investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
BASF	18-Sep-06	220	**258**	300
HCL Tech	30-Dec-03	103	**333**	395
Infosys	30-Dec-03	689	**1,926**	2440
Madras Cement	17-Nov-05	1,498	**2,860**	4,000
Ranbaxy	24-Dec-03	533	**389**	558

Tata Motors

Apple Green

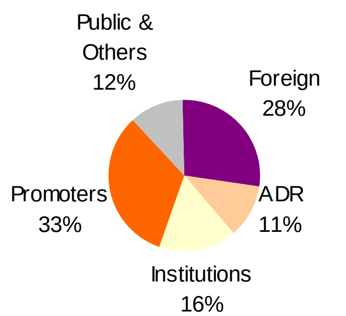
Stock Update

Price target revised to Rs980

Buy; CMP: Rs708

Company details	
Price target:	Rs980
Market cap:	Rs27,362 cr
52 week high/low:	Rs975/651
NSE volume: (No of shares)	14.3 lakh
BSE code:	500570
NSE code:	TATAMOTORS
Sharekhan code:	TELCO
Free float: (No of shares)	21.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.5	-13.5	-12.7	-3.0
Relative to Sensex	-3.3	-16.3	-17.6	-30.8

Result highlights

- Tata Motors' Q4FY2007 results are slightly below are expectations, primarily on the margin front. The Q4FY2007 net sales (excluding a foreign exchange [forex] gain) of the company grew by 20.0% to Rs8,206.8 crore, driven by a volume growth of 16.2% and a realisation growth of 3.3%.
- Excluding the effect of the forex gain/loss, the operating profit margin (OPM) has fallen by 160 basis points year on year (yoy) and by 130 basis points sequentially to 11.0%. This was mainly owing to a higher raw material cost and a sequential drop in the realisation due to a change in the product mix. Consequently, the operating profit grew by just 5.1% to Rs906 crore.
- The other income was higher at Rs60.4 crore against Rs4.4 crore last year. Further, lower interest cost and taxes, and stable depreciation aided the company to record a 25.9% growth in its profit to Rs576.7 crore.
- For the full year, net revenues grew by 33% to Rs27,404.8 crore against Rs20,672 crore last year, while the net profit grew by 25% to Rs1,913.5 crore.
- The consolidated sales for the full year grew by 36.4% to Rs32,426.4 crore while net profit grew by 25.4% to Rs2,170 crore.
- We are taking a cautious view on the commercial vehicle (CV) industry and expect the slowdown to continue in the first half of FY2008 on the back of tightening liquidity and higher interest rates. However, we expect the situation to correct itself towards the second half of the fiscal with the peaking out of interest rates and better availability of funds.

Result table Rs (cr)

Particulars	Q4FY07	Q4FY06	% yoy	FY2007	FY2006	% yoy
Net sales	8,267.0	6,869.7	20.3	27,535.2	20,653.5	33.3
Sales excl forex gain/loss	8,206.8	6,840.3	20.0	27,404.8	20,672.0	32.6
Total expenditures	7,300.8	5,977.8	22.1	24,221.5	18,077.8	34.0
Operating profits	966.2	891.8	8.3	3,313.7	2,575.7	28.7
Operating profits excl forex gain/loss	906.0	862.5	5.1	3,313.7	2,623.6	26.3
Other income	60.4	4.4	1267.4	245.2	289.1	-15.2
EBIDTA	1,026.7	896.3	14.6	3,558.9	2,864.8	24.2
Interest	59.8	69.2		313.1	226.4	
PBDT	966.9	827.1	16.9	3,245.8	2,638.4	23.0
Depreciation	186.8	189.2		671.3	594.7	
PBT	780.1	637.9	22.3	2,574.5	2,043.7	26.0
Tax	203.1	189.5		659.7	524.5	
PAT	577.1	448.4	28.7	1,914.8	1,519.2	26.0
Extraordinary item	-0.3	9.7		-1.4	9.7	
Reported PAT	576.7	458.1	25.9	1,913.5	1,528.9	25.2
EPS (Rs)	15.0	11.7		49.7	39.4	
OPM (%)	11.7	13.0		12.0	12.5	
OPM -excl forex gain (%)	11.0	12.6		12.1	12.7	
PATM (%)	7.0	6.5		7.0	7.4	

- We are downgrading our FY2008 earnings estimate by 6.2% to Rs53.4 and are also introducing our FY2009 estimate. We expect stand-alone earnings of Rs60.8 and consolidated earnings of Rs70.3 in FY2009. At the current levels, the stock trades at 11.7x its FY2009 stand-alone earnings per share (EPS) and 10.1x its consolidated earnings. We maintain our Buy recommendation on the stock with a revised price target of Rs980.

Top line growth slower due to low sales in March

The net sales excluding the forex gain/loss of the company grew by 20% to Rs8,206.8 crore. The growth was driven by a volume growth of 16% and a realisation growth of 3.4%. The growth rates in the CV segment started to slow down a bit towards the end of the year because of tightening liquidity conditions and rising interest rates, as medium and heavy commercial vehicle (M&HCV) sales volumes grew by 18.6% during the quarter and the light commercial vehicle (LCV) sales grew by 28.1%. The utility vehicle (UV) segment continued to do well with the success of *Safari* after its prices were slashed. The car sales also slowed down in Q4FY2007 and grew at 10.3% affected by new launches from competition and higher interest rates.

Sales performance

	Q4FY07	Q4FY06	% yoy	FY07	FY06	% yoy
M&HCV	51,076	43,060	18.6	172,889	128,715	34.3
LCV	36,399	28,415	28.1	125,792	86,236	45.9
UV	16,543	12,985	27.4	47,893	37,902	26.4
Cars	53,340	48,360	10.3	179,000	150,952	18.6
Domestic sales	157,358	132,820	18.5	525,574	403,805	30.2
Exports	14,568	15,334	-5.0	53,301	50,032	6.5
Total sales	171,926	148,154	16.0	578,875	453,837	27.6

High raw material cost affects margins

The operating profit (excluding forex gain/loss) grew by just 5.1% to Rs906.0 crore as the OPM declined by 160 basis points to 11.0%. The profitability was affected by the high raw material cost and higher other expenses during the quarter.

A higher other income of Rs60.4 crore, stable interest costs and depreciation, and lower taxes helped the company to record a 25.9% growth in its adjusted profits as the same rose to Rs576.7 crore for the quarter.

On a full year basis, the net revenues (adjusted for forex gain/loss) rose by 33% to Rs27,404.8 crore, while the margin fell by 60 basis points to 12.1%. The net profit for the year grew by 25% to Rs1,913.5 crore.

Strong consolidated performance

The consolidated net revenues for FY2007 increased by 36.4% to Rs32,426.4 crore. The earnings before interest, tax, depreciation and amortisation (EBITDA) margin declined by 60 basis points to 13.2% as the consolidated net profit increasing by 29% to Rs2,170.1 crore. All subsidiaries with the exception of Tata Technologies rendered a strong performance during the year.

Tata Daewoo (TDCV)

The FY2007 turnover increased by a solid 47.2% to Rs2,333.6 crore, while the profit after tax (PAT) grew equally well by 42.3% to Rs83 crore. The volumes for the year grew at 46% to 8,630 units even though the domestic market remained almost stagnant, registering a meagre 0.8% growth. The exports of the company grew by 46.8% yoy, as the company had raised its capacity utilisation to 42.7% during the year from 28.2% last year.

Telco Construction Equipment Co (Telcon)

In FY2007 the turnover rose by 40.1% yoy to Rs1,827.7 crore while the PAT grew brilliantly by 111.7% to Rs183.9 crore. This was possible due to a strong 46.5% growth in the volumes and better operating efficiencies. Telcon continued to be the leader in excavators, with a 53% market share, while its market share in wheel-loaders and backhoe loaders remained at 23% and 10% respectively. Going forward, as a growth strategy, the company would be launching new products, and has already launched large sized Zaxis excavators and Hitachi Sumitomo cranes in India.

Tata Technologies Ltd (TTL)

Though the turnover grew strongly by 76.2% to Rs960.5 crore, the profitability remained a concern as the net profit grew by just 4% during the year to Rs16.3 crore. This happened because the integration of TTL with INCAT took longer time than initially expected. The profitability of this venture is expected to improve this year.

HVAL and HVTL

HVTL's profits grew by 49.5% while HVAL's profits grew by 25.1%. The growth in these ventures are linked with the growth in the CV business. During the year, HVTL saw a volume growth of 47% while HVAL's volumes grew by 55%.

Capex and new product launches

As mentioned by the company on previous occasions, it has drawn up an aggressive capital expenditure (capex) plan of Rs12,000 for the next four years. Out of this Rs8,000

Subsidiary performance

	Turnover (Rs crore)			PAT (Rs crore)		
	FY07	FY06	% change	FY07	FY06	% change
Tata Daewoo CV Ltd, Korea	2,333.6	1,584.9	47.2	83.0	58.3	42.4
Telco Construction Equipment Co	1,827.7	1,305.0	40.1	183.9	86.8	111.9
TML Financial services	160.2	0.0		12.8	0.0	
Tata Technologies	960.5	545.0	76.2	16.3	11.6	40.5
HV Transmissions	175.6	127.7	37.5	45.0	30.1	49.5
HV Axles	196.7	143.9	36.7	57.9	46.3	25.1

crore would be spent towards new product development and the balance would be spent towards capacity expansions, modernisation and on sustaining capex. Out of the total capex, Rs7,500 crore will be funded through internal accruals, while the remaining shall be funded through a mix of instruments, details of which shall be chalked out at a later date.

The company has got a number of product launches in the line in the next few years, including its new world truck *Novus*, a new range of cars expected next year, followed by a new UV platform and the "small car".

Cautious outlook on CV industry

We take a very cautious outlook on the CV industry following the rising interest rates and tightening liquidity. Many financiers have reduced their exposure towards the industry, leading to a slowdown in the segment. We believe that this lacklustre trend would continue for the next two quarters. With the interest rates peaking out, operators' profitability remaining intact and better availability of funding, we believe the situation would correct from the second half of the year.

In view of the slowdown in the CV segment, we are downgrading our FY2008 earnings estimate by 6.2% to Rs53.4 and introducing our FY2009 numbers. We expect stand-alone earnings of Rs60.8 and consolidated earnings of Rs70.3 in FY2009. At the current levels, the stock trades at its FY2009 stand-alone EPS by 11.7x and its consolidated earnings by 10.1x. We maintain our Buy recommendation on the stock with a price target of Rs980.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Stand alone					
Net profit (Rs cr)	1,228.7	1,519.2	1,914.8	2,058.4	2,465.4
% yoy change	*44.0*	*23.6*	*26.0*	*7.5*	*19.8*
EPS (Rs)	34.0	39.7	47.2	53.4	60.8
PER (x)	21.0	18.0	15.1	13.3	11.7
EV/EBIDTA (x)	11.5	10.5	8.5	6.9	6.0
RoCE (%)	32.5	30.1	29.9	28.3	29.9
RoNW (%)	29.9	27.4	28.0	25.1	28.0
Consolidated					
Net profit (Rs cr)	1,334.8	1,730.6	2,170.1	2,431.9	2,834.7
% yoy change	*45.3*	*29.7*	*25.4*	*12.1*	*16.6*
EPS (Rs)	36.9	45.2	56.3	63.5	70.3
PER (x)	19.2	15.7	12.6	11.2	10.1
EV/EBIDTA (x)	10.4	9.2	6.6	5.7	5.0
ROCE (%)	33.2	30.8	33.4	32.1	31.8
RONW (%)	30.9	27.9	28.4	25.3	23.9

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

Punjab National Bank

Ugly Duckling

Stock Update

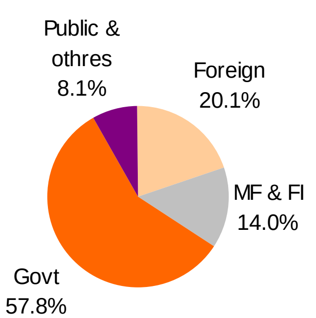
Q4FY2007 results: First-cut analysis

Buy; CMP: Rs559

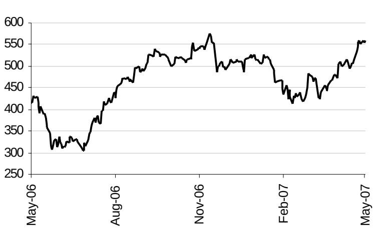
Company details

Price target:	Rs578
Market cap:	Rs17,625 cr
52 week high/low:	Rs585/300
NSE volume: (No of shares)	6.3 lakh
BSE code:	532461
NSE code:	PNB
Sharekhan code:	PUNBANK
Free float: (No of shares)	13.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.2	23.6	3.1	37.3
Relative to Sensex	10.8	19.5	-2.7	-2.1

Result highlights

- The Q4FY2007 results of Punjab National Bank (PNB) are much below our expectations with the profit after tax (PAT) reporting a decline of 17.7% year on year (yoy) to Rs237 crore compared with our estimate of Rs460 crore. The PAT declined mainly due to higher than expected staff expenses and provisions.
- The adjusted staff expenses (adjusted for Rs225 crore of write-back in pension liability expenses during Q4FY2006) grew by 35.2% yoy and 34.4% quarter on quarter (qoq) to Rs781 crore from Rs581 crore in December 2006 and Rs577.6 crore in March 2006. Such a sudden spike could be due to a one-off item, details of which are awaited.
- The reported net interest income (NII) was up 20.6% yoy but down by 1.6% qoq to Rs1,423 crore. However, adjusted for a one-time cash reserve ratio (CRR) interest income of around Rs56 crore the NII was up 15.8% yoy to Rs1,367 crore. The net interest margin (NIM) of the bank is likely to have declined on a sequential basis.
- The non-interest income was up 23% yoy and higher by 30.2% qoq to Rs518.4 crore.
- The adjusted operating expenses shot up by 27.8% yoy and 30.4% qoq mainly due to the jump in the staff expenses, which restricted the operating profit growth to 6.9% yoy. The provisions remained stable yoy but showed an increase of 41.6% qoq; a detailed break-up of the same is awaited.
- The asset quality of the bank has shown some deterioration with the net non-performing asset (NPA) in percentage terms at 0.76% in March 2007 compared with 0.42% in December 2006 and 0.29% in March 2006. However, the gross NPA stood at 3.45% compared with 3.65% in December 2006, largely due to a higher advances base because in absolute terms the gross NPA increased to Rs3,391 crore from Rs3,268 crore in December 2006.
- The bank management has said that it needs around Rs2,000 crore of additional capital in FY2008 for its overseas subsidiaries and to meet Basel-II compliance. It plans to raise Rs500 crore tier-II capital by June-end and additional equity capital could also be raised which will dilute the government's stake from the existing 57.8% to 51% in CY2008.
- At the current market price of Rs559, the stock is quoting at 8.4x its FY2008E earnings and 1.4x FY2008E book value. A detailed result update would follow.

Result table Rs (cr)

Particulars	Q4FY07	Q4FY06	% yoy	FY2007	FY2006	% yoy
Net interest income*	1367.0	1180.2	15.8	5514.6	4666.8	18.2
Non-interest income	518.4	421.5	23.0	1042.3	1231.2	-15.3
Net income	1885.4	1601.7	17.7	6556.9	5897.9	11.2
Operating expenses**	1059.1	828.4	27.8	3326.2	3023.2	10.0
Operating profit	826.4	773.3	6.9	3230.6	2874.7	12.4
Provisions & contingencies	612.7	611.1	0.3	1061.5	839.9	26.4
PBT	269.7	387.1	-30.3	2169.1	2034.8	6.6
Provision for taxes	32.0	98.4	-67.5	629.1	595.5	5.6
Net profit	237.7	288.7	-17.7	1540.1	1439.3	7.0

* Adjusted for a one-time CRR interest income of around Rs56 crore earned during Q4FY2007
** Adjusted for a write-back of Rs225 crore of pension liability expenses incurred during Q4FY2006

NIIT Technologies

Ugly duckling

Stock Update

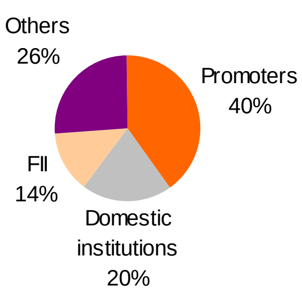
Price target revised to Rs720

Buy; CMP: Rs519

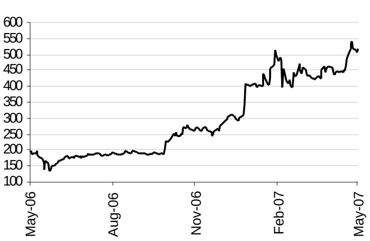
Company details

Price target:	Rs720
Market cap:	Rs2,007 cr
52 week high/low:	Rs564/131
NSE volume: (No of shares)	1.4 lakh
BSE code:	532541
NSE code:	NIITTECH
Sharekhan code:	NIITTECH
Free float: (No of shares)	2.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.6	2.8	93.8	177.0
Relative to Sensex	4.4	-0.5	83.0	97.6

Result highlights

- NIIT Technologies Ltd (NTL) reported a growth of 5.2% quarter on quarter (qoq) and 46.5% year on year (yoy) in its consolidated revenues to Rs243.5 crore during the fourth quarter. The organic revenues grew at a rate of 5.2% sequentially. The revenues of Room Solutions (acquired in May 2006) also grew by 5.2% qoq to Rs31.3 crore.
- The company reported an improvement of 70 basis points in its operating profit margin (OPM) to 21.9% on a sequential basis, despite the adverse impact of the appreciation of the rupee during the quarter. The margin improvement was driven by the cumulative impact of a favourable revenue mix, savings in the overhead cost as a percentage of sales, higher margins in the business process outsourcing (BPO) business and better profitability of Room Solutions.
- The increase in the other income (Rs5.6 crore as compared with the third quarters' Rs3.3 crore, which was driven by tax refund in its overseas subsidiary), lower depreciation charges and a steep decline in effective tax rate (down to 2% due to the write-back of the provisions made earlier) aided the earnings growth during the quarter. Consequently, the consolidated earnings grew at an explosive rate of 32.7% qoq and 138.9% yoy to Rs45.9 crore. This is the third consecutive quarter of over 20% sequential growth in the earnings.
- In terms of the outlook, the company is expected to maintain the growth momentum on the back of the record order intake of $72 million during the quarter and $209 million over FY2007. The pending order backlog of $103 million (executable over the next one year) is one of the highest ever reported by the company. The management expects the margin to also improve with the improving profitability of the BPO business, the efforts taken to increase the proportion of

Result table Rs (cr)

Particulars	Q4FY07	Q4FY06	Q3FY07	% yoy	% qoq
Net revenue	**243.5**	**166.2**	**231.5**	**46.5**	**5.2**
Operating expenses	190.1	133.0	182.4	42.9	4.2
Operating profit	53.4	33.2	49.1	60.8	8.8
Other income	5.6	1.1	3.3	409.1	69.7
Depreciation	9.7	11.0	10.5	-11.8	-7.6
Profit before tax	49.3	23.3	41.9	111.4	17.7
Prov for taxation	2.0	3.6	6.8	-44.4	-70.6
Net profit	47.3	19.7	35.1	139.9	34.8
Minority share	1.4	0.5	0.5	180.0	180.0
RPAT	**45.9**	**19.2**	**34.6**	**138.9**	**32.7**
Equity capital	38.7	38.7	38.7		
EPS (Rs)	11.9	5.0	8.9		
Margins (%)					
OPM	21.9	20.0	21.2		
NPM	18.9	11.6	14.9		

the high-margin offshore revenues and other cost levers like a lower overhead cost. There is enough scope for further improvement in the overhead cost (at 20% of its sales in FY2007). Consequently, the earnings estimate has been revised upwards by 16.4% for FY2008.

- Along with the results, the company has rewarded the shareholders with a bonus issue of one equity share for every two shares held and a dividend of 65% on the existing capital.
- At the current market price the stock trades at 12.2x FY2008 and 10.1x FY2009 estimated earnings. We re-iterate our Buy call on the stock with an upgraded price target of Rs720 (14x FY2009 earnings).

Revenue growth dented by rupee appreciation

In dollar terms, the consolidated revenues of NTL grew by 6.3% but the appreciation of the rupee limited the growth to 5.2% in rupee terms on a sequential basis. The revenue growth was largely even across organic software service, BPO and Room Solution businesses.

Revenue break-up

	Q4FY07	Q3FY07	% qoq
Organic software services	197.0	187.6	5.0
Room Solutions	31.3	28.7	5.2
BPO	15.2	14.2	7.0
Total revenues	243.5	231.5	5.2

Margins continue to firm up

Despite the adverse impact of the appreciation of the rupee, the company reported a 90-basis-point improvement in its margins during the quarter. Sequentially, the company benefited from the steep improvement in the BPO business' margin, up from 3.5% in Q3 to 9.9% in Q4. Moreover, the OPM of Room Solutions also continued to improve sequentially. The OPM of Room Solutions improved by around 180 basis points to 8% in Q4, resulting in a combined positive impact of around 60 basis points on the margins. In addition to this, the company gained from saving in the selling, general and administration (SG&A) cost as percentage of sales.

Outlook is encouraging

NTL does not provide any specific growth guidance, however while announcing the results the management sounded quite confident of maintaining the growth momentum going forward. The strategy to focus on the key verticals is not only resulting in a better revenue growth but has also enabled NTL to significantly improve its employee productivity (revenue per employee) over the past couple of quarters.

In terms of margins, the management expects the OPM to improve in the coming quarters. The three key levers of margin improvement are going to be the improvement in the contribution from the offshore revenues (37% and 36% of the total turnover in Q4 and FY2007 respectively), the leverage in the SG&A expenses (the SG&A expenses are relatively high at 20% of the turnover), further improvement in the profitability of the BPO business and firming up of the billing rates.

In view of the exponential growth in the last three quarters, the healthy order intake and the encouraging outlook, we have revised upwards the earnings estimate for FY2008 by 16.4%.

Other highlights

The fresh order intake of $72 million is one of the highest reported in any quarter. Consequently, the pending order backlog executable over the next four quarters has increased to $103 million (up from $95 million reported as in December 2006). The company added three new clients during the quarter.

NTL added only 249 employees during the quarter. The net addition of 278 employees in the software service business was in line with the earlier trend and as per expectations. However, the company reduced its BPO headcount by 33 employees as part of the restructuring programme. Going forward, the company expects to add over 1,000 employees in the current fiscal.

The joint venture announced with Adecco has been formed in the last quarter and is likely to commence operation from July 2007. The company expects the joint venture to make a reasonable contribution to the overall growth in FY2008. We have not factored the same in our estimates yet and would wait for more details to do so.

Valuation

At the current market price the stock trades at 12.2x FY2008 and 10.1x FY2009 estimated earnings. We re-iterate our Buy call on the stock with an upgraded price target of Rs720 (14x FY2009 earnings).

Earnings table

Particulars	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	607.5	885.9	1145.7	1432.6
Net profit (Rs cr)	66.3	129.2	166.1	200.9
No of shares (crs)	3.9	3.9	3.9	3.9
EPS (Rs)	17.2	33.0	42.5	51.4
% y-o-y change	*13.2*	*92.7*	*28.6*	*20.9*
PER (x)	30.3	15.7	12.2	10.1
Price/BV (x)	7.4	5.5	4.0	3.0
EV/EBIDTA(x)	16.4	10.8	7.8	6.1
Dividend yield (%)	1.16	1.25	1.35	1.45
RoCE (%)	25.9	38.7	39.0	37.8
RoNW (%)	30.3	39.0	35.0	31.0

Automobiles

Sector Update

Dream run interrupted

The commercial vehicle (CV) segment has been on a dream run, with FY2007 being its sixth straight year of positive growth. A strong growth in the economy, easy availability of finance, lower interest rates and high freight rates contributed to this phenomenal performance. We believe that the time has come for taking a slight breather. While the macro factors still appear to be strong, we expect the growth to slacken in the next 6-12 months.

In the shorter term, we expect a slowdown in the first half of the current fiscal primarily for the following reasons.

1. Tightening auto credit, as many banks are lowering their exposure towards the sector.
2. Rising interest rates, which are leading to postponement of buying decision by prospective customers.
3. High base of last year, as last year's sales included the maximum impact of one-time demand created due to a ban on the overloading of trucks.

However, we are expecting the situation to correct itself in another 6-12 months, as the interest rates would peak out by then. We also expect the credit availability to improve, as the banks would again start focusing on the segment. Hence, we believe that this slowdown is an aberration and on a longer-term basis, we expect the CV growth to continue on a fast track, considering the buoyancy in the country's economy. We expect the CV segment to record a growth of 9.7% in FY2008 and of 10% in FY2009.

To impact earnings of the current year

The slowdown in the CV segment in the current fiscal would affect the earnings estimate of major CV players like Tata Motors and Ashok Leyland. We currently expect Tata Motors to record a growth of 12.9% in its CV sales in the current year. Ashok Leyland is expected to record an 11.9% growth. Any further slowdown can adversely affect the earnings of these two companies and we estimate that a 100-basis-point drop in growth can affect the earnings estimate by 1.2% for Tata Motors and by 2.1% for Ashok Leyland.

However, the long-term fundamentals of both the companies remain intact and hence we are positive on the long-term outlook for the sector and these two companies. Hence we maintain our Buy recommendation on Tata Motors with a price target of Rs980 and that on Ashok Leyland with a price target of Rs44.

Valuation table

Companies	PER (X)		EV/EBIDTA (x)	
	FY2007	FY2008	FY2007	FY2008
Tata Motors	12.6	11.2	6.6	5.7
Ashok Leyland	11.5	10.5	6.8	6.6

Economic buoyancy to fuel CV growth in the long term

With continued buoyancy in the industry, we expect the upswing in freight availability to continue going forward as we expect the road freight in the country to grow at a compounded annual growth rate of 12.2% between FY2007 and FY2009. The higher base of last year due to the demand generated from the ban on the overloading of trucks plus rising interest rates would slow down the growth of the CV industry. Based on our analysis, we forecast the CV industry would grow at 9.7% in FY2008 and at 10% in FY2009.

Auto credit tightening affecting sales volumes

We gather that many banking companies have raised the number of checks regarding the creditworthiness of the prospective buyers due to increasing cases of delinquencies. Some of the banks are also lowering their exposure to the auto sector and hence are not extending any credit towards the same. This is a key challenge in front of the manufacturers, as lack of funding would result in an adverse impact on the CV sales. Many companies have their own financing arms and as a countermove these are still extending credit at attractive terms. However, the penetration of the same is still limited to lower tonnage vehicles and this is affecting the sales in the higher tonnage segment.

As the interest rates and inflation are expected to peak out soon, we are expecting the situation to correct itself in another 6-12 months' time. Hence, we expect the same to hamper growth in the auto sector for the next couple of quarters.

Effect of interest rates

Rising interest rates and tightening liquidity in the system have been primarily responsible for spoiling the party for the automobile sector. The interest rates have witnessed a growth of about 3-4% in the past one and a half years. The rising interest rates have reached an inflection point where these have started hurting the demand. The rising interest rates have started to have an impact on the industry and the sales have been affected in the last couple of months. We expect that this would continue to hurt the whole automobile sector in the coming months, particularly in the first half of FY2008. We expect the situation to improve in the second half of the year, as the rates stabilise. On the other hand, the tightening of liquidity by banks and funding companies to curb inflation is leading to slowdown in the sanctioning of the auto loans.

About 80-85% of the CVs sold are financed; hence the rising interest rates are expected to trigger a slowdown in the segment. Approximately a 400-basis-point rise in the interest rates has increased the monthly installments of truck owners by about 4.8%. A further 100-basis-point rise in the rates would make the monthly installments costlier by 1.9%. However, we believe that the interest rates are nearly peaking out and consequently expect the demand to pick up in the second half of the fiscal.

Fleet operators still profitable

On the positive side, we gather that the fleet operators are still making money and are enjoying sufficient margins on their business. Parallel to the rise in the fuel costs and interest charges in the last one year, the freight rates have also gone up consistently in the last two years. Consequently, we believe that the fleet operators are still making adequate profits and have been in a position to pass on the impact of higher interest costs and fuel prices.

We also gather that the large fleet operators now have more than half the share in the CV segment as even the single owner truckers are joining bigger transport companies, making the whole industry more organised. In our view, this is a positive for the industry, as such consolidation would lead to more organised activities and the operators are in a better position to utilise most of their capacity.

Truck operators' profitability

	Base	Current	Forecast
Revenues	100	100	100
Total expenditures (%)	92.2	92.1	92.1
Fuel & Oil cost (%)	51.8	52.7	50.7
EMI (%)	27.2	26.7	28.1
Tyre cost (%)	1.0	1.1	1.2
Staff cost (%)	2.6	2.5	2.5
Other cost (%)	9.6	9.1	9.6
Operating profits (%)	7.8	7.9	7.9

Freight rates have risen by almost 30% in the last two years, fuelled by the ban on the overloading of trucks, rising interest and high fuel costs. The rise in the freight rates has been in tandem with the rise in the costs of the freight operators and hence they have been adequately compensated. With lower fuel prices and also higher use of higher tonnage vehicles (offering better economics), the freight rates are expected to remain stable in the medium term.

Product innovations, more cost efficiencies to lead the way

Two companies dominate the CV industry: Tata Motors and Ashok Leyland. Going forward, with the industry growth rates expected to taper down, higher product innovations and better cost efficiencies are likely to fuel growth for these companies. The last few years have witnessed a number of strong innovations in the CV space, namely the launch of *Ace* by Tata Motors and the roll-out of tractor trailers and other multi fuel vehicles. The incremental growth for companies has come through these new innovations, which have also led to the formation of new segments. Going forward, we believe that strong innovation skills would be the key to success for any company, particularly with the implementation of Euro IV norms from April 1, 2010 for the CV majors. However, we believe that the CV majors in India are geared up to face technological challenges of the future and we would continue to see strong product innovations going forward too. The two companies under our coverage would face a bit of heat in the coming two years due to volume slowdown, margin pressure owing to high raw material prices, and higher interest and depreciation charges on account of their huge capex. However, we are positive on the long-term prospects of these companies. Consequently, we maintain our positive outlook on these two companies. We maintain our Buy recommendation on Tata Motors with a price target of Rs980 and that on Ashok Leyland with a price target of Rs44.

Sharekhan Stock Ideas

Evergreen

- HDFC Bank
- Infosys Technologies
- Reliance Industries
- Tata Consultancy Services

Apple Green

- Aditya Birla Nuvo
- ACC
- Apollo Tyres
- Bajaj Auto
- 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
- HCL Technologies
- 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 Power Infrastructures
- 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

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