



ENAM

Sensex: 11,822

India Strategy

What to Retain as the market cracks

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Investment Summary

- **Markets crack at last, on commodity price fall, fears of liquidity contraction, oil prices**
 - Sensex has fallen ~800 points in the last 3 trading days
 - Market risk not yet in earnings growth, but in Volatility due to externalities
- **Domestic economic trajectory & Liquidity remain strong despite:**
 - Outcome of recent State polls
 - Oil prices & interest rate hikes
 - Sensex valuations at 18x FY07EPS of Rs 669
- **Trend-Reversal unlikely due to continuing relative attractiveness of Equities vs other fin assets, & equity allocation to EMs/ India. However, markets expected to remain volatile**
- **Recommend retaining undervalued large-caps.**
- **Top Absolute Buys*: ONGC, Rel Comm, Suzlon Energy, Tata Steel, Sterlite Ind., Hindalco, Grasim, PNB, MTNL, BEL, Bank of Baroda, I-flex, Sesa Goa, Pantaloon, Tata Tea**
- **Top Absolute Sells*: BHEL, HDFC Bank, Cipla, Ranbaxy, ACC, Dr Reddy's, Rel Capital, Tata Power, Zee, HPCL, Glaxo Pharma, UltraTech Cement**

** Only stocks above \$ 1 bn+ considered, in order of mkt cap.
RIL in Grey Period*

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The continuing Search for a black cat in a dark attic

Source of Funds

Global trade/ currency regimes

- **Managed currencies + CA surplus** (Japan, China, Middle East etc.) offsetting interest hike pressures
- **No proxy to USD as yet**

Wealth effect

- **Asset values** – esp US
- **Commodity prices** eg Middle East, Russia
- **GDP growth** in US, China, Russia offsetting lack of growth elsewhere in absolute terms



Alternate use of Funds

- **Physical Investment:** options still limited; flow to financial markets
- **Equity - TINA** – other asset classes also high priced, interest rate hike more deleterious in these
- **Emerging Markets** still a better class vs Dev. mkts

- Resurgence of Development in monarchies/ ex-state-run ecos?
- Interest rate cycle & asset bubble prick?
- Geo political risks in EMs ?



Liquidity reversal fears: China, US, Japan

⇒ Currencies:

- **Managed currencies:** A policy reversal could exacerbate interest rate uptrend. China unlikely to allow rapid Yuan revaluation risking deflation/ de-growth *a la* Japan in the 90s
- **Alternate reserve currency:** Anemic Euro growth, deflationary Yen-land, over-heated Yuan = unlikely successors

⇒ Interest rates:

- With the **Fed nearing the end of its tightening cycle** ... will other central banks follow suit?
- **Project economics:** Much EM Capex not extravagant, unlike in earlier decades. **Interest rate hikes not likely to be substantial enough to jeopardize physical investments in EMs**, even in China. **Non-addressal of financial sector reforms in China remains the key issue** v/s interest rate effect
- **Alternative investments:** Bonds unlikely to become the preferred investment class in a rising interest rate scenario. However, **interest rate hikes could prick Liquidity supply (wealth effect) of asset bubble**

⇒ Resurgence of Physical Development:

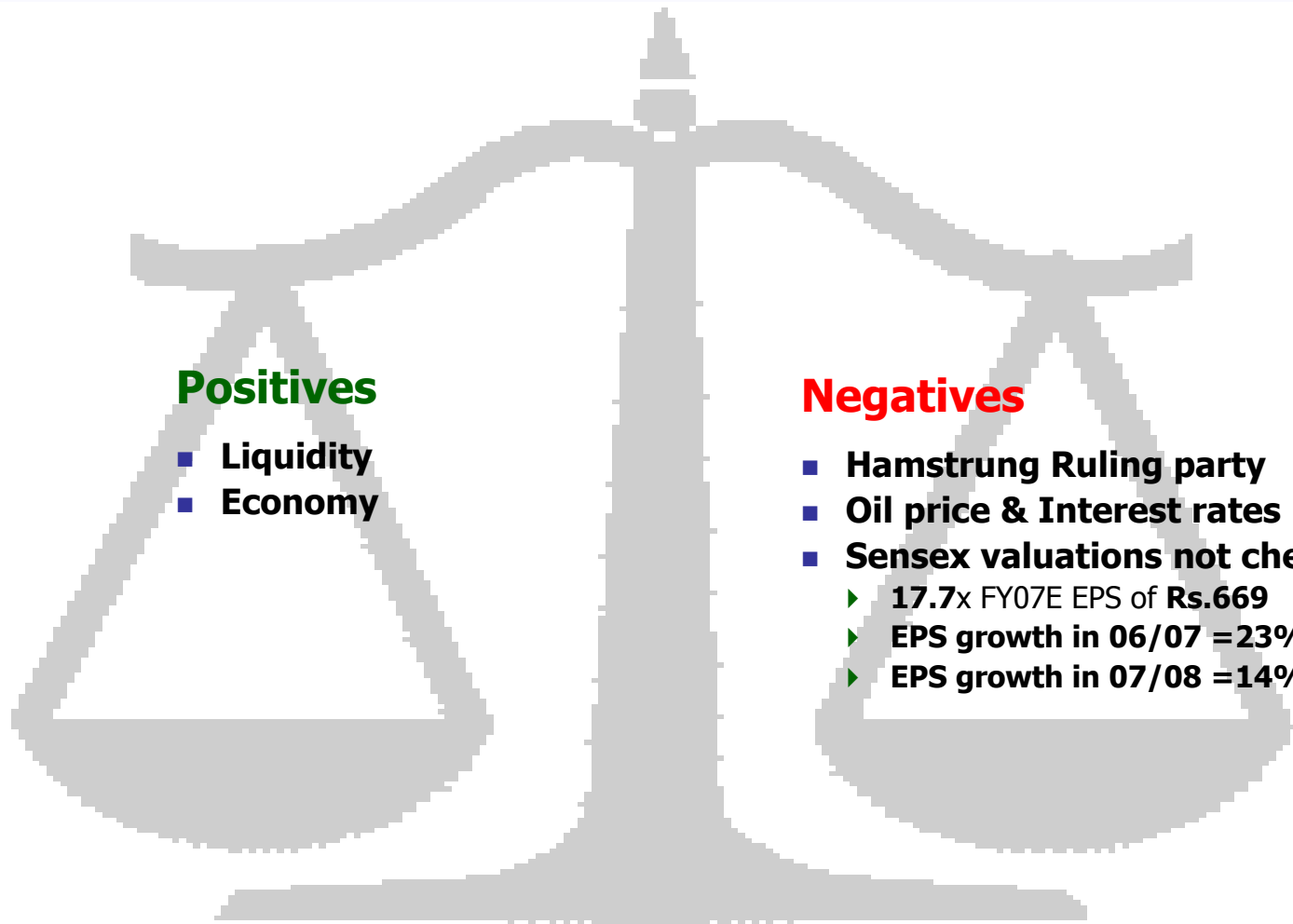
- While monarchies and ex-State economies are supposedly sucking in liquidity flows into physical development, aggregate amounts likely to remain small till geo-political clime becomes more conducive

⇒ Geo political risks to EM Equity investing:

- Iran, Iraq remain at epicenter of oil and political worries. The liquidity bowl could contract
- But relative attractiveness of equities to bonds doesn't yet change – as these are cataclysmic events, not fore-runners to a depression, which would raise the premium for bonds over equities

EMs vulnerable to Liquidity Contraction; depends on inscrutable China's measures ultimately pricking asset bubble

Domestic imperatives



Positives....

⇒ Liquidity:

- **Domestic:** Draw out of domestic *altricial* investors:
 - ▶ Under-penetrated
 - ▶ No alternative inflation-hedges
 - ▶ Excellent capital gains tax regime (long term=0, short term= 10%)
- **Paper Supply:** Post state elections, go-slow on PSU divestment program (~USD 8-10bn), may partially alleviate risk of paper supply
- **Overseas:** India is ONE haven which could even benefit in global slowdowns:
 - ▶ 2/3rd of GDP is consumption led, unlike all other EMs
 - ▶ **Least dependent on global trade.** And (net) exports are NOT consumer products or commodities – India's Services and Project exports are lower end, whose volume growth offsets rate cuts during slowdowns

⇒ Economy:

- **GDP:** Services led economy, favourable demographics, globally competitive Corporate sector
- **Consumption & wealth effect: New geographies (non- metros)** likely to add to Services-led Consumption growth: Confluence of penetration of transportation, telecom, electrification, rural lending, property development plans

Economic trajectory and liquidity remain favourable

Post-polls, can the govt push reforms?

- **State polls this month: Left's thumping majority decelerating policy momentum?**
 - **Broad thrust to remain**, specific areas could be impacted
 - However, **breakthru reforms ruled out**, eg infrastructure, agriculture, labour. Expected Pension & insurance sector reforms may have increasing hurdles
 - A critical factor is: **which CPI (M) boss calls the shots** – Prakash **Karat**, the hardliner or the pragmatic **Buddhadeb** Bhattacharjee ?
 - The Govt can use statutes and move through executive orders and **obviate parliamentary approval** eg in lifting FII/ FDI limits
- **Policy liberalisation** may still get a nod (with caveats) in:
 - **Retail** (trading sub-sector)
 - **Pension sector**: Regulator to be set up
- ...and some may not, eg **PSU divestment**

Risk is loss of political momentum and not backtracking on reforms

Oil Prices: Will the govt bell the cat?

➤ The govt's dilemma:

- Indian basket of crude oil at ~USD70/ bbl: Total under-recoveries : ~USD18-20bn

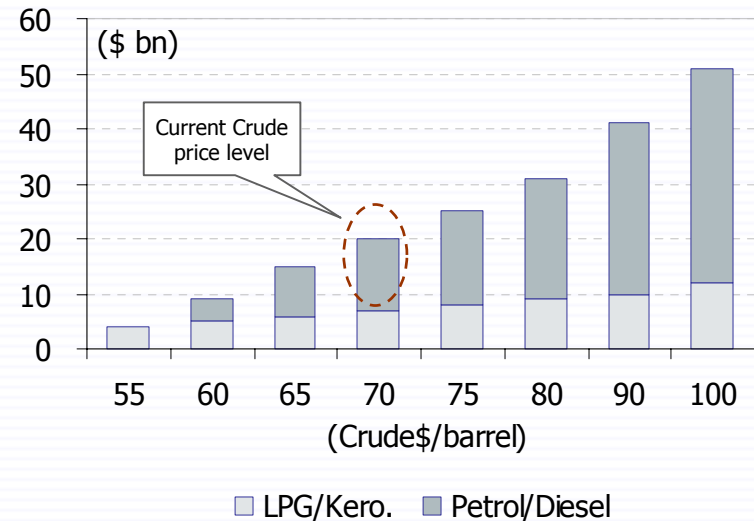
➤ The likely move: Consumers unlikely to share higher burden post-polls

- A combination of: (Subsidy from upstream + price hike+ issuance of oil bonds and duty cuts)
- A hike in Retail prices i.e Diesel & Petrol by Rs.2-4/ ltr, Rs.2/ ltr in kerosene and Rs.50 on LPG: could fetch ~\$3.7-4.7bn
- Subsidy from upstream cos ~\$5.4bn
- Issuance of oil bonds, duty cuts ~\$6.1bn

➤ Diesel and petrol prices owe ~40 and 50% respectively to taxes. However, over half the taxes fall under state purview

- **Excise + SED:** Rs.13/ltr on petrol, Rs.5/ltr on diesel: Can be tinkered to soften the retail blow
- **Sales tax:** Wt.avg rate: 26.7% for Petrol and 21% for Diesel – Can be reduced to a uniform rate
- **Oil cess** could be unwound to lower the burden

Size of the oil deficit at various crude prices



- The price hike will have a direct+indirect impact of ~40-50bps on inflation (keeping inflation well around RBI forecast of 5-5.5% for FY07)
- Fiscal impact likely to be ~30-40bps on the fiscal deficit
- Pressure on INR could be exacerbated/ offset by global inflows

Post-polls, Oil sector & Govt will have to bear a larger burden yet again, like in FY 06 (Oil sector 63%, Govt 25% and Consumers 12%)

Recommendation

- **Markets nervously poised due to high F&O position, vertical climb of Sensex, fears of liquidity contraction, etc**
- **However, a Depression or a reversal of India-advantage unlikely**
- **Hence, recommend bias to liquid Large-caps:**

Sector	Top Absolute BUYs	Top Absolute SELLs
Banking	PNB, Bank of Baroda	HDFC Bank
Cement	Grasim	ACC, UltraTech Cement
Energy	-	Tata Power
Engineering	Suzlon Energy, BEL	BHEL
Financial Services	-	Rel. Capital
FMCG	Tata Tea	-
IT Services	i-flex	-
Media	-	Zee
Metals	Tata Steel, Sterlite, Hindalco, Sesa Goa	-
Petrochem	ONGC	HPCL
Pharmaceuticals	-	Cipla, Ranbaxy, DRL, Glaxo Pharma
Retail	Pantaloon	-
Telecom	RCVL, MTNL	-

Mkt cap > \$ 1bn summarised above. **RIL in Grey period**

Source: ENAM Research,

Top Absolute BUYS

Company	Sector	CMP (Rs.)	Mkt cap (US\$ m)	EPS (Rs.)			PE (x)			RoE (%)
				FY05	FY06E	FY07E	FY05	FY06E	FY07E	FY06E
ONGC	PETROCHEM	1,367	42,858	128	132	124	11	10	11	24
RCVL*	TELECOM	306	13,902	2	11	15	130	29	20	16
Suzlon Energy	ENGINEERING	1,228	7,760	25	46	58	48	27	21	40
Tata Steel	METALS	586	7,127	70	89	93	8	7	6	41
Sterlite Ind.	METALS	514	6,319	130	158	146	4	3	4	58
Hindalco	METALS	210	5,356	13	21	24	16	10	9	22
Grasim	CEMENT	2,126	4,285	113	148	180	19	14	12	22
PNB	BANKING	470	3,257	289	344	403	2	1	1	20
MTNL	TELECOM	193	2,667	13	13	14	15	15	14	7
BEL	ENGINEERING	1,313	2,310	73	89	104	18	15	13	32
Bank of Baroda	BANKING	255	2,040	206	225	253	1	1	1	14
I-flex	IT SERVICES	1,216	2,036	29	44	55	42	27	22	22
Sesa Goa	METALS	1,291	1,117	142	209	221	9	6	6	54
Pantaloon	RETAIL	1,801	1,064	27	48	79	66	38	23	20
Tata Tea	FMCG	824	1,019	57	64	71	14	13	12	18

**on going restructuring. O/s to increase from 1,233mn to 2,045mn
Source: Bloomberg, ENAM Research; Note: Prices are as on May 15, 2006*

Top Absolute SELLS

Company	Sector	CMP (Rs.)	Mkt cap (US\$ m)	EPS (Rs.)			PE (x)			RoE (%)
				FY05	FY06E	FY07E	FY05	FY06E	FY07E	FY06E
BHEL	ENGINEERING	2,255	12,133	64	87	101	35	26	22	28
HDFC Bank	BANKING	848	5,840	167	193	237	5	4	4	20
Cipla	PHARMACEUTICALS	266	4,540	8	9	11	34	29	25	27
Ranbaxy	PHARMACEUTICALS	480	3,935	6	13	21	78	37	23	20
ACC	CEMENT	862	3,532	34	42	49	25	21	17	26
Dr Reddy's	PHARMACEUTICALS	1,594	2,686	30	47	55	53	34	29	15
Rel Capital	FINANCIAL SERVICES	574	2,568	183	210	240	3	3	2	16
Tata Power	ENERGY	569	2,475	22	23	24	26	24	24	8
Zee	MEDIA	273	2,474	5	6	8	52	43	33	9
HPCL	PETROCHEM	331	2,467	6	15	26	54	22	13	5
Glaxo Pharma	PHARMACEUTICALS	1,307	2,433	37	44	50	36	30	26	35
UltraTech Cement	CEMENT	684	1,869	17	36	39	40	19	18	32

Source: Bloomberg, ENAM Research; Note: Prices are as on May 15, 2006

Enam covered stocks

Company Name	Price (Rs.)	Mkt. Cap (US\$ m)	ENAM estimates										Relative to sector			
			IBES EPS		EPS (Rs.)				P/E (x)			RoE (%)		Target PE	Target Price (Rs.)	Potential upside (%)
			CY06E/ FY07E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E	CY07E/ FY08E		Price (Rs.)	upside (%)	
AUTO																
Tata Motors	919	7,737	52	46	52	60	20	18	15	31	18	1,098	19	OP		
Bajaj Auto	3,039	6,761	136	112	131	155	27	23	20	25	21	3,280	8	N		
Maruti Udyog	883	5,608	48	38	45	49	23	19	18	22	17	843	(5)	UP		
Hero Honda	862	3,786	56	48	56	60	18	16	14	49	16	932	8	N		
M&M	668	3,549	41	27	31	37	25	22	18	27	20	723	8	N		
Mico	3,074	2,166	130	119	143	168	26	21	18	25	20	3,361	9	N		
Bharat Forge	409	1,998	17	13	17	22	32	24	19	57	20	438	7	NR		
TVS Motors	152	792	7	5	6	7	31	26	22	19	18	122	(20)	UP		
BANKING																
			Adj. BV (Rs.)				P/ABV (X)			Tgt. Adj. BV (Rs.)						
ICICI Bk	622	12,170	37	240	264	290	2.6	2.4	2.1	13.5	2.4	710	14	OP		
SBI	925	10,698	123	608	729	837	1.5	1.3	1.1	17.1	1.3	1,055	14	OP		
HDFC	1,358	7,449	58	179	211	249	7.6	6.4	5.4	30.2	5.8	1,436	6	N		
HDFC Bank	848	5,840	38	167	193	237	5.1	4.4	3.6	20.1	3.0	710	(16)	UP		
PNB	470	3,257	59	289	344	403	1.6	1.4	1.2	19.5	1.5	590	26	OP		
Canara Bank	253	2,284	37	155	183	217	1.6	1.4	1.2	20.0	1.2	270	7	N		
UTI Bank	346	2,121	21	96	111	130	3.6	3.1	2.7	19.3	2.5	325	(6)	UP		
Bank of Baroda	255	2,040	30	206	225	253	1.2	1.1	1.0	14.4	1.2	300	17	OP		
BoI	137	1,472	22	79	98	117	1.7	1.4	1.2	17.4	1.4	160	16	OP		
OBC	240	1,321	35	163	193	226	1.5	1.2	1.1	20.2	1.3	300	25	OP		
Corporation Bank	347	1,096	37	227	253	281	1.5	1.4	1.2	14.0	1.4	400	15	OP		
Centurion Bank	26	733	1	6	7	8	4.2	3.7	3.3	13.3	3.5	27	4	N		
Yes Bank	104	615	4	21	35	39	4.9	2.9	2.7	11.1	2.9	114	10	OP		
LIC Hsg.	208	388	25	126	141	159	1.7	1.5	1.3	15.0	1.4	228	10	OP		
CEMENT																
Grasim	2,126	4,285	135	113	148	180	19	14	12	22	15	2,705	27	OP		
ACC	862	3,532	43	34	42	49	25	21	17	26	12	603	(30)	UP		
Gujarat Ambuja	101	3,002	6	5	6	7	21	17	15	29	16	105	4	N		
UltraTech Cement	684	1,869	26	17	36	39	40	19	18	32	15	581	(15)	UP		
ENERGY																
NTPC	129	23,421	8	7	8	8	18	16	15	14	14	120	(7)	N		
Reliance Energy	586	2,603	34	34	31	31	17	19	19	9	21	650	11	OP		
Tata Power	569	2,475	25	22	23	24	26	24	24	8	20	490	(14)	UP		
GMDC	389	272	68	10	57	57	37	7	7	22	8	475	22	OP		
PTC India	70	230	3	3	4	5	27	18	13	22	14	75	8	N		

Enam covered stocks

Company Name	Price (Rs.)	Mkt. Cap (US\$ m)	ENAM estimates											Relative to sector (OP, UP, N, NR)		
			IBES EPS	EPS (Rs.)				P/E (x)			RoE (%)		Target PE		Target Price (Rs.)	Potential upside (%)
			CY06E/ FY07E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E			
ENGINEERING																
BHEL	2,255	12,133	89	64	87	101	35	26	22	28	20	2,000	(11)	UP		
L&T	2,710	8,212	94	63	91	131	43	30	21	26	23	3,000	11	OP		
Suzlon Energy	1,228	7,760	49	25	46	58	48	27	21	40	27	1,563	27	OP		
Siemens	5,696	4,222	151	175	238	291	33	24	20	44	21	6,200	9	N		
ABB	2,995	2,790	78	52	80	113	58	38	26	32	25	2,825	(6)	N		
BEL	1,313	2,310	100	73	89	104	18	15	13	32	16	1,700	29	OP		
Crompton	1,137	1,309	51	33	40	46	34	29	25	35	25	1,142	0	NR		
Kirloskar Bros	474	1,102	20	13	18	22	37	27	21	31	22	502	6	NR		
BEML	1,324	1,069	62	56	62	69	24	21	19	25	18	1,239	(6)	UP		
Cummins	215	936	11	9	10	12	25	21	18	25	19	220	2	N		
Thermax	328	860	12	9	14	18	35	24	18	30	20	355	8	NR		
Kirloskar Oil Engine	286	610	16	11	13	16	26	21	17	17	21	335	17	NR		
AIA Engineering	644	252	40	25	40	52	25	16	12	22	15	780	21	OP		
Kirloskar Pneumatics	414	117	9	9	23	31	48	18	13	53	15	471	14	NR		
FINANCIAL SERVICES																
Rel Capital	574	2,568	N.A.	183	210	240	3	3	2	16	2	520	(9)	NR		
Aditya Birla Nuvo	859	1,414	45	27	45	N.A.	32	19	N.A.	17	N.A.	992	15	OP		
FMCG																
HLL	264	12,797	7	6	7	9	43	36	31	71	33	280	6	N		
Nestle	1,264	2,680	40	32	40	48	39	32	26	138	28	1,359	7	N		
Dabur	153	1,924	5	4	5	6	36	31	26	61	29	170	11	OP		
Colgate-Palmolive	404	1,209	14	13	16	19	32	26	22	74	25	460	14	NR		
Tata Tea	824	1,019	58	57	64	71	14	13	12	18	15	1,050	27	OP		
Godrej Consumer	725	902	27	21	29	37	34	25	20	135	23	850	17	NR		
Titan Industries	721	704	26	19	25	30	37	29	24	39	24	710	(2)	NR		
Marico	504	643	22	21	22	27	24	23	19	40	23	620	23	NR		
IT SERVICES																
TCS	1,966	21,148	77	60	78	97	33	25	20	54	23	2,174	11	N		
Infosys	3,157	19,125	119	90	117	145	35	27	22	39	23	3,330	5	UP		
Wipro	536	16,789	19	14	18	23	38	29	23	29	25	570	6	N		
Satyam	750	5,353	37	32	38	44	23	20	17	26	20	885	18	OP		
HCL Tech	556	3,948	30	23	31	38	24	18	15	24	16	620	12	N		
I-flex	1,216	2,036	42	29	44	55	42	27	22	22	27	1,466	21	OP		

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				CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E					
MEDIA																
Zee	273	2,474	7	5	6	8	52	43	33	9	29	245	(10)	N		
Adlabs Films	334	264	12	7	10	25	48	34	14	11	18	450	35	OP		
Radio Mirchi	242	253	N.A.	5	7	N.A.	46	35	N.A.	11	N.A.	255	5	N		
METALS																
Hindustan Zinc	900	8,357	42	35	87	73	26	10	12	72	14	1,050	17	UP		
SAIL	85	7,673	13	11	16	16	8	5	5	41	6	101	20	UP		
Tata Steel	586	7,127	70	70	89	93	8	7	6	41	8	741	27	OP		
Sterlite Ind.	514	6,319	38	130	158	146	4	3	4	58	5	725	41	OP		
Hindalco	210	5,356	21	13	21	24	16	10	9	22	12	290	38	OP		
Nalco	286	4,056	30	24	35	30	12	8	10	34	12	355	24	UP		
Sesa Goa	1,291	1,117	188	142	209	221	9	6	6	54	7	1,637	27	OP		
OTHER COMMODITIES																
Balrampur Chini	175	957	10	8	11	13	21	16	13	35	16	210	20	N		
PAINTS																
Asian Paints	627	1,321	33	22	26	29	28	24	21	34	22	650	4	N		
Goodlass Nerolac	850	477	45	29	45	52	30	19	16	25	19	1,000	18	OP		
PETROCHEM																
ONGC	1,367	42,858	143	128	132	124	11	10	11	24	14	1,800	32	OP		
RIL	1,021	31,285	68	GP	GP	GP	GP	GP	GP	GP	GP	GP	GP	GP		
IOC	541	13,886	52	47	42	44	12	13	12	12	11	500	(8)	N		
Gail	271	5,038	27	27	27	26	10	10	11	19	12	313	15	N		
BPCL	419	2,762	43	16	27	31	26	16	14	9	13	400	(4)	UP		
HPCL	331	2,467	31	6	15	26	54	22	13	5	9	245	(26)	UP		
IPCL	254	1,385	29	35	35	31	7	7	8	20	9	275	8	N		
Petronet	57	933	3	3	5	5	22	12	11	32	12	60	6	UP		
Chennai Petro	252	825	41	36	48	46	7	5	5	21	8	350	39	OP		
Indraprastha Gas	141	432	9	7	9	10	19	16	15	26	18	175	25	OP		
Gujarat Gas	1,271	358	79	71	82	95	18	16	13	21	14	1,350	6	UP		

Enam covered stocks

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			IBES EPS		EPS (Rs.)				P/E (x)			RoE (%)	Target PE		Target Price (Rs.)	Potential upside (%)
			CY06E/ FY07E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY05/ FY06E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E	CY06E/ FY07E	CY07E/ FY08E			
PHARMACEUTICALS																
Cipla	266	4,540	9	8	9	11	34	29	25	27	22	232	(13)	N		
Ranbaxy	480	3,935	16	6	13	21	78	37	23	20	20	421	(12)	UP		
Sun Pharma	872	3,558	34	28	33	39	31	26	22	39	22	879	1	OP		
Dr Reddy's	1,594	2,686	44	30	47	55	53	34	29	15	22	1,206	(24)	UP		
Glaxo Pharma	1,307	2,433	43	37	44	50	36	30	26	35	21	1,078	(17)	UP		
Nicholas	229	1,053	10	6	8	11	39	30	22	15	20	212	(7)	N		
Biocon	464	1,020	23	17	22	27	27	21	17	22	18	494	7	N		
Glenmark	375	980	20	4	9	12	100	43	32	43	33	380	1	N		
RETAIL																
Pantaloon	1,801	1,064	44	27	48	79	66	38	23	20	29	2,300	28	OP		
Shoppers' Stop	641	485	15	8	11	14	80	56	45	13	42	600	(6)	N		
Trent	894	283	26	21	28	33	42	32	27	13	30	992	11	N		
TELECOM																
Bharti Tele-venture	403	16,795	24	12	17	22	34	24	18	29	20	447	11	N		
RCVL*	306	13,902	10	2	11	15	130	29	20	16	26	400	31	OP		
VSNL	431	2,700	19	13	16	18	32	27	23	7	27	500	16	N		
MTNL	193	2,667	9	13	13	14	15	15	14	7	19	260	35	OP		
TEXTILES																
Arvind Mills	91	417	7	5	5	7	17	19	13	7	12	85	(6)	UP		
Gokaldas Exports	650	246	49	34	46	58	19	14	11	21	13	750	15	OP		
TRANSPORTATION																
Container Corp	1,724	2,463	94	77	94	115	22	18	15	26	16	1,844	7	N		
Jet Airways	930	1,766	47	29	40	67	32	23	14	13	16	1,100	18	N		
Gateway Distriparks	243	493	10	8	13	15	32	19	17	18	19	270	11	NR		

Source: Company, ENAM Research

Note: ICICI Bank & HDFC valuations are not adjusted for value of investments

Note: Price as on May 15, 2006

*on going restructuring. O/s to increase from 1233mm to 2045mm

GP = Grey Period

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