

DECEMBER 2011 – NEWSLETTER

2ND JANUARY. 2012

Let Us Thank all the Good People like U, Who made '2011' so Beautiful 4 Us.
We Pray U be Blessed with Faithful Years Ahead.

Happy New Year
2012

Happy Investing

Monthly Newsletter

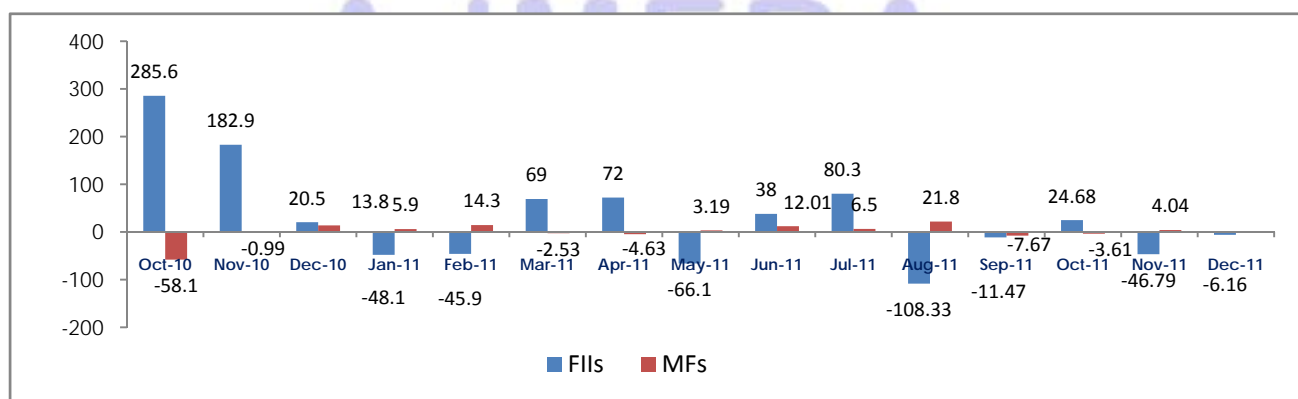
“Domestic bourses under pressure in CY11, 2012 expected to bring some cheer”

The domestic bourses were under tremendous pain owing to poor Industrial performance. It further deteriorated as reflected in the decline of the index of industrial production (IIP) by 5.1 per cent, y-o-y, in October 2011. This was mainly due to contraction in manufacturing and mining activities. The contraction was particularly sharp in capital goods with a y-o-y decline of 25.5 per cent, reinforcing the investment decline story emerging from the GDP numbers. Current concerns over the eurozone region has put rupee under tremendous pressure. Rupee has depreciated by 17% since August 2011. To arrest dollar appreciation, the central bank sold dollars and also took some measures to control excessive speculation in the currency markets. This resulted in Rupee climbing back above the 53 mark after depreciating below 54 per dollar. The RBI in its third quarter policy left the rates unchanged after 13 rate hikes spanning over 22 months taking its toll on GDP growth.

Globally, earlier during the month, at the EU summit on December 8-9, 2011, the European leaders agreed on a new fiscal policy. While the agreement is necessary for medium and long-term sustainability of the euro area, its ability to resolve short-term funding pressures was questioned by markets. Q3 euro area growth, at 0.8 per cent, was anaemic and 2012 growth is now expected to be weaker than earlier projected. Reflecting these projections, the European Central Bank (ECB) cut its policy rate twice in the last two months, and also implemented some non-standard measures. By contrast, growth in the US in Q3 of 2011 was better than in Q2, although still substantially below trend. US economy witnessed positive triggers which were reflected in US bourses performance. New U.S. single-family home sales rose to a seven-month high in November and the supply of houses on the market was the lowest in 5-1/2 years, giving hope for a recovery in the sector. In addition to this positive economic data and deal to extend the payroll-tax cut for two months added to the enthusiasm.

FII during the month “December – 2011” remained sellers and sold worth Rs. 6.16bn. On the other hand, Mutual Funds bought worth Rs. 5.5 bn.

Trend in FII and MF activity in equity (Rs. bn)



Source: SEBI, Money control website

Monthly indices

Index	30th Dec, 2011	30th Nov, 2011	% change
Dow Jones	12,217.56	12,045.68	1.43
FTSE	5,572.28	5,505.4	1.21
Hang Seng	18,434.39	18,914.63	(2.5)
Nikkei	8,455.35	8,607.1	(1.8)
Nifty	4,624.3	4,832.05	(4.3)
Sensex	15,450	16,123.46	(4.2)
BSE –Midcap	5,135.05	5,627.69	(8.8)
BSE-500	5,778.68	6,117	(5.5)

Source: Ajcon Research

Yearly returns in domestic bourses

Index	30th Dec, 2011	31st Dec, 2010	% change
Sensex	15,450	20,509	(23)
BSE –Midcap	5,135.05	7,802.7	(34)
BSE-500	5,778.68	7,961.06	(27)

Source: Ajcon Research

Yearly returns in global equities – Pathetic performance...

Index	Yearly returns (%)
US markets	
Dow Jones	5
Nasdaq	(3)
S&P 500	(1)
European markets	
CAC	(20)
DAX	(16)
FTSE	(8)
Asian markets	
Sensex	(23)
Nifty	(23)
Shanghai	(23)
Nikkei	(19)
Taiwan	(21)
Hang Seng	(21)
Strait Times	(17)
Kospi	(10)

Source: Ajcon Research

Key developments in 2011 that affected Indian Equities

- 1) **Arrests of key people in 2G scam:** 2G scam got exposed and saw arrests of former Union Telecom Minister A Raja, DMK Leader Kanimozhi and key officials of various companies like Swan Telecom and Reliance Communication. This brought some nervousness in the minds of investors.
- 2) **Union Budget 2012:** Rising Fiscal Deficit was the main area of concern which worried investors. The budget disappointed the street as there were populist measures like the Food Security Bill and damage control exercise in line with global mishaps.
- 3) **Rating agency "Standard & Poor's downgrading US sovereign debt:** For the first time, the rating agency downgraded to AA+ from AAA credit rating. The rationale of the rating agency was US government's fiscal consolidation plan was not sufficient to stabilize the debt.
- 4) **Reserve Bank of India using its antibiotic to control inflation:** Rising food prices of essential commodities were the headlines of the year. To arrest this problem, RBI hiked rates by 300 basis points in phased manner. However, the situation still remains bleak affecting market sentiments.
- 5) **Eurozone debt crisis adding to woes:** After US, it was time for Eurozone to be in limelight for all the wrong reason. Initially, problem started with Greece in terms of it defaulting on account of its high debt. Gradually, the situation started worsening with other members of Eurozone like Italy, Ireland, Portugal and Spain coming in headlines for the same reason.
- 6) **Introduction of Mining Bill and mining scam:** Sell off in the metal stocks was triggered as this Bill made it mandatory for the companies to share a portion of the profits with the local population. Later, mining scams in Karnataka and Goa hurted the sentiments which resulted in steep fall of the few metal companies.
- 7) **Strike at Maruti's Plant:** The Company suffered on production numbers owing to strike by agitated employees. It started in June 2011 when set of some workers called an illegal strike to demand the formation of a separate union for the Manesar plant employees. This event resulted in significant turnover loss for the company and thereby affecting its market share.
- 8) **Savings rate deregulation:** Diwali of 2011 would always be remembered in the Indian economy as a special gift was given by RBI by freeing up interest rates for savings deposits across the country. With this move, Indian Banks can individually set rates according to the market situation.
- 9) **Crude oil, the main culprit for rising inflation:** Rising crude oil prices forced the Oil Marketing companies to hike the fuel costs to reduce the under recoveries to some extent which resulted into high fuel price inflation. During the year OMCs hiked the fuel prices by Rs. 20 in total (in phased manner). Presently, petrol deregulation continues to be a sour topic between UPA allies the Congress Party and Mamata Banerjee's led Trinamool congress.
- 10) **Gold witnessing new high:** With the underperformance of equities, investors turned to safe haven. It is regarded as the best asset class in times of rising inflation and devaluing currencies. This resulted in gold touching an all time high of Rs. 29,433, per 10 gms providing annual returns of over 40%.
- 11) **Poor industrial performance:** Series of continuous hike in interest rates affected the Index of Industrial Production (IIP). Capital goods sector saw the major decline. October 2011 IIP number was the worst as it declined by 5%. It is the first decline in more than two years.

- 12) **Rupee Depreciation – Poison pill for raw material importing companies:** The Indian Rupee created a history by setting up a new record of touching Rs. 54.2 as against the dollar. This was mainly on account of investors switching to dollar. The depreciated rupee would now result in increased forex losses and depressed Operating profit margin.
- 13) **Pledge shares – “Emerging negative mantra”:** Liquidity crisis and companies in debt trap prompted the promoters’ top pledge their shares with Non Banking Financial Companies to meet their working capital requirements. Global woes resulted in weakening of share prices of the mid cap companies. As a result NBFCs demanded for providing additional collateral. In the event of failure, many lenders were forced to sell the shares leading to crash in prices. This led to massive value destruction.
- 14) **Nightmare for the aviation sector:** In addition to rising oil prices, huge debt position and competitive pricing put pressure on liquor Baron Mr. Vijay Mallya’s Kingfisher Airlines affecting its performance significantly and turning investors risk averse towards the aviation sector.

Ajcon’s view

The Indian equity markets have ended the year in red. 2011 was the second worst year in the last fourteen years for Indian markets. The BSE Sensex once again emerged as the biggest loser in Asia as most of the other Asian markets, including the Chinese, Japanese and Hong Kong markets ended in green. The Rajya Sabha fiasco over the Lokpal Bill had a negative overhang on market sentiments. The BSE Sensex lost more than 24 per cent in 2011, making it one of the worst performers in the world. It is a year that the markets will like to put behind and start the New Year afresh.

At the current level, the Sensex trades at a PE of 14x FY12E earnings estimate and 12x FY13E earnings estimate by the street. With due consideration to interest rate cycle close to peaking out, we believe that rate sensitive cyclicals will stand to benefit. Accordingly, we recommend to increasing exposure in leading PSU and Private sector banks. We recommend investors with 9-12 months horizon to adopt stock specific strategy for investment. In our view, investors can consider investing in companies like Reliance Industries, Larsen and Toubro, BHEL, ICICI Bank, Engineers India, Opto Circuits, Coal India, Bajaj Finserv, State Bank of India, Persistent Systems, Apollo Hospitals, Fortis Healthcare, Dr. Reddy’s, IPCA Labs, Eros International Media, IDFC and Power Finance Corporation (PFC).

In this newsletter, we have touched upon ABC Shipyard Ltd. Please find a brief study attached below:

ABG Shipyard Ltd.

2nd January, 2011

NSE/BSE Code	/532682
Promoter's holding (%)	61.67%
FV	Rs. 10
Equity Capital (Rs in mn)	509.2
Market Capitalization (Rs in bn)	19.8
52 week high/low	Rs. 434.4 (4 th January, 2011)/Rs. 311.35(11 th February, 2011)
CMP	389
Target Price	Not rated

ABG Shipyard incorporated at Surat in 1985 is the largest private sector ship building company in India. It was initially promoted by a technocrat passed out from prestigious IIT Kharagpur in 1955. Owing to knowledge only on the technical front, the management of the company was taken over by Mr. Rishi Agarwal in 1990. The company has state of the art infrastructure in place at Dahej and Surat yards. It is fully equipped to build and repair all kinds of ships, rigs and offshore structures/platforms for its wide range of customers and defense sector. The company since its inception has delivered 148 vessels and in FY11 the company has successfully delivered 16 vessels. In H1FY12, the company has delivered seven ships in H1FY12 and is expected to deliver 10-11 ships in H2FY12. As on 30th September, 2011, the company's order book stood at Rs. 149 bn while the unexecuted orders were ~Rs. 100 bn which is 4.9x FY11 revenues indicating good revenue visibility

Recently, the company has bagged the first of its kind order from Indian Navy for the construction of two Cadet Training Ships and a prestigious order for the construction of two Jack-up rigs from Drilling & Offshore Pte Ltd., Singapore. In addition, the company has received another milestone with the delivery of a 32,000 DWT, Double Hull, Bulk Carrier, first to be built in India with CSR and PSPC Compliances, to Precious Shipping Public Co.Ltd., Thailand.

FINANCIAL SUMMARY (RS MN)

Particulars	FY10	FY11	FY12E
Net sales	18,124	21,338	23,899
Growth (%)		17.7	12
Operating Profit	5,017	5,044	5,523
OPM (%)	27.7	23.6	23.1
PAT	2,181	2,041	1,920
PAT (%)	12.0	9.6	8.0
Outstanding shares (mn)	50.9	50.9	50.9
EPS	42.8	40.1	37.7
P/E(x)	9	9	10
P/BV(x)	1.8	1.5	1.3
EV/EBITDA	9.7	7.6	5.2
ROE (%)	19.6	15.8	13.0
Debt/Equity	2.6	2.0	1.4

Source: Company, Ajcon Research

INDUSTRY OVERVIEW

The shipbuilding industry is cyclical in nature. The current downturn poses a challenge to the industry. However, it does not compare to previous downturns that took place in the late 1970's and 1980's. Globally, after turbulence in 2009, shipyards have scripted an exciting recovery in 2010 when new orders are touching ~60mnGT and fundamentals have improved significantly. The prices of ships are determined at global level. The largest shipyard owners are present in countries like Japan, Korea and China. Globally, ABG has distinguished advantage of providing customization service. This advantage is on account of cheap labour and global shipyard companies unable to service smaller ship orders as they standardized systems and process suited for higher tonnage ships.

The global financial meltdown has dealt a severe blow to the global shipbuilding industry and many China shipbuilders 'clients had to postpone deliveries due to stringent cash flows or shrinking demand. A total of 70 mn deadweight tonnage (DWT) of ships were scheduled for delivery in 2010, but only 56.76 million DWT were actually delivered by Chinese shipbuilders by the end of November which accounted for 72.8 percent of the total orders. China has surpassed the Republic of Korea to become the world's largest shipbuilder by volume of contracts.

In Dry Bulk segment, the demand for two commodities – coal and iron ore will drive the dry bulk industry in the near future.

INVESTMENT RATIONALE

Opportunity presented by the sector to Indian Shipbuilders: India owing to its long coastline of about 7,517 km, coupled with 190 major and non – major ports. Indian Government has recognized the need to promote the quality of the shipping and ocean resources, ports, harbours and the new technologies to be developed in this emerging scenario as approximately 90 percent of the country's trade by volume and 70% by value is moved through maritime transport.

Over the years, cargo handled at Indian ports quadrupled from 180 million tones in 1993-94 to 850 mn tones in 2009-10, while the growth in Indian tonnage has been slow compared to burgeoning merchandise trade volumes. The Indian shipbuilding industry, which had only about 0.1% share of the world shipbuilding in 2002, expanded over 10 fold to claim 1% share by 2008.

Presently, Indian ship building industry is in its nascent stage and is dependent on government support for subsidy. The industry is expected to become self sufficient in about 10 years time. The previous subsidy scheme had expired on 14th August 2007 and the industry has made a representation for the extension of the same which is under the consideration of the Government. Although India has not become a significant The Indian shipbuilding industry is on a high growth trajectory and is expected to grow at a CAGR of 30%.

Opportunity for shipbuilders...

40% of Indian ships will need to be replaced over the next five years owing to more than 20 years of age and mandatory IMO regulations for phasing out single hull tankers. At present, domestic shipping companies rely heavily on foreign yards for acquisition or repairs. The current capacity of all shipbuilding yards in India is approximately 5,00,000 DWT.

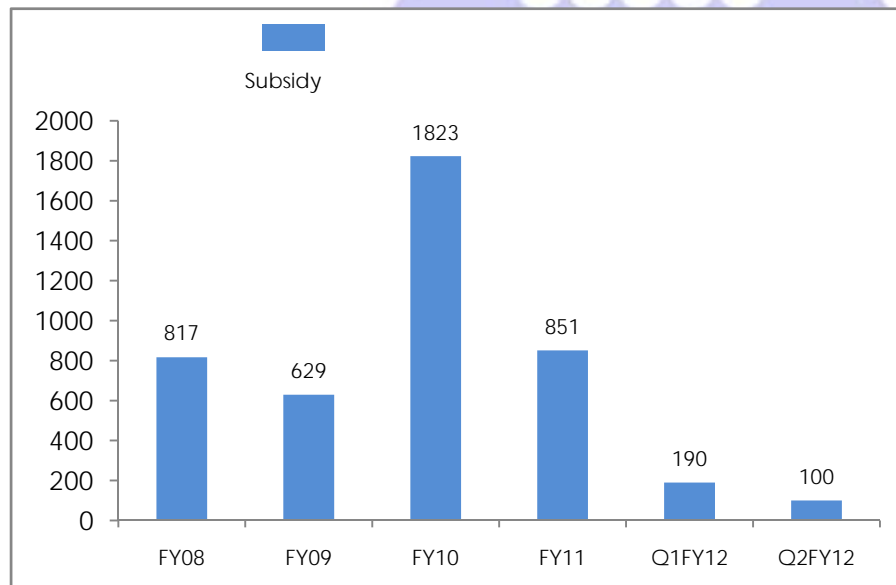
The Ministry of Shipping had envisaged, under the National Maritime Development Programme (NMDP), to set up two international size shipyards, one on the west coast and the other on the east coast. Recently, it has been decided by the Ministry that since the private sector has come up with setting up of two international size shipyards one on the east coast and another on the west coast, the Government may not pursue the matter regarding setting up of two international size shipyards and may act only as a facilitator.

The National Manufacturing Competitive Council (NMCC) has emphasized the need for a shipbuilding policy to enable Indian shipyards to compete effectively on both domestic and export markets to help build a strong shipbuilding sector in the country. Towards this direction, NMCC has recommended that the shipbuilding industry in India needs to be granted Infrastructure status and be declared as a strategic sector. In order to achieve the coveted goal of transforming Indian ports into world class facilities. In order to achieve this, the Government of India has formulated Maritime Agenda 2010-20, with a target, inter alia, of achieving a global shipbuilding market share of 5% by 2020 with strong R&D facilities and design capabilities for the commercial shipbuilding.

With the Government of India's decision to open the Defense sector contracts for private participation and given the size of defense sector contracts, a new area of opportunity with great potential to grow has been created for shipbuilding companies in private sector.

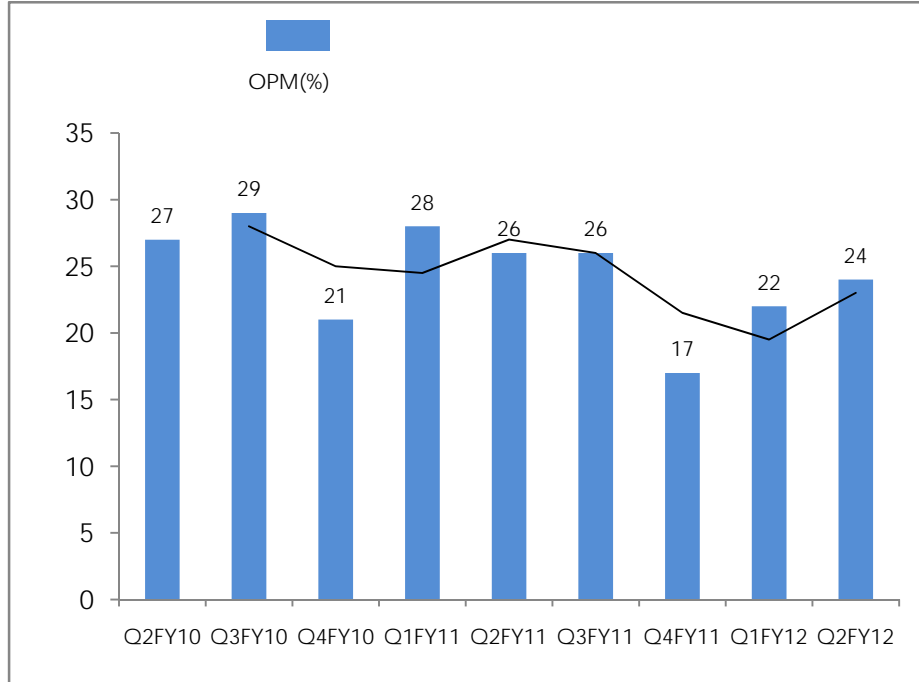
Financial performance:

Lower subsidy affecting OPM, lowest in H1FY12

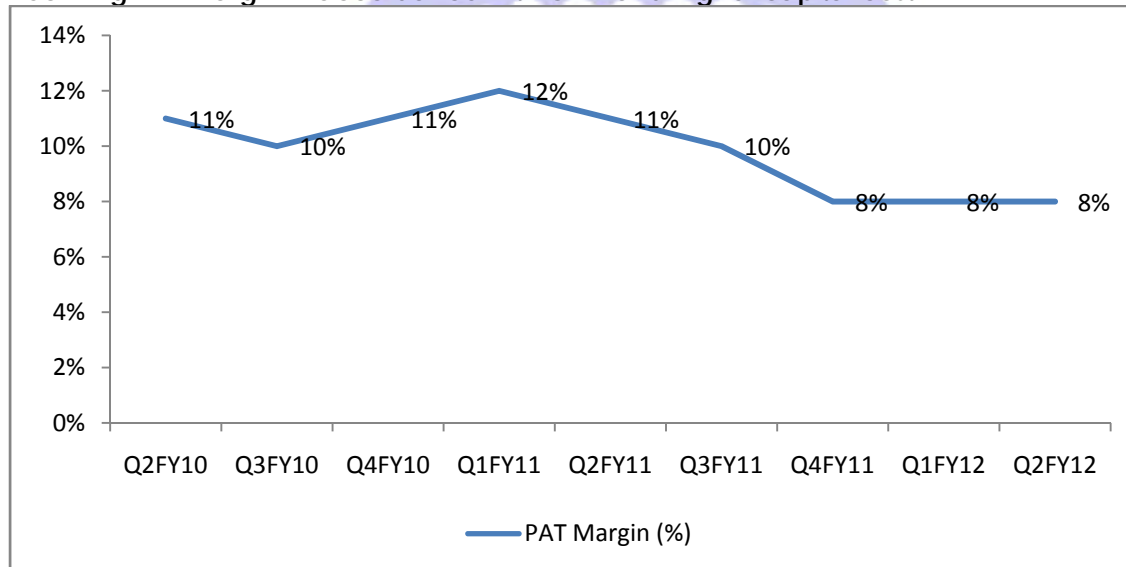


Source: Company, Ajcon Research

OPM declining on account of lower subsidy income



Declining PAT margin in accordance with OPM and higher capital cost



Robust order book

The company has a robust order book worth Rs. 150 bn which represents about 91 vessels. ABG's delivery rates for last three years have been very good. In FY11, the company delivered about

16 ships. In H1FY12, it has delivered seven ships and it expects to deliver another 10-11 ships before March, 2012. More than 50 percent of the orders are repeat orders. It is also catering to group company orders. It is building 12 clinker carriers for its own ABG cement plants. The company has received huge advances for the same. 15 percent of the total advances is accounted by group company orders which is used to meet the working capital requirements.

Subsidiary “Western India Shipyard (WIS)” witnessing strong performance:

WIS is engaged in ship and rig repairs which is a high margin business on account of its expertise developed in customized shipbuilding domain for Indian and global clients. It recorded strong performance both on the topline and PAT front. In H1FY12, its revenues increased by ~56% to Rs. 801 mn on yoy basis. However, EBITDA declined by 900 bps to 25.7%. The company currently has three rigs for repair and is converting one naval frigate into carrier training ship.

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