investor's eye

Index

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- Stock Update >> Corporation Bank
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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
F-M Goetze	18-Jan-07	385	**339**	559
HCL Tech	30-Dec-03	206	**652**	720
HLL	24-Nov-05	172	**201**	280
India Cements	28-Sep-06	220	**191**	315
SKF	23-Dec-04	141	**285**	406

Orchid Chemicals & Pharmaceuticals

Emerging Star

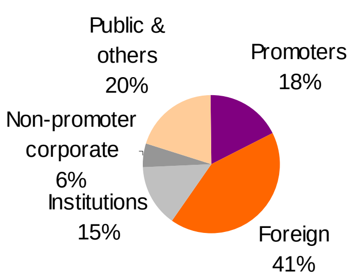
Stock Update

FCCB issue to be EPS accretive

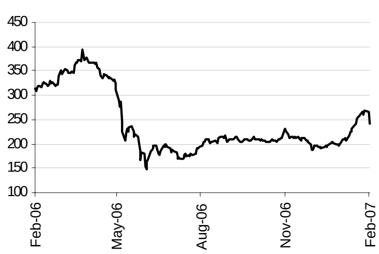
Buy; CMP: Rs242

Company details	
Price target:	Rs390
Market cap:	Rs1,593 cr
52 week high/low:	Rs400/142
NSE volume: (No of shares)	11.8 lakh
BSE code:	524372
NSE code:	ORCHIDCHEM
Sharekhan code:	ORCHID
Free float: (No of shares)	5.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	34.8	21.2	38.8	-10.2
Relative to Sensex	33.5	13.3	9.1	-36.9

Key points

- Orchid Chemicals & Pharmaceuticals (Orchid) has raised $200 million through a zero coupon foreign currency convertible bond (FCCB) offering of $175 million, with a greenshoe option of $25 million. The bonds are convertible into equity shares at an initial conversion price of Rs348.34.
- Further, the company is proposing to issue 5 million warrants to the promoter group, which are convertible into equity shares of face value Rs10 at a conversion price of Rs202.58 within 18 months of their effective date of issue in January 2007.
- With majority of its capital expenditure (capex) over, Orchid intends to use the entire funds to repay a large portion of the Rs1,012-crore debt that it has on its books. With this, we believe that the company will save interest costs of approximately Rs81 crore in FY2008, leading to an incremental earnings per share (EPS) of Rs0.6.
- At the initial conversion price of Rs348.34, the FCCB issue is likely to result in an equity dilution of 37%. Despite the equity dilution, we believe that the FCCB issue will be earnings accretive for the company as it will reduce its debt level and interest burden going forward.
- In order to incorporate the effect of the equity dilution from the FCCB issue and the resultant savings in the interest cost due to the reduced debt burden, we are revising our FY2008 earnings estimate for Orchid; we are however keeping our FY2007 estimate unchanged. We are also maintaining our revenue projections for both the years. We have upgraded our FY2008 earnings estimate by 2.2% to Rs26.1 per share on a fully diluted basis.
- At the current market price of Rs242, Orchid is trading at 9.3x its estimated FY2008 earnings. In view of the bright prospects for the company, we retain our positive stance on Orchid and maintain our Buy call with a price target of Rs390.

Event

Pursuant to the approval received from the shareholders for raising funds in the overseas markets, Orchid has placed a zero coupon five-year FCCB offering of $175 million with a greenshoe option of $25 million, aggregating to $200 million. The bonds are due for redemption in 2012.

Valuation table Rs crore

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Net sales	680.8	638.4	821.5	907.4	1181.1
PAT	31.0	31.0	82.9	92.3	248.3
Shares in issue (cr)	3.2	3.4	6.5	6.9	9.5
EPS (Rs)	9.6	9.1	12.8	13.3	26.1
PER (x)	25.3	26.6	18.9	18.2	9.3
Cash EPS (Rs)	27.1	27.2	25.7	26.8	37.0
Cash PER (x)	8.9	8.9	9.4	9.0	6.5
EV	1522.3	1792.4	2580.7	2590.9	2170.1
EV/Ebidta (x)	10.0	11.0	10.2	8.8	5.5
Book value (Rs/share)	129.3	138.1	121.5	141.7	220.8
P/BV (x)	1.9	1.8	2.0	1.7	1.1

Further, the board of the company has also decided to issue up to 5 million warrants to its promoter group on a preferential basis. The company has called for an extraordinary general meeting on February 14, 2007 to obtain the shareholders' approval for the same.

Details of the FCCB issue

Orchid has placed a five-year zero coupon FCCB offering of $175 million with a greenshoe option of $25 million, aggregating to $200 million. The bonds are convertible at an initial conversion price of Rs348.34 per unit which represents a premium of 30% over Monday's (February 12, 2007) closing price of the company's scrip on the National Stock Exchange (Rs267.95). The bonds have a maturity period of five years, with a yield-to-maturity of 7.25%. Merrill Lynch International has acted as the sole book runner to the issue. This offering is subject to fulfillment of various conditions including approvals by the Singapore Stock Exchange, Bombay Stock Exchange, National Stock Exchange and Madras Stock Exchange.

Details of the warrants

Orchid's board has proposed the issue of 5 million warrants on a preferential basis to the company's promoters. The warrants are convertible into equity shares of face value Rs10 within 18 months of their effective date of issue, ie January 2007. The conversion price has been set at Rs202.58 per warrant, representing a premium of Rs192.58 per share.

Proposed deployment of the funds

With majority of its investments over, Orchid intends to use the entire $200 million (approximately Rs900 crore) raised through the FCCB issue to repay its debt. The FCCB funds (after the reduction of the assumed FCCB issue expenses of 4%) coupled with the 10% share application money for the warrant issue would bring Rs847.1 crore to the company. As per our estimates, the company has around Rs1,012 crore of debt on its balance sheet (excluding the unconverted portion on the previous $42.5 million FCCB). Due to this high level of debt, Orchid has been incurring an interest cost to the tune of Rs23-25 crore every quarter. With the repayment of a large portion of the debt, the company expects to realise tremendous cost savings due to the resultant reduction in the interest burden.

Impact on financials

Based on our calculations, we believe that the $200-million FCCB issue and the allotment of 5 million warrants will have a substantial impact on the company's financials in FY2008. We believe that the FCCB issue will be earnings accretive for the company despite the equity dilution as it will result into tremendous cost savings due to the reduction in the interest expense.

- At an initial conversion price of Rs348.34 per unit, the FCCB issue will result in an increase in the company's equity capital to Rs95.2 crore, implying a dilution of 37%.
- Due to the repayment of debt, we expect Orchid to save Rs81.1 of the interest expense in FY2008, leading to an incremental EPS of Rs0.60.
- With the conversion of the newly issued FCCBs, the promoter holding is expected to fall from the current 18% to approximately 13%. However, Orchid has also proposed to issue 5 million warrants to its promoters, which upon conversion will once again increase the promoter holding to approximately 17%.

Revising estimates

In order to incorporate the effect of the equity dilution from the FCCB issue and the resultant savings in the interest cost due to the reduced debt burden, we are revising our earnings estimate for Orchid for FY2008, while keeping our FY2007 earnings estimate unchanged. We are also maintaining our revenue projections for both the years. We have upgraded our FY2008 earnings by 2.2 % to Rs26.1 per share on a fully diluted basis.

Revision in estimates

	Old		Revised		% chg	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Net sales	907.4	1181.1	907.4	1181.1	0	0
Net profit	92.3	177.2	92.3	248.3	0	40.1
EPS (Rs)	13.3	25.5	13.3	26.1	0	2.2

Valuation & view

With FY2008 approaching, Orchid's lean phase seems to be getting over. Orchid has been investing steadily in building its product pipeline to expand its presence in the regulated markets of the USA and Europe. Going forward, especially from FY2008 onwards, we believe the company will grow by leaps and bounds, with its big launches in the USA and entry into Europe. The approval from the UK MHRA for the betalactum active pharmaceutical ingredient facility at Aurangabad and the sign-up of a marketing tie-up with the European drug major, Actavis, are indicative of the fact that Orchid seems to be on track with its planned launches in the European market. With the new FCCB issue, the company is also in the process of cleaning up its balance sheet, which was a cause of huge concern for investors in the past. With a strong top line growth, robust margins and a clean balance sheet, Orchid's future seems very bright.

At the current market price of Rs242, Orchid is trading at 9.3x its estimated FY2008 earnings. In view of the bright prospects for the company, we retain our positive stance on the stock and maintain our Buy call with a price target of Rs390.

Corporation Bank

Apple Green

Stock Update

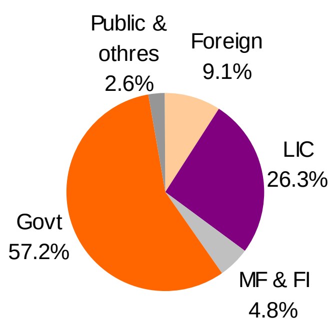
Price target revised to Rs380

Buy; CMP: Rs295

Company details

Price target:	Rs380
Market cap:	Rs4,231 cr
52 week high/low:	Rs445/205
NSE volume: (No of shares)	1.5 lakh
BSE code:	532179
NSE code:	CORPBANK
Sharekhan code:	CORPBANK
Free float: (No of shares)	2.4 cr

Shareholding pattern



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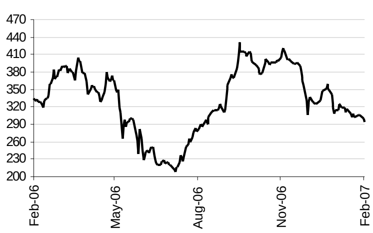


Price performance

(%)	1m	3m	6m	12m
Absolute	-6.5	-26.3	5.6	-10.6
Relative to Sensex	-7.5	-31.1	-17.0	-37.2

Result highlights

- Corporation Bank's results are slightly above our expectations; its profit after tax (PAT) grew by 27.2% to Rs146.4 crore compared with our estimates of Rs135.9 crore due to a higher than expected non-interest income led by a higher treasury income.
- During the quarter, one of the wholly-owned subsidiaries of the bank, Corp Bank Homes, was merged with the bank. Due to the merger the current quarter numbers include an additional provision of Rs16.8 crore excluding which the PAT growth would have been higher at 41% to Rs162.4 crore.
- The net interest income (NII) was up by 1.5% to Rs333.3 crore compared with our estimates of Rs343 crore. The net interest margin (NIM) was down five basis points to 3.15% for the nine-month period ended December 2006 compared with 3.2% for H1FY2007.
- The non-interest income increased by 49.6% to Rs159.3 crore, mainly due to a higher treasury income, which increased by 212.5% year on year (yoy) to Rs40 crore compared with a treasury income of Rs12.8 crore in Q3FY2006 and a treasury loss of Rs5.4 crore in Q2FY2007. The fee income was up 20.3% yoy and 3.3% quarter on quarter (qoq).
- With the net income up 13.2% yoy and the operating expenses up only 3.1% yoy, the operating profit was up by 21.4% yoy and 24.4% qoq to Rs293.1 crore.
- Provisions declined by 8.4% to Rs83.2 crore despite a one-time higher provision charge on account of the merger mainly due to nil standard assets provisions. A moderate operating profit growth and a decline in the provisions helped the PAT grow by 27.2% to Rs146.4 crore.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy	% qoq	M9FY07	M9FY06	% yoy
Net interest income	333.3	328.5	1.5	5.2	974.8	915.9	6.4
Non-interest income	159.3	106.5	49.6	40.9	459.8	414.0	11.1
Treasury	40.0	12.8	212.5	LP	114.2	123.5	-7.5
Fee	89.3	74.2	20.3	3.3	250.4	216.0	15.9
Net income	492.6	434.9	13.2	14.6	1,434.6	1,329.9	7.9
Operating expenses	199.5	193.5	3.1	2.8	581.9	547.6	6.3
Operating profit	293.1	241.5	21.4	24.4	852.7	782.4	9.0
Core operating profit*	227.2	215.2	5.6	6.7	663.1	610.8	8.6
Provisions & contingencies	83.2	90.8	-8.4	115.2	228.1	268.1	-14.9
PBT	209.9	137.9	52.2	3.7	550.5	390.8	40.9
Provision for taxes	63.5	35.6	78.2	-9.3	207.0	170.1	21.7
Net profit	146.4	115.1	27.2	15.3	417.7	344.2	21.4

*Core operating profit = operating profit excluding treasury and cash recovery

LP = loss to profit

- The asset quality of the bank continues to be healthy with the net non-performing asset (NPA) in percentage terms at 0.47%, down from 0.8% yoy and 0.5% qoq. The capital adequacy ratio (CAR) remains at a comfortable 13.7% with the Tier-I capital at 12.3%. However with the implementation of the Basel II norms the same is expected to come down to 12.5%.

- The bank has witnessed serious pressure on the NIM front, which we feel would sustain considering the rise in the deposit rates and the bank's inability to mobilise more low cost deposits. The non-interest income growth excluding the treasury income remains weak and going forward the incremental recovery amounts would decrease. Hence the overall non-interest component would also not add significantly to the operating level. The above concerns have led us to decrease the FY2008E PAT estimate by 5.4% to Rs628.5 crore from the earlier projection of Rs664.6 crore. We have also revised our one-year price target from Rs425 to Rs380.

- At the current market price of Rs295, the stock is quoting at 6.7x its FY2008E earnings per share (EPS), 3.3x pre-provision profits (PPP) and 1x book value (BV). We maintain our Buy call on the stock with a revised price target of Rs380.

NII growth driven by increase in assets, NIM shows a decline

During the quarter the bank's NII grew by 1.5% yoy and 5.2% qoq to Rs333.3 crore. The 5.2% sequential growth in the NII was mainly driven by a 5% growth in the balance sheet size. The NIM was down five basis points to 3.15% for the nine-month period ended December 2006 compared with 3.2% for H1FY2007.

Yield analysis (%)

Particulars	9MFY07	9MFY06	H1FY07
Yield on funds	7.93	7.57	7.79
Cost of funds	4.77	3.96	4.59
NIM	3.15	3.61	3.20

Source: Company

Higher loan growth funded by high cost deposits affects margins

Corporation Bank has reported a 30.7% year-on-year (y-o-y) and 3% quarter-on-quarter (q-o-q) growth in advances. A large part of the incremental loan was funded by raising high cost deposits and borrowings. The deposit growth for the bank stood at 33.2% yoy. Such a high growth in deposits was primarily driven by a 42% y-o-y and 5.5% q-o-q growth in the term deposits, while the low cost current and savings account (CASA) deposits grew at 15.7% yoy and 1.4% qoq. Hence the CASA ratio fell to 29% from 33.6% on a y-o-y basis but remained stable sequentially. All these added to the cost of funds significantly. The NIM declined by 46 basis points on a y-o-y basis mainly due to the pressure on the cost of funds. The cost of funds increased by 81 basis points even as the yields improved by only 36 basis points on a y-o-y basis.

Non-interest income surges due to higher treasury income

The non-interest income increased by 49.6% yoy to Rs159.3 crore, mainly due to a higher treasury income, which increased by 212.5% yoy to Rs40 crore compared with a treasury income of Rs12.8 crore in Q3FY2006 and a treasury loss of Rs5.4 crore in Q2FY2007. Fee income grew by 20.3% yoy and 3.3% qoq while non-interest income excluding treasury and recovery grew by 16.5% yoy and 3.5% qoq.

Non-interest income (Rs crore)

	Q3FY07	Q3FY06	% yoy	% qoq
Treasury income	40.0	12.8	212.5	LP
Fee income	89.3	74.2	20.3	3.3
Forex	4.12	6.01	-31.4	8.4
Recovery of bad debts	25.9	13.5	92.4	-8.1
Non-interest income (excluding treasury & recovery)	93.4	80.2	16.5	3.5
Total	159.3	106.5	49.6	40.9

Source: Company, Sharekhan Research

* LP = loss to profit

Core growth at 5.6% yoy compared with operating profit growth of 21.4% yoy

With the net income up 13.2% yoy and the operating expenses up only 3.1% yoy, the operating profit was up by 21.4% yoy and 24.4% qoq to Rs293.1 crore. However, the core operating profit, ie the operating profit excluding the treasury gains and cash recoveries, reported a 5.6% y-o-y and 6.7% q-o-q growth.

Provisions decline despite a one-time charge

The provisions declined by 8.4% to Rs83.2 crore despite a one-time higher provision charge of Rs16.8 crore on account of the merger of its subsidiary. The provisions were lower mainly due to nil standard assets provisions in Q3FY2007 compared to Rs 22.4 crore in Q3FY2006. The moderate operating profit growth and a decline in the provisions helped the PAT rise by 27.2% to Rs146.4 crore.

Asset quality continues to remain healthy

The asset quality of the bank continues to be healthy with net NPA in percentage terms at 0.47%, down 0.8% yoy and 0.5% qoq.

Capital adequacy remains comfortable

The CAR remains at a comfortable 13.7% with the Tier-I capital at 12.3%; however with the implementation of the Basel II norms, the bank's CAR is expected to decline to 12.5%.

Valuation and view

The bank has witnessed significant pressure on the NIM front and the same, we feel, would sustain considering the rise in the deposit rates and the bank's inability to mobilise more low cost deposits. The non-interest income growth excluding the treasury income remains weak and going forward the incremental recovery amounts would decrease. Hence the overall non-interest component would also not add significantly to the operating level. The above mentioned concerns have led us to downgrade the FY2008E PAT estimate by 5.4% to Rs628.5 crore from Rs664.6 crore projected earlier. We have also revised downward our one-year price target from Rs425 to Rs380.

At the current market price of Rs295, the stock is quoting at 6.7x its FY2008E EPS, 3.3x PPP and 1x BV. We maintain our Buy call on the stock with a revised price target of Rs380.

Valuation table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	504.1	402.2	444.5	524.3	628.5
Shares in issue (cr)	14.3	14.3	14.3	14.3	14.3
EPS (Rs)	35.1	28.0	31.0	36.5	43.8
% y-o-y change	*18.6*	*-20.2*	*10.5*	*18.0*	*19.9*
PE (x)	8.4	10.5	9.5	8.1	6.7
P/PPP (x)	4.7	4.0	4.0	3.9	3.3
Book value	193.0	213.0	235.3	261.4	291.5
P/BV (x)	1.5	1.4	1.3	1.1	1.0
Adj book value	175.6	198.6	224.6	250.9	279.4
P/ABV (x)	1.7	1.5	1.3	1.2	1.1
RONW (%)	19.7	13.8	13.8	14.7	15.8

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

Mahindra & Mahindra

Apple Green

Stock Update

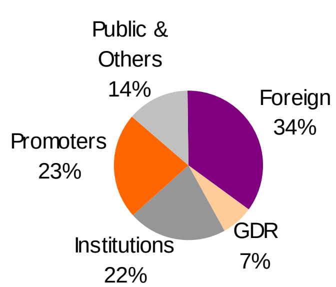
Bidding for Punjab Tractors

Buy; CMP: Rs870

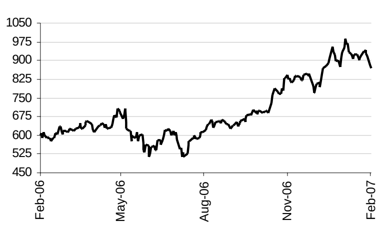
Company details

Price target:	Rs1,050
Market cap:	Rs21,228 cr
52 week high/low:	Rs1,002/488
NSE volume: (No of shares)	7.4 lakh
BSE code:	500520
NSE code:	M&M
Sharekhan code:	M&M
Free float: (No of shares)	17.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.7	6.2	43.6	52.4
Relative to Sensex	-6.6	-0.8	12.9	7.0

Key points

- Mahindra & Mahindra (M&M) has made a non-binding bid to acquire the private equity fund Actis' 29% stake and the Burman Family's 14.5% stake in Punjab Tractors Ltd (PTL).
- PTL, with an installed capacity to manufacture 60,000 tractors, enjoys an overall market share of 10% in the domestic tractor market. We believe that acquiring PTL makes good strategic sense for M&M as it would help consolidate its presence in the 31-40 horse power (HP) category, and help it to acquire a dominant status in the >51HP category. This would be a huge positive as a strong growth is expected in the higher-end tractor segment.
- Further, M&M can take advantage of the strong brand equity of PTL and its strong distribution network.
- The deal could cost M&M somewhere between Rs1,200 and Rs1,500 crore (including the open offer). Though PTL's valuations appear to be a bit stretched due to the recent run-up in its stock price, we do feel that the acquisition would yield substantial long-term benefits to M&M considering that the deal would give M&M a dominant status in the tractor industry (particularly in the higher HP category), and a strong distribution network.
- Many other players including TAFE, Escorts, Tata Motors, the Sonalika group and Ashok Leyland are also in the race to acquire a stake in PTL, which may heat up the valuations further.
- At the current levels, M&M trades at 13.1x its FY2008E consolidated earnings. We maintain our Buy recommendation on the stock with a price target of Rs1,050.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Stand-alone				
Net sales (Rs cr)	6,511.0	7,977.2	10,272.5	11,805.4
y-o-y change (%)	*33.6*	*22.5*	*28.8*	*14.9*
Net profit (Rs cr)	499.5	647.9	866.7	1,012.7
Shares in issue (cr)	23.34	23.36	23.36	23.36
EPS (Rs)	21.4	27.7	37.1	43.4
y-o-y change (%)	*54.9*	*29.6*	*33.8*	*16.8*
PER (x)	40.6	31.4	23.4	20.1
Consolidated				
Net profit (Rs cr)	711.0	1050	1351.2	1553.9
y-o-y change (%)	*78.5*	*47.7*	*28.7*	*15.0*
Shares in issue (cr)	23.34	23.36	23.36	23.36
EPS (Rs)	30.5	44.9	57.8	66.5
y-o-y change (%)	*78.5*	*47.6*	*28.7*	*15.0*
PER (x)	28.6	19.4	15.0	13.1

M&M makes a non-binding bid for stake in Punjab Tractors

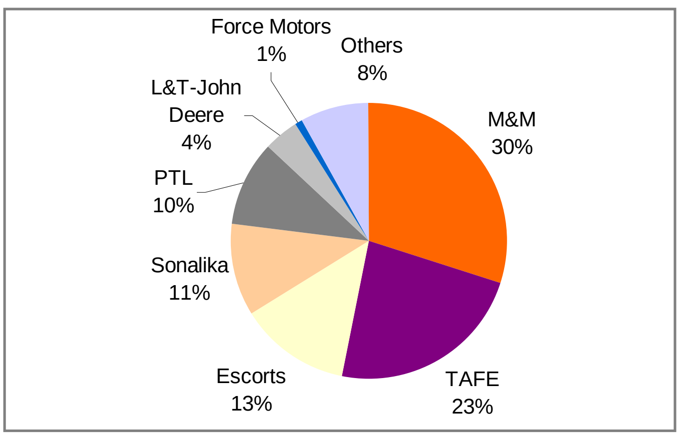
India's largest tractor maker M&M has submitted a non-binding bid to acquire a 43.5% stake in Punjab Tractors Ltd. The private equity fund Actis' 29% stake and the Burman family's 14.5% stake are up for sale.

Punjab Tractors, a part of the Swaraj group, commands a 10% market share in the domestic tractor market. It has an installed capacity to manufacture 60,000 tractors per annum. The company is mainly present in two categories ie the 31-40HP category (contributing 62% of its total sales volumes) and in the over 51HP category (contributing about 26% of the sales volumes). In the last few years, the company has lost considerable market share to other players like M&M, Sonalika and John Deere. Currently, its overall market share stands at about 10%. Its market share has also been adversely impacted by its non-presence in the 41-50HP category, which has grown at a healthy pace in the last few years.

Acquisition would consolidate M&M's position

We believe that acquiring PTL makes good strategic sense for M&M as it would help consolidate its presence in the 31-40 HP category and help it to make its presence felt in the over 51HP category. The competition in the tractor segment has intensified in the past few years with the entry of new players like Sonalika, John Deere and New Holland Tractors, restricting the market share growth of M&M. Hence we believe that the acquisition is a good option to increase its market share. In case the acquisition goes through, M&M would increase its overall market share from the current 30% to 40%.

Domestic tractor market share



Dominating presence in the higher-end tractor segment

M&M has a strong presence across different categories in the tractor market. It commands a dominant market share in the 31-40HP category (32% share) and the 41-50HP category (30% share). However, in the >51HP category, the company is behind John Deere and Punjab Tractors in terms of its market share. The acquisition would increase its market share in the 31-40HP category to about 40% and would also give it a commanding share of 49% in the >51 HP category. This would be a huge positive since the Indian tractor market is expected to undergo a change in favour of the higher-end tractor segment, in line with the international markets.

PTL's sales break-up

	% sales	Market share
21-30 HP	62	8
31-40 HP	14	11
>51 HP	24	28

Strong distribution network

The acquisition would help M&M take advantage of the strong brand equity of PTL. Further, it would also give M&M access to the strong distribution network of PTL. PTL has a strong dealer network of 433 dealers across the nation compared to 450 dealers of M&M. In FY2006, PTL's capacity utilisation stood at just 51.8%.

Others line up as well

The last few days have seen a lot of action in this space and the race to buy a stake in PTL has heated up with the entry of many new players. Apart from M&M, the other players believed to be in the race include Tractors and Farm Equipment Ltd (TAFE), Escorts, the Sonalika group, Tata Motors (in collaboration with New Holland Tractors, though not confirmed by the company) and Ashok Leyland.

Valuations stretched; however acquisition should yield long-term benefits

The recent run-up in the stock price of Punjab Tractors would make the deal more expensive. At the current levels, the buyout of the 43.5% stake would cost the acquirer Rs827.2 crore. Adding to this, it would have to make an open offer to the existing shareholders of PTL, which would further cost the company about Rs380 crore. PTL also holds a 33% stake in Swaraj Engines, which was formed in technical and financial collaboration with Kirloskar Oil Engines Ltd (KOEL) for the manufacture of diesel engines. With the acquisition of the 43.5% stake in PTL, M&M's stake in Swaraj Engines would stand at 14.4%. However, post the open offer in PTL, the indirect stake in Swaraj Engines is expected to exceed 15%, which would also trigger an open offer in Swaraj Engines. Hence, we expect the deal to cost about Rs1,200-1,500 crore. M&M is likely to fund the acquisition through a mix of debt and internal accruals.

	At CMP	At Rs350	At Rs400
Cost of acquisition			
Value of PTL (43.5% stake)	827.2	925.0	1057.1
Value of 20% open offer	380.3	425.3	486.0
Open offer to Swaraj Engines' shareholders	40.2	40.2	40.2
Total cost	1207.5	1350.3	1543.2
Valuations			
PER	20.8	23.3	26.6
EV/EBIDTA	12.9	14.6	16.8

At the current levels, the valuations of PTL appear stretched as it is trading at about 20.8x its FY2008E earnings and at an enterprise value/earnings before interest, depreciation, tax and amortisation of 12.9x. However, considering the potential benefits of the acquisition like PTL's strong presence in the higher HP segment, its strong distribution network and its strong brand equity, we believe that the deal would further consolidate M&M's position in the tractor market and give it a dominant status in the industry. Hence, though the price may be high, we believe that the deal would lead to substantial long-term benefits for M&M. At the current levels, M&M trades at 13.1x its FY2008E consolidated earnings. We maintain our Buy recommendation on the stock with a price target of Rs1,050.

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

Mutual Gains

Mutual Fund

Sharekhan's top equity fund picks

The market maintained its upward momentum in January 2007. Fuelled by strong corporate results along with sustained buying by foreign institutional investors (FIIs), the Sensex and the Nifty both posted gains of around 2.5% during the month. More importantly, January has been a milestone month, with the Sensex having comfortably vaulted over the 14,000 mark. Even its rival index, the Nifty, seems to have successfully crossed the 4,000 level, after exhibiting considerable volatility in the early part of the month.

The long-term outlook for the Indian economy continues to remain bright. The Central Statistical Organisation (CSO) revised the country's economic growth rate for FY2006 to 9% from 8.5% projected earlier. The government too has just released its first official growth estimate for FY2007 and the same stands at 9.2%! Futuristically, if the sustained double-digit growth in every other key economic indicator is any indication, the economy is poised to move on to an even higher growth plane. Growth in almost all the key economic indicators has accelerated in recent months. Even industrial production, an important component of the gross domestic product (GDP), has moved onto the double-digit growth zone fuelled by the growth in the capacities of Indian companies in the past few years. The growth rate of the Index of Industrial Production (IIP) has shifted from 7% in FY2003 to double digits in this fiscal. The index grew by 10.6% during the April-November 2006 period vs 8.3% in the corresponding period of FY2006.

The buoyancy in the economy is translating into growth for the corporate sector, whose earnings have been growing at over 20% for the past couple of quarters. Also, the earnings are growing in spite of rising input costs and hardening interest rates. India Inc reported absolutely stellar numbers for the third quarter of FY2007, beating all expectations. Surpassing market expectations of a strong 26% growth, the earnings of the Sensex companies grew by a handsome 40% year on year. The brilliant performance of Q3FY2007 has resulted in a 1-2% upgrade in the earnings estimates of the Sensex companies for FY2007 and FY2008. The earnings of the Sensex blue chips excluding Reliance Communications are now expected to grow by 27.8% in FY2007 and by 14.6% in FY2008. Going forward also, the high growth rate in corporate earnings is expected to sustain on the back of the ongoing capex drive and the surging internal consumption.

The government's fiscal position too has progressively improved of late. The government's net tax collections rose by 37.6% for the April-December 2006 period, which resulted in a 28.8% growth in its total receipts. The higher receipts combined with a comparatively lower total expenditure, which grew by only 15.4%, helped bring down the fiscal deficit by 12.4% to Rs94,854 crore during the nine-month period. The surging tax revenues and the strong 9.1% GDP growth in H1FY2007 are expected to help the government reduce the fiscal deficit below the targeted 3.8% of the GDP in FY2007. Also, considering the buoyant tax collections and lower expenditure, we do not expect any significant tax measures in the forthcoming Union Budget for 2007-08 and expect the budget to be positive.

On the flip side, the rising inflation continues to give us sleepless nights. It has crossed 6% recently owing to a rise in the prices of primary food articles. To keep inflation within its targeted range of 5.0-5.5% the central bank, in its January review of the credit policy, has hiked the repo rate by another 25 basis points to 7.5%. The government has also reduced customs and import duties on several items. We feel that the recent policy measures, the softening crude prices, the impending better than expected *rabi* harvest and a large-scale import of food grains will moderate inflation in the days to come.

Crude and the US economy, the other two concerns of last year, are however expected to remain benign this year. Crude oil has fallen to levels below $60 per barrel and the probability that current levels would be maintained is high. There is more clarity regarding the US economy too. Driven by consumer spending, the economy grew by 3.5% in the fourth quarter, up from 2% in the third quarter. Moreover, recent data has suggested some signs of stabilisation in the housing market. The core inflation continues to be moderate. The US Federal Reserve has left the interest rates unchanged in its January 31 meeting, for the fifth time in a row after raising them 17 times at a measured pace from 2.5% in June 2004 to June 2006.

Net-net, the climate continues to remain conducive to investment in the stock market. If anything it may get more pleasant in the long term. In the short term, the market may take its cue from the Union Budget announcements due at the end of the month. In the long term, the favourable global cues, along with the growing corporate earnings, would continue to drive the market.

We have identified the best equity-oriented schemes available in the market today based on the following parameters: the past performance as indicated by the returns, the Sharpe ratio and Fama (net selectivity).

The past performance is measured by the returns generated by the scheme. Sharpe indicates risk-adjusted returns, giving the returns earned in excess of the risk-free rate for each unit of the risk taken.

FAMA measures the returns generated through selectivity, ie the returns generated because of the fund manager's ability to pick the right stocks. A higher value of net selectivity is always preferred as it reflects the stock picking ability of the fund manager.

For our selection of funds, we have given 50% weightage to the past performance as indicated by the returns, 25% weightage to the Sharpe ratio of the fund and the remaining 25% to the FAMA of the fund.

All the returns stated below, for less than one year are absolute and for more than one year the returns are annualised.

We present below our recommendations in the equity-oriented mutual fund category.

Aggressive Funds

Mid-cap Category

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Sundaram BNP Paribas Select Midcap	94.48	8.61	51.25	61.69
Prudential ICICI Emerging STAR	29.92	18.17	37.50	61.72
Reliance Growth	276.61	11.38	36.31	57.24
Birla Mid Cap	66.80	8.79	32.07	47.29
Franklin India Prima	216.32	10.25	20.06	40.93
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Opportunities category

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Dynamic Plan	67.80	14.58	52.31	63.33
DSP ML Opportunities	56.48	8.84	35.02	47.95
ING Vysya Domestic Opportunities Fund	27.69	8.67	34.42	46.57
Kotak Opportunities	29.35	10.85	33.29	51.92
Franklin India Opportunity	26.97	10.85	50.59	55.04
HSBC India Opportunities	29.34	13.17	43.92	48.67
Tata Equity Opportunities	59.55	10.83	30.21	46.72
Birla India Opportunities	54.19	11.78	31.98	40.38
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Equity diversified/conservative funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
SBI Magnum Global Fund 94	45.82	17.16	49.45	71.38
SBI Magnum Multiplier Plus 93	55.19	13.91	39.58	62.38
HDFC Equity	151.39	8.58	33.90	53.97
Franklin India Prima Plus	142.93	12.11	45.02	52.98
Birla SunLife Equity	186.87	12.34	38.44	53.28
Prudential ICICI Power	83.32	9.32	39.47	51.73
Prudential ICICI Growth Plan	94.95	7.30	34.83	49.36
Sundaram BNP Paribas Select Focus	61.63	9.46	40.57	49.04
SBI Magnum Equity	28.53	12.28	46.39	50.80
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Thematic/emerging trend funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Infrastructure	19.19	12.62	50.39	--
Prudential ICICI Service Industries	15.94	21.31	47.32	--
Tata Infrastructure	24.24	10.61	44.35	55.15
DSP ML India Tiger	34.10	14.43	44.36	56.91
SBI Magnum Sector Umbrella - Contra	38.78	10.45	43.21	63.59
Sundaram BNP Paribas CAPEX Opportunities	17.90	11.97	41.71	--
Kotak Global India	27.23	12.27	26.95	42.01
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Balanced funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
HDFC Prudence	117.00	9.56	33.22	43.59
FT India Balanced	33.51	6.91	31.00	34.15
DSP ML Balanced	39.09	7.00	28.15	33.57
SBI Magnum Balanced	36.15	8.95	29.25	42.27
Birla SunLife 95	179.78	5.80	28.95	33.34
Tata Balanced	50.55	9.27	29.12	34.86
Prudential ICICI Balanced	35.63	8.50	24.97	36.87
Indices				
Crisil Balanced Index	2482.27	5.77	23.21	25.63

Tax planning funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
PRINCIPAL Tax Savings	79.69	15.21	39.40	49.62
SBI Magnum Tax Gain Scheme 93	57.87	15.44	42.95	71.42
HDFC Taxsaver	146.13	4.46	25.37	51.80
Sundaram BNP Paribas Taxsaver	28.57	13.02	24.32	46.13
Birla SunLife Tax Relief 96	150.37	8.96	37.70	43.37
HDFC Long Term Advantage Fund	95.22	8.07	21.88	42.46
Franklin India Taxshield	130.01	5.75	22.28	40.91
Prudential ICICI Taxplan	93.75	2.76	22.92	45.87
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Risk-return analysis

The charts on the following pages give you a snapshot of how the mutual funds have performed on the risk-return parameters in the past. We have used the bubble analysis method to measure their performances on three parameters viz risk, return and fund size. The risk is measured by standard deviation, which measures the average deviation of the returns generated by a scheme from its mean returns. We have tried to explain the same with the help of a diagram, which is divided into four quadrants, with each quadrant containing funds of a particular risk-return profile. The size of the bubble indicates the size of the fund.

The funds in the **high-risk high returns** quadrant follow a very aggressive approach and deliver high absolute returns compared to its peers albeit at a higher risk.

The funds in the **low-risk high returns** quadrant outperform the peer group on the risk-adjusted returns basis as they deliver higher returns compared to its peers without exposing the portfolio to very high risk.

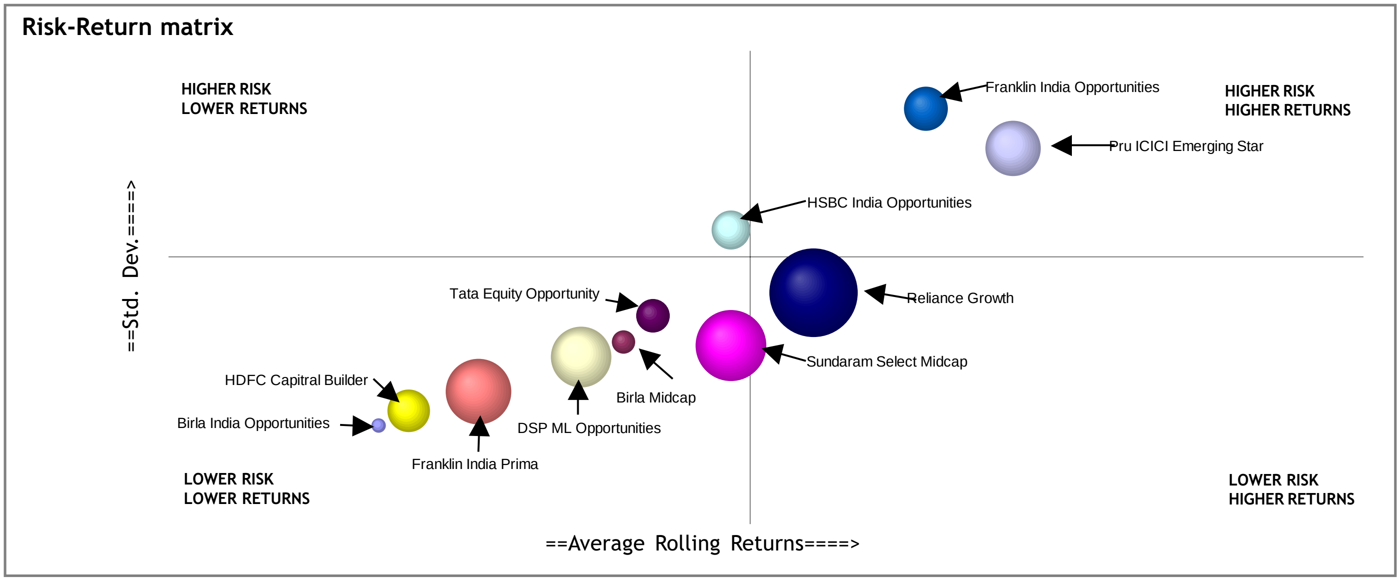
The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

The funds in the **high-risk low returns** quadrant underperform the peers on the risk adjusted returns basis as they adopt a high-risk strategy but the returns fail to compensate the risk taken by the fund.

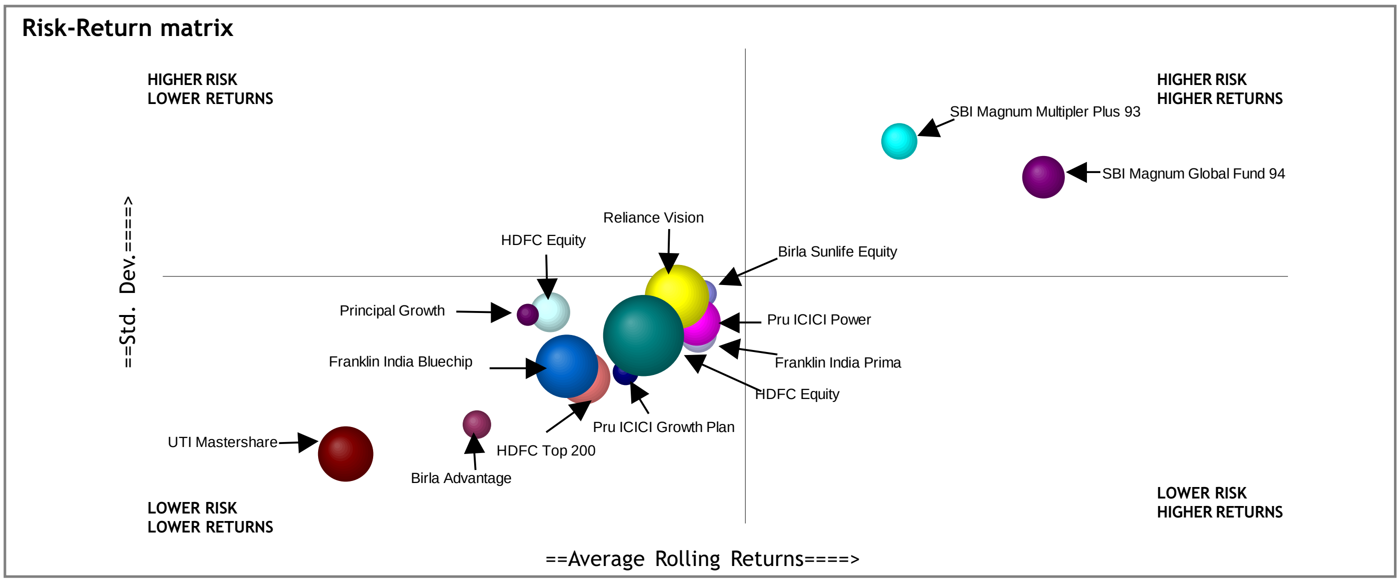
For aggressive, conservative and tax planning funds, risk is measured in terms of two years' volatility while returns are measured as two years' average rolling returns as on January 31, 2007. For thematic and balanced funds, risk is measured in terms of one year's volatility while returns are measured as one year's average rolling returns as on January 31, 2007.

Every individual has a different investment requirement, which depends on his financial goals and risk-taking capacities. We at Sharekhan first understand the individual's investment objectives and risk-taking capacity, and then recommend a suitable portfolio. So, we suggest that you get in touch with our Mutual Fund Advisor before investing in the best funds.

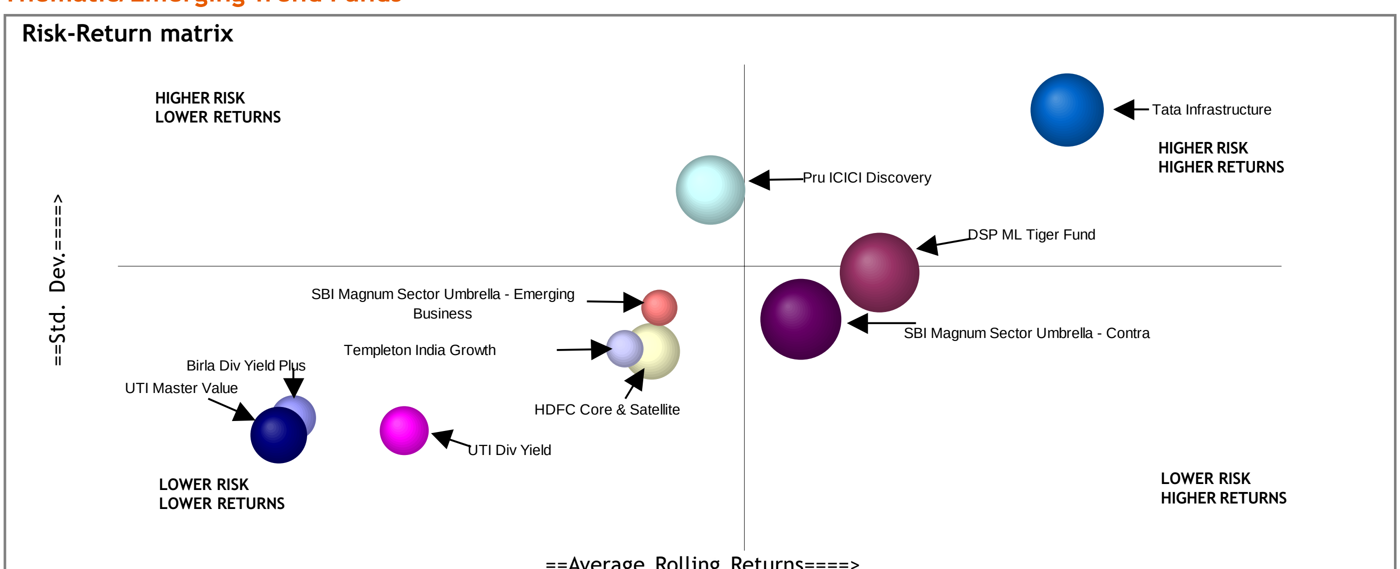
Aggressive Funds



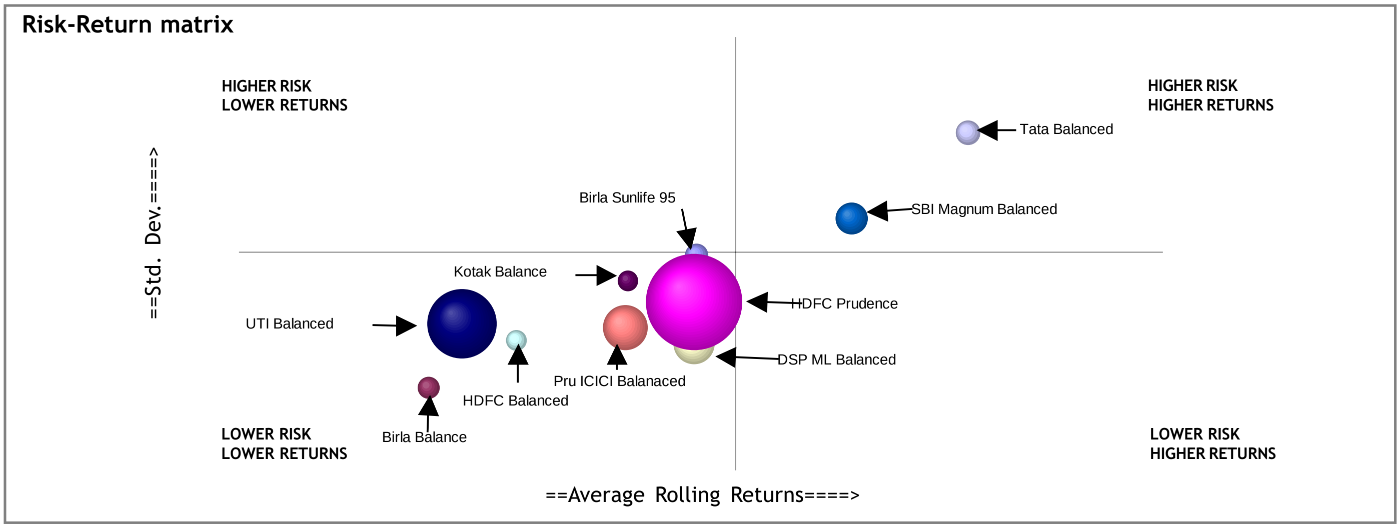
Equity Diversified/Conservative Funds



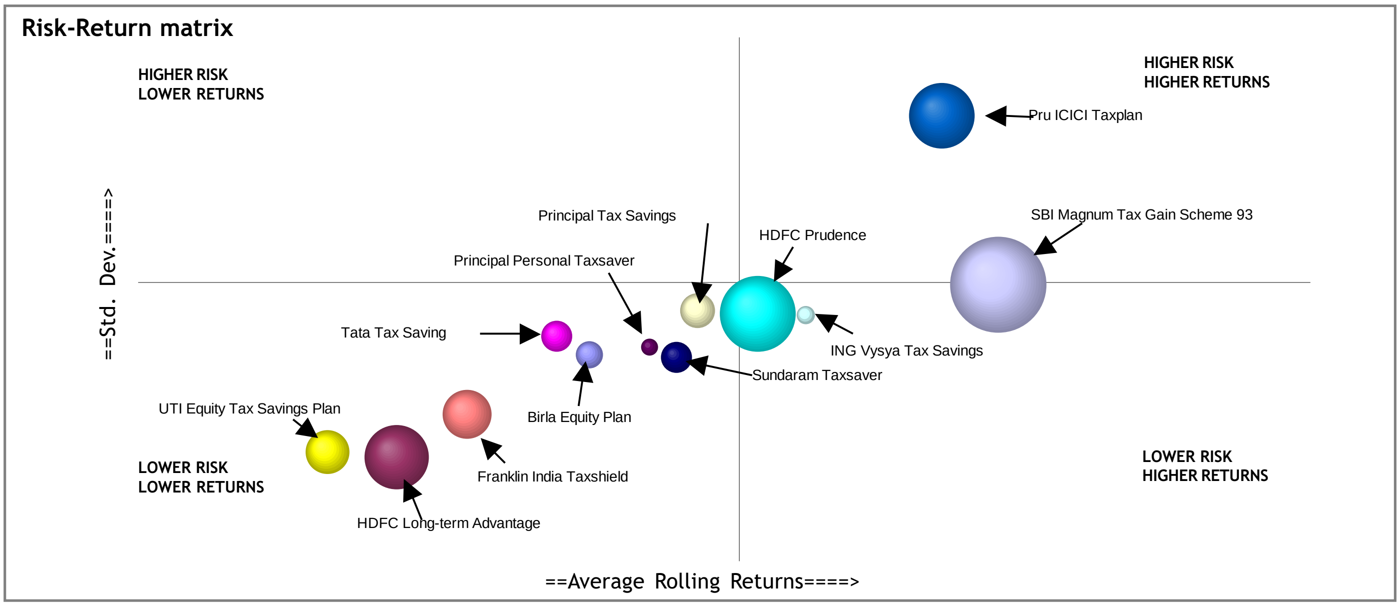
Thematic/Emerging Trend Funds



Balanced Funds



Tax Planning Funds



Disclaimer: mutual fund investments are subject to market risk. Please read the offer document carefully before investing. Past performance may or may not be sustained in the future.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Balrampur Chini Mills
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Overseas Electronics
HCL Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
Orient Paper and Industries
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