

INVESTMENT MATTERS

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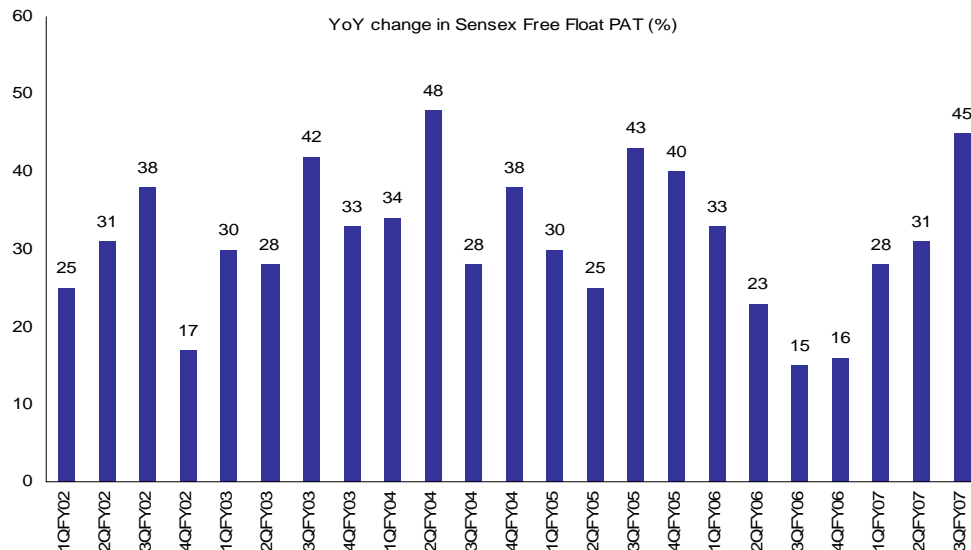
2007: A Good Start to the Earnings

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Investor sentiment, liquidity flows and fundamentals are the three most important drivers of stock market performance. Liquidity flows and investor sentiment impacts the short term market behavior whereas the fundamentals determine the long term market movement. Earnings growth is the most important constituent amongst various fundamental factors - and hence monitoring aggregate earnings performance is very important. The year 2007 has started on a very good note in this respect, with corporate earnings for Dec-06 quarter showing the highest year on year PAT growth for Sensex companies in the last 13 quarters. Revenues and PAT for Sensex (free-float) earnings ex-HLL are up 34% yoy and 45% yoy respectively (HLL results are not yet declared). These robust numbers signify that revenues have been growing despite a higher base and profit growth has outpaced revenue growth - a sign of continued productivity growth and sustained operating/financial leverage.

Fundamentally, this strong earnings growth performance should act as a strong base for sustaining valuations.



Source: CLSA

In sync, Alchemy portfolio companies have also performed exceptionally well on the earnings front during the same period. The YOY revenue and PAT growth of the Alchemy portfolio are 38% and 49% respectively. Needless to mention that the strong fundamental performance has enabled many of our mid-cap stocks to perform strongly post the earnings announcements.

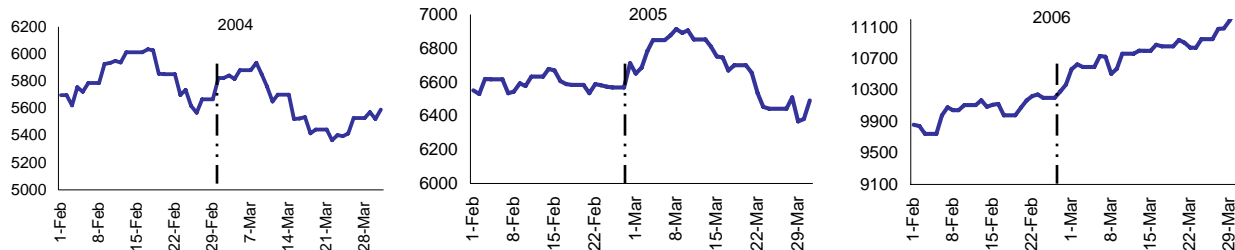
This brings us to the next pet topic - The Budget and what it would have in store for us.

Over the years, our fiscal and tax policies have matured and have started to follow a relatively consistent direction and form. This has therefore reduced if not completely eliminated the probability of any unanticipated surprise - rude or otherwise!

For instance, the Finance Minister has already announced the government's intention to divest its stake in PSU like BEML, Power Grid Corporation, REC and NHPC, restructuring of HOCL and reducing customs duty on certain products like cement. This clearly shows that there is an effort to portray the budget as a statement of the country's finances and priorities, a welcome shift from the earlier practice of using the budget as a big bang policy statement.

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Historically markets have been subdued post budget more often than not; however there is no discernible pattern to it (see charts below). Unwinding of Speculative build-up pre budget (in order to pre-empt certain budget announcements) and the seasonal squeeze in domestic liquidity due to fiscal year-end in March were the primary reasons for the fallout post budget. However with increasing participation of foreign capital in recent times the traditional post budget weakness may not necessarily play out.



The recent correction in the markets is driven in part by excessive ebullience in some IPOs, real estate stocks and high inflation numbers. The RBI has already hiked the CRR by 50bps to curb inflation and we expect the government to take steps like reduction in custom duties in the budget. The market correction which we are witnessing would flush out any excesses that may be present.

We, at Alchemy, would therefore not like to pre-empt any action in the short term based on any likely announcements in the upcoming budget. For us a better way to respond to the budget would be to first fully understand the ramifications of any broad policy nuances or specific policy announcements and then alter the portfolio if required.