investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aurobindo	28-May-07	684	**769**	914
Crompton	19-Aug-05	88	**254**	280
HDFC Bank	23-Dec-03	358	**1,130**	1355
JP Associates	30-Dec-03	125	**778**	850
Zensar Tech	18-Jun-07	342	**350**	484

Sharekhan Ltd
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Sharekhan Special

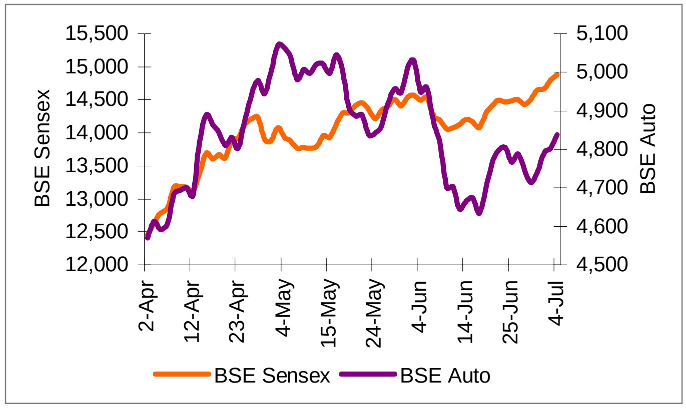
Q1FY2008 Auto earnings preview

The first quarter of the current fiscal has started on a weak note for the automobile industry, as the sales volumes were affected by the rising interest rates, tightening of liquidity by the financiers and the seasonal effect of the monsoon. The two-wheeler segment was the worst affected as the sales in the 100cc segment were hit by price wars that led to stringent checks and lower loan sanctions by financiers. The commercial vehicle (CV) sales too slowed down during the quarter due to lower availability of finance as well as freight (the latter due to the monsoon). The surprise in the pack was the passenger car segment, which saw a good growth led by a number of new launches in the recent times.

The automobile sector has underperformed the Sensex since April 2007 (as can be seen from the chart). This underperformance is likely to continue in the second quarter as well and a revival is expected from September-October onwards.

Among the heavyweights, Bajaj Auto Ltd's (BAL) sales volumes declined by 11.9%, whereas Hero Honda Motors (Hero Honda) reported a decline of 3.6% in its sales for the first quarter. Maruti Udyog Ltd's (MUL) car sales grew by a strong 17.1%; the overall sales of Mahindra & Mahindra (M&M) were up by 21.9% and Tata Motors' sales grew by a mere 1%.

Auto Index vs Sensex performance during last quarter



The operating profit margins (OPMs) are expected to remain under pressure for the whole sector considering the high raw material prices and increasing competition (particularly in the two-wheeler segment). **We expect MUL, Ceat, Apollo Tyres and Ahmednagar Forgings to be among the lead performers in the sector in Q1FY2008.**

Quarterly estimates

(Rs crore)		Net sales			Profit after tax	
	Q1FY08E	Q1FY07	% change	Q1FY08E	Q1FY07	% change
Bajaj Auto	1,987.5	2,202.7	-9.8	241.2	277.6	-13.1
Maruti Udyog	3,817.6	3,114.0	22.6	374.8	338.0	10.9
Mahindra & Mahindra	2,548.5	2,236.3	14.0	203.7	205.7	-0.9
Tata Motors	5,791.2	5,819.0	-0.5	326.9	417.5	-21.7
Ashok Leyland	1,598.3	1,423.9	12.3	71.4	75.6	-5.6
Omax Auto	150.5	160.3	-6.1	1.6	5.7	-71.9
Sundaram Clayton	214.2	189.9	12.8	19.5	18.0	8.6
Subros	159.7	141.6	12.8	5.4	5.9	-10.0
Ahmednagar Forgings*	172.5	98.7	74.8	18.7	10.3	82.5
SKF India**	364.2	327.9	11.1	28.6	25.3	13.0
Federal-Mogul Goetze**	126.4	114.5	10.3	3.1	-3.4	NA
Ceat	537.5	497.7	8.0	22.5	0.2	9,685.4
Apollo Tyres	830.8	757.3	9.7	38.1	16.3	134.1
Auto universe	**18,298.8**	**17,083.6**	**7.1**	**1,353.9**	**1,392.6**	**-2.8**

*June ending **December ending

BAL

We expect BAL to report disappointing numbers for the first quarter. Its sales performance in the first quarter was disappointing as the sales were affected by the slowdown in the sector, particularly in the 100cc segment, and inventory corrections. The motorcycle sales declined sharply by 13.1% year on year (yoy) while the three-wheeler sales remained flat at 0.7%. Due to increased competition from archrival Hero Honda, the company lost considerable market share in the economy segment, even though it reduced *Platina's* prices during the quarter and passed on the benefit derived from the commissioning of its new plant at Uttarakhand.

As a result the sales for the quarter are projected to decline by 9.8%. The OPM is likely to fall to 13.7% from 16.4% in Q1FY2006 on the back of a higher raw material cost and intensified competition. The profit after tax (PAT) is thus projected to decline by 13.1%.

Sales performance

Volume	Q1FY08	Q1FY07	% yoy chg
Other two-wheelers	6,212	9,007	-31.0
Motorcycles	493,565	568,187	-13.1
Total two-wheelers	**499,777**	**577,194**	**-13.4**
Three-wheelers	71,336	70,875	0.7
Grand total	**571,113**	**648,069**	**-11.9**

M&M

M&M rendered a good performance in Q1FY2008 with the sales of its utility vehicles (UVs) rising by an impressive 23.5%. The growth was backed by the good sales of the all-new *Scorpio*, whose sales grew by 16.1%, and *Bolero*. The light commercial vehicle (LCV) sales continued to be strong while three-wheeler sales were also good in comparison with the industry, as the same grew by 11.5% on the back of the success of its offering *Alfa*. Tractor sales remained sluggish, almost flat, during the quarter but are expected to improve going forward on the back of a good monsoon.

Sales performance

Volume	Q1FY08	Q1FY07	% yoy chg
Utility vehicles	31,171	25,216	23.6
Scorpio	9,392	8,093	16.1
UVs w/o Scorpio	21,779	17,123	27.2
LCVs	2,681	1,930	38.9
Three-wheelers	7,336	6,582	11.5
Total domestic automotive	**41,188**	**33,728**	**22.1**
Exports	2,436	1,331	83.0
Total automotive	43,624	35,059	24.4
Tractors	27,291	27,367	-0.3
Total	**70,915**	**62,426**	**13.6**
Cars (in JV)	5,175	0	NA
Grand total	**76,090**	**62,426**	**21.9**

MUL

The winner is MUL as it continued its impressive show in the first quarter of the fiscal. The volumes in the A2 segment comprising *Alto*, *Zen Estilo*, *Wagon R* and *Swift* grew by 20.7% in the quarter, led by the strong performance of the *Alto* and *Diesel Swift*. The sales of *Omni* and *Versa* were also good in Q1 (up 22.7% yoy) while the greatest improvement was in the A3 segment's sales, which grew by 46% led by the launch of *SX4*. The model is already believed to have toppled *Honda City* in the premium sedan category. The exports grew by 15.6% yoy to 9,065 units during the quarter.

We expect slight pressure on the margin front, due to the higher contribution from the new products and the continuing loss suffered by the Manesar plant. The company also offered heavy discounts during the quarter to achieve sales volumes. Consequently, we expect the OPM to decline by 116 basis points to 13.45%, while the net profit before extraordinaries is expected to grow by 10.9% to Rs374.8 crore.

Sales performance

Volume	Q1FY08	Q1FY07	% yoy chg
M-800	17,994	20,300	-11.4
Omni, Versa	20,631	16,809	22.7
Alto, Zen, Wagon-R, Swift	110,413	91,450	20.7
SX4, Esteem	11,056	7,571	46.0
Total passenger cars	**160,094**	**136,130**	**17.6**
MUV	510	974	-47.6
Domestic	160,604	137,104	17.1
Export	9,065	7,844	15.6
Total sales	**169,669**	**144,948**	**17.1**

Tata Motors

Tata Motors delivered a lacklustre performance in Q1FY2008 with an overall volume growth of just 1%. The CV segment's sales were hit during the month as the segment faced heat from the financiers. Many financiers, in their endeavour to reduce exposure to the automobile sector, withdrew from the market. The sales were also affected by the onset of the monsoon. The UV segment continued to do well as *Safari* continued to do well. The car sales also slowed down in Q1FY2008, growing by 0.7%, as sales of *Indigo* and *Indica* were affected due to the recent launches from competition, such as *Chevrolet Spark* and *Mahindra Logan*. The PAT for the quarter is expected to decline sharply by 21.7% to Rs326.9 crore.

Sales performance

Volume	Q1FY08	Q1FY07	% yoy chg
M&HCV	32,655	36,607	-10.8
LCV	29,044	26,535	9.5
UV	10,040	8,417	19.3
Cars	41,800	41,489	0.7
Domestic sales	113,539	113,048	0.4
Exports	13,822	13,106	5.5
Total sales	**127,361**	**126,154**	**1.0**

Ashok Leyland

Ashok Leyland has made up for the slowdown in the CV segment by higher sales of buses during the quarter, as some of the orders to the State Transport Corporation were due. The sales volume for the quarter have grown by 6.6%.

For Q1, we expect Ashok Leyland to post a sales growth of 12.3%; while the net profit for the quarter is projected to decline by 5.6% to Rs71.4 crore.

Sales performance

Volume	Q1FY08	Q1FY07	% yoy chg
MDV passenger	5,128	2,181	135.1
MDV goods	12,876	14,762	-12.8
LCV	159	97	63.9
Total sales	**18,163**	**17,040**	**6.6**

Ahmednagar Forgings

We expect Ahmednagar Forgings to continue on its growth path and report good numbers for the last quarter of the fiscal ending June. The company had recently commissioned its two Anvil lines and is slowly ramping up production from those lines. It will be further raising its capacity to 140,000 tonne per annum in the next couple of months. For Q4FY2007, we expect the company to post a top line growth of 74.8% and a bottom line growth of 82.5%.

Apollo Tyres

The slowdown in CV sales would affect Apollo Tyres as well. We expect the sales volume to grow by 10% during the current quarter. The margin is expected to improve to 11% mainly on the back of soft rubber prices. The first quarter of last year was one of the worst quarters for the whole industry as the rubber prices were at their peak then and price hikes were effected for part of the quarter only. The net profit for the quarter is expected to improve by 134% to Rs38.1 crore.

Ceat

We expect Ceat to continue to deliver a strong performance in Q1FY2008, despite the slowdown from the original equipment manufacturers (OEMs). The company is realigning its strategies to push its replacement and export sales to counter the slowdown in the OEM segment. For the current quarter, we expect the company to report an 8% growth in its top line to Rs537.5, while we expect the margins to improve due to lower raw material prices. On a year-on-year basis, we expect the margins to improve by 430 basis points to 8%. There also might be an extraordinary gain to the tune of Rs20 crore during the quarter relating to certain tax refunds. Excluding the same, we expect the company to report a net profit of Rs22.5 crore against Rs0.2 crore reported last year.

Federal Mogul Goetze

The slowdown in the CV and two-wheelers segment is expected to take a toll on the performance of the company as it has a large exposure to these segments. For the quarter we expect the sales to grow by 10%. We expect the company to report a profit of Rs3.1 crore as against a loss of Rs3.4 crore in the corresponding period of the previous year.

Omax Auto

We expect the performance of Omax Auto to be adversely affected as the majority of its sales comes from the two-wheeler segment. We expect the company to report a decline of 6% in its top line while its margins too would be lower due to the low volume growth and the pressure from the OEMs to reduce prices. We expect the company to report a marginal profit of Rs1.6 crore for the first quarter.

Sundaram Clayton

The slowdown in the CV segment is expected to affect the performance of Sundaram Clayton too in the first quarter, as its key clients Tata Motors and Ashok Leyland reported a sluggish growth during the period. The margins are expected to be maintained at last year's levels, but the bottom line is expected to be affected by the higher interest and depreciation costs as a result of its high capital expenditure. Overall, we expect the sales to grow by 12.8% and the net profit to grow by 8.6% to Rs19.5 crore.

Subros

Subros' performance is dependent on the performance of its key clients MUL and Tata Motors. The company is already supplying for *M800*, *Alto* and *Wagon*R, and is also a part supplier for *Swift* and *SX4*. We expect Subros to report a decent top line growth for Q1FY2008, as the net sales are projected to grow by 12.8%, while the OPM is expected to be maintained at 11%. However, higher interest and depreciation costs are expected to affect the profitability during the quarter and hence the PAT is projected to decline by 10% to Rs5.4 crore.

SKF India

SKF India is expected to report steady performance for the second quarter of CY2007, though the performance would be slightly lower due to the slowdown in the automobile sector. We also anticipate an improvement in its OPM on the back of greater operating efficiencies resulting from increased capacity utilisation. For Q2CY2007, we anticipate a top line growth of 11%, a margin improvement of 40 basis points to 13.4% and a PAT growth of 13% to Rs28.6 crore.

Valuation table—Sharekhan auto universe

Particulars	CMP	EPS		PER		EV/EBIDTA	
	(RS)	FY07	FY08E	FY07	FY08E	FY07	FY08E
Ahmednagar Forgings	240	20.3	36.5	11.8	6.6	7.7	4.6
Apollo Tyres	360	24.4	31.3	14.7	11.5	6.3	5.1
Ashok Leyland	38	3.1	3.5	12.5	11.0	7.5	7.4
Bajaj Auto	2,090	98.6	116.8	21.2	17.9	13.8	11.5
Ceat	167	8.7	15.9	19.2	10.5	7.6	4.9
Federal Mogul Goetze	200	-	12.6	-	15.9	23.7	9.0
Maruti Udyog	805	54.0	59.2	14.9	13.6	11.2	9.3
M&M*	771	62.3	71.3	12.4	10.8	6.7	5.7
Omax Auto	81	11.1	9.3	7.3	8.7	4.2	4.5
Subros	219	26.6	32.8	8.2	6.7	4.3	3.4
Sundaram Clayton	830	48.9	59.1	12.1	10.0	9.1	7.7
Tata Motors*	707	56.3	60.9	12.6	11.6	6.6	5.9
SKF India	417	18.8	24.2	22.2	17.2	11.9	9.4

*Consolidated numbers

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

Sharekhan Special

Q1FY2008 Banking earnings preview

We expect the first quarter numbers from the banking industry to be mixed as the net interest margins (NIMs) and provisions are expected to vary across banks. With liquidity not being a concern for the major part of this quarter, we expect most of the banks had a sound operational quarter.

The NIM is expected to vary across banks mainly due to the impact of the deposit costs. The across-the-board prime lending rate (PLR) hikes would definitely show up as an improvement in the asset yields for all banks but the differentiator would be the higher increase in the cost of funds for certain banks who raised large-scale high cost bulk deposits during Q4FY2007.

For most banks the non-interest income component is expected to show a steady year-on-year (y-o-y) growth but a sequential decline, as the non-interest income is normally higher in the fourth quarter compared with the other quarters.

Although benchmark yields have not moved up significantly from March 2007 levels, yet provisions are expected to vary across the board for public sector banks, as some of them shifted securities from the "available for sale" (AFS) category to the "held to maturity" (HTM) category. This would result in a one-time hit during the quarter. The expected increase in the loan loss provisions would also keep the provision figure high.

Expected performance of certain private and public banks

Banks	Key highlights
SBI	We expect the NIM to improve marginally due to an increase of 125 basis points in the PLR. The NSE stake sale would keep treasury gains high. However provisions are expected to remain high on account of investment depreciation booked as the bank has shifted securities from its AFS portfolio to its HTM portfolio. Higher provisions on account of deterioration in asset quality are also expected. The y-o-y profit growth is likely to be sharp on account of a lower base in Q1FY2007.
PNB	Has also shifted securities from its AFS portfolio to HTM portfolio. But investment depreciation is not expected to be significant as the bank's investment book was protected till the benchmark yield of 8.01% as on March 2007 and at the time of shifting the securities the yield was only six to seven basis points higher than the March 2007 yield.
BOB	NIM expected to remain stable with global business reporting a growth of around 22-23%; has also shifted securities but the impact of the shift would be nominal. The treasury income is expected to remain high as we expect the NSE stake sale amount to get reflected in the current quarter. The y-o-y profit growth would be sharply influenced by a lower base in Q1FY2007.
ICICI	Expected to face some pressure on NIM, non-interest income growth to remain steady. However, provisions may remain high due to higher loan loss provisions.
UTI	Expected to show best earnings growth among the private players. Some pressure on NIM is expected on a sequential basis in line with past trends, as low yielding securities brought on books to meet regulatory requirements may affect the asset yields. Operating expenses are expected to remain high, as the bank has been hiring aggressively. So far we have not witnessed any weakness in asset quality of the bank but we have assumed a higher loan loss provision for the quarter.

Quarterly estimates (Rs crore)

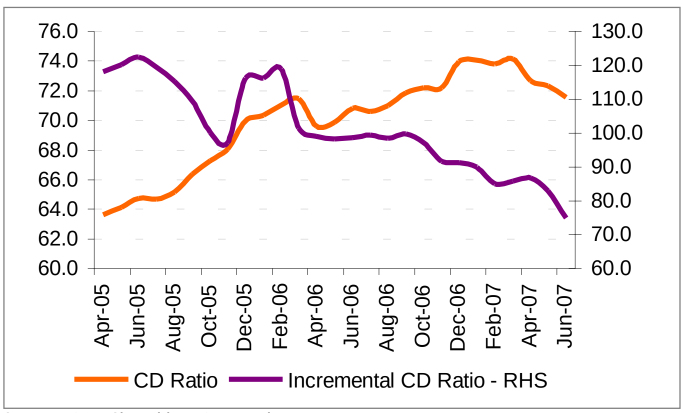
Banks	NII Q1FY08E	(%) yoy chg	(%) qoq chg	PPP Q1FY08E	(%) yoy chg	(%) qoq chg	PAT Q1FY08E	(%) yoy chg	(%) qoq chg
ICICI Bank	1854.2	25.7	1.6	1635.6	32.9	-21.7	704.0	13.6	-18.2
HDFC Bank	2121.0	41.0	8.5	855.8	39.0	8.3	313.5	31.0	-8.8
UTI Bank	471.7	46.6	1.6	374.7	22.0	-11.3	188.1	56.1	-11.2
Total - Private	**4446.9**	**34.7**	**4.8**	**2866.1**	**33.1**	**-13.2**	**1205.7**	**23.1**	**-14.9**
SBI	4767.6	22.7	8.2	3292.9	16.1	-8.5	1147.4	43.7	-23.2
PNB	1327.3	2.7	-2.9	868.3	-1.0	-17.0	401.5	9.2	68.9
BOB	1091.5	34.3	3.7	751.8	35.3	8.6	292.1	78.8	18.9
Total - Public	**7186.4**	**20.0**	**5.3**	**4913.0**	**15.1**	**-7.9**	**1841.0**	**38.5**	**-6.9**
Total	**11633.3**	**25.2**	**5.1**	**7779.1**	**21.1**	**-9.9**	**3046.7**	**32.0**	**-10.2**

The latest credit and deposit growth rates at 25.6% (31% in FY2007) and 23.4% respectively show that the gap in advances and deposits has reduced significantly. This would put less pressure on the deposit rates (especially on bulk deposits, some banks have reduced the bulk deposit rates by 200 basis points to 10% levels from the 12% levels offered during March 2007). With inflation having moderated to 4% levels and less pressure on deposit rates, we feel that interest rates are likely to remain stable in the medium term, thereby providing a good operational environment for banks going forward. Our top picks in the private bank space remain HDFC Bank and UTI Bank while in the public sector we like State Bank of India and Bank of Baroda.

Incremental credit/deposit ratio on a steady decline

With most banks having run out of excess statutory liquidity ratio (SLR) holdings, the gap in credit and deposit growth is slowly going to close, as we are witnessing currently. The incremental credit/deposit (CD) ratio has steadily declined from 120% levels to 75% at present. We expect banks to be net buyers of investments in FY2008 and if there is a an SLR cut in the second half of the current fiscal, then it would be a significant earnings driver for the banking sector as incremental advances yields are higher by 2-3% compared to investment yields. Our estimates suggest that a 2% cut in the SLR would improve the earnings by 2.3% and improve the valuations by 5%.

CD ratio and incremental CD ratio

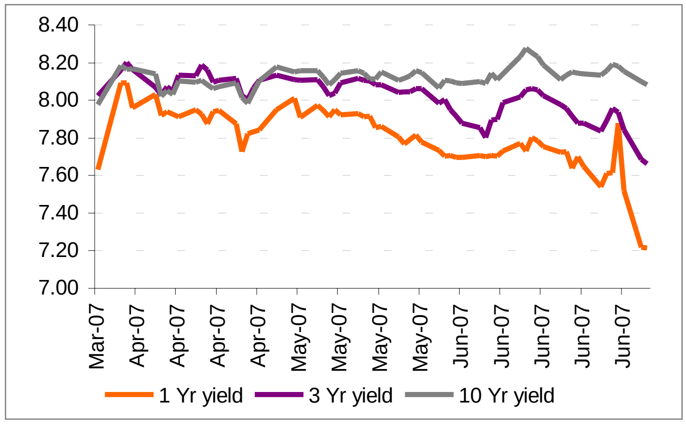


Source: RBI, Sharekhan Research

Benchmark yields have not increased significantly from the March 2007 levels

The benchmark yields of the shorter and medium ends of the yield curve (one-year and three-year) have declined while the 10-year yield has not moved up significantly from the March 2007 levels. Hence the marked-to-market provisions are expected to remain low. However provisions are expected to vary across the board for public sector banks as some of them shifted securities from the AFS category to HTM category which would result in a one-time hit during the quarter.

Benchmark yields for 1 year, 3 year and 10 year



Source: Bloomberg

The banking stocks had a phenomenal run in the last three months

Led by the largest bank State Bank of India, which gained 73%, the banking sector witnessed robust gains across the board. Easing interest rate concerns, improved liquidity conditions coupled with a positive macro and policy environment provided the best ground for the banking stocks to record robust gains.

Banking stock performance

Banks	3 Month	
	Absolute	Relative to Sensex
HDFC Bank	26.9	7.7
BOB	37.2	16.4
BOI	41.4	20.0
Canara	55.2	31.7
Corp Bank	30.4	10.7
ICICI Bank	21.5	3.1
SBI	72.6	46.5
UTI Bank	35.1	14.7
PNB	28.8	9.3
UBI	41.6	20.2
Allahabad Bank	24.1	5.3
Andhra Bank	22.3	3.8

Valuation table

Company	Price target	PER (x)			P/BV (x)			P/PPP (x)		
		FY06	FY07E	FY08E	FY06	FY07E	FY08E	FY06	FY07E	FY08E
Allahabad Bank	101	5.2	4.9	4.4	1.2	1.0	0.9	3.6	3.1	2.6
Andhra Bank	101	8.6	7.8	6.8	1.4	1.3	1.1	5.4	4.5	3.8
Bank of Baroda	310	12.0	9.7	7.6	1.3	1.1	1.0	4.9	4.1	3.4
Bank of India	219	15.3	9.6	8.0	2.2	1.8	1.5	5.5	4.1	3.4
Canara Bank	268	8.2	7.7	6.9	1.5	1.1	0.9	4.2	3.8	3.5
Corp Bank	374	10.1	8.4	7.1	1.3	1.2	1.1	4.3	3.7	3.3
PNB	578	11.6	10.8	8.5	1.8	1.6	1.4	5.3	5.2	4.3
SBI*	1,780	18.5	17.9	17.1	2.2	1.9	1.6	7.2	7.1	6.7
UBI	141	9.7	7.8	6.1	1.4	1.3	1.1	4.1	3.0	2.7
HDFC Bank	1,355	40.6	31.6	27.1	6.7	5.6	3.5	17.9	12.9	10.4
ICICI Bank	1,173	35.2	29.1	28.1	4.0	3.7	2.4	19.1	13.2	12.4
UTI Bank	638	36.2	26.9	25.6	6.1	5.2	2.7	11.0	10.8	8.1

*For P/BV we have taken consolidated book value

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

Aurobindo Pharma

Ugly Duckling

Stock Update

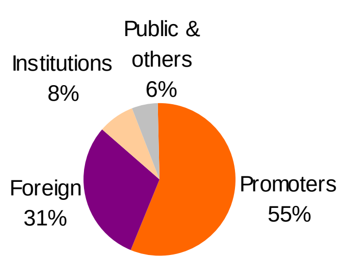
FY2007 results in line with expectations

Buy; CMP: Rs769

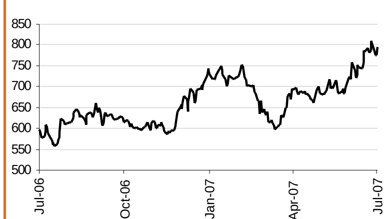
Company details

Price target:	Rs914
Market cap:	Rs4,076 cr
52 week high/low:	Rs820/552
NSE volume: (No of shares)	1.0 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Sharekhan code:	AURPHARM
Free float: (No of shares)	2.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.6	11.5	5.1	35.9
Relative to Sensex	4.4	-4.6	-2.7	-4.0

Result highlights

- For FY2007 Aurobindo Pharma has reported an impressive growth of 349.8% in its consolidated profit to Rs203.2 crore against our expectations of a profit of Rs202.7 crore.
- In FY2007 the company's consolidated revenue grew by 32.7% to Rs2,250.2 crore. The revenue growth was driven by a 64% increase in the international business during the year. The exports from the domestic base increased by 34% to Rs1,147.6 crore in the same period.
- The operating profit margin (OPM) expanded by 230 basis points to 13.4%, which was lower than our expectations. However, the operating profit grew by 70% to Rs302.0 crore during the year. The net profit jumped by 349.8% to Rs203.2 crore on the back of a 25% fall in the interest cost and a substantial decline in the tax incidence brought about by the minimum alternate tax (MAT) credit entitlement of Rs14.54 crore.
- At the current market price of Rs769, the stock trades at 13.4x of its FY2009E earnings. We maintain our Buy recommendation on the stock with a price target of Rs914 per share.

International business reports 64% growth

In FY2007 the consolidated revenues of the company grew by 32.7% to Rs2,250.2 crore. The revenue growth was driven by a 64% increase in the international business during the year. The exports from the domestic base grew by 34% to Rs1,147.6 crore. Basically, the company's efforts to establish its business in the USA, the European Union (EU) and the other key countries helped it to expand its international business. With the ramp-up in the formulation exports, the formulation business contributed about 37.5% to the consolidated top line in FY2007 vs 29.2% in FY2006.

Results table (consolidated) Rs (cr)

Particulars	FY2006	FY2007	% yoy chg
Gross sales	**1,695.5**	**2,250.2**	**32.7**
Total operating expenditure	1,518.0	1,948.2	28.3
Operating profit	177.5	302.0	70.1
OPM (%)	10.5	13.4	28.2
Other income	53.5	49.5	-7.4
Interest costs	60.4	45.4	-24.9
Depreciation	72.1	99.7	38.2
PBT	98.5	206.4	109.6
Total tax	20.9	2.1	-89.8
Profit after tax	**77.6**	**204.3**	**163.4**
Minority interest (MI)	1.4	1.1	-22.0
Profit after MI	**76.2**	**203.2**	**166.8**
Net profit margin (%)	4.5	9.0	101.0
Tax of previous year	6.5	2.2	-65.9
Adjusted PAT	**69.7**	**201.0**	**188.4**

OPM saw marginal expansion

With the increasing contribution of formulations, the OPM of the company improved by 290 basis points to 13.4%, which was less than our expectation of a 15.3% improvement.

Cost analysis (consolidated)

Particulars	FY2006	FY2007	% yoy
Adjusted RM cost	953.7	1170.4	22.7
% of sales	*56.2*	*52.0*	
Employee expenses	102.4	150.4	46.9
% of sales	*6.0*	*6.7*	
Other mfg expenses	461.9	627.4	35.8
% of sales	*27.2*	*27.9*	
Total operating expenditure	1518.0	1948.2	28.3
% of sales	*89.5*	*86.6*	
Operating profit	177.5	302.0	70.1
OPM (%)	10.5	13.4	

The gross margin increased by 420 basis points to 48% in FY2007. But the 70-basis-point increase in both the employee cost and the other expenses restricted the margin growth. The employee expenses went up by 46.9% on account of the integration of the newly acquired Dutch company, Pharmacin International, and the Sandoz's facility in the USA. Also the company added 360 employees (total: 4,600 employees) during year which inflated the employee cost. The other operating expenses rose because of higher dossier filings expenses (up 55% to Rs62 crore) during the year.

Though the Pen-G prices rose by more than two times, the company could not take advantage of the same because the Pen-G prices saw a significant rise only in January 2007. During the fourth quarter the company executed only old contracts where the realisations were capped at the prices agreed upon earlier.

A few words on the company's business structure for Pen-G related products. The stand-alone business procures Pen-G and its derivatives from the company's Chinese unit as raw material and converts the same into end products like Cephalosporins in India for supplying to customers. Aurobindo Pharma takes about three to four months to execute the Cephalosporin supply orders. While booking the supply orders for Cephalosporins, the company fixes the prices of both Cephalosporins and Pen-G simultaneously for a specific order. That is why when the Pen-G prices were rising in the last couple of months, the realisation of the Chinese unit (from Pen-G supplies) as well as of the stand-alone business (from supplies of end-product Cephalosporin) got capped for the ongoing orders. Thus the margin expansion of the consolidated business was not as high as our estimate for FY2007. However, with the progressive rise in the Pen-G prices, the Chinese unit has started generating cash profits since January 2007.

Aurobindo Pharma is currently booking new orders at higher prices. The benefit of the same would be reflected from Q1FY2008 onwards in the form of higher OPM for the consolidated business.

However, we expect the margin expansion to continue on the back of the increasing contribution of the high-margin formulations, its entry into the US injectable market, improving Pen-G prices etc. We expect the consolidated OPM to improve to 17-18% levels during FY2007-09.

Bottom line jumps 349.8%

With the improvement in both the top line and the margin, the operating profit rose by 70.1% to Rs177.5 crore in FY2007. Subsequently, the profit after tax stood at Rs204.3 crore owing to a 25% fall in the interest cost and a substantial decline in the tax incidence.

In fact, the interest cost (net of interest income coming from the FCCB proceeds) fell by 24.9% to Rs45.4 crore and the net tax (after the MAT credit entitlement of Rs14.54 crore) declined by 90% to Rs2.1 crore in FY2007. The company had raised foreign curency convertible bonds (FCCBs) worth $200 million in FY2006. The minority interest was down to Rs1.1 crore, resulting in a 166.8% rise in the profit after minority interest to Rs203.2 crore (against our estimate of Rs202.7 crore).

Again the previous year's profits were boosted by an extraordinary income of Rs30.98 crore. So if we discount the impact of the extraordinary income from the FY2006 profit, the FY2007 net profit after minority interest actually jumps by 349.8%.

Stand-alone results: strictly not comparable

The stand-alone financials are not strictly comparable, as the company merged two of its wholly owned subsidiaries, APL Life Science and Senor Organics Pvt Ltd, with effect from April 1, 2007.

In Q4FY2007, the company saw a modest 15% revenue growth to Rs463.04 crore, as its Cephalosporin bulk business declined by 13.5%. The Cephalosporin revenue fell because the company temporarily stopped manufacturing a few Cephalosporins during the quarter. The company expects growth in Cephalosporins from Q2FY2008 onwards.

The decline in the Cephalosporin revenue overshadowed the impressive 69.2% growth in the formulation sales. The formulations contributed 33.1% to the total sales in Q4FY2007 as against 22.5% in Q4FY2006.

Result table (stand-alone) Rs (cr)

Particulars	Q4FY2006	Q4FY2007	% yoy chg	FY2006	FY2007	% yoy chg
Net sales	463.0	532.8	15.1	1472.2	1979.7	34.5
Adjusted RM cost	263.9	305.6	15.8	875.2	1122.0	28.2
Employee expenses	20.3	32.0	58.0	79.2	112.9	42.5
Other expenses	107.3	130.0	21.1	339.3	466.3	37.4
Total operating expenditure	391.5	467.6	19.5	1293.7	1701.1	31.5
Operating profit	71.6	65.2	-9.0	178.5	278.6	56.1
OPM (%)	15.5	12.2	-20.9	12.1	14.1	16.1
Other income	6.4	15.2	138.7	10.3	43.1	317.5
EBIDTA	78.0	80.4	3.1	188.9	321.7	70.4
EBIDTA margin (%)	16.8	15.1	-10.4	12.8	16.3	26.7
Interest	12.0	3.0	-75.2	44.8	18.7	-58.2
Depreciation	13.3	26.3	97.0	51.1	71.8	40.6
PBT	52.7	51.1	-2.9	92.9	231.2	148.8
Total tax	8.7	-30.1	-446.7	17.1	-0.2	-100.9
PAT	44.0	81.3	84.8	75.8	231.3	205.1
PAT margin (%)	9.5	15.3	60.6	5.2	11.7	126.8
Tax of previous year	6.4	3.2	-50.9	6.5	2.2	-65.3
Adj profit	37.5	78.1	108.1	69.4	229.1	230.2
Net profit margin (%)	8.1	14.7		4.7	11.6	

Product-mix (stand-alone)

	Q4FY06	Q4FY07	% yoy	FY06	FY07	% yoy
SSP	105.9	126.4	19.3	363	466.7	28.6
% of sales	*22.9*	*23.7*		*24.7*	*23.6*	
Cephalosporins	121.9	105.5	-13.5	484	539.2	11.4
% of sales	*26.4*	*19.8*		*32.9*	*27.2*	
ARVs & Others	130.4	124.9	-4.2	354	400.2	13.1
% of sales	*28.2*	*23.4*		*24.1*	*20.2*	
Formulations	104.2	176.3	69.2	270	573.6	112.4
% of sales	*22.5*	*33.1*		*18.4*	*29.0*	
Total	462.5	533.1	15.3	1471.0	1979.7	34.6

During the quarter, the OPM declined by 330 basis points to 12.2% basically due to the merger of the low-margin businesses of APL Life Science and Senor Organics Pvt Ltd. The merger added Rs3.8 crore to the staff cost. Further, the company provided Rs3.6 crore as additional exgratia during the quarter and increased its employee strength to 4,600 employees by adding 360 new employees. This caused a 160-basis-point rise in the staff cost. If we discount the additional employee charges, the OPM was down by 180 basis points. However, Aurobindo Pharma expects the margin to improve from Q1FY2008 onwards on the back of the increasing contribution of the high-margin formulation business and its entry into the US injectable market.

Cost analysis (stand-alone) Rs (cr)

Particulars	Q4FY2006	Q4FY2007	% yoy
Adjusted RM cost	263.9	305.6	15.8
% of sales	*57.0*	*57.4*	
Staff cost	20.2	32.0	58.0
% of sales	*4.4*	*6.0*	
Other Expenses	107.3	130.0	21.1
% of sales	*23.2*	*24.4*	
Total operating expenditure	391.5	467.6	19.5
% of sales	*84.5*	*87.8*	
Operating profit	71.6	65.2	-11.4
OPM (%)	15.5	12.2	

The operating profit stood at Rs71.58 crore, down 20.9%. The other income (including about Rs7.0 crore from dossier sales; the company had earned Rs2 crore from dossier sales in Q4FY2006) was up 138.7% to Rs15.2 crore. The interest cost (net of the interest income coming from the FCCB fund) fell by 75%. There was a tax credit of Rs30.13 crore (against a tax charge of Rs8.7 crore in Q4FY2006), which doubled (up 108.1%) the net profit to Rs78.11 crore in Q4FY2007.

In FY2007, the stand-alone revenue grew by 34.5% to Rs1,472.2 crore and the OPM improved by 200 basis points to 14.1%, resulting in a 230.2% growth in the bottom line to Rs229.08 crore.

Aggressive product registration continues

During the year, 69 patents were filed for active pharmaceutical ingredients (APIs)/formulation processes, taking the total cumulative patents filed to 249.

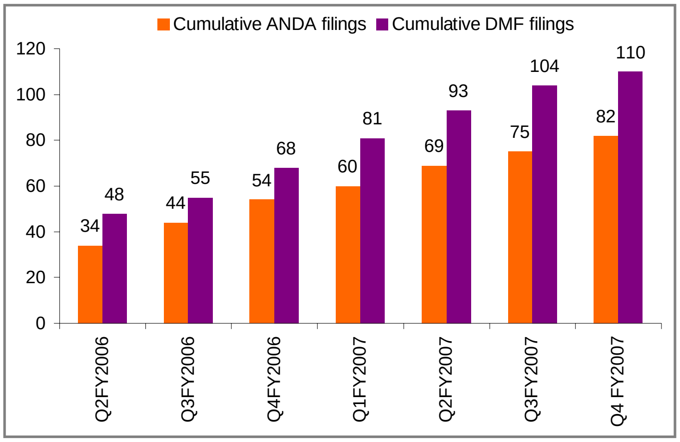
Aurobindo Pharma filed 43 drug master files (DMFs) in FY2007, taking the cumulative filings to 110 in the USA/ the EU. This took the cumulative filings in the key markets to 503.

During the year, 31 abbreviated new drug applications (ANDAs) were filed in the USA, taking the cumulative filings to 82. As many as 98 filings were also made in the key regulated markets, including the USA and Europe. This took the cumulative filings in the regulatory markets to 221.

During the year, 13 ANDA approvals took place, taking the cumulative approvals to 38 in the USA. Most the of the approvals came in the latter part of FY2007. The size of the US branded market for the filings of the company is about $108 billion, which speaks volumes for the huge revenue potential of the company.

With the recent US Food and Drug Authority (USFDA) approval for products, viz Bisoprolol, Simvastatin, Zolpidem tartarate and Cefprozil, we estimate incremental revenue of Rs100 crore from the US generic business during FY2008.

US product pipeline to enrich earnings



In FY2007, Aurobindo Pharma filed 15 CTD/DCP EU based dossiers and received three approvals. The total number of filings in the EU stands at 35 with five approvals. The company also filed 47 dossiers in South Africa and had a headstart with nine approvals. The total number of filings in the South African market stands at 82 with 11 approvals.

Valuation and view

To sum up, the FY2007 consolidated financials of Aurobindo Pharma are in line with our estimates, with sales and profits of Rs2,250.2 crore and Rs203.2 crore respectively. On the other hand, the stand-alone Q4FY2007 numbers are a bit disappointing with a 230-basis-point decline in the OPM. We feel the consolidated financials reflect the true performance of the company.

Aurobindo Pharma has already made its presence felt in the USA generic market with a robust product pipeline. Gradually, it is improving the quality of its ANDA filings for US generics, as is evident from the product approval of Cefedoxime proxetil, Quinapril Hydrochloride and Hydrochlorothiazide, which are having just two to four competitors. On the other hand, the initiatives taken to establish its business in the EU and the other emerging markets are well on track. Also, by setting up a subsidiary in South Africa the company is well prepared to participate in the upcoming $600-million tender of South Africa for ARVs. All these efforts of the company would fuel growth in the formulation business.

On the margin front, we believe the increasing contribution of the formulation business, that too from the regulated markets, and higher Pen-G prices would expand the OPM of the company going forward. We expect the consolidated OPM to improve to 17-18% levels during FY2007-09.

At the current market price of Rs769, Aurobindo Pharma is trading at 13.4x its FY2009E earnings. Its transition from a mere API player to a speciality formulation maker (and that too in the regulated markets like the USA) is very impressive and would boost its revenue and profitability. We maintain our Buy recommendation on the stock with a price target of Rs914.

Valuation table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	1321.6	1593.6	2250.2	2622.4	3143.1
PAT (Rs cr)	4.8	45.5	203.2	277.9	348.4
Shares in issue (cr)	5.1	5.3	5.3	6.1	6.1
EPS (Rs)	0.9	8.6	38.1	45.8	57.1
PER (x)	815.0	89.8	20.2	16.8	13.4
Cash EPS (Rs)	13.7	22.1	56.8	62.2	74.7
Cash PER (x)	56.1	34.8	13.5	12.4	10.3

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