Man Top Picks

Man Financial Equity Research Team

LARGE CAP TOP PICKS

Bharat Forge (Rating: Buy, Target: Rs 500)

- Focusing on turning around American and Swedish units and using new domestic capacities to cater to heavy duty-machined crankshaft market in US, and passenger car chassis components in Europe. CDP's presence to help penetrate European car market and enhance market share in the chassis parts.
- Except for likely opportunities from Delphi's asset restructuring it is not planning any acquisitions.
- 35 active global customers, which includes top-five in both heavy trucks and passenger cars. In Q3FY06, BFL bagged three new global customers for supplying machined power train parts.
- Foresees opportunities and faster growth in non-automotive business, especially in aerospace segment.
- Valuations appear rich in discrete terms, but a turnaround in overseas units will make valuations attractive and provide upside to the stock.
- PER of 22x FY07E and 16x FY08E and PEG of 0.5x FY07E.
- ROIC of 45% in FY07E helped by asset turnover rising from 3x to 5x

Hindalco (Rating: Buy, Target: Rs 249)

- Hindalco Industries Limited, a flagship company of the Aditya Birla Group, is structured into two strategic businesses — aluminium and copper. It is the largest aluminium producer and copper smelter in India. Its aluminium operations consist of bauxite mines, alumina refineries, aluminium smelters and power plants, which ensure cost control. Its copper smelter is among the largest single location smelters in the world, which is backed by copper mines in Australia through its 51% Australian subsidiary Aditya Birla Minerals.

Hindustan Lever (Rating: Market Outperformer, Target: Rs 300)

- **Continued brand investment and upsurge in sector growth drives up sales by 10% yoy. Higher ad spends offsets 250bps improvement in material costs/net sales in Q1.**
- **Price hikes in key categories like detergents (2%), toothpastes (5%), personal care (10%), etc.**
- **We are tweaking down our EPS estimates, reiterate Outperformer.**
- **Q3 results to face tough base, disappointment likely**

Despite tough base, domestic FMCG sales grow 12.7% in Q2CY06

- FMCG sales up 12.7% yoy driven by HPC sales growth of 14.6% (excluding the impact of *Nihar*'s disposal). Most brands recorded double-digit growth, except tea.
- However, market share declined in almost all key categories despite growing faster-than-category growth.

Price hikes to defend margins

- Price hikes in key categories like detergents (2%), toothpastes (5%), personal care (10%), etc. Margin pressure will reduce with the recent rounds of price hikes. The company has taken price hikes in detergents, oral care and skin care in the last several months. However, with crude oil prices abating a bit, we see further scope for margin expansion.

Reiterate Outperformer

- We believe that there were no directional deviations in this quarter results, except for foods. We are building into our expectations higher adspend/net sales and a slightly lower growth in CY06. The stock is trading at 32.7x CY06E and 27.2x CY07E EPS. Our DCF value comes to Rs 303. **We reiterate our Outperformer with a price target of Rs 300.**

Man Financial

Hindustan Zinc (Rating: Buy, Target: Rs 900)

- Hindustan Zinc (HZL) is among world's top-10 integrated zinc miners and smelters.
- With its recently expanded zinc smelting capacities of 400,000 tons, HZL is well poised to ride the boom in zinc demand and prices.
- Its largest zinc concentrate source is its Rampura Agucha mine, which supplies more than 60% of its total zinc concentrate requirements. Its total reserves have recently expanded to 50.1mn tons from 42.3mn tons, which have resulted in an extension of its mining life by three years. The increased mine output will cater to its newly expanded Chanderiya smelter.

Infosys Technologies (Rating: Buy, Target: Rs 2,420)

- Infosys is the second largest IT company in India with a US$ 2bn run rate. The company employs over 50,000 people, which includes 40,000 software professionals. Its global delivery model is spread across 21 countries with global development centers in USA, Canada, UK, and Japan and 19 offshore development centers in India.
- Infosys has a track record of growing faster than the industry. Indian IT services and software exports are expected to grow at a CAGR of 28% over 2005-2010 and we believe Infosys will continue to grow faster than the industry.
- For the second consecutive quarter Infosys has reported excellent results in H2FY07 followed by guidance upgrades.
- Infosys' management has upped its guidance for FY07:
- Revenues: Rs 138.9bn from Rs 138.5bn (45.8% yoy growth)
- EPS: Rs 66.00 from Rs 62.87 (45.5% yoy growth)
- We have upgraded our revenues estimates for FY07 and FY08 by 4% and 4%, respectively, to adjust to the strong growth in Q2FY07.
- EBITDA margins will be 33.48% (32.9% earlier) led by strong resilience in Q2FY07. We assume stable margins in FY08E
- Our revised FY07 and FY08 EPS estimates are Rs 69.9 and Rs 90.5, respectively.
- Infosys' FY07E guidance upgrade reinforces our view about volume growth over the next two years. At 22x FY08E earnings (revised), we believe the stock will outperform the market. We maintain our Buy on Infosys with a revised price target of Rs 2,420 (27x FY08E earnings).

Maruti Udyog (Rating: Buy, Target: Rs 1,200)

- New-plant-led export thrust lends tremendous growth visibility and derisks its revenue model from impending domestic rivalry (Tata's small car, GM's neo-*Matiz*)
- Raising FY08 earnings estimates by 11% on revised volume growth estimates to 18.0% from 10.5% with increased exports clarity.
- In spite of fuel price and interest rate inflation, small car demand not to be hurt due to small loan value, higher fuel efficiency, and entry into the diesel segment, which is both 30% cheaper and more fuel efficient than petrol.
- Trades at 18.5x FY07, 14.6x FY08, and 12.8x FY09 earnings estimates.
- Deserves to trade at premium valuations due to foreign ownership, highest EBIDTA margins, non-cyclical car industry and focus on small cars, and increased growth visibility via exports thrust.
- **We revise our price target to Rs 1,200 from Rs 900, at which the stock will trade at 18.8x FY08 earnings**

Reliance Industries (Rating: Buy, Target: Rs 1,400)

- After having a good run with robust financial performance for last couple of years on the back of strong revival in refining and petrochemical margins; exploration and production and retailing will be the new avenues that will propel RIL's growth. E&P holds significant value for RIL and will be a major contributor to profits from FY09E onwards as production goes on stream. We value E&P assets at Rs 270 per share with scope for upside on further success. Major capacity addition through Reliance Petroleum would drive growth after the refinery is commissioned in 2008. Tie-up with Chevron will open up window of new business opportunities. RIL is expected to make huge investments in organized retailing, which offers a great opportunity for wealth creation. We believe that the stock price will move up further as details of the retailing plans are disclosed.
- Currently, the stock is trading at a P/E and EV/EBIDTA of 15.3x and 9.6x, respectively, for FY08E. Although trading at premium multiples, sum-of-parts valuations make the stock attractive at the current price. Assuming 20% discount to market value of investments, RIL's core business of refining and petrochemical is valued at 6.1x EV/EBIDTA for FY08E. Our fair price estimate of Rs 1,108 is based on a sum-of-the-parts valuation, which excludes upsides from retailing business, SEZ and upward revision of gas reserves. **We believe the stock will trade above its fair price due to potential upside and view it as an excellent long-term buy.**

State Bank of India (Rating: Buy, Target: Rs 1,048)

- State Bank of India is the country's largest bank with ~ 20% market shares in deposits and advances. Together with its seven associate banks (ownership ranges from 75% to 100%), the SBI group has more than 26% market share in deposits and 24% in advances.
- The total number of branches of the group stood at 13,635. SBI has transformed itself into a financial powerhouse through various subsidiaries and joint ventures. Apart from the steady growth in the core earnings we expect the stock to be re-rated upon value unlocking from the subsidiaries and after the listing of the associate banks.
- At the current prices, the stock is trading at a P/E of 7.5x on FY08E EPS and P/Adj. BV of 1.3x FY08E Adj. Book Value.
- **We have a BUY rating on the stock with a price target of Rs 1,048.**

Sun Pharma (Rating: Market Outperformer, Target: Rs 924)

- The demerger will expand the standalone entity's EBITDA margins by 250 bps
- This entity's robust business model with "chronic" formulation focus (+ 60% of revenue) will drive a 15% CAGR in the domestic market and 40% CAGR in the export (non-US) market over FY06-08E.
- The stock is not cheap, even on standalone basis. It trades at the trend-line levels of EV/Sales and EV/EBITDA multiples at the sectoral level. But considering sum-of-the-parts valuations and the possibility of inorganic triggers, we term Sun Pharma an Outperformer
- On a consolidated basis, the stock is trading at a PER of 27.3x FY07E and 23.2x FY08E. However, after the demerger (standalone, after deducting the DCF value of the innovative R&D entity), the stock is trading at 24.6x FY07E and 20.7x FY08E earnings.
- We initiate coverage with a Outperformer rating and a price target of Rs 924 based on sum-of-the-parts valuation, which includes: (a) target price of the standalone entity (Rs 887 based on 22.5x FY08E standalone earnings), and (b) our fair value of Rs 37 for the innovative R&D entity.

Tata Tea (Rating: Marker Outperformer, Target: Rs 880)

Tata Tea held an analyst meet on Friday to discuss its recent stake acquisition in Glaceau. Tata Tea's top management, Tata Coffee, and Glaceau's promoter were present.

- **Robust growth to continue albeit at a slower pace:** Going by the way the entire new-age beverage market and Glaceau are growing, we believe that Tata Tea's existing growth pace will get a significant thrust. However, to maintain growth as well as hedge against growing competition, Glaceau might need to increase its products to span new-age beverages.
- **Financial leverage is the biggest risk:** In the note, we have highlighted some of the risks that Tata Tea's business might face including excessive financial leverage and exchange rate risk. We believe that Tata Tea could raise equity, probably in the international market, to reduce the extent of its financial leverage. Also, structured instruments can reduce immediate cash flow requirements.
- **Risk perception to improve once financial numbers start flowing in:** Management hardly shared any financials, making it difficult to take a definitive call. However, we believe that as the financials start coming in and concrete signs of synergies between Glaceau and Tata group both in the US and the rest of the world appear, risk perception could alter.
- **Valuation:** Based on our assumptions, we expect the stake acquisition to be EPS accretive in FY09E. Based on SOTP, we expect stock returns at 12.2% CAGR over the next two years, mostly back-ended. At Rs 729, the stock is trading at 12.4x FY08E EPS. We will advise remaining invested in Tata Tea for the long-term. However, near-term prospects look clouded with uncertainties. We rate the stock Outperformer, with a 12-month price target (relative to market) of Rs 880.

Man Financial

MIDCAP TOP PICKS

Amtek Auto (Rating: Buy, Target: Rs 450)

- Setting up a large integrated machining facility at Pune, which will enable it to machine forging products manufactured in its forging plants, which are undergoing capacity expansions.
- Ramping up forging capacity to 220,000 MTPA by FY08 from current 160,000 MTPA
- While standalone revenues are expected to grow by 25% each year over the next two years, earnings will grow at 31% and 26%. In FY06, we expect consolidated revenues and earnings to grow by 80% each.
- EBIDTA margins of 32% for standalone entity and 17-18% for consolidated entity in FY07-08E are one of the highest in the industry.
- Exports to account for 40% of standalone revenues in FY07E, with three fourth coming from GWK.
- Stock quotes at 12.5x FY07E and 10.3x FY08E, which is at discount to its nearest peer, Bharat Forge 19x FY07E and 14x FY08E.
- Consolidation apart, news flows related to exports initiatives and new client wins and acquisitions will fuel valuations.

Amtek India (Rating: Buy, Target: Rs 200)

- Manufactures and supplies machined castings for transmission and suspension assembly parts to Maruti, Hyundai, CNH, John Deere, Kinetic Engineering, Escorts, etc
- Raising capacity from current 40,000MTPA to 70,000MTPA in FY07E and 130,000MTPA by FY08E.
- Outsourcing from Sigmacast and Group Company Zelter for turbocharger housings offers significant growth opportunity.
- Expect 41% and 56% CAGR in revenues and earnings over FY05-08E driven by domestic demand and outsourcing-driven exports.
- Rigid environmental norms in the west to help boost exports.
- **Stock trades at 9.5x FY07E and 8x FY08E earnings.**

ANG Auto (Rating: Buy, Target: Rs 500)

- Strong growth opportunities from new products such as ASAs and fully dressed dummy-axle assemblies. It expects its axle assemblies to replace the existing axle assemblies used by Tata Motors and Ashok Leyland.
- Forayed into trailer manufacturing with a 75: 25 JV with Fuwa (China) with an initial capacity of 6000-units — already has orders from Ashok Leyland.
- Supplies brake and axle assembly components to global OEMs such as Arvin Meritor, Bosch, Daimler Chrysler, and Fuwa.
- Expect it to have a 30-40% market share in ASAs, as it is the only company that holds product patents.
- **Stock quotes at 16x FY07E and 11x FY08E earnings.**

Glenmark Pharma (Rating: Market Outperformer, Target: Rs 406)

- Glenmark has proven its innovative R&D skills by out-licensing its first NCE — Oglemilast (currently in Phase-II, indication – chronic obstructive pulmonary disease and asthma) — to Forest Labs and Teijin Pharma for the US and Japanese markets, respectively. The deal is valued at US$ 243mn.
- The company has received US$ 26mn from its partners till date (US$ 20mn in FY05 and US$ 6mn in FY06) and is estimated to receive US$ 34mn in FY07E and US$ 35mn in FY08E.
- The probability of success of this molecule remains high as the molecule is well tolerated (without emesis) even at higher testing doses. Most of the molecules in the milast category have faced emesis issues at higher doses.
- While Glenmark is expected to out-license Oglemilast for the European market, its second NCE - GRC 8200 (anti-diabetic), which is in Phase –II could also be out-licensed.
- Glenmark's base business is gaining traction and is expected to grow at a CAGR of 28% over FY06-08E (on a lower base), driven by new product introductions in the exports market.
- At its CMP of Rs 342, the stock is trading at a PER of 15.7x FY07E and 13.2x FY08E earnings including two years of out-licensing income. Considering two different business entities, we have valued Glenmark on a SOTP basis, which is what our target price is. We arrived at a DCF value of Rs 155 for the Oglemilast molecule and valued its base business at Rs 250 on 17x FY08E earnings. The total value comes to Rs 406, which offers 19% upside from the current price. We rate the stock an Outperformer.

Goetze India (Rating: Buy, Target: Rs 500)

- Federal Mogul's taking controlling stake is a significant driver of the company's fortunes as exports and expansion plans are now getting a huge boost.
- Company has changed its financial year from March ended to December ended.
- Parent Federal Moghul has relocated its plant in Malden (US) to Patiala (India) which is now part of GIL and will contribute around Rs 500mn to revenues from CY07 to GIL.
- We expect exports of Rs200 mn in CY06 (Rs 280mm in FY06) and Rs 800 mninCY07.
- We expect stronger financial performance in CY06 and CY07 on the back of strong domestic growth and exports led by parent outsourcing
- Goetze is a leading supplier of piston and piston rings to OEMs across vehicle segments. It has a 65% share in the OEM segment and 70-80% penetration in CVs and tractors. The OEM and replacement sales mix is 70:30. Out of OEM sales, roughly 40% each comes from CVs and two wheelers, while the rest comes from railways, cars and tractors. New Euro emission norms will further help organized players like Goetze to gain market share.
- **At 15x CY07, the stock is one of our top picks in the midcap auto parts space given the strong earnings leverage to FM takeover and new growth opportunities.**

JK Cement (Rating: Buy, Target: Rs 230)

- JK cement is one of the top 5 cement manufacturers in North India and the 2nd largest white cement manufacturer in India. JK's grey cement capacity is available at ~25% discount to replacement cost. The stock offers multiple earnings triggers over FY06-09E and is a potential re-rating candidate driven by streamlined operating cost structure, reduced financial leverage, future regional diversification, and volume growth. Capacity-addition-led volume growth and cost benefits (~Rs200/tonne) from additional captive power to flow through in FY08E, creating a shield against possible downturn in FY09E. Capacity expansion from greenfield project in Karnataka (3mtpa, +75%) to kick-in by FY09E; to facilitate regional diversification of cement capacity.
- At CMP: P/E of 9.3x FY07E and 7.5x FY08E; EV/EBITDA of 5.9x FY07E, 5.2x FY08E.
- At target price: P/E of 11x FY07E and 8.9x FY08E; EV/EBITDA of 6.8x FY07E, 5.9x FY08E

Orchid Chemicals (Rating: Buy, Target: Rs 322)

- Orchid, the largest cephalosporins manufacturer and exporter from India, has consolidated its position amongst the top-5 players globally.
- Business model set to transform from APIs to formulations and from less-regulated markets to regulated markets = better profitability.
- New favourably tilted partnerships with established global generic companies for product distribution in regulated markets to help gain market share
- The investment period for cephalosporins is over. So RoIC will improve. New investments to go into NPNC segment.
- Out-licensing opportunity of anti-diabetic molecule, BLX-1002, after August 2006 is not in our estimates.
- At Rs 219, the stock is trading at a PER 17.9x FY07E and 8.0x FY08E earnings. We initiate coverage with a Buy rating and a 12-month DCF-based price target of Rs 322. At our target price, the PER of the stock would trade at 11.8x FY08E earnings. Our target represents a 47% upside from its CMP.

Shree Cement (Rating: Buy, Target: Rs 1,296)

- One of the leading cement manufacturers in North India. Stock performance to be driven by continued earnings momentum and valuations upside from regional leadership in North India. Shree Cement is better positioned amongst the North Indian peers to withstand the likely supply overhang in FY09E thanks to volume growth from its ongoing capacity addition projects and competitive cost structure. Shree will account for ~19% of average North Indian capacity in FY09E versus around 11% in FY06 .
- At CMP: P/E of 11.5x FY07E and 7.3x FY08E; EV/EBITDA of 7.3x FY07E, 5.4x FY08E.
- At target price: P/E of 13.3x FY07E and 8.5x FY08E; EV/EBITDA of 8.3x FY07E, 6.2x FY08E

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