	10.4	1.7	1.1	21.6
Logistics	95.8	16.5	11.9	18.7	29.2	8.9	6.6	21.1	55.2	5.4	3.7	20.7	11.4	2.3	1.6	3.9
Media	65.0	15.2	10.9	40.3	34.5	9.2	6.4	48.1	25.0	4.9	3.8	28.8	5.6	1.1	0.7	30.3
Metals	2,121.3	512.7	303.5	8.2	1,694.3	448.5	279.4	8.0	341.7	53.8	18.4	12.1	85.3	10.4	5.7	7.4
Mining	69.4	41.4	27.9	13.4	58.2	38.0	27.1	13.0	10.0	3.1	0.7	27.9	1.3	0.3	0.2	13.0
Miscellaneous	53.9	4.5	2.1	22.3	-	-	-	-	36.5	2.8	1.4	23.5	17.4	1.7	0.6	19.7
Oil & Gas	6,373.0	718.2	458.0	10.8	6,299.5	709.3	453.6	10.8	73.5	9.0	4.4	18.7	-	-	-	-
Packaging	55.7	8.5	4.3	20.3	1.6	0.1	0.2	133.8	40.1	6.7	3.2	14.7	14.1	1.7	0.8	10.5
Petrochemicals	387.2	39.6	25.2	20.1	149.4	28.9	16.3	26.6	214.3	9.0	8.3	7.5	23.5	1.7	0.7	18.0
Power	565.2	116.2	102.0	19.6	506.0	109.0	97.3	20.0	50.1	5.6	3.8	10.3	9.0	1.5	0.9	7.5
Retail	38.7	3.1	2.0	51.1	23.9	1.7	1.1	49.2	14.8	1.3	0.8	51.1	-	-	-	-
Shipping	77.9	24.4	17.3	6.5	38.9	11.5	10.8	4.2	37.8	12.6	6.3	9.6	1.3	0.3	0.2	30.2
Technology	909.7	192.4	164.3	29.9	714.9	158.8	139.9	32.1	139.5	23.9	17.0	21.1	55.2	9.8	7.4	9.0
Textile	346.2	53.7	26.0	18.0	91.1	12.6	4.6	34.9	172.9	30.8	17.3	14.5	82.2	10.3	4.1	13.5
Total	18,749.0	3,888.6	2,020.5	17.5	14,864.8	3,241.5	1,725.8	17.8	2,945.3	535.0	235.0	16.3	938.9	112.2	59.6	12.4

Source: ARG Research

Recommendation

Sector	Outlook	Large cap picks	Mid / Small cap picks
Agro-chem	Neutral		Coromandel Fert, Zuari
Agro-products	Cautious		Triveni Engg, Ruchi Soya
Auto	Positive	M&M, Maruti, Bajaj	
Auto Anc.	Neutral	Amtek Auto, Motherson Sumi	Asahi India, Tube Investment, Subros, Denso
Bldg. Material	Positive	Gujarat Ambuja, Shree Cement, Madras Cement	Mysore, Orient Paper, Mangalam, JK Lakshmi, Nitco
Communication	Positive	Idea Cellular	Sterlite Optical
Construction	Positive	Anant Raj, Patel Engg, IVRCL	Prajay
Engineering	Positive	Bharat Electronic, Voltas, Alstom Proj, L&T	Havells, Jyoti Str, Asian Elec
Fin. Services	Positive	ICICI Bank, SBI, UTI, Bol, Centurion BoP, Yes	Shriram Transport Finance, South India Bank
FMCG	Neutral	Marico	Emami, VST, Navneet
Healthcare	Positive	Ranbaxy, Nicholas, Wockhardt, Biocon	Pfizer, Novartis, Alembic, Elder
Hospitality	Positive	Indian Hotel	Royal Orchid
Logistics	Neutral		Allcargo Sec
Metals	Neutral	Hindalco, Hindustan Zinc	Welspun Gujarat Stahl
Oil & Gas	Neutral	Petronet LNG	Gujarat State Petronet
Shipping	Cautious		ABG Shipyard, Bharti Shipyard
Technology	Positive	TCS, Mphasis	Polaris, Zensar
Textile	Positive		SRF, Alok, Eastern Silk

Source: ARG Research

Summing Up

- Sector views : Top down call remains bullish
 - Growth is broad based and remains high
 - Results better than expectations for last three years
- Valuation of 671 companies @ 17.5x TTM basis
 - Large cap, mid cap & small cap TTM PER @ 17.8x, 16.3x & 12.4x, respectively
 - Small/mid caps continue to offer good value
- Market call : Sensex targets
 - In FY07 sensex EPS revised twice by 4.8% from 692 to 725
 - PE re-ratings; forward multiples are still reasonable at 19.4x
 - Our targets based only on earnings growth
 - Any further re-rating provides upward bias

		FY06	FY07E	FY08E	FY09E
EPS	(Rs.)	546	725	850	980
Growth	%	19.6	32.7	17.2	15.3
PER	x	21.2	20	19.4	19.4
Sensex	(Index)	11,280	14,500	16,500	19,000

Macroeconomic snapshot

	FY04	FY05	FY06	Current	Relate to	FY07E	FY08E
Income							
GDP at current market price (Rs.bn)	27,654	32,265	35,671	16,733	1HFY07	40,879	45,784 ¹
GDP (US\$bn)	571	702	794	366	1HFY07	929	1,090
Real GDP growth rate (%)	8.5	8.4	9.0	9.1	1HFY07	9.1	8.5 ²
Sectoral Growth (%)							
Agriculture	10.0	0.0	6.0	2.6	1HFY07	4.0	3.0 ²
Industry	4.1	9.8	9.6	7.8	1HFY07	10.2	8.5
Services	8.5	9.6	9.8	10.0	1HFY07	10.5	10.2 ²
Prices (%)							
Wholesale price inflation (%)	5.5	6.5	4.4	6.2	Jan-07	5.5	3.5 ³
Consumer price inflation (%)	3.8	3.9	4.2	6.7	Dec-06	5.5	4.3 ³
Monetary and Banking Indicators (%)							
Money supply (M3) growth	16.7	12.2	20.4	21.1	19-Jan-07	16.0	17.0
Bank credit growth	15.3	22.8	31.7	29.8	26-Jan-07	26.0	22.0
Repo rate	6.00	6.25	6.50	7.50	Jan-07	7.50	7.00 ⁴
Reverse repo rate	5.00	5.25	5.50	6.00	Jan-07	6.00	6.00
Financial Market Indicators							
Sensex (Index)	5,229	6,844	10,372	14,652	08-Feb-07	14,500	16,500 ⁵
Nifty (Index)	1,428	1,805	2,517	4,223	08-Feb-07	4,200	4,700 ⁵
10Y Yield (%)	6.9	5.4	6.3	7.8	08-Feb-07	7.5	7.0
Forex Market Indicators							
Rupee Dollar rate (INR per US\$)	48.4	46.0	44.9	44.0	08-Feb-07	44.0	42.0
Rupee Euro rate (INR per €)	48.1	54.0	56.5	57.2	08-Feb-07	57.2	56.7
Rupee Yen rate (INR per 100¥)	39.7	40.7	41.8	36.2	08-Feb-07	38.3	40.0

Continued...

Macroeconomic snapshot (concluded)

	FY04	FY05	FY06	Current	Relate to	FY07E	FY08E
Foreign Trade Indicators							
Exports (US\$ bn)	63.8	83.5	102.8	89.5	Apr-Dec 06	123.3	150.4
Export growth (%)	21.1	30.8	23.0	36.3	Apr-Dec 06	20.0	22.0
Import (US\$ bn)	78.1	111.5	142.4	131.2	Apr-Dec 06	162.3	188.3
Import growth (%)	27.3	42.6	27.8	36.3	Apr-Dec 06	14.0	16.0
Oil import (US\$ bn)	20.6	29.8	44.0	43.8	Apr-Dec 06	55.0	49.5
Trade balance (US\$ bn)	-14.3	-27.9	-39.7	-41.7	Apr-Dec 06	-39.0	-37.9
External Account Indicators							
Current account balance (US\$ bn)	14.1	-2.5	-10.6	-11.7	1HFY07	1.7	9.7
Current account balance (% GDP)	2.5	-0.4	-1.3	-3.2	1HFY07	0.2	0.9
Services export (US\$ bn)	10.1	15.2	22.2	12.1	1HFY07	28.1	35.1
Workers' remittance (US\$ bn)	21.6	20.5	24.1	11.2	1HFY07	30.0	37.5
FDI (US\$ bn)	4.3	6.0	7.7	7.4	Apr-Oct 06	16.0	19.0
Portfolio (FII) investment (US\$ bn)	10.9	9.3	9.9	3.4	Apr-Oct 06	6.0	12.0
NRI deposits (US\$ bn)	3.6	-1.0	2.2	2.1	Apr-Oct 06	2.6	3.2
Foreign exchange reserve (US\$ bn)	112.9	141.5	151.6	180.0	02-Feb-07	175.0	190.0
Commodities							
Oil (Brent) (US\$)	30	40	59	58	08-Feb-07	60	70
Gold (US\$)	415	438	517	659	08-Feb-07	625	750
Copper (US\$)	2,321	3,280	4,585	5,226	08-Feb-07	6,800	6,600
Aluminium (US\$)	1,593	1,964	2,285	2,730	08-Feb-07	2,700	2,600

Note: Figures in red indicate new numbers

- (1) Govt released revised updates on national income statistics
- (2) With the buoyancy in GDP, FY08 target has been revised upwardly
- (3) Inflationary tendencies would be contained due to base effect and price control due to buoyancy in agriculture production
- (4) RBI revised the short-term lending rate upwardly though long term rates remained unchanged as per our estimates
- (5) Considering the re-rating due to strong corporate earnings growth both BSE and NSE targets are revised upwardly

Other Macro Indicators

	FY03	FY04	FY05	FY06	Current	Relate to	
Demography							
Population (bn)	1.06	1.07	1.09	1.11	1.11	FY06	
Population growth (%)	1.77	1.71	1.58	1.56	1.56	FY06	
Dependency (Age15-64/Popu.) (%)	38.3	38.0	37.6	37.3	37.3	FY06	
Per capita income (US\$)	486	533	644	717	717	FY06	1
Real per capita income growth (%)	1.9	7.0	5.7	7.4	7.4	FY06	1
Saving, Investment (Gross)							
Saving rate (% GDP)	28.9	32.4	34.3	35.9	35.9	FY06	1
Investment rate (% GDP)	27.6	30.6	34.8	37.3	37.3	FY06	1
Agricultural Production							
Growth in production (%)	-18.5	22.3	-6.9	5.2	0.3	FY07E	2
Foodgrain production (mn. tonnes)	174	213	198	208.6	209.2	FY07E	
Growth in Industrial Production							
General index (%)	5.7	7.0	8.4	8.0	10.8	Apr-Dec 06	
Mining and Quarrying (%)	5.8	5.2	4.4	0.8	3.9	Apr-Dec 06	
Manufacturing (%)	6.0	7.4	9.1	9.0	11.8	Apr-Dec 06	
Electricity (%)	3.2	5.1	5.2	5.1	7.5	Apr-Dec 06	
Fiscal Indicators							
Central government deficit (Rs.bn.)	1,451	1,233	1,392	1,462	948	Apr-Dec 06	
Central government debt (Rs.bn)	10,207	11,417	12,759	13,559	13,559	FY06	
State government deficit (Rs.bn.)	1,021	1,214	1,093	1,140	1,140	FY06	
Monetary and Banking Indicators							
Bank deposit (% growth)	13.4	17.5	13.4	14.6	22.8	26-Jan-07	
Bank non-food credit (% growth)	18.6	18.4	27.5	37.3	27.4	26-Jan-07	
Bank investment (% growth)	22.0	23.0	13.0	3.0	7.1	26-Jan-07	
Deposit rate - 1 to 3 years(%)	7.50-8.50	4.25-6.00	4.00-5.25	5.25-5.50	7.25-8.50	26-Jan-07	
Prime lending rate (%)	11.5	11.0	10.75	10.75	12.00	26-Jan-07	

Note: Figures in red indicate new numbers

(1) Govt released revised and new updates on national income statistics

(2) Second advanced estimates released by Ministry of Agriculture

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