MOSt Value

A Monthly newsletter on value investing

JANUARY 2007

From the desk of

Equity Strategist

Dear Investor,

The markets extended its gain last fortnight on sustained buying by foreign investors (FIIs), strong economic growth data and healthy corporate earnings expected in the January 2007 quarter. A cut in retail fuel prices by the centre following drop in global crude oil prices further boosted sentiments . The liquidity driven rally took the BSE 30-share Sensex closer to the 14000 levels and Nifty to 4000 at the end of the F&O settlement on 28th December 2006

Today everyone is anxious how the secondary markets would behave in the year 2007. In the immediate short term markets should continue to do well with the coming January quarterly results and budget. Over the last four years, bulls have dominated the bourses. But I am not so sure whether the bulls would continue to do the same in 2007. The way the market is witnessing volatility; I would not be surprised if the bull is reined in. Since the last two years we have seen the sensex going up by more than 40 per cent. Can the dream run continue? I have my doubts.

In a nutshell, in the year ahead it would not be an easy year to make money hence one should be extra careful with his/her investments whether in the primary markets or the secondary markets.

Happy Investing!

Sincerely yours,

Manish Sonthalia
VP - Equity Strategy

WEALTH CREATION THOUGHT

Every business design has limited value creation life cycle

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Model Retail Portfolios

Select the portfolio that best suits your risk profile.

Scrip	MBP*	Wtg.*	%	First Reco.	
				Date	Price
AGGRESSIVE - HIGH RISK, HIGH RETURNS					
Apollo Tyres	343	H	8	Apr-05	280
Bharti Tele	630	H	7	Aug-03	48
EIH Associates	161	H	6	Jan-05	33
Nagarjuna Fertilizers	13	M	3	Dec-04	13
Rallis	266	M	3	Nov-04	120
Arvind Mills	52	L	8	Feb-05	94
Satnam Overseas	69	L	8	Mar-06	80
Genus Overseas	204	H	8	Apr-06	210
Jindal Saw	387	H	7	Apr-06	415
JSW Steel	380	H	5	Aug-06	271
Ultra Tech	1081	M	5	Sep-06	868
Kansai Nerolac	806	M	4	Sep-06	877
Kesoram	545	M	5	Sep-06	466
Maha Seamless	470	M	5	Nov-06	420
Goldiam Int.	105	M	5	Nov-06	120
Investment %			**87**		

Our Aggressive Portfolio works on the principle of 'no pain no gain'. The target returns are high at 30%+. Portfolio includes commodity, cyclical and small-cap stocks.

Scrip	MBP*	Wtg.*	%	Date	Price
MODERATE - MEDIUM RISK, MEDIUM RETURNS					
Bharti Tele	630	H	6	Aug-04	33
EIH Associates	161	H	9	Mar-03	260
Indian Oil	446	M	3	Dec-04	13
Nagarjuna Fertilizers	13	H	6	May-06	516
Rallis	266	M	4	Aug-05	206
Reliance Energy	521	L	5	Aug-03	48
SBI	1236	H	9	Jan-06	613
Vindhya Telelink	131	H	6	Nov-04	120
Raymond Limited	397	L	8	Dec-03	375
Pfizer Ltd	762	M	8	Feb-05	415
Era Constructions	471	M	8	Apr-06	170
NIIT Ltd	494	H	8	May-06	365
Maruti	924	M	5	Sep-06	920
Navneet Publications	59	M	5	Dec-06	54
NIIT Tech	294	H	10	Dec-06	296
Investment %			**100**		

Some moderation is achieved in this portfolio by investing in large and growth stocks available at value. The aim is to generate 20%+ annualized returns with less risk.

Scrip	MBP*	Wtg.*	%	Date	Price
DEFENSIVE - LOW RISK, LOW RETURNS					
Amtek Auto	356	H	5	Sep-05	235
Glaxo	1162	M	5	Mar-04	800
Hindusthan Lever	220	M	9	Dec-04	130
Indian Oil	446	M	5	Dec-03	375
Nestle Ltd	1133	M	7	Jan-05	935
SBI	1236	L	10	Nov-02	375
Union Bank	123	L	5	Dec-04	90
United Phos	302	L	12	Jan-05	140
Biocon	368	H	8	Apr-06	453
BEL	1327	M	5	Sep-06	1,141
Investment %			**71**		

Our Defensive Portfolio is exposed to very low capital erosion risk and yet could generate annualized returns of 15%+. Recommended for investors with low risk appetite, e.g. retired or aged individuals.

MBP* : Maximum Buying Price. One should not buy the stock if Price is above MBP.
Wtg.* : Weightage refers to the size of the position recommended. H-High, M-Medium, L-Low.

Foreign fund managers are supposed to get into the holiday mood as Christmas and New Year approaches. But not in India, it seems. The nip in the weather is missing. Things are heating up The stock markets kissed the 14000 mark early December 2006 and the data released indicated and economy riding a bullet train. As mentioned in the Most Value for the previous month, markets were expected to take a sharp correction in the short term and so it did. The markets lost 1200 points in a matter of few days, as a result of the RBI raising the CRR by 50 bps and IIP numbers coming lower than expected for the month of October

The markets have recovered almost the entire loss at the end of the current month with the sensex gaining by 1% and the nifty gaining by 0.4% during the month. The direction of the markets in the markets is clear. It would move according to the fund flows from overseas. Valuations are pretty high and there is nothing new to write about that. The quarterly are expected to be just fine if one goes by the advance tax figures. Any negative surprises on this front would take the markets sharply lower. There would be action stock specific and one needs to keep a strong vigil to spot winners.

We have no additions in our Aggressive & Defensive Portfolios & we have added NIIT Tech in our Moderate Portfolio.

Our Aggressive, Moderate & Defensive Portfolio were down by 0.7%, 1 % & 1.6% respectively. Additions or deletions of stocks are being communicated through our morning conference call, MOSt Market action emails or on 'AWACS' during market hours.

Sector	Allocation (%) Agg.	Mod.	Def.
Agrichem & fertilisers	6	10	12
Auto & Ancillaries		5	5
Banking		9	15
Cement	10		
Engineering			
FMCG	12		16
Hotels	6	9	
Miscellaneous	13	5	5
Oil & Gas		3	5
Pharma		8	13
Power		5	
Software		18	
Steel	12		
Construction		8	
Pipes	5		
Textiles	8	8	
Telecommunication	7	12	
Tyres	8		
Total	**87**	**100**	**71**

Mahindra & Mahindra

BUY

CMP - Rs887 | **MBP - Rs900** | **TARGET - Rs1,094**

YEAR END	NET SALES (Rs m)	PAT (Rs m)	Adj. EPS (Rs)	CONS. EPS (%)	P/E (x)	CONS. P/E (x)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/06A	81,412	6,479	25.3	37.8	33.5	22.5	22.3	22.1	2.3	20.6
3/07E	97,488	9,171	35.8	53.8	23.7	15.8	25.2	26.3	1.8	13.6
3/08E	105,665	10,255	40.1	65.1	21.2	13.0	23.8	25.5	1.6	11.7

We are revising upward our earnings estimates for Mahindra & Mahindra by 2.1% for FY08 and by 5.3% for FY09 following Tech Mahindra's US$1b 5-year deal with BT to provide it with strategic sourcing services. We have introduced a Buy rating on Tech Mahindra with a target price of Rs1,800. As M&M owns 47% stake in Tech Mahindra, we are upgrading our target price for M&M by 17.6% to Rs1,094 (applying a 20% holding company discount to all listed investments). Maintain **Buy.**

US$1b deal to sustain growth momentum in Tech Mahindra's BT revenues post FY07:

Tech Mahindra has signed US$1b IT outsourcing order from BT group for managed services, IT and BPO services, to be executed over a period of 5 years. This deal greatly improves the visibility of revenue from BT, Tech Mahindra's top client (65% of revenue at present) and removes concerns of any slowdown in this account. We expect that the high visibility of revenue and earnings growth over the next few years from its top clients would help the stock command a high PE (discussed separately below).

Potential for more positive surprises:

Besides Tech Mahindra, we are also bullish on M&M's core business, as evidenced by the strong FY07 YTD volume growth in tractors (+25.1% YoY) and three-wheeler sales (+55.3% YoY). Further potential upside for M&M's earnings estimates would arise from inorganic growth strategy at its components division, Mahindra Systech whilst Mahindra Gesco may also potentially add to M&M's valuations. Further, the JVs with Renault for passenger cars and with ITEC for commercial vehicles, have initiated growth prospects for M&M in its automotive business.

Potential growth ahead via new ventures

M&M's JV with Renault was initially for manufacture of Renault's car, Logan at M&M's Nashik plant. M&M has since expanded the scope of this JV to include setting up of a new venture: a new 50:50 greenfield facility, to manufacture passenger cars with initial capacity of 0.3m units by mid-2009, to be scaled up to 0.5m units by 2012 at a cost of approximately US$1b. Moreover, it is likely Nissan will participate by taking a stake in this venture.

M&M also has a JV with ITEC, which can revitalize the company's prospects in the CV business.

These two JVs hold the potential to add significantly to M&M's earnings post FY08/FY09 and hence we have not yet fully factored this in its earnings.

Mahindra Gesco to benefit from ongoing realty boom:

Mahindra Gesco (MG), which is engaged in property development, has acquired a sizeable land bank in the past three years across India. Besides three SEZs in Chennai (southern India), Jaipur (northern India) and Pune (western India), MG is engaged in developing residential and commercial projects in Mumbai, Pune, Chennai, Faridabad, Bangalore, Delhi etc. The company completed a US$105m QIP in October 2006 for development of SEZs.

In view of Mahindra Gesco's property development plans in the scenario of the ongoing realty boom, we see tremendous scope for value addition to M&M's valuations. We have valued Mahindra Gesco at Rs35 per share of Mahindra whilst considering M&M's valuations.

Outlook and view:

Considering the above mentioned arguments, we believe there exists strong potential of a rerating to M&M's valuations. We expect M&M to report consolidated EPS of Rs53.8 and Rs65.1 for FY07E and FY08E respectively. The stock is trading at a P/E of 15.8x FY07E and 13x FY08E earnings. We maintain **Buy** with a price target of Rs1,094 (an upside of 29%).

NIIT Technologies

BUY

CMP - Rs291 **MBP - Rs320** **TARGET - Rs432**

YEAR END	NET SALES (Rs m)	PAT (Rs m)	EPS (Rs)	EPS Growth (%)	P/E (x)	P/BV (x)	ROE (%)	ROCE (%)	EV/SALES (x)	EV/EBITDA (x)
3/06A	6,075	640	16.5	10.8	17.6	4.2	25.6	19.5	1.4	7.5
3/07E	8,855	1,009	26.1	57.5	11.2	3.3	33.1	19.9	0.9	4.9
3/08E	11,233	1,240	32.0	22.9	9.1	2.7	32.4	26.3	0.6	3.5

Background

NIIT Technologies Ltd. was formed by hiving off the global solutions business of NIIT Ltd. in FY04. The demerger was part of a restructuring exercise by NIIT Ltd. to provide strategic focus to its education and IT services business. The shareholders of NIIT were allotted shares in NIIT Tech in the ratio of 1:1.5, as a result of which NIIT Ltd. holds a 25% stake in NIIT Tech.

The company is among the top 20 IT software and solutions provider from India and employs around 4,200 people.

It offers services in application development and maintenance, enterprise solutions including managed services, and business process management in banking, financial services and insurance (BFSI), transport, manufacturing and retail space.

Large clients include the ING group, British Airways, SEI Investments, Singapore Airlines, Toshiba, Toyota, Office Depot and the Ministry of Defence - Singapore.

Coming of Age

NIIT Technologies has transformed itself into a focused player with over 80% of revenues coming from BFSI, transportation, and manufacturing and retail verticals.

We expect the Room Solutions acquisition and the Adecco JV to drive 33% CAGR in EPS through FY09E. The stock is the cheapest among peers. **BUY**.

Focused player in large verticals

Post demerger from NIIT in FY04, NIIT Tech has focused on BFSI, transportation, and manufacturing and retail verticals. This has begun to pay off with these verticals contributing over 80% of revenues in 2QFY07. Client additions are healthy and order intake is rising.

Beneficiary of Europe's rising IT spend

IT exports to Europe have registered a CAGR of 39% (FY03-FY06E). NIIT Tech has an early mover advantage in Europe with some relationships like British Airways dating back to 10 years. The recent acquisition of UK-based Room Solutions strengthens its presence. We believe NIIT Tech is well-placed to capitalise on Europe's rising IT spend.

Creating growth opportunities

NIIT Tech is one of the few Tier II players offering integrated solutions including BPO and managed infrastructure services. We expect the Room Solutions acquisition and the Adecco JV to drive growth going forward. The Rs1b capex for Noida facility convinces us that NIIT Tech is gearing up for the next level of growth.

EPS CAGR of 33% through FY09E; cheapest among peers; Buy

We expect EPS CAGR of 33% through FY09E. The stock is trading at a PE of 9.1x FY08E. It is the cheapest among peers but the highest on RoE, dividend yield, and per employee revenue and PAT. Our 12-month target price is Rs432 based on a current PE of 13.5 on its FY08E EPS of Rs32. We recommend **BUY**.