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BSE Sensex: Taking stock

High commodity prices, wage inflation and rising interest rates may slow down the Sensex rally

Niraj Bhatt & Amriteshwar Mathur / Mumbai December 30, 2006

After stunning returns for three years in a row at the stock markets, 2006 threw in another surprise with the Sensex gaining 46.7 per cent during the year.



Since the end of 2002, the Sensex has recorded a compounded growth of 42 per cent. So, are there chances of the markets being kind in the new year?

The key highlight of 2006 was the focused action on large caps, specifically those constituting the Sensex. The gains in the other indices such as the Nifty (up 39.83 per cent) or the BSE 100 (up 40.97 per cent) pale in comparison with the Sensex.

The BSE 500 was even lower at 38.85 per cent. If the previous years had a lot of activity in mid-cap stocks, this year, they became the poor cousins to large caps. The BSE

Mid-cap Index gained 31.13 per cent, while the BSE Small-cap was up 15.97 per cent.

It was again a year driven by global liquidity. Except for a brief hiccup between May and July, FIIs poured in Rs 35,638.73 crore into India. Though not as much as in the previous two years (Rs 38,413.20 crore in 2004 and Rs 47,603.90 crore in 2005), it was enough to keep the Sensex at the five-figure levels for most of the year.

High crude oil and commodity prices, weakening dollar, rising gold prices and fears of a high interest rate regime did have their impact on global equity markets, which resulted in the Sensex losing nearly 30 per cent within a month between mid-May and mid-June.

But strong corporate earnings and the resilient domestic economy helped the Sensex to regain the losses and reach newer heights.

For 2007, investors are unlikely to see returns like those in the past. The markets are likely to consolidate at the current levels. Though the industrial growth and the GDP growth rate are in a fine fettle, there are rumblings at the cost levels at the corporate level.

High commodity prices, wage inflation across industries, rising interest rates and the capex plans are all likely to dent margins for many companies.

If volume expansion takes care of earnings growth, then there won't be much of a problem. The Sensex trades at a trailing P/E of 25.2 and a forward P/E of 20.2, which is expensive, but most markets are trading high globally.

Plethico: Herbal push

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Plethico Pharmaceuticals benefited from improved demand conditions for its repertoire of herbal-based medications for treating lifestyle-related disorder such as diabetes and cholesterol in the year ended September 2006. However, the company had to grapple with higher operational costs.

As a result, the company has grown its consolidated operating profit by 50.7 per cent y-o-y to Rs 101.9 crore in the previous financial year, as compared with a 67.4 per cent growth in net sales to Rs 375.5 crore.

Its operating profit margin also declined by 270 basis points y-o-y to 27.2 per cent in the previous year. This pressure on margins was due to other expenditure jumping 175.4 per cent y-o-y to Rs 76.3 crore in the year ended September 2006.

Apart from strong demand in the domestic markets, Plethico exports to over 45 countries, including CIS countries, Africa and Latin America. The company had come out with its IPO at Rs 300 in April 2006.

On Friday, the stock closed at Rs 376 and strong investor interest for the mid-cap pharma sector has helped it outperform the Sensex over the past three months.

With the stock trading at 12 times estimated FY07 (September) earnings, it is still reasonable.

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