India Alternative Research

hEDGE

The alternative insights monthly

February, 2007

February view: Trade the range

- Banking – higher provisioning to impact EPS
- FMCG – little respite on the topline and bottomline
- Cement – import duty cut to keep a check on prices

January retrospective:

· Positive trend in stock rollovers; Nifty rolls remain weak

Though rollovers of stock futures positions to February series were strong, Nifty saw very weak rolls. The rollovers of stock futures position is highest rolled in any expiry. The average roll cost of stock futures for the expiry week managed to stay firm in the range of 70bps to 75bps. On the other hand, after witnessing all time high rollovers in the previous expiry, rollovers in Nifty failed to pick up. Huge Nifty futures position expired on the last day of expiry simultaneously with the fall in Nifty roll cost to -28bps from 12bps, indicating lack of long rollers in the market. This divergence in rollover trend indicates the willingness of market participants to bet on individual stocks, but not on the entire market.

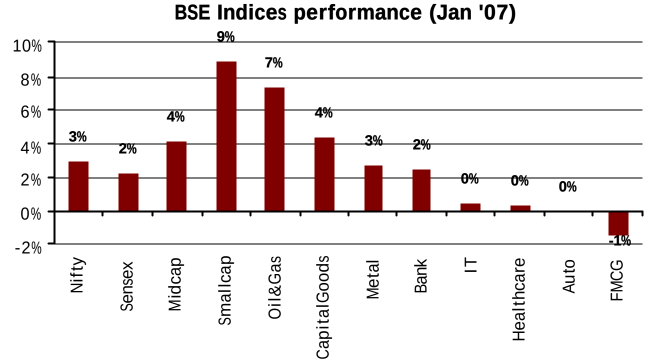
· FIIs buyers in all emerging markets except India

Foreign institutional investors (FIIs) were net sellers for second month consecutively, with a total outflow of USD 527 mn in January 2007 (sale of USD 567 mn in futures and purchases of USD 40 mn in cash). However, they have been net buyers in all the other emerging markets with the highest funds of USD 586 mn poured in Taiwan. Mutual funds too sold very aggressively in January. The net selling of USD 303 mn by the domestic funds is the highest in any month since June 2006. Majority of the USD 376 mn pumped in December 2006 was taken out of the market. Last month's purchases of USD 376 mn was the highest monthly investment since May 2006.

· Small-cap stocks become new favourite; Large cap remain range bound

Continuing the last month's trend, small cap and mid cap stocks that remained neglected for quite some time, witnessed a shift of investor's interest. Among the sectoral indices, oil and gas index saw the highest appreciation on the back of easing crude prices. In line with our expectations, FMCG remained out of flavour for the third month in row.

BSE Indices performance (Jan '07)



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Jan Retrospect

India vs. Global Markets

Under perform	In line	Out perform

Fund Flows

- FII ↓
- MF ↓

Sectoral performance

- Outperformers – Oil & Gas and Telecom
- Underperformers – Sugar and FMCG

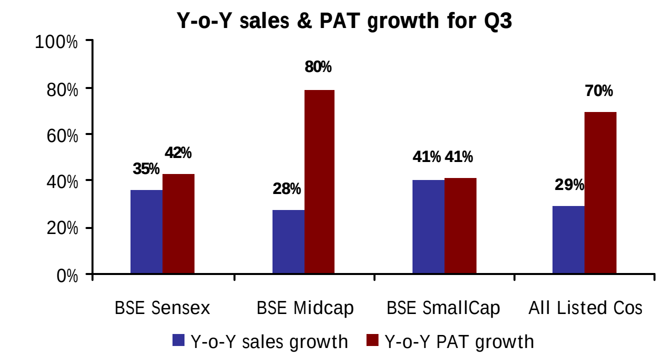
February–Sectors to watch

- Outperformers
  - o Engineering & Capital Goods
- Underperformers
  - o FMCG
  - o Banking
  - o Cement

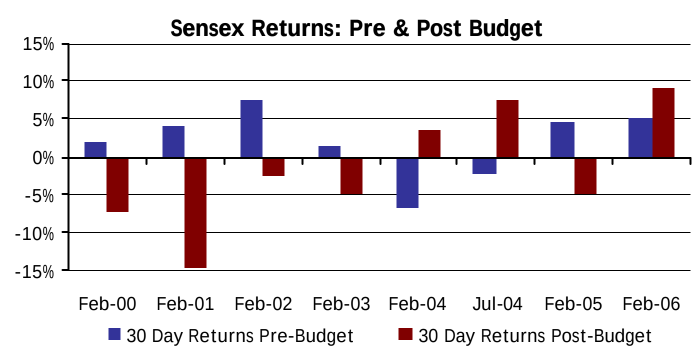
Feb: What lies ahead…

February view: Trade the range

The current earnings season has been very impressive with many companies delivering double digit growth rates, thereby re-imposing investor's confidence. Out of 1,654 companies that have declared their results so far, more than 60% companies have shown double digit topline and bottomline growth. The combined topline and bottomline Y-o-Y growth for all the 1,654 companies stand at 29% and 70% respectively. Interestingly, not only the large-cap stocks, but even mid cap, and small cap stocks have shown excellent performance.



However, we believe that most of the earnings were already factored in the prices and hence market did not react very positively even after such strong results. On the other hand, most of the times in the history, markets have remained quite stable before the budget season (see chart below). FIIs have also preferred to stay on sidelines waiting for the markets to cool off a bit. Based on the above-mentioned factors, we expect the markets to remain fairly range bound, ahead of the budget season with increased intra day volatility.



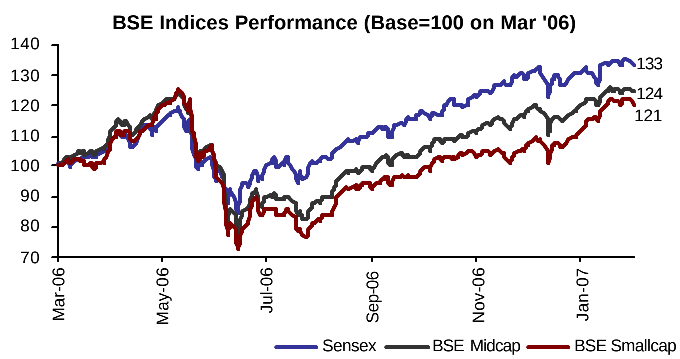
Further, the strong economic fundamentals and the confidence among the market players, after good quarterly earnings would prevent any significant correction in the market.

Feb: What lies ahead…

Strong results to keep mid-cap and small-cap stocks in limelight

In the last month's issue, we had mentioned about the next round of rally witnessing participation from the mid-cap and small-cap stocks, which in turn, would be keeping the markets firm. We believe that this trend would continue over the next month. The delivery of strong results was not just limited to large companies, with many mid-cap and small-cap companies outperforming large cap stocks in terms of sales and profit growth. The aggregate sales and profit of 740 companies from BSE mid-cap and small-cap index, which have declared their results, has grown 32% and 68% respectively. Though the Y-o-Y sales growth of Sensex companies, at 35%, is marginally higher than the mid-cap and small-cap companies, the profit growth of 50% recorded by Sensex is much lower than 68% PAT growth of mid-cap and small-cap companies.

Hence, besides continued underperformance, strong results delivered by the mid-cap and small-cap companies would keep them in limelight.



Banking: Higher provisioning to impact EPS

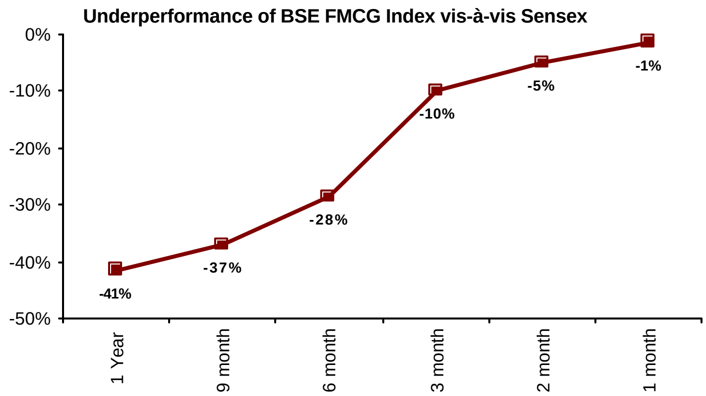
The credit policy unveiled by RBI on January 31 opted to keep the reverse repo rate unchanged at 6%, while hiked the repo rate by 25bps to 7.50%. Provisioning requirement for banks' exposure to non-deposit taking non-banking financial companies (NBFCs) has been increased to 2% from 0.4%. Also, the risk weight for banks' exposure to such NBFCs has been raised to 125% from 100%. Provisioning requirements on credit cards, personal loans, capital markets, and real estate exposure has also been raised to 2% from 1% earlier. The provisioning move is aimed at keeping credit quality in check. It also aims at selective cooling off of consumption demand.

We think that this move would necessitate higher provisioning for all banks in general and private sector banks in particular, given that their balance sheets are more skewed towards retail assets. The actual impact would be felt in the Q4 numbers; the Q4 EPS projections should see some downward revisions. While this is a sure negative, the valuations for banking stocks are not too demanding at this juncture. Besides, expectation of a slowdown in credit growth will result in banking scrips underperforming the broader market in the near term.

FMCG : Little respite on the topline and bottomline

We had previously stated that input cost pressures would make operating environment for FMCG companies challenging. We continue to opine the same for the next month. The prices of key inputs such as crude, palm oil, milk solids, and wheat continue to remain firm. The recent government move to reduce import duties on edible palm oil is unlikely to have any beneficial impact on the FMCG majors, since they are already entitled to imports of crude palm oil at concessional rates (which haven't been altered).

The volume growth for most FMCG majors would also be somewhat muted, given the high base effect of the previous year. The key thing to watch would be the VAT rate that would be imposed on cigarettes in the forthcoming annual budget. A lower than expected VAT rate could be beneficial for ITC. In the backdrop of volume growth possibly tapering off slightly and there being no respite on the input cost pressure front, we expect FMCG scrips to remain lackluster.



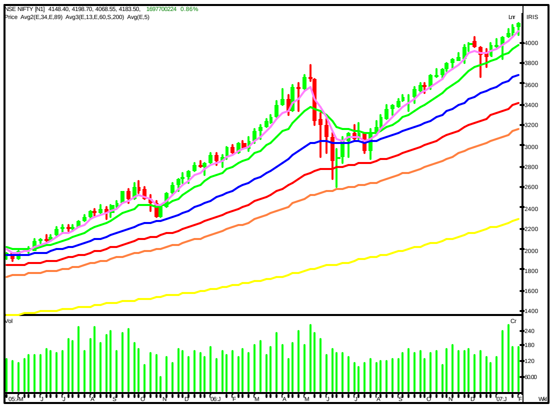
Cement – import duty cut to keep a check on prices

The government decision to do away with the 12.5% import duty on Portland cement saw cement scrips correct by 5%-8% during the last week of January. Although we believe that this is not going to have any material impact on the ground, this announcement would queer the pitch for cement companies.

Construction companies do not propose to import cement even if landed cost of imports is slightly higher than domestic price, given the cumbersome nature of imports, additional inland transportation cost to be incurred, and storage and bagging costs. Also, cement accounts for ~6% of total construction cost, which is relatively low. Hence, this announcement is not likely to lead to a meaningful increase in cement imports, or cause cement prices to decline. However, this announcement will stem the pace and magnitude of price hikes that cement majors were looking to effect, going forward. This situation would hold true, particularly in case of the northern and western zones.

Media reports have surfaced that the coal ministry is working towards a "February-end" deadline to finalise a policy, which may phase out cheap coal availability to the aluminum, cement, and steel sectors. The inclusion of these industries in the "non-core sector" pricing band, may lead to a 30% hike in the cost of coal, a key input. For cement companies, the margin impact could be around 2-3%. We believe that the likelihood of cement majors not effecting price hikes to the extent that was anticipated previously, coupled with the news that cement companies may have to pay market linked prices for their coal, would keep cement stocks subdued.

Technical View



Weekly Chart

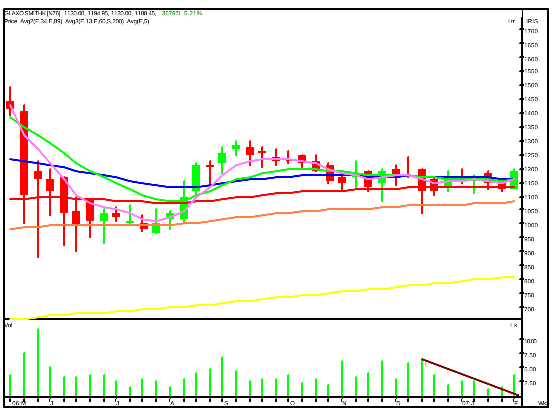
Nifty: Bullish momentum

Short Term – bullish

Intermediate Term – cautious bullishness

The bullish nuances in the Nifty are apparent, as it managed to absorb substantial selling pressure in the beginning of the previous month. The bulls seem to have feverishly capitalised on the bullish momentum and we believe that the bullish bandwagon would continue to venture into greener pastures. Once the 4047 level was breached, markets entered into a bullish frenzy (as indicated in our previous report) and from here if the Nifty breaks the 4200 level, the next resistance would be only at the 4267 level.

In a nutshell: The momentum is feverishly bullish.



Weekly Chart

Glaxo Smithkline

Intermediate Term – bullish

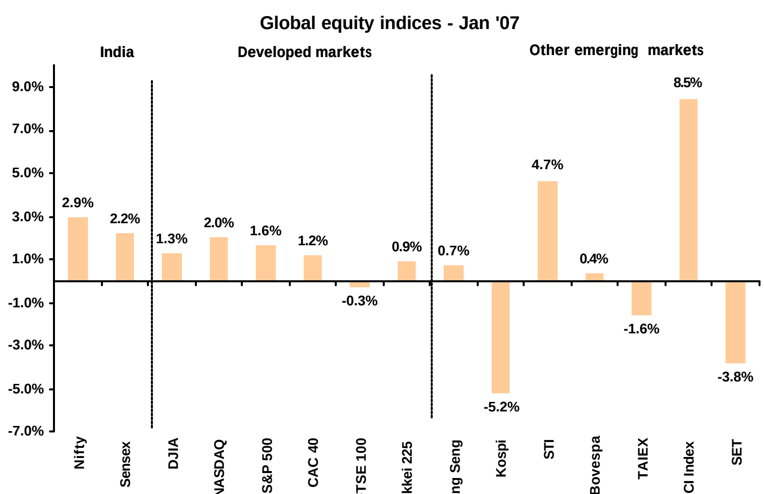
The stock has taken a support at its 60 WMA and the current setup, where the volumes have been falling for the past eight weeks without a corresponding fall in the prices. This indicates that all the bearish pressure built over the weeks have been absorbed by the bulls. The bullish candle that completes a flag pattern, along with strong volume that has also broken out of its downtrend, clearly shifts the balance in the favour of the bulls. Buy the stock with a stop-loss of INR 1130 for a target of INR 1364.

Global context

Nifty and Sensex ended the month well above the psychological mark of 4000 and 14,000 respectively, with the Nifty appreciating by 2.9% and Sensex by 2.2%.

Emerging markets saw a mixed trend; developed markets managed to stay in positive territory, supported by better than expected US GDP growth numbers

- Indian markets started the month on a lacklustre note, with the Nifty shedding nearly 3% in the first seven trading sessions of the month. An ordinance passed by the Union Cabinet, granting RBI autonomy to lower the SLR (currently at 25%), as per the prevailing liquidity conditions, buoyed the overall market, with the Nifty rising by 2.4%. The market moved sideways thereafter, until it spurted on expiry day with Nifty gaining 1.4%. Nifty ended the month with a gain of 2.9% over the previous month.
- The Bank of Japan's decision, to keep the key rate unchanged at 0.25%, was well-received by the Japan stock market with Nikkei appreciating by ~1%. US Q4 GDP growth came in at a better than expected 3.5%. This enthused equity markets worldwide. The tech heavy NASDAQ managed to close in the green (up 2%), after being under pressure in the start of the month on the back of disappointing results by Motorola. European markets managed to close in positive territory. CAC40 rose 1.2%.
- Emerging markets were a mixed bag, after the good all round show during December. Malaysia leads the pack with the KLCI Index surging by 8.5%. Singapore was the other performer of note, with the STI gaining 4.7%.
- The Bovespa and TAIEX were flat compared with the previous month. Kospi was the worst performer among the markets, ending the month with -5.2% returns. Thailand's stock markets are still in the red, with the SET down by 3.8%.



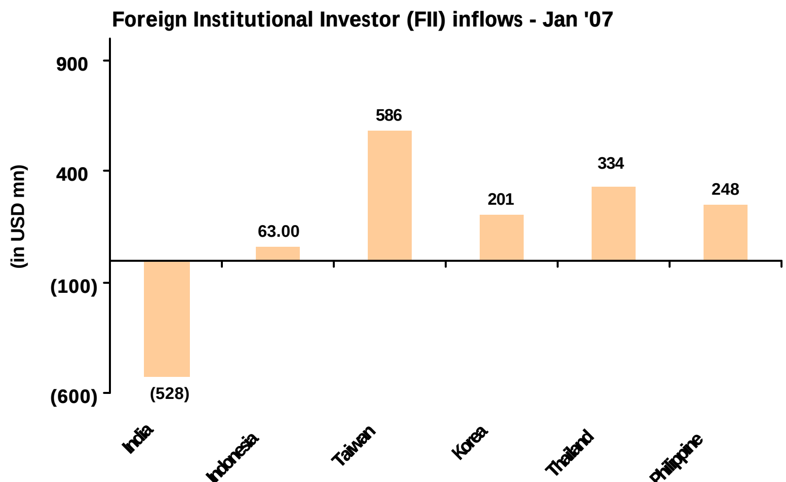
Source: Bloomberg

Global FII flows

FIIs stand net seller for the second month consecutively. Indian markets witness an outflow of USD 528 mn in January 2007. Taiwan maintained its preferred status, garnering positive FIIs flows for the sixth successive month.

Emerging markets, except India, see FII inflows across the board

- FIIs stood net sellers for the second month consecutively to the tune of USD 528 mn (cumulative flows Cash + F&O till January 25, 2007). FII pumped in USD 783 mn in the first two trading sessions, followed by strong selling in the cash segment (nearly USD 1 bn), which came in the next four trading sessions. Marginal buying was witnessed towards the latter part of the month, resulting in the FII Flows in F&O and Cash to USD 528mn.
- Other emerging markets managed to draw FII inflows. Taiwan retained its status, drawing inflows of USD 586 mn. It drew FII flows to the tune of USD 334 mn, with the dust seemingly settling over the turmoil witnessed during the previous month.



Source:Bloomberg

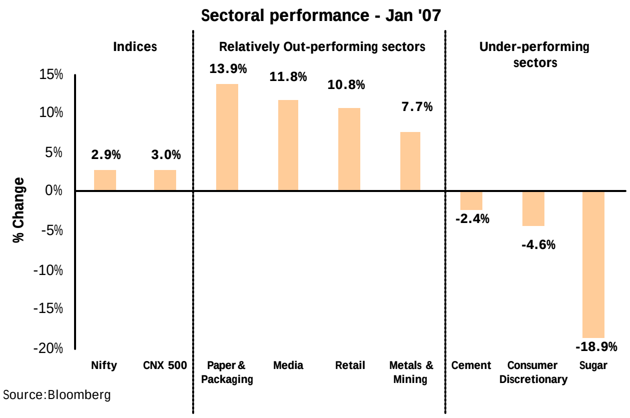
Note : FII Data for India is update till 25th Jan '07

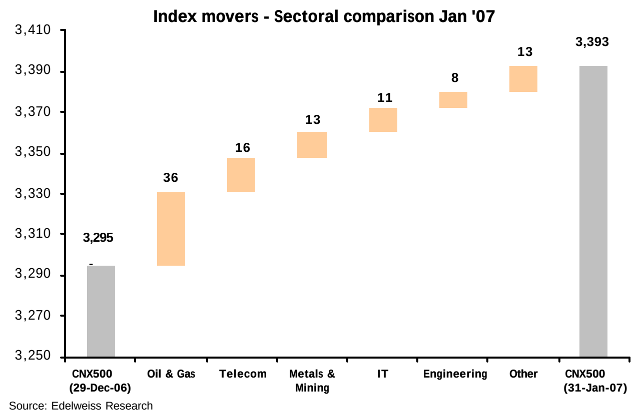
On the domestic front

Strong corporate results boost Indian markets to a new high

Markets spurted towards the latter part of the month. Oil and Gas stocks ruled the roost. FMCG stocks continue to languish.

- Markets consolidated on the previous month's gains. The earnings announcements were largely in line with expectations.
- Oil and Gas stocks hogged the limelight in the backdrop of lower crude prices and the receipt of oil bonds from the government. HPCL (up 12.1%) and IOC (up 10%) were at the vanguard. Consumer durables caught investor fancy with Videocon rising by a whopping 21.6%.
- The FMCG sector continues to underperform. There seems to be no respite on the margin front at this moment. Sector heavy weights such as Colgate (down 10%), HLL (down 3.8%), led the decline.. Within the broader FMCG space, certain stocks such as Gillette (up 8%) and United Spirits (up 5.5%) gained smartly.

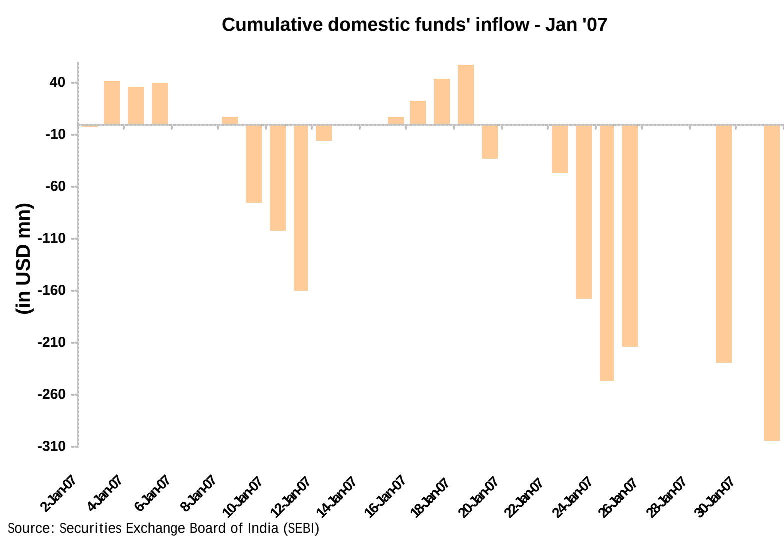




Domestic funds begin the year on a negative note

Selling towards the latter part of the month led to net sell of USD 303 mn by the domestic funds.

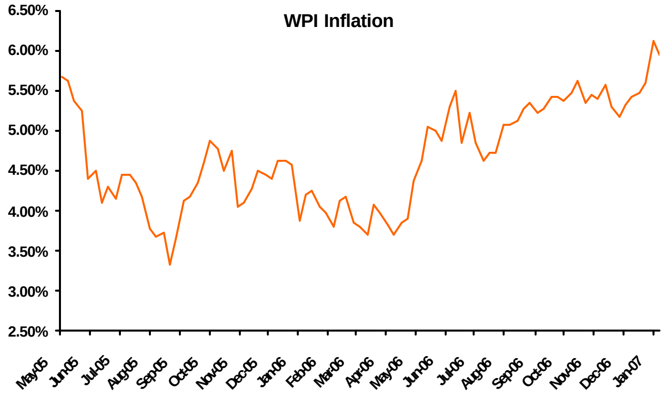
- After witnessing strong inflows for five consecutive months, domestic funds took a break with the total outflow of USD 303 mn in January 2007.
- The funds started the month on a slightly positive note and continued with a very subdued participation. Good amount of selling in the later part ended the month with a net sell of USD 303 mn.



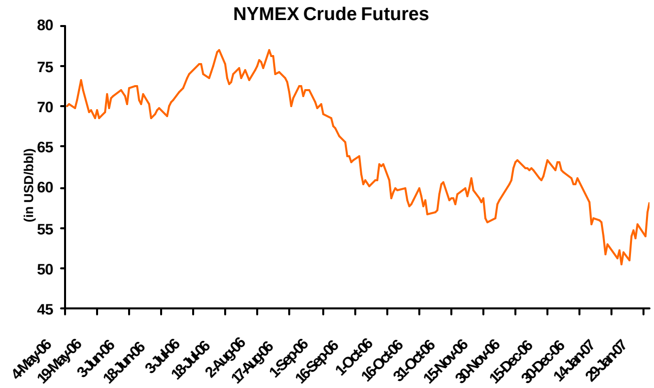
Till Dec '06	Domestic Flows (fig in USD Mn)
CY-00	(135.40)
CY-01	(1,050.00)
CY-02	(630.70)
CY-03	179.30
CY-04	(203.90)
CY-05	2,998.20
CY-06	3,555.90
CY-07	(303.20)

Macro environment -India

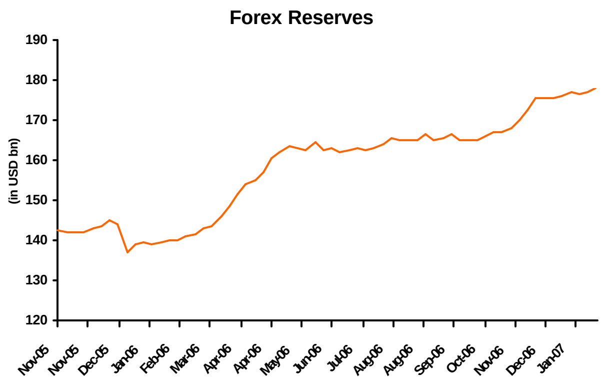
Inflation breaches the 6% mark.



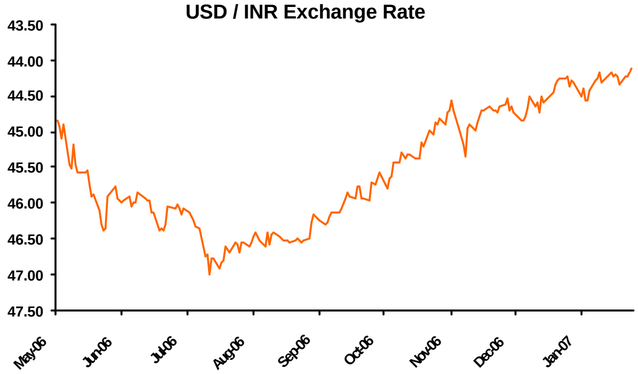
Crude bounces back to 58$/Barrel, on faster than expected draw down of heating oil inventories



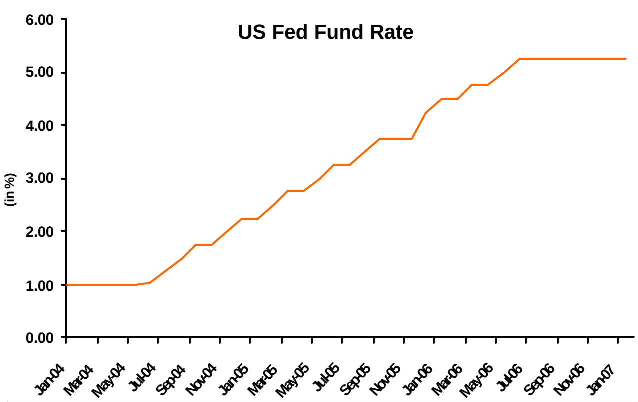
Steady accretion to reserves continues, currently at USD 178



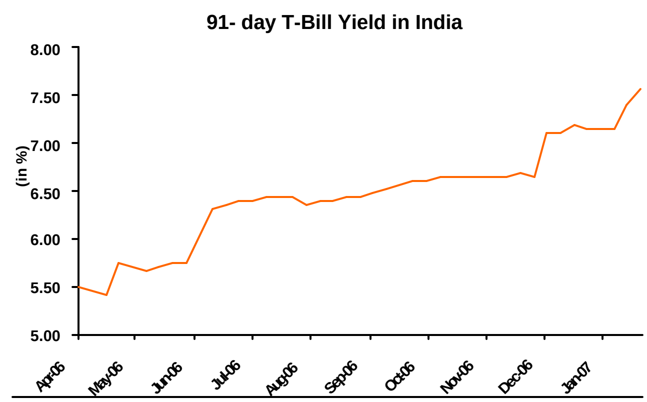
Rupee rules firm; ends the month at levels of 44.11



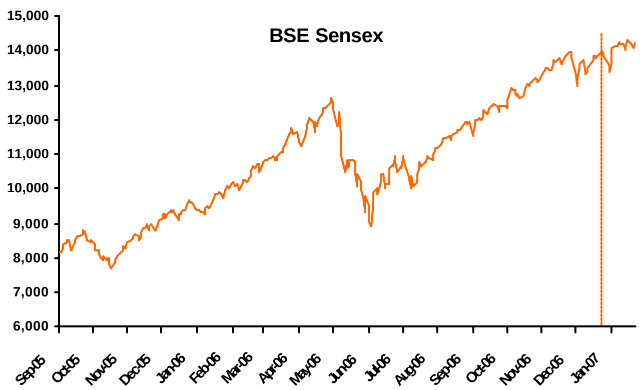
FOMC decides to keep the Fed rate unchanged at 5.25%.



Indian short-term yields inch up, as RBI raises repo rate to 7.5%



Sensex ends the month at 14,090, gaining 2.3% over December.



Nickel surges ahead on concerns of supply disruptions, Copper Corrects on rising LME inventories

Commodities		Price	1Mth Chg	3Mth Chg	1 Year Chg
STEEL	USD/ton	520	0.0%	-6.3%	-1.0%
TIN	USD/ton	12,000	4.3%	17.1%	52.8%
ZINC	USD/ton	3,480	-17.7%	-17.5%	50.9%
COPPER	USD/ton	5,735	-9.4%	-22.3%	18.5%
ALUMINIUM	USD/ton	2,230	-5.1%	-2.4%	0.5%
NICKEL	USD/ton	37,000	11.0%	18.0%	143.0%
LEAD	USD/ton	1,679	0.8%	3.8%	27.0%
GOLD	USD/T.Oz.	656	3.0%	6.2%	15.2%
SILVER	USD/T.Oz.	13.63	5.6%	9.4%	39.6%

Source: Bloomberg

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Vikas Khemani – 2286 4206	Head, Institutional Equities

INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
Gautam Roy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
Vishal Goyal, CFA	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
Sumeet Budhraja	-	2286 4430	FMCG
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Hitesh Zaveri	-	2286 4424	Information Technology
Parul Inamdar	-	2286 4355	Information Technology
Priyank Singhal	-	2286 4302	Media, Retail
Prakash Kapadia	-	2286 4432	Mid Caps
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals
Manika Premsingh	-	4019 4847	Economist
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Shabnam Kapur	-	2286 4394
Amish Choksi	-	2286 4201
Balakumar V	-	(044) 4263 8283
Monil Bhala	-	2286 4363
Ashish Agrawal	-	2286 4301
Nikhil Garg	-	2286 4282
Swati Khemani	-	2286 4266
Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
Anubhav Kanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Ravi Pilani	-	4009 4533
Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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INDIA RESEARCH			SECTOR	INSTITUTIONAL SALES		
Shriram Iyer	-	2286 4256	Head – Research	Nischal Maheshwari	-	2286 4205
Gautam Roy	-	2286 4305	Airlines, Textile	Rajesh Makharia	-	2286 4202
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components	Shabnam Kapur	-	2286 4394
Vishal Goyal, CFA	-	2286 4370	Banking & Finance	Amish Choksi	-	2286 4201
Revathi Myneni	-	2286 4413	Cement	Balakumar V	-	(044) 4263 8283
Sumeet Budhraja	-	2286 4430	FMCG	Monil Bhala	-	2286 4363
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps	Ashish Agrawal	-	2286 4301
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom	Nikhil Garg	-	2286 4282
Hitesh Zaveri	-	2286 4424	Information Technology	Swati Khemani	-	2286 4266
Parul Inamdar	-	2286 4355	Information Technology	Neha Shahra	-	2286 4276
Priyank Singhal	-	2286 4302	Media, Retail	Priya Ramchandran	-	2286 4389
Prakash Kapadia	-	2286 4432	Mid Caps	Anubhav Kanodia	-	2286 4361
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan	-	2286 4439
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani	-	2286 4419
Manika Premsingh	-	4019 4847	Economist	Nirmal Ajmera	-	2286 4258
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