investor's eye

Index

- Sharekhan Special >> Q4FY2007 earnings preview
- Sharekhan Special >> Q4FY2007 Auto earnings preview
- Stock Update >> Hyderabad Industries

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Deepak Fertilisers	17-Mar-05	50	**85**	126
HLL	24-Nov-05	172	**205**	280
ICICI Bank	23-Dec-03	284	**859**	1,240
IndoTech Trans	28-Nov-06	199	**283**	335
Infosys	30-Dec-03	689	**1,992**	2,670

Sharekhan Ltd
A-206, Phoenix House, 2nd Floor, Senapati Bapat Marg, Lower Parel, Mumbai - 400013, India.

Sharekhan Special

Q4FY2007 earnings preview

Key points

- The Sensex earnings are expected to grow by 37% year on year (yoy) for Q4FY2007. However, excluding oil the earnings are expected to grow by 34% driven by the earnings in the software, cement and banking sectors. These three sectors are expected to contribute 42% of the Q4FY2007 Sensex earnings excluding oil. On a quarter-on-quarter (q-o-q) basis the expected growth is only 1.2%, which indicates expectations of some slowdown in the earnings momentum.
- Strong earnings growth is expected in the pharma sector mainly due to a very low base. On the other hand information technology (IT) earnings will be affected due to the sharp appreciation in the rupee. Auto numbers are not expected to be great due to margin pressure and a slowdown in the volumes.
- Strong year-on-year (y-o-y) earnings growth is expected from Reliance Communications, Bharti Tele, Ranbaxy, Dr Reddy's Laboratories, Grasim and Tata Steel.
- Two-wheeler majors Hero Honda and Bajaj Auto are expected to report a y-o-y decline in the profits.
- Some of the non-Sensex companies where high growth is expected are Dabur Pharma, Syndicate Bank, Polaris and India Cements.
- In the absence of any major surprises, the fourth quarter results of the Indian companies may not be a trigger for the market, but the market will keenly await the guidance on the FY2008 prospects of the corporate sectors, especially automobiles, banks and the other interest rate sensitive sectors.

Expected and implied growth for fourth quarter

We have also prepared a list of the Sensex companies for which we have the expected and implied y-o-y growth rates. The implied growth rate is arrived at after deducting the nine-month actual results from the consensus annual earnings estimates. If the expected earnings estimates are higher than the implied growth rates then it signals that the market is expecting higher earnings and hence a possibility of an earnings upgrade increases and the converse is true when the implied growth rate is higher than the expected growth rate.

The table below suggests that some earnings upgrade possibilities are there for Hindalco, Bharti and Reliance Communications, while the downgrades are likely for most IT companies, Hero Honda and ICICI Bank.

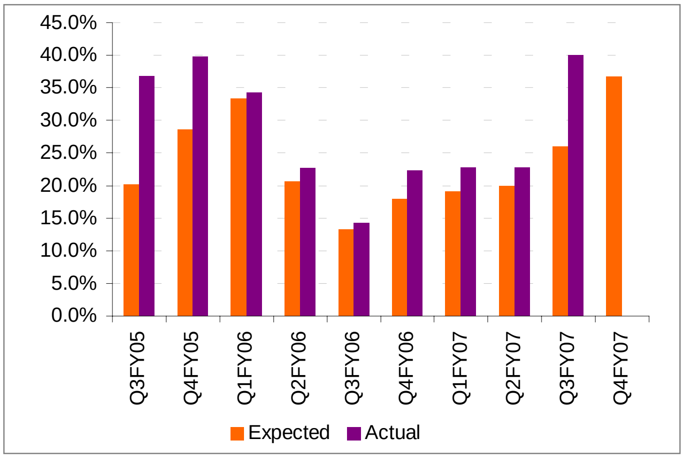
Expected and implied growth for few Sensex stocks

Company	Q4 FY07E	Q4 FY06A	% yoy Expected	% yoy Implied
Bharti Tele	1,290.0	682.4	89.0	85.0
Cipla	201.1	171.1	17.5	10.0
HDFC Bank	336.0	263.2	27.7	26.0
Hero Honda	202.4	267.2	-24.3	-19.0
Hindalco	650.7	626.3	3.9	-2.0
HDFC	513.0	426.5	20.3	21.0
ICICI	1,004.1	789.9	27.1	35.0
Infosys	1,031.3	673.0	53.2	56.0
Maruti	425.1	360.9	17.8	19.0
Rel Commn	911.7	403.4	126.0	118.0
TCS	1,170.6	800.0	46.3	50.0
Wipro	775.4	597.5	29.8	29.0

Sensex' Q4FY2007E earnings growth (%)

Sector	Expected % y-o-y chng	% q-o-q chng
Auto	5.3	2.6
Banking & finance	33.7	18.8
Capital goods	23.0	61.3
Cement	57.2	6.6
FMCG	22.4	-12.2
IT	41.4	5.1
Metal	31.1	4.4
Oil and gas	43.5	-4.9
Pharma	124.3	-40.5
Power	1.1	-23.8
Telecom	102.8	11.9
Total	36.7	1.2
Total - ex oil	34.2	3.8

Sensex earnings expected to grow by 36.7%



Source: Sharekhan Research

Auto—margin pressure concerns

Automobile sales numbers rendered a mixed performance in Q4FY2007. The four-wheeler growth rate outpaced the growth rate in the two-wheelers. The operating profit margins are expected to remain under pressure for the whole sector due to the high raw material prices. The margin pressure would be higher in the two-wheeler segment due to the intensified competition, various sales promotion activities and discounts being offered by the major players.

Banking—asset quality issue remains a concern

The business growth is likely to remain robust in the banking sector with credit and deposits growing by 30% and 24% yoy respectively for FY2007. However, two lending rate hikes coupled with the interest income on the cash reserve ratio (CRR) with retrospective effect will help banks counter the increase in the deposit costs and higher provisioning requirements. The asset quality will be an important factor to watch.

The net interest margins for banks may not be impacted in this quarter, as the full quarter impact of the increase in the deposit costs will start reflecting only from Q1FY2008 when we may see some margin pressure. The increase in the bond yields by 37 basis points would also keep the marked-to-marked provisions high for some public sector banks like Canara Bank, Punjab National Bank and Oriental Bank of Commerce.

Our estimates for SBI are ahead of the market estimates, as we believe that the one-time CRR income plus the PLR hikes would be more than enough to negate the increase in the deposit costs.

Cement—no major concerns in this quarter

During the quarter the cement industry witnessed a 22.5% yoy and a 3-4% q-o-q increase in the prices. The realisations for the companies in our coverage will see a 19.2% year on year growth.

The volumes for Gujarat Ambuja and the AV Birla group cumulatively increased by 13% yoy. ACC witnessed a 1.1% y-o-y decline in the volumes mainly on account of maintenance and shutdown exercise at its various facilities. We expect the cement stocks under our coverage to post a 31.2% y-o-y growth in sales and an 85.9% y-o-y growth in the profit after tax (PAT).

Capital goods—healthy growth

We expect a more than 40% y-o-y top line growth for the capital goods companies and around a 35% bottom line growth. The operating margins are expected to improve as new priced orders come in for execution and the operating leverage comes into play. However the rising interest rates will have some negative impact at the net margins level.

As per the recent report of the Working Group on Power for the 11th Five-Year Plan, a capacity addition 69,000 megawatt (MW) in power generation is envisaged for the 11th Five-Year Plan and another 86,000MW for the 12th Five-Year Plan, which we believe will keep the momentum going for the power equipment companies.

FMCG—benefits likely from price hikes

We expect the market leader in the fast moving consumer goods (FMCG) segment, Hindustan Lever Ltd's (HLL) profits to grow by 18.8% yoy backed by the strong growth in the HPC segment and the price increases in the key product segments. We expect the margin to improve from 11.8% in Q1CY2006 to 12.8% in Q1CY2007, which would be primarily due to the price hikes undertaken in many of the company's products. We also expect the margins in the soaps and detergent segment to get slightly affected by the strong palm oil prices.

ITC's profits are expected to grow by a strong 24% yoy. We expect the growth to be broad-based with the magnitude of losses in the non-FMCG business coming down. A 12.5% value-added tax (VAT) getting implemented would result in lower growth or no growth in the cigarette volumes. The company has gone for a price increase of 10-25% across all segments. We believe the stock would continue to underperform till clarity emerges on how the subsequent price hike would affect the company's volumes. But looking at the rising disposable income and addictive nature of cigarette consumption, we believe the volumes will not fall drastically. The VAT is having a dampening effect but we believe any decline is a good opportunity to buy.

Telecom services—high growth on a low base

Despite the re-verification of the pre-paid customers and lesser number of days in the month of February, the subscriber additions continued to show a strong growth momentum during the fourth quarter. The industry added around 19 million subscribers in Q4, which is a tad lower than the 19.8 million subscribers added in the previous quarter.

Bharti Airtel (BAL) continues to lead the growth in subscriber additions and it added around 5.07 million subscribers (not adjusting for any churn due to the re-verification process) in Q4, higher than the 4.9 million subscribers added in Q3FY2007. Consequently, we expect BAL's revenues to grow by 12.8% quarter on quarter (qoq) and 62.4% yoy to Rs5,541 crore. The consolidated earnings are estimated to grow by 6% qoq and 89% yoy to Rs1,290 crore. Our earning estimates are ahead of the consensus estimates of around Rs1,246 crore.

IT services—rupee appreciation to take its toll

The steep appreciation of the rupee has further added to the seasonal weakness in Q4, which would result in limiting the revenue growth in the front-line IT services companies to 5-6.6% on a sequential basis. The margins would be under pressure, especially in case of Wipro (relatively lower forward cover and the impact of annual salary hikes to its onsite employees in Q4) and Satyam (due to the incremental cost of $4.5 million related to stock-based compensation). The earnings growth is expected to vary substantially among the various companies with a wide range of 1.3% to 6% sequentially.

Our earnings estimates are more or less in line with the consensus estimates. The only exception is Tata Consultancy Services (TCS) where our earnings estimates are a bit conservative at Rs1,170 crore as compared to the consensus estimates of Rs1,208 crore.

More than the quarterly performance, the guidance for FY2008 would be an important factor. The street expectations have toned down considerably with most analysts expecting Infosys to give an earnings guidance of 22-24% in the rupee terms. It is much lower than the 26.5-28.5% earnings growth guidance at the beginning of FY2007 and implies a less than 5% sequential growth in the earnings over the four quarters.

Metals—better numbers expected

The price cut in aluminium could see Hindalco's realisations getting reduced while Tata Steel is expected to see high volume growth.

Oil & gas—better numbers expected

The oil & gas sector is expected to report a good y-o-y growth on the back of an improvement in the crude oil prices, higher refining margins, rupee appreciation etc. The high fuel marketing under recoveries will continue to impact the bottom line of the government oil marketing companies. However, the likely issue of the oil bonds by the government will provide some cushion.

Pharma—high growth on a low base

We remain positive on the Indian pharmaceutical sector on the back of the continued domestic growth, steady contributions from exports and synergies arising out of integration of acquisitions. Further, the increased focus towards drug discovery and collaborative research with the global players enhances the medium term earnings visibility for the sector.

In line with the business trend, the domestic market growth moderated to around 9% in Q4FY2007 from more than 15% in the last couple of quarters. But the formulation exports continue to be robust and the successful integration of acquisitions (Like Ranbaxy's Terapia, Wockhardt's Pinewood, Nicholas' Morpeth etc) will drive the revenue growth for the sector. We expect the pharmaceutical companies under our coverage to report a revenue growth of 20.3% for Q4FY2007.

With increasing competition in the generics segment,US and European generics markets continue to remain challenging for most of the players. But thanks to the cost-cutting efforts, improvement in the product mix and larger thrust on branded formulation business by the local players ensures higher margins. The pharmaceutical companies under our coverage are expected to report a 420-basis-point expansion in the operating profit margin (OPM), leading to a 30% growth in their net profit in Q4FY2007. Ranbaxy and Nicholas are expected to report the highest growth rates during the quarter.

Annexure-I

Stocks where the earnings growth is expected to be high

Company	Q4FY07E	Q4FY06A	% yoy chg
Rel. Commn	911.7	403.4	126.0
Bharti Tele	1,290.0	682.4	89.0
Ranbaxy	131.0	71.8	82.5
Grasim	443.0	258.6	71.3
TISCO	1,167.5	760.1	53.6

Stocks where lower earnings growth/decline is likely

Company	Q4FY07E	Q4FY06A	% yoy chg
Hero Honda	202.4	267.2	-24.3
Bajaj Auto	276.3	321.8	-14.1
Reliance Energy	159.2	169.5	-6.1

Annexure-II

Non-Sensex companies where high yoy growth is expected

Company	Q4FY07E	Q4FY06A	% yoy chg
Dabur Pharma	8.7	0.2	4042.9
Syndicate bank	168.7	10.3	1536.0
Polaris	31.3	4.8	553.0
India Cements	109.2	24.3	348.8

Sharekhan Special

Q4FY2007 Auto earnings preview

Automobile companies reported a mixed performance in terms of sales volumes for Q4FY2007, maintaining the trend of the past two quarters. The growth in four-wheelers has outpaced that in two-wheelers. Rising interest rates and tightening liquidity have taken their toll on the automobile sector, as the growth rates are beginning to slow down. Competitive pressures continue in the two-wheeler segment even as volume growth has slowed down. Among the heavyweights, Bajaj Auto Ltd (BAL) has reported a sales growth of a meagre 1% whereas Hero Honda Motors has reported a rise of 10.8% in its sales for the fourth quarter. The four-wheeler segment has continued on its growth path, with the commercial vehicle (CV) segment reporting a growth of 25% for the quarter (with the exception of March). The passenger car segment has grown by 20% in the quarter. The segment is expected to see a flurry of activity with a number of new launches planned in this fiscal. Maruti Udyog's car sales have grown by a strong 29.6%; the overall sales of Mahindra & Mahindra (M&M) are up by 18.8% and Tata Motors' commercial vehicle sales have increased by 22.4%.

The operating profit margins (OPMs) are expected to have been under pressure for the whole sector considering the high raw material prices. The margin pressure would be most evident in the two-wheeler segment due to the intensified competition as well as various sales promotion activities and discounts being offered by the major players during the period.

We expect M&M, Tata Motors, Ceat, Ahmednagar Forgings and SKF India to be among the lead performers in the sector for Q4FY2007.

BAL

BAL is expected to report a disappointing sales performance for Q4FY2007. The motorcycle sales remained flat year on year (yoy) while the three-wheeler sales witnessed a growth of 16.5%. The company has maintained its market share in the premium segment motorcycles, whereas in the economy segment motorcycles it has lost market share due to strong sales incentives by the competition.

Quarterly estimates

(Rs crore)	Net sales			Profit after tax		
	Q4FY07E	Q4FY06	% change	Q4FY07E	Q4FY06	% change
Bajaj Auto	2,188.7	2,165.9	1.1	276.3	321.8	-14.1
Maruti Udyog	4,292.4	3,260.3	31.7	425.1	360.9	17.8
Mahindra & Mahindra@	2,711.7	2,288.8	18.5	233.0	155.1	50.2
Tata Motors	8,304.0	6,882.8	20.6	588.0	432.0	36.1
Ashok Leyland	2,287.9	1,734.8	31.9	153.6	135.5	13.3
Omax Auto	170.0	142.1	19.7	6.2	5.0	26.1
Sundaram Clayton	214.4	174.3	23.0	24.2	22.7	6.7
Subros	193.5	168.7	14.7	11.0	9.7	13.9
Ahmednagar Forgings*	160.0	103.4	54.7	17.7	11.0	60.5
SKF India**	388.4	295.9	31.2	31.6	22.5	40.2
Federal-Mogul Goetze**@	124.6	105.7	17.9	3.4	-14.3	-
Ceat	537.9	484.4	11.1	11.2	4.8	134.3
Apollo Tyres	843.8	745.9	13.1	26.3	17.7	48.5
AUTO UNIVERSE	**22,417.4**	**18,552.9**	**20.8**	**1,807.7**	**1,484.4**	**21.8**

*Q3 for Ahmednagar Forgings since it is a June ending company
**Q1 for SKF India & Federal Mogul since they are calendar year ending companies

The fourth quarter last year was the strongest for the company with the highest OPM. On the back of a lacklustre growth in the sales volume in Q4FY2007, the sales for the quarter are projected to grow marginally by 1.1%. The OPM is likely to fall yoy on the back of higher raw material costs and intensified competition. The profit after tax (PAT) is thus projected to decline by 14.1%.

Sales performance

Particulars	Q4FY07	Q4FY06	% chg	FY2007	% chg
Other two-wheelers	7,895	13,540	-41.7	20,480	-82.4
Motorcycles	532,864	533,018	0.0	2,376,519	24.3
Total two-wheelers	**540,759**	**546,558**	**-1.1**	**2,396,999**	**18.2**
Three-wheelers	84,598	72,638	16.5	321,796	27.7
Grand total	**625,357**	**619,196**	**1.0**	**2,718,795**	**19.2**

M&M

M&M rendered a good performance in Q4FY2007 with utility vehicle (UV) sales rising by an impressive 18.5% backed by good sales of the all new *Scorpio*, whose sales grew by 32.6%. The light commercial vehicle (LCV) and three-wheeler sales were extremely good as the company's product, viz *Alfa*, performed well in the market. Its tractor sales tapered off to 8.5% due to seasonal factors.

Sales performance

Particulars	Q4FY07	Q4FY06	% chg	FY2007	% chg
Utility vehicles	39,879	33,654	18.5	127,913	11.5
- Scorpio	11,341	8,552	32.6	38,029	20.1
- UVs w/o Scorpio	28,538	25,102	13.7	89,884	8.3
- LCVs	2,565	1,545	66.0	8,652	27.7
Three-wheelers	9,823	7,136	37.7	33,700	50.3
Total domestic	52,267	42,335	23.5	170,265	18.3
Exports	1,977	1,424	38.8	8,023	45.0
Total automotive	**54,244**	**43,759**	**24.0**	**178,288**	**19.3**
Tractors	23,476	21,640	8.5	102,536	20.6
Total	**77,720**	**65,399**	**18.8**	**280,824**	**19.8**

Maruti Udyog

Maruti Udyog continued its strong performance in the fourth quarter. The volumes in the A2 segment comprising *Alto*, *Zen*, *Wagon R* and *Swift* marked a growth of 45.3% in the quarter, led by the strong performance of the *Wagon R Duo* and *Zen Estilo*, which was launched towards the end of the last quarter. The sales of *Omni* and *Versa* were also good in Q4 (up 36.2% yoy) while that of *Baleno* and *Esteem* declined by 24.6% as *Baleno* was discontinued during the quarter. The exports grew by 74.9% yoy to 14,213 units as some large shipments were made towards the end of the year. The company made its much awaited entry into the diesel segment during the quarter with the introduction of *Swift Diesel* in January. The margins are expected to decline marginally due raw material cost pressures, higher import content and strengthening of the yen.

Sales performance

Particulars	Q4FY07	Q4FY06	% chg	FY2007	% chg
A1-M-800	19,117	25,273	-24.4	79,245	-11.2
A2-Alto, Zen, Wagon-R, Swift	134,717	92,715	45.3	440,375	31.4
A3-Baleno, Esteem	6,827	9,050	-24.6	2,414	-92.4
Omni, Versa	24,333	17,870	36.2	83,091	25.2
Total passenger cars	184,994	144,908	27.7	632,408	21.0
MUV	905	1,367	-33.8	3,221	-26.4
Domestic	185,899	146,275	27.1	635,629	20.6
Export	14,213	8,125	74.9	39,295	13.0
Total sales	**200,112**	**154,400**	**29.6**	**674,924**	**20.1**

Tata Motors

Tata Motors delivered a good performance in Q4FY2007 with an overall growth of 16%. The growth rates in the CV segment started to slow down a bit on the back of a high base of the previous quarter and low availability of finance. The UV segment continued to do well with the success of *Safari* after its prices were slashed a couple of months back. The car sales growth also slowed down in Q4FY2007 as it grew by 10.3% affected by new launches from competition and higher interest rates. The PAT for the quarter is expected to increase by 36.1% to Rs588 crore.

Sales performance

Particulars	Q4FY07	Q4FY06	% chg	FY2007	% chg
M&HCV	51,076	43,060	18.6	172,889	34.3
LCV	36,399	28,415	28.1	125,792	45.9
UV	16,543	12,985	27.4	47,893	26.4
Cars	53,340	48,360	10.3	179,000	18.6
Domestic sales	157,358	132,820	18.5	525,574	30.2
Exports	14,568	15,334	-5.0	53,301	6.5
Total sales	**171,926**	**148,154**	**16.0**	**578,875**	**27.6**

Ashok Leyland

Ashok Leyland is expected to have witnessed a strong volume growth in Q4FY2007 as volumes grew by 28.2%. However, the growth rates tapered off towards the end of the quarter in March when the company recorded a disappointing performance. The goods carrier segment, contributing the bulk of the sales, led the growth with a brilliant 29.9% increase yoy. The sales of the passenger carrier segment too improved during the quarter as the segment recorded a growth of 26.3% yoy. For Q4, we expect Ashok Leyland to post a strong sales growth of 31.9%; however the margins are expected to decline on a year-on-year basis due to the higher share of truck sales in the overall mix. The net profit for the quarter is projected to grow by 13.3% to Rs153.6 crore.

Sales performance

Particulars	Q4FY07	Q4FY06	% chg	FY2007	% chg
MDV passenger	5,094	4,032	26.3	15,497	-1.1
MDV goods	21,006	16,169	29.9	67,301	48.9
LCV	47	201	-76.6	303	-62.0
Total sales	**26,147**	**20,402**	**28.2**	**83,101**	**34.8**

Omax Auto

We expect the revenues of Omax Auto to mark an increase of 19.7% yoy for the quarter. The company's performance had improved in the previous quarter and the trend is expected to have continued in the current quarter. The OPM is expected to have improved to 10.4% due to higher operating efficiencies and the commencement of operations of Omax Steel. The net profit for the quarter is expected to mark a growth of 26.1% to Rs6.2 crore.

Ahmednagar Forgings

We expect Ahmednagar Forgings to report extremely good results for Q3FY2007 with added momentum as a result of higher outsourcing to Anvil. The company has commissioned additional capacity to cater to its outsourcing orders, which should trigger a higher top line growth in the subsequent quarters. For Q3FY2007, we expect the company to post a top line growth of 54.7% and a bottom line growth of 60.5%.

Sundaram Clayton

The buoyancy in the CV segment should trigger a good growth in Sundaram Clayton as a result of the strong performance of its key clients like Tata Motors and Ashok Leyland. The margins are expected to decline a bit yoy to about 16.4%. We expect both the die-casting and the brakes division to perform well during the quarter and expect a sales growth of 23% for Q4 and a net profit growth of 6.7%.

Subros

Led by the good volumes of key clients like Maruti Udyog and Tata Motors, Subros is expected to report a strong volume growth in Q4FY2007. We expect Subros to surpass its yearly volume target of 460,000 units for FY2007 by reporting volumes of 467,000 units. Consequently, the net sales are projected to mark a 14.7% growth in Q4FY2007, while the OPM is expected to improve to 12.9%. Consequently, we expect the PAT to grow by 13.9% to Rs11.0 crore.

Ceat

We expect Ceat to deliver a strong performance in Q4FY2007, led by a good volume growth and increasing exports. We expect the margins to improve by 160 basis points yoy to 6.9% on the back of improved operational performance. Ceat is likely to be least affected by the rise in rubber prices during the quarter due to some amount of forward booking done by the company to source rubber at lower prices. We expect Ceat to report strong results with a top line growth of 11.1% and a PAT growth of 134.3% to Rs11.2 crore.

Apollo Tyres

Strong CV sales and higher replacement demand should result in a strong growth for Apollo Tyres. We project a sales growth of 13.1% yoy. The margin is expected to improve to 8.5% yoy while the same is expected to decline on a sequential basis due to firm rubber prices. The net profit for the quarter is expected to improve by 48.5% to Rs26.3 crore.

Federal Mogul Goetze

This leading manufacturer of piston and piston rings for the automotive segment is on its turnaround path. For the quarter we expect the sales to grow by 18%, in view of the commencement of outsourcing from the parent. The profit margin is also expected to improve in view of the rising sales. The company is expected to report a profit of Rs3.4 crore against an adjusted loss of Rs13.4 crore for the corresponding previous quarter.

Valuation table-Sharekhan auto universe

Particulars	CMP	EPS		PER		EV/EBIDTA	
	(RS)	FY07	FY08	FY07	FY08	FY07	FY08
Ahmednagar Forgings	249	21.3	38.1	11.7	6.5	6.7	3.9
Apollo Tyres	277	20.1	31.3	13.8	8.8	6.1	4.1
Ashok Leyland	37.0	3.2	3.6	11.6	10.3	6.0	6.0
Bajaj Auto	2,277	125.1	151.5	18.2	15.0	11.8	8.9
Ceat Ltd	111	6.1	15.7	18.2	7.1	6.2	3.8
Federal Mogul Goetze	245	-2.5	18.0	-98.2	13.6	32.8	7.6
Maruti Udyog	783	52.4	65.2	14.9	12.0	10.5	7.8
M&M*	727	58.2	68.1	12.5	10.7	6.7	5.8
Omax Auto	90	11.5	14.2	7.8	6.3	4.3	3.7
SKF India	321	19.3	26.2	16.6	12.3	8.7	6.5
Subros	238	27.4	38.8	8.7	6.1	4.6	3.3
Sundaram Clayton	924	49.6	71.5	16.0	11.1	12.5	8.6
Tata Motors*	723	56.9	70.1	12.7	10.3	6.9	5.3

* Consolidated

Hyderabad Industries

Apple Green

Stock Update

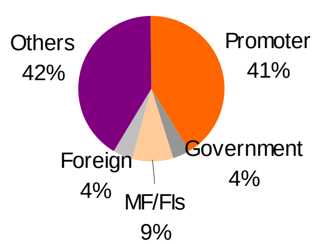
Book profit

Book Profit; CMP: Rs230

Company details

Market cap:	Rs166 cr
52 week high/low:	Rs506/139
NSE volume: (No of shares)	60,427
BSE code:	509675
NSE code:	HYDRBADIND
Sharekhan code:	HYDIND
Free float: (No of shares)	43.8 lakh

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	49.3	-4.7	-23.4	-43.7
Relative to Sensex	45.5	-3.7	-28.5	-51.0

Result highlight

- Hyderabad Industries Ltd (HIL) has delivered a disappointing performance yet again in Q3FY2007. Lower than expected sales, the company's inability to pass on the costs to the consumers and higher raw material costs affected its performance during the quarter.
- In Q3FY2007, the net sales rose by 4.7% to Rs100 crore. Not only was the company unable to pass on the higher costs to the consumers, but it also faced a lot of competitive pressures, leading to a loss in its market share. The operating margins have come down drastically from 11.7% to 3.5% due to the very high cement prices, as cement is the key raw material. Consequently, the operating profit for the quarter declined by 69% to Rs3.46 crore.
- With all the asbestos majors adding capacity, there is overcapacity in the industry, leading to more competitiveness. This has capped the pricing power of the companies, and they are unable to pass on the impact of the higher raw material costs to the consumers. We expect this scenario would continue to adversely affect the company going forward, and expect the margin pressure to continue as all the players gun for a higher market share.
- At the current levels, the stock discounts its FY2008E earnings by 10x and quotes at an enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 6x. At these levels, the stock does not look attractive and hence we are closing our recommendation on the stock. We had initiated the stock at a price of Rs163, and the stock has given a return of 41%.

Result table Rs (cr)

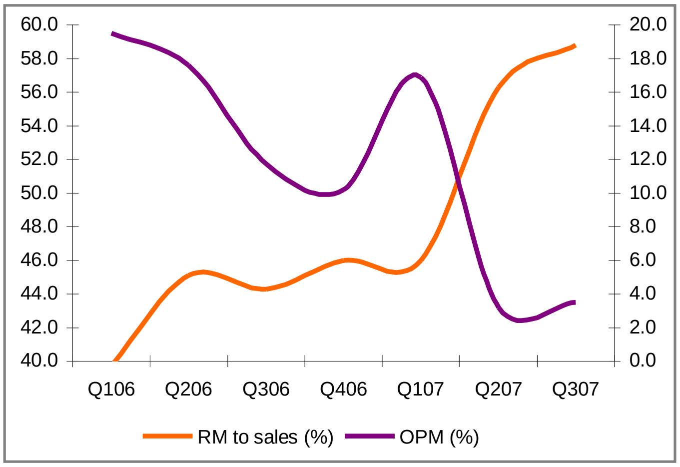
Particulars	Q3FY07	Q3FY06	% yoy	9MFY07	9MFY06	% yoy
Net sales	100.0	95.5	4.7	324.2	314.9	3.0
Total expenditure	96.6	84.4	14.4	296.7	262.6	13.0
Consumption of RM	68.7	39.4		187.9	134.4	
Incr/decr in stock	-16.8	6.6		-26.1	0.7	
Employee expenses	9.4	8.3		28.2	29.5	
Selling & adm expenses	12.6	12.1		38.9	36.5	
Other expenses	22.6	18.1		67.8	61.5	
Operating profits	3.5	11.2	-69.0	27.5	52.3	-47.4
Other income	0.8	0.6		3.1	2.4	
EBIDTA	4.2	11.8	-63.9	30.6	54.7	
Interest	1.4	0.9	55.6	2.8	3.1	
PBDT	2.8	10.9	-73.8	27.8	51.6	-46.1
Depreciation	2.4	1.9		6.6	6.0	
PBT	0.4	8.9		21.2	45.5	
Tax	1.1	3.2		7.1	17.5	
Profit after tax	-0.7	5.7	-112.4	14.2	28.1	-49.6
Extraordinary items	-1.0	0.0		2.9	-1.7	
Reported PAT	0.3	5.7	-94.4	11.3	29.8	-62.2
EPS (Rs)	-1.0	8.0		18.9	37.4	
OPMs (%)	3.5	11.7		8.5	16.6	

Disappointing performance yet again

HIL rendered a disappointing performance in Q3FY2007 as its net sales rose by just 4.7% to Rs100 crore. Even though there were a couple of small price hikes during the quarter, the sales on a sequential basis have remained almost flat, signifying a further loss in its market share. Very high competitive pressures, and the company's inability to pass on the impact of high raw material costs to the consumers had an adverse effect on the margins of the company as the same plummeted from 11.7% last year to 3.5%. The operating profit for the quarter marked a decline of 69% to Rs3.46 crore. The interest costs and the depreciation for the quarter were high due to the increased capital expenditure (capex) of the company. Consequently, the net profit declined by 94% to Rs0.32 crore.

The operating margins for Q3FY2007 declined significantly as a consequence of the rise in the cement prices, as cement is the primary raw material for its building products business. The raw material cost rose from 44.3% to 58.8% as a percentage of sales.

Higher cement prices hurting margins



Looking at the segmental numbers, the revenues from the building products division rose by just 3.8% to Rs94.6 crore, while the margins fell drastically from 13% to 2.7%. In the nine-month period too, the revenues from the building products division have risen by just 3.9%, while the profit before interest and tax (PBIT) margins have fallen from 20% to 8.9%.

Overcapacity in the industry

The industry has witnessed high capacity additions in the last couple of years, with the total capacity going up by almost 30%, while the industry demand has grown by 8-10%. High capacity additions have increased competitive pressures in the industry, adversely affecting the pricing power. With intensified competition, the asbestos manufacturers have not been able to pass on the high raw material costs to their consumers, which has negatively affected the margins of the whole industry.

Demand-supply mismatch in the industry

Particulars	FY2005	FY2006	FY2007	FY2008
Expected capacity of top organised players (MT in lakh)	15.12	19.21	21.11	22.31
% change		*27.1*	*9.9*	*5.7*
Sales quantity of top organised playres (MT in lakh)	13.94	15.99	17.75	19.35
% change		*14.7*	*11.0*	*9.0*
Overcapacity		3.22	3.36	2.96

We expect that the current situation is likely to continue going forward, considering that some more capacity is coming up in the next two years. The mismatch would lead to further competitiveness in the industry, and a price war may be triggered in an effort to gain higher market share, which would lead to continued pressure on the operating margins.

Segmental results

Particulars	Q3FY07	Q3FY06	% change	9MFY07	9MFY06	% change
Revenues (Rs cr)						
Building products	94.61	91.14	3.8	306.7	295.3	3.9
Heavy engineering	-0.52	0.04	-1400.0	1.6	6.0	-73.6
Others	6.12	4.58	33.6	17.1	14.5	17.8
Profit (Rs cr)						
Building products	2.53	11.85	-78.6	27.4	59.0	-53.5
Heavy engineering	-0.7	-0.6	16.7	-1.1	-5.4	-78.8
Others	1.62	0.96	68.8	3.9	3.2	21.8
Margins (%)						
Building products	2.7	13.0		8.9	20.0	
Heavy engineering	134.6	-1500.0		-72.6	-90.6	
Others	26.5	21.0		22.9	22.1	

Margins of all the players affected

	Q3FY07	Q3FY06	Change (in basis points)
Everest Inds	4.6	12.5	795
Ramco	8.7	18.9	1,015
Visaka*	9.2	20.1	1,091
Hyderabad Inds	3.5	11.7	822

*PBIT Margins

Lost market share not regained yet

To make matters worse for Hyderabad Industries, it had reported lower than expected sales in the past couple of quarters, owing to certain quality issues that saw a large amount of rejections. This led to a considerable market share loss for the company. Usually, Hyderabad's products command a premium over the other brands. However, with the competition resorting to heavy discounts, HIL has not been able to regain its market share. In the last few quarters, players like Visaka Industries have gained considerable market share.

Valuation and view

High overcapacity in the industry has had an adverse impact on the pricing power of the industry majors, having a negative impact on their profitability. Further, the high capex of HIL would have a negative impact on its cash flows especially when the sales have been below estimates. At the current levels, the stock is trading at 20x FY2008 earnings and 8.2x its FY2008 EBIDTA.

The company is believed to be selling some of its land, which is located at the posh locality of Banjara Hills at Hyderabad and expects to receive a large sum for the same. This has been driving up the stock in the recent times. The value unlocking through land sale is expected to benefit the company but is likely to take time and happen over a longer period. However, looking at the fundamentals, and the steep valuations of the company, we do not think that the valuations are justified and hence are closing our recommendation on the stock. We had initiated the stock at a price of Rs163, and the stock has given a return of 41%.

Earnings table

Particulars	FY2005	FY2006	FY2007	FY2008
Net sales (Rs crore)	408.0	450.3	440.8	489.4
Net profits (Rs crore)	25.7	40.3	15.4	8.6
% y-o-y change		*286.8*	*-59.2*	*-43.9*
EPS (Rs)	35.9	53.8	20.5	11.5
PER (x)	6.5	4.3	11.3	20.1
EV/EBIDTA (x)	5.3	2.9	7.3	8.9
RoCE (%)	21.2	34.3	12.8	8.2
RoNW (%)	30.5	30.4	10.5	5.6

The author doesn't hold any investment in any of the companies mentioned in the article.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Balrampur Chini Mills
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
Hindustan Lever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Overseas Electronics
HCL Technologies
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India

Home