# investor's eye



## Index



## Take Five

| Scrip | Reco Date | Reco Price | CMP | Target |
|---|---|---|---|---|
| Aurobindo | 28-May-07 | 684 | **728** | 914 |
| BASF | 18-Sep-06 | 220 | **260** | 300 |
| Grasim | 30-Aug-04 | 1,119 | **2,356** | 2,975 |
| Infosys | 30-Dec-03 | 689 | **1,982** | 2,440 |
| JP Associates | 30-Dec-03 | 125 | **660** | 850 |



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## Pulse Track

### Inflation expected to moderate further

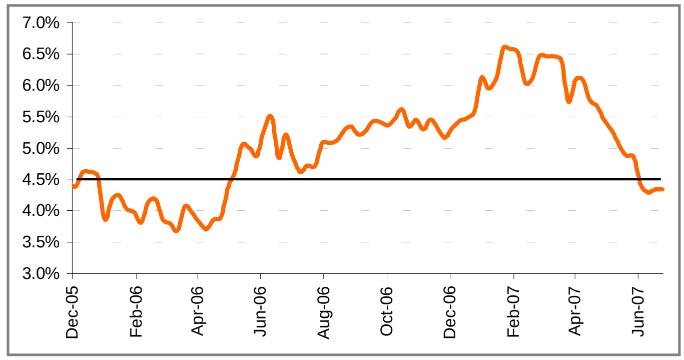
The Wholesale Price Index (WPI) stood at 4.85% for the week ended May 26, 2007 as against 5.06% recorded in the week ended May 19, 2007. The market expected a stable inflation number at 5.05% but was completely surprised by the sudden dip in the number to below 5%. Lower food article prices and stable manufacturing prices resulted in a more than expected drop in inflation .

**Base effect will continue, but didn't contribute much to the sudden fall**

Inflation has gradually come down over the past few weeks primarily due to the high base effect and the gradual drop was along the expected lines. But inflation for the week ended May 26, 2007 plunged to below 5% levels mainly due to a moderation in the primary article prices coupled with stable manufacturing prices. The higher base effect didn't play much part as the base WPI of all commodities recorded in May 2006 had only increased from 201.7 to 201.90 during this week.

The decline in the primary article prices was brought about by a fall in the prices of many components of the food articles index, such as food grains, fruits, vegetables, spices and oil seeds. If we look at the week-on-week inflation numbers, all the items have reported a decline or remained stable which is a positive development.

**Inflation is expected to go down below 4.5% by end-June 2007**




Source: MOSPI

**Outlook**

The inflation number has moderated along the expected lines, and we expect the same to moderate further and go down below 4.5% by end-June 2007, as primary article and manufacturing inflation moderate further and the higher base effect continues to play its part. Our inflation expectation for the coming week ended June 02, 2007 is at 4.84%.

| Weight | Particulars | % yoy change | | | % Weekly change | | |
|---|---|---|---|---|---|---|---|
| | | 12-May-07 | 19-May-07 | 26-May-07 | 12-May-07 | 19-May-07 | 26-May-07 |
| 100.0 | WPI of all commodities | 5.27 | 5.06 | 4.85 | 0.14 | 0.09 | -0.09 |
| 100.0 | WPI of primary articles | 10.52 | 9.35 | 8.62 | 0.50 | 0.18 | -0.27 |
| 15.4 | WPI of food articles | 9.77 | 8.15 | 7.30 | 0.68 | 0.14 | -0.50 |
| 2.9 | WPI of fruits & vegetables | 14.60 | 12.26 | 9.48 | 1.97 | 0.81 | -2.04 |
| 14.2 | WPI of fuel, power, light & lubricant | 0.63 | 0.50 | 0.50 | 0.00 | 0.06 | 0.00 |
| 63.7 | WPI of manufactured products | 5.02 | 5.20 | 5.14 | 0.05 | 0.05 | 0.00 |

# Cadila Healthcare

**Emerging Star**

## Stock Update

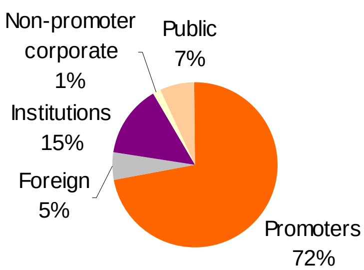
## Three product approvals in succession

**Buy; CMP: Rs338**

### Company details

| | |
|---|---|
| **Price target:** | Rs425 |
| **Market cap:** | Rs4,246 cr |
| **52 week high/low:** | Rs385/230 |
| **NSE volume:** (No of shares) | 31,038 |
| **BSE code:** | 532321 |
| **NSE code:** | CADILAHC |
| **Sharekhan code:** | CADILAHEAL |
| **Free float:** (No of shares) | 3.5 cr |

### Shareholding pattern




### Price chart


### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 4.3 | 8.2 | 8.1 | 35.5 |
| Relative to Sensex | 1.6 | -1.7 | -1.3 | -10.5 |

### Key points

- Cadila Healthcare (Cadila) has received three product approvals from the US Food and Drug Administration (USFDA) in quick succession. These are the final approvals for Benzonatate tablets, and Naproxen tablets and the tentative approval for Amlodipine Besylate.
- Benzonatate and Naproxen are already off patent products and have market sizes of $143 million and $53 million respectively. On the other hand, Amlodipine is current under exclusivity, which is set to expire in September 2007. The annual market size for amlodipine stands at $2.7 billion.
- Based on our calculations, we believe the three products together would generate combined revenues and profits of $18.5 million and $3.7 million respectively for Cadila in FY2009, translating into incremental earnings of Rs1.2 per share.
- At the current market price of Rs338, the stock discounts its FY2009E earnings by 12.7x. With a strong momentum in the US generic market, a ramp-up in the contract manufacturing business and the turn-around of the French business, we believe Cadila has a bright future and hence maintain our Buy recommendation on the stock, with a price target of Rs425.

### Event

Cadila has received three product approvals from the USFDA in quick succession. These are:

1. the final approval for Benzonatate tablets 100mg and 200mg;
2. the final approval for Naproxen tablets; and
3. the tentative approval for Amlodipine besylate

### About the products

Benzonatate is the generic version of Forest Labs' Tessalon. The product has anti-tussive properties and is used in the treatment of cough. The product is already generic in the USA, with three players (including Cadila) marketing the product apart from the innovator. As per NDC, the branded sales of the product stood at $134 million in 2006.

**Valuation table (consolidated)**

| Particulars | FY2005 | FY2006 | FY2007 | FY2008E | FY2009E |
|---|---|---|---|---|---|
| Net sales (Rs cr) | 1277.9 | 1484.5 | 1828.8 | 2129.7 | 2474.0 |
| Net profit (Rs cr) | 132.4 | 164.9 | 233.8 | 277.4 | 335.6 |
| Shares in issue (cr) | 12.6 | 12.6 | 12.6 | 12.6 | 12.6 |
| EPS (Rs) | 10.5 | 13.1 | 18.6 | 22.1 | 26.7 |
| *% y-o-y change* | *0.4* | *24.5* | *41.8* | *23.9* | *21.0* |
| PER (x) | 32.1 | 25.8 | 18.2 | 15.3 | 12.7 |
| Cash EPS (Rs) | 16.3 | 19.3 | 25.2 | 29.7 | 34.9 |
| Cash PER (x) | 20.8 | 17.5 | 13.4 | 11.4 | 9.7 |

Naproxen is the generic version of Hoffman ala Roche's Naprosyn, which is used as an analgesic and anti-inflammatory product for the treatment of various types of inflammatory diseases including rheumatoid arthritis, juvenile arthritis, ankylosing spondilitis and osteoarthritis. This product too is off patent, with 13 players in the market including the innovator, Cadila and generic companies like Mylan, Teva, Sandoz and Glenmark. The sales of this product in 2006 were estimated to be $53 million.

Amlodipine besylate is the generic version of Pfizer's Norvasc. The drug is a calcium channel blocker and is used to treat hypertension, angina and various other heart conditions. The market size for this product is close to $2.7 billion. Around 13 players are present in the market including the innovator. The other companies having the tentative approval for this product include Dr Reddy's Laboratories, Mylan, Apotex and Watson. The patent for this product expired in March 2007, following which Mylan, being the first to file a Para IV ANDA for the product, was awarded a 180-day exclusivity to market the product in the USA. The exclusivity is set to expire in September 2007, following which generic companies can enter the market with their versions of generic Amlodipine besylate.

### Implications for Cadila

Since Benzonatate and Naproxen are already off patent, Cadila can begin shipment of these products immediately. However, Amlodipine besylate will be launched only after the expiration of Mylan's exclusivity in September 2007.

*Benzonatate:* We believe Cadila will be able to garner a healthy 10% share of the Benzonatate market since the competition will be limited to just four players. Based on this and a modest 30% price erosion of the $134-million branded market (since the competition is less), we expect Cadila to generate $9.4 million in revenue and $1.9 million in profits from this product, translating into incremental earnings of Rs0.60 per share in FY2009.

*Naproxen:* We believe Cadila will be able to capture only 5% share of the crowded Naproxen market. Based on this and a marginal 10% price erosion of the $153-million generic market, we expect Cadila to generate $2.4 million in revenue and $0.5 million in profits from this product, translating into incremental earnings of Rs0.15 per share in FY2009.

*Amlodipine besylate:* Being a large product, with 13 players already having tentative approvals, we expect the prices of Amlodipine besylate to crash by 95% when several generic players launch their versions on day 1 following the expiration of the exclusivity. We believe Cadila will be able to capture only 5% share of this highly competitive market. Based on this, we expect Cadila to generate $6.8 million in revenue and $1.4 million in profits from this product, translating into incremental earnings of Rs0.43 per share in FY2009.

**Earnings estimates from product approvals**

| Particulars | Benzonatate | Naproxen | Amlodipine besylate |
|---|---|---|---|
| Market size ($mn) | 134 | 53 | 2700 |
| Price erosion | 30% | 10% | 95% |
| Market share | 10% | 5% | 5% |
| Revenues in FY2009E ($mn) | 9.4 | 2.4 | 6.8 |
| Profits in FY2009E ($mn) | 1.9 | 0.5 | 1.4 |
| Incremental EPS (Rs) | 0.6 | 0.2 | 0.4 |

### Valuation & view

With sales of Rs142.8 crore and profits of $13.4 crore in FY2007, the performance of Cadila's US business has exceeded both ours as well as the company's estimates. The above three product approvals reinforce Cadila's plan of launching eight to ten new products in the USA during FY2008. With these and more approvals coming through, we believe Cadila's US business will continue to surpass our expectations. Further, with its strong selling and marketing ability in the USA, Cadila could easily capture a higher share of the markets for the above three products compared with what has been conservatively assumed by us.

At the current market price of Rs338, the stock discounts its FY2009E earnings by 12.7x. With a strong momentum in the US generic market, a ramp-up in the contract manufacturing business and the turn-around of the French business, we believe Cadila has a bright future and hence maintain our Buy recommendation on the stock, with a price target of Rs425.

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

# Aurobindo Pharma

**Ugly Duckling**

**Stock Update**

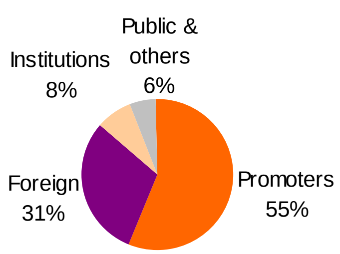
## Denies any stake sale plan

**Buy; CMP: Rs728**

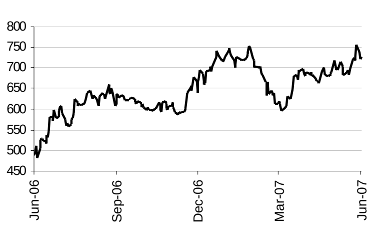
**Company details**

| | |
|---|---|
| **Price target:** | Rs914 |
| **Market cap:** | Rs3,877 cr |
| **52 week high/low:** | Rs770/468 |
| **NSE volume:** (No of shares) | 1.0 lakh |
| **BSE code:** | 524804 |
| **NSE code:** | AUROPHARMA |
| **Sharekhan code:** | AURPHARM |
| **Free float:** (No of shares) | 2.4 cr |

**Shareholding pattern**




**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 4.6 | 17.5 | 12.6 | 41.5 |
| Relative to Sensex | 1.9 | 6.8 | 2.9 | -6.5 |

Reacting to a media report that said Aurobindo Pharma is open to a partial stake sale, the management of the company has clarified that the company has no such plans. On the other hand, the management has indicated that the company is doing well in all its business segments including formulation exports, anti-retroviral (ARV) business and bulk business.

### Guides for $1 billion revenue target

The company has 1,172 formulation dossiers for various markets. More specifically, it has 110 drug master files and 82 abbreviated new drug applications for the US market. Encouraged by its robust formulation product pipeline and steady progress in the ARV business, the company has fixed revenue and profit targets of $1 billion (ie about Rs4,100 crore) and Rs1,000 crore for the next two to three years. In other words, it expects to achieve these targets by 2010. Such an impressive guidance adds to our confidence that the company would be able to meet our FY2009 financial projections: revenue of Rs3,143.1 crore and profit of Rs348.4 crore.

### European strategy well on track

In order to establish its position in the European market, Aurobindo Pharma continues with its dossier-filing spree. As of now it has 45 filings in Europe. On the inorganic front, the company has already acquired the UK-based Milpharma and the Netherlands-based Pharmacin International both of which have added 303 marketing authorisations. Further, to boost its European business the company is looking to acquire a couple of mid-sized companies with marketing platform in Spain, Italy and Portugal. The acquisitions will be funded through the $200 million raised earlier via a foreign currency convertible bond issue.

### Valuation

At the current market price of Rs728, Aurobindo Pharma is trading at 15.9x its FY2008E and 12.7x its FY2009E earnings. The company's transition from a mere active pharmaceutical ingredient player to speciality formulation maker and that too in regulated markets like the USA is very impressive and would boost its revenues and profitability going forward. Hence, we maintain our Buy recommendation on the stock with a one-year price target of Rs914.

**Earnings table**

| Particulars | FY2005 | FY2006 | FY2007E | FY2008E | FY2009E |
|---|---|---|---|---|---|
| Net sales (Rs cr) | 1321.6 | 1593.6 | 2057.5 | 2622.4 | 3143.1 |
| PAT (Rs cr) | 4.8 | 45.5 | 202.7 | 277.9 | 348.4 |
| Shares in issue (cr) | 5.1 | 5.3 | 6.1 | 6.1 | 6.1 |
| EPS (Rs) | 0.9 | 8.6 | 33.4 | 45.8 | 57.1 |
| PER (x) | -348.3 | 55.2 | 21.8 | 15.9 | 12.7 |
| Cash EPS (Rs) | 13.7 | 22.1 | 47.7 | 62.2 | 74.7 |
| Cash PER (x) | 53.0 | 32.8 | 15.2 | 11.7 | 9.7 |
| EV | 4656.1 | 5034.3 | 5236.6 | 5310.3 | 5158.9 |
| EV/Ebidta (x) | 35.0 | 24.1 | 12.5 | 9.8 | 8.0 |
| Book value (Rs/share) | 133.9 | 153.3 | 247.3 | 291.4 | 347.0 |
| P/BV (x) | 5.4 | 4.7 | 2.9 | 2.5 | 2.1 |

# ICICI Bank

Apple Green

## Stock Update

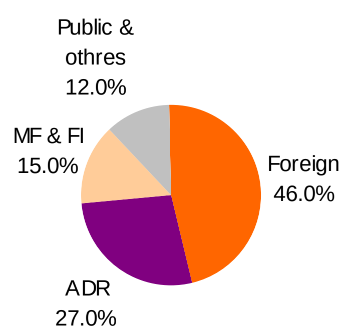
## Valuation of key subsidiaries above market estimates

Buy; CMP: Rs913

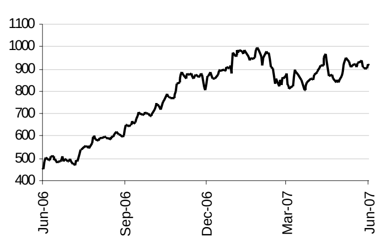
### Company details

| | |
|---|---|
| **Price target:** | Rs1,173 |
| **Market cap:** | Rs81,257 cr |
| **52 week high/low:** | Rs1,007/440 |
| **NSE volume:** (No of shares) | 14.3 lakh |
| **BSE code:** | 532,174 |
| **NSE code:** | ICICIBANK |
| **Sharekhan code:** | ICICIBANK |
| **Free float:** (No of shares) | 65.2 cr |

### Shareholding pattern




### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 8.3 | 5.7 | 14.1 | 96.8 |
| Relative to Sensex | 5.5 | -4.0 | 4.3 | 30.0 |

### Key points

- India's largest private sector lender ICICI Bank has announced plans to raise Rs20,000 crore ($5 billion) through a follow-on public offer (FPO). The FPO is likely to be equally distributed in the domestic and foreign markets. It is expected to open in the third week of this month. The price band and other issue details are awaited.
- The bank's management has indicated that the pace of growth in the economy as well as the bank's business in the past few years is unprecedented and the FPO tries to address the increased capital requirements of the bank for the next three years.
- The life insurance sector has been growing at a scorching pace for the past few years and ICICI Prudential Life Insurance is the private sector leader with a 30% market share among the private players and a 10% market share in the overall insurance market. The insurance sector is considered to be a sunrise sector and currently there are no listed insurance companies to play on the boom in the insurance sector. Hence, ICICI Bank, which has a 74% stake in ICICI Prudential Life Insurance, remains our preferred choice to play on the insurance story.
- In the past the bank has had to divert a significant amount of the capital raised through its earlier issues to fund its insurance subsidiaries. However this time we feel the difference is that ICICI Bank has already made arrangements for continuous funding of its insurance businesses. Thus with the funding of the insurance businesses taken care of, we feel, there will be more capital available to the bank to grow its core banking business without frequent dilutions in future. However, the huge FPO would take its toll on the return on equity (RoE), which is expected to come down to 10.3% and 10.5% in FY2008 and FY2009 respectively from 13.3% in FY2007.
- We feel one of the concerns pertaining to the bank remains in the form of the delay in obtaining the regulatory approval for the entire ICICI Financial Services (IFS) deal. The fact that the valuation of IFS is much higher than market estimates is a positive development. However the regulatory approval is very important, as it will set the precedence based on which the market would assign improved

**Valuation table**

| Particulars | FY2005 | FY2006 | FY2007E | FY2008E | FY2009E |
|---|---|---|---|---|---|
| Net profit (Rs cr) | 2005.2 | 2540.1 | 3110.2 | 4015.7 | 5120.6 |
| Shares in issue (cr) | 73.7 | 89.0 | 89.9 | 113.5 | 113.5 |
| EPS (Rs) | 27.2 | 28.5 | 34.6 | 35.4 | 45.1 |
| EPS growth (%) | 2.5 | 4.9 | 21.2 | 2.3 | 27.5 |
| PE (x) | 33.5 | 32.0 | 26.4 | 25.8 | 20.2 |
| P/PPP (x) | 22.8 | 17.3 | 11.9 | 11.3 | 9.0 |
| Book value (Rs/share) | 170.3 | 249.6 | 270.3 | 413.8 | 443.5 |
| P/BV (x) | 5.4 | 3.7 | 3.4 | 2.2 | 2.1 |
| Adj book value (Rs/share) | 149.9 | 237.7 | 247.9 | 392.0 | 416.1 |
| P/ABV (x) | 6.1 | 3.8 | 3.7 | 2.3 | 2.2 |
| RONW (%) | 18.1 | 13.6 | 13.3 | 10.3 | 10.5 |

valuation to the bank. An uptick in the non-performing assets (NPAs) and related provisions remains the other concern.

- We feel the stock will continue to consolidate around the current levels, as has been the case in the past after the announcement of any equity issuance. This provides a good opportunity to buy the stock. At the current market price of Rs913, the stock is quoting at 20.2x its FY2009E earnings per share (EPS), 9x its pre-provision profits (PPP) and 2.1x FY2009E book value (BV). We maintain our Buy recommendation on the stock with the price target of Rs1,173.

## Investment positives

### Life insurance subsidiary, the key value driver

ICICI Bank had transferred its 74% stake in the insurance business (life and general) and 51% stake in the asset management business to a separate wholly owned subsidiary company called ICICI Holdings (IH) for an aggregate investment value of Rs2,228 crore at year-end FY2007. IH was registered under the name of ICICI Financial Services.

The life insurance sector has been growing at a scorching pace for the past few years and ICICI Prudential Life Insurance is the private sector leader with a 30% market share among the private players and a 10% market share in the overall insurance market. The insurance sector is considered to be a sunrise sector and currently there are no listed insurance companies to play on the boom in the insurance sector. Hence, ICICI Bank, which has a 74% stake in ICICI Prudential Life Insurance, remains our preferred choice to play on the insurance story. We assign 90% (Rs325 per share) of the total per share value of IFS (Rs360 ) to the life insurance subsidiary based on our FY2009 estimates.

| Business | Period | Basis | Value/Share |
|---|---|---|---|
| Stand-alone core banking | FY09E | 1.8x BV | 790.0 |
| ICICI Financial Services | FY09E | | 360.0 |
| of which life insurance | FY09E | 21x NBAP | 325.0 |
| Others* | FY09E | | 23.0 |
| SOTP | | | 1,173.0 |

*brokerage business, venture funds, other investments etc

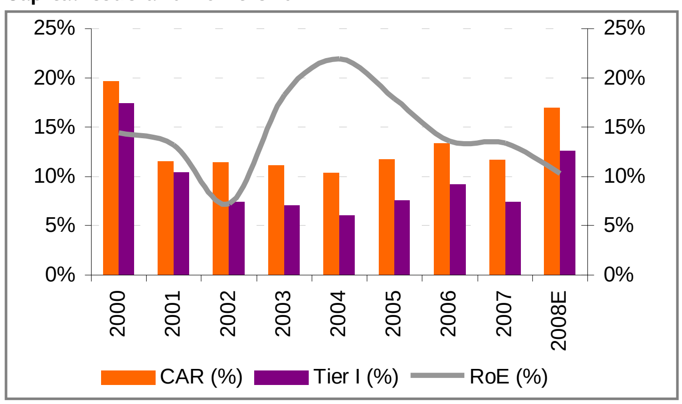
### Stake sale in subsidiary to be positive for the bank's FPO

The bank has offloaded 5.9% stake to five investors for around Rs2,650 crore, which translates into a valuation of Rs44,600 crore ($11 billion) for IFS. The placement is however subject to regulatory clearance, which we feel would take its due course. The market estimates for IFS' valuations range between $8 billion and $10 billion. Since the placement has been made at a higher price, the same has set a benchmark for evaluating the subsidiary, which is a positive development in the build-up to the FPO.

### RoE is expected to improve faster post-FPO

In the past the bank has had to divert a significant amount of its capital to fund its insurance subsidiaries even though the only income that it received from these subsidiaries was in form of dividends. This resulted in a lower RoE for the bank overall and led to lower price/BV multiples compared with its peer group. However this time we feel the difference is that ICICI Bank has already made arrangements for continuous funding of its insurance businesses by selling further stake in IFS. It also plans to list IFS in the next couple of years. The past trend shows that the bank made frequent equity dilutions that to a great extent were influenced by the capital need of its insurance businesses. With the capital needs of the insurance business now taken care of, we feel, there will be more capital available to the bank to grow its core banking business without frequent dilutions in future and also improve the RoE at a faster pace. However, the huge FPO would take its toll on the RoE, which is expected to come down to 10.3% and 10.5% in FY2008 and FY2009 respectively from 13.3% in FY2007.

**Capital issue and RoE trend**




Source: Bloomberg

### Growth is not a constraint for the bank

This leading private sector bank has always identified lucrative segments for growth and these segments have yielded tremendous growth opportunities for the bank. The management should be credited for identifying such segments and making the bank a major and dominant player in them. The bank has the largest retail presence and with its retail book already attaining a critical size (60-65% of its total advances) the bank has strategically focused on rural and foreign operations, which will be the next growth engines.

### Improvement in margins expected

With the interest rates expected to peak out soon and the deposit rate war over, we expect the interest rates to stabilise going forward. However the prime lending rates are not expected drop anytime soon. Hence the margins of the banking sector could improve from the second half of FY2008 when the burden of high cost short-term deposits would start decreasing. For ICICI Bank the margins have remained stable at 2.4%. Some margin improvement is expected on the back of the excess funds that would become available after the FPO. The Sangli Bank merger would also add 195 new branches to the bank's existing network which would help it to increase the low-cost deposit base and improve the cost of funds, thereby improving the margin.

## Investment concerns

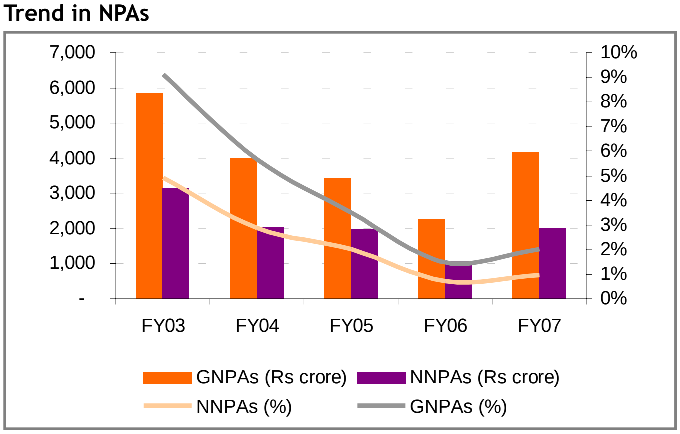
### Regulatory clearance for the IFS deal

We feel one of the concerns pertaining to the bank remains the delay in the receipt of the regulatory approval for the entire IFS deal. A lot of it is in the process and the details related to the deal have not been made public yet by the company, perhaps due to SEBI compliance norms where a company is not allowed to disclose any material fact other than what is mentioned in the issue prospectus. The fact that the valuations of IFS are much higher than market estimates is a positive development. However the regulatory approval is very important, as it will set the precedence based on which the market would assign improved valuation to the bank.

### Higher non-NPAs and related provisions

We have witnessed that the bank's gross NPAs and net NPAs have increased during FY2007 in both absolute and percentage terms. The increase compared to a declining trend is due to the bank's increasing exposure to non-collateralised loans (personal loans and credit cards), which showed higher defaults in FY2007. Any further increase in the interest rates could lead to higher defaults in the retail segment. The bank's mortgage portfolio could also be prone to defaults if the rates rise further, as in many cases the home loan tenure cannot be extended anymore with a subsequent increase in the home loan rate as then the loan repayment period would exceed the working life of an individual. Hence, increasing the borrower's equated monthly installments would be the only option in which case the chances of defaults would also increase.

**Trend in NPAs**

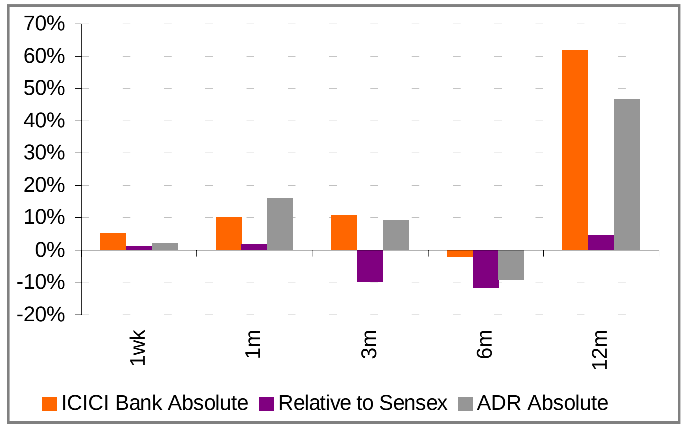



Source: Sharekhan Research

### Share price performance, after the previous FPO announcement in December 2005

The past trend shows that after the news of its equity issue hits the market the bank underperforms and consolidates before making a big move in the following eight to twelve months. We feel the bank is currently in the consolidation phase and provides a good opportunity to buy the stock for the reasons mentioned earlier.

**ICICI Bank stock price performance after previous FPO**




Source: Bloomberg

## Valuation and view

We have factored in a dilution of 23.5 crore equity shares at an offer price of Rs850. This will help the bank to raise the desired amount. We continue to remain bullish on ICICI Bank due to the following facts. The bank enjoys strong growth visibility with improvement on the operational front following the Sangli Bank merger. Also, the benchmark valuation of the insurance subsidiaries is ahead of market estimates; this along with any future stake sale and the listing of IFS would help to unlock significant value in its subsidiaries. We feel the stock will continue to consolidate around the current levels, as has been the case in the past, and this is a good opportunity to buy the stock. At the current market price of Rs913, the stock is quoting at 20.2x its FY2009E EPS, 9x its PPP and 2.1x FY2009E BV. We maintain our Buy recommendation on the stock with the price target of Rs1,173.

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 continued its upward march in May 2007. The BSE Sensex and the Nifty advanced by an appreciable 4.8% and 5.1% respectively. Further, the country's leading stock exchange, the Bombay Stock Exchange, achieved an important milestone. The market capitalisation of all the companies listed on the bourse crossed the "one trillion dollar" mark on May 28. The question is: What is filling the market with so much buoyancy even when it is fairly priced at the current levels?

Three things: easing of some concerns, flow of certain positive data and most importantly, strong liquidity. Inflation has been one of the key concerns of the market in recent times, as it has compelled the central bank to tighten its fiscal policy, resulting in higher interest rates and a stronger rupee. Well, the good news is that inflation has finally eased. After spending nearly four months at its high perch of above 6%, the Wholesale Price Index has dramatically climbed down to 4.85% for the week ended May 26. That's the lowest since the week ended July 29 last year and has been achieved in just about a month's time. With the easing of inflation the pressure on interest rates is also expected to ease.

Another source of worry in recent times has been the rupee. The local currency has gained 8% so far in the current year and 14% since August 2006 due to strong foreign fund inflows and the Reserve Bank of India's (RBI) reluctance to support the rupee, as the central bank is concerned that the money supply growth would add to inflationary pressures. But now that inflation has moderated, the probability of the RBI's intervention in the foreign exchange market to support the rupee has increased. In fact, according to media reports, the central bank has already made a beginning by purchasing $500 million from the foreign exchange market on May 28.

That brings us to the factor that is most responsible for the market's steady rise despite having reached its fair value and that is liquidity. Liquidity is in abundance, both locally and globally. Liquidity has swelled globally in the past few years owing to lenient monetary policies of central banks, the emergence of financial instruments like derivatives, and the growth of hedge funds and private equity firms. Investors have been pumping money into India from around the globe in the hope of superior returns. Foreign institutional investors have invested $4.0 billion in Indian equities so far in CY2007 vs $8.8 in CY2006.

No doubt it is India's brilliant performance that is attracting foreign funds by planeloads. The country's economy seems to be on a real high as indicated by the strong economic data released last month. Industrial production grew by 12.9% during March 2007 as against 8.9% in the corresponding period last year. The quick estimates of the Central Statistical Organisation peg the industry growth rate for the entire fiscal at 11.3%. The GDP, the key indicator of the economy's health, grew by a good 9.1% in the March quarter, taking the growth for the full fiscal to a strong 9.4%, higher than the government's estimate of 9.2% and the highest in almost two decades!

Some positive data also flowed from the USA last month, allaying fears that the world's largest economy may be headed for recession. For instance, business activity has rebounded, the jobless rate is almost the lowest in six years and stock markets are on a roll in the world's largest economy. Although inflation at 2% remains in the upper band of the Federal Reserve's (Fed) comfort zone, the Fed chief expects inflation to "moderate gradually over time". The Fed thus appears in no hurry to cut interest rates and the same is reflected in the Fed futures rate chart, which shows a horizontal straight line. The Fed kept the key rate unchanged at its May 9 meeting and its next meeting on June 27-28 is also not expected to yield a rate cut.

However there are some concerns that might spook the market going forward. For one, a host of public offerings-including those of DLF and ICICI Bank-is expected to hit the market in June which is likely to divert a large amount of funds to the primary market. Sample this: DLF and ICICI Bank are together looking to mobilise some Rs25,000-30,000 crore! Besides, the market's valuation at 16.5x forward earnings is close to the level at which it has corrected in the past few instances.

Crude could also pose a threat. Continuing its upward march it touched a high of $70 last month and is expected to hover at these elevated levels in the near term, as it is the peak driving season in the USA and the demand for gasoline would remain high. Also, the hurricane season has begun in the USA and more hurricane storms have been forecast for this year. If crude sustains at such higher levels, the Indian government may be forced to hike the prices of petroleum and petroleum products, which might stoke inflation again.

Most importantly, even though interest rates are expected to peak soon, they have taken their toll on Indian companies in the past few months by slowing down demand and automobiles are expected to be the hardest hit. This coupled with a possible slowdown in export demand and exchange rate impact is likely to take its toll on the earnings of the corporate sector, at least in the first half of FY2008. As earnings growth picks up in the second half, we expect the market sentiment to revive.

*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).*

*We have identified the best equity-oriented schemes available in the market today based on the following 3 parameters: the past performance as indicated by the one and two year returns, the Sharpe ratio and Fama (net selectivity).*

*The past performance is measured by the one and two year 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. The Sharpe ratio is also indicative of the consistency of the returns as it takes into account the volatility in the returns as measured by the standard deviation.*

*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.*

*We have selected the top 10 schemes upon ranking on each of the above 4 parameters and then calculated the mean value of each of the 4 parameters for the top 10 schemes. Thereafter, we have calculated the percentage underperformance or over performance of each scheme (relative performance) in each of the 4 parameters vis a vis their respective mean values.*

*For our final selection of schemes, we have generated a total score for each scheme giving 30% weightage each to the relative performance as indicated by the one and two year returns, 30% weightage to the relative performance as indicated by the Sharpe ratio and the remaining 10% to the relative performance as indicated by the FAMA of the scheme.*

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

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

## Aggressive Funds

### Mid-cap Category

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| Reliance Growth | 294.38 | 12.91 | 33.48 | 49.08 |
| Birla Mid Cap | 71.82 | 16.74 | 34.82 | 44.58 |
| ICICI Prudential Emerging STAR | 30.71 | 11.88 | 31.80 | 50.99 |
| SBI Magnum Midcap | 23.63 | 10.42 | 30.41 | 48.54 |
| Kotak Midcap | 22.04 | 14.15 | 24.15 | 41.40 |
| **Indices** | | | | |
| BSE Midcap | | 12.96 | 23.16 | 38.09 |

### Opportunities category

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| ICICI Prudential Dynamic Plan | 69.97 | 11.24 | 38.75 | 56.19 |
| ABN AMRO Opportunities | 23.81 | 21.01 | 45.15 | 52.67 |
| Fidelity Equity | 23.48 | 16.16 | 44.28 | 51.12 |
| HSBC India Opportunities | 30.50 | 14.77 | 35.18 | 50.55 |
| Franklin India Opportunity | 27.83 | 16.37 | 40.60 | 51.52 |
| DSP ML Opportunities | 59.28 | 13.65 | 34.36 | 48.50 |
| Reliance Equity Opportunities | 22.74 | 11.06 | 33.81 | 48.91 |
| Franklin India Flexi Cap | 22.25 | 13.38 | 31.56 | 48.12 |
| **Indices** | | | | |
| BSE Sensex | 14544.46 | 12.42 | 39.87 | 47.17 |

## Equity diversified/conservative funds

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| Birla SunLife Frontline Equity | 55.67 | 16.54 | 49.33 | 49.98 |
| DSP ML Top 100 Equity | 63.88 | 17.09 | 45.36 | 52.28 |
| HDFC Equity | 161.28 | 14.20 | 39.96 | 50.16 |
| Franklin India Prima Plus | 151.53 | 14.26 | 47.47 | 51.12 |
| ICICI Prudential Power | 89.20 | 14.86 | 37.51 | 52.51 |
| HDFC Top 200 | 119.10 | 15.33 | 36.37 | 47.24 |
| Sundaram BNP Paribas Select Focus | 63.20 | 11.45 | 32.64 | 51.02 |
| SBI Magnum Multiplier Plus 93 | 56.39 | 11.42 | 32.25 | 54.45 |
| ICICI Prudential Growth Plan | 99.80 | 13.89 | 33.74 | 47.62 |
| Birla SunLife Equity | 202.36 | 18.65 | 46.53 | 49.64 |
| **Indices** | | | | |
| BSE Sensex | 14544.46 | 12.42 | 39.87 | 47.17 |

## Thematic/Emerging trend funds

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| DSP ML India Tiger | 36.68 | 16.67 | 45.00 | 58.95 |
| SBI Magnum Sector Umbrella - Contra | 41.43 | 16.08 | 35.44 | 55.38 |
| Tata Infrastructure | 25.74 | 16.68 | 34.84 | 51.44 |
| Tata Equity P/E | 29.68 | 23.82 | 41.71 | 42.61 |
| Templeton India Growth | 73.63 | 18.18 | 35.92 | 41.20 |
| **Indices** | | | | |
| BSE Sensex | 14544.46 | 12.42 | 39.87 | 47.17 |

## Balanced funds

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| HDFC Prudence | 120.89 | 8.43 | 33.88 | 37.27 |
| DSP ML Balanced | 42.51 | 14.87 | 33.04 | 36.93 |
| Birla SunLife 95 | 199.50 | 15.12 | 32.73 | 36.46 |
| FT India Balanced | 35.23 | 10.55 | 31.47 | 34.21 |
| Tata Balanced | 54.42 | 13.06 | 29.05 | 33.29 |
| **Indices** | | | | |
| Crisil Balanced Fund Index | 2577.86 | 9.95 | 25.29 | 26.96 |

## Tax planning funds

| Scheme Name | NAV | Returns as on May 31, 07(%) | | |
|---|---|---|---|---|
| | | 3 Months | 1 Year | 2 Years |
| PRINCIPAL Tax Savings | 86.09 | 16.28 | 37.32 | 50.45 |
| SBI Magnum Tax Gain Scheme 93 | 46.57 | 8.60 | 37.81 | 48.25 |
| Birla SunLife Tax Relief 96 | 101.92 | 16.77 | 38.27 | 47.47 |
| HDFC Taxsaver | 153.77 | 13.79 | 27.00 | 42.35 |
| **Indices** | | | | |
| BSE Sensex | 14544.46 | 12.42 | 39.87 | 47.17 |

## 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.

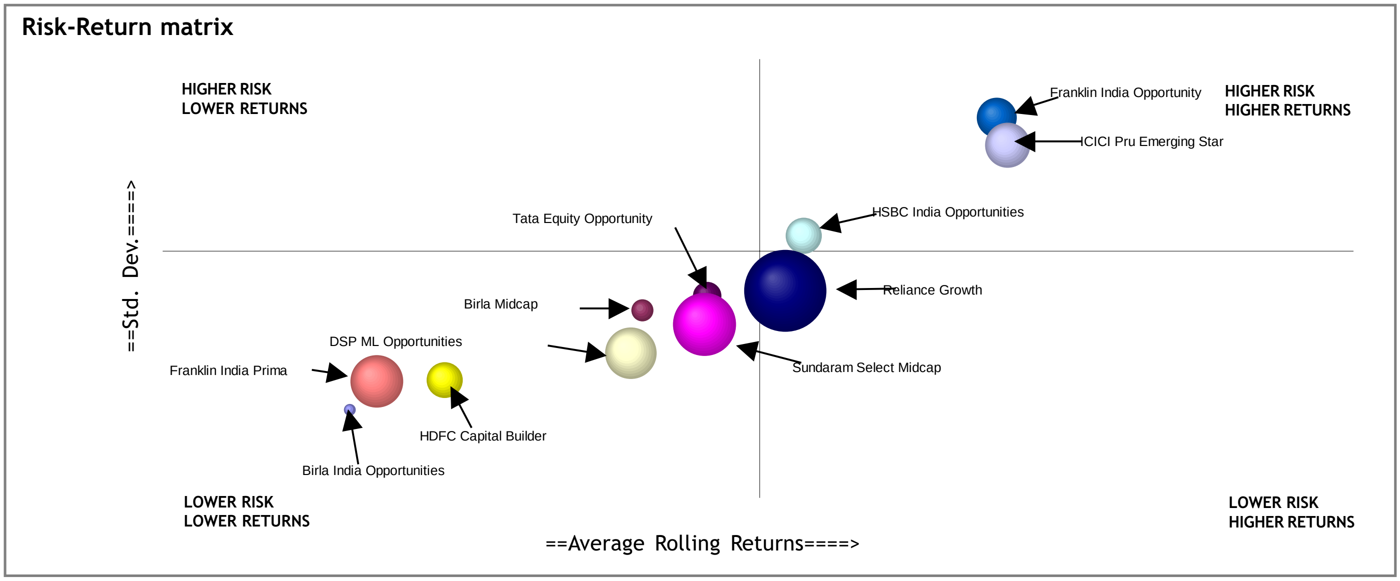
The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

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.

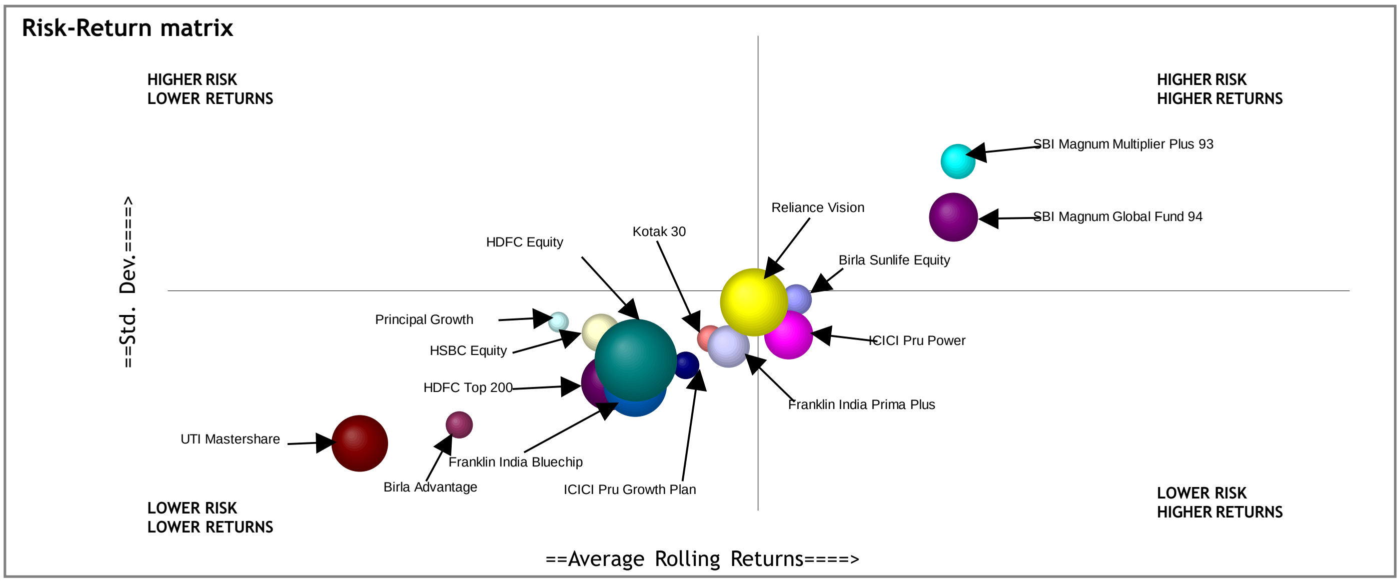
For aggressive, conservative and tax planning funds, risk is measured in terms of two years' volatility while returns are measured as two years' average rolling returns as on May 31, 2007. For thematic and balanced funds, risk is measured in terms of one year's volatility while returns are measured as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

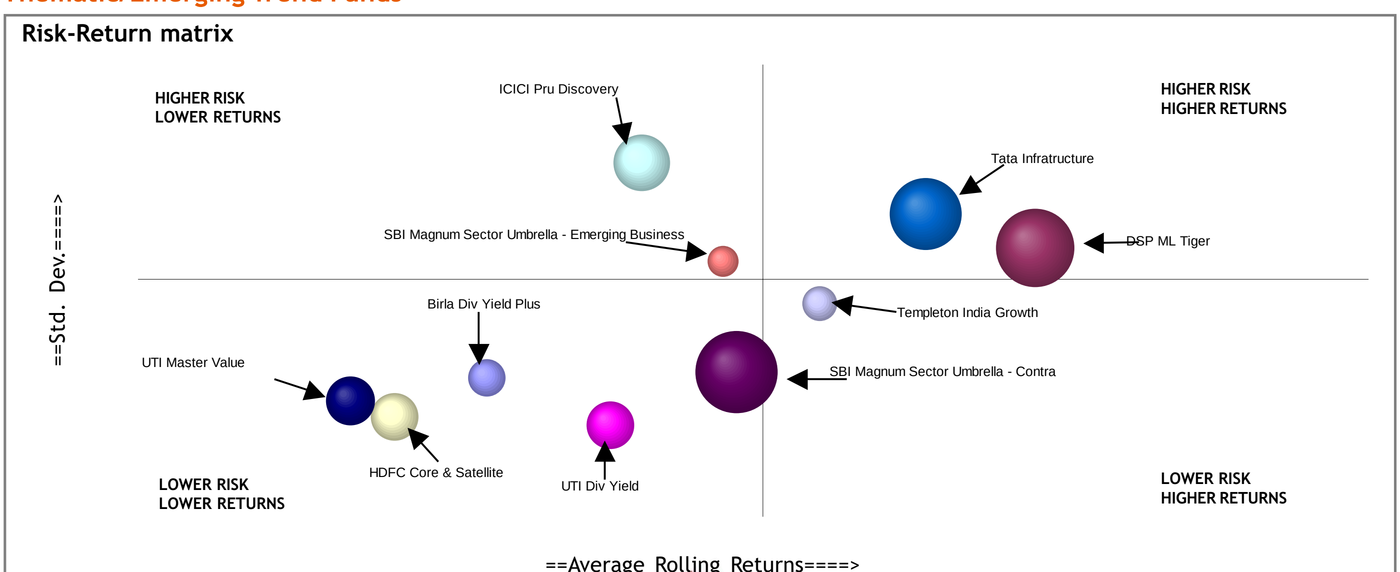
## Aggressive Funds



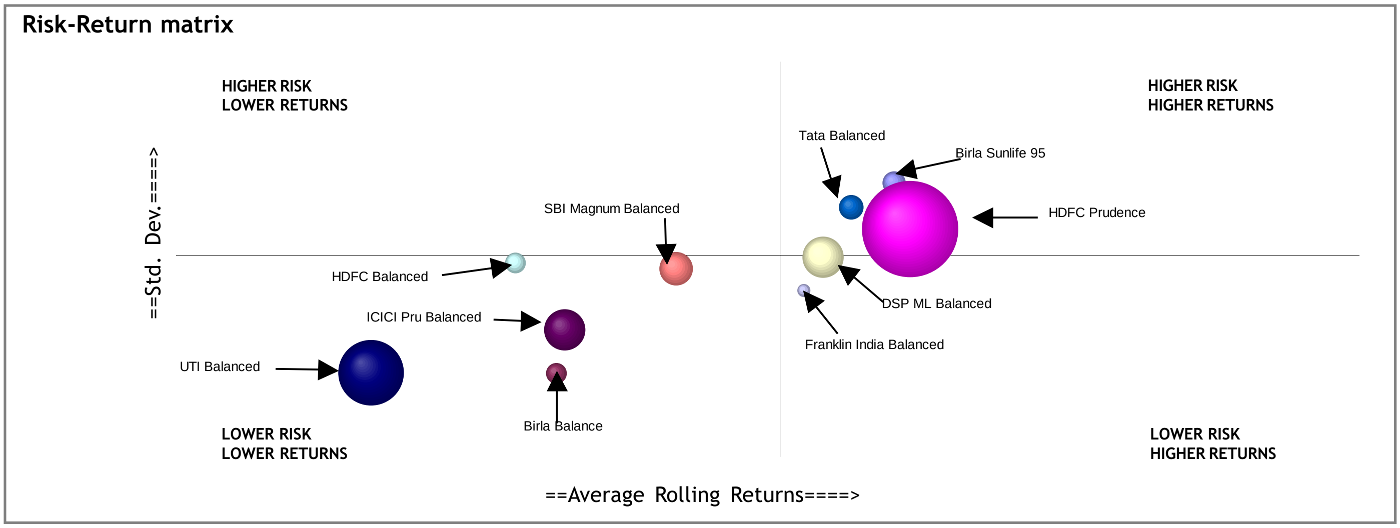

## Equity Diversified/Conservative Funds



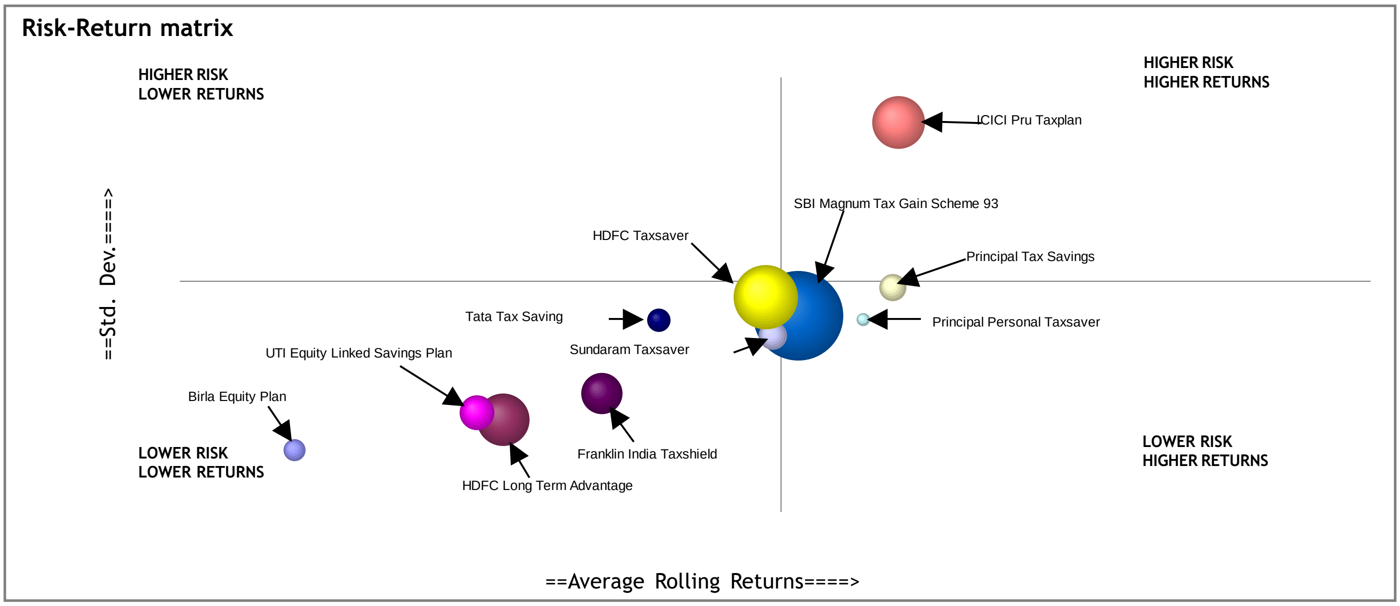

## Thematic/Emerging Trend Funds



## 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
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
HCL Technologies
Hindustan Lever
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
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Power Infrastructures
Hexaware 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
WS Industries India