investor's eye

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April 19, 2007

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
HLL	24-Nov-05	172	**207**	280
ICICI Bank	23-Dec-03	284	**905**	1,240
JP Associates	30-Dec-03	125	**574**	850
Maruti	23-Dec-03	360	**775**	1,050
Sun Pharma	24-Dec-03	302	**1,159**	1,341

Sharekhan Special

Monetary policy preview

The Reserve Bank of India (RBI) is going to announce its annual monetary policy for FY2008 on April 24, 2007 and we are highlighting our expectations from the policy.

- The market is currently not expecting another 50-basis-point cash reserve ratio (CRR) hike and we also don't expect the same. The reason why we don't expect any further tightening is because we feel the RBI has already taken action on March 30, 2007, which was completely unexpected, by increasing the repo rate by 25 basis points and the CRR by 50 basis points.
- Further the inflation is expected to moderate going forward and the non-food credit and money supply growth have also shown some moderation, which favour a status quo. If the RBI goes ahead and hikes the CRR again it could be a setback for the markets.
- Liquidity management will remain high on the agenda for 2007-08, with the policy rates such as the repo rate, the reverse repo rate and the bank rate likely to remain unchanged.
- The gross domestic product (GDP) growth estimates for FY2008 could be in the range of 8-8.5% while the target zone for inflation may remain unchanged at 5-5.5%.
- A curb on foreign flows through the lowering of the NRI deposit rates to make them less attractive and lowering the external commercial borrowing limits may be undertaken to control capital inflows at least in the short term as long as the inflation is above the RBI's comfort zone.
- Some mention on the credit and fund flow to sensitive sectors like the commercial real estate may find its place in the policy, as the RBI is very concerned about the escalating real estate prices, which could lead to an asset price bubble.
- We feel the RBI should avoid excessive tightening so that concern over the economic growth potential in the next fiscal doesn't come under serious scrutiny.

The RBI has indicated that it wants to control the inflation at any cost and its recent 25-basis-point repo rate hike

Factors RBI is keeping a close watch on

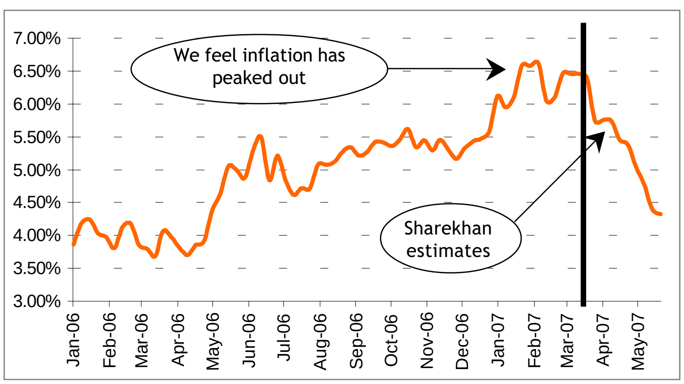
Particulars	Last policy action	Current status	Remarks
IIP numbers (%)	11	11.1	Remain strong compared to last year.
WPI numbers (%)	6.46	5.74	Expected to decline further mainly due to a higher base effect but not within the RBI's comfort range of 5-5.5% before the RBI announces the annual policy.
CPI-IW (%)	7.6	Latest data not available	Expected to have a downward bias.
Non-food credit growth (%)	29.5	27.9	Expected to track the deposit growth rates more closely as the demand shows some slowdown with a lagged effect of the policy measures and the unavailability of excess SLR holdings to fund credit by liquidating investments.
Deposit growth (%)	24.8	23	Expected to be around the 20% plus levels.
Money supply (%)	22	20.7	Moderation is visible but further policy action cannot be ruled out completely.
Forex reserves	$198 billion	$200 billion	Swelling forex kitty could call for some measures to curb NRI deposits, FDI flows into real estate and ECB by corporates in the short term to control money supply growth and maintain the stability in the rupee for export competitiveness.

and the 50-basis-point CRR hike on March 30, 2007 (when the market least expected the hikes ahead of the annual policy) goes to show that the RBI could take sudden measures to control inflation. Strong capital flows have remained the main concern of the RBI, which have contributed to the dramatic rise in the money supply and in turn raising inflationary concerns. The recent decision by the RBI to stay away from the foreign exchange (forex) market has seen the rupee appreciate significantly hurting our export competitiveness. However, uncertainty over the apex bank's monetary policy actions has also increased due to the global factors, as increased liquidity flows in emerging economies have been a major concern.

Inflation expected to moderate going forward

We expect the inflation to moderate from the current levels of 5.74% going forward as the high base effect kicks in and the inflation settles within the RBI's comfort zone by end May 2007. The Indian Meteorological Department expects the June-September 2007 rainfall for the country to be at 95% of the long period average that translates into below normal monsoon, which is not good news for agricultural growth, primary article prices and inflation going forward.

Wholesale Price Index expected to moderate going forward



Source: Office of the Economic Adivsor

Uncertainty over policy changes looms large due to global factors at play

The RBI is closely monitoring the policy stance of global central banks; as per the RBI's statements globally the process of withdrawal of accommodation in monetary policy is being actively pursued. In a meeting with the bond and foreign exchange dealers the RBI governor YV Reddy is understood to have highlighted a point that there is no concrete six-month horizon, as the global markets are in a state of flux and so the markets and bankers need to be prepared for changes. He also pointed out that all Asian countries are currently facing a task of tackling huge capital flows.

Steps taken by RBI so far to control inflation and liquidity

- The repo rate hiked by 125 basis points in 5 phases of 25 basis points each to 7.75%. The reverse repo rate hiked by 50 basis points in 2 phases of 25 basis points each to 6%.
- The CRR hiked by 150 basis points in three phases of 50 basis points each to 6.5%.
- Modified the liquidity adjustment facility (placing a Rs3,000 crore cap on the reverse repo window) and revived dated bond issuances under the market stabilisation scheme along with scheduled treasury bill auctions to mop up excess liquidity from the system on a more stable basis.
- Not injecting rupee liquidity in the system by buying dollars from the market and as a result the rupee has seen a sharp rise in the past one month.
- Increase in the risk weights and standard assets provisioning norms to discourage credit flow to certain sensitive sectors like personal loans, capital market and commercial real estate.

Foreign inflows the main cause of the high money supply growth

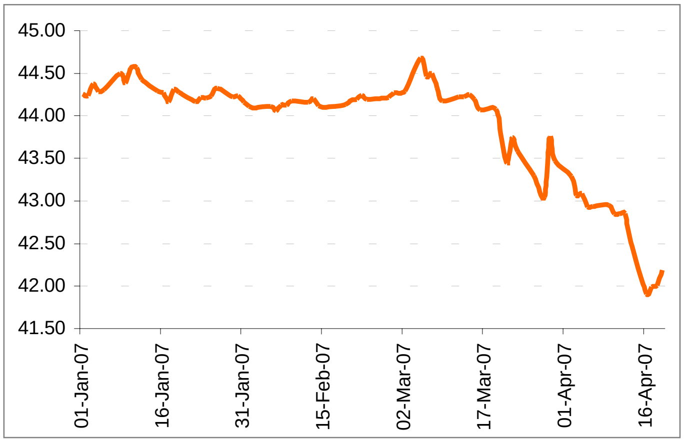
The RBI's concern on high money supply growth resulting in excess liquidity in the system, which could fuel inflation, is mainly emanating from the external commercial (ECB) borrowings by Indian corporates, FDI flows and non-resident Indian deposits. To keep the rupee from appreciating rapidly, the RBI buys dollars and in the process injects rupee liquidity into the banking system.

The money supply growth has moderated to 20.7% from 22% levels a fortnight back, due to the lagged effect of the CRR hikes and the RBI's decision to refrain itself from buying dollars. However the RBI's decision not to intervene in the forex market has led to a sharp appreciation in the rupee thus hurting the export competitiveness. Till what level the RBI would allow the rupee to appreciate before it provides some support by buying dollars remains a key question now.

NRI deposits and ECB may be discouraged

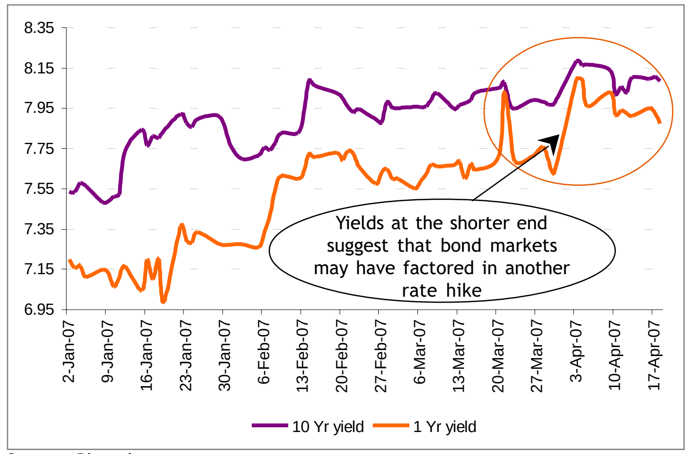
A curb on foreign flows through the lowering of the NRI deposit rates to make them less attractive and lowering the external commercial borrowing limits may be undertaken to control capital inflows at least in the short term as long as the inflation is above the RBI's comfort zone.

Rupee appreciated significantly



Source: Bloomberg

Yields rise after RBI's sudden decision to increase rates



Source: Bloomberg

What do the yields say?

The 1-year yield closed 46 basis points above its previous closing on April 4, 2007 when the bond markets reopened and reacted to the RBI's sudden announcement of a 25-basis-point repo rate hike and a 50-basis-point CRR hike. However, the yield at the shorter end has come down of late but that has been possible because of the easing of liquidity. We feel some ambiguity still remains in the market as to whether the RBI would hike the rates or maintain the status quo.

Will RBI hike rates in its upcoming policy meet?

Bloomberg estimates suggest that 36% of the market is expecting a 25-basis-point repo rate hike, around 27% expect a 25-basis-point reverse repo rate hike while less than 10% expect another 50-basis-point CRR hike.

We feel the annual policy would leave the CRR and other policy rates unchanged as we have witnessed an unexpected tightening at end-March 2007. Further the inflation is expected to moderate going forward and the non-food credit growth and money supply have shown some moderation. The RBI should avoid excessive tightening so that concern over the economic growth potential in the next fiscal doesn't come under serious scrutiny.

South East Asia Marine Engineering & Construction

Ugly Duckling

Stock Update

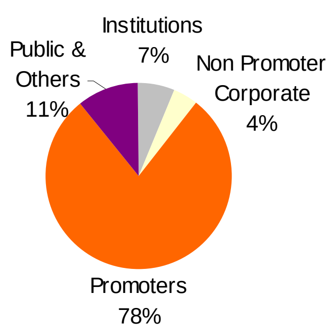
ONGC contract boosts Q1 performance

Buy; CMP: Rs205

Company details

Price target:	Rs300
Market cap:	Rs695 cr
52 week high/low:	Rs239/106
NSE volume: (No of shares)	70,337
BSE code:	526807
NSE code:	SEAMECLTD
Sharekhan code:	PEERSSHIP
Free float: (No of shares)	0.74 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	20.5	8.2	6.9	95.3
Relative to Sensex	9.4	12.2	0.1	66.2

Result highlights

- South East Asia Marine Engineering & Construction (SEAMEC) has reported a 107.9% growth in its revenues to Rs56.1 crore for the first quarter ended March 2007. The growth was higher than expectation due to the two-month extension of the contract from Oil & Natural Gas Corporation (ONGC; with relatively high day rates) for one of its vessels.
- The operating profit margin (OPM) slipped from 61.3% to 48.2% primarily due to the incremental cost related to SEAMEC Princess (the fourth vessel that is undergoing modification and that didn't contribute to revenues in Q1). This coupled with the general wage inflation resulted in a four-fold jump in the staff cost to Rs20.2 crore as compared with Rs5.2 crore in Q1CY2006. Consequently, the earnings grew at a relatively lower rate of 61.2% to Rs24.4 crore.
- In terms of the outlook on charter rates, the company expects the day rates to remain firm on the back of the favourable demand environment. Even after the anticipated addition of multi-support vessels (MSVs) by some of the Indian companies (like Great Offshore) there would be a shortage of MSVs in the coming years due to the huge requirement to set up the required infrastructure to transport hydrocarbons produced from the large offshore fields discovered in India over the past few years.
- To factor in the robust performance of Q1 and the higher than expected dry docking expenses indicated by the management, we are revising downwards the CY2007 earnings estimates by 4.9% but maintaining the CY2008 earnings estimates.
- At the current market price the stock trades at 8.8x CY2007 and 5.8x CY2008 estimated earnings. We maintain our Buy call on the stock with a price target of Rs300.

Result table Rs (cr)

Particulars	Q1CY07	Q1CY06	% yoy chg
Net sales	**56.1**	**27.0**	**107.9**
Total expenditure	29.1	10.5	178.2
Operating profit	27.0	16.5	63.4
Other income	2.7	2.0	35.0
Interest	0.1	0.1	50.0
Depreciation	4.5	2.8	60.7
EBT	25.2	15.7	60.3
Tax	0.8	0.6	37.5
Reported profit after tax	**24.4**	**15.1**	**61.2**
Equity cap	33.9	33.9	
EPS (Rs)	7.2	4.5	
Margins (%)			
OPM	48.2	61.3	
NPM	43.5	56.0	

Extension of ONGC contract boosts Q1 performance

The company benefited from the extension of the ONGC contract by two months at higher rates, which brought in incremental revenues of around $1.8 million during the quarter. Moreover, the other two vessels (SEAMEC II and III) are also deployed at substantially higher rates with effect from August 2006.

Q2 is likely to be subdued

The robust performance in Q1 is likely to be followed by a rather subdued performance in the second quarter. That's because one of its vessels is scheduled to go for dry docking in Q2 and that would result in lower revenues and additional expenses during the quarter. Moreover, the deployment of SEAMEC Princess is delayed by a couple of months and would start contributing to revenues only by Q3 now.

This essentially means that the growth would be largely back-ended and the stock could underperform in the short-term due to the expectations of a muted growth in the second quarter.

AGM highlights

First, in the recently held annual general meeting (AGM), the chairman opted to retire and he would be replaced by a nominee from the parent company, Technip. Second, the management is looking at right opportunities to further expand its fleet base. Third, the company is exploring newer business opportunities like forward integration into marine construction projects. But nothing has been finalised yet. Lastly, the parent company would have to reduce its shareholding from 78.24% to below 75% by the end of June as per the regulations, and it is exploring ways to do the same.

Valuation

To factor in the robust performance of Q1 and the higher than expected dry docking expenses indicated by the management, we are revising downwards the CY2007 earnings estimates by 4.9% but maintaining the CY2008 earnings estimates.

At the current market price the stock trades at 8.8x CY2007 and 5.8x CY2008 estimated earnings. We maintain our Buy call on the stock with a price target of Rs300.

Key financials

Year ended Dec 31	2005	2006	2007	2008
Net profit (Rs cr)	19.4	58.6	79.1	119.3
% y-o-y growth	*-54.0*	*202.0*	*35.0*	*51.0*
Shares in issue (cr)	3.39	3.39	3.39	3.39
EPS (Rs)	5.7	17.3	23.3	35.2
% y-o-y growth	*-54.0*	*202.0*	*35.0*	*51.0*
PER (x)	35.8	11.9	8.8	5.8
Book value (Rs)	53	70	93	129
P/BV (Rs)	3.9	2.9	2.2	1.6
EV/EBIDTA (x)	22.7	8.9	6.2	3.4
RoCE (%)	13.0	29.0	30.0	33.0
RoNW (%)	11.0	25.0	25.0	27.0

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

Aban Offshore

Emerging Star

Stock Update

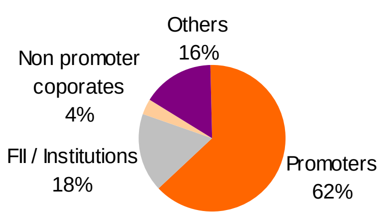
Price target revised to Rs2,528

Buy; CMP: Rs2,280

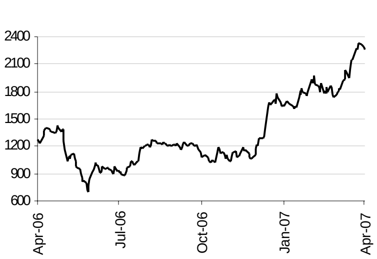
Company details

Price target:	Rs2,528
Market cap:	Rs8,776 cr
52 week high/low:	Rs2,374/645
NSE volume: (No of shares)	86,963
BSE code:	523204
NSE code:	ABANLOYD
Sharekhan code:	ABANLOYD
Free float: (No of shares)	1.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	31.2	38.7	102.1	80.6
Relative to Sensex	19.1	43.8	89.2	53.6

Result highlights

- Aban Offshore (AOL) reported a marginal decline in its stand-alone revenues to Rs118.7 crore during Q4FY2007. This is in line with expectations as there was no re-pricing of any asset in the parent company. In fact, one of its assets Aban II was not operational for part of the quarter.
- The operating profit margin (OPM) slipped sharply to 40.2% (down from 57.1% in Q4FY2006) due to lower revenues from Aban II, increase in the staff cost (380 basis points) and insurance charges (430 basis points) as a percentage of sales, and extraordinary expenses of Rs7.5 crore (incurred towards the issue of foreign currency convertible bonds [FCCB] and preferential shares).
- However, the jump in the other income component to Rs34.9 crore (up from Rs3.7 crore) enabled the company to report a 34.5% growth in its earnings to Rs29.6 crore. The other income was boosted by the foreign exchange (forex) gains (on the forward hedges and FCCB proceeds) of around Rs17 crore. Moreover, the company would also have benefited from the interest on loans given to its Singapore subsidiary, Aban Singapore Pte (ASPL).
- On the full year basis also, the stand-alone revenue growth was largely flat at Rs497.5 crore as compared to Rs490.2 crore in FY2006. The OPM declined by 740 basis points to 49.8%. However, the huge jump in the other income to Rs59.2 crore (up from Rs15.3 crore) enabled the company to post a 9.2% growth in the stand-alone earnings to Rs91.5 crore. It should be noted that the stand-alone results do not reflect the complete picture, as the company has been valued at its FY2009 estimated earnings on a consolidated basis.

Result table Rs (cr)

Particulars	Q4FY07	Q4FY06	% yoy chg	FY2007	FY2006	% yoy chg
Net sales	118.7	120.2	-1.3	497.5	490.2	1.5
Total expenditure	71.0	51.6	37.7	249.9	208.9	19.6
Operating profit	47.7	68.7	-30.5	247.6	281.3	-12.0
Other income	34.9	3.7	843.0	59.2	15.3	286.9
PBIDT	82.6	72.4	14.1	306.8	296.6	3.4
Interest	12.0	8.5	41.9	44.5	43.6	2.1
PBDT	70.6	63.9	10.5	262.3	253.0	3.7
Depreciation	21.6	22.0	-1.8	96.1	95.1	1.1
PBT before amortisation	49.0	41.9	16.9	166.2	157.9	5.3
Goodwill amortised	1.6	1.6	-	6.3	6.3	-
PBT	47.4	40.3	17.6	159.9	151.6	5.5
Tax	17.9	18.3	-2.7	68.4	67.8	0.9
PAT	**29.6**	**22.0**	**34.5**	**91.5**	**83.8**	**9.2**
EPS	7.4	5.5		22.9	21.0	
Margins						
OPM (%)	40.2	57.1		49.8	57.4	
PBT(%)	41.3	34.8		33.4	32.2	
PAT (%)	24.9	18.3		18.4	17.1	

- Along with the results the company has announced the conversion of the $100 million FCCB at a price of Rs2,789 per share. Thus, the dilution in equity would be around 1.5 million equity shares (as against our base case estimate of the conversion at Rs1,400 per share). Consequently, even though the estimates for FY2008 and FY2009 remain unchanged, the target price is revised upwards to Rs2,528 to factor in the lower than anticipated dilution in equity. We maintain our Buy call on the stock.

Key financials (consolidated)

Year ended March	31FY06	FY07E	FY08E	FY09E
Net profit (Rs cr)	76.8	128.7	489.9	1216.3
Shares in issue (Cr)	3.7	3.8	3.8	3.8
EPS (Rs)	20.8	33.4	127.3	316.0
% y-o-y chg	*49.9*	*60.4*	*280.7*	*148.3*
PER (x)	109.4	68.2	17.9	7.2
Book value (Rs)	116.9	255.1	380.4	694.3
P/BV (Rs)	19.5	8.9	6.0	3.3
EV/EBIDTA (x)	25.7	23.0	10.0	4.4
RoCE (%)	15.9	7.1	19.0	30.2
RoNW (%)	26.3	13.1	33.5	45.5

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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
HCL Technologies
Hindustan Lever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
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SKF India
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Tata Tea
Unichem Laboratories
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Cannonball

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

Emerging Star

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Thermax
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Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Overseas Electronics
Hexaware Technologies
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