investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Bharat Bijlee	29-Nov-04	192	**1,326**	1,425
Ceat	28-Nov-06	122	**132**	190
India Cements	28-Sep-06	220	**250**	315
Indo Tech Trans	28-Nov-06	199	**265**	280
Lupin	06-Jan-06	403	**579**	670

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

Tata Consultancy Services

Evergreen

Stock Update

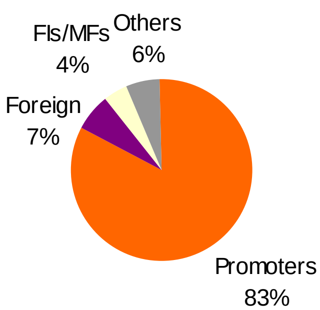
Results ahead of expectations

Buy; CMP: Rs1,342

Company details

Price target:	Rs1,508
Market cap:	Rs131,328 cr
52 week high/low:	Rs1,370/900
NSE volume: (No of shares)	7.6 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCSCONS
Free float: (No of shares)	17.1 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14.9	20.5	42.2	62.3
Relative to Sensex	10.6	8.5	7.0	6.1

Result highlights

- Tata Consultancy Services (TCS) has reported a growth of 8.4% quarter on quarter (qoq) and of 40.8% year on year (yoy) in its consolidated revenues to Rs4,860.5 crore. The sequential revenue growth was driven largely by a 7.87% growth in the volumes, a 2% improvement in the billing rates and productivity gains of 2.6% on the fixed price projects. On the other hand, the revenue growth was dented by the appreciation of the rupee (to an extent of 2.46%) and an increase in the offshore contribution (to an extent of 1.56%).
- The earnings before interest and tax (EBIT) margin improved by 79 basis points to 26.1% on a sequential basis. The steep appreciation of the rupee dented the margin by 1.37% but the dip in the margin was more than made up by the positive impact of the higher billing rates (1.74%), the shift towards the high-margin offshore business (0.28%) and the cost efficiencies (0.14%). The company maintained its broad guidance of sustaining the full year margin at close to 25.8%, as reported in FY2006. However, we have factored in a decline of 60 basis points in the margin on a full year basis.
- The other income stood at Rs30 crore (includes foreign exchange fluctuation gain of around Rs3.6 crore), up from Rs7.7 crore in Q2FY2007. Consequently, the earnings grew at a relatively higher rate of 11.4% qoq and 47.2% yoy to Rs1,104.7 crore, which is much higher than the consensus estimate of around Rs1,086 crore.

Result table (consolidated US GAAP) Rs (cr)

Particulars	Q3FY07	Q2FY07	Q3FY06	% qoq chg	% yoy chg
Revenue	4,860.5	4,482.2	3,452.7	8.4	40.8
Development cost	2,575.8	2,388.0	1,806.4	7.9	42.6
Gross profit	2,284.7	2,094.2	1,646.3	9.1	38.8
SG&A expenses	909.4	864.8	669.6	5.2	35.8
Operating profit	1,375.3	1,229.4	976.7	11.9	40.8
Depreciation	108.0	95.8	73.8	12.7	46.4
EBIT	1,267.3	1,133.6	903.0	11.8	40.3
Other income	30.0	7.7	-15.4	287.8	-
Profit before tax	1,297.3	1,141.4	887.6	13.7	46.2
Tax	182.8	144.7	131.9	26.3	38.6
PAT	1,114.5	996.7	755.7	11.8	47.5
Affiliates earnings	1.7	0.8	-0.3	122.6	-
Minority interest	11.5	5.9	4.8	93.5	137.3
RPAT	**1,104.7**	**991.5**	**750.3**	**11.4**	**47.2**
Equity capital	97.9	97.9	97.9		
EPS(Rs)	11.3	10.1	7.7		
Margins (%)					
GPM	47.0	46.7	47.7		
EBIT	26.1	25.3	26.2		
NPM	22.6	22.1	21.8		

- In terms of operational highlights, the company added 5,562 employees and 55 new clients during the quarter. It also bagged five large deals, including two deals of over $100 million and three deals of over $50 million. The management also indicated that it is currently pursuing around ten large deals of over $50 million each.
- Given the better than expected performance, we are revising upward the earnings estimates by 3.8% for FY2007 and by 5.6% for FY2008. We maintain the Buy call on the stock with a price target of Rs1,508.

Volume growth accompanied by strong productivity gains...

TCS reported a robust volume growth of 7.9% on a sequential basis. This is the fifth consecutive quarter of over 7% sequential growth in the volumes and clearly reflects the strong demand environment. What's more encouraging are the marked improvement in the realisation (in time and material contracts by 2%) and the productivity gains in the fixed price projects (a positive impact 2.59%). These enabled the company to effectively mitigate the adverse impact of the rupee appreciation and the shift towards offshore business. A 60-basis-point increase in the offshore revenue contribution to the total turnover resulted in a negative impact of 1.56% on the sequential growth in the revenues.

Factors influencing revenue growth

	% qoq chg
Volume growth	7.87
Pricing and productivity gains	4.59
Forex impact	(2.46)
Offshore shift	(1.56)
Net q-o-q growth	**8.44**

...result in margin expansion

The strong improvement in the realisations and the productivity gains on the fixed priced projects boosted the overall profitability by 1.74% and more than mitigated the adverse impact of the rupee appreciation on the margins. The company also benefited from the higher contribution from the high-margin offshore business and other cost efficiencies (like savings in the selling, general and administrative cost as a percentage of sales). The EBIT margin expansion by 79 basis points was ahead of our expectations.

Margins firm up

	% qoq chg
Pricing and productivity gains	1.74
Offshore shift	0.28
Other cost efficiencies	0.14
Forex impact	(1.37)
Net gains	**0.79**

Though the management indicated that it would be able to broadly maintain the margins at around 25.8% as reported in FY2006, we believe it would be an uphill task as the EBIT margin for the first nine month stands at 24.7% only (down by 110 basis points as compared with the FY2006 figure). Consequently, we have factored in a margin decline of around 60 basis points for FY2007.

Management appears optimistic and confident

The management is confident about maintaining the growth momentum going forward. It bagged five large deals (two of over $100 million and three of over $50 million) in five different continents during the quarter. It expects to close more such deals and is actively pursuing ten deals currently.

In terms of margins also, the management expects the improvement in the billing rates and the efficiency gain in the fixed priced projects to continue in the coming quarters. Moreover, the offshore contribution is expected to improve by 200-300 basis points over the next few quarters and would positively affect the overall profitability. Consequently, TCS expects to maintain its margins in a narrow range going forward also.

Revision in earnings

To factor in the better than expected performance and the management's growing confidence in maintaining the growth momentum, the earnings estimates have been revised upwards by 3.8% and 5.6% for FY2007 and FY2008 respectively. The implied sequential growth for Q4FY2007 works out to 7.9% and 5.5% for the revenues and the earnings respectively.

Other highlights

In terms of specific growth drivers, the company reported an impressive growth in the revenues from both the Americas and Europe. The key industry verticals of banking, financial services and insurance, manufacturing and healthcare also showed significant traction with a double-digit sequential growth in the revenues. In terms of service offerings, application development & management (11.4% qoq), asset leveraged solutions (16.8% qoq) and assurance services (38.6% qoq) boosted the overall growth in the revenues.

TCS added 5,562 employees during the quarter, taking the consolidated employee base to 83,500. The attrition rate was flat at 10.6% (on an LTM basis). The company maintained its guidance of around 30,000 gross recruitments in the current fiscal.

It added 55 new clients during the quarter. The top 10 clients grew at a healthy rate of 11.7% on a sequential basis.

The company has announced an interim dividend of Rs3 per share.

Valuation

At the current market price the stock trades at 31.8x FY2007 and 24.9x FY2008 earnings estimates. We maintain the Buy call on the stock with a price target of Rs1,508 (28x FY2008 earnings).

Earnings table

Particulars	FY05	FY06	FY07E	FY08E
Net revenue (Rs cr)	9727	13245	18733	24483
Net profit (Rs cr)	2356	2911	4124	5272
Number of shares (cr)	96.0	97.9	97.9	97.9
EPS(Rs)	24.5	29.7	42.1	53.9
% y-o-y chg		*21.3*	*41.7*	*27.8*
PER	54.7	45.1	31.8	24.9
OPM (%)	27.7	25.7	25.2	24.7
RoNW (%)	58.2	49.4	45.2	39.4
RoCE (%)	51.4	40.1	39.6	36.5

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

Bajaj Auto

Apple Green

Stock Update

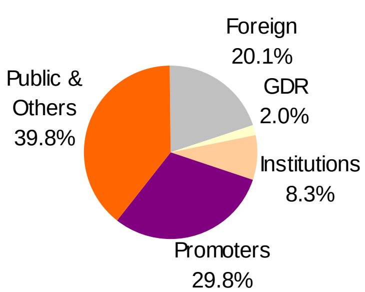
Profit margins disappoint, other income perks up

Buy; CMP: Rs2,775

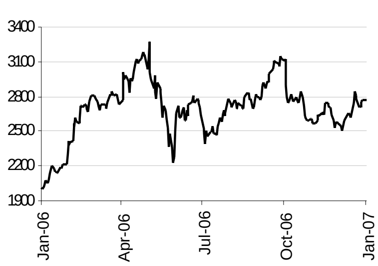
Company details

Price target:	Rs3,300
Market cap:	Rs28,068 cr
52 week high/low:	Rs3325/1974
NSE volume: (No of shares)	2.2 lakh
BSE code:	500490
NSE code:	BAJAJAUTO
Sharekhan code:	BAJAJ
Free float: (No of shares)	6.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.6	-11.4	4.6	39.6
Relative to Sensex	3.6	-20.6	-21.3	-8.7

Result highlights

- Bajaj Auto's Q3FY2007 results have perked up due to the other income component while the operating margins continued to be under pressure during the quarter.
- The net sales rose by 28.4% to Rs2,568.2 crore, which is slightly ahead of our estimates, led by a 22.9% growth in the volumes and a 4.5% growth in the realisations.
- Higher sales of the entry-level bikes, high raw material costs and intensified competition leading to higher selling costs exerted pressure on the margins. The operating margins declined by 370 basis points year on year (yoy) and by about 80 basis points sequentially to 14.2%. Consequently, the operating profit rose by just 1.5% to Rs363.6 crore.
- Higher other income of Rs161 crore and lower interest costs helped the company to post a 22.8% growth in its net profit at Rs357.1 crore. The profit after tax (PAT) after extraordinary items rose by 23.3% to Rs345.2 crore.
- Our view is that Bajaj Auto is the best pick in the two-wheeler space with its strong brand equity and product mix in comparison to its peers. The operating profit margins should improve going forward. We maintain our positive stance on the stock on back of the company's strong position in the two-wheeler industry and continued growth in the insurance segment. A possible demerger of its investment portfolio may act as a further trigger for the stock in the coming times.
- At the current market price of Rs2,775 , the stock discounts its FY2008E earnings by 18.3x and quotes at an enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 10.7x. We maintain our Buy recommendation on the stock with a sum-of-parts price target of Rs3,300.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy chg	M9FY07	M9FY06	% yoy chg
Net sales	**2568.2**	**2000.9**	**28.4**	**7206.9**	**6069.3**	**18.7**
Total expenditure	2204.6	1642.8	34.2	6116.2	2927.9	108.9
Raw material consumed	1890.3	1402.9		5184.6	2441.6	
Stock adjustment	-4.7	-5.0		24.6	-1.1	
Employee expenses	75.7	67.6		232.7	138.4	
Other expenses	249.2	177.4		680.2	349.0	
Expenses capitalised	-5.9	0.0		-5.9	0.0	
Operating profit	**363.6**	**358.1**	**1.5**	**1090.7**	**573.2**	**90.3**
Other income	161.0	106.4	51.3	397.9	229.0	73.8
EBIDTA	524.6	464.5	12.9	1488.6	802.2	85.6
Interest	0.2	0.1		3.0	0.1	
PBDT	524.4	464.4	12.9	1485.7	802.0	85.2
Depreciation	47.2	49.1		144.5	95.2	
PBT	477.1	415.3	14.9	1341.2	706.8	89.7
Tax	120.0	124.5		375.0	207.0	
Profit after tax	357.1	290.8	22.8	966.2	499.8	93.3
Extraordinary items	12.0	-10.8		36.1	0.0	
Reported PAT	**345.2**	**301.6**	**14.4**	**930.1**	**499.8**	**86.1**
EPS	34.1	27.7		91.9	49.4	
PBIDTM (%)	14.2	17.9		15.1	9.4	

Segmental analysis

	Q3FY07	Q3FY06	% change	M9FY07	M9FY06	% change
Segment revenue						
Automotive	2559.9	2002.0	27.9	7200.0	5505.4	30.8
Insurance	1377.3	984.0	40.0	3470.9	2084.7	66.5
Investment & others	162.5	107.5	51.2	400.8	340.4	17.7
Total	4099.7	3093.5	32.5	11071.7	7930.6	39.6
Less: Inter segment revenue	9.1	5.7		27.3	21.2	29.1
Net Sales/Income from operations	4090.6	3087.8	32.5	11044.4	7909.4	39.6
Segment profit/(loss) before tax and interest						
Automotive	306.8	307.0	-0.1	929.4	806.7	15.2
Insurance	-22.7	-25.9	-12.6	-66.7	-36.4	83.4
Investment & others	160.2	92.8	72.7	384.3	313.9	22.4
Total	444.4	373.8	18.9	1247.0	1084.2	15.0
Less: Interest	0.2	0.1		3.0	0.3	
Total profit before tax	444.1	373.7	18.9	1244.0	1084.0	14.8

Robust volume growth helps record a strong top line growth

Bajaj Auto Ltd (BAL) reported a strong growth in its top line in Q3FY2007. The net sales rose by 28.4% to Rs2,568.2 crore led by a 22.9% volume growth and the average realisation increased by 4.5%. The motorcycle sales during the quarter rose by 27.6% as the company increased its market share to 34%, rising by 3% in comparison to the last year. *Platina* recorded a good volume growth during the quarter, fuelled by a price cut in September. *Platina* has recorded sales of over 500,000 vehicles since its launch in April 2006. In the price segment BAL continues with its leadership position with a market share of 45%. BAL's share in the value segment has increased to 21% as of December 31, 2006. The three-wheeler segment too recorded a strong growth of 48.8%.

Sales performance

	Q3FY07	Q3FY06	% growth
Motorcycles	652,406	511,106	27.6
Other two-wheelers	173	32,146	-99.5
Total two-wheelers	**652,579**	**543,252**	**20.1**
Three-wheelers	85,640	57,572	48.8
Grand total	**738,219**	**600,824**	**22.9**
Exports (out of above)	**115,619**	**64,359**	**79.6**

The growth in realisation can be attributed to the price hikes undertaken by the company and the launch of the new *Pulsar 220cc*. The price of *Platina* was hiked by about 1.5-2% while the price of the upgraded *Pulsar* twins with DTSi at a higher price point was introduced in December 2006. The prices of three-wheelers have also been hiked by 1.5%-2%.

Margins continue to be under pressure

BAL's margins continued to be under pressure due to higher sales of the entry-level bikes, intense competition leading to higher selling costs and high raw material costs. Higher contribution of *Platina*, the entry-level bike, affected the overall margins of the company since the profitability is relatively lower in this segment. The price war between the two stalwarts of motorcycle manufacturers during the quarter led to both the players offering various sales promotion schemes in order to boost their sales volumes, the subvention of the finance costs affecting the margins. Higher raw material costs further dampened the operating margins as the raw material cost as a percentage of sales rose from 70% last year to 73.5% in the quarter under review.

The operating profit margins (OPMs) declined by 370 basis points yoy and by 70 basis points sequentially to 14.2%. Consequently, the operating profit marked a meagre growth of 1.5% yoy to Rs363.6 crore.

Insurance business—continues on its growth path

The insurance subsidiaries of Bajaj Auto continued with their splendid performance. The gross written premium of the general insurance subsidiary, Bajaj Allianz General Insurance, rose to Rs459.4 crore during the quarter, marking a year-on-year growth of 38%. The gross written premium collected by the life insurance subsidiary, Bajaj Allianz Life Insurance, showed a growth of 36% yoy to Rs1,098.1 crore. Its growth has been affected due to a slow-down seen in the single premium revenues due to a lock-in period imposed on the same. To compensate for this, the company has been able to substantially increase its non-single premium revenues. To illustrate, the non-single premium revenues have grown by 151% year-till-date in FY2007. Also, the margins are much higher in the non-single premiums. The total number of policies issued in the life insurance business during the quarter was 435,504 as against 177,026 in Q3FY2006.

Higher other income perks up bottom line

The other income was considerably higher at Rs161 crore during the quarter. Further, low interest costs and stable depreciation aided the company to deliver a profit after tax of Rs357.1 crore as against Rs290.8 crore in the corresponding quarter of the last year. The PAT after extraordinary items stood at Rs345.1 crore, marking a year-on-year growth of 23.3%.

Exports

Exports witnessed a strong growth of 80% in the current quarter. Exports now constitute 17% of the total sales. PT Bajaj Auto Indonesia commenced operations during the current quarter. Despatches to Iran have started. Also, the company continues to expand its sales and service network in Nigeria. These new markets should generate significant export volumes in the next year.

Outlook

We continue to view Bajaj Auto as the best pick in the two-wheeler space. We believe that currently BAL has got the best product mix and the best brands in comparison to its peers, which places it in a better position in their comparison.

The company continues its focus on higher end motorcycles. It plans to upgrade the consumers from the 100cc segment to value-added and profitable products that may help it improve its profit margins. Three new motorcycles will be launced in the next few months. The motorcycle capacity is being expanded to 3 million bikes per month from April 2007 in anticipation of the growing demand.

The company's strong position in the two-wheeler industry and the continued growth in the insurance segment re-enforces our faith in the stock and we maintain our positive stance on the stock. A possible demerger of its investment portfolio may act as a further trigger for the stock in the coming times.

Considering the higher-than-expected sales and other income we have upgraded our total income estimates for FY2007 and FY2008. We maintain our PAT estimates in view of the profit pressures.

At the current market price of Rs2,775 , the stock discounts its FY2008E earnings by 18.3x and quotes at an EV/EBIDTA of 10.7x. We maintain our Buy recommendation on the stock with a sum-of-parts price target of Rs3,300.

Sum-of-parts valuation

Business	Basis	Per share (Rs)
Automobiles	At 16x its FY2008E core EPS	1829.48
Insurance business	At 16x its FY2008E NBAP	733.86
Investment book	At 5% discount to market value	795.07
Total value		3358.40

Earnings table Rs (cr)

Year to Mar 31	FY2005	FY2006	FY2007E	FY2008E
Net sales	5724.0	7469.4	9717.9	12608.1
Net profits	801.4	1117.5	1265.3	1533.1
% y-o-y change		*39.4*	*13.2*	*21.2*
EPS (Rs)	79.2	110.4	125.1	151.5
PER (x)	35.0	25.1	22.2	18.3
Book value	408.6	471.5	552.1	647.9
P/BV	6.8	5.9	5.0	4.3
EV/EBIDTA (x)	25.5	16.7	14.1	10.7
RoCE (%)	13.9	19.1	19.6	21.8
RoNW (%)	14.9	18.6	18.9	20.2

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

Sun Pharmaceutical Industries

Ugly Duckling

Stock Update

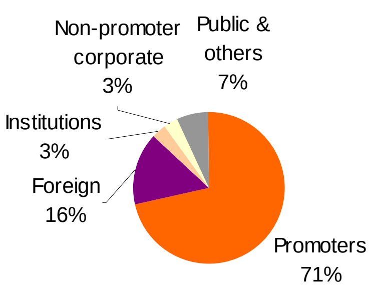
Price target revised to Rs1,341

Buy; CMP: Rs1,038

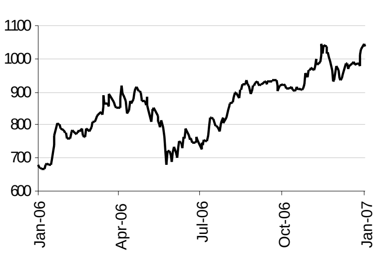
Company details

Price target:	Rs1,341
Market cap:	Rs21,500 cr
52 week high/low:	Rs1,065/640
NSE volume: (No of shares)	1.6 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Sharekhan code:	SUNPHARM
Free float: (No of shares)	5.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.8	13.7	40.5	56.5
Relative to Sensex	2.8	2.3	5.8	2.4

Key points

- Sun Pharmaceuticals Industries (Sun Pharma) recently received the approval for the 100-milligram capsules of the anti-convulsant drug, Phenytoin, used to treat seizures related to epilepsy and neurosurgery. Anticipating a 20% market share for Caraco Pharmaceuticals (Caraco) at 50% price erosion, we believe this approval is likely to add revenue worth $20 million to the FY2008 revenues.
- In view of the recent launches like Phenytoin, Ondansetron and Glipizide, and the potential revenue flowing from the tentative approvals (eg Zolpidem Tartarate and Carvedilol), we expect Caraco's revenues to grow by 44.1% and 48.9% to Rs537.1 crore and Rs799.6 crore in FY2007 and FY2008 respectively.
- The rest-of-the-world market is likely to maintain the CAGR at 53% for the next two years. Hence, our revised export estimates stand at Rs1,026.8 crore and Rs1,484.2 crore for FY2007 and FY2008 respectively. That is a CAGR of 49.4%.
- On the domestic formulations front, the evolution index of Sun Pharma is 106% whereas the industry grew at above 17% in the last couple of quarters. Hence, we have revised our growth estimates for the business from the earlier 16% to 18%. As a result, our revised top line estimates for the company stand at Rs2,145.8 crore and Rs2,791.2 crore for FY2007 (up 31.1%) and FY2008 (up 30.1%) respectively.
- With more and more revenues flowing from the high-margin US market, the OPM is likely to expand by 390 basis points to 33.9% in FY2008. As per our revised estimate, the net profit would grow at over 27% CAGR to Rs712.2 crore in FY2007 and to Rs927.2 crore in FY2008.
- The demerger of the innovative research unit is expected to be completed by the end of FY2007. Post-demerger, the R&D expenses would reduce by ~35%, leading to the accretion of Rs2.1 and Rs2.7 to the FY2007E and FY2008E EPS respectively.
- Our revised EPS estimates stand at Rs36.7 (up 7.5%) and Rs47.5 (up 3.5%) for FY2007 and FY2008 respectively. As per our revised estimates, we have valued the base business at Rs1,287 and the demerged R&D entity at Rs54 per share (as per our previous estimate). This gives us a fair value of Rs1,341 for Sun Pharma. Hence, we maintain our Buy recommendation on Sun Pharma with a revised price target of Rs1,341.

Valuation table (consolidated) Rs (cr)

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Net sales	983.0	1185.3	1637.2	2145.8	2791.2
PAT	315.6	396.2	573.6	712.2	927.2
Shares in issue (cr)	9.3	18.6	18.6	20.7	20.7
EPS (Rs)	33.9	21.4	30.9	36.5	47.5
PER (x)	30.6	48.6	33.6	28.4	21.9
cash EPS (Rs)	37.0	23.5	34.2	40.4	51.6
cash PER (x)	28.1	44.1	30.4	25.7	20.1
EV	9925.0	19441.0	19612.1	19690.9	18962.5
EV/Ebidta (x)	25.0	45.9	39.8	26.9	20.0
Book value (Rs/share)	87.9	60.9	85.6	190.6	239.5
P/BV (x)	11.8	17.0	12.1	5.4	4.3
Mcap/sales	9.8	16.2	11.8	10.0	7.7

Sun Pharma's US outfit—Caraco—grew at a compounded annual growth rate (CAGR) of 50% during FY2002-06. Caraco has further stepped up its growth momentum by aggressively registering and launching more products in the US market in FY2007. To be specific, the recent approval of Caraco's neurosurgery product, Phenytoin, along with its large product pipeline (56 abbreviated new drug applications pending approval) has boosted the visibility of its earnings. Alongside, the domestic formulation business of Sun Pharma is also growing faster than the industry. To account for the increased momentum in the US business and the domestic formulation business, we have revised our estimates upward for FY2007 and FY2008.

Sun Pharma recently received the approval for the 100-milligram capsules of Phenytoin, the anti-convulsant drug used to treat seizures related to epilepsy and neurosurgery. It is a generic version of Pfizer Inc's Phenytoin extended release. The annual market size of the product is $200 million. Just four players, including Barr Lab, Mylan, Taro and Pfizer (innovator), are present in the space and the product has been generic since 1998. So we do not expect any major price erosion for the product. Anticipating a 20% market share for Caraco at 50% price erosion, we believe this approval is likely to add revenue worth $20 million to the FY2008E revenues.

In view of the recent launches, eg Phenytoin, Ondansetron and Glipizide, and the potential revenue flowing from the tentative approvals (eg Zolpidem Tartarate and Carvedilol), we expect Caraco's revenues to grow by 44.1% and 48.9% to Rs537.1 crore and Rs799.6 crore in FY2007 and FY2008 respectively. The previous growth estimates for FY2007 and FY2008 were 30.9% and 28.8% respectively. On the other hand, the rest-of-the-world (ROW) market (supported by 750 product registrations and another 300+ products pending approval) is likely to maintain the CAGR at 53% for the next two years. Hence, our revised export estimates stand at Rs1,026.8 crore and Rs1,484.2 crore for FY2007 and FY2008 respectively. That is a CAGR of 49.4% in effect.

On the other hand, the domestic formulations, which maintained a steady growth despite the turbulence in the Indian market in the last couple years, witnessed an increasing momentum in the recent times. The momentum has been fuelled by approximately 30 new launches per year and a strong brand building capability. The evolution index (the company's growth as a percentage of the industry's growth) of the company is 106% whereas the industry grew at above 17% in the last couple of quarters. Hence, we have revised our growth estimates for the domestic formulation business from the earlier 16% to 18%. As a result, our revised top line estimates for the company stand at Rs2,145.8 crore and Rs2,791.2 crore for FY2007 (a 31.1% growth) and FY2008 (a 30.1% growth) respectively.

With more and more revenues flowing from the high-margin US market, the operating profit margin is likely to expand by 390 basis points to 33.9% in FY2008. As per our revised estimate, the net profit would grow at over 27% CAGR to Rs712.2 crore in FY2007 and to Rs927.2 crore in FY2008.

The demerger of Sun Pharma's innovative research division is expected to be completed by the end of the current fiscal. The company's disclosed innovative research and development (R&D) pipeline consists of one new chemical entity (NCE) and two novel drug delivery systems (NDDS). The NCE is an anti-allergic molecule undergoing Phase-II trials in the USA, whereas the NDDS are awaiting the signal of the US Food and Drug Administration to commence the Phase-III trials directly. Subsequent to the demerger, the R&D expenses would drop by about 35%, leading to EPS accretion of Rs2.1 and Rs2.7 to the estimated FY2007 and FY2008 earnings respectively.

Valuation

Our revised EPS estimates stand at Rs36.7 (up 7.5%) and Rs47.5 (up 3.5%) for FY2007 and FY2008 respectively. At current price of Rs1038 stock trades at 21.9x FY20008E EPS. As per our revised estimates, we have valued the base business at Rs1,287 and the demerged R&D entity at Rs54 per share (as per our previous estimate). This gives us a fair value of Rs1,341 for Sun Pharma. Hence, we maintain our Buy recommendation on Sun Pharma with a revised price target of Rs1,341.

Revision table (consolidated) (Rs cr)

		Old earnings		Revised earnings		% revision	
	FY2006	FY2007E	FY2008E	FY2007E	FY2008E	FY2007E	FY2008E
Net sales	1,637.2	2,106.8	2,686.0	2,145.8	2,791.2	1.9	3.9
% y-o-y chg		*28.7*	*27.5*	*31.1*	*30.1*		
PAT	573.6	661.0	896.0	712.2	927.2	7.7	3.5
% y-o-y chg		15.2	35.6	24.2	30.2		
Shares in issue (cr)	18.6	20.7	20.7	20.7	20.7		
EPS (Rs)	30.8	31.9	43.3	34.4	44.8		
Addition due to merger		2.1	2.6	2.1	2.7		
Total EPS		34.0	45.9	36.5	47.5	7.5	3.5

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

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